

Eesti Pank

EESTI PANK
ANNUAL REPORT
2010

2011

The inserts of Eesti Pank's annual report 2010 for the year preceding the changeover depict the Estonian kroon banknotes that were in circulation in the years 1992–2010. As well as the circulating banknotes, the insert also includes the only Estonian kroon collector banknote, which was issued in 2008. The explanatory texts by each banknote briefly describe the people and motifs depicted on the banknote.

The 1- and 2-kroon banknotes were designed by Rihet-Urmas Ploomipuu and printed by the Unites States Banknote Company (the later 2-kroon series were printed at the Giesecke Devrient GmbH print house). The 5-, 10-, 25-, 100- and 500-kroon banknotes were designed by Vladimir Taiger. The first series of these notes were printed by Thomas De la Rue and Company Ltd; the later series were printed at the print houses of De la Rue Currency, Giesecke Devrient GmbH and Bundesdruckerei GmbH.

The designers of the 10-kroon collector banknote were Günther Reindorff and Vladimir Taiger. The front of the banknote is an exact copy of the 10-kroon banknote designed by Günther Reindorff before World War II, while the reverse is from the 10-kroon banknote of the re-established Republic of Estonia and was designed by Vladimir Taiger. The collector banknotes were printed by the De La Rue Currency print house.

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The front of the **1-kroon banknote** features the Estonian artist, educator and cultural historian **Kristjan Raud** (1865–1943). Kristjan Raud is best known for his national romantic pencil and charcoal drawings, but above all he is famous for his illustrations for the national epic *Kalevipoeg*. Raud was one of the leaders of the popular national campaign for collecting antiquities in the first decades of the 20th century.

The reverse features a view of **Toompea Castle**. Toompea Castle is one of the most famous historical and architectural monuments of Tallinn. Building work started for the castle of the knights of the Teutonic Order in the 13th century. Although the castle was almost completely destroyed during the Great Northern War in the 18th century, in the second half of the century it was partially rebuilt as the official building of the provincial government. In the first years of the Republic of Estonia, the building of the Riigikogu, the Estonian Parliament, was built in the place of a former convent in the yard of this castle, and the Parliament continues to work there to this day.



MAIN FEATURES AND FUNCTIONS OF EESTI PANK



Main features and functions of Eesti Pank

Eesti Pank is the central bank of the Republic of Estonia and a member of the European System of Central Banks.

The primary objective of Eesti Pank is to maintain price stability. Eesti Pank also supports the achievement of other economic policy objectives in accordance with the Treaty on the Functioning of the European Union.

The functions of Eesti Pank are:¹

- to help to define the monetary policy of the European Community and to implement the monetary policy determined by the Governing Council of the European Central Bank;
- to hold and manage the official foreign exchange reserves;
- to promote the smooth operation of the payment systems and the stability of the financial system;
- to participate in the development of the payment systems and the financial system;
- to regulate currency circulation, contribute to the issuance of euro banknotes and issue of euro coins;
- to compile the balance of payments of Estonia;
- to collect and release statistics necessary for the performance of its functions;
- other functions of Eesti Pank arising from the law.

Eesti Pank is an independent constitutional institution and it is not subordinated to the Government or any other executive state agency. Eesti Pank is not held liable for the financial liabilities of the state, nor is the state held liable for the financial liabilities of the Bank. The highest organisational body of the Bank is the Supervisory Board which may not comprise members of the government. This gives the central bank the best opportunities to maintain monetary and financial stability.

¹ § 2 of the Eesti Pank Act – http://www.eestipank.ee/pub/en/dokumendid/dokumendid/oigusaktid/seadused/epact_2011.html.

The front of the **2-kroon banknote** shows **Karl Ernst von Baer** (1792–1876) – a biologist and medical scientist, and the founder of descriptive and comparative embryology. He was born in Estonia in Piibe manor and studied at Tallinn Dome School; after that he went on to study medical science at the University of Tartu and furthered his education in Berlin, Vienna and Würzburg. Baer worked at the universities of Königsberg, St Petersburg, and Tartu and was a member of the St Petersburg Academy of Sciences, the founder and first president of the Russian Geographical Society and a founding member of the Russian Entomological Society. He spent the final years of his life in Tartu, where he was the Chairman of the Estonian Naturalists' Society.

The reverse features a view of the **main building of the University of Tartu**. The High-Classical building was built in 1804–1809 from the project by the architect Johann Wilhelm Krause on the ruins of St Mary's Church. The façade's porticus with six columns has become the symbol of Estonian higher education.



FOREWORD
BY THE GOVERNOR
OF EESTI PANK



Foreword by the Governor of Eesti Pank

In 2010, Eesti Pank's work in managing the country's monetary system and fulfilling the duties of a central bank went flawlessly and smoothly. We not only did all of our ordinary work, but we also made major preparations for the adoption of the euro, which involved thorough preparations for our work in the Eurosystem where we must carry out the tasks of a national central bank in the euro area. Indeed, in 2010 Eesti Pank's main agenda was the introduction of the euro.

The preparations for the changeover had actually already been going on for years. The adoption of the euro became a strategic goal of Estonia and Eesti Pank in autumn 2003, when the Estonian people voted in a public referendum in favour of joining the European Union, which also meant agreeing to join the euro area. Estonia joined the exchange rate mechanism ERM II immediately after becoming a member of the European Union in 2004, as this was one of the conditions of the transition to the euro. A National Changeover Committee was established in January 2005 to prepare Estonia for the euro and systematic preparations began in all areas.

Estonia became a member of the Eurosystem on 1 January 2011. This day changed the real life of people in Estonia as the euro became legal tender. During the two-week dual circulation period, Estonians became accustomed to using euro banknotes and coins alongside their kroons, then gradually Eesti Pank eliminated the kroon banknotes and coins from circulation and replaced them with the new currency. By the end of the second week of 2011, the value of the euro banknotes issued by the central bank exceeded the amount in kroons still in circulation. Households, the retail trade, businesses and banks all coped equally successfully with the transition and the exceptional period. The adoption of the euro was seen as positive by 87% of Estonian residents, who considered the transition to have been smooth and efficient.

Since the day when Eesti Pank became one of the seventeen central banks of the Eurosystem, it has also assumed a share of the responsibility for the monetary policy of the euro area. Eesti Pank started to answer for the whole euro area's price stability together with other euro area countries. This means that as the Governor of Eesti Pank, I have been participating since the beginning of 2011 in making decisions that concern not only Estonians but all 331 million people in the euro area. In consequence, the operation range of the central bank has expanded dramatically. In 2010, we prepared ourselves for the new role by participating as observers in the European Central Bank's Governing Council, committees and working groups. Our final adjustment to the new range of our operations and tasks will be achieved over a few years through actually doing the work of the Eurosystem.

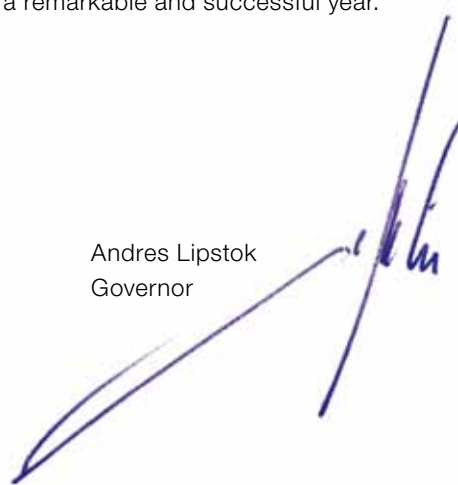
The key goal of Eesti Pank was and still is to maintain price stability. The year 2010, the year of transition to the euro for Estonia, saw relatively rapid global economic growth that was nevertheless threatened by several risks. In the second half of the year, inflationary pressures started to grow following a hike in the price of energy and food. This led to a rather swift rise in prices in Estonia too, where prices grew by 3%, year-on-year. Moreover, in the last quarter of 2010, food prices climbed by 10.8%. This also left a mark on the preparations for the euro changeover and required additional efforts to alleviate the price rise anxiety and explain the inflation mechanism. The display of prices in two currencies turned out to be essential, and this practice will continue until 30 June 2011.

In addition to alleviating fears about price rises, the nation-wide information campaign and Eesti Pank's pre-changeover information distribution focused on practical points. According to surveys, the national euro information campaign was successful across all target groups and nearly 95% of the population was sufficiently informed about the practical aspects of the euro changeover. The smooth changeover boosted popular support for the euro to 60% and this was definitely a major success.

In 2010, Eesti Pank finished implementing one of its most important strategic goals as the euro was adopted successfully and a development stage in Estonian monetary and economic policy came to an end. With the adoption of the euro, a new era began for Eesti Pank in an expanded and changed environment with much greater responsibility. Our final identification as a member of the Eurosystem still lies ahead; in this respect, Eesti Pank's preparations for the adoption are still continuing.

The adoption of the euro means more for Estonia than merely replacing one currency with another. The introduction of the euro has changed our economic context considerably. The adoption process involved companies, organisations, state agencies and also the Estonian people, but during the extensive and time-consuming preparations, ordinary operations also had to continue on their usual scale. Everybody had to make an effort and we all coped very well, and everybody deserves the deepest gratitude and praise for this! It was a remarkable and successful year.

Andres Lipstok
Governor



The front of the **5-kroon banknote** features the Estonian chess player, international champion and chess theoretician **Paul Keres** (1916–1975). He was born in Narva, went to school in Pärnu and studied mathematics at the University of Tartu. Keres won his first Estonian chess championship in 1935 and he won his first international tournament in 1936 in Bad Nauheim, Germany. In 1937, Keres became an international grandmaster. He participated in more than 70 international tournaments and won many championships, and in between 1930 and 1960, he was one of the main pretenders to the title of world champion. He also wrote chess text books.

The reverse of the banknote shows a view of the Narva River with **Narva's Hermann Castle** standing on its left bank and the Jaanilinna Castle on its right bank. These two castles form a unique historical and architectural ensemble on the eastern border of the European Union. The first records of the Narva Castle date back to 1254. Throughout the centuries, the border castle has been attacked many times and it has been repeatedly destroyed and rebuilt. The city of Narva, which received its city rights under the law of Lübeck in 1345, has also suffered severe damage during the attacks on the castle. In World War II, the castle was greatly damaged and restoration work continues to this day.



CENTRAL BANK ACCOUNTABILITY



CENTRAL BANK ACCOUNTABILITY

Central bank independence is an integral part of any monetary system that aims to ensure price stability. The principles of modern democracies, however, expect any independent institution performing public functions to be accountable for its actions. For Eesti Pank, the autonomous central bank of the Republic of Estonia, accountability entails explaining its status of assets and liabilities, and its economic policy views and decisions to the citizens of Estonia and their democratically elected representatives. The principles of accountability and autonomy of the central bank counterbalance each other.

Regular reporting on economic policy views and publication of economic data

The central bank's reliability for the public and the transparency of its activities are the preconditions for the smooth operation of the monetary system. Eesti Pank must provide both the general public and the experts with regular, profound and high-quality information on economy.

Eesti Pank may and must gather and publish **monetary, financial and balance of payments statistics**. The statistical data are published on the bank's website. For further information on the statistics activities of Eesti Pank see p 47.

The central bank publishes press releases and statements to comment on the latest economic data and developments. In 2010, 25 press releases and statements were issued.

Four times a year, Eesti Pank publishes **quarterly bulletins that focus either on monetary or financial policy issues**. In addition, Eesti Pank publishes a number of different publication series that are available on its website (for the full list see "Publications of Eesti Pank in 2010", p 126). Year 2010 was exceptional in the sense that there was an increased need for distributing euro-related information to Estonian residents, and so Eesti Pank sent brochures about the security features of the euro to 561,000 households all over Estonia.

Until the end of 2010, Eesti Pank had to publish its monthly balance of payments and data on the reserves backing the kroon. After the adoption of the euro, the central bank's balance of payments is published quarterly.

The **Annual Report** of Eesti Pank gives a detailed overview of the bank's activities and the annual accounts for the year. The Supervisory Board of Eesti Pank approves the Annual Report and submits it, together with the auditor's report, to the Riigikogu. Along with the Annual Report of the central bank the Riigikogu receives the Annual Report of the Financial Supervision Authority after the report has been approved by its Supervisory Board. Governor of Eesti Pank makes also a presentation in the Riigikogu on the Annual Report.

Accountability vis-à-vis the Riigikogu

Governor of Eesti Pank presents the Annual Report to the Riigikogu every year. In addition, the central bank and the Riigikogu cooperate in the form of meetings and bank representatives explain and comment on the issues raised by members of the Riigikogu.

The top executives and experts of Eesti Pank meet regularly with the Finance Committee of the Riigikogu to explain the central bank's estimates on economic processes and discuss topical economic issues. The primary topic of interest in 2010 was the preparations for the euro change-over, which was discussed at meetings with the representatives from the European Union Affairs Committee and the Finance Committee of the Riigikogu. The labour market situation was in focus at the meeting with the Social Committee.

Upon request of parliamentary factions the top executives of Eesti Pank introduce the central bank's economic policy standpoints and activities.

In 2010, Eesti Pank replied to one interpellation of a member of the Riigikogu concerning the change-over to the euro, and to one written question.

The front of the **10-kroon banknote** shows **Jakob Hurt** (1839–1907), a folklorist, theologian and linguist, and one of the leaders of the Estonian National Movement in the 19th century. Hurt studied theology at the universities of Tartu and Helsinki, was a home tutor, a secondary school teacher and the minister of the Estonian Jaani Congregation in St Petersburg. Hurt was a member of the working group of the first Estonian Song Festival in 1869. As President of the Head Committee of the Estonian Alexander School and the Society of Estonian Literati, he represented the moderate direction of the National Movement. His writings helped create the idea of school education being provided in our mother-tongue. As a writer, Hurt promoted the new way of writing and adjusted the Estonian literary language. His role as the leader of the Estonian-wide collection campaign of Estonian folklore and as the initiator of the scientific publication of folklore is extremely important.

The reverse depicts the **Tamme-Lauri oak**, which grows in Urvaste, Võrumaa. It is the thickest and oldest oak in Estonia. Its girth measures eight meters and it is 685 years old. The oak's name originates from the Tamme-Lauri farmstead, which was in turn named after the oak itself and the spirit that was believed to live in the oak and bring bad luck and misery, and sometimes also good fortune, to the farms in the neighbourhood. According to legend, it was the spirit of fire, who was called Laurits and who had "already burnt down the Urvaste schoolhouse many times".



THE STRATEGIC
OBJECTIVES OF
EESTI PANK
IN 2010



THE STRATEGIC OBJECTIVES OF EESTI PANK IN 2010

I. THE ADOPTION OF THE EURO (see "Preparations for joining the euro area" pp 24–32).

- The technical preparations for the adoption of the euro will be completed by 1 January 2011.
- We will ensure a smooth transition to the euro and the circulation of euro cash in Estonia as of 1 January 2011.
- We inform the public about the changes in the economic policy framework and central bank's responsibilities that are due to the adoption of the euro.
- In reserve management we ensure the optimum investment of assets also when Estonia becomes a full member of the Economic and Monetary Union.
- We prepare the procedures and documentation for participation in monetary policy operations.
- As of 1 January 2011, we will be ready to participate in the design of single European monetary policy along with other national central banks in the euro area.

II. OTHER RESPONSIBILITIES

Monetary policy (see "Monetary policy" pp 36–39)

- We ensure price stability in Estonia through the fixed exchange rate of the Estonian kroon by maintaining the currency board arrangement until Estonia's accession to the Economic and Monetary Union. After that, we will contribute to ensuring price stability in the euro area.
- In monetary policy analysis we focus on Estonia's economic adjustment after the global recession.
- We facilitate joint research with other EU central banks and support domestic research and development.

Reserve management (see "Reserve management" pp 40–42)

- We hold and manage reserve assets to ensure the reliability and financial independence of the central bank.

Financial stability (see "Ensuring financial stability" pp 43–46)

- We adjust to and participate in the design of the updated framework for financial sector supervision.
- We strengthen joint crisis management together with the Ministry of Finance, the Financial Supervision Authority and international institutions.
- We contribute to the further integration of European financial markets by participating in the work of EU institutions.

Developments in statistics (see "Developments in statistics" pp 47–50)

- We ensure the consistent compilation of balance of payments and financial sector statistics in compliance with EU standards.

Payment and settlement systems (see "Payment and settlement systems" pp 51–56)

- We change the payment and settlement systems over to the euro and bring them into compliance with the Eurosystem requirements.
- We participate in the development of the securities settlement system TARGET2-Securities to strengthen the securities market infrastructure.

Cash (see "Meeting the cash demand" pp 57–62)

- We ensure the smooth circulation of currency and increase the performance of cash handling.

Partnership (see "International partnership and Public relations" pp 63–72)

- We protect Estonia's economic policy interests in international cooperation forums.
- We provide economic agents with the background information they need for making economic decisions, and the reliability and transparency of the central bank.

Organisation (see "Governance, organisation and human resources policy" pp 73–78)

- We develop the professional skills and knowledge of the staff to provide the central bank services in the most effective way.

The front of the **25-kroon banknote** depicts the famous Estonian writer **Anton Hansen Tammsaare** (1878–1940). He was the most outstanding representative of 20th-century Estonian critical realism, expressing strong social criticism and ethical standpoints in his works. He also wrote richly imaginative fairy tales, miniatures and essays. His writing reached its peak with the play *Judith* and the novel *The Master of Kõrboja*. The five-part novel *Truth and Justice* is central to his oeuvre, portraying developments in Estonian society from the final decades of the 19th century until the economic crisis at the end of the 1920s. Social life is also criticised in the allegorical novel *Misadventures of the New Satan* and the play *The King Is Cold*.

To the right of the writer's portrait is a motif of a marsh landscape with trees, bog pools and small plants.

The back of the banknote features a view of the Tammsaare-Põhja farmstead, where the writer was born. Today, the A. H. Tammsaare Museum is in Vargamäe, where theatre performances based on the writer's works are staged every summer. This traditional house for kiln-drying grain with a typical North-Estonian plan was built in 1870; in the centre, there is a dwelling house built in 1933 and the barns are on the right.



CHANGE OVER TO THE EURO



PREPARATIONS FOR JOINING THE EURO AREA

General framework

The adoption of the euro has been a strategic goal of Estonia and Eesti Pank since as long as the autumn of 2003, when the Estonian people voted in favour of joining the European Union and adopting the euro in a public referendum. Preparations for the changeover have been being made in all areas since 2004.

Immediately after becoming a member of the European Union in 2004, Estonia joined the exchange rate mechanism ERM II.

The National Changeover Committee¹ was established in January 2005 to prepare Estonia for the euro. Eesti Pank was represented in the Committee by Deputy Governors Andres Sutt and Rein Minka, and in addition, many specialists from Eesti Pank participated in its work. In pin-pointing the problems related to the changeover and finding solutions to them, the National Changeover Committee was initially supported by six working groups:

- the Eesti Pank and credit institutions WG;
- the business environment WG;
- the public sector technical readiness WG;
- the consumer protection WG;
- the legal matters WG; and
- the communications WG.

The first version of the National Changeover Plan was completed as early as autumn 2005, while the ninth and final version of the plan was published in 2010. In 2009, the Committee submitted two interim reports to the Government on the progress of preparations, and in 2010 the Committee submitted four reports, one for each quarter.

The preparations for joining the euro area slowed down in the summer of 2006, when it became

clear that Estonia is not able to meet the Maastricht inflation criterion in the near future, but the preparations picked up pace again in 2009. The decision was taken to set up another, seventh, working group to

- monitor and account for the fulfilment of the euro changeover criteria.

The euro preparations of Eesti Pank mainly focused on

- monitoring the fulfilment of the euro changeover criteria;
- working with credit institutions to guarantee the smoothness and security of the cash changeover;
- making changes in payment and settlement systems; and
- informing the general public.

Euro changeover criteria

Before the introduction of the euro, the main focus was on achieving the price stability and fiscal position criteria. The European Commission and the European Central Bank assessed Estonia's eligibility for the euro on the basis of the fiscal position of 2009 and the inflation indicators fixed in April 2010. The budget deficit for 2009 was 1.7% of GDP and Estonia achieved the inflation criterion in November 2009.

The long-term government bonds used to assess the interest rate criterion are not used in Estonia. Instead, other indicators were assessed thoroughly and with all the circumstances considered, the conclusion was reached that Estonia would not have a problem in fulfilling this criterion. Estonia has not had trouble meeting the public debt criterion, as our government sector's debt is among the smallest in Europe. Estonia has been in compliance with the exchange rate criterion since 28 June 2006, when it reached

¹ Order No 53 of the Government of the Republic of 31 January 2005 on the formation of the National Changeover Committee to coordinate the operations necessary to guarantee a smooth euro adoption process.

the required two years of membership of the exchange rate mechanism ERM II.

On 3 June 2010, the Minister of Finance Jürgen Ligi and Eesti Pank Governor Andres Lipstok sent a letter to the European Commission, the Eurogroup and the Ecofin council about Estonia's economic policy goals as a member of the euro area. The letter confirmed our readiness to continue with responsible fiscal policies and, in other areas, with policies that support balanced economic development.² Ecofin made its final decision about Estonia's accession to the euro area on 13 July 2010.

Preparations by Eesti Pank and credit institutions for the euro

Preparations in the area of cash and account money were central to the success of the euro changeover. The changeover went smoothly and without any major problems. At the turn of the year, Eesti Pank's work went smoothly with state agencies and with the private sector, that is the credit institutions and the security company G4S. Everything happened according to the planned scenario and there was no need to launch contingency plans. Three main threads can be identified in the enormous amount of work done by the commercial banks, and these were exchanging and distributing cash; managing and adjusting information systems; and informing the general public.

Front loading and sub-front loading of cash and returning cash

October 2010 marked the beginning of the **coin collection campaign** for Estonian kroons, run together with the Estonian Banking Association, the commercial banks, the G4S cash division and charity organisations. During the campaign

period, approximately 125 million coins, weighing 350 tonnes in total, were returned to Eesti Pank.

At the beginning of November, Eesti Pank received the first euro banknotes through the European System of Central Banks. The **front-loading of euro banknotes** to commercial banks started on 15 November 2010. During the front-loading period until 31 December 2010, the sum of euro cash issued to commercial banks totalled about 215 million euros. Commercial banks, in turn, **sub-front loaded euro banknotes and coins** to their clients for a total value of about 31 million euros.

To spread the work of cash exchange, the central bank and commercial banks decided to **let people already exchange kroons at the official exchange rate against euro banknotes in December**. On 1 December, the euro **starter kits** were made available for sale at the price of 200 kroons (€12.79) per kit; the kits contained 42 euro coins and a security token to verify their authenticity. The sale of starter kits in commercial banks and in branches of Eesti Post was very successful. By 31 December, 510,473 starter kits had been sold.

One indicators of the success of the currency exchange was the rapid and **smooth adoption of the euro in ATMs**. At the end of December, 867 ATMs were operating in Estonia. Refilling of the ATM network started on 30 December during the day and the procedure was finished in the evening of 31 December. There were no failures in the operation of ATMs due to the euro changeover, and immediately after midnight, the ATMs issued euro banknotes successfully. The first euro banknote was withdrawn from an ATM four minutes after midnight. In the first two days of 2011, about 85,000 withdrawals were made from ATMs for a total value of about 5 million euros.

² See the letter of 3 June 2010 from the Minister of Finance and Eesti Pank Governor to the European Commission, Eurogroup and the Ecofin council, which is also available on Eesti Pank's website (<http://www.eestipank.info/pub/et/EL/ELiit/euro/yhiskiri.pdf?ok=1>).

From the last week of December, the **amount of cash in kroons in circulation** started to decrease rapidly. At the beginning of December, about 8.1 billion kroons were still in circulation, but by the end of 2010 the amount of circulating cash only totalled 5.8 billion kroons. An additional 4.1 billion kroons were removed from circulation in January 2011 and by the end of the month the amount of circulating cash had dropped to 1.7 billion Estonian kroons. By the end of January, the net amount of euro cash issued by Eesti Pank had risen to 245 million euros, of which 216 million was in banknotes and 29 million in coins.

In contrast to the method used in other countries, **post offices in Estonia were also involved in the euro changeover.** The network of Eesti Post's branches contributed a great deal to the exchange of daily circulating money, enabling every person to exchange kroons worth a total of 1,000 euros every day. The participation of Eesti Post in the currency exchange process facilitated the changeover in areas where banking services are not so easily available.

Many bank branches and post offices were also open exceptionally on 1 and 2 January. On 1 and 2 January, the branches of Eesti Post exchanged a total of 8.6 million kroons into euros, with the average amount exchanged in each transaction remaining below 200 euros.

Euro cash training

At the beginning of June, the training specialists of credit institutions and the representatives of major companies took part in a training session. Over the course of three seminars, the training specialists heard from top experts at the Bank of Finland, the Finnish Central Criminal Police and Nordea Bank Finland.

From September until December, experts from

Eesti Pank arranged lectures for cash handlers in every county together with the county offices of Enterprise Estonia (EAS). The training gave an overview of the changeover principles and of the design and security features of euro cash. The target groups of the county lectures were cashiers, small traders and service establishments that directly handle cash. The lectures were also a suitable place for distributing over 50,000 copies of publications explaining the euro's security elements and appearance. The county lectures were extremely popular and additional lectures had to be arranged in several towns. Altogether, more than 3,000 cash handlers attended a total of 30 lectures.

Adoption of the euro as account money

The introduction of euro account money was the responsibility of the central bank, and credit institutions and their related infrastructures: the interbank payment and settlement system, the settlement system for card payments, and the securities settlement system. There was no transitional period for account money – the euro was introduced on €-day. The value date for the conversion of account money was 1 January 2011 and account numbers remained the same. On the first working day of the year, Eesti Pank's payment and settlement system for Ordinary Payments, ESTA, was also open as usual.

The **payment and settlement systems** of Eesti Pank were made available in euros on 1 January 2011. As of the first banking day of the changeover month, 3 January 2011, Eesti Pank's payment and settlement systems settle payments only in euros.

The preparations required for the transition of the payment and settlement systems to the euro had already been carried out in advance.³ On 19 May 2008, Eesti Pank launched TARGET2-

³ See more about these preparations in the chapter "Payment and Settlement Systems", p 51.

Eesti for express cross-border euro payments. On 1 January 2011, Eesti Pank closed the real-time settlement system EP RTGS and transferred most of the transactions that had been conducted through the EP RTGS, including interbank payments, collateral payments of ESTA and cash transactions, to TARGET2-Eesti. Since the euro changeover, the stock exchange and over-the-counter settlements that were performed through the EP RTGS have been executed on the custodians' liquidity accounts opened in the Estonian Central Securities Depository.⁴ On €-day, 1 January 2011, Eesti Pank stopped forwarding foreign exchange reference rates to credit institutions. The reference rates are available on the website of the European Central Bank and they are published on the working days of TARGET. When TARGET is closed on a working day in Estonia, such as the Easter Monday, the latest published rates apply.

Provision of information

In the distribution of euro information, Estonian state agencies followed a single changeover communication strategy, which focused on informing the public about the practical sides of the changeover. The national euro information campaign had two primary goals, which were also central for Eesti Pank in its euro-related communications:

- to ensure that all Estonian residents be informed of the changeover's impact on the country's economic development and of the accompanying practical changes; that the changeover be as smooth as possible; and that the community support the introduction of the euro;
- to reach 90% in the level of awareness and 65% in the level of support for the euro among the Estonian population by the end of the information campaign.

All the goals of the communication strategy were achieved. Furthermore, several additional, previously unplanned communication operations were carried out, as they became necessary due to changes in the general economic situation, the emergence of new topics of debate, and shifts in emphasis in several areas relating to economic events in the euro area and feedback received from public opinion polls.

The main target groups were the general public and the business sector, but minority groups were also covered. Eesti Pank paid a lot of attention to informing the visually impaired, the young and cash handlers.

The euro information campaign for the business sector was divided into several areas:

- the guaranteeing of technical readiness of information systems and accounting;
- the obligation to display dual prices;
- the fair pricing agreement;
- practical aspects of the euro changeover, including cash training.

No major technical problems have occurred in the business sector because of the adoption of the euro. The results from the campaign of informing business owners were revealed by the Eurobarometer survey arranged in September 2010, which showed that 93.8% of the business owners questioned considered themselves well or very well informed on the issues related to the euro changeover, while 62% of them regarded the adoption as beneficial or very beneficial in the medium or long term. Furthermore, the press have not spotted a single problem related to any specific target group that could have been caused by insufficient awareness.

According to the survey, for a long time support for the euro amount the whole population ranged between 48% and 54%, but a survey conducted

⁴ The euro changeover brought some changes to the securities settlement system of Eesti Pank.

in January 2011 showed that public support for the euro had increased to 60%. The rise in support undoubtedly stemmed from the smooth changeover process.

According to the survey⁵ ordered by Eesti Pank and arranged by TNS Emor, the national euro information campaign was successful across all target groups. The percentage noticing the euro information campaign was 95% or more in all the target groups, which were based on nationality, age, income and place of residence.

Eesti Pank's work in the area of changeover communication is described more thoroughly in the chapter "Public relations", p 68.

CHANGES IN EESTI PANK'S OPERATION FRAMEWORK IN 2011 IN CONNECTION WITH THE EURO AREA

Estonia has been a member of the Eurosystem⁶ since 1 January 2011. The Eurosystem consists of the European Central Bank (ECB) and the national central banks of the countries that have adopted the euro. The articles of the Treaty on the Functioning of the European Union that only apply to euro area countries came into force in Estonia on 1 January 2011. In addition, the articles of the Statute of the European System of Central Banks and of the European Central Bank that apply to the Eurosystem's members were also imposed on Eesti Pank. The main change in the legal environment is that all ECB legislation – regulations and decisions – now also apply in Estonia. The Currency Act and the Act on Security for the Estonian Kroon were repealed with

the Euro Adoption Act. The provisions of the Eesti Pank Act that brought the Eesti Pank Act into compliance with the requirements laid down in Article 131 of the Treaty on the Functioning of the European Union came into force. In consequence of these amendments, several decrees of the Eesti Pank Governor have been repealed or amended (see also "Decrees of the Governor of Eesti Pank in 2010", p 122; the full texts of the decrees are available on the website of Eesti Pank).

More extensive changes in the working arrangements of Eesti Pank began in the second half of 2010 after the Council of the European Union took the decision to allow Estonia to adopt the euro. From that moment on, Eesti Pank was invited to participate as an observer in all the committees and working groups of the Eurosystem. In addition to attending the meetings of the ECB General Council, which take place four times a year, the Governor of Eesti Pank also started participating as an observer in the meetings of the most important decision-making body, the Governing Council⁷ of the European Central Bank. Since 1 January 2011, Eesti Pank has also participated as a full member in all the committees, working groups and task forces of the ECB Governing Council. This means that on top of its existing responsibilities, the bank now has new ones related to the cooperation forums handling the euro area's monetary policy, the analysis of the ECB Governing Council's documentation and the preparation of Estonia's standpoints.

