

ESTONIAN ECONOMY IN 2009

NON-FINANCIAL SECTOR

Monetary policy environment

The monetary policy environment remained accommodative throughout 2009 and helped reduce the impact of the global financial crisis. The majority of central banks saw a clear need to keep the interest rates low and not to rush to reduce economic stimulation measures. In the first half of the year, the European Central Bank lowered its monetary policy interest rate to 1%. The low interest rate was further facilitated by deflationary pressures that stemmed from a decline in commodity prices, which in turn resulted from an easing in global demand and declining wage pressures.

The dollar continued to depreciate throughout 2009 until December, when the trend turned. Despite this, at the end of 2009 the dollar was

approximately 3% cheaper than it had been at the beginning of the year. The Russian rouble depreciated by almost 5% against the Estonian kroon, but the impact of the cheapening of these currencies was mitigated by the appreciation of the Swedish krona.

Although global interest rates declined in 2009, this did not push down domestic interest rates (see Figure 1). Growth in the net interest margin offset the impact of the fall in the key interest rate.

All in all, crediting conditions in 2009 in Estonia turned out to be significantly tighter than in 2008. As the global interest rate environment eased, the interest payments on loans with a floating interest rate fell. On the other hand, growth in the interest margins on new loans considerably reduced the demand for credit.

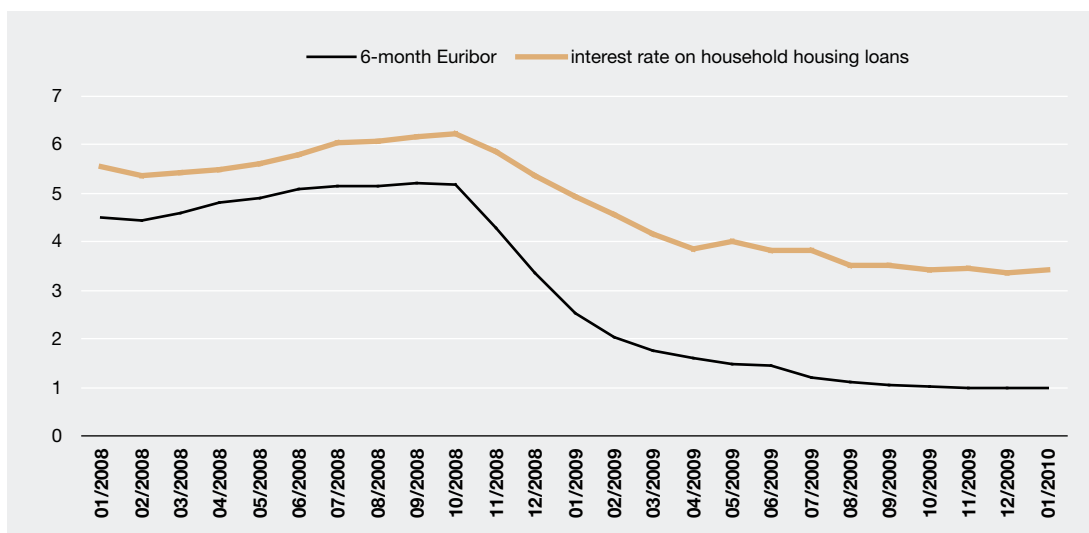


Figure 1. Changes in the interest rates on long-term loans issued in Estonia and euro area money market interest rates in 2008-2009

Domestic and external demand

Estonian economic activity declined drastically at the beginning of 2009 as a result of the global financial crisis, and this was reflected in both domestic and external demand. This led to a recession in which the economy shrank by 14%. In the second half of the year, the decline in GDP slowed, and in the fourth quarter the downward trend reversed on a quarter-by-quarter basis (see Table 1).

The export sector contributed the most to the economic recovery. According to preliminary estimates, goods exports fell by nearly a third over the year. At the end of the year, the decline in exports slowed, and in December it was comparable to the decline of December 2008, although this was also partly attributable to the base effect. According to balance of payments flash estimates, services exports contracted by 12% and imports by 22%.

Domestic demand weakened throughout 2009 and the underutilisation of production resources also hampered investment. Private consumption fell back as purchasing power declined as a consequence of high unemployment and tax rises. As a result, the retail trade contracted by 15% in 2009 compared to 2008. Consumption also declined because of higher saving as consumers became more cautious. At the end of the year, the planned rise in excise duties led intermediaries and distributors to build up their reserve stocks, but this was only a one-off contribution to the rise in economic activity.

A sharp fall in imports as a result of weak domestic demand significantly improved Estonia's external balance. According to balance of payments flash estimates, the surplus on the current account in 2009 amounted to 10 billion kroons, or 5% of GDP. In 2008, the current account had had a deficit of 9% (see Figure 2). The improvement in the external balance was

Table 1. Real GDP growth by economic sectors in 2008-2009 (%)

	2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	2009
Agriculture and hunting	-2.5	0.2	-11.4	-22.8	-4.2	-10.2
Forestry	7.6	15.8	-11.7	25.4	36.3	16.6
Fishing	5.6	3.5	-8.5	3.5	22.5	5.8
Mining and quarrying	-8.5	-13.6	-26.5	-6.7	3.2	-11.1
Manufacturing	-4.2	-29.0	-31.2	-26.9	-14.3	-25.8
Energy, gas and water supply	-7.4	-0.5	-18.3	-24.4	-11.7	-12
Construction	-5.3	-31.5	-30.6	-31.7	-26.3	-30.1
Wholesale and retail trade; repair of motor vehicles and household appliances	-8.6	-20.9	-20.9	-21.2	-15.5	-19.7
Hotels and restaurants	-7.9	-25.2	-26.9	-17.0	-23.0	-22.9
Transport, storage and communications	-4.1	-17.1	-16.8	-16.6	-12.8	-15.9
Financial intermediation	-2.9	-26.1	-28.4	-29.7	-21.2	-26.5
Real estate, renting and business activities	-0.5	-8.0	-8.4	-5.3	-6.1	-7
Public administration and defence; statutory social insurance	6.8	1.5	2.0	0.5	1.2	1.4
Education	1.2	-5.1	-3.0	-3.6	-4.5	-4.1
Health and social care	-0.4	-0.6	-1.1	-4.9	-2.9	-2.3
Other community, social and personal services	0.0	-12.8	-18.4	-15.8	-13.5	-15.1
Total GDP	-3.0	-15.3	-17.5	-17.0	-10.7	-15.2
Net taxes on products	-7.2	-13.0	-5.0	-4.4	0.5	-5.4
GDP at market prices	-3.6	-15.0	-16.1	-15.6	-9.5	-14.1

