



LATVIJAS BANKA
EIROSISTĒMA

LATVIJAS BANKA: ANNUAL REPORT 2018

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ABBREVIATIONS

AML/CFT	anti-money laundering and combating the financing of terrorism
AS	joint stock company
BIS	Bank for International Settlements
CIT	corporate income tax
CSB	Central Statistical Bureau of Latvia
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFC	Economic and Financial Committee
EKS	Electronic Clearing System of Latvijas Banka
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
€STR	euro short-term rate
EU	European Union
EURIBOR	Euro Interbank Offered Rate
Eurostat	Statistical Bureau of the EU
expanded APP	expanded asset purchase programme
FCMC	Financial and Capital Market Commission
FRS	US Federal Reserve System
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IReF	ESCB Integrated Reporting Framework
Ltd.	limited liability company
M1	narrow monetary aggregate
M2	intermediate monetary aggregate
M3	broad monetary aggregate
MFI	monetary financial institution
NCB	national central bank
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PIT	personal income tax
PSPP	public sector asset purchase programme
SDDS Plus	Special Data Dissemination Standard Plus
SDR	Special Drawing Rights
SEPA	Single Euro Payments Area
SRS	State Revenue Service
SSM	Single Supervisory Mechanism
TLTRO	targeted longer-term refinancing operations
UK	United Kingdom
US	United States of America
VAT	Value Added Tax

FOREWORD



The year 2018 saw rapid economic expansion all over the world, yet there were also some strong headwinds, including the one stemming from the US–China trade tensions, the UK's decision to leave the EU and severe financial market turbulences. Moreover, growth became more heterogeneous across various regions and countries of the world. Global GDP increased by 3.7%, just a fraction less than in 2017 (3.8%). According to the baseline scenario, the global economic growth is expected to decelerate slightly in 2019. This will be driven by several factors, including the threat of protectionism and the probability of global trade wars, rising costs of funding as a result of the major global central banks gradually unwinding their monetary policies as well as the developments around Brexit. There are indications that the global economic cycle is mature.

The euro area witnesses economic slowdown driven by softer external demand and some country and sector-specific factors. Despite the highly accommodative financing conditions that continue to support the euro area economy and the rising employment and wages, external risks suggest that the economic policy makers should remain vigilant.

Primarily as a result of the monetary policy implemented by the Eurosystem, the medium-term inflation has approached the inflation target of below, but close to, 2%. Core inflation can be expected to strengthen in the medium term under the impact of the accommodative monetary policy measures, economic growth and rising wages.

Latvia's economic growth remained robust in 2018 at roughly 5%, much like in 2017. The role of exports as the key driver of GDP growth has been gradually taken over by domestic demand and construction development supported by EU funding inflows. Exports have contracted primarily on account of developments in Latvia's most significant external markets.

Latvia's economic growth is expected to decelerate in 2019, although it will remain relatively buoyant. Considering the global market developments, the slowdown of Latvia's economic growth and the approaching end of the EU funds programming period, it is vital to implement an economic policy geared towards long-term economic growth. The government budget should run a surplus, particularly taking account of the fact that the period of low interest

rates cannot last forever and considering the expected economic deceleration on a global scale and in Latvia.

Latvia saw continued wage increases in 2018, and this trend is likely to persist also in 2019. Although the rising wages increase domestic consumption and, consequently, benefit economic growth, the widening wage–productivity gap is a matter of concern since it creates a cost pressure on businesses and has a negative effect on their global competitiveness. Discussions about potential solutions to address labour market problems are also gathering strength. People are the key to Latvia's competitiveness, and investment in education and innovation to boost productivity has a major role to play in strengthening economic sustainability. Therefore, it is vital that the Latvian government and parliament continue with reforms in 2019, particularly in the education and health sectors.

The overhaul of the financial sector in 2018 affected the credit institutions mostly targeting foreign customers. Deposits and payments by foreign customers contracted even more significantly than before, with the above-mentioned credit institutions cutting services to high-risk customers and reviewing their business models. In response to the MONEYVAL report published in August and identifying the gaps in the field of AML/CFT, the government implemented a set of measures to achieve significant progress in the field of anti-money laundering in the course of 2019.

As of 19 February 2018, a prohibition to engage in any activities relating to decision-making, control and supervision functions in Latvijas Banka was imposed on Ilmārs Rimšēvičs, Governor of Latvijas Banka. It is vital that Latvijas Banka, being the national central bank, was able to continue to operate smoothly and successfully and the population, businesses and the overall financial sector continued to receive services as usual. This was also confirmed by the central bank team's successful hosting of one of the most important events of the year in global finance, the external meeting of the Governing Council of the ECB in Riga in June 2018. On 26 February 2019, the Court of Justice of the EU lifted the prohibition to discharge the duties of Governor of Latvijas Banka imposed on Ilmārs Rimšēvičs as of 19 February 2018. Consequently, he was reinstated in office as of 26 February 2019.

In 2018, Latvijas Banka focused its work on further development of several significant projects, and in the last months of the year already over 90% of the customers of Latvian credit institutions had access to instant interbank payments at any time of the day, including weekends and holidays. The total value of instant payments executed in Latvia is expected to exceed 1 billion euro in mid-2019. It is anticipated that credit institutions and financial sector companies will soon offer their customers an option to make instant payments using mobile phone numbers. The opportunities provided by instant payments will be used more extensively also in trade and e-commerce.

On 1 August 2018, Latvia adhered to the IMF's Special Data Dissemination Standard Plus (SDDS Plus) and became the 17th country in the world implementing the highest tier of the IMF's Data Standards Initiatives. Latvia's adhering to the SDDS Plus standard is a result of joint efforts by Latvijas Banka, the Central Statistical Bureau of Latvia, the Treasury, the Financial and Capital Market Commission and AS Nasdaq Riga. Latvijas Banka coordinates the implementation of the SDDS Plus standard.

In 2018, the role of Latvijas Banka as the Baltic regional cash storage and processing centre was strengthened, the operation of the Credit Register was improved and other activities were implemented.

The year 2019 can be expected to be equally busy; therefore, I would like to express my gratitude to the staff of Latvijas Banka for their high professionalism and hard work in 2018 and wish everyone plenty of energy and strength to fulfil all future aspirations.

A handwritten signature in blue ink, appearing to read 'Z. Razmusa', with a long horizontal flourish extending to the right.

Zoja Razmusa
Deputy Governor of Latvijas Banka
Riga, 18 April 2019

VISION, MISSION AND VALUES OF LATVIJAS BANKA

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

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

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

2018 IN FIGURES

in Latvia and the euro area

ECONOMIC GROWTH REMAINED FAST AND BALANCED

 *in Latvia*
5.0%

 *in the euro area*
1.9%



Latvia's rapid growth was driven by high investment activity and robust income gains underpinning a rise in private consumption.

Real growth of gross domestic product (seasonally and calendar adjusted data).

EXPORTS CONTINUED TO EXPAND

 *in Latvia*
5.2%

 *in the euro area*
2.8%



Despite the high level of uncertainty prevailing in the external environment, Latvia's exports followed an upward trend.

Nominal exports of goods and services.

INFLATION REMAINED MODERATE

 *in Latvia*
2.6%

 *in the euro area*
1.8%



Sustainable income convergence and functioning of Latvia's economy slightly above its potential pushed up inflation slightly above the euro area average.

UNEMPLOYMENT CONTINUED ON A DOWNWARD TREND

 *in Latvia*
7.4%

 *in the euro area*
8.2%



With unemployment declining and more people entering the labour market, employment was on a rise.

LENDING DYNAMICS REMAINED SLOW

 *in Latvia*
1.2%*

 *in the euro area*
3.2%



Lending still was not among the key factors stimulating economic growth; an increase in investment was ensured by firms' own funds and absorption of European Union (EU) funds.

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

LABOUR DEMAND CONTRIBUTED TO INCOME GAINS OF THE EMPLOYED

 *in Latvia*
7.8%

 *in the euro area*
2.4%



The rising income increased well-being; however, higher productivity played an ever more important role in maintaining competitiveness.

Compensation per employee.

INTEREST RATES REMAINED LOW

 *in Latvia*
2.8%

 *in the euro area*
1.5%



With the accommodative monetary policy still in place, the interest rate level was low.

The average annual interest rate on new loans to non-financial corporations.

EXPANSIONARY FISCAL POLICY

 *in Latvia*
-1.0%
of GDP

 *in the euro area*
-0.5%
of GDP

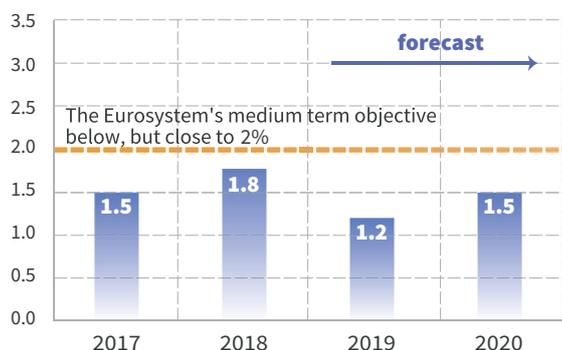


Robust tax revenue growth could not offset the increase in expenditure associated with an active implementation of EU co-financed projects and allocation of additional funding to certain sectors. Latvia's budget still ran a deficit.

LATVIJAS BANKA IN 2018

STABLE VALUE OF MONEY

Euro area inflation (%)



The amount of securities purchased by Latvijas Banka under the expanded asset purchase programme totalled

0.7 billion euro



in 2018

7.4 billion euro



since 2015

PAYMENT INNOVATION



Instant payments executed within a matter of seconds have become commonplace in Latvia and are available to **>90% of the customers of Latvian credit institutions**



2.4 million instant payments made



amounting to **494 million euro**

The amount of securities purchased by Latvijas Banka under the expanded asset purchase programme totalled

0.7 billion euro



in 2018

7.4 billion euro



since 2015



Latvijas Banka compiles statistical data, analyses and comments on trends as well as **seeks solutions through discussions.**

CASH SECURITY AND QUALITY

The average time needed to identify counterfeits has decreased to **1.5 days**



144 million banknotes checked



17 million banknotes replaced by new ones

PROFIT (millions of euro)

Profit Profit share paid into the central government budget



76.8 million euro of Latvijas Banka's profit totalling **117.0 million euro** was appropriated to the central government budget since the euro changeover in 2014

OTHER EVENTS



Participation in decision-making regarding the future of the euro area.

An event of international significance – a meeting of the Governing Council of the European Central Bank – was held in Riga in June 2018.



AnaCredit

Enhancing financial stability in the euro area.

The Credit Register commenced the provision of the data it contains, using the Eurosystem's Analytical Credit Dataset AnaCredit.



Stronger dialogue with regions.

Discussions on opportunities for raising well-being organised during meetings with representatives of the public in nine Latvia's cities.



Sustainable environmental solutions.

Solar panels generate electricity necessary for the operation of the cash vault and the cash processing centre.

5 YEARS IN THE EURO AREA

Latvijas Banka delivers more than before

with less resources

Decrease in the number of employees

13%



- The economic analysis of the euro area and participation in the formulation and implementation of the single monetary policy.
- The Eurosystem's foreign reserve management together with the central bank of Austria amounting to 1.5 billion euro.
- The development of the Eurosystem's settlement systems, innovation development in the field of instant payments and other payments.
- The takeover of the functions of the central national currency authentication centre under the responsibility of Latvijas Banka.
- The implementation of the highest level data dissemination standard by adhering to the International Monetary Fund's standard SDDS Plus.
- Strengthening the role of Latvijas Banka as the Baltic regional cash storage and processing centre.

ECONOMIC ENVIRONMENT



There was an increasing divergence across the largest economic areas and countries in 2018

Europe and Asia as well as individual countries of the Middle East and Latin America experienced deceleration of growth, while the North American economies reported acceleration. Almost all economies suffered from deterioration of the economic sentiment and weakening international trade flows, yet there were also some significant country-specific factors at play, such as disruptions in the German car industry production associated with the roll-out of the new Worldwide Harmonised Light Vehicles Test Procedure (WLTP), excessive current account deficit and sovereign debt burden in Turkey and shrinking investment in the UK.

Despite the slowdown in economic growth, labour markets remained strong in most advanced economies in 2018, as reflected in employment gains and rising wages. At the same time, this was not yet reflected in sustainable inflation growth where energy and food prices remain major contributors, particularly in Europe.

Major central banks continued to implement accommodative monetary policies, despite some degree of tightening in the course of the year. The ECB reduced and subsequently ended net asset purchases under the expanded APP, yet the overall monetary policy stance remained essentially patient, prudent and persistent, preserving an ample degree of monetary accommodation. The Bank of England and the FRS proceeded with gradual normalisation of their monetary policies, whereas the Bank of Japan continued with a highly accommodative monetary policy.

Global growth weakened in 2018

At the beginning of 2018, confidence indicators around the globe continued along the path of 2017 and remained high by historical standards. Yet at the end of the first quarter, following an unexpectedly sharp contraction in world trade, many economies, particularly those with already existing structural vulnerabilities, experienced deceleration of growth. Against the background of weakening international trade, the significance of private consumption in global economic development increased. Investment developments were different across regions and countries, yet the overall contribution to growth was positive. Employment continued on an upward trend, and many countries saw the lowest unemployment levels of the last decade, with wage growth accelerating. The monetary policies pursued by the advanced economies remained overall accommodative, yet in the middle of the year the observed trends and the monetary policy normalisation expectations raised some concerns about the vulnerability of emerging market economies and caused negative financial flows.

As a result of the tax reforms implemented at the turn of 2017, GDP growth in the US reached levels that had not been seen for the last four years. In response to this strong growth, the FRS raised the target range of the federal funds rate in four steps over the year, to 2.25%–2.50%. Thus the pace of the monetary policy normalisation implemented by the FRS was faster than that of other major central banks. In 2018, the FRS continued with the balance sheet reduction process that started in 2017 and increased the monthly redemption caps to 50 billion US dollars in total as of October.

The UK's annual economic growth ended the year 2018 below the EU average for the third consecutive year. With the date of the UK's exit from the EU approaching, the country's economic growth outlook was clouded by the uncertainty about its future international economic relations. Brexit related uncertainty weighed down on investment, with business investment, the largest component, shrinking by 0.9% in the course of the year. Balance of foreign trade also deteriorated and the growth of private consumption decelerated,

highlighting the importance of an access to the EU market in the UK's future. Inflation eased in the course of the year, although remaining above the inflation target set by the Bank of England. In August, the Bank of England raised the Bank Rate to 0.75%. This was the second raise since 2009 and happened at a time when the economic growth was decelerating. No changes were introduced to the Asset Purchase Facility. Lower inflation was achieved on account of the stabilisation of value of the British pound sterling, with the rising trend in the prices on imports of goods that was observed during the previous two years coming to an end.

The recovery of the economic activity in Japan ended at the beginning of 2018. Private consumption and investment remained weak in comparison with exports, hence the economic development was largely dependent on external conditions. An additional growth-dampening factor were several episodes of natural disasters. In response, the Bank of Japan remained the only major central bank that continued with a highly accommodative monetary policy. In 2018, it retained the existing short-term policy interest rate, the target level of 10-year government bond yields and the annual pace of increase of the monetary base unchanged, at -0.1%, 0%, and 80 trillion Japanese yen respectively.

The growth of emerging economies in 2018 was dampened by the rising interest rates in the US and the deceleration of global trade. The monetary policy normalisation carried out by the FRS in combination with growing debt service costs in the emerging economies reduced the availability of financing, resulting in significant volatility of the national currencies. Argentina agreed on a lending programme with the IMF. As a result of the shrinking international trade, China experienced the lowest GDP growth since 1990 when it was still exposed to international sanctions because of its human rights violations.

Oil prices continued to rise over the first three quarters of 2018, followed by a sharp reversal only towards the end of the year. Consequently, the oil-exporting countries enjoyed economic recovery in the course of the year overall.

Global inflation was driven by the rising commodity prices

One of the factors behind the development of global inflation in 2018 were the energy price movements. The aggregate oil production output in the first half of the year was roughly in tune with demand, thereby underpinning prices. However, with the US oil producers continuing to ramp up production as well as against the background of lower expectations of the global economic growth and of postponement of the US sanctions against imports of Iranian oil, the market participants' perception of the required oil supply and demand abruptly changed, causing a price dive. The price of Brent crude oil rose from 67 US dollars per barrel at the beginning of 2018 to 86 US dollars per barrel in October, followed by a reversal to 54 US dollars per barrel at the turn of the year (a 20% fall since the beginning of the year). Global oil production increased primarily on account of the US oil output, whereas the output of OPEC and its cooperation partners remained broadly unchanged in the course of the year. Higher energy prices pushed up the headline inflation in both advanced and emerging economies. Core inflation in the US strengthened in the circumstances of a tight labour market, while that of the euro area remaining unchanged. In the emerging markets, higher core inflation was supported by the upward pressure of the weakening exchange rates on import prices. The fall of the oil prices observed over the last months of the year helped to ease the inflationary pressures in the advanced economies.

Deceleration of economic growth and monetary policy divergence resulted in higher financial market volatility

In 2018, the euro depreciated against the US dollar and the Japanese yen and appreciated against the British pound sterling. In the course of the year, euro fell by 4.5% against the

US dollar (from 1.2005 at the beginning of the year to 1.1467 at the end of the year) and by 7.0% against the Japanese yen (from 135.2 at the beginning of the year to 125.7 at the end of the year), at the same time rising against the British pound sterling by 1.2% (from 0.888 at the beginning of the year to 0.898 at the end of the year). The nominal effective exchange rate of the euro decreased by 0.8% in 2018. At the beginning of 2018, the value of the euro was the highest since the start of the monetary policy measures aimed at increasing the monetary base. This was based on expectations caused by the strong economic activity and the subsequent monetary policy normalisation. Nevertheless, with the spring data revealing deceleration of growth, the euro weakened. The euro was additionally weakened by the Italian government's budget battle with the EC and the mass protests in France at the end of the year. The euro failed to reach the previous levels vis-à-vis the US dollar in the course of the year also because the FRS continued with raising the federal funds rate, thereby increasing the attractiveness of the US dollar. The exchange rate of the euro against the British pound sterling exhibited strong volatility throughout the year peaking above the beginning-of-the-year rate on many occasions as well as sliding below that level, yet overall ending the year slightly above the value at the start of the year. This volatility of the British pound sterling was primarily caused by the Brexit negotiations and the resulting deceleration of the economic growth. The appreciation of the Japanese yen in the course of the year was the most notable as compared to other major global currencies.¹ The growth figures of the Japanese economy were unimpressive, yet the Japanese yen was strengthened by the financing inflows supported by the uncertainty caused by the trade tensions between the US and China at the beginning of the year and significant volatility in the European and the US stock markets towards the end of the year.

The stock market indices of the advanced economies experienced the steepest dive of the most recent years in 2018. Fear of a potential darkening of the outlook for global growth, the strengthening of the trade tensions between major global economies and the growing political role of anti-liberals in several European countries contributed to the stock market plunge. A similar fall was observed also in the stock markets of emerging economies, getting an additional continued pressure from the strengthening US dollar and the rising FRS rates.

The price of gold decreased significantly up to the middle of the third quarter of 2018, followed by a strong recovery towards the turn of the year and ending the year at 1283 US dollars per troy ounce, only 1.6% lower year-on-year. The main reason behind the fall of the gold price was the US dollar appreciation.

EURO AREA ECONOMY AND EUROSISTEM'S MONETARY POLICY

Euro area economic growth continued in 2018

Following strong growth in 2017, the growth rate moderated and developed more unevenly in 2018; nonetheless, it remained above its long-term average² (1.9%; see Chart 1 for annual percentage changes in quarterly GDP). In the second half of 2018, the contribution of the foreign trade to the euro area economic growth decreased due to the global political uncertainty. Growth continued to be driven by the domestic demand, supported by improving employment indicators, the level of household wealth as well as good corporate profit indicators. Moreover, despite a decline in the global growth rate in 2018, the overall external demand contribution to growth was positive. Inflation of 2018 amounted to 1.8% vis-à-vis 1.5% in 2017. The demand-side pressure on inflation remained muted. Nevertheless, a decline in the spare economic capacity and the continued

¹ Appreciation was estimated against a basket of currencies comprising the US dollar, euro, British pound sterling, Swiss franc, Australian dollar and Canadian dollar.

² The average euro area real GDP growth was 1.6% in 1996–2017.

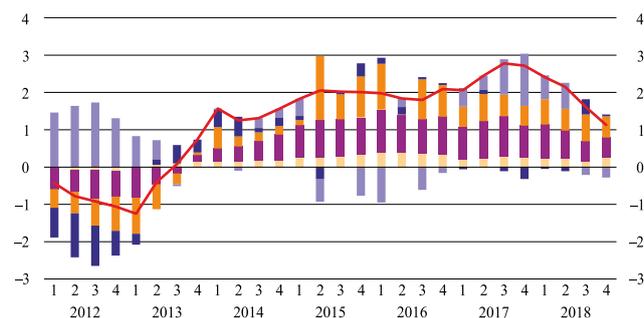
accommodative monetary policy provided assurance to the ECB that, in the medium term, inflation will return to its target level. Owing to the progress achieved towards a sustained adjustment in the path of inflation, the Governing Council of the ECB decided at its June 2018 meeting in Riga to reduce the monthly pace of the net asset purchases under the expanded APP to 15 billion euro in September 2018 and discontinue the net asset purchases under the expanded APP after December 2018. A sizeable stock of purchased assets, reinvestments of asset principal payments and the forward guidance in relation to the key ECB interest rates continue to preserve an ample degree of the monetary policy accommodation.

Chart 1

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

Government consumption
Private consumption
Investment
Changes in inventories
Net exports
GDP

Source: Eurostat.



The domestic demand continues to support the euro area economic growth

In the first half of 2018 the euro area growth continued, albeit somewhat slower than in 2017, and was supported by both accommodative monetary policy and positive global economic growth which started to moderate due to intensifying trade conflicts and political uncertainty. In the first half of 2018, GDP grew by 2.3%. In the first half of the year, strong domestic demand continued to support the GDP growth on account of persistently favourable financing conditions and a robust increase in income. Owing to a favourable labour market situation, employment growth and higher household income underpinned an increase in private consumption. In the first half of 2018, private consumption grew by 1.5% (0.2 percentage point less than in 2017). High production capacity utilisation along with favourable financing conditions ensured a higher rise in investment than on average in 2017. Investment growth reached 3.1% in the first half of 2018. Moreover, a stable rise in investment was reported for both machinery and construction.

Favourable conditions for growth were also underpinned by a substantial rise in income driven by stronger labour market dynamics. Unemployment indicators decreased throughout 2018, and employment grew further to stand above the pre-crisis level.

Net export contribution to GDP growth declined year-on-year in the first half of 2018 and turned negative at the end of the year. Exports expanded by 3.9% in the first half of 2018, significantly less than in the respective period of 2017 (4.8%). The external demand shrank on account of growing trade disputes between the US and China. Export activity was also adversely affected by the previous appreciation of the euro. The overall euro area growth rate decelerated notably due to a fall in the demand for export goods.

The euro area inflation rate rose from 1.3% in January 2018 to 2.0% in June 2018. In the first half of 2018, the rise in inflation was driven by the impact of energy prices and, to a lesser extent, food prices on consumption prices. With producer prices of goods and services increasing and wage growth accelerating again, cost pressures on consumer prices continued on an upward trend. However, their impact was not reflected in consumer price dynamics.

The Governing Council of the ECB decided in Riga on decreasing the amount of net asset purchases, while maintaining accommodative monetary policy

Economic and monetary analyses suggested that the still accommodative monetary policy will continue to have a positive effect on the availability of funding as well as the lending conditions for households and non-financial corporations. With the demand for export goods declining, growth rate weakened at the beginning of 2018 as compared to its rapid pace in 2017; nevertheless, the domestic demand remained strong and supported a broad-based economic expansion in the euro area. A decline in the spare production capacity in the economy, a steeper increase in wages and a production cost pressure on prices pointed to a sustainable upward path of inflation over the medium term.

Thus, the Governing Council of the ECB concluded at its June 2018 meeting in Riga that a significant progress towards a sustained adjustment in the path of inflation has been achieved. Longer-term inflation expectations remained stable at the beginning of 2018. Euro area economic growth and the still ample degree of monetary accommodation gave reason to believe that, even after gradually decreasing the amount of the net asset purchases, sustained adjustment in the path of inflation towards the ECB's inflation aim will continue. The Governing Council of the ECB decided to continue the asset purchases in the amount of 30 billion euro until September 2018. If economic indicators confirm the medium-term inflation dynamics, the amount of net asset purchases will be reduced to 15 billion euro after September, and they will end in December. At the same time, the Governing Council of the ECB decided that the key ECB interest rates will remain unchanged until the summer of 2019.

External uncertainty and some domestic factors hampered growth

In the second half of 2018, in the third quarter in particular, the euro area growth rate decreased significantly. In the second half of 2018, GDP picked up by 1.4% on account of the weakening external demand and some short-term factors, e.g. disruptions in the German car industry production associated with the introduction of the new WLTP. Uncertainty was deepened by political tensions in Italy and a wave of protests in France. Following a 2.7% increase in the first half of 2018, manufacturing production in the euro area shrank by 0.3% year-on-year in the second half of the year. Deteriorating external environment combined with supply disruptions and insufficient production capacity constrained the expansion of exports (2.2% in the second half of the year) and undermined the business and consumer confidence with respect to the growth potential in the future. Nonetheless, labour market developments remained favourable, unemployment reached the level observed in October 2008 (7.8%) at the end of the year and wages continued to grow rapidly but the expansion of the domestic demand weakened. In the second half of 2018, the private consumption growth moderated and stood at 1.0% (1.8% in the respective period of 2017). By contrast, the growth rate of investment accelerated to 3.1% (2.7% in 2017), with investment recording particularly strong growth in sectors experiencing significant production capacity constraints.

In the second half of 2018, inflation stabilised close to 2%, and higher global oil prices remained a significant contributor to inflation. Against the backdrop of rising volumes of oil production and concerns about the economic growth outlook, oil prices dropped sharply in the fourth quarter, thus affecting the consumer price index also in November and December, with inflation reaching 1.5% in December. In the second half of 2018, remuneration continued to increase significantly both in the manufacturing and services sectors causing a strong rising cost pressure on prices. Despite the cost pressure, however, core inflation did not increase also in the second half of the year and continued to fluctuate around 1%.

In view of the growing uncertainty and lower-than-expected growth indicators, the Governing Council of the ECB emphasised that its monetary policy stance remains essentially patient, persistent and prudent, since sustained adjustment in the path of inflation towards its target level can be ensured by maintaining the impact of the accommodative monetary policy. Some of the factors reducing the euro area growth indicators in the second half of 2018 had a short-term impact, whereas others, inter alia the deteriorating external environment, pointed to decelerating growth. Despite a decline in the growth momentum, economic development remained strong and the domestic demand expanded, supported by still very favourable labour market indicators and a high level of production capacity utilisation which, combined with strong profitability indicators, contributes to sustained investment. The Governing Council of the ECB still considered that the risks associated with the economic growth remained balanced; however, it also pointed to the strengthening of the downside risks owing to the global political uncertainty.

In December, the Governing Council of the ECB confirmed that, based on the available information on the economic growth and despite the fact that selected indicators are weaker than previously expected, the projections for the economic activity growth in the medium term largely support the June projections and the related risks remain balanced; at the same time, downside risks become increasingly stronger due to geopolitical factors and protectionism threats. The ever growing domestic demand and the intensification of the labour cost pressure on prices induced confidence that sustained adjustment in the path of inflation towards its target level will continue without further net asset purchases. In the light of the decisions taken at its June 2018 meeting in Riga, the Governing Council of the ECB decided to terminate the net asset purchases. At the same time, the accommodative monetary policy discussed at the meeting of the Governing Council of the ECB was underpinned by the forward guidance on the key ECB interest rates and reinvestments of principal payments from purchased maturing assets (see Table 1 for the key ECB interest rates; see Chart 2 for the composition of the Eurosystem's assets).

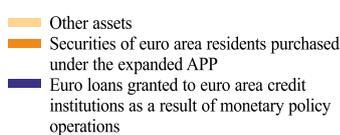
Table 1

KEY ECB INTEREST RATES
(%)

Types of key ECB interest rates	31 December 2017	31 December 2018
Deposit facility	-0.40	-0.40
Main refinancing operations	0.00	0.00
Marginal lending facility	0.25	0.25

Source: ECB.

Chart 2

EUROSYSTEM'S ASSETS
(trillions of euro)


Source: ECB.

ECONOMIC DEVELOPMENT OF LATVIA

FINANCIAL CONDITIONS AND MONEY SUPPLY

The restructuring of Latvia's credit institution sector commenced in 2018. After the Financial crimes enforcement network (FinCEN) of the US Department of the Treasury released a statement on 13 February 2018 proposing action regarding ABLV Bank, AS which was named an institution of money laundering concern pursuant to Section 311 of the USA PATRIOT Act, ABLV Bank, AS, the largest credit institution providing services to foreign customers, announced self-liquidation. Overall in 2018, significant AML/CFT measures were carried out in Latvia, including a prohibition to carry out transactions with the so-called shell companies. At the end of 2018, Latvia's regulatory framework for AML/CFT was among the most stringent in Europe, and its effective implementation is being improved.

Part of the Latvian credit institutions saw their balance sheets shrink significantly and the total credit institutions' assets on their balance sheets contracted by a fifth due to a change in the credit institutions' business model. Outflow of funds of high risk customers did not have a significant impact on the liquidity situation of banks as these funds were primarily invested in high-quality liquid assets. The total capital ratio of credit institutions remained at a high level of 21.7% at the end of the year (the minimum requirement is 8%).

A decline in the outstanding amount of foreign currency deposits contributed to a contraction in the balance of current accounts to foreign credit institutions. The overall volume of foreign exchange transactions carried out by Latvian credit institutions in the foreign exchange market shrank, while the volume of foreign exchange transactions with domestic financial and non-financial corporations continued to increase.

However, a large part of credit institutions providing services to foreign customers were only marginally involved in the domestic economy, and the above changes had no significant impact on the domestic economy. Owing to the ECB's accommodative monetary policy stance, the financial market conditions in Latvia remained favourable for the government, non-financial corporations and households in 2018. Although the fall in interest rates on loans to households and non-financial corporations in Latvia was less pronounced than before, the share of the loan portfolio in the credit institutions' assets continued to increase. Yields on government securities started to rise, whereas the stock market index began a downward trend. In 2019, efficient implementation of the recommendations laid out in the assessment report of the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) will be important for Latvia.

Against the backdrop of still high excess liquidity, interbank market activity declined

With the number of high risk customers decreasing and the role of US dollars in transactions diminishing, the change in the Latvian credit institutions' business model caused corresponding changes in the previously relatively stable trends of money markets where Latvian credit institutions conducted primarily short-term unsecured lending and borrowing transactions.

In 2018, money market developments were further affected not only by the above changes but also the overall accommodative monetary policy in the euro area, thus continuing to ensure large liquidity surpluses which partly accumulated also in Latvia's monetary and financial institutions as deposits with the national central bank. In each of the eight reserve maintenance periods of 2018, the excess reserves, i.e. funds held in excess of the required minimum reserves, accumulated by Latvia's credit institutions amounted to

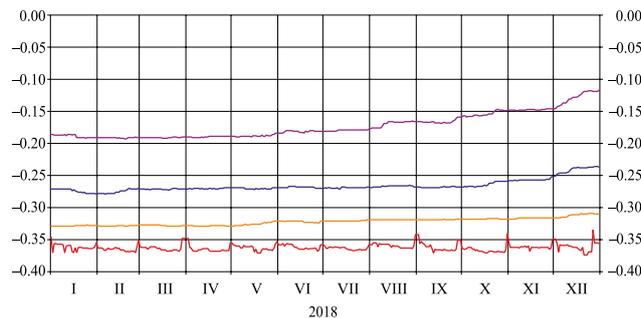
4.8 billion euro on average. Thus, credit institutions had no need to take part in money market transactions to ensure funds for liquidity.

On account of the overall accommodative monetary policy in the euro area, the money market interest rates stood at a historically low level also in 2018, e.g. EONIA fluctuated around -0.36% , whereas the 3-month and the 6-month EURIBOR averaged -0.32% and -0.27% respectively (see Chart 3). Nevertheless, with the amount of the monetary policy instruments contracting and the expanded APP portfolio expansion ending, the 6-month and 1-year money market indices increased slightly.

Chart 3

EURO MONEY MARKET RATES (%)

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



Source: Bloomberg.

Amid low interest rates and large surpluses of funds, the aggregate volume of unsecured euro lending transactions concluded among Latvian credit institutions in the money market stood below 100 million euro in 2018, exceeding the volume of transactions in 2017 by a mere 1.8%. The volume of unsecured overnight transactions exceeded that of the previous year by 10.0 million euro and, like in previous years, accounted for the largest volume of all transactions concluded in the domestic money market. Changes in the domestic interbank market were much more substantial, with domestic credit institutions providing unsecured foreign currency loans to foreign partners and receiving such loans.

The monthly average volume of lending transactions concluded in foreign currencies in the domestic interbank market shrank by 71.1% year-on-year to stand at 87.7 million euro in 2018 (303.8 million euro in 2017). The volume of transactions, which were carried out by Latvian credit institutions and involved foreign currency lending to foreign credit institutions, shrank almost at the same pace: in 2018, the monthly average of such transactions decreased by 53% year-on-year to 6.9 billion euro (almost 15 billion euro in 2017). The change in the business model of the domestic credit institutions will most likely result in a further decline in the volume of interbank market transactions.

Future trends of money market transactions with domestic and foreign counterparties will, to a large extent, depend on monetary policy decisions both in the euro area and other countries. Credit institutions will continue to accumulate a considerable amount of funds; therefore, the interbank market activity is not expected to expand notably. At the same time, the introduction of a new money market reference rate is expected.

The ECB and the national central banks of the Eurosystem agreed on the introduction and publication of a new money market overnight reference rate already in 2017, and a corresponding notice was published on 21 September 2017. The above reference rate will replace private sector reference rates. On 28 June 2018, the €STR calculation methodology and the planned publication date (October 2019) was revealed. Historic €STR calculations were also given to provide market participants with an insight into the

expected €STR trends and differences from EONIA¹. Regulation (EU) No 1333/2014 of the ECB of 26 November 2014 concerning statistics on the money markets (ECB/2014/48) provides that the range of agents reporting statistical data concerning money markets shall be expanded to include credit institutions from each euro area country.

With the ECB withdrawing the monetary stimuli, yields on government securities rose, whereas the stock market indices declined

In 2018, the Treasury offered 5-year bonds in the primary market auctions of government securities. Overall, over the course of the year two issues maturing in May 2023 and November 2023 respectively were offered. Over the year, the supply amounted to 330 million euro at the primary auctions, while the demand stood at 1373 million euro, and the entire amount supplied was sold.