⁵ A summary of the survey is available on the website of Eesti Pank: http://www.eestipank.info/pub/et/dokumendid/publikatsioonid/seeriad/selgitused/emor_111.pdf.

⁶ Until recently, the term *Eurosystem* was used unofficially, but for the first time it was mentioned officially in the Lisbon Treaty (Article 282 of the Treaty on the Functioning of the European Union).

⁷ The ECB Governing Council consists of the members of the ECB's Executive Board and the governors of the national central banks of the euro area.

Tasks of the Eurosystem

Key tasks of the Eurosystem

- Setting monetary policy
- Executing currency operations
- Guaranteeing the smooth functioning of payment and settlement systems
- Holding and managing the currency reserve

Other tasks of the Eurosystem

- Performing advisory functions
- Collecting and compiling statistics
- Supervising the fulfilment of prudential norms and guaranteeing financial stability
- Issuing euro banknotes and guaranteeing their security
- Engaging in international partnership

The following briefly covers the areas related to the tasks of the Eurosystem where the year 2011 will bring major changes for Eesti Pank.

Monetary policy and economic analysis

The Eurosystem is responsible for setting and implementing the monetary policy in the euro area. For Estonia, the greatest change that stemmed from joining the euro area was that while Estonia used to apply a currency board system that helped to maintain price stability **in Estonia** through a fixed exchange rate, now Eesti Pank participates in setting the monetary policy for the **whole euro area** and in compiling the analytical materials⁸ that form the basis for monetary policy decisions. The interests of the euro area as a whole are also taken into account in the decision-making process of the ECB Governing Council, where the Governor of Eesti Pank

is a member. The main goal of the Eurosystem's monetary policy is to maintain **price stability in the euro area**. This has been laid down in Article 127(1) on monetary policy in the Treaty on the Functioning of the European Union. According to the definition approved by the ECB Governing Council,⁹ **price stability is a medium-term year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below but close to 2%**.

The euro area's monetary policy follows the principle of central decision-making and decentralised implementation. This means that all monetary policy issues fall under the responsibility of the Governing Council of the ECB, as does the enforcement of rules and decisions concerning the Eurosystem's tasks. **The Eurosystem cooperates closely to develop the monetary policy framework and set monetary policy goals.** Cooperation takes place in numerous ESCB committees, task forces, meetings and tele-conferences where all important issues are discussed before decisions are made. Eesti Pank started to participate in monetary policy cooperation immediately after the decision was taken to accept Estonia into the euro area. This meant a lot of work had to be done compiling various analytical materials and participating in the joint forecasting exercises.

The euro area's monetary policy framework is formed by regular refinancing operations, or repurchase auctions, the system of required reserves and the standing facilities for borrowing and depositing. In addition, extraordinary measures have been used to contain the financial crisis. The 2% reserve requirement currently

⁸ The ECB Governing Council makes interest rate decisions on the basis of a comprehensive analysis of the euro area's economy and money aggregates. The analytical work is divided between two major areas. The first focus is that the ECB and the euro area's national central banks monitor the euro area's economy in general, observing gross demand, the interest level and liquidity of financial markets, the capital and labour market situations, changes in the euro exchange rate and overall global economic developments; as a result of this economic analysis, a short and mid-term assessment is prepared to help anticipate inflationary changes. The other focus of attention is on the aggregate indicators of money supply and credit, and on their long-term effects on inflation. The analysis is supported by the Bank Lending Survey, which is regularly conducted among banks that are active in the loan market of a Member State.

⁹ See e.g. <http://www.ecb.int/mopo/strategy/pricestab/html/index.en.html>.

applies to liabilities due in up to two years on the balance sheets of credit institutions. **The most important monetary policy interest rate is the ECB's refinancing operations' minimum bid rate, the latest value of which was posted at 1.25% as of 13 April 2011.**

Monetary policy operations

Day to day monetary policy is implemented by the ECB and the other central banks of the Eurosystem. For instance, the volume of regular refinancing operations – the total amount of short-term loans granted against collateral to the Eurosystem's commercial banks – and, if necessary, other important conditions¹⁰, are determined by the Governing Council of the ECB, but monetary policy transactions are intermediated by national central banks. Essentially, the partner of a loan transaction is a national central bank of the euro area, not the ECB. The required reserves of commercial banks are also deposited on the accounts of the national central banks and accounting for this is the task of national central banks.

By the beginning of 2011, Eesti Pank had prepared and tested the procedure and documentation for participation in the monetary policy operations of the Eurosystem. Compared to the earlier currency board system, this meant thorough changes for Eesti Pank and commercial banks. New instruments were introduced, through which commercial banks would then obtain liquidity from the central bank, and the entire legal framework connected to these instruments also changed.

Reserve management

The implementation of the new monetary policy framework changes the central bank's reserve holding goals, which may in turn alter its invest-

ment principles, but this will be analysed more thoroughly in 2011.

One of the key goals of the Eurosystem's foreign currency reserve is to guarantee that the ECB has sufficient funds for currency operations. The management of the ECB's currency reserve is decentralised and is carried out by the national central banks that have decided to participate in the management of the ECB's currency reserve operations. The central banks operate on behalf of the ECB in accordance with the guidelines received from the ECB.

In 2010, Eesti Pank prepared the documentation and rules so as to be ready to participate in the ECB's foreign reserve management. Under the contract concluded between Eesti Pank and the Bank of Finland, investments with the share of the reserve managed by Eesti Pank are made by the Bank of Finland.

Payment and settlement systems

The flawless operation of payment and settlement systems is ensured by the Eurosystem's national central banks in three ways: as managers of the payment and settlement systems, as developers of policy for them, and as overseers of them. Eesti Pank continues to manage payment and settlement systems and as a member of the Eurosystem is more involved in developing policy for payment and settlement systems, by creating the ESCB standards and guidelines and legislation of the European Central Bank. Eesti Pank is also the payment systems' overseer, assessing the compliance of payment and settlement systems with the established standards.

After the introduction of the euro, all the country's important payment and settlement systems have to comply with the requirements of

¹⁰ Conditions are at present a little different from usual, for example the volume of loans is currently not limited.

the Eurosystem and be deemed suitable for the Eurosystem. In 2011, the important settlement systems in Estonia include two¹¹ payment and settlement systems managed by Eesti Pank:

- TARGET2-Eesti, the subsystem for settling cross-border express payments;
- ESTA, the Settlement System of Ordinary Payments¹²

The preparations required for the transition of the settlement systems to the euro had already been under way for years. On 19 May 2008, Eesti Pank launched TARGET2-Eesti for express cross-border euro payments. On 31 December 2010, Eesti Pank closed the real-time settlement system EP RTGS and transferred the transactions that had been conducted through the EP RTGS to TARGET2-Eesti.

Statistical work

The Eurosystem needs detailed information about the euro area's economy and financial system in order to carry out its key tasks. **The division of tasks between the ECB and national central banks for the collection, processing, analysis and publication of data and methodological work is similar to that in monetary policy.** The ECB Governing Council approves the standardised statistics requirements and due dates for the submission of statistics, having consulted with national central banks first. Central banks must then collect and process the statistical data and compile statistical outputs.

Joining the euro area brought many changes to banking and other financial statistics. A number of new areas were added to the composition of the transmitted data, the frequency of data transmission was increased and due dates were short-

ened. Changes involved the statistics of monetary financial institutions and investment funds, while new areas included the statistics of securities, insurance companies and pension funds.

Changes in the reserve requirement framework of credit institutions resulted in the creation of a new statement, and data collection for it was commenced. The data collected are used to check the size of the reserve requirement calculated by credit institutions and to compile the required reserve statistics for the European Central Bank.

In the area of the balance of payments statistics, joining the euro area imposed additional data transmission requirements on entries and geographical origin. The monthly balance of payments will become more detailed, especially for portfolio investments. Therefore, in 2010 the central bank paid great attention to preparations for the changeover to security by security reporting in the statistics on the external transactions and positions of portfolio investments. Besides security by security reporting, euro area countries have to submit the results of their portfolio investments by currency and by issuers' sector.

Additional data transmission requirements for general economic statistics also extended to statistics for corporate demography, assets (including household assets), wage agreements and commercial real estate prices.

Cash

Euro banknotes and coins are the sole legal tender in the euro area. The task of the Eurosystem is to guarantee a smooth and efficient supply of banknotes and maintain the public's trust in the euro. The security of euro banknotes is

¹¹ Until 2010, important payment and settlement systems also included the Real-Time Gross Settlement System EP RTGS for Estonian kroon payments, which was closed at the end of the year.

¹² The ESTA was not evaluated before the introduction of the euro; it will be assessed by Eesti Pank after the changeover.

achieved through the research and development of security elements and through prevention and surveillance of counterfeiting. Central banks, credit institutions and other cash handlers (for instance, cash transport companies) have to follow common quality standards and authentication requirements when handling banknotes.

Unlike the design of the banknotes, the design of euro coins falls under the competence of the Member States, not the ECB. A Member State that wishes to issue a coin with a new motif must inform the European Commission and other European Union countries of it in advance. The Commission checks that the new design complies with the guidelines and then publishes the relevant notification on its website.

The regulations and rules pertaining to the circulation of cash in the euro area are laid down by the ECB Governing Council. **The day to day management of cash circulation is the responsibility of the Eurosystem's central banks** and euro cash is issued into circulation by national central banks, not the ECB. This means that it is the duty of the national central banks to circulate euro cash, not of the ECB, and this is reflected accordingly on their balance sheets.

Ensuring financial stability

The Member States are directly responsible for guaranteeing financial stability. Meanwhile, according to the Treaty on the Functioning of the European Union¹³, the Eurosystem must also support policies that aim to guarantee financial stability. The key prerequisite of effective monetary policy is a strong and well-functioning financial sector. The ECB works closely with other euro area's central banks to analyse financial stability risks and compile assessments. In addition

to analyses, the euro area's central banks advise the Eurosystem on planning and on changing the policies and regulations for the European Union's financial sector.

The central bank's assets and liabilities after the changeover

Eesti Pank and the national central banks of other euro area countries are independent and self-sufficient central banks with their own assets and liabilities. However, the structure of Eesti Pank's assets and liabilities changed with the introduction of the euro.

Two major changes occurred on the **liabilities side** of Eesti Pank's balance sheet. First, the issuance of cash increased, and on the balance sheet, this is included under the central bank's liabilities. As of joining the euro area the entry for cash issued on the balance sheet is technically an approximate value, i.e. an estimate of Estonia's share of the cash released into circulation in the euro area. This estimate is calculated from Estonia's equity in the ECB's fixed capital and is determined by GDP and the size of the population.

Secondly, the level of liabilities and assets on the balance sheet of Eesti Pank fell, because the reserve requirement was reduced and so the funds of commercial banks were returned to their command.¹⁴

On the side of assets, Eesti Pank's share in the ECB's capital increased and some of the reserves were transferred. In addition, Eesti Pank's financial assets shrank because of the reduction of the reserve requirement, and the difference between the amount of cash actually issued and its estimate on the liabilities' side of the balance sheet is covered by a claim against the Eurosystem.

¹³ Article 127 of the Treaty on the European Union. The ESCB fosters the smooth supervision of the fulfilment of credit institutions' prudential norms and the flawless functioning of institutions that are connected with the stability of the monetary system.

¹⁴ The reserve requirement dropped from 15% to 2%. The actual decrease in the reserves deposited in the central bank will be smaller, as banks may fulfil about half of their reserve requirement with high-quality liquid external assets.

Governing Council of the European Central Bank

The Governing Council of the European Central Bank is the highest decision-making body of the ECB. It includes:

- all the members of the Executive Board of the European Central Bank;
- the governors of all the central banks of the EU countries that have adopted the euro.

By the Treaty on the Functioning of the European Union and the Statutes of the European System of Central Banks, the Governing Council of the ECB has been **granted the authority to make the most important and strategically crucial decisions about the Eurosystem**. In the decision-making process concerning monetary policy and the other tasks of the Eurosystem, the members of the Governing Council operate independently, not as representatives of their countries.

Currently, the meetings are held twice a month, usually on the first and third Thursday of each month. Interest rate issues are usually discussed only at the first meeting of the month.

Although the meetings are confidential, the Governing Council of the ECB publishes their results – especially the key interest rates – at a press conference that takes place after the first monthly meeting of the Governing Council. Since December 2004, the Eurosystem's central banks have also published other monetary policy decisions on their websites every month.

The front of the **50-kroon banknote** shows the Estonian composer, organist and choral conductor **Rudolf Tobias** (1873–1918). Tobias, who was born in Käina in Hiiumaa was the first Estonian to train as a composer and choral conductor at the St Petersburg Conservatoire. He worked as the organist of the Estonian Jaani Congregation in St Petersburg and as a music teacher in Tartu. From 1910, Tobias worked as an organist and journalist and as a professor of the Royal University of Music in Berlin. In August 1913, Tobias visited Estonia in connection with the opening festivities of the new building of the Estonia Theatre, where he also conducted performances of his compositions. One of his most famous works is *Des Jona Sendung*, which was premièred in Leipzig in 1909.

To the right of the portrait is the organ façade in Käina Church, featuring the image of the Eye of Providence. Many people associate this detail with freemasonry, but it is a religious symbol, God's Eye of Providence.

The reverse of the banknote features a view of the **Estonia theatre and concert building**, which was completed in 1913. Its architects were Armas Lindgren and Wivi Lönn. The Neo-Classical building, which features only a few details of the Jugendstil prevalent at the time, was designed as a cultural and business centre, with the two monumental halls linked by a lower middle section. The ground floor of the middle section was for office spaces and a restaurant with a pool hall; the first floor housed a casino, a theatre and a concert hall. The building was severely damaged in World War II; after the end of the war it was restored to a project by Alar Kotli and the restored and expanded building was 1.4 times bigger than the original. Its style could be called Stalinist Classicism, as its interiors reflected the new "Communist paradise on Earth" and its altar was the pompous ceiling painting by the Estonian artists Evald Okas, Richard Sagrits and Elmar Kits. The most recent restoration has brought the appearance of the building nearer to its original form again.



TASKS AND ACHIEVEMENTS OF EESTI PANK IN 2010



MONETARY POLICY

The monetary policy objective of Eesti Pank, up to the moment of Estonia's accession to the euro area, was to ensure price stability by maintaining the fixed exchange rate of the Estonian kroon. Within the framework of the currency board system, the main monetary policy instrument of Eesti Pank was the standing facility for buying and selling foreign currency, the forex window available to credit institutions. The forex window enabled banks to increase their Estonian kroon reserves by selling an amount of foreign currency to the central bank equivalent to the amount they wanted in Estonian kroons, and vice versa, buying foreign currency for Estonian kroons. The reserve requirement was another important monetary policy instrument used by Eesti Pank, obliging banks to keep a part of their assets as buffers in Eesti Pank or in high-quality external assets.

The external monetary policy environment was lenient throughout 2010. The monetary policy rates remained low in the euro area, as the key policy rate of the European Central Bank remained unchanged at 1%.

The risk premiums of the local money market dropped significantly in 2010. Whereas 12 months ago the local money market interest rate (the 6-month Talibor) was nearly triple the euro area money market interest rate (the 6-month Euribor), the differences in interest levels vanished during the year. The volume of forward premiums continued to drop during the year, with the market participants having no interest in hedging the risks related to the Estonian kroon. This was prompted both by the imminent accession to the euro area and by a conservative fiscal policy which kept the debt burden low and the budget deficit significantly below the maximum allowed by the Stability and Growth Pact.

In connection with the changeover to the euro, the minimum reserve requirement was gradually lowered from 15% to the 2% in the euro area from September 2010 onwards. From the beginning of 2011, all Estonian credit institutions must thus adhere to the 2% reserve requirement in the euro area. The change of the reserve requirement did not cause any significant changes in the behaviour of the banks. In the second half of 2010, Eesti Pank's monetary policy activities also revolved around the preparation for participation in the Eurosystem monetary policy operations.

Estonia used the fixed exchange rate and the currency board system successfully for 18 years. The strengths of the system have been revealed during the recent economic downturn, when the flexibility of wages and prices allowed Estonia to cope well with the difficult conditions in the changed economic environment. It also helped to prepare for participation in the euro area, the single currency area.

Estonia has joined the euro area and since 1 January 2011, Eesti Pank has participated in shaping and implementing euro area monetary policy decisions. As a result, Eesti Pank's monetary policy activities started to change in 2010. Preparations for participation in the Eurosystem cooperative analysis work had already started at the beginning of the year. With the permission to accede to the euro area, Eesti Pank started to participate actively in the analytical exercises concerning all NCBs and in preparing the Eurosystem forecasts.

The primary objective of the Eurosystem monetary policy is to maintain price stability in the euro area. This objective has been stipulated in Article 127 (1) of the Treaty on the Functioning of the European Union. In 1998, the Governing Council of the ECB gave a quantitative definition

¹ Decision of the Governing Council of 13 October 1998.

of price stability: "Price stability is defined as a yearly increase in the Harmonised Consumer Price Index (HCPI) of the Euro Currency Area of less than 2%. Price stability shall hold over the medium term."¹ In addition, the Governing Council explained in May 2003 that, in the pursuit of price stability, it would aim to maintain inflation rates "below but close to 2% over the medium term".² **Price stability is thus defined as the Harmonised Consumer Price Index of the Euro Currency Area at below but close to 2% over the medium term.**

Monitoring

Monitoring in Eesti Pank in 2010 can be divided into two periods: monitoring before and after July 13 when the Economic and Financial Affairs Council (ECOFIN) adopted the final approval of Estonia's accession to the euro area. In addition to standard monitoring of the domestic and external economy, the focus laid on monitoring and evaluating the fulfilment of the Maastricht criteria. In the second half-year, the focus fell on the monitoring of the economy of the euro area, and on preparations for participation in euro area analysis and monitoring, and in the monetary policy decision process in the euro area.

Monitoring by Eesti Pank focused mainly on analysing and commenting on major current economic and political topics in the domestic and external environments. Owing to the debt crisis faced by several euro area countries in 2010, Eesti Pank started regular in-depth monitoring and analysis of the economies and financial markets of these countries in order to ascertain the risks of any potential spillover, so as to be able to respond promptly to such risks. The results of the monitoring are published in the central bank's various publications, press releases and public comments.

Economic reviews

During the global financial and economic crisis, Eesti Pank resolved to comment on Estonia's economic situation and development in more detail six times a year. In 2010, five comments from Eesti Pank were published. Twice in the year, Eesti Pank published a longer economic overview including the latest economic forecast.

In 2010, the central bank analysed the situation in the financial sector once in every six months, as usual. The results of the analysis were published in the Financial Stability Review. Due to the changeover to the euro, the experts of the central bank also analysed the sustainability of the Estonian economic development, with the results published in the Report on the Adoption of the Euro. Smooth income convergence with more prosperous countries requires a flexible labour market and wage setting based on productivity growth. Therefore, Eesti Pank also published the Labour Market Review on a regular basis in 2010. The central bank now prepares and publishes labour market comments over a shorter period of time than usual. From 2011, the Labour Market Review will no longer be published, as the topics covered by the review are now discussed in the economic forecast.

Economic forecasts

Eesti Pank usually issues economic forecasts twice a year. In 2010, Eesti Pank issued the spring forecast in April and the autumn forecast in September. The forecast comprises the baseline scenario and the risk scenario, addressing the economic development in the current year and the next two years, as well as background information on current economic and political subjects. The results of the macro-economic model and expert assessments are used as

² Decision of the Governing Council of 8 May 2003.

the basis for the economic forecast. Risk scenarios mostly reflect the risks endangering the economy.

In connection with the accession to the euro area, Eesti Pank started to participate in the preparation of the Eurosystem staff projections³. The Eurosystem staff projection is included in the materials used by the Governing Council twice a year for evaluating risks related to price stability and economic development. In connection with its participation in the preparation of Eurosystem projections, Eesti Pank published a comment on the adjusted forecast for inflation and economic growth in December. Due to its participation in the common Eurosystem projection process, Eesti Pank is publishing economic forecasts in June and December from 2011 onwards.

Economic research

Eesti Pank's economic research projects are based on the strategic research plan, which sets the general framework for studies conducted in the bank. The priorities for 2010 included the development of the macro-economic and banking sector model system, research into monetary policy and the financial sector, and analysis of the sustainability of the Estonian monetary system. Ten research projects on these issues were conducted by the Research Department in 2010. Eesti Pank continued to improve its banking sector credit risk model and profitability model, to prepare the monetary policy simulation model and to develop the macro model of the Estonian economy.

In addition to being published in the Eesti Pank Working Papers Series⁴, the central bank's economic research gained recognition in the international arena. In 2010, various research papers

were published in internationally recognised academic journals such as the Journal of the European Economic Association and the Scandinavian Journal of Economics, and presented at international conferences, including the 70th International Atlantic Economic Conference organised by the International Atlantic Economic Society and the Conference on the Euro Area and the Financial Crisis organised by Národná Banka Slovenska, the central bank of Slovakia.

Cooperation on research at international and domestic level continued in 2010. Eesti Pank's specialists attended the Working Group of Econometric Modelling, composed of members of the European System of Central Banks, and participated in the Household Finance and Consumption Network and the Macro-prudential Research Network. Eesti Pank also participated in the preparation of the international conference *Economies of Central and Eastern Europe: Convergence, Opportunities and Challenges 2010* on economies in transition, organised under the leadership of the Tallinn University of Technology in June 2010.

Alongside the presentation of its own surveys, Eesti Pank also invited experts from foreign countries to Estonia to present the results of their research. A total of fourteen seminars were held in 2010, eleven of them featuring guest lecturers from abroad and three presenting the central bank's own research projects. For instance, Iikka Korhonen, Head of the Bank of Finland's Institute for Economies in Transition (BOFIT) presented research on the causes, development and impact of the financial crisis in various countries, while Mihails Hazans, research fellow with the Baltic International Centre for Economic Policy Studies and professor of economics at the University of Latvia, gave a presentation

³ For further information see "A guide to Eurosystem staff macroeconomic projection exercises", available on the ECB website at <http://www.ecb.int/pub/pdf/other/staffprojectionsguideen.pdf>.

⁴ For a complete list, see "Publications of Eesti Pank in 2010", pp 126-127.

on the adjustment of the Latvian labour market during the economic downturn. The annual series of lectures dedicated to the internationally renowned Estonian economist Professor Ragnar Nurkse continued in 2010 with a lecture by Stefan Ingves, Governor of Sveriges Riksbank, the central bank of Sweden.

Eesti Pank's visiting researcher programme continues to contribute to research cooperation. In 2010, three foreign experts took part in the economic research projects of Eesti Pank. The traditional annual research award for a young Estonian economist was awarded for the eighth time and was given to Marge Reinap, Doctoral candidate of the Tallinn School of Economics and Business Administration for her research on "The economic burden of major behavioural health risks".

RESERVE MANAGEMENT

Reserve management in 2010

The foreign exchange reserves of Eesti Pank backed the Estonian kroon until the end of 2010, ensuring the stability of the kroon. In the currency board system, foreign exchange reserves had to fully cover all the liabilities of Eesti Pank, including the banknotes and coins issued, and the funds of commercial banks held with Eesti Pank.

The central bank proceeds from strict risk constraints in investing the reserves, while taking into account the primary objectives: the preservation and liquidity of assets. Return comes third on the list of objectives.

The structure of foreign exchange reserves

The structure of foreign exchange reserves did not change in 2010. The reserves consisted of the **liquidity buffer** and the investment portfolio. A small part of the reserves was held in gold.

The liquidity buffer accounted for around 10% of the total reserves and the central bank could use it at any time for Eesti kroon and foreign currency transactions with domestic credit institutions.

Assets of the other major component of the foreign exchange reserves – **the investment portfolio** – were invested in international financial markets. The objective of investments has been to achieve the optimum balance of risk and average return above money market interest rates throughout a global economic cycle. Investment portfolio assets were primarily invested in the liquid bond markets of leading industrial countries, while constantly monitoring and managing the interest rate, credit, currency and liquidity risks of the investments.¹

The investment process

Eesti Pank manages interest rate risk through the benchmark portfolio. This determines the average

risk level the bank is ready to accept, and it is also used for performance measurement purposes in reserve management. The benchmark portfolio does not include currency risk. Limits have been set within which the actual investment portfolio may deviate from the benchmark portfolio.

The decisions regarding changes in the risk level of the benchmark portfolio are made by the Executive Board of Eesti Pank (until 31/12/2010 in the form of the Monetary Policy Committee). Lowering the risk level of the benchmark portfolio essentially means reducing the average duration of the portfolio: more assets are invested in low-volatility financial instruments providing more stable yields. In the case of increasing the risk level, more assets are invested in longer-term instruments; that is, government bonds with the maturity of more than one year.

In addition to earning on a relatively stable benchmark portfolio, or passive investment, Eesti Pank is also engaged in active investment, taking positions in global financial markets. Such investment decisions are taken based on economic analysis, market relationships and other factors. Markets and securities are chosen on the basis of the concept, expected horizon and efficiency of the investment. The investment philosophy generally lies in diversification: the aim is to spread risks and make better use of market opportunities. Strategies utilise primarily fixed income and interest rate markets and exchanges of the world's developed economies. Portfolio managers make investment decisions independent of each other. This is possible because the overall risk limit is divided into portions and the use of each portion is up to its portfolio manager.

Eesti Pank tries to keep up with the times and find its niche in today's relatively efficient markets. Two different approaches are used in making investment decisions, the subjective approach and the model based approach. The subjective approach is based on qualitative analysis of economic processes, market psychology and the experience of portfolio managers. The model-based approach draws

¹ For further information on risk management see the website of Eesti Pank.

on quantitative market relationships derived from investment models. The best decisions for investment in money, capital and foreign exchange markets are made by combining these two approaches.

External asset managers also have a role in active investment. In 2010, Eesti Pank used the services of four external asset managers. Informed Portfolio Management started cooperation with the central bank in 2007. BlackRock has been investing Eesti Pank's assets since 2006 and PIMCO since 2005. In 2010, Eesti Pank signed a contract with Nomura Asset Management. The external asset management programme is based on overlay mandates and the managers express the majority of strategies through derivative instruments.

In 2010, active investment resulted in 21.3 basis points of excess return over the benchmark portfolio.

Results and determinants of investment in 2010

The foreign exchange reserves of Eesti Pank totalled 30 billion kroons at the end of 2010, having decreased by 13.1 billion kroons from 2009. The reserves decreased largely because of lowering the minimum reserve requirement for credit institutions from 15% to 2%. The excess reserve accounted for nearly 17%, or 5.1 billion kroons, of the total reserve.

Investment income totalled 369 million kroons in 2010 and exceeded expectations by two times.

The main event in the first half of 2010 was the deepening of the sovereign debt crisis in some euro area countries, first in Greece and then also in some other countries with weak fiscal positions. Consequently, the interest rates on major strong (primarily US and German) government bonds dropped considerably, whereas the interest rates on the bonds of peripheral euro area countries rose, which had

a positive impact on the investment yield of Eesti Pank's foreign exchange reserves.

Markets were volatile also in the second half of the year, but the key interest rates remained broadly unchanged at their low levels. Therefore, the structure of foreign exchange reserves did not change considerably over this period.

In total, the return on foreign exchange reserves was 1.03%; that is significantly higher than the return on money market (see Figure 1).²

Changes in the benchmark portfolio in 2010

Interest rates dropped somewhat in the first half of 2010 and rose in the second half, but generally fluctuated within a relatively narrow range of very low levels. Therefore in 2010, Eesti Pank did not change the benchmark portfolio that had been established in June 2009 (see Table 1).

Asset management services provided to the public sector

In 2010, Eesti Pank continued to provide the full package of asset management services to the Guarantee Fund, whose investment portfolios totalled 2.3 billion kroons at the end of the year.

Preparations for the euro and changes in reserve management

European Union treaties make depositing and managing foreign exchange reserves a key task of national central banks. All the euro area's national central banks have reserves that can be mobilised for the benefit of the Eurosystem's exchange rate policy, if needed.

The strict principles of the currency board arrangement set out that all the kroon liabilities of Eesti

² Until 2007 the Citigroup's indices of three-month return on euro money market were used as the return on money market, calculated based on three-month interbank euro deposit rates. However, as this instrument includes considerable credit risk, which has been significantly minimised by Eesti Pank in recent years as regards foreign exchange reserves investment, since 2008 the return on money market is calculated as the return on three-month repos.

Table 1. Structure of the benchmark portfolio

	3 month	1–3 y	3–5 y	5–7 y	7–10 y	10+ y
Euro area	88.05%	5.26%	2.71%	1.86%	1.37%	0.76%
USA	92.79%	3.50%	1.65%	1.18%	0.89%	



Figure 1. Return on foreign exchange reserves compared to return on money market

Pank had to be fully covered by liquid foreign assets in order to ensure the fixed exchange rate of the kroon. Since 1 January 2011, when Estonia became a member of the euro area, foreign assets³ only have to cover a part of the central bank's liabilities and some of the money may be issued to credit institutions as monetary policy loans. So while Estonian kroons were only issued against foreign currencies, euros may be also issued against euro-denominated assets.

At the time of adopting the decision on Estonia's accession to the euro area, the foreign exchange reserves of Eesti Pank totalled almost 40 billion kroons, most of it being the assets backing the currency board. The stock of foreign exchange reserves decreased before accession to the euro area owing to a change in the monetary policy framework, the lowering of the reserve requirement ratio for commercial banks.

With the adoption of the euro on 1 January 2011, Eesti Pank carried out its obligation to transfer

some of its reserves to the European Central Bank. European Union treaties state that all the central banks of the Member States who have adopted the single currency must make a contribution out of their foreign exchange reserves to the European Central Bank. The level of reserves is usually calculated in proportion to their share of the subscribed capital of the European Central Bank. Eesti Pank transferred 145,853,596.60 euros of its foreign exchange reserves to the European Central Bank, and the equivalent sum is now reflected in the balance sheet of Eesti Pank as a claim against the European Central Bank. The European Central Bank pays interest to Eesti Pank on the sum that was transferred.

Besides the foreign exchange and gold reserves, Eesti Pank's financial assets still include a portfolio of securities in euros, which has now become our domestic currency since we joined the euro area. The aim of the euro portfolio is to cover the operating costs of Eesti Pank and to make sure there is sufficient capital to cover potential losses.

³ With the adoption of the euro, the definition of Eesti Pank's foreign assets changed considerably.

