



LATVIJAS BANKA: ANNUAL REPORT 2019

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

Details may not add because of rounding-off.

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

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ABBREVIATIONS

AML/CFT/CFP	anti-money laundering and combating the financing of terrorism and proliferation
APP	asset purchase programme
AS	joint stock company
BIS	Bank for International Settlements
CIT	corporate income tax
CSB	Central Statistical Bureau of Latvia
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFC	Economic and Financial Committee
EKS	Electronic Clearing System of Latvijas Banka
EMU	Economic and Monetary Union
EONIA	euro overnight index average
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
€STR	euro short-term rate
EU	European Union
EURIBOR	Euro Interbank Offered Rate
Eurostat	statistical office of the European Union
FCMC	Financial and Capital Market Commission
FRS	US Federal Reserve System
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
M1	narrow monetary aggregate
M2	intermediate monetary aggregate
M3	broad monetary aggregate
MFI	monetary financial institution
NCB	national central bank
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
OPEC+	OPEC Member States and the Russian Federation, the Republic of Azerbaijan, the Kingdom of Bahrain, Brunei Darussalam, the Republic of South Sudan, the Republic of Kazakhstan, Malaysia, the United Mexican States, the Sultanate of Oman and the Republic of Sudan
OTC	over-the-counter
ST	solidarity tax
PIT	personal income tax
PSPP	public sector asset purchase programme
SDDS Plus	Special Data Dissemination Standard Plus
SDR	Special Drawing Rights
SEPA	Single Euro Payments Area
SIA	limited liability company
SRS	State Revenue Service
SSM	Single Supervisory Mechanism
TLTRO	targeted longer-term refinancing operations
UK	United Kingdom
US	United States of America
VAT	value added tax



This is the first time when I have the pleasure of addressing the readers of the Annual Report of Latvijas Banka in the capacity of the Governor of Latvijas Banka. I would like to thank the Saeima of the Republic of Latvia and the public at large for their trust and support, and my central bank colleagues for their readiness to address all tasks, no matter how complicated, with the highest degree of professionalism and dedication.

In 2019, Latvijas Banka continued implementation of the function of the Baltic regional cash processing centre and developed the Proxy Registry "Instant Links" enabling innovative payments based on a mobile phone number. Every sixth payment made in the Electronic Clearing System of Latvijas Banka (EKS) was an instant payment, and information from the Credit Register is now available also via smart devices. In support of an efficient and environment-friendly approach, Latvijas Banka initiated a discussion about dropping 1 cent and 2 cent coins from circulation and intends to continue this discussion. Latvijas Banka researchers analysed the challenges faced by the Latvian economy as well as solutions important for the overall euro area development, and their views were also appreciated by the general public. Latvijas Banka's profit has grown by 86% as compared to the previous year. I would like to express gratitude to my colleagues for their accomplishments in 2019 and the ambitious future plans.

2019 brought changes for both Latvijas Banka and Latvia's financial sector. The beginning of a new era in the central bank was symbolically marked by the change of its Governor in December 2019. My priority in the office of the Governor of Latvijas Banka is to strengthen Latvijas Banka's position as the best performing, most ambitious and most effective central bank in Northern Europe. Finding solutions to many complex problems in the next couple of years will be imperative for successful functioning of Latvijas Banka and strengthening of Latvia's financial sector.

The most important near-term tasks in context of the central bank functions include modernising the Law on Latvijas Banka, changing Latvijas Banka management model and evaluating the potential benefits and drawbacks of the FCMC and Latvijas Banka merger, providing a full analysis to the decision-makers at the Parliament. At the euro area level, we are focussing on participation in the ongoing monetary policy strategy review, support to the introduction of state-of-the-art technologies in the financial system and implementation of measures to limit climate change. This will have an effect also on the economic policies and application of policy tools at the disposal of central banks. The events unfolding in spring 2020 in connection with the coronavirus Covid-19 outbreak

and its economic implications have proven that the euro area central banks together with the ECB are ready to act swiftly, effectively and in a coordinated manner in order to provide the necessary monetary policy support to the governments in their attempts to soften the crisis impact on households, businesses and the euro area in general.

The performance of Latvijas Banka staff will have a decisive role in accomplishing those tasks. Teamwork has always been and will remain central in the process of transforming the financial sector. Significant progress was made in 2019. At the beginning of 2020 international experts concluded that Latvia has shown positive results with regard to implementing an up-to-date regulatory framework for prevention of money laundering in compliance with international standards and supporting the economy. This was achieved through resolute, well-targeted and coordinated joint efforts of the Parliament, the government, the national law enforcement authorities as well as Latvijas Banka.

Systemic restructuring of the financial sector will continue to build on the accomplishments in the field of prevention of money laundering and terrorism and proliferation financing. Transparent, sustainable and sound operation of the financial sector should become the new reality. Clean-up of the financial sector will also have a positive effect on Latvia's economic growth, sustainability and resilience to shocks. Moreover, this is a pan-European priority requiring an adequately powerful institutional framework and economic policy instruments. Fighting the consequences of Covid-19 affecting the health of economies and households worldwide, including in Latvia, has turned a new page in human history and requires mobilisation of all efforts and resources as well as special central bank measures and involvement.

Latvijas Banka stands ready to contribute to this work. Therefore, I would like to encourage my colleagues to set ambitious goals and pursue them with perseverance.



Mārtiņš Kazāks
Governor of Latvijas Banka
Riga, 9 April 2020

VISION, MISSION AND VALUES OF LATVIJAS BANKA

Latvijas Banka is a professional and innovative central bank of a euro area member state acting for the good of the people and ensuring high-quality standards and efficiency in its work.


Latvijas Banka's mission is to promote sustainable economic development. Price stability, modern and reliable payments infrastructure as well as a sound financial system are pre-requisites for Latvia's economic growth and prosperity of its people.

Latvijas Banka's key values are competence, responsibility and result-orientation. Latvijas Banka is transparent and cooperative in its operation and is active in voicing and explaining its views.

2019 IN FIGURES

in Latvia and the euro area

ECONOMIC GROWTH

 *in Latvia*

2.2%


Economic growth decelerated due to external uncertainties

 *in the euro area*

1.2%



EXPORTS

 *in Latvia*

1.9%


Exports reflected weak external demand

 *in the euro area*

2.5%



INFLATION

 *in Latvia*

2.7%


Inflation remained moderate

 *in the euro area*

1.2%



REMUNERATION

 *in Latvia*

8.8%


Rise in remuneration boosted purchasing power

 *in the euro area*

2.0%



UNEMPLOYMENT

 *in Latvia*

6.3%


Limited labour supply reduced unemployment

 *in the euro area*

7.6%



LENDING

 *in Latvia*

-1.1%*

More cautious lending

 *in the euro area*


3.3%



* Taking into account the structural changes in the credit institution sector.

MONETARY POLICY

Interest rate on new loans to non-financial corporations

 *in Latvia*

3.0%

Accommodative monetary policy ensured low interest rates


 *in the euro area*

1.4%



FISCAL POLICY

General government deficit

 *in Latvia*

0.2%
of GDP

More restrictive fiscal policy

 *in the euro area*

0.6%
of GDP



Sources: Latvijas Banka, European Central Bank, Central Statistical Bureau of Latvia and Eurostat.

LATVIJAS BANKA IN 2019

BACKBONE OF LATVIA'S PAYMENT SYSTEM

Systems maintained by Latvijas Banka

TARGET2-Latvija

468.9 **209.2**
volume of payments (in thousands) value of payments (in EUR billion)

Latvijas Banka's electronic clearing system (EKS)

61.7 **88.6**
volume of payments (in millions) value of payments (in EUR billion)

Instant payments accounted for **15%** of the volume of Latvia's credit institution payments in the EKS at the end of 2019



Instant payments

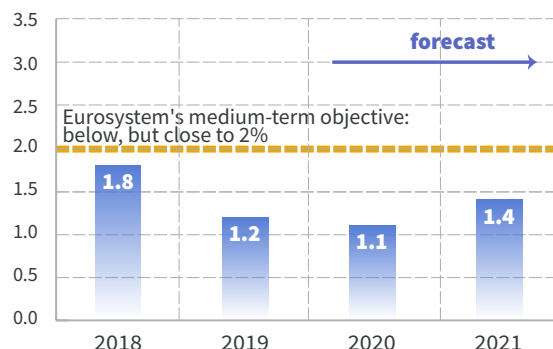
volume (in millions)



value (in EUR million)



INFLATION IN THE EURO AREA (%)



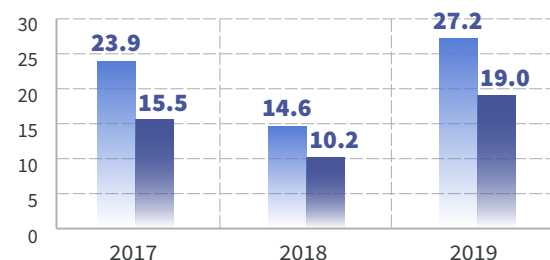
BALTIC REGIONAL CASH STORAGE AND PROCESSING CENTRE



152.3 million banknotes checked.
24 million banknotes replaced by new ones.

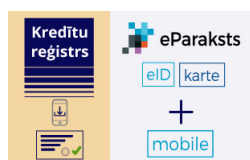
PROFIT (in EUR million)

Profit Profit share paid into the central government budget



95.8 million euro of Latvijas Banka's profit totalling **144.2 million euro** appropriated to the central government budget since the euro changeover in 2014.

INNOVATIONS



Further **development of Credit Register** enables receipt of information from the Register also via smart devices.



ZIBSAIŠU REĢISTRS

The Proxy Registry "Instant Links" was established enabling payments based on payee's phone number only. Users include also Estonian credit institutions.

QUALITY OF ECONOMIC ANALYSIS



Research of topical economic issues, providing analytical information for policy makers, inter alia on labour reserves and local government spending.

How much does the public at large listen to the experts and respect their opinion regarding economic developments?



Source: survey by SIA "LATVIJAS FAKTI".

- **90%** of respondents respect Latvijas Banka's opinion
- **4** economists of Latvijas Banka ranked among **TOP 10** economics experts in Latvia



The highest level data dissemination by adhering to the **International Monetary Fund's standard SDIS Plus** has been fully ensured.

CASH



A discussion about **rounding up invoice amounts** was initiated, thereby limiting the costs and environmental impact associated with the use of 1 and 2 cent coins. Introduction of the **Europa series banknotes** was completed.

STABILITY

Participation in the largest **financial crisis simulation exercise** (31 participants, including entities from eight countries and the European Union) facilitated cooperation among the Nordic and Baltic countries in the field of financial stability.



EFFICIENCY



The range of Latvijas Banka's tasks has expanded since the euro changeover, while **the number of employees has shrunk** by 22% (by 10% since the beginning of 2019 – from 498 to 449*).

* Data as at 1 February 2020.

ECONOMIC ENVIRONMENT



Prolonged geopolitical tensions weakened global economic growth in 2019

The year was defined by tensions between countries due to various political and trade-related disagreements which negatively affected international trade volume and investment. In addition, several environmental issues took centre stage. As a result, in 2019 global economic growth fell to its lowest level since the global financial crisis. Growth weakened in both developing countries, e.g. India and China, and developed countries, including the US, euro area countries and the UK.

Global trade continued contracting due to the trade policy implemented by the US to reduce the US foreign trade deficit. The policy is directed against the countries having the largest trade imbalance with the US, i.e. China, EU countries and India. The tariff escalation between the US and China eased at the end of 2019, with the parties negotiating an initial trade truce. However, the situation has not yet returned to normal. The protracted Brexit negotiations not only created additional political uncertainty but also negatively affected the trading activity and economic growth.

Due to global disputes, the industrial output has continued on a downward trend; meanwhile, the services sector has so far remained unaffected

Global trade tensions mainly affected manufacturing as its output relies on well-functioning supply chains and export markets. Manufacturing indicators deteriorated not only with respect to the sentiment but also the real industrial output. This trend was generally broad-based across economies and especially affected countries that were directly involved in trade-related disputes or whose manufacturing was closely linked with such countries. Meanwhile, trade disputes between major economies could not hinder growth in the services sector which was driven by strong domestic demand as labour market conditions were particularly favourable for employees. Wages and employment increased and the unemployment rate declined both in the US, Japan and the UK and in euro area countries. This can be partly attributed to the accommodative monetary policy implemented by central banks, in the US and euro area in particular. Economic growth was also facilitated by the fiscal policy implemented by the US government over the past few years. The confidence of households regarding their future employment prospects also improved the consumer sentiment indicators.

Labour market conditions have been very favourable for employees; however, contrary to the expectations of several central banks, including the ECB, the declining unemployment rate and the rising wages have not yet resulted in a sustained increase in prices

Favourable labour market trends had no significant impact on inflation. Consumer prices in OECD countries rose by 2.1% in 2019 as compared to a 2.4% increase in 2018. Over the year, inflation volatility was driven by oil price dynamics. At the beginning of 2019, an upward trend in oil prices was fuelled by larger-than-expected oil production cuts in OPEC+ countries as well as geopolitical disputes. Meanwhile, concerns about the rising global trade tensions and the related economic growth expectations created a downward pressure on oil prices in the second half of the year. Nevertheless, oil prices resumed growth towards the end of the year.

Given the fragile economic development and the growing downward risks, several central banks were cautious and, once again, took measures to ensure more accommodative financial conditions. In response to the global economic uncertainty, in 2019 the FRS

reduced the target range for the federal funds rate three times (overall from 2.25%–2.50% to 1.50%–1.75%) thereby bringing the previous year's monetary policy normalisation to a halt. Weak investment and export developments as well as growing risks were highlighted by the FRS as the main considerations for monetary easing. The FRS planned to moderate balance-sheet reduction. In response to the rise in the credit institutions' demand for liquidity, the FRS injected a significant amount of extra liquidity into the money market at the end of 2019.

Due to the uncertainty regarding the conditions of the UK's exit from the EU, Bank of England took a wait-and-see approach. In the UK, like in other economies, the labour market saw positive trends, with the unemployment rate remaining low and the sustained increase in wages supporting private consumption. However, investment inflows and trade volume decreased due to the uncertainty over Brexit. If the consequences of the UK's exit from the EU turn out to be severe for the UK's economy, Bank of England is prepared to ensure even more accommodative financial conditions.

While remaining strong vis-à-vis the developed countries, China's economic growth declined to a 30-year low on account of the trade disputes. In order to keep growth at the projected level, China implemented large-scale fiscal and monetary stimuli ranging from lower tax rates to reduced minimum reserve requirements for credit institutions. Over the past few years, the very accommodative policy implemented by the Chinese government and central bank has resulted in a higher debt burden. In light of this, many experts are concerned about the sustainability of China's development, especially if trade wars and social issues intensify. Meanwhile, after some deterioration in 2018, Japan's economic indicators improved; however, the consumption tax increase at the end of 2019 led to a substantial deceleration of economic growth. The Bank of Japan continued to pursue accommodative monetary policy, and the government of Japan stood ready to support the expansionary stance with a fiscal stimulus package.

In the coming years, special attention will be paid to sustainable environment considerations

Climate change-related issues are becoming ever more relevant. Global economy has suffered major losses from increasingly devastating natural disasters. 2019 was no exception. To reduce the scale of natural disasters and the human impact on the environment, the governments of several countries have expressed their commitment to implement more environmentally friendly policies. The objective to achieve climate-neutral economy with low-carbon development by 2050 is anchored in both the European Commission's strategic long-term vision and the legislation of several countries, including the UK, France, Denmark and New Zealand. It should be noted, however, that these countries account for a small share in the global volume of carbon dioxide emissions.

Global political tensions have also affected the financial markets

In 2019, the euro depreciated against the US dollar by 2.2% (from 1.1467 to 1.1213 at the end of 2018 and 2019 respectively), reaching its high at 1.1570 on 10 January, and hitting a low at 1.0879 on 1 October. In 2019, the euro fluctuations against the US dollar were the smallest since its introduction. Over the first nine months of 2019, the euro was on a downward trend against the US dollar. Over the year, both the euro and US dollar interest rates declined. However, the interest rates of the US dollar were substantially higher and among the highest compared to other G10 currencies. Therefore, investors were more interested in US dollar-denominated assets. The sluggish economic growth in the euro area, trade wars and the uncertainty associated with the UK's exit from the EU contributed to a decline in the value of the euro at the beginning of the year. Given

some stabilisation in the slowdown of the euro area economic growth and the progress in the US–China trade talks, the euro stopped depreciating and even appreciated slightly against the US dollar over the last quarter of the year. Over the year, the British pound sterling appreciated vis-à-vis the US dollar by 3.9% (from 1.2754 to 1.3257 at the end of 2018 and 2019 respectively), reaching its high at 1.3514 on 13 December and hitting a low at 1.1959 on 3 September. In 2019, economic data had a minor impact on the value of the British pound sterling. Instead, markets were focussed on the process of the UK's exit from the EU. On 3 September, the British pound sterling vis-à-vis the US dollar was nearing a record low of the last 35 years. Only the UK Parliament's vote preventing a no-deal Brexit allowed the British pound sterling to appreciate gradually. The early elections held on 12 December 2019 brought a resounding victory for the UK's Conservative Party thereby easing market participants' concerns over a potential no-deal Brexit. The Japanese yen vis-à-vis the euro appreciated in the first half of 2019. However, with the US–China trade talks advancing and the likelihood of a no-deal Brexit falling, the Japanese yen vis-à-vis the euro depreciated in the second half of 2019. In 2019 overall, the euro depreciated vis-à-vis the Japanese yen by 3.1% (from 125.85 to 121.94 at the end of 2018 and 2019 respectively).

In 2019, the stock market indices in advanced economies increased, with some countries recording the highest rises in the past few years. Despite geopolitical issues and relatively weaker economic growth in many countries, the expansionary monetary policy implemented by central banks and the US–China trade talks, which were nearing a breakthrough, supported the stock markets which had seen substantial falls in their indices in 2018.

At the end of 2019, the price of WTI (West Texas Intermediate) and Brent crude oil was 61.06 and 66.00 US dollars per barrel respectively. The price of gold rose substantially on account of record-low interest rates globally and geopolitical issues. In 2019, the price of gold rose by 18.3% and 21.0% in US dollar and euro terms respectively.

EURO AREA ECONOMY AND EUROSISTEM'S MONETARY POLICY

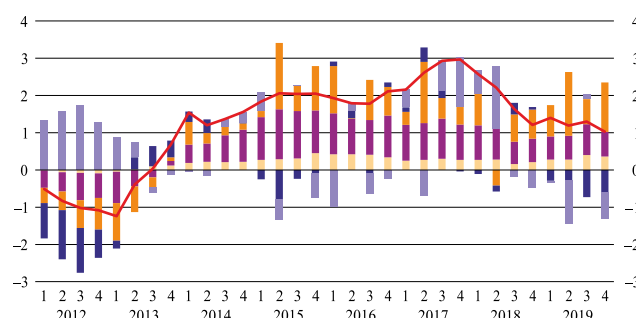
The weak growth of the global economy went hand in hand with the euro area economic growth momentum. Euro area's annual GDP growth rate fell to 1.2% as compared to a 1.9% growth rate in 2018 (for changes vis-à-vis the corresponding quarter of the previous year, see Chart 1). However, while export indicators deteriorated substantially on account of external uncertainties, euro area economic growth remained resilient. Domestic growth was further supported by highly favourable financial conditions created by a particularly accommodative monetary policy and robust labour market ensuring sustained income gains for households and strengthening consumption indicators. External factors also affected the headline inflation dynamics: as a result of global energy price changes, inflation declined to 1.2% in 2019. In response to the economic slowdown, which was sharper than expected and pushed inflation further away from its target, monetary policymakers reinforced the accommodative effects of Eurosystem's monetary policy. The ECB changed its forward guidance and launched the third series of targeted longer-term refinancing operations (TLTRO III) already at the beginning of the year. With euro area economic growth decelerating further amid trade disputes and persistently high uncertainty, the Governing Council of the ECB, after signalling of potential further interest rate reduction in mid-2019, lowered the deposit facility rate on 12 September, and the Eurosystem resumed the net asset purchases under the APP in the fourth quarter of 2019.

Chart 1

CHANGES IN EURO AREA REAL GDP
(year-on-year percentage changes; percentage point contributions)

Government consumption
Private consumption
Investment
Changes in inventories
Net exports
GDP

Source: Eurostat.



Euro area economic growth moderated significantly due to worsening external environment

Euro area saw a significant decline in its export volume on account of a slowdown of global economic growth, the ongoing escalation of international trade disputes and concerns over Brexit. In 2019, economic growth decelerated further to a five-year low. Increasing downward risks to the global economic growth also dampened the investment activity of businesses. Deteriorating external environment significantly affected manufacturing which relies on foreign trade, as the sector's income is dependent on its ability to export the produced goods. In 2019, manufacturing output shrank by 1.7%. The impact of declining international trade volumes on manufacturing was particularly strong in Germany where the manufacturing output fell by 4.4% in 2019.

Supported by the accommodative monetary policy, financial conditions remained very favourable. However, the weak export dynamics weighed on the sentiment of other economic agents. Optimism also faded in the services sector. Nevertheless, the fall in the services sector was much less pronounced than in manufacturing, and the sentiment indicators continued to suggest growth in the services sector.

In 2019, external demand contribution to growth decreased further. Exports increased only by 2.5% as compared to 3.4% and 5.5% in 2018 and 2017 respectively. Export growth was curbed by continued global trade tensions as well as the uncertainty over the prolonged Brexit negotiations. Export flows to the UK, Asian countries and territories, China, Hong Kong, South Korea and India in particular, and Turkey contracted.

The consumer confidence indicator remained positive and started following a downward trend only at the end of 2019. Sustained increase in the level of income resulted in a relatively strong consumption growth momentum. In the second half of 2019, the growth rate of consumption moderated as more households chose to build up precautionary savings. In December, the volume of household deposits increased by 5.8% year-on-year. In 2019, private consumption grew by 1.3% on average, only somewhat slower than in 2018 (1.4%).

Sustained income gains were driven by robust labour market conditions. Contracting external demand lead to lower production capacity utilisation thereby mitigating the issue of labour shortages. While growth in labour demand decelerated, employment continued to increase by 1.2% on average and the unemployment rate declined further, in countries with high unemployment rate in particular. In 2019, the euro area unemployment rate decreased to 7.6% on average as compared to 8.2% in 2018, while wages and salaries per employee grew by 2.0%.

Furthermore, euro area inflation dropped to 1.2% in 2019. Inflation dynamics were primarily affected by the fluctuations of global energy prices. Against the backdrop of rising volumes of global oil production and the expectations of a future increase in oil

production, oil prices declined by a third in the second half of 2018. At the beginning of 2019, oil prices rose somewhat but remained below their 2018 high. The price drop had a notable effect on consumer price fluctuations throughout the euro area. In the fourth quarter of 2018, the rise in energy prices accounted for 0.8 percentage point of the annual headline inflation. In 2019, by contrast, the contribution of energy prices declined to 0.1 percentage point and even turned negative at the end of the year. Meanwhile, the impact of domestic consumption fluctuations on inflation was relatively stable. In 2019, underlying inflation (excluding the dynamics of the volatile food and energy prices) was 1.0% on average, unchanged for the third consecutive year.

In response to weakening economic growth, the Governing Council of the ECB decided on increasing the monetary policy stimuli

The information and projections received already at the beginning of 2019 suggested that the slowdown in the growth rate will be more persistent than previously expected, and monetary policymakers will have to assess the need to change the monetary policy stance. Deteriorating external environment and rising global political uncertainty dampened growth, and this had significant implications for the euro area economy which is heavily dependent on the export capacity of businesses. At first, deteriorating external environment affected primarily the export-producing sectors, manufacturing in particular. As the difficulties dragged on, however, the economic slowdown affected an increasingly larger part of the economy.

In light of slower-than-expected economic development, at its March meeting the Governing Council of the ECB announced the launch of the third series of quarterly targeted longer-term refinancing operations (TLTRO III) with a maturity of 2 years, starting in September 2019 and ending in March 2021. Fixed rate tender procedures will continue with full allotment. Like the previous programmes, TLTRO III featured built-in incentives for credit conditions to remain favourable. In addition, the Governing Council of the ECB changed its forward guidance, confirming that the key ECB interest rates are expected to remain at their present levels at least by the end of 2019.

The decline in international trade in an environment of persistent global uncertainties continued to weigh on the euro area manufacturing sector and dampen investment growth thereby also curbing the potential for growth in the rest of the economy. Based on factors such as weak growth dynamics, the persistence of prominent downside risks and low inflation, the Governing Council of the ECB decided to reinforce the accommodative effects of monetary policy. At its July meeting, the Governing Council of the ECB noted that interest rates may be decreased even further. At its September meeting, the Governing Council of the ECB already decided to act by reinforcing the accommodative monetary policy.

First, it decided to lower the interest rate on the deposit facility by 10 basis points to -0.50%. Forward guidance was modified stating that the Governing Council now expects the key ECB interest rates to remain at their present or lower levels until the inflation outlook is seen to robustly converge to a level sufficiently close to, but below, 2% within the projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

Second, the Governing Council announced a restart of net asset purchases under the APP at a monthly pace of 20 billion euro as from 1 November.

Third, the principal payments from maturing securities purchased under the APP will continue to be reinvested for an extended period of time past the date when the Governing Council starts raising the key ECB interest rates.

Fourth, the Governing Council decided to change the modalities of the quarterly targeted longer-term refinancing operations (TLTRO III), making the interest rate of these operations more appealing to banks as well as extending the maturity of the operations from two to three years. The purpose was to support the lending potential of banks and facilitate economic growth.

Fifth, a new two-tier system for reserve remuneration was announced, in which part of commercial banks' holdings of excess liquidity will be exempt from the negative deposit facility rate. The new system is expected to strengthen the monetary policy transmission via the banking system.

ECONOMIC DEVELOPMENT OF LATVIA

FINANCIAL CONDITIONS AND MONEY SUPPLY

Restructuring of Latvia's credit institution sector continued in 2019, including measures to implement the recommendations of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism MONEYVAL. Overall, the operation of Latvia's credit institutions stabilised in 2019, yet several credit institutions continued with changing their business models to refocus their services on customers from Latvia and other EU countries.

Although the monetary policy remained accommodative and the financial market conditions were favourable in 2019, higher costs of funds for credit institutions, including the additional costs associated with AML/CFT/CFP measures, and precautionary considerations prompted Latvia's credit institutions to raise their lending rates. Economic deceleration in Latvia and uncertainties in external markets weighed on the recovery of lending which started in the previous years. The increase in loans from other financial institutions also moderated. The uncertainty clouding the future outlook supported an increase in deposits of non-financial corporations with credit institutions.

In 2019, money market developments in Latvia continued to be driven by the accommodative monetary policy of the ECB, and interest rates fell to their historical lows

Supported by the ECB's accommodative monetary policy, excess liquidity increased in credit institutions of the euro area, including Latvia, hence the money market activity continued to decline. An additional activity-reducing factor in Latvia was the business model transformation undertaken by several credit institutions, reducing the number of high-risk customers and the role of the US dollar in transactions. In each of the eight reserve maintenance periods which started in 2019, the excess reserves of Latvia's credit institutions, i.e. liquidity holdings in excess of the minimum reserve requirements, averaged 4.6 billion euro. Introduction of the two-tier system exempting credit institutions from remunerating, at the negative rate applicable in 2019, part of their excess liquidity (i.e. reserve holdings in excess of the minimum reserve requirements) had no effect on the money market developments in Latvia, considering that only a minor part of market participants held excess reserves below their exemption threshold. At the same time, the introduction of the two-tier excess reserve remuneration system did slightly change the money market flows in the euro area overall, as credit institutions effectively used this opportunity to reduce their costs of parking liquidity. From the start of the seventh reserve maintenance period on 30 October 2019, when the two-tier system for remunerating excess reserve holdings was first applied, liquidity flows from credit institutions with excess liquidity exceeding their exemption threshold to credit institutions with excess liquidity below the threshold were observed in the euro area.

The total value of unsecured money market lending transactions in euro between Latvia's credit institutions decreased to 10.9 million euro in 2019. The value of wholesale money market transactions in foreign currencies also continued to shrink, with the US dollar being the dominant currency. The monthly average volume of lending transactions concluded in foreign currencies in the domestic interbank market shrank by 76.3% year-on-year, from 87.7 million euro to 20.8 million euro in 2019. The volume of foreign currency lending by Latvian credit institutions to foreign credit institutions, shrank at a similar rate: the monthly average of such transactions decreased from 6.8 billion euro in 2018 to 2.8 billion euro in 2019.

Money market benchmark reforms continued

On 2 October 2019, the ECB published the new euro money market benchmark rate €STR for the first time. The new euro short-term rate €STR became the replacement rate for EONIA. Market participants were advised to use €STR instead of EONIA as a reference rate in new business since the start of the €STR publication, as well as to phase in €STR in legacy contracts valid beyond 3 January 2022.

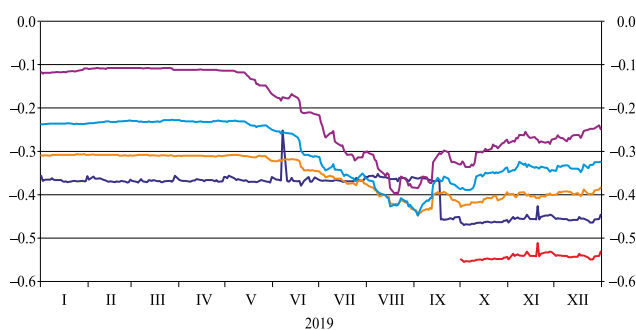
The working group on euro risk-free rates recommended market participants incorporate fallback provisions in all new financial instruments and contracts referencing also EURIBOR. In legacy contracts referencing EURIBOR and entered into after 2018, fallback provisions should be introduced when they are next amended. These recommendations were issued in order to support compliance with the EU Benchmarks Regulation¹ and reduce uncertainty.

Euro area money market interest rates in the overnight segment fell to a new historical low, following the decision of the Governing Council of the ECB to decrease the deposit facility rate to -0.50% on 12 September. Longer-term money market interest rates slightly increased and stabilised, as market participants no longer anticipated any further policy rate cuts. Before and after the decision of the Governing Council of the ECB on cutting the deposit facility rate, EONIA hovered around -0.36% and -0.46% respectively. This demonstrates an effective transmission of the ECB policy rate cut to the money market interest rates, regardless of the introduction of the two-tier excess reserve remuneration system. In 2019 overall, EONIA averaged -0.39% . From its first publication on 2 October 2019 till the end of 2019, the new euro area money market benchmark €STR averaged -0.54% , lower than the ECB's deposit facility rate. This can be explained by the fact that the coverage of the €STR is broader and includes also transactions with market participants with no access to regular central bank operations. 3-Month EURIBOR and 6-month EURIBOR averaged -0.36% and -0.30% respectively (see Chart 2).

Chart 2

EURO MONEY MARKET RATES (%)

— EONIA
— €STR
— 3-month EURIBOR
— 6-month EURIBOR
— 12-month EURIBOR



Source: Bloomberg.

¹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014. Official Journal of the European Union, 29.06.2016, L 171, pp. 1–65.

As a result of further monetary accommodation measures implemented by the ECB, government bond yields remained low throughout the euro area, whereas rating agencies maintained Latvia's sovereign credit ratings stable in light of the reforms undertaken by Latvia's credit institutions, its balanced fiscal policy and relatively stable economic growth outlook.

Japanese rating agency R & I upgraded Latvia's credit rating from 'A-' to 'A', preserving a stable outlook on 2 December 2019, while other major rating agencies left Latvia's credit rating unchanged and with a stable outlook.¹ The agencies appreciated the balanced fiscal policy pursued by Latvia, its institutional stability and political framework ensured by EU and euro area membership as well as the scale-back of credit institution services to non-residents.

Like in the previous year, the Treasury offered 5-year government bonds at primary market auctions of government securities in 2019 (maturing in 2023 and 2025). 16 auctions were held in 2019 (14 auctions in 2018). Supply, bids and the amount sold totalled 440 million euro, 1907 million euro and 422 million euro respectively. Average yield at the auctions decreased from 0.56% in January to 0.09% at the last auction of December. A similar declining trend in yields was observed at auctions throughout the euro area.

On the secondary market, the yield on Latvia's eurobonds maturing in 2028 decreased from 1.02% at the end of 2018 to 0.14% at the end of 2019, whereas the spread over same maturity German government bonds narrowed from 92 basis points to 41 basis points. The narrowing was largely determined by the reversal of the initial negative effect caused by MONEYVAL placing Latvia in an enhanced follow-up process. Following a critical report published by MONEYVAL in August 2018, and the yield on the above-mentioned Latvian eurobonds rose by 40 basis points in the period up to the end of 2018. Decisive action by the Latvian authorities, led to a decline of those bond yields in the first half of 2019. In addition to that, further monetary accommodation measures implemented by the ECB also supported a fall in the Latvian domestic government bond and eurobond yields. Towards the end of the year, however, with the global risks associated with the trade wars and Brexit fading, the yields rebounded.

The Treasury took advantage of an opportunity to issue long-term Latvian government bonds at low interest rates

The Treasury took advantage of the low interest rate period when the euro borrowing rates had reached their historical lows and issued new 30-year eurobonds in February in the total amount of 700 million euro, maturing in 2049. The yield and the coupon rate were 1.93% and 1.875% respectively, while the bids totalled 1.1 billion euro. On the previous occasion when Latvia launched 30-year bonds on international markets in September 2019, the average yield was 1.86% and the volume merely 200 million euro. In May, the Latvian government tapped an outstanding 30-year eurobond issue in the amount of 300 million euro with the average yield of 1.76% and a similar spread as at the previous auction.

Despite favourable financial market conditions, the outstanding amount of bonds issued by Latvia's private sector and listed in Nasdaq CSD SE decreased by 1.5%, to stand at 894.2 million euro in 2019. Of all issues newly-listed on Nasdaq CSD SE, the tap issue by AS Attīstības finanšu institūcija Altum in the amount of 15 million euro should be singled out. Mainly Baltic investors participated in the auction, and their bids exceeded

¹ The international rating agency S & P Global Ratings upgraded Latvia's sovereign credit rating from A to A+ with a stable outlook on 21 February 2020.

the supply 13 times. The yield of those bonds was 0.95% and the residual maturity was 6 years. AS Air Baltic Corporation listed its bond issue abroad and issued 5-year bonds in the amount of 200 million euro at an interest rate of 6.75%.

EU funding programme "Support for raising finance for SMEs in capital markets" that was launched by the Latvian government¹ will help to strengthen the capital market in the coming years.

Prices increased in Latvia's stock market, although at a slower rate than in the euro area overall

Over the year, Latvian stock market index OMXR and the Baltic stock market index OMXBBI grew by 11.5% and 13.6% respectively. Both stock market indices were supported by the steadily climbing stock prices in developed markets. Moreover, pharmaceutical companies announced their entry into new markets. Nevertheless, the quotes of some companies were also affected by their failures on external markets.

Share turnover at Riga Stock Exchange AS Nasdaq Riga totalled 24.1 million euro, as opposed to 14.0 million euro in 2018. The largest turnover was recorded for the shares of AS Olainfarm and AS GRINDEKS (12.5 million euro and 8.2 million euro respectively). The most impressive price increases were recorded for several large joint stock companies ((AS GRINDEKS (+127.7%), AS SAF TEHNIKA (+61.2%) and AS PATA Saldus (+27.6%)), whereas the steepest falls were registered for the shares of AS VALMIERAS STIKLA ŠĶIEDRA (−46.4%), AS HansaMatrix (−3.8%) and AS Latvijas Gāze (−2.9%).

Against the background of further restructuring of Latvia's credit institution sector, trading activity on the foreign exchange market decreased

In 2019, the overall volume of foreign exchange transactions carried out by Latvia's credit institutions declined by 14.5% year-on-year. The monthly average of such transactions amounted to 18.7 billion euro (21.9 billion euro in 2018). In credit institutions, foreign exchange transactions with both local and foreign counterparties contracted in 2019 (by 27.3% and 18.4% respectively). At the same time, the volume of transactions with households there grew more than twofold. The overall decrease in foreign exchange transactions was primarily determined by less trading with non-EU counterparties and restructuring of Latvia's credit institution sector.

The volume of foreign exchange transactions between domestic credit institutions continued to contract (monthly average of 644 million euro; a 52.2% year-on-year decrease), yet the contraction was partly offset by an increase in transactions with domestic financial institutions, excluding MFIs (monthly average of 478.0 million euro; an increase of 84.4%). The shrinking of the volume of foreign exchange transactions between credit institutions was primarily determined by a decline in euro and US dollar currency swaps. At the same time, transactions with domestic financial institutions, excluding MFIs, followed an opposite trend, reflecting a demand for currency risk hedging instruments. Following a steep rise in 2018, transactions with domestic non-financial corporations slightly decreased in 2019 (by 14.2%; to a monthly average of 309 million euro) on account of weakening trade with non-EU counterparties and a fall in exports of financial services. This sector's decline was also determined by transactions in US dollar and euro.

As to business with foreign counterparties, transactions with both financial institutions and non-financial corporations contracted. This reflects the restructuring of Latvia's credit institution sector, with the share of business with non-EU customers in overall business of credit institutions focussing on non-resident services shrinking. At the same time,

¹ Cabinet of Ministers of the Republic of Latvia approved the programme in January 2020.

the share of business with foreign counterparties in the overall composition of foreign exchange transactions still remained high (84.5%).

The volume of foreign exchange transactions in cash continued on a downward trend, posting a year-on-year decrease of 21.7% in 2019, with the monthly average of such transactions amounting to approximately 31.5 million euro. Overall, most foreign exchange transactions in cash were still executed at licensed currency exchange offices (70.0%). Credit institutions continued to offer electronic services and introduced various incentives to encourage their customers to use remote and electronic services. Therefore, the volume of cash foreign exchange transactions decreased further. In 2019, the dominant currencies in cash foreign exchange transactions were US dollars, British pounds sterling, Russian rubles and Norwegian kroner.

Despite continued monetary accommodation in 2019, the perception of economic risks decelerated the lending recovery that started in the previous years and increased borrowing costs

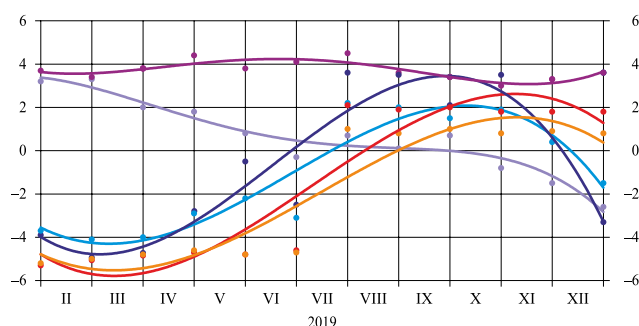
Prolonged uncertainty in external markets slowed down Latvia's economic growth as well. Despite the growing liquidity, the minor upward trend in lending flattened and the contribution of lending to economic growth decreased. Although loans to infrastructural projects and real estate, and, to a minor extent, to households continued to grow, investment in exporting sectors, including manufacturing and agriculture, was limited. At the same time, short-term loans that were granted primarily for the purpose of financing current assets also decreased. Consequently, the opportunities provided by the ECB's accommodative monetary policy to offer better credit terms and lower interest rates were not sufficiently used in Latvia.

Loans to domestic customers, excluding the government, decreased by 1.5% in 2019 (see Chart 3 for developments in loans to financial institutions, non-financial corporations and households in 2019). Looking past the impact of restructuring of the credit institution sector, the overall loan portfolio contracted by 1.1% in the course of the year, including a 2.4% decline in loans to non-financial corporations. Loans to households continued on a slightly upward trend, with the aggregate loan portfolio growing by 0.8% in the course of the year, including a 1.8% and a 3.6% increase in loans for house purchase and consumer credit respectively.

Chart 3

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

- Loans to non-financial corporations
- Loans to households
- Loans for house purchase
- Total loans to financial institutions, non-financial corporations and households
- Consumer credit
- Loans to financial institutions



Source: Latvijas Banka.

Although for the most part of the year the loan portfolio of non-financial corporations was slowly expanding and the annual growth rate was also positive, the situation reversed in autumn, with loans to non-financial corporations decreasing in several major credit institutions as a result of repayments of both short-term and long-term loans. Contrary to the previously-observed trends, loans to non-bank financial sector also slightly contracted on account of the growth of non-bank lenders' portfolio decelerating. The annual growth rate of all loans by non-bank lenders was 4.4% in 2019 (6.6% in 2018).

