

# Latvijas Banka

Annual Report  
1994

Riga 1995

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ISBN 9984-9092-1-2

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## INTRODUCTION

During 1994, Latvia's economy experienced a continued development in market mechanisms and principles while the direct participation of the state in economic processes decreased. Market forces alongside private initiative promoted structural changes in the economic system: ownership relations were transformed, and private capital gained significance in the economy, thus enhancing the share of the private sector in gross domestic product. Examining the structure of GDP, the share of agriculture and industry contracted, while the share of construction and services (especially trade and transport) increased. Changes also continued in foreign trade, affecting its trends and structure.

With the continuing structural transformations in the national economy, several macroeconomic indicators stabilized in 1994, and some tended to improve. Among those, the deceleration in the rate of inflation (to 26.3% versus 34.9% in 1993) and the rise in real household income were notable, as well as the fact that the rapid decline in GDP over the past years was stopped. Data provided by the Republic of Latvia State Statistics Committee show that GDP in 1994 had fallen by 2.2% when compared with 1993. However, according to other experts, GDP had increased by about 2%; the difference is attributable to the discrepancies in statistical data on the development of the private sector.

The budget deficit was quite small (2.4% of GDP) with over 90% of the deficit being financed with Government securities.

In order to overcome the difficulties caused by the economic transition processes, and support the recovery of the national economy, the Bank of Latvia's monetary policy was aimed towards ensuring a low level of inflation and currency stability.

As of February 1994, the exchange rate of the national currency to the SDR currency basket was stabilized, and the exchange rate of lats against the SDR remained unchanged throughout the year. Following the fluctuations in the SDR basket's component currencies' exchange rates in the world market, lats appreciated against the US dollar and the British pound, and simultaneously depreciated against the French franc, the Japanese yen, and the German mark. The increase in the Bank of Latvia's foreign reserves validated the objective assessment of lats exchange rate.

The stability of the national currency contributed significantly to stricter discipline in macroeconomic and fiscal policies, and promoted a significant decrease in interest rates. However, commercial bank lending rates declined more slowly than deposit rates.

In 1994, the Bank of Latvia furthered its supervision efforts by introducing new regulations for the licencing of credit institutions, and by supplementing the economic requirements for monitoring the activities

of credit institutions, as well as further developing accounting procedures and statistics. The regulations were revised to gradually bring them into line with EU requirements for banking activities.

The monetary policy results presented in the Annual Report are derived from the monetary and banking statistics compiled by the Bank of Latvia. The economic situation in the country has been analysed utilizing data provided by the Republic of Latvia State Statistics Committee.

## ECONOMIC CONDITIONS IN THE REPUBLIC OF LATVIA AND THE BANK OF LATVIA'S MONETARY POLICY

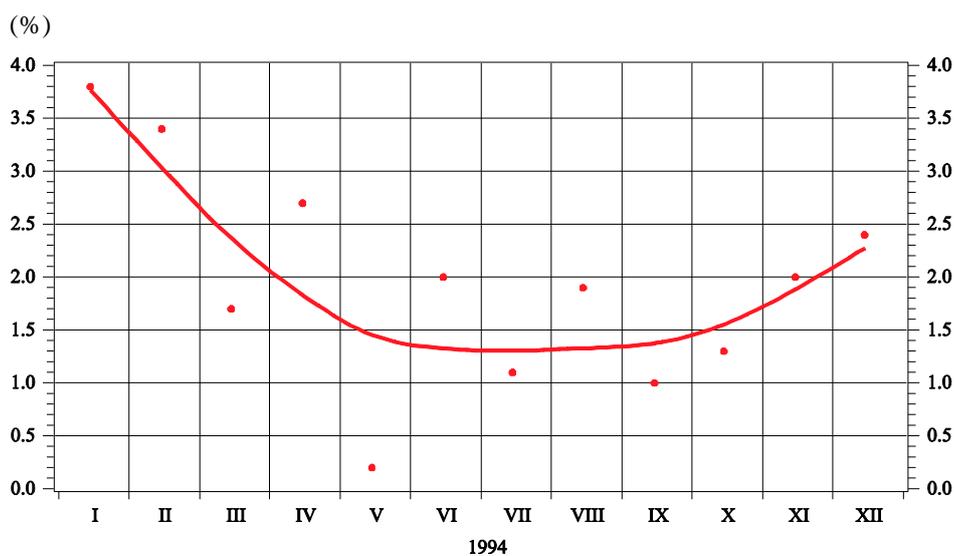
### INFLATION AND PRICES

The growth in the consumer price index (CPI) was somewhat slower in 1994 than in 1993, and, correspondingly, inflation during the year was 26.3% (compared with 34.9% in 1993). When comparing 1994 with the year before, prices did not undergo rapid month-on-month fluctuations in 1994, with the exception of rises of over 3% in January and February. Overall inflation in the first quarter was 9.2%. Subsequently, price increases fluctuated between 0.2% (in May) and 2.7% (in April). In the second quarter, the CPI grew by 5.0%, then by 4.1% in the third quarter, and after that by 5.8% in the fourth quarter (see Chart 1). Inflation was affected largely by the increase in the turnover tax and the excise duty on several groups of commodities, by the rise in import duties and other measures initiated to protect the domestic market, as well as by wage increases (particularly during the fourth quarter). Prices of food products and seasonal changes in prices for public services also had an impact on inflation, especially at the beginning and the end of the year.

Price increases on major groups of goods and services recorded during the year varied significantly: only 14.6% for food products, 34.3% for garments and footwear, and 37.5% for apartment rents and maintenance costs. Health care and recreation, culture and education costs

Chart 1

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



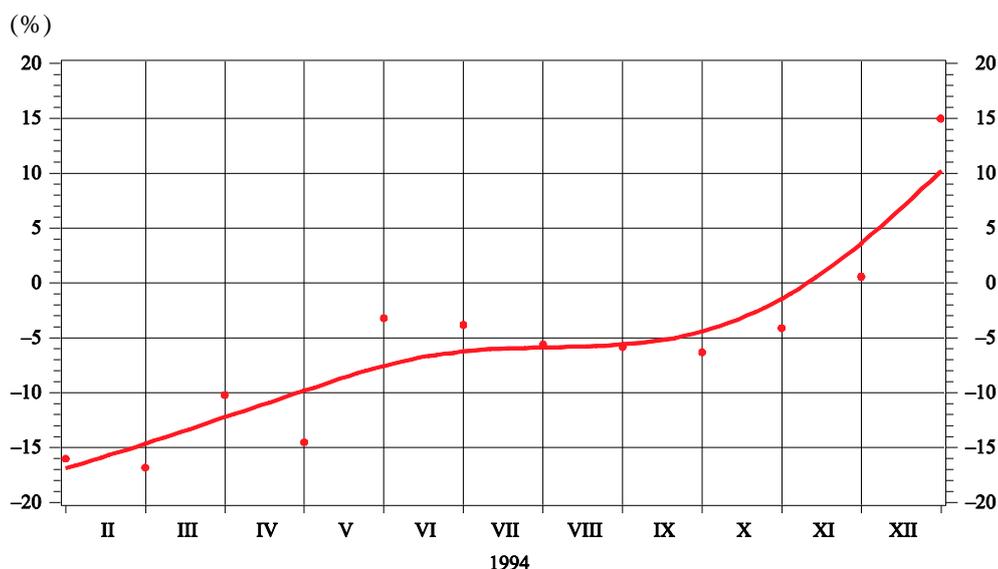
experienced the relatively highest price rises (62.8% and 55.0%, respectively).

In 1994, the real purchasing power of public sector employees increased by 15.0%, since the growth in average wages (by 45.3% during the year) notably exceeded the rise in the CPI (see Chart 2). Following the increase to 71.46 LVL (120.10 USD) in December 1993, due mainly to the customary additional payments at year-end, monthly average wages for public sector employees did not exceed this level during the first four months of 1994. Further on, the average wages rose throughout the year, particularly in the fourth quarter, after the increase in the minimum wages as of October 1, and amounted to 103.82 LVL (189.45 USD) in December. The rise in December again occurred because of the customary additional payments at the end of the year.

Compared with the previous year, the growth in the producer price index was substantially slower, 10.7% versus 36.3% in 1993. The most rapid price increases were in the production of associated transport equipment (railway carriages, tram cars and mopeds), and in the production of rubber, plastics and articles thereof (45.6% and 45.3%, respectively). During the year, producer prices fell by 17.8% in metallurgy, by 3.9% on products of the metal processing industry, and by 3.4% in garment and fur industries.

Chart 2

**CHANGES IN THE INDEX OF REAL WAGES IN THE PUBLIC SECTOR  
(COMPARED TO DECEMBER 1993)**



## DEVELOPMENT OF THE NATIONAL ECONOMY

GDP at constant prices continued to decrease, and in 1994, GDP amounted to 1 434.0 million lats (which was 2.2% less than during 1993, or 48.6% of the level in 1990). Of this amount, 1 303.1 million lats was total added value, and 130.9 million lats were taxes on products. Agriculture, hunting, forestry, fishing and manufacturing decreased their contribution to the total added value, while construction, mining and quarrying, and services increased their shares (see Table 1).

The development in GDP at constant prices over the past years shows that the contribution of manufacturing, construction and agriculture (to a lesser degree) has decreased, while the share of services has increased notably.

In 1994, GDP at current prices stood at 1 695.6 million lats, having risen by 15.6% during the year as a result of inflation. The highest increase was 65.0% in construction, and 33.3% in mining and quarrying. Compared with 1990, GDP at current prices rose 24 times, including 12 times in agriculture, 15 times in manufacturing, 43 times in services, and 82 times in power, gas and water supply.

Table 1

### TOTAL ADDED VALUE (AT CONSTANT PRICES) AND ITS STRUCTURE

(in million lats)

	1990		1993		1994	
		%		%		%
Total	2 701.1	100.0	1 331.8	100.0	1 303.1	100.0
Agriculture, hunting, forestry	277.5	10.3	155.5	11.7	111.5	8.6
Fishing	3.5	0.1	1.3	0.1	1.1	0.1
Mining and quarrying	7.5	0.3	2.4	0.2	2.7	0.2
Manufacturing	882.1	32.7	307.1	23.1	282.1	21.6
Power, gas and water supply	182.7	6.8	100.2	7.5	96.9	7.4
Construction	460.3	17.0	56.6	4.2	65.2	5.0
Services	887.5	32.8	708.7	53.2	743.6	57.1

Source: The Republic of Latvia State Statistics Committee data.

The output in most categories of agriculture decreased: meat production decreased by 34.8%, milk production by 13.6% and egg production by 7.5%. Industrial output at constant prices diminished by 9.5%, capital investment in construction declined by 11.6%, but trade turnover experienced a decrease of only 6.6%. Output increased only in the transport sector: total freight turnover grew by over 11%, but cargo turnover at ports increased by over 22%.

At the end of 1994, 83 946 unemployed persons were registered in Latvia, which was 6.5% of the economically active population (compared with 5.8% at the beginning of the year). The largest increase in unemployed persons was observed during the first four months, when it amounted to 87 511 at the end of April. Within the next six months, the number decreased slightly, starting to grow again during the last two months of the year. The number of persons registered as permanently unemployed grew from 25 274 to 36 075 over the course of the year.

