

Eesti Pank

EESTI PANK
ANNUAL REPORT
2011

2012

Eesti Pank is the central bank of the Republic of Estonia, and a member of the European System of Central Banks and the Eurosystem¹.

The primary function of Eesti Pank is to contribute to price stability within the euro area. Eesti Pank serves its function by formulating the single monetary policy together with other members of the euro area, and by implementing the single monetary policy of the euro area in Estonia. Besides the price stability objective, the central bank also contributes to achieving other economic policy goals of Estonia and the euro area in line with the Treaty on the Functioning of the European Union.

In addition, Eesti Pank fulfils the traditional functions of a central bank: regulates currency circulation; supports and organises transfers between commercial banks; participates in safeguarding financial stability; manages the foreign reserves of Estonia; prepares financial sector statistics and balance of payments statistics, and advises the government in economic policy issues in Estonia and the euro area.

¹ The European System of Central Banks (ESCB) comprises the European Central Bank (ECB) and the national central banks of European Union Member States. Eesti Pank became a member of the ESCB in 2004 upon Estonia's accession to the European Union. The Eurosystem consists of the ECB and the national central banks of countries that have adopted the euro. Eesti Pank became a member of the Eurosystem in 2011 upon Estonia's accession to the euro area and adoption of the euro.

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Merike Tiivits
2010
"In the rain"





FOREWORD BY
THE GOVERNOR
OF EESTI PANK

Foreword by the Governor of Eesti Pank

2011 was a year full of challenges and hard work for Eesti Pank. Estonia became the seventeenth member of the euro area. The economy proved highly unpredictable, significantly complicating economic forecasts and analysis of the real economy and the financial sector. It became increasingly clear to everybody that bold and decisive steps were needed in the euro area.

Estonia witnessed a smooth changeover to the euro. This required the joint effort of the entire nation. Residents and retail traders, entrepreneurs and banks – we all made an effort and succeeded. Despite growing uncertainties, public support to the euro has not wavered.

The transition to the euro brought along new duties and a greater responsibility for Eesti Pank – we are now equal partners and decision-makers within the Eurosystem. For a small nation, this can be considered quite an achievement. But also a challenge.

In the euro area economy, the first and second half of the year proved very different, indeed. The beginning of the year saw a continued economic recovery, both on the global scale and in the euro area, even though the rate of growth slowed. Oil and other commodity prices soared and there was plenty of liquidity available, which placed upward pressure on euro area prices. Our principal task was to contribute to price stability in the euro area, in other words to maintain the year-on-year increase in consumer prices below but close to 2% over the medium term. To maintain price stability, the Governing Council of the European Central Bank decided to raise the monetary policy rates after a 12-month hiatus. The ECB key interest rates were raised in April and June.

The tides were turned in the second half of the year, with waning confidence and growing uncertainties on the financial markets starting to curb global growth. The underlying reason for this was market participants' concerns about the public finance situation in several euro area countries. While the first half of the year saw cautious optimism, growing anxieties forced companies to postpone their investment and recruitment decisions starting from summer. Loss of confidence slowed down the economic growth, easing inflationary pressures. In November and December, we therefore reduced the interest rates to a historical low.

Under normal circumstances, the change of interest rates alone would have been sufficient to influence prices and economic activity. Unfortunately, the crisis proved as extensive as to disturb the functioning of monetary policy transmission mechanism. The ability of commercial banks to issue loans to companies and households was thus significantly reduced. This compelled us to take various extraordinary measures, starting from August. We supported the securities market to avoid paralysing the activities of banks; we continued providing unlimited liquidity to banks; we offered banks three-year loans at highly favourable conditions; we expanded the list of assets eligible as collateral for liquidity credit, and lowered the minimum reserve requirement from 2% to 1% at the end of the year.

These were bold steps but necessary. As a result, the Eurosystem – the euro area central banks and the European Central Bank – were able to make a significant contribution to the preserving of stability and confidence on the euro area financial markets. Our primary goal was to ensure the functioning

of monetary policy and the liquidity of banks, and to alleviate the impact of the financial problems of some crisis-stricken countries on corporate and household lending in the euro area.

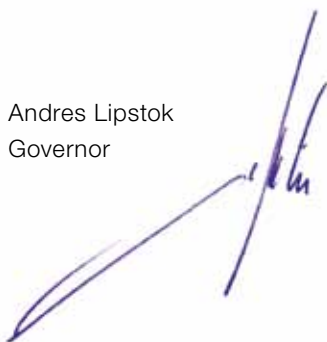
This all has come with a price: the risks inherent in the balance sheets of central banks have increased. Risk analysis and augmenting the risk buffers of its balance sheet will be a challenge for Eesti Pank also in the forthcoming years. The central bank just finished its first year as a member of the euro area, with one of the lowest equity to monetary policy assets ratios among euro area central banks.

It is not only the central banks that can contribute to a successful exit from the crisis. The measures agreed upon by the European Council and the euro area heads of state and government must be implemented swiftly by the governments of the member states. It is necessary to focus on further developing the economic policy cooperation between euro area countries. Alongside crisis management measures, attention should be paid to laying a foundation for sustainable growth in the long perspective. The euro area countries all share a common interest here – the growth of the debt burden has to be halted. We need a framework which would feed market confidence in the sustainability of public finance in euro area countries. For this purpose, we must even now pursue structural reforms with the aim of enhancing economic flexibility, adding to competitive strength and boosting employment in the member states.

Unlike several other euro area countries, Estonia had no need to engage in local crisis management in 2011. The Estonian economic outlook has remained relatively good and the financial sector is strong. We need to keep up the good work, ensure the budget balance and make an effort to recover the reserves. We should also be cautious of further energy price hikes being used as a pretext for raising other prices.

The economic and monetary union today still has all the good characteristics, for which it was established in the first place. We now need to enhance the union's efficiency, strength and security in the service of our best interests.

Andres Lipstok
Governor



Margus Opp

2012

“Watery undergrowth”





EESTI PANK'S
PRIORITIES
IN 2011

EESTI PANK'S PRIORITIES IN 2011

In 2011, Estonia adopted the euro. The changeover added to the responsibilities of the central bank and triggered changes in the operational framework. In adopting and implementing decisions regarding the euro area, the Eurosystem follows the principle that the decisions are adopted centrally in the Governing Council of the European Central Bank¹ and implemented by national central banks (NCBs) thereafter.

Eesti Pank thus follows two important operating principles.

1. As a member of the Governing Council of the European Central Bank – that is, as a decision-maker – the Governor of Eesti Pank participates in the adoption of all decisions regarding the Eurosystem.
2. Implementation of the Eurosystem decisions in Estonia falls within the responsibility of Eesti Pank, not the European Central Bank.

The Governor of Eesti Pank and the central bank itself act independently and are not allowed to take orders or instructions from the government or other interest groups outside the bank in the performance of their statutory duties. The power of self-government and independent analysis provide central banks with the best chances of ensuring monetary and financial stability.

In 2011, Eesti Pank focused on the following strategic areas.

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

The primary function of Eesti Pank is to contribute to price stability within the euro area. This means the objective of keeping the consumer price increase in the euro area below but close to 2%. Price stability is the precondition for a strong economy.

Eesti Pank serves the function of ensuring price stability by formulating the single monetary policy together with other members of the euro area. For this purpose, Eesti Pank participates in the preparation of analyses and reports that are used as an input for adopting monetary policy decisions. The cooperation also takes the form of numerous committees and task forces as well as teleconferences, where all major decisions are previously discussed. The Governor of Eesti Pank participates in the adoption of monetary policy decisions and other important decisions in the Governing Council of the European Central Bank.² The single monetary policy in the euro area is implemented by the Eurosystem central banks.

¹ The Governing Council of the European Central Bank comprises the governors of the national central banks of euro area countries (17 central banks) and the Executive Board of the European Central Bank (6 members).

² See list of decisions in the annexes "Monetary policy decisions of the ECB Governing Council" and "Other decisions of the ECB Governing Council".

Eesti Pank had the following priorities in monetary policy in 2011:

- enhancing competence in the monitoring and analysis required for adopting monetary policy decisions in the euro area;
- establishing the framework for the implementation of monetary policy;
- taking account of the development needs of the Estonian economy in the process of monitoring and analysis, and advising the government.

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

2. Participating in ensuring financial stability through formation of financial sector policy and development of the financial sector safety net

Eesti Pank regularly analyses the functioning of the financial system and issues financial stability assessments, with the aim of early detection of any risks endangering the financial system and introduction of the corresponding changes in the Estonian financial sector policy. Eesti Pank can only serve its primary function – to maintain price stability – if the financial intermediation system functions smoothly.

Alongside the prevention of problems, a great deal of importance must be placed on ensuring that Estonia is prepared for crisis management in the financial sector. In a crisis, the primary task of Eesti Pank is to ensure sufficient liquidity within the banking system. In cooperation with the Guarantee Fund, the Ministry of Finance and the Financial Supervision Authority, Eesti Pank serves to strengthen the financial sector safety measures.

Eesti Pank participates in the evaluation of the functioning of the financial system of the euro area and the European Union, and in the preparation of analyses on financial stability within the European Union. The cooperation takes the form of committees and working parties, where all major decisions are previously discussed. The Governor of Eesti Pank is also a member of the European Systemic Risk Board.

The experience of Eesti Pank in ensuring financial stability in a financial sector largely owned by foreign investors, and the close partnership of Nordic countries and the Baltic States in pursuit of financial stability, is highly appreciated within the Eurosystem.

Eesti Pank had the following priorities in the field of financial stability in 2011:

- participating in the joint activities of euro area central banks in pursuit of financial stability;
- participating in the activities of the European Systemic Risk Board;
- enhancing cooperation in the financial stability group comprising Nordic countries and the Baltic States to ensure data exchange and smooth functioning of the financial system, to prevent the spread of potential financial crises, and to minimise the damage of financial crises;
- enhancing the efficiency of the financial sector legal framework and safety net in the European Union.

Further information on these matters is provided in the chapter “Safeguarding financial stability”.

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

Eesti Pank has been charged with the task of ensuring smooth transfer of both domestic and cross-border payments and settlements. Eesti Pank operates two interbank settlement systems: TARGET2-Eesti, the component system of the Trans-European Automated Real-time Gross Settlement Express Transfer System TARGET2, and ESTA, the settlement system for retail payments. In the current economic and financial environment, the efficiency and reliability of the financial sector depends, among other things, on the smooth and sustainable functioning of the settlement systems.

Eesti Pank also contributes to the development of payment and settlement systems, and functions as the supervisor of settlement systems both on the national and the EU level.

Eesti Pank had the following priorities in the field of payment and settlement systems in 2011:

- maintaining the reliability and business continuity of the settlement systems operated by Eesti Pank;
- bringing the interbank retail settlement system of Estonia into line with the requirements of the Single Euro Payments Area (SEPA);
- participating in the development of the Eurosystem's central securities settlement platform TARGET2-Securities;
- developing and announcing the settlement system supervision framework, and concluding the cooperation agreement between the central bank and the Financial Supervision Authority.

Further information on these matters is provided in the chapter "Payment and settlement systems".

4. Regulating cash circulation in Estonia and contributing to smooth cash circulation within the euro area

After the changeover to the euro, the daily regulation of cash circulation in Estonia has remained one of the principal tasks of Eesti Pank. This includes contributing to smooth cash circulation, detecting counterfeit euro currency and replacing worn-and-torn banknotes in Estonia. The total cash to be launched into circulation in the Eurosystem as well as the number of different banknotes required for meeting the cash demand is subject to the joint decision of the Eurosystem.

The production of banknotes also lies within the responsibility of the NCBs. The Eurosystem decides by agreement which NCB assumes the task of producing certain banknotes at a given time.

Through partnership with the Eurosystem and the European Union, Eesti Pank contributes to ensuring a high level of security of euro banknotes, as well as development of common quality standards for handling euro coins and banknotes.

Eesti Pank had the following priorities in the field of cash circulation in 2011:

- meeting the demand for euro banknotes and coins, and safeguarding the cash reserves required for cash circulation;
- processing euro banknotes and coins in compliance with the common quality standards as well as the requirements for authenticity and fitness checking and recirculation of euro banknotes and coins;

- exchanging Estonian kroons into euros, removing Estonian banknotes and coins from circulation and rendering them unfit for circulation.

Further information on these matters is provided in the chapter “Meeting the cash demand”.

5. Maintaining and enhancing Estonia’s official foreign reserves and other financial assets under the management of Eesti Pank

Eesti Pank has been charged with the task of maintaining and managing the official foreign reserves of Estonia. The foreign reserves and other financial assets under the management of Eesti Pank serve to support the Eurosystem’s ability to exercise efficient monetary policy and ensure Eesti Pank’s financial ability to fulfil its tasks. Reserves help to ensure public trust in the euro area monetary system, as well as financial independence of the central bank.

Pursuant to the Treaty on the Functioning of the European Union, the central banks of Member States that have adopted the single currency have transferred to the European Central Banks foreign reserves³ which, as a rule, are proportional to the participation of the Member States in the capital of the European Central Bank. Eesti Pank transferred a total of 103,115,678 euros to the foreign reserve of the European Central Bank. The foreign reserves of the European Central Bank amount to a total of 50 billion euros.

The daily management of the foreign reserves of the European Central Banks has been entrusted to the NCBs. Eesti Pank manages a portion of the foreign reserves of the European Central Bank in cooperation with Suomen Pankki.

Eesti Pank makes investments under the principle of conservatism, focusing on maintaining the assets and ensuring sufficient liquidity, while also giving attention to yield. The investment portfolio of Eesti Pank comprises the foreign currency portfolio and the euro portfolio, with the funds invested in international financial markets. The investment portfolio is mainly based on the liquid securities markets of leading industrial societies, with the risks stemming from the investments subjected to continual monitoring and management.

Eesti Pank had the following priorities in the management of foreign reserves in 2011:

- in-depth analysis of the structure of investments against the background of certain changes in the requirements for liquidity and sustainability of investments upon adoption of the euro;
- gradual diversification of investments in the upcoming years on the basis of the results of analyses and without significantly raising the risk level, pursuing a higher yield in the long term.

Further information on these matters is provided in the chapter “Implementing monetary policy in the euro area and Estonia”, and the Annual Accounts of Eesti Pank for 2011.

³ See also http://www.eestipank.info/pub/en/ylidine/pank/haldamine/ekp_reserv.html.

6. Preparing financial sector statistics and the Estonian balance of payments

To serve its primary functions, the Eurosystem needs detailed information on the euro area economy and its financial system. Similarly to all other areas, the quality requirements and deadlines for submission of statistics are decided jointly, while the NCBs retain responsibility for the daily collection and processing of statistical data and preparation of output statistics. Eesti Pank has been charged with the task of collecting financial sector statistics and preparing the balance of payments of the Republic of Estonia.

Eesti Pank's experience in the preparation of statistics and implementation of innovative technologies in the collection of statistical data is highly appreciated within the Eurosystem.

Eesti Pank had the following priorities in the field of statistics in 2011:

- preparing for the fulfilment of the data requirements arising from the accession to the monetary union;
- making the transition to the revised international standards on statistics in 2014;
- developing the user-friendly statistics column on the Eesti Pank's website.

Further information on these matters is provided in the chapter "Developments in statistics".

7. Supporting stable and sustainable economic development in Estonia, advising the government and cooperating with other central banks and international institutions

Eesti Pank has the important task of advising the government of the Republic in economy political issues. The government would not adopt major economy political decisions without hearing Eesti Pank.

Estonia's participation in the decision-making process within the euro area means that the economic policy is a matter of domestic policy, rather than foreign policy. Membership in the Eurosystem entails self-confident participation in discussions regarding pan-European matters. This requires active communication not merely within the Eurosystem, but also with other international organisations and the international media, where Eesti Pank represents both Estonia and the Eurosystem.

Eesti Pank had the following priorities in government advising and international cooperation in 2011:

- contributing to the process of counselling in economic analysis and economic policy in Estonia in connection with the membership with the Eurosystem and the updated European calendar;
- improving the organisation of work within Eesti Pank to efficiently participate in the work of and decision-making in the Eurosystem;
- participating in the EU institutions and the International Monetary Fund to provide solutions to the sovereign debt crisis in Europe as well as the global financial crisis;
- specifying, in the Estonian legislation, the financial obligations and representative's functions related to membership with the International Monetary Fund.

Further information on these matters is provided in the chapter "Cooperation".

8. Developing a cost-effective and sustainable organisation, and a competent and well-motivated staff to fulfil the tasks of the central bank

Eesti Pank had the following priorities in the area in 2011:

- continuing the systematic organisational development and conducting the regular study of management quality;
- ensuring the comparability of the bank's processes with the functional framework of the Eurosystem, and preparing to contribute to the cost comparison to be conducted within the Eurosystem;
- launching the renovated Eesti Pank Museum.

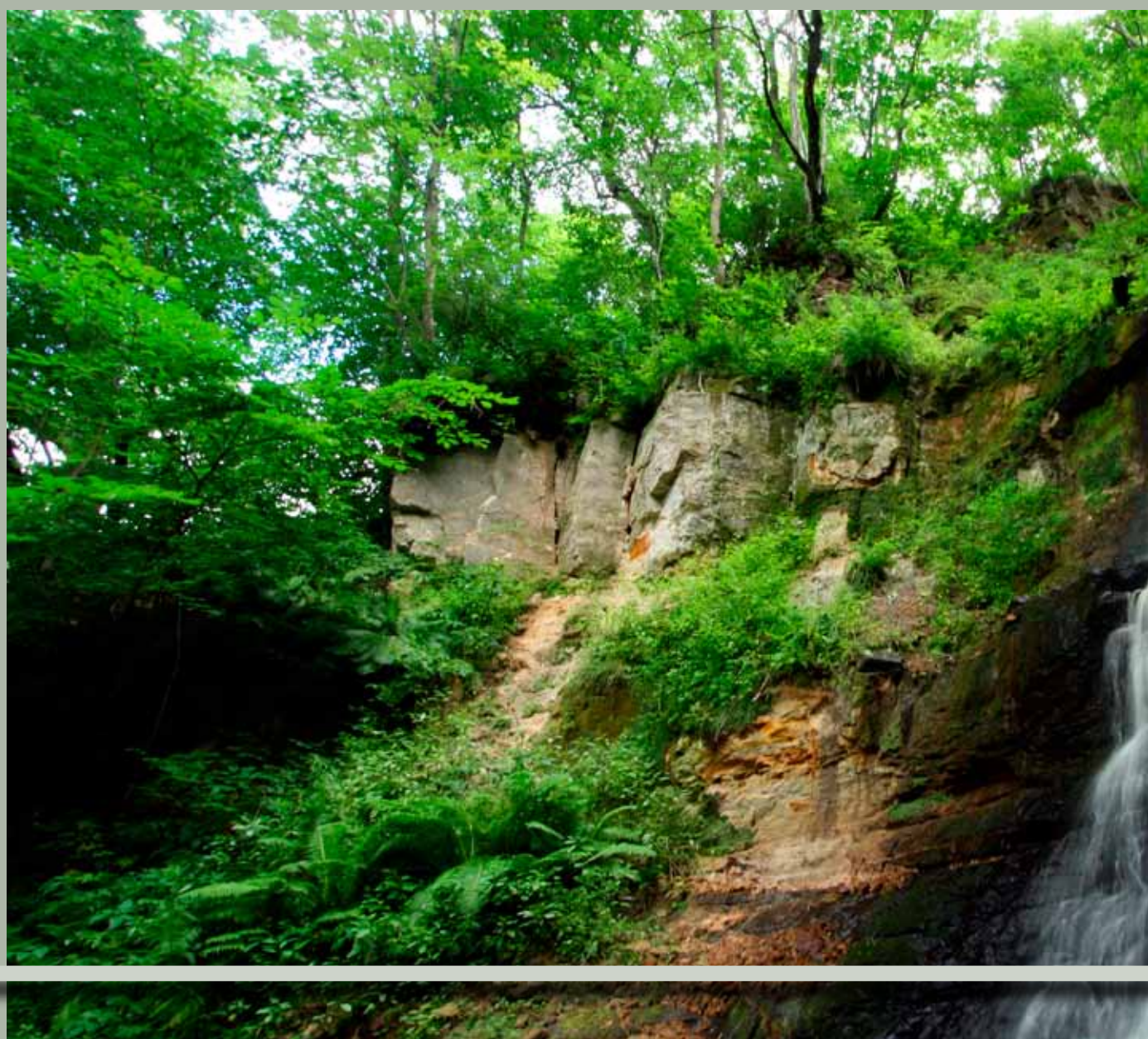
Further information on these matters is provided in the chapters "Governance, organisation and human resources policy" and "Cooperation".

Veiko Belials

2012

“Kivisilla, also known as Saka cascade”

Photograph taken in the framework of the year of forests photo project “There is life in the forest”.





THE EURO AREA AND ESTONIAN ECONOMY IN 2011

THE EURO AREA AND ESTONIAN ECONOMY IN 2011

GLOBAL ECONOMY¹

In 2011, the global economy continued to recover from the crisis of 2008-2009, but GDP grew slower than in 2010. Growth slowed down in the second quarter against the backdrop of a decrease in global demand. In the second half of the year, growth was hampered by the negative impact of the sovereign debt crisis on financial markets and confidence. Economic growth varied by countries: while advanced economies showed a GDP growth of 1.6%, the growth was four times faster in emerging economies, amounting to 6.2%.

The recovery of the global economy along with energy and food price hikes boosted inflation in many countries in the first half of 2011. The prices showed signs of stabilisation thereafter, exerting downward pressure on inflation. The change of pace was also reflected in the monetary policy of central banks. While several central banks tightened their monetary policy in the first half of 2011, quite a few advanced economies (e.g. Australia, Sweden, Norway) loosened their policy in the second half of the year by lowering key interest rates.

In 2011, global financial markets were affected by the deterioration of the euro area debt crisis, which lowered stock prices and boosted the demand for safe investments in the second half of the year. A general decrease was evident in the price of raw materials, the Commodity Research Bureau's index for 22 major raw materials dropped by 7% during the year. The price of crude oil increased by 14%. Fuelled by a strong demand, the price of gold increased by 10% to 1,564 US dollars per ounce. Money market interest rates retained a low level in advanced economies. The long-term interest rates of the USA and Germany were lowered, with the spread between the long-term interest rates of euro area peripheral countries (Greece, Italy, Spain, Portugal and Ireland) and those of Germany increasing significantly.

Even though the global economy stabilised somewhat at the end of 2011, GDP growth is forecasted to slow further in 2012.

Euro area

The beginning of 2011 was characterised by optimistic trends in the euro area economy, but the trends were reversed at the end of summer. Economy grew by 0.7% in the first quarter of the year, compared to the previous quarter, while the pace of growth dropped to 0.1% in the third quarter. Employment increased in the euro area at the beginning of the year, with unemployment remaining on par with the level achieved at the end of 2010, a stable 10%. The corporate financing conditions improved to some extent, except for SMEs. New loans were issued to households, with the annual growth stabilising at around 3%.

The deterioration of the sovereign debt crisis exacerbated the outlook for the euro area economy in the summer. Changes in the economic environment were manifested in a sudden decline in the confidence of consumers and enterprises. Being quite optimistic in the first half of the year, loss of

¹ Preliminary data: IMF, "World Economic Outlook Update", January 2012.

confidence forced enterprises to start postponing their investment and recruitment decisions in summer. This was accompanied by a drop in domestic demand, especially in countries facing sovereign debt challenges. The positive employment trends were reversed in the second half of the year, when unemployment started to rise again, reaching 10.4% in December.

In 2011, euro area economy grew by an estimated 1.6%, with Germany serving as the biggest contributor. Huge regional differences were evident in economic activity (see Figure 1).

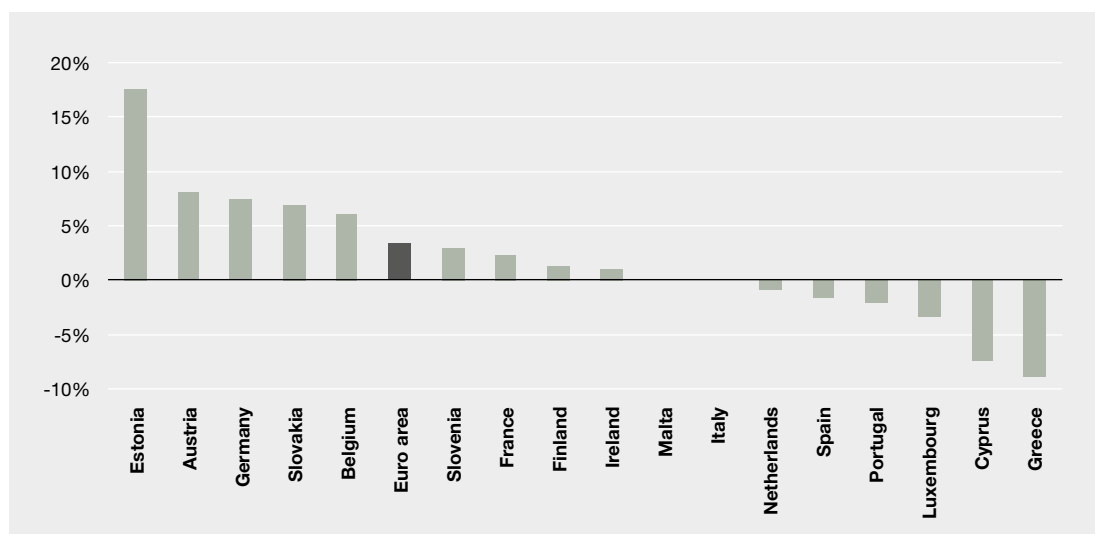


Figure 1. Industrial production growth in euro area countries in 2011

Raw material price hikes on the global market, along with signs of overheating in emerging economies, added to inflationary pressures in the first half of 2011. The Harmonized Consumer Price Index of the euro area remained above 2% throughout the year. The inflation was 2.8% in spring, and 3% for several months in autumn, when the impact of the price increase experienced in spring passed through to consumers. In December, inflation declined to 2.7%. The exchange rate against key currencies climbed in the first half of the year. Starting from October, the failure to provide a solution to the sovereign debt crisis negatively affected the exchange rate, exerting pressure on the entire European financial sector. At 1.48 USD per EUR in May, the exchange rate dropped to 1.29 USD at the end of the year.

The euro area sovereign debt crisis and counter-measures of governments

Indications of a stabilisation of the global financial markets were overturned by the outbreak of the sovereign debt crisis in certain euro area countries in the spring of 2010. Reasonable doubts regarding government solvency forced Ireland and Greece to request financial assistance from the European Union and the International Monetary Fund. Loss of confidence thwarted the functioning of monetary policy transmission mechanisms, forcing the European Central Bank to take extraordinary measures to improve the monetary policy operational framework.²

² The Covered Bond Purchase Programme was launched in 2009 and the Securities Market Programme in 2010.

At the same time, the governments of euro area countries and the European Commission made an effort to reorganise economic governance, with sights set on exiting the crisis and ensuring the stabilisation of the economic and monetary union in the long perspective.

The first stage of measures were implemented in 2010. In May, the Greek bail-out programme was developed and a decision was adopted to establish the European Financial Stability Facility (EFSF). The EFSF was to be a temporary facility to be replaced by the permanent European Stability Mechanism (ESM) later on.

A total of six legal acts (the so-called six-pack) were established to revise the EU economic and fiscal policy governance framework in order to improve the implementation of the Stability and Growth Pact. In addition, minimum requirements for national fiscal policy frameworks were established. Furthermore, it was decided to address the issue of imbalances on a scale larger than merely in public finance: in internal economy with regard to price growth and developments in the real estate and credit markets, as well as in external balance issues, such as current account deficits/surpluses and net foreign investment positions. In order to enhance analysis of the relations between the financial sector and real economy and to prevent potential vulnerabilities, the European Systemic Risk Board (ESRB) was set up with the European Central Bank at the end of 2010.

However, the sovereign debt crisis deepened at the beginning of 2011. The increased risk of contagion triggered the second stage of implementation of the stability measures. The process was initiated at the summits of March and July, where heads of state and government resolved to: (a) support the unconditional and efficient implementation of the six-pack;³ b) expand, through financial leverage, the EFSF and the ESM, which was to be launched earlier than planned (in July 2012), and enhance their flexibility through the adoption of new instruments; (c) establish additional requirements to reinforce the capital base of banks by the summer of 2012.

Unfortunately, these measures failed to instil confidence in market participants. Similarly, the functioning of the monetary policy transmission mechanisms was still hindered. The Eurosystem central banks thus started to buy up government bonds on the secondary market, and to further develop the set of extraordinary measures⁴. The heads of state and government of euro area countries also expressed their willingness to further develop the operational framework for economic governance. To this end, they resolved to conclude an agreement which obliged Member States to establish the rule of a balanced combined budget in their national law, reduce excessive government debt, and develop a mechanism which would automatically adjust any deviation of public finance from the country specific medium-term objectives. At the end of the year, the European Commission, in turn, initiated two legal acts (the so-called two-pack), designed to tighten the requirements for the fiscal policy of euro area countries, improve the monitoring of problematic countries, and enhance the efficiency of the management of excessive budget deficit.

³ Currently fully operating.

⁴ Additional information on the Eurosystem measures has been disclosed in the chapters "Participating in the formulation of monetary and economic policy" and "Implementing monetary policy decisions in the euro area and Estonia".

ESTONIA'S ECONOMY

Non-financial sector

In 2011, the Estonian economy was characterised, on the one hand, by a quick recovery in the first half of the year, and, on the other hand, deceleration of growth due to increased uncertainties regarding the external environment in the second half of the year. Growth was primarily driven by the exporting manufacturing sector, where the value added exceeded the pre-crisis level. According to preliminary estimates, annual GDP growth amounted to 7.6% in Estonia. The current account remained in surplus, as the quick recovery of economy was export-led and the increase in domestic demand was much more balanced compared to the previous periods of growth.

The recovery boosted employment and reduced unemployment. In the middle of the year, the employment rate reached the level of the pre-boom year of 2005. Nonetheless, unemployment remained at 10%. This can be attributed to the increased participation rate in recent years. The general recovery of the economy also raised wages. Despite the increase in consumption, households succeeded in reducing the loan burden accumulated in the boom-time years, as well as making deposits.

