Eesti Pank
Bank of Estonia

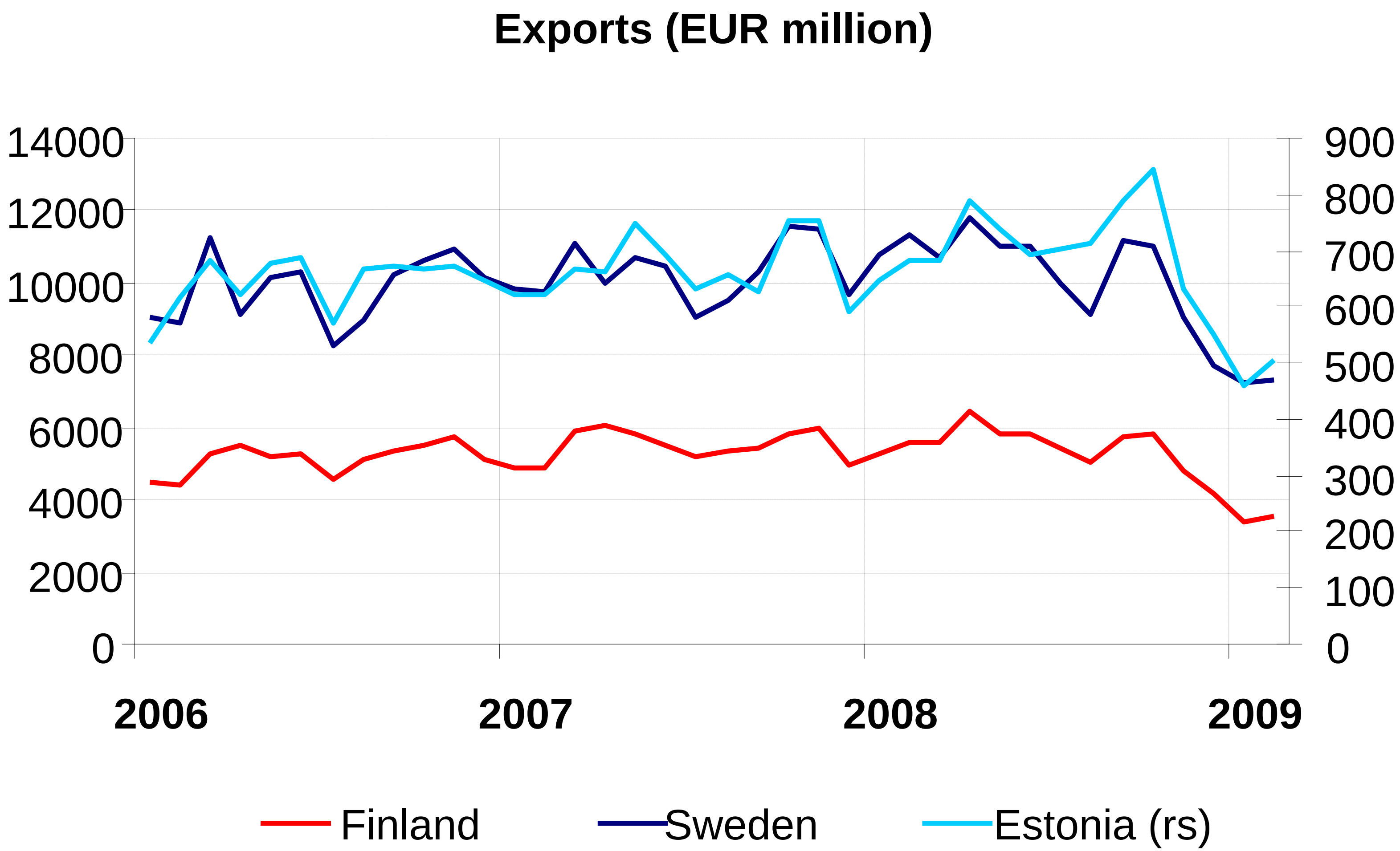
Economic policy statement of Eesti Pank

22 April 2009

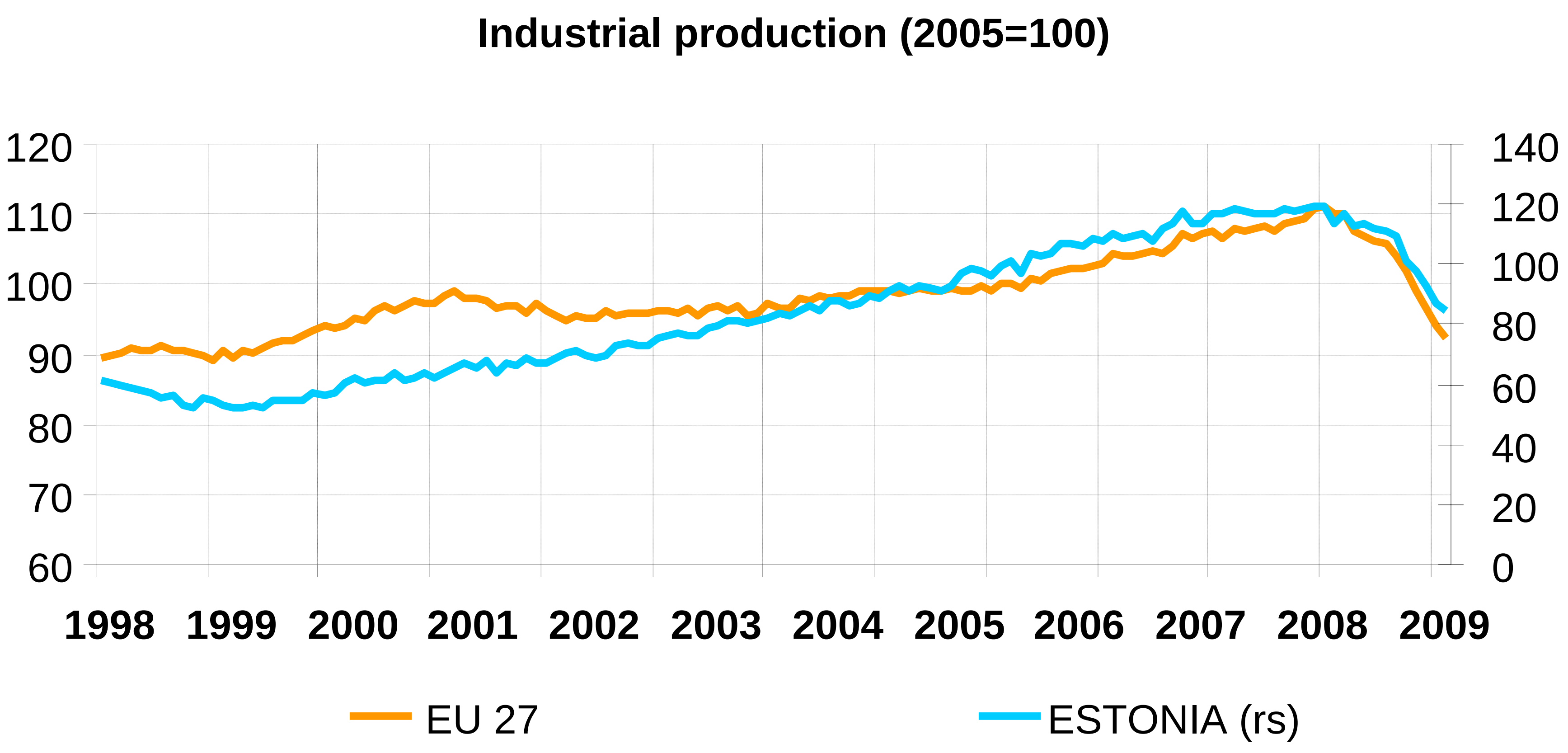
Main issues

- The global economic situation is bad. How bad?
- How to adjust to the bad situation?
- What should the government do?