The average auction interest rate rose from 0.20% in December 2017 to 0.58% in December 2018 owing to both domestic developments in Latvia and external factors. The domestic factors were driven by the developments associated with ABLV Bank, AS and the MONEYVAL assessment report on Latvia. Among the external factors are the gradually decreasing monetary policy support in the world, reduced amount of purchases under the expanded APP in 2018 and the announcement of the ending of the expanded APP portfolio expansion in 2019. In addition, 2019 budget negotiations between Italy and the EU institutions began in the autumn, thus increasing the uncertainty about the future developments.

In September, the international rating agency Standard & Poor's upgraded Latvia's sovereign credit rating from A– to A with a stable outlook. The decision was based on the strong dynamics of the economy, the low level of sovereign debt as well as the decrease in the share of foreign customer deposits. Latvia successfully launched two bond issues in the international markets.

In May, Latvia issued a new 10-year government bond in the international markets and carried out an additional issue of a previously issued 30-year bond. The average yields on bonds with a 10-year and 30-year maturity stood at 1.15% and 1.94% respectively, whereas the margins over the average swap rate were 15 basis points and 37 basis points respectively. Compared to the yields on similar credit rating bonds issued by the EU countries, the yields on the Latvian government bonds remain among the lowest ones.

In September, Latvia issued 350 million euro worth of bonds in the external market. This was a tap issue of 10-year and 30-year government bonds originally launched in May 2018 and February 2017. At the September auction, the average yield on the 10-year government bond was 1.00% and that on the 30-year bond was 1.86%, with the spreads over the same maturity German government bonds being 62 basis points and 81 basis points respectively. Investors from 70 countries participated at the auction.

The yield on Latvian government long-term bonds maturing in 2047 and sold in the secondary market rose from 1.76% at the end of 2017 to 1.89% at the end of 2018 due to reasons similar to those mentioned for the domestic bond developments. The spread vis-à-vis the German government bonds of equivalent maturities rose from 38 basis points to 100 basis points.

Over the year, Latvia's share index OMXR decreased by 6.7%, whereas the Baltic

¹ On its website, the ECB publishes both the aggregated statistical data concerning money markets and information on pre-€STR containing the interest rate calculated based on the €STR methodology, the volume of transactions used in calculations, the number of credit institutions and transactions as well as other information to ensure that market participants are able to acquaint themselves with the new money market reference rate in a timely manner. The published information cannot be used as a reference rate (an index used in financial contracts and instruments).

share index OMXBBGI contracted by 7.4%. Looking at the major Latvian joint stock companies, only the stock prices of AS Latvijas Gāze remained unchanged, while those of AS Latvijas balzams, AS GRINDEKS, AS Olainfarm and AS VALMIERAS STIKLA ŠĶIEDRA declined. Financial indicators of joint stock companies declined slightly in comparison with the previous years. However, global developments played a more important role in the deterioration of the investor sentiment and the stock index as the uncertainty surrounding the future global economic growth and the increasing geopolitical risks lead to lower stock indices.

The outstanding amount of bonds issued by Latvia's private sector and registered in Nasdaq CSD SE decreased by 22.1% to stand at 907.9 million euro in 2018. The termination of ABLV Bank, AS operation had a relatively pronounced impact as this credit institution was the largest private issuer of bonds in Latvia. Over the year, the above credit institution began settling its liabilities against the holders of bonds, and the issues with a maturity after 2018 were also partly redeemed. Meanwhile, new issuers entered the market: AS BlueOrange Bank with its issue of 1.5-year bonds amounting to 20.0 million euro and AS Attīstības finanšu institūcija Altum with its issue of 7-year bonds amounting to 10.0 million euro.

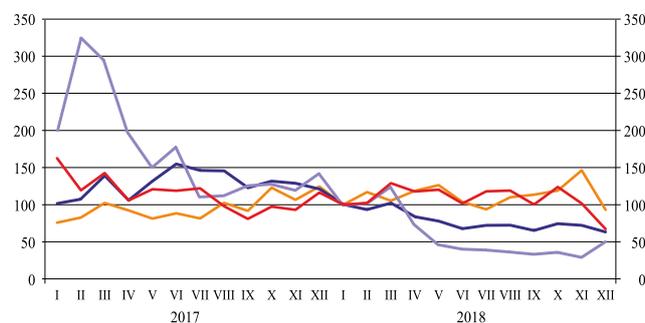
The domestic demand for foreign exchange transactions reflected strong economic activity despite the overall subsiding activity in the foreign exchange market

The volume of foreign exchange transactions carried out by Latvian credit institutions declined by 39.3% in 2018. The monthly average of the said transactions amounted to 21.9 billion euro (36.1 billion euro in 2017). The decline in the volume of foreign exchange transactions mostly resulted from a decrease in the credit institutions' activity in transactions with foreign counterparties: the volume of foreign exchange transactions with foreign non-financial corporations recorded a sharp fall of 65.8% and the volume of transactions with foreign credit institutions also contracted at a relatively rapid pace by 40.0%. Meanwhile, the volume of transactions with foreign financial institutions (excluding MFIs) shrank by 27.1%. The volume of transactions with foreign counterparties, both financial institutions and non-financial corporations, stabilised in the second half of the year (see Chart 4).

Chart 4

VOLUME DYNAMICS OF LATVIAN CREDIT INSTITUTIONS' FOREIGN EXCHANGE TRANSACTIONS WITH DOMESTIC AND FOREIGN COUNTERPARTIES
(January 2018 = 100)

— Domestic financial institutions
— Domestic non-financial corporations
— Foreign financial institutions
— Foreign non-financial corporations



Source: Latvijas Banka.

In 2018, the volume of foreign exchange transactions with the domestic non-financial corporations and financial institutions (excluding credit institutions) continued to expand on account of the strong economic growth, overall openness of the economic model and higher foreign trade volume. The volume of transactions with non-financial corporations recorded the sharpest increase of 16.8% year-on-year, with the monthly average standing at 360 million euro.

The demand of the domestic non-financial corporations for foreign exchange services involving the exchange of the euro into the British pound sterling rose by 27.8% in

2018, thus exceeding the increase in the volume of exchange transactions in other pairs of currencies. In 2018, spot transactions were the most common foreign exchange transactions with the domestic non-financial corporations. At the same time, the contribution of swaps continued to gain importance.

The volume of foreign exchange transactions among domestic credit institutions contracted further by 6.9% year-on-year in 2018; nonetheless, despite the changes in the domestic financial market, the decline was less pronounced than in the previous year. The decrease was primarily caused by a drop in the currency swaps denominated in euro and US dollars, reflecting the changes in the credit institutions' business model. Meanwhile, with the diversity of economic links among Latvian businesses expanding due to geographically broader trade and transaction flows, the significance of other foreign currencies in spot transactions grew.

In 2018, the volume of foreign exchange transactions conducted by households via credit institutions declined by 5.2%, less than in the previous year when it decreased by 20.3%.

The volume of cash foreign exchange transactions continued on a downward trend posting a year-on-year decrease of 11.1% in 2018, with the monthly average of the said transactions amounting to approximately 40 million euro. Like before, most of the cash foreign exchange transactions were conducted at licensed currency exchange offices where 62.1% of all said transactions were exchanged against the euro. With credit institutions providing increasingly more electronic services and encouraging their customers, in various forms, to use remote and electronic services, the volume of cash foreign exchange transactions declined by 17.7% (by 12.3% in 2017). US dollars, Russian rubles, British pounds sterling and Norwegian kroner dominated cash foreign exchange transactions in 2018.

Interest rates on new loans, except those on consumer credit, ceased declining

Funding costs of loans to large businesses remained overall low in 2018. They were best characterised by the interest rate applied by credit institutions on new euro loans exceeding 1 million euro. In 2018, the above interest rate stood at 2.6%, up by 0.1 percentage point as compared to 2017. A steeper interest rate rise was constrained by the application of tighter credit standards in some Latvian credit institutions. Funding costs of loans to large enterprises grew in the autumn when credit institutions widened their margins slightly as a result of higher AML/CFT costs, rising funding costs of credit institutions and less competition among credit institutions. At the same time, some credit institutions lowered the risk level of loans by applying slightly tighter credit standards due to less competition and deteriorating operation prospects for selected sectors or businesses. The respective interest rate declined notably in December; however, this does not point to a trend, since competitive businesses increased their demand for loans. For instance, AS Latvenergo informed the public that it has agreed with several Latvian credit institutions on a long-term loan of 240 million euro for the reconstruction of the Daugava hydroelectric power stations and other purposes.

Funding costs of loans to small and medium-sized enterprises, measured by the interest rate applied by credit institutions on new euro loans of low and medium value of up to 1 million euro, remained unchanged in 2018 (3.6%).

The overall actual annual percentage rate of charge on loans to households for house purchase remained broadly unchanged (2.8%). At the same time, loans for house purchase became more available due to a higher ratio of the maximum amount of a loan vis-à-vis the collateral requirements. In the first half of 2018, amendments to the state support programme for house purchase became effective, expanding the state support to include young specialists among the beneficiaries. The programme expansion supported the

demand for loans to households for house purchase and motivated credit institutions to actively participate in granting new loans. Due to competitive pressure, several credit institutions reduced their margins and increased the ratio of the maximum amount of a loan vis-à-vis the collateral requirements for loans to households for house purchase. However, the credit institutions' view on the housing market development prospects as well as the credit standards for loans to households for house purchase changed several times over the year causing fluctuations in the respective weighted average interest rate.

With the overall actual annual percentage rate of charge on new consumer loans shrinking by 2.0 percentage points (to 19.8%), lending costs decreased in 2018. This was due to competitive pressure on loan margins and a decrease in the credit risk of households underpinned by employment growth and higher average wages in the economy.

The interest rate on euro demand deposits of households and non-financial corporations remained close to zero in 2018. Meanwhile, the interest rate on new fixed-term euro deposits from households and non-financial corporations remained approximately the same as in the previous year at 0.2%. The interest rate on new fixed-term euro deposits from households was higher (0.5%) than that from non-financial corporations (0.1%) since households invested part of their funds in longer-term deposits and part of their funds was deposited with credit institutions whose financial resources are primarily made up of domestic deposits and, thus, they are willing to pay a higher interest rate to attract those resources.

Monetary policy continued to be accommodative and interest rates remained low; however, lending activity did not increase significantly, while the leasing sector continued to grow

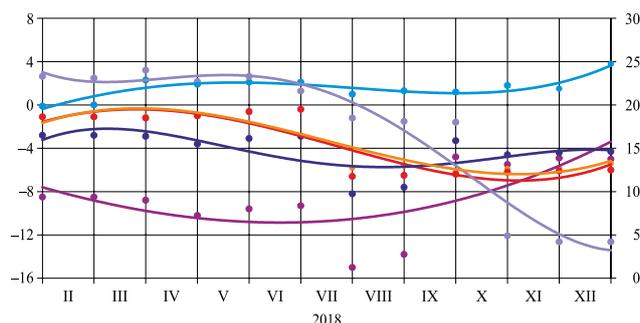
In 2018, relatively rapid economic growth continued in Latvia. Like in the previous year, however, lending growth remained slow and was still not among the key factors stimulating economic growth. Loans were mainly granted for infrastructure projects and real-estate development, whereas export-producing sectors and households received less loans as the opportunities provided by the ECB accommodative monetary policy were not sufficiently used to ensure more favourable lending terms and conditions and lower interest rates.

The nominal amount of the domestic loan portfolio was substantially reduced by a one-off factor, i.e. the decision of the ECB to withdraw the licence of ABLV Bank, AS on 11 July. In 2018, the outstanding amount of loans to financial institutions, non-financial corporations and households shrank by 4.3% (see Chart 5). Disregarding the impact of the structural changes in the credit institution sector, the outstanding amount of loans to domestic customers, the government excluded, rose by 1.2% over the year, with the loan portfolio of non-financial corporations inching up by 0.9% and that of households posting just a minor increase of 0.1%.

Chart 5

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

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



Source: Latvijas Banka.

The portfolio of loans granted to non-financial corporations changed only slightly in the first half of the year. However, the summer and autumn saw a strong increase in the short-term loans which were repaid towards the end of the year. In the last months of 2018, several large loans for infrastructure projects in the energy and transport sectors as well as loans to businesses in the trade and accommodation sectors were granted. On account of the positive leasing sector development and its increasing role in financing the economy, loans to the non-bank financial sector increased somewhat over the year. The annual growth rate of the domestic leasing portfolio reached 9.6%, including that of non-financial corporations which stood at 5.4%. The leasing portfolio of non-financial corporations accounted for 23.8% of the credit institution loans to non-financial corporations. Lending to households remained broadly unchanged. As a result of expanding the range of guarantee beneficiaries under the state support programme for house purchase for families with children by adding young specialists, the portfolio of loans to households for house purchase stopped declining and, disregarding the impact of the structural changes, this type of loans grew by 0.5% over the year.

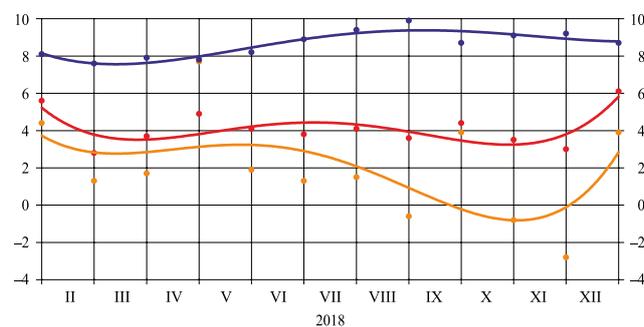
Stable economic situation facilitated the growth of domestic deposits

With the deposits by foreign customers decreasing rapidly and the parent bank funding shrinking further at a moderate pace, the primary source of credit institutions' funding were the ever-growing domestic deposits in 2018. Due to rising wages and declining unemployment, the increase in household deposits with credit institutions was most notable and stable, with their annual growth rate recording 8%–10% in 2018 (see Chart 6), thus following roughly the same path for the fifth consecutive year. An expansion of the deposits received from households also contributed to an upward trend in the aggregate domestic deposits (6.1%), whereas the deposits of non-financial corporations were more volatile over the year and even recorded a negative annual rate of change in some months as businesses used their savings for imports and investment. Deposits with credit institutions decreased further as non-bank financial institutions chose more profitable opportunities to allocate their funds. As the remuneration on deposits was low, the bulk of deposits were still concentrated in the most liquid segment, i.e. in overnight deposits, with their annual growth rate recording 8.1%, whereas deposits redeemable at notice and fixed-term deposits shrank.

Chart 6

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

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



Source: Latvijas Banka.

Economic stability and the euro area economic integration were reflected by monetary developments

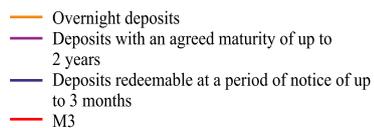
In terms of volume, the main driver of broad money growth was the expansion of narrow money as the credit institutions' customers preferred demand deposits due to the low interest rates on fixed-term deposits. Latvia's contribution to the euro area narrow monetary aggregate M1 (overnight deposits) increased by 14.7% in 2018. The rise in Latvia's contribution to the euro area intermediate monetary aggregate M2 was similar at 14.5% as deposits with an agreed maturity of up to two years expanded substantially by

26.4%, while deposits redeemable at notice of up to 3 months shrank by 1.3%. Likewise, the number of additional components in Latvia's contribution to the euro area broad monetary aggregate M3 was insignificant, and overall 2018 contribution of Latvia to the euro area monetary aggregate M3 increased by 13.9% (see Chart 7 and Appendix 1).

Chart 7

LATVIA'S CONTRIBUTION TO EURO AREA MONEY SUPPLY AND ITS COMPONENTS

(year-on-year changes; %)



Source: Latvijas Banka.

Latvia's contribution to the euro area monetary base contracted by 4.4% in 2018, reaching 9.7 billion euro at the end of the period. It consisted of the credit institutions' demand deposits (including the mandatory reserve system; 5.1 billion euro) and Latvijas Banka's proportionate share in the total amount of banknotes issued by the Eurosystem (4.6 billion euro). Latvijas Banka's net foreign assets (non-euro area assets) shrank by 2.1% to stand at 3.9 billion euro.

Significant changes were observed with respect to the credit institutions' services to foreign customers

As a result of the money laundering/terrorist financing risk mitigating measures, part of Latvian credit institutions saw their balance sheets shrink significantly in 2018 leading to a 19.4% decrease in the overall assets in the credit institution sector¹ (for their structure, see Chart 8). The share of the loan portfolio of the domestic customers, the government excluded, in the credit institutions' assets grew further by 8.5 percentage points (to 59.3%).

Chart 8

COMPOSITION OF CREDIT INSTITUTION ASSETS (%)



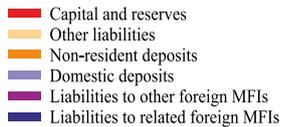
Source: Latvijas Banka.

In 2018, foreign financing contracted significantly in the composition of the liabilities of Latvian credit institutions (see Chart 9) mainly on account of a 58.8% fall in foreign customer deposits. At the end of 2018, the share of foreign customer deposits in the aggregate non-bank deposits reached a historic low (20.3%). MFI financing attracted from abroad, its major part coming from parent banks, did not change substantially (10.8% of total liabilities of credit institutions). Deposits from domestic customers continued on a stable upward trend in 2018, reinforcing its status as the main source of financing and accounting for 56.9% of the total liabilities of credit institutions at the end of the year.

¹ 20 credit institutions, including five branches of foreign credit institutions, were registered in the Republic of Latvia at the end of 2018.

Chart 9

COMPOSITION OF CREDIT INSTITUTION LIABILITIES (%)



Source: Latvijas Banka.

In 2018, domestic loans granted by Latvian credit institutions were fully covered by domestic deposits. Domestic loans corresponded to 91.7% deposits at the end of 2018 (101.9% in 2017).

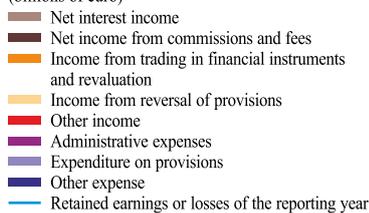
Despite significant structural changes in the credit institution sector, key financial indicators testified to the stability of Latvian credit institutions

The share of the liquid assets of Latvian credit institutions in the total assets remained high accounting for almost one third of the total assets (31.8% at the end of 2018). In the context of stable economic growth, the quality of the credit institutions' loan portfolio remained unchanged, and at the end of 2018 the share of loans past due over 90 days was 4.0% in the aggregate loan portfolio of credit institutions (the lowest level since the end of 2008). The financial sector stability was also confirmed by the credit institutions' total capital ratio recording 21.4% at the end of 2018 (the minimum requirement is 8%), while the Common Equity Tier I (CET1) capital ratio was 19.7%. Profit of Latvian credit institutions (see Chart 10) reached 294.4 million euro in 2018 (226.4 million euro in 2017). The increase was mainly due to the structural changes in the credit institution sector and the reform of the tax system. Overall the profitability of Latvia's credit institutions can be viewed as stable.

Chart 10

DYNAMICS OF CREDIT INSTITUTION INCOME, EXPENSE AND PERFORMANCE RESULTS

(billions of euro)



Source: Latvijas Banka.

The composition of financial income remained broadly unchanged. With persistently low market interest rates, the proportion of the net interest income in the financial income contracted somewhat; nevertheless, net interest income still accounted for approximately half of the financial income. Meanwhile, net income from commissions accounted for slightly more than one third of the financial income.

Moderation in external demand growth found reflection in a weaker performance of Latvia's exports, with the external environment related risks strengthening at the end of the year

In 2018, Latvia's external demand posted a more moderate increase than a year ago on account of the slowdown observed in the economic growth globally, in the euro area, as well as in Latvia's major trade partners. The deteriorating economic sentiment in the euro area and escalating trade tensions between the US and China, along with a slowdown in international trade dynamics and concerns about the mounting protectionism risks, were the main constraints to more rapid economic growth in the euro area.

This also resulted in a slower increase in real exports of Latvian goods and services, i.e. 2.0%, compared to 5.9% in 2017. Breakdown by trade partner shows that Lithuania, Estonia and Poland provided the highest positive contribution to Latvia's external demand; however, annual import growth also moderated in the above economies, except Estonia. Estonia saw a decline in unemployment and a rise in wages and salaries; EU investment inflows persisted, thus expanding consumption and imports. Although Lithuania and Poland faced a similar situation, their imports expanded at a slower pace than projected. As regards Russia, in 2018 the rise in the demand for imports posted a sharp decline, following the rapid import growth in the previous year. Although Russia's economy benefited from the high oil price, the depreciation of the Russian ruble made imports less appealing. Export growth of Latvian goods to Russia also shrank notably. In the third quarter, the economic growth in Germany contracted on account of a considerable disruption in the car production associated with the roll-out of the new WLTP as of 1 September; moreover, the economy couldn't recover by the end of the year. Uncertainty associated with the Brexit persisted, in the second half of the year developing into a higher probability of the UK leaving the EU without an agreement. In 2018, exports of Latvian goods to the UK recorded buoyant growth, mostly on account of exports of wood and articles of wood, whereas the dynamics of financial services and travel services contributed to the minor drop in exports of services. Risks associated with the future foreign trade with the UK have elevated considerably.

In 2018, exports of goods grew by 7.2%. The increase was driven by expanding volumes of real exports (3.9%) and also by export price rises (3.2%). The unfavourable weather conditions for working forests and farmland, observed at the beginning of the year, resulted in considerable price hikes for agricultural products and wood. Prices of exports of food, chemical and oil products, as well as articles of base metals also rose notably.

By commodity group, exports of wood and articles of wood accounted for the largest positive contribution to export volume. The difficulties in working forests in the spring notwithstanding, the overall volume of real exports posted a substantial annual increase. The major wood markets remained the same: the UK, Scandinavia and the Baltic States, with the largest increases also registered there. Exports of machinery and mechanical appliances, electrical equipment, as well as base metals and articles of base metals provided robust contribution in annual terms. However, exports of the above groups of goods were volatile as to their destination markets and volumes. Agriculture accounted for the largest negative contribution: despite the price rise, the unfavourable weather conditions prevented the sector from reaching the expected harvest levels and hence the real export volumes of agricultural products.

The services exports increase of 6.4% was slower than in 2017, both as a result of a fall in exports of financial services and weak growth of transportation services exports. Despite the persistently rapid growth of transportation by air and the unexpectedly high performance results of transportation by rail, supported by the protracted repairs at ports

in Russia, the overall transportation services posted merely a slight increase. Growth was mostly hindered by a fall in exports of transportation by road on account of the mounting protectionism in EU countries. Exports of travel services, i.e. spending of foreign visitors, increased; however, more impressive growth of travel services exports associated with Latvia's centenary and the XXVI Nationwide Latvian Song and XVI Dance Celebration had been expected. Of the exporting services sectors, the largest positive contribution was provided by the information and communication services sector, with its annual export growth standing at 24.6%. In the future, the above sector's growth might slow down on account of labour shortage.

Looking at exports of goods by country, in 2018 the most accelerated fall in annual exports growth to Latvia's major trade partners was observed to Russia. Of the major groups of goods exports to Russia, those of agricultural products and textile articles recorded a decline which was not offset by the rapid expansion in exports of optical instruments and machinery and electrical equipment. Export growth to Germany also moderated considerably. However, exports to Scandinavia saw a particularly steep increase on account of exports of wood. Looking at exports of services by country, the most notable export growth to Latvia's major trade partners was registered to Switzerland (transportation services) and Sweden (information and communication services), while the most pronounced drop in exports was observed to Lithuania and Russia on account of transportation services and travel services.

The market share of Latvia's exports of goods expanded globally; profitability remained high

In 2018, the average level of unit labour costs in the Latvian economy was slightly above the respective level observed in 2017. The dynamics of cost and price competitiveness indicators comprising both the fluctuations of the nominal effective exchange rate and the domestic cost and price development relative to the major trade partners was not favourable overall; however, the nominal effective exchange rate fluctuations were the decisive ones. At the end of the year, the cost and price competitiveness indicators stabilised. In 2018, the share of Latvia's exports of goods in global imports continued to increase, and Latvia's market share expanded in several major trade partners, e.g. the UK and Germany. The profitability of Latvia's manufacturing companies remained high and even improved.

DOMESTIC ECONOMIC ACTIVITY

The significance of the factors behind the accelerated economic growth shifted as export contribution contracted and the domestic demand became more dominant.

Rapid economic growth persisted in Latvia also in 2018: GDP increased by 5.0% according to seasonally and calendar adjusted data and by 4.8% according to non-adjusted data. The first half of the year saw strong growth both in export and domestic markets. Supply-side factors, i.e. labour shortage and the high degree of production capacity utilisation were the major obstacles to faster growth. In the second half of the year, however, the domestic demand was behind the GDP growth as exports weakened in comparison with the first half of 2018. Exports contracted on account of both moderation in the external demand growth in the second half of the year and some sector-specific developments, e.g. narrowing of the financial sector segment servicing foreign customers and smaller grain harvest in agriculture due to the dry summer. As to the domestic demand, it remained stable due to the recovery of investment growth observed already since 2017, as well as a robust increase in private consumption resulting from employment growth and a rise in average wages and salaries.

The increase in investment was facilitated by construction of buildings, engineering structures, as well as major investment in industrial machinery and equipment also contributing to import growth. Imports of transport vehicles were also boosted by the expansion of AS Air Baltic Corporation fleet, which had started already in 2016. Investment was financed both by the internal sources of finance of businesses as well as the financing of the EU funds which, like in 2017, played a significant role in supporting investment growth. Although lending posted a minor increase and its contribution to the economic growth was moderate, it supported investment in infrastructure projects in energy and transport as well as in production development.

As regards private consumption growth, it was driven both by an increase in employment and a rise in wages and salaries, as well as an improvement in consumer sentiment. Moreover, a vast programme dedicated to Latvia's centenary celebration was organised throughout 2018, with its implementation also supporting a pick-up in consumption. An accelerated wage rise and moderate inflation accounted for higher income growth than in the previous year, i.e. served as a driver for purchasing power strengthening, enabling households to increase their savings.

In 2019, with the potential of the domestic demand also weakening on account of external environment developments, Latvia's economic growth will become slower. The domestic demand will continue to be the growth driver; however, the private consumption contribution is likely to play the main role. As a result of both the wage rises and the previous increases in savings, the private consumption growth will be more robust than that of investment. The possibility of maintaining the investment growth rate equivalent to the dynamics observed in 2017 and 2018 is highly unlikely in an environment of weaker external demand and geopolitical risks, notwithstanding the fact that absorption of the resources of EU funds and the launched private sector projects will also continue. According to the EC confidence indicators, the business and consumer sentiment has remained relatively optimistic overall; nevertheless, the slowdown of the global economic growth might cause postponement of investment decisions on expansion by export market oriented manufacturers.

In 2018, accelerated, but balanced economic growth continued

With high investment activity persisting, in 2018 the steepest pace of development was recorded in the construction sector. Overall, the economic growth is deemed to be balanced. Many sectors developed successfully; at the same time, no demand-side pressure was observed, with the core inflation and also headline inflation remaining moderate. Lending still evolved at quite a sluggish pace. Although the growth of manufacturing and trade, the major sectors in the structure of the economy, moderated in 2018, several services sectors recorded successful development, e.g. the information and communication services sector posted a stable and rapid increase, and the contribution of the accommodation and catering services expanded. The positive dynamics of the transport sector performance indicators was supported by temporary factors. Meanwhile, although the fall in foreign customer deposits accelerated in 2018, one-off income in several periods as well as the stable performance results of credit institutions servicing domestic customers curbed the slowdown in the value added of the financial sector in comparison with 2017.

The implementation of the EU structural fund projects and private investment continued to ensure notable construction sector growth in 2018. The value added of the construction sector surged by 24.2% in comparison with 2017. Construction output at current prices increased in all construction segments. The largest positive contribution to the sector was provided by the construction of engineering structures, i.e. road and communication lines, as well as non-residential (trade and office buildings) and residential (apartment blocks)

buildings. The sector grew mostly on account of the boosting domestic construction activity, with the volume of construction works outside Latvia also increasing, albeit at a considerably slower pace than a year ago. In 2019, the EU fund contribution to the construction growth will continue; however, more moderate increase in construction in comparison with 2018 might result from the cautious private investment decisions related to external environment risks and a rise in construction costs.

The weak capacity on the supply side in the first half of the year, i.e. insufficient investment in the previous years and labour shortage, as well as weaker external demand in the second half of the year resulted in moderate manufacturing growth, with its value added moving up by 3.2%. Looking by sub-sector, positive dynamics was demonstrated by the high technology sectors and wood industry providing notable contribution to the sectoral growth over the year. The development of other sectors was not homogeneous, restricted by different factors, e.g. labour shortage in mechanical engineering and metalworking businesses, stronger competitiveness in Latvia, e.g. in the dairy processing sector, and an increase in costs, particularly for food processing businesses, due to a rise in grain prices.

The year 2018 was favourable for the transport sector, although mostly on account of temporary factors. The sector's value added increased by 5.2%, and, following a downturn of three years, the volume of cargoes loaded and unloaded at ports and the volume of rail freight posted an increase again, with considerable contributions by coal and wood cargoes. Nevertheless, the above growth should be viewed with caution as the cargo volumes still stand below the level of 2014 and the improvements seen in 2018 are mostly related to limited capacity of Russian ports during their repair period when freights were redirected to Latvian ports. Although the cargo volume from Belarus also posted an increase, Russian export freights that still account for the major part of freight transportation for the ports and railway in Latvia, might soon be redirected back to the ports in Russia, thus resulting in a decline in the freight volume serviced in Latvia. VAS STARPTAUTISKĀ LIDOSTA "RĪGA", which continued to invest in building its capacity, has increased the number of passengers and the volume of freight transported by air; however, the last months of 2018 saw a decline in freight transportation in annual terms. The largest negative contribution to transport services exports resulted from road transport performance which was negatively affected by protectionism measures in Europe and labour shortage; consequently, freight turnover growth decreased.

In 2018, the domestic factors, e.g. strong increase in the average wages and salaries and entrance of new participants in the market which were likely to catch the consumers' interest at least in the initial stage of their operation, were favourable for the trade sector development. However, the trade sector's value added expanded merely by 2.4% year-on-year on account of weaker exports, thus affecting wholesale trade indicators, and also more moderate retail trade indicators.

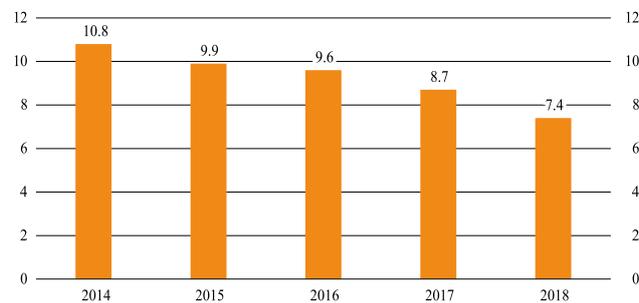
LABOUR MARKET

Unemployment and number of economically inactive persons decreased

Against the background of persistently solid growth, labour demand continued to expand. With more people entering the labour market, both participation rate and employment increased. Unemployment continued to shrink gradually and fell to the lowest level of the last 11 years (7.4% of economically active population; see Chart 11).

Chart 11

RATE OF JOB SEEKERS
(% of the economically active population)



Source: CSB.

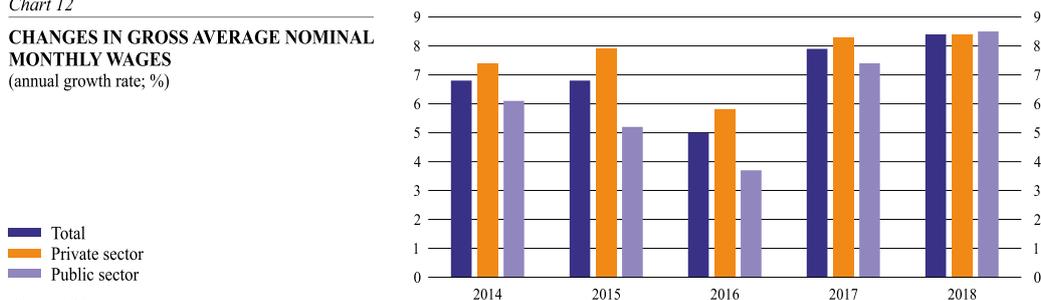
Both participation and employment rates reached their historical highs. A growing number of formerly economically inactive persons joined the labour market and the number of previously discouraged persons declined. The number of long-term unemployed returning to the labour market also increased. In 2018, economically inactive population could still be used as a good source of labour, yet this pool is drying out quickly and, given the negative demographic trends and negative net migration, the supply of labour for the coming years remains limited. A growing number of businesses mention labour shortages as a major business obstacle; however, this perception was much stronger in the pre-crisis period, in 2007 and 2008.

Wages increased across all sectors

The overall rise in wages was supported by productivity gains and growing labour demand, the raising of the minimum wage and commitment to increase wages in individual sectors (healthcare, education). The gross average wage grew by 8.4% in 2018, rising above the 1000 euro mark. Wages increased in both private and public sector (see Chart 12). An improvement was seen in all economic sectors, yet it was the most notable in sectors starting from a lower level.

Chart 12

CHANGES IN GROSS AVERAGE NOMINAL MONTHLY WAGES
(annual growth rate; %)



Source: CSB.

Looking at the developments in Latvia's labour market, it is obvious that significant regional disparities still persist despite all efforts to kick-start the labour market and boost the overall economic development in the peripheral regions. For example, the average wage in Latgale roughly amounts to merely 60% of the average wage in Riga, whereas unemployment within this region is more than 3.5 times higher than in Riga. Regional disparities like that point to the presence of structural unemployment in Latvia despite the generally observed positive labour market developments.

The growth of wages over the most recent years outpaced productivity gains on account of gradual income convergence with the EU average, with wages growing in line with productivity in the tradable sector and outstripping productivity in the non-tradable sector. Although the wage-productivity gap remained unchanged in 2018, in the circumstances of decelerating economic growth sustainability of competitiveness remains a source of uncertainty. Despite the expected moderation of wage growth, the tightening of the labour

market in combination with the negative demographic trends underscores the growing importance of achieving higher productivity in the context of economic development.

