

Eesti Pank
Bank of Estonia



On Estonian economy

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Fundamental starting point in Estonia before EU accession



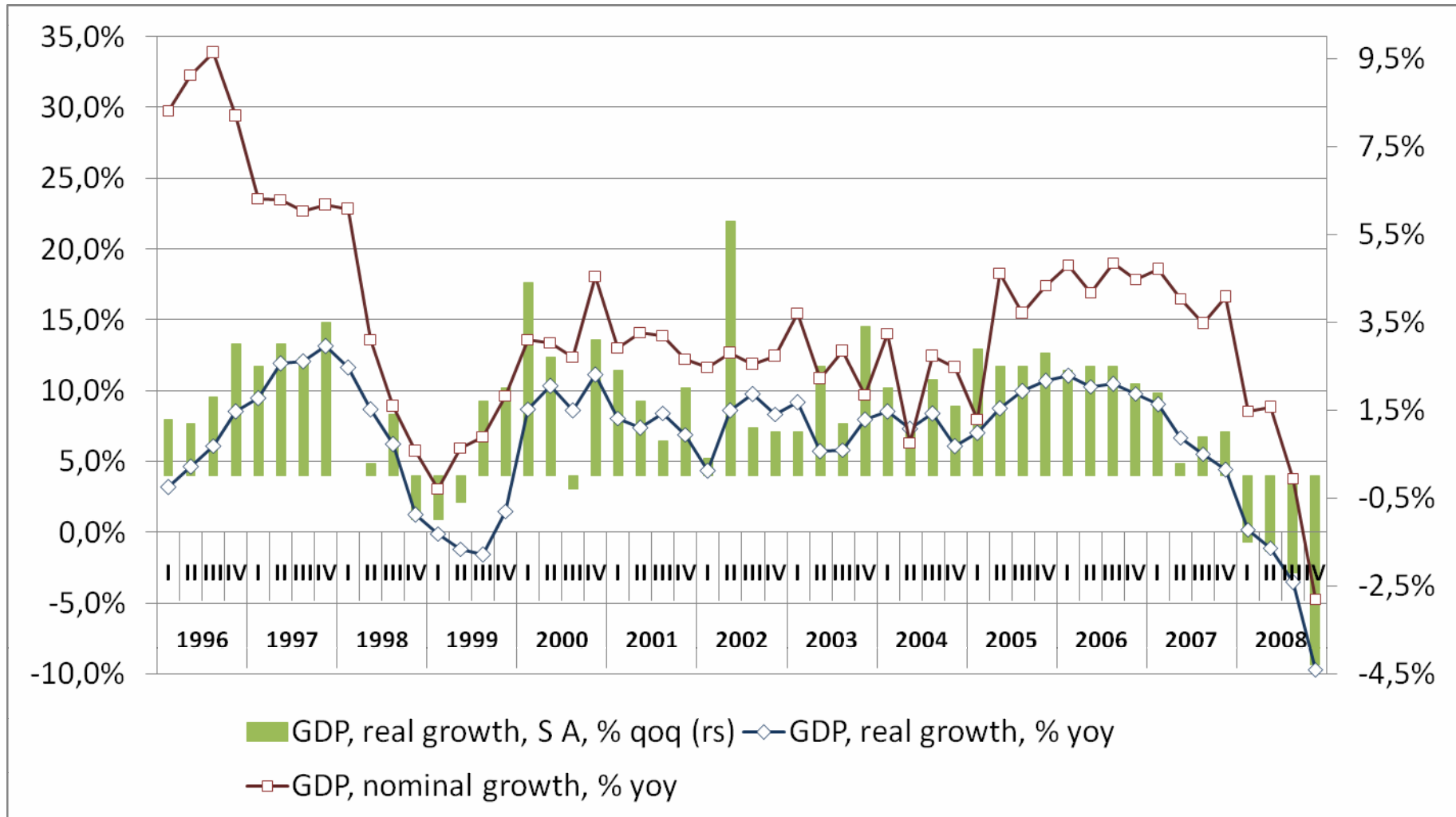
- 12 years of experience under currency board/fixed exchange rate
 - Not always easy times (early banking crises, Russian crisis etc)
- Highly integrated banking market after 2000
 - Essentially all resident deposits in Nordic banking groups
- High level of labour market flexibility
- Very high openness to trade and investment

The drivers of economic performance during the boom years



- EU accession and favourable external environment 2005-07
 - Estonia
 - Enhanced labour mobility and strengthened wage expectations
 - Increased productivity (incl in exporting sector)
 - Fastened financial integration, lower interest rates and longer maturities in lending
 - External world
 - Period of relatively (ex post: excessively) fast growth, abundant credit and low interest rates
- Adjustment of imbalances in Estonia under way already in 2007

