Madis Müller: Presentation of Bank of Estonia's Annual Report 2024

Speech by Mr Madis Müller, Governor of the Bank of Estonia (Eesti Pank), to the Riigikogu (the unicameral Parliament of Estonia), at the presentation of Bank of Estonia's Annual Report 2024, Tallinn, 18 September 2025.

* * *

Check against delivery

Members of the Riigikogu.

Thank you for the opportunity to present a review of the activities of Eesti Pank in 2024.

I will also speak about the main events in the economy and the financial sector, and about the difficulties that have been caused as the world has become more uncertain.

I would like first to state that in 2024 Eesti Pank carried out all of its core tasks, which cover maintaining price stability and implementing monetary policy in the euro area, managing the currency reserves of the state, ensuring the circulation of cash and operation of payment systems, and securing financial stability in Estonia. Eesti Pank also produces economic and financial statistics and economic analysis, works internationally with partners, and advises the government on matters of monetary and economic policy.

Topics of particular note last year were

- inflation falling in the euro area, which allowed the European Central Bank to start cutting interest rates after having had to raise them rapidly
- signs of recovery starting to appear in the Estonian economy
- security deteriorating in Europe, which required services that are vital for society to be made more resilient to any crisis. For the central bank this primarily means that we must invest more in securing our activities against any crisis and ensuring that payment services and the circulation of cash are fully resilient.

I will begin with the topic that is most important for the central bank, which is maintaining price stability. We at the Governing Council of the European Central Bank became sufficiently confident last June that the rate of inflation in the euro area had come down enough and was on track to reach the target of 2%. This meant we could start cutting central bank interest rates gradually. We had had to raise them sharply in the preceding couple of years, after which they had remained at record high levels for nine months. Lower interest rates make borrowing cheaper, leaving borrowers more money at hand and making investment more affordable for businesses. We have now cut interest rates in the euro area eight times, and the main interest rate at the central bank has now come down by half from its peak of 4%. The key interest rate for borrowers in Estonia is the six-month Euribor, which follows the movements in the European Central Bank's interest rates. It peaked at above 4% but has now come down to close to 2%, falling by almost half, as the central bank rates have gradually been cut.

We also continued to bring the balance sheet of the European Central Bank back to its normal level, after it had expanded because of the crisis measures taken in earlier years. Those measures have been taken to support economic activity in the euro area during the years of crisis. All of the asset purchase programmes of the central bank have now been terminated and purchases are no longer being made, and the reinvestment of maturing bonds was also ended last year. The balance sheet of the European Central Bank was shrunk by almost half a trillion euros last year.

The general economic environment continued to be affected last year by the war Russia started in Ukraine, which has deepened geopolitical instability and pushed up prices of energy and commodities. The new wave of uncertainty was caused by the sharp change in US trade policy after the US presidential elections, as additional tariff barriers started to appear in trade between countries.

Statistics Estonia revised its recent figures for growth in the Estonian economy and now found that instead of GDP growing constantly throughout all of last year, there was actually a decline in it. I should state though that a much larger set of statistical indicators need to be considered if reliable conclusions are to be drawn about the economy and the most objective possible assessment made. Those statistical indicators include many that point to the economy recovering, as retail sales, industrial output, exports and several other key indicators were all rising last year for example. The economy is recovering, but it is doing so quite slowly. The purchasing power of the average wage, which is the gross wage adjusted for inflation, has risen, but by the end of last year it had reached the same level that it was at in May 2021 before the energy crisis and the sharp rise in cost of living.

Inflation staying high and its impact on the purchasing power of people in the country remains a concern. The cost of living rose last year by around 3.5%, but inflation in Estonia this year is expected to be 5-6%, of which about a third will come from tax rises. The remainder will mainly come from growth in wages and from prices for food rising because commodities prices have risen on global markets. Real incomes will not increase this year, because the rise in the average wage will only just exceed inflation in the consumer basket, while the income tax rate rose at the start of this year. They may be expected to do so from next year, when the tax-free threshold is extended to all taxpayers and as inflation falls.

It is good to see that the labour market in the euro area and in Estonia has resisted very well, even when the economy was facing challenging times. Unemployment has risen in Estonia, but by less than would be considered normal during such a recession. Companies have preferred to keep their employees on the payroll in the expectation of better times ahead, and to avoid redundancies because finding new staff may prove more expensive and difficult as there is a shortage of skilled labour in Estonia. Companies have instead sacrificed part of their expected profits, and so labour costs hit a record level last year as a share of corporate profit.

That people in Estonia have kept their jobs and their incomes have increased in euros has helped them cope with their financial obligations. They have managed this despite the weakness in the economy and interest rates being much higher than they had been in earlier years. The resilience of companies was aided by the buffers that they built up in the years before the recession, and so although the share of problem loans at the banks has increased a little, it still remains small.