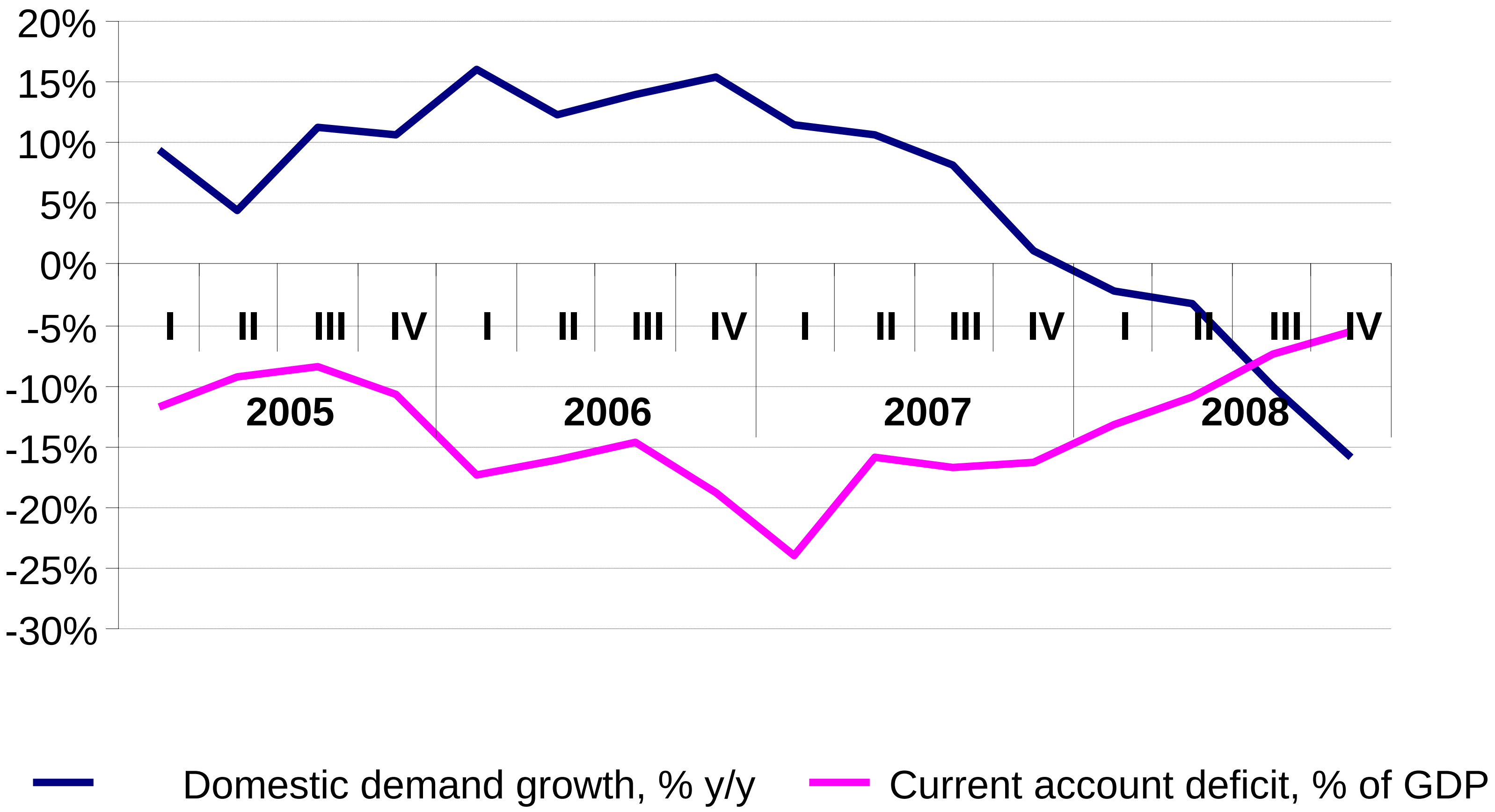
Estonia's exports behaves very similarly to Nordic exports



