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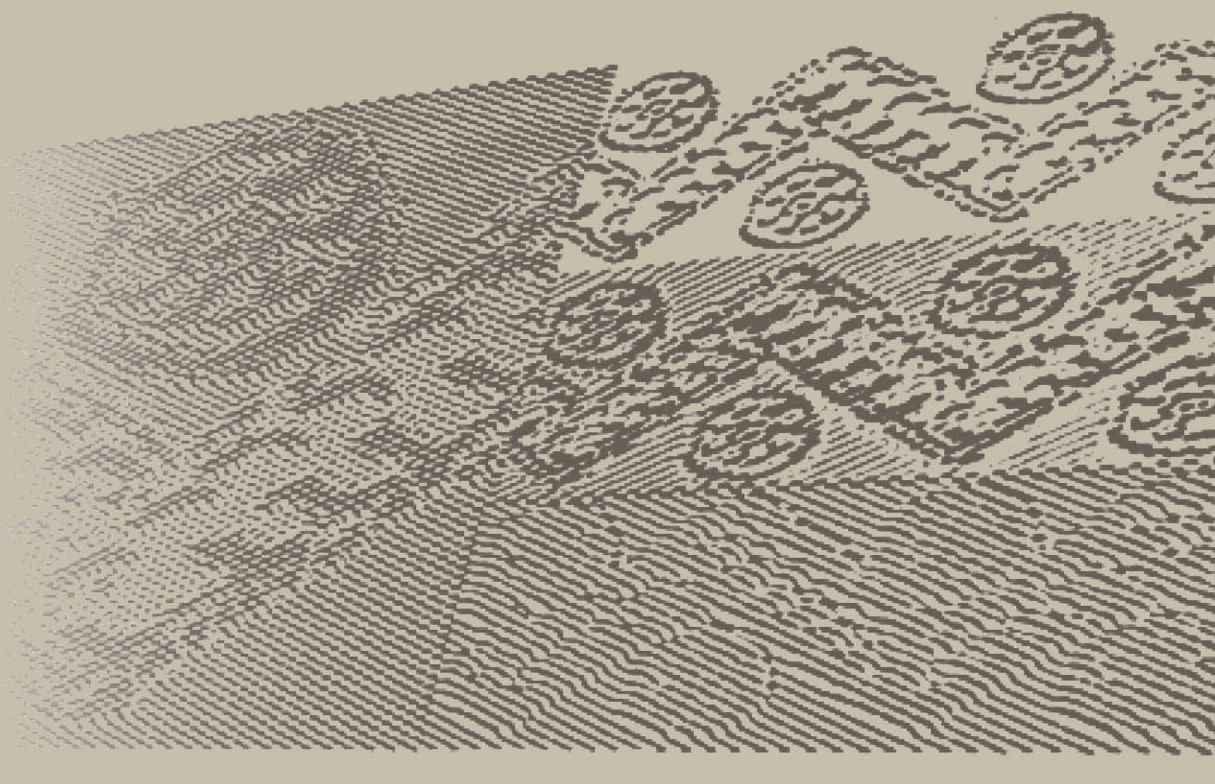
BANK OF LATVIA: ANNUAL REPORT 2006



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

Details may not add because of rounding-off.

– *no transactions or no outstanding amounts in the period.*
x *no data available or no computation of indicators possible.*
0 *the indicator is below 0.5 but over 0, or the result of the computation of the indicator is 0.*

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Photos by Gunta Andersone and Andris Tenass.

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ABBREVIATIONS

BIS	Bank for International Settlements
CEBS	Committee of European Banking Supervisors
CIF	cost, insurance and freight at the importer's border
CIS	Commonwealth of Independent States
CSB	Central Statistical Bureau of Latvia
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EFC	Economic and Financial Committee
EKS	Bank of Latvia's Electronic Clearing System
EMU	Economic and Monetary Union
ERM II	Exchange Rate Mechanism II
ESCB	European System of Central Banks
EU	European Union
EU8	countries which joined the EU on 1 May 2004 (except Cyprus and Malta)
EU10	countries which joined the EU on 1 May 2004
EU15	EU countries before 1 May 2004
Eurostat	Statistical Bureau of the European Community
FCMC	Financial and Capital Market Commission
FM	Ministry of Finance of the Republic of Latvia
FOB	free on board at the exporter's border
FRS	US Federal Reserve System
GDP	gross domestic product
IMF	International Monetary Fund
ISO	International Organization for Standardization
JSC	joint stock company
KMAS	Customer Payments Processing System
LCD	Latvian Central Depository
M0	monetary base
M1	narrow monetary aggregate
M2	intermediate monetary aggregate
M2X	broad money
M3	broad monetary aggregate
MFI	monetary financial institution
NACE	Statistical classification of economic activities within the Community *(Nomenclature statistique des activités économiques dans la Communauté européenne)*
NATO	North Atlantic Treaty Organisation
OECD	Organisation for Economic Co-operation and Development
OFIs	other financial intermediaries, except insurance corporations and pension funds
Plc	public limited company
RIGIBID	Riga Interbank Bid Rate; the index of Latvian interbank interest rates on deposits
RIGIBOR	Riga Interbank Offered Rate; the index of Latvian interbank lending interest rates
RSE	Riga Stock Exchange
SAMS	Bank of Latvia's Interbank Automated Payment System
SEPA	single euro payments area
SDR	Special Drawing Rights
TARGET2	a new generation of Trans-European Automated Real-time Gross settlement Express Transfer system
US	United States of America
VAT	value added tax
VNS	Bank of Latvia securities settlement system

FOREWORD OF THE GOVERNOR

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In 2006, the pace of economic growth in Latvia remained the highest among the EU countries for the third consecutive year, resulting in notably improved prosperity of the nation. However, the growth was primarily driven by domestic consumption, with the contribution from exports, though solid overall, shrinking. The GDP growth was also supported by an ongoing integration with the EU and a steep rise in foreign direct investment inflows, to 8.1% of GDP, an increase of 2.2 times.

This rapid growth, however, was accompanied by signs of macroeconomic imbalances: high and sustainable inflation exceeding 6% for the third consecutive year, more pronounced external imbalances (imports in excess of exports), and a growing external debt. To address these imbalances, the Government of Latvia and other economic policy makers must consistently implement a coordinated action plan.

Monetary policy decisions of the Bank of Latvia have focused on dampening the pace of inflation and promoting a balanced long-term economic growth. Duly accounting for the need to minimise economic overheating that might present an upward risk for sustainable economic development over a longer horizon as well as for the negative real interest rates on transactions in lats and increases in the ECB key interest rates and the US base rates, the Bank of Latvia raised its refinancing rate on two ocassions to 5.0% (in July and November by 0.5 percentage point). The central bank left its reserve ratio unchanged to stand at 8%, but expanded the minimum reserve base of banks.

In order to rein in the growth of lending, a key driver of domestic consumption, the Bank of Latvia engaged in attracting government deposits so far placed with other banks, thus trying out solutions less typical for a central bank. Following the repegging of the lats to the single European currency, the lats and the euro have become easily interchangeable currencies. Interest rates have lost their effectiveness as one of the main monetary policy instruments in cases that require adjustments of macroeconomic trends, as more than a half of all loans to residents have been extended in euro. Thus the impact and effectiveness of the traditional central bank's monetary policy instruments have substantially weakened, and macroeconomic adjustments were to be primarily made in the fiscal policy domain. With this in view, the Bank of Latvia actively continued to advocate the need for a tighter fiscal policy during the expansion of the business cycle.

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Given the ever more threatening signs of economic overheating, the Government of Latvia formed after October 2006 elections was urged to develop an anti-inflation and macroeconomic stabilisation plan, which was endorsed in March 2007. Although the fixed exchange rate regime in Latvia offers certain advantages, it also implies that the key inflation curbing measures should refer to the fiscal policy area, with provisions being made for the time when the contraction of the business cycle sets in. The plan provides for a balanced budget in 2007 and 2008 and for a budget with a surplus in 2009 and 2010; it envisages measures to dampen the pace of mortgage lending and to boost export competitiveness and domestic competition, including an increase in the number of small and medium-sized enterprises as well as productivity improvements in an attempt to confine inflation already in the coming years.

Steady commitment to the measures under the plan will serve as evidence of the Government's understanding of macroeconomic processes and its ability to control them; if consistently implemented, this set of measures may prove to be sufficiently effective in reducing risks to Latvia's macroeconomic development in the coming years. It may likewise permit projecting the years 2011 to 2013 as the period for Latvia to attain full compliance with the Maastricht criteria while promoting sustained economic growth and readiness for the euro changeover, the main macroeconomic challenge for the Government of Latvia and the Bank of Latvia for some time to come.

Six new collector coins were minted in 2006. Continuing to diversify the design of the Latvian money through limited issues of 1-lats coins, the Bank of Latvia released new coins *Pinecone* and *Līgo Wreath*. The Bank of Latvia continued the established tradition of holding annual public opinion polls to nominate the coin of the year. The heptagonal *Coin of Digits* won the title *Latvia's Coin of the Year 2006*.

The Bank of Latvia strongly believes in promoting public awareness of its operation and decision-making process as well as the economic development of the country as one of its most important missions. With this in view, *The Bank of Latvia's Statements of Its Vision, Mission and Values* was approved by the Bank of Latvia's Council in July 2006; that is why the reports and discussions at the conference *Latvia on Its Way to Prosperity: Growth Potential and Development Prospects*, hosted by the Bank of Latvia in October 2006, focused on preconditions for Latvia's convergence with the EU in terms of average prosperity levels, a topic so vital for both the economic policy makers and public at large.

Hereby I would like to express my deep gratitude to the Council and Board of the Bank of Latvia for successful organisation of Bank of Latvia's work and to each employee of the Bank for their committed everyday contribution to and creativity in helping in the implementation of the Bank of Latvia's tasks.

May the Annual Report enable everyone to examine and evaluate the Bank of Latvia's work!

Ilmārs Rimšēvičs
Governor, Bank of Latvia
Riga, 11 April 2007

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NATIONAL ECONOMY DEVELOPMENTS AND MONETARY POLICY

GLOBAL ECONOMIC ENVIRONMENT

In 2006, the global economic development proceeded at a faster pace than expected. In the first half of the year, inflationary pressures even intensified further under the impact of oil price rises and triggered the raising of central bank key rates. Nonetheless, following the steep growth in the first half of the year, the global economy started losing some momentum in the second half of the year. It was primarily caused by a stronger moderation of the US economic growth that started in the second quarter and was on account of a sluggish real estate sector and later also industry. The US GDP growth rate picked up only towards the close of the year due to the fall in fuel prices (with a positive effect on private consumption) and successful expansion of exports. As a result, the US position of the driver of global economic growth slightly weakened, with Asian countries (excluding Japan where strengthening of domestic demand proceeded at a slower pace in the second half of the year) taking the lead in the second half of the year. In 2006 compared with the previous year, the economic growth in the euro area was comparatively buoyant, yet the performance differed across countries.

The economic growth at the end of the year was fuelled by a substantial reversal in oil prices, after a prolonged period on an upward trend, on account of shrinking demand and increasing stocks in the US as well as a more favourable political situation in oil-producing countries. Following the upswing from 59 US dollars per barrel at the beginning of the year to the high of 78 US dollars in August, oil prices dropped to the start-of-the-year level again towards the end of the year.

Global economic growth stirred up investors' interest in equity securities. In 2006, the European stock market index Dow Jones EUROSTOXX 50 increased by 15.1%, the US stock market index S&P 500 by 13.6%, NASDAQ Composite by 9.5%, and the Japanese stock market index Nikkei 225 by 6.9%. A particularly sizeable increase was observed in China where SSE A Share stock market index surged by 130.6%. The high prices of natural resources underpinned the economic growth in Russia, and its stock market index RTS grew by 70.7%.

Interest rates increased in 2006. Drawing on the upward medium-term risks to price stability in the euro area, the ECB increased its key interest rate by 1.25 percentage points to 3.50% (in five consecutive steps). A number of EU central banks also increased their base rates substantially. The FRS continued raising the base rates in the first half of the year (from 4.25% to 5.25%). In Japan, the deflation trend that had been undermining the national economy for seven years and the initial signs of consumer price rises urged the central bank not only to adjust the monetary policy's operational target, i.e. the money market interest rate on unsecured overnight lending transactions, but also to resolve on raising this rate from 0.10% to 0.25%.

With short-term interest rates increasing in the first half of the year, the yields on long-term debt securities also moved up. Nevertheless, the moderation of the economic growth anticipated to result from the restrictive monetary policy of central banks triggered a drop in long-term interest rates in the second half of the year, with the respective end-of-the-year rates still above the level of the beginning of the year. Yields on 2-year US government bonds stood at 4.8% at the end of the year (4.4% at the beginning of the year), whereas those on 10-year bonds were 4.7% (4.4%). Yields on 2-year German government bonds rose from 2.9% to 3.9%, whereas those on 10-year bonds went up from 3.3% to 4.0%.

In 2006, the euro appreciated against the US dollar and the Japanese yen but depreciated against the British pound sterling. The US economic data that testified to a potential overhang, and the projections that other major central banks will proceed to implement restrictive monetary policies weakened the position of the US dollar in the global market. In 2006, the euro appreciated against the US dollar from 1.18 to 1.32.

The economy of the euro area displayed positive trends in 2006, with GDP growing rather dynamically and exceeding the potential growth level in the first two quarters. In the second half of the year, the economic activity again lost some momentum and the growing domestic demand was the main driving force behind the growth, while the contribution of net exports to the GDP growth became negative in the third quarter. The increase in domestic demand in 2005 and 2006 was essential for a balanced economic development in the euro area. At first, the dynamics was on account of notably larger investment, with private consumption gradually assuming more importance. The contributions of private consumption and investment to GDP growth were almost equal already in the third quarter. Positive trends in the euro area labour market and lower oil prices were the main drivers of the growing private consumption. Compared with 2005 and overall, inflation in the euro area remained unchanged in 2006 (2.2%). Inflation rose over 2.5% in the second quarter but dropped below 2% (the ECB inflation reference value) at the end of the year after more than two years due to a fall in oil prices.

By country, the euro area GDP growth rates continued to vary, yet in most of the euro area countries the GDP growth rate was above that in 2005. A rather steep rise in GDP was observed in Germany and France, the two largest EU countries. Thus in Germany GDP increased by 2.7% in 2006, with both the external and domestic demand supporting it (private consumption expanded after a two-year slowdown and investment also grew in 2006). In France, GDP rose by 2.2%.

In 2006, the economic growth in the EU8 countries remained buoyant, with its pace accelerating more in Poland, Slovakia, the Baltic States, the Czech Republic and Slovenia. Inflation was the highest in the Baltic States, which also reported the most dynamic growth, and in Hungary and Slovakia. The Czech Republic and Poland were the only countries in this group whose inflation remained close to the ECB reference value. Inflationary pressures were re-enforced by substantial wage increases and lending expansion. The decision of the EU institutions to approve of Slovenia as first among the new EU Member State to join the euro area and introduce the single currency as of 1 January 2007 was the most significant event.

Despite shrinking domestic demand in the second half of the year, the GDP growth in the United Kingdom was robust. As starting with the second quarter inflation rose above the Bank of England's reference value, the base rates were raised by 0.5 percentage point in August and November (to 5.0%).

GDP in Sweden increased rapidly in 2006 (by 4.4% compared to 2.9% in the previous year). At the beginning of the year, the growth was basically on account of export expansion. Domestic demand was also solid, particularly contributing to the economic growth in the second half of the year. On the back of the rapid economic development and upward inflationary risks, *Sveriges Riksbank* raised its base rate by 1.25 percentage points in six consecutive steps (to 3.0%).

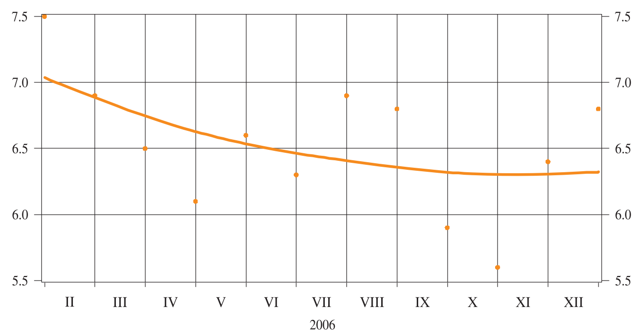
In Russia, GDP gained 6.7% in 2006. On the demand side, growth was primarily driven by expanding private consumption and capital investment, with a negative contribution from net exports. On the supply side, construction and trade developed dynamically but the growth rate of industry moderated.

INFLATION AND PRICES

In 2006, the average annual inflation in Latvia was 6.5%, only slightly below the 2005 level. This high level was attributable to adjustments in indirect taxes, gradually rising administered prices and higher food prices together with the robust domestic demand supporting rather high core inflation (5.1%), including a steep rise in non-administered service prices. In December 2006 compared with the respective period of the previous year, consumer price inflation stood at 6.8% (see Chart 1).

Chart 1

ANNUAL CONSUMER PRICE INFLATION
(year-on-year basis; %)



Source: CSB.

In contrast to 2005, the growth in average service prices slightly outpaced that in goods prices. Comparative robustness of goods prices was determined by the exchange rate dynamics, stable and low inflation in the majority of Latvia's main trade partners and an abundant supply of non-food commodities (household appliances, clothing and footwear). Due to oil price volatility, the contribution of fuel prices to total inflation shrank.

Due to the alignment of tax legislation, the excise tax on tobacco and alcoholic beverages was raised in January. Natural resources tax on electrical appliances did not affect inflation notably, whereas heating prices recorded a temporary drop after VAT cuts to 5% as of July.

In the group of administered prices, substantially more costly energy resources (the price of natural gas went up in January and May) caused an upsurge of heating tariffs. In March, electricity for households became 6.7% more expensive. In the course of the year, the majority of public utility service prices went up, rent for housing increased, costs gradually pushed up transport service prices, and kindergarten fees rose markedly. The impact of administered prices on the average annual inflation rate was almost two times stronger than in the previous year (1.5 percentage points).

The impact of fuel prices on overall inflation weakened (0.4 percentage point in 2006 and 1.1 percentage points in 2005). The drop was on account of oil price volatility and the excise tax, which, unlike the last year, remained unchanged.

Food prices continued on an upward trend due to costs and poor harvest. They went up notably in the second half of the year when cereal product prices hiked. The contribution of unprocessed food prices to inflation was almost the same as in 2005 (0.8 percentage point).

Though core inflation was slightly below the last year's rate, it soared at the end of the year to 5.8%. Prices of processed food and non-administered services posted the highest rises. The prices of personal grooming, public catering and hotel ser-

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vices posted a considerable seasonal pickup due to the rising number of tourists arriving to attend significant international events hosted in Riga. Communication service prices continued to decline (albeit less than in the previous year) due to competition.

In 2006, producer prices in industry grew by 10.3% on average, including an increase of 10.0% for goods sold within the domestic market and 10.9% for exported goods. Higher prices of energy, capital goods and intermediate goods (by 14.8%, 12.6% and 11.2% respectively) had the most pronounced effect on the domestic price surge. The prices of non-durable consumer goods (together with energy prices directly affecting consumer price rises) picked up 6.1% (including a 7.2% increase in food, alcoholic beverages and tobacco prices), whereas those of durable consumer goods dropped 0.3%.

In line with a 44.2% rise in wages and salaries, construction costs posted a very rapid increase of 20.9%. Maintenance and operational costs of machinery and mechanical appliances also grew by 20.9% and building material prices by 10.1%.

Both the export and import unit value continued to increase in 2006, albeit at a slower pace than in the previous year. Export prices grew by 9.7% (by 10.3% in 2005) and import prices moved up by 9.3% (12.6%). Since the export price rise was faster, the terms of trade improved.

Base metals and articles of base metals, mineral products, transport vehicles and products of the chemical and allied industries posted price rises of 22.0%, 18.8%, 12.3% and 11.2% respectively. The prices of wood and articles of wood, and prepared foodstuffs, the major export commodities, also rose substantially (by 5.3% and 4.7% respectively). The growth of export volume was only marginal (2.9%), thus overall export growth was underpinned by price rises.

The import unit value, in turn, recorded the fastest year-on-year growth for all commodities and products dominating imports: mineral products (22.3%), machinery and mechanical appliances, electrical equipment (9.0%), base metals and articles of base metals (7.1%), and transport vehicles (5.7%). Price rises accounted for one third and volume expansion for two thirds of import growth.

GROSS DOMESTIC PRODUCT

A very buoyant but hardly balanced economic growth was observed in Latvia in 2006. It was underpinned by swiftly surging private consumption and sustainable high investment growth, the components of domestic demand. Although the external demand was relatively solid, it followed a downward trend of change. GDP amounted to 11.3 billion lats at current prices, with real GDP exceeding the level of the previous year by 11.9% (see Table 1).

Table 1

ANNUAL GROWTH OF GDP AND GROSS VALUE ADDED
(at constant prices; %)

	2005	**2006**
GDP	10.6	**11.9**
Gross value added	10.8	**11.5**
Goods-producing sector	8.5	**7.0**
Services sector	11.7	**13.1**

Source: CSB.

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In the first nine months of 2006, private consumption grew by 17.0% and accounted for the major part of the strengthening in domestic demand. Larger household expenditure in 2006 was supported by an on-going expansion of lending and a notable rise in disposable income fuelled by improved employment, higher real average wages and salaries, increasing compensation of residents abroad, and rising social benefits and pensions. In addition to these impartial factors, price rise expectations and the optimism generated by increases in households' assets and the buoyant economic development were the drivers of consumption.

Gross capital formation amounted to 41.0% of GDP in the first nine months of 2006. At the same time, gross fixed capital formation in this period grew by 13.5%. In the previous period of five years, the average increase in investment in fixed assets was 15.8% on an annual basis mainly on account of the low base, since in the early 1990s economic slowdown was observed and practically no dwelling space was renovated or new housing built. Along with the base effect, the growth was boosted by positive financial performance of businesses in the previous periods (reinvested earnings), dynamic development of lending, and expectations for on-going buoyant economic growth, the latter mainly underpinning investment in trade and real estate, renting and other business activities, the most rapidly growing sectors.

In real terms, exports of goods and services increased by 11.3% in the first nine months of 2006, while imports driven by the expansion of domestic demand grew at a faster pace (by 18.7%). Deceleration in export growth was on account of shrinking export volumes or moderation of the growth rate for certain commodity groups (mineral products, paper and paperboard, wood and articles of wood, etc.). Growing costs and rising prices impaired Latvia's external competitiveness, and it was an additional incentive for businesses to primarily focus on meeting the domestic demand.

At the same time, the pressure increased from such factors as growing labour market tensions, price rises, upsurge in household debt, disproportionate strengthening of domestic demand contributing to negative net exports, large investments in housing, cars and sectors with a relatively low value added, all of which constraining further economic development.

In the services sector, which posted the highest growth overall, particularly strong development was observed in trade, its key branch (17.4%), real estate, renting and business activities (17.6%), and transport, storage and communication (9.3%).

In 2006, the expansion of retail trade turnover at current prices (including sales of motor vehicles and automotive fuel retailing) was particularly strong (29.8%), with sales rising to new record highs every quarter in the last couple of years. This increase was primarily triggered by the demand for durable goods, with sales of furniture, household goods (mainly electrical appliances), and building materials posting a very large pickup in the second half of the year along with rapidly growing trade in transport vehicles (an annual increase of 13.0 percentage points on average). The contribution of this commodity group to the overall increase in trade turnover grew from 3.5 percentage points in the first half of the year to 5.8 percentage points in the second half of the year.

In the transport, storage and communication sector, substantial increases were recorded for commercial freight transportation by road (33.7%), oil product transportation by pipeline (22.0%) and a number of communication services. By contrast, freight transportation by rail declined (by 11.2%) mainly on account of narrowing volumes of oil products and mineral fertilisers. Notwithstanding the increase (3.8%) in freight turnover at Riga port, the total freight turnover at Latvian ports decreased somewhat (by 0.9%).

Moderation in the goods sector growth was a result of a slowdown in manufacturing (6.2%) on account of weakening external demand and narrowing manufacture of wood and products of wood and cork. In the course of the year, construction developed very successfully, recording a 13.6% increase.

The buoyant development of economy was boosted by significant investment in the production development. Non-financial investment amounted to 2.0 billion lats at constant prices (a 12.0% increment year-on-year). The largest investment was made in four sectors: manufacturing (353.9 million lats), real estate, renting and business activities (267.8 million lats), transport, storage and communication (258.6 million lats), and trade (257.2 million lats).

The robust economic growth for the second consecutive year was a driver behind a notable drop in the registered unemployment rate (from 7.4% at the end of December 2005 to 6.5% at the end of December 2006). The rapid increase in the number of registered job vacancies (twice as many year-on-year in December) also pointed to the effects of economic growth and labour mobility; the average number of vacancies registered per annum exceeded the respective indicator for 2005 by 89.2%. With the number of unemployed shrinking and that of registered vacancies increasing, the unemployment/vacancy ratio (the number of registered unemployed per vacancy) declined to 5.4 (11.7 in 2005).

The total unemployment rate was still affected by structural unemployment. Despite the fastest drop in unemployment in 2006, its rate in Latgale region was still high (14.1%). At the end of 2006, the lowest unemployment rate was registered in Riga (3.8%), while in Kurzeme, Zemgale and Vidzeme it was 6.6%, 6.7% and 6.8% respectively. With the State Employment Service sustaining its activities, a considerable progress in reducing the number of long-term unemployed was made. At the end of 2006, 15.9 thousand long-term unemployed or 23.1% of the total number of unemployed persons was registered (20.6 thousand or 26.2% in 2005).

FOREIGN TRADE AND THE BALANCE OF PAYMENTS

In 2006, the foreign trade turnover was 9.6 billion lats (see Table 2). Following the accelerated growth in the previous year, the expansion of exports of goods (13.3%) moderated notably whereas the boom in imports (29.4%) was driven by the persistently strengthening domestic demand, including the implementation of several large investment projects. The excess of imports over exports reached 92.5% (68.5% in 2005).

Table 2

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

	2005	**2006**
Exports	2 888.2	**3 272.5**
Imports	4 866.9	**6 298.3**
Balance	–1 978.7	**–3 025.7**

Source: CSB.

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Foreign trade deficit increased for the groups of transport vehicles, machinery and mechanical appliances, electrical equipment and mineral products since the year-on-year expansion of imports of the above commodity groups several times exceeded that of exports. Only wood and articles of wood posted a surplus. The highest foreign trade deficit growth was recorded with EU countries (mostly EU15 countries), moderating with CIS countries. Of the major trade partners, it was only with the United Kingdom that Latvia recorded a foreign trade surplus, which also shrank. The considerable widening of the foreign trade deficit with Germany and Poland was driven by the rapid rise in imports from these countries.

Wood and articles of wood (22.6% of total exports), base metals and articles of base metals (14.9%), agricultural and food products (13.3%), machinery and mechanical appliances, electrical equipment (9.8%), as well as textiles and textile articles (8.2%) were Latvia's major export goods in 2006. The largest increase was recorded for exports of base metals and articles of base metals, transport vehicles, agricultural and food products, products of the chemical and allied industries, and machinery and mechanical appliances, electrical equipment. Exports of transport vehicles, agricultural and food products, and machinery and mechanical appliances, electrical equipment grew on account of expanding volume, while base metals and articles of base metals increased due to price rises; both factors contributed to the increase in exports of products of the chemical and allied industries and textiles and textile articles. The growth rate of exports slowed down notably as a result of the subdued increase (2.9%) in wood and articles of wood, the major group of exports, the 13.2% fall in exports of pulp of wood, paper and paperboard and the drop in exports of mineral products by one third on account of declining volume.

In 2006, three fourths of total exports went to EU countries, with the year-on-year growth expanding by 11.0%. The largest share of the increase in exports of goods was delivered to EU10 countries (Lithuania and Estonia), whereas exports to Poland decreased 1.9 times. Exports to EU15 countries grew on account of higher exports to Germany, Belgium, Italy and the Netherlands, at the same time recording a decrease to the United Kingdom, Sweden and Finland. Wood and articles of wood (26.8% of total exports to the EU), base metals and articles of base metals (15.7%), agricultural and food products (12.1%), textiles and textile articles (8.0%), and machinery and mechanical appliances, electrical equipment (7.9%) were Latvia's major export goods to EU countries. Exports expanded by almost one third to CIS countries, primarily Russia, and slightly also to other countries (Norway and Algeria). Exports to CIS countries were dominated by machinery and mechanical appliances, electrical equipment (20.6% of total exports to this group of countries), agricultural and food products (19.9%), products of the chemical and allied industries (14.9%), and textiles and textile articles (10.6%), whereas wood and articles of wood (19.9%), base metals and articles of base metals (18.8%), mineral products (14.8%), and agricultural and food products (13.2%) were major exports to other countries. In 2006, Latvia's principal export partners were Lithuania (14.6% of total exports), Estonia (12.6%), Germany (10.1%), Russia (8.9%), the United Kingdom (8.0%) and Sweden (6.5%).

