SPRING 2013 FORECAST OF THE MINISTRY OF FINANCE OF ESTONIA

SUMMARY

The **assumptions** of the current forecast were fixed in the end of February, 2013. After the completion of the ministry's previous forecast in August, 2012, the development of European real economy and different sentiment indicators has been contradictory. On the positive side, EU27 economic sentiment index turned to a positive trend in autumn 2012, after a prolonged decline. In addition to that, European and especially US stock indexes have been on the rise and stock volatility indexes have been calming down. Southern European countries' bond spreads with Germany have decreased after ECB promises to do "whatever it takes" to keep the eurozone together. Despite of that has the eruozone economy been in recession over a year already and the start of recovery has constantly been postponed. Fortunately the main trading partners for Estonia are doing relatively well and the baseline scenario of this forecast does not count on new severe setbacks is the external environment.

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Estonian GDP will grow by 3.0% in 2013 and 3.6% in 2014. Forecast of economic growth for 2013 has not changed compared to last forecast made in August 2012. Economic growth this year will be based on domestic demand, though its growth rate will decelerate. Due to the recovery in foreign demand, exports is expected to show higher growth rate in 2014. Growth of exports will slightly exceed imports, generating positive contribution from net exports. During 2015–2017 economic growth will stabilise around 3.5%. In addition to exports, stable increase in domestic demand will support GDP expansion.

Domestic demand will increase during the forecast period, supported by gradual restoration of investment levels. Decrease of public sector investments this year and during a couple of future years is expected to be balanced by quick growth of company investments into machines and equipment which exceeded its latest peak already in 2012.

The willingness to consume has increased as well, thanks to improving employment levels and growing real income. Private consumption is also supported by decreased unemployment contributions starting 2013 and the upcoming reduction of income tax rate in 2015. On the other hand, households borrowing behavior will probably not change notably in the coming years and thus there will also be no significant growth of the loan stock to support consumption, enabling household's loan ratio to the GDP to continue its decrease.

Based on the forecasts of main trading partners, foreign demand turns out to be weaker this year compared to 2012. Foreign demand is expected to recover gradually in the second half of this year, supporting thereby quickening in Estonian exports growth. Altogether, 4.5% growth of **exports of goods and services** can be expected in 2013. Next year, in line with the recovery in foreign demand, growth of Estonian exports will speed up. In the second half of forecast horizon growth of exports will stabilize below 7%, surpassing slightly the growth rate of demand of main trading partners. Growth of **imports of goods and services** will slow down to 5.1% this year due to more moderate investment activity of companies and decline in general government investments. In following years, the growth of imports will accelerate as a result of relatively high import content of exports and increasing investment activity of private companies.

In terms of deteriorating foreign environment which constrained exports and the strength in domestic demand supported by strong investments, **current account** turned to deficit in 2012. During the forecast period current account deficit will widen gradually, mainly caused by high investment needs of companies. Decline in services surplus and slight weakening of income account due to growing profits of foreign companies will influence external balance as well.

Consumer price (CPI) increase will slow down to 3.4% in 2013 and in next years to stabilize around 2.8%. Deceleration in inflation is the result of decreasing impact coming from foreign factors due to the weakness of global growth. Though the opening of the electricity market has a significant effect on inflation this year, its impact will soften receding price pressures in service prices and in foreign environment. In 2014, the impact from electricity market opening will fade out, wherefore deceleration in consumer prices can be expected. Acceleration in wage growth and continuous increase in employment together with the ending of one-time price decreases in some services will bring along higher core inflation. In mid-term perspective consumer price increase will stabilize in Estonia, but will have a higher rate compared to euro zone because of the continuous convergence of income and price level.

In relation to slowdown of consumer price growth, real **wage growth** will increase in the coming years, reaching 2.5 percent this year and accelerating to 3.5 percent in 2014. Growth of average salary increased to nearly 6 percent in 2012 and should remain at that speed in 2013 as well. Wage growth is caused by expected recovery of export markets and low levels of available labour force.