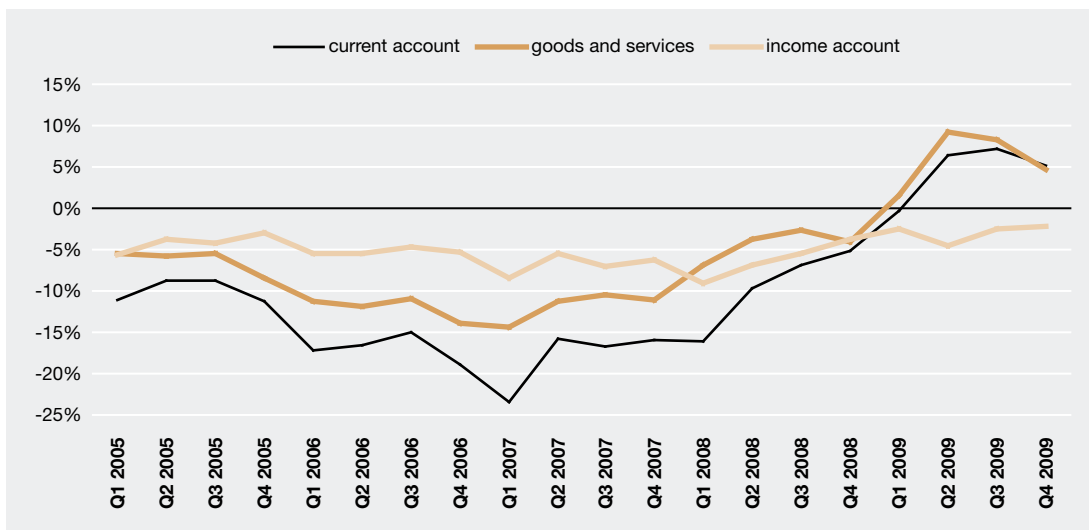


Figure 2. Current account balance and main accounts of the balance of payments (% of GDP)

also supported by a decline in the net outflow of income to 0.3 billion kroons in December. The negative income account was offset by a drop in income earned by non-residents in Estonia.

Inflation

The rapid rise in prices seen in earlier years was replaced by a fall in 2009. In December, the price level in Estonia was 1.8% lower than in December 2008, although the annual average inflation rate was still 0.2% higher. Since November, the inflation rate has been lower than the Maastricht inflation criterion.

In 2009, the prices of food and the housing costs dropped the most, by 6.4% and 7.1% respectively. This was caused primarily by external factors as lower global oil prices brought down household heating costs and the price of motor fuel, and the raw materials for food became cheaper. The low point for external inflation factors has probably by now been passed.

With the global crisis and the following extensive economic decline in Estonia, households already became more cautious in their consumption decisions in 2008. In addition, there was a considerable decline in incomes and credit demand, and as a result, domestic demand contracted significantly, forcing companies to reduce prices. The drop in prices was also facilitated by companies' wish to reduce stocks, to achieve which they held discount sales campaigns. Apart from housing rental and hotel accommodation, the prices of services have responded less to the contraction of the economy on average than have the prices of goods (see Figures 3-4).

In summer 2009, several tax rises were passed in order to improve the budget position, but this did not stop the fall in prices. In July, the VAT rate rose from 18% to 20% and motor fuel excise duties increased as well. The majority of retailers, however, did not pass the VAT increase fully on to customers.

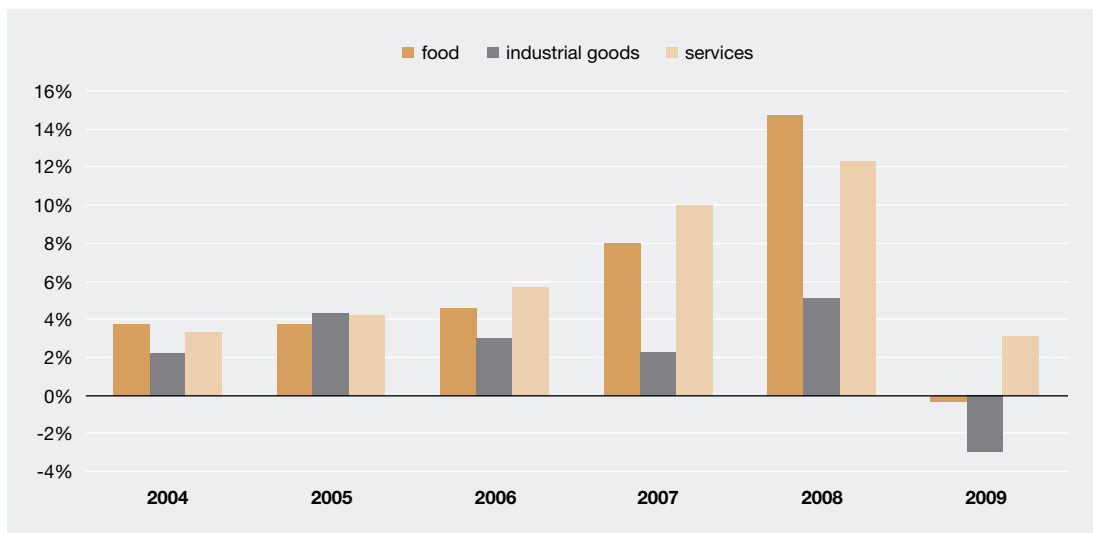


Figure 3. Changes in the prices of services, food and industrial goods (y-o-y)

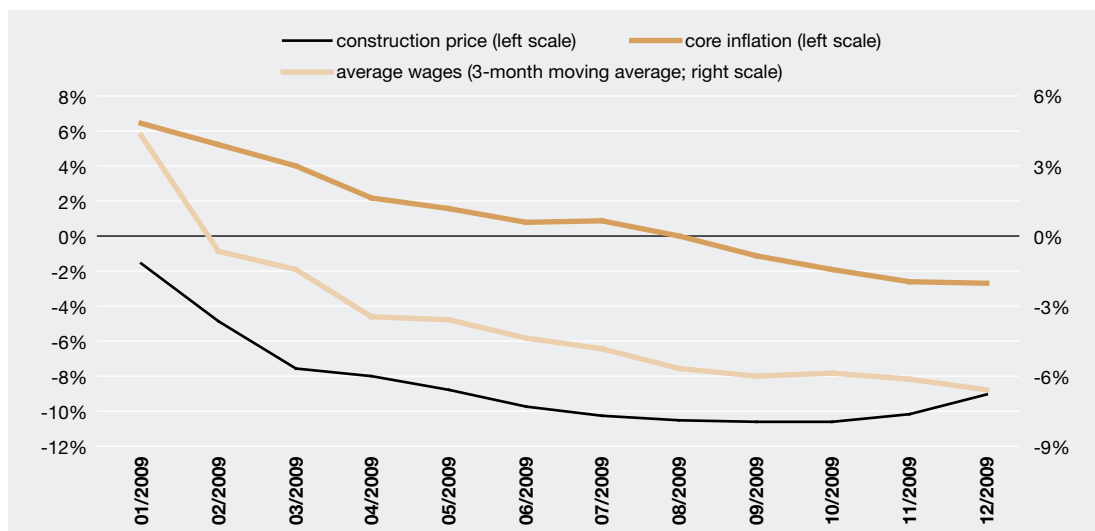


Figure 4. Changes in core inflation, construction prices and average wages (y-o-y)

