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FOR AGENDA

SM/02/186
Correction 1

CONTAINS CONFIDENTIAL INFORMATION

June 27, 2002

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Republic of Estonia—Staff Report for the 2002 Article IV Consultation**

The attached corrections to SM/02/186 (6/17/02) have been provided by the staff:

Page 1, second bullet, line 2: for "Tõnission" read "Tõnisson"

Page 4, last row, stub: for "Average nominal wage (in EEK)"
read "Average nominal wage (in EEK) 2/"
column 3: for "7.8" read "10.6"
footnote 2: added to read "2/ Annual average calculated as arithmetic mean of monthly average wages."

Page 10, para. 6, line 6: for "Reserve requirements were eased"
read "The domestic currency component of the reserve requirements was eased"
line 8: for "to hold" read "to fulfill"
line 9: for "denominated assets" read "denominated foreign assets"

Page 11, third Box: left y axis numbers revised to match right y axis numbers

Page 12, line 8: for "75 percent of total assets and 82 percent of banks'"
read "two-thirds of total assets and banks'"
Table: Bank Performance Indicators in Selected Countries: revised

Page 21, footnote 13, line 6: for "(TRGS)" read "(RTGS)"

Page 22, chart: revised
last para., lines 5–9: for "In 2001,…should qualify." removed

Page 25, line 5: for "Estonian Airlines" read "Estonian Air"

Page 26, para. 37, lines 1–3: for "lower reserve...increase in liquidity"
read "lower the domestic currency component of reserve requirements towards levels in the euro area. In order to preclude an undesirable increase in liquidity, commercial banks have to fulfill the reserve requirement in the form of high-quality euro-denominated foreign assets."

Page 39, figure: for "Figure. Estonia:" read "Estonia"

Page 48, line 2, column 13: for "3/2502" read "3/25/02"
line 6, columns 12 and 13: for "01/" read "E"

Questions may be referred to Mr. Haas, EU2 (ext. 35630), Mr. Burgess, EU2 (ext. 37341), Mr. Schipke, EU2 (ext. 34569), and Ms. Sheridan, EU2 (ext. 35681).

Att: (11)

Other Distribution:
Department Heads

Corrected: 6/25/02

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

REPUBLIC OF ESTONIA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation
with the Republic of Estonia

Approved by John Dodsworth and Anne McGuirk

June 14, 2002

- The discussions were held in Tallinn during April 18–30, 2002

- The mission met with Prime Minister Kallas, Minister of Finance Õunapuu, the Bank of Estonia's Governor Kraft, Minister of Economic Affairs Tõnisson, Minister of Social Affairs Oviir, the chairperson of the Financial Supervision Authority as well as with representatives of commercial banks, industry, and the European Union.

- The mission team consisted of Messrs. Haas (head), Burgess, Schipke, Ms. Sheridan (all EU2), Mr. Mitchell (PDR), and Mr. MacFarlan (RES). Mr. Knöbl, the Fund's senior resident representative, assisted the mission. Mr. Andersen, Alternate Executive Director for Estonia, and Mr. Alber, Assistant to the Executive Director, participated in the discussions.

- Estonia accepted the obligations of Article VIII, sections 2,3 and 4, in 1994 and maintains no restrictions on payments and transfers in respect of current or capital account transactions. A fourth Stand-By Arrangement (SBA), which the authorities regarded as precautionary, expired on August 31, 2001. The authorities do not intend to seek another arrangement.

- The FSSA and associated ROSC modules on banking supervision, insurance supervision, monetary and financial policy transparency, payments systems, and securities regulation were completed in 2000. ROSC modules on fiscal transparency and data were issued in July and October 2001, respectively. Information updates for each ROSC will be issued as supplements to the staff report.

- As background to the forthcoming Board discussion, a paper on "The Baltic Countries: Medium-Term Fiscal Issues Related to EU and NATO Accession" (IMF Occasional Paper No. 213), as well as a paper providing statistical information (SM/02/187, 6/17/02), have been issued.

