September 1999

IMF Staff Country Report No. 99/99

Latvia: Selected Issues and Statistical Appendix

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LATVIA

Selected Issues and Statistical Appendix

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July 14, 1999

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Latvia: Basic Data

Social and demographic indicators 1/				
Area	64,589 sq. km.			
Population	2.4 million			
Urban	69 percent			
Rate of population growth	-0.8 percent per year			
Life expectancy at birth				
Male	64 years			
Female	75 years			
Infant mortality rate (per 1,000 births)	14.9			
Hospital beds (per 10,000 inhabitants)	95			
Physicians (per 10,000 inhabitants)	33			

	1995	1996	1997	1998
	In percent of GDP			
Shares of gross domestic product				
Agriculture and fishing	10.8	9.0	8.1	7.5
Industry	22.6	21.2	21.2	21.2
Electricity	5.5	5.3	4.1	4
Construction	5.1	4.7	4.5	4.8
Services	56.0	59.9	62.1	62.5
GDP				
Nominal GDP (in million of lats)	2,349	2,829	3,275	3,774
GDP per capita (in lats)	934	1,136	1,326	1,541
Real GDP (percentage change)	-0.8	3.3	8.6	3.6
Consumer prices (percentage change, end-period)	23	13	7	3
General government finances				
Total revenue	875	1,076	1,288	1,530
(in percent of GDP)	37.2	38.0	39.3	40.6
Total expenditure	952	1,118	1,275	1,557
(in percent of GDP)	40.5	39.5	38.9	41.3
Financial balance	-77	-43	13	-26
(in percent of GDP)	-3.3	-1.5	0.4	-0.7
Net lending	15	5	10	2.6
(in percent of GDP)	0.6	0.2	0.3	0.1
Fiscal balance	-92	-48	3	-29
(in percent of GDP)	-3.9	-1.7	0.1	-0.8
Money and credit (end-period)				
Net foreign assets	300	445	619	415
Broad money	524	628	871	923
Domestic credit	332	366	479	647
Velocity (level)	4.5	4.5	3.8	4.1
Balance of payments				
Total exports (GNFS)	1,102	1,475	1,702	1,863
Total imports (GNFS)	1,156	1,668	1,945	2,303
Current account balance	-9	-121	-170	-346
Official reserves (in months of imports of goods and nonfactor services)	3.2	3.1	3.0	2.7
Exchange rate, lats per US$, end-period	0.537	0.556	0.590	0.569

Sources: Latvian authorities; and Fund staff estimates.

I. INTRODUCTION

1. The strong economic expansion that began in 1996 and accelerated in the following year reversed sharply in mid-1998 as a result of both external and domestic shocks. The initial expansion was fueled by accelerating domestic private and public demand, as well as growing demand for Latvia's output in both new, mostly EU, and the traditional, CIS markets. Domestic consumer and investment demand were supported by growing real incomes and tax revenues and pent-up demand carried over from previous years, and reinforced by improving consumer and investor confidence and projections of rising real income in the medium-term. Improved economic performance in the European Union and in Russia and Ukraine increased demand for Latvian exports. Low capital intensive and fast maturing foreign direct investments contributed to increase in productive capacity and competitiveness of Latvia's manufacturing base. The expansion was easily financed with relatively cheap domestic credit provided by an extremely competitive financial system still relatively free of regulatory restrictions, and foreign direct and portfolio investment inflows.

2. The concurrence of strong external demand, positive domestic factors, and availability of financing did not last beyond mid-1998. The positive external environment changed overnight following the partial default of the Russian Federation government on its debt and the ensuing steep depreciation of the Russian ruble in August 1998. The modest economic slowdown in the EU area in the second half of 1998, economic slowdown in other central European economies, and the direct exposure to the Russian crisis of Latvia's two Baltic neighbors, Estonia and Lithuania, and other CIS members left large parts of Latvia's export-oriented producers with few viable alternatives to the Russian market. Sharp contraction in external demand in CIS could not be fully compensated by already declining rate of growth of exports to the EU. As a result of weaker external demand, a number of companies began shedding their labor force, which led to the deterioration in consumer confidence and spending. Lower tax revenues in early 1999 constrained public demand. Also, as expected, the very high credit expansion of 1997-98 resulted in increasing proportion of nonperforming loans. Weaker and less liquid balance sheets forced banks to tighten credit and seek stable, albeit, lower returns in more secure assets, such as government securities. The slowdown in credit expansion was accelerated and deepened by the sizeable losses resulting from banks' direct exposure to Russian government securities and Latvian companies doing business with Russia.

3. The Russian crisis transformed, what might have been a "soft landing" of an overheating Latvian economy into a deep and full fledged recession. Over the course of three quarters of 1998, Latvia's economic growth decelerated from a 12-month quarterly growth of almost 9 percent to a 1.9 percent economic contraction in the final quarter of 1998, a reversal of almost 11 percentage points. The crisis, and especially the depreciation of the ruble, and the growing current account deficit also raised questions about Latvia's competitiveness. Latvia's firm adherence to a fixed exchange rate regime (with lats pegged to SDR) since 1994 inevitably resulted in some deterioration of competitiveness as domestic inflation in

Latvia systematically exceeded inflation rates of its EU partners. Although a number of transition economies experienced even higher inflation rates, few, with the exception of Estonia and Lithuania, maintained fixed exchange rates over the previous five years. Russia, one of the most important partners, depreciated its currency steeply in August 1998, effectively, at least temporarily, pricing most Latvian goods out of its market. The real appreciation of the lats vis-à-vis its trading partners has been partly blamed for the growing current account deficit.

4. The following chapters address in detail three issues that gained prominence during the previous eighteen months in policy analysis in Latvia. Chapter II examines in great detail the economic interrelationship between Latvia and Russia and explains how the dramatic contraction of export markets in the CIS and the geographical proximity of Russia with its resulting links, have had a significant slowing effect on the Latvian economy in general and on selected economic sectors. Chapter III discusses the issue of external competitiveness of the Latvian economy. It provides the results of a comparative study of alternative calculations of real exchange rate indicators and other competitiveness indicators, such as wages and market shares. Chapter IV reviews the developments in Latvia's financial system during the past four years. A Statistical Appendix is also attached.

5. The three chapters carry a number of messages and lessons. Chapter II argues that, given the dramatic decline in the value of the ruble and other CIS currencies, as well as a pessimistic outlook for growth in these economies, demand from these markets is likely to remain depressed and, therefore, Latvian producers will have to continue restructuring their operations to improve competitiveness and diversify further their trade away from the CIS if they are to remain viable. Even if in the end the impact of the ruble depreciation on competitiveness of Latvian goods in the CIS proves to be temporary, Latvian companies specializing in operations in the CIS may face stronger competition from other transition economies in their fight to preserve what used to be a very profitable, even though volatile, export market. Given the geographic proximity and traditional economic ties between the three Baltic states and the western part of the CIS area, it is quite conceivable that the decline in the share of Latvian exports to Russia would be reversed in the future.

6. Chapter III argues that, on the one hand, although the various calculations of the real exchange rate give a mixed picture, they generally indicate that Latvia has lost some of its external competitiveness. On the other hand, while Latvia's wages have been converging to their equilibrium level, they remain below them and, therefore, there remains scope for further appreciation. The strong competitive position of Latvia is also evidenced by its ability to increase its exports market share, in particular in the EU. The chapter concludes that the continued maintenance of Latvia's external competitiveness will be partly dependent on Latvia's ability to continue to attract foreign direct investment, which in turn will be influenced by its progress in structural reforms and ability to maintain macroeconomic stability.

7. Chapter IV concludes that Russian crisis, which had a significant impact on the Latvian banking system, exposed vulnerabilities that had built up during the expansion period from

1996 and proved more reforms were needed in the aftermath of the 1995 crisis. Much blame for the 1998 banking problems have been placed on banks' exposure to Russian assets and the regulatory failure, evidenced in criticisms directed at the Bank of Latvia that it should have prevented banks from speculating in high-yielding Russian securities. However, it is clear that poor lending and investment decisions made by bankers themselves were the primary cause of the 1995 and 1998 banking crisis. The shock waves from the Russian crisis most likely only accelerated (and initially deepened) the onset of the banking crisis in a sector dominated by too many weak financial institutions. Even the largest Latvian banks in August 1998 were probably too small to weather successfully the expected volatility of operating in a small and open economy that was so much dependent on the economic fortunes of its neighboring transition economies. Market-driven and, to a large extent, foreign financed consolidation of the banking system is bound to accelerate as stronger institutions take over weaker ones. Increase in foreign participation should bring in new technology and modern banking skills. It is unlikely, however, that any consolidation not accompanied by strengthened supervisory rules can produce a competitive financial system that will completely free itself of the disturbances caused by periodic domestic and external shocks.

8. There is one lesson from the economic developments of the past 18 months that should not be lost in the detailed review of the main conclusions presented in Chapter 2 through 4. To overcome the current crisis and better prepare itself to face future external and internal shocks the Latvian government must continue with its policy of prudent fiscal performance, and go on to complete the ambitious agenda of remaining structural reforms which should aim at integrating the country with the world economy. The ultimate lesson from the reversal of economic fortunes over the past 18 months should be that it is less important how deeply output contracts in response to outside events, and more important how quickly the Latvian enterprises can adjust to the new environment and resume profitable growth.

II. EFFECTS OF THE 1998 RUSSIAN CRISIS ON THE LATVIAN ECONOMY

A. Background

9. This chapter traces the effects of the Russian economic and financial crisis on different sectors of the Latvian economy. The effective devaluation of the ruble on August 17, 1998 and the subsequent government-imposed debt repayment moratorium considerably set back the Russian economy and thus destabilized the region as a whole. The Russian crisis has impacted the Latvian economy through both direct and indirect channels, and as a result annual GDP growth slowed considerably to 3.6 percent in 1998 from 8.6 percent one year earlier. Latvian growth projections for 1999 and 2000 have been revised downwards, as economic activity is only expected to pick up slowly from its current contraction. The effect of the Russian crisis on the Baltic region as a whole has been larger than most would have originally anticipated, in particular as these economies have been fairly successful in diversifying their trade since the dissolution of the Soviet Union. In the wake of the crisis, it has become evident that Latvia's ties to Russia extend beyond traditional trade channels, and that these have transmitted the slowdown in Russia to most sectors of the Latvian economy.

B. Links Between the Latvian and Russian Economies

10. **Foreign trade.** Exports of goods and services accounted for roughly 52 percent of Latvia's GDP in 1997. Since the dissolution of the Soviet Union, Latvia has significantly increased the share of its exports going to the EU (see Table 1). However, the countries of the BRO have remained important trade partners, and in 1997 still accounted for 41 percent of Latvia's exports and 32 percent of Latvia's imports (Table 2). In other words, Latvian exports to the BRO accounted for roughly 21 percent of GDP in 1997. To the extent that there are linkages from export industries to other sectors of the economy, the contraction in exports to the BRO that resulted from the economic and financial crisis in Russia has spread throughout the economy.

Table 1. Latvia: Distribution of Exports by Destination
(In percent of total exports)

	1993	1994	1995	1996	1997	1998
EU	32.1	39.3	44.2	44.1	48.9	56.6
BRO	51.8	50.8	46.8	47.5	41.1	28.9
Russia	28.6	28.1	24.9	23.2	20.9	12.1
Estonia and Lithuania	6.0	8.2	8.8	11.2	11.7	12.0
Other BRO countries	17.3	14.5	13.1	13.1	8.5	4.9
Rest of the world	16.1	9.9	9.0	8.4	10.0	14.5

Source: Direction of Trade Statistics; Central Statistical Bureau of Latvia.

Table 2. Latvia: Distribution of Imports by Origin

(In percent of total imports)

	1993	1994	1995	1996	1997	1998
EU	27.0	40.7	49.9	49.1	53.2	55.3
BRO	50.8	39.9	38.7	37.6	32.1	27.2
Russia	28.1	23.5	21.6	20.3	15.6	11.8
Estonia and Lithuania	13.3	9.5	10.6	12.0	12.4	12.9
Other BRO countries	9.4	6.8	6.5	5.3	4.1	2.5
Rest of the world	22.2	19.5	11.4	13.3	14.8	17.5

Source: Direction of Trade Statistics; Central Statistical Bureau of Latvia.

11. **Transport.** The Latvian economy, in particular its transport sector, benefits from a favorable geographical location that allows it to act as a conduit for trade between Europe and the CIS. Latvia has ten ports located on its 500 kilometer Baltic Sea coast. The three largest ports - Riga, Ventspils and Liepaja - are primarily engaged in reloading of transit freight, which represents the majority of Latvia's cargo transportation. The seven smaller ports handle local freight. Transit trade heading into the CIS primarily consists of consumer or investment goods (e.g. machinery), while transit trade coming from the CIS consist of raw materials, notably Russian oil and oil products (13 percent of Russia's oil exports are transshipped by Latvia's Ventspils terminal). The performance of the transport sector is closely tied to demand for imports from Russia as well as Russia's exports to Europe and beyond.

12. **Banking and finance.** The Latvian banking sector is both directly and indirectly tied to developments in Russia. Latvian banks were exposed to risk through loans made to companies engaged in business with Russia as well as through holdings of Russian government securities. They were also vulnerable to rapid withdrawal of funds held by Russian (or Russia-focused) firms in the event the financial situation of these firms worsened. To the extent that Latvian firms were reliant on exporting to Russia and other CIS members, the collapse of these markets increases the risk involved in lending to these firms, leading to an increase in the global perception of Latvian risk and higher real interest rates. The stock market was also subject to pressure when exporting prospects for firms listed on the exchange were downgraded.

C. Latvia's Economic Performance Following the Russian Crisis

13. Economic growth in Latvia was robust in 1997, with real GDP expanding by 8.6 percent (see Table 3). During 1998, this rapid pace of economic activity began to abate from the second quarter onward, indicating that a weakening Russian economy may have begun affecting Latvia well before the mid-August 1998 financial crisis. Latvia's GDP contracted

by 1.9 percent in the fourth quarter of 1998 compared to one year earlier, and by another 2.3 percent in the first quarter of 1999. The main areas of economic activity to slow have been agriculture, fishing, manufacturing, and transport, which have exported significant shares of their output to the CIS. Below, we consider first the aggregate performance of Latvian trade during 1998 and 1999, and then look more closely at sectoral developments.

Table 3. Latvia: Real GDP Growth by Activity

(Annual rate of growth, percent)

	1996	1997	1998	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1
GDP	3.3	8.6	3.6	8.9	5.6	2.1	-1.9	-2.3
Agriculture	-5.3	4.9	-4.8	-1.3	-4.9	-7.8	-1.5	-1.4
Fishing	-5.7	-24.7	-1.3	20.9	15.6	-15.9	-32.4	6.1
Industry	2.9	13.7	3.0	16.6	9.5	0.4	-11.1	-14.5
Mining	2.4	8.6	5.8	-4.9	44.0	-10.0	5.7	-34.6
Manufacturing	4.1	17.1	3.4	21.0	12.1	-0.2	-15.3	-17.3
Electricity, gas and water	-1.9	-0.7	1.1	-1.0	-6.8	5.4	5.8	-0.1
Construction	5.3	8.2	11.1	8.0	6.1	21.1	8.0	10.0
Services	5.0	7.5	4.7	6.4	5.7	3.6	2.9	3.3
Wholesale and retail trade	0.8	13.9	20.4	21.1	24.4	22.8	13.5	11.4
Transport, storage and Communications	13.6	7.4	-1.3	3.1	-1.4	-5.3	-1.5	-3.5
Financial intermediation	-8.0	4.0	-0.8	8.7	2.5	-6.7	-6.3	-1.1
Real estate and business Services	6.8	9.3	3.2	3.0	2.1	4.2	3.5	18.8

Source: Central Statistical Bureau of Latvia.

14. **Foreign trade.** Merchandise export growth slowed considerably between 1997 and 1998, from 22 percent to 10 percent per annum in lats terms. This slowdown was primarily due to a contraction in CIS markets, to which exports fell by 29 percent. It is worth noting that this decline was dominated by a 41 percent drop in exports to Russia, with Latvian exports to other CIS countries contracting by only 2 percent over the year and actually growing in the fourth quarter (Table 4). Exports to non-CIS countries remained buoyant, most notably increasing by 27 percent to the EU. In the first quarter of 1999, total exports were down 13 percent year-on-year, while exports to the CIS remained more than 60 percent lower than one year earlier.

Table 4. Latvia: Growth of Merchandise Exports

(In lats terms, annual rate in percent)

	1998				1998
	Q1	Q2	Q3	Q4	
TOTAL	29.5	17.7	3.9	-6.8	10.0
EU	32.9	23.7	24.5	29.0	27.3
CIS	12.2	-9.1	-44.7	-62.6	-29.4
Russia	13.2	-10.7	-55.7	-86.9	-40.6
Other CIS	9.8	-5.9	-15.5	5.3	-2.0
Rest of the world	46.4	37.1	24.5	-1.5	24.6

Source: Central Statistical Bureau of Latvia.

15. Import growth remained high in 1998 at 19 percent, but eased somewhat from its 24 percent growth rate in 1997 (Table 5). Given the significant depreciation of the ruble and of other CIS currencies in late 1998, one would have expected Latvian imports from the CIS to increase significantly post-August 1998. However, this has not been the case. In fact, already from the second quarter onwards Latvian imports from Russia began to decline on a year-on-year basis, culminating in a contraction of 21 percent in the fourth quarter and a more than 40 percent drop in the first quarter of 1999. One explanation for this is that traditional business relations may have been upset by the financial turmoil that hit Russia in August. As bank accounts were frozen, Russian firms may have found it more difficult to execute normal business transactions. Another possible reason is that the crisis has driven trade into the unrecorded sector, thus lowering the official tally of imports. A third possibility is that importers have sought other sources of supply in markets with less uncertainty.

Table 5. Latvia: Growth of Merchandise Imports

(In lats terms, annual rate in percent)

	1998				1998
	Q1	Q2	Q3	Q4	
TOTAL	33.0	25.2	21.0	2.4	18.9
EU	45.4	26.7	23.7	6.8	23.6
CIS	8.0	1.5	-8.4	-12.3	-3.6
Russia	2.0	-7.3	-12.4	-20.5	-10.4
Other CIS	34.2	29.7	4.6	23.8	22.3
Rest of the world	31.4	37.8	36.1	4.9	26.1

Source: Central Statistical Bureau of Latvia.

16. **Agriculture and fishing.** The importance of agriculture and fishing has declined considerably over the course of the transition period, so that by 1997 these sectors accounted for only 8.2 percent of GDP. Nevertheless, products originating in these sectors accounted for nearly 15 percent of total merchandise exports in 1997[1], primarily focused on Russia and other CIS markets.[2] Both sectors performed poorly in 1998, contracting by 5 percent and 1 percent, respectively.

17. **Manufacturing.** Real output increased by a robust 17 percent in 1997 over 1996, and output accounted for 19 percent of GDP. During the course of 1998, growth slowed considerably, from 21 percent in the first quarter, to a 15 percent contraction in the fourth quarter (annual growth rates), for an annual increase of 3.4 percent. The contraction in manufacturing accelerated during the first quarter of 1999 to an annual rate of 17 percent. This can be linked to the slowdown in demand from Russia and other CIS markets, as discussed in greater detail below. Table 6 summarizes the performance of manufacturing exports by sector and destination.

- **Food products and beverages.** This is the largest sector within manufacturing, accounting for 39 percent of total manufacturing output in 1997. Prepared foodstuffs were also the third largest item overall in merchandise exports, with a share of 10 percent. The sector is heavily dependent on exports to the CIS, which accounted for roughly three-quarters of exports in 1997, including a 56 percent share for Russia. In 1998, total exports in this category fell by 27 percent, including a 47 percent drop in exports to the CIS (51 percent drop in exports to Russia). Exports to the EU fell as well, by 9 percent. Imports of food products increased by 22 percent overall in 1998, with growth coming both in imports from the EU (17 percent growth) and imports from Russia (47 percent growth). These developments indicate that Latvian food exporters may have lost competitiveness.

- **Wood and wood products.** Latvia is richly endowed with woodlands and enjoys a 45 percent forest coverage. In 1997, the wood industry accounted for 19 percent of total manufacturing output. It is a highly export-oriented sector, with 90 percent of output being exported in 1997, representing 30 percent of Latvia's total merchandise exports.[3] Roughly 90 percent of wood sector exports were destined for the EU, and less than

[1] Exports originating from agriculture or fishing comprise live animal and animal products, vegetable products, fats and oils, and prepared foodstuffs.

[2] In 1997, Russia accounted for the following shares of Latvian agriculture-related exports: live animals and animal products, 42 percent; vegetable products, 24 percent; fats and oils, 41 percent; and prepared foodstuffs, 56 percent.

[3] Exports of wood and wood products also include unprocessed timber, which is not included in manufacturing sector output.

