



ESTONIA: Will the tide come in again?

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In Estonia the prospects facing exporters are slim where the neighbouring countries to the east and the north are concerned. Household consumption provides life support to GDP growth estimated at 1.7% for 2014, while the current account deficit remains low at 1.6% of GDP. The government's hesitant expenditure policy will result in a budget close to balance.

In the first half of 2014 exports kept on falling. Not only trade with Russia remained low, due to the sluggish economic activity in the neighbouring country, but also exports to Finland. The latter country, being Estonia's second most important trading partner, has been in recession since 2012 and is expected to escape the crisis only in the course of 2015. The austerity policy of the government in Finland – a country that is also hit hard by the Russian sanctions – lowers the export chances of Estonian producers. Meanwhile exports to Sweden, Estonia's most important trading partner, started to grow again in the second quarter of this year. The Swedish GDP is still expected to rise by 1.7% in 2014 and gain momentum in the coming year. The incoming left-wing coalition government in Sweden is likely to raise public investment in 2015. Overall we expect Estonian export dynamics to remain negative in the second half of the year. The Russian economic sanctions will particularly hit the dairy sector (24% of total exports of this industry were directed to Russia in 2013) and, to a smaller extent, meat and fish producers. However, also the transport and wholesale sectors will be affected negatively by lower direct exports and transit trade. In addition, demand from the euro area countries remains sluggish.

Although consumer demand continues to grow swiftly, imports of goods and services are on the decline. The main reason for this is the restraint of producers to invest. Although the capacity utilisation rate has increased to almost 75% recently, the prospects of exporting firms are, as already mentioned, further deteriorating. Likewise, the public sector remains reluctant to invest and will remain so during 2015. The only sector increasing its investment outlays is for the time being the household sector. Households started to increase their loan burden in order to invest in real estate.

While overall growth in economic activity slowed down the unemployment rate kept on falling and will continue to do so throughout 2014 and in the coming two years alike. The working-age population is expected to fall by about 3% within the next five years, equivalent to 30 thousand persons. The negative migration balance adds to the natural decrease of the population. This will aggravate particularly the scarcity of the highly skilled labour force. Nevertheless, participation rates of both men and women could still be increased. Another effect of the shrinking working-age population is the ongoing rise in wage levels. In the first half of 2014 monthly wages increased by 5.7% in real terms on average and particularly strongly in the private and public service sectors.

At the same time consumer price inflation has turned negative in the most recent months. The Russian sanctions on meat, fruits and dairy products will lead to higher competition and thus also price levels are to fall further for food and beverages this year and throughout 2015.

Low consumer inflation and strongly rising incomes keep households in a good spending mood. Retail figures show an upswing in the acquisition of consumer durables that are also financed by consumer credits. Although we expect the increase in gross wages to abate slightly in the coming months, household consumption will remain the main driver of Estonia's economic growth up to 2016.

In September the government agreed upon a draft budget for 2015 foreseeing a structural surplus of 0.6% of GDP. The flat income tax rate is planned to be reduced by 1 percentage point to 20% from January next year onwards, while the unemployment insurance contribution will decline from 3% to 2.4%. On the expenditure side, above-average increases are foreseen for the ministries of defence (whose budget exceeds 2% of GDP) and internal affairs, while the budget proposal includes a doubling of the monthly child benefits and an increase in minimum pensions by 6% nominally to EUR 374 per month.

The next parliamentary elections are scheduled for March 2015. According to the latest polls the ruling centre-right Reform Party and its coalition partner, the Social Democrats, are running head to head; the Centre Party has been in opposition in the past three years. However, a change in government will not lead to significant modifications of the economic and fiscal policies conducted.

More lively household consumption and lower import activity than expected result in an upward revision of the GDP forecast for 2014 to 1.7%. In the coming two years, the government of Estonia –the country with the highest per capita allocations from EU funds in the period 2014-2020 – will be eager to use the resources as soon as possible for public infrastructure. Thus public investment activity is expected to rise already towards the end of 2015 and particularly in 2016. In both years however, household consumption will still remain the most important driver of economic activity. For 2015 we expect GDP to grow by 2% and in 2016 by 2.9%.

