

Eesti Pank

EESTI PANK
ANNUAL REPORT
2012

2013

CONTENTS

FOREWORD BY THE GOVERNOR OF EESTI PANK	6
EESTI PANK'S MAIN OPERATIONS AND ACTIVITIES IN 2012.....	10
THE GLOBAL, EURO AREA AND ESTONIAN ECONOMIES IN 2012.....	20
The global and euro area economies	20
The Estonian economy and financial sector	22
ACTIVITIES AND ACHIEVEMENTS OF EESTI PANK IN 2012	28
1. PARTICIPATING IN THE FORMULATION OF MONETARY AND ECONOMIC POLICY	28
Monetary policy decisions	28
Implementing monetary policy decisions in the euro area and Estonia	30
Monitoring and economic analysis at Eesti Pank.....	35
2. SHARING THE RESPONSIBILITY FOR SAFEGUARDING FINANCIAL STABILITY.....	40
Macro-prudential supervision.....	40
Financial stability assessments in 2012.....	41
BACKGROUND: The single supervisory mechanism for banks	44
3. DEVELOPMENT, COMPILATION AND DISSEMINATION OF STATISTICS	46
Financial sector statistics.....	46
External sector statistics.....	47
General economic statistics.....	48
4. PAYMENT AND SETTLEMENT SYSTEMS	50
Settlements in the payment and settlement systems managed by Eesti Pank.....	50
Development of the financial market infrastructures	51
5. CASH.....	55
Banknotes in circulation in the euro area and Estonia and their structure	55
Expert analysis and handling of cash	56
Preparation of new banknotes and coins	57
6. INTERNATIONAL PARTNERSHIPS AND PUBLIC COMMUNICATIONS	59
International cooperation	59
Accountability of the central bank.....	62
Public relations.....	64
7. GOVERNANCE, ORGANISATION AND HUMAN RESOURCES POLICY	66
Supervisory and governing bodies of Eesti Pank.....	66
Development of the management system and work organisation of Eesti Pank	68
Risk management	68
Human resources at Eesti Pank.....	68

ANNUAL ACCOUNTS OF EESTI PANK FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012	74
APPENDICES	104
DECREES OF THE GOVENOR OF EESTI PANK 2012	104
DECISIONS OF THE SUPERVISORY BOARD OF EESTI PANK IN 2012.....	107
EESTI PANK PUBLICATIONS 2012	108

FOREWORD BY
THE GOVERNOR
OF EESTI PANK

FOREWORD BY THE GOVERNOR OF EESTI PANK

The year 2012 was the second that Eesti Pank spent as the central bank of a country in the euro area. We have by now adapted well to our new operating environment and have been able to make an active contribution to the development of the euro area in partnership with the central banks of the other euro area countries.

The main task of the central bank is to maintain price stability. As the central bank of a country in the euro area, Eesti Pank carries out this responsibility jointly with the other central banks of the Eurosystem, which comprises the European Central Bank and the national central banks of the countries of the euro area. The main objective is to keep consumer price inflation in the euro area as a whole below but close to 2% per year. Inflation in Estonia is slightly higher than the euro area average, but this is to be expected because the economy is growing faster than that of the euro area as a whole as relative income levels converge.

At the start of 2012, inflation in the euro area stood at elevated levels above 2% for a time, though core inflation and the inflation expectations of the markets remained firmly anchored below 2%. Inflation started to slow down in the second half of the year and at the start of 2013 it had passed below 2%. Given that the realisation of some risks to economic growth in the euro area would lead to a slowing of growth and a weakening of inflation pressures, the key interest rates were cut on 5 July to their lowest ever levels, where they remained for the rest of the year. Under normal circumstances, this would have been sufficient to have an impact on prices and economic activity.

Unfortunately however, financial markets were under great stress at the start of the year, and non-standard measures were required to deal with this. In order to underpin the liquidity needed by the banks at a time when interbank lending was disrupted, we continued to provide three-year loans in unlimited amounts to banks under very favourable terms. We also broadened even further the range of assets that could be accepted as collateral for Eurosystem credit operations. To calm the fears that had started to emerge in the middle of 2012 about the future of the euro and to strengthen the transmission mechanism of monetary policy, we announced in August that we were prepared to undertake outright monetary transactions. It is important to note that outright transactions can only be made if specific conditions are met relating to the economic stability of the applicant country. Although no outright transactions have been made so far, the programme has had a noticeable positive effect on investor confidence. Financial markets started to stabilise in the second half of 2012, largely thanks to the non-standard measures taken by the Eurosystem and the forceful statements it issued.

These were necessary steps with which the Eurosystem made a major contribution to maintaining stability and confidence in the financial markets. An unfortunate consequence of these measures has been an increase in the risks on the balance sheets of central banks. Eesti Pank needs to deal seriously with risk analysis and increases to buffers in this and the coming years, as the bank's ratio of equity to assets used in monetary policy operations is one of the lowest among the central banks of the euro area.

One of Eesti Pank's main roles is participation in ensuring the stability of the national financial system. The risks to financial stability in Estonia are currently small and the financial sector is in good shape. The main danger stems from the fragmentation in the debt markets of the euro area, which could inhibit economic growth across the whole of the European Union. Confidence, which recovered partially in the markets at the end of last year, could quickly crumble again if there are member states that do not do enough to carry through reforms.

A major step forward was taken in 2012 towards strengthening the financial framework of the euro area. The agreement reached in December to create a single banking supervisory mechanism under the ECB was an important event in the history of European financial integration. However, the proposed European Union banking union clearly requires a single bank resolution mechanism and common system of deposit insurance to be developed further alongside the supervisory mechanism. At the same time, it must be remembered that the exit from the financial and debt crisis is not in the hands of the central banks alone, but also requires decisive action and full implementation of agreements by European governments. Crisis management measures must be accompanied by a focus on the creation of stable foundations for growth in the long term. Among other things, this will require structural reforms to increase the flexibility, competitiveness and employment levels of the economies of the member states.

Alongside our important work together with all our European partners, the central bank has a whole range of other duties. Eesti Pank is the second official compiler of statistics in Estonia alongside Statistics Estonia, and it is the job of Eesti Pank to ensure the secure functioning of the payment and settlements systems used in Estonia and to help to develop them. Eesti Pank is also responsible for satisfying the demand for cash in Estonia and for cash circulation. We carried out all our duties in 2012 in full and without interruption. The main focus in the organisation of work at Eesti Pank in 2012 was on openness and efficiency. Estonia has a small and very open economy and the stability of the Estonian monetary and financial systems depends to a considerable degree on what happens elsewhere in Europe and the world. For this reason we consider it important to draw attention to the economic development of our country both at home and abroad. Members of the Eesti Pank management and other spokespeople took this responsibility seriously in 2012 and communicated the bank's position clearly on a range of questions. Key milestones in public communication were passed with the publication of the VEB-fund audit and the launch of a new version of the bank's website. We also increased the internal openness of the central bank, by adopting a new approach to communicating about changes in the organisation of our work for example.

We reviewed the efficiency of the work organisation and operating environment at Eesti Pank, continuing to emphasise cost-effectiveness, and in 2012 our actual costs were lower than planned. The organisation of procurements by the bank was also updated in 2012. We have confirmed a budget for 2013 where our costs other than cash-related costs grow by about three percentage points less than the Estonian economy as a whole at a time when the amount of work we do has in no way diminished. In October 2012, structural reforms were started in Eesti Pank with the aim of making management more efficient and increasing synergies between different departments, and this resulted in the bank's 13 departments being reduced to 11. In conclusion, 2012 was a successful year for both Eesti Pank and the Estonian economy, and we can feel proud of what we have achieved. However, we will need to keep working hard to maintain our success and we will need to be aware of the risks to it.

Finally, I would like to emphasise that the change of Governor in the middle of 2012 went very smoothly for Eesti Pank and I am grateful to Andres Lipstok and all my colleagues who helped me to settle into my new position.

 Governor of Eesti Pank,
Ardo Hansson

EESTI PANK'S
MAIN OPERATIONS
AND ACTIVITIES
IN 2012

EESTI PANK'S MAIN OPERATIONS AND ACTIVITIES IN 2012

Eesti Pank is a national central bank in the euro area. The principle is followed in the Eurosystem¹ that important decisions that affect the euro area as a whole are taken jointly in the Governing Council of the European Central Bank. These decisions are then implemented individually through the National Central Banks of the euro area.

Two important principles follow from this.

1. As a member of the Governing Council of the European Central Bank, the Governor of Eesti Pank is party to all the important decisions that affect the euro area.
2. Implementing the decisions of the Eurosystem in Estonia is the job of Eesti Pank, not the European Central Bank.

As well as areas that the Eurosystem manages jointly, activities that are the responsibility of each nation individually are handled by the national central bank.

The Governor of Eesti Pank and the central bank itself act independently and are not allowed to take orders or instructions from the government or other interest groups outside the bank in the performance of their statutory duties. Self-government and independent analysis give the central bank the best chances of fulfilling its duties.

IN 2012 EESTI PANK FOCUSED ON THE FOLLOWING AREAS.

1. Participating in the formation and implementation of monetary policy in the euro area

The primary function of Eesti Pank is to contribute to **price stability within the euro area**. This leads to the objective of keeping the consumer price increase in the euro area below but close to 2%. At the start of 2012, inflation in the euro area was above its target but this did not lead to any rise in inflation expectations. The rise in prices started to slow in the second half of the year and at the start of the new year the inflation rate was below 2%. The fact that Estonia's inflation is slightly higher than the euro area average is to be expected and is a consequence of faster economic growth and harmonisation of relative incomes with those of the euro area.

Eesti Pank serves the function of ensuring price stability by **formulating the single monetary policy together with other members of the euro area**. The Governor of Eesti Pank participates in the adoption of monetary policy decisions and other important decisions in the Governing Council of the European Central Bank². Experts from Eesti Pank participate in the preparation of analyses and reports that are used as an input for decisions. All important decisions are discussed thoroughly before they are taken.

The second Longer Term Refinancing Operation (LTRO) with a three-year maturity was held in February and was one of the largest of the **monetary policy operations for implementing the single monetary policy** in the euro area. Monetary policy goals were also pursued in 2012 through the second Covered Bond Purchase Programme (CBPP2). The last transactions of the Securities Market Programme, SMP,

¹ The Eurosystem is the system of European central banks containing the European Central Bank and the central banks of the EU countries that have adopted the euro.

² The Governing Council of the European Central Bank comprises the governors of the national central banks of the euro area countries (17 central banks) and the Executive Board of the European Central Bank (6 members).

were made at the start of the year. No transactions were made in the Outright Monetary Transactions, OMT, programme announced in August, but the programme had a significant positive impact on financial markets, as the Eurosystem had shown it was willing to make unlimited purchases within it. Investors gained confidence that the Eurosystem would intervene directly in the market if necessary. Largely under the influence of the Eurosystem's non-standard measures and strong statements, confidence began to grow in the second half of 2012 and the financial markets to stabilise.

The banks operating in Estonia made only modest use of the refinancing facilities offered by the Eurosystem in 2012. The liquidity management of the bank groups is largely centralised and local banks have sufficient liquidity buffers. The banks continued to be more interested in depositing money at the central bank, using both the deposit facility and the weekly deposit auctions.

Eesti Pank had the following duties in monetary policy in 2012:

- Improving monitoring and analysis of the economy and financial markets in the euro area
- Expanding the data management infrastructure used for analysis of the euro area
- Developing Eesti Pank staff for analysing the euro area economy and preparing decisions on monetary policy
- Improving the formal framework for participation in economic forecasting for the euro area and the models used, and harmonising the Estonian forecasting cycle with that of the Eurosystem
- Working in the research networks of the European System of Central Banks, ESCB (the Macroeprudential Research Network, the Household Finances and Consumption Network and the Competitiveness Network)
- Conducting monetary policy operations with Estonia's transaction partners
- Updating the guidelines and procedures for monetary policy operations between Eesti Pank and the commercial banks
- Enhancing the collateral management system for monetary policy operations
- Participating in developing the operational framework for monetary policy in the Eurosystem

Further information on these matters can be found in the chapters “Participating in the formulation of monetary and economic policy” and “Implementing monetary policy decisions in the euro area and Estonia”.

The foreign reserves and other financial assets managed by Eesti Pank should support the capacity of the Eurosystem to implement monetary policy efficiently, and should ensure that Eesti Pank has the financial strength to carry out its own duties. The existence of the reserves ensures confidence in the monetary system of the euro area and underpins the stability of the Estonian economy and financial system.

The goal of investment of the reserves is to earn a moderate level of stable income while ensuring that the assets are preserved over the long term. The central bank mainly invests in the liquid money and capital markets of developed countries. In order to hedge risks better, the central bank started investing to a very small degree in global stock markets in 2012.

At the end of 2012, Eesti Pank's portfolio of investment assets stood at 319 million euros. During the year a total of 12.3 million euros was earned from investments³ meaning the return on invested assets

³ Not including gold and income from gold.

was 3.72%, which was higher than in 2011 and significantly higher than the return from the money market.

Eesti Pank had the following duties in managing reserve assets in 2012:

- Investing financial assets conservatively, with the main focus on preserving assets and ensuring sufficient liquidity
- Earning sufficient income to cover Eesti Pank's costs by taking the optimal level of interest risk, currency risk and credit risk
- Participating in managing the reserve assets of the European Central Bank
- Diversifying investments in line with market developments

Further information on these matters can be found in the chapter "Implementing monetary policy decisions in the euro area and Estonia" and in the annual accounts of Eesti Pank for 2012.

2. Participating in safeguarding financial stability

One of Eesti Pank's responsibilities is ensuring the stability of the financial system, which the central bank does in close cooperation with the Financial Supervision Authority and the Ministry of Finance.

To this end, the central bank produces analysis and forecasts for the financial sector, assesses risks to the functioning of the whole system and takes the steps necessary to mitigate any risks and vulnerabilities threatening financial stability. Analysis of the financing in the non-financial sector is also carried out to assess corporate and household borrowing and borrowing capacity. The analysis is released on the Eesti Pank website, presented in seminars and published in print.

Eesti Pank participates in **policy making for the financial sector**, which includes participating in drafting and enacting legislation for the sector. In recent years the financial sector has become ever more regulated at European Union level, and this has meant that Eesti Pank has had to make a larger contribution to the drafting of the Estonian position, and to be more involved in the European Union decision making processes.

It is the responsibility of Eesti Pank to provide emergency liquidity assistance to banks if needed. Alongside this it should also ensure the speedy and efficient resolution of any crisis that may arise.

Eesti Pank had the following duties in safeguarding financial stability in 2012:

- Developing analytical methods and measures for macro-prudential supervision
- Carrying out macro-prudential research and stress tests
- Working with the European Union through the European Systemic Risk Board and with the other Nordic and Baltic countries on macro-prudential supervision
- Participating in drafting and introducing European Union legislation for the financial sector, together with the Ministry of Finance and the Financial Supervision Authority
- Setting policy for the financial sector, focusing on achieving the goals of monetary policy and macro-prudential supervision
- Testing and developing the capacity for Emergency Liquidity Assistance (ELA)
- Strengthening crisis management cooperation with the central banks of the Nordic and Baltic countries.

Further information on these matters can be found in the chapter “Sharing the responsibility for safeguarding financial stability”

3. Development, compilation and dissemination of statistics

Eesti Pank is the second official compiler of statistics in Estonia alongside Statistics Estonia. The central bank supplies good quality, reliable, up to date and impartial statistics that are used in the bank's own work and are released publicly.

The central bank fulfilled all its statistical tasks under the national statistical programme in 2012. It compiled and published both the preliminary and quarterly versions of Estonia's balance of payments, the international investment position, the gross external debt, the international reserves, and the quarterly financial accounts for the Estonian economy, and it carried out research work on the financial behaviour and consumption habits of Estonian households.

Eesti Pank had the following duties in statistical work in 2012:

- Adopting the new statistical standards of the Balance of Payments Manual 6th Edition, System of National Accounts 2008, and the European System of Accounts 2010
- Participating in changing the statistical regulations of the ECB and in drawing up new regulations, and preparing for the changes to be applied in Estonia (statistics on holders of securities, MFI balance sheet and interest rate statistics, statistics on investment funds, statistics on insurance companies and payment statistics)
- Developing methods for preparing accounts to meet the new standards
- Improving methods of data collection and reporting
- Adapting and developing the applications used for processing and checking data and for preparing releases of data
- Explaining the content of the changes to users of statistics
- Developing the statistics section of the bank's public website and improving the metadata
- Creating data visualisation

Further information on these matters can be found in the chapter “Development, compilation and dissemination of statistics”

4. Operating and developing reliable and well-functioning settlement systems

It is the job of Eesti Pank to ensure the secure functioning of the payment and settlements systems and to help to develop them. The efficiency and reliability of the financial sector depend on the smooth functioning of the settlement systems.

Eesti Pank has three different roles in the settlement systems as operator, regulator and supervisor of the systems. Eesti Pank is also involved in the development of financial sector infrastructure at Estonian and EU levels, and in shaping and implementing the policy and legal framework.

Eesti Pank had the following duties in payment and settlement systems in 2012:

- Maintaining the smooth and secure functioning of settlement in the express transfer system TARGET2-Eesti and in the retail payments system ESTA

- Developing the TARGET2-Eesti and ESTA settlement systems to meet the needs of the Estonian market and to fit the arrangements of the Eurosystem
- Participating in the development of the Eurosystem's central securities settlement platform TARGET2-Securities
- Bringing the interbank retail settlement system of Estonia into line with the requirements of the Single Euro Payments Area (SEPA)
- Working with partners in Estonia and the European Union to set and implement the legal framework for settlement systems
- Creating the Estonian Payment Forum and running it jointly with the Ministry of Finance and the Estonian Banking Association
- Overseeing the TARGET2-Eesti and ESTA settlement systems used in Estonia and the securities settlement system run by the Estonian Central Securities Depository, and participating in the oversight of other payment and settlement systems in the Eurosystem.
- Adopting new oversight requirements and methods suitable for the financial sector infrastructure

Further information on these matters can be found in the chapter "Payment and settlement systems"

5. Managing cash circulation in Estonia and contributing to the smooth circulation of cash within the euro area

Cash continues to play an important role in society as a means of payment and a store of value despite the increasing share of electronic payments in the last decade. Cash is one of the symbols of stability and security in society. The demand for cash and changes in that demand reflect social and economic developments and daily consumption habits.

As the central bank of a euro area country, Eesti Pank is responsible for satisfying the demand for euro banknotes and coins in Estonia and for maintaining the security of the cash resources needed for circulation. Eesti Pank's role in organising cash circulation gives it responsibility for ensuring that notes and coins are made to the common standards of the euro area and that requirements for recirculation and authenticity control are met.

Eesti Pank had the following duties in cash management in 2012:

- Managing the cash inventories and planning the cash resources of the Republic of Estonia in order to supply the circulating medium required for cash circulation; participating in the cash management of the Eurosystem
- Storing and preserving cash reserves securely
- Tendering for circulation and collector euro coins and participating in the Joint European Tender project of the central banks for the production of euro notes
- Making technical preparations for the release into circulation of the second series of five-euro notes, including improvements to banknote sorters ready for processing of the new series of notes
- Providing expert analysis and handling of cash and removing from circulation cash that is not fit for purpose
- Checking the authenticity and fitness for circulation of euro banknotes, and implementing and supervising the requirements for the recirculation of banknotes
- Collecting data on cash handling equipment and processing volumes to meet the reporting

requirements of the currency information system CIS2

- Deploying the new cash inventories management and logistics system Cash Single Shared Platform, CashSSP
- Selling numismatic products and exchanging Estonian kroons for euros

Further information on these matters can be found in the chapter “Cash”

6. Supporting stable and sustainable economic development in Estonia, advising the government and working with other central banks and international and domestic institutions

Eesti Pank disseminates information on the national economy and the economic policy of Estonia at home, in the euro area and around the world. Estonia has a small and very open economy and the stability of the Estonian monetary and financial systems depends to a noticeable degree on the decisions and actions of international organisations and other countries where these affect economic policy, the financial sector and monetary policy. Although the government plays an important role in supporting stable and sustainable economic development, Eesti Pank has a part to play through cooperation with other state institutions in its areas of responsibility and clearly focused information transmission to the government and the public, with particular attention paid to explaining the principles of operation of the Eurosystem.

Eesti Pank observes and regularly analyses international information in areas that affect the work of the central bank in order to decide the bank's positions in the ESCB and in the wider international arena.

Eesti Pank had the following duties in domestic and international cooperation in 2012:

- Distributing appropriate information on the economic policies and development of Estonia and the euro area in international organisations including the IMF, the EU and the euro area
- Participating effectively in international decision-making processes by working with other institutions
- Presenting the economic development of Estonia and the euro area in Estonia, the euro area and the wider world
- Distributing appropriate information about euro area monetary policy and developments to domestic institutions
- Making policy proposals for domestic and Eurosystem economic policy decisions
- Organising meetings with representatives of government and constitutional institutions
- Working with the Ministry of Finance on macroeconomic and financial stability issues

Further information on these matters can be found in the chapter “International partnerships and public communications”

7. Developing a cost-effective and sustainable organisation with a skilled and motivated staff

For a small central bank, a well-considered, efficient and knowledgeable working environment is particularly important, as Eesti Pank should do the same work as the central banks of countries that are much bigger than Estonia.

Eesti Pank had the following duties in organisation and human resources in 2012:

- Harmonising Eesti Pank's data security requirements with the requirements of the European System of Central Banks (ESCB)⁴ and improving the organisation of information systems in order to reduce risks
- Starting structural reform
- Harmonising the process for drawing up the working plans of the departments
- Updating the management competencies model and carrying out 360 degree feedback research
- Correcting the process descriptions of Eesti Pank

Further information on these matters can be found in the chapter "Governance, organisation and human resources policy"

⁴ The European System of Central Banks (ECBS) consists of the European Central Bank and the central banks of all the countries in the European Union

THE GLOBAL,
EURO AREA AND
ESTONIAN ECONOMIES
IN 2012

THE GLOBAL, EURO AREA AND ESTONIAN ECONOMIES IN 2012

The recovery in the global economy continued at the start of 2012 but slowed in the second half of the year. The initial estimate of the International Monetary Fund, the IMF, shows that global growth slowed in 2012 to 3.2%⁵. GDP growth was not equally distributed by region, running at an estimated 1.3% in developed countries and 5.1% in developing countries. The euro area was the only developed region to slide into recession as GDP fell over the year by 0.6% according to initial estimates. The speed of growth, consumer price inflation, labour market indicators and financing conditions were very uneven across the countries of the euro area.

The main risk remained the euro area sovereign debt crisis, which reduced confidence and caused volatility in the financial markets. Uncertainty was also caused by the budget debates in the USA. During the year, however, belief strengthened in the effectiveness of the reforms that had been undertaken and the measures that had been taken to solve the crisis, and uncertainty started to diminish. The IMF expects global economic growth to accelerate in 2013 to 3.5%, and growth in the euro area is forecast to pick up in the second half of the year.

The Estonian economy has recovered well from the recession. The growth that followed the fall has reduced imbalances and the ground has been laid for sustainable growth. In 2012 Estonia and Slovakia were the fastest growing economies in the euro area and Eesti Pank forecasts that annual GDP growth in Estonia will remain close to 3% in 2013.

THE GLOBAL AND EURO AREA ECONOMIES

The Global Economy

At the start of 2012 the global economy continued to recover, but the average growth rate for the year was slower than that of 2011. Data from the IMF show that the global economy grew by 3.2% in 2012, having been a markedly quicker 3.9% in 2011. Economic activity declined in the second half of 2012.

Growth was not equally distributed by region, running at an estimated 1.3% in developed countries and 5.1% in developing countries. The growth figure for developing countries according to the World Bank was the lowest of the last decade. Among the developed regions, the decline in the euro area slowed to -0.4%, while the USA grew more quickly than in 2011 at 2.3% and growth accelerated in Japan to 2.0%. The main risk was still the euro area sovereign debt crisis, which reduced confidence and caused volatility in the financial markets. Uncertainty was also caused by the budget debates in the USA.

High unemployment is becoming an ever more serious problem, and while it has fallen back to its levels of before the crisis in developing countries, in developed countries it has not declined significantly. The unemployment rate in the euro area had climbed to a record 11.8% by the end of 2012.

Central banks continued to apply the monetary policy measures taken to encourage recovery, and base interest rates were lower at the end of the year than they were in 2009 during the financial crisis. In July the European Central Bank lowered its key interest rates and promised to help the functioning of financial markets by making unlimited purchases of bonds from countries that had sought help from

⁵ Figures from the IMF's World Economic Outlook Update, January 2013.

the European Financial Stability Fund and the European Stability Mechanism. The central banks of the USA, Japan and the UK broadened their programmes of bond purchases.

Inflation continued to fall at the start of the year, under the impact of lower commodity and oil prices, and it later stabilised.

Stock markets were volatile in the first half of 2012 because of the sovereign debt crisis in the euro area and weak economic figures. Belief in the chances of success of the measures taken to resolve the crisis strengthened in the second half of the year, and this helped the main share indexes to rise despite the unimpressive economic figures. Over the whole year, the euro area Euro Stoxx 50 index rose by 15%, the US S&P 500 index rose by 12% and the Japanese Nikkei 225 index rose by 23%.

The price index of 22 main commodities⁶, used as an indicator of general commodity prices, did not change, while gold rose by 6% and the oil price by 3%.

Although the risks to economic development were still there at the end of 2012, growth of 3.5% is expected in 2013. The measures taken so far have allowed confidence to recover largely and it is now expected that their effect will pass into the real economy. The majority of the bigger central banks should continue with the same monetary policy and no major additions to monetary policy measures are expected.

The euro area economy

Economic growth in the euro area slowed as expected in 2012 and initial estimates show that euro area GDP fell by 0.6% over the year. This was a result of unfavourable prevailing financing conditions in some countries, debt reduction in several economic sectors, and general uncertainty about the future. Exports made a positive contribution to the economy.