## FOREIGN TRADE

In 1994, the foreign trade turnover of Latvia totalled 1 248.0 million lats, excluding reexports and reimports, thus having decreased by 5.1% in comparison with the previous year. Exports decreased by 18.1%, but imports had increased by 8.7%. The foreign trade balance of Latvia was negative (see Table 2), and comprised 8.3% of GDP. Reexports and reimports decreased by one third in comparison with 1993, thus constituting only 1.8% of total foreign trade turnover.

Table 2

### FOREIGN TRADE TURNOVER (EXCL. REEXPORTS AND REIMPORTS)

(in million lats)

	1992	1993	1994
Exports	572.7	675.6	553.4
Imports	541.5	639.2	694.6
Balance	31.2	36.4	-141.2

Source: The Republic of Latvia State Statistics Committee data.

In 1994, Latvia's major trading partners were the CIS (42.7% of total exports, compared to 47.6% in 1993) and the EU (27.9% and 24.6%, respectively). The major import partners were also the CIS (30.4% of total imports, compared to 38.2% in 1993), and the EU (24.9% and 17.3%, respectively). The share of trade with member countries of the EFTA increased. Latvia's largest trade turnover was with Russia, Germany, Sweden, Finland and Lithuania.

Latvia mainly exported wood pulp and articles thereof (20.3% of total exports), textiles and textile articles (13.2%), base metals and articles of base metals (10.1%), and vehicles and transport equipment (10.0%). The share of wood pulp and articles thereof in total exports doubled during the year, in contrast to the share of live animals and livestock products which decreased by half. The export of mineral products decreased almost eight-fold.

A significant part of Latvian imports was comprised of mineral products (29.4% of total imports, though their share decreased 1.5 times during the year), mechanical and electrical machinery and equipment (16.1%), and chemical products (10.2%).

## **FISCAL POLICY**

Over the reporting period, Latvia's budget deficit exceeded the forecast by 40 million lats, and was 41.3 million lats, or 2.4% of GDP. 90.2% of the deficit was financed with Treasury bills.

Over 98.8% of budget revenue was comprised of taxes and duties. The share of indirect taxes (the turnover tax, and excise and customs duties) increased substantially from 27.4% to 40.4%, while the share of direct taxes decreased from 64.7% to 53.9%.

Budget revenue was affected to a great extent by payment arrears that increased by 12.2 million lats, amounting to 34.8 million lats at the end of the reporting year.

The major part of budget revenue was utilized for social and cultural activities, including 33.1% for pension payments, 13.7% for education, and 5.7% for health care. The level of public investment was very low, accounting for slightly over 2.3% of expenditures or 0.8% of GDP. With the rise in foreign borrowing and issue of Government securities, the expenditure to meet domestic and foreign obligations increased as well, constituting almost 4.6% of total budget expenditure.

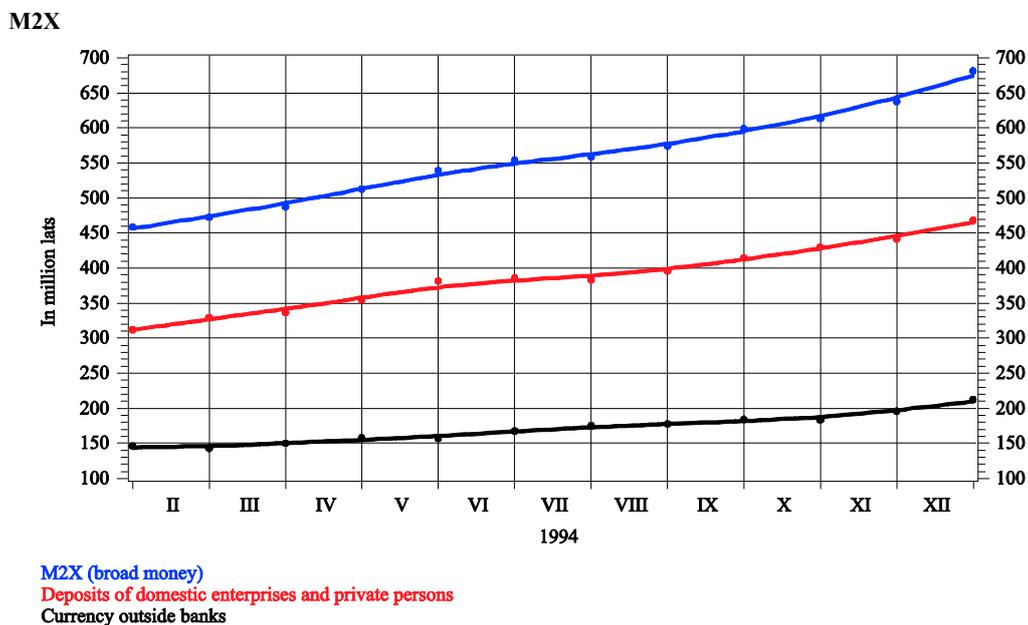
## MONEY SUPPLY

Due to a decrease in velocity and inflation in 1994, the growth rate of M2X<sup>1</sup> fell. While in 1993, broad money increased by an average of 6.5% per month, in 1994 its growth rate slowed down to 4.0% per month. At the end of the year, money supply was 681.6 million lats (see Chart 3). Over the reporting period, deposits of the nonbank sector increased 1.5 times, and currency outside banks grew 1.4 times (overall monetary indicators of the Latvian banking system and the Bank of Latvia are presented in Appendix 1 to the Annual Report).

In 1994, the structure of broad money underwent changes as well: the share of long-term deposits increased from 15.0% at the end of 1993 to 31.5% at the end of 1994, their total rising by more than 100 million lats (see Chart 4). Deposits of private persons constituted 58.3% of total deposits, and 69.3% of private person deposits were held in lats.

At the end of the year, demand deposits constituted about half of total nonbank deposits; private enterprise deposits dominated.

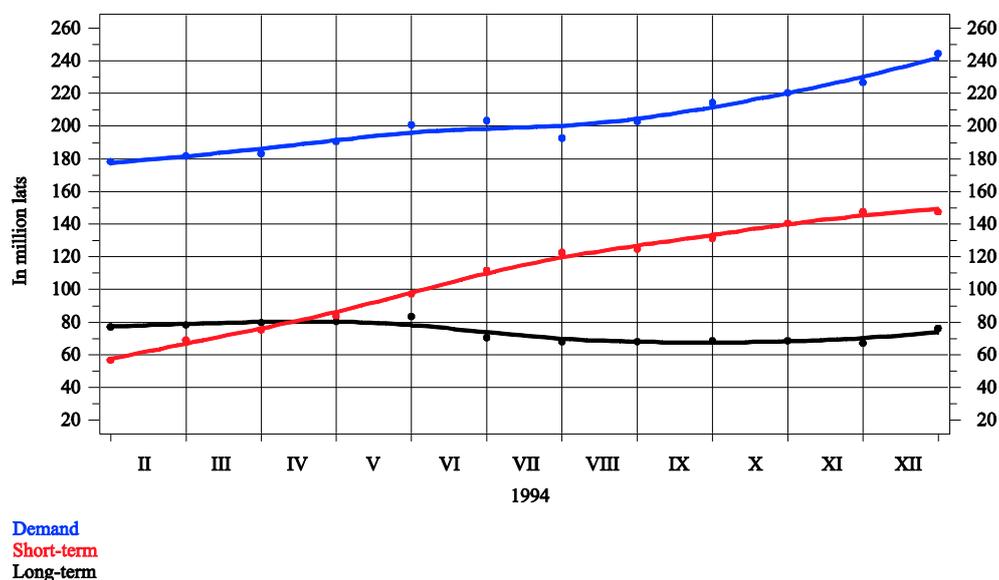
Chart 3



<sup>1</sup> Currency in circulation minus vault cash of banks plus deposits of domestic enterprises and private persons in national and foreign currencies.

Chart 4

**DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH  
COMMERCIAL BANKS IN NATIONAL AND FOREIGN CURRENCIES (AT END OF  
PERIOD)**



In 1994, the currency structure of deposits did not change significantly: about 60% of total deposits were held in lats, and deposits in foreign currencies constituted about 40%.

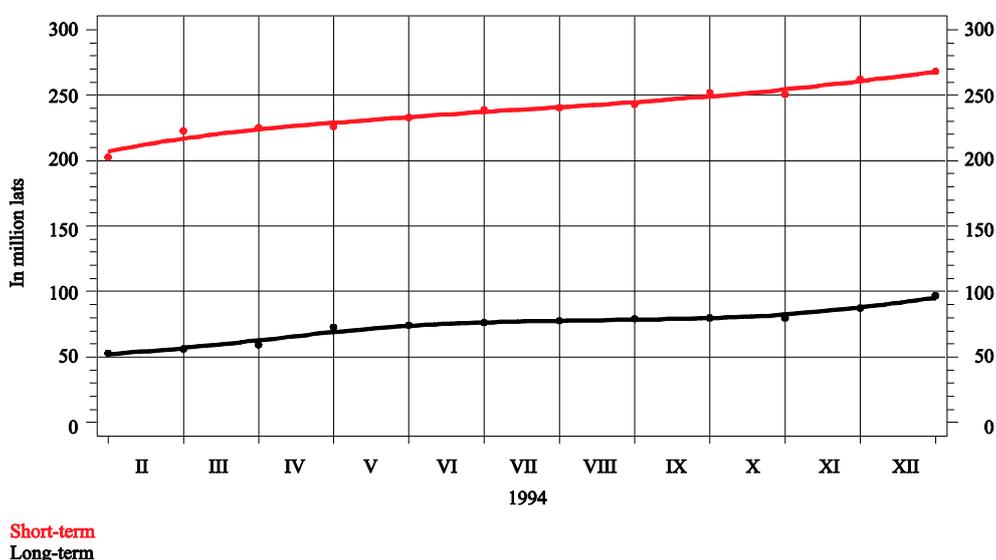
In contrast to the previous year, vault cash in national currency decreased 1.4 times during the year, and its share in currency in circulation contracted from 18.2% to 8.2%. This development was prompted mainly by limitations on the cash component in required reserves introduced by the Bank of Latvia. Decreasing the level of excess reserves, commercial banks hastened to get rid of their "extra" cash, thus bringing about changes in the reserve structure. During 1994, the share of cash in total reserves contracted from 43.0% to 33.5%.

The stability of the monetary system, the liberal foreign exchange policy and positive real interest rates prompted an inflow of foreign currencies into Latvia. During the year, net foreign assets of the banking system increased by 58.1 million lats or 18.6%. The sustained purchase of foreign currencies, though at a slower rate than in 1993, brought about an increase in net foreign assets of the Bank of Latvia of 19.1 million lats or 8.2%.

In 1994, credits to domestic enterprises and private persons increased by 96.3 million lats, or 1.4 times (see Chart 5).

Chart 5

**COMMERCIAL BANK CREDITS TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS IN NATIONAL AND FOREIGN CURRENCIES (AT END OF PERIOD)**



Most lending continued to be in short-term credits. However, credits with maturity from one to five years experienced the most rapid increase. At the end of the year, long-term credits constituted 26.6% of total credits. The share of credits in lats decreased from 45.8% to 39.9%. This was due to the fact that credits were utilized mainly by trade where most transactions were settled in foreign currencies. Lending was mainly directed towards the private sector. Total credits to private persons increased 1.8 times, credits to private enterprises grew 1.6 times, but total credits to public enterprises decreased 1.4 times.