General government

The economic decline in Estonia turned out to be deeper than expected due to the joint impact of a decline in domestic demand after the real estate boom and a sharp contraction in global trade. As a consequence, since the second half of 2008 the Government has been taking measures to improve the consolidated budget bal-

ance. The total consolidation package put forward in 2009 was worth nearly 9% of Estonia's annual GDP. The measures included a rise in consumption taxes and cuts in budget expenditure in 2009–2011. The cuts touched almost all categories of expenditure, with the exception of social benefit transfers to households. Another exception among the fiscal measures was the 5% increase in old age pensions. Around a third

of the measures were temporary, including the suspension of state contributions to the mandatory pension funds and a larger withdrawal of dividends from state companies.

These measures helped cut the large state budget deficit, and in the second half of the year the consolidated budget surplus was already more than 3.5% of the GDP of that period. The annual consolidated budget deficit fell to 1.7% of GDP.

In 2009, the consolidated budget deficit was mainly financed from the reserves accumulated in the years of strong growth. Loans to local governments and non-profit associations pushed the general government debt up to about 7% of GDP by the end of 2009. At the same time, the sales of assets increased cash reserves and at the end of the year, the Estonian government was still a net lender.

SOVEREIGN RATING

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

In 2009, Estonia's sovereign rating was constantly scrutinised by all of the three rating agencies, and they all officially revised and/or changed Estonia's sovereign ratings. In 2009, Moody's and Fitch visited Eesti Pank, two telephone conferences were held with Standard & Poor's and Fitch, and experts from the central bank also met Standard & Poor's separately in London. Communication with Estonian analysts and exchanges of information were intensified. The key topics at the meetings in 2009 were:

1. **Financial sector issues**, including relations between subsidiaries and parent banks such as refinancing and the potential nationalisation of the Swedish parent banks. As earlier, the agencies drew attention to Estonia's large external debt and its financing difficulties.
2. **Estonia's fiscal policy situation and outlook**, including the possible use of economic policy measures and the timing of decisions to improve Estonia's fiscal position.
3. **The prospect of joining the euro area and an action plan for this.**
4. **The impact of economic developments in Latvia on Estonia**, primarily the potential for change in the exchange rate change of the Latvian lat.
5. **The labour market situation and outlook**, notably the impact of increased unemployment on the repayment of loans, and wage developments in 2009.
6. **Estonia's competitiveness** in the region, given the depreciation of the Swedish, Polish and Russian currencies and for other factors.

On 24 February 2009, **Standard & Poor's** decided to start revising the ratings of Estonia's short-term and long-term foreign currency liabilities (A/A-1/negative), and to downgrade them if necessary. On 21 April, the rating committee confirmed the ratings of Estonia's long-term and short-term foreign currency liabilities at the same level as before. In its decision the agency noted that Estonia's sovereign ratings draw from the strength of state institutions and also from the low government debt and considerable fiscal reserves. In addition, the ratings are supported by Estonia's competitive, flexible and open economy and the prospect of joining the euro area. Despite this, on 10 August 2009, Standard & Poor's downgraded Estonia's long-term and short-term sovereign ratings from

A/A-1 to A-/A-2. The sovereign rating outlook remained negative. The rating decision made in August 2009 reflected the agency's opinion that Estonia's problems would worsen, as the country's economy must make great adjustments to lower its dependence on foreign funding. This, however, might postpone Estonia's accession to the Economic and Monetary Union. The negative outlook is based on the probability that the rating will drop if economic adjustments fail to increase Estonia's competitiveness or if tensions in the external environment, such as a major trading partner of Estonia choosing to devalue its currency.

Moody's decided to start revising Estonia's sovereign rating (A1/negative) on 10 February 2009, and was considering the possibility of a downgrade. On 23 April 2009, Moody's affirmed Estonia's sovereign rating at A1, but retained the negative outlook. The rating has remained at A1 for nearly eight years, since November 2002. The agency believes that in a deepening and prolonged economic decline, the creditworthiness of the Estonian general government would probably remain strong enough. The Government is trying to reduce the budget deficit and liquidity is guaranteed. In April 2009, Moody's said that Estonia's budget deficit in 2009 would probably remain within the limit of the Maastricht criterion of below 3% of GDP, following prudent fiscal policy in the years of rapid growth and impressive budget adjustments. This result – one of the best in the EU – should enable Estonia to follow its crisis management strategy and officially adopt the euro in January 2011.

Fitch Ratings decided to downgrade the ratings of Estonia's, Latvia's and Lithuania's short-term and long-term foreign currency liabilities and the rating of long-term kroon liabilities on 8 April 2009. The sovereign ratings of long-term foreign currency liabilities for the three countries are BBB+, BB+ and BBB respectively.

The agency stated that Estonia's ratings were downgraded due to a worsening outlook for growth, which increased pressure on macro-economic policies. The downgrading of Estonia's and Lithuania's ratings also reflected their vulnerability to negative events in Latvia, where risks had increased at that time through three risk sources: trade, a lack of diversity among owners of the banking sector, and people's confidence in the local currency and banking system. Although the devaluation of the Latvian lat was not anticipated in Fitch's baseline scenario, any such event would have put heavy pressure on the Estonian kroon and the Lithuanian litas. In April 2009, Fitch believed that with the backdrop of Estonia's rapid economic decline, further measures to improve the country's fiscal position would be difficult to implement and that the budget deficit for 2009 could easily exceed the goal of 2.9% of GDP. Fitch also noted that thanks to fiscal reserves worth 9% of GDP at the end of 2008, the Estonian general government is at least partly able to finance its budget deficit. Estonia's rating was supported by the low general government debt, which stood at 4.8% of GDP as at the end of 2008. In the near future the demand for external financing is expected to remain high in all three Baltic States.

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

Supporting factors:

- political and institutional strength together with EU membership;
- strong fiscal policy to date and a considerable liquidity buffer, low government debt (the lowest in the EU);
- no state-owned banks in Estonia, with 98% of the banking system's assets belonging to foreign owners;
- a competitive and open economy, which is flexible enough to cope with temporary weak demand;

- the chance of joining the European Economic and Monetary Union in the next few years, which lowers the currency risk.