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

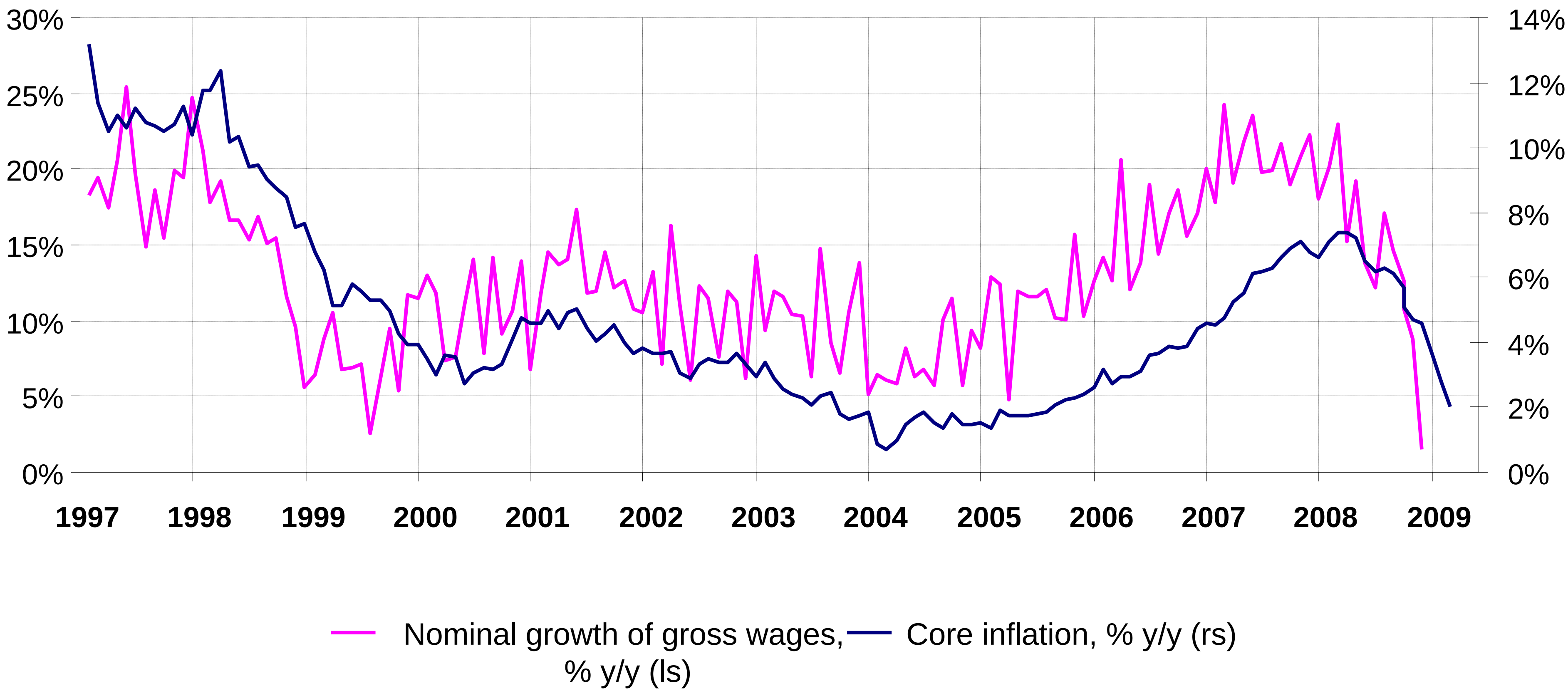


Rapidly declining consumption and investment have reduced the current account deficit. Thus, the economy is no longer so vulnerable.

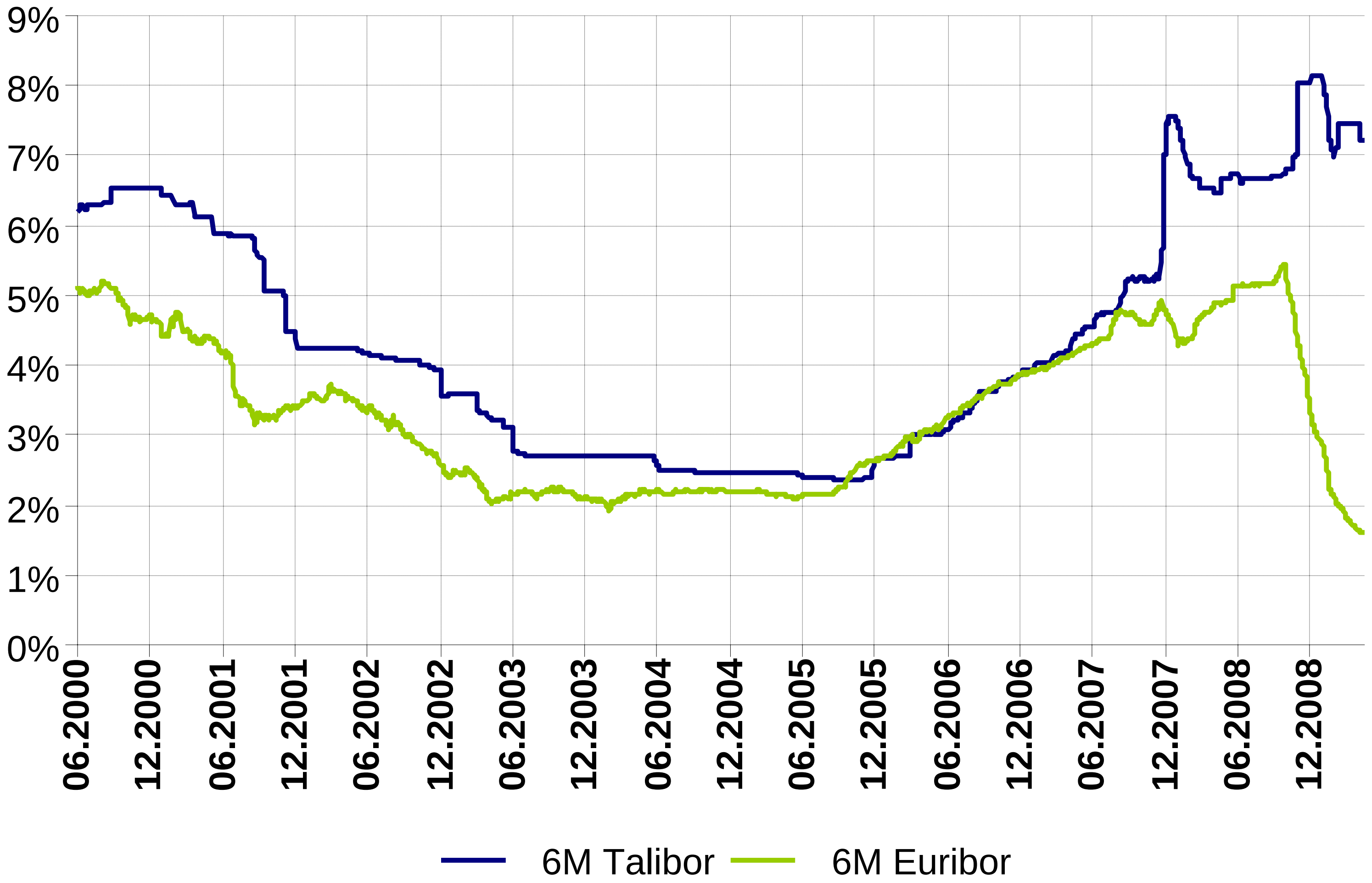


Wages and prices show flexibility:

