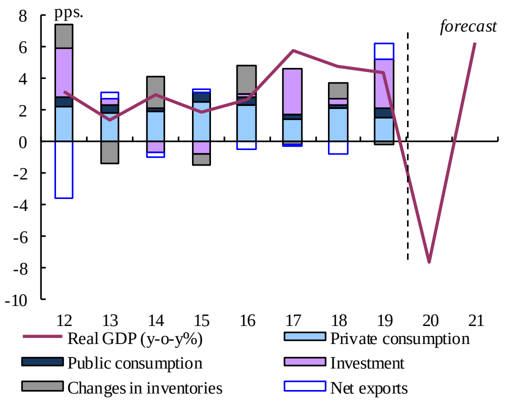
2.3. ESTONIA

GDP fell more than expected in the first quarter of the year, by 3.7% q-o-q and 0.8% y-o-y. The contraction was largely due to factors unrelated to the COVID-19 lockdown measures such as lower production in the energy sector and negative effects on GDP from stocking of motor fuels in the last quarter of 2019. The growth of household consumption flattened to little over zero and corporate equipment investment dropped in the first quarter. At the same time, construction activity was affected less quickly and still expanded. Imports declined by more than exports, increasing the current account surplus.

Estonia's labour market has reacted relatively rapidly to the crisis. In end-June the registered unemployment rate hit almost 8%, compared to 4.7% a year ago. Many companies have responded by either shedding jobs or cutting wages or both but the fall in employment is currently still cushioned by a wage subsidy scheme, in which the state Unemployment Insurance Fund pays part of the wage, subject to certain conditions. After rising sharply early on, the rise in unemployment slowed in May and June.

The economic crisis is expected to bottom out in the second quarter. Some rebound has already been suggested by short-term indicators in May, including a pick-up in retail trade. Pessimism in the manufacturing sector, however, remains entrenched due to high uncertainty surrounding foreign markets and the high reliance of the Estonian economy on exports. The tourism sector will likely have to rely this summer season mostly on tourists from some neighbouring countries, who typically account for fewer than half of foreign tourists in Estonia. Given the weaker first quarter and the extended uncertainty for the exporting sectors, GDP is now forecast to contract by over 7½ % in 2020. In 2021, GDP is expected to rebound by over 6%, reflecting the base effects and the already taken stimulus measures boosting investment and overall confidence.

Graph 2.3: **Estonia - Real GDP growth and contributions**



Inflation turned strongly negative in April and May, primarily reflecting lower energy prices and cuts in excises on some energy products in May. The economic crisis appears to have supressed prices in most product and service categories and the supply side restrictions during the confinement did not lead to higher prices overall. Inflation is forecast to reach just 0.3% in 2020, but to rebound to about 2% in 2021, in line with the assumed recovery in energy prices and the economy.