No essential improvement in competitiveness was observed on any of the major trade partner markets in 2006. The decrease in the nominal effective exchange rate of the lats (0.5%) in comparison with the average in 2005 was too insignificant to offset the rise in prices and costs vis-à-vis most of major trade partner currencies (except Russia, Poland, Lithuania and Estonia). The CPI-deflated real effective exchange rate of the lats increased by 3.2%, including a rise of 4.8% against the currencies of the developed countries. The rapid increase in producer prices in industry resulted in a more pronounced fall in cost competitiveness: the PPI-deflated real effective exchange rate of the lats moved up 4.3%, including a 5.9% rise relative to the currencies of the developed countries.

In 2006, the notable expansion in imports was on account of Latvia's major import goods: machinery and mechanical appliances, electrical equipment (19.5% of total imports), mineral products (13.6%), transport vehicles (13.5%), agricultural and food products (11.2%), base metals and articles of base metals (9.6%), as well as products of the chemical and allied industries (8.4%). The expanding volume had a notable impact on imports of transport vehicles, prepared foodstuffs, base metals and articles of base metals, and products of the chemical and allied industries. Higher imports of machinery and mechanical appliances, electrical equipment resulted from both growing volume and prices while imports of mineral products increased due to rising prices as the volume decreased.

Imports from EU countries accounted for 76.4% of total imports, mostly machinery and mechanical appliances, electrical equipment, transport vehicles, agricultural and food products, and products of the chemical and allied industries. Imports from CIS countries were dominated by mineral products, base metals and articles of base metals and wood and articles of wood whereas machinery and mechanical appliances, electrical equipment, mineral products, products of the chemical and allied industries and agricultural and food products. Latvia's principal trade partners in imports of goods were Germany (15.3% of total imports), Lithuania (13.0%), Russia (7.9%), Estonia (7.7%) and Poland (7.2%).

In 2006, the current account deficit of the balance of payments reached 21.1% of GDP (12.6% in 2005). The current account deficit widened due to a significant increase in the ratio of deficit of goods to GDP (from 18.9% in 2005 to 24.4% in 2006) and a higher income deficit ratio to GDP. At the same time, the ratios of surplus of services and current transfers to GDP decreased.

In 2006, the services surplus increased by 41.1 million lats year-on-year due to a higher rise in exports of services. The transportation services surplus went up notably, with the travel services deficit narrowing less. The surplus of other services contracted. Transportation services, other services and travel services accounted for 53.4%, 28.0% and 18.6% of total exports of services respectively. In the imports of services, the contribution of all services groups was similar.

The surplus of transportation services increased by 38.0 million lats, primarily on account of expanding exports of freight transportation services by road. Exports of passenger transportation services rendered by air also posted a solid increase, widening the surplus of this group of transportation services. The surplus of transportation services by sea shrank as a result of imports of freight transportation and other transportation-related services growing more than exports. With exports of travel services expanding at a faster rate than their imports, the travel services deficit narrowed by 14.0 million lats. According to the data provided by the CSB, in 2006 the spending of Latvia's travellers abroad was 138.4 million lats higher than that of non-resident spending in Latvia, despite a four times larger increase in the number of foreign visitors to Latvia than Latvian travellers abroad. The largest number of foreign travellers came from Lithuania and Estonia, with visitors from Lithuania and Germany spending the largest amount of money in Latvia. The most popular destinations for Latvian travellers were Lithuania (33% of the total number of Latvian travellers), Estonia (17%), Russia (11%) and Belarus (6%), while the largest amounts were spent in Lithuania (23.0% of overall spending abroad), Germany (10.1%) and Russia (8.6%). The surplus of other services shrank by 10.8 million lats. Although exports of financial services and their surplus recorded a notable increase, imports of other business activities (trade mediation and different business services) and construction services also posted considerable growth, and their balances turned negative.

In 2006, income deficit grew by 176.4 million lats year-on-year since the increase in the non-resident income from investment in Latvia (mostly in the form of income from direct investment and other investment) was three times that in resident income from investment abroad. It was only partly offset by a rise in compensation of employees received by residents abroad.

The current transfers surplus shrank by 66.2 million lats, mostly on account of larger amounts of debit transactions in other sectors and general government sector. Government contributions to the EU budget increased year-on-year, with the amount of the EU funds received remaining almost unaltered.

In 2006, net inflow of the capital and financial account amounted to 2 414.0 million lats. The current account deficit was covered by long-term capital in the form of foreign direct investment and long-term loans.

Net inflow of the capital account was 133.2 million lats, an 11.2% increase year-on-year. As in the previous two years, most of the net inflow of the capital account (98.2%) was the result of the EU fund inflows for investment.

Net inflow of foreign direct investment (915.9 million lats or 8.1% of GDP) was 2.2 times larger year-on-year, covering 38.5% of the current account deficit (a high of the last four years). Foreign direct investment in Latvia was made in the form of reinvested earnings (43.1% of total direct investment) and equity capital (35.7%). In 2006, the highest growth was observed in investment from Estonia, Cyprus, Sweden, Denmark and Germany, made in financial intermediation (mostly as a result of banks increasing their share capital), real estate, renting and business activities, wholesale and retail trade.

In 2006, portfolio investment posted a considerable increase both on the asset and liabilities sides, hence the net outflow reached only 6.9 million lats. Assets grew on account of bank investment in debt securities (60.8% of portfolio investment assets) and corporate sector investment in equity securities (20.8%). Liabilities expanded as a result of bank bond issues.

The surplus of other investment amounted to 2 522.3 million lats or 22.4% of GDP, mostly contributed by transactions in the banking sector (97.9%). The surplus of bank loans reached 2 214.9 million lats, with long-term loans accounting for the largest share (59.0%). The share of long-term loans in the bank net lending posted a considerable year-on-year drop (in 2005, long-term loans accounted for 73.1% of bank net lending). Non-resident demand deposits with Latvian banks grew by 283.3 million lats.

Foreign liabilities of the corporate sector posted a slightly higher growth than its claims. Long-term loans in the amount of 554.5 million lats dominated the increase in the corporate sector liabilities. The rise in lending resulted from the restructuring of funds within the financial groups: part of other financial intermediaries (leasing and factoring companies) borrowed from non-resident credit institutions rather than from their subsidiaries in Latvia.

In 2006, reserve assets increased by 1 103.0 million lats as a result of higher demand for lats, inter alia in relation to the compliance with the banks' minimum reserve requirement following the expansion of the banks' minimum reserve base.

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FISCAL POLICY

Based on the accrual principle used for evaluating compliance with the Maastricht criterion, the general government consolidated budget posted a surplus of 47.4 million lats or 0.4% of GDP in 2006. However, based on the cash flow principle the general government consolidated budget ran a financial deficit of 98.6 million lats or 0.9% of GDP. The ratio of the financial deficit to GDP was lower than the 1.3% of GDP reported in 2005 and also lower than the 1.4% of GDP projected in the budget. It was mostly achieved due to the steep increase in tax revenue resulting from the high economic growth rate.

The general government consolidated budget revenue reached 4.0 billion lats or 36.6% of GDP in 2006 representing an increase of 823.6 million lats or 25.7% over the year, with its ratio to GDP posting a 0.7 percentage point rise.

Tax revenue increased by 753.0 million lats or 29.6% year-on-year in 2006. Against the background of persistently growing private consumption, VAT collections posted an annual rise of 37.4%. Excise tax revenue grew by 16.6% on account of higher tax rates imposed on oil products, alcoholic beverages and beer, and tobacco products. Of the direct tax group, the most pronounced growth of 40.5% was reported for corporate income tax revenue resulting from surging corporate profits. Personal income tax revenue also increased notably by 29.0%. The dampening effect of raising the monthly untaxed minimum of personal income from 26 to 32 lats and monthly tax relief for a dependant from 18 to 22 lats was offset by increasing the minimum wage from 80 to 90 lats as well as by the rapidly growing employment and wages and salaries. The increase in wages and salaries also resulted in a significant growth in social security contribution revenue, amounting to 207.5 million lats or 27.6%.

Non-tax revenue expanded by a mere 10.7% year-on-year in 2006. Disbursements from the EU structural funds also posted a minor increase of 1.6%.

In 2006, the general government consolidated budget expenditure reached 4.1 billion lats or 37.4% of GDP, representing an increase of 808.8 million lats or 24.4%, with the ratio to GDP growing by 0.3 percentage point. With public sector wages and salaries rising, the related government spending increased notably by 24.6%. As a result of the pension indexation implemented in April and October 2006 and the changes in pension indexation provisions as well as an increase in some benefits, grants to the population expanded by 19.1%. Capital investment expenditure surged further considerably by 39.4%, partly on account of public investment in projects co-financed from EU funds.

The 2006 financial deficit of the general government consolidated budget stemmed from a significant deficit in the central government basic budget amounting to 283.6 million lats, whereas the deficit of the local government consolidated budget was only 3.1 million lats. The central government social security fund, by contrast, accumulated a notable financial surplus of 181.6 million lats, including a surplus of 141.2 million lats in the state pension fund resulting from the growth in social security contributions outpacing that of pension disbursements.

At the end of 2006, the general government debt totalled 1 115.1 million lats, representing an increase of 68.5 million lats year-on-year. The debt expanded primarily on account of the central government borrowing from the European Investment Bank to co-finance the Cohesion Fund and structural funds projects amounting to 52.7 million lats and an increase of 18.1 million lats in the foreign

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borrowing of the local governments. The domestic debt of the central government shrank by 3.7 million lats.

BANKING DEVELOPMENTS

At the end of 2006, 21 banks (the licence of one bank was cancelled in December), three branches of foreign banks (including two that were opened in 2006), 35 credit unions, three electronic money institutions and two money market funds were registered in the Republic of Latvia. Three new branches of Latvian banks were registered abroad in 2006. All Latvian banks, except one, are private in Latvia, and the Government's participating interest in the banking sector's paid-up share capital contracted to 8.2% at the end of 2006. The Latvian State is the sole owner of the SJSC *Latvijas Hipotēku un zemes banka*.

Against the background of persistently high economic growth and strong domestic demand, the activity of Latvia's financial sector continued increase; consequently, bank assets expanded by 45.4% in the course of the year. The rapid expansion of assets remained to be driven by the annual growth in lending to residents that was close to 60% in the second half of the year and even 90% in the case of mortgage lending. Lending to residents was increasingly more financed by borrowing from foreign MFIs totalling 34.2% of total liabilities at the end of the year, including 25.4% of the financing was received from parent banks.

Despite the raise of the minimum reserve requirements of the banks and growing interest rates, banks retained high profitability and cost-efficiency. The unaudited profit of banks for 2006 amounted to 265.9 million lats, whereas the ROE was 26.3%. The total spread continued to shrink, as under the circumstances of tight bank competition the climbing market rates fuelled a more rapid increase of interest expenditure, particularly relating to liabilities to MFIs. If the growth rate of interest expenditure continues to exceed that of revenue from interest, the banks' profitability will eventually be impaired.

The quality of bank assets improved further, whereas the capital adequacy ratio remained at the level of 2005; therefore, the banks' shock absorption capacity remained rather high.

Banks continued to develop and offered their customers new opportunities by opening branches both in Latvia and abroad, establishing investment management corporations and funds, improving remote settlement systems and introducing cash-in machines.

MONEY SUPPLY

Annex 1 provides an overview of the principal monetary aggregates of MFIs. Overall, the monetary growth supported the persistence of ample lats liquidity in 2006. M3 (broad monetary aggregate) increased by 40.3% over 39.3% in 2005, amounting to 5 506.8 million lats at the end of 2006 (see Chart 2). The robust growth of the Latvian economy and persistent inflation resulted in acceleration of the growth of money supply, with M3 expanding by 15.4% and 21.6% in the first and second half of the year respectively. The highest growth rate of M3 at 44.3% was reported in October (see Chart 3), whereas the biggest monthly increase of 296.3 million lats or 5.7% in December, when deposits with MFIs (except the Bank of Latvia) increased significantly and seasonal factors pushed up the demand for cash.

Chart 2

MONETARY AGGREGATES
(at end of period; in millions of lats)

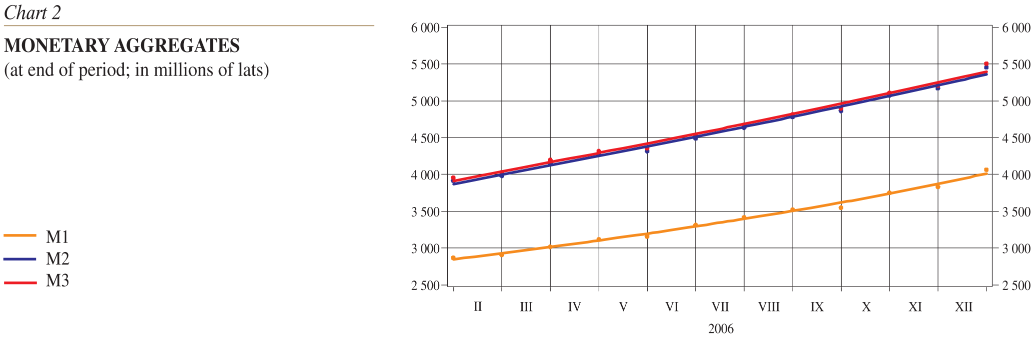
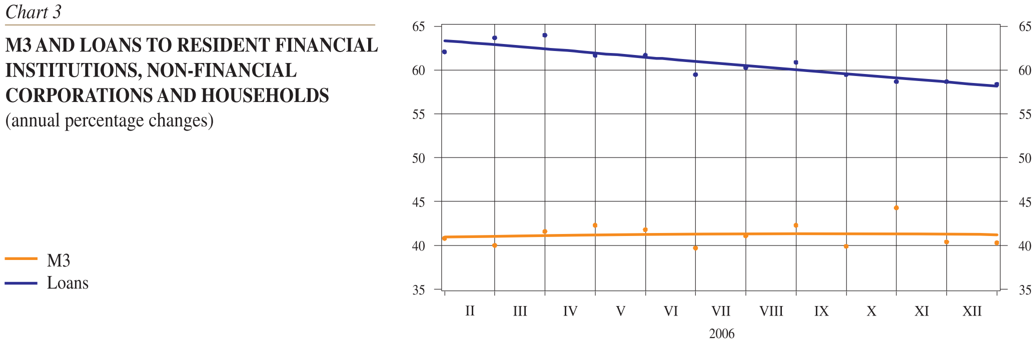


Chart 3

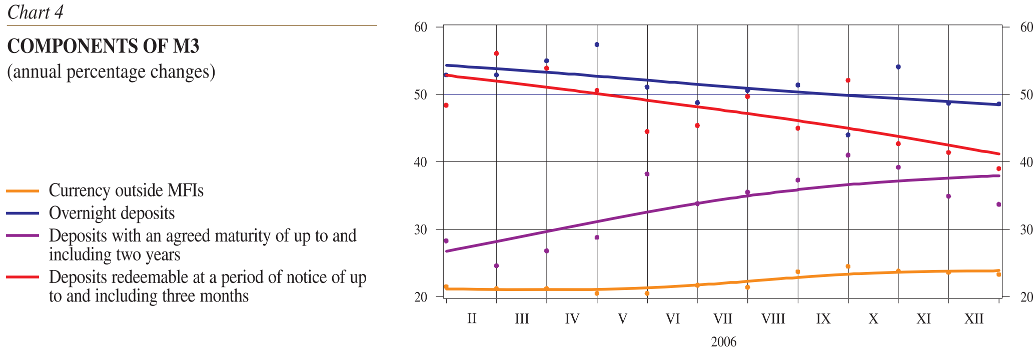
M3 AND LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(annual percentage changes)



The overall growth of M3 mostly reflected the expansion of the most liquid components of the narrow monetary aggregate M1, which increased by 41.7%, with overnight deposits with MFIs in all currencies growing by 48.6% (see Chart 4). The growth of currency outside MFIs accelerated to 23.3% in comparison with 21.8% in 2005, on account of mainly domestic demand driven economic growth, which was significantly affected by expanding retail trade turnover, and of high inflation. Yet M3 expanded mainly on account of bank deposits, and the cash component of M3 continued to shrink, contracting from 20.0% at the end of 2005 to 17.6% at the end of 2006.

Chart 4

COMPONENTS OF M3
(annual percentage changes)



M2 (intermediate monetary aggregate) increased by 39.7% in comparison with 38.7% in 2005, with all currency deposits redeemable at a period of notice of up to and including three months and all currency deposits with an agreed maturity of up to and including two years held with MFIs growing by 39.0% and 33.7%, respectively. The rapid growth rate notwithstanding, additional components comprised in the broad monetary aggregate M3 remained low, with money market fund shares/units growing 2.9 times during the year and totalling 46.1 million lats at the end of the year and MFI debt securities with a maturity of up to two years expanding by 41.2% in 2006 to stand at 4.8 million lats at the end of the year. So far, Latvian banks have concluded no repo agreements included in M3.

The monetary expansion was mainly driven by MFI loans to the private sector. The rapid lending growth notwithstanding, the money multiplier shrank, reaching 2.45 in December in comparison with 2.91 in December 2005. Economic stability and growing savings facilitated deceleration of the velocity of money circulation from 2.3 in 2005 to 2.0 in 2006.

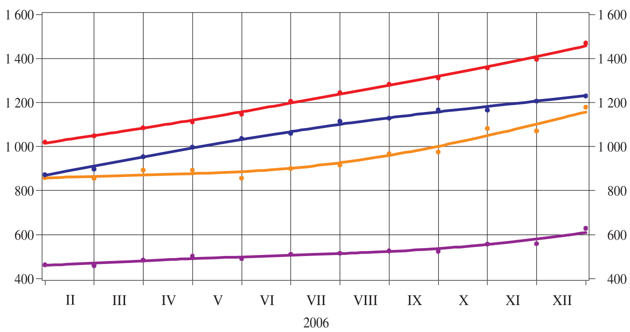
Growth of deposits in 2006 was supported by higher real income of the population, overall economic growth, development of banking services and an increasingly wider application of electronic payment instruments. Hence, deposits of resident financial institutions, non-financial corporations and households with MFIs increased by 1.3 billion lats or 41.0% in 2006 in comparison with 43.9% in 2005. Looking at the maturity profile of deposits, the share of overnight deposits expanded to 65.9% from 63.2% at end of 2005, with the share of time deposits contracting accordingly. Household deposits amounted to 59.9% of all resident deposits (58.2% at the end of 2005, see Chart 5), accounting for 74.9% of time deposits and 52.1% of overnight deposits (in 2005, 68.0% and 52.6% respectively).

Chart 5

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

(at end of period; in millions of lats)

- Lats deposits of financial institutions and non-financial corporations
- Lats deposits of households
- Foreign currency deposits of financial institutions and non-financial corporations
- Foreign currency deposits of financial institutions and non-financial corporations



Although lats deposits had higher yield rates, foreign currency deposits expanded at a slighter higher rate, with the annual increase of deposits in lats and foreign currencies amounting to 39.6% and 43.1% in 2006 respectively. The growing significance of the euro in the Latvian economy, its dominance in lending and the fixed exchange rate against the lats contributed to a notable increase in deposits made in this particular currency, and deposits by resident non-MFIs made in euro grew by 67.6% in 2006. The US dollar exchange rate volatility and persistently narrowing use of this currency in domestic transactions underlay an annual rise in the US dollar deposits by a mere 2.2%. At the end of 2005, deposits in the US dollars accounted for 34.1% of resident non-MFI deposits made in foreign currencies, while at the end of 2006 the share contracted to 24.1%, with the share of the euro in total deposits expanding from 63.6% to 73.7%. Lats deposits amounted to 58.8% of deposits by financial institutions, non-financial corporations and households at the end of 2006 as opposed to 59.4% at the end of 2005.

Capital inflows remained abundant and were reflected in the changes of the net foreign assets. Net foreign assets of the Bank of Latvia expanded further significantly by 73.7% totalling 2 414.4 million lats at the end of the year, whereas the negative net foreign assets of MFIs doubled in the course of the year to stand at 2 634.7 million lats. The negative net foreign assets increased on account of borrowing from non-resident MFIs (mainly parent banks) used to grant loans. Foreign liabilities of MFIs (excluding the Bank of Latvia) grew by 2.6 billion lats or

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42.6%, including an increase of 2.4 billion lats or 79.3% in liabilities to foreign MFIs (of which, liabilities to associated and affiliated MFIs rose by 2.0 billion lats or 2.0 times) and a rise of a mere 91.6 million lats in non-resident non-MFI deposits. The increase in foreign assets of MFIs (excluding the Bank of Latvia) was considerably lower at 259.2 million lats, with claims on foreign non-MFIs expanding by 220.6 million lats, including an increase of 231.6 million lats in outstanding loans. Claims on non-resident MFIs increased by only 20.1 million lats, including investment in debt securities of foreign MFIs by 86.9 million lats. Thus, the negative net foreign assets of MFIs (excluding the Bank of Latvia) had grown by 2.3 billion lats year-on-year at the end of 2006.

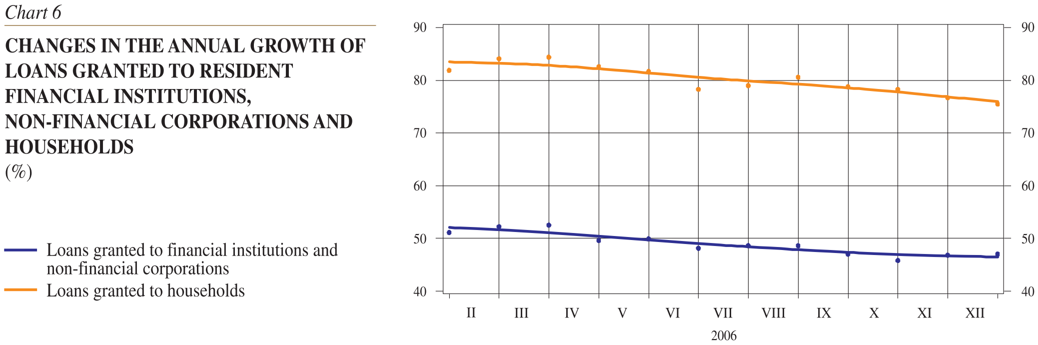
The growth of money supply was driven by MFI loans. In 2006, loans granted to resident financial institutions, non-financial corporations and households expanded by 3.6 billion lats or 58.4% in comparison with 2.4 billion lats or 64.3% in 2005. The annual growth decelerated on account of the high base, as a significant increase in outstanding loans in the absolute terms was reported every month, with the average monthly rise in the second half of 2006 amounting to 366.2 million lats. Through stimulating a build-up of the domestic demand, such a buoyant lending expansion led to persistently high inflation and aggravated the risks associated with imbalanced economic development. At the end of 2006, exposure to lending amounted to 61.3% of the aggregate balance sheet assets of MFIs (excluding the Bank of Latvia) in comparison with 56.0% at the end of 2005.

With the general government consolidated budget deficit shrinking, net MFI claims on the Government contracted 2.6 times, to 100.5 million lats.

The developments concerning MFI loans have been similar across both money-holding sectors for several years already. Yet the household sector has reported a slightly more notable growth in loans in the absolute terms and a significantly higher growth rate. Lending to households expanded by 1.9 billion lats or 75.5% as opposed to 84.2% in 2005 (see Chart 6), mainly on account of easing of lending conditions against the background of soaring prices on the housing market. Household loans for house purchase grew by 86.4% (see Chart 7) totalling 3.3 billion lats or 75.8% of all loans granted to households at the end of 2006 in comparison with 71.4% at the end of 2005. The growth of consumer credit was slightly lower at 63.5%, and its share in total household loans declined by 1.0 percentage point to 13.8%.

Chart 6

CHANGES IN THE ANNUAL GROWTH OF LOANS GRANTED TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(%)



Loans for house purchase determined the predominance of mortgage loans in total loans. The annual growth rate of mortgage lending to financial institutions and non-financial corporations was slightly higher and amounted to 94.0%; overall, mortgage loans increased by 89.2% in 2006 in comparison with 2.0 times in 2005 and constituted 54.6% of total outstanding loans at the end of the year as

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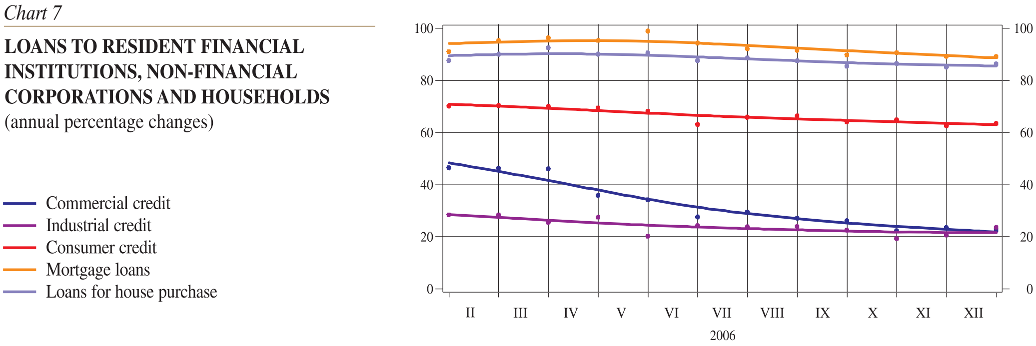
Chart 7

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



opposed to 45.7% in 2005. The annual growth rate to other major corporate loans was considerably lower and still on a downward trend, with commercial credit increasing by 22.6% and industrial credit by 23.6% during the year and totalling 20.4% and 12.7% of the total loans at the end of 2006 respectively (26.4% and 16.3% in 2005). Thus the annual growth of corporate lending (to financial institutions and non-financial corporations) decelerated from 53.3% in 2005 to 47.0% in 2006.

The rise in corporate loans was dominated by lending to real estate, renting and business activities which expanded by 40.0%. Thus the share of this sector in the corporate loan portfolio amounted to 29.6% at the end of the year. The increase was less notable in financial intermediation, manufacturing, trade and construction: 16.1%, 12.7%, 12.2% and 10.0% of total corporate loans respectively.

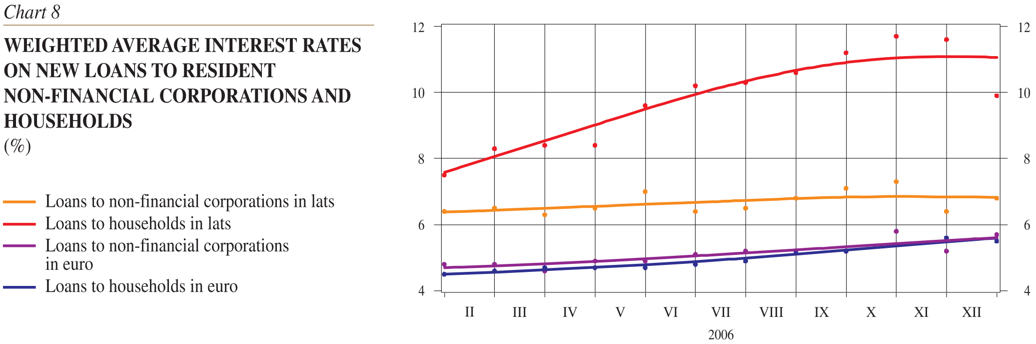
Lower lending rates determined the growing dominance of euro-denominated loans in lending to non-financial corporations and households. Resident non-MFI loans in the national currency increased by 393.6 million lats or 21.0% in comparison with 25.8% in 2005, whereas loans granted in euro expanded by 3.5 billion lats or 2.0 times in comparison with 3.0 times in 2005. Rising and volatile US dollar rates, in turn, caused the US dollar loans to shrink significantly by 341.6 million lats or 2.0 times in 2006. Consequently, the share of resident non-MFI loans granted in lats and US dollars declined by 7.0 and 7.6 percentage points respectively, to stand at 23.1% and 3.6% at the end of 2006, whereas that of the loans granted in euro increased by 14.4 percentage points and amounted to 73.0% of outstanding loans.