Labour force's contribution to economic growth is starting to decline. 0.3–0.4 percent increase of **employment** is expected this as well as the next year. However, the number of employed people may then stop growing due to demographic reasons. Unemployment rate is forecasted to drop to 7 percent by 2017 and employment rate is expected to increase to 64 percent which is nearly 1 percentage point above the latest peak of 2008.

In 2013 general government **budgetary position** is in deficit by 0.5% of GDP. Most of the deficit comes from central government but also local governments will be in deficit. Social security funds are still in surplus due to Unemployment Insurance Fund (0.3% of GDP in 2013). In 2014 general government budget deficit decreases to 0.1% of GDP. Most of the deficit comes still from state pension insurance (central government level) which expenditure exceed revenues by 2% of GDP. The central government budgetary position is also substantially affected by investments which are linked to the revenue of AAUs (-0.2% of GDP in 2013 and 2014). At local government's level the budgetary deficit remain the same level (0.2% of GDP). At the same time social security funds contribution to the budgetary position is positive. In coming years the general government budgetary position will improve gradually. According to forecast the budget surplus will be achieved in 2015 and by the end of forecast period in 2017 surplus will reach 1.6% of GDP.

In 2013 the **tax burden** is forecasted to be at 32.9% of GDP. By 2017 tax burden decreases to 31.4% of GDP. In 2013 the unemployment insurance payment was reduced. In 2014–2017 there are higher pension II pillar payments by government. In 2015 the income tax rate will be reduced to 20%. All these have decreasing effect on tax burden. In conclusion during 2013–2017 tax revenues will grow annually 1.1 percent slower than GDP.

General government **debt burden** rose to 10,1% of GDP by the end of 2012, without the technical impact from European Financial Stability Facility (EFSF) to 8,1% of GDP. By the end of this year the debt burden will rise to 10,2% of GDP due to the increase in EFSF outstanding debt. After that the growth rate of EFSF outstanding debt will slow down and general government debt burden will start to decline, constituting 8,3% of GDP by the end of year 2017.

Table 1

GDP Forecast for 2012–2017

(per cent)

	2012	2013*	2014*	2015*	2016*	2017*
1. Growth of real GDP	3.2	3.0	3.6	3.5	3.5	3.5
1a. GDP in real terms (bln EUR)	12.6	13.0	13.4	13.9	14.4	14.9
2. Growth of nominal GDP	6.6	6.6	6.8	6.6	6.5	6.4
2a. GDP in nominal terms (bln EUR)	17.0	18.1	19.4	20.6	22.0	23.4
2b. GNI in nominal terms (bln EUR)	16.0	17.1	18.2	19.4	20.7	22.0
Components of real GDP						
3. Private consumption expenditure (incl. non-profit organisations)	4.5	3.8	3.8	4.3	3.6	3.6
4. Government final consumption expenditure	4.0	0.8	0.2	0.2	0.2	0.2
5. Gross fixed capital formation	20.9	5.2	5.8	6.1	7.2	7.2
6. Changes in inventories (% of GDP)	2.6	2.6	2.6	2.6	2.7	2.6
7. Exports of goods and services	5.6	4.5	6.0	6.5	6.8	6.8
8. Imports of goods and services	9.1	5.1	5.9	7.0	7.2	7.2
Contributions to real GDP growth [1)]						
9. Domestic demand (without inventories)	7.6	3.4	3.5	3.8	3.8	3.9
10. Changes in inventories	-0.4	0.0	-0.1	0.0	0.0	-0.1
11. Ext. balance of goods and services	-2.9	-0.5	0.1	-0.5	-0.4	-0.4
Value added growth						
12. Primary sector	13.1	2.1	3.0	2.0	2.2	1.8
13. Industry	-2.4	5.1	5.7	5.3	5.0	4.8
14. Construction	14.3	4.0	4.6	4.4	4.2	4.0
15. Other services	3.3	2.4	2.8	2.9	3.0	3.1

1) Contribution to GDP growth indicates the share of a specific field in the economic growth. It is calculated by multiplying the field's growth with its share in GDP. The sum of the fields' share makes up the economic growth (the reason for a little difference is a statistical error – the part of GDP that could not be divided between the fields).
Source: Ministry of Finance of Estonia, Statistics Estonia.