INFLATION

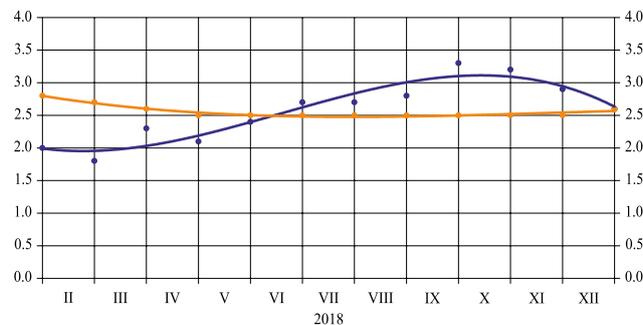
Inflation developments were primarily driven by oil prices

Consumer price inflation (HICP) was 2.6% in 2018, representing a minor fall in comparison with the previous year (see Chart 13). The prices of food products increased comparatively less as a result of the shrinking global prices of various food commodities (milk, sugar and coffee) as well as the introduction of a reduced VAT rate on fruit and vegetables typical of Latvia. Energy prices rose more substantially on account of oil prices that exceeded the levels of the respective period of the previous year during the first eleven months of 2018. Solid economic growth led to a slightly stronger upward effect of domestic demand on inflation.

Chart 13

HICP DYNAMICS (%)

— HICP (year-on-year)
— 12-month moving average HICP



Source: CSB.

Up to mid-October, oil prices and also consumer price inflation followed an upward trend. During the last two months of the year, however, oil prices reversed and dropped one third. This was underpinned by several factors: a record-high oil production output in the US, weakening demand for oil as well as a significantly lower-than-expected downward impact of the US sanctions against Iran on the oil supply. As a result, after a several months' break the market was again dominated by concerns over excessive supply. To ease the concerns, in December the OPEC agreed on slightly larger oil production cuts than expected by market analysts. The plunge in oil prices was relatively quickly reflected in fuel prices. At the same time, the heating prices in various Latvian cities most likely will continue to grow in the coming months, reflecting the previous hikes of oil prices with a lag.

The hot and dry summer in Europe caused the global wheat harvest fall to the lowest level of the last five years. As a consequence, the prices of wheat and also bakers' wares moderately increased. Moreover, because of the weather conditions, electricity output generated within the Baltic region also decreased, driving up the Nord Pool power prices. This will have an effect on consumer price inflation mostly in 2019.

A close to 3% inflation rate is currently adequate for Latvia

Latvia's consumer prices have been rising at a rate exceeding the EU average for the second consecutive year. First and foremost, it is a side-effect of solid income growth. There is a close positive correlation between the income and price levels in a country. Consequently, the EU countries enjoying more substantial income growth are also experiencing higher inflation.

Second, a minor upward effect on inflation also stemmed from Latvia being in the expansion phase of the business cycle. Currently, Latvia's economic growth is slightly

above potential. Other euro area countries with economic growth close to or even marginally above potential also have a slightly higher inflation rate than the countries where growth is considerably below potential.

Third, the difference in inflation rates across countries can be partly explained by the country-specific features of the consumption basket. Latvia's consumption basket contains a relatively large proportion of energy-related goods; therefore, higher oil prices may have a relatively stronger effect on inflation in Latvia in comparison with some other EU countries. Moreover, the consumption basket also contains a rather significant proportion of excise goods whose tax rates are regularly raised, such as fuel and alcoholic beverages.

The projected annual inflation rate which is close to 3% in the medium-term should be viewed as a sign that Latvia's economy is developing soundly and it reflects sustainable income convergence with other EU countries and the current expansion phase of the business cycle.

BALANCE OF PAYMENTS AND EXTERNAL DEBT

Robust domestic demand in combination with a weakening external demand resulted in a moderate current account deficit

Despite the high level of uncertainty in the external environment, strong and sustained export growth helped to achieve a current account surplus in the first half of 2018. The second half of the year, however, saw considerably higher imports as well as weakening external demand and exports; therefore, the current account turned negative. In 2018 overall, the current account deficit totalled 283 million euro or 1.0% of GDP.

The deficit of the balance of goods at 8.7% of GDP reflected the gradual deterioration of the external demand and the strength of the domestic demand. Exports of goods increased significantly in the first half of the year. Nevertheless, looking at the year overall, the growth rate was lower (4.7%). At the beginning of the year, significant contributors to the overall export growth were the exports of wood (on account of both higher prices and demand) and machinery (partly as a result of re-export flows). Exports of beverages, mineral products, cereals as well as several less significant commodity groups shrank considerably in the second half of the year. At the same time, underpinned by high investment activity and robust consumption, import growth of 5.9% outpaced that of the exports. Despite the unusually strong import growth in the third quarter associated with the imports of natural gas and the global oil price hikes, the overall annual growth of imports was also weaker than in 2017.

Exports of services decelerated slightly, to 6.4%. Lower income from financial services on account of significantly shrinking foreign customer deposits in Latvia had a downward effect. Exports of information and communication services continued to expand, at the same time sustaining a high level of imports within this particular group of services. The growth rate of services imports remained high at 9.8%. Nevertheless, imports constitute only half of the services exports in absolute terms, including those of information and communication services. As a result, the surplus of services remained solid also in 2018 (8.1% of GDP).

The year 2018 saw record-high inflows of EU funding into the balance of payments (1135 million euro). 45% of those were the EU structural funds related inflows into the capital account which supported an impressive growth of investment. The bulk of the remaining EU funding inflows were attributable to rural development and farmer support.

Following two years of a minor current account surplus, the deficit of 2018 points to the strength of the domestic demand. In Latvia's case, taking into account the low level

of savings and investment needs, a moderate current account deficit is considered to be consistent with economic growth. Towards the end of the year, however, against the background of rising external risks and weakening external demand the role of sustainable competitiveness in achieving balanced growth became increasingly more significant.

The rate of decrease in foreign liabilities was higher than that in assets; therefore, Latvia's net external debt to GDP decreased

Cross-border financial flows recorded in the financial account of the balance of payments in 2018 show that Latvia's foreign assets decreased less than its foreign liabilities (by 1.9 billion euro and 2.5 billion euro respectively). This resulted in a net outflow of financing from Latvia. In the circumstances of shrinking debt-related foreign liabilities, Latvia's gross external debt contracted to 121.0% of GDP in 2018. With foreign assets decreasing less than the respective liabilities, net external debt also declined to 22.7% of GDP.

The largest financial flows were observed in the credit institution sector, where both external liabilities and, to a lesser extent, external assets contracted. Significant, albeit smaller flows, were recorded in the central bank assets and government sector liabilities which both increased. Benefiting from the low interest rate environment supported by the accommodative monetary policy implemented in the euro area, the government launched long-term bonds on the external market, yet the overall shrinking of the foreign liabilities was primarily driven by the decreasing foreign customer deposits with credit institutions. Deposit disbursements were largely covered by the proceeds from credit institution asset disposal abroad. The disposals exceeded the increase in other sector assets and resulted in an overall decrease in foreign assets. Latvijas Banka's foreign assets expanded, with the central bank continuing to participate in the expanded asset purchase programme within the framework of the Eurosystem's monetary policy and reserve assets abroad also growing. Insurance corporations and pension funds also increased their investment portfolio abroad.

Inflow of foreign direct investment was close to its historical average, reaching 2.5% of GDP. In terms of volume, the largest flows were recorded in the second half of the year in trade, real estate and financial sectors. Nevertheless, manufacturing also experienced a notable surge in foreign investment in 2018. Looking by country, the largest investment inflows were received from Estonia, Sweden, Luxembourg, the Netherlands and Russia.

FISCAL POLICY

An expansionary fiscal policy was still implemented, with the ratio of the structural budget balance to GDP deteriorating

Latvia's general government budget deficit stood at 1.0% of GDP in 2018, compared with 0.6% of GDP in 2017. Robust tax revenue growth could not offset the increase in expenditure caused by an active implementation of EU funds co-financed projects and allocation of additional funding to defence and health care sectors.

In 2018, an increase was reported for all major expenditure items of the consolidated general government budget (except the expenditure for interest payments for debt servicing). The largest rise in government spending was recorded for items reflecting implementation of EU funds co-financed projects (subsidies and grants, government investment). Local government spending on the implementation of EU co-financed projects and projects implemented by higher education institutions which also were EU co-financed constituted a significant part of the increase. Budget expenditure on compensation of employees and that on goods and services reflecting government consumption dynamics grew significantly. This was due to the allocation of additional

funding to defence, targeting to reach 2% of GDP, and for health care. Government consumption growth is expected to moderate in the coming years in view of the limited financing for the implementation of new policies.

The economic growth in 2018 was also reflected in tax revenue. Both the favourable economic situation that was a driver of household income and accordingly consumption and improvements in tax collections provided for a positive contribution to tax revenue growth. However, within the framework of the tax reform, certain changes negatively affecting tax revenue also took effect as of 2018. The most visible change was related to the corporate income tax as, starting from the middle of the year, enterprises no longer had to pay monthly CIT advance payments, but had to pay tax on dividend payments received. Tax revenue was also adversely affected by changes related to PIT as the non-taxable minimum and tax relief for dependent persons were raised as well as the progressive personal income tax was introduced. Nevertheless, in many cases, the economic growth could offset the negative effects of changes in taxation. Overall, an increase in revenue was reported for almost all major types of taxes (PIT, VAT, state compulsory social security contributions and excise tax), except CIT. Revenue from PIT, VAT, state compulsory social security contributions and excise tax rose by 2.1%, 12.3%, 12.7% and 13.5% respectively in comparison with 2017. It was these taxes that were the main contributors to the rise in tax revenue.

In preparation for the redemption of part of the debt planned for 2019, while ensuring financing resources to cover current needs, the Treasury issued eurobonds in the amount of 1 billion euro in 2018. The government debt ratio declined somewhat both in nominal terms and vis-à-vis GDP (to 35.9% compared with 40.0% of GDP in 2017).

Latvia's budgetary plan for 2019 foresees a general government budget deficit of 0.5% of GDP. Considering that Latvia's economic growth rate still exceeds its potential, the government should reduce the structural deficit aiming at a balanced budget in structural terms. To this end, Latvia's government should plan the nominal general government balance with a surplus.

OPERATIONS AND ACTIVITIES OF LATVIJAS BANKA



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

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

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

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

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

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

In 2018, Governor of Latvijas Banka and Zoja Razmusa, Deputy Governor of Latvijas Banka, as authorised by Governor of Latvijas Banka, participated in the work of the Governing Council and the General Council of the ECB, namely, in the formulation of the Eurosystem's monetary policy and decision-making related to the tasks of the Eurosystem and the ESCB. The monetary policy meeting of the Governing Council of the ECB was held in Riga, at Latvijas Banka, on 13 and 14 June 2018.

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

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

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

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

In 2018, Latvijas Banka participated in the work of the ESRB which made decisions on the issues related to the EU macroprudential policy. Representatives of Latvijas Banka engaged in the work of the Advisory Technical Committee of the ESRB and its working groups.

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

MONETARY POLICY IMPLEMENTATION IN LATVIA

In 2018, implementing the Eurosystem's monetary policy, Latvijas Banka participated in the PSPP by purchasing debt securities of the Latvian government or in case their purchase was limited by the purchase limits under the PSPP or the market situation, Latvijas Banka purchased securities issued by international institutions. As excess liquidity continued to accumulate in euro area banks, a large amount of free liquidity accumulated also in Latvian credit institutions' settlement accounts opened with Latvijas Banka thus dampening the credit institutions' interest in borrowing financial resources via Eurosystem monetary policy operations.

Over the year, Latvijas Banka's balance sheet item "Securities held for monetary policy purposes" grew from 6.7 billion euro to 7.4 billion euro (the average monthly purchase value of securities stood at 59 million euro; 192 million euro in 2017). Overall, the Eurosystem's holding of the Latvian government securities totalled 2.1 billion euro at the end of 2018¹ (1.7 billion euro at the end of 2017). The average remaining maturity of the purchased Latvian government securities was 8.74 years at the end of 2018 (7.60 years at the end of 2017). The amount of the purchases of government securities carried out by Latvijas Banka decreased on account of a decline in the amount of the securities purchased under the PSPP (the monthly pace of the net asset purchases was reduced to 30 billion euro as from January 2018 and to 15 billion euro as from October 2018; at the end of December, net asset purchases were discontinued). In 2018, Latvijas Banka reduced the amount of the purchases of government securities and that of the securities issued by international institutions by approximately one fourth and three fourths respectively year-on-year. Most securities sold to Latvijas Banka still came from foreign credit institutions.

Following the record high of 5.0 billion euro in December 2017, excess liquidity in Latvian credit institutions declined to an average of 4.4 billion euro in December 2018. As a result of the cancellation of the ABLV Bank, AS credit institution's licence as well as the outflows of foreign customer deposits, several credit institutions' need to hold additional funds with Latvijas Banka declined. The minimum reserve requirements for

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

credit institutions shrank from 212 million euro at the end of 2017 to 156 million euro at the end of 2018. The ratio of balance on credit institutions' settlement accounts to the minimum reserve requirements rose from 27 at the end of 2017 to 32 at the end of 2018. At the same time, the euro area average remained unchanged at 10. At the end of 2018, the ratios of Lithuania (27), Estonia (26) and Finland (22) were the closest to that of Latvia.

Several credit institutions made early repayments of funds borrowed via TLTROs; thus, their average outstanding amount contracted from 244.7 million euro in 2017 to 119.6 million euro in 2018. The average outstanding amount of the longer-term refinancing operations with a 3-month maturity rose from 1.8 million euro to 18.2 million euro, while the average outstanding amount of the main refinancing operations increased from 0.5 million euro to 4.6 million euro.

ECONOMIC RESEARCH, ANALYSIS AND FORECASTING

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

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

Daily analytical work is no less important than forecasting and, in cooperation with other euro area central banks, it is conducted within the Eurosystem/ESCB Monetary Policy Committee and its three Working Groups on Econometric Modelling, on Forecasting and on Public Finance, wherein substantiated discussions form the basis for the Eurosystem's monetary policy decisions. The joint work of the researchers of Latvijas Banka and other central banks of the Eurosystem/ESCB was reflected in three publications of the ECB Working Paper Series and several publications of the ECB Occasional Paper Series, co-authored by Latvijas Banka's experts.

In 2018, Latvijas Banka proceeded with research activities in three priority directions: 1) monetary policy transmission, 2) fiscal policy and public debt sustainability and 3) long-term growth and competitiveness.

In 2018, Latvijas Banka published five working papers and one discussion paper on its website (see Appendix 8).

Working Paper No. 1/2018 was prepared in 2017 with the objective to investigate the importance of EU regional support programmes for firm performance. The results of the Working Paper show that participation in the projects co-funded by the European Reconstruction and Development Fund boosts business investment and production output soon after their initiation. Meanwhile, the impact on productivity and labour productivity can only be observed three years later. However, since the positive productivity premium differs in various businesses, it will most likely first materialise in less productive businesses as well as in medium-sized and large businesses.

Working Paper No. 2/2018 proposes an estimation method of the natural rate of interest enabling the estimation of the natural rate of interest by using information from nominal yields data, based on the shadow rate term structure model. The results show that the

euro area natural rate of interest has followed a downward trend until 2013, whereafter the trend was no longer observed.

The goal of Working Paper No. 3/2018 was to investigate the effect of export entry on the productivity, employment and wages of Latvian and Estonian businesses. Like in many countries, exporting businesses in Latvia and Estonia are more capital-intensive, more productive and larger than non-exporting businesses; moreover, they pay higher wages to their employees.

Although this is due in part to the fact that more productive and better-performing businesses are initially in a better position to start exporting, labour productivity in Latvian and Estonian firms increases by more than 23% and 14% respectively following their involvement in exports. The commencement of exports boosts employment and average wages. Gains are particularly large when businesses engage in export areas associated with knowledge-intensive activities in the initial stages of the global pricing chain.

Working Paper No. 4/2018 analyses the international spillovers of a euro area monetary policy shock, focusing on countries from Central, Eastern and Southeastern Europe. The results of the above Working Paper show that in response to the tightening of the euro area monetary policy before the 2008 crisis, prices in most euro area countries and other countries of Central, Eastern and Southeastern Europe decreased, and economic growth slowed down; however, the degree of heterogeneity was significant.

Working Paper No. 5/2018 aims at analysing the effectiveness of fiscal rules. The results show that fiscal rules, even if they are not always complied with, can be effective in lowering fiscal policy uncertainty and hence contribute to less volatile GDP growth rate. However, this effect only holds for rules which are designed to be unaffected by the current state of the business cycle.

Discussion Paper No. 1/2018 presents an overview of the main results of the Household Finance and Consumption Survey conducted in Latvia in 2014. Unique data on household financial situation, including their assets and liabilities, as well as income and consumption were gathered within the survey. The results show that households in Latvia, in comparison with those in the euro area, have much higher ownership rates of the most important household asset – the main residence. However, the median value of this asset and of total assets is markedly lower than in the euro area. Taking all components of a household balance sheet together, the median net wealth of households in Latvia is more than seven times smaller than that of euro area households.

Quality research activities are impossible without continuous improvement of staff qualifications and thorough assessment of the results achieved. External reviewers from national central banks and academia of other countries are involved in assessing working papers to ensure their high quality. The publication of employees' working papers in internationally refereed journals is also supported. Four such working papers were published in 2018. For instance, the *Journal of Productivity Analysis* (Springer) published an article analysing production fragmentation and productivity of Latvia's businesses, while the *IZA Journal of Labor Policy* (Springer) published an article examining the ways Eastern European firms adjust to a rise in the minimum wage.

Presentation of papers by Latvijas Banka's researchers at international conferences and seminars is enhanced to raise researchers' qualifications and promote research work. In 2018, papers by Latvijas Banka's researchers were presented at more than 20 conferences and seminars – the academic ones and those organised by Eurosystem/ESCB institutions. Publications in working paper series of other institutions also reflect international cooperation of researchers. In 2018, researchers of Latvijas Banka co-authored publications in working paper series of the OECD, the Swiss Economic Institute (KOF, Zurich) and Česká národní banka.

With a similar aim, Latvijas Banka also organises regular seminars to which highly qualified experts are invited to present their research results. To improve qualifications of Latvijas Banka's staff, 10 seminars were held in 2018; interested parties from other institutions were also invited to participate in the above events.¹

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

INVESTMENT MANAGEMENT

Foreign reserves of gold and foreign currencies as well as other financial investment of Latvijas Banka amounted to 5.7 billion euro at the end of 2018 (as was the case at the end of 2017).

Latvijas Banka manages its investment in compliance with the guidelines adopted by the Council of Latvijas Banka. The major share of Latvijas Banka's financial assets was managed relative to the weighted index of 1–10 year government securities of the US, euro area countries, Canada and the UK. The benchmark currency is the euro, and the benchmark assets are composed of 55% US dollar-denominated, 21% euro-denominated, 14% British pound sterling-denominated and 10% Canadian dollar-denominated assets. In the second half of 2018, the risk of interest rates on financial assets of Latvijas Banka was mitigated by shortening maturities of US and Canadian government securities indices from 1–10 years to 1–3 years. Latvijas Banka invests its financial assets in safe and liquid financial instruments, basically in debt securities issued by the governments of EU countries and the US government, their agencies and international organisations as well as in highly rated bank and corporate debt securities and asset-backed debt securities. Interest rate futures are used to regulate the duration and to implement yield curve strategies on the interest rate market, whereas both currency futures and forward exchange rate contracts ensure the optimal currency composition of financial assets.

When managing investment, interest rate dynamics of 2, 5 and 10-year bonds was assessed. The year 2018 saw the weighted average interest rate on the German 2-year government bonds increase from –0.63% to –0.61% and the weighted average interest rate on the 5 and 10-year government bonds decrease from –0.20% to –0.31% and from 0.43% to 0.24% respectively. The weighted average interest rate on the UK 2, 5 and 10-year government bonds picked up from 0.44% to 0.75%, from 0.72% to 0.90% and from 1.19% to 1.28% respectively, while the US experienced a rise in the above interest rate from 1.88% to 2.49%, from 2.21% to 2.51% and from 2.41% to 2.68% respectively. Meanwhile, the weighted average interest rate on the Canadian 2 and 5-year government bonds climbed from 1.69% to 1.86% and from 1.87% to 1.89% respectively, but the weighted average interest rate on 10-year government bonds shrank from 2.05% to 1.97%. With historically very low interest rates persisting, it is complicated for a national central bank as conservative investor with modest risk appetite to generate positive yields in the respective business cycle in the short term.

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

Latvijas Banka uses the services provided by eight external managers. They manage a portion of Latvijas Banka's financial assets in compliance with the guidelines adopted by the Council of Latvijas Banka to further diversify financial assets and boost income in proportion to the undertaken risk over the medium and longer term. In the light of that objective, a new external manager, which had started to invest in the securities included in the stock market indices of advanced economies, was selected in 2018.

¹ More detailed information on the research seminars is available in the Research section at macroeconomics.lv.

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

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

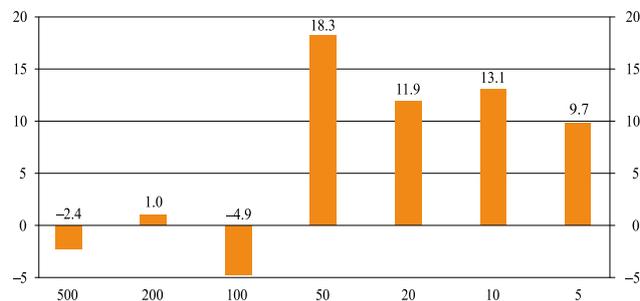
CURRENCY IN CIRCULATION

The net issuance of euro banknotes by Latvijas Banka continued on a downward trend in 2018, i.e. from –3.9 million euro in 2017 to –132.6 million euro in 2018. This was because the amount of 100 euro and 500 euro banknotes deposited with Latvijas Banka exceeded the amount of the above banknotes withdrawn from Latvijas Banka. Meanwhile, the net issuance of euro coins by Latvijas Banka picked up from 67.1 million euro in 2017 to 73.5 million euro in 2018. Thus, the net issuance of euro banknotes and coins by Latvijas Banka was –59.1 million euro in 2018.

The net issuance of banknotes by Latvijas Banka in terms of number grew by 7.1% (to 46.7 million banknotes) during 2018. It is the net issuance of 50 euro and 10 euro banknotes by Latvijas Banka that predominated over other denominations in the period lasting from the euro changeover day on 1 January 2014 until the end of 2018 (18.3 million and 13.1 million banknotes respectively; see Chart 14).

Chart 14

EURO BANKNOTES ISSUED BY LATVIJAS BANKA IN NET TERMS
(2014–2018; face value; number in millions)

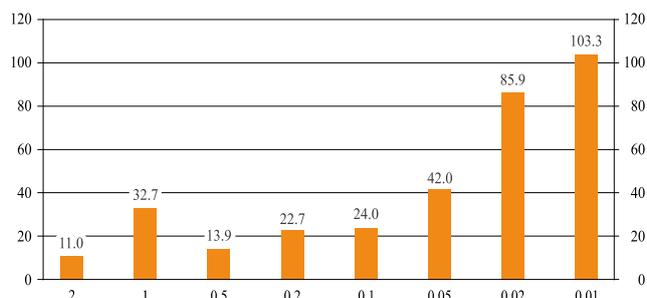


Source: Latvijas Banka.

Meanwhile, the net issuance of coins by Latvijas Banka in terms of number augmented by 13.7% (to 335.6 million coins) during 2018. It is the 1 cent and 2 cent coins that accounted for a major portion of the net issuance of coins by Latvijas Banka during the period starting from the euro changeover day on 1 January 2014 and ending in late 2018 (103.3 million and 85.9 million coins respectively; see Chart 15).

Chart 15

EURO COINS ISSUED BY LATVIJAS BANKA IN NET TERMS
(2014–2018; face value; number in millions)



Source: Latvijas Banka.

The cash received from credit institutions was checked for fitness and authenticity by automated cash processing systems of Latvijas Banka. They processed 144.0 million banknotes in 2018. 12.0% (17.3 million) of the processed banknotes were identified as unfit for circulation and destroyed.

2 EURO COMMEMORATIVE COINS



CENTENARY OF THE BALTIC STATES

Struck in 2018 by UAB Lietuvos monetų kalykla (Lithuania)

The national side artist Justas Petrulevičius (graphic design)
The national side features a symbolic plait in which the fates of the three Baltic sisters intertwine.



ZEMGALE

Struck in 2018 by Staatliche Münzen Baden-Württemberg (Germany)

The national side artists: Laimonis Šēnbergs (graphic design) and Jānis Strupulis (plaster model)
The national side features the coat of arms of Zemgale.

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

COLLECTOR COINS

MY LATVIA

Face value: 5 euro
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness; quality: proof; with three-colour print on the reverse

Struck in 2018 by Koninklijke Nederlandse Munt (The Netherlands)
Artists: Sandra Krastiņa (graphic design) and Jānis Strupulis (plaster model). The reverse was designed using the drawing by Elizabete Kandere.



HONEY COIN

Face value: 5 euro
Weight: 16.50 g; shape: hexagon with wavy edges and split off vertices; the long diagonal – 29.00 mm
Metal: silver of .925 fineness, gold plated (.995), quality: proof

Struck in 2018 by UAB Lietuvos monetų kalykla (Lithuania)
Artist: Artūrs Anals (graphic design)

THE GARDEN OF DESTINY

Face value: 5 euro
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness; quality: proof; with two-colour print on the obverse

Struck in 2018 by Koninklijke Nederlandse Munt (The Netherlands)
Artists: Francēska Kirke (graphic design) and Līgita Franckeviča (plaster model)



CURONIAN KINGS

Face value: 5 euro
 Weight: 22.00 g; diameter: 35.00 mm
 Metal: silver of .925 fineness; quality: proof
 Struck in 2018 by UAB Lietuvos monetų kalykla (Lithuania)
 Artists: Arvīds Priedīte (graphic design) and Līgita Franckeviča (plaster model).



COATS OF ARMS COIN

Face value: 5 euro
 Weight: 31.47 g; diameter: 38.61 mm
 Metal: silver of .925 fineness; quality: proof; with two-colour print on the obverse
 Struck in 2018 by UAB Lietuvos monetų kalykla (Lithuania)
 Artists: Laimonis Šēnbergs (graphic design) and Jānis Strupulis (plaster model)



GOLD BROOCHES. THE BUBBLE FIBULA

Face value: 75 euro
 Weight: 13.00 g; diameter: 22.00 mm
 Metal: 999.9° gold; quality: proof; with five round transparent Swarovski crystals
 Struck in 2018 by Münze Österreich Aktiengesellschaft (Austria)
 Artists: Ingūna Elere (graphic design) and Jānis Strupulis (plaster model)

In 2018, Latvijas Banka continued to register merchants engaged in handling and recirculating of euro banknotes and coins and to monitor their operation. A merchant is entitled to handle and recirculate euro banknotes and coins in the Republic of Latvia upon registering with Latvijas Banka as a cash handling institution. At the end of 2018, 57 cash processing institutions were registered in Latvia. Latvijas Banka conducted inspections of cash handlers and assessed the compliance of their operation with the requirements of laws and regulations governing cash handling.

In 2018, the National Analysis Centre and the Coin National Analysis Centre received and identified 1337 euro counterfeits (1103 banknotes and 234 coins). In 2017, 1749 banknotes and coins were found to be counterfeits, including 1462 banknotes and 287 coins.

The total nominal value of counterfeits (64.4 thousand euro) detected in 2018 decreased year-on-year, but the number of received counterfeits fell by 412. The 50 euro, 20 euro and 100 euro notes were the most counterfeited banknotes.

In 2018, withdrawal of lats banknotes and coins from circulation continued. In 2018, the lats banknotes and coins received from circulation by Latvijas Banka totalled 1.7 million lats; 1.6 million lats were in banknotes and 0.1 million lats in coins. Lats banknotes and coins worth 43.3 million lats and 44.2 million lats respectively were in circulation at the end of 2018. In late December 2018, the 5 lats and 20 lats banknotes (1.7 million and 0.8 million respectively) and the 1 santim and 2 santim coins (150.0 million and 90.0 million respectively) accounted for the majority of banknotes and coins in circulation in terms of number.

In 2018, to mark anniversaries significant to Latvian history and culture, including Latvia's centenary and other events, Latvijas Banka put into circulation collector coins "My Latvia" (issued on 9 March 2018), "Honey Coin" (issued on 22 May 2018), "The

Garden of Destiny" (issued on 22 June 2018), "Curonian Kings" (issued on 17 August 2018), "Coats of Arms Coin" (issued on 22 October 2018) and "Gold Brooches. The Bubble Fibula" (issued on 8 November 2018).

In the year 2018, Latvijas Banka issued 2 euro commemorative coins "Centenary of the Baltic States" (in circulation as of 31 January 2018) and "Zemgale" (in circulation as of 26 September 2018).

In 2018, the silver collector coin "National Entrepreneur" issued by Latvijas Banka in 2016 was announced the winner in the category "Most Artistic Coin" at the contest Coin of the Year organised by Krause Publications, the US numismatics publishing house, and its magazine World Coin News. Collector coins of Latvijas Banka also received recognition at the international Coin Constellation Contest organised by Watermark, Russian Numismatic Publishing House. The coins issued in 2017 were assessed at the above contest. The silver collector coin "Fairy Tale Coin III. The Old Man's Mitten" was awarded the third place in the category "Successful Artistic Solution".

PAYMENT AND SETTLEMENT SYSTEMS

OPERATION OF TARGET2-LATVIJA AND TARGET2-SECURITIES

In 2018, Latvijas Banka continued to maintain TARGET2-Latvija – one of the 25 TARGET2 component systems. TARGET2, operated by the Eurosystem, is one of the largest payment systems in the world. It provides real-time gross settlement in euro to support the implementation of the Eurosystem's monetary policy operations and interbank market transactions, the enforcement of customers' urgent payments and interbank settlement of other payments, securities settlement and financial instrument clearing systems.

In response to global trends in the field of payments as well as the growing demand for quick and secure payments 24/7, Latvijas Banka together with other Eurosystem central banks introduced the TARGET Instant Payment Settlement (TIPS) service on 30 November 2018. European banks are expected to start using the new TARGET2 service more actively in 2019. Latvijas Banka introduced customer instant payments in euro in Latvia already in August 2017 as it started providing the operation of the EKS instant payment service.

In 2018, Latvijas Banka together with other members of the Eurosystem continued to implement the Eurosystem's strategic project, i.e. the consolidation of TARGET2 and TARGET2-Securities. T2 services, a new real-time settlement system, will be developed under the above project by employing the modern technologies of the TARGET2-Securities platform. On 22 November 2021, it will replace TARGET2 and, along with the TARGET2-Securities platform and the TIPS service, will become part of TARGET services. The new TARGET services will provide a single connection to the Eurosystem's market infrastructure. T2 services will provide an opportunity to optimise credit institutions' liquidity management as well as execute real-time settlement by using more sophisticated infrastructure; moreover, the cybersecurity of all infrastructures will be enhanced.

The availability of TARGET2, including TARGET2-Latvija, accounted for 99.98% in 2018. TARGET2-Latvija processed 507.1 thousand payments totalling 199.5 billion euro in 2018 (see Table 2), i.e. on average 2.0 thousand payments totalling 782.4 million euro per day.

The total volume of payments increased by 5.7%, while their total value decreased by 17.0% year-on-year. The first and last months of the year saw the highest payment volume executed in TARGET2-Latvija (see Chart 16).

Table 2

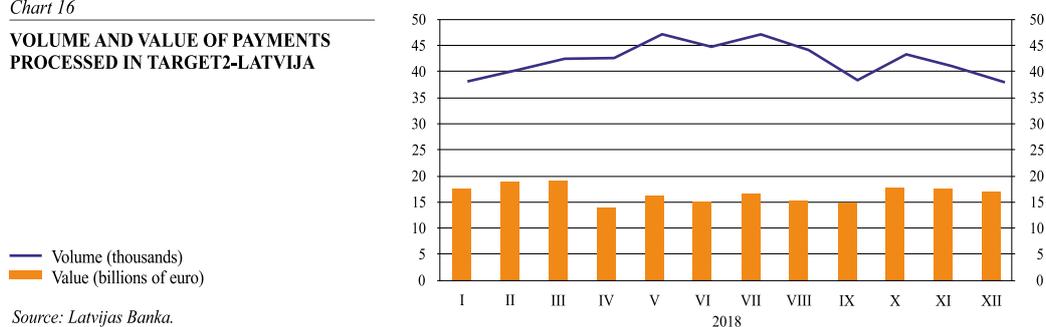
PAYMENTS PROCESSED IN TARGET2-LATVIJA

	Volume (thousands)			Value (billions of euro)		
	Interbank payments	Customer payments		Interbank payments	Customer payments	
2018	127.0	380.1	507.1	178.4	21.1	199.5
2017	115.2	364.6	479.8	216.8	23.6	240.4
2016	89.8	339.4	429.2	209.7	25.4	235.1
2015	68.3	290.8	359.1	243.6	21.1	264.7
2014	75.1	281.2	356.3	326.9	16.1	343.0

Source: Latvijas Banka.

Chart 16

VOLUME AND VALUE OF PAYMENTS PROCESSED IN TARGET2-LATVIJA



Source: Latvijas Banka.

At the end of 2018, 18 credit institutions, the Treasury and Latvijas Banka were the participants of TARGET2-Latvija. TARGET2-Latvija also ensured the final settlement in euro on the participants' settlement accounts opened in TARGET2-Latvija for the EKS and the payment card processing system of Worldline Latvia Ltd.

OPERATION OF THE ELECTRONIC CLEARING SYSTEM, MAINTAINED BY LATVIJAS BANKA, INSTANT PAYMENTS AND OTHER PAYMENT SERVICES

The EKS instant payment service introduced by Latvijas Banka in August 2017 continued ensuring that Latvia's credit institutions and Latvijas Banka are able send and receive customer instant payments within a matter of seconds 24/7, including weekends and holidays. Moreover, the EKS instant payment service ensured broad reachability of EKS participants across Europe (2.3 thousand banks and other reachable payment service providers) via RT1 which is managed by EBA CLEARING and serves as a connection to the pan-European instant payment solution.



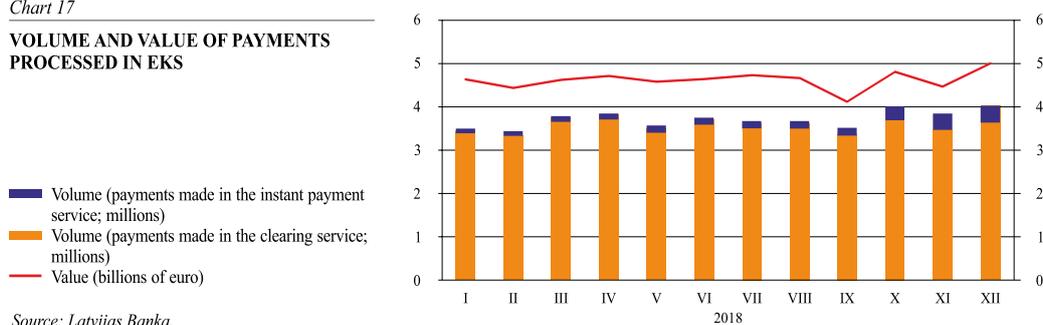
In 2018, Latvijas Banka's instant payment service, whose availability stood at 99.98%, processed 2.4 million instant payments totalling 494.3 million euro, with approximately 20 thousand instant payments processed on certain days at the end of the year. At the end of 2018, over 90% of the Latvian credit institutions' customers already had access to instant payments. With new EKS participants connecting to the instant payment service and other instant payment solutions available in Europe, more and more people in Latvia will be able to use the benefits of the innovative instant payment service.