During the reporting year, the Republic of Latvia Ministry of Finance made use of the short-term credit facility extended by the Bank of Latvia. The Bank of Latvia came to terms with the Ministry of Finance about the maximum allowable month-end balance, the maximum daily credit balance, and the average permissible monthly credit balance. The credit line was utilized most during the third quarter (10.0 million lats at the end of September). During the last months of the year, a smaller part of the credit line was utilized due to increasing budget revenue and the possibility to finance the deficit by issuing Treasury bills. Daily indicators were usually well below the agreed average permissible monthly credit balance.

In 1994, bank credits to the Government grew by 79.8 million lats, but Bank of Latvia credit to the Government increased only by 5.3 million lats.

## LENDING AND DEPOSIT RATES

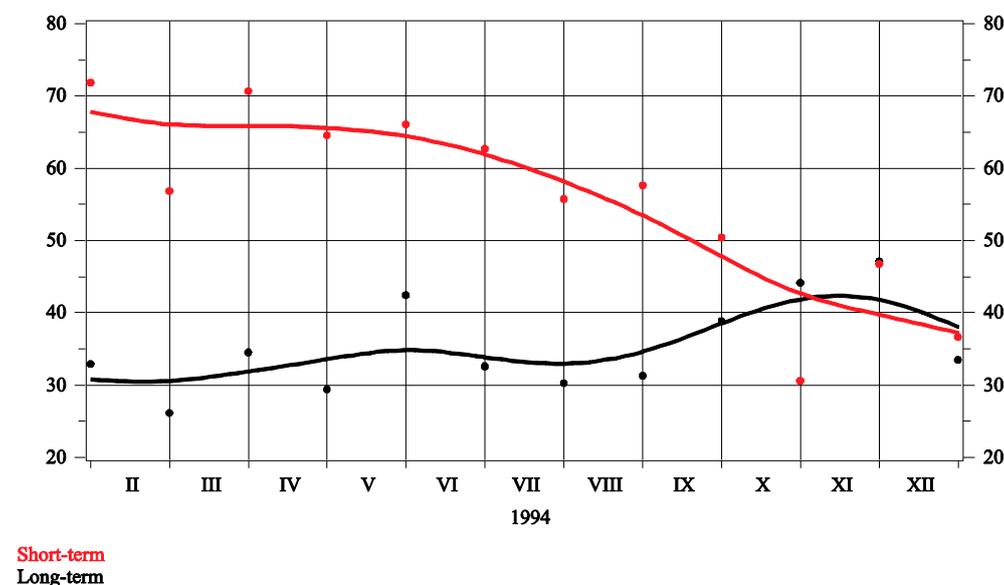
During 1994, a distinct trend towards the reduction in commercial bank lending and deposit rates was observed.

Rates on short-term credits both in lats and foreign currencies experienced a substantial, though irregular, reduction.

The average weighted interest rates within the year decreased from 71.9% on credits in lats and 75.3% on credits in foreign currency in January, to 36.7% and 29.5%, respectively, in December (see Chart 6). Nevertheless, the credit market witnessed wide fluctuations around these averages.

Chart 6

**AVERAGE WEIGHTED LENDING RATES OF COMMERCIAL BANKS ON CREDITS IN NATIONAL CURRENCY TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS (%)**



Average weighted interest rates on long-term credits fluctuated without revealing a distinct positive or negative trend. They varied from 26.2% to 47.0% on credits in lats, and from 14.2% to 54.7% on credits in foreign currency.

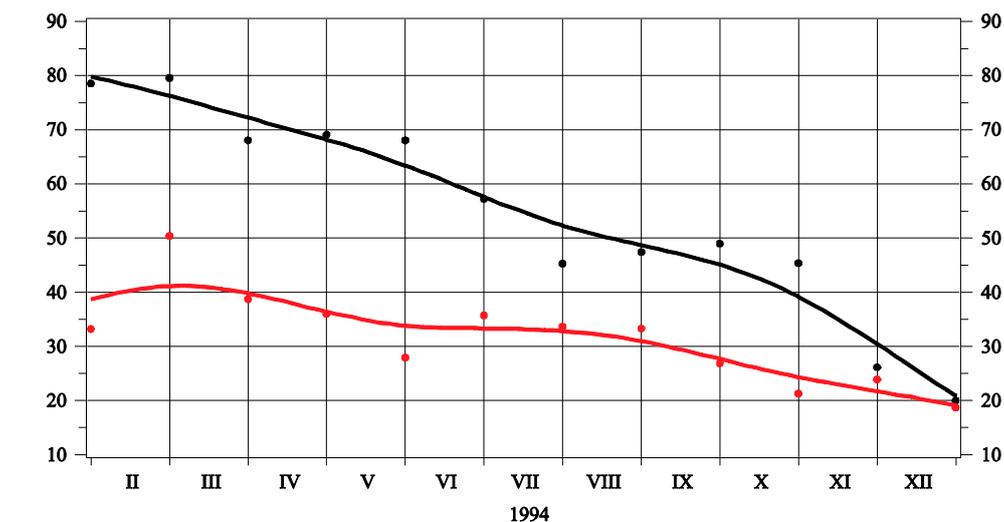
One of the factors responsible for the reduction in short-term lending rates was the rapid reduction in interest rates on deposits in lats. At the end of the year, deposit rates fell below the inflation level. In January – February, the average weighted long-term deposit rate was about 79% (though some banks offered interest up to 100%); further on, deposit rates declined gradually, reaching an average of 20.0% in December. Interest

rates on short-term deposits in lats also decreased from 33.3% in January to 18.8% in December (see Chart 7).

Chart 7

**AVERAGE WEIGHTED INTEREST RATES ON DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH COMMERCIAL BANKS IN NATIONAL CURRENCY**

(%)



Short-term  
Long-term

During the year, interest rates on foreign currency deposits remained somewhat lower than on deposits in lats. However, by year-end, this difference narrowed (rates on long-term foreign currency deposits experienced a reduction from 18.7% at the beginning of the year to 17.9% at year-end; rates on short-term deposits fell from 27.0% to 16.5%, respectively).

**THE INTERBANK MARKET**

In 1994, commercial banks were less active in the domestic interbank market, engaging more in deals with foreign banks. Total credits to domestic commercial banks were an average of 10–15 million lats per month, which represented only about 10% of similar investments with foreign banks. These consisted mainly of credits with maturities up to three months (similar amounts in lats and in foreign currency). During the year, lending rates fluctuated between 28% and 43%, tending to decline slightly during the second half of 1994. Thus, by the end of the year, these rates were only slightly lower than lending rates in the nonbank sector.

Credits to foreign banks were mostly overnight deposits; their interest rates increased from 3.6% to 5.5.% during the year. Commercial banks were most active in these transactions in the first and the fourth quarter of 1994.

## **REQUIRED RESERVES**

Over the reporting period, the Bank of Latvia maintained its reserve requirement at 8% of average deposits, irrespective of currencies and maturities. With a rise in total deposits with commercial banks during the year, the level of required reserves increased from 29.5 million lats in January to 48.3 million lats in December.

As of September, the cash component in required reserves was limited to 50%. Although the share of cash in required reserves usually exceeded 50% until August, it decreased significantly by year-end, and amounted to only 32% in December.

In 1994, excess reserves of commercial banks with the Bank of Latvia declined more than seven times, from 40.1 million lats to 5.6 million lats. The growing market of safe, liquid and profitable Treasury bills brought about a decrease in commercial bank deposits with the central bank. The dynamics of excess reserves in 1994 gives grounds to assume that banks were reducing their unprofitable assets.

## **RESERVE MONEY**

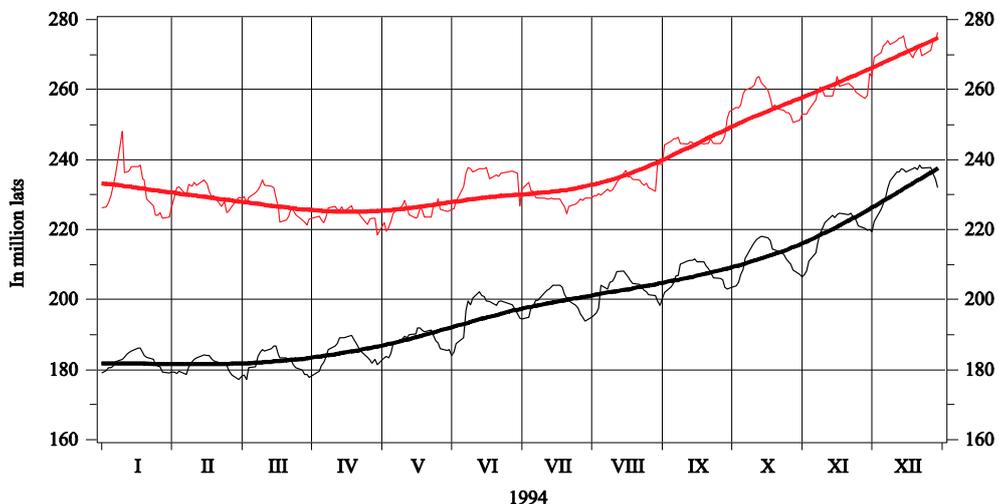
In 1994, reserve money M0<sup>1</sup> increased by 19.8%, amounting to 269.4 million lats by the end of the year (see Chart 8). The average increase in reserve money was 1.6% per month, which was about five-fold slower than in the previous year. The decrease in the growth rate of currency issue and the average annual level of commercial bank deposits with the Bank of Latvia expanded the share of cash in reserve money, to 86.2% at the end of 1994.

During 1994, net foreign assets of the Bank of Latvia increased by 8.2%, representing 4.4 months of imports by the end of the year. During the first half of 1994, foreign currency sales prevailed, reducing foreign assets to 201.2 million lats by the end of June. However, during the second half of 1994, net foreign reserves increased again by 51.5 million lats (see Chart 9).

<sup>1</sup> Currency in circulation plus deposits of banks with the Bank of Latvia.