LENDING AND DEPOSIT RATES

In 2006, lending rates of all major currencies (euro, lats and US dollars) rose. The central banks raised the key interest rates on several occasions; therefore, the money market interest rates and the rates on loans granted to resident non-financial corporations and households rose accordingly (see Chart 8). The steepest rise was reported for the rates on US dollar loans granted to resident non-financial

Chart 8

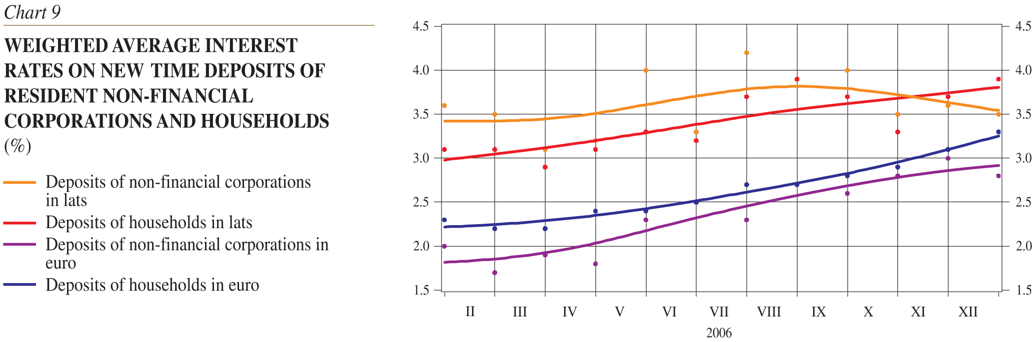
WEIGHTED AVERAGE INTEREST RATES ON NEW LOANS TO RESIDENT NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(%)



corporations and households. Although the lending rates in euro also increased, they remained considerably lower than the lats and US dollar lending rates, thus strengthening the position of the euro in newly-granted loans. At the end of 2006, the euro accounted for three fourths of the newly-granted loans. Interest rates on new deposits also increased slightly (see Chart 9).

Chart 9

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



Although the rising borrowing costs dampen the demand for loans, active advertising campaigns for MFI loan products, easing of the lending conditions as well as higher income of population and willingness to improve the living standards underlay a further expansion of lending. Against the background of persistently tight competition, banks offered lower margins on euro loans in 2006, applying lower rates in business with households in comparison with those applied in business with non-financial corporations.

The tight monetary policy implemented by the Bank of Latvia through raising the refinancing rate and expanding the minimum reserve base for banks also had an upward effect on the interest rates on MFI lats loans. Weighted average interest rates on new lats loans granted to resident non-financial corporations and households increased by 1.1 and 3.3 percentage points respectively, from 5.7% and 6.6% in December 2005 to 6.8% and 9.9% in December 2006. Weighted average interest rates on new foreign currency loans also moved similarly and stood 1.1 and 0.9 percentage point higher in December 2006 over December 2005, amounting to 5.9% for lending to non-financial corporations and 5.7% for that to households, including a rise in interest rates on the dominating euro loans granted to both non-financial corporations and households by 1.1 percentage points.

In 2006, borrowers still preferred floating interest rates and initial interest rate fixation period of up to one year; these loans comprised almost 90% of the new loans granted during the year. Lower interest rates on euro loans underlay an increase in euro loans and a decline in the share of the lats and US dollar denominated loans.

Mirroring the money market trends, weighted average interest rates on time deposits received by MFIs also climbed. In December 2006, the weighted average interest rates on time deposits received from resident non-financial corporations and households reached 3.5% and 3.9% in comparison with 3.0% and 3.1% in December 2005. As in 2005, the weighted average interest rates on time deposits in foreign currencies rose further to 3.4% for deposits from non-financial corporations and to 3.9% for household deposits. The weighted average rates on euro-denominated time deposits received from non-financial corporations and households went up by 1.3 percentage points, to 2.8% for deposits from non-financial corporations and 3.3% for household deposits, whereas the weighted average interest rate on US dollar-denominated time deposits increased by 1.0 and 0.9 percentage point respectively.

Most new time deposits of resident non-financial corporations and households (about 98%) were still with a maturity of up to one year. Of those, about 40% were time deposits in lats; the share of euro-denominated time deposits expanded, whereas that of US dollar-denominated time deposits contracted.

Although inflation remained high, real interest rates on the lats loans with a floating interest rate and initial interest rate fixation period of up to one year increased and the real lats interest rates turned positive, rising by 1.8 percentage points in the course of the year to stand at 0.5% in December 2006. The real interest rates on time deposits in lats, on the contrary, remained negative.

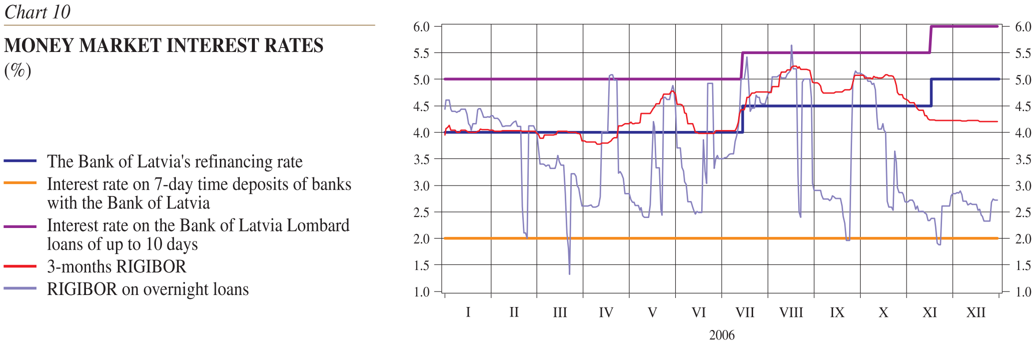
INTERBANK MARKET

The weighted average interest rate on overnight lats loans on the domestic interbank market amounted to 3.24% in 2006, representing a year-on-year increase of 71 basis points. The domestic interbank business rates rose as a result of both the monetary policy measures taken by the Bank of Latvia and the euro money market rates developments. In 2006, EONIA (euro overnight index average) on the interbank market of the euro area increased by 74 basis points and reached 2.83%. Against the background of rising overnight lending rates in lats and their development expectations, the RIGIBOR of all maturities also increased.

The average annual RIGIBOR on overnight loans rose by 80 basis points to 3.56%. The RIGIBOR on transactions with a maturity of one year increased at a higher rate by 135 basis points, amounting to 4.58%. With the RIGIBOR yield curve steepening, the 3-month RIGIBOR which is the most popular in lending also rose by 132 basis points and its annual average reached 4.38%. Yet towards the end of the year, the 3-month RIGIBOR edged down to 4.20% (see Chart 10).

Chart 10

MONEY MARKET INTEREST RATES
(%)



Although implied 3-month RIGIBOR forward rates in 3 months (RIGIBOR 3f6) may differ substantially from the actual rates in 3 months, during the first 10 month of 2006 they were on average only 3 basis points below the actual rates. In 2005, the banks had also been quite accurate in their projections of the 3-month RIGIBOR and were only 3 basis points above the actual figure.

In 2006, the amount of interbank loans granted to domestic banks continued to grow rapidly, reaching 21.6 billion lats or increasing by 38.5% over 2005, including transactions in lats expanded to 9.6 billion lats or by 41.2%. The share of business conducted in lats and euro on the domestic interbank market grew slightly to 44.8% and 21.0% respectively, whereas that of other currency business contracted to 34.2%.

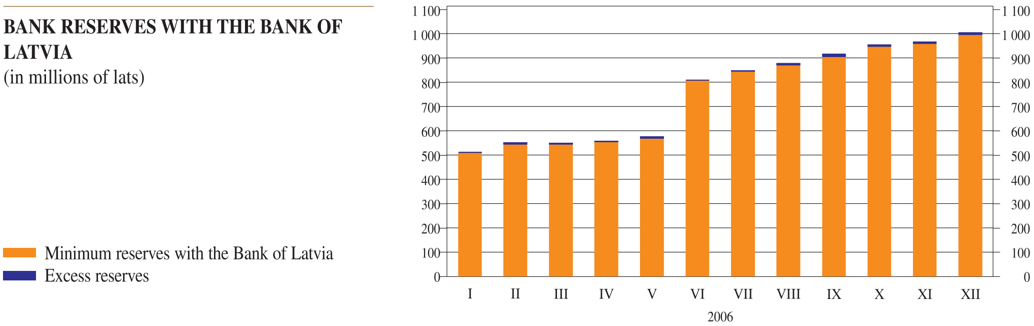
The share of transactions with a maturity of over one day increased from 21.2% in 2005 to 27.2% in 2006. Maturities increased starting from May partly as a result of introducing an 8% minimum reserve requirement for bank liabilities with a maturity of over two years.

MONETARY BASE

With the Bank of Latvia expanding the reserve base and deposits with banks growing, minimum reserves held by banks on settlement accounts with the Bank of Latvia continued to increase (see Chart 11). Thus deposits from credit institutions and other financial institutions held by the Bank of Latvia grew by 701.5 million lats or 2.5 times as opposed to 2.1 times in 2005. Demand for cash also rose rapidly: currency in circulation grew by 196.6 million lats or 22.4% in 2006 over 20.6% in 2005. As a result, the central bank's money supply or monetary base M0 increased at a considerably quicker pace than in 2005 (namely, by 66.5%) and totalled 2 248.8 million lats at the end of the period, whereas the cash component of the monetary base shrank to 47.8% in comparison with 65.0% at the end of 2005.

Chart 11

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

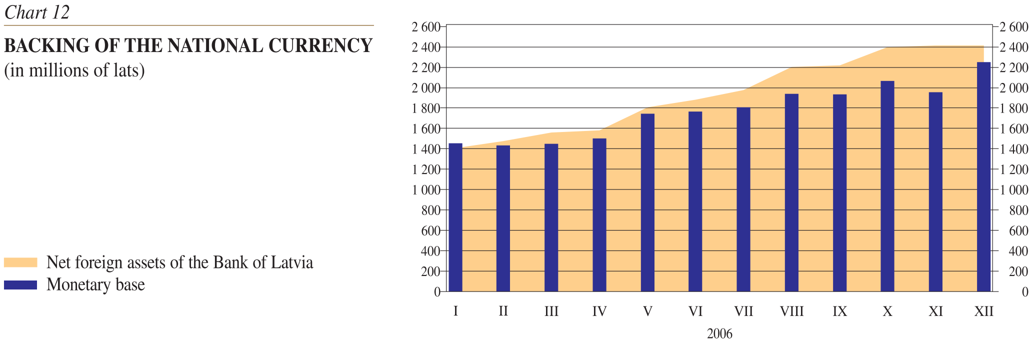


The growth of the monetary base was mainly underpinned by the record-high increase in net foreign assets of the Bank of Latvia amounting to 1 024.1 million lats or 73.7%, with the Bank of Latvia net purchases of foreign currency totalling 1 008.7 million lats. Large amounts of foreign currency sold to the Bank of Latvia were determined by the continued rapid growth of euro loans subsequently converted into lats and by the expansion of the minimum reserve base, which created an additional demand for the lats liquidity. Selling of foreign currencies to the Bank of Latvia was additionally fostered by inflows of foreign investment and the EU structural funds in the economy. The central bank offered the banks foreign exchange swap opportunities; however, there was almost no demand. At the end of 2006, the Bank of Latvia's net foreign assets covered the goods imports of about 4.6 months (of 3.4 months at the end of 2005), whereas the backing of the national currency with the Bank's net foreign assets was 107.4% (see Chart 12; 102.9% at the end of 2005).

Overall, the changes in the Bank of Latvia's net domestic assets were less pronounced (their negative value increased by 126.1 million lats), as a result of the outstanding domestic loans contracting. In the domestic loan portfolio, lending to banks decreased slightly, by 23.3 million lats. Government deposits with the Bank of Latvia shrank by 18.6 million lats, the central bank's government securi-

Chart 12

BACKING OF THE NATIONAL CURRENCY
(in millions of lats)



ties portfolio was sold on the secondary market and redeemed in the total amount of 98.8 million lats; net credit to the Government decreased by 80.2 million lats and became negative.

The Bank of Latvia's total loans to credit institutions at 790.0 million lats increased 3.4 times in comparison with 2005, with the demand for repo loans strengthening and the amount of Lombard loans remaining broadly unchanged (for the monthly average amounts outstanding, see Table 3).

Table 3

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

	2005	**2006**
January	8.9	**66.0**
February	12.9	**18.0**
March	8.6	**1.4**
April	9.7	**12.2**
May	10.5	**12.5**
June	7.4	**7.7**
July	5.6	**17.3**
August	3.7	**28.4**
September	9.2	**2.0**
October	4.0	**10.7**
November	2.8	**0**
December	4.2	**0**

Of the Bank of Latvia's loans to credit institutions, repo loans accounted for 93.6% in 2006 as opposed to 79.0% in 2005, and the share of demand Lombard loans was 6.4%. There was no demand for automatic Lombard loans.

Only 7-day repo loans were granted. Overall, the amount of repo loans granted increased 4.1 times over the previous year, whereas the demand Lombard loans by 3.7%.

THE FOREIGN EXCHANGE MARKET AND LATVIA'S EXTERNAL DEBT

In 2006, the US dollar depreciated against the euro and the pound sterling on the global foreign exchange market, and appreciated somewhat against the Japanese yen. For the most part, interest rate changes in different economies accounted for exchange rate fluctuations throughout 2006.

In 2006, the euro appreciated by 11.4% against the US dollar (from 1.1849 at the

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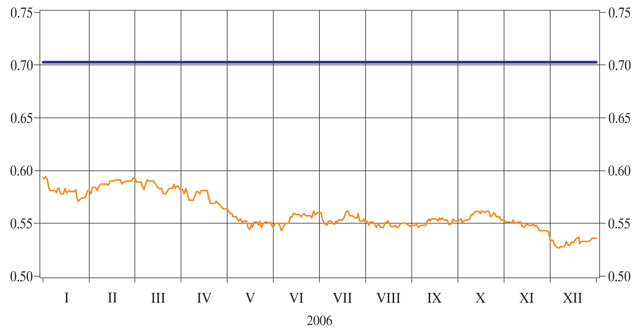
end of 2005 to 1.3199 at the end of 2006), reaching its high (1.3343) on 4 December. The US dollar appreciated vis-à-vis the Japanese yen (from 117.75 at the end of 2005 to 119.07 at the end of 2006, rising by 1.1%), reaching its high (119.78) on 11 October and low (109.76) on 16 May. The Japanese yen depreciated against the other major currencies. In 2006, the British pound sterling appreciated by 13.7% against the US dollar (from 1.7230 at the end of 2005 to 1.9589 at the end of 2006), reaching its high (1.9815) on 4 December.

The US dollar depreciated against the lats on the domestic foreign exchange market (from 0.5877 at the end of 2005 to 0.5283 at the end of 2006; a 10.1% decrease). In 2006, the US dollar peaked on 2 January (0.5888), whereas the lowest exchange rate (0.5230) was recorded on 4 December (for the most significant developments of the exchange rates as set by the Bank of Latvia, see Chart 13 and Appendix 5).

Chart 13

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



In 2006, the euro exchange rate against the lats remained broadly unchanged and fluctuated in a tight range just above and to the lower limit of the intervention band set by the Bank of Latvia (EUR 1 = LVL 0.6958).

According to the international investment position data, Latvia's gross external debt increased by 3 701.8 million lats in 2006, totalling 12 705.4 million lats (112.8% of GDP) at the end of the year, with net external debt amounting to 4 904.7 million lats (43.5% of GDP). In 2006, the Government and the central bank's liabilities to non-residents grew by 62.2 million lats, the banking sector and other sectors' liabilities posted increases of 2 653.0 million lats and 725.1 million lats respectively, and debt-related direct investment expanded by 261.5 million lats. Consequently, the external debt composition by sector changed: the share of banks' liabilities increased to 68.8% (67.7% in 2005) and that of other sectors' liabilities to 17.9% (17.2% in 2005), while the share of the Government and the central bank's debt and the debt-related direct investment shrank to 5.2% (6.7% in 2005) and 8.0% (8.4% in 2005) respectively.

The breakdown of the external debt by instrument slightly changed in 2006, with loans expanding from 50.2% to 59.9% and the share of other debt instruments shrinking. At the end of 2006, currency and deposits, debt-related direct investment and debt securities accounted for 20.5%, 8.0% and 5.3% of the external debt respectively. At the end of 2006, long-term debt stood at 7 115.9 million lats, and short-term debt amounted to 5 589.5 million lats.

At the end of 2006, MFI (excluding the Bank of Latvia) external debt amounted to 8 745.7 million lats. The maturity profile of banks' foreign liabilities changed considerably, with the banks increasing the received long-term funds 1.7 times to amount to 4 050.3 million lats or 46.3% of the external debt of the banking sector at the end of 2006 (38.8% at the end of 2005). Although the share of currency and deposits remained high (29.5%; 41.4% at the end of 2005), that of loans from parent corporations expanded notably (to 45.9%; 32.9% at the end of 2005). At the end of 2006, the banking sector's net external debt amounted to 5 217.7 million lats.

At the end of 2006, the external debt of other sectors was 2 276.2 million lats, including long-term liabilities in the amount of 1 405.9 million lats. In 2006, foreign liabilities grew by 46.7%, with the share of loans increasing to 67.9% (59.8% at the end of 2005) and that of trade credit shrinking to 30.1% (38.4% at the end of 2005). Other sectors and banks' debt liabilities to direct investors increased gradually as well. In 2006, they amounted to 1 020.5 million lats.

According to the Treasury data, the Government external debt in foreign currencies increased by 39.6 million lats over 2006, standing at 580.3 million lats (5.2% of GDP) at the end of the year. The Government received foreign financing in the amount of 54.4 million lats in 2006. 42.5 million lats, equalling 0.9% of annual exports of goods and services, were used to service foreign debt (including 15.2 million lats for repayment of the principal amount of loans). The euro-denominated liabilities of the Government continued to grow (from 92.9% to 94.5%), whereas those in US dollars shrank from 7.0% to 5.4%.

SECURITIES AND STOCK MARKET

The primary placement of the Latvian Government securities was organised by the RSE. In 2006, the amount of securities supplied by the Treasury on the domestic primary market expanded year-on-year whereas the overall demand moderated. The fall in the demand partly resulted from the tightening monetary policy measures taken by the Bank of Latvia: their implementation promoted the possibility of a price rise for the refinancing loans of the lats assets in the future. Market participants' interest in the primary market auctions of government securities also subsided due to the secondary market auctions organised by the Bank of Latvia where a considerable amount of government securities was sold. Dynamics of the balance of the lats funds with the Treasury was another factor reducing banks' interest in participating in the primary market auctions of government securities. With the lats funds balance remaining high, the Treasury was not willing to trade securities with high interest rates. Overall, the budgetary positions were sound in 2006, the GDP posted rapid growth, with the budgetary collections benefiting from the above; hence there was no need for increasing the amount of securities outstanding and it even decreased somewhat from 423.0 million lats to 418.7 million lats.

The total amount of government securities offered at all primary auctions was 248.0 million lats, 83.7% higher year-on-year. Total bids amounted to 252.5 million lats, which is 30.9% less than in the previous year, whereas the allotted amount was 130.0 million lats, which is a 15.2% increase year-on-year.

The rise in the yield of government securities was both due to raising interest rates in the euro area and factors hindering the convergence of the euro and the lats interest rates, inter alia the absorption of liquidity on the lats money market and the uncertainty about the timeline of the euro changeover. The yields on 6- and 12-month Treasury bills rose from 2.43% to 4.84% and from 2.70% to 4.25% respectively. The yields on 5- and 10-year Treasury bills rose from 3.40% to 5.24% and from 3.62% to 4.73% respectively. Yields tended to rise throughout the year.

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The government securities holdings of Latvian banks expanded from 40.4% (at the end of 2005) to 57.1% (at the end of 2006) of total outstanding amount, those held by other residents increased from 27.4% to 36.0% and those held by non-residents moved up from 4.9% to 6.9%; the Bank of Latvia held no government securities at all at the end of the year compared to the 27.3% portfolio at the end of 2005.

Publicly traded corporate debt securities, denominated in lats and registered with the LCD, dropped by 38.6% (to 49.8 million lats) in 2006. Seven issues of credit institution securities in the amount of 29.6 million lats matured and two new issues in the amount of 4.3 million lats were launched. The rise in interest rates on lats transactions exceeded that of interest rates on transactions in euro, and there was some uncertainty with respect to the future developments in lats interest rates; consequently, the market of private debt securities denominated in lats stagnated while that of euro-denominated bonds experienced rapid growth. The growth was also fuelled by the issuers of the euro-denominated debt securities investing the received funds in the real estate market.

The publicly traded bonds, denominated in euro and registered with the LCD, increased from 4.7 million lats to 54.2 million lats. An issue of the SJSC *Latvijas Hipotēku un zemes banka* mortgage bonds in the amount of 14.0 million lats (maturing in 2012) and that of the JSC *Alta Real Estate Partners* zero-coupon bonds in the amount of 10.5 million lats (maturing in 2008) were the largest ones.

In 2006, the 1.1 million lats turnover of debt securities on the RSE was comparatively small for reasons related to the trading infrastructure: the turnover was considerably affected by the introduction of the common trading platform SAXESS in September 2004. Over 2006, the bid rate quoted for 10-year Treasury bonds (maturing in 2015) moved up from 3.42% to 5.00%, and that for 12-month Treasury bills rose from 2.77% to 4.27%. The bid rate on 10-year bonds of the SJSC *Latvijas Hipotēku un zemes banka* (maturing in 2013) climbed from 4.80% to 5.18%. The interest rate rise on the secondary market was driven by the factors observed also on the primary market.

The bid rate quoted for Latvian eurobonds (maturing in 2014) rose from 3.40% to 4.15% in 2006. The spread between the Latvian eurobond yields and the same maturity German Government eurobond yields remained broadly unchanged at approximately 20 basis points.

In 2006, OMX Riga fell by 3.1% to 655.5 points, and the overall Latvian stock market capitalisation decreased by 4.2% to 1 430 million lats whereas the Baltic States stock index BALTIX moved up by 10.7%. The key factor for the OMX Riga decline was its high base. In the first quarter of 2006, investors recorded profits due to an unexpectedly rapid recurrent growth. The overall low liquidity on the Latvian stock market to a certain extent caused price changes on the RSE. On account of the subsequent sound financial performance and the future development plans of Latvian corporations, the stock price index started to rise again. By mid-March OMX Riga posted a rapid fall (20.2%), followed by a period of fluctuations, to increase again from mid-June by 18.5%.

In 2006, the RSE stock market turnover amounted to 61.6 million lats (of that, shares of the Main List accounted for 70.9% of the turnover). In 2005, the overall stock turnover was 54.0 million lats, with the shares of the Main List accounting merely for 40.7% of the turnover. The most actively traded shares were those of the JSC *Grindeks* (16 million lats) and JSC *Latvijas Kuģniecība* (13 million lats).

At the end of 2006, shares of 40 corporations were listed on the RSE (45 corporations in 2005): six corporations were listed on the Main List, five corporations were included on the I-List, and 29 corporations on the Free List.

In October, the state-owned shares of the JSC *Ventspils nafta* were sold, with 38.6% of the total amount or 40.3 million shares being offered and the minimum price set at LVL 1.81 per share. At the auction, the demand slightly exceeded the supply, and the bid price was LVL 1.84 per share. The Netherlands oil company Vitol Group bought 34% of the JSC *Ventspils nafta* shares.

CENTRAL BANK OPERATIONS AND ACTIVITIES

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

In 2006, the Bank of Latvia continued to operate within the ESCB. The Governor of the Bank of Latvia participated in the ECB General Council meetings on a regular basis. In compliance with the Statute of the ESCB and ECB, the ECB General Council meetings discussed macroeconomic, monetary and financial developments in the EU, reports on functioning of the ERM II as well as addressed other issues concerning the central banks of all EU Member States. In May, the ECB General Council approved the ECB Convergence Report on the readiness of Slovenia and Lithuania for the introduction of the euro; in December, the ECB Convergence Report on the readiness of the other EU10 countries and Sweden to introduce the euro was approved.

The Bank of Latvia's representatives continued to participate in 13 ESCB committees (see Appendix 8) and more than 30 working groups, dealing with issues related to monetary policy, banking supervision, euro banknotes, statistics, accounting, market operations, payment systems, international relations and other issues. Moreover, in June 2006 the Thematic Meeting of the Working Group on External Statistics of the ESCB Statistics Committee was held in Riga where the Bank of Latvia presented its framework for the balance of payments statistics compilation and Latvia's experience to the representatives of EU countries.

The ECB General Council and the ESCB committees and working groups engaged in preparations for Slovenia to join the euro area and for the Central Bank of Slovenia to integrate within the Eurosystem, as well as for the central banks of Bulgaria and Romania to integrate within the ESCB after their countries' accession to the EU.

The Bank of Latvia's experts also participated in several committees and working groups of the Council of the EU and the EC. Sitting on the EFC and its subcommittees, the representatives of the Bank of Latvia regularly participated in the decision-making concerning the economic and financial development of the EU, discussed the preparation of the EU10 countries for the introduction of the euro, relations with the third countries and policies of international financial institutions as well as drafted proposals addressing the economic policy strategy and instruments in conjunction with other EU Member States.

The Bank of Latvia's representatives continued their participation in the EC and Eurostat working groups dealing with the issues of euro coins, payment systems, economic forecasting and statistics.

Pursuant to the provisions of the Statute of the ESCB and ECB, the Bank of Latvia ensured preparation for publishing in Latvian of the ECB Annual Report 2005, the ECB Convergence Report of May 2006, the Introduction and Executive Summary of the ECB Convergence Report of December 2006 and the publication "The implementation of monetary policy in the euro area: General documentation on Eurosystem monetary policy instruments and procedures", as well as translation of the quarterly version of the ECB's Monetary Bulletin (published on the Internet).

STRATEGIC PLANNING

The Bank of Latvia's strategic management process has been improved since the beginning of 2006, taking into account the best practices of management systems.

In July, the Council of the Bank of Latvia approved The Bank of Latvia's Statements of Its Vision, Mission and Values (see Appendix 12). The statement of vision presents the Bank of Latvia's long term goal and its perception. The statement of mission reveals the essence of the central bank's operation and sets its future direction. The statement of values highlights what the Bank considers of high importance qualities and what it wants to be like.

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

The work is planned so as to reach the objectives stated in the strategic guidelines and vision and mission statements. In 2006, a uniform structure of the action plans of the Bank of Latvia's organisational units has been developed and a common action plan created and systematised by function and objective. The clear planning provides for monitoring and assessment of the stated goals.

FOREIGN EXCHANGE POLICY AND FOREIGN RESERVES

Latvia continued to participate in the ERM II to become a full-fledged member of the EMU and implement the euro. The Maastricht criteria specify that for at least two years prior to the euro changeover the lats is to be pegged to the euro, with the fluctuation of the lats exchange rate against the euro not exceeding ±15% against the central parity rate of the lats vis-à-vis the euro. The Bank of Latvia has unilaterally ensured the lats exchange rate fluctuations against the euro within ±1% of the central parity rate. In 2006, the euro exchange rate against the lats fluctuated in a tight range just above and to the lower limit of the intervention band set by the Bank of Latvia (EUR 1 = LVL 0.6958).

As a result of the Bank of Latvia conducting significant interventions on the foreign exchange market, the Bank of Latvia's foreign reserves, which include gold, convertible foreign currencies and SDR, amounted to 2 417.0 million lats at the end of 2006 (1 399.8 million lats at the end of 2005). The Bank of Latvia generated income by investing its foreign reserves on the financial markets in compliance with the guidelines approved by the Council of the Bank of Latvia.

The Bank of Latvia manages its foreign reserves in compliance with the guidelines drawn up by the Council of the Bank of Latvia. The base currency of the benchmark portfolio is the euro and the benchmark assets are composed of 50% of euro-denominated assets, 40% of US dollar-denominated assets and 10% of Japanese yen-denominated assets.

The Bank of Latvia invests its foreign reserves in safe and liquid financial instruments, primarily in debt securities issued by governments and government agencies of the euro area countries and the US and international organisations, as well as in highly rated bank and corporate debt securities, asset-backed securities and callable bonds. Interest rate futures are used to manage the duration of the reserves. For the purpose of implementing yield curve strategies on the interest rate market, interest rate swaps are used, whereas to ensure the optimal currency composition of the foreign reserves foreign exchange forwards are applied.

The gold reserves of the Bank of Latvia were invested into short-term deposits with highly rated foreign credit institutions. Foreign exchange forwards and interest rate swaps were also used in the management of the gold reserves.

