

## IV. ENSURING MONETARY POLICY STABILITY

In Estonia the central bank performs its constitutional function – to maintain the stability of the national currency – applying fixed-exchange-rate-system based monetary policy. The fixed exchange rate and its stringent monetary policy foundation constituted a starting point for restructuring of the economy in the early years after the reintroduction of the kroon. Their co-impact was rapidly revealed both on stabilising price level and in lower interest rate level. In the current economic policy environment the exchange rate system supports also the smooth nominal and real convergence of Estonia's economy with that of the EU economy. Estonia's monetary policy principles in their openness and transparency comply with internationally accepted good practice<sup>1</sup>. Thus, a reliable foundation has been set for elaborating the entire national economic policy.

### ECONOMIC POLICY OUTLINES FROM MONETARY POLICY STABILITY PERSPECTIVE

Economic policy has to be uniform in order to achieve stable and sustainable economic growth. Monetary policy can be successful only insofar as its objectives comply with the economic policy.

**The overall objective of Estonia's economic policy is to achieve sustainable, socially and regionally balanced development.** The specific economic policy objective is to support productivity growth and thereby also to decrease development difference between Estonia and the European Union, securing meeting of economic criteria and gradual convergence of income levels<sup>2</sup>.

Both before joining the Economic and Monetary Union and after Estonia has become a member, the overall macroeconomic stability will be the prime prerequisite to achieve price stability and sustainable economic growth. The stability assumes conservative economic policy favouring market flexibility and balanced efficiency-growth-oriented development in the private sector.

Economic policy choices made to achieve the targets have remained unchanged for at least ten years. After the restoration of independence ensuring of liberal trade policy and favourable investment environment, as well as currency board and balanced budget principles have been considered securing economic growth. The government has laid special stress on balanced budget as a means to ensure both macro-equilibrium and favourable investment climate. A simple broad-based taxation system supports domestic and foreign investors' investment decisions.

Execution of structural reforms enhancing competitiveness of economy is an inseparable part of pursuance of the above economic policy principles. The year 2001 was no exception. Relatively rapid economic growth and maintenance of foreign investor confidence under deteriorating external environment allowed the government to continue with intended reforms.

- To reduce future commitments of the government a legislation package was worked out to launch the pre-financed pension system.
- Mandatory unemployment insurance was implemented to enhance support to the unemployed.

<sup>1</sup> Report on Observance of Standards and Codes (ROSC). Estonia.

<sup>2</sup> See Real and Nominal Convergence, pp 38–39.

- To strengthen competitiveness of the economy, business support systems were continuously worked at.
- The government prepared a national action plan to increase employment and labour market flexibility.
- Privatisation of railway and water supply of larger cities came to an end, sale of state land and registration of land ownership were continued.

**The role of the strategic development plan in ensuring economic policy consistency kept increasing.** In order to support the supply-side flexibility of the economy, the government renewed the mid-term reform scheme. The programme for 2001–2005, a starting point for the pre-accession economic programme, is based on current economic policy principles and focuses on the pre-accession period. The outlined reforms should maintain both internal and external equilibrium and ensure as rapid convergence of income levels – real convergence – as possible.

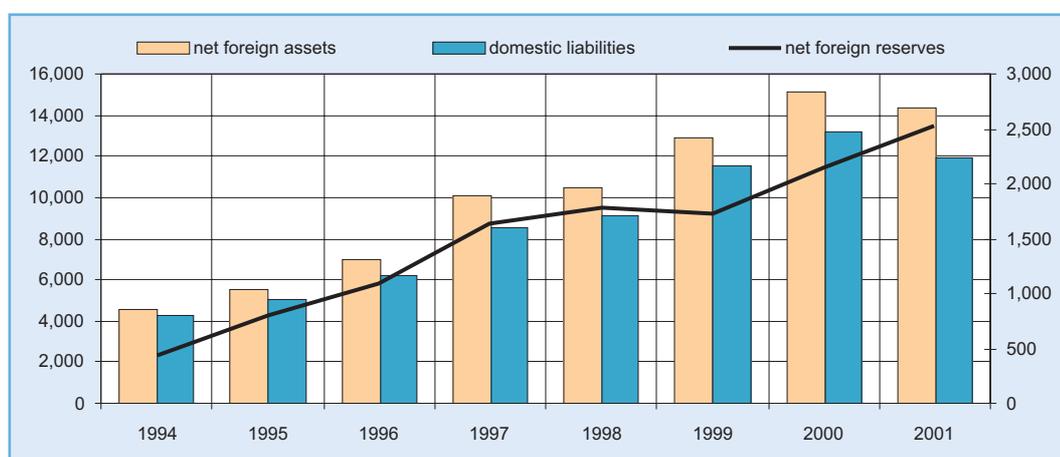
**The conservative (currency-board-arrangement and balanced-budget based) but simultaneously also liberal (without current and capital account restrictions) economic policy has established a favourable investment environment in Estonia and facilitated sustainable growth of the economy.** The continuity of this trend will support smooth nominal and real convergence of Estonian economy with that of Europe.

