

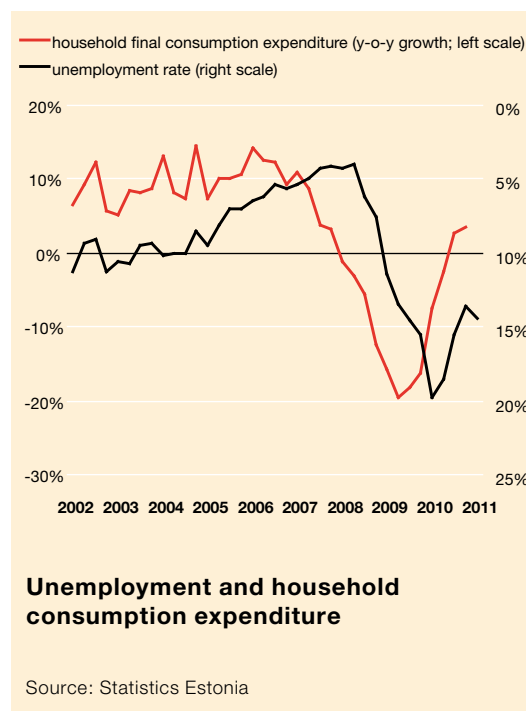
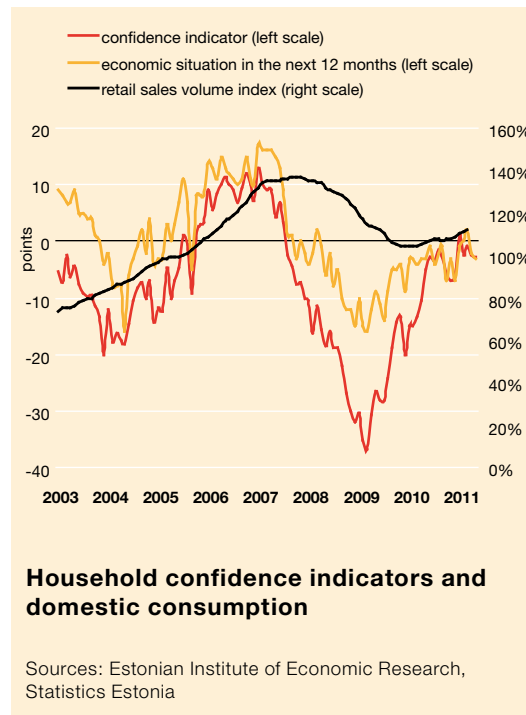
FINANCING OF HOUSEHOLDS IN ESTONIA

The economic situation of households

The pessimism of households is abating. Confidence has mainly been boosted by positive developments in the labour market. Although unemployment grew to 14.4% in the first quarter of 2011 owing to seasonal factors, activity in the labour market has perked up a bit in recent months. This is confirmed by the remarkable drop in the number of the registered unemployed, the rise in employment and the number of job offers that has regained its boom-time level. Moreover, nominal wages have also started to grow. However, the real purchasing power of households has not recovered to its pre-crisis level because of the rapid rise in prices.

Against the backdrop of economic recovery, the estimates of households regarding their economic situation in the next 12 months have slightly improved, and so their high propensity to save, which increased considerably during the recession, is on the wane. This is reflected in consumption, which started to improve gradually at the end of the third quarter of 2011. In the fourth quarter of 2010, household consumption expenditure grew by 3.5% year-on-year. Nevertheless, households remain cautious about their consumption and investment decisions owing to the recent crisis experience, and consumption currently remains at the level of 2006. Purchase of durables is expected to grow relatively modestly, as consumers sense the rapid rise in the cost of living. Furthermore, the fall in real incomes has been accompanied by an increase in share of inescapable expenses (expenditure on housing and food) in household budgets by 5 percentage points to 45% over the last three years¹. This means that less money is available for other expenses. However, borrowing for making the necessary purchases is not so common and households prefer to use their savings and existing assets for that purpose.

¹ Source: Statistics Estonia, Household Budget Survey 2010.



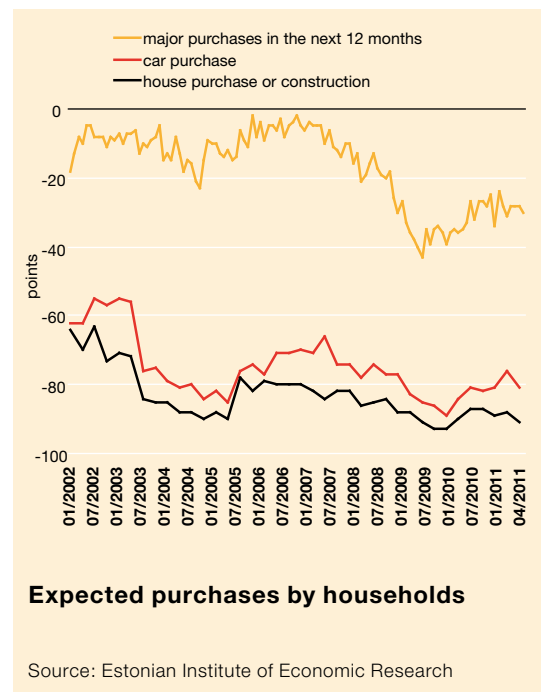
In 2010, households decreased their financial liabilities by repaying part of their loans, which helped improve their financial position considerably as shown by the financial account data. The financial assets of households grew by around 3%, largely owing to the price rise in stock markets and payments into life and pension insurance. The stock of household deposits has increased too. Households presumably continue saving despite the low interest rates and recovering consumption, albeit at a smaller scale than during the recession.