In 2006, the Bank of Latvia terminated a contract with one external reserve manager and continued to use the services of two external reserve managers. They manage a portion of the Bank of Latvia's foreign reserves pursuant to the guidelines set by the Council of the Bank of Latvia.

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

MONETARY POLICY INSTRUMENTS

In 2006, the Bank of Latvia pursued a tight monetary policy under the conditions of a rapid economic growth rate, continually increasing current account deficit and persistent high inflation.

The Bank of Latvia raised the refinancing rate on two occasions in 2006 (overall by 100 basis points). The refinancing rate was raised from 4.00% to 4.50% as of 15 July and from 4.50% to 5.00% as of 17 November. Interest rate on Lombard loans was also raised correspondingly, where the Lombard loan balance had been maintained for up to 10 days in the last 30 days, for 11 to 20 days in the last 30 days or longer than 20 days in the last 30 days – by 6.00%, 7.00% and 8.00% respectively. The interest rates on bank 7- and 14-day time deposits remained unchanged (2.00% and 2.25% respectively). The ECB raised the base rate on five occasions in the course of the year (by total 125 basis points; to 3.50%).

In its pursuit of a restrictive monetary policy, the Bank of Latvia expanded the minimum reserve base. As of 24 May 2006, the minimum reserve base also included bank liabilities with a maturity of over two years. Hence the reserve requirements increased in June by 240.8 million lats or 42.5% over the previous

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maintenance period. With the amount of funds attracted by banks and reserve ratio increasing, the minimum reserves grew by 503.2 million lats or 2.0 times in 2006 (to 1 012.1 million lats). In 2005, the minimum reserves expanded 2.7 times. At the end of 2006, 21 banks and three branches of foreign banks were subject to the minimum reserve requirements.

Currency exchange in the Bank of Latvia continued to be the major source for acquiring lats liquidity by banks. In 2006, the Bank of Latvia purchased the historically highest amount of euro by issuing lats (1 008.7 million lats net; a 2.9 times increase year-on-year). As in 2005, the lats liquidity at times accumulated on the interbank market as the banks sold more euro to the Bank of Latvia than necessary to meet the minimum reserve requirements, and overall, banks placed time deposits with the Bank of Latvia rather than used repo loans.

In 2006, the bid amount of repo loans was 5.5 times higher year-on-year, reaching 1 042.3 million lats. A more intense use of repo loans to meet the banks' minimum reserve requirements contributed to the rise in demand. Although in 2006 the total repo loan allotment was 23.6% lower year-on-year (3 865.0 million lats), the average end-of-day balance of repo agreements was 14.5 million lats in 2006 (7.1 million lats in the previous year). The weighted average interest rate on 7-day repo loans rose to 4.30 % in 2006 (4.01% in 2005), reflecting the raising of the Bank of Latvia's refinancing rate. All repos were granted with a 7-day maturity in 2006.

Foreign exchange swaps were executed with the Bank of Latvia on a smaller scale. The average end-of-day balance of currency swap transactions was 0.3 million lats in 2006 (0.6 million lats in 2005).

The average end-of-day balance of Lombard loans was a modest 0.3 million lats (0.2 million lats in 2005), and their weighted average interest rate was 5.03%. All loans granted in 2006 were demand Lombard loans received on the last days of the four reserve maintenance periods, when some banks experienced a temporary shortage of lats required to meet the minimum reserve requirements.

The end-of-day balance on banks' time deposits averaged 24.4 million lats in 2006 (a year-on-year decrease of 2.5 times). In 2005, 14-day time deposits accounted for 97.9% of the average amount, whereas in 2006 their share diminished to 62.0%.

To reduce the lats liquidity in banks, in 2006 the Bank of Latvia sold the whole government securities portfolio denominated in lats at the nominal value of 53.0 million lats via interventions on the securities secondary market from April to July. Of the Bank of Latvia's securities portfolio denominated in lats, government securities were redeemed at the nominal value of 39.2 million lats, and the average end-of-day balance of the Bank of Latvia's government securities portfolio (excluding securities pledged under repurchase agreements) was 34.1 million lats in 2006 (98.1 million lats in 2005).

Reverse repo agreements for government securities were not concluded in 2006.

The Bank of Latvia continued to quote RIGIBID and RIGIBOR in accordance with the Bank of Latvia's "Regulation for the Calculation of RIGIBID and RIGIBOR", including those banks in quotation list that were active on the interbank market and able to conduct market operations at the quoted money market rates on transactions in lats: in 2006, JSC Baltic Trust Bank, JSC *Hansabanka*, JSC *Latvijas Krājbanka*, JSC SEB *Latvijas Unibanka*, JSC *Parex banka*, JSC HVB Bank Latvia (as of 20 February 2007, JSC UniCredit Bank) and the Latvian Branch of Nordea Bank Finland Plc.

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CASH MANAGEMENT

In 2006, the currency in circulation increased by 22.4% (from 877.3 million lats to 1 073.9 million lats). Over the last five years, the currency in circulation has grown 1.9 times.

Banknotes and coins received from banks were checked for authenticity and fitness for circulation by using automated cash processing systems. In 2006, the amount of processed cash (2 652.6 million lats) exceeded that of the currency in circulation 2.5 times (2.5 times in 2005 as well). Of the amount processed, 319.1 million lats or 12.0% were withdrawn from circulation (322.0 million lats or 14.6% in 2005).

The total nominal value of counterfeits detected in 2006 (9.0 thousand lats) accounted for only 0.001% of the currency in circulation.

In 2006, the Bank of Latvia released a new issue of 2- and 5-santims coins and a new 5-lats banknote with improved security features.

A limited number of special 1-lats circulation coins *Līgo Wreath* (in circulation as of 15 June 2006) and *Pinecone* (in circulation as of 4 December 2006), supplemented the stock of coins.

Six collector coins have been issued in 2006. The Bank of Latvia issued the coin *January 1991*, commemorating the barricades of January 1991 (in circulation as of 6 January 2006). The series *People* of the national collector coin program *Latvia. Times and Values* was completed with the coins *Krišjānis Valdemārs* (in circulation as of 28 March 2006) and *Krišjānis Barons* (in circulation as of 7 August 2006). The issue of the fourth and the last series within this program, the *State*, has commenced. The first coin *Fight for Freedom* was put into circulation on the eve of the 88th anniversary of the proclamation of the Republic of Latvia (in circulation as of 10 November 2006). The international coin program *Hansa Cities* was complemented by the coin *Straupe* (in circulation as of 18 December 2006). The heptagon-shaped *Coin of Digits* was issued as a Christmas surprise (in circulation as of 8 December 2006).

STATISTICS

In 2006, the major tasks in the area of financial market and monetary statistics involved the identification of the new data collection options and their costs, participation in drafting new EU legislation and improvements in the area of compilation of statistics.

In view of the fact that the ECB plans to amend Regulation (EC) No 2423/2001 (ECB/2001/13) concerning the consolidated balance sheet of the monetary financial institutions sector and Regulation (EC) No 63/2002 (ECB/2001/18) concerning statistics on interest rates applied by monetary financial institutions to deposits and loans vis-à-vis households and non-financial corporations, a survey of MFIs was conducted to identify the feasibility of providing additional statistical data on the securitisation and sale of loans as well as detailed recording of financial instruments in the MFI balance sheet and interest rate statistics, and determine costs of collecting the additional data. The survey also examined the possibility of collecting information on MFI loans granted to commercial companies, taking into account the breakdown by the size and sector of a commercial company, as well as information on changes in the investment policy of investment funds and

BANK OF LATVIA'S BANKNOTES AND COINS PRINTED AND STRUCK IN 2006

5 LATS

Face value: 5 lats
Size: 130 x 65 mm
Colour: green
Printed by
Giesecke & Devrient GmbH
(Germany)
Artists:
Imants Žodžiks,
Valdis Ošiņš

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

Reverse. A design of an ornamental sun cut in wood is superimposed on a distaff motif. On the left of it, there is a vertical metallic band worked into the paper with the inscription of the nominal value and a hologram; on the right, there is a stylised oak-leaf. Across the top of the banknote, there is the inscription PIECI LATI (five lats) and the numeral 5. At the bottom of the banknote, there is the numeral 5 and the two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia). A vertical band with diagonal stripes comprising numerals 5 and shading into one another is on the left of the distaff motif. Along the edge of the band, there is the vertical inscription © LATVIJAS BANKA 1992. A design of the large coat of arms of the Republic of Latvia with the year 2006 inscribed beneath it is depicted on a white background on the right. Above the coat of arms, there is a watermark of a profile of a Latvian folk-maid.

2 SANTIMS

Weight: 1.90 g; diameter: 17.00 mm
Metal: copper-clad steel
Struck by *Koninklijke Nederlandse Munt* (Netherlands)
Artists: Gunārs Lūsis (graphic design), Jānis Strupulis (plaster model)

Obverse. The small coat of arms of the Republic of Latvia encircled by the inscription LATVIJAS REPUBLIKA • 2006 (Republic of Latvia 2006) is placed in the centre.
Reverse. The numeral 2 is centred on the coin. The inscription SANTĪMI arranged in a semicircle is beneath the numeral 2. Two diamond-shaped suns are located on either side of the numeral. At the top of the coin, five arcs (representing work cycle) join the two diamond-shaped suns.
Edge. Plain.

5 SANTIMS

Weight: 2.50 g; diameter: 18.50 mm
Metal: alloy of copper, nickel and zinc
Struck by *Royal Mint* (United Kingdom)
Artists: Gunārs Lūsis (graphic design), Jānis Strupulis (plaster model)

Obverse. The small coat of arms of the Republic of Latvia encircled by the inscription LATVIJAS REPUBLIKA • 2006 (Republic of Latvia 2006) is placed in the centre.
Reverse. The numeral 5 is centred on the coin. The inscription SANTĪMI arranged in a semicircle is beneath the numeral 5. Two diamond-shaped suns are located on either side of the numeral. At the top of the coin, five arcs (representing work cycle) join the two diamond-shaped suns.
Edge. Plain.

SPECIAL CIRCULATION COINS WITH A LIMITED BATCH

LĪGO WREATH

Face value: 1 lats
Weight: 4.80 g; diameter: 21.75 mm
Metal: cupro-nickel
Struck by *Rahapaja Oy* (Finland)
Artists: Dace Lielā (graphic design),
Ligita Franckeviča (plaster model)

PINECONE

Face value: 1 lats
Weight: 4.80 g; diameter: 21.75 mm
Metal: cupro-nickel
Struck by *Rahapaja Oy* (Finland)
Artists: Henrihs Vorkals (graphic design),
Jānis Strupulis (plaster model)

COLLECTOR COINS

JANUARY 1991

Face value: 1 lats
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness
Quality: *proof*
Struck by *Rahapaja Oy* (Finland)
Artists: Juris Petraškevičs
(graphic design),
Andris Vārpa (plaster model)

COIN OF DIGITS

Face value: 1 lats
Weight: 27.0 g; diameter
(the longest diagonal): 38.61 mm
Metal: silver of .925 fineness
Quality: *proof*
Struck by *Münze Österreich* (Austria)
Artists: Ilmārs Blumbergs
(graphic design),
Jānis Strupulis (plaster model)

COINS ISSUED WITHIN THE SERIES *PEOPLE* AND *STATE* OF THE NATIONAL COLLECTOR COIN PROGRAMME *LATVIA. TIMES AND VALUES*

KRIŠJĀNIS BARONS

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

KRIŠJĀNIS VALDEMĀRS

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

FIGHT FOR FREEDOM

Face value: 1 lats
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness
Quality: *proof*
Struck by *Rahapaja Oy* (Finland)
Artists: Ivo Grundulis (graphic design),
Ligita Franckeviča (plaster model)

COIN ISSUED WITHIN THE INTERNATIONAL COLLECTOR COIN PROGRAMME *HANSA CITIES*

STRAUPE

Face value: 1 lats
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness
Quality: *proof*
Struck by *Rahapaja Oy* (Finland)
Artists: Gunārs Krollis (graphic design),
Jānis Strupulis (plaster model)

LATVIJAS BANKA LATVIJAS BANKA

money market funds, and valuation of securities when preparing statistics. The Bank of Latvia also provided comments and recommendations for the ECB draft Regulation on post office giro institutions and balance sheet statistics of investment funds.

The Bank of Latvia continued to study some types of OFIs for the needs of the ECB's OFI statistics project, obtaining information on the services provided by the major OFIs of Latvia and their key balance sheet items as well as requesting the OFIs to classify their operations according to the NACE. As financial vehicle corporations are to be shown as a separate category of the OFI sector, and the ECB has established specific procedures for the identification of these corporations, the Bank of Latvia has initiated this procedure in Latvia as well.

The Bank of Latvia expanded the range of data sent to the ECB by commencing compilation of OFI balance sheet statistics in accordance with the ECB Guideline of 6 February 2003 concerning certain statistical reporting requirements of the european central bank and the procedures for reporting by the national central banks of statistical information in the field of money and banking statistics (ECB/2003/2).

The Bank of Latvia established the Information System of Macroeconomic Indicators (MARS) to ensure the storing and processing of statistical data received from the ECB, the CSB and the FCMC.

In 2006, a greater emphasis was placed on a further improvement of methodology and data publication and data quality assessment within Latvia's balance of payments statistics.

The quarterly *Latvijas Maksājumu Bilance*. *Latvia's Balance of Payments* published by the Bank of Latvia has been improved substantially, including an extended outline of the methodology used in compiling the balance of payments, new previously unpublished statistical data and a detailed breakdown of data previously disseminated. The complemented publication provides more versatile information to the users of statistics on net transactions and outstanding amounts of direct investment abroad and in Latvia by type of transactions and countries as well as other developments of the external sector in the economy.

At the end of 2006, with Eurostat commencing an assessment of the quality of balance of payments statistics, the Bank of Latvia provided an explanation of the methodology of balance of payments compilation, reasons for making data revisions and adjustment and foreign trade data relation with the balance of payments data.

With a view to improving the quality of the government financial statistics, the Bank of Latvia's experts participated in cross-institutional working groups dealing with the provision of information on the volume and spending of EU funds, accounting of public and private partnership projects and issues related to the preparation of notification on Government deficit and debt. In December, the Bank of Latvia, along with other institutions of Latvia, participated in the meeting of the FDP Dialogue Mission held by the representatives of the EU institutions. To meet the ECB requirements in respect of convergence, the Bank of Latvia made an estimate of the Government debt's historic data by type of maturity, currency and interest rate.

The Bank of Latvia continued to participate also in the project of the ECB's Centralised Securities Database, improving the quality of securities data in Latvia.

In June 2006, a regular transmission of information to the ECB about the quoted security prices commenced, complementing the information already sent on particulars of securities issues.

In autumn 2006, the Bank of Latvia's experts participated in the Working Group on Improvement of Real Estate Statistics, established by the CSB to prepare the laws and regulations for a regular survey of real estate businesses.

In May 2006, the Bank of Latvia participated in the workshop organised by Eurostat and shared experience in the preparation of balance of payments statistics for transmission and data quality analysis.

The Bank of Latvia is also represented in two significant international statistics forums since 2006: the Irving Fisher Committee and the Seasonal Adjustment Steering Group established by the ECB and Eurostat.

The Bank of Latvia improved the regular transmission of statistical data to the BIS, using the BIS data transmission software and direct connection to the BIS databank. The IMF project for the preparation of financial stability data, in which the Bank of Latvia participated in the capacity of the project coordinator in Latvia and prepared methodology descriptions and financial stability indicators for 2005, was concluded successfully.

The Bank of Latvia disseminated financial and balance of payments statistics via its regular publications and the Bank's website, IMF publications *International Financial Statistics and Balance of Payments Statistics Yearbook*, with the help of the Bank for International Settlements and Eurostat, and also within the IMF *Special Data Dissemination Standard*. Methodology descriptions for the financial and real sector indicators published in the IMF *Special Data Dissemination Standard* have been updated in line with the requirements of the *Data Quality Assessment Framework*. The Bank of Latvia made use of the opportunity to provide the methodology description of the breakdown of the non-MFI sector used in Latvia's financial and monetary statistics for the purpose of the updated ECB publication *Money and Banking Statistics Sector Manual. Guidance for the Statistical Classification of Customer*. An overview of the Latvian securities market was prepared and the respective data were compiled for inclusion in the ECB publication *Bond Markets and Long-term Interest Rates in Non-euro Area EU Member States and in Acceding Countries*. The Bank of Latvia continued to provide information on macroeconomic indicators for the ECB publication *Orange Book*, payment system statistics for the ECB publication *Blue Book* and structural statistics data for the ECB's report *EU Banking Structures*.

PAYMENT AND SETTLEMENT SYSTEMS

The Bank of Latvia continued to ensure the operation of two payment systems (the SAMS – real-time gross settlement system for interbank and urgent payments and the EKS – clearing and settlement of net positions of batch retail payments).

At the end of 2006, 21 banks, one branch of a foreign bank and the Bank of Latvia were the participants in the Bank of Latvia's payment systems. In 2006, 80.7% of all interbank payments initiated in Latvia in lats were made via the SAMS and their share of value was 74.8% (83.7% and 87.9% respectively in 2005). Total volume of payments processed within the SAMS increased by 19.6% year-on-year, reaching 198.6 thousand, while their total value rose by 38.9%, amounting to 51.6

billion lats. The share of customer and interbank payments in the SAMS remained unchanged – the volume of processed customer payments (64.8%) and the value of interbank payments (75.5%) posted an increase. With the growth rate of value exceeding that of volume by 16.2% (an increase of 259.6 thousand lats), the average value of a single payment rose. The volume concentration ratio of the SAMS was 67.3% and the value concentration ratio amounted to 73.5%.

The SAMS ensured an all-time high availability of the system to its participants in 2006 (99.98%; 99.83% in 2005). Hence, the SAMS was only unavailable for 19 minutes and 47 seconds in 2006. Overall, six operational failures of the system were identified in the SAMS, mainly attributed to the operational problems of the SWIFT network, and none of them reaching 5 minutes.

In 2006, 76.0% of all customer payments executed by banks in Latvia in lats were processed in the EKS and their share of value was 69.9% (77.2% and 72.2% respectively in 2005). The volume of payments processed in the EKS increased by 26.1% (to 27.4 million) and their total value rose by 22.7% (to 10.3 billion lats). The payments in the EKS were mainly processed in the first clearing cycle (from 8.30 to 10.30), the participants, however, also continued to use the second clearing cycle in the EKS (from 10.30 to 15.00) executing 32.5% and 41.2% of all payments in the EKS in terms of volume and value. In 2006, the average value of a single payment declined by 2.7% (to LVL 377.12). The volume concentration ratio of the EKS was 76.2% and the value concentration ratio stood at 73.1%.

In 2006, all banks and the Bank of Latvia approved the strategy for implementation of the euro settlements in the EKS under which the processing of euro payments made by the banks in Latvia will commence in the EKS as of 1 January 2008. The strategy stipulates that after the implementation of the euro settlements the EKS will be further developed by ensuring an adherence to the SEPA standards.

The Bank of Latvia improved customer services by introducing an automated cash settlement of the securities supply versus delivery made by the LCD. In 2006, the Depositories of the Baltic States harmonised their net settlements, thus the Bank of Latvia changed the time for making net settlements at the LCD.

Pursuant to the *Bank of Latvia's Payment System Policy* concerning the oversight of retail settlement and clearing systems of the Republic of Latvia, in 2006 the Bank of Latvia assessed the payment card data processing centre, the limited liability company First Data Latvia, in accordance with the ECB guidelines. The limited liability company First Data Latvia, the only payment card processing system in the country, was assessed as a system of prominent importance. In 2005, it serviced 66.7% of the total payments made by cards in Latvia, their value reaching 53.8% of the total value.

Six electronic money institutions had notified the Bank of Latvia by the end of 2006 on the commencement of operation in line with the requirements of the Credit Institution Law. The settlement scheme of the electronic money institutions is based on electronic money storage in the computer memory, and each user is provided with a virtual cash account.

Within the framework of payment system oversight, the Bank of Latvia also collated data on the payment instruments used. As in previous years, customer credit transfers (107.4 million payments or 60.3%) and payments by cards (66.0 million payments or 37.1%) accounted for the majority of all payment instruments used in Latvia in 2006. The value of these payments was 383.7 billion lats and 1.2 billion lats respectively. With the number of foreign tourists visiting Latvia on the rise and the points of sale infrastructure expanding, the volume of payments by payment cards issued abroad rose by 65.0%, reaching 3.9 million payments. The value of these payments grew by 59.5% year-on-year (to 241.2 million lats).

Along with the central banks of other EU countries, the Bank of Latvia continued to participate in the Working Group on Payment System Policy of the ESCB's Committee on Payment and Settlement Systems pursuing an oversight of TARGET, developing oversight guidelines for card schemes and improving payment statistics methodology. In 2006, an updated review of the payment systems in Latvia has been prepared for incorporation into the complemented ECB publication of the *Blue Book*. The Bank of Latvia also participated in the regular survey of electronic payment systems observatory conducted by the ECB and the national central banks on innovative payment services in Europe. The results of the survey indicated that an increasing number of companies along with the banks offer their customers diverse payment related services in Latvia, such as initiating payments via mobile phone and Internet.

In 2006, the Working Group on TARGET2 of the ESCB's Committee on Payment and Settlement Systems finalised the TARGET2 Level2 acceptance testing documentation as well as the price structure development for TARGET2 optional modules/services and commenced the elaboration of a legal framework. The strategy for implementation of TARGET2 was approved in Latvia, stipulating that Latvia along with seven other EU countries will join TARGET2 with the first wave of migration on 19 November 2007 (the migration of EU countries to TARGET2 is split into three waves of migration). In 2006, the regular meetings of the Bank of Latvia's Working Group on TARGET2 and the meetings of the banks' Working Group on TARGET2 Project, with the representatives from LCD and the Treasury participating therein, were convened to discuss the progress achieved in project development and technical preparation, the preliminary actions to be taken, time schedule, system testing and other issues. The Bank of Latvia's staff participated in several TARGET2 technical workshops organised by the system developer banks, where experts from central banks were introduced to the TARGET2 structure and its operational principles.

The Bank of Latvia continued to ensure the operation of the VNS in 2006. At the end of the year, securities in the amount of 272 million lats, including the Treasury bills – 23 million lats, Treasury bonds – 242 million lats and the private sector's debt securities – 7 million lats, were held in the VNS. In 2006, the turnover of the VNS was 3 156 million lats, including the transactions of the Bank of Latvia – 2 420 million lats, mutual transactions of the VNS participants – 441 million lats, securities transfers between the VNS and the LCD – 159 million lats, settlements related to the redemption of securities – 136 million lats.

To state the Bank of Latvia's role and tasks in the oversight of the VNS, the Council of the Bank of Latvia approved the *Oversight Policy for the Securities Settlement Systems* of Latvia in May 2006. The system oversight is an activity for promoting smooth operation of securities settlement infrastructure, and it can be achieved by monitoring the operation of the existing systems, evaluating them as per the tasks set and proposing the necessary changes.

FINANCIAL STABILITY

In view of the persistently increasing financial market integration, coordinated approach to the issues related to financial stability is a top priority in the economic cooperation of EU countries. Representatives of the Bank of Latvia and the FCMC participated on CEBS, the ESCB's Banking Supervision Committee as well as several working groups. In 2006, the above bodies continued to draft clarifying documents on issues concerning the structural changes of the EU financial system, measures and cooperation in financial crisis situations as well as various issues related to the new capital requirements directive, to work on cross-border financial consolidation, harmonisation of the concept of equity capital, etc.

Development of concerted and coordinated action of the EU competent authorities in a potential financial crisis situation was one of the priorities of the EU authorities in the field of financial stability in 2006. In April 2006, the Bank of Latvia together with the FCMC and the Ministry of Finance participated in the simulation exercise organised by the EFC with the aim of testing the Memorandum of Understanding on co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis situations concluded in 2005.

In September 2006, the Bank of Latvia signed the "Agreement on Cooperation Framework in Potential Banking Crisis Situations" with the FCMC and the Ministry of Finance, and in December a Memorandum of Understanding between the *Sveriges Riksbank* and the central banks of the Baltic States on cooperation in crisis situations.

The Bank of Latvia in cooperation with the FCMC continued the macro-prudential monitoring of banks in order to detect and evaluate macro-risks posing potential threats to the banks' stability in due time. As before, the main attention was paid to banks since they played the most significant role in financial intermediation. Nevertheless, the importance of other financial institutions and markets continued to grow, and their relationship with banks expanded.

In contrast to the FCMC, the Bank of Latvia does not monitor the financial status of individual financial institutions but assesses the financial system stability and its vulnerability in the overall macroeconomic situation.

In 2006, the Bank of Latvia conducted a liquidity adequacy assessment of the SAMS with the help of the payment and settlement system simulator developed by *Suomen Pankki – Finlands Bank*. The simulation suggested that, given the SAMS turnover and liquidity on banks' settlement accounts with the SAMS, the potential liquidity problems of individual participants could not affect the capability of other participants to fulfil their settlement obligations in the system.

In 2006, the Bank of Latvia published two *Financial Stability Reports* where, on the basis of analysing the dynamics of the indicators of the macro-prudential monitoring of banks and the financial vulnerability of non-financial corporations and households, as well as the impact of external economic and financial developments, risks posing potential threats to the stability of the Latvian banking sector were assessed, at the same time acknowledging its sound financial status. The most significant risks relate to the rise in euro interest rates and the potential accelerated adjustment of the real estate prices. High inflation, widening current account deficit and expanding external debt as well as the accelerated rise in housing prices continued to increase the risk of rapid adjustment of the domestic and external imbalances in the Latvian economy.

INFORMATION SYSTEMS

The upgrading project of the Bank's information system *Globus* was successfully completed in 2006, resulting in a long-term solution for a uniform and secure processing and accounting of all financial transactions by the Bank of Latvia, including system preparations for organising the accounting following the ECB guidelines.

The first step in developing a new Economic and Financial Statistics Information System function, designated for automated data transmission to the ECB and Eurostat, has been completed.

The information system for drawing up the national balance of payments was notably improved in 2006 by creating a new set of balance of payments for public use that contain a more detailed information, by switching over to electronic co-ordination and approval of accounts for public use, as well as by making the necessary changes in data transmission to the ECB and Eurostat in compliance with the new requirements of the said institutions.

The first steps towards the enhancement of the Bank's electronic document management system eDPS have been completed: the Bank of Latvia's Council and Board meetings are now digitalised, including electronic submission and approval of documents and a joint register containing the documents approved by the Bank of Latvia's Council and Board and the orders issued by the Bank's management.

INFORMATION TO THE PUBLIC

In his presentation at the conference on development prospects of the Latvian economy (hosted by the Bank of Latvia in 2006) Otomar Issing, an economist and a former Member of the Executive Board of the ECB, pointed out that proper communication is a key condition for a successful conduct of monetary policy. The more convincing the explanations on monetary policy decisions offered by central banks to community, the more efficient their monetary policies.

The Bank of Latvia implemented a number of activities to provide the general public, public institutions and financial market participants with generous and timely information about the decisions and considerations of the central bank. The Bank of Latvia has devoted special effort to improve the overall awareness regarding price stability as the most critical condition for a successful and sustainable growth of national economy and for increase of people's welfare. To attain this goal, a set of activities such as media relations, central bank publications, website, Visitors Centre "Money World" etc. has been tailor-made for the needs of various target audiences.

Monetary policy, the decisions passed by the Bank of Latvia's Council, and the considerations of the Bank's economists form the core of the information that needs to be disseminated quickly, clearly and as widely as possible. The Governor of the Bank of Latvia used to brief the audience at press conferences run immediately after the close of the Bank of Latvia's Council meetings, on the Council's monetary policy decisions and the economic aspects behind them, to offer national macroeconomic development forecasts, and to answer questions from media representatives. Press releases contained information on the Bank of Latvia's monetary and other decisions. The address and the statements by the Governor of the Bank of Latvia were immediately posted on the website, thus making them accessible to any market participant and other interested parties on the very same day.

The Bank of Latvia's website is an environment where all public information about the Bank of Latvia's operations, including publications, is available. The information on the Bank of Latvia, its regulations, financial statistics, payment and settlement systems, Latvian money, and other areas of interest was complemented and updated on the website on a regular basis. Considering the fact that the amount of information posted on the website is continuously increasing, the layout of the site has been changed and new features introduced, making the website more user-friendly in terms of searching, receiving and personalising the necessary information (for example, data delivery in RSS format has become possible).

