



ESTONIA: Growth remains below potential

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Given the sluggish external demand, economic growth in 2015 compared to the previous year is not expected to accelerate. However, an increase in earnings and thus household consumption will keep the economy afloat, which is projected to grow by 2% in 2015. From 2016 onwards, we expect an investment revival and positive developments in terms of exports.

The dampening effect of the Russian embargo on European Union exports of food products in 2014 was less severe than expected for the Estonian economy; nevertheless it slowed down export growth. However, the recession of the neighbouring economy and the depreciation of the Russian rouble will have a more severe impact on Estonian exports and transit trade in 2015. By contrast, economic activity is accelerating in Sweden, Estonia's most important trading partner, while the northern neighbour Finland will move out of a four-year recessionary period only in 2016.

On account of the sluggish external demand, industrial production has developed at a slow pace, increasing below productivity growth. Thus the investment activity of the enterprise sector will remain subdued also throughout 2015 – idle capacity prevails in the manufacturing sector. Moreover, the government refrains from giving the economy an additional stimulus and plans to keep public investments at the level of 2014 in real terms.

The budget plan of the Estonian government for 2015 foresees the budget deficit to remain stable at 0.5% of GDP. From January 2015 onwards the flat personal income tax rate was reduced from 21% to 20%, the support for children was doubled and public pensions were raised by about 6%. The average old-age pension thus amounts to EUR 374 this year. Commenting on the draft budgetary plans of the Estonian government, the European Commission again pointed out that the high tax wedge for low-income earners should be reduced in order to ease job creation for this group of the work force. However, the cut in income and unemployment tax enacted in the budget plan of 2015 are not targeted at low-wage earners.

Towards the end of last year the unemployment rate fell below 7% of the workforce. The increase in employment still taking place in 2014 has come to an end. Demographic developments will result in a slight decrease of the workforce in the coming years. However, unemployment rates will continue to fall throughout the period 2015 to 2017.

The shortage of skilled workforce will keep wages growing at a remarkable pace also in 2015 and the following year, particularly in the services sectors. The slow increase in consumer prices will lift net

earnings of households by more than 6% in real terms this year. The drop in energy prices resulted in a deflationary period in the second half of 2014. We expect prices to strengthen in the second half of 2015.

Household consumption will remain the most important driver of GDP growth in the coming two years. From 2016 onwards we expect the external environment of the Estonian economy to improve. With a revival in the price of crude oil the Russian economy should gain momentum and thus lift also the prospects for Finland. Recovering external demand will result in an upswing in investments in the Estonian manufacturing sector. Moreover, public investments will increase thereupon with the availability of new co-financing from EU funds for the period 2014-2020. We therefore expect GDP growth to remain somewhat sluggish with 2% in 2015. For 2016 and 2017 we forecast an upswing to 2.5% and 3.1%, respectively, a slight downward revision compared to our autumn forecast.