The result: already high growth added few notches for a while





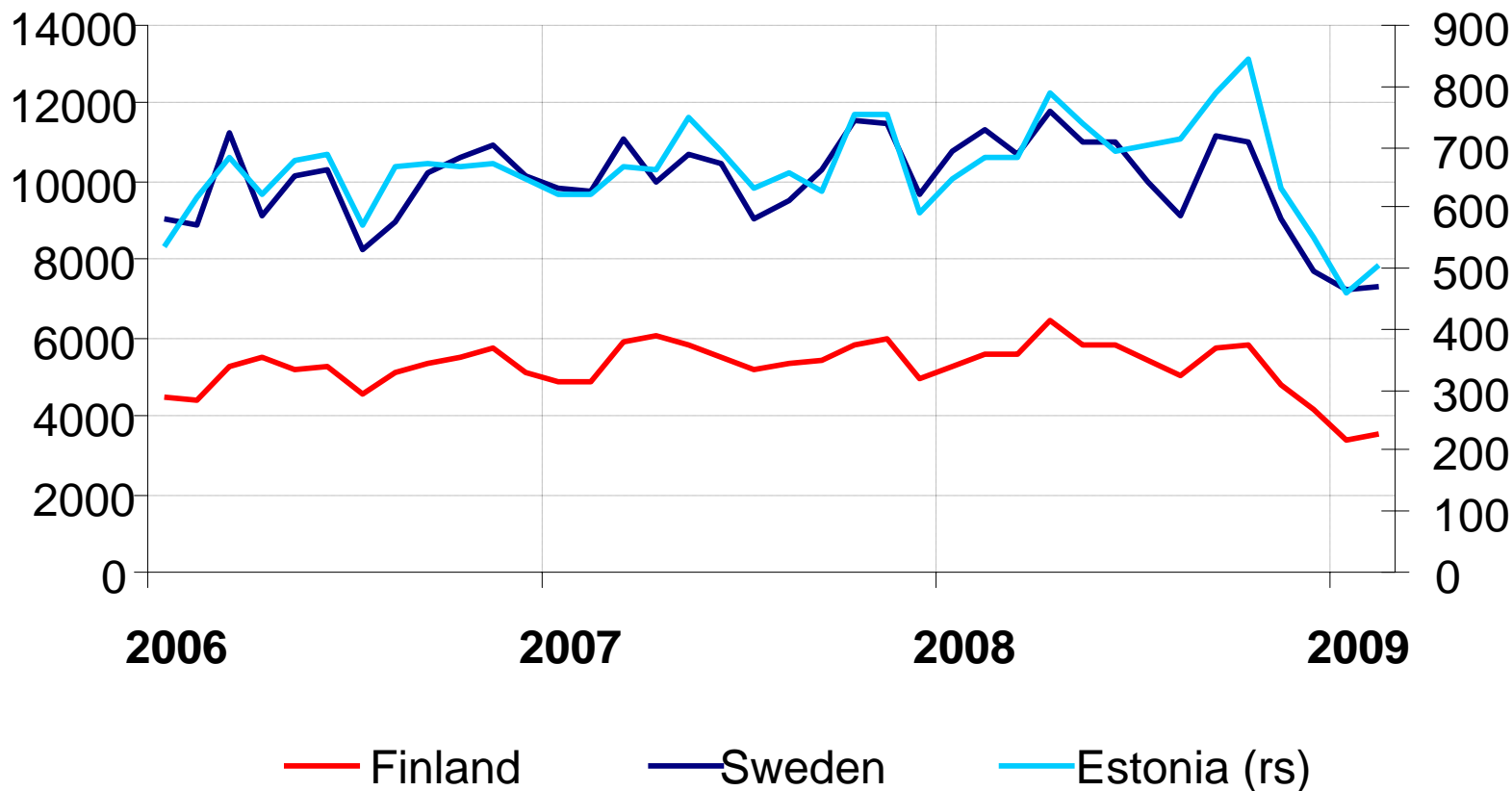
Main issues today

- The global economic situation is bad. How bad?
- How to adjust to the bad situation?
 - Adjustment from previous imbalances was well underway
- Policies?
 - Is it temporary or permanent shock in abroad?

