

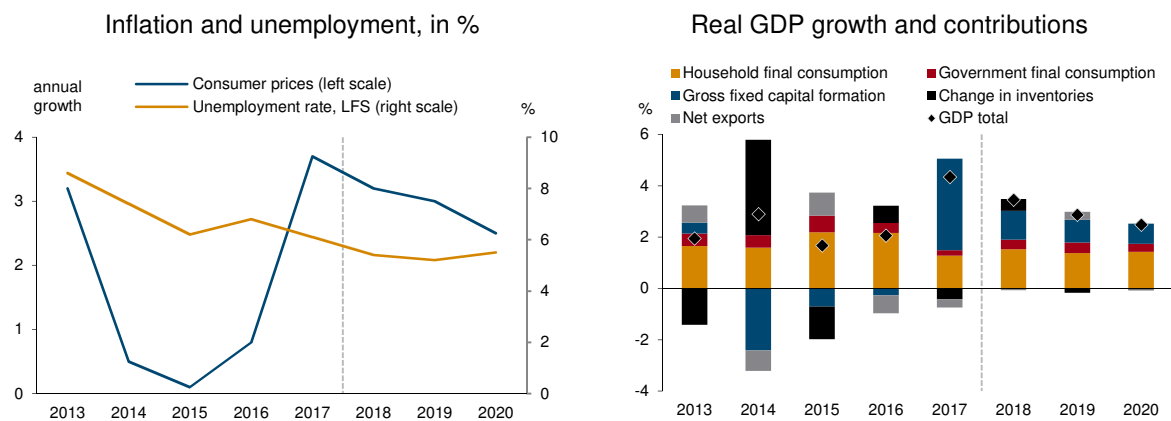


ESTONIA: Investment keeps growth in high gear

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Investment activity picked up more strongly than expected in both the private and the public sectors, pushing GDP growth to 4.3% in 2017. Although it has already peaked, economic activity will remain vibrant in 2018 and thereafter. External demand will continue to grow at a good pace, though somewhat more slowly than last year. Household consumption, backed by a considerable rise in real wages and tax cuts, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.5% in 2018 and 2.9% in 2019, declining somewhat to 2.5% in 2020.

Figure 46 / Estonia: Main macroeconomic indicators



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

Investment activity in the public and private sectors will keep on supporting growth in 2018 and 2019. In 2017, increasing inflows of fresh EU funds from the 2014-2020 programming period allowed the government to increase capital outlays substantially, particularly in road and railway infrastructure. The 2018 budget foresees a further rise in public investment, to 5.6% of GDP, and a stabilisation at that level thereafter. Rising expenditure will be devoted to defence and the health sector. The government foresees a budget deficit of 0.3% for 2018, and a further reduction in public debt to close to 8% of GDP is to be expected by 2019. Private investment by both enterprises and households will continue to develop swiftly in 2018. Given the favourable demand situation and still rising levels of sentiment, entrepreneurs are increasing their investments in equipment and buildings. Building permits for dwellings and non-residential buildings suggest that construction activity will flourish in 2018. Growing

wages and very low interest rates – the average interest rate on housing loans was 2.3% in December 2017 – have resulted in a double-digit increase in new credits for households. Apartment prices, which are rising swiftly at the moment, have reached pre-crisis levels in Tallinn. Today, however, the situation is less overheated than in the boom years before 2008, the financial situation of households is more stable and there is no credit bubble in sight.

Export activity evolved dynamically throughout 2017 and is expected to keep going this year, too. In particular, goods exports to Russia gained strongly in momentum, increasing by more than 20% nominally in 2017. This also fosters growth in services exports, since transit trade with Russia has revived as well. Moreover, activity in the tourism industry has regained its momentum. In the coming years, Russian import growth will slow (see country report on Russia). The economy of neighbouring Sweden is expected to expand at close to 3% per annum in 2018, in line with that of Finland, which has lately experienced new dynamism. Export activity to neighbouring Latvia and Lithuania has also regained momentum. Only the highly export-oriented machinery and electronics industry is currently suffering from sector-specific low external demand. Rising wages are putting pressure on assembly work performed in Estonia for Nordic firms. In order to remain competitive, Estonian producers will have to move up the value-added chain. Overall, in 2018 we expect growth in goods exports to keep pace with last year, but to level off in 2019 and 2020. Given the swiftly rising household incomes, imports should increase even more strongly than exports.

The unemployment rate continued to decline slightly to 6% through 2017, while the employment rate has almost attained the level of the Scandinavian economies. While employment in the services sectors has continued to rise, it is stagnant in agriculture and industry. The work ability reform of 2016 forced people who had previously received incapacity pensions to look more actively for jobs. This temporarily increased the labour supply and the unemployment rate. However, the recent strong labour demand resulted in declining unemployment in 2017, and will lead to a further fall in the unemployment rate to close to 5% in the coming two years. Moreover, the employment rate among those aged 15 to 64 years increased to over 73% of the population in 2017; on that indicator, Estonia ranks 7th among the EU countries.

The increase in real net wages dropped to 3.5% in 2017 year on year, but still pushed household consumption upwards. We expect the pace of growth to remain at that level in real terms in 2018, too. Consumer inflation rose throughout last year, and in December 2017 the rate was even 3.8% year on year. However, the upward price movement was mostly caused by an increase in excise taxes and by rising energy prices. In 2018, consumer prices will continue to rise more swiftly, pushed up by rising import prices. Forward-looking consumer confidence indicators show an improvement at the beginning of 2018, and the most recent retail trade and credit statistics indicate a good spending mood. Monthly incomes will continue to grow considerably in 2018, not least thanks to another increase in the monthly minimum wage from January 2018 to EUR 500. Moreover, the government's 2018 budget contains additional measures to reduce the income tax burden – in particular, an increase in the non-taxable basic exemption from EUR 180 to EUR 500, which substantially increases the net income of low- and middle-income earners.