Contents

Page

Appendixes

Attachment

Corrected: 6/25/02

Estonia: Basic Data

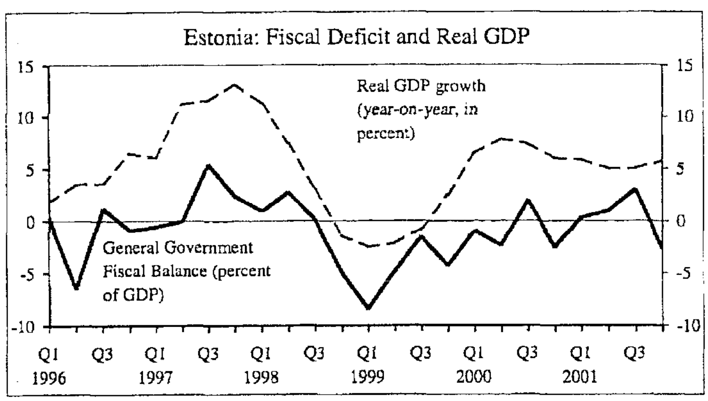
Social and demographic indicators, 2000	
Area	45,227 sq. km.
Population	1.3642 million
Rate of population growth	-0.4 percent per year
Life expectancy at birth 1/	70.6 years
Male	65.3 years
Female	76.1 years
Infant mortality rate (per 1,000 births) 1/	9.5
Hospital beds (per 10,000 inhabitants) 1/	71.9
Physicians (per 10,000 inhabitants) 1/	39.9

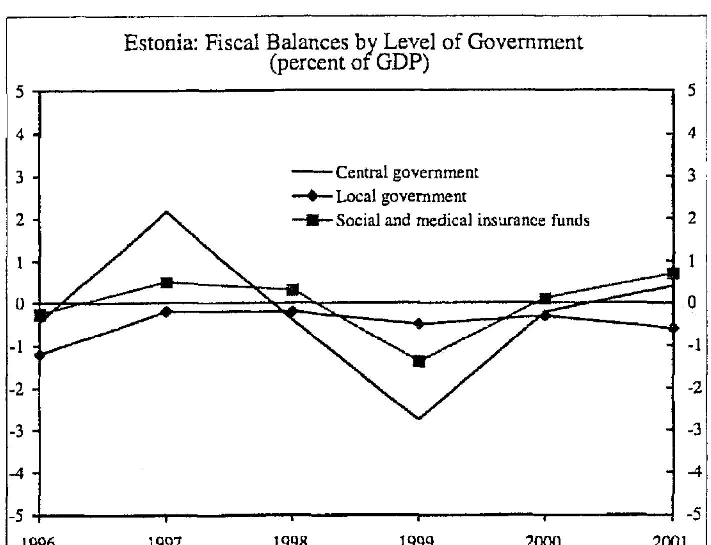
	1997	1998	1999	2000	2001
Nominal GDP (in million of EEK)	64,045	73,538	76,327	85,436	95,275
GDP per capita (in US$)	3158	3594	3597	3670	3969
Real GDP (percentage change)	10.4	5.0	-0.7	6.9	5.4
Sectoral distribution of GDP	(In percent of value added)				
Agriculture, hunting, forestry, and fishing	7.9	7.2	6.7	6.3	6.3
Mining, manufacturing, and energy	23.0	22.6	21.1	22.3	22.1
Construction and services	69.1	70.2	72.2	71.4	71.6
Trade	(In millions of kroons, unless otherwise specified)				
Total exports of goods	31,847	37,786	36,995	56,013	58,640
(in percent of GDP)	49.7	51.4	48.5	65.6	61.5
Total imports of goods	47,499	53,512	49,092	69,507	72,450
(in percent of GDP)	74.2	72.8	64.3	81.4	76.0
General government	(In millions of kroons, unless otherwise specified)				
Total revenue	25,478	28,887	29,083	33,062	36,881
(in percent of GDP)	39.8	39.3	38.1	38.7	38.7
Total expenditure	24,068	29,115	32,622	33,638	36,485
(in percent of GDP)	37.6	39.6	42.7	39.4	38.3
Net lending	264	-77	-81	329	63
(in percent of GDP)	0.4	-0.1	-0.1	0.4	0.1
Overall surplus / deficit(-)	1,410	-228	-3,539	-575	396
(in percent of GDP)	2.2	-0.3	-4.6	-0.7	0.4
Money and credit (end-period)	(In millions of kroons, unless otherwise specified)				
Net foreign assets	5,083	5,112	8,022	9,098	12285
Broad money (M3)	20,466	21,328	26,390	33,162	40,803
Domestic credit	20,797	24,223	26,542	33,758	41994
Claims on general government (net)	-1,716	-930	-197	-1,078	-575
Other selected indicators	(Annual percentage change)				
GDP at current prices	22.1	14.8	3.8	11.9	11.5
Average CPI	11.2	8.1	3.3	4.0	5.8
Average nominal wage (in EEK) 2/	19.6	14.7	10.6	10.6	12.9

Sources: Estonian authorities; and Fund staff estimates.
1/ Data for 1999.
2/ Annual average calculated as arithmetic mean of monthly average wages.

