IV SECURITIES AND MONEY MARKET

MONEY MARKET

At the end of 2005, the European Central Bank started to raise monetary policy interest rates again after five years and did it twice with a three-month interval: on 6 December 2005 and on 8 March 2006 by a total of 50 basis points. In Estonia, the development of money market interest rates has remained in line with the interest rate changes in the euro area. As the increase in interest rate quotations in Estonia and the euro area occurred at different times, the difference between **money market interest rates** even turned negative for a while during the weeks preceding the decision to increase monetary policy interest rates (see Figure 4.1).

In the middle of April, the difference between the money market interest rates in Estonia and in the euro area stabilised within the range of 6–14 basis points. This is comparable to the September 2005 level before the expectations of an interest rate rise started to increase. Also, the difference in interest quotations, which form the basis for future Estonian kroon and euro transactions (forward difference) has retained previous price differences (see Figure 4.2). Thus, the liquidity of the Estonian kroon has remained stable, and there have not been any problems with the kroon liquidity either.

The continuously high confidence of international financial markets in investing in Estonia is also reflected in the convergence of long-term interest rates with the euro area interest rates. The **yield of the five-year Estonian Government Eurobond** has been moving in line with the yields of government bonds issued by other European countries. The difference between the yield of Estonian Eurobonds and German bonds with comparable maturity reached an average of 14.5 basis points in the first half of 2006, whereas the difference with comparable Austrian bonds stood at an average of 3 basis points (see Figure 4.3).

The money market turnover has not changed significantly, except for the large turnover of derivatives in the past half-year, which stemmed from the large-scale currency exchange transactions between a local bank and its parent bank. Excluding these transactions, the turnover of derivatives has remained relatively stable. During the last half-year, its share accounted for approximately 33% of the total turnover of money market loans, whereas non-residents' transactions comprised nearly half of that. The turnover of short-term kroon loans formed about a quarter of the total money market turnover, of which transactions related to non-residents comprised 90% with Swedish and Finnish banks prevailing.

BOND MARKET

The domestic bond market has significantly revived owing to the still expansive environment. In March 2006, the growth of the **primary bond market** turnover accelerated to 57% (see Figure 4.4). As a result, bond market capitalisation increased 45% compared to a year ago, reaching 5.3 billion kroons, i.e. 3.1% of GDP, by the end of March. The market expanded because of a 75% growth in the volume of resident companies' bond issues. The volume of bonds issued by non-financial sector companies again multiplied. Though the volume of bonds issued by credit institutions increased by more than a half, the growth of the entire market outpaced that and at the end of March the stock of bank bonds comprised 36% of the total bond market capitalisation.

Thanks to the boost in the primary bond market turnover, also the **secondary bond market** picked up pace, growing by 2.8 times, year-on-year, by the end of the first quarter (see Figure 4.5). The average daily turnover increased from 7.2 million kroons the year before to 19.9 million by March as the sum of four consecutive quarters. 42% of the transactions made through the Estonian Central Register of Securities were performed with bonds issued by non-residents, and 9% of these comprised bonds registered in the Latvian Central Depository and 8% in the Lithuanian Central Securities Depository.

