
# ESTONIA: Revival of investment keeps growth buoyant

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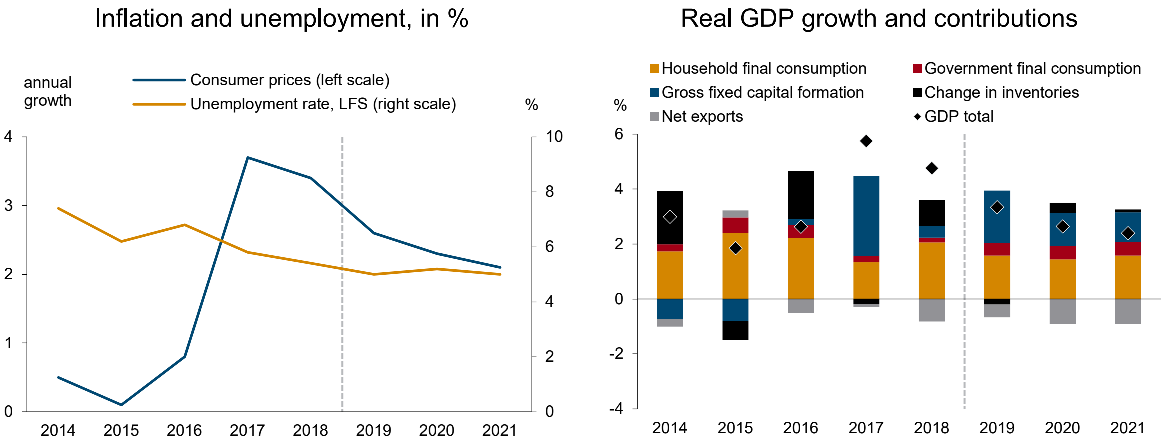
**Investment activity revived in 2019, following last year's slowdown. Furthermore, external demand continued growing at a higher pace than expected. Household consumption, backed by a considerable rise in employment and real wages, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.4% in 2019, followed by a slowdown to 2.7% in 2020 and further to 2.4% in 2021.**

**Figure 5.7 / Estonia: Main macroeconomic indicators**




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

**Contrary to expectations, GDP growth remained high in the first half of 2019, at 4.2% in real terms year on year.** One of the reasons is that exports continued to grow strongly in 2019. Estonia's trade partners in the Scandinavian region have relatively stronger links with the USA, which keeps exports afloat in spite of the slowdown in the Euro Area. External demand from Sweden however is sluggish due to the cooling of the housing market there. This results in negative effects on the manufacturing and service exports of the Estonian building sector. The slowdown of growth in Russia also caused a further decline of Estonian exports to the neighbouring country in 2019.

**Fluctuations in the oil price have a rather strong influence on Estonia's export dynamics.** After a rise in 2017-2018, the stabilisation of the price of crude oil at the lower level of about USD 65 in 2019 resulted in a reduction in foreign demand for Estonian shale oil, being used as a substitute for crude oil, by about 10% in nominal terms this year compared to 2018. Overall, we expect real growth in goods exports to level off in 2020-2021. Given swiftly rising household incomes, imports will increase more strongly than exports. In general, extensive wage increases and thus unit labour costs are putting pressure on the competitiveness of the industrial sector in Estonia. Accordingly, a gradual decline of the manufacturing share in the economy is taking place.

**After a slowdown in 2018, growth in investment activity revived this year.** Following the design phase and site investigations, the construction of the main infrastructure of Rail Baltica, the high-speed train project connecting the Baltics with the Central European network, started. Furthermore, public road infrastructure investment will enable growth to continue. Given the favourable demand situation, private enterprises are increasing their investments in equipment, particularly strongly in the manufacturing branches, wholesale and retail, transport and the ICT sectors. Strong growth in wages and very low interest rates are driving an ongoing increase in new mortgages (+7% January to August year on year) to households. Real estate prices are still growing rapidly and are above pre-crisis levels in Tallinn. Following a decline in granted building permits for dwellings in 2018, we see a revival thereof this year. Thus an upswing in housing construction is also likely to take place in 2020.