There continue to be major differences between the countries of the euro area, and these are particularly noticeable in the labour market. The general improvement in labour market indicators, which lasted until the middle of 2011, continued in only a few countries in 2012, while in the majority the trend went into reverse and the average unemployment rate for the euro area climbed above 11%. The unemployment rate varied between countries, and at the end of the year it ranged from a little over 5% in Germany to more than 26% in Greece and Spain. Financing conditions also varied, and the large differences in labour market and financing conditions are a reflection of how much or how little countries have been able to ease the imbalances in the real economy, state financing and the financial sector.

The improvement in confidence and competitiveness and the return of faith to the markets following the measures that have been taken to stimulate the economy will take time, but in the second half of 2012 there was an increase in general confidence. The European Central Bank's non-standard monetary policy measures and the new international financing agreement for the Greek aid package stabilised the financial markets. The interest rates on bonds issued by several countries experiencing difficulties in their state finances fell significantly at the end of the year and for the first time in the last couple of years it was possible to hope that the bottom of the recession had been reached.

⁶ US Commodity Research Bureau, CRB, index

A recovery in growth in the second half of 2013 can be expected because of the acceleration of growth in external demand, and also because the reforms in the euro area have boosted competitiveness and the monetary policy interest rate is favourable. The European Commission forecasts that the average fall in GDP for the year will be 0.3% ⁷.

Inflation in the euro area was 2.5% in 2012, which was a little higher than the Eurosystem target for the medium term of 2%, but it fell by the end of the year to near to its target level. Inflation was boosted by energy and commodity prices, which remained high for longer than expected; a temporary slide in the value of the euro in the middle of the year; and the rise in indirect taxes and regulated prices in some countries of the euro area. The rise in indirect taxes was part of the package of fiscal consolidation measures in some countries, but it was offset by the reduction in price and wage pressures caused by the low levels of economic activity.

THE ESTONIAN ECONOMY AND FINANCIAL SECTOR

The Estonian Economy

Estonia has recovered well from the economic downturn of 2008 and 2009. The growth that followed the fall has reduced the imbalances that had appeared and has laid the ground for sustainable growth. Household debt levels are lower than they were before the crisis, and savings have grown, while wages reflect productivity better. The current account deficit is low, as is general government debt, and the state budget is near to balance.

In the first half of 2012 uncertainty deepened further in external markets and modest external demand inhibited growth in the Estonian exporting sector. Weak exports were offset by consumption and investment and consumption was supported by higher household incomes. The continuing growth in investments was encouraged by government investment activity, which saw the income from sales of emissions quotas in the previous year used to finance investments. The growth in the annual average GDP slowed to 3.2% in 2012 but it remained the fastest in the euro area and Eesti Pank forecasts that it will remain at the same level in 2013.

In 2012 Estonia was one of the few countries in the euro area where the labour market indicators continued to improve. Unemployment in Estonia had fallen by autumn to around half of the peak it had hit during the recession, while the employment rate reached the same level as in the second half of 2006. Regardless of the rapid fall in unemployment, labour shortages became more acute and this increased wage pressures. At the end of the year, unemployment stood at 9%, which means that active labour market measures are needed.

Inflation in Estonia in 2012 was relatively fast owing to external factors. By the end of the year, the harmonised consumer price index calculated using the Eurostat methodology had fallen to 3.6%. Prices were affected by higher oil prices, and there was a sharp jump in global food commodity prices in the summer that had an impact on Estonian consumer prices in the autumn. The recovery of the real estate market was one domestic factor that impacted consumer prices by raising rental prices,

⁷ http://ec.europa.eu/economy_finance/publications/european_economy/2012/pdf/ee-2012-7_en.pdf.

while hotel and restaurant prices increased due to a recovery in tourism. In general the domestic price pressures in 2012 were quite modest.

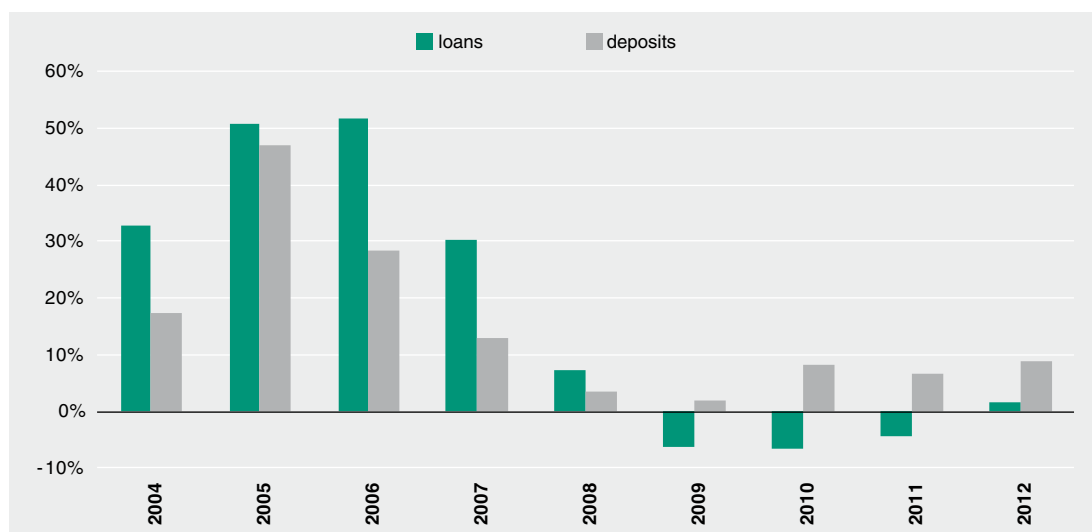
The general government budget had a slight deficit in 2012 and general government debt was the lowest in the European Union, and Eesti Pank forecasts that the budget should be near to balance in 2014.

The Estonian Financial Sector

The fall in the real sector lending portfolio, which had lasted for over three years, stopped in 2012, and at the end of the year the loan portfolio was 1.6% bigger than at the same point in 2011. The total volume of loans and leases issued grew as companies started taking more loans again. As before, the loans were mainly short-term, but during the year there was an increase in the volume of long-term loans taken to finance corporate investments. In the household sector both the housing loan market and the market for leases for new cars picked up, while the volume of other loans grew moderately. More active borrowing in the real sector was also encouraged by improved confidence and low interest rates. Bank lending was supported by relatively rapid growth in deposits, which grew for Estonian companies and households by 9% over the year.

Larger financial buffers and better borrowing capacity in the real sector improved the quality of the loan portfolios of the banks. The volume of loans overdue by more than 60 days fell in 2012 by 197 million euros, and their share in the total loan portfolio of the real sector fell by one percentage point to 3.2%. A large share of this fall came from write-offs of uncollectible loans.

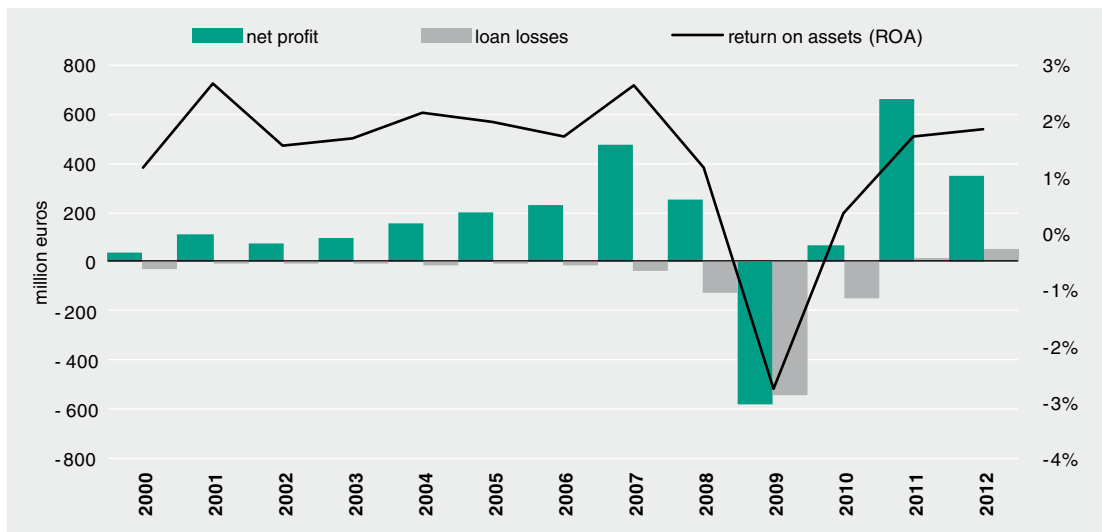
Figure 1. Annual growth in loans and deposits in the real sector in Estonia



The reduction in credit risk allowed banks to undo earlier write-downs and bring loans that had been written off back onto the books as profits. The profitability of the banks was cut somewhat only by the very low base interest rates, as the reduction in interest income had more of an impact than the reduction in interest expenses. The profitability of assets remained at a high 1.9% for the year and the

banks earned more than 350 million euros in net profit in 2012. The profit earned in the preceding years also helped to improve the capitalisation of the banking sector and at the end of the year all the banks were able to meet the 10% minimum capital requirement with only Tier 1 own funds. The current capital buffers are sufficiently strong to ensure that the banks will be solvent even were there to be a repeat of the events that led to the recession of 2009.

Figure 2. Profitability of the banking sector



ACTIVITIES AND
ACHIEVEMENTS
OF EESTI PANK
IN 2012

ACTIVITIES AND ACHIEVEMENTS OF EESTI PANK IN 2012

1. PARTICIPATING IN THE FORMULATION OF MONETARY AND ECONOMIC POLICY

*The role of monetary policy in reducing general uncertainty and insecurity in the euro area economy was illustrated clearly in 2012. As inflation pressures fell and demand remained weak, the monetary policy of the Eurosystem was accommodative and on 5 July the Governing Council of the ECB lowered its key interest rates by 25 basis points. At the end of the year the minimum bid rate on the main refinancing operations of the Eurosystem was 0.75%, the interest rate on the marginal lending facility was 1.50%, and the interest rate on the deposit facility was 0.00%. Interest rates have never been so low in the history of the monetary union. As a non-standard measure the decision was taken to continue conducting the ECB main refinancing operations as fixed rate tender procedures with full allotment, and the **Outright Monetary Transactions (OMT)**⁸ programme was set up ready for use.*

Largely under the influence of the Eurosystem's non-standard measures and strong statements, the financial markets began to stabilise in the second half of 2012.

The banks operating in Estonia made only modest use of the facilities offered by the Eurosystem because their liquidity buffers were sufficient and the bank groups use centralised liquidity management. An exception to this was the three-year longer-term refinancing operation in February, in which two banks participated, and at the same time the banks continued to be interested in depositing money at the central bank.

The participation of the Governor of Eesti Pank in defining monetary policy for the euro area, the implementation of monetary policy decisions, and the work of Eesti Pank in advising the government were all supported by the bank's twice-yearly economic forecasts, its constant monitoring work and the individual works of research produced by the bank.

MONETARY POLICY DECISIONS

At the start of the year, rises in indirect taxes brought about by austerity measures and higher commodity prices combined to push inflation in the euro area slightly higher than the Eurosystem target⁹ and it passed 2%, but in the second half of the year it started to slow. This fitted with the Eurosystem's economic forecast, which expects price rises to be below 2% in the euro area in future. With inflation pressures expected to decline, monetary policy in the Eurosystem in 2012 remained accommodative, helping companies and households at a time of weak economic activity, and on 5 July the Governing Council of the ECB lowered the key interest rates by 25 basis points. At the end of the year the minimum bid rate on the main refinancing operations of the Eurosystem was 0.75%, the interest rate on the marginal lending facility was 1.50%, and the interest rate on the deposit facility was 0.00%. Interest rates have never been so low in the history of the monetary union.

⁸ For more about the Outright Monetary Transactions programme, see the section "Implementing monetary policy decisions in the euro area and Estonia"

⁹ The primary goal of monetary policy in the Eurosystem is to maintain price stability in the euro area. This is set out in article 127 section 1 of the Treaty on the Functioning of the European Union, which covers monetary policy. Price stability is defined as annual growth in the harmonised consumer price index (HICPI) of the euro area of below, but close to, 2% over the medium term.

The Eurosystem also continued to expand its set of non-standard monetary policy measures and in February it held a longer term refinancing operation (LTRO) with a three-year maturity¹⁰, which allowed credit institutions in the euro area to take three-year loans with very low interest rates¹¹. On 26 July Mario Draghi, President of the European Central Bank gave a speech at the Global Investment Conference in London, in which he said: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

The non-standard measures aim to make the functioning of the transmission mechanisms for monetary policy in the euro area more efficient and they are temporary by nature. As part of this, the Governing Council decided at its meeting of 2 August to announce a new programme of Outright Monetary Transactions, OMTs, which will see the Eurosystem buy short-term bonds from those states of the euro area who have accepted a programme of the European Financial Stability Fund (EFSF) or the European Stability Mechanism (ESM). Such programmes might be full EFSF and ESM macroeconomic adjustment programmes or the Enhanced Conditions Credit Line preventative programmes¹². The Governing Council will consider performing such transactions only if they are justified by monetary policy and the programme conditionality is fully respected¹³, and it will end the transactions when they have achieved their aim or if the macroeconomic adjustment programme or preventative programme is not being followed. The IMF may also be asked to help set the specific conditions for each state and monitor how well the programme is followed.

No transactions were made under the OMT programme in 2012 but the announcement of the new programme had a calming impact on financial markets around the world so that borrowing costs fell for the euro area countries with problems and the interest spread over German ten-year bonds narrowed sharply. This showed that risk aversion had started to wane. In June and September the rules on what collateral could be accepted for monetary policy operations of the Eurosystem were also loosened¹⁴ in order to give euro area credit institutions easier access to the refinancing operations of the Eurosystem as this would then support lending by the credit institutions to the real sector in the euro area.

Although money market interest rates depend not only on base interest rates but also on market expectations of future rates, the three-month Euribor gives a good reflection of the transfer of base interest rates into money market interest rates. In June it was still at 0.65–0.66%, but after base interest rates were lowered in July it fell quite quickly to 0.26% by the start of September, and then further to 0.18%. Towards the end of the year, analysts considered it less likely that interest rates would fall again in the euro area, and the three-month Euribor rose in the final weeks of December a little.

At the start of 2012, growth in the money supply in the euro area was moderate and the broad money aggregate M3¹⁵ grew at 2.9% in the first quarter. After that, growth accelerated, reaching 3.6% in July,

10 Long-term refinancing operations can be for three months, for six, twelve or thirteen months, or for three years. Three-year refinancing operations were added in the last quarter of 2011.

11 An interest rate that is equivalent to main refinancing operations offer rate.

12 A line of credit with additional terms and conditions.

13 See: http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html

14 See <http://www.ecb.int/press/pr/date/2012/html/pr120622.en.html> and

15 M3 is a broad monetary aggregate that comprises M2 plus market instruments, notably repurchase agreements, money market fund shares and units, and debt securities issued by Monetary Financial Institutions (MFIs) with a maturity of up to two years.

then falling again to as low as 2.6% in September, mainly because liquidity buffers and deposits declined temporarily. Throughout the year the biggest impact on the money supply came from the narrow M1, and particularly the overnight deposits it contains. However, at the end of the year the money supply in the euro area started to increase faster again and the rate of increase of M3 reached 3.8% at the end of November.

IMPLEMENTING MONETARY POLICY DECISIONS IN THE EURO AREA AND ESTONIA

The Eurosystem's monetary policy framework

The basic framework for the Eurosystem's monetary policy operations emerged before the economic and financial crisis of 2007-2008 and is similar to those used by many other central banks. The main elements of this framework are open market operations; standing marginal lending and deposit facilities; and the minimum reserve requirement (see Table 1). Open market operations run to a strict timetable and if necessary the central bank can start additional operations to increase or decrease the liquidity funds available for use by credit institutions. Credit institutions make use of the standing facilities by borrowing money from the central bank or depositing money at the central bank at their own initiative. The minimum reserve requirement for banks is primarily intended to stabilise money market interest rates and to create or increase restrictions on liquidity.

Table 1. The Eurosystem's monetary policy framework

A. Main elements
1. Open market operations
Main refinancing operations
Long-term refinancing operations
Fine-tuning operations
Structural reverse operations
2. Standing facilities
Deposit facility
Marginal lending facility
3. Reserve requirement
B. Non-standard measures
1. Easing of refinancing conditions
Fixed rate tender procedures with full allotment
Refinancing operations with extended maturity
Currency swap agreements with leading central banks
Easing of the eligibility criteria for collateral assets and extending the range of assets accepted as collateral
The Covered Bond Purchase Programmes (CBPP and CBPP2)
2. Sovereign debt market programmes
Securities market programme (SMP)
Outright Monetary Transactions (OMT)

The monetary policy framework contains not only the main elements, but also the non-standard measures that have been taken during and since the crisis in order to alleviate it and to improve the liquidity conditions for credit institutions. The main goal of the non-standard measures is to ensure that market disruptions do not impede the functioning of the monetary policy transmission mechanisms. Non-standard measures are measures to loosen general lending conditions, such as the extension of the maturities of refinancing operations; the use of fixed rate tender procedures with full allotment; currency swaps to ensure liquidity in particular currencies, notably the US dollar; a loosening of eligibility standards for collateral assets; and purchases of covered bonds¹⁶. Measures have also been taken to support problematic sovereign bond markets so as to make the transmission mechanisms for monetary policy function more efficiently. The first of these was the Securities Market Programme, which was started in 2010 to buy sovereign bonds, and the second was the Outright Market Transactions programme announced in 2012.

Monetary policy operations of the Eurosystem in 2012

One of the largest monetary policy operations was the second longer-term refinancing operation (LTRO) with a three-year maturity held in February, in which credit institutions in the euro area took 530 billion euros of three-year loans with very low interest rates of 1%. The operation saw 800 banks participate. The first such operation in December 2011 supplied 489 billion euros, so the two operations together lent over one trillion euros to credit institutions, leading the Eurosystem's balance to rise to 1.4 trillion euros by the end of February. The biggest borrowers in the two three-year refinancing auctions were banks from Italy, Spain and France. These operations led to an increased surplus of liquidity, and in consequence there was a decline in 2012 in the average volume of one-week main refinancing operations to 98 billion euros from the weekly average of 159 billion euros in 2011.

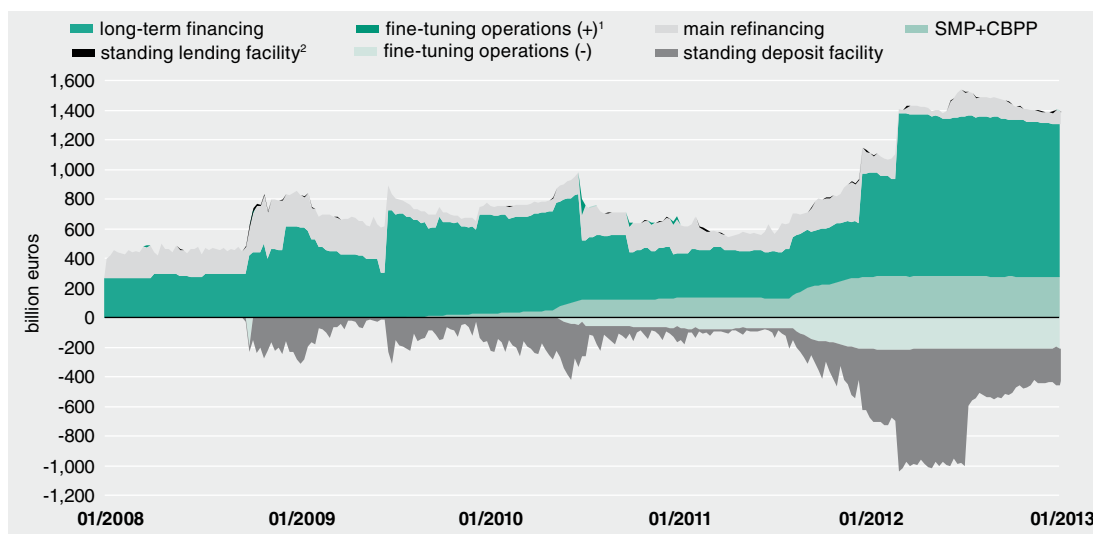
The three-year refinancing operations had some degree of positive impact on market confidence, which helped alleviate the debt crisis in the euro area. Despite the major increase in liquidity, however, the banks did not significantly increase their lending to the real sector but deposited the majority of the money borrowed back in the central banks of the euro area, using primarily the standing deposit facility. After February's three-year LTRO the deposits in the central banks of the euro area grew to over 800 billion euros from 477 billion just before the auction. On 5 July the European Central Bank lowered the interest rate on the standing deposit facility to 0%, which led to a drop in the use of it. At the end of 2012 the deposit facility had absorbed 262 billion euros of liquidity while 456 billion euros was held on the current accounts of euro area banks in the Eurosystem. In 2012 the liquidity surplus in the Eurosystem increased from 430 billion euros to 612 billion.

Monetary policy goals were also pursued in 2012 through the second Covered Bond Purchase Programme (CBPP2), which led the portfolio to increase from 3.1 billion euros to 16.4 billion. The total value of all transactions in the two covered bond programmes rose to 68.5 billion euros. The last transactions in the Securities Market Programme (SMP) were made in February and March, and the value of the portfolio fell by 3.6 billion euros to 208.3 billion in 2012. The liquidity added by the SMP transactions was absorbed by the weekly deposit auctions. No transactions were made in the Outright Monetary Transactions (OMT) programme announced at the start of August, but the programme had a significant positive impact on

16 Covered Bond Purchase Programme (CBPP). The first purchase programme started in July 2009 and the second programme (CBPP2) started in September 2011.

financial markets, as it gave investors confidence that the Eurosystem would intervene directly in markets if necessary. Figure 3 shows the development and structure of the Eurosystem's monetary policy operations.

Figure 3. The Eurosystem's monetary policy operations 2008–2012



1 Fine-tuning operations (+) – no such operations took place in 2012

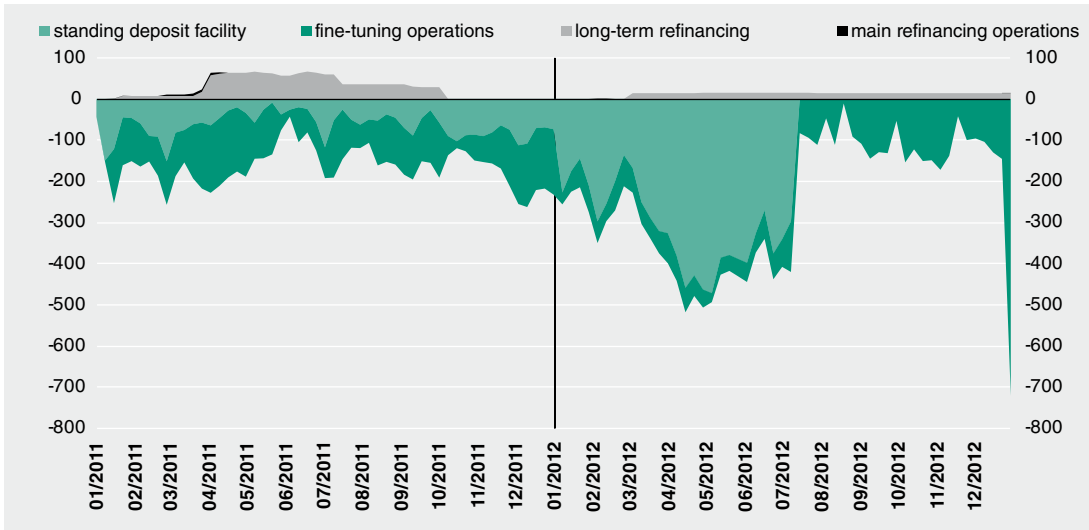
2 Standing lending facility – the standing lending facility was used every week but on average for only 1.7 billion euros with a peak of around 14 billion.

Eesti Pank's monetary policy operations

The banks operating in Estonia made only modest use of the lending facilities offered by the Eurosystem in 2012. The main reason for the low take-up was that the bank groups use centralised liquidity management and the local banks have sufficient liquidity buffers, meaning that the banks are not very dependent on the liquidity supplied by the central bank. An exception to this was the three-year refinancing operation in February, in which banks from Estonia participated.

The banks continued to be more interested in depositing money at the central bank, using both the standing deposit facility and the weekly deposit auctions, which are more in the category of fine-tuning. The standing deposit facility was used in the first half of the year and the weekly average for deposits at that time was around 300 million euros. After the Governing Council of the ECB lowered the deposit interest rate to zero on 5 July, the banks lost interest in using the deposit facility, as might be expected. The deposit facility offered as a fine-tuning operation was used around the year, though the auctions generally put the deposit interest rate at only 0.01%. The sums deposited in these operations were mostly between 20 and 170 million euros and averaged 95 million euros (see Figure 4). In the last days of the year the sums deposited at the central bank increased significantly.

Figure 4. Eesti Pank's monetary policy operations 2011–2012 (weekly average figures)



* Figures are weekly averages. A positive value indicates added liquidity, a negative value indicates absorption of liquidity

Eesti Pank continued to take part in the non-standard SMP and CBPP2 measures. No additional purchases of bonds were made in the SMP while purchases were made in the CBPP2 until the ECB ended the programme on 31 October.

RESERVE MANAGEMENT

Eesti Pank's reserves help support the reliability of the monetary system of the euro area. The reserves also guarantee the bank freedom of action and ensure that it has sufficient capital to cover any possible losses.

The goal of investment of the reserves is to earn a moderate level of stable income while ensuring that the assets are preserved over the long term. As Eesti Pank has a long investment horizon, it is able to benefit from the diversification of its investments in a range of asset classes. This allows risks to be diversified better without making any concessions in the expected return on the investments. The investments are mainly made in the liquid money and capital markets of developed countries.

Eesti Pank measures and manages all the risks associated with the investment of financial assets¹⁷.