1 percent to Russia. Therefore the downturn in Russia only had a minor impact on exports in this sector. In fact, total exports in this category expanded by 24 percent in 1998. Latvia's wood sector shows good potential to increase its production of higher value-added goods. Furniture exports have increased rapidly in recent years, growing at an average annual rate of 20 percent since 1994.

- **Textiles.** Apparel and textiles accounted for 12 percent of manufacturing production in 1997. Roughly 68 percent of its output was exported in 1997, thus making the textile sector Latvia's second largest export category with 16 percent of total merchandise exports in 1997, of which 60 percent went to the EU and 26 percent to the CIS (16 percent to Russia). During 1998, textile exports to the CIS fell by 30 percent (28 percent decline to Russia), while exports to the EU rose by 14 percent. Total exports in this category grew 14 percent in 1998.

Table 6. Latvia: Growth of Selected Manufacturing Exports, 1997-98

(In percent, in lats terms)

	EU	Russia	Other CIS	Rest of the world	Total	Share in total exports, 1997	Russian share in each category, 1997
Wood and wood products	24	-7	8	30	24	30	1
Textiles and textile articles	33	-28	-34	14	14	16	16
Prepared foodstuffs	-9	-51	-36	40	-27	10	56
Machinery and mechanical appliances	1	-34	-13	-10	-17	9	40
Base metals	56	-87	123	30	26	9	12
Chemical and allied industry products	15	-42	-6	23	-2	7	30
Pulp of wood, paper and paperboard	107	20	6	29	25	3	30
Transport vehicles	-23	-35	-1	23	-13	2	36
Plastics and rubbers	122	5	31	28	46	1	25
Miscellaneous manufactured items	41	-67	74	41	25	4	16
All merchandise exports	27	-41	-2	25	10	100	21

Source: Central Statistical Bureau of Latvia.

18. **Transport sector.** Output in the transport, storage and communications sector accounted for 15 percent of GDP in 1997. Turnover of cargo in Latvian ports grew from 45 to 50 million tons during 1997, and output rose by 7.4 percent (Table 7). In 1998, despite a 4 percent increase in cargo turnover, output contracted by roughly 1 percent. This presumably reflects the change in the composition of goods that pass as cargo through

Latvian ports. The value of Russian imports transiting through Latvia, which tend to be higher-end consumer goods and thus command higher transport, processing and storage fees, dropped off considerably after August 1998.[4] Although total merchandise exports from Russia fell during 1998 and early 1999, oil and other raw material exports have increased.[5] The transport sector continued contracting in the first quarter of 1999, at a rate of 3.5 percent. Transport service receipts have been declining in recent years and did not contract dramatically in 1998 (Table 7). This trend can partly be explained by the fact that an increasing number of Latvian ships have changed their registration from Latvian flags to cheaper "flags of convenience".

Table 7. Latvia: Cargoes Loaded and Unloaded at Latvia's Ports

(In millions of tons unless otherwise noted)

				1998				1999
	1996	1997	1998	Q1	Q2	Q3	Q4	Q1
Cargoes loaded	41.9	46.7	48.6	11.9	11.4	12.2	13.0	11.8
Dry cargoes	12.4	16.6	19.7	4.9	5.3	4.8	4.6	4.4
Liquid cargoes	29.5	30.0	28.9	7.0	6.1	7.4	8.4	7.4
Cargoes unloaded	3.1	4.0	3.7	1.3	1.2	0.8	0.5	0.6
Total cargo turnover	45.0	50.7	52.3	13.2	12.6	13.0	13.5	12.4
Transport service receipts ($US mn)	533	515	488	122	117	101	149	n.a.

Source: Central Statistical Bureau of Latvia; Fund staff estimates.

19. **Banking and financial sector.** While banking indicators do not suggest that there has been a major deterioration in loan portfolios since the onset of the crisis, the banking system has become significantly more fragile. The Riga Stock Exchange Price Index (RICI) had peaked at nearly 1000 in mid-October 1997, but as a result of global market sentiment

[4] Russian merchandise imports amounted to $9.6 billion in the fourth quarter of 1998 and $9.4 billion in the first quarter of 1999, compared to $18.1 billion in the first quarter of 1998 (Russian Economic Trends, June 1999).

[5] In the first four months of 1999, Russian oil exports totaled 45.9 million tons, compared with 43.1 million tons for the same period in 1998 (Russian Economic Trends, July 1999). Ventspils Nafta, Latvia's primary oil transshipment facility, reportedly reloaded 5.4 million tons of oil and oil products in the first quarter of 1999, slightly higher than in the first quarter of 1998. In the second quarter of 1999, the terminal reloaded 5.7 million tons, which was 1.5 million tons more than one year earlier.

turning against emerging markets, it dropped more or less continuously over the following year, reaching roughly 400 by the end of July 1998. The devaluation of the ruble did not have any immediate dramatic effect on the Latvian stock market, but the index continued to fall, bottoming out at 150 in later October 1998. Since then the stock market has remained depressed, and had only risen to 165 by the end of June. Turnover has fallen considerably and averaged roughly $221,000 per day during the first half of the year, with daily turnover volumes as low as $50,000. Market capitalization only represented 11 percent of GDP at the end of the second quarter.

20. **Construction and retail trade**. When the incomes of those directly involved with trade to Russia and the CIS declined, their reduced spending power in turn acted as a brake on growth in sectors without strong direct ties to the CIS. These spillover effects appear to have set in by the fourth quarter of 1998. In construction, the annualized real growth rate slowed considerably in the fourth quarter, although it was still 8 percent and recovered to 10 percent in the first quarter of 1999 (Table 3). The pace of activity in retail and wholesale trade, where growth was running at over 20 percent per year in the first three quarters of 1998, fell to 14 percent in the fourth quarter and 11 percent in the first quarter of 1999. Financial intermediation already began contracting in the third quarter, possibly reflecting the immediate effect of the collapse in CIS export markets.

D. Spillover Effects on Wages and Employment

21. In the initial years of transition, employment in Latvia contracted by more than one-third as state enterprises were privatized and restructured.[6] At the end of 1996, employment started growing, reaching 1.05 million by the end of the third quarter of 1998. The immediate effect of the Russian crisis on Latvian employment was small, resulting in a one percent reduction (annualized basis) during the fourth quarter. Unemployment rose from 7.4 percent in August to 9.2 percent in December 1998. The increase in the number of unemployed between September and December 1998 was larger than total job losses, indicating that labor market entrants (e.g. recent graduates) were also having trouble finding employment. By April 1999, unemployment had risen further to 10.2 percent.

22. Latvia has traditionally exhibited large regional discrepancies in labor market performance, with Riga and the port city of Ventspils enjoying significantly lower unemployment than other cities and regions. Those districts bordering Russia were already exhibiting above average unemployment rates in early 1998 (Table 8). These rates did not rise much after the onset of the crisis in August. Conversely, unemployment has risen dramatically in two major port areas (Ventspils and Liepaja), which possibly reflects the contraction in Russian imports transiting through Latvia.

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[6] Employment fell from 1.39 million in early 1992 to 1.01 million in late 1996.

Table 8. Latvia: Regional Unemployment

(Percent of the labor force)

	1998				1999
	March	June	September	December	March
Average	7.1	7.2	7.6	9.2	10.1
Major Cities					
Riga	3.2	3.2	3.7	4.8	5.6
Daugavpils	7.9	8.4	8.9	10.6	11.5
Jelgava	8.8	8.5	8.7	9.4	10.6
Jurmala	6.3	6.0	6.8	9.5	10.3
Liepaja	8.2	9.1	10.4	14.2	16.0
Rezekne	11.4	11.0	11.5	15.7	16.1
Ventspils	3.6	3.9	5.4	7.5	8.6
Districts bordering Russia					
Aluksne	10.9	10.8	11.5	11.5	11.4
Balvi	21.7	21.8	21.9	22.1	23.2
Gulbenes	9.7	9.9	10.4	10.2	10.4
Kraslavas	21.5	21.5	22.2	23.2	23.7
Ludza	18.4	19.1	19.5	19.9	20.8
Preilu	22.0	22.9	22.3	23.2	23.8
Rezekne	28.3	27.5	27.5	28.2	29.1

Source: Central Statistical Bureau of Latvia.

23. Wage growth has more or less reflected the varied impact of the Russian crisis on different sectors of the economy (Table 9). For Latvia as a whole, real wage growth halved between 1997 and 1998, from 12 to 6 percent. Sectors heavily dependent on exports to Russia—notably fishing, manufacturing and transport—experienced little if any real wage growth during 1998, while sectors more insulated from international trade (e.g., construction and domestic trade) enjoyed significant real wage gains. Since the August crisis, wage growth has been driven by the public sector. Between end-September 1998 and end-March 1999, real public sector wages grew at an annual rate of roughly 10 percent, whereas private sector wages only increased by slightly more than 2 percent (annualized basis).

Table 9. Latvia: Growth of Real Wages
(In percent, annualized basis)

	1996	1997	1998	1999-Q1
Whole economy	-6.3	12.1	6.1	5.1
Public sector	-6.3	12.6	7.7	10.0
Private sector	-6.3	11.6	5.8	1.7
Agriculture, hunting and forestry	-7.8	9.7	7.9	4.0
Fishing	-17.7	20.1	-32.5	-8.1
Industry	-2.4	12.1	1.8	0.1
Mining	17.4	6.7	2.4	7.7
Manufacturing	-3.5	12.6	0.6	-1.8
Electricity, gas and water supply	1.9	8.5	9.0	8.8
Construction	-16.1	21.2	11.7	2.5
Wholesale and retail trade	-12.7	12.5	8.4	5.1
Hotels and restaurants	-17.3	18.8	-5.3	-3.0
Transport, storage and communications	-5.0	8.1	-0.2	1.6
Financial intermediation	7.7	16.9	10.7	4.3
Business services	-5.5	13.7	17.0	14.8
Public administration	-7.4	13.3	11.3	11.7
Education	-7.2	9.7	11.0	13.4
Health and social work	-8.0	7.6	9.9	17.9
Other community services	-3.6	11.1	7.1	11.6

Source: Central Statistical Bureau of Latvia.

E. Conclusions

24. The dramatic contraction of exports to the CIS—by 75 percent during the fourth quarter of 1998 and the first quarter of 1999—has had a significant slowing effect on the Latvian economy, with growth falling by roughly 5 percentage points during 1998. The fact that Latvia's exports to the EU and other areas of the world continue to grow, and that exports to CIS markets apart from Russia appear to be recovering, indicate that many Latvian producers remain internationally competitive.[7] However, firms that were highly dependent on the Russian market, most prominently those in the agricultural and food processing sectors, have seen their demand collapse. Given the dramatic decline in the value of the ruble and a pessimistic outlook for growth in Russia, demand from this market is likely to remain depressed. Latvian producers will therefore have to further diversify their trade away from the CIS if they are to remain viable. This is neither easy nor can it be done rapidly, and will require intensified efforts in improving marketing and sales. During the interim adjustment period, export growth will remain slow compared to recent years. But the medium-term outlook for export growth, and hence for economic growth, remains favorable for Latvia.

[7] See Chapter III for analyses of Latvia's competitiveness.

III. An Assessment of Latvia's External Competitiveness

A. Introduction

25. Following years of relatively small external current account deficit that was more than financed by foreign direct investment (FDI), Latvia's current account deficit almost doubled to 9.5 percent of GDP in 1998 with only half financed by FDI. While this deterioration was largely a result of the Russia crisis, it has raised the issue of the external competitiveness of Latvia, especially in view of the large devaluations in CIS currencies. This chapter looks at this issue, starting with an overview of developments in Latvia's trade and current account and its financing (section B). The chapter then calculates and analyses various competitiveness indicators, including Latvia's market share in its now-major market, the European Union (section C). Finally, section D summarizes the main findings and conclusions.

B. The Current Account and its Financing

Trends in the current account and the underlying factors

26. Latvia's current account balance moved from a surplus to an increasing deficit starting 1995. This trend mirrored a declining trend in the large services surplus, as well as a widening in the merchandise trade deficit (Table 42). While the former may largely reflect data problems rather than an actual reduction in transport receipts, the widening of the trade deficit reflected a successful transition to a faster economic growth trajectory as GDP real growth accelerated to 8.6 percent by 1997. This growth was supported by an increase in gross domestic investment form 17.6 percent of GDP in 1995 to 23 percent at present. National savings financed only part of this increase in investment; foreign saving also increased, as mirrored in a current account deficit. At the same time, per capita income increased, and this has contributed to an increase in consumer imports in an environment of liberalized trade. In 1998 the current account deficit almost doubled to 9.5 percent of GDP. The Russia crisis led to declines in transport receipts and exports to CIS countries. At first imports continued their fast growth but then decelerated in the second half of the year, due to a lag in adjustment to the slowdown in the economy.

Trends in imports and their composition

27. The increase in investment, especially foreign direct investment, led directly to an increase in imports, with the share of capital goods imports in total imports doubling from 9.3 percent in 1993 to 20 percent in 1998. At the same time, the share of consumer goods imports also increased at the expense of intermediate imports reflecting the liberalization of the trade regime. Between 1993 and 1998, the former increased from 12 percent to 26 percent while

the latter declined from 79 percent to 54 percent of total imports (Table 45). This decline may reflect a reallocation of export activities from the processing of imported intermediate goods in the Soviet period, towards the strong comparative advantage in the wood products. There has also been a shift in the origin of imports with a substantial decline in the CIS shares, and a counterpart increase in imports from the EU (see Table 2).

Trends in exports and their destination and composition

28. The structure of exports exhibited a clear transformation between 1993 and 1998 with the shares of wood products and textiles in total exports increasing significantly from 10 percent and 13 percent to 37 percent and 16 percent respectively. On the other hand, the food products, machinery and chemicals, and vehicles fell reflecting a reorientation towards Latvia's comparative advantages. The destination of exports also changed as the share of exports to CIS countries in total exports declined, and the share of exports to the EU increased (see Table 1). This shift was facilitated by quality improvements as well as an increase in the marketing capability brought about in large part by accumulated foreign direct investment. Latvia has been able to develop niche markets for textile in particular, and also wood products (such as furniture, sawn wood, and wood panels) in important EU markets, including Germany, the UK, and Sweden.[8]

Trends in the financing of the current account deficit

29. A notable dimension of Latvia's current account deficit is its financing by non-debt creating inflows, in particular foreign direct investment. The ratio of inward foreign direct investment to the current account deficit was about 180 percent in 1996 and 1997 (Table 42). This ratio, however, declined to 45 percent in 1998 due the doubling of the current account deficit in the one hand, the less favorable international sentiments in the aftermath of the Asian and Russia crises, and delays in Latvia's large scale privatization program. As a result, the share of loan financing increased, although this has been largely medium-term and private. Public debt and publicly guaranteed external debt remained at about 7-8 percent of GDP, and increased to a still relatively low 10.5 percent of GDP in May 1999 as a result of a eurobond issue which is being allocated to future maturing debt service, rather than to current account financing.

[8] For a study of the experience of the BRO countries in reorienting their trade see Havrylyshyn and Al-Atrash (1998).

C. Competitiveness Indicators

30. In view of the recent widening of the current account deficit and the sharp devaluation of CIS currencies, it is necessary to reassess Latvia's external competitiveness. This section starts by calculating and analyzing trends in the real effective exchange rate. However, while the real effective exchange rate is one of the most frequently used competitiveness indicators and can be readily calculated, it suffers from important shortcomings.[9] First, it is a static measure of competitiveness because it is influenced by the existing, rather than the potential, shares of trade partners. Second, it is not always conclusive because an appreciation or a depreciation in that rate may not be evidence of a change in competitiveness, but, rather, in productivity. This problem is especially relevant in transition economies where large changes in productivity are expected as resources are reallocated and reform progresses.[10] Third, looking at the trend in the real effective exchange rate provides information about a change in the level of competitiveness, rather than about whether a country is competitive or not at the new rate. This section therefore proceeds by looking at trends in various calculations of the real effective exchange rate using alternative weights, and then looks at other indicators of competitiveness such as dollar wages, productivity, until labor cost, the equilibrium exchange rate, and market share, emphasizing the trend relative to the EU market as well as other transition economies that compete with Latvia's exports in that market.

REER using updated trade weights

31. Figure 1a plots the real effective exchange rate for Latvia, calculated using CPI data and shares of significant trading partners in Latvia's trade. The real effective exchange rate of the lats has appreciated by about 325 percent since the beginning of 1992. Two phases of appreciation are noticeable. The first phase was during the period 1992–1994 when Latvia's inflation was well above the EU levels. During that period, the lats appreciated by about 260 percent in real effective terms. After a few years of relative stability in the real effective rate, it entered into a second phase of appreciation with the collapse of the Russian ruble and other CIS countries starting mid-1998. This appreciation has been much smaller, however, and amounted to about 13 percent thus far. It is therefore clear that the real effective exchange rate of the lats was relatively stable since the mid-nineties until the Russia crisis in mid-1998 when it started appreciating somewhat due to the collapse of CIS currencies.

REER against western trading partners

32. Assuming that the current re-orientation of exports to Latvia's western trading partners will continue, it is useful to measure real effective changes in the lats versus these partners in order to help inform a forward looking analysis (Figure 1.b). This shows the lats has been

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[9] For reviews, and assessments, of various competitiveness indicators, see Lipshitz and McDonald (1991), Turner and Van 't dack (1993), and Marsh and Tokarick (1994).

[10] Furthermore, the likely impact of EU expected accession on Latvia's productivity cannot be underestimated. See for example Havrylyshyn (1998).

virtually stable in real effective terms vis a vis these partners since mid-1997. A small appreciation occurred in the first quarter of 1999 due to the appreciation of the US dollar which is an important components of the SDR basket, against which the lats is pegged.

REER using a basket of competitors in EU markets (other Baltics, Finland, Sweden)

33. Figure 1c plots the real effective exchange rate of the lats against a basket of currencies of the other Baltics as well as Finland, Poland, and Sweden which are three important competitors in Latvia's main export; wood products. Belarus is another important wood producer which was, however, excluded because it appears less of a competitor with Latvia as the latter managed to upgrade the quality of it products. Indeed Latvia has started importing Belarussian wood material for reexporting at higher prices and value added after processing. The figure shows that the lats has been virtually stable in real terms over the last two years against the currencies of the above mentioned countries. As in the case of the appreciation against western trading partners, the lats mild appreciation vis a vis Latvia's main competitors has been in part a result of the dollar appreciation against the currencies of those competitors.

The relative price of nontradable to tradable goods

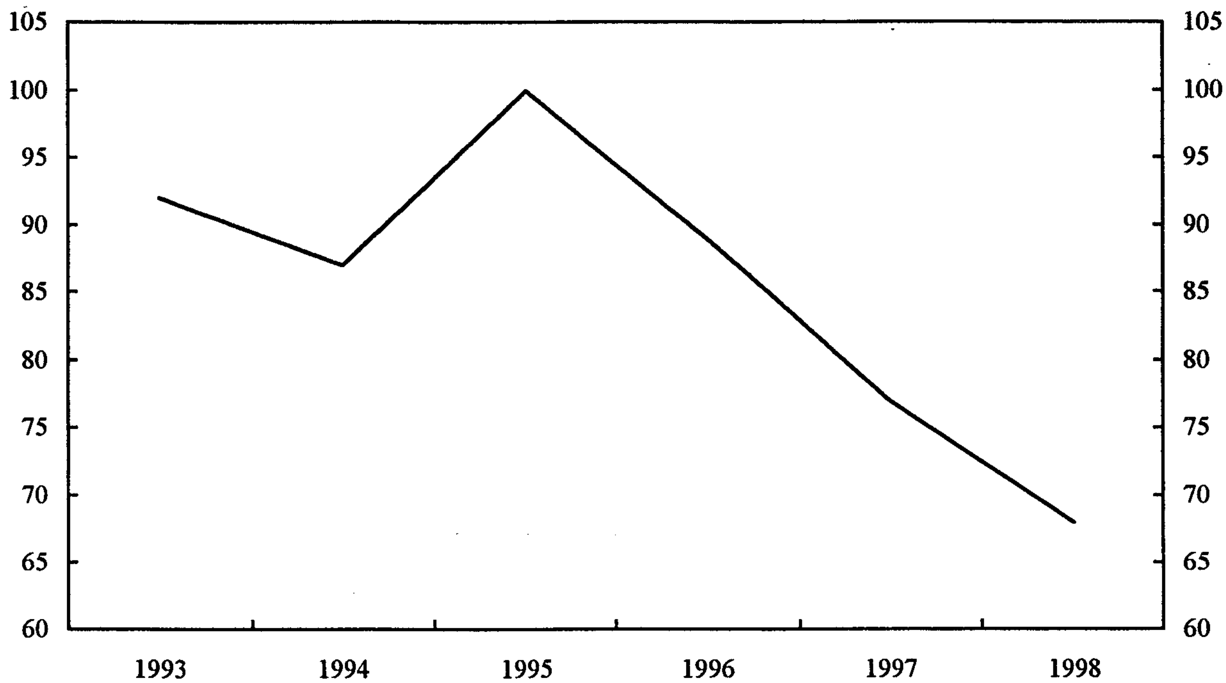
34. Another measure of the real exchange rate which encompasses the various domestic costs and exchange rate competitiveness factors is the price of tradable relative to non-tradable goods. Movements in this price importantly affect the allocation of resources between these two commodity categories. One methodological problem in calculating this measure is determining whether a particular commodity is tradable or not as certain traditionally non-tradables, including many services are becoming more tradable (and this is particularly relevant in Latvia with its important services sector). It is, however, beyond the scope of this paper to accurately investigate and determine the tradability of each good and service. It has been common in the literature to use the price indices of agriculture and manufacturing as a proxy for the price of tradables, and the price indices of all other sectors as a proxy for the price of non-tradables.[11] Figure 2 shows the movement in the real exchange rate defined as the ratio of the price index of non-tradable to tradable goods. The rate exhibited an appreciation of about 18 percent over the period 1993 to 1995 and then started to depreciate steadily since then. The accumulated depreciation thus far amounts to 32 percent. This is in contrast with the results we get from calculating the real effective exchange rate as reported above. The reason for these conflicting outcomes may be data problems in the deflators used in calculating the price indices of tradable and non-tradable goods, the shortcomings of the efficiency in the real effective exchange rate as a measure of competitiveness as described above, or a combination of both. This contrast in the results emphasizes the need for caution in interpreting the trend in any one measure of competitiveness.

