

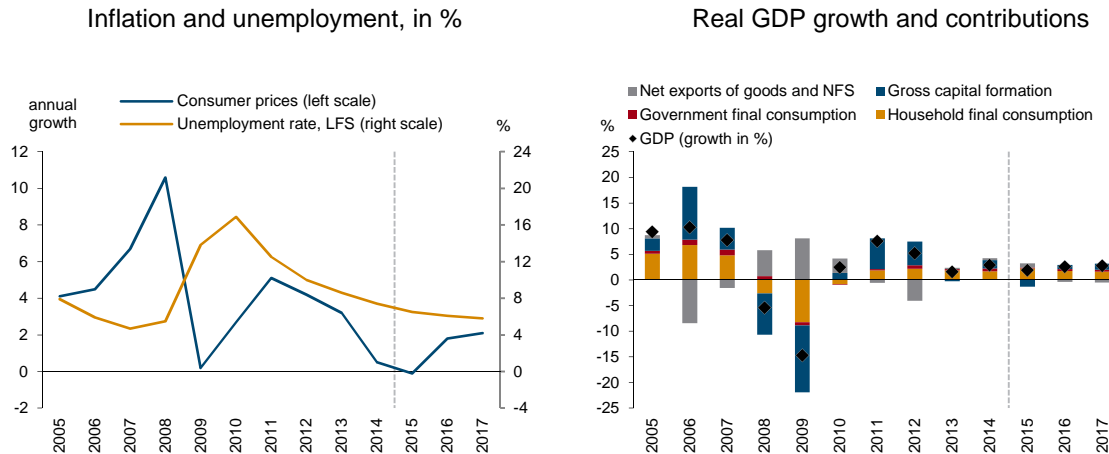


ESTONIA: Consumption growth remains robust

SEBASTIAN LEITNER

Dragged down by dwindling external demand in the neighbouring countries to the east and the current decline in investments, the Estonian GDP will grow by 1.9% in 2015. Household consumption remains the strongest driver of economic activity. Over the next two years we expect a recovery in trade with countries to the west, while the decline in exports to Russia should come to a halt. Moreover, an upswing, particularly in public investments, should boost GDP growth to 2.6% and 2.8% in 2016 and 2017, respectively.

Figure 45 / Estonia: Main macroeconomic indicators



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

In the first half of this year sentiment indicators of households and the services sectors showed declining confidence in the prospects of the Estonian economy. However, in the past four months the fear that the Russian economic turmoil could slash growth also in Estonia has gradually vanished. This comes with no surprise when looking at the current situation of the Estonian labour market. The unemployment rate came down to 6.5% in the second quarter of 2015, while net wages increased by more than 7% on average in the first half of this year. As a result, household consumption has remained a stable driver of GDP growth.

The number of unemployed is reduced by a decline in the working-age population, but the statistics also show a strong increase in employment, by 2.3% year-on-year in the first half of 2015. In part, however, this is the effect of the new employment register, introduced in July 2014. Enterprises now have to

register their workers before their employment starts. This regulation reduces the size of the shadow economy in Estonia, estimated at about 10% of GDP, particularly in the construction and the restaurants and accommodation sectors, and results in higher tax income for the government. Nevertheless, envelope payment of a part of the wages of employees is still possible and evident, since the figures of the employment register show that an overly high share of the newly registered persons declared to receive only the national minimum income.

The vacancy statistics show that in effect employment demand is actually declining, particularly in the manufacturing subsectors, which are hit by shrinking exports. In the coming years, demographic factors will further reduce labour supply and thus also the unemployment rate, although more gradually compared to the past years of recovery. The upward pressure on gross wages will remain and net incomes will grow even more owing to the planned reductions in the labour tax burden.

