

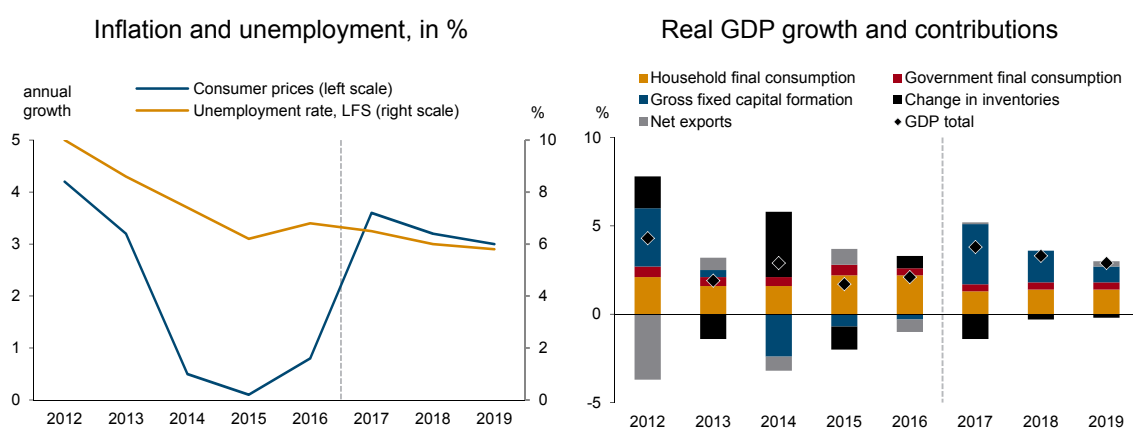


ESTONIA: Investment and revived exports drive growth

SEBASTIAN LEITNER

Investment activity in both the private and the public sector picked up more strongly than expected, pushing GDP growth upwards in both 2017 and 2018. Meanwhile exports have also gained momentum and recovered, particularly towards Russia. Household consumption, backed by a still considerable rise in real wages, continues to be a strong driver of economic activity. A speed-up in economic activity in the short run is projected to result in a GDP growth rate of 3.8% in 2017 and 3.3% in 2018, declining somewhat to 2.9% in 2019.

Figure 36 / Estonia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The export activity throughout 2017 has evolved much more dynamically than expected. In particular, goods exports to Russia gained strongly in momentum, increasing by almost 30% nominally in the first half of 2017. This also fosters growth in services exports, since transit trade with Russia has revived as well. Moreover, also activity in the tourism industry has regained momentum. The economy of neighbouring Sweden is expected to expand at about 3% per annum in 2017, while that of Finland is expected to grow by about 2.5% this year and close to 2% in 2018. Export activity with neighbouring Latvia, Estonia's third most important trading partner after Sweden and Finland, still remains stagnant. However, it is anticipated to strengthen on account of the revival of investment in that country as was already the case with Lithuania. Last year's slump in the production of shale oil, Estonia's second most important export product after assembled mobile phones, caused by low oil prices, was counterbalanced in 2017. As a result, shale oil-based electricity production has regained momentum and electricity imports from Finland have declined again. Overall, we expect growth in goods exports to increase at a

stronger pace in 2017 and 2018, while levelling off in 2019. From 2018 onwards, however, imports should increase even more strongly than exports.

Investment activity of the public and private sectors became even more pronounced than expected. In 2017, external demand and industrial production have started to strengthen; furthermore, activity in the construction sector has gained momentum as well. In the residential construction sector we see a strong growth in new floor space being built, but also prices and wages growing. Data on building permits and mortgage loans suggest that dwelling construction will continue to expand not only in 2017, but also in 2018. Economic sentiments of employers rose substantially this year and are back at levels as before the crisis in 2008. As forecasted, public investment has started to increase markedly in 2017, driven by inflows of fresh EU funds. In total, the government anticipates that EU funds for public and private investment will amount to 2-3% of GDP this year. In its 2018 budget plan, the government foresees a low budget deficit of 0.5% for 2017 and 0.3% for 2018, easily achievable given the good economic growth prospects. A further reduction in the public debt to close to 8% of GDP is envisaged towards 2019. A larger part of the rising public expenditure in 2017 will be devoted to defence (2.1% of GDP) and the health sector.