In 2011, consumer prices increased rapidly at 5.1%. This can mainly be attributed to price changes in the external environment, and partly to the recovery of economic growth. Still, the increase in food prices slowed down markedly in the second half-year. The sudden increase in the price of energy passed through also to 2012. The core inflation was 2.4%, which was more in line with the economic cycle.

Inflationary effects of the adoption of the euro in Estonia

Estonia adopted the euro on 1 January 2011. Consumer prices grew by 5.3% from January 2010, yet remained unchanged from December 2010. This was partly conditioned by the decrease in prices for electricity and gas.

Like in other countries that had introduced the euro, also Estonia faced the question whether and to what extent the euro contributed to inflationary pressures. In order to analyse the impact of the euro, Eesti Pank conducted a study of the CPI sub-indices to discover unusual price movements from December 2010 to March 2011. A similar methodology had been used by Eurostat to assess the impact of the adoption of the euro in Estonia, and by the Institute for Economic Research in Slovenia. The study excluded from the calculations the prices of food, fuel and transport services, since these were affected by the hike in commodity prices and administered prices. Larger than usual increases were found mainly for various services and for goods and services related to spending leisure time.

The study revealed that the total contribution of the stronger-than-usual growth to inflation over the four months under review was 0.3%, which broadly coincides with Eurostat's assessment of 0.2–0.3%.⁵

⁵ See http://epp.eurostat.ec.europa.eu/portal/page/portal/hicp/documents_pub/TTNR_EURO_CHANGE_OVER_INFLATION_ESTONIA_2011_05.pdf.

The government continued with its prudent fiscal policy of previous periods. In order to rebuild the diminishing reserves and restore the budget surplus, the increase in general government expenditure was kept below the rise in tax revenues. The government also cancelled some of its extraordinary measures taken during the crisis. For instance, it restored payments to the second pension pillar to the extent of 50% and drew fewer dividends from state-owned enterprises. Based on preliminary estimates, the budget surplus was 0.7% of GDP, supported by the growth in tax revenues and proceeds from the trade of emission quotas.

Financial sector

Loan repayments exceeded new loans also in 2011. The loan portfolio contracted by 4.3%, despite the one-fifth increase in new lending to companies and households due to the recovering economic activity. The accommodative monetary policy of central banks kept the loan interest rates at a very low level, with the interest margins also dropping significantly. Companies started to engage short-term loans to finance growing business volumes. The turnover of long-term loans used for financing investment showed a more modest growth. Households increased borrowing for purchasing real estate above all.

Unlike the loan stock, the volume of deposits grew significantly in 2011. The volume of household and corporate deposits grew by 6.6%, year-on-year. The growth in deposits allowed banks to repay the funds taken from parent banks (see Figure 2).

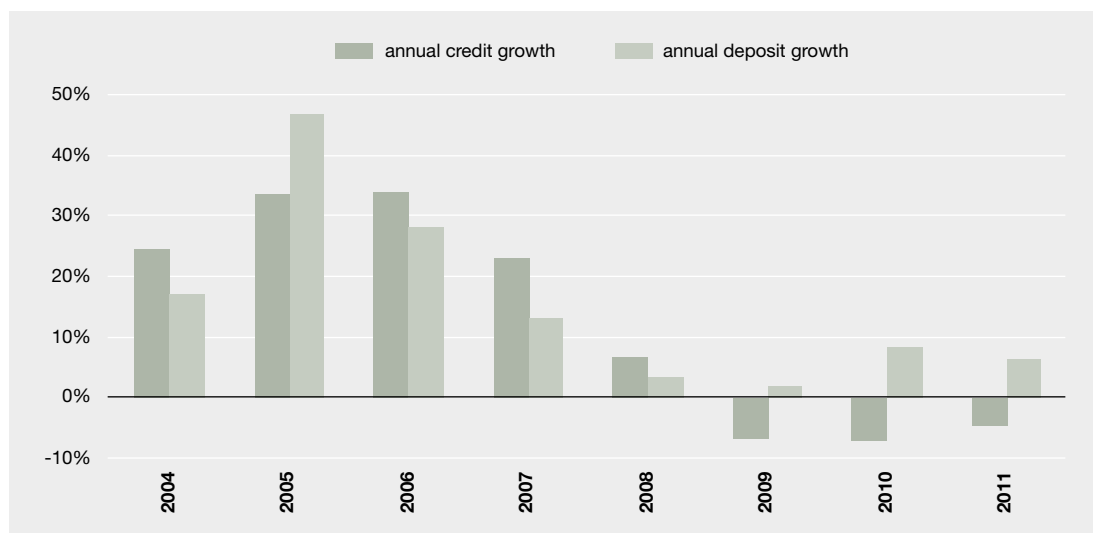


Figure 2. Estonian non-financial sector's loans and deposits

The improvement in the financial position of the private sector enhanced the quality of the banks' loan portfolio. The share of loans overdue by more than 60 days in the outstanding loan stock dropped from 6.5% at the end of 2010 to 4.8% at the end of 2011.

In 2011, the banking sector posted a net profit of 663 million euros, with non-recurring income contributing nearly a half to it (see Figure 3). The ROA of the banking sector without the non-recurring

income⁶ was 1.7% – a level comparable to 2002–2006. The revenue of the banking sector was supported by the drop in interest expenses. Furthermore, banks had no need to make additional provisions for contingent loan losses. The (retained) earnings serve to ensure that banks have sufficient capital for covering loan losses and other risks. The biannual stress tests carried out in 2011 reveal strong capitalisation of the banking sector, and a sufficient capital buffer to absorb contingent risks even in case of economic scenarios much worse than those forecasted.

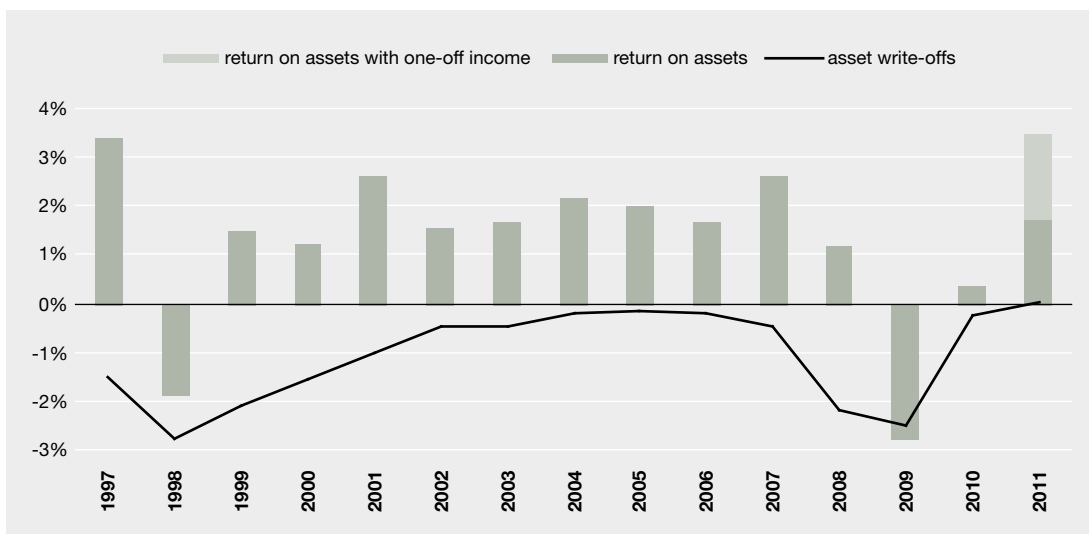
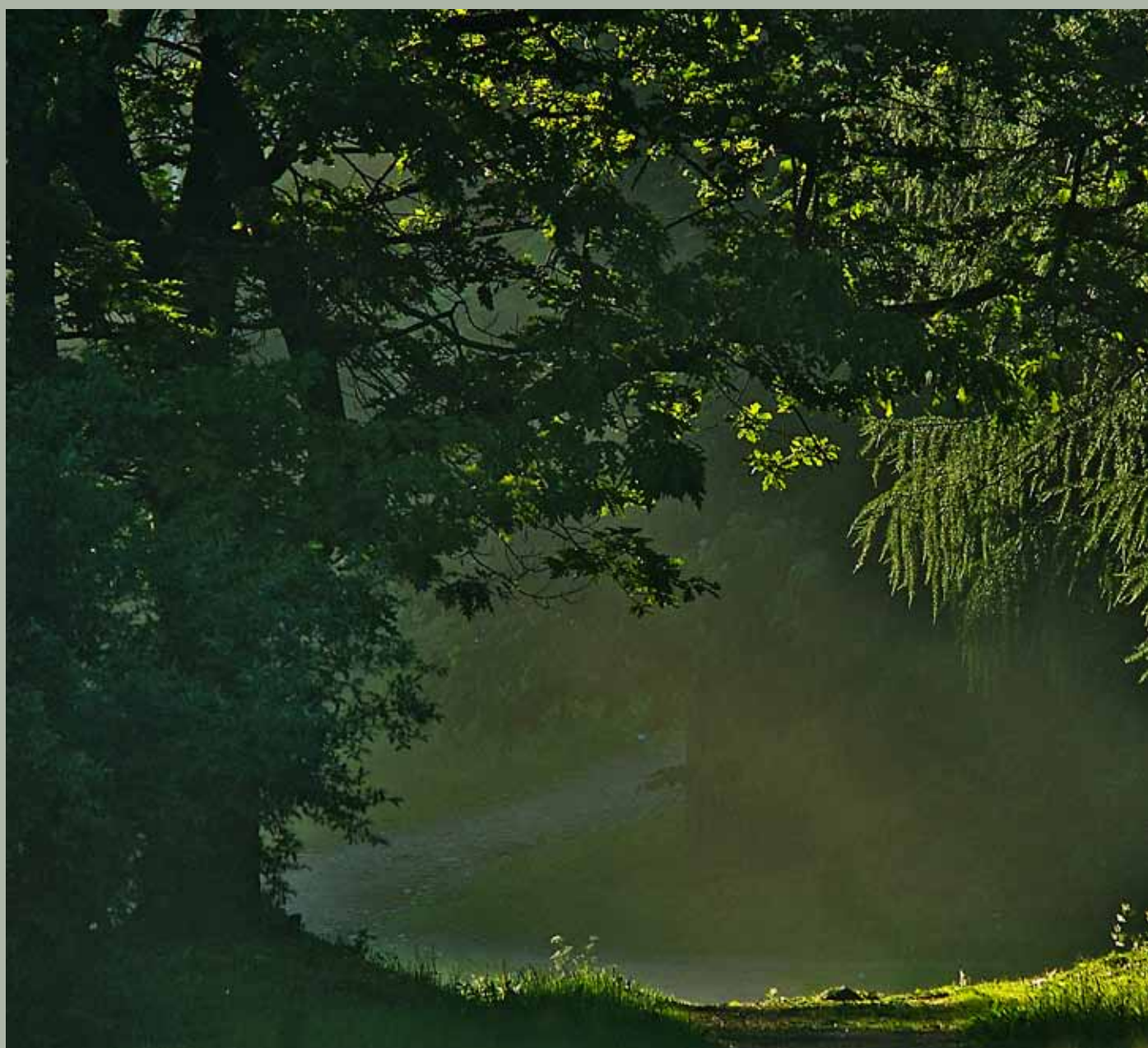


Figure 3. Profitability of the Estonian banking sector

⁶ The exceptional revenue posted from a structural change in a banking group has been deducted from the net profit. With exceptional revenue included, the ROA of the banking sector was 3.5% in 2011.

Eha Roosalu
2009
"Mysterious"





TASKS AND ACHIEVEMENTS OF EESTI PANK IN 2011

PARTICIPATING IN THE FORMULATION OF MONETARY AND ECONOMIC POLICY

Monetary policy decisions

At the beginning of 2011, Estonia became a member of the euro area. In addition to maintaining price stability in Estonia, Eesti Pank was thus charged with the task of maintaining price stability in the entire euro area. In line with the Treaty on the Functioning of the European Union, Eesti Pank also supports the achievement of other economic policy objectives.

Responsibility for implementation of the single monetary policy in the euro area lies with the Eurosystem, which comprises the euro area central banks and the Frankfurt-based European Central Bank (ECB). The adoption of monetary policy decisions is the task of the Governing Council of the ECB, set up of the governors of Eurosystem central banks and members of the Executive Board of the ECB.

The primary objective of the Eurosystem monetary policy is to maintain price stability in the euro area, as established with Article 127 (1) of the Treaty on the Functioning of the European Union. The Governing Council of the European Central Bank has defined price stability as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below but close to 2% over the medium term.

Overall, the monetary policy interest rates in the euro area remained low in 2011, despite the Governing Council's decision to raise the key policy rate in the first half of the year, after a breather of more than 12 months. This was done twice: the interest rate for main refinancing operations was raised from 1.00% to 1.25% in April, and from 1.25% to 1.50% in July. The interest rates for the lending and deposit facilities were raised in the same extent. The interest rate advancement was caused by the quicker-than-expected price increase in the euro area in the first half of the year. At its sessions in November and December, the Governing Council resolved to lower the interest rate by 25 basis points, as uncertainties on the financial markets, fuelled by the sovereign debt crisis, had significantly

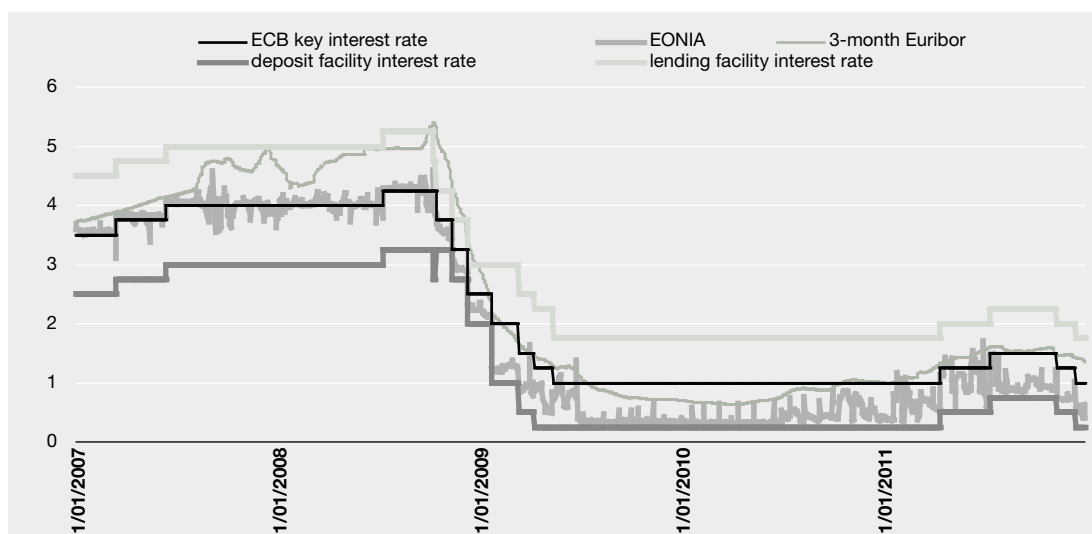


Figure 4. ECB key monetary policy interest rates and EONIA

undermined the growth outlook for both the euro area and the global economy. Moreover, the slow-down in economic growth, induced by general uncertainty, led to weakening inflationary pressures. At the end of the year, the key interest rate of the ECB stood at 1.00%. The interest rate has never been lower in the history of the single currency (see Figure 4).

In order to provide the euro area banks with a sufficient liquidity buffer and enhance the efficiency of the functioning of monetary policy transmission mechanisms, the Eurosystem expanded the set of extraordinary monetary policy measures. In 2011, the Eurosystem offered unlimited liquidity to banks at a fixed interest rate¹ in both main refinancing operations and longer-term refinancing operations². In addition, it was decided in autumn to resume longer-term refinancing operations³ as well as to launch the second, 40-billion-euro Covered Bond Purchase Programme⁴. The Eurosystem also promised to continue the provision of unlimited liquidity to euro area banks at least until 10 July 2012. Furthermore, the Eurosystem continued to perform purchases under the Securities Markets Programme, which aims at intervening, through purchases, in the sovereign bond market, where monetary policy transmission mechanisms have been dysfunctional due to the debt crisis. To enhance the banks' access to the Eurosystem liquidity operations, the threshold for collaterals eligible in monetary policy operations was lowered, and the minimum reserve ratio⁵ reduced from 2% to 1%. To support money market activity, the fine-tuning reverse operations carried out at the end of the required reserves maintenance period⁶ were cancelled. All extraordinary monetary policy measures that have been adopted due to tensions brewing on the financial markets are of temporary nature.

Changes in the key interest rate, along with market expectations of future interest rate levels, have also translated into money market interest rates. This is reflected in the development of the 3-month Euribor. Following the rise in the key interest rate in April, the 3-month Euribor also started to increase: from 1.25% in April to 1.61% at the beginning of August, by a total of 33 basis points. With the deterioration of the sovereign debt crisis in the euro area at the beginning of August, the Euribor started to decline. After the key interest rate was lowered in November and December, the 3-month Euribor dropped to 1.35% by the end of December.

The supply of broad money in the euro area increased at the beginning of 2011, alongside the relatively stable and moderate growth of the euro area economy, rising to 2.9% by August – the quickest growth after the middle of 2009. Towards the end of the year, the annual growth of M3⁷ slowed down,

¹ An interest rate which equals to the bid rate on the main refinancing operations.

² With a maturity of three months.

³ With a maturity of 6, 12, 13 and 36 months.

⁴ Covered bonds are debt securities issued by financial institutions or fully covered by a financial institution's collateral. The text refers to the second Covered Bond Purchase Programme (CBPP2). The first Covered Bond Purchase Programme (for a nominal value of 60 billion euros) was implemented from July 2009 to June 2010.

⁵ Credit institutions established in the euro area are required to hold deposits on accounts with their national central banks. These are called "minimum" or "required" reserves.

⁶ The term of the minimum reserve maintenance period is approximately one month, with the schedule depending on the sessions of the Governing Council. The indicative calendar has also been published on the ECB webpage at <http://www.ecb.int/press/pr/date/2011/html/pr110520.en.html>.

⁷ M3 – broad monetary aggregate, which comprises M2 and marketable instruments, in particular repurchase agreements, money market fund shares/units and bonds issued by monetary financial institutions with a term of up to two years.

amounting to a mere 1.5% in December, with the three-month average being 2.1%. Thus, the risks posed by the increase in money supply to price stability remain low.

Monitoring

The adoption of the euro changed both the scope and procedure for conducting monitoring in Eesti Pank. The focus previously lay on trade partners and target markets. Membership in the euro area and participation in the Eurosystem monetary policy decision-making process added to the significance of monitoring the economy of the entire euro area. Every month, the central bank prepares an economic analysis of the euro area, which will then be used for briefing the Governor of Eesti Pank prior to his participation in interest decision making at the Governing Council of the European Central Bank.

The implementation of the Eurosystem's single monetary policy is supported by the Monetary Policy Committee. The Head of the Economics and Research Department is a member of the Monetary Policy Committee on behalf of Eesti Pank. The committee also comprises representatives of central banks who have not adopted the euro. The other key task of the committee is thus to coordinate the monetary policy of the Eurosystem and other central banks of the European Union. The committee also coordinates preparation of the euro area macro forecasts, and public finance projections. Working groups on forecasts and public finance have been set up for that. The experts with the Economics and Research Department participate in these working groups on behalf of Eesti Pank.

Participation in the working groups requires continual monitoring and analysis of the Estonian economy. The results of the analysis are prepared as bimonthly reports. Where necessary, in-depth analyses are conducted for the purpose of preparing assessments of the economic situation in a particular area. The Estonian economy strongly depends on exports. For the most part, the analyses thus revolve around competition issues.

Monitoring was also affected by the sovereign debt crisis in the euro area in 2011. As the crisis deteriorated and the risk of spillover increased, additional monitoring and analysis was launched on the economy and financial markets of crisis-stricken or endangered member states in the spring of 2011. Such weekly assessments have occasionally been prepared ever since the autumn of 2008.

The results of monitoring conducted by Eesti Pank are published via the bank's press releases and public comments. These consist of regular releases involving key economic indicators, including the financial sector and foreign sector statistics, and releases dedicated to current economic policy issues.⁸

Economic forecasts

Forecasts for the Estonian economy must answer the question of how the global situation and economic policy of other nations will affect the near future in Estonia, and whether or not market participants take into account the developments of the Eurosystem and place importance on the principle

⁸ Similarly to previous periods, the central bank prepared an assessment of the financial sector on a semi-annual basis also in 2011. Further information is available in the chapter "Safeguarding financial stability".

of long-term sustainability. As a member of the euro area, Eesti Pank started to participate in the preparation of the biannual Eurosystem staff projections used for ascertaining the risks to price stability and preparing assessments of the economic development. For the macro forecasts of Eesti Pank, this meant the adoption of the same forecast inputs used by other Eurosystem central banks, a prolonged preparation process and adherence to the Eurosystem's common rules of publication. The forecast still covers the current year and the two years following.

The bank's spring forecast was published in June, and autumn forecast at the beginning of December. The forecasts comprised both the baseline scenario and the risk scenario considered by experts to be the most credible. The spring forecast touched upon the risk of wage pressures while the autumn forecast analysed the risk of a sharper and longer-than-expected drop in external demand. In addition, the spring forecast included background information on and factors contributing to price movements on the Estonian food market.

The preparation of the forecast was based on the quarterly macro-economic model and expert assessments. In the macro model, long-term growth stems from supply-based factors, while short-term fluctuations, due to the slow adjustment of prices, are driven by demand. Overall, the macro model used by Eesti Pank follows the logic of the structural blocks of member states in the European System of Central Banks Multi-Country Model, taking into account the specifics of Estonia as a very small and open economy on the path of EU convergence. Expert assessments are a part of the preparation of the forecast.

Even though the preparation of the economic forecast was incorporated in the Eurosystem's single forecast system, the bank retained its ability and readiness for preparing independent additional forecasts, should the results of monitoring require that. The preparation of any additional forecasts was not considered necessary in 2011.

Advising the government

Economic forecasts together with monitoring provide Eesti Pank with the background information required for advising the government. The economic development and key problems of economic policy are discussed in the quarterly meetings with the Ministry of Finance and the Ministry of Economic Affairs and Communications. The Prime Minister's Office and the Office of the President of the Republic are also represented at these meetings. In addition, the bank's experts participate in the European Union Coordination Council which gathers on a weekly basis in the State Chancellery. Eesti Pank's experts mainly contribute to the preparation of the meetings of the EU ministers of finance (ECOFIN) and heads of government (European Council).⁹

Consultations on fiscal policy have also become a norm. In the spring forecast cycle, the consultations and discussions mainly revolve around the budget strategy and stability programme. In autumn, the next year's budget is discussed. Key subjects in 2011 included further development of the national fiscal policy framework.

⁹ Further information on cooperation in financial stability is provided in the chapter "Safeguarding financial stability".

From the point of view of sustainability of public finance, Eesti Pank has always emphasised the need to further efforts towards reducing budget deficit and enhancing the efficiency of the general government. The state budget strategy prepared in the spring of 2010 stems from the same basic idea, with the consolidated budget scheduled to generate a surplus at the latest in 2013. Eesti Pank considers the established objective to be quite reasonable. While government expenditure decreased against massive cut-backs in 2009-2010, a moderate increase in expenditure could be seen in 2011. The consolidated budget objective was based on the assumption that the increase in expenditure would be much slower than the increase in tax revenue in 2011 and the subsequent periods. In the first half of the year, the objective seemed relatively easy to achieve.

The end of the summer saw a significant increase in the probability of the pessimistic scenarios for the global economy to realise. The debate over the state budget for 2012 thus had to consider the deteriorating outlook. Eesti Pank stressed in its statements that growing uncertainty calls for especially strict requirements for the Estonian fiscal policy, and pointed out the difficulties in forecasting economic growth and tax revenues in the upcoming periods.

The draft state budget prepared by the government for 2012 was based on the assumption that government expenditure would increase by a little over 5% (without considering the one-off impact of emissions trading). Eesti Pank reckoned that the figure fell short of Estonia's ability to grow and boost tax revenue in the medium perspective, but still jeopardized the strategic objective of eliminating the budget deficit by 2013. The upswing in government spending would have fuelled unreasonable expectations. The structural budget balance – the budget position indicator without considering the impact of the economic cycle as well as extraordinary revenue and expenditure – would still have shown a surplus, but the fiscal policy would have been relaxed to some extent. Eesti Pank thus advised, in the discussions with the government and the Finance Committee of the Riigikogu, to build the state budget for 2012 on the Ministry of Finance's risk scenario, while continuing to pursue the goal of eliminating the budget deficit. At the same time, the central bank called attention to the need to refrain from excessive volatility of government expenditure, and ensure the availability of sufficient reserves.

Economic research

Eesti Pank's economic research projects are based on the strategic research plan. A total of ten research projects were completed in 2011,¹⁰ addressing the financial crisis and fiscal policy in the European Union, the impact of the volatility of economic growth on long-term growth, the loan stock and loan turnover of Estonian banks and factors influencing the bank interest spread, price and wage setting of companies, and labour mobility in Estonia. Eesti Pank continued the improvement of the credit risk and profitability model of the banking sector, development of the dynamic stochastic general equilibrium model of Estonia and the euro area, as well as the macro model of the Estonian economy.

In addition to the publications in the Working Paper Series of Eesti Pank, the research results were also introduced abroad: at international conferences and in academic publications (*Journal of Comparative Economics*, *Eastern European Economics*, *Baltic Journal of Economics*, etc.).

¹⁰ See the list of working papers in the annex "Publications of Eesti Pank in 2011".

Cooperation on the international and domestic level continued in 2011. 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 Macroprudential Research Network. Within the framework of the Doctoral School in Economics and Innovation, Eesti Pank participated in the 14th summer school organised for doctoral students in July 2011, and contributed to the preparation for the international conference "Economies of Central and Eastern Europe: Convergence, Opportunities and Challenges 2011", organised under the leadership of the Tallinn University of Technology.

There were eleven public presentations of economic research projects in 2011, featuring guest lecturers from Estonia or beyond on nine occasions, and the authors of the bank's own research on two occasions. Shang Jin-Wei of Columbia University gave an overview of the forces behind Chinese economic development, Istvan Konya, a colleague from the Magyar Nemzeti Bank, presented a monetary policy research on interest premiums and adjustment in a small open economy, and Christian Schumacher, economist at the Deutsche Bundesbank, introduced the results of the Bundesbank's research programme on nowcasting and forecasting methods for German GDP. The annual Ragnar Nurkse Memorial Lecture Series, dedicated to the internationally renowned Estonian-descended international economist and policy maker Professor Ragnar Nurkse, continued in 2011 with a lecture by Axel A. Weber, President of Deutsche Bundesbank.

Eesti Pank's visiting researcher programme continues to play an important role in cooperation on research. In 2011, two visiting researchers (one from Estonia and the other from Sweden) participated in the economic research projects. Eesti Pank also continued the tradition presenting the young economist research award dedicated to Urmas Sepp. This time, the award was given to Indrek Saar, doctoral student of the Faculty of Economics and Business Administration at the University of Tartu, for his research "Optimal alcohol taxation: simulation results for Estonia".

Andres Ello

2012

“Summer morning in Kakerdaja bog”





IMPLEMENTING MONETARY POLICY DECISIONS IN THE EURO AREA AND ESTONIA

Foundations of the framework for the implementation of the Eurosystem monetary policy

The monetary policy interest rate decisions of the Governing Council of the European Central Bank are translated into market interest rates via the framework for implementation of monetary policy (see Table 1). The basic elements of the framework include open market operations, marginal lending and deposit facilities and the minimum reserve requirement. In the conditions of the financial crisis and the European sovereign debt crisis, substantial changes had to be made in the standard framework to ensure sufficient financing for fulfilling the price stability objective.

Table 1. Framework for monetary policy implementation

Open market operations	Standing facilities
Main refinancing operations	Standing deposit facility
Long-term refinancing operations	Standing lending facility
Fine-tuning operations	
Structural operations	Reserve requirement

The Eurosystem is the monopoly supplier of the monetary base.¹¹ Therefore, the conditions under which the Eurosystem lends money and provides deposit facilities to banks has a direct impact on short-term market interest rates. Among other things, banks need central bank financing to meet the cash demand and to fulfil the minimum reserve requirement. The Eurosystem provides funding through main refinancing operations, which are conducted on a decentralised basis¹², against eligible collateral. The monetary policy stance is reflected by the lowest bid rate interest for main refinancing operations¹³. Main refinancing operations are auctions with a term of one week. The Eurosystem also conducts longer-term refinancing operations. Fine-tuning operations allow to boost or reduce liquidity in the financial sector, as necessary. Structural operations are used for adjusting the liquidity of the entire financial sector with respect to the Eurosystem. During the crisis, the Eurosystem also provided liquidity in foreign currencies and conducted purchase programmes.

In addition to the rate on the main refinancing operations, there are interest rates on the deposit and marginal lending facilities. The deposit facility provides the option of making an overnight deposit, and the marginal lending facility the option of taking an overnight loan against eligible collateral. The interest rates of standing facilities establish the scope of fluctuations in the short-term unsecured

¹¹ Monopoly supplier of monetary base means that the Eurosystem is the sole issuer of banknotes and bank reserves in the euro area. This makes it the monopoly supplier of the monetary base, which consists of: (1) currency (banknotes and coins) in circulation; (2) the reserves held by counterparties with the Eurosystem, and (3) recourse by credit institutions to the Eurosystem's deposit facility.

¹² Principle of decentralised implementation – the required reserve limit and the volume of regular refinancing operations, i.e. the total amount of short-term loans granted to credit institutions in the Eurosystem, are determined by the Eurosystem, but monetary policy transactions are intermediated by national central banks.

¹³ Signalling the monetary policy stance – changing the conditions under which the central bank is willing to enter into transactions with credit institutions.

money market interest rates. The Governing Council of the European Central Bank establishes the key interest rates for a period of approximately one month. During this period, the banks are obliged to adhere to the minimum reserve requirement, maintaining on the current account with the national central bank a balance which, on average, complies with the established requirements. The purpose of adherence to the minimum reserve requirements on average is to minimise the money market fluctuations.

