

III MONEY AND CAPITAL MARKET

The monetary sector continues to enjoy high liquidity, which has not dropped despite the impact of the restrictive monetary policy adopted by the European Central Bank. The Estonian loan market interest rates have gradually grown in line with the 6-month EURIBOR since the end of 2005, which marks the beginning of the upward cycle of the European Central Bank's monetary policy interest rates (see Figure 1).

Compared to the beginning of the upward cycle in 2005, interest rates have climbed by an average of 1.7 percentage points. On average, housing loan interest rates have been 0.9 percentage points higher than the 6-month EURIBOR (see Figure 2). The average interest rate on long-term corporate loans has remained more volatile than the rate on housing loans, but generally still follows the rise of the EURIBOR. The expected increase of loan interest rates in Estonia, resulting from the European Central Bank's monetary policy, should remain relatively limited in the coming years.

The rapid growth rate of money supply also indicates the persistence of high liquidity in the economy.

The year-on-year growth rate of monetary aggregates that started decelerating at end-2006 picked up again in February 2007. The year-on-year growth of currency in circulation remained at the previous years' level. The money supply growth accelerated mainly thanks to the increased inflow of household demand deposits. The primary determinants were probably income tax returns, which have increased substantially during recent years and raised the volume of household demand deposits. The volume of household time deposits also grew quite fast. The rapid increase of incomes and easy access to loan money has kept the year-on-year growth of the volume of household deposits over the level of 30% since July 2006, and the same may probably be expected also in the forthcoming months. The volume of long-term savings and financial investments continued to grow modestly.

The growth rate of the volume of corporate deposits has decelerated to the level seen at the beginning of 2005. The traditionally volatile growth of corporate deposits held back slightly at the beginning of 2007 compared to the end of last year. In February, the growth of demand deposits recovered. The vol-

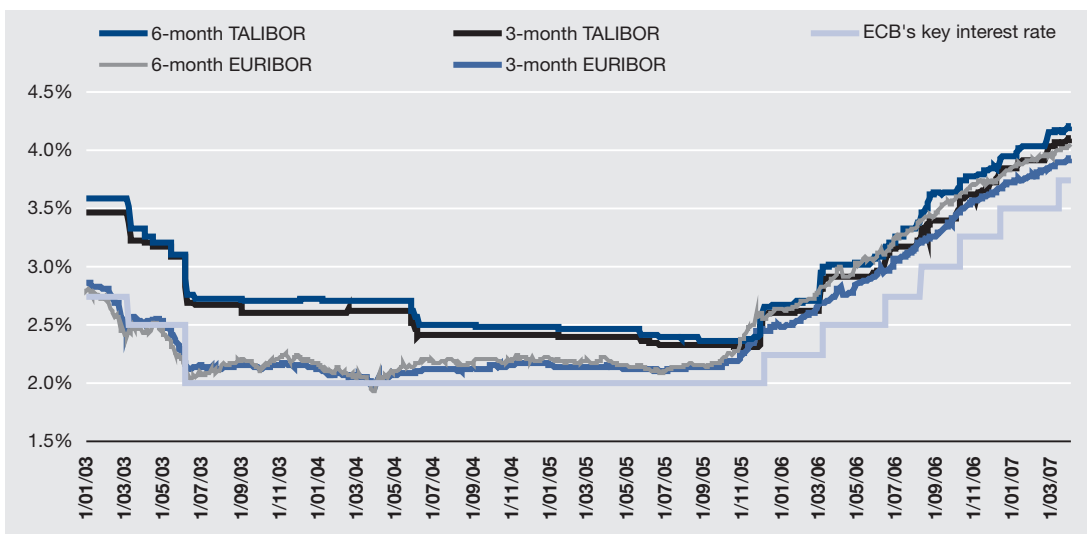


Figure 1. ECB's key interest rate and money market interest rates of the Estonian kroon and the euro

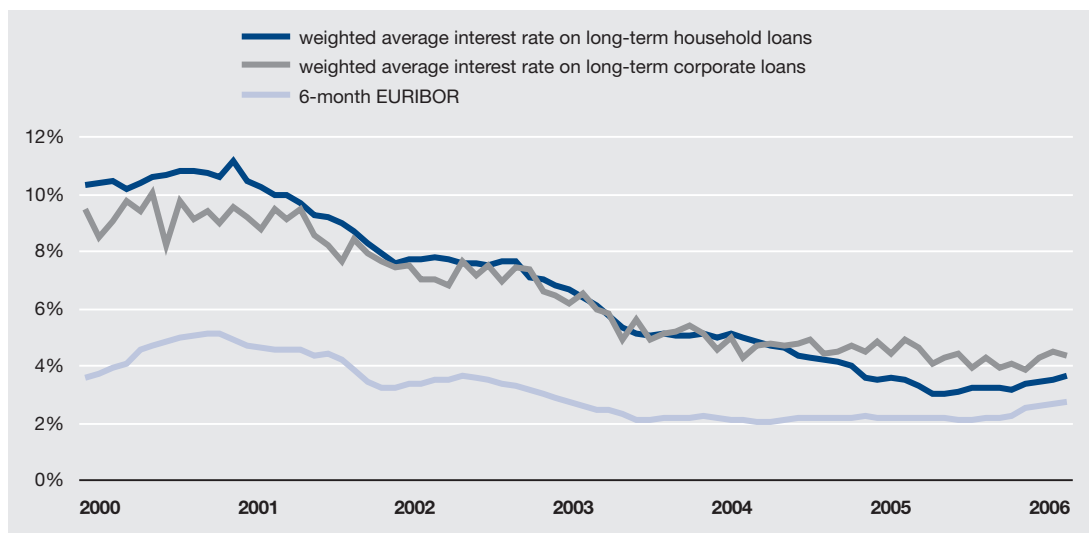


Figure 2. Interest rates of the domestic non-financial sector and 6-month EURIBOR