[11] This has been typical in Dutch Disease empirical literature. See for example the various studies in Gelb and associates (1988).

Figure 1. Latvia: Real Effective Exchange Rates, 1996-99

Source: INS data system, adjusted weights.

Figure 2. Latvia: The Ratio of the Price of Non-tradable to Tradable Goods, 1993-98
(1995 = 100)



Source: Implicit deflators calculated from data provided by the Central Bureau of Statistics.

Dollar wages

35. Table 10 shows that while Latvia's dollar wages are above dollar wages in Russia, they remain below dollar wages in the other Baltics and Central European economies. In fact, Latvia's dollar wages have risen the least in the three Baltic states since 1994. It therefore seems that according to this indicator of competitiveness that Latvia has lost some of its competitiveness vis a vis Russia and other CIS countries but remains competitive vis a vis the other Baltics and central European states.

Equilibrium dollar wages

36. The equilibrium dollar wage rate is calculated using proxies for potential productivity and human capital. A useful competitiveness indicator is to compare the actual wage level with a calculated equilibrium level. Krajnyak and Zettlemeyer (1997) estimate the determinants of the equilibrium wage using a panel of 85 countries.[12] They regress the dollar wage on a set of fundamentals and indicators of human capital such as the purchasing power parity GDP per capita, the share of agriculture in the economy as a proxy for the level of development, and secondary school enrollment as a proxy for the stock of human capital. Their study covered the period 1990–95 and found that most transition economies, including Latvia, had room for appreciation before reaching their equilibrium level. Table 11 updates the calculation for Latvia using Krajnyak and Zettlemeyer estimated equation.[13] The table shows that while the gap between the equilibrium and actual wage levels is narrowing, the actual level remain below the equilibrium level by about 35 percent which indicates that there is still some margin for further appreciation and wage increase. Furthermore, compared to the other Baltic countries, the remaining gap between the actual and equilibrium rates for Latvia is somewhat smaller than for Estonia but much larger than for Lithuania.

Productivity

37. Detailed productivity data are available only for the manufacturing sector (Table 12). They indicate that labor productivity in manufacturing has been growing at quite high rates. Cumulative productivity in the period 1994–1997 has ranked in the top tier in transition economies according to the EBRD. In a group of 12 transition economies, Latvia came second from the top (Figure 3). However, wages in the sector have been growing even faster than productivity, resulting in a positive growth in unit labor cost in this sector (Table 12) (unit labor cost as a measure of competitiveness is investigated below). Among important

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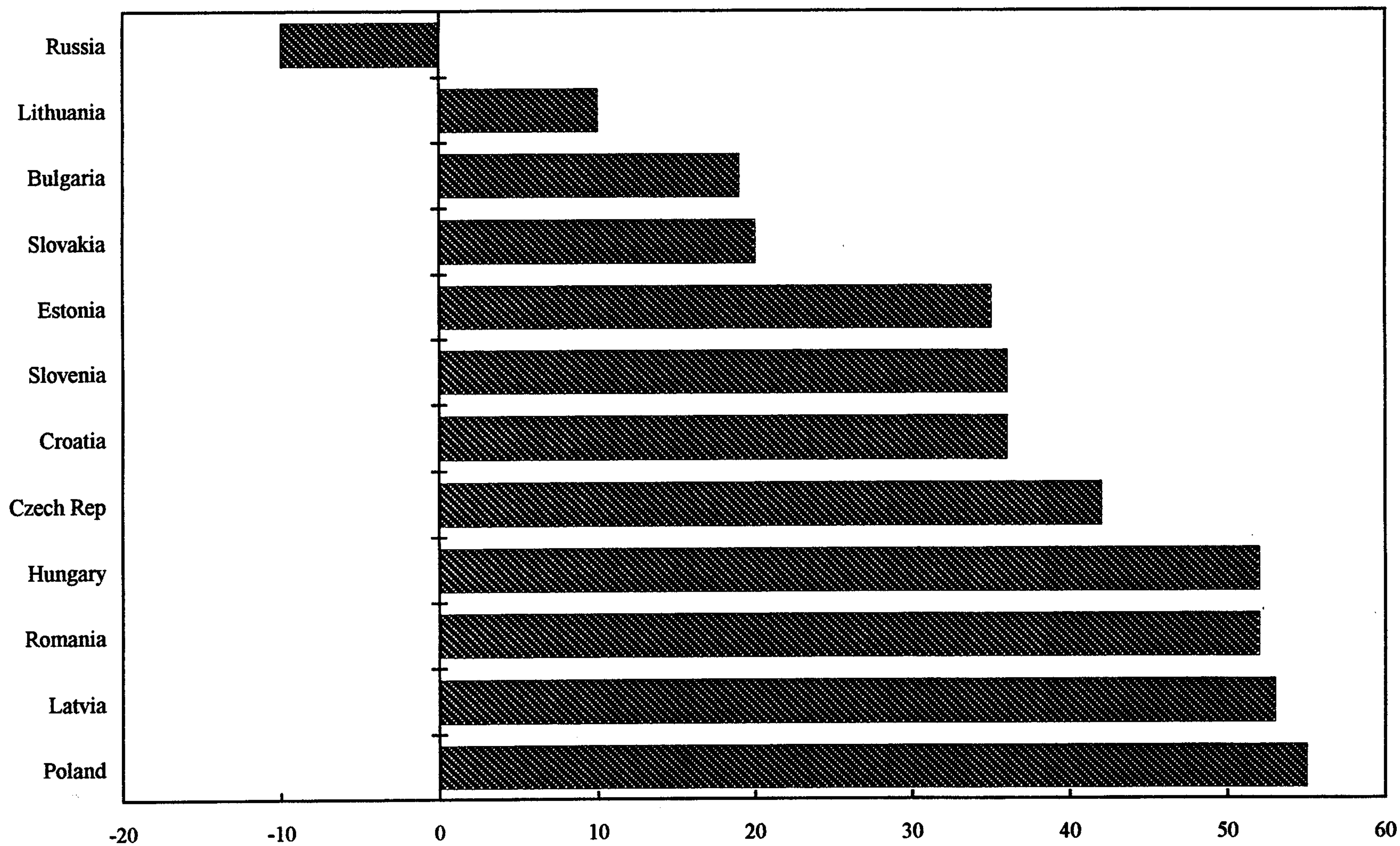
[12] See also Halpern and Wyplosz (1997).

[13] It is important to note that this methodology has two pitfalls. First, it is assumed that the equation is stable over time, so it can be used beyond the period in which it was estimated for. Second, the data used in the estimation suffer from important data problems especially in relation to estimates of purchasing power parity GDP.

Figure 3. Latvia: Cumulative Productivity in Manufacturing, 1994-97
(In percent)



Source: EBRD Transition Report, 1998.
Note: Calculated as the ratio of manufacturing production over manufacturing employment in 1994-97.

industries, wood and paper industries, and food industries appear to have the highest output per worker (Figure 4).

Unit labor cost

38. Unit labor cost is one of the preferred indicators of competitiveness and is measured by dividing wages by output. Accurate calculations of unit labor cost for Latvia are difficult to make because of data shortcomings. Using available data, staff estimates indicate that unit labor cost index in Latvia has not changed much over the last few years. However, in relative terms, unit labor cost in Latvia has been growing and is now almost 30 percent higher than in Poland. This growth has been significantly faster than in Estonia, although slower than in Lithuania (Table 13). While it seems that Latvia's competitiveness measured by ULC somewhat deteriorated, it should be noted that this measure indicates more the relative change in the level of competitiveness rather than whether the country is competitive or not in absolute terms.

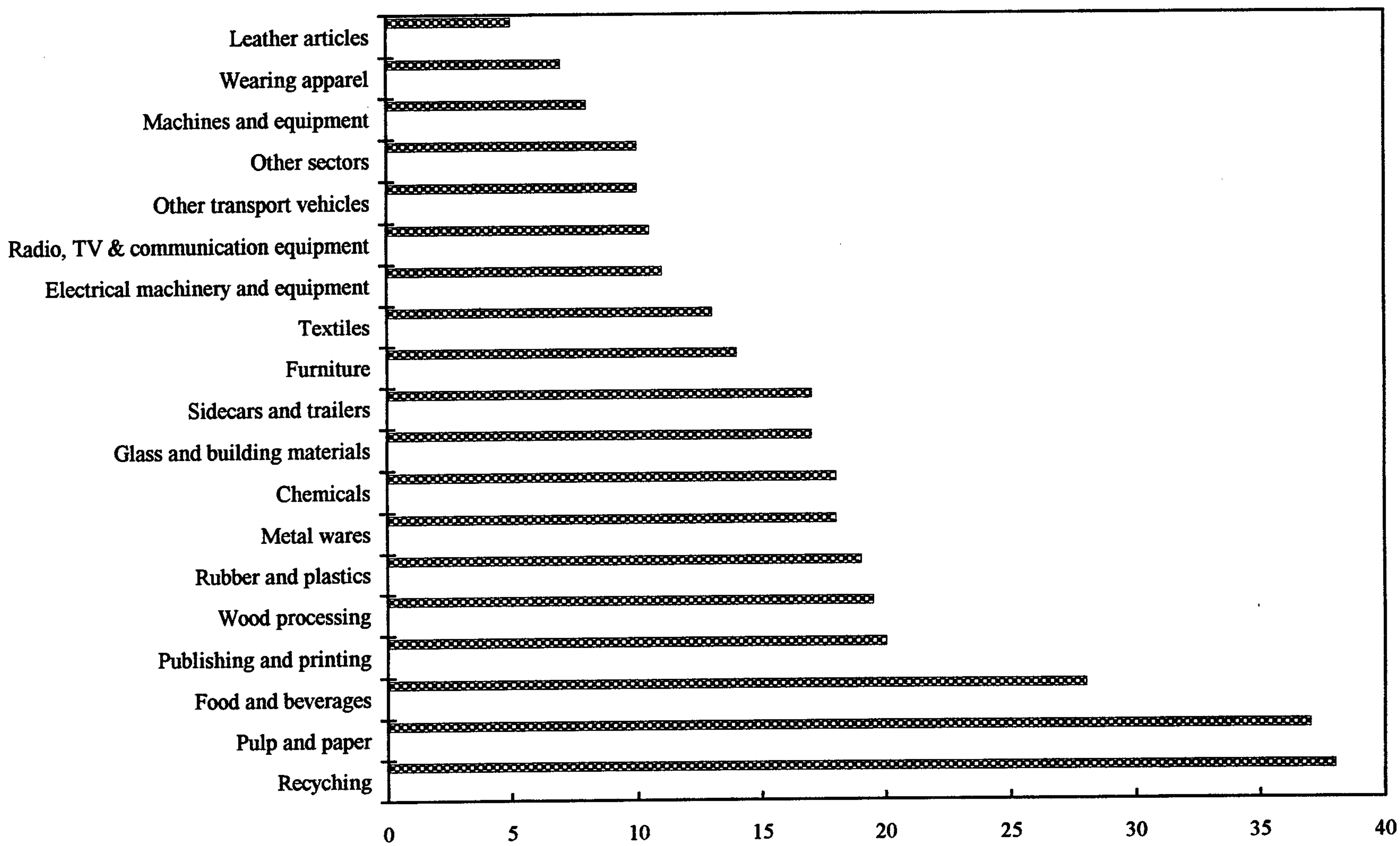
Market share

39. This is perhaps the most direct ex-post measure of competitiveness and reflects all the relevant factors. Table 14 shows the calculations of Latvia's market share in goods and in goods and services. The calculations indicated that Latvia market share in goods has been growing at about 10 percent over the last two years. The share of Latvia's exports of goods and services has been growing and an average rate of about 8 percent over the last three years. Latvia has been successful in shifting its trade to new markets in the west as discussed earlier in this chapter. This has been reflected in its share of EU imports (excluding intra-EU trade) which has increased fourthfold since 1992 from 0.057 percent to 0.230 percent (Table 15). Latvian exports have been particularly successful in penetrating new markets in important EU economies, including Germany and Scandinavian countries, in which Latvia's market share has been growing steadily over the last three years (Table 16).

D. Conclusions

40. Motivated by the recent widening in the current account deficit and the decline in the share of foreign direct investment in financing that deficit, this chapter has attempted to examine recent developments in Latvia's external competitiveness. Alternative calculations of the real exchange rate give a mixed picture. On the one hand, many indicators show some degree of deteriorating competitiveness. On the other hand, the relative appreciation or increase in costs is very small vis a vis Latvia's main trading partners, and its principal competitors in its major exports. Furthermore, it appears that the margin of competitiveness, even before including future productivity changes, is still considerable. Thus, in assessing if this deterioration relative to the past, has resulted in Latvia becoming seriously incompetitive, this chapter investigated Latvia's dollar wages relative to their equilibrium level as well as

Figure 4. Latvia: Manufacturing Productivity, 1998
(In percent)



Source: Central Statistical Bureau of Latvia.
Note: Productivity measured as output per employee, average output-weighted manufacturing productivity was USD 18.2 thousand.

trends in Latvia's market share. The results indicate that, while Latvia's wages have been converging to their equilibrium level, they remain well below them and, therefore, there remains scope for further appreciation. Furthermore, it appears that Latvia has been successful in increasing its exports market share, in particular in the EU. This was possible as a result of the positive impact of accumulated foreign direct investment on the quality of Latvian exports and the countries marketing capabilities. The continued maintenance of Latvia's external competitiveness will therefore be partly dependent on Latvia's ability to continue to attract foreign direct investment and to maintain progress in its reform efforts.

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Table 10. Latvia: Monthly Wages, 1993-98
(In U.S. dollars)

Country	1993	1994	1995	1996	1997	1998
Latvia	77	138	179	192	214	241
Estonia		134	207	248	258	291
Lithuania	43	92	129	172	213	265
Russia	64	146	168	183	173	114
Poland	207	229	288	329	329	359
Czech Republic	196	231	303	348	327	n.a.
Slovak Republic	175	196	242	270	264	n.a.
Hungary	287	304	309	309	308	313

Sources: Latvian authorities; and Fund staff estimates.

Table 11. Baltic Countries: Equilibrium Monthly Wage Estimates, 1993-98 1/
(In U.S. dollars)

Country	Indicator	1993	1994	1995	1996	1997	1998
Latvia	Estimated Equilibrium Wage	289	310	321	344	375	374
	Actual Wage in percent of Equilibrium	...	45	56	56	57	65
Estonia	Estimated Equilibrium Wage	363	388	402	420	472	496
	Actual Wage in percent of Equilibrium	...	34	51	59	55	59
Lithuania	Estimated Equilibrium Wage	221	217	225	237	255	270
	Actual Wage in percent of Equilibrium	...	42	57	73	84	98

1/ Staff calculations based on Krajnyak and Zettelmeyer (1998), and using updated IMF estimates of PPP-GDP per employee.

Table 12. Latvia: Productivity and Unit Labor Cost in Manufacturing, 1993-96

	1993	1994	1995	1996	1997	1998
Average nominal wages in lats	46.2	73.7	91.8	104.3	127.4	134.2
Average nominal wage (percentage change)	...	59.7	24.6	13.6	22.2	5.3
Labor productivity (annual percentage change)	...	5.1	1.7	8.2	15.1	4.2
Unit labor costs (annual percentage change)	...	52.0	22.5	5.0	7.9	1.1

Source: Latvian authorities.

Table 13. Latvia: Unit Labor Cost Indicators, 1993-98

	1993	1994	1995	1996	1997	1998
			(Index 1995= 100)			
Unit Labor Cost 1/						
Economy average	...	...	100	90.4	99.5	95.7
Manufacturing	...	...	100	102.2	90.0	95.3
Unit Labor Costs Relative to Poland 2/						
Latvia	0.53	0.97	1.10	1.11	1.18	1.29
Estonia	0.41	0.68	0.84	0.9	0.86	0.89
Lithuania	0.55	0.95	1.13	1.44	1.72	1.95

Source: Latvian authorities, and Fund staff estimates.
1/ Calculated from sectoral data on output, average wages and employment.
2/ Calculated using IMF PPP GDP estimates.

Table 14. Latvia: Analysis of Global Export Market Share, 1993-98
(Percentage change)

	1993	1994	1995	1996	1997	1998
Goods and services:						
Market growth	4.8	5.5	10.0	11.3	9.4	3.3
Growth of Latvia's exports	37.0	-0.6	7.2	26.3	13.5	10.7
Change in Latvia's market share	30.7	-5.8	-2.5	13.5	3.7	7.2
Goods:						
Market growth	6.3	6.2	10.4	10.8	8.8	1.7
Growth of Latvia's exports	9.5	-28.9	6.8	8.9	20.2	11.3
Change in Latvia's market share	3.0	-33.1	-3.3	-1.7	10.5	9.4

Sources: WEO database; and Fund staff estimates .

Table 15. Selected Country's Share in Total EU Imports 1/, 1992-97
(In percent)

	1992	1993	1994	1995	1996	1997
Latvia	0.057	0.063	0.115	0.163	0.187	0.230
Estonia	0.107	0.149	0.163	0.178	0.187	0.209
Lithuania	0.000	1.199	1.423	1.650	1.680	0.203
Czech Republic	1.082	1.037	1.169	1.397	1.517	1.635
Hungary	1.725	1.799	1.953	2.249	2.109	1.622
Poland	0.397	0.676	0.732	0.779	0.735	2.107
Slovenia	0.000	0.301	0.432	0.567	0.589	0.690
Slovak Republic	2.325	3.634	4.146	3.941	4.000	0.583

Sources: Direction of Trade Statistics; and Eurostat.
1/ Excluding intra-EU-trade.

Table 16. Latvia: Export Market Shares in Selected
EU Countries, 1996-98

	1996	1997	1998
Germany	0.036	0.041	0.047
Finland	0.097	0.070	0.095
Sweden	0.113	0.167	0.217
Denmark	0.100	0.115	0.161
UK	0.045	0.061	0.059

Source: Latvian authorities.

IV. The Latvian Banking Sector in the Aftermath of the Russian Crisis

A. Introduction

41. While the Latvian economy in general has outperformed most of its BRO neighbors, in terms of both higher growth and lower inflation, and has succeeded in completing all the major first generation reforms, banking sector difficulties remain a possible obstacle in Latvia's path towards sustainable growth and convergence with the EU economies. Latvia's banking sector faced a major crisis in 1995 and has again met with renewed difficulties in the wake of the 1998 Russia crisis. This chapter presents an outline of recent banking sector developments, focusing on the effects of the Russian crisis and the response by the banking sector and the authorities. Section B discusses the initial transition phase, section C reviews the subsequent period of recovery and financial deepening, section D covers the recent period of distress, and section E concludes.

B. The First Phase of Transition and the 1995 Banking Crisis

42. As in other BRO economies, the Latvian banking sector emerged from the break up of the old monobank structure inherited from the soviet regime.[14] In the initial phase of the transition the Bank of Latvia (BoL) was set up as a the central bank, directed and subsidized credits, and interest rate controls were phased out, and a large number of commercial banks were established—as many as 63 banks were operating in the country at the end of 1993.[15] Many of the newly established banks were small and weak, and their number grew very rapidly.

43. Banking sector problems first surfaced in 1994, and the BoL revoked 15 bank licenses. The publication of audited reports in April 1995 revealed that two thirds of the audited banks reported losses for 1994, and information emerged that the largest commercial bank was having difficulties in concluding its audit. The subsequent closure of the largest bank, Baltija Bank (with 30 percent of deposits), which had suffered a run, and of two other major banks triggered a systemic banking crisis in the spring of 1995. The authorities eventually decided to liquidate Baltija Bank, and several other banks, including a few large ones, had their licenses revoked.

