3. ESTONIA

After a drop of nearly 3% in 2020, Estonia's GDP is forecast to recover by 2.8% in 2021 and by 5% in 2022. Growth is set to be spurred by household consumption, which should receive an additional boost from a partial cashing out of second pillar pension savings in September 2021. Energy prices are set to drive inflation above 2% by 2022. While the fiscal stimulus measures are expected to be discontinued in 2022, the budget deficit is projected to remain above 3% of GDP due to some permanent expenditure increases. Estonia's public debt is forecast to remain the lowest in the EU at 24% of GDP in 2022.

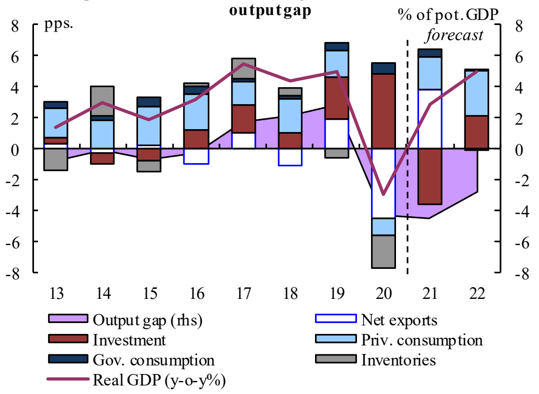
A consumption-driven rebound

GDP contracted by 2.9% in 2020, mainly due to a decline in household consumption, while exports of goods held up relatively well and exports by the ICT services sector increased strongly. A single large investment into software led to a jump in investment and imports and depressed the current account surplus, but with no significant impact on GDP. The 2021 forecast reflects the corresponding base effects for investment, imports and the current account.

In 2021, GDP is forecast to grow by 2.8%. Goods exports have continued to hold up well in the first months of the year. Private consumption is forecast to rebound as soon as COVID-19 restrictions are lifted, as households have accumulated record high savings. In addition, the recent changes to the second pillar of the pension system will allow savers to withdraw their accumulated pension assets at any point in time, even before they reach pension age. The first wave of withdrawals will be paid out in September 2021. It is expected that about a quarter of second pillar pension savings will be cashed out then, amounting to €1.3 bn euro or 4.6% of GDP. This will give a short-term boost to household consumption, the real estate sector and possibly financial investments or repayment of existing consumer loans. The boost to GDP will be dampened somewhat as the sudden income increase will likely be spent on consumer durables, vehicles and holidays abroad, which have a significant import content.

Growth is expected to accelerate to 5% in 2022. That acceleration reflects the low base effect from the first half of 2021, but also investment and household consumption spurred by pension fund withdrawals. In addition, the inflow of EU funds, including from the RRF, is projected to rise and support investment in 2022.

Graph II.3.1: **Estonia - Real GDP growth and contributions, output gap**



Energy prices driving inflation

Consumer prices decreased by 0.6% in 2020, notably due to a fall in global fuel prices. This effect was amplified by a temporary drop in excise duties on diesel fuel from 1 May 2020 for two years. Inflation is forecast to pick up to 1.6% in 2021 and to over 2% in 2022, as global energy prices are assumed to recover and as the higher diesel excise will be reapplied in May 2022. The remaining slack in the economy is expected to dampen services inflation, especially over 2021.

Wages driven up by the ICT and healthcare sectors

Unemployment has stabilised since the end of 2020, even though the first employment support scheme ran out in July 2020 (a more limited scheme ran from December 2020 until February 2021). A second more comprehensive employment support scheme was launched in March 2021 in response to the renewed tightening of restrictions. On an annual basis, the average unemployment rate is forecast to reach almost 8% in 2021, and to decline to over 6% in 2022.

Average wages increased by 2.5% in 2020, notably driven by a strong impact from the ICT sector and extra funding for healthcare. Given that many economic sectors weathered the crisis well and that labour shortages persist for some skills, wage growth is expected to pick up slightly in 2021 and 2022, even if unemployment is expected to remain above pre-crisis levels and the public sector is moderating wages.

Large fiscal stimulus reinstated for 2021

The general government deficit reached 4.9% of GDP in 2020, driven by both lower revenue and fiscal stimulus measures of about 3% of GDP (wage support scheme, healthcare expenditure, investment, local governments, temporary lowering of fuel excises).