## MONETARY POLICY

### CONTINUITY

In 2002 it will be ten years from Estonia's monetary reform, which introduced the Estonian kroon, established the currency board system and fixed the exchange rate of the kroon against the German mark (1 DEM = 8 EEK). **Since 1 January 1999 the exchange rate of the Estonian kroon has also been fixed against the euro, the currency of the European Economic and Monetary Union (1 EUR = 15.6466 EEK).** The Estonian kroon is freely convertible, ie there are no restrictions on the free movement of capital between Estonia and foreign countries.

Currency board arrangement is a special kind of fixed exchange rate system where the upper limit of base money (notes and coins in circulation and credit institutions' deposits with the central bank) emission depends on the amount of central bank's foreign reserves. This ensures an automatic cover to the kroon, as the decrease of central bank's reserve will not jeopardise preservation of exchange rate (the reserve of the currency board will not diminish; see Figure 4.1).



**Figure 4.1.** Eesti Pank net foreign assets, domestic liabilities (EEK m, the left scale) and net foreign reserves (EEK m, the right scale)

The constitutional function of Eesti Pank to maintain the stability of the national currency means essentially **the development of a long-term price stability-oriented monetary policy**. Price (including interest rates) developments in a small open economy with the fixed exchange rate are primarily subject to external impacts. The task of the monetary policy framework would be to secure that the external signals reach domestic prices unchanged and thereby to allow smooth adjustment of the price level and structure with that of developed market economies. The monetary policy consistency together with specific strategic objectives is one of the most significant factors in directing the development of the economy, also in shaping inflation expectations.

## EMU – STRATEGIC GOAL OF ESTONIAN MONETARY POLICY

**Considering the small size of the Estonian economy and openness towards the European Union, entering into EMU and the Eurosystem, out of all options, is best suited to the strategic goals of Estonian monetary policy.** Estonia's participation in the EMU with a significant economic partner – the European Union, sustains Estonia's long-term stable economic growth, securing contemporaneously the stability of our currency, low inflation rate and participation in economic policy discussions about the future of the EMU. Prior to joining the EMU Estonia has neither technical nor economic necessity to change monetary policy foundation. The exchange rate of the kroon fixed against the euro supports continuous integration with the European economic space whereas the currency board arrangement sets additional guarantees to perform reliable economic and monetary policy.

Upon Estonia's accession to the European Union, the exchange rate policy will become a matter of common concern<sup>3</sup>. **Estonian monetary policy will remain unchanged until Estonia joins the European Economic and Monetary Union.** In 2000 Ecofin, the European Commission and the European Central Bank confirmed that in principle the euro-based currency board framework complies with ERM2 requirements. The currency board does not replace the requirement to participate in ERM2, but a country, which has efficiently implemented currency board principles does not have to change its exchange rate system prior to joining the Eurosystem: there will be no need if the economic growth is sustainable.

The explicit objective to accede to the European Union and criteria to be met back the pre-accession fixed exchange rate policy and enhance the credibility of Estonia's economic and monetary policy steps. The necessary prerequisites to accede to the EU and ERM2 – harmonisation of legislation and necessary development to secure economic convergence – provide both domestic economic agents and international community a signal that the state prefers long-term development strategy to short-term economic policy objectives.

The introduction of euro notes and coins in the EMU Member States at the beginning of 2002 did not change Estonia's monetary policy strategy: joining the Eurosystem will take place according to the rules, in three stages and the currency board will not be given up before that. The euro will become the legal tender in Estonia upon Estonia's joining the Eurosystem.

