



Sebastian Leitner

Estonia: Consumption should avert a second dip

In Estonia the ongoing recessionary economic environment in the EU in general and stagnation in the Scandinavian countries placed a strain on the country's growth prospects. Thus, the mood of entrepreneurs to invest remains subdued, while public investment activity has been sharply curtailed compared to the recent recovery phase. Only household consumption is fuelling GDP growth thanks to real wages increasing more than productivity.

The ongoing recessionary economic environment in the EU in general and stagnation in the Scandinavian countries placed a strain on the country's growth prospects. Thus, the mood of entrepreneurs to invest remains subdued, while public investment activity has been sharply curtailed compared to the recent recovery phase. Only household consumption is fuelling GDP growth thanks to real wages increasing more than productivity.

The euro area and Estonia's second most important trading partner Finland are in recession in 2013, while in Sweden private and public consumption prevent the country's economy from slipping down the same road. As expected, the Estonian export growth will slow down further this year after being already anaemic in 2012, driven by low expectations for short- to medium-term recovery in the Nordic trading partners and the euro area in general. However, most likely the still more lively economic activity in the Baltic neighbours and demand from Russia should prevent Estonian exports from falling nominally, especially in the electronics industry, which had to suffer last year. In the wake of reduced public investments imports are stagnating as well, thus the contribution of net exports to GDP growth will most probably be slightly positive.

The strong impetus to economic growth coming from gross fixed capital formation last year is absent in 2013. It had resulted from public investments in the construction sector, transport and energy infrastructure, financed by EU funds and revenues from the sales of CO₂ emission certificates. Most of these projects have been finalised and the government refrains from applying expansionary fiscal measures to bolster growth. At the same time the corporate sector hesitates to upgrade its equipment given the meagre outlook for

external demand. Furthermore, reported capacity utilisation rates remain at a low level of 70% in the manufacturing sector. Enterprises began to increase their loan stock gradually starting already in the second half of 2012. However, we expect enterprises to raise their expenditures for capital replacement only towards the end of the year 2013. Although the real estate market has bottomed out and dwelling prices are slightly rising again, households started to increase their debt burden only very slightly at the beginning of 2013. As a result, investments in the housing sector are still meagre. In general we expect growth in fixed investments to remain stagnant in 2013, given the reduction of public outlays this year.

While throughout 2012 still lively demand on the domestic market resulted in an improved labour market situation, the growth in employment almost came to a halt. The number of jobs in industrial sectors is declining and stagnating in construction while still growing slightly in higher-skilled service sectors. Total employment growth, which still amounted to 2.6% in 2012, is presumably to slow down to 1.5% in 2013. Accordingly, the unemployment rate, which had already fallen to below 10% in the second half of 2012, will decrease further only gradually in 2013 and also beyond. The overall level of employment in 2013 is still 5% lower compared to 2007.

In line with a slight amelioration of the labour market in general and quite a favourable situation for highly skilled workers, gross wages continued to rise, by 2.7% in real terms in the first quarter of 2013. We expect the rise in labour costs to act as a driver of overall price developments in 2013. The completion of the opening of the electricity market in January 2013 has already caused a substantial rise in the price of electricity for households. Only in 2014, when the EstLink 2 cable – which will triple the transport capacity of electricity between the Estonian and the Finish grid – is to be launched, a slight fall in electricity prices is to be expected. Due to the low price increases of imports and the expected slight fall of the price of oil and gas, the consumer inflation rate is to fall slightly to 3.4% in 2013.

In spite of stagnant manufacturing and construction output the consumption activity of Estonian households remained rather robust also at the beginning of 2013. Consumer surveys show that spending plans have not deteriorated, while deleveraging of households has bottomed out. Thus we expect that also in 2013 domestic consumption will grow by 3.3% in real terms and thus keep up overall GDP growth.

The final outcome of last year's budget figures was a deficit of 0.3% of GDP, a more favourable than expected result driven by growing tax revenues. On the expenditure side the partial offset of the public wage cuts, executed during the Estonian bust, a small

pension increase of about 5% and a capital injection for the national air carrier will be positive drivers, while public investment cuts will lead to a decline in total public outlays. Apart from the increase in excise taxes and a reduction of the unemployment insurance contribution from 4.2% to 3% of labour costs, the 2013 budget approved last December does not foresee any major changes in the tax code. Hence, a lower GDP growth will also bring down the growth rate of government revenues, thus we expect the public deficit to remain close to zero also in 2013. The plan of the Estonian government to attain a budget surplus in 2014 can be effected.

Although the outlook for 2014 is slightly better for the euro area and Estonia's main trading partners, external demand will most probably remain a subdued driver of economic growth. However, we expect that together with stable household consumption it should help renew entrepreneurs' good spirits in order to recover private investments. But given the planned further cuts in public investments, which had supported the overall economic activity in the rebound up to 2012, we expect GDP growth to remain below Estonia's potential not only in 2013 with 2.0% but also in 2014 with 3.2%. The most likely scenario for the subsequent years, given a very restrained revival in the euro area, reckons with near-stagnation in view of austerity and structural reform policies. Thus also in Estonia the economic activity will remain subdued. However, if growth resumes as forecasted in 2014 and thereafter, the country might attain in 2015 the GDP level it had already in 2007 before the economy went bust and 'internal devaluation' policies were implemented.