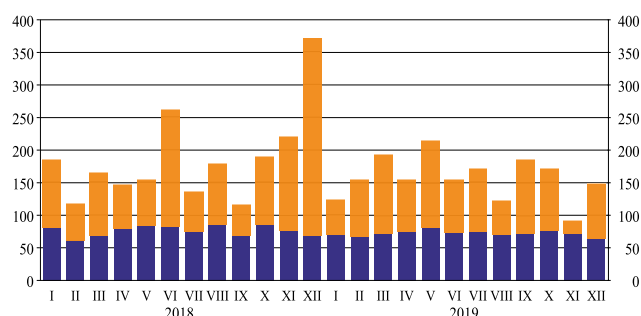
Reluctance was also evident in new lending: new loans totalled 1.9 billion euro in 2019, representing a 16.0% year-on-year decline (see Chart 4 for the monthly volumes of new loans), including a 23.8% contraction in new loans to non-financial corporations and a 4.7% fall in new loans to households on account of a lower volume of new loans for house purchase and consumer credit.

Chart 4

NEW LOANS
(millions of euro)

■ Households
■ Non-financial corporations

Source: Latvijas Banka.



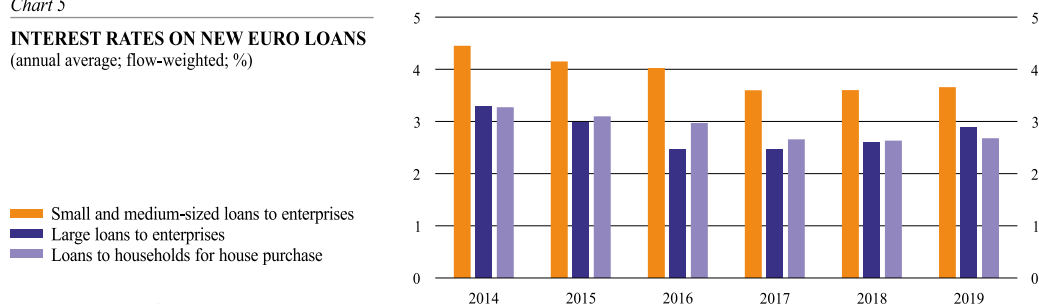
Financing costs of loans to non-financial corporations increased in 2019. Because of the AML/CFT/CFP measures, several Latvia's credit institutions primarily focussed on domestic customers, increased their margins as well as tightened other credit terms and conditions, while the credit institutions mainly servicing non-residents were refocussing on the domestic market and granted more loans to medium-risk companies at higher interest rates. At the same time, the accommodative monetary policy pursued by the ECB, lower risk score of the granted loans as a result of tighter credit standards and decreased demand for loans to non-financial corporations limited the rise of interest rates.

In their responses to the euro area bank lending survey, Latvia's credit institutions highlighted the increase of margins on loans to enterprises, with the main reasons being cost of funds, balance sheet constraints, less competition, general situation in the market, higher risk and AML/CFT/CFP and customer due diligence measures. According to the euro area bank lending survey, Latvia's credit institutions overall tightened their credit standards for loans to enterprises in the first and fourth quarters, whereas a fall in demand in this lending segment was observed in the third and fourth quarters. Interest rate statistics show that the interest rates on small and medium-sized loans (up to 1 million euro), providing the best indication of the costs of funds of small and medium-sized enterprises, grew by 0.1 percentage point in 2019, to 3.7%. At the same time, the respective rate on large loans (over 1 million euro), characterising the costs of funds of large enterprises, increased by 0.3 percentage point, to 2.9%. Overall, the interest rate on new loans to non-financial corporations increased by 0.2 percentage point, to 3.0%. The increase in cost of funds for loans to households for house purchase was relatively small in 2019. Moreover, the interest rates were rising only in the first quarter and exhibited a slightly downward trend thereafter. The effective interest rate on loans for house purchase which includes fees and commissions and other non-interest rate charges grew by 0.1 percentage point over the year, to 2.9%. Tightening of the loan size limits and maturity also decreased the availability of loans for house purchase. According to the results of the euro area bank lending survey, two of the four surveyed Latvia's credit institutions widened their margins on loans to households for house purchase in the first quarter of 2019 because of higher cost of funds and balance sheet constraints as well as in association with the risk rating and risk tolerance level. The narrowing of the margins in the second half of the year, in turn, was supported by the accommodative monetary policy of the ECB and competition from other credit institutions. A higher demand for loans to households for house purchase was still supported by the state aid programme implemented by AS Attīstības finanšu institūcija Altum and improved household confidence in the future. In each euro area bank lending survey, the respondent Latvia's credit institutions reported a rising demand for loans to households for house purchase. High demand for loans

enabled credit institutions to apply slightly higher interest rates, overall increasing the portfolio of household loans for house purchase (see Chart 5 for the annual developments of interest rates on new loans to households for house purchase).

Chart 5

INTEREST RATES ON NEW EURO LOANS
(annual average; flow-weighted; %)



Source: Latvijas Banka.

The cost of funds for consumer credit and other lending to households was volatile in 2019, with interest rates on consumer credit remaining broadly unchanged and those on other lending to households rising. An upward effect on the interest rates on consumer credit was exerted by changes in pricing models implemented by some credit institutions (for example, a reduction in fees and commissions by pricing the administrative expenses into the agreed interest rate). The downward effect of the tightening of credit standards on interest rates was associated with the deterioration of the general economic situation and outlook, rising credit risk of consumers and lower operational risk tolerance of credit institutions. Interest rate on new consumer credit in euro decreased by 0.1 percentage point in 2019 (to 15.1%), whereas the rate on other lending to households grew by 1.1 percentage points (to 5.2%).

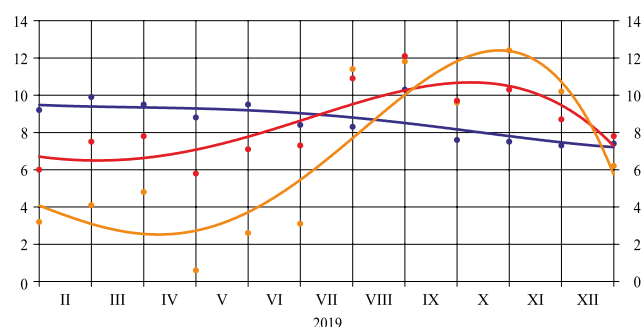
Economic deceleration and higher uncertainty surrounding the future outlook supported an increase in deposits by non-financial corporations in credit institution accounts. With the labour market conditions remaining favourable, the growth of household deposits was also steady

Albeit at a slower pace, deposits by foreign customers continued to shrink in 2019, and parent bank financing contracted even more than in 2018. Thus the steadily growing domestic deposits (an annual increase of 7.8%; 6.1% in 2018) became the main source of financing for credit institutions. With labour market conditions remaining favourable for employees, household deposits continued to grow for the seventh consecutive year, rising by 7.4% in 2019 (see Chart 6). Deposits by non-financial corporations increased at a higher than in 2018 and constantly positive annual rate in 2019, expanding by 6.2%, whereas deposits by non-bank financial institutions grew by 22.5%. The low level of interest rates continued to increase polarisation of deposits depending on their purpose. Overnight deposits held for settlement purposes grew by 10.3%, whereas long-term deposits with a maturity over 2 years on savings accounts also increased, as their remuneration is quite competitive, albeit still comprising merely about 2% of the overall deposits, as well as deposits redeemable at notice expanded. Meanwhile, the demand for short-term deposits decreased even more due to the extremely low interest rates and limited liquidity.

Chart 6

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

— Deposits of non-financial corporations
— Household deposits
— Total deposits of financial institutions, non-financial corporations and households



Source: Latvijas Banka.

The cost of funds of Latvia's credit institutions on the domestic deposits market remained broadly unchanged, and the interest rates on the stock of domestic deposits, constituting the bulk of credit institution funds, increasingly approached zero, albeit still remaining slightly positive. In 2019, the interest rate on euro deposits of domestic non-financial corporations and households stood at 0.07% (0.08% in 2018). The interest rates on new fixed-term euro deposits by households and non-financial corporations decreased by 0.1 percentage point and 0.04 percentage point respectively (to 0.5% and 0.04% respectively). The decision of the Governing Council of the ECB to cut the deposit facility rate by 10 basis points (to –0.50%) on 12 September as well as suspension of the operation of the relatively small AS PNB Bank had a downward effect on deposit rates.

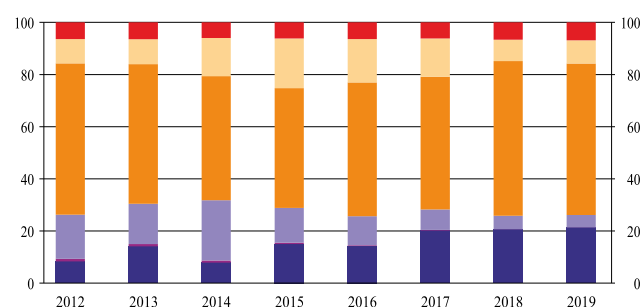
Following the turbulences observed in the previous year, the operation of Latvia's credit institutions stabilised in 2019

Part of Latvia's credit institutions¹ still faced the challenge of changing their business models to refocus their services on customers from Latvia and other EU countries. This was reflected in a minor increase of credit institution assets in 2019 (by 1.5%; see Chart 7 for asset composition) as opposed to a 19.4% fall in 2018². Although the loan portfolio still represented a large share of the overall assets (58.1% of assets), credit institutions were reluctant lenders, as suggested by the significant share of deposits placed with Latvijas Banka (21.4%, representing an annual rise of 0.8 percentage point).

Chart 7

COMPOSITION OF CREDIT INSTITUTION ASSETS (%)

— Other assets
— Debt securities and other fixed income securities
— Loans
— Claims on foreign MFIs
— Claims on domestic MFIs (except Latvijas Banka)
— Claims on Latvijas Banka



Source: Latvijas Banka.

The dominant position of non-bank deposits in the composition of the credit institution liabilities continued to strengthen (see Chart 8): 74.2% of liabilities as opposed to 71.4% of liabilities at the end of 2018. The share of non-resident deposits remained broadly unchanged, yet their composition changed significantly, with deposits by customers

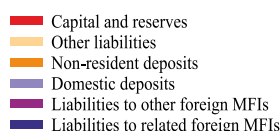
¹ 19 credit institutions, including five branches of foreign credit institutions, were registered in the Republic of Latvia at the end of 2019. The most significant structural change was the transformation of the Latvian subsidiary of Luminor Bank into Latvia branch of Luminor Bank AS registered in Estonia.

² On 15 August 2019, the ECB assessed that AS PNB Banka was failing or likely to fail, and the City of Riga Vidzeme District Court declared AS PNB Banka insolvent on 12 September. As its banking licence was only cancelled as of 18 February 2020, 2019 data on AS PNB Banka have been included in the aggregate data on credit institutions.

from EU countries expanding to 69.2% of all non-resident deposits (54.8% at the end of 2018). At the end of 2018, deposits from non-EU customers constituted merely 5.8% of all credit institution deposits (9.2% at the end of 2018). This has decreased the risk associated with non-resident deposits, as deposits from other EU countries are treated more like domestic deposits. This is ensured by the EU's single rulebook for banking sector supervision, including the AML/CFT/CFP framework. At the same time, MFI financing from abroad, mostly from Nordic parent banks, decreased to 6.5% of total liabilities of credit institutions due to the slowdown of lending development. In 2019, domestic loans granted by Latvia's credit institutions remained fully covered by the domestic deposits received. Domestic loans corresponded to 84.1% of deposits at the end of 2019 (91.7% at the end of 2018). This was ensured by the stable growth of domestic deposits constituting 60.2% of credit institution liabilities at the end of 2019.

Chart 8

COMPOSITION OF CREDIT INSTITUTION LIABILITIES (%)



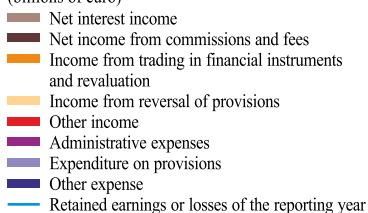
Source: Latvijas Banka.

The share of liquid assets in aggregated assets of Latvia's credit institutions remained large: 32.1% at the end of 2019. The liquidity coverage ratio of credit institutions was also high at 308.2% (EU average is 145.2%¹). With the economy growing, the quality of the credit institutions' loan portfolio remained broadly unchanged, and at the end of 2019 the share of loans past due over 90 days was 4.2% of the aggregate loan portfolio of credit institutions. Another proof of the financial sector's stability was the credit institutions' total capital ratio standing at 21.0% at the end of 2019 (the minimum requirement is 8%), while the Common Equity Tier I (CET1) capital ratio was 19.5%. Despite a significant drop in credit institutions' profit in 2019 (to 117.2 million euro as compared to 294.4 million euro in 2018; see Chart 9), this was mostly associated with several one-off effects causing a short-term increase in administrative expenses of individual credit institutions and a rise in provisioning expenses, and having no direct association with the economic development. The operating income of credit institutions also contracted, yet it was mainly in connection with the business model changes started by several credit institutions in 2018. As a result of this process, the income from commissions and fees decreased considerably in several credit institutions, while the aggregate net interest income of credit institutions remained stable.

Chart 9

DYNAMICS OF CREDIT INSTITUTION INCOME, EXPENSE AND PERFORMANCE RESULTS

(billions of euro)



Source: Latvijas Banka.

¹ Data on the third quarter of 2019.

External uncertainties resulted in a slowdown of external demand in 2019

Latvia's external demand continued to decelerate in 2019 under the impact of external uncertainties. This was also reflected by a slowdown in real exports of goods and services from 4.1% in 2018 to 1.9% in 2019. The prolonged US-China trade dispute and Brexit-related uncertainties also weighed on the euro area's economic sentiment following a downward trend for most part of the year. Towards the end of the year, however, the uncertainties decreased with the signing of the US-China Phase 1 trade deal and the EU's approval of the agreement on the UK's withdrawal from the EU.

Breakdown by trade partner countries shows that Lithuania and Estonia were the biggest positive contributors to Latvia's external demand, as both countries remained on the path of solid growth, with consumption supported by a further rise in wages and shrinking unemployment. Nevertheless, some signs of decelerating growth appeared in Estonia at the end of the year, with exports decreasing. Demand for imports in Germany also decelerated as it continued to face problems in manufacturing and its economic growth was weak. Regardless of that, the external demand in the euro area as a whole remained resilient.

At the same time, the growth of external demand outside the euro area decelerated significantly. A considerable slowdown of growth was reported in Russia where exports contracted under the impact of external environment. Moreover, the launch of investment projects in Russia scheduled for 2019 to stimulate economic growth was delayed until the end of the year. Demand was also hindered in Poland where exports slowed down on account of a lower demand from trade partners, thereby dampening economic growth. In Sweden, investment in housing market remained limited which was reflected in weaker economic growth. At the same time, in the United Kingdom demand for imports increased in the first quarter of 2019 on account of stockpiling ahead of the initially-agreed Brexit date, while in the second half of the year import growth decelerated, with negative implications for Latvia's exports.

Deceleration of external demand resulted in weakening of Latvia's exports

Overall, exports of goods increased by a mere 0.2% in 2019. The annual growth of the real exports of goods was also negligent (0.4%), whereas the export prices slightly contracted (by 0.2%). The increase in the export value of goods was mainly associated with the rise in exports of agricultural products observed in the second half of the year which partly offset the fall in the export value of mechanisms, base metals and wood. The export value of mechanisms and base metals decreased as a result of weaker re-export flows, whereas the exports of wood were affected by several factors. First of all, prices declined following a steeper rise caused by some short-term tensions in 2018 which were exacerbated by the fact that, in the circumstances of a weaker demand, supply was ample in Central Europe and Eastern Europe because of the damage caused by bark beetles. Second, the warm weather conditions in winter had a negative effect on logging. The most impressive drop in prices over the year was recorded for products of forestry and logging, whereas the prices on products of wood declined less. This suggests that the movements of raw material prices had a lesser effect on products of the same sector with a higher level of added value (for example, the export prices of furniture increased over the year). At the same time, the increase in export prices of agricultural products, a significant component of exports, was minor in 2019, and the impressive rise in exports can be explained by higher volumes on account of the previously-observed favourable weather conditions. Exports to EU countries were more resilient, while the value of

exports to non-EU countries decreased. The growth of exports to Estonia (on account of exports of wood and natural gas) and to Germany (on account of agricultural and food products) significantly outpaced the average growth of overall exports.

Services exports increased by 6.8%, while the contributions of various service groups changed. The highest growth was reported in business services (mostly trade-related and advertising services), while the growth of the previous leader, information and communication services, moderated and even became negative at the end of 2019. Following a short-lived rise in 2018, exports of transit-related transportation services by sea and by rail also contracted significantly as a result of the long-term freight logistics policy pursued by Russia and lower demand for coal caused by the warm winter. Regardless of that, overall exports of transportation services saw an increase due to the rapidly growing exports of transportation services by road. Exports of construction services expanded significantly to Sweden, Germany and Finland, the traditional trade partners. The most significant growth of services exports was reported to Lithuania and Russia, while Sweden retained its leading position even despite a significantly lower increase in 2019.

The global market share of Latvia's exports of goods contracted, while the cost competitiveness was retained

In 2019, Latvia's export market share contracted both in global imports of goods and, following a steeper rise in the previous year, in the EU market (by 6.5%; mainly as a result of deteriorating competitiveness). At the same time, the increase in relative unit labour costs stabilised. This could mean that the loss of competitiveness was triggered by the previously-observed higher growth of unit labour costs. Preliminary data suggests a minor deterioration in corporate profitability in 2019. As regards the exporting sectors, a small decline in profitability was reported in manufacturing, whereas agriculture saw an improvement.

DOMESTIC ECONOMIC ACTIVITY

Latvia's economic growth decelerated primarily on account of weakening external demand, gradually having a negative effect also on domestic decisions

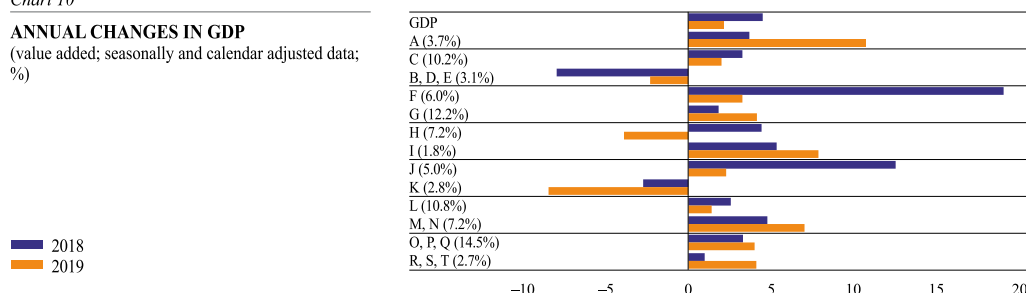
In 2019, Latvia's GDP growth was 2.2% (see Chart 10) which is two times lower than in 2018. A significant shift in the factors supporting and limiting growth were observed in 2019. The previously-observed challenges posed by undercapacity of the supply side (shortage of labour and high degree of capacity utilisation) largely disappeared, with insufficient demand becoming the main growth-limiting factor.

On the expenditure side, the steadily rising private consumption was the main contributor to GDP growth in 2019 (an increase of 2.8%; contributing 59.7% of nominal GDP; see Chart 11). Private consumption increased primarily on account of higher net wages, with the number of employed remaining at the level of the previous year. At the same time, the savings accumulated during the previous years provided more freedom in planning the spending. According to Latvijas Banka estimates, the steeply rising income enabled further build-up of savings also in 2019. Overall, consumer confidence remained above the long-term average all year, except in some episodes.

Chart 10

ANNUAL CHANGES IN GDP

(value added; seasonally and calendar adjusted data; %)



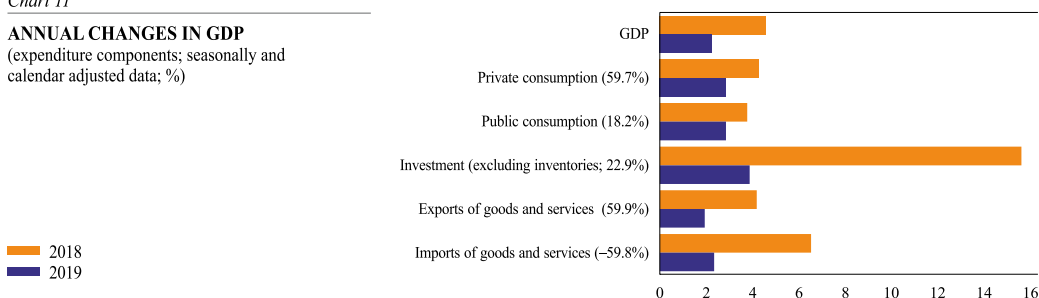
Source: CSB.

Sectoral contributions are provided in brackets (% of nominal GDP). Classification as per Statistical classification of economic activities in the European Community (NACE Rev. 2): A – Agriculture, forestry and fishing; B – Mining and quarrying; C – Manufacturing; D – Electricity, gas, steam and air conditioning supply; E – Water supply, sewerage, waste management and remediation activities; F – Construction; G – Wholesale and retail trade; repair of motor vehicles and motorcycles; H – Transportation and storage; I – Accommodation and food service activities; J – Information and communication; K – Financial and insurance activities; L – Real estate activities; M – Professional, scientific and technical activities; N – Administrative and support service activities; O – Public administration and defence; compulsory social security; P – Education; Q – Human health and social work activities; R – Arts, entertainment and recreation; S – Other service activities; T – Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use.

Chart 11

ANNUAL CHANGES IN GDP

(expenditure components; seasonally and calendar adjusted data; %)



Source: CSB.

Note. Component contributions are provided in brackets (% of nominal GDP).

Investment increased by 3.8% in 2019, which is a weak result in comparison with the previous years when 11%–15% growth was reported. Growth was underpinned by further implementation of the previous years' investment plans in the circumstances of low capacity and high demand, as well as projects co-financed from EU funds. Investors, however, became increasingly cautious in 2019 and in some cases their previous investment plans were put on hold. EU funds and own funds of businesses were the main financing sources for investment. Lending remained sluggish, with financial institutions maintaining tight credit standards and relatively high interest rates, considerably above the euro area average. In 2019, a large part of investment was again used for purchasing manufacturing equipment, thereby improving the productivity of the exporting sectors and strengthening competitiveness.

External uncertainties and weakening external demand were primarily reflected in the slowdown of exports of goods and, along with decreasing domestic consumption (particularly that of imported capital goods), also in decelerating import growth. At the same time, external trade in services was more resilient. Prevailing uncertainties increase competition in export markets. At the same time, more flexibly adjusting companies operating in niche markets have certain competitive advantages. Nevertheless, Latvia's global export market share slightly contracted in 2019 overall.

Economic growth decelerated in 2019, yet part of the downward factors were temporary

Economic growth decelerated in 2019. The development of construction, previously receiving ample investment inflows, moderated, and the growth in information and communication services also slowed. Some of the factors affecting growth were temporary (for example, weather conditions, forest infestation by insects). However, other already

earlier-observed factors (like the progress in the international trade negotiations and Brexit) did not lose their relevance. Weakening external demand and unfavourable development of the global prices weighed on the growth of manufacturing (particularly, that of wood processing). Energy, forestry and wood industry suffered from insufficient water flows and mass forest infestation by insects. At the same time, the weather conditions were favourable for agriculture, and the record-high grain harvest supported the expansion of wholesale and exports.

In 2019, value added in construction increased by 3.3% year-on-year. Although construction had been on an upward trend for three consecutive years and was still growing faster than the economy overall, its growth decelerated significantly in comparison with the previous two years. This was determined by the completion of large construction projects, weaker investment inflows in connection with external uncertainties, slowdown of the global economic growth and the maximum level achieved in absorption of EU funds, when additional investment inflows and financing for the construction sector is no longer generated. Construction output was supported by both rising real volumes and costs of construction. The annual growth of overall construction costs continued to decelerate in 2019, despite an increase in the sector's wages in November and December following the general agreement on the minimum gross wage in construction taking effect on 3 November. Construction output increased in all basic groups. The most significant contribution was provided by the increase in construction of buildings, including private houses, industrial buildings, warehouses, hotels, wholesale and retail buildings, traffic and communication buildings. The development of civil engineering and specialised construction activities, however, was weaker.

Against the background of shrinking external and domestic demand, manufacturers were facing strong competition in export and domestic markets in 2019. The sector's added value grew by merely 2.0% in 2019, and its growth has been gradually decelerating already since 2017. Moreover, the challenges faced by manufacturers were enhanced also by some supply side factors.

Wood industry was expecting a gradual fall in the previously-high prices on wood products against the background of lower demand (particularly, in the Scandinavian countries and the United Kingdom) and the fading effect of unfavourable weather conditions on logging. In 2019, extensive salvage logging due to the damages caused by insect infestation of forest areas (particularly, in Germany and Czechia) increased the supply of wood and added to the fall in its prices. Latvia also suffered from a notable increase in the areas of forests damaged by insect infestation, yet the increase was comparatively smaller and Latvia is already quite experienced in handling biotic forest damages. Sectoral prices were affected by the development of supply and demand in the region overall. The output of the high technology sector and manufacture of fabricated metal products started to decelerate gradually. Manufacture of food products continued to perform poorly.

As expected, 2019 was not a good year for the transport sector, with its value added contracting by 3.9%. The volume of cargoes loaded and unloaded at ports and that of freight transport by rail decreased considerably on account of lower contributions from coal and wood shipments. The decline in coal cargoes was associated with both cargoes being rerouted through Russian ports and lower demand resulting from the warm winter. The volume of wood cargoes, in turn, decreased due to falling prices. The turnover of freight transport by road also contracted on account of lower turnover of international freight transport (particularly, import transportation). Moreover, the progress made with the EC's Mobility Package 1 suggests that international transportation by road could face some challenges in the near term. At the same time, air transportation continued to develop steadily, with the number of passengers travelling through Riga International Airport growing and investment projects progressing.

The surprisingly good performance of the trade sector in 2019 was primarily underpinned by temporary factors, including a good harvest in agriculture, having a short-lived positive effect on wholesale development in the respective commodity group. At the same time, the growth of retail trade decelerated and the development of external demand was unfavourable, weighing on export and wholesale growth opportunities. The 4.1% increase in the trade sector's value added was more than two times higher than in 2018.

The sector continued to steadily strengthen its capacity and intensify competition. Construction and opening of new trading venues continued, as well as reconstruction and expansion of the existing ones, development of logistics centres and entry of new players into the market. Despite the relatively steady growth of household income, the development of retail trade decelerated, which could probably be explained by rising caution in connection with the high degree of external uncertainties. This was partly confirmed by the weak growth and even contraction reported in certain groups of commodities related to housing improvement and renovation.

LABOUR MARKET

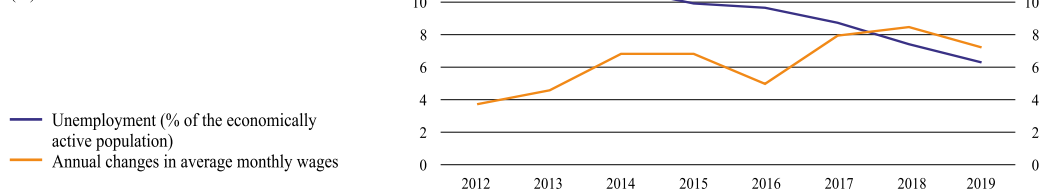
Deceleration of economic growth was reflected also in the labour market

Labour market conditions in 2019 reflected both slower economic growth and a decline in the working age population. An increase in the economic activity of population was no longer observed in 2019, with both the number and share of economically active population contracting. There was a slight fall in the number of employed, yet, considering that the number of working age population also decreased, employment reached its historical high at 65.0%.

Unemployment continued to shrink (6.3%; see Chart 12). With the economic growth decelerating, in the second half of the year shortage of labour was mentioned as a limiting factor less often in business surveys, although it remained a significant problem. Regional and skills mismatches remained one of the obstacles to an even faster decline in unemployment.

Chart 12

UNEMPLOYMENT AND ANNUAL CHANGES IN AVERAGE MONTHLY WAGES (%)



Source: CSB.

In order to encourage the labour market participation of employees, the duration and size of the unemployment benefit were reduced as of 2020, providing for an 8-month period (instead of the previous 9-month period) of disbursement and a consecutive decrease in the size of benefit after every two months of unemployment.

Wages continued to grow steadily

Despite the economic deceleration, wages continued to grow steadily (by 7.2%), with the growth of private sector wages outpacing that of the public sector. Employers mentioned the requirement to disclose the expected remuneration in job advertisements as the reason for increasing wages (particularly, in low-paid jobs), as this improved the employees'

position to negotiate wages and supported migration to better-paid jobs. At the same time, a steeper rise in gross wage per employed (8.8%) suggests a more significant increase in the social payments of employers (compulsory and voluntary social security contributions, severance and other benefits).

General agreement on a higher minimum gross monthly wage (780 euro) than the one stipulated by law came to effect in the construction sector in November. The increase in public sector wages was determined by the decisions to raise the wages of medical staff, social care workers, judges, prosecutors and teaching staff. Regional wage disparities did not decrease considerably in Latvia in 2019: for example, the average monthly wage in Latgale is still about 70% of the national average. Moreover, significant regional differences with regard to unemployment levels still exist, suggesting that structural unemployment is not declining.

Rising wages in the circumstances of a low inflation have supported in an increase of purchasing power and consumption. Real wages of employees and consequently also the purchasing power increased by 3.9% in 2019. The wage-productivity gap, observed since earlier years, however, continued to widen in 2019, suggesting that further productivity improvements are still required. Cost competitiveness in the tradable sector¹ remained stable in 2019, with wages growing in line with productivity, and weakening economic activity could cause a slowdown of wage growth going forward.

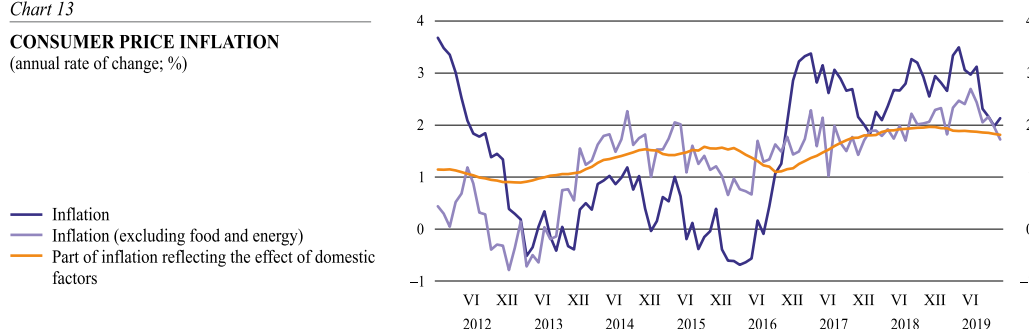
INFLATION

The rise in consumer prices was primarily driven by domestic demand

Consumer price inflation (HICP) was 2.7% in 2019 (see Chart 13 for inflation developments). Primarily on account of domestic factors, the growth rate of Latvia's consumer prices was slightly higher than the euro area average for the third consecutive year. The part of inflation reflecting the effect of domestic factors with a few months' lag started declining in the middle of the year, in response to deceleration of the economic growth.

Chart 13

CONSUMER PRICE INFLATION (annual rate of change; %)



Sources: CSB and Latvijas Banka calculations.

Notes. The effect of domestic demand on consumer prices was estimated for 34 consumer price components separately and the results were subsequently aggregated. Domestic factors mainly include an increase in costs of labour as well as the long-term trend (reflecting the rise of competition in the domestic market). The timing and scale of the price transmission have been examined in Latvijas Banka Working Paper No. 1/2020 "Short-Term Inflation Projections Model and Its Assessment in Latvia".

Changes in economic activity had the strongest and fastest effect on services prices: their annual growth rate steadily declined below 3% towards the end of the year. At the same time, the prices for industrial goods were rising slightly faster than usually, owing to two factors. First, producer prices of fabricated products continued to grow in response to the rising labour costs. Second, import prices of non-durable goods also rose somewhat, and this could reflect a slight depreciation of the euro against the US dollar.

¹ Includes manufacturing, agriculture and forestry.

Global oil and food prices were volatile

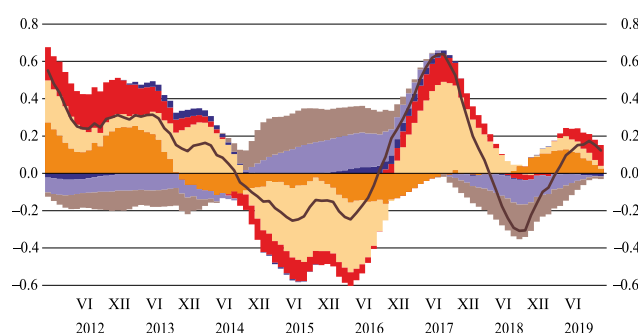
The contribution of energy to annual inflation decreased. In 2019, the average oil price at 64 US dollars per barrel stood 10% lower than a year before. At the end of 2019, oil price climbed to the highest semi-annual peak, mainly in response to the OPEC agreement on further oil production cuts reached at the end of December, tensions between the US and Iran as well as the progress made in the US-China trade negotiations.

No single trend was observed over the year in the development of various global food price indices directly passed through to the consumer prices of food products (see Chart 14 for the effects on Latvia's annual consumer price inflation) and indirectly reflected in prices on catering services. Meat prices remained high as the widespread outbreak of African swine fever in Asia reduced the global pork supply. At the same time, the outbreak of African swine fever compressed the demand for fodder and thus also the prices of cereals, with the good grain harvest because of the favourable weather conditions being an additional factor. Conversely, the prices of dairy products in Europe increased somewhat due to the high demand. Inflation in Latvia was also dampened by a short-lived reduction of excise tax on spirits.

Chart 14

PASS-THROUGH OF GLOBAL FOOD COMMODITY PRICES TO LATVIA'S ANNUAL CONSUMER PRICE INFLATION (contributions in percentage points)

Grain
Milk
Meat
Fish
Sugar
Coffee
Total



Sources: CSB, EC and Bloomberg data, and Latvijas Banka calculations.

Notes. Global grain, milk and meat prices were estimated based on DG AGRI price indices published by the EC, whereas global fish prices were calculated using Nasdaq Salmon Index. Global sugar and coffee prices are Bloomberg data. Pass-through of global food commodity prices to five unprocessed food and 12 processed food components was estimated separately and the results were subsequently aggregated. The timing and scale of the price transmission have been examined in Latvijas Banka Working Paper No. 1/2020 "Short-Term Inflation Projections Model and Its Assessment in Latvia".

Electricity prices increased significantly in January, reflecting higher wholesale prices of electricity in 2018 as a result of the hot and dry summer. As regards administered prices, the prices of waste collection and heating contributed most to inflation rise.

BALANCE OF PAYMENTS AND EXTERNAL DEBT

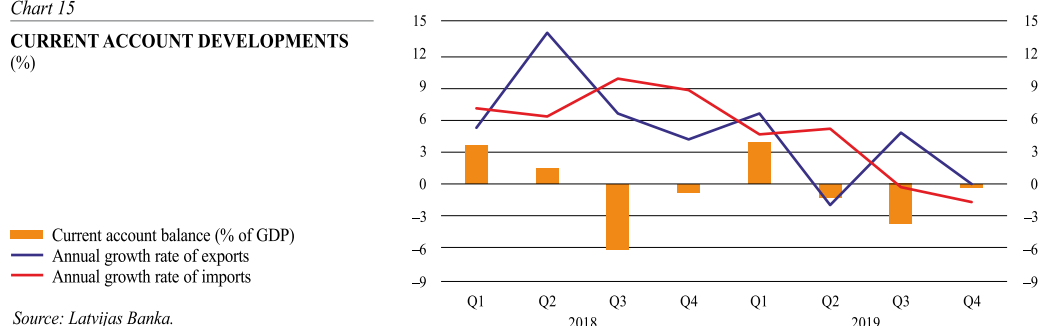
Prolonged external uncertainties and restructuring of Latvia's credit institution sector had a significant effect on the balance of payments developments

Growing caution on the domestic front in association with the prolonged external uncertainties as well as restructuring of Latvia's credit institution sector had a significant effect on the balance of payments developments in 2019. In the circumstances of a softer external demand, the balance of trade remained close to balance due to the weakening of some domestic demand components. Despite the solid household consumption underpinned by the strong labour market, with production capacity utilisation decreasing on account of weaker exports and the credit terms tightening in the course of the year, businesses held back on their investments. As a result, imports of capital and intermediate goods decreased and the overall import growth moderated accordingly. At the same time, export growth (see Chart for the annual growth rates of exports) was additionally supported by trade, miscellaneous business services and construction. These sectors boosted their exports despite an increasingly more complicated external environment.

All this led to a minor surplus in the goods and services account (0.1% of GDP), while the deficit of the current account (0.5% of GDP) was determined by the deficit of the income account, as the positive balance of other income groups could not offset the income of foreign investors in Latvia.

Chart 15

CURRENT ACCOUNT DEVELOPMENTS
(%)



Source: Latvijas Banka.

External debt contracted on account of shrinking liabilities due to restructuring of Latvia's credit institution sector

Given the continued inflows of EU funding, the capital account remained in surplus in 2019 (1.9% of GDP). At the same time, net financing outflow from Latvia was recorded in the financial account. Contraction of external debt liabilities was only partly offset by a decrease in external assets; therefore, Latvia's gross and net external debt declined to 116.2% of GDP and 19.7% of GDP respectively.

The largest financial flows were observed in the credit institution sector and were related to the active measures implemented by the government to prevent money laundering, terrorist and proliferation financing risk. The above measures resulted in a decrease of non-resident deposits with Latvia's credit institutions. The cross-border financing flows of the public sector were primarily associated with the government debt refinancing, management of Latvijas Banka reserves and participation in the Eurosystem's monetary policy operations. Foreign direct investment inflows were consistent with the average level of the most recent years (2.3% of GDP). These inflows were associated with reinvested earnings, equity investment and loans from foreign affiliates. The most significant inflows of foreign direct investment were registered in the second half of the year, while, over the year as a whole, the largest inflows were reported in manufacturing, real estate and professional services. The largest investment flows to Latvia originated in Estonia, Germany, Lithuania and Finland.

FISCAL POLICY

A more contractionary fiscal policy was implemented, with the ratio of the structural budget balance to GDP improving

In 2019, Latvia's general government budget deficit stood at 0.2% of GDP, representing a decrease of 0.6 percentage point of GDP vis-à-vis the budget deficit level in 2018. The high revenue from taxes on labour had a positive effect on the central government special budget and local government budgets. Meanwhile, the transitional period of the corporate income tax reform and a rise in government spending on remuneration, observed at the beginning of the year, resulted in a higher basic budget deficit than in 2018.

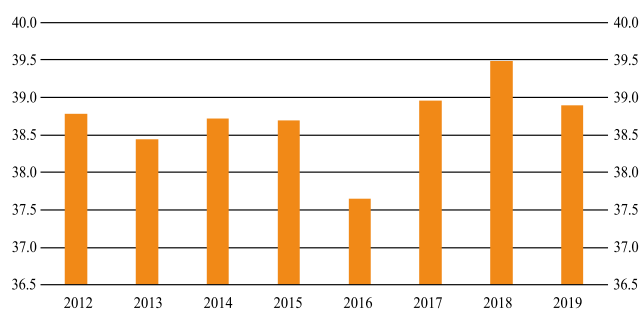
The general government expenditure reached 38.9% of GDP in 2019 (see Chart 16)¹. As the economic performance declined, overall expenditure growth stood moderate at 3.3%.

¹ According to preliminary data published by the CSB.

Slower government consumption growth at 5.5% vis-à-vis 2018 mostly resulted from a smaller rise in budget expenditure on compensation, while that on goods and services continued on an upward trend. Year 2019 started with a "technical" or temporary budget in Latvia, with no plans to finance new policy initiatives. Nevertheless, legislation allowed for providing financing for benefit disbursements granted by law to those working in the interior sector, as well as raising the wages of health care professionals, teaching staff, judges and prosecutors. Meanwhile, government investment growth was negative at –13.5% (year 2016 was the last time a fall was registered in this segment). Lower expenditure levels in local government budgets, limited by borrowing conditions for new investment projects to ensure core functions, as well as stabilization of financing flows from EU funds were factors contributing to the above. Social policy expenditure, in its turn, grew by 8.1% in comparison with 2018. With the average wage level set for social security contributions increasing due to tight labour market conditions, all types of social benefits saw a considerable rise in the average benefit level. Moreover, the tax reform expanded the range of persons covered by social security schemes and entitled to receive benefits. At the same time, interest expense continued to decrease in the consolidated general government budget.