The risk level accepted by Eesti Pank and the expected return are reflected by the benchmark portfolio, which is used for measuring the returns and risks of investments. The Executive Board of Eesti Pank sets the risk level of the benchmark portfolio, basing it on the situation in global financial markets. The benchmark portfolio is reviewed and adjusted to match the agreed risk level at least once a quarter.

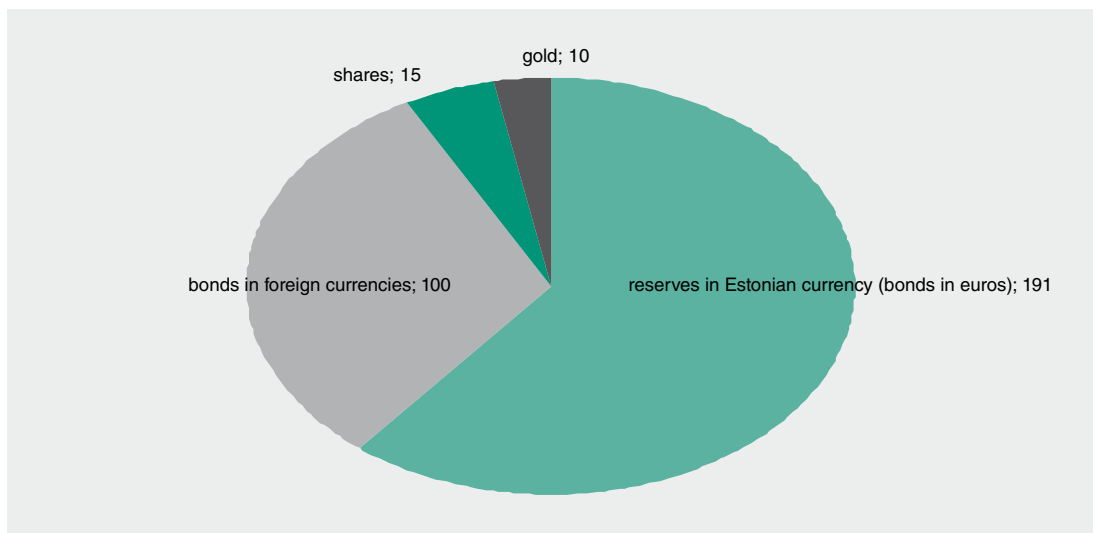
¹⁷ More information about the investment process and risks can be found on the Eesti Pank website <http://www.eestipank.ee/raha-poliitika/investeerimine>.

The Structure of Investment Assets

In 2012 the majority of Eesti Pank's invested reserves were in sovereign bonds of euro area countries (see Figure 5) and at the end of the year a total of 191 million euros had been invested in eurobonds. The foreign currency reserve or investments in currencies other than the euro stood at 115 million euros in 2012. The majority of the foreign currency reserve was made up of US Treasury Notes, of which 100 million euros in value was held. Following long and thorough analysis, it was decided in 2012 to add shares to the list of investment instruments used by Eesti Pank. The reason for doing this was to gain greater diversification of risk and during the year 15 million euros were invested in the stock markets of developed countries.

Eesti Pank continues to hold 8250 ounces or 256.6 kg of gold.

Figure 5. The structure of Eesti Pank's investment assets (million euros)



Return on investments

At the end of 2012, Eesti Pank's portfolio of investment assets stood at 319 million euros. During the year a total of 12.3 million euros was earned from investments¹⁸ meaning the return on invested assets was 3.72%, which was higher than in 2011 and significantly higher than the return from money markets (see Figure 6).

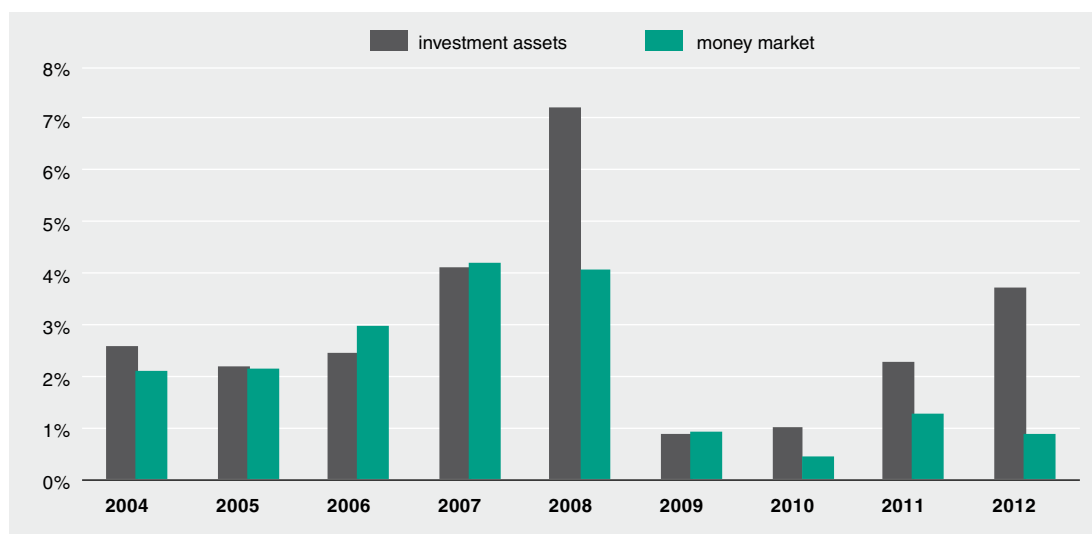
As a result of active investment, 39.7 basis points more income was earned in 2012 as a whole than with the benchmark portfolio. External asset managers made a major contribution to active investment in 2012 and at the end of the year Eesti Pank continued to use four external managers. These were PIMCO, which Eesti Pank has used since 2005; BlackRock, used since 2006; Informed Portfolio Management, since 2007; and Nomura Asset Management, added in the middle of 2010. Part of the risk limit is at the disposal of the external asset managers, and they invest mainly in derivative instruments.

¹⁸ Not including gold and income from gold. Measured at market prices.

Asset management services provided to the public sector

In 2012 Eesti Pank continued working with the public sector as it has for many years. Full asset management services were provided to the Guarantee Fund, whose investment portfolio amounted to 175 million euros at the end of 2012.

Figure 6. Return on investment assets and returns from the money markets



MONITORING AND ECONOMIC ANALYSIS AT EESTI PANK

Monitoring

Eesti Pank conducts monitoring to support the implementation of decisions that shape the monetary policy of the euro area and to support the bank's role in advising the government. For this reason Eesti Pank not only analyses the global, euro area and Estonian economies, but also looks at a range of topical economic policy issues.

The organisation and priorities of monitoring have had to be changed several times in recent years in response to changes in the global economy and the problems facing the euro area and Estonian economies. The euro area debt crisis and Estonia's recovery from the recent recession meant that in 2012 the sustainability of economic development in a broad sense, including questions of financial stability, had gained importance alongside price stability¹⁹.

The monitoring cycle of the euro area economy is largely set to fit with the participation of the Governor of Eesti Pank in making monetary policy decisions. A regular analysis of the euro area economy was written each month in 2012 to support monetary policy decision making. Due to the debt crisis in the euro area, a weekly review of financial markets was also made and in spring the economies of the countries affected or threatened by the crisis were also monitored.

¹⁹ Further information on monitoring and on advising the government in the context of financial stability can be found in the chapter "Sharing the responsibility for safeguarding financial stability".

Assessments of such situations have been provided since the autumn of 2008, with some interruptions, and in 2012 it was decided to continue with the schedule of frequent reports on the crisis.

Eesti Pank's monitoring activity is used as an input for the monetary policy committee of the ECB, where two Eesti Pank employees attend the committee meetings and participate in its work. The task of the committee is to support the implementation of the single monetary policy of the euro area, and to help all the central banks of the European Union coordinate their monetary policy.

Reports covering the Estonian economy more narrowly were prepared every two months in 2012. These give an assessment of the development of the Estonian economy, comparing it to forecasts and the criteria for balanced development. If necessary, deeper analysis of the economic situation is also carried out on specific areas.

In 2012 two labour market reviews were produced, the first in April and the second in November. The reviews cover the main developments in the Estonian labour market, labour demand and supply, institutional developments in the labour market and other labour market issues. The central bank observes the labour market for two reasons. Firstly, labour is an important production input, as a change in the supply or activity of labour can directly affect potential growth. Secondly, events in the labour market can have a major impact on inflation. Given the orientation of the euro area monetary policy towards price stability and the openness of the Estonian economy, the economy adjusts to changes principally through the prices and volumes of production inputs. For this reason it is important for the labour market to be flexible and for wage rises to correspond to productivity growth, as otherwise the increase in production costs could lead to excessive inflation.

The results of Eesti Pank's monitoring work were made public through press releases and through public commentaries and presentations. Some of these were related to the regular publication of key economic figures, including Eesti Pank's statistics on the financial and external sectors²⁰. In addition to the usual press conferences, seminars and articles, public lectures were organised by Eesti Pank in 2012 for the first time to present the results of the analyses.

²⁰ For further information, see the chapters "Development, compilation and dissemination of statistics" and "International partnerships and public communications".

Forecast

Eesti Pank publishes economic forecasts twice a year, in June and in December. Eesti Pank prepares its forecast as part of the joint BMPE forecast²¹ produced with the ECB and the other central banks of the Eurosystem. The central bank of each country produces a report on the outlook of its own economy for the current year and the next two for the BMPE. The forecast for the euro area as a whole is put together from the economic forecasts of all the member states.

Producing the economic forecasts of all the euro area countries simultaneously helps to ensure their consistency and timeliness. For this reason, the forecasts are checked to see how well they match, and the forecast of each national central bank is analysed and discussed by experts from the ECB and the other central banks. It also lets all the central banks, including Eesti Pank, use the latest data and assumptions on the external environment from the forecasts written in the other central banks. To ensure the consistency of the euro area economic forecast, all member countries use the same technical assumptions, such as the expected development of the global economy and external trade, the prices of oil and commodities and the expected exchange rate.

The production of economic forecasts for the euro area and its member countries is coordinated at the ECB by the monetary policy committee²². The ECB's monetary policy committee contains working groups on forecasting, econometric modelling and public finance, and experts from Eesti Pank are part of these working groups. The BMPE forecasts are used by the Governing Council of the ECB for assessing the state of the economy and risks to price stability²³. The euro area forecast is an important input for monetary policy decisions.

Eesti Pank's forecast for the Estonian economy is jointly written by a number of experts and the macro-econometric model of the Estonian economy EMMA is used to ensure that all the figures are consistent. EMMA contains the most important relationships for all the Estonian economic figures and is updated before each forecast to make sure that the relationships are up to date, so as to achieve greater forecast accuracy.

An inflation forecast is made to accompany the macro economic forecast as part of the euro area's narrow inflation projection exercise. The inflation forecast is updated four times a year, twice a year as part of the Eesti Pank economic forecast, and twice a year in March and September as part of the euro area monetary policy exercise.

Although Eesti Pank produces forecasts as part of the joint process of the euro area, a separate additional forecast can be produced if necessary to take account of the specific features of the Estonian economy. This was not considered necessary in 2012. On top of their work in preparing the euro area forecasts, experts from Eesti Pank also participate in the forecasting working groups of the European Commission and of the Organisation for Economic Cooperation and Development (OECD).

²¹ Broad Macroeconomic Projection Exercise (BMPE).

²² See also previous section "Monitoring".

²³ Alongside the euro area economic forecast prepared together with the central banks of the euro area countries, the ECB produces two other forecasts called the macroeconomic projection exercise, MPE, in March and September.

Advising the government

Eesti Pank advises the government and the government does not take any important economic policy decisions without first listening to Eesti Pank's opinion. In its advice, Eesti Pank uses information from its regular economic forecasts and ongoing monitoring and from its work in the committees and working groups of the Eurosystem and the ESCB.

Eesti Pank's historical background and long experience in the currency committee mean that for years it has been the government's main partner in discussions over fiscal policy. During the spring forecasting cycle, the consultations mostly centre on the state budget strategy and the stability programme, while in autumn they cover the government's budget for the next year. In 2012 the discussions focused on the long-term outlook resulting from the relatively strong position of the consolidated budget. Eesti Pank called for government vigilance about the constantly increasing budget spending, and backed the addition to the budget framework of provisions to curb spending increases in the medium term. Like the government, Eesti Pank was in favour of recovering and increasing the general government reserves that had shrunk during the recession. Eesti Pank did not consider it appropriate for the target of achieving a general budget surplus in 2013 to be pushed back to next year. There were no disagreements between Eesti Pank and the government over fiscal policy for the short term, including the elimination of the deficit through a more rapid rise in income than in spending.

Eesti Pank stressed that the creation of new parallel structures should be avoided when rules and regulations are arranged for the further development of the state budget framework, and that more emphasis should be put on development through current institutions. The bank believes that the same principle should be applied in economic management throughout the European Union.

The analysis and forecasts of Eesti Pank in 2012 showed a relatively strong recovery in the Estonian economy and a retreat in the negative output gap looking forward one or two years. In these circumstances it is understandable that an important place in the consultations between Eesti Pank and the government was occupied by the debt crisis in the euro area and the further institutional development of the Economic and Monetary Union. In this Eesti Pank supported the government's position in discussions within Estonia on the need for the European Stability Mechanism, ESM, in the interests of Estonia and the euro area as a whole. The bank and the government also hold similar positions on the question of solutions to the crisis and the redesign of a more integrated economic and monetary union. They both find that the first need is to apply the current rules in full and the additional stronger control measures known as the two-pack, and to implement the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, known as the fiscal compact. Both Eesti Pank and the government consider it right that the main emphasis in the short term should be on more effective observance of the existing rules and on passing new rules if necessary, and not on delegating management functions to euro area level. Equally, pressure must be maintained on countries with excessive deficits and debts to implement austerity measures and carry out reforms to boost competitiveness. Success in this should raise confidence in the future in a more integrated monetary union.

In the longer perspective, Eesti Pank is in favour of solutions that cover the whole of the European Union and are supported by market-based mechanisms. To avoid moral hazard, it is important to preserve the individual responsibility of each member state, meaning that each country is responsible

for its own debts and that the central banks do not finance the costs of the government sector. An excessive bias towards joint responsibility must be avoided.

Research

Eesti Pank's economic research is carried out according to an annual research plan, which sets the overall research goals and priorities within the bank. The main areas of research in 2012 were development of the central bank's macroeconomic and banking models, monetary policy and financial sector research, and analysis of economic growth and business cycles. Eight research papers were published on these topics.

The papers included a review of the effect of the Eurosystem's monetary policy on the euro area and Estonia and the functioning of the transmission mechanism; an analysis of the effect of real interest rates on the Estonian economy; an assessment of equilibrium inflation for Estonia; and research into the effect of foreign direct investment on the volatility of employment in the recipient country. Updates to the bank's macroeconomic models included changes to the EMMA macro-econometric model of the Estonian economy, the bank's dynamic stochastic general equilibrium model of Estonia and the euro area, and the credit risk and profitability models of the Estonian financial sector.

Working papers are published by Eesti Pank and the results of the central bank's economic research have been presented internationally. In 2012 research was published in international academic journals including the Journal of Comparative Economics, Labour Economics, and Eastern European Economics, and presented at international scientific conferences.

The bank's staff researchers continued working with Estonian and foreign partners in 2012, participating in the ESCB econometric modelling working group, the ESCB's Macroprudential Research Network and Competitiveness Network, and the Household Finance and Consumption Network run by the central banks of the euro area. They also took part in the 15th doctoral summer school co-organised by the Doctoral School in Economics and Innovation of Tartu University and Tallinn University of Technology in July 2012, and helped organise the international conference on transition economies "Economic Challenges in Enlarged Europe 2012" under the auspices of Tallinn University of Technology in June 2012.

To augment the research by Eesti Pank staff, foreign experts were invited to Estonia to talk about their work. A total of 13 seminars were given in 2012, ten of them by guest speakers from Estonia or abroad and three by the bank's staff researchers. The foreign experts included Juha Kilponen from the Finnish central bank talking about the background of the European debt crisis, Gábor Kátay from the Hungarian central bank presenting research on the Hungarian tax system, and Jaime Guajardo of the IMF and Indermit Gill of the World Bank on the economic outlooks prepared by their organisations.

The Eesti Pank guest researcher programme continued to play an important role in the international research collaboration, with two foreign experts taking part in the bank's research activities in 2012. The central bank also awarded its traditional annual research prize for a young Estonian economist. In 2012 the prize was awarded for the tenth time and went to doctoral student Aleksei Netšunajev of the faculty of economics at Tallinn University of Technology and the European University Institute for his research "Reaction to Technology Shocks in Markov-switching Structural VARs: Identification via Heteroskedasticity".

2. SHARING THE RESPONSIBILITY FOR SAFEGUARDING FINANCIAL STABILITY

One of Eesti Pank's responsibilities is ensuring the stability of the financial system, which the central bank does in close cooperation with the Financial Supervision Authority and the Ministry of Finance.

*Eesti Pank's role is to safeguard the functioning of the financial system as a whole through **macro-prudential supervision**. To this end, the central bank produces analysis and forecasts for the financial sector, assesses risks to the functioning of the whole system and takes the steps necessary to mitigate the risks and vulnerabilities threatening financial stability. Analysis of the financing of the economy is also carried out to assess corporate and household borrowing and borrowing capacity. The analysis is released on the Eesti Pank website, presented in seminars and published in print.*

*Eesti Pank participates in policy making for the financial sector, which includes participating in **drafting and enacting legislation for the sector**. In recent years the financial sector has become ever more regulated at European Union level, and this has meant that Eesti Pank has had to make a larger contribution to the drafting of the Estonian position, and to become more involved in the European Union decision making processes.*

An important part of the central bank's work is to take action to prevent financial crises. Alongside this it should also ensure the speedy, timely and efficient resolution of any crisis that may arise. It is the responsibility of Eesti Pank to provide emergency liquidity assistance to banks if needed. To be better able to fulfil these functions, the central bank regularly reviews its procedures. In 2012 Eesti Pank ran exercises to test and improve its readiness to provide emergency liquidity assistance.

Effective crisis management needs joint action in both domestic and international stability groups. Estonia is part of a cooperation network bringing together the central banks, supervisory authorities and ministries of finance from the Nordic and Baltic countries. Within this network Eesti Pank has participated in developing a framework for assessment of systemic risks that affect the whole of the Nordic and Baltic region.

Macro-prudential supervision

Eesti Pank regularly analyses and forecasts the functioning of the financial system in order to identify vulnerabilities and possible risks. Financial stability covers many areas, running the range from financial markets, institutions and infrastructure, especially payment and settlement systems, to the financial behaviour and risks of businesses and households. As the Estonian financial system is heavily focused on banks, the analysis centres on risks that threaten the operation of the banking sector.

The analysis is followed by a risk assessment built on expert opinion and various stress tests and sensitivity analyses used to assess how resilient the financial system would be if any of the identified risks were to materialise. The results of the analysis and the assessment are published twice a year by Eesti Pank in the Financial Stability Review.

In its macro-prudential supervision, Eesti Pank takes the necessary measures to reduce the build-up of systemic risk from, for example, excessively fast growth in credit or real estate prices, and to increase the

resilience of the financial system. Eesti Pank has direct responsibility for measures that affect the banking sector and conducts macro-prudential supervision in close cooperation with other domestic and foreign authorities. It is necessary to work with other domestic authorities primarily because some of the macro-prudential tools, like tax policy tools or regulation of the insurance industry and financial markets, lie outside the responsibility of Eesti Pank. Risk assessment also needs to consider the particular risk profiles of individual market participants, which are covered by micro-prudential supervision.

In 2014 new capital requirements regulations will come into force across the European Union, covering macro-prudential supervision measures and how they apply to cross-border banking groups. In the beginning of 2012 Eesti Pank started to develop a framework for analysis that will help assess the need for counter-cyclical measures to smooth the economic cycle.

As the Estonian financial system is tightly integrated with that of the Nordic countries, both risk assessment and the measures taken need to consider the cross-border implications. In 2011 the Nordic-Baltic Macroprudential Forum (NBMF) was founded to bring together the heads of the central banks and supervisory authorities in order to discuss key macro-prudential policy issues from the perspective of financial stability in the Nordic and Baltic region. In 2012 the main focus of NBMF discussions was on risks related to the financing of real estate transactions. It was considered necessary to assess the accuracy of the risk weights given to mortgage loans and the possibility of raising the risk weights applied to capital requirement calculations. A specially set up NBMF working group started work on a harmonised analysis methodology for the imposition of counter-cyclical capital buffers.

As well as assessing the risks to financial stability, Eesti Pank analyses the financing of the economy, access to lending, and the financial behaviour of households and non-financial companies. An important source of information for this, alongside the banking statistics, is the financial accounts statistics, which cover the financial assets and liabilities and transactions of various sectors of the economy. Once a year the bank publishes its Lending Review on its website. Assessment of the financing of the economy needs not only aggregated macro-level analysis and forecasts of borrowing and deposits, but also a micro-level view. For this reason Eesti Pank commissioned a survey from TNS EMOR on the financial behaviour of households in 2012, and presented the results in a public lecture.

Since 2011, Eesti Pank has participated in drawing up the euro area's bank lending survey, which is published quarterly and reviews how the banks assess changes in the supply and demand for credit and their future expectations. The four biggest banks in Estonia take part in the survey.

Financial stability assessments in 2012

Eesti Pank's financial stability assessments for 2012 showed that the biggest impact on the risks to the banks operating in Estonia came from the debt crisis in the euro area. In the second half of the year the tensions from the debt crisis started to ease due to decisions taken by the European Council and measures taken by the Eurosystem. The risk premiums on bonds in international financial markets lowered, and the ability of several large European banks to get funding from the financial markets improved. The weak economic situation in the euro area was among the external risks that merited particular attention in 2012, as the low external demand could mean much more modest financial results for businesses from the Nordic region and could make it harder for borrowers to repay their loans.

Risks to financial stability stemming from domestic factors within Estonia lessened further in 2012. Lower debt levels and larger financial buffers have helped to alleviate the loan repayment risks of companies and households. Low interest rates have also helped to reduce the repayment costs for borrowers and supported a moderate recovery in borrowing.

However, Eesti Pank highlighted to market participants the risks associated with low interest rates, as the banks and other financial institutions that had been investing more actively in international financial markets had started to allocate more assets into higher risk instruments in order to preserve profitability. Although no market participant individually was systemically important, Eesti Pank considered it worth emphasising that financial institutions should be aware of the larger risks associated with these investments and the impact they could have on the financial results of the institutions.

The relatively rapid growth in deposits in banks operating in Estonia has helped to lower liquidity and funding risks, while the liquidity and capital position of the bigger banks has been supported by their membership of Nordic bank groups. Banks in the Nordic region have managed to maintain high confidence from the markets thanks to their good financial results and strong economic policies in the region. However, there are some weaknesses in the Swedish financial sector, like the excessive reliance on financial markets for funding, the continued growth in recent years in real estate prices and debt levels, and the high share of the total economy for which financial sector assets account. If developments are less favourable, they could cause the markets to lose confidence. This has prompted the Swedish central bank and financial supervision institutions to develop measures to tighten the capital and liquidity requirements for systemically important banking groups. Eesti Pank declared its support for the measures proposed in Sweden, but on the strength of its financial stability assessments did not consider it necessary to implement additional measures in Estonia in 2012.

The European Systemic Risk Board

The European Systemic Risk Board (ESRB) is responsible for macro-prudential oversight of the financial system in the European Union. The main role of the ESRB is to assess the threats to financial stability in the European Union and to make recommendations for improving the situation.

The priority of the ESRB in its second year of operation was to develop an effective and comprehensive framework for macro-prudential supervision for the European Union and for individual countries. It proposed supplementing the new bank capital regulation to give member states sufficient room for action in macro-prudential supervision and in implementing supervisory tools. It stressed the same principle when discussing the creation of the Single Supervisory Mechanism (SSM). Eesti Pank and the ESRB share the position that if a banking union is to be effective, then a single crisis resolution system will be needed as well as a single supervisory mechanism.

The ESRB put great emphasis on analysing the systemic risks to the European Union's financial sector. The main risks identified in 2012 were the debt crisis in countries of the euro area, the worsening of profitability and of loan quality for banks as economic growth slowed, the funding problems of banks in countries in difficulties, and the fragmentation in financial sector developments across European countries. The ESRB analysed the systemic risks arising from changes in the funding structure of banks and from the insufficiently regulated shadow banking sector.

The results of the risk analysis are published quarterly in a Risk Dashboard, starting from 2012. The Risk Dashboard contains various qualitative and quantitative indicators that can be used to identify and measure systemic risks. The ESRB also released two public recommendations in 2012 on the US dollar-denominated funding of credit institutions and on the macro-prudential mandate of national authorities.

Designing the legal framework for the financial sector

In 2012 the framework for the operation of the financial sector in the European Union was strengthened and several important decisions were taken. The key topics for Eesti Pank remained the new capital framework for banks and the harmonisation of crisis management principles between countries. The need to find a solution to the continuing difficulties of the euro area financial sector and the desire to create a more effective framework for the financial sector of the European Union and the euro area were also part of the mix. Europe's leaders based key decisions on the consideration of these factors in 2012.

At the end of June the European Council decided to strengthen the European Union's financial framework and set out the aim of creating a banking union. A banking union is understood as single banking supervision with a single resolution mechanism for reorganising banks and a common system of deposit protection. Following the Council's lead, the European Commission produced a proposal in September for a single bank supervision mechanism.²⁴

Eesti Pank took part in the discussions about these matters through the Eurosystem, the ESRB and ECOFIN, the Economic and Financial Affairs Council of the European Union, and was also involved in formulating Estonia's position on it. Creating a banking union for the European Union is an important step for the functioning and further development of the single market. Eesti Pank considers that a successful banking union requires the three pillars of supervision of banks, deposit insurance and crisis resolution to fit together well and function efficiently. The rights and obligations of the member states and the EU institutions also need to be matched and this means other components of the banking union have to be developed in future beyond the supervisory mechanisms.