The clearing service, the second EKS service maintained by Latvijas Banka, continued to ensure customer payments in euro within SEPA for Latvian credit institutions and the Treasury. Latvijas Banka carried out fully automated processing of SEPA credit transfers in the EKS clearing service, providing settlement seven times a day within TARGET2-Latvija on the participants' settlement accounts opened with Latvijas Banka. The EKS clearing service ensured payments from one customer account held with a credit institution to a customer account of another credit institution within a few hours on business days. The availability of the EKS clearing service accounted for 100% in 2018. The average volume and value of the customer SEPA credit transfers processed by the EKS clearing service on a daily basis was 165.8 thousand and 215.8 million euro respectively.

In 2018, 44.7 million SEPA credit transfers totalling 55.5 billion euro were executed in the EKS (in the instant payment service and the clearing service combined). The volume and value of the payments processed in the EKS increased by 6.3% and declined by 0.9% respectively year-on-year. As previously, the year-end saw the highest volume of payments processed in the EKS (4.0 million payments, including 390.0 thousand instant payments, in December; see Chart 17).

Chart 17

VOLUME AND VALUE OF PAYMENTS PROCESSED IN EKS



Source: Latvijas Banka.

At the end of 2018, the EKS clearing service comprised the following direct participants: 13 credit institutions, the Treasury and Latvijas Banka, as well as two indirect participants.

Latvijas Banka also ensured the execution of SEPA credit transfers to its customers, i.e. the financial institutions whose settlement accounts were opened with Latvijas Banka, but which were not direct participants of Latvijas Banka's payment systems, including credit unions. Thus, a possibility to make and receive payments in euro throughout the SEPA area was ensured by executing SEPA credit transfers in the EKS. For other Latvijas Banka's customers which had not migrated to the SEPA Credit Transfer Scheme Latvijas Banka ensured access to SEPA by submitting credit transfers on their behalf. In 2018, Latvijas Banka provided payment services in euro to the FCMC and other Latvian, foreign and international financial institutions, processing payments in the amount of 2.7 billion euro (1.2 billion euro in 2017).

OVERSIGHT OF PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

In 2018, Latvijas Banka participated in the joint oversight of the payment and securities settlement organised by the Eurosystem, thus enhancing the development of efficient and secure payment systems in the EU.

In 2018, Latvijas Banka together with other central banks of the Eurosystem and in cooperation with other institutions carried out the oversight of the TARGET2-Securities platform, in particular, by participating in the comprehensive assessment of the compliance of the TARGET2-Securities platform with the international Principles for financial market infrastructures (hereinafter, the PFMI), preparing draft assessment reports on its management and liquidity risk to verify that the TARGET2-Securities platform is fully compliant with the PFMI.

In May 2018, Latvijas Banka, with the support of the FCMC, organised a workshop on the implementation of the requirements of the Payment Services Directive¹ and the respective regulatory technical standards stipulated by the above directive for credit institutions and other payment service providers, consultants and technology providers. Regulatory technical standards on secure communication and strong user authentication will improve consumer protection and payment services security and will encourage competition and innovation in the field of payments. In 2018, Latvijas Banka continued to take part in the Eurosystem's consultations and discussions by participating in the creation of a secure and harmonised payment market in Europe and by representing the interests of Latvia's payment market.

Despite the fact that negative trends prevailed in the cryptocurrency market in 2018, the Latvian public remained focused on this sector. In early 2018, both the EC and the ECB reminded the public that cryptocurrencies do not fulfil all functions of money and should be considered to be cryptoassets due to their speculative nature. Latvijas Banka continued to follow the cryptoasset market developments and raised public awareness on the nature and risks of cryptoassets. With the support of the FCMC and the State Revenue Service, Latvijas Banka organised the first workshop discussion on cryptoassets for public authorities. Representatives of credit institutions and other payment service providers, academics, legal advisers and representatives of the cryptoasset sector also participated in the workshop to discuss the risks and the potential of cryptoassets as well as the possibilities of their effective regulation. Latvijas Banka supported the proposal of the Prime Minister of the Republic of Latvia to establish a working group of cryptocurrency experts and actively participated in its work and the preparation of the informational report "On Benefits and Risks of Using Cryptocurrencies and Further Action to Ensure Sector Development and Reduce Identified Risks".

Latvijas Banka was one of the first institutions in Latvia suggesting that the blockchain and distributed ledger technology should not be attributed to cryptoassets, e.g. the Bitcoin, alone since the technology has a broad potential and could increase the efficiency of certain business processes, reduce the costs related to the record keeping of information and transactions of the financial sector as well as enhance the processes which involve several counterparties and could be executed more swiftly and efficiently. Latvijas Banka has already pointed out that interinstitutional information exchange and cooperation is key to more efficient development of the blockchain technology-based services in Latvia; therefore, Latvijas Banka participated in the working group established by the Ministry of Economics of the Republic of Latvia to evaluate the potential of the technology to enhance the efficiency and security of public administration services, identify obstacles and prepare proposals on measures to support the blockchain technology development.

Latvijas Banka together with other European central banks continued to participate in the project aimed at creating a payment system prototype by employing the blockchain and distributed ledger technology. Since the Eurosystem agreed that the testing scope is very broad and tends to expand even more, the project was transformed into Eurochain, a platform to facilitate central banks' cooperation in matters related to the blockchain and distributed ledger technology. Eurochain examines the possibilities of using the technology in payments, securities accounting and related processes as well as other functions of central banks. Eurochain participants take part in teleconferences every week and hackathons (creative marathon-like technology events lasting 48 hours during which topical issues are discussed and the respective technological solutions are sought, created and tested) are organised at least twice a year.

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

To promote the development of innovative settlement, Latvijas Banka continued delivering advice to payment service providers on the instant payment functionality, technical requirements as well as the opportunities instant payments can provide. To drive more widespread development and use of instant payments in Latvia, Latvijas Banka organised seminar discussions with merchants and payment card experts to identify the requirements of today's users, payment solutions and the advantages provided by instant payments to merchants and consumers. Meanwhile, to discuss changing customer behaviours and the impact of innovation on consumer protection measures, Latvijas Banka, in collaboration with the FCMC, organised a triologue seminar with the Consumer Rights Protection Centre, where the parties agreed to strengthen their cooperation in matters related to consumer education.

In 2018, Latvijas Banka, in cooperation with Eesti Pank and Lietuvos bankas, carried out the oversight of the securities settlement systems of Nasdaq CSD SE, the joint securities depository of the Baltic States, to facilitate its compliance with the best practice of operation and oversight principles. Latvijas Banka completed the monitoring of compliance with the oversight recommendations included in the PFMI assessment of Nasdaq CSD SE, making sure that all recommendations have been implemented. Thus, Nasdaq CSD SE achieved full compliance with the PFMI.

Latvijas Banka continued to coordinate the opinion of the Baltic States' overseers on the securities settlement systems maintained by Nasdaq CSD SE, with regard to cybersecurity in particular. Latvijas Banka in its capacity as overseer and the central bank of the Eurosystem's currency issue participated in the work of Nasdaq CSD SE supervisory college, established to supervise Nasdaq CSD SE as required by the regulation of the European Parliament and of the Council on central securities depositories¹. Supervisory and oversight authorities of the Baltic States take part in the supervisory college and provide their opinion on issues related to the operation of Nasdaq CSD SE securities settlement systems in Latvia.

Latvijas Banka compiled and analysed data on the development of the customer payment market in Latvia (see Table 3). The total volume of non-cash payments made by customers continued on an upward trend in 2018, increasing by 10.4% (to 487.3 million) as compared to 2017. At the same time, the total value shrank by 18.2% (to 203.0 billion euro), on account of a decrease in the cross-border foreign currency payments of customers to third countries. Card payments were the most popular non-cash payments in Latvia. Overall,

Table 3

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

	Volume (millions)				Value (billions of euro)			
	Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments		Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments	
2018	175.4	311.0	0.9	487.3	197.4	5.4	0.3	203.0
2017	167.3	271.9	2.0	441.2	242.6	5.0	0.4	248.0
2016	156.0	242.8	0.5	399.3	284.8	4.6	0.1	289.5
2015	147.1	215.2	0.1	362.5	361.6	4.2	0.0	365.9
2014	138.3	191.0	5.0	334.3	437.9	3.8	0.3	442.0

Source: Latvijas Banka.

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

311.0 million card payments in the amount of 5.4 billion euro were made in 2018. The volume and value of card payments picked up by 14.4% and 6.7% respectively year-on-year. The second most widely used non-cash payment instrument was customer credit transfers with their volume reaching 175.4 million (annual growth of 4.8%), and their value standing at 197.4 billion euro (a decrease of 18.6%) in 2018. In 2018, the value of credit transfers declined primarily on account of a decrease in the value of foreign currency payments (66.4%) driven by substantial structural changes in the financial sector as well as the risk mitigation measures and the customer base restructuring policies implemented by Latvian credit institutions. Other payment instruments, i.e. cheques, e-money payments and other payment instruments, were relatively seldom used.

FINANCIAL STABILITY

Latvijas Banka participated in the improvement of the regulatory framework to promote more responsible lending and reduce the interest payment burden related to non-bank loans. Latvijas Banka prepared a detailed proposal on the calculation of the maximum total loan costs applicable to consumers (analogous to setting a maximum Annual Percentage Rate), which was considered by the Saeima of the Republic of Latvia as part of the legislative process.

In 2018, Latvijas Banka continued its close cooperation with the Ministry of Finance of the Republic of Latvia, the FCMC and other public institutions in the prevention of money laundering and financing of terrorism. Latvijas Banka together with other public institutions participated and continues to participate in the implementation of the MONEYVAL recommendation plan which includes ensuring the risk prevention coordination, implementing a risk-based approach in supervision, strengthening preventive measures and improving the regulatory framework.

With close cooperation among the Nordic and Baltic countries continuing, in 2018 a hypothetical crisis scenario was developed within the Nordic-Baltic Cross-Border Stability Group to test the respective institutions' crisis management capability and their regional cooperation. Latvijas Banka was also actively involved in the development of the above scenario.

In 2018, within the framework of the EBA stress test, the ECB carried out the stress test of the most significant euro area banks. As part of this exercise, the ECB developed a new macroprudential stress test model with representatives of Latvijas Banka participating in its development and application.

Latvijas Banka took part in the workstream meetings of the Macroprudential Policy Working Group of the Financial Stability Committee comprising representatives of the ECB, national central banks and supervisory authorities by forging a shared approach to the analysis of cross-border effects on macroprudential instruments. So far, workstream meetings have covered the theoretical influence channels of macroprudential instruments and the EU Member States' practice regarding their impact assessment. Based on the information obtained, a uniform analysis methodology has been developed.

In 2018, a new working group was established by the Financial Stability Committee with the aim to create a broader and much more detailed analytical framework for setting the countercyclical capital buffers to support ECB decision-making by assessing the countercyclical capital buffers set by national supervisory authorities. The working group is planning to develop a methodology based on the work already done by the ECB in the field of the cyclical risk assessment and the experience of EU Member States. Latvijas Banka also participates in this working group.

CREDIT REGISTER AND PROVISION OF DATA TO ANACREDIT

Latvijas Banka continued to accumulate data on credit liabilities of and guarantees provided by natural and legal persons by collecting and storing in the Credit Register data on its participants' (credit institutions, credit institutions' subsidiaries (leasing companies), other companies having close links with credit institutions, credit unions, insurers and AS Attīstības finanšu institūcija Altum) borrowers and borrowers' guarantors, their credits and delayed payments.

The Treasury commenced its participation in the Credit Register on 1 October 2018 to submit data on its borrowers and borrowers' guarantors, which are legal persons, to the Credit Register. Thus, the amount of data on the persons' obligations included in the Credit Register has expanded significantly. Moreover, it is ensured that, for assessing the creditworthiness of a person, Credit Register participants can also obtain data on a person's obligations with respect to the Treasury, whereas the Treasury can obtain data on a person's obligations with respect to the Credit Register participants.

When using Credit Register data, its participants and the Treasury have an opportunity to assess the creditworthiness of the person applying for credit or wanting to provide a guarantee for other person's obligations. Thus, the use of the Credit Register data enhances honest and responsible lending and borrowing, thereby strengthening the stability of Latvia's financial system.

At the same time, since the data on a person's obligations settled more than a decade ago has no significant impact on that person's current creditworthiness and to limit the amount of the personal data stored in the Credit Register, starting from 1 April 2018, the time frame for the storage of data on persons and their obligations included in the Credit Register has been reduced from 15 years to 10 years following the actual termination of the person's obligations.

In 2018, the Credit Register website for servicing natural persons electronically (address: <https://manidati.kreg.lv>) was also improved. Starting from 31 August 2018, the Credit Register data can be accessed interactively not only by natural persons with respect to the data pertaining to them but also by legal persons with respect to the data pertaining to their businesses.

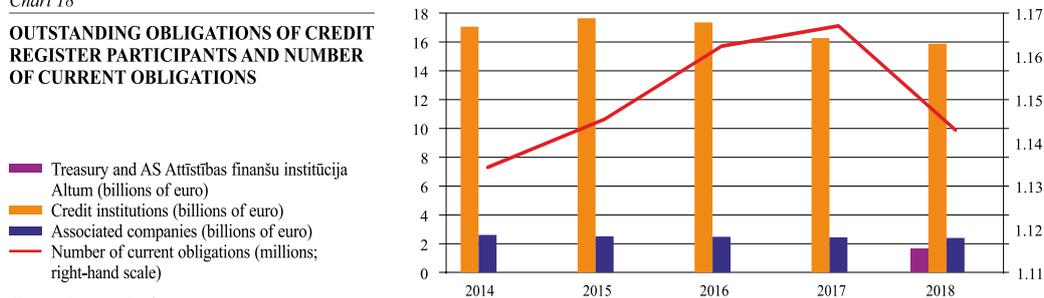
At the same time, the Credit Register provides information necessary for the fulfilment of Latvijas Banka's and FCMC's tasks, contributes to the execution of the ESCB's tasks as well as presents additional opportunities for public institutions to receive data for the purpose of the analysis to be carried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

In 2018, Latvijas Banka, having joined the first group of the euro area central banks, successfully commenced providing data to AnaCredit in accordance with the requirements of Regulation (EU) 2016/867 of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13). AnaCredit brings together the data, provided by the euro area central banks, on loans granted to legal persons into a single system with the aim to improve the availability of detailed lending information for statistical needs, monetary policy analysis and decision-making as well as the financial stability analysis and risk assessment. Latvijas Banka ensures data provision to AnaCredit every month.

At the end of 2018, the Credit Register comprised 96 participants (including the Treasury) who authorised 625 users to work with the Credit Register (in 2017 – 104 participants and 825 users respectively). The Credit Register contained data on 4.8 million obligations, of which 1.1 million obligations were outstanding, pertaining to 1.2 million persons (at the end of 2017, on 4.6 million obligations pertaining to 1.2 million persons). The total outstanding obligations of the Credit Register participants amounted to 19.9 billion euro (18.8 billion euro at the end of 2017; see Chart 18).

Chart 18

OUTSTANDING OBLIGATIONS OF CREDIT REGISTER PARTICIPANTS AND NUMBER OF CURRENT OBLIGATIONS



Source: Latvijas Banka.

Note. Over a five-year period, the average outstanding obligations of insurers constituted 0.01 billion euro and those of cooperative credit unions – 0.02 billion euro.

Latvijas Banka made it possible for any person to receive Credit Register data pertaining to him/her/it free of charge. In 2018, 4.0 thousand persons (4.6 thousand persons in 2017) used this opportunity by arriving at Latvijas Banka in person. Meanwhile, over the year persons requested information about themselves in electronic form 1117 times (website: <https://manidati.kreg.lv>; 1066 times in 2017). Credit Register participants submitted 12.0 million requests (13.2 million requests in 2017) to the Credit Register for the purpose of the assessment of the creditworthiness of their current or potential borrowers and borrowers' guarantors.

In 2018, Latvijas Banka continued to take care of the quality of the data contained in the Credit Register and the rationale behind the requests by checking activities undertaken by Credit Register participants on a regular basis.

STATISTICS

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

Activities of Latvijas Banka in the field of statistics are reflected in Latvijas Banka's annual statistical programme published on a regular basis and in the medium-term statistical work programme for the period of three years. The above programmes provide transparent information on statistical activities planned by Latvijas Banka both with regard to the most important planned new tasks and the types of statistical data Latvijas Banka compiles and publishes. The Statistical Programme of Latvijas Banka for 2018 was successfully implemented.

DEVELOPMENT OF THE REGULATORY FRAMEWORK GOVERNING STATISTICS

In 2018, Latvijas Banka continued to improve the regulatory framework governing statistics and examined reporting agents' possibilities to provide more exhaustive and comprehensive data and to create a more effective system for the submission and use of statistical data.

With Latvijas Banka participating in the ESCB expert group, fact-finding survey documents and those explaining the survey were developed. The above documents relate to the creation of the ESCB Integrated Reporting Framework (IReF). Latvian credit

institutions assessed the potential benefits from the IReF introduction (e.g. harmonisation of the methodology, the use of granular data for the provision of various statistics, the reduction of the burden arising from the provision of aggregated data and convenience of data provision for banking groups), problems (e.g. maintenance of two parallel reporting systems during the transition period and costs of information systems) and their importance as well as suggested the preferred deadline for the IReF introduction. Latvijas Banka also provided its assessment to the ECB concerning the possibilities of the IReF introduction. The IReF will ensure data acquisition and the provision of granular data by their type from credit institutions' information systems, using the Banks' Integrated Reporting Dictionary to provide for maximum harmonisation of data requirements for the needs of statistics and supervision of credit institutions.

The possibility of amending Regulation (EU) No 1409/2013 of the European Central Bank of 28 November 2013 on payments statistics (ECB/2013/43) was explored. Amendments are required to ensure information on innovation in the area of payment services (e.g. on providers of account information or payment initiation services, contactless payments and various payment initiation channels) as well as to respond to the changes imposed by Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market and to provide statistics on fraudulent payment transactions and on requirements of data users in the areas of the compilation of the balance of payments and GDP forecasting. For the purpose of determining the costs incurred by the central banks of EU countries and payment service providers, a costs survey on changes in the requirements of payments statistics was conducted within the ESCB. It was Latvijas Banka that organised and conducted the survey in Latvia.

The Council of Latvijas Banka approved the revised "Regulation for Compiling Reports on Securities" of Latvijas Banka (see Appendix 10) to meet the requirements for the provision of information on the securities holdings of banking groups laid down in Regulation (EU) 2016/1384 of the European Central Bank of 2 August 2016 amending Regulation (EU) No 1011/2012 (ECB/2012/24) concerning statistics on holdings of securities (ECB/2016/22).

COLLECTING AND COMPILING STATISTICS

The range of statistics collected and compiled by Latvijas Banka with regard to financial institutions other than MFIs and Latvian credit institutions included in the list of the ECB's significant banking groups expanded in 2018. To ensure high-quality innovation, the new statistical data reporting requirements were fully explained to reporting agents.

In 2018, Latvijas Banka compiled annual financial account statistics for the first time, taking over this task from the CSB. Latvijas Banka also continued to produce quarterly financial account statistics, thus ensuring quality and harmonised time series of annual and quarterly financial accounts.

As part of the drive to provide data for the 2017–2019 Household Finance and Consumption Survey, Latvijas Banka examined the quality of the data furnished by reporting agents as well as edited and imputed them. For the purpose of reducing the number of questions addressed to households, administrative data sources were more widely employed in this survey, e.g. to obtain information on household pension income. This is already the second survey in Latvia and, in accordance with the ECB requirements, it is conducted every three years to obtain data on the real and financial assets, credit liabilities, income and consumption of households.

To ensure the compliance with the requirements laid down in Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13), in 2018 Latvijas Banka started to send the key indicators enabling the identification of resident non-financial corporations to the ECB Register

of Institutions and Affiliates Data (RIAD). The new requirements were implemented without additional burdens for reporting agents, using information provided by the Enterprise Register of the Republic of Latvia and the State Revenue Service. In order to ensure full implementation of the requirements set out in Guideline (EU) 2018/876 of the European Central Bank of 1 June 2018 on the Register of Institutions and Affiliates Data (ECB/2018/16), improvement of information systems was also pursued.

DISSEMINATION OF STATISTICAL INFORMATION

On 1 August 2018, Latvia adhered to the IMF's Special Data Dissemination Standard Plus (SDDS Plus) and became the 17th country in the world implementing the initiative of the highest-level IMF data dissemination standard. Latvijas Banka, the CSB, Treasury, FCMC and AS Nasdaq Riga produce and publish certain categories of statistical data relating to the economy, population and the financial, fiscal and external sectors. Latvijas Banka coordinates the implementation of SDDS Plus in Latvia, while the CSB maintains the National Summary Data Page where any data user can access user-friendly information on the most important categories of national economic and financial statistics and the institutions responsible for their production as well as links to data, including in machine-readable format, and explanatory descriptions.

Latvijas Banka continued regular transmission of statistical data to the ECB, BIS, Eurostat, the OECD, World Bank and IMF as well as provided statistical information to other data users in Latvia and abroad. To furnish a wide range of data users with timely information, Latvijas Banka disseminated financial and monetary statistics, balance of payments statistics and financial account statistics of Latvia via its regular publications and the website of Latvijas Banka and compiled data for publishing them in the ECB publications and the ECB Statistical Data Warehouse as well as in IMF publications, on its website and within the framework of SDDS Plus. Latvijas Banka participated in the IMF's Financial Access Survey, reporting data on the access to and scope of the services provided to households by Latvia's credit institutions and other financial institutions. In its continued endeavours to provide data users with modern, user-friendly and adaptable data selection, Latvijas Banka supplemented the range of data available on its internet statistical database INTS with statistical data of other financial intermediaries, except insurance corporations and pension funds.

PROVIDING FINANCIAL SERVICES TO THE GOVERNMENT

In order to facilitate efficient and safe budgetary payments of Latvia, the management of the Treasury's settlement accounts opened with Latvijas Banka was ensured by Latvijas Banka in 2018. The Treasury used payment services provided by Latvijas Banka for effecting settlement and participated in its TARGET2-Latvija and the EKS as direct participant. In 2018, the Treasury had settlement accounts in euro and foreign currencies with Latvijas Banka. Over the year, Latvijas Banka settled 1.0 thousand payments of the Treasury in euro and foreign currencies totalling 7.5 billion euro (1.3 thousand payments accounting for 14.8 billion euro in 2017).

ADVICE ON MATTERS WITHIN LATVIJAS BANKA'S COMPETENCE

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

In 2018, officials of Latvijas Banka and its employees held regular meetings with the representatives of the Saeima and the government of the Republic of Latvia, including participation in meetings of the committees of the Saeima and the Cabinet of Ministers

of the Republic of Latvia and in the work of several committees established by the government, providing opinion on the financial and economic development as well as recommendations on structural reforms. In 2018, when analysing Latvia's economic growth prospects, Latvijas Banka focused in particular on the labour market situation as well as on changes in Latvia's financial sector and on the analysis of the potential effect of the UK's exit from the EU on Latvia's economy.

Employees of Latvijas Banka contributed to the promotion of Latvia's economic development by participating in different working groups and professional organisations, sharing experience and providing advice and support to them, including in the fields of the government expenditure and securities settlements and payments, as well as in the process of drafting legal acts and their amendments regulating the financial sector, financial services, the prevention of money laundering and financing of terrorism, state-funded pensions and other areas. In 2018, representatives of Latvijas Banka also played an active role in exploring several innovative areas through supporting a number of working groups and engaging in the work of various organisations and fora involving the analysis of benefits and risks arising from the use of cryptoassets and blockchain technologies. Public administration institutions were advised in a number of areas concerning the opportunities to apply various calculation methodologies and to prevent shortcomings of particular indicators.

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

Employees of Latvijas Banka in their capacity as experts continued to participate in the Working Group for the Preparation of the Notification of the General Government Budget Deficit and Debt, compiling the notification data of the general government budget deficit and debt for 2017 and dealing with the methodological issues related to accounting of general government budget deficit and debt.

Representatives of Latvijas Banka were engaged in the evaluation of the enterprises participating in a competition "Export and Innovation Award" organised by the Investment and Development Agency of Latvia in cooperation with the Ministry of Economics of the Republic of Latvia. Latvijas Banka's employees also engaged in the process of developing the future competence-based school learning content, making proposals for economics education and acting in close cooperation with "School2030" experts.

INFORMATION AND EDUCATIONAL FACILITIES PROVIDED TO THE PUBLIC

Communication with economic policy-makers, economists and financial specialists as well as with the general public plays an increasing role in the operation of central banks. A central bank should not only provide information on its operation and the considerations underpinning monetary policy decisions to the population, entrepreneurs, financial sector representatives and decision-makers but also listen to the public for the purpose of understanding motivation and sentiment of economic agents. This interaction helps to strengthen the population's knowledge about the economy – a precondition for enhancing wealth of people and their country. It is therefore right to look for ways to facilitate economic and financial literacy at schools and universities.

In 2018, Latvijas Banka launched a number of activities significant for each individual and the public at large, e.g. an educational programme enhancing financial literacy aimed at raising people's interest in the economy and improving their understanding of efficient management of personal finances and economic regularities.

In the first half of 2018, Latvijas Banka in cooperation with a newspaper "Latvijas Avīze" organised a number of meetings with the population of Latvia's regions, their entrepreneurs, students of regional universities, teaching staff and representatives of local governments to raise public awareness of economic regularities.



Throughout the year, Latvijas Banka used also social networks (Twitter, Facebook, draugiem.lv, SlideShare, YouTube and Flickr) to hold an intensive dialogue with the public on the aspects of enhancing prosperity.

Competitive infrastructure has an important role to play in economic development. Therefore, Latvijas Banka's annual economic conference was dedicated to development of modern payment services. During the conference "Payments of 22nd Century: Future Starts Today" held on 3 October 2018, leaders of the financial technology sector, policy-makers and experts had a discussion on how modern payments change people's daily lives and help to strengthen the economic potential.



Latvijas Banka, being the first euro area central bank to introduce instant payments, informed the public on the major advantages of instant payments and the course of their implementation.

In June 2018, the Governing Council of the ECB held its external meeting in Latvia. During the meeting, Riga became the world's financial capital. All leading international financial and other media reflected the course of the meeting and the decisions taken therein. The formation and management of future expectations play an ever stronger role in the public communication of central banks. Actual interest rate changes are becoming less important since market participants incorporate the planned interest rate changes in their day-to-day transactions in a timely manner provided the central bank has promptly and successfully announced its intention to change interest rates. It was during the meeting

held in Riga that the Governing Council of the ECB outlined the euro area monetary policy direction planned in the next few years.

In 2018, Latvijas Banka continued to inform the public about significant Eurosystem's monetary policy decisions and Latvijas Banka's participation in their implementation. At press conferences, Deputy Governor of Latvijas Banka Zoja Razmusa provided information about the economic growth and challenges, the necessary structural reforms and the fiscal discipline in both the euro area and Latvia and about decisions taken by the Governing Council of the ECB.

The wide range of Latvijas Banka's regular publications played an important role in explaining the position and opinion of Latvijas Banka. Incorporating the data provided by Latvijas Banka, the CSB, Ministry of Finance of the Republic of Latvia, FCMC and other institutions, the Macroeconomic Developments Report, issued in June and December, assessed developments of the external sector, financial market, domestic demand and supply, costs and prices and balance of payments as well as presented GDP and inflation forecasts. The balance of payments statistics compiled by Latvijas Banka are published in "Latvijas Maksājumu Bilance. Latvia's Balance of Payments. 2017", while the publication "Financial Stability Report" assesses major financial stability risks. In 2018, five working papers and one discussion paper by Latvijas Banka's experts were published on the websites of Latvijas Banka. Economists of Latvijas Banka published their working papers on the websites of Latvijas Banka and in respectable international peer-reviewed journals, series and magazines. The general public was given an opportunity to familiarise itself with ECB information on monetary policy decisions and accommodative monetary policy measures as well as on global and euro area economic development. In compliance with the requirements of the Statute of the ESCB and ECB, Latvijas Banka ensured the Latvian translation of the ECB's Annual Report 2017, the Summary of the ECB's Convergence Report of May 2018, and the ECB's Economic Bulletin issues which were published after the monetary policy meetings of the Governing Council of the ECB in March, June, September and December (published on the internet).

Based on the analysis carried out by economic experts, Latvijas Banka actively expressed its opinion regarding the economic development of Latvia and the euro area, showing in particular the importance of boosting productivity to ensure sustainable economic development. The central bank's communication channels, including the websites bank.lv and macroeconomics.lv and the publication "Macroeconomic Developments Report", highly valued by experts, were used for this purpose. In 2018, more than 100 analytical articles and commentaries by economists concerning current economic developments were published on the website macroeconomics.lv. The series of articles "Latvian Economy: Looking Ahead to the Next 100 Years" generated particular interest of readers. Latvijas Banka's economists use the above series to publish their analyses of the work to be carried out to make the dream of prosperous welfare state come true in Latvia over the following 100 years.

In 2018, Latvijas Banka's officials, economists and other experts provided answers to more than 600 journalists' questions concerning Latvijas Banka's operation and macroeconomic and financial analysis; the number of published interviews exceeded 100.

For the purpose of stepping up and improving communication with the public, restructuring of the website bank.lv has been started to create a modern, user-friendlier functional design allowing users to receive information in various ways and formats.

95% of respondents to the 2018 survey of teaching staff on teaching economics consider that Latvijas Banka plays an important role in enhancing economic and financial literacy. For the sixth consecutive year, teachers, pupils and their parents have the possibility of using various materials available at naudasskola.lv, an educational website of Latvijas

Banka in terms of economics, to learn economic relationships in a systematic, consistent and complete manner.

New teaching aids helping teachers to organise the process of learning economic relationships in compliance with the competence-based approach are being created within the framework of the development of the above website's content.

Following a substantial renewal of its display, Latvijas Banka's Knowledge Centre "Money World" reached a wide audience and generated sustained understanding of the work carried out by Latvijas Banka and the Eurosystem. As suggested by surveys and visitors' feedback, the renewed display is highly appreciated by teaching staff and other interested parties.



In 2018, Latvijas Banka supported the most talented and target-oriented pupils in their endeavours to improve their knowledge in economics. More specifically, it helped Latvia's pupils to prepare for the first International Economics Olympiad in which pupils from Latvia won gold and bronze medals. Latvijas Banka engaged in the creation of an economics section for the most talented 10th graders excelling in social sciences within the "School of Excellence" organised by the Youth Foundation "Vertical".

In response to the invitation within the project "School2030" implemented by the National Centre for Education to assess the project "Modern Literacy Education: Description of the Learning Content and Approach" subject to a public consultation, economists of Latvijas Banka submitted their proposals concerning the mandatory economics learning content and the outputs to be delivered.

A unique series of research articles about Latvijas Banka's contribution provided during the initial stage of the establishment of the State of Latvia as well as about the brightest personalities of Latvijas Banka and Latvia have been published on a microwebsite lb100.lv dedicated to the centenary of Latvia and Latvijas Banka. In 2018, Latvijas Banka participated in the festival of light art installations "Staro Rīga 2018", making the facade of the central building the focus of much attention from thousands of festival participants who had an opportunity to watch and hear an emotional and informative message about the past, present and future of the Republic of Latvia, its financial system and the national central bank.

COOPERATION WITH INTERNATIONAL ORGANISATIONS AND FOREIGN CENTRAL BANKS

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

In 2018, Latvijas Banka continued to represent Latvia's interests at meetings of the IMF Board of Governors and in the coordination of operational issues. Priorities of the IMF policy were mainly related to the developments in the global economy and the financial system. The IMF continued to indicate that the current recovery of the global economic growth was an appropriate moment to implement reforms. This would reduce medium-term risks and boost the economic growth potential of the countries. In 2018, the IMF focused particularly on the risks associated with a departure from the principles of free trade and multilateral international cooperation as well as with the potential adverse effects arising from monetary policy normalisation in other developed countries.

With digital technologies developing also in the financial sector, the IMF started to analyse risks and opportunities relating to development of financial technologies (fintech).

The adequacy of the IMF resources was reviewed, and the 15th review of quotas and the review of the quota formula used for calculation of the quota share are still underway.

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

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

In 2018, cooperation with the IMF, based on consultations under Article IV of the IMF Articles of Agreement, continued.

In 2018, Latvijas Banka continued its membership in the BIS.

Several external meetings of the Eurosystem/ESCB Committees and their Working Groups as well as other events were organised in Riga in 2018.

Latvijas Banka organised meetings of coordinators of the Governing Council and the General Council of the ECB in April, while in September – meetings of the Eurosystem/ESCB Legal Committee and the ESCB Working Group on Monetary and Foreign Exchange Policy Implementation Framework. In 2018, Latvijas Banka held several ESCB and SSM training workshops for improving different professional skills and research workshops with the participation of the experts of the national central banks of different countries and the OECD. Cooperation between the central banks of the Nordic and Baltic countries also continued to be the case, including the discussion on topical digital communication issues held in Riga in April.

In 2018, Latvijas Banka maintained a high level of engagement with foreign central banks. Employees of Latvijas Banka shared experience with experts of Česká národní banka (on accounting of mortgage-backed securities and management of investment portfolios) and representatives of Lietuvos bankas (on information technology solutions for accounting of cash transactions).