Chart 16

GENERAL GOVERNMENT EXPENDITURE (% of GDP)



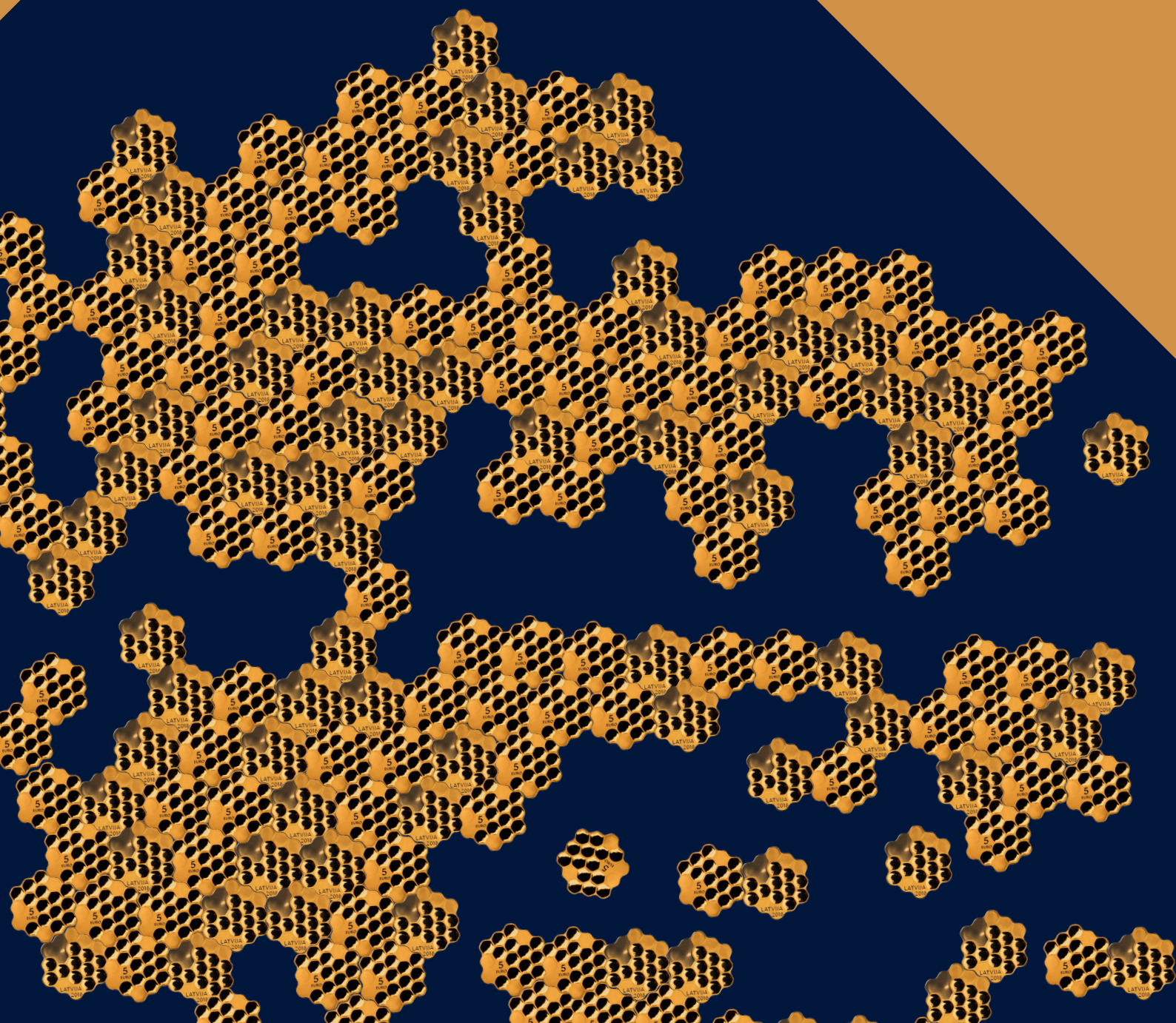
Source: CSB.

In 2019, the share of government revenue in GDP remained broadly unchanged year-on-year at 38.7% of GDP. A lower rate of increase in tax revenue (4.7%) than in 2018 was mostly a result of plummeting CIT revenue by 85% during the transition period of the tax reform. Although the negative fiscal effect of a conceptually new payment procedure of CIT gradually faded in the second half of the year, the overall annual dynamics of CIT revenue was negative. At the same time, the rise in household income caused an increase in consumption, thus promoting revenue growth of almost all eligible types of taxes, e.g. VAT revenue and state compulsory social security contributions increased by 7.5% and 10.3% respectively. Meanwhile, due to accounting specificities, PIT revenue remained unchanged over 2018. A high employment rate and expansion of the range of persons covered by social security schemes facilitated an increase in revenue from state social security contributions.

At the end of 2019, the general government consolidated debt stood at 11.24 billion euro or 36.9% of GDP (a nominal increase of 0.4 billion euro, but a decrease of 0.3 percentage points in its share of GDP in comparison with the end of 2018). In view of the planned redemption of part of the debt and ensuring financing to cover current needs, the Treasury launched two issues of eurobonds totalling 1 billion euro in 2019. Assessing the fiscal policy and reforms implemented by the government, in 2019 several international credit rating agencies either upgraded Latvia's credit rating (R & I) or kept it unchanged at A rating group level (Fitch Ratings, Moody's Investors Service, S & P Global Ratings), preserving a stable outlook. Such Latvia's credit rating dynamics and the accommodative monetary policy pursued by the ECB help to have interest rates on debt securities close to their historic low and support an opportunity for debt refinancing to longer maturities.

With the budget deficit decreasing and economic growth slowing down, a more contractionary fiscal policy was implemented in 2019.

OPERATIONS AND ACTIVITIES OF LATVIJAS BANKA



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

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

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

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

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

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

In 2019, Governor of Latvijas Banka and Zoja Razmusa, Deputy Governor of Latvijas Banka, as authorised by Governor of Latvijas Banka, participated in the work of the Governing Council and the General Council of the ECB, namely, in the formulation of the Eurosystem's monetary policy and decision-making related to the tasks of the Eurosystem and the ESCB.

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

Representatives of Latvijas Banka participated in the Eurosystem/ESCB committees (see Appendix 6) and working groups, dealing with issues related to monetary policy, market operations, financial stability, payment systems, euro banknotes, statistics, international relations, communication, financial accounting, etc.

Experts of Latvijas Banka also participated in committees and working groups of the Council of the EU and the EC. Sitting on the EFC and its subcommittees, representatives of Latvijas Banka regularly participated in the preparation of decisions concerning the economic development and financial stability of the EU and the development of the EU economic policy strategy, focusing in particular on the implementation of structural reforms and prudent fiscal policy in the EU and further strengthening of the EMU and Brexit-related issues, as well as in the formulation of the policies of international financial institutions.

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

In 2019, Latvijas Banka participated in the work of the ESRB which made decisions on the issues related to the EU macroprudential policy. Representatives of Latvijas Banka also engaged in the work of the Advisory Technical Committee of the ESRB and its working groups.

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

IMPLEMENTATION OF EUROSISTEM MONETARY POLICY IN LATVIA

In 2019, Latvijas Banka reinvested in full the principal payments from maturing securities, but in November and December, implementing the Eurosystem's monetary policy, net purchases restarted under the PSPP. A large amount of free liquidity was held in Latvian credit institutions' settlement accounts opened with Latvijas Banka. This amount followed an upward trend, reducing interest of Latvian credit institutions in the Eurosystem's monetary policy operations.

Over the year, Latvijas Banka's balance sheet item "Securities held for monetary policy purposes" grew from 7.4 billion euro to 7.6 billion euro. Overall, the Eurosystem's holding of the Latvian government securities totalled 2.4 billion euro¹ at the end of 2019 (2.1 billion euro at the end of 2018). The average remaining maturity of the purchased Latvian government securities increased from 8.7 years at the end of 2018 to 10.6 years at the end of 2019.

In 2019, the smaller amount of securities purchased under the PSPP allowed increasing the share of Latvian government securities in the amount of the newly bought securities to 76.7% (in 2018 – 35.2%). Most securities sold to Latvijas Banka still came from foreign credit institutions.

The excess liquidity of Latvian credit institutions increased from the average of 4.4 billion euro in December 2018 to the average of 5.2 billion euro in December 2019. Inflows of funds borrowed by the government into Latvia and the general government budget deficit as well as changes in the liquidity placement of some bank groups contributed to money inflows from the euro area via TARGET2. The minimum reserve requirements for credit institutions expanded to 162 million euro in the first half of 2019 along with an upward trend in deposits of households and non-financial corporations resident in Latvia and other euro area countries. However, later, when credit institutions' short-term liabilities to MFI decreased, the minimum reserve requirements shrank to 156 million euro, the level recorded at the end of 2018.

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

Therefore, the ratio of balance on credit institutions' settlement accounts to the minimum reserve requirements rose from 32 at the end of 2018 to 36 in late 2019, remaining the highest one among the euro area countries. At the end of 2019, the average ratio stood at 11 in the euro area, but the level closest to Latvia was in Lithuania (30), Estonia (23) and Finland (21). As of 30 October, the Eurosystem introduced a two-tier system for remuneration of excess reserves, which provides that part of banks' holdings of excess liquidity is exempt from the negative deposit facility rate. The reserve multiplier was set at 6, and it refers to excess liquidity, i.e. 0% rate was applied to excess liquidity in the amount of the multiplied reserves. This also mitigates the adverse effect of negative interest rates on financial indicators of Latvian credit institutions.

As a result of early repayment of TLTRO loans by credit institutions, the average outstanding amount of funds borrowed via TLTROs decreased at Latvijas Banka from 119.6 million euro in 2018 to 30.0 million euro in 2019, but the average balance of the main refinancing operations – from 4.6 million euro to 0.2 million euro respectively. Meanwhile, longer-term refinancing operations with a 3-month maturity were not used, but the average recourse to the marginal lending facility stood at 0.04. million euro. The new TLTRO III tenders took place in September and December, in which Latvian credit institutions did not participate.

ECONOMIC RESEARCH, ANALYSIS AND FORECASTING

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

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

Daily analytical work is no less important than forecasting and, in cooperation with other euro area central banks, it is conducted within the Eurosystem/ESCB Monetary Policy Committee and its Working Groups on Econometric Modelling, on Forecasting and on Public Finance, wherein substantiated discussions form the basis for the Eurosystem's monetary policy decisions.

In 2019, Latvijas Banka proceeded with research activities in three priority directions: 1) monetary policy transmission, 2) fiscal policy and public debt sustainability and 3) long-term growth and competitiveness.

In 2019, Latvijas Banka published four working papers and three discussion papers on its website (see Appendix 8).

Working Paper No. 1/2019 was aimed at comparing the forecasting performance of more complicated and simple models in different stages of the business cycle. The comparison of US GDP forecasts provided by the Bayesian mixed-frequency model suggested by A. Carriero, T. E. Clark and M. Marcellino with those provided by the benchmark univariate AR(2) model makes it possible to conclude that most of evidence in favour of a more sophisticated model relative to the simple benchmark model is based on a rather small number of observations during recessions (the Great Depression in

particular). By contrast, an increase in forecasting accuracy during expansions compared to the benchmark model is at best very modest. This means that the relative forecasting performance of models changes along with stages of the economic cycle. Choosing to ignore this fact, leads to a distorted picture, i.e. the relative forecasting performance of the most sophisticated model relative to the simplest benchmark model is overestimated during expansions and understated during recessions.

Working Paper No. 2/2019 evaluated the macroeconomic effects of the ECB's APP on Latvia and other euro area countries as well as investigated the transmission mechanism of the programme. To that end, two different models have been used to evaluate the spillovers stemming from the monetary policy actions, namely, a bilateral structural VAR model with block exogeneity (BSVAR-BE) and a multi-country mixed cross-section global VAR with stochastic volatility (MCS-BGVAR-SV). The working paper finds that the APP had a limited and weak impact on Latvia's output and that most of the effect was generated by spillovers from other countries. However, the results also provide evidence that the APP had a robust impact on Latvian inflation due to depreciation of the euro. Regarding other euro area countries, the results suggest that the ECB's asset purchases had a larger impact on industrial production in the countries where the portfolio rebalancing channel was activated.

Working Paper No. 3/2019 aimed to evaluate the macroeconomic effects of the ECB's forward guidance on the euro area economy. The working paper finds that the ECB's forward guidance in relation to interest rates is an effective policy tool having significant effects on output and the price level. In addition, multiple evidence suggests that the introduction of the APP in 2015 considerably enhanced the credibility of forward guidance. Regarding the transmission mechanism, the working paper finds that forward guidance significantly lowered uncertainty in the euro area as well as borrowing costs for both households and firms.

Working Paper No. 4/2019 proposes to construct impulse response functions as deviations from deterministic global solution. The approach detects asymmetric reactions of an economy to shocks in different initial conditions. For example, in an economic downturn a negative shock might affect the economy more severely than in normal economic conditions. The method allows for constructing the impulse response functions for highly non-linear DSGE models.

Discussion Paper No. 1/2019 employs econometric methods to obtain evidence pointing to a negative correlation between the size of population living in the territories of Latvia's municipalities and the municipal spending per capita. Namely, the smaller the municipality, the higher the per capita costs incurred by the municipality in the performance of its functions. The research also suggests that concentration of local government services in administrative territorial units that are larger in terms of their population size could result in significant potential savings of budgetary resources that could be spent to improve the supply of local government services or their quality within specific municipalities.

Discussion Paper No. 2/2019 was aimed at analysing labour reserves in the Baltic States. Considerable internal labour reserves exist in the form of still high natural rate of unemployment and hidden unemployment as many economically inactive people are available for work but are not actively engaged in job seeking. The study finds that the employment rate is particularly low for upper-middle-aged men, especially those without a tertiary education degree, which is likely to reflect a low incidence of lifelong learning, low digital skills and rapidly deteriorating health condition. Employment of youth is also low, mirroring low prevalence of apprenticeships. Moreover, a postponed entry of young women into the labour market can be observed in Lithuania and Latvia. The employment rate of Estonian women of fertile age, who hold a tertiary education degree, is lower than that of their EU counterparts. These internal labour reserves total more than 25 thousand

people in Estonia, 55 thousand in Latvia and 85 thousand in Lithuania, corresponding to 4%–7% of the total employment in these countries.

Discussion Paper No. 3/2019 provided new evidence on sector-specific differences in the age-productivity and firm productivity profiles in a country that has witnessed substantial shifts in the economic structure and features flexible labour market and high labour force participation among the elderly. Using a matched employer–employee dataset of Latvian firms, the paper unveils a conventional hump-shaped or downward sloping relationship in manufacturing and trade, but almost no or very small negative effect of ageing workforce in knowledge-intensive service sectors that largely employ high-skilled white-collar employees. The results suggest that investing in human capital, in particular training of elderly employees as well as addressing severe skill shortages in the sector of information and communication services have to be considered to reduce the downward pressure of ageing on firm performance.

Quality research activities are impossible without continuous improvement of staff qualifications and thorough assessment of the results achieved. External reviewers from national central banks and academia of other countries are involved in assessing working papers to ensure their high quality. The publication of employees' working papers in internationally refereed journals is also supported. Seven such working papers were published in 2019. For example, *Economic Policy (Oxford Academic)* published an article in 2019 which concludes that participation in the projects co-funded by the European Reconstruction and Development Fund boosts business investment and production output soon after their initiation, but the impact on productivity and labour productivity can only be observed three years later. Meanwhile, the article published by *Empirical Economics (Springer)* studies the relationship between firms' research expenditure and employment in these firms, using a unique OECD enterprise database. The study results suggest that this relationship is non-linear, i.e. research expenditure has positive effects on employment within certain limits, but it becomes negative if firms' research expenditure is very high.

Presentation of papers by Latvijas Banka's researchers at international conferences and seminars is enhanced to raise researchers' qualifications, get peer review and recommendations provided by other researchers as well as promote research work. In 2019, papers by Latvijas Banka's researchers were presented at 30 conferences and seminars – the academic ones and those organised by Eurosystem/ESCB institutions. Publications in working paper series of other institutions also reflect international cooperation of researchers. For example, in 2019, a researcher of Latvijas Banka co-authored a publication in a working paper series of the Swiss Economic Institute (KOF). To improve competences of Latvijas Banka's staff, Latvijas Banka also organises regular seminars to which highly qualified experts are invited to present their research results. In 2019, eight such seminars were organised, and interested parties from other institutions were also invited to participate.¹

Latvijas Banka also disseminates research findings to the public at large by explaining conclusions of working and discussion papers via articles and blogs published on www.macroeconomics.lv and other thematically related websites.

INVESTMENT MANAGEMENT

Foreign reserves of gold and foreign currencies as well as other financial investment of Latvijas Banka amounted to 5.7 billion euro at the end of 2019.

Latvijas Banka manages its investment in compliance with the guidelines adopted by the Council of Latvijas Banka. The majority of Latvijas Banka's financial assets was managed relative to the weighted index of 1–3 year government securities of the US and

¹ For more detailed information on the research seminars, see the Research section at macroeconomics.lv.

Canada and that of 1–10 year government securities of euro area countries and the UK. The benchmark currency is the euro, and the benchmark assets are composed of 55% US dollar-denominated, 21% euro-denominated, 14% British pound sterling-denominated and 10% Canadian dollar-denominated assets. Latvijas Banka invests its financial assets in safe and liquid financial instruments, mainly debt securities issued by the governments of EU countries and the US, their agencies and international organisations as well as in highly rated bank and corporate debt securities, asset-backed debt securities and callable bonds. A small share of financial assets is invested in equities of the companies included in the equity securities index of the developed countries. Interest rate futures are used to regulate the duration and to implement yield curve strategies on the interest rate market, whereas both currency futures and forward exchange rate contracts ensure the optimal currency composition of financial assets.

When managing investment, the primary focus was on 2-, 5- and 10-year government bonds. In 2019, almost all markets and interest rate segments experienced lower interest rates (see Table 1).

Table 1

CHANGES IN GOVERNMENT BOND YIELDS

(as at the year-end; %)

Country	2-year government bond yield		5-year government bond yield		10-year government bond yield	
	2018	2019	2018	2019	2018	2019
Germany	-0.61	-0.60	-0.31	-0.47	0.24	-0.19
UK	0.75	0.55	0.90	0.60	1.28	0.82
US	2.49	1.57	2.51	1.69	2.68	1.92
Canada	1.86	1.70	1.89	1.69	1.97	1.70

Source: Bloomberg.

The gold reserves of Latvijas Banka are stored in the Bank of England.

Latvijas Banka uses the services provided by eight external managers. They manage a portion of Latvijas Banka's financial assets in compliance with the guidelines adopted by the Council of Latvijas Banka to further diversify financial assets and boost income in proportion to the undertaken risk over the medium and longer term. In the light of that objective, Latvijas Banka continued to increase investment in equities.

Risk management and control is a cornerstone of investment management at Latvijas Banka. Risk allocation and compliance in Latvijas Banka's investment portfolios is monitored and controlled on a daily basis.

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

CURRENCY IN CIRCULATION

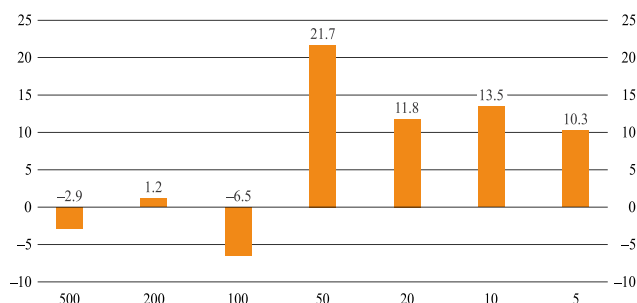
The net issuance of euro banknotes by Latvijas Banka continued on a downward trend in 2019, i.e. from -132.6 million euro in 2018 to -332.7 million euro in 2019. This was because the amount of 100 euro and 500 euro banknotes deposited with Latvijas Banka exceeded the amount of the above banknotes withdrawn from Latvijas Banka. Meanwhile, the issuance of euro coins by Latvijas Banka picked up from 73.5 million euro in 2018 to 79.5 million euro in 2019. Thus, the net issuance of euro banknotes and coins by Latvijas Banka was -253.2 million euro in 2019.

The net issuance of banknotes by Latvijas Banka in terms of number grew by 5.2% (to 49.1 million banknotes) during 2019. It is the net issuance of 50 euro and 10 euro banknotes by Latvijas Banka that predominated over other denominations in the period

lasting from the euro changeover in January 2014 until the end of 2019 (21.7 million and 13.5 million banknotes respectively; see Chart 17).

Chart 17

EURO BANKNOTES ISSUED BY LATVIJAS BANKA IN NET TERMS
(2014–2019; face value; number in millions)

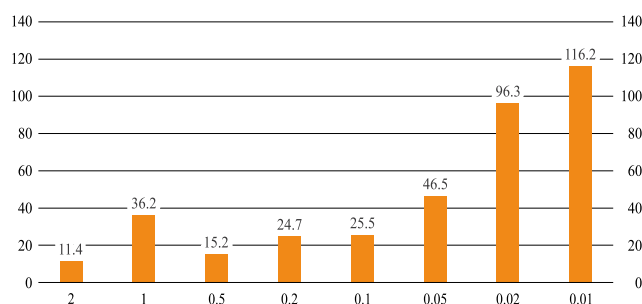


Source: Latvijas Banka.

Meanwhile, the net issuance of coins by Latvijas Banka in terms of number augmented by 10.9% (to 372.0 million coins). It is the 1 cent and 2 cent coins that accounted for a major portion of the net issuance of coins by Latvijas Banka during the period starting from the euro changeover day in January 2014 and ending in late 2019 (116.2 million and 96.3 million coins respectively; see Chart 18).

Chart 18

EURO COINS ISSUED BY LATVIJAS BANKA IN NET TERMS
(2014–2019; face value; number in millions)



Source: Latvijas Banka.

The cash received from credit institutions was checked for fitness and authenticity by automated cash processing systems of Latvijas Banka. They processed 152.3 million banknotes in 2019, i.e. 5.8% more than in 2018. 15.8% (24.0 million) of the processed banknotes were identified as unfit for circulation and destroyed.

In 2019, Latvijas Banka continued to register merchants, engaged in handling and recirculating of euro banknotes and coins, and to monitor their operation. A merchant is entitled to handle and recirculate euro banknotes and coins in the Republic of Latvia upon registering with Latvijas Banka as a cash handling institution. At the end of 2019, 56 cash processing institutions were registered in Latvia. Latvijas Banka conducted inspections of cash handlers and assessed the compliance of their operation with the requirements of laws and regulations governing cash handling. In 2019, 32 inspections of operation of cash processing institutions were carried out.

In 2019, the National Analysis Centre and the Coin National Analysis Centre received and identified 1337 counterfeits (928 banknotes and 409 coins). Counterfeits of euro banknotes and coins constituted 92% of the counterfeits, but those of lats banknotes and coins – 4.2%. The share of identified counterfeits of banknotes and coins of US, UK, Chinese and Swiss national currencies was rather small, i.e. 1.6%, 1.0%, 0.7% and 0.6% respectively.

In 2019, the number of counterfeit banknotes and coins identified in circulation was 707 and 356 respectively, and their total nominal value stood at 42.4 thousand euro (in 2018 – 54.3 thousand euro). As compared to 2018, the total number of counterfeits in circulation decreased by 6%, but the number of counterfeit coins moved up by 52%.

2 EURO COMMEMORATIVE COIN



THE RISING SUN

Struck in 2019 by Koninklijke Nederlandse Munt (the Netherlands)

Artist of the national side of the coin: Ivars Drulle (graphic design and plaster model)

The national side features the motif of a raising sun used in the Coat of Arms of Latvia.

Weight: 8.50 g; diameter: 25.75 mm; thickness: 2.20 mm

Shape: round; colour: outer part silver, inner part gold

Composition: outer part – copper-nickel (Cu, Ni), inner part – three layers: nickel, copper and zinc; nickel; nickel, copper and zinc (Ni, Cu, Zn; Ni; Ni, Cu, Zn)

The edge of the coin bears the inscription "DIEVS * SVĒTĪ * LATVIJU *" (God, Bless Latvia).

The common side artist Luc Luyckx

COLLECTOR COINS

CAT'S MILL

Face value: 5 euro

Weight: 22.00 g; diameter: 35.00 mm

Metal: silver of fineness .925; quality: proof

Struck in 2019 by UAB Lietuvos monetų kalykla (Lithuania)

Artists: Elīna Brasliņa (graphic design) and Līgita Franckeviča (plaster model)



NIKLĀVS STRUNKE

Face value: 5 euro

Weight: 20.00 g; shape: circle (diameter 32.00 mm) where the edge cut by a secant forms a 99° angle with the circle's tangent (the distance from the rounded angular tip together with the diameter – 35.00 mm)

Metal: silver of fineness .925; quality: proof; with frosting of different intensity

Struck in 2019 by UAB Lietuvos monetų kalykla (Lithuania)

Artists: Paulis Liepa (graphic design) and Ivars Drulle (plaster model)



GIFTS OF THE FOREST

Face value: 5 euro

Weight: 22.00 g; diameter: 35.00 mm

Metal: silver of .925 fineness, quality: proof

Struck in 2019 by Koninklijke Nederlandse Munt (the Netherlands)

Artists: Edmunds Jansons (graphic design of the obverse), Edgars Folks (graphic design of the reverse) and Līgita Franckeviča (plaster model of the reverse)



FREEDOM FIGHTS (1918–1920)

Face value: 5 euro

Weight: 22.00 g; diameter: 35.00 mm

Metal: silver of .925 fineness, quality: proof; with two-colour print on the reverse

Struck in 2019 by UAB Lietuvos monetų kalykla (Lithuania)

Artist: Andris Vārpa (graphic design and plaster model)



The 50 euro and 20 euro banknotes (77% of counterfeits of euro banknotes identified in circulation) and 2 euro coins were the most counterfeited denominations.

In 2019, withdrawal of lats banknotes and coins from circulation continued. In 2019, the lats banknotes and coins received from circulation by Latvijas Banka totalled 1.6 million lats; 1.4 million lats were in banknotes and 0.2 million lats in coins. Lats banknotes and coins worth 41.8 million lats and 44.0 million lats respectively were in circulation at the end of 2019. In late December 2019, the 5 lats and 20 lats banknotes (1.7 million and 0.8 million respectively) and the 1 santim and 2 santim coins (149.7 million and 89.8 million respectively) accounted for the majority of banknotes and coins in circulation in terms of number.

In 2019, to mark significant cultural and historic events, facts and habits, Latvijas Banka issued collector coins "Cat's Mill" (issued on 11 April 2019), "Nīklāvs Strunke" (issued on 17 July 2019), "Gifts of the Forest" (issued on 17 October 2019) and "Freedom Fights (1918–1920)" (issued on 7 November 2019). In 2019, Latvijas Banka issued a 2 euro commemorative coin "The Rising Sun" (in circulation as of 17 September 2019).

In 2019, several coins issued by Latvijas Banka in 2018 were submitted for participation in international contests: Coin Constellation – 2019¹, an international collector coin contest organised by the Water Mark Publishing House (Russia), and Coin of the Year Awards (COTY) organised by Active Interest Media (AIM). In October 2019, the COTY Nomination Committee selected the "Honey Coin", issued by Latvijas Banka in 2018, one of the world's top ten coins in the category Most Artistic Coin, but the coin "The Garden of Destiny" – one of the world's top ten in the category Most Inspirational Coin.²

PAYMENT AND SETTLEMENT SYSTEMS

PAYMENT INNOVATIONS, INSTANT PAYMENTS AND OPERATION OF LATVIJAS BANKA'S ELECTRONIC CLEARING SYSTEM AND PROXY REGISTRY "INSTANT LINKS"

In 2019, Latvijas Banka continued to develop instant payments and the Proxy Registry "Instant Links". The EKS instant payment service provided an opportunity for Latvian credit institutions, their reachable institutions and Latvijas Banka to send and receive instant payments made by customers within a few seconds at any time of day or night, every day, including weekends and holidays. The EKS instant payment service ensured broad reachability to its participants in the Single Euro Payments Area (SEPA), using a connection to the pan-European instant payment solution via RT1 system, which is managed by EBA CLEARING, and the link to the Eurosystem's instant payment settlement service TARGET2 Instant Payment Settlement TIPS established on 15 April 2019.

¹ In 2020, four collector coins issued by Latvijas Banka in 2018 also received recognition: The "Honey Coin" (the first place in the category Unique Concept), "Curonian Kings" (the first place in the category Coin Classic), "Coats of Arms Coin" (shared second place in the category Silver Coin of the Year) and "Gold Brooches. The Bubble Fibula" (shared third place in the category Gold Coin of the Year). Meanwhile, the 2 euro commemorative coin with a common design "Centenary of the Baltic States" issued within a cooperation project of three countries (Latvia, Lithuania and Estonia) and dedicated to the 100th anniversary of the Baltic States was awarded a shared third place in the category Best Circulation Coin.

² For more detailed information, see <https://www.numismaticnews.net/coin-of-the-year/nominees-for-2020-coin-of-the-year-awards-determined>. On 1 February 2020, the "Honey Coin" was announced the world's Most Artistic Coin and the Coin of the Year (see <https://www.numismaticnews.net/article/coin-of-the-year-goes-to-latvia>).



ZIBMAKSĀJUMS

NODROŠINA: LATVIJAS BANKA
EIROSISTĒMA

In 2019, 6.4 million instant payments totalling 1.2 billion euro were made in the EKS instant payment service, handling more than 40 thousand instant payments a day in the last months of the year. With new EKS participants connecting to the instant payment service, an increased use of this innovative payment service will be fostered in Latvia. At the end of 2019, instant payments accounted for 15.2% of the volume of Latvia's credit institution payments in the EKS, with their share constantly increasing. Latvijas Banka ensured a very high availability of the EKS instant payment service and the Proxy Registry "Instant Links". It accounted for 99.99% in 2019, i.e. the above services were not available for about 65 minutes over the year.



ZIBSAIŠU REĢISTRS

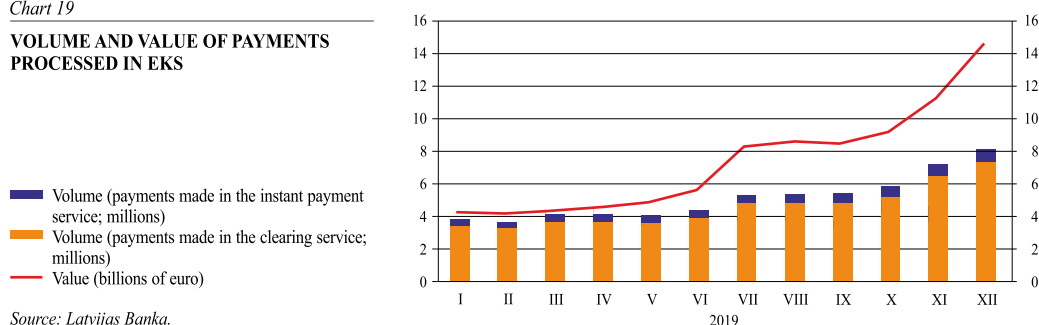
NODROŠINA: LATVIJAS BANKA
EIROSISTĒMA

The Proxy Registry "Instant Links" established and maintained by Latvijas Banka ensures even more convenient execution of instant and other payments, indicating the payee's mobile phone number only when making a payment (other identifiers linked to customer accounts, e.g. e-mail address, ID card number, could also be used in the future). The credit institutions employing the Proxy Registry "Instant Links", according to customer requirements, enter their customer mobile phone numbers or other identifiers in the Registry, thus providing the opportunity to make payments in a more convenient and faster manner. In 2019, when credit institutions started to use the Proxy Registry "Instant Links", it contained 25 thousand instant links and 14.5 thousand payment requests, using a mobile phone number. In March and April 2020, all largest Latvian and Estonian credit institutions intend to start using the Proxy Registry "Instant Links" of Latvijas Banka.

The EKS clearing service maintained by Latvijas Banka continued to ensure payments from one customer account held with a credit institution to a customer account of another credit institution within a few hours on business days, accepting, processing and executing interbank settlement seven times a day. The EKS clearing service continued to ensure customer payments in euro within SEPA for Latvian and Estonian credit institutions and the Treasury. The average volume and value of the customer SEPA credit transfers made by the EKS clearing service on a daily basis was 216.8 payments and 342.7 million euro respectively. The availability of the EKS clearing service accounted for 99.94% in 2019.

In 2019, 61.7 million SEPA credit transfers totalling 88.6 billion euro were executed in the EKS (in the instant payment service and the clearing service combined). The volume and value of the payments executed in the EKS increased by 38% and by 59.6% respectively year-on-year (the volume and value of the payments increased by 6.3% and declined by 0.9% respectively in 2018; see Chart 19). The significant upward trend in the volume and value of payments was attributable to the fact that the EKS started to provide the execution of payments of credit institutions' Baltic branches. This suggests that the EKS maintained by Latvijas Banka ranks among the most efficient retail customer payment systems operating in Europe.

Chart 19

VOLUME AND VALUE OF PAYMENTS PROCESSED IN EKS

Source: Latvijas Banka.

At the end of 2019, the EKS clearing service comprised the following direct participants: 12 credit institutions, the Treasury and Latvijas Banka.

TARGET2-LATVIJA OPERATION

In 2019, Latvijas Banka continued to provide the operation of TARGET2-Latvija – one of the 25 TARGET2 component systems. TARGET2, operated by the Eurosystem, is one of the largest payment systems in the world. It provides real-time gross settlement in euro to support the implementation of the Eurosystem's monetary policy operations and interbank market transactions, the enforcement of customers' urgent payments and interbank settlement of other payments, securities settlement and financial instrument clearing systems.

In 2019, Latvijas Banka together with other members of the Eurosystem continued to implement the Eurosystem's strategic project, i.e. the consolidation of TARGET2 and TARGET2-Securities. Within the framework of the project, a new TARGET system is being developed employing the modern technologies of the TARGET2-Securities platform. The new system will include the T2 service (accounts for transactions with the central bank and a real-time settlement system), the TARGET Instant Payment Settlement (TIPS) service and the TARGET2-Securities platform, which will replace TARGET2 on 22 November 2021 and together with the TARGET2-Securities platform for securities settlement will be included in TARGET services. The new TARGET services will provide a single connection to the Eurosystem's market infrastructure, making it possible to optimise credit institutions' liquidity management, execute real-time settlement by using a more sophisticated infrastructure as well as enhance the cybersecurity of the infrastructure. The consolidation of TARGET2 launched in 2007 and TARGET2-Securities will provide an opportunity to optimise the system maintenance costs of the Eurosystem.

The availability of TARGET2, including TARGET2-Latvija, accounted for 100% in 2019. TARGET2-Latvija processed 468.9 thousand payments totalling 209.2 billion euro in 2019 (see Table 2), i.e. on average 1.8 thousand payments a day totalling 820.2 million euro.

Table 2

PAYMENTS PROCESSED IN TARGET2-LATVIJA

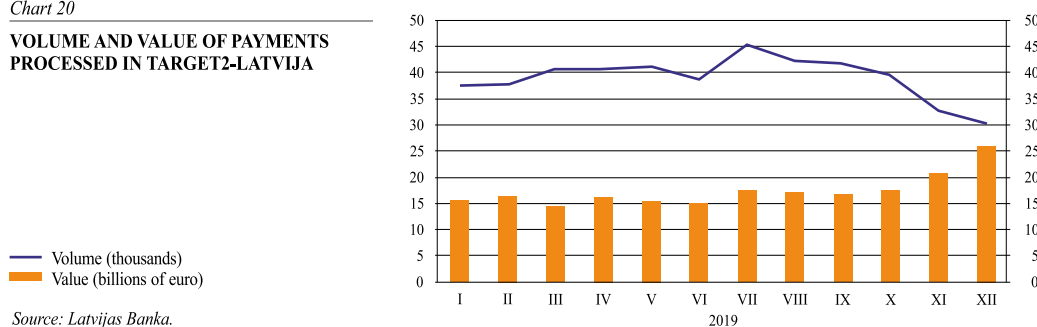
	Volume (thousands)			Value (billions of euro)		
	Interbank payments	Customer payments		Interbank payments	Customer payments	
2019	122.5	346.4	468.9	196.0	13.2	209.2
2018	127.0	380.1	507.1	178.4	21.1	199.5
2017	115.2	364.6	479.8	216.8	23.6	240.4
2016	89.8	339.4	429.2	209.7	25.4	235.1
2015	68.3	290.8	359.1	243.6	21.1	264.7

Source: Latvijas Banka.

The total volume of payments decreased by 7.5%, while their total value increased by 4.8% year-on-year. The last months of the year saw the highest payment volume executed in TARGET2-Latvija (see Chart 20).

Chart 20

VOLUME AND VALUE OF PAYMENTS PROCESSED IN TARGET2-LATVIJA



Source: Latvijas Banka.

At the end of 2019, 17 credit institutions, one investment brokerage firm, the Treasury and Latvijas Banka were the participants of TARGET2-Latvija. TARGET2-Latvija also ensured interbank settlement in euro of the EKS maintained by Latvijas Banka and of the card settlement system Worldline Latvia CSM maintained by SIA Worldline Latvia.

Latvijas Banka also ensured the execution of payments in euro to its customers – the FCTC, Latvian, foreign and international financial institutions whose settlement accounts were opened with Latvijas Banka, but which were not direct participants of Latvijas Banka's payment systems. In 2019, such customer payments executed by Latvijas Banka amounted to 2.5 billion euro.

PAYMENT SYSTEM OVERSIGHT

Latvijas Banka continued to support the progress of participants of the Latvian payment market towards the introduction of payment services in Latvia based on innovative and instant payments. Latvijas Banka created the Instant Payment Laboratory ZibLab++. ZibLab++ is an innovative cooperation platform aimed to enhance the development of innovative payment solutions in the Baltic States based on technologies of instant payments and instant links. The creation of an instant payment request service will be among the first tasks to ensure the employment of this innovative service at interbank level. In 2019, Latvijas Banka participated in the Eurosystem's analytical work on a more widespread use of instant payments in Europe both in the Eurosystem/ESCB committee working groups and in the Instant Payments at Points of Sale Working Group of the Euro Retail Payments Board (ERPB).

In 2019, Latvijas Banka continued to participate in discussions with participants of the Latvian payment market and the FCTC on the implementation of the requirements and respective regulatory technical standards of the Payment Services Directive¹. They facilitated the transition to the use of strong customer authentication and the introduction of innovative account information and payment initiation services in Latvia. As a result of concerted and proactive efforts made by Latvijas Banka, the FCTC and market participants, all participants of the Latvian payment market fulfilled the requirements laid down in the Directive in a timely manner. In 2019, Latvijas Banka continued to take part in the Eurosystem's consultations and discussions by participating in the creation of a secure and harmonised payment market in Europe, representing the interests of Latvia.

The potential impact of cryptoassets (particularly stablecoins or digital assets pegged to the value) on the financial sector was one of the most topical payment policy issues

¹ Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC. Official Journal of the European Union, L 337, 23.12.2015, pp. 35–127.

in 2019. Latvijas Banka analysed and prepared public information about the operating principles and risks of cryptocurrencies, for which Facebook's global digital currency project Libra served as example.

Latvijas Banka together with other EU national central banks continued to participate in the Eurosystem's EUROchain project exploring the use of blockchain and other technologies in payments, in the creation of digital currency and securities transactions. Experts of Latvijas Banka participated in the *.tax Blockchain* hackathon organised by the Ministry of Economics of the Republic of Latvia in cooperation with the State Revenue Service and startup accelerator Startup Wise Guys. The hackathon sought blockchain technologies driven solutions, which the public sector could employ in the areas of big data, modern technologies, tax fraud and the cash accounting system. Latvijas Banka's experts shared their experience during the hackathon.

In 2019, Latvijas Banka started to analyse the digital transformation of the field of payments and the potential of leading-edge technologies (e.g. blockchains, machine learning and artificial intelligence) in enhancing the development of innovative, efficient, secure and user-friendly payment services in Latvia. Latvijas Banka created and published a Fintech Glossary, which contains terms most frequently used in the field of financial technologies and explains them in a plain language. Latvijas Banka also assessed the adverse effects attributable to this digital transformation, e.g. exclusion of senior population, and produced a publication on the issue.

In 2019, Latvijas Banka participated in the oversight of 42 payment systems operating in the EU organised by the Eurosystem, thus contributing to development of secure payments in the EU, with particular focus on payment systems in Latvia.

Within the framework of TARGET2 oversight, Latvijas Banka participated in the assessment of changes effected in the system and analysis of its operation. In 2019, Latvijas Banka together with other central banks of the Eurosystem carried out a comprehensive assessment of TARGET2 pursuant to the Regulation on oversight requirements for systemically important payment systems¹, including the assessment of compliance with the recommendations for improvements of the payment system performance. The assessment results suggested that the risk mitigation measures of TARGET2 improved in 2019 enhanced security and efficiency of the system.

Latvijas Banka conducted day-to-day oversight of the payment systems maintained by it, analysing the technical and operational functions of the systems, and compiling statistical data on the systems. The year 2019 did not see any changes in the EKS operation and legal framework which would lead to a need for a comprehensive oversight reassessment. EKS operation and development ensured a secure and efficient interbank payment environment in Latvia.