(partly the result of food scares in the EU), and the lagged effects of the earlier weakness of the euro—began to fade. The 12-month CPI inflation rate stood at 4.1 percent in May 2002, but underlying inflationary pressures are slightly lower as price increases partly reflect the impact of an administered increase in electricity prices in April.

5. **The budget registered a small surplus of 0.4 percent of GDP in 2001** (Tables 2 and 3). Staff estimates that the fiscal stance was only mildly contractionary in 2001, following a major withdrawal of stimulus in 2000. Taxes and spending unfolded broadly as anticipated in the budget, although a small deficit at the local government level was offset by a central government surplus. Increases in government wages and salaries were below the rate of inflation for a second successive year. In line with the government's objective, overall public spending fell further relative to GDP. Tax revenues also fell slightly relative to GDP because of a 25 percent increase in the personal income tax threshold, and the delayed impact of the abolition of corporate income tax on reinvested earnings in 2000. These effects were more than offset, however, by higher dividend payments from public companies and EU grants. The resulting surplus, together with privatization receipts equal to 2 percent of GDP, led to a net repayment of debt and a build-up of government deposits abroad.





6. **Monetary and credit aggregates grew relatively strongly in 2001, helping to support domestic demand, but slowed slightly during the first quarter of 2002.** (Figure 2 and Table 5). Credit growth was fueled by lower interest rates in the euro area and a decline in the risk premium for Estonia. The rapid expansion of financial leasing continued in 2001 and through the first quarter of 2002, albeit at a slightly slower pace, and leasing now accounts for almost one third of credit to the private sector.[4] The domestic currency component of the reserve requirements was eased (in two stages) in 2001, with a view to eventual convergence on lower ECB levels, by allowing commercial banks to fulfill a proportion of their reserves in high-quality euro-denominated foreign assets. This led to a decline in gross international reserves and base money and an increase in the money multiplier. The modest reduction in net foreign assets at the BoE was more than matched, however, by a sharp increase in the net foreign assets of commercial banks.

7. **Prudential indicators show the banking system to be in a strong financial position** (see Box 1 and Table 8). The average capital adequacy ratio increased slightly to 14½ percent by the end of 2001, well above the required 10 percent. The volume of nonperforming loans remains low, at 1.3 percent of total loans, and continues to be fully provisioned.