Weakening factors:

- Estonia's continuous strong demand for external financing; most of the need for external funds is related to foreign-owned parent banks or companies;
- Estonia's gross and net external debt, compared to countries with similar ratings;
- the performance of the banks increases credit risks that are related to market risks, through the high share of foreign currency loans compared to foreign currency deposits;
- Estonia's options for domestic budget financing are limited, which increases the country's dependence on fiscal reserves or foreign loans;
- the high debt burden of the private sector and the relatively low level of incomes;
- the need to restrain the earlier large foreign trade imbalances, which has led to a serious decline in economic growth and a drop in incomes.

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

FINANCIAL SECTOR

The year 2009 was a difficult one for the banking sector especially, even as securities markets gained momentum from the recovery of confidence in the global economy. There were no significant changes in the structure of Estonia's financial sector in 2009, but the financial assets of banks grew in relative terms as GDP fell (see Figure 1). The relative shares of investment funds and the stock market increased as assets and capitalisation grew and GDP dropped.

The banking sector

Institutional developments

In May 2009, a new player joined the Estonian banking market, when AS LHV Group, which had previously only engaged in asset management, received a licence to operate as a commercial bank. Consequently, there are now seven credit institutions and ten branches of foreign credit institutions operating as banks in Estonia, and approximately 230 foreign credit institutions providing cross-border banking services.

Changes in the operational environment have

resulted in some changes in the strategies of market participants. Risks have increased and so former market leaders have lost some of their market share, while larger banking groups operating as branches on the local market have increased theirs.

Assets and liabilities of banks

In 2009 the uncertain economic environment pushed the assets of banks down by 5.6% to 322 billion kroons. In the previous year they had risen by 6.5%. The total value of the financing portfolios of banks and leasing companies was 264 billion kroons in 2009, a fall of around 18 billion kroons or 6.3% over the year. This was the first year since the recession at the end of the 1990s that the total value of the financing portfolios of banks shrank.

The value of financing portfolios declined evenly throughout the year, although there were some differences between sectors. In the household loans segment, it was consumer loans that dropped the most, at 11% down compared to a year earlier. This led to housing loans increasing as a percentage of loans granted to households (see Figure 2).

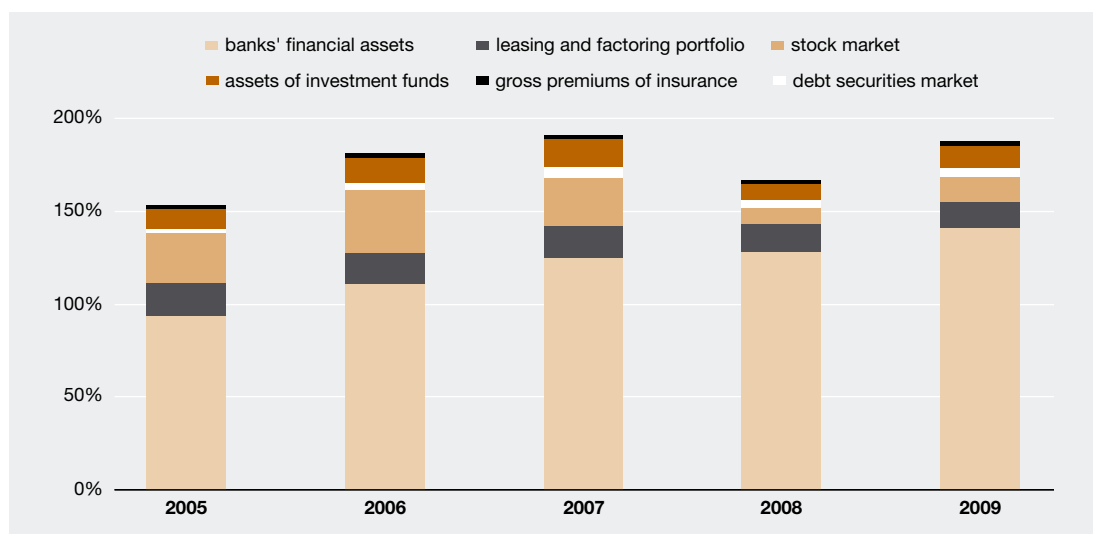


Figure 1. Structure of Estonia's financial intermediaries

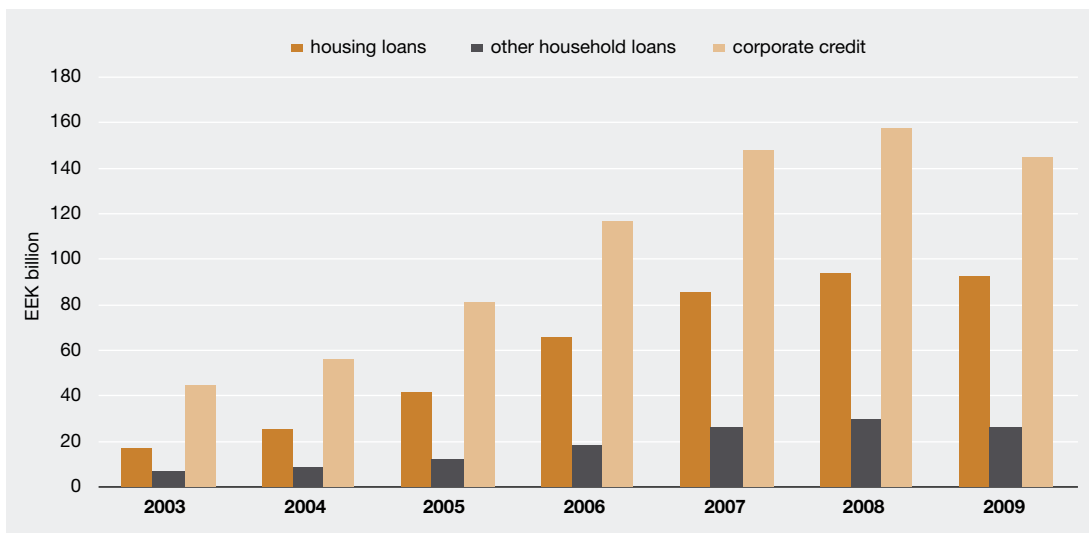


Figure 2. Non-financial sector loans

The dynamics of loans and leases issued to companies differed greatly across sectors. The falls in the loans and leases granted to business services companies and wholesale and retail trade companies were considerable at 28% and 24% respectively. The loan stock of the hotel and restaurant sector increased 28% and that of the energy sector grew by 13%.

The assets of banks fell by 19 billion kroons and funds borrowed from foreign banks by around 10 billion kroons in 2009. The share of deposits among the funds raised by banks increased despite the deep recession, with household deposits growing by 1.5 billion kroons and corporate deposits by 0.6 billion kroons in 2009. Total household deposits and corporate deposits stood at 55.4 billion kroons and 52.6 billion kroons, respectively.