Table EE

Estonia: Selected Economic Indicators

	2009	2010	2011	2012 ¹⁾	2012 1st quarter	2013	2013 Forecast	2014	2015
Population, th pers., average ²⁾	1340.3	1340.2	1294.7	1290.5	1294.5	1286.5	1285	1280	1275
Gross domestic product, EUR mn, nom.	13762	14323	15951	16998	3856	4075	17900	19200	20800
annual change in % (real)	-14.1	3.3	8.3	3.2	3.4	1.1	2.0	3.2	3.5
GDP/capita (EUR at exchange rate)	10300	10700	12300	13200	.	.	.	.	.
GDP/capita (EUR at PPP)	14700	15500	17500	18700	.	.	.	.	.
Consumption of households, EUR mn, nom.	7271	7287	7929	8560	2065	2218	.	.	.
annual change in % (real)	-15.2	-2.4	3.6	4.4	4.1	3.6	3.3	3.5	4.0
Gross fixed capital form., EUR mn, nom.	2949	2733	3460	4247	817	801	.	.	.
annual change in % (real)	-38.3	-7.4	25.7	20.9	20.2	-6.5	1.0	5.0	7.0
Gross industrial production									
annual change in % (real)	-24.0	23.6	19.9	-0.2	0.1	3.7	2.8	7.0	9.0
Gross agricultural production (EAA)									
annual change in % (real)	2.8	-4.0	9.7	0.4	.	.	.	.	.
Construction industry									
annual change in % (real)	-29.8	-8.5	27.3	18.4	27.9	1.6	.	.	.
Employed persons, LFS, th, average	595.8	570.9	609.1	624.4	614.3	623.1	634	642	650
annual change in %	-9.2	-4.2	6.7	2.5	3.9	1.4	1.5	1.3	1.2
Unemployed persons, LFS, th, average	95.1	115.9	86.8	70.5	79.6	70.8	66.6	63.5	56.5
Unemployment rate, LFS, in %, average	13.8	16.9	12.5	10.2	11.5	10.2	9.5	9.0	8.0
Reg. unemployment rate, in %, end of period	13.3	10.1	7.3	6.1	7.6	6.7	.	.	.
Average gross monthly wages, EUR	784	792	839	887	846.8	900.4	.	.	.
annual change in % (real, gross)	-4.9	-1.8	0.9	1.7	2.4	2.7	.	.	.
Consumer prices (HICP), % p.a.	0.2	2.7	5.1	4.2	4.6	3.8	3.4	4.0	4.5
Producer prices in industry, % p.a.	1.0	3.2	4.2	2.6	3.6	7.5	.	.	.
General governm. budget, EU-def., % of GDP									
Revenues	43.5	40.9	39.5	40.2	.	.	39.5	39.0	39.0
Expenditures	45.5	40.7	38.3	40.5	.	.	39.8	39.0	38.5
Net lending (+) / net borrowing (-)	-2.0	0.2	1.2	-0.3	.	.	-0.3	0.0	0.5
Public debt, EU-def., % of GDP	7.2	6.7	6.2	10.1	6.8	.	11.0	10.5	9.0
Central bank policy rate, % p.a., end of period ³⁾	2.83	0.92	1.00	0.75	1.0	0.8	.	.	.
Current account, EUR mn	470	420	339	-205	-108	-122	-550	-700	-900
Current account, % of GDP	3.4	2.9	2.1	-1.2	-2.8	-3.0	-3.1	-3.6	-4.3
Exports of goods, BOP, EUR mn	6460	8770	12056	12565	2994	2945	12800	14000	15500
annual change in %	-23.9	35.8	37.5	4.2	9.2	-1.6	2.0	9.0	11.0
Imports of goods, BOP, EUR mn	7051	9035	12277	13301	3143	3129	13500	15500	18000
annual change in %	-33.0	28.1	35.9	8.3	9.4	-0.5	1.0	15.0	16.0
Exports of services, BOP, EUR mn	3200	3442	3900	4243	901	1001	4650	5300	6200
annual change in %	-11.1	7.6	13.3	8.8	17.5	11.1	10.0	14.0	17.0
Imports of services, BOP, EUR mn	1809	2102	2660	3021	673	765	3350	3800	4500
annual change in %	-20.9	16.2	26.5	13.6	21.0	13.6	11.0	13.0	18.0
FDI inflow, EUR mn	1325	1207	185	1144	141	115	800	.	.
FDI outflow, EUR mn	1115	106	-1049	689	85	67	300	.	.
Gross reserves of NB excl. gold, EUR mn ⁴⁾	2758	1904	150	218	202	241	.	.	.
Gross external debt, EUR mn	17204	16420	15250	16622	15610	16054	.	.	.
Gross external debt, % of GDP	125.0	114.6	95.6	97.8	97.0	89.7	.	.	.
Purchasing power parity EUR/EUR	0.6966	0.6906	0.7044	0.7060	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Account of Agriculture (EAA).

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 4) From January 2011 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.