

**EESTI PANK**  
**ANNUAL REPORT**  
**1999**

**TALLINN 2000**



*The year 1999 leaves a multi-faceted impact on history. The European integration took a step forward – the euro was introduced as account money. Securities have been issued in euros in most of the European countries but also in Argentina, Brazil, Philippines, Canada and in the Republic of South Africa. The euro achieved a significant position in international transactions regardless its depreciation against the US dollar. The exchange rate of the Estonian kroon against the euro was fixed on 31 December 1998 (1 EUR = 15.6466 EEK), which meant pursuing our monetary policy – to apply the fixed exchange rate within the currency board system – until joining the European Economic and Monetary Union.*

*Eesti Pank has drafted the monetary policy principles, and the specification of the strategy underlying the accession negotiations continues. The position of the European Central Bank on the plurality of monetary systems allowed until joining EMU reassures that the fixed exchange rate and currency board arrangement are the right and firm foundation for Estonia's accession to the European Union.*

*Estonian real economy continued functioning in the economic downfall in 1999, returning to the growth path by the end of the year. The new Credit Institutions Act had a major impact on the financial intermediation. The banks pursued conservative loan policy in order to avoid exposure to new risks arising from high liquidity and low borrowing demand. Eesti Pank started to remunerate all reserves held by commercial banks with the central bank to bring our monetary policy framework closer to that of the European Central Bank and reduce the necessity for banks to increase their profitability by regularly depositing large sums abroad for short time.*

*Due to negative yield of the world bond markets, the central bank ended the year 1999 at a loss although it could avoid decreasing of the reserves. The latter was achieved through a new and more precise system for measuring the reserve investment risks and efficiency and through an agreement concluded with a foreign asset manager at the beginning of the year on a part of the reserve to increase risk diversification. Thus we gained access to top know-how and could compare the performance in reserve management.*

*Bearing in mind better future outlooks we drafted the principles of the Eesti Pank profit distribution. The principles, based on the ratio of the central bank reserves to the gross domestic product and the broad money supply, shall ensure the continued stability of not only the banking but also the Estonian monetary system.*

*The legislative framework for credit institutions reached a new level in 1999 and is mostly in compliance with the directives of the European Central Bank. We also specified the rights and obligations of the Banking Supervision Department pursuant to the new Credit Institutions Act. What is more important, Eesti Pank formulated its position in unified financial supervision. The implementation of the position – the adoption of the timetable and activities of a new independent public institution based on current supervision institutions – will hopefully take place in 2000.*

*Estonian banking in 1999 is characterised, apart from high capitalisation and liquidity and more conservative handling of loan projects, also by wider use of telebanking. By the end of the year every second resident of Estonia had a bank card. The central bank continued selling its holdings in commercial banks – we sold our shares in Hansapank and discovered a foreign investor significant in enhancing competition and are negotiating selling the investor Eesti Pank's holding in Optiva Pank.*

*The credibility of the banking increased also due to steady Swedish financial institutions growing their share in two major Estonian banks. The openness and transparency of the banks was enhanced by the regulations entering into force in 1999 on bank owners and executive management and their financial interests as well as the public disclosure report accessible to all the customers of commercial banks, providing a complete overview of the bank's financial status. The openness of Eesti Pank was enhanced through restructuring of information accessible over the Internet and reforming of periodicals. Organisational changes were introduced as well. The number of employees did not increase whereas tasks became more complicated. The education qualifications improved – about 14% of the specialists in Eesti Pank hold an academic degree.*

*Due to the detailed and early preparations, the year 2000 did not bring along any computer failures related problems in the Estonian banking system in general or in the central bank specifically. We were reassured that the operational performance would function in the more complicated environment as well.*

*The society expects Eesti Pank to continue being targeted in its activities in 2000 as well. I wish success to everybody considering reading of the Annual Report necessary.*

*Last but not least – this Annual Report is different from previous issues. It is a logical continuation in enhancing the transparency of the central bank and manifesting how one of the significant public institutions meets its constitutional functions.*



A handwritten signature in black ink, consisting of a large, stylized initial 'V' followed by a long horizontal stroke that ends in a small loop.

