Euler Hermes Economic Research

Country Report

Estonia

Geopolitical uncertainties weigh on growth

General Information

GDP	USD21.85 bn (World ranking 102, World Bank 2012)
Population	1.34 mn (World ranking 152, World Bank 2012)
Form of state	Parliamentary Republic
Head of government	Andrus ANSIP
Next elections	2015, legislative

Strengths

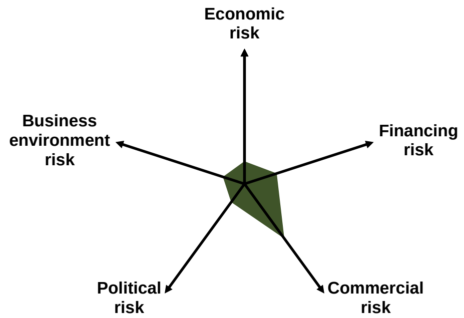
- Low systemic political risk
- Good regional and international relations (except with Russia), EU membership
- One of the most open and liberal economies in the world
- Eurozone membership provides for low transfer and convertibility risk
- Healthy public finances
- Strong business environment, supported by stable institutions and an independent judiciary

Weaknesses

- High gross external debt
- Trade and energy dependence on Russia

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Sweden	16%	1	13%	Russian Federation
Finland	14%	2	11%	Finland
Russian Federation	11%	3	9%	Germany
Latvia	9%	4	9%	Lithuania
Lithuania	6%	5	8%	Sweden

By product (% of total)

Exports		Rank		Imports
Telecommunications Equipment	13%	1	23%	Refined Petroleum Products
Refined Petroleum Products	9%	2	5%	Electrical Apparatus
Electrical Apparatus	5%	3	4%	Telecommunications Equipment
Construction Equipment	4%	4	3%	Cars And Cycles
Non-Edible Agricultural Prod.	3%	5	3%	Plastic Articles

Sources: Unctadstat, Chelem (2012)

Economic Overview

Moderate recovery

Following the financial crisis and deep recession in 2008-2009, the Estonian economy has rebounded strongly and shown resilience to the ongoing eurozone crisis that emerged at end-2009, growing by an average annual +5% in 2010-2012, clearly outpacing the rest of the eurozone. Real GDP growth decelerated markedly to +1.6% in 2013, which was entirely driven by domestic demand, with private consumption expanding by +3.8%, government consumption by +2.8% and fixed investment by +2.5%. External trade activity decelerated in 2013 owing to weakening demand from the eurozone. Net exports subtracted -0.5pps from growth as exports increased by +2.6% while imports grew by +3.1%.

In 2014, real GDP growth slowed down further to just +0.3% y/y in Q1, but picked up again to +2.4% y/y in Q2. The average growth of +1.4% y/y in H1 was again driven by domestic demand, with private consumption increasing by +3.6% y/y, government consumption by +0.5% y/y and fixed investment by +2.5% y/y. External trade activity remained weak in H1, with exports up by just +0.3% y/y and imports by +0.9%, such that net exports subtracted -0.4pps from H1 growth. Against the background of a moderate recovery in the eurozone and an expected recession in Russia as well as geopolitical uncertainties – Russia is a main trading partner and energy provider for Estonia – EH forecasts full-year GDP growth of +1.5% in 2014 for Estonia, followed by +2% in 2015.

Deflation risk

Headline consumer price inflation has gradually moderated from a high of 5.7% y/y at end-2010 to 1.4% y/y at end-2013 and has entered deflationary territory in June 2014, reaching -0.7% y/y in August. Deflation has been mainly driven by sharply falling energy costs as well as lower food prices. EH expects deflation to continue until early 2015, before giving way to positive inflation which is projected to reach about 1.5% at end-2015.

Public finances favourable

Estonia has had a long-lasting commitment to budgetary prudence, reflected in many years of large fiscal surpluses. But in the wake of the economic downturn in 2008 the fiscal account shifted into a deficit of 2.7% of GDP. Thanks to sharp fiscal tightening, the government achieved a remarkably low 2% of GDP fiscal deficit in 2009, despite the steep -14.7% contraction of GDP which eroded the tax base. Thanks to sizeable sales of so-called "Kyoto units" (representing an allowance to emit greenhouse gases), the fiscal balance shifted to small surpluses in 2010 and 2011. However, the fiscal balance shifted back into small deficits of 0.2% of GDP in both 2012 and 2013. Marked increases of public wages and pensions are expected to widen the annual fiscal deficit to about 0.5% of GDP in 2014-2015, which still will not pose any problem.

Gross public debt has remained very low, estimated at about 10% of GDP at end-2013, and the government has remained a net external creditor.

Eurozone membership beneficial

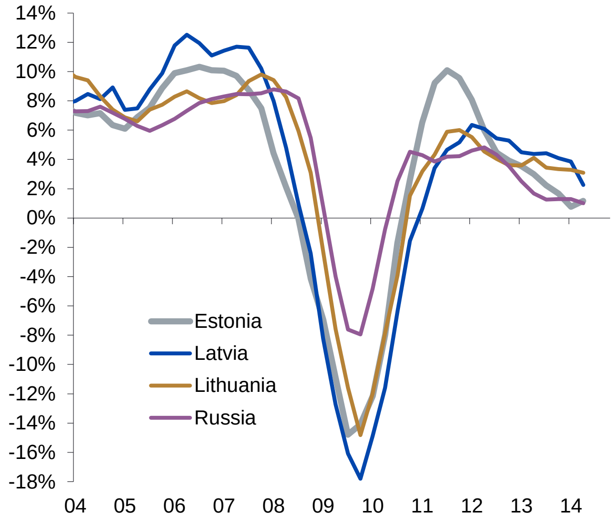
Thanks to retention of favourable fiscal indicators as well as to low inflation and exchange rate stability, Estonia was able to join the eurozone at the start of 2011. While monetary policy is now conducted by the European Central Bank (ECB), membership of the eurozone