The Bank of Latvia's regular publications provided comprehensive information on Latvia's financial sector and the national economy. At the beginning of 2006, the Bank of Latvia published its Annual Report 2005 to provide information on its operations and financial results. Latvia's economic development has been analysed in the context of developments in global economy. The Bank of Latvia's *Monetārais Apskats*. *Monetary Review*, *Monetary Bulletin*, *Latvijas Maksājumu Bilance*. *Latvia's Balance of Payments*, *Latvia's Balance of Payments (Key Items)* and *Financial Stability Report* play an important role in providing information.

To enable the Bank of Latvia to make its monetary policy decisions well-considered and responsible, its experts carried out in-depth studies and encouraged research and public discussion on the key topics. Several working papers by the Bank of Latvia's staff members were published in 2006 (see Appendix 9).

In the middle of October the Bank of Latvia invited university lecturers, experts from public institutions, businessmen and finance professionals to its annual conference on Latvian economic development *Latvia on Its Way to Prosperity: Growth Potential and Development Prospects*. The discussion points – Latvia's sustainable growth and migration of labour force – were topical indeed. This was evidenced both by the panel discussions and the follow-up publications in mass media, analysing and, jointly with economists, evaluating the development models of the Latvian national economy.

With the increasing public discussion on macroeconomic risks and Latvia's development prospects, it is critically important that the journalists have as good an understanding of the situation as possible. For this purpose the Bank of Latvia organised two seminars for journalists, where the issues related to macroeconomic risks and sustainable growth were discussed in great detail.

In 2006, the Bank of Latvia suggested a number of research topics for its annual competition of student research papers: the effects of lending on Latvian national economy; an estimate of Latvia's current account deficit permissible limits; conditions for Latvia's sustainable macroeconomic development; equilibrium price on the real estate market. Out of nine papers enrolled in the competition, four fetched awards. The prize-winners were invited to round-table discussion on macroeconomic issues, with the Governor of the Bank of Latvia, experts and journalists as other participants.

The target audience of the quarterly bulletin *Averss un Reverss* is researchers and financial analysts. The publication provides analysis of topical trends in macroeconomic development (price increase and the elements of economic growth), lending, labour market, sectors of the economy, foreign trade, banking sector, disseminates the Slovenian experience in attaining macroeconomic stability, as well as contains information on the euro payment system that Latvia is expected to join in 2007. In 2006 a special issue was dedicated to the conference *Latvia on Its Way to Prosperity: Growth Potential and Development Prospects*.

The above have also been the discussion topics for the TV broadcast *Kā bankā* and the radio broadcast *Lata spogulī* (prepared in cooperation with the Bank of Latvia), gives the Bank an opportunity to address a vast audience and improve its awareness regarding public and personal finances.

The Visitors Centre at the Bank of Latvia "Money World" is open to any visitor from Latvia or abroad, providing an adequate source of information about the operations of the central bank and national macroeconomic developments. The information is presented in a clear, accurate, interactive and state-of-the-art manner. The Centre had eight thousand visitors in 2006.

The key target audience of the Visitors Centre is young people studying economics – secondary school seniors and university students majoring in social sciences. In 2006, in cooperation with teachers of economics, methodological guidelines for visiting the Centre were developed and approved, including recommendations, worksheets and tests. The guidelines have been posted on the website of the Bank of Latvia, and have made the students' visits more focused and valuable. Employees from central and local government institutions, politicians, journalists, pensioners, professionals from financial institutions, businessmen and representatives from other professional and social groups have been updated on the macroeconomic situation while visiting the Centre.

Latvia is on its way of becoming a full-fledged participant of the EMS. This is why the information on operation of the Eurosystem and on the single European currency euro, the currency already used by travellers from Latvia on foreign trips, has to be presented in a timely fashion and gradually. The euro notes and coins themselves carry messages about the national values of the European countries. Therefore the Bank of Latvia, jointly with the EC, held an exhibition "The Origins of Euro Coins" in the premises of Riga Latvian Society House in July and August of 2006. The display traced the process of choosing the design for the euro coins, and presented the designs and samples of coins. The presentation by of the Bank of Latvia was the very first occasion when draft designs of the Latvian euro coins were on public display.

The contribution by the Bank of Latvia and artists in creating commemorative coins and special circulation coins have received praise from Latvian public and international juries. In 2006, the Bank of Latvia conducted a poll *Latvia's Coin of the Year 2005*, with the number of respondents close to 13 thousand. 100-santims nominal silver coin *Baron Münchhausen* received the largest number of votes; it also won the main award as the most outstanding coin of the year 2005 at the coin exhibition "Vicenza Numismatica" in Italy.

The Bank of Latvia is undertaking historic and cultural as well as corporate social responsibility, thus once again demonstrating its integral role in the developments taking place in the Latvian state, community and environment. The Visitors Centre "Money World", located in the renovated part of the main building of the Bank of Latvia (an architectural monument), received the award "Golden Crutch 2006", given by "Apeirons", an association of people with disabilities and their friends, as the friendliest building for handicapped people. New and renovated buildings were assessed in the contest, and the building of the Bank of Latvia at K. Valdemāra iela 2A was praised for its impeccable accessibility. For the third year running, the Bank of Latvia's Riga Branch building received the Riga City Council prize for the most attractive greenery in the category of public buildings.

LATVIJAS BANKA

ORGANISATIONAL DEVELOPMENT

The composition of the Council of the Bank of Latvia, as at the end of 2006, was as follows:

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

The Board of the Bank of Latvia, as at the end of 2006, was as follows:

– Chairperson of the Board:	**Māra Raubiško**;
– Deputy Chairmen of the Board:	**Reinis Jakovļevs**, **Helmūts Ancāns**;
– Members of the Board:	**Māris Kālis**, **Andris Ņikitins**, **Harijs Ozols**.

At the end of 2006, the Bank of Latvia's staff numbered 635, of which 33 had a job contract for a limited period (648 and 23 at the end of 2005 respectively). As at the end of 2006, 56% of the Bank's staff were males and 44% were females.

To ensure exchange of information between the Bank of Latvia and the EU institutions, the Bank of Latvia's special attaché at the Latvia's Mission to the EU continued his work in 2006.

Structural improvements continued at the Bank of Latvia in 2006.

The number of employees was increased in the Statistics Department in order to cope with the ECB requirements regarding MFIs statistics and development of Centralised Securities Database, and to proceed with the cooperation with the IMF in the areas of preparing annual financial stability key data and maintaining methodology descriptions when consolidating data according to the consolidation method proposed by the IMF.

With the growth of currency in circulation, and, consequently, cash handling volumes in the regional branches, the number of cash handlers in Liepāja and Rēzekne Branches has been increased.

Restructuring has been accomplished at the Communications Department by segregating the translation and protocol functions, with the purpose to optimise the translation and editing workflows. The erstwhile Division of Translation and Protocol has been replaced by a Protocol Division.

Improvements in the security systems and work organisation resulted in a further reduction in the number of security staff.

The Bank of Latvia employees continued with their academic studies and additional professional training, participating in seminars, workshops, courses and conferences in Latvia and abroad to keep up with the latest in the fields of monetary policy, financial stability, macroeconomics, econometrics, foreign exchange operations, payment systems, statistics, bank accounting and information technologies. A number of the Bank's employees successfully participated in international professional certification programmes.

In 2006, 3.2% of total expense on wages, salaries and other personnel costs was spent on Bank's personnel training (3.6% in 2005).

The focus of the training continued to be on developing skills necessary for successful cooperation of the Bank's personnel with the ECB and the national central banks of other EU countries. The personnel involved in the ESCB's committees and working groups had an opportunity to improve their business English writing skills and international meetings management skills.

In-depth studies in the fields of business presentations, communication, efficient time management, business etiquette, stress management, lateral thinking continued as did computer skills and foreign language (English, French, German) training. As a part of development programme for managers, their knowledge was enhanced in the fields of emotional culture, efficient management routines and conflict psychology.

Workshops "Advanced Writing Skills" (for the English language translators), "Effective Report Writing" and "Working Effectively Across Cultures" (for employees participating in ESCB committees and working groups), run by lecturers of a language training firm from the United Kingdom, were conducted at the premises of Training and Recreation Centre of the Bank of Latvia.

Special seminars were held for recently hired employees to inform them about the Bank's tasks and its organisational units fulfilling these tasks. The speakers in one-day seminars were experts from Monetary Policy Department, Market Operations Department and Communications Department, presenting the key areas of operations of their respective units. Public Relations Department organised a seminar about media relations.

Similar to previous years, the Bank of Latvia's specialists could apply for temporary short-term positions at the ECB. In 2006, three Bank's employees improved their professional skills on short-term assignments at the ECB. The Bank of Latvia's staff may also participate in workshops organised by the ESCB. This kind of participation provides knowledge about topical ESCB issues and processes.

The Training and Recreation Centre, providing a high quality technical support to training, hosted the second part of the seminar "Heading for Leadership" (the first part was conducted in Vienna). Heads of structural units from the central banks of 12 EU Member States were the audience.

RISK AND QUALITY MANAGEMENT

In 2006, the Bank of Latvia's Board continued to develop risk management in line with the core principles stipulated in the "Bank of Latvia's Security Policy", taking into consideration the development of the financial market and the Bank of Latvia's operation. According to the document, oversight is the function of the Bank of Latvia's Security Supervision Commission comprising four members of the Bank of Latvia's Council.

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

The analysis of the Bank of Latvia's all essential information systems risks was carried out. The analysis of this type also becomes a part of any information system development or upgrading project.

The management of the Bank of Latvia's core operational risks was coordinated by the Bank's Risk Manager, who assessed and summarised risk reports drafted by the Bank's organisational units and classified the risks thereby maintaining and updating the Bank of Latvia's risk matrix.

In April 2006, the Bank of Latvia's Board reviewed and approved the Bank's risk report as well as reported to the Bank of Latvia's Council on the situation in the area of risk management. Personnel training in the field of information and information system security, operations continuity and risk management was also organised.

In 2006, the following business continuity improvement measures were implemented in the Bank of Latvia: documents governing business continuity management procedure and organisational procedures were prepared or updated, and the business continuity action plans of the Bank of Latvia's structural units were tested. Overall, these measures currently form the business continuity management system of the Bank of Latvia, ensuring timely detection and prevention of incidents and emergencies, preparation of proposals for incident and emergency prevention in the future, staff training as well as testing and updating of action plans for ensuring business continuity.

The Bank of Latvia's quality management system has been functioning since 2000. In 2006 it was audited for recertifying purposes, and not a single incompliance was detected.

The description of processes and procedures have been reviewed and, if need be, revised with the aim to enhance the system and its functionality. It was decided that the operational processes of the Bank of Latvia be described according to the pattern of function distribution within the ESCB and integrated into the quality management system, thus establishing a single management system for the Bank of Latvia.

The Bank's "Quality Management System Manual" is undergoing revisions; the management system is now being tailored to suit the Bank of Latvia's future policy in management matters. Particular attention was paid to describe the procedures for corrective and preventive measures, and to introduce the newly-hired staff with the quality management system.

INTERNAL AND EXTERNAL AUDIT

Internal audit, after carrying out an unbiased examination of the Bank's functions and processes, provides the Bank of Latvia's management with an independent evaluation of the efficiency of risk management, control systems and processes, and gives recommendations as to the necessary improvements. The internal audit of the Bank of Latvia is conducted by the Internal Audit Department. An Audit Committee operates in the Bank of Latvia, supervising and helping to improve internal audit.

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The internal audit is organised and conducted according to the "Internal Audit Policy of the Bank of Latvia", complemented in 2006 with more precise guidelines for assuring and improving the internal audit quality: now the quality system evaluation organisational arrangements are in place for internal ongoing, internal regular and external audits. The internal audit is organised and conducted according to the "International Standards for the Professional Practice of Internal Auditing" and "Code of Conduct" developed by the Institute of Internal Auditors as well as to the standards established by the Control Objectives for Information and Related Technology (CobiT) and the Information System Audit and Control Association (ISACA).

The internal audit addresses all operational areas of the Bank of Latvia. Internal audits are planned and conducted on the basis of risk assessment. The ESCB internal audits are conducted in the Bank of Latvia pursuant to the ESCB audit plan. The results of each internal audit are reported to the Bank of Latvia's Governor. On a quarterly basis, the Bank of Latvia's Audit Committee is informed about the findings of the conducted internal audits, recommendations and their implementation progress. The Bank of Latvia's Council is advised about the accomplished internal audits and the key findings on a yearly basis.

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

ACCOUNTING AND BUDGET MANAGEMENT

The Bank of Latvia's accounting system has been established and managed in line with the "Bank of Latvia Accounting Manual" approved by the Board of the Bank of Latvia and the other regulations of the Bank, in compliance with the Law "On the Bank of Latvia" and other laws and regulations binding on the Bank of Latvia.

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

The Council of the Bank of Latvia approves the Bank of Latvia's budget; the budget management proceeds in compliance with the "Regulation for Managing the Bank of Latvia's Budget" approved by the Council of the Bank of Latvia and aimed at ensuring spending efficiency. The Regulation provides for the procedure of drafting, approving and monitoring the execution of the Bank's budget. In 2006, the Bank of Latvia's Council approved amendments to the Regulation with the purpose to specify the budget drafting obligations of the Bank's organisational units and the Board, and to enhance the approval procedures and the monitoring of the budget execution.

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

COOPERATION WITH INTERNATIONAL ORGANISATIONS

The Bank of Latvia continued to represent the Republic of Latvia interests at the meetings of the IMF Board of Governors as well as in daily matters.

Latvia's interests in the IMF were represented in the Nordic-Baltic Constituency, that includes Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden. One Executive Director represented this constituency on the IMF Executive Board, with a total of 3.52% votes.

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

Cooperation with the IMF, based on consultations under Article IV of the IMF Articles of Agreement, continued. On 4 October 2006, the IMF Executive Board reviewed a report on the development trends in the Latvian economy and on the implementation of monetary and financial policy.

In 2006, Latvia continued its activities as a member of the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation and the European Bank for Reconstruction and Development. The Bank of Latvia continued its participation in the activities within the BIS.

COOPERATION WITH FOREIGN CENTRAL BANKS AND TECHNICAL ASSISTANCE

In 2006, the Bank of Latvia continued its cooperation with the central banks of other countries, sharing expertise and information.

Within the framework of the World Bank technical assistance, in February and June the staff members of the Accounting Department prepared the evaluation of the accounting practices in the banking sector of Georgia, but in November – that of Ukraine. In March and April, they advised the specialists of the Central Bank of Trinidad and Tobago on issues of foreign exchange reserves accounting.

On several occasions, the staff of the Public Relations Department shared their expertise in using the Visitors Centre as an instrument for increasing public awareness with specialists from *Lietuvos bankas*.

In April, experts of the Monetary Policy Department and Public Relations Department participated in the annual seminar of the central banks of the Baltic States.

As a part of lasting cooperation, in July MA students from the Banking College of Uzbekistan met with the experts from the Bank of Latvia at the Bank's Visitors Centre "Money World" and discussed the development trends of the Latvian economy, as well as issues related to monetary policy and payment systems.

In August, under the IMF technical assistance mission to Belarus, an expert from the Accounting Department advised the central bank of Belarus on issues related to the implementation of International Financial Reporting Standards.

In September, specialists from the Payment Systems Department provided an overview of the oversight of payment systems in Latvia at a conference hosted by the Central Bank of Kazakhstan; in November, they participated in an international conference in Hungary, on topical issues for banks in view of Latvia's anticipated joining SEPA.

In November, the Monetary Policy Department hosted a visit of experts from the central bank of Bulgaria to share its experiences in matters concerning participation in ERM II. The development trends of the Latvian economy, the functions and operation of the Bank of Latvia were discussed with the experts from the central bank of the Ukraine.

The Bank of Latvia organised several international meetings. In June, Thematic Meeting of the Working Group on External Statistics of the ESCB Statistics Committee was held in Riga, with participation of experts in the area of balance of payments from all EU countries, Switzerland, Romania and the ECB.

In September, the Bank of Latvia organised a meeting on the issues of foreign reserves management, with representatives from the EU10 central banks, central banks of Romania and Bulgaria and the World Bank as participants.

In October, the Bank of Latvia hosted a seminar for the experts of the EU national central banks and the ECB on the internal audit quality assurance and enhancement system.

In December, a seminar "Development of the Bank of Latvia's Functions" was organised for the needs of the ECB and the Bank of Latvia's experts who are involved in drafting laws and regulations, publications and other texts in the Latvian language. The issues of monetary policy, accounting, the oversight of payment systems and market operations were discussed.

International financial institutions and foreign central banks extended support to the Bank of Latvia, providing opportunities to participate in the workshops and courses hosted by these institutions as well as to obtain consultations on the issues related to the central bank operations. In 2006, the Bank of Latvia's employees also participated in a number of courses held by the ECB, the IMF Institute and the Joint Vienna Institute as well as seminars organised by the central banks of the Czech Republic, France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom.

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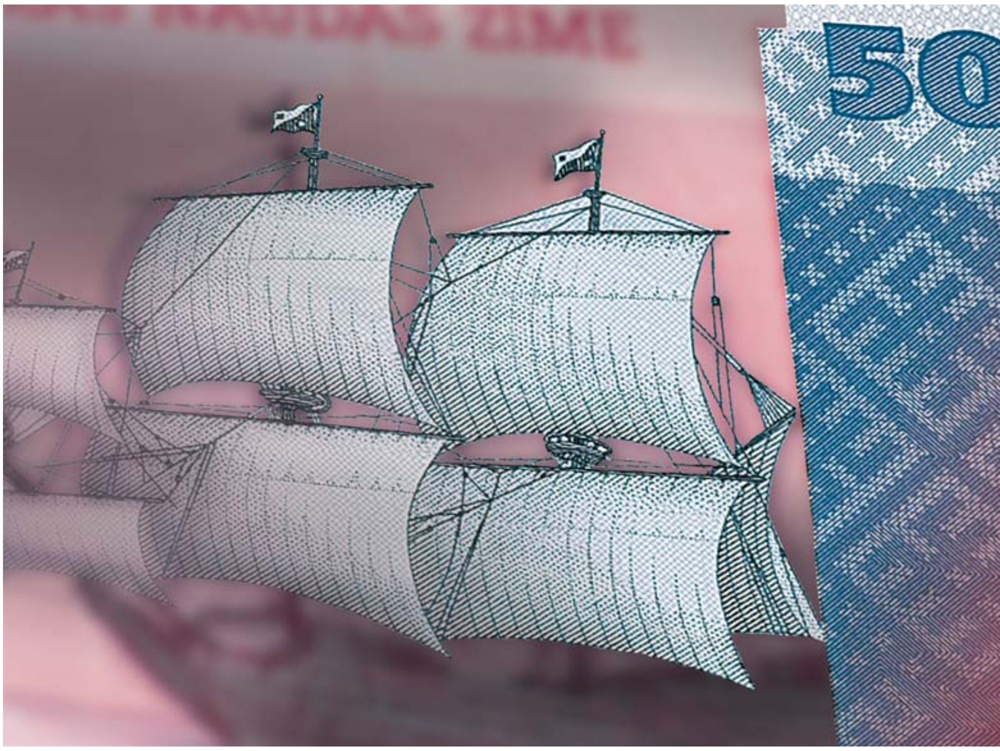
THE BANK OF LATVIA'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006



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THE BANK OF LATVIA'S BALANCE SHEET

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

ASSETS	Notes[1]	2006	2005
FOREIGN ASSETS		**2 553 022**	1 513 427
Gold	4	83 668	76 170
Special Drawing Rights	6	85	85
Convertible foreign currencies	5	2 333 279	1 323 520
International Monetary Fund	6	101 815	107 633
Participating interest in the European Central Bank	7	760	760
Participating interest in the Bank for International Settlements	8	1 763	1 763
Other foreign assets	9	31 652	3 496
DOMESTIC ASSETS		**34 873**	159 487
Loans to credit institutions		–	23 300
Government securities	10	–	98 817
Fixed assets	11	32 763	34 878
Other domestic assets	12	2 110	2 492
TOTAL ASSETS		**2 587 895**	1 672 914

[1] The accompanying notes set out on pages 64 to 94 are an integral part of these financial statements.

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

LIABILITIES, CAPITAL AND RESERVES	Notes	**2006**	2005
FOREIGN LIABILITIES		**138 656**	123 196
Convertible foreign currencies	13	21 158	3 295
International Monetary Fund	6	102 044	107 875
Other international institution deposits in lats	14	1 348	1 105
Foreign bank deposits in lats		448	486
Other foreign liabilities	15	13 658	10 435
LATS IN CIRCULATION	16	**1 073 851**	877 274
DOMESTIC LIABILITIES		**1 271 929**	575 762
Balances due to credit institutions	17	1 212 263	502 669
Balances due to the Government	18	49 818	68 389
Balances due to other financial institutions		6 308	2 004
Other domestic liabilities	19, 20	3 540	2 700
CAPITAL AND RESERVES		**103 459**	96 682
Nominal capital	21	25 000	25 000
Reserve capital	21	54 898	48 090
Valuation account	21	16 442	13 333
Profit of the reporting year	21	6 586	9 726
European Union grant	21	533	533
TOTAL LIABILITIES, CAPITAL AND RESERVES		**2 587 895**	1 672 914
MEMORANDUM ITEMS	31		

These financial statements, which are set out on pages 58 to 94 were authorised by the Board of the Bank of Latvia on 23 February 2007.

BOARD OF THE BANK OF LATVIA

M. Raubiško

R. Jakovļevs

H. Ancāns

M. Kālis

A. Ņikitins

H. Ozols

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	**2006**	2005
INTEREST AND SIMILAR INCOME			
Foreign operations			
Gain on investments in debt securities		45 789	31 021
Interest on deposits with foreign credit institutions and other foreign financial institutions		5 268	2 452
Dividends on shares in the Bank for International Settlements		211	200
TOTAL foreign operations		**51 268**	33 673
Domestic operations			
Interest on loans to credit institutions		644	308
Gain/loss (–) on investments in government securities		–3 811	4 772
TOTAL domestic operations		**–3 167**	5 080
INTEREST EXPENSE			
Foreign operations			
Interest on deposits		8	9
TOTAL foreign operations		**8**	9
Domestic operations			
Interest on deposits of credit institutions		16 103	6 954
Interest on government deposits		4 017	3 032
Interest on deposits of other financial institutions		68	32
TOTAL domestic operations		**20 188**	10 018
NET INTEREST AND SIMILAR INCOME	22	**27 905**	28 726

(cont.) (in thousands of lats)

	Notes	2006	2005
OTHER OPERATING INCOME	23	**712**	577
OTHER OPERATING EXPENSE			
Remuneration	24	10 207	9 294
Social security costs	24	1 943	1 788
Depreciation and amortisation charges	11, 12	4 077	2 780
Maintenance and operation of information systems		1 086	1 059
Banknote production and coinage costs	25	1 071	296
Costs of financing the Financial and Capital Market Commission	26	240	600
Other operating expense	27	3 407	3 760
TOTAL other operating expense		**22 031**	19 577
PROFIT OF THE REPORTING YEAR		**6 586**	9 726

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

(in thousands of lats)

	Notes	**2006**	2005
RESULT ON REVALUATION			
Result on revaluation of assets and liabilities denominated in foreign currencies and gold		–29 767	5 576
Result on revaluation of non-traded financial derivative contracts		24 608	–5 128
Result on revaluation of securities		8 268	–8 236
NET RESULT ON REVALUATION	21	**3 109**	–7 788
PROFIT OF THE REPORTING YEAR		**6 586**	9 726
TOTAL		**9 695**	1 938

THE BANK OF LATVIA'S CASH FLOW STATEMENT

(in thousands of lats)

	Notes	**2006**	2005
CASH FLOW FROM OPERATING ACTIVITIES			
Profit of the reporting year		6 586	9 726
Non-cash transaction adjustments	28 (1)	4 078	2 871
Net movements in balance sheet positions	28 (1)	49 710	–107 976
Net cash and cash equivalents inflow/outflow (–) from operating activities		**60 374**	–95 379
CASH FLOW FROM INVESTING ACTIVITIES			
Purchase of shares in the Bank for International Settlements		–	–763
Dividends on shares of the Bank for International Settlements		211	200
Acquisition of fixed assets		–1 192	–1 058
Acquisition of intangible assets		–360	–321
Net cash and cash equivalents outflow from investing activities		**–1 341**	–1 942
CASH FLOW FROM FINANCING ACTIVITIES			
Profit appropriated to the state budget		–2 918	–987
Net cash and cash equivalents outflow from financing activities		**–2 918**	–987
NET CASH AND CASH EQUIVALENTS INFLOW/OUTFLOW (–)		**56 115**	–98 308
Cash and cash equivalents at the beginning of the year	28 (2)	**67 831**	166 139[1]
Cash and cash equivalents at the end of the year	28 (2)	**123 946**	67 831[1]

[1] Indicators of 2005 are restated due to policy changes in the definition of cash and cash equivalents (see Notes 3 and 28).

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NOTES TO THE BANK OF LATVIA'S FINANCIAL STATEMENTS

1. PRINCIPAL ACTIVITIES

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

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

In the execution of its tasks, the Bank of Latvia is not subject to decisions and instructions by the Government or other institutions. The Bank of Latvia is independent in setting and implementing policy under its legal mandate. The Bank of Latvia is supervised by the Parliament (Saeima) of the Republic of Latvia.

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

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

2. RISK MANAGEMENT

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

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

The Bank of Latvia manages financial risks related to foreign currency and gold reserves (hereinafter, foreign reserves) in accordance with the "Guidelines for Managing the Bank of Latvia's Foreign Reserves" (hereinafter, the Guidelines), as approved by the Council of the Bank of Latvia. Managing of foreign reserves is conducted in compliance with the basic principles set out in the Guidelines, including preserving the value of foreign reserves, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting to the Bank of Latvia's monetary policy objectives.

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

Parameters for a benchmark portfolio reflecting the return target and acceptable level of financial risks, as well as the target structure of investments are set out for each portfolio type in the Guidelines. On a business day basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the requirements set out in the Guidelines.

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

MARKET RISK

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates). The Bank of Latvia manages interest rate risk inherent mainly in financial instruments sensitive to interest rate fluctuations by using a modified duration limit set individually for each investment portfolio. The Bank of Latvia incurs interest rate risk mainly from investment in foreign debt securities and interest rate financial derivatives that are used within the framework of foreign reserves management.

The Bank of Latvia monitors the currency risk by determining open currency position limits. In accordance with the exchange rate policy of the Bank of Latvia for foreign reserves portfolios, except for portfolios of borrowed funds, the benchmark portfolio currency is euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with parameters of respective liabilities. Deviations from the benchmark currency structure give rise to the open currency position. Pursuant to the Guidelines, substantial deviation from the benchmark position is not permissible; hence the exposure of the Bank of Latvia to exchange rate risk is minimal.

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

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

The Bank of Latvia manages interest rate risk arising from foreign reserves by investing only in financial instruments denominated in the currencies of the OECD countries.

The Bank of Latvia does not hedge interest rate risk, which is related to domestic

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financial assets in order to avoid a conflict with the monetary policy objectives pursued by the Bank.

Exposure of the Bank of Latvia to market risk (as at the end of 2006) is provided in Notes 33 and 34.

CREDIT RISK

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

The Bank of Latvia manages exposure to credit risk related to investments made in foreign debt securities and short-term cash and gold deposits by establishing limits on investments of different credit quality in the Guidelines. Credit quality is evaluated on the basis of ratings assigned by the international rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's. Limits are set also on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. In order to monitor the Bank's exposure to credit risk associated with its foreign operations, the Risk Management Division of the Market Operations Department is involved in monitoring of the Bank of Latvia's compliance with the Guidelines on a business day basis. Short-term loans granted to domestic credit institutions are secured by collateral of Latvian Government securities (hereinafter, government securities) and such private sector debt securities, which are tradable, have been included on the list of securities approved by the Chairperson of the Board of the Bank of Latvia, and whose issuers' ratings assigned by international rating agencies are not below the rating thresholds established by the Council of the Bank of Latvia in respect of the issuers' long-term liabilities in foreign currencies. The Monetary Policy Department reviews the compliance of ratings assigned to issuers of securities on the list referred above with the requirements of the Council of the Bank of Latvia and monitors the adequacy of collateral on a regular basis. Exposure of the Bank of Latvia to credit risk (as at the end of 2006) is provided in Notes 35 to 37.

LIQUIDITY RISK

Liquidity risk is associated with a failure to meet liabilities timely and to dispose of assets close to fair value. The Bank of Latvia manages liquidity risk by investing foreign exchange reserves in liquid debt securities and other financial instruments issued by international institutions, foreign governments and the corporate sector, while investing its gold reserves in short-term deposits with foreign financial institutions. Investments are made so as to ensure timely meeting of the Bank of Latvia's liabilities. The structure of the Bank of Latvia's cash and its equivalents is provided in Note 28.