Negotiations continued in 2012 over the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) for transposing the banking sector's global Basel III prudential framework into the acquis of the European Union. In May the member states agreed a joint position and negotiations started with the European Parliament. The new capital requirements are needed for the financial sector to operate more securely and to ensure that Europe's capital requirements meet international standards. The new framework sets stricter requirements for credit institutions' own funds and liquidity and identifies where national measures could additionally be used to reduce the risks to financial stability.

Eesti Pank is in favour of strengthening the capitalisation of banks and harmonising minimum requirements and also supports the idea that it should be possible to set prudential requirements that are stricter than the minimum requirements for the sake of financial stability, if it is necessary to reduce risks and increase the resilience of the banking sector. This is particularly important for small countries that are affected more by the external environment.

²⁴ Single Supervisory Mechanism (SSM).

In June the European Commission published a long-awaited legislative proposal for bank recovery and resolution. The proposal aims to harmonise the principles of the member states for preventing and resolving financial crises and the steps to be taken. It lists a range of measures, which can be categorised in three groups for their implementation time and intensity. The three groups are preventative measures, measures enabling early intervention, and crisis resolution measures. Giving member states such tools should allow them to reorganise struggling financial institutions more effectively, and so reduce the costs to society of crisis resolution. In this case the costs would first of all have to be borne by the owners and creditors of the bank through write-offs of claims or through conversion of debt into equity. The proposal also allows funds to be collected from banks into targeted funds known as crisis resolution funds.

The important part of these discussions for Estonia is how crisis management of cross-border banking groups is organised. It is important that the division of costs for cross-border crisis management should ensure that the rights and obligations of the states are balanced.

BACKGROUND: The single supervisory mechanism for banks

In September 2012 the European Commission proposed setting up a Single **Supervisory Mechanism, SSM, for banks**. Intensive discussions were held at various levels in the second half of the year and at the end of 2012 a general agreement was reached by the member states. Under this agreement the single bank supervisory mechanism would be fully operational 12 months after the regulation came into force.

The proposal gave a central role in the SSM to the ECB, which would take over the direct supervision of systemically important banks. The assessment of systemic importance under the agreement between the states would look at the value of the bank's assets and the size of those assets relative to national GDP. The ECB would also run the supervision if a bank had applied for or received direct financial assistance from the EFSF or the ESM. Regardless of these criteria, the three most important banks of each country joining the SSM would be supervised by the ECB, unless there were justifiable reasons otherwise, such as one of the three banks being very small. Under these principles, the banks operating in Estonia that would fall under the direct supervision of the ECB are Swedbank, SEB and the branch of Nordea that operates in Estonia through the Finnish subsidiary. Estonia will of course continue to support the ECB in its practical supervision of these banks and will be able to take part in cross-border supervisory meetings.

Supervision of less significant banks will be carried out by the supervisory authorities of the SSM member state, under the single rules and regulations of the SSM and with the ECB being informed about all important decisions. The ECB has ultimate responsibility for the functioning of the SSM as a whole and for this reason it not only conducts direct supervision of banks, but also assesses the work of local supervisory authorities and if necessary takes struggling banks under central supervision.

The proposal also sets out the principles for application of macro-prudential supervision measures in the SSM. The measures can be applied by member states or by the European Central

Bank, but the ECB can set stricter requirements than the member state has set in order to ensure financial stability in Europe. The use of measures should be coordinated in advance by the member states and the ECB and the ECB needs to consider the impact of the measures on individual member states.

To separate the supervisory and monetary policy functions of the ECB, a new decision-making body is to be set up as a supervisory board comprised of representatives from the ECB and the national supervisory authorities. Under the Treaty on the Functioning of the European Union, the final decision-making powers will remain with the Governing Council, but the Supervisory Board will prepare the content of the decisions and operate the supervision. A small steering committee will also be set up to support the Supervisory Board, and the member states will sit on the steering committee in rotation.

All the countries of the euro area will participate in the Single Supervision Mechanism for banks. Countries from outside the euro area will be able to join the SSM if they choose and take a full part in the Supervisory Board of the ECB if they sign an agreement to that effect with the ECB. The Estonian banking market is dominated by Nordic bank groups, and so it is important for Estonia to continue working with the Nordic and Baltic countries even if they decide not to join the Single Supervision Mechanism.

3. DEVELOPMENT, COMPILATION AND DISSEMINATION OF STATISTICS

Eesti Pank is the second official compiler of statistics in Estonia alongside Statistics Estonia. The central bank supplies good quality, reliable, up to date and impartial statistics that are used in the bank's own work and are released publicly. Eesti Pank compiles the national balance of payments, banking statistics and other financial sector statistics.

In 2012 the statistical work of Eesti Pank was mainly focused on preparing for the transition to the updated international statistics standards in 2014.

To make Eesti Pank's statistics easier to access and to use, the bank continued to improve the statistics section of its website, developing software to allow graphic presentations of data and moving some particular statistics into a new display form. This meant giving users new tools to create data views, publishing new tables, and adding notes, explanations and other meta-information to the tables. Further development of the output and the addition of graphic views of data will continue in 2013.

The Official Statistics Act stipulates that a national programme of statistics for the next five years must be drawn up every year and one part of that is the statistics work of Eesti Pank. In 2012 the central bank fulfilled all its statistics duties under the national statistics programme, publishing both the preliminary and quarterly versions of the balance of payments, the international investment position, the gross external debt, the international reserves, and the quarterly financial accounts for the national economy, and preparing for the Households Finance and Consumption Survey into the financial behaviour and consumption habits of Estonian households in 2013.

Preparations were made to adopt a new data view application that will allow users within Eesti Pank to create better designed reports with more sophisticated content in both tables and graphs and to connect data from different databases, and major development was carried out for this in the statistics IT system and database.

Financial sector statistics

For financial statistics, 2012 was quieter than 2011, which had seen major projects like the follow-up work after the changeover to the euro and the redesign of the financial sector statistics on Eesti Pank's website. The work of the previous year was analysed, corrected and enhanced in 2012 and some new individual areas of development were also covered. The regular compilation and publication of statistical output went smoothly.

In the first half of the year the central bank prepared changes to the reporting of credit institutions, which were caused by a need for more data and the need to update reporting guidelines and improve data collection. At the start of May changes came into force in the reporting of payment statistics, and in November there were changes to the additional reporting of the balance sheets of credit institutions and the reports of investment services. On top of the changes to the content, the deadlines for presenting these reports changed and the reporting period was shortened from the quarter to the month. Improving the reporting meant that timely data were available for supervision, economic analysis and statistical work.

The European Central Bank, the ECB, prepared changes to its regulations on the balance sheet statistics and interest rate statistics of Monetary Financial Institutions and the statistics of investment funds, and it started work on a statistics regulation for insurance corporations. The ECB usually makes changes to its statistics regulations every five years, principally in response to the data needs of statistics users. Changes to the framework for national accounts that the European Union statistical work is based on also have an impact. The updated European System of Accounts 2010, ESA2010, must be applied by members of the European Union from 2014. In preparing for regulatory changes, the ECB gathers inputs from statistics users, data suppliers and national central banks. What data requirements are finally put into the regulation depends on the relative share of the data segment, its importance to the user and the costs of data collection. Changes to the regulation are made following close cooperation with the national central banks.

In 2012 the discussions with the ECB's statistics department over the classification of Estonian Savings and Loan Associations, SLAs, came to an end after many years. Following the decision of the Governing Council of the ECB, Eesti Pank reclassified the SLAs from the start of January 2013 and started to list them as credit institutions for ECB statistics and minimum reserve requirements. This meant that the SLAs had to report their calculation of the minimum reserve. This is a technical change that doesn't have any effect on the statistics published by the central bank.

A new data format was adopted for Eesti Pank to send statistics to the Estonian Leasing Association and association members, shortening the time needed for the bank to compile the statistics and allowing lease companies to carry out additional analysis. The central bank signed new data exchange agreements with the association and member companies and changed the guidelines for reporting to the central bank by lease companies.

To help it cope with its ever increasing list of duties, Eesti Pank continued the automation of the process for compiling its statistical output and for data control in 2012. The most important task in this was introducing new software for the national quarterly financial accounts. Automating the compilation of the accounts as much as possible is necessary to cover staffing risks and to allow ever shorter deadlines²⁵ to be met.

External sector statistics

In 2014 the requirements of the IMF's new Balance of Payments Manual 6th Edition will need to be implemented and so in 2012 Eesti Pank continued to study the manual. The main changes to the methodology and the structure of accounts were studied and appropriate decisions were taken about the methodology used by Eesti Pank. The statistical models and calculation algorithms were updated, and the forms for the statistical surveys and the IT systems used for statistical work were improved. The updated reporting requirements apply to companies from the first quarter of 2013 because international agreements state that statistics that meet the new requirements will first be published in 2014 and will cover 2013. The European Centralised Securities Database, CSDB, became more important than before for the compilation of portfolio investments and for other statistics. In line with the ECB's guidelines on data quality management for the CSDB, Eesti Pank paid more attention to increasing

25 From 2014 the ECB wants to get the financial account data for each quarter 85 days after the end of the quarter rather than the current 110 days.

the quality of Estonian securities data so that they would meet the statistics needs of other countries and of the euro area as a whole.

Eesti Pank started preparations for collecting and analysing information about the holders of securities in order to serve the securities holdings database being set up for the monetary union under the auspices of the ECB. The regular transmission of statistics on securities holdings between the central banks and the ECB will start at the end of 2013 under the ECB's regulation on the collection of national data on securities holdings.

In 2012 detailed attention was paid to the statistical methods for reflecting derivatives and insurance-related transactions. During the development work, the methods for deriving the data on derivative transactions and the necessary reports were defined. The methods for recording external sector statistics on the assets and liabilities of insurance companies and insurance services were reviewed, as were methods for collecting the statistics so that data queries needed by the central bank could be added to the joint reports package of Eesti Pank and Statistics Estonia.

Until now, the household sector has been insufficiently covered in the external sector statistics but the central bank started negotiations with the Tax and Customs Board to improve this. One reason for turning to the tax board was to gain access for statistical purposes to the data that are already in the national registers, which would reduce the need for reporting. Various income tax and VAT declarations were processed, the data requirements were defined, and an agreement between the two offices was drawn up. The agreement is to be signed at the start of 2013 and regular transmission of data to Eesti Pank will start in the same year. It is planned that the scope of the agreement will be widened in future to cover the needs of Estonia's part of the household finance and consumption survey coordinated by the ECB.

Eesti Pank employs an innovative approach for compiling the travel services account for the balance of payments, using information from mobile positioning about the movement of travellers across Estonia's borders as an input for its statistical models. The system for collecting the statistics was designed by researchers at Eesti Pank and the University of Tartu in partnership with OÜ Positium LBS. Eesti Pank started publishing statistics about foreign travel in the first quarter of 2012 and new publication principles were agreed and a new section made for the travel statistics in the statistics section of the Eesti Pank website. The data are released once a quarter.

At the end of 2012 the central bank prepared and ran a public procurement for a new partner to help develop the eAruanne online data reporting environment.

General economic statistics

The central bank continued its regular exchange of data with the ECB and the Bank for International Settlements, the BIS, for general economic statistics and government finance statistics. The set of data that is sent was supplemented by statistics showing new orders for industrial production, housing market indicators and the house price index.

Since the middle of 2012, Eurostat no longer asks member states for the statistics on new orders for industrial production, so several countries stopped collecting those statistics. Some, including

Estonia, continued to collect them. As the statistics on new orders are operationally important for the economic forecasting of the Eurosystem, the ECB wanted the national central banks to organise the direct transmission of new orders statistics from national statistics authorities to the ECB. For this reason, Eesti Pank's transfer of general economic data to the ECB was supplemented in 2012 by the statistics for new industrial orders.

Also in 2012, Statistics Estonia started to publish a house price index that matched the joint methodological standards of the EU. This index is more representative and internationally comparable than the real estate price index that had previously been compiled in Estonia. Eesti Pank added the index to the data sent to the ECB and the BIS.

Since joining the euro area, Eesti Pank has taken part in the Household Finances and Consumption Survey, HFCS, which is coordinated by the ECB and carried out in the countries of the euro area using a single methodology. The survey collects micro level data on the assets and liabilities of households. The main survey will be carried out in the second quarter of 2013 and the results will be published in 2014.

An agreement on the survey was signed in 2011 with Statistics Estonia, who will do the actual survey work and in 2012 experts from Eesti Pank made preparations for the survey by compiling the first Estonian version of the survey questionnaire, training the interviewers for the pilot survey, analysing the data from the pilot survey and making final adjustments to the questionnaire. Ways of linking registry data from various sources with the survey were explored. Putting the set of data collected during the household interviews alongside the data taken from other sources should create a base that will allow the same survey to be carried out in future primarily from registry data. The commercial register, securities register and traffic register were all analysed to see whether the data they contain could be used for the survey and the commercial banks were consulted for the same purpose.

In 2012 follow-up work continued to the audit of government finance statistics carried out in the central banks by the ECB in 2011. High quality government finance statistics are very important for the European System of Central Banks and the audit found that the central banks need to watch the quality of these statistics closely. Eesti Pank helped draft an action plan and minimum requirements for quality monitoring for government finance statistics, which must be followed by the statistical departments of all the central banks of the European Union.

4. PAYMENT AND SETTLEMENT SYSTEMS

The central bank is responsible for ensuring the secure functioning of the payment and settlement systems in Estonia in a way that meets the needs of system participants with minimum risk exposure and at reasonable cost. Eesti Pank does this through its roles as operator, regulator and overseer of payment systems. Eesti Pank is also involved in the development of financial market infrastructures such as TARGET2 and SEPA at Estonian and EU levels, and in shaping and implementing the policy and legal framework.

Settlements in the payment and settlement systems managed by Eesti Pank

Eesti Pank manages two inter-bank payment systems: TARGET2-Eesti, which is part of TARGET2, the Trans-European Automated Real-time Gross Settlement Express Transfer System, and ESTA, the settlement system for domestic retail payments

The TARGET2 system contains the 18 central banks of the euro area, including the ECB, and six central banks from outside the euro area²⁶. In 2012, 17 credit institutions were members of TARGET2-Eesti. TARGET2-Eesti is mainly used for high-value euro payments and monetary policy operations of the Eurosystem. Payments made through TARGET2-Eesti reach the payee from the payer instantly.

One credit institution joined the ESTA, meaning the system had 16 members at the end of the year. The ESTA is one of the fastest systems in Europe, with interbank payments settled ten times a day on work days.

A daily average of 101,000 payments with a total value of 1.5 billion euros (see Table 2) were settled through the interbank payment settlement systems in 2012.

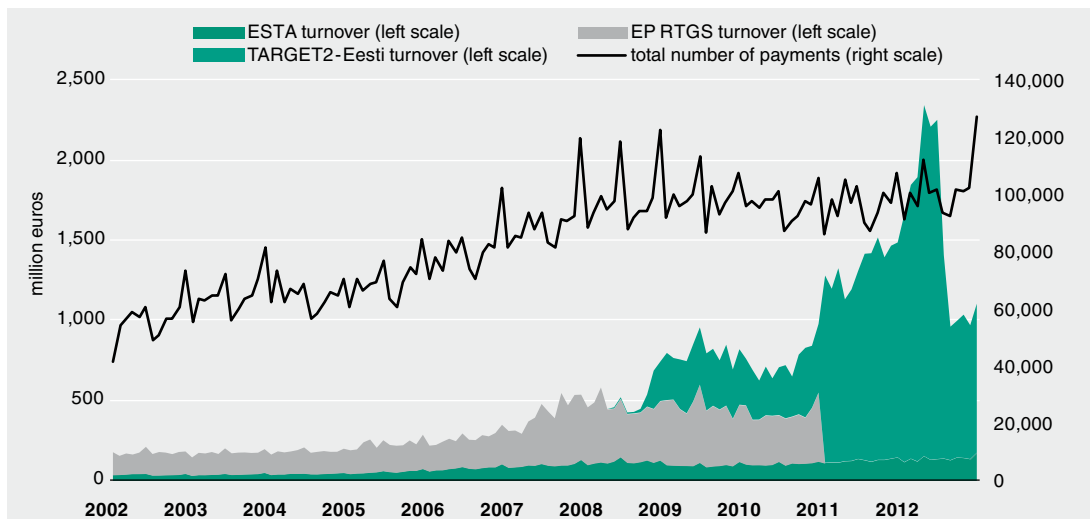
Table 2. Use of Eesti Pank's payment and settlement systems in 2012 (daily average)

System	Turnover (EUR m)	% of total payment turnover	Number of payments	% of total number of payments
ESTA	133.6	8.6%	100,775	99.6%
TARGET2-Eesti	1,412.8	91.4%	363	0.4%
Total	1,546.4		101,137	

TARGET2-Eesti settled a daily average of 363 payments in 2012, with a total turnover of 1.4 billion euros. The number of payments was 9% higher than in 2011 and turnover was 16% higher. In the first half of 2012 the banks operating in Estonia used the overnight deposit facility actively, and payments connected to overnight deposits made up a third of the total turnover of TARGET2-Eesti. After the European Central Bank decided to lower the interest rate on the standing deposit facility to 0.00% the banks stopped using the overnight deposit facility at the central bank and the daily turnover of TARGET2-Eesti fell by half (see Figure 7).

²⁶ The central banks of Bulgaria, Lithuania, Latvia, Poland, Romania and Denmark.

Figure 7. Payments made through Eesti Pank's payment and settlement systems in 2012 (daily average)



A daily average of 100,775 payments with a total value of 133.6 million euros were settled through the ESTA in 2012. The number of payments was 5% higher than in 2011 and value was 9% higher. The average size of payments made through ESTA in 2012 was 1326 euros, which is 4% more than in the previous year.

Development of the financial market infrastructures

Eesti Pank coordinates the development of the settlement systems mainly through the **Estonian Council of Payment System Experts** and its working groups, and the **Estonian National User Group of TARGET2-Securities**. It also works with the **Ministry of Finance** and the **Financial Supervision Authority** under an agreement²⁷ signed in 2007.

In April 2012, the **Estonian Payment Forum**²⁸ was created to agree the joint positions on the development of the payment landscape. The forum is chaired by Eesti Pank, working closely with the Ministry of Finance and the Estonian Banking Association. The members of the forum are Estonian credit institutions; users of payment services; representatives of interest groups affected, including some from the public sector; and infrastructure companies. Two meetings were held in 2012, focusing particularly on how the goals of the Single Euro Payments Area, SEPA, can be achieved.

The Single Euro Payments Area (SEPA)

New pan-European payment instruments²⁹ will be introduced with the SEPA. It will make payments in the European economic area simpler, faster, safer and cheaper for consumers and companies, and all that will be needed is a bank account and payment card based in one country.

²⁷ <http://www.eestipank.ee/en/financial-stability/cooperation>

²⁸ <http://www.pangaliit.ee/et/maksefoorum> (in Estonian).

²⁹ The payment instruments to be focused in SEPA are credit transfers, direct debits and cards.

In 2012 the SEPA regulation came into force³⁰ requiring local credit transfers and direct debits to be replaced by new instruments that meet the SEPA requirements by 1 February 2014. This means that payments in euros in the European Union will need to use the international bank account number, IBAN, and the ISO 20022 XML messaging standard³¹. The requirements in the regulation apply to payment service providers, and implementation of the regulation will be supervised by the Financial Supervision Authority. In order to ensure the proper functioning of payment services and facilitate the transition to the new service standard, the exceptions permitted by the SEPA regulation will be used in Estonia, allowing payments to be converted to SEPA standards after 31 January 2014.

The requirement to make the transition to SEPA direct debits needs particular attention, given the current payment landscape in Estonia. SEPA direct debits are significantly different from the domestic ones that are currently in use and so the banks have decided to stop using the current service from 31 January 2014 and replace it with an e-invoice based service. The decision of the banks only affects direct debits within Estonia. If there is sufficient demand from banks and clients, SEPA direct debits for cross-border payments will be brought to market, allowing Estonian bank customers to consume goods and services from the European Economic Area more easily.

The ESTA currently run by Eesti Pank doesn't process credit transfers and direct debits that meet SEPA conditions, and it is not interoperable with the other payment systems of the euro area. Under the SEPA regulation it will not be possible to continue using the ESTA after 1 February 2014 in its present form. This means that banks will have to decide which system to use in the future. In the Single Euro Payments Area each bank can choose the service provider that suits it best for making interbank transfers in euros. Eesti Pank has proposed one solution, but others are available that the banks may consider.

TARGET2 developments

An upgrade was made in 2012 to the Trans-European Real-Time Gross Settlement Express Transfer System TARGET2 to repair some software bugs in earlier versions and improve the statistics module.

At the end of 2012 the TARGET2 price list changed, having been the same for around five years. The changes were made because the forecast for the number of payments that had been the basis for the price list turned out to have been too optimistic, and the system was not able to cover its costs. The new TARGET2 price list applies from the start of 2013.

TARGET2-Securities (T2S)

For the TARGET2-Securities project, 2012 was a very important year as the **TARGET2-Securities Framework Agreement** was signed at the end of June by 23 depositories to confirm their participation in the project. One of the signatories to the framework agreement was the Estonian Central Securities Depository or Eesti Väärtpaberikeskus (EVK).

On 1 July 2012 the new T2S management structure started work. It was changed so that all T2S contractual partners could be involved in the decision making process. The T2S Board has 13 members,

³⁰ Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009

³¹ <http://www.eestipank.ee/en/sepa>

and its membership is reviewed every two years. The CSD Steering Group was set up as a new body to represent the interests of the depositories participating in T2S. The Advisory Group continues as the large scale forum with around 100 members, three of whom – EVK, Eesti Pank and Swedbank – are from Estonia. The new management structure is a permanent arrangement and it will remain in place even after T2S has been launched.

The work of T2S is coordinated in Estonia by the Estonian National User Group, whose role is to determine the position of the market. The User Group meets on the initiative of Eesti Pank.

A key milestone in 2012 was the confirmation of the composition of migration waves, as migration to the platform will be happening over 18 months (see Table 3). The T2S platform will become operational in June 2015 and the Estonian depository will join in the last migration wave at the start of 2017.

Table 3. Stages of the T2S project

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Preparatory stages		Definition of the T2S platform					Migration				
						Development and testing			user testing		

Oversight of payment and settlement systems

The primary objective of oversight is to ensure the smooth operation of the financial market infrastructures, including the settlement systems for payments and securities. Eesti Pank is responsible for overseeing payment systems nationally and as part of the European System of Central Banks.

As a member of the Eurosystem, Eesti Pank is involved in the cooperation of the central banks of the euro area, working from the base of the Eurosystem oversight policy framework³² and the guidelines and recommendations it contains. Oversight in the Eurosystem covers payment systems, securities settlement systems, payment instruments, central counterparties, trade repositories and third-party service providers.

The priority in oversight in 2012 in the Eurosystem was the preparation for adoption of the principles for financial market infrastructures³³ of the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). The principles were published in April 2012 and replace several principles used earlier³⁴. The new principles that financial market infrastructures³⁵ have to meet are stricter and give greater flexibility in the event of a financial crisis.

Eesti Pank oversees the payment systems that are important or systemically important nationally, within the Eesti Pank framework for oversight. These payment and settlement systems are the ESTA

³² <http://www.ecb.int/pub/pdf/other/eurosystemoversightpolicyframework2011en.pdf>.

³³ CPSS-IOSCO "Principles for Financial Market Infrastructures".

³⁴ "Core Principles for systemically important payment systems" (2001); "Recommendations for securities settlement systems" (2001); "Recommendations for central counterparties" (2004).

³⁵ Systemically important payment systems, securities settlement systems, central securities depositories, central counterparties and trade repositories.

and TARGET2-Eesti systems run by Eesti Pank and the securities settlement system of the Estonian Central Securities Depository. The system operator has the prime responsibility for making sure that the system meets the trans-European standards and that it is reliable, safe and efficient. It is the job of the overseer to give an independent assessment of the functioning of the systems and how well they meet the standards. If necessary the overseer can make recommendations on how the system could be improved.

The ESTA and TARGET2-Eesti worked without any major incidents in 2012. No incidents arose that could have posed a threat to financial stability or interrupted the settlement of payments.

The average availability of both TARGET2-Eesti and ESTA was 100% during the year. The EVK securities settlement system also operated without any major incidents.

At the recommendation of the overseer, attention was paid at national level and in the Eurosystem to liquidity provision in TARGET2 in a situation where the TARGET2 system is not working and critical payments have to be made through the TARGET2 contingency module. As the operator of the system, Eesti Pank amended the TARGET2-Eesti contingency rules for liquidity supply and also adopted additional **measures that allow the ESTA day to be started even if there is a disruption in the TARGET2 system.**

In 2012 the focus of oversight for the system for retail payments was mainly on developing the system currently in use and on the possible participation of payment institutions in the Eesti Pank payment and settlement systems. In 2012 several payment institutions³⁶ requested to open an account with Eesti Pank and join the ESTA operated by Eesti Pank. Eesti Pank did not accept these applications.

³⁶ A payment institution is company whose main activity is the provision of payment services. A payment service is any service that allows cash payments to and cash withdrawals from payments accounts, or payment instruments to be issued, payment transactions to be made or money remittance.

5. CASH

Banknotes in circulation in the euro area and Estonia and their structure

Cash continues to play an important role in society as a means of payment and a store of value despite the increasing share of electronic payments in the last decade. Cash is one of the symbols of stability and certainty in society, and the demand for cash and changes in the structure of that demand reflect social and economic developments and daily consumption habits.

As the central bank of a euro area country, Eesti Pank is responsible for satisfying the demand for euro banknotes and coins in Estonia and for the safekeeping of the banknote and coin reserves needed for cash circulation. Eesti Pank's role in organising cash circulation gives it responsibility for ensuring that the handling of notes and coins meets the common standards of the euro area and that requirements for recirculation and authenticity control are met.