In 2021, the deficit is projected to deteriorate to 5.6% of GDP as the 2021 budget foresaw further expenditure rises, notably for investment, an increase in pensions as well as spending on R&D, healthcare and defence. In addition, in response to the second lockdown in March-April 2021, a supplementary budget of 2.3% of GDP was adopted, covering mainly increased healthcare costs, employment and business support measures. At the same time, revenues in the first quarters still show an impact from the crisis. Partly offsetting the deficit increasing measures, the income tax revenue from the second pillar withdrawals is expected to amount to about 1% of GDP.

In 2022, as the tax base recovers and temporary COVID-19 support measures expire, the deficit is projected to decline to 3.3% of GDP, as some of the expenditure increases taken over 2020-2021 (pension increases, investments) are permanent. This forecast integrates RRF-financed expenditure in the same way as the Estonian 2021 Stability Programme. Public debt is forecast to increase from 18.2% of GDP in 2020 to 24% of GDP by 2022.

Table II.3.1:

Main features of country forecast - ESTONIA

		2019			Annual percentage change					
	bn EUR Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	28.1	100.0	3.4	5.5	4.4	5.0	**-2.9**	**2.8**	**5.0**
Private Consumption	13.8	49.0	4.2	2.9	4.6	3.3	**-2.3**	**4.3**	**5.8**
Public Consumption	5.6	19.9	2.5	1.1	0.7	3.0	**3.6**	**2.1**	**0.1**
Gross fixed capital formation	7.4	26.2	5.1	7.8	3.9	11.1	**18.4**	**-11.4**	**7.9**
of which: equipment	2.8	9.9	4.9	9.9	7.8	21.2	**-16.3**	**11.6**	**9.4**
Exports (goods and services)	20.5	72.9	7.0	4.1	4.0	6.2	**-5.5**	**5.5**	**5.7**
Imports (goods and services)	19.4	68.9	7.7	3.0	5.7	3.7	**0.7**	**0.0**	**5.9**
GNI (GDP deflator)	27.5	97.7	3.5	5.3	4.8	4.7	**-2.0**	**2.2**	**4.9**
Contribution to GDP growth: Domestic demand			4.5	3.6	3.4	4.9	**4.4**	**-1.0**	**5.0**
Inventories			0.1	1.3	0.5	-0.6	**-2.1**	**0.0**	**0.0**
Net exports			-0.8	1.0	-1.1	2.0	**-4.5**	**3.9**	**0.0**
Employment			0.4	2.7	1.2	1.3	**-2.7**	**-0.8**	**1.7**
Unemployment rate (a)			9.4	5.8	5.4	4.4	**6.8**	**7.9**	**6.3**
Compensation of employees / head			8.0	10.5	9.0	9.3	**2.5**	**3.5**	**3.5**
Unit labour costs whole economy			4.9	7.6	5.7	5.4	**2.7**	**-0.1**	**0.3**
Real unit labour cost			0.2	4.3	1.5	2.1	**3.2**	**-1.9**	**-2.0**
Saving rate of households (b)			4.5	10.1	10.4	13.5	**16.0**	**13.5**	**10.8**
GDP deflator			4.7	3.1	4.2	3.2	**-0.4**	**1.8**	**2.3**
Harmonised index of consumer prices			3.5	3.7	3.4	2.3	**-0.6**	**1.6**	**2.2**
Terms of trade goods			0.8	0.9	0.0	-0.7	**1.1**	**-0.3**	**-0.1**
Trade balance (goods) (c)			-10.2	-3.8	-4.7	-3.2	**-0.6**	**-0.8**	**-1.3**
Current-account balance (c)			-5.2	2.3	0.9	1.9	**-1.0**	**1.9**	**1.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.4	3.2	2.2	3.1	**0.3**	**3.2**	**2.9**
General government balance (c)			0.5	-0.7	-0.6	0.1	**-4.9**	**-5.6**	**-3.3**
Cyclically-adjusted budget balance (d)			0.3	-1.6	-1.6	-1.3	**-2.8**	**-3.4**	**-1.9**
Structural budget balance (d)			0.5	-1.6	-1.6	-1.3	**-2.8**	**-4.2**	**-2.1**
General government gross debt (c)			6.8	9.1	8.2	8.4	**18.2**	**21.3**	**24.0**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.
Note : Contributions to GDP growth may not add up due to statistical discrepancies.