# SUMMER 2013 FORECAST OF THE MINISTRY OF FINANCE OF ESTONIA

## SUMMARY

The **assumptions** of this forecast were fixed as of the end of July 2013. Since the Ministry of Finance's last, spring 2013 forecast, the development of economic sentiment indicators has improved and its trend is positive. However, Estonian economic sentiment of consumers, manufacturing and construction has weakened somewhat compared to the spring level. After the one and half years of decline, EU economy showed positive growth rate in Q2. Moreover, Latvia and Lithuania keep recovering fast from the crisis. However, GDP forecasts of Finland and Russia have been revised downwards lately. US stock market indices have shown faster increase during the last six months compared to EU stock market indices. The forecast of Estonian export demand for 2013 has been cut during the last two years and currently it is lower than in spring projection. At the same time, the growth of export markets for 2014 has not changed compared to spring. Current economic forecast is based on a gradual recovery of foreign demand.

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The **gross domestic product** of Estonia will increase by 1.5% in 2013 and 3.6% in 2014. In 2015 3.5% growth can be expected. Ministry of Finance has cut the GDP forecast of this year compared to the spring forecast mainly due to weak growth rate of the first half of 2013. Economic growth forecast for 2014 and 2015 has not been revised compared to spring projection. GDP growth will be supported by the increase of foreign and domestic demand in coming years. Growth of exports will be faster compared to imports and therefore the contribution of net exports will turn positive. During 2016-2017 economic growth will accelerate to 3.6% and 3.8% respectively. The main drag to growth will be exports, but the contribution of domestic demand should increase as well.

**Domestic demand** growth rate will decelerate in 2013 after two years of rapid growth. This is mainly caused by marginal growth expectations of investment, mostly because of the very high base level last year, as growth rates during the past two years exceeded 20%. During the coming years a negative contribution to investment growth comes from the government sector because of the decline in the use of both $CO_2$ quota revenues and EU structural funds. Business investment will be constrained by low demand and enough spare resources, but as foreign demand is expected to pick up next year, their contribution should turn positive again. Housing investment by households is still subdued because of low confidence in taking new loans and limited capacity to increase the aggregate loan stock. Investment should grow 1,2% in 2013 and 3% in 2014. Private consumption growth decelerates to 3,5% this year, which is faster than GDP growth but remains lower than real wage growth. The decline in households' saving rate since the peak of the crisis may have stopped and nominal consumption growth will not exceed income growth during the following years, but lower inflation rate permits acceleration of consumption next year. In 2015 consumption possibilities are increased by income tax rate reduction.

**Exports of goods and services** will grow by 6% in 2013. Although foreign demand is weaker this year compared a year ago, this will not lead to smaller growth rate of exports. Strong exports in the first half of 2013 indicates to strengthening of Estonian export position in main trading markets. In the second half of the year foreign demand will be supported by better economic outlook of the euro zone. Main export markets will show faster recovery in 2014, thereby increasing growth opportunities of our manufacturing companies. Growth of exports will accelerate gradually and will stabilize below 7% in the end of forecast horizon. Growth of **imports** of goods and services will slow to 6.8% in 2013 due to weaker investment activity of companies and general government. During 2014-2015 exports will show higher growth rate compared to imports and therefore the contribution of net exports will turn positive.

Capacious investment activity together with the deteriorating foreign environment caused the **current account** turning into deficit in 2012. In 2013, current account deficit will remain at the same level like a year ago, reaching 1.8% of GDP. In the following years the deficit will narrow as a result of weaker investment activity. Foreign balance will be affected by slight decline of services surplus as well, largely related to weakness of exports of transport services.

**Consumer price (CPI)** increase will slow down from 3.9% in 2012 to 3.2% in 2013 and to 2.7% in 2014. Deceleration in inflation in the second half of the year is favored by the decreasing effect of foreign factors due to the strong base effect from a year ago and due to fall in prices of education services. Food inflation will be higher this year as a result of unfavorable weather conditions, which caused the price increases in fruits and vegetables. In 2014, inflation will decelerate due to receding price pressures coming from energy prices. Dropping out the impact from electricity market opening will be the biggest factor in the beginning of next year. On the other hand, core inflation will accelerate during 2014, contributing from stronger wage increases and the ending of one-off price decreases of some services. Taking into consideration that there will not be any large price fluctuations in commodity prices, consumer price increase will stabilize below 3% in following years.