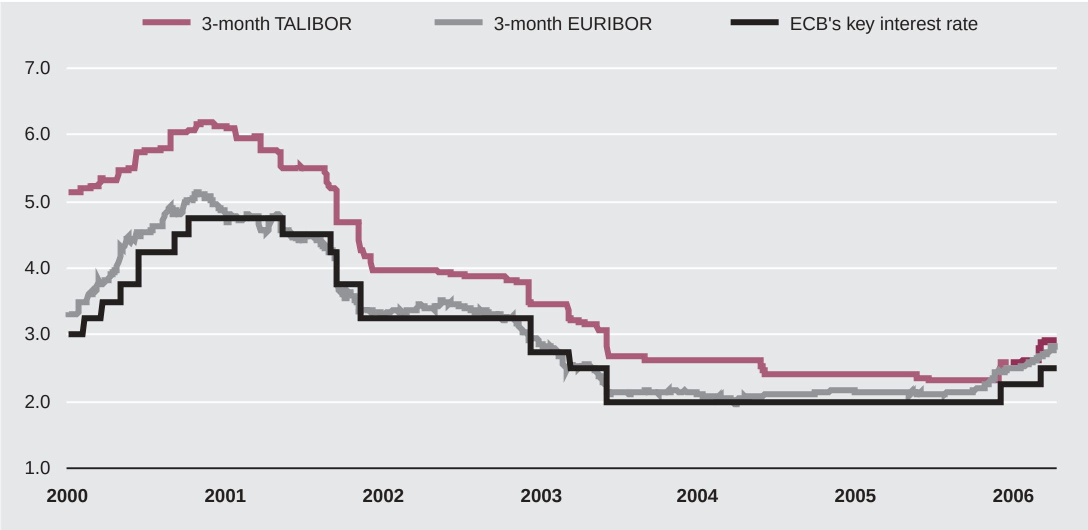

Figure 4.1. Money market interest rates in Estonia and in the euro area (%)

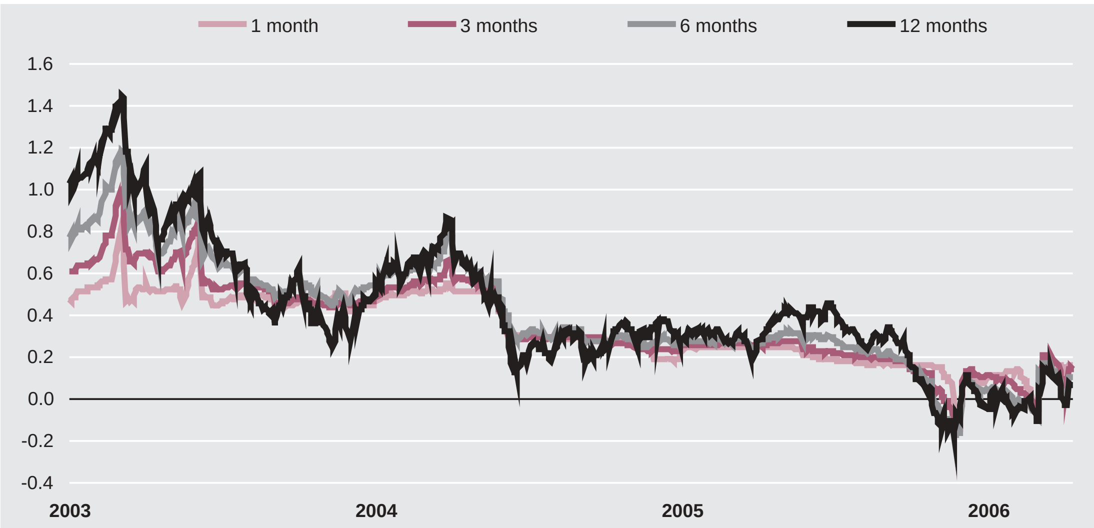

Figure 4.2. Difference between money market interest rates in Estonia and in the euro area (percentage points)

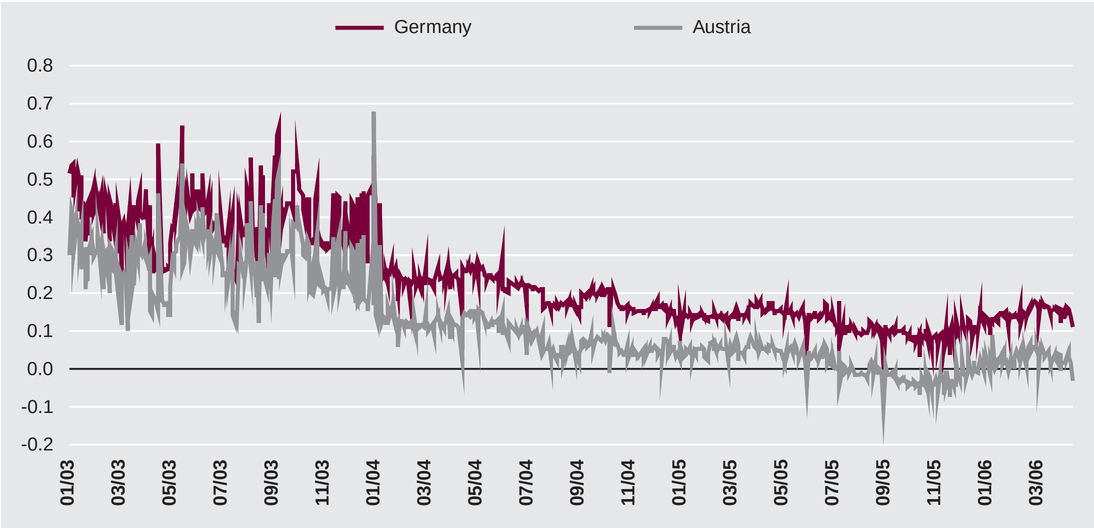

Figure 4.3. Yield difference between Estonian Government Eurobonds and respective bonds in Austria and Germany (percentage points)