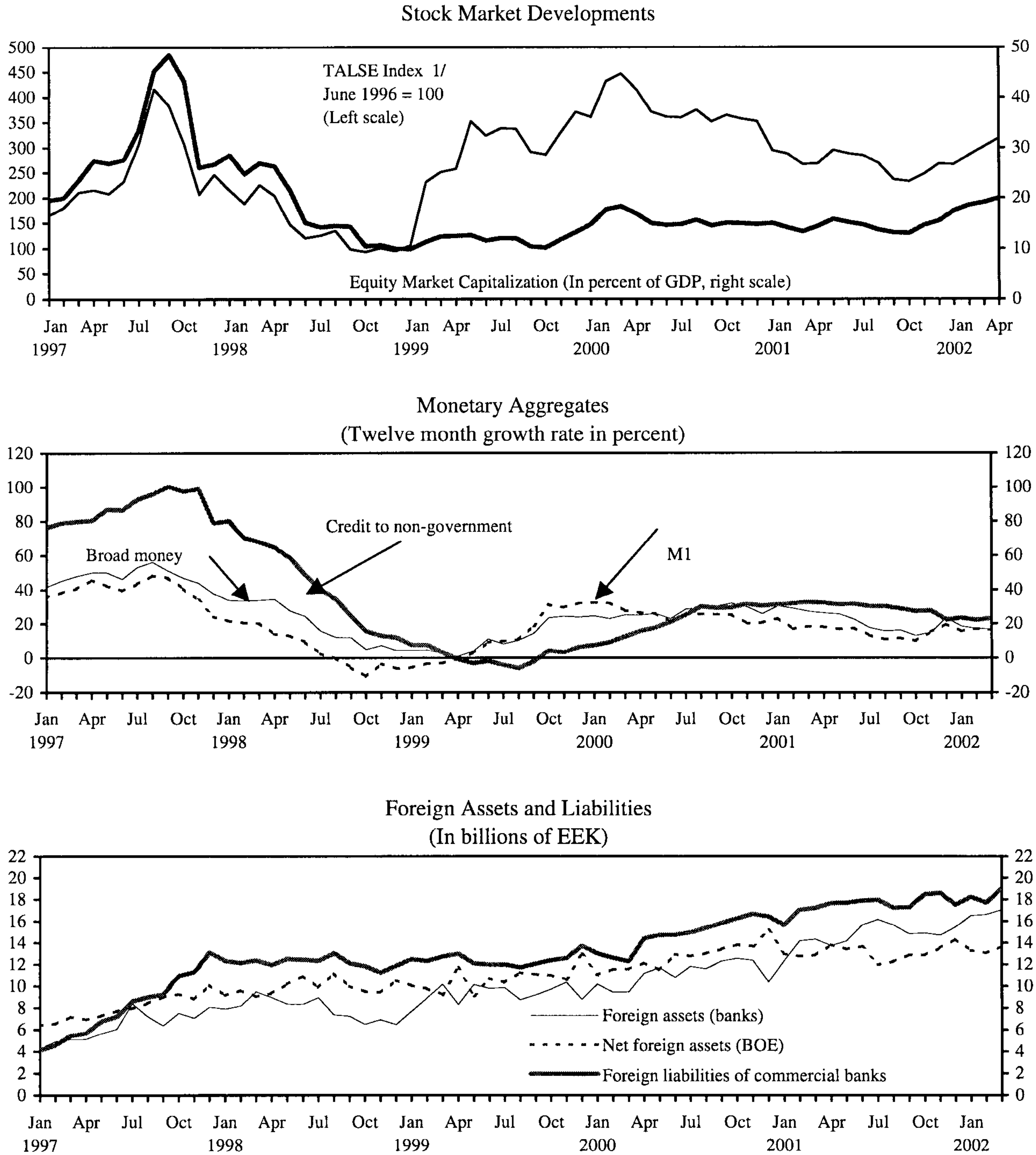
8. **The current account deficit was broadly unchanged at 6½ percent of GDP in 2001** (Figure 3 and Table 4). The trade deficit in goods and services narrowed further to 4.2 percent of GDP, current transfers increased a little (reflecting higher EU grants), while outflows on the income account were again substantial:[5]

- The growth of exports of goods and services slowed sharply to 7 percent in 2001. This largely reflected the global downturn in the mobile telecommunications sector, which led to a collapse in trade flows (both exports and imports) associated with sub-contracting for Scandinavian electronics companies. Exports excluding goods for processing performed relatively well, rising by 13 percent. The latter appears to reflect a number of factors, including: the relatively rapid growth of the Russian and some other eastern European markets; competitive pressures within the EU, which may have increased the attractiveness of lower-cost Estonian goods; and an increase in EU quotas that has encouraged exports of food products.

[4] Despite the strong credit growth and increase in lease financing, household debt remains relatively low, amounting to 15 percent of GDP. See also box 1.

[5] The trade balance benefited from an improvement in the terms of trade in 2001, reflecting an increase in export prices. The latter appears to be concentrated in one or two sectors and may reflect specific intra-company pricing practices. The trade position in volume terms was less favorable, with a significant negative contribution of net exports to GDP growth.

Figure 2. Estonia: Monetary and Financial Indicators, 1997-2002



Sources: Bank of Estonia; Statistical Office of Estonia, IFS, and Fund staff estimates.

1/ Tallinn Stock Exchange index.

Box 1. Estonia's Banking System

Financial intermediation in Estonia is unusual in that it relies to a very large degree on foreign-owned banks. Faced with a number of banking crises in the mid-to-late 1990s, the authorities restructured the banking system and started to seek strategic foreign investors. As a result, the number of banks has fallen from 40 to 7 since 1992. In addition, the largest two banks (Hansabank and Union Bank of Estonia) control about two-thirds of total assets and banks' share capital. The consolidation of the banking system has been associated with an increase in the stability of the system. All of the banks are privately owned.