Estonia's exports behaves very similarly to Nordic exports



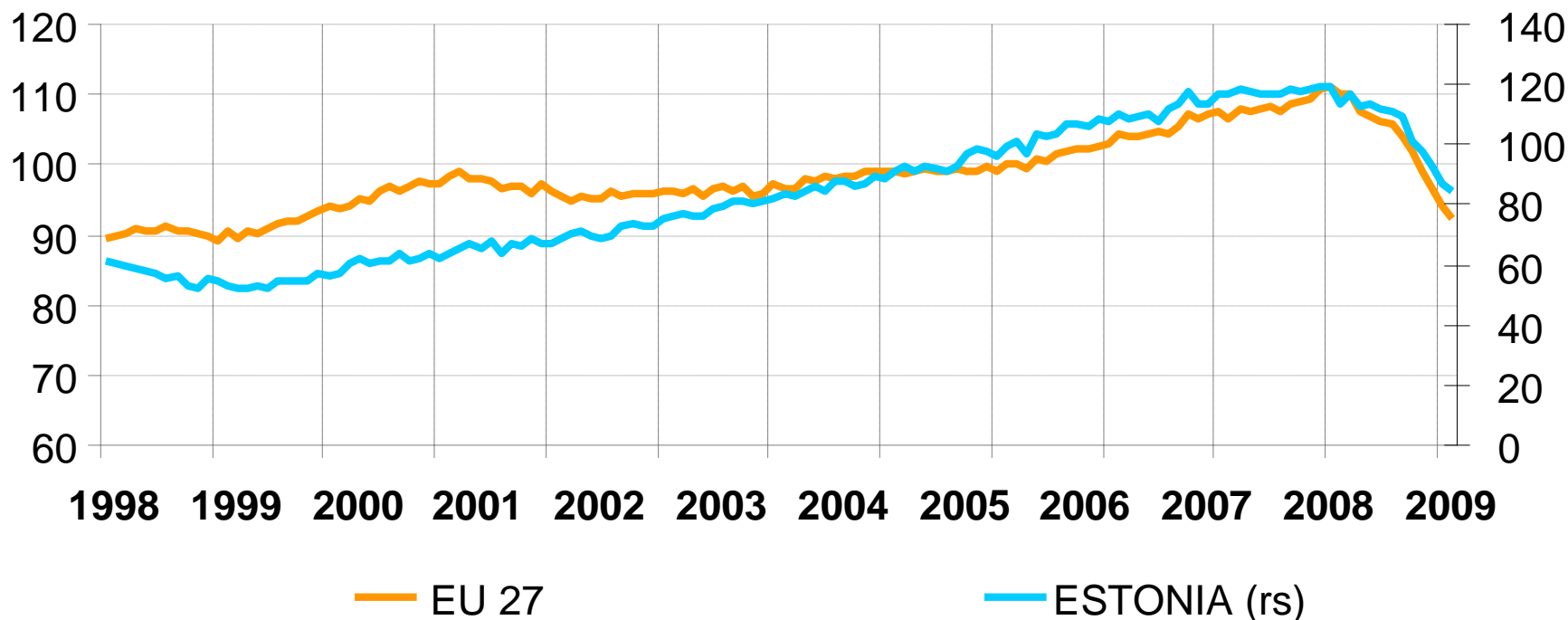
Exports (EUR million)



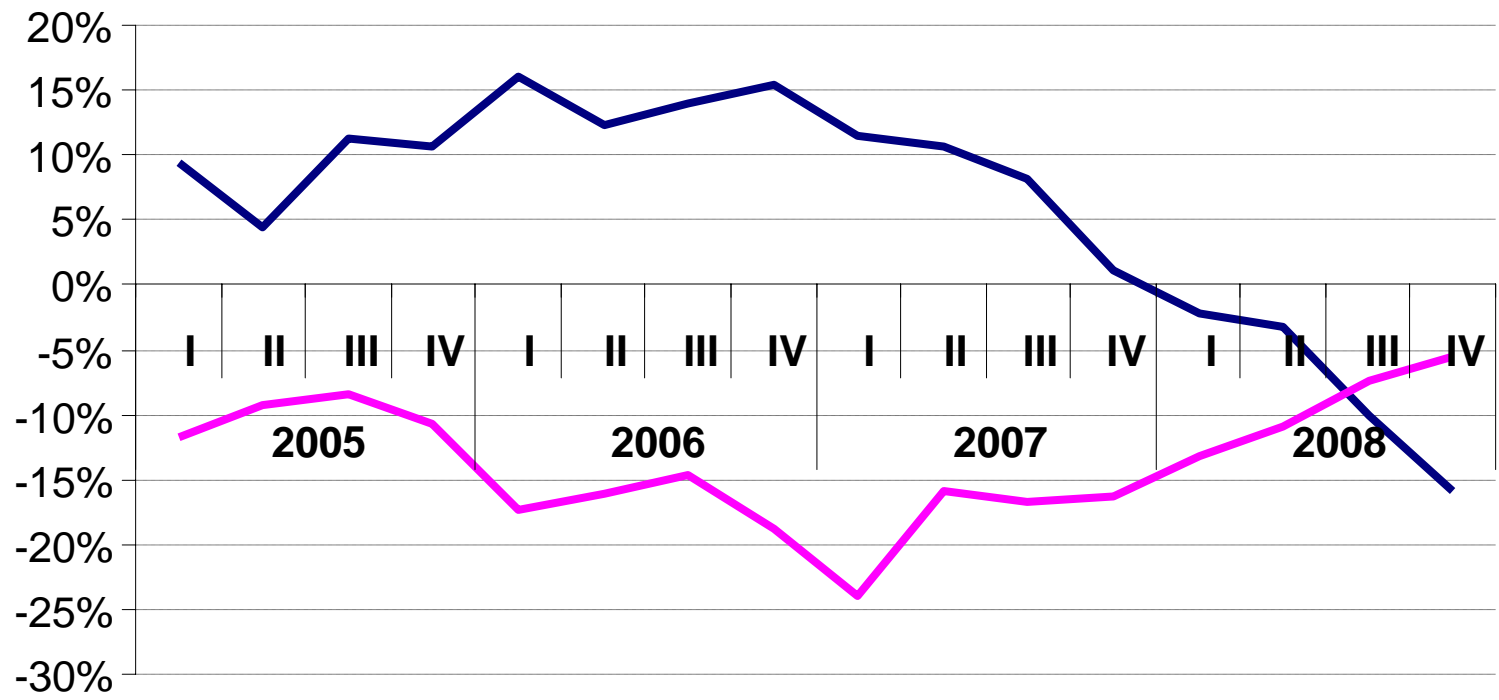
Industrial production has fallen very sharply in Estonia and in the EU. Is the new level going to persist?