At the end of 2012, 15.69 billion banknotes were circulating in the euro area with a combined total value of 912.59 billion euros. A year earlier, 14.95 billion banknotes were circulating with a combined value of 888.6 billion euros. In 2012 the total value of euro banknotes in circulation increased by around 2.7% from 2011, and the number of banknotes by around 4.7%. At the end of 2012, 41% of all the notes in circulation were 50-euro notes, and 50-euro notes accounted for 35.3% of the total value in circulation, followed by 500-euro notes on 32.2%.

The euro cash in circulation in Estonia includes both the cash issued by Eesti Pank to meet the cash demand of credit institutions and their customers, and the cash brought to Estonia by companies and individuals. This means that the total value and volume of euro cash in circulation in Estonia can only be estimated.

Eesti Pank issued 1441.1 million euros in total to credit institutions in 2012 and a total of 1323.0 million euros were returned to the central bank (see Table 4). The net amount of euro cash issued by Eesti Pank increased by the end of 2012 to 118.2 million euros, of which 112.4 million euros was in banknotes and 5.8 million euros in coins. Of the notes issued, 34% were 50-euro notes, the largest share, and 31% were 5-euro notes, while 50-euro notes also accounted for the largest share of the total value in circulation with 52%, followed by 500-euro notes on 26%. There were more 10, 20, 100 and 200-euro notes in the cash that Eesti Pank received back than had been issued, which is a reflection of the way that banknotes and people move around Europe.

Table 4. Cash flows between Eesti Pank and credit institutions

Year	Total amount (EUR million)		Number (million)			
	Issued by Eesti Pank	Received by Eesti Pank	Issued by Eesti Pank		Received by Eesti Pank	
			Banknotes	Coins	Banknotes	Coins
2011	1661.2	1045.5	45.0	124.5	34.8	22.3
2012	1441.1	1323.0	43.8	35.9	43.2	5.0

More than half of the circulation coins issued were of the smallest denominations as 27% were one-cent coins and 27% were two-cent coins, while 53% of the total value in coins was in two-euro coins.

Alongside its issuing and receipt of euro cash, the central bank continued to receive Estonian kroons that had remained in circulation. In 2012, 4.1 million euros worth of cash was returned to Eesti Pank through credit institutions and the Eesti Pank museum. At the end of 2012 there was still around 52 million euros worth of cash in kroons that had not yet been returned to the central bank. As there is still some public demand to exchange kroons in the commercial banks, Eesti Pank extended its exchange agreement with Swedbank and SEB for another year and so in 2013 Swedbank and SEB cash-handling offices across Estonia will join the central bank in exchanging kroons for euros. Eesti Pank exchanges Estonian kroon notes and coins for euros at the central rate of 1 EUR = 15.6466 EEK in unlimited amounts and without any limit of time.

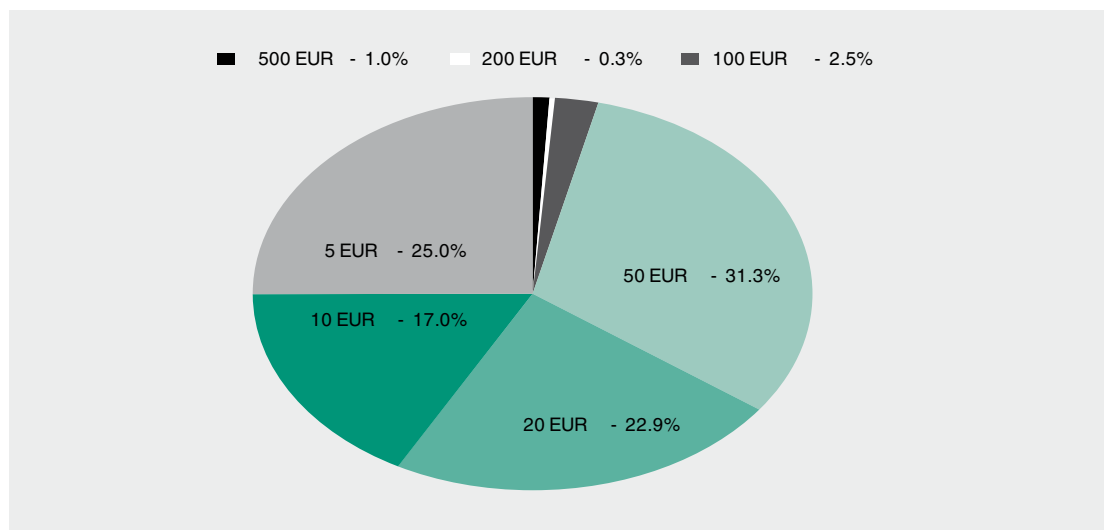
Expert analysis and handling of cash

All the banknotes received by Eesti Pank are sorted in fully automatic sorting machines.

A total of 41.5 million banknotes were processed, which is around 17.4% more than in 2011. After sorting, banknotes that are worn or have been damaged in circulation are destroyed and those still fit for use are released back into circulation. In 2012 a total of 4 million euro banknotes that were deemed unfit were withdrawn from circulation and destroyed during processing, meaning that on average every tenth or eleventh banknote was withdrawn.

In 2012, 14,782 damaged banknotes and 209 damaged coins underwent expert analysis at Eesti Pank. Ten counterfeit banknotes and three coins were discovered and four counterfeit kroon banknotes. No kroon coins were subjected to expert analysis.

Figure 8. Distribution of sorted euro banknotes in 2012



In 2012 a total of 531,000 counterfeit euro banknotes were removed from circulation, mostly in the euro area and other EU countries. This number was 12.4% smaller than in 2011.

A total of 202 counterfeit euro banknotes were discovered in the expert analyses conducted by the Estonian Forensic Science Institute in 2012, which is 27% fewer than in 2011, and 161 counterfeit euro coins were discovered, up from 104 in 2011. A further eight kroon banknotes were confirmed as counterfeit by the expert analysis in 2012. The most common counterfeit note encountered was the 100-euro note, which accounted for 38% of the counterfeits, while a further 33% were 50-euro notes. Two-euro coins accounted for 73% of the counterfeit coins. Given how many banknotes and coins are in circulation, the number of counterfeits discovered is negligible.

In 2012 the bank started preparations for deployment of the new Cash Single Shared Platform accounting and logistics system, which is an IT system specially designed for the needs of central banks and their cash clients. When the innovative modern technology is adopted at the end of 2013, the working processes for cash handling will become much more efficient and security will improve. It will also automate data exchanges between Eesti Pank and the ECB on cash matters.

There were no incidents in the circulation of cash in 2012.

Preparation of new banknotes and coins

Banknotes

In 2012 Eesti Pank was involved in the production of euro banknotes. The European Central Bank allocated Eesti Pank the production of 64.11 million 20-euro banknotes to cover the 44 million notes lent in 2010 for the changeover to the euro and the annual production quota. The notes will be supplied to the shared stock of the Eurosystem in the first half of 2013. The production of the banknotes is organised jointly with seven other central banks of the euro area, which run a joint procurement. The notes are made by printers that are accredited for the production of euro banknotes.

Circulation coins

At the start of 2012 a commemorative two-euro circulation coin came into circulation to mark the tenth anniversary of the euro as cash, with an identical national side for all members of the euro area but a different national symbol and text for each issuing country. Eesti Pank ordered two million of the coins from the Staatliche Münze Berlin mint in Germany.

To match the demand for cash, the stock of coins circulating was supplemented in 2012 with additional low-value coins and the new one and two-cent coins marked 2012 entered circulation in May. The coins were minted in the Royal Dutch Mint, and 25 million of each were made. This will be enough to cover the demand for low-value coins for some years.

Collector coins and numismatic products

In July 2012, Eesti Pank issued a silver collector coin with a nominal value of 12 euros into circulation to mark the summer Olympic games in London. The design on the reverse of the coin reflects movement, the denomination "€ 12" and the logo of the Estonian Olympic Committee. The front bears the

large coat of arms of the Republic of Estonia and the year 2012. The coin was designed by Liis Dvornjanski. A total of 7500 of the coins were minted in the Royal Dutch Mint.

At the start of 2012 the refurbished Eesti Pank museum and shop opened. Estonian kroons can be exchanged for euros in the museum shop, worn or damaged cash can be submitted to expert analysis for exchange, and collector coins and numismatic products can be bought along with other publications and souvenirs from the bank. In 2012, 2200 people used the services of the museum shop for exchanging kroons for euros, and 42 worn or damaged notes or coins were submitted for analysis. The collector coins that were sold most by the museum shop were the 12-euro collector coin for the London Olympics and the 25-kroon collector coin dedicated to Estonian history.

6. INTERNATIONAL PARTNERSHIPS AND PUBLIC COMMUNICATIONS

International cooperation

Foreign relations for Eesti Pank were marked in 2012 by the continuing euro area debt crisis and uncertainty about the economic outlook in several other economic areas. This meant that the institutions of the European Union and other international bodies worked hard on solutions to the crisis and added to the institutional framework for economic policy. The main focus fell on the sustainability of state finances, a return to economic growth, further development of the rulebooks created to achieve smooth functioning of the financial sector, and a strengthening of the global financial safety net, while in the European Union the focus was also on institutional reforms like the European Stability Mechanism and the Single Supervisory Mechanism.

The bulk of Eesti Pank's foreign communications were with the institutions of the European Union. The work of the central banks in the Eurosystem is so closely intertwined that most of the employees of the bank see some international communication every day. The Governor of Eesti Pank plays an important role in decision making on the Governing Council of the European Central Bank and as a member of the Steering Committee of the European Systemic Risk Board, ESRB. Staff from Eesti Pank also work in the committees and working groups of the Council of the European Union and the European Commission.

The central bank's most important partner in global financial and economic policy is the IMF and its members. Eesti Pank represents Estonia at the IMF and bears the monetary obligations stemming from Estonia's membership. Eesti Pank also works in the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD).

An important role among Eesti Pank's foreign partners has been played for two decades by the central banks of the Nordic and Baltic countries. They make up a group together with Estonia at the IMF and the World Bank and work together on issues affecting the financial sector³⁷ and Eesti Pank works with the Finnish central bank in managing reserves for the ESCB.

In 2012 Eesti Pank also provided technical assistance, focusing on advising the central banks of EU candidate countries.

Work with Institutions of the European Union

The European Central Bank

The European Central Bank, ECB, is Eesti Pank's most important partner in the European Union. Eesti Pank is a full member of the European System of Central Banks, ESCB, as Estonia uses the euro as currency. The Governor of Eesti Pank attends meetings of the Governing Council of the ECB twice a month with the governors of the central banks of the other euro area countries. These meetings take decisions on the monetary policy of the euro area and pass the guidelines for carrying out the other duties of the Eurosystem. In 2012 the Governing Council of the ECB paid a lot of attention in its discussions

³⁷ See also the chapter "Sharing the responsibility for safeguarding financial stability".

to the creation of single banking supervision centred at the ECB, which was being prepared by high-level bodies in which staff from Eesti Pank were involved. Four times a year, the Governor of Eesti Pank and the governors of the other national central banks of the EU countries attend the meetings of the General Council of the ECB, where the economy of the EU and the monetary policy of non-euro area countries are discussed. In 2012 the ECB wrote its regular convergence report on compliance with the conditions of euro area membership, and the final wording was coordinated with all the central banks of the EU and approved by the General Council of the ECB.

Day-to-day work takes place in seventeen committees, which meet separately for the Eurosystem and the European System of Central Banks, and in their substructures. The committees and working groups consist of representatives from the central banks and prepare the work of the decision-making bodies, the Governing Council and the General Council of the ECB. The committees cover all the areas of responsibility of the central banks.

Eesti Pank, the ECB and the other central banks of the Eurosystem are part of a technical assistance programme for the central bank of the Former Yugoslav Republic of Macedonia, which started work on 15 October 2012. The programme will support the Macedonian central bank in implementing the EU standards for central banks in ten areas. Experts from Eesti Pank will contribute to the internal audit and foreign reserve management. Other experts continued their work in 2012 in the ESCB's technical cooperation programme for Serbia in harmonising legislation and developing the compilation and dissemination of statistics.

The European Systemic Risk Board

The European Systemic Risk Board (ESRB) is responsible for macro-prudential supervision of the financial system in the European Union. The main role of the ESRB is to assess the threats to financial stability in the European Union and to make recommendations for improving the situation. Estonia is represented on the General Board of the ESRB by the Governor of Eesti Pank, who has voting rights, and the Chairman of the Management Board of the Financial Supervision Authority, who has no voting rights. Staff from Eesti Pank are also part of the ESRB Advisory Technical Committee and its structures. For more about the ESRB's work in 2012, see the chapter "Sharing the responsibility for safeguarding financial stability".

Council of the European Union

Eesti Pank's representatives attend various committees and working groups set up by the Council of the European Union. In March and September 2012, the Governor of Eesti Pank participated in the informal meetings of the Economic and Financial Affairs Council (ECOFIN). These meetings discussed the economy and state finances in the euro area and the EU and ways of shoring up financial stability.

When preparing for the monthly meetings of the ECOFIN, the experts of Eesti Pank work with the Ministry of Finance on issues for which the central bank is responsible. In 2012, the key issues were the strengthening of public finance, the plans for the single supervisory mechanism, and the harmonisation of legislation for the whole financial sector. ECOFIN also approved the EU positions for the G20 meetings and for several issues discussed in the IMF.

Representatives of Eesti Pank were involved in preparations for meetings of heads of state and

government of the EU in the European Council on the topics of the future of the economic and monetary union and single financial supervision for Europe.

The European Commission

Representatives of Eesti Pank attend the European Banking Committee, the Balance of Payments Committee and the Committee on Monetary, Financial and Balance of Payments Statistics and working groups dealing with statistics, economic forecasts, payment and settlement systems, banking, banknotes and coins, and counterfeit money. Meetings are held on a regular basis with the macro-economy experts of the European Commission, and the Estonian economists provide their input to the biannual economic forecast prepared by the European Commission.

Work with the IMF

The main objectives of the IMF are to ensure the stability of the international monetary and financial system and to support stable and sustainable economic growth. Estonia has been a member of the IMF since 1992. The interests of Estonia in the IMF are represented by Eesti Pank, which is also responsible for the financial liabilities that come with membership.

The Board of Governors is the highest decision-making body of the IMF, where Estonia is represented by the Governor of Eesti Pank. The alternate governor for Estonia is the Secretary General of the Ministry of Finance. and they both attend the annual meeting of the IMF. The International Monetary and Financial Committee (IMFC), the advisory body to the Board of Governors, meets twice a year in spring and in autumn, with Estonia represented by the Nordic-Baltic Constituency.

Day-to-day work with the IMF is conducted primarily through the Nordic-Baltic Constituency and joint positions are represented to the IMF Executive Board by the constituency's Executive Director. Within Estonia, Eesti Pank is responsible for day-to-day organisation and for formulating Estonia's positions in cooperation with the government. Nordic and Baltic countries discuss their policy priorities and agree the joint positions of the constituency in the Nordic-Baltic Monetary and Financial Committee (NBMFC) twice a year. Each constituency country is represented in the committee by a representative of the central bank and a representative of the government.

IMF representatives visited Estonia in 2012 as part of their monitoring programme. The IMF mission came to look at the recent economic development of Estonia and the outlook for growth, and attention was also directed towards the long-term sustainability of the budget, the stability of the financial sector and labour market developments. Full-scale economic policy consultations under Article IV of the IMF Articles of Agreement will be held on 6-18 March 2013.

BACKGROUND: Estonia's quota and the IMF's loan financing activities

Estonia's participation or quota in the IMF is 93.9 million SDRs³⁸ or about 109 million euros, which is equal to 0.039% of the IMF's total of quotas. Estonia's voting rights give it 0.067% of all the votes. When the increase in the quota approved in the IMF's regular review of 2010 comes

38 Special Drawing Rights (SDR) are the IMF's unit of account, whose value is based on a basket of four major currencies, USD, EUR, JPY and GBP.

into force, Estonia's quota will be 243.6 million SDRs or about 282 million euros. Estonia's voting rights will also increase together with this to 0.077% of all votes.

Article V of the Articles of Agreement of the IMF requires each member state whose external position the fund believes to be strong enough to use its quota resources to participate in financing the lending activities of the IMF. This obligation is implemented through the IMF's financial transactions plan, and Estonia was included in the plan on 1 October 2012. This means that Estonia participates in financing the lending of the IMF through its quota, like other euro area countries do.

Work with the Bank for International Settlements

The Bank for International Settlements, BIS, is the oldest international organisation for cooperation in monetary and financial policy. Eesti Pank was one of the founders of the BIS in the 1930s and the Governor of Eesti Pank attends the regular meetings of the heads of central banks. The meetings address the most topical monetary policy issues, the economic and financial market situation in different regions, and financial sector management and supervision. The BIS committees set the international best practices and standards for financial sector supervision and payment systems, and coordinate certain statistics-related tasks of the central banks.

In 2012 representatives from Eesti Pank took part in a meeting of the Irving Fisher Committee for central bank statisticians at the BIS and the subsequent global statistics conference. The main focus was on areas where the availability of statistics leaves something to be desired, such as shadow banking, real estate and especially commercial property price statistics, financial accounts, and household statistics.

Work with the Organisation for Economic Cooperation and Development

Work with the Organisation for Economic Cooperation and Development, OECD, lies in the exchange of economic policy experience and the development of international standards and best practices. The experts of Eesti Pank participate in the OECD working groups and committees that address economic and financial sector policy issues and statistics. The central bank's representatives regularly meet with the OECD experts to present their views on the economic and financial sector trends and related policies. The OECD publishes its economic review of Estonia every two years, and the latest review was published in autumn 2012. Angel Gurría, Secretary-General of the OECD, visited Eesti Pank during his visit to Estonia in October.

Accountability of the central bank

The independence of the central bank is an indispensable part of a monetary system that aims to maintain price stability. At the same time, a modern democratic society requires every public institution to report on its activities. As the independent central bank of the Republic of Estonia, Eesti Pank has to explain its opinions and positions on economic policy to the citizens of the country and their elected representatives. Accountability and the independence of the central bank are two principles that balance each other.

Regular public presentation of economic policy positions and economic data

Trustworthiness and transparency at the central bank are vital for a successfully functioning monetary system. Both specialists and members of the public need to be able to get regular, detailed and good-quality economic information from Eesti Pank.

The central bank has the right and the duty to collect monetary, financial and balance of payments statistics that fall within its areas of responsibility, and to process them within the applicable regulations. These statistics are then published on the Eesti Pank website in the statistics section³⁹.

It is stated in § 21 section 5 of the Eesti Pank Act that "Eesti Pank shall periodically publish information concerning its activities and the economy of Estonia and the European Union." Eesti Pank publishes its comments on the latest economic indicators and current developments in press releases and releases quarterly bulletins with a focus alternately on monetary or financial policy in the Estonian Economy and Monetary Policy report and the Financial Stability Review. The website of the bank also contains other publication series and one-off publications. Requests for information can also be sent to Eesti Pank by mail, by email or by telephone⁴⁰.

Like the central banks of the other euro area countries, Eesti Pank publishes the national language version of a wide-ranging quarterly review of the euro area economy and the activities of the European System of Central Banks. This duty to publish comes from protocol no. 4 to the Treaty on the European Union and the Treaty on the Functioning of the European Union, which concerns the statute of the European System of Central Banks and the European Central Bank.

A more detailed annual review of Eesti Pank's work is published in the annual report under § 31 section 4 of the Eesti Pank Act together with the annual accounts. The annual report is approved by the supervisory board of Eesti Pank and then presented together with the auditor's opinion to the Riigikogu. The Governor of Eesti Pank presents the central bank's annual report at a hearing held by the Riigikogu.

Accountability to the Riigikogu

On top of the Governor's annual presentation to the Riigikogu, the central bank has regular meetings with members of the parliament and provides explanations and comments to questions posed by Riigikogu members, who were interested in the ECB's non-standard monetary policy measures in 2012, for example. In 2012, members of the Riigikogu submitted two interpellations to the Governor of the central bank. One concerned Eesti Pank's actions in connection with the VEB fund, and the other concerned the availability of cash. Managers and staff from Eesti Pank regularly meet with the Riigikogu Finance Committee to explain the bank's understanding of economic processes and to discuss key questions of economic development. Eesti Pank's leaders have made presentations on the central bank's positions on economic policy and its areas of work when groups in the Riigikogu have expressed an interest.

³⁹ See also the chapter "Development, Compilation and Dissemination of Statistics".

⁴⁰ See also the section on "Public relations".

Public relations

The public relations of Eesti Pank support the central bank in its primary role of ensuring price stability in the euro area and in achieving its strategic goals. Public relations and communication help to manage public expectations for the economy in Estonia and in the euro area as a whole, which can then have an indirect impact on people's decisions about buying or selling real estate, making investments, taking a bank loan, buying a domestic appliance, or much more. The better the public and market participants understand the actions of the central bank, the more successfully the Eurosystem, including Eesti Pank, can do its work, as the decisions taken by central banks have a direct and rapid impact on events in the markets. Public support for the central bank's monetary policy is a great help in maintaining stable and sustainable economic growth in Estonia and the euro area and in achieving financial stability.

The priority for the central bank is to give its information out as quickly, comprehensively and clearly as possible. Eesti Pank releases regular and comprehensive information about its activities and about important economic policy questions. Disclosure of information is fuller and more frequent than legal accountability⁴¹ demands. During the past year, the bank issued its opinion on the Estonian economy four times with two reviews of the financial sector and two economic forecasts. A further 20 commentaries were issued on the latest economic figures and various other reviews and analyses⁴². As a member of the Eurosystem, it is important for Eesti Pank to pass on information about decisions that could have a direct impact on the euro area and Estonia, and so the bank published 16 press releases from the European Central Bank on monetary policy and euro banknotes, and published the editorial to the ECB's monthly bulletin on its website every month. More detailed reports on the euro area economy and the work of the European System of Central Banks were published on the Eesti Pank website four times during the year.

In addition to releasing information on the website and in various printed publications, Eesti Pank also handles direct inquiries for information by mail, email or phone. In 2012 the bank received a total of 2596 inquiries, 1973 of which were by telephone and the remainder by email, the "Ask a question" website interface or mail. Eleven inquiries were registered as requests for information under the definition in the Public Information Act.

Media communication and public appearances

Around 4,200 written articles, news stories, radio and TV news items and links to Eesti Pank commentaries were published or released in the Estonian media in 2012. Media interest in the euro area debt crisis and its resolution was high during the year, and attention also focused on Estonia's role in the European Stability Mechanism, ESM. The outlook for the euro area economy and Estonia's progress in the volatile global economy were covered in depth, and there was interest in inflation and the labour market while constant attention was paid to the banking sector. In the last months of the year, the media spotlight fell on the VEB fund, which featured in more than half of the media references to Eesti Pank.

41 See also the section on "Accountability of the central bank".

42 See also the appendix "Eesti Pank's publications in 2012".

In 2012 Eesti Pank held seven press conferences and presentations and issued 104 press releases and commentaries, while 33 longer interviews with managers and experts from the bank were published and five articles on economic policy. Spokespersons from the bank provided over 250 comments on current affairs in writing or in spoken form such as radio and television interviews. During the year, representatives of the bank gave 64 public speeches or presentations in Estonian, Russian and English, with ten presentations in the programme of public lectures in the Eesti Pank museum.

Eesti Pank's communication projects in the Eurosystem

The joint information projects of the Eurosystem focus on financial education and on raising awareness of the security features of euro cash to help people tell the difference between real and counterfeit banknotes. In 2012 the central banks began to prepare information materials for the second series of euro banknotes. The first series of euro banknotes started to be used ten years ago and the technology for making banknotes has improved constantly since then. The second series of euro notes is produced using the latest technology and the security features are more effective. Initial information about the first newly-designed banknote, the five-euro note, and an interactive presentation of it were released in November on a website all about the second series of banknotes⁴³. The new five-euro banknote will enter circulation in Estonia and the whole euro area in May 2013 and Eesti Pank is planning an information campaign to teach cash handlers and the general public about the security features, mainly by distributing printed materials. The information campaigns will continue in subsequent years to present the other banknotes of the second series as they enter into circulation.

Eesti Pank Museum

The role of the Eesti Pank museum is to maintain and cherish the history of Eesti Pank and Estonian money as a part of the Estonian cultural heritage, and it also provides a detailed introduction to the central bank's role and functions in society through a diverse programme of information and events. In the middle of the year it started a programme of public lectures to present the various issues relating to the key functions of the central bank and economic questions. During the year, 12 public lectures were held, attracting a total audience of 500. The lectures discussed economic reviews and the latest forecasts for the economy, the state of the banking sector, wage setting in Estonia and elsewhere in Europe, the Estonian labour market in 2012, and the financial behaviour of households. The museum also hosted excursions, visits and economics lectures. Guided visits around the museum proved popular, with over 6000 people taking such tours during the year. On average, one or two pre-booked groups visit the museum every day, with a large proportion of the groups consisting of pupils in their final year of basic school. More than 28,000 people visited the refurbished Eesti Pank museum during the year, which is 3.5 times the number that visited in earlier years.

In 2012 the Eesti Pank museum led the creation of a new section on the Eurosystem for the popular travelling exhibition "Estonian Currency from the Mark to the Euro". The travelling exhibition can be ordered free of charge.

⁴³ Further information can be found on the website <http://www.new-euro-banknotes.eu/>.

7. GOVERNANCE, ORGANISATION AND HUMAN RESOURCES POLICY

Supervisory and governing bodies of Eesti Pank

Eesti Pank Supervisory Board

The Eesti Pank Supervisory Board provides oversight of the work of Eesti Pank. The responsibilities of the Supervisory Board are set out in the Eesti Pank Act.

The Eesti Pank Supervisory Board receives regular reports from the Governor of Eesti Pank on the economy, monetary policy and financial sector of Estonia and the euro area and on the Eesti Pank budget and spending. The Supervisory Board meets at least eight times a year.

