ESTONIA

Economic growth is projected to reach 3.5% in 2019, before slowing to 2.3% in 2020 in line with weakening external demand. Increasing real wages will support robust private consumption growth. Investment is set to pick up, supported by strong business confidence and the recovering housing market. Inflation will remain at a high level, sustained by further tightening of the labour market.

The government budget is projected to be in surplus during the projection period, while the public debt-to-GDP ratio will remain among the lowest in the OECD. While procyclical fiscal policy should be avoided, there is space to let fiscal policy play a more active role to boost job creation, invest in infrastructure, and mitigate environmental concerns.

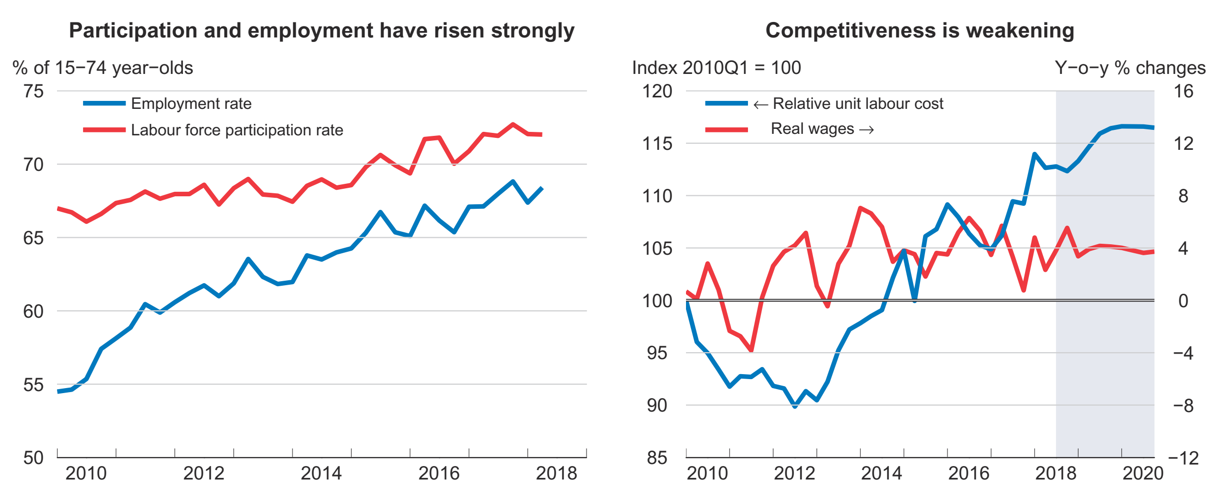
Strong and broad-based growth continues

The economy continues its expansion with relatively broad-based economic growth. Strong household and business confidence is supporting private consumption. Residential investment has picked up following a housing downturn, and now makes a sizeable contribution to growth. Robust foreign demand has supported export growth. As slack is being eliminated from the economy and employment has risen, nominal wage growth has been strong, around 6% a year, and labour shortages are emerging, particularly in sectors such as retail. Thus far, strong wage growth has not given rise to an acceleration of price inflation. Core inflation is currently around 1%, whereas headline is around 3-4%, lifted by higher excise taxes and large movements in energy prices.

Sustainable growth requires productivity-enhancing reforms and immigration

Monetary policy for the euro area is projected to remain very accommodative for a prolonged period. While fiscal policy should avoid being expansionary, which would aggravate labour and product market tensions, there is space to address supply constraints

Estonia



Source: OECD Economic Outlook 104 database; and OECD Labour Force Statistics database.

StatLink http://dx.doi.org/10.1787/888933876575

Estonia: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	20.6	3.5	4.7	3.3	3.5	2.3
Private consumption	10.6	4.1	2.7	4.3	4.0	3.5
Government consumption	4.1	2.1	0.6	0.0	0.9	0.8
Gross fixed capital formation	4.9	3.5	12.9	1.8	6.1	4.6
Final domestic demand	19.6	3.6	4.9	2.8	3.8	3.2
Stockbuilding[1]	0.2	1.0	-0.5	0.2	0.0	0.0
Total domestic demand	19.8	4.7	4.4	3.0	3.8	3.2
Exports of goods and services	16.0	5.2	3.5	4.4	4.4	3.1
Imports of goods and services	15.2	5.4	3.6	5.1	4.3	4.4
Net exports[1]	0.8	0.0	0.1	-0.3	0.2	-0.8
Memorandum items						
GDP deflator	_	1.4	4.0	3.7	3.1	3.2
Harmonised index of consumer prices	_	0.8	3.7	3.1	2.9	2.8
Harmonised index of core inflation[2]	_	1.2	2.0	1.4	2.8	2.8
Unemployment rate (% of labour force)	_	6.8	5.8	5.8	5.8	6.0
Household saving ratio, net (% of disposable income)	_	6.5	7.9	7.9	7.6	7.3
General government financial balance (% of GDP)	_	-0.3	-0.4	0.7	0.3	0.1
General government gross debt (% of GDP)	_	12.7	12.6	11.9	11.2	10.4
General government debt, Maastricht definition (% of GDP)	_	9.2	8.7	8.1	7.4	6.6
Current account balance (% of GDP)	_	1.9	3.1	2.7	2.3	1.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933877639

and step up redistribution through taxes and transfers to improve opportunities for those currently at risk of poverty.

Negative demographic trends and emigration of workers accentuate labour shortages and make finding labour increasingly expensive. Around a third of the registered unemployed are people with reduced working ability, reflecting implementation of the Work Ability reform to bring individuals back into the labour force. Policy measures to help people into employment can help ease some of the pressures while also boosting household incomes. Labour market tensions will be aggravated further in the future by a shrinking working-age population, limiting the growth potential of the economy. Recent reform of immigration policies has eased access to skilled workers from non-EU countries. Annual quotas remain tight, but could be relaxed further, which would help to ease labour shortages.

Business fixed investment has slowed markedly and is now at historically low levels as a share of GDP. Furthermore, investment is lacking in sectors with low productivity. The weakness of investment has meant that the economy has hit capacity constraints. This puts competitiveness at risk of deteriorating. However, Estonian exports have moved up in the value-added chain, facilitating higher prices, which have partly compensated for higher labour costs. Structural policies to boost productivity growth will help sustain income growth. Improving insolvency procedures to speed up the reallocation of resources will help in this regard.

Growth is projected to slow

The economy is projected to slow to a more sustainable pace during the projection period. Business investment will nevertheless recover, partly with the assistance of EU structural funds. For example, the construction of Rail Baltica will boost both public and business investment in 2020. As the economy slows, inflation will stabilise. With the economy approaching its supply constraints, there is a risk of higher wage and price inflation, which can further deteriorate competitiveness. In addition, Estonia is particularly vulnerable to drops in external demand, being a very open economy.