Quality of the loan portfolio

The loan portfolios had already started to deteriorate at the end of 2008 as the economic environment worsened, but the deterioration gained considerable momentum in the first half of 2009. The share of loans overdue for more than 60

days in the loan portfolio rose from 2.9% at the end of 2008 to 6.5% by August 2009 and then remained at that level (see Figure 3). The quality of loans to the construction sector deteriorated the most, with the percentage of overdue loans rising from 5% to 19.2% over the year. Transport has been the business sector least affected by the crisis, and the percentage of overdue loans in that sector grew by only 0.5 percentage points to 1.4% in 2009.

The percentage of overdue household loans was highest among household consumer loans, reaching 9.9% of the loan portfolio while the proportion of overdue housing loans increased modestly from 1.8% to 4.2% despite the deep recession and the decline in incomes.

Profitability

In 2009, the profitability of banks was curbed mainly by two factors: the need to adjust the value of loan portfolios, which had the bigger impact, and the low level of key interest rates. In 2009, the banks operating in Estonia earned 4 billion kroons of net interest income in total, which was over a third less than in 2008.

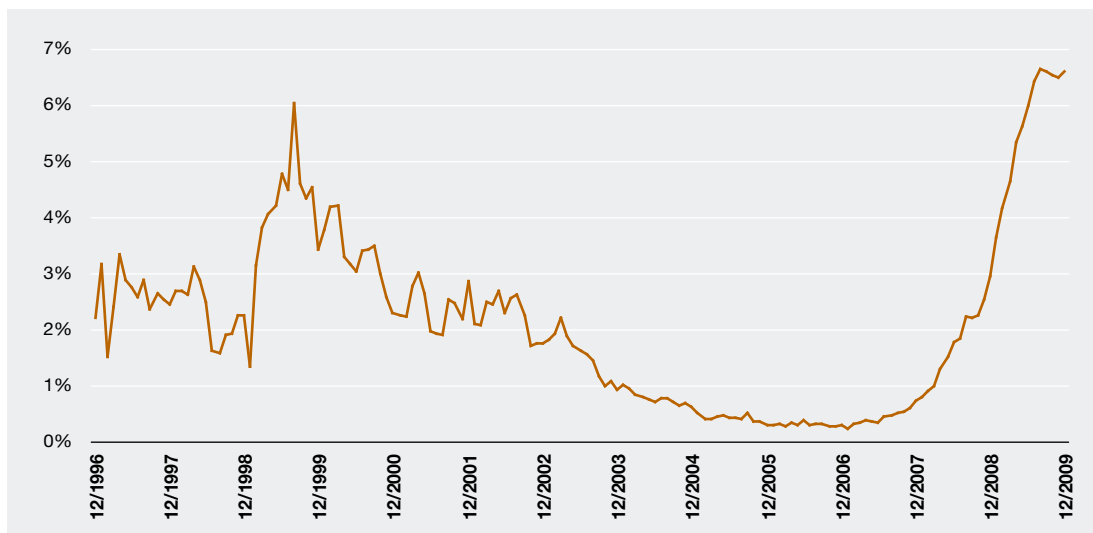


Figure 3. Percentage of loans overdue for more than 60 days

The decline in net interest income slowed in the second half of 2009 and banks earned pre-provision profits on a consolidated basis in 2009, though these were still insufficient to cover the provisions. In total, banks earned a loss of 8.9 billion kroons in 2009. Additional write-downs during the year amounted to 8.1 billion kroons, or nearly 3.5% of the total loan portfolio of banks. Banks also had to bear losses due to write-downs of investments in subsidiaries totalling around 3.4 billion kroons.

Since banks' incomes and loan portfolios decreased in 2009, they had to cut expenses. Compared to 2008, operating expenses were reduced by 10% in 2009, partly because of the elimination of the bonus reserve.

Capital adequacy and risks

In 2009, the capital adequacy ratio of the banks was mostly affected by a decrease in risk assets,

which had two causes. First, in addition to SEB Pank, Swedbank also introduced the internal ratings based method for calculating the capital requirements for credit risk. Second, in 2009 the banks' capital requirements for credit risk also fell in tandem with the decline in the loan portfolio. In addition, banks increased the amount of capital required for covering the risks by adding the retained profits of previous periods under Tier 1 equity.

The aggregate capital adequacy ratio of banking groups increased from 13.3% at the end of 2008 to 15.7% in 2009 (see Figure 4), and the lowest capital adequacy ratio among the banking groups was 13.7%. The capitalisation ratios of the banks operating in Estonia confirm that they have sufficient capital buffers to cope with large loan write-downs.

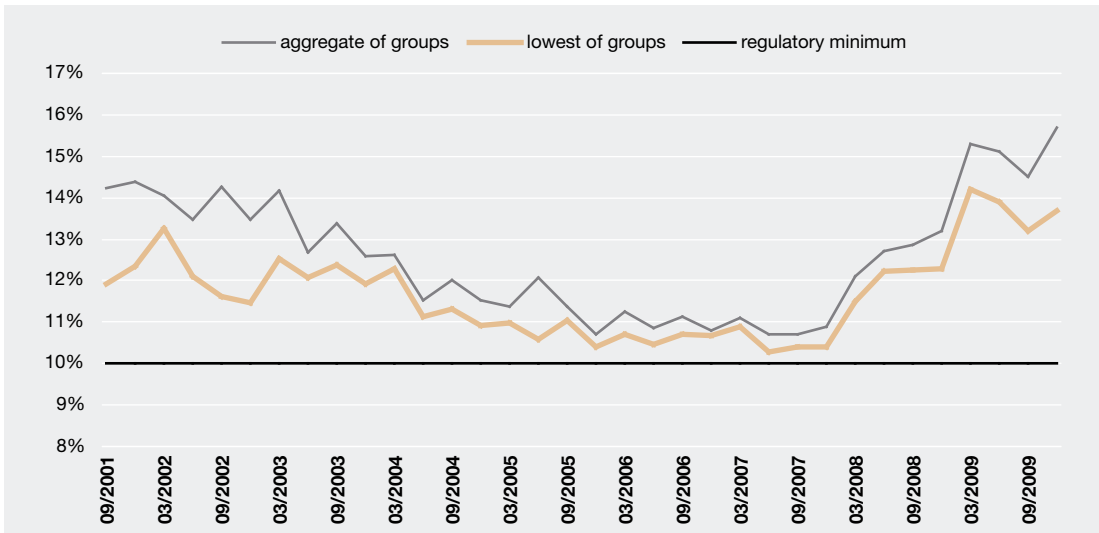


Figure 4. Capital adequacy of banking groups

Securities markets

Bond market

The primary bond market was very quiet in 2009 compared to 2008, although in the first half of the year it was stimulated by bond issues from the general government and from financial institutions. The number of bond issues fell 50% from 2008 and the monthly average totalled only 270 million kroons (see Figure 5).