Despite the deceleration of economic growth, the **average wage** growth in the first half of 2013 was fast. Wage growth in 2013 will be at 6%, which increases in 2014 to 6.2% due to acceleration of economic growth and improvement of the situation in the main partner countries. The slowdown of consumer price growth will support the increase of real wage growth, which will remain slightly below 3% in 2013, but accelerate in the following years.

The increase of **employment** accelerated in the first half of 2013, but compared to last year, the increase will slow to 1.3%. In 2014, employment growth will decline further to 0,4% and is forecasted stop in the following years. This is due to demographic reasons, which in the immediate years are compensated by the activity level rising above 68%. Unemployment will continue to fall with the unemployment rate expected to reach 9.3% in 2013 and 8.3% in 2014.

In 2013 general government **budgetary position** is in deficit by 0.2% 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 increases to 0.6% 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 (-0.3% of GDP in 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. According to forecast the budget balance will be achieved in 2016 and surplus of 0,9% of GDP in 2017.

In 2013 the **tax burden** is forecasted to be at 33.3% of GDP. In 2014–2017 there are higher pension II pillar payments by government which technically decreases tax burden. In 2015 the income tax rate will be reduced to 20%. During 2014–2017 tax revenues will grow annually 1.1 percent slower than GDP and tax burden decreases to 32.0% of 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 10,3% of GDP due to the increase in EFSF outstanding debt. In 2013 the negative cash flow will be financed from reserves but in 2015-2016 the loans are needed. In spite of that general government debt burden will start to decline, constituting 9,4% of GDP by the end of year 2017.

## Table 1

### GDP Forecast for 2013–2017

*(per cent)*

| | 2012 | 2013* | 2014* | 2015* | 2016* | 2017* |
|---|---|---|---|---|---|---|
| 1. Growth of real GDP | 3.2 | 1.5 | 3.6 | 3.5 | 3.6 | 3.8 |
| 1a. GDP in real terms (bln EUR) | 12.6 | 12.8 | 13.2 | 13.7 | 14.2 | 14.8 |
| 2. Growth of nominal GDP | 6.6 | 5.8 | 6.8 | 6.5 | 6.7 | 6.9 |
| 2a. GDP in nominal terms (bln EUR) | 17.0 | 18.0 | 19.2 | 20.4 | 21.8 | 23.3 |
| 2b. GNI in nominal terms (bln EUR) | 16.2 | 17.0 | 18.2 | 19.4 | 20.6 | 22.0 |
| **Components of real GDP** | | | | | | |
| 3. Private consumption expenditure (incl. non-profit organisations) | 4.4 | 3.5 | 4.1 | 4.2 | 3.7 | 3.8 |
| 4. Government final consumption expenditure | 4.0 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| 5. Gross fixed capital formation | 20.9 | 1.2 | 3.0 | 4.0 | 6.1 | 9.2 |
| 6. Changes in inventories (% of GDP) | 2.6 | 2.8 | 3.0 | 2.9 | 3.0 | 2.9 |
| 7. Exports of goods and services | 5.6 | 6.0 | 6.2 | 6.5 | 6.8 | 6.8 |
| 8. Imports of goods and services | 9.1 | 6.8 | 5.5 | 6.2 | 6.9 | 7.4 |
| **Contributions to real GDP growth 1)** | | | | | | |
| 9. Domestic demand (without inventories) | 7.5 | 2.2 | 2.9 | 3.2 | 3.5 | 4.3 |
| 10. Changes in inventories | -0.4 | 0.0 | 0.0 | -0.1 | 0.1 | -0.2 |
| 11. Ext. balance of goods and services | -2.9 | -0.7 | 0.6 | 0.3 | 0.0 | -0.5 |
| **Value added growth** | | | | | | |
| 12. Primary sector | 13.1 | -1.5 | 3.4 | 2.0 | 2.3 | 2.2 |
| 13. Industry | -2.4 | 5.6 | 5.3 | 5.2 | 5.0 | 5.2 |
| 14. Construction | 14.3 | -0.3 | 3.0 | 3.4 | 4.5 | 4.6 |
| 15. Other services | 3.3 | 1.1 | 3.1 | 3.0 | 3.2 | 3.4 |

