

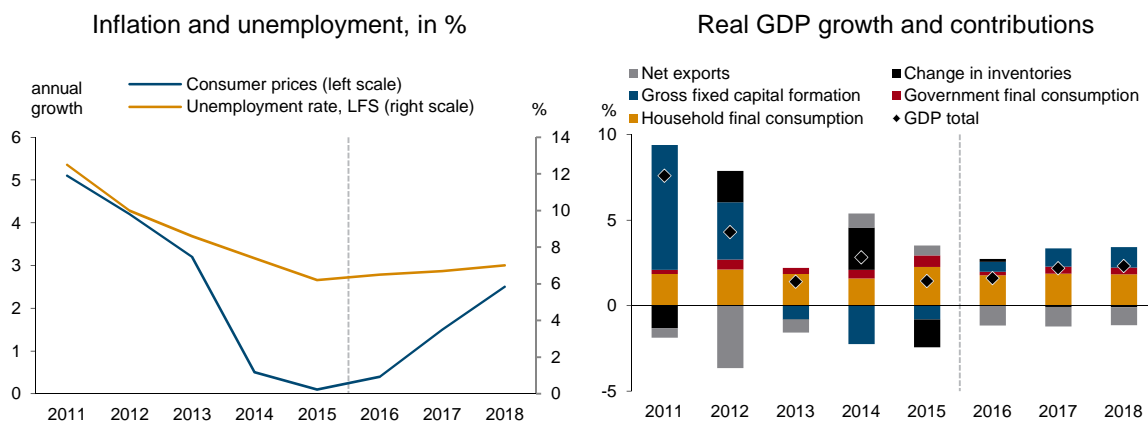


ESTONIA: Investment and exports to gain momentum

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Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. For the two years ahead we expect a recovery in terms of trade with Western markets, while the decline in exports to Russia has already steadied. Moreover, an upswing in public investments should also speed up economic activity next year. GDP growth is projected to increase from 1.6% in 2016 to 2.2% in 2017.

Figure 29 / Estonia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Estonian exporters have experienced a slight tailwind in the past months, goods volumes have increased year on year, while prices are still on the decline. Particularly goods and services exports to Russia are stabilising gradually after having dropped by more than a third in 2015. The economy of neighbouring Sweden is continuously flourishing at an average growth rate of 3% per annum, while Finland came out of a three-year recession period last year and is expected to grow by about 1% this year and in 2017, respectively. Exports to the third-most important trade partner, Latvia, are ailing on account of a slump in investment in the neighbouring country. Low oil prices render the production of shale oil – Estonia's second-most important export product – inefficient. As a result, mostly shale oil-based electricity production is gradually declining due to higher electricity imports from Finland. Overall, we expect exports to continue to recover towards the end of this year and further on in 2017. However, imports will grow even more strongly, dragging down overall GDP growth.

Investment activity of the enterprise sector slightly increased in the first half of 2016 and will continue to do so. On the one hand, external demand and industrial production are still developing rather sluggishly; on the other hand, activity in the construction sector has gained momentum. Data on building permits and mortgage loan growth suggest that dwelling construction will continue to rise this year and in 2017. Public investments will strongly increase in 2017. At the end of September 2016, the Estonian government approved the draft state budget of 2017, expecting additional EU funds for public and private investments of 2% to 3% of GDP. Moreover, the government plans to introduce various measures to lower the income tax burden, such as a reduction of the employer social security contributions by 1 percentage point to 32% over the coming two years and establishing an income tax refund for low-income groups. Overall, the budget is foreseen to remain slightly in surplus in 2017 and a further reduction of the public debt burden is envisaged, which will be below 10% of GDP already this year.

The recovery in the years after the bust in 2008/2009 brought about a continuous decline in the unemployment rate, to 6.2% in 2015. This improvement of the labour market situation started to stumble in the first half of 2016. While employment in the services sectors went on rising, it fell particularly in the shale oil and energy industry. The work ability reform, launched in July 2016, will increase the number of people registered as unemployed. In order to continue receiving benefits, persons that have been qualifying for work incapacity pensions up to now have to look more actively for jobs and take part in public activation measures. This is expected to increase both activity rates but also unemployment rates since only part of those having to look for a job will finally find employment. Demographic statistics show that net emigration, which was substantial in the years after the economic crisis, has finally come to a halt in Estonia.

Strongly increasing real net wages (up 8.5% in the first half of 2016) are further pushing consumption activity of Estonian households upwards; we expect an increase of 3.5% in real terms in 2016 and a slight upswing in the coming years. Forward-looking consumer confidence indicators show an improvement throughout the year 2016 and most recent retail trade and credit statistics indicate an increasing propensity to spend. Monthly wages will keep on growing strongly, not least due to another planned increase in the minimum wage by 10% at the beginning of 2017, following a hike of the same magnitude at the beginning of 2016. Nevertheless, the ratio of the minimum wage to the national average wage is still one of the lowest in the European Union.

Consumer prices have started to increase slightly in recent months. However, the upward price movement is mostly caused by an increase in excise taxes. The downward pressure of falling energy prices is fading, while the core inflation rate is still rather low despite the fast growth of wages. In 2017 consumer prices will rise again more swiftly.