Industrial production (2005=100)



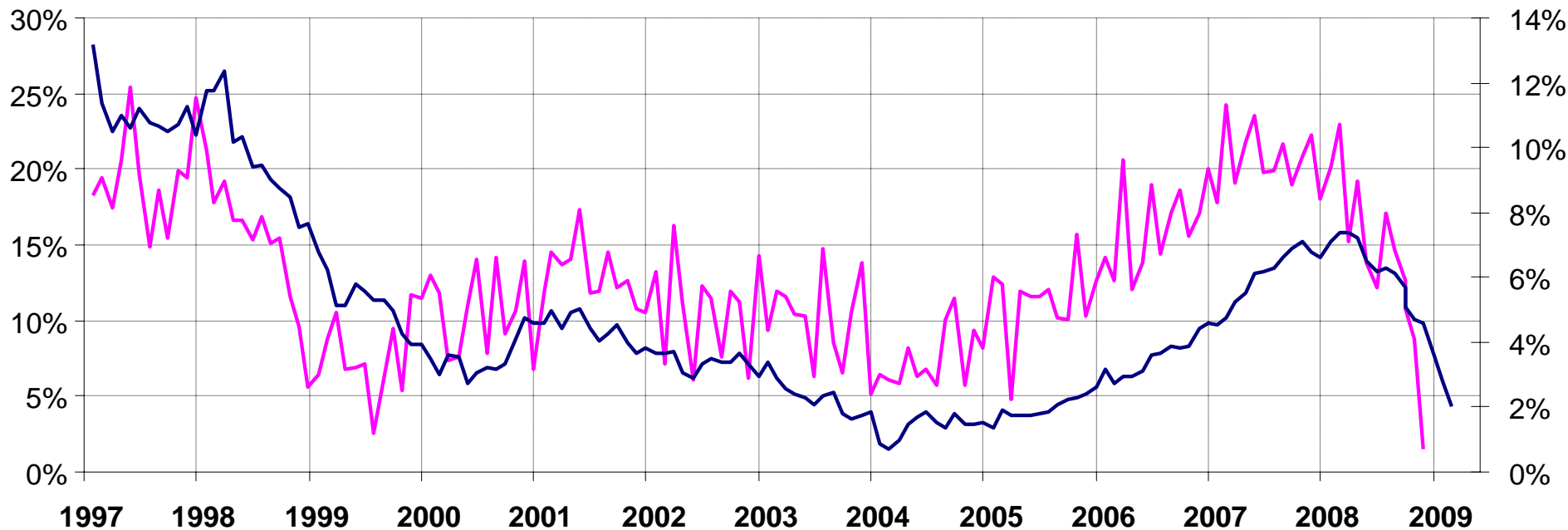
Rapidly declining consumption and investment have reduced the current account deficit. Thus, the economy is no longer so vulnerable.