The current members of the Supervisory Board were appointed by the Riigikogu on 18 February 2009. The members are Jaan Männik (chairman, appointed 13 June 2008); Kalev Kallo, member of the Riigikogu; Irene Kull, Professor of Civil Law in the Chair of Commercial Law and Intellectual Property Law in the University of Tartu Faculty of Law; Enn Listra, Professor of Finance and Banking in the Tallinn School of Economics and Business Administration at the Tallinn University of Technology; Tõnis Palts, member of the Riigikogu; Liina Tõnisson, social scientist and economist; and Urmas Varblane, Professor of International Business in the Institute of Business Administration at the University of Tartu. Jürgen Ligi, member of the Riigikogu, was also appointed as a member of the Supervisory Board of Eesti Pank, but his membership was suspended following his appointment as Minister of Finance on 4 June 2009. While he serves as a member of the Government, the Riigikogu appointed Valdo Randpere, member of the Riigikogu, as an alternate member of the Supervisory Board of Eesti Pank from 26 January 2010.

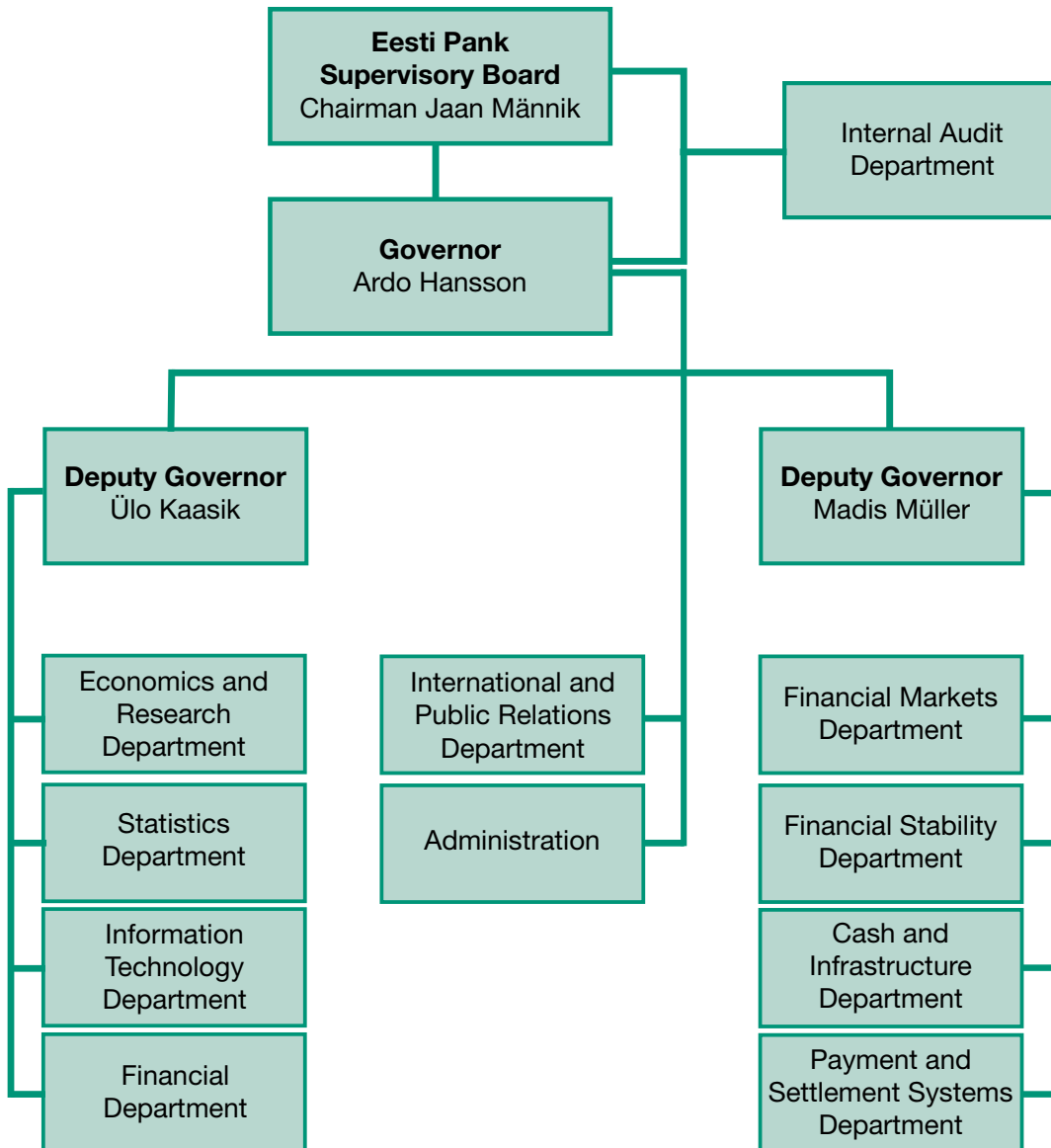
The Executive Board of Eesti Pank

The Executive Board serves as the governing body of Eesti Pank. The Governor of Eesti Pank is, by virtue of office, the Chairman of the Executive Board. The Executive Board consists of the Governor and the Deputy Governors. The Executive Board comprised Governor Andres Lipstok and Deputy Governors Ülo Kaasik and Madis Müller until 6 June 2012 and from 7 June the new Governor Ardo Hansson became a member of the board.

The management system and work organisation of Eesti Pank

In October 2012 the management of Eesti Pank started structural reforms to make the organisation less fragmented. The financial sector statistics division of the Financial Stability Department was merged with the Statistics Department; real estate services were moved from the Administrative Department to the Cash and Security Department; and a new department called Administration was created from the remainder of the Administrative Department, the Human Resources Department and the Legal Department. The structural changes were to be enacted from 1 February 2013.

**Eesti Pank Organisation Chart
(01/02/2013)**



Development of the management system and work organisation of Eesti Pank

At the start of 2012, a review and mapping of Eesti Pank's processes was started. The process map represents a system connecting all the processes of Eesti Pank, so that description of the processes reveals the connections between various processes in the bank. By the end of the year, most of the process descriptions for Eesti Pank's activities had been updated. Preparatory work is now underway for adoption of the interactive process map.

The way that departments plan their work was harmonised and the work planning format for the whole bank was changed to produce a document that serves as the basis for management reporting in Eesti Pank.

Bureau Veritas Eesti OÜ confirmed the ISO 9001:2008 quality standard that the Cash and Security Department was first awarded in 2002. The quality certificate confirms that cash handling and cash security at Eesti Pank meet the requirements of the standard.

Managers got feedback from the 360 degree survey for the third time. The earlier management competence models were updated for this, identifying management practices that can help distinguish successful managers from the unsuccessful. The assessment results were used to produce a summary analysis of management quality across the whole bank and individual reports of managers for making personal development plans.

Risk management

Risk management at Eesti Pank covers all the processes of the bank and allows various risks to be tackled in a single framework. Risk management aims to reduce the damaging effect that unforeseen events can have on the bank's work to achieve its goals. Reporting and analysis of risks show that the internal risk level is stable but external risks have increased significantly. Contingency plans for services are used to reduce the impact of any possible interruption to the bank's processes and to ensure the continuity of activity. The risk management systems of the bank are assessed by both the internal and external auditors.

To reduce risks, Eesti Pank has harmonised its internal data security requirements with those of the European System of Central Banks and improved the organisation of its information technology systems.

Human resources at Eesti Pank

Eesti Pank's human resources policy is to recruit, develop and train the employees needed for the bank to achieve its goals, and to motivate the staff and remunerate them competitively.

Number of employees

At the end of 2012, there were 240 employees working at Eesti Pank, down from 244 in 2011. Of them, 20 were working part-time, so the average equivalent of full time workers was 237 in 2012, down from 241 in 2011. In 2012 one employee of Eesti Pank was on short term secondment to the ECB and one was at the

Table 5. Number of employees at Eesti Pank on 31/12/2012

	Total	Men	Women
Number of signed employment contracts	258	105	153
of which suspended contracts	18	2	16
on maternity leave	12	0	12
other, including secondment to the ECB or other international organisation	6	2	4
Total number of employees	240	103	137
of whom full time employees	220	99	121
part time employees	20	4	16

Italian central bank. One ECB employee was on short term secondment at Eesti Pank as was one employee of the Finnish central bank.

The average age of Eesti Pank employees in 2012 was 43.3 and 103 of the bank's employees, or 43%, were men, and 137 or 57% were women.

Remuneration

Members of the Eesti Pank Supervisory Board were compensated for their work. In 2012 the chairman of the Supervisory Board received 1661.70 a month in compensation and other members of the board received 1022.59 a month. The total sum paid in compensation to members of the Eesti Pank Supervisory Board in 2012 was 105,837.96 euros.

The salaries of the Governor of Eesti Pank and the Deputy Governors are set by the Supervisory Board. In 2012 Governor Ardo Hansson was confirmed in office with a salary of 8100 euros a month, Deputy Governor Madis Müller's salary was 6500 euros a month and Deputy Governor Ülo Kaasik's salary was 5500 euros a month. In total the members of the Executive Board of Eesti Pank were paid salary of 350,308.79 euros in 2012, of which 85,130 euros was paid to the departing Governor as severance pay.

The average monthly salary at Eesti Pank, including holiday pay and additional pay for working overtime, at night, during holidays and during national holidays, was 1912.70 euros in 2012, up from 1856.50 euros in 2011. This figure covers everyone from the top managers to the service staff, but 85% of the bank's employees are professional specialists. A mid-level specialist has a Master's degree, at least three years of professional experience and good spoken and written English, and where necessary they participate in some working groups of the European Central Bank or the European Union. The average salary for these staff was 1527.73 euros a month in 2012, up from 1450.02 euros a month in 2011.

Development and training

Staff development costs totalled 225,280 euros in 2012, which is equal to 2.9% of the payroll, and 229 employees or 95% of the staff took part in training. On average each employee received 6.2 days of training in the year costing 962 euros.

Training was most popular in 2012 in management, communications, foreign languages and economic theory and policy. There were 55 employees studying for a qualification, and over 80% of them were studying for a Master's degree or a doctorate.

The Eesti Pank sports club, chamber choir and national dance group

Eesti Pank places a high value on a healthy lifestyle and on preserving Estonian cultural heritage. The bank has a sports club that allows members to take part in sporting activity, promotes an active lifestyle and lets colleagues meet outside of work. At the end of 2012 the Eesti Pank sports club had 248 members from Eesti Pank and the Financial Supervision Authority. During the year, a winter sports event was held in Jõulumäe and a summer sports event in Vaibla and players participated in sporting events held by the European central banks for futsal, basketball, badminton, volleyball and chess. There was also a friendly basketball match against the Finnish central bank and the bank's basketball team entered the competition for teams from banks organised by Eesti Firmsport and came first. The 25-member choir formed of employees from Eesti Pank and the Financial Supervision Authority was conducted in 2012 by Sven Peterson. Since 22 November 2011 a national dance group has also been run by Märt Agu for staff from Eesti Pank and the Financial Supervision Authority.

ANNUAL ACCOUNTS OF EESTI PANK

for the financial year ended 31 December 2012

ANNUAL ACCOUNTS OF EESTI PANK FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012

APPROVAL OF THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 BY THE EXECUTIVE BOARD OF EESTI PANK

The Executive Board recognises its responsibility for the Annual Accounts of Eesti Pank for the financial year ended 31 December 2012.

The Annual Accounts have been drafted in accordance with the rules established in Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank. The parts of the Annual Accounts that are not regulated by ECB guidelines have been drafted in accordance with the accounting principles generally accepted in Estonia. The Annual Accounts give a true and fair view of the assets and liabilities, equity and financial performance of Eesti Pank.

The preparation of the Annual Accounts in conformity with the above requirements requires the Executive Board to provide estimates of the determinants affecting the assets and liabilities of Eesti Pank as at the accounting date and income and expenses during the accounting period. These estimates are based on the information available about Eesti Pank, its intentions and risks as at the date of preparation of the Annual Accounts. The final outcome of the economic transactions reflected in the Annual Accounts may differ from the estimates of the Executive Board.

On 26 March 2013, all the members of the Executive Board of Eesti Pank on that day signed the Annual Accounts.

Ardo Hansson
Governor of Eesti Pank,
Chairman of the Executive
Board



Ülo Kaasik
Deputy Governor,
Member of the Executive
Board



Madis Müller
Deputy Governor,
Member of the Executive
Board



BALANCE SHEET AS AT 31 DECEMBER 2012 AND 2011

thousand euros

	Item	31/12/2012	31/12/2011
ASSETS			
Gold and gold receivables	1	10,405	10,039
Claims on non-euro area residents denominated in foreign currency		215,561	151,829
Receivables from the IMF	2	81,846	74,133
Balances with banks, security investments and other external assets	3	133,715	77,696
Claims on euro area residents denominated in foreign currency	4	21,144	4,929
Claims on non-euro area residents denominated in euro	5	2,714	1,650
Lending to euro area credit institutions related to monetary policy operations denominated in euro	6	13,900	0
Other claims on euro area credit institutions denominated in euro	7	9,845	12,128
Securities of euro area residents denominated in euro		564,723	544,214
Securities held for monetary policy purposes	8	373,251	344,311
Other securities	9	191,472	199,903
Intra-Eurosystem claims		3,398,491	2,333,169
Participating interest in the European Central Bank	10	82,895	79,911
Claims equivalent to the transfer of foreign reserves	11	103,116	103,116
Net claims related to the allocation of euro banknotes within the Eurosystem	12	1,446,009	1,501,976
Other claims within the Eurosystem (net)	13	1,766,471	648,166
Other assets		44,941	43,557
Tangible assets	14	22,421	23,272
Other financial assets	15	217	217
Off-balance-sheet instruments revaluation differences	16	927	317
Accruals and prepaid expenses	17	12,639	11,959
Sundry assets	18	8,737	7,792
TOTAL ASSETS		4,281,724	3,101,515
LIABILITIES			
Banknotes in circulation	19	2,149,154	2,140,879
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro		1,527,860	465,676
Current accounts (including those covering the minimum reserve system)	20	517,860	252,624
Deposit facility	21	0	54,052
Fixed-term deposits	22	1,010,000	159,000
Liabilities to other euro area residents denominated in euro	23	9,737	8,737
Liabilities to non-euro area residents denominated in euro	24	15	14
Liabilities to non-euro area residents denominated in foreign currency	25	18,950	0
Counterpart of the special drawing rights allocated by the IMF	26	72,232	73,536
Other liabilities		86,153	38,909
Off-balance-sheet instruments revaluation differences	16	369	2,695
Accruals and income collected in advance	27	3,073	2,910
Sundry liabilities	28	82,711	33,304
Provisions	29	11,500	18
Revaluation accounts	30	13,679	9,740
Capital and reserves	31	358,337	341,333
Capital		147,237	130,233
Reserves		211,100	211,100
Profit for the year		34,107	22,673
TOTAL LIABILITIES		4,281,724	3,101,515

PROFIT AND LOSS ACCOUNT FOR 2012 AND 2011

thousand euros

	Item	2012	2011
Interest income		38,929	31,524
Interest expense		-9,188	-10,901
Net interest income	32	29,741	20,623
Realised gains/losses arising from financial operations		4,937	4,684
Write-downs on financial assets		-1,244	-509
Provisions for exchange rate risk, interest risk and credit risk		-11,500	
Net result of financial operations, write-downs and risk provisions	33	-7,807	4,175
Fees and commissions income		899	825
Fees and commissions expense		-106	-101
Net income from fees and commissions	34	793	724
Income from equity shares and participating interests	35	1,884	1,738
Net result of pooling of monetary income	36	24,402	8,520
Other income	37	1,336	6,248
Total net income		50,349	42,028
Staff costs	38	-7,859	-7,701
Administrative expenses	39	-5,160	-5,312
Depreciation of tangible fixed assets	14	-2,258	-2,233
Other expenses	40	-965	-4,109
Operating expenses		-16,242	-19,355
Profit for the year		34,107	22,673

NOTES ON THE ANNUAL ACCOUNTS OF EESTI PANK

ACCOUNTING POLICIES USED IN THE ANNUAL ACCOUNTS

General principles

The Annual Accounts have been drafted in accordance with the rules established on the basis of Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank.¹ The parts of the Annual Accounts that are not regulated by ECB guidelines have been drafted in accordance with the accounting principles generally accepted in Estonia.

The preparation of the Annual Accounts requires the Executive Board to provide estimates of the determinants affecting the assets and liabilities of Eesti Pank and income and expenses during the accounting period as at the balance sheet date. These estimates are based on the information available about Eesti Pank and its intentions and risks as at the date of preparation of the Annual Accounts.

Eesti Pank does not prepare a Cash Flow Statement for the Bank as this does not provide significant relevant information to the readers of the Annual Accounts of Eesti Pank, given its role as the central bank.

The Annual Accounts have been prepared in thousands of euros (EUR thousand) unless indicated otherwise.

The Balance Sheet items are grouped by residency (euro area, non-euro area) and currency (euro, other currency). The assets and liabilities related to monetary policy are recorded on separate rows.

The Annual Accounts have been prepared on the historical cost basis, except in cases explained in the following accounting principles.

Assets and liabilities

Assets and liabilities are recognised in the Balance Sheet when it is probable that any associated future economic benefit will flow to or from Eesti Pank; substantially all of the risks and rewards related to assets and liabilities have been transferred; and the cost or value of an asset or a liability and the resulting gains or losses can be measured reliably.

Financial assets and liabilities

A financial asset is any asset that is cash, or a contractual right to receive cash or any other financial assets from another entity, or a contractual right to exchange financial assets with another entity under conditions that are potentially favourable. Financial liability is any liability that is a legal obligation to deliver cash or any other financial assets to another entity or to exchange financial assets with another entity under conditions that are potentially unfavourable.

Financial assets are initially recorded at their acquisition cost, which is the fair value of the amount paid for the financial asset at acquisition. Financial liabilities are initially recorded at their acquisition cost, which is the fair value of the amount received for the financial liability at acquisition. Subsequent

¹ Guideline ECB/2010/20 of 11 November 2010 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast); Guideline ECB/2011/27 of 21 December 2011 and Guideline ECB/2012/29 of 10 December 2012 amending Guideline ECB/2010/20 on the legal framework for accounting and financial reporting in the European System of Central Banks.

measurement of financial assets and liabilities is based on the market value, the acquisition cost or the amortised cost depending on the type of asset or liability. Market value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction. Financial assets recorded at market value are revalued on every balance sheet date.

Financial assets recorded at adjusted acquisition cost are written down if the recoverable amount of an asset is likely to be smaller than its carrying amount. The impairment of significant financial assets is measured for each object separately. The impairment of financial assets that are not individually significant and that are not expected to be impaired is measured for all assets together. Write-downs of financial assets are recorded as an expense of the accounting period in the Profit and Loss Account.

Recording of transactions in foreign currency

With the exception of spot transactions in securities, transactions in financial instruments denominated in foreign currency are recorded in off-balance-sheet accounts on the trade date. At the settlement date the off-balance-sheet entries are reversed and transactions are booked on-balance-sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date, and realised results arising from sales are also calculated on that date. Accrued interest, premiums and discounts related to financial instruments denominated in foreign currency are calculated and recorded daily, and the foreign currency position is also affected daily by these accruals.

Assets and liabilities denominated in foreign currency are converted into euro at the exchange rate prevailing on the recording date. Profits and losses are converted at the official exchange rate prevailing on the trade date. The revaluation of on-balance-sheet and off-balance-sheet instruments and of foreign exchange assets and liabilities is performed on a currency-by-currency basis.

The special drawing right (SDR) of the International Monetary Fund (IMF) is defined in terms of a basket of currencies. To revalue Eesti Pank's holdings of SDRs, the value of the SDR was calculated as the weighted sum of the exchange rates of four major currencies (the US dollar, euro, Japanese yen and pound sterling) converted into euro as at 31 December 2012.

The exchange rates applied on 31 December 2012 and 2011 were as follows:

	31/12/2012	31/12/2011
USD	1.3194	1.2939
GBP	0.8161	0.8353
JPY	113.61	100.2
SDR	1.1657	1.1867

Gold

Gold is valued at the market price prevailing at the year-end. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on the basis of the price in euro per fine ounce of gold, which, for the year ending 31 December 2012, was derived from the exchange rate of the euro against the US dollar on 31 December 2012.

Securities

Marketable securities (other than those classified as held-to-maturity) and similar assets are valued

either at the mid-market prices or on the basis of the relevant yield curve prevailing on the balance sheet date, on a security-by-security basis. For the year ending 31 December 2012, mid-market prices on 31 December 2012 were used.

Securities held for monetary policy purposes, which are classified as held-to-maturity securities, are valued on an amortised cost basis subject to impairment.

Income recognition

Income and expenses are recognised in the Profit and Loss Account in the period in which they are earned or incurred, regardless of when cash was received or paid. Realised gains and losses arising from the sale of foreign exchange, gold and securities are taken to the Profit and Loss Account. Such realised gains and losses are calculated by reference to the average cost of the respective asset.

Unrealised gains are not taken to the Profit and Loss Account, but are recognised on the Balance Sheet under "Revaluation accounts".

Unrealised losses are recorded in the Profit and Loss Account under "Write-downs on financial assets" if, at the year-end, they exceed previous revaluation gains registered in the corresponding revaluation account. Unrealised losses on any one currency or security or on gold are not netted against unrealised gains on other currencies or securities or gold.

In the event of an unrealised loss on any item at the year-end, the average cost of that item is reduced to the year-end exchange rate or market price.

Premiums or discounts arising on purchased securities are recorded as part of interest income and are amortised over the remaining life of the securities on a straight-line basis.

Reverse transactions

Repurchase transactions (sale/repurchase transactions) are recorded as collateralised loans taken at their fair value; that is, securities are recorded as assets on the Balance Sheet and the repurchase sum as a liability. Interest payable is recorded on an accrual basis on the Balance Sheet under Accruals and prepaid expenses.

Reverse repurchase transactions (purchase/resale transactions) are recorded as collateralised loans granted. Interest receivable is recorded on an accrual basis on the Balance Sheet under Accruals and prepaid expenses and interest income on the Profit and Loss Account. Securities used as collateral for reverse repurchase transactions are not recorded on the Balance Sheet of Eesti Pank.

Investment in shares

Investment in shares is recorded at market value if it can be assessed reliably. The assessment of the market value of shares is not reliable if they are not actively traded and there are no alternative methods for assessing their value reliably. In this case shares are recorded at their acquisition cost. Profits and losses on the sale of shares are recorded in the Profit and Loss Account after all conditions of sale are fulfilled. Dividend income is recorded as income for the period.

Fixed assets

Fixed assets are assets with a useful life of over a year and an acquisition cost in excess of 3200 euros. Fixed assets are recorded at their acquisition cost, including purchase price and other expenditure directly related to bringing assets to the location and condition necessary for their intended use. Land, buildings, utility systems of buildings, IT hardware, software, and other assets with long-term useful lives are recorded as fixed assets on the Balance Sheet. Prepayments for fixed assets are also recorded as fixed assets.

Land and objects of art and culture are not depreciable assets. Other fixed assets are depreciated on a straight-line basis over the estimated useful lives of the assets at the following rates:

	2012
Land and buildings	3%
Utility systems of buildings	10%
Hardware	20%
Software	15–50%
Other fixed assets	7–20%

The need to differentiate between software depreciation rates arose due to the implementation of application software with high acquisition cost and different useful lives.

Subsequent expenditure incurred for items of fixed assets is recognised as fixed assets when it is probable that Eesti Pank will derive future expected benefits from the asset and the cost of the asset can be measured reliably. Other maintenance and repair costs are recognised as expenses at the time they are incurred.

Provisions for exchange rate risk, interest risk, credit risk and gold price risk

Given the nature of the operations of a central bank, Eesti Pank may set up provisions on the balance sheet for exchange rate risk, interest rate risk, gold price risk and credit risk. The management of the bank decides on the size and use of the provisions, using a reasonable estimate of the bank's exposure.

Claims on and liabilities to the Financial Supervision Authority

The Balance Sheet of Eesti Pank contains a claim on the Financial Supervision Authority in relation to services provided by Eesti Pank and acquisition of current assets, and a liability to the Financial Supervision Authority in relation to its current account held with Eesti Pank.

Off-balance-sheet instruments

Currency instruments, namely foreign exchange forward instruments, forward legs of foreign exchange swaps and other currency instruments involving an exchange of one currency for another at a future date, are included in the net foreign currency position for the purpose of calculating foreign exchange gains and losses.

Interest rate instruments are revalued on an item-by-item basis. Daily changes in the variation margin of open interest rate futures contracts are recorded in the Profit and Loss Account. The valuation of forward transactions in securities and of interest rate swaps is based on generally accepted valuation methods, using observable market prices and rates and the discount factors from the settlement dates to the valuation date.

Contingent liabilities

Contingent liabilities are recorded in the Notes on the Annual Accounts and include commitments, guarantees and other liabilities which may, under certain conditions, become liabilities in the future, where the probability of their realisation is considered lower by the management of the Bank than the probability of their non-realisation.

Post-balance-sheet events

Assets and liabilities are adjusted for events that occur between the balance sheet date and the date of compilation of the Annual Accounts but are related to transactions during the accounting period or earlier periods or materially affect the condition of assets and liabilities on the balance sheet date. Important post-balance-sheet events that do not affect the condition of assets and liabilities on the balance sheet date are disclosed in the Notes.

Banknotes in circulation

The European Central Bank and the euro area national central banks, which together comprise the Eurosystem, issue euro banknotes.² The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key.³

The European Central Bank has been allocated a share of 8% of the total value of euro banknotes in circulation, and the remaining 92% has been allocated to the Eurosystem central banks according to their weightings in the capital key of the ECB. The share of banknotes allocated to each Eurosystem central bank is disclosed under the balance sheet liability item *Banknotes in circulation*.