Due to an unexpectedly poor performance in the second quarter of this year we had to revise our forecast for GDP growth in Estonia in 2016 to 1.6% in real terms. An upswing in external demand is in sight but delayed and private investment activity is still ailing. For 2017 and 2018 we forecast an upswing to 2.2% and 2.3%, respectively. We expect a recovery of external demand mostly from Western trade partners, while the decline in exports to Russia should come to a halt. A strong upswing in investments will be facilitated from 2017 onwards by increasing inflows of EU funds.

Table 12 / Estonia: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	1,323	1,318	1,315	1,315	.	.	1,310	1,305	1,300
Gross domestic product, EUR mn, nom.	17,935	18,890	19,758	20,252	9,824	10,099	20,700	21,500	22,500
annual change in % (real)	4.3	1.4	2.8	1.4	1.6	1.1	1.6	2.2	2.3
GDP/capita (EUR at exchange rate)	13,500	14,300	15,000	15,400	.	.	15,800	16,500	17,300
GDP/capita (EUR at PPP)	19,500	19,900	20,700	21,200	.	.	.	.	.
Consumption of households, EUR mn, nom.	8,885	9,465	9,818	10,267	5,120	5,309	.	.	.
annual change in % (real)	4.3	3.7	3.2	4.6	5.6	3.4	3.5	3.7	3.6
Gross fixed capital form., EUR mn, nom.	5,128	5,206	4,814	4,790	2,153	2,170	.	.	.
annual change in % (real)	12.7	-2.8	-8.1	-3.3	-5.8	2.4	2.5	4.5	5.0
Gross industrial production									
annual change in % (real)	1.1	4.1	3.9	-2.2	0.1	-1.5	-1.2	2.5	3.0
Gross agricultural production									
annual change in % (real)	5.6	4.7	4.6	4.0	.	.	.	.	.
Construction industry									
annual change in % (real)	16.7	-0.1	-2.1	-5.3	-4.8	3.9	.	.	.
Employed persons, LFS, th, average	614.9	621.3	624.8	640.9	631.6	643.5	650	655	660
annual change in %	1.9	1.0	0.6	2.6	2.3	1.9	1.4	0.8	0.8
Unemployed persons, LFS, th, average	68.5	58.7	49.6	42.3	44.3	44.5	45	47	50
Unemployment rate, LFS, in %, average	10.0	8.6	7.4	6.2	6.6	6.5	6.5	6.7	7.0
Reg. unemployment rate, in %, end of period ²⁾	6.2	5.3	4.4	4.7	4.1	4.3	.	.	.
Average monthly gross wages, EUR	887	949	1,005	1,065	1,046	1,127	1,140	1,230	1,320
annual change in % (real, gross)	1.7	4.1	6.0	6.5	5.6	8.4	7.0	6.0	5.0
Average monthly net wages, EUR	706	757	799	859	843	910	920	980	1,030
annual change in % (real, net)	1.1	4.3	5.7	8.0	7.2	8.5	6.5	4.5	2.5
Consumer prices (HICP), % p.a.	4.2	3.2	0.5	0.1	0.1	0.2	0.4	1.5	2.5
Producer prices in industry, % p.a.	2.7	7.2	-2.7	-3.0	-2.2	-2.2	-2.0	1.0	2.0
General governm. budget, EU-def., % of GDP									
Revenues	39.0	38.4	39.1	40.4	.	.	38.7	38.5	38.6
Expenditures	39.2	38.5	38.4	39.9	.	.	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.3	-0.2	0.8	0.5	.	.	-0.3	-0.5	-0.4
Public debt, EU-def., % of GDP	9.6	10.0	10.5	9.8	.	.	10.0	9.0	8.0
Central bank policy rate, % p.a., end of period ³⁾	0.75	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-350	-66	182	447	196	19	-50	-400	-800
Current account, % of GDP	-1.9	-0.4	0.9	2.2	2.0	0.2	-0.2	-1.9	-3.6
Exports of goods, BOP, EUR mn	10,750	11,080	11,089	10,853	5,405	5,467	11,100	11,500	12,000
annual change in %	3.5	3.1	0.1	-2.1	0.2	1.1	2.3	3.6	4.3
Imports of goods, BOP, EUR mn	12,030	12,057	12,092	11,714	5,762	5,970	12,230	12,800	13,400
annual change in %	12.1	0.2	0.3	-3.1	-2.5	3.6	4.4	4.7	4.7
Exports of services, BOP, EUR mn	4,672	4,876	5,322	5,204	2,476	2,553	5,480	5,770	6,000
annual change in %	15.7	4.4	9.1	-2.2	-1.2	3.1	5.3	5.3	4.0
Imports of services, BOP, EUR mn	3,115	3,534	3,623	3,502	1,700	1,781	3,690	3,840	4,000
annual change in %	13.9	13.5	2.5	-3.3	-2.1	4.8	5.4	4.1	4.2
FDI liabilities (inflow), EUR mn	1,394	820	1,252	-597	-774	350	400	.	.
FDI assets (outflow), EUR mn	996	635	677	-423	-585	218	300	.	.
Gross reserves of NB excl. gold, EUR mn	218	222	352	373	336	418	.	.	.
Gross external debt, EUR mn	17,957	17,593	19,101	19,208	19,831	19,566	19,500	19,800	20,700
Gross external debt, % of GDP	100.1	93.1	96.7	94.8	97.9	94.5	94.0	92.0	92.0
Purchasing power parity EUR/EUR	0.6944	0.7195	0.7252	0.7284	.	.	.	.	.

1) Preliminary. - 2) In % of labour force (LFS). - 3) Official refinancing operation rate for euro area (ECB).

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