

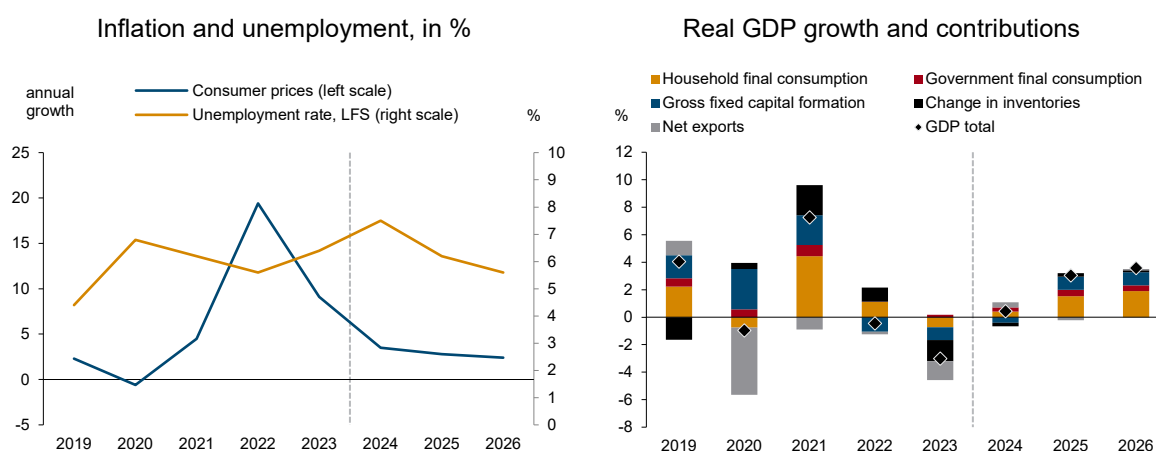


## ESTONIA: Over the worst

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The past year presented significant challenges for the Estonian economy. A constellation of factors, including the disproportionately severe impact of the war in Ukraine, weak domestic and international demand, disruption to supply chains and a shift away from traditional export markets, dealt the economy a heavy blow. However, 2024 will mark a turning point, with stabilising prices, a modest resurgence in external demand and a robust labour market all indicating that the worst may be over. Nevertheless, to enter a new cycle of economic growth, the competitiveness of Estonian firms needs to be revived and new export markets need to be established.

Figure 6.7 / Estonia: Main macroeconomic indicators



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

**Last year, Estonia experienced the most significant economic decline of all European Union countries, with a 3% decrease in GDP.** Although value added fell in most sectors, the recession was driven primarily by the energy and mining, manufacturing, transportation, and storage sectors, which collectively accounted for nearly a quarter of Estonia's GDP in 2021. Those sectors have been disproportionately affected by the war in Ukraine and by the weak economic performance of key export markets, including the Nordic countries, Latvia and Lithuania.

**GDP will start gradually to recover in 2024, but all-out growth will only be seen in 2025.** As major supply-side issues are being resolved, and as demand – both domestic and on the country's primary export markets – is gradually improving, no further economic downturn is foreseen. Factors contributing to economic stabilisation include a decrease in commodity and production input costs, lower energy

prices, reduced interest rates, a stabilisation of prices and improved purchasing power. However, the economy will gain momentum very slowly, with GDP growth forecast to be 0.4% in 2024. With ample production capacities standing idle, there is abundant potential for firms to undertake a rapid revival of industrial production as the economy recovers and companies venture into new markets. This will result in more confident GDP growth of 3% in 2025 and 3.6% in 2026.

**An increase in VAT led to a rise in year-on-year consumer price inflation (CPI) to 3.9% in March; however, without the impact of this tax hike, inflation would have stood at 2.4%.** Throughout 2024, prices for energy, agricultural products and manufactured goods are expected to continue to fall, indicating that overall inflation will likely hover at around 3.5%. The CPI is projected to decline further to 2.8% in 2025 and 2.4% in 2026. However, such a fall could be offset by several new planned tax increases, including a car tax.