## MONETARY POLICY TRANSMISSION IN ESTONIA

Due to the currency board arrangement the exchange rate has a significant place in Eesti Pank's monetary policy. The central bank has no independent interest rate objective under the currency board arrangement and domestic interest rates and monetary aggregates develop freely, based on market mechanism and the impact of anchor currency interest rates on domestic interest rates.

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<sup>3</sup> Upon joining the EMU Member States are obliged to align their exchange rate policy with other Member States.

The currency board arrangement links Estonia's monetary environment conditions through interest rate parity with the European Central Bank's (ECB) monetary policy. Therefore, Estonia's money market interest rates follow trends in the euro area (see Figure 4.2). Increasingly closer integration of Estonian financial markets with foreign markets as well as the operational framework of Estonian currency board arrangement, which favours external-assets-based liquidity management in Estonian financial sector, facilitates the infusion of the external interest rate to the Estonian money market.

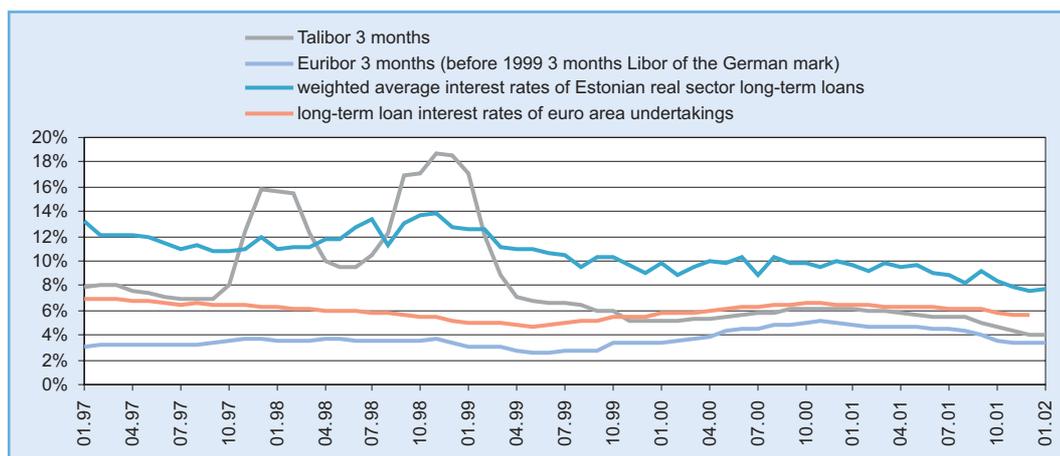


Figure 4.2. Three months Talibor and Euribor and long-term loan interest rates of Estonia and euro area

Empirical studies show that euro area monetary policy steps reach the Estonian money market and quite rapidly also deposit and loan interest rates. ECB's monetary policy decisions have an almost immediate impact on real sector loan interest rates in Estonia, having a two-quarter delay in exercising maximum impact on real sector's investment and saving behaviour. Also Estonia's inflation pace is subject to inflation in the euro area.

In future the economy in all candidate countries should respond adequately to ECB's monetary policy signals in order to be ready for the ultimate adoption of the euro. Therefore, it is extremely significant that due to the currency board system and fixed exchange rate the ECB's monetary policy impact is transferred to the Estonian real sector already today, guiding corporate and private economic decisions. Furthermore, the ECB's monetary policy impact is transferred to Estonia quite similar to monetary policy transmission within the euro area.

## EVERYDAY MONETARY POLICY AND PREPARATIONS TO ADOPT EMU FRAMEWORK

The function of Eesti Pank is to set prerequisites to maintain public confidence in monetary policy and develop such monetary policy framework that safeguards smooth performance of the currency board arrangement. It is also important that monetary policy instruments and their implementation principles would consider the ongoing integration of Estonian financial markets into international markets and upcoming accession to the monetary union.

The primary monetary policy instrument of Eesti Pank is the "forex window" offered to commercial banks. The standing facility safeguards the exchange rate of the kroon and the euro, as Eesti Pank is ready to meet the demand of the foreign exchange market for the kroon or foreign currency and balance the market at the fixed exchange rate. Pursuant to financial environment development, Eesti Pank has kept improving monetary policy operational framework (see Table 4.1).