In high appreciation of Latvijas Banka's experience in the operation and development of an educational visitors' centre as well as its experience in the fields of financial

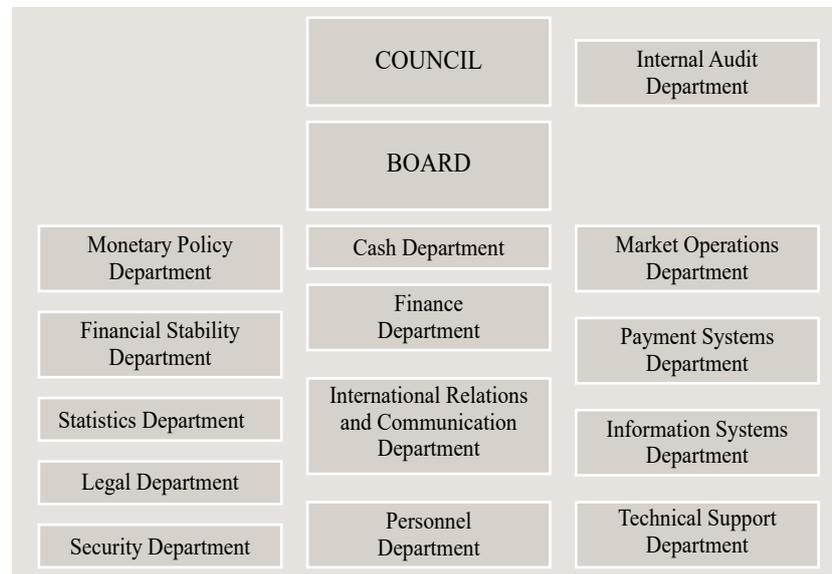
literacy and public education, representatives of the Central Bank of the Republic of Armenia visited Latvijas Banka in 2018 to learn its experience in person, but experts of Latvijas Banka visited their peers in the National Bank of the Republic of Belarus to pass on their experience. An expert of Latvijas Banka also continued his engagement in development planning of the museum of the Central Bank of the Russian Federation in an advisory capacity.

In 2018, international financial organisations and foreign central banks extended support to Latvijas Banka, providing opportunities to participate in the workshops and courses hosted by these institutions. Employees of Latvijas Banka participated in courses, seminars and conferences organised by the EC, ECB, IMF, Joint Vienna Institute, Study Center Gerzensee, Federal Reserve Bank of New York, BIS as well as by the central banks of the UK, Belgium, France, Ireland, Italy, Lithuania, the Netherlands, Spain, and Sweden.

MANAGEMENT AND ORGANISATION OF LATVIJAS BANKA



ORGANISATIONAL STRUCTURE OF LATVIJAS BANKA¹



THE COUNCIL OF LATVIJAS BANKA

The Council of Latvijas Banka takes decisions on behalf of Latvijas Banka. The term of office of Governor, Deputy Governor and Members of the Council of Latvijas Banka is six years. Edvards Kušners held office as Member of the Council of Latvijas Banka until 30 May 2018, the expiration date of his term of office. On 21 June 2018, the Saeima of the Republic of Latvia appointed Mārtiņš Kazāks Member of the Council of Latvijas Banka; he took office on 1 August 2018. The composition of the Council of Latvijas Banka, as at the end of 2018, was as follows:

- Governor
- Deputy Governor
- Members of the Council:

Ilmārs Rimševičs;
Zoja Razmusa;
Mārtiņš Kazāks,
Vita Pilsuma,
Arvils Sautiņš,
Aivars Skopiņš.

Meetings of the Council of Latvijas Banka are held as appropriate, but at least once a quarter. The Council of Latvijas Banka held 19 meetings in 2018. In the framework of the implementation of the tasks set out in the Law on Latvijas Banka, the Council of Latvijas Banka adopted 132 legal acts in 2018 concerning the use of monetary policy instruments, investment management, provision of currency in circulation, compiling statistical data, operation and oversight of the payment and securities settlement systems, operation of the Credit Register, licensing and supervising of purchase and sale of foreign currency, and other issues pertaining to the operation, management and organisation of Latvijas Banka.

THE BOARD OF LATVIJAS BANKA

To carry out and efficiently manage day-to-day activities of Latvijas Banka, the Council of Latvijas Banka has established the Board of Latvijas Banka that performs activities on a continuous basis. At the end of 2018, its composition was as follows:

- Chairman of the Board **Māris Kālis;**
- Deputy Chairperson of the Board **Ilze Posuma;**

¹ The Operational Risk Management Department is in place as of 1 February 2019.

– Members of the Board:

**Jānis Blūms,
Jānis Caune,
Harijs Ozols,
Raivo Vanags.**

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

EMPLOYEES OF LATVIJAS BANKA

At the end of 2018, Latvijas Banka employed 498 people, eight of whom had fixed-term employment contracts (528 and 19 employees at the end of 2017 respectively). At the end of 2018, 59% of Latvijas Banka's staff were male and 41% were female. The Counsellor of Latvijas Banka worked at the Permanent Representation of the Republic of Latvia to the EU in 2018.

Structural improvements continued at Latvijas Banka in 2018. Given that the latest trends in the provision of statistics worldwide mark the transition to the execution of the tasks simultaneously covering several types of statistics, the use of individual-level data as well as the creation of a single information system, changes were introduced in operational organisation of the Statistics Department, and an appropriate body of the Statistics Department ensuring the fulfilment of the new integrated tasks was established.

Taking account of the experience gained by other national central banks of the euro area in the organisation of the training process and to optimise the use of resources, Latvijas Banka's future intentions include the use of its premises located at K. Valdemāra iela 2A and K. Valdemāra iela 1B, Riga, for the organisation of the professional development and training process, including the ESCB training process, and meetings. Therefore, the Training Centre of Latvijas Banka was closed in late 2018.

COMMISSIONS, COMMITTEES AND WORKING GROUPS OF LATVIJAS BANKA

In order to ensure quality performance of Latvijas Banka's tasks, several committees, commissions and working groups approved by the Council of Latvijas Banka, Governor of Latvijas Banka or the Board of Latvijas Banka continued their work in 2018.

The Commission for Management of Banknotes and Coins of Latvijas Banka made decisions on the replacement of damaged euro and lats banknotes and circulation coins, exercised control of identification, accounting, storage and destruction of banknotes and coins with signs of counterfeiting and counterfeits, registered cash processing institutions and cancelled their registration, and controlled the operation of cash processing institutions. To ensure the fulfilment of the requirements specified for purchasing and selling foreign currency as a financial service, the Licensing Committee of Latvijas Banka issued, re-registered and rewrote licences of capital companies for purchasing and selling foreign currency as a commercial activity and controlled the operation of licensed capital companies.

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

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

COMMISSIONS AND COMMITTEES OF LATVIJAS BANKA AT THE END OF 2018

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

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

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

MANAGEMENT PRINCIPLES AND DEVELOPMENT

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

The "Vision, Mission and Values of Latvijas Banka" and the priority objectives of Latvijas Banka underlie the operation and development planning. Progress towards achieving the set objectives is measured annually. At the same time, the execution of functions and processes is monitored daily, and the fulfilment of work plans is reviewed on a regular basis.

RESOURCE MANAGEMENT

HUMAN RESOURCES

In 2018, Latvijas Banka continued to pursue its key principles of human resources policy of hiring qualified and professional employees by way of an effective staff recruitment process and establishing long-term employment relationships, creating a motivating working environment and enhancing professional development opportunities.

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

Latvijas Banka participated in the Schuman programme designed to provide ESCB and SSM staff members with multi-directional, project-based external work experience. Within the framework of the programme, an expert from Lietuvos bankas was engaged in the research project submitted by the Monetary Policy Department, while an expert from the Cash Department took part in the project of Nationale Bank van België/Banque Nationale de Belgique.

Another employee of Latvijas Banka, appointed as the Adviser to the Executive Director of the Nordic-Baltic Constituency of the IMF, continued her work.

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

Staff training costs of Latvijas Banka amounted to 1.5% of the total expenses on remuneration (1.6% in 2017).

FINANCIAL RESOURCES

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

Latvijas Banka finances its operation primarily from the income generated from managing financial assets and from monetary policy operations. Latvijas Banka does not receive financing from the state budget. Instead, it transfers 70% of the profit made during the reporting year to the state budget. In 2018, Latvijas Banka recorded a profit of 14.6 million euro, of which 10.2 million euro are to be transferred to the state budget. Over the last five years, Latvijas Banka's profit totalled 117.0 million euro, of which 76.8 million euro was transferred to the state budget.

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

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

by the Board of Latvijas Banka, and other regulations of Latvijas Banka pursuant to the Law on Latvijas Banka and requirements of other laws and regulations of the Republic of Latvia binding on Latvijas Banka.

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

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

INFRASTRUCTURE RESOURCES

Engineering and technical infrastructure resources

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

In 2018, reconstruction of the electrical installation of the Riga Branch was carried out by building a solar power plant and integrating it into the power supply system of the building.

The perimeter security alarm system was replaced in the territory of the Liepāja Branch building. The automatic fire detection alarm system was renewed at K. Valdemāra iela 2A, Riga. Access control equipment was replaced and the video surveillance system was upgraded as well as the replacement of the voice notification system was commenced in the Riga Branch. A new x-ray equipment for screening postal items was purchased to ensure higher quality of their examination.

Resources of information technologies

Improvements were introduced to more widely use the internet to support the operation of Latvijas Banka's payment systems, thus reducing their maintenance costs.

Information systems of Latvijas Banka were upgraded to maximise the execution of Latvijas Banka's payments as instant payments.

Latvijas Banka's public keys infrastructure was upgraded, thus ensuring the transition to even more secure cryptographic algorithms. The above solution has been certified also for the use within the ESCB.

Cyber security testing of Latvijas Banka's information systems infrastructure has been conducted; security solutions and procedures were improved to mitigate risks associated with cyber security and the most current technological threats.

Environmental resources

Latvijas Banka is an environmentally friendly institution aware of its obligation to contribute to environmental protection and taking care of an efficient use of environmental resources. Environmental protection is inseparable from Latvijas Banka's day-to-day operation. Moreover, Latvijas Banka raises awareness of its employees, invites them to choose more environmentally friendly options for using resources and constantly reduces its ecological footprint with the support from its staff.

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

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

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

An important project, i.e. the installation of solar panels in the Riga Branch building, was implemented in 2018. The electricity generated by these solar panels is used to meet the building's power consumption needs, thus reducing the volume of electricity to be purchased. Replacing the volume of electricity produced from non-renewable resources with that generated by the sun reduces CO₂ emissions.

RISK MANAGEMENT

Latvijas Banka manages strategic, financial and operational risks. Latvijas Banka's risk management goal and basic principles are set in the "Risk Management Policy of Latvijas Banka" adopted by the Council of Latvijas Banka.

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

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

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

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

Latvijas Banka's investments are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable levels of financial risks and return are set out for each financial instrument portfolio and the Risk Management Division of the Market Operations Department monitors compliance with them. For the purpose of managing investment, including the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves investment tactics, sets detailed limits for financial risks, and oversees the operation of external investment managers. The Investment Committee of Latvijas Banka reviews the investment strategy on a quarterly basis, but on a weekly basis receives and reviews reports on and forecasts for developments in financial markets prepared by financial investment portfolio managers, reports by financial risk managers and approves investment management tactics for the forthcoming week. The Market Operations Department informs the Council and the Board of Latvijas Banka about the results of investment management on a regular basis.

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

Latvijas Banka's operational risks are managed subject to a uniform operational risk management framework, with the major operational risks being compliance risks (inter alia in preventing conflict of interests, anti-corruption control, personal data protection, prevention of money laundering and terrorism financing, and ensuring workplace environment protection), risks related to business continuity, physical security, information security and information systems (including cyber security). Latvijas Banka's operational risks are managed through processes and projects by identifying and assessing risks and, depending on the risk assessment, defining and implementing the most appropriate actions. In 2018, the management of operational risks was organised by the Operational Risk Manager of Latvijas Banka and conducted, on a daily basis, by the structural units of Latvijas Banka, project managers and other employees of Latvijas Banka responsible for the execution of Latvijas Banka's processes. Operational risk management was supervised by the Operational Risk Management Committee of Latvijas Banka, appointed by the Board of Latvijas Banka, which effected the coordination of measures to be carried out under the operational risk management process and provided support to the Board of Latvijas Banka in the area of risk management. As part of further improvement of the risk management process, inter alia for the purpose of concentrating resources allocated for operational risk management, thus developing a more efficient model for managing this process, the Operational Risk Management Department is in place as of 1 February 2019.

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

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

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

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

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

In view of the growing cyber security risks, extra security testing was carried out and measures to enhance the protection of Latvijas Banka's information systems and their infrastructure were implemented in 2018.

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

INTERNAL AND EXTERNAL AUDIT

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

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

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

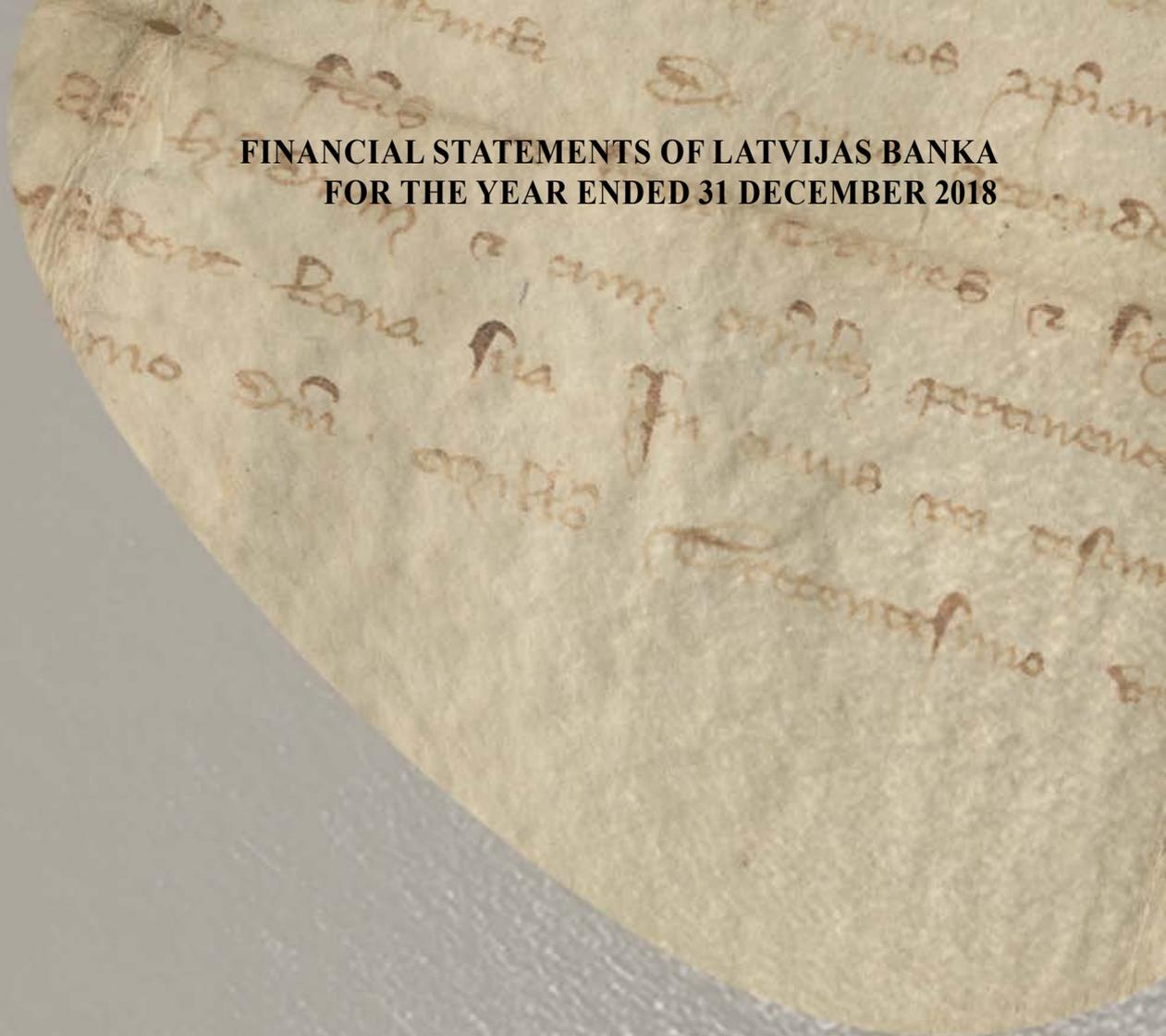
The internal audit covers all business areas of Latvijas Banka. Internal audits are planned and conducted using a risk-based approach. The Head of the Internal Audit Department reports the outcomes of each internal audit to Governor and the Audit Committee of Latvijas Banka. The Audit Committee of Latvijas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

The Internal Audit Department also carries out internal audits based on the audit plan agreed with the Eurosystem/ESCB Internal Auditors Committee. In 2018, the Internal Audit Department performed three such internal audits at Latvijas Banka. The staff of the Internal Audit Department engage also in the fulfilment of other Eurosystem/ESCB internal audit tasks. In 2018, Latvijas Banka's auditors participated in three working groups responsible for Eurosystem/ESCB internal audit planning and implementation; during one of such internal audits they carried out internal audit inspections in other central banks of the Eurosystem. Moreover, to support the mobility of auditors and to expand their knowledge, a short-term assignment to the ECB's Directorate Internal Audit was arranged for one internal auditor.

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

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

**FINANCIAL STATEMENTS OF LATVIJAS BANKA
FOR THE YEAR ENDED 31 DECEMBER 2018**



BALANCE SHEET

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

	Note ¹	2018	2017
ASSETS			
Gold and gold receivables	6	239 195	230 856
Claims on non-euro area residents denominated in foreign currency	7	3 566 027	3 608 692
Receivables from the International Monetary Fund		146 833	143 477
Balances with banks and security investments, external loans and other external assets		3 419 194	3 465 215
Claims on euro area residents denominated in foreign currency	8	326 308	355 065
Claims on non-euro area residents denominated in euro	9	101 837	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	38 750	244 660
Longer-term refinancing operations		38 750	244 660
Other claims on euro area credit institutions denominated in euro	11	488	438
Securities of euro area residents denominated in euro	12	8 813 038	8 131 197
Securities held for monetary policy purposes		7 423 080	6 719 984
Other securities		1 389 958	1 411 213
Intra-Eurosystem claims	13	4 952 780	4 604 114
Participating interest in the European Central Bank		115 082	115 082
Claims equivalent to the transfer of foreign reserves		163 480	163 480
Other claims within the Eurosystem		4 674 218	4 325 552
Other assets	14	208 724	222 287
TOTAL ASSETS		18 247 147	17 498 642

¹ The accompanying Notes set out on pages 76 to 119 are an integral part of these financial statements.

<i>(cont.)</i>	(at the end of the year; in thousands of euro)		
	Note	2018	2017
LIABILITIES			
Banknotes in circulation	15	4 536 729	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	5 050 101	5 712 980
Current accounts (covering the minimum reserve system)		5 050 101	5 712 980
Other liabilities to euro area credit institutions denominated in euro	17	13 847	22 610
Liabilities to other euro area residents denominated in euro	18	1 449 237	215 712
General government		129 113	29 516
Other liabilities		1 320 124	186 196
Liabilities to non-euro area residents denominated in euro	19	16 524	2 535
Liabilities to euro area residents denominated in foreign currency	20	150 535	144 324
Liabilities to non-euro area residents denominated in foreign currency	21	115 284	634
Intra-Eurosystem liabilities	13	6 212 645	6 339 683
Liabilities related to TARGET2 and correspondent accounts (net)		6 212 645	6 339 683
Other liabilities	22	251 877	305 552
Capital and reserves	23	450 368	440 524
TOTAL LIABILITIES		18 247 147	17 498 642

PROFIT AND LOSS STATEMENT

		(in thousands of euro)	
	Note	2018	2017
Net interest income	33	79 494	71 498
Interest income		180 907	138 189
Interest expense		-101 413	-66 691
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions		-42 387	-28 175
Realised gains arising from financial operations	34	-49 690	33 292
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	-47 903	-18 791
Provisions for market risk and credit risk	36	55 206	-42 676
Net expense from fees and commissions		-2 783	-3 087
Fees and commissions income		644	397
Fees and commissions expense		-3 427	-3 484
Income from equity securities and participating interest	37	6 922	5 258
Net result of pooling of monetary income	38	122	3 651
Other operating income	39	9 270	12 382
NET INCOME		50 638	61 527
Remuneration	40	-17 515	-17 616
Social security costs and solidarity tax	40	-4 031	-3 962
Banknote and coin acquisition costs	41	-2 104	-4 542
Depreciation of fixed assets and amortisation of intangible assets	14	-4 189	-3 750
Other operating expenses	42	-8 233	-7 773
PROFIT OF THE REPORTING YEAR		14 566	23 884

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

		(in thousands of euro)	
	Note	2018	2017
Profit of the reporting year		14 566	23 884
Revaluation	23	-26 962	-18 274
Realisation of the accumulated revaluation result	23	-10 139	-29 576
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	47 903	18 791
Total changes in the valuation account	23	10 802	-29 059
TOTAL		25 368	-5 175

The financial statements, which are set out on pages 72 to 119, were authorised by the Board of Latvijas Banka on 7 March 2019.

BOARD OF LATVIJAS BANKA

M. Kālis

I. Posuma

J. Blūms

J. Caune

H. Ozols

R. Vanags

NOTES TO THE FINANCIAL STATEMENTS

1. PRINCIPAL ACTIVITIES

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

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

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

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

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

The Head Office of Latvijas Banka is situated at K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its branches in Riga and Liepāja. As a result of improvements in the professional development and training process, Latvijas Banka was able to discontinue the use of its Training Centre and close it in 2018.

2. PRINCIPAL ACCOUNTING POLICIES

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

2.1 BASIS OF PREPARATION

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

2.2 BASIS OF MEASUREMENT

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

2.3 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

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

2.4 FOREIGN CURRENCY AND GOLD TRANSLATION

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

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

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

The exchange rates of major foreign currencies (currency units per euro) and gold price (euro per troy ounce) in euro used in the preparation of the balance sheet for the year ended 31 December 2018 and the year ended 31 December 2017 are as follows:

	(at the end of the year)		
	2018	2017	Changes (%)
US dollar (USD)	1.1450	1.1993	-4.5
Japanese yen (JPY)	125.85	135.01	-6.8
Canadian dollar (CAD)	1.5605	1.5039	3.8
British pound sterling (GBP)	0.89453	0.88723	0.8
Gold (XAU)	1120.961	1081.881	3.6

2.5 RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

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

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

2.6 OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

2.7 USE OF ESTIMATES AND ASSUMPTIONS

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

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

2.8 GOLD AND GOLD RECEIVABLES

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

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

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

2.9 DEBT SECURITIES

Debt securities are stated at fair value in the balance sheet, except those held to maturity

and securities held for monetary policy purposes, measured at amortised cost. Securities held to maturity are securities with fixed or determinable payments and fixed maturity which Latvijas Banka intends to hold to maturity.

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

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

2.10 REVERSE REPURCHASE AGREEMENTS

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

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

2.11 REPURCHASE AGREEMENTS

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

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

2.12 SECURITIES LENDING

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

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

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

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

2.14 EQUITY SECURITIES AND PARTICIPATING INTEREST

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

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

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

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

2.15 DERIVATIVE FINANCIAL INSTRUMENTS

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

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

2.16 ACCRUED INTEREST INCOME AND EXPENSE

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

2.17 FIXED ASSETS

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

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

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

In 2018, the useful lives set for fixed assets were not changed. In 2018 and 2017, the useful lives set for fixed assets were as follows:

	(years)	
	2018	2017
Buildings and their components, improvements to the territory, incl.	5–100	5–100
structures	100	100
finishing, equipment and engineering communications	5–20	5–20
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–5	2–5
Other fixed assets	5–15	5–15

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

2.18 INTANGIBLE ASSETS

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

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

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

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

2.19 IMPAIRMENT OF ASSETS

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

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

2.20 CURRENCY IN CIRCULATION

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

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

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

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

2.21 COLLECTOR COINS

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

2.22 PROVISIONS

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

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

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

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

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

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

2.24 INTEREST INCOME AND EXPENSE

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

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

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

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

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

2.25 REALISED GAINS OR LOSSES FROM FINANCIAL OPERATIONS

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

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

2.26 INCOME FROM EQUITY SECURITIES AND PARTICIPATING INTEREST

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

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

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

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

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

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

2.27 NET RESULT OF POOLING OF MONETARY INCOME

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs gain income from the implementation of the single monetary policy of the Eurosystem. Total monetary income of the Eurosystem equals the income on assets arising from the issue of euro banknotes and receiving deposits from credit institutions. The income is allocated to euro area NCBs in proportion to their shares in the capital of the ECB. For the first six years following the joining of the Eurosystem an euro area NCB's monetary income is

adjusted in compliance with a definite coefficient to avoid significant euro area NCB income fluctuations (see also Note 33).

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

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

2.28 BANKNOTE AND COIN ACQUISITION COSTS

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

2.29 OTHER EXPENSE AND INCOME

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

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

3.1 FINANCIAL POSITION

In 2018, Latvijas Banka's assets grew by 748.5 million euro, mostly due to securities purchases for monetary policy purposes.

In 2018, following the decisions of the Governing Council of the ECB on the PSPP, Latvijas Banka made purchases of securities issued by the Latvian government and international institutions; mostly as a result of the above purchases, the balance of the balance sheet item "Securities held for monetary policy purposes" increased by 703.1 million euro. Euro area NCBs purchased PSPP securities in proportion to their shares in the ECB's capital. In 2018, the amounts of securities purchases were smaller vis-à-vis 2017 as the ECB's Governing Council made a decision to gradually reduce the monthly average pace of security purchases set by the Eurosystem to 30 billion euro from January to September 2018 and to 15 billion euro from October to December. The ECB's Governing Council decided to discontinue net purchases of those securities under the PSPP starting from 2019 and in the future merely reinvest the principal payments from maturing securities.

A decrease in the assets under the balance sheet item "Balances with credit institutions and security investments, external loans and other external assets" and "Claims on euro area residents denominated in foreign currency" basically resulted from revaluation of the above investments due to a rise in interest rates(see also Note 4).

In 2018, the amount of loans granted to credit institutions by Latvijas Banka as a result of monetary policy operations (longer-term refinancing operations) decreased by 205.9 million euro (see also Note 10.2).

Other claims related to other operational requirements within the Eurosystem grew by

348.7 million euro, mostly due to a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2018, banknotes in circulation increased by 222.6 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs.

At the end of 2018, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", decreased by 662.9 million euro. The decrease is mostly related to the reclassification of funds from the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro" to the balance sheet item "Liabilities to other euro area residents denominated in euro".

As a result of cross-border payments, liabilities to the ECB for the settlement result in TARGET2, reported under the balance sheet item "Intra-Eurosystem liabilities", decreased by 127.1 million euro to 6212.6 million euro (6339.7 million euro at the end of 2017).

Capital and reserves of Latvijas Banka increased by 9.8 million euro due to net changes in the "Valuation account" balance (10.8 million euro) and the profits earned in 2018 (14.6 million euro), while the share of profits earned in 2017 and remitted to the state budget revenue (15.5 million euro) had a decreasing effect.

3.2 FINANCIAL PERFORMANCE

In 2018, Latvijas Banka's profit amounted to 14.6 million euro (23.9 million euro in 2017). Net interest income in 2018 grew by 8.0 million euro as compared to 2017.

42.7 million euro growth in interest income resulted from a 25.5 million euro rise in interest income on investment due to increasing interest rates. Interest income on monetary policy operations grew by 14.1 million euro, basically as a result of PSPP securities purchases in 2018 and an increase in negative interest received on credit institution demand deposits.

An 34.7 million euro increase in interest expense was mostly a result of a rise in interest expense on investment in relation to the transactions carried out by Latvijas Banka for the purpose of hedging currency risk.

The realised result from financial operations was negative (49.7 million euro) in contrast to the positive result of 33.3 million euro a year ago, while the recognition of the negative revaluation result on financial assets and positions in profit and loss statement amounted to 47.9 million euro (18.8 million euro in 2017) due to a rise in interest rates in Latvijas Banka's major investment markets.

In view of the negative realised result from financial operations and the negative revaluation result on financial assets and positions determined by a rise in interest rates in Latvijas Banka's major investment markets, Latvijas Banka used the established provisions for market risk and credit risk in the amount of 55.6 million euro (in 2017 the respective provisions were increased by 42.4 million euro).

Pursuant to the Statute of the ESCB and of the ECB, the income generated by euro area NCBs through the implementation of the single monetary policy of the Eurosystem is allocated to euro area NCBs in proportion to their shares in the ECB's capital. In 2018, Latvijas Banka's net result of pooling of monetary income was 122 thousand euro (3.7 million euro in 2017).

Other operating income (9.3 million euro; 12.4 million euro in 2017) decreased primarily due to a smaller result of remeasurement of liabilities for the issued lats banknotes and coins.

Total recognised financial result, including changes in the "Valuation account" balance, increased by 30.5 million euro on account of a 39.9 million euro increase in the "Valuation account" primarily due to the recognition of the negative result on revaluation of financial instruments in the profit and loss statement, while the profits of the reporting year dropped 9.3 million euro as compared to 2017.

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

4. FINANCIAL INVESTMENT POLICY

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

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

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

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

The breakdown of investments by type of investment portfolio at the end of 2018 and 2017 was as follows:

	Book value (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
1–10 year fixed income securities portfolios	3 564 297	3 708 630	62.2	63.9
Mortgage-backed securities portfolios	1 131 910	1 158 211	19.8	20.0
Long-term fixed income securities portfolio	502 397	502 820	8.8	8.7
Gold portfolio	239 195	230 856	4.2	4.0
Portfolios of borrowed funds	150 535	144 324	2.6	2.5
Equity securities portfolio	90 618	–	1.6	–
Latvian government securities portfolio	47 847	49 481	0.8	0.9
Total	5 726 799	5 794 322	100.0	100.0

The 1–10 year fixed income securities portfolio benchmark at the end of 2017 was the weighted 1–10 year government securities index of the UK, the US, euro area countries and Canada. In 2018, Latvijas Banka changed the 1–10 year fixed income securities portfolio benchmark. At the end of 2018, the 1–10 year fixed income securities portfolio benchmark comprised the weighted 1–10 year government securities index of the UK and euro area countries, and the 1–3 year government securities index of the US and Canada.

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

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

The gold portfolio comprises the gold of Latvijas Banka.

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

In 2018, Latvijas Banka established an equity securities portfolio. The equity securities portfolio benchmark is the equity securities index covering the developed markets across the world.

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

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

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

BALANCE SHEET NOTES

5. FAIR VALUE MEASUREMENT

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

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

At the end of 2018 and 2017, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2018 and 2017, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value method (see also Note 14.2).

At the end of 2018 and 2017, the breakdown of financial instruments and gold carried at fair value and of the financial instruments whose fair value is different from their book value, according to the fair value hierarchy was as follows:

	Book value	Fair value			Total fair value	Difference between fair value and book value
		Quoted market price	Observable data	Non-observable data		
As at 31 December 2017						
Gold	230 856	230 856	–	–	230 856	–
Securities in investment portfolios	5 280 437	4 766 081	517 419	–	5 283 500	3 063
Forward exchange rate contracts	30 907	–	27 971	–	27 971	–2 936
Securities held for monetary policy purposes	6 781 748	6 811 835	–	–	6 811 835	30 087
Participating interest in the Bank for International Settlements	30 414	–	–	30 414	30 414	–
Total	12 354 362	11 808 772	545 390	30 414	12 384 576	30 214
As at 31 December 2018						
Gold	239 195	239 195	–	–	239 195	–
Securities in investment portfolios	5 159 064	4 614 683	544 966	–	5 159 649	585
Forward exchange rate contracts	20 942	–	19 428	–	19 428	–1 514
Interest rate swap arrangements	–378	–378	–	–	–378	–
Securities held for monetary policy purposes	7 486 168	7 481 885	–	–	7 481 885	–4 283
Participating interest in the Bank for International Settlements	31 321	–	–	31 321	31 321	–
Total	12 936 312	12 335 385	564 394	31 321	12 931 100	–5 212

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

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

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

6. GOLD AND GOLD RECEIVABLES

	Troy ounces	In thousands of euro
As at 31 December 2016	213 384	234 305
During 2017		
Decrease in gold market value	x	–3 449
As at 31 December 2017	213 384	230 856
During 2018		
Increase in gold market value	x	8 339
As at 31 December 2018	213 384	239 195

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

At the end of 2018, gold in the amount of 117 701 thousand euro (0 at the end of 2017) had been involved in gold swaps arrangements (see also Notes 21 and 44).

At the end of 2018 and 2017, Latvijas Banka had no gold receivables.

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

7.1 RECEIVABLES FROM THE INTERNATIONAL MONETARY FUND

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

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

Latvia's liabilities to the IMF are made up of the IMF holdings in euro and IMF allocations. At the end of 2018, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 146 833 thousand euro (143 477 thousand euro at the end of 2017), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 1025 thousand euro (1007 thousand euro at the end of 2017) held on its Accounts No. 1 and No. 2 (see also Note 19).

At the end of 2018 and 2017, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2018	2017	2018	2017
Latvia's quota in the International Monetary Fund	403 877	394 640	332 300	332 300
International Monetary Fund holdings in euro	-403 825	-394 595	-332 257	-332 262
Promissory note of the Latvian government	-402 800	-393 587	-331 414	-331 414
Account No. 1	-1 010	-987	-831	-831
Account No. 2	-15	-21	-12	-17
Reserve position in the International Monetary Fund	67	66	55	55
SDR	146 833	143 477	120 811	120 813
General allocation	-114 245	-111 632	-93 998	-93 998
Special allocation	-32 602	-31 856	-26 824	-26 824
Latvia's net receivables from the International Monetary Fund	53	55	44	46

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

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

	(in thousands of euro)	
	2018	2017
Securities	3 320 051	3 395 413
Demand deposits	99 119	51 436
Reverse repurchase agreements	–	18 344
Foreign currency in cash	24	22
Total	3 419 194	3 465 215

8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	(in thousands of euro)	
	2018	2017
Securities	326 081	354 947
Demand deposits	227	118
Total	326 308	355 065

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

	(in thousands of euro)	
	2018	2017
Securities	98 940	96 414
Demand deposits	2 897	4 919
Total	101 837	101 333

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

At the end of 2018, the total amount of Eurosystem loans in monetary policy operations reached 734 382 million euro (764 310 million euro at the end of 2017), including 38.8 million euro (244.7 million euro at the end of 2017) of loans granted by Latvijas Banka. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are allocated among euro area NCBs in proportion to their share in the ECB's capital (see Note 2.27). Losses from Eurosystem lending related to monetary policy operations might only be incurred where the counterparty defaults on its obligations and the funds recovered as a result of the disposal of the collateral provided by the counterparty are not sufficient (see also Note 25.1.2).

10.1 MAIN REFINANCING OPERATIONS

Main refinancing operations are open market operations executed through liquidity providing reverse transactions, conducted through weekly standard tenders with a maturity of one week. These operations play a key role in steering interest rates, managing market liquidity and signalling the monetary policy stance. At the end of 2018 and 2017, Latvijas Banka had granted no loans in main refinancing operations.