ENSURING FINANCIAL STABILITY

The stability of the financial system is secured when the smooth functioning of the entire system is ensured. One of the missions of Eesti Pank is to safeguard the stability of the Estonian financial system. For this purpose, Eesti Pank monitors and analyses the functioning of the financial sector and assesses the threats to it. If necessary, the central bank takes measures to minimise the risk of such threats materialising.

Eesti Pank works with the Ministry of Finance and the Financial Supervision Authority in ensuring the reliability of the Estonian financial system and the appropriateness of the regulation underpinning the financial sector. The principles of cooperation and the division of tasks are set out in the Memorandum of Understanding concluded in 2007. A committee of representatives of these bodies has been set up to organise day to day cooperation.

The Estonian financial sector is globally integrated, with the development and performance of the local financial system depending largely on events in the outside world. It is thus essential to maintain cross-border cooperation with the institutions that have an influence on the sector's operational environment. As a member of the European System of Central Banks (ESCB), Eesti Pank participates in the joint activity of the central banks of EU countries. Eesti Pank also formulates and expresses Estonia's positions on the EU financial stability framework and financial sector policy matters.

Above all, the Estonian financial system is interlinked with the financial systems of its neighbouring countries. Productive cooperation with the central banks of Nordic and Baltic countries is thus very important. In August 2010, the ministries of finance, central banks and financial supervision authorities of the Nordic and Baltic countries entered into an agreement on the prevention and management of financial crises. A cross-border financial stability group, the first

of its kind in Europe, was set up in the autumn, consisting of representatives of the signatory bodies. The main objective of regional cooperation is to ensure the smooth functioning of the financial system, prevent the spread of financial crises and minimise the overall costs related to the financial crisis.

Financial sector analysis and financial stability assessment

The main output of the financial stability analysis conducted by Eesti Pank is the biannual Financial Stability Review. In addition to the results of analyses, the Financial Stability Review also contains the central bank's assessment of financial stability. The scope of the review was clarified more precisely in 2010, so the review now focuses expressly on the processing and assessment of financial stability risks.

According to Eesti Pank's financial stability assessment published at the end of 2010, the threats endangering financial stability did not increase in Estonia during the year, but neither was the risk level lowered by tensions brewing in the global economy and financial markets. The direct effect of the threats posed to the Estonian financial system by the unstable external environment was mitigated by the incorporation of the major banks operating in Estonia within Nordic banking groups. The permission to accede to the euro area and to join the Organisation for Economic Co-operation and Development (OECD) added to the reliability of the Estonian financial environment in the eyes of the outside world. The improved outlook for economic growth gradually lowered the credit risk related to Estonian private individuals and companies. The improvement in loan quality facilitated the growth in profitability and the capitalisation of banks.

Eesti Pank conducts banking sector stress tests to evaluate the performance of the financial system. These tests are based on macro-scenarios,

with the methods themselves being continually improved. According to regular stress tests conducted in 2010, the banks had sufficient capital buffers to cover contingent risks.

Eesti Pank started preparing the Lending Review in the autumn of 2010. The biannual review analyses the need for financing of Estonian private individuals and companies, and the availability of funds and the lending terms and conditions, matters which were previously addressed in the Financial Stability Review. The new output focuses on specific funding-related issues and provides a higher-quality input for economic forecasts.

From 2011, further lending market analysis will be provided in the Bank Lending Survey. With Estonia's accession to the euro area, Eesti Pank incurred the obligation to poll on a quarterly basis the banks that are most active in the local lending market on the changes experienced and expected in credit demand and credit supply. The results of the survey conducted in the euro area will be used for the preparation of monetary policy decisions and in analysis of the effect of the measures applied. In 2010, the specialists of Eesti Pank agreed with the European Central Bank on the implementation of the survey and the technical solutions for communicating the data from it.

Within the ESCB, Eesti Pank and other central banks, along with the supervision authorities contributed to the preparation of the EU financial stability assessments. The most important subjects for Estonia's financial stability among those addressed by the European Central Bank and the Member States in 2010 included the fall in financial leverage and the risk level of foreign currency loans. Eesti Pank emphasised the need to address the decrease in financial leverage, in addition to financing restrictions, from the point of view of the demand and need for credit in the real economy. As regards foreign currency loans,

Eesti Pank noted that the risks related to credit growth must be analysed comprehensively, with the same principle also being applied to the preparation of risk-mitigation measures.

Financial sector policy and regulation

Events in the global financial system have created a need to enhance supervision and improve regulation of the financial sector. The key subjects addressed by the European Union in 2010 included the launch of the financial sector supervision reform, the termination of state aid measures, the organisation of cross-border cooperation, crisis management, and the raising of the capital requirements for banks. Eesti Pank participated in the discussions as a member of the ESCB in the Economic and Financial Committee.

The crisis management measures related to the EU financial sector safety net were developed further. The ultimate objective is to create a framework that would allow for a swift and smooth reorganisation or dissolution of financial vehicle corporations that are facing problems, on a uniform basis. Estonia drew attention to the crisis management of cross-border groups in the discussions. Special attention was also paid in 2010 to covering the costs of the crisis. In June, the European Council agreed on the principle that the banking sector must contribute to covering the costs of the crisis, with the Member States thus required to set the charges and taxes for the banks. Eesti Pank has supported the general principle that the costs of the banking crisis should, first and foremost, be borne by the banks themselves. Nonetheless, emphasis must be laid on preventing double taxation, harmful competition and other factors that endanger the single service market. Overall, the framework must facilitate the efficient functioning and stability of the single European financial market.

In connection with the introduction of additions to the laws governing the financial sector, the

amendments to the Capital Requirements Directive for the banking sector (the CRD-II), adopted by the European Parliament in 2009, were transposed into the national law in 2010. These amendments addressed the enhancement of cross-border cooperation between financial supervision authorities, tightening up the requirements for securitisation and the concentration of exposures in banks. In the next stage of revision of the Capital Requirements Directive (the CRD-III), the European Union approved the supplementary amendments which serve to strengthen the requirements for the trading book, disclosure of securitisation exposures and remuneration policies. These additions must be transposed by the Member States by the end of 2011.

The development of the prudential ratios of the banking sector continued on a global scale with the preparation of the Basel III framework. The new regulatory framework establishes stricter requirements for the own funds held by credit institutions, lessening the amplification of the economic cycle, and it tightens up the liquidity requirements. Following the recommendations of the Basel Committee on Banking Supervision, the European Commission continued to develop further the prudential ratios of banks, proposing the amendment of the Capital Requirements Directive (the CRD-IV) scheduled to be prepared by the middle of 2011. Eesti Pank has supported the strengthening of the banks' capitalisation and harmonisation of the minimum requirements within the European Union. Alongside the needs of the common market, the position of each Member State and the specific risks to its financial stability must be considered.

The protection of depositors, investors and pension fund shareholders forms an integral part of the safety net for the financial sector. In 2010, the European Commission made proposals for amendments to the Deposit Guarantee Schemes Directive and the Investor Compensation Schemes Directive, initiating negotiations

with the Member States. The ultimate aim is to harmonise further the EU deposit guarantee systems, simplifying and reducing the scope of deposit guarantees and the payout methods. These proposals have also been supported by Eesti Pank.

In December 2010, the Riigikogu adopted a law to enhance the protection of depositors, raising the minimum coverage level to 100,000 euros and reducing the term of payout to 20 working days. Entering into force on 1 January 2011, the law adds the deposits of large companies to the list of guaranteed deposits. In consideration of the deposit growth forecast, the Supervisory Board of the Guarantee Fund raised the quarterly contribution to the Sectoral Fund from 0.025% to 0.047% at the recommendation of Eesti Pank. The higher rate will apply from the second quarter of 2011.

An amendment to the law was passed in 2010 to prevent financial crises occurring, and to enhance the efficiency of the management of them, by extending the rights of the Financial Supervision Authority to intervene in and inspect the activities of banks in an emergency or crisis. As an important amendment, the state was granted the right to consider expropriating the shares held by the owners of banks operating in Estonia. This is an extreme measure, only to be applied if the other planned measures fail to secure the stability of the national financial system.

To provide an alternative to bankruptcy for private persons, the Riigikogu passed the Debt Restructuring and Debt Protection Act, which allows the debts of natural persons temporarily facing financial difficulties to be restructured. Eesti Pank submitted its views on the draft act twice, expressing concern that the entry into force of the act in the proposed form may urge banks to stop lowering interest margins and to restrict the loan supply. The act will enter into force in the second quarter of 2011.

An important step was taken in the implementation of the EU supervision reform and the reduction of systemic risks with the establishment of the European Systemic Risk Board (ESRB) and three supervisory authorities after tense negotiations between the Council of the European Union, the European Parliament and the Euro-

pean Commission. The first official meetings of the ESRB and the new supervisory authorities took place in January 2011. The new EU financial stability framework serves to improve the sense of security and create the conditions for successful prevention of financial crises in the future.

Changes in the EU financial stability framework

Immediately after the eruption of the global financial crisis, the European Commission set up a high-level working group led by Jacques de Larosière. The working group was charged with the task of preparing recommendations for improving financial supervision within the European Union so as to protect the interests of the citizens and restore confidence in the financial system. The group proposed establishing a system of financial supervision authorities in order to enhance the efficiency of cooperation between the supervisory authorities. The working group also proposed setting up a body for conducting macro-prudential supervision over the risks endangering the EU financial system. Negotiations were immediately launched for the implementation of the reforms. At the end of 2010, the Council of the European Union and the European Parliament agreed on the launch of the supervision reform.

The new EU supervisory framework entered into force on 1 January 2011. Three separate supervisory authorities were established for the purpose of enhancing cooperation in banking, securities markets and insurance supervision: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities Market Authority. The EU supervisory authorities are composed of the national supervisory authorities, and representatives of the EU institutions. The new supervisory authorities have more options and obligations in organising pan-European financial supervision and preparing regulations than they had under the earlier cooperation framework. The European supervisory authorities have been charged with contributing to the preparation of and binding implementation of common standards, promoting a common supervisory culture, settling supervisory disputes and applying EU law in the Member States consistently.

The reform significantly expanded the role of central banks in safeguarding financial stability. Given the central banks' experience in macro-prudential supervision, the European Systemic Risk Board was set up with the European Central Bank. The ESRB is composed of the Governors of NCBs, the President and Vice-President of the European Central Bank, a member of the European Commission, the chairs of the European supervisory authorities and the chairs of the Advisory Scientific Committee and the Advisory Technical Committee. The representatives of the national supervisory authorities, and the President of the Economic and Financial Committee are members without voting rights. Eesti Pank is represented at the General Board of the ESRB by Governor Andres Lipstok.

The European Systemic Risk Board is responsible for the macro-prudential supervision of the EU financial system. Among other things, the ESRB must monitor and evaluate the functioning of the EU financial system and the systemic risks endangering the system. If the ESRB identifies a significant risk, the ESRB will issue a warning and, if necessary, recommendations for remedial action. These warnings and recommendations will, if necessary, be issued to the entire European Union, or to one or several Member States or supervisory authorities.

DEVELOPMENTS IN STATISTICS

It is the responsibility of Eesti Pank to compile Estonia's balance of payments statistics and banking and other financial statistics. The goal of the statistics work of the central bank is to give the general public high-quality, reliable, up-to-date and unbiased statistics. Eesti Pank's system of collecting, processing, and publishing statistics is compatible with international standards and good statistics practices. To maintain the optimum reporting burden, the central bank works closely with Statistics Estonia, the Financial Supervision Authority, the Estonian Central Securities Depository and other partners.

The new Official Statistics Act, which was drafted with the help of statistics experts from Eesti Pank, came into force on 1 August 2010. The new act is more extensive than the earlier one and includes also the population, housing and agriculture census. The new act details the organisation of statistics in the country, and establishes the Statistical Council and the official statistics programme. The aim of establishing the Statistical Council is to involve various interest groups in society in helping decide what kind of official statistics are needed. In addition, the principles for collecting, using and disseminating the data and the quality criteria for compiling statistics are set out in this act.

To make the statistics produced by Eesti Pank more available and user-friendly, Eesti Pank continued working in 2010 on a new structure and new content for the statistics section of the bank's public website.

Preparations in statistics for EMU accession

In 2010, Eesti Pank's statistics work was related to the preparations for joining the euro area. The first half of 2010 saw participation in the preparation of statistics section for the European Central Bank's (ECB) Convergence Report 2010, which was the last for Estonia. After the announcement

of the decision accepting Estonia into the European Monetary Union, Eesti Pank and the ECB had a number of statistics-related meetings and consultations, aiming to guarantee Eesti Pank's readiness to fulfil the statistics requirements that apply to euro area countries.

In the course of the euro preparations, the principles and action plan for the conversion into euros of the time series of the collected input data and the published statistics were also elaborated.

Read more about the preparations for joining the euro area in individual statistics areas below.

Banking and other financial statistics

Preparations for the adoption of the euro were already begun in the area of banking and other financial statistics at the beginning of 2010 before it was clear whether the decision about Estonia's accession would be positive. First, all of the Eesti Pank Governor's Decrees that would require amendments were mapped. Reporting subjects were also informed of the scheduled changes early on, so that they could plan their funds more efficiently in order to change the report compiling systems.

As mentioned above, Eesti Pank and the European Central Bank held several meetings and consultations. In the area of banking and other financial statistics, the dialogue between Eesti Pank and the European Central Bank was particularly intense, because accession to the euro area entailed many changes. Although the data transmission procedures remained the same, a number of new areas were added to data transmission, the frequency of data transmission was increased and due dates were shortened.

Preparations for the changes in compiling the statistics of monetary financial institutions and investment funds, securities, insurance companies and pension funds required the most effort.

Statistical inputs had to be prepared, indicators calculated and outputs forwarded. The information base for compiling statistics in these areas was sufficient, because most of the required changes in the composition of the collected data had already been made a year earlier. The statistics for the required reserve of credit institutions were an exception, as they needed a new report to be designed as the entire framework had changed. The development of the report, the launch of data collection and the transmission of the required reserve statistics to the European Central Bank succeeded without incident. The first data were transmitted following the new Decree on 7 December and credit institutions had to use those data to begin fulfilling the reserve requirement as of 1 January 2011.

The European Central Bank requires the data of almost all transmissions for the three years prior to the accession to the euro area, as if the country that is about to join the euro area had already been a member of the euro area. Eesti Pank started to send these data at the end of 2010.

To achieve greater efficiency in data collection and the publication of statistics, the central bank focused in 2010 also on the development of information technology. For instance, besides other options, an application was developed to enable the reporting agents to sign the submitted reports with an ID card. Furthermore, a control system for the data transmitted to the European Central Bank was created and preparations continued for introducing the software for compiling quarterly financial accounts.

Close work with Statistics Estonia and the Estonian Central Securities Depository (ECSD) continued. Eesti Pank and the ECSD agreed on the updates to the data transmitted by the ECSD, as this enables the bank to check and improve the quality of data sources more successfully. Eesti Pank's cooperation with Statistics Estonia to define the financial sector also serves

the same purpose. The financial sector is very specific and complex, and therefore, Eesti Pank and Statistics Estonia decided to join their forces and determine with greater precision which companies belong to the Estonian financial sector. Among other things, they agreed that the list of companies included in the financial sector would be published on the website of Statistics Estonia and updated twice a year. In the future, the list should become very helpful for reporting entities in deciding the sectors their clients or transaction partners belong to. The uniform classification of companies will definitely improve the quality of statistics and cut the costs of statistics producers and respondents.

Balance of payments statistics

In 2010, the central bank made preparations in the area of the balance of payments statistics for changing over to security by security reporting in the statistics of the external transactions and positions of portfolio investments. According to the requirements of the European Central Bank for the balance of payments statistics, the compilation method for the portfolio investment accounts of the euro area countries must use security by security data collection. Besides security by security reporting, euro area countries have to submit the results of their portfolio investment account to the ECB by currency and by issuers' sector.

The Centralised Securities Database (CSDB), which was set up by the ECB, offers help in meeting these requirements, as Member States receive information about the necessary securities and also participate in the joint administration of the database and in the quality control of the data. The data quality management of the CSDB has become more important due to the increasing use of the CSDB in the compilation of the European Central Bank's statistics and national statistics on the balance of payments, investment funds and other areas.

So far, the data source for securities has been the aggregate information from the accounting of economic agents, which was affected by the assessment methodology used. Changing over to the new methodology will guarantee a uniform country-wide statistical approach. The methodology uses uniform price and interest rate information and division by the issuer's country, and thereafter divides again at the national level by the issuer's sector. This will decrease asymmetry between countries, a factor that has become statistically significant in analysis of the mirror statistics of portfolio investments. The implementation of the new methodology will also enable the reporting load of the respondents to be reduced. Eesti Pank enforced the new methodology in the balance of payments statistics in January 2011. The preparations for the implementation of the methodology, including the creation of the related statistics compilation methodology and database developments took place in 2010.

In 2008, the OECD adopted the 4th edition of the Benchmark Definition of Foreign Direct Investment, which will be implemented in the European Union as of 2014. The main innovation of the standard is that the statistics for direct investments will also include sister companies, which are companies that are under the influence of the same investor but have a share of less than 10% or no share at all in each other's equity capital. One of the conditions of Estonia's accession to the OECD was the implementation of the new methodology requirements from 2010. Therefore, in 2010 the experts of Eesti Pank continued to work on the new compilation method for the direct investments account and the adjustment of the data collection system, including questionnaires, to the methodology. This meant that data on 2010 could already be collected according to the new standard. Although until 2013 the balance of payments statistics of Estonia will still be published using the current methodology, the parallel use of the new methodology enabled Eesti Pank to participate in the Coordinated

Direct Investment Survey organised by the International Monetary Fund and to fulfil the promise given to the OECD.

As Estonia joined the Schengen visa zone in 2008, the border crossing statistics of Statistics Estonia no longer include the movement of people within the Community, although this comprised about 85% of border crossings. Statistics Estonia terminated these observations due to under-financing. This data source, however, was important for the compilation of the travel services sub-account of the current account of the Estonian balance of payments. For this reason, Eesti Pank continued the work that had begun in 2008 with OÜ Positium LBS, a company of the University of Tartu, to design a border-crossing methodology based on mobile positioning. This would allow the interrupted but important time series of border-crossing statistics to be continued for one-day visitors, visitors for several days and transit travellers with geographic division of up to 100 countries. In 2010, OÜ Positium gave Eesti Pank the first results of the methodology and the survey. At the year-end, Eesti Pank announced a public procurement for the compilation of monthly border-crossing statistics based on mobile positioning, and the winner of the procurement was OÜ Positium. Eesti Pank concluded a three-year contract with the company.

As in earlier years, Eesti Pank's statistics experts also compiled two quality analyses for the balance of payments statistics in 2010. The analyses use various statistical methods to measure the discrepancies between the preliminary and later data published on the same period.

One analysis was compiled for internal use. The other analysis was compiled in accordance with the regulations of the European Union and under the leadership of Eurostat and it focused on the quality of the current account and direct investment statistics for the balance of pay-

ments. Drawing on this report, Eurostat gave a positive assessment of the quality of Estonia's balance of payments, as later revisions have always remained within acceptable limits. Eurostat only evaluated the quality of the statistics for the turnover between Estonia and countries outside the European Union, which comprises only about 20% of the current account turnover of the balance of payments. For this reason, the statisticians of the central bank compiled a quality report for internal use, which encompassed the statistics for the whole balance of payments (the flash estimate on the balance of payments, the quarterly balance of payments and the international investment position). Recent developments allow the conclusion that the balance of payments statistics of Eesti Pank have reached a consistently high level. Corrections in the most important accounts for goods and services are insignificant, while the somewhat greater correction of the income and current transfers account does not depend on Eesti Pank. The quality report is available in the statistics section of Eesti Pank's website.

In 2010, Eesti Pank updated the procedure for declaring international payments and submitting data for the balance of payments statistics. The change was brought about by the new Official Statistics Act and the revised version of the Eesti Pank Act that entered into force as of 1 January 2011. The central bank also replaced the old version of the classification of economic activities in the balance of payments statistics, EMTAK2003 (NACE Rev.1.1), with the new version EMTAK2008 (NACE Rev.2).

General economic statistics

Regular submission of general economic statistics and statistics on public finances to the ECB, the Bank for International Settlements (BIS) and the Directorate General for Economic and Financial Affairs (ECFIN) also continued in 2010. The areas of general economic statistics, on which

the euro area countries have to submit more data to the European Central Bank than other EU Member States do, include business demography, capital stock statistics (including household housing wealth), and statistics on negotiated wages agreements and commercial real estate prices. To obtain the data, the central bank negotiated with Statistics Estonia, the Centre of Registers and Information Systems, the Ministry of Social Affairs and real estate companies. The central bank submitted the time series of the appropriate data to the European Central Bank in the areas of business demography and assets. To date, there are no statistics for negotiated wages agreements in Estonia, but the Ministry of Social Affairs is dealing with this issue.

After Estonia's accession to the euro area, Eesti Pank will start participating in the Household Finances and Consumption Survey, which is arranged in euro area countries using a common methodology and coordinated by the European Central Bank, and which deals with the financial condition and consumption of households. The aim of the observation is to obtain micro-level data about the assets and liabilities of households and the observation will be conducted at least once every three years. In 2010, the experts of Eesti Pank compiled a preliminary schedule for the survey and searched for a cooperation partner. Statistics Estonia has consented to conduct the technical aspect of the interviews, which cover about 2,000 households; Eesti Pank's task is to process and analyse the data, and to send the results to the European Central Bank. The first observation will be arranged in 2013.

PAYMENT AND SETTLEMENT SYSTEMS

Development of payment and settlement systems

The keyword in the management of payment and settlement systems in 2010 was preparations for the euro changeover. Until the end of 2010, Eesti Pank managed three interbank payment and settlement systems: the Settlement System of Ordinary Payments (ESTA) and the Real-Time Gross Settlement System (EP RTGS) for kroon payments, and the TARGET2-Eesti for express cross-border euro payments.

Eesti Pank changed the payment and settlement systems over to the euro on 1 January 2011 and closed the Real-Time Gross Settlement System EP RTGS on 31 December 2010. Most of the transactions that were so far settled in the EP RTGS (collateral transactions of the ESTA, currency transactions with Eesti Pank and transactions related to monetary policy operations) are now settled in the TARGET2-Eesti. Due to the renewal of the securities settlement system along with the euro changeover, the stock exchange and over-the-counter transactions that were previously settled in the EP RTGS are now executed on the account holder's liquidity accounts held with the Estonian CSD.

At the beginning of 2011, the number of participants in TARGET2-Eesti grew by 10 up to 19 members. All credit institutions that are subject to the minimum reserve requirement must be members of the TARGET2-Eesti. This membership gives banks much broader opportunities to manage their cash flows both on the level of individual Estonian banks and European-wide banking groups.

At the beginning of 2011, the settlement currency of the ESTA, the Estonian kroon, was replaced by the euro. As of 3 January 2011, the first banking day of the month of the changeover, Eesti Pank's payment and settlement systems settle pay-

ments only in euro. All these changes entailed a number of developments and required close cooperation with the commercial banks.

Amendments in the legal framework for payments and settlements

22 January 2010 marked the enforcement of the Payment Institutions and Electronic Money Institutions Act and amendments in other related acts, including amendments to the Law of Obligations Act, which were passed to adopt the EU **Payment Services Directive**. The most essential amendments to the Law of Obligations Act were made in Chapter 40 regarding the issues of payment orders and payment services. Operating credit institutions, the providers of payment services, had to bring their activities and documentation into compliance with the new legislation by 22 May 2010 at the latest.

Until the enforcement of the amended acts Eesti Pank regulated the procedures and deadlines for processing payments intermediated by credit institutions as set out in Eesti Pank Governor's Decree¹, which was repealed in 2010.

With the amendments to the Law of Obligations Act, Eesti Pank was granted the authority to enforce more specific requirements for credit institutions and other financial institutions in connection with holding payment accounts and settling payments. In May 2010, Eesti Pank enforced the Decree "Conditions for acceptance of payment orders", which regulates the content of payment orders, lays down clearer terms for the acceptance of payment orders, and enforces minimum requirements for the forwarding of information specified in the payment order.

The Payment Institutions and Electronic Money Institutions Act sets out that before applying for a licence to manage payment and settlement

¹ Governor's Decree No 2, 14/05/2001 "Confirmation of instructions for settlement of payments".

systems, a payment institution has to apply for Eesti Pank's approval to the technical, economic and legal principles of a payment and settlement system and to the draft rules for the operation of the system.

The directly applicable regulation of the European Parliament and of the Council on cross-border payments in the Community, which stepped into force in November 2009, was fully applicable as of the day Estonia joined the euro area. This regulation harmonises the **charges for cross-border and domestic payments in euro** in the European Community. To bring charges into compliance with the regulation, Estonian banks started to adjust their price lists gradually in the middle of 2010.

In spring 2010, the European Commission together with other international institutions compiled an in-depth analysis of how to make the implementation of the Single Euro Payments Area (SEPA) and the transition to the SEPA schemes more effective. The analysis showed that enforcing a European Union regulation² would be the most appropriate way. In December 2010, the Commission published the proposal for a regulation on the end-dates for the migration to the SEPA. This lays down technical requirements for credit transfers and direct debits in euro together with their implementation deadlines: the requirements for credit transfers must be implemented at least within 12 months and those of direct debits within at least 24 months after the enforcement of the regulation. Member States have submitted their initial comments on the proposal of the European Commission, work with the draft regulation continues in the first half of 2011 with the intention to adopt the regulation in 2011.

The improvement of securities market infra-structures

In order to improve Estonia's financial system, Eesti Pank participates in the Eurosystem's project of TARGET2-Securities (T2S), the single technical platform for the settlement of securities transactions. Estonia is represented in the project by the **T2S Estonian National User Group (EENUG)**, which was established under the leadership of the central bank's experts who are currently also members of the group.

Year 2010 was successful for the project with developments both in policy and technical areas. Two major decisions were made in 2010:

1. In the first half of 2010, the go-live date of the T2S was postponed by one year. The T2S project is very extensive and includes many participants, and so the specification stage took longer than anticipated. The platform will be ready for use in September 2014.
2. In December 2010, the Governing Council of the European Central Bank gave a conditional approval to the T2S pricing policy for eight years (2014–2022³) and set the delivery versus payment price at 15 euro cents per instruction. One of the most significant changes was the change in the weighting of settlement services and other services (information service) in generating annual revenues of the T2S to 75% and 25% respectively.

In 2010, the T2S team did not yet finalise documents dealing with legal issues, but made preparations for the governance of the T2S project in the future and drafted agreements to regulate parties' relations. The signing of the Framework

² The regulations of the European Union are fully binding and mandatory for all Member States. Upon publication in the Official Journal of the European Union, regulations automatically become part of the legal system of the Member States without any domestic adjustment needed.

³ With a fixed increase in the first four years and not over 10% in the next four years.

Agreement between the Eurosystem and central securities depositories is scheduled for the second half of 2011.

Apart from the policy decisions adopted for the advancement of the project, the T2S team developed the documentation of T2S. Spring 2010 marked the completion of General Functional Specifications. The working group also started to develop User Detailed Functional Specifications for the users of T2S; public consultations regarding these matters started in March 2011.

After the adoption of the euro in Estonia, Eesti Pank became a full member of the Eurosystem and, in addition to its catalyst role that Eesti Pank has had in the T2S project so far, the central bank will be one of the future owners of the T2S platform. Even though the central bank's role increased, the domestic governance structure and the distribution of obligations and responsibilities in the T2S project remains the same. Eesti Pank continues to coordinate the Estonian national user group (EENUG) by supporting market participants in forming their positions, and, together with the Estonian CSD, represents the interests of the Estonian securities market in the T2S Advisory Group.

The most important issues for the EENUG are some technical and legal matters, especially as regards direct holding markets,⁴ such as the account allocation, pricing and potential connectivity with the T2S platform. In these matters, the T2S team and the Eurosystem in general have

made remarkable improvements, but there are still areas where the specificities of direct holding markets should be considered more. Another crucial issue for the EENUG is the Framework Agreement that regulates the relationship between the Eurosystem and CSDs.

Payments in the payment and settlement systems managed by Eesti Pank

In 2010, around 96,000 payments a day were settled in the interbank payment and settlement systems with the total value of 11.6 billion Estonian kroons.

The TARGET2-Eesti, a component system of the Trans-European Automated Real-Time Gross Settlement Express Transfer system, was launched on 19 May 2008. In 2010, TARGET2-Eesti gained more popularity as a channel for customer payments. Consequently, the average number of daily payments rose by 82% from 2009 to 130 payments in 2010. The average daily value of the payments initiated by the users of TARGET2-Eesti was 5.1 billion kroons (323 million euros), which is 2% less than in 2009. Estonian bank customers and banks received an average of 222 payments every day in the TARGET2 with the total value of 5.1 billion kroons (323 million euros).

In 2010, on average 212 payments a day were settled in the **Real-Time Gross Settlement System EP RTGS** with the total value of 4.9 billion kroons (313 million euros). Compared to 2009, the value of payments dropped by 15%,

Table 1. The use of Eesti Pank's settlement systems in 2010 (daily average)

Settlement system	Turnover (EEK billion)	% in total payment turnover	Number of payments	% in total number of payments
ESTA	1.6	14.1%	96,007	99.6%
EP RTGS	4.9	42.1%	212	0.2%
TARGET2-Eesti	5.1	43.8%	130	0.1%
Total	11.6		96,349	

⁴ A market where an account in the depository may be opened in the name of the final investor (end-user), not the representative (e.g. credit institution).