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



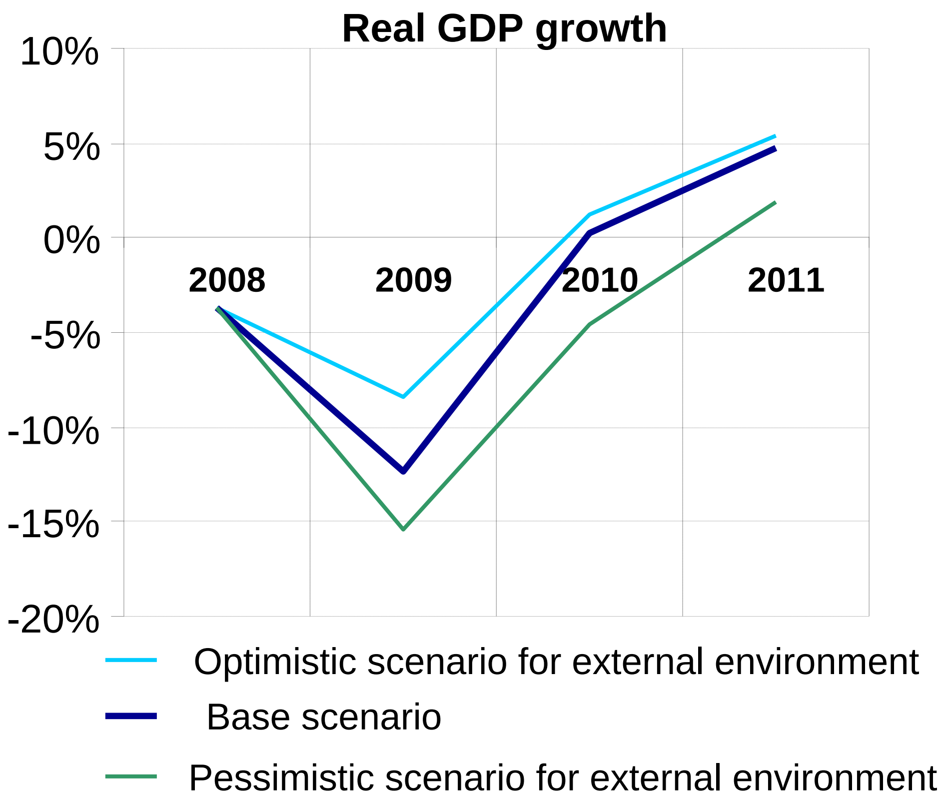
Lack of trust in financial markets persists