## PREPARATION FOR THE ADOPTION OF THE MONETARY POLICY FRAMEWORK OF THE EMU

### *How will the Functions and Role of Eesti Pank Change when Estonia Becomes an EU Member State?*

When Estonia becomes a Member State of the European Union, it does not mean that the functions of the central bank will change immediately. Changes appear only after Estonia accedes to the Eurosystem. Prior to the accession to the Eurosystem the central bank (ie Eesti Pank) of a Member State continues to exercise national monetary and exchange rate policy as well as to prepare the financial system for the common monetary policy and adoption of the euro. However, after the accession to the European Union the functions of Eesti Pank will expand significantly compared to current functions.

Upon Estonia's accession to the European Union, the central bank will acquire new obligations: the Governor of Eesti Pank will start participating in the ECB General Council. The competencies of the General Council involve exchange of monetary policy information, consultations with national central banks of ins and pre-ins, definition of ECB statistics requirements, preparation of the accession of a new Member States to the Eurosystem, etc. After the accession to the Eurosystem the Statute of the European System of Central Banks and of the European Central Bank will determine the tasks and competencies of ECB Member States. The national central banks are the sole subscribers to and holders of the capital of the ECB. Each Member State will pay up in full their respective subscriptions to the ECB's capital according to the key. The subscription of capital is based on a key established according to the EU Member State's respective share in the GDP and population of the Community (with the 50% weight of each).

### *Participation in Taking the Most Significant Decisions in the European Central Bank*

Each Governor of national central bank is the member of the ECB's Governing Council. The Governing Council is the highest monetary policy body in the Eurosystem, formulating the political framework of the Community and taking major monetary policy decisions. The decisions to change ECB benchmark rates are the most important ones for the monetary policy environment. All the members of the ECB's Governing Council should consider the economic condition of the Eurosystem in its entirety, establishing additional requirements especially for smaller Member States regarding economic and monetary policy analysis and know-how. With the participation in the Eurosystem the relative international influence of small states will increase. For the central banks of the small states this will also set additional requirements for other countries' economic and financial environment analysis and new requirements for monetary policy analysis.

### *Everyday Committee Work in the European Central Bank*

Besides co-operating in the ECB Governing Council, specialists from all national central banks (NCB) participate also in the ECB daily work: 13 committees have been set up at the ECB (eg Monetary Policy Committee, Market Operations Committee, Payment and Settlement Systems Committee, etc) comprising ECB and NCB specialists with the task to consult the ECB performing its key functions.

The distribution of competencies between the ECB and NCBs defines the functions as regards the monetary policy infrastructure of the Eurosystem's NCBs. In monetary policy the competencies fall as follows: the ECB takes monetary policy decisions and implements them with the assistance of NCBs. For example, the competencies between the ECB and NCBs in open market operations are distributed as follows: the ECB determines the schedule of regular auctions and the ECB Governing Council the interest rate; the NCBs forward offers of commercial banks to the ECB; based on the offers the ECB determines the total liquidity volume allocated to the market; pursuant to the ECB decision the NCBs credit the commercial banks.

Another significant set of tasks for NCBs of the Eurosystem is to administer both national and ECB official external reserves and to operate in the foreign exchange market pursuant to the ECB guidelines. The NCBs perform also within the Eurosystem all regular central bank operations as regards payment systems, issue of cash and collection of statistics. The ECB establishes a compatible payment system standard, but the NCBs are responsible for setting up and administering of a high value payments' system.

The NCBs are also responsible for the issue and circulation of euro notes and coins on the territory of their states. They carry the responsibility for collection and processing of statistics necessary to pursue single monetary policy. The NCBs of the Eurosystem can also perform functions set by national legislation. Here the most important field is financial sector supervision that is to be managed by the Member States and where most of the NCBs are involved to a smaller or larger extent. The overall opinion is that the participation of the central bank in the supervision is of critical importance.