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[14]The origins of the Savings Bank (Krajbanka) can, however, be traced back to Latvia's inter-war independence period.

[15] This section draws on Chapter VI of the 1995 Latvia Recent Economic Developments publication (SM/95/265).

44. The 1995 crisis had many causes, including lack of managerial experience with the banks' new operating environment, inadequacy of internal and external governance, and an excessive number of banks given the size of the existing market. Lack of collateral laws and poor enterprise accounting contributed to credit risk, while the liberalization of credit markets and of the capital account increased the banks' ability to engage in risky operations. As was common in transition economies, the banking sector faced scarcity of skills in risk assessment, accounting, and administration. Widespread insider lending, capitalization of interest on unpaid debt, and fraud also contributed to the banks' problems. Moreover, liberal licensing requirements, lax supervision, and inadequate enforcement of prudential regulations led to a proliferation of unsound banks, while the absence of an explicit deposit insurance scheme led agents to react swiftly to news regarding banks' difficulties. The banking system also had suffered a loss of inflation related revenues after the February 1994 stabilization of the lats.

45. The authorities responded to the crisis by immediately implementing tighter prudential regulations, raising the minimum capital requirement for banks, enhancing monitoring through more frequent on-site inspections and the requirements of external audits, the creation of a two-tier banking system, in which only 'core-banks' that comply with stringent prudential regulations and have a relatively high capital base are allowed to take household deposits, and rapid closure of banks which failed to comply with prudential standards. Nevertheless, the aftermath of the crisis was a severe decline in the level of loans extended, a sharp contraction of monetary aggregates, and a fall in economic activity. As can be seen in Table 17, the number of banks fell by 25 percent between end–1994 and end–1995, while total bank credit shrunk by 49 percent. In fact, bank credit to the private sector only surpassed the 1994 levels by 1997, and, as a share of GDP (18 percent), only in 1998. Perhaps more importantly, the crisis shook the public's confidence in the banking sector, a fact with which the banks and the authorities have had to cope ever since. It is also important to note that although the number of banks began to decline after the 1995 crisis, the process of consolidation has been quite slow.

C. Financial Deepening and Exposure to Russia: 1996-1998

46. Between 1996 and mid-1998 the banking sector recovered from the 1995 crisis and expanded, with banks' assets and deposits increasing by 125 percent and 120 percent, respectively. During the recovery Latvia's financial sector became significantly bank dominated, following the universal banking model—Latvian banks own approximately half of the domestic non-banking financial institutions (NBFIs). At end-1997 there were 31 banks, of which 2 were state-owned and 16 were foreign-owned (Table 17). Subsidiaries of Estonian, Finnish, German, and Russian banks as well as a branch of a French bank also operated in Latvia. State-controlled banks accounted for about 8 percent of the sector's assets, but were dominant in certain activities, notably mortgage lending and accepting small household deposits.[16] Seven small credit unions

[16] In early 1999 control of the Savings Bank passed to the private sector. The state retains control of the Mortgage Bank.

(continued...)

operated in Latvia, but their role in the financial system was marginal. During this period the share of bank credit allocated to the agricultural sector fell whereas the financial sector's share increased, with the share of the trade sector, the largest of all, remaining relatively stable.

47. The banking system went through a long process of consolidation and came to be dominated by two relatively large banks (Parex and Unibanka), and four medium-sized banks (Rietumu, Hansabank, Riga Komercbank, and the Savings Bank/Krajbanka), who together accounted for about 50 percent of bank assets and more than 60 percent of bank deposits (Table 18). The other banks in the system were on average quite small compared with these larger institutions. Note that the 1998 banking difficulties accelerated the concentration of bank assets and deposits in the larger banks. Nevertheless, the number or banks operating in Latvia still appears to be large relative to the size of the domestic economy, which suggests that the consolidation process is as yet incomplete.[17] Table 18 also indicates that traditional banking business such as deposit taking and lending, seems to be more concentrated on the largest banks than other activities such as proprietary securities trading. In fact, according to the BoL, by end–1998 the five (ten) largest banks accounted for 63 (77) percent of total bank credit.

48. Table 17 highlights one of the main features of the Latvian banking sector, namely its degree of internationalization. Majority foreign-owned banks were responsible for more than 50 percent of total bank assets by 1996, 72 percent by end-1997, and almost 85 percent at end-1998. It should be noted, however, that the figures for foreign ownership are somewhat inflated, since tax regulations have led Latvian entrepreneurs to use off-shore companies to control their banks — these tax regulations are no longer in place, but will benefit existing banks until 2001. It should also be noted that Sweden's SEB acquired a large stake of Unibanka in late 1998, and the Finnish-Swedish Merita Nordbanken Group took complete control of the Latvian Investment Bank. Importantly, since 1996 foreign currency denominated assets and liabilities have on average been equivalent to about ⅔ of total banks' assets, and non-residents have been responsible for about 40 percent of total bank deposits. This significant 'financial openness', which was partly responsible for the vulnerability of the Latvian banking sector to the Russian crisis, has several causes. First, the economy is extremely open to foreign trade, which has been equivalent to more than ¾ of GDP in the last three years. Second, Latvia has a large population of Russian speakers, and has had strong cultural, trade (in particular transit trade through Latvia's ports), and financial linkages with its eastern neighbors (as well as the other Baltic republics and Scandinavia) for a long time. Third, the relative success of its transition process, including inflation stabilization, political stability, and increasing ties with the EU economies, have contributed to make the Latvian banking sector a 'safe haven' for investors from Russia and other CIS countries. Indeed, several Latvian banks, including some of the largest ones, have traditionally had extensive links

[17] There is a consensus that Latvia is overbanked. See for instance Standard and Poor's January 1998 Bank Industry Risk Analysis.

with the Russian business community and whereas larger institutions have also focused on domestic operations, many small banks have maintained profitability by holding foreign (CIS-country) government securities.

49. Before examining the extent of systemic exposure to Russia, it is worth noting that domestic credit was also expanding rapidly in the 18 months or so before mid-1998. Bank credit to Latvian private enterprises and financial (non-bank) institutions rose from LVL 208.5 million at end-1996 to LVL 418 million at end-1997 and LVL 545 million by mid-1998. This credit boom was merely bringing Latvian credit aggregates (as a share of GDP) more in line with the ratios observed in other successful transition economies, yet extremely fast credit expansion always entails a risk that credit analysis may in some cases be inadequate, and engenders a potential for a deterioration of the quality of banks' loan portfolio, especially in the event of an economic deceleration.

50. Along with the structural factors noted above, increased competition for domestic lending business, large interest rate differentials between Latvian and Russian instruments, and an inadequate regulatory treatment and monitoring of banks' exposure to foreign government bonds, led to the build up of Latvian banks' exposure to CIS assets. Table 17 shows that the average lending spread fell from 16 percent in 1995 to just about 7 percent in 1997, and remained around that level until the second half of 1998, as larger institutions developed their credit making expertise, and used their stronger capital base to price smaller banks out of the market. The improvement in Latvia's fiscal outlook, together with lower inflation, brought about a trend of declining Latvian interest rates, with the average nominal treasury bill yield (percent per annum) falling from 28.2 percent in 1995 to 16.3 percent in 1996, 4.7 percent in 1997, and 4.9 percent in the first half of 1998, when Russian treasury bills were offering an annual return (in rubles) of about 33 percent.[18] With hindsight it became clear that the currency and credit risks priced into those yield differentials were not unwarranted, and, as will be seen below, would eventually cause serious losses to Latvian banks, but at the time the yield differential proved to be the dominant attraction, as happened with many banking institutions in the West. Finally, until the onset of the crisis the BoL attributed a zero risk weight, for purposes of calculation of the capital adequacy ratio, to non-OECD government bonds denominated in *domestic currency*, such as Russian GKOs. Although this practice was in compliance with the letter of the 1988 Basel Capital Accord, it is still the case that national supervisory authorities need to assess country risk, particularly when domestic banks concentrate their foreign exposure into a small set of non-OECD countries. In turn, this regulatory problem stemmed from inadequacies in banks' prudential reports, which did not allow a timely monitoring of their exposure to country risk.

51. Table 19 presents Latvia's banking system exposure to Russian securities as of July/August and December 1998. It shows total systemic exposure, exposure of selected groups of banks

[18] According to IFS data, the interest rate spread between Russian and Latvian treasury bills was 18.7 percent in 1997 and rose to 28.1 percent in the first half of 1998. Spreads in money market rates were even higher.

according to their estimated end-1998 risk-weighted capital adequacy ratios (CAR) and amounts of Russian assets, and the situation of the Riga Komercbanka (RKB), which was Latvia's third largest bank before the crisis and was heavily exposed to Russia.[19] The systemic exposure amounted to 11 percent of total assets as of August 1998, more or less evenly distributed between claims on the Russian public sector and private sector, and also between ruble denominated and non-ruble denominated securities. Moreover, it can be seen that exposure to Russia was concentrated on a set of seven institutions that together accounted for about 75 percent of the total claims. In particular, it is clear that the RKB had a very substantial exposure to Russia, equivalent to 30 percent of its total assets and almost four times the bank's capital. This excessive exposure made the RKB particularly vulnerable to the situation in Russia. Also, banks typically kept their Russian government bonds in trust arrangements with a limited number of local institutions, who also provided hedge against local currency risk through forward contracts, an arrangement that engendered a significant element of counterparty risk. It should be noted that the banks had also accumulated some exposure to other CIS economies, such as Ukraine (LVL 46 million) and Kazakhstan (LVL 11 million), but their subsequent difficulties appear to have been mostly related to impairment of Russian assets.

52. Capital availability ultimately determines banks' ability to withstand shocks, so it is of interest to note that by end–1997 the system seemed to be well capitalized, with an average CAR of 21 percent, well above the 10 percent regulatory minimum which, once breached, requires banks to take remedial action and entitles the BoL to place institutions under a regime of intensified supervision. In fact, as can be seen in Table 20, the number of banks with CARs below 15 percent, which could be seen as particularly vulnerable to shocks that might imply a need for recapitalization, declined from 27 percent of the total number of surveyed banks in late 1994 to just 6 percent (two banks) in late 1997, before rising again to eleven percent in the aftermath of the 1998 crisis. Note, however, that up to late 1998, the banks' CARs were biased upwards by the zero risk weight that was attached to holdings of Russian GKOs and other domestic currency denominated non-OECD government bonds.

D. The Impact of the Russian Crisis

Direct impact on banking system

53. The sharp depreciation of the ruble versus the lats since August 17, 1998 has considerably reduced the lats value of the ruble denominated assets held by Latvian banks, as hedges against

[19] These estimates were performed by the BoL before the publication of banks' audited 1998 financial statements. The BoL estimated that there were 3 solvent banks with high exposure to Russia and CARs below 10 percent, and another 3 banks with large exposures and CARs between 10 and 15 percent.

the risk of a ruble devaluation failed to perform.[20] Also, the moratorium on payments which was declared by the Russian authorities, and the ensuing negotiations with creditors clearly indicate that only a very limited portion of the nominal value will ever be repaid on ruble-denominated government bonds such as the GKOs. Furthermore, some of the private debtors in Russia are in weak financial state and credit losses are likely. Finally, in May 1999, the Russian government defaulted on 'MinFins', dollar denominated obligations of the Finance Ministry, which undermined the widely held assumption that dollar denominated assets would have preferred treatment. Ultimately, payments of coupons on Russian eurobonds and MinFins would hinge on Russia's ability to enter an SBA with the IMF and use it as a catalyst for obtaining funds from other (public and private) sources.

54. Therefore, given its overall exposure it is not surprising that the Latvian banking system was significantly affected by the Russian crisis. To date three small banks have been closed or suspended while the RKB became insolvent and will need a large recapitalization package in order to avoid closure.[21] There were bank runs in August–September 1998, focused on the RKB and smaller institutions, after the extent of these banks' exposure to Russia became known, and a milder episode in March 1999, this time focused on the largest banks, when the BoL suspended operations of the RKB in an environment of uncertainty regarding the publication of banks' audited financial statements at the end of the month. There are signs that at least one major bank still had a worrisome level of exposure to Russia by May 1999, and would need to be recapitalized as a result of losses derived from its MinFins portfolio. Table 21 presents various leading indicators of banking sector distress, and shows that the Russian crisis had a severe and immediate impact on banks' capital base, with the average capital adequacy ratio falling by 5 percentage points between the end of June and the end of September, 1998. Moreover, as banks lost deposits their liquidity was also significantly affected. Clearly, losses from Russia also affected banks' earnings indicators—Latvian banks as a whole posted significant losses, for the first time since 1994 (see Table 17). The substantial increase in the loans/capital ratio indicates that depletion of the banks' capital has made them more vulnerable to an eventual deterioration of the quality of the loan portfolio. A positive impact of the crisis was the deceleration of the previously excessive asset and credit growth rates.

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[20]In many cases, the sheer magnitude of the ruble depreciation, the severe impairment of their own assets in the aftermath of the crisis, and administrative measures, implied that Russian counterparty banks could not meet their obligations when the forward contracts that had been used to hedge devaluation risk reached maturity.

[21]Kapital and Viktorija banks were closed in 1998 and the Latvian Industrial Bank, which had longstanding difficulties, was suspended in early 1999. In August 1998, the RKB was placed under 'intensified supervision', a regime that enabled the central bank to have close oversight over its operations.

Effects on banks' loan portfolios

55. Note that the indicators in Table 21 do not suggest that there was a significant deterioration in the loan portfolio, with the ratio of nonperforming to total loans increasing just to 7 percent by year-end and declining to 6 percent by March 1999, and provisioning for loan losses rebounding rapidly after a dip in the third quarter of 1998. However four caveats are necessary. First, the nonperforming loans ratio (as well as the other indicators) for end-March 1999 excludes the RKB, so that a more realistic figure, according to the BoL, would be about 8 percent. Second, the authorities are currently revising their regulations on loan classification and loan-loss provisioning, which, once implemented, might lead to an upward revision of the nonperforming loans ratio. Third, and more importantly, since the ratio of nonperforming to total loans tends to respond with some time lag to shifts in economic activity, a further deterioration of asset quality in the next few months might be expected. Fourth, two of the largest banks have recently indicated that they had losses and/or had to realize collateral, in sizeable loans to firms with strong Russian business ties. Rough calculations conducted by the staff indicate that, in the absence of other shocks, the system could probably withstand a substantial increase in nonperforming loans, up to about 13–5 percent of the total, but it could face severe difficulties if nonperforming loans increase beyond this threshold. Note, however, that the situation may be more delicate for individual banks, particularly those which have already faced sizeable losses derived from their *direct* exposure to Russia.

The Bank of Latvia's role

56. The BoL's response to the crisis was threefold: provision of liquidity to the system, improving the prudential regime, and dealing with the specific problems faced by the RKB. Liquidity has been provided when necessary through discount (refinance) and repurchase operations. According to BoL data, the central bank's gross claims on commercial banks increased from LVL 13 million by end-June 1998, to LVL 33 million by end-September, LVL 55 million by year-end, and LVL 68 million by end-March 1999.[22] Clearly, the crisis in August-September 1998 and the March 1999 runs had a significant impact on bank liquidity which had to be remedied by the central bank. In fact, in March 1999 the BoL had to provide LVL 60 million in liquidity support to the system, LVL 40 million in refinance credits and LVL 20 million through repurchase operations. In addition, activity in the interbank market diminished considerably, with the monthly turnover falling by about 50 percent between June 1998 and early 1999. Interbank credit limits were cut and smaller banks were excluded from the market, so that the BoL had to become a market maker shifting funds from liquid to illiquid institutions. In principle, liquidity credit should be fully collateralized, but, as illustrated by the case of RKB, the collateral may become significantly impaired if the borrower institution becomes insolvent.

[22] At the same time, banks' net balance with the BoL went from LVL 77 million by end-June 1998 to LVL 47 million by end-September, LVL 41 million by end-December, and negative LVL 0.4 million by end-March 1999.

57. The BoL has been strengthening prudential regulations, in agreement with and with the cooperation of the IMF, according to an action plan aimed at making its regulatory practices fully compliant with the Basel Core Principles of Effective Bank Supervision (BCP) and the relevant EU directives – see Table 22 for an overview of Latvia's regulatory regime.[23] In reaction to the Russian crisis, the BoL raised the risk-weight of non-OECD ('zone B') domestic currency denominated government bonds from zero to 50 percent, and established strict limits to banks' total exposure to zone B countries, whereby banks cannot invest more than 25 percent of own funds on any one zone B country, and no more than 200 percent of own funds in all zone B countries. In addition, in October 1998, a deposit insurance scheme was introduced, with coverage of all deposits up to LVL 500, rising to LVL 13000 by 2008, when it will be on a par with similar schemes in the EU. Finally, the supervisory authority has been preparing new reporting requirements aimed at strengthening its ability to monitor the emergence of risk concentrations by country and currency.[24] It should be noted that the BoL refrained from imposing uniform provisioning rules for the banks' Russian exposure, leaving the issue to be decided by the banks' auditors and their parent offices, whereas some commercial banks would have preferred the introduction of uniform standards.

58. As noted above, the RKB was put under intensified supervision, as of August 28, 1998, and had to rely on BoL (collateralized) liquidity support to maintain payments. The BoL knew that the bank was insolvent but decided to support it because of its size (see Table 18), and as yet good franchise value, and particularly because of the concern that closing a large bank in a scenario of high uncertainty regarding the exposures of other banks to Russia could lead to a systemic crisis.

The banking system's reaction to the crisis

59. Estimates undertaken by the IMF staff under favorable, neutral, and unfavorable scenarios for losses derived from Russian exposure suggested that the impact of the crisis was indeed considerable and that capital injections equivalent to about 1.5–3 percent of GDP would be needed to bring the system average CAR to a comfortable 15 percent.[25] These can be seen as

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[23] See also the report of the latest MAE technical assistance mission to Latvia (November 1998).

[24] Prudential reports showing a break-down by country of banks' assets are expected to be implemented from the third quarter of 1999.

[25] Under the favorable scenario, ruble denominated government bonds are provisioned at 60 percent, whereas other public sector ruble denominated securities are provisioned at 30 percent—the rationale for this differential treatment is that sub-units of the Russian public sector are apparently in a better financial position than the federal government. In addition, eurobonds and all other exposures are expected to be paid in full. In the neutral scenario ruble denominated government bonds are provisioned at 80 percent, eurobonds and other public sector non-ruble denominated securities are provisioned at 30 percent, other public sector ruble denominated securities are provisioned at 50 percent, and exposure to the Russian private sector is provisioned

(continued…)

lower bound estimates, since they exclude the second-round effects of the crisis through deterioration of the loan portfolio to domestic firms with large turnover with Russia, and potential losses from exposure to other CIS countries.

60. Several large institutions were indeed recapitalized between the second half of 1998 and the first quarter of 1999. Unibanka, which posted the largest losses in absolute terms in 1998 (about LVL 15 million) got large capital inflows from SEB through share purchases and conversion of subordinated debt into capital, and the Swedish group now has operational control of the bank and 44 percent of its capital. The Savings Bank, which became insolvent as a result of Russian exposure, was recapitalized through a closed share issue by its private investors which brought the government's share of the bank's capital down from 54 to 42 percent. Nevertheless, although this operation brought the banks' capital to LVL 2.43 million, above the LVL 2 million absolute minimum required by the BoL, the bank still falls short of the 10 percent CAR minimum and is searching for a strategic investor. Rietumu bank was also recapitalized by its existing shareholders. The largest and most controversial recapitalization operation was that envisaged for the RKB, discussed below. In addition, the BoL has recently approved the merger between Tranzitu Banka and the Latvian Oil and Chemical Bank, which will create another middle-sized institution.

61. In spite of the successful recapitalization of various banks, the system still faces downside risks. Those derive in part from residual exposure to Russia, which, as can be seen in Table 19, still accounted for 7.5 percent of total assets at end-1998, or 64 percent of total capital. In addition, the RKB's recapitalization/rehabilitation plan could yet unravel, which under certain circumstances (e.g. if at the same time difficulties emerge in another large institution) could pose systemic difficulties. Also, if, contrary to current expectations, the present economic deceleration becomes a protracted recession, the ratio of nonperforming loans is bound to increase, causing difficulties to banks that over-extended credit lines to the private sector. In addition, a possible impairment of Latvian banks' claims on other CIS countries could cause problems, especially in banks that have already faced large losses from their Russian exposure. While the outlook for the economy is good with economic growth likely to recover and the current account deficit to narrow, it is useful to be aware of the possible impact on the banking sector of a more pessimistic scenario. Were the macroeconomic outlook to deteriorate and/or the current account deficit to worsen, this could bring pressures on the lats.The negative impact of any devaluation is not easy to predict, but to the extent that most of the foreign currency denominated loan portfolio of

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at 25 percent. The unfavorable scenario includes 95 percent provisioning for ruble denominated government bonds, 60 percent provisioning for eurobonds and other public sector non-ruble denominated securities, 70 percent provisioning for other public sector ruble denominated securities, and 50 percent provisioning for Russian private sector assets. The relatively lower provisioning for non-ruble denominated public sector assets reflects the view that Russian eurobonds have a higher repayment probability than ruble denominated securities.