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	4.7	1.6	1.5	2.0
Inflation (%, end-year)	3.5	1.4	-0.5	1.5
Fiscal balance (% of GDP)	-0.2	-0.2	-0.5	-0.6
Public debt (% of GDP)	9.8	10.0	9.8	9.6
Current account (% of GDP)	-2.1	-1.4	-2.1	-2.4
External debt (% of GDP)	101.9	93.6	94.0	93.0

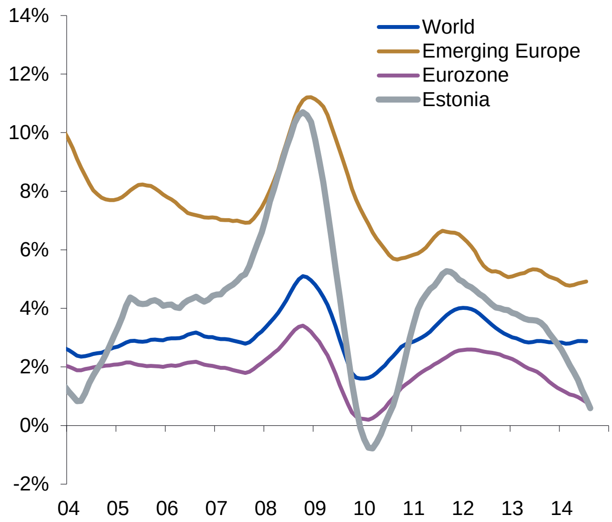
Sources: National sources, IHS, Euler Hermes

GDP growth (% y/y, 4 qtrs cumulated)



Sources: National sources, IHS, Euler Hermes

Inflation rate (12-month moving average, %)



Sources: National sources, IHS, Euler Hermes provides for low transfer and convertibility risk (as long as the eurozone remains intact) and has substantially decreased external vulnerabilities related to exchange rate risk.

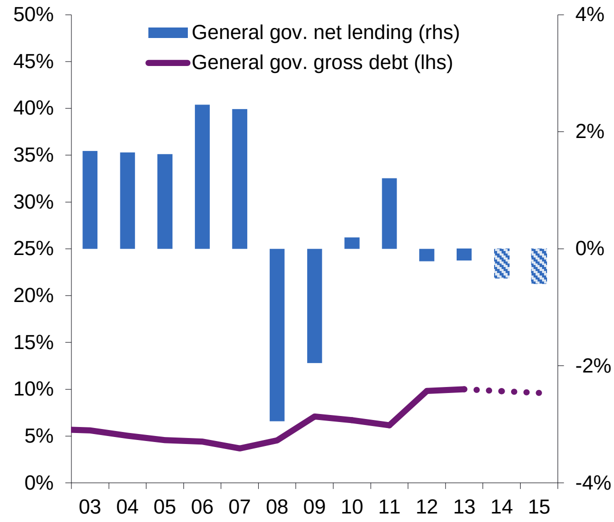
Current account deficit unproblematic

Following years of unsustainably high deficits until 2008, the current account swung to a 2.5% of GDP surplus in 2009, as imports (in line with domestic demand) contracted even sharper than exports. The surplus narrowed to 1.8% in 2010 and 0% in 2011, before shifting back to moderate annual deficits of 2.1% of GDP in 2012 and 1.4% in 2013 as external demand weakened. EH forecasts the annual deficit to widen slightly to still acceptable ratios of 2-3% of GDP in 2014-2015.

External debt high but manageable

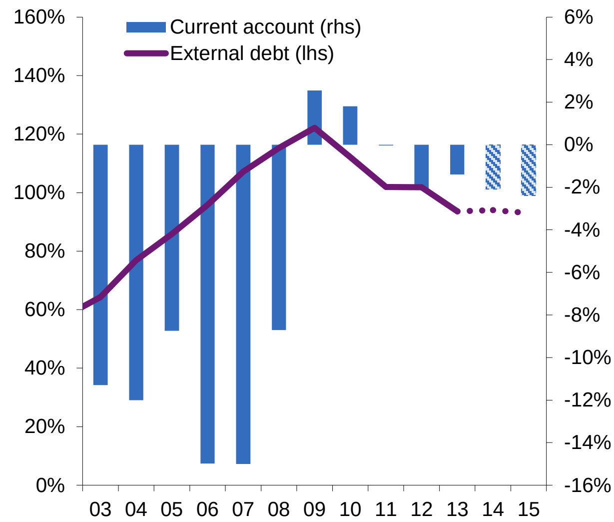
Gross external debt stood at EUR19bn in Q2 2014. This was still relatively high in relation to GDP (approximately 94%), however, that ratio has improved from a peak of 122% in 2009. Moreover, external assets have increased substantially in recent years and reached EUR20bn in Q2 2014, i.e. Estonia has become a net external creditor (currently net external debt stands at about 6% of GDP). Around 46% of gross external debt is short-term.

Public finances (% of GDP)



Sources: National sources, IHS, Euler Hermes

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2014-09-09
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com