

Estonian Economy

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|----------------------------------|---|---------------------------------|---|
| ESTONIAN ECONOMIC POLICY | 1 | BANKING | 4 |
| MAJOR ECONOMIC INDICATORS | 2 | CONSTRUCTION | 4 |
| FISCAL POLICY | 2 | ENERGY | 4 |
| LABOUR MARKET | 2 | INDUSTRY | 5 |
| PRICES | 3 | IT | 5 |
| FOREIGN ECONOMIC RELATIONS | 3 | MEDIA, TELECOMMUNICATIONS | 5 |
| DEVELOPMENT BY SECTORS | 4 | REAL ESTATE | 5 |
| | | TRANSPORT | 6 |

ESTONIAN ECONOMIC POLICY

- **Estonian PM Ansip finds that the aim of slowing down the growth rate in the consumer price index to 3.5 percent by 2011 is not ambitious enough.** Ansip said he would rather prefer to trust institutions that promise lowering our inflation rate to under 3 percent by that time. The government has received an overview of the economic growth and employment for the years 2008-2011, which fixes 9 main aims of raising Estonia's competitiveness. Speaking about aims of the program, Ansip underlined, that also in the future the government sector budget would be planned with a 1 percent surplus above the GDP and to reduce the government sector loan burden by 0.1 percent to 3.3 percent of GDP. Among other things the aim is to increase the share of expenditure on research and development activity to 2 percent of GDP. The share of people taking part in lifelong learning should rise to 12.5 percent by 2011. Productivity should rise to 80 percent of the EU average according to the plan. Estonia must present the new economic growth and employment strategy plan to the European Commission by October 15. According to the plan the program will be submitted for endorsement by the government on its session on October 9.
- **A consumer poll of the Estonian Institute of Economic Research (EKI) carried out in May showed continued fall in consumers' sense of security, although families' economic situation had not deteriorated.** Expectations of the economic situation of the family as well as of the country during the next year had deteriorated. In consumer's opinion unemployment could increase and the activity of buying durable goods was low. At the same time, the poll showed that the immediate financial situation of families had not deteriorated. In May 46 percent managed to make savings, 43 percent made ends meet and 8 percent of the respondents lived on debts. Compared with 2006 and 2007 the number of people living at the expense of earlier savings and debts had not increased. Many consumers have cut back their purchases in accordance with the rising prices and as a result cope with the financial situation of the family.
- **The Estonian Tax Board said that 2,300 taxpayers declared incomes of more than one million kroons (EUR 64,000) for 2007, nearly one third more than the year before.** The number of persons who earned an income of more than one million kroons grew by 565. Most of the people who declared incomes of more than 10 million kroons mainly earned it from the sale of property. The oldest person who declared an income of more than 10 million kroons was 71 and the youngest 27 years old. The average age in this group of taxpayers was 49.
- **A poll on the reputation of major Estonian companies established that Hansapank has the best reputation among the country's major companies in 2008.** Hansapank's reputation has been high through the years, last year the company ranked second. Following Hansapank comes AS Kalev, the company with the best reputation last year, and AS SEB bank, last year's No 5. Of major state-owned companies, Eesti Energia, No 12 in the general list, is regarded as having the best reputation.
- **Siim Kallas, Vice-President of the European Commission, that assessment of interested countries' euro readiness could become stricter than at present.** In his comment, Kallas referred to Slovenia and Slovakia. Slovakia adopted the euro from the beginning of last year, but the rate of inflation has been considerably higher

there than in other countries using the euro. So the annual inflation of the whole euro zone was 3.3 percent, while in Slovenia the figure was 6.2 percent. Also Slovakia recently received the European Commission's recommendation to switch to the euro, but the European Central Bank has warned that rising prices could create problems also there. Germans in particular are critical of the enlargement of the euro zone at present. Kallas said that it was a problem that Estonia had still not managed to adopt the euro. If Estonia were using the euro, the country would have one worry less.

MAJOR ECONOMIC INDICATORS

- **Estonia has dropped one notch in the competitiveness ranking of the Lausanne, Switzerland-based international business school IMD, placing nevertheless in the high 23rd position.** Last year Estonia ranked 22nd and a year before that, 19th. The United States topped the ranking also this year, followed by Singapore and Hong Kong. Of East European countries, the Czech Republic was the second most competitive economy after Estonia in 28th. Lithuania dropped from 31st to 36th and Latvia was not among the 55 countries surveyed. Russia dropped from 43rd to 47th.