**Throughout the year, the unemployment rate continued to decline and is expected to average 5% (according to LFS) for 2019 as a whole.** A further fall however will not take place in the near future. Job vacancy rates did not increase further compared to the previous year and fell strongly in the financial sector, accommodation and construction. Public administration and the ICT sectors, however, are intensively searching for employees. Given the expected growth slowdown, the labour market situation is likely to remain unchanged in the coming two years. However, a gradual increase in jobs is expected to take place, particularly in the private service sectors, but also in public sectors like health and education. Since the native work force is going to decline in the coming years, short-term labour immigration from Ukraine and Belarus is likely to increase in the medium term.

**Given the still rather tight labour market situation, wages continued to rise strongly this year.** Real gross wages picked up by another 4.9% year on year in the first half of 2019, and as a result, growth in retail trade turnover even accelerated compared to the previous year. Household incomes will be bolstered by a further increase of approximately 8-9% in the minimum wage from January 2020 onwards. Following an increase to 3.4% last year, consumer price inflation has declined again in 2019 (mostly caused by a falling oil price and smaller excise taxes hikes) which has further strengthened real income growth. Household consumption will remain a stable driver of growth in the coming two years; however forward-looking consumer confidence indicators show a slight downturn.

**The draft budget of the coalition government for 2020 foresees a continuation of the path close to balance.** No changes in taxes are announced for 2020 except an increase in the non-taxable minimum income and a smaller than expected rise in excise taxes. Above average expenditure growth is planned for defence and the health and welfare sectors. The concluded pension hike of EUR 45 per month will increase the average pension by about 10% in nominal terms in 2020. The foreseen wage increase for teachers, kindergarten teachers and social workers will result in only a small catching up in comparison to the average salary level. The increase of the R&D budget to only 0.74% of GDP in comparison to the promised 1% resulted in protests by the university personnel and opposition from the wider public. The public debt level is expected to decrease further, to as low as 8% of GDP in 2020.

**Compared to our Summer Forecast we have become more optimistic, increasing the forecast GDP growth rate for 2019 from 3.2% to 3.4%** on account of reviving public and private investment and higher than expected external demand. The relatively tight situation in the labour market will keep wage growth high and will thus also bolster private consumption over the coming two years. While investment growth lost steam in 2018, public infrastructure projects will result in a revival in 2019-2020. In the medium term, however, we expect export growth to lose momentum while import demand will remain strong due to rising household incomes. As a result, we forecast a decline of GDP growth rates to 2.7% and 2.4% for 2020 and 2021 respectively.