The Eurosystem's monetary policy operations in 2011

The European Central Bank has taken additional measures to prevent market disturbances from hindering the functioning of the monetary policy transmission mechanism. The ECB thus continued to serve the bids of all interested parties in the refinancing operations with the interest rate for main refinancing operations (full allotment and fixed interest rate policy), extended the term of the operations, offered financing options in foreign currency, lowered the minimum reserve requirement and arranged purchase programmes. The full allotment and fixed interest rate policy was first implemented in October 2008, and will be continued until July 2012.

No major changes were introduced in the conditions of the refinancing operations in the first half of 2011. In addition to regular main refinancing operations and the monthly longer-term refinancing operations with a term of three months, the Eurosystem also arranged for additional operations, conducted as maintenance period auctions with a maturity of one month. The total volume of Eurosystem's refinancing operations amounted to 400–500 billion euros. In the second half of 2011, the Governing Council re-introduced the six-month (in August) and 12-month (in October) operations. In December, three-year operations were announced, with the first operation conducted on 21 December in the amount of 489 billion euros – the greatest operation ever performed by the Eurosystem. The total volume of open market operations reached nearly 900 billion euros. The fixed interest of all operations with a term longer than one maintenance period was the average rate for main refinancing operations. In December, the minimum reserve requirement was lowered from 2% to 1% of the reserve base.

The financing options provided by the Eurosystem were widely used. Banks deposited a bulk of their borrowings in the central bank's deposit facility. The average value of the deposits amounted to 30 billion euros in the first half of the year, but increased gradually to nearly 200 billion euros in the second half of the year, peaking at 400 billion euros after the end of the three-year operation. The marginal lending facility was also widely used at times.

Weekly fixed-rate full allotment dollar auctions with a term of one week were conducted throughout the year. Monthly operations with a term of three months were re-introduced in September. The term of the currency swap with the Federal Reserve is February 2013. Where the price of currency risk hedging was reduced, participation in the transactions increased from a few billion dollars to major amounts. At the end of 2011, the balance of dollar loans taken from the Eurosystem amounted to 85 billion dollars.

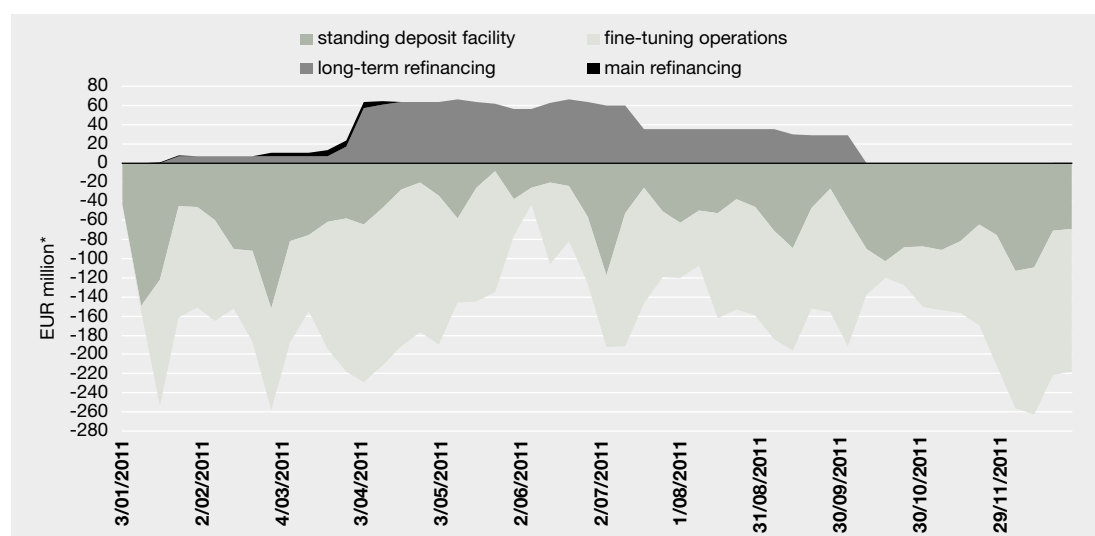
The Eurosystem also continued the Securities Market Programme with the aim of ensuring the functioning and liquidity of the sovereign bond markets. Prior to autumn, the volume of bonds purchased

within the framework of the programme was insignificant. By August, however, the sovereign debt crisis had deteriorated to an extent, where active purchase of securities was announced within the framework of the programme. Thus, the volume of the programme grew significantly: from 75 billion euros at the beginning of the year to 211.5 billion euros at the end of the year. The impact of these interventions on liquidity was regulated via the auction of one-week deposits with a floating interest rate. A new Covered Bond Purchase Programme (CBPP2) was launched in October in the amount of 40 billion euros. The programme is scheduled to end in October 2012.

Eesti Pank's monetary policy operations

The year 2011 was Eesti Pank's first year in the new operational framework, using the euro area monetary policy instruments. The monetary policy loan option offered by the Eurosystem did not prove to be very popular in 2011. This was mainly due to the banking groups' centralised liquidity management and the local banks' sufficient liquidity buffers. The local banks are thus not very dependent on liquidity offered by the central bank. Neither were the banks operating in Estonia affected by the euro area debt crisis. The financial position of local banks was further strengthened by Estonia's rapid economic growth.

Open market operations played a key role among the euro area monetary policy instruments, with the banks operating in Estonia participating in weekly main refinancing operations a total of six times. Participation was more active at the beginning of the year, when the need for liquidity was greater and the banks were eager to try out the new instrument. A total of 27 longer-term refinancing operations were made, including an auction with a term of three years, held at the end of the year. The longer-term operations proved more popular than auctions with a term of one week: a total of nine transactions were made. The deposit facilities offered on a weekly basis via fine-tuning operations were used on nearly all occasions. The banks were more successful at the beginning and at the end of the year, with the deposit volumes rising to a total of 160 million euros (see Figure 5).



* Positive values show adding of liquidity, while negative values indicate absorbing of liquidity.

Figure 5. Monetary policy operations of Eesti Pank in 2011

In 2011, the Eurosystem boosted liquidity on the markets via refinancing operations as well as purchase of securities and bonds within the framework of the SMP and CBPP2 programmes. Eesti Pank participated in these programmes too. The liquidity added by the SMP was absorbed by fine-tuning operations. The liquidity increase on the euro area money market (especially evident in the second half of the year) was also reflected in the drop of the interbank overnight deposit interest rate to the level of the central bank's standing deposit facility interest rate. Similarly, the average monthly overnight deposit volume at the end of the year was twice as high as in the summer months, amounting to approximately 80 million euros. This reflected the tensions brewing on the interbank money market, with the banks preferring the financing options provided by the central bank to trading with other market participants. One of the transaction partners of Eesti Pank became insolvent in 2011. Even though the collateral to the transactions conducted by that partner had to be realised, no damage was caused to Eesti Pank or the Eurosystem. To enhance risk appetite, the requirements established for collateral to monetary policy loans were eased, and the minimum reserve requirement was lowered to 1%. Additional funds were thus released to banks operating in Estonia.

Reserve management

The foreign exchange reserves of Eesti Pank backed the Estonian kroon until the end of 2010, ensuring the stability of the kroon. With the changeover to the euro, a bulk of the foreign reserves was transformed into a securities portfolio denominated in domestic currency (the euro). The investment targets changed alongside changes in the monetary policy framework. The main purpose of the reserves shifted to supporting the credibility of the euro area monetary system and ensuring the financial independence of the central bank.

The structure of investment assets

In 2011, the investment assets of Eesti Pank were divided between the money market portfolio and the securities portfolio. A small part of the portfolio consisted of gold.

So far, the objective of investing was to achieve an optimum return within the pre-determined restrictions throughout the global economic cycle. The investment portfolio was primarily invested in liquid bond markets of leading industrial countries, while continually monitoring and managing the interest, credit, currency and liquidity risks accompanying the investments. A detailed description of the investment process and investment risks is provided on Eesti Pank's website.¹⁴

The changeover to the euro, which entailed the abolishment of the currency board system, allowed to loosen the previous requirements for liquidity and sustainability of investment assets. This allowed to invest in longer-term bonds and engage more volatile, but presumably more profitable assets. Indeed, great attention was paid in 2011 on the analysis of the potential changes in the structure of Eesti Pank's investment assets. The possibility of engaging sovereign bonds of newly established countries as well as asset classes were considered, among other things. On the basis of the analysis conducted, future investments will gradually be diversified, adding new markets and asset classes.

¹⁴ <http://www.eestipank.info/pub/en/yldine/pank/haldamine/invest.html?ok=1>

Still, the year 2011 saw some changes in the structure of Eesti Pank's investment assets. Against the significant drop in the return on short-term bonds of countries with a low credit risk, the portion of money market instruments was significantly reduced in the investment assets of Eesti Pank in 2011. The investment assets thus decreased, boosting the claims within the Eurosystem in Eesti Pank's balance sheet (see Table 2).

Table 2. Eesti Pank's investment assets

		2010	2011
Bonds	EUR	7.7%	49.8%
	USD	2.5%	21.4%
Money market instruments	EUR	89.9%	25.9%
	USD	0.4%	3.1%
Other		-0.6%	-0.2%
Invested reserve assets (EUR m)		1,677	270

The investment process

Eesti Pank manages the investment risks through the benchmark portfolio. This is a theoretical portfolio that is used to determine the average risk level the bank is willing to accept, and to measure performance in reserve management. Financial assets are included in the benchmark portfolio by analysis of the preservation of the financial asset at annual intervals: there must be a probability of 95% that the value of the asset has remained the same or has slightly increased in order for the requirement to maintain the assets to be fulfilled. The benchmark portfolio of Eesti Pank does not include the 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. 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, i.e. government bonds with a maturity of more than one year.

In addition to earning on the relatively stable benchmark portfolio, or passive investment, Eesti Pank is also engaged in active investments, taking positions in global financial markets. Such investment decisions are made 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. Investments are made on several markets, utilising different financial instruments and taking positions of different durations. 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 experience of portfolio managers. The model-based approach draws 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 2011, Eesti Pank used the services of four external asset managers. PIMCO has been investing Eesti Pank's assets since 2005, BlackRock since 2006 and Informed Portfolio Management since 2007. In the middle of 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 2011, active investment resulted in 7.4 basis points of excess return over the benchmark portfolio.

Results and determinants of investment in 2011

The investment portfolio of Eesti Pank amounted to 270 million euros at the end of 2011. A total of 13.6 million euros were generated in return on investment.

The year began with expectations of an economic revival and inflation increase in the United States and the euro area. To lessen inflationary pressures, the European Central Bank decided to raise the key interest rate from 1% to 1.5% in the first half of the year. The economic recovery and growth expectations raised the yield of sovereign bonds. Still, growth was hampered by the earthquake in Japan and the unstable political situation in North Africa and the Near East.

Tensions on the international financial markets were also fuelled by other factors. Economic indicators deteriorated in both Europe and the United States. The lowering of the US credit rating, brought on by the need to raise the debt ceiling, added to the tensions. The sovereign debt crisis, initially only affecting Greece, Portugal and Ireland, reached major countries. As a result of the significant widening of the spread between the interest rates of Italian and Spanish bonds and German bonds in July, the European Central Bank resolved to extend the SMP programme to the two countries in August. This triggered a quick drop in the yield of the bonds of euro area core countries, and a sell-off of high-risk asset categories (including stocks). Uncertainties around the sovereign debt crisis in the euro area persisted until the end of the year, keeping the yield of low-risk bonds at a very low level.

Overall, the return on investment assets stood at 2.27%¹⁵, exceeding both the corresponding figure for 2010 and the return on money market (see Figure 6).

¹⁵ Except for gold.

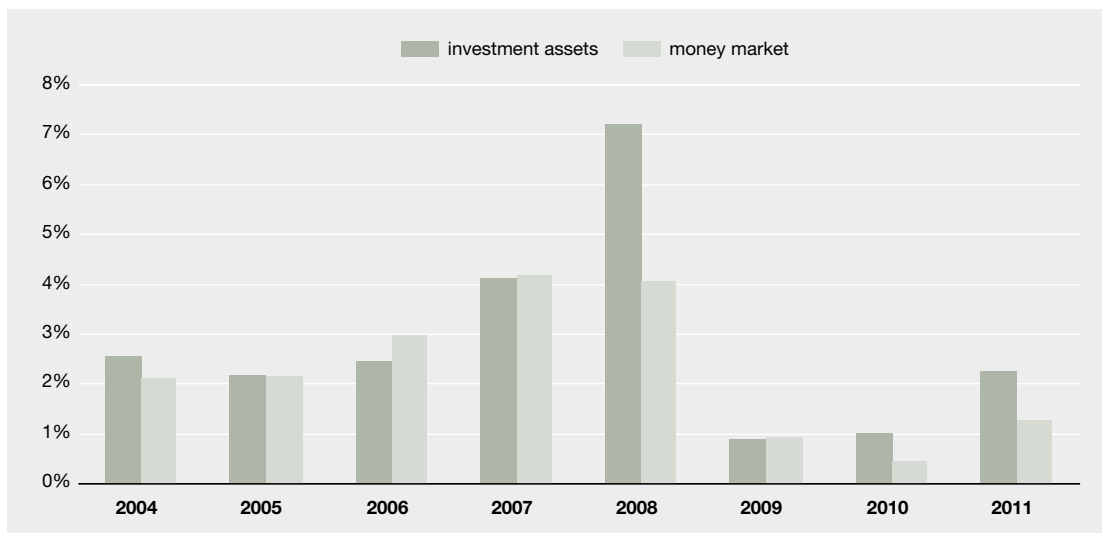


Figure 6. Return on investment assets, compared to return on money market

Asset management services provided to the public sector

Eesti Pank has cooperated with public sector bodies for several years. To optimise the resources, the risk management service agreement with the Estonian Unemployment Insurance Fund was cancelled. At the same time, Eesti Pank continued to provide full asset management services to the Guarantee Fund, whose investment portfolio amounted to 156 million euros at the end of 2011.

Gaida Jakson

2011

"Traces of human activity"





SAFEGUARDING FINANCIAL STABILITY

Safeguarding financial stability is one of the key functions of Eesti Pank. The central bank focuses on tasks contributing to the prevention of financial crises.

Monitoring of the financial sector plays an important role in identifying the risks to the functioning of the financial system. Eesti Pank thus regularly analyses the functioning of the financial system and assesses financial stability. Where necessary, Eesti Pank takes measures to minimise the materialisation of risks, and to support the balanced development of both the financial sector and the general economic environment.

Eesti Pank cooperates with the Ministry of Finance and the Financial Supervision Authority in ensuring the reliability and stability of the Estonian financial system and the appropriateness of the regulation underpinning the financial sector. For this purpose, a committee of representatives of these bodies has been established, with the principles of cooperation and the division of tasks set out in a Memorandum of Understanding.

The Estonian financial system is closely linked to the Nordic and Baltic countries. Productive cooperation with the neighbouring countries is thus highly important. In 2011, cooperation was enhanced primarily within the framework of the Nordic-Baltic Cross-Border Stability Group (NBSG), which comprises the representatives of central banks, financial supervision authorities and ministries of finance in accordance with the cooperation agreement concluded in 2010. The main objective of the NBSG is to ensure the exchange of information and smooth functioning of the financial system, prevent the spread of potential financial crises and minimise the overall costs related to financial crises. A total of four working groups have been set up to achieve the established objectives. Eesti Pank participates in the Monitoring Working Group, which serves to prepare financial stability assessments and develop the common assessment framework. In addition to cooperation within the NBSG, in 2011 the governors of central banks and heads of supervision authorities had additional meetings to discuss the details of macro-prudential supervision.

The role of Eesti Pank in safeguarding financial stability in the European Union expanded in 2011. As a full member of the Eurosystem, which consists of the European Central Bank and the NCBs of euro area countries, Eesti Pank takes part in the joint actions of the euro area central banks. The central bank also participates in the European Systemic Risk Board (ESRB) that was launched in 2011. The ESRB is responsible for the macro-prudential supervision of the financial system, and is charged with the task of assessing the risks to financial stability in the European Union. Where necessary, the ESRB issues warnings and recommendations for reducing the risks. Eesti Pank also continues to formulate and express its positions on the legal framework for financial stability in the European Union and financial sector policies.

Financial sector analysis and financial stability assessment

The assessment of financial stability is a continuous process, and 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 contains the central bank's assessment of financial

stability and recommendations regarding policy measures. Based on Eesti Pank's financial stability assessment published at the end of 2011, the main factor influencing the risks of banks operating in Estonia, and the materialisation of these risks, was the deteriorating sovereign debt crisis in the euro area and the related uncertainties. The main threats identified by the central bank included the potential spill-over of the euro area liquidity and funding tensions through Nordic parent banks to their subsidiaries and branches operating in Estonia, and a significant decrease in the Estonian economic activity against the drop in external demand.

The integration of the Estonian and the Nordic financial systems, and the confidence of money markets in the Nordic banking system, economic and fiscal policy, have reduced the risks to financial stability in Estonia. Potential external risks have also been warded off by sufficient capitalisation of the Estonian banking sector. Based on the stress tests conducted during preparation of the Financial Stability Review, the capital buffers of banks in Estonia were sufficient to withstand a sudden deterioration in loan quality, comparable with the previous economic decline.

The deepening of the crisis and deterioration of the global macroeconomy in the second half of 2011 exerted great pressure on the liquidity and capital buffers of European banks. According to Eesti Pank, the decisions regarding profit allocation, capital and liquidity management in the banks operating in Estonia and their parent banks must take account of the necessity for adequate and sustainable buffers in the current volatile economic and financial environment.

In addition to the Financial Stability Review, Eesti Pank prepares the biannual Lending Review, which analyses the need for funding in the private and corporate sectors, availability of funds and credit standards – that is, the funding of economic development. Even though the Estonian banking sector has a strong capital base, with sufficient domestic funds to issue new loans, the financial behaviour of companies remained conservative in 2011, similarly to households, who remained cautious in their consumption and loan decisions. The quarterly Bank Lending Survey is published on Eesti Pank's website from 2011 onwards, providing an overview of banks' estimates regarding current and future changes in the demand and supply of credit.

Activities of the European Systemic Risk Board

The European Systemic Risk Board (ESRB) contributed to the search of solutions to the European sovereign debt crisis and strengthening of the resilience of the financial sector. Concerning the financial sector, the most important tasks in 2011 included conducting a stress test of banks operating in the European Union, in cooperation with the European Banking Authority, as well as an analysis of the banks' funding structure along with the risks related to loans denominated in foreign currency. In November 2011, the ESRB also issued the first public recommendation concerning the measures for reduction of risks related to foreign currency loans. In Estonian banks, the volume of loans denominated in foreign currency is negligible. Thus, no additional measures need to be taken in Estonia.

In addition to risk assessments, the ESRB placed focus on developing and strengthening the European Union's macro-prudential supervision framework to minimise the probability of materialisation of the systemic risks to the financial sector. For this purpose, the ESRB proposed to the EU legislative bodies to improve the legal framework for the capital requirements of banks so that the Member

States would be able to establish prudential standards stricter than the minimum requirements to ensure financial stability and prevent accumulation of systemic risks. Eesti Pank supports that initiative. The ESRB also started to develop the institutional framework for efficient implementation of macro-prudential supervision in the Member States, analysing the possible measures and making the relevant policy recommendations.

Legal framework for the financial sector

Efforts towards enhancing the legal framework for the EU financial sector continued in 2011. Eesti Pank participates in the discussions as a member of the Eurosystem and the ESRB, and through the Economic and Financial Affairs Council (ECOFIN). Eesti Pank also expresses its opinions in the formulation of Estonia's positions at the state level. The most important topics for the central bank included the development of the new legal framework for the capital requirements of banks and the safety net for the European Union financial sector, including the preparation of the legislative proposal for the crisis management framework and negotiations on the proposal for amendment of the Deposit Guarantee Directive.

In connection with the introduction of additions in the financial sector legislation, the amendments to the Capital Requirements Directive adopted by the European Parliament in 2010 (the so-called CRD-III) were transposed into the Estonian law in 2011. The amendments specified the procedure for disclosure of the trading book and securitisation exposures as well as remuneration policies.

In relation to the transposition of the Basel III global prudential standards for the banking sector into the EU law, the European Commission published in July 2011 the proposals for amendment of the Capital Requirements Directive (CRD-IV) and the draft of the new directly applicable regulation (CRR). The new regulatory framework introduces stricter requirements for the own funds and liquidity of credit institutions, establishes the capital conservation buffer and the countercyclical buffer, and specifies the coordination of cross-border supervision of banking groups. The new requirements are scheduled to be implemented in the European Union in 2013. Eesti Pank supports the strengthening of the capitalisation of banks, and harmonisation of the minimum requirements as well as establishment of additional buffers. Similarly, the option of establishing prudential standards stricter than the minimum requirements to ensure financial stability is considered important by the central bank. Eesti Pank has prepared a preliminary assessment of setting the countercyclical buffer requirement in Estonia, and will continue the analysis and development of the methodology in 2012.

To enhance the efficiency of the financial sector safety net, the preparation of the legal acts regulating crisis management in the European Union was continued with the aim of allowing efficient reorganisation or winding-up of financial institutions that are facing problems. The objective is to ensure efficient functioning of the financial market and reduction of the costs related to banking crises. A public consultation was held in the spring of 2011 on certain technical aspects but the final proposal has yet to be announced. Estonia's focus in the discussions lies in the crisis management of cross-border banking groups and the sharing of the related costs. These matters are also addressed from the regional perspective in the Nordic-Baltic Cross-Border Stability Group (NBSG).

Negotiations with the Member States and the European Parliament for introduction of amendments to the Deposit Guarantee Directive continued in 2011 with the aim of harmonising the EU deposit guarantee conditions and activities in all Member States. In Estonia, the amendments to the Guarantee Fund Act entered into force on 1 January 2011, raising the limit of the deposit guarantee to 100,000 euros and cutting the term of payment of compensation down to 20 working days.

Peeter Sink
2010
"Springtime!"





DEVELOPMENTS IN STATISTICS

Eesti Pank is the other primary agency besides Statistics Estonia that conducts official statistics in Estonia. The goal of the central bank is to provide high-quality, reliable, up-to-date and unbiased statistics which are used both for in-house purposes and to inform the public. It is the responsibility of Eesti Pank to compile the balance of payments statistics and the financial sector statistics in Estonia.

The strategic objectives in the field of statistics in 2011 included fulfilment of the data requirements associated with the accession to the monetary union, preparation for the transition to the new international statistical standards in 2014, and development of the user-friendly statistics section of the bank's public website.

As a member of the Eurosystem, Eesti Pank fulfils the statistical requirements established by the European Central Bank for the euro area countries. Even though Eesti Pank submitted extensive statistics to the European Central Bank long before accession to the euro area, a lot of new areas were added in 2011, while the deadlines for preparation and submission of statistics were shortened. In addition, all of the databases used by Eesti Pank and the statistics time series published on the bank's website were converted into euros.

Pursuant to the new Official Statistics Act that entered into force in 2010, the Statistical Council was set up in Estonia in 2011, with the deputy governor representing Eesti Pank. The purpose of the Statistical Council is to engage various interest groups within the society in contributing to the development of official statistics. The new act provides for the preparation of the official statistics programme for the following five years. The list of statistical actions conducted by Eesti Pank forms a part of the programme. The central bank fulfilled all of the statistical tasks established for 2011 in the official statistics programme: the balance of payments flash estimate, quarterly balance of payments, international investment position, total external debt, international reserves, quarterly national financial account and preparation for conducting the Household Finance and Consumption Survey of Estonian Households.

The statistics section of Eesti Pank's website was updated in 2011 with the aim of enhancing availability and user-friendliness. The added functions allow the user to flexibly create data views. The bank also introduced new options for disclosing methods, notes, clarifications and other meta-data. A new financial sector statistics section was developed and launched on the basis of the added technical features. Major changes in the presentation of external sector statistics are scheduled to be introduced in 2012.

In addition to improving the presentation of statistics, the bank also entered information intended to reporters in the new menu item "For reporters". Alongside the reporting obligation, the new item also includes examples, references to methods and other information designed to aid the preparation of reports.

As a result of the accession to the euro area and upgrading of the format of the metapages containing information on the economic indicators of the Special Data Dissemination Standard (SDDS) of the

International Monetary Fund, all metapages of the SDDS under the competence of Eesti Pank were updated in 2011, and are available on IMF's SDDS website¹⁶.

Financial sector statistics

Similarly to many other areas, the activities related to accession to the monetary union required the most resources in financial sector statistics. For instance, statistics on insurance corporations and pension funds as well as securities holders must now be produced. The new rules also required calculation and submission to the European Central Bank of the data on previous periods (i.e. as if the country had already been a member of the euro area).

In 2011, the central bank agreed on the new data exchange principles with the Estonian Leasing Association and its members, and started to make preparations for entry into a new cooperation agreement (the valid agreement dates back to 1998). The cooperation agreement on the exchange of data was also renewed with the Estonian CSD. This was conditioned by new software implementation in the Estonian CSD on the one hand, and Eesti Pank's need for additional data, on the other.

Together with the Financial Supervision Authority, Eesti Pank continued to develop the data collection system. A software upgrade was outsourced for the web portal which was launched in 2010 and provides information on the status of report processing. The changes were introduced with the aim of enhancing user convenience. Firstly, the screen feature was added for submitting reports. Secondly, report files can now be uploaded via a web interface. Thirdly, the submission of reports can now be made fully automatic via the specially designed web service. The upgrade uses the DigiDoc platform to secure the exchange of data. Convenience is also added by the on-screen error identification feature. The upgrade was implemented as a test project for reports of money transferors from 1 January 2012 onwards. The completed portal will be opened to all users in the near future.

In 2011, the central bank developed amendments to the decree specifying the reporting commitments of credit institutions. The biggest challenge lied in modernising the reporting on payment statistics. This is a highly specific area. Eesti Pank thus increased the inclusion of credit institutions in the process. Consequently, the draft decree is more transparent and considers both the special needs of users and developments in the whole area. The central bank also started to prepare amendments to the supplementary reports on the balance sheet of credit institutions and report on investment services. The amendments will be introduced in the corresponding decrees in the first half of 2012.

The central bank continued the preparatory work for implementation of the IT application for preparation of quarterly financial accounts. A majority of the inputs had been integrated into the system by the end of the year, allowing partial use of the system, regardless of ongoing development. The implementation of the application enables to reduce various risks in the future, and to cope with the ever-shortening reporting deadlines (from 2014 onwards, the European Central Bank requests submission of the quarterly financial account data within 85 days after the end of the quarter, instead of the current 110 days).

¹⁶ <http://dsbb.imf.org>.

External sector statistics

In the balance of payments statistics, Eesti Pank commenced in 2011 with the regular reporting to the European Central Bank in line with the requirements established by the monetary union. Among other things, this meant additional reporting requirements for both entries and geographical breakdown. The monthly balance of payments flash estimates became more specific, especially with respect to portfolio investments.

The requirements of IMF's new Balance of Payments Manual (6th Edition) will be implemented in 2014. The analysis of the manual started in the second half of 2011 with the identification of the key changes in methodology and account structure. Decisions were passed with regard to the methods to be applied by Eesti Pank. Analysis of the new standard for external sector accounts will continue in 2012.

From 2011, the security by security approach is used in external sector statistics for preparation of entries on transactions and positions of portfolio investments and the yield generated. The central bank continued the development of the securities database (SEC) established for the purpose, by giving consideration to the general objectives of the production of statistics. The database relies on the Centralised Securities Database (CSDB), which provides the NCBs with access to the price and interest information as well as data on the denomination of securities, residence of issuers and institutional sectors. The use of the central database allowed to ease the reporting burden of reporting agents and harmonise differences in NCB statistics.

On the initiative of the European Central Bank, the preparation of the next Securities Holdings Statistics Database (SHSDB) was launched. Similarly to the CSDB, the database requires the contribution of all NCBs in the submission of data on securities holders. For this purpose, Eesti Pank is planning to update the data in its SEC, which provides input to the SHSDB.

The meaning and scope of the reserve assets of the Estonian balance of payments changed with the accession to the Eurosystem. Euro-denominated claims on non-residents are no longer reported under reserve assets. Neither are foreign currency-denominated claims on other euro area countries, including claims on transfer of foreign currency reserves to the European Central Bank, reported under reserve assets. From 2011, the amounts derecognised from reserve assets are reported under the corresponding entries of direct investments, portfolio investments and other investments.

Eesti Pank uses an innovative approach in the preparation of the travel services account of the balance of payments, by applying statistical models that receive their input from the information obtained via mobile positioning systems on passenger movement across the state border. The data collection methods have been developed in cooperation with OÜ Positium LBS, involving researchers of Eesti Pank and the University of Tartu, charged with the task of collecting and processing data. Mobile positioning helps to determine the physical person's outbound travel during the person's stay outside the country of residence in the coverage area of the foreign mobile operator on the basis of phone roaming (call, SMS, data transmission operation, etc.). As no full-scale border crossing statistics are produced in Estonia, Eesti Pank will be publishing these data as of the first quarter of 2012. For this purpose, the bank developed the dissemination principles and prepared the corresponding statistics section for the bank's website.

On European Central Bank's request, the methodologists of Eesti Pank participated in the ECB's technical assistance programme in the first half of 2011, advising the Serbian central bank in issues related to external sector statistics.

General economic statistics

In the area of general economic statistics and public finance statistics, the central bank continued regular data exchange with the European Central Bank and the Bank for International Settlements (BIS). Unlike other EU Member States, euro area countries are expected to submit to the European Central Bank additional economic indicators on business demography, capital stock statistics, statistics on negotiated wage agreements, commercial real estate prices, etc. Should the required data be unavailable in the Estonian official statistics system, alternative indicators or estimations may be used for compiling the data.

Following the accession to the euro area, Eesti Pank started to participate in the Household Finances and Consumption Survey. This is a survey that is conducted in euro area countries by using a common methodology and that gathers information on the financial position and consumption of households. The aim of the observation is to obtain micro-level data on the assets and liabilities of households. The observation will be conducted at least once every three years. In 2011, the experts of Eesti Pank made preparations for conducting the survey, searched for a cooperation partner and produced the detailed activity plan and time schedule. Statistics Estonia has consented to coordinate the technical aspects of the interviews, which will cover a total of nearly two thousand households. Eesti Pank will be responsible for processing and analysing the data, associating the data with the registers, and submitting the results to the European Central Bank. The first observation will be organised in 2013, with the final results to be submitted to the European Central Bank in 2014.

