



ESTONIA: Waiting for Scandinavian neighbours to revive

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The end of stagnation in Northern Europe will allow the Estonian GDP to grow by 2.6% in 2014. Strong increases in real wages coupled with still substantial employment growth will further support the upswing. A stronger revival in private and public investment activity should lift GDP growth to 3% in 2015 and 3.2% in 2016.

The development of Estonia's economy, with a ratio of exports to GDP of about 90%, is highly dependent on the evolution of external markets. In 2013 Finland was in recession with a GDP decline of 1.8% and in Sweden growth was rather sluggish at 1% per annum. At the same time also Russian economic activity decelerated remarkably. The effect for Estonia was a contraction of goods and services exports by about 2% in nominal terms last year. Particularly transit volumes to and from Russia declined. Prospects for the Scandinavian economies for 2014 are rather positive, with Finland escaping recession and an upswing in Sweden driven by household consumption and investment. Thus we expect Estonian exports to revive, although the drag of Russia's growth remaining subdued will further have a negative impact. Industry confidence indicators have improved at the beginning of this year, producers becoming particularly more confident about export volumes to increase in the coming months.

The stagnation in gross fixed capital investment last year was to a large extent due to the cut of public outlays for infrastructure projects compared to 2012. For 2014 the budget plan of the government foresees real estate investments to increase by 10%. However, only in 2015-2016 a stronger rise is to be expected when EU funds become gradually available for the government. Enterprise investments in construction and repair of buildings increased by about 15%, whereas outlays for machinery and equipment remained stagnant in the total economy and fell by almost 20% in manufacturing, influenced by the decline in exports. In addition, enterprises significantly reduced the level of inventories last year. Accordingly, the rise in the stock of loans to enterprises slowed down in 2013. At the same time deleveraging of households has come to an end, the stock of housing loans started to increase slightly. Based on the allocation of building permits in past quarters we expect a slight increase in the construction of dwellings in 2014. The upswing of exports and further growth of industrial production for domestic consumption should result in increasing investments into machinery.

Employment kept on growing also in 2013 at a high pace with 2% annually. Additional jobs were created particularly in tourism, trade and public administration. Also in manufacturing employment grew by more than 2%, while the transport sector has been gradually losing jobs over the past years due to falling transit with Russia that widens the capacity of its own ports. For 2014 and thereafter we expect employment growth to decline since the employment rate of the population aged 15-64 has regained,

with close to 70%, almost the pre-crisis level. Vacancies remained at the same level throughout last year compared to 2012, while the unemployment rate fell to 8.6%.

Average wage growth amounted to 4% in real terms in 2013. Unit labour costs in the manufacturing sector started to rise substantially faster than in the West and North European trading partners, a development exporting firms should keep an eye on. The amelioration of the labour market situation will keep wages growing at a high pace in the total economy. In order to lower wage inequality the government increased the minimum wage by 10% from January 2014 onwards. At the beginning of 2015 a further increase of the same amount will lift the minimum monthly salary to EUR 390, i.e. 40% of the average wage.

Despite the sluggish developments in overall economic activity, retail volumes kept on growing swiftly throughout 2013. Surveys show that expectations of households are increasingly positive at the beginning of 2014. Private consumption, which kept GDP growth alive in 2013, will still increase strongly in the coming years. However, due to employment rising at a slower pace in the coming years the contribution to overall GDP growth will decline slightly.

Although GDP growth decreased markedly in 2013, the budget deficit remained almost balanced. The Estonian government refrained from pursuing countercyclical fiscal policies. In March 2015 the next parliamentary elections will take place. Most recent polls show that it will be difficult for the Reform Party of Prime Minister Andrus Ansip to win the relative majority again. Hence, for 2014 the coalition government stipulated in its budget plan to increase not only the minimum wages but also pensions by 5.8% on average. Moreover, wages of public employees are to be lifted by about 5%.

Inflation still amounted to 3.2% in 2013 although commodity prices, particularly of fuels, were on the decline. The opening-up of the electricity market led to a hike in prices for households and rising labour costs pushed up core inflation. In 2014 and 2015 the increase of consumer prices should fall below 3%, the one-off effect of electricity price liberalisation will abate. Nevertheless, the wage growth particularly in the labour-intensive services sectors will keep inflation rates above those in most other EU countries.

In 2014 a revival of growth in the North European countries will pull the Estonian economy out of stagnation, rising by 2.6% p.a. Strong increases of average incomes and particularly minimum wages will in the two years thereafter result in household consumption remaining the main driver of economic activity. However, employment growth will slowly abate. In 2015 and 2016 an upswing in investment activity will be caused by rising capacity utilisation rates in the enterprise sector. In addition, public outlays for infrastructure will increase with EU funds becoming gradually available in this period. In real terms GDP growth will attain 3% in 2015 and 3.2% in 2016.