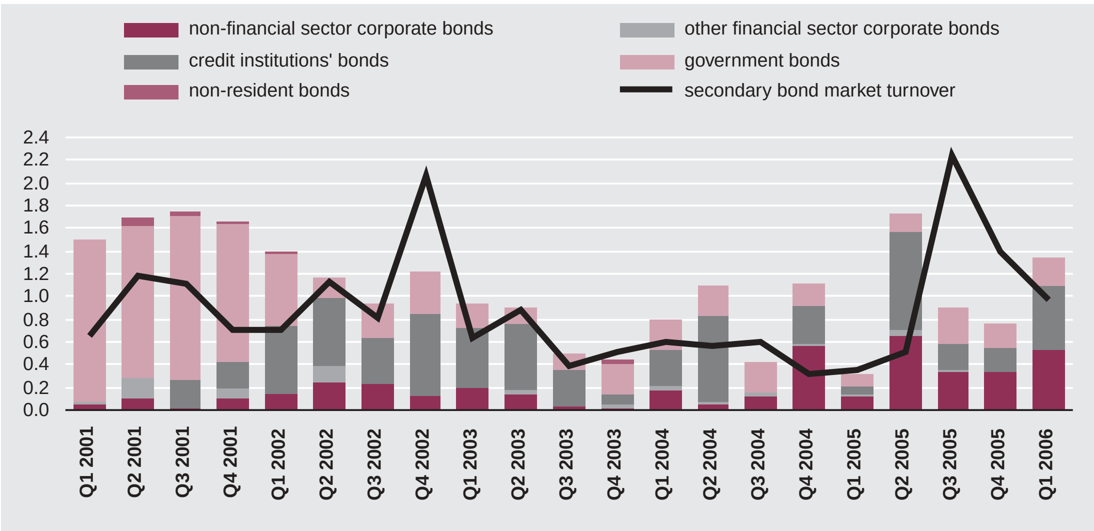

Figure 4.4. Volume of quarterly issued bonds and secondary bond market turnover (EEK bn)

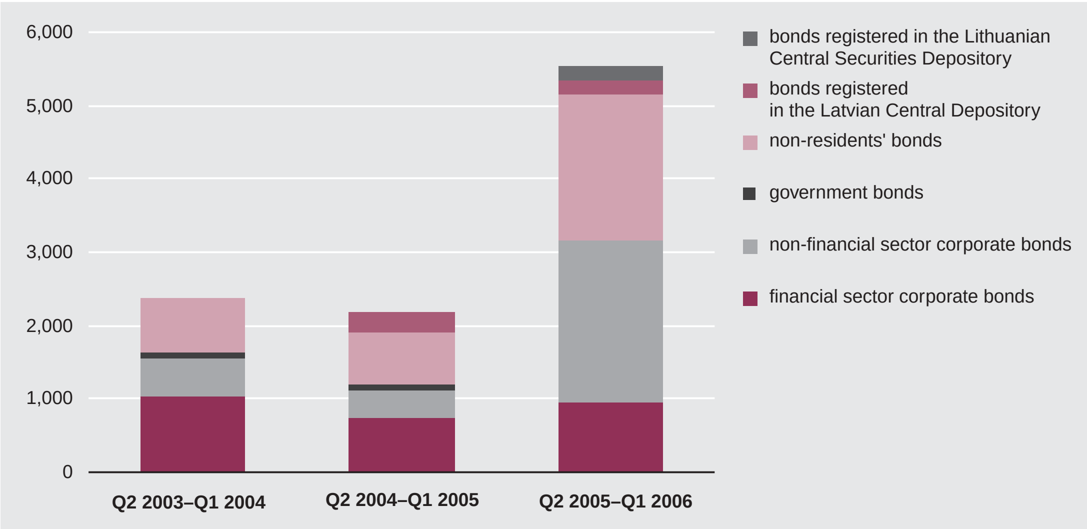

Figure 4.5. Structure of secondary bond market turnover (EEK m)

The turnover of non-financial sector bonds had grown the fastest (over seven times) by March as the sum of four consecutive quarters.