Table 1 / Estonia: Selected Economic Indicators

	2010	2011	2012	2013	2014 ¹⁾	2015	2016	2017
						Forecast		
Population, th pers., average ²⁾	1,331	1,327	1,323	1,318	1,310	1,305	1,300	1,295
Gross domestic product, EUR mn, nom. ³⁾	14,709	16,404	17,637	18,739	19,200	19,700	20,600	21,900
annual change in % (real) ³⁾	2.5	8.3	4.7	1.6	1.8	2.0	2.5	3.1
GDP/capita (EUR at exchange rate)	11,000	12,400	13,300	14,200	14,700	15,100	15,800	16,900
GDP/capita (EUR at PPP)	16,100	17,700	18,700	19,200	19,800	.	.	.
Consumption of households, EUR mn, nom. ³⁾	7,480	8,054	8,759	9,373	9,790	.	.	.
annual change in % (real) ³⁾	-1.6	2.3	5.1	3.8	3.9	3.7	3.5	3.3
Gross fixed capital form., EUR mn, nom. ³⁾	3,125	4,226	4,759	5,118	5,030	.	.	.
annual change in % (real) ³⁾	-2.6	33.0	10.4	2.5	1.0	1.0	4.0	5.0
Gross industrial production								
annual change in % (real)	23.6	19.9	1.0	2.9	2.0	3.0	4.0	6.0
Gross agricultural production								
annual change in % (real)	-4.0	9.7	5.6	4.7	1.8	.	.	.
Construction industry								
annual change in % (real)	-8.5	27.3	16.5	0.8	-4.5	.	.	.
Employed persons, LFS, th, average ⁴⁾	570.9	609.1	614.9	621.3	625.0	625	620	615
annual change in %	-4.2	6.7	1.9	1.0	0.6	0.0	-0.8	-0.8
Unemployed persons, LFS, th, average ⁴⁾	115.9	86.8	68.5	58.7	50.0	44	40	38
Unemployment rate, LFS, in %, average ⁴⁾	16.9	12.5	10.0	8.6	7.4	6.6	6.1	5.8
Reg. unemployment rate, in %, end of period	10.2	7.4	6.2	5.3	4.3	.	.	.
Average monthly gross wages, EUR	792	839	887	949	1,000	.	.	.
annual change in % (real, gross)	-1.8	0.9	1.7	4.1	5.5	.	.	.
Average monthly net wages, EUR	637	672	706	757	798	.	.	.
annual change in % (real, net)	-2.9	0.5	1.1	4.3	5.5	.	.	.
Consumer prices (HICP), % p.a.	2.7	5.1	4.2	3.2	0.5	0.8	2.2	3.0
Producer prices in industry, % p.a.	3.2	4.2	2.6	7.3	-2.7	.	.	.
General governm. budget, EU-def., % of GDP								
Revenues	40.6	39.1	39.5	38.4	38.2	38.5	38.2	38.0
Expenditures	40.4	38.0	39.7	38.9	38.7	39.0	38.5	38.3
Net lending (+) / net borrowing (-)	0.2	1.0	-0.3	-0.5	-0.5	-0.5	-0.3	-0.3
Public debt, EU-def., % of GDP	6.5	6.0	9.7	10.1	10.0	9.7	9.4	9.0
Central bank policy rate, % p.a., end of period ⁵⁾	0.92	1.00	0.75	0.25	0.05	.	.	.
Current account, EUR mn ⁶⁾	266	223	-439	-211	-166	-300	-450	-500
Current account, % of GDP	1.8	1.4	-2.5	-1.1	-0.9	-1.5	-2.2	-2.3
Exports of goods, BOP, EUR mn ⁶⁾	7,482	10,384	11,104	11,387	11,422	11,400	12,000	12,700
annual change in %	41.3	38.8	6.9	2.6	0.3	-0.2	5.3	5.8
Imports of goods, BOP, EUR mn ⁶⁾	7,886	10,735	12,283	12,341	12,428	12,600	13,200	14,000
annual change in %	31.0	36.1	14.4	0.5	0.7	1.4	4.8	6.1
Exports of services, BOP, EUR mn ⁶⁾	3,567	4,040	4,486	4,745	5,050	5,250	5,560	5,850
annual change in %	7.9	13.3	11.0	5.8	6.4	4.0	5.9	5.2
Imports of services, BOP, EUR mn ⁶⁾	2,225	2,734	3,131	3,520	3,584	3,660	3,780	3,930
annual change in %	18.4	22.9	14.5	12.4	1.8	2.1	3.3	4.0
FDI inflow (liabilities), EUR mn ⁶⁾	1,936	818	1,394	672	1,114	.	.	.
FDI outflow (assets), EUR mn ⁶⁾	923	-951	996	538	575	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁷⁾	1,904	150	218	222	352	.	.	.
Gross external debt, EUR mn ⁶⁾	16,492	16,721	17,966	17,515	19,100	.	.	.
Gross external debt, % of GDP	112.1	101.9	101.9	93.5	99.5	.	.	.
Purchasing power parity EUR/EUR	0.6871	0.6967	0.7136	0.7398	0.7388	.	.	.

1) Preliminary and wiiw estimates. - 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.