In 2019, Latvijas Banka carried out an oversight assessment of Worldline Latvia CSM in relation to its compliance with the Principles for Financial Market Infrastructures (hereinafter, the PFMI). The assessment took account of the changes introduced in the Latvian card payment infrastructure in 2017 when the French payment company Worldline took over SIA First Data Latvia and established SIA Worldline Latvia. In its oversight assessment, Latvijas Banka concluded that the planned operation and legal framework of Worldline Latvia CSM does not pose any financial and legal risks that might have adverse effects on smooth operation of payment systems in Latvia.

Latvijas Banka, within the framework of the repeated survey on cyber resilience of all euro area financial market infrastructures, compiled and analysed the information provided

¹ Regulation of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28). Official Journal of the European Union, L 217, 23.07.2014, pp. 16–30.

by operators of the EKS and Worldline Latvia CSM to assess the general resilience of these systems to cyber attacks and to reveal areas with scope for further improvement to provide increased protection of the systems against cyber attacks.

Latvijas Banka compiled and analysed data on the development of the customer payment market in Latvia (see Table 3). The total volume of non-cash payments made by customers continued on an upward trend in 2019, increasing by 11.0% (to 530.6 million) as compared to 2018. At the same time, the total value shrank by 10.2% (to 203.0 billion euro), primarily on account of a decrease in foreign currency payments of customers. Card payments remained the most popular non-cash payments in Latvia. Overall, 352.1 million card payments in the amount of 5.9 billion euro were made in 2019. The volume and value of card payments picked up by 13.2% and 10.8% respectively in comparison with 2018. The second most widely used non-cash payment instrument was customer credit transfers with their volume reaching 177.6 million in 2019 (annual growth of 6.3%), but their value stood at 196.9 billion euro (a decrease of 10.7%). Significantly, the total number of instant payments made in Latvia was 13.8 million, totalling 2.9 billion euro in 2019. Other payment instruments, i.e. cheques, e-money payments and other payment instruments, were relatively seldom used.

Table 3

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

	Volume (millions)				Value (billions of euro)			
	Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments		Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments	
2019	177.6	352.1	0.9	530.6	196.9	5.9	0.2	203.0
2018	167.1	311.0	0.9	479.0	220.4	5.4	0.3	226.0
2017	159.9	271.9	2.0	433.8	268.6	5.0	0.4	274.1
2016	156.0	242.8	0.5	399.3	318.9	4.6	0.1	323.7
2015	147.1	215.2	0.1	362.5	401.0	4.2	0.0	405.3

Source: Latvijas Banka.

OVERSIGHT OF SECURITIES SETTLEMENT SYSTEMS

In 2019, Latvijas Banka together with other central banks of the Eurosystem and in cooperation with other institutions carried out the oversight of the TARGET2-Securities platform. Within the framework of the comprehensive assessment of the compliance of the TARGET2-Securities platform with the PFMI, Latvijas Banka drafted assessment reports on its management and liquidity risk. The assessment concludes that overall, TARGET2-Securities services are provided in a secure and efficient manner, however, there are areas requiring improvements.

In 2019, Latvijas Banka participated in the joint oversight of the securities settlement organised by the Eurosystem, thus enhancing the development of efficient and secure securities settlement in the EU (in 2019, 30 depositories were operational in the EU).

Latvijas Banka engaged in drafting the opinion of the Eurosystem – the central bank issuing euro – on the compliance of 11 central securities depositories, undergoing the licensing process, and one link of central securities depositories with the Regulation of the European Parliament and of the Council on central securities depositories¹ (hereinafter, the CSDR).

¹ Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012. Official Journal of the European Union, L 257, 28.08.2014, pp. 1–72.

In 2019, Latvijas Banka, in cooperation with Eesti Pank and Lietuvos bankas, carried out the oversight of the securities settlement systems of Nasdaq CSD SE, the joint securities depository of the Baltic States, continuing to coordinate the opinion of the Baltic States' overseers on the securities settlement systems maintained by Nasdaq CSD SE, with regard to cybersecurity issues in particular.

Latvijas Banka in its capacity as overseer and as representative of the central bank issuing euro participated in the work of Nasdaq CSD SE supervisory college, established to supervise the compliance of Nasdaq CSD SE with the CSDR requirements. Supervisory and oversight authorities of the Baltic States take part in the supervisory college and provide their opinion on issues related to the operation of Nasdaq CSD SE securities settlement systems.

Latvijas Banka, representing the Eurosystem – the central bank issuing euro – assessed Nasdaq CSD SE and drafted the Eurosystem's opinion on the compliance of Nasdaq CSD SE with the CSDR requirements important for the Eurosystem in its above capacity. The assessment revealed areas requiring improvements.

In the context of the expansion of Nasdaq CSD SE operation by adding the Icelandic securities settlement system, Latvijas Banka launched an assessment in late 2019 to draft the Eurosystem's opinion pursuant to the CSDR (scheduled to be completed in 2020).

FINANCIAL STABILITY

Latvijas Banka, within the scope of its competence, is active in providing advice to the Latvian government and other public institutions (including within the framework of the Council of the Financial Sector Development) with regard to various legislative initiatives, regulations of the Cabinet of Ministers of the Republic of Latvia and other legal acts.

In 2019, Latvijas Banka continued its close cooperation with the Ministry of Foreign Affairs of the Republic of Latvia, the Ministry of Finance of the Republic of Latvia, the FCMC, the Financial Intelligence Unit and other public institutions in the prevention of money laundering and financing of terrorism and the enforcement of sanctions. Latvijas Banka together with other public institutions participated and continues to participate in the implementation of MONEYVAL recommendations in accordance with the plan of measures approved by the Cabinet of Ministers and including the risk prevention coordination, implementing a risk-based approach in supervision, strengthening preventive measures and improving the regulatory framework.

In 2019, Latvijas Banka in cooperation with the FCMC, the Consumer Rights Protection Centre and the Finance Latvia Association participated in the working group developing standards for responsible and sustainable consumer lending that were included in the FCMC regulation¹. Amendments have laid down several quantity standards to be adhered to by credit institutions when assessing the creditworthiness of households based on the maximum ratio of debt servicing costs to borrower's net income (40%), the maximum ratio of borrower's total debt and 12 month net income (six times), the maximum maturity of consumer credits (mortgage loans with maturity of 30 years and consumer credits with maturity of seven years), as well as the maximum loan-to-value ratio of loans aimed at financing the purchase of real estate for rent (70%). They will facilitate the development of sustainable and responsible consumer lending and strengthen resilience to potential financial shocks.

Latvijas Banka provided opinion on the state guarantee programme for house purchase or construction and proposals to improve the programme.

¹ Amendments to FCMC Regulation No 120 "Regulations on Credit Risk Management" of 27 November 2019 taking effect on 1 June 2020.

The Nordic and Baltic financial stability authorities have conducted a joint financial crisis management exercise, which was held in January 2019 and involved 31 authorities (financial supervisory authorities and resolution authorities, central banks and finance ministries) from Denmark, Estonia, Iceland, Latvia, Lithuania, Norway, Finland and Sweden, as well as the EU. The IMF also observed the simulation exercise. Representatives of Latvijas Banka also actively took part in designing and conducting this simulation exercise as well as in analysing its results.

In 2019, upon the request of Latvijas Banka, the IMF started to conduct the assessment of Latvia's financial sector as part of the Financial Sector Assessment Programme (FSAP). This is a comprehensive and in-depth assessment of the stability and shock absorption capacity of the country's financial sector, as well as of the ability of supervisory authorities and other authorities involved to react in an effective manner in the event of systemic stress. The assessment also includes the analysis of the financial sector's systemic risks, the evaluation of the shock absorption capacity of credit institutions, inter alia, the conduct of stress tests, as well as the analysis of the macro-prudential policy framework. In 2019, representatives of Latvijas Banka were actively involved in providing informative and analytical support necessary for the IMF to conduct the assessment, in particular as regards the stress tests and financial stability analysis, the macroprudential policy and financial crisis management, as well as intend doing so in 2020.

Latvijas Banka engages in the work of the ECB Macropprudential Forum. Latvijas Banka, through its engagement in the implementation of the ECB macropprudential policy and in close cooperation with the FCMC, provided contribution to the assessment of systemic risks to financial stability in the euro area, the development of financial stability analysis tools and the evaluation of macropprudential policy instruments by participating in the work of the Eurosystem/ESCB Financial Stability Committee and the relevant groups. In parallel with the above euro area working groups, Latvijas Banka engaged in the work of the ESRB Advisory Technical Committee and its working groups and contributed to drafting ESRB policy and analysis documents and defining opinion.

In March 2019, the ECB Working Group on Countercyclical Capital Buffers (CCyB) completed the development of the analytical framework for the validation of the CCyB decisions, with Latvijas Banka taking part in it. The developed tools will facilitate the decision-making process in the context of Article 5 of the SSM Regulation¹, establishing the ECB's rights with respect to capital reserves to apply more stringent requirements than those imposed by national competent authorities.

In 2019, Latvijas Banka developed a new instrument for the cyclical risk assessment – a composite cyclical risk indicator comprising several additional indicators for setting the CCyB rates. This indicator will be an addition to the existing CCyB framework under which, in line with the ESRB recommendations, the initial CCyB level is determined mechanically based on just one indicator – the deviation of the ratio of credit-to-GDP from its long-term trend.

To improve the stress testing methodology, the market risk stress test framework for Latvia's credit institution sector has been improved and the market risk stress test has been included in the overall stress test of credit institutions' solvency.

CREDIT REGISTER AND PROVISION OF DATA TO ANACREDIT

Latvijas Banka continued to maintain and develop the Credit Register by collecting and storing in the Credit Register data on its participants' (credit institutions, credit

¹ Regulation (EU) No 1024/2013 of the Council of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. Official Journal of the European Union, L 287, 29.10.2013, pp. 63–89.

institutions' subsidiaries (leasing companies), other companies having close links with credit institutions, credit unions, insurers and AS Attīstības finanšu institūcija Altum) and borrowers from the Treasury and borrowers' guarantors, their credits and delayed payments.

As of 1 April 2019, the scope of the data to be submitted to the Credit Register was expanded to include the data on surety services by which a Credit Register participant acting as a guarantor assumes liability in a certain amount for the person's debt where the person is not exempt from it (warranty (guarantee)). Thus, several new participants providing surety services commenced their participation in the Credit Register. When using the Credit Register data, its participants and the Treasury have an opportunity to assess the creditworthiness of the person applying for credit, a warranty (a guarantee) or a letter of credit or wanting to provide a guarantee for other person's obligations, thus enhancing honest and responsible lending and borrowing and strengthening the stability of Latvia's financial system.

In 2019, the scope of the data to be submitted to the Credit Register was expanded to comply with the requirement to provide some new data to the FCMC, thus enabling the FCMC to increasingly use the Credit Register data in the supervision of financial market participants. As of 1 April 2019, the Credit Register participants have only provided granular data on credits to the Credit Register (Latvijas Banka) instead of two institutions (the FCMC and Latvijas Banka) as before.

In 2019, the Credit Register website for servicing natural and legal persons electronically was upgraded (<https://manidati.kreg.lv>), inter alia, by also enabling persons to use the mobile application *eParaksts Mobile* for the purpose of proving their identity and receive the Credit Register data pertaining to them from smart devices. Moreover, the amendments enable natural and legal persons to receive the Credit Register data through electronic identification means also recognised by other EU countries.

In 2019, Latvijas Banka continued to report the Credit Register data to AnaCredit on a monthly and quarterly basis in accordance with the requirements of Regulation (EU) No 2016/867 of the ECB of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13)¹. AnaCredit brings together the data provided by the euro area central banks on loans granted to legal persons into a single system with the aim to improve the availability of detailed lending information for statistical needs, monetary policy analysis and decision-making as well as the financial stability analysis and risk assessment.

In 2019, the Credit Register data were provided to any natural and legal person to his/her official electronic address (e-address) if the person had activated his/her e-address and submitted a Credit Register data request pertaining to him/her or his/her company. Moreover, public institutions are able to receive the Credit Register data necessary for the performance of the tasks stipulated by laws and regulations efficiently and quickly by using e-addresses.

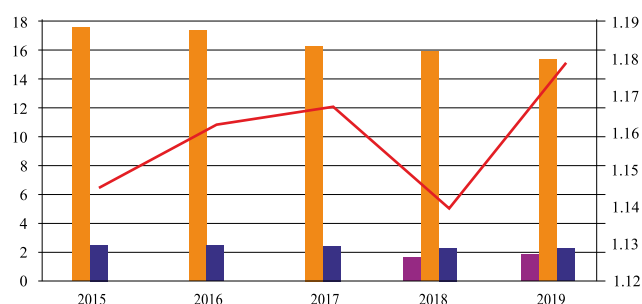
At the end of 2019, the Credit Register comprised 104 participants (including the Treasury) who authorised 597 users to work with the Credit Register. The Credit Register contained data on 4.3 million obligations pertaining to 1.2 million persons. The total outstanding obligations of the Credit Register participants amounted to 19.7 billion euro (see Chart 21 for the amount of the outstanding obligations of the Credit Register participants) and the off-balance sheet amount of the obligations amounted to 4.0 billion euro (it mostly comprised the credit card balance and the number of the granted and unused guarantees and mortgage loans).

¹ Official Journal of the European Union, L 144, 01.06.2016, pp. 44–98.

Chart 21

OUTSTANDING OBLIGATIONS OF CREDIT REGISTER PARTICIPANTS AND NUMBER OF CURRENT OBLIGATIONS

Treasury and AS Attīstības finanšu institūcija
 Altum (billions of euro)
 Credit institutions (billions of euro)
 Associated companies (billions of euro)
 Number of current obligations (millions;
 right-hand scale)



Source: Latvijas Banka.

Latvijas Banka made it possible for any person to receive the Credit Register data pertaining to him/her/it free of charge. In 2019, 3.2 thousand persons used this opportunity by arriving at Latvijas Banka in person. At the same time, electronic receipt of data (<https://manidati.kreg.lv>) became increasingly popular in 2019; over the year, persons requested information about themselves in electronic form 3674 times. The Credit Register participants submitted 15.6 million requests to the Credit Register for the purpose of assessing the creditworthiness of their current or potential borrowers and borrowers' guarantors.

In 2019, Latvijas Banka continued to take care of the quality of the data contained in the Credit Register and to verify the requests by checking activities undertaken by Credit Register participants on a regular basis.

STATISTICS

Latvijas Banka collects and compiles financial and monetary statistics and balance of payments statistics as well as prepares financial account statistics and government finance statistics. Following the ECB's request, Latvijas Banka has also been involved in addressing the methodology-related issues of some fields of economic statistics and in compiling specific aggregates. Latvijas Banka employs statistical data to perform financial and macroeconomic analyses, assess financial stability as well as raise public awareness of the developments in the financial sector and the economy. The ECB uses statistical data produced by Latvijas Banka to compile the Eurosystem's monetary statistics and the relevant euro area statistical data as well as to discharge its other tasks.

Activities of Latvijas Banka in the field of statistics are reflected in Latvijas Banka's annual statistical programme published on a regular basis and in the medium-term statistical work programme for the period of three years. The above programmes provide transparent information on statistical activities planned by Latvijas Banka both with regard to the most important planned new tasks and the types of statistical data Latvijas Banka compiles and publishes. The Statistical Programme of Latvijas Banka for 2019 was implemented within the deadlines specified therein, except for individual works with their deadlines changed at the ESCB level.

DEVELOPMENT OF THE REGULATORY FRAMEWORK GOVERNING STATISTICS

In 2019, Latvijas Banka, just like other central banks of the EU, conducted a costs survey on potential amendments to Regulation (EU) No 1071/2013 of the European Central Bank of 24 September 2013 concerning the balance sheet of the monetary financial institution sector (ECB/2013/33). The results of the survey suggest that the introduction of the planned amendments overall will not lead to substantial costs to Latvia's reporting agents as most of the data are already reported in accordance with Latvijas Banka Regulation No 132 "Regulation for Compiling the 'Monthly Financial Position Report' of Monetary Financial Institutions" of 16 May 2014.

Within the ESCB framework, experts of Latvijas Banka continued to prepare amendments to Regulation (EU) No 1409/2013 of the European Central Bank of 28 November 2013 on payments statistics (ECB/2013/43) which are planned to be approved in 2020. The range of the data necessary for monitoring the operation of payment systems and for more accurate presentation of individual indicators in the balance of payments statistics will be expanded.

In accordance with the ESCB work plans and the Statistical Programme of Latvijas Banka for 2019, it was intended to introduce the requirements of Regulation (EU) No 1333/2014 of the ECB of 26 November 2014 concerning statistics on the money markets (ECB/2014/48)¹ in Latvia. However, the ECB postponed the introduction of these requirements, and the Governing Council of the ECB did not specify Latvia's MFIs which should be subject to reporting requirements concerning statistics on the money markets. In 2019, 50 MFIs selected by the Governing Council of the ECB, based on the criteria set out in the Regulation, reported statistical money market data to the ECB. Statistical money market data are collected for the needs of monetary policy and financial stability, and they are also used for setting €STR (euro short-term rate).

Latvijas Banka continued to participate in the Expert Group on the ESCB Integrated Reporting Framework. In 2019, it was not only intended to draw up a costs survey for the assessment of the costs of the financial market participants and the central banks in relation to the introduction of the Integrated Reporting Framework, but also to conduct it. Therefore, the conduct of the survey was also included in the Statistical Programme of Latvijas Banka for 2019. However, taking account of the fact that a thorough analysis of the results of the fact-finding survey conducted in 2018 was performed, the costs survey by the ECB was postponed to 2020. The Integrated Reporting Framework will ensure data acquisition and the provision of granular data by their type from credit institutions' information systems, using the Banks' Integrated Reporting Dictionary, thereby providing for maximum harmonisation of data requirements for the needs of statistics and supervision of credit institutions.

In autumn 2019, Latvijas Banka started participating in the newly established ESCB expert group for addressing methodological issues in the area of insurance statistics to improve the quality of insurance statistics data. The group's activities were aimed at developing methodology for compiling harmonised reclassification adjustment data.

COLLECTING AND COMPILING STATISTICS

Latvijas Banka examined the quality of the data furnished by reporting agents of the second Household Finance and Consumption Survey, edited and imputed them, as well as added administrative data to the data obtained in the survey.

To pursue the common European revision policy adopted in 2012 and complemented in 2017 by the Eurostat Committee on Monetary, Financial and Balance of Payments Statistics in the field of national account, balance of payments and international investment position statistics, Latvijas Banka carried out the revision of time series of financial account statistics and the balance of payments statistical data, harmonising financial account statistics for the rest of the world sector with the balance of payments statistical data. At the same time, Latvijas Banka significantly upgraded the information systems used in the compilation of financial account statistics, thus optimising the process of compiling these statistics.

To ensure the compliance with the requirements of Regulation (EU) No 2018/231 of the European Central Bank of 26 January 2018 on statistical reporting requirements for pension funds (ECB/2018/2) and Regulation (EU) No 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data

¹ Official Journal of the European Union, L 359, 16.12.2014, pp. 97–116.

(ECB/2016/13), in 2019 Latvijas Banka prepared and sent the indicators enabling the identification of pension funds to the ECB Register of Institutions and Affiliates Data (RIAD) and expanded the range of indicators identifying non-financial corporations and characterising their activity. The requirements of both Regulations were implemented without additional burdens for reporting agents, using information provided by the FCMC, the CSB and the Enterprise Register of the Republic of Latvia. Moreover, Latvijas Banka, observing the time frame approved by the ECB and binding on all national central banks of the euro area, was among the first central banks starting to provide a hundred per cent linkage of the data on the issuers of securities contained in the ECB Register of Institutions and Affiliates Data (RIAD) with the ECB's Centralised Securities Database information on the issued securities as well as the Securities Holding Statistics Database on the securities held by the groups of large banks.

DISSEMINATION OF STATISTICAL INFORMATION

Latvijas Banka complemented the published Household Finance and Consumption Survey data with the results of the second such survey, enabling data analysts and researchers as well as other interested parties to analyse the dynamics of real and financial assets, credit liabilities, income and expenses, employment and consumption of households. Moreover, the published information provides an opportunity to analyse the indicators of various groups of households (e.g. households with debt, unemployed persons, households with different wealth levels). Based on this information, it is possible to better understand the households' economic decisions, to assess the operation of the monetary policy transmission mechanism and to carry out the financial stability analysis.

Latvijas Banka continued regular transmission of statistical data to the ECB, BIS, Eurostat, OECD, the World Bank and IMF as well as provided statistical information to other data users in Latvia and abroad. To furnish a wide range of data users with timely information, Latvijas Banka disseminated financial and monetary statistics, balance of payments statistics and financial account statistics of Latvia via its regular publications and website and compiled data for publishing them in the ECB publications and the ECB Statistical Data Warehouse as well as in IMF publications, on its website and within the framework of SDDS Plus.

Latvijas Banka participated in the IMF's Financial Access Survey, reporting data on the access to and scope of the services provided to households by Latvia's credit institutions and other financial institutions.

Latvijas Banka continued to perform the tasks of the coordinating institution in Latvia within the framework of SDDS Plus. As of 30 December 2019, Latvia ensures the publication of all SDDS Plus data categories, inter alia, by publishing the data category "General Government Operations" subject to a transitional period at the moment of Latvia's joining the SDDS Plus.

In its continued endeavours to provide data users with modern, user-friendly and adaptable data selection, in 2019 Latvijas Banka supplemented the range of data available on its internet statistical database INTS with statistical data on foreign exchange transactions statistics and expanded the range of data on MFI balance sheet statistics.

PROVIDING FINANCIAL SERVICES TO THE GOVERNMENT

In order to facilitate efficient and safe budgetary payments of Latvia, the management of the Treasury's settlement accounts opened with Latvijas Banka was ensured by Latvijas Banka in 2019. The Treasury used the payment services provided by Latvijas Banka for effecting settlement and participated in TARGET2-Latvija and the EKS as a direct participant. In 2019, the Treasury had settlement accounts in euro and foreign currencies with Latvijas Banka.

ADVICE ON MATTERS WITHIN LATVIJAS BANKA'S COMPETENCE

One of the tasks of Latvijas Banka is to advise the Saeima and the Cabinet of Ministers of the Republic of Latvia on monetary policy and aspects of economic policy associated with Latvia's participation in the euro area as well as other issues related to the performance of the tasks of Latvijas Banka.

In 2019, officials of Latvijas Banka and its employees held regular meetings with the representatives of the Saeima and the government of the Republic of Latvia, including participation in meetings of the committees of the Saeima and the Cabinet of Ministers of the Republic of Latvia and in the work of several committees established by the government, providing opinion on the financial and economic development. In 2019, when analysing Latvia's economic growth prospects, Latvijas Banka focused on the issues related to the labour market situation, the sustainability of public finances, the income inequality as well as the tax policy and regional development. Additional attention was also paid to changes in Latvia's financial sector and the analysis of the potential effect of Brexit on Latvia's economy.

Employees of Latvijas Banka contributed to the promotion of Latvia's economic development by participating in different working groups and professional organisations, sharing experience and providing advice and support to them, including in the fields of economic forecasts and the government expenditure as well as in the process of drafting legal acts and their amendments regulating the financial sector, financial services, AML/CFT/CFP and other areas. Public administration institutions were advised in selected areas concerning the opportunities to apply various calculation methodologies and to prevent shortcomings of particular indicators.

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

Employees of Latvijas Banka in their capacity as experts continued to participate in the Working Group for the Preparation of the Notification of the General Government Budget Deficit and Debt for 2018, compiling the notification data of the general government budget deficit and debt and dealing with the methodological issues related to accounting of the general government budget deficit and debt.

Representatives of Latvijas Banka were engaged in the evaluation of the enterprises participating in the competition "Export and Innovation Award" organised by the Investment and Development Agency of Latvia in cooperation with the Ministry of Economics of the Republic of Latvia.

INFORMATION AND EDUCATIONAL FACILITIES PROVIDED TO THE PUBLIC

Effective communication from central banks has become one of the key support tools for the implementation of monetary policy that helps increase the awareness of financial market participants of the economic and financial sector development, explain the decisions taken by the central banks, as well as shape their expectations of the future path of monetary policy. It is increasingly important for the central banks to receive information and views directly from economic agents, thus also improving monetary policy decisions and their transmission to the economy. Public understanding of economic developments and households' abilities to take wiser and more far-sighted personal financial decisions are likewise important.

Therefore, in 2019 Latvijas Banka continued and expanded activities significant for each individual and the public at large, including an educational programme enhancing

financial literacy aimed at raising people's interest in the economy and improving their understanding of economic regularities and efficient management of personal finances. Within the framework of this project and in cooperation with the news portal Delfi, analytical articles and interviews with public figures and several experts on money issues were prepared and offered for a wide audience of users. Latvijas Banka continued to actively communicate with the public also by means of social networks (Twitter.com, Facebook.com, draugiem.lv, etc.).

Latvijas Banka's economic conference is the most important annual event to engage in discussions with economists and analysts. In 2019, it addressed topics such as labour force availability and development. The labour market situation in all three Baltic States was analysed, inviting to the significant forum not only experts from Latvia, Lithuania and Estonia, but also from the IMF, OECD, Suomen Pankki – Finland's Bank and Copenhagen Business School. Two other topics significant for Latvia's economy, social system and monetary policy transmission (the sustainability of the pension system and reducing of poverty and inequality) were addressed, based on the analysis by Latvijas Banka's researchers, by a wide range of experts at the Expert Roundtable Discussion held by Latvijas Banka.

The public was widely informed about the activities of Latvijas Banka in different areas, e.g. the most important news regarding the introduction of AML/CFT/CFP rules, further development of the innovative instant payment infrastructure and the completion of the introduction of the euro banknotes of the second series or Europa series with 100 euro and 200 euro banknotes released into circulation. Sociological studies confirm that Latvia's society ranks among the best informed in the euro area regarding the design and security features of the euro.

At the end of the year, there was an intense debate in the mass media of Latvia about the most suitable candidate for the position of the Governor of Latvijas Banka, with several candidates revealing their ideas and actively engaging in discussions on the future vision of the activities of the central bank. The process ended up with Mārtiņš Kazāks being appointed the Governor of Latvijas Banka by an open majority vote of the Saeima of the Republic of Latvia. These events received considerable attention in local and international media, and Latvijas Banka's communication experts reflected the activities of the central bank in a transparent and easy-to-understand way.

Latvijas Banka's regular electronic publications played an important role in explaining the position and opinion of Latvijas Banka. Incorporating the data provided by Latvijas Banka, the CSB, Ministry of Finance of the Republic of Latvia, FCMC and other institutions, the publication "Macroeconomic Developments Report", issued in June and December, assessed developments of the external sector, financial market, domestic demand and supply, costs and prices and balance of payments, as well as presented GDP and inflation forecasts, while the publication "Financial Stability Report" assessed major financial stability risks.

In 2019, four working papers and three discussion papers by Latvijas Banka's experts were published on the websites of Latvijas Banka. Economic experts of Latvijas Banka published their articles and working papers on the websites of Latvijas Banka and in respectable international peer-reviewed journals, series and magazines. The general public was given an opportunity to familiarise itself with ECB information on monetary policy decisions and accommodative monetary policy measures as well as on global and euro area economic development. In compliance with the requirements of the Statute of the ESCB and ECB, Latvijas Banka ensured the Latvian translation of the ECB's Annual Report 2018 and the ECB's Economic Bulletin issues which were published after the monetary policy meetings of the Governing Council of the ECB in March, June, September and December (published on the internet).

Based on the analysis carried out by economic experts, Latvijas Banka actively expressed its opinion regarding the economic development of Latvia and the euro area, showing in particular the importance of boosting productivity to ensure sustainable economic development. The central bank's communication channels, including the websites macroeconomics.lv and bank.lv and the publication "Macroeconomic Developments Report", highly valued by experts, were used for this purpose. Approximately 100 articles and commentaries by Latvijas Banka's economists concerning current economic developments were published on the economic analysis website macroeconomics.lv recognised by experts. Special attention was paid to Latvia's economic development forecasts, the analysis of the labour market and the tax framework as well as analytical articles about reducing inequality and poverty in the society. At the same time, the publication "Latvia's Macro Profile" provided a brief analytical insight into Latvia's economic situation and forecasts, informing the existing and potential investors.

In 2019, Latvijas Banka's officials, economists and other experts provided answers to almost 600 journalists' questions concerning Latvijas Banka's operation and macroeconomic and financial analysis; approximately 150 interviews were published. In 2019, more than 7500 articles and stories on monetary policy and economic development issues were overall published in Latvia's mass media, representing a significant year-on-year increase, and the public has been increasingly interested in economic subjects.

For the purpose of stepping up and improving communication with the public, restructuring of the website bank.lv has been started to create a modern, user-friendlier functional design allowing users to receive information in various ways and formats. Changes in the structure of the website make information on Latvijas Banka, its activities and services easier to view. The use of the new opportunities offered by the website has contributed to the creation of explanatory and educational materials (e.g. the "Payment Radar" and the Fintech Glossary).

95% of respondents to the 2018 survey of teaching staff on teaching economics considered that Latvijas Banka plays an important role in enhancing economic and financial literacy. In 2019, Latvijas Banka continued to update the content of Latvijas Banka's economic literacy website "Money School" and to develop new teaching aids "My Economics" for class 1 to 12 in cooperation with experienced Latvian teachers of economics and social sciences. These teaching aids will help teachers to organise the process of learning economic regularities in all age groups in compliance with the competence-based approach. The educational work also continued to enhance the skills of primary school students to identify the security features of euro banknotes and coins.

Latvijas Banka's Knowledge Centre "Money World" – the second major player in enhancing financial literacy – continued to educate its visitors about financial and economic issues. Cooperation with the most active visitors – the teaching staff of general education and professional schools as well as higher education institutions – was established with the aim of reviewing and improving the display. To improve access to the content of the display, a virtual visit solution, enabling not only to have a virtual tour of the display, but also to learn the content of individual multimedia presentations, has been developed. The significantly expanded content of the display offers new multimedia applications on the operating principles of euro area banks and the global financial market developments. An interactive online programme for statistical data analysis "Our Latvia" offering an insight into the diversity of the country's economic resources has been developed in cooperation with the CSB.

In 2019, during Museum Night 2019 visitors were kindly welcomed by Latvijas Banka's Knowledge Centre "Money World". Latvijas Banka offered knowledge enhancing activities to adults and primary school students, thus raising their awareness of financial and economic issues. Over 1700 visitors used this opportunity.



COOPERATION WITH INTERNATIONAL ORGANISATIONS AND FOREIGN CENTRAL BANKS

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

In 2019, Latvijas Banka continued to represent Latvia's interests at meetings of the IMF Board of Governors and in the coordination of operational issues. Priorities of the IMF policy were mainly related to the developments in the global economy and the financial system. In 2019, the IMF focused particularly on the risks associated with the obstacles to the development of free trade as well as a slower global growth rate and persistently low interest rates. The adequacy of the IMF resources was reviewed, and the 15th General Review of Quotas was concluded with no increase in quotas, while discussions on alternative sources of financing are underway. The IMF pays increasingly more attention to the climate change impact.

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

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

In 2019, cooperation with the IMF, based on consultations under Article IV of the IMF Articles of Agreement, continued.

In 2019, Latvijas Banka continued its membership in the BIS. In February, Latvijas Banka organised the annual meeting of the BIS Working Party on Monetary Policy in Central and Eastern Europe.

Several external meetings of the Eurosystem/ESCB Committees and their Working Groups as well as other events were organised in Riga in 2019.

Latvijas Banka hosted a meeting of the Eurosystem/ESCB Information Technology

Committee in May, while in June – a meeting of the Eurosystem/ESCB Monetary Policy Committee, in July – a meeting of the Eurosystem/ESCB Risk Management Committee and in September – a meeting of the Eurosystem/ESCB Market Operations Committee. In 2019, Latvijas Banka held several ESCB and SSM training workshops for improving different professional skills and research workshops with the participation of the experts of the national central banks of different countries and the ECB.

Latvijas Banka continued its cooperation with the central banks of Finland and the Baltic States in the area of financial investment management by exchanging the most up-to-date information and sharing their experience in using various investment management solutions at the annual forum.

In 2019, Latvijas Banka maintained a high level of engagement with foreign central banks and other institutions. Employees of Latvijas Banka provided the experts of public financial institutions of the Republic of North Macedonia and Mongolia with information on the development of Latvia's payment systems, payment and financial instrument settlement systems and innovative technologies in the area of financial services, while the representatives of Lietuvos bankas were informed about the issues concerning securities market operations. Cooperation between the central banks of the Nordic and Baltic countries also continued to be the case, including the discussion on topical human resources policy issues held in Riga in May as well as high-level meetings and seminars for experts of the national central banks of the Baltic States.

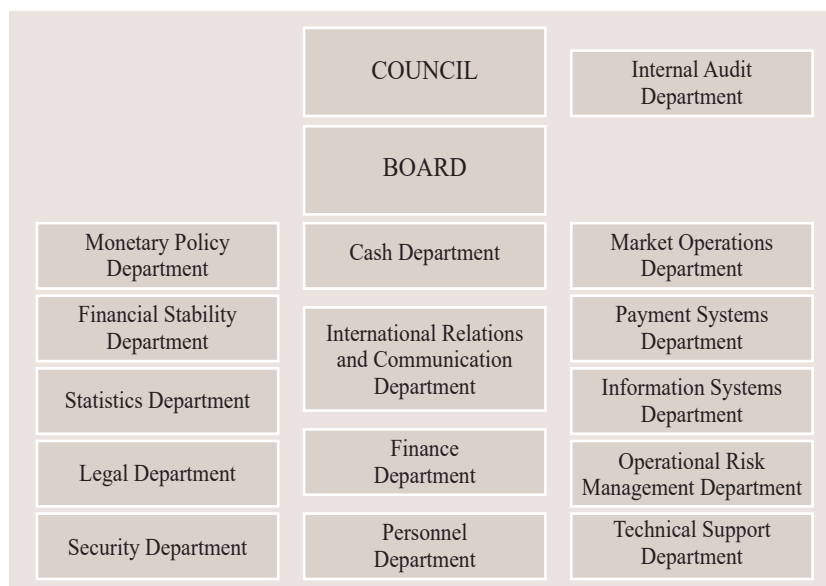
In high appreciation of Latvijas Banka's experience in the operation and development of an educational visitors' centre as well as its experience in the fields of promoting financial literacy and educating the population, representatives of the National Bank of Ukraine visited Latvijas Banka in 2019 to learn its experience in person; moreover, an expert of Latvijas Banka provided consultations to the developers of the design project of the Knowledge Centre of the National Bank of Ukraine.

In 2019, international financial organisations and foreign central banks extended support to Latvijas Banka, providing opportunities to participate in the workshops and courses hosted by these institutions. Employees of Latvijas Banka participated in courses, seminars and conferences organised by the EC, ECB, IMF, Joint Vienna Institute, Study Center Gerzensee, Federal Reserve Bank of New York, as well as by the central banks of the UK, Belgium, Czechia, France, Italy, Lithuania, the Netherlands, Finland, and Spain.

**MANAGEMENT AND ORGANISATION OF
LATVIJAS BANKA**



ORGANISATIONAL STRUCTURE OF LATVIJAS BANKA



THE COUNCIL OF LATVIJAS BANKA

The Council of Latvijas Banka takes decisions on behalf of Latvijas Banka. Pursuant to the Amendments to the Law on Latvijas Banka¹, the term of office of Governor, Deputy Governor and Members of the Council of Latvijas Banka is five years. Meanwhile, the current Deputy Governor or Member of the Council of Latvijas Banka shall continue to hold office by the end of the six-year term of office. Ilmārs Rimšēvičs held office as Governor of Latvijas Banka until 20 December 2019, the expiration date of his term of office. On 12 December 2019, the Saeima of the Republic of Latvia appointed Mārtiņš Kazāks, Member of the Council of Latvijas Banka, the Governor of Latvijas Banka; he took office on 21 December 2019. The composition of the Council of Latvijas Banka, as at the end of 2019, was as follows:

– Governor	Mārtiņš Kazāks;
– Deputy Governor	Zoja Razmusa²;
– Members of the Council:	Vita Pilsuma, Arvils Sautiņš, Aivars Skopiņš.

Meetings of the Council of Latvijas Banka are held as appropriate, but at least once a quarter. In 2019, the Council of Latvijas Banka held 16 meetings where decisions were taken on the use of monetary policy instruments, investment management, provision of currency in circulation, compiling statistical data, operation and oversight of the payment and securities settlement systems, operation of the Credit Register, licensing and supervising of purchase and sale of foreign currency, and other issues pertaining to the operation, management and organisation of Latvijas Banka.

THE BOARD OF LATVIJAS BANKA

To carry out and efficiently manage day-to-day activities of Latvijas Banka, the Council of Latvijas Banka has established the Board of Latvijas Banka that performs activities

¹ *Latvijas Vēstnesis*, No. 248A, 10 December 2019, official publications No. 2019/248A.12 (with effect from 11 December 2019).

² The term in office expired on 12 March 2020.

on a continuous basis. Pursuant to the Amendments to the Law on Latvijas Banka the number of Members the Board of Latvijas Banka is reduced from six to four Members. The composition of the Board of Latvijas Banka, as at the end of 2019, was as follows:

– Chairman of the Board	Māris Kālis¹;
– Deputy Chairperson of the Board	Ilze Posuma²;
– Members of the Board:	Jānis Blūms³, Jānis Caune, Harijs Ozols³, Raivo Vanags.

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

EMPLOYEES OF LATVIJAS BANKA

At the end of 2019, the number of Latvijas Banka employees was 479, of which 10 had fixed-term employment contract (compared with 498 and 8 employees at the end of 2018, respectively). At the end of 2019, 60% of Latvijas Banka's staff were male and 40% were female. The Counsellor of Latvijas Banka worked at the Permanent Representation of the Republic of Latvia to the EU in 2019.

Structural improvements continued at Latvijas Banka in 2019. In order to improve the risk management process and strengthen Latvijas Banka's internal control system, Latvijas Banka established the Operational Risk Management Department on 1 February 2019. The key task of the Operational Risk Management Department is to maintain a common operational risks management framework and organise the operational risk management process at Latvijas Banka, inter alia, ensure, in cooperation with Latvijas Banka's structural units, the identification and assessment of risks, the planning and implementation of the measures aimed at mitigating operational risks as well as the management of incidents.

Proceeding with the implementation of cost efficiency improvement measures of Latvijas Banka, the Council of Latvijas Banka made a decision to discontinue services provision at its Liepāja Branch as of 30 December 2019 and to close it on 30 January 2020. This decision was made in view of the modernisation project of the Riga Branch of Latvijas Banka which was completed in 2019; as a result, Latvijas Banka's capacity was expanded and its role as the cash currency supply centre in the Baltic region was strengthened.

COMMISSIONS, COMMITTEES AND WORKING GROUPS OF LATVIJAS BANKA

In order to ensure quality performance of Latvijas Banka's tasks, several committees, commissions and working groups approved by the Council of Latvijas Banka, Governor of Latvijas Banka or the Board of Latvijas Banka continued their work in 2019.

The Commission for Management of Banknotes and Coins of Latvijas Banka made decisions on the replacement of damaged euro and lats banknotes and circulation coins, exercised control of identification, accounting, storage and destruction of banknotes and coins with signs of counterfeiting and counterfeits, registered cash processing institutions and cancelled their registration, and controlled the operation of cash processing institutions. To ensure the fulfilment of the requirements specified for purchasing and

¹ As of 13 March 2020 – Deputy Governor of Latvijas Banka.

² As of 13 March 2020 – also acting Chairperson of the Board of Latvijas Banka.

³ The term in office expired on 29 February 2020.

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

The Security Oversight Commission of Latvijas Banka supervised the management process of operational risks, including physical security risks. The Information Systems Management Committee of Latvijas Banka monitored and coordinated issues related to the operation and development of Latvijas Banka's information systems and personal data processing.

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

The Budget Commission of Latvijas Banka contributed to an efficient use of Latvijas Banka's financial resources during the process of management of Latvijas Banka's budget. The Standing Commission for Procurement of Latvijas Banka implemented this objective in the area of procurements organised by Latvijas Banka. The Investment Committee of Latvijas Banka developed and defined a strategy for and made tactical decisions on managing financial assets and gold.

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

COMMISSIONS AND COMMITTEES OF LATVIJAS BANKA AT THE END OF 2019

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

MANAGEMENT PRINCIPLES AND DEVELOPMENT

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

The "Vision, Mission and Values of Latvijas Banka" and the priority objectives of Latvijas Banka underlie the operation and development planning. Progress towards achieving the set objectives is measured annually. At the same time, the execution of

functions and processes is monitored daily, and the fulfilment of work plans is reviewed on a regular basis.