Overall, GDP growth will remain strong in 2018. The 2017 GDP growth of 4.3% in real terms was somewhat higher than forecast, due to an unexpectedly sharp upswing in public and private investment and strong export demand from Russia and the euro area. An ongoing good (though somewhat slower) growth in public investments both this year and in 2019 will be facilitated by increasing inflows of EU funds. Private investment in construction and equipment will foster growth, but external demand will also remain quite lively in 2018. Rising private income will also help household consumption to grow swiftly. Thus, for 2018 we forecast real GDP growth to remain strong at 3.5%; due to a flattening of the investment cycle and lower external demand activity, we expect economic activity to calm down slightly in 2019 (2.9%) and 2020 (2.5%).

Table 16 / Estonia: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018	2019	2020
						Forecast		
Population, th pers., average	1,318	1,315	1,315	1,316	1,315	1,318	1,320	1,322
Gross domestic product, EUR mn, nom.	18,932	19,766	20,348	21,098	22,800	24,300	25,700	27,000
annual change in % (real)	1.9	2.9	1.7	2.1	4.3	3.5	2.9	2.5
GDP/capita (EUR at PPP)	20,200	21,000	21,700	21,900	22,900	.	.	.
Consumption of households, EUR mn, nom.	9,457	9,813	10,232	10,771	11,400	.	.	.
annual change in % (real)	3.3	3.2	4.4	4.3	2.5	3.0	2.7	2.8
Gross fixed capital form., EUR mn, nom.	5,253	4,829	4,807	4,712	5,700	.	.	.
annual change in % (real)	1.5	-8.7	-2.9	-1.2	16.0	5.0	4.0	3.5
Gross industrial production								
annual change in % (real)	4.1	3.9	0.3	2.4	7.7	7.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	4.7	4.6	8.7	-17.2	7.4	.	.	.
Construction industry								
annual change in % (real)	-0.1	-2.1	-3.4	2.6	20.0	.	.	.
Employed persons, LFS, th, average	621.3	624.8	640.9	644.6	655.0	660	665	668
annual change in %	1.0	0.6	2.6	0.6	1.6	0.8	0.8	0.5
Unemployed persons, LFS, th, average	58.7	49.6	42.3	46.7	42.0	38	37	39
Unemployment rate, LFS, in %, average	8.6	7.4	6.2	6.8	6.1	5.4	5.2	5.5
Reg. unemployment rate, in %, eop ²⁾	5.3	4.4	4.7	4.4	4.8	.	.	.
Average monthly gross wages, EUR	949	1,005	1,065	1,146	1,226	1,320	1,410	1,500
annual change in % (real, gross)	4.1	6.0	6.5	7.4	3.5	4.0	4.0	3.5
Average monthly net wages, EUR	757	799	859	924	985	1,050	1,120	1,190
annual change in % (real, net)	4.3	5.7	8.0	7.4	3.0	3.5	4.0	3.5
Consumer prices (HICP), % p.a.	3.2	0.5	0.1	0.8	3.7	3.2	3.0	2.5
Producer prices in industry, % p.a.	7.2	-2.7	-3.0	-1.3	3.0	3.2	3.0	2.5
General governm. budget, EU-def., % of GDP								
Revenues	38.3	39.1	40.3	40.3	39.5	38.6	38.6	38.6
Expenditures	38.5	38.4	40.2	40.6	40.0	39.0	38.8	38.6
Net lending (+) / net borrowing (-)	-0.2	0.7	0.1	-0.3	-0.5	-0.4	-0.2	0.0
General gov.gross debt, EU def., % of GDP	10.2	10.7	10.0	9.4	9.0	8.5	8.0	8.0
Stock of loans of non-fin.private sector, % p.a.	0.7	2.6	4.8	6.6	0.7	.	.	.
Non-performing loans (NPL), in %, eop	1.7	1.5	1.1	1.0	0.8	.	.	.
Central bank policy rate, % p.a., eop ³⁾	0.25	0.05	0.05	0.00	0.00	.	.	.
Current account, EUR mn	99	51	398	400	610	333	183	229
Current account, % of GDP	0.5	0.3	2.0	1.9	2.7	1.4	0.7	0.8
Exports of goods, BOP, EUR mn	10,968	10,998	10,757	11,168	11,820	13,100	13,800	14,490
annual change in %	2.0	0.3	-2.2	3.8	5.8	10.8	5.3	5.0
Imports of goods, BOP, EUR mn	11,893	12,089	11,612	11,958	12,754	13,900	14,900	15,645
annual change in %	-1.1	1.6	-3.9	3.0	6.7	9.0	7.2	5.0
Exports of services, BOP, EUR mn	4,992	5,323	5,237	5,496	6,058	6,400	6,800	7,140
annual change in %	6.8	6.6	-1.6	4.9	10.2	5.6	6.3	5.0
Imports of services, BOP, EUR mn	3,535	3,673	3,568	3,892	4,148	4,500	4,800	5,040
annual change in %	13.5	3.9	-2.9	9.1	6.6	8.5	6.7	5.0
FDI liabilities, EUR mn	834	1,308	-661	665	645	.	.	.
FDI assets, EUR mn	641	847	-532	156	186	.	.	.
Gross reserves of NB excl. gold, EUR mn	222	352	373	325	279	.	.	.
Gross external debt, EUR mn	17,618	19,062	19,178	19,072	19,380	19,400	20,600	21,600
Gross external debt, % of GDP	93.1	96.4	94.3	90.4	85.0	80.0	80.0	80.0

1) Preliminary and wiiw estimates. - 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.