



Sebastian Leitner

Estonia: Weakness of external demand will drag down strong recovery

After a year of strong economic activity, the recessionary developments in the eurozone also impair the growth prospects of the Estonian economy. Thus, the growth of investments will abate throughout 2012 while household demand will still support the trade cycle. Moreover, the latest protests and strikes in Estonia should give rise to stronger wage increases this year. In 2013 and 2014 a slight upswing of external demand should bring forth a revival of faster GDP growth.

The first year after the accession to the eurozone saw a very strong revival of economic activity in Estonia with a GDP growth rate of 7.5% in real terms. Goods exports rose by almost 40% in nominal terms year on year, particularly fast to Russia and Sweden, but also to other Northern European countries (except for Finland and Germany). The nominal level of exports in 2011 already surpassed the pre-crisis level of 2008 by more than 40% in nominal terms. Also total industrial production grew for the second year by almost 20%, thus Estonian companies started raising their investments again after the economic crisis. Strong impulses came from the manufacturing sector, which more than doubled its purchases for new equipment. Even construction activity, although still on a much lower level than before the crisis, regained momentum and grew by more than 20% in 2011. Another important driver of high GDP growth was household consumption, which rose by about 4% in real terms, triggered by the revival of employment growth.

However, the figures for the 4th quarter of 2011 already showed that external demand is substantially losing momentum, especially in Germany, and even declining nominally in Sweden. The latter is also due to the economic troubles of the mother company of Elcoteq Tallinn, the latter being one of the main Estonian exporters performing assembly work predominantly for Swedish electronics producers. The mother company went bankrupt in October 2011; by the end of January 2012 three investors expressed interest in taking over the profitable Tallinn subsidiary. Thus the continuation of the production site currently working below capacity seems assured. For 2012 in general, however, the external demand of the EU markets will be much weaker than last year following the European-wide fiscal consolidation process and the cautious credit supply of the EU banking sector. Thus we expect export growth to decline substantially.

In 2011 the labour market showed a remarkable recovery. Although the overall employment level is still about 6% below the 2008 peak, the growth rate amounted to 6.7% in 2011. New jobs were created in manufacturing in particular, but also in transport and communications and in construction, while the public service sectors have not been hiring new staff. The unemployment rate fell by more than 4 percentage points to 12.5% in 2011 on average. As economic growth will dwindle this year, a further improvement of the labour market situation will take a longer time.

Corresponding to the revival in the labour market also gross wages recovered and contributed to the above-mentioned upswing of household consumption in 2011. Since sluggish external demand will also reduce the growth of income in 2012, consumer expectations and those of the retail sector have already declined in the past three months. Nevertheless, we expect that household consumption will still be growing in 2012, although by only 2% in real terms.

With lower growth of wages and a decline in Europe-wide growth of demand, the rise in prices of imported and home-produced goods should decline. While in 2011 the revival of economic growth together with rising prices of imported oil products caused consumer prices to increase by slightly above 5% p.a., for 2012 the inflation rate is expected to amount to only 3.3%.

Although investments increased strongly in 2011, both the corporate and the household sector were still in a process of deleveraging. The combined debt of non-financial enterprises and households declined from 103% of GDP in December 2009 to 80% at the end of 2011; at the same time the gross external debt of the Estonian economy fell from 125% of GDP to slightly below 100%. It should be pointed out that the Estonian share of non-performing loans of 4.5% of total loans is the lowest among the new EU member states.

With economic activity strongly reviving, government revenues increased and the fiscal year 2011 once again ended with a surplus of the general government of more than 1% of GDP. The budget of 2012 foresees a deficit of about 2%, since public investments and social expenditures are planned to rise by about 10%. Moreover, the defence budget is raised to 2% of GDP. In the years thereafter the deficit is to decline again.