Chart 8

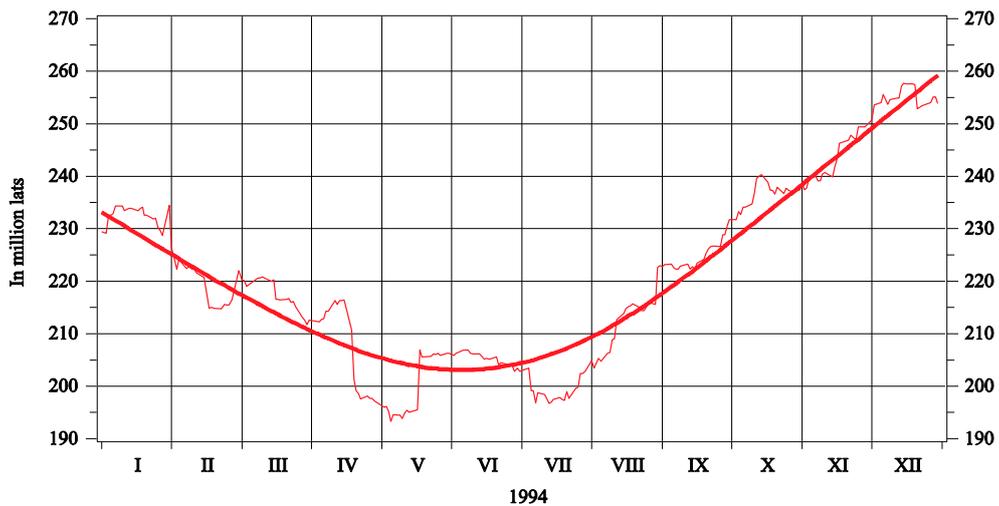
**RESERVE MONEY**



Reserve money  
Currency in circulation

Chart 9

**NET FOREIGN ASSETS OF THE BANK OF LATVIA**



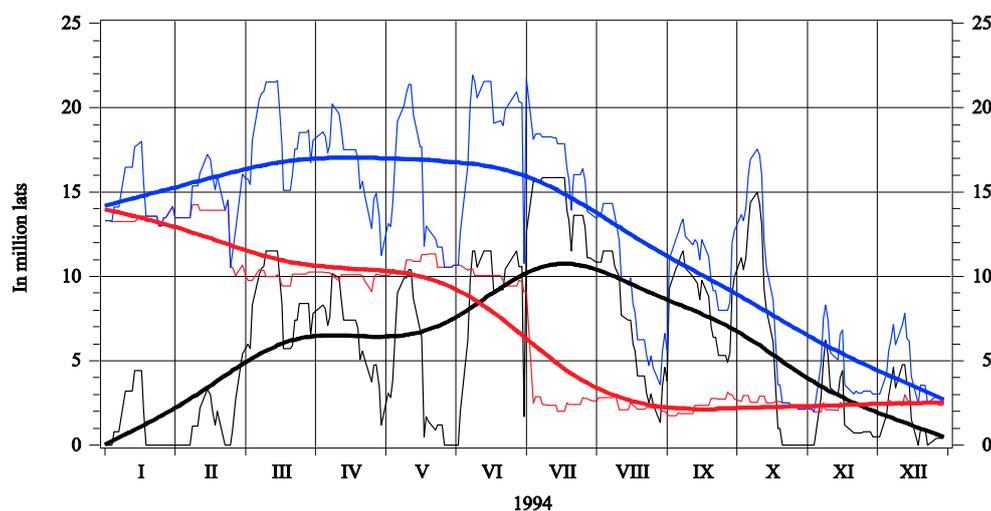
The growth in foreign assets of the Bank of Latvia decreased the central bank's lending to the Latvian banking system (see Chart 10). The chief refinancing instrument was a series of weekly short-term credit auctions, during which 88.6% of total refinancing credits were advanced. In the first nine months, the Bank of Latvia offered credits at auctions with maturities of 60 days; as of October, the maturity was reduced to 30 days.

The refinancing rate of 27% determined by the Bank of Latvia did not change for the most part of the year. Nevertheless, as of October 31, it was reduced to 26% and further to 25% on December 23, thus reflecting the stabilization of the macroeconomic situation in the country. This caused a more rapid decrease in the average weighted credit rates at auctions in the fourth quarter. However, a steady reduction trend in the rate was present throughout the year, from 35.8% during the first quarter to 29.2% in the fourth quarter.

In 1994, 28 banks participated in credit auctions. Total credits supplied by the Bank of Latvia amounted to 25.8 million lats, while demand by commercial banks was 27.9 million lats. During the fourth quarter, the supply and demand ratio at credit auctions changed, and the supply exceeded the demand.

Chart 10

**THE BANK OF LATVIA CREDITS TO COMMERCIAL BANKS AND THE GOVERNMENT**



Total  
Credits to commercial banks  
Credits to the Government

## THE FOREIGN EXCHANGE MARKET

In 1994, the Bank of Latvia continued to purchase and sell convertible foreign currencies (US dollars, German marks, British pounds, French francs, Japanese yen) to commercial banks and the Government. The Bank of Latvia's policy to purchase and sell unlimited amounts of currency provided a stable and liquid foreign exchange market in the country. US dollar transactions dominated the currency market.

The Bank of Latvia published official exchange rates for 21 convertible currencies on a daily basis. Rates for non-convertible currencies were published on a weekly basis. When major exchange rate fluctuations were encountered, the buying and selling rates for convertible currencies were changed several times daily to eliminate arbitrage possibilities. In 1994, the Bank of Latvia purchased a total of 42.0 million lats in foreign currencies from commercial banks and the

Table 3

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

(in lats; at end of period)

	USD	DEM	GBP	FRF	100 JPY
1994					
I	0.5820	0.3360	0.8730	0.0988	0.5340
II	0.5730	0.3330	0.8490	0.0981	0.5460
III	0.5670	0.3380	0.8390	0.0989	0.5500
IV	0.5630	0.3380	0.8490	0.0987	0.5560
V	0.5650	0.3430	0.8520	0.1004	0.5400
VI	0.5510	0.3480	0.8540	0.1015	0.5540
VII	0.5540	0.3470	0.8460	0.1017	0.5520
VIII	0.5520	0.3490	0.8460	0.1019	0.5530
IX	0.5450	0.3520	0.8590	0.1032	0.5540
X	0.5370	0.3580	0.8770	0.1046	0.5530
XI	0.5480	0.3500	0.8570	0.1021	0.5550
XII	0.5480	0.3530	0.8560	0.1023	0.5490

Government. Foreign convertible currency reserves of the Bank of Latvia increased by 97.4 million lats in 1994 (totalling 298.9 million lats at the end of the year). These reserves were invested in safe, liquid instruments, in accordance with the investment guidelines affirmed by the Bank of Latvia Council, with preservation of value and liquidity as a primary, and the rate of return as a secondary objective.

At the beginning of the year, the exchange rate of lats continued to appreciate, but since February 12, 1994, its rate against SDR has remained constant (1 SDR = 0.7997 LVL). The rate of lats against different foreign currencies fluctuated only as a result of price changes in the world currency market. On January 1, 1994, the US dollar rate was 1 USD = 0.595 LVL, but on December 31, 1994, it stood at 1 USD = 0.548 LVL (see Table 3). The rate of lats against the Russian ruble appreciated substantially. On January 1, 1994, the rate was 1 000 RUR = 0.478 LVL, but on December 31, 1994, it had appreciated significantly to 1 000 RUR = 0.161 LVL.

#### **GOVERNMENT FOREIGN BORROWINGS**

The Republic of Latvia Ministry of Finance is responsible for Latvia's foreign borrowings. According to the data provided by the Ministry of Finance, Government foreign debt increased by 64.2 million lats during the year, totalling 197.9 million lats at the end of the year (361.1 million US dollars). Of this, 189.0 million lats were foreign loans, and 8.9 million lats were direct foreign loans to enterprises with Government guarantees.

As the financial agent of the Government, the Bank of Latvia participated in the receipt and disbursement of foreign loans. At the end of the reporting year, total foreign borrowings amounted to 128.4 million lats, including 18.3 million lats received from the IMF Systemic Transformation Facility. The Bank of Latvia managed the 51.2 million lats that were advanced to Latvia under the IMF stand-by arrangement (including 7.3 million lats received during this reporting year). At the end of 1994, foreign loans disbursed through the Bank of Latvia to commercial banks amounted to 53.0 million lats, and to the Government equalled 13.1 million lats.

To ensure that the received credits are utilized more efficiently, the Bank of Latvia started macroeconomic analysis of the foreign debt. At the end of 1994, foreign loans bearing Government guarantees constituted 11.6% of GDP (9.1% at the end of 1993), but the amount necessary for servicing of foreign loans was 3.0% of total exports.

## **THE SECURITIES MARKET**

In 1994, the securities market for Republic of Latvia Treasury bills became very active. The Bank of Latvia acted as the Government agent organizing auctions for securities and booking transactions.

During the year, the Government issued bills with a maturity of 28 days. In the second quarter, bills with a maturity of 91 days were introduced. In January–July, auctions were held once a fortnight, and once a week as of August.

In 1994, 39 auctions of short-term Treasury bills were held, during which 37 issues of 28 day bills and 15 issues of 91 day bills were supplied. The total issuance of Treasury bills amounted to 259.0 million lats, of which 213.8 million lats was for bills with a maturity of 28 days, and 45.2 million lats was for bills with a maturity of 91 days. Though total demand was 94.1% of the supply, demand prevailed in about half of the auctions. During the year, 203.2 million lats of Treasury bills were sold. Of this volume, 169.5 million lats were bills with a maturity of 28 days, and 33.7 million lats were bills with a maturity of 91 days.

The Ministry of Finance supply at separate auctions fluctuated between 2 and 10 million lats. On average, 3 to 6 banks participated in each auction.

The average weighted discount rate on these bills decreased during the year. For bills with a maturity of 28 days, it fell from 24.2% in the first quarter to 21.6% in the fourth quarter (at several auctions it fluctuated between 17.7% and 26.0%). For bills with a maturity of 91 days, the discount rate decreased from 24.5% in the second quarter to 22.9% in the fourth quarter, fluctuating between 20.8% and 25.0%.

Furthermore, in order to increase the liquidity of Government securities, in April 1994, the Bank of Latvia started to quote the buying and selling rates of Treasury bills, and to act in the secondary market, executing transactions for 20.5 million lats.

## **MONEY CIRCULATION**

During 1994, cash in circulation increased from 179.1 million lats to 232.1 million lats. Circulation of Latvian rubles was discontinued effective June 30, 1994, and lats became the only national currency. Besides coins, bank notes were circulated in 5, 10, 20, 50, and 100 lats denominations.

Credit institutions received cash from and delivered cash to the Bank of Latvia branch in Riga, as well as the Bank of Latvia regional branches in Jelgava, Liepāja, Valmiera, Rēzekne and Daugavpils.

In order to ensure that only "clean" money is circulated, the Bank of Latvia instituted a modern money processing system. All cash received from credit institutions was checked automatically for authenticity and fitness for circulation, sorting out and destroying all damaged and soiled notes. The system was introduced with the considerable assistance provided by the central bank of Germany. The number of forged bank notes was rather insignificant due to the reliable security features incorporated in the notes.

Due to the necessity for extensive construction and rebuilding both in the Bank of Latvia and its branches, the Construction Committee and its bureau were established in 1994. Rebuilding projects for branches were worked out in order to ensure the continuation of quick, comfortable and secure service to clients. During the period under review, major rebuilding was completed in the Rēzekne branch, and work was started in Valmiera branch.

## **SUPERVISION OF CREDIT INSTITUTIONS**

### **SYSTEM OF CREDIT INSTITUTIONS**

At the end of the reporting year, 73 licenced credit institutions were operating in Latvia, of which 55 were commercial banks, 16 pawnshops, and 2 credit unions. The Bank of Latvia was responsible for their supervision.

In 1994, the Bank of Latvia granted licences to 2 credit unions, 6 pawnshops and 1 commercial bank (Multibanka), which was established by privatizing the Bank of Latvia Foreign Operations Branch. In addition, Societe Generale was granted a permit to open a branch and Dresdner Bank received a permit to establish a representative office in Latvia.