Latvian banks is, according to the Bol, with firms that have some "natural" hedge(exports, transit trade), it would require a substantial devaluation for the effect to be significant.

62. The process of banking sector consolidation has continued, but at a relatively slow pace, and has been taking place more through bank closures/voluntary exit than via mergers. This reflects uncertainty regarding banks' financial position, a certain lack of complementary branch network and product lines, the mostly hands-off stance taken by the authorities, and the fact that hitherto the system has included a host of 'pocket banks' that have a small number of clients and a limited range of business activities, mostly Russia related, and are therefore unattractive targets for mergers or acquisitions.[26]

63. The impact of the crisis on asset and particularly credit growth raised the perspective of a credit crunch, a situation in which undercapitalized banks become too risk averse and refrain from extending loans even if there is ample liquidity and buoyant credit demand. Nevertheless, it appears that the recent deceleration in credit growth reflects a simultaneous decline in the demand for as well as the supply of lending, as the real sector impact of the Russian crisis brought about an economic slowdown. Moreover some of the largest institutions appear to be well capitalized, and would seem to be able to meet any significant increase in loan demand.[27] Finally, for well capitalized institutions, particularly those which may count on support from large foreign parent groups to fund their expansion plans, liquidity should not pose a constraint to a resumption of credit growth.

The situation of the Riga Komercbanka

64. Since the summer of 1998 the difficulties at the RKB have been the focal point of the problems faced by the Latvian banking sector. In September 1998, and again in March 1999, IMF staff made rough calculations (the correctness of which were broadly confirmed by the BoL and the RKB) which indicated that the own capital of the bank was drastically eroded by the Russian crisis, to the extent that around LVL 40 million would be needed just to recapitalize the bank back to a zero-capital position, under an unfavorable, but not unlikely, scenario for the valuation of the bank's assets. In fact, the RKB's court appointed administrator stated that the bank's assets at end-March had a market value of LVL 45 million, and total liabilities were assessed at LVL 89 million, which indicates a solvency gap of about LVL 44 million.

65. In practical terms, the BoL opened a credit line in order to provide the bank with day-to-day liquidity—the size of the line has been gradually increased and amounted in March 1999 to some

[26] Lack of potential synergies was the reason cited for the failure of the merger between Unibanka and Saules Bank.

[27] As of end-March 1999 Unibanka's CAR was 15 percent, whereas Parex's was about 16 percent, well above the regulatory minimum.

LVL 18-20 million. Since the fall of 1998 the authorities have been taking part in multi-party negotiations on a recapitalization plan for RKB. These negotiations have involved the EBRD, the bank's largest shareholder, other lesser shareholders, as well as a group of syndicated creditors, led by Fuji bank and Dresdner bank. In March 1999, the BoL suspended the RKB's operations (which implies that the remaining deposits at the bank have been frozen). The bank was later formally declared insolvent and an administrator was appointed with the role of preparing the bank for rehabilitation or, if additional capital could not be found, liquidation. In May, a rehabilitation plan was approved by the BoL, and it is now expected that a revived RKB would return to normal operations by end-July.

66. The plan, which has effectively been under consideration by the various parties since the fall of 1998, involves a LVL 15.5 million capital injection from the BoL, about LVL 5.3 million from the EBRD, LVL 1 million from the Latvian government, and contributions from some of the main creditors, which would take the bank's capital up to about LVL 6.3 million. There are, however, still some doubts about the scheme's feasibility, in particular because the RKB has made losses on residual exposure to Russia of about LVL 4 million in 1999, and there are misgivings on whether the bank, which lost a significant share of its deposits and business relations, would be viable even after the recapitalization. The BoL indicated that given these recent additional losses, large depositors are now being approached with a proposal to convert their claims into capital with the objective of increasing the bank's capital base before resuming operations. This recapitalization plan has some worrisome aspects. First, it includes a central bank financed subsidy to a private company, whereas the preferable approach would be for the subsidy to be directly funded by the government. A central bank subsidy typically implies an increase in money supply and is a non-transparent way of funding what is in effect a quasi-fiscal operation. Moreover, there is a clear potential for conflict of interest between the central bank's supervisory activities and its shareholding of RKB. Second, it could be interpreted that the operation is against the spirit of the Bank of Latvia Law.[28] Moreover, the BoL will offer a liquidity guarantee to the bank's remaining clients (up to LVL 18 million), which constitutes an additional contingent liability. The total commitment of BoL funds to the rehabilitation process would, therefore, amount to almost 1 percent of GDP. The BoL's direct involvement in the rehabilitation of RKB also raises moral hazard problems and creates a precedent that could be exploited by other banks that are facing or may eventually face difficulties. It would be important, therefore, that the BoL divest its shareholdings of the RKB as soon as market conditions permit, and the authorities should be prepared to close the bank if further investment sources cannot be found to provide it with a sound capital base or if the bank finds it difficult to attract new clients and to compete with established institutions on a level playing field.

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[28] Article 14 of that law states that 'The Bank of Latvia shall not participate in any business venture'.

E. Conclusion

67. The Russian crisis had a significant impact on the Latvian banking system and exposed vulnerabilities that had built up during the expansion period from 1996. The most important was excessive exposure to Russian assets, relative to the banks' capital base, which turned out to cause large losses to domestic banks—LVL 53 million, even excluding banks with suspended operations. In turn, the roots of this excessive exposure were partly structural, but banks turned to Russian assets also partly due to regulatory failure and, somewhat paradoxically, to the success of the Latvian fiscal retrenchment and stabilization, which allowed domestic interest rates to fall sharply in 1996-1998. Another key vulnerability has been the public's residual mistrust of the banking sector, inherited from the 1995 crisis, which has led it sometimes to overreact to news about banks' situation. Moreover, an unfinished consolidation process implied that the system still included a significant number of small banks with excessive dependence on Russia related operations.

68. Latvian banks are likely to witness a continuation of this consolidation process in the coming months and years. The reasons for that are many, including the fact that small banks that used to rely on investing in Russia would face serious difficulties in maintaining their viability, particularly after January 2000, when the minimum capital requirement will be raised to the equivalent of €5 million—Table 17 shows that by end-1998 there were 13 banks with capital below that threshold. Also, because the losses derived from the Russian crisis have already created sizeable (relative) recapitalization requirements for some small institutions. Finally, small banks face difficulties obtaining funds in the interbank market, and often face liquidity constraints, which would limit their ability to extend credit and therefore weaken an already fragile competitive position vis-à-vis the larger banks.

69. The 1998–1999 difficulties faced by the Latvian banking sector confirm several policy lessons that have been drawn from the recent international financial crises. First, is the importance of ensuring that supervisors have adequate capability to monitor the foreign operations of domestic banks in countries with open capital accounts, which should also be fully covered by prudential regulations. Second, is that lack of transparency tends to increase rather than diminish the public's concerns with the banking sector, especially after it is acknowledged that a major institution is facing problems while there is considerable uncertainty regarding the position of other banks. Third, the crisis showed that the provisions of the Basel Capital Accord regarding risk weights, as much as the BCP, are really minimum standards, which the individual national supervisory authorities should supplement as needed according to their perceptions of the risks faced by their respective banking sectors. Fourth, is the usefulness, for countries with pegged exchange rates, of having a foreign exchange reserve cover that is sufficiently large to accommodate a significant short-term expansion of central bank credit to commercial banks in times of distress. Moreover, the Latvian banking problems indicate that a protracted period of uncertainty regarding the situation of a major bank can contribute significantly to erode the system's credibility, and risks endangering the position of otherwise healthy institutions.

70. Under policies that take into account the lessons from the crisis, with strengthened supervisory rules, increased foreign participation, and a healthy process of consolidation, which would bring about institutions with a larger capital base without jeopardizing the competitive environment, it is expected that the Latvian banking system will emerge stronger from its present difficulties.

Table 17. Latvia: Structure and Performance of the Financial Sector, 1994-98
(Annual end of period data, in millions of lats, unless indicated otherwise)

	1994	1995	1996	1997	1998
Number of licensed banks	56	42	35	31	27
of which:					
majority state-owned banks	3	2	2	2	2
majority foreign-owned banks	...	11	14	16	15
branches of foreign banks	0	1	1	1	1
Number of nonbank deposit-taking institutions	2	1	4	6	7
Number of banks accounting for					
25 percent of total assets	2	2	2	2	2
75 percent of total assets	15	15	10	11	8
Number of banks with					
capital below LVL 2 million 1/	38	24	15	8	0
capital between LVL 2 and LVL 3.4 million 2/	6	6	5	8	13
capital between LVL 3.4 and LVL 10 million	10	8	10	11	8
capital above LVL 10 million	1	1	2	4	6
other 3/	1	3	3	0	0
Total bank assets	1,103	835	1,137	1,847	1,686
of which:					
held by majority state-owned banks	159	127	83	118	143
held by majority foreign-owned banks	...	326	584	1,334	1,428
held by branches of foreign banks	0	8	15	26	30
Total assets held by nonbank deposit-taking institutions	0.3	0.0	0.1	0.3	0.5
Total foreign currency-denominated assets	672	468	732	1,262	1,111
Total foreign currency-denominated liabilities	538	452	707	1,187	1,063
of which: liabilities with less than 30 days to maturity	...	246	426	563	478
Contingent and off-balance sheet accounts	31	20	78	537	506
of which: foreign currency-denominated	5	0	41	455	337
Total loans	489	249	288	502	733
of which: real estate loans	7	11	6	10	26
Credit to the private sector	369	191	242	482	710
Total deposits, excluding interbank deposits	625	530	686	1,080	1,042
Central bank credit to banks	55	25	10	8	52
Average pretax return (profits), in domestic currency	-4	7	35	53	-28
Average lending spread (lending rate - deposit rate)	...	16.1%	10.3%	6.7%	9.9%
Nonperforming loans (substandard or lower quality)	56	47	60	49	46
in percentage of total loans	0.1	0.2	0.2	0.1	0.1
Total provisions for loan losses					
Specific provisions	66	47	45	37	45
General provisions	1	2	1	2	7
Risk-weighted capital adequacy ratio	14.0%	20.1%	23.0%	21.0%	17.4%
Stock market capitalization	...	...	84	199	391
Overall stock market price index	...	...	248	346	98
Memorandum item:					
Gross domestic product	2,043	2,349	2,829	3,275	3,774

Sources: Bank of Latvia, Association of Latvian Commercial Banks.

1/ Capital includes equity and reserves.
2/ LVL 3.4 million (about 5 million Euro) will be the minimum capital requirement from January 2000.
3/ Banks which did not respond to the Association of Commercial Banks Survey.

Table 18. Latvia: Assets and Deposits in the Five Largest Banks, 1995-1998
(End of period, percentage of total banking sector assets and deposits, unless otherwise indicated)

	1995		1996		1997		1998	
	Assets	Deposits	Assets	Deposits	Assets	Deposits	Assets	Deposits
Bank								
Parex	12.2	15.0	14.6	19.8	14.7	18.6	18.4	20.8
Unibanka	13.9	12.3	13.2	15.4	14.7	15.3	18.2	17.9
Riga Komercbanka 1/	8.8	10.0	8.6	12.0	8.6	10.9	...	...
Krajbanka/Savings Bank	8.1	12.5	...	8.1	...	6.8	5.9	7.7
Hansabank	...	...	5.6	...	5.2	...	8.6	10.6
Rietumu Bank	5.4	7.3	7.8	11.2	7.0	8.9	6.5	9.5
Total	48.4	57.0	49.7	66.5	50.1	60.5	57.5	66.6
Other banks (total)	51.6	43.0	50.3	33.5	49.9	39.5	42.5	33.4
Other banks (average)	1.4	1.2	1.7	1.1	1.9	1.5	1.9	1.5
Total (all banks, as a share of GDP)	35.5	22.6	40.2	24.2	56.4	33.0	44.7	27.6

Source: Bank of Latvia.

1/ Under Bank of Latvia intensified supervision since August 1998, operations suspended in March 1999.

Table 19. Latvia: Banking Sector Exposure to Russia, 1998
(In millions of lats, unless otherwise specified)

	1998	
	end-August	end-December
Banking Sector		
Capital (Tier I+Tier II)	224	197
Risk-weighted capital/assets ratio (in percent) 1/ 2/	15.0	17.4
Total assets 3/	1834	1686
Total assets in Russia	203	127
Public sector	108	49
Private sector	95	78
Ruble denominated	106	56
Non-ruble denominated	97	71
Banks with estimated CAR between 10 and 15 percent		
Capital (Tier I+Tier II)	61	61
Risk-weighted capital/assets ratio (in percent) 2/	12.9	...
Total assets	693	689
Total assets in Russia	54	34
Public sector	23	13
Private sector	31	21
Banks with estimated CAR between 0 and 10 percent		
Capital (Tier I+Tier II)	35	23
Risk-weighted capital/assets ratio (in percent) 2/	19.8	...
Total assets	391	339
Total assets in Russia	43	21
Public sector	33	17
Private sector	9	4
Riga Komercbanka 4/		
Capital (Tier I+Tier II)	15	...
Risk-weighted capital/assets ratio (in percent) 2/	18.9	...
Total assets	190	...
Total assets in Russia	57	...
Public sector	54	...
Private sector	3	...

Sources: Bank of Latvia; and Fund staff estimates.

1/ Figure for December 1998 excludes the Riga Komercbanka.
2/ Calculated by the Bank of Latvia based on banks' data.
3/ Book values.
4/ As of end-July 1998.

Table 20. Latvia: Distribution of Capital Adequacy, 1994-98 Ratios of Latvian Banks 1/
(End-of-year)

CAR levels	1994	1995	1996	1997	1998
	(Number of banks)				
CAR < 10 %	5	4	2	1	5
10% < CAR < 15%	10	5	4	1	6
15% < CAR < 20%	9	2	7	10	0
20%< CAR < 30%	8	11	3	6	5
CAR > 30%	23	17	17	13	11

Source: Bank of Latvia

1/ 10 percent is the regulatory minimum CAR.

Table 21. Latvia: Banking Sector Vulnerability Indicators, 1994-99
(In percentages, unless noted otherwise, end of period)

	1994	1995	1996	1997	1998				1999 4/
					I	II	III	IV	I
Capital									
Capital adequacy ratio 1/	14.0	20.0	23.0	21.0	23.0	20.0	15.0	17.4	18.0
Loan loss reserves/assets	5.9	5.6	3.9	2.2	2.0	1.5	1.4	1.9	2.0
Asset quality									
Nonperforming loans/total loans	11.0	19.0	20.0	10.0	8.0	6.0	5.0	7.0	6.0
Nonperforming loans/assets	4.9	5.7	5.1	3.0	2.8	2.1	2.1	3.0	2.7
Total provisions for loan losses/total loans	13.5	19.5	15.8	7.8	5.9	4.3	3.3	5.3	4.6
Total provisions for loan losses/nonperforming loans	122.9	102.8	78.8	78.3	73.6	72.0	66.8	76.0	76.5
Annual rate of asset growth	...	-24.2	36.2	62.5	48.2	48.0	17.5	-0.3	-9.1
Annual rate of credit growth	...	-49.1	15.6	74.4	95.6	86.3	76.1	46.0	17.3
Safe investment securities/assets 2/	8.5	13.6	11.5	6.7	5.9	6.1	5.0	4.2	6.1
Loans/capital	385.8	241.4	193.5	228.5	263.4	278.9	330.1	373.5	422.4
Management									
Expenses/total revenue	102.7	96.7	83.7	77.6	82.9	85.8	95.0	113.2	82.2
Earnings									
Net operating income/assets	-0.4	1.2	3.2	3.2	0.7	1.1	0.8	-1.5	0.6
Change in interest and fee income/assets	...	1.0	0.3	1.8	1.8	2.0	1.7	1.4	1.7
Change in interest expenses/assets	...	-10.7	-0.7	0.6	0.6	0.6	0.7	0.6	0.7
Liquidity									
Liquid assets/total assets 3/	40.6	56.4	59.2	55.1	48.1	50.5	38.3	39.3	39.7
State of the economy									
Current account balance (in percent of GDP)	-0.2	-3.4	-4.1	-6.9	-3.6	-6.1	-12.7	-11.3	n.a.
Real GDP growth (year-on-year)	2.1	0.3	2.8	7.4	7.6	5.4	1.9	-1.0	n.a.
Exchange rate changes (lats/USD)	...	-2.0	3.5	0.7	0.8	1.2	-0.2	-5.2	3.5
Banking sector credit to the government/total loans	1.6	7.6	8.6	0.5	2.4	1.4	1.2	1.1	1.2

Sources: Bank of Latvia; IMF staff estimates.

This table is based on standard leading indicators of banking system vulnerability, see Lindren, Garcia, and Saal, "Bank Soundness and Macroeconomic Policy," IMF, 1996.

1/ Bank of Latvia estimates for third quarter of 1998.

2/ Investment in Latvian central government bonds/total assets.

3/ Liquid assets include cash, claims on the BoL, claims on other banks, and government bonds and Treasury Bills.

4/ Excluding banks with suspended operations.

Table 22. Latvia: Summary of Regulatory Framework for Commercial Banks

Type	Prudential Regulations	Comparison with minimum EU Standards
Basic Requirements		
Capital adequacy ratio	10% (risk-weighted)	8 % (risk-weighted)
Liquidity indicator	Maintain liquid assets not below 30 % of total current liabilities	Not harmonized, but exists in some countries)
Limits on lending (as % of own capital)		
Credit concentration per client (or group of connected clients)	25%	25%
Insider lending (aggregate)	15%	20%
Limits on foreign exchange exposure (as % of own capital)	20% (overall) 10% (any one currency)	> 2%, excess multiplied by 8 to get capital adequacy
Loan classification Provisioning	10% for close watch 30% for substandard 60% for doubtful 100% for losses	No EU-wide standards (Latvia is strengthening its classification and provisioning regulations)
Licensing requirements		
Minimum capital requirements	LVL 2 million from April 1998 Euro 5 million from January 2000 1/	Euro 5 million
Minimum registered capital (for new banks)	Euro 5 million (shall be paid in lats)	Euro 5 million
Competence of bank management	(Requisites defined in articles 24 and 25 of the Law on Credit Institutions)	Article 1, para. 2, First Council Directive, 77/780/EEC
Main reporting requirements		
Audited annual reports	By international audit companies approved by the Bank of Latvia	Comprehensive external audits
Quarterly balance-sheet publication	Required for "core" banks accepting household deposits	No explicit rules, but most banks submit quarterly balance sheets.

Sources: Bank of Latvia and IMF staff.

1/ About LVL 3.4 million as of June 1999.

I. TAX SUMMARY
(as of June 1999)

A. Taxes on Income and Property

The Corporate Income Tax

Nature of the tax

1. The Law on the Corporate Income Tax replaced the Law on the Profit Tax effective April 1, 1995. Together with the Law on the Personal Income Tax, the law forms a unified system of taxation on all types of income in Latvia unless otherwise stipulated by acts of legislation. The tax applies both to residents and "permanent establishments" of nonresidents. Taxable income is defined as the profit or loss as determined by Law on Annual Reports of Enterprises, adjusted according to provisions of the Law. The annual depreciation amount for fixed assets is set at twice the depreciation rate under the law (rates between 5 percent and 25 percent) multiplied by the remaining balance: Tax losses can be carried forward for five years. The capitalization rules limit the amount of interest payments that can be deducted in any year, and the transfer pricing rule is applied to cross-border transactions between Latvian residents and nonresidents. Amendments to the enterprise income tax law were introduced in 1997, allowing the transfer of losses between members of an enterprise group.

Tax rates

2. The standard tax rate is 25 percent. There are withholding rates of 5-25 percent on income paid to nonresidents, with a rate of 10 percent applying to dividends and interest payments. Tax credits apply to charitable deductions, small enterprises, enterprises that use prisoner labor, income from agricultural activity, income of enterprises established by associations for the handicapped, charities and health foundations, and on tax paid in foreign countries. Small enterprises are defined as those satisfying requirements on the value of fixed assets, net turnover, or the number of employees.

Tax exemptions

3. Exempt entities include nonprofit organizations and enterprises run by associations for the handicapped, charities, and health-care foundations. Amendments to the Law on Foreign Investments introduced in 1995 abolish the tax holidays for enterprises with foreign capital.

The Personal Income Tax (PIT)

Nature of the tax

4. The personal income tax is assessed on salary, income from self-employment, property income, as well as on all other remuneration, bonuses, compensation for unused vacation time, disability assistance payments, and all other kinds of payments which have not been exempted from the income tax. Tax levied on salaries and wages is withheld at source. Taxpayers must file an annual income declaration by April 1 of the following year for taxes owed during the previous calendar year. Persons whose only source of income is labor income and from whom income tax is withheld at the source do not submit declarations. The following do not file declarations: persons under 16 years of age; persons who have received income for fewer than 183 days during the year; and persons whose income does not exceed the yearly nontaxable income.