The medium-term economic outlook for 2013 and 2014 holds many uncertainties. The value of Estonian goods and services exports amounts to 100% of GDP, which highlights

the strong dependence of economic activity on developments in external markets. Thus even the forecast for 2012 could easily change for the better or worse within the coming months. The insecurity concerning the financial and demand developments in the European Union could bring about an even stronger decline of external demand. However, the latest figures on economic activity in Northern European countries and the USA in early 2012 could be interpreted as a sign that the recessionary expectations prevailing at the end of 2011 may have been too gloomy. In any case, having reduced the external imbalances of the pre-crisis period to a large extent, the Estonian economy today is less vulnerable to shocks in financial markets; also, a worldwide trade deterioration as experienced in 2008 is not likely to come about. Thus we expect that 2012 will be a year of slow GDP growth of only 1.9%. In 2013 and 2014 a slight revival of external demand should bring forth again a positive contribution of net trade, which is expected to give some impulse also to an increase of corporations' investments. Assuming that the growth slowdown in 2012 will cause no major job cuts in the manufacturing sector, we are likely to see a swifter rise in wages again in 2013 and 2014 since the potential of skilled labour force is quite scarce in Estonia. Thus also the growth of household demand is likely to recover rather quickly.

Table EE

Estonia: Selected Economic Indicators

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 ¹⁾ | 2012 | 2013 | 2014 | Forecast |
|---|---------|---------|---------|---------|---------|--------------------|-------|-------|-------|----------|
| Population, th pers., average ²⁾ | 1343.5 | 1341.7 | 1340.7 | 1340.3 | 1340.2 | 1317.5 | 1311 | 1305 | 1298 | |
| Gross domestic product, EUR mn, nom. | 13390.8 | 16069.4 | 16304.2 | 13839.6 | 14305.3 | 16200 | 17100 | 18500 | 20200 | |
| annual change, % (real) | 10.0 | 7.5 | -3.6 | -14.3 | 2.2 | 7.5 | 1.9 | 4 | 5 | |
| GDP/capita (EUR at exchange rate) | 10000 | 12000 | 12200 | 10300 | 10700 | 12300 | . | . | . | |
| GDP/capita (EUR at PPP) | 15600 | 17500 | 17300 | 14900 | 15700 | 17400 | . | . | . | |
| Consumption of households, EUR mn, nom. | 7254.1 | 8517.0 | 8656.9 | 7200.8 | 7235.1 | 7800 | . | . | . | |
| annual change in % (real) | 13.5 | 8.8 | -6.4 | -16.1 | -1.7 | 4.1 | 2 | 2.2 | 3 | |
| Gross fixed capital form., EUR mn, nom. | 4817.4 | 5710.3 | 4846.6 | 2972.8 | 2693.7 | 3350 | . | . | . | |
| annual change in % (real) | 23.0 | 9.3 | -15.1 | -37.8 | -9.1 | 20 | 6 | 7 | 9 | |
| Gross industrial production | | | | | | | | | | |
| annual change in % (real) | 9.9 | 6.4 | -5.2 | -24.0 | 20.9 | 17.8 | 3 | 8 | 10 | |
| Gross agricultural production (EAA) | | | | | | | | | | |
| annual change in % (real) | -2.1 | 12.5 | -1.2 | 2.8 | -4.0 | 1.3 | . | . | . | |
| Construction industry | | | | | | | | | | |
| annual change in % (real) | 26.9 | 13.5 | -13.3 | -29.8 | -12.4 | 22.2 | . | . | . | |