The Bank of Latvia revoked licences of 8 commercial banks; the Economic Court of Latvia recognized 5 of them as insolvent. Licences of one credit union and a pawnshop were revoked as well. The licence of Latvijas Tautas Banka was suspended.<sup>1</sup>

In 1994, the formerly state-owned bank Latvijas Investiciju Banka was transformed into a mixed ownership joint-stock company. The European Bank for Reconstruction and Development, Swedfund International AB and the Finnish Fund for Industrial Cooperation Ltd. became its shareholders.

<sup>1</sup> On January 18, 1995, the Economic Court of Latvia declared the bank insolvent. The Bank of Latvia revoked its licence on January 23, 1995.

The Government is the sole owner of 3 commercial banks: Latvijas Hipotēku un Zemes Banka, Latvijas Krājbanka, and Latvijas Universālā Banka. Their total paid-up share capital was 9.5 million lats, and total assets were 146.9 million lats.

Nonperforming loans of Latvijas Universālā banka and Latvijas Krājbanka were replaced by the Government long-term bonds. Following the proposals of the World Bank experts, the concept of privatizing Latvijas Universālā Banka was initiated.

In 1994, 41 commercial banks received permission to increase their share capital. At the end of 1994, total paid-up share capital of commercial banks constituted 121.1 million lats, but their total assets were 1 033.9 million lats, which was twice as large as at the end of 1993. The liberal foreign exchange regime, the stability of the national currency, the favourable geographical position of Latvia as well as the wide network of correspondent accounts with foreign banks contributed greatly to the rapid development of Latvia's banks.

## **REGULATIONS GOVERNING THE ACTIVITIES OF CREDIT INSTITUTIONS**

During the reporting year, the Bank of Latvia improved the supervision of credit institutions by implementing new regulations on their licencing, supplementing economic standards to the activities of credit institutions and instructions on accounting and statistics.

Modifications in licencing regulations were implemented considering the necessity for the Bank of Latvia to improve the quality of initial supervision not only before the granting of licences to credit institutions, but also during further activities, and to follow continuously the developments within the registered credit institutions.

In 1994, economic standards to the activities of credit institutions and the regulations on their calculation were upgraded in accordance with the EU directives and Basle Committee requirements. New regulations were effective as of October 1, 1994.

The following indicators in the performance of credit institutions were supervised: minimum initial capital; capital adequacy; liquidity; concentration of exposures; quality of the credit portfolio; loan loss provisions; open foreign currency positions.

According to amendments to the Law "On Joint-Stock Companies" passed by the Council of Ministers on January 7, 1994 (procedure set in Article 81 of the Republic of Latvia Satversme) and by the Republic of Latvia Parliament (Saeima) on July 28, 1994, the minimum initial capital

of bank joint-stock companies was established 2 million lats instead of 100 thousand lats. The minimum initial capital of registered banks shall be 1 million lats until the 1995 Annual Report is approved, and 2 million lats until the 1997 Annual Report is approved.

The ratio of the credit institution's own capital to total risk-weighted assets and off-balance sheet items shall not fall below 10%, and the credit institution's own capital shall not be less than the minimum initial capital prescribed by the Law.

Total exposure to a single person or a group of related persons must not exceed 50% of the credit institution's own capital, while exposure to a single person related to the credit institution shall not exceed 25% of own capital. As of December 1, 1994, total exposures to persons related with a credit institution were restricted to 50% of the credit institution's own capital. Total large exposures shall not exceed the credit institution's own capital more than eight times. The small capital of Latvian commercial banks still prevented the introduction of all limitations on exposures envisaged by the EU directives. Though the limitations were rather liberal in 1994, they will gradually be brought in line with the EU directives.

The credit institution's holdings in the initial capital of an entrepreneurial society, that is not a credit institution, shall not exceed 15% of the credit institution's own capital, but total holdings shall not exceed 60% of own capital. The credit institution's total investment in real estate, movable property and holdings in the initial capital of an entrepreneurial society that is not a credit institution, shall not exceed the credit institution's own capital.

Following Bank of Latvia regulations, credit institutions started forming loan loss provision for nonperforming loans. All credit institutions were required to report their open foreign currency positions.<sup>1</sup>

## **EXAMINATIONS OF THE ACTIVITIES OF CREDIT INSTITUTIONS**

The Bank of Latvia exercised its supervisory powers by conducting off-site analysis and carrying out on-site examinations.

The reporting system includes monthly, quarterly and annual reports. Attention was focused on the quality of data, since analysis of the quality of information may signal the problems a credit institution may face in advance. Submission of qualitative reports on time also provides a possibility to evaluate indirectly the management and their ability to conduct professionally the credit institution's operations.

<sup>1</sup> As of January 1, 1995, the open foreign currency position in an individual foreign currency shall not exceed 30% of the credit institution's own capital.

Opinions on the 1993 Annual Reports of the 21 major commercial banks were given by international audit firms Arthur Andersen, Coopers & Lybrand, and Price Waterhouse. Annual reports of other commercial banks were audited by chartered accountants in Latvia.

Data bases for financial analysis were created at the Bank of Latvia, thus extending the possibilities to analyse the development of each separate credit institution and the system as a whole.

In 1994, the Bank of Latvia performed planned as well as unexpected on-site examinations in 50 commercial banks, 2 credit unions and 13 pawnshops. As a result of these examinations, credit institutions started to evaluate their asset (particularly loan) quality more professionally, and create the required loan-loss provisions for nonperforming loans.

The Credit Institutions Supervision Committee was established at the Bank of Latvia in 1994. During its meetings, attended by managers of separate banks, the performance of the respective bank was analysed pointing out inconsistencies in their activity and their development potentials. In addition, its operational problems and improvement possibilities were discussed.

#### **COOPERATION IN THE AREA OF SUPERVISION**

During the reporting year, the Bank of Latvia continued to establish working contacts with domestic and foreign institutions directly or indirectly involved in supervision. Discussions on bank accounting and tax issues contributed to the establishment of close cooperation with the Republic of Latvia Ministry of Finance. Regular cooperation with the Association of Commercial Banks of Latvia, foreign supervisory institutions, the Basle Committee, the World Bank and the IMF continued. The personnel of the Bank of Latvia Credit Institution Supervision Department participated in several regional conferences.

## **MONETARY POLICY HIGHLIGHTS – 1994**

- April 7            The Board of the Bank of Latvia approved "Temporary Provisions for Accounting and Circulation of Treasury Bills".
- April 8            The Bank of Latvia passed Regulation No. 17 "On Issuing the 50 Lats and the 100 Lats Notes" (effective May 2, 1994).
- April 12          The Board of the Bank of Latvia passed a Resolution "On the Procedure of Applying Measures to the Credit Institutions that Violate the Republic of Latvia Legislation, the Bank of Latvia Regulations, and Their Own Charter".
- May 5             The Board of the Bank of Latvia passed a Resolution "On Provisions for Buying and Selling of Cash Foreign Currency".
- May 12            The Saeima passed Amendments to the Law "On Banks".
- May 13            The Council of the Bank of Latvia passed a Resolution "On Ceasing the Exchange of the Latvian Ruble" (effective July 1, 1994).
- June 16            The Board of the Bank of Latvia passed a Resolution "On Amendments to the Procedure of Calculating the Reserve Requirement".
- July 14            The Council of the Bank of Latvia passed a Resolution "On Economic Standards to the Activities of Credit Institutions".
- July 18            The Board of the Bank of Latvia approved "Regulations on Calculating the Economic Standards to the Activities of Credit Institutions".
- July 21            The Board of the Bank of Latvia passed a Resolution "On Amendments to Provisions for Buying and Selling of Cash Foreign Currency".
- August 25        The Board of the Bank of Latvia passed a Resolution "On Amendments to Temporary Provisions for Organizing Short-Term Credit Auctions".

- October 31 The Bank of Latvia reduced its refinancing rate from 27% to 26% per year.
- November 10 The Board of the Bank of Latvia passed a Resolution "On Regulations to the Bank of Latvia Extraordinary and Lombard Credits".
- November 17 The Council of the Bank of Latvia passed a resolution on amending economic standards to the activities of credit institutions.  
The Council of the Bank of Latvia passed a Resolution "On Utilization of the Bank of Latvia Credit Line to the Government in 1995".  
The Council of the Bank of Latvia passed a Resolution "On Audits of Annual Reports of Commercial Banks".
- November 22 The Council of the Bank of Latvia passed a resolution on amendments to the general principles of annual reports of credit institutions.
- December 20 The Council of the Bank of Latvia approved "Regulations on Granting and Revocation of Licences granted to Credit Institutions".  
The Council of the Bank of Latvia approved "Regulations on Amending the Charter and Changing Shareholders, the Basic (Share) Capital, the Management, the Chief Accountant, the Legal Address and the Name of Credit Institutions".
- December 23 The Bank of Latvia reduced its refinancing rate from 26% to 25% per year.

## **MULTILATERAL COOPERATION**

### **INTERNATIONAL FINANCIAL ORGANIZATIONS**

In 1994, Latvia as a member country continued its activity within the International Monetary Fund (IMF), the International Bank for Reconstruction and Development, the International Development Association, and the International Financial Corporation. The Bank of Latvia also continued to participate in the Bank for International Settlements.

Pursuant to the Article IV of the IMF Articles of Agreement, the IMF mission consultations were held with the Government of Latvia and the Bank of Latvia. In accordance with the stand-by arrangement signed between Latvia and the IMF in December 1993, the IMF mission and the Republic of Latvia Government participated in elaborating two reports on the fulfilment of the Government's economic and financial program.

### **COOPERATION WITH FOREIGN CENTRAL BANKS**

During the reporting year, the Bank of Latvia continued its cooperation and exchange of know-how and information with central banks in other countries.

The personnel of the Bank of Latvia visited the central banks of Germany, Denmark, Iceland, Sweden, Estonia and the Czech Republic with an aim to study their experience within different areas of central banking and exchange experiences. The Governor of the central bank of Sweden visited the Bank of Latvia to discuss issues relating to the activity of both central banks.

In June 1994, a seminar on exchange of know-how was held in Estonia for the staff of central banks of Estonia, Latvia and Lithuania; it was the first time the staff of the three central banks had the opportunity to discuss their approach to commercial bank supervision and monetary policy, as well as central bank activities within areas of information and publications.

### **TECHNICAL ASSISTANCE**

In 1994, the Bank of Latvia continued to receive technical assistance from international financial organizations and foreign central banks.

The IMF Technical Assistance Mission, comprising representatives from the central banks of Denmark, Norway, and the IMF experts visited the Bank of Latvia. Within the framework of the mission, consultations

were extended on monetary policy, foreign exchange transactions and foreign reserve management.

Regular technical assistance was rendered by the central bank of Germany. Within the framework of the technical assistance programs, the representatives of the Bank of Latvia participated in several training courses at the Joint Vienna Institute organized by international financial institutions, as well as in seminars offered by the central banks of England, Italy, Switzerland, Sweden, and US Federal Reserve System.

During the reporting year, four resident advisors continued their work at the Bank of Latvia; they were financed by the IMF (advisor on credit institutions supervision; until September 1994), the EU PHARE program (advisor on commercial bank accounting and reporting issues), the US Treasury (advisor on general central banking issues; until May 1994), and the US Agency for International Development (advisor on supervisory issues).