— Domestic demand growth, % y/y — Current account deficit, % of GDP

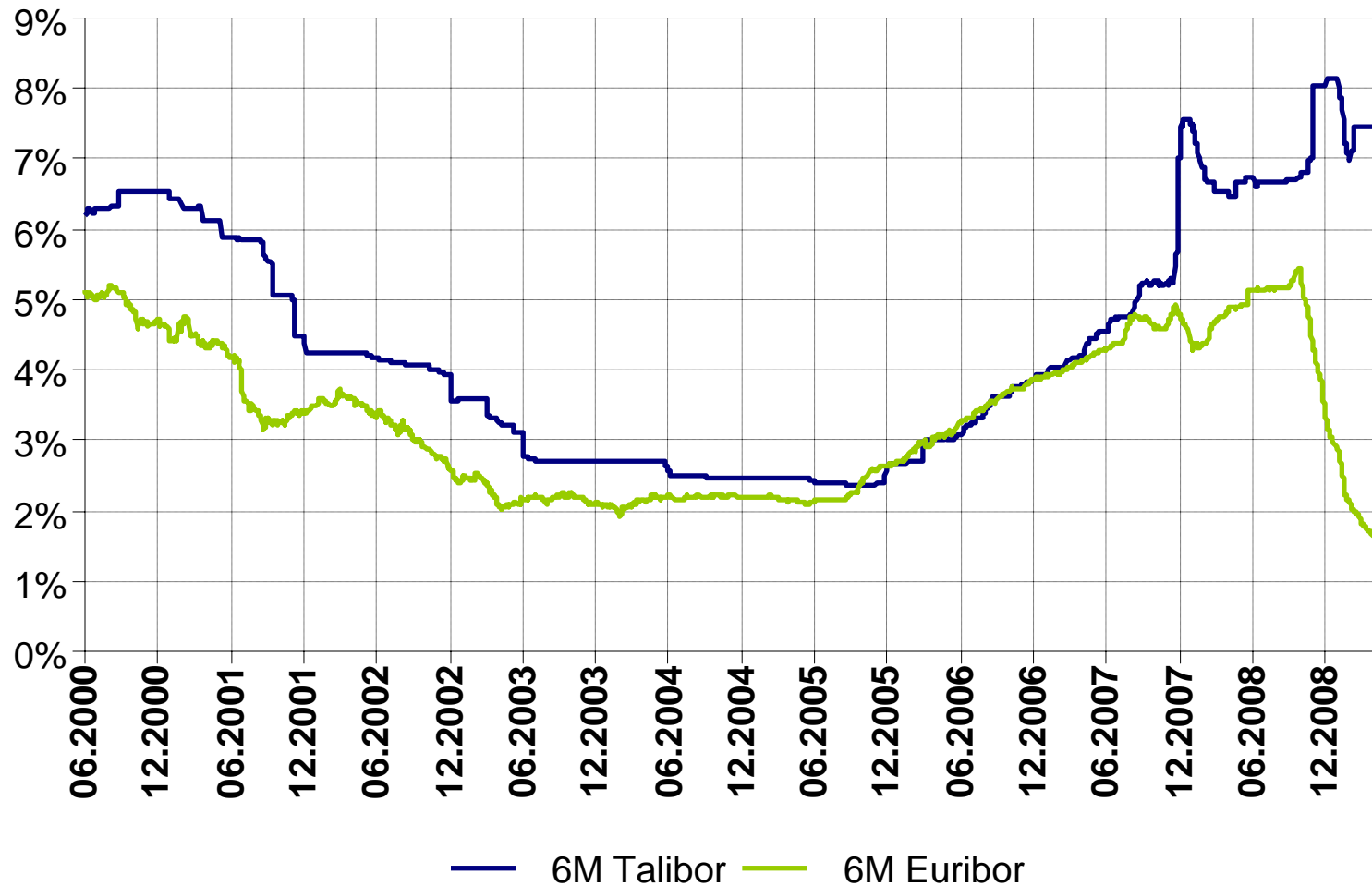
Wages and prices show flexibility:

prices have been declining for the past half a year,
and the Tax Board data show wages started to drop in February



— Nominal growth of gross wages, — Core inflation, % y/y (rs)
% y/y (ls)

However: lack of trust in financial markets persists



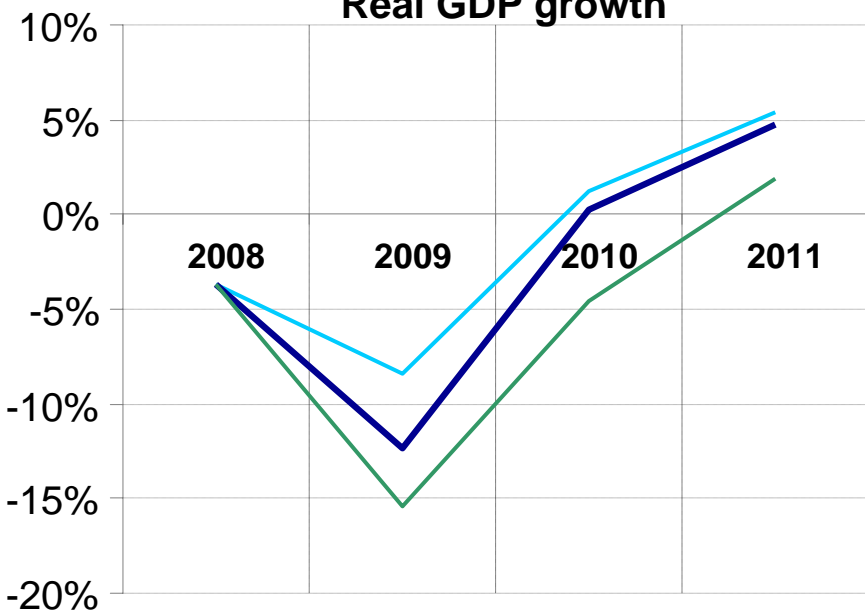
The impact of the current situation on the economic outlook



- The external environment plays an important role in Estonia's development. Unfortunately, it is characterised by great uncertainties.
- Several vulnerabilities have decreased and the economy is proving its flexibility, but distrust in the Estonian economy is still strong.
- The euro will significantly contribute to the improvement of the economic environment, increasing the credibility of the Estonian economy.