Table 1 / Estonia: Selected Economic Indicators

	2010	2011	2012	2013 ¹⁾	2013 January-June	2014	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average ²⁾	1,331	1,327	1,323	1,318	.	.	1,310	1,305	1,300
Gross domestic product, EUR mn, nom. ³⁾	14,708	16,404	17,637	18,739	9,084	9,450	19,100	19,800	20,800
annual change in % (real) ³⁾	2.5	8.3	4.7	1.6	2.3	1.4	1.7	2.0	2.9
GDP/capita (EUR at exchange rate)	11,000	12,400	13,300	14,200	.	.	.	.	.
GDP/capita (EUR at PPP)	16,100	17,700	18,700	19,600	.	.	.	.	.
Consumption of households, EUR mn, nom. ³⁾	7,482	8,054	8,759	9,373	4,638	4,862	.	.	.
annual change in % (real) ³⁾	-1.6	2.3	5.1	3.8	4.6	3.6	3.2	3.1	3.0
Gross fixed capital form., EUR mn, nom. ³⁾	3,125	4,226	4,759	5,118	2,187	2,319	.	.	.
annual change in % (real) ³⁾	-2.6	33.0	10.4	2.5	1.5	4.9	2.0	3.0	5.0
Gross industrial production									
annual change in % (real)	23.6	19.9	1.0	2.9	3.3	-0.2	0.3	2.0	3.0
Gross agricultural production									
annual change in % (real)	-4.0	9.7	5.6	2.8	.	.	.	.	.
Construction industry									
annual change in % (real)	-8.5	27.3	16.5	0.8	0.9	-3.8	.	.	.
Employed persons, LFS, th, average ⁴⁾	570.9	609.1	614.9	621.3	621.1	615.1	615	610	605
annual change in %	-4.2	6.7	1.9	1.0	1.9	-1.0	-1.0	-0.8	-0.8
Unemployed persons, LFS, th, average ⁴⁾	115.9	86.8	68.5	58.7	61.3	51.6	50	46	42
Unemployment rate, LFS, in %, average ⁴⁾	16.9	12.5	10.0	8.6	9.0	7.7	7.5	7.0	6.5
Reg. unemployment rate, in %, end of period	10.2	7.4	6.2	5.3	5.6	4.4	.	.	.
Average monthly gross wages, EUR	792	839	887	949	938	994	.	.	.
annual change in % (real, gross)	-1.8	0.9	1.7	4.0	3.8	5.7	.	.	.
Average monthly net wages, EUR	637	672	706	757	750	790	.	.	.
annual change in % (real, net)	-2.9	0.5	1.1	4.9	4.0	5.1	.	.	.
Consumer prices (HICP), % p.a.	2.7	5.1	4.2	3.2	3.8	0.9	0.4	1.5	2.2
Producer prices in industry, % p.a.	3.2	4.2	2.6	7.3	7.8	-3.2	.	.	.
General governm. budget, EU-def., % of GDP									
Revenues	39.7	38.2	38.7	37.5	.	.	37.2	37.2	37.2
Expenditures	39.5	37.1	39.0	37.7	.	.	37.7	37.7	37.3
Net lending (+) / net borrowing (-)	0.2	1.1	-0.2	-0.2	.	.	-0.5	-0.5	-0.1
Public debt, EU-def., % of GDP	6.5	6.0	9.7	9.8	.	.	10.1	9.9	9.5
Central bank policy rate, % p.a., end of period ⁵⁾	0.92	1.00	0.75	0.25	0.50	0.15	.	.	.
Current account, EUR mn ⁶⁾	265	-6	-364	-261	-110	-122	-300	-400	-600
Current account, % of GDP	1.8	0.0	-2.1	-1.4	-1.2	-1.3	-1.6	-2.0	-2.9
Exports of goods, BOP, EUR mn ⁶⁾	7,482	10,228	11,340	11,460	5,785	5,681	11,500	12,500	13,200
annual change in %	41.3	36.7	10.9	1.1	6.5	-1.8	0.0	9.0	6.0
Imports of goods, BOP, EUR mn ⁶⁾	7,887	10,839	12,414	12,466	6,253	6,142	12,500	13,700	14,800
annual change in %	31.0	37.4	14.5	0.4	5.2	-1.8	0.0	10.0	8.0
Exports of services, BOP, EUR mn ⁶⁾	3,567	4,083	4,461	4,746	2,236	2,398	4,900	5,120	5,500
annual change in %	7.9	14.4	9.3	6.4	5.0	7.3	3.0	4.0	7.0
Imports of services, BOP, EUR mn ⁶⁾	2,226	2,746	3,137	3,520	1,660	1,744	3,700	4,100	4,500
annual change in %	18.5	23.4	14.2	12.2	14.2	5.0	5.0	11.0	10.0
FDI inflow (liabilities), EUR mn ⁶⁾	1,587	941	1,293	674	591	520	700	.	.
FDI outflow (assets), EUR mn ⁶⁾	437	-900	1,005	508	411	268	400	.	.
Gross reserves of NB excl. gold, EUR mn ⁷⁾	1,904	150	218	222	196	309	.	.	.
Gross external debt, EUR mn ⁶⁾	16,492	16,721	17,966	17,540	17,738	18,948	.	.	.
Gross external debt, % of GDP	112.1	101.9	101.9	93.6	94.7	99.2	.	.	.
Purchasing power parity EUR/EUR	0.6871	0.6967	0.7136	0.7398	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 6) BOP 6th edition. - 7) 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.