The coordinator meetings held by the Bank for International Settlements contributed significantly to a better coordination of technical assistance and improving its efficiency; they were attended regularly by the Bank of Latvia representatives.

## **THE BANK OF LATVIA ADMINISTRATION, AND PERSONNEL TRAINING**

At the end of 1994, 501 persons (104 more than a year earlier) were employed by the Bank of Latvia. The reporting structure to the President, the Chairman of the Board and the Deputy Chairman of the Board was changed. The Coin Marketing Manager and branches of the Bank of Latvia in Daugavpils, Jelgava<sup>1</sup>, Liepāja, Rēzekne, Rīga, and Valmiera came under supervision of the Cashier's and Money Operations Department. The Recreation Centre "Pumpuri" came under supervision of the General Service Department, and the Personnel Department oversaw the activities of the Latvian Banking College.

Other structural changes took place in several departments of the Bank of Latvia. The Department of Publications was established. Its main task is to disseminate information through regular publishing activities.

The composition of Bank of Latvia Council did not change in the reporting year, and at the end of 1994 it was:

– Chairman of the Council, President of the Bank of Latvia	Einars Repše;
– Chairman of the Board, Vice President of the Bank of Latvia	Ilmārs Rimšēvičs;
– members of the Council:	Harijs Bušs, Valentīna Kolotova, Vita Pilsuma, Bruno Rubess, Varis Zariņš, Valentīna Zeile.

During the reporting year, the Bank of Latvia's daily activities were managed by the Bank of Latvia Board. Māra Raubiško was appointed the Deputy Chairperson of the Board effective May 13, 1994. The composition of the Bank of Latvia Board did not change in 1994, and at the end of the year it was as follows:

– Chairman of the Board	Ilmārs Rimšēvičs;
– Deputy Chairperson of the Board	Māra Raubiško;
– members of the Board:	Silvija Lejniece, Laila Rūse, Antonija Sileniece, Guna Varslavāne.

<sup>1</sup> Ceased activity on April 1, 1995.

During 1994, the Bank of Latvia personnel training was directed towards supervision of credit institutions, payment system, statistics, accounting and monetary policy. Training courses and seminars were held by the IMF, the World Bank, and the central banks of Austria, Switzerland, Italy, Hungary and Germany.

The Bank of Latvia personnel improved their knowledge at the universities of California, USA, and Lund, Sweden, at the Stockholm School of Economics, Sweden, and the London School of Economics and Political Science, Great Britain, as well as at the central banks of Iceland and Sweden according to a special grant project funded by the Nordic Council of Ministers.

Seven Bank of Latvia employees participated in a two-stage program on reorientation of the Latvian financial sector, organized jointly by the Stockholm School of Economics and the central bank of Sweden. In 1994, the first part of the program took place in Riga.

Personnel of the Cashier's and Money Operations Department received regular support from the central bank of Germany, contributing to their skill in improving the quality of money circulation.

**THE BANK OF LATVIA BALANCE SHEET AT DECEMBER 31,  
1994**

(in thousand lats)

ASSETS	Notes <sup>1</sup>	1994	1993	1992
FOREIGN ASSETS		416 177	385 358	108 476
Gold	1	40 972	43 268	16 902
Special Drawing Rights (SDR)		174	58 359	22 419
Convertible currencies	2	298 919	201 543	36 636
International Monetary Fund (IMF)	3	72 929	74 853	—
Shares	4	959	1 040	1 461
Other foreign assets		958	2 053	—
Correspondent accounts		10	467	41
Receivables from the FSU		—	145	8 152
Non-convertible currencies	5	1 256	3 630	22 865
CASH		—	—	42
DOMESTIC CREDITS		67 979	54 357	62 055
To banks	6	54 468	51 981	56 055
To the Government		13 126	2 376	6 000
Government securities	7	385	—	—
OTHER ASSETS	8	9 098	4 603	12 615
<b>TOTAL ASSETS</b>		<b>493 254</b>	<b>444 318</b>	<b>183 188</b>

<sup>1</sup> See pages 37–41.

(cont.)	(in thousand lats)			
LIABILITIES	Notes	1994	1993	1992
<b>FOREIGN LIABILITIES</b>		161 913	149 585	36 592
IMF accounts	3	161 289	146 042	29 581
Other foreign liabilities		6	6	–
Foreign bank deposits in lats		219	2 421	–
Non-convertible currencies	5	399	1 116	7 011
<b>LATS IN CIRCULATION</b>	9	232 100	179 132	77 467
<b>DOMESTIC DEPOSITS</b>		88 706	91 342	39 770
Banks		37 326	46 423	36 582
Government		7 986	2 140	480
Government risk fund		932	237	–
Government provision for credits		1 187	–	–
Government foreign borrowings	10	40 604	41 842	–
Humanitarian aid accounts		671	700	2 708
<b>CAPITAL AND RESERVES</b>		8 020	14 702	17 134
Nominal capital	11	2 500	2 500	1 829
Reserve capital	11	625	625	290
Fixed assets reserve	11	4 160	–	–
Valuation account	12	4	10 904	15 015 <sup>1</sup>
EU grant	13	731	673	–
<b>OTHER LIABILITIES</b>		2 515	9 557	12 225
<b>TOTAL LIABILITIES</b>		493 254	444 318	183 188

<sup>1</sup> In the Annual Report 1992, the valuation account was shown separately for convertible and non-convertible currencies.

**THE BANK OF LATVIA PROFIT AND LOSS STATEMENT  
FOR THE YEAR ENDED DECEMBER 31, 1994**

(in thousand lats)

	Notes <sup>1</sup>	1994	1993	1992
<b>INTEREST INCOME</b>				
Foreign operations				
Interest on bank deposits		5 706	3 938	301
Income from securities		4 639	915	54
Other income		1 540	620	47
Dividends on BIS shares		99	105	143
<b>GROSS foreign income</b>	<b>1</b>	<b>11 984</b>	<b>5 578</b>	<b>545</b>
Domestic operations				
Interest on loans to banks		1 748	18 876	10 894
Interest on other loans		1 630	3 596	1 372
Other income		1 168	239	–
<b>GROSS domestic interest income</b>	<b>1</b>	<b>4 546</b>	<b>22 711</b>	<b>12 266</b>
<b>INTEREST EXPENSES</b>				
Foreign operations				
Interest on credits		2 909	1 991	–
Other expenses		73	54	289
<b>Gross foreign interest expenses</b>		<b>2 982</b>	<b>2 045</b>	<b>289</b>
Domestic operations				
Interest on deposits		712	–	–
Other expenses		1 043	51	31
<b>GROSS domestic interest expenses</b>		<b>1 755</b>	<b>51</b>	<b>31</b>

<sup>1</sup> See page 42.

(cont.)		(in thousand lats)		
	Notes	1994	1993	1992
<b>NET INTEREST INCOME</b>				
		11 793	26 193	12 491
Net foreign exchange profit/loss	2	-2 354	-185	-5 261
Net valuation adjustments		-2 354	-185	-5 261
<b>NET INTEREST INCOME AND VALUATION ADJUSTMENTS</b>				
		9 439	26 008	7 230
<b>OPERATING INCOME</b>				
Other operating income		2 379	393	10
<b>TOTAL operating income</b>				
		2 379	393	10
<b>OPERATING EXPENDITURE</b>				
Salaries, wages and other personnel costs		2 429	1 010	89
Social security		890	373	37
Money printing		599	5 686	4 497
Depreciation		311	43	10
Other operating expenses		3 429	1 821	171
<b>TOTAL operating expenses</b>				
		7 658	8 933	4 804
Net operating expenses		5 279	8 540	4 794
Exceptional items		-	9 497	-

(cont.)	(in thousand lats)			
	Notes	1994	1993	1992
<b>PROFIT BEFORE APPROPRIATION</b>		4 160	7 971	2 436
<b>APPROPRIATION OF PROFIT</b>				
Nominal capital		–	–	1 339
Reserve capital		–	58	244
Fixed assets reserve	3	4 160	–	–
State budget, donations		–	–	853
Remaining profit appropriated to the State budget		–	7 913	–

## **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1994**

### **FORM OF PRESENTATION OF ACCOUNTS**

The Bank of Latvia's financial statements have been prepared so as to fairly present the financial position of the Bank of Latvia in accordance with International Accounting Standards (IAS) as they may be applied to central banks. Certain central bank accounting practices were followed as set out below.

#### **TREASURY BILLS AND BONDS**

Treasury bills and bonds are stated at cost plus accrued interest as the intention is to hold these instruments until maturity.

#### **FOREIGN CURRENCY TRANSLATION**

Assets and liabilities denominated in foreign currencies are translated into lats at the official rates set by the Bank of Latvia at year end.

Gains or losses on translation are credited or charged to the valuation account.

#### **INCOME RECOGNITION**

Interest income and expenses are recognised on an accruals basis. Interest income is recognised on non-performing loans as well, simultaneously making provisions for such loans.

#### **FIXED ASSETS**

Fixed assets are recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method based on the estimated useful lives of assets, as follows:

Computer equipment	20%
Furniture and fittings	10%
Motor vehicles	20–33%
Buildings	1–2%
Land	0%

## NOTES TO THE BALANCE SHEET

### 1. GOLD

As in previous years, gold has been valued at 300 USD per troy ounce.

The official fixing of the gold price in London on December 30, 1994, was 383.1 USD per troy ounce. The market value of the Bank of Latvia's gold reserves at the end of 1994 was therefore 52 322 thousand lats.

Gold reserves deposited with the Federal Reserve Bank before the occupation in 1940 and blocked, were returned to the ownership of the Bank of Latvia in May 1994. Movements in gold reserves in 1994 were as follows:

	Ounces	In thousand lats
Gold at December 31, 1993	242 803	43 268
Deposits from the Federal Reserve Bank	6 420	1 144
Exchange rate difference	–	–3 440
Gold at December 31, 1994	249 223	40 972

### 2. CONVERTIBLE CURRENCIES

At the end of 1994, the Bank of Latvia's foreign currency assets, translated into lats, consisted of the following items: accounts with foreign banks and institutions – 207 958 thousand lats, Treasury bills and bonds – 90 015 thousand lats, cash on hand – 946 thousand lats, total 298 919 thousand lats. The Bank of Latvia's foreign assets invested in foreign banks and other financial institutions were denominated in cash deposits, Treasury bills and bonds of high liquidity.

The analysis by currency of the convertible currency reserves of the Bank of Latvia was as follows:

	(percentage)	
	1994	1993
US dollars	77	78
German marks	14	8
British pounds	2	1
Japanese yen	5	–
French francs	2	–
ECU	–	13
Total	100	100

### 3. INTERNATIONAL MONETARY FUND ACCOUNTS

This item contains claims on the International Monetary Fund (IMF) arising from Latvia's membership in the IMF, that is financed and held by the Bank of Latvia. The IMF accounts and amounts received under the IMF stand-by arrangement and the Systemic Transformation Facility are booked as a liability. The quota of SDR allocated to the Republic of Latvia in the IMF is 91.5 million SDR. The lats subscription and the corresponding lats accounts are linked to the exchange rate of the Special Drawing Rights (SDR).