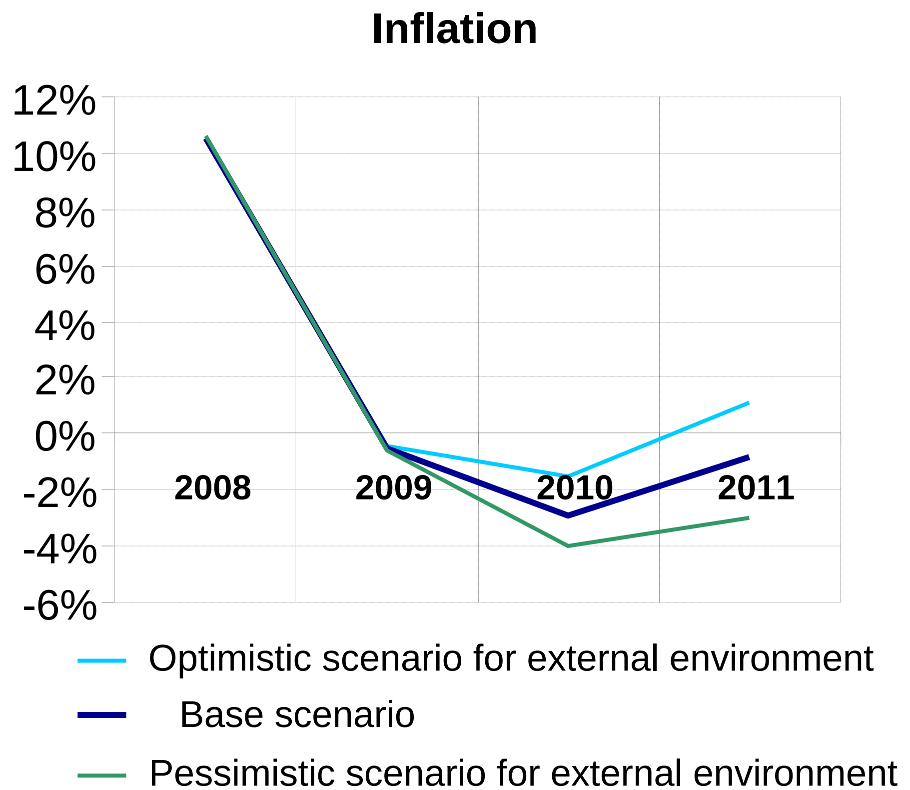


The impact of the current situation on the economic outlook

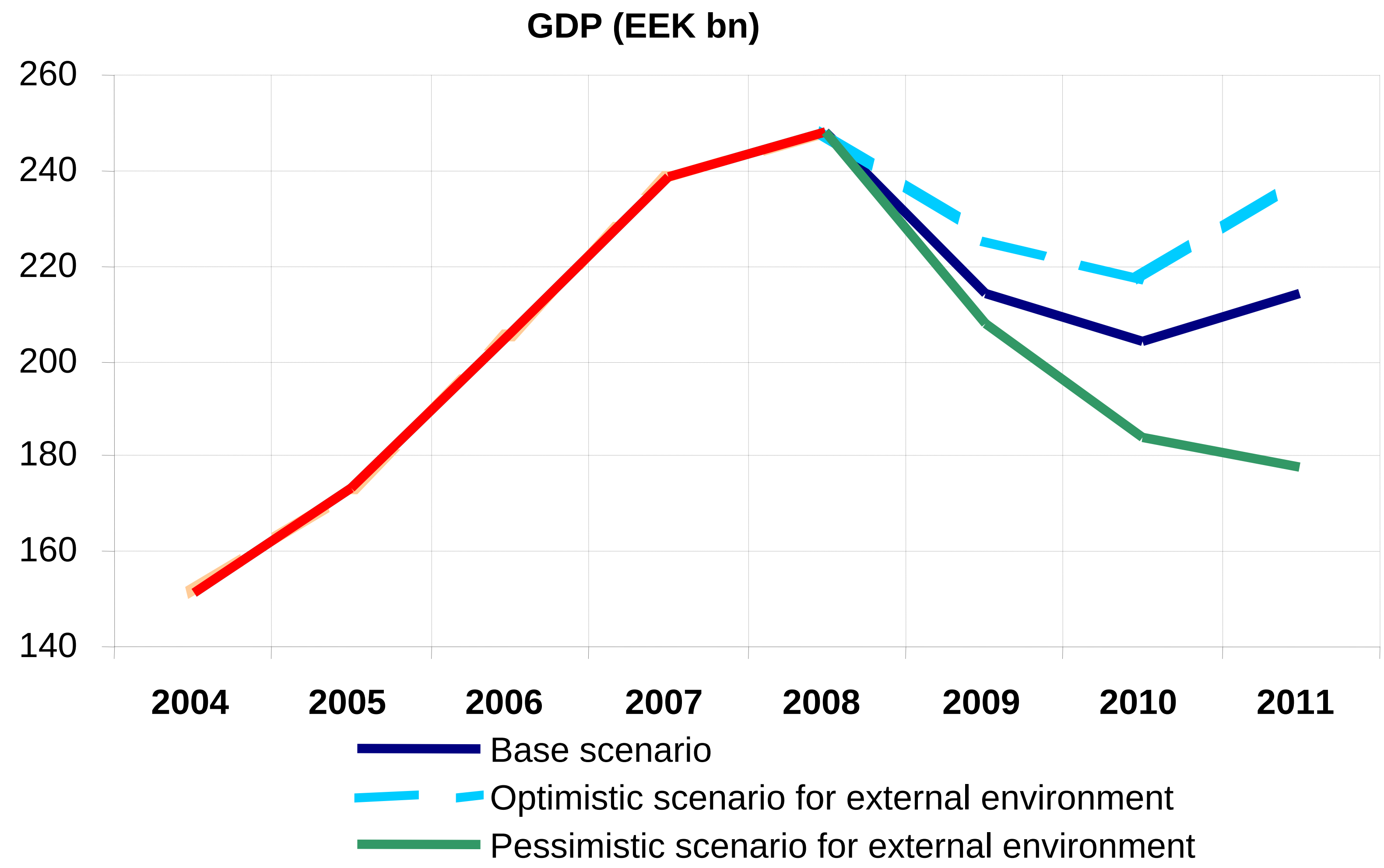
- The external environment plays an important role in Estonia's development. Unfortunately, it is characterised by great uncertainties.
- Several vulnerabilities have decreased and the economy is proving its flexibility, but distrust in the Estonian economy is still strong.
- The euro will significantly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

