

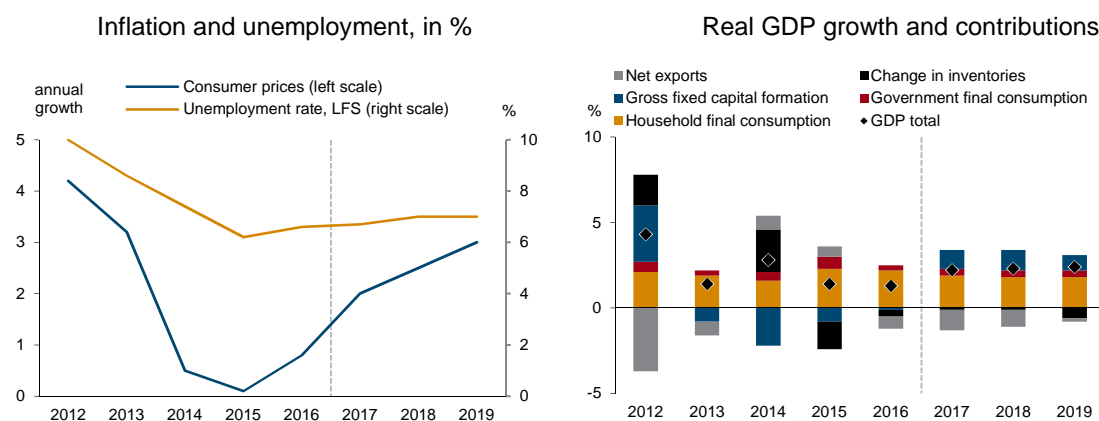


ESTONIA: Public investment and private consumption will drive growth

SEBASTIAN LEITNER

In the next two years, we will see an improvement in the terms of trade with Western markets; meanwhile exports to Russia have already started to recover. Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. Moreover, an upswing in public investments should also speed up economic activity in the short run. GDP growth is projected to rise: from 2.2% in 2017 to 2.3% in 2018 and 2.4% in 2019.

Figure 39 / Estonia: Main macroeconomic indicators



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

Export growth started to accelerate in the final months of 2016, and this trend will continue in 2017. Goods volumes have increased year on year, while producer prices are still on the decline. In particular, goods and services exports to Russia gained strongly in momentum, having dropped by more than a third in 2015 and in the first half of 2016. The economy of neighbouring Sweden is expected to expand at an average of 2.5% per annum, while that of Finland – having emerged from a three-year recession last year – is expected to grow by about 1% both this year and in 2018. Exports to neighbouring Latvia, Estonia's third most important trade partner, continue to struggle, but are similarly expected to strengthen on account of a revival in investment in that country. Low oil prices render the production of shale oil – Estonia's second most important export product – economically inefficient. As a result, mostly shale oil-based electricity production is gradually declining, due to higher electricity imports from Finland. Overall, we expect goods exports to keep on growing at a stronger pace in 2017 and 2018.

In the second half of 2017, Estonia will assume the presidency of the Council of the EU, which is likely to increase income from tourism somewhat. However, we expect imports to grow even more strongly than exports in the next two years.

Investment activity of the enterprise sector will increase in 2017 and 2018. External demand and industrial production have started to strengthen; furthermore, activity in the construction sector has gained momentum. Data on building permits and mortgage loan growth suggest that dwelling construction will continue to expand in 2017. Public investment will increase markedly in 2017. The 2017 state budget of the Estonian government anticipates additional EU funds for public and private investment of 2-3% of GDP. Moreover, the government has enacted various measures to lower the income tax burden, such as a reduction in employer social security contributions of 1 percentage point (to 32%) over the coming two years, and an income tax refund for low-income groups. Overall, we expect the budget to remain slightly in surplus in 2017, while a further reduction in the public debt burden (which already fell below 10% of GDP in 2016) is envisaged. A large part of the rising public expenditure in 2017 will be devoted to defence (2.2% of GDP).

The population is finally growing again, and the activity and unemployment rate are both rising. The recovery in the years following the 2008/2009 bust brought a steady decline in the unemployment rate, to 6.2% in 2015. But this improvement in the labour market situation started to falter in 2016. While employment in the services sectors went on rising, it fell particularly in the shale oil and energy industry. The work ability reform, introduced in July 2016, increased the number of people registered as unemployed. In order to continue to receive benefits, people who hitherto qualified for a work incapacity pension now have to look more actively for jobs and take part in public work activation measures. The outcome is an increase both in activity rates, and in unemployment rates, since only some of those who have to look for a job actually 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 and the population of the country is growing again.

Strongly increasing real net wages (8.1% in 2016) are further pushing Estonian household consumption upwards. We expect an increase of 3.7% in real terms in 2017 and a slight deceleration in the years after that. Consumer prices have started to increase slightly in recent months. However, the upward price movement is mostly caused by an increase in excise taxes and, most recently, by rising energy prices. The core inflation rate is still rather low; however, in 2017 consumer prices will again rise more swiftly, pushed up by rising import prices. Forward-looking consumer confidence indicators show an improvement at the beginning of 2017, and the most recent retail trade and credit statistics indicate an increasing propensity to spend. Monthly incomes will continue to grow strongly, not least thanks to another increase in the minimum wage of 10% at the beginning of 2017 (to EUR 470), 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.