Table 4.1. Evolution of Eesti Pank monetary policy operational framework

	1998 <sup>1</sup>	1999	2000	2001
<b>1. "Forex window"</b>	Eesti Pank is obliged to conduct exchange transactions with Estonian credit institutions without constraints between USD, JPY, SEK, GBP, EUR, national currencies of EMU countries and EEK			
Exchange rate spread	No exchange rate spread of DEM-EEK (purchase and sale) transactions between Eesti Pank and credit institutions (1 DEM = 8 EEK). Since 1 July 1996	No exchange rate spread of EEK-EUR as well as EEK and national currencies of common currency countries' purchase and sale transactions between credit institutions and Eesti Pank (1 DEM = 8 EEK; 1 EUR = 15.64664 EEK). Since 1 January 1999		
<b>2. Reserve requirement</b>	Estonian credit institutions are obliged to keep certain amount of their incorporated assets liquid in assets determined by Eesti Pank.			
1) Reserve requirement base	a) Liabilities to customers; b) debt securities issued by banks; c) net liabilities to foreign credit institutions; d) financial guarantees to financial institutions and non-resident credit institutions. Since 1 September 1998 <sup>2</sup>			
2) Monthly minimum reserve requirement	10% of the reserve requirement calculation base Since 1 January 1993		13% of the reserve requirement calculation base Since 1 July 2000	
Additional liquidity requirement	3% of the reserve requirement base <sup>3</sup> Between 1 November 1997 - 30 June 2000		-	
3) Assets eligible for meeting reserve requirement	a) Deposits with Eesti Pank b) credit institutions' cash in hand - up to 20% of the monthly minimum reserve requirement  Since 19 June 1998		a) Deposits with Eesti Pank b) credit institutions' cash in hand - up to 20% of kroon reserve requirement c) quality foreign securities - up to 50% of reserve requirement <sup>4</sup> Since 1 July 2001	
4) Averaging	Averaging on monthly basis. Averaging begins on the first calendar day of each month and ends on the last calendar day. Since 1 July 1996			
Daily minimum reserve requirement	40% of the monthly minimum reserve requirement  Since 1 November 1997		40% of kroon reserve requirement Since 1 January 2001	
5) Remuneration of the reserve requirement	-		ECB deposit interest rate Since 1 July 1999	
<b>3. Standing deposit facility in Eesti Pank</b>	Eesti Pank offers to credit institutions possibility to earn interest on the settlement account's average monthly balance exceeding the minimum reserve requirement with Eesti Pank			
	Deutsche Bundesbank discount rate. Since 1 November 1997		ECB deposit interest rate Since 1 January 1999	
<b>4. Eesti Pank certificates of deposit (CDs)</b>	Once a month Eesti Pank organises auctions of the Eesti Pank short-term (1 month) certificates of deposit with limited issue (up to EEK 30 m). Between 19 March 1993 - 19 May 2000		-	
<b>5. Facility to sell foreign securities to Eesti Pank</b>	-		Eesti Pank is ready to buy from credit institutions securities which meet the quality requirements set to meeting the reserve requirement. Since 1 January 2001	

<sup>1</sup> For requirements to monetary policy operational framework of earlier years see the monetary policy chapter in the Eesti Pank annual reports of those years.

<sup>2</sup> Since 1 August 1998 up to 50% of the issued financial guarantees were included into minimum reserve requirement calculation base, since 1 September 1998 by 100%.

<sup>3</sup> Since 1 November 1997 - 2%, since 1 December 1997 - 3% of reserve requirement base.

<sup>4</sup> Since 1 January 2001 - limit for external assets 25%, since 1 July 2001 - 50% of the reserve requirement.

Taking into account the upcoming accession to the European union and the EMU, Estonia's monetary policy framework is also being aligned with that of the EMU. Under free movement of capital and reliable monetary and financial policy, the monetary policy environment of Estonian credit institutions and liquidity management is already quite similar to the Eurosystem. Primarily exchange rate mechanisms facilitate the transmission of ECB interest rate signals to Estonia. The impact of the signals' transmission channels does not significantly differ from the situation if Estonia were already a full member of the Economic and Monetary Union. Therefore, rapid full compatibility of the Estonian monetary policy operational framework with that of the System of European Central Banks is not a goal in itself. Considering international integration of Estonian financial markets and upgraded broad-based liquidity management, there is no need to exercise additional influence on interest rates.

According to the three-phase Eurosystem accession scheme some differences in the accents of the monetary policy instruments will survive until Estonia's full participation in the EMU. Thus, in the

implementation of Estonian monetary policy reserve requirement and the “forex window” will remain slightly more significant than in the euro area. However, amendments made in the operational framework in recent years consider also the upcoming participation in the EMU.