Bond capitalisation fell 2 billion kroons to 9.6 billion kroons, or 4.4% of GDP, in 2009. This was mainly caused by a drop in the stock of debt securities issued by non-financial sector companies and credit institutions.

The percentage of local issuers increased to around 91% by the end of the year owing to the low levels of activity in the primary bond market.

There were also some changes among bond investors, as non-financial sector companies decreased their share of bond-holding to 25%, while the share of bonds held by insurance companies and pension funds fell to 9%. At the same time, the proportion of bonds held by credit institutions increased to 34%. The share of resident investors in bond capitalisation continued to increase in 2009 and at the end of the year amounted to 72% of total bonds issued, of which around 2.8% belonged to private persons.

In 2009, the bonds of four companies were redeemed on the Tallinn Stock Exchange. At the end of the year, only two companies had bonds listed on the stock exchange with a total value of 101 million kroons.

The secondary bond market was also very quiet. The average daily turnover of bonds was only 5 million kroons, which is 19% of the average daily turnover in 2008.

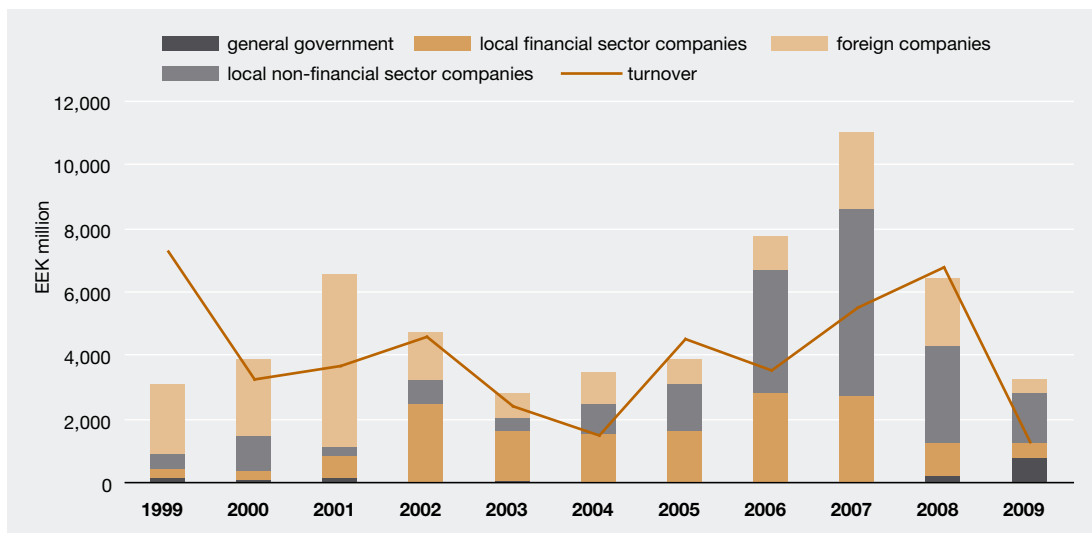


Figure 5. Debt securities by issuers and secondary market turnover

Stock market

The takeover bid of TeliaSonera AB for Eesti Telekom in the second half of August breathed life into the Estonian stock market. There was a small correction at the end of the year when the value of the index declined from its 2009 peak of 456 points to 404 points, and capitalisation contracted by 3 billion kroons to 29 billion

(see Figure 6). The average daily turnover of the stock exchange was 16 million kroons.

The primary list of the Tallinn Stock Exchange contained 16 companies at the end of 2009. Active trade involved the shares of three companies, which accounted for 67% of the total turnover of the year. The shares of AS Starman and AS Luterma were delisted from the primary

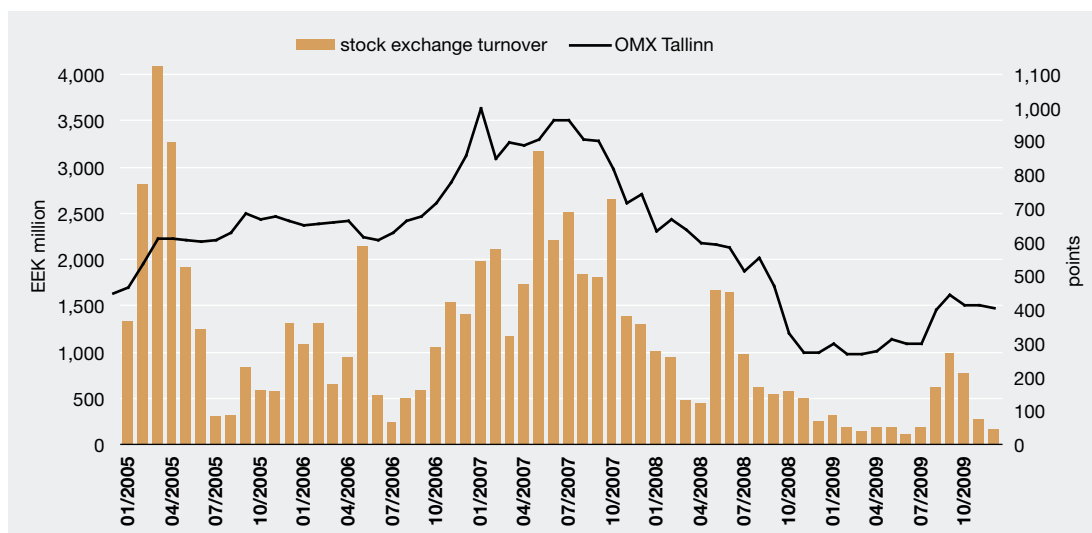


Figure 6. Monthly turnovers of the Tallinn Stock Exchange and OMX Tallinn index as at month-end