Table 1 / Estonia: Selected Economic Indicators

	2009	2010	2011	2012	2013 ¹⁾	2014	2015	2016	
							Forecast		
Population, th pers., average ²⁾	1334.5	1331.5	1327.4	1322.7	1316.0	1310	1305	1300	
Gross domestic product, EUR mn, nom.	13970	14371	16216	17415	18100	19000	20100	21400	
annual change in % (real)	-14.1	2.6	9.6	3.9	0.7	2.6	3.0	3.2	
GDP/capita (EUR at exchange rate)	10500	10800	12200	13200	13800	.	.	.	
GDP/capita (EUR at PPP)	15000	15700	17500	18500	18900	.	.	.	
Consumption of households, EUR mn, nom.	7334	7310	7964	8662	9300	.	.	.	
annual change in % (real)	-15.2	-2.7	3.8	4.9	4.5	4.4	4.2	4.0	
Gross fixed capital form., EUR mn, nom.	2960	2726	3825	4392	4600	.	.	.	
annual change in % (real)	-39.0	-7.2	37.6	11.0	1.0	2.5	5.0	6.0	
Gross industrial production									
annual change in % (real)	-24.0	23.6	19.9	-0.2	3.4	5.0	7.0	9.0	
Gross agricultural production									
annual change in % (real)	2.8	-4.0	9.7	5.6	2.3	.	.	.	
Construction industry									
annual change in % (real)	-29.8	-8.5	27.3	18.4	1.9	.	.	.	
Employed persons, LFS, th, average ³⁾	595.8	570.9	609.1	614.9	621.3	630	635	640	
annual change in % ³⁾	-9.2	-4.2	6.7	1.9	1.0	1.4	0.8	0.8	
Unemployed persons, LFS, th, average ³⁾	95.1	115.9	86.8	68.5	58.7	53.3	49.3	46.7	
Unemployment rate, LFS, in %, average ³⁾	13.8	16.9	12.5	10.0	8.6	7.8	7.2	6.8	
Reg. unemployment rate, in %, end of period	13.3	10.1	7.3	6.1	5.1	.	.	.	
Average monthly gross wages, EUR	784	792	839	887	952	.	.	.	
annual change in % (real, gross)	-4.9	-1.8	0.9	1.7	4.0	.	.	.	
Average monthly net wages, EUR	637	637	672	706	764	.	.	.	
annual change in % (real, net)	-4.9	-2.9	0.5	1.1	4.9	.	.	.	
Consumer prices (HICP), % p.a.	0.2	2.7	5.1	4.2	3.2	2.5	2.8	3.2	
Producer prices in industry, % p.a.	1.0	3.2	4.2	2.6	7.3	.	.	.	
General governm. budget, EU-def., % of GDP									
Revenues	42.8	40.6	38.7	39.2	38.0	37.5	37.0	36.5	
Expenditures	44.7	40.5	37.5	39.5	38.5	37.9	37.2	36.6	
Net lending (+) / net borrowing (-)	-2.0	0.2	1.1	-0.2	-0.5	-0.4	-0.2	-0.1	
Public debt, EU-def., % of GDP	7.1	6.7	6.1	9.8	10.2	10.0	9.7	9.4	
Central bank policy rate, % p.a., end of period ⁴⁾	2.83	0.92	1.00	0.75	0.25	.	.	.	
Current account, EUR mn	382	408	291	-311	-250	-300	-400	-600	
Current account, % of GDP	2.7	2.8	1.8	-1.8	-1.4	-1.6	-2.0	-2.8	
Exports of goods, BOP, EUR mn	6354	8770	12049	12587	12249	12700	13600	15000	
annual change in %	-25.2	38.0	37.4	4.5	-2.7	4.0	7.0	10.0	
Imports of goods, BOP, EUR mn	7051	9039	12378	13363	13078	13900	15000	16400	
annual change in %	-33.0	28.2	36.9	8.0	-2.1	6.0	8.0	9.0	
Exports of services, BOP, EUR mn	3220	3442	3987	4256	4404	4750	5180	5440	
annual change in %	-10.6	6.9	15.8	6.7	3.5	8.0	9.0	5.0	
Imports of services, BOP, EUR mn	1809	2102	2665	3043	3238	3600	4030	4550	
annual change in %	-20.9	16.2	26.8	14.2	6.4	11.0	12.0	13.0	
FDI inflow, EUR mn	1325	1207	245	1180	837	.	.	.	
FDI outflow, EUR mn	1115	106	-1046	740	433	.	.	.	
Gross reserves of NB excl. gold, EUR mn ⁵⁾	2758	1904	150	218	222	.	.	.	
Gross external debt, EUR mn	17204	16420	15250	16622	16000	.	.	.	
Gross external debt, % of GDP	123.2	114.3	94.0	95.4	88.4	.	.	.	
Purchasing power parity EUR/EUR	0.6978	0.6871	0.6967	0.7136	0.7269	.	.	.	

1) Preliminary and wiiw estimates. - 2) According to census March 2011. - 3) From 2012 according to census March 2011. - 4) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 5) From January 2011 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

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