

Foreword by Governor of Eesti Pank

For Estonia, 2005 was a year of fast economic growth, higher than expected employment, and households' growing confidence in the future. However, the rapid development was accompanied by a few risks, which the central bank repeatedly drew attention to.

As far as external risks are concerned, the central bank calls for more attention to rising oil prices in the world market and their impact on Estonian consumer prices, as well as the influence of oil price dynamics on other prices.

Internal risk monitoring entails examining the economy as a whole but also the supply and demand situation by sectors both in the labour as well as the services market. Moreover, the fast growth of household debt burden needs more attention.

Looking further ahead, most probably risks emanating from the supply-side can be expected. Estonian enterprises have to be ready for moving up in the value added chain. This means a transition to more knowledge-based products and services. However, the lack of qualified labour force sets limits here.

Robust economic growth in 2005 was boosted by exports growth and the flourishing real estate sector. While the balance of the whole Estonian economy implies long-term sustainable development, the real estate sector showed signs of imbalance. In December 2005, Eesti Pank decided to take measures to tighten the legal framework for housing loans.

The driving force behind investment activity in 2005 was household investment, which increased considerably faster than corporate fixed investment. The share of private consumption in GDP decreased and households invested a considerable amount of their savings in real estate. What is important for Estonia, however, is the further growth of export-oriented investments.

Strong economic growth ensured a fast increase in government revenue and the effective tax revenue collection exceeded expectations. The surplus of the state budget for 2005 was nearly 1.6 per cent of GDP. Nevertheless, the surplus should have been even larger, given that economic growth was faster than in previous years.

The average consumer price inflation was 4.1 per cent in 2005. Taking into account the income level convergence, the 3–4% rise in consumer prices can be considered consistent with price stability in the context of rapid and balanced (in terms of increased labour productivity) economic growth. At the same time, it is hard to comply with the inflation criterion necessary for joining the euro area.

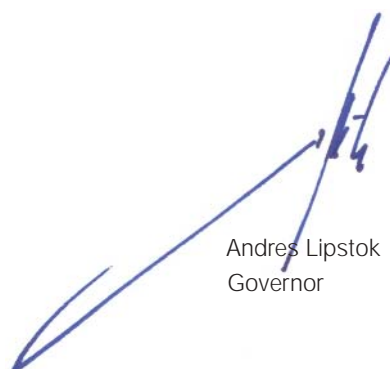


Eesti Pank and the Government have established the goal to introduce the euro as soon as Estonia meets all necessary requirements. Given that Estonia has successfully implemented the currency board arrangement with the fixed exchange rate against the euro (until 1999 equivalently against the Deutsche Mark) since the summer of 1992, the accession to the euro area will not bring about any essential changes in economic policies. Adoption of the euro will contribute to Estonian economic success and help to develop it further under more favourable conditions.

Eesti Pank's operations and activities in 2005 derived from the strategic task to ensure technical readiness to join the euro area by the second half of 2006. To this end, serious work is done in all fields of responsibility: devising of monetary and financial policies, analysis and monitoring of economic development, collection and analysis of economic and financial statistics, monitoring and improvement of the payment environment, regulation of payment intermediation and currency circulation, and distribution of economic information.

For Estonia, year 2005 was the first full year as a Member State of the European Union. For the central bank, this meant even more serious and efficient work so as to bring Estonia's positions to the forums that develop common ground on the economic policy of the European Union.

The international respectability of the central bank should always be backed by bank's reputation in its own country. According to the latest data from March 2006, 79% of the Estonian population trusts Eesti Pank. The bank highly appreciates such support from the society and will do its best to justify that trust also in the future.



Andres Lipstok
Governor