### 4. SHARES

The Bank of Latvia owns 1 000 shares in the Bank for International Settlements (BIS). The shares are denominated in the gold equivalent and are valued at 300 USD per troy ounce.

### 5. NON-CONVERTIBLE CURRENCIES

The amount receivable consists of old accounts which were established during 1991 and 1992 in order to settle payments between the CIS countries.

### 6. DOMESTIC CREDITS TO BANKS

The Bank of Latvia was acting as an agent for the distribution of foreign loans received by the Republic of Latvia. This item comprises foreign loans for 53.0 million lats that were distributed to domestic commercial banks for further distribution of these funds as loans to final borrowers.

### 7. GOVERNMENT SECURITIES

The Bank of Latvia is a market-maker for Treasury bills issued by the Ministry of Finance. The agreement between the Bank of Latvia and the Ministry of Finance set the limit of 2.0 million lats for the Bank of Latvia's buying of Treasury bills at the end of 1994. Of that limit, the Bank of Latvia at December 31, 1994, held Treasury bills for 385 thousand lats.

### 8. OTHER ASSETS

Other assets comprise fixed assets, prepayments to equipment suppliers, stocks of office supplies, and accrued interest. Total other assets of 9 098 thousand lats include (in thousand lats):

Machinery and equipment	1 451
Real estate	855
Prepayments to equipment suppliers	1 169
Furniture and fittings	867
Accrued interest	3 839
Other assets	917

## 9. LATS IN CIRCULATION

At the end of 1994, the following bank notes and coins were in circulation:

Nominal	Amount (in thousand lats)		Number (in thousand units)		Percentage (%)	
	1994	1993	1994	1993	1994	1993
Bank notes						
Ls 100	9 093	–	91	–	3.9	–
Ls 50	11 122	–	222	–	4.8	–
Ls 20	58 432	32 234	2 922	1 612	25.2	18.0
Ls 10	63 448	23 028	6 345	2 303	27.4	12.9
Ls 5	73 625	104 000	14 725	20 800	31.8	58.2
Coins						
Ls 2	5 220	7 235	2 610	3 617	2.3	4.0
Ls 1	4 764	5 693	4 764	5 693	2.1	3.2
50 s	2 941	3 620	5 882	7 240	1.3	2.0
20 s	1 110	1 072	5 548	5 360	0.5	0.6
10 s	757	865	7 568	8 640	0.3	0.5
5 s	508	538	10 162	10 760	0.2	0.3
2 s	296	279	14 784	13 950	0.1	0.2
1 s	232	158	23 157	15 800	0.1	0.1
Total	231 548	178 722	–	–	100.0	100.0

At the end of 1994, silver 10 lats commemorative coins and gold 100 lats commemorative coins were in circulation alongside with the souvenir sets of circulation coins of total value 552 thousand lats.

At the end of 1993, Latvian rubles in circulation amounted to 410 thousand lats. Latvian rubles ceased to be a legal tender from October 18, 1993, but the Bank of Latvia continued to exchange them for lats until July 1, 1994. Latvian rubles outstanding and not claimed for exchange to lats were booked as extraordinary income in 1994.

## 10. GOVERNMENT FOREIGN BORROWINGS

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

## 11. NOMINAL CAPITAL, RESERVE CAPITAL, FIXED ASSETS RESERVE

The Law "On the Bank of Latvia" sets a maximum level of nominal and reserve capital. The Bank of Latvia achieved the maximum set by the Law in 1993. Accordingly, the capital remained unchanged in 1994. Pursuant Article 20 of the Law "On the Bank of Latvia", the fixed assets reserve was formed in 1994.

## 12. VALUATION ACCOUNT

Movements in the valuation account in 1994 were as follows:

	Gold	Foreign currencies		Total
		Conver- tible	Non-con- vertible	
Valuation account at December 31, 1993	49 575	-8 932	-29 739	10 904
Deposit from Federal Reserve Bank	1 144	-	-	1 144
Exchange loss	-3 440	-	-	-3 440
Revaluation	-	-7 245 <sup>1</sup>	-1 359 <sup>1</sup>	-8 604
Valuation account at December 31, 1994	47 279 <sup>2</sup>	-16 177	-31 098	4

## 13. EU GRANT

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

<sup>1</sup> Realised and unrealised exchange gains and losses in both convertible and non-convertible currencies are taken to the valuation account.

<sup>2</sup> The valuation account for gold includes 6 307 thousand lats realised as sales during 1993.

## **NOTES TO THE INCOME STATEMENT**

### **1. INTEREST INCOME**

Interest income is recognised on an accruals basis. Interest income is recognised on non-performing loans as well, simultaneously making provisions for these loans. Commissions and other income are credited to income at the time of the related transactions.

Interest income from international operations increased in 1994 due to the more efficient and successful investment of a larger proportion of the Bank of Latvia's foreign exchange reserves in more profitable foreign market instruments.

### **2. FOREIGN EXCHANGE LOSSES**

The Bank of Latvia booked foreign currency exchange rate differences to the valuation account in the balance sheet. The valuation account also included movements in gold. Due to the increased value of lats, the Bank of Latvia suffered a loss on revaluating its foreign assets, and the foreign currency exchange losses in excess of the valuation account balance have been charged to the profit and loss account.

### **3. FIXED ASSETS RESERVE**

Pursuant Article 20 of the Republic of Latvia Law "On the Bank of Latvia", net profit was appropriated to the fixed assets reserve.

## **REPORT OF THE AUDIT COMMISSION**

We have audited the financial statements of the Bank of Latvia as at December 31, 1994, together with the related notes set out on pages 37 to 42. The final statements are the responsibility of the Bank's management. Our responsibility is to express the opinion of the financial statements based on our audit.

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

In our opinion the financial statements and related notes present fairly the financial position of the Bank of Latvia as at December 31, 1994, in accordance with accounting and related disclosures appropriate for a central bank.

ARTHUR ANDERSEN

The Republic of Latvia State Control

Riga  
March 30, 1995

## APPENDIX 1. MONETARY INDICATORS IN 1994

(at end of month; in million lats)

	I	II	III	IV	V	VI
<b>Bank of Latvia</b>						
Reserve money M0	223.7	229.2	222.9	218.4	225.4	226.9
Currency in circulation	179.2	177.3	177.8	181.5	185.8	194.6
Bank deposits	44.5	51.9	45.1	36.9	39.6	32.3
Currency vs reserve money (%)	80.1	77.4	79.8	83.1	82.4	85.8
Net foreign assets	232.6	220.3	211.1	204.3	204.4	201.1
In convertible currencies	234.0	221.7	212.4	205.7	203.5	200.4
In non-convertible currencies	-1.4	-1.4	-1.3	-1.4	0.9	0.7
Net domestic assets	-8.9	8.9	11.8	14.1	21.0	25.8
Credits	44.6	57.8	59.6	69.9	68.0	67.7
To banks	45.1	43.1	42.3	58.9	59.5	57.2
To Central Government (net)	-7.8	7.5	10.1	3.8	1.3	3.9
Credit line	0	5.4	7.8	1.2	0	1.7
Other items (net)	-53.5	-48.9	-47.8	-55.8	-47.0	-41.9
<b>Banking system</b>						
Broad money M2X	459.0	472.9	487.7	513.2	539.5	554.3
Currency in circulation <sup>1</sup>	146.5	143.3	150.5	158.1	157.5	168.2
Nonbank <sup>2</sup> deposits (total)	312.4	329.6	337.2	355.1	382.0	386.1
In foreign currencies	128.8	132.4	137.1	146.4	152.9	152.6
Domestic money supply M2D <sup>3</sup>	330.2	340.5	350.6	366.8	386.6	401.7
Net foreign assets	299.1	299.5	301.1	301.6	295.0	293.8
Net domestic assets	159.9	173.4	186.6	211.6	244.5	260.5
Credits	255.0	278.5	284.9	299.2	307.9	315.6
Bank of Latvia refinancing rate (%)	27.0	27.0	27.0	27.0	27.0	27.0
Average interest rates (%)						
In the interbank market	39.9	43.5	39.1	32.9	42.3	43.3
In the nonbank sector						
Short-term credits granted in lats	71.9	56.9	70.7	64.6	66.1	62.7
Long-term deposits in lats	55.9	65.0	53.5	52.6	48.0	46.5
LVL vs USD	0.582	0.573	0.567	0.563	0.565	0.551

<sup>1</sup> Less vault cash balances.

<sup>2</sup> Enterprises and private persons.

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

(cont.)

(at end of month; in million lats)

	VII	VIII	IX	X	XI	XII
<b>Bank of Latvia</b>						
Reserve money M0	229.0	238.7	253.6	251.5	264.7	269.4
Currency in circulation	193.8	198.4	203.3	207.2	220.0	232.1
Bank deposits	35.2	40.4	50.3	44.3	44.7	37.3
Currency vs reserve money (%)	84.6	83.1	80.2	82.4	83.1	86.2
Net foreign assets	201.2	221.5	230.2	235.8	248.7	252.7
In convertible currencies	200.8	221.2	230.0	235.7	248.7	252.7
In non-convertible currencies	0.4	0.3	0.2	0.1	0	0
Net domestic assets	27.8	17.2	23.4	15.7	16.0	16.7
Credits	69.2	61.4	66.2	53.0	58.4	60.0
To banks	57.2	56.6	55.4	51.7	53.6	54.5
To Central Government (net)	12.0	4.8	10.8	1.3	4.8	5.5
Credit line	9.6	4.6	10.0	0	0	0
Other items (net)	-41.4	-44.2	-42.8	-37.3	-42.4	-43.3
<b>Banking system</b>						
Broad money M2X	559.4	574.4	599.4	613.7	638.1	681.6
Currency in circulation <sup>1</sup>	175.6	178.1	184.5	183.6	196.1	213.1
Nonbank <sup>2</sup> deposits (total)	383.8	396.3	414.9	430.1	442.0	468.6
In foreign currencies	153.9	159.7	168.4	168.0	175.3	190.1
Domestic money supply M2D <sup>3</sup>	405.5	414.7	431.0	445.7	462.8	491.5
Net foreign assets	314.2	309.7	320.9	318.1	333.8	371.1
Net domestic assets	245.2	264.7	278.5	295.6	304.3	310.5
Credits	318.4	322.4	332.1	330.8	347.7	365.3
Bank of Latvia refinancing rate (%)	27.0	27.0	27.0	26.0	26.0	25.0
Average interest rates (%)						
In the interbank market	34.1	36.5	37.5	28.5	30.6	37.8
In the nonbank sector						
Short-term credits granted in lats	55.8	57.7	50.5	30.7	46.1	36.7
Long-term deposits in lats	39.5	40.4	38.0	33.4	25.0	19.4
LVL vs USD	0.554	0.552	0.545	0.537	0.548	0.548

<sup>1</sup> Less vault cash balances.<sup>2</sup> Enterprises and private persons.<sup>3</sup> Currency outside banks plus deposits of domestic enterprises and private persons in national currency.