For the second time, Eesti Pank participated in 2011 in the preparation of the quality report on the financial statistics on the general government of euro area countries (GFS Quality Report 2011), commissioned by the European Central Bank. The overall assessment of the European System of Central Banks on the euro area public finance statistics will be submitted to the Governing Council of the European Central Bank in the spring of 2012.

Both the Council of the European Union and the Governing Council of the European Central Bank have emphasised that central banks, in serving their role as independent institutions, must strengthen the surveillance of the quality of public finance statistics. An audit of the said role was thus conducted within the European System of Central Banks. Even though the activities of Eesti Pank were deemed to be in line with the requirements, stricter adherence to the quality of public finance statistics is expected from euro area central banks in the future.

Heino Ruiso

2002

“Layered morning”





PAYMENT AND SETTLEMENT SYSTEMS

The central bank is responsible for ensuring safety and functioning of the payment and settlement systems in Estonia in a way which would satisfy the needs of system participants with minimum risk exposure and at reasonable cost.

As a central bank of the Eurosystem, Eesti Pank fulfils three different roles in connection with settlement systems, similarly to the period before accession to the euro area.

The central bank is:

- operator of systems – Eesti Pank is the service provider and owner of the interbank payment and settlement systems it manages;
- regulator of systems – Eesti Pank enforces the legal acts on the payment and settlement systems for interbank payments;
- overseer of systems – Eesti Pank assesses and guides the operation and development of payment and settlement systems both on the national level and within the euro area.

Eesti Pank also participates in the development of the financial sector infrastructure and in the design and implementation of the related policies and legal framework both in Estonia and the European Union.

Settlements in the payment and settlement systems managed by Eesti Pank

Eesti Pank manages two interbank payment and settlement systems: the TARGET2-Eesti, the real-time gross settlement system for express transfers, and the ESTA, the settlement system of ordinary payments.

The Eurosystem's monetary policy operations are conducted via the Trans-European Real-Time Gross Settlement Express Transfer System TARGET2, which is also used for settling high-value payments in euro. Eighteen euro area central banks (including the European Central Bank) and six non-euro area central banks¹⁷ participate in the TARGET2 system. In Estonia, the TARGET2-Eesti – the TARGET2 component system – was implemented in 2008. The central bank previously used and managed the Real-Time Gross Settlement System EP RTGS, which operated as a sub-system of the TARGET. At the end of 2011, the Estonian component system had a total of 18 participants – credit institutions who participate in the system via Eesti Pank. All those who must comply with the reserve requirement (i.e. credit institutions) are obliged to participate in the system.

The ESTA had a total of 15 participants at the end of 2011. The ESTA is among Europe's fastest retail payment settlement systems, with interbank settlements performed a total of ten times a day. A daily average of 96,000 payments with a total turnover of 1.3 billion euros (see Table 3) were settled through the interbank payment settlement systems in 2011.

¹⁷ The central banks of Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

Table 3. Eesti Pank's payment and settlement systems in 2011 (daily average)

System	Turnover (EUR m)	% in total payment turnover	Number of payments	% in total number of payments
ESTA	122.4	9.1%	95,926	99.7%
TARGET2-Eesti	1,222.9	90.9%	333	0.3%
Total	1,345.3		96,259	

The TARGET2-Eesti settled a daily average of 333 payments in 2011, with the total turnover amounting to 1.2 billion euros. Compared to 2010, the number of payments doubled and the turnover increased fourfold. There are several reasons for the increase in the use of the system. Upon changeover to the euro, Eesti Pank shut down the real-time gross settlement system, the EP RTGS. A majority of the previous EP RTGS transactions (collateral operations in the ESTA, cash transactions with Eesti Pank and transactions related to monetary policy operations) are now conducted via the TARGET2-Eesti.

From the beginning of 2011, banks have the option of using the Eurosystem monetary policy instruments. The deposit facility has proved to be the most popular. In 2011, a total of 1,051 overnight deposits were made in the TARGET2 by banks operating in Estonia, in the total amount of 16.8 billion euros. With the reserve requirement being significantly lower after accession to the euro area, banks obtained additional funds that could be deposited with the central bank. Upon adoption of the euro, banks also changed the channels of cross-border payments. While cross-border payments were previously transferred mainly through correspondent banks, the TARGET2-Eesti was taken into use in 2011. For the above reasons, the turnover of cross-border interbank payments increased by 2.6 times from 2011 (see Figure 7).

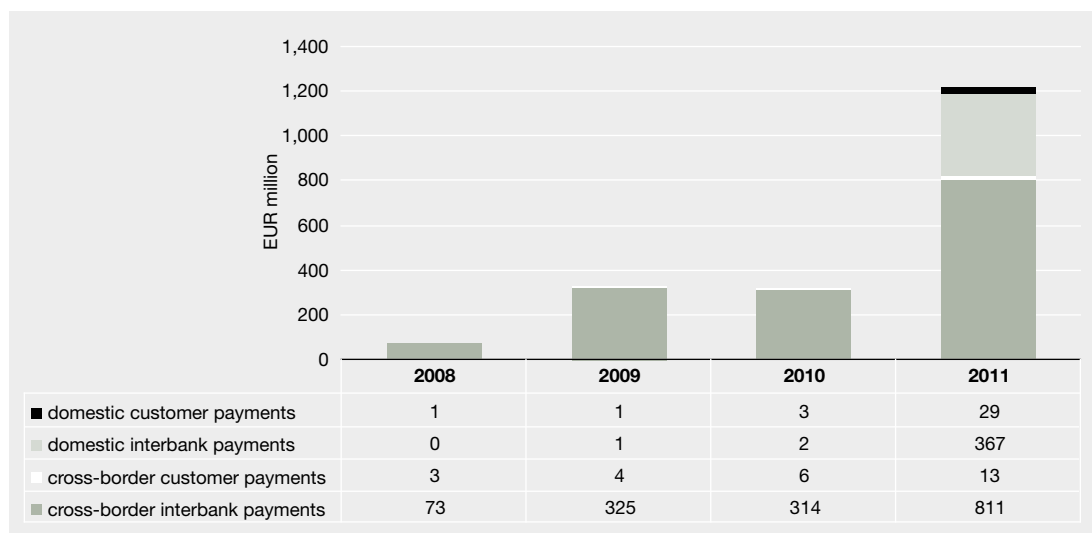


Figure 7. Structure of payments in the TARGET2-Eesti (daily average)

In 2011, 99.7% of all interbank payments were settled in the ESTA. Still, these payments only generated 9% of the total turnover of the systems. The ESTA settled a daily average of 95,926 payments at a total turnover of 122.4 million euros. The number of payments has remained on par with 2010, while turnover has increased by 17%. The average size of a payment settled through the ESTA was 1,273 euros (see Figure 8).

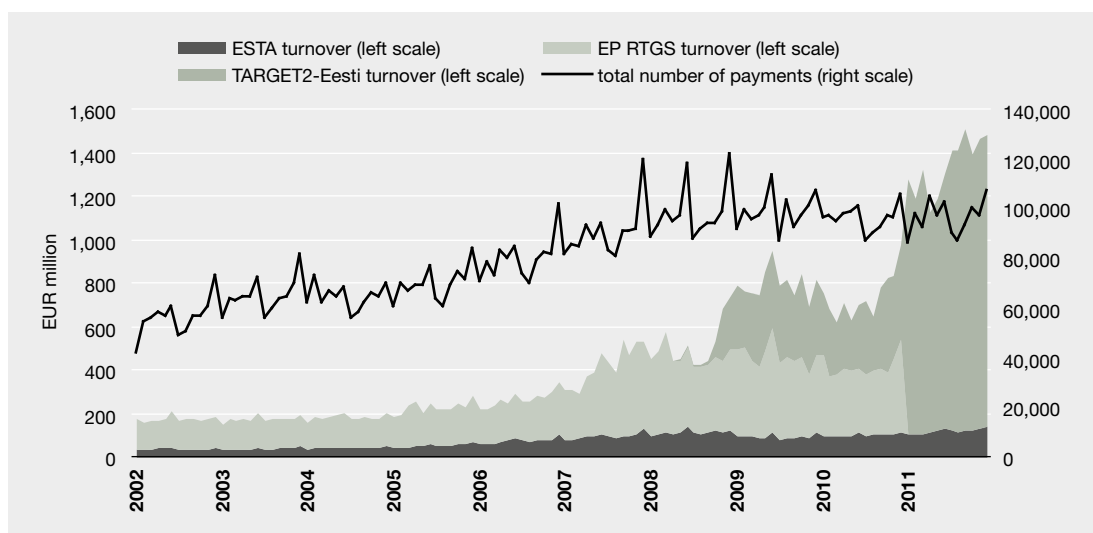


Figure 8. Payments settled through Eesti Pank's payment and settlement systems (daily average)

Development and policy of the financial sector infrastructures

Eesti Pank coordinates the development of the settlement systems mainly through the Estonian Council of Payment System Experts and its working groups, and the Estonian National User Group of TARGET2-Securities. Where necessary, the Ministry of Finance and the Financial Supervision Authority are involved under the cooperation agreement concluded in 2007. Eesti Pank also participates in the discussions and working groups headed by the Estonian Banking Association with the aim of implementing the Single Euro Payments Area (SEPA) requirements in Estonia.

Single Euro Payments Area

The changeover to the euro had a direct effect on payment intermediaries in Estonia. The beginning of 2011 saw full enforcement of the euro payments regulation adopted in 2009. The regulation harmonised the transaction fees of cross-border and domestic payments initiated in the euro in the European Economic Area. Prior to accession to the euro area, the regulation only applied to Estonia in a limited extent. The commission fees of cross-border payments of up to 50,000 euros were thus reduced up to five times (to nearly 0.3 euros in case of payments initiated in the internet bank).

The promotion of the transition to the SEPA garnered much more attention in 2011¹⁸. On the initiative of the Ministry of Finance, Eesti Pank, together with the Estonian Banking Association, contributed to consultations on the draft SEPA regulation. The central bank also advised the Estonian Banking Association on the renewal of the Estonian SEPA Action Plan. The action plan points out the key changes that would affect the retail customers (transition to the international bank account number IBAN, implementation of the cross-border SEPA direct debit services and ISO standards), and the action to be taken for their implementation. In order to promote the payment landscape and enhance the efficiency of the implementation of the requirements stipulated in the SEPA regulation, Eesti Pank

¹⁸ See Eesti Pank's tasks in the promotion of the SEPA: <http://www.eestipank.ee/pub/en/ylidine/pank/maksesyysteem/sepa.html>.

together with the Ministry of Finance and the Estonian Banking Association will establish a forum¹⁹ in the first half of 2012, with the preparatory work launched already in the second half of 2011.

The retail payment system ESTA does not process the direct debit and credit transfers in accordance with the SEPA terms and conditions. Neither is the ESTA interoperable with other euro area retail payment systems. Therefore, a new solution must be developed for retail payments in Estonia by the term established in the SEPA regulation by February 2014. The possible solutions include the upgrading of the retail payment system managed by the central bank to bring it in line with the SEPA requirements, or subscription of the Estonian retail payment service providers (mostly banks) to one or several European-based systems which comply with the SEPA requirements.

In most other euro area member states and other developed countries, the task of operation of the retail payment system rather lies with the private sector, with the central bank only offering systemically important interbank payment settlement system services. Nevertheless, Eesti Pank is currently unable to abandon its role as the retail payment system operator. Even though there are already settlement systems available in Europe that comply with the SEPA requirements, the use of these systems would not provide the banks operating in Estonia with equal conditions with respect to competition. Neither would it ensure the speed of payments and settlements to which the Estonian payment service users have become accustomed to. If different banks choose different trans-European settlement systems, dependence on service providers operating outside Estonia will significantly increase. The speed of domestic payments is likely to drop considerably, and customers would no longer receive interbank payments within a couple of hours. In 2011, Eesti Pank thus undertook the task of making active preparations for launching, in 2014 at the latest, a solution that would comply with the SEPA requirements and meet the Estonian market needs.

The Eurosystem platforms TARGET2 and TARGET2-Securities

November 2011 saw the end of the transition period of the TARGET2 for the first wave of migration. During this period, the NCBs transferred the settlement of payments between credit institutions, payments between credit institutions and ancillary systems, and payments related to the Eurosystem open market transactions into the Payment Module (PM) accounts opened in the TARGET2 single shared platform. The transition period for the second and third wave of migration expires in February and May 2012, respectively. Eesti Pank transferred the settlement of all of the above payments to the PM accounts opened in the TARGET2 single shared platform upon adoption of the euro in January 2011.

At the end of 2010, the TARGET2 started providing, as an alternative to SWIFT (the international interbank telecommunication network), the option of sending payment orders and monitoring account movements through web-based access. Three credit institutions have been using this option in Estonia since the beginning of 2011.

By the end of 2011, the Eurosystem in cooperation with relevant stakeholders had developed the TARGET2-Securities (T2S), the single platform for securities settlement, to a level where the gen-

¹⁹ The Estonian payment forum to be chaired by Eesti Pank.

eral principles for the single platform had been established, the technical documentation had been approved and the public procurement for the network service providers organised. To provide participants with additional time for making preparations for the migration and for testing the new environment, the preparatory phase for the project was extended to June 2015. According to the updated schedule, the platform should be launched thereafter. SWIFT and the joint venture SIA/Colt were the winners of the public procurement. The exact price should be determined in the next stages during negotiations with the market participants.

After years of negotiation, the Framework Agreement between the Eurosystem and the CSDs is scheduled to be signed by the CSDs and the NCBs at the end of June 2012 at the latest. All CSDs who wish to migrate to the platform and NCBs whose currency is included in the T2S and who will start using the T2S must submit their feasibility assessments by the same term. The Framework Agreement also establishes the T2S governance structure and service price list applying to all participating CSDs.

In May 2011, the Eurosystem NCBs entered into an agreement which governs the legal and financial relations between the Eurosystem and the four central banks charged with the task of building the platform (Deutsche Bundesbank, Banco de España, Banque de France and Banca d'Italia). The contract specifies the liabilities and tasks of the Eurosystem NCBs. The first payments for the financing of the platform were made by the NCBs on 31 May 2011.

The main tasks of the T2S Estonian National User Group²⁰ in 2011 included analysis of the T2S project impact, formulation of the national user group's position regarding the potential migration of the Estonian Central Register of Securities to the T2S platform, and the pursuit of migration options and conditions for the direct holding markets. Together with Finland, Estonia applied for special rules to the pricing of the transactions of the direct holding markets in the T2S platform²¹. These rules were approved by the Governing Council of the European Central Bank as a part of the Framework Agreement in November 2011. The rules will only apply, when the CSD which operates on the corresponding market and migrates to the platform, transfers all accounts registered with the CSD (including end-investor accounts) to the T2S.²²

Eesti Pank has decided to support the signing of the T2S Framework Agreement by the Estonian CSD. The impact analysis of the Estonian National User Group "The impact of the TARGET2-Securities project on the Estonian market" was completed in December 2011. The Estonian National User Group concluded in the analysis that, from the perspective of economic policy, migration to the T2S platform is necessary for the Estonian market and the Estonian CSD. In view of the decisions regarding pricing and the legal complexity of the migration of the Estonian market via an indirect model, the

²⁰ The Estonian National User Group (EENUG) was established with the Eesti Pank Governor's Decree at the beginning of 2009 to promote cooperation between the providers and users of securities settlement services, and to support the development and implementation of the T2S. EENUG cooperates with the T2S Advisory Group. See also <http://www.eestipank.ee/pub/en/yldine/pank/stabiilsus/T2S/t2s.html>.

²¹ Estonia, Finland, Scandinavian countries and smaller markets in Southern Europe.

²² With the derogation, the transaction price amounts to 0.03 euros instead of 0.15 euros for a DVP (delivery versus payment) transaction or 0.09 euros for a FOP (free of payment) transaction. A CSD which transfers all accounts to T2S must choose one of the offered solutions. In the first case, all FOP transactions between the accounts of the CSD's customers will be covered by the derogation. In the second case, all DVP and FOP transactions, where a retail investor serves as a party to the transaction, will have a discount price.

most suitable solution for the Estonian market is to transfer all accounts registered with the CSD to the T2S.

Oversight of payment and settlement systems

The role of Eesti Pank as the overseer of payment and settlement systems was expanded upon the country's accession to the euro area. Above all, the scope of oversight was extended, along with the list of standards governing the oversight. Oversight is based on the Eurosystem Oversight Policy Framework²³ and the guidelines and recommendations provided in its annex. The updated framework was published in July 2011 and it addresses the oversight of the following financial sector infrastructures:

- payment systems (systemically important payment systems, euro retail payment systems);
- payment instruments and schemes (including e-money, card payment schemes, direct debit and credit transfer schemes);
- financial instrument settlement systems (securities settlement systems, central counterparties);
- trade repositories, correspondent banks, third party service providers (e.g. the T2S) and non-bank service providers, who are subjected to Eurosystem oversight without specific oversight principles.

Major tasks fulfilled by Eesti Pank within the Eurosystem Oversight Policy Framework in 2011 included the assessments of the new version and incidents of the TARGET2, and pre-assessment of the T2S. In addition, the Eurosystem analysed the institution-based-interdependencies, assessed the separation of payment systems operations and oversight functions, and assessed the draft legal acts governing the financial market infrastructures, initiated by the European Commission.

Eesti Pank has been conducting the oversight of the payment and settlement systems for over a decade, but the full oversight framework was not officially published until 2011.²⁴ The Eesti Pank's framework for the oversight of payment and settlement systems describes the central bank's role as the overseer of payment and settlement systems, the nature of these systems, and the purpose and process of oversight.

Eesti Pank is the overseer of:

- the ESTA;
- the TARGET2-Eesti;
- the securities settlement system operated by the Estonian Central Register of Securities.

In overseeing the securities settlement system, Eesti Pank cooperates with the Financial Supervision Authority. For this purpose, a cooperation agreement was concluded in November 2011. The agreement specifies the essence of cooperation between Eesti Pank and the Financial Supervision Authority in adopting decisions affecting securities settlements, oversight and supervision of securities settlement systems, and exchange of information. The Financial Supervision Authority inspects the securities settlement systems and the activities of their operators, grants approvals and

²³ <http://www.ecb.int/pub/pdf/other/eurosystemoversightpolicyframework2011en.pdf>

²⁴ http://www.eestipank.info/pub/en/dokumendid/publikatsioonid/seeriad/finantsvahendus/_2011_2/_4_211.pdf

addresses violations. Eesti Pank assesses the securities settlement systems and facilitates to their development, including within the framework of the T2S project.

There were no major failures endangering the stability of the financial system or significantly altering the smooth functioning of the payment and settlement systems under the oversight of Eesti Pank in 2011. The annual average availability of the TARGET2-Eesti stood at 99.87% and that of the retail payment system ESTA at 99.89% – a little higher than the required level.²⁵

The smooth functioning of payments and settlement was only disturbed by a major incident on the TARGET2 central settlement platform, which affected both the ESTA and the securities settlement system of the Estonian Central Register of Securities. The incident demonstrated the high cross-border dependence of the Estonian payment and settlement systems, and the need to either prevent such contingency situations by applying local solutions or to reduce the impact of failures. As the overseer of payment and settlement systems, Eesti Pank thus proposed to the operators of the ESTA and the settlement system of the Estonian Central Register of Securities to review and update their contingency procedures. The aim is to prevent situations where, due to a TARGET2 holiday or incident, it is not possible to settle domestic interbank payments or securities transactions on an ordinary working day in Estonia or the settlement of payments is extensively delayed.

The changes in Eesti Pank's payment and settlement systems associated with the changeover to the euro (shutdown of the EP RTGS, enhanced use of the TARGET2-Eesti and changes in the liquidity requirements and management of banks) increased the probability of materialisation of operational risks to the systems, and somewhat hindered smooth settlement at the beginning of 2011.

Regarding the development of the retail payment system in line with the SEPA requirements, Eesti Pank as the overseer of systems is on the opinion that, apart from the international requirements that arise from the oversight framework and the SEPA requirements, the future solution must endorse competition between the system participants. Moreover, the system must be as independent on external systems and connections as possible. The pre-assessment of alternative solutions, prepared in 2011, will be followed by the full pre-assessment of the retail payment system by the overseer prior to the launch of the new system in 2014.

²⁵ The required level for the TARGET2 and the ESTA is 99.7% and 99.4%, respectively.

Tõnu Noorits
2011
"Spring landscape 2"





MEETING THE CASH DEMAND

Banknotes in circulation in the euro area and Estonia

As a euro area NCB, Eesti Pank is responsible for meeting the demand for euro banknotes and coins, and for safeguarding and maintaining the cash reserves required for circulation. As the regulator of cash circulation, Eesti Pank must ensure compliance of banknote and coin handling with the common quality standards and the requirements for authenticity and fitness checking and recirculation of banknotes and coins.

A total of 14.95 billion banknotes with the total value of 888.6 billion euros were in circulation in the euro area at the end of 2011. In the previous year, the number of banknotes in circulation stood at 14.17 billion and had a total value of 839.7 billion euros. Both the value and number of euro banknotes in circulation thus increased by approximately 6%. €50 banknotes made up the biggest share of the banknotes in circulation at the end of 2011 (41%). In terms of value, €50 and €500 banknotes were equal contributors (34%).

The adoption of the euro changed the structure of cash in circulation in Estonia. Compared to the Estonian kroon circulation indicators prior to the launch of the euro, the net amount of euro banknotes is several times smaller. Lower-value kroon-banknotes have partially been replaced with euro coins. In the first year of euro cash circulation, the share of the value of euro coins intended for circulation increased by nearly 2.5 times, and the net amount of coins in circulation was over 102 million pieces.

The euro cash in circulation in Estonia includes both the cash issued by Eesti Pank on the basis of the cash demand of credit institutions and their customers, and the cash brought to Estonia by companies and individuals. The total value and volume of euro cash in circulation in Estonia is thus based only on estimates.

Eesti Pank issued 1,661.2 million euros in total to credit institutions in 2011. A total of 1,045.5 million euros were returned to the central bank (see Table 4). The net amount of euro cash released into circulation by Eesti Pank reached 615.7 million euros at the end of 2011, with banknotes contributing 590.7 million euros and coins 25.0 million euros. In terms of value, these indicators are comparable with those of the circulation of the Estonian kroon in the first half of 2010. In terms of volume, €50 (29%) and €5 banknotes (27%) were the biggest contributors. Value-wise, €50 banknotes again ranked first (40%), followed by €500 notes (36%).

Table 4. Cash flows between Eesti Pank and credit institutions

Year	Total amount (EUR million)		Number (million)			
	Issued by Eesti Pank	Received by Eesti Pank	Issued by Eesti Pank		Received by Eesti Pank	
			Banknotes	Coins	Banknotes	Coins
2011	1,661.2	1,045.5	45.0	124.5	34.8	22.3

One-cent (22%) and two-cent (21%) coins were the biggest contributors to coins intended for circulation with respect to volume, and two-euro coins (44%) with respect to value. For almost all denominations, Eesti Pank has released more banknotes than it has received in return. The volume returned only exceeded the volume issued for €100 and €200 banknotes. Simultaneously with the

release of the euro cash, the central bank continued to withdraw Estonian kroons from circulation. In total, 4,975.3 million Eesti kroons of cash were returned to Eesti Pank in 2011. The return peaked in the first months of 2011, when the central bank received around 88% of the total volume of the return for the year.

Nearly 77 million pieces of Estonian kroon coins were returned in 2011, which is about 20% of the coins in circulation at the beginning of the year. This can be considered quite a result, considering that approximately the same amount of coins was returned in the last three months of 2010, following the coin collection campaign in the autumn of 2010. The total number of coins returned in the last two years amounts to nearly 167 million pieces, weighing more than 470 tonnes in total. All of the coins were sorted and deformed, and the resulting metal alloy was auctioned.

At the end of 2011, the central bank had yet to receive cash worth 851.7 million kroons (see Table 5). Eesti Pank will continue to exchange Eesti kroon banknotes and coins into euros at the official exchange rate and without a service fee for an unlimited period of time.

Table 5. Kroon banknotes and coins in circulation as at year-end

Nominal value	Total amount (EEK million)				Number (million)			
	31/12/2008	31/12/2009	31/12/2010	31/12/2011	31/12/2008	31/12/2009	31/12/2010	31/12/2011
1 kroon	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
2 krooni	39.6	39.2	35.3	21.6	19.8	19.6	17.7	10.8
5 krooni	49.9	48.8	44.9	24.3	10.0	9.8	9.0	4.9
10 krooni	95.0	92.4	83.0	40.9	9.5	9.2	8.3	4.1
25 krooni	232.8	230.8	196.7	63.1	9.3	9.2	7.9	2.5
50 krooni	52.1	48.5	45.0	22.7	1.0	1.0	0.9	0.5
100 krooni	1,165.2	1,044.7	798.5	171.6	11.7	10.4	8.0	1.7
500 krooni	10,194.6	8,104.1	4,490.5	404.8	20.4	16.2	9.0	0.8
Banknotes total	11,833.9	9,613.2	5,698.4	753.5	86.3	80.0	65.2	29.8
5 senti	2.0	2.0	2.0	1.9	40.8	40.4	39.3	38.2
10 senti	15.2	15.4	13.9	11.5	152.1	154.1	139.0	115.3
20 senti	26.1	26.6	22.0	17.2	130.6	132.8	109.9	86.2
50 senti	27.2	28.0	23.1	17.4	54.4	55.9	46.2	34.8
1 kroon	74.8	74.8	56.3	39.9	74.8	74.8	56.3	39.9
5 krooni	9.4	9.7	11.4	10.2	1.9	1.9	2.3	2.0
Coins total	154.9	156.4	128.6	98.1	454.6	460.0	392.8	316.3
Collector coins	7.5	7.9	11.2	11.2	0.1	0.2	0.3	0.3
Total	11,996.3	9,777.5	5,838.2	862.9	-	-	-	-

Expert analysis and handling of cash

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 fit for circulation released back into circulation with the aim of ensuring cash quality. In 2011, Eesti Pank continued to destroy Estonian kroon banknotes withdrawn from circulation. A total of 3.2 million euro banknotes, which were deemed unfit, were withdrawn from circulation and destroyed, with their total value amounting to 83.1 million euros (see Table 6).

Table 6. Unfit euro banknotes withdrawn from circulation as at year-end

Nominal value	Total amount (EUR million)	Number (million)
	2011	2011
5 euros	4.0	0.81
10 euros	8.9	0.89
20 euros	12.3	0.61
50 euros	36.4	0.73
100 euros	11.0	0.11
200 euros	2.7	0.01
500 euros	7.8	0.02
Total	83.1	3.18

In 2011, experts of Eesti Pank analysed 6,163 damaged banknotes and 631 damaged coins submitted by credit institutions. Six counterfeit banknotes and five coins were discovered. No counterfeit kroon banknotes or coins were found.

A total of 276 counterfeit euro banknotes and 104 counterfeit euro coins were discovered in the expert analyses conducted by the Estonian Forensic Science Institute in 2011. In addition, 16 counterfeit kroon banknotes were detected.

€50 banknotes made up a bulk of the counterfeit notes (46.7%). Considering the total number of euro banknotes and coins in circulation, the number of counterfeits discovered is negligible.

There were no failures in the circulation of cash in 2011.

Preparation of new banknotes and coins

Coins intended for circulation

In the first half of 2011, the Mint of Finland delivered the second batch of euro coins intended for circulation within the framework of the changeover to the euro in Estonia. Preparations were made for the specially designed €2 commemorative coin to be produced in celebration of the 10th anniversary of the euro cash. The coin was released into circulation at the beginning of 2012.

Collector coins and numismatic products

In January 2011, Eesti Pank released into circulation the first series of euro collector coins, consisting of a €10 silver coin decorated with a diamond application and a €20 bimetallic collector coin.

The €10 silver collector coin is decorated with a diamond application and is called "The Future of Estonia". The coin depicts Kalevipoeg, the hero of the Estonian national epic, and Vanapagan, the villain of many Estonian folk tales, doing the national dance of kaerajaan under the blue sky of Estonia. The reverse of the coin displays the denomination "€10". The obverse of the silver coin depicts the Coat of Arms of the Republic of Estonia and bears the words "REPUBLIC OF ESTONIA" and the year of issue 2011. The mintage of the coin is 30,000. The design is by the local sculptor Simson von Seakyl, and the coin was produced by the Mint of Finland.

The €20 gold and silver bimetallic collector coin bears the name “The accession of Estonia”. The coin depicts the single currency system as a mechanism of a clock’s cogwheels. The reverse of the coin displays the denomination “€20”. The obverse depicts a freely drawn Coat of Arms of the Republic of Estonia, symbolising Estonia’s dynamic development. It also bears the words “REPUBLIC OF ESTONIA” and the year of issue 2011. The bimetallic coin has a mintage of 10,000. The coin was designed by the local artist Priit Pärn, and produced by the Mint of Finland.

The central bank also issued the first set of Estonia’s euro coins, consisting of eight Estonian euro circulation coins – one coin for each denomination. Designed by the local artists Tiiu Pirsko and Mati Veermets and produced by Zenith Print and Packaging, the coin set depicts the Estonian nature.

A collector coinset was launched in November 2011, containing Estonia’s euro circulation coins in proof quality. The set also includes a silver-coated medallion “Hello, euro!”, made of copper-nickel alloy. Produced by the Mint of Finland, the coinset’s mintage is 3,500.

Romeo Koitmäe
2009
"Storm"





COOPERATION

Central bank accountability

Central bank independence is an integral part of any monetary system that aims to ensure price stability. At the same time, the principles of modern democracies expect any independent institution performing public functions to be accountable for its actions. Eesti Pank, the autonomous central bank of the Republic of Estonia, has to explain its economic policy positions and decisions to Estonian citizens and their democratically elected representatives in a clear and profound manner. 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 reliability of the central bank and transparency of their activities are the preconditions for the smooth operation of the monetary system. Eesti Pank must provide the general public and the experts with regular, profound and high-quality information on the economy.