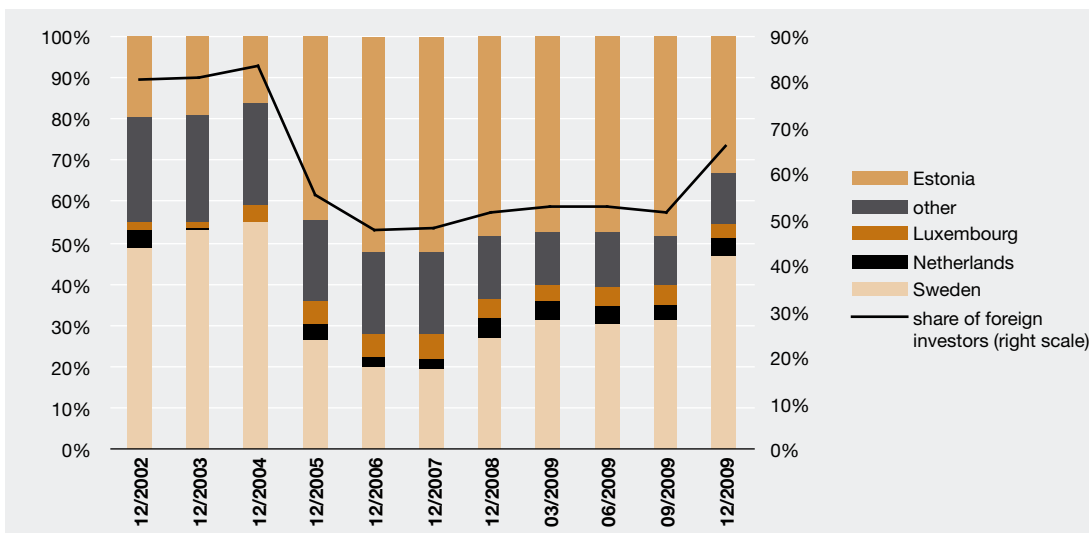


Figure 7. Structure of investors on the Tallinn Stock Exchange

exchange and the shares of AS Järvevana were listed on the secondary exchange. In October Eesti Telekom applied for delisting, which took place at the beginning of 2010 when the company's capitalisation comprised 44% of the total stock exchange capitalisation.

In the fourth quarter of 2009 the structure of the Tallinn Stock Exchange, which had been relatively similar since 2006, changed considerably (see Figure 7). The stock of shares held by Swedish residents increased significantly, which raised their share in the stock market capitalisation to 48% by the end of the year and the share of foreign investors to 66%. Local investors held around 9.7 billion kroons, or 34%, of the capitalisation. The stock of shares held by households increased to 14% in the fourth quarter.

At the end of 2009, the Tallinn Stock Exchange had 33 registered members, of which three companies accounted for 76% of total stock exchange transactions.

Other financial intermediaries

Investment and pension funds

In summer 2009, the Government ceased making payments into the second pillar pension funds. The state's payments will be resumed in 2011, but almost 40% of the current subscribers have decided to continue making payments in 2010. In 2009, many switched pension fund. Around 28% of the 220,000 subscribers who decided to continue paying in 2010 have opted for a different pension fund. People mainly shifted their payments from the major high-risk funds of Swedbank and SEB to smaller or new pension funds.

In 2009, one real estate fund and two mandatory pension funds entered the market. Meanwhile, Swedbank Investment Funds eliminated three of its funds, including the Swedbank Money Market Fund, which means that there are no money market funds in Estonia any longer. Of the three risk capital funds registered in 2008, the only one

left is the Gild Arbitrage Risk Capital Fund, which was made into a non-public fixed-term fund and whose loan liabilities were reconstructed into long-term bonds. At the end of the year, there were in total 43 investment funds and 33 pension funds registered in Estonia.

Investment fund assets totalled 8.9 billion kroons at the end of 2009, which is approximately as much as in 2008 (see Figure 8). Since the yield of interest funds has declined and two funds have been eliminated, the assets of funds have fallen by around 1 billion kroons in total and their share in the total assets of investment funds has dropped to 18%. The share of risk capital funds fell in the same way, and was 8% at the end of the year. Equity fund assets increased, mainly as a result of an increase in asset prices, rising by more than 2.2 billion kroons in total. Consequently, the share of these assets rose to 65% of the total investment fund portfolio.

Even though many have suspended payments for the time being, the assets of pension funds increased by almost 3.6 billion kroons in 2009, reaching a historical high of 15.9 billion kroons (see Figure 9). The assets of third pillar pen-

sion funds and second pillar high-risk pension funds grew relatively faster in 2009, at 34%, than did the assets of other pension funds. This led to a rise in the share of high-risk pension fund assets to 77% of total second-pillar pension fund assets. Including pension insurance, the assets of third pillar pension funds stood at 3.4 billion kroons at the end of 2009, of which pension funds comprised 33.4%.

Insurance

In 2009, the Estonian insurance market sank in line with the contraction in the real economy. At the end of 2009, 19 life insurance and non-life insurance companies were still operating in Estonia but the total of insurance premiums had fallen by 11% over the year. Total market profitability improved in 2009 despite a significant decline in sales, a high contract termination rate and fierce competition between market participants. This largely resulted from the cost-effective operations of insurance companies and a somewhat better return on investment. Aggregate profitability was also affected by the merger of two insurance companies, with the joint company being based in Estonia.

