

Estonia Business Forecast Report