We at Eesti Pank consider that the measures taken so far to ensure stability in the financial sector are appropriate in the current environment. The risks however have increased. The growth in the amount lent to households and companies by the domestic financial sector and from abroad at the end of 2024 exceeded long-term nominal GDP growth, and it accelerated even further in 2025. We consequently consider it reasonable to maintain the countercyclical capital buffer rate at 1.5% to reduce the risks to the banking sector from rapid growth in lending. Yearly growth in lending in Estonia has been among the fastest in the euro area at almost 10%, while the average in the euro area has been below 3%. We must be aware that geopolitical tensions causing a new recession in the economy could increase the amount of problem loans. In that case it would become necessary to maintain the current larger capital buffers of the banks, even though their own funds are sufficient to cover worse loan losses than expected.

Geopolitical tensions could also hinder banks that are trying to access capital from international money and capital markets, and so restrict the loan supply. A large part of the liabilities of the banking sector are local deposits, but other sources of funding have notably increased as a share of the financing of the banks in recent years. Proximity to an aggressive Russia has probably increased the risk level of Estonia and its neighbourhood in the eyes of foreign investors, and international financial markets have been volatile, but the Estonian banks have been successful in their bond issues.

An important topic that has arisen across Europe and in Estonia is the need to assess whether various regulations are holding enterprise back, including enterprise in the financial sector. I am personally part of a high-level working group handling this at the European Central Bank, but we are also assessing proposals made by the Estonian banks and other financial companies that would for example make reporting simpler.

The third main topic I mentioned earlier was security in a crisis, which we are working on throughout the whole of the Eesti Pank organisation.

Crisis readiness affects the operations of the central bank itself, and also its role in the operation of the two vital services of cash circulation and payment services. During the large-scale electricity blackout in Spain and Portugal in the spring, food and other essentials could only be bought for cash. This was a clear reminder for all of us of how important it is to hold some funds as physical cash. Digital payments are convenient, but we must be ready and able to cope if they stop working. We ran several business continuity exercises during the year at Eesti Pank, and organised exercises with other institutions, banks and other businesses to practice cooperation and sharing responsibility in the event of a crisis. We helped providers of vital cash circulation services compile their risk analyses and continuity plans. We run the crisis exercise and resilience tests every year so that Estonia would be as ready as possible to deal with any disruption to the circulation of cash or any interruption to payments. We ran a larger crisis exercise in the spring together with the banks and we focused closely on working together with local governments.

We updated last year the resilience requirements for payment systems for the banks providing vital services, which are currently Swedbank, SEB, Luminor, LHV and Coop Pank, to be certain that payments would continue to function in even harsher circumstances if even greater dangers were to be realised. We are working with the commercial banks to develop backup solutions, including offline card payments that are intended principally for use in shops, petrol stations and chemists that provide vital services in a crisis. These would allow vitally important purchases to be made even if the information systems of the banks are not functioning, there is no communication connection, or the card schemes are down.

We took the initiative to launch discussions on how to find backup solutions that could ensure resilience of operation at the European Union level as well. An example of this is the ongoing preparations of the European Central Bank to bring the euro into circulation in a digital form. One feature of the digital euro is that it would equally allow digital payments to be made when there is no internet connection, and this would make European payment systems more autonomous and more resilient to any crisis in future. The digital euro project is currently in its preparatory phase and the legal basis that is needed for it is under discussion in the European Parliament and at the Council. I would invite anybody who is interested in this topic to attend the international conference on the digital euro being organised at the end of September by Eesti Pank together with the Latvian and Lithuanian central banks.

We also ran exercises for how to cope with a financial crisis. It is unlikely that any such crisis would occur in Estonia, but if it did, then it would have a widespread impact across the financial system. This is why the Nordic and Baltic states worked together last year to hold a third crisis exercise that also involved supervision and resolution authorities at the European Union level. It is important when running such exercises to map the potential weak points and ways that they could be remedied.

I may now also say a few words about Eesti Pank's constitutional role as an economic policy adviser to the government. We have regular meetings with members of the government, the President of the Republic and the parties in the Riigikogu, and I would like to highlight how experts from Eesti Pank contributed to the expert group on competitiveness set up in 2023 by the Economic Affairs Committee of the Riigikogu. The result of this work was the first report on competitiveness, which was released last year, and the conclusions of which were discussed in the Riigikogu as a question of national importance. We held a high-level public seminar at Eesti Pank with international experts that concentrated on increasing productivity in the economy and the role of the state in achieving this. The second report by the expert group was presented to the Riigikogu in June this year, and on 24 September an international seminar based on report will be held. We believe it is important that this work continue in the years ahead.

Our message on the state finances has always been that orderly state finances are the cornerstone of growth in economy. Orderly state finances means more than having a fiscal deficit that is lower than planned for one-off or temporary reasons, as happened last year and is highly likely to happen again this year. There should be a long-term plan for the needs and possibilities of the state that is based on sustainable fiscal rules and that gives confidence to local businesses and foreign investors. The exemption clause from the European fiscal rules allows countries, including Estonia, to run a fiscal deficit of up to 4.5% of GDP if it is used to strengthen national defence. There are two restrictions on this though, as the deficit may only be increased temporarily and the increase must be specifically targeted. The temptation to make the maximum use of the additional fiscal space, including by spending it for other purposes, could threaten the sustainability of the state finances in the longer term. Permanently higher spending by the state requires there to be a larger revenue base.