**Household consumption contracted by 1.5% in 2023, as the full-scale distorting effect of inflation materialised (while savings had already been depleted the year before).** Consumers remain cautious about future economic developments, and this is resulting in weaker consumption and investment activity. Although consumption probably reached its nadir in 2023, the combination of higher VAT (up from 20% to 22%) and sluggish real wage growth is expected to restrain private consumption through 2024, resulting in meagre growth of 0.8%. However, certain factors that are on the cards – such as a recovery in the purchasing power of wages, an interest rate decline, a strong labour market and a higher tax-free income threshold due to come into force in 2025 – are projected to drive consumption growth back up to 3% in 2025 and 3.7% in 2026.

**Gross industrial production fell by approximately 10% year on year in 2023.** The most pronounced decline in industrial output over the past two years was observed in the wood and metal production sectors. This was driven by the disruption to the supply of cheap raw materials from Russia and Belarus, diminishing competitiveness and modest demand. Companies are gradually adjusting and seeking out new markets and substitutes for the disrupted supply chains; however, demand-side factors will continue to restrain growth in 2024.

**The foreign trade turnover declined by 5% in 2023, largely on account of exports and imports of goods.** Both were down by 16% compared to 2022, owing to a significant decline in manufacturing exports across all exporting branches. The depreciation of the currencies of countries outside the euro area, including Sweden and Norway, further undermined the competitiveness of Estonian products. This added to the ongoing detrimental effects of an upsurge in input prices and supply-chain distortions. Despite these challenges, trade in services picked up in 2023. There was 5% year-on-year growth in service exports, largely due to ICT, processing and tourism services, and a 7% growth in service imports.

**No significant revival in foreign trade is anticipated in 2024, as heavy competition pressure remains and the assessments by business continue to be gloomy.** There will be a further real decrease of 1.3% in exports and 1.8% in imports in 2024. However, the steady weakening of energy and input price pressures, as well as the more favourable exchange rates for Swedish krona and Norwegian krone anticipated for later this year, should give a boost to exports. Consequently, a gradual but steady recovery in foreign trade is projected to commence in 2025, driven by strengthening foreign demand and improved domestic economic conditions.

**The labour market proved resilient throughout 2023, and the impact on it of the ongoing stagnation in business activity is expected to be minimal this year.** Companies, anticipating an economic revival and a resurgence of labour shortages, are inclined to hang onto employees even during challenging times and in the face of rising costs. A generally weak economic outlook, coupled with a rise in minimum and public-sector wages, is expected to push the unemployment rate up to 7.5% in 2024. However, this surge in joblessness is likely to be temporary. Unemployment is forecast to fall to below 6% in the subsequent years, as labour demand strengthens rapidly and labour shortages re-emerge as the primary factor constraining economic growth.

**Real wages grew steadily throughout 2023, but the reduced capacity of companies to keep up with higher labour costs will retard wage growth this year.** Despite high inflation, real wage growth in 2023 was positive, and the average nominal wage growth of 11% marginally outstripped inflation. In 2024, nominal wages are set to rise by 6%, thanks to a 10% increase in public-sector wages and a 13.1% boost to the minimum wage.

**Budget expenditure rose steeply in 2023, driven by an increase in public-sector wages and in social and defence spending.** Revenue was restrained by an overall economic slump, resulting in a budget gap of around 3.3% of GDP in 2023. Despite tax increases, slower real wage growth and a temporary spike in unemployment are expected to lead to lower tax receipts this year. On the expenditure side, the growth in public-sector wages and social transfers will decelerate. Although the government is aiming for a 3% budget deficit this year, persistently high government consumption will likely result in a wider budget gap of 3.6% of GDP. The effective reduction in personal income tax is likely to result in a short-lived expansion of the budget deficit to around 4.5% in 2025, though it should subsequently narrow to 3.7% in 2026.