Table: Foreign Bank Ownership in Selected Countries

	Dec. 1995		Dec. 2000	
	Total Assets	Foreign Control 1/	Total Assets	Foreign Control 1/
	(In billions of US dollars)	*(In percent)*	*(In billions of US dollars)*	*(In percent)*
Baltic States				
Estonia	2.6	40	6.2	82
Latvia	2.2	24	7.6	32
Lithuania	2.0	19	7.4	64
Total	6.8	29	21.3	58
Central Europe				
Czech Republic	114.3	46	80.3	56
Hungary	98.7	21	87.1	32
Poland	89.8	23	170.5	52
Total	302.9	35	338.0	48
Western Europe				
Netherlands	1,248.2	38	2,739.3	24
Spain	2,488.6	13	2,276.9	26
Total	3,736.7	21	5,016.2	25

Source: Fitch IBCA's BankScope Database, Bank of Estonia.

Table: Bank Performance Indicators in Selected Countries 1/
(Average for 1999-2000)

	Problem Loans/Total Loans		Cost-to-Income Ratio		Return on average equity	
	Foreign banks 2/	All banks	Foreign banks 2/	All banks	Foreign banks 2/	All banks
Baltic States						
Estonia	2.8	2.7	57.0	56.0	8.3	8.0
Latvia	3.3	6.6	105.2	86.6	8.5	10.9
Lithuania	9.3	9.0	76.8	84.6	3.9	4.8
Central Europe						
Czech Republic	18.8	48.3	72.3	68.6	-0.3	34.8
Hungary	4.9	6.4	86.0	84.0	3.8	5.9
Poland	9.5	9.3	56.7	60.2	2.5	5.8
Western Europe						
Netherlands	1.1	0.4	49.9	56.9	16.0	22.6
Spain	1.6	1.4	81.0	65.9	5.1	8.6

Source: Fitch IBCA's BankScope Database; Bank of Estonia.

1/ Based on available data in IBCA's BankScope Database.
2/ Ratio of assets of banks where foreigners own more than 50 percent of total equity to total bank assets.

While credit growth has been strong over the past year, some market participants point out that the current structure of the banking system limits the access of small- and medium-sized enterprises to bank financing. An unusual feature of Estonia's banking system is the importance of lease financing. For the most part, leasing companies are owned by banks and banks encourage lease financing because under such contracts the collateral can be seized more easily.

Estonia's banking system performed quite well with respect to key indicators as reflected, for example, in the low ratio of non-performing loans. The reduction in required reserves in 2001 from 13 percent to 6.5 percent has given the profitability of banks an additional boost, and a further reduction to 2 percent over the medium term will improve the position even further.

A disadvantage of the concentration of banks is that they have effectively become "too large to fail". While adequate prudential regulation and supervision reduces the probability of bank failures, the creation of banks that are "too large to fail" could lead to suboptimal behavior by these banks.

intention to maintain the current exchange rate arrangement until eventual adoption of the euro following membership in the European Monetary Union.

21. **While money and credit aggregates have recently grown more slowly, credit to leasing companies continues to be strong.** Particularly pronounced has been the growth in lease financing in the automobile and real estate sector, which contributed to a sharp increase in real estate prices.[12] The mission encouraged the authorities to monitor these developments closely, and to reevaluate and, if necessary, tighten prudential standards on leasing.

22. **There is a concern that small- and medium-sized enterprises do not have access to adequate financing because of the concentration of the banking system and the lack of a developed domestic capital market.** The authorities responded that the government had implemented a program (KredEx) that in addition to providing export guarantees would also provide support to small enterprises. While the mission did not object in principle to an institution such as KredEx, it pointed out the potential dangers that could arise and encouraged the authorities to limit its operations and to assure a high degree of transparency especially with respect to government guarantees. It further encouraged the authorities to improve the efficiency of credit markets including the elimination of a tax that penalizes non-bank borrowing (see Box 3).

23. **While the authorities indicated that they intend to reduce the cash reserve requirement further over the medium term, no decisions have been made yet with respect to when and how this will be done**. The mission cautioned the authorities against hastening further reductions, especially if these were to imply an increase in liquidity that could have inflationary consequences.[13]

24. **The Financial Supervision Authority (FSA) has become fully operational since the beginning of 2002, which should improve the scope and effectiveness of financial supervision.** According to the authorities, the staffing of the institution has been sufficient to conduct an adequate number of on-site inspections during the transition period and commit