The downturn of the Russian economy in the first half of 2015 by 3.4% year-on-year resulted in Estonian exports to plummet by about 40% to the eastern neighbour in the same period. The still persistent stagnation in Finland and relatively low economic growth in Latvia and Lithuania, the three main trading partners, further dampen the export activity of Estonian entrepreneurs. Not only manufacturing, but also the transport sector is hit hard by dwindling external demand. However, exports to the rest of the European Union are on the upswing. A strong increase in foreign demand is recorded for Sweden, which is expected to attain a GDP growth rate of about 3% in 2015. Overall, while we expect exports to decline slightly this year, imports are going to shrink even more owing to low investment activity, and net exports will contribute positively to GDP growth in 2015. This will change in 2016 and thereafter, when stronger GDP growth will be supported by increases in exports, but an even swifter revival of imports due to an upswing in investment is assumed.

On account of overall sluggish external demand and stagnating industrial production, investment activity of the enterprise sector will decline once again throughout 2015 – there is ample idle capacity in the manufacturing sector. Also, construction output will shrink in real terms since public investments will gain momentum only in 2016 when EU funds will ease those investments' financing. Households still refrain from taking up new mortgages to invest in housing.

The decline in import prices, particularly of oil and gas as well as home-produced food (caused inter alia by the Russian embargo), has led to consumer price stagnation throughout 2015. The strong growth in wages has not raised core inflation to more than 1% in the first seven months of this year. From 2016 onwards consumer prices will rise again, also driven by announced hikes in excise taxes.

The budget proposal for 2016 presented by the Estonian government foresees an increase in the personal income tax-exempt threshold, a rise in pensions by 5.5% on average and higher child benefits. Apart from somewhat higher excise taxes, the reduced VAT rate on accommodation will be raised from 9% to 14%. The budget of the government should be more or less balanced in the subsequent two years after attaining a deficit of not more than 0.5% of GDP in 2015.

Our forecast for GDP growth in 2015 has been slightly revised downwards, to 1.9% in real terms. For 2016 and 2017 we forecast an upswing to 2.6% and 2.8%, respectively. We expect a recovery of external demand mostly from Western trading partners, while the decline in exports to Russia should come to a halt. An upswing in investments will be facilitated by public investments co-financed by EU funds.