**Table 6.7 / Estonia: Selected economic indicators**

	2020	2021	2022	2023 <sup>1)</sup>	2024	2025	2026
					Forecast		
Population, th pers., average	1,330	1,331	1,349	1,366	1,360	1,355	1,350
Gross domestic product, EUR m, nom.	27,430	31,169	36,011	37,682	39,200	41,500	44,000
annual change in % (real)	-1.0	7.2	-0.5	-3.0	0.4	3.0	3.6
GDP/capita (EUR at PPP)	25,590	28,180	30,140	30,670	.	.	.
Consumption of households, EUR m, nom.	13,168	14,991	17,933	19,306	.	.	.
annual change in % (real)	-1.5	9.3	2.3	-1.5	0.8	3.0	3.7
Gross fixed capital form., EUR m, nom.	8,174	9,090	9,910	10,016	.	.	.
annual change in % (real)	10.8	7.3	-3.7	-3.4	-1.5	3.6	3.6
Gross industrial production							
annual change in % (real)	-3.0	13.3	1.8	-11.4	2.7	4.5	5.6
Gross agricultural production							
annual change in % (real)	0.0	-4.9	7.2	-7.1	.	.	.
Construction industry							
annual change in % (real)	-6.1	9.4	-1.2	-5.8	.	.	.
Employed persons, LFS, th, average <sup>2)</sup>	656.6	654.2	680.8	700.0	690	710	730
annual change in %	-2.2	-0.5	4.1	2.8	-1.2	3.0	2.4
Unemployed persons, LFS, th, average <sup>2)</sup>	47.9	43.1	40.2	47.7	56	47	43
Unemployment rate, LFS, in %, average <sup>2)</sup>	6.8	6.2	5.6	6.4	7.5	6.2	5.6
Reg. unemployment rate, in %, eop <sup>3)</sup>	8.3	6.8	7.7	7.7	.	.	.
Average monthly gross wages, EUR <sup>4)</sup>	1,448	1,548	1,645	1,832	1,950	2,070	2,200
annual change in % (real, gross)	3.4	2.1	-6.5	2.0	3.0	3.3	4.0
Consumer prices (HICP), % p.a.	-0.6	4.5	19.4	9.1	3.5	2.8	2.4
Producer prices in industry, % p.a.	-2.2	11.9	25.3	-0.3	3.5	2.8	2.4
General governm. budget, EU def., % of GDP							
Revenues	39.4	39.4	38.8	41.5	41.8	41.5	42.3
Expenditures	44.9	41.9	39.8	44.8	45.4	46.0	46.0
Net lending (+) / net borrowing (-)	-5.4	-2.5	-1.0	-3.3	-3.6	-4.5	-3.7
General gov. gross debt, EU def., % of GDP	18.6	17.8	18.5	21.0	22.0	22.4	21.5
Stock of loans of non-fin. private sector, % p.a.	4.8	7.5	11.7	6.1	.	.	.
Non-performing loans (NPL), in %, eop	0.4	0.2	0.2	0.2	.	.	.
Central bank policy rate, % p.a., eop <sup>5)</sup>	0.00	0.00	2.50	4.50	.	.	.
Current account, EUR m	-521	-808	-1,163	-781	-780	-710	-780
Current account, % of GDP	-1.9	-2.6	-3.2	-2.1	-2.0	-1.7	-1.8
Exports of goods, BOP, EUR m	13,269	16,414	20,143	17,872	17,150	17,540	17,980
annual change in %	-0.4	23.7	22.7	-11.3	-4.0	2.3	2.5
Imports of goods, BOP, EUR m	13,542	17,674	22,715	20,255	19,600	20,230	21,020
annual change in %	-4.9	30.5	28.5	-10.8	-3.2	3.2	3.9
Exports of services, BOP, EUR m	5,716	8,606	10,748	11,667	12,110	12,500	13,020
annual change in %	-20.5	50.6	24.9	8.6	3.8	3.2	4.2
Imports of services, BOP, EUR m	5,594	7,658	8,367	9,062	9,420	9,760	10,200
annual change in %	9.2	36.9	9.3	8.3	4.0	3.6	4.5
FDI liabilities, EUR m	3,243	6,322	1,696	4,878	.	.	.
FDI assets, EUR m	315	5,561	1,628	2,035	.	.	.
Gross reserves of CB excl. gold, EUR m	1,615	2,081	2,068	2,335	.	.	.
Gross external debt, EUR m	24,333	26,523	30,519	33,993	35,700	36,600	38,200
Gross external debt, % of GDP	88.7	85.1	84.7	90.2	91.1	88.2	86.8

Note: Introduction of new index 2021=100 (new weights) for gross industrial production and producer prices in industry.

1) Preliminary and wiiw estimates. - 2) From 2021 new LFS methodology in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of labour force (LFS). - 4) From 2022 based on tax administration data, survey data before. - 5) Official refinancing operation rate for euro area (ECB).

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