Eesti Pank's forecast





Smaller nominal GDP means that problems do not settle automatically



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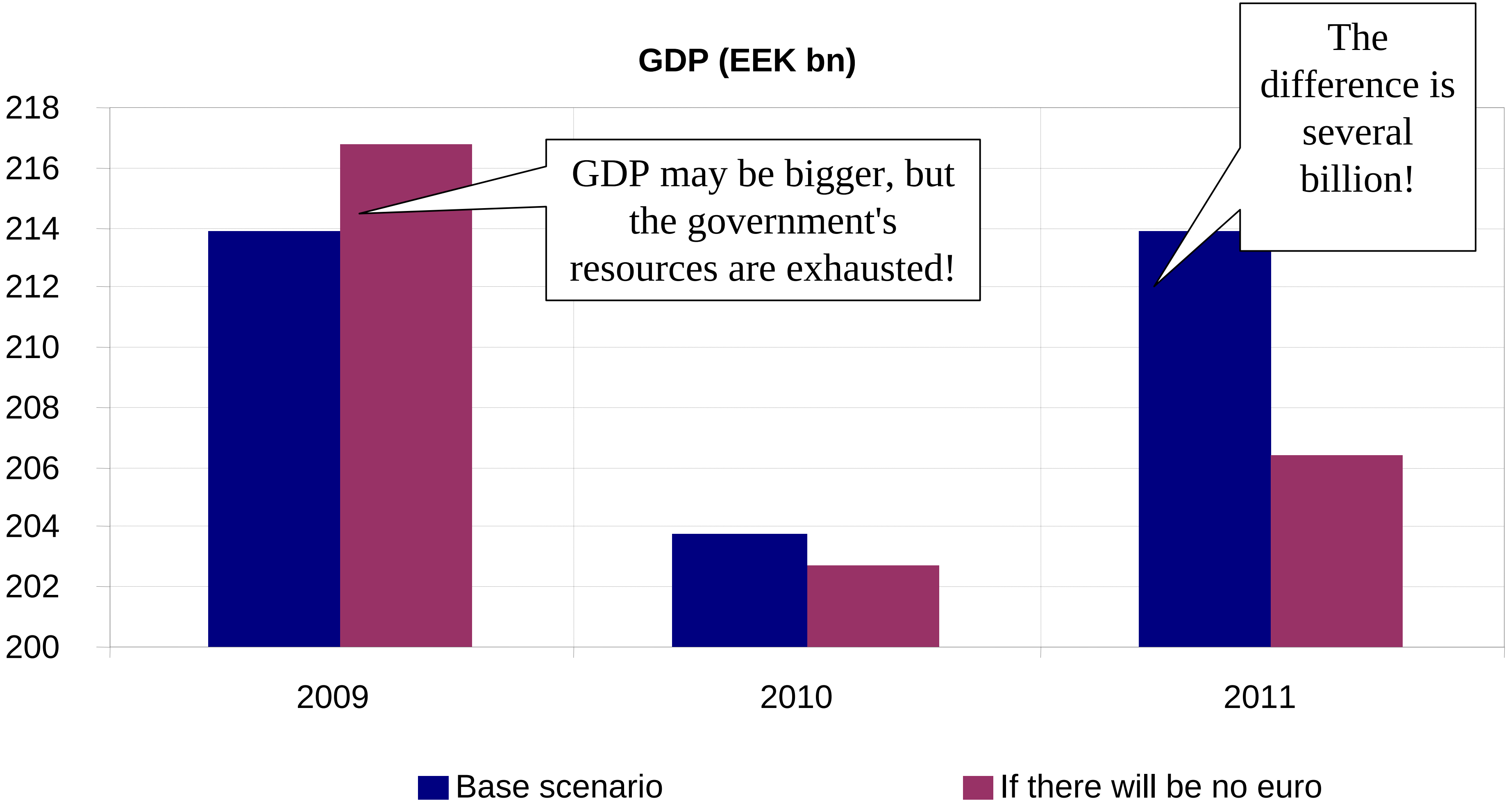
Monetary policy conclusions

The monetary system supports adjustment to changed circumstances

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

If the government fails to make sufficient efforts this year, next years will be even more difficult