The Bank of Latvia manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same class and in financial instruments of the same issuer.

OPERATIONAL RISK

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

Group whose main task is to provide opinion to the Board of the Bank of Latvia on operational risks identified and initiate activities that would minimise these risks, and the Committee for Managing the Bank of Latvia's Information Systems to review, on a regular basis, the management system of information system related operational risk have been established at the Bank of Latvia.

The goal and basic principles of the Bank of Latvia's security policy are determined by the Council of the Bank of Latvia. "The Security Policy of the Bank of Latvia", approved by the Council, covers risk management, management of operational continuity, security of information and information systems, and physical security; it also lays down regulations for uninterrupted and secure execution of the Bank of Latvia's tasks.

The Board of the Bank of Latvia determines the procedure for Bank of Latvia's risk management. "The Regulation for Managing the Bank of Latvia's Risks" covers the procedure for identifying, documenting, assessing and minimising risks. The management of the Bank of Latvia's operational risk is coordinated by the Risk Management Working Group.

In order to ensure confidentiality, accessibility and integrity, information and relevant technical resources are classified under the internal control system. The Bank of Latvia has appointed owners of information and information systems who are responsible for classification, risk analysis and protection of relevant information or information systems, as well as determination of access rights and their application procedure.

"The Procedure for Managing the Continuity of the Bank of Latvia's Operation" approved by the Bank of Latvia's Council sets out general procedure for managing Bank of Latvia's operational continuity. An operational continuity management system to ensure timely identification of incidents and emergency situations and their prevention, to develop proposals for prevention of incidents and emergency situations in the future, to organise education and training of employees, to test and update action plans for ensuring operational continuity has been established at the Bank of Latvia. The Bank of Latvia's Board is responsible for the management of incidents and emergency situations at the Bank of Latvia. "The Procedure for Managing Incidents and Emergency Situations at the Bank of Latvia" approved by the Board covers timely identification of incidents and emergency situations and provides for coordinated and effective activities of the Bank of Latvia's departments in the event of an incident or emergency situation.

The Bank of Latvia has specified the functions whose forced discontinuity may endanger the execution of the Bank of Latvia's tasks; specified also are the maximum permissible periods of forced discontinuity and the critical resources used in the implementation of these functions. On a regular basis, the Bank of Latvia's management reviews the adequacy and availability of the resources for ensuring the continuity of the Bank's operations in case of emergency.

In order to improve the organisation of the Bank of Latvia's operational activities and to mitigate operational risk, the Bank of Latvia has designed and is continuously developing a quality management system in compliance with the quality management system standard ISO 9001:2000.

Within the framework of measures for managing total operational risk, the Bank of Latvia has been insured against certain types of operational risk.

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3. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the Bank of Latvia in the preparation of these financial statements is set out below. The adopted accounting policies have been applied consistently in the preparation of financial statements for the years ended 31 December 2006 and 31 December 2005, unless otherwise stipulated.

BASIS OF PRESENTATION

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

USE OF ESTIMATES

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

FOREIGN CURRENCY TRANSLATION

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

The principal exchange rates of foreign currencies and gold set by the Bank of Latvia and used in the preparation of the balance sheet for the year ended 31 December 2006 and the year ended 31 December 2005 are as follows:

(at the end of the year)

	2006	2005	Changes (%)
Euro (EUR)	**0.702804**	0.702804	0
US dollar (USD)	**0.536**	0.593	–9.6
Japanese yen (JPY)	**0.00451**	0.00504	–10.5
Gold (XAU)	**336.421**	306.27	9.8
Special Drawing Rights (XDR)	**0.805**	0.851	–5.4

RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

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

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

FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

Fair value of financial assets and financial liabilities is obtained from quoted market prices or discounted cash flows. Discounted cash flows are modelled on the basis of financial instruments' quoted market prices and money market interest rates.

Fair value of the Bank of Latvia's financial assets and financial liabilities at the end of 2006 and 2005 did not differ materially from the reported book value of the respective assets and liabilities.

OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

GOLD

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

SECURITIES

Debt securities of foreign issuers and Latvian government securities are stated at fair value in the balance sheet. Adjustments to the value of securities arising from revaluation of these financial instruments are reported in the balance sheet caption "Valuation account" until their disposal. Upon disposal of such securities and on the basis of weighted average cost, the accumulated revaluation result is transferred from the balance sheet caption "Valuation account" to the relevant profit and loss statement caption.

REVERSE REPURCHASE AGREEMENTS

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

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

REPURCHASE AGREEMENTS

Repurchase agreements are accounted for as financing transactions. Securities

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

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

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

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

PARTICIPATING INTEREST

Participating interest includes long-term investments of the Bank of Latvia in equity instruments. The Bank of Latvia has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate. As these equity instruments do not have a market price quoted in an active market and their fair value cannot be reliably measured, they are reported in the balance sheet at cost. An increase or decrease in participating interest due to acquisition or sale of new equity instruments is recognised considering the historical cost basis.

FINANCIAL DERIVATIVES

The Bank of Latvia enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, interest rate future contracts which are reported in off-balance sheet accounts at their contract or notional amount. Subsequent to initial recognition, these financial derivatives are revalued on a regular basis and reported in the balance sheet at fair value.

Fair value of forward exchange rate contracts and interest rate and currency swap arrangements is obtained as fair value of the respective financial asset less fair value of financial liabilities.

Result on a change in fair value of interest rate future contracts is determined and settled on a business day basis.

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

ACCRUED INTEREST INCOME AND EXPENSE

Accrued interest income on debt securities of foreign issuers and Latvian government securities are reported under the balance caption "Convertible foreign currencies" or "Government securities", respectively. Accrued interest income and expense on other financial instruments are reported under relevant balance sheet captions of other assets or other liabilities.

FIXED ASSETS

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

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

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

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

(%)

	2006	2005
Buildings		
– structures	**1**	1–3
– outer finishing	**5**	1–3
– interior decorations	**5–20**	1–3
– engineering communications	**5**	1–3
– other components	**10–20**	1–3
Improvement of territory	**10**	1–3
Transport vehicles	**10–20**	10–20
Office furniture	**10**	10
Computer equipment	**20–33**	20–33
Other office equipment	**20**	20
Cash processing equipment	**10–20**	10–20
Tools	**50**	50
Other fixed assets	**10–20**	10–20

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

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

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

INTANGIBLE ASSETS

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

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

Acquisition costs of intangible assets are amortised over the period of the licensed use as specified in the relevant agreements using the straight-line method; however, this period may not exceed 10 years.

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

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IMPAIRMENT OF ASSETS
The Bank of Latvia's organisational units assess the quality of the Bank of Latvia's assets on a regular basis. When an impairment of an asset is identified, adequate provisions for a relevant asset are established. Such provisions are recognised in the profit and loss statement with the respective reduction in the asset carrying amount.

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

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

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

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

CASH AND CASH EQUIVALENTS
In order to reflect the Bank of Latvia's cash flow more accurately, in 2006 the Bank of Latvia changed the composition of cash and cash equivalents by excluding from the estimate of cash and cash equivalents foreign debt securities disposable within 24 hours, by including deposits with an original maturity up to 5 business days made with foreign credit institutions and other foreign financial institutions as well as not excluding demand deposits from foreign institutions, Latvian Government, domestic credit institutions, and other domestic financial institutions.

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

INTEREST AND SIMILAR INCOME AND EXPENSE
Interest income and expense are recognised in the profit and loss statement on an accrual basis. Dividends on participating interest are recognised in the profit and loss statement when received.

Interest and similar income includes interest on acquired securities, deposits, loans granted as a result of monetary operations as well as the result on disposal of debt securities, the result on changes in the fair value of interest rate future contracts, and dividends on BIS shares.

Interest expense includes interest on deposits received from the Latvian Government, domestic credit institutions and other financial institutions.

BANKNOTE PRODUCTION AND COINAGE COSTS
Banknote production and coinage costs are charged to the profit and loss statement when incurred.

OTHER EXPENSE AND INCOME
Bank's other operational expense and income are recognised in the profit and loss statement on an accrual basis.

4. GOLD

Movements in gold reserves during 2006 and 2005 were as follows:

	Troy ounces	Amount in thousands of lats
As at 31 December 2004	248 583	56 901
Net changes resulting from gold deposits and their withdrawal	118	27
Increase in gold market value	x	19 242
As at 31 December 2005	248 701	76 170
Increase in gold market value	x	7 498
As at 31 December 2006	**248 701**	**83 668**

The Bank of Latvia hedges the risk related to fluctuations in gold reserves market value by entering into forward exchange rate contracts (see also Note 33).

5. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets of the Bank of Latvia are invested primarily in debt securities of high liquidity.

The carrying amount of interest bearing debt securities include both interest income purchased at the date of acquisition and interest income accrued subsequent to the date of acquisition of the securities (22 972 thousand lats at the end of 2006 and 18 610 thousand lats at the end of 2005).

In 2006, the increase in the Bank of Latvia's investment in foreign financial instruments was primarily on account of the Bank of Latvia's intervention in the foreign exchange market (1 009 million lats; 352 million lats in 2005). The funds were mainly invested in debt securities of foreign governments, financial institutions and non-financial corporations, with their value growing by 953 644 thousand lats against 2005.

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At the end of 2006 and 2005, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

(in thousands of lats)

	2006	2005
Debt securities of foreign governments, financial institutions and non-financial corporations	**2 209 333**	1 255 689
Demand deposits with foreign central banks, credit institutions and international institutions	**116 298**	67 632
Time deposits with foreign credit institutions and other foreign financial institutions	**7 504**	–
Foreign currency in cash	**144**	199
Total	**2 333 279**	1 323 520

6. INTERNATIONAL MONETARY FUND

Claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian Government promissory note issued to the IMF and is recorded as an asset denominated in SDR. The total Latvian quota in the IMF is 126 800 thousand SDR. The Latvian Government has paid up share of Latvia's quota in the IMF in the amount of 322 thousand SDR. The unpaid share of Latvia's quota in the IMF is recognised in the balance sheet in the amount of 126 478 thousand SDR (101 815 thousand lats).

Liabilities to the IMF consist of the IMF holdings in lats, which are the resources at the disposal of the IMF held on its accounts with the Bank of Latvia and used in the IMF transactions.

At the end of the year 2006 and 2005, net claims on the IMF were as follows:

	(in thousands of lats)		(in thousands of SDR)	
	2006	2005	**2006**	2005
Total Latvian quota in the IMF	**102 074**	107 907	**126 800**	126 800
IMF holdings in lats	**–102 044**	–107 875	**–126 762**	–126 762
incl. No. 2 Account	**14**	15	**17**	17
Reserve position in IMF	**44**	47	**55**	55
Special Drawing Rights	**85**	85	**105**	100
Net claims on IMF	**129**	132	**160**	155

The reserve position in the IMF is a difference between the total Latvian quota in the IMF and the IMF holdings in lats, excluding No. 2 Account, which is used for the IMF administrative expenditure and receipts.

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

7. PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, the Bank of Latvia became a subscriber of the capital of the ECB. The share of the Bank of Latvia in the ECB's capital at the end of 2006 and 2005 was 0.2978%, which corresponds to 16 572 thousand euro. In accordance with the Statute of the ESCB and the ECB, the share of the Bank of Latvia in the ECB's capital was calculated on the basis of the EU states' population and GDP data and is adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States. As Latvia does not participate in the euro area, pursuant to the transitional provisions of the Statute of the ESCB and the ECB, the Bank of Latvia paid up a minimal 7% contribution of its total subscribed capital in the ECB amounting to 1 160 thousand euro or 760 thousand lats (see also Note 32).

8. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2006 and 2005, the Bank of Latvia owned 1 070 shares in the BIS, which corresponds to 0.20% of the total subscribed and paid-up BIS capital.

The nominal value of the Bank of Latvia's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 25% or 1 338 thousand SDR (see also Note 32). The paid-up share of this holding as at 31 December 2006 and 31 December 2005 is reported in the Bank of Latvia's balance sheet in the amount of 1 763 thousand lats.

9. OTHER FOREIGN ASSETS

At the end of 2006 and 2005, other foreign assets consisted of the following items:

(in thousands of lats)

	2006	2005
Non-traded financial derivative contracts with foreign financial institutions	**31 087**	3 281
Prepaid expense	**268**	207
Advance payment for delivered goods	**269**	–
Other	**28**	8
Total	**31 652**	3 496

10. GOVERNMENT SECURITIES

As a result of implementing monetary policy as well as redeeming the Latvian government securities, in 2006 the Bank of Latvia disposed of all the Latvian government securities held by it (see also Note 22).

At the end of 2005, the Bank of Latvia held Latvian government securities with the following residual maturity:

(in thousands of lats)

Residual maturity	**2006**	2005
Up to 3 months	**–**	36 030
3 to 6 months	**–**	1 255
6 to 12 months	**–**	4 819
1 to 3 years	**–**	25 146
Over 3 years	**–**	31 567
Total	**–**	98 817

11. FIXED ASSETS

The following changes in fixed assets took place in 2006 and 2005:

(in thousands of lats)

	Buildings improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
As at 31 December 2004						
Cost	31 401	6 078	3 857	1 176	4 454	46 966
Accumulated depreciation	–1 676	–3 959	–1 939	–689	–2 772	–11 035
Net book value	29 725	2 119	1 918	487	1 682	35 931
During 2005						
Additions	50	582	270	55	101	1 058
Change in classification	–213	58	–	–	155	0
Disposals	–114	–469	–27	–21	–194	–825
Net change in cost	–277	171	243	34	62	233
Depreciation charge	–441	–649	–233	–93	–604	–2 020
Change in classification	2	–6	–	–	4	0
Accumulated depreciation on disposals	31	463	27	21	192	734
Net change in accumulated depreciation	–408	–192	–206	–72	–408	–1 286
As at 31 December 2005						
Cost	31 124	6 249	4 100	1 210	4 516	47 199
Accumulated depreciation	–2 084	–4 151	–2 145	–761	–3 180	–12 321
Net book value	29 040	2 098	1 955	449	1 336	34 878
During 2006						
Additions	359	398	140	26	269	1 192
Change in classification	–238	373	–	–	–135	–
Disposals	–	–135	–	–123	–	–258
Net change in cost	121	636	140	–97	134	934
Depreciation charge	–1 708	–679	–248	–93	–578	–3 306
Change in classification	–10	–15	–	–	25	–
Accumulated depreciation on disposals	–	134	–	123	–	257
Net change in accumulated depreciation	–1 718	–560	–248	30	–553	–3 049
As at 31 December 2006						
Cost	31 245	6 885	4 240	1 113	4 650	48 133
Accumulated depreciation	–3 802	–4 711	–2 393	–731	–3 733	–15 370
Net book value	**27 443**	**2 174**	**1 847**	**382**	**917**	**32 763**

In 2006, the Bank of Latvia changed the useful life for components of buildings. As a result of the Bank of Latvia decreasing the useful life of several parts of buildings, the depreciation expense of fixed assets was 1 259 thousand lats higher in comparison with that calculated according to the previously effective annual depreciation rates.

12. OTHER DOMESTIC ASSETS

At the end of 2006 and 2005, other domestic assets consisted of the following items:

(in thousands of lats)

	2006	2005
Intangible assets	**1 832**	2 243
Prepaid expense	**134**	142
Other	**144**	107
Total	**2 110**	2 492

Intangible assets include the rights to use software acquired by the Bank of Latvia and other rights.

The following changes in intangible assets took place in 2006 and 2005:

(in thousands of lats)

As at 31 December 2004	
Cost	4 078
Accumulated amortisation	–1 396
Net book value	2 682
During 2005	
Additions	321
Disposals	–281
Net change in cost	40
Amortisation charge	–760
Accumulated amortisation on disposals	281
Net change in accumulated amortisation	–479
As at 31 December 2005	
Cost	4 118
Accumulated amortisation	–1 875
Net book value	2 243
During 2006	
Additions	360
Disposals	–167
Net change in cost	193
Amortisation charge	–771
Accumulated amortisation on disposals	167
Net change in accumulated amortisation	–604
As at 31 December 2006	
Cost	4 311
Accumulated amortisation	–2 479
Net book value	**1 832**

13. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency liabilities consist of funds on the EC account for settlements in euro as well as liabilities to other foreign institutions; the respective account is used by the EC for the distribution of EU budgetary funds (see also Note 14).

At the end of 2006 and 2005, the balance sheet liability caption "Convertible foreign currencies" consisted of the following items:

(in thousands of lats)

	2006	2005
European Commission demand deposits	**21 158**	2 844
Other liabilities	**–**	451
Total	**21 158**	3 295

14. OTHER INTERNATIONAL INSTITUTION DEPOSITS IN LATS

Deposits of other international institutions in lats consist of funds on the EC account for settlements in lats, which is used for effecting Latvian Government payments to the EU budget (see also Note 13) and liabilities to other international institutions.

At the end of 2006 and 2005, the breakdown of deposits of other international institutions in lats was as follows:

(in thousands of lats)

	2006	2005
European Commission demand deposits	**1 051**	571
Other deposits	**297**	534
Total	**1 348**	1 105

15. OTHER FOREIGN LIABILITIES

At the end of 2006 and 2005, other foreign liabilities consisted of the following items:

(in thousands of lats)

	2006	2005
Non-traded financial derivative contracts with foreign financial institutions	**13 436**	10 193
Accrued expense	**182**	202
Other	**40**	40
Total	**13 658**	10 435

Restated to include liabilities in non-convertible currencies (40 thousand lats), which in the financial statements for the year ended 31 December 2005 were reported under the caption "Non-convertible currencies".

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16. LATS IN CIRCULATION

At the end of 2006 and 2005, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount (in thousands of lats)		Number (in thousands of units)		Percentage (%)	
	2006	2005	**2006**	2005	**2006**	2005
Banknotes						
LVL 500	**179 559**	145 212	**359**	290	**16.7**	16.5
LVL 100	**201 953**	166 744	**2 020**	1 667	**18.8**	19.0
LVL 50	**70 500**	47 826	**1 410**	957	**6.6**	5.5
LVL 20	**429 028**	344 418	**21 451**	17 221	**40.0**	39.3
LVL 10	**76 298**	72 385	**7 630**	7 239	**7.1**	8.3
LVL 5	**68 473**	59 120	**13 695**	11 824	**6.4**	6.7
Total banknotes	**1 025 811**	835 705	**x**	x	**95.6**	95.3
Coins						
LVL 100	**404**	395	**4**	4	**0**	0
LVL 10	**145**	144	**14**	14	**0**	0
LVL 5	**98**	92	**20**	18	**0**	0
LVL 2	**8 027**	7 187	**4 013**	3 594	**0.7**	0.8
LVL 1	**22 207**	18 762	**22 207**	18 762	**2.1**	2.1
50 s	**6 648**	5 757	**13 296**	11 514	**0.6**	0.7
20 s	**3 632**	3 234	**18 159**	16 167	**0.3**	0.4
10 s	**2 264**	2 027	**22 643**	20 264	**0.2**	0.2
5 s	**1 713**	1 472	**34 265**	29 430	**0.2**	0.2
2 s	**1 642**	1 373	**82 125**	68 665	**0.2**	0.2
1 s	**1 260**	1 126	**126 046**	112 641	**0.1**	0.1
Total coins	**48 040**	41 569	**x**	x	**4.4**	4.7
Total lats in circulation	**1 073 851**	877 274	**x**	x	**100.0**	100.0

At the end of 2006, the total nominal value of gold circulation coins (fineness .999) issued, with the denomination of LVL 100, was 1 987 thousand lats (1 984 thousand lats at the end of 2005). The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

Among coins in circulation, there were also collector coins that did not represent any liability of the Bank of Latvia to holders of these coins, and their total nominal value was 1 064 thousand lats at the end of 2006 (1 024 thousand lats at the end of 2005). These coins are not included in the balance sheet caption "Lats in circulation".

17. BALANCES DUE TO CREDIT INSTITUTIONS

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

At the end of 2006 and 2005, balances due to credit institutions consisted of the following items:

(in thousands of lats)

	2006	2005
Demand deposits in lats	**1 168 763**	471 669
Time deposits in lats	**43 500**	31 000
Total	**1 212 263**	502 669

The increase in the deposits of the domestic credit institutions resulted from an increase of the credit institution liabilities subject to the minimum reserve requirements as well as the expansion of the minimum reserve requirement base, implemented by the Bank of Latvia in 2006 and incorporating credit institution liabilities with maturity of over two years.

18. BALANCES DUE TO THE GOVERNMENT

Latvian Government deposits consist of the Treasury demand deposits and time deposits in lats and foreign currencies received by the Bank of Latvia acting as the financial agent of the Latvian Government.

At the end of 2006 and 2005, the breakdown of Latvian Government deposits was as follows:

(in thousands of lats)

	2006	2005
Demand deposits in lats	**–**	8 022
Demand deposits in foreign currencies	**18 120**	45 481
Time deposits in lats	**23 405**	–
Time deposits in foreign currencies	**8 293**	14 886
Total	**49 818**	68 389

19. OTHER DOMESTIC LIABILITIES

At the end of 2006 and 2005, other domestic liabilities consisted of the following items:

(in thousands of lats)

	2006	2005
Accrued expense and similar liabilities	**2 305**	1 728
Deferred liabilities to constructors	**661**	688
Accrued interest expense	**513**	215
Tax liabilities	**45**	59
Other	**16**	10
Total	**3 540**	2 700

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20. TAXES

In 2006 and 2005, the Bank of Latvia calculated and paid the following taxes:

(in thousands of lats)

	Personal income tax	Compulsory social security contributions (by employer)	Compulsory social security contributions (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2004	–	6	2	–	125	–	133
During 2005							
Calculated	1 982	1 788	676	443	280	1	5 170
Changes in deferred liabilities	–	–3	–	–	–	–	–3
Paid	1 982	1 791	676	443	354	1	5 247
Liabilities as at 31 December 2005	–	6	2	–	51	–	59
During 2006							
Calculated	2 136	1 943	723	426	246	1	5 475
Changes in deferred liabilities	–	20	–	–	–	–	20
Paid	2 136	1 922	722	426	262	1	5 469
Liabilities as at 31 December 2006	**–**	**7**	**3**	**–**	**35**	**–**	**45**

In addition to the tax payments indicated herein, the Bank of Latvia transfers a part of the profit for the reporting year and the payment for the usage of state capital (2 918 thousand lats in 2006; 987 thousand lats in 2005; see also Notes 21 and 29) to the state budget.

21. CAPITAL AND RESERVES

In 2006 and 2005, changes in the Bank of Latvia's capital and reserves were as follows:

(in thousands of lats)

	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	EU grant	Capital and reserves
As at 31 December 2004	25 000	45 787	21 121	3 289	533	95 730
During 2005						
Net result on revaluation	x	x	–7 788	x	x	–7 788
Profit appropriated to the state budget	x	x	x	–987	x	–987
Profit transferred to the reserve capital	x	2 302	x	–2 302	x	–
Profit of the reporting year	x	x	x	9 726	x	9 726
As at 31 December 2005	25 000	48 090	13 333	9 726	533	96 682
During 2006						
Net result on revaluation	x	x	3 109	x	x	3 109
Profit appropriated to the state budget	x	x	x	–2 918	x	–2 918
Profit transferred to the reserve capital	x	6 808	x	–6 808	x	–
Profit of the reporting year	x	x	x	6 586	x	6 586
As at 31 December 2006	**25 000**	**54 898**	**16 442**	**6 586**	**533**	**103 459**

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

The Law "On the Bank of Latvia" establishes that a part of the Bank of Latvia's profit of the reporting year, calculated by applying the same percentage as the tax rate set for residents of Latvia by the Law "On Enterprise Income Tax", together with a payment in the amount of 15% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget. At the end of 2006 and 2005, the enterprise income tax rate applicable to residents of Latvia was 15%. Therefore, 30% of the Bank of Latvia's profit of the reporting year shall be transferred to the state budget within 15 days following the approval of the annual report by the Council of the Bank of Latvia.

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

In the financial statements for the year ended 31 December 2005, profit of the reporting year (9 726 thousand lats) was stated dividedly. Profit appropriated to the state budget (2 918 thousand lats) was reported under the caption "Other domestic liabilities", and increase in reserve capital (6 808 thousand lats) was reported under the caption "Reserve capital".

22. NET INTEREST AND SIMILAR INCOME

In 2006, the Bank of Latvia's net interest and similar income amounted to 27 905 thousand lats (28 726 thousand lats in 2005). The income was mainly derived from investing foreign currency reserves.

Interest and similar income from foreign operations increased by 17 595 thousand lats in comparison with 2005. Although the interest rate rise in financial markets of the US, euro area and Japan had a negative impact on the market value of foreign debt securities, the increase in income was primarily achieved by the Bank of Latvia's significant interventions in foreign currency markets (as a result, the Bank of Latvia's foreign reserves increased by 1 009 million lats in 2006 (352 million lats in 2005).

As a result of implementing monetary policy as well as redeeming the Latvian government securities, in 2006 the Bank of Latvia disposed of all the Latvian government securities held by it. Although the Bank of Latvia earned fixed income from the above investment in early 2006, overall investment in the Latvian government securities caused losses in the amount of 3 811 thousand lats in 2006, as the Bank of Latvia does not hedge interest rate risk related to the domestic financial assets in order to avoid a conflict with the monetary policy objectives.

In 2006, interest income on loans to domestic credit institutions increased by 336 thousand lats due to higher amount of repurchase agreements in comparison with 2005.

At the end of 2006 and 2005, the breakdown of interest and similar income was as follows:

(thousand lats)

	2006	2005
Foreign operations		
Interest on demand deposits	**4 010**	1 825
Interest on time deposits	**1 418**	746
Gain on investment in debt securities	**47 335**	30 396
Gain/loss (–) on interest rate futures	**–1 081**	1 094
Dividends on shares in the Bank for International Settlements	**211**	200
Expense related to the management of foreign reserves	**–625**	–588
Domestic operations		
Interest on loans to credit institutions	**644**	308
Gain/loss (–) from investment in government securities	**–3 811**	4 772
Total	**48 101**	38 753

Interest expense (20 196 thousand lats; 10 027 thousand lats in 2005) was largely comprised of interest on deposits of domestic credit institutions and the Latvian Government. The increase in interest expense on credit institution deposits by 9 149 thousand lats was mainly caused by the significant growth in minimum reserves deposited with the Bank of Latvia. The Bank of Latvia received a larger amount of Latvian Government funds as deposits than in 2005, therefore interest expense on Government deposits increased by 985 thousand lats in the reporting year.

23. OTHER OPERATING INCOME

Other operating income in 2006 and 2005 was as follows:

(in thousands of lats)

	2006	2005
Income from sale of collector coins	**330**	265
Income from payment and securities settlement services	**185**	169
Other	**197**	143
Total	**712**	577

24. REMUNERATION AND SOCIAL SECURITY COSTS

Remuneration and social security costs in 2006 and 2005 were as follows:

(in thousands of lats)

	2006	2005
Remuneration		
Remuneration of members of the Council and the Board	**995**	1 006
Remuneration of other personnel	**9 212**	8 288
Total remuneration	**10 207**	9 294
Social security costs	**1 943**	1 788
Total remuneration and social security costs	**12 150**	11 082

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

The number of employees in 2006 and 2005 was as follows:

	2006	2005
Number of employees at end of year		
Members of the Council and the Board	**14**	14
Other personnel	**621**	634
Total at end of year	**635**	648
Average number of employees per year	**637**	671

25. BANKNOTE PRODUCTION AND COINAGE COSTS

The breakdown of banknote production and coinage costs in 2006 and 2005 was as follows:

(in thousands of lats)

	2006	2005
Banknote production	**601**	–
Coinage of collector coins	**242**	163
Coinage of circulation coins	**228**	133
Total	**1 071**	296

26. COSTS OF FINANCING THE FINANCIAL AND CAPITAL MARKET COMMISSION

Pursuant to Article 5 of the Transition Rules of the Law "On the Financial and Capital Market Commission", by 31 December 2006 the operation of the FCMC was financed from payments made by financial and capital market participants, the state budget and the Bank of Latvia. In 2006, the Bank of Latvia contributed 240 thousand lats to financing the FCMC operation (600 thousand lats in 2005). In the future, the Bank of Latvia will no longer make such payments.