**APPENDIX 2. CREDIT INSTITUTIONS THAT AT THE END OF 1994  
HAD A VALID LICENCE ISSUED BY THE BANK OF LATVIA**

**COMMERCIAL BANKS**

1. Stockholding Company "Aizkraukles Banka"
2. Stockholding Company "Ako Banka"
3. Stockholding Company "Alejas Komercbanka"
4. Stockholding Company "Baltijas Starptautiskā Banka"
5. Stockholding Commercial Bank "Baltijas Tranzītu Banka"
6. Stockholding Company "Banka Atmoda"
7. Stockholding Company "Banka Baltija"
8. Stockholding Company "Bauskas Banka"
9. Stockholding Company "Centra Banka"
10. Stockholding Company "Daugavas Banka"
11. Stockholding Commercial Bank "Doma Banka"
12. Stockholding Commercial Bank "Jelgava"
13. Stockholding Company "Komercbanka "Dinastija""
14. Stockholding Company Bank "Land"
15. Latgale Stockholding Commercial Bank<sup>1</sup>
16. Stockholding Company "Latintrādes Banka"<sup>2</sup>
17. Stockholding Company "Latvijas Biznesa Banka"
18. Stockholding Company "Latvijas Depozītu Banka"
19. Stockholding Company "Latvijas Ekonomiskā Komercbanka"
20. State Stockholding Company "Latvijas Hipotēku un Zemes Banka"
21. Stockholding Company Commercial Bank "Latvijas Industriālā Banka"
22. Stockholding Company "Latvijas Investīciju Banka"
23. Stockholding Company "Latvijas Kapitāl-Banka"
24. Stockholding Company "Latvijas Komercbanka "Kredo-Banka""
25. State Stockholding Company "Latvijas Krājbanka"
26. Stockholding Company "Latvijas Kredītbanka"
27. Stockholding Commercial Bank "Latvijas Privātbanka"
28. Stockholding Company "Latvijas Tautas Banka"<sup>3</sup>
29. Stockholding Company "Latvijas Tirdzniecības Komercbanka"
30. Stockholding Company "Latvijas Universālā Banka"
31. Stockholding Company "Latvijas Zemes Banka"
32. Stockholding Company Commercial Bank "Lettika"
33. Stockholding Company "Liepājas Komercbanka"
34. Stockholding Company "LTN-Skonto Banka"

<sup>1</sup> Licence revoked on March 11, 1995.

<sup>2</sup> Licence suspended on March 24, 1995.

<sup>3</sup> Licence revoked on January 23, 1995.

35. Stockholding Company "Multibanka"<sup>1</sup>
36. Stockholding Company "Ogres Komercbanka"
37. Stockholding Commercial Bank "Olimpija"
38. Stockholding Company "Olti-Banka"
39. Stockholding Company "Parekss-Banka"
40. Stockholding Commercial Bank "Paritāte"
41. Stockholding Commercial Bank "Polārzsvaigzne"
42. Stockholding Company "Rietumu Banka"
43. Stockholding Commercial Bank "Rīga-Bank"
44. Stockholding Commercial Bank "Rīgas Apvienotā Baltijas Banka"
45. Stockholding Company "Rīgas Komercbanka"
46. Stockholding Company "Rīgas Naftas un Ķīmijas Banka"
47. Stockholding Company "Rīgas Starptautiskā Banka"
48. Latvian Commercial Bank Stockholding Company "Sakaru Banka"
49. Stockholding Company "Saules Banka"
50. Stockholding Company "Talsu Komercbanka"
51. Stockholding Company "Tukuma Banka"
52. Stockholding Company "Vācijas-Latvijas Banka"
53. Stockholding Company Commercial Bank "VEF Banka"
54. Stockholding Company Commercial Bank "Ventspils Apvienotā Baltijas Banka"
55. Stockholding Company Commercial Bank "Viktorija"

## PAWNSHOPS

1. Stockholding Company Pawnshop "Aizdevums"
2. Stockholding Company "Apvienotais Lombards"
3. Stockholding Company Pawnshop "Baltijas Pērle"
4. Stockholding Company Pawnshop "Dagne"
5. Stockholding Company Pawnshop "Klints"<sup>2</sup>
6. Stockholding Company "Liepājas Lombards"<sup>3</sup>
7. Stockholding Company "Lombards Karāts"<sup>4</sup>
8. Stockholding Company "Lombards Laimdota"
9. Stockholding Company "Lombards "Laterna""
10. Stockholding Company "Lombards Timits"<sup>5</sup>
11. Stockholding Company "Lombards Velve"
12. Stockholding Company Pawnshop "Louan"

<sup>1</sup> Licence granted on April 18, 1994.

<sup>2</sup> Licence granted on February 3, 1994.

<sup>3</sup> Licence granted on July 21, 1994.

<sup>4</sup> Licence granted on September 29, 1994.

<sup>5</sup> Licence granted on December 29, 1994.

13. Stockholding Company Pawnshop "Margerts"
14. Stockholding Company Pawnshop "Nauda un Labklājība"
15. Stockholding Company Pawnshop "Omega"<sup>1</sup>
16. Stockholding Company "Pirmais Privātais Lombards Rīgā"
17. Stockholding Company Pawnshop "Rocība"<sup>2</sup>
18. Stockholding Company Pawnshop "Unions"
19. Stockholding Company "Vecpilsētas Lombards"

#### CREDIT UNIONS

1. Credit Union "Bastejs"<sup>3</sup>
2. Credit Union "Vienība"<sup>4</sup>

#### BRANCHES AND REPRESENTATIVE OFFICES OF FOREIGN COMMERCIAL BANKS

1. Branch of Stockholding Company "Societe Generale" (France)<sup>5</sup>
2. Representative Office of Stockholding Company "Dresdner Bank" (Germany)<sup>6</sup>

<sup>1</sup> Licence granted on November 24, 1994.

<sup>2</sup> Licence granted on June 9, 1994.

<sup>3</sup> Licence granted on February 24, 1994.

<sup>4</sup> Licence granted on July 7, 1994.

<sup>5</sup> Licence granted on July 14, 1994.

<sup>6</sup> Licence granted on March 17, 1994.

**APPENDIX 3. STRUCTURE OF THE BANK OF LATVIA  
DEPARTMENTS AT THE END OF 1994**

**MONETARY POLICY DEPARTMENT:**

- Analysis Division;
- Securities Division;
- Refinancing Division.

**CREDIT INSTITUTION SUPERVISION DEPARTMENT:**

- Licensing Division;
- Supervision Division;
- Methodological Division.

**FOREIGN EXCHANGE DEPARTMENT:**

- Settlements Division;
- Market Operations and Investment Division;
- Foreign Loan Division.

**ACCOUNTING AND SETTLEMENTS DEPARTMENT:**

- Central Accounting Division;
- Internal Operations Division;
- Settlements Division.

**INFORMATION SYSTEMS DEPARTMENT:**

- Systems Analysis and Design Division;
- Programming and Systems Introduction Division;
- Technical Maintenance Division.

**STATISTICS DEPARTMENT:**

- Statistics Division;
- Mathematical Analysis of Statistics Division.

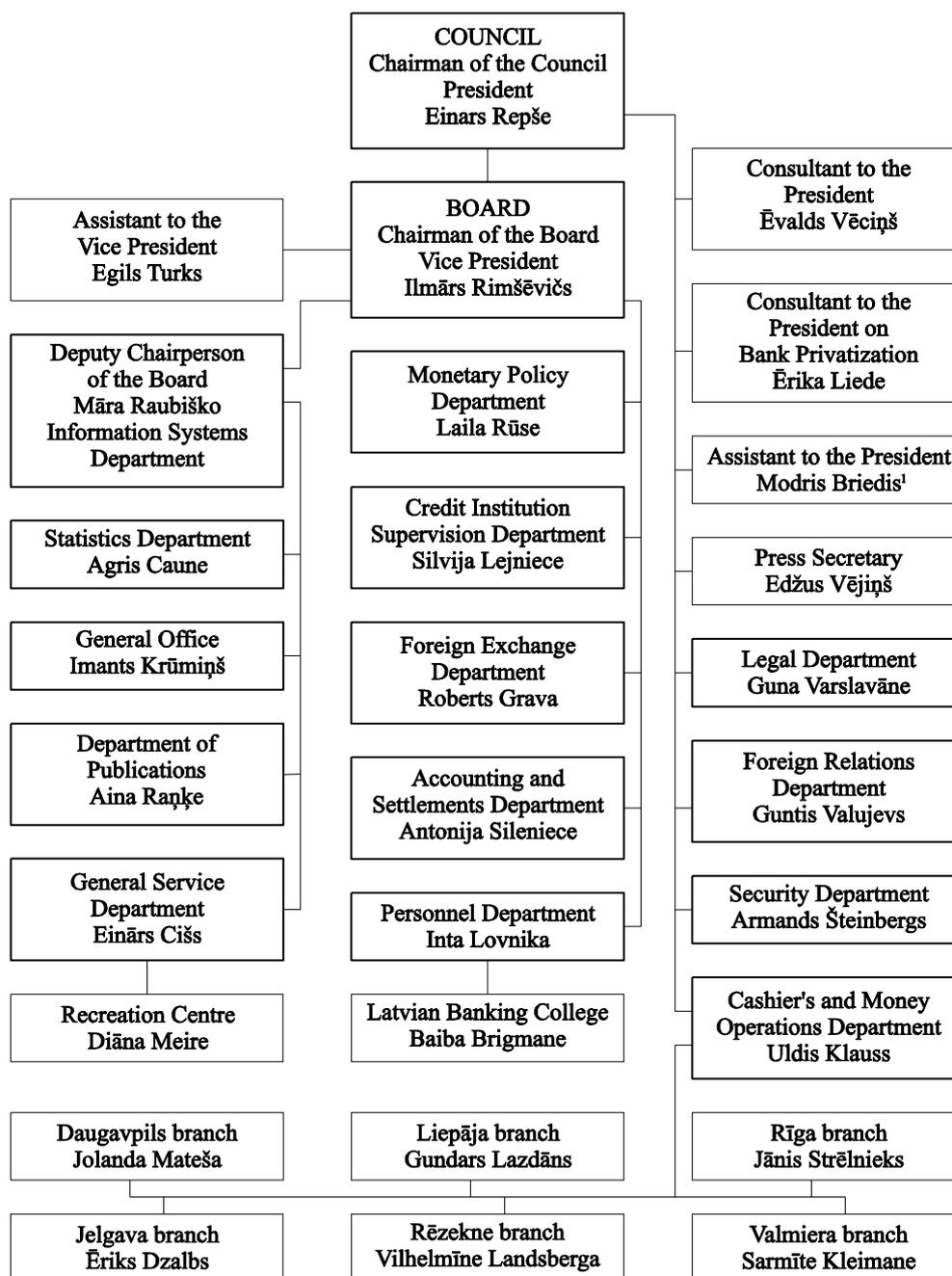
**CASHIER'S AND MONEY OPERATIONS DEPARTMENT:**

- Cash and Money Transportation Division;
- Money Turnover Regulation Division.

**GENERAL OFFICE:**

- Clerical Office;
- Guest Reception and Translation Division.

## STRUCTURE OF THE BANK OF LATVIA AT THE END OF 1994



<sup>1</sup> Ineffective January 4, 1995; Head of the Internal Auditing Department since January 5, 1995.

## Latvijas Banka. Annual Report 1994

Latvijas Banka (Bank of Latvia)

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Printing by Publishing House "Jāņa sēta"

Elizabetes iela 83/85 korp. 2, LV-1011 Rīga, Latvia