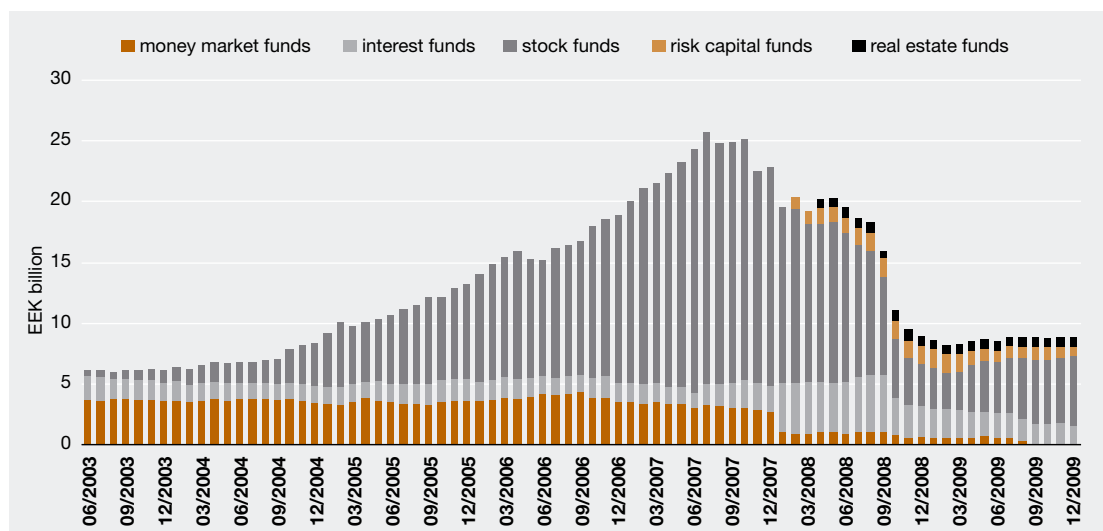


Figure 8. Value of investment fund assets as at month-end

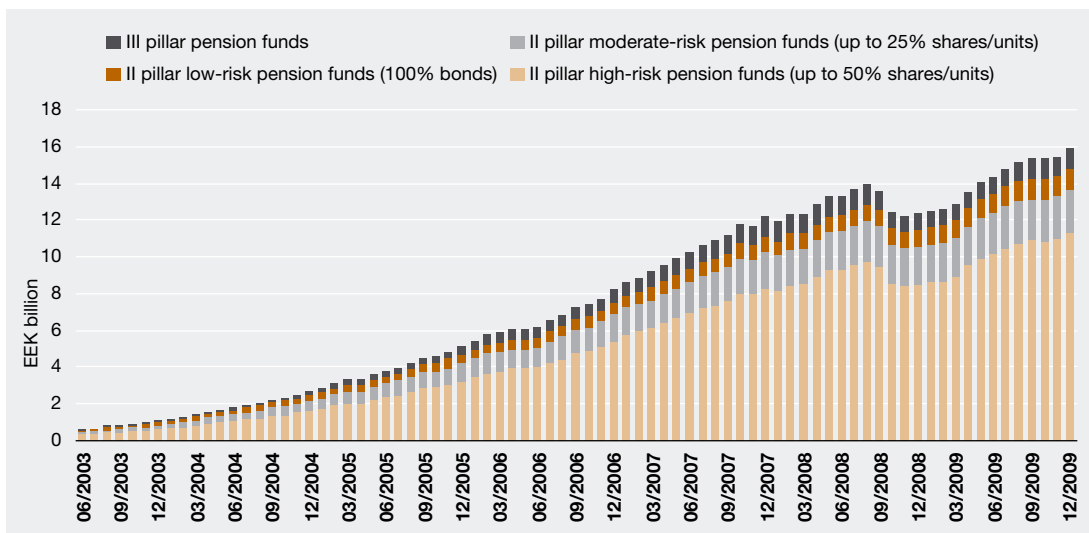


Figure 9. Value of pension fund assets as at period-end

The life insurance sector had already adjusted to market developments in 2008. Although the insurance premiums collected in Estonia at 1.1 billion kroons in 2009 represented a fall of 9.4% over the year, the performance of the insurance companies indicates rather more of a stabilisation in the market. Insurance companies finished 2009 with a 453 million-kroon unaudited profit, which facilitated growth in equity and capitalisation. The life insurance sector is very concentrated with three major insurance companies holding 85% of the total market.

Estonia's annuity insurance market opened in 2009¹. In accordance with the Funded Pensions Act, insurance companies have been concluding pension contracts for mandatory funded pension payments since 1 January 2009.

The non-life insurance sector adjusts to changes in the economy with a lag. This saw the sale of insurance suffer a major drop of 16% in 2009, when 3.2 billion kroons of insurance premiums

were collected in Estonia. Even though the percentage of vehicle insurance is 65%, and interest in new vehicles was lower, insurance companies still earned a record unaudited profit of 890 million kroons. Profitability was also curbed by low loss given defaults and partly also by the profits of the previous years and earlier contracts. As is the case in the life-insurance market, the non-life insurance market is dominated by three major companies, but foreign branches have also significantly increased their market share from 9% to 14%.

Payment instruments

The value of payments, which had witnessed relatively robust growth in the previous years, suffered a decline of around 13% in 2009 (see Figure 10). The value of both cash and non-cash payments declined to a similar extent. People's payment habits show that one chosen payment instrument is usually preferred for its ease, convenience and cost of use. Among non-cash pay-

¹ Since 2009, those who reach pensionable age are entitled to payments from the second pillar funds. For those whose pension account exceeds or equals 50 times the national pension rate (starting from 95,657.01 kroons), the only way to receive payments is to conclude an annuity contract with an insurance company (source: www.pensionikeskus.ee).

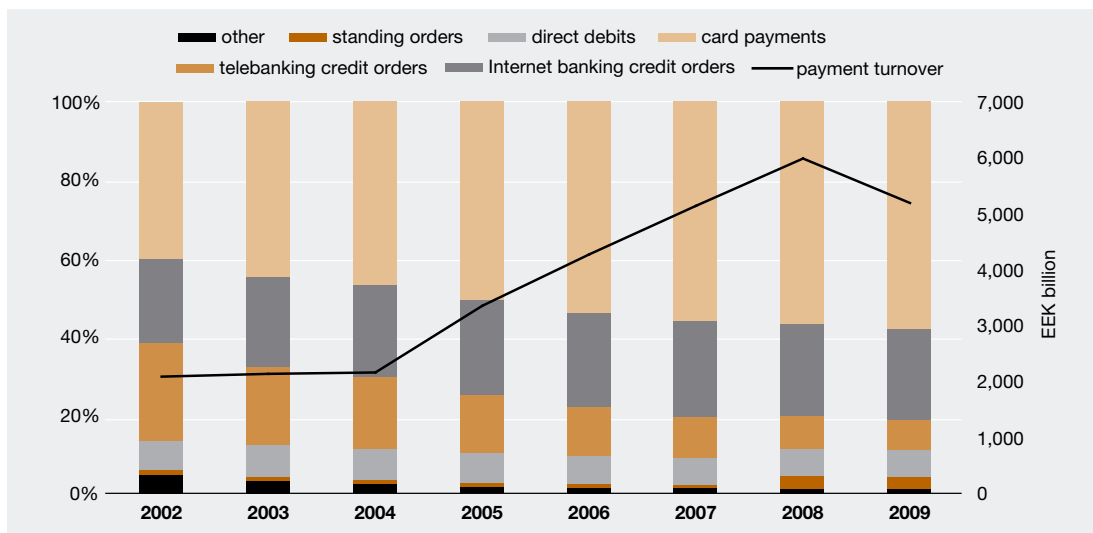


Figure 10. Most common payment instruments in Estonia

ment transactions, the share of both card payments and direct debits has increased, to 58% and 7% respectively, while the number of telebanking payments has fallen to 8%.

The number of payment cards issued in 2009 remained at the same level as in 2008: altogether 1.84 million payment cards were in use at the end of 2009, which is 1.3 payment cards per one person. The majority, or 77%, of the payment cards issued are debit cards, of which more than 80% are in active use. The use of credit cards is still low, at only 55%. Compared to 2008, the total number of credit cards contracted by almost 16,000, while conversely the number of revolving credit cards grew by more than 13,000 and their percentage increased to 32%.

The number of points of sale (POS) and payment terminals accepting electronic payments increased to 17,671 and 26,903, respectively. The number of POS went up mainly due to a rise

in the number of POS accepting card payments, which are a majority of all POS. The number of POS accepting mobile payments fell sharply and by the end of 2009 only 89 POS out of 716 were left. The number of automatic teller machines (ATM) decreased slightly to 1,006 ATMs, largely owing to a decline in the number of payment terminals.