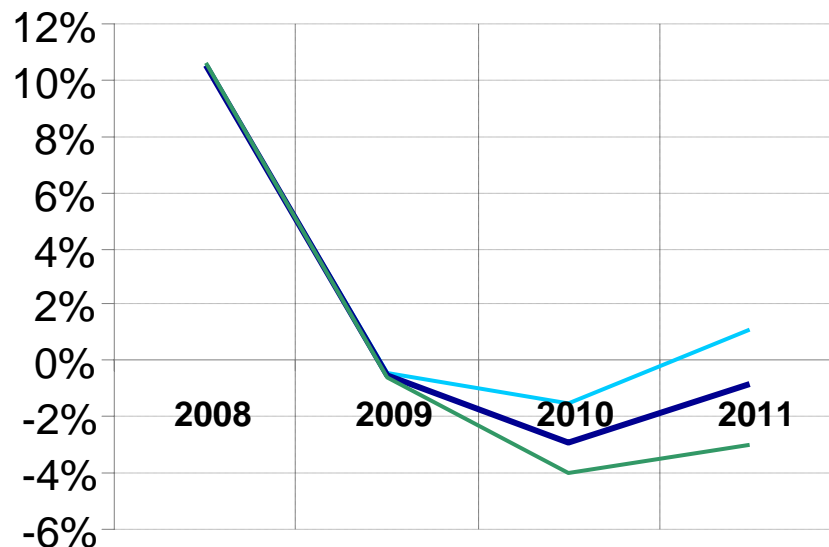
Eesti Pank's forecast

Real GDP growth



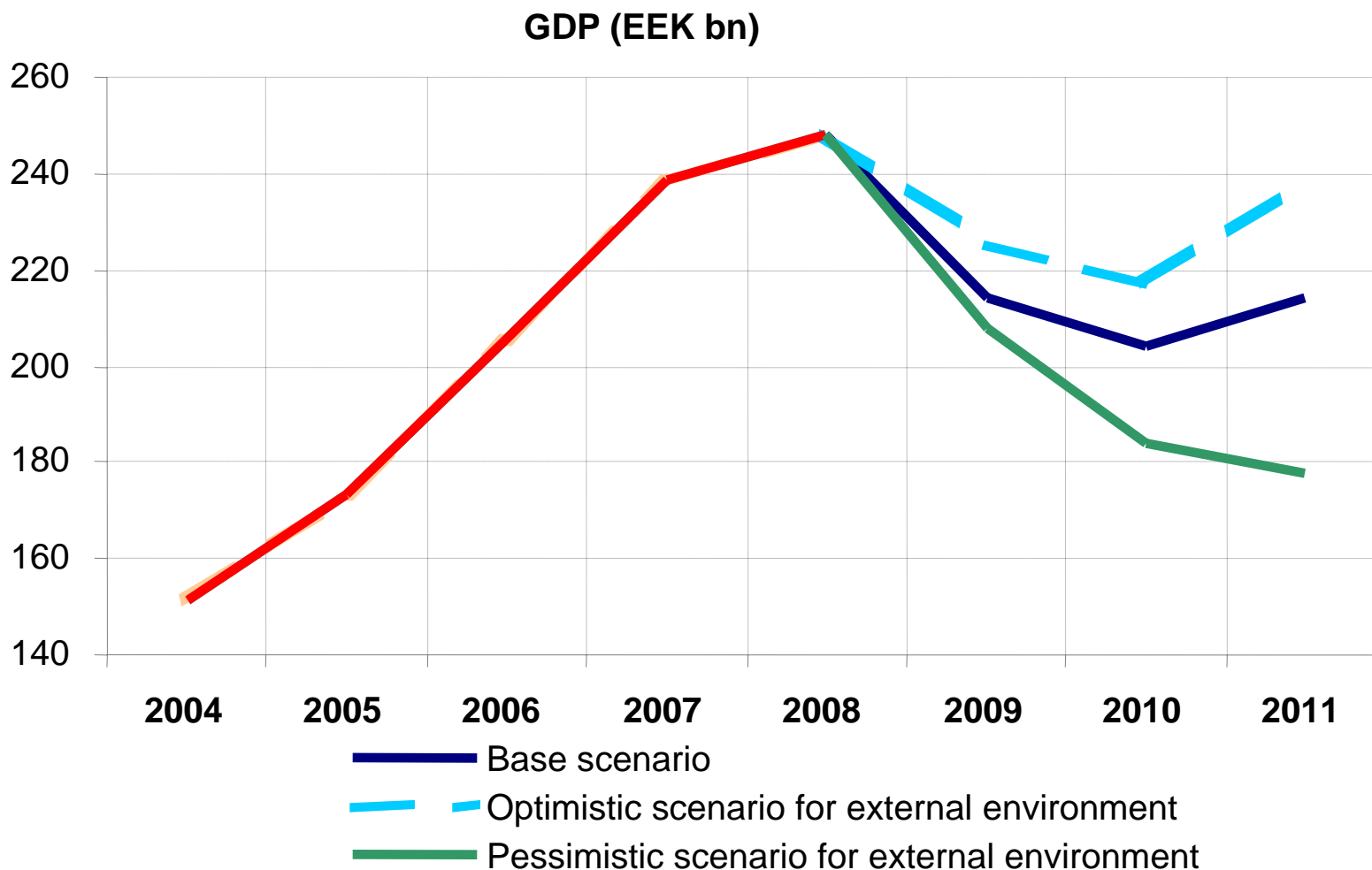
- Optimistic scenario for external environment
- Base scenario
- Pessimistic scenario for external environment

