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Estonia Recovering again on the fast lane

In Estonia, exports have expanded much faster than expected since the end of 2010. This has led to a substantial upward revision of economic growth forecasts. A revival of gross fixed investment acts as an additional growth driver as well as household consumption. For 2011 we expect GDP to grow by 5.7% in Estonia. In the subsequent two years, when growth in external demand will be abating, we expect only a slight deceleration to 4.5% and 4.8% p.a. Despite the revival in growth, the situation in the labour markets will remain disappointing for a longer period.

In the first quarter of 2011 soaring exports continued to be the main growth driver for the Estonian economy. This time the upswing in external demand was triggered not only by Sweden and the eastern neighbours, but also by the US and the EU's new member states. While in 2010 currency appreciations led to a rise in unit labour costs (ULC) in many NMS, in Estonia a decline of ULC resulted from strong employment cuts in manufacturing and a general wage restraint. The improvement in external competitiveness facilitated growth rates of more than 50% in goods exports in nominal terms, and a more than 30% increase in industrial production in real terms. At the same time the structure of Estonian exports has been upgrading. Almost 30% of exports are now composed of machinery and equipment. As the medium-term growth forecasts for the main export markets are quite positive, external demand will remain to serve as a strong stimulus for the Estonian economy.

Household consumption, after having stabilized in the second half of 2010, is reviving again: in the first quarter of 2011 it grew by 5.4% year on year in real terms. The recovery in the labour market has led to slight rises in nominal wages. Real wages, however, are still declining due to rising consumer prices. Therefore household demand will recover only gradually in the medium term. At the same time, the investment activity of enterprises is on the rise again, particularly in manufacturing, transport and business services. The ongoing process of restocking represents a strong impulse for domestic demand.

Rising prices for imported food and raw materials caused inflation to climb to above 5% p.a. in the past half year. Although the pressure from trade-induced price rises is expected to abate somewhat, the substantial economic upswing in 2011 will result in rising nominal wages and therefore also higher core inflation. Thus, we expect consumer prices to rise by about 5.5% on average in 2011, while in the coming two years only a slight deceleration of inflation is going to take place.

The economic revival in 2010 and the first quarter of 2011 caused employment to grow again, particularly in manufacturing and business services but more recently also in construction. However, the overall employment is still nearly 10% below the pre-crisis level. The unemployment rate amounted to 14.4% in the first quarter of 2011. Although forecasts of economic growth are favourable, unemployment rates are expected to fall below 10% only in 2013 in line with a more substantial and lasting upswing of domestic demand.

In 2010 Estonia was the only EU country to attain a fiscal surplus, which amounted to 0.1% of GDP. This achievement, however, was in part the result of sizeable sales of Kyoto carbon units and a delay of planned public investments. We expect that in both 2011 and 2012 public finances are going to deteriorate somewhat. Since the entry to the eurozone has been accomplished and one-off austerity measures are going to expire, a somewhat laxer fiscal policy stance is to be expected. Nevertheless, the budget deficit will remain very low (and public debt almost non-existent). The Estonian medium-term state budget strategy approved in April 2011 foresees a fiscal surplus to be attained again in 2013.

As expected, the introduction of the euro at the beginning of the year did not bring about any major changes. However, the FDI inflow started to pick up more swiftly than in other new EU member states. For 2011 we expect the revival of economic activity to become stronger and more broadly based. The growth drivers of 2010 – the replenishment of inventories and export activity (increasing still stronger than imports) – will still play an important role. But, as already observed in the first quarter of 2011, the upswing of gross fixed investment and household consumption is becoming more pronounced. The increase in employment and a slight rebound in wages should help household demand to give an additional, if still small impulse. Thus, with stronger domestic demand and rising imports the current account balance will turn into deficit – albeit small. In 2012 and 2013, we expect GDP to grow at a somewhat slower pace, by 4.5% and 4.8%, respectively. External demand will lose some of its dynamism. At the same time the deleveraging process of households and enterprises will come to an end, allowing private demand and imports to increase again more swiftly.