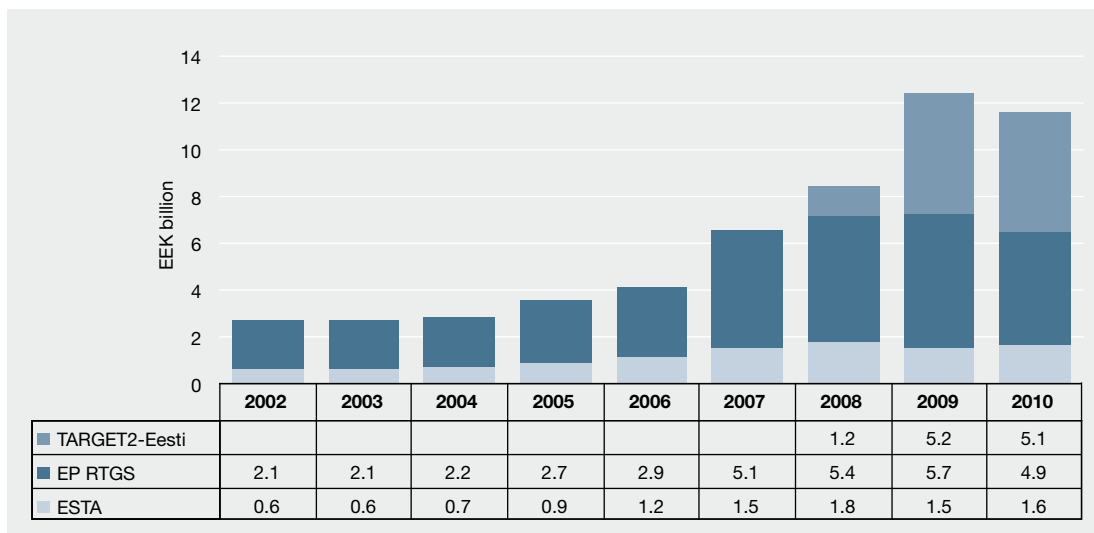


Figure 1. Daily average turnover of settlement system

while the number of payments grew by 10%. The changes stemmed from customer payments, as their value decreased by 36% from 2009. Though the number of customer payments was higher in 2009, their size was smaller. Customer payments comprised about 75% of the volume, but only 9% of the value of payments in the EP RTGS. Half of the value of EP RTGS payments stemmed from transactions related to the collateral account of the ESTA, and 25% from currency and foreign exchange transactions with Eesti Pank. The average size of a payment in the EP RTGS stood at 2.8 million kroons (0.2 million euros) in 2010. The settlement in TARGET2-Eesti and the EP RTGS is processed immediately, transfers between banks take around five minutes.

The Settlement System of Ordinary Payments, the ESTA, settled about 99.6% of total interbank payments in Estonia, but only 14% of the total value of the three systems. 75% of the payments settled in the ESTA were smaller than 5,000 kroons (320 euros), although the size of a payment in the ESTA is not limited. Only 0.2% of the payments in 2010 exceeded 1 million kroons (64,000 euros). The average payment was 17,711 kroons, having increased

by 10% over the year. The total value of the payments settled in the ESTA was 8.6% higher and the total volume was 2.4% smaller than in 2009. The ESTA is among the fastest systems in Europe. Payments are transferred to accounts in other banks ten times a day.

The oversight of payment and settlement systems

Eesti Pank's key tasks in the oversight of payment and settlement systems in 2010 were related to the adoption of the euro.

In order to change over to the euro, all important payment and settlement systems of the country must comply with the requirements of the Eurosystem and be deemed eligible for the Eurosystem.

In 2010, important payment and settlement systems in Estonia included the securities settlement system managed by the Estonian CSD and three payment and settlement systems managed by Eesti Pank:

- the TARGET2-Eesti, a component system of the Trans-European Automated Real-Time Gross Settlement Express Transfer system

- for settling cross-border payments in euro;
- the Real-Time Gross Settlement System EP RTGS for Estonian kroon payments;
- the ESTA, the Settlement System of Ordinary Payments.

There were no such incidents in the operation of these systems in 2010 that would have jeopardised the smooth functioning of settlements or the stability of the financial sector.

The TARGET2-Eesti, a component system of the TARGET2, is overseen based on the Eurosystem oversight policy framework and is in compliance with international standards.⁵ The EP RTGS was not assessed by Eesti Pank, because the system was closed along with the adoption of the euro. From thereon, real-time express payments are settled in the TARGET2-Eesti. The TARGET2 is the only real-time express transfer system of gross settlements in the euro area that enables settlements in central bank money. The TARGET2 is used by the Eurosystem's central banks for settling payments stemming from monetary policy operations. The ESTA will be assessed by Eesti Pank after the changeover to the euro, because before joining the euro area, Estonia as an EU Member State only had to assess all systemically important payment and settlement systems. Eesti Pank did not classify the ESTA as a systemically important system in the euro area. For Estonia, the ESTA still remains an important payment and settlement system domestically and Eesti Pank is responsible for its oversight.

From among the important payment and settlement systems of Estonia, the only direct assessment object for the European System of Central Banks (ESCB) in 2010 was the securities settlement system of the Estonian CSD. In addition, the ESCB assessed the eligibility of the solution applied

between Eesti Pank and commercial banks for the mobilisation of cross-border collaterals in international central securities depositories (ICSD)⁶. The securities settlement systems were assessed to determine their eligibility for the use in ESCB credit operations between Eesti Pank and Estonian credit institutions that stem from monetary policy operations and intraday credit transactions.

The Eurosystem enables to use four solutions to transfer assets eligible for collateralising the monetary policy and intraday credit operations of the ESCB:

- 1) a domestic securities settlement system that is eligible for the Eurosystem;
- 2) links between securities settlement systems that are eligible for the Eurosystem;
- 3) the Correspondent Central Banking Model (CCBM);
- 4) exceptions granted by the Governing Council of the European Central Bank.

The assessments of the securities settlement systems were based on international standards. The ESCB conducted the assessment in cooperation with Eesti Pank.

The assessment of the ECSD's securities settlement system was complicated by the fact that the ECSD planned to replace the existing depository and settlement system Depo2000 along with the euro changeover. Therefore, it was necessary to assess both the new settlement system Depend to be launched in 2011 and Depo2000, which was used at the time of the assessment and which the ECSD was supposed to use as a back-up solution, should the changeover to Depend fail. The greatest difference between Depend and Depo2000 is that the new system is no longer a net settlement system where the final settlement is performed on

⁵ See Financial Stability Review No 1/2008, pp 66-67, http://www.eestipank.info/pub/en/dokumendid/publikatsioonid/seeriad/finantsvahendus/_2008_1/_6_108.pdf.

⁶ Clearstream Banking Luxembourg in Luxembourg and Euroclear Bank in Belgium.

net basis in Eesti Pank. It is a transaction-based gross settlement system where the final settlement is performed in central bank money, but on the liquidity accounts of the account holders in the securities settlement system of the ECSD.

Both securities settlement systems of the ECSD were deemed generally eligible for use in ESCB credit operations. The securities settlement system of the ECSD will reach full compliance with the Eurosystem's standards, if

- the ECSD implements the recommendations set out in the assessment⁷; there will be securities issued in the ECSD that are eligible as collateral in the ESCB credit operations, or it will be possible to settle such securities of other countries through the eligible links with the securities settlement systems of other countries.⁸

The ESCB assessed the solution of using ICSDs in ESCB credit operations between Eesti Pank and commercial banks after the Governing Council of the European Central Bank had authorised the use of this exception. The solution, which was previously used in Estonia in the management of the reserve requirement and in the provision of intraday credit in the Estonian kroon, was deemed eligible for the Eurosystem and compatible with international standards. Estonia needed this solution because the CCBM is not available for the eligible counterparties in Estonia throughout the settlement day (the working hours of the CCBM are from 10:00 to 17:00 local time). The use of CCBM would have put Estonian commercial banks at a disadvantage compared to the other commercial banks in the Eurosystem.

⁷ The ECSD has implemented most of the recommendations provided in the assessment in 2006.

⁸ Such links between the securities settlement systems must be assessed before they can be deemed eligible for their use in ESCB credit operations.

MEETING THE CASH DEMAND

Banknotes and coins in circulation and their structure

On 31 December 2010, the total amount of currency in circulation was 5,838 million Estonian kroons. 1,740 million kroons (29.8%) were in the vaults of credit institutions, and savings and loan associations operating in Estonia; 4,098 million kroons (70.2%) was in circulation outside credit institutions and savings and loans associations.

In 2010, the amount of cash in circulation decreased by 3,939 million kroons, or by 40%. This mostly took place in December 2010, just before the adoption of the euro. The number of 500-kroon banknotes dropped the most, by 3,614 million kroons. The amount of 500-kroon banknotes also shrank most rapidly over the year. Other banknotes in circulation decreased considerably less. Consequently, the number of banknotes in circulation diminished by less than 20% with the year: from 80.0 million banknotes to 65.2 million.

The number of coins in circulation remained

relatively stable until October 2010. The beginning of October marked the launch of the coin campaign, which meant that credit institutions accepted coins without a service fee. Great amounts of coins were returned to Eesti Pank, but at year-end there were still 392.8 million coins in circulation; that is, over 290 coins per resident.

At the end of 2010, the average calculated value of a banknote in circulation stood at 87.34 kroons. The average calculated value of a coin in circulation was 33 cents.

Expert analysis and handling of cash

In 2010, Eesti Pank issued 9,918.2 million kroons to credit institutions and received 13,834.6 million kroons (see Table 1). The issue of cash decreased and the amount of returned cash grew compared to previous years, which mainly indicates that the changes in circulation took place due to the approaching euro adoption. It is particularly noteworthy that the volume of coins returned was considerably greater than in previous years.

Table 1. Banknotes and coins in circulation as at year-end

Nominal value	Total amount (EEK million)				Number (million)			
	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2007	31/12/2008	31/12/2009	31/12/2010
1 kroon	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
2 krooni	38.5	39.6	39.2	35.3	19.2	19.8	19.6	17.7
5 krooni	49.5	49.9	48.8	44.9	9.9	10.0	9.8	9.0
10 krooni	94.3	95.0	92.4	83.0	9.4	9.5	9.2	8.3
25 krooni	233.4	232.8	230.8	196.7	9.3	9.3	9.2	7.9
50 krooni	54.4	52.1	48.5	45.0	1.1	1.0	1.0	0.9
100 krooni	1,193.1	1,165.2	1044.7	798.5	11.9	11.7	10.4	8.0
500 krooni	9,942.5	10,194.6	8104.1	4490.5	19.9	20.4	16.2	9.0
Banknotes total	11,610.3	11,833.9	9,613.2	5,698.4	85.4	86.3	80.0	65.2
5 senti	2.1	2.0	2.0	2.0	41.2	40.8	40.4	39.3
10 senti	14.6	15.2	15.4	13.9	146.0	152.1	154.1	139.0
20 senti	24.7	26.1	26.6	22.0	123.4	130.6	132.8	109.9
50 senti	25.1	27.2	28.0	23.1	50.2	54.4	55.9	46.2
1 kroon	69.7	74.8	74.8	56.3	69.7	74.8	74.8	56.3
5 krooni	9.0	9.4	9.7	11.4	1.8	1.9	1.9	2.3
Coins total	145.1	154.9	156.4	128.6	432.3	454.6	460.0	392.8
Collector coins	6.7	7.5	7.9	11.2	0.1	0.1	0.2	0.3
Total	11,762.2	11,996.3	9,777.5	5,838.2	-	-	-	-

Table 2. Cash flows between Eesti Pank and credit institutions

Year	Total amount (EEK million)		Number (million)			
	Issued by Eesti Pank	Received by Eesti Pank	Issued by Eesti Pank		Received by Eesti Pank	
			Banknotes	Coins	Banknotes	Coins
2007	12,474.8	12,472.6	114.6	38.4	110.5	0.3
2008	12,897.5	12,646.9	102.0	24.7	101.1	2.6
2009	10,131.5	12,337.0	77.1	12.0	82.7	6.7
2010	9,918.2	13,834.7	68.5	16.3	83.1	88.0

Table 3. Banknotes unfit for and withdrawn from circulation as at year-end

Nominal value	Total amount (EEK million)				Number (million)			
	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2007	31/12/2008	31/12/2009	31/12/2010
1 kroon	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.0
2 krooni	14.1	11.0	8.1	14.6	7.0	5.5	4.0	7.3
5 krooni	16.5	11.4	11.3	12.0	3.3	2.3	2.3	2.4
10 krooni	61.3	30.8	26.5	82.8	6.1	3.1	2.6	8.3
25 krooni	47.3	154.0	241.2	80.7	1.9	6.2	9.6	3.2
50 krooni	16.0	17.5	5.0	36.8	0.3	0.4	0.1	0.7
100 krooni	284.6	1017.6	902.5	775.8	2.8	10.2	9.0	7.8
500 krooni	124.8	1774.0	1039.0	3514.8	0.2	3.5	2.1	7.0
Total	564.6	3016.3	2233.4	4517.4	21.8	31.2	29.8	36.7

All banknotes that are returned to Eesti Pank are sorted with fully automatic sorting machines. Banknotes that are worn or have been damaged in circulation are destroyed and those still suitable for circulation are released back into circulation. This way the quality of cash is guaranteed. In 2010, 36.7 million banknotes totalling 4,517 million kroons were destroyed (see Table 2).

The number of banknotes destroyed by Eesti Pank increased from 2009, because in the autumn of 2010 the central bank also started to destroy banknotes that were suitable for circulation but became unnecessary due to the adoption of the euro.

In 2010, the experts of Eesti Pank analysed 15,998 damaged and mutilated banknotes and 1,372 coins submitted by credit institutions. Four suspect counterfeit banknotes were discovered and were submitted to the police for further investigation.

In 2010, altogether 161 counterfeit Estonian kroon banknotes were discovered (including the

suspect counterfeit banknotes discovered by Eesti Pank) and were analysed at the Estonian Forensic Science Institute. 500-kroon banknotes accounted for the largest share of counterfeit money at 41.6%. Given the total number of banknotes in circulation, the number of counterfeits is relatively marginal. No counterfeit coins were found in 2010.

There were no failures in the circulation of cash in 2010.

The preparation of new banknotes and coins

No new Estonian kroon banknotes or circulating coins were acquired in 2010 due to the adoption of the euro.

In December 2010, Eesti Pank released a three-coin series of collector coins into circulation, dedicated to the Estonian kroon. The series includes a 25-kroon silver coin with spoke coin features, a 50-kroon coin with limestone core and a 100-kroon gold coin. In total 15,500 25-kroon silver

collector coins were issued, dedicated to the history of Estonia and designed by Kärt Summatavet. The number of 50-kroon silver collector coins totalled 20,000 and they were dedicated to the Estonian nature. The coin is pervaded by a round limestone. Limestone and its outcrops are the most famous natural symbol of Estonia, and since 1992 limestone is also the national stone of Estonia. The silver collector coin was designed by Leonhard Lapin and is dedicated to the Estonian people, with 7,500 coins issued in total. The coin depicts a passage of human DNA. The gold collector coin was designed by Hannes Starkopf. All the new collector coins were produced by the Mint of Finland.

The preparations for the euro changeover and changes in the structure of cash

October 2010 marked the beginning of the **coin collection campaign** of Estonian kroons in cooperation with the Estonian Banking Association, commercial banks, the G4S cash division and charity organisations. From October to January, around 125 million coins with a total weight of over 350 tonnes were returned to Eesti Pank. All the returned coins are sorted and deformed and the resulting metal alloy is auctioned.

In the first days of November, Eesti Pank received the first euro banknotes that were acquired through the European System of Central Banks. The **front loading of euro banknotes** to commercial banks started on 15 November 2010 and lasted until 31 December. During that time, 215 million euros – 187 million banknotes and 28 million coins – were front loaded to commercial banks (see Figure 1-2). Commercial banks, in turn, **sub-front loaded euro banknotes and coins** to their clients in the sum of about 31 million euro.

As set out in the guidelines of the European Central Bank and concluded contracts, the commercial banks that participated in front loading or sub-front loading were prohibited to circulate the euro cash received within the front loading or sub-front loading procedure before 1 January 2011. The fulfilment of this obligation was monitored by Eesti Pank’s **Surveillance Committee**. The committee discovered five companies that had violated the terms of the front loading contract concluded with the commercial bank. All the companies that violated the contract terms received a claim for the payment of a contractual penalty. No credit institutions were found to be in violation of the terms of their concluded front loading contracts.

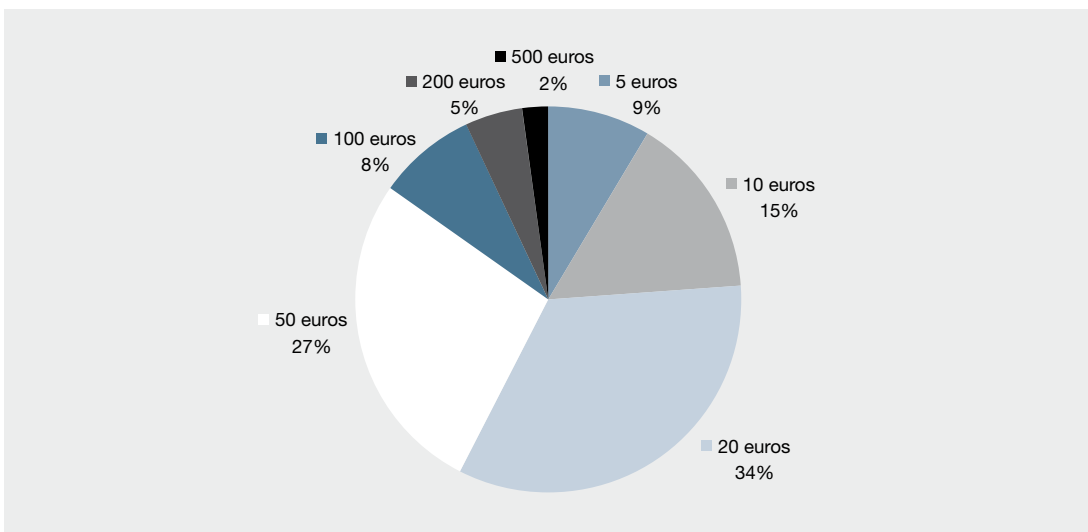


Figure1. Frontloaded banknotes by the total sums of denominations

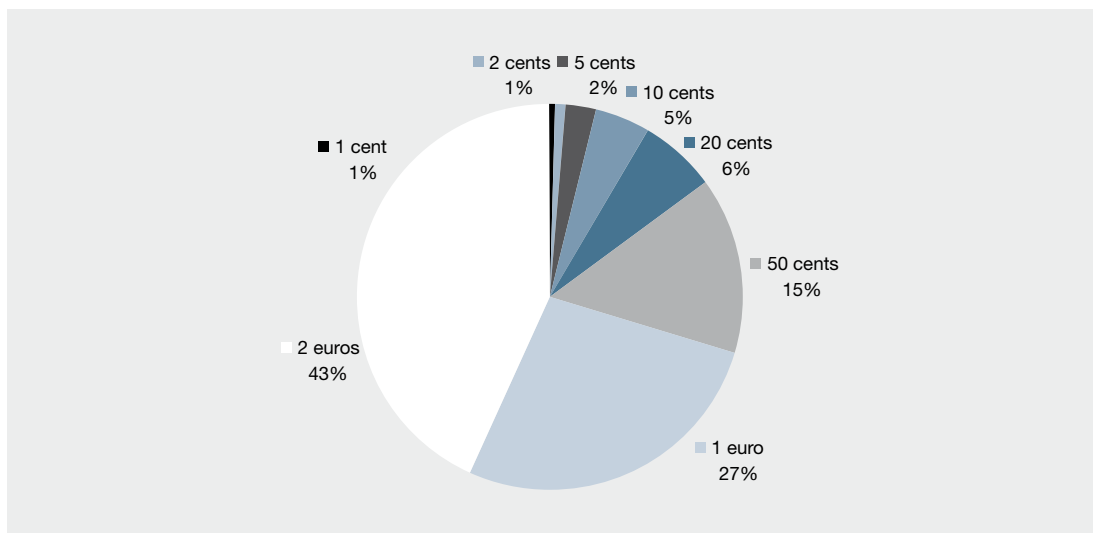


Figure 2. Frontloaded coins by the total sums of denominations

To distribute the workload of cash exchange, Eesti Pank together with commercial banks decided to **offer people an opportunity to exchange kroons at the official exchange rate against euro banknotes already in December**. For that, Eesti Pank made a separate purchase of euro banknotes, as the euro cash obtained for the changeover through the European System of Central Banks could not be circulated before 1 January 2011, and issued these banknotes to commercial banks for exchanging the cash of natural persons at the official exchange rate. In total, Eesti Pank issued 72.5 million euro worth of banknotes to commercial banks.

On 1 December 2010, the euro **starter kits** were made available for sale at the price of 200 kroons (12.79 €) per kit; the kits contained 42 euro coins and a security mark to verify their authenticity. The sale of starter kits in commercial banks and at the post offices of Eesti Post was very successful: nearly 247,000 kits were sold within the first three days. By 31 December 2010, 510,473 had been sold in total (see Figure 3).

Currency exchange is, among other aspects, indicated by the rapid and smooth **adoption of the euro in ATMs**. At the end of December,

867 ATMs were operating in Estonia; 832 of them were refilled by the security company G4S Eesti AS and 35 ATMs were refilled by commercial banks themselves. The refilling of the ATM network was commenced on 30 December during the day and ended in the evening of 31 December, when 99.9% of ATMs were filled with euro banknotes (see Figure 4).

Despite the difficult winter weather, ATMs were filled as planned. There were no failures in the operation of ATMs in terms of the euro changeover, and immediately after midnight, the ATMs of Swedbank, SEB and Nordea issued euro banknotes. The first euro banknote was withdrawn 4 minutes after midnight. On 1 and 2 January 2011, 85,000 withdrawals were made from ATMs with the total value of about 5 million euro.

During the last week of December, **the amount of kroon cash in circulation** decreased rapidly. At the beginning of December, there were still about 8.1 billion kroons in circulation, while at the end of the month this figure stood at about 5.8 billion kroons. Another 4.1 billion kroons were removed from circulation in January 2011, and at the end of the month, kroon cash in circulation totalled 1.7 billion Estonian kroons. By the end of

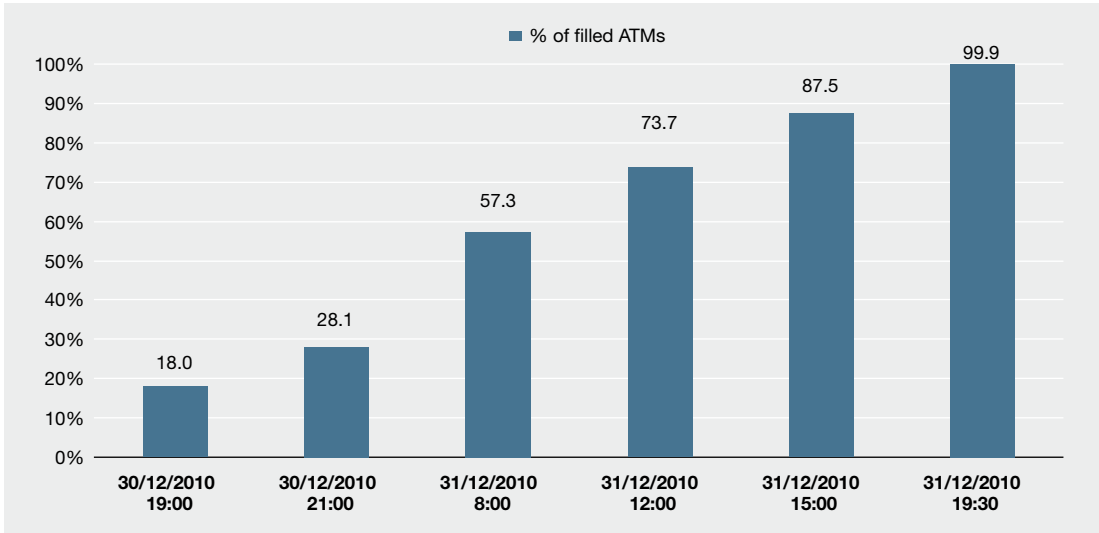


Figure 3. Filling ATMs with euros 30-31/12/2010

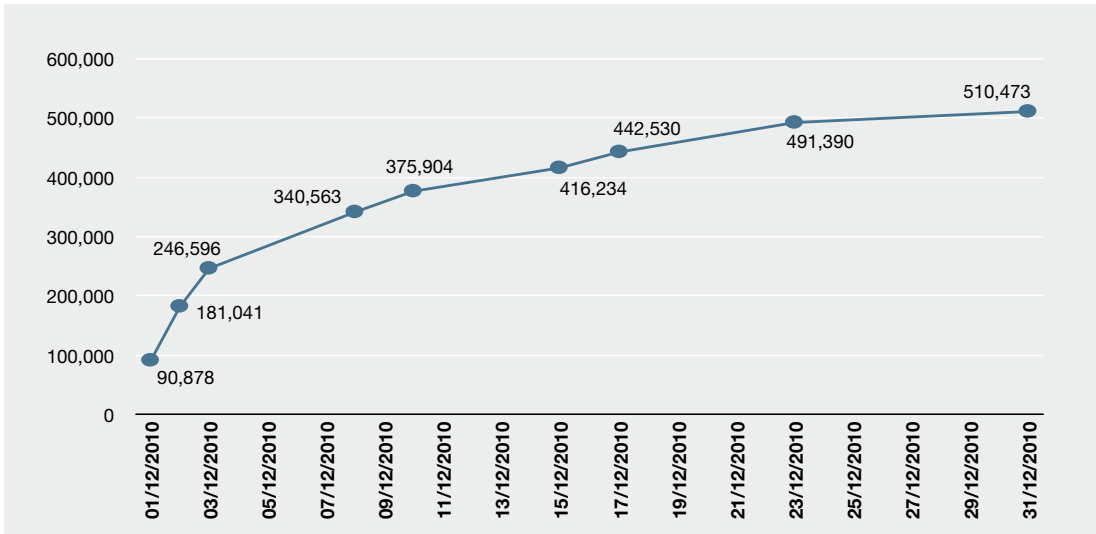


Figure 4. Number of starter kits sold

January, Eesti Pank had issued 245 million euro (net), of which banknotes made up 216 million and coins 29 million euro. The breaking point, when the sum of Estonian kroons in circulation

was smaller than the net issue of euro cash, arrived on the tenth day of the dual circulation period (see Figure 5).

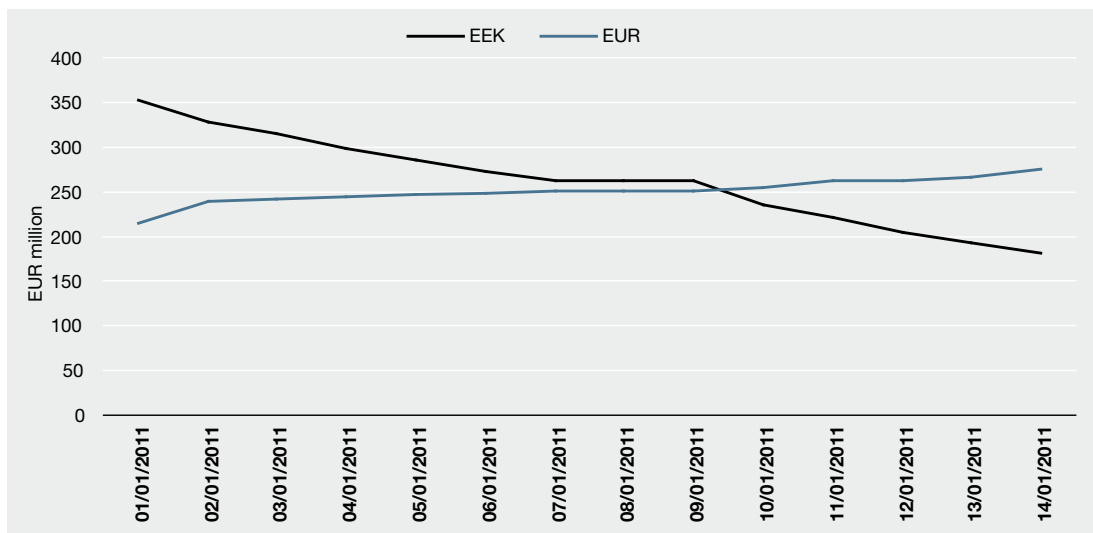


Figure 5. Euros and kroons in circulation

INTERNATIONAL PARTNERSHIP

The central bank's international communications play an important role in protecting Estonia's economic policy interests and explaining the issues related to the country's economic development to the international public and foreign investors. The central topic of 2010 was naturally Estonia's preparations for joining the euro area. This added to the usual areas of cooperation through many bi- and multilateral meetings, where we needed to explain our positions on the suitability of the Estonian economy and economic policy for accession to the euro area. There was close cooperation to handle the practical issues related to the adoption of the euro at every level.

Communication with various European Union institutions makes up the largest share of Eesti Pank's external communication and this already took on a new and deeper dimension six months before the actual accession to the euro area. In addition, new forums for partnership were added in 2010 as the new financial supervision system was established in the European Union (for more details see "Ensuring financial stability", p 43). Eesti Pank represents the interests of Estonia in the International Monetary Fund (IMF) and coordinates national cooperation in this area. In 2010, Estonia joined the Organisation for Economic Cooperation and Development (OECD), and Eesti Pank's personnel participate in its working groups. Working with the Bank for International Settlements (BIS) remains important for Eesti Pank.

Nordic and Baltic central banks have held a special place among Eesti Pank's communication partners for nearly twenty years. Cooperation with Nordic and Baltic countries is also closer because Estonia is in a single constituency with these countries in the IMF and the World Bank. Cooperation takes place through bilateral meetings, presentations of research projects and

seminars, and meetings for management members. The connection of the Estonian financial sector to those of neighbouring countries makes it necessary to work more closely on financial stability (for further information see "Ensuring financial stability", p 43).

Cooperation with European Union institutions

European Central Bank

The European Central Bank (ECB) is the most significant partner for Eesti Pank in the European Union. The euro area's monetary policy decisions are made in the Governing Council of the ECB, and the decision-making bodies of the ECB also discuss various other important issues that concern the work of central banks. Eesti Pank is a fully-fledged member of the European System of Central Banks (ESCB) and the Governor of Eesti Pank participates in the ECB General Council's meetings, which are held four times a year. After the decision by the EU Ministers of Finance on 13 July 2010 to accept Estonia accession to the euro area, the Governor of Eesti Pank also participated in the meetings of the ECB Governing Council as an observer until the end of 2010. As of the start of 2011, Eesti Pank is a member of the Eurosystem and the Governor of Eesti Pank is a member of the ECB Governing Council. The meetings of the Governing Council are usually held twice a month.

Day-to-day work takes place in the seventeen committees of the Eurosystem and the ESCB and their substructures, where joint analyses are written, positions are discussed and various documents are prepared in consultation with representatives of the NCBs. The committees help the decision-making bodies of the ECB to gather information so that they can make and implement the decisions. The committees cover all the fields of activity of the central bank. Besides the Governor of Eesti Pank, other rep-

Table. Eesti Pank's participation in the work of international organisations and institutions

Committees and other Bodies of the Council of the European Union	Informal meeting of the Economic and Financial Affairs Council Economic and Financial Committee
Committees and other Bodies of the European Commission	European Banking Committee Committee on Monetary, Financial and Balance of Payments Statistics Balance of Payments Committee
Committees and other Bodies of the Eurosystem and the European System of Central Banks	Governing Council of the European Central Bank General Council of the European Central Bank Accounting and Monetary Income Committee Financial Stability Committee Budget Committee Cost Methodology Committee Eurosystem IT Steering Committee Risk Management Committee Banknote Committee Eurosystem/ESCB Communications Committee Human Resources Conference Information Technology Committee Internal Auditors Committee International Relations Committee Legal Committee Market Operations Committee Monetary Policy Committee Payment and Settlement Systems Committee Statistics Committee
Committees of the European Systemic Risk Board	The Steering Committee of the ESRB Advisory Technical Committee
European Banking Authority	Committee of European Banking Supervisors
International Monetary Fund	Board of Governors of the IMF Nordic-Baltic Monetary and Financial Committee
Organisation for Economic Cooperation and Development	Economic Policy Committee Investments Committee Financial Markets Committee Statistics Committee
Bank for International Settlements	Board of Governors of BIS Meetings of BIS central bank governors BIS Monetary Policy Working Party

representatives of Eesti Pank also participated as observers in the Eurosystem's committees and substructures from the second half of 2010.