Vahur Kraft  
Governor

26 April 2000

# CONTENTS

I. THE ROLE OF A CENTRAL BANK IN THE SOCIETY .....	7
What Is the Independence of the Central Bank and Why Is it Necessary? .....	7
International Experience in Central Bank's Independence .....	8
The Strategic Development Plan of Eesti Pank .....	10
II. DEVELOPMENT TRENDS IN WORLD ECONOMY .....	11
America .....	12
Asia .....	13
European Union .....	13
Northern Europe .....	14
Transition Economies in Central and Eastern Europe .....	15
Russia .....	17
Latvia and Lithuania .....	17
Financial Markets of Developed Countries in 1999 .....	17
World Economic Outlooks in the Year 2000 .....	19
III. SURVEY OF THE ESTONIAN ECONOMY AND FINANCIAL INTERMEDIATION .....	21
REAL SECTOR .....	21
The Impact of the External and Monetary Environment .....	21
Government Sector .....	27
Inflation .....	28
FINANCIAL INTERMEDIATION .....	29
Credit Institutions .....	29
Banking Sector in 1999 .....	29
Operating Credit Institutions and their Owners .....	31
Consolidated Balance Sheet and Prudential Ratios .....	31
Major Changes in the Banking Landscape .....	34
Other Financial Intermediaries .....	35
Bond Market .....	35
Insurance .....	36
Leasing .....	37
Investment Funds .....	37
IV. CONSISTENT MONETARY POLICY .....	39
Estonia's Monetary Policy Framework .....	39
Most Significant Monetary Policy Decisions of 1999 .....	41
Interest Payment for Reserve Requirement .....	41
Monetary Policy Aspects in Eesti Pank's Profit Distribution Strategy .....	41
Monetary Policy Aspects in European Integration .....	42
FINANCIAL COMMITTEE .....	44
V. RESEARCH UNDERLYING DECISION-MAKING .....	45
Research Focus in Central Bank .....	45
Research Department .....	45
Research Completed in 1999 .....	46
VI. INTERNATIONAL COOPERATION .....	47
Eesti Pank and European Union .....	47
Accession Negotiations .....	47
Action Plans and Reports in Accession Process .....	48
Relations with European Central Bank .....	49
Economic Policy Cooperation between Estonia and International Monetary Fund .....	50
Estonia's Participation in New International Initiatives of IMF .....	50
Cooperation in Technical Assistance between Eesti Pank and IMF .....	51
Cooperation in Nordic-Baltic Constituency .....	52
Cooperation with Other International Organisations .....	52
Cooperation with Other National Central Banks .....	52
Eesti Pank and Country Rating .....	53

VII. OPENNESS AND TRANSPARENCY .....	55
Good Practices Ensure Comparability .....	55
Comparable with Europe .....	56
Eesti Pank Is Maximum Open in its Decisions .....	56
Qualitative Changes in Eesti Pank's Publications .....	57
Applying New Technology .....	57
VIII. BANKING SUPERVISION UNDER NEW LAW .....	58
New Credit Institutions Act and Arising Regulations .....	58
<i>BANKING SUPERVISION COMMITTEE</i> .....	61
Functions and Rights of the Banking Supervision Department under the New Act .....	61
Structure of Banking Supervision Department .....	62
Consolidated Supervision .....	62
Cooperation with Other Supervisory Bodies .....	63
Unified Financial Supervision .....	64
IX. PAYMENT AND SETTLEMENT SYSTEM PERFORMANCE .....	65
Systemic Development in 1999 .....	65
<i>PAYMENT COMMITTEE</i> .....	66
Settling of Payments through Eesti Pank .....	66
Payment Instruments .....	67
Cash Demand .....	68
Issue of Banknotes and Coins and their Structure .....	68
Cash Movement .....	70
Introduction of New Banknotes, Cash Examination .....	71
Commemorative Coins, Other Numismatic Items .....	72
X. STATISTICAL ACTIVITY .....	73
Intra-bank Activity .....	73
Closer International Cooperation .....	74
XI. FOREIGN CURRENCY RESERVES MANAGEMENT .....	76
Foreign Currency Reserves: Their Role and Structure .....	76
Investment Process .....	77
Reserve Management in 1999 .....	77
XII. LEGISLATIVE DRAFTING .....	79
Preparations to Amend Central Bank Act .....	79
Towards Improved Cooperation in Legislative Drafting .....	80
XIII. DEVELOPING ORGANISATION .....	81
Executive Management and Areas of Responsibility .....	81
Reorganisation of Organisational Chart .....	81
Strategic Planning .....	83
<i>DEVELOPMENT COMMITTEE</i> .....	84
Bank Employees .....	85
Personnel Policy .....	85
Training .....	86
Hobbies and Traditions .....	87
Open to Children and Other Interested Parties .....	87
XIV. BOARD OF EESTI PANK .....	89
XV. YEAR 2000 PROBLEM: SUCCESSFUL SOLUTION .....	91
Organisation of Preparations for Year 2000 in Eesti Pank .....	91
The Role of the Central Bank in Securing the Y2K Compliance of the Banking System .....	92
Securing Smooth Operation of Payment and Settlement Systems .....	92
Meeting Cash Demand .....	93
Before and After the Change-over Period .....	93
In Conclusion .....	93
FINANCIAL STATEMENTS FOR 1999 OF EESTI PANK .....	95
Auditor's Report .....	112
APPENDICES .....	113
Chronicle – 1999 .....	115
The Strategic Development Plan of Eesti Pank .....	119
Brief Overview of Research Year 1999 in Eesti Pank .....	123
Statistics .....	127