Republic of Estonia
IMF Staff Visit-Concluding Statement

August 9, 2002

We visited Tallinn from August 5-9, 2002, to discuss current macroeconomic developments and the preparation of the budget for 2003. We also discussed the authorities' planned technical reforms of the monetary policy framework in order to harmonize the Estonian banking system with the requirements of EU membership.

The outlook for the Estonian economy remains favorable, although we are concerned about the continued weakness of external demand, which has left the economy overly reliant on domestic demand to support growth. The recent deterioration in the current account balance is significant and warrants close attention, especially in light of current uncertainties about the emerging external environment, including the possibility that growth in some of Estonia's major trading partners will be weaker than had been anticipated at the time of our last visit in April.

Monetary conditions are primarily determined externally, given Estonia's currency board arrangement, and, in the near term at least, are likely to remain relatively easy. Fiscal policy thus has the major role to play in ensuring that Estonia's external position remains sustainable. The strong performance of tax revenues over the first half of the year is welcome in this regard, and could act as an automatic stabilizer for the economy provided that the bulk of revenues are saved rather than injected back into the economy in the form of higher public spending. We continue to believe, therefore, that it would be more prudent, from a macroeconomic perspective, to refrain from additional spending commitments in 2002 of the scale envisaged in the proposed second supplementary budget.

At this stage, the intention to balance the budget in 2003 is appropriate, although the government should stand ready to tighten fiscal policy if the current account position begins to threaten external sustainability. In addition, the government should avoid further increases in the overall level of public spending relative to the size of the economy. In meeting these goals, the government will be helped by continued restraint of public sector wages, increases in pensions that are limited to the existing indexation formula, better targeting of social benefits (especially disability benefits), and prudent expenditure management by municipal authorities.

Regarding the monetary policy framework, we discussed the authorities' strategy for convergence with the operational requirements of the euro area. It will be necessary to ensure that, in implementing these requirements, the authorities' capacity to manage the overall liquidity in the banking system is not unduly limited, and we discussed a range of possible options in this regard.