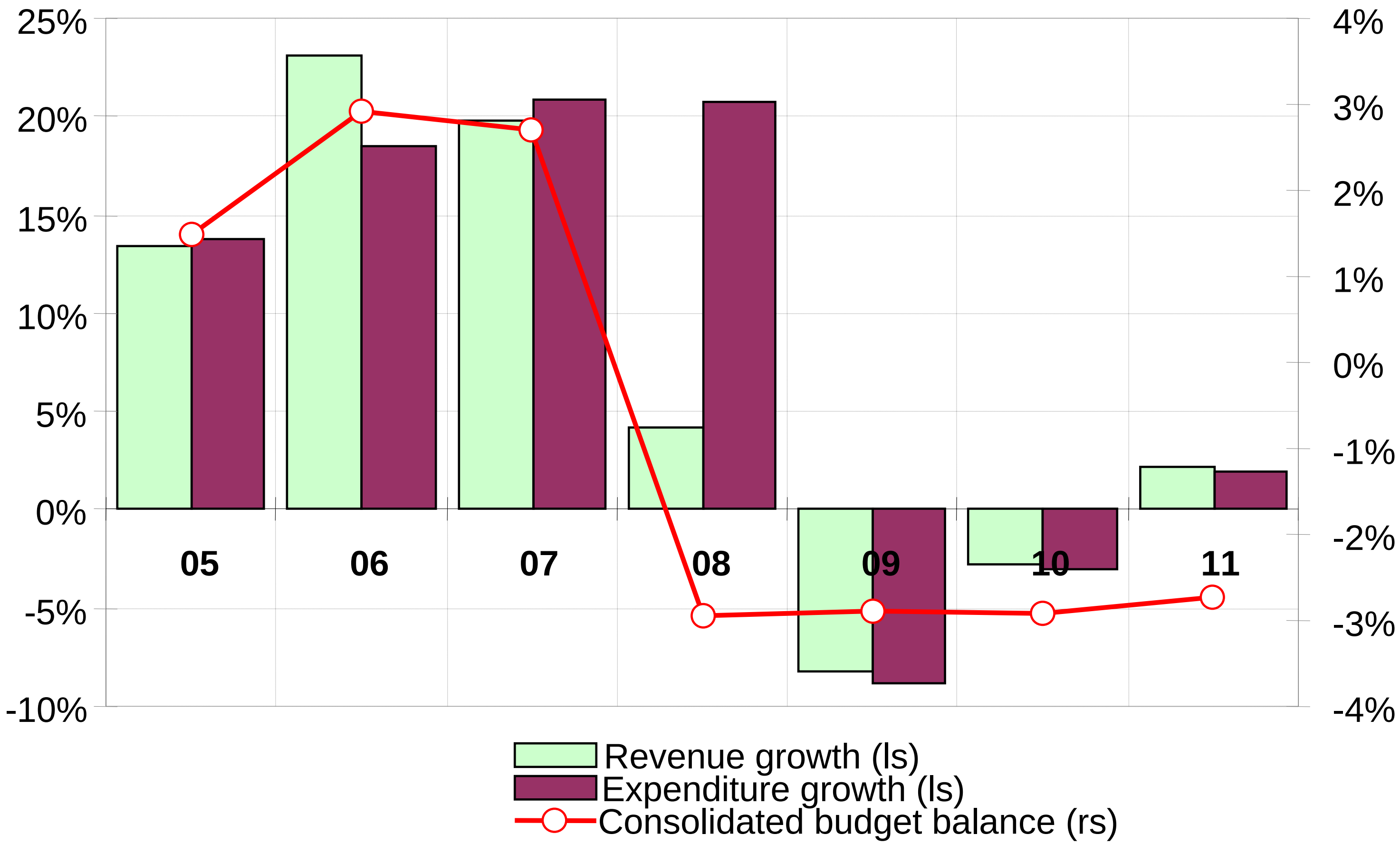


Fiscal developments and the adoption of the euro require extra efforts

- If the expenditure level is not lowered, the materialisation of the base scenario will mean a large fiscal deficit
  - This possibility needs to be considered now, not in the third quarter.
- Thus, this spring's budgetary planning should be based at least on the government's risk scenario
  - In addition to steps aimed at cutting expenditure also measures to increase revenue need to be taken.
- If the fiscal balance is not improved, the ratio of general government expenditure to GDP will be over 45%!!!

Afterwit?

Despite numerous warnings the government was unable to control expenditure growth and adjust to the changed circumstances



The government must do everything they can to avoid a deficit of over 3%

- In Eesti Pank's estimate, based on the data available in March, the government needs to improve the fiscal balance by 8.5 billion kroons.
  - Although the government has taken some further steps (as regards the second pension pillar), the health insurance fund cuts promised in the supplementary budget have not been implemented
- The more the budget is changed towards long-term positive effects the better. It is not going to be easier in the next years.
  - Changes in the second pension pillar are just a temporary solution buying the government more time to bring their expenditure structure in line with longer-term requirements

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Thank you!

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Eesti Pank's revised forecast

	Eesti Pank's forecast	2008	2009*	2010*	2011*
GDP (EEK bn)	**Base scenario**	**248**	**214**	**204**	**214**
	Optimistic scenario for external environment	248	226	218	238
	Pessimistic scenario for external environment	248	208	184	178
Real GDP growth (%)	**Base scenario**	**-3.6**	**-12.3**	**0.2**	**4.7**
	Optimistic scenario for external environment	-3.6	-8.4	1.2	5.4
	Pessimistic scenario for external environment	-3.6	-15.3	-4.6	1.9
Inflation (%)	**Base scenario**	**10.6**	**-0.5**	**-2.9**	**-0.8**
	Optimistic scenario for external environment	10.6	-0.4	-1.5	1.1
	Pessimistic scenario for external environment	10.6	-0.6	-4.0	-3.0

* Forecast

Projections have markedly deteriorated...

Growth is expected to decline further in the next months, but several signs refer to an improvement in the second half of the year