Inflation



- Optimistic scenario for external environment
- Base scenario
- Pessimistic scenario for external environment

Smaller nominal GDP means that problems do not settle automatically



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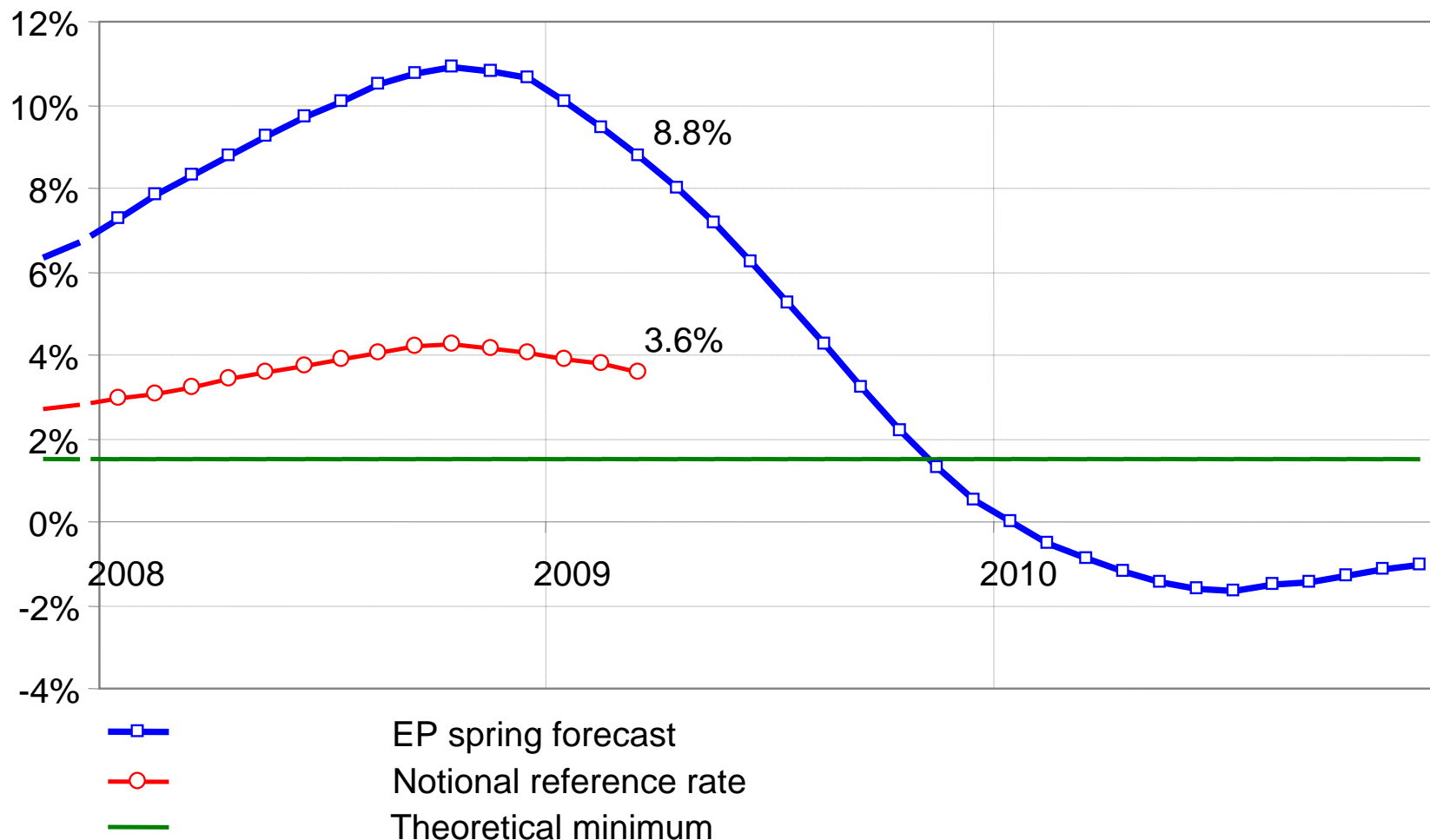
Monetary policy conclusions