The financial behaviour of households

The financial position of households has improved, as their financial liabilities – mainly long-term loans – have shrunk by 4% with the year. At the end of the first quarter of 2011, the ratio of household debt to GDP stood at 50% and the ratio of debt to disposable income was 91%. Although the level of debt is decreasing, it is still high and curbs households' desire to borrow. As households remain cautious in their financial behaviour, the volume of private consumer credit will probably be smaller in the current economic cycle than it was in the previous cycle, and total financial liabilities will also contract this year.

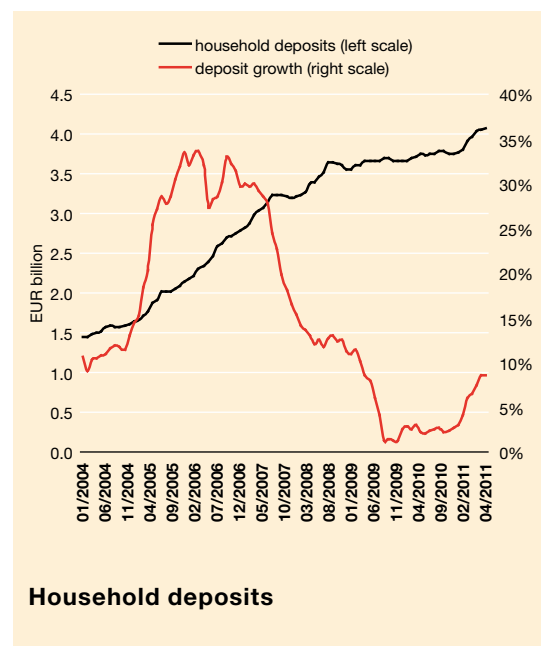
The majority of Estonian households have their own housing, with 17%² of them having real-estate related financial liabilities. Thus, their wealth depends greatly on developments in the real estate market. The real estate market has been recovering more modestly than expected, which may arise from the cautious behaviour of households, but also from the loans already obtained or the scarcity of suitable real estate. There is a number new development projects on the market and the number of offers is generally rising, but the data of the Tallinn apartment market show that the transaction activity was almost 10% lower in the first four months of 2011

² TNS EMOR's survey "F-monitor: Financial Behaviour of Estonian Households, September-October 2010".



Expected purchases by households

Source: Estonian Institute of Economic Research

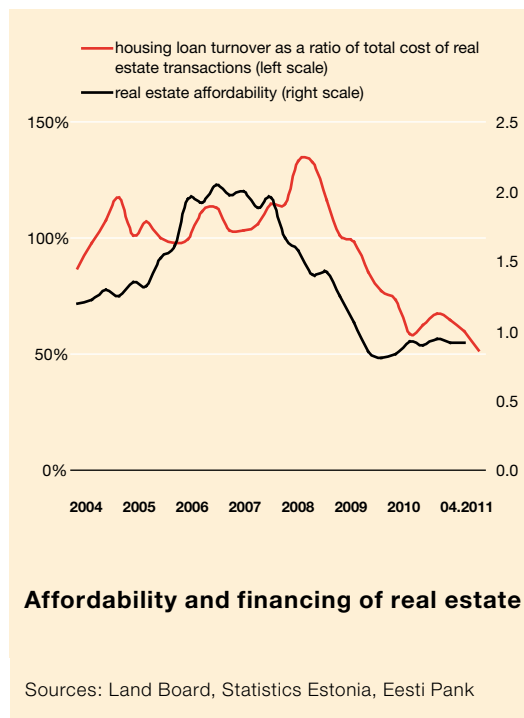
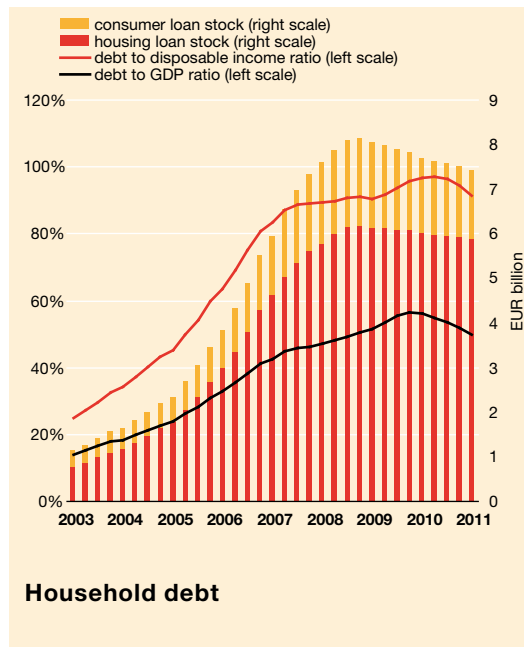