The unemployment rate has remained stable at a rather low level, whereas the employment rate almost attains the level of the Scandinavian economies. While employment in the services sectors has continued to rise, it is stagnant in agriculture and industry. Due to the work ability reform, introduced in July 2016, more people have entered the labour market in search of work. People having received work incapacity pensions in the past now have to look more actively for jobs and take part in public work activation measures. Thus, the unemployment rate increased in 2016 and refrains from declining in 2017 irrespective of the decent growth in jobs. Moreover, the employment rate of those aged 15 to 64 years increased to more than 73% of the population; in that indicator Estonia ranks 7th in the list of EU countries.

The increase in real net wages went down to 3.5% in the first half of 2017 year on year, still pushing household consumption upwards. Nevertheless, we expect somewhat lower growth than recently: 2.5% in real terms in 2017 and a slight acceleration in 2018. Consumer prices have started to rise somewhat in recent months. However, the upward price movement is mostly caused by an increase in excise taxes and, most recently, by rising energy prices. In 2018 consumer prices will continue to rise more swiftly, pushed up by rising import prices. Forward-looking consumer confidence indicators show an improvement in 2017, and the most recent retail trade and credit statistics indicate a good spending mood. Monthly incomes will continue to grow considerably in both 2017 and 2018, not least thanks to another increase in the minimum wage that is planned for 2018. Moreover, the government's 2018 budget plan comprises additional measures to lower the income tax burden, in particular an increase of the non-taxable basic exemption from EUR 180 to EUR 500, which will substantially increase the net incomes of low- and middle-income earners.

Overall, strong GDP growth has returned to Estonia. The 2016 GDP growth of 2.1% in real terms was somewhat lower than forecasted, due to the unexpectedly poor performance of investment. But the remarkable revival of external demand particularly from Russia has continued, and private investment activity is thriving much more than expected. An ongoing upswing in public investments, not only this year but also in 2018 and 2019, will be facilitated by increasing inflows of EU funds. Rising private income will help household consumption to grow swiftly. Thus, for 2017 and 2018, we have revised our forecast for real GDP growth substantially upwards, to 3.8% and 3.3%, respectively, while for 2019 we expect economic activity to develop at a pace of 2.9%.