| Employed persons - LFS, th, average | 646.3 | 655.3 | 656.5 | 595.8 | 570.9 | 609.2 | 615 | 630 | 640 | |
| annual change in % | 6.4 | 1.4 | 0.2 | -9.2 | -4.2 | 6.7 | 1 | 2 | 2 | |
| Unemployed persons - LFS, th, average | 40.5 | 32.0 | 38.4 | 95.1 | 115.9 | 86.9 | . | . | . | |
| Unemployment rate - LFS, in %, average | 5.9 | 4.7 | 5.5 | 13.8 | 16.9 | 12.5 | 11.5 | 10 | 9 | |
| Reg. unemployment rate, in %, end of period | 1.9 | 2.2 | 4.6 | 13.3 | 10.1 | 7.3 | . | . | . | |
| Average gross monthly wages, EUR | 601 | 725 | 825 | 784 | 792 | 831 | . | . | . | |
| annual change in % (real, gross) | 11.6 | 13.0 | 3.2 | -4.9 | -1.8 | -0.1 | . | . | . | |
| Consumer prices (HICP), % p.a. | 4.5 | 6.7 | 10.6 | 0.2 | 2.7 | 5.1 | 3.3 | 3.8 | 4 | |
| Producer prices in industry, % p.a. | 4.2 | 8.1 | 8.0 | 0.7 | 3.2 | 4.3 | . | . | . | |
| General governm. budget, EU-def., % GDP | | | | | | | | | | |
| Revenues | 36.1 | 36.4 | 36.5 | 43.2 | 40.9 | 39.3 | 38.5 | 39.5 | 39.0 | |
| Expenditures | 33.6 | 34.0 | 39.5 | 45.2 | 40.6 | 38.0 | 40.5 | 40.0 | 38.5 | |
| Net lending (+) / net borrowing (-) | 2.5 | 2.4 | -2.9 | -2.0 | 0.3 | 1.3 | -2.0 | 0.5 | 0.5 | |
| Public debt, EU-def., in % of GDP | 4.4 | 3.7 | 4.5 | 7.2 | 6.7 | 5.5 | 7 | 6 | 5 | |
| Central bank policy rate, % p.a., end of period ³⁾ | 3.76 | 7.03 | 7.02 | 2.83 | 0.92 | 1.00 | . | . | . | |
| Current account, EUR mn | -2053 | -2563 | -1577 | 513 | 513 | 498 | 0 | -300 | -500 | |
| Current account in % of GDP | -15.3 | -15.9 | -9.7 | 3.7 | 3.6 | 3.1 | 0 | -1.6 | -2.5 | |
| Exports of goods, BOP, EUR mn | 7774 | 8132 | 8542 | 6551 | 8777 | 12084 | 12900 | 14300 | 16300 | |
| annual growth rate in % | 22.5 | 4.6 | 5.0 | -23.3 | 34.0 | 38 | 7 | 11 | 14 | |
| Imports of goods, BOP, EUR mn | 10078 | 10774 | 10664 | 7109 | 9028 | 12251 | 13200 | 14700 | 17300 | |
| annual growth rate in % | 27.6 | 6.9 | -1.0 | -33.3 | 27.0 | 36 | 8 | 11 | 18 | |
| Exports of services, BOP, EUR mn | 2871 | 3289 | 3537 | 3174 | 3422 | 3974 | 4100 | 4400 | 4900 | |
| annual growth rate in % | 9.9 | 14.6 | 7.5 | -10.3 | 7.8 | 16 | 3 | 7 | 11 | |
| Imports of services, BOP, EUR mn | 1980 | 2247 | 2293 | 1815 | 2109 | 2696 | 2800 | 3000 | 3400 | |
| annual growth rate in % | 11.7 | 13.5 | 2.0 | -20.8 | 16.2 | 28 | 4 | 7 | 13 | |
| FDI inflow, EUR mn | 1432 | 1986 | 1181 | 1323 | 1162 | 249 | . | . | . | |
| FDI outflow, EUR mn | 880 | 1277 | 761 | 1115 | 100 | -1121 | . | . | . | |
| Gross reserves of NB excl. gold, EUR mn ⁴⁾ | 2115 | 2236 | 2814 | 2758 | 1904 | 150 | . | . | . | |
| Gross external debt, EUR mn | 12944 | 17406 | 19039 | 17256 | 16481 | 15650 | . | . | . | |
| Gross external debt in % of GDP | 96.7 | 108.3 | 116.8 | 124.7 | 115.2 | 96.6 | . | . | . | |
| 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 | 0.6388 | 0.6834 | 0.7020 | 0.6922 | 0.6808 | 0.7060 | . | . | . | |

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). 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 and wiw estimates. - 2) Estimation based on population census 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: wiw Database incorporating Eurostat and national statistics. Forecasts by wiw.