ume of corporate time deposits, on the other hand, shrunk even further and growth is likely to fluctuate notably also in the coming months. If last year's developments were to repeat, the growth rate should slow down even further.

The continuing growth of the loan turnover and the number of leasing contracts concluded indicated that interest rates has remained favourable for borrowers. At the end of 2006 and the beginning of this year, the average monthly growth of the loan and leasing stock of companies and households remained at a level comparable with earlier results. Typically of the beginning of a year, borrowing activity was slightly lower in the first months of 2007. Nonetheless, at the beginning of the year the growth of loans granted to the non-financial sector exceeded last year's level.

Although the year-on-year growth of the non-financial sector's loan and leasing stock increased substantially, it has been following a downward trend since mid-2006. This stems from the base effect, i.e. the rapid growth at the beginning of last year, as well as from a slightly lower borrowing activity. Due to the above-mentioned reasons, a stabilisation or

continuation of a slight downward trend of the year-on-year growth of corporate and household loan stock may be expected in the first half of 2007.

The growth of household loan and leasing stock seems to start decelerating. The growth peak of the loan volume apparently remained in the second half of 2006. On one hand, this is typical of the beginning of a year when the borrowing activity is slower. On the other hand, such developments may be caused by raised interest rates and, to some extent, also by the cooling in the real estate market, considering that housing loans account for approximately 80% of the growth of household loan stock. No significant changes occurred in the growth trends of other household loans (except for real estate loans). Their contribution to the year-on-year growth of household loans remains at an average level of 12 percentage points and their volume grows by 0.5 billion kroons per month on average.

No remarkable changes took place in the growth of corporate loan and leasing stock either. At the end of 2006 and the beginning of this year, the year-on-year growth of the loan volume stood at 47% on average (see Figure 3). As for economic sectors,

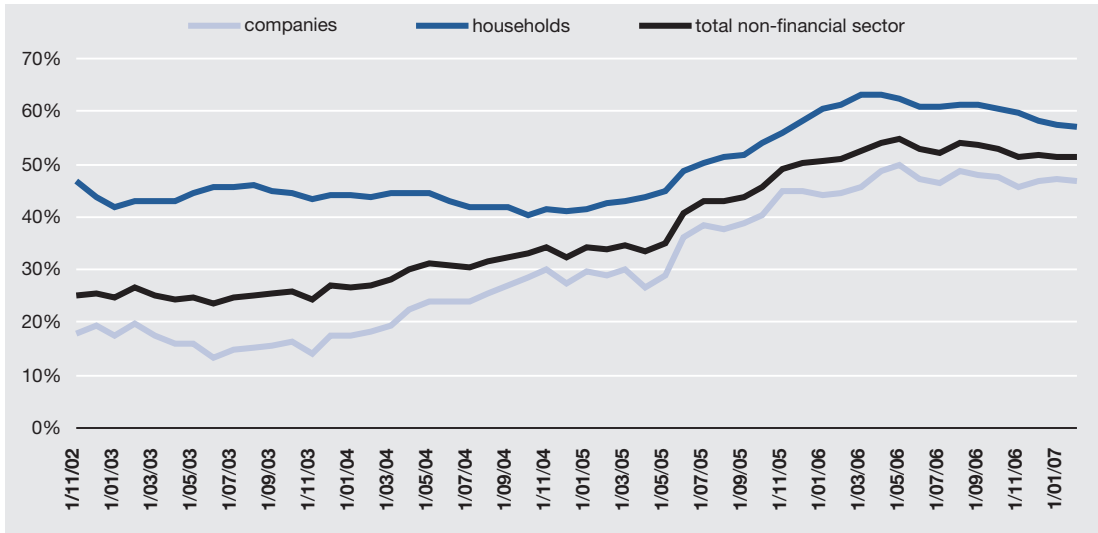


Figure 3. Domestic bank loans and leasing of resident non-financial companies and households (annual growth)

the increase in the loan and leasing stock of the non-tradable sector, which is oriented to domestic demand, contributes 90% of the growth of the corporate loan and leasing stock. Most of it may be attributed to the real estate sector. Compared to the non-tradable sector, the loan and leasing stock of the export sector has grown modestly.

The money supply was boosted by the rapid inflow of foreign capital also in 2006. Eesti Pank's foreign

exchange reserves grew about twice faster than a year ago and comprised about 4% of GDP. Like earlier, capital inflow occurred mainly via the banking sector, mostly owing to the growth of external liabilities. The customary inflow of direct investments in non-financial sector companies continued as well, also comprising about 4% of GDP.