Tax rates

5. The tax rate is 25 percent of taxable income.

Exemptions and deductions

6. The income tax is imposed on taxpayers' income for the calendar year, except for nontaxable activities. The following are deducted from taxpayer income: (a) a nontaxable minimum (LVL 21/month effective January 1, 1997), (b) a deduction for each dependent (LVL 10.50/month effective January 1, 1997); (c) state social insurance contributions; (d) expenses for the education and health care of the taxpayer or family members; (e) donations to charity; and (f) benefits for handicapped or politically repressed persons or members of the movement of national opposition.

7. Income tax is not assessed on: agricultural income of individual farmers if it does not exceed LVL 3,000; dividends or business profits subject to the Corporate Income Tax; interest income; social benefits from the budget including unemployment compensation and social maintenance, except for temporary disability payments; scholarships; child support; alimony; worker's compensation and long-term disability payments; insurance compensation and payments; and income from the sale of private property.

Social Insurance Contributions

Nature of the tax

8. The social insurance contribution is imposed on salaries, wages, fees, other remunerations and rewards for work.

Tax rates

9. According to the provisions of the Law, On State Social Insurance, the tax rate will be 33 percent from assessable object, starting with January 1, 2002. During the transition period, the social insurance contribution rate will be 37 percent plus an additional .09 percent for insurance against job-related accidents.

10. The proportions to be paid by an employer and an employee during this transition period will be 28.09:9, with the exception that the rate for insurance against job-related accidents can change every year.

Exemptions

11. The social insurance contribution is not assessed on: income form property, dividends, interest payments, royalties, and other income which is not related to employment.

Real Estate Tax

Nature of the tax

12. The law On Real Estate Tax replaces the law On Land Tax in 1998. During a transition period through 2000 only land will be taxed. The tax is paid directly to the respective village, town or city budget.

Tax rates

13. The real estate tax is 1 percent of the cadastral value of real estate. During the transition period, the tax rate will be 1.5 percent of land value.

Exemptions and deductions

Exemptions

14. The following are exempt from the real estate tax:

♦ local government real estate used by local government and municipal enterprises in health care and social services;

♦ real estate owned by foreign countries and used as diplomatic and consular representatives;

♦ real estate of religious organizations;

♦ real estate that is a state cultural memorial;

- land under newly planted forest;

- real estate used for sports activities.

- individual (private) dwelling house and privately owned apartment in an apartment building; until December 31, 2003.

15. Local governments may reduce the tax for the certain groups of taxpayers in accordance with their own judgments.

Property tax

Nature of the tax

16. The property tax is paid by physical persons and legal entities on buildings and constructions located in the Republic of Latvia.

Tax rates

17. The tax imposed depends on the value of property as follows. Property worth less than LVL 1,500 is not taxed. A minimum tax of 0.5 percent is imposed on property valued at between LVL 1,500 and LVL 25,000. A maximum rate of 4 percent is applied when the value of property exceeds LVL 2.5 million. The tax is to be paid entirely to the local governments.

18. If a taxpayer owns several items of property, the tax is computed for the total value of the property, and if a taxpayer's property is located in different jurisdictions, the share to be paid to the local budget is proportional to the value of taxable property in each administrative or territorial unit.

Exemptions

- Property of individuals, if not used for business purposes.

- Property used or meant to be used solely for agricultural purposes.

- Government property used for health care, sports, education, and cultural purposes, except for cinemas, etc.

- Roads and roadside property as well as road service facilities, bridges, and viaducts; communication lines and stretches of land beneath them; and buildings of post offices and telephone exchanges in rural areas.

- Property used for environmental protection and fire safety.

- Property of religious organizations, national culture societies, and other public organizations approved by Parliament.

- Residences and property used in municipal services.

B. Taxes on Goods and Services

Value-Added Tax

Nature of the tax

19. This is a tax on value added, which uses the credit system and is levied on goods and services at the manufacturing/import, wholesale, and retail stages. The new law became effective on May 1, 1995 and replaced the old Turnover Tax Law which had been administered as a VAT.

Tax rates

20. The standard tax rate is 18 percent of taxable value of supplies of goods (including imports), services, and supplies for internal consumption. A tax rate of zero applies to exports, international transportation, or services connected with export supplies of goods.

Exemptions

21. The VAT is not charged on: educational services; school books, scientific literature, and certain Latvian language literature; public library services; scientific research; services of nursing homes, day-care centers, and kindergartens; banking, financial and insurance services; betting, lotteries, and other types of gambling; registered mass media; used real estate sales and rent payments by individuals; movies (except video), concerts, cultural, and amateur sporting events, etc.; certain approved medical services, supplies and goods; certain approved baby-foods; funerals and religious services; humanitarian aid and approved gifts; consular services; certain services provided by agricultural companies to farmers; fire-fighting services; supplies of imported goods not subject to customs duties; certain approved fixed assets; catering in penitentiaries; post offices; tuition for unemployed persons' professional training organized by the State Employment Service; sales of land; and works of art brought in to supplement museum reserves.

Excise taxes

Nature of the tax

22. Excise taxes are payable by individuals and enterprises that produce or import the products listed below.

Tax rates

Item to be taxed	**Unit tax (LVL) or general rate (in percent of price)**
Passenger cars	LVL 10-20 per year + (0.03 to 0.55) per each cm of motor cylinder
Alcohol or alcoholic drinks (per liter of absolute alcohol equivalent)	LVL 4.60
Beer between 5.5 and 7 percent alcohol (per liter of absolute alcohol equivalent	LVL 4.00
Champagne and wines (per liter)	LVL 0.25
Smoking tobacco (per 1,000 grams)	LVL 5.50
Cigarettes with filter, per one cigarette	LVL .0045
Cigarettes without filter, per one cigarette	LVL .0055
Cigars and cigarillos per one unit	LVL 0.011
Precious metals and jewelry with precious and semi-precious stones	20% (in percent of price)

The excise tax schedule for petrol is as follows.

- Unleaded petrol, its substitutes and components per liter:

From January 1, 1999	LVL 0.16
From January 1, 2000	LVL 0.18
From January 1, 2001	LVL 0.20

- Leaded petrol, its substitutes and components per liter:

From January 1, 1999	LVL 0.19
From January 1, 2000	LVL 0.21
From January 1, 2001	LVL 0.23

♦ Gas oil and kerosene, their substitutions and components per liter:

		For heating purpose
From January 1, 1999	LVL 0.13	LVL 0,013
From January 1, 2000	LVL 0.16	LVL 0.013
From January 1, 2001	LVL 0.17	LVL 0.013

♦ Fuel oil, its substitutes and components per kilogram:

From January 1, 1999	LVL 0.13	LVL 0.01
From January 1, 2000	LVL 0.16	LVL 0.01
From January 1, 2001	LVL 0.17	LVL 0.01

♦ Heavy fuel oil, its substitutes and components, per kilogram:

From March 16, 1999	LVL 0.02

♦ Oil gases and other gaseous hydrocarbons, except natural gas, per kilogram:

From January 1, 1999	LVL 0.03
From January 1, 2000	LVL 0.05
From January 1, 2001	LVL 0.07

Exemptions

23. Excise taxes are not imposed on exports, on ethyl alcohol used for medical, pharmaceutical and scientific purposes, and certain automobiles with small engines or more than seven years old. For agricultural producers the tax paid for consumed gas oil shall be refunded, calculated for up to 120 liters of gas oil per hectare of land used for agricultural purposes, per calender year.

C. Other Taxes

Tax on Natural Resources

Nature of the Tax

24. A new version of the law "Tax on Natural Resources" became effective on January 1, 1996. The tax is paid by all natural and legal persons who obtain natural resources in the territory of Latvia (or continental shelf), or pollute the environment, or sell self-produced or imported goods which are dangerous to the environment. In the latter case, a permit is required for such activities.

25. The tax on acquisition of natural resources and environmental pollution is calculated on a per unit basis for each unit of natural resources or pollutant. For imports of goods dangerous to the environment, the tax is calculated in lats and levied per unit or as a percentage of the total value at customs including an import duty if applicable. The tax on the sale of self-produced goods dangerous to the environment is calculated in lats and levied per unit or as a percentage of the selling price, net of excise tax and VAT.

26. The tax on natural resources is included in as a special budget of environmental protection and in special local government budgets of environmental protection in the territory from where the resource originates.

Table 23 Latvia: Summary Overview of the Trade System, 1999

Trade policy instrument	Status as at April 1, 1999
1. Import customs tariffs	There are 14 tiers of *ad valorem* rates of the basic tariffs, ranging from zero to 75 percent (0, 1, 2, 3, 5, 6,10, 20, 25, 30, 35, 40, 55, and 75 percent)
Ad valorem tariff rate for final non-agricultural goods:	
Basic rate:	Simple average of 3.71 percent with 1 percent the most common rate
MFN rate:	Simple average of 2.47 percent
Tariff rates (ad valorem and some specific) for agricultural goods:	
Basic rate:	Simple average of 19.5 percent and a production-weighted average of 34.9 percent
MFN rate:	Simple average of 14.07 percent
2. Goods subject to specific import tariffs:	Sugar, alcoholic beverages and tobacco cigarettes
3. Goods subject to quantitative restrictions:	None
4. Goods subject to import licensing:	Nondiscriminatory and in accordance with WTO requirements. For health and related reasons import licenses for some goods are issued by a designated authority. Except for weapons, explosives and fuels, licensing is virtually automatic. The processing period for applications is no more than 10 working days and fees reflect processing costs.
5. Anti-dumping and countervailing provisions:	Broadly consistent with WTO provisions
6. Customs valuation of goods:	In accordance with GATT/WTO, utilizing the transaction value
7. Goods subject to export duties:	Ferrous waste and scrap; antique printed material; and works of art
8. Goods subject to export quotas:	Only in the case of goods for which Latvia's international agreements specify export quotas (e.g., textiles under the EU FTA)

Sources: Information supplied by the authorities.

1/ Estimated production-weighted average tariff rates.

Table 24. Latvia: Savings-Investment Balance, 1995-98 1/

	1995	1996	1997	1998
	(In percent of nominal GDP)			
Foreign savings 2/	3.6	4.2	5.1	9.5
Gross national savings	14.0	14.6	17.7	13.5
Government 3/	-2.4	0.3	2.9	3.2
Nongovernment	16.4	14.3	14.8	10.3
Gross domestic investment	16.7	18.8	22.8	23.0
Government 3/	0.9	1.8	2.5	3.9
Nongovernment	16.7	17.0	20.3	19.1
Fixed investment	15.1	18.1	18.7	20.1
Change in stocks 4/	2.5	0.7	4.0	2.9
	(Annual percentage change)			
Memorandum item:				
Real GDP growth rate	-0.8	3.3	8.6	3.6

Sources: Latvian authorities; and Fund staff estimates.

1/ Columns may not sum due to rounding.

2/ External current account deficit.

3/ From 1995 includes extrabudgetary investment in the PIP.

4/ Includes statistical discrepancy.

Table 25. Latvia: Agricultural Production, 1994-98

	1994	1995	1996	1997	1998
Livestock, Meat Production (index)	40.1	37.8	28.6	28.7	28.1
Meat, deadweight	136	123	76	71	71
(Index of Production)	(44.1)	(39.8)	(24.5)	(23.1)	(23.0)
Of which: private farms (percent of total)	68.7	72.6	58.5	58.3	59.3
Beef and veal	68	48	27	26	26
Cattle (thousand heads)	551	537	509	477	434
Pork	54	63	40	37	36
Pigs (thousand heads)	501	553	460	430	421
Poultry	11	11	9	8	8
Poultry (thousand heads)	3,700	4,198	3,791	3,551	3,209
Milk Production	1,001	948	923	988	950
(Index of Production)	(52.8)	(50.0)	(48.7)	(52.2)	(50.2)
Egg Production	360	421	471	465	456
(Index of Production)	(44.0)	(51.4)	(57.5)	(56.8)	(55.7)
Crop Production (index)	71.1	65.5	76.4	76.5	65.8
Cereals	901	694	969	1043	970
(Index of Production)	(55.5)	(42.8)	(59.7)	(64.3)	(59.8)
Of which: private farms (percent of total)	71.5	72.1	74.8	80.1	81.8
Area sown (thousand hectares)	489	411	450	488	473
Sugarbeets	228	250	258	388	597
(Index of Production)	(51.9)	(56.9)	(58.8)	(88.2)	(136.0)
Area sown (thousand hectares)	12	10	10	11	16
Potatoes	1,045	864	1,082	946	694
(Index of Production)	(102.9)	(85.0)	(106.5)	(93.1)	(68.3)
Of which: private farms (percent of total)	96.5	96.2	95.8	96.8	96.2
Area sown (thousand hectares)	80	75	79	70	59
Fodder	921	611	569	595	661
(Index of Production)	(27.9)	(18.5)	(17.2)	(18.0)	(20.0)
Of which: private farms (percent of total)	78.9	76.4	78.3	87.4	88.3
Area sown (thousand hectares)	591	413	429	418	419
Vegetables	233	224	180	162	120
(Index of Production)	(137.9)	(132.5)	(106.5)	(95.9)	(71.0)
Area sown (thousand hectares)	18	17	16	13	12
Memorandum items:					
Yield per hectare for cereals (in 100 kg)					
Private farms	19	17	21	22	21
State-owned farms	18	17	22	21	21

Sources: Central Statistical Bureau; and Fund staff calculations.

Table 26. Latvia: Energy Consumption, 1994-98

	1994	1995	1996	1997	1998
Coal	425	252	239	196	146
Gasoline	459	412	406	374	350
Diesel oil	565	502	375	391	391
Heavy fuel oil	1,415	1,017	1,141	832	733
Natural gas (million cubic meters)	1,028	1,254	1,088	1,326	1,299
Liquefied petroleum gas	52	34	35	38	44
Electricity (million kilowatt hours)	6,259	6,235	6,351	6,325	6,327

Source: Latvian authorities.

Table 27. Latvia: Labor Market Indicators, December 1995-March 1999
(In thousands)

	1995	1996				1997				1998				1999
	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March
Registered unemployed 1/	83.2	88.2	88.5	88.5	90.8	94.7	95.3	88.6	84.9	86.3	87.6	92.9	111.4	120.5
Of which:														
Women	43.5	45.5	45.6	47.5	49.7	52.9	55.2	52.2	50.4	50.2	50.9	54.6	65.2	69.5
Long term unemployed 2/	37.5	41.9	46.1	47.1	49.5	53.8	54.8	53.6	52.7	31.3	31.2	29.1	29.3	30.5
Benefit recipients 3/	27.5	26.5	26.2	30.1	32.2	32.1	32.8	32.4	26.2	23.2	29.7	32.3	37.5	47.2
Memorandum items:														
Hidden unemployment 4/ 5/	7.2	7.1	6.5	6.0	6.6	11.0	9.5	8.7	8.3	9.6	8.2	10.3	10.8	...
Total employment 6/	1,040	1,024	1,020	1,016	1,012	1,020	1,037	1,048	1,043	1,045	1,048	1,047	1,033	...
Unemployment rate 1/ (In percent of labor force)	6.6	7.0	7.0	7.0	7.2	7.7 *	7.8 *	7.3 *	7.0	7.1	7.2	7.6	9.2	10.1

Source: Central Statistical Bureau.

1/ End of the period.

2/ Persons unemployed for six months or more.

3/ Data for 1994 are end-period data; beginning 1995–average number of recipients.

4/ Defined as the full time work equivalent of working time that is reported lost due to enforced reduced hours and unpaid leave.

5/ Until December 1994—only in the mentioned month, beginning with 1995—in the period from the beginning of the year.

6/ Average quarterly. The number of emplyed persons has been revised on the basis of data about the economically active popuplation, employed persons as well as on the number of jobseekers obtained from the Labour Force Survey.

* Data revised.

Table 28. Latvia: Average Wages, 1994–98

	Whole Economy	State Sector 1/	Budgetary Organizations	State Enterprises	State Sector In US$	Min. Wage In Lats
			(In lats per month)			
1994						
Jan-Marc	61.37	61.74	54.01	70.75	106.44	15.00
Apr-June	71.84	72.42	57.45	85.09	128.18	22.50
July-Sep	75.76	74.92	57.76	91.66	136.47	22.50
Oct-Dec	80.51	86.51	74.39	102.06	158.73	28.00
1995						
Jan-Marc	82.35	87.18	73.54	98.99	162.65	28.00
Apr-June	89.50	94.80	80.37	107.79	185.52	28.00
July-Sep	90.27	93.65	79.23	107.28	177.70	28.00
Oct-Dec	95.29	101.83	87.65	115.54	189.98	28.00
1996						
Jan-Marc	89.41	95.20	79.99	109.79	174.36	28.00
Apr-June	99.21	105.70	87.55	123.99	191.14	38.00
July-Sep	102.29	106.20	88.27	125.61	192.74	38.00
Oct-Dec	107.54	117.51	99.68	137.55	212.11	38.00
1997						
Jan-Marc	109.81	116.91	98.64	137.26	203.68	38.00
Apr-June	118.55	125.26	104.21	148.90	216.34	38.00
July-Sep	122.24	127.12	106.31	150.57	216.93	38.00
Oct-Dec	129.59	138.90	119.62	161.52	237.44	38.00
1998						
Jan-Marc	123.07	128.49	109.53	151.61	216.31	42.00
Apr-June	132.98	142.00	120.13	169.19	237.86	42.00
July-Sep	136.50	145.42	126.49	169.44	243.58	42.00
Oct-Dec	140.82	156.64	141.53	176.13	273.85	42.00
			(Real terms, index 1993=100)			
1994 averag	111.99	105.56	105.66	108.62	n.a.	129.51
1995 averag	111.54	107.39	113.26	109.06	n.a.	131.84
1996 averag	104.60	102.10	106.26	106.97	n.a.	142.14
1997 averag	117.28	113.09	118.06	119.06	n.a.	140.29
1998 averag	124.50	121.80	130.97	126.80	n.a.	148.21

Source: Latvian authorities.

1/ The state sector includes enterprises where central or local government capital participation in the company capital is equal to or above 50 percent.

Table 29. Latvia: Consumer Price Inflation

Year/Month	Consumer Price Index	Percentage Change Over Previous Month	Percentage Change Over Same Month Last Year			Annual Average Inflation	Quarterly Inflation	
			All Items	Goods	Services		Over Previous Quarter	Over Previous Year
1990								
December	100.0	12.5	...	...	...	...	4.2	...
1991								
December	362.4	49.7	262.4	...	...	124.4	39.6	203.1
1992								
December	3,836.9	2.6	958.7	...	...	951.2	53.8	1,222.7
1993								
December	5,174.1	5.1	34.9	...	...	109.1	12.7	33.9
1994								
December	6,533.4	2.4	26.3	21.4	45.3	35.8	4.9	31.1
1995								
December	8,045.2	1.7	23.1	20.0	30.3	25.1	4.6	23.8
1996								
December	9,100.6	0.6	13.1	11.0	18.6	17.6	2.2	14.4
1997								
January	9,273.6	1.9	11.4	10.8	13.8	...		
February	9,307.9	0.4	9.9	9.1	13.0	...		
March	9,348.2	0.4	8.7	7.8	12.3	...	3.0	9.9
April	9,410.0	0.7	8.8	7.6	13.9	...		
May	9,470.4	0.6	9.0	8.0	13.2	...		
June	9,492.1	0.2	7.5	6.1	13.4	...	1.6	8.5
July	9,536.8	0.5	7.7	5.3	17.2	...		
August	9,575.6	0.4	8.6	5.6	20.7	...		
September	9,592.7	0.2	8.1	5.1	19.7	...	1.2	8.1
October	9,665.8	0.8	7.7	4.5	20.0	...		
November	9,715.7	0.5	7.4	4.6	18.3	...		
December	9,738.1	0.2	7.0	4.2	18.2	8.4	1.4	7.3
1998								
January	9,861.6	1.3	6.3	3.7	16.5	...		
February	9,879.7	0.2	6.1	3.8	15.3	...		
March	9,908.2	0.3	6.0	3.6	15.2	...	1.8	6.2
April	9,977.7	0.7	6.0	3.7	14.9	...		
May	9,982.4	0.1	5.4	2.9	14.9	...		
June	10,053.8	0.7	5.9	3.2	16.5	...	1.2	5.8
July	9,972.9	-0.8	4.6	2.5	12.1	...		
August	9,925.4	-0.5	3.7	2.4	8.1	...		
September	9,928.2	0.0	3.5	2.5	7.0	...	-0.6	3.9
October	9,945.3	0.2	2.9	1.9	6.5	...		
November	9,987.2	0.4	2.8	1.6	7.1	...		
December	10,006.2	0.2	2.8	1.4	7.0	4.7	0.4	2.8
1999								
January	10,121.4	1.2	2.6	1.6	6.2	...		
February	10,142.8	0.2	2.7	1.7	6.0	...		
March	10,138.8	0.0	2.3	1.2	5.9	...	1.6	2.6
April	10,126.5	-0.1	1.5	0.7	4.2	...		
May	10,167.0	0.4	1.8	1.1	4.4	...		
June	10,238.2	0.7	1.9	1.0	4.6		0.4	1.7

Sources: Data provided by the Latvian authorities; and Fund staff estimates.