In November 2005, two debt securities were added to the bonds of companies listed on the stock exchange[1]: the bonds of Balti Investeeringute Grupi Pank AS (BIG) and Sportland International Group AS. Hence, at the end of March 2006, the market value of the bonds of eight companies listed on the Tallinn Stock Exchange amounted to 0.7 billion kroons, i.e. 13% of the total bond market volume. Although listing company bonds on the stock exchange has become more frequent, they are still mainly acquired for holding. Contrary to the robust growth of bonds traded on the over-the-counter market, no trading with bonds listed on the stock exchange could be witnessed during the past half-year (except for one transaction).

STOCK MARKET

The rapid rise on the **stock markets of Central and Eastern Europe and Russia**, which commenced at the beginning of 2005, slowed down slightly in autumn (see Figure 4.6). In October and March 2006, the correction on these markets remained more short-lived than expected. The increase in stock prices continued due to the growth potential of these countries as well as the shrinking risk margins, but also because of the relatively low level of key interest rates and the rise in raw material prices.

By the end of April 2006, the Russian stock market had experienced the strongest growth, which reached nearly 147%. The stock exchanges of Poland and Hungary followed with 70% and 49%, respectively. Czech, Latvian and Croatian stock market indices have moved in line with the euro area indices (annual growth over 30%). Similarly to the situation on the Estonian stock market, the Lithuanian market's growth rate has also slowed down, reaching only 16%, which is modest compared to other developing markets. Analysts are moderately optimistic about the market growth of Eastern and Central Europe and Russia based on the potential of these regions and the possible enlargement of the EU (Bulgaria, Romania).

[1] AS SBM Pank, AS Eesti Post, AS Fenniger, LHV Ilmarise Kinnisvaraportfelli OÜ, AS Sampo Pank and AS Tallinna Sadam.

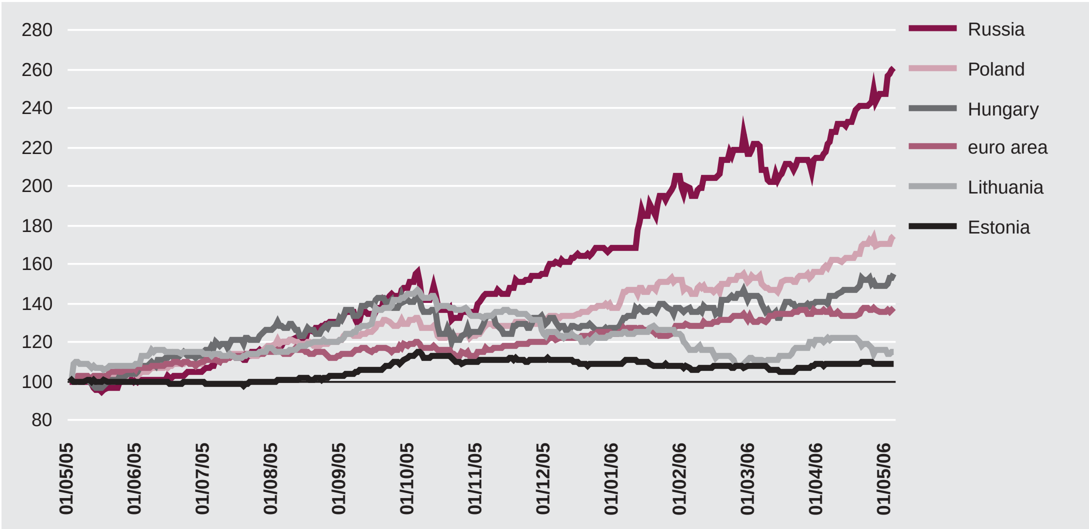

Figure 4.6. Dynamics of stock exchange indices of the new EU Member States, the euro area and Russia (points; 01/05/2005 = 100)

Source: EcoWin AB

The most significant event of the last half-year on the **Tallinn Stock Exchange** was listing the stocks of AS Tallink Group, the most rapidly developing shipping company on the Baltic Sea, on the primary list of the stock exchange (see Figure 4.7). Trading with shares started on 9 December 2005. As a result, **stock market capitalisation** shot up to 47 billion kroons, i.e. 28% of GDP, by the end of March.