10.2 LONGER-TERM REFINANCING OPERATIONS

Longer-term refinancing operations are open market operations with a maturity of over 1 week, executed through reverse transactions with the aim to provide credit institutions with additional longer-term refinancing. Following the decision of the Governing Council of the ECB, targeted longer-term refinancing operations were launched in 2014. These liquidity providing reverse operations are conducted by way of a fixed-rate tender

procedure aiming to promote lending to households and non-financial corporations by credit institutions in euro area countries. At the end of 2018, the balance of the targeted longer-term refinancing operations conducted by Latvijas Banka stood at 38 750 thousand euro (year of maturity of these operations: 2020; at the end of 2017 the balance was 244 660 thousand euro), with several credit institutions making an early repayment of the loans granted in the above operations.

In 2018, the interest rate on the previously conducted targeted longer-term refinancing operations was fixed. Pursuant to the decision of the Governing Council of the ECB, the applicable interest rate is set within the range of -0.4% to 0% depending on the compliance of credit institutions with the criteria for the loans they issue. Following the interest rate fixation, the result of interest recalculation for the previous years was reported in the profit and loss statement for 2018.

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

Other claims on euro area credit institutions denominated in euro mostly include Latvijas Banka's demand deposits in euro with euro area credit institutions (488 thousand euro at the end of 2018; 168 thousand euro at the end of 2017). At the end of 2017, Latvijas Banka's pledged assets for providing collateral for transactions in financial derivatives were also reported under this item and their book value and market value amounted to 270 thousand euro.

12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

In 2018, Latvijas Banka purchased securities issued by the Latvian government and international institutions under the PSPP; and the balance sheet item "Securities held for monetary policy purposes" grew by 703 096 thousand euro.

At the end of 2018, the amount of securities held by the Eurosystem for monetary policy purposes totalled 2651 billion euro (2386 billion euro at the end of 2017). Of them, Latvijas Banka held 7 423 080 thousand euro (6 719 984 thousand euro at the end of 2017). Pursuant to the Statute of the ESCB and of the ECB, any income and losses, if any materialise, are allocated among euro area NCBs in proportion to their share in the ECB's capital, except any risks associated with the purchases of government securities carried out by Latvijas Banka and other euro area NCBs under the PSPP. Of the total amount of securities held by the Eurosystem for monetary policy purposes, at the end of 2018 the amount of government securities purchased by the euro area NCBs under the PSPP totalled 1 681 113 million euro (1 508 842 million euro at the end of 2017); of them, Latvijas Banka held securities in the amount of 1 186 436 thousand euro (982 537 thousand euro at the end of 2017).

The ECB's Governing Council made a decision to increase the monthly amount of security purchases under the APP from 60 billion euro to 80 billion euro from April 2016, and after March 2017 to continue monthly purchases of securities in the amount of 60 billion euro up to December 2017. From January 2018 to December 2018, the monthly average net securities purchases were gradually reduced from 30 billion euro at the beginning of 2018 to 15 billion euro, continuing the respective purchases by the end of 2018.

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

(in thousands of euro)		
	Book value	
	2018	2017
Securities held for monetary policy purposes	7 423 080	6 719 984
Latvian government securities	1 186 436	982 537
Debt securities issued by international institutions	6 236 644	5 737 447
Other securities	1 389 958	1 411 213
Securities not held to maturity	887 561	908 393
Securities held to maturity	502 397	502 820
Total	8 813 038	8 131 197

13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (-)

(in thousands of euro)			
	Note	2018	2017
Participating interest in the European Central Bank	13.1	115 082	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	163 480	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	4 669 321	4 317 942
Claims related to other operational requirements within the Eurosystem	13.5	4 897	7 610
Total intra-Eurosystem claims		4 952 780	4 604 114
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	-6 212 645	-6 339 683
Total intra-Eurosystem liabilities		-6 212 645	-6 339 683
Intra-Eurosystem liabilities (net)		-1 259 865	-1 735 569

13.1 PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, the weighting assigned to Latvijas Banka in the ECB capital subscription key is calculated on the basis of Latvia's population and gross domestic product data. The weightings assigned to the NCBs in the ECB's capital subscription key are adjusted every five years or at shorter intervals depending on changes in the number of the EU Member State NCBs that contribute to the ECB's capital. Since 1 January 2014 Latvijas Banka's weighting in the ECB's capital key was 0.2821%, equivalent to 30 537 thousand euro; however, on 1 January 2019, the weightings of NCBs in the ECB's capital subscription key were adjusted, therefore Latvijas Banka's weighting in the ECB capital subscription key decreased to 0.2731%, equivalent to 29 563 thousand euro.

The Statute of the ESCB and of the ECB stipulates that a euro area NCB shall pay up its subscribed share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the valuation account for financial instruments, in proportion to its share in the ECB's capital. As of 1 January 2014, participating interest in the ECB consists of the paid up shares in the amount of 30 537 thousand euro in the ECB's capital, transfers to the financial instrument revaluation account amounting to 42 752 thousand euro and the difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro (see also Note 13.2).

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

	2018	2017
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	10 825 007	10 825 007
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	30 537	30 537
The percentage share of Latvijas Banka in the European Central Bank's capital (%)	0.2821	0.2821

At the end of 2018 and 2017, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	(%)	
	2018	2017
Nationale Bank van België/Banque Nationale de Belgique	2.4778	2.4778
Deutsche Bundesbank	17.9973	17.9973
Eesti Pank	0.1928	0.1928
Banc Ceannais na hÉireann/Central Bank of Ireland	1.1607	1.1607
Bank of Greece	2.0332	2.0332
Banco de España	8.8409	8.8409
Banque de France	14.1792	14.1792
Banca d'Italia	12.3108	12.3108
Central Bank of Cyprus	0.1513	0.1513
Latvijas Banka	0.2821	0.2821
Lietuvos bankas	0.4132	0.4132
Banque centrale du Luxembourg	0.2030	0.2030
Bank Ċentrali ta' Malta/Central Bank of Malta	0.0648	0.0648
De Nederlandsche Bank	4.0035	4.0035
Oesterreichische Nationalbank	1.9631	1.9631
Banco de Portugal	1.7434	1.7434
Banka Slovenije	0.3455	0.3455
Národná banka Slovenska	0.7725	0.7725
Suomen Pankki – Finlands Bank	1.2564	1.2564
Subtotal for euro area NCBs	70.3915	70.3915
Българска народна банка (Bulgarian National Bank)	0.8590	0.8590
Česká národní banka	1.6075	1.6075
Danmarks Nationalbank	1.4873	1.4873
Hrvatska narodna banka	0.6023	0.6023
Magyar Nemzeti Bank	1.3798	1.3798
Narodowy Bank Polski	5.1230	5.1230
Banca Națională a României	2.6024	2.6024
Sveriges Riksbank	2.2729	2.2729
Bank of England	13.6743	13.6743
Subtotal for non-euro area NCBs	29.6085	29.6085
Total	100.0000	100.0000

In 2018, the subscribed and paid-up capital of the ECB remained unchanged.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2018 and 2017 were as follows:

	(in thousands of euro)			
	Subscribed capital		Paid-up capital	
	2018	2017	2018	2017
Nationale Bank van België/ Banque Nationale de Belgique	268 222	268 222	268 222	268 222
Deutsche Bundesbank	1 948 209	1 948 209	1 948 209	1 948 209
Eesti Pank	20 871	20 871	20 871	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	125 646	125 646	125 646	125 646
Bank of Greece	220 094	220 094	220 094	220 094
Banco de España	957 028	957 028	957 028	957 028
Banque de France	1 534 899	1 534 899	1 534 899	1 534 899
Banca d'Italia	1 332 645	1 332 645	1 332 645	1 332 645
Central Bank of Cyprus	16 378	16 378	16 378	16 378
Latvijas Banka	30 537	30 537	30 537	30 537
Lietuvos bankas	44 729	44 729	44 729	44 729
Banque centrale du Luxembourg	21 975	21 975	21 975	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	7 015	7 015	7 015	7 015
De Nederlandsche Bank	433 379	433 379	433 379	433 379
Oesterreichische Nationalbank	212 506	212 506	212 506	212 506
Banco de Portugal	188 723	188 723	188 723	188 723
Banka Slovenije	37 400	37 400	37 400	37 400
Národná banka Slovenska	83 623	83 623	83 623	83 623
Suomen Pankki – Finlands Bank	136 005	136 005	136 005	136 005
Subtotal for euro area NCBs	7 619 885	7 619 885	7 619 885	7 619 885
Българска народна банка (Bulgarian National Bank)	92 987	92 987	3 487	3 487
Česká národní banka	174 012	174 012	6 525	6 525
Danmarks Nationalbank	161 000	161 000	6 038	6 038
Hrvatska narodna banka	65 199	65 199	2 445	2 445
Magyar Nemzeti Bank	149 363	149 363	5 601	5 601
Narodowy Bank Polski	554 565	554 565	20 796	20 796
Banca Națională a României	281 710	281 710	10 564	10 564
Sveriges Riksbank	246 042	246 042	9 227	9 227
Bank of England	1 480 244	1 480 244	55 509	55 509
Subtotal for non-euro area NCBs	3 205 122	3 205 122	120 192	120 192
Total ¹	10 825 007	10 825 007	7 740 077	7 740 077

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

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

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

between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro is reported as participating interest in the ECB (see also Note 13.1). The interest rate on the main refinancing operations set by the ECB is applied to the claims equivalent to the transfer of foreign reserves to the ECB (see also Note 33).

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

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

In 2018, liabilities related to TARGET2 and national central bank correspondent accounts (net) decreased as a result of the cross-border payments effected by credit institutions and Latvijas Banka.

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

13.4 CLAIMS FOR THE ALLOCATION OF BANKNOTES IN THE EUROSISTEM

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

13.5 CLAIMS RELATED TO OTHER OPERATIONAL REQUIREMENTS WITHIN THE EUROSISTEM

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

Monetary income to be received by Latvijas Banka in 2018 was higher than its monetary income to be pooled. This resulted in a claim on the ECB associated with the net result of pooling of monetary income, standing at 122 thousand euro at the end of 2018 (3651 thousand euro at the end of 2017; see also Notes 2.27 and 38).

Claims for the ECB's interim profit distribution in the amount of 4775 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (3959 thousand euro at the end of 2017; see also Notes 2.26 and 37).

14. OTHER ASSETS

(in thousands of euro)

	Note	2018	2017
Accrued income on securities		85 690	83 973
OTC financial derivative contracts and spot exchange rate contracts	24	38 999	42 551
Fixed assets	14.1	37 790	39 665
Participating interest in the Bank for International Settlements	14.2	31 321	30 414
Claims on collateral for the use of the instant payment service	17	10 017	20 960
Intangible assets	14.3	2 406	2 363
Other accrued income		1 159	791
Prepaid expenses		704	867
Other		638	703
Total		208 724	222 287

14.1 FIXED ASSETS

(in thousands of euro)

	Buildings, improvement of territory, and land	Furniture and office equipment	Computer and telecommunication equipment	Cash processing and storage equipment	Transport vehicles	Other fixed assets	Total
As at 31 December 2016							
Cost	59 306	4 761	5 427	7 033	1 727	7 923	86 177
Accumulated depreciation	-27 682	-3 792	-3 979	-5 125	-1 231	-6 757	-48 566
Net book value	31 624	969	1 448	1 908	496	1 166	37 611
During 2017							
Additions	2 154	1 597	679	175	110	787	5 502
Change in classification	-5	66	-	12	-	-73	-
Disposals and write-offs	-	-66	-171	-134	-85	-234	-690
Net change in cost	2 149	1 597	508	53	25	480	4 812
Depreciation charge	-1 884	-148	-617	-388	-88	-301	-3 426
Change in classification	-	-61	-	-12	-	73	-
Accumulated depreciation on disposals and write-offs	-	51	170	132	82	233	668
Net change in accumulated depreciation	-1 884	-158	-447	-268	-6	5	-2 758
As at 31 December 2017							
Cost	61 455	6 358	5 935	7 086	1 752	8 403	90 989
Accumulated depreciation	-29 566	-3 950	-4 426	-5 393	-1 237	-6 752	-51 324
Net book value	31 889	2 408	1 509	1 693	515	1 651	39 665
During 2018							
Additions	995	95	235	48	771	219	2 363
Disposals and write-offs	-1 101	-138	-1 575	-88	-649	-586	-4 137
Net change in cost	-106	-43	-1 340	-40	122	-367	-1 774
Depreciation charge	-1 961	-269	-619	-375	-118	-347	-3 689
Accumulated depreciation on disposals and write-offs	656	121	1 573	84	594	560	3 588
Net change in accumulated depreciation	-1 305	-148	954	-291	476	213	-101
As at 31 December 2018							
Cost	61 349	6 315	4 595	7 046	1 874	8 036	89 215
Accumulated depreciation	-30 871	-4 098	-3 472	-5 684	-761	-6 539	-51 425
Net book value	30 478	2 217	1 123	1 362	1 113	1 497	37 790

At the end of 2018, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 209 thousand euro (306 thousand euro at the end of 2017).

14.2 PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2018 and 2017, Latvijas Banka owned 1070 shares in the BIS, which corresponded to 0.19% of the total subscribed and paid-up BIS capital.

The total nominal value of Latvijas Banka's shareholding in the BIS is 5350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1338 thousand SDR or 25% (see also Note 46). At the end of 2018 and 2017, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka's management, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest published financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at The Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2018, the estimated fair value of BIS shares was 31 321 thousand euro (30 414 thousand euro at the end of 2017).

14.3 INTANGIBLE ASSETS

(in thousands of euro)

As at 31 December 2016	
Cost	6 617
Accumulated amortisation	-4 644
Net book value	1 973
During 2017	
Additions	718
Derecognised intangible assets	-77
Net change in cost	641
Amortisation charge	-324
Accumulated amortisation on derecognised intangible assets	73
Net change in accumulated amortisation	-251
As at 31 December 2017	
Cost	7 258
Accumulated amortisation	-4 895
Net book value	2 363
During 2018	
Additions	543
Derecognised intangible assets	-1
Net change in cost	542
Amortisation charge	-500
Accumulated amortisation on derecognised intangible assets	1
Net change in accumulated amortisation	-499
As at 31 December 2018	
Cost	7 800
Accumulated amortisation	-5 394
Net book value	2 406

15. BANKNOTES IN CIRCULATION

	(in thousands of euro)	
	2018	2017
Euro banknotes	4 536 729	4 314 088
Net issuance of euro banknotes by Latvijas Banka	-132 592	-3 854
Adjustment for banknote allocation in the Eurosystem	4 669 321	4 317 942
Total	4 536 729	4 314 088

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

As a result of cross-border flows of euro banknotes, in 2018 the amount of banknotes deposited with Latvijas Banka continued to exceed that of banknotes withdrawn from Latvijas Banka; consequently, the negative net issuance of euro banknotes by Latvijas Banka increased to 132 592 thousand euro. At the end of 2018, the total amount of euro banknotes in circulation in the Eurosystem grew to 1231 billion euro (1171 billion euro at the end of 2017); as a result, an increase in the adjustment for banknote allocation in the Eurosystem was reported on the balance sheet of Latvijas Banka.

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

Current accounts contain the credit balances on the transaction accounts of credit institutions that are required to hold minimum reserves. The latest available interest rate used by the Eurosystem in its tenders for main refinancing operations is applied to the balances held on those accounts within the framework of the reserve requirements. Since June 2014, the lower rate of either zero per cent or the ECB's deposit facility rate has been applied to the reserves held in excess of the required minimum reserves. At the end of 2017, balance on the current accounts with Latvijas Banka was 5 050 101 thousand euro (5 712 980 thousand euro at the end of 2017), including the minimum reserves in the amount of 156 079 thousand euro (211 742 thousand euro at the end of 2017).

16.2 DEPOSIT FACILITY

Deposit facility is a standing facility of the Eurosystem used by credit institutions to place their overnight deposits at a pre-specified rate. No such deposits were placed with Latvijas Banka at the end of 2018 and 2017.

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

Other liabilities to euro area credit institutions denominated in euro resulted from funds received as collateral for the use of the instant payment service and forward exchange rate contracts accounting for 13 847 thousand euro at the end of 2018 (22 610 thousand euro at the end of 2017). Collateral received from credit institutions for the use of the instant payment service has been transferred to the respective service provider (see also Note 14).

18. LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

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

Deposits of other financial institutions include the funds of the FCMC and the Deposit Guarantee Fund and Fund for the Protection of the Insured, both managed by the FCMC. At the end of 2018, an increase in the deposits of other financial institutions was mostly related to the reclassification of funds from the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro" to the balance sheet item "Liabilities to other euro area residents denominated in euro".

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

	(in thousands of euro)	
	2018	2017
European Commission	11 076	186
Other financial institutions	4 423	1 342
International Monetary Fund	1 025	1 007
Total	16 524	2 535

20. LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Liabilities to euro area residents denominated in foreign currency comprise demand deposits of the Latvian government in foreign currency standing at 150 535 thousand euro at the end of 2018 (144 324 thousand euro at the end of 2017; see also Note 43).

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

	(in thousands of euro)	
	2018	2017
Liabilities for gold swap arrangements	114 323	–
Liabilities for collateral for forward exchange rate contracts	961	634
Total	115 284	634

To reduce the costs for hedging currency risks and increase return on financial investments, Latvijas Banka started to engage in gold swap arrangements in 2018 (see also Notes 6 and 24).

22. OTHER LIABILITIES

		(in thousands of euro)	
	Note	2018	2017
Provisions for market risk and credit risk	36	123 970	179 176
Euro coins in circulation	22.1	73 513	67 099
Lats banknotes in circulation	22.1	25 798	34 091
OTC financial derivative contracts	24	17 003	11 404
Accrued expense and similar liabilities		6 533	7 408
Lats coins in circulation	22.1	3 116	4 440
Tax liabilities	22.2	66	75
Other		1 878	1 859
Total		251 877	305 552

22.1 BANKNOTES AND COINS IN CIRCULATION

Apart from the lats and euro circulation coins issued by Latvijas Banka and recognised on the balance sheet, euro collector coins, lats collector coins and precious metal circulation

coins were also in circulation with the total nominal value of 6878 thousand euro at the end of 2018 (6703 thousand euro at the end of 2017). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Note 2.21 and 46).

Issued lats banknotes and coins with low probability of exchange, in the amount of 95 600 thousand euro (lats banknotes in the amount of 35 791 thousand euro and lats coins in the amount of 59 809 thousand euro; 88 400 thousand euro, including lats banknotes in the amount of 29 731 thousand euro and lats coins in the amount of 58 669 thousand euro at the end of 2017) have not been reported as a liability on the balance sheet (see also Note 46).

22.2 TAX LIABILITIES

At the end of 2018 and 2017, tax liabilities of Latvijas Banka were as follows:

	(in thousands of euro)						
	Personal income tax	State compulsory social security contributions and ST (by employer)	State compulsory social security contributions and ST (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2016	–	–	–	–	159	–	159
During 2017							
Calculated	3 254	3 962	1 764	228	1 379	2	10 589
Decrease in deferred liabilities	–	2	–	–	–	–	2
Paid	–3 254	–3 964	–1 760	–228	–1 467	–2	–10 675
Liabilities as at 31 December 2017	–	–	4	–	71	–	75
During 2018							
Calculated	3 081	4 031	1 844	228	1 326	3	10 513
Decrease in deferred liabilities	–	12	–	–	–	–	12
Paid	–3 081	–4 043	–1 848	–228	–1 332	–2	–10 534
Liabilities as at 31 December 2018	–	–	–	–	65	1	66

In addition to the tax payments indicated herein, in 2018 and 2017 Latvijas Banka transferred to the state budget 65% of the profit for the previous year (15 524 thousand euro in 2018; 7653 thousand euro in 2017; see also Notes 23 and 43). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

23. CAPITAL AND RESERVES

	(in thousands of euro)				
	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2016	100 000	223 883	117 696	11 773	453 352
During 2017					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	–29 059	x	–29 059
Profit appropriated to the state budget	x	x	x	–7 653	–7 653
Profit transferred to the reserve capital	x	4 120	x	–4 120	–
Profit of the reporting year	x	x	x	23 884	23 884
As at 31 December 2017	100 000	228 003	88 637	23 884	440 524

(continued)

(in thousands of euro)

	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
During 2018					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	10 802	x	10 802
Profit appropriated to the state budget	x	x	x	-15 524	-15 524
Profit transferred to the reserve capital	x	8 360	x	-8 360	-
Profit of the reporting year	x	x	x	14 566	14 566
As at 31 December 2018	100 000	236 363	99 439	14 566	450 368

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

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

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

The Law on Latvijas Banka establishes that a part of Latvijas Banka's profit of the reporting year, calculated by applying the same percentage as the tax rate set for resident corporate entities of Latvia by the Law on Corporate Income Tax, together with a payment in the amount of 50% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget, as well as that the Council of Latvijas Banka, upon approving the annual report, may make a decision on reducing the percentage share of the payment for the usage of state capital where it is necessary for increasing the reserve capital of Latvijas Banka in relation to the financial risks Latvijas Banka is exposed to when executing its tasks. At the end of 2018 the corporate income tax rate applicable to residents of Latvia was 20% (15% at the end of 2017). Therefore, unless the Council of Latvijas Banka decides otherwise, 70% of Latvijas Banka's profit of the reporting year or 10 196 thousand euro shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2018 by the Council of Latvijas Banka.

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

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

In 2018 and 2017, changes in the valuation account were as follows:

(in thousands of euro)

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

	2017	Recognition in profit and loss statement	Revaluation	Realisation	2016
Initial valuation account	8 521	x	x	-8 395	16 916
Revaluation reserve for participating interest	27 905	-	-1 821	-	29 726
Result on revaluation of foreign currencies and gold	32 446	2 862	-5 626	-239	35 449
Result on revaluation of securities	19 765	15 929	-10 827	-20 942	35 605
Total	88 637	18 791	-18 274	-29 576	117 696

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

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

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

24. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements, forward transactions in securities, and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's investments. At the end of 2018 and 2017, the contract or notional amounts and book value of the above transactions were as follows:

	Contract or notional amount		Book value			
			Assets		Liabilities	
	2018	2017	2018	2017	2018	2017
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	4 183 931	4 230 740	35 347	41 165	13 880	10 709
Spot exchange rate contracts	378 896	391 716	–	451	525	–
Forward transactions in securities	881 305	1 223 116	3 500	935	2 068	695
Interest rate swap arrangements	52 838	11 257	152	–	530	–
Total	x	x	38 999	42 551	17 003	11 404
Derivative OTC gold swap arrangements	114 323	–	117 701	–	114 480	–
Traded financial derivative contracts						
Interest rate future contracts	1 938 588	1 030 055	x	x	x	x
Currency future contracts	100 000	100 000	x	x	x	x

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

To reduce the costs for hedging currency risks and increase return on financial investments, Latvijas Banka started to engage in gold swap arrangements in 2018 (see also Notes 6 and 21).

MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT

25. RISK MANAGEMENT

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

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

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

25.1 FINANCIAL RISKS

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks Latvijas Banka is exposed to in its daily activities. Financial risks are managed to mitigate a potential negative impact on Latvijas Banka's financial position and financial performance that might arise from adverse changes in financial

market factors or a counterparty default. When managing financial risks, acceptable types of risks and their parameters are taken into consideration to preserve the value of investments ensuring the required liquidity and income earning in the long term.

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

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

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

25.1.1 MARKET RISK

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

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

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

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

positions with the limits, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

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

Latvijas Banka's exposure to market risk (as at the end of 2018 and 2017) is disclosed in Notes 26–28.

25.1.2 CREDIT RISK

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

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

In 2018 and 2017, loans granted to credit institutions in monetary policy operations were secured by securities collateral in compliance with the ECB requirements. The Market Operations Department monitors the adequacy of collateral of the respective loans and its eligibility and compliance with the ECB's requirements on a regular basis, as well as maintains a list of securities issued and held in the Republic of Latvia and eligible for monetary policy operations.

Latvijas Banka's exposure to market risk (as at the end of 2018 and 2017) is disclosed in Notes 30–32.

25.1.3 LIQUIDITY RISK

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

liquidity structure of Latvijas Banka's assets and liabilities as at the end of 2018 and 2017 is disclosed in Note 29.

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

25.2 OPERATIONAL RISKS

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

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

Latvijas Banka's operational risks are managed through processes and projects by identifying and assessing risks and, depending on the risk assessment, defining and implementing the most appropriate actions. The management of operational risks in 2018 was organised by the Operational Risk Manager of Latvijas Banka and conducted, on a daily basis, by the structural units of Latvijas Banka, project managers and other employees of Latvijas Banka responsible for the execution of Latvijas Banka's processes. In 2018, the operational risk management was overseen by the Operational Risk Management Committee of Latvijas Banka, appointed by the Board of Latvijas Banka, which ensured coordination of the measures to be carried out under the operational risk management process and provided support to the Board of Latvijas Banka in the area of risk management. As part of further improvement of the risk management process, inter alia for the purpose of concentrating resources allocated for operational risk management, thus developing a more efficient model for managing this process, Operational Risk Management Department is in place as of 1 February 2019.

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

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

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

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

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

In view of the persistently growing cyber security risks, additional security tests were carried out and measures were taken to improve the information system infrastructure and their protection in 2018.

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

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

In 2018, operational risks, inter alia risks related to ensuring Latvijas Banka's business continuity, information and information systems security, as well as physical security were appropriately managed. The above risks as well as events disclosed in Note 47 did not substantially hamper Latvijas Banka's operation.

26. CURRENCY STRUCTURE

(in thousands of euro)

	EUR	USD	CAD	GBP	Gold	Other	Total
As at 31 December 2018							
Total assets	14 145 578	3 063 666	353 345	331 782	239 195	113 581	18 247 147
Total liabilities	18 015 451	192 871	576	12 127	–	26 122	18 247 147
Net position on balance sheet	–3 869 873	2 870 795	352 769	319 655	239 195	87 459	0
Net position on financial instruments' off-balance sheet accounts	3 565 725	–2 807 729	–348 794	–314 702	–	–72 504	21 996
Net position on balance sheet and off-balance sheet accounts	–304 148	63 066	3 975	4 953	239 195	14 955	21 996
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–1.6	0.3	0.0	0.0	1.3	0.1	0.1
As at 31 December 2017							
Total assets	13 337 282	3 207 840	365 280	320 727	230 856	36 657	17 498 642
Total liabilities	17 393 027	66 822	246	11 879	–	26 668	17 498 642
Net position on balance sheet	–4 055 745	3 141 018	365 034	308 848	230 856	9 989	0
Net position on financial instruments' off-balance sheet accounts	3 851 322	–3 131 099	–364 533	–306 232	–	–18 311	31 147
Net position on balance sheet and off-balance sheet accounts	–204 423	9 919	501	2 616	230 856	–8 322	31 147
Net position on balance sheet and off-balance sheet accounts to total assets (%)	–1.2	0.1	0.0	0.0	1.3	0.0	0.2

27. REPRICING MATURITY

The table below reflects the sensitivity of Latvijas Banka's assets, liabilities and off-balance sheet accounts to a change in interest rates. Items reported in this table are stated at carrying amounts, except for interest rate and currency future contracts and

forward transactions in securities that are stated at notional amounts and included in off-balance sheet accounts. A nearest contractual interest repricing or residual maturity date to 31 December of the reporting year is used for categorising the items sensitive to a change in interest rates reported in this table.

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

(continued)

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
As at 31 December 2017							
Gold and gold receivables	–	–	–	–	–	230 856	230 856
Claims on non-euro area residents denominated in foreign currency	67 100	121 206	68 878	831 120	2 325 453	194 935	3 608 692
Claims on euro area residents denominated in foreign currency	3 326	–	44 883	178 647	128 091	118	355 065
Claims on non-euro area residents denominated in euro	–	–	–	6 011	90 403	4 919	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	–	–	244 660	–	–	244 660
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	438	438
Securities of euro area residents denominated in euro	–	–	47 224	300 226	7 783 747	–	8 131 197
Intra-Eurosystem claims	–	–	–	–	–	4 604 114	4 604 114
Other assets	3	–	424	5 286	78 056	138 518	222 287
Total assets	70 429	121 206	161 409	1 565 950	10 405 750	5 173 898	17 498 642
Banknotes in circulation	–	–	–	–	–	4 314 088	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 712 980	–	–	–	–	–	5 712 980
Other liabilities to euro area credit institutions denominated in euro	22 610	–	–	–	–	–	22 610
Liabilities to other euro area residents denominated in euro	213 147	–	–	–	–	2 565	215 712
Liabilities to non-euro area residents denominated in euro	1 528	–	–	–	–	1 007	2 535
Liabilities to euro area residents denominated in foreign currency	144 324	–	–	–	–	–	144 324
Liabilities to non-euro area residents denominated in foreign currency	634	–	–	–	–	–	634
Intra-Eurosystem liabilities	6 339 683	–	–	–	–	–	6 339 683
Other liabilities	–	–	–	–	–	305 552	305 552
Capital and reserves	–	–	–	–	–	440 524	440 524
Total liabilities	12 434 906	–	–	–	–	5 063 736	17 498 642
Net position on balance sheet	–12 364 477	121 206	161 409	1 565 950	10 405 750	110 162	–
Assets on financial instruments' off-balance sheet accounts	5 438 300	3 335	168 598	165 842	1 184 268	–	6 960 343
Liabilities on financial instruments' off-balance sheet accounts	6 352 409	2 501	182 468	30 850	360 968	–	6 929 196
Net position on balance sheet and off-balance sheet accounts	–13 278 586	122 040	147 539	1 700 942	11 229 050	110 162	31 147

28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–3 year fixed income securities and 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return

between the investment portfolio and the respective benchmark (see also Note 25.1). At the end of 2018 and 2017, the actual (ex-post) tracking error of the 1–10 year fixed income securities portfolios was 30 and 16 basis points respectively. At the end of 2018 and 2017, the actual (ex-post) tracking errors of the mortgage-backed securities portfolios were 61 basis points and 53 basis points respectively.

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

	Book value (at the end of the year; in thousands of euro)	Expected tracking error (number of business days)		
		10–39	40–69	70–99
During 2018				
1–10 year fixed income securities portfolios	3 564 297	252	–	–
Mortgage-backed securities portfolios	1 131 910	220	32	–
During 2017				
1–10 year fixed income securities portfolios	3 708 630	253	–	–
Mortgage-backed securities portfolios	1 158 211	13	240	–

29. LIQUIDITY STRUCTURE

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

(in thousands of euro)

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

(continued)

(in thousands of euro)

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	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2017				
Assets				
Gold and gold receivables	230 856	–	–	230 856
Claims on non-euro area residents denominated in foreign currency	3 608 692	–	–	3 608 692
Claims on euro area residents denominated in foreign currency	355 065	–	–	355 065
Claims on non-euro area residents denominated in euro	101 333	–	–	101 333
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	244 660	–	244 660
Other claims on euro area credit institutions denominated in euro	438	–	–	438
Securities of euro area residents denominated in euro	7 628 377	502 820	–	8 131 197
Intra-Eurosystem claims	7 610	–	4 596 504	4 604 114
Other assets	148 275	–	74 012	222 287
Total assets	12 080 646	747 480	4 670 516	17 498 642
Liabilities				
Banknotes in circulation	–	–	4 314 088	4 314 088
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 712 980	–	–	5 712 980
Other liabilities to euro area credit institutions denominated in euro	22 610	–	–	22 610
Liabilities to other euro area residents denominated in euro	215 712	–	–	215 712
Liabilities to non-euro area residents denominated in euro	2 535	–	–	2 535
Liabilities to euro area residents denominated in foreign currency	144 324	–	–	144 324
Liabilities to non-euro area residents denominated in foreign currency	634	–	–	634
Intra-Eurosystem liabilities	6 339 683	–	–	6 339 683
Other liabilities	199 894	–	105 658	305 552
Total liabilities	12 638 372	–	4 419 746	17 058 118
Net position on balance sheet	–557 726	747 480	250 770	x

30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
International institutions	5 240 794	4 661 390	28.7	26.6
European Central Bank	4 952 780	4 604 114	27.1	26.3
Central governments and other governmental institutions	3 864 866	3 872 539	21.2	22.1
Other financial institutions	3 147 598	3 100 377	17.2	17.7
Central banks and credit institutions	732 836	985 722	4.0	5.6
Local governments	168 883	165 704	0.9	0.9
Non-financial corporations	88 566	42 895	0.5	0.2
Unclassified assets	50 824	65 901	0.4	0.6
Total	18 247 147	17 498 642	100.0	100.0

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

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
International institutions	5 240 794	4 661 390	28.7	26.6
European Central Bank	4 952 780	4 604 114	27.1	26.3
Euro area countries	4 397 379	4 506 818	24.1	25.8
US	1 914 927	2 005 183	10.5	11.5
UK	600 132	625 523	3.3	3.6
Canada	569 508	585 857	3.1	3.3
Other European Union countries	174 396	160 235	1.0	0.9
Japan	118 417	73 199	0.6	0.4
Other countries	278 814	276 323	1.6	1.6
Total	18 247 147	17 498 642	100.0	100.0

32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2018	2017	2018	2017
European Central Bank	4 952 780	4 604 114	27.1	26.3
AAA	6 822 777	6 261 804	37.4	35.8
AA	4 044 179	4 171 968	22.2	23.8
A	1 919 038	1 446 160	10.5	8.3
BBB	399 965	704 458	2.2	4.0
Assets not exposed to credit risk and assets without counterparty credit rating	108 408	310 138	0.6	1.8
Total	18 247 147	17 498 642	100.0	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above table show the breakdown of Latvijas Banka's assets as at the end of the reporting period. The rating "AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" – the counterparty's strong capacity to meet its financial commitments in the long term. "BBB" is a medium grade considered to be the lowest level of investment-grade rating.

Assets not exposed to credit risk and assets without counterparty credit rating mostly comprise securities purchased in longer-term refinancing operations with Latvian credit institutions (38 750 thousand euro; 244 660 thousand euro at the end of 2017) and fixed assets (37 790 thousand euro; 39 665 thousand euro at the end of 2017).

PROFIT AND LOSS STATEMENT NOTES

33. NET INTEREST INCOME

	(in thousands of euro)	
	2018	2017
Interest income	180 907	138 189
Interest on investments	116 817	91 353
Interest on customer deposits	4 077	881
Interest on monetary policy operations	60 013	45 955
Interest expense	-101 413	-66 691
Interest on investments	-98 771	-64 404
Interest on monetary policy operations	-2 642	-2 287
Net interest income	79 494	71 498

Net interest income was mainly derived from debt securities. In 2018, net interest income increased by 7996 thousand euro in comparison with 2017. Positive contribution mostly resulted from higher interest rates on investment and an increase in the amount of monetary policy operations, while a negative impact resulted from higher interest expense on investment, mainly due to a rise in the costs for hedging currency risks resulting from the widening of the spread between the interest rates of the euro and other investment currencies of Latvijas Banka.