Table 11 / Estonia: Selected economic indicators

	2013	2014	2015	2016 ¹⁾	2016 January-June	2017	2017 Forecast	2018 Forecast	2019
Population, th pers., average	1,318	1,315	1,315	1,316	.	.	1,315	1,315	1,315
Gross domestic product, EUR mn, nom.	18,932	19,766	20,348	21,098	10,133	11,078	22,700	24,200	25,600
annual change in % (real)	1.9	2.9	1.7	2.1	1.5	5.2	3.8	3.3	2.9
GDP/capita (EUR at PPP)	20,200	20,900	21,700	21,700	.	.	.	.	.
Consumption of households, EUR mn, nom.	9,457	9,813	10,232	10,771	5,351	5,625	.	.	.
annual change in % (real)	3.3	3.2	4.4	4.3	4.3	1.5	2.5	2.8	2.9
Gross fixed capital form., EUR mn, nom.	5,253	4,829	4,807	4,712	2,219	2,686	.	.	.
annual change in % (real)	1.5	-8.7	-2.9	-1.2	3.8	17.4	15.0	8.0	4.0
Gross industrial production									
annual change in % (real)	4.1	3.9	0.3	2.4	-1.0	11.7	9.0	7.0	5.0
Gross agricultural production									
annual change in % (real)	4.7	4.6	8.7	-16.7	.	.	.	.	.
Construction industry									
annual change in % (real)	-0.1	-2.1	-3.4	2.6	3.9	18.7	.	.	.
Employed persons, LFS, th, average	621.3	624.8	640.9	644.6	643.5	650.2	655	660	665
annual change in %	1.0	0.6	2.6	0.6	1.9	1.0	1.6	0.8	0.8
Unemployed persons, LFS, th, average	58.7	49.6	42.3	46.7	44.5	43.7	46	42	41
Unemployment rate, LFS, in %, average	8.6	7.4	6.2	6.8	6.5	6.3	6.5	6.0	5.8
Reg. unemployment rate, in %, eop ²⁾	5.3	4.4	4.7	4.4	4.2	4.6	.	.	.
Average monthly gross wages, EUR	949	1,005	1,065	1,146	1,127	1,198	1,230	1,320	1,430
annual change in % (real, gross)	4.1	6.0	6.5	7.4	8.4	3.1	3.5	4.0	5.0
Average monthly net wages, EUR	757	799	859	924	910	967	980	1,040	1,110
annual change in % (real, net)	4.3	5.7	8.0	7.4	8.5	3.1	2.5	3.0	4.0
Consumer prices (HICP), % p.a.	3.2	0.5	0.1	0.8	0.2	3.2	3.6	3.2	3.0
Producer prices in industry, % p.a.	7.2	-2.7	-3.0	-1.3	-2.2	2.5	3.0	3.2	3.0
General governm. budget, EU-def., % of GDP									
Revenues	38.3	39.1	40.3	40.3	.	.	38.5	38.6	38.6
Expenditures	38.4	38.4	40.2	40.1	.	.	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.2	0.7	0.1	0.3	.	.	-0.5	-0.4	-0.4
Public debt, EU-def., % of GDP	10.2	10.7	10.0	9.4	.	.	9.0	8.5	8.0
Stock of loans of non-fin.private sector, % p.a	0.7	2.6	4.8	6.6	8.6	5.3	.	.	.
Non-performing loans (NPL), in %, eop	1.7	1.5	1.1	1.0	1.1	0.8	.	.	.
Central bank policy rate, % p.a., eop ³⁾	0.25	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	99	51	398	400	29	179	400	250	100
Current account, % of GDP	0.5	0.3	2.0	1.9	0.3	1.6	1.8	1.0	0.4
Exports of goods, BOP, EUR mn	10,968	10,998	10,757	11,168	5,483	5,839	12,100	13,100	13,800
annual change in %	2.0	0.3	-2.2	3.8	1.8	6.5	8.0	8.0	5.0
Imports of goods, BOP, EUR mn	11,893	12,089	11,612	11,958	5,920	6,323	12,900	13,900	14,900
annual change in %	-1.1	1.6	-3.9	3.0	3.0	6.8	7.5	8.0	7.0
Exports of services, BOP, EUR mn	4,992	5,323	5,237	5,496	2,562	2,864	5,900	6,400	6,800
annual change in %	6.8	6.6	-1.6	4.9	3.2	11.8	8.0	8.0	6.0
Imports of services, BOP, EUR mn	3,535	3,673	3,568	3,892	1,876	2,022	4,200	4,500	4,800
annual change in %	13.5	3.9	-2.9	9.1	8.7	7.8	7.5	8.0	7.0
FDI liabilities, EUR mn	834	1,308	-661	665	350	382	750	.	.
FDI assets, EUR mn	641	847	-532	156	207	219	300	.	.
Gross reserves of NB excl. gold, EUR mn	222	352	373	325	418	282	.	.	.
Gross external debt, EUR mn	17,618	19,062	19,178	19,072	19,443	18,943	19,300	20,100	20,500
Gross external debt, % of GDP	93.06	96.43	94.25	90.40	92.16	83.45	85.0	83.0	80.0

1) Preliminary. - 2) In % of labour force (LFS). - 3) Official refinancing operation rate for euro area (ECB).

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