The difference between the value of euro banknotes allocated to each Eurosystem central bank in accordance with the banknote allocation key and the value of euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which bear interest⁴, are disclosed under the sub-item *Intra-Eurosystem balances: net claims/liabilities related to the allocation of euro banknotes within the Eurosystem* (see *Intra-Eurosystem balances* in the notes on accounting policies).

From the cash changeover year⁵ until five years following the cash changeover year, the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the Eurosystem central bank's relative income positions as compared to previous years. The adjustments are effected by taking into account the differences for the observation period⁶ between the average value of banknotes released into circulation by the central banks of the Eurosystem countries and the average value of the banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments are reduced in annual stages until the first day of the sixth year after the cash changeover year, when income on banknotes is

2 Decision ECB/2010/29 of 13 December 2010 on the issue of euro banknotes (recast), OJ L 35, 9.2.2011, p 26.

3 Banknote allocation key – the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in that total.

4 Decision ECB/2010/23 of 25 November 2010 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast), OJ L 35, 9.2.2011, p 17.

5 The year of changeover to the euro is the year when euro banknotes become the legal tender of a Member State.

6 The period is 24 months long and starts 30 months before the day that the euro banknotes become the legal tender of the country in question. For Eesti Pank the period was from July 2008 to June 2010.

allocated fully in proportion to the Eurosystem central bank's paid-up shares in the ECB's capital. The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under *Net interest income*.

Interim profit distribution of the ECB

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, and the ECB's (net) income arising from SMP securities shall be due in full to the NCBs in the same financial year it accrues. The European Central Bank distributes this income in January of the following year in the form of an interim distribution of profit.⁷ The amount of the ECB's income on euro banknotes in circulation may be reduced in accordance with any decision by the Governing Council in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes. Before the end of the year the Governing Council decides whether all or part of the ECB's income arising from SMP securities and, if necessary, all or part of the ECB's income on euro banknotes in circulation should be retained to the extent necessary to ensure that the amount of distributed income does not exceed the ECB's net profit for that year.

The Governing Council may also decide to transfer all or part of the ECB's income arising from securities purchased under the Securities Market Programme and if necessary all or part of the ECB's income on euro banknotes in circulation to a provision for foreign exchange rate, interest rate, credit and gold price risks. The amount distributed to the Eurosystem central banks is disclosed in the Profit and Loss Account under *Income from equity shares and participating interests*.

Intra-Eurosystem balances

The European System of Central Banks' (ESCB) transactions are cross-border transactions between two national central banks of the European Union. The intra-ESCB transactions are settled primarily in TARGET2, the Trans-European Automated Real-time Gross Settlement Express Transfer system, and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. Intra-Eurosystem balances of euro area NCBs vis-à-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (e.g. interim profit distributions to NCBs) are presented in the Balance Sheet as a single net asset or liability position and disclosed under *Other claims within the Eurosystem (net)* or *Other liabilities within the Eurosystem (net)*.

Intra-Eurosystem balances arising from Eesti Pank's equity participation in the ECB are included under *Participating interest in the European Central Bank*.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a net single asset or liability under *Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem* (see "Banknotes in circulation" in the notes on accounting policies).

Intra-Eurosystem balances arising from the transfer of foreign reserve assets to the ECB by NCBs joining the Eurosystem are denominated in euro and reported under *Claims equivalent to the transfer of foreign reserves*.

⁷ Decision ECB/2010/24 of 25 November of 2010 on the interim distribution of the income of the European Central Bank on euro banknotes in circulation and arising from securities purchased under the Securities Market Programme (recast), OJ L 6, 11.1.2011, p 35.

NOTES ON THE BALANCE SHEET

NOTE 1 – GOLD AND GOLD RECEIVABLES

Changes in the value of Eesti Pank's gold reserves are as follows:

	31/12/2012	31/12/2011
Gold (ounces)	8,250.171	8,250.171
Ounce market value (euro)	1,261.18	1,216.86
Revaluation (thousand euros)	366	1,337
Market value (thousand euros)	10,405	10,039

ITEM 2 – RECEIVABLES FROM THE IMF

Item 2 includes the SDR account in the IMF, reserve position in the IMF and other receivables.

	31/12/2012	31/12/2011
		<i>thousand euros</i>
SDR account in the IMF	72,308	73,607
Reserve position in the IMF	9,538	8
Other receivables from the IMF	0	518
Receivables from the IMF	81,846	74,133

The SDR account in the IMF

An SDR account is generated for every IMF Member State for conducting loan transactions and several other related operations between a Member State and the IMF.

Reserve position in the IMF

Eesti Pank represents the Republic of Estonia in the IMF. A quota has been established for each IMF member determining its participation (subscription) and voting power in the IMF. Participation in the IMF is recorded under assets on the Balance Sheet and equals the country's quota.

On 15 December 2011 the Estonian parliament voted to accept the increase of the Estonian quota at the IMF by 28.7 million SDRs and authorised Eesti Pank to make the necessary transactions for this. This decision entered into force on 24 December 2011.

The parliament passed a law changing all previous acts relating to the IMF and stating that Eesti Pank was to make all the payments for membership of the IMF in the name of the Estonian Republic, and the government withdrew all bonds previously issued to cover Estonia's quota, which were to be replaced by a payment by Eesti Pank of the same value by 31 January 2012 at the latest.

On 23 January 2012 Eesti Pank transferred 8,528,600 euros to the IMF to receive 7,175,000 SDRs, increasing the Estonian quota by 25%. At the same time Eesti Pank credited the IMF's No.1 account at Eesti Pank with 25,540,291 euros, equivalent to 21,525,000 SDRs or 75% of the Estonian quota.

Under the new law, Eesti Pank credited the IMF's No.1 account at Eesti Pank with 77,121,595 euros, equivalent to 64,997,000 SDRs, on 24 January 2012. Under point 7² of the decision by the Supreme Council of the Republic of Estonia on joining the IMF, the EBRD and their associated organisations,

Eesti Pank backed up the bonds issued by the government to cover Estonia's quota at the IMF. At the end of 2012 the quota of the Republic of Estonia was 93,900,000 SDRs.

thousand euros

	31/12/2012	31/12/2011
Reserve position in the IMF	9,538	8
Participation in the IMF	109,471	77,373
IMF securities account and IMF No.1 account (liabilities)	-99,933	-77,365

The reserve position in the IMF comprises the net amount of the quota and the IMF No.1 account. Because the reserve position grew in 2012, the down payment of 25% of the Estonian quota was 7,175,000 SDRs and the participation in the IMF's Financial Transactions Plan (FTP) was 1,000,000 SDRs. Estonia has participated in the FTP since 2012.

Other receivables from the IMF

Since March 1997 this item has reflected the amounts that the IMF has reserved to strengthen its financial situation. The source of these amounts is the percentage added to the interest rate on the Stand-by Arrangement (SBA) and the Systemic Transformation Facility (STF), which is about 0.1%.

thousand euros

	31/12/2012	31/12/2011
Other receivables from the IMF	0	518
Eesti Pank, SBA loan-related receivable	0	399
Government, STF loan-related receivable	0	119

In 2012 the management of Eesti Pank decided to follow the IMF guidelines and write these off as uncollectible receivables and consequently they appear as a contingent claim on the IMF and a contingent liability to the Government of the Republic of Estonia in off-balance sheet accounts.

ITEM 3 – BALANCES WITH BANKS, SECURITY INVESTMENTS AND OTHER EXTERNAL ASSETS

Item 3 reflects bank balances in foreign currency with credit institutions outside the euro area and the security investments denominated in US dollars of non-euro area residents. In 2012, Eesti Pank's foreign reserves were invested mainly in the low-risk government bonds of the United States.

thousand euros

	31/12/2012	31/12/2011
Securities	100,718	66,018
Current accounts	11,153	11,678
Reverse repurchase transactions	21,844	0
Total	133,715	77,696

thousand euros

	31/12/2012	31/12/2011
USD	133,030	76,910
CAD	269	197
GBP	196	214
AUD	108	90
SEK	44	159
JPY	38	63
NZD	18	18
CHF	7	15
NOK	3	13
DKK	2	17
Total	133,715	77,696

ITEM 4 – CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Item 4 reflects bank balances in foreign currency with credit institutions in the euro area and the investments in equities denominated in US dollars of euro area residents.

thousand euros

	31/12/2012	31/12/2011
Equities	15,347	0
Current accounts	5,797	4,929
Total	21,144	4,929

thousand euros

	31/12/2012	31/12/2011
USD	18,843	2,782
GBP	1,591	978
AUD	283	640
JPY	217	217
SEK	194	179
CHF	8	8
CAD	7	94
NZD	1	1
NOK	0	30
Total	21,144	4,929

ITEM 5 – CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO

Item 5 reflects bank balances in euro with credit institutions outside the euro area and the security investments denominated in euro of non-euro area residents.

ITEM 6 – LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

The total Eurosystem holding of monetary policy assets amounts to 1,127,092 million euros of monetary policy claims, of which Eesti Pank's balance is 13.9 million euros of long-term refinancing transactions. Under Article 32.4 of the Statute of the ESCB, any risks from monetary policy operations, if they were

to materialise, should eventually be shared in full by the Eurosystem central banks in proportion to the prevailing ECB capital key shares. Eesti Pank's share is 0.25582%.

Losses can occur only if the counterparty is insolvent and has insufficient funds to realise the guarantees given. It should be noted that the Governing Council has ruled out risk sharing for guarantees that the NCB may accept at its own discretion.

ITEM 7 – OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Item 7 reflects the balances with banks of euro area credit institutions denominated in euro.

ITEM 8 – SECURITIES HELD FOR MONETARY POLICY PURPOSES

Item 8 reflects securities acquired by Eesti Pank within the scope of the purchase programmes for covered bonds,⁸ and public debt securities acquired in the scope of the Securities Market Programme (SMP).⁹

	<i>thousand euros</i>	
	31/12/2012	31/12/2011
SMP	340,996	342,273
CBPP2	32,255	2,038
Total	373,251	344,311

The SMP was established in May 2010. The ECB and NCBs may purchase euro area public and private debt securities to address the malfunctioning of certain segments of the euro area debt securities markets and to restore the proper functioning of the monetary policy transmission mechanism. The SMP balance declined during 2012 as the redemption of bonds at their maturity date surpassed the purchases of bonds.

The ECB Governing Council regularly assesses the financial risks associated with the securities bought under the SMP and the two covered bond purchase programmes.

The total Eurosystem central banks holding of SMP securities amounts to 192,608 million euros, of which Eesti Pank holds 341 million euros. Under Article 32.4 of the Statute of the ESCB, any risks from holdings of SMP securities, if they were to materialise, should eventually be shared in full by the Eurosystem central banks in proportion to the prevailing ECB capital key shares.

In February 2012, the Eurosystem central banks exchanged their holdings of Greek government bonds bought as part of the SMP for new Greek government bonds. The new bonds have the same nominal value, interest rate, interest payment dates and redemption dates as the bonds purchased under the SMP. The new bonds were not on the list of bonds that were restructured for private investors, and so Eesti Pank did not bear any loss on its Greek government bonds.

⁸ Decision ECB/2009/16 of 2 July 2009 on the implementation of the covered bond purchase programme (OJ L 175, 4.7.2009, p 18) and Decision ECB/2011/17 of 3 November 2011 on the implementation of the second covered bond purchase programme (OJ L 297, 16.11.2011, p 70).

⁹ Decision ECB/2010/5 of 14 May 2010 establishing a securities markets programme (OJ L 124, 20.5.2010, p 8).

Securities purchased under the Securities Market Programme and the covered bond purchase programme are classified as held-to-maturity securities and are valued on an amortised cost basis subject to impairment (see “Securities” in the notes on the accounting policies). Annual impairment tests are conducted on the basis of information available and estimated recoverable amounts as at the year-end.

In the SMP impairment test at the end of 2012, the Governing Council of the ECB identified two possible indicators of impairment, both related to Greek government bonds. The first was the partial restructuring of Greek government debt in March and the second was the repurchase transaction of the debt by the Greek government in December. The ECB Governing Council considered these indicators and found from the information in its possession at the end of 2012 that they will not entail any change in the future cashflows from the securities. For this reason no impairment loss was recorded at the end of the year.

Equally, the test did not show or register any fall in the value of other securities that were bought as part of the SMP or the two covered bond purchase programmes.

ITEM 9 – OTHER SECURITIES

Item 9 reflects investments in securities denominated in euro by euro area residents.

ITEM 10 – PARTICIPATING INTEREST IN THE ECB

Item 10 reflects the participating interest of Eesti Pank in the European Central Bank (ECB). Article 28 of the Statute of the European System of Central Banks (ESCB) states that the national central banks of the ESCB are the sole subscribers of the capital of the ECB. Subscriptions depend on the capital key weighting that is established in compliance with Article 29.3 of the ESCB Statute and that is adjusted every five years, last on 1 January 2009. Consequently, Eesti Pank’s share in the subscribed capital of the ECB increased from 0.1703% to 0.1790%.

In December 2010, the ECB decided to increase its subscribed capital by 5 billion euros from 5.76 billion to 10.76 billion euros as of 29 December 2010. The national central banks of the euro area paid up their additional capital contributions in three equal annual instalments.

In accordance with the legal acts adopted by the ECB Governing Council on the increase of the subscribed capital of the ECB on 29 December 2010 and the paying up of the increase in three instalments¹⁰, Eesti Pank paid an additional 2,983,333 euros to the ECB on 27 December 2012, representing the third instalment of the contribution to the increase in the ECB’s capital.

The subscribed and paid up capital contributions of the national central banks are as follows:

¹⁰ Decision ECB/2010/26 of 13 December 2010 on the increase of the European Central Bank’s capital (OJ L 11, 15.1.2011, p 53); Decision ECB/2010/27 of 13 December 2010 on the paying in of the increase of the European Central Bank’s capital by the national central banks of Member States whose currency is the euro (OJ L 11, 15.1.2011, p 54); Decision ECB/2010/34 of 31 December 2010 on the paying in of capital, transfer of foreign reserve assets and contributions by Eesti Pank (OJ L 11, 15.1.2011, p 58); Agreement of 31 December 2010 between Eesti Pank and the European Central Bank regarding the claim credited to Eesti Pank by the European Central Bank under Article 30.3 of the Statute of the European System of Central Banks and of the European Central Bank (OJ C 12, 15.2.2011, p 6).

	Subscribed capital as of 1 January 2009	Subscribed capital as of 29 December 2010	Paid-up capital before 26 December 2012	Paid-up capital as of 27 December 2012
	%	€	€	€
Nationale Bank van België / Banque Nationale de Belgique	2.4256	261,010,385	220,583,718	261,010,385
Deutsche Bundesbank	18.9373	2,037,777,027	1,722,155,361	2,037,777,027
Eesti Pank	0.1790	19,261,568	16,278,234	19,261,568
Central Bank of Ireland	1.1107	119,518,566	101,006,900	119,518,566
Bank of Greece	1.9649	211,436,059	178,687,726	211,436,059
Banco de España	8.3040	893,564,576	755,164,576	893,564,576
Banque de France	14.2212	1,530,293,899	1,293,273,899	1,530,293,899
Banca d'Italia	12.4966	1,344,715,688	1,136,439,021	1,344,715,688
Central Bank of Cyprus	0.1369	14,731,333	12,449,666	14,731,333
Banque centrale du Luxembourg	0.1747	18,798,860	15,887,193	18,798,860
Central Bank of Malta	0.0632	6,800,732	5,747,399	6,800,732
De Nederlandsche Bank	3.9882	429,156,339	362,686,339	429,156,339
Oesterreichische Nationalbank	1.9417	208,939,588	176,577,921	208,939,588
Banco de Portugal	1.7504	188,354,460	159,181,126	188,354,460
Banka Slovenije	0.3288	35,381,025	29,901,025	35,381,025
Národná banka Slovenska	0.6934	74,614,364	63,057,697	74,614,364
Suomen Pankki – Finlands Bank	1.2539	134,927,820	114,029,487	134,927,820
Subtotal – euro area national central banks*		7,529,282,289	6,363,107,289	7,529,282,289
Българска народна банка (Bulgarian National Bank)	0.8686	93,467,027	3,505,014	3,505,014
Česká národní banka	1.4472	155,728,162	5,839,806	5,839,806
Danmarks Nationalbank	1.4835	159,634,278	5,986,285	5,986,285
Latvijas Banka	0.2837	30,527,971	1,144,799	1,144,799
Lietuvos bankas	0.4256	45,797,337	1,717,400	1,717,400
Magyar Nemzeti Bank	1.3856	149,099,600	5,591,235	5,591,235
Narodowy Bank Polski	4.8954	526,776,978	19,754,137	19,754,137
Banca Națională a României	2.4645	265,196,278	9,944,860	9,944,860
Sveriges Riksbank	2.2582	242,997,053	9,112,389	9,112,389
Bank of England	14.5172	1,562,145,431	58,580,454	58,580,454
Subtotal – non-euro area national central banks*		3,231,370,113	121,176,379	121,176,379
Total*	100.0000	10,760,652,403	6,484,283,669	7,650,458,669

* Owing to rounding, the total may not correspond to the sum of all figures shown.

Upon Estonia's accession to euro area, Eesti Pank became subject to Article 48.2 of the ESCB's Statute, which sets out that Eesti Pank is required to pay a part of the reserves, revaluation accounts and risk provisions of the ECB in proportion to its share in the subscribed capital of the ECB. Starting from 2011 the sums paid for the reserves, the revaluation accounts and the risk provision of the ECB, amounting to 63,633,111 euros in total, are shown under this item.

ITEM 11 – CLAIMS EQUIVALENT TO THE TRANSFER OF FOREIGN RESERVES

Item 11 reflects claims of Eesti Pank that come from the transfers made to the foreign currency reserves of the ECB. The claims are denominated in euro at a value fixed at the time of their transfer. They are remunerated at the latest available marginal rate for the Eurosystem's main refinancing operations, adjusted to reflect a zero return on the gold component.

ITEM 12 – NET CLAIMS RELATED TO THE ALLOCATION OF EURO BANKNOTES WITHIN THE EUROSISTEM

Item 12 reflects Eesti Pank's claims on the Eurosystem relating to the allocation of euro banknotes within the Eurosystem (see "Banknotes in circulation" and "Intra-Eurosystem balances" in the notes on the accounting policies).¹¹

ITEM 13 – OTHER CLAIMS WITHIN THE EUROSISTEM (NET)

	<i>thousand euros</i>	
	31/12/2012	31/12/2011
TARGET2 balance	1,740,599	637,978
Claims on the ECB in relation to the allocation of monetary income	24,402	8,520
Partial allocation of ECB profit	1,470	1,668
Total	1,766,471	648,166

Item 13 reflects net claims arising from the TARGET2 balance, the amount due to the difference between monetary income to be pooled and redistributed to the Eurosystem central banks, and the amount due to the distribution of the ECB's income on euro banknotes.

The remuneration on the balance of the TARGET2 account is calculated daily at the marginal interest rate of Eurosystem main refinancing operations.

The claim on the ECB in connection with the annual pooling and allocation of monetary income comes from the difference between the amounts pooled and distributed by the Eurosystem NCBs (see item 36 of the Profit and Loss account, "Net result of pooling of monetary income").

At the decision of the Governing Council of the ECB, the ECB partially retained its 2012 income (see item 35 of the Profit and Loss account "Income from equity shares and participating interests").

¹¹ In accordance with the accounting methods chosen by the Eurosystem in relation to the euro banknotes, 8% of the total value of euro banknotes in circulation is allocated to the ECB on a monthly basis. The other 92% of the euro banknotes in circulation are allocated to the national central banks on a monthly basis, while the latter reflect their percentages of the euro banknotes in their Balance Sheets in proportion to their paid-up contributions to the ECB capital. In accordance with these accounting methods, the difference between the value of euro banknotes allocated to a national central bank and the value of euro banknotes issued into circulation is recorded under *Intra-Eurosystem net claims/liabilities related to the allocation of euro banknotes within the Eurosystem*.

ITEM 14 – FIXED ASSETS

thousand euros

Acquisition costs	Buildings	Hardware	Software	Inventory	Total
Balance at the end of 2011	27,669	3,182	4,103	6,186	41,140
Acquisitions	549	501	84	48	1,182
Disposals	0	-87	-69	-7	-163
Balance at the end of 2012	28,218	3,596	4,118	6,227	42,159
Accumulated depreciation					
Balance at the end of 2011	8,540	2,493	3,342	3,768	18,143
Depreciation charge	1,237	243	282	496	2,258
Disposals	0	-87	-69	-7	-163
Balance at the end of 2012	9,777	2,649	3,555	4,257	20,238
Carrying amount					
at the end of 2011	19,129	689	761	2,418	22,997
at the end of 2012	18,441	947	563	1,970	21,921
Prepayments for fixed assets					
Balance at the end of 2011	0	0	275	0	275
Balance at the end of 2012	5	0	495	0	500
Total fixed assets					
at the end of 2011	19,129	689	1,036	2,418	23,272
at the end of 2012	18,446	947	1,058	1,970	22,421

The cost of fixed assets acquired in 2012 was 1.2 million euros (2.9 million euros in 2011). The largest share of the acquisition cost was spent on procurements for the renovation of buildings and technical networks. Hardware procurements were held for a new IP-telephone system and to acquire servers. The largest software procurements were for business analysis software and additional database software. The main inventory procurement was for cash handling equipment.

ITEM 15 – OTHER FINANCIAL ASSETS

Eesti Pank holds 214 shares (200 voting shares) in the Bank for International Settlements at an acquisition cost of 217,118 euro.

ITEM 16 – OFF-BALANCE-SHEET INSTRUMENTS REVALUATION DIFFERENCES

Item 16 reflects valuation changes in swap and forward transactions in foreign currency outstanding at year-end. These valuation changes result from the conversion of such transactions into their euro equivalents at the exchange rates prevailing on the balance sheet date, compared with the values resulting from the conversion of the transactions at the average cost in the respective foreign currency on that date.

Valuation gains in outstanding interest rate swap transactions are also included in this item.

ITEM 17 – ACCRUALS AND PREPAID EXPENSES

thousand euros

	31/12/2012	31/12/2011
Interest income	11,175	10,469
Securities	8,950	7,670
Intra-Eurosystem balances	1,966	2,676
Derivative instruments	140	91
Monetary policy operations	101	0
Fixed-term deposits and current accounts	9	24
Loans	9	8
Prepaid expenses	575	583
Claims on the Financial Supervision Authority	551	518
Other claims	338	389
Total	12,639	11,959

ITEM 18 – SUNDRY ASSETS

thousand euros

	31/12/2012	31/12/2011
Loans to employees of Eesti Pank	5,899	5,056
Foreign exchange transactions	1,760	1,361
Numismatic banknotes and coins of the Estonian kroon	939	952
Credits related to margin calls	23	209
Other	116	214
Total	8,737	7,792

Mortgage loans have been granted to employees of Eesti Pank for a maximum of 30 years and consumption loans for up to two years. The Supervisory Board of Eesti Pank establishes the interest rate on consumption loans for each year. The interest rate on consumption loans is comparable to the interest rate charged by Estonian credit institutions under similar conditions. The interest rate on mortgage loans granted before 2012 is the standing deposit facility interest payable to credit institutions plus the risk margin but not more than the minimum loan interest rate established by the Minister of Finance. The deposit facility rate equals the ECB deposit interest rate, which was 0-0.25% in 2012. The interest rate on mortgage loans granted since 2012 is the six-month Euribor plus 0.5 per cent but no more than the minimum loan interest rate established by the Minister of Finance. In addition, study loans have been granted for a maximum of ten years and with a 5% interest rate.

ITEM 19 – BANKNOTES IN CIRCULATION

Item 19 reflects Eesti Pank's share of the total euro banknotes in circulation (see "Banknotes in circulation" in the notes on accounting policies).

thousand euros

	31/12/2012	31/12/2011
Estonian kroon banknotes	0	48,161
Euro banknotes	703,145	590,743
Adjustments of euro banknotes	1,632,778	1,683,840
ECB banknotes (8%)	-186,769	-181,865
Total	2,149,154	2,140,879

In the first year after the changeover to the euro, Estonian kroon banknotes were recorded in the row “Banknotes in circulation”, but since 2012 they have been recorded under “Sundry liabilities”.

In 2013 the Estonian kroon is still being exchanged for euros at the central rate of 15.6466 with no service fee at Swedbank and SEB cash handling branches throughout Estonia as well as the museum of the central bank.

ITEM 20 – CURRENT ACCOUNTS (INCLUDING THOSE COVERING THE MINIMUM RESERVE SYSTEM)

Item 20 contains the credit balances on the current accounts of Estonian credit institutions held with Eesti Pank. The credit balances that are required to be held in Eesti Pank to cover the minimum reserve have been remunerated at the prevailing marginal interest rate for the Eurosystem’s main refinancing operations. Interest is not paid for amounts in excess of the minimum reserve.

ITEM 21 – DEPOSIT FACILITY

Item 21 reflects the standing deposit facility of the Eurosystem available for Estonian credit institutions for overnight depositing with the central bank at a pre-fixed interest rate.

ITEM 22 – FIXED-TERM DEPOSITS

Item 22 reflects the fixed-term deposits of Estonian credit institutions held with the central bank. Fixed-term deposits are collected in a variable rate tender, so that counterparties bid the amounts of money and the interest rate at which they want to enter into transactions. The ECB’s allocation decision determines the counterparties whose bids are satisfied.

ITEM 23 – LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

Item 23 reflects mainly the current account of the Financial Supervision Authority held with Eesti Pank, on which interests are calculated quarterly on the basis of the average balance of the current account. The interest rate is equal to the yield of the foreign exchange reserves in the previous quarter.

ITEM 24 – LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO

Item 24 reflects the euro deposits of non-euro-area residents. These deposits do not bear interest.

ITEM 25 – LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Item 25 reflects repurchase transactions with non-euro area residents.