For a more detailed overview of the activities of the ESCB and Eesti Pank's preparations for joining the Eurosystem, see the other chapters of the annual report.

The new European financial supervision system

The Council of the European Union, the European Parliament and the European Commission reached an agreement at the end of 2010 to establish the European Systemic Risk Board (ESRB) and three European supervision institutions: the European Banking Authority, the

European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). The new framework entered into force on 1 January 2011. The aim of the reform is to be more efficient at preventing financial crises, and it lays down the role of central banks in the joint work of ensuring financial stability more precisely and formally. Eesti Pank's representative in the General Board of the ESRB is Eesti Pank's Governor Andres Lipstok. On the level of experts, Eesti Pank is involved in the Advisory Technical Committee of the ESRB, and the bank participates as an observer in the Committee of European Banking Supervisors (for further information see "Ensuring financial stability", p 43).

Council of the European Union

Eesti Pank's representatives attend various committees and working groups set up by the Council of the European Union, that is the Council of Ministers. In April and September 2010, the Governor of Eesti Pank attended the informal meetings of the Economic and Financial Affairs Council (ECOFIN). The topics discussed included the European and global economic situation and outlook; issues related to EU financial stability; harmonisation of the supervisory practices of the EU's financial sector; the termination of the extraordinary measures adopted during the crisis; and improving public finances. The principles for assisting euro area countries with unbalanced public finances and unstable financial sectors became particularly important. At the European Council in December, the EU heads of states agreed to establish a European Stability Mechanism (ESM) after the termination of the temporary European Financial Stability Facility (EFSF) in June 2013.

In addition, central bank experts advise the officials of the Ministry of Finance who participate in the monthly ECOFIN meetings on matters that fall under the competence of Eesti Pank. In 2010, such matters included ensuring the sustainability of public finances; an assessment of the Member States' economic and monetary policy, which includes Estonia's convergence report; and financial market supervision and cross-border crisis management, including an assessment of the financial sector's stress test results. ECOFIN also approved the positions of the European Union for the international meetings with the IMF and G20. Membership of the euro area also gave the Minister of Finance the opportunity to participate in the meetings of the euro area's Ministers of Finance, or the Eurogroup.

One of the most important substructures of the Council of the European Union that Eesti Pank's representatives participate in is the Economic

and Financial Committee (EFC) and its working groups dealing with questions of the international economy and coins. Since the EFC prepares the meetings of ECOFIN, all the important issues listed above were discussed in the ECF meetings of 2010 too.

European Commission

Representatives of Eesti Pank participate in the Banking Advisory Committee, the Banking Supervisory Committee, the Balance of Payments Committee, and the Committee on Monetary, Financial and Balance of Payments Statistics set up by the European Commission. These committees address issues related to communications, statistics, economic forecasts, payment and settlement systems, banking, banknotes and coins, and counterfeit money. Regular meetings with European Commission experts are held in both Estonia and Brussels to specify the data the Commission needs to produce its economic forecasts for EU Member States. In 2010, the long-term outlooks of the Estonian economy within the framework of the Lisbon Strategy EU 2020 were discussed for the first time.

Cooperation with the International Monetary Fund

The International Monetary Fund is an important forum for international cooperation with 187 members or most of the countries in the world. The main objectives of the IMF are to ensure the stability of the international monetary and financial system, to support stable and sustainable economic growth, and through this, to prevent financial and balance of payments crises, and to facilitate international trade. The Republic of Estonia has been a member of the IMF since 1992 and the interests of Estonia in the IMF are represented by Eesti Pank.

In March 2011, the reform of the system of quotas and voting power approved in 2008 by the

IMF Board of Governors entered into force. Previously, Estonia's quota had been 65.2 million SDRs, or 0.03% of the total of the IMF's quotas, giving Estonia 902 votes, or 0.04% of total votes. After the reform, Estonia's quota in the IMF increased by 31% to 93.9 million SDRs and our voting weight rose by 46% to 0.067% of total votes. The Riigikogu approved the amendments to the IMF's Articles of Agreement in October 2010.

The Governor of Eesti Pank is a member of the highest decision-making body of the IMF, the Board of Governors, which makes him the Governor of Estonia. The Secretary General of the Ministry of Finance is the alternate member of the Board of Governors, or the Deputy Governor of Estonia. Both members attend the IMF Annual Meeting every year. The International Monetary and Financial Committee (IMFC), the advisory board to the Board of Governors, meets twice a year in April and September, where Estonia is represented by the Nordic-Baltic Constituency. In 2010, the Nordic-Baltic Constituency was represented by Denmark.

Day-to-day work with the IMF is conducted first and foremost through the Nordic-Baltic Constituency, which represents Estonia among others. Strategic issues and related problems within the sphere of interests of the Nordic and Baltic countries are discussed twice a year in the Nordic-Baltic Monetary and Financial Committee (NBMFC). Each constituent country is represented in the Committee by a representative of the government and one of the central bank.

In 2010, representatives of the IMF paid three visits to Estonia within the framework of bilateral surveillance. On 2–13 December, regular economic policy consultations were carried out under Article IV of the IMF Articles of Agreement. In December, the IMF focused on the adjustment of the Estonian economy and its outlook for growth in the more distant future. The long-term

sustainability of our fiscal policy and the stability of the financial system were also scrutinised. After a discussion in the IMF Executive Board, a report completed from the visit (Article IV report) was published on the websites of both the IMF and Eesti Pank.

Against the backdrop of insecurity in the global economy, the focus in 2010 was on supporting countries that were affected by the crisis, and so the discussions among the IMF's Member States centred on the **IMF's lending capacity and credit instruments**. To increase the loan resources of the IMF, many Member States contributed additional funds to the fund. A new borrowing arrangement was adopted and the flexibility of several loan instruments was improved in order to guarantee the accessibility of financial aid. Due to changes in the global economy, **updating the IMF's mandate and surveillance activities** was also discussed. The goal was to find solutions to balance the surveillance by allowing a focus on multilateral surveillance without endangering the quality of bilateral surveillance.

In autumn 2010, the Board of Governors of the IMF passed a **reform of the IMF's principles of governance**, as a result of which:

- all the members of the IMF's Executive Board shall be elected;
- the Executive Board shall include 24 members and its composition shall be reviewed after every eight years;
- the representation of advanced European economies shall be reduced in the Executive Board by two chairs;
- a second Alternate Executive Director's position shall be established in Constituencies that include seven or more Member States.

The reform also included the completion of the general **review of the Member States' quotas**. As a result of the reform, an agreement

was reached to double the quotas to 476.8 billion SDRs and redistribute over 6% of the quota shares to under-represented and dynamic emerging markets and developing countries. The parliaments of the Member States must approve this reform for it to come into force.

Cooperation with the Bank for International Settlements

The Bank for International Settlements (BIS) is one of the oldest partnership forums for central banks. 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 meeting agendas mostly contain topical monetary policy issues (including the role of central banks), the situation of economic and financial markets in different regions, and financial sector management and supervision.

In February 2010, Eesti Pank hosted the BIS's Working Party on Monetary Policy in Central and Eastern Europe in Tallinn.

Cooperation with rating agencies

Since 1997, Estonia has been assessed by three major international rating agencies: Moody's Investors Service, Standard & Poor's and Fitch Ratings. Eesti Pank coordinates relations between Estonia and the rating agencies. This includes rating agencies' visits once a year and day-to-day communication with the analysts. Rating agencies' annual reports on Estonia are available on the website of Eesti Pank. Read more about the agencies' decisions regarding Estonia's rating and their assessments of Estonia's economic situation in "Sovereign rating", p 111.

PUBLIC RELATIONS

The public relations of Eesti Pank are structured so as to reflect the strategic goals of the bank and the organisation's concept of a central bank's role and activities. The aim is to support the stability of the economy and the financial system in the current monetary policy framework.

The communications from the central bank help market participants to form reasonable expectations and to maximise the efficiency of their economic decisions at all times.

Public relations aim for the following goals:

- to improve the general public's understanding of the central bank's monetary policy, thus guaranteeing sufficient support for it;
- to maintain and enhance the reputation of Eesti Pank as a competent, independent, and credible institution that plays a significant role in guiding Estonia's economic policy and economic development; to help make the activities of Eesti Pank as transparent as possible and to be ready to communicate with the general public through various social groups;
- to guarantee the best possible availability of background information for market participants to support their economic decisions.

Transparency and reliability in the public eye is very important in the activities of the central bank.

The general public and various target groups in Estonia and abroad must receive regular, sufficiently thorough and high-quality information about economic policy issues from Eesti Pank. Eesti Pank has undertaken to publish information more extensively and frequently than is laid down by its legal accountability (see also "Central bank accountability", p 17). The central bank presented its view of the Estonian economic situation four times in the past year in a more thorough commentary, and published 20 shorter statements about current economic

indicators and several other overviews and analyses (see also "Publications of Eesti Pank in 2010", p 127).

For the central bank, the precise timing, intelligibility and convenience of the information it provides are very important. For example, Eesti Pank's regular publications are free of charge for subscribers and these information materials are read both in Estonia and abroad. In addition, Eesti Pank sends its publications out to Estonian universities, libraries and media organisations to foster financial education. All the publications of Eesti Pank are also available on Eesti Pank's website.

As well as releasing publications and the information published on the website, Eesti Pank also handles direct inquiries. **Information can be requested** by mail, e-mail or phone. The number of daily inquiries increased substantially in 2010: Eesti Pank received a total of 3,752 **inquiries**, 2,566 of them by phone, and 1,186 by e-mail and mail and through the "Ask a question" interface on the bank's website. Of the inquiries, 25 were registered as requests for information.

Eesti Pank replied to 472 questions in 2010 through the Euroweb's "Questions and answers" section.

The number of questions that Eesti Pank was asked soared in the last quarter of 2010, when people were most interested in the practical aspects of the euro changeover. Many questions concerned the validity of the euro coins, the deadline for currency exchange and the exchange rate; a lot of attention was also focused on the starter kits of Estonian euro coins. Detailed questions were also asked about the euro information campaigns or about some major changes that were implemented, for instance, business owners were very interested in the rules for the dual display of prices and for rounding.

Throughout the whole year, interest in Eesti Pank's numismatic products and the museum

remained high, and these subjects also attracted a lot of questions.

Media communication and public appearances

Approximately 6,000 written articles, news stories, and radio and TV news items reflecting the work of Eesti Pank and its economic policy positions were published or released in the Estonian media in 2010. At the beginning of the year, interest was greatest in the post-crisis economic development and the outlook for the economy; in the second quarter the main attention shifted to the preparations for the euro changeover, then in the second half of the year, the focus was on the central bank's practical preparations for the adoption of the euro and the economic perspectives for Estonia and the euro area. The most frequent concern regarding the euro adoption was the fear of price rises.

In 2010, Eesti Pank arranged nine press conferences and presentations, and issued 171 press releases and statements. In addition, 60 longer interviews were conducted with the bank's managers and experts and four economic policy articles were published in 2010. During the year, the representatives of the bank made 115 public presentations in Estonian, Russian or English.

The distribution of information about the changeover

For Eesti Pank, the year 2010 was the last year of operating within the framework of the currency board system. Joining the euro area on 1 January 2011 meant that as well as handling ordinary communications, Eesti Pank's communication department was also actively in preparing the Estonian national euro communication campaign and public information projects.

In arranging the distribution of euro information, Estonian state agencies used a single changeover communication strategy¹. The aim of the national information campaign was to make sure the entire population was aware of the impacts of the changeover on the country's economy and development and of the practical changes accompanying the euro changeover. The key target groups were the general public and business people, but consumers, pensioners and recipients of social benefits, the non-Estonian speaking population, children and young people, people with special needs, local governments, tourists and foreigners were also targeted separately. Information was distributed through various channels, such as the local and national press, television and radio, an information phone line, the internet, mailings and publications, and outdoor advertisements.

Several target and risk groups were approached on the basis of their specific needs and channel preferences. For instance, Eesti Pank helped to record information about the practical aspects of the euro changeover and produce cards to identify circulating coins and banknotes for the **visually impaired**. Another special target group was **young people**: publications were made for various age groups presenting the euro coins and banknotes and showing how to differentiate between authentic and counterfeit money. Eesti Pank arranged a radio quiz for children and worked with the Ministry of Finance and other partners to arrange popular essay and drawing competitions for young people on the topic of the changeover and the euro. For the youngest target group, the children's website Lastekas.ee showed four cartoons about the euro changeover, and the cartoons were also broadcast on Estonian Television.

From June 2010 until December, the specialists

¹ See also http://euro.eesti.ee/EU/Prod/Euroveeb/Avaleht/Vasakmenueue/Publikatsioonid/Dokumendid_uelemineku_kohta/Kommunikatsioonistrateegia.pdf.

of the central bank arranged **euro cash training** sessions and held lectures in Estonian county centres. More than 30 lectures with over 3,000 participants were organised for cash handlers who deal with cash in their daily work. In the lectures, the central bank's experts presented the euro, its design and its security features, and explained how to differentiate between authentic and counterfeit money; they also gave an overview of the principles of cash exchange.

In order to introduce the euro banknotes and coins and their security features to the general public, in November about 561,000 Estonian households received an **information publication** compiled by Eesti Pank and the European Central Bank. In addition, Russian publications were distributed in districts of Tallinn and local government regions across the country where the population register indicated that at least half of the residents are non-Estonian speaking, meaning the towns of Paldiski, Maardu, Loksa, Sillamäe, Kohtla-Järve, Kiviõli, Narva, Narva-Jõesuu, Mustvee and Kallaste, and the rural municipalities of Peipsiääre, Aseri, Piirissaare, Alajõe, Vaivara, Jõhvi and Kasepää). In Tallinn, Russian publications were distributed to all the addressees of the districts of Haabersti, Põhja-Tallinn and Lasnamäe. Materials in English were distributed to foreigners residing in Estonia and tourists who visited Estonia.

Traditionally, the countries that are about to adopt the euro organise events to celebrate the changeover approximately a hundred days before €-day. In Estonia, an **international conference** was arranged on 20 September in the Estonia Concert Hall jointly by Eesti Pank, the European Central Bank, the European Commission and the Ministry of Finance, focusing on the future of Europe in terms of its expansion. The speakers at the conference included the Prime Minister of Estonia Andrus Ansip, the President of the European Central Bank Jean-Claude Trichet, and the European Commissioner for Eco-

nomics and Monetary Affairs Olli Rehn. The conference also included a panel discussion, where the implications of the euro area's expansion in the immediate and more distant future were discussed by the Governor of the Bank of Finland Erkki Liikanen, Governor of the National Bank of Poland Marek Belka, Senior Advisor of the International Monetary Fund's European Department Anne-Marie Gulde-Wolf and the Minister of Finance of the Republic of Estonia Jürgen Ligi. The discussion was chaired by the Director of the Economic Analysis and Research Department of the national bank of Austria, Peter Mooslechner. The conference was concluded by Andres Lipstok, Governor of Eesti Pank.

The opening ceremony of the **euro exhibition** by the European Central Bank and the European Commission in Tallinn took place on 20 September 2010. The exhibition, which was on display in four Estonian towns during five months, covered the most important euro-related topics and presented the history of the European single currency and the conditions for joining the euro area. The exhibition was visited by 67,000 people. At the seminars of the euro exhibition, representatives of Eesti Pank, the Ministry of Finance and the Banking Association talked about the security of the euro, daily banking operations and other euro adoption issues. Events organised in cooperation with the Estonian Debating Society focused on the most topical euro-related issues: economic growth, price increases and the sustainability of the euro area.

Estonia's accession to the euro area was also celebrated at a festive reception at Eesti Pank on 19 September. The guest of honour was the President of the European Central Bank Jean-Claude Trichet, who gave the Governor of Eesti Pank Andres Lipstok the symbolic Euro Star to commemorate Estonia's accession to the euro area. The same event also marked the beginning of the joint media campaign by Eesti Pank and the European Central Bank regarding euro bank-

notes, and unveiled the information clips produced for the campaign. Participants included the representatives of the agencies and banks that had prepared the transition, the European Commission and the EU's central banks, and also dozens of journalists from Estonia and abroad, totalling about 200 people. This festive event was broadcast live on the news portal of the Estonian Public Broadcasting organisation.

In order to coordinate euro communication at the turn of the year², a special communication group was assembled, with communication specialists from the Ministry of Finance, Eesti Pank, the commercial banks, the Consumer Protection Board and the police. A special communication plan establishing the arrangement of work, the use of infrastructure, and the goals and key messages of communication, was prepared to monitor the changeover and prevent possible emergencies. The headquarters of the communication group were created at Eesti Pank.

From 31/12/2010 to 2/01/2011, the changeover communication group did its job successfully by providing round-the-clock information to the NCC and the general public about the technical progress of the changeover. As no emergencies or crises occurred during the changeover, there was no need to resort to crisis communication. The communication group wrote and issued press releases, replied to inquiries and answered the euro information phone line. The headquarters also coordinated the exchange of information with institutions that were involved in the currency exchange process, and prepared and arranged press conferences to summarise events.

Results of the euro information work

As a result of the successful organisation of the nation-wide information work, the euro communi-

cation working group that operated under the NCC hit all the goals it had set: all the euro communication target groups reached a high level of awareness and full readiness for the changeover, which was also confirmed by the smooth and problem-free adoption of the euro. According to the survey conducted by Faktum & Ariko in December 2010, 94% of Estonia's residents were sufficiently informed of the practical aspects of euro adoption.

According to the survey ordered by Eesti Pank and conducted by TNS Emor, the national euro information work reached all its target groups well, regardless of their nationality, age, income or place of residence. According to a survey conducted in the middle of January, 97% of the people had noticed the euro information materials. The percentage noticing the euro information campaign was 95% or more in all the target groups that were defined based on nationality, age, income or place of residence. This is an excellent result, because various information campaigns do not usually reach the Estonian and non-Estonian speaking communities equally well. As regards the national euro information campaign, the non-Estonian speaking population had noticed the fair pricing campaign slightly less, but in other issues the level of awareness was equally high. Another noteworthy result was the equal awareness among urban and rural residents.

Those who had seen the information materials assessed their usefulness as follows:

- the publications about euro cash were considered useful by 71%;
- the posters about euro cash were considered useful by 63%;
- the tiltable bank-card sized exchange rate card was considered useful by 65%;
- the brochures about counterfeit euro money for cashiers were considered useful by 78%;

² See also the Report on the Fulfilment of the Communication Strategy For the Adoption of the Euro, pp 15–16 http://euro.eesti.ee/EU/Prod/Euroveeb/Avaleht/Vasakmenueue/Publikatsioonid/Dokumendid_ulemineku_kohta/aruanne.pdf.

- the “speaking cards” for the visually impaired were considered useful by 58%;
- the posters for the fair pricing campaigns were considered useful by 47%;
- the advertisements for the fair pricing campaign were considered useful by 48%.

According to the surveys, public support for the euro ranged between 48% and 54% during the six months. The questionnaire conducted after the introduction of the euro in January 2011 showed that public support for the euro had increased to 60%.

The rise in the support undoubtedly stemmed from the changeover process: it was smooth and

did not encounter any major failures. The banks’ rearrangements went according to plan: the ATMs and card payments were already functional a few minutes after midnight on January 1; the accounts and IT-systems were converted successfully and bank branches were also open during the weekend. In addition, in the dual circulation period the network of banks was supported by the cash exchange facility of Eesti Post in rural areas. National information systems, including the most important systems of the Tax and Customs Board and the Social Insurance Board, started operating in the euro regime as planned. Investments in security were also successful, as no incidents related to currency exchange were registered.

Eesti Pank Museum

In 2010, interest in the museum was considerably greater than usual: it had a total of 13,083 visitors, of whom 5,833 were exhibition visitors and 7,250 coin purchasers. Following the decision to join the euro area and adopt the euro on 1 January 2011, interest in purchasing circulating Estonian kroon coins, banknotes and commemorative coins soared. The museum sold numismatic and bonistic products for a record 31.6 million kroons. The majority of the buyers were Estonian residents who wished to keep Estonian kroons as souvenirs.

In 2010, two temporary exhibitions were arranged in Eesti Pank Museum:

- the exhibition “Gold Loads of Freedom” in cooperation with the Pärnu Museum in March;
- “Sports Gold of Estonia” in May, organised by the Kalev Sports Society and the Estonian Sports Museum.

Due to the currency change in Estonia in 2011, interest in the touring exhibitions of Eesti Pank increased substantially last year, especially in the exhibition about the history of money. As well as touring 15 places all across Estonia, these exhibitions were also on display at the world exhibition EXPO 2010 in Shanghai, the European Commission headquarters in Brussels and the Permanent Representation of Estonia to the European Union. Among the other touring exhibitions, “Our Daily Bank Card” toured six Estonian locations and “Fifteen Years of Our Money: Designs of the Eesti Kroon” was on display at the central library of Jõgevamaa in Põltsamaa and at the central library of Pärnu.

On 15 May, the second Estonia-wide museum night took place under the title “Stories in the Night”. The museum of Eesti Pank also participated in the museum night with the story “An old photo tells a story: Paul Keres’s simultaneous play at Eesti Pank in 1937”. The museum opened the exhibition “Books by and about Keres”, where Paul Keres was remembered by chess master Ivo Nei. The museum was open from 18:00 to 22:00 and was visited by 1,572 people.

GOVERNANCE, ORGANISATION AND HUMAN RESOURCES POLICY

The governing and decision-making bodies of Eesti Pank

The Supervisory Board of Eesti Pank

Pursuant to the Eesti Pank Act, the Supervisory Board of Eesti Pank is the highest body of Eesti Pank, exercising supervision over all activities of the central bank.

In 2010, the Supervisory Board had exclusive competence in the following areas:

- Making a proposal to the President of the Republic for appointment of the Governor of Eesti Pank;
- Appointment to office and release of the Deputy Governors of Eesti Pank, the heads of the independent divisions and representative offices and Head of the Internal Audit Department of Eesti Pank; appointment and removal of two members to the Supervisory Board of the Financial Supervision Authority¹ on the proposal of the Governor of Eesti Pank;
- Approval of the Statute of Eesti Pank, the statutes of its independent divisions and representations and the Statute of the Internal Audit Department;
- Supervision over the execution over the Eesti Pank budget;
- Appointment of the internal auditors of Eesti Pank and approval of the internal audit work schedule;
- Appointment of the independent auditors of Eesti Pank;
- Approval of Eesti Pank's Annual Report on the proposal of the Governor;

- Making decisions regarding the denomination and design of new banknotes and coins;
- Making decisions regarding the establishment, reorganisation and liquidation of the independent divisions of Eesti Pank on the proposal of the Governor;
- Reviewing and approving written proposals and other documents submitted to the Riigikogu in the name of Eesti Pank.

The Governor of Eesti Pank reports regularly to the Supervisory Board on the situation in Estonia's economy, monetary policy and financial sector, and on the implementation of the central bank's budget.

The Riigikogu appointed the current Supervisory Board of Eesti Pank to office on 18 February 2009. The Board includes Jaan Männik (Chairman of the Board, appointed to office on 13 June 2008); Kalev Kallo, Member of the Riigikogu; Professor Irene Kull, Head of Chair of Commercial Law and Intellectual Property Law at the Institute of Private Law, University of Tartu; Professor Enn Listra, Dean of the School of Economics and Business Administration at Tallinn University of Technology; Tõnis Palts, public figure and economist; Liina Tõnisson, public figure and economist; and Professor Urmas Varblane, Head of Chair of International Business and Innovation, Faculty of Economics of the University of Tartu. In relation to the appointment of Jürgen Ligi as Minister of Finance on 4 June 2009, his membership of the Supervisory Board of Eesti Pank has been suspended. For the time of Mr Ligi's position as a member of the Government, the Riigikogu appointed Valdo Randpere the alternate member of the Supervisory Board of Eesti Pank as of 26 January 2010.

¹ The Supervisory Board of the Financial Supervision Authority comprises six members: two of them – the Minister of Finance and the Governor of Eesti Pank – are members by virtue of office while four are appointed. The Board is chaired by the Minister of Finance. Half of the members are appointed and removed by the Government of Estonia on the proposal of the Minister of Finance and half by the Supervisory Board of Eesti Pank on the proposal of the Governor of Eesti Pank.

The Governor of Eesti Pank

Andres Lipstok commenced his duties as the Governor of Eesti Pank on 7 June 2005.

The Executive Board of Eesti Pank

Pursuant to the Eesti Pank Act, the Executive Board of Eesti Pank is responsible for planning and organising the tasks of the central bank. The Governor of Eesti Pank is, by virtue of office, the Chairman of the Executive Board.

In 2010, the Executive Board comprised Governor Andres Lipstok and Deputy Governors Rein Minka and Märten Ross.

Governor Andres Lipstok is in charge of the overall governance of the responsibilities of Eesti Pank. His exclusive competence involves organising the designing of banking policies and the overall governance of the responsibilities of Eesti Pank; supervision of the enforcement of the decisions passed by the Supervisory Board and implementation of measures necessary for that purpose; approval of Eesti Pank's budget, and supervision of the execution of the tasks of the European System of Central Banks.

The Governor reports to the Riigikogu and responds to interpellations concerning Eesti Pank's responsibilities. The Governor regularly reports on his activities to the Supervisory Board.

The Governor controls the work of Deputy Governors and is responsible for public and international relations, development of the legal environment, supervision of the bank's management systems, internal administrative services and the operational working environment.

Deputy Governor Rein Minka is responsible for coordinating the tasks related to currency circulation; safety of the working environment; development and implementation of financial sector

policies; coordination of collection, handling and disclosure of financial sector information; supervision of payment and settlement systems; reliable, cost-efficient and integrated development of the settlement system of Eesti Pank; the information technology working environment, and human resources management.

Deputy Governor Märten Ross is responsible for the preparation and implementation of monetary and economic policy decisions; management of the financial assets of Eesti Pank; coordination of collection, compilation, and disclosure of national statistics; financial accounting and reporting; coordination of economic research and activities related to in-service economic training.

The Monetary Policy Committee

A standing Monetary Policy Committee operated in Eesti Pank until 1 January 2011 to develop positions on monetary, economic and financial policies and to coordinate the tasks of the central bank.

In 2010, the Committee included members of the Executive Board – Governor Andres Lipstok and Deputy Governors Rein Minka and Märten Ross – and Janno Luurmees, Head of the Financial Markets Department; Ülo Kaasik, Head of the Economics Department; Martti Randveer, Head of the Research Department; Rait Roosve, Head of the Cash and Security Department; and Jaak Tõrs, Head of the Financial Stability Department.

Cooperation with the Financial Supervision Authority

The Financial Supervision Authority (FSA) operates as an agency of Eesti Pank. It exercises national supervision over banks, insurance companies, financial intermediaries, investment funds and management companies licensed and operating in Estonia as well as the securities market.

The FSA is governed by the Supervisory Board chaired by Raul Malmstein. The tasks of the FSA are planned by the Supervisory Board chaired by the Minister of Finance by virtue of office (by Jürgen Ligi in 2010). Members of the Supervisory Board include Governor of Eesti Pank Andres Lipstok, Deputy Governor Rein Minka and Member of the Supervisory Board Valdo Randpere.

The development of the management system and work organisation of Eesti Pank in 2010

Organisational values and value-based management

The Executive Board of Eesti Pank has defined the following values of Eesti Pank.

Competence

- We keep ourselves informed on our long-term goals and follow them in our activities
- The messages we communicate are clear and understandable
- Our employees have the best qualification and a broad basis of knowledge
- We value self-learning and individual development and we learn from the best
- The sharing of employee skills and knowledge is well organised
- We are committed to fulfilling our main goals and we are prudent in our activities

Cooperation orientation

- We are flexible and innovative
- We engage the necessary expertise and make contributions where relevant
- We act in good will and trust each other
- We work as a team

Reliability

- We are loyal to our organisation and committed to our work
- Our words match with our deeds
- We are candid and self-critical

- We are consistent

Consideration

- We keep each other informed in regard with our work and give feedback
- We give recognition to good employees
- We have consideration for others and we are helpful and obliging

These values are part of the Bank's management system. They are used in the daily and case-by-case analysis of work as well as in more general analysis conducted in annual development interviews.

Development interviews

The traditional appraisal interviews were conducted also in 2010. The Human Resources Department compiled a summary of the interviews with the focus on preparations for the adoption of the euro and the staff's proposals concerning the organisation. These proposals were presented to all employees. At the traditional spring seminar, members of the Executive and Supervisory Boards had an in-depth analysis of the proposals.

The development of the management system of Eesti Pank

In 2009 the Management System Committee was established at Eesti Pank to make and analyse proposals regarding the development of the management system of Eesti Pank. In 2010 the Committee dealt with risk management, business continuity and activity-based budgeting issues. In addition, the Committee continued compiling the description of the organisation on the basis of the Excellence Model of the European Foundation for Quality Management (EFQM). This description will be used in 2011 for the organisation's self-assessment, which will be followed by actions necessary for driving the organisation towards excellence. Last but not least, the public

strategy document of the bank was developed further and will be published in 2011.

Bureau Veritas Eesti OÜ carried out a compliance audit in Eesti Pank and validated the ISO 9001:2000 Quality Certificate issued to the Cash and Security Department in 2008. The certificate serves as a proof that cash handling and security processes in Eesti Pank comply with the requirements set forth in the standard.

In financial and management accounting, a new business management software SAP was introduced in 2010. SAP is used also in many other banks in the European System of Central Banks. For the adoption of the euro, the bank adopted accounting principles and procedures that comply with its needs and are similar to those implemented in other national central banks in the euro area.

Risk management

The management of risks and business continuity continued in 2010 in compliance with the established principles and procedures. The focus of risk management in 2010 was mainly on one project, the introduction of the euro.

The total risk level dropped 11% in 2010 to 495 million kroons by the end of the year. The risk level indicates (in monetary terms) the total impact of all potentially harmful events during a year. The risks related to the working environment decreased the most, while the risks related to the information systems were adjusted upward. A major revaluation of risks will be ahead in 2011, providing input on whether the total risks of Eesti Pank will increase, as indicated by preliminary assessments at the end of 2009, or whether the bank has taken sufficient measures to reduce its risks.