Eesti Pank analysed competition between the banks in the Estonian lending market at the start of 2024, and found that concentration is higher and competition generally weaker in Estonia's small market than in most other European countries. Together with Finantsinspektsioon we made several proposals for ways to make it simpler and cheaper to transfer a housing loan from one bank to another. We proposed removing the requirement to have the transaction notarised when a mortgage is moved from one bank to another and the conditions of the contract do not change, and we proposed that the requirement to have a property revalued every time a loan is refinanced could be lifted. Clients would also gain if banks were no longer able to charge three months of interest when the client wants to terminate their loan contract early. The legislative changes were not made in 2024, but the government has by now started working on several of those proposals. I may add that competition has improved in the housing loan market in recent years, and the margins on housing loans have narrowed. This does not mean though that our proposals are no longer relevant.

Eesti Pank worked with the Ministry of Finance to produce a draft act for the rounding rule for small coins, which was passed by the Riigikogu last year and came into force at the start of this. We have seen that the change happened smoothly, with the heavy lifting done by merchants in Estonia, who worked hard to ensure the rounding rule was applied successfully at checkouts in shops. I would like to thank the Estonian Traders Association for their excellent and proactive cooperation in this. The changes meant that Eesti Pank no longer needs to produce tonnes of one and two-cent coins that are not used for payment and place a heavy burden on the environment. We have also continued to work with Omniva to allow people to exchange their coins for larger banknotes. This has all improved the recirculation of coins substantially, as last year we issued 30% fewer circulating coins than in the previous year, while 64% more coins were returned to us from circulation. So many one and two-cent coins were returned to us that we were able to trade them with the Latvian central bank at the start of this year as we exchanged our one and two-cent coins for two-euro coins from them. This was an excellent example of successful cooperation between multiple partners.

From our statistical work I would like to highlight the closer cooperation with Statistics Estonia to service the forecasting and economic analysis models of Eesti Pank. Analysts at Eesti Pank can now access several pseudonymised microdata registers and databases, which should help them to understand better what is happening in the economy. It should also make our analysis and political advice even more accurate. We use the microdata in analysing the labour market, in economic research, and in studying the productivity and competitiveness of businesses.

Developing new methods of analysis will help us understand better how climate change affects inflation and economic growth. We worked with the European Central Bank and other central banks in Europe to assess how climate risks and the goals of the green transition will affect the financial sector, and last year we analysed the carbon intensity of the corporate loans portfolios of the banks. We also monitor climate targets in the Eesti Pank investment portfolio, and as an organisation we are trying to reduce the carbon footprint of our activities.

An important part of our international cooperation is representing Estonia at the International Monetary Fund. The increase in the IMF quota has been a current topic for several years, and it is needed so that the IMF can maintain its capacity to lend. The Riigikogu has approved the increase in the Estonian quota, but the national legislative processes have not yet been completed in several member states, and so last year Eesti Pank extended its bilateral loan contract with the IMF to 2027.

The profits of Eesti Pank recovered last year, and that has allowed us to resume the practice of transferring a quarter of the central bank's profit from the previous year to the state budget. We continue to look to organise the work of the central bank as efficiently and effectively as possible, and as part of this we share support services with Finantsinspektsioon, which is housed in the same buildings as us, and we monitor carefully that our activities do not overlap. We finally succeeded this year in selling Maardu Manor, which is not needed for the core activities of the central bank but took several years to sell. The bank made a profit of 74 million euros last year. The Supervisory Board of Eesti Pank decided to transfer a quarter of this, or 18.5 million euros, to the state budget. Since 1992 Eesti Pank has allocated a total of 192 million euros from its profit to the state budget.

We also continued to build up the Eesti Pank capital buffers so they would be sufficient for the central bank to carry out its core activities. Our long-term plan is to reach the average level of the central banks in the euro area, and at the end of 2024 this meant we needed to raise the capital buffers several times from their level of 715 million euros.

A few words now on what lies ahead for the economy. Unfortunately we should not hope that the economy will recover at the same speed that it did after earlier recessions. This is partly because we have become wealthier as a nation and raising our level even further is a stiffer challenge for growth than it was in earlier years. Interest rates have come down a long way, which benefits people and companies, but there remains a lot of uncertainty about the future. This encourages saving, and putting money to one side rather than spending or investing it. Neither is it clear what form global trade relations will take, though the rules on trade between the European Union and the USA are a little better defined than they were in the summer.

Eesti Pank held a public seminar on trade barriers in the spring, at which businesses and experts spoke. The general opinion was that there will be no return to the past and that it is necessary to adapt to the new circumstances. This gives even greater priority to resolving the pinch points in competitiveness in Estonia, and to the ability to be part of the changed value chains. It is important to work with the business environment that we have and to eliminate the bottlenecks that choke the development and growth of companies. Efforts at the level of the European Union are also important, and we should make better use than we have so far of our potential in the large single market, and we should develop the single capital market so that we can fund the needs of Europe for development and defence.

Eesti Pank is keen to offer its advice and its efforts for these topics, though our core task remains maintaining price stability.

Thank you for your attention and I am ready to answer any questions you may have.