FISCAL POLICY

- **Moody's Investors Service published an overview of developing European countries' rating outlooks, assessing pressures on the Estonian country rating weaker than on those of Latvia and Lithuania.** Moody's said that tensions in the economy of developing Europe were growing and were about to reach a critical level. Many countries have had current account deficits for years and fast growth in loans has created the danger of hard landings. But there had been next to no changes in the country rating as according to the agency's main scenario tensions in the economy were going to gradually decrease. Moody's carried out a tension tolerance test in order to assess vulnerability. Moody's said that it was worried about the threat of hard landing varying from moderate to severe. Hard landing means fast and painful adaptation of the economy after a long period of growth.
- **The inflow of tax revenue in May apparently has happened at a faster rate than in any other month so far this year, Estonian PM Ansip said.** It can be said with certainty now that both the fuel excise duty and the alcohol excise duty have started to come in at a solid rate again. The government is not predicting a substantial improvement in the intake of the tobacco excise duty in the near term, yet also in that respect the situation was better in May than in February or March. As regards VAT, May definitely will produce the year's biggest monthly intake, and the sum received will be in line with the state budget, Ansip said. The government this year will start the process of drafting next year's state budget a little later than usual.
- **Estonia's fiscal policy must not fully lose a positive impulse, especially through the cutting of investments, a mission of the IMF visiting Estonia said.** IMF backs Estonia's intention to find further means for cost-saving. At the same time, investments are necessary for restoring economic growth. More generally, saving, which will lead to a more effective distribution of resources, should be given a priority. First and foremost a balance should be maintained in Estonia's fiscal policy between improving the weakened fiscal position and supporting demand. The negative supplementary budget whose draft was endorsed in Estonia lately contains adjustments that will simultaneously reduce the estimated gap and maintain a positive fiscal impulse to soften the slowdown. The IMF mission describes the fiscal measures by the Estonian government to be a well-balanced response to the slowing down of the economy. The head of the IMF mission wrapping up its visit to Estonia, welcomed the proposal of the government to freeze the government sector payroll for the next two years, which would give a strong signal for a slowdown of wage growth to the private sector as well.

LABOUR MARKET

- **24 percent of employers in Estonia take interest in foreign labor, it appears from a recent survey.** The share of such respondents increased by nearly 10 percentage points compared with a similar poll taken 3 years ago. Employers are keen to employ workers primarily from Ukraine, Russia, Finland and elsewhere in Europe. They generally have their sights on nearby countries where wages are either lower or equal with the Estonian pay level. If in 2005 employers most often wished to hire specialists from abroad, then now a bigger need has arisen for skilled workers and simple laborers, it appears from the survey. At the same time, 79 percent of employers are in their own opinion not sufficiently informed about matters related to hiring labor from other EU member states. 84 percent said they were not informed about hiring labor from third countries.
- **Analysts find that the growth in wages in Estonia should slow down this year.** Above all, the expected slowdown in the growth of wages depends on the situation of the labor market, the need of workers in various sectors. Hansapank Markets analysts are expecting a fall in the number of employees in the building sector (above all in housing construction), as well as companies that have lost its competition advantages due to cheap

output. Until the present, the growth in wages has mainly been nurtured by shortage of workhands and inflation. But it is necessary to bear in mind in the present decelerating economic growth conditions that the situation on the labor market is no longer so strenuous and more labor is available. At the same time it has become more complicated to sell the output. Analysts of Nordea Pank forecast that the growth in wages would fall to a sustainable or even lower level during the year. Due to the high inflation, growth in real wages has been considerably smaller than that in nominal wages.