Eesti Pank may and must gather and publish monetary, financial and balance of payments statistics in its field of responsibility. The statistical data are published on the bank's website. The central bank publishes press releases and statements to comment on the latest economic data and developments. Four times a year, Eesti Pank publishes quarterly bulletins that focus either on monetary or financial policy issues (Estonian Economy and Monetary Policy, Financial Stability Review). The website includes also other publication series and single publications by the central bank. In addition, information can be requested by mail, e-mail or phone.

The Annual Report gives a detailed overview of the central bank's activities and the annual accounts for the year. After the Annual Report is approved by the Supervisory Board of Eesti Pank, the Board submits it to the Riigikogu together with the auditor's report. The Governor of Eesti Pank also makes a presentation in the Riigikogu on the Annual Report.

Accountability vis-à-vis the Riigikogu

Besides the Governor's annual presentation of the Annual Reports, the central bank and the Riigikogu cooperate in the form of meetings, and bank representatives 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 top executives of Eesti Pank have also introduced the central bank's economic policy standpoints and fields of responsibility to parliamentary factions upon their request.

International partnership

In 2011, international relations were influenced by the increasing volatility of the external environment and the sovereign debt crisis in the euro area which required enhanced cooperation. Focus was laid

on the efficient functioning of the international monetary system, development of the international financial safety net, and surveillance of the economic development and policy.

Communication with the European institutions makes up a bulk of Eesti Pank's international relations (see Table 7) and it changed significantly from 1 January 2011 when the central bank became a member of the Eurosystem. Consequently, partnership with other euro area NCBs and the European Central Bank enhanced in all areas. Furthermore, the European Systemic Risk Board and the European Banking Authority were put into operation within the framework of the new financial supervision system on 1 January 2011. This also helped to frame more clearly the role of the NCBs of the European Union in the common pursuit of financial stability.

Table 7. Eesti Pank's participation in the work of international organisations and institutions

Economic and Financial Committee	Informal meetings of the Economic and Financial Affairs Council
	Economic and Financial Committee
European Commission	European Banking Committee
	Committee on Monetary, Financial and Balance of Payments Statistics
	Balance of Payments Committee
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
	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	
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 central bank governors
	Monetary Policy Working Party
	Irving Fischer Committee

In addition to European institutions, Eesti Pank deems it important to participate in the work of other international institutions. The central bank represents Estonia in the International Monetary Fund (IMF). The law amendments affirming Eesti Pank as the country's representative in IMF entered into force in December 2011. The financial obligations related to the membership were thus transferred by the government to the central bank. In addition, Eesti Pank participates in the work of the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD).

Nordic and Baltic central banks have held a special place among Eesti Pank's partners for nearly twenty years. Estonia forms a constituency with these countries in the IMF and the World Bank, and cooperates with them in financial sector issues (see chapter "Safeguarding financial stability"). Together with Suomen Pankki, Eesti Pank manages part of the reserves of the ESCB. Cooperation takes place through bilateral meetings, presentations of research projects and seminars, and meetings for management members.

Eesti Pank also provided technical assistance in 2011, focusing on advising the central banks of EU candidate countries.

Cooperation with European Union institutions

The European System of Central Banks and the Eurosystem²⁶

Eesti Pank is a member of the Eurosystem since 1 January 2011. This means that twice a month, the Governor of Eesti Pank participates, together with other governors of euro area central banks, at the meetings of the Governing Council of the European Central Bank. The representatives of Eesti Pank participate as full members in the committees and substructures of the Eurosystem.

The Governing Council of the ECB is the main decision-making body in the Eurosystem. The Governing Council formulates the monetary policy in the euro area and makes decisions that implement the other tasks of the Eurosystem. Four times a year, the Governor of Eesti Pank, together with other governors of the EU NCBs, participates at the meetings of the General Council of the ECB.

Day-to-day work takes place in the seventeen committees of the Eurosystem and the European System of Central Banks, and their substructures. Comprising the representatives of central banks, the committees and working groups prepare the work of the decision-making bodies, the Governing Council and the General Council of the ECB. The committees cover all fields of central banks' responsibilities. In addition to committees, several high-level cooperation groups have been set up to implement major joint projects, for instance groups that include Eurosystem members and market participants (e.g. TARGET2-Securities Advisory Group, see chapter "Payment and settlement systems").

Together with the European Central Bank and the national central banks of 20 countries, Eesti Pank participates in the two-year technical assistance programme for the Serbian central bank. The programme started on 1 February 2011 and it aims at supporting the Serbian central bank in the imple-

²⁶ The European System of Central Banks (ESCB) comprises the European Central Bank and the central banks of all EU countries, regardless of whether or not they have adopted the euro. The Eurosystem consists of the European Central Bank and the central banks (a total of 17) of countries that have adopted the euro. See also <http://www.ecb.int/ecb/orga/escb/html/index.en.html>.

mentation of the EU NCB standards in 11 areas. The experts of Eesti Pank advise on the harmonisation of the legal regulation and statistics.

The European Financial Supervision System

2011 was the first full year of operation for the European Systemic Risk Board. The Governor of Eesti Pank participates in the work of the General Board of the ESRB, which met four times in 2011. See chapter “Safeguarding financial stability” for information on the selected decisions of the General Board.

Council of the European Union

Eesti Pank’s representatives attend various committees and working groups set up by the Council of the European Union. They were also engaged in preparing the meetings of the heads of state and government of EU Member States (European Council). These meetings mainly addressed the deepening of the euro area sovereign debt crisis in 2011, as well as economic and financial cooperation and functioning of the euro area

In April and September 2011, the Governor of Eesti Pank participated in the informal meetings of the Economic and Financial Affairs Council (ECOFIN). These meetings discussed the economic programmes for crisis countries, strengthening of the fiscal policy, and financial sector issues, such as the draft directive on the harmonisation of the capital requirements and evaluation of the results of banks’ stress tests.

The experts of Eesti Pank advise the Ministry of Finance in issues within the competence of the central bank at the monthly meetings preparing the ECOFIN. In 2011, the key issues involved the strengthening of public finance and the working principles of the European Financial Stability Facility and the European Stability Mechanism. ECOFIN also approved the EU positions for the G20 meetings and for several issues discussed in the IMF.

Eesti Pank also participates in the various substructures of the Council of the European Union, for instance the Economic and Financial Committee and its working groups related to the IMF as well as coins issues.

European Commission

Representatives of Eesti Pank attend the European Banking Committee, the Balance of Payments Committee and the Committee on Monetary, Financial and Balance of Payments Statistics and working groups dealing with communications, statistics, economic forecasts, payment and settlement systems, banking, banknotes and coins, and counterfeit money.

Meetings are held on a regular basis with the macro-economy experts of the European Commission, and the Estonian economists provide their input to the biannual economic forecast prepared by the European Commission.

Cooperation with the International Monetary Fund

The International Monetary Fund comprises 188 countries. 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, to prevent financial and balance of payments crises, and to facilitate international trade. Estonia has been a member of the IMF since 1992. The interests of Estonia in the IMF are represented by Eesti Pank (see also background information “National framework for the relations between Estonia and the IMF”).

The monetary relations between members and the IMF, and the voting power are based on the members' share or quota. After the reform of the IMF quotas and voting power, which was approved in 2008 and entered into force in March 2011, Estonia's quota increased by 31% to 93.9 million SDRs (the IMF unit of account) and the voting power rose by 46% to 0.067% of total votes. The parliament approved the rise in the Estonian quota in December 2011. Upon entry into force of the 14th general review of quotas approved by the Board of Governors in 2010, the Estonian quota will be raised by 149.7 million SDRs to 243.6 million SDRs, amounting to 0.051% of the total IMF quotas.

Estonia is represented at the IMF Annual Meeting by the Governor of Eesti Pank as a member of the IMF Board of Governors, and the Secretary General of the Ministry of Finance as the alternate member of the Board of Governors. The International Monetary and Financial Committee (IMFC), the advisory body to the Board of Governors, meets twice a year (in spring and in autumn), with Estonia represented by the Nordic-Baltic Constituency. Under the current rotation scheme, the eight constituency countries (Estonia, Iceland, Lithuania, Latvia, Norway, Sweden, Finland, Denmark) are represented by Denmark in 2010–2012.

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

Within the framework of statistical work, Eesti Pank participated in the implementation of the Coordinated Direct Investment Survey and the Coordinated Portfolio Investment Survey.

Against growing uncertainties in the global economy, the IMF Board of Governors and Executive Board focused in 2011 on strengthening the international monetary system and supporting countries affected by the crisis. The IMF focused on strengthening the IMF's lending capacity and improving its credit instruments, as well as on surveillance. In spring 2011, a new borrowing arrangement was introduced to increase the IMF resources. The Fund's lending capacity was raised to nearly 370 billion SDRs by increasing the country contributions. In addition, the IMF's surveillance priorities were reviewed in 2011. It was emphasised that increasing the traction of IMF policy advice is needed to safeguard financial and external stability.

In 2011, the IMF representatives visited Estonia twice. On 6–17 October, regular policy consultations were held, focusing on the adjustment of the Estonian economy and its long-term growth outlook.

The Article IV Report was prepared on the basis of the visits and published on the websites of the IMF and Eesti Pank on 29 November 2011. According to the Fund, Estonia's reliable economic and fiscal policy provided for a quick recovery of the country's economy. The main challenges highlighted by the IMF included the achievement of sustainable economic growth, strengthening of the fiscal framework, and lowering of the unemployment rate. Although the local banking system has been resilient to the global financial crisis, safeguarding the financial sector stability must remain a priority. For this purpose, cross-border supervision and cooperation must be enhanced.

National framework for the relations between Estonia and the IMF

Ever since Estonia joined the International Monetary Fund in 1992, Eesti Pank has been responsible for the country's relations with the IMF, cooperating with the government institutions. On 24 December 2011, a law amendment²⁷ entered into force, establishing this practice as a legal obligation.

Eesti Pank was appointed as the country's representative in the International Monetary Fund. The Governor of Eesti Pank represents Estonia in the highest decision-making body of the IMF, the Board of Governors, where he serves as the Governor of Estonia. The government also appoints the Alternate Governor, the Secretary General of the Ministry of Finance, to replace the Governor in the Board of Governors, if necessary. Eesti Pank coordinates Estonia's positions with the Ministry of Finance and presents them in the IMF. The partnership between Eesti Pank and the Ministry of Finance in IMF-related issues will be further stated in a Memorandum of Understanding.

In addition, the financial relations between Estonia and the International Monetary Fund were revised in 2011. The government transferred to Eesti Pank the financial obligations associated with the IMF membership. As a result, the government bonds issued to cover Estonia's quota in the IMF were replaced with the monetary contribution by Eesti Pank. In January 2012 Eesti Pank paid 34 million euros to the IMF due to the increase of the country's quota, following the change of the IMF's quota formula in 2008.

Cooperation with the Organisation for Economic Cooperation and Development

Cooperation with the Organisation for Economic Cooperation and Development (OECD) lies in the exchange of economic policy experience and development of best practices. The experts of Eesti Pank participate in the OECD working groups and committees that address the economic and financial sector policy and statistics. The central bank's representatives regularly meet with the OECD experts to present their views on the economic and financial sector trends and related policies. The OECD publishes Estonian economic reviews every two years.

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.

²⁷ The parliament adopted amendments to legislation relating to Estonia's membership in the IMF.

The meetings address the most topical monetary policy issues, economic and financial market situation in different regions, and financial sector management and supervision. The BIS committees develop the international best practices and standards for financial sector supervision and payment systems, and coordinate certain statistics related tasks of central banks.

Cooperation with rating agencies

Since 1997, Estonia has obtained assessments from three major international rating agencies: Moody's Investors Service, Standard & Poor's and Fitch Ratings. Communication with the rating agencies includes visits to Estonia by the agencies once a year and regular exchange of information.

Eesti Pank was responsible for the country's relations with the rating agencies until October 2011 when it became the responsibility of the Ministry of Finance. Eesti Pank will continue to respond to the information requests of the rating agencies and share its views on the Estonian economy and banking sector.

Domestic partnership

Eesti Pank works closely with other state institutions, professional associations, private sector representatives and universities. The management and experts of Eesti Pank also participate in various bodies for cooperation in Estonia (see Table 8).

Table 8. Domestic partnership

- Supervisory Board of the Financial Supervision Authority
- Supervisory Board of the Guarantee Fund
- Council of the Stabilisation Reserve Fund
- Statistical Council
- Estonian Council of Payment System Experts
- Risk Management Committee established with the Ministry of Finance
- Joint committee of the Ministry of Finance, Eesti Pank and the Financial Supervision Authority
- Coordination Council of EU issues
- Working group for revision and implementation of the Estonian strategy for competitiveness
- Government committee for simplification of administrative reporting
- NASDAQ OMX Tallinn Listing and Surveillance Committee
- European Payments Council Estonian Committee
- SWIFT National User Group with the Estonian Banking Association
- TARGET2-Securities Estonian National User Group
- Working group for communications with the Estonian Banking Association
- Committee for the development of the strategy for promoting financial literacy, set up with the Ministry of Finance
- Governmental committee for the coordination of money laundering prevention
- Working group for the development of national positions for representing Estonia in the European Commission, the European Court of Justice and the Court of First Instance
- Working group for the future enlargement of the European Union

The Governor and members of the Executive Board of Eesti Pank meet with the President of the Republic, the Prime Minister, the Minister of Finance and representatives of the parliamentary committees (Finance Committee, Economic Affairs Committee and European Union Affairs Committee). Together with the Ministry of Foreign Affairs, Eesti Pank has meetings with the ambassadors residing in Estonia and abroad.

Eesti Pank holds quarterly meetings for high officials of the central bank, the Ministry of Finance, the Ministry of Economic Affairs and Communications, the Prime Minister's Office, and the Economic Adviser to the President of the Republic. The topics of discussion include Estonia's economic situation and forecast, fiscal strategy, financial stability, labour market, international cooperation, to name a few.

Participation in the EU decision-making process is coordinated by the Coordination Council of EU issues, which was set up in 2005 and includes representatives of all ministries and the central bank. The Council coordinates the transposition of European Union legislation, discussion of EU-related positions submitted to the Government, and exchange of information between state institutions on EU matters. In August 2011, Eesti Pank organised a meeting of the Coordination Council, where the representatives of the central bank gave an overview of the role of Eesti Pank in the Eurosystem, and tasks related to the euro cash. Under the leadership of the EU Secretariat of the State Chancellery, the policy document "Estonia's European Union Policy for 2011–2015" was discussed prior to its submission to the government for approval.

Eesti Pank and the Ministry of Finance collaborate on a daily basis in drafting legislation, international communications and several other areas. A joint seminar of the central bank and the Ministry of Finance was organised in 2011, focusing on the outlook for economic growth, implementation of the EU fiscal and economic surveillance system, and sustainability of public finance and fiscal policy.

The Governor of Eesti Pank is a member of the Supervisory Board of the Financial Supervision Authority. Daily cooperation with the Financial Supervision Authority focuses on the surveillance of financial system developments, financial sector regulation and international partnership. The joint committee of Eesti Pank, the Ministry of Finance and the Financial Supervision Authority gathers on a quarterly basis to discuss financial sector policy issues.

Several high-level meetings were held in 2011 with the members of the Estonian Banking Association, the representatives of commercial banks operating in Estonia. The experts of commercial banks frequently meet with the representatives of Eesti Pank to specify the business and technical aspects of the development of the financial sector infrastructure, and statistical reporting requirements. The Governor of Eesti Pank is the Chairman of the Supervisory Board of the Guarantee Fund, with Eesti Pank providing asset management services to the Guarantee Fund.

To optimise the reporting burden in statistics, Eesti Pank works closely with Statistics Estonia, the producer of official statistics, and with the Financial Supervision Authority, the Estonian CSD, the Centre of Registers and Information Systems of the Ministry of Justice, and other partners. The Statistical Council, established under the Official Statistics Act in 2011, also plays an important role by engaging different interest groups in the development of official statistics. Deputy Governor of Eesti Pank represents the central bank in the Statistical Council.

In the management of cash circulation Eesti Pank cooperates, on a daily basis, with credit institutions and cash-in-transit (CIT) companies AS G4S Eesti and Eurex CS OÜ. Eesti Pank has also established a close relationship with several other companies, for instance Estonian Post Ltd. The national cash working group, which prepared the changeover to the euro, continued its meetings in 2011, with the participants including cash managers of credit institutions and representatives of CIT companies. In the spring and summer of 2011, the experts of Eesti Pank's Cash and Security Department organised training sessions for cash handlers. In the area of security, Eesti Pank also cooperates with the Ministry of the Interior, Ministry of Defence, the Police and Border Guard Board, the Security Police, the Rescue Board, the Defence Forces and the National Defence League. The Estonian Forensic Science Institute conducts expert analysis of suspected counterfeit cash under the cooperation agreement with Eesti Pank.

Public relations

The public relations of Eesti Pank support the central bank's primary objective of ensuring price stability in the euro area as well as achieving the strategic goals of the bank. Public relations and communication help market participants to form reasonable expectations of the economic development and pass economic decisions. Public appreciation of the central bank's activities and decisions secures the successful fulfilment of the tasks of the Eurosystem, including Eesti Pank. Public support also contributes to the stable and sustainable economic development of the country.

Eesti Pank's public relations aim to:

- improve the general public's understanding of the central bank's monetary policy and guarantee sufficient support for it;
- maintain and enhance the reputation of Eesti Pank as a competent, independent and trustworthy institution that plays a significant role in guiding Estonia's economic policy and economic development;
- guarantee the best possible availability of background information for market participants to support their economic decisions.

Eesti Pank's communication policy is governed by five principles: the bank strives to be trustworthy, open, unanimous, comprehensible and representative. This means that the main priority of communication is to develop and maintain the image of trustworthiness. This, in turn, is rooted in competence and open communication – the central bank's communication is always comprehensible, whatever the channel and whoever the spokesperson might be. Eesti Pank's spokespersons, and the bank's staff in general, must always bear in mind that they represent Eesti Pank at any given moment in time.

From the beginning of 2011, Eesti Pank also serves as a representative of the Eurosystem. This has generated new tasks and added weight to the principles of communication. For instance, the members of the Governing Council of the European Central Bank, including the Governor of Eesti Pank, have agreed not to comment or give interviews on the forthcoming decisions one week before the meeting scheduled for adopting monetary policy decisions.

As a member of the Eurosystem and a central bank of the euro area, Eesti Pank also upholds the image of the Eurosystem and the euro. The trustworthiness of the Eurosystem is as important as the trustworthiness of Eesti Pank. Eesti Pank is in the position to give consistent and comprehensible explanations, so that people would understand the developments in the euro area. Public support helps to achieve economic and financial stability in the euro area.

Eesti Pank regularly provides comprehensive information regarding its fields of activity and economic policy. The bank has undertaken to publish information more extensively and frequently than is laid down by its legal accountability (see also “Central bank accountability” in the chapter “Cooperation”). In 2011, the central bank presented its views of the Estonian economic situation four times (two financial sector overviews and two economic forecasts) and published 16 statements about current economic indicators, as well as several other overviews and analyses²⁸. We also mediated a total of 15 press releases of the European Central Bank in 2011, and published on our website the Estonian-language editorials of the monthly bulletin of the European Central Bank.

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 private and state subscribers, and they are read both in Estonia and abroad. In addition, Eesti Pank sends its publications to Estonian universities, libraries and media organisations to foster financial education. All the publications of Eesti Pank are also available on the bank’s website.

In addition to 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. Similarly to 2010, the number of daily inquiries increased substantially in 2011: Eesti Pank received a total of 5,162 inquiries, with 3,978 inquiries submitted by phone and 1,184 inquiries by e-mail and mail and through the “Ask a question” website interface. Of the inquiries, 25 were registered as requests for information.

The number of questions asked from Eesti Pank soared in the last quarter of 2010, when people were most interested in the practical aspects of the changeover to the euro. Many questions concerned the validity of euro coins, the deadline for currency exchange and the exchange rate; a lot of attention and interest focused on the starter kits of Estonian euro coins. Detailed questions were also asked about the euro information campaigns or major changes implemented. For instance, business owners were highly 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.

Media communication and public appearances

Approximately 5,200 written articles, news stories, 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 2011. The beginning of the year witnessed huge media interest in the changeover to the euro, especially its technical aspects. The interest in Estonian kroons still in circulation persisted throughout the year. Alongside the progress of the adoption of the euro, there was great interest in the euro area economic and financial position, and the impact of the financial crisis on the economic development and outlook. Price rises remained of interest throughout the year.

²⁸ See also “Publications of Eesti Pank in 2011”.

In 2011, Eesti Pank held nine press conferences and presentations, and issued 119 press releases and statements. In addition, 38 longer interviews were conducted with the bank's executives and experts, and seven economic policy articles were published. Representatives of the central bank made approximately 30 public presentations in Estonian, Russian or English.

Eesti Pank's communication projects in the Eurosystem

In 2011, Eesti Pank started to participate in the awareness raising projects of the euro area national central banks. The NCBs have focused their attention to raising public awareness of the security features of euro cash in order to prevent the spread of counterfeit banknotes. All euro area NCBs, including Eesti Pank, disseminate comprehensive information on the security features of banknotes as well as guidelines on how to identify counterfeit banknotes. The majority of the projects have been designed for the specific purpose of raising awareness among different target groups.

The first major project was the online "Euro Run" competition, conducted among basic school students in Estonia. The aim of the game was to identify the security features of euro banknotes and the national sides of euro coins, and also collect points in the process. There was active student participation in the competition from schools all over Estonia. The four classes with the highest scores were invited to the finale in Eesti Pank, with the 6th grade of the Suure-Jaani Secondary School declared the winner. Representatives of the European Central Bank participated in the finale and the price award ceremony. A new round of the competition will be held in 2012, providing students with the opportunity to participate in the pan-European competition and to advance to the finale in Frankfurt.

In the spring and summer of 2011, the experts of Eesti Pank's Cash and Security Department conducted several training sessions for cash handlers. Detailed information on the euro banknote security features is available on the websites of Eesti Pank and the European Central Bank. Brochures on these subjects may be ordered from Eesti Pank or printed out from the bank's website.

Another major Eurosystem project in which Eesti Pank participated in 2011 was the preparation for the 10th anniversary of the euro cash. Even though Estonia had been a member of the monetary union for less than a year, we helped prepare the information materials. A special logo was designed for the anniversary, comprising the corresponding information and drawing attention to the single currency's ten-year history. Once again, focus was laid on the security of the euro. A short film was published on the production of euro banknotes and coins and their security features. The "feel-look-tilt" method familiar to Estonians from the changeover campaign, was used in the short film. All materials dedicated to the 10th anniversary of the euro cash are available on the websites of Eesti Pank and the European Central Bank.

The advancement of financial knowledge plays an important role in the Eurosystem. For this purpose, the European Central Bank, along with other euro area NCBs, has developed online games for various target groups. The games have been designed to explain the logic behind economy and economic policy ("€conomia") as well as price hikes and price stability („Inflation Island"), especially to secondary school students. Still, all interested students are able to test their knowledge through the game. Simpler games are available to primary and basic school students, along with interactive presentations on the activities of the central bank and security features of euro cash.

The Eurosystem plans to continue these games, and to disseminate general financial knowledge. In addition to cooperation with various establishments and schools, central banks also have their own museums, which introduce the monetary history and provide interactive and fascinating ways of becoming acquainted with the central bank and its tasks.

Eesti Pank Museum

The Eesti Pank Museum was closed down in April 2011, re-opening with a new display on new premises at the end of the year.

Although the museum was completely transformed, its main objective remained the same: to maintain and cherish the history of Eesti Pank and Estonian money as a part of the Estonian cultural heritage. The museum was also charged with the task of introducing and explaining the role of the central bank and its tasks in the society. Herein lies the biggest challenge for the new museum in the forthcoming years. Banking is made attractive through interactive games and lecture series intended to complement classes conducted in schools on the subject.

Above all, the museum endeavours to widen the horizons of students of all ages. Still, the museum is of interest to all those who wish to freshen their knowledge of the Estonian money, central bank or its activities.

The preparatory work for the new museum started in 2008, with the preparation for construction and design continuing in 2009 and 2010. The total cost of the project amounts to 1.7 million euros.

The new museum of Eesti Pank was first presented on 30 December 2011 and daily work started on 3 January 2012.

Ülo Udumäe
2010
"Võrumaa"





GOVERNANCE, ORGANISATION AND HUMAN RESOURCES POLICY

The supervisory and governing bodies of Eesti Pank

The Supervisory Board of Eesti Pank

The Supervisory Board of Eesti Pank serves as the supervisory body of Eesti Pank. The competence of the Supervisory Board is stipulated in the Eesti Pank Act. Among other things, the following issues are in the exclusive competence of the Supervisory Board:

- 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 the Head of the Internal Audit Department of Eesti Pank; appointment and removal of two members to the Supervisory Board of the Financial Supervision Authority²⁹ on the proposal of the Governor of Eesti Pank;
- approval of the Statute of Eesti Pank and the statutes of the independent divisions and representative offices of Eesti Pank and the Internal Audit Department;
- supervision of the implementation of the budget of Eesti Pank;
- appointment of internal auditors of Eesti Pank, approval of the work schedule for internal audits and adoption of decisions based on the audit results;
- appointment of the independent auditors of Eesti Pank;
- approval of Eesti Pank's annual report on the proposal of the Governor;
- review and approval of 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 the economy, monetary policy and financial sector in Estonia and the euro area, and on the implementation of the central bank's budget. The Supervisory Board gathers at least eight times a year.

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; Irene Kull, Professor and Head of Chair of Commercial Law and Intellectual Property Law at the Institute of Private Law, University of Tartu; Enn Listra, Professor with the School of Economics and Business Administration at the Tallinn University of Technology; Tõnis Palts, public figure and economist; Liina Tõnisson, public figure and economist; and Urmas Varblane, Professor with the Chair of International Business and Innovation, Faculty of Economics of the University of Tartu. Jürgen Ligi, Member of the Riigikogu, was also appointed a member of the Supervisory Board of Eesti Pank, but his membership has been suspended in relation to his appointment as Minister of Finance on 4 June 2009. For the time of his 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.

²⁹ The Supervisory Board of the Financial Supervision Authority consists of six members. Two of these members – the Minister of Finance and the Governor of Eesti Pank – are members by virtue of office, while the other four members appointed. The Chairman of the Supervisory Board is the Minister of Finance. Half of the appointed members are appointed and removed by the Government of the Republic 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 has been the Governor of Eesti Pank since 7 June 2005.

The Executive Board of Eesti Pank

The Executive Board serves as the governing body of Eesti Pank. The Governor of Eesti Pank is, by virtue of office, the Chairman of the Executive Board. The Executive Board consists of the Governor and Deputy Governors.

In 2011, the Executive Board comprised Governor Andres Lipstok and Deputy Governors Rein Minka and Märten Ross, whose term of office expired on 7 July 2011. The Supervisory Board of Eesti Pank appointed Ülo Kaasik and Madis Müller as the new Deputy Governors on 8 July 2011 and 1 September 2011, respectively.

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.

In connection with the changes in the Executive Board of Eesti Pank, the fields of responsibility of the members of the Executive Board were changed in 2011.

Until September 2011, Governor Andres Lipstok was responsible for the overall governance of the bank, revision and supervision of the bank's management system, public and international relations, development of the legal environment, internal administrative services and the operational working environment. From September, the Governor is no longer responsible for the operational working environment. Instead, the Governor is now responsible for human resources management and development of the organisation as well as coordination of currency circulation and safety of the working environment. The Governor also supervises the work of Deputy Governors and the Head of the Internal Audit Department.

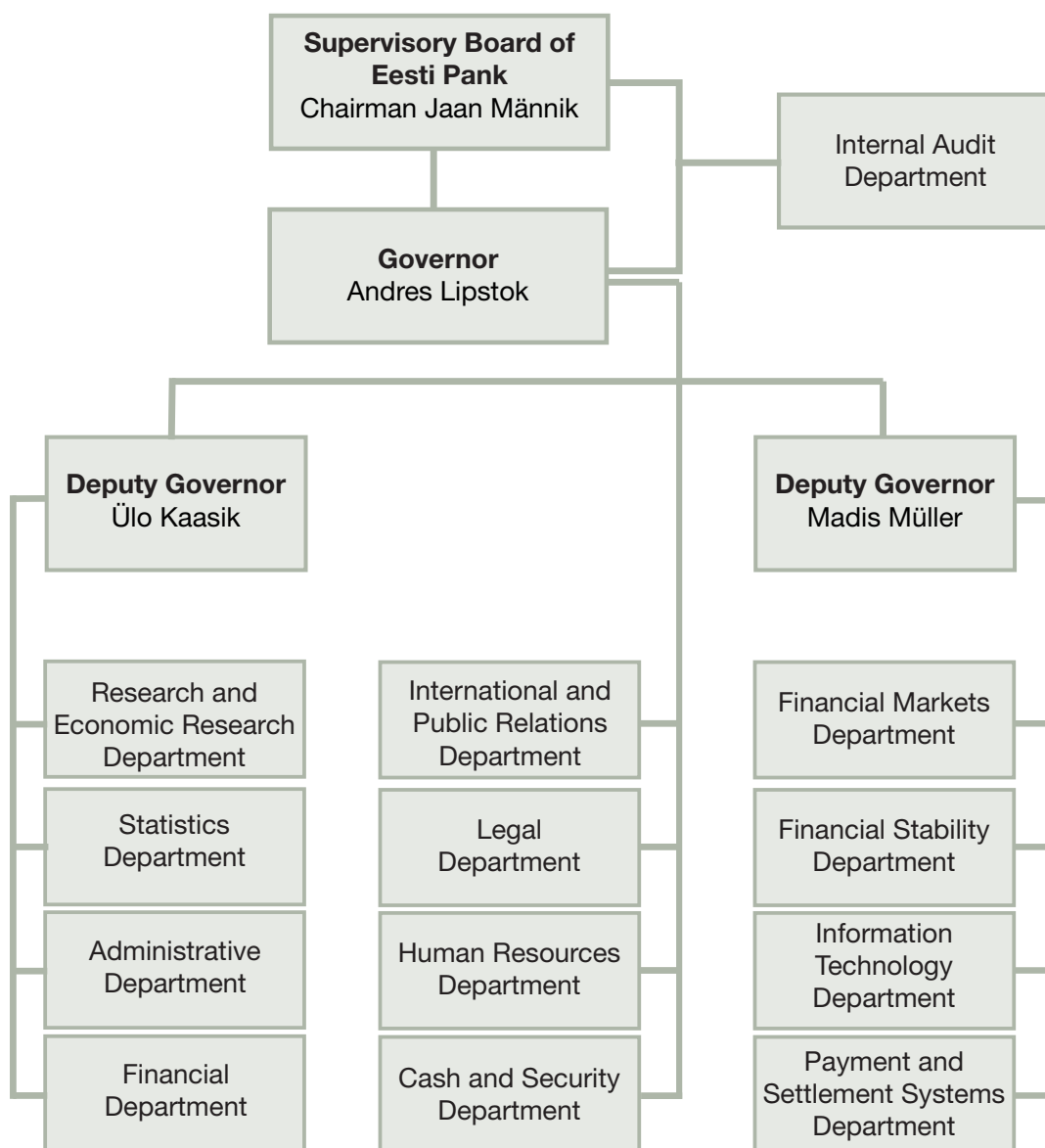
Deputy Governor Märten Ross, whose term of office expired on 7 July 2011, was responsible for the preparation and implementation of monetary policy decisions, management of the financial assets of Eesti Pank, coordination of the collection, compilation and disclosure of official statistics, coordination of the economic research and activities related to in-service economic training, as well as financial accounting and reporting.