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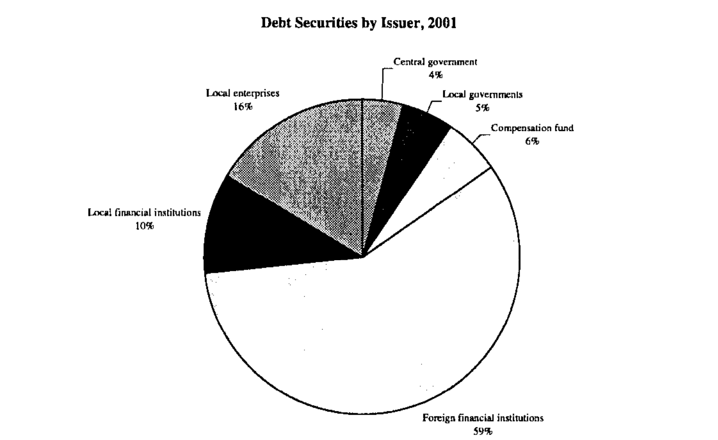
[12] House prices have risen at an annualized rate of about 20 percent over the first five months of 2002. These increases also reflect some structural factors, such as prospective increases in VAT on heating fuel, which are thought to have boosted demand for smaller-sized apartments.

[13] Depending on the modalities, a further reduction of required reserves could have implications for Estonia's payments system. In general, commercial banks can sell an unlimited amount of foreign currency or eligible foreign fixed income securities to the BoE to increase liquidity. In order to manage the liquidity after a further reduction of required reserves, the BoE is considering the introduction of an intraday repo facility. The BoE is also interested in integrating its payments system (RTGS) with the centralized payments system of the euro area (TARGET).

Box 3: Financial Markets

Estonia's money and capital markets are relatively underdeveloped. This reflects a very prudent fiscal policy resulting in little government debt, the currency board arrangement, the size of the country, and increasing integration with EU financial markets.

While market capitalization of Estonia's equity market relative to GDP is about as high as market capitalization of the Euro area was in 1997, the secondary market is dominated by only two internationally rated entities, which together represent almost 85 percent of total market capitalization. As part of an effort to integrate its capital market with western Europe, Estonia became the first country of the former Soviet Union and eastern Europe to merge with a foreign (Helsinki) stock exchange in 2002.



Source: Bank of Estonia

The government and corporate debt market, measured by outstanding stock of securities, amounted to about 4 percent of GDP at the end of 2001. There is practically no market for government securities. However, in order to refinance (more expensive) World Bank loans and to "test" the market, the government intends to issue its first Eurobond (€100 million) in 2002. Estonia's sovereign rating was recently increased by Standard and Poor's to A- from a BBB+. The largest amount of corporate debt was issued by foreign owned financial institutions.

The introduction of the second pension pillar (in mid 2002) will boost the amount of funds that are channeled through capital markets. The regulations governing investments of these funds are extremely liberal compared to regulations in other countries that moved from a pay-as-you-go to a partly funded system since there are no limits on the share that can be invested in EU and OECD countries. Furthermore, 50 percent of the assets of a pension fund can be invested in equities. While the absence of any restrictions vis-à-vis investments abroad allows for a broad diversification, it also implies that the reform will only marginally improve the development of domestic capital markets.

The lack of a domestic capital market and the continued effort of the authorities to integrate Estonia's financial system into global markets contributed to the stability of the system. However, this strategy has not come without costs. Given the concentrated structure of the banking system (see box on banking system), a more developed domestic capital market could increase competition and put pressure on bank lending rates and provide an alternative to bank financing especially for medium-size companies. Because of high information and transaction costs associated with borrowing in international capital markets, the access to such markets is most likely limited to larger enterprises. In addition to purely financing issues, a more developed domestic capital market would provide more information about market expectations and real sector developments.[1]

While it is questionable to what degree the government should create the framework for and actively encourage the development of a domestic capital market, there are a number of issues that should be addressed to eliminate distortions. Investment income from sources other than bank deposits is taxed at the prevailing income tax rate of 26 percent while income from bank deposits is tax free. The latter tax exemption is likely to distort investment decisions and should therefore be eliminated.

[1] Some information on the term structure of interest rates can, for example, be derived from bank lending rates for different maturities, however, the interpretation of changes and shifts in such a yield curve is less clear.

cautioned that financing arrangements should not include any government guarantees. In other areas, **privatization is more or less complete**. The Estonian Privatization Agency was wound up at the end of 2001, and there are no current plans to sell the government's remaining shareholdings, which are small but include the port of Tallinn and minority stakes in Estonian Telecom and Estonian Air.