Table EE

Estonia: Selected Economic Indicators

	2007	2008	2009	2010 ¹⁾	2010 1st quarter	2011	2011 Forecast	2012 Forecast	2013
Population, th pers., average	1341.7	1340.7	1340.3	1340.1	.	.	1339	1338	1338
Gross domestic product, EUR mn, nom.	15827	16107	13861	14501	3236	3709	16200	17700	19400
annual change, % (real)	6.9	-5.0	-13.9	3.1	-2.6	8.5	5.7	4.5	4.8
GDP/capita (EUR at exchange rate)	11800	12000	10300	10800	.	.	.	.	.
GDP/capita (EUR at PPP)	17400	17000	15000	15900	.	.	.	.	.
Consumption of households, EUR mn, nom.	8470	8690	6993	7000	1640	1831	.	.	.
annual change in % (real)	8.6	-5.5	-18.8	-1.9	-7.7	5.4	1.7	1.7	2.5
Gross fixed capital form., EUR mn, nom.	5452	4610	2991	2703	610	708	.	.	.
annual change in % (real)	6.0	-15.0	-32.9	-9.2	-20.2	12.0	9	9	10
Gross industrial production									
annual change in % (real)	6.4	-5.2	-24.0	20.9	5.5	32.3	23	18	15
Gross agricultural production									
annual change in % (real)	12.5	-1.2	2.8	-2.5	.	.	.	.	.
Construction industry									
annual change in % (real)	13.5	-13.3	-29.8	-12.4	-34.2	.	.	.	.
Employed persons - LFS, th, average	655.3	656.5	595.8	570.9	553.6	591.3	595	610	620
annual change in %	1.4	0.2	-9.2	-4.2	-9.6	6.8	4	3	2
Unemployed persons - LFS, th, average	32.0	38.4	95.1	115.9	136.9	99.3	.	.	.
Unemployment rate - LFS, in %, average	4.7	5.5	13.8	16.9	19.8	14.4	13	11.5	9.5
Reg. unemployment rate, in %, end of period	2.2	4.6	13.3	10.1	14.7	10.2	.	.	.
Average gross monthly wages, EUR	725	825	784	792	758	792	.	.	.
annual change in % (real, gross)	13.0	3.2	-4.9	-1.8	-2.6	-0.9	.	.	.
Consumer prices (HICP), % p.a.	6.7	10.6	0.2	2.7	0.0	5.2	5.5	4.5	4.5
Producer prices in industry, % p.a.	8.1	8.0	0.7	3.2	-0.1	4.9	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	36.9	37.0	43.4	40.1	.	.	39.1	38.5	38.3
Expenditures	34.4	39.9	45.2	40.0	.	.	39.9	40.3	39.8
Net lending (+) / net borrowing (-)	2.5	-2.9	-1.8	0.1	.	.	-0.8	-1.8	-1.5
Public debt, EU-def., in % of GDP	3.7	4.6	7.2	6.6	.	.	6.1	6.9	6.5
Central bank policy rate, % p.a., end of period ²⁾	7.0	7.0	2.8	0.9	1.6	1.0	.	.	.
Current account, EUR mn	-2721	-1568	628	517	6	-63	-100	-500	-800
Current account in % of GDP	-17.2	-9.7	4.5	3.6	0.2	-1.7	-0.6	-2.8	-4.1
Exports of goods, BOP, EUR mn	8142	8539	6536	8819	1780	2744	11900	14000	16800
annual growth rate in %	4.7	4.9	-23.5	34.9	17.9	54.1	35	18	20
Imports of goods, BOP, EUR mn	10871	10664	7096	9033	1911	2861	12000	14400	17600
annual growth rate in %	7.9	-1.9	-33.5	27.3	11.5	49.7	33	20	22
Exports of services, BOP, EUR mn	3196	3513	3159	3403	700	770	3900	4400	4800
annual growth rate in %	11.3	9.9	-10.1	7.7	2.3	10.0	15	13	9
Imports of services, BOP, EUR mn	2245	2288	1814	2093	465	561	2500	2800	3100
annual growth rate in %	13.4	1.9	-20.7	15.4	5.9	20.5	19	12	11
FDI inflow, EUR mn	1992	1179	1209	1197	251	427	1800	.	.
FDI outflow, EUR mn	1276	760	1110	291	51	195	.	.	.
Gross reserves of NB excl. gold, EUR mn ³⁾	2236	2814	2758	1904	2656	155	.	.	.
Gross external debt, EUR mn	17406	19039	17256	16481	17113	16255	.	.	.
Gross external debt in % of GDP	110.0	118.2	124.5	113.7	118.0	100.3	.	.	.
Average exchange rate EUR/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.6834	0.7062	0.6905	0.6808	.	.	.	.	.

Note: Estonia has introduced the Euro from 1 January 2011. Up to and including 2010 all time series in EKK as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 15.6466 (EKK per EUR) to a kind of statistical EUR (euro-fixed).

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2.

1) Preliminary. - 2) TALIBOR one-month interbank offered rate (Estonia has a currency board). 3) From January 2011 (Euro introduction) only the foreign currency reserves nominated in non-euro currency are included.

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