27. OTHER OPERATING EXPENSE

Other operating expense in 2006 and 2005 was as follows:

(in thousands of lats)

	2006	2005
Business travel	**443**	436
Tax on real estate	**426**	443
Maintenance of buildings, territory and equipment	**394**	642
Municipal services	**337**	316
Risk insurance	**304**	187
Telecommunications services and system maintenance	**281**	320
Information and public relations	**238**	268
Acquisition of low value office supplies	**166**	175
Personnel training	**135**	148
Audit, advisory and legal services	**51**	154
Other	**632**	671
Total	**3 407**	3 760

28. CASH FLOW STATEMENT

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

(in thousands of lats)

	2006	2005
Profit before appropriation	**6 586**	9 726
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	**4 077**	2 780
Losses on disposal of fixed assets	**1**	91
Net change in balance sheet items		
Net increase in gold	**–**	–27
Net increase in Special Drawing Rights	**–5**	–3
Net increase in foreign debt securities and other foreign investments	**–983 757**	–437 586
Net increase (–)/decrease in loans to domestic credit institutions	**23 300**	–10 420
Net increase (–)/decrease in Latvian government securities	**99 759**	–4 958
Net increase (–)/decrease in other assets	**–379**	47
Net increase in foreign convertible currencies	**17 863**	851
Net increase/decrease (–) in foreign bank and other international institution deposits in lats	**205**	–20 320
Net increase in lats in circulation	**196 577**	149 920
Net increase in time deposits of domestic credit institutions	**709 594**	273 797
Net decrease (–) in Latvian Government time deposits	**–18 571**	–38 767
Net increase in time deposits of other financial institutions	**4 304**	704
Net increase/decrease (–) in other liabilities	**820**	–21 214
Net cash and cash equivalents inflow/outflow (–) arising from operating activities	**60 374**	–95 379

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

In order to reflect the Bank of Latvia's cash flow more accurately, in 2006 the Bank of Latvia changed the composition of cash and cash equivalents by excluding from the estimate of cash and cash equivalents foreign debt securities disposable within 24 hours, by including deposits with an original maturity up to 5 business days made with foreign credit institutions and other foreign financial institutions as well as not excluding demand deposits from foreign institutions, Latvian Government, domestic credit institutions, and other domestic financial institutions.

The above-mentioned policy change for establishing cash and cash equivalents was applied retrospectively; therefore, the balance of the Bank of Latvia's cash and cash equivalents as at the end of 2005 is by 467 702 thousand lats smaller than the respective balance stated in the financial statements for 2005.

(at end of year; in thousands of lats)

	2006	Change	2005	Change	2004
Convertible foreign currencies in cash	**144**	–55	199	–375	574
Demand deposits with foreign credit institutions and other foreign financial institutions	**116 298**	48 666	67 632	–97 933	165 565
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	**7 504**	7 504	–	–	–
Total cash and cash equivalents	**123 946**	56 115	67 831	–98 308	166 139

29. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

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

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

At the end of 2006 and 2005, the breakdown of the Bank of Latvia claims on and liabilities to the Latvian Government and the respective interest rates were as follows:

	Amount (in thousands of lats)		Yield (%)	
	2006	2005	**2006**	2005
Assets				
Government securities	**–**	98 817	**–**	3.82–4.65
Total assets	**–**	98 817	**x**	x
Liabilities				
Demand deposits	**18 120**	53 503	**3.00–5.00**	2.00–3.94
Time deposits	**31 698**	14 886	**2.49–3.57**	2.25–2.30
Tax liabilities	**45**	59	**x**	x
Accrued interest expense	**17**	10	**x**	x
Total liabilities	**49 880**	68 458	**x**	x

In 2006 and 2005, the breakdown of the Bank of Latvia's income and expense related to the Latvian Government, as well as the Bank of Latvia's profit appropriated to the state budget in 2006 and 2005 was as follows (see also Note 22):

(in thousands of lats)

	2006	2005
Income		
Gain/loss (–) on investment in government securities	**–3 811**	4 772
Total income	**–3 811**	4 772
Expense and the Bank of Latvia's profit appropriated to the state budget		
Interest on government deposits	**4 017**	3 032
Taxes	**5 475**	5 170
Bank of Latvia's profit appropriated to the state budget	**2 918**	987
Total expense and the Bank of Latvia's profit appropriated to the state budget	**12 410**	9 189

30. PLEDGED ASSETS

Securities with the market value of 5 323 thousand lats at the end of 2006 (2 947 thousand lats at the end of 2005) have been pledged to provide collateral for interest rate future contract transactions. These securities are included in the balance sheet asset caption "Convertible foreign currencies".

31. OFF-BALANCE SHEET ACCOUNTS

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

At the end of 2006 and 2005, the Bank of Latvia's off-balance sheet account profile was as follows:

(in thousands of lats)

	Contract or notional amount		Fair value			
			Assets		Liabilities	
	2006	2005	**2006**	2005	**2006**	2005
Non-traded financial derivative contracts with foreign financial institutions						
Forward exchange rate contracts	**1 461 493**	783 045	**28 554**	2 418	**10 637**	10 183
Gold interest rate swap arrangements	**21 531**	39 203	**539**	818	**2**	10
Other interest rate contracts	**601 992**	7 259	**1 994**	45	**2 797**	–
Total non-traded financial derivative contracts with foreign financial institutions	**x**	x	**31 087**	3 281	**13 436**	10 193
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	**1 030 233**	199 163	**941**	113	**2 512**	217
Other transactions						
Agreements concluded on a regular way receipt and placement of time deposits	**–**	3 479	**x**	x	**x**	x
Contracted commitments related to acquisition and rent of fixed assets	**483**	71	**x**	x	**x**	x

32. CONTINGENT LIABILITIES AND COMMITMENTS

In May 2005, JSC *BDO Invest Rīga* being the liquidator of the bankrupt JSC *Banka Baltija* filed a claim against the Bank of Latvia on behalf of the creditors of JSC *Banka Baltija* in the Riga Regional Court for the recovery of losses in the amount of 185.6 million lats. The claimant alleges that the Bank of Latvia, as the institution in charge of banking supervision at that time, is responsible for losses arising from the bankruptcy of JSC *Banka Baltija* in 1995. The Bank of Latvia is confident that the claim is without merits; therefore no provision is recognised in the financial statements. The final ruling on the case is expected no earlier than in 2008.

The Bank of Latvia has not paid up 93% of the Bank of Latvia's share in the ECB subscribed capital, which is payable following the decision of the ECB. At the end of 2005, the Bank of Latvia's unpaid share in the ECB subscribed capital was 15 412 thousand euro (10 831 thousand lats).

The Bank of Latvia's uncalled portion of the BIS shares is 75% of their nominal value. These shares are callable following the decision of the BIS Board. At the end of 2005, the uncalled portion of the BIS share holding was 4 013 thousand SDR (3 230 thousand lats).

33. CURRENCY PROFILE

At the end of 2006 and 2005, the currency profile of the Bank of Latvia's assets, liabilities and memorandum items was as follows:

(in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
As at 31 December 2006								
Foreign assets								
Gold	–	–	–	–	–	83 668	–	83 668
Special Drawing Rights	–	85	–	–	–	–	–	85
Convertible foreign currencies	–	–	1 026 010	1 081 957	222 824	–	2 488	2 333 279
International Monetary Fund	–	101 815	–	–	–	–	–	101 815
Participating interest in the European Central Bank	–	–	–	760[1]	–	–	–	760
Participating interest in the Bank for International Settlements	–	1 763[1]	–	–	–	–	–	1 763
Other foreign assets	30 292	–	50	1 191	–	–	119	31 652
Domestic assets								
Fixed assets	32 763	–	–	–	–	–	–	32 763
Other domestic assets	2 104	–	–	6	–	–	–	2 110
TOTAL ASSETS	**65 159**	**103 663**	**1 026 060**	**1 083 914**	**222 824**	**83 668**	**2 607**	**2 587 895**
Foreign liabilities								
Convertible foreign currencies	–	–	–	21 158	–	–	–	21 158
International Monetary Fund	102 044[2]	–	–	–	–	–	–	102 044
Other international institution deposits in lats	1 348	–	–	–	–	–	–	1 348
Foreign bank deposits in lats	448	–	–	–	–	–	–	448
Other foreign liabilities	13 100	–	149	367	–	–	42	13 658
Lats in circulation	1 073 851	–	–	–	–	–	–	1 073 851
Domestic liabilities								
Balances due to credit institutions	1 212 263	–	–	–	–	–	–	1 212 263
Balances due to the Government	23 405	85	1 644	24 626	58	–	–	49 818
Balances due to other financial institutions	6 286	–	20	2	–	–	–	6 308
Other domestic liabilities	2 897	–	–	643	–	–	–	3 540
TOTAL LIABILITIES	**2 435 642**	**85**	**1 813**	**46 796**	**58**	**–**	**42**	**2 484 436**
Net position on balance sheet	–2 370 483	103 578	1 024 247	1 037 118	222 766	83 668	2 565	103 459
Net position on financial instruments' off-balance sheet accounts	–	–	–1 023 095	1 350 021	–221 952	–83 462	–3 861	17 651
Net position on balance sheet and off-balance sheet accounts	–2 370 483	103 578	1 152	2 387 139	814	206	–1 296	121 110

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

(cont.) (in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	–229[1]	1 152	2 386 379	814	206	–1 296	2 387 026
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	–0.01	0.05	99.97	0.03	0.01	–0.05	100.0
Benchmark currency structure	x	0	0	100.0	0	0	0	100.0
As at 31 December 2005								
TOTAL ASSETS	162 797	109 481	519 882	739 483	29 237	76 171	35 863	1 672 914
TOTAL LIABILITIES	1 514 560	85	12 103	52 360	2	–	40	1 579 150
Net position on balance sheet	–1 351 763	109 396	507 779	687 123	29 235	76 171	35 823	93 764
Net position on financial instruments' off-balance sheet accounts	–	–	–503 841	638 276	–27 733	–76 228	–37 386	–6 912
Net position on balance sheet and off-balance sheet accounts	–1 351 763	109 396	3 938	1 325 399	1 502	–57	–1 563	86 852
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	–242[1]	3 938	1 324 639	1 502	–57	–1 563	1 328 217
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	–0.02	0.30	99.73	0.11	0	–0.12	100.0
Benchmark currency structure	x	0	0	100.0	0	0	0	100.0

34. REPRICING MATURITY AND TRACKING ERROR

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

(in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
As at 31 December 2006							
Foreign assets							
Gold	18 513	–	–	–	–	65 155	83 668
Special Drawing Rights	85	–	–	–	–	–	85
Convertible foreign currencies	652 530	92 070	418 752	879 522	289 799	606	2 333 279
International Monetary Fund	–	–	–	–	–	101 815	101 815
Participating interest in the European Central Bank	–	–	–	–	–	760	760
Participating interest in the Bank for International Settlements	–	–	–	–	–	1 763	1 763
Other foreign assets	–	–	–	–	–	31 652	31 652

[1] Net XDR position on balance sheet and off-balance sheet accounts exposed to currency risk comprises liabilities to the IMF (102 044 thousand lats; 107 875 thousand lats in 2005) and does not include participating interest in BIS (1 763 thousand lats; 1 763 thousand lats in 2005).

(cont.) (in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
Domestic assets							
Fixed assets	–	–	–	–	–	32 763	32 763
Other domestic assets	–	–	–	–	–	2 110	2 110
TOTAL ASSETS	**671 128**	**92 070**	**418 752**	**879 522**	**289 799**	**236 624**	**2 587 895**
Foreign liabilities							
Convertible foreign currencies	–	–	–	–	–	21 158	21 158
International Monetary Fund	–	–	–	–	–	102 044	102 044
Other international institution deposits in lats	–	–	–	–	–	1 348	1 348
Foreign bank deposits in lats	422	–	–	–	–	26	448
Other foreign liabilities	–	–	–	–	–	13 658	13 658
Lats in circulation	–	–	–	–	–	1 073 851	1 073 851
Domestic liabilities							
Balances due to credit institutions	1 212 263	–	–	–	–	–	1 212 263
Balances due to the Government	49 818	–	–	–	–	–	49 818
Balances due to other financial institutions	1 766	–	–	–	–	4 542	6 308
Other domestic liabilities	–	–	–	–	–	3 540	3 540
TOTAL LIABILITIES	**1 264 269**	**–**	**–**	**–**	**–**	**1 220 167**	**2 484 436**
Net position on balance sheet	–593 141	92 070	418 752	879 522	289 799	x	x
Assets on financial instruments' off-balance sheet accounts	1 507 956	–	112 750	1 472 618	5 538	x	x
Liabilities on financial instruments' off-balance sheet accounts	2 517 120	20 175	407 676	9 367	126 872	x	x
Net position on balance sheet and off-balance sheet accounts	–1 602 305	71 895	123 826	2 342 773	168 465	x	x
As at 31 December 2005							
TOTAL ASSETS	299 822	18 473	133 684	777 103	232 933	210 899	1 672 914
TOTAL LIABILITIES	572 841	–	–	–	–	1 006 309	1 579 150
Net position on balance sheet	–273 019	18 473	133 684	777 103	232 933	x	x
Assets on financial instruments' off-balance sheet accounts	824 262	22 930	87 851	59 489	23 805	x	x
Liabilities on financial instruments' off-balance sheet accounts	892 272	87 851	–	5 693	39 433	x	x
Net position on balance sheet and off-balance sheet accounts	–341 029	–46 448	221 535	830 899	217 305	x	x

The exposure of foreign reserves portfolios to credit risk and aggregated market risk, except for the gold portfolio and portfolios of borrowed funds, can be characterised by the tracking error, which is measured as the annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark portfolio. For foreign reserves portfolios, except for the gold portfolio and portfolios of borrowed funds, the benchmark portfolio is pledged to

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the weighted 1–3 year government securities index of the euro area countries, US and Japan in euro, eliminating the currency risk.

In 2006 and 2005, the average weighted tracking error of the Bank of Latvia's foreign reserves portfolios, except for the gold portfolio and portfolios of borrowed funds, was 38 and 31 basis points respectively, and it lay within the following basis points intervals during the year:

Tracking error (in basis points)	Number of business days	
	2006	2005
10–20	**30**	1
20–30	**113**	135
30–40	**94**	69
40–50	**13**	48
Total	**250**	253

35. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of 2006 and 2005 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2006	2005	**2006**	2005
Claims				
Foreign central governments and other governmental institutions	**1 250 360**	590 804	**48.3**	35.3
Foreign local governments	**31 632**	62 107	**1.2**	3.7
Foreign central banks and credit institutions	**449 194**	376 010	**17.4**	22.5
Other foreign financial institutions	**655 507**	286 874	**25.3**	17.1
Foreign non-financial corporations	**41 379**	57 589	**1.6**	3.4
International institutions	**124 852**	138 531	**4.8**	8.3
Latvian central government	**–**	122 125	**0**	7.3
Domestic credit institutions	**29**	17	**0**	0
Unclassified assets	**34 942**	38 857	**1.4**	2.4
Total	**2 587 895**	1 672 914	**100.0**	100.0

For the purposes of credit risk analysis, claims arising from securities purchased under reverse repurchase agreements are classified herein according to the issuer of the security. As a result, claims arising from government securities purchased under agreements to resell to domestic credit institutions (in the amount of 23 300 thousand lats at the end of 2005) are reported as exposure to the Latvian central government.

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

At the end of 2006 and 2005, the Bank of Latvia's foreign assets broken down by their location or the counterparty's domicile were as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2006	2005	**2006**	2005
Euro area	**1 094 291**	702 867	**42.9**	46.4
US	**738 291**	337 601	**28.9**	22.3
Japan	**247 115**	65 093	**9.7**	4.3
Other countries	**348 473**	269 335	**13.6**	17.8
International institutions	**124 852**	138 531	**4.9**	9.2
Total	**2 553 022**	1 513 427	**100.0**	100.0

37. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

At the end of 2006 and 2005, the Bank of Latvia's assets broken down by categories of credit ratings assigned to the counterparty were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2006	2005	**2006**	2005
FOREIGN ASSETS					
Gold	AAA	**43 225**	39 351	**1.7**	2.4
	AA	**40 443**	36 819	**1.6**	2.2
Special Drawing Rights	AAA	**85**	85	**0**	0
Foreign debt securities	AAA	**1 599 278**	934 021	**61.8**	55.8
	AA+	**87 772**	45 996	**3.4**	2.7
	AA	**55 102**	41 384	**2.1**	2.5
	AA–	**185 937**	122 269	**7.2**	7.3
	A+	**29 782**	33 303	**1.2**	2.0
	A	**248 918**	70 442	**9.6**	4.2
	A–	**2 544**	8 274	**0.1**	0.5
Deposits with foreign financial institutions	AAA	**106 990**	52 727	**4.1**	3.2
	AA+	**2 253**	42	**0.1**	0
	AA	**4 953**	2 778	**0.2**	0.2
	AA–	**5 149**	4 391	**0.2**	0.3
	A+	**4 025**	3 037	**0.2**	0.2
	A	**379**	1 068	**0**	0.1
	A–	**53**	3 589	**0**	0.2
Foreign currency in cash	AAA	**144**	199	**0**	0
International Monetary Fund	AAA	**101 815**	107 633	**3.9**	6.4
Participating interest in the European Central Bank	AAA	**760**	760	**0**	0

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(cont.)

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2006	2005	**2006**	2005
Participating interest in the Bank for International Settlements	AAA	**1 763**	1 763	**0.1**	0.1
Derivative financial instruments	AAA	**1 742**	44	**0.1**	0
	AA+	**1 145**	197	**0**	0
	AA	**5 987**	173	**0.2**	0
	AA–	**14 562**	1 362	**0.6**	0.1
	A+	**4 902**	1 072	**0.2**	0.1
	A	**2 593**	–	**0.1**	–
	A–	**156**	433	**0**	0
Accrued interest income	Different	**6**	1	**0**	0
Other foreign assets	Different	**559**	214	**0**	0
DOMESTIC ASSETS					
Loans to credit institutions	Different	**–**	23 300	**0**	1.4
Government securities	A–	**–**	98 817	**0**	5.9
Other	Different	**34 873**	37 370	**1.3**	2.2
TOTAL		**2 587 895**	1 672 914	**100.0**	100.0

At the end of 2006 and 2005, the Bank of Latvia's foreign assets broken down by major categories of credit ratings assigned to the counterparty were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2006	2005	**2006**	2005
Foreign assets	AAA	**1 855 802**	1 136 583	**72.7**	75.1
	AA	**403 303**	255 411	**15.8**	16.9
	A	**293 352**	121 218	**11.5**	8.0
	Different	**565**	215	**0**	0
Total		**2 553 022**	1 513 427	**100.0**	100.0

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

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

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Bank of Latvia ("the Bank"), which comprise the balance sheet as at 31 December 2006, and the related statements of profit and loss, total recognized gains and loses and cash flow for the year then ended, and a summary of principal accounting policies and other explanatory notes to the financial statements, as set out on pages 58 to 94.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with the accounting principles adopted by the Bank and the law "On the Bank of Latvia".

Stephen Young	Inguna Sudraba
KPMG Baltics SIA	The State Audit Office
Licence No 55	of the Republic of Latvia

Riga, Latvia
23 February 2007

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APPENDICES

Appendix 1

MONETARY INDICATORS IN 2006

(at end of period; in millions of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	**XII**
BANK OF LATVIA												
M0	1 454.9	1 433.3	1 451.4	1 501.2	1 741.9	1 766.0	1 805.3	1 940.2	1 936.2	2 065.1	1 957.2	**2 248.8**
Currency in circulation	853.9	862.1	865.1	885.7	892.2	927.9	948.8	961.4	983.5	998.0	1 023.8	**1 073.9**
Demand deposits with the Bank of Latvia	601.0	571.2	586.3	615.5	849.7	838.1	856.4	978.8	952.6	1 067.1	933.4	**1 174.9**
Currency vs monetary base (%)	58.7	60.1	59.6	59.0	51.2	52.5	52.6	49.6	50.8	48.3	52.3	**47.8**
Net foreign assets	1 406.8	1 473.5	1 559.2	1 579.6	1 807.3	1 879.9	1 978.6	2 201.5	2 218.3	2 397.1	2 413.1	**2 414.4**
Net domestic assets	48.1	–40.2	–107.8	–78.4	–65.4	–113.9	–173.4	–261.4	–282.1	–332.1	–455.9	**–165.6**
Credit	111.0	21.8	–49.4	–24.4	–7.7	–58.9	–113.1	–196.6	–212.6	–258.5	–277.0	**–49.8**
To MFIs	74.0	2.0	1.0	1.2	46.3	1.2	0	10.0	20.8	0	0	**0**
To central government (net)	37.0	19.8	–50.4	–25.6	–54.0	–60.1	–113.1	–206.6	–233.4	–258.5	–277.0	**–49.8**
Other assets (net)	–62.9	–62.0	–58.4	–53.9	–57.7	–55.0	–60.3	–64.8	–69.5	–73.6	–178.8	**–115.8**
BANKING SYSTEM												
M1	2 869.1	2 908.7	3 017.8	3 120.8	3 157.7	3 315.7	3 419.5	3 523.2	3 549.9	3 752.8	3 833.7	**4 065.8**
M2	3 915.9	3 983.7	4 151.8	4 274.4	4 318.6	4 491.0	4 637.6	4 782.6	4 866.2	5 074.8	5 173.0	**5 456.0**
M3	3 957.6	4 028.7	4 198.2	4 316.9	4 357.8	4 528.1	4 673.1	4 817.0	4 899.9	5 110.7	5 210.5	**5 506.8**
M2X	3 984.3	4 038.3	4 195.0	4 303.6	4 339.7	4 518.9	4 652.4	4 782.2	4 872.9	5 069.9	5 157.6	**5 479.9**
Currency outside MFIs	768.2	775.5	775.9	796.6	807.0	839.5	859.0	874.6	892.5	904.4	921.3	**969.3**
Deposits of resident financial institutions, non-financial corporations and households	3 216.1	3 262.8	3 419.1	3 507.0	3 532.7	3 679.4	3 793.5	3 907.6	3 980.4	4 165.4	4 236.3	**4 510.6**
In foreign currencies	1 336.0	1 357.1	1 439.3	1 500.5	1 528.2	1 571.8	1 631.2	1 656.3	1 691.5	1 724.2	1 766.8	**1 859.7**
Net foreign assets	–1 410.5	–1 460.6	–1 539.5	–1 419.7	–1 482.1	–1 590.1	–1 724.1	–1 851.4	–2 028.1	–2 131.0	–2 390.4	**–2 634.7**
Net domestic assets	5 394.8	5 498.9	5 734.4	5 723.3	5 821.9	6 109.0	6 376.5	6 633.6	6 901.0	7 200.9	7 548.1	**8 114.6**
Loans to resident financial institutions, non-financial corporations and households	6 315.9	6 501.2	6 806.6	6 929.9	7 270.5	7 525.9	7 856.9	8 201.4	8 537.0	8 873.7	9 323.3	**9 722.9**
Bank of Latvia refinancing rate (at end of period; %)	4.0	4.0	4.0	4.0	4.0	4.0	4.5	4.5	4.5	4.5	5.0	**5.0**
Weighted average interest rates on transactions in lats (%)												
Interbank loans	4.0	3.7	2.9	3.2	3.0	3.0	4.0	4.4	2.7	3.7	2.2	**2.3**
Loans to non-financial corporations and households with a floating interest rate and an initial rate fixation of up to 1 year (new business)	6.5	6.9	6.6	6.8	7.3	7.0	7.4	7.8	8.1	8.3	7.5	**7.3**
Time deposits of non-financial corporations and households (new business)	3.4	3.4	3.1	3.2	3.7	3.3	4.0	3.9	3.9	3.4	3.7	**3.7**

Appendix 2

THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS FOR 2006

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	**XII**
FOREIGN ASSETS	1 523 951	1 599 009	1 681 979	1 695 536	1 926 300	2 003 837	2 108 954	2 322 234	2 341 423	2 520 855	2 547 908	**2 553 022**
Gold	81 244	81 996	82 902	89 189	88 711	80 918	87 053	83 750	82 642	82 920	85 189	**83 668**
SDR	84	87	85	84	84	85	85	85	85	85	85	**85**
Convertible foreign currencies	1 324 961	1 403 076	1 482 784	1 476 729	1 701 060	1 808 480	1 909 906	2 115 547	2 138 267	2 322 029	2 332 208	**2 333 279**
IMF	106 494	107 633	105 736	104 344	103 459	104 091	103 838	102 827	103 333	103 333	102 194	**101 815**
Participating interest in the ECB	760	760	760	760	760	760	760	760	760	760	760	**760**
Participating interest in the BIS	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	**1 763**
Other foreign assets	8 645	3 694	7 949	22 667	30 463	7 740	5 549	17 502	14 573	9 965	25 709	**31 652**
DOMESTIC ASSETS	174 223	100 511	98 893	96 825	140 648	87 018	40 170	45 380	55 851	34 904	34 607	**34 873**
Loans to credit institutions	74 000	2 000	1 000	1 200	46 250	1 200	–	10 000	20 800	–	–	**–**
Government securities	62 879	61 285	61 009	58 662	57 830	49 935	4 590	–	–	–	–	**–**
Fixed assets	34 607	34 340	34 089	33 836	33 593	33 377	33 139	33 027	32 804	32 691	32 501	**32 763**
Other domestic assets	2 737	2 886	2 795	3 127	2 975	2 506	2 441	2 353	2 247	2 213	2 106	**2 110**
TOTAL ASSETS	1 698 174	1 699 520	1 780 872	1 792 361	2 066 948	2 090 855	2 149 124	2 367 614	2 397 274	2 555 759	2 582 515	**2 587 895**
FOREIGN LIABILITIES	117 197	125 467	122 814	115 984	119 019	123 893	130 323	120 693	123 142	123 725	134 805	**138 656**
Convertible foreign currencies	4 139	4 051	1 591	1 835	1 789	2 544	9 657	8 759	6 017	409	3 101	**21 158**
IMF	106 734	107 875	105 973	104 579	103 691	104 325	104 072	103 058	103 565	103 565	102 424	**102 044**
Other international institution deposits in lats	1 082	1 644	6 048	1 235	4 650	7 439	8 433	2 622	997	3 654	14 824	**1 348**
Foreign bank deposits in lats	745	674	624	450	595	463	538	1 678	1 082	1 102	492	**448**
Other foreign liabilities	4 497	11 223	8 578	7 885	8 294	9 122	7 623	4 576	11 481	14 995	13 964	**13 658**
LATS IN CIRCULATION	853 868	862 058	865 084	885 731	892 153	927 892	948 829	961 360	983 549	997 960	1 023 837	**1 073 851**
DOMESTIC LIABILITIES	631 044	616 602	700 293	702 841	964 527	951 159	977 459	1 188 532	1 188 785	1 329 579	1 315 704	**1 271 929**
Balances due to credit institutions	599 852	569 545	584 486	609 351	843 422	836 084	850 721	969 884	949 547	1 063 027	1 032 083	**1 212 263**
Balances due to the Government	25 833	41 516	111 402	84 280	111 826	110 063	117 689	206 555	233 390	258 453	277 037	**49 818**
Balances due to other financial institutions	2 366	2 605	2 004	6 305	6 475	2 223	5 910	9 124	3 282	5 294	3 413	**6 308**
Other domestic liabilities	2 993	2 936	2 401	2 905	2 804	2 789	3 139	2 969	2 566	2 805	3 171	**3 540**
CAPITAL AND RESERVES	96 065	95 393	92 681	87 805	91 249	87 911	92 513	97 029	101 798	104 495	108 169	**103 459**
TOTAL LIABILITIES, CAPITAL AND RESERVES	1 698 174	1 699 520	1 780 872	1 792 361	2 066 948	2 090 855	2 149 124	2 367 614	2 397 274	2 555 759	2 582 515	**2 587 895**

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Appendix 3

THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR THE YEARS 2002–2006

(at end of year; in thousands of lats)

	2002	2003	2004	2005	**2006**
FOREIGN ASSETS	894 613	937 526	1 170 605	1 513 427	**2 553 022**
Gold	51 025	55 543	56 901	76 170	**83 668**
SDR	41	75	77	85	**85**
Convertible foreign currencies	737 313	774 834	986 458	1 323 520	**2 333 279**
IMF	101 144	101 144	101 144	107 633	**101 815**
Participating interest in the ECB	–	–	760	760	**760**
Participating interest in the BIS	1 197	1 000	1 000	1 763	**1 763**
Other foreign assets	3 893	4 930	24 265	3 496	**31 652**
DOMESTIC ASSETS	146 321	162 716	145 283	159 487	**34 873**
Loans to credit institutions	30 690	59 320	12 880	23 300	**–**
Transit credits	11 749	3 018	–	–	**–**
Government securities	64 382	62 273	93 208	98 817	**–**
Fixed assets	32 798	34 200	35 931	34 878	**32 763**
Other domestic assets	6 702	3 905	3 264	2 492	**2 110**
TOTAL ASSETS	1 040 934	1 100 242	1 315 888	1 672 914	**2 587 895**
FOREIGN LIABILITIES	116 778	113 545	131 291	123 196	**138 656**
Convertible foreign currencies	–	149	2 445	3 295	**21 158**
IMF	110 388	104 423	101 773	107 875	**102 044**
Other international institution deposits in lats[1]	257	268	21 515	1 105	**1 348**
Foreign bank deposits in lats[1]	422	409	396	486	**448**
Other foreign liabilities[2]	5 711	8 296	5 162	10 435	**13 658**
LATS IN CIRCULATION	622 632	682 145	727 354	877 274	**1 073 851**
DOMESTIC LIABILITIES	204 335	209 472	361 513	575 762	**1 271 929**
Balances due to credit institutions	134 223	123 810	228 872	502 669	**1 212 263**
Balances due to the Government	62 079	80 254	107 156	68 389	**49 818**
Balances due to other financial institutions	3 012	1 670	1 300	2 004	**6 308**
Other domestic liabilities	5 021	3 738	24 185	2 700	**3 540**
CAPITAL AND RESERVES	97 189	95 080	95 730	96 682	**103 459**
Nominal capital	25 000	25 000	25 000	25 000	**25 000**
Reserve capital[3]	28 835	37 928	45 787	48 090	**54 898**
Valuation account	28 389	19 712	21 121	13 333	**16 442**
Profit of the reporting year[3]	14 434	11 908	3 289	9 726	**6 586**
EU grant	531	532	533	533	**533**
TOTAL LIABILITIES, CAPITAL AND RESERVES	1 040 934	1 100 242	1 315 888	1 672 914	**2 587 895**

[1] Other international institution deposits in lats were reported under the caption "Foreign bank deposits in lats" in the financial statements for the years 2002–2003.
[2] Liabilities in non-convertible currencies that were reported under the caption "Non-convertible currencies" in the financial statements for the years 2002–2003 are also included.
[3] Breakdown of profit of the reporting year is reported in the financial statements for the years 2002–2005 with the profit appropriated to the State budget under the caption "Other domestic liabilities" and the increase of the reserve capital under the caption "Reserve capital".