- **Statistics Estonia said the average gross wages of full and part time workers of enterprises, institutions and organizations were 12,337 kroons (EUR 788.3) per month and 74.74 kroons per hour in Q1.** Compared with Q1 last year the average gross monthly wages increased by 19.5 percent and the gross hourly wages by 20.5 percent.
- **Compared with other countries of the EU, Estonia spent relatively the least on labor policy measures 3 years ago, it appears from a recent Eurostat survey.** If 2.11 percent of the GDP was allocated for measures to return to the labor market unemployed people and other groups of residents whose situation was worse than that of others in 2005, then in Estonia the figure was 0.19 percent. Labor policy expenditures were the highest in Denmark (4.1 percent of GDP), followed by Belgium and the Netherlands. Latvia spent 0.54 of its GDP on labor market measures and Lithuania 0.34 percent.
- **Estonia's unemployment rate was 4.2 percent and women's situation on the labor market worsened in the first quarter of 2008.** Last year unemployment decreased continuously: if in the first quarter the jobless rate was 5.3 percent, then at the end of the year it fell to 4.1 percent. In the first quarter of this year the downward trend of unemployment continued only among men while the situation of women on the labor market deteriorated. The jobless rate of women grew to 4.8 percent and was bigger than that of men. It was primarily non-Estonian women who had problems with finding a job. Their unemployment rate rose to 8.6 percent in the first quarter. Employment increased among men due to the decline in both joblessness and inactivity.

PRICES

- **Producer prices climbed by 7.3 percent on year in Estonia in April and by 0.7 percent against March.** In March, the average rise in the producer price index on year was 8 percent. In April against the same month last year the producer price was affected the most by a rise in energy prices, in mining and in the production of foodstuffs and beverages. On month the price rise in energy, mining, leather processing and leather products manufacturing as well as in rubber and plastic products affected producer prices more than the average. The rise in the export price index in April 2008 against the same period last year was by 5.2 percent and by 0.4 percent against March. The import price index climbed by 5.5 percent on year and by 0.7 percent against March in April 2008.
- **The consumer price index in Estonia in April 2008 was by 11.4 percent higher than in April 2007.** The increase in the consumer price index that had slightly slowed down in March accelerated again in April. The annual rate of increase in the consumer price index has stayed close to 11 percent in the first months of this year. Previously this year the highest rate of inflation was recorded in February, when the annual increase in CPI was 11.3 percent. In March the price increase slightly slowed down. In April 2008 compared to April of the previous year, the prices of goods rose by 10.4 percent on average, including food by 15.3 percent and manufactured goods by 6.5 percent. Prices of services increased by 13.4 percent. On average, the prices of goods and services in April were by 1.0 percent higher than in March. The monthly change in the consumer price index was mainly the result of an increase in the prices of food and thermal energy. Fresh vegetables, cereal and meat products gave 80 percent of the price increase of food.

FOREIGN ECONOMIC RELATIONS

- **The budget strategy for 2009-2012 that the Estonian government approved sets out 457.8 billion kroons (EUR 29.27 b) as the combined size of the budgets for the next four years.** According to the projection, the size of Estonia's state budget would be 99.5 billion kroons in 2009, 110.9 billion kroons in 2010, 119.7 billion kroons in 2011 and 127.8 billion kroons in 2012. The drafting of the budget for 2009 will formally start with the issuance of a regulation by the minister of finance, which is due by mid-June. The fiscal strategy takes into account the changed economic environment and observes the 3 main principles of fiscal policy -- namely the maintaining of a balanced government sector budget, seeing to it that fiscal policy supported the development of the economy, and having a flexible fiscal policy that would in the event of necessity allow to change existing plans and decisions.
- **Estonian producers' price rises may in the future bolster imports which declined in March.** On the whole, growth in exports is likely to outpace import growth both this and the next year. Analysts predict an increase in the import of goods in 2010 when the economy will likely have entered a growth phase again. The

growth of import should stay modest right now because of smaller internal demand. But if domestic producers raised prices to a level where consumption of imported goods was more advantageous this could boost the growth of imports. Estonia's principal export partners are countries of the EU whose growth forecasts are quite encouraging, and therefore Estonia is expecting positive export growth also in the future.

Further information is available:

<http://www.eestipank.info/pub/en/dokumentid/statistika/>

DEVELOPMENT BY SECTORS

BANKING

- **The interest rate on euro loans given by Estonian banks in April averaged 5.36 percent, down by 0.13 percentage point from March.** Compared to April 2007, the average interest on euro loans was 0.50 percentage point higher. Average interest on Estonian kroon loans fell during the month by 1.05 percentage point to 11.61 percent. A year ago kroon loans carried an average interest of 8.0 percent. Euro loans to private individuals came with an average interest of 5.72 percent and corporate loans, with 6.36 percent in April. Average interest rates for kroon loans were respectively 19.25 percent and 7.53 percent.
- **The danger of the Baltic countries' hard landing has grown.** Due to a sharp slowdown of the Estonian and Latvian economy lowering of the region's macroeconomic forecasts is inevitable, analysts forecast growth of loan losses for Sweden's Swedbank and SEB in the Baltic countries. Next year the level of Swedbank's loan losses in the Baltic countries will be 120 points and that of SEB's loan losses 100 points. This means that both the banks' profit forecasts will be lowered by 5-10 percent per share in 2009 and 2010.
- **Change of Hansabank's name into that of Swedbank over 2 years will cost about 10 million euros.** The investment has been very equally distributed between the three Baltic countries. The preliminary budget has been drawn up in cooperation with the Swedish owners. Concrete investments are connected with the visual identity of the new name and the network of its gearing, and the group is also planning to organize numerous campaigns directed at clients while introducing the new brand. The exact date of transition to the new brand has not been fixed yet, but legally the name change should take effect at the end of this year or the beginning of the next. The name change will bring no negative consequences to the clients, only the visual identity of the bank will change and the quality of banking services will improve. The contracts signed with the clients will remain the same and no new contracts will be signed.
- **Some 86 percent of Internet users in Estonia use the services of Internet banks.** One third of them carry out online transactions every day. All in all, 69 percent of Estonia's population aged 15-74 use the Internet. The results mean that six out of 10 people in Estonia use online banking services. There are considerably more people who prefer Internet banking in Estonia than in most other East European countries. The large number of Internet bank users is the reason why banks are making remarkable investments in developing online services. Banking transactions are made online also by people who do not have a computer at home and lack access to the Internet. Nevertheless, among the latter people who are not using the services of online banks are in the majority. The use of Internet banking services is equally widespread among ethnic Estonians and Estonian residents of other nationalities. However, a group which clearly stands out from among others is people with a higher education, who use online banking services on a daily basis several times more frequently than people with a lower educational level.

CONSTRUCTION

- **Estonian building companies built 4 percent less in Estonia and foreign countries in Q1 this year than in the same period in 2007 and the building market turned into a fall.** The building market, which had been growing fast during the past few years, slowed down in 2007 and turned into a fall at the beginning of this year due to contraction in domestic housing market volumes. In turn, the situation of the building market was influenced by the general cooling of the economy, continued rise in loan interests and growing building prices. In Q1 building companies' total construction volume in Q1 was 7.3 billion kroons (EUR 466 mln) -- buildings for 5.4 billion and other structures for 1.9 billion kroons. Compared with the same period last year construction of buildings in stable prices declined by 9 percent while the building of structures increased by 17 percent.

ENERGY

- **Greta Energy, a Canadian developer of wind farms, is planning to set up wind farms also on the Estonian island of Hiiumaa in addition to its known projects related to the locations of Udria and Purtse.** It is performing measurements in six places on the northwestern island, focusing on the municipality of Kaina. The capacity planned in Hiiumaa by the Greta Energy subsidiary AS Raunistal would be eight times the capacity of the largest wind farm planned by the national power utility Eesti Energia. With 39 megawatts of capacity, the Eesti Energia wind farm in the Noarootsi area in northwestern Estonia would be the largest such facility in the Baltic states. According to initial plans a single wind farm of Raunistal in Hiiumaa would have a capacity of 310 megawatts.
- **The Estonian seller of heating solutions OU Kuttemaailm says that the already occurred and forthcoming increases in the price of natural gas have cut the sale of gas fueled heating equipment by nearly a third.** Gas fueled equipment, which used to be the most popular kind of heating equipment in Estonia, has yielded its place at the top of the table to more innovative heating systems based on renewable energy. In the sale of equipment using natural gas a 30 percent drop was recorded in the first quarter of 2008 compared with the same three-month period a year ago. Such equipment still accounted for 30 percent of total unit sales. The sale of equipment using renewable energy more than tripled to nearly 40 percent of total unit sales. A particularly notable increase took place in the sale of solar water-heating collectors. Electrical heating equipment is gaining popularity again now that it comes in a combination with other solutions and heat pumps. Such solutions account for 25 percent of total sales.

INDUSTRY

- **Although industrial production in Estonia was expected to decline in March, the decrease was sharper than anticipated.** There are several reasons why production volumes declined more than expected. The cooling of the construction business affects the building materials industry, production volumes of the textile and light industries are decreasing due to the poor competitiveness of the sector -- the rising costs of labor and production mean shutdown of production and taking it out of Estonia. The cutdown in production at Kreenholm has clearly affected the results of the sector and will make itself felt in the future as well. The wood industry is influenced by the overall low economic activity and more expensive raw material, and production volumes in the food industry have declined because of the price rise. Consumers give up expensive domestic products, this is particularly obvious in the dairy industry. There is no reason to think that the production of building materials, the wood industry or the light industry will start showing positive growth figures in the near future.