Deputy Governor Rein Minka, whose term of office expired on 7 July 2011, was responsible for coordination of the currency circulation, safety of the working environment, reliable and integrated

development of the settlement systems of Eesti Pank, information technology working environment, human resources management, development and implementation of financial sector policies, coordination of the collection, handling and disclosure of financial sector information.

From September 2011, Deputy Governor Ülo Kaasik is responsible for the preparation of monetary policy decisions, economic research, financial accounting and reporting, external sector statistics and other tasks related to statistics, as well as internal administrative services and the operational working environment.

Organisation chart of Eesti Pank (31/12/2011)



Deputy Governor Madis Müller is responsible for the reliable and cost-efficient development of the settlement systems, information technology working environment, safeguarding financial stability, coordination of the collection and disclosure of financial sector statistics, implementation of monetary policy decisions, and management of the financial assets of Eesti Pank.

Cooperation with the Financial Supervision Authority

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

The Financial Supervision Authority is governed by the Management Board, chaired by Raul Malmstein. The tasks of the Financial Supervision Authority are planned by the Supervisory Board chaired, by virtue of office, by the Minister of Finance (Jürgen Ligi in 2011). Members of the Supervisory Board of the Financial Supervision Authority include Governor of Eesti Pank Andres Lipstok, member of the Supervisory Board of Eesti Pank Valdo Randpere and Rein Minka, who has been appointed by Eesti Pank.

The development of the management system and work organisation of Eesti Pank in 2011

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 of 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 2011. In addition to recommendations related to the organisation, initial feedback was collected on the changeover to the euro. The proposals and feedback were discussed at the special seminar with the bank's staff.

The development of the management system of Eesti Pank

The merger of the Economics Department and the Research Department into the Economics and Research Department was launched in the summer of 2011 and completed in autumn.

In 2011, Eesti Pank also transformed the bank's Management System Committee, which is now called the Organisational Development Committee. The transformation serves to secure a broad-based preparation for the development of the organisation.

Bureau Veritas Eesti OÜ validated the ISO 9001:2008 quality certificate awarded to the bank's Cash and Security Department in 2002. The quality certificate confirms that cash handling and cash security in Eesti Pank comply with the standard requirements.

The biennial staff satisfaction and dedication survey was conducted by TNS Emor for the sixth time. The survey confirmed the high dedication of the bank's staff.

e-Eesti Pank

The key challenges of e-Eesti Pank or the administrative services development strategy included:

- integration with the euro area document management system;
- harmonisation of Eesti Pank's administrative services with the standards of the European Central Bank;
- reorganisation of documents worth archiving;
- review of the metadata of document registers;
- evaluation of the archiving value of Eesti Pank's documents in cooperation with the State Archives;
- preparation for the ordering and accounting of collector coins intended as gifts.

Risk management

The management of risks and business continuity continued in 2011 in compliance with the established principles and procedures. Eesti Pank's accumulated risk level showed no major changes from 2010. The bank has implemented sufficient risk management measures.

In the field of business continuity management, Eesti Pank participated in the analysis of the Emergency Act organised by the Ministry of the Interior, making proposals on the improvement of the regulation and organisation of critical services. In 2011, the principles for testing the central bank's business continuity plan were reviewed, with the number and scope of the tests enhanced. This serves to ensure that the bank is ready to respond to any crisis.

The human resources policy of Eesti Pank

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 when internal competition has failed or when 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 32 million euros. 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 2011, the total remuneration (basic wages and additional remuneration) paid to the members of the Supervisory Board amounted to 105,837.96 euros and that of the Executive Board to 381,033.99 euros. The remuneration to members of the Executive Board also includes the compensations to Deputy Governors for termination of contract.

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 2011, the average monthly wages (including holiday pay and additional remuneration for working during evening and night hours, on days off and public holidays) was 1,856.5 euros (1,922 euros in 2010). 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 2011, the monthly wages of a specialist complying with these requirements was 1,450.02 euros (1,545 euros in 2010).

At the beginning of 2011, the bank had contracts of employment with 260 employees (244 were actually working, as contracts with 16 employees had been suspended), while at the end of the year the respective figure was 259 (244 were actually working and 15 contracts had been suspended). The reasons for suspending contracts of employment were maternity leave, service with the European Central Bank or other international organisations.

The average age of the staff in 2011 was 43.5 years. The employees included 105 men (41%) and 154 women (59%).

Development and training

Development costs totalled 206,161 euros in 2011, which accounts for 2.7% of the staff's payroll. In total, 213 employees (87% of total staff) attended trainings. On average, every employee received 3.9 days of training with the total cost of 830 euros.

The most popular fields of training in 2011 included management and communication, and languages, with the corresponding training volume being twice as high as that of other areas. 98% of the trainings in core fields took place abroad. Regarding other areas, the volume of training conducted in Estonia was twice as high as training abroad. Implementation of the in-house training budget was extremely low in 2011 (32.8%). This may be attributed to the cancellation of two major trainings in core fields for various reasons, and the postponement of the management reserve training to the beginning of 2012.

In 2011, 54 employees were engaged in further education: 80% of them were acquiring a Master's or Doctor's degree.

One employee of Eesti Pank participated in a short-term secondment programme at the European Central Bank (two weeks) and one employee at Suomen Pankki (three months). In turn, Eesti Pank hosted an employee of Deutsche Bundesbank (two weeks), an employee of the European Central Bank (two weeks) and an employee of the Ministry of Finance (one month).

The sports club

The sports club of Eesti Pank had 247 members at the end of 2011. The most popular sports included swimming, fitness, badminton, basketball, volleyball, tennis, yoga, dancing, bowling and cross-country skiing. In addition, winter sports games were held in Jäneda and summer sports days in Kihnu. Members of the staff also went bowling and sailing, and participated in chess tournaments.

Within the framework of company sport, members of the central bank's staff participated in tennis, soccer and volleyball competitions, as well as the bank league for basketball. Our representatives

also participated in the sports events of the European central banks in indoor soccer in Finland, basketball in France, badminton in Luxembourg and chess in Spain.

We also successfully battled with the Financial Supervision Authority in soccer and basketball.

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 now comprises 25 members and has been conducted by Sven Peterson since the beginning of 2011. The choir is coordinated by the board that is elected every year.

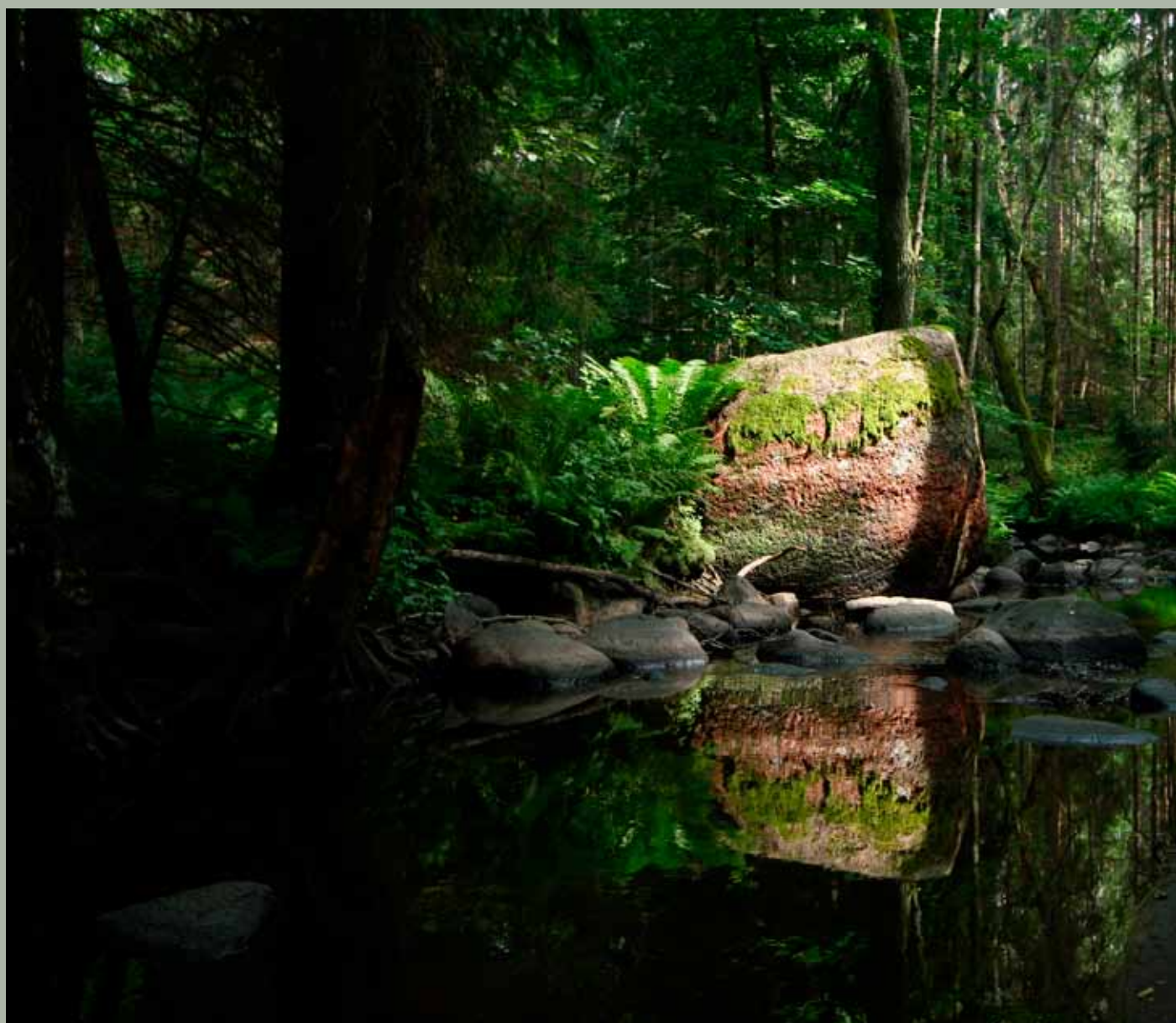
The highlights for 2011 included participation in Euroculture, the ESCB culture festival organised by the central bank of Portugal in Lisbon. We also continued our Christmas concert tradition.

Veiko Belials

2012

"A large boulder indulging in the sun"

Photograph taken in the framework of the year of forests photo project "There is life in the forest."





ANNUAL
ACCOUNTS
OF EESTI PANK

for the financial
year ended
31 December 2011

**APPROVAL OF THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR
ENDED 31 DECEMBER 2011 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 2011.

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

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

On 27 March 2012, all members belonging to the Executive Board of Eesti Pank on that day signed the Annual Accounts.

Andres Lipstok

Governor of Eesti Pank,
Chairman of the Executive Board

Ülo Kaasik

Deputy Governor,
Member of the Executive Board

Madis Müller

Deputy Governor,
Member of the Executive Board

BALANCE SHEET AS AT 31 DECEMBER 2011 AND 2010

EUR thousand

	Note	31/12/2011	31/12/2010
ASSETS			
Gold and gold receivables	1	10,039	8,702
Claims on non-euro area residents denominated in foreign currency		151,829	132,790
Receivables from the IMF	2	74,133	72,653
Balances with banks, security investments and other external assets	3	77,696	60,137
Claims on euro area residents denominated in foreign currency	4	4,929	5,388
Claims on non-euro area residents denominated in euro	5	1,650	431,011
Lending to euro area credit institutions related to monetary policy operations denominated in euro	6	0	0
Other claims on euro area credit institutions denominated in euro	7	12,128	15,227
Securities of euro area residents denominated in euro		544,214	1,179,538
Securities held for monetary policy purposes	8	344,311	0
Other securities	9	199,903	1,179,538
Intra-Eurosystem claims		2,333,169	116,280
Participating interest in ECB	10	79,911	722
Claims equivalent to the transfer of foreign reserves	11	103,116	0
Net claims related to the allocation of euro banknotes within the Eurosystem	12	1,501,976	0
Other claims within the Eurosystem (net)	13	648,166	115,558
Other assets		43,557	55,940
Tangible fixed assets	14	23,272	22,407
Other financial assets	15	217	217
Off-balance-sheet instruments revaluation differences	16	317	4,681
Accruals and prepaid expenses	17	11,959	5,501
Sundry	18	7,792	23,134
Loss for the year		0	1,723
TOTAL ASSETS		3,101,515	1,946,599
LIABILITIES			
Banknotes in circulation	19	2,140,879	364,192
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro		465,676	1,125,386
Current accounts (covering the minimum reserve system)	20	252,624	1,125,386
Deposit facility	21	54,052	0
Fixed-term deposits	22	159,000	0
Liabilities to other euro area residents denominated in euro	23	8,737	6,509
Liabilities to non-euro area residents denominated in euro	24	14	214
Counterpart of the special drawing rights allocated by the IMF	25	73,536	72,066
Other liabilities		38,909	26,297
Off-balance-sheet instruments revaluation differences	16	2,695	584
Accruals and income collected in advance	26	2,910	10,342
Sundry	27	33,304	15,371
Provisions	28	18	81
Revaluation accounts	29	9,740	8,798
Capital and reserves	30	341,333	343,056
Capital		130,233	38,347
Reserves		211,100	304,709
Profit for the year		22,673	0
TOTAL LIABILITIES		3,101,515	1,946,599

The notes on pages 103–127 form an integral part of the Annual Accounts.

PROFIT AND LOSS ACCOUNT FOR 2011 AND 2010

EUR thousand

	Note	2011	2010
Interest income		31,524	23,128
Interest expense		-10,901	-11,295
Net interest income	31	20,623	11,833
Realised gains/losses arising from financial operations		4,684	9,268
Write-downs on financial assets		-509	-2,222
Net result of financial operations, write-downs and risk provisions	32	4,175	7,046
Fees and commissions income		825	926
Fees and commissions expense		-101	-67
Net income from fees and commissions	33	724	859
Income from equity shares and participating interests	34	1,738	174
Net result of pooling of monetary income	35	8,520	0
Other income	36	6,248	3,261
Total net income		42,028	23,173
Staff costs	37	-7,701	-7,715
Administrative expenses	38	-5,312	-5,422
Depreciation of tangible fixed assets	14	-2,233	-2,000
Other expenses	39	-4,109	-9,759
Operating expenses		-19,355	-24,896
Profit (+) / loss (-) for the year		22,673	-1,723

The notes on pages 103–127 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 drafted in accordance with the rules established on the basis of Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank. The parts of the Annual Accounts that are not regulated by ECB guidelines have been drafted in accordance with the accounting principles generally accepted in Estonia.

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

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 euros (EUR thousand) unless indicated otherwise.

Estonia joined the euro area on 1 January 2011 and the Estonian kroon (EEK) was replaced by the euro (EUR). Eesti Pank converted its accounting to euros on the date of changeover to the euro and the Annual Accounts were prepared in euros. The comparative data for 2010 that are included in the Annual Accounts for 2011 were converted at the official exchange rate of 1 euro = 15.6466 kroons. The structure of Eesti Pank's Balance Sheet and the Profit and Loss Account changed in 2011 after Estonia's accession to the euro area. The balance sheet items are grouped by residency (euro area, non-euro area) and currency (euro, other currencies). The assets and liabilities related to monetary policy are recorded on separate rows. Consequently, the data for the comparable period are presented differently from the previous Annual Accounts and the data for 2010 have been adjusted as follows:

EUR thousand

	Note	Preliminary 31/12/2010	Adjustment	Adjusted 31/12/2010
ASSETS				
Gold and gold receivables	1	8,702	0	8,702
Claims on non-euro area residents denominated in foreign currency		1,955,330	-1,822,540	132,790
Receivables from the IMF	2	148,470	-75,817	72,653
Balances with banks, security investments and other external assets	3	1,806,860	-1,746,723	60,137
Claims on euro area residents denominated in foreign currency	4	0	5,388	5,388
Claims on non-euro area residents denominated in euro	5	0	431,011	431,011
Other claims on euro area credit institutions denominated in euro	7	0	15,227	15,227
Securities of euro area residents denominated in euro		0	1,179,538	1,179,538
Other securities	9	0	1,179,538	1,179,538
Intra-Eurosystem claims		722	115,558	116,280
Participating interest in ECB	10	722	0	722
Other claims within the Eurosystem (net)	13	0	115,558	115,558
Other assets		55,940	0	55,940
Tangible fixed assets	14	22,407	0	22,407
Other financial assets	15	217	0	217
Off-balance-sheet instruments revaluation differences	16	4,681	0	4,681
Accruals and prepaid expenses	17	5,501	0	5,501
Sundry	18	23,134	0	23,134
Loss for the year		0	1,723	1,723
TOTAL ASSETS		2,020,694	-74,095	1,946,599
LIABILITIES				
Banknotes in circulation	19	373,128	-8,936	364,192
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro		1,009,868	115,518	1,125,386
Current accounts (covering the minimum reserve system)	20	1,009,868	115,518	1,125,386
Liabilities to other euro area residents denominated in euro	23	6,509	0	6,509
Liabilities to non-euro area residents denominated in euro	24	0	214	214
Liabilities to euro area residents denominated in foreign currency		115,518	-115,518	0
Counterpart of the special drawing rights allocated by the IMF	25	147,929	-75,863	72,066
Other liabilities		17,530	8,767	26,297
Off-balance-sheet instruments revaluation differences	16	584	0	584
Accruals and income collected in advance	26	10,298	44	10,342
Sundry	27	6,648	8,723	15,371
Provisions	28	81	0	81
Revaluation accounts	29	8,798	0	8,798
Capital and reserves	30	343,056	0	343,056
Capital		38,347	0	38,347
Reserves		304,709	0	304,709
Profit for the year		-1,723	1,723	0
TOTAL LIABILITIES		2,020,694	-74,095	1,946,599

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

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

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

The special drawing right (SDR) of the International Monetary Fund (IMF) is defined in terms of a basket of currencies. To revalue Eesti Pank's holdings of SDRs, the value of the SDR was calculated as the weighted sum of the exchange rates of four major currencies (the US dollar, euro, Japanese yen and pound sterling) converted into euro as at 30 December 2011.

The exchange rates applied on 31 December 2011 and 2010 were as follows:

	31/12/2011	31/12/2010*
USD	1.2939	1.3361
GBP	0.8353	0.8621
JPY	100.2	108.6652
SDR	1.1867	1.1630

* Eesti Pank's exchange rate converted at EEK/EUR 15.6466.

Gold

Gold is valued at the market price prevailing at the year-end. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on the basis of the price in euro per fine ounce of gold, which, for the year ending 31 December 2011, was derived from the exchange rate of the euro against the US dollar on 30 December 2011.

Securities

Marketable securities (other than those classified as held-to-maturity) and similar assets are valued either at the mid-market prices or on the basis of the relevant yield curve prevailing on the balance sheet date, on a security-by-security basis. For the year ending 31 December 2011, mid-market prices on 30 December 2011 were used.

Securities held for monetary policy purposes classified as held-to-maturity are valued at amortised cost subject to a Eurosystem impairment framework.

Income recognition

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

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

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

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

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

Reverse transactions

Repurchase transactions (sale/repurchase transactions) are recorded as collateralised deposits taken at their fair value; that is, securities are recorded as assets on the Balance Sheet and the repurchase amount as a liability. Interest payable is recorded on an accrual basis on the Balance Sheet under *Accruals and income collected in advance*.

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

Investment in shares

Investment in shares is recorded at market value if it can be assessed reliably. The measurement of the market value of shares is not reliable if the shares are not actively traded and there are no alternative methods to measure their value reliably. 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 3,200 euros. Fixed assets are recorded at cost, which includes purchase price and other expenditure directly related to the use of these assets. 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. Pre-payments 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:

	2011
Buildings	3%
Utility systems of buildings	10%
Hardware	20%
Software	15–50%
Other fixed assets	7–20%

The need to differentiate between software depreciation rates arises from 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.

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, as well as 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, while 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

The values of assets and liabilities are adjusted for events that occur between the annual 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.

Banknotes in circulation

The European Central Bank and the euro area national central banks, which together comprise the Eurosystem, issue euro banknotes.¹ The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month in accordance with the banknote allocation key.²

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

¹ Decision ECB/2010/29 of 13 December 2010 on the issue of euro banknotes (recast), OJ L 35, 9.2.2011, p 26.

² Banknote allocation key – the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in that total.

The difference between the value of euro banknotes allocated to each Eurosystem central bank in accordance with the banknote allocation key and the value of euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which bear interest,³ are disclosed under the sub-item *Intra-Eurosystem balances: net claims/liabilities related to the allocation of euro banknotes within the Eurosystem* (see *Intra-Eurosystem balances* in the notes on accounting policies).

From the cash changeover year⁴ until five years following the cash changeover year the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the Eurosystem central bank's relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments will be reduced in annual stages until the first day of sixth year after the cash changeover year when income on banknotes will be allocated fully in proportion to the Eurosystem central bank's paid-up shares in the ECB's capital. The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under *Net interest income*.

Interim profit distribution

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, and the ECB's (net) income arising from SMP securities shall be due in full to the NCBs in the same financial year it accrues. The European Central Bank shall distribute this income in January of the following year in the form of an interim distribution of profit.⁵ The amount of the ECB's income on euro banknotes in circulation may be reduced in accordance with any decision by the Governing Council in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes. Before the end of the year the Governing Council decides whether all or part of the ECB's income arising from SMP securities and, if necessary, all or part of the ECB's income on euro banknotes in circulation should be retained to the extent necessary to ensure that the amount of the distributed income does not exceed the ECB's net profit for that year.

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

Intra-Eurosystem balances

The European System of Central Banks' (ESCB) transactions are cross-border transactions between two national central banks of the European Union. The intra-ESCB transactions are settled primarily in TARGET2 – the Trans-European Automated Real-time Cross Settlement Express Transfer system

³ Decision ECB/2010/23 of 25 November 2010 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast), OJ L 35, 9.2.2011, p 17.

⁴ The year of changeover to the euro is the year when euro banknotes become the legal tender of a Member State.

⁵ Decision ECB/2010/24 of 25 November of 2010 on the interim distribution of the income of the European Central Bank on euro banknotes in circulation and arising from securities purchased under the Securities Market Programme (recast), OJ L 6, 11.1.2011, p 35.

(see chapter "Payment and settlement systems" in the Annual Accounts) – and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. Intra-Eurosystem balances of euro area NCBs vis-à-vis the ECB arising from TARGET2, as well as other intra-Eurosystem balances denominated in euro (e.g. interim profit distributions to NCBs) are presented in the Balance Sheet as a single net asset or liability position and disclosed under *Other claims within the Eurosystem (net)* or *Other liabilities within the Eurosystem (net)*.

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

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

Notes on the Balance Sheet

ITEM 1 – GOLD AND GOLD RECEIVABLES

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

	Amount (ounce)	Market price per ounce (EUR)	Market value (EUR thousand)
Balance at the end of 2010	8,250.171	1,054.77*	8,702
Revaluation	-	-	1,337
Balance at the end of 2011	8,250.171	1,216.86	10,039

* Eesti Pank's exchange rate converted at EEK/EUR 15.6466.

ITEM 2 – RECEIVABLES FROM THE IMF

Receivables from the IMF include the SDR account in the IMF, reserve position in the IMF and other receivables.

EUR thousand

	31/12/2011	31/12/2010
Receivables from the IMF	74,133	72,653
SDR account in the IMF	73,607	72,137
Other receivables from the IMF	518	508
Reserve position in the IMF	8	8

The SDR account in the IMF

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

Reserve position in the IMF

Eesti Pank acts as a fiscal agent between the Republic of Estonia and the IMF and as a depository of IMF's euro 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. The quota of the Republic of Estonia in the IMF was 65,200,000 SDRs at the end of 2011.

The Republic of Estonia has paid its subscription in government debt obligations deposited with Eesti Pank. These debt obligations do not bear interest.

The reserve position in the IMF comprises of the net amount of the quota and the debt obligations.

EUR thousand

	31/12/2011	31/12/2010
Reserve position in the IMF	8	8
Participation in the IMF	77,373	75,827
IMF securities account and IMF No. 1 account (liabilities)	-77,365	-75,819

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%.

EUR thousand

	31/12/2011	31/12/2010
Other receivables from the IMF	518	508
Eesti Pank, SBA loan-related receivable	399	391
Government, STF loan-related receivable	119	117

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

Item 3 reflects balances with banks and security investments denominated in US dollars. In 2011, Eesti Pank's foreign reserves were invested mainly in the low-risk government bonds of the United States (for further information on investments see "Reserve management" in the Annual Accounts).

EUR thousand

	31/12/2011	31/12/2010
	77,696	60,137
Securities	66,018	48,887
Current accounts	11,678	11,250

EUR thousand

	31/12/2011	31/12/2010	Change
	77,696	60,137	17,559
USD	76,910	59,438	17,472
GBP	214	361	-147
CAD	197	152	45
SEK	159	71	88
AUD	90	31	59
JPY	63	23	40
NZD	18	17	1
DKK	17	18	-1
CHF	15	12	3
NOK	13	14	-1

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

Item 4 reflects the balances with banks vis-à-vis euro area residents denominated in foreign currency.

EUR thousand

	31/12/2011	31/12/2010	Change
	4,929	5,388	-459
USD	2,782	3,483	-701
GBP	978	242	736
AUD	640	371	269
JPY	217	143	74
SEK	179	406	-227
CAD	94	326	-232
NOK	30	401	-371
CHF	8	15	-7
NZD	1	1	0

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

Item 5 reflects security investments denominated in euro vis-à-vis non-euro area residents as at 31 December 2011. Item 5 decreased in 2011 because at the end of 2010 the item included also fixed-term deposits and reverse repurchase transactions.

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

The total Eurosystem holding of monetary policy assets amounts to 863,568 million euros. In accordance with Article 32.4 of the Statute of the ESCB, any risks from the monetary policy operations, if they were to materialise, should eventually be shared in full by the Eurosystem central banks in proportion to the prevailing ECB capital key shares. Eesti Pank's share is 0.25582%.

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

Item 7 reflects the balances with banks vis-à-vis euro area credit institutions denominated in euro.

ITEM 8 – SECURITIES HELD FOR MONETARY POLICY PURPOSES

Item 8 reflects securities acquired by Eesti Pank within the scope of the purchase programmes for covered bonds⁶ and public debt securities acquired in the scope of the Securities Market Programme (SMP).⁷

⁶ Decision ECB/2009/16 of 2 July 2009 on the implementation of the covered bond purchase programme (OJ L 175, 4.7.2009, p 18) and Decision ECB/2011/17 of 3 November 2011 on the implementation of the second covered bond purchase programme (OJ L 297, 16.11.2011, p 70).

⁷ Decision ECB/2010/5 of 14 May 2010 establishing a securities markets programme (OJ L 124, 20.05.2010, p 8).

The total Eurosystem central banks holding of SMP securities amounts to 211,947 million euros, of which Eesti Pank holds 342 million euros. In accordance with Article 32.4 of the Statute of the ESCB, any risks from holding of SMP securities, if they were to materialise, should eventually be shared in full by the Eurosystem central banks, must in proportion to the prevailing ECB capital key shares.

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

In this context, the ECB Governing Council considered the impact of the private sector involvement (PSI) initiative announced in 2011, which proposed a restructuring of part of the debt issued by the Hellenic Republic to secure debt sustainability in the long term. Part of the ECB's holdings under the Securities Market Programme comprises debt securities issued by the Hellenic Republic. However, given that the initiative was designed to voluntarily restructure debt held by the private sector, it was not expected to result in changes to any future contractual cash flows associated with the ECB's holdings of these securities. As at 31 December 2011 the Governing Council considered that there was no evidence to assume that the initiative would not be successfully implemented, therefore, no impairment losses were recorded at the year-end.

Furthermore, no impairment was recorded in respect of the other securities purchased under the Securities Market Programme or the securities bought under the two covered bond purchase programmes. The ECB Governing Council assesses on a regular basis the financial risks associated with the securities held under the Securities Market Programme and the two covered bond purchase programmes.

ITEM 9 - OTHER SECURITIES

Item 9 reflects investments in securities of euro area residents denominated in euro. These positions decreased in 2011 due to the decrease in the investment portfolio at the beginning of the year.

ITEM 10 - PARTICIPATING INTEREST IN THE ECB

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

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

Pursuant to the ECB's Governing Council's decision 2010/416/EC of 13 July 2010, which was adopted in accordance with Article 140(2) of the Treaty on the Functioning of the European Union, Estonia adopted the single currency on 1 January 2011. In accordance with Article 48.1 of the Statute of the ESCB and the legislation adopted by the ECB's Governing Council on 13 December and 30 December 2011, Eesti Pank paid up 12,572,592 euros to the capital of the ECB. This amount includes the increase of the ECB capital as of 29 December 2010, with due regard to the paid up additional capital contributions.