RESOURCE MANAGEMENT

HUMAN RESOURCES

In 2019, Latvijas Banka continued to pursue its key principles of human resources policy of hiring qualified and professional employees by way of an effective staff recruitment process and establishing long-term employment relationships, creating a motivating working environment and enhancing professional development opportunities.

Like in previous years, Latvijas Banka used staff rotation and promotion to foster personnel development and career. Within a short-term ECB secondment programme, two employees of Latvijas Banka went to the ECB to enhance their work experience at the ECB's Directorate General Macprudential Policy and Financial Stability and Directorate Internal Audit.

Latvijas Banka participated in the Schuman programme designed to provide ESCB and SSM staff members with multi-directional, project-based external work experience. Within the framework of the programme, an expert from Lietuvos bankas was engaged in the research project submitted by the Monetary Policy Department, while experts from the Cash Department and the Information Systems Department (one from each department) took part in the project of Nationale Bank van België/Banque Nationale de Belgique. The employee of Latvijas Banka appointed as the Adviser to the Executive Director of the Nordic-Baltic Constituency of the IMF in 2018 continued her work.

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

Latvijas Banka's staff training costs amounted to 1.3% of the total expenses on remuneration (1.5% in 2018).

FINANCIAL RESOURCES

The financial management system of Latvijas Banka has been developed to ensure support to decision making, financial risk management and efficient use of financial resources.

Latvijas Banka finances its operation primarily from the income generated from managing financial investments and from monetary policy operations. Latvijas Banka does not receive financing from the state budget. Instead, it transfers 70% of the profit made during the reporting year to the state budget. In 2019, Latvijas Banka recorded a profit of 27.2 million euro, of which 19.0 million euro are to be transferred to the state budget. Over the last five years, Latvijas Banka's profit totalled 107.4 million euro, of which 71.9 million euro was transferred to the state budget (for each year's data, see Annex 4).

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

by the Eurosystem. Meanwhile, operations related to the implementation of monetary policy are performed by Latvijas Banka in line with the "Procedure for Participation in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka" adopted by the Council of Latvijas Banka.

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

Latvijas Banka publishes a monthly closing balance sheet as well as other financial information, which is also available on the website of Latvijas Banka. Latvijas Banka's integrated information system ensures a standardised, automated, secure and efficient execution of financial transactions of Latvijas Banka, their uniform accounting and drawing up of financial statements. Within the framework of the internal financial control system, the management of Latvijas Banka regularly analyses changes in assets and liabilities as well as those in income and expenses of Latvijas Banka, paying particular attention to both the results of investment management and compliance of operating costs and long-term investments with the approved budget of Latvijas Banka. The Council of Latvijas Banka approves the annual budget of Latvijas Banka; the management of the budget is carried out according to the "Regulation for Managing the Budget of Latvijas Banka", adopted by the Council of Latvijas Banka and aimed at ensuring efficient use of Latvijas Banka's financial resources. The Regulation provides for the procedure of drafting, approving and monitoring the execution of Latvijas Banka's budget. Within the budget management and planning framework, Latvijas Banka assesses the effectiveness, costs and human resources of each project on a continuous basis in order to ensure efficient use of funds. To assure the independence of internal audit function, the Council of Latvijas Banka also approves the expenditure plan for the Internal Audit Department.

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

INFRASTRUCTURE RESOURCES

Engineering and technical infrastructure resources

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

In 2019, the following works were carried out: exchange of the water supply main, improvement of the ventilation system, reconstruction of the staff entrance and replacement of video surveillance system monitors in the building at K. Valdemāra iela 2A, Riga; and reconstruction of the lightning protection system, reinforcement of a part of the fence enclosing the territory, replacement of the voice notification system, and replacement of the automated units of the smoke exhaust system (not completed yet) in the Riga Branch building.

Resources of information technologies

Latvijas Banka developed a centralised solution ensuring the use of qualified authentication tools (recognised in Latvia and the whole EU) for Latvijas Banka's information systems. The Credit Register's self-service portal was the first to be adapted to the above solution, inter alia, by making it available on mobile devices.

Latvijas Banka substantially improved its computer network by applying an advanced solution to separate the server and data centre infrastructures and, thus, mitigating Latvijas Banka's business continuity risks and strengthening the security.

Latvijas Banka introduced a new centralised data storage and management system which ensures important additional functionalities, substantially higher speed and more storage space for the ever-growing amount of information and, at the same time, requires significantly less electricity for its operation.

Latvijas Banka introduced additional security solutions and procedures to improve information and cyber security and to mitigate risks associated with the most current technological threats.

Latvijas Banka conducted penetration testing of its websites and enhanced the technical solution to ensure an even higher level of security for those websites.

Environmental resources

Latvijas Banka is an environmentally friendly institution taking care of an efficient use of environmental resources.

Over time, a number of measures have been taken to reduce the use of paper and, consequently, also resources required for its production. Electronic circulation of documents has been fully provided within Latvijas Banka and, to the extent possible, also between Latvijas Banka and its external cooperation partners, thus substantially reducing the need for document printing and, at the same time, speeding up the document circulation. Waste paper is recycled.

Efficient printer mode is used to ensure lower consumption of materials (toner, ink and paper) and smaller amount of required paper (by applying duplex printing). The employees are encouraged to choose a more efficient printing mode by assessing the necessity of printing (colour material printing in particular).

As regards the area of energy efficiency, Latvijas Banka also focuses on the energy consumption of the new equipment when implementing projects in relation to technical modernisation of equipment. The energy efficiency ratio is considered when upgrading hardware and other technical equipment as well as when improving lighting solutions.

An important project, i.e. the installation of solar panels in the Riga Branch building, was completed at the end of 2018. The electricity generated by these solar panels is used to meet the building's power consumption needs, thus reducing the volume of electricity to be purchased. The first year's performance of the solar panels corresponds to the initial assessment generating approximately 5.5% of the total electricity necessary for the building. Replacing the volume of electricity produced from non-renewable resources with that generated by the sun reduces CO₂ emissions.

RISK MANAGEMENT

Latvijas Banka manages financial and operational risks according to its principles and policies as set out in the "Risk Management Policy of Latvijas Banka" adopted by the Council of Latvijas Banka.

Risk management at Latvijas Banka is carried out as part of a systematic process identifying, analysing and assessing risks, developing and implementing relevant risk mitigation measures, overseeing and reviewing risks on a regular basis in order to timely identify, assess and efficiently manage risks that are likely to have a negative effect on:

- the financial position and financial performance of Latvijas Banka;
- Latvijas Banka's capability to perform the tasks provided for in the legislative acts in a quality and efficient manner, inter alia, to participate in the implementation of the ESCB functions.

Financial risks are managed with the aim of minimising their potential negative impact on Latvijas Banka's financial position and financial performance that might result from adverse changes in financial markets or a counterparty default. When managing financial risks, including market risk (price, interest rate and currency risks), credit risk and liquidity risk, acceptable types of risks and their parameters are taken into consideration to preserve the value of investments ensuring the required liquidity and income earning in the long term.

Latvijas Banka's investment risks are managed in accordance with the "Procedure for Managing Financial Assets and Gold of Latvijas Banka" adopted by the Council of Latvijas Banka.

Latvijas Banka's investments are managed by dividing them into different investment portfolios. Parameters for a benchmark reflecting the acceptable levels of financial risks and return are set out for each investment portfolio and the Risk Management Division of the Market Operations Department monitors compliance with them. For the purpose of managing investment, including the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves investment tactics, sets additional limits for financial risks, and oversees the operation of external investment managers. The Investment Committee of Latvijas Banka reviews the investment strategy once a quarter, and, on a weekly basis, reviews performance reports prepared by risk managers, financial market development reports and forecasts prepared by investment portfolio managers, and approves the weekly investment management decisions. The Market Operations Department informs the Council and the Board of Latvijas Banka about the results of investment management and risk assessment on a regular basis.

Operational risks of Latvijas Banka are managed to mitigate a potential negative impact on Latvijas Banka's operation, reputation or financial position and financial performance, resulting from inadequate or erroneous execution of processes, acts or omissions on the part of an employee, inadequate operation or unavailability of either the infrastructure of information systems, the information systems or other infrastructure of Latvijas Banka, or external events.

Latvijas Banka's operational risks are managed subject to a uniform operational risk management framework, with the major operational risks being compliance risks (inter alia, in preventing conflict of interests, anti-corruption control, personal data protection, AML/CFT/CFP, and ensuring workplace environment protection), risks related to business continuity, physical security, information security and information systems (including cyber security). Latvijas Banka's operational risks are managed through processes and projects by identifying and assessing risks and, depending on the risk assessment, defining and implementing the most appropriate actions. In order to improve the operational risk management of Latvijas Banka and strengthen the internal control system, among other things ensuring efficient use of the resources allocated to operational risk management, the Operational Risk Management Department was established at Latvijas Banka on 1 February 2019. The Department is in charge of organising the risk management process as well as providing an independent and well-argued opinion on operational risk management to Latvijas Banka top management.

The heads of the structural units of Latvijas Banka and project managers of Latvijas Banka in cooperation with the Operational Risk Management Department provide the management of operational risks on a daily basis.

Compliance risks at Latvijas Banka are managed to ensure compliance of Latvijas Banka's operation, inter alia, that of activities of Latvijas Banka's officials and employees, with the legislative acts.

Risks related to the business continuity of Latvijas Banka are managed to mitigate a potential negative impact on the execution of critical processes where their discontinuity may cause negative consequences for Latvia's financial system or adversely affect the implementation of Latvijas Banka's tasks, inter alia, by ensuring continuity of the critical processes or their recovery as soon as possible and to a full extent in the event of their disruption or failure, as well as efficient incident management.

Risks related to physical security, including risks associated with fire safety and civil protection are managed to mitigate a potential negative impact on the physical security of persons present on the premises of Latvijas Banka, the premises of Latvijas Banka and valuables therein, transportation of its valuables and the events organised by Latvijas Banka.

Risks related to information security are managed to prevent unauthorised disclosure or use of confidential information, classifying it by its degree of confidentiality and ensuring appropriate protection, at the same time taking care that the protective measures do not prevent Latvijas Banka from providing non-classified information to its cooperation partners and general public.

Risks related to information systems, including cyber security risks are managed to prevent a potential negative impact on availability, security and integrity of the information systems and infrastructure of Latvijas Banka. The information systems of Latvijas Banka are classified on the basis of their importance in implementing Latvijas Banka's tasks and the confidentiality, integrity and availability requirements regarding the data to be processed, establishing appropriate physical and logical protection for each level of classification.

In view of the growing cyber security risks, extra security testing was carried out and measures to enhance the protection of Latvijas Banka's information systems and their infrastructure were implemented in 2019.

Latvijas Banka ensures risk management training for its employees, inter alia, to maintain appropriate level of their know-how and skills, and conducts, on a regular basis, training sessions and tests in risk management for employees.

INTERNAL AND EXTERNAL AUDIT

By applying a systemic and planned approach, the internal audit provides the management of Latvijas Banka with an objective and independent evaluation of the effectiveness of Latvijas Banka's governance, risk management, control system and processes and advises on improvements in Latvijas Banka's operation.

The internal audit at Latvijas Banka is conducted by the Internal Audit Department. The internal audit is organised and conducted in accordance with "The Internal Audit Policy of Latvijas Banka", adopted by the Council of Latvijas Banka, and the Regulation of the Internal Audit Department. It is carried out in line with the "Core Principles for the Professional Practice of Internal Auditing", "International Standards for the Professional Practice of Internal Auditing" and the "Code of Ethics" of the Institute of Internal Auditors.

The compliance of internal audit activities with the "International Standards for the Professional Practice of Internal Auditing" and the "Code of Ethics" of the Institute of Internal Auditors is also assessed by an external assessor every five years. In 2015, the external assessment was carried out by PricewaterhouseCoopers SIA. The assessment confirmed compliance of the internal audit activities with the above standards and the "Code of Ethics".

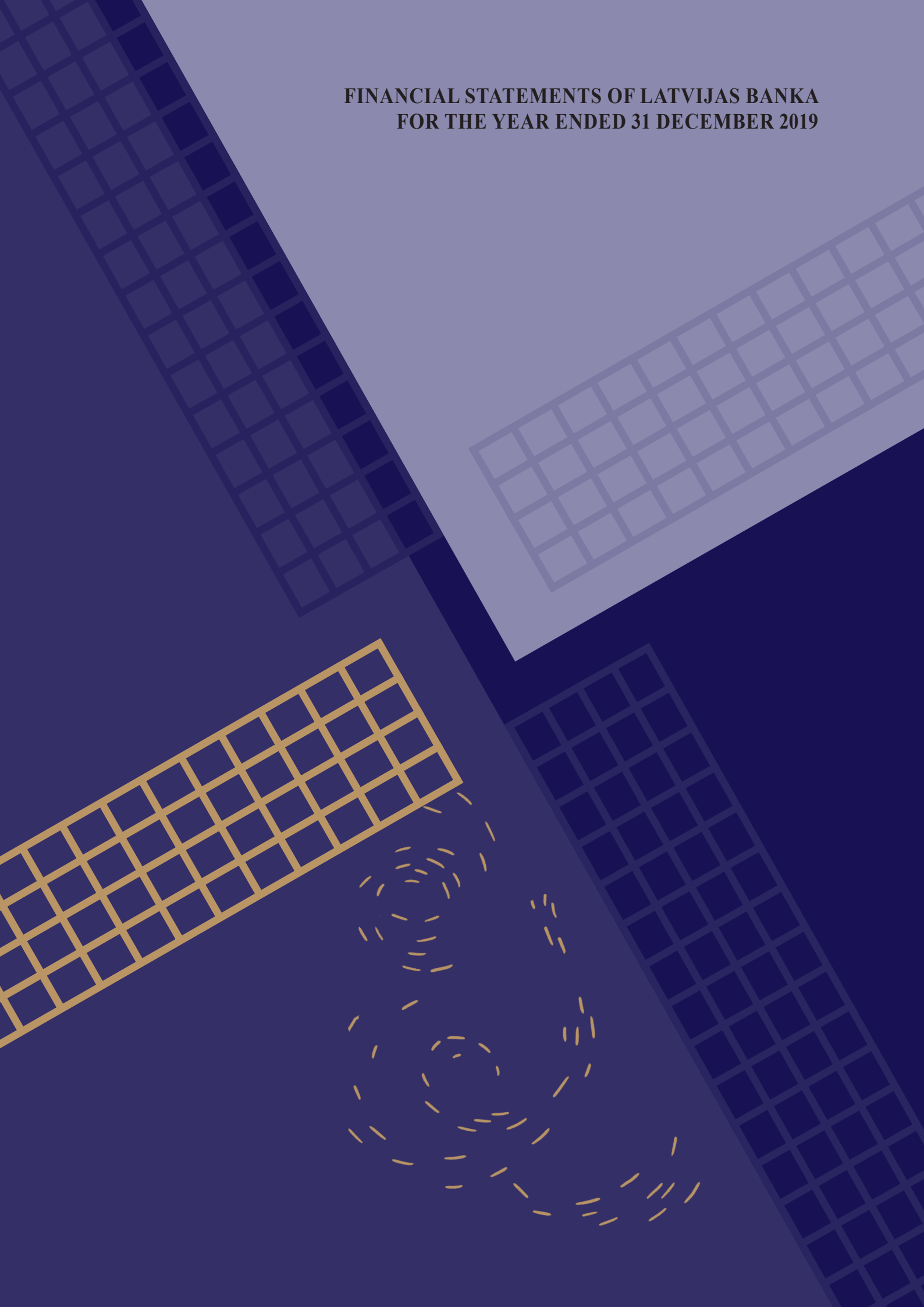
The internal audit covers all business areas of Latvijas Banka. Internal audits are planned and conducted using a risk-based approach. The Head of the Internal Audit Department reports the outcomes of each internal audit to the Council and the Board of Latvijas Banka. The Internal Audit Department submits a report on the performance of the approved annual plan of internal audits, the accomplished internal audits, their results and identified findings, the status of the follow-up of the previously reported audit findings and other relevant information to the Audit Committee of Latvijas Banka on a quarterly basis. The results of internal audit activities are reported to the Council of Latvijas Banka on an annual basis.

The Internal Audit Department also carries out internal audits based on the audit plan of the Eurosystem/ESCB/SSM Internal Auditors Committee. In 2019, the Internal Audit Department performed three such internal audits at Latvijas Banka. The staff of the Internal Audit Department also engage in the fulfilment of other Eurosystem/ESCB/SSM internal audit tasks. In 2019, Latvijas Banka's auditors participated in three working groups responsible for Eurosystem/ESCB/SSM internal audit planning and implementation and work organisation. Moreover, to support the mobility of auditors and to expand their knowledge, a short-term assignment to the ECB's Directorate Internal Audit was arranged for one internal auditor.

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

Activities of the internal audit and the external auditor auditing Latvijas Banka's financial statements are overseen by the Audit Committee of Latvijas Banka.

**FINANCIAL STATEMENTS OF LATVIJAS BANKA
FOR THE YEAR ENDED 31 DECEMBER 2019**



BALANCE SHEET

(at the end of the year; in thousands of euro)			
	Note ¹	2019	2018
ASSETS			
Gold and gold receivables	6	289 043	239 195
Claims on non-euro area residents denominated in foreign currency	7	3 688 972	3 566 027
Receivables from the International Monetary Fund		149 082	146 833
Balances with banks and security investments, external loans and other external assets		3 539 890	3 419 194
Claims on euro area residents denominated in foreign currency	8	460 415	326 308
Claims on non-euro area residents denominated in euro	9	90 139	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	12 250	38 750
Longer-term refinancing operations		12 250	38 750
Other claims on euro area credit institutions denominated in euro	11	8	488
Securities of euro area residents denominated in euro	12	8 721 137	8 813 038
Securities held for monetary policy purposes		7 636 472	7 423 080
Other securities		1 084 665	1 389 958
Intra-Eurosystem claims	13	5 277 483	4 952 780
Participating interest in the European Central Bank		114 108	115 082
Claims equivalent to the transfer of foreign reserves		158 264	163 480
Other claims within the Eurosystem		5 005 111	4 674 218
Other assets	14	206 062	208 724
TOTAL ASSETS		18 745 509	18 247 147

¹ The accompanying Notes set out on pages 75 to 119 are an integral part of these financial statements.

<i>(cont.)</i>	<i>(at the end of the year; in thousands of euro)</i>		
	Note	2019	2018
LIABILITIES			
Banknotes in circulation	15	4 666 799	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	5 660 676	5 050 101
Current accounts (covering the minimum reserve system)		5 660 676	5 050 101
Other liabilities to euro area credit institutions denominated in euro	17	11 871	13 847
Liabilities to other euro area residents denominated in euro	18	1 506 709	1 449 237
General government		442 044	129 113
Other liabilities		1 064 665	1 320 124
Liabilities to non-euro area residents denominated in euro	19	307 239	16 524
Liabilities to euro area residents denominated in foreign currency	20	153 351	150 535
Liabilities to non-euro area residents denominated in foreign currency	21	1 642 368	115 284
Intra-Eurosystem liabilities	13	3 833 540	6 212 645
Liabilities related to TARGET2 and correspondent accounts (net)		3 826 452	6 212 645
Liabilities related to other operational requirements within the Eurosystem		7 088	–
Other liabilities	22	329 326	251 877
Capital and reserves	23	633 630	450 368
TOTAL LIABILITIES		18 745 509	18 247 147

PROFIT AND LOSS STATEMENT

		(in thousands of euro)	
	Note	2019	2018
Net interest income	33	95 946	79 494
Interest income		198 804	180 907
Interest expense		–102 858	–101 413
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions		–37 821	–42 387
Realised gains arising from financial operations	34	46 253	–49 690
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	–3 856	–47 903
Provisions for market risk and credit risk	36	–80 218	55 206
Net expense from fees and commissions		–3 607	–2 783
Fees and commissions income		811	644
Fees and commissions expense		–4 418	–3 427
Income from equity securities and participating interest	37	14 884	6 922
Net result of pooling of monetary income	38	–6 801	122
Other operating income	39	1 300	9 270
NET INCOME		63 901	50 638
Remuneration	40	–17 660	–17 515
Social security costs and solidarity tax	40	–3 941	–4 031
Banknote and coin acquisition costs	41	–1 791	–2 104
Depreciation of fixed assets and amortisation of intangible assets	14	–4 129	–4 189
Other operating expenses	42	–9 225	–8 233
PROFIT OF THE REPORTING YEAR		27 155	14 566

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

		(in thousands of euro)	
	Note	2019	2018
Profit of the reporting year		27 155	14 566
Revaluation	23	169 433	–26 962
Realisation of the accumulated revaluation result	23	–6 986	–10 139
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	3 856	47 903
Total changes in the valuation account	23	166 303	10 802
TOTAL		193 458	25 368

The financial statements, which are set out on pages 71 to 119, were authorised by the Board of Latvijas Banka on 27 February 2020.

BOARD OF LATVIJAS BANKA

M. Kālis

I. Posuma

J. Blūms

J. Caune

H. Ozols

R. Vanags

PRINCIPAL ACTIVITIES

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

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

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

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

Latvijas Banka's execution of operating activities is mainly financed from income received from its investment management and monetary policy operations.

The Head Office of Latvijas Banka is situated at K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its branch in Riga. Proceeding with the implementation of cost efficiency improvement measures, inter alia upgrading the cash processing equipment of the Riga Branch and centralising the cash circulation process, in 2019 Latvijas Banka decided to close its Liepāja Branch as of 30 January 2020, with services to customers being provided until 30 December 2019.

2. PRINCIPAL ACCOUNTING POLICIES

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

2.1 BASIS OF PREPARATION

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

2.2 BASIS OF MEASUREMENT

These financial statements have been prepared in accordance with the historical cost basis of accounting. Gold, securities (except held-to-maturity debt securities and securities held for monetary policy purposes that are measured at amortised cost), participating interest (except the participating interest in the ECB), currency future contracts and interest rate derivatives are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 2.15. The comparison of the book value and fair value of these instruments is provided in Note 5.

2.3 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

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

2.4 FOREIGN CURRENCY AND GOLD TRANSLATION

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

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

Transactions in foreign currencies are included in the calculation of net foreign currency position of the respective currency. The transactions in foreign currencies reducing the respective currency position result in realised gains or losses. Any gain or loss arising from revaluation of transactions in foreign currencies and foreign currency positions are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve ("Valuation account") in accordance with the principles referred to in Note 2.23. The principles referred to herein and in Note 2.23 for valuation and recording of transactions denominated in foreign currencies are also applied to gold.

The exchange rates of major foreign currencies (currency units per euro) and gold price (euro per troy ounce) in euro used in the preparation of the balance sheet for the year ended 31 December 2019 and the year ended 31 December 2018 are as follows:

	(at the end of the year)		
	2019	2018	Changes (%)
US dollar (USD)	1.1234	1.1450	-1.9
Japanese yen (JPY)	121.94	125.85	-3.1
Canadian dollar (CAD)	1.4598	1.5605	-6.5
British pound sterling (GBP)	0.85080	0.89453	-4.9
Gold (XAU)	1354.104	1120.961	20.8

2.5 RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

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

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

2.6 OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

2.7 USE OF ESTIMATES AND ASSUMPTIONS

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

The major estimates and assumptions in the preparation of the financial statements have been made with respect to the following: accounting policy for securities held to maturity (see Note 2.9), the useful life of fixed assets and intangible assets (see Notes 2.17 and 2.18), impairment of assets (see Note 2.19), the exchange probability of those lats banknotes and coins that have not been yet exchanged for the euro banknotes and coins (see Note 2.20), the repurchasing probability of collector coins (see Note 2.21), provisions for market risk and credit risk (see Notes 2.22 and 36), the breakdown of fair value determination (see Note 5), the method for establishing the fair value of the BIS shares (see Note 14.2), and the method of recognising a part of the initial valuation account balance in profit and loss statement (see Note 23).

2.8 GOLD AND GOLD RECEIVABLES

Gold is stated at market value in the balance sheet in accordance with the principles described in Note 2.4.

Gold swap arrangements are treated as repurchase agreements (see also Notes 2.11 and 2.15).

Any gain or loss arising from revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency and gold revaluation reserve in accordance with the principles described in Note 2.23.

2.9 DEBT SECURITIES

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

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income (see also Note 2.24).

Gain or loss arising from transactions in debt securities and revaluation of the debt securities stated at fair value are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the securities revaluation reserve in accordance with the principles referred to in Note 2.23.

2.10 REVERSE REPURCHASE AGREEMENTS

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

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

2.11 REPURCHASE AGREEMENTS

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

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

2.12 SECURITIES LENDING

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

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

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

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

2.14 EQUITY SECURITIES AND PARTICIPATING INTEREST

Equity securities consist of investments in marketable capital instruments made in the course of investment management by Latvijas Banka.

Participating interest includes permanent investments of Latvijas Banka in other entities equity. Latvijas Banka has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate.

Equity securities and participating interest are reported at fair value in the balance sheet, except participating interest in the ECB, which is reported at cost in the balance sheet in accordance with the ECB's legal framework for accounting and financial reporting.

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

2.15 DERIVATIVE FINANCIAL INSTRUMENTS

Latvijas Banka enters into commitments involving forward exchange rate contracts, currency, gold 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, except gold swap arrangements that are treated as repurchase agreements and related claims and liabilities are reported on the balance sheet of Latvijas Banka. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on the transaction day at the spot rate of the transaction and are recorded in the balance sheet in euro at the exchange rate of the respective currency at the end of the reporting period. Other derivative financial instruments are reported in the balance sheet at fair value.

Interest on derivative financial instruments, including the spot and forward interest rate spread of forward exchange rate contracts and currency swap arrangements, is recognised in the profit and loss statement as interest income or interest expense over the term of the agreement. Any gain or loss arising from a change in fair value of interest rate and currency future contracts, as well as OTC interest rate swap arrangements is included in the profit and loss statement taking into account settlement. Any gain or loss arising from a change in fair value of other derivative financial instruments is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the revaluation reserve in accordance with the principles referred to in Note 2.23.

2.16 ACCRUED INTEREST INCOME AND EXPENSE

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

2.17 FIXED ASSETS

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

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

Depreciation is recognised using the straight-line method over the estimated useful life of the asset. Assets under construction or development, land and works of art are not depreciated. Buildings and structures are accounted for by separate components, with individual useful life set for each such component.

In 2019, the useful lives set for fixed assets were not changed. In 2019 and 2018, the useful lives set for fixed assets were as follows:

	(years)	
	2019	2018
Buildings and their components, improvements to the territory, incl.	5–100	5–100
structures	100	100
finishing, equipment and engineering communications	5–20	5–20
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–5	2–5
Other fixed assets	5–15	5–15

In accordance with generally accepted principles for hedge accounting, the cost of

individual fixed assets includes an effective result arising from financial instruments designated as hedges of exchange risk associated with development of the respective fixed assets.

2.18 INTANGIBLE ASSETS

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

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

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

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

2.19 IMPAIRMENT OF ASSETS

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

The ECB carries out impairment assessment of securities held for monetary policy purposes, identifying any potential changes in future cash flows and any other factors encumbering the fulfilment of the liabilities by the securities issuer. Assets are impaired when the carrying amount of securities held for monetary policy purposes exceed their recoverable amount. The latter in its turn is defined as the present value of a future cash flow estimate. The ECB Governing Council approves the results of the asset impairment assessment carried out by the ECB (see Note 36).

2.20 CURRENCY IN CIRCULATION

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

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

The lats banknotes and coins issued by Latvijas Banka which have not been yet exchanged for the euro banknotes and coins are recognised in the balance sheet as liabilities considering the exchange probability of such lats banknotes and coins within 20 years from the euro changeover. The exchange probability of the lats banknotes and coins is assessed annually on the basis of the actual exchange data of the above banknotes and coins (see Note 22.1).

Euro coins and the lats banknotes and coins in circulation issued by Latvijas Banka that have been recognised as liabilities by Latvijas Banka, except collector coins (see also Note 2.21), are reported under the balance sheet item "Other liabilities" at nominal value.

2.21 COLLECTOR COINS

Collector coins sold are not included in the balance sheet as liabilities, as the probability, that the coins will be sold back to Latvijas Banka at their nominal value is low (e.g. the value of precious metals of which the coins are made exceeds the nominal value). Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred. The accounting principles established with respect to collector coins are applied to the lats gold circulation coins and collector coins.

2.22 PROVISIONS

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

In addition, on the basis of reasonable risk estimates and in accordance with the legal framework for accounting and financial reporting in the ESCB, Latvijas Banka's Council decides on making provisions for market risk (price, interest rate and currency risks) and credit risk associated with Latvijas Banka's investment management and other financial transactions (see also Note 36), as well as the use of the provisions should the above risks materialise.

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

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

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

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

2.24 INTEREST INCOME AND EXPENSE

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

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

Interest expense includes interest on deposits received from the Latvian government, credit institutions and other financial institutions, as well as interest on forward exchange

rate contracts and currency and interest rate swap arrangements, and intra-Eurosystem liabilities, as well as negative interest on securities, loans granted and deposits placed.

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

2.25 REALISED GAINS OR LOSSES FROM FINANCIAL OPERATIONS

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

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

2.26 INCOME FROM EQUITY SECURITIES AND PARTICIPATING INTEREST

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

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

In recognising income from equity securities, the income recognition principles established by the ECB legal framework for accounting and financial reporting are applied to the investment portfolio rather than individual securities where externally managed investments in equity securities replicate the structure of an index-linked equity fund.

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

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

Income from equity securities and participating interest is reported under the profit and loss statement item "Income from equity securities and participating interest".

2.27 NET RESULT OF POOLING OF MONETARY INCOME

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

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

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

2.28 BANKNOTE AND COIN ACQUISITION COSTS

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

2.29 OTHER EXPENSE AND INCOME

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

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

3.1 FINANCIAL POSITION

In 2019, Latvijas Banka's assets grew by 498.4 million euro.

In 2019, the balance sheet item "Securities held for monetary policy purposes" increased by 213.4 million euro, the amounts of securities purchases under the asset purchase programme were smaller vis-à-vis 2018 as the ECB's Governing Council made a decision to discontinue net purchases of securities under the asset purchase programme starting from 2019 and in the future merely reinvest the principal payments from maturing securities. As of 1 November 2019, the Governing Council of the ECB decided to resume securities purchases under the asset purchase programme.

In 2019, the amount of loans granted to credit institutions by Latvijas Banka as a result of longer-term refinancing operations decreased by 26.5 million euro (see also Note 10.2).

Other claims related to other operational requirements within the Eurosystem grew by 330.9 million euro, mostly due to a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2019, banknotes in circulation increased by 130.1 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs.

The increase by 290.7 million euro under balance sheet item "Liabilities to non-euro area residents denominated in euro" is mostly related to concluded repurchase agreements.

The increase by 1527.1 million euro under balance sheet item "Liabilities to non-euro area residents denominated in foreign currency" is mostly related to concluded gold swaps arrangements and repurchase agreements to reduce the costs for hedging currency risks and increase return on financial investments.

At the end of 2019, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", increased by 610.6 million euro. As a result of cross-border payments, liabilities to the ECB for the settlement result in TARGET2, reported under the balance sheet item "Intra-Eurosystem liabilities", decreased by 2386.2 million euro to 3826.5 million euro (6212.6 million euro at the end of 2018).

Capital and reserves of Latvijas Banka increased by 183.3 million euro due to net changes in the "Valuation account" balance (166.3 million euro) and the profits earned in 2019 (27.2 million euro), while the share of profits earned in 2018 and remitted to the state budget revenue (10.2 million euro) had a decreasing effect.

3.2 FINANCIAL PERFORMANCE

In 2019, Latvijas Banka's profit amounted to 27.2 million euro (14.6 million euro in 2018).

Net interest income in 2019 grew by 16.5 million euro as compared to 2018 and reached the amount of 95.9 million euro. 17.9 million euro growth in interest income mainly resulted from a rise in interest income on investment by 10.6 million euro on account of higher average yields. Interest income on monetary policy operations grew by 3.7 million euro under PSPP, while 3.6 million euro growth in interest income for deposits received was mostly a result of higher negative interest received on deposits from the Government and other financial institutions. Interest expense grew by 1.4 million euro.

The realised result from financial operations was positive (46.3 million euro) in contrast to the negative result of 49.7 million euro a year ago, while the recognition of the negative revaluation result on financial assets and positions in profit and loss statement amounted to 3.9 million euro (47.9 million euro in 2018) due to a drop in interest rates in Latvijas Banka's major investment markets (see also Notes 34 and 35).

In 2019, additional provisions in the amount of 80.2 million euro were established for market risk and credit risk (in 2018, provisions had been cut by 55.6 million euro).

Income from equity securities and participating interest amounted to 14.9 million euro (6.9 million euro in 2018), the increase resulting from higher income from participating interest in the ECB as well as higher dividends due to the equity securities portfolio growth.

Pursuant to the Statute of the ESCB and of the ECB, the income generated by euro area NCBs through the implementation of the single monetary policy of the Eurosystem is allocated to euro area NCBs in proportion to their shares in the ECB's capital. In 2019, Latvijas Banka's net result of pooling of monetary income was negative (6.8 million euro; positive at 0.1 million euro in 2018).

Other operating income (1.3 million euro; 9.3 million euro in 2018) decreased primarily on account of remeasurement of liabilities for the issued lats banknotes and coins in the amount of 7.2 million euro, whereas in 2019 the valuation of liabilities for the issued lats banknotes and coins remained unchanged.

Total recognised financial result, including changes in the "Valuation account" balance, increased by 168.1 million euro and reached the amount of 193.5 million euro on account of an increase of 196.4 million euro in the revaluation result and a 44.0 million euro fall in the negative result on revaluation of financial assets and positions in the profit and loss statement, while the profits of the reporting year grew by 12.6 million euro as compared to 2018.

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

4. FINANCIAL INVESTMENT POLICY

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

Investments include assets reported under the balance sheet items "Gold and gold receivables", "Claims on non-euro area residents denominated in foreign currency",

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

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

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

The breakdown of investments by type of investment portfolio at the end of 2019 and 2018 was as follows:

	Book value (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
1–10 year fixed income securities portfolios	3 535 151	3 502 941	62.5	61.8
Mortgage-backed securities portfolios	1 175 059	1 134 877	20.8	20.0
Equity securities portfolio	289 428	90 618	5.1	1.6
Gold portfolio	289 043	239 195	5.1	4.2
Long-term fixed income securities portfolio	168 099	502 397	3.0	8.9
Portfolios of borrowed funds	153 351	150 535	2.7	2.7
Latvian government securities portfolio	47 912	47 848	0.8	0.8
Total	5 658 043	5 668 411	100.0	100.0

The 1–10 year fixed income securities portfolio benchmark comprised the weighted 1–10 year government securities index of the UK and euro area countries, and the 1–3 year government securities index of the US and Canada.

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

The equity securities portfolio benchmark is the equity securities index covering the developed markets across the world.

The gold portfolio comprises the gold of Latvijas Banka.

The long-term fixed income securities portfolio comprises euro area government securities denominated in euro, with the original maturity of 10 years.

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

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

The benchmark currency of Latvijas Banka's investment portfolios is the euro, except for portfolios of borrowed funds, the equity securities portfolio and the gold portfolio, thus limiting the currency risk. For portfolios of borrowed funds, the benchmark currency structure is formed considering the currency of the respective liabilities.

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

BALANCE SHEET NOTES

5. FAIR VALUE MEASUREMENT

Fair value of Latvijas Banka's assets is determined using the following hierarchy (see also Note 2.3):

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

At the end of 2019 and 2018, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2019 and 2018, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value method (see also Note 14.2).

At the end of 2019 and 2018, the breakdown of financial instruments and gold carried at fair value and of the financial instruments whose fair value is different from their book value, according to the fair value hierarchy was as follows:

value, according to the fair value hierarchy was as follows:

	(in thousands of euro)					
	Book value	Fair value			Total fair value	Difference between fair value and book value
		Quoted market price	Observable data	Non-observable data		
As at 31 December 2018						
Gold	239 195	239 195	–	–	239 195	–
Securities in investment portfolios	5 159 064	4 614 683	544 966	–	5 159 649	585
Forward exchange rate contracts	20 942	–	19 428	–	19 428	–1 514
Forward exchange rate contracts	–378	–378	–	–	–378	–
Securities held for monetary policy purposes	7 486 168	7 481 885	–	–	7 481 885	–4 283
Participating interest in the Bank for International Settlements	31 321	–	–	31 321	31 321	–
Total	12 936 312	12 335 385	564 394	31 321	12 931 100	–5 212
As at 31 December 2019						
Gold	289 043	289 043	–	–	289 043	–
Securities in investment portfolios	5 151 246	4 552 682	610 900	–	5 163 582	12 336
Forward exchange rate contracts	24 649	–	24 043	–	24 043	–606
Interest rate swap arrangements	–533	–533	–	–	–533	–
Securities held for monetary policy purposes	7 703 471	8 155 588	–	–	8 155 588	452 117
Participating interest in the Bank for International Settlements	34 341	–	–	34 341	34 341	–
Total	13 202 217	12 996 780	634 943	34 341	13 666 064	463 847

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

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

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

6. GOLD AND GOLD RECEIVABLES

	Troy ounces	In thousands of euro
As at 31 December 2017	213 384	230 856
During 2018		
Increase in gold market value	x	8 339
As at 31 December 2018	213 384	239 195
During 2019		
Increase in gold market value	x	49 749
Net change resulting from gold swaps arrangements	73	99
As at 31 December 2019	213 457	289 043

The revaluation result of gold is recognised under the balance sheet item "Capital and reserves" as the revaluation reserve.

At the end of 2019, all gold in the amount of 289 043 thousand euro (117 701 thousand euro at the end of 2018) had been involved in gold swaps arrangements (see also Notes 21 and 44).

At the end of 2019 and 2018, Latvijas Banka had no gold receivables.

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

7.1 RECEIVABLES FROM THE INTERNATIONAL MONETARY FUND

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

Latvia's claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian government promissory note issued to the IMF and denominated in SDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in euro and IMF allocations. At the end of 2019, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 149 082 thousand euro (146 833 thousand euro at the end of 2018), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 1035 thousand euro (1025 thousand euro at the end of 2018) held on its Accounts No. 1 and No. 2 (see also Note 19).

At the end of 2019 and 2018, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2019	2018	2019	2018
Latvia's quota in the International Monetary Fund	410 025	403 877	332 300	332 300
International Monetary Fund holdings in euro	-409 967	-403 825	-332 253	-332 257
Promissory note of the Latvian government	-408 932	-402 800	-331 414	-331 414
Account No. 1	-1 025	-1 010	-831	-831
Account No. 2	-10	-15	-8	-12
Reserve position in the International Monetary Fund	68	67	55	55
SDR	149 082	146 833	120 822	120 811
General allocation	-115 984	-114 245	-93 998	-93 998
Special allocation	-33 098	-32 602	-26 824	-26 824
Latvia's net receivables from the International Monetary Fund	68	53	55	44

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

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

	(in thousands of euro)	
	2019	2018
Securities	3 501 497	3 320 051
Demand deposits	38 375	99 119
Foreign currency in cash	18	24
Total	3 539 890	3 419 194

8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	(in thousands of euro)	
	2019	2018
Securities	460 047	326 081
Demand deposits	368	227
Total	460 415	326 308

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

	(in thousands of euro)	
	2019	2018
Securities	84 352	98 940
Demand deposits	5 787	2 897
Total	90 139	101 837

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

At the end of 2019, the total amount of Eurosystem loans in monetary policy operations reached 624 233 million euro (734 382 million euro at the end of 2018), including 12.3 million euro (38.8 million euro at the end of 2018) of loans granted by Latvijas Banka. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are allocated among euro area NCBs in proportion to their share in the ECB's capital (see Note 2.27). Losses from Eurosystem lending related to monetary policy operations might only be incurred where the counterparty defaults on its obligations and the funds recovered as a result of the disposal of the collateral provided by the counterparty are not sufficient (see also Note 25.1.2).

10.1 MAIN REFINANCING OPERATIONS

Main refinancing operations are open market operations executed through liquidity providing reverse transactions, conducted through weekly standard tenders with a maturity of one week. These operations play a key role in steering interest rates, managing market liquidity and signalling the monetary policy stance. At the end of 2019 and 2018, Latvijas Banka had granted no loans in main refinancing operations.