## REFORM OF MONETARY POLICY OPERATIONAL FRAMEWORK

In spring 2000 the Board of Eesti Pank approved the reform strategy of the monetary policy operational framework with two clearly distinctive objectives. The short-term objective involved revision of the current framework in order to safeguard the smooth performance of the fixed exchange rate under the currency board arrangement and reduce market distortions. The solution of this objective, involving foreign assets in meeting reserve requirement as of 2001, was contemporaneously also a preparatory step for the long-term objective to ensure technical and operational readiness in order to smoothly introduce all monetary policy instruments of the Eurosystem upon Estonia's accession to the euro area.

The most significant component in **the first stage of the reform** was the transition to partially involve foreign assets in meeting reserve requirement in order to make the reserve requirement more market-based. The core change in reforming the reserve requirement lies in permitting banks to meet 25% of the minimum reserve requirement by holding high quality foreign assets as of 1 January 2001 instead of depositing the reserve requirement with the central bank. Only bonds denominated in euro and possessing high credit rating (at least S&P AA-/Moody's Aa3) are eligible, issued by governments of developed countries or supranational credit institutions (such as the World Bank, European Bank for Reconstruction and Development, Nordic Investment Bank, etc). Criteria for eligible assets in meeting the reserve requirement are comparable to the quality requirements set to the foreign exchange reserve backing the kroon.

The banking sector was positive about the switchover to using foreign assets in meeting the reserve requirement. Already in January three credit institutions joined the system, in early-March one more. By the end of the first quarter the liquidity portfolio deposited on Euroclear and Clearstream accounts had reached 2.5 billion kroons. As of 1 July 2001 the foreign assets cannot account for more than 50% of the reserve requirement. As a result, the liquidity portfolio has grown to 3.3 billion kroons, maintaining the level till the end of the year (see Figure 4.3). As the growth in high-quality foreign assets and contemporaneous shrinkage in the kroon reserve requirement, accompanying the first stage of the reform, were of about the same volume, **the annualised monetary impact of the reform was neutral** – the gross volume of liquidity buffers remained unchanged.

The decreased kroon reserve requirement was also visible **in contracting base money and Eesti Pank's gross reserve**. The kroon cover did not change whereas the structural change in the reserve

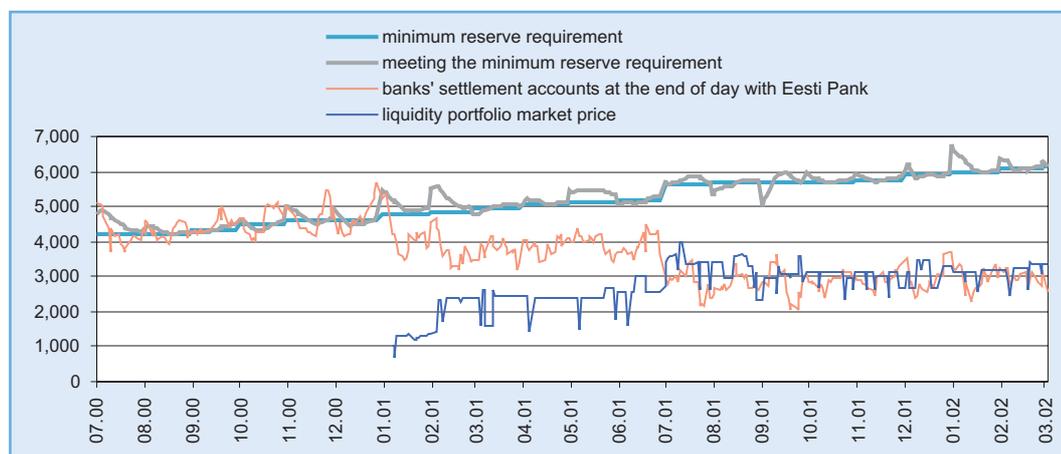


Figure 4.3. Banks' minimum reserve requirement and its meeting (EEK m)

requirement influenced balance of payments' reserves, balance of the financial account and structure of international investment position.

The involvement of foreign assets in meeting reserve requirement had a significant role in establishing external buffers. Expanding opportunities of Estonian credit institutions in liquidity management on money markets of the euro area, a strong foundation was set to make the currency-board-based monetary policy more efficient. It is also important that now we have a framework to proceed with further steps to converge with the euro area.

The objective of **the second stage of the reform** is to ensure technical and operational readiness in order to adopt smoothly all monetary policy instruments of the Eurosystem upon Estonia's accession to the euro area.

