Euler Hermes Economic Research

Country Report

Estonia

Exports affected by crisis in Russia but economic fundamentals remain strong

General Information

GDP	USD25.9bn (World ranking 104, World Bank 2014)
Population	1.31mn (World ranking 154, World Bank 2014)
Form of state	Parliamentary Republic
Head of government	Taavi ROIVAS
Next elections	2016, presidential

Strengths

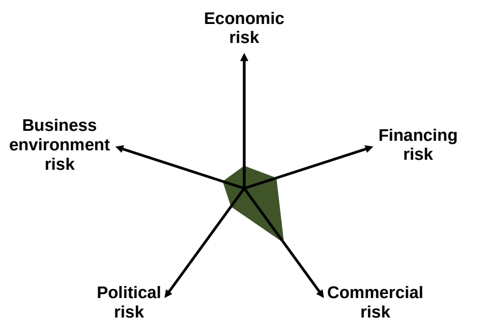
- Low systemic political risk
- Good regional and international relations (except with Russia), EU membership
- One of the most open and liberal economies in the world
- Eurozone membership provides for low transfer and convertibility risk
- Healthy public finances
- Strong business environment, supported 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	17%	Refined Petroleum Products
Refined Petroleum Products	6%	2	5%	Electrical Apparatus
Electrical Apparatus	5%	3	5%	Telecommunications Equipment
Non-Edible Agricultural Prod.	4%	4	4%	Cars And Cycles
Construction Equipment	4%	5	3%	Plastic Articles

Source: Unctadstat, Chelem (2013)

Economic Overview

Growth affected by Russia crisis

Following the financial crisis and deep recession in 2008-2009, the Estonian economy rebounded strongly and showed resilience to the Eurozone crisis that emerged at end-2009, growing by an average annual +4% in 2010-2014, clearly outpacing the rest of the Eurozone. In 2014, however, external trade activity decelerated markedly as a result of sanctions on and the economic slowdown in Russia, but thanks to a strong inventory build-up (adding +2.5pps) annual real GDP still grew by +2.9%.

In 2015, the negative impact of the crisis in Russia has intensified. Real GDP contracted by -0.8% q/q in Q1, followed by +0.6% q/q growth in Q2 and another decline by -0.4% q/q in Q3. On a y/y basis in the first three quarters, real exports contracted by -0.8% and real imports by -2.2%. The latter mainly reflects a sharp drop in fixed investment by -7.1% and strong inventory de-stocking which subtracted -2.6pps from overall y/y GDP growth. Thanks to continued robust expansion of private consumption (+5.1% y/y) and public spending (+1.6% y/y), the economy still grew by +1.3% y/y in Q1-Q3. Euler Hermes expects a relatively weak Q4 and full-year growth of +1.1% in 2015. The negative impact from Russia should fade next year as trade with the eastern neighbour should stabilise, such that a moderate recovery with average annual economic growth of around +2.5% is forecast in 2016-2017.

Deflation to fade gradually in 2016

Headline consumer price inflation has been in deflationary territory since June 2014 – except for May 2015 – and stood at -0.2% y/y in November 2015. Deflation has been mainly driven by sharply falling energy costs as well as lower food prices. As the effect of low oil and energy prices will wane in 2016, deflation should give way to positive inflation in the next quarters. Euler Hermes projects inflation to reach about 1% at end-2016.

Public finances to remain 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 -2.9% of GDP. Thanks to sharp fiscal tightening, the government achieved a remarkably low -1.9% of GDP fiscal deficit in 2009, despite the steep -14.3% 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, before it moved back into small deficits in 2012 and 2013. A fiscal surplus of +0.7% of GDP was achieved in 2014. As a result of the growth slowdown, the annual fiscal account is forecast to move to near zero in 2015-2016.

Gross public debt has remained very low, estimated at just above 10% of GDP currently, and the government has remained a net external creditor.

Eurozone membership is beneficial

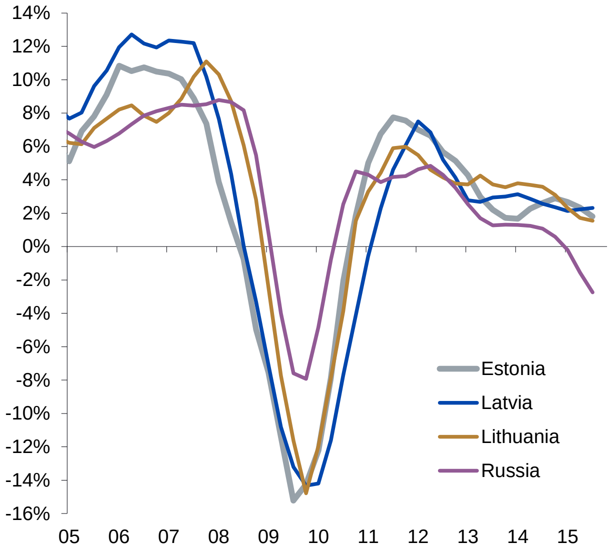
Estonia joined the Eurozone at the start of 2011. While monetary policy is now conducted by the European Central Bank (ECB), membership of the Eurozone provides for low transfer and convertibility risk and has substantially decreased external vulnerabilities related to exchange rate risk.

Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	2.9	1.1	2.5	2.6
Inflation (%, end-year)	-0.5	-0.5	1.0	1.5
Fiscal balance (% of GDP)	0.7	-0.1	0.0	0.1
Public debt (% of GDP)	10.4	10.5	10.0	9.8
Current account (% of GDP)	1.2	1.7	1.0	0.8
External debt (% of GDP)	94.6	100.1	99.0	98.0

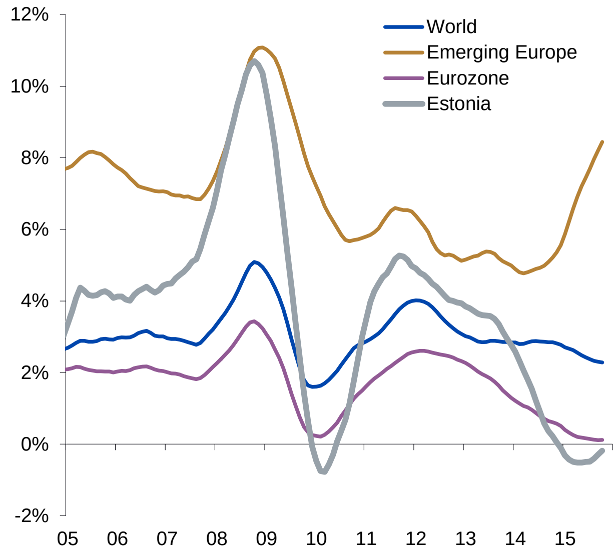
Sources: National sources, IHS, Euler Hermes

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

Export growth hit by Russia crisis ...

The Baltic States are more vulnerable to disruptions to export flows to Russia than other EU countries because their share of exports to Russia in total exports is much higher: 21% for Lithuania, 15% for Latvia and 10% for Estonia in 2014, as compared to an average 4% for the 11 EU members in Central Europe or just 2% for the whole EU. In H1 2015, nominal exports of goods to Russia dropped the most in Estonia, by -42% y/y. This caused total nominal exports of goods to decline by -2%.

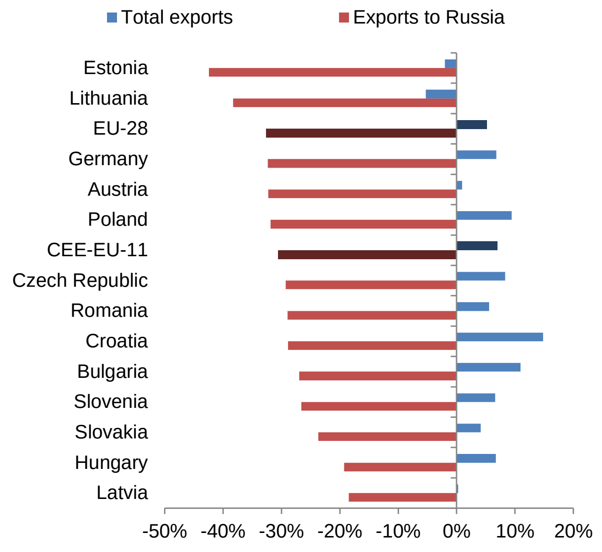
... but current account surplus to remain

Following moderate annual deficits of -2.8% of GDP in 2012 and -0.1% in 2013, the current account swung to a +1.2% of GDP surplus in 2014, as the moderation in import growth was stronger than in exports. Since this pattern has continued in 2015 – nominal imports of goods and services contracted by -4.2% y/y in Q1-Q3, nominal exports of goods and services by -2.9% y/y – Euler Hermes expects the current account surplus to widen further in 2015. A surplus should be retained in 2016-2017 but is forecast to narrow gradually as import growth is likely to gain momentum following two years of substantial declines in investment.

External debt is high but manageable

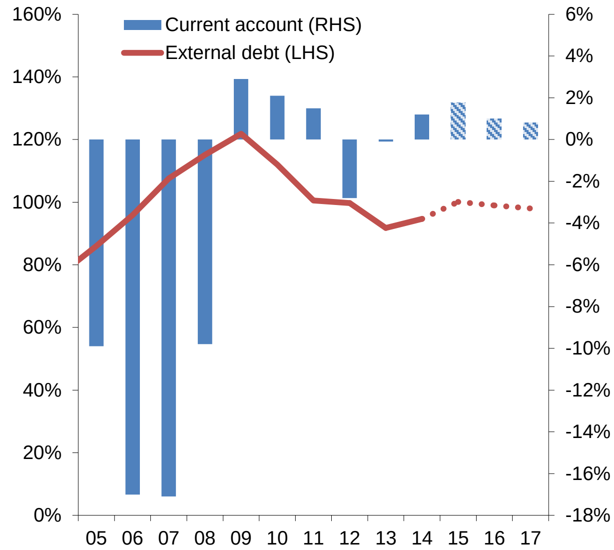
Gross external debt stood at EUR20bn in Q2 2015. This was still relatively high in relation to GDP (approximately 100%), however, that ratio has improved from a peak of 122% in 2009. Moreover, external assets have increased substantially in recent years and reached EUR21bn in Q2 2015, i.e. Estonia has become a net external creditor. Around 46% of gross external debt is short-term.

Change in exports to Russia and total exports (% y/y, H1 2015), selected economies



Sources: IMF, 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: 2015-12-09
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com