Owing to the takeover bid for Hansapank and the listing of new stocks on the Tallinn Stock Exchange, the **stock index OMXT**[2] reached its record level with 700 points on 4 October 2005 (see Figure 4.8). By the end of September, the year-on-year index growth amounted to 90%. After that OMXT underwent a correction characteristic of extremely rapid growth. By the beginning of May 2006, the year-on-year index growth decreased to 9%, a level similar to economic growth.

Mainly because of the listing of new stocks on the stock exchange, the **average daily turnover** of transactions on the stock exchange reached 43 million kroons in the past half-year. This is close to the year-ago level if excluding the record months related to the takeover transactions of Hansapank. The main driving force was trading with the shares of Tallink, forming 37% of the stock exchange turnover. Other more liquid securities at that period were the shares of AS Eesti Telekom and AS Tallinna Vesi, comprising 23% and 16%, respectively, of the total turnover.

191 stock exchange members were entitled to act as brokers; three of them are temporarily inactive. 12 stock members trade from abroad. In March, transactions brokered by AS Suprema Securities and Hansapank again made up the majority with 94% of the total value of transactions as a sum of four consecutive years.

[2] As of 3 October 2005, OMX harmonised the index name structure for all OMX exchanges, including in Tallinn. The new name of the Tallinn Stock Exchange index is OMX Tallinn (OMXT).

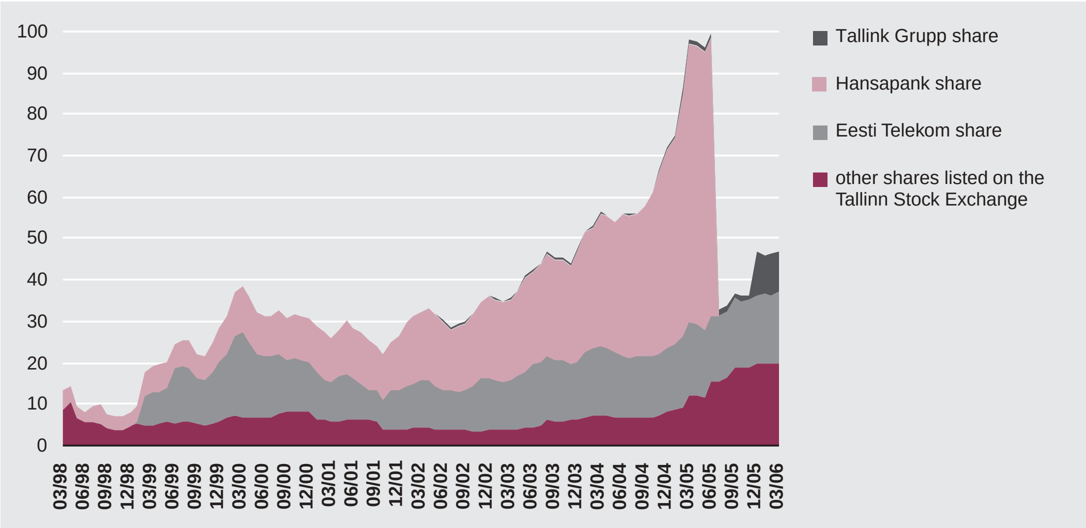

Figure 4.7. Market capitalisation of shares listed on the Tallinn Stock Exchange (end of month; EEK bn)