Interest income from and interest expense on the intra-Eurosystem claims and liabilities are remunerated by applying the ECB's interest rate on the main refinancing operations and include income from foreign reserves transferred to the ECB and claims on allocation of banknotes in the Eurosystem, as well as expense on liabilities related to TARGET2 settlements. The interest rate on the main refinancing operations set by the ECB was 0% in 2018 and 2017, therefore Latvijas Banka had neither such interest income nor interest expense.

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

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

In 2018, interest income on monetary policy operations increased due to the implementation of the PSPP and higher interest income received on credit institution's demand deposits.

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

34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	(in thousands of euro)	
	2018	2017
Derivative financial instruments	-36 668	8 753
Debt securities	-25 306	15 073
Foreign exchange transactions	12 284	9 466
Total	-49 690	33 292

The result on derivative financial instruments posted a decrease of 45 421 thousand euro in comparison with 2017, mostly due to the result of interest rate future contracts, negatively affected by interest rate changes, as well as the result of currency future contracts concluded for the purpose of hedging currency risks. The positive result of the currency future contracts concluded for the purpose of hedging currency risk exposure is offset in equal value by the negative revaluation result of the balance sheet items hedged for foreign currency risk.

The result on the disposal of debt securities decreased by 40 379 thousand euro in comparison with 2017, mostly due to a rise in interest rates.

In 2018 and 2017, the realised gains on foreign exchange transactions resulted from the recognition of a part of the initial valuation account balance in profit and loss statement (see also Note 23), as well as the appreciation of the US dollar vis-à-vis the euro in 2018.

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

	(in thousands of euro)	
	2018	2017
Securities	-47 150	-15 929
Foreign currency positions	-407	-2 862
Interest rate swap arrangements	-346	-
Total	-47 903	-18 791

The revaluation result of several debt securities, foreign currency positions, and interest rate swap arrangements at the end of 2018 and 2017 was negative, and it has been recognised in the profit and loss statement. At the end of 2018, the total revaluation result on the equity securities portfolio was negative, and this was recognised in the profit and loss statement, while the positive result on the revaluation of debt securities, foreign currency positions, and interest rate swap arrangements has been reported under the balance sheet item "Capital and reserves" as the revaluation reserve of securities, foreign currency, and interest rate swap arrangements (see also Note 23).

The increase in the negative result on revaluation of debt securities is related to a rise in interest rates in Latvijas Banka's major investment markets in 2018.

36. PROVISIONS FOR MARKET RISK AND CREDIT RISK

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

The financial risks for the gold portfolio, long-term fixed income securities portfolio and equity securities portfolio have been assessed in compliance with the ECB's common

methodology for Eurosystem financial risk assessment using the Expected Shortfall (ES) measure with confidence level of 99% for a risk horizon of one year. ES99% describes the losses determined by the average value of 1% of the most unfavourable simulated profitability scenarios. The above methodology takes account of various market risk and credit risk factors as well as uses historical data and assumptions of the Eurosystem/ESCB's Risk Management Committee. ES99% includes assumptions concerning development of adverse financial market factors, e.g. interest rate rise, widening of the interest rate spreads, euro appreciation, and credit rating downgrades. Meanwhile, for the other portfolios financial risks have been assessed according to the change in the investment portfolio value if the interest rates rise by 100 basis points. According to the above methodology, the targeted amount of provisions for market risk and credit risk in 2018 was 190 000 thousand euro (220 000 thousand euro in 2017). In 2018, the decrease in the targeted amount of provisions for market risk and credit risk resulted from changes in the structure of Latvijas Banka's investment portfolios, mostly due to a decrease in the modified duration of the benchmark portfolios. Review of the targeted amount of provisions takes place on an annual basis taking into account the level of financial risks, the available financial reserves and long-term prospects of the financial market development.

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

In 2018, due to the substantial rise in interest rates in Latvijas Banka's major investment markets, the revaluation result on debt securities to be recognised in the profit and loss statement at the end of the year, as well as the realised result of interest rate future contracts were negative; therefore, in 2018 the Council of Latvijas Banka decided to use the provisions for market risk and credit risk related to the financial investments managed by Latvijas Banka, reducing the total amount by 55 576 thousand euro (in 2017 the respective provisions were increased by 42 400 thousand euro). In addition to the above, provisions for credit risk, associated with the Eurosystem monetary policy operations, in the amount of 370 thousand euro were established (276 thousand euro in 2017); as a result, the total outstanding amount of provisions reached 123 970 thousand euro at the end of 2018 (179 176 thousand euro at the end of 2017).

37. INCOME FROM EQUITY SECURITIES AND PARTICIPATING INTEREST

Income from participating interest comprises dividends received from the participating interest in the BIS in the amount of 305 thousand euro (390 thousand euro in 2017; see also Note 14.2) and income from the ECB's interim profit distribution for the reporting year and the remainder of the ECB's annual profit of the previous year in the amount of 5925 thousand euro (4868 thousand euro in 2017, see also Note 2.26).

Income from equity securities comprises the accrued and received dividends of the equity securities portfolio in the amount of 692 thousand euro (0 in 2017).

38. NET RESULT OF POOLING OF MONETARY INCOME

(in thousands of euro)

	2018	2017
Monetary income pooled	-50 208	-39 575
Monetary income received	50 330	43 226
Net result of pooling of monetary income	122	3 651

The monetary income pooled and received grew mainly due to an increase in the amount of securities purchased under the PSPP.

39. OTHER OPERATING INCOME

(in thousands of euro)

	2018	2017
Revaluation of liabilities for the issued lats banknotes and coins	7 200	10 300
Income from sale of collector coins	1 329	1 536
Other	741	546
Total	9 270	12 382

As a result of revaluation of liabilities for the issued lats banknotes and coins, income increased as the lats banknotes and coins, whose exchange probability is low, are not reported on the balance sheet pursuant to the "Financial Accounting Policy of Latvijas Banka" (see also Note 2.20). Revaluation of liabilities for the issued lats banknotes and coins is performed on an annual basis, taking into account the latest data on the exchange of lats banknotes and coins to euro banknotes and coins. In 2018, with the pace of exchange of the lats banknotes and coins moderating, the valuation of liabilities for the issued lats banknotes and coins decreased considerably (see also Note 22.1).

40. REMUNERATION, SOCIAL SECURITY COSTS, AND SOLIDARITY TAX

(in thousands of euro)

	2018	2017
Remuneration		
Remuneration for performance of duties of the Council and the Board	-880	-955
Remuneration of other personnel	-16 635	-16 661
Total remuneration	-17 515	-17 616
Social security costs and solidarity tax	-4 031	-3 962
Total remuneration, social security costs, and solidarity tax	-21 546	-21 578

At the end of 2018, the number of employees was 498 (528 at the end of 2017), representing 496 full-time equivalents in 2018 (511 in 2017).

41. BANKNOTE AND COIN ACQUISITION COSTS

(in thousands of euro)

	2018	2017
Acquisition of banknotes	-1 271	-3 148
Acquisition of collector coins	-752	-1 159
Acquisition of circulation coins	-81	-235
Total	-2 104	-4 542

42. OTHER OPERATING EXPENSES

	(in thousands of euro)	
	2018	2017
Maintenance and operation of information systems	-3 773	-3 404
Municipal services	-830	-837
Maintenance of buildings, territory and equipment	-615	-614
Disposal of material values	-529	-4
Business travel	-440	-516
Information and public relations	-319	-410
Personnel training	-256	-285
Telecommunication services and system maintenance	-243	-288
Tax on real estate	-228	-228
Acquisition of low value office supplies	-173	-322
Event services	-170	-102
Risk insurance	-151	-189
Transport provision	-80	-106
Other	-426	-468
Total	-8 233	-7 773

Other expenses also comprise the remuneration in the amount of 29 thousand euro paid to KPMG Baltics SIA for the audit of 2018 financial statements of Latvijas Banka (29 thousand euro in 2017). Expenses on disposal of material values comprise 484 thousand euro for transferring Latvijas Banka's real estate in the possession of the Ministry of Finance without any compensation due to closing the Training Centre of Latvijas Banka in 2018.

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

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

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

Pursuant to Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of both 2018 and 2017 (-0.356% and -0.346% respectively) to the amount of the Treasury's deposits in euro up to 200 million euro. As regards the total outstanding amount of the Treasury's settlement accounts in euro and foreign currencies exceeding 200 million euro, Latvijas Banka applies the deposit facility rate set by the ECB (it was negative at the end of both 2018 and 2017 - -0.40%).

At the end of 2018 and 2017, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	(in thousands of euro)	
	2018	2017
Claims		
Securities held for monetary policy purposes	1 186 436	982 537
Other securities	46 990	48 629
Accrued interest on debt securities	13 220	13 984
Total claims	1 246 646	1 045 150
Liabilities		
Demand deposits in euro	129 113	29 516
Demand deposits in foreign currencies	150 535	144 324
Tax liabilities	66	75
Total liabilities	279 714	173 915

In 2018 and 2017, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 22.2 and 23):

	(in thousands of euro)	
	2018	2017
Income (-)/expense and Latvijas Banka's profit appropriated to the state budget		
Interest on debt securities	-7 466	-4 459
Negative interest on government deposits	-544	-263
Taxes	10 513	10 589
Profit appropriated to the state budget	15 524	7 653
Total net expense and Latvijas Banka's profit appropriated to the state budget	18 027	13 520

44. PLEDGED ASSETS

Debt securities, gold and other financial instruments purchased by Latvijas Banka with the market value of 137 040 thousand euro, as at the end of 2018 (28 671 thousand euro at the end of 2017), have been pledged to provide collateral for gold swap arrangements, forward exchange rate contracts, interest rate and currency future contracts, and to ensure payment system operation. At the end of 2018, the pledged assets mostly consisted of the gold involved in gold swap arrangements in the amount of 117 701 thousand euro (0 at the end of 2017).

45. SECURITIES LENDING

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

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

At the end of 2018, the fair value of the securities lent, determined using quoted prices

in an active market, was 27 886 thousand euro (7427 thousand euro at the end of 2017); inter alia, the fair value of securities purchased and lent under the PSPP stood at 14 824 thousand euro at the end of 2018 (2073 thousand euro at the end of 2017).

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

46. CONTINGENT LIABILITIES AND COMMITMENTS

The uncalled portion of the BIS shares held by Latvijas Banka is 75% of their nominal value; these shares are callable following a respective decision of the BIS Board. At the end of 2018, the uncalled portion of the BIS shareholding was 4012 thousand SDR (4877 thousand euro; 4012 thousand SDR (4766 thousand euro) at the end of 2017; see also Note 14.2).

At the end of 2018, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 6878 thousand euro (6703 thousand euro at the end of 2017). These coins may be represented to Latvijas Banka at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

At the end of 2018, Latvijas Banka had issued lats banknotes and coins with the face value of 124 514 thousand euro (126 931 thousand euro at the end of 2017), reported on the balance sheet in the amount of 28 915 thousand euro (38 531 thousand euro at the end of 2017). Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited. In the opinion of the management of Latvijas Banka, the probability that Latvijas Banka would be required to exchange lats banknotes and coins in the amount of 95 600 thousand euro (88 400 thousand euro at the end of 2017) at face value, is low.

47. EVENTS AFTER THE REPORTING PERIOD

From 19 February 2018 to 25 February 2019, a prohibition to execute the functions of decision-making, control and supervision in Latvijas Banka was imposed on Ilmārs Rimšēvičs, Governor of Latvijas Banka. According to Latvijas Banka's management, the above factor had no effect on the financial position of Latvijas Banka and its financial performance results, or Latvijas Banka's capability to perform its tasks. Pursuant to the Judgement of the European Court of Justice of 26 February 2019 in the Joined Cases C-202/18 and C-238/18, the above prohibition was annulled and Ilmārs Rimšēvičs, Governor of Latvijas Banka, resumed his duties as the Governor of Latvijas Banka on 26 February 2019. In view of the fact that Ilmārs Rimšēvičs, the Governor of Latvijas Banka, is currently involved in an investigation, the Council of Latvijas Banka has defined appropriate work procedures, including information circulation, in order to prevent any potential conflict of interest in the actions of Ilmārs Rimšēvičs, the Governor of Latvijas Banka, and to ensure protection of official secrets.

TO THE COUNCIL OF LATVIJAS BANKA

Our Opinion on the Financial Statements

We have audited the accompanying financial statements of Latvijas Banka ("the Bank") set out on pages 72 to 119, which comprise:

- the balance sheet as at 31 December 2018,
- the profit and loss statement for the year then ended,
- the statement of total recognised gains and losses for the year then ended,
- the notes to the financial statements, which include a summary of principal accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Latvijas Banka as at 31 December 2018, and of its financial performance for the year then ended in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the Law on Latvijas Banka governing financial reporting.

Basis for Opinion

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

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

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

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

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

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

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

Auditors' Responsibility for the Audit of the Financial Statements

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

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

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

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

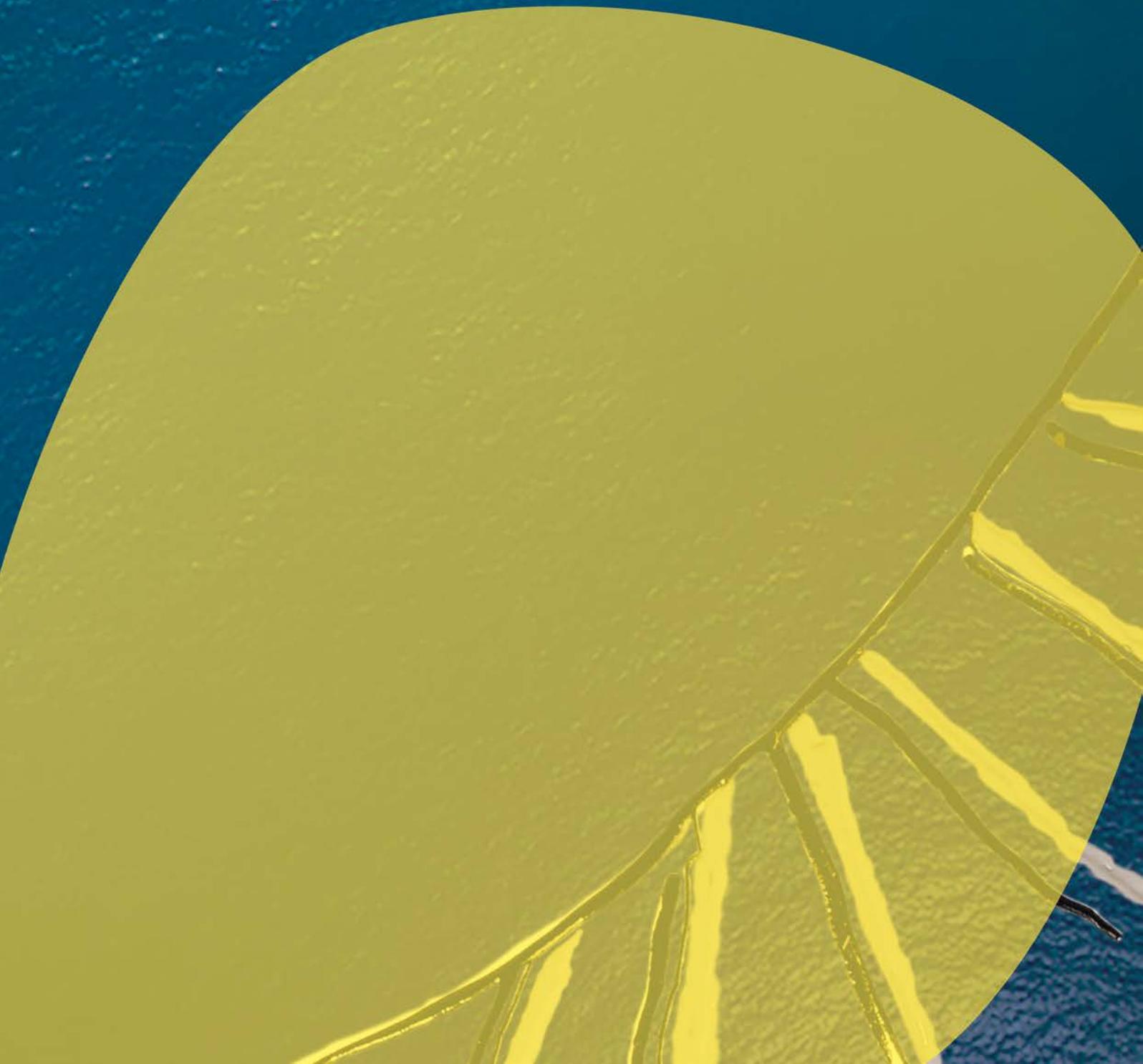
We communicate with those charged with the Bank's governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG Baltics SIA
Licence No. 55

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

7 March 2019

APPENDICES



MONETARY INDICATORS IN 2018

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
LATVIJAS BANKA												
Latvia's contribution to the euro area monetary base	9 928.9	9 391.9	9 702.3	10 128.2	9 696.7	9 729.3	8 461.7	8 679.0	8 673.9	8 842.0	8 880.1	9 696.5
Currency in circulation	4 332.3	4 333.1	4 394.7	4 403.7	4 422.1	4 461.3	4 492.0	4 505.7	4 513.8	4 531.5	4 544.2	4 646.4
Current accounts (covering the minimum reserve system)	5 596.6	5 058.8	5 307.6	5 724.5	5 274.6	5 268.0	3 969.7	4 173.3	4 160.1	4 310.5	4 335.9	5 050.1
Foreign assets outside the euro area	3 813.3	3 927.2	3 909.0	3 993.5	4 042.6	3 952.5	3 956.2	3 979.3	3 976.7	4 071.7	3 957.2	3 985.7
Foreign liabilities outside the euro area	25.4	6.7	4.6	1.1	1.1	1.6	1.3	11.2	5.5	1.0	1.0	131.8
Credit	8 834.4	9 171.0	8 937.3	9 013.3	9 071.9	8 967.8	9 035.5	9 066.9	9 123.0	9 173.9	9 169.1	9 180.0
To MFIs in the euro area	506.5	746.2	491.5	478.6	504.6	302.2	338.1	275.1	273.5	305.0	283.6	258.0
To the general government sector in the euro area	2 130.1	2 162.4	2 120.3	2 136.9	2 172.6	2 221.0	2 255.9	2 268.3	2 269.3	2 280.7	2 283.1	2 283.1
To other euro area residents	6 197.8	6 262.4	6 325.5	6 397.8	6 394.7	6 444.6	6 441.5	6 523.5	6 580.2	6 588.2	6 602.4	6 638.9
MFI												
Overnight deposits (Latvia's contribution to M1 of the euro area)	10 815.0	11 020.3	10 838.4	10 917.1	10 649.8	10 730.0	11 536.0	11 626.2	11 515.1	11 672.8	11 731.0	12 347.1
Deposits with an agreed maturity of up to 2 years	1 033.1	1 076.6	1 088.0	1 167.2	1 186.1	1 148.5	1 198.4	1 186.5	1 140.4	1 110.8	1 196.2	1 282.6
Deposits redeemable at notice of up to 3 months	954.7	954.9	953.5	948.4	938.6	941.8	931.3	922.4	926.7	934.2	936.2	938.5
Latvia's contribution to M2 of the euro area	12 802.8	13 051.8	12 879.9	13 032.7	12 774.5	12 820.3	13 665.7	13 735.1	13 582.2	13 717.8	13 863.4	14 568.1
Money market fund shares and units	0	0	0	0	0	0	0	0	0	0	0	0
Debt securities with a maturity of up to 2 years	43.4	17.8	19.3	20.1	22.6	22.8	-12.3	-12.3	-11.0	-11.1	-11.1	-13.7
Latvia's contribution to M3 of the euro area	12 846.2	13 069.6	12 899.2	13 052.8	12 797.1	12 843.1	13 653.4	13 722.8	13 571.1	13 706.6	13 852.3	14 554.5
Net foreign assets outside the euro area	113.6	837.7	404.7	580.7	935.2	859.9	2 485.9	2 494.1	2 552.9	2 626.6	2 703.4	2 331.0
Credit to euro area financial institutions, non-financial corporations and households	13 912.0	13 925.5	13 869.3	13 788.8	13 802.9	13 935.5	13 047.9	13 126.5	13 139.4	13 180.3	13 257.2	13 276.5
Loans to resident financial institutions, non-financial corporations and households	12 379.9	12 377.8	12 379.0	12 306.6	12 314.5	12 372.0	11 730.3	11 814.7	11 840.3	11 836.2	11 905.6	11 863.8
Deposits by resident financial institutions, non-financial corporations and households	11 451.7	11 308.9	11 363.4	11 561.9	11 303.3	11 362.5	11 320.2	11 386.6	11 277.3	11 394.1	11 534.8	12 093.7
INTEREST RATES												
Interest rate on the main refinancing operations (at end of period; %)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Weighted average interest rates on transactions in euro (%)												
Interbank loans	-0.40	-0.40	-0.39	-0.37	-0.40	-0.40	-0.40	-0.40	-0.40	-0.37	-0.38	-0.40
Loans to non-financial corporations and households with a floating interest rate and an initial rate fixation of up to 1 year (new business)	3.0	3.3	3.1	2.3	3.1	2.7	2.8	3.0	3.2	3.1	3.0	2.5
Time deposits by non-financial corporations and households (new business)	0.3	0.6	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.2	0.2	0.2

MONTH-END BALANCE SHEETS OF LATVIJAS BANKA FOR 2018

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
ASSETS	17 548 224	17 879 054	17 660 262	17 816 136	17 970 788	17 810 651	17 948 482	18 062 954	18 094 663	18 275 458	18 188 713	18 247 147
Gold and gold receivables	230 188	230 444	229 542	232 056	237 971	229 033	221 947	220 563	218 139	229 089	229 276	239 195
Claims on non-euro area residents denominated in foreign currency	3 480 264	3 594 640	3 575 965	3 645 627	3 687 624	3 616 303	3 575 671	3 606 455	3 603 981	3 630 763	3 522 480	3 566 027
Receivables from the IMF	141 315	142 994	142 571	143 755	146 410	145 867	144 622	145 226	145 601	147 365	147 051	146 833
Balances with credit institutions and security investments, external loans and other external assets	3 338 949	3 451 646	3 433 394	3 501 872	3 541 214	3 470 436	3 431 049	3 461 229	3 458 380	3 483 398	3 375 429	3 419 194
Claims on euro area residents denominated in foreign currency	349 049	369 716	359 774	354 631	351 728	348 077	349 587	324 223	336 187	355 820	333 258	326 308
Claims on non-euro area residents denominated in euro	102 799	102 152	103 506	115 863	116 983	107 171	158 540	152 278	154 556	211 885	205 452	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	244 660	194 660	247 660	247 660	247 660	58 750	58 750	58 750	43 250	54 450	54 450	38 750
Main refinancing operations	–	–	–	–	–	–	–	–	4 500	15 700	15 700	–
Longer-term refinancing operations	244 660	194 660	247 660	247 660	247 660	58 750	58 750	58 750	38 750	38 750	38 750	38 750
Other claims on euro area credit institutions denominated in euro	648	298 691	136	5 933	14 925	5 098	41 858	94	2 236	5 648	3 081	488
Securities of euro area residents denominated in euro	8 239 989	8 307 803	8 329 691	8 405 108	8 457 602	8 555 803	8 585 336	8 683 812	8 741 300	8 757 957	8 778 268	8 813 038
Securities held for monetary policy purposes	6 800 459	6 882 915	6 889 365	6 966 797	7 051 589	7 146 373	7 187 300	7 292 363	7 352 227	7 393 905	7 404 528	7 423 080
Other securities	1 439 530	1 424 888	1 440 326	1 438 311	1 406 013	1 409 430	1 398 036	1 391 449	1 389 073	1 364 052	1 373 740	1 389 958
Intra-Eurosystem claims	4 582 633	4 585 730	4 619 478	4 645 226	4 688 931	4 709 449	4 762 005	4 804 004	4 818 086	4 862 225	4 876 553	4 952 780
Participating interest in the ECB	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082
Claims equivalent to the transfer of foreign reserves to the ECB	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480
Claims related to other operational requirements within the Eurosystem	4 304 071	4 307 168	4 340 916	4 366 664	4 410 369	4 430 887	4 483 443	4 525 442	4 539 524	4 583 663	4 597 991	4 674 218
Other assets	317 994	195 218	194 510	164 032	167 364	180 967	194 788	212 775	176 928	167 621	185 895	208 724

Appendix 2 (cont.)

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
LIABILITIES	17 548 224	17 879 054	17 660 262	17 816 136	17 970 788	17 810 651	17 948 482	18 062 954	18 094 663	18 275 458	18 188 713	18 247 147
Banknotes in circulation	4 226 990	4 228 044	4 289 521	4 298 177	4 315 743	4 353 942	4 383 304	4 396 257	4 402 960	4 420 810	4 434 076	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	5 596 627	5 058 789	5 307 552	5 724 476	5 274 601	5 268 036	3 969 744	4 173 273	4 160 076	4 310 454	4 335 850	5 050 101
Current accounts (covering the minimum reserve system)	5 596 627	5 058 789	5 307 552	5 724 476	5 274 601	5 268 036	3 969 744	4 173 273	4 160 076	4 310 454	4 335 850	5 050 101
Other liabilities to euro area credit institutions denominated in euro	38 925	20 470	23 582	20 112	20 634	20 575	21 022	26 450	24 263	19 739	19 900	13 847
Liabilities to other euro area residents denominated in euro	214 181	719 306	821 857	836 751	731 308	679 964	1 930 424	1 505 870	1 516 687	1 392 942	1 654 950	1 449 237
General government	21 128	43 750	230 241	291 113	226 079	212 055	480 182	80 674	126 971	25 471	314 473	129 113
Other liabilities	193 053	675 556	591 616	545 638	505 229	467 909	1 450 242	1 425 196	1 389 716	1 367 471	1 340 477	1 320 124
Liabilities to non-euro area residents denominated in euro	21 898	6 268	4 641	1 054	1 075	1 562	1 260	8 959	4 956	1 037	1 036	16 524
Liabilities to euro area residents denominated in foreign currency	142 727	143 922	142 873	146 957	147 067	147 393	147 954	145 649	146 427	148 682	148 074	150 535
Liabilities to non-euro area residents denominated in foreign currency	3 524	393	–	–	–	–	–	2 232	587	–	–	115 284
Intra-Eurosystem liabilities	6 599 220	6 976 554	6 368 854	6 041 596	6 729 542	6 640 931	6 837 395	7 132 436	7 169 013	7 271 421	6 924 336	6 212 645
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	6 599 220	6 976 554	6 368 854	6 041 596	6 729 542	6 640 931	6 837 395	7 132 436	7 169 013	7 271 421	6 924 336	6 212 645
Other liabilities	308 195	350 594	308 695	378 970	379 690	330 727	306 379	309 753	330 232	371 470	316 155	251 877
Capital and reserves	395 937	374 714	392 687	368 043	371 128	367 521	351 000	362 075	339 462	338 903	354 336	450 368

YEAR-END BALANCE SHEETS OF LATVIJAS BANKA FOR THE YEARS 2014–2018

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

	2014	2015	2016	2017	2018
ASSETS	8 024 508	11 118 687	14 772 305	17 498 642	18 247 147
Gold and gold receivables	210 774	207 670	234 305	230 856	239 195
Claims on non-euro area residents denominated in foreign currency	2 441 368	2 949 979	3 092 076	3 608 692	3 566 027
Receivables from the IMF	144 069	153 780	153 992	143 477	146 833
Balances with banks and security investments, external loans and other external assets	2 297 299	2 796 199	2 938 084	3 465 215	3 419 194
Claims on euro area residents denominated in foreign currency	486 242	541 073	358 839	355 065	326 308
Claims on non-euro area residents denominated in euro	214 953	169 490	144 564	101 333	101 837
Lending to euro area credit institutions related to monetary policy operations denominated in euro	85 520	263 730	257 160	244 660	38 750
Main refinancing operations	–	–	–	–	–
Longer-term refinancing operations	85 520	263 730	257 160	244 660	38 750
Other claims on euro area credit institutions denominated in euro	4 475	2 491	9 071	438	488
Securities of euro area residents denominated in euro	1 095 446	3 015 433	6 319 754	8 131 197	8 813 038
Securities held for monetary policy purposes	–	1 808 374	4 357 306	6 719 984	7 423 080
Other securities	1 095 446	1 207 059	1 962 448	1 411 213	1 389 958
Intra-Eurosystem claims	3 393 275	3 802 596	4 195 918	4 604 114	4 952 780
Participating interest in the ECB	115 082	115 082	115 082	115 082	115 082
Claims equivalent to the transfer of foreign reserves to the ECB	163 480	163 480	163 480	163 480	163 480
Claims related to other operational requirements within the Eurosystem	3 114 713	3 524 034	3 917 356	4 325 552	4 674 218
Other assets	92 455	166 225	160 618	222 287	208 724

Appendix 3 (cont.)

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

	2014	2015	2016	2017	2018
LIABILITIES	8 024 508	11 118 687	14 772 305	17 498 642	18 247 147
Banknotes in circulation	3 849 170	3 992 436	4 150 106	4 314 088	4 536 729
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	2 423 356	4 784 410	4 191 147	5 712 980	5 050 101
Current accounts (covering the minimum reserve system)	2 073 356	4 784 410	4 191 147	5 712 980	5 050 101
Deposit facility	350 000	–	–	–	–
Other liabilities to euro area credit institutions denominated in euro	540	8 830	720	22 610	13 847
Liabilities to other euro area residents denominated in euro	126 919	145 894	212 239	215 712	1 449 237
General government	50 900	38 055	46 710	29 516	129 113
Other liabilities	76 019	107 839	165 529	186 196	1 320 124
Liabilities to non-euro area residents denominated in euro	23 986	9 099	17 888	2 535	16 524
Liabilities to euro area residents denominated in foreign currency	144 579	155 228	159 844	144 324	150 535
Liabilities to non-euro area residents denominated in foreign currency	–	478	–	634	115 284
Intra-Eurosystem liabilities	796 980	1 312 104	5 292 395	6 339 683	6 212 645
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	796 980	1 312 104	5 292 395	6 339 683	6 212 645
Other liabilities	180 089	258 853	294 614	305 552	251 877
Capital and reserves	478 889	451 355	453 352	440 524	450 368

PROFIT AND LOSS STATEMENTS OF LATVIJAS BANKA FOR THE YEARS 2014–2018

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

	2014	2015	2016	2017	2018
Net interest income	38 799	44 953	56 801	71 498	79 494
Interest income	50 097	64 696	102 982	138 189	180 907
Interest expense	-11 298	-19 743	-46 181	-66 691	-101 413
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions	-5 310	-11 717	-100 590	-28 175	-42 387
Realised gains arising from financial operations	11 135	37 216	38 539	33 292	-49 690
Recognition of revaluation result on financial assets and positions in profit and loss statement	-1 645	-13 633	-52 729	-18 791	-47 903
Provisions for market risk and credit risk	-14 800	-35 300	-86 400	-42 676	55 206
Net expense from fees and commissions	-1 213	-1 388	-2 200	-3 087	-2 783
Fees and commissions income	302	422	396	397	644
Fees and commissions expense	-1 515	-1 810	-2 596	-3 484	-3 427
Income from participating interest	3 650	4 157	5 242	5 258	6 922
Net result of pooling of monetary income	31 953	25 675	10 834	3 651	122
Other operating income	3 666	1 762	81 051	12 382	9 270
NET INCOME	71 545	63 442	51 138	61 527	50 638
Remuneration	-16 839	-16 932	-17 184	-17 616	-17 515
Social security costs and solidarity tax	-3 382	-3 518	-3 852	-3 962	-4 031
Banknote and coin acquisition costs	-2 633	-1 955	-7 283	-4 542	-2 104
Depreciation of fixed assets and amortisation of intangible assets	-3 685	-3 722	-3 755	-3 750	-4 189
Other operating expenses	-8 246	-7 278	-7 291	-7 773	-8 233
PROFIT OF THE REPORTING YEAR	36 760	30 037	11 773	23 884	14 566
Profit transferrable to the reserve capital	12 866	10 512	4 120	8 359	4 370
Profit transferrable to the state budget	23 894	19 525	7 653	15 525	10 196

ORGANISATIONAL UNITS OF LATVIJAS BANKA AT THE END OF 2018¹

1. CASH DEPARTMENT
 - 1.1 Cash Operations Division
 - 1.2 Coin Division
 - 1.3 Cash Technology Division
 - 1.4 Riga Branch
 - 1.5 Liepāja Branch
2. FINANCE DEPARTMENT
 - 2.1 Financial Statements and Accounting Policy Division
 - 2.2 Internal Banking Operations Division
3. FINANCIAL STABILITY DEPARTMENT
 - 3.1 Financial Stability Division
4. INFORMATION SYSTEMS DEPARTMENT
 - 4.1 System Design and Programming Division
 - 4.2 Computer Network and Server Systems Division
 - 4.3 Bank Information System Maintenance and Development Division
 - 4.4 Information Systems Security Division
 - 4.5 Information Systems Quality Assurance Division
 - 4.6 Systems Maintenance Division
5. INTERNAL AUDIT DEPARTMENT
6. INTERNATIONAL RELATIONS AND COMMUNICATION DEPARTMENT
 - 6.1 Document Management and Library Division
 - 6.2 Publications Division
 - 6.3 Public Relations Division
 - 6.4 International Relations and Protocol Division
7. LEGAL DEPARTMENT
8. MARKET OPERATIONS DEPARTMENT
 - 8.1 Trading and Investment Division
 - 8.2 Risk Management Division
9. MONETARY POLICY DEPARTMENT
 - 9.1 Macroeconomic Analysis Division
 - 9.2 Financial Market Analysis Division
 - 9.3 Monetary Research and Forecasting Division
10. PAYMENT SYSTEMS DEPARTMENT
 - 10.1 Payment Systems Policy Division
 - 10.2 Payment Systems Operations Division
 - 10.3 Payment and Settlement Division
 - 10.4 Credit Register Division
11. PERSONNEL DEPARTMENT
12. SECURITY DEPARTMENT
 - 12.1 Analytical Unit
 - 12.2 Armament Unit
 - 12.3 Central Division
 - 12.4 Riga Division
 - 12.5 Liepāja Division

¹ The Operational Risk Management Department is in place as of 1 February 2019.

Appendix 5 (cont.)