Appendix 4

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENTS FOR THE YEARS 2002–2006

(in thousands of lats)

	2002	2003	2004	2005	**2006**
INTEREST AND SIMILAR INCOME					
Foreign operations	30 762	27 327	21 760	33 673	**51 268**
Domestic operations	5 550	5 984	7 005	5 080	**–3 167**
INTEREST EXPENSE					
Foreign operations	127	8	8	9	**8**
Domestic operations	3 688	2 651	5 282	10 018	**20 188**
NET INTEREST AND SIMILAR INCOME	32 497	30 652	23 475	28 726	**27 905**
OTHER OPERATING INCOME	605	994	447	577	**712**
OTHER OPERATING EXPENSE	18 668	19 738	20 633	19 577	**22 031**
PROFIT BEFORE APPROPRIATION	14 434	11 908	3 289	9 726	**6 586**

Appendix 5

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

(LVL vs foreign currency)

2006	GBP				100 JPY				USD			
	Maximum	Average	Minimum	At end of period	Maximum	Average	Minimum	At end of period	Maximum	Average	Minimum	At end of period
I	1.0290	1.0230	1.0190	1.0270	0.5090	0.5027	0.4950	0.4950	0.5940	0.5806	0.5710	0.5810
II	1.0340	1.0284	1.0230	1.0330	0.5100	0.4981	0.4910	0.5100	0.5930	0.5875	0.5780	0.5930
III	1.0330	1.0214	1.0130	1.0130	0.5100	0.4994	0.4950	0.4960	0.5930	0.5855	0.5780	0.5820
IV	1.0180	1.0120	1.0030	1.0070	0.4960	0.4900	0.4840	0.4920	0.5830	0.5742	0.5640	0.5640
V	1.0380	1.0273	1.0070	1.0250	0.4990	0.4932	0.4870	0.4900	0.5640	0.5520	0.5440	0.5480
VI	1.0300	1.0249	1.0180	1.0180	0.4890	0.4852	0.4800	0.4810	0.5620	0.5543	0.5430	0.5600
VII	1.0300	1.0201	1.0110	1.0290	0.4840	0.4786	0.4750	0.4800	0.5620	0.5541	0.5480	0.5540
VIII	1.0440	1.0377	1.0270	1.0400	0.4820	0.4745	0.4680	0.4680	0.5520	0.5487	0.5460	0.5470
IX	1.0490	1.0410	1.0320	1.0420	0.4750	0.4707	0.4670	0.4700	0.5550	0.5511	0.5460	0.5520
X	1.0490	1.0438	1.0380	1.0480	0.4730	0.4695	0.4680	0.4710	0.5620	0.5569	0.5510	0.5530
XI	1.0510	1.0436	1.0350	1.0390	0.4710	0.4667	0.4640	0.4660	0.5530	0.5479	0.5420	0.5420
XII	1.0490	1.0446	1.0380	1.0480	0.4600	0.4543	0.4500	0.4510	0.5370	0.5321	0.5270	0.5360

Appendix 6

THE BANK OF LATVIA'S ORGANISATIONAL UNITS AT THE END OF 2006

1. ACCOUNTING DEPARTMENT
(Head of Department, Chief Accountant – Māris Kālis; Deputy Chief Accountants – Jānis Caune, Leo Ašmanis)
1.1 Financial Statements and Accounting Policy Division (Head of Division – Maija Kurpniece)
1.2 Internal Banking Operations Division (Head of Division – Anita Jakāne)

2. CASHIER'S AND MONEY OPERATIONS DEPARTMENT
(Head of Department – Veneranda Kausa; Deputy Head of Department – Vilnis Kepe)
2.1 Cash Operations Division (Head of Division – Oskars Zaltans)
2.2 Money Operations Division (Head of Division – Ruta Strēle)
2.3 Coin Division (Head of Division – Maruta Brūkle)
2.4 Money Expertise and Equipment Maintenance Division (Head of Division – Andris Tauriņš)

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

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

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

6. INTERNAL AUDIT DEPARTMENT
(Head of Department – Modris Briedis)
6.1 Operational Audit Division (Head of Division, Deputy Head of Department – Anita Hāznere)
6.2 Information System Audit Division (Head of Division – Juris Ziediņš)

7. INTERNATIONAL DEPARTMENT
(Acting Head of Department – Guntis Valujevs; Deputy Head of Department – Aleksandra Bambale)

Appendix 6
(cont.)

8. LEGAL DEPARTMENT
(Acting Head of Department – Bruno Mačs[1]; Deputy Head of Department – Edvards Kušners)

9. MARKET OPERATIONS DEPARTMENT
(Head of Department – Raivo Vanags)
9.1 Trading and Investment Division (Head of Division, Deputy Head of Department – Kārlis Bauze)
9.2 External Debt Management Division (Head of Division – Agita Birka)
9.3 Risk Management Division (Head of Division – Daira Brunere)
9.4 Analysis Division (Head of Division, Deputy Head of Department – Aigars Egle)
9.5 Payments and Settlements Division (Head of Division – Una Ruka)

10. MONETARY POLICY DEPARTMENT
(Head of Department – Helmūts Ancāns; Deputy Heads of Department – Ēriks Āboliņš, Zoja Medvedevskiha)
10.1 Macroeconomic Analysis Division (Head of Division – Vilnis Purviņš)
10.2 Financial Market Analysis Division (Head of Division – Mārtiņš Prūsis[2])
10.3 Monetary Research and Forecasting Division (Head of Division – Mārtiņš Bitāns)
10.4 Securities Settlement Division[3] (Head of Division – Anda Kalniņa[4])
10.5 Financial Stability Division (Head of Division – Jeļena Zubkova)

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

12. PERSONNEL DEPARTMENT
(Head of Department – Inta Lovnika; Deputy Head of Department – Elita Lukina)

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

14. SECURITY DEPARTMENT
(Head of Department – Romualds Namnieks; Deputy Head of Department – Oļegs Rītiņš)
14.1 Analytical Unit (Head of Unit – Māris Dzelme)
14.2 Armament Unit (Head of Unit – Juris Kušķis)
14.3 Central Division (Head of Division – Guntars Ezeriņš)
14.4 Riga Division (Head of Division – Sandis Mackēvičs)
14.5 Daugavpils Division (Head of Division – Ilmārs Suhockis)

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[1] Until 1 April 2007. As of 2 April 2007, Deputy Head of Department; Head of Department Ms. Ilze Posuma.
[2] As of 26 March 2007, Mr. Elmārs Zakulis.
[3] As of 26 March 2007, closed.
[4] Position vacant from 15 February till 25 March 2007.

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14.6 Liepāja Division (Head of Division – Gints Liepiņš)
14.7 Rēzekne Division (Head of Division – Andrejs Gugāns)

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

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

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

18. DAUGAVPILS BRANCH
(Branch Manager – Jolanda Mateša; Deputy Branch Manager – Bernarda Kezika)

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

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

21. TRAINING AND RECREATION CENTRE
(Director – Zaiga Blūma; Deputy Director – Dace Miķilpa)

Appendix 7

THE BANK OF LATVIA'S STRUCTURE AT THE END OF 2006

- Governor's Office
  Guntis Valujevs
- COUNCIL
  Governor
  Ilmārs Rimšēvičs
  Deputy Governor
  Andris Ruselis
- Internal Audit Department
  Modris Briedis
- BOARD
  Chairperson of the Board
  Māra Raubiško
  Deputy Chairmen of the Board
  Reinis Jakovļevs
  Helmūts Ancāns
- Information Systems Department
  Harijs Ozols
- Monetary Policy Department
  Helmūts Ancāns
- Public Relations Department
  Press Secretary
  Mārtiņš Grāvītis
- Payment Systems Department
  Egons Gailītis
- Market Operations Department
  Raivo Vanags
- Legal Department
  Bruno Mačs[1]
- Statistics Department
  Agris Caune
- Accounting Department
  Māris Kālis
- International Department
  Guntis Valujevs
- Communications Department
  Aina Raņķe
- Personnel Department
  Inta Lovnika
- Security Department
  Romualds Namnieks
- Technical Support Department
  Andris Ņikitins
- Cashier's and Money Operations Department
  Veneranda Kausa
- Training and Recreation Centre
  Zaiga Blūma
- Daugavpils Branch
  Jolanda Mateša
- Riga Branch
  Jānis Strēlnieks
- Liepāja Branch
  Gundars Lazdāns
- Rēzekne Branch
  Anna Matisāne

[1] Until 1 April 2007. As of 2 April 2007, Deputy Head of Department; Head of Department Ms. Ilze Posuma.

Appendix 8

REPRESENTATION OF THE BANK OF LATVIA IN INTERNATIONAL ORGANISATIONS

EUROPEAN UNION

Economic and Financial Committee (EFC)
Helmūts Ancāns, Deputy Chairman of the Bank of Latvia's Board, Head of Monetary Policy Department (together with Inta Vasaraudze, Deputy State Secretary of the Ministry of Finance of the Republic of Latvia)
Committee of Alternates (EFC): Jeļena Zubkova, Head of Financial Stability Division, Monetary Policy Department (together with Daina Ispodkina, Head of European Union Affairs Division, European Union and International Affairs Department of the Ministry of Finance of the Republic of Latvia)

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

EFC's Sub-Committee on IMF and related issues (SCIMF)
Guntis Valujevs, Head of Governor's Office, Acting Head of International Department

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

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

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

Republic of Latvia Mission to the EU
Aldis Austers, Special Attaché of the Bank of Latvia

EUROPEAN SYSTEM OF CENTRAL BANKS

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

Accounting and Monetary Income Committee (AMICO)
Māris Kālis, Member of the Bank of Latvia's Board, Chief Accountant of the Bank of Latvia
Jānis Caune, Deputy Chief Accountant of the Bank of Latvia

Banking Supervision Committee (BSC)
Zoja Medvedevskiha, Deputy Head of Monetary Policy Department (Banking Supervisory Institution is represented by Uldis Cērps, Chairman of FCMC)

Banknote Committee (BANCO)
Veneranda Kausa, Head of Cashier's and Money Operations Department
Vilnis Kepe, Deputy Head of Cashier's and Money Operations Department

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

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

Information Technology Committee (ITC)
Harijs Ozols, Member of the Bank of Latvia's Board, Head of Information Systems Department
Egons Bušs, Deputy Head of Information Systems Department, Head of Computer Network and Server Systems Division

Internal Auditors Committee (IAC)
Modris Briedis, Head of Internal Audit Department
Anita Hāznere, Deputy Head of Internal Audit Department, Head of Operational Audit Division

International Relations Committee (IRC)
Andris Ruselis, Deputy Governor of the Bank of Latvia
Guntis Valujevs, Head of Governor's Office, Acting Head of International Department

Legal Committee (LEGCO)
Ilze Posuma, Head of Legal Department[1]
Iveta Krastiņa, Legal Adviser, Legal Department

Market Operations Committee (MOC)
Raivo Vanags, Head of Market Operations Department
Aigars Egle, Deputy Head of Market Operations Department, Head of Analysis Division

Monetary Policy Committee (MPC)
Helmūts Ancāns, Deputy Chairman of the Bank of Latvia's Board, Head of Monetary Policy Department
Uldis Rutkaste, Chief Economist of Macroeconomic Analysis Division, Monetary Policy Department

Payment and Settlement Systems Committee (PSSC)
Egons Gailītis, Head of Payment Systems Department
Ēriks Āboliņš, Deputy Head of Monetary Policy Department

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

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

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

Nordic-Baltic Monetary and Financial Committee, Group of Alternates (NBMFC Alternates)
Guntis Valujevs, Head of Governor's Office, Acting Head of International Department

[1] On parental leave until 1 April 2007.

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(cont.)

Nordic-Baltic IMF Office in Washington
Juris Kravalis, Senior Advisor to the Executive Director of the Nordic-Baltic Constituency of the IMF, Latvia's representative in IMF

Appendix 9

THE BANK OF LATVIA'S 2006 PUBLICATIONS

This list contains publications prepared and issued by the Bank of Latvia in 2006. These publications are available on the Bank of Latvia's website (www.bank.lv). It is possible to receive them in print free of charge both at the Bank of Latvia and by mail (if not indicated otherwise and a sufficient number of copies are available) sending a request to the address indicated on the last page of this publication or by e-mailing to: info@bank.lv.

REGULAR PUBLICATIONS

Bank of Latvia: Annual Report 2005
Monetārais Apskats. Monetary Review (3, 4/2005 and 1, 2/2006)
Monetary Bulletin (12/2005 and 1–10/2006)
Financial Stability Report (2/2005 and 1/2006)
Latvijas Maksājumu Bilance. Latvia's Balance of Payments (3, 4/2005 and 1, 2/2006)
Latvia's Balance of Payments (Key Items) (11, 12/2005 and 1–10/2006)

WORKING PAPERS

Ajevskis, V., Vītola, K. "A Factor Model of the Term Structure of Interest Rates and Risk Premium Estimations for Latvia's Money Market".
Beņkovskis, K., Stikuts, D. "Latvia's Macroeconomic Model".
Dāvidsons, G., Meļihovs, A. "The Role of Production Progress and Human Capital in the Economic Growth of Latvia".

Appendix 10

2006 HIGHLIGHTS OF RESOLUTIONS AND REGULATIONS ADOPTED IN PURSUIT OF THE BANK OF LATVIA'S MAIN TASKS

14 March
The Council of the Bank of Latvia passed a resolution "On the Reserve Ratio for Banks" (in effect as of 24 May 2006), stipulating that the reserve ratio for banks (as defined in the "Regulation for Calculating and Fulfilling the Minimum Reserve Requirement for Banks" approved by Resolution No. 110/3 of the Council of the Bank of Latvia on 11 March 2004) shall be 8%, except for the funds-received item "Repo transactions" on the liabilities side (reserve ratio: 0%).

The Council of the Bank of Latvia made amendments to the "Regulation for Calculating and Fulfilling the Minimum Reserve Requirement for Banks" (in effect as of 24 May 2006).

The Council of the Bank of Latvia approved a revised "Regulation for Purchasing and Selling Cash Foreign Currency" (in effect as of 1 April 2006).

10 May
The Board of the Bank of Latvia passed a resolution "On Amendment to the 'Regulation for Tenders of the Secondary Market for Securities Organised by the Bank of Latvia' " (in effect as of 22 May 2006).

The Board of the Bank of Latvia passed a resolution "On Amendment to the 'Regulation for Setting Interest Rates on Securities in the Monetary Operations of the Bank of Latvia' ".

11 May
The Council of the Bank of Latvia approved the "Oversight Policy for the Securities Settlement Systems of Latvia".

July 14
The Council of the Bank of Latvia passed a resolution "On Interest Rates" (in effect as of 15 July 2006), increasing the refinancing rate by 0.5 percentage point (to 4.5% per annum) as well as the interest rates on Lombard loans (to 5.5% per annum, where the Lombard loan balance has been maintained for up to 10 days in the last 30 days; to 6.5% per annum, where the Lombard loan balance has been maintained for 11 to 20 days in the last 30 days, and to 7.5% per annum, where the Lombard loan balance has been maintained for 21 days or longer in the last 30 days).

September 5
The Board of the Bank of Latvia approved the "Procedure for the Oversight of the Securities Settlement Systems of Latvia".

16 November
The Council of the Bank of Latvia passed a resolution "On Interest Rates" (in effect as of 17 November 2006), increasing the refinancing rate by 0.5 percentage point (to 5.0% per annum) as well as the interest rates on Lombard loans (to 6.0% per annum, where the Lombard loan balance has been maintained for up to 10 days in the last 30 days; to 7.0% per annum, where the Lombard loan balance has been maintained for 11 to 20 days in the last 30 days, and to 8.0% per annum, where the Lombard loan balance has been maintained for 21 days and longer in the last 30 days).

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The Council of the Bank of Latvia approved the "Regulation for the Use of the Bank of Latvia's Monetary Policy Instruments" (in effect as of 24 March 2007), consolidating the Bank of Latvia's regulations for particular monetary policy instruments into one document and adjusting these instruments to the monetary policy instruments used by the Eurosystem.

The Council of the Bank of Latvia approved the "Regulation for the Securities Settlement System of the Bank of Latvia" (in effect as of 24 March 2007).

The Council of the Bank of Latvia passed a resolution "On Amendments to the 'Regulation for Calculating and Fulfilling the Minimum Reserve Requirement for Banks' " (in effect as of 24 March 2007).

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GLOSSARY

Automatic Lombard loan – a Lombard loan granted to a bank or a branch of a foreign bank registered in the Republic of Latvia, holding a cash account for settlements in lats with the Bank of Latvia and participating in the securities settlement system organised by the Bank of Latvia, until the next business day for the purpose of eliminating an overdraft resulting from interbank settlements.

Balance of payments – a statistical report that summarises Latvia's economic transactions with other countries. This report reflects transactions related to goods, services, income and transfers and net transactions resulting in financial claims ("Assets") or financial liabilities ("Liabilities") to other countries.

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

Central government – public institutions, including ministries, embassies, representative offices, agencies, councils, educational, healthcare, law enforcement, cultural and other public institutions whose competence covers the whole economic territory of a country. Central government includes state non-profit institutions managed and financed by the central government.

Clearing – the process of transmitting, processing and reconciling payment documents prior to settlement, resulting in establishment of the multilateral net position of each bank by netting all payment documents submitted by the bank, i.e. establishing net cash liabilities to or claims on other banks.

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

Credit institution – a corporation whose business is to receive deposits or other repayable funds from the public and to grant credits on its own account and provide other financial services, or electronic money institutions issuing means of payment in the form of electronic money. The credit institutions of the Republic of Latvia (banks and electronic money institutions) have been included on the "List of Monetary Financial Institutions of the Republic of Latvia" (see Statistical Reporting Forms under Laws and Regulations on the Bank of Latvia's website at www.bank.lv).

Credit risk – the risk to incur losses as a result of a counterparty failing to settle an obligation.

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

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Demand Lombard loan – a Lombard loan granted upon request of a bank or a branch of a foreign bank registered in the Republic of Latvia, holding a cash account for settlements in lats with the Bank of Latvia and participating in the securities settlement system organised by the Bank of Latvia, for an agreed period which does not exceed 30 consecutive days.

Deposits redeemable at notice – cash assets deposited with an MFI without any specified maturity, with the possibility of withdrawing on demand either subject to notifying the MFI within an agreed period of notice or subject to payment of a substantial penalty.

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

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

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

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

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

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

Euro area – EU countries which have adopted the euro as their single currency in accordance with the Treaty establishing the European Community and in which a single monetary policy is conducted under the responsibility of the Governing Council of the ECB. As at the end of 2006, the euro area comprised Austria,

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Belgium, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Finland, Spain and Germany (Slovenia also joined the euro area on 1 January 2007).

European Central Bank (ECB) – the central institution of the ESCB and the Eurosystem having a legal personality under the Community law. The ECB implements the tasks conferred upon the Eurosystem and the ESCB pursuant to the Statute of the ESCB and ECB in cooperation with the national central banks. The ECB is governed by the Governing Council and the Executive Board, and, until all EU Member States introduce the euro, by a third decision-making body, the General Council.

European System of Central Banks (ESCB) – includes the ECB and the national central banks of the EU Member States. The national central banks of those EU Member States which have not adopted the euro implement an independent monetary policy according to national law and are thus not involved in the conduct of the monetary policy of the Eurosystem.

Eurosystem – comprises the ECB and the national central banks of the Member States of the euro area. The decision-making bodies of the Eurosystem are the Governing Council and the Executive Board of the ECB.

Exchange rate mechanism II (ERM II) – the exchange rate arrangement that ensures the framework for exchange rate policy cooperation between the euro area countries and the EU Member States not participating in Stage Three of EMU. As at the end of 2006, Denmark, Estonia, Cyprus, Latvia, Lithuania, Malta, Slovakia and Slovenia were members of the ERM II. (With the introduction of the euro on 1 January 2007, Slovenia ceased to participate in ERM II).

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

Financial institutions – OFIs, financial auxiliaries, insurance corporations and pension funds.

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

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

Foreign exchange swap – a simultaneous spot purchase/sale and forward sale/purchase of one currency against another.

General Council of the ECB – one of the decision-making bodies of the ECB,

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comprising the President and the Vice-President of the ECB and the Governors of all EU national central banks.

General government – public institutions engaged in production of non-market goods and services intended for individual and collective consumption or public institutions engaged in redistribution of national income or wealth. General government in the Republic of Latvia includes central government and local government.

Gross settlement system – a transfer system in which the cash settlement or the transfer of securities occurs on an instruction-by-instruction basis.

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

Interbank automated payment system (SAMS) – the Bank of Latvia's gross settlement system used for interbank settlements in real-time.

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

International Monetary Fund (IMF) – an international organisation, founded in July 1944, to facilitate international monetary cooperation, exchange rate stability, national economic growth and employment growth, and ensure short-term financial assistance, should any of the IMF Member States need to solve balance-of-payments related problems.

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

Local government – public institutions, whose competence covers only a local economic territory. Local government includes state non-profit institutions managed and financed by the local government. In the Republic of Latvia, the local government level is comprised of the local authorities.

Lombard loan – a short-term loan of the Bank of Latvia granted to a bank or a branch of a foreign bank registered in the Republic of Latvia, holding a cash account for settlements in lats with the Bank of Latvia and participating in the securities settlement system organised by the Bank of Latvia, in exchange for an unencumbered securities collateral owned by the bank or the branch of a foreign bank. The Bank of Latvia grants automatic Lombard loans and demand Lombard loans.

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

M1 (narrow monetary aggregate) – this monetary aggregate is calculated on the

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

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

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

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

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

Monetary financial institutions (MFIs) – institutions forming the money-issuing sector. The Bank of Latvia maintains the "List of Monetary Financial Institutions of the Republic of Latvia" (see Statistical Reporting Forms under Laws and Regulations on the Bank of Latvia's website at www.bank.lv) which comprised the Bank of Latvia, 27 credit institutions, two money market funds and 34 other MFIs (credit unions) as at the end of 2006. The ECB regularly publishes the "List of MFIs of the EU Member States" on its website (see Links on the Bank of Latvia's website at www.bank.lv).

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

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

Original maturity – in accordance with the terms and conditions agreed at the beginning of a financial operation, time from the issue date of a debt instrument

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to its maturity date or from the lending date to the maturity date or from the start date to the final date of any other financial operation.

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

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

Real-Time Gross Settlement (RTGS) system – a settlement system in which processing of payments and settlement take place on an order-by-order basis (without netting) in real time.

Repurchase agreements – operations whereby a tender participant (a bank or a branch of a foreign bank registered in the Republic of Latvia, holding a cash account for settlements in lats with the Bank of Latvia and participating in the securities settlement system organised by the Bank of Latvia) sells securities owned by it to the Bank of Latvia and upon maturity repurchases them from the Bank of Latvia at a price agreed at the moment the transaction was concluded.

Reserve base – the sum of the balance sheet items which constitute the basis for calculating the reserve requirements of banks and branches of foreign banks registered in the Republic of Latvia.

Reserve holdings – money holdings of banks and branches of foreign banks registered in the Republic of Latvia with the Bank of Latvia which serve to fulfil reserve requirements.

Reserve ratio – the percentage share of the reserve base defined by the Bank of Latvia. Central banks may also define a ratio for each category of balance sheet items included in the reserve base. The ratios are used to calculate reserve requirements.

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

Residual maturity – time remaining until the maturity date of a debt instrument or loan or time remaining until the final date of any other financial operation.

Reverse repurchase agreements – operations whereby a tender participant (a bank or a branch of a foreign bank registered in the Republic of Latvia or a foreign bank, international foreign exchange, financial or credit institution holding a cash

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account for settlements in lats with the Bank of Latvia and participating in the securities settlement system organised by the Bank of Latvia) purchases securities owned by the Bank of Latvia from the Bank of Latvia and upon maturity resells them to the Bank of Latvia at a price agreed at the moment the transaction was concluded.

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

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

SEPA (Single Euro Payment Area) – area in which consumers, companies and other economic agents will be able to make and receive payments in euro both across countries and within the borders of each country regardless of their location in accordance with one and the same main provisions, rights and obligations.

TARGET (Trans-European Automated Real-time Gross settlement Express Transfer) system – a real-time gross settlement system for the euro. It is a decentralised system consisting of 17 national real-time gross settlement systems, the ECB payment mechanism and the Interlinking mechanism at the end of 2006.

Time deposit with the Bank of Latvia – cash assets in lats accepted by the Bank of Latvia for a fixed term and with a fixed interest rate from a bank registered in the Republic of Latvia, including a bank which has been rendered insolvent or to undergo liquidation, or from a branch of a foreign bank registered in the Republic of Latvia, repaid by the Bank of Latvia to the above counterparties upon maturity together with interest.

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Appendix 12

THE BANK OF LATVIA'S STATEMENTS OF ITS VISION, MISSION AND VALUES

THE BANK OF LATVIA'S VISION

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

THE BANK OF LATVIA'S MISSION

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

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

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

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

The Bank of Latvia is a reliable cooperation partner.

OUR VALUES

Our employees are of utmost value to us. We maintain a safe and healthy working environment. Employee motivation, creative approach and responsibility are essential preconditions for successful operation of the Bank of Latvia. In its employees, the Bank of Latvia highly values the following:
1. orientation towards service quality and result;
2. use of high technologies and corporate government principles;
3. teamwork and maintaining favourable working environment;
4. professionalism:
– quality performance of tasks, meeting the deadlines,
– initiative,
– ability to identify drawbacks, inform about them or correct them if the person himself/herself can do it,
– ability and willingness to admit one's mistakes and correct them,
– application of the principles of best practice,
– ability to be prudent and risk-appraising when making decisions,
– ability to safeguard information,
– willingness to acquire knowledge and ability to be flexible regarding reasonable changes,
– ability to be part of the team and share know-how and experience with colleagues;
5. ethical attitude towards work and colleagues:
– intelligence in mutual relationships,
– honesty,
– good fellowship,

Appendix 12
(cont.)

– respectful attitude and behaviour and no discrimination on the basis of nationality, gender, religion and opinions,
– awareness of the special responsibility and the importance of the duties of the employees of the central bank in order to promote the Bank of Latvia's credibility;
6. civic qualities: patriotism and sense of duty towards the country and its people.

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