Household deposits

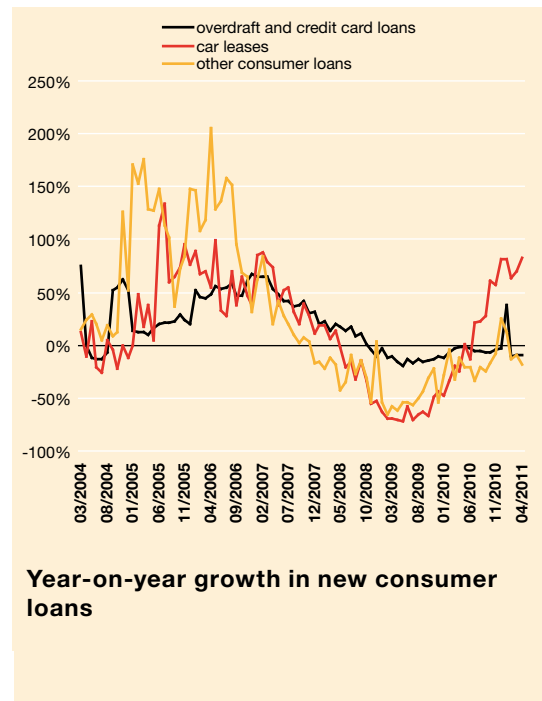
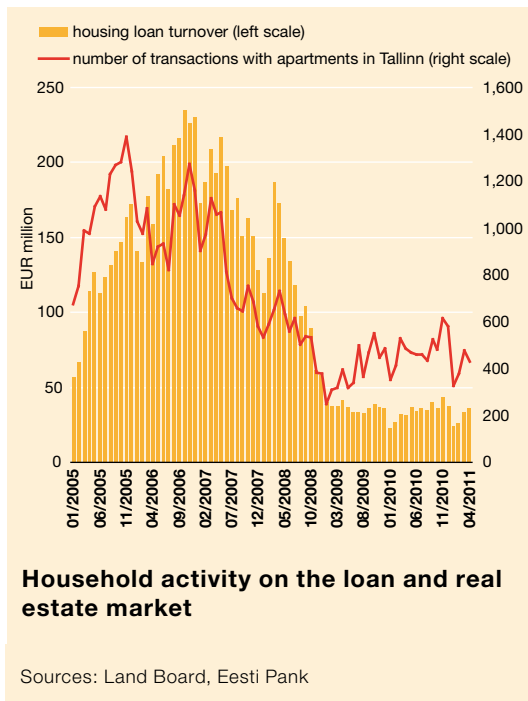
than it was a year earlier. The structure of real estate transactions has changed and transactions are mostly performed with new apartments or apartments in good condition, which partially explains the rise in real estate prices. As for the price level, the market remains at the level of 2005, and the affordability of real estate for the residents of Tallinn who earn average wages is still good. In the first quarter of 2011, the affordability indicator was 0.91, which is lower than the long-term average. Given that prices are at levels recorded six years ago, the value of the collateral real estate of a third of the borrowers is currently smaller than the loan amount, which inhibits their activity on the real estate and loan markets.

Borrowing by households is still modest. Although in April the volume of new housing loans was 16% higher than it was a year ago due to the low reference base, 7% fewer loan contracts were concluded. The forecast of Eesti Pank expects the recovery of the housing loan market to continue and the turnover of housing loans to rise by approximately 7% in 2011, but will nonetheless only reach the level of 2003. As the volume of new housing loans has been smaller than amortisation of the existing loan stock, the total stock of housing loans has dropped by 2.2% over the year. Considering the low borrowing activity, the loan portfolio of banks will shrink also in 2012.

Private consumption is financed mainly with savings, as indicated by the fact that the stock of short-term household loans in the loan portfolio has shrunk by 9% over the year. In April, the monthly turnover of consumer credit was still lower than last year, having decreased by 5% year-on-year. Only the car lease market has bounced back: twice as many vehicles were sold in the first four months of 2011 than in the same period last year. Consequently, the lease turnover had increased by 83% in April 2011 from a year earlier, though not reaching the pre-crisis levels yet. Consumer credit still mostly consists of overdraft facility and credit



Sources: Land Board, Statistics Estonia, Eesti Pank



card loans that comprised approximately two thirds of the 70 million euro turnover in April. Considering that households' propensity to save is abating and consumption is picking up, growth in the turnover of consumer credit is expected to recover by the end of 2011. However, as the amortisation of earlier loans is fast, the portfolio of consumer credit will shrink further this year.