Table 12 / Estonia: Selected economic indicators

	2011	2012	2013	2014 ¹⁾	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average ²⁾	1,327	1,323	1,318	1,315	.	.	1,305	1,300	1,295
Gross domestic product, EUR mn, nom. ³⁾	16,668	18,006	19,015	19,963	9,673	9,949	20,300	21,200	22,200
annual change in % (real)	7.6	5.2	1.6	2.9	2.7	1.6	1.9	2.6	2.8
GDP/capita (EUR at exchange rate) ³⁾	12,500	13,600	14,400	15,200	.	.	15,600	16,300	17,100
GDP/capita (EUR at PPP) ³⁾	18,000	19,200	19,800	20,300	.	.	.	.	.
Consumption of households, EUR mn, nom. ³⁾	8,195	8,850	9,463	9,861	4,871	5,117	.	.	.
annual change in % (real)	3.6	4.4	3.8	3.3	2.5	5.3	4.5	3.5	3.3
Gross fixed capital form., EUR mn, nom. ³⁾	4,367	4,761	5,153	5,033	2,326	2,205	.	.	.
annual change in % (real)	34.4	6.7	3.2	-3.1	7.2	-8.8	-5.0	3.0	4.5
Gross industrial production									
annual change in % (real)	19.9	1.1	4.1	1.9	-0.3	0.4	0.0	3.0	4.0
Gross agricultural production									
annual change in % (real)	9.7	5.6	4.7	3.6	.	.	.	.	.
Construction industry									
annual change in % (real)	27.3	16.6	-0.1	-2.6	-3.8	-4.6	.	.	.
Employed persons, LFS, th, average ⁴⁾	609.1	614.9	621.3	624.8	617.7	631.6	635	630	625
annual change in %	6.7	1.9	1.0	0.6	-0.6	2.3	1.6	-0.8	-0.8
Unemployed persons, LFS, th, average ⁴⁾	86.8	68.5	58.7	49.6	52.2	44.3	44	41	39
Unemployment rate, LFS, in %, average ⁴⁾	12.5	10.0	8.6	7.4	7.8	6.6	6.5	6.1	5.8
Reg. unemployment rate, in %, end of period ⁵⁾	7.4	6.2	5.3	4.4	4.4	4.1	.	.	.
Average monthly gross wages, EUR	839	887	949	1,005	994	1,046	1,060	1,150	1,240
annual change in % (real, gross)	0.9	1.7	4.1	6.0	5.7	5.6	6.0	6.5	6.0
Average monthly net wages, EUR	672	706	757	799	791	844	850	910	970
annual change in % (real, net)	0.5	1.1	4.3	5.7	5.2	7.2	6.5	5.0	4.5
Consumer prices (HICP), % p.a.	5.1	4.2	3.2	0.5	0.9	0.1	-0.1	1.8	2.1
Producer prices in industry, % p.a.	4.2	2.6	7.3	-2.7	-3.2	-2.2	-2.0	0.0	1.0
General governm. budget, EU-def., % of GDP									
Revenues	38.6	38.8	38.0	38.5	.	.	38.5	38.2	38.0
Expenditures	37.4	39.0	38.2	37.9	.	.	39.0	38.5	38.3
Net lending (+) / net borrowing (-)	1.2	-0.2	-0.2	0.6	.	.	-0.5	-0.3	-0.3
Public debt, EU-def., % of GDP	5.9	9.5	9.9	10.4	.	.	10.1	10.0	6.5
Central bank policy rate, % p.a., end of period ⁶⁾	1.00	0.75	0.25	0.05	0.15	0.05	0.05	0.05	0.20
Current account, EUR mn ⁷⁾	223	-438	-20	205	-39	296	400	-50	-400
Current account, % of GDP ⁷⁾	1.3	-2.4	-0.1	1.0	-0.4	3.0	2.0	-0.2	-1.8
Exports of goods, BOP, EUR mn ⁷⁾	10,384	11,104	11,624	11,430	5,594	5,500	11,200	11,650	12,330
annual change in %	38.8	6.9	4.7	-1.7	-4.1	-1.7	-2.0	4.0	5.8
Imports of goods, BOP, EUR mn ⁷⁾	10,735	12,283	12,522	12,429	6,108	5,849	11,870	12,230	12,970
annual change in %	36.1	14.4	1.9	-0.7	-2.5	-4.2	-4.5	3.0	6.1
Exports of services, BOP, EUR mn ⁷⁾	4,040	4,486	4,876	5,320	2,506	2,500	5,270	5,480	5,770
annual change in %	13.3	11.0	8.7	9.1	9.3	-0.3	-0.9	4.0	5.3
Imports of services, BOP, EUR mn ⁷⁾	2,734	3,131	3,556	3,639	1,747	1,719	3,580	3,690	3,840
annual change in %	22.9	14.5	13.6	2.3	4.0	-1.6	-1.6	3.1	4.1
FDI liabilities (inflow), EUR mn ⁷⁾	818	1,394	664	1,172	511	-445	-300	.	.
FDI assets (outflow), EUR mn ⁷⁾	-951	996	578	617	257	-200	-150	.	.
Gross reserves of NB excl. gold, EUR mn	150	218	222	352	309	336	.	.	.
Gross external debt, EUR mn ⁷⁾	16,721	17,957	17,455	18,902	18,906	20,185	18,900	18,700	18,900
Gross external debt, % of GDP ⁷⁾	100.3	99.7	91.8	94.7	94.7	99.4	93.0	88.0	85.0
Purchasing power parity EUR/EUR	0.6947	0.7092	0.7291	0.7467	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) In % of labour force (LFS) and according to census March 2011. - 6) Official refinancing operation rate for euro area (ECB). - 7) BOP 6th edition.

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