Table 2

Price Forecast for 2012–2017

(per cent)

	2012	2013*	2014*	2015*	2016*	2017*
1. GDP deflator	3.2	3.5	3.1	3.0	2.9	2.8
2. Private consumption deflator	3.4	3.3	2.6	2.6	2.6	2.6
3. Harmonised consumer price index	4.2	3.6	2.9	2.9	2.9	2.8
3a. Consumer price index	3.9	3.4	2.8	2.8	2.8	2.7
4. Public consumption deflator	3.2	4.2	4.3	4.4	4.5	4.5
5. Investment deflator	1.3	2.7	2.6	2.6	2.6	2.7
6. Export price deflator	2.0	1.1	1.9	2.1	2.0	2.0
7. Import price deflator	2.6	0.9	1.8	2.0	2.1	2.1

Source: Ministry of Finance of Estonia, Statistics Estonia.

Table 3

Labour Market Forecast for 2012–2017 (15–74- year-old)

(per cent)

	2012	2013*	2014*	2015*	2016*	2017*
1. Employment. thousands	624.4	626.3	628.8	628.8	628.8	628.8
1a. Growth of employment	2.5	0.3	0.4	0.0	0.0	0.0
2. Unemployment rate	10.2	9.1	8.3	7.8	7.5	6.9
3. Growth of labour productivity (per person)	1.1	2.7	3.2	3.5	3.5	3.5
4. Real growth of average monthly wage	1.9	2.5	3.5	3.3	3.1	3.2
4a. Average monthly wage (EUR)	884	937	997	1 059	1 122	1 189
4b. Nominal growth of average monthly wage	5.9	6.0	6.4	6.2	6.0	6.0

Source: Ministry of Finance of Estonia, Statistics Estonia.

Table 4

Balance of Payments Forecast for 2012–2017

(% of GDP)

	2012	2013*	2014*	2015*	2016*	2017*
1. Net lending/borrowing vis-à-vis the rest of the world	2.2	2.0	1.4	-0.2	-1.1	-1.0
1a. Current account	-1.2	-1.2	-1.3	-2.1	-2.9	-3.1
2. Balance of goods and services	2.9	2.7	3.0	2.7	2.3	1.9
3. Balance of primary incomes and transfers	-4.1	-3.9	-4.2	-4.8	-5.1	-5.0
4. Capital account	3.4	3.3	2.7	2.0	1.8	2.1
5. Errors and omissions	-0.5					

Source: Ministry of Finance of Estonia, Bank of Estonia.

Table 5

General government budgetary position, debt and tax burden 2012–2017

(% of GDP)

	2012	2013*	2014*	2015*	2016*	2017*
Budgetary position						
1. General government	**-0.3**	**-0.5**	**-0.1**	**0.0**	**1.0**	**1.6**
2. Central government	-0.8	-0.6	-0.2	-0.2	0.8	1.4
3. Other general government	0.5	0.1	0.1	0.2	0.2	0.2
incl. Social security funds	0.7	0.3	0.3	0.3	0.4	0.4
incl. Local governments	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
General government debt						
4. General government	**10.1**	**10.2**	**9.9**	**9.3**	**8.8**	**8.3**
6. incl. central government (with EFSF)	6.8	6.9	6.6	6.1	5.7	5.2
7. incl. local governments	3.3	3.3	3.3	3.2	3.2	3.1
Tax burden	**33.3**	**32.9**	**32.1**	**31.7**	**31.6**	**31.4**

Source: Ministry of Finance of Estonia, Statistics Estonia.