10.2 LONGER-TERM REFINANCING OPERATIONS

Longer-term refinancing operations are open market operations with a maturity of over 1 week, executed through reverse transactions with the aim to provide credit institutions with additional longer-term refinancing. Such operations are conducted through monthly standard tenders with a 3-month maturity. In addition, following the decision of the Governing Council of the ECB, TLTROs were launched in 2014. They are liquidity providing reverse operations providing longer-term liquidity to credit institutions on attractive terms, so that they can continue easing the terms and conditions of lending to the private sector and to encourage their lending to the real economy. In 2016, the ECB's Governing Council introduced a new series of four targeted longer-term refinancing operations (TLTRO II). These operations have a four-year maturity, with a possibility of early repayment after two years. In 2019, the Governing Council introduced a new series of seven quarterly targeted longer-term refinancing operations (TLTRO III). These operations have a three-year maturity, with a possibility of early repayment after two years. The lowest interest rate applicable to the above operations will be equal to the average interest rate on the Eurosystem deposit facility prevailing over the life of the respective TLTRO III operation. In 2019, Latvijas Banka did not engage in operations under TLTRO III. At the end of 2019, the balance of the TLTRO conducted by Latvijas Banka stood at 12 250 thousand euro (year of maturity of these operations: 2020; at the end of 2018 the balance was 38 750 thousand euro), with credit institutions making an early repayment of the loans granted in the above operations.

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

Other claims on euro area credit institutions denominated in euro mostly include Latvijas Banka's demand deposits in euro with euro area credit institutions (8 thousand euro at the end of 2019; 488 thousand euro at the end of 2018).

12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

At the end of 2019, the amount of securities held by the Eurosystem for monetary policy purposes totalled 2632 billion euro (2651 billion euro at the end of 2018). Of them, Latvijas Banka held 7636 million euro (7423 million euro at the end of 2018). Pursuant to the Statute of the ESCB and of the ECB, any income and losses, if any materialise, are allocated among euro area NCBs in proportion to their share in the ECB's capital,

except any risks associated with the purchases of government securities carried out by Latvijas Banka and other euro area NCBs under the PSPP. Of the total amount of securities held by the Eurosystem for monetary policy purposes, at the end of 2019 the amount of government securities purchased by the euro area NCBs under the PSPP totalled 1681 billion euro (1681 billion euro at the end of 2018); of them, Latvijas Banka held securities in the amount of 1448 million euro (1186 million euro at the end of 2018).

In accordance with the ECB Governing Council decision, from January 2018 to December 2018 the monthly average net securities purchases were gradually reduced from 30 billion euro to 15 billion euro, continuing the respective purchases by the end of 2018. Between January 2019 and October 2019, the Eurosystem fully reinvested the principal payments from maturing securities. As of 1 November 2019, the ECB Governing Council decided to restart its net purchases of securities under the APP at a monthly pace of 20 billion euro. The ECB Governing Council expects them to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before ECB starts raising the key ECB interest rates.

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

	(in thousands of euro)	
	2019	2018
Securities held for monetary policy purposes	7 636 472	7 423 080
Latvian government securities	1 447 653	1 186 436
Debt securities issued by international institutions	6 188 819	6 236 644
Other securities	1 084 665	1 389 958
Securities not held to maturity	916 566	887 561
Securities held to maturity	168 099	502 397
Total	8 721 137	8 813 038

13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (–)

		(in thousands of euro)	
	Note	2019	2018
Participating interest in the European Central Bank	13.1	114 108	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	158 264	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	4 999 497	4 669 321
Claims related to other operational requirements within the Eurosystem	13.5	5 614	4 897
Total intra-Eurosystem claims		5 277 483	4 952 780
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	–3 826 452	–6 212 645
Other liabilities within the Eurosystem	13.5	–7 088	–
Total intra-Eurosystem liabilities		–3 833 540	–6 212 645
Intra-Eurosystem claims/liabilities (–) (net)		1 443 943	–1 259 865

13.1 PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, the weighting assigned to Latvijas Banka in the ECB capital subscription key is calculated on the basis of the share of Latvia's population and gross domestic product in the EU. The

weightings assigned to the NCBs in the ECB's capital subscription key are adjusted every five years or at shorter intervals depending on changes in the number of the EU NCBs that contribute to the ECB's capital. Since 1 January 2014, Latvijas Banka's weighting in the ECB's capital key was 0.2821%, equivalent to 30 537 thousand euro; however, on 1 January 2019, the weightings of NCBs in the ECB's capital subscription key were adjusted, therefore Latvijas Banka's weighting in the ECB capital subscription key slightly decreased to 0.2731%, equivalent to 29 563 thousand euro. As a result of the departure of the UK from the European Union and consequent withdrawal of the Bank of England from the ESCB, the weightings assigned to the remaining NCBs in the key for subscription to the ECB's capital were adjusted with effect from 1 February 2020. The Bank of England's share in the ECB's subscribed capital (14.3374%) was reallocated among other NCBs; hence the capital key of Latvijas Banka increased from 0.2731% to 0.3169%, equivalent to 34 305 thousand euro.

The Statute of the ESCB and of the ECB stipulates that a euro area NCB shall pay up its subscribed share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the valuation account for financial instruments, in proportion to its share in the ECB's capital. After Latvijas Banka's weighting in the ECB capital subscription key changed in 2019, the paid-up share in the ECB's capital decreased by 974 thousand euro, claims equivalent to the transfer of foreign reserves to the ECB shrank by 5216 thousand euro (see also Note 13.2), and the share of transfers to the financial instrument revaluation account contracted by 2757 thousand euro, recognised as realised gains (see also Note 37). At the end of 2019, participating interest in the ECB consisted of the paid up shares in the amount of 29 563 thousand euro in the ECB's capital, transfers to the financial instrument revaluation account amounting to 42 752 thousand euro and the difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro (see also Note 13.2).

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

	2019	2018
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	10 825 007	10 825 007
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	29 563	30 537
The percentage share of Latvijas Banka in the European Central Bank's capital (capital key; %)	0.2731	0.2821

At the end of 2019 and 2018, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	(%)	
	2019	2018
Nationale Bank van België/Banque Nationale de Belgique	2.5280	2.4778
Deutsche Bundesbank	18.3670	17.9973
Eesti Pank	0.1968	0.1928
Banc Ceannais na hÉireann/Central Bank of Ireland	1.1754	1.1607
Bank of Greece	1.7292	2.0332
Banco de España	8.3391	8.8409
Banque de France	14.2061	14.1792
Banca d'Italia	11.8023	12.3108
Central Bank of Cyprus	0.1503	0.1513
Latvijas Banka	0.2731	0.2821
Lietuvos bankas	0.4059	0.4132
Banque centrale du Luxembourg	0.2270	0.2030
Bank Ċentrali ta' Malta/Central Bank of Malta	0.0732	0.0648
De Nederlandsche Bank	4.0677	4.0035
Oesterreichische Nationalbank	2.0325	1.9631
Banco de Portugal	1.6367	1.7434
Banka Slovenije	0.3361	0.3455
Národná banka Slovenska	0.8004	0.7725
Suomen Pankki – Finlands Bank	1.2708	1.2564
Subtotal for euro area NCBs	69.6176	70.3915
Българска народна банка (Bulgarian National Bank)	0.8511	0.8590
Česká národní banka	1.6172	1.6075
Danmarks Nationalbank	1.4986	1.4873
Hrvatska narodna banka	0.5673	0.6023
Magyar Nemzeti Bank	1.3348	1.3798
Narodowy Bank Polski	5.2068	5.1230
Banca Națională a României	2.4470	2.6024
Sveriges Riksbank	2.5222	2.2729
Bank of England	14.3374	13.6743
Subtotal for non-euro area NCBs	30.3824	29.6085
Total ¹	100.0000	100.0000

In 2019, the subscribed and paid-up capital of the ECB remained unchanged, but the paid-up capital decreased by 80 633 thousand euro due to the overall reduction in the weightings of the euro area NCBs (with fully paid-up subscription) in the ECB's subscribed capital and the equivalent increase in the weightings of non-euro area NCBs (which have only paid up 3.75% of their subscriptions) in the ECB's subscribed capital.

¹ The total amount and the sum of the components may differ due to rounding.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2019 and 2018 were as follows:

	(in thousands of euro)			
	Subscribed capital		Paid-up capital	
	2019	2018	2019	2018
Nationale Bank van België/ Banque Nationale de Belgique	273 656	268 222	273 656	268 222
Deutsche Bundesbank	1 988 229	1 948 209	1 988 229	1 948 209
Eesti Pank	21 304	20 871	21 304	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	127 237	125 646	127 237	125 646
Bank of Greece	187 186	220 094	187 186	220 094
Banco de España	902 708	957 028	902 708	957 028
Banque de France	1 537 811	1 534 899	1 537 811	1 534 899
Banca d'Italia	1 277 600	1 332 645	1 277 600	1 332 645
Central Bank of Cyprus	16 270	16 378	16 270	16 378
Latvijas Banka	29 563	30 537	29 563	30 537
Lietuvos bankas	43 939	44 729	43 939	44 729
Banque centrale du Luxembourg	24 573	21 975	24 573	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	7 924	7 015	7 924	7 015
De Nederlandsche Bank	440 329	433 379	440 329	433 379
Oesterreichische Nationalbank	220 018	212 506	220 018	212 506
Banco de Portugal	177 173	188 723	177 173	188 723
Banka Slovenije	36 383	37 400	36 383	37 400
Národná banka Slovenska	86 643	83 623	86 643	83 623
Suomen Pankki – Finlands Bank	137 564	136 005	137 564	136 005
Subtotal for euro area NCBs	7 536 110	7 619 885	7 536 110	7 619 885
Българска народна банка (Bulgarian National Bank)	92 132	92 987	3 455	3 487
Česká národní banka	175 062	174 012	6 565	6 525
Danmarks Nationalbank	162 224	161 000	6 083	6 038
Hrvatska narodna banka	61 410	65 199	2 303	2 445
Magyar Nemzeti Bank	144 492	149 363	5 418	5 601
Narodowy Bank Polski	563 636	554 565	21 136	20 796
Banca Națională a României	264 888	281 710	9 933	10 564
Sveriges Riksbank	273 028	246 042	10 239	9 227
Bank of England	1 552 025	1 480 244	58 201	55 509
Subtotal for non-euro area NCBs	3 288 897	3 205 122	123 334	120 192
Total	10 825 007	10 825 007	7 659 444	7 740 077

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

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

euro, i.e. in proportion to the value of the respective claims of other euro area NCBs. In 2019 after Latvijas Banka's weighting in the ECB capital subscription key changed this claim decreased to the amount of 158 264 thousand euro. The difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro is reported as participating interest in the ECB (see also Note 13.1). The interest rate on the main refinancing operations set by the ECB is applied to the claims equivalent to the transfer of foreign reserves to the ECB (see also Note 33).

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

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

In 2019, liabilities related to TARGET2 and national central bank correspondent accounts (net) decreased as a result of the cross-border payments effected by credit institutions and Latvijas Banka and a result of Latvijas Banka's investment management.

The interest rate on the main refinancing operations set by the ECB is applied to the above claims and liabilities.

13.4 CLAIMS FOR THE ALLOCATION OF BANKNOTES IN THE EUROSISTEM

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

13.5 CLAIMS/LIABILITIES RELATED TO OTHER OPERATIONAL REQUIREMENTS WITHIN THE EUROSISTEM

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

Monetary income to be pooled by Latvijas Banka in 2019 was higher than its monetary income to be received. This resulted in a liability to the ECB associated with the net result of pooling of monetary income, standing at 7088 thousand euro at the end of 2019 (122 thousand euro claim at the end of 2018; see also Notes 2.27 and 38).

Claims for the ECB's interim profit distribution in the amount of 5614 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (4775 thousand euro at the end of 2018; see also Notes 2.26 and 37).

14. OTHER ASSETS

(in thousands of euro)

	Note	2019	2018
Accrued interest on securities held for monetary policy purposes		66 999	63 088
Participating interest in the Bank for International Settlements	14.2	34 341	31 321
OTC financial derivative contracts and spot exchange rate contracts	24	32 492	38 999
Fixed assets	14.1	35 319	37 790
Accrued interest on other securities		20 146	22 602
Claims on collateral for the use of the instant payment service	17	11 581	10 017
Intangible assets	14.1	2 263	2 406
Other accrued income		1 491	1 159
Prepaid expenses		951	704
Other		479	638
Total		206 062	208 724

14.1 FIXED ASSETS AND INTANGIBLE ASSETS

(in thousands of euro)

	Buildings, improvement of territory, and land	Furniture and office equipment	Computer and telecommunication equipment	Cash processing and storage equipment	Other fixed assets	Total fixed assets	Intangible assets
As at 31 December 2017							
Cost	61 455	6 358	5 935	7 086	10 155	90 989	7 258
Accumulated depreciation/amortisation	-29 566	-3 950	-4 426	-5 393	-7 989	-51 324	-4 895
Net book value	31 889	2 408	1 509	1 693	2 166	39 665	2 363
During 2018							
Additions	995	95	235	48	990	2 363	543
Disposals and write-offs	-1 101	-138	-1 575	-88	-1 235	-4 137	-1
Net change in cost	-106	-43	-1 340	-40	-245	-1 774	542
Depreciation/amortisation charge	-1 961	-269	-619	-375	-465	-3 689	-500
Accumulated depreciation/amortisation on disposals and write-offs	656	121	1 573	84	1 154	3 588	1
Net change in accumulated depreciation/amortisation	-1 305	-148	954	-291	689	-101	-499
As at 31 December 2018							
Cost	61 349	6 315	4 595	7 046	9 910	89 215	7 800
Accumulated depreciation/amortisation	-30 871	-4 098	-3 472	-5 684	-7 300	-51 425	-5 394
Net book value	30 478	2 217	1 123	1 362	2 610	37 790	2 406

(cont.)

(in thousands of euro)

	Buildings, improvement of territory, and land	Furniture and office equipment	Computer and telecom- munication equipment	Cash processing and storage equipment	Other fixed assets	Total fixed assets	Intangible assets
During 2019							
Additions	616	35	431	1 540	202	2 824	387
Change in classification	-3	-	-	-	3	-	-
Disposals and write-offs	-3 664	-119	-259	-3 253	-285	-7 580	-77
Net change in cost	-3 051	-84	172	-1 713	-80	-4 756	310
Depreciation/amortisation charge	-1 982	-264	-564	-310	-479	-3 599	-530
Change in classification	3	-	-	-	-3	-	-
Accumulated depreciation/amortisation on disposals and write-offs	2 269	116	258	2 963	278	5 884	77
Net change in accumulated depreciation/amortisation	290	-148	-306	2 653	-204	2 285	-453
As at 31 December 2019							
Cost	58 298	6 231	4 767	5 333	9 830	84 459	8 110
Accumulated depreciation/amortisation	-30 581	-4 246	-3 778	-3 031	-7 504	-49 140	-5 847
Net book value	27 717	1 985	989	2 302	2 326	35 319	2 263

At the end of 2019, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 11 thousand euro (209 thousand euro at the end of 2018).

14.2 PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2019 and 2018, Latvijas Banka owned 1070 shares in the BIS, which corresponded to 0.19% of the total subscribed and paid-up BIS capital.

The total nominal value of Latvijas Banka's shareholding in the BIS is 5350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1338 thousand SDR or 25% (see also Note 46). At the end of 2019 and 2018, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest published financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at The Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2019, the estimated fair value of BIS shares was 34 341 thousand euro (31 321 thousand euro at the end of 2018).

15. BANKNOTES IN CIRCULATION

(in thousands of euro)

	2019	2018
Euro banknotes	4 666 799	4 536 729
Net issuance of euro banknotes by Latvijas Banka	-332 698	-132 592
Adjustment for banknote allocation in the Eurosystem	4 999 497	4 669 321
Total	4 666 799	4 536 729

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

As a result of cross-border flows of euro banknotes, in 2019 the amount of banknotes deposited with Latvijas Banka continued to exceed that of banknotes withdrawn from Latvijas Banka; consequently, the negative net issuance of euro banknotes by Latvijas Banka increased to 332 698 thousand euro. At the end of 2019, the total amount of euro banknotes in circulation in the Eurosystem grew to 1293 billion euro (1231 billion euro at the end of 2018); as a result, an increase in the adjustment for banknote allocation in the Eurosystem was reported on the balance sheet of Latvijas Banka.

16. LIABILITIES TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

16.1 CURRENT ACCOUNTS (COVERING THE MINIMUM RESERVE SYSTEM)

Current accounts contain the credit balances on the transaction accounts of credit institutions that are required to hold minimum reserves. The latest available interest rate used by the Eurosystem in its tenders for main refinancing operations is applied to the balances held on those accounts within the framework of the reserve requirements. Since June 2014, the lower rate of either zero per cent or the ECB's deposit facility rate has been applied to the reserves held in excess of the required minimum reserves. On 12 September 2019, the ECB's Governing Council decided to introduce a two-tier system for reserve remuneration, which exempts part of credit institutions' excess liquidity holdings (i.e. reserve holdings in excess of minimum reserve requirements) from the negative remuneration rate applicable on the deposit facility.

At the end of 2019, balance on the current accounts with Latvijas Banka was 5 660 676 thousand euro (5 050 101 thousand euro at the end of 2018), including the minimum reserves in the amount of 156 304 thousand euro (156 079 thousand euro at the end of 2018).

16.2 DEPOSIT FACILITY

Deposit facility is a standing facility of the Eurosystem used by credit institutions to place their overnight deposits at a pre-specified rate. No such deposits were placed with Latvijas Banka at the end of 2019 and 2018.

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

Other liabilities to euro area credit institutions denominated in euro resulted from funds received as collateral for the use of the instant payment service (11 871 thousand euro at the end of 2019; 13 847 thousand euro at the end of 2018). Collateral received from credit institutions for the use of the instant payment service has been deposited with the ECB and is held by the respective payment system operator (see also Note 14).

18. LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

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

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

Liabilities to other financial institutions mostly comprise funds received under repurchase agreements concluded in 2019.

	(in thousands of euro)	
	2019	2018
Other financial institutions	306 195	4 423
International Monetary Fund	1 035	1 025
European Commission	9	11 076
Total	307 239	16 524

20. LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Liabilities to euro area residents denominated in foreign currency comprise demand deposits of the Latvian government in foreign currency standing at 153 351 thousand euro at the end of 2019 (150 535 thousand euro at the end of 2018; see also Note 43).

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

	(in thousands of euro)	
	2019	2018
Liabilities for repurchase agreements	1 363 337	–
Liabilities for gold swap arrangements	279 031	114 323
Liabilities for collateral for forward exchange rate contracts	–	961
Total	1 642 368	115 284

22. OTHER LIABILITIES

		(in thousands of euro)	
	Note	2019	2018
Provisions for market risk and credit risk	36	203 900	123 970
Euro coins in circulation	22.1	79 496	73 513
Lats banknotes in circulation	22.1	23 719	25 798
Accrued expense and similar liabilities		9 805	6 533
OTC financial derivative contracts and spot exchange rate contracts	24	7 837	17 003
Lats coins in circulation	22.1	2 855	3 116
Tax liabilities	22.2	13	66
Other		1 701	1 878
Total		329 326	251 877

22.1 BANKNOTES AND COINS IN CIRCULATION

Apart from the lats and euro circulation coins issued by Latvijas Banka and recognised on the balance sheet, euro collector coins, lats collector coins and precious metal circulation coins were also in circulation with the total nominal value of 6960 thousand euro at the end of 2019 (6878 thousand euro at the end of 2018). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Notes 2.21 and 46).

Issued lats banknotes and coins with low probability of exchange, in the amount of 95 600 thousand euro (lats banknotes in the amount of 35 791 thousand euro and lats

coins in the amount of 59 809 thousand euro) have not been reported as a liability on the balance sheet at the end of 2019 and 2018 (see also Note 46).

22.2 TAX LIABILITIES

At the end of 2019 and 2018, tax liabilities of Latvijas Banka were as follows:

	(in thousands of euro)						
	Personal income tax	State compulsory social security contributions and ST (by employer)	State compulsory social security contributions and ST (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2017	–	–	4	–	71	–	75
During 2018							
Calculated	3 081	4 031	1 844	228	1 326	3	10 513
Decrease in deferred liabilities	–	12	–	–	–	–	12
Paid	–3 081	–4 043	–1 848	–228	–1 332	–2	–10 534
Liabilities as at 31 December 2018	–	–	–	–	65	1	66
During 2019							
Calculated	3 076	3 941	1 843	225	1 349	1	10 435
Increase in deferred liabilities	–	101	–	–	–	–	101
Paid	–3 076	–4 042	–1 843	–225	–1 401	–2	–10 589
Liabilities as at 31 December 2019	–	–	–	–	13	–	13

In addition to the tax payments indicated herein, in 2019 Latvijas Banka transferred to the state budget 70% of the profit for the previous year (10 196 thousand euro in 2019) but in 2018 65% of the profit for 2017 (15 524 thousand euro in 2018; see also Notes 23 and 43). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

23. CAPITAL AND RESERVES

	(in thousands of euro)				
	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2017	100 000	228 003	88 637	23 884	440 524
During 2018					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	10 802	x	10 802
Profit appropriated to the state budget	x	x	x	–15 524	–15 524
Profit transferred to the reserve capital	x	8 360	x	–8 360	–
Profit of the reporting year	x	x	x	14 566	14 566
As at 31 December 2018	100 000	236 363	99 439	14 566	450 368
During 2019					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	166 303	x	166 303
Profit appropriated to the state budget	x	x	x	–10 196	–10 196
Profit transferred to the reserve capital	x	4 370	x	–4 370	–
Profit of the reporting year	x	x	x	27 155	27 155
As at 31 December 2019	100 000	240 733	265 742	27 155	633 630

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

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

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

The Law on Latvijas Banka establishes that a part of Latvijas Banka's profit of the reporting year, calculated by applying the same percentage as the corporate income tax rate set by the Law on Corporate Income Tax, together with a payment in the amount of 50% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget, as well as that the Council of Latvijas Banka, upon approving the annual report, may make a decision on reducing the percentage share of the payment for the usage of state capital where it is necessary for increasing the reserve capital of Latvijas Banka in relation to the financial risks Latvijas Banka is exposed to when executing its tasks. At the end of 2019 and 2018 the corporate income tax rate was 20%. Therefore, unless the Council of Latvijas Banka decides otherwise, 70% of Latvijas Banka's profit of the reporting year or 19 009 thousand euro shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2018 by the Council of Latvijas Banka.

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

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

In 2019 and 2018, changes in the valuation account were as follows:

(in thousands of euro)

	2019	Recognition in profit and loss statement	Revaluation	Realisation	2018
Initial valuation account	–	x	x	–2 859	2 859
Revaluation reserve for participating interest	31 832	–	3 020	–	28 812
Result on revaluation of foreign currencies and gold	91 419	145	45 994	–	45 280
Result on revaluation of interest rate swap arrangements	62	431	–369	–	–
Result on revaluation of securities	142 429	3 280	120 788	–4 127	22 488
Total	265 742	3 856	169 433	–6 986	99 439

	2018	Recognition in profit and loss statement	Revaluation	Realisation	2017
Initial valuation account	2 859	x	x	-5 662	8 521
Revaluation reserve for participating interest	28 812	–	907	–	27 905
Result on revaluation of foreign currencies and gold	45 280	407	12 596	-169	32 446
Result on revaluation of interest rate swap arrangements	–	346	-346	–	–
Result on revaluation of securities	22 488	47 150	-40 119	-4 308	19 765
Total	99 439	47 903	-26 962	-10 139	88 637

In accordance with the ECB's legal framework for accounting and financial reporting, on 1 January 2014 Latvijas Banka reclassified the accumulated result on revaluation of foreign currencies to the initial valuation account. The initial valuation account also comprises the accumulated result on revaluation of financial instruments and gold prior to the change in the accounting policy on 1 January 2007.

The balance on the initial valuation account is recognised in the profit and loss statement to compensate lower remuneration for claims related to the banknote allocation within the Eurosystem as per the coefficients applied in accordance with the decisions of the Governing Council of the ECB for the calculation of the remuneration adjustment for claims related to the banknote allocation within the Eurosystem in the first six years after an NCB joins the Eurosystem (see Note 33). The amount to be recognised in the profit and loss statement for the respective year is calculated by multiplying the balance on the initial valuation account as at 1 January 2014 with the share of the coefficient for calculating the compensation amount for the respective year in the total coefficients (indicated in Note 33) during the transition period when the adjustment amounts for the claims on banknote allocation in the Eurosystem are calculated. In 2019, the above six-year transition period following Latvijas Banka's joining the Eurosystem came to an end/ended.

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

24. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements, forward transactions in securities, and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's investments. At the end of 2019 and 2018, the contract or notional amounts and book value of the above transactions were as follows:

	Contract or notional amount		Book value			
	2019	2018	Assets		Liabilities	
			2019	2018	2019	2018
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	2 524 378	4 183 931	31 570	35 347	6 477	13 880
Spot exchange rate contracts	396 631	378 896	–	–	444	525
Forward transactions in securities	788 442	881 305	843	3 500	304	2 068
Interest rate swap arrangements	36 229	52 838	79	152	612	530
Total	x	x	32 492	38 999	7 837	17 003
Derivative OTC gold swap arrangements	279 031	114 323	289 043	117 701	279 419	114 480
Traded financial derivative contracts						
Interest rate future contracts	1 374 836	1 938 588	x	x	x	x
Currency future contracts	100 000	100 000	x	x	x	x

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

To reduce the costs for hedging currency risks and increase return on financial investments, Latvijas Banka engages in gold swap arrangements (see also Notes 6 and 21).

MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT

25. RISK MANAGEMENT

Financial and operational risks are the main risks associated with the activities of Latvijas Banka. Management of Latvijas Banka's risks is organised and implemented according to the Risk Management Policy of Latvijas Banka approved by the Council of Latvijas Banka.

Risk management at Latvijas Banka is carried out as part of a systemic process identifying, analysing and assessing risks, developing and implementing relevant risk mitigating measures, overseeing and reviewing risks on a regular basis in order to timely identify, assess and efficiently manage risks that are likely to have a negative effect on the financial position and financial performance of Latvijas Banka as well as Latvijas Banka's capability to perform the tasks provided for in the legislative acts in a quality and efficient manner, inter alia to participate in the implementation of the ESCB functions.

The risk management process is organised in compliance with the international principles of best practice in risk management, in view of the aims and tasks of Latvijas Banka and the external environment developments, as well as complying with the requirements of the ECB.

25.1 FINANCIAL RISKS

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks Latvijas Banka is exposed to in its daily activities. Financial risks are managed to mitigate a potential negative impact on Latvijas Banka's financial position and financial performance that might arise from adverse changes in financial market factors or a counterparty default. When managing financial risks, acceptable types of risks and their parameters are taken into consideration to preserve the value of investments ensuring the required liquidity and income earning in the long term.

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

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

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

25.1.1 MARKET RISK

Market risk is exposure to losses due to adverse changes in financial markets.

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

Latvijas Banka's exposure to currency risk is determined by its investment structure. Latvijas Banka manages currency risk by establishing that the benchmark currency is the euro, thus hedging the currency risk (except for the gold portfolio as Latvijas Banka discontinued the hedging of the gold price risk in 2017, and the equity securities portfolio where investments are made in the stock denomination currencies of the respective equity securities index), and using tracking error limits in relation to the respective benchmark. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark. The aggregate market risk of 1–10 year fixed income securities portfolios, mortgage-backed securities portfolios, and the equity securities portfolio (see Note 4) is managed by determining the tracking error limit. Tracking error in 2019 and 2018 is disclosed in Note 28.

The equity securities portfolio is exposed to the market price risk (a risk that the value of investment might decrease due to price changes). As the equity securities portfolio is highly diversified, it is mostly exposed to the risk of systematic share price movements.

For investment portfolios, except for portfolios of borrowed funds, the equity securities portfolio, and the gold portfolio, the benchmark currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the respective currency. Deviations from the benchmark currency structure give rise to the

open currency position. In order to achieve the compliance of open foreign currency positions with the limits, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

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

Latvijas Banka's exposure to market risk (as at the end of 2019 and 2018) is disclosed in Notes 26–28.

25.1.2 CREDIT RISK

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

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

In 2019 and 2018, loans granted to credit institutions in monetary policy operations were secured by securities collateral in compliance with the ECB requirements. The Market Operations Department monitors the adequacy of collateral of the respective loans and its eligibility and compliance with the ECB's requirements on a regular basis, as well as maintains a list of securities issued and held in the Republic of Latvia and eligible for monetary policy operations.

Latvijas Banka's exposure to market risk (as at the end of 2019 and 2018) is disclosed in Notes 30–32.

25.1.3 LIQUIDITY RISK

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

term deposits with foreign financial institutions and other financial instruments. The liquidity structure of Latvijas Banka's assets and liabilities as at the end of 2019 and 2018 is disclosed in Note 29.

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

25.2 OPERATIONAL RISKS

Operational risks are managed to ensure efficient attainment of quality result of a process or project as scheduled/within the specified time frame as well as continuous, adequate and safe implementation of the process, mitigating such a potential negative impact on Latvijas Banka's capability to accomplish its tasks, on its reputation or financial position and financial performance, that could be triggered by an inadequate or erroneous implementation of Latvijas Banka's processes, acts or omissions on the part of an employee, or unavailability of an employee; inadequate operation or unavailability of either the infrastructure of information systems, the information systems, or other infrastructure of Latvijas Banka, or external events.

Latvijas Banka's operational risks are managed subject to a uniform operational risk management framework, with the major operational risks being compliance risks (inter alia in preventing conflict of interests, anti-corruption control, personal data protection, prevention of money laundering and terrorism financing, and ensuring workplace environment protection), risks related to business continuity, physical security, information security and information systems (including cyber security).

Latvijas Banka's operational risks are managed through processes and projects by classifying processes and risks, evaluating the impact of risks on the results of processes or projects and, depending on the risk classification, defining and implementing the most appropriate actions to ensure adequate risk management. In order to improve the operational risk management of Latvijas Banka and strengthen the internal control system, the Operational Risk Management Department was established on 1 February 2019, combining the existing competence and expertise in the field of operational risk management at Latvijas Banka's disposal. The Department is in charge of maintaining a common operational risks management framework, organising incident management as well as providing regular information on operational risk management pursuant to the legal acts of Latvijas Banka. The improved risk management process is based on the best practice in the field of risk management and concentrates the resources allocated to operational risk management, thereby increasing the effectiveness of this management model. In 2019, the operational risk management was overseen by the Operational Risk Management Committee of Latvijas Banka.

Compliance risks are managed to ensure compliance of Latvijas Banka's operation with the legislative acts.

Risks related to the business continuity of Latvijas Banka are managed to mitigate a potential negative impact on the execution of critical processes where their discontinuity may cause negative consequences for Latvia's financial system or adversely affect the implementation of Latvijas Banka's tasks, inter alia by ensuring continuity of the critical processes or their recovery as soon as possible and to a full extent in the event of their disruption or failure, as well as efficient incident management.

Risks related to physical security, inter alia risks associated with fire safety and civil protection are managed to mitigate a potential negative impact on the physical security of persons, the premises of Latvijas Banka, transportation of its valuables and the events organised by Latvijas Banka with a priority focus on protecting the life and health of individuals.

Risks related to information security are managed to prevent unauthorised disclosure or use of confidential information, classifying it by its degree of confidentiality and ensuring appropriate protection, at the same time taking care that the protective measures do not prevent Latvijas Banka from providing non-classified information to its cooperation partners and general public.

Risks related to information systems, including cyber security risks are managed to prevent a potential negative impact on availability, security and integrity of the information systems and infrastructure of Latvijas Banka. Information systems at Latvijas Banka are classified on the basis of their importance for implementing Latvijas Banka's tasks and the confidentiality, integrity and availability requirements regarding the data to be processed, establishing appropriate physical and logical protection for each level of classification.

Latvijas Banka ensures risk management training for its employees, inter alia to maintain appropriate level of their know-how and skills, and conducts, on a regular basis, training sessions and tests in risk management for employees.

As part of the framework of operational risk mitigation measures, Latvijas Banka is insured against a possible impact of certain types of operational risks.

In 2019, operational risks, inter alia risks related to ensuring Latvijas Banka's business continuity, information and information systems security, as well as physical security were appropriately managed. The above risks did not substantially hamper Latvijas Banka's operation.

26. CURRENCY STRUCTURE

(in thousands of euro)

	EUR	USD	CAD	GBP	Gold	Other	Total
As at 31 December 2019							
Total assets	14 338 668	3 264 840	386 768	360 716	289 043	105 474	18 745 509
Total liabilities	16 986 997	1 274 718	346 416	109 526	–	27 852	18 745 509
Net position on balance sheet	–2 648 329	1 990 122	40 352	251 190	289 043	77 622	0
Net position on financial instruments' off-balance sheet accounts	2 131 383	–1 811 033	–28 960	–235 321	–	–31 414	24 655
Net position on balance sheet and off-balance sheet accounts	–516 946	179 089	11 392	15 869	289 043	46 208	24 655
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–2.8	1.0	0.1	0.1	1.5	0.2	0.1
As at 31 December 2018							
Total assets	14 145 578	3 063 666	353 345	331 782	239 195	113 581	18 247 147
Total liabilities	18 015 451	192 871	576	12 127	–	26 122	18 247 147
Net position on balance sheet	–3 869 873	2 870 795	352 769	319 655	239 195	87 459	0
Net position on financial instruments' off-balance sheet accounts	3 565 725	–2 807 729	–348 794	–314 702	–	–72 504	21 996
Net position on balance sheet and off-balance sheet accounts	–304 148	63 066	3 975	4 953	239 195	14 955	21 996
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–1.6	0.3	0.0	0.0	1.3	0.1	0.1

27. REPRICING MATURITY

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

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
As at 31 December 2019							
Gold and gold receivables	–	–	–	–	–	289 043	289 043
Claims on non-euro area residents denominated in foreign currency	31 972	24 540	125 046	746 551	2 315 288	445 575	3 688 972
Claims on euro area residents denominated in foreign currency	–	–	148 724	158 393	148 076	5 222	460 415
Claims on non-euro area residents denominated in euro	–	–	134	6 061	78 120	5 824	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	–	12 250	–	–	12 250
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	8	8
Securities of euro area residents denominated in euro	–	–	–	185 186	8 535 951	–	8 721 137
Intra-Eurosystem claims	–	–	–	–	–	5 277 483	5 277 483
Other assets	146	–	1 860	5 013	79 906	119 137	206 062
Total assets	32 118	24 540	275 764	1 113 454	11 157 341	6 142 292	18 745 509
Banknotes in circulation	–	–	–	–	–	4 666 799	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 660 676	–	–	–	–	–	5 660 676
Other liabilities to euro area credit institutions denominated in euro	11 871	–	–	–	–	–	11 871
Liabilities to other euro area residents denominated in euro	1 506 709	–	–	–	–	–	1 506 709
Liabilities to non-euro area residents denominated in euro	306 204	–	–	–	–	1 035	307 239
Liabilities to euro area residents denominated in foreign currency	153 351	–	–	–	–	–	153 351
Liabilities to non-euro area residents denominated in foreign currency	1 642 368	–	–	–	–	–	1 642 368
Intra-Eurosystem liabilities	3 833 540	–	–	–	–	–	3 833 540
Other liabilities	3 016	–	–	–	–	326 310	329 326
Capital and reserves	–	–	–	–	–	633 630	633 630
Total liabilities	13 117 735	–	–	–	–	5 627 774	18 745 509
Net position on balance sheet	–13 085 617	24 540	275 764	1 113 454	11 157 341	514 518	–
Assets on financial instruments' off-balance sheet accounts	3 700 161	7 922	637 084	23 431	807 984	–	5 176 582
Liabilities on financial instruments' off-balance sheet accounts	4 495 103	130 374	93 564	101 122	331 764	–	5 151 927
Net position on balance sheet and off-balance sheet accounts	–13 880 559	–97 912	819 284	1 035 763	11 633 561	514 518	24 655

(cont.)

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
As at 31 December 2018							
Gold and gold receivables	–	–	–	–	–	239 195	239 195
Claims on non-euro area residents denominated in foreign currency	44 487	103 076	448 148	–	2 645 773	324 543	3 566 027
Claims on euro area residents denominated in foreign currency	5 220	–	90 800	1	228 668	1 619	326 308
Claims on non-euro area residents denominated in euro	–	–	–	–	98 911	2 926	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	38 750	–	–	–	38 750
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	488	488
Securities of euro area residents denominated in euro	17 179	114 914	888 757	–	7 792 188	–	8 813 038
Intra-Eurosystem claims	–	–	–	–	–	4 952 780	4 952 780
Other assets	16	1 290	11 976	2	72 432	123 008	208 724
Total assets	66 902	219 280	1 478 431	3	10 837 972	5 644 559	18 247 147
Banknotes in circulation	–	–	–	–	–	4 536 729	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 050 101	–	–	–	–	–	5 050 101
Other liabilities to euro area credit institutions denominated in euro	13 847	–	–	–	–	–	13 847
Liabilities to other euro area residents denominated in euro	1 449 237	–	–	–	–	–	1 449 237
Liabilities to non-euro area residents denominated in euro	15 499	–	–	–	–	1 025	16 524
Liabilities to euro area residents denominated in foreign currency	150 535	–	–	–	–	–	150 535
Liabilities to non-euro area residents denominated in foreign currency	115 284	–	–	–	–	–	115 284
Intra-Eurosystem liabilities	6 212 645	–	–	–	–	–	6 212 645
Other liabilities	157	–	–	–	–	251 720	251 877
Capital and reserves	–	–	–	–	–	450 368	450 368
Total liabilities	13 007 305	–	–	–	–	5 239 842	18 247 147
Net position on balance sheet	–12 940 403	219 280	1 478 431	3	10 837 972	404 717	–
Assets on financial instruments' off-balance sheet accounts	5 449 230	289 956	777 991	10 123	926 481	–	7 453 781
Liabilities on financial instruments' off-balance sheet accounts	6 633 299	–	96 452	297 467	404 567	–	7 431 785
Net position on balance sheet and off-balance sheet accounts	–14 124 472	509 236	2 159 970	–287 341	11 359 886	404 717	21 996

28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–10 year government fixed income securities portfolios, mortgage-backed securities portfolios and the equity securities portfolio is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark (see also Note 25.1). At the end of 2019 and 2018, the actual (ex-post) tracking error of the 1–10 year fixed income securities portfolios were identical (30 basis points). At the end of 2019 and

2018, the actual (ex-post) tracking errors of the mortgage-backed securities portfolios were 75 basis points and 61 basis points respectively.

The expected (ex-ante) tracking error of the equity securities portfolio does not exceed 30 basis points during the year and compliance with this limit is monitored by the respective external investment manager. The expected (ex-ante) tracking error in 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios lay within the following basis point intervals during the year:

	Book value (at the end of the year; in thousands of euro)	Expected tracking error (number of business days)		
		10–39	40–69	70–99
During 2019				
1–10 year fixed income securities portfolios	3 535 151	250	–	–
Mortgage-backed securities portfolios	1 175 059	166	84	–
During 2018				
1–10 year fixed income securities portfolios	3 502 941	252	–	–
Mortgage-backed securities portfolios	1 134 877	220	32	–

29. LIQUIDITY STRUCTURE

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

	(in thousands of euro)			
	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2019				
Assets				
Gold and gold receivables	289 043	–	–	289 043
Claims on non-euro area residents denominated in foreign currency	3 688 972	–	–	3 688 972
Claims on euro area residents denominated in foreign currency	460 415	–	–	460 415
Claims on non-euro area residents denominated in euro	90 139	–	–	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	12 250	–	12 250
Other claims on euro area credit institutions denominated in euro	8	–	–	8
Securities of euro area residents denominated in euro	8 553 038	168 099	–	8 721 137
Intra-Eurosystem claims	5 614	–	5 271 869	5 277 483
Other assets	132 709	–	73 353	206 062
Total assets	13 219 938	180 349	5 345 222	18 745 509

(cont.)