*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 2013–2017

*(per cent)*

| | 2012 | 2013* | 2014* | 2015* | 2016* | 2017* |
|---|---|---|---|---|---|---|
| 1. GDP deflator | 3.2 | 4.2 | 3.0 | 2.9 | 2.9 | 2.9 |
| 2. Private consumption deflator | 3.4 | 3.2 | 2.6 | 2.7 | 2.7 | 2.6 |
| 3. Harmonised consumer price index | 4.2 | 3.5 | 3.0 | 3.0 | 3.1 | 3.0 |
| 3a. Consumer price index | 3.9 | 3.2 | 2.7 | 2.8 | 2.9 | 2.8 |
| 4. Public consumption deflator | 3.2 | 4.6 | 3.9 | 4.0 | 4.0 | 4.0 |
| 5. Investment deflator | 1.3 | 3.9 | 2.5 | 2.6 | 2.6 | 3.1 |
| 6. Export price deflator | 2.0 | -0.3 | 1.4 | 2.1 | 2.0 | 2.0 |
| 7. Import price deflator | 2.6 | -0.7 | 1.4 | 2.1 | 2.1 | 2.1 |

*Source: Ministry of Finance of Estonia, Statistics Estonia.*

## Table 3

### Labour Market Forecast for 2013–2017 (15–74- year-old)

*(per cent)*

| | 2012 | 2013* | 2014* | 2015* | 2016* | 2017* |
|---|---|---|---|---|---|---|
| 1. Employment. thousands | 624.4 | 632.5 | 635.0 | 635.0 | 635.0 | 635.0 |
| 1a. Growth of employment | 2.5 | 1.3 | 0.4 | 0.0 | 0.0 | 0.0 |
| 2. Unemployment rate | 10.2 | 9.3 | 8.3 | 7.9 | 7.5 | 7.1 |
| 3. Growth of labour productivity (per person) | 0.7 | 0.2 | 3.2 | 3.5 | 3.6 | 3.8 |
| 4. Real growth of average monthly wage | 1.7 | 2.7 | 3.4 | 3.4 | 3.5 | 3.6 |
| 4a. Average monthly wage (EUR) | 887 | 940 | 998 | 1 061 | 1 130 | 1 204 |
| 4b. Nominal growth of average monthly wage | 5.7 | 6.0 | 6.2 | 6.3 | 6.5 | 6.5 |

*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 | 1.7 | 1.8 | 1.6 | 0.9 | 0.8 | 0.4 |
| 1a. Current account | -1.8 | -1.8 | -1.2 | -1.3 | -1.5 | -2.1 |
| 2. Balance of goods and services | 2.6 | 1.9 | 2.6 | 2.9 | 2.8 | 2.2 |
| 3. Balance of primary incomes and transfers | -4.4 | -3.7 | -3.8 | -4.1 | -4.3 | -4.4 |
| 4. Capital account | 3.6 | 3.6 | 2.9 | 2.2 | 2.3 | 2.5 |
| 5. Errors and omissions | 0.0 | | | | | |

*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** | **-0.2** | **-0.6** | **-0.8** | **0.0** | **0.9** |
| 2. Central government | -0.7 | -0.3 | -0.7 | -1.0 | -0.3 | 0.6 |
| 3. Other general government | 0.5 | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 |
| incl. Social security funds | 0.7 | 0.3 | 0.3 | 0.4 | 0.4 | 0.5 |
| incl. Local governments | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| **General government debt** | | | | | | |
| 4. General government | **10.1** | **10.3** | **10.0** | **10.3** | **10.0** | **9.4** |
| 6. incl. central government (with EFSF) | 6.8 | 7.0 | 6.7 | 7.0 | 6.7 | 6.1 |
| 7. incl. local governments | 3.3 | 3.4 | 3.3 | 3.3 | 3.3 | 3.3 |
| **Tax burden** | **33.3** | **33.3** | **32.5** | **32.1** | **32.0** | **32.0** |

*Source: Ministry of Finance of Estonia, Statistics Estonia.*