ITEM 26 – COUNTERPART OF THE SPECIAL DRAWING RIGHTS ALLOCATED BY THE IMF

Item 26 reflects the liability to the IMF arising from the IMF's decision of 7 August 2009 to increase the SDR issues for all of its member states. This was done in order to increase global liquidity by providing support to the foreign reserves of the member states. As a result, Estonia received 61,965,241 SDRs.

ITEM 27 – ACCRUALS AND INCOME COLLECTED IN ADVANCE

thousand euros

	31/12/2012	31/12/2011
Accounts payable	826	907
Tax liabilities	784	688
Recreation reserve	568	561
Employee salaries payable	526	506
Interest expense	292	244
Derivative instruments	230	90
Deposits with credit institutions	52	125
SDR allocation	9	22
Monetary policy operations	1	7
Other liabilities	77	4
Total	3,073	2,910

ITEM 28 – SUNDRY LIABILITIES

thousand euros

	31/12/2012	31/2/2011
Estonian kroon banknotes	44,146	0
Euro coins	30,862	25,076
Estonian kroon coins	7,530	7,632
Loans to employees of Eesti Pank	80	201
Credits related to margin calls	23	23
Foreign exchange transactions	0	227
Other liabilities	70	145
Total	82,711	33,304

The balances related to foreign exchange transactions arise from the conversion of such transactions into their euro equivalents at the respective currency's average cost on the balance sheet date, compared with the euro values at which the transactions were initially recorded.

In the first year after the changeover to the euro, Estonian kroon banknotes were recorded in the row "Banknotes in circulation", but since 2012 they have been recorded under "Sundry liabilities".

ITEM 29 – PROVISIONS

Item 29 reflects general risk provisions in 2012 for exchange rate risk, interest rate risk and credit risk. The size of the provisions has been decided by the management of Eesti Pank on the basis of risk assessment of assets.

ITEM 30 – REVALUATION ACCOUNTS

	<i>thousand euros</i>	
	31/12/2012	31/12/2011
Securities	8,234	6,044
Gold	3,159	2,793
Equities	839	0
Foreign currency	796	638
Derivative instruments	651	265
Total	13,679	9,740

These accounts represent revaluation reserves that arise from unrealised gains on assets and liabilities.

The unrealised losses at the end of the year are recognised in the Profit and Loss Account as expenses under “Write-downs on financial assets”.

ITEM 31 – CAPITAL AND RESERVES

Changes in capital and reserves in 2012:

	<i>thousand euros</i>		
	31/12/2012	Distribution of profit for 2011	31/12/2011
Fixed Capital	100,000		100,000
Reserve Capital	47,237	17,004	30,233
Special Reserve	211,100		211,100
Total	358,337	17,004	341,333

Section 30 of the Eesti Pank Act sets out that at least 25% of the annual profit must be allocated for increasing both statutory and reserve capital. After these allocations, part of the profit can be allocated for establishing and supplementing the special reserve for specific purposes, at the decision of the Supervisory Board of Eesti Pank. The remaining profit is transferred to the state budget.

NOTES ON THE PROFIT AND LOSS ACCOUNT

ITEM 32 – NET INTEREST INCOME

thousand euros

	2012	2011
Net interest income	29,741	20,623
Interest income	38,929	31,524
Intra-Eurosystem balances	27,134	14,701
Securities	9,506	13,026
Derivative instruments	2,053	2,977
Loans to employees of Eesti Pank	99	105
Current accounts	90	312
Reverse repurchase transactions	32	290
Fixed-term deposits	15	113
Interest expense	-9,188	-10,901
Securities	-4,845	-2,688
Derivative instruments	-2,367	-2,900
Intra-Eurosystem balances	-1,650	-4,681
Euro deposits	-185	-71
	-82	-282
Current accounts	-59	-158
Repurchase transactions	0	-121
Fixed-term deposits		

thousand euros

	2012	2011
Intra-Eurosystem interest income	27,134	14,701
Monetary policy operations	16,978	6,538
Interest income on TARGET accounts	6,274	2,149
Allocation of banknotes within the Eurosystem	3,097	4,911
Transfer of foreign currency reserves	785	1,103
Intra-Eurosystem interest expense	-1,650	-4,681
Interest expense from minimum reserves	-1,095	-2,815
Monetary policy operations	-555	-1,141
Interest expense from TARGET accounts	0	-687
Transfer of capital share	0	-38

ITEM 33 – NET RESULT OF FINANCIAL OPERATIONS, WRITE-DOWNS AND RISK PROVISIONS

thousand euros

	2012	2011
Net result of financial operations, write-downs and risk provisions	-7,807	4,175
Realised gains/losses arising from financial operations	4,937	4,684
Securities	4,375	1,819
Derivative instruments	1,344	-1,137
Financial asset management costs	-294	-10
Exchange rate profit/loss	-488	4,012
Write-downs on financial assets	-1,244	-509
Exchange rate write-downs	-454	-198
Other receivables from the IMF	-394	0
Derivative instruments	-350	-311
Securities	-46	-1
Net change of loan portfolio write-downs	0	1
Provisions for exchange rate risk, interest risk and credit risk	-11,500	0

ITEM 34 – NET INCOME FROM FEES AND COMMISSIONS

thousand euros

	2012	2011
Net income from fees and commissions	793	724
Fees and commissions income	899	825
Current accounts service fees	860	825
Fines, arrears and other	39	0
Fees and commissions expense	-106	-101
Commission fees	-71	-61
TARGET2 fees	-29	-30
Other fees and commissions	-6	-10

ITEM 35 – INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS

Item 35 reflects dividends from the shares of the Bank for International Settlements. This item also includes the distribution of the ECB's income from euro banknotes of 1.5 million euros (see "Interim profit distribution" in the notes on the accounting policies).

Following a decision by the ECB Governing Council, the ECB distributed part of its 2012 income totalling 575 million euros.

ITEM 36 – NET RESULT OF POOLING OF MONETARY INCOME

thousand euros

	2012	2011
Net result of pooling of monetary income	24,402	8,520
Distribution of monetary income	24,382	8,520
Monetary income pooled by Eesti Pank	-35,492	-31,608
Monetary income allocated to Eesti Pank	59,874	40,128
Adjustment for the monetary income of the previous year	20	0

The net result of pooling of monetary income from the Eurosystem central banks in 2012 totalled 23,404,802,733 euros, which includes the share of Eesti Pank.

The monetary income pooled by the Eurosystem is allocated among Eurosystem central banks according to the subscribed ECB's capital key. The difference between the monetary income pooled by Eesti Pank of 35,492,178 euros and that reallocated to Eesti Pank of 59,874,657 euros is the net result of 24,382,479 euros arising from the calculation of monetary income.

The amount of each national central bank's monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base. The liability base consists mainly of the following items: banknotes in circulation; liabilities to euro area credit institutions related to monetary policy operations denominated in euro; net intra-Eurosystem liabilities resulting from TARGET2 transactions; net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The earmarkable assets consist mainly of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; securities held for monetary policy purposes; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET2 transactions; net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; a limited amount of each national central bank's gold holdings in proportion to each national central bank's capital key share.

Gold is considered to generate no income. Securities held for monetary policy purposes under Decision ECB/2009/16 of 2 July 2009 on the implementation of the covered bonds purchase programme and under Decision ECB/2011/17 of 3 November 2011 on the implementation of the second covered bond purchase programme are considered to generate income at the latest available marginal rate for the Eurosystem's main refinancing operations. Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to the value of the difference the latest available marginal rate for the Eurosystem's main refinancing operations and the total income or expense for the year shall be considered in the allocation of monetary income.

ITEM 37 – OTHER INCOME

	<i>thousand euros</i>	
	2012	2011
Other income	1,336	6,248
Expenses compensated by the Financial Supervision Authority	586	547
Income from the sale of collector coins and numismatic products	352	2,057
Compensation for expenses in the changeover to the euro	219	0
Income on financial asset management	118	107
Rental income	42	39
Income from the sale of coin metal	0	3,474
Other income	19	24

Under the cooperation protocol between the Financial Supervision Authority and Eesti Pank, the Financial Supervision Authority reimbursed, in monthly payments, 100% of the cost of the support services provided by Eesti Pank. Eesti Pank provides the Financial Supervision Authority with information technology, accounting, real estate, and administration services. The Financial Supervision Authority covers the depreciation costs of fixed assets used.

Income from the sale of numismatic products mostly came from the sales income from collector coins, around 38% of which came from sales of the silver collector coins made to commemorate the London Olympic Games.

The European Commission compensated Eesti Pank for the expenses for the changeover to the euro, covering the costs of the euro starter pack and the communications expenses for 2011 and 2010.

Income from asset management includes the service fee paid by the Guarantee Fund to Eesti Pank for investing their assets.

Income from the rent of the training centres of Eesti Pank is recorded under "Rental Income".

ITEM 38 – STAFF COSTS

thousand euros

	2012	2011
Staff costs	-7,859	-7,701
Wages	-5,736	-5,609
Social tax	-1,921	-1,881
Compensations and benefits	-128	-134
Unemployment insurance	-74	-77

Staff costs are mainly wage costs, including taxes.

Compensation and benefits include pension benefits and fringe benefits tax calculated on the preferential interest rate on mortgage loans and the preferential price for the rent of the training centre.

On average, there were 237 employees at Eesti Pank in full-time employment in 2012 (241 in 2011).

ITEM 39 – ADMINISTRATIVE EXPENSES

thousand euros

	2012	2011
Administrative expenses	-5,160	-5,312
Information technology maintenance	-1,209	-1,424
Real estate renovation and administration	-1,179	-948
Financial asset management	-916	-972
Business travel	-561	-582
Public relations and publications	-318	-415
Training	-225	-206
Office	-176	-193
Communications and transport	-113	-108
Legal and arbitration	-76	-22
Other administrative expenses	-387	-442

The costs of financial asset management and settlements comprise the cost of market information, fees and costs of cross-border payments, and management costs of foreign reserves.

The procurements of public relations and publications include the costs of public events, publications, information agencies, the public web and online databases, public relations research polls, information campaigns, advertising and the Museum of Eesti Pank.

Business travel expenses reflect the costs of staff business travel for the representation of Eesti Pank and cooperation with international organisations and financial institutions. There were a total of 762 business trips in 2012 (727 in 2011).

Other expenses consisted mostly of the costs of security, the foreign representation of Eesti Pank and economic research.

ITEM 40 – OTHER EXPENSES

thousand euros

	2012	2011
Other expenses	-965	-4,109
Production of euro coins	-438	-2 855
Production of collector coins and numismatic products	-213	-532
Cash circulation management	-132	-524
Other expenses	-182	-198

ITEM 41 – DERIVATIVE INSTRUMENTS

Futures purchase transactions with a contract value of 305.4 million euros and futures sale transactions with a contract value of 168.5 million euros were outstanding as at 31 December 2012 (in 2011, 18.7 million and 169.6 million euros, respectively). The contract value of outstanding interest rate swaps totalled 265.6 million euros (in 2011, 148.5 million euros). Foreign exchange swap and forward transaction claims of 191.4 million and liabilities of 189.4 million euros were outstanding as at 31 December 2012 (in 2011, 126.3 and 127.6 million euros respectively).

ITEM 42 – CONTINGENT LIABILITIES

thousand euros

	31/12/2012	31/12/2011
Contingent liabilities	2,345	2,105
Contractual obligations to produce banknotes and coins	1,793	1,542
Unpaid share capital (75%) of BIS	552	563

The production of banknotes and coins

At the end of 2012, the contingent liabilities of Eesti Pank arising from the Joint Euro Tender for the production of euro banknotes in 2013 stood at 1.8 million euros. Of this, 1.5 million euros was an obligation carried forward from 2012.

Eesti Pank has participated in the production of euro banknotes since Estonia joined the euro area. Eesti Pank must return to the Eurosystem 44 million banknotes that were lent to Eesti Pank in autumn 2010 for the changeover to the euro. Furthermore, a certain amount of euro cash that is determined by the ECB Governing Council must be produced for the euro area countries. Eesti Pank procures the euro banknotes through a joint tender with eight other euro area central banks. Under the tender, 20-euro banknotes are produced that are included in the joint assets of the Eurosystem.

Bank for International Settlements

Since 1930 Eesti Pank has had a contingent liability to the Bank for International Settlements regarding the unpaid part of the share capital (75%) of the BIS denominated in Swiss gold francs, which totalled 551,810 euros on the balance sheet date (see Item 15).

INDEPENDENT CERTIFIED AUDITOR'S REPORT

To the Supervisory Board of Eesti Pank:

We have audited the accompanying financial statements of Eesti Pank, which comprise the statement of financial position as at 31 December 2012, and the statement of revenues and expenses and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these financial statements in accordance with the guidelines established by the Governing Council of European Central Bank, which are set out in Decision ECB/2010/20 (recast) on 11 November 2010 and Eesti Pank Act, and for such internal control as the Management Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Certified Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.


An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the certified auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the certified auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Eesti Pank as at 31 December 2012, and its financial performance for the year then ended in accordance with the guidelines established by the Governing Council of European Central Bank, which are set out in Decision ECB/2010/20 (recast) on 11 November 2010 and Eesti Pank Act.

26 March 2013


Veiko Hintsov
Certified Auditor, No. 328
AS Deloitte Audit Eesti
Licence No. 27

APPENDICES

APPENDICES

DECREES OF THE GOVERNOR OF EESTI PANK 2012

No 1, 13 January 2012

Approval of the list of statistical actions of Eesti Pank under the official statistical programme

(officially published: RT I, 18.01.2012, 3)

The decree approves the list of statistical actions of Eesti Pank for 2012-2016. The list of statistical actions approved by the Governor of Eesti Pank is a part of the official statistical programme. Under the Eesti Pank Act § 34 paragraph 1, Eesti Pank collects data for monetary, financial and balance of payments statistics. The decree was established on the basis of clause 16 (1) 2) of the Official Statistics Act.

No 2, 24 January 2012

Payments statistics submitted by credit institutions

(officially published: RT I, 14.11.2012, 5)

The decree establishes requirements for the contents and structure of statistical reports and the terms and procedure for submission of reports to Eesti Pank. Decree No 10 of the Governor of Eesti Pank from 23 August 2007, "Confirmation of reports on payments statistics submitted by credit institutions" was repealed by the decree.

Under the decree, all credit institutions and branches of credit institutions operating in Estonia must prepare and submit reports on the payments, card transactions and mobile payments, bank cards, automated teller machines, points of sale and sales terminals, and electronic payment channels of their entities in Estonia.

The decree was established on the basis of subsection 91 (1) of the Credit Institutions Act.

No 3, 24 April 2012

Terms and conditions for holding accounts in Eesti Pank

(officially published: RT I, 27.04.2012, 2)

These terms and conditions for holding accounts in Eesti Pank regulate the relationships between Eesti Pank as the account manager and a person applying to open an account in Eesti Pank or a person holding an account in Eesti Pank regarding the opening and usage of accounts held in Eesti Pank. Decree No 10 of the Governor of Eesti Pank from 13 May 2004 "Establishment of general terms and conditions and price list of account management" was repealed by the decree.

The decree was established under clauses 14 2) and 5) of the Eesti Pank Act.

No 4, 25 May 2012

Establishment of supplementary reports on credit institution's balance sheet

(officially published: RT I, 01.06.2012, 5)

The decree sets requirements for the contents and structure of the reports submitted to the Financial Supervision Authority and Eesti Pank and for the terms and procedure for their submission. Decree No 5 of the Governor of Eesti Pank from 13 July 2010 "Supplementary reports on credit institutions' balance sheet" was repealed by the decree.

Credit institutions must submit reports to the Financial Supervision Authority on their turnover of resources; balance of resources; turnover of loans; balance of loans; changes in claims written off from the credit institution's balance sheet; securities; turnover of liabilities related to securities; and liabilities related to securities. Credit institutions must submit reports to Eesti Pank on the regional breakdown of deposits and loans;

the accounting of intangible assets and tangible fixed assets; and the quarterly balance of loans. The decree was established on the basis of clause 2 (2) 7) of the Eesti Pank Act and subsections 91 (1) and (3) of the Credit Institutions Act.

No 5, 29 May 2012

Amendments to Decree No 16 of the Governor of Eesti Pank from 9 November 2007 "Establishment of off-balance-sheet reporting of credit institutions"

(officially published: RT I, 05.06.2012, 1)

The decree amends Decree No 16 of the Governor of Eesti Pank from 9 November 2007 "Establishment of off-balance-sheet reporting of credit institutions". The amendments clarify the use of terms and amend the format for reporting and the security requirements for data exchange.

The decree was established under subsection 91 (1) of the Credit Institutions Act.

No 6, 29 June 2012

Issue of collector coins

(officially published: RT I, 03.07.2012, 18)

The decree was the basis for the issuance in the Republic of Estonia on 12 July 2012 of a silver collector coin dedicated to the London Olympic Games with nominal value 12 euros and the year of issue 2012.

The decree was based on subsection 141 (2) of the Eesti Pank Act and Decision No 2-2 of the Supervisory Board of Eesti Pank dated 27 March 2012.

No 7, 6 November 2012

Repeal of Eesti Pank Governor's Decree No 15 of 20 September 2002 'Electronic Format of Reports' and amendments to Decrees of the Governor of Eesti Pank

(officially published: RT I, 13.11.2012, 3)

Decree No 15 of the Governor of Eesti Pank from 20 September 2002 'Electronic Format of Reports' was repealed by the decree. Amendments were also made to the following decrees of the Governor of Eesti Pank:

- Decree No 8 of the Governor of Eesti Pank from 22 June 2007 'Establishment of substantive and formal requirements for the balance sheet and income statement of a credit institution and a consolidation group of credit institution';
- Decree No 11 of the Governor of Eesti Pank from 1 October 2007 'Establishment of the report on deposits guaranteed by the Guarantee Fund and the report on quarterly contributions paid to the Guarantee Fund';
- Decree No 14 of the Governor of Eesti Pank from 1 October 2007 'Establishment of balance of payments reports of credit institutions';
- Decree No 16 of the Governor of Eesti Pank from 9 November 2007 'Establishment of off-balance-sheet reporting of credit institutions';
- Decree No 19 of the Governor of Eesti Pank from 7 December 2007 'Establishment of supplementary reports on the balance sheet of a credit institution's consolidation group';
- Decree No 22 of the Governor of Eesti Pank from 7 December 2010 'Establishment of reports on credit institutions' reserve requirement calculation';
- Decree No 4 of the Governor of Eesti Pank from 25 May 2012 'Establishment of supplementary reports on credit institution's balance sheet'.

Under the amendments in the decree, reports must be submitted electronically as XML (eXtensible Markup

Language) formatted documents in accordance with decree No 9 of the Governor of Eesti Pank from 9 December 2011 'Requirements for submission of reports formatted as XML documents'. The decree also makes some minor editorial corrections, updates references and repeals certain provisions that were no longer necessary following changes to the law or to working procedures.

The decree was established under section 91(1) and 91(3) of the Credit Institutions Act, section 2(2) clause 7 and section 34(1) of the Eesti Pank Act, and section 92(2) clause 1 of the Guarantee Fund Act.

No 8, 6 November 2012

Establishment of requirements to the contents and form of savings and loan associations' balance sheet statement and income statement and the procedure of submitting the reports to Eesti Pank

(officially published: RT I, 14.11.2012, 1)

The decree established requirements to the contents and form of the balance sheet statement and income statement of savings and loan associations operating in Estonia and the procedure for submitting the reports to Eesti Pank. The balance sheet statement and income statement of savings and loan associations must be prepared in accordance with subsection 17 (1) of the Accounting Act. The appendices of the decree set the requirements for the preparation of the balance sheet and the income statement.

The decree was established on the basis of subsection 34 (1) of the Eesti Pank Act.

No 9, 6 November 2012

Amendment to the Eesti Pank Governor's Decree No 2 "Payments statistics submitted by credit institutions" dated 24 January 2012

(officially published: RT I, 14.11.2012, 2)

The decree amends Appendix 1 "Report on payments" of the Eesti Pank Governor's Decree No. 2 "Payments statistics submitted by credit institutions" dated 24 January 2012 and establishes it in a new wording.

The decree was established on the basis of subsection 91 (1) of the Credit Institutions Act.

No 10, 4 December 2012

Amendments to Eesti Pank Governor's Decree No 22 of 7 December 2010 "Establishment of reports on credit institutions' reserve requirement calculation"

(officially published: RT I, 07.12.2012, 6)

The amendment broadens the applicability of the earlier decree by adding savings and loan associations to the list of institutions that must submit reports on their reserve requirement calculation from 01.01.2013.

The decree was established on the basis of subsection 34 (1) of the Eesti Pank Act.

DECISIONS OF THE SUPERVISORY BOARD OF EESTI PANK IN 2012

No 1-1, 31 January 2012

Making proposals for the appointment of the Governor of Eesti Pank

No 2-1, 27 March 2012

The remuneration package of the Governor of Eesti Pank

2-2, 27 March 2012

Confirmation of the nominal value and design of collector coins

No 3-1, 10 April 2012

Annual report 2011 of Eesti Pank

No 3-2, 10 April 2012

Principles of remuneration for the Eesti Pank management board

No 3-3, 10 April 2012

Strategy for distributing the profit of Eesti Pank

No 3-4, 10 April 2012

Distribution of profits of Eesti Pank for 2011

No 4-1, 24 May 2012

Approval of the work plan of the Eesti Pank internal audit department for 2012

No 4-2, 24 May 2012

Payment of severance pay

No 5-1, 11 September 2012

Dismissal of the internal auditor of Eesti Pank

No 5-2, 11 September 2012

Appointment of members of the supervisory board of the Financial Supervisory Authority

No 8-1, 4 December 2012

Approval of the work plan of the Eesti Pank internal audit department for 2013

EESTI PANK PUBLICATIONS 2012

The website of Eesti Pank is www.eestipank.ee. The website contains information on Eesti Pank and its responsibilities, and on the Estonian monetary system, economy and financial environment. It also features information on banking legislation; information on Estonian banknotes and coins, including guidelines for collectors; Eesti Pank's press releases and publications; information on the European Union and the euro; and much more. There is also a comprehensive statistics database. In addition, there is a virtual library in Estonian only, which links to other libraries of economics texts.

Annual report

The Annual Report gives a review of the central bank's activities and results during the reporting year and the financial statement. It also reviews the economic and financial environment, decisions adopted by the Eurosystem, a list of decrees of the Governor of Eesti Pank and of the decisions of the Supervisory Board, and a list of the publications of the year.

Economic policy statement of Eesti Pank

The statements provide prompt and concise opinions of the central bank on the most relevant issues concerning economic and banking policies. The statements are available on the bank's website, published as press releases and often also presented at a press conference. Four economic policy statements were released in 2011.

Financial Stability Review

The Financial Stability Review is published twice a year and it examines the financial behaviour of Estonian companies and households, related risks, financial markets, payment systems, and similar.

Issues published in 2012:

- Financial Stability Review 1/2012
- Financial Stability Review 2/2012

The balance of payments and the international investment position

The balance of payments gives a review of Estonia's foreign trade activities, including the country's international investment position and external debt. It contains a lot of statistical data.

Issues published in 2012:

- Estonia's Balance of Payments for 2011
- Estonia's Balance of Payments for the First Quarter of 2012
- Estonia's Balance of Payments for the Second Quarter of 2012
- Estonia's Balance of Payments for the Third Quarter of 2012
- Estonia's Balance of Payments Yearbook 2011

Estonian Economy and Monetary Policy: current state and forecast

The Estonian Economy and Monetary Policy is a biannual publication presenting a thorough economic review and an economic forecast.

Issues published in 2012:

- Estonian Economy and Monetary Policy 1/2012
- Estonian Economy and Monetary Policy 2/2012

Working Papers

The Working Papers are summaries of the economic studies conducted at Eesti Pank. The target group of the Working Papers is, above all, economists and economic experts, and the papers are often published in English only.

Publications in 2012

- Eesti Pank Working Papers 1/2012: Kadri Männasoo. Determinants of Bank Interest Spread in Estonia
- Eesti Pank Working Papers 2/2012: Jaanika Meriküll. Households Borrowing during a Creditless Recovery
- Eesti Pank Working Papers 3/2012: Merike Kukk, Dmitry Kulikov, Karsten Staehr. Consumption Sensitivities in Estonia: Income Shocks of Different Persistence
- Eesti Pank Working Papers 4/2012: David Seim. Job Displacement and Labour Market Outcomes by Skill Level
- Eesti Pank Working Papers 5/2012: Hubert Gabrisch, Karsten Staehr. The Euro Plus Pact: Competitiveness and External Capital Flows in the EU Countries
- Eesti Pank Working Papers 6/2012: Aleksei Netšunajev. Reaction to Technology Shocks in Markov-switching Structural VARs: Identification via Heteroskedasticity
- Eesti Pank Working Papers 7/2012: Aurelijus Dabušinskas, Dmitry Kulikov, Martti Randveer. The Impact of Volatility on Economic growth
- Eesti Pank Working Papers 8/2012: Jaanika Meriküll, Tairi Rõõm, Karsten Staehr. Perceptions of Unreported Economic Activities in Baltic Firms. Individualistic and Non-individualistic Motives

Labour market review

The Labour Market Review discusses the most important trends in the Estonian labour market, labour supply and demand, institutional developments in the labour market, and other related issues.

Issues published in 2012:

- Labour Market Review 1/2012
- Labour Market Review 2/2012

Other publications

- The Art of Eesti Pank. Art book. Eesti Pank, 2012
- The Estonian Money from the Mark to the Euro. Eesti Pank, 2012

© Eesti Pank, 2013

Address

Estonia pst 13
15095 Tallinn

Phone

+372 6680 719

Fax

+372 6680 836

E-mail

info@eestipank.ee

Website

www.eestipank.ee

**Subscriptions for publications
of Eesti Pank**

Phone: +372 6680 998

fax: +372 6680 954

e-mail: trykis@eestipank.ee

ISSN 1406-1414

Editor: Kaja Kell

Language editors: Robin Anthony Hazlehurst

Layout: Urmas Raidma