In accordance with the legal acts adopted by the ECB Governing Council on the increase of the subscribed capital of the ECB on 29 December 2010 and the pay-up of the increase via three instalments,⁸ Eesti Pank has paid up an additional 2,983,333 euros to the ECB on 28 December 2011, representing the second instalment of the contribution to the increase in the ECB's capital.

As a result, the subscribed and paid up capital contributions of the national central banks is as follows:

	Subscribed capital as of 1 Jan 2009	Subscribed capital as of 29 Dec 2010	Paid-up capital as at 31 Dec 2010	Paid-up capital as at 31 Dec 2011
	%	€	€	€
Nationale Bank van België / Banque Nationale de Belgique	2.4256	261,010,385	180,157,051	220,583,718
Deutsche Bundesbank	18.9373	2,037,777,027	1,406,533,694	1,722,155,361
Eesti Pank	0.1790	19,261,568	722,309	16,278,234
Central Bank of Ireland	1.1107	119,518,566	82,495,233	101,006,900
Bank of Greece	1.9649	211,436,059	145,939,392	178,687,726
Banco de España	8.3040	893,564,576	616,764,576	755,164,576
Banque de France	14.2212	1,530,293,899	1,056,253,899	1,293,273,899
Banca d'Italia	12.4966	1,344,715,688	928,162,355	1,136,439,021
Central Bank of Cyprus	0.1369	14,731,333	10,168,000	12,449,666
Banque centrale du Luxembourg	0.1747	18,798,860	12,975,526	15,887,193
Central Bank of Malta	0.0632	6,800,732	4,694,066	5,747,399
De Nederlandsche Bank	3.9882	429,156,339	296,216,339	362,686,339
Oesterreichische Nationalbank	1.9417	208,939,588	144,216,254	176,577,921
Banco de Portugal	1.7504	188,354,460	130,007,793	159,181,126
Banka Slovenije	0.3288	35,381,025	24,421,025	29,901,025
Národná banka Slovenska	0.6934	74,614,364	51,501,030	63,057,697
Suomen Pankki – Finlands Bank	1.2539	134,927,820	93,131,154	114,029,487
Subtotal – euro area national central banks*		7,529,282,289	5,184,359,697	6,363,107,289

⁸ Decision ECB/2010/26 of 13 December 2010 on the increase of the European Central Bank's capital (OJ L 11, 15.1.2011, p 53); Decision ECB/2010/27 of 13 December 2010 on the paying-up of the increase of the European Central Bank's capital by the national central banks of Member States whose currency is the euro (OJ L 11, 15.1.2011, p 54); Decision ECB/2010/34 of 31 December 2011 on the paying-up of capital, transfer of foreign reserve assets and contributions by Eesti Pank (OJ L 11, 15.1.2011, p 58); Agreement of 31 December 2010 between Eesti Pank and the European Central Bank regarding the claim credited to Eesti Pank by the European Central Bank under Article 30.3 of the Statute of the European System of Central Banks and of the European Central Bank (OJ C 12, 15.2.2011, p 6).

	Subscribed capital as of 1 Jan 2009	Subscribed capital as of 29 Dec 2010	Paid-up capital as at 31 Dec 2010	Paid-up capital as at 31 Dec 2011
	%	€	€	€
Българска народна банка (Bulgarian National Bank)	0.8686	93,467,027	3,505,014	3,505,014
Česká národní banka	1.4472	155,728,162	5,839,806	5,839,806
Danmarks Nationalbank	1.4835	159,634,278	5,986,285	5,986,285
Latvijas Banka	0.2837	30,527,971	1,144,799	1,144,799
Lietuvos bankas	0.4256	45,797,337	1,717,400	1,717,400
Magyar Nemzeti Bank	1.3856	149,099,600	5,591,235	5,591,235
Narodowy Bank Polski	4.8954	526,776,978	19,754,137	19,754,137
Banca Națională a României	2.4645	265,196,278	9,944,860	9,944,860
Sveriges Riksbank	2.2582	242,997,053	9,112,389	9,112,389
Bank of England	14.5172	1,562,145,431	58,580,454	58,580,454
Subtotal – non-euro area national central banks*		3,231,370,113	121,176,379	121,176,379
Total*	100.0000	10,760,652,403	5,305,536,076	6,484,283,669

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

Eesti Pank will pay the third instalment of its contribution to the increase in the ECB capital at the end of 2012 in the amount of 2,983,333 euros.

Upon Estonia's accession to euro area, Article 48.2 of the Statute of the ESCB required Eesti Pank to pay to the ECB a part of the reserves, revaluation accounts and risk provisions of the ECB in proportion to Eesti Pank's 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 63,633,111 euros.

ITEM 11 – CLAIMS EQUIVALENT TO THE TRANSFER OF FOREIGN RESERVES

In accordance with Article 48.1 of the Statute of the ESCB in conjunction with Article 30.1, Eesti Pank transferred 103,115,678 euros of foreign reserves to the ECB as of 1 January 2011. 85% of the reserves consisted of Japanese yen and 15% of gold. The claims are denominated in euro at a value fixed at the time of their transfer. They are remunerated at the latest available marginal rate for the Eurosystem's main refinancing operations, adjusted to reflect a zero return on the gold component.

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

Item 12 reflects Eesti Pank's claims vis-à-vis the Eurosystem relating to the allocation of euro banknotes within the Eurosystem (see Banknotes in circulation and Intra-Eurosystem balances in the notes on the accounting policies).⁹

⁹ In accordance with the accounting methods chosen by the Eurosystem in relation to the euro banknotes, 8% of the total value of euro banknotes in circulation is allocated to the ECB on a monthly basis. The rest of the 92% of the euro banknotes in circulation are allocated to the national central banks on a monthly basis, while the latter reflect their percentages of the euro banknotes in their Balance Sheets in proportion to their paid-up contributions to the ECB capital. In accordance with these accounting methods, the difference between the value of euro banknotes allocated to a national central bank and the amount of euro banknotes issued into circulation is recorded under *Intra-Eurosystem net claims/liabilities related to the allocation of euro banknotes within the Eurosystem*.

ITEM 13 – OTHER CLAIMS WITHIN THE EUROSISTEM (NET)

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

ITEM 14 – FIXED ASSETS

EUR thousand

Acquisition cost	Buildings	Hardware	Inventory	Software	Total
Balance at the end of 2010	26,287	3,305	5,432	4,483	39,507
Acquisitions	1,382	283	953	305	2,923
Disposals	0	-406	-199	-685	-1,290
Balance at the end of 2011	27,669	3,182	6,186	4,103	41,140
Accumulated depreciation					
Balance at the end of 2010	7,368	2,691	3,444	3,698	17,201
Depreciation charge	1,172	208	524	329	2,233
Disposals	0	-406	-200	-685	-1,291
Balance at the end of 2011	8,540	2,493	3,768	3,342	18,143
Carrying amount					
at the end of 2010	18,919	614	1,988	785	22,306
at the end of 2011	19,129	689	2,418	761	22,997
Prepayments for fixed assets					
Balance at the end of 2010	73	1	27	0	101
Balance at the end of 2011	0	0	0	275	275
Total fixed assets					
at the end of 2010	18,992	615	2,015	785	22,407
at the end of 2011	19,129	689	2,418	1,036	23,272

The cost of fixed assets acquired in 2011 amounted to 2.9 million euros (6.8 million euros in 2010). Over half of the acquisition cost (1.5 million euros in total) was spent on procurements related to the renovation, purchase of hardware and interactive exhibition software, furniture and exhibition equipment of the Eesti Pank Museum. In addition, hardware was acquired for the expansion of the back-up centre and for the data communication network, as well as a new database for the accounting software of the money market operations. Other purchases of fittings included safety and cash handling equipment.

ITEM 15 – OTHER FINANCIAL ASSETS

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

ITEM 16 – OFF-BALANCE-SHEET INSTRUMENTS REVALUATION DIFFERENCES

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

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

ITEM 17 – ACCRUALS AND PREPAID EXPENSES

EUR thousand

	2011	2010
Interest income	10,469	3,718
Securities	7,670	3,466
Intra-Eurosystem balances	2,676	0
Derivative instruments	91	191
Fixed-term deposits and current accounts	24	53
Loans	8	8
Prepaid expenses	583	856
Claims on the Financial Supervision Authority	518	524
Other claims	389	403
Total	11,959	5,501

ITEM 18 – SUNDRY ASSETS

EUR thousand

	2011	2010
Euro banknotes	0	16,160
Loans to employees of Eesti Pank	5,056	4,907
Foreign exchange transactions	1,361	356
Numismatic banknotes and coins of the Estonian kroon	952	1,125
Credits related to margin calls	209	419
Other	214	167
Total	7,792	23,134

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

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 remained within 0.25–0.75% in 2011. 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 32.

ITEM 19 – BANKNOTES IN CIRCULATION

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

	<i>EUR thousand</i>	
	2011	2010
Estonian kroon banknotes	48,161	364,192
Euro banknotes	590,743	0
Adjustments of euro banknotes	1,683,840	0
ECB banknotes (8%)	-181,865	0
Total	2,140,879	364,192

From the beginning of 2012 Estonian kroons can be exchanged for euros at the Eesti Pank Museum at the central exchange rate (1 euro = 15.6466 kroons) and without any service fee, in unlimited amounts and for an unlimited period of time. In the first half of 2012 the cash offices of Swedbank and SEB Pank exchange kroons for euros all over Estonia under the same conditions. Kroons are exchanged for euros also at some offices of Sampo Pank and Krediidipank.

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

Item 20 records the current accounts of credit institutions held with Eesti Pank for covering the minimum reserve. The interest paid on the money on the current accounts of credit institutions, held for covering the minimum reserve, is the latest available marginal interest rate for the Eurosystem's main refinancing operations.

ITEM 21 – DEPOSIT FACILITY

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

ITEM 22 – FIXED-TERM DEPOSITS

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

ITEM 23 – LIABILITIES TO OTHER RESIDENTS DENOMINATED IN EURO

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

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

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

ITEM 25 – COUNTERPART OF THE SPECIAL DRAWING RIGHTS ALLOCATED BY THE IMF

Item 25 reflects the liability to the IMF arising from the IMF's decision of 7 August 2009 to increase the SDR issues for all of its member states. The objective was to increase global liquidity by supporting the foreign reserves of the IMF's member states. As a result, Estonia received 61,965,241 SDRs.

ITEM 26 – ACCRUALS AND INCOME COLLECTED IN ADVANCE

EUR thousand

	2011	2010
Liability to the Mint of Finland for euro coin production	0	6,259
Tax liabilities	688	868
Interest expense	244	412
Deposits with credit institutions	125	221
Derivative instruments	90	147
SDR allocation	22	44
Monetary policy operations	7	0
Other liabilities	1,978	2,804
Total	2,910	10,342

Other liabilities reflect liabilities outstanding on the balance sheet date, the majority of which were wages earned but not paid and vacation reserve fund totalling 1.1 million euros, and unpaid invoices for services provided to Eesti Pank totalling 0.9 million euros.

ITEM 27 – SUNDRY LIABILITIES

EUR thousand

	2011	2010
Euro coins	25,076	0
Estonian kroon coins	7,632	9,583
Foreign exchange forwards	227	3,590
Loans to employees of Eesti Pank	201	137
Credits related to margin calls	23	531
Foreign exchange transactions	0	898
Other	145	632
Total	33,304	15,371

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

Item 27 also 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).

ITEM 28 – PROVISIONS

Item 28 reflects performance bonuses to employees of the Financial Markets Department and related taxes for the investment results of the financial year. The amount of bonuses is approved by the Deputy Governor in charge of the Financial Markets Department after the approval of the audited Eesti Pank Annual Report by the Supervisory Board of Eesti Pank.

ITEM 29 – REVALUATION ACCOUNTS

EUR thousand

	2011	2010
Securities	6,044	2,539
Foreign currencies	3,431	5,511
Derivative instruments	265	748
Total	9,740	8,798

The revaluation accounts reflect revaluation reserves arising 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 30 – CAPITAL AND RESERVES

Changes in capital and reserves in 2011:

EUR thousand

	Balance at the end of 2011	Increase in fixed capital	Distribution of 2010 loss	Balance at the end of 2010
Fixed capital	100,000	93,609	0	6,391
Reserve capital	30,233	0	-1,723	31,956
Special reserve	211,100	-93,609	0	304,709
Total	341,333	0	-1,723	343,056

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.

Notes on the Profit and Loss Account

ITEM 31 – NET INTEREST INCOME

EUR thousand

	2011	2010
Net interest income	20,623	11,833
Interest income	31,524	23,128
Intra-Eurosystem balances	14,701	0
Securities	13,026	19,158
Derivative instruments	2,977	2,406
Current accounts	312	229
Reverse repurchase transactions	290	1,039
Fixed-term deposits	113	211
Loans to employees of Eesti Pank	105	85
Interest expense	-10,901	-11,295
Intra-Eurosystem balances	-4,681	0
Derivative instruments	-2,900	-2,276
Securities	-2,688	-4,911
Current accounts	-282	-219
Repurchase transactions	-158	-61
Fixed-term deposits	-121	0
Euro deposits	-71	-3,828

EUR thousand

Intra-Eurosystem interest income	14,701
Monetary policy operations	6,538
Allocation of banknotes within the Eurosystem	4,911
Interest income on TARGET accounts	2,149
Transfer of foreign currency reserves	1,103
Intra-Eurosystem interest expense	-4,681
Interest expense from minimum reserves	-2,815
Monetary policy operations	-1,141
Interest expense from TARGET accounts	-687
Transfer of capital share	-38

ITEM 32 – NET RESULT OF FINANCIAL OPERATIONS, WRITE-DOWNS AND RISK PROVISIONS

EUR thousand

	2011	2010
Net result of financial operations, write-downs and risk provisions	4,175	7,046
Realised gains arising from financial operations	4,684	9,268
Income/expense of exchange rate differences	4,012	2,587
Securities	1,819	7,668
Derivative instruments	-1,137	184
Financial asset management costs	-10	-1,190
Other	0	19
Write-downs on financial assets	-509	-2,222
Derivative instruments	-311	-616
Exchange rate write-downs	-198	-1,115
Securities	-1	-478
Net change of loan portfolio write-downs	1	-13

ITEM 33 – NET INCOME FROM FEES AND COMMISSIONS

EUR thousand

	2011	2010
Net income from fees and commissions	724	859
Income from fees and commissions	825	926
Current accounts service fees	825	921
Fines, arrears and other	0	5
Expense from fees and commissions	-101	-67
Commissions on futures and options	-61	-63
TARGET2 fees	-30	-1
Other fees and commissions	-10	-3

ITEM 34 – INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS

Item 34 reflects dividends from the shares of the Bank for International Settlements. This item also includes the distribution of the ECB's income on euro banknotes amounting to 1.7 million euros (see "Interim profit distribution" in the notes on the accounting policies).

In 2011, following a decision by the ECB Governing Council on establishing a provision for foreign exchange rate, interest rate, credit and gold price risks, the ECB did not distribute its income arising from the securities purchased under the Securities Market Programme, and distributed part of its income earned on euro banknotes in circulation in the total amount of 652 million euros.

ITEM 35 – NET RESULT OF POOLING OF MONETARY INCOME

The net result of pooling of monetary income from the Eurosystem central banks in 2011 totalled 15,685,891,079 euros, which includes the share of Eesti Pank.

The monetary income pooled by the Eurosystem is allocated among Eurosystem central banks according to the subscribed ECB's capital key. The difference between the monetary income pooled by Eesti Pank amounting to 31,608,124 euros and reallocated to Eesti Pank amounting to 40,127,976 euros is the net result 8,519,852 euros arising from the calculation of monetary income.

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

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

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

ITEM 36 – OTHER INCOME

EUR thousand

	2011	2010
Other income	6,248	3,261
Income from the sale of coin metal	3,474	0
Income from the sale of collector coins and numismatic-bonistic products	2,057	2,566
Expenses compensated by the Financial Supervision Authority	547	549
Income on financial asset management	107	100
Rental income	39	34
Income from the sale of assets	1	2
Other income	23	10

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 financial asset management includes the service fee paid by the Guarantee Fund to Eesti Pank for investing the Fund's assets.

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

Income from the sale of assets includes income from the sale of fixed assets and inventories unnecessary for Eesti Pank.

ITEM 37 – STAFF COSTS

EUR thousand

	2011	2010
Staff costs	-7,701	-7,715
Wages	-5,609	-5,622
Social tax	-1,881	-1,884
Compensations and benefits	-134	-132
Unemployment insurance	-77	-77

Staff costs mainly include 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.

On average, there were 241 employees at Eesti Pank in full-time equivalent in 2011 (232 in 2010).

ITEM 38 – ADMINISTRATIVE EXPENSES

EUR thousand

	2011	2010
Administrative expense	-5,312	-5,422
Information technology maintenance	-1,424	-1,369
Financial asset management	-972	-914
Real estate renovation and administration	-948	-1,051
Business travel	-582	-478
Public relations and publications	-415	-691
Training	-206	-169
Office	-193	-193
Communications and transportation	-108	-111
Legal and arbitration	-22	-53
Other	-442	-393

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

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

Business trip expenses reflect the staff's business travel for the representation of Eesti Pank and cooperation with international organisations and financial institutions. There were 727 business trips in total in 2011 (709 in 2010).

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

ITEM 39 – OTHER EXPENSES

	<i>EUR thousand</i>	
	2011	2010
Other expenses	-4,109	-9,759
Production of euro coins	-2,855	-2,595
Production of collector coins and numismatic products	-532	-6,542
Cash circulation management	-524	-481
Other	-198	-141

ITEM 40 – DERIVATIVE INSTRUMENTS

Futures purchase transactions with a contract value of 18.7 million euros and futures sale transactions with a contract value of 169.6 million euros were outstanding as at 31 December 2011 (53.0 and 24.0 million euros respectively in 2010). The contract value of outstanding interest rate swaps totalled 148.5 million euros (53.7 million euros in 2010). Foreign exchange swap and forward transaction claims of 126.3 million and liabilities of 127.6 million euros remained outstanding as at 31 December 2011 (138.9 and 138.1 million euros respectively in 2010).

ITEM 41 – CONTINGENT LIABILITIES

	<i>EUR thousand</i>	
	Balance at the end of 2011	Balance at the end of 2010
Contingent liabilities	2,105	3,139
Contractual obligations to produce banknotes and coins	1,542	2,594
Unpaid share capital (75%) of BIS	563	545

The production of banknotes and coins

The contingent liabilities of Eesti Pank arising from the Joint Euro Tender for the production of euro banknotes in 2012 totalled 1.5 million euros in 2011.

Eesti Pank will participate in the production of euro banknotes for the first time in 2012. In 2012, Eesti Pank must return to the Eurosystem 44 million banknotes that were lent to Eesti Pank in autumn 2010 for the changeover to the euro. Furthermore, a certain amount of euro cash that is determined by the ECB Governing Council must be produced for the euro area countries. Eesti Pank will procure the euro banknotes through a joint tender with eight other euro area central banks. Following the tender, Eesti Pank will produce 20-euro banknotes that will be included in the joint assets of the Eurosystem.

Bank for International Settlements

Eesti Pank has a contingent liability to the Bank for International Settlements since 1930 regarding the unpaid part of the share capital (75%) of the BIS denominated in Swiss gold francs, which totalled 562,685 euros on the balance sheet date (see Item 15).

ITEM 42 – IMPORTANT POST-BALANCE-SHEET EVENTS

The Riigikogu adopted a decision on 15 December 2011 to agree to the increase of Estonia's quota in the IMF in the amount of 28.7 million SDRs, and authorised Eesti Pank to do the necessary transactions. The decision entered into force on 24 December 2011.

The Riigikogu adopted the amendment act for amending legislation related to Estonia's IMF membership, which, among other things, sets out that Eesti Pank performs the IMF membership payments on behalf of the Republic of Estonia, and that the government recalls the debt securities it issued for covering Estonia's previous quota to be replaced by an equivalent payment by Eesti Pank on 31 January 2012 at the latest.

On 23 January 2012, Eesti Pank transferred 8,528,600 euros to the IMF to acquire 7,175,000 SDRs, which constitute 25% of the increase in the quota of the Republic of Estonia. Eesti Pank also credited the IMF No. 1 Account held with Eesti Pank in the amount of 25,540,291 euros, which equals to 21,525,000 SDRs and constitutes 75% of the increase in the quota of the Republic of Estonia.

Pursuant to the amendment act for amending legislation related to IMF membership, Eesti Pank credited the IMF No. 1 Account with Eesti Pank on 24 January 2012 in the amount of 77,121,595 euros, which equals to 64,997,000 SDRs. Pursuant to Clause 72 of the Resolution of the Supreme Council of the Republic of Estonia of 22 April 1992 on approving membership of the Republic of Estonia in the International Monetary Fund, the International Bank for Reconstruction and Development and related organisations, Eesti Pank returned to the Minister of Finance the debt securities issued by the Government of the Republic for covering Estonia's quota in the International Monetary Fund.

INDEPENDENT CERTIFIED AUDITOR'S REPORT

To the Supervisory Board of Eesti Pank:

We have audited the accompanying annual accounts of Eesti Pank, which comprise the statement of financial position as at 31 December 2011, and the statement of revenues and expenses and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Annual Accounts

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

Certified Auditor's Responsibility

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

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

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 annual accounts present fairly, in all material respects, the financial position of Eesti Pank as at 31 December 2011, and its financial performance for the year then ended in accordance with the guidelines established by the Governing Council of European Central Bank, which are set out in Decision ECB/2010/20 (recast) on 11 November 2010 and Eesti Pank Act.

27 March 2012



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

Maret Gerz
2011
"Flower meadow"





ANNEXES

MONETARY POLICY DECISIONS OF THE ECB GOVERNING COUNCIL

13 January 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

3 February 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

3 March 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

The Council also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the sixth maintenance period of 2011 on 12 July 2011.

7 April 2011

The Governing Council of the European Central Bank decided to:

- increase the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 1.25%, starting from the operation to be settled on 13 April 2011;
- increase the interest rate on the marginal lending facility by 25 basis points to 2.00%, with effect from 13 April 2011;
- increase the interest rate on the deposit facility by 25 basis points to 0.50%, with effect from 13 April 2011;

5 May 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.25%, 2.00% and 0.50% respectively.

9 June 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.25%, 2.00% and 0.50% respectively.

The Council also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the ninth maintenance period of 2011 on 11 October 2011.

7 July 2011

The Governing Council of the European Central Bank decided to:

- increase the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 1.50%, starting from the operation to be settled on 13 July 2011;
- increase the interest rate on the marginal lending facility by 25 basis points to 2.25%, with effect from 13 July 2011;
- increase the interest rate on the deposit facility by 25 basis points to 0.75%, with effect from 13 July 2011.

4 August 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

Given the renewed tensions in some financial markets in the euro area, the Governing Council decided to conduct a liquidity-providing supplementary longer-term refinancing operation (LTRO) with a maturity of approximately six months. The Council also decided to continue conducting its MROs as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the last maintenance period of 2011 on 17 January 2012.

8 September 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

6 October 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

The Governing Council announced details of refinancing operations from October 2011 to 10 July 2012. The Council decided to conduct two longer-term refinancing operations (LTROs), one in October 2011 with a maturity of approximately 12 months, and the other in December 2011 with a maturity of approximately 13 months. In addition, the Council decided to continue conducting its MROs as fixed rate tender procedures with full allotment for as long as necessary. The Council also decided to launch a new covered bond purchase programme (CBPP2) in November 2011.

3 November 2011

The Governing Council of the European Central Bank decided to:

- decrease the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 1.25%, starting from the operation to be settled on 9 November 2011;
- decrease the interest rate on the marginal lending facility by 25 basis points to 2.00%, with effect from 9 November 2011;
- decrease the interest rate on the deposit facility by 25 basis points to 0.50%, with effect from 9 November 2011.

8 December 2011

The Governing Council of the European Central Bank decided to:

- decrease the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 1.00%, starting from the operation to be settled on 14 December 2011;
- decrease the interest rate on the marginal lending facility by 25 basis points to 1.75%, with effect from 14 December 2011;
- decrease the interest rate on the deposit facility by 25 basis points to 0.25%, with effect from 14 December 2011.

The Governing Council also announced measures to support bank lending and money market activity and decided to:

- conduct two longer-term refinancing operations (LTROs) with a maturity of 36 months;
- increase collateral availability;
- reduce the reserve ratio from 2% to 1%;
- discontinue for the time being the fine-tuning operations carried out on the last day of each maintenance period.

OTHER DECISIONS OF THE ECB GOVERNING COUNCIL

Monetary policy

Central bank compliance with prohibitions on monetary financing and privileged access

On 17 March 2011, in accordance with the Treaty on the Functioning of the European Union, which assigns the ECB the task of monitoring EU central banks' compliance with the prohibitions specified in Articles 123 and 124 thereof and the related Regulations, the Governing Council approved the report covering the year 2010.

Market operations

Temporary liquidity swap facility with the Bank of England

On 17 December 2010 the ECB announced the signing of a swap facility agreement with the Bank of England. This is due to expire at the end of September 2011.

Acceptance of Coface rating tool for the purposes of the Eurosystem credit assessment framework

On 18 February 2011 the Governing Council approved the rating tool of Coface Serviços Portugal, S.A. for use within the Eurosystem credit assessment framework (ECAAF). The full list of systems accepted by the Eurosystem for the purposes of the ECAAF is available on the ECB's website.

Refinancing operations of the Eurosystem with settlement up to July 2011

On 3 March 2011 the Governing Council took several decisions related to the ECB's non-standard operational measures.

Concerted G7 intervention in the foreign exchange markets

On 18 March 2011 the Governing Council approved the Eurosystem's participation in a concerted G7 intervention in the foreign exchange markets, which was launched at the request of the Japanese authorities in order to limit the volatility of the exchange rate of the yen.

Asset-backed securities loan-level initiative

Following its December 2010 decision to establish loan-by-loan information requirements for asset-backed securities (ABSs) accepted as collateral in Eurosystem credit operations (the "ABS loan-level initiative"), the Governing Council expressed, by means of a letter of intent which is available on the ECB's website, the Eurosystem's intention to make use of the data warehouse that will be set up to process, verify and transmit ABS loan-level data. The purpose of the ABS loan-level initiative is to help kick-start the European ABS market by improving transparency and facilitating the risk assessment of ABSs used as collateral by Eurosystem counterparties in monetary policy operations and thereby restoring investor confidence in the ABS markets.

Change in the eligibility of debt instruments issued or guaranteed by the Irish government

On 31 March 2011 the Governing Council decided to suspend, until further notice, the application of the minimum credit rating threshold in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations in the case of all outstanding and new marketable debt instruments issued or guaranteed by the Irish government. On the same day the Governing Council adopted the related Decision of the European Central Bank on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Irish government (ECB/2011/4).

Eurosystem collateral framework (single list): minimum size threshold for credit claims

On 7 April 2011 the Governing Council confirmed its February 2005 decision (see Decisions taken by the Governing Council of the ECB – February 2005) that the common minimum size threshold for credit claims should be set at €500,000, but decided to link the introduction of this minimum size threshold to the implementation of CCBM2, which is scheduled to take place in the course of 2013. CCBM2 is the new collateral management system that will enable the Eurosystem to manage collateral both for domestic and cross-border operations.

Loan-level data templates for new classes of asset-backed securities

In line with the Governing Council's decision of December 2010 (see Decisions taken by the Governing Council of the ECB – December 2010) to gradually phase in loan-by-loan reporting requirements for several classes of asset-backed securities in the Eurosystem collateral framework, on 29 April 2011 the Governing Council approved the templates for commercial mortgage-backed securities and small and medium-sized enterprise transactions.

Tender operations and maintenance periods in 2012 and 2013

On 18 May 2011 the Governing Council took note of the indicative calendars for the Eurosystem's regular tender operations and for the reserve maintenance periods in 2012 and 2013.

Refinancing operations of the Eurosystem with settlement up to October 2011

On 9 June 2011 the Governing Council decided on the tender procedures in the Eurosystem's refinancing operations up to 11 October 2011.

Extension of US dollar liquidity-providing operations

In agreement with the Federal Reserve System, and in coordination with the Bank of Canada, the Bank of England and the Swiss National Bank, the Governing Council decided to extend its liquidity swap arrangements with the Federal Reserve System until 1 August 2012 and to continue, for the time being, to conduct US dollar liquidity-providing operations.

Change in eligibility of debt instruments issued or guaranteed by the Portuguese government

On 7 July 2011 the Governing Council decided to suspend, until further notice, the application of the minimum credit rating threshold in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations in the case of all outstanding and new marketable debt instruments issued or guaranteed by the Portuguese government. The Governing Council adopted on the same day the related Decision on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Portuguese government (ECB/2011/10).

Decisions related to refinancing operations and tender procedures

On 4 August 2011 the Governing Council took decisions relating to refinancing operations and tender procedures in order to address renewed tensions in some financial markets in the euro area.

Extension of swap facility agreement with the Bank of England

On 25 August 2011, in coordination with the Bank of England, the Governing Council announced that the liquidity swap arrangement entered into by the two central banks on 17 December 2010 would be extended until 28 September 2012. The arrangement had been due to expire at the end of September 2011.

Additional US dollar liquidity-providing operations covering the end of the year

On 14 September 2011, in coordination with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, the Governing Council decided to conduct three US dollar liquidity-providing operations with a maturity of approximately three months covering the end of the year, in addition to its weekly seven-day US dollar operations.

Update of the ECB's General Documentation

On 20 September 2011 the Governing Council approved a new version of "The implementation of monetary policy in the euro area – general documentation on Eurosystem monetary policy instruments and procedures" and adopted Guideline ECB/2011/14 on monetary policy instruments and procedures of the Eurosystem. This version of the General Documentation includes all amendments made since it was last updated. Guideline ECB/2011/14 will apply from 1 January 2012 and will be published in the Official Journal of the EU and on the ECB's website.

Details of refinancing operations from October 2011 to July 2012

On 6 October 2011 the Governing Council took several decisions relating to the Eurosystem's main and longer-term refinancing operations and the tender procedures employed for such operations.