Table 30. Latvia: Summary of General Government Operations, 1994–98

	1994	1995	1996	1997	1998
			(In millions of lats)		
Revenue	739	875	1,076	1,288	1,530
Of which :					
Profit tax	74	48	57	79	92
Income and social tax	329	419	485	567	647
Taxes on goods and services	228	281	379	431	506
Expenditure	780	952	1,118	1,275	1,557
Of which :					
Wages and salaries	177	209	257	278	355
Transfers to households	334	408	477	455	538
Interest	13	29	49	34	28
Other current	235	247	290	407	491
Investment	22	22	51	81	145
Financial surplus(+)/deficit(-)	-35	-77	-43	13	-26
Net lending	-48	-15	-5	-10	-3
Fiscal surplus(+)/deficit(-)	-90	-92	-48	3	-29
Financing of fiscal balance	90	92	48	-3	29
Privatization	7	9	8	42	37
Domestic	48	51	28	-51	-21
Banking system	36	49	15	-45	5
Other domestic	12	2	13	-6	-26
Foreign	35	32	12	6	13
			(In percent of GDP)		
Revenue	36.5	37.2	38.0	39.3	40.6
Of which :					
Profit tax	3.6	2.0	2.0	2.4	2.4
Income and social tax	16.1	17.8	17.1	17.3	17.1
Taxes on goods and services	11.2	11.9	13.4	13.1	13.4
Expenditure	38.2	40.5	39.5	38.9	41.2
Of which :					
Wages and salaries	8.7	8.9	9.1	8.5	9.4
Transfers to households	16.3	17.4	16.9	13.9	14.2
Interest	0.6	1.2	1.7	1.0	0.7
Other current	11.5	10.5	10.3	12.4	13.0
Investment	1.1	0.9	1.8	2.5	3.9
Financial surplus(+)/deficit(-)	-1.7	-3.9	-1.7	0.1	-0.8
Net lending	-2.3	-0.6	-0.2	-0.3	-0.1
Fiscal surplus(+)/deficit(-)	-4.0	-3.9	-1.7	0.1	-0.8
Defense expenditure (percent of GDP)	2.5	0.8	0.7	0.7	0.6

Sources: Latvian authorities and Fund staff estimates.

Table 31. Latvia: Central Government and Social Security, 1994-98

	1994	1995	1996	1997	1998
	(In millions of lats)				
Revenue - total	577	647	788	968	1,106
Current revenue	575	647	787	968	1,106
Taxes on income, profits and property	76	49	58	81	92
Tax on profits	73	48	57	79	92
Property tax	0	0	0	2	0
Social security taxes	236	291	328	381	427
Taxes on goods and services	227	273	347	393	452
Taxes on domestic transactions	203	255	328	372	432
Turnover/VAT	174	220	268	289	316
Excise	29	35	61	83	116
Taxes on international trade	23	18	19	22	20
Other taxes	23	24	14	8	0
Other current revenue	14	9	40	105	134
Transfer from priv. fund	n.a.	4	1	21	27
Non-budgeted revenues	...	...	18	53	69
Capital revenue	2	1	1	0	0
Expenditure - total	606	725	815	909	1,089
Current expenditure	592	714	800	878	1,028
Wages and salaries	135	180	178	155	181
Supplies and maintenance	86	81	94	119	132
Interest payments	13	30	38	31	25
Subsidies	5	9	9	12	20
Transfers	324	389	465	558	662
To individuals	271	334	427	453	550
Social budget	n.a.	275	337	361	430
Basic budget	n.a.	58	90	92	120
To local government	53	55	38	92	92
To extrabudgetary funds	...	...	...	13	20
Other current expenditure	22	24	16	4	8
Investment	14	12	15	31	61
Financial Surplus(+)/Deficit(-)	-29	-78	-27	58	17
Net lending	-48	-18	-5	-10	-12
Fiscal Surplus(+)/Deficit(-)	-77	-96	-32	34	5
Basic budget	n.a.	-112	-23	14	8
Social budget	n.a.	16	-9	20	-3
Financing fiscal balance	77	96	32	-34	-5
Domestic	41	64	20	-40	-18
Banking system	37	55	12	-36	8
Other domestic	4	9	8	-4	-26
Foreign	35	32	12	6	13
	(In percent of GDP)				
Revenue	28.3	26.0	26.8	29.0	29.3
Of which: Basic budget	...	14.3	15.6	17.6	18.0
excl. non-budgeted revs.	...	14.3	15.0	16.0	16.1
Of which: Social budget	...	11.7	11.1	11.4	11.3
Expenditure	29.7	29.1	27.7	27.3	28.9
Financial balance	-1.4	-3.1	-0.9	1.7	0.5
Net lending	-2.3	-0.7	-0.2	-0.3	-0.3
Fiscal balance	-3.7	-3.8	-1.1	1.0	0.1

Sources: Latvian authorities and Fund staff estimates.

Table 32. Latvia: Local Government Operations, 1994-98

	1994	1995	1996	1997 1/	1998 1/
	(In millions of lats)				
Revenue	179	222	238	334	366
Taxes on income, profits and property	113	153	189	163	206
Tax on profits	1	0	0	0	0
Income tax	90	127	157	132	158
Property tax	12	15	19	20	30
Land tax	10	11	13	17	18
Taxes on goods and services	2	0	4	4	1
Turnover/VAT	2	0	0	0	1
Other taxes	10	9	7	0	0
Other current revenue	54	57	38	138	140
Transfers from central government	53	55	38	95	96
Other revenue	1	2	0	30	46
Expenditure	185	212	238	334	364
Current expenditure	177	202	218	308	306
Wages and salaries	35	61	63	123	128
Interest payments	0	5	2	3	2
Supplies and maintenance	55	70	87	147	130
Subsidies	0	0	0	4	6
Transfers	63	65	50	22	31
To enterprises	0	0	0	0	0
To individuals	63	67	50	22	31
Other current expenditure	25	8	19	7	10
Capital expenditure	8	10	20	27	60
Investment	8	10	20	22	21
Fiscal Surplus(+)/Deficit(-)	-6	4	-4	-1	2
	(In percent of GDP)				
Revenue	8.8	8.8	8.1	9.1	8.5
Expenditure	9.1	8.6	8.2	9.2	8.5
Fiscal balance	-0.3	0.1	-0.1	-0.1	0.0

Sources: Latvian authorities and Fund staff estimates.

1/ Includes special funds of local governments.

Table 35. Latvia: Treasury Bill Auctions, 1995-June 1999

(In millions of lats, at face value)

	Gross sales of treasury bills 1/						Outstanding stock (end-month) 1/					
	28 day	91 day	182 day	1 year	2 year	Total	28 day	91 day	182 day	1 year	2 year	Total
1994	169.7	33.7	0.0	0.0	0.0	203.4	11.2	27.8	0.0	0.0	0.0	39.0
1995	197.4	102.8	26.0	0.0	0.0	326.2	15.0	47.0	21.9	0.0	0.0	83.9
1996	67.6	105.2	125.2	57.4	0.0	355.4	4.5	12.8	56.0	57.4	0.0	130.6
1997	30.7	47.8	58.5	86.0	34.0	256.0						
Jan.	5.5	6.1	7.3	10.0	0.0	28.8	4.2	13.3	52.0	67.4	0.0	136.9
Feb.	2.6	3.8	6.0	0.0	0.0	12.3	2.5	15.0	48.7	67.4	0.0	136.9
Mar.	2.9	4.4	7.5	12.0	0.0	26.7	2.8	14.2	46.2	79.4	0.0	142.6
Apr.	3.4	6.5	7.0	0.0	17.0	33.9	2.5	14.6	42.0	75.9	17.0	153.7
May	2.0	4.0	2.0	10.0	0.0	18.0	2.0	14.8	36.0	80.2	17.0	149.9
June	2.0	3.7	4.0	0.0	0.0	9.7	2.0	14.2	33.8	75.6	17.0	142.5
July	2.1	4.3	4.0	12.0	0.0	21.7	1.9	11.2	30.5	81.3	17.0	141.9
Aug.	1.9	3.1	4.0	12.0	0.0	21.0	1.9	10.3	28.5	89.5	17.0	147.2
Sep.	2.0	2.7	4.0	10.0	0.0	18.7	2.0	9.3	25.0	94.5	17.0	147.8
Oct.	2.5	4.1	5.0	0.0	17.0	28.6	2.0	9.9	23.0	80.8	34.0	149.7
Nov.	1.8	2.3	3.7	10.0	0.0	17.8	1.8	9.1	24.7	86.0	34.0	155.6
Dec.	2.0	2.8	4.0	10.0	0.0	18.8	1.5	8.5	24.7	86.0	34.0	154.7
1998	13.6	21.4	30.8	46.4	34.1	145.8						
Jan.	0.7	0.8	0.5	0.0	0.0	2.0	0.7	5.9	21.2	76.0	34.0	137.8
Feb.	1.1	1.5	2.1	5.4	0.0	10.0	1.1	5.1	19.3	81.4	34.0	140.8
Mar.	0.3	0.7	4.0	2.6	0.0	7.5	0.3	2.9	19.3	72.0	34.0	128.4
Apr.	2.0	2.8	6.0	10.0	0.0	20.7	2.0	4.9	20.3	82.0	34.0	143.1
May	2.0	2.8	4.0	0.0	17.0	25.8	2.0	6.2	20.6	72.0	51.0	151.8
June	2.0	2.8	4.0	10.0	0.0	18.8	2.0	8.4	20.6	82.0	51.0	163.9
July	2.5	3.5	4.0	10.0	0.0	20.0	2.0	9.1	24.1	80.0	51.0	166.2
Aug.	1.3	2.6	3.9	8.0	0.0	15.8	1.3	8.9	25.9	76.0	51.0	163.1
Sep.	1.0	1.7	1.1	0.0	0.0	3.8	1.0	7.7	23.0	66.0	51.0	148.7
Oct.	0.2	0.3	0.3	0.2	0.0	1.0	0.2	4.5	17.3	66.2	51.0	139.2
Nov.	0.2	1.1	0.3	0.0	7.8	9.3	0.2	3.1	13.6	56.2	58.8	131.8
Dec.	0.3	0.8	0.6	0.2	9.3	11.1	0.3	2.1	10.2	46.4	68.0	127.0
1999 H1	10.0	14.5	18.3	43.0	17.0	102.6						
Jan.	0.0	1.6	1.8	13.3	0.0	16.6	0.0	3.5	8.0	59.6	68.0	139.1
Feb.	1.7	2.8	4.0	6.2	0.0	14.7	1.7	5.2	8.0	57.8	68.0	140.7
Mar.	2.1	2.7	2.8	2.4	0.0	10.0	2.1	7.0	9.8	60.2	68.0	147.1
Apr.	2.6	2.5	2.5	6.2	17.0	30.8	2.1	8.0	11.9	56.5	68.0	146.5
May	1.3	1.8	3.2	4.3	0.0	10.6	1.3	6.3	14.8	61.0	68.0	151.4
June	2.3	3.1	4.0	10.6	0.0	20.0	1.8	7.0	18.2	61.6	68.0	156.6

Sources: Latvian authorities; and Fund staff estimates.

1/ Dates refer to those of auctions rather than settlements.

Table 34. Latvia: Pension System, 1994-98

	1994	1995	1996	1997	1998
			(In thousands)		
Number of recipients	654	638	641	643	639
Old age	496	497	504	511	512
Disability	104	103	98	94	90
Survivors	29	30	30	29	28
Social	19	n.a.	n.a.	n.a.	n.a.
Service	6.5	6.1	6.1	6.3	5.1
			(Lats per month)		
Average benefit	27.0	32.7	38.5	42.4	51.2
Old age	27.3	32.6	38.3	42.6	51.6
Disability	28.3	33.9	39.2	42.8	50.9
Survivors	23.6	28.2	32.2	35.9	42.2
Social	18.4	n.a.	n.a.	n.a.	n.a.
Service	30.1	31.8	37.4	45.7	61.2
Other	23.5	64.4	64.0	69.5	77.7
			(In millions of lats)		
Expenditure	199.6	239.1	299.3	340.9	401.7
Old age	150.2	181.8	231.5	268.6	316.1
Disability	34.8	43.5	48.2	50.3	59.8
Survivors	8.4	10.4	12.4	13.5	15.8
Social	3.8	n.a.	n.a.	n.a.	n.a.
Other	2.4	3.4	7.3	8.5	10.0
Memorandum item:					
Total expenditure (percent of GDP)	9.8	10.2	10.6	10.4	10.6

Sources: Ministry of Labor, Welfare and Health; and Fund staff estimates.

1/ From 1995, all pensions except social pension are paid by the social budget rather than by the basic budget.

Table 35. Latvia: Family Benefits, 1994-97

	1994	1995	1996	1997	1998
Number of beneficiaries (thousands)					
Birth grant	24	22	19	19	18
Maternity leave	380	363	298	80	95
Child care allowances	68	58	55	47	45
Ages 0-1.5	32	27	26	22	22
Ages 1.5-3	36	31	30	24	24
Family allowances	552	546	540	515	500
Average benefit (lats per month)					
Birth grant	34.8	73.4	97.5	117.0	180.4
Maternity leave (lats per day)	2.1	2.9	3.4	3.0	3.5
Child care allowances	9.6	10.2	9.8	10.0	15.2
Ages 0-1.5	11.9	12.5	11.7	11.8	20.7
Ages 1.5-3	7.5	8.1	7.2	7.2	6.7
Family allowances	6.6	6.5	7.5	4.9	5.0
Expenditure (millions of lats)	38.2	38.2	41.5	40.9	44.7
Birth grant	0.8	1.6	1.8	2.2	3.3
Maternity leave	2.1	2.4	2.6	2.7	3.2
Child care allowances	7.8	7.1	6.5	5.6	8.3
Family allowances	27.5	27.1	30.6	30.4	30.0
Memorandum item:					
Total expenditure (percent of GDP)	1.9	1.6	1.5	1.2	1.2

Sources: Latvian Ministry of Labor, Welfare and Health; and Fund staff estimates.

Table 36. Latvia: Reserve Money and Net Domestic Assets of the Bank of Latvia, 1995-99

	1995	1996				1997				1998				1999
							New Acct. 1/							
	Dec.	March	June	Sept.	Dec.	March	June	Sept	Dec	Mar	Jun	Sept	Dec	Mar
						(In millions of lats)								
Reserve money	270.3	261.4	311.0	309.7	340.7	350.0	370.9	388.6	420.3	433.9	470.5	457.4	471.5	481.0
Currency in circulation	225.9	224.7	244.0	261.0	282.6	291.8	310.0	327.7	359.4	357.2	380.5	374.0	374.4	393.4
Bank deposits	44.5	36.8	67.0	48.7	58.1	58.2	60.9	60.9	60.9	76.7	90.0	83.4	97.0	87.6
Foreign currency deposits	--	--	11.6	12.5	6.8	8.3	3.1	0.1	0.1	--	--	--	--	--
Other	44.5	36.8	55.4	36.2	51.3	49.9	56.9	60.8	60.8	76.7	90.0	83.4	97.0	87.6
Net foreign assets 2/ 3/	221.0	242.7	280.3	304.1	349.4	357.5	391.0	426.0	433.1	463.8	529.7	480.9	463.9	488.5
Net International Reserves 1/	226.9	248.8	286.3	309.4	354.6	362.6	396.1	431.0	438.2	462.7	528.6	480.4	463.6	488.2
Correspondent accounts 1/ 2/	-5.8	-6.1	-6.0	-5.3	-5.2	-5.1	-5.1	-5.1	-5.1	1.1	1.1	0.5	0.3	0.3
Net domestic assets	49.3	18.7	30.7	5.6	-8.7	-7.5	-21.0	-37.4	-12.8	-30.0	-59.2	-23.5	7.6	-7.4
Domestic credit	100.3	73.2	86.9	62.6	43.3	52.3	47.8	30.4	83.0	47.9	44.9	84.6	113.8	100.8
Banks	43.5	46.6	40.4	30.7	10.0	28.4	6.3	1.1	7.6	10.3	13.0	33.4	52.0	84.0
BoP assistance	39.9	40.1	37.1	28.1	5.6	24.0	3.0	0.6	0.6	0.2	0.1	0.1	0.1	0.1
Refinance credits	3.5	6.5	3.3	2.6	4.3	4.4	3.3	0.5	6.9	10.1	12.9	33.3	51.9	83.9
Government, net 4/	56.9	26.6	46.5	31.9	33.3	23.9	41.5	29.3	75.5	37.6	31.9	51.2	61.7	16.8
BoP assistance	35.8	34.5	34.1	37.1	50.3	42.4	59.8	60.7	59.4	59.2	60.7	55.8	54.3	55.6
Other government, net 5/	21.0	-7.9	12.4	-5.2	-16.9	-18.4	-18.3	-31.4	16.1	-21.6	-28.7	-4.6	7.4	-38.7
Other items, net	-51.0	-54.5	-56.2	-57.0	-52.0	-59.8	-68.8	-67.8	-95.9	-77.8	-104.1	-108.1	-106.2	-108.2
Memorandum Items:														
						(Percentage change from previous quarter)								
Reserve money	3.6	-3.3	18.9	-0.4	10.0	2.7	5.7	5.0	8.2	3.2	8.4	-2.8	3.1	2.0
Domestic credit	19.1	-27.0	18.6	-28.0	-30.8	15.5	-8.7	-39.2	173.3	-42.3	-6.2	88.3	34.5	-11.4
Banks	-3.4	7.3	-13.3	-23.9	-67.6	-4.3	-77.8	-95.2	579.0	35.9	26.3	157.4	56.0	61.4
Government, net 4/	44.7	-53.2	74.6	-31.5	4.6	53.1	73.3	9.7	157.9	-50.2	-15.1	60.3	20.5	-72.8
Exchange rate (LVL/US$)	0.537	0.549	0.554	0.555	0.556	0.580	0.574	0.586	0.590	0.595	0.602	0.583	0.569	0.590
NFA total (US$mn)	422.5	453.1	516.7	557.5	637.8	625.1	690.1	726.9	734.0	779.5	879.9	824.9	815.2	827.9

Sources: Bank of Latvia; and staff estimates.

1/ New accounting to include changes instituted in June 1997 by the BOL and is a break in series.

2/ Valued at current exchange rates.

3/ As the Bank of Latvia has almost no medium- and long-term foreign currency liabilities, NFA equals NIR.

4/ Excluding proceeds from foreign loans for balance of payments support.

Table 37. Latvia: Monetary Survey and Net Domestic Assets of the Banking System, 1995-99
(In millions of lats)

	1995	1996				1997				1998				1999	
							NewAcct.1/								
	Dec. adj.	March	June	Sept	Dec.	March	June	Sept	Dec	Mar	June	Sept	Dec	Mar	May
Broad money (M2X)	524	504	544	601	628	654	724	805	871	879	975	921	923	920	928
Currency held by public	210	212	230	244	264	274	286	304	333	332	352	344	340	358	360
Household deposits	65	61	63	64	67	71	76	86	96	104	114	111	118	109	111
Enterprise deposits	95	80	84	95	104	98	133	148	170	173	211	197	200	195	206
Residents' FC deposits 2/	154	152	168	198	193	211	229	267	272	271	298	269	264	259	252
Total deposits	314	293	314	357	364	380	438	501	538	547	623	577	583	563	569
Net foreign assets (total) 3/	300	318	368	403	445	457	548	619	619	606	676	485	415	416	475
OECD currencies	287	277	336	397	440	436	450	493	512	459	534	509	501	497	559
Non-OECD currencies	13	41	32	6	5	21	98	126	107	148	142	-24	-86	-81	-84
Net domestic assets	224	186	177	199	183	197	177	186	252	272	299	436	508	504	453
Domestic credit	332	311	333	348	366	371	390	428	479	495	538	584	647	676	615
Households	28	26	25	25	21	23	25	31	37	43	52	58	64	70	74
Enterprises	176	171	168	168	185	196	230	267	327	397	460	517	513	527	527
Government, net	127	113	139	156	160	152	135	129	115	54	27	9	70	79	14
Restructuring Bonds	61	54	54	53	53	33	33	32	24	24	24	24	24	24	24
Other Credit to Government	66	59	86	102	107	119	102	97	91	30	3	-15	46	55	-10
Other items, net	-108	-125	-156	-150	-183	-173	-214	-242	-227	-222	-239	-148	-140	-172	-162
Memorandum Items:															
	Percentage change from previous quarter														
Broad money(M2X)	-19	-4	8	10	4	4	11	11	8	1	11	-6	0	0	1
Domestic credit	-33	-6	7	5	5	6	5	14	12	3	9	9	11	4	-9
Households	-34	-6	-4	-1	-15	7	8	27	17	19	19	13	10	9	7
Enterprises	-50	-3	-2	0	10	6	18	16	22	21	16	12	-1	3	0
Other credit to Government	59	-11	46	20	4	33	-14	11	-6	-67	-91	-699	-400	20	-118
Exchange rate (LVL/US$)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Total NFA (US$mn) 3/															
Total	558	580	664	726	800	788	955	1,057	1,049	1,019	1,123	832	729	706	796
of which: comm. banks	147	138	158	178	172	171	273	330	315	240	243	8	-86	-122	-156

Sources: Bank of Latvia; and Fund staff estimates.