31. **The trade system remains fully liberal, with the exception of import tariffs on selected agricultural products that were imposed in January 2000 primarily to demonstrate the administrative capacity for handling the EU's tariff and trade system.** [16]As a result, Estonia's index of overall trade restrictiveness (according to the staff scale) continues to be 1, the most liberal level.

IV. Other Issues

32. **The authorities continue to demonstrate a high degree of transparency in public policymaking.** Estonia subscribes to the Fund's Special Data Dissemination Standard and provides all core data necessary for surveillance on a timely basis. The 2001 ROSC data module concluded that the quality of data was generally good. The authorities are addressing most of the issues noted in the ROSC in the context of their multi-year program to meet the demanding statistical requirements of EU membership.

V. Staff Appraisal

33. **The Estonian economy showed remarkable resilience in 2001 and early 2002, despite the slowdown in its major western European trading partners**. Growth was driven largely by domestic demand, especially investment. The weakness in the export sector was less than expected and concentrated in the low-value added electronics assembly sector. FDI reached record levels and more than covered the current account deficit.

34. **These results are, in large measure, the result of sound macroeconomic policies and structural reforms, which have provided a strong foundation for continued robust economic growth**. With its favorable policy environment and economic flexibility, Estonia is also well placed to benefit from EU accession.

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[16] These tariffs are below WTO bindings and only affect those countries that do not have a free trade agreement with Estonia. They therefore affect only a small portion of agricultural trade, mostly with Canada, Russia, and the United States. Estonia's trade prospects would benefit from prospective Russian WTO membership through the extension by Russia of tariff rates on a most-favored-nation (MFN) basis. This may also provide a further spur to FDI in Estonia if, as a result, foreign companies seek to use Estonia as a gateway to the Russian market.

35. **While Estonia's fiscal position is currently very healthy, large planned increases in current spending will add to budgetary tensions in future years.** The authorities' fiscal target for 2002—a deficit on the order of ¾ percent of GDP—was broadly appropriate when adopted, but with the recent strength of the economy likely to be at least partly sustained through 2002, a somewhat tighter policy would be appropriate. This could be accomplished by allowing automatic stabilizers to operate fully. The authorities' intention to finance additional mid-year increases in spending by using the unexpected cyclical improvement in revenues that has already taken place will not undermine sustainability. Any further overperformance in 2002, however, should be used to reduce the size of the fiscal deficit. In addition, the supplementary budget will add to the already substantial planned increases in current spending. This is a concern as it will increase budgetary tensions in future years when additional EU- and NATO-related expenditures will need to be accommodated.

36. **The currency board arrangement continues to serve Estonia well and confidence in it remains high.** The authorities' intention to adopt the euro as soon as possible after EU accession provides a clear exit strategy from the currency board arrangement. Their intention to maintain the latter until the eventual adoption of the euro is sensible. Strong financial supervision is particularly important within currency board arrangements and Estonia has done well in this regard.

37. **The authorities have adroitly managed to lower the domestic currency component of reserve requirements towards levels in the euro area**. In order to preclude an undesirable increase in liquidity, commercial banks have to fulfill the reserve requirement in the form of high-quality euro-denominated foreign assets.This process is not yet complete and it is important to avoid an unintended inflationary increase in liquidity. Monetary and credit aggregates have begun to grow more slowly and this is desirable. However, credit to leasing companies remains strong and needs to be monitored.

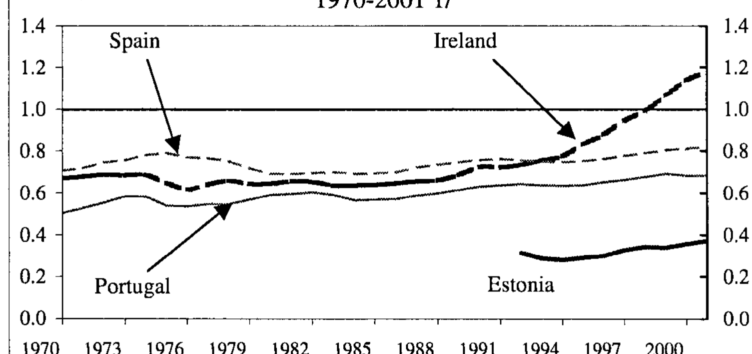
38. **The successful establishment of the Financial Supervision Authority at the beginning of 2002 will enable the authorities to monitor more effectively the financial system.** However, the authorities should also remove distortions that might undermine an efficient allocation of savings and prevent small- and medium-sized enterprises from having access to adequate financing. In particular, the authorities should eliminate the current tax exempt status on income earned from bank deposits. This in turn would encourage the development of more market-based financing and therefore lead to more competition.