### Table 5.7 / Estonia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 1,315 | 1,316 | 1,317 | 1,322 | 1,319 | 1,325 | 1,325 | 1,328 | 1,330 |
| Gross domestic product, EUR mn, nom. | 20,782 | 21,694 | 23,776 | 26,036 | 12,516 | 13,594 | 27,600 | 29,000 | 30,300 |
| annual change in % (real) | 1.8 | 2.6 | 5.7 | 4.8 | 4.6 | 4.2 | 3.3 | 2.6 | 2.4 |
| GDP/capita (EUR at PPP) | 22,100 | 22,500 | 23,800 | 25,500 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 10,329 | 10,869 | 11,566 | 12,502 | 6,024 | 6,392 | . | . | . |
| annual change in % (real) | 4.9 | 4.5 | 2.7 | 4.2 | 3.4 | 3.2 | 3.3 | 3.0 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 5,054 | 5,054 | 5,899 | 6,211 | 2,729 | 3,462 | . | . | . |
| annual change in % (real) | -3.2 | 0.9 | 12.5 | 1.7 | -8.2 | 21.4 | 8.0 | 5.0 | 4.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 0.3 | 3.4 | 4.1 | 4.0 | 4.1 | 0.5 | 3.5 | 3.0 | 2.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 8.7 | -17.2 | 6.5 | -5.6 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -3.5 | 4.6 | 21.5 | 17.4 | 20.5 | 2.6 | . | . | . |
| Employed persons, LFS, th, average | 640.9 | 644.6 | 658.6 | 664.7 | 658.6 | 667.7 | 672 | 676 | 678 |
| annual change in % | 2.6 | 0.6 | 2.2 | 0.9 | 1.3 | 1.4 | 1.1 | 0.6 | 0.3 |
| Unemployed persons, LFS, th, average | 42.3 | 46.7 | 40.3 | 37.7 | 41.6 | 34.1 | 35 | 37 | 36 |
| Unemployment rate, LFS, in %, average | 6.2 | 6.8 | 5.8 | 5.4 | 6.0 | 4.9 | 5.0 | 5.2 | 5.0 |
| Reg. unemployment rate, in %, eop 2) | 4.7 | 4.4 | 4.8 | 4.8 | 4.5 | 4.6 | . | . | . |
| Average monthly gross wages, EUR | 1,065 | 1,146 | 1,226 | 1,310 | 1,282 | 1,380 | 1,400 | 1,480 | 1,560 |
| annual change in % (real, gross) | 6.5 | 7.4 | 3.5 | 3.5 | 3.7 | 4.9 | 4.0 | 3.2 | 3.0 |
| Average monthly net wages, EUR | 859 | 924 | 985 | 1,050 | . | . | 1,120 | 1,180 | 1,240 |
| annual change in % (real, net) | 8.0 | 7.4 | 3.0 | 3.2 | . | . | 4.0 | 3.0 | 2.7 |
| Consumer prices (HICP), % p.a. | 0.1 | 0.8 | 3.7 | 3.4 | 3.3 | 2.6 | 2.6 | 2.3 | 2.1 |
| Producer prices in industry, % p.a. | -2.5 | -0.9 | 3.3 | 3.9 | 3.6 | 0.8 | 0.5 | -0.5 | 1.0 |
| General governm. budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 39.5 | 39.1 | 38.6 | 38.4 | . | . | 39.5 | 39.2 | 39.5 |
| Expenditures | 39.4 | 39.4 | 39.0 | 39.0 | . | . | 39.8 | 39.4 | 39.7 |
| Net lending (+) / net borrowing (-) | 0.1 | -0.3 | -0.4 | -0.5 | . | . | -0.3 | -0.2 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 9.8 | 9.2 | 9.2 | 8.3 | . | . | 8.3 | 8.3 | 8.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.8 | 6.6 | 0.7 | 5.1 | 1.1 | 5.7 | . | . | . |
| Non-performing loans (NPL), in %, eop | 1.1 | 1.0 | 0.8 | 0.5 | 0.7 | 0.5 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 366 | 360 | 635 | 516 | 349 | 175 | 784 | 635 | 636 |
| Current account, % of GDP | 1.8 | 1.7 | 2.7 | 2.0 | 2.8 | 1.3 | 2.8 | 2.2 | 2.1 |
| Exports of goods, BOP, EUR mn | 10,692 | 11,293 | 12,029 | 12,720 | 6,309 | 6,722 | 13,700 | 14,150 | 14,600 |
| annual change in % | -3.0 | 5.6 | 6.5 | 5.7 | 6.4 | 6.5 | 7.7 | 3.3 | 3.2 |
| Imports of goods, BOP, EUR mn | 11,571 | 12,043 | 12,866 | 13,720 | 6,705 | 7,094 | 14,500 | 15,200 | 15,700 |
| annual change in % | -3.7 | 4.1 | 6.8 | 6.6 | 5.7 | 5.8 | 5.7 | 4.8 | 3.3 |
| Exports of services, BOP, EUR mn | 5,284 | 5,509 | 6,074 | 6,613 | 3,136 | 3,206 | 6,800 | 7,100 | 7,400 |
| annual change in % | -1.9 | 4.3 | 10.2 | 8.9 | 9.2 | 2.2 | 2.8 | 4.4 | 4.2 |
| Imports of services, BOP, EUR mn | 3,593 | 3,911 | 4,219 | 4,699 | 2,206 | 2,307 | 4,850 | 5,050 | 5,300 |
| annual change in % | -2.7 | 8.9 | 7.9 | 11.4 | 9.6 | 4.6 | 3.2 | 4.1 | 5.0 |
| FDI liabilities, EUR mn | -654 | 832 | 1,532 | 996 | 805 | 1,700 | 1250 | . | . |
| FDI assets, EUR mn | -522 | 315 | 606 | -221 | 164 | 1,573 | 300 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 373 | 325 | 279 | 651 | 325 | 942 | . | . | . |
| Gross external debt, EUR mn | 19,161 | 19,194 | 19,766 | 19,886 | 20,064 | 22,045 | 21,000 | 21,500 | 21,800 |
| Gross external debt, % of GDP | 92.2 | 88.5 | 83.1 | 76.4 | 77.1 | 79.9 | 76.0 | 74.0 | 72.0 |

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.