13. STATISTICS DEPARTMENT

13.1 Data Management Division

13.2 Statistics Compilation Division

13.3 Statistics Development Division

14. TECHNICAL SUPPORT DEPARTMENT

14.1 General Service Division

14.2 Building Systems Division

14.3 Security Systems Division

**PARTICIPATION OF LATVIJAS BANKA IN THE EUROSISTEM AND
THE EUROPEAN SYSTEM OF CENTRAL BANKS**

Governing Council of the ECB

General Council of the ECB

Supervisory Board of the ECB

Accounting and Monetary Income Committee (AMICO)

Banknote Committee (BANCO)

Budget Committee (BUCOM)

Committee on Controlling (COMCO)

Eurosystem/ESCB Communications Committee (ECCO)

Financial Stability Committee (FSC)

Human Resources Conference (HRC)

Information Technology Committee (ITC)

Internal Auditors Committee (IAC)

International Relations Committee (IRC)

Legal Committee (LEGCO)

Market Infrastructure and Payments Committee (MIPC)

Market Operations Committee (MOC)

Monetary Policy Committee (MPC)

Organisational Development Committee (ODC)

Risk Management Committee (RMC)

Statistics Committee (STC)

REPRESENTATION OF LATVIJAS BANKA IN INTERNATIONAL ORGANISATIONS

EUROPEAN UNION

ESRB

Advisory Technical Committee of the ESRB

Economic and Financial Committee for the Council of the EU (EFC)

EFC's Euro Coin Sub-Committee (ECSC)

EFC's Sub-Committee on IMF and Related Issues (SCIMF)

Board of Supervisors of the EBA

Permanent Representation of Latvia to the EU

Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)

EC Public Administration Network (PAN II)

INTERNATIONAL MONETARY FUND

Board of Governors

Nordic-Baltic Monetary and Financial Committee (NBMFC)

Alternates of Nordic-Baltic Monetary and Financial Committee (NBMFC Alternates)

Office of the Nordic-Baltic Executive Director in Washington

Appendix 8

LATVIJAS BANKA PUBLICATIONS AND MAJOR PUBLICATIONS BY THE EXPERTS OF LATVIJAS BANKA IN 2018

The following Latvijas Banka publications are available on Latvijas Banka website (www.bank.lv).

REGULAR PUBLICATIONS AND SERIAL PUBLICATIONS

Financial Stability Report. 2018

Latvijas Banka: Annual Report 2017

Latvijas Maksājumu Bilance. Latvia's Balance of Payments. 2017

Macroeconomic Developments Report (June and December; No. 27 and 28, 2018)

WORKING PAPERS

BENĶOVSKIS, Konstantīns, TKAČEVŠ, Oļegs, YASHIRO, Naomitsu (2018). *Importance of EU Regional Support Programmes for Firm Performance*. Latvijas Banka Working Paper, No. 1. 34 p.

AJEVSKIS, Viktors (2018). *The Natural Rate of Interest: Information Derived from a Shadow Rate Model*. Latvijas Banka Working Paper, No. 2. 15 p.

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HIGHLIGHTS OF EUROSISTEM'S MONETARY POLICY AND OTHER IMPORTANT TASKS IN 2018

On 2 January, the Governing Council of the ECB adopted Opinion CON/2018/1 on a proposal for a regulation of the European Parliament and of the Council on European business statistics amending Regulation (EC) No 184/2005 and repealing 10 legal acts in the field of business statistics.

On 25 January, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.40% respectively, expecting the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases;
- 2) to confirm that the net asset purchases, at the new monthly pace of 30 billion euro, are intended to run until the end of September 2018, or beyond, if necessary, and in any case until the Governing Council of the ECB sees a sustained adjustment in the path of inflation consistent with its inflation aim. If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council of the ECB stands ready to increase the expanded APP in terms of size and/or duration;
- 3) to reinvest the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary.

On 26 January, the Governing Council of the ECB:

- 1) decided to again include the Icelandic króna in the list of currencies for which the ECB publishes daily euro foreign exchange reference rates;
- 2) reviewed the list of acceptable non-regulated markets for assets eligible as collateral for Eurosystem monetary policy operations; the list of issuers classified as multilateral development banks and international organisations; and the list of issuers classified as agencies in haircut category II;
- 3) approved the establishment of a Euro Cyber Resilience Board for pan-European Financial Infrastructures;
- 4) adopted Regulation ECB/2018/2 on statistical reporting requirements for pension funds.

On 31 January, the Governing Council of the ECB approved the organisation of annual meetings to foster discussions about statistical issues between members of the Eurosystem/ESCB Statistics Committee and banking sector representatives.

On 7 February, the Governing Council of the ECB adopted the following documents:

- 1) Guideline ECB/2018/3 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework;
- 2) Guideline ECB/2018/4 amending Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework;
- 3) Guideline ECB/2018/5 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral.

On 9 February, the Governing Council of the ECB approved the extension of the additional credit claims frameworks in their current format until the maturity date of the final targeted longer-term refinancing operation in the second series (TLTRO II), which is scheduled for 24 March 2021.

On 22 February, the Governing Council of the ECB adopted Regulation ECB/2018/7 amending Regulation (EU) No 1011/2012 and Guideline ECB/2018/8 amending Guideline ECB/2013/7, which both concern statistics on holdings of securities.

Appendix 9 (cont.)

On 2 March, the Governing Council of the ECB:

- 1) approved a revised mandate of the European Forum on the Security of Retail Payments (SecuRe Pay);
- 2) adopted Opinion CON/2018/12 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board.

On 8 March, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting them to remain at the present levels for an extended period of time, and well past the horizon of the net asset purchases;
- 2) to confirm that the net asset purchases, at the current monthly pace of 30 billion euro, are intended to run until the end of September 2018, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim;
- 3) to reinvest the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary.

On 9 March, the Governing Council of the ECB approved the Eurosystem response to the European Securities and Markets Authority public consultation on disclosure requirements for securitisations.

On 15 March, the Governing Council of the ECB approved the launch of a second public consultation on the detailed features of the new euro unsecured overnight interest rate.

On 29 March, the Governing Council of the ECB decided to enhance the communication on the ESCB's integrated statistical reporting framework for banks by approving the publication on the ECB's website of an update on the Banks' Integrated Reporting Dictionary and the Integrated Reporting Framework.

On 6 April, the Governing Council of the ECB approved the launch of a public consultation on draft cyber resilience oversight expectations for financial market infrastructures.

On 11 April, the Governing Council of the ECB adopted the following documents:

- 1) Opinion CON/2018/19 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) and related legal acts;
- 2) Opinion CON/2018/20 on a proposal for a regulation on the establishment of the European Monetary Fund.

On 26 April, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting them to remain at the present levels for an extended period of time, and well past the horizon of the net asset purchases;
- 2) to continue the net asset purchases at the current monthly pace of 30 billion euro until the end of September 2018, or beyond, if necessary, and in any case until the Governing Council of the ECB sees a sustained adjustment in the path of inflation consistent with its inflation aim;
- 3) to reinvest the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary.

Appendix 9 (cont.)

On 30 April, the Governing Council of the ECB approved the European Framework for Threat Intelligence-based Ethical Red Teaming (TIBER-EU FRAMEWORK. How to implement the European framework for Threat Intelligence-based Ethical Red Teaming. May 2018).

On 3 May, the Governing Council of the ECB:

- 1) adopted Guideline ECB/2018/14 on the Eurosystem's provision of reserve management services in euro to central banks and countries located outside the euro area and to international organisations;
- 2) took note of the TARGET Annual Report 2017. (TARGET Annual Report 2017. May 2018).

On 11 May, the Governing Council of the ECB adopted the following documents:

- 1) Opinion CON/2018/25 on a proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States;
- 2) Opinion CON/2018/26 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and related legal acts; and on a proposal for a directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

On 16 May, the Governing Council of the ECB:

- 1) decided that the new ECB unsecured overnight rate would be called ESTER (euro short-term rate; as of 12 March 2019 – €STR). This interest rate will be produced before 2020;
- 2) authorised the publication of the "Financial Stability Review" (Financial Stability Review. May 2018).

On 18 May, the Governing Council of the ECB approved the Eurosystem's response to the European Securities and Markets Authority consultation on application requirements for securitisation repositories.

On 23 May, the Governing Council of the ECB took note of the 2017 annual progress report on the preparatory measures for the long-term framework for the collection of granular credit data, prepared in accordance with Article 3(2) of Decision ECB/2014/6 on the organisation of preparatory measures for the collection of granular credit data.

On 25 May, the Governing Council of the ECB approved the 17th annual review of the international role of the euro (The international role of the euro. June 2018).

On 1 June, the Governing Council of the ECB adopted the following documents:

- 1) Guideline ECB/2018/16 on the Register of Institutions and Affiliates Database;
- 2) Guideline ECB/2018/17 amending Guideline ECB/2014/15 on monetary and financial statistics.

On 7 June, the Governing Council of the ECB approved an updated version of the Eurosystem assessment methodology for payment systems (Revised assessment methodology for payment systems. June 2018).

On 14 June, the Governing Council of the ECB, at its meeting in Riga, decided:

- 1) that net purchases under the expanded APP would continue at the current monthly pace of 30 billion euro until the end of September 2018, but after September 2018, subject to incoming data confirming the Governing Council's medium-term inflation outlook, the monthly pace of net asset purchases would be reduced to 15 billion euro until the end of December 2018 and that net purchases would then end;

Appendix 9 (cont.)

2) to maintain its policy of reinvesting the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;

3) that the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with our current expectations of a sustained adjustment path.

On 21 June, the Governing Council of the ECB approved a change to the TARGET2-Securities pricing policy whereby the settlement fee for a delivery versus payment instruction will increase from 15 euro cents to 23.5 euro cents as from 1 January 2019.

On 25 June, the Governing Council of the ECB approved the methodology for calculating the €STR (The euro short-term rate (€STR) methodology and policies).

On 5 July, the Governing Council of the ECB approved the indicative calendars for the Eurosystem's regular tender operations and reserve maintenance periods for 2019.

On 12 July, the Governing Council of the ECB adopted Opinion CON/2018/32 on a proposal for a regulation on minimum loss coverage for non-performing exposures.

On 18 July, the Governing Council of the ECB adopted Opinion CON/2018/33 on a proposal for a regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims.

On 26 July, the Governing Council of the ECB decided:

1) that the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;

2) to continue to make net purchases under the expanded APP at the current monthly pace of 30 billion euro until the end of September 2018, expecting that after September 2018, subject to incoming data confirming the Governing Council's medium-term inflation outlook, the monthly pace of the net asset purchases will be reduced to 15 billion euro until the end of December 2018 and that net purchases will then end, and intending to reinvest the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 27 July, the Governing Council of the ECB:

1) took note of the mutual decision of the EU national central banks participating in the Memorandum of Understanding established in April 2010 on bilateral voluntary data exchange among EU central credit registers that it be discontinued by September 2018, in light of the imminent establishment of AnaCredit;

2) approved the annual confidentiality report on the measures adopted to safeguard the confidentiality of statistical information in accordance with Council Regulation (EC) No 2533/98.

On 2 August, the Governing Council of the ECB adopted the following documents:

1) Guideline ECB/2018/19 amending Guideline ECB/2011/23 on the statistical reporting requirements of the European Central Bank in the field of external statistics;

Appendix 9 (cont.)

2) a decision to launch a public consultation on the draft ECB regulation amending Regulation (EU) No 1333/2014 concerning statistics on the money markets (ECB/2014/48).

On 3 August, the Governing Council of the ECB:

- 1) adopted Guideline ECB/2018/20 amending Guideline ECB/2012/27 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2);
- 2) approved the TIBER-EU Framework Services Procurement Guidelines (TIBER-EU Framework. Services Procurement Guidelines. August 2018).

On 16 August, the Governing Council of the ECB adopted Opinion CON/2018/35 on a proposal for a regulation of the European Parliament and of the Council establishing an exchange, assistance and training programme for the protection of the euro against counterfeiting (the 'Pericles IV programme').

On 22 August, the Governing Council of the ECB adopted the following documents:

- 1) Opinion CON/2018/36 on the review of prudential treatment of investment firms;
- 2) Opinion CON/2018/37 on a proposal for a directive of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU; and on a proposal for a regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds.

On 31 August, the Governing Council of the ECB adopted Opinion CON/2018/38 on a proposal for a regulation on certain charges on cross-border payments in the Union and currency conversion charges.

On 6 September, the Governing Council of the ECB approved the publication of the Eurosystem report on the gap assessment of card payment schemes against the "Oversight framework for card payment schemes – standards".

On 13 September, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
- 2) to continue to make net purchases under the expanded APP at the current monthly pace of 30 billion euro until the end of September 2018, expecting that after September 2018 the monthly pace of the net asset purchases will be reduced to 15 billion euro until the end of December 2018 and that subject to incoming data confirming the medium-term inflation outlook net purchases will then end, and intending to reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 20 September the Governing Council of the ECB took note of the fifth report on card fraud and authorised its publication (Fifth report on card fraud. September 2018).

On 8 October, the Governing Council of the ECB adopted Decision ECB/2018/24 amending Decision ECB/2007/7 concerning the terms and conditions of TARGET2-ECB.

On 25 October, the Governing Council of the ECB decided:

- 1) that the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting the key ECB interest rates to remain at their present levels at least through the summer

Appendix 9 (cont.)

of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term; 2) to continue to make net purchases under the expanded APP at the new monthly pace of 15 billion euro until the end of December 2018, anticipating that, subject to incoming data confirming the medium-term inflation outlook, the net asset purchases will then end, and intending to reinvest the principal payments from maturing securities purchased under the expanded APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

On 9 November, the Governing Council of the ECB adopted Opinion CON/2018/51 on a proposal for a regulation on the establishment of a European Investment Stabilisation Function.

On 20 November, the Governing Council of the ECB adopted Opinion CON/2018/54 on credit servicers, credit purchasers and the recovery of collateral.

On 29 November, the Governing Council of the ECB:

- 1) approved the closure report on the UNITAS market-wide crisis communication exercise performed on 28 June 2018 with European financial infrastructures and central bank overseers based on a scenario of a cyberattack;
- 2) approved the final cyber resilience oversight expectations for financial market infrastructures (Cyber resilience oversight expectations for financial market infrastructures. December 2018);
- 3) adopted Decision ECB/2018/27 on the national central banks' percentage shares in the key for subscription to the European Central Bank's capital and repealing Decision ECB/2013/28;
- 4) adopted Decision ECB/2018/28 on the paying-up of the European Central Bank's capital by the national central banks of Member States whose currency is the euro, amending Decision ECB/2014/61 and repealing Decision ECB/2013/30;
- 5) adopted Decision ECB/2018/29 laying down the terms and conditions for transfers of the European Central Bank's capital shares between the national central banks and for the adjustment of the paid-up capital and repealing Decision ECB/2013/29;
- 6) adopted Decision ECB/2018/30 laying down the measures necessary for the contribution to the European Central Bank's accumulated equity value and for adjusting the national central banks' claims equivalent to the transferred foreign reserve assets and repealing Decision ECB/2013/26;
- 7) adopted Decision ECB/2018/31 amending Decision ECB/2010/29 on the issue of euro banknotes.

On 30 November, the Governing Council of the ECB adopted Decision ECB/2018/32 on the paying-up of the European Central Bank's capital by the non-euro area national central banks and repealing Decision ECB/2013/31.

On 7 December, the Governing Council of the ECB adopted the following documents:

- 1) Opinion CON/2018/55 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) and related legal acts;
- 2) Regulation ECB/2018/33 amending Regulation (EU) No 1333/2014 concerning statistics on the money markets.

On 13 December, the Governing Council of the ECB:

- 1) decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged, expecting that the key ECB interest rates would remain at their present levels at least through the

Appendix 9 (cont.)

summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;

2) decided to end net asset purchases under the expanded APP in December 2018, and at the same time to enhance its forward guidance on reinvestment. Accordingly, the Governing Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the expanded APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation;

3) approved the TIBER-EU White Team Guidance.

**2018 HIGHLIGHTS OF REGULATORY DOCUMENTS ADOPTED IN
PURSUIT OF THE MAIN TASKS OF LATVIJAS BANKA**

Regulatory document	No.	Date of adoption (effective date)	Title of the regulatory document adopted by the Council of Latvijas Banka
Regulation	159	18.01.2018 (01.02.2018)	"Amendment to Regulation No. 130 'Regulation for Electronic Information Exchange with Latvijas Banka' of Latvijas Banka of 12 December 2013"
Regulation	160	18.01.2018 (01.04.2018)	"Regulation for the Credit Register"
Regulation	161	18.01.2018 (01.04.2018)	"Regulation on the Provision of Information on the Credit Institutions' Credit Exposures and the Persons Involved"
Regulation	162	18.01.2018 (01.04.2018)	"Regulation for Electronic Information Exchange with Latvijas Banka"
Regulation	163	15.03.2018 (01.09.2018)	"Regulation for Compiling Reports on Securities"
Regulation	164	15.03.2018 (01.09.2018)	"Amendments to Regulation No. 162 'Regulation for Electronic Information Exchange with Latvijas Banka' of Latvijas Banka of 18 January 2018"
Regulation	165	15.03.2018 (21.03.2018)	"Amendments to Regulation No. 36 'Regulation for Purchasing and Selling Cash Foreign Currencies' of Latvijas Banka of 13 May 2009"
Procedure	272/1	06.04.2018 (16.04.2018)	"Amendment to Procedure No. 217/1 'Participation Procedure in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka' of the Council of Latvijas Banka of 12 December 2013"
Procedure	272/2	06.04.2018 (16.04.2018)	"Amendment to Procedure No. 260/3 'Participation Procedure in the Eurosystem Monetary Policy Operations in US Dollars Organised by Latvijas Banka' of the Council of Latvijas Banka of 14 September 2017"
Regulation	166	10.05.2018 (01.06.2018)	"Amendment to Regulation No. 133 'Regulation for Compiling Interest Rate Reports of Monetary Financial Institutions' of Latvijas Banka of 16 May 2014"
Regulation	167	10.05.2018 (01.06.2018)	"Amendment to Regulation No. 134 'Regulation for Compiling the 'Report on Adjustments in Respect of Write-Offs/Write-Downs of Loans and Price Revaluations of Securities' of Latvijas Banka of 16 May 2014"
Procedure	275/4	10.05.2018 (10.05.2018)	"Amendments to Procedure No. 232/5 'Participation Procedure in Cash Transactions at Latvijas Banka' of the Council of Latvijas Banka of 27 April 2015"
Regulation	168	19.07.2018 (31.08.2018)	"Amendments to Regulation No. 160 'Regulation for the Credit Register' of Latvijas Banka of 18 January 2018"
Procedure	279/2	20.09.2018 (18.11.2018)	"Amendments to Procedure No. 183/3 'Participation Procedure in the Electronic Clearing System of Latvijas Banka' of the Council of Latvijas Banka of 9 September 2010"
Procedure	279/3	20.09.2018 (18.11.2018)	"Latvijas Banka's Procedure for the Use of the IBAN Register"
Procedure	279/4	20.09.2018 (18.11.2018)	"Amendments to Procedure No. 213/9 'On the Regulation for Servicing of Customer Accounts of Latvijas Banka' of the Council of Latvijas Banka of 16 September 2013"
Procedure	281/2	15.11.2018 (30.11.2018)	"Amendments to Procedure No. 186/4 'Participation Procedure in TARGET2-Latvija' of the Council of Latvijas Banka of 4 November 2010"
Regulation	169	20.12.2018 (01.01.2019)	"Amendment to Regulation No. 162 'Regulation for Electronic Information Exchange with Latvijas Banka' of Latvijas Banka of 18 January 2018"

*Appendix 11***GLOSSARY**

AnaCredit (analytical credit datasets): a common Eurosystem's granular analytical credit database containing data on all euro area Member States. The collection of granular credit and credit risk data is based on harmonised ECB statistical reporting requirements.

Balance of payments: a statistical statement summarising transactions between Latvia's residents and the residents of the rest of the world. It incorporates the current account, the capital account and the financial account.

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

Banking union: an EU-level framework for banking supervision and resolution operating based on a single rulebook applicable in the entire EU. Euro area countries and those EU countries outside the euro area opting to participate in the banking union are members of the banking union.

Blockchain: a continuously growing list of records forming blocks of records which are linked and secured using cryptography. Each block of records typically contains a cryptographic hash of the previous block, timestamp and transaction data.

Capital account: a balance sheet component reflecting gross acquisitions/disposals of non-produced non-financial assets and capital transfers between Latvia's residents and the residents of the rest of the world.

Central government: public institutional units, including ministries, embassies, representative offices, agencies, councils, educational, healthcare, law enforcement, cultural and other public institutions whose competence covers the whole economic territory of the country, except for the administration of social security funds. The list of the institutional units of the Latvian central government is prepared by the CSB.

Clearing: the process of transmitting, processing and reconciling payment documents or securities transfer orders prior to settlement, resulting in establishment of the net position of each settlement participant by netting all payment documents submitted by the settlement participants, i.e. establishing net cash liabilities to or claims on other settlement participants.

Collateral: assets that are pledged or otherwise transferred to secure repayment of a loan, as well as those sold under repurchase agreements. The collateral used in the Eurosystem's reverse transactions should meet certain eligibility criteria.

Council of the EU (EU Council): the institution representing the governments of EU countries. The ministers of EU countries meet in the EU Council to adopt legislative acts and coordinate policies. The EU Council is an essential EU decision-maker. It is a single legal entity, but it meets in 10 different configurations, depending on the subject being discussed. The most significant tasks of the EU Council include negotiating and adopting legislative acts, developing common foreign and security policy of the EU, signing international agreements on behalf of the EU as well as adopting the EU budget together with the European Parliament.

Credit institution: a capital company whose business is to receive deposits or other repayable funds from the public and to grant credits on its own account and provide other financial services.

Appendix II (cont.)

Current account: a balance sheet component reflecting flows in goods, services, primary income and secondary income between Latvia's residents and the residents of the rest of the world.

Debt security: a security representing an obligation on the part of the issuer to make one or more payment(s) to the holder of the security at a specified future date or dates. Such security usually carries a specific rate of interest (the coupon) or is sold at a discount/premium to the amount that will be repaid at maturity.

Deposit facility: a standing facility of the Eurosystem which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to make overnight deposits with Latvijas Banka at a pre-specified interest rate.

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

Deposits: funds placed on the accounts of MFIs for a specified or unspecified period of time, with or without earning interest.

Direct investment: investment by an investor (direct investor) made directly or indirectly (through subsidiaries or associated companies) to acquire a lasting interest (corresponding to at least 10% ownership of ordinary shares or voting rights) in an enterprise (direct investment enterprise). The components of direct investment are equity and debt instruments.

Distributed ledger technology: a technology using protocols and support infrastructure to enable nodes in various locations to propose and validate transactions and synchronised record updates across all network.

EBA Clearing (EBA Clearing S.A.S. à capital variable): a capital company established by the major European and international banks, which provides pan-European payment infrastructure solutions, offering clearing and settlement services for both high-value and low-value euro payments to a wide community of banks in the EU.

Economic and Financial Committee (EFC): a counselling body set up to promote economic and financial policy coordination among the EU countries. In its fields of competence, the EFC delivers opinions at the request of the EU Council or the EC, as well as provides framework for the dialogue between the EU Council and the ECB and contributes to the preparation of the work of the EU Council. The EFC is composed of representatives of the governments (usually Ministries of Finance) and central banks of the EU Member States as well as representatives of the EC and ECB.

Electronic Clearing System of Latvijas Banka (EKS): net settlement system of Latvijas Banka ensuring the processing of retail payment orders and the settlement of net positions.

EONIA (euro overnight index average): a measure of the effective interest rate prevailing in the euro interbank overnight market. It is calculated as a weighted average of the interest rates on unsecured overnight loans denominated in euro, as reported by a panel of contributing banks.

Equities: securities representing ownership of a stake in a commercial company. They comprise shares traded on stock exchanges (quoted shares), unquoted shares and other forms of equity. Equities usually produce income in the form of dividends.

Appendix 11 (cont.)

€STR (euro short-term rate): ECB's short-term rate reflecting the wholesale euro unsecured overnight borrowing costs of euro area banks and complementing the existing benchmark rates produced by the private sector.

EURIBOR (euro interbank offered rate): the rate at which euro interbank term deposits are being offered within the euro area by one credit institution which is an active euro money market participant to another credit institution of such type in the euro area at 11.00 a.m. CET.

Euro area: EU countries which have adopted the euro as their single currency in accordance with the Treaty on the Functioning of the European Union and in which a single monetary policy is conducted under the responsibility of the Governing Council of the ECB. As at the end of 2018, the euro area comprised Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

European Banking Authority (EBA): an EU body with legal personality which forms part of the European System of Financial Supervisors and works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objective is to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

European Central Bank (ECB): the central institution of the ESCB and the Eurosystem having a legal personality under the EU law. The ECB implements the tasks conferred upon the Eurosystem and the ESCB pursuant to the Statute of the ESCB and the ECB in cooperation with the national central banks of the EU Member States.

European Council: an EU institution defining the EU's overall political direction and priorities. It is comprised of the heads of state or government of the EU Member States, the President of the European Council and the President of the EC.

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

European Systemic Risk Board (ESRB): an independent EU body which is a part of the European System of Financial Supervision and is responsible for the macro-prudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system, taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It contributes to the smooth functioning of the internal market and thereby ensures a sustainable contribution of the financial sector to economic growth.

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

Expanded asset purchase programme (APP): includes all public and private sector asset purchase programmes that the Eurosystem implements to address the risks of a too prolonged period of low inflation. The APP includes the covered bond purchase programme (CBPP), the asset-backed securities purchase programme (ABSPP), the public sector asset purchase programme (PSPP) and the corporate sector purchase programme (CSPP).

Appendix 11 (cont.)

Financial account: a balance sheet component reflecting financial assets and financial liabilities (direct investment, portfolio investment, financial derivatives, other investment and reserve assets) between Latvia's residents and the residents of the rest of the world.

Financial stability: the condition in which the financial system (financial intermediaries, markets and market infrastructures) is capable of withstanding shocks without significant disruptions in the financial intermediation process and the supply of general financial services.

Fine-tuning operation: an open market operation executed by the Eurosystem in order to deal with unexpected liquidity fluctuations in the market. The frequency and maturity of these operations are not standardised.

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

General Council of the ECB: one of the decision-making bodies of the ECB, comprising the President and the Vice-President of the ECB and the Governors of the central banks of all EU countries.

General government: public institutional units engaged in production of goods or provision of services intended for individual or collective consumption free of charge or at economically insignificant prices, primarily financed from the compulsory payments (taxes and duties) imposed on economic agents, as well as institutional units engaged in redistribution of national income or wealth. General government in the Republic of Latvia includes central government, local governments and social security funds. The list of the institutional units of the Latvian central government is prepared by the CSB.

Governing Council of the ECB: the main decision-making body of the ECB. It consists of members of the Executive Board of the ECB and the governors of the national central banks of the euro area.

Gross settlement system: a transfer system in which the settlement concerning each cash or securities transfer order occurs on an instruction-by-instruction basis in the order of receipt.

Household: a natural person or group of natural persons in the capacity of a consumer and producer of goods and a provider of non-financial services for exclusively own final use; a sole proprietor which is an economic unit established by a natural person or a group of natural persons; this natural person or group of natural persons is liable for the settlement of the obligations of the economic unit with its entire property and the unit's accounting is organised in accordance with the single-entry system.

Instant payment: execution of customer payments within a matter of seconds, making cash transfers 24 hours a day, 7 days a week, 365 days a year, including holidays and weekends.

Integrated Reporting Framework (IReF): an important initiative of the ESCB providing for maximum harmonisation of data requirements for the needs of statistics and supervision of credit institutions ensuring optimal data availability on the level of both granular and aggregate data. IReF envisages data collection from credit institutions' information systems and reporting based on the Bank's Integrated Reporting Dictionary (BIRD) and a data exchange standard.

International investment position: a statistical statement reflecting the value and composition of financial claims (assets) on and financial obligations (liabilities) between

Appendix 11 (cont.)

Latvia's residents and the residents of the rest of the world, on a specific date, as well as changes in the residual values in the respective time period.

International Monetary Fund (IMF): an international organisation operating to facilitate international monetary cooperation, exchange rate stability, national economic growth and employment growth, and provide short-term financial assistance to IMF member countries for balancing the payment flow.

Key ECB interest rates: the interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility set by the Governing Council of the ECB.

Local government: institutional units of the local public administration, whose competence covers only a local economic territory. The list of the institutional units of the Latvian central government is prepared by the CSB.

M1: a narrow monetary aggregate comprising currency in circulation and overnight deposits held with MFIs by euro area residents.

M2: an intermediate monetary aggregate comprising M1 and deposits held with MFIs by euro area residents and redeemable at a period of notice of up to and including 3 months (i.e. short-term savings deposits) and those with an agreed maturity of up to and including 2 years (i.e. short-term time deposits).

M3: a broad monetary aggregate comprising M2 and marketable instruments, in particular repurchase agreements, money market fund shares/units, and debt securities with a maturity of up to and including 2 years issued by MFIs.

Main refinancing operation: a regular open market operation executed by the Eurosystem in the form of reverse transactions. Such operations are carried out through a weekly standard tender and normally have a maturity of one week.

Marginal lending facility: a standing facility, offered by the Eurosystem, which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to receive overnight credit from Latvijas Banka at a pre-specified interest rate against marketable or non-marketable assets.

Market risk: the risk related to fluctuations of the fair value or cash flow of financial instruments on account of movements in market prices. Market risk reflects the interest rate risk, currency risk and price risk.

Monetary base (base money): currency (banknotes and coins) in circulation, the minimum reserves credit institutions are required to hold with the Eurosystem as well as any excess reserves they may hold under the Eurosystem's deposit facility or as other liabilities related to the monetary policy operations.

Monetary financial institution (MFI): a central bank, credit institution, credit union, money market fund and other financial institution whose business is to receive deposits or close substitutes for deposits from customers other than MFIs and, on their own account, to grant credits and invest in securities, as well as an electronic money institution whose core business is to issue electronic money. Latvijas Banka sets up, maintains and regularly updates the List of Monetary Financial Institutions of the Republic of Latvia (see section Statistics on Latvijas Banka's website www.bank.lv). The list is also available on the ECB website where the ECB publishes the list of MFIs of the EU Member States on a regular basis. As at the end of 2018, there were 57 MFIs in Latvia.

Appendix 11 (cont.)

Monetary income: income accruing to the national central banks of the euro area in the process of the Eurosystem's monetary policy implementation, derived from assets earmarked in accordance with guidelines established by the Governing Council and held against banknotes in circulation and credit institutions' deposits with central banks of the euro area.

Non-financial corporation: an institutional unit whose principal activity is producing goods and providing non-financial services, including an economic unit established by a natural person or a group of natural persons; this natural person or group of natural persons is liable for the settlement of the obligations of the economic unit with its entire property and the unit's accounting is organised in accordance with the single-entry system.

Open market operation: an operation executed in the financial market on the initiative of a central bank. With regard to their aims, regularity and procedures, Eurosystem's open market operations can be divided into four categories: main refinancing operations, longer-term refinancing operations, fine-tuning operations and structural operations.

Organisation for Economic Co-operation and Development (OECD): an intergovernmental organisation, a forum providing a platform for seeking answers to common problems, identifying good practices and coordinate domestic and stimulating policies that improve the economic and social well-being of persons.

Outright transactions: open market operations where the Eurosystem purchases or sells eligible assets outright in the market. Outright transactions are executed only for structural purposes.

Price stability: the maintenance of price stability is the primary objective of the Eurosystem. The Governing Council of the ECB has defined price stability as a year-on-year increase in the HICP for the euro area that is below 2%. The Governing Council has also stated that, in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2%.

Real-Time Gross Settlement (RTGS) system: a settlement system in which processing of cash or securities transfer orders and settlement takes place on an individual basis and in a consecutive order (without netting) in real time.

Register of Institutions and Affiliates Database (RIAD): a shared central repository maintained by the ECB that holds reference data (attributes) on legal units and other statistical institutional units, the collection of which supports business processes across the Eurosystem and the performance of the tasks of the ESCB and the SSM. RIAD facilitates the integration of a variety of datasets, in particular by providing common identifiers. RIAD data are also used to prepare the official lists of monetary financial institutions, investment funds, financial vehicle corporations engaged in securitisation transactions, payment statistics relevant institutions and insurance corporations.

Reserve requirement: a requirement for credit institutions and credit unions to hold their minimum reserves with the national central bank over the reserve maintenance period. Compliance with the requirement is determined on the basis of the average end-of-day balance on the reserve account over the reserve maintenance period.

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

Reverse transaction: a transaction whereby the Eurosystem buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

Appendix 11 (cont.)

Securities settlement system: an agreement between at least three participants, apart from the operator of the system, on the execution of securities' transfer orders between those participants in accordance with uniform regulations and standardised procedures.

Single Euro Payments Area (SEPA): a project proposed by the European banks and supported by the Eurosystem and the EC to harmonise the way retail payments in euro are made, making payments in euro across European countries as fast, secure and effective as domestic payments. SEPA enables consumers, businesses and other economic agents to make both domestic and cross-border payments in euro on the same main terms and conditions, with the same rights and obligations, regardless of their location. As at the end of 2018, SEPA encompassed all EU Member States, Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland.

Single Supervisory Mechanism (SSM): an EU-level framework for a prudential supervision of credit institutions in the euro area countries and in those EU countries outside the euro area opting to participate in the mechanism. The SSM is one of the central pillars of the banking union, comprising the ECB as the final responsible supervisory authority and the relevant national supervisory authorities of the EU countries.

Special Data Dissemination Standard Plus (SDDS Plus): the highest data dissemination standard of the IMF. Its purpose is to provide comprehensive, internationally comparable, timely, accessible, reliable and high-quality statistical data on population, financial, economic, fiscal and external sectors, including information on statistical data categories and responsible institutions in each country, as well as links to data and their clarification notes.

Structural operations: open market operations executed by the Eurosystem on a regular or non-regular basis whenever the ECB wishes to adjust the structural liquidity position of the Eurosystem vis-à-vis the financial sector.

Systemic risk: the risk that the inability of one participant to meet its obligations in a system will cause other participants to be unable to meet their obligations when they become due, potentially with spillover effects threatening the stability of or confidence in the financial system. That inability to meet obligations can be caused by operational or financial problems.

TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer system): the Eurosystem's real-time gross settlement system for the euro. The first generation TARGET system was replaced by TARGET2 in May 2008.

TARGET2: the second-generation TARGET system. It settles payments in euro in central bank money and functions on the basis of a single IT platform, to which all payment orders are submitted for processing.

TARGET2-Latvija: a component system of TARGET2 in Latvia. Its operation is ensured by Latvijas Banka in conjunction with the national central banks of the ESCB participating in TARGET2.

TARGET2-Securities (T2S): the Eurosystem's single technical platform enabling central securities depositories and national central banks to provide borderless and neutral core securities settlement services in the central bank money in Europe.

Targeted longer-term refinancing operation (TLTRO): reverse operation of the Eurosystem providing longer-term liquidity to credit institutions on attractive terms, so that they can continue easing the terms and conditions of lending to the private sector and to encourage their lending to the real economy.