The monetary system supports adjustment to changed circumstances



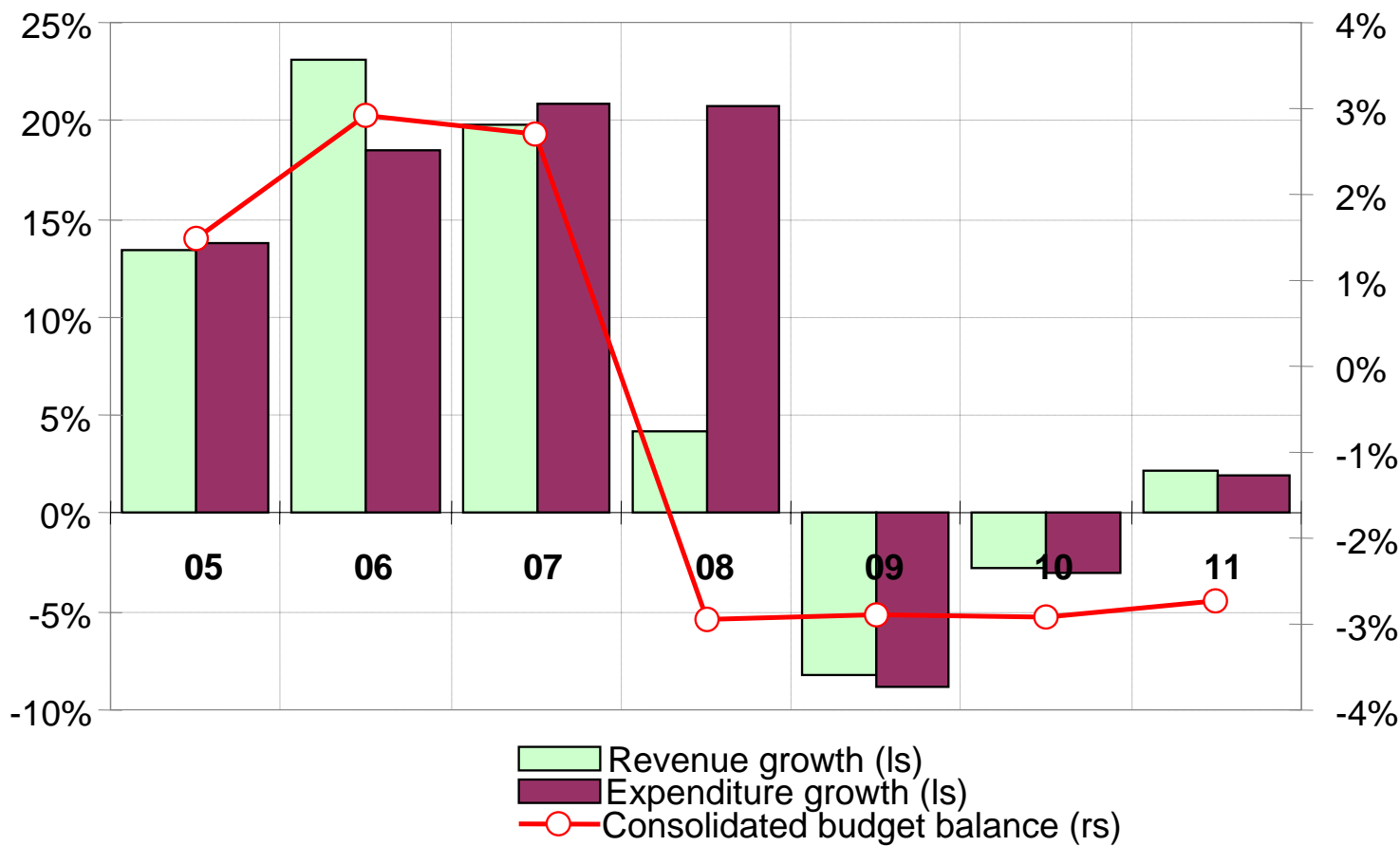
- The ECB's monetary policy has resulted in declining interest rates on euro loans in Estonia as well. Thus, loan servicing costs have lowered considerably.
- Economic restructuring is supported by the currency board, which backs different decisions in the form of a sound currency.
- The recent vast uncertainties in the economy prove once again that moving towards euro adoption is worth any short-time price to be paid.

Possibility of fulfilling inflation criterion high by the end of the year



Years of fiscal surplus gave necessary buffer

- government debt is negligible



Financial sector benefits from European integration



- High level of banking sector integration into the Nordic-Baltic banking sector has been a cornerstone for stability
 - Otherwise weathering global crisis would have been much more complicated
 - The issue of short-term debt is grossly misintepreted, the facts are fundamentally different
- However, high emphasis should be given to EU wide financial market improvenemnt initiatives
 - Incl. How we participate in regional “exercises”

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Thank you!

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