(in thousands of euro)

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	Up to 3 months	Over 3 months	No fixed maturity	Total
Liabilities				
Banknotes in circulation	–	–	4 666 799	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 660 676	–	–	5 660 676
Other liabilities to euro area credit institutions denominated in euro	11 871	–	–	11 871
Liabilities to other euro area residents denominated in euro	1 506 709	–	–	1 506 709
Liabilities to non-euro area residents denominated in euro	307 239	–	–	307 239
Liabilities to euro area residents denominated in foreign currency	153 351	–	–	153 351
Liabilities to non-euro area residents denominated in foreign currency	1 642 368	–	–	1 642 368
Intra-Eurosystem liabilities	3 833 540	–	–	3 833 540
Other liabilities	223 228	–	106 098	329 326
Total liabilities	13 338 982	–	4 772 897	18 111 879
Net position on balance sheet	–119 044	180 349	572 325	x
As at 31 December 2018				
Assets				
Gold and gold receivables	239 195	–	–	239 195
Claims on non-euro area residents denominated in foreign currency	3 566 027	–	–	3 566 027
Claims on euro area residents denominated in foreign currency	326 308	–	–	326 308
Claims on non-euro area residents denominated in euro	101 837	–	–	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	38 750	–	38 750
Other claims on euro area credit institutions denominated in euro	488	–	–	488
Securities of euro area residents denominated in euro	8 310 641	502 397	–	8 813 038
Intra-Eurosystem claims	4 897	–	4 947 883	4 952 780
Other assets	135 865	–	72 859	208 724
Total assets	12 685 258	541 147	5 020 742	18 247 147
Liabilities				
Banknotes in circulation	–	–	4 536 729	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 050 101	–	–	5 050 101
Other liabilities to euro area credit institutions denominated in euro	13 847	–	–	13 847
Liabilities to other euro area residents denominated in euro	1 449 237	–	–	1 449 237
Liabilities to non-euro area residents denominated in euro	16 524	–	–	16 524
Liabilities to euro area residents denominated in foreign currency	150 535	–	–	150 535
Liabilities to non-euro area residents denominated in foreign currency	115 284	–	–	115 284
Intra-Eurosystem liabilities	6 212 645	–	–	6 212 645
Other liabilities	149 424	–	102 453	251 877
Total liabilities	13 157 597	–	4 639 182	17 796 779
Net position on balance sheet	–472 339	541 147	381 560	x

30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
International institutions	5 207 114	5 240 794	27.8	28.7
European Central Bank	5 277 483	4 952 780	28.2	27.1
Central governments and other governmental institutions	3 945 280	3 864 866	21.0	21.2
Other financial institutions	3 126 037	3 147 598	16.7	17.2
Central banks and credit institutions	662 329	732 836	3.5	4.0
Non-financial corporations	246 393	88 566	1.3	0.5
Local governments	218 538	168 883	1.2	0.9
Unclassified assets	62 335	50 824	0.3	0.4
Total	18 745 509	18 247 147	100.0	100.0

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

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
International institutions	5 207 114	5 240 794	27.8	28.7
European Central Bank	5 277 483	4 952 780	28.2	27.1
Euro area countries	4 386 728	4 397 379	23.4	24.1
US	2 106 897	1 914 927	11.2	10.5
UK	658 809	600 132	3.5	3.3
Canada	595 578	569 508	3.2	3.1
Other European Union countries	168 590	174 396	0.9	1.0
Japan	86 384	118 417	0.5	0.6
Other countries	257 926	278 814	1.3	1.6
Total	18 745 509	18 247 147	100.0	100.0

32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2019	2018	2019	2018
European Central Bank	5 277 483	4 952 780	28.2	27.1
AAA	6 721 962	6 798 753	35.9	37.3
AA	4 119 413	4 026 575	22.0	22.1
A	1 866 878	1 889 665	10.0	10.4
BBB	378 991	376 603	2.0	2.1
Assets without counterparty credit rating	19 431	40 636	0.1	0.2
Assets not exposed to credit risk	361 351	162 135	1.8	0.8
Total	18 745 509	18 247 147	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 table show the breakdown of Latvijas Banka's assets as at the end of the reporting period. The rating

"AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" – the counterparty's strong capacity to meet its financial commitments in the long term. "BBB" is a medium grade considered to be the lowest level of investment-grade rating.

Assets without counterparty credit rating mostly comprise securities purchased in longer-term refinancing operations with Latvian credit institutions. Assets not exposed to credit risk mostly comprise securities in the equity securities portfolio, participating interest in the BIS, fixed assets and intangible assets.

PROFIT AND LOSS STATEMENT NOTES

33. NET INTEREST INCOME

	(in thousands of euro)	
	2019	2018
Interest income	198 804	180 907
Interest on investments	127 405	116 817
Interest on customer deposits	7 689	4 077
Interest on monetary policy operations	63 710	60 013
Interest expense	–102 858	–101 413
Interest on investments	–100 505	–98 771
Interest on monetary policy operations	–2 353	–2 642
Net interest income	95 946	79 494

Net interest income was mainly derived from debt securities investments in debt securities as well as interest income on monetary policy operations. In 2019, net interest income increased by 16 452 thousand euro in comparison with 2018. This was mainly a result of a higher average yield of securities and an increase in the amount of monetary policy operations. The costs of hedging currency risks continued to have a negative effect on net interest income in 2019, with the spreads between the interest rates of the euro and other investment currencies of Latvijas Banka remaining wide.

Interest income from and interest expense on the intra-Eurosystem claims and liabilities are remunerated by applying the ECB's interest rate on the main refinancing operations and include income from foreign reserves transferred to the ECB and claims on allocation of banknotes in the Eurosystem, as well as expense on liabilities related to TARGET2 settlements. The interest rate on the main refinancing operations set by the ECB was 0% in 2019 and 2018, therefore Latvijas Banka had neither such interest income nor interest expense.

According to the ECB Governing Council's decision on the allocation of monetary income for first six years following the euro changeover the remunerable part of euro area NCBs of the claims on banknote allocation in the Eurosystem is reduced in compliance with a definite coefficient to avoid significant income fluctuations of these NCBs. The adjustment of the reduction of the remunerable part of Latvijas Banka's claims on banknote allocation in the Eurosystem ended in 2019 and in the course of these six years was as follows:

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

In 2019, interest income on monetary policy operations mainly increased due to the implementation of the PSPP and larger negative interest received on deposits from the Government and other financial institutions.

The application of the interest on deposits is stipulated in the Guideline (EU) 2019/671 of the ECB of 9 April 2019 on domestic asset and liability management operations by the national central banks (recast) (ECB/2019/7).

34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	(in thousands of euro)	
	2019	2018
Derivative financial instruments	-19 903	-36 668
Debt securities	54 186	-25 306
Foreign exchange transactions	11 970	12 284
Total	46 253	-49 690

The result on derivative financial instruments posted an improvement of 16 765 thousand euro in comparison with 2018, mostly on account of a smaller negative result on interest rate future contracts due to a positive contribution from falling interest rates in the course of 2019, as well as the negative result on currency future contracts concluded for the purpose of hedging currency risk exposure, affected by the US dollar appreciation against the euro. The negative result of the currency future contracts concluded for the purpose of hedging currency risk exposure is offset in an equal value by the positive revaluation result of the balance sheet items hedged for foreign currency risk.

The result on the disposal of debt securities increased by 79 492 thousand euro in comparison with 2018, mostly due to a decrease in interest rates and disposal of securities held in the long-term fixed income securities portfolio.

In 2019 and 2018, the realised gains on foreign exchange transactions also included the recognition of the initial valuation account in profit and loss statement (see also Note 23). In 2019, the realised gains on foreign exchange transactions were positively affected by the appreciation of the US dollar against the euro.

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

	(in thousands of euro)	
	2019	2018
Securities	-3 280	-47 150
Interest rate swap arrangements	-431	-407
Foreign currency positions	-145	-346
Total	-3 856	-47 903

The revaluation result of several debt securities, foreign currency positions, and interest rate swap arrangements at the end of 2019 and 2018 was negative, and it has been

recognised in the profit and loss statement. At the end of 2019, net revaluation result on the equity securities portfolio was positive and has been reported under the balance sheet item "Capital and reserves" as the securities' revaluation result, whereas at the end of 2018, the total revaluation result on the equity securities portfolio was negative, and this was recognised in the profit and loss statement, while the positive result on the revaluation of debt securities, foreign currency positions, and interest rate swap arrangements has been reported under the balance sheet item "Capital and reserves" as the revaluation reserve of securities, foreign currency, and interest rate swap arrangements (see also Note 23).

The decrease in the negative result on revaluation of securities is related to a decrease in interest rates in Latvijas Banka's major investment markets in 2019, as well as the positive net revaluation result on the equity securities portfolio.

36. PROVISIONS FOR MARKET RISK AND CREDIT RISK

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

The financial risks for the gold portfolio, long-term fixed income securities portfolio, equity securities portfolio and Eurosystem monetary operations have been assessed in compliance with the ECB's common methodology for Eurosystem financial risk assessment using the Expected Shortfall (ES) measure with confidence level of 99% for a risk horizon of one year. ES99% describes the losses determined by the average value of 1% of the most unfavourable simulated profitability scenarios. The above methodology takes account of various market risk and credit risk factors as well as uses historical data and assumptions of the Eurosystem/ESCB's Risk Management Committee. ES99% includes assumptions concerning development of adverse financial market factors, e.g. interest rate rise, widening of the interest rate spreads, euro appreciation, and credit rating downgrades. Meanwhile, for the other portfolios financial risks have been assessed according to the change in the investment portfolio value if the interest rates rise by 100 basis points. According to the above methodology, the targeted amount of provisions for market risk and credit risk in 2019 was 310 000 thousand euro (190 000 thousand euro in 2018). In 2019, the increase in the targeted amount of provisions for market risk and credit risk resulted from inclusion of Eurosystem monetary operations in the risk assessment. Review of the targeted amount of provisions takes place on an annual basis taking into account the level of financial risks, the available financial reserves and long-term prospects of the financial market development.

Provisions for market risk and credit risk are established during a longer time period in the amount of 25%–75% of the positive total financial performance result included in the profit and loss statement of the reporting year before establishment of provisions for financial risks, not exceeding the targeted amount of provisions for financial risks. Provisions for market risk and credit risk are used, if the financial risks materialise and their negative result is not covered by other income or the balance of the provisions considerably exceed the targeted amount of the provisions.

In 2019, due to the above mentioned risk assessment, the Council of Latvijas Banka decided to increase the provisions for market risk and credit risk related to the financial investments managed by Latvijas Banka, by 80 218 thousand euro or a percentage of the positive total financial performance result included in the profit and loss statement before establishment of provisions for financial risks as laid down in the above-mentioned methodology (in 2018 the respective provisions were reduced by 55 576 thousand euro). In addition to the above, provisions for credit risk, associated with the Eurosystem monetary policy operations, in the amount of 288 thousand euro were reduced (370 thousand

euro increase in 2018); as a result, the total outstanding amount of provisions reached 203 900 thousand euro at the end of 2019 (123 970 thousand euro at the end of 2018).

37. INCOME FROM EQUITY SECURITIES AND PARTICIPATING INTEREST

Income from participating interest comprises dividends received from the participating interest in the BIS in the amount of 322 thousand euro (305 thousand euro in 2018; see also Note 14.2) and income from the ECB's interim profit distribution for the reporting year, the remainder of the ECB's annual profit of the previous year, and realised gains on a decrease in the participating interest in the ECB (see also Note 13.1) in the amount of 9910 thousand euro (5925 thousand euro in 2018; see also Note 2.26).

Income from equity securities comprises the accrued and received dividends of the equity securities portfolio in the amount of 4652 thousand euro (692 thousand euro in 2018). Income grew on account of higher dividends due to an increase in the equity securities portfolio.

38. NET RESULT OF POOLING OF MONETARY INCOME

	(in thousands of euro)	
	2019	2018
Monetary income pooled	-51 356	-50 208
Monetary income received	44 555	50 330
Net result of pooling of monetary income	-6 801	122

Net result of pooling monetary income decreased on account of smaller monetary income received, primarily due to redemptions of securities held for monetary policy purposes within the framework of the discontinued asset purchase programmes.

39. OTHER OPERATING INCOME

	(in thousands of euro)	
	2019	2018
Income from sale of collector coins	675	1 329
Revaluation of liabilities for the issued lats banknotes and coins	–	7 200
Other	625	741
Total	1 300	9 270

As a result of revaluation of liabilities for the issued lats banknotes and coins, income is recognised because the lats banknotes and coins, whose exchange probability is low, are not reported on the balance sheet pursuant to the "Financial Accounting Policy of Latvijas Banka" (see also Note 2.20). Reassessment of liabilities for the issued lats banknotes and coins is performed on an annual basis, taking into account the latest data on the exchange of lats banknotes and coins to euro banknotes and coins. In 2019, the valuation of liabilities for the issued lats banknotes and coins remained unchanged (see also Note 22.1).

40. REMUNERATION, SOCIAL SECURITY COSTS, AND SOLIDARITY TAX

(in thousands of euro)

	2019	2018
Remuneration		
Remuneration for performance of duties of the Council and the Board	-984	-880
Remuneration of other personnel	-16 676	-16 635
Total remuneration	-17 660	-17 515
Social security costs and solidarity tax	-3 941	-4 031
Total remuneration, social security costs, and solidarity tax	-21 601	-21 546

At the end of 2019, the number of employees was 479 (498 at the end of 2018), representing 465 full-time equivalents in 2019 (496 in 2018).

41. BANKNOTE AND COIN ACQUISITION COSTS

(in thousands of euro)

	2019	2018
Acquisition of banknotes	-1 140	-1 271
Acquisition of collector coins	-363	-752
Acquisition of circulation coins	-288	-81
Total	-1 791	-2 104

42. OTHER OPERATING EXPENSES

(in thousands of euro)

	2019	2018
Maintenance and operation of information systems	-3 850	-3 773
Disposal of material values	-1 695	-529
Municipal services	-734	-830
Maintenance of buildings, territory and equipment	-621	-615
Business travel	-462	-440
Information and public relations	-245	-319
Tax on real estate	-226	-228
Personnel training	-225	-256
Acquisition of low value office supplies	-225	-173
Risk insurance	-217	-151
Telecommunication services and system maintenance	-183	-243
Event services	-151	-170
Transport provision	-53	-80
Other	-338	-426
Total	-9 225	-8 233

Other operating expenses also comprise remuneration in the amount of 29 thousand euro paid to KPMG Baltics AS for the audit of 2019 financial statements of Latvijas Banka (29 thousand euro in 2018 to KPMG Baltics SIA). Expenses on disposal of material values comprise the write-off of the residual book value of capital investment in the building of the Liepāja Branch of Latvijas Banka in the amount of 1401 thousand euro due to the closure of the said Branch. The building of the Liepāja Branch of Latvijas Banka is to be transferred in the possession of the Ministry of Finance of the Republic of Latvia without any compensation (see also Note 43).

OTHER NOTES

43. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

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

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

Pursuant to Guideline (EU) 2019/671 of the ECB of 9 April 2019 on domestic asset and liability management operations by the national central banks (recast) (ECB/2019/7), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of both 2019 and 2018 (−0.446% and −0.356% respectively)) to the amount of the Treasury's deposits in euro up to 200 million euro. As regards the total outstanding amount of the Treasury's settlement accounts in euro and foreign currencies exceeding 200 million euro, by 30 September 2019 Latvijas Banka applied the deposit facility rate set by the ECB, but as of 1 October 2019 the lower of the following rates: the ECB's deposit facility rate or the euro overnight index average (EONIA) rate (the ECB's deposit facility rate was negative at the end of both 2019 and 2018 at −0.50% and −0.40% respectively).

At the end of 2019 and 2018, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	(in thousands of euro)	
	2019	2018
Claims		
Securities held for monetary policy purposes	1 447 653	1 186 436
Other securities	47 057	46 990
Accrued interest on debt securities	17 485	13 220
Total claims	1 512 195	1 246 646
Liabilities		
Demand deposits in euro	442 044	129 113
Demand deposits in foreign currencies	153 351	150 535
Tax liabilities	13	66
Total liabilities	595 408	279 714

In 2019 and 2018, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 22.2 and 23):

	(in thousands of euro)	
	2019	2018
Income (–)/expense and Latvijas Banka's profit appropriated to the state budget		
Interest on debt securities	–10 381	–7 466
Negative interest on government deposits	–2 478	–544
Taxes	10 435	10 513
Profit appropriated to the state budget	10 196	15 524
Disposal of the real estate	1 401	484
Total net expense and Latvijas Banka's profit appropriated to the state budget	9 173	18 511

Expenses on disposal of real estate comprise the transfer of the real estate of the Liepāja Branch of Latvijas Banka (decision on its closure was made in 2019) and that of the Training Centre of Latvijas Banka closed in 2018 in the possession of the Ministry of Finance without any compensation pursuant to the Law on Public Entity's Property Disposal.

44. PLEDGED ASSETS

Debt securities, gold and other financial instruments purchased by Latvijas Banka with the market value of 1 977 786 thousand euro, as at the end of 2019 (137 040 thousand euro at the end of 2018), have been pledged to provide repurchase agreement deals, collateral for gold swap arrangements, forward exchange rate contracts, interest rate and currency future contracts, and to ensure payment system operation. At the end of 2019, the pledged assets mostly consisted of securities pledged under repurchase agreements in the amount of 1 670 109 thousand euro (0 at the end of 2018).

45. SECURITIES LENDING

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

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

At the end of 2019, the fair value of the securities lent, determined using quoted prices in an active market, was 1460 thousand euro (27 886 thousand euro at the end of 2018); inter alia, the fair value of securities purchased and lent under the PSPP stood at 16 thousand euro at the end of 2019 (14 824 thousand euro at the end of 2018).

Foreign currency cash or securities received in the agent account of Latvijas Banka's automated security lending programme as collateral for securities lending transactions is not recognised in Latvijas Banka's balance sheet (see also Note 2.12).

46. CONTINGENT LIABILITIES AND COMMITMENTS

The uncalled portion of the BIS shares held by Latvijas Banka is 75% of their nominal value; these shares are callable following a respective decision of the BIS Board. At the end of 2019, the uncalled portion of the BIS shareholding was 4012 thousand SDR

(4951 thousand euro; 4012 thousand SDR (4877 thousand euro) at the end of 2018; see also Note 14.2).

At the end of 2019, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 6960 thousand euro (6878 thousand euro at the end of 2018). These coins may be represented to Latvijas Banka at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

At the end of 2019, Latvijas Banka had issued lats banknotes and coins with the face value of 122 174 thousand euro (124 514 thousand euro at the end of 2018), reported on the balance sheet in the amount of 26 574 thousand euro (28 915 thousand euro at the end of 2018). Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited. In the opinion of the management of Latvijas Banka, the probability that Latvijas Banka would be required to exchange lats banknotes and coins in the amount of 95 600 thousand euro (95 600 thousand euro at the end of 2018) at face value, is low.

From 19 February 2018 to 25 February 2019, a prohibition to execute the functions of decision-making, control and supervision in Latvijas Banka was imposed on Ilmārs Rimšēvičs, Governor of Latvijas Banka. Pursuant to the Judgement of the European Court of Justice of 26 February 2019 in the Joined Cases C-202/18 and C-238/18, the above prohibition was annulled and Ilmārs Rimšēvičs, Governor of Latvijas Banka, resumed his duties as the Governor of Latvijas Banka on 26 February 2019. Ilmārs Rimšēvičs' term of office as the Governor of Latvijas Banka expired on 20 December 2019, and Mārtiņš Kazāks became Governor of Latvijas Banka on 21 December 2019. According to Latvijas Banka's management, the factors associated with Ilmārs Rimšēvičs, former Governor of Latvijas Banka, had no effect on the financial position of Latvijas Banka and its financial performance results and will have no future effect either.

47. EVENTS AFTER THE REPORTING PERIOD

As a result of the departure of the UK from the EU on 30 January and the withdrawal of the Bank of England from the ESCB, the weightings of the remaining NCBs in the key for subscription to the ECB's capital were adjusted with effect from 1 February 2020. The Bank of England's share in the ECB's subscribed capital (14.3374%) was reallocated among other NCBs; hence the capital key of Latvijas Banka increased from 0.2731% to 0.3169%. The total subscribed capital of the ECB remained unchanged at 10.8 billion euro; therefore, the share of Latvijas Banka in the ECB's subscribed capital increased by 4742 thousand euro, to 34 305 thousand euro.

Proceeding with the implementation of cost efficiency improvement measures, inter alia upgrading the cash processing equipment of the Riga Branch and centralising the cash circulation process, in 2019 Latvijas Banka decided to close its Liepāja Branch as of 30 January 2020, with services to customers being provided until 30 December 2019. As a consequence, the number of employees of Latvijas Banka decreased from 479 employees at the end of 2019 to 448 employees on 30 January 2020.

TO THE COUNCIL OF LATVIJAS BANKA

Our Opinion on the Financial Statements

We have audited the accompanying financial statements of Latvijas Banka ("the Bank") set out on pages 71 to 119, which comprise:

- the balance sheet as at 31 December 2019,
- the profit and loss statement for the year then ended,
- the statement of total recognised gains and losses for the year then ended,
- the notes to the financial statements, which include a summary of principal accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Latvijas Banka as at 31 December 2019, and of its financial performance for the year then ended in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the Law on Latvijas Banka governing financial reporting.

Basis for Opinion

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

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

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

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

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

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

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

Auditors' Responsibility for the Audit of the Financial Statements

Our audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or

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

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

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

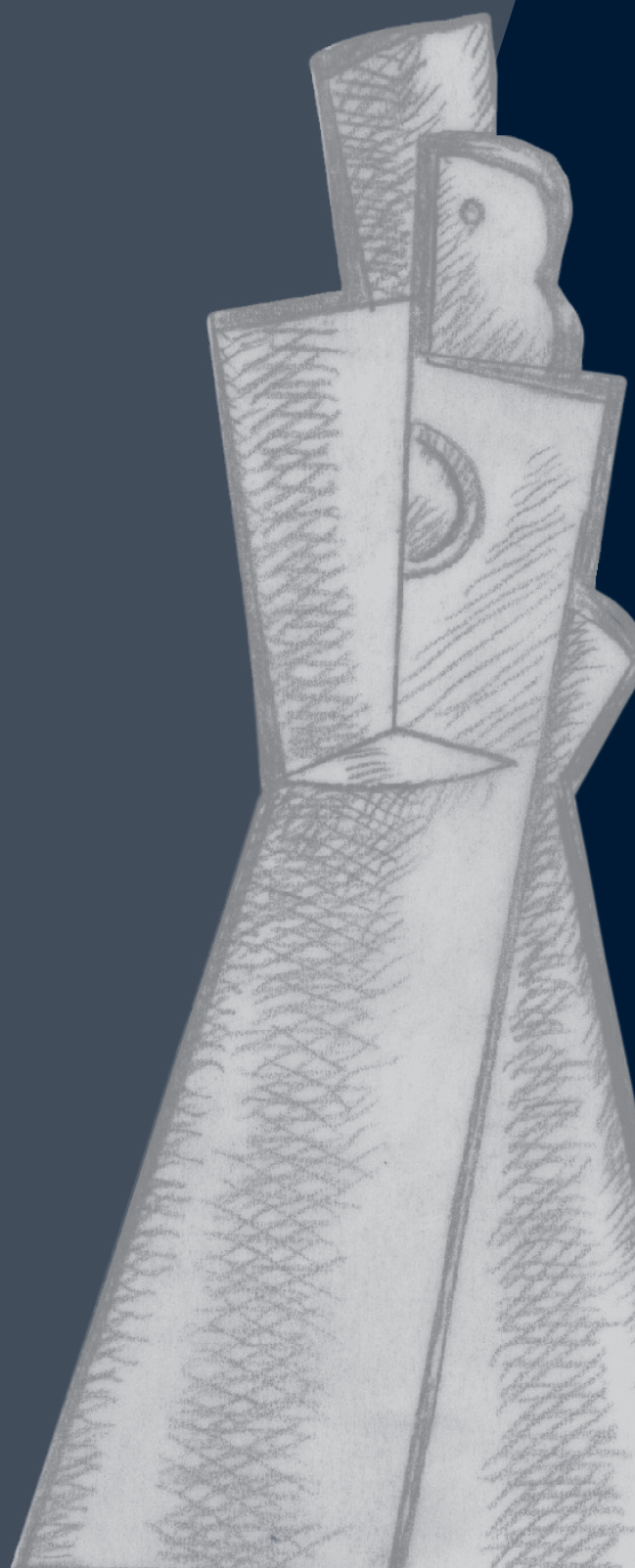
We communicate with those charged with the Bank's governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG Baltics AS
Licence No. 55

Rainers Vilans
Partner
Latvian Certified Auditor
Certificate No. 200
Riga, Latvia

27 February 2020

APPENDICES



MONETARY INDICATORS IN 2019

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
LATVIJAS BANKA												
Latvia's contribution to the euro area monetary base	9 060.4	9 053.6	8 836.0	8 962.2	8 759.2	8 984.8	9 239.9	9 279.6	9 508.9	9 744.2	9 711.0	10 433.6
Currency in circulation	4 464.5	4 472.1	4 490.9	4 539.0	4 547.2	4 577.1	4 616.6	4 619.1	4 627.6	4 649.6	4 673.0	4 772.9
Current accounts (covering the minimum reserve system)	4 595.9	4 581.5	4 345.1	4 423.2	4 212.0	4 407.7	4 623.3	4 660.5	4 881.3	5 094.6	5 038.0	5 660.7
Foreign assets outside the euro area	4 086.4	4 127.1	4 158.6	4 175.9	4 170.2	4 165.8	4 368.0	4 395.1	4 434.5	4 409.7	4 465.5	4 320.7
Foreign liabilities outside the euro area	241.2	305.6	756.8	1 508.2	1 567.0	1 713.5	1 714.2	1 922.8	2 029.2	1 993.8	1 985.3	1 949.6
Credit	9 219.6	9 218.2	9 231.0	9 257.8	9 259.3	9 120.5	9 161.5	9 041.4	9 055.4	9 126.3	9 137.7	9 198.7
To MFIs in the euro area	266.4	276.8	282.7	279.1	275.2	265.5	270.4	263.7	241.9	263.2	303.5	309.8
To the general government sector in the euro area	2 290.3	2 276.2	2 283.4	2 310.9	2 340.6	2 208.8	2 243.2	2 118.7	2 150.1	2 192.3	2 196.3	2 243.2
To other euro area residents	6 662.9	6 665.2	6 664.9	6 667.8	6 643.5	6 646.2	6 647.9	6 659.0	6 663.4	6 670.8	6 637.9	6 645.7
MFI												
Overnight deposits (Latvia's contribution to M1 of the euro area)	12 291.8	12 332.6	12 503.1	12 501.7	12 446.7	12 529.9	12 680.5	12 777.0	12 447.9	12 668.7	12 714.4	13 035.4
Deposits with an agreed maturity of up to 2 years	1 260.5	1 269.2	1 231.5	1 237.9	1 253.5	1 258.7	1 370.1	1 427.5	1 288.1	1 326.6	1 260.9	1 464.9
Deposits redeemable at notice of up to 3 months	948.0	954.2	949.6	945.2	950.9	952.5	953.5	961.3	964.4	957.1	962.9	969.8
Latvia's contribution to M2 of the euro area	14 500.3	14 556.0	14 684.2	14 684.8	14 651.1	14 741.1	15 004.1	15 165.8	14 700.4	14 952.4	14 938.2	15 470.1
Money market fund shares and units	0	0	0	0	0	0	0	0	0	0	0	0
Debt securities with a maturity of up to 2 years	-12.3	-13.1	-8.7	-8.7	-38.8	-38.7	-38.8	-38.9	-38.9	-39.7	-9.8	-9.6
Latvia's contribution to M3 of the euro area	14 488.0	14 542.9	14 675.5	14 676.1	14 612.3	14 702.4	14 965.3	15 126.9	14 661.5	14 912.7	14 928.4	15 460.5
Net foreign assets outside the euro area	2 704.5	2 899.4	2 873.3	2 137.0	2 319.6	2 231.6	2 465.6	2 416.0	2 139.9	2 107.2	2 311.0	2 222.5
Credit to euro area financial institutions, non-financial corporations and households	13 341.2	13 312.7	13 263.5	13 347.8	13 468.6	13 397.5	13 416.3	13 478.8	13 434.5	13 463.9	13 340.6	13 089.1
Loans to resident financial institutions, non-financial corporations and households	11 922.0	11 870.0	11 879.1	11 922.4	12 048.1	11 982.3	11 985.9	12 046.0	12 015.6	12 058.1	11 956.8	11 684.6
Deposits by resident financial institutions, non-financial corporations and households	12 137.2	12 151.8	12 247.6	12 236.0	12 100.7	12 186.9	12 557.8	12 760.1	12 373.2	12 562.6	12 536.4	13 031.1
INTEREST RATES												
Interest rate on the main refinancing operations (at end of period; %)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Weighted average interest rates on transactions in euro (%)												
Interbank loans	-0.38	-0.40	-0.40	-0.38	-0.40	-0.40	-0.38	-0.40	-0.41	-0.44	-0.50	-0.50
Loans to non-financial corporations and households with a floating interest rate and an initial rate fixation of up to 1 year (new business)	2.6	2.6	2.9	3.4	3.3	3.2	3.6	3.0	2.8	3.4	3.6	3.3
Time deposits by non-financial corporations and households (new business)	0.2	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.1	0.3

MONTH-END BALANCE SHEETS OF LATVIJAS BANKA FOR 2019

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
ASSETS	18 211 871	18 238 678	18 273 052	18 873 359	18 406 597	18 316 210	18 562 255	18 521 585	18 598 935	18 641 181	18 701 848	18 745 509
Gold and gold receivables	245 824	247 758	246 792	244 447	248 480	265 080	274 332	295 095	290 986	288 396	282 517	289 043
Claims on non-euro area residents denominated in foreign currency	3 610 119	3 638 144	3 666 508	3 679 448	3 677 815	3 652 840	3 790 008	3 802 948	3 827 752	3 757 076	3 816 759	3 688 972
Receivables from the IMF	147 280	147 932	149 298	149 249	149 271	147 580	149 046	149 807	151 100	149 433	150 858	149 082
Balances with credit institutions and security investments, external loans and other external assets	3 462 839	3 490 212	3 517 210	3 530 199	3 528 544	3 505 260	3 640 962	3 653 141	3 676 652	3 607 643	3 665 901	3 539 890
Claims on euro area residents denominated in foreign currency	350 216	366 202	374 254	366 967	370 166	365 380	371 256	398 555	396 224	422 591	452 240	460 415
Claims on non-euro area residents denominated in euro	102 336	105 414	106 806	107 675	105 501	105 668	111 065	108 273	120 763	123 587	114 074	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	38 750	38 750	38 750	38 750	38 750	32 250	32 250	32 250	12 250	12 250	12 250	12 250
Longer-term refinancing operations	38 750	38 750	38 750	38 750	38 750	32 250	32 250	32 250	12 250	12 250	12 250	12 250
Other claims on euro area credit institutions denominated in euro	2 146	2 121	3 154	5 591	571	431	1 386	74	2 517	1 416	715	8
Securities of euro area residents denominated in euro	8 826 288	8 808 822	8 812 366	8 843 992	8 847 337	8 719 947	8 753 026	8 606 886	8 640 651	8 685 383	8 667 625	8 721 137
Securities held for monetary policy purposes	7 432 731	7 419 793	7 422 148	7 459 538	7 461 176	7 491 418	7 519 212	7 539 815	7 575 300	7 626 213	7 595 821	7 636 472
Other securities	1 393 557	1 389 029	1 390 218	1 384 454	1 386 161	1 228 529	1 233 814	1 067 071	1 065 351	1 059 170	1 071 804	1 084 665
Intra-Eurosystem claims	4 849 166	4 851 097	4 849 617	5 435 305	4 958 266	4 981 380	5 059 958	5 100 746	5 139 362	5 164 368	5 189 376	5 277 483
Participating interest in the ECB	114 108	111 351	111 351	111 351	111 351	111 351	111 351	111 351	111 351	111 351	111 351	114 108
Claims equivalent to the transfer of foreign reserves to the ECB	158 264	158 264	158 264	158 264	158 264	158 264	158 264	158 264	158 264	158 264	158 264	158 264
Claims related to other operational requirements within the Eurosystem	4 576 794	4 581 482	4 580 002	5 165 690	4 688 651	4 711 765	4 790 343	4 831 131	4 869 747	4 894 753	4 919 761	5 005 111
Other assets	187 026	180 370	174 805	151 184	159 711	193 234	168 974	176 758	168 430	186 114	166 292	206 062

Appendix 2 (cont.)

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
LIABILITIES	18 211 871	18 238 678	18 273 052	18 873 359	18 406 597	18 316 210	18 562 255	18 521 585	18 598 935	18 641 181	18 701 848	18 745 509
Banknotes in circulation	4 363 252	4 370 894	4 390 060	4 437 347	4 444 513	4 473 956	4 512 991	4 515 222	4 527 390	4 543 427	4 567 029	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 595 903	4 581 500	4 345 123	4 423 214	4 211 967	4 407 739	4 623 327	4 660 480	4 881 253	5 094 610	5 038 027	5 660 676
Current accounts (covering the minimum reserve system)	4 595 903	4 581 500	4 345 123	4 423 214	4 211 967	4 407 739	4 623 327	4 660 480	4 881 253	5 094 610	5 038 027	5 660 676
Other liabilities to euro area credit institutions denominated in euro	9 519	9 725	9 598	9 639	10 402	14 805	9 631	11 161	192 729	218 205	277 761	11 871
Liabilities to other euro area residents denominated in euro	1 383 158	1 489 102	1 410 775	1 556 904	2 078 308	2 408 083	2 411 772	2 286 825	2 121 973	2 082 807	1 869 379	1 506 709
General government	83 555	176 214	110 119	255 092	781 941	1 116 290	1 118 564	1 089 365	1 010 781	993 435	792 417	442 044
Other liabilities	1 299 603	1 312 888	1 300 656	1 301 812	1 296 367	1 291 793	1 293 208	1 197 460	1 111 192	1 089 372	1 076 962	1 064 665
Liabilities to non-euro area residents denominated in euro	2 116	3 056	190 926	250 700	276 818	327 861	308 510	407 851	385 379	383 859	303 544	307 239
Liabilities to euro area residents denominated in foreign currency	148 262	207 176	209 181	211 881	210 390	207 383	212 983	219 333	243 989	249 577	160 316	153 351
Liabilities to non-euro area residents denominated in foreign currency	239 108	302 567	565 836	1 257 462	1 290 206	1 385 667	1 405 705	1 514 901	1 643 787	1 609 934	1 681 803	1 642 368
Intra-Eurosystem liabilities	6 749 255	6 527 663	6 338 947	5 436 486	5 082 760	4 235 830	4 167 903	3 932 718	3 628 366	3 511 612	3 834 832	3 833 540
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	6 749 255	6 527 663	6 338 947	5 436 486	5 082 760	4 235 830	4 167 903	3 932 718	3 628 366	3 511 612	3 834 832	3 826 452
Liabilities related to other operational requirements within the Eurosystem	—	—	—	—	—	—	—	—	—	—	—	7 088
Other liabilities	247 253	251 515	275 726	764 416	251 697	245 442	272 784	267 040	273 108	253 013	267 671	329 326
Capital and reserves	474 045	495 480	536 880	525 310	549 536	609 444	636 649	706 054	700 961	694 137	701 486	633 630

YEAR-END BALANCE SHEETS OF LATVIJAS BANKA FOR THE YEARS 2015–2019

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

	2015	2016	2017	2018	2019
ASSETS	11 118 687	14 772 305	17 498 642	18 247 147	18 745 509
Gold and gold receivables	207 670	234 305	230 856	239 195	289 043
Claims on non-euro area residents denominated in foreign currency	2 949 979	3 092 076	3 608 692	3 566 027	3 688 972
Receivables from the IMF	153 780	153 992	143 477	146 833	149 082
Balances with banks and security investments, external loans and other external assets	2 796 199	2 938 084	3 465 215	3 419 194	3 539 890
Claims on euro area residents denominated in foreign currency	541 073	358 839	355 065	326 308	460 415
Claims on non-euro area residents denominated in euro	169 490	144 564	101 333	101 837	90 139
Lending to euro area credit institutions related to monetary policy operations denominated in euro	263 730	257 160	244 660	38 750	12 250
Longer-term refinancing operations	263 730	257 160	244 660	38 750	12 250
Other claims on euro area credit institutions denominated in euro	2 491	9 071	438	488	8
Securities of euro area residents denominated in euro	3 015 433	6 319 754	8 131 197	8 813 038	8 721 137
Securities held for monetary policy purposes	1 808 374	4 357 306	6 719 984	7 423 080	7 636 472
Other securities	1 207 059	1 962 448	1 411 213	1 389 958	1 084 665
Intra-Eurosystem claims	3 802 596	4 195 918	4 604 114	4 952 780	5 277 483
Participating interest in the ECB	115 082	115 082	115 082	115 082	114 108
Claims equivalent to the transfer of foreign reserves to the ECB	163 480	163 480	163 480	163 480	158 264
Claims related to other operational requirements within the Eurosystem	3 524 034	3 917 356	4 325 552	4 674 218	5 005 111
Other assets	166 225	160 618	222 287	208 724	206 062

Appendix 3 (cont.)

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

	2015	2016	2017	2018	2019
LIABILITIES	11 118 687	14 772 305	17 498 642	18 247 147	18 745 509
Banknotes in circulation	3 992 436	4 150 106	4 314 088	4 536 729	4 666 799
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 784 410	4 191 147	5 712 980	5 050 101	5 660 676
Current accounts (covering the minimum reserve system)	4 784 410	4 191 147	5 712 980	5 050 101	5 660 676
Other liabilities to euro area credit institutions denominated in euro	8 830	720	22 610	13 847	11 871
Liabilities to other euro area residents denominated in euro	145 894	212 239	215 712	1 449 237	1 506 709
General government	38 055	46 710	29 516	129 113	442 044
Other liabilities	107 839	165 529	186 196	1 320 124	1 064 665
Liabilities to non-euro area residents denominated in euro	9 099	17 888	2 535	16 524	307 239
Liabilities to euro area residents denominated in foreign currency	155 228	159 844	144 324	150 535	153 351
Liabilities to non-euro area residents denominated in foreign currency	478	—	634	115 284	1 642 368
Intra-Eurosystem liabilities	1 312 104	5 292 395	6 339 683	6 212 645	3 833 540
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	1 312 104	5 292 395	6 339 683	6 212 645	3 826 452
Liabilities related to other operational requirements within the Eurosystem	—	—	—	—	7 088
Other liabilities	258 853	294 614	305 552	251 877	329 326
Capital and reserves	451 355	453 352	440 524	450 368	633 630

PROFIT AND LOSS STATEMENTS OF LATVIJAS BANKA FOR THE YEARS 2015–2019

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

	2015	2016	2017	2018	2019
Net interest income	44 953	56 801	71 498	79 494	95 946
Interest income	64 696	102 982	138 189	180 907	198 804
Interest expense	–19 743	–46 181	–66 691	–101 413	–102 858
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions	–11 717	–100 590	–28 175	–42 387	–37 821
Realised gains arising from financial operations	37 216	38 539	33 292	–49 690	46 253
Recognition of revaluation result on financial assets and positions in profit and loss statement	–13 633	–52 729	–18 791	–47 903	–3 856
Provisions for market risk and credit risk	–35 300	–86 400	–42 676	55 206	–80 218
Net expense from fees and commissions	–1 388	–2 200	–3 087	–2 783	–3 607
Fees and commissions income	422	396	397	644	811
Fees and commissions expense	–1 810	–2 596	–3 484	–3 427	–4 418
Income from participating interest	4 157	5 242	5 258	6 922	14 884
Net result of pooling of monetary income	25 675	10 834	3 651	122	–6 801
Other operating income	1 762	81 051	12 382	9 270	1 300
NET INCOME	63 442	51 138	61 527	50 638	63 901
Remuneration	–16 932	–17 184	–17 616	–17 515	–17 660
Social security costs and solidarity tax	–3 518	–3 852	–3 962	–4 031	–3 941
Banknote and coin acquisition costs	–1 955	–7 283	–4 542	–2 104	–1 791
Depreciation of fixed assets and amortisation of intangible assets	–3 722	–3 755	–3 750	–4 189	–4 129
Other operating expenses	–7 278	–7 291	–7 773	–8 233	–9 225
PROFIT OF THE REPORTING YEAR	30 037	11 773	23 884	14 566	27 155
Profit transferrable to the reserve capital	10 512	4 120	8 359	4 370	8 146
Profit transferrable to the state budget	19 525	7 653	15 525	10 196	19 009

ORGANISATIONAL UNITS OF LATVIJAS BANKA AT THE END OF 2019

1. CASH DEPARTMENT
 - 1.1 Cash Operations Division
 - 1.2 Coin Division
 - 1.3 Cash Technology Division
 - 1.4 Riga Branch
 - 1.5 Liepāja Branch¹
2. FINANCE DEPARTMENT
 - 2.1 Financial Statements and Accounting Policy Division
 - 2.2 Internal Banking Operations Division
3. FINANCIAL STABILITY DEPARTMENT
 - 3.1 Financial Stability Division
4. INFORMATION SYSTEMS DEPARTMENT
 - 4.1 System Design and Programming Division
 - 4.2 Computer Network and Server Systems Division
 - 4.3 Bank Information System Maintenance and Development Division
 - 4.4 Information Systems Security Division
 - 4.5 Information Systems Quality Assurance Division
 - 4.6 Systems Maintenance Division
5. INTERNAL AUDIT DEPARTMENT
6. INTERNATIONAL RELATIONS AND COMMUNICATION DEPARTMENT
 - 6.1 Document Management and Library Division
 - 6.2 Publications Division
 - 6.3 Public Relations Division
 - 6.4 International Relations and Protocol Division
7. LEGAL DEPARTMENT
8. MARKET OPERATIONS DEPARTMENT
 - 8.1 Trading and Investment Division
 - 8.2 Risk Management Division
9. MONETARY POLICY DEPARTMENT
 - 9.1 Macroeconomic Analysis Division
 - 9.2 Financial Market Analysis Division
 - 9.3 Monetary Research and Forecasting Division
10. OPERATIONAL RISK MANAGEMENT DEPARTMENT
11. PAYMENT SYSTEMS DEPARTMENT
 - 11.1 Payment Systems Policy Division
 - 11.2 Payment Systems Operations Division
 - 11.3 Payment and Settlement Division
 - 11.4 Credit Register Division
12. PERSONNEL DEPARTMENT
13. SECURITY DEPARTMENT
 - 13.1 Analytical Unit
 - 13.2 Armament Unit
 - 13.3 Central Division
 - 13.4 Riga Division

¹ The Liepāja Branch of the Cash Department has been closed as of 30 January 2020.