Preparations for joining the euro area and management of related risks were carried out as a special project, which was systematically con-

trolled by the management of Eesti Pank. In addition, a special euro project team was established, consisting of representatives of the Ministry of Finance, credit institutions and other major partners and public agencies.

The main development regarding business continuity in 2010 was the inclusion of external cooperation partners to map and evaluate common risks to the financial sector on the basis of the new Emergency Act that entered into force in 2009. The central bank collaborated closely with all systemically important risk management and business continuity units of commercial banks. The implementation of the Act has gone smoothly and in line with the set time schedules.

In September, the self-assessment of risk management came to an end, providing recommendations for further enhancement of risk management and closer integration with other fields of management. Recommendations for raising the awareness and inclusion of the bank's personnel received an explicit output by the management already during the assessment, as the management established the principles for risk management training and business continuity exercises. Most of the recommendations will be implemented in 2011.

e-Eesti Pank

The main tasks related to e-Eesti Pank, the development strategy for document and information management, in 2010 were preparing for the adoption of the euro, reorganisation of records management, developing the application for the management of documents' life cycle, and readjusting the workflow of account settlement. The workflows for processing the management's decisions and internal audit regulations were developed further too. In addition, a survey was held among the users of e-Eesti Pank to get feedback. Users' proposals will be taken into account in further developments of e-Eesti Pank.

The human resources policy

The aim of Eesti Pank's human resources policy is to ensure the recruitment of employees needed for accomplishing the main objectives of the bank, to develop and train, and to motivate and provide fair remuneration to the staff.

Employees

Internal competition is preferred in **recruitment** in order to motivate the staff by providing horizontal career opportunities within the bank. External competition is used if internal competition has failed or if an employee with different experience is needed. When recruiting for executives or other highly responsible posts, a competency model is used, which provides the best opportunity to evaluate candidates' knowledge, skills, and personal characteristics.

Staff remuneration derives from the need to recruit and retain highly competent staff and to motivate them to work effectively and contribute to the good reputation of the bank. The average remuneration should be competitive in the labour market where the bank competes for employees, that is the financial sector labour market in Tallinn.

When determining the remuneration of the top management, the Supervisory Board of Eesti Pank takes into consideration top executives' wages in state and private enterprises with turnovers larger than 500 million kroons. The size of the remuneration paid to top executives is affected by changes in the wage market data in the financial sector. The remuneration of the Governor of Eesti Pank should not be smaller than the average wages of top executives in comparable enterprises and agencies.

In 2010, the total remuneration (basic wages and additional remuneration) paid to the members of the Supervisory Board amounted to 2.009 million

kroons (1.798 million kroons in 2009) and that of the Executive Board to 4.139 million kroons (4.374 million kroons in 2009).

Non-managerial positions have been assessed using the Hay method. Depending on the assessment results, all positions have been divided into wage groups listed in the classification of central bank positions. Eesti Pank has implemented a wage scale that comprises all wage grades. The employees (members of the Executive Board excluded) receive remuneration on the basis of their wage grade, comparable by groups of similar work within as well as outside the bank.

In 2010, the average monthly wages (including holiday pay and additional remuneration for working during evening and night hours, on days off and public holidays) was 30,078 kroons. This includes the top executives, specialists (about 85% of the total staff) and the support staff. The intermediate-level specialists employed in Eesti Pank must have a Master's degree, at least three years of professional experience and proficiency in written and oral English. They are also expected to attend some EU or European Central Bank working group. In 2010, the monthly wages of a specialist complying with these requirements was 24,181 kroons.

At the beginning of 2010, the bank had contracts of employment with 253 employees (231 were actually working, as contracts with 22 employees had been suspended), while at the end of the year the respective figure was 262 (246 were actually working and 16 contracts had been suspended). The staff increased because of the need for additional fixed-term employees in connection with preparations for the euro changeover. The majority of these fixed-term contracts will end in the spring or summer of 2011. The reasons for suspending contracts of employment were maternity leave, work at the European Central Bank or other international organisations.

The average age of the staff in 2010 was 43.6 years. The employees included 104 men (40%) and 158 women (60%).

Development and training

Development costs totalled 2.62 million kroons in 2010, which accounts for 2.2% of the staff's payroll. In total, 194 employees (84% of total staff) attended trainings. On average, every employee received five days of training with the total cost of 11,344 kroons.

The most popular fields of training in 2010 were economic theory and policy, management and communication, and languages. Many of the trainings in core fields take place abroad. Group trainings mostly include in-house training courses and open seminars.

51 employees were engaged in academic studies in 2010: 75% of them were acquiring a Master's or Doctor's degree.

Three employees of Eesti Pank and one employee of the European Central Bank participated in short-term secondment programmes at the ECB and Eesti Pank, respectively.

Hobbies and traditions of the staff

The sports club

The sports club of Eesti Pank had 227 members at the end of 2010. The most popular sports included swimming, fitness, badminton, basketball, yoga, volleyball, tennis, gym, water aerobics and roller-skating. In addition, there were winter and summer sports days, bowling competitions and a spa party for the staff and family members.

Some employees went sailing and some competed in a chess tournament. Competitions were held also in tennis, football and basketball. Some of the staff competed in indoor football in Hun-

gary, in basketball in Spain and in a chess tournament in Denmark.

There were also traditional football and basketball competitions with the Financial Supervision Authority.

The chamber choir

The chamber choir of the employees of Eesti Pank and the Financial Supervision Authority first gathered on 15 May 1998. The choir has been conducted by Peeter Perens. The choir is coordinated by the board that is elected every year.

In 2010, the choir had 28 members who participated in the singing day of mixed choirs in Türi and performed at the Euro Conference at the Estonia Concert Hall in Tallinn. The choir took a break in the second half of 2010 due to tight work schedules.



The front of the **100-kroon banknote** features the Estonian poetess, playwright and luminary of the Estonian National Awakening, **Lydia Koidula** (1843–1886). Koidula was a romantic bard of patriotism and her plays paved the way for Estonian drama and theatre. She also participated in organising the first Estonian Song Festival in 1869 and worked as a journalist.

The figure of a nightingale to the right of the portrait is a reference to a collection of Lydia Koidula's poems, *Nightingale of Emajõgi*. Some of the 100-kroon banknotes also feature Koidula's signature.

The reverse features a **stormy sea and a limestone bluff**. Limestone is the national stone of Estonia. The strip of limestone bluff in Northern Estonia, which is about 300 km long, begins from the Pakri Peninsula and continues until the Narva River. It is a natural rarity, as the bank reveals Palaeozoic rocks. The fossils which have been well preserved in these limestone walls reflect the development of the Earth and life about 460–540 million years ago. The limestone wall has been shaped by rivers, continental glaciers and the Baltic Sea. The soil under the ancient-looking forest on the banks is unique and provides a home for rare plant species, where a number of remnant species have also survived. The limestone bluff of Northern Estonia also has great important cultural importance, as the first information about human settlement originates from this area from the end of the 1st millennium B.C.



ANNUAL ACCOUNTS OF EESTI PANK

for the financial year ended
31 December 2010



**APPROVAL OF THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED
31 DECEMBER 2010 BY THE EXECUTIVE BOARD OF EESTI PANK**

The Executive Board acknowledges its responsibility for the Annual Accounts of Eesti Pank for the financial year ended 31 December 2010.

The Annual Accounts have been prepared in accordance with the Eesti Pank Act and the internal accounting policies and procedures of Eesti Pank. The Annual Accounts give a true and fair view of the assets and liabilities, equity and financial performance of Eesti Pank.

In order to prepare the Annual Accounts in conformity with the requirements outlined in the previous section, the Executive Board is expected to provide estimates that affect 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 14 March 2011, all members of the Executive Board of Eesti Pank on that day signed the Annual Accounts.

Andres Lipstok
Governor of Eesti Pank,
Chairman of the Execut



Rein Minka
Deputy Governor,
Member of the Executive Board



Märten Ross
Deputy Governor,
Member of the Executive Boarde



BALANCE SHEET AS AT 31 DECEMBER 2010 AND 2009 (EEK THOUSAND)

	Note	31/12/2010	31/12/2009
ASSETS			
Gold and gold receivables	1	136,157	99,057
Claims on non-residents denominated in foreign currency		30,594,281	43,459,024
Receivables from the IMF	2	2,323,073	2,173,802
Balances with banks, security investments and external loans	3	28,271,208	41,285,222
Intra-Eurosystem claims	4	11,302	11,294
Other assets		875,259	1,206,222
Fixed assets	5	350,599	304,300
Other financial assets	6	3,397	3,397
Off-balance-sheet instruments revaluation differences	7	73,235	15,078
Accruals and prepaid expenses	8	86,061	133,199
Sundry assets	9	361,966	750,248
Total assets		31,616,998	44,775,597
LIABILITIES AND EQUITY			
Currency in circulation	10	5,838,201	9,777,491
Liabilities to residents related to monetary policy	11	15,800,990	25,979,554
Liabilities to other residents denominated in kroon	12	101,838	99,684
Liabilities to residents denominated in foreign currency	13	1,807,470	838,663
Liabilities to non-residents denominated in foreign currency	14	0	109,636
Liabilities to the IMF	2	2,314,596	2,165,650
Other liabilities		274,291	161,648
Off-balance-sheet instruments revaluation differences	7	9,133	43,670
Accruals and income collected in advance	15	171,235	92,357
Sundry liabilities	16	93,923	25,621
Provisions	17	1,261	2,070
Revaluation accounts	18	137,654	102,154
Capital and reserves	19	5,367,660	4,853,501
Capital		600,000	600,000
Reserves		4,767,659	4,253,501
Profit/loss for the year		-26,964	685,544
Total liabilities and equity		31,616,998	44,775,597

The notes on pages 86–101 form an integral part of the Annual Accounts.

PROFIT AND LOSS ACCOUNT FOR 2010 AND 2009 (EEK THOUSAND)

	Note	2010	2009
Interest income		414,471	853,103
Interest expense		-220,483	-329,118
Net interest income	20	193,988	523,984
Realised gains/losses arising from financial operations		136,157	395,530
Write-downs		-34,759	-20,531
Net result of financial operations, write-downs and provisions	21	101,398	374,999
Net result of fees and commissions	22	13,444	12,968
Dividend income	23	2,725	1,134
Other operating income	24	51,023	29,736
Operating expenses	25	-389,541	-257,277
Staff costs		-120,719	-118,718
Banknote and coin production services		-150,485	-22,087
Administrative expenses		-87,037	-82,259
Depreciation of fixed assets		-31,301	-34,213
Profit/loss for the year		-26,964	685,544

The notes on pages 86–101 form an integral part of the Annual Accounts.

STATEMENT OF CHANGES IN EQUITY (EEK THOUSAND)

	Fixed capital	Reserve capital	Special reserve	Profit/loss	Total
Balance at the end of 2008	100,000	500,000	3,712,407	1,247,094	5,559,501
Distribution of the 2008 profit	0	0	541,094	-541,094	0
Allocations to the state budget	0	0	0	-706,000	-706,000
Profit of 2009	0	0	0	685,544	685,544
Balance at the end of 2009	100,000	500,000	4,253,501	685,544	5,539,046
Distribution of the 2009 profit	0	0	514,158	-514,158	0
Allocations to the state budget	0	0	0	-171,386	-171,386
Loss of 2010	0	0	0	-26,964	-26,964
Balance at the end of 2010	100,000	500,000	4,767,659	-26,964	5,340,696

The notes on pages 86–101 form an integral part of the Annual Accounts.

NOTES ON THE ANNUAL ACCOUNTS OF EESTI PANK

ACCOUNTING POLICIES USED IN THE ANNUAL ACCOUNTS

General principles

The Annual Accounts have been prepared in accordance with the Eesti Pank Act and the internal accounting policies and procedures of Eesti Pank. The internal accounting policies of Eesti Pank have been drawn from the European Central Bank's (ECB) guidelines for accounting financial instruments. The accounting of other assets and liabilities is based on the accounting principles generally accepted in Estonia.

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

The preparation of the Annual Accounts requires the Executive Board to provide estimates regarding the aspects 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.

The Executive Board of Eesti Pank is of the opinion that the publication of the Bank's Cash Flow Statement 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 Estonian kroons (EEK thousand) unless indicated otherwise.

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; the cost or value of an asset or a liability and the resulting gains or losses can be measured reliably.

Financial assets and liabilities

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 in question. Financial liabilities are initially recorded at their acquisition cost, which is the fair value of the amount received for the financial liability in question. Subsequent measurement of financial assets and liabilities is based on the market value, the acquisition cost or amortised cost depending on the type of a respective 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 in case 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

The functional currency of Eesti Pank is the Estonian kroon. The transactions of financial instruments (except securities) denominated in foreign currency are recorded in off-balance-sheet accounts on the trade date. On the settlement date, off-balance-sheet entries are reversed and transactions are recorded on the Balance Sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date; realised results arising from sales are also calculated on the trade date. The interest accrued on financial instruments denominated in foreign currency and the premiums or discounts are calculated and recorded on a daily basis. These receivables also affect the foreign currency position on a daily basis.

Transactions in foreign currency are recorded on the basis of the official daily fixings of Eesti Pank as quoted by Eesti Pank on the trade date. Assets and liabilities denominated in foreign currencies are translated into Estonian kroons at the official daily fixings effective on the balance sheet date, except for the exchange rate of SDR that is translated at the IMF's exchange rate.

The official daily fixings applied on 31 December 2010 and 2009 were as follows:

	2010	2009
USD	11.7107	10.8653
SDR	18.1969	17.0276
EUR	15.6466	15.6466

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.

Unrealised gains are not recognised as income but are transferred to a revaluation account in the balance sheet.

Unrealised losses are recorded in the Profit and Loss Account under *Write-downs* if they exceed previous revaluation gains recorded in the corresponding revaluation account. Unrealised losses in any one currency or security or in gold are not netted against unrealised gains in 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.

Gold

Gold is valued at the market price prevailing at year-end, equal to Eesti Pank's daily fixing of the Estonian kroon and gold.

Foreign currency claims on non-residents

Claims on non-residents denominated in foreign currency are divided into two: *Receivables from the IMF* and *Balances with banks, security investments and external loans*.

Foreign debt instruments and other quoted securities denominated in foreign currencies are recorded at their year-end market value. Debt instruments are revalued on the last banking day of the year by reference to the market prices on the last banking day.

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 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 accrual basis on the Balance Sheet under *Accruals and income collected in advance* and interest income in 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 reliably measured. The measurement of the market value of shares is not reliable if they are not actively traded and there are no alternative methods to assess their value in a reliable way. In this case shares are recorded at their acquisition cost. Gains 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 useful life over a year and acquisition cost in excess of 50,000 kroons. Fixed assets are initially recorded at cost, which includes purchase price and other expenditure directly related to bringing the 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:

	2010
Buildings	3%
Utility systems of buildings	20%
Hardware	33%
Software	20–50%
Other fixed assets	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 asset are 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 expensed at the time they are incurred.

Currency in circulation

Currency in circulation comprises banknotes and coins issued by Eesti Pank at their nominal value and recorded on the Balance Sheet as a liability to the holder of currency. Currency in the cash desk of Eesti Pank is deducted from this liability.

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, whereas 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 and/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.

Notes on the Balance Sheet

ITEM 1 – GOLD

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

	Amount (ounce)	Market price per ounce (EEK)	Market value (EEK thousand)
Balance at the end of 2009	8,250.171	12,006.70	99,057
Revaluation	-	-	37,099
Balance at the end of 2010	8,250.171	16,503.50	136,157

EEK thousand

The market price for an ounce is equal to Eesti Pank's daily fixing of the Estonian kroon and gold.

ITEM 2 – RELATIONS WITH THE INTERNATIONAL MONETARY FUND (IMF)

Item 2 includes the SDR account in the IMF, participation in the IMF and other receivables. The value of SDR is determined on the basis of a basket of currencies. It is the weighted average of the exchange rates of the four main currencies (the euro, the Japanese yen, the pound sterling and the US dollar).

	31/12/2010	31/12/2009
Participation in the IMF	1,186,438	1,110,200
SDR account in the IMF	1,128,694	1,056,172
Other receivables from the IMF	7,941	7,431
Total receivables from the IMF	2,323,073	2,173,802
IMF kroon accounts (liabilities)	1,186,333	1,110,102
Allocation of SDR	1,128,263	1,055,548
Total liabilities to the IMF	2,314,596	2,165,650

EEK thousand

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.

Participation in the IMF

Eesti Pank acts as a fiscal agent between the Republic of Estonia and the IMF and as a depository of IMF's kroon deposits and debt instruments. 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 to the country's quota. At the end of 2010, the quota of the Republic of Estonia in the IMF was 65,200,000 SDRs.

The Republic of Estonia has paid its subscription in government debt instruments deposited with Eesti Pank, which are recorded under Liabilities to the IMF. These debt instruments do not bear interest.

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%.

EEK thousand

Other receivables from the IMF	31/12/2010	31/12/2009
Eesti Pank, SBA loan-related receivable	6,117	5,724
Government, STF loan-related receivable	1,824	1,707
Total	7,941	7,431

ITEM 3 – BALANCES WITH BANKS, SECURITY INVESTMENTS AND EXTERNAL LOANS

EEK thousand

	Balance at the end of 2009	Structure of residual maturity				
		Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years
	41,285,222	23,958,788	13,815,399	1,640,000	811,189	1,059,847
Current accounts	1,236,331	1,236,331	-	-	-	-
Fixed term deposits	3,240,103	3,240,103	-	-	-	-
Securities	33,946,987	16,620,552	13,815,399	1,640,000	811,189	1,059,847
Reverse repurchase transactions	2,861,801	2,861,801	-	-	-	-
	Balance at the end of 2010	Structure of residual maturity				
		Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years
	28,271,208	17,300,451	8,660,377	1,032,178	522,474	755,728
Current accounts	2,307,437	2,307,437	-	-	-	-
Fixed-term deposits	594,571	594,571	-	-	-	-
Securities	19,245,121	8,274,365	8,660,377	1,032,178	522,474	755,728
Reverse repurchase transactions	6,124,079	6,124,079	-	-	-	-

In 2010, Eesti Pank's foreign reserves were mainly invested in the markets of low-risk government bonds of leading industrial countries of the euro area and the United States with an average maturity of about 0.6 years.

The guidelines for the management of Eesti Pank's foreign reserves allow only transactions with highly rated international banks and financial institutions and limit any credit risk the bank can take in managing its foreign assets. The issuer risk is allowed for the following minimum credit ratings assigned by international rating agencies (Standard & Poor's, Moody's):

- A-1 or P-1 for securities with the maturity of up to one year;
- AA- or Aa3 for securities with the maturity of over one year.

For national issuers the following minimum credit ratings are allowed:

- A-2 or P-2 for securities with the maturity of up to one year;
- BBB- or Baa3 for securities with the maturity of over one year.

ITEM 4 – INTRA-EUROSISTEM CLAIMS

The item reflects participation of Eesti Pank in the European Central Bank (ECB). According to Article 28 of the Statute of the European System of Central Banks (ESCB), 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. The capital key weighting 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%.

As the Republic of Estonia was not yet a member of the euro area on 31/12/2010, the transitional provisions of Article 47 of the Statute applied. Eesti Pank was required to pay up a minimal contribution of 7% of its subscribed capital to the ECB upon entry to the ESCB. Eesti Pank was obliged to pay the remaining 93% after the abrogation of the derogation established for Estonia as set out in Article 139 of the Treaty on the Functioning of the European Union; that is, after Estonia's accession to the Economic and Monetary Union.

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 (NCB) of the euro area will pay up their additional capital contributions in three equal annual instalments. The minimal percentage of the subscribed capital that is required from non-euro area NCBs was reduced from 7.00% to 3.75%. Therefore, the non-euro area NCBs made only small adjustments to their capital shares. On 29 December 2010, Eesti Pank paid up the additional 499 euros to the fixed capital of the ECB.

ITEM 5 –FIXED ASSETS

EEK thousand

Acquisition cost	Buildings	Hardware	Furniture and fixtures	Software	Total
Balance at the end of 2009	343,443	49,999	75,477	62,479	531,398
Acquisitions	67,855	4,759	25,003	8,658	106,275
Disposals	0	-3,048	-15,480	-987	-19,515
Balance at the end of 2010	411,298	51,710	85,000	70,150	618,158
Accumulated depreciation					
Balance at the end of 2009	100,060	41,246	62,396	53,654	257,356
Depreciation charge	15,224	3,909	6,966	5,201	31,300
Disposals	0	-3,048	-15,480	-987	-19,515
Balance at the end of 2010	115,284	42,107	53,882	57,868	269,141
Carrying amount					
at the end of 2009	243,383	8,753	13,081	8,825	274,042
at the end of 2010	296,014	9,603	31,118	12,282	349,017
Prepayments for fixed assets					
Balance at the end of 2009	26,859	0	0	3,400	30,259
Balance at the end of 2010	1,141	13	428	0	1,582
Total fixed assets					
at the end of 2009	270,242	8,753	13,081	12,225	304,301
at the end of 2010	297,155	9,616	31,546	12,282	350,599

The cost of fixed assets acquired in 2010 totalled 106.3 million kroons (35.5 million kroons in 2009). The majority of the acquisition of buildings was composed of the renovation of the cash centre in the total amount of 19 million kroons (continuation of the 2009 project) and the IT room in the total amount of 19.2 million kroons.

The majority of the purchases of fittings consisted of cash processing equipment in the total amount of 21.4 million kroons. Major hardware purchases included new servers, data communication commutators and back-up devices, while major software procurements consisted of a new business management software, and improvements to the settlement system and to the system for the collection of balance of payments reports.

ITEM 6 – OTHER FINANCIAL ASSETS – investment in shares and units

Eesti Pank holds 214 shares (200 voting shares) in the Bank for International Settlements in the total amount of 3,397,000 kroons.

ITEM 7 – OFF-BALANCE-SHEET INSTRUMENTS REVALUATION DIFFERENCES

Item 7 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 at the central exchange rates of Eesti Pank on the balance sheet date, compared with the values resulting from the conversion of the transactions at the average cost of the respective foreign currency on that date.

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

ITEM 8 – ACCRUALS AND PREPAID EXPENSES

EEK thousand

	2010	2009
Interest income	58,161	109,901
Securities	54,225	108,133
Derivative instruments	2,983	1,094
Fixed-term deposits and current accounts	826	555
Loans	126	118
Prepaid expenses	13,388	10,469
Claims on the Financial Supervision Authority	8,206	8,108
Other claims	6,306	4,720
Total	86,061	133,199

ITEM 9 – SUNDRY ASSETS

EEK thousand

	2010	2009
Euro banknotes	252,849	663,416
Loans to employees of Eesti Pank	76,767	63,547
Numismatic banknotes and coins of the Estonian kroon	17,604	0
Credits related to margin calls	6,558	3,042
Foreign exchange transactions	5,573	5,059
Foreign exchange forwards	0	6,693
Other	2,615	8,490
Total	361,966	750,248

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

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 once a 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 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 ECB deposit interest rate, which was 0.25% in 2010. In addition, study loans have been granted for a maximum of ten years and with a 5% interest rate. Additional information on write-downs of loans is provided under Item 21.

ITEM 10 – CURRENCY IN CIRCULATION

	<i>EEK thousand</i>	
	2010	2009
Banknotes	5,698,370	9,613,196
Coins	139,830	164,295
Total	5,838,201	9,777,491

In December 2010, Eesti Pank started to exchange Estonian kroons for euros via commercial banks without a service fee and at the mid-market exchange rate. This was done to make the changeover to the euro as smooth as possible, while drawing kroons gradually from circulation.

ITEM 11 – LIABILITIES TO RESIDENTS RELATED TO THE MONETARY POLICY

This item includes the current accounts of credit institutions with Eesti Pank. The deposits of credit institutions decreased by 10.2 million kroons in 2010. Eesti Pank has imposed the deposit interest rate of the European Central Bank effective on the last banking day of the accounting month as the interest rate on credit institutions' deposits held with the central bank. In 2010, the ECB deposit interest rate was 0.25%. The interest rate is calculated on the basis of the monthly average balance of the current account (see Item 15). In 2010, the required reserve ratio for commercial banks was reduced from 15% to 2% over the year.¹ Consequently, the level of liabilities and assets in the balance sheet of Eesti Pank decreased.

ITEM 12 – LIABILITIES TO OTHER RESIDENTS DENOMINATED IN KROON

This item reflects the current account of the Financial Supervision Authority held with Eesti Pank, which subjects of financial supervision pay as supervision fees. Interests on the Financial Supervision Authority's current account 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 reserves.

¹ The actual decrease in the reserves deposited in the central bank is smaller, as banks are allowed to fulfil about half of their reserve requirement with high-quality liquid foreign assets.

In addition, this item reflects the current accounts of NASDAQ OMX Tallinn and the Estonian Central Register of Securities.

ITEM 13 – LIABILITIES TO RESIDENTS DENOMINATED IN FOREIGN CURRENCY

In November 2006, Eesti Pank joined the Trans-European Automated Real-Time Gross Settlement Express Transfer system TARGET. Item 13 reflects the euro current accounts of Estonian credit institutions that have joined TARGET.

ITEM 14 – LIABILITIES TO NON-RESIDENTS DENOMINATED IN FOREIGN CURRENCY

This item includes the repurchase transactions of 2009.

ITEM 15 – ACCRUALS AND INCOME COLLECTED IN ADVANCE

EEK thousand

	2010	2009
Liability to Mint of Finland for euro coin production	97,925	0
Tax liabilities	13,586	10,539
Interest expense	5,755	6,464
on deposits with credit institutions	3,456	5,770
on derivative instruments	2,299	694
Other liabilities	53,969	75,353
Total	171,235	92,357

ITEM 16 – SUNDRY LIABILITIES

Item 16 mainly includes negative balances related to swap and forward transactions in foreign currency that were outstanding on 31 December 2010 and totalled 70.2 million kroons (10.2 million kroons in 2009). These balances arise from the conversion of such transactions into their Estonian kroon equivalents at the respective currency's average cost on the balance sheet date, compared with the kroon values at which the transactions were initially recorded. This item includes also 8.3 million kroons of deposits related to margin calls.

In addition, Item 16 includes accounts for the Republic of Estonia's claim on the IMF, which is recorded on the Balance Sheet of Eesti Pank as the bank's liability to the Government of the Republic of Estonia. The claim is related to the participation of the Republic of Estonia in strengthening the financial situation of the IMF through premium calculated on the Systemic Transformation Facility (STF).

Other entries include the current accounts of non-residents with Eesti Pank, contingent loan liabilities and the market value of options.

ITEM 17 – PROVISIONS

This item consists of performance bonuses to employees of the Financial Markets Department for the results of the financial year. The amount of bonuses is approved by the Deputy Governor in charge

of the Financial Markets Department after the audited Eesti Pank Annual Report has been approved by the Supervisory Board of Eesti Pank.

ITEM 18 – REVALUATION ACCOUNTS

EEK thousand

	2010	2009
Foreign currencies	86,229	49,965
Securities	39,720	48,395
Derivative instruments	11,705	3,794
Total	137,654	102,154

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*.

ITEM 19 – CAPITAL AND RESERVES

Changes in capital and reserves in 2010:

EEK thousand

	Balance at the end of 2010	Distribution of 2009 profit	Balance at the end of 2009
Fixed capital	100,000	0	100,000
Reserve capital	500,000	0	500,000
Special reserve	4,767,659	514,158	4,253,501
Total	5,367,660	514,158	4,853,501

The profit distribution strategy of Eesti Pank is based on the principle of avoiding too rapid decrease of Eesti Pank's equity and net foreign reserves against key economic indicators prior to joining the Economic and Monetary Union.

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 foundation capital and funds for specific purposes, based on the decision of the Supervisory Board of Eesti Pank. The remaining profit is transferred to the state budget.

In 2010, the Supervisory Board of Eesti Pank decided to transfer 171.4 million kroons from the profit for 2009 to the state budget and 541.1 million kroons to the special reserve fund.

Notes on the Profit and Loss Account

ITEM 20 – NET INTEREST INCOME

EEK thousand

	2010	2009
Net interest income	193,988	523,984
Interest income	414,471	853,103
Securities	299,755	684,870
Derivative instruments	90,234	131,155
Reverse repurchase transactions	16,262	25,464
Fixed-term deposits	3,309	7,834
Current accounts	3,578	2,391
Loans to personnel	1,333	1,389
Interest expense	-220,483	-329,118
Derivative instruments	-79,373	-89,796
Securities	-76,835	-134,412
Credit institutions' deposit interests	-59,143	-102,514
Current accounts	-3,427	-1,130
Repurchase transactions	-957	-543
Other	-748	-722

ITEM 21 – NET RESULT OF FINANCIAL OPERATIONS, WRITE-DOWNS AND PROVISIONS

EEK thousand

	2010	2009
Net result of financial operations	101,398	374,999
Realised gains/losses arising from financial operations	136,157	395,530
Securities	119,983	348,210
Income/expense of exchange rate differences	40,475	1,678
Financial asset management costs	-18,627	-30,699
Derivative instruments	-5,967	74,445
Other	293	1,896
Write-downs	-34,759	-20,531
Exchange rate write-downs	-17,451	-2,527
Derivative instruments	-9,631	-7,571
Securities	-7,465	-9,065
Net change of loan portfolio write-downs	-211	-113
Other provisions	0	-1,255

ITEM 22 – NET RESULT OF FEES AND COMMISSIONS

EEK thousand

	2010	2009
Fees and commissions	13,444	12,968
Current accounts service fees	14,373	14,245
Commissions on futures and options	-983	-1,405
Fines, arrears and other	55	127

The majority of this item accounts for income from servicing credit institutions' current accounts.

ITEM 23 – DIVIDEND INCOME

This item reflects dividends from the shares of the Bank for International Settlements.

ITEM 24 – OTHER OPERATING INCOME

EEK thousand

	2010	2009
Other operating income	51,023	29,736
Income from the sale of collector coins and numismatic-bonistic products	40,141	11,876
Expenses compensated by the Financial Supervision Authority	8,594	15,245
Income on financial asset management	1,569	1,538
Rental income	532	507
Income from the sale of assets	35	182
Other income	153	389

Income on services provided to the Financial Supervision Authority totalled 8.6 million kroons. Pursuant to 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 also the depreciation costs of fixed assets used.

Income on the sale of numismatic-bonistic products mainly consisted of income on the sale of collector coins.

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

Income on the rent of the training centres of Eesti Pank is recorded under Rental income. Income on the sale of assets reflects income on the sale of fixed assets and inventories unnecessary for Eesti Pank.