39. **Recent developments in the labor market have been encouraging although unemployment remains high, especially in some regions**. Employment rose and unemployment fell for the first time in 2001. This suggests that labor shedding may be coming to an end. If true, this marks an important milestone in the transition process. More generally, Estonia's liberal labor market policies are to be welcomed; they are particularly important in a country with a currency board arrangement where labor markets play an important role in the adjustment process. The authorities are working to bring about further reductions in unemployment, by ensuring macroeconomic stability and targeted job training and education reforms. This is the right approach, but the authorities should also guard against disincentives arising from the interaction of tax and benefit systems at low incomes.

achieved remarkable growth since then. Trends in FDI and trade openness were more uniform, with FDI rising sharply in all three countries in the period following accession, and trade generally picking up steadily.[10]

EU accession in itself is not a guarantee of more rapid growth, as the example of Ireland during much of the 1970s and 1980s illustrates. However, accession offers the prospect of further trade and financial integration, institutional strengthening, and reduction in risk premia. The Estonian economy appears well placed to benefit from these developments, especially in view of the capacity it has shown over the past ten years for economic adjustment, supported by policies conducive to investment and growth. Estonia's openness to trade and levels of FDI are already high in comparison to Ireland, Portugal, and Spain when they joined the EU, but are not high compared with some current EU members (or other small open economies)[11]; hence, there is scope for ongoing growth and convergence through these channels. Support will also need to come from progress with human capital development, especially through education and training, so that Estonia can overcome potential skill shortages and take full advantage of technological advances. While the sizeable undervaluation of real exchange rates at the start of transition in Estonia and elsewhere appears to have largely corrected, ongoing real appreciation can be expected in proportion to the real growth differential over advanced economies, speeding the convergence of nominal (euro) incomes.[12]

Estonia and Selected Countries: Convergence of GDP per capita, 1970-2001 1/



1/ GDP per capita (on a purchasing power parity basis) of the countries shown relative to a weighted average of the founding members of the Union plus the United Kingdom and Denmark (which joined in 1973).
Source: World Economic Outlook database.

[10] See Box 4.2 in the October 2000 *World Economic Outlook.*

[11] For example, direct investment liabilities are about 20 percent of PPP-based GDP in Estonia, compared with nearly 60 percent in the Netherlands and 70 percent in Belgium.

[12] Estimates in the October 2000 *World Economic Outlook* suggest that for each 1 percent growth differential above the advanced economies, relative price levels in the transition economies could increase by 0.4 percent. For example, if Estonia's potential growth rate were to be around 5 percent compared with 2½ percent in the EU, this could lead to a sustainable real exchange rate appreciation of 1 percent in Estonia.

In conclusion, the quantitative and comparative indicators noted above provide little basis for thinking that Estonia would be unable to sustain its recent trend growth rate of around 5 percent over the medium to long term. Ongoing productivity growth will be the key, supported by further capital deepening and human capital accumulation. In this regard, economic and policy conditions—including the prospect of EU accession—appear to provide a favorable climate for Estonia to take full advantage of the large potential for catch up that currently exists.

Estonia: Core Statistical Indicators
(As of June 5, 2002)

	Exchange Rates	Interna-tional Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	4/30/02	4/30/02	4/30/02	4/30/02	4/30/02	4/02	4/02	3/02	Q4/01	3/02	Q4/01	Q4/01
Date Received	5/2/02	5/8/02	5/8/02	5/8/02	5/20/02	5/24/02	5/6/02	5/6/02	3/18/02	4/30/02	3/28/02	3/25/02
Frequency of Data	D	M	M	M	M	M	M	M	Q	M	Q	Q
Frequency of Reporting	D	M	M	M	M	M	M	M	Q	M	Q	Q
Source of Update	N	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting	E	E	E	E	E	E	E	E	E	E	E	E
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication	D	M	M	M	M	M	M	M	Q	M	Q	Q

Explanation of abbreviations:
Frequency of data, reporting and publication: D—daily, M—monthly, Q—Quarterly.
Source of data: A—direct reporting by Bank of Estonia, Ministry of Finance, or Statistical Office of Estonia.
Mode of reporting: E—electronic (e-mail or internet).
Confidentiality: C—unrestricted.