IT

- **The IT Grupp information technology company has estimated that computers for 2 billion kroons (EUR 128 mln) were bought in Estonia last year.** IT Grupp's market analysis includes laptop and desktop computers plus servers bought in Estonia and reflects both domestic and foreign manufacturers. The sale of laptop and desktop computers plus servers increased by nearly 36 percent in terms of units, while the real growth of the market in financial terms was nearly 10 percent. This is due to the general fall in computer prices by 15-20 percent last year.
- **Estonian Economic Affairs Minister Juhan Parts has underlined the need to develop user-friendly e-services in Estonia.** According to Parts, it appears from studies that there are too few e-services at present, as the people use only a few of them. Parts said that it was important that ideas for the development of services should come from their users. He added that opportunities should be created for increased use of computers and the Internet by the elderly.

MEDIA, TELECOMMUNICATIONS

- **The Nordic telecommunications group Teliasonera announced that it had signed an agreement with Apple on the sale of iPhone multimedia handsets in the Nordic and Baltic countries.** The rights cover Sweden, Norway, Denmark, Finland, Estonia, Latvia and Lithuania. The sale of iPhones will start this year. EMT, the mobile subsidiary of Eesti Telekom, has said earlier it is interested in selling iPhones and that Teliasonera, the Nordic parent of Eesti Telekom, is holding talks to that effect.

REAL ESTATE

- **According to the real estate experts, selling the state properties that Estonia has slated for sell-off is extremely complicated in the present situation.** Uus Maa real estate group said that while the properties actually were rather attractive, the present market situation was too difficult for selling. There are buyers for the properties, but the problem is at what price it will be possible to sell them. There are more and more real estate developers and even speculators with no history of activity in the Baltic countries coming to look around on

the market, keen to make use of today's poor market situation. Of the items that the Estonian state is about to sell, the former presidential summer residence at Paslepa is the most liquid and can be bought for someone for his own needs. There hardly is anyone wishing to obtain the Patarei prison in central Tallinn for the same reason.

- **The recent Estonian real estate boom has not brought any considerable increase in housing in terms of square meters per resident.** Banks and real estate companies say the number of people using their housing loans for the purchase of 1-2 room apartments preferably in an older block of flats is growing. Only a couple of years ago there was higher interest in houses or parts of houses. The reason for the change is high real estate prices, poorer economic situation and tougher loan terms, which do not leave people enough money to buy more spacious housing.

TRANSPORT

- **Rapidly rising fuel prices are forcing Estonian transport companies of different spheres to consider price rises.** Gobus said the fuel price rise put Gobus into a bad fix. It would be necessary to rise prices but on public services this cannot be done due to limits laid down on respective contracts. But the prices of commercial services are likely to rise. Many transport companies are hovering on the verge of profit and loss, which means a price rise of the services for clients.
- **The Estonian government approved a bill bringing the law on safety at sea into line with the respective EU directive.** The directive deals with the mutual recognition of seafarers' certificates issued by the member states. As the deadline for transposing the directive into national legislation was October 2007, the EU's executive Commission has started a violation proceeding against Estonia. The amended law will implement in Estonia the mutual recognition of seafarers' diplomas and certificates issued by EU member states. The bill also allows lighthouse, icebreaking and navigation dues to be enforced by the execution proceeding.
- **More than half of transport companies have trouble with lack of work and one-third of them predict the situation will deteriorate further in the next 6 months.** Compared with January, problems relating to lack of work have grown. If in January 46.5 percent of the firms complained about insufficient demand, then last month already 62.5 percent did. In April 2007 only 23.7 percent of the companies experienced shortage of orders. Meanwhile 31 percent of the firms predicted in April an increase in demand for the next 3 months. Yet half (52.1 percent) do not foresee a growth in demand. Regardless of scant demand, 38.1 percent of the companies said they would raise prices of their services in the next 3 months. Around 60 percent of the firms however are not planning a price rise. Some 12.5 percent of transport companies suffered from a shortage of labor last month compared to 20.5 percent at the beginning of this year. In April 2007, however, half of the firms, in July 80 percent, and in October 59 percent were short of labor.