ITEM 25 – OPERATING EXPENSES

EEK thousand

	2010	2009
Staff costs	-120,719	-118,718
Wages	-87,968	-86,444
Social tax	-29,482	-29,086
Compensation and benefits	-2,064	-2,335
Unemployment insurance	-1,204	-853

Staff costs include mainly wage costs, including taxes, but also performance bonuses to employees of the Financial Markets Department for the results of the financial year.

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.

The production services of banknotes and coins mainly consist of the production costs of numismatic-bonistic products and euro coins.

EEK thousand

	2010	2009
Administrative costs	-87,037	-82,259
Information technology maintenance	-21,406	-19,999
Real estate renovation and administration	-16,449	-13,760
Financial asset management	-14,294	-17,174
Public relations and publications	-10,817	-5,695
Business travel	-7,481	-6,777
Office costs	-3,025	-3,637
Training	-2,647	-3,637
Communications and transportation	-1,735	-751
Legal and arbitration	-821	-510
Other	-8,362	-10,318

The costs of financial asset management and settlements are comprised of the costs 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 trip expenses arise from the representation of Eesti Pank and cooperation with international organisations and financial institutions. There were altogether 709 business trips in 2010 (594 in 2009).

Other expenses primarily consisted of costs of security, sovereign rating of Estonia, the foreign representative of Eesti Pank, and economic research.

ITEM 26 – DERIVATIVE INSTRUMENTS

Derivative instruments are used for risk hedging in managing the foreign reserves.

Futures purchase transactions with a contract value of 828.9 million kroons and futures sale transactions with a contract value of 376 million kroons were outstanding as at 31 December 2010 (in 2009, 601.8 million and 3.008 billion kroons, respectively). The contract value of outstanding interest rate swaps totalled 839.6 million kroons (in 2009, 1.209 billion kroons). Foreign exchange swap and forward transaction claims of 2.173 billion and liabilities of 2.160 billion kroons were outstanding as at 31 December 2009 (in 2008, 1.840 and 1.862 billion kroons, respectively).

ITEM 27 – CONTINGENT LIABILITIES

EEK thousand

	Balance at the end of 2010	Balance at the end of 2009
Contingent liabilities	49,113	40,227
Contractual obligations to produce banknotes and coins	40,587	32,317
Unpaid share capital (75%) of BIS	8,526	7,911

The Bank for International Settlements

Since 1930 Eesti Pank has a contingent liability to the Bank for International Settlements – the unpaid part of the share capital (75%) of the BIS denominated in Swiss gold francs, totalling 8.5 million kroons on the balance sheet date (see Item 6).

The production of banknotes and coins

At the end of 2010, the contractual liabilities of Eesti Pank for printing banknotes and minting coins in 2010 amounted to 40.6 million kroons, which primarily arises from the potential costs related to the minting of euro coins.

ITEM 28 – IMPORTANT POST-BALANCE-SHEET EVENTS

In 2004, the Republic of Estonia joined the European Union and Eesti Pank became a member of the ESCB. Until Estonia's accession to the euro area, the transitional provisions of Article 47 of the ESCB's Statute applied to Eesti Pank. When Eesti Pank joined the ESCB, it had to pay up a minimal contribution of 7% of its subscribed capital to the ECB. This minimal contribution to the subscribed capital of the ECB that the national central banks of the Eurosystem have to pay is used for covering the ECB's operating expenses, and it does not give a right to a share of the profit or any other incomes of the ECB.

In December 2010, the ECB decided to increase its subscribed capital by 5 billion euros from 5.76 billion to 10.76 billion euros with effect from 29 December 2010. The national central banks of the euro area will pay up their additional contributions in three equal annual instalments. The minimal percentage of the subscribed capital that is required from non-euro area countries was reduced from 7.00%

to 3.75%. So, the non-euro area NCBs made only minor adjustments to their subscribed capital. On 29 December 2010, Eesti Pank paid up the additional 499 euros to the share capital of the ECB.

When Eesti Pank joined the Eurosystem on 1 January 2011, it had to pay up 9,589,259.01 euros (150,039,000 kroons) of the unpaid share capital in January 2011. Owing to an increase in the ECB's share capital, Eesti Pank is required to pay up 8,950,000 euros as set out in the decision of the ECB's Governing Council. This decision entered into force with regard to Estonia on 1 January 2011, and so Eesti Pank made its first instalment of 2,983,333 euros (46,679,018 kroons) on the first banking day of 2011, that is 3 January 2011. The other euro area NCBs made their first annual instalment on 29 December 2010. Eesti Pank will pay up the remaining two instalments at the end of 2011 and 2012 in the total amount of 5,966,667 euros (93,358,052 kroons).

Besides the contribution to the ECB's key capital, Article 48.1 of the ESCB's Statute requires Eesti Pank, upon joining the Eurosystem, to transfer foreign reserve assets to the ECB. In January 2011, Eesti Pank transferred 85% of the foreign reserve assets in Japanese yen and 15% in gold to the ECB. The calculation of the payment of foreign reserve assets includes all previous transfers to the ECB's foreign reserve assets together with the changes in the capital key in 2004, 2007 and 2009, while translating the previous transfers of foreign reserve assets into euros using the exchange rate as at 31 December 2010. The capital key for Eesti Pank gives us the size of payment in euros, which is divided into 85% (the Japanese yen) and 15% (gold). Using the exchange rates as at 31 December, the exact payments in Japanese yen and gold are then calculated. The total amount to be paid into the foreign reserve assets of the ECB is 145,853,597 euros (2,282,112,885 kroons).

Upon Estonia's accession to euro area, Article 48.2 of the ESCB's Statute started to apply to Eesti Pank, which sets out that the latter 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. The total amount paid for the reserves, revaluation accounts and the risk provisions of the ECB was 20,895,192.06 euros (326,938,712 kroons).

Translation of the Estonian Original

INDEPENDENT AUDITOR'S REPORT

To the Supervisory Board of Eesti Pank

We have audited the accompanying financial statements of Eesti Pank on pages 82 to 101 which comprise the balance sheet as at 31 December 2010, and the report on revenues and expenses and statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Eesti Pank Act and the accounting principles stated in the "Accounting Policies used in the Annual Accounts" of the accompanying financial statements, and for such internal control as management determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error

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 (Estonia). 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 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 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 management, 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 2010, and its financial performance for the year then ended in accordance with Eesti Pank Act and the accounting principles stated in the "Accounting Policies used in the Annual Accounts" of the accompanying financial statements.

Tallinn, 14 March 2011



Ivar Kiigemägi
Ernst & Young Baltic AS



Tiina Sõmer
Authorised Auditor

The front of the **500-kroon banknote** features the social figure, politician and publicist **Carl Robert Jakobson** (1841–1882). Jakobson worked as a school and home teacher in Estonia and St Petersburg, and as a publicist and a school writer. He participated in the work of the Estonian Alexander School and the Society of Estonian Literati. In 1881, he was elected President of the Society of Estonian Literati. In 1868 and 1870, Jakobson gave his three famous patriotic speeches in the Vanemuise Society.

In 1874, Jakobson bought the Kurgja farmstead near Vändra in order to make it an example household. Jakobson gave Estonian peasants tips on how to manage their farms and was the president of several agricultural societies. From 1878, Jakobson became the editor of the newspaper of Viljandi, *Sakala*. The newspaper criticised the existing agrarian system, the hegemony of the nobility and institutions that were based on social standing; he pursued reforms and demanded the liberation of public schools from the church. His high-quality and innovative school textbooks shaped the development of Estonian public schools. Within 40 years, the first part of his *School Reading Book* was printed in 15 editions. He wanted Estonian choirs to sing original repertoires and issued several music books.

To the right of the portrait there is the header motif of *Sakala*, and under it a sheaf of grain tied together with a yellow ribbon. The ribbon features the text "Written by C. R. Jakobson". There is a woman with a sickle to the left and a man with a scythe to the right of the grain sheaf.

The reverse features a motif of a Southern Estonian landscape with forests, meadows and a body of water. In the foreground we can see a chimney swallow, the Estonian national bird, in flight. The Southern Estonian landscape is less flat and much more diverse than the rest of Estonia. This kind of countryside meant that settlement was also more scattered, and allegedly this made Southern Estonians more self-conscious. In the 19th century, the relatively fertile agricultural land and diligence made southern Estonian peasants more successful than their northern compatriots and the area of southern Viljandimaa called Mulgimaa was also the birthplace of the Estonian National Awakening.



ANNEXES



GLOBAL ECONOMY IN 2010¹

The year 2010 was a year of relatively quick growth for the global economy. According to the International Monetary Fund (IMF), the global economy grew by 5% in 2010 after the 0.5% fall in 2009. The rapid growth was achieved in advanced economies due to the overly accommodating monetary and fiscal policy implemented by the central banks and governments to overcome the crisis. Economic activity dropped to some degree in the middle of the year, but began to rise once again in October.

Even though economy grew, several risks threatened the recovery, above all, the weak labour market and, in some countries, the weak housing market. The debt crisis faced by some euro area countries added to the risks, exerting pressure on the stability of public finances and the financial sector in the region, and stoking tensions on the financial markets. Several emerging economies, on the other hand, experienced a rapid capital inflow, facing inflationary pressures and the risk of overheating. Nonetheless, the outlook for global growth improved, with GDP growth of 4.4% forecast for 2011.

Regionally, economic growth was very uneven in 2010, with the advanced economies lagging behind emerging economies. Advanced economies showed GDP growth of approximately 3%, while the growth in emerging economies was over twice as high at 7.3%. The fastest economic growth, 9.5%, was witnessed by the developing Asian industrial countries, while China's economic growth was 8.7%, which was 1.1% higher than in 2009. The Central and Eastern European countries conquered the recession, with the region recording 4.2% growth in GDP year on year. Among major economies, the quickest economic growth was witnessed by Japan at 3.9%, fuelled by strong demand from other Asian countries. GDP grew by 2.8% in the United States of America and by 1.7% in the euro area.

The economic growth in euro area countries still remains uneven, as Germany saw growth of 3.5%, while several other economies came to a standstill or even contracted. The unemployment rate was 9.6% in the USA, 10% in the euro area and 5.1% in Japan.

Inflationary pressures remained modest in most advanced economies, starting to rise in the second half-year, fuelled by energy and food price hikes. With the dollar depreciating against other currencies, US monetary policy had a huge effect on the increase in raw material prices. The inflation rate for advanced economies rose from 0.1% to 1.6%. In emerging economies, the inflation rate rose from 5.2% to 6.2%, forcing several central banks to tighten their monetary policy.

Global financial markets continued to stabilise, with improvement in the outlook for economic growth in 2010. The debt crisis erupting in some euro area countries at the end of April forced Greece and Ireland to request financial aid from the IMF and the EU, and added to the vulnerability of several countries, especially Portugal and Spain. Against the backdrop of economic revival and improvement in the outlook for growth, the stock markets recovered to some degree, with different results seen in different countries. In the United States, for instance, the S&P 500 index advanced by 13%, while the euro area stock market index Eurostoxx more or less retained its previous level, dropping by 0.1%. The prices of raw materials soared. The CRB index, which covers the prices of 22 major raw materials, advanced by 24% during the year. The price of crude oil rose by 22% and there was still strong demand for gold, the price of which rose by 30% and exceeded 1,400 dollars per ounce. Money market interest rates remained at a low level while the long-term interest rates of the United States and the core euro area countries dropped.

¹ IMF "World Economic Outlook", April 2011; Reuters EcoWin.

United States and Japan

The United States recovered from the recession in 2010, with GDP growing by 2.8% year on year. Economic growth was supported by the growth in corporate investments and stock. Due to the weak labour market, the contribution of private consumption remained small, with foreign trade having a negative effect and imports exceeding exports. The annual growth in industrial production was 5.9%.

While the economy recovered, growth in employment remained sluggish. The average monthly growth in non-farm employment was 75,000 people. The unemployment rate dropped from 9.9% at the beginning of the year to 9% at the end of the year, a fall of less than one percentage point. Private consumption grew by 4.1% over the year, but the consumers' sense of security did not improve until the revival of the labour market at the end of the year.

The frailty of the economy could also be seen in the drop in the sale of residential buildings. The external balance of the US economy deteriorated in 2010, with the current account deficit rising to 3.5% of GDP.

The economic decline restored the level of inflation after consumer prices had fallen in 2009. Consumer prices increased by approximately 1.6% in 2010, but excluding energy and food prices, inflation fell to 0.6% by the end of the year.

In order to boost the economy and reduce the risk of deflation, the US Federal Reserve kept the federal funds rate at its historical low (0.0–0.25%) throughout 2010 and resolved to support the economy through the government debt purchase programme for a total of nearly 600 billion dollars. The government also continued to support the economy with an expansion-

ary fiscal policy. Nonetheless, the state budget deficit shrank to some degree from last year.

The Japanese economy saw a rapid recovery in 2010, with GDP growing by 4.3% after the 6.3% drop last year. The economic recovery was mainly fuelled by the rapid growth in export-demand based industrial production as annual growth in industrial production was 4.9%. Economic growth decelerated at the end of the year, and GDP dropped somewhat. However, this is expected to be temporary. Japan's domestic demand has been relatively weak for quite a few years, with the annual growth in the retail trade remaining negative. Unemployment remained between 4.9% and 5.3%, showing no signs of improvement. Despite the recovery of economic activity, deflation persisted in Japan, even though by the end of the year consumer prices reached their level of 12 months ago.

China overtook Japan in GDP in 2010, becoming the second-largest economy in the world.

Euro area

Economic activity in the euro area showed signs of recovery in 2010. According to Eurostat, GDP in the euro area rose by 1.7%. Economic growth was supported by the rise in global economic activity which boosted export revenues. This, in turn, accelerated the growth in GDP.

The pressure exerted by inflation remained modest. The rate of inflation for 2010 was 1.6%, with price increases accelerating at the end of the year and reaching 2.2% in December. The price increase was mostly fuelled by external factors, meaning the increase in the price of food and energy on the global market. Core inflation, which reflects the inflationary pressures within the euro area, remained low, rising from 0.8% to 1.1% over the year. In most Member States, the pressure on prices is eased by huge levels of unemployment.

The lack of greater inflationary pressure allowed the European Central Bank to keep its key interest rate at the low level of 1% in 2010. The European Central Bank continued its main refinancing operations through unlimited fixed rate tenders throughout the year. The low level of the key interest rate and a favourable liquidity environment allowed it to lower loan interest rates and resuscitate the credit supply.

The economic recovery in the euro area has been uneven in the Member States. In some countries, unemployment has dropped to its pre-crisis level or below. In other countries, unemployment remained high in the second half of 2010, or even showed a further increase. The consolidation measures required for ensuring the sustainability of public finances may slow down the economic recovery, especially in countries which fail to generate significant export revenues.

The differences in the economic recovery and the public finance situation caused huge changes in the euro area government bond market. The risk premiums of several Member States increased rapidly, reflecting extreme uncertainty regarding the solvency of these countries in the market. At the beginning of May, the interest rate spread of the government bonds of several euro area countries over the interest rates for German bonds reached a record high since the launch of the euro. Given the significance of government bonds in the monetary policy transfer mechanism, the European Central Bank launched a bond purchase programme, allowing the Eurosystem to purchase government and private sector bonds. This programme helped to tone down the speculation over the sustainability of the public finance of some Member States at the beginning and end of the year.

The quicker-than-expected economic growth in 2010 suggests a further revival of the economy in 2011. The improvement in the labour market situation is expected to boost income, and the improved sense of security to temper the savings rate. In the short term, economic activity will, however, be hampered by the budget consolidation measures. For 2011, the European Central Bank forecasts growth of 0.7–2.1%², and the IMF growth of 1.6%³.

² Eurosystem staff macroeconomic projections for the euro area, 2 December 2010.

³ IMF "World Economic Outlook", April 2011.

ESTONIAN ECONOMY IN 2010

THE NON-FINANCIAL SECTOR

The monetary policy environment

The monetary policy environment remained accommodative throughout 2010. The monetary policy rates stayed low in the euro area, as the key policy rate of the European Central Bank remained unchanged at 1%.

The risk premiums of the local money market fell significantly. At the beginning of 2010, the 6-month Talibor of the local money market was almost triple the 6-month Euribor, but the differences in interest levels faded away during the year. By the end of the year, the Talibor had retreated to the level of the Euribor. The volume of forward transaction continued to fall during the year, with market participants showing no interest in hedging the risks related to the Estonian kroon. The risk premium for the credit default swap (CDS) of the Republic of Estonia dropped by nearly half. These positive trends started in the first half of the year, nourished by the conviction that Estonian fiscal policy would be able to avoid an excessive increase in the debt burden, and that the accession to the euro area was ever more likely. The final confirmation of the accession to the euro area was received on 13 July, when the EU ministers of finance set the official conversion rate of 15.6466 kroons per euro.

In connection with the changeover to the euro, the minimum reserve requirement was gradually lowered from 15% to the 2% of the euro area from September 2010 onwards. From the beginning of 2011, all Estonian credit institutions must adhere to the 2% reserve requirement used in the euro area. As anticipated, the change in the reserve requirement did not trigger significant changes in the behaviour of the banks.

Domestic and external demand

In 2010, Estonian economic activity was affected above all by the recovery in external demand. Both global economic growth and the recovery of Estonia's main trade partners proved quicker than expected. The recovery in global demand enhanced the Nordic export indicators and it also brought in orders to the Estonian subcontracting industry. The sudden downturn in 2009 was followed by economic growth in 2010. According to the flash estimates of Statistics Estonia, GDP rose by 3.1% in 2010 compared to 2009.

The economic recovery was led by the export sector and growth in the exports of goods gained momentum throughout the year. Export indicators improved in all categories of goods, with the total exports of goods at current prices breaking the all-time record in the fourth quarter. According to preliminary estimates, the exports of goods at current prices increased by nearly 35% and the exports of services by nearly 7% in 2010, compared to 2009. The rapid growth in exports reflects the successful attempts of several exporters to improve their competitive position in the market. The advantages of Estonian businesses lie in their flexibility in serving orders, and their favourable production costs for the Nordic supply chain.

Domestic demand remained weak in 2010. The low level of incomes and the underutilisation of resources were the main reasons why the indicators for both private consumption and investments remained at low levels. Nonetheless, domestic demand ceased to decline in the second half of the year. The decline was even reversed in the retail trade at the end of the summer, with sales volumes starting to grow at the end of the year. The recovery in domestic demand was mainly driven by the labour market situation.

The unemployment rate was 19.8% in the first quarter of 2010, having declined quickly to 13.6% by the last quarter of the year. The annual average unemployment rate still peaked at 16.9%, which is the highest rate since independence was regained. Employment recovered above all in the processing industry, as a consequence of the increase in exports. In several sectors, the production capacity recovered mainly due to the rise in the number of hours worked and growth in productivity. The re-creation of jobs, however, will take time. Nevertheless, the labour market recovery exceeded expectations in 2010, fuelled by the rapid growth in exports and the competitiveness of Estonian labour force in the neighbouring countries.

Weak domestic demand held back the rise in import volumes to its pre-crisis level. According to preliminary estimates, imports at current prices grew by nearly a quarter, year-on-year. The underutilisation of production resources decreased the imports of investment goods. Private consumption was hampered by uncertainty, along with a fall in income. The main contributor to the growth in imports was the growth in exports of goods. The surplus of the services account of the balance of payments remained more or less on a par with that of 2009, with the trade deficit falling back by nearly 60%. The positive impact of the fall in the trade deficit on the current account was counteracted by the increase in the income account deficit due to the restored profitability of investments. The net outflow of income mainly consisted of reinvested income. Overall, the current account surplus remained more or less on a par with that of 2009, amounting to approximately 3.5% of the GDP according to preliminary estimates.

Estonia's gross external debt fell by 5% to 16.6 billion euros by the end of the year. The drop in the debt level was mainly caused by the decrease in the liabilities of credit institutions.

Inflation

In 2010, increased commodity prices together with economic revival brought about the acceleration of inflation. Year-on-year, prices climbed by 3% and in December, annual inflation reached 5.7%.

An annualised average rise in food prices was 2.8%, accelerating to 10.8% year-on-year in the last quarter of 2010. This was caused by the increase in the global price of raw materials for food, new export opportunities, poor weather conditions and the recovery of the food industry and of retail trade margins. The price of fresh vegetables, for example, showed a dramatic year-on-year increase of 40.4%.

Housing costs increased by 2.9%, fuelled mainly by the increase in the price of electricity, gas and heat energy. This can be directly associated with the rapid rise in the global price of oil in 2010. For the same reason, the price of motor fuel rose by 20.1%.

The post-crisis economic adaptation through price decline came to a halt in the first quarter of 2010, with domestic price pressures remaining low throughout the year. High unemployment eased the wage pressures, while utilisation of production capacities grew, although it remained significantly below its historical average.

The hikes in alcohol and tobacco excise duties and also in motor vehicle excise duties in January 2010 were among these administrative decisions that affected the increase in price level the most. Furthermore, a 1% sales tax was established in Tallinn in June.

General government

The fiscal policy of 2010 relied on measures implemented to improve the fiscal position in

2009. The general government expenditure for 2010 remained more or less on a par with that of the previous year. At the same time, revenues were buoyed by temporary and one-off measures, including the government's decision to suspend temporarily its contributions to the second-pillar pension fund to cover other expenses, and the sale of property.

The quicker-than-expected recovery of the economy helped to boost tax revenues. Tax revenues for 2010 remained similar to those of 2009, and the forecasted decline did not materialise. Nearly 107% of the budgeted non-tax revenues were collected. Revenues were mainly collected from assets, above all emissions trading, and the EU budget.

According to preliminary estimates, the Estonian general government deficit of 1.7% of GDP in 2009 turned into a surplus of 0.1% of GDP in 2010. The deficit was mainly reduced by the sales of Kyoto Assigned Amount Units.¹ The fiscal position is expected to deteriorate to some degree in 2011.

The government has set a priority of restoring the fiscal reserves and generating a surplus in 2013. In achieving this objective, the guiding principle should be that growth in general government expenditures may not exceed growth in revenues.

Sovereign rating

Sovereign rating, or the credit rating of a country, is an assessment by private international rating agencies of a country's ability and willingness to repay its long-term foreign liabilities on time. The sovereign rating indirectly reflects the reliability of a country's economy and economic policy and

it largely determines the interest rate on foreign borrowings.

The rating agency Standard & Poor's raised Estonia's sovereign rating from A-, outlook negative to outlook stable in February 2010, upgrading the rating by one level to A in June and maintaining the stable outlook. In March 2010, Moody's raised Estonia's sovereign rating outlook from negative to stable, giving a rating of A1. The rating agency Fitch raised Estonia's sovereign rating from BBB+ outlook negative to outlook stable in February 2010, and upgraded the rating by two levels to A in July, with outlook stable. The upgrade in the ratings and outlooks stemmed from a significant improvement in the Estonian economic and public finance outlook, as well as the prospects of acceding to the euro area.

In their reports for 2010, the rating agencies highlighted the following factors that support or weaken Estonia's sovereign ratings:

Supporting factors

- Strong fiscal policy to date and a considerable liquidity buffer. Government debt and deficit among the lowest in the European Union. The economic decline was addressed without significantly increasing the government debt.
- Accession to the Economic and Monetary Union in 2011, expected to lower the currency risk and enhance access to capital markets.
- A competitive and open economy which is flexible enough to cope with temporary weak demand.
- The foreign-owned banking sector lessens the state's burden of providing liquidity and supporting the domestic banking sector. This also serves to hedge the external

¹ By international methodology, the revenues from the sales of Assigned Amount Units are accounted in Government Finance Statistics within the period when the ownership of these units changes, and the "green investments" made out of these revenues are accounted accordingly in the period when the expenditures occur.

financing risk, as a majority of the external financing is made up of the capital flow between parents and subsidiary banks.

Weakening factors

- The relatively low level of incomes.
- Potentially huge incidental expenses of the financial system, partially balanced by the support of Nordic parent banks.
- Dependence on the conditions of the external markets.
- Estonia's gross and net external debt, compared to countries with similar ratings.
- The private sector's high debt burden, which exceeds the level of incomes per capita.

The rating agencies' annual reports on Estonia are available on the website of Eesti Pank.

THE FINANCIAL SECTOR

The deterioration of the banking sector's loan quality, which was triggered by the sudden economic decline in 2009, was reversed in 2010 as the economy recovered. The level of problem loans peaked in the second trimester of 2010. Even though loan quality problems of the pre-

vious cycle will continue to affect banks' balance sheets in the next few years, the proportion of problem loans is clearly shrinking. Above all, banks' assets have been affected by private sector's deleveraging, which has inhibited credit demand. Banks' assets also decreased due to writing off more uncollectible receivables.

The year was quite unfavourable for securities markets. Stock market capitalisation fell significantly and local bond market activity dropped to a record low level. In total, the assets of financial system participants as a ratio of GDP declined during the year (see Figure 1).

The banking sector

Institutional developments

At the end of 2010, seven credit institutions were operating in Estonia. Among those offering private financing, Folkia joined the ten branches of foreign credit institutions operating in the market. In addition, Parex Banka Estonian branch was transformed into Citadele Banka branch. A total of 251 foreign credit institutions provided cross-border banking services.

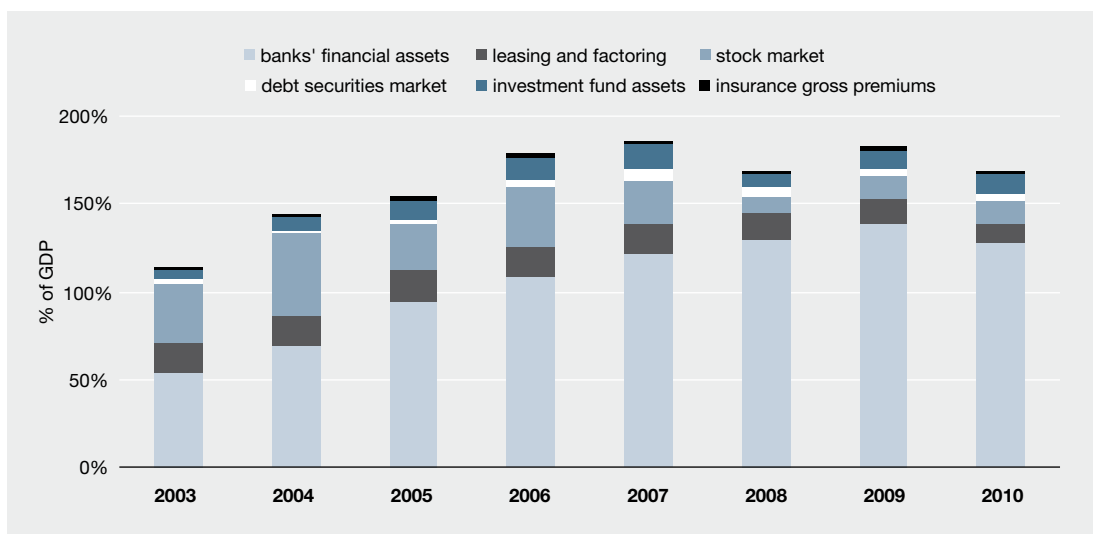


Figure 1. Structure of Estonia's financial system

The re-division of the market, which began in 2009 against the backdrop of a change in the operating environment, continued in 2010. The branches of foreign credit institutions and small banks increased their market share at the expense of larger banks (see Figure 2).

Assets and liabilities of banks

Banks' assets continued to fall in 2010 as companies and households reduced their finan-

cial leverage. The loan portfolio, which makes up the bulk of assets, contracted throughout the year, shrinking by a total of over 4.8% as a result of loan amortisation and low level of new lending (see Figure 3). The stock of new loans is very small. In consequence, the banks continued investing their assets in other instruments in 2010, bonds above all. This means that the banks' assets are much more liquid than they were a few years ago.

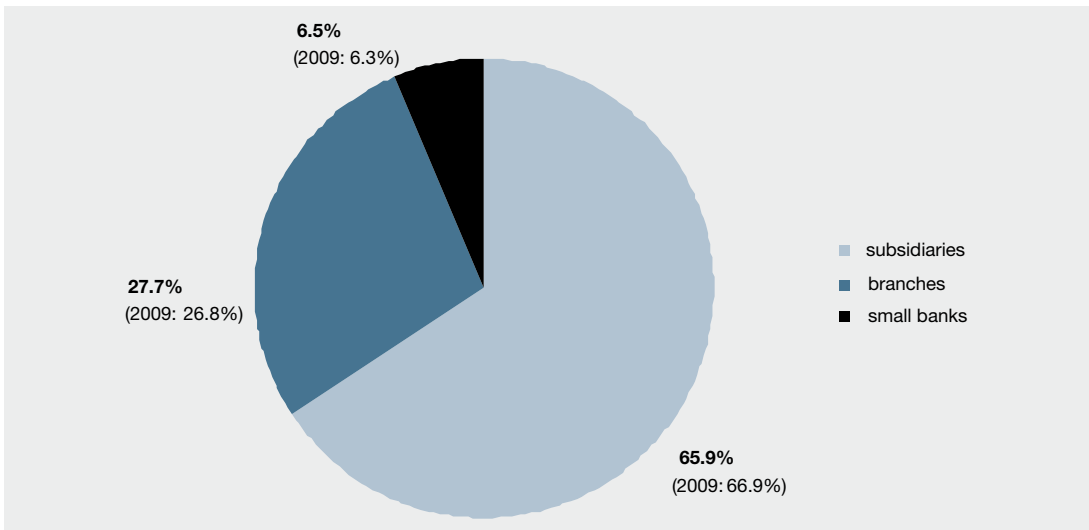


Figure 2. Banks' market share by total lending

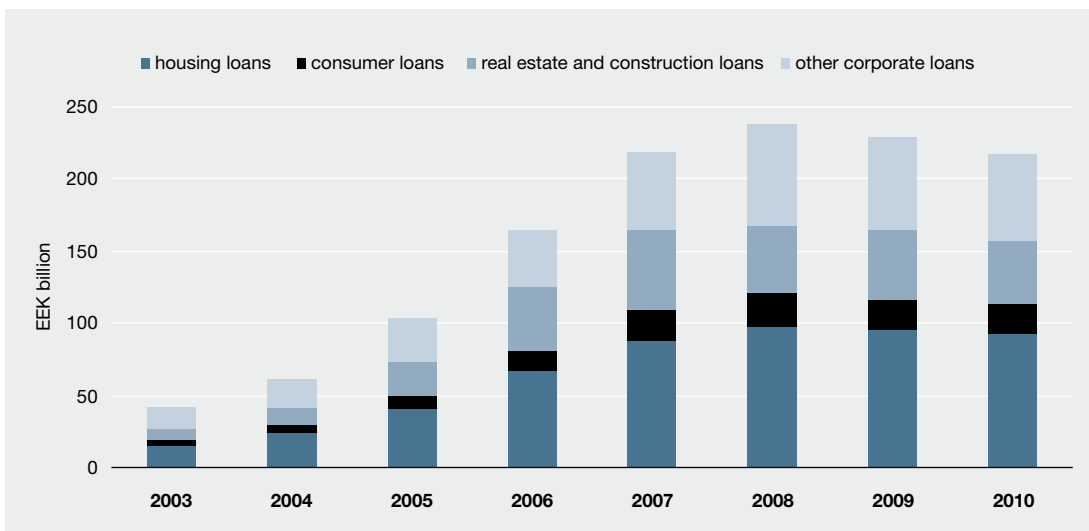


Figure 3. Banks' loan portfolio at year-end

Loan stock decreased mainly through the contraction of the corporate loan portfolio as low domestic credit demand cut the corporate loan stock by 6.4%. The loan stock of the construction and real estate sectors and manufacturing and logistics shrank the most. At the same time, the stock of loans issued for infrastructure development and to the farming and fishing industry was higher than it was at the end of 2009. Bank loans to households also shrank by a total of 3.3% against the backdrop of high unemployment and weak domestic demand. Even though the housing loan stock dropped by 2.3%, the slow amortisation of long-term loans raised the share of these loans in the total loan portfolio to 43%. The stock of consumer loans fell by 8.1% over the year.