*Appendix 5 (cont.)*13.5 Liepāja Division¹

14. STATISTICS DEPARTMENT

14.1 Data Management Division

14.2 Statistics Compilation Division

14.3 Statistics Development Division

15. TECHNICAL SUPPORT DEPARTMENT

15.1 General Service Division

15.2 Building Systems Division

15.3 Security Systems Division

¹ The Liepāja Division of the Security Department has been closed as of 30 January 2020.

**PARTICIPATION OF LATVIJAS BANKA IN THE EUROSISTEM AND
THE EUROPEAN SYSTEM OF CENTRAL BANKS**

Governing Council of the ECB

General Council of the ECB

Supervisory Board of the ECB

Accounting and Monetary Income Committee (AMICO)

Banknote Committee (BANCO)

Budget Committee (BUCOM)

Committee on Controlling (COMCO)

Eurosistem/ESCB Communications Committee (ECCO)

Financial Stability Committee (FSC)

Human Resources Conference (HRC)

Information Technology Committee (ITC)

Internal Auditors Committee (IAC)

International Relations Committee (IRC)

Legal Committee (LEGCO)

Market Infrastructure and Payments Committee (MIPC)

Market Operations Committee (MOC)

Monetary Policy Committee (MPC)

Organisational Development Committee (ODC)

Risk Management Committee (RMC)

Statistics Committee (STC)

REPRESENTATION OF LATVIJAS BANKA IN INTERNATIONAL ORGANISATIONS

EUROPEAN UNION

Advisory Technical Committee of the ESRB
Board of Supervisors of the EBA
Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)
EFC's Euro Coin Sub-Committee (ECSC)
EFC's Sub-Committee on IMF and Related Issues (SCIMF)
EC Public Administration Network (PAN II)
Economic and Financial Committee for the Council of the EU (EFC)
ESRB
Permanent Representation of Latvia to the EU

INTERNATIONAL MONETARY FUND

Board of Governors
Nordic-Baltic IMF Office in Washington
Nordic-Baltic Monetary and Financial Committee (NBMFC)
Alternates of Nordic-Baltic Monetary and Financial Committee (NBMFC Alternates)

BANK FOR INTERNATIONAL SETTLEMENTS

Irving Fisher Committee on Central Bank Statistics

Appendix 8

LATVIJAS BANKA PUBLICATIONS AND MAJOR PUBLICATIONS BY THE EXPERTS OF LATVIJAS BANKA IN 2019

The following Latvijas Banka publications are available on Latvijas Banka website (www.bank.lv).

REGULAR PUBLICATIONS AND SERIAL PUBLICATIONS

Financial Stability Report. 2019

Latvijas Banka: Annual Report 2018

Latvijas Maksājumu Bilance. Latvia's Balance of Payments. 2018

Macroeconomic Developments Report (June and December; No. 29 and 30, 2019)

WORKING PAPERS

SILIVERSTOVS, Boriss (2019). *Assessing Nowcast Accuracy of US GDP Growth in Real Time: The Role of Booms and Busts.* Latvijas Banka Working Paper, No. 1. 42 p.

ZLOBINS, Andrejs (2019). *Country-Level Effects of the ECB's Expanded Asset Purchase Programme.* Latvijas Banka Working Paper, No. 2. 31 p.

ZLOBINS, Andrejs (2019). *Macroeconomic Effects of the ECB's Forward Guidance.* Latvijas Banka Working Paper, No. 3. 21 p.

AJEVSKIS, Viktors (2019). *Generalised Impulse Response Function as a Perturbation of a Global Solution to DSGE Models.* Latvijas Banka Working Paper, No. 4. 17 p.

DISCUSSION PAPERS

VILERTS, Kārlis, ZUTIS, Klāvs, BEŅKOVSKIS, Konstantīns (2019). *Factors Determining Municipal Spending Differences in Latvia.* Latvijas Banka Discussion Paper, No. 1. 38 p.

KRASNOPJOROVS, Oļegs (2019). *Anatomy of Labour Reserves in the Baltic Countries: A Snapshot 15 years After the EU Accession.* Latvijas Banka Discussion Paper, No. 2. 71 p.

BEŅKOVSKIS, Konstantīns, TKAČEVŠ, Oļegs (2019). *Getting Old Is No Picnic? Sector-Specific Relationship Between Workers Age and Firm Productivity.* Latvijas Banka Discussion Paper, No. 3. 24 p.

PUBLICATIONS

BABECKÝ, Jan, BERSON, Clémence, FADEJEVA, Ludmila, LAMO, Ana, MAROTZKE, Petra, MARTINS, Fernando, STRZELECKI, Paweł (2019). Non-base Wage Components as a Source of Wage Adaptability to Shocks: Evidence from European Firms, 2010–2013. *IZA Journal of Labor Policy*, Springer, No. (2019)8:1, January 2019. 30 p.

BEŅKOVSKIS, Konstantīns, BLUHM, Benjamin, BOBEICA, Elena, OSBAT, Chiara, ZEUGNER, Stefan (2019). What Drives Export Market Shares? It Depends! An Empirical Analysis Using Bayesian Model Averaging. *Empirical Economics*, published online 18 July 2019. <https://link.springer.com/article/10.1007/s00181-019-01727-z>.

BEŅKOVSKIS, Konstantīns, TKAČEVŠ, Oļegs, YASHIRO, Naomitsu (2019). Importance of EU Regional Support Programmes for Firm Performance. *Economic Policy, Oxford Academic*, vol. 34, issue 98, April 2019, pp. 267–313.

Appendix 8 (cont.)

KRASNOPJOROVŠ, Oļegs (2019). *Why Is Education Performance so Different across Latvian Schools? Economics of Transition and Institutional Change*. Wiley, published online 19 April 2019. <https://onlinelibrary.wiley.com/doi/abs/10.1111/ecot.12227>.

SILIVERSTOVŠ, Boriss (2019). Assessing Nowcast Accuracy of US GDP Growth in Real Time: The Role of Booms and Busts. *Empirical Economics*, Springer, vol. 58, pp. 7–27(2020), published online 17 May 2019. <https://link.springer.com/article/10.1007/s00181-019-01704-6>.

SILIVERSTOVŠ, Boriss, KANCS, d'Artis (2019). Employment Effect of Innovation. *Empirical Economics*, Springer, published online 17 June 2019. <https://link.springer.com/article/10.1007/s00181-019-01712-6>.

SILIVERSTOVŠ, Boriss, WOCHNER, Daniel (2019). *Recessions as Breadwinner for Forecasters – State-dependent Evaluation of Predictive Ability: Evidence from big Macroeconomic Data*. KOF Working Papers, No. 19-463, KOF Swiss Economic Institute, ETH Zurich. 42 p.

TKAČEVŠ, Oļegs, VILERTS, Kārlis (2019). The Impact of Government Borrowing Costs on Fiscal Discipline. *Kyklos. Wiley*, vol. 72, issue 3, August 2019, pp. 446–471.

HIGHLIGHTS OF EUROSISTEM'S MONETARY POLICY AND OTHER IMPORTANT TASKS IN 2019

On 9 January, the Governing Council of the ECB approved the entry of the ECB into a multilateral agreement on the practical modalities for the exchange of information between the ECB and the competent anti-money laundering and combating the financing of terrorism authorities of EEA Member States.

On 24 January, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged (0.00%, 0.25% and -0.40% respectively), expecting the key ECB interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
- 2) to continue reinvesting, in full, the principal payments from maturing securities purchased under APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 25 January, the Governing Council of the ECB adopted Decision ECB/2019/3 on the Market Infrastructure Board and repealing Decision ECB/2012/6 on the establishment of the TARGET2-Securities Board.

On 14 February, the Governing Council of the ECB approved the publication of a report presenting the results of a qualitative stock-taking questionnaire on the ESCB Integrated Reporting Framework and amendments accordingly made to related ECB webpages, in particular those for the Banks' Integrated Reporting Dictionary and the Integrated Reporting Framework (The ESCB's long-term approach to banks' data reporting).

On 22 February, the Governing Council of the ECB took note of the impact assessment report on the migration to the SEPA credit transfers and direct debits and approved its publication on the ECB's website (SEPA Migration: Impact Assessment).

On 7 March, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and the deposit facility would remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the end of 2019 and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
- 2) to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;
- 3) to launch a new series of quarterly TLTRO III, starting in September 2019 and ending in March 2021, each with a maturity of two years;
- 4) to continue conducting the Eurosystem's lending operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021 for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021.

On 15 March, the Governing Council of the ECB approved an update of the correspondent central banking model procedures for Eurosystem counterparties (Correspondent central banking model (CCBM): Procedures for Eurosystem counterparties) and their

Appendix 9 (cont.)

publication on the ECB's website, together with a technical annex (CCBM information for counterparties: Summary of legal instruments used in the euro area).

On 20 March, the Governing Council of the ECB:

- 1) in accordance with the Treaty on the Functioning of the European Union, which assigns the ECB the task of monitoring the compliance of EU central banks with the prohibitions referred to in Articles 123 and 124 thereof and the related Regulations, approved the report covering the year 2018 (see Section "Compliance with the prohibition of monetary financing and privileged access" of ECB Annual Report 2018);
- 2) decided to withdraw the recommendation of the ECB for a decision of the European Parliament and of the Council amending Article 22 of the Statute of the ESCB and the ECB.

On 22 March, the Governing Council of the ECB:

- 1) decided to adjust the Eurosystem collateral framework's eligibility criteria to reflect the disclosure requirements and registration process for securitisation repositories specified in the regulatory framework for securitisations applicable since 1 January 2019;
- 2) took note of a report, entitled "Card payment in Europe – current landscape and future prospects: the Eurosystem perspective", and approved its publication on the ECB's website.

On 26 March, the Governing Council of the ECB decided:

- 1) to further harmonise the agency concepts currently used in the Eurosystem monetary policy framework and align the criteria used for recognised agencies in the collateral framework and agencies eligible for the Public Sector Purchase Programme;
- 2) to leave unchanged the list of acceptable non-regulated markets for assets eligible as collateral for Eurosystem monetary policy operations and the list of issuers classified as multilateral development banks or international organisations.

On 9 April, the Governing Council of the ECB adopted Guideline ECB/2019/7 on domestic asset and liability management operations by the national central banks (recast) and Decision ECB/2019/8 amending Decision ECB/2014/8 on the prohibition of monetary financing and the remuneration of government deposits by national central banks.

On 10 April, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility would remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the end of 2019 and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
- 2) to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 26 April, the Governing Council of the ECB approved the publication of the 2018 quality reports on euro area monetary and financial statistics, on euro area and national quarterly financial accounts, and on euro area and national balance of payments and international investment position statistics (Euro area monetary and financial statistics – 2018 quality report; Euro area and national quarterly financial accounts – 2018 quality report; Euro area and national balance of payments and international investment position statistics – 2018 quality report).

On 10 May, the Governing Council of the ECB:

- 1) adopted Guideline ECB/2019/11 amending Guideline (EU) 2015/510 on the implemen-

Appendix 9 (cont.)

tation of the Eurosystem monetary policy framework, Guideline ECB/2019/12 amending Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework, and Guideline ECB/2019/13 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral;

2) took note of a report, prepared by the Eurosystem/ESCB Market Infrastructure and Payments Committee, on the implications of digitalisation in retail payments on the catalyst role of the Eurosystem, and approved its publication on the ECB's website (Implications of digitalisation in retail payments for the Eurosystem's catalyst role. July 2019).

On 22 May, the Governing Council of the ECB:

- 1) authorised the publication of the "Financial Stability Review" (Financial Stability Review. May 2019);
- 2) approved the launch of a six-week market consultation on a potential Eurosystem initiative regarding a European mechanism for the issuance and initial distribution of debt securities in the EU;
- 3) authorised the publication of the 18th annual review of the international role of the euro (The international role of the euro. June 2019).

On 23 May, the Governing Council of the ECB took note of the TARGET Annual Report 2018 (TARGET Annual Report 2018. May 2019).

On 6 June, the Governing Council of the ECB, at its meeting in Vilnius, decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the first half of 2020, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
- 2) to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;
- 3) that the interest rate in each TLTRO III operation will be set at a level that is 10 basis points above the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeds a benchmark, the rate applied in TLTRO III will be lower and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation plus 10 basis points;
- 4) to approve the major parameters of TLTRO III.

On 7 June, the Governing Council of the ECB:

- 1) approved the extension of the additional credit claims frameworks in their current format until the maturity date of the final TLTRO III, which is scheduled for end-March 2023;
- 2) adopted Decision ECB/2019/15 amending Decision ECB/2011/20 establishing detailed rules and procedures for implementing the eligibility criteria for central securities depositories to access TARGET2-Securities services and Guideline ECB/2019/16 amending Guideline ECB/2012/13 on TARGET2-Securities;
- 3) adopted Guideline ECB/2019/17 amending Guideline (EU) 2018/876 on the Register of Institutions and Affiliates Data and Guideline ECB/2019/18 amending Guideline ECB/2014/15 on monetary and financial statistics.

On 12 June, the Governing Council of the ECB adopted Opinion CON/2019/22 on the

Appendix 9 (cont.)

objectives and governance of the Latvian Financial and Capital Market Commission at the request of the Latvian Minister for Finance.

On 10 July, the Governing Council of the ECB:

- 1) approved the business process for the production of €STR, in particular the publication of the €STR on each TARGET2 business day at 8.00 CET, possibly followed by republication at 9.00 CET if errors of more than two basis points are detected following the standard publication;
- 2) adopted Guideline ECB/2019/19 on the euro short-term rate (€STR).

On 18 July, the Governing Council of the ECB adopted Decision ECB/2019/20 on the procedure for recognising non-euro area Member States as reporting Member States under Regulation (EU) 2016/867 on the collection of granular credit and credit risk data.

On 22 July, the Governing Council of the ECB adopted Decision ECB/2019/21 on a third series of targeted longer-term refinancing operations, and Decision ECB/2019/22 amending Decision (EU) 2016/810 (ECB/2016/10) on a second series of targeted longer-term refinancing operations.

On 25 July, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the first half of 2020, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to its aim over the medium term;
- 2) to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;
- 3) to underline the need for a highly accommodative stance of monetary policy for a prolonged period of time, as inflation rates, both realised and projected, have been persistently below levels that are in line with its aim;
- 4) to act in line with its commitment to symmetry in the inflation aim if the medium-term inflation outlook continues to fall short of its aim, and to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner;
- 5) to task the relevant Eurosystem Committees with examining options, including ways to reinforce its forward guidance on policy rates, mitigating measures, such as the design of a tiered system for reserve remuneration, and options for the size and composition of potential new net asset purchases.

On 26 July, the Governing Council of the ECB:

- 1) announced that the signatories of the Central Bank Gold Agreement had concluded that a formal gold agreement would no longer be necessary after its expiry on 26 September 2019;
- 2) in application of Article 21(2) of Regulation (EU) 2017/2094 amending Regulation (EU) No. 795/2014 on oversight requirements for systemically important payment systems adopted Decision ECB/2019/25 on the procedure and conditions for exercise by a competent authority of certain powers in relation to oversight of systemically important payment systems and decided to publish together with the Decision a summary of the responses received in the context of a public consultation which took place on the draft Decision between 8 March and 12 April 2019 (Response to the public consultation on draft ECB Decision under Article 21 of the revised SIPS Regulation. August 2019).

On 12 September, the Governing Council of the ECB decided:

- 1) that the interest rate on the deposit facility will be decreased by 10 basis points (to

Appendix 9 (cont.)

–0.50%), but the interest rate on the main refinancing operations and the rate on the marginal lending facility will remain unchanged at their current levels (0.00% and 0.25% respectively), expecting the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics;

2) that net purchases will be restarted under the APP at a monthly pace of 20 billion euro as from 1 November, expecting them to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates;

3) that reinvestments of the principal payments from maturing securities purchased under the APP will continue, in full, for an extended period of time past the date when the Governing Council starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;

4) that the modalities of TLTRO III will be changed to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. The interest rate in each operation will now be set at the level of the average rate applied in the Eurosystem's main refinancing operations over the life of the respective TLTRO. For banks whose eligible net lending exceeds a benchmark, the rate applied in TLTRO III operations will be lower, and can be as low as the average interest rate on the deposit facility prevailing over the life of the operation. The maturity of the operations will be extended from two to three years;

5) to introduce a two-tier system for reserve remuneration, in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facility rate;

6) to modify some of the key parameters of TLTRO III (see Decision ECB/2019/28 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations);

7) that interest rate on three-month longer-term refinancing operations will be fixed at the average rate of the main refinancing operations over the life of the respective TLTRO, at least until the end of the reserve maintenance period starting in March 2021;

8) to take note that the prolongation of the maturity of the TLTRO III operations implied that the additional credit claims frameworks needed to be extended until end-March 2024, in view of the decision of the Governing Council of 7 June 2019 to extend the additional credit claims frameworks until the maturity date of the final TLTRO III operation.

On 23 September, the Governing Council of the ECB decided to publish additional data on the ECB's foreign exchange interventions (as of April 2020).

On 27 September, the Governing Council of the ECB adopted Regulation ECB/2019/29 amending Regulation (EU) ECB/1333/2014 concerning statistics on the money markets.

On 4 October, the Governing Council of the ECB:

1) approved the remapping of Fitch's short-term ratings "F1" and "F3" to Credit Quality Step 3 on the Eurosystem's harmonised rating scale (will enter into force on 1 November 2019);

2) adopted Guideline ECB/2019/30 amending Guideline ECB/2012/27 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2).

On 15 October, the Governing Council of the ECB adopted Decision ECB/2019/31 on the remuneration of holdings of excess reserves and of certain deposits (recast).

On 23 October, the Governing Council of the ECB confirmed that the main features of the APP will remain mostly unchanged when net purchases are restarted.

Appendix 9 (cont.)

On 24 October, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged (0.00%, 0.25% and -0.50% respectively, expecting the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics;
- 2) that net purchases will be restarted under the APP at a monthly pace of 20 billion euro as from 1 November, expecting them to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates;
- 3) that reinvestments of the principal payments from maturing securities purchased under the APP will continue, in full, for an extended period of time past the date when the Governing Council starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 25 October, the Governing Council of the ECB:

- 1) approved a revised Agreement on Net Financial Assets (Agreement of 25 October 2019 on net financial assets);
- 2) adopted Opinion CON/2019/36 on amendments to the Law on Latvijas Banka at the request of the Budget and Finance (Tax) Commission of the Saeima (Parliament) of the Republic of Latvia.

On 30 October, the Governing Council of the ECB adopted Opinion CON/2019/37 on a proposal for a regulation on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area at the request of the Council of the European Union and the European Parliament.

On 31 October, the Governing Council of the ECB approved updated information security policy documentation for TARGET2 and TARGET2-Securities (T2S).

On 7 November, the Council of the ECB took note of the report, covering the first semester of 2018, on the confidentiality of the individual statistical information collected by the ECB, assisted by the euro area national central banks, and approved the publication of its summary (Statistical confidentiality protection the European System of Central Banks: Confidentiality Report January–June 2018 (summary)).

On 13 November, the Governing Council of the ECB authorised the publication of the "Financial Stability Review" (Financial Stability Review. November 2019).

On 5 December, the Governing Council of the ECB adopted Decision ECB/2019/39 amending Decision ECB/2010/14 on the authenticity and fitness checking and recirculation of euro banknotes.

On 12 December, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics;
- 2) to make net purchases restarted under the APP on 1 November at a monthly pace of 20 billion euro for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates;
- 3) to continue reinvesting, in full, the principal payments from maturing securities

Appendix 9 (cont.)

purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 13 December, the Governing Council of the ECB decided that it would no longer accept as Eurosystem collateral secured marketable assets other than asset-backed securities and covered bonds.

2019 HIGHLIGHTS OF REGULATORY DOCUMENTS ADOPTED IN PURSUIT OF THE MAIN TASKS OF LATVIJAS BANKA

Regulatory document	No.	Date of (adoption effective date)	Title of the regulatory document adopted by the Council of Latvijas Banka
Regulation	170	28.03.2019 (01.04.2019)	"Amendments to Regulation No. 60 'Regulation for the Credit Register' of Latvijas Banka of 18 January 2018"
Regulation	171	28.03.2019 (01.04.2019)	"Amendments to Regulation No. 161 'Regulation on the Provision of Information on the Credit Institutions' Credit Exposures and the Persons Involved' of Latvijas Banka of 18 January 2018"
Regulation	172	28.03.2019 (01.04.2019)	"Amendments to Regulation No. 162 'Regulation for Electronic Information Exchange with Latvijas Banka' of Latvijas Banka of 18 January 2018"
Procedure	287/5	28.03.2019 (15.04.2019)	"Amendments to Procedure No. 183/3 'Participation Procedure in the Electronic Clearing System of Latvijas Banka' of the Council of Latvijas Banka of 9 September 2010"
Procedure	287/6	28.03.2019 (15.04.2019)	"Amendments to Procedure No. 279/3 'Latvijas Banka's Procedure for the Use of the IBAN Register' of 20 September 2018"
Procedure	287/7	28.03.2019 (15.04.2019)	"Amendments to Procedure No. 213/9 'On the Regulation for Servicing of Customer Accounts of Latvijas Banka' of the Council of Latvijas Banka of 16 September 2013"
Procedure	287/8	28.03.2019 (01.05.2019)	"Amendments to Procedure No. 216/7 'Participation Procedure in the VNS System of Latvijas Banka' of the Council of Latvijas Banka of 11 November 2013"
Regulation	173	28.03.2019 (01.04.2019)	"Amendments to Regulation No. 36 'Regulation for Purchasing and Selling Cash Foreign Currencies' of Latvijas Banka of 13 May 2009"
Regulation	174	28.03.2019 (01.04.2019)	"Amendments to Regulation No. 158 'Requirements for the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorism Financing in Purchasing and Selling Cash Foreign Currencies' of the Council of Latvijas Banka of 30 October 2017"
Procedure	288/3	29.04.2019 (01.05.2019)	"Amendments to Procedure No. 232/5 'Participation Procedure in Cash Transactions at Latvijas Banka' of Latvijas Banka of 27 April 2015"
Procedure	292/3	16.07.2019 (01.08.2019)	"Amendments to Procedure No. 213/9 'On the Regulation for Servicing of Customer Accounts of Latvijas Banka' of the Council of Latvijas Banka of 16 September 2013"
Procedure	292/4	16.07.2019 (05.08.2019)	"Amendments to Procedure No. 217/1 'Participation Procedure in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka' of the Council of Latvijas Banka of 12 December 2013"
Regulation	175	16.07.2019 (19.07.2019)	"Amendments to Regulation No. 36 'Regulation for Purchasing and Selling Cash Foreign Currencies' of Latvijas Banka of 13 May 2009"
Regulation	176	16.07.2019 (19.07.2019)	"Requirements for Anti-Money Laundering and Combating the Financing of Terrorism and Proliferation and Sanction Risk Management in Purchasing and Selling Cash Foreign Currencies"
Procedure	295/1	26.09.2019. (10.10.2019)	"Amendments to Procedure No. 279/3 'Latvijas Banka's Procedure for the Use of the Proxy Registry "Instant Links"' of 20 September 2018"
Procedure	295/2	26.09.2019. (18.11.2019)	"Amendments to Procedure No. 183/3 'Participation Procedure in the Electronic Clearing System of Latvijas Banka' of the Council of Latvijas Banka of 9 September 2010"
Procedure	295/3	26.09.2019. (10.10.2019)	"Amendments to Procedure No. 213/9 'On the Regulation for Servicing of Customer Accounts of Latvijas Banka' of the Council of Latvijas Banka of 16 September 2013"
Procedure	296/2	31.10.2019 (17.11.2019)	"Amendments to Procedure No. 186/4 'Participation Procedure in TARGET2-Latvija' of the Council of Latvijas Banka of 4 November 2010"
Procedure	297/4	28.11.2019 (29.11.2019)	"Amendments to Procedure No. 232/5 'Participation Procedure in Cash Transactions at Latvijas Banka' of Latvijas Banka of 27 April 2015"

GLOSSARY

AnaCredit (analytical credit datasets): a common Eurosystem's granular analytical credit database containing data on all euro area Member States. The collection of granular credit and credit risk data is based on harmonised ECB statistical reporting requirements.

Asset Purchase Programme (APP): part of a package of non-standard monetary policy measures approved by the Governing Council of the ECB, comprising corporate sector purchase programme (CSPP), public sector purchase programme (PSPP), asset-backed securities purchase programme (ABSPP) and the third covered bond purchase programme (CBPP3).

Balance of payments: a statistical statement summarising transactions between Latvia's residents and the residents of the rest of the world. It incorporates the current account, the capital account and the financial account.

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

Banking union: an EU-level framework for banking supervision and resolution operating based on a single rulebook applicable in the entire EU. Euro area countries and those EU countries outside the euro area opting to participate in the banking union are members of the banking union.

Blockchain: a continuously growing list of records forming blocks of records which are linked and secured using cryptography. Each block of records typically contains a cryptographic hash of the previous block, timestamp and transaction data.

Capital account: a balance sheet component reflecting gross acquisitions/disposals of non-produced non-financial assets and capital transfers between Latvia's residents and the residents of the rest of the world.

Central government: public institutional units, including ministries, embassies, representative offices, agencies, councils, educational, healthcare, law enforcement, cultural and other public institutions whose competence covers the whole economic territory of the country, except for the administration of social security funds. The list of the institutional units of the Latvian central government is prepared by the CSB.

Clearing: the process of transmitting, processing and reconciling payment documents or securities transfer orders prior to settlement, resulting in establishment of the net position of each settlement participant by netting all payment documents submitted by the settlement participants, i.e. establishing net cash liabilities to or claims on other settlement participants.

Collateral: assets that are pledged or otherwise transferred to secure repayment of a loan, as well as those sold under repurchase agreements. The collateral used in the Eurosystem's reverse transactions should meet certain eligibility criteria.

Council of the EU (EU Council): the institution representing the governments of EU countries. The ministers of EU countries meet in the EU Council to adopt legislative acts and coordinate policies. The EU Council is an essential EU decision-maker. It is a single legal entity, but it meets in 10 different configurations, depending on the subject being discussed. The most significant tasks of the EU Council include negotiating and adopting legislative acts, developing common foreign and security policy of the EU, signing international agreements on behalf of the EU as well as adopting the EU budget together with the European Parliament.

Appendix 11 (cont.)

Credit institution: a capital company whose business is to receive deposits or other repayable funds from the public and to grant credits on its own account and provide other financial services.

Current account: a balance sheet component reflecting flows in goods, services, primary income and secondary income between Latvia's residents and the residents of the rest of the world.

Debt security: a security representing an obligation on the part of the issuer to make one or more payment(s) to the holder of the security at a specified future date or dates. Such security usually carries a specific rate of interest (the coupon) or is sold at a discount/premium to the amount that will be repaid at maturity.

Deposit facility: a standing facility of the Eurosystem which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to make overnight deposits with Latvijas Banka at a pre-specified interest rate.

Deposits redeemable at notice: funds deposited with an MFI without any specified maturity, with the possibility of withdrawing on demand either subject to notifying the MFI within an agreed period of notice or subject to payment of a substantial penalty.

Deposits: funds placed on the accounts of MFIs for a specified or unspecified period of time, with or without earning interest.

Direct investment: investment by an investor (direct investor) made directly or indirectly (through subsidiaries or associated companies) to acquire a lasting interest (corresponding to at least 10% ownership of ordinary shares or voting rights) in an enterprise (direct investment enterprise). The components of direct investment are equity and debt instruments.

Distributed ledger technology: a technology using protocols and support infrastructure to enable nodes in various locations to propose and validate transactions and synchronised record updates across all network.

EBA Clearing (ABE Clearing S.A.S. à capital variable): a capital company established by the major European and international banks, which provides pan-European payment infrastructure solutions, offering clearing and settlement services for both high-value and low-value euro payments to a wide community of banks in the EU.

Economic and Financial Committee (EFC): a counselling body set up to promote economic and financial policy coordination among the EU countries. In its fields of competence, the EFC delivers opinions at the request of the EU Council or the EC, as well as provides framework for the dialogue between the EU Council and the ECB and contributes to the preparation of the work of the EU Council. The EFC is composed of representatives of the governments (usually Ministries of Finance) and central banks of the EU Member States as well as representatives of the EC and ECB.

Electronic Clearing System of Latvijas Banka (EKS): net settlement system of Latvijas Banka ensuring the processing of retail payment orders and the settlement of net positions.

EONIA (euro overnight index average): a measure of the effective interest rate prevailing in the euro interbank overnight market. Until 30 September 2019, it was calculated as a weighted average of the interest rates on unsecured overnight loans denominated in euro, as reported by a panel of contributing banks. From 2 October 2019 to 3 January 2022, when its use will be discontinued, it is calculated as €STR plus 8.5 basis points.

Appendix 11 (cont.)

Equities: securities representing ownership of a stake in a commercial company. They comprise shares traded on stock exchanges (quoted shares), unquoted shares and other forms of equity. Equities usually produce income in the form of dividends.

€STR (euro short-term rate): a reference rate based on the money market statistical reporting data collected by the Eurosystem and reflecting the wholesale euro unsecured overnight borrowing costs of euro area banks. As of 2 October 2019, it is published on each TARGET2 business day on the basis of the previous day's trading activity.

EURIBOR (euro interbank offered rate): the rate at which one bank which is an active euro money market participant offers to lend euro funds to another bank of such type. It is calculated daily as the average of the daily offer rates of a representative panel of banks for interbank deposits with a maturity of one week to 12 months.

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 2019, the euro area comprised Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

European Banking Authority (EBA): an EU body with legal personality which forms part of the European System of Financial Supervisors and works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objective is to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

European Central Bank (ECB): the central institution of the ESCB and the Eurosystem having a legal personality under the EU law. The ECB implements the tasks conferred upon the Eurosystem and the ESCB pursuant to the Statute of the ESCB and the ECB in cooperation with the national central banks of the EU Member States.

European Council: an EU institution defining the EU's overall political direction and priorities. It is comprised of the heads of state or government of the EU Member States, the President of the European Council and the President of the EC.

European System of Central Banks (ESCB): includes the ECB and the national central banks of the EU Member States. The national central banks of those EU countries that have not yet adopted the euro implement an independent monetary policy according to their national law and are thus not involved in the conduct of the monetary policy of the Eurosystem.

European Systemic Risk Board (ESRB): an independent EU body which is a part of the European System of Financial Supervision and is responsible for the macro-prudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system, taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It contributes to the smooth functioning of the internal market and thereby ensures a sustainable contribution of the financial sector to economic growth.

Eurosystem: comprises the ECB and the national central banks of the Member States of the euro area. The decision-making bodies of the Eurosystem are the Governing Council and the Executive Board of the ECB.

Financial account: a balance sheet component reflecting financial assets and financial liabilities (direct investment, portfolio investment, financial derivatives, other investment and reserve assets) between Latvia's residents and the residents of the rest of the world.

Appendix 11 (cont.)

Financial stability: the condition in which the financial system (financial intermediaries, markets and market infrastructures) is capable of withstanding shocks without significant disruptions in the financial intermediation process and the supply of general financial services.

Fine-tuning operation: an open market operation executed by the Eurosystem in order to deal with unexpected liquidity fluctuations in the market. The frequency and maturity of these operations are not standardised.

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

General Council of the ECB: one of the decision-making bodies of the ECB, comprising the President and the Vice-President of the ECB and the Governors of the central banks of all EU countries.

General government: public institutional units engaged in production of goods or provision of services intended for individual or collective consumption free of charge or at economically insignificant prices, primarily financed from the compulsory payments (taxes and duties) imposed on economic agents, as well as institutional units engaged in redistribution of national income or wealth. General government in the Republic of Latvia includes central government, local governments and social security funds. The list of the institutional units of the Latvian central government is prepared by the CSB.

Governing Council of the ECB: the main decision-making body of the ECB. It consists of members of the Executive Board of the ECB and the governors of the national central banks of the euro area.

Gross settlement system: a transfer system in which the settlement concerning each cash or securities transfer order occurs on an instruction-by-instruction basis in the order of receipt.

Household: a natural person or group of natural persons in the capacity of a consumer and producer of goods and a provider of non-financial services for exclusively own final use; a sole proprietor which is an economic unit established by a natural person or a group of natural persons; this natural person or group of natural persons is liable for the settlement of the obligations of the economic unit with its entire property and the unit's accounting is organised in accordance with the single-entry system.

Instant payment: execution of customer payments within a matter of seconds, making cash transfers 24 hours a day, 7 days a week, 365 days a year, including holidays and weekends.

Integrated Reporting Framework (IReF): an important initiative of the ESCB providing for maximum harmonisation of data requirements for the needs of statistics and supervision of credit institutions ensuring optimal data availability on the level of both granular and aggregate data. IReF envisages data collection from credit institutions' information systems and reporting based on the Bank's Integrated Reporting Dictionary (BIRD) and a data exchange standard.

International investment position: a statistical statement reflecting the value and composition of financial claims (assets) on and financial obligations (liabilities) between Latvia's residents and the residents of the rest of the world, on a specific date, as well as changes in the residual values in the respective time period.

International Monetary Fund (IMF): an international organisation operating to facilitate international monetary cooperation, exchange rate stability, national economic

Appendix 11 (cont.)

growth and employment growth, and provide short-term financial assistance to IMF member countries for balancing the payment flow.

Key ECB interest rates: the interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility set by the Governing Council of the ECB.

Local government: institutional units of the local public administration, whose competence covers only a local economic territory. The list of the institutional units of the Latvian central government is prepared by the CSB.

M1: a narrow monetary aggregate comprising currency in circulation and overnight deposits held with MFIs by euro area residents.

M2: an intermediate monetary aggregate comprising M1 and deposits held with MFIs by euro area residents and redeemable at a period of notice of up to and including 3 months (i.e. short-term savings deposits) and those with an agreed maturity of up to and including 2 years (i.e. short-term time deposits).

M3: a broad monetary aggregate comprising M2 and marketable instruments, in particular repurchase agreements, money market fund shares/units, and debt securities with a maturity of up to and including 2 years issued by MFIs.

Main refinancing operation: a regular open market operation executed by the Eurosystem in the form of reverse transactions. Such operations are carried out through a weekly standard tender and normally have a maturity of one week.

Marginal lending facility: a standing facility, offered by the Eurosystem, which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to receive overnight credit from Latvijas Banka at a pre-specified interest rate against marketable or non-marketable assets.

Market risk: the risk related to fluctuations of the fair value or cash flow of financial instruments on account of movements in market prices. Market risk reflects the interest rate risk, currency risk and price risk.

Monetary base (base money): currency (banknotes and coins) in circulation, the minimum reserves credit institutions are required to hold with the Eurosystem as well as any excess reserves they may hold under the Eurosystem's deposit facility or as other liabilities related to the monetary policy operations.

Monetary financial institution (MFI): a central bank, credit institution, credit union, money market fund and other financial institution whose business is to receive deposits or close substitutes for deposits from customers other than MFIs and, on their own account, to grant credits and invest in securities, as well as an electronic money institution whose core business is to issue electronic money. Latvijas Banka sets up, maintains and regularly updates the List of Monetary Financial Institutions of the Republic of Latvia (see section Statistics on Latvijas Banka's website www.bank.lv). The list is also available on the ECB website where the ECB publishes the list of MFIs of the EU Member States on a regular basis. As at the end of 2019, there were 56 MFIs in Latvia.

Monetary income: income accruing to the national central banks of the euro area in the process of the Eurosystem's monetary policy implementation, derived from assets earmarked in accordance with guidelines established by the Governing Council and held against banknotes in circulation and credit institutions' deposits with central banks of the euro area.

Non-financial corporation: an institutional unit whose principal activity is producing goods and providing non-financial services, including an economic unit established by

Appendix 11 (cont.)

a natural person or a group of natural persons; this natural person or group of natural persons is liable for the settlement of the obligations of the economic unit with its entire property and the unit's accounting is organised in accordance with the single-entry system.

Open market operation: an operation executed in the financial market on the initiative of a central bank. With regard to their aims, regularity and procedures, Eurosystem's open market operations can be divided into four categories: main refinancing operations, longer-term refinancing operations, fine-tuning operations and structural operations.

Organisation for Economic Co-operation and Development (OECD): an intergovernmental organisation, a forum providing a platform for seeking answers to common problems, identifying good practices and coordinate domestic and stimulating policies that improve the economic and social well-being of persons.

Outright transactions: open market operations where the Eurosystem purchases or sells eligible assets outright in the market. Outright transactions are executed only for structural purposes.

Price stability: the maintenance of price stability is the primary objective of the Eurosystem. The Governing Council of the ECB has defined price stability as a year-on-year increase in the HICP for the euro area that is below 2%. The Governing Council has also stated that, in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2%.

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.

Register of Institutions and Affiliates Database (RIAD): a shared central repository maintained by the ECB that holds reference data (attributes) on legal units and other statistical institutional units, the collection of which supports business processes across the Eurosystem and the performance of the tasks of the ESCB and the SSM. RIAD facilitates the integration of a variety of datasets, in particular by providing common identifiers. RIAD data are also used to prepare the official lists of monetary financial institutions, investment funds, financial vehicle corporations engaged in securitisation transactions, payment statistics relevant institutions and insurance corporations.

Reserve requirement: a requirement for credit institutions and credit unions to hold their minimum reserves with the national central bank over the reserve maintenance period. Compliance with the requirement is determined on the basis of the average end-of-day balance on the reserve account over the reserve maintenance period.

Residual maturity: time remaining until the maturity date of a debt instrument or a loan or time remaining until the final date of any other financial operation.

Reverse transaction: a transaction whereby the Eurosystem buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

Securities settlement system: an agreement between at least three participants, apart from the operator of the system, on the execution of securities' transfer orders between those participants in accordance with uniform regulations and standardised procedures.

Single Euro Payments Area (SEPA): a project proposed by the European banks and supported by the Eurosystem and the EC to harmonise the way retail payments in euro are made, making payments in euro across European countries as fast, secure and effective as domestic payments. SEPA enables consumers, businesses and other economic agents to make both domestic and cross-border payments in euro on the same main terms and conditions, with the same rights and obligations, regardless of their location. As at the

end of 2019, SEPA encompassed all EU Member States, Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland.

Single Supervisory Mechanism (SSM): an EU-level framework for a prudential supervision of credit institutions in the euro area countries and in those EU countries outside the euro area opting to participate in the mechanism. The SSM is one of the central pillars of the banking union, comprising the ECB as the final responsible supervisory authority and the relevant national supervisory authorities of the EU countries.

Special Data Dissemination Standard Plus (SDDS Plus): the highest data dissemination standard of the IMF. Its purpose is to provide comprehensive, internationally comparable, timely, accessible, reliable and high-quality statistical data on population, financial, economic, fiscal and external sectors, including information on statistical data categories and responsible institutions in each country, as well as links to data and their clarification notes.

Structural operations: open market operations executed by the Eurosystem on a regular or non-regular basis whenever the ECB wishes to adjust the structural liquidity position of the Eurosystem vis-à-vis the financial sector.

Systemic risk: the risk that the inability of one participant to meet its obligations in a system will cause other participants to be unable to meet their obligations when they become due, potentially with spillover effects threatening the stability of or confidence in the financial system. That inability to meet obligations can be caused by operational or financial problems.

TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer system): the Eurosystem's real-time gross settlement system for the euro. The first generation TARGET system was replaced by TARGET2 in May 2008.

TARGET2: the second-generation TARGET system. It settles payments in euro in central bank money and functions on the basis of a single IT platform, to which all payment orders are submitted for processing.

TARGET2-Latvija: a component system of TARGET2 in Latvia. Its operation is ensured by Latvijas Banka in conjunction with the national central banks of the ESCB participating in TARGET2.

TARGET2-Securities (T2S): the Eurosystem's single technical platform enabling central securities depositories and national central banks to provide borderless and neutral core securities settlement services in the central bank money in Europe.

Targeted longer-term refinancing operation (TLTRO): reverse operation of the Eurosystem providing longer-term liquidity to credit institutions on attractive terms, so that they can continue easing the terms and conditions of lending to the private sector and to encourage their lending to the real economy. It is part of a package of non-standard monetary policy measures approved by the Governing Council of the ECB.