1/ Revised data include accounting changes that began in June 1997 and represent a break in series.

2/ As of June 1997, residents' foreign currency deposits are deposits in all currencies except lats.

3/ Valued at current exchange rates. Due to changes in accounting, from May 1997 the source of convertible balances is OECD countries only.

Table 38. Latvia: Enterprise and Household Deposits , 1996-99
(In millions of lats)

	1996	1997				1998				1999
	December	March	June	September	December	March	June	September	December	March
Enterprise deposits	234.8	240.5	288.8	332.7	345.8	337.6	386.4	358.7	353.9	348.9
Commercial banks	233.1	238.2	285.9	329.1	337.6	323.1	353.7	338.4	349.5	341.1
Latvian Savings Bank	1.7	2.3	2.9	3.6	8.2	14.5	32.7	20.3	4.4	7.8
Household deposits	129.4	139.9	149.6	169.0	192.8	209.9	236.7	218.6	229.0	214.2
Commercial banks	79.4	89.3	97.6	113.6	132.5	147.3	171.2	152.8	157.5	146.1
Latvian Savings Bank	50.0	50.6	52.0	55.4	60.3	62.6	65.5	65.8	71.5	68.1
Total deposits from private sector	364.3	380.4	438.4	501.7	538.6	547.5	623.2	577.3	582.9	563.1
Commercial banks	312.5	327.5	383.5	442.7	470.1	470.4	525.0	491.2	507.0	487.3
Latvian Savings Bank	51.7	52.9	54.9	59.0	68.5	77.1	98.2	86.1	75.9	75.8
Memorandum item:										
Enterprise deposits/total (in percent)	64.5	63.2	65.9	66.3	64.2	61.7	62.0	62.1	60.7	62.0

Sources: Bank of Latvia; and Fund staff calculations.

Table 39. Latvia: Enterprise and Household Credits, 1996-99
(In millions of Lats)

	1996	1997				1998				1999
	December	March	June	September	December	March	June	September	December	March
Enterprise credit	190.1	203.4	234.6	275.1	337.2	389.7	451.3	508.1	504.7	519.2
Commercial banks	178.7	191.7	223.2	266.2	323.5	376.9	432.3	482.2	485.7	494.7
Latvian Savings Bank	11.4	11.7	11.4	8.9	13.7	12.8	19.0	25.9	19.0	24.5
Household credit	21.4	23.0	24.9	31.5	37.1	43.8	52.3	58.8	64.4	70.1
Commercial banks	16.3	17.8	19.8	23.5	30.4	37.0	44.7	50.6	54.9	60.1
Latvian Savings Bank	5.1	5.2	5.1	8.0	6.7	6.8	7.6	8.2	9.5	10.0
Total credit to private sector	211.5	226.4	259.5	306.6	374.3	433.5	503.5	566.9	569.1	589.3
Commercial banks	195.0	209.6	243.0	289.6	353.9	413.9	476.9	532.8	540.6	554.8
Latvian Savings Bank	16.5	16.8	16.5	17.0	20.4	19.6	26.6	34.1	28.5	34.5
Memorandum item:										
Enterprise credit/total (in percent)	89.8	89.8	90.4	89.7	90.1	89.9	89.6	89.6	93.4	93.6

Sources: Bank of Latvia; and Fund staff estimates.

Table 40. Latvia: Sectoral Distribution of Credit, 1994-99
(In percent of total)

	1994	1995	1996	1997	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1
Agriculture	8.5	7.1	7.5	5.7	6.5	7.7	7.4	7.2	7.2
Manufacturing	15.3	24.6	25.4	27.4	26.8	26.7	26.1	26.2	25.4
Electricity, gas, and water supply	4.9	9.9	9.2	3.7	3.1	2.3	1.6	1.6	2.3
Construction	8.2	6.1	7.6	3.8	3.7	3.8	4.0	4.5	5.3
Trade	37.5	33.5	31.6	29.2	26.7	26.1	24.9	25.3	26.5
Transport, storage, and communication	6.1	6.0	5.4	14.3	16.1	15.6	15.1	14.8	14.3
Financial intermediation	5.7	1.2	3.5	4.2	7.3	7.0	5.7	5.4	5.3
Other services	11.5	8.9	7.2	9.2	7.8	8.4	13.4	13.0	11.9
Other	2.2	2.7	2.7	2.5	2.0	2.4	1.8	2.0	1.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
In domestic currency	37.5	39.7	32.4	46.8	45.3	44.8	45.6	45.3	44.4
In foreign currency (incl. G-24 credits)	62.5	60.3	67.6	53.2	54.7	55.2	54.4	54.7	55.6
Short-term credits (up to 1 year)	74.2	52.3	44.5	44.4	40.2	39.0	36.9	32.9	30.5

Source: Bank of Latvia

Banking institution	Total Assets 1/ 1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	Capital and Reserves 1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1
Bank of Latvia	658.5	645.4	700.0	755.4	741.7	814.3	36.6	45.1	45.4	46.1	47.2	54.3
Commercial banks and other credit institutions	1,771.8	1,783.2	1,893.1	1,709.6	1,733.2	1,708.9	219.6	225.6	233.2	207.2	196.3	134.4
Five largest	744.1	803.5	882.1	988.4	1,044.0	1,034.6	87.7	88.2	94.0	113.8	106.0	86.2
Unibank	222.0	235.7	272.9	285.6	300.0	313.5	33.2	32.2	33.6	32.1	32.9	30.3
Parex	294.6	311.1	302.2	304.8	327.2	303.6	34.0	34.3	37.1	39.6	38.1	34.8
Hansabank	88.8	83.3	86.4	88.5	148.8	158.8	6.6	6.3	6.4	6.0	11.2	11.1
Rietumu	184.9	167.3	167.2	151.5	156.8	148.6	17.8	19.6	21.0	20.3	10.4	6.8
Latvian Savings Bank	89.1	97.5	129.9	124.6	106.4	110.2	5.5	6.1	6.6	6.6	4.1	3.2
Riga Commercial 2/	138.4	159.2	177.1	121.9	111.7	72.3	15.0	15.6	16.7	15.3	13.4	-30.0
Baltija	...	...	...	...	...	...	...	...	...	...	...	...
Other commercial banks and credit institutions	1,027.7	979.7	1,011.0	721.2	689.2	674.3	131.9	137.4	139.2	93.4	90.3	48.2
Of which:												
Merita Nordenbanken 3/	25.4	28.3	30.7	...	...	...	5.3	5.4	5.4	...	...	...
Pawnshops	...	...	...	...	...	...	...	...	...	...	...	...
Credit Unions	0.34	0.40	0.44	0.49	0.54	0.58	0.11	0.13	0.14	0.15	0.16	0.17

Banking institution	Credit to Private Sector 1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	Deposits from Private Sectors 1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1
Bank of Latvia	...	...	...	...	...	...	...	...	...	...	...	...
Commercial banks and other credit institutions	374.3	433.5	503.5	566.9	569.1	589.3	538.6	547.5	623.2	577.3	582.9	563.1
Five largest	196.8	223.1	258.3	323.7	350.0	378.5	315.8	353.0	381.6	361.2	345.2	387.1
Unibank	95.0	107.3	120.4	154.0	158.9	171.1	121.9	135.4	143.1	152.7	142.4	125.2
Parex	55.3	65.7	79.6	91.7	95.8	101.5	39.3	49.7	47.1	48.5	54.4	47.8
Hansabank	20.8	34.4	38.0	38.6	55.6	57.1	30.1	27.5	38.3	41.7	80.7	92.3
Rietumu	7.9	7.9	14.3	14.4	14.6	14.3	27.9	30.0	30.4	23.0	25.3	11.8
Latvian Savings Bank	20.4	19.6	26.6	34.2	28.5	34.5	68.5	77.1	98.2	86.1	75.9	75.8
Riga Commercial 2/	26.1	30.5	31.7	29.3	25.1	21.7	86.1	90.8	93.2	50.9	42.4	34.1
Baltija	...	...	...	...	...	...	...	...	...	...	...	...
Other commercial banks and credit institutions	177.5	210.4	245.2	243.2	219.1	210.8	222.8	194.5	241.6	216.1	237.7	176.0
Of which:												
Merita Nordenbanken 3/	15.0	16.2	18.9	...	...	...	0.1	0.1	0.2	...	...	...
Pawnshops	...	...	...	...	...	...	...	...	...	...	...	...
Credit Unions	0.30	0.35	0.40	0.45	0.48	0.50	0.19	0.22	0.25	0.27	0.28	0.31

Source: Bank of Latvia.

1/ Computed on the basis of the net asset position of the government.

2/ Suspended from March 7, 1999.

3/ Former Latvian Investment Bank (excluded from other credit institutions, from the beginning of 1998 it has full licence).

Table 42. Latvia: Balance of Payments, 1995-98

	1995	1996	1997	1998
	(In millions of U.S. dollars)			
Current account balance	-16.2	-217.2	-287.5	-607.5
excluding Official transfers	-60.4	-275.6	-328.9	-660.7
Trade Balance	-579.6	-798.3	-847.9	-1,130.4
Exports, f.o.b.	1,367.6	1,487.6	1,838.1	2,011.1
Imports, f.o.b.	-1,947.2	-2,285.9	-2,686.0	-3,141.5
Services,income & transfers balance	563.5	581.1	560.4	522.9
Of which:				
Transport sector, net	506.1	533.1	515.1	488.4
Travel, net	-4.4	-93.7	-75.7	-68.9
Interest, net	19.8	2.7	14.3	12.2
Other income	...	38.6	40.5	41.5
Other services	-27.6	9.1	-11.2	-35.1
Current transfers, net	70.8	98.1	77.4	84.9
Capital account balance	653.3	547.9	360.7	578.0
Capital transfers	0.0	0.0	13.7	10.4
Foreign investment , net	207.8	237.6	-56.8	225.9
Foreign direct investment, net	244.6	378.6	515.0	219.6
FDI in Latvia	179.6	381.7	521.1	273.7
Direct investment abroad	65.0	-3.0	-6.1	-54.2
Portfolio investment, net	-36.8	-141.0	-571.8	6.4
Other medium and long-term capital	142.2	57.4	164.9	201.4
Government, net	55.5	44.7	20.2	45.2
Other sectors, net	86.7	12.7	144.7	156.2
Other capital and investment, net	303.4	252.9	238.9	140.3
Errors and omissions	-651.5	-108.7	29.0	92.1
Overall balance	-14.4	222.0	102.2	62.6
Financing items:	14.4	-222.0	-102.2	-62.6
Change in NFA, total	32.1	-211.1	-102.2	-62.6
Official NIR (increase,-)	32.1	-211.1	-102.2	-62.6
Gross convertible reserves	35.0	-185.6	-65.4	-37.9
Use of Fund credit net	-2.9	-25.5	-36.8	-24.7
Natural gas arrears	-17.7	-10.9	0.0	0.0
	(In percent of GDP unless otherwise stated			
Current account balance	-0.4	-4.2	-5.1	-9.5
Curr.acc.balance excl. official transfers	-1.4	-5.4	-5.8	-10.3
Trade balance	-13.0	-15.5	-15.0	-17.7
Exports	30.7	29.0	32.6	31.5
Imports	43.7	44.5	47.6	49.1
Services, income & transfers balance	12.6	11.3	9.9	8.2
Gross official reserves (millions of US$)	583.2	772.5	837.9	875.8
in months of GNFS imports	3.2	3.1	3.0	2.7
Volume growth of goods exports (percent)	6.8	8.9	20.2	11.3
Volume growth of goods imports (percent)	23.6	22.7	15.5	15.6
Value growth of imports of GNFS (percent)	38.8	38.0	10.6	16.5
Value growth of exports of GNFS (percent)	33.6	28.3	9.4	7.8
FDI stock	12.4	15.4	13.0	15.0
External public debt stock, eop (millions of US$) 1/	428.8	432.1	417.4	471.9
in percent of GDP	9.6	8.4	7.4	7.4
Public debt service (in percent of exports) 1/	2.4	4.4	7.0	3.8

Sources: Data provided by Latvian authorities; and staff estimates.
1/ Includes private publicly guarnateed debt.

Table 43. Latvia: Trade Outside the Baltics, Russia, and Other Former Soviet Union Countries, 1995–98
(In percent of total)

	Exports				Imports			
	1995	1996	1997	1998	1995	1996	1997	1998
Europe 1/	94.0	91.3	89.6	87.9	90.7	91.0	91.4	91.3
Belgium	1.7	2.0	2.0	1.6	2.2	2.9	2.7	3.1
Denmark	3.8	6.9	6.6	7.4	4.7	6.3	5.1	5.3
Finland	6.1	4.5	2.6	3.1	17.0	14.7	14.3	13.4
France	2.4	2.4	2.2	2.5	2.5	2.5	3.1	3.7
Germany	25.6	26.0	23.4	22.6	25.2	22.2	23.6	23.6
Italy	2.2	2.1	1.6	2.6	3.8	4.2	4.6	5.1
The Netherlands	3.7	3.6	4.1	5.0	5.0	5.6	5.5	5.0
Poland	4.7	2.6	2.1	2.6	3.1	4.1	4.7	5.0
Sweden	17.5	12.3	14.1	14.9	13.1	12.6	11.3	10.1
United Kingdom	17.1	20.9	24.4	19.6	4.4	4.4	4.8	4.4
Africa	1.0	2.9	1.3	1.4	0.2	0.2	0.2	0.1
Asia and Middle East 1/	2.3	4.3	5.8	4.7	3.3	2.5	2.8	4.0
China	0.0	0.2	0.2	0.0	0.2	0.2	0.3	0.6
Thailand	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.1
Western Hemisphere	2.7	1.5	3.2	5.9	4.4	6.1	5.5	4.3
United States	2.5	1.2	2.3	4.2	3.2	3.4	3.5	2.9
Australia, Oceania	0.0	0.0	0.1	0.1	1.4	0.2	0.1	0.3
Total (outside BRO)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Latvian authorities.
1/ Excluding the Baltics, Russia, and other former Soviet Union countries.

Table 44. Latvia: Trade with the Baltics, Russia, and Other Former Soviet Union Countries, 1994–98

	In percent of total				
	1994	1995	1996	1997	1998
Exports					
Estonia	5.1	6.6	7.8	10.1	14.7
Lithuania	10.9	11.8	15.9	18.2	24.0
Russia	55.3	54.0	48.7	50.8	39.0
Ukraine	11.6	11.7	13.2	9.4	9.3
Other BRO	17.1	15.9	14.4	11.5	13.0
Total	100.0	100.0	100.0	100.0	100.0
Imports 1/					
Estonia	7.4	13.0	15.2	18.7	22.9
Lithuania	12.5	14.3	16.8	19.9	21.8
Russia	49.9	55.9	53.9	48.7	40.7
Ukraine	6.4	5.9	6.8	6.4	6.5
Other BRO	8.0	10.9	7.3	6.3	8.1
Total	100.0	100.0	100.0	100.0	100.0

Sources: Central Statistical Bureau of Latvia; and Fund staff estimates.

1/ Import figures for 1994 are based on upwardly adjusted estimates of energy imports. A large share of these imports are from Russia.

Table 45. Latvia: Trade by HS Commodity, 1996-98

(In percent of total)

	1996	1997	1998
Exports			
Live animals and animal products (I)	4.6	3.7	3.1
Vegetable products (II)	0.4	0.7	0.6
Animal, vegetable fats and oils (III)	0.1	0.1	0.4
Food, drinks and tobacco (IV)	11.8	10.1	6.7
Mineral products (V)	2.6	1.5	2.3
Chemicals (VI)	6.7	6.5	5.8
Plastics and rubber products (VII)	0.9	1.0	1.3
Hide, skin and leather (VIII)	1.4	1.1	0.8
Wood and wood products (IX)	24.4	29.7	33.5
Pulp and paper products (X)	2.2	2.6	2.9
Textiles and textile articles (XI)	16.9	15.6	16.1
Footwear; feather/down products (XII)	0.6	0.8	0.6
Stone, cement and ceramic products (XIII)	1.9	1.7	1.9
Precious metals (XIV)	0.3	0.5	0.3
Base metals and base metals products (XV)	7.0	8.5	9.8
Machinery and electrical equipment (XVI)	9.7	9.0	6.8
Transport vehicles and parts; vessels (XVII)	4.1	2.1	1.6
Optical equipment and musical instruments (XVIII)	0.3	0.4	0.6
Arms and ammunition (XIX)	0.0	0.1	0.0
Furniture; miscellaneous manufactured goods (XX)	4.0	4.2	4.8
Works of art and antiques (XXI)	0.0	0.0	0.0
Other goods	0.1	0.1	0.1
Total	100.0	100.0	100.0
Imports			
Live animals and animal products (I)	2.0	2.4	1.9
Vegetable products (II)	4.4	3.5	3.2
Animal, vegetable fats and oils (III)	0.9	1.1	1.1
Food, drinks and tobacco (IV)	6.1	6.9	7.1
Mineral products (V)	22.2	14.0	10.5
Chemicals (VI)	11.0	10.9	11.1
Plastics and rubber products (VII)	3.9	4.3	4.4
Hide, skin and leather (VIII)	0.4	0.5	0.4
Wood and wood products (IX)	0.5	0.7	0.8
Pulp and paper products (X)	4.5	4.5	4.2
Textiles and textile articles (XI)	8.0	7.8	7.8
Footwear; feather/down products (XII)	0.7	0.8	0.8
Stone, cement and ceramic products (XIII)	1.9	2.3	2.3
Precious metals (XIV)	0.1	0.3	0.2
Base metals and base metals products (XV)	6.4	8.0	8.4
Machinery and electrical equipment (XVI)	16.8	19.3	20.5
Transport vehicles and parts; vessels (XVII)	5.9	8.3	10.4
Optical equipment and musical instruments (XVIII)	2.2	2.0	2.3
Arms and ammunition (XIX)	0.1	0.1	0.1
Furniture; miscellaneous manufactured goods (XX)	2.0	2.3	2.5
Works of art and antiques (XXI)	0.0	0.0	0.0
Other goods	0.0	0.0	0.0
Total	100.0	100.0	100.0

Source: Latvian authorities.

Table 46. Latvia: Domestic Arrears in the Energy Sector, 1993–97
(In millions of lats)

	Debtor Arrears		Creditor Arrears	
	Latvenergo	Latvijas Gaze	Latvenergo	Latvijas Gaze
1994				
March	69.9	55.3	48.9	39.5
June	59.6	48.8	29.6	35.2
September	55.2	48.7	30.0	36.8
December	70.1	48.7	51.4	49.9
1995				
March	82.4	65.6	55.0	39.9
June	79.6	54.1	57.1	35.1
September	69.1	54.8	60.2	46.4
December	48.5	59.4	44.9	50.5
1996				
March	60.2	65.9	51.2	51.1
June	56.2	61.0	36.3	45.7
September	53.7	57.4	38.3	46.1
December	56.9	13.8	49.8	30.6
1997				
March	57.5	13.1	59.9	28.7
June	43.2	11.2	49.9	17.2
September	33.6	11.7	45.5	19.5
December	37.4	11.7	61.1	14.0
1998				
March	40.5	11.6	53.5	6.9
June	36.2	8.3	49.9	5.1
September	36.4	8.8	46.9	11.3
December	37.4	10.0	47.6	7.9
1999				
March	38.9	8.8	45.0	3.0

Source: Latvian authorities.

Table 47. Latvia: Foreign Trade by Free Trade Agreement Countries, 1996-98
(In thousands of Lats)

	Exports			Imports		
	1996	1997	1998	1996	1997	1998
Total	795,172	971,749	1,068,852	1,278,169	1,582,352	1,881,285
EU	355,457	474,807	604,459	629,465	841,225	1,039,492
Czech Republic	3,817	3,425	3,346	11,368	15,113	25,570
Estonia	29,088	40,570	48,526	72,818	94,691	124,827
Lithuania	59,147	72,990	79,325	80,626	100,788	118,518
Slovakia	1,847	2,450	1,956	4,552	8,090	7,339
Slovenia	452	1,344	2,110	2,074	1,857	1,966
Iceland	852	1,843	2,324	615	690	508
Liechtenstein	215	2,751	136	3,768	298	251
Norway	5,274	5,721	8,237	17,467	23,738	29,049
Switzwerland	2,787	5,260	4,868	11,516	21,973	28,871
Ukraine	49,066	37,809	30,646	32,671	32,306	35,350
Other countries	287,170	322,779	282,919	411,229	441,583	469,544

Source: Central Statistical Bureau of Latvia.