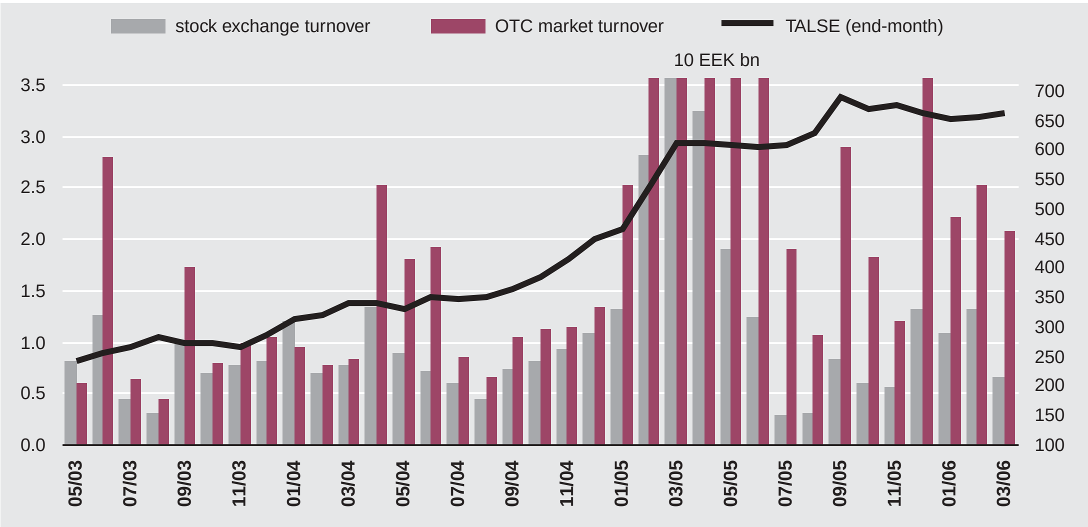

Figure 4.8. Stock turnover on the Tallinn Stock Exchange and OTC market (EEK bn; left scale) and Tallinn Stock Exchange index TALSE (points; right scale)

The all-time record level of **non-residents' investments**, which accounted for 87% in the capitalisation of shares listed on the stock market before the final takeover of Hansapank, dropped until January 2006, but has started to recover again (see Figure 4.9). In the first quarter, foreign investors mainly invested in the shares of Baltika AS and Klementi AS. At the end of March, the majority (41% of the shares' market value) belonged to Estonian investors. Resident investors were primarily financial and non-financial sector companies, whose investments in listed shares increased to 16.6 billion kroons, i.e. 34% of the total stock market capitalisation. Within a half-year, the investments of retail investors on the stock market increased by one-third up to 2.1 billion kroons, i.e. to over 4% of the total value of listed shares.

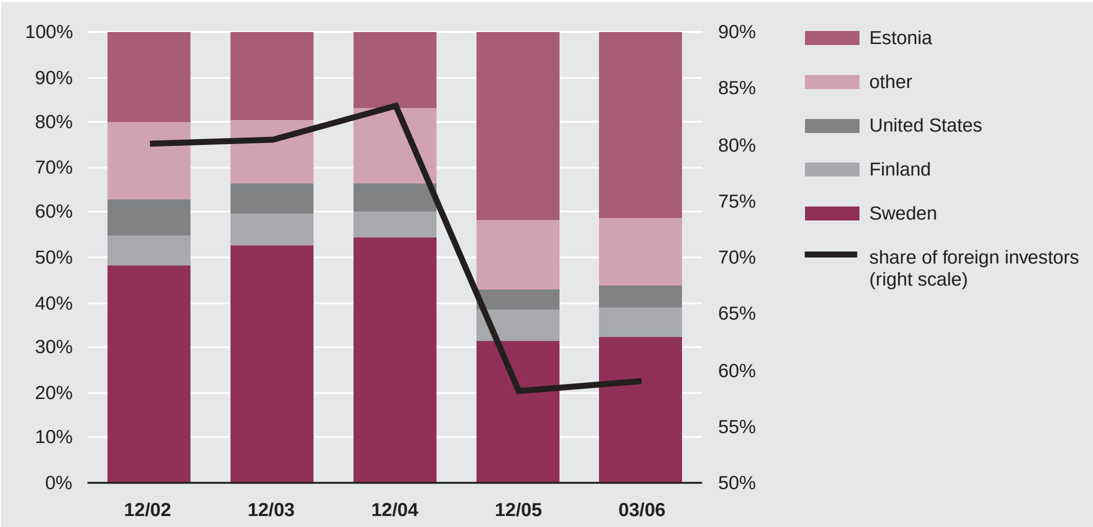

Figure 4.9. Structure of investors by residency and share of foreign investors of shares listed on the Tallinn Stock Exchange (%)