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**Latvian Overnight Interbank Rates: Determinants and Predictability**

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## **Abstract**

In this paper the determinants of the spread between the daily Latvian interbank market rates and the Bank of Latvia target rates are determined. Moreover, the possibility of performing predictions on this spread is analyzed, the result of which is that the spread can be forecasted. Basing on out-of-sample one-step and multi-step predictions, EGARCH specification was declared to have the best predictive power of the Latvian interbank spread. The variables included in the model are based on martingale hypothesis, which is adjusted to deal for irrationality of the market participants. Clear and exact implications for the Bank of Latvia and the commercial banks are given as the result of the research.