Launch of a second covered bond purchase programme

On 6 October 2011 the Governing Council decided to launch a second covered bond purchase programme and announced some of its main features.

Second covered bond purchase programme

On 3 November 2011 the Governing Council decided on the technical modalities of its second covered bond purchase programme.

Coordinated central bank action to address pressures in global money markets

On 30 November 2011 the ECB, the Bank of Canada, the Bank of England, the Bank of Japan, the Federal Reserve and the Swiss National Bank jointly announced coordinated actions to enhance their capacity to provide liquidity support to the global financial system. In that context, the Governing Council of the ECB decided in cooperation with other central banks to establish a temporary network of reciprocal swap lines with the partner central banks which will remain valid until 1 February 2013. The purpose of this network is to enable non-domestic currency to be provided, if needed, in addition to the existing operations in US dollars. Furthermore, the Governing Council decided to regularly conduct the existing US dollar liquidity-providing operations at a lower price and to reduce the initial margin for three-month US dollar operations while introducing weekly margin calls.

Measures to support bank lending and money market activity

On 8 December 2011 the Governing Council approved additional enhanced credit support measures to support bank lending and liquidity in the euro area money market. In particular, the Governing Council decided to: i) conduct two longer-term refinancing operations with a maturity of 36 months and the option of early repayment after one year; ii) discontinue, for the time being, the fine-tuning operations carried out on the last day of each maintenance period; iii) reduce the reserve ratio from 2% to 1% as from the reserve maintenance period starting on 18 January 2012; and iv) increase collateral availability. On 14 December 2011 the Governing Council adopted the relevant legal acts required to implement these measures, namely an ECB Decision on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2011/25) and an ECB Regulation amending Regulation (EC) No 1745/2003 on the application of minimum reserves (ECB/2011/26).

Extension of US dollar liquidity-providing operations

In agreement with the Federal Reserve System, and in coordination with the Bank of Canada, the Bank of England, the Bank of Japan and the Swiss National Bank, the Governing Council has decided to extend its liquidity swap arrangements with the Federal Reserve System until 1 August 2011 and continue to conduct US dollar liquidity-providing operations with a maturity of seven days.

2010 Euro Money Market Study

On 20 December 2010 the Governing Council authorised the publication of the 2010 Euro Money Market Study. This eighth edition is based on surveys covering the second quarters of 2009 and 2010 and analyses the euro money market in terms of trends in turnover and developments as regards its integration and efficiency.

Economic, monetary and financial situation

Reaction to the Irish authorities' banking system announcements

On 31 March 2011 the Governing Council welcomed the measures announced by the Irish authorities to strengthen the Irish banking system.

Assessment of the Portuguese economic and financial adjustment programme

On 5 May 2011 the Governing Council positively assessed the Portuguese economic and financial adjustment programme adopted that day by the Portuguese government.

Financial stability and supervision

ECB response to the European Commission consultation on the countercyclical capital buffer

On 13 January 2011 the Governing Council approved the position adopted by the ECB in the European Commission's public consultation on the countercyclical capital buffer. The ECB's response calls for this instrument to be designed as an effective policy tool and implemented in a consistent manner throughout the EU in order to ensure a level playing field for internationally active banks.

Eurosystem's contribution to the European Commission's public consultation on credit rating agencies

On 11 February 2011 the Governing Council approved the Eurosystem's reply to the Commission's public consultation on credit rating agencies and possible future initiatives at EU level aimed at strengthening the regulatory framework related to their activities.

Eurosystem's contribution to the European Commission's public consultation on the "Review of the Markets in Financial Instruments Directive (MiFID)"

On 17 February 2011 the Governing Council approved the Eurosystem's reply to the Commission's public consultation on the review of the MiFID.

BSC report on recent developments in securitisation

On 17 February 2011 the Governing Council approved the publication of a report on recent developments in the European securitisation markets, prepared by the former Banking Supervision Committee. The report considers those developments in the light of factors impacting on the demand for and the supply of securitised products.

Eurosystem stance on the IASB's proposal relating to hedge accounting

On 15 March 2011 the Governing Council approved the Eurosystem's reply to the public consultation of the International Accounting Standards Board (IASB) on its proposals for the improvement of the existing accounting rules on hedging activities. Once finalised, the new hedge accounting

requirements, which aim at reducing the complexity of hedge accounting rules and better reflect the economic substance of prevailing hedging strategies, will form part of the new accounting standard for financial instruments.

ECB's 2011 report on "Financial integration in Europe"

On 17 March 2011 the Governing Council took note that the fifth edition of the ECB's report on "Financial integration in Europe" would be published on the ECB's website in May 2011. This edition of the report presents the state of financial integration in the euro area and the Eurosystem's activities with regard to financial integration. It also contains three special features on the following topics: dealing with crisis management and resolution from a financial integration perspective; insurance corporations and pension funds in the euro area; and developments in the euro area bond market amid the financial crisis.

Financial Stability Review – June 2011

On 19 May 2011 the Governing Council authorised the publication of the "Financial Stability Review – June 2011". The review provides a comprehensive assessment of the capacity of the euro area financial system to absorb adverse disturbances and examines the main sources of risks to and vulnerability of financial system stability.

Financial Stability Review – December 2011

On 17 November 2011 the Governing Council authorised the publication of the "Financial Stability Review – December 2011", which provides a comprehensive assessment of the capacity of the euro area financial system to withstand adverse developments and examines the main sources of risk to and vulnerabilities of financial system stability.

Statistics

ECB Decision on transmission of confidential data under the common framework for business registers for statistical purposes

On 27 December 2010 the Governing Council adopted this Decision (ECB/2010/33), which defines the format, security and confidentiality measures, as well as procedures concerning the data that the ECB and national central banks (NCBs) receive from the Commission and the data transmitted from the NCBs to the national statistical institutes.

Improvements in the quality of government finance statistics

On 17 March 2011 the Governing Council considered the quality of government finance statistics and approved proposals for further enhancement thereof. In particular, the Governing Council supported advancing the reporting deadlines for the quarterly government accounts under the European System of Accounts transmission programme and the excessive deficit procedure data to t + 85 by 2014, aiming at t + 82 by 2017 to support the compilation of full quarterly integrated euro area accounts at t + 90.

2010 statistical quality reports

On 18 March 2011 the Governing Council approved the annual assessment of the availability and quality of the various kinds of statistics that are compiled by the Eurosystem on the basis of an ECB legal act. It also authorised the publication of the 2010 quality report on euro area balance of payments and international investment position statistics, as well as the report on monetary and financial statistics.

Confidentiality of statistical information collection

On 28 April 2011 the Governing Council approved the recommendations of the report on the measures adopted to safeguard the confidentiality of the statistical information referred to in Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB.

Addition of new domain to the Eurosystem's joint dissemination framework

On 10 June 2011 the Governing Council approved the regular publication, starting from July 2011, of quarterly euro area aggregate statistics for the insurance corporations and pension funds sector as a new domain of the Eurosystem's joint dissemination framework.

ECB legal acts regarding the balance sheet of the monetary financial institutions sector

On 25 August 2011 the Governing Council adopted Regulation ECB/2011/12 amending Regulation ECB/2008/32 concerning the balance sheet of the monetary financial institutions sector and Guideline ECB/2011/13 amending Guideline ECB/2007/9 on monetary, financial institutions and market statistics.

Amendment of legal acts on the statistical reporting requirements of the ECB in the field of external statistics

On 9 December 2011 the Governing Council adopted a Guideline (ECB/2011/23) and a Recommendation (ECB/2011/24) on the statistical reporting requirements of the ECB in the field of external statistics. The recast of the Guideline incorporates changes in the relevant international statistical standards while the Recommendation is addressed to the Central Statistics Office of Ireland and the National Statistics Office of Malta that compile balance of payments and international investment position statistics in those Member States.

Payment systems and market infrastructure

ECB Decision concerning the administration of EFSF loans

On 20 December 2010 the ECB adopted a Decision concerning the opening of accounts for the processing of payments in connection with European Financial Stability Facility loans to Member States whose currency is the euro (ECB/2010/31).

TARGET2-Securities progress report

On 17 February 2011 the Governing Council considered the state of progress of the TARGET2-Securities Programme (T2S).

ECB Guideline amending Guideline ECB/2007/2 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2)

On 17 March 2011 the Governing Council adopted a Guideline amending Guideline ECB/2007/2 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2) (ECB/2011/2).

TARGET2-Securities

On 20 April 2011 the Governing Council considered the state of progress of the TARGET2-Securities (T2S) Programme. More information will be provided in due course in the T2S section of the ECB's website.

TARGET Annual Report 2010

On 12 May 2011 the Governing Council took note of the TARGET Annual Report 2010. The report indicates that TARGET2 continues to be instrumental in promoting an integrated euro area money market, which is a prerequisite for the effective conduct of the single monetary policy and contributes to the integration of the euro financial markets.

European forum on the security of retail payments

On 19 May 2011 the Governing Council approved the mandate for a European forum on the security of retail payments (SecuRe Pay). The forum, which is a voluntary cooperative initiative, aims at sharing knowledge and enhancing understanding, in particular between overseers and supervisors of payment service providers, on issues related to the security of retail payments. The integrated payments market needs such cooperation between authorities in order to: (i) facilitate a level playing field between payment service providers; (ii) to prevent, to the extent possible, regulatory arbitrage; and (iii) to foster the exchange of information between authorities.

Review of the Eurosystem oversight policy framework

On 19 May 2011 the Governing Council authorised the publication of an updated version of the Eurosystem oversight policy framework, which provides an overview of the existing set of methods and instruments that the Eurosystem employs for the oversight of payment systems. The framework has been updated, inter alia, to expressly record the Eurosystem's interest in the smooth functioning of trade repositories and in the oversight of TARGET2-Securities.

The connection of Banca Națională a României to TARGET2

On 23 June 2011 the Governing Council endorsed the legal documentation enabling **Banca Națională a României** to join the TARGET2 system with effect from 4 July 2011.

ECB participation in the cooperative oversight arrangement for Warehouse Trust

On 7 July 2011 the Governing Council approved the participation of the ECB in the cooperative oversight arrangement for Warehouse Trust, a trade repository, in order to lend its experience in the cooperative oversight of cross-border financial market infrastructures and to represent the Eurosystem.

TARGET2-Securities

On 20 July 2011 the Governing Council considered the status of the TARGET2-Securities (T2S) Programme and decided that it would make its final offer on the Framework Agreement with central securities depositories interested in T2S by the end of October 2011. A related press release is available on the ECB's website.

Comprehensive oversight assessment of EURO1

On 11 August 2011 the Governing Council approved the conclusions of an oversight assessment of EURO1 – a private sector payment system for single domestic and cross-border payments in euro between banks operating in the EU – against the principles established by the Committee on Payment and Settlement Systems.

Developments in the TARGET2-Securities (T2S) project

On 22 September 2011 the Governing Council appointed Mr Kristian Kjeldsen, Head of Payment Systems at Danmarks Nationalbank, as an alternate member of the T2S Programme Board. The T2S Programme Board was set up on 19 March 2009 to assist the ECB's decision-making bodies in ensuring the successful completion of the T2S project.

On 20 October 2011 the Governing Council decided that T2S would go live nine months later than planned – i.e. in June 2015, rather than September 2014. The Governing Council also decided to extend the deadline for the signing of the Framework Agreement.

Amendments to the TARGET2 Guideline

On 14 October 2011 the Governing Council adopted Guideline ECB/2011/15 amending Guideline ECB/2007/2 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2). The Guideline, which inter alia takes into account the updates needed by the TARGET2 release 5.0, will apply as from 21 November 2011.

Standards for the use of central counterparties in Eurosystem foreign reserve management operations

On 9 November 2011 the Governing Council authorised the publication of the “Standards for the use of central counterparties in Eurosystem foreign reserve management operations”. These standards aim to ensure that the selection of providers of clearing services for Eurosystem foreign reserve management operations meets three objectives. Namely, that it ensures (i) the safe and efficient use of infrastructure by the Eurosystem; (ii) consistency with the Eurosystem’s broader objectives and statutory tasks in the field of clearing and settlement; and (iii) neutrality vis-à-vis the clearing industry.

TARGET2-Securities (T2S) programme

On 17 November 2011 the Governing Council endorsed the Framework Agreement, which will soon be conveyed to central securities depositories (CSDs), together with a financial incentive package for early signatories. In addition, it approved a new version of the User Requirements document and an update of the General Principles of T2S, and adopted Decision ECB/2011/20 establishing detailed rules and procedures for implementing the eligibility criteria for central securities depositories to access T2S Services.

Publication of the oversight assessment report of EURO1

Further to its approval in August 2011 of the conclusions of the oversight assessment of EURO1 – a private sector payment system for single domestic and cross-border payments in euro between banks operating in the EU – the Governing Council authorised on 4 November 2011 the publication of the assessment.

Assessment of direct and relayed links between securities settlement systems in the euro area

On 24 November 2011 the Governing Council approved the assessment of new direct and relayed links eligible to be used for the collateralisation of Eurosystem credit operations.

Issuance of banknotes and coins

Annual report on the implementation of the Banknote Recycling Framework

On 27 December 2010 the Governing Council noted that further progress had been made in 2010 with the implementation of the Banknote Recycling Framework – which was replaced on 1 January 2011 by an ECB Decision on the authenticity and fitness checking and recirculation of euro banknotes (ECB/2010/14) – and decided that the national central banks would continue preparing annual progress reports to monitor amendments to national legal frameworks and recirculation in the Member States.

ECB Decision amending Decision ECB/2009/25 on the volume of coin issuance for 2010

On 22 December 2010 the Governing Council adopted a Decision amending Decision ECB/2009/25 on the approval of the volume of coin issuance in 2010 (ECB/2010/32).

Legal framework for the procurement of euro banknotes

On 18 March 2011 the Governing Council adopted Guideline ECB/2011/3 amending Guideline ECB/2004/18 on the procurement of euro banknotes. The amending guideline foresees the start of the single Eurosystem tender procedure at the latest on 1 January 2014.

ECB Decision on the environmental and health and safety accreditation procedures for the production of euro banknotes

On 21 June 2011 the Governing Council adopted a Decision on the environmental and health and safety accreditation procedures for the production of euro banknotes (ECB/2011/8).

ECB Guideline amending Guideline ECB/2008/8 on data collection regarding the euro and the operation of the Currency Information System 2

On 30 June 2011 the Governing Council adopted Guideline ECB/2011/9 amending Guideline ECB/2008/8 on data collection regarding the euro and the operation of the Currency Information System 2 (CIS 2). The Guideline lays down the rules and responsibilities within the Eurosystem for the collection and dissemination of cash-related data. The amendments relate to the scope of the data on cash infrastructure and cash recirculation activities reported to the CIS 2 and introduce daily reporting functionalities in addition to the monthly and semi-annual reporting functionalities already provided for in Guideline ECB/2008/8.

Extension of the extended custodial inventory (ECI) programme

On 21 October 2011 the Governing Council approved the extension of the regional scope of the ECI programme, launched in March 2008, from Asia to North America and the Middle East by way of an open tender procedure, and the prolongation of the current three-year ECI programme until the award of contracts to the successful bidders for the new programme. ECIs facilitate the international distribution of euro banknotes outside the euro area and provide valuable related information.

ECB Decision on the volume of coin issuance for 2012

On 1 December 2011 the Governing Council adopted Decision ECB/2011/21 on the approval of the volume of coin issuance in 2012.

International and European cooperation

Technical assistance programme for the National Bank of Serbia

On 17 December 2010 the Governing Council authorised the establishment of a Eurosystem technical assistance programme for the National Bank of Serbia. This two-year programme, which involves the ECB and 21 of the national central banks of the ESCB, will aim to strengthen the institutional capacity of the National Bank of Serbia, moving it towards the ESCB's benchmarks.

Eurosystem's contribution to the European Commission's public consultation on the Single Market Act

On 10 February 2011 the Governing Council approved the Eurosystem's reply to the European Commission's public consultation on the communication "Towards a Single Market Act", which contains a list of proposals for relaunching the Single Market and aims at their full implementation by 2012.

The tenth annual report on "The international role of the euro"

On 7 July 2011 the Governing Council approved the publication of the tenth annual report on "The international role of the euro". The report, which covers developments in 2010, examines the role of the euro in global markets and countries outside the euro area and aims to enhance the understanding of the current state of internationalisation of the euro, identifying the main developments and underlying trends.

Extension of the Eurosystem's cooperation programme with the Central Bank of Egypt

On 13 October 2011 the Governing Council approved the extension of the Eurosystem's cooperation programme with the Central Bank of Egypt, which will now end on 31 March 2012. This programme aims to support the Central Bank of Egypt in its gradual adoption of the Basel II framework.

External communication

Decisions taken by the Governing Council of the ECB" translated into all official EU languages

On 6 January 2011 the Governing Council decided that, as of January 2011, its monthly communication "Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates)" would be made available on the websites of the ECB and the national central banks of the ESCB in all official languages of the EU.

ECB's Annual Report 2010

On 17 March 2011 the Governing Council adopted the ECB's Annual Report 2010 which will be presented to the European Parliament and made available on the ECB's website in 21 official languages of the EU on 19 April 2011.

Statement on key issues for the euro area

On 7 August 2011 the Governing Council made a statement on issues that it considers to be of key importance for the euro area.

Statement on the decision by the Swiss National Bank regarding the Swiss franc's exchange rate vis-à-vis the euro

On 6 September 2011 the Governing Council took note of the unilateral decision taken by the Swiss National Bank regarding the Swiss franc's exchange rate vis-à-vis the euro.

Tenth anniversary of the introduction of the euro banknotes and coins

On 21 October 2011 the Governing Council approved, as part of the activities related to the tenth anniversary of the introduction of the euro banknotes and coins in January 2002, a press kit which will be published shortly on the websites of the Eurosystem central banks.

Corporate governance

Organisational change

On 29 December 2010 the Governing Council took note of the transformation of the ESRB Preparatory Secretariat – until then part of the Directorate General Financial Stability – into the ESRB Secretariat, a new ECB business area reporting to the President. This took effect on 1 January 2011.

Establishment and mandate of the Financial Stability Committee

On 13 January 2011 the Governing Council approved the mandate of the Financial Stability Committee (FSC), the Eurosystem/ESCB committee set up to assist the Governing Council in the fulfilment of the ECB's tasks relating to financial stability (replacing the Banking Supervision Committee, which was dissolved by the Governing Council in view of the formal establishment of the European Systemic Risk Board). This new arrangement will avoid any overlap between the FSC and the ESRB's Advisory Technical Committee in terms of responsibilities. The mandate of the FSC will be the same length as those of all other Eurosystem/ESCB committees and will expire at the end of August 2013.

ECB Decision on matters relating to Eesti Pank's entry into the Eurosystem

On 31 December 2010 the Governing Council adopted a Decision on the paying-up of capital, transfer of foreign reserve assets and contributions by Eesti Pank to the European Central Bank's reserves and provisions (ECB/2010/34).

Agreement on Eesti Pank's claim under Article 30.3 of the Statute of the ESCB

On 31 December 2010 the ECB and Eesti Pank concluded an Agreement regarding the claim credited to Eesti Pank by the European Central Bank under Article 30.3 of the Statute of the ESCB.

Chair of the Financial Stability Committee (FSC)

On 3 February 2011 the Governing Council appointed Mr Mauro Grande, Director General of the ECB's Directorate General Financial Stability, as Chairman of the FSC.

ECB's annual accounts 2010

On 3 March 2011 the Governing Council approved the audited annual accounts of the ECB for the financial year 2010. The annual accounts, together with a related press release were published on the same day. A management report for the year 2010 will be published in the ECB's Annual Report 2010 on 19 April 2011.

Opinion of the Governing Council of the European Central Bank on a Council recommendation on the appointment of a member of the Executive Board of the European Central Bank

On 3 March 2011 the Governing Council adopted this Opinion at the request of the President of the European Council (CON/2011/16)

Schedules for the meetings of the Governing Council and General Council of the ECB in 2012 and 2013

On 31 March 2011 the Governing Council approved its meeting schedule for the calendar years 2012 and 2013. The General Council also approved its meeting schedule for that period.

Public access to ECB documents

On 9 May 2011 the Governing Council adopted a technical amendment to Decision ECB/2004/3 on public access to European Central Bank documents (ECB/2011/6).

Opinion of the Governing Council of the European Central Bank on a Council recommendation on the appointment of the President of the European Central Bank

On 9 June 2011 the Governing Council adopted this Opinion at the request of the President of the European Council (CON/2011/48).

ECB Recommendation on the external auditors of the Oesterreichische Nationalbank

On 9 June 2011 the Governing Council adopted a Recommendation to the Council of the European Union on the external auditors of the Oesterreichische Nationalbank (ECB/2011/7).

On 7 July 2011 the Governing Council assessed Mr Axel Weber's future position as a member of the board of directors of UBS with effect from 1 May 2012 as being compatible with the Code of Conduct.

ECB Recommendation on the external auditors of the Banco de Portugal

On 25 August 2011 the Governing Council adopted Recommendation ECB/2011/11 to the Council of the European Union on the external auditors of the Banco de Portugal for the financial years 2011–2016.

Chair of the ECB's Budget Committee (BUCOM)

On 8 August 2011 the Governing Council appointed Mr Malo de Molina (Director General for Economics, Statistics and Research at the Banco de España) Chairman of BUCOM, with immediate effect. His term of office as Chairman of BUCOM will end on 31 August 2013, so as to coincide with the expiry of the terms of office of the other chairpersons of Eurosystem/ESCB committees, who were appointed by the Governing Council on 22 July 2010 for a three-year period.

Opinion of the Governing Council of the European Central Bank on a Council recommendation on the appointment of a member of the Executive Board of the European Central Bank

On 6 October 2011 the Governing Council adopted this Opinion at the request of the President of the European Council (CON/2011/77).

Opinion of the ECB Governing Council on a Council recommendation on the appointment of a member of the Executive Board of the ECB

On 7 December 2011 the Governing Council adopted this Opinion at the request of the President of the European Council (CON/2011/100).

Chair of the International Relations Committee (IRC)

On 8 December 2011 the Governing Council appointed Wolfgang Duchatzek, Vice-Governor of the Oesterreichische Nationalbank, as Chair of the IRC with immediate effect. His term as IRC Chairman will expire on 31 August 2013 to coincide with the expiry of the terms of office of all the other Eurosystem/ESCB committee chairpersons, who were (re-)appointed by the Governing Council on 22 July 2010 for a three-year period.

ECB Recommendation to the Council of the European Union on the external auditors of De Nederlandsche Bank

On 9 December 2011 the Governing Council adopted a recommendation to the Council on the external auditors of De Nederlandsche Bank (ECB/2011/22).

Eurosystem Procurement Coordination Office (EPCO) budget and procurement plan for 2012

On 19 December 2011 the Governing Council approved the EPCO's budget and procurement plan for 2012.

Invitation to Hrvatska narodna banka (the Croatian national bank) to participate as an observer in the General Council and ESCB committees

On 21 December 2011 the Governing Council decided to grant observer status to experts from Hrvatska narodna banka with respect to ESCB committees when they meet in the ESCB composition. On 22 December 2011 the General Council decided to invite the Governor of the Central Bank of Croatia to participate in its meetings as an observer. These decisions, which are in line with the approach taken for the central banks of the ten accession countries in 2003 and for Bulgaria and Romania in 2005, follow the signature by Croatia of the Accession Treaty on 9 December 2011.

ECB Guideline amending the legal framework for accounting and financial reporting in the ESCB

On 21 December 2011 the Governing Council adopted the ECB Guideline amending Guideline ECB/2010/20 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2011/27).

New ECB premises project

Agreement on execution of structural works

On 8 February 2011 the European Central Bank issued a press release on its agreement with Baresel GmbH, according to which the company will complete the structural works for the new double office tower up to the ground floor.

DECREES OF THE GOVERNOR OF EESTI PANK IN 2011

No 1, 6 January 2011

Amendments to Eesti Pank Governor's Decree No 11 "Establishment of the report on deposits guaranteed by the Guarantee Fund and the report on quarterly contributions paid to the Guarantee Fund".

Amendments concern the appendices "Report on deposits guaranteed by the Guarantee Fund" and "Report on quarterly contributions paid to the Guarantee Fund". The need for amendments stemmed from the adoption of the euro and the resulting requirement to present data in euros instead of the Estonian kroons, and from the amendment to the Guarantee Fund Act that allows the Fund to compensate also for the deposits of corporate customers that are legal persons.

No 2, 17 March 2011

List of statistical actions of Eesti Pank under the official statistical programme

This decree establishes the list of statistical actions of Eesti Pank for 2012–2016. The decree was established on the basis of clause 16 (1) 2) of the Official Statistics Act, which sets out that the list of statistical actions approved by the Governor of Eesti Pank is part of the official statistical programme.

No 3, 18 April 2011

Amendment to "Approval of TARGET2-Eesti rules"

The decree adopts the amendments to the European Central Bank guideline ECB/2007/2 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2) established on 17 March 2011. The amendments establish the rules for the provision of short-term loans by Eesti Pank to the participants of TARGET2-Eesti for the purpose of making payments.

No 4, 1 September 2011

Repeal of Eesti Pank Governor's Decree No 32 of 6 February 1996 "Transportation of one-kroon coins across the customs border"

At the time of adoption of that decree, the purpose was to hinder the transportation of one-kroon coins from Estonia to abroad, because the one-kroon coins issued in 1992, 1993 and 1995 could be used in payment terminals in Germany instead of German one-mark coins. Now that both Germany and Estonia have adopted the euro, the problem no longer exists.

No 5, 4 November 2011

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"

Amendments to the decree arise from the amendments to the European Parliament's and the Council's Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions. The decree establishes principles and procedures for disclosure of information, information subject to disclosure concerning securitisation, and information to be published on calculation of the capital requirements for securitisation positions.

No 6, 4 November 2011**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"**

Amendments to the decree arise from the amendments to the European Parliament's and the Council's Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions. The decree adopts the amended provisions of these directives by establishing requirements for extending the basis of calculation of capital requirement for settlement/delivery risk.

No 7, 4 November 2011**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"**

Amendments to the decree arise from the amendments to the European Parliament's and the Council's Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions. The decree adopts the amendments to the rules of calculation of capital requirements for credit institutions.

No 8, 21 November 2011**Amendments to Eesti Pank Governor's Decree No 4 of 9 May 2008 "Approval of TARGET2-Eesti rules"**

The decree adopts the amendments to the European Central Bank guideline ECB/2007/2 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2) established on 14 October 2011. The amendments concerns rules for limitation of intraday credit for TARGET2 participants, and requirements resulting from administrative or restrictive measures imposed pursuant to Articles 75 or 215 of the Treaty on the Functioning of the European Union.

No 9, 9 December 2011**Requirements for submission of reports formatted as XML documents**

The decree establishes requirements to reports submitted to Eesti Pank and the Financial Supervision Authority, and formatted as XML documents.

No 10, 21 December 2011**Amendment of Eesti Pank Governor's Decree No 10 of 20 June 2002 "Procedure for submitting information on deposits and depositors to the Guarantee Fund"**

The decree shortens the time limit for the trustee in bankruptcy, moratorium administrator or liquidator of a credit institution for providing the Guarantee Fund with information on the depositors from 24 to 7 days. The decree was amended pursuant to amendment of § 38 of the Guarantee Fund Act.

PUBLICATIONS OF EESTI PANK IN 2011

The **website** of Eesti Pank is 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 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 also presented at a press conference. In total, four economic policy statements were released in 2011.

Annual Report

The Annual Report gives an overview of the central bank's activities during the reporting year and the financial statement. It also includes an overview of the economic and financial environment, decisions adopted by the Eurosystem, Eesti Pank Governor's decrees, and the publications of the year.

Estonian Economy and Monetary Policy

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

Issues published in 2011:

- Estonian Economy and Monetary Policy (1/2011)
- Estonian Economy and Monetary Policy (2/2011)

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 2011:

- Financial Stability Review (1/2011)
- Financial Stability Review (2/2011)

The 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 2011:

- Estonia's Balance of Payments for 2010
- Estonia's Balance of Payments for the First Quarter of 2011
- Estonia's Balance of Payments for the Second Quarter of 2011
- Estonia's Balance of Payments for the Third Quarter of 2011
- Estonia's Balance of Payments Yearbook 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 2011:

- Lending Review (June 2011)
- Lending Review (December 2011)

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.

Working papers published in 2011:

- Working Papers 1/2011: J. Meriküll. Labour Market Mobility during a Recession: The Case of Estonia
- Working Papers 2/2011: J. Masso, J. Meriküll, P. Vahter. Gross Profit Taxation versus Distributed Profit Taxation and Firm Performance: Effects of Estonia's Corporate Income Tax Reform
- Working Papers 3/2011: K. Kondor, K. Staehr. The Impact of the Global Financial Crisis on Output Performance across the European Union
- Working Papers 4/2011: A. Dabušinskas, T. Rõõm. How Wages Respond to Shocks: Asymmetry in the Speed of Adjustment
- Working Papers 5/2011: J. Meriküll, K. Männasoo. R&D, Demand Fluctuations and Credit Constraints: Comparative Evidence from Europe
- Working Papers 6/2011: A. Dabušinskas, T. Rõõm. Survey Evidence on Wage and Price Setting in Estonia
- Working Paper 7/2011: J. Meriküll, K. Männasoo. R&D in Boom and Bust: Evidence from the World Bank Financial Crisis Survey
- Working Paper 8/2011: J. C. Cuestas, K. Staehr. Fiscal Shocks and Budget Balance Persistence in the EU Countries from Central and Eastern Europe
- Working Paper 9/2011: J. Meriküll, K. Männasoo. How Do Demand Fluctuations and Credit Constraints Affect R&D? Evidence from Central, Southern and Eastern Europe
- Working Paper 10/2011: L. Kulu, M. Randveer, L. Uusküla. The Impact of Private Debt on Economic Growth

Other publications

From traditional wrap to wall tapestry. Art book. Eesti Pank, 2011.

From traditional wrap to wall tapestry. Art calendar. Eesti Pank, 2011.

The launch of the euro in Estonia. Eesti Pank, 2011.

Money of the Republic of Estonia, 3. Eesti Pank, 2011.

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