The monetary policy operational framework together with foreign-exchange-markets and foreign-assets-based liquidity management characteristic of the currency board arrangement will make the full and rapid operational convergence with the Eurosystem less expedient. Maintenance of liquidity buffers stronger than those offered by the Eurosystem is also typical of the currency board arrangement. Therefore, considering the necessity to keep a currency-board-arrangement-based integral solution until Estonia's full participation in the Monetary Union, the achievement of full technical preparedness vis-à-vis all the monetary policy instruments of the Eurosystem should be considered the most significant in the operational convergence. This involves changes necessary for convergence to be implemented in the currency board framework (such as amendments to the reserve requirement, preparations to implement standing facilities and open market transactions, etc) whereas full operational convergence will be achieved – just like the states acceding to the Eurosystem did previously – immediately before the accession.

## ECONOMIC ANALYSIS AND FORECAST

### ECONOMIC ANALYSIS

It is very important to consider the current stage in the economic policy cycle and evaluate correctly implications in taking every single monetary policy decision (as well as more broadly – taking economic policy decisions). Eesti Pank's current economic policy analysis should provide as precise an overview as possible of the situation and development perspectives in Estonian and world economy. Eesti Pank applies an economic analysis system based on regular monthly and quarterly surveys. The monthly surveys outline economic policy assessments by Eesti Pank's analysts, supplemented by economic policy recommendations in the quarterly surveys. The quarterly economic policy comment is the most significant economic policy public output of Eesti Pank.

Besides the surveys there are also single analyses on different essential topics. In 2001 the analysis focused on potential implications of the adoption of euro notes and coins on the Estonian economy. The conclusion was that the direct and short-time impact of the adoption of the euro notes and coins both on the euro area and Estonia's economic development was small, rather, the EMU as a whole has more significant long-term implications. The most important of which would be safeguarding stable price level all over Europe.

In 2001 the monthly and quarterly analysis methodology was upgraded and an inter-department system was introduced to co-ordinate economic analyses. Eesti Pank expanded the number of departments involved in the system in order to ensure an operational and efficient economic analysis.

### FORECAST

Forecasting of development trends has become ever more significant in drafting monetary policy decisions over the recent years. Economic forecasts have allowed participating also in broader economic policy

discussion. In autumn 2001 Eesti Pank was actively involved in the 2002 budgetary discussions, analysing the potential impact of the world economic recession on the Estonian economy, also on budget revenues. Eesti Pank publishes its forecasts twice a year – in spring and autumn, if necessary, more often.

One of the priorities in Eesti Pank's economic research has been ongoing improvement of forecast models. Guest researchers have also been involved in this research. The achievements allowed improving the model in long-term economic growth and analysing better Estonia's relations with its long-term trade partners. Also forecast methodology was worked at and its timetable, division of labour, processing and disclosure were specified.

## ECONOMIC RESEARCH

**The main aim of Eesti Pank's economic research is to support central bank's primary fields of activity, primarily adjustment of the monetary policy operational framework and solving of key issues in the accession to the European Union and the EMU.** High level research is also essential in the current and future relations of Eesti Pank with the European Central Bank and national banks of the EMU Member States. Enhanced competence of economists involved in economic research is a prerequisite to be able to participate in solving issues important for Eesti Pank upon accession to the European Union.

According to Eesti Pank's Strategic Research Plan the key areas of research in 2001 were **analysis and modelling of the Estonian economy, real and nominal convergence of the EU accession countries and monetary transmission issues under the currency board arrangement and the fixed exchange rate.** Compared to previous years, the central-bank-specific research area was deepened: research on the currency board, neutrality of money and income curve as well as inflation in Estonia. Regular research was conducted also in other areas: exchange rate and competitiveness, unemployment and labour mobility, EU impacts on Estonia's external trade, implications on capital flows, links between Nordic and Estonian economies and factors influencing country rating. Researching accession countries' real and nominal convergence, convergence of economic structures was focused upon. The results were published in the series of Working Papers of Eesti Pank. The studies were also presented in international conferences in Vienna, Budapest, Ljubljana and elsewhere as well as to wider public in Estonia.

## DEVELOPMENTS IN STATISTICS

Economists involved in economic analyses nowadays require ever more extensive and thorough statistics on financial sector developments. Thus, Eesti Pank continues to expand the circle of financial institutions and fields involved in statistical observations. Pursuant to the development of financial sector, the amount of data is diversified at the same time. Currently, the central bank together with the Financial Supervision Authority is elaborating reporting principles for investment companies.