Low demand for financing was reflected in the leasing and factoring portfolio which contracted by over 20% in 2010. Corporate leasing showed the biggest decline and private car leasing fell by nearly 16% over the year.

Domestic deposits showed a rapid increase in 2010, which changed banking sector funding to a more traditional retail deposit based one. Deposits grew by 5.3% in the banks operating in Estonia in 2010, to a total of nearly 158 billion kroons at the end of the year. The lowering of the deposit interest rates to a level comparable with that of the euro area reduced the appetite for term deposits, with the share of term deposits in total deposits thus dropping by 8 percentage points to 43%. Against the growth in deposits and modest credit demand, funds borrowed from foreign banks were repaid during the year. At the end of the year, funding from foreign banks totalled 102 billion kroons, or a little more than 37% of the total liabilities. As a result, the loan-to-deposit ratio decreased by over 14 percentage points to 140% at the end of the year.

Quality of the loan portfolio

With the recovery of economic activity, the negative trends were reversed in the second half of 2010 after a natural time-lag, and the quality of the banks' loan portfolio started to improve. The share of loans overdue for more than 60 days in the loan portfolio amounted to 7.6% in August, and had dropped to 6.5% by the end of the year. This was prompted by non-performing loans starting to perform again, and by the write-off of uncollectible receivables.

Even though the share of uncollectible corporate loans decreased during the year, the dynamics differed greatly across sectors. The biggest increase could be seen in loans overdue for more than 60 days, issued to the manufacturing, transport and trade sectors, while the overdue loans of real estate and construction companies decreased.

Despite persistent unemployment, the quality of housing loans improved in the year. At the end of the year, loans overdue for more than 60 days made up 4% of the loans issued. At the same time, the quality of consumer loans deteriorated. By the end of the year, overdue loans accounted for 8.4% of the sector's loans.

Profitability and capitalisation

The banking sector posted a net profit of 1.1 billion kroons in 2010² (see Figure 4). Banks' profitability has been enhanced primarily by the decline in provisions for loan losses. The previously established provisions were even charged to profit by some banks in the last quarters of the year.

The ratio of the banks' net interest income to assets showed moderate but stable growth. This growth has been encouraged by the

² Unaudited net profit as at the preparation of the Annual Report.

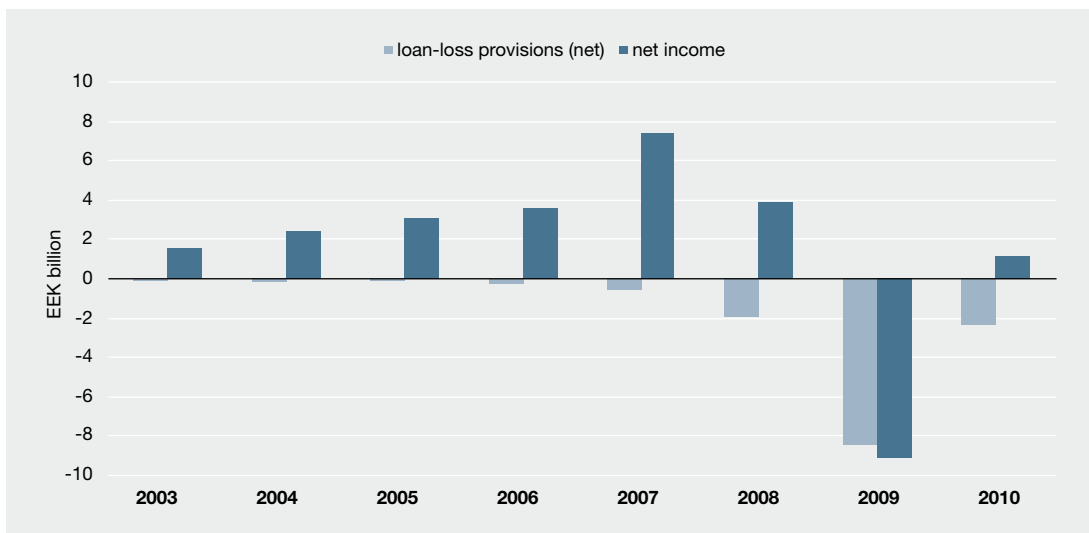


Figure 4. Banking sector profitability

decline in interest expenses, which gained momentum in the autumn of 2009 as the banks gradually lowered the interest rates for kroon deposits.

The banks' administrative expenses went up by 4% in 2010. The acceleration in the growth in expenditure in the second half of the year was fuelled by the preparation for the adoption of the euro. Nevertheless, banks succeeded in maintaining their high profitability. Profitability before provisions and write-offs also grew in the last quarter.

The banks' consolidated capital adequacy ratio reached 16.2% at the end of the year, significantly exceeding the 10% minimum requirement. Stress tests confirm the sufficiency of the capital buffers even in the worst case scenario.

Securities markets

Bond market

The primary bond market was very quiet in 2010. The volume of new bond issues constituted only 15% of the volume in 2009. Issuers

were mainly local non-financial sector companies (see Figure 5).

On account of the small volume of bonds issued and the redemption of bonds, bond market capitalisation fell by 7.3% in the year. At the end of the year, capitalisation totalled 8.9 billion kroons, or 4.0% of GDP, with the bonds of non-financial sector companies contributing 74%. No bonds were listed on the Tallinn Stock Exchange after June, when the last two listed bonds were redeemed.

The year 2010 also saw some changes among bond investors. Compared to last year, insurance companies and pension funds decreased their share of bond-holding, while the proportion of bonds held by the non-financial sector, credit institutions and private persons increased. The proportion of local investors fell for the first time in three years, accounting for 71% of the total bonds issued at the end of the year.

The secondary bond market was also very quiet. The average daily turnover decreased and at the end of 2010, reaching a half of the average daily turnover for 2009.

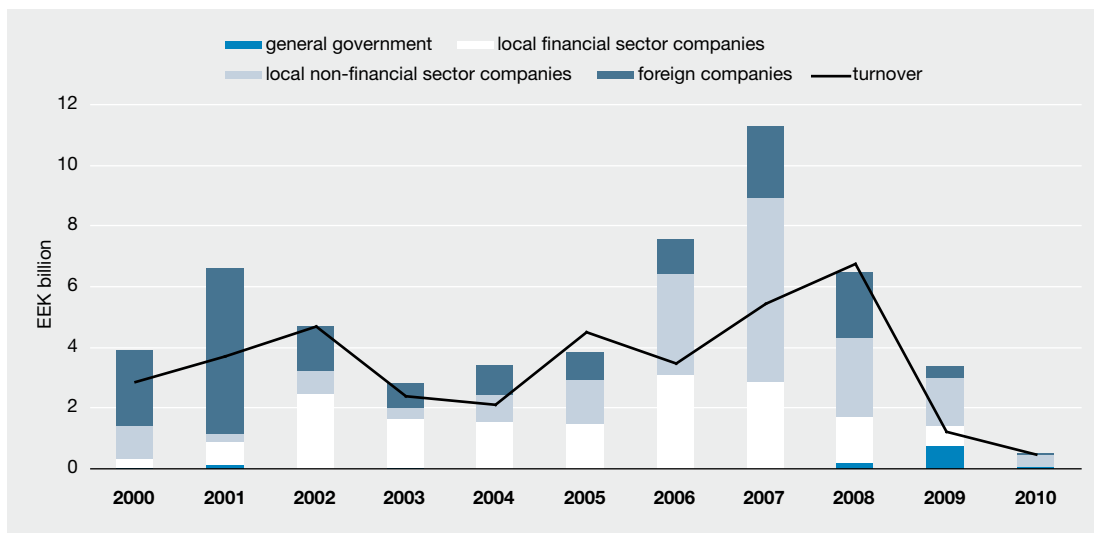


Figure 5. Debt securities by issuers and secondary market turnover

Stock market

At the beginning of 2010 the shares of Eesti Telekom and Norma were delisted from the primary exchange and in May the shares of Premia Foods were listed on the primary exchange. As at the end of the year, the shares of 15 companies were listed on the Tallinn Stock Exchange, with the total transactions concluded with the shares of

three companies contributing more than half of the total turnover.

The OMXT index advanced by nearly 73%, reaching its level of the beginning of 2008 (see Figure 6). Stock exchange capitalisation fell by 9%, following the delisting of one of the biggest companies, Eesti Telekom, at the beginning of 2010.

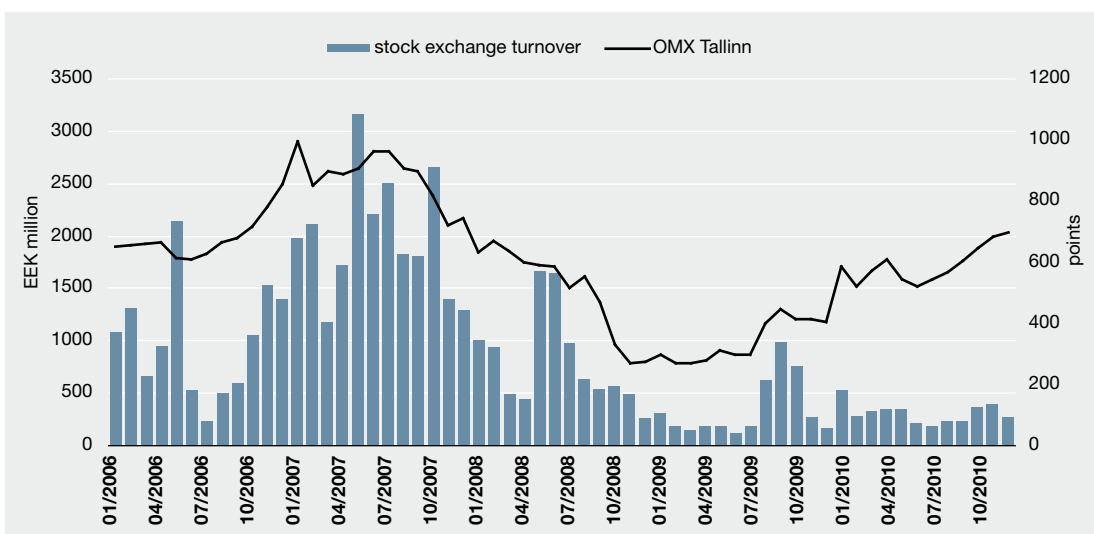


Figure 6. Monthly turnover of the Tallinn Stock Exchange and OMX Tallinn index as at month-end

The delisting of two companies resulted in a fall of nearly 30 percentage points in the share of the market held by non-resident investors to 37% at the end of 2010. At the same time, private persons held 10% of the listed shares.

Other financial intermediaries

Investment and pension funds

Two new stock funds, a real estate fund and two second-pillar pension funds were launched in the Estonian market in 2010, while two stock funds and an interest fund were eliminated. At the end of 2010, 41 investment funds and 35 pension funds were registered in Estonia.

Investment fund assets totalled 9.8 billion kroons at the end of 2010, which is more or less the same as at the end of 2008 (see Figure 7). Despite the positive annual yield of interest funds, the interest fund assets dropped by 10% due to the elimination of a fund. Stock fund assets grew by nearly 23% as a result of the yield and the addition of new stock funds.

Contributions to the second-pillar pension funds dropped by nearly three times in 2010. This was

mainly caused by the suspension of state contributions in the second half of 2009. At the same time, the second-pillar pension fund assets have grown by 13%, fuelled by the yield, amounting to 16.8 billion kroons at the end of the year. The assets of the third-pillar pension funds grew by 23% during the year. Together with insurance contracts, the assets of the third-pillar pension funds totalled 3.9 billion kroons as at the end of 2010.

Insurance

In 2010, insurance companies collected 5% fewer insurance premiums from Estonian residents than they did in 2009, with the result that the local insurance market sank for the third year in a row. At the same time, indemnities also dropped by 5%, so the operating results of insurance companies remained very good. As at the end of 2010, 13 life insurance and non-life insurance companies were authorised to operate in Estonia, with five branches of foreign non-life insurers registered.

Life insurance companies collected 1.2 billion kroons in life insurance premiums in 2010, which was 7% more than in 2009. Despite the growth

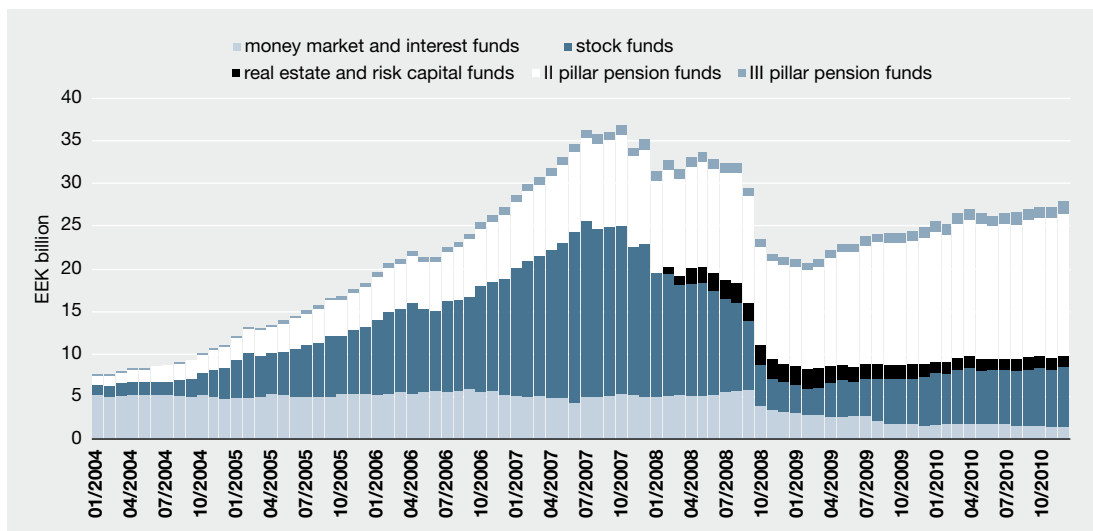


Figure 7. Value of investment and pension fund assets as at month-end

in insurance premiums, the difficulties in agreeing new contracts and maintaining existing contracts continued. Half of the Estonian life insurance market is still focused on unit-linked life insurance products. In unit-linked life insurance, the risk is borne by the policy holder, so the risks for insurance companies have been lower and the operations more profitable than those in other EU Member States. Life insurance companies posted a net profit of 407 million kroons (unaudited) in 2010.

Even though the state capital-based KredEx Krediidikindlustus entered the non-life insurance market in 2010 by engaging in export credit risk insurance, total insurance premiums still dropped by 9% to 3.4 billion kroons in 2010. Growth in the sale of new cars heralds an upturn that is expected to boost revenues from third party liability motor insurance and voluntary motor insurance of land vehicles. Despite the drop in sales, non-life insurance companies posted a net profit of 548 million kroons (unaudited) in 2010. Profitability was buoyed by cost cutting and by a 7% drop in indemnities compared to the last period. A total of 2.1 billion kroons were paid in indemnities over the course of the year.

Payment instruments

After a fall in 2009, the value of inter-bank payments started to rise in 2010, which was mainly due to the increase in non-cash payments. The value of non-cash payments increased by 3.3% to an average of 14.7 billion kroons per day, while the value of cash payments decreased by 8.5% to an average of 4.6 million kroons per day (see Figure 8). This change can be attributed to the recovery of economic growth.

The preferred choice of payment instruments follows the trend for pursuing the most efficient solution. The Estonian payment environment is sufficiently well-established, and a payment instrument is usually preferred for its convenience, speed and price rather than its novelty. In addition, international surveys suggest that the pricing of payment services in Estonia is relatively transparent, compared to that in a majority of EU countries, and this makes the choice of a suitable payment instrument easier for the client.

In 2010, the greatest increase could be seen in the value of internet bank payment orders and other types of credit orders. The value of direct

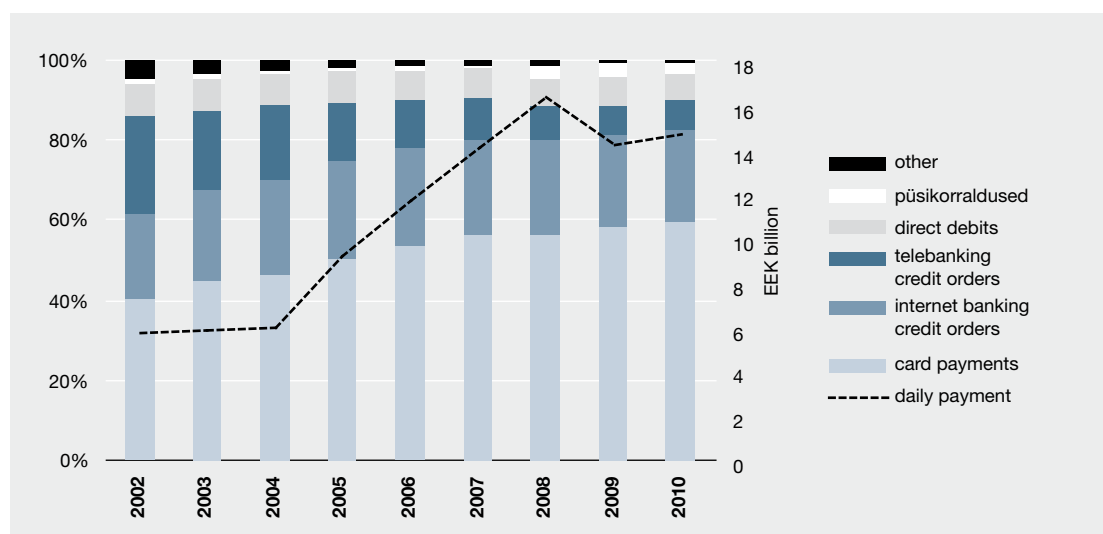


Figure 8. Most common payment instruments in Estonia and average daily payment turnover

debits and card payments, the most common payment instrument, increased 17% and 5.5%, respectively. The value of paper-based and tel-bank credit orders continues to decrease. The value of mobile payments – a new service which gained momentum a short time ago – dropped by 19.6% to an average of 1,227 kroons per day.

The number of payment cards issued fell by approximately 41,000 to 1.8 million in 2010 or 1.3 cards per person. Even though the numbers dropped for all types of payment cards, the biggest decrease could be seen in the number of credit cards. The number of credit cards dropped by 35,000, with credit cards accounting for 22% of all payment cards issued at the end of 2010³. The shares of instalment cards and charge cards showed the biggest decline among credit cards, dropping by 20,977 and 11,841, respectively. The numbers of actively used debit and credit cards grew by 2% and 4%, respectively. This means that the number of payment cards issued dropped mainly at the expense of cards which were not previously used in daily payment transactions.

The most popular debit cards are the international VISA cards, which made up 68.4% of all cards, and 87.5% of debit cards. The international VISA and MasterCard cards are equally popular among credit cards.

The number of ATMs decreased by four, owing to a fall in the number of payment ATMs. The number of points of sale (POS) and POS terminals decreased sharply in 2010. The number of points of sale dropped by 338 to 17,333 for points of sale accepting both card and mobile payments⁴. The number of POS accepting mo-

bile payments started to fall rapidly in earlier periods, with only 29 mobile payment points of sale remaining by the end of 2010. The number of POS terminals dropped by 616 to 26,287. Even though the number of POS terminals accepting cards grew by 234, the number of cash register systems dropped by a total of 981⁵.

³ Four types of credit cards are issued in Estonia: revolving credit cards, charge cards, instalment cards and other credit cards with several different options for repaying the credit generated upon use of the card.

⁴ Three types of points of sale can be distinguished: points of sale accepting card payments, those accepting mobile payments and those accepting both card and mobile payments.

⁵ There are five types of POS terminals: POS-terminals, cash register systems, imprinter, e-commerce and MOTO (mail order/telephone order).

On 20 June 2008, Eesti Pank unveiled the collector banknote dedicated to the 90th anniversary of the Republic of Estonia and the 16th anniversary of the re-establishment of the Estonian kroon.

The design of the collector banknote draws on the then valid 10-kroon note and the pre-war 10-kroon note. The front of the collector banknote is an exact copy of the pre-war banknote designed by Günther Reindorff. The reverse of the collector banknote is a copy of the latest 10-kroon note, designed by Vladimir Taiger and depicting the famous Tamme-Lauri oak, and it also bears the national coat of arms of the Republic of Estonia. In total 30,000 collector banknotes were issued.

The idea of issuing collector banknotes was inspired by three original printing plates for 10-kroon banknotes, which were found hidden away in the vault of Eesti Pank in 2000 and date back to 1940. Most probably, the plates had been hidden there after Estonia was occupied in 1940 and were supposed to be destroyed along with the printed 10-kroon banknotes.



DECREES, DECISIONS AND PUBLICATIONS



DECREES OF THE GOVERNOR OF EESTI PANK IN 2010

No 1, 26 January 2010

Amendments to Eesti Pank Governor's Decree No 4 of 27 March 2007 "Reports on prudential ratios of credit institutions and consolidation groups of credit institutions"

No 3, 5 March 2010

Establishment of the requirements for balance of payments reporting of commercial undertakings

No 4, 11 May 2010

Conditions for acceptance of payment orders

No 5, 13 July 2010

Supplementary reports on credit institution's balance sheet

No 6, 21 July 2010

Repeal of Eesti Pank Governor's Decree No 8 of 19 September 2006 "Establishment of foreign currency purchase and sale report"

No 7, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 13 of 29 December 2006 "Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions"

No 8, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 10 of 7 November 2008 "Establishment of requirements to the contents and form of savings and loan associations' balance sheet statement and income statement"

No 9, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 8 of 2 November 2009 "Information subject to disclosure concerning risk management, own funds and capital adequacy of credit institutions"

No 10, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 4 of 27 March 2008 "Reports on prudential ratios of credit institutions and consolidation groups of credit institutions"

No 11, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 8 of 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"

No 12, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 10 of 23 August "Establishment of reports on payment statistics submitted by credit institutions"

No 13, 21 July 2010

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

No 14, 21 July 2010

Amendments to Eesti Pank Governor's Decree No 19 of 7 December 2007 "Establishment of supplementary reports on the balance sheet of a credit institution's consolidation group"

No 15, 22 July 2010

Amendments to Eesti Pank Governor's Decree No 14 of 1 October 2007 "Establishment of balance of payments reports of credit institutions"

No 18, 15 November 2010

Amendments to Eesti Pank Governor's Decree No 4 of 9 May 2008 "Approval of TARGET2-Eesti rules"

No 19, 16 November 2010

Repeal of Eesti Pank Governor's Decree No 39 of 31 December 1998 "Fixing the Estonian kroon rate against the euro"

No 21, 3 December 2010

Repeal of Eesti Pank Governor's Decree No 2 of 31 January 1997 "Reports by credit institutions"

No 22, 7 December 2010

Establishment of reports on credit institutions' reserve requirement calculation

No 23, 10 December 2010

Amendments to Eesti Pank Governor's Decree No 4 of 9 May 2008 "Approval of TARGET2-Eesti rules"

No 24, 15 December 2010

The procedure for sending euro banknotes and coins to Eesti Pank

No 25, 16 December 2010

Declaration of international payments and submission of data required for balance of payments statistics

No 26, 17 December 2010

Repeal of the decree on establishing interest rates to the reserves and standing deposit facility

No 27, 17 December 2010

Amendments to Eesti Pank Governor's Decree No 10 of 13 May 2004 "Establishment of general terms and conditions and price list of account management"

No 28, 20 December 2010

Repeal of Eesti Pank Governor's Decree No 15 of 29 December 2000 "Procedure for securities transactions between Eesti Pank and credit institutions", Decree No 20 of 13 December 2002 "Approval of the rules on fixing daily exchange rates of the Estonian kroon" and Decree No 7 of 18 June 2007 "Rules for fixing the Estonian interbank interest rate on loans and deposits"

No 29, 20 December 2010

Repeal of Eesti Pank Governor's Decree No 1 of 10 January 2002 "Approval of documentation of payment systems of Eesti Pank" and Decree No 9 of 7 November 2006 "Approval of documentation of the Real-Time Gross Settlement System of Eesti Pank"

No 30, 21 December 2010

Amendments to Eesti Pank Governor's Decree No 13 of 29 December 2006 "Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions"

No 31, 21 December 2010

Amendments to Eesti Pank Governor's Decree No 4 of 27 March 2007 "Reports on prudential ratios of credit institutions and consolidation groups of credit institutions"

No 32, 22 December 2010

Repeal of decree establishing requirements to the euro cash purchase and sale report

DECISIONS OF THE SUPERVISORY BOARD OF EESTI PANK IN 2010

No 2-1, 9 March 2010

Amendments to the Statute of Eesti Pank

No 3-1, 27 April 2010

Profit distribution strategy of Eesti Pank

No 3-2, 27 April 2010

2009 Annual Report of Eesti Pank

No 4-1, 18 May 2010

Appointment of auditors

No 5-1, 8 June 2010

Approval of the designs and nominations of collector coins

No 7-1, 19 October 2010

Approval of the Statute of the Internal Audit Department of Eesti Pank

No 8-1, 7 December 2010

Establishment of the interest rate on consumer loans issued to the employees of Eesti Pank

No 8-2, 7 December 2010

Amendments to the Supervisory Board's decision No 10-1 of 25 November 2008 concerning the terms and conditions for the study loans issued by Eesti Pank

No 8-3, 7 December 2010

Approval of the work schedule for 2011 of the Internal Audit Department of Eesti Pank

No 8-4, 7 December 2010

Appointment of an auditor

PUBLICATIONS OF EESTI PANK IN 2010

The website of Eesti Pank is located at www.bankofestonia.ee. The website contains information on Eesti Pank and its responsibilities, and on the Estonian monetary system, economy and financial environment. Other topics available on the site include 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 so on. There is also a comprehensive statistics database. In addition, there is a virtual library (in Estonian only), which links to other libraries in the field of economy.

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 usually presented at a press conference. In total, five economic policy statements were released in 2010.

Annual Report

The Annual Report provides an overview of the central bank's activities during the reporting year and the financial statement. The annexes to the Annual Report include an overview of the economic and financial environment, a list of Eesti Pank Governor's decrees issued during the year, and a list of publications of the year.

Estonian Economy and Monetary Policy

The Estonian Economy and Monetary Policy is published twice a year and it includes a thorough economic review and an **economic forecast**. Issues published in 2010:

- Estonian Economy and Monetary Policy (1/2010)
- Estonian Economy and Monetary Policy (2/2010)

Financial Stability Review

The Financial Stability Review is published twice a year and it examines the financial behaviour of Estonian enterprises and households, related risks, financial markets, payment systems, etc. Issues published in 2010:

- Financial Stability Review (1/2010)
- Financial Stability Review (2/2010)

Balance of Payments

The Balance of Payments gives an overview 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 2010:

- Estonia's Balance of Payments for 2009
- Estonia's Balance of Payments for the First Quarter of 2010
- Estonia's Balance of Payments for the Second Quarter of 2010
- Estonia's Balance of Payments for the Third Quarter of 2010
- Estonia's Balance of Payments Yearbook 2009

Report on the Adoption of the Euro

The Report on the Adoption of the Euro provides information about the preparations made by Eesti

Pank for the changeover to the euro, which took place on 1 January 2011. Issues published in 2010:

- Report on the Adoption of the Euro (September 2010)

Lending Review

In 2010 Eesti Pank started to publish the Lending Review. The review of financing and lending in the non-financial sector covers banking and leasing statistics, financial accounts analysis and credit supply and demand. Issues published in 2010:

- Lending Review (November 2010)

Labour Market Review

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

Issues published in 2010:

- Labour Market Review 1/2010 (January 2010)
- Labour Market Review 2/2010 (July 2010)

Working Papers

The Working Papers are summaries of the economic studies conducted at Eesti Pank. The target group of the Working Papers includes, above all, economists and economic experts, and are often published in English only. Issues published in 2010:

- Working Papers 1/2010: R. Kattai. Credit Risk Model for the Estonian Banking Sector
- Working Papers 2/2010: K. Staehr. The Global Financial Crisis and Public Finances in the New EU Countries from Central and Eastern Europe
- Working Papers 3/2010: R. Kattai. Potential Output and the Output Gap in Estonia
- Working Papers 4/2010: K. Staehr. Income Convergence and Inflation in Central and Eastern Europe: Does the Sun Always Rise in the East?
- Working Papers 5/2010: J. Masso, T. Roolaht, U. Varblane. Foreign Direct Investment and Innovation in Central and Eastern Europe: Evidence from Estonia
- Working Papers 6/2010: K. Staehr. Inflation in the New EU Countries from Central and Eastern Europe: Theories and Panel Data Estimations
- Working Paper 7/2010: G. Bertola, A. Dabušinskas, M. Hoeberichts, M. Izquierdo, C. Kwapil, J. Montornès, D. Radowski. Price, Wage and Employment Response to Shocks: Evidence from the WDN Survey

Other publications

Rahvapärased õllekannud Eesti Rahva Muuseumi kogust = Traditional wooden tankards from the collection of the Estonian National Museum. Eesti Pank 2010

Estonian currency from the mark to the euro. Eesti Pank, 2010 (in Estonian, English and Russian)

Vabaduse kullakoormad = The Gold Loads of Freedom. Catalogue for the joint art exhibition of the Pärnu Museum and the Museum of Eesti Pank, 2010

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ISSN 1406-1414

Executive editor: Kadri Põdra

Layout: Vincent OÜ

Design and layout: Urmas Raidma

Printed in Folger Art