Moderate GDP growth returns to Estonia. GDP growth of 1.3% in real terms in 2016 was somewhat lower than forecast, due to the unexpectedly poor performance of investment. An upswing in external demand is ongoing, and private investment activity is picking up gradually. A strong upswing in public investments, not only this year, but also in 2018 and 2019, will be facilitated by increasing inflows of EU funds. Rising private income will help household consumption to grow swiftly. Thus, for 2017 and 2018, we maintain our forecast of an upswing to produce real GDP growth of 2.2% and 2.3%, respectively.

Table 10 / Estonia: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017 Forecast	2018 Forecast	2019
Population, th pers., average	1,323	1,318	1,315	1,315	1,315	1,315	1,315	1,315
Gross domestic product, EUR mn, nom.	17,935	18,890	19,758	20,252	20,680	21,560	22,610	23,850
annual change in % (real)	4.3	1.4	2.8	1.4	1.3	2.2	2.3	2.4
GDP/capita (EUR at PPP)	19,600	20,100	20,900	21,600	22,000	.	.	.
Consumption of households, EUR mn, nom.	8,885	9,465	9,818	10,267	10,790	.	.	.
annual change in % (real)	4.3	3.7	3.2	4.6	4.3	3.7	3.6	3.5
Gross fixed capital form., EUR mn, nom.	5,128	5,206	4,814	4,790	4,800	.	.	.
annual change in % (real)	12.7	-2.8	-8.1	-3.3	-0.5	4.5	5.0	4.0
Gross industrial production								
annual change in % (real)	1.1	4.1	3.9	-2.2	2.3	2.5	3.0	3.5
Gross agricultural production								
annual change in % (real)	5.6	4.7	4.6	8.7	-10.2	.	.	.
Construction industry								
annual change in % (real)	16.7	-0.1	-2.1	-5.3	2.5	.	.	.
Employed persons, LFS, th, average	614.9	621.3	624.8	640.9	650.0	655	660	665
annual change in %	1.9	1.0	0.6	2.6	1.4	0.8	0.8	0.8
Unemployed persons, LFS, th, average	68.5	58.7	49.6	42.3	46.0	47	50	50
Unemployment rate, LFS, in %, average	10.0	8.6	7.4	6.2	6.6	6.7	7.0	7.0
Reg. unemployment rate, in %, end of period ²⁾	6.2	5.3	4.4	4.7	4.5	.	.	.
Average monthly gross wages, EUR	887	949	1,005	1,065	1,150	1,240	1,330	1,450
annual change in % (real, gross)	1.7	4.1	6.0	6.5	7.8	6.0	5.0	6.0
Average monthly net wages, EUR	706	757	799	859	930	1,000	1,070	1,160
annual change in % (real, net)	1.1	4.3	5.7	8.0	8.1	5.0	4.0	5.0
Consumer prices (HICP), % p.a.	4.2	3.2	0.5	0.1	0.8	2.0	2.5	3.0
Producer prices in industry, % p.a.	2.7	7.2	-2.7	-3.0	-1.3	1.0	2.0	3.0
General governm. budget, EU-def., % of GDP								
Revenues	39.0	38.4	39.1	40.5	38.7	38.5	38.6	38.6
Expenditures	39.3	38.5	38.5	40.3	39.0	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.3	-0.2	0.7	0.1	-0.3	-0.5	-0.4	-0.4
Public debt, EU-def., % of GDP	9.7	10.2	10.7	10.1	9.8	9.0	8.0	7.5
Stock of loans of non-fin.private sector, % p.a	0.3	-0.7	2.6	4.7	3.0	.	.	.
Non-performing loans (NPL), in %, Dec	3.0	1.7	1.5	1.1	1.0	.	.	.
Central bank policy rate, % p.a., end of period ³⁾	0.75	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-350	-66	182	447	553	200	100	0
Current account, % of GDP	-1.9	-0.4	0.9	2.2	2.7	0.9	0.4	0.0
Exports of goods, BOP, EUR mn	10,750	11,080	11,089	10,853	11,206	11,600	12,100	12,700
annual change in %	3.5	3.1	0.1	-2.1	3.3	3.6	4.3	5.0
Imports of goods, BOP, EUR mn	12,030	12,057	12,092	11,714	12,096	12,700	13,400	14,200
annual change in %	12.1	0.2	0.3	-3.1	3.3	5.0	5.5	6.0
Exports of services, BOP, EUR mn	4,672	4,876	5,322	5,204	5,514	5,800	6,000	6,300
annual change in %	15.7	4.4	9.1	-2.2	6.0	5.5	3.4	5.0
Imports of services, BOP, EUR mn	3,115	3,534	3,623	3,502	3,719	3,900	4,100	4,400
annual change in %	13.9	13.5	2.5	-3.3	6.2	5.4	5.1	6.1
FDI liabilities, EUR mn	1,394	820	1,252	-597	629	.	.	.
FDI assets, EUR mn	996	635	677	-423	491	.	.	.
Gross reserves of NB excl. gold, EUR mn	218	222	352	373	325	.	.	.
Gross external debt, EUR mn	17,957	17,593	19,101	19,208	19,400	19,800	20,800	21,500
Gross external debt, % of GDP	100.1	93.1	96.7	94.8	93.8	92.0	92.0	90.0

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.