In recent years the quality and the assessment of statistical data are being given much attention to in the world. The IMF has worked out a methodology to evaluate the quality of countries' statistics. In May a mission of the fund visited Estonia. Their aim was to find out, using the mentioned methodology, whether Estonian statistics corresponds to the international and good practice as it is treated in the International Data Dissemination Standard (SDDS). The IMF mission gave high evaluation to monetary, banking and balance of payments statistics, which is the responsibility of Eesti Pank. The report of the mission stated that Eesti Pank follows the SDDS requirements concerning data timeliness, availability and publication.

## DEVELOPMENT OF FINANCIAL STATISTICS CONCERNING MONETARY POLICY

Statistics is serving interests of both monetary policy and financial stability. In 2001 as well as during the last couple of years developments in monetary and banking statistics were subject to Estonia's

request to accede to the European Union. A significant step in converging Estonian monetary and banking statistics with the EU requirements was to define Estonia's Monetary Financial Institutions<sup>4</sup> (MFI) sector and to disclose their data together with other candidate countries at the ECB's web page. The MFIs play a central role in ECB statistics concept – monetary and banking statistics is collected not only from credit institutions but also from all financial institutions belonging to the above sector. In future the list of MFIs will be updated regularly.

In earlier years Eesti Pank focused in statistics on studying the methodology of data compilation and upgrading the existing data collection system. In 2001 preparations were launched for data dissemination to ECB: technical resources were studied and the data volume and contents were agreed upon. In January 2002 the data dissemination started, being a significant step towards a merger with the ECB statistics system.

Co-operation with the State Statistical Office in drawing up financial account of national accounts<sup>5</sup> is extremely important. In February an activities plan was signed to merge relevant knowledge and skills in both institutions. The financial account is an important component in evaluating, comparing and analysing the EU member economies. As the financial account holds a significant position also within the Eurostat statistical system, such a compatible account is significant from the EU accession perspective as well.

### **UPGRADING FINANCIAL SECTOR ACCOUNTABILITY**

In gathering adequate data about the financial sector it was crucial to elaborate leasing statistics in the field of non-banking financial statistics in 2001. The need for leasing statistics appeared due to the rapid growth in the leasing sector, rendering the current quarterly reporting inadequate – the data did not allow assessing adequately developments in the sector. Upgrading involved additional templates and more frequent submission of reports. For safeguarding the financial sector stability, it was especially important to introduce a specific report on the quality of the leasing portfolio. The report is similar to banks' loan portfolio report.

### **DEVELOPMENTS IN BALANCE OF PAYMENTS STATISTICS**

Eesti Pank has developed statistics on the external sector of the Estonian economy along the same principles as in upgrading statistics in general. The IMF Balance of Payments Manual 5th Edition serves as a methodological base. In compiling balance of payments the central bank uses a combined system – survey system and settlements system.

In 2001 the central bank launched a project to establish an integrated balance of payments compilation information system, linking two independent databases into a whole, ensuring better quality and availability of the source information and providing data surveys on different aggregation levels. The implementation of the new system is more in compliance with the Eurostat and ECB requirements for balance of payments compilation<sup>6</sup>. The project will continue in 2002.

Since 1998 Eesti Pank has been preparing the compilation of monthly balance of payments. In end-2001 the level achieved allowed publishing monthly balance of payments as of January 2002.

<sup>4</sup> Monetary Financial Institutions (MFI) – resident credit institutions as defined in the Credit Institutions Act, as well as all other resident financial institutions, which deal with involving deposits and/or deposit-like instruments from non-MFIs and crediting and/or investing in securities. MFIs in Estonia include Eesti Pank, credit institutions, savings and loan associations and money market funds, which are in compliance with the EU criteria. The list of Estonian MFIs is available in the Internet: <http://www.ecb.int/mfi/pdf/mfiac-es.pdf>.

<sup>5</sup> The financial account is a component of national accounts describing by economic sector transactions with financial assets and liabilities. The account reveals net borrowing/lending by the economic sectors.

<sup>6</sup> Estonian Balance of Payments Yearbook – first published in 2001 on the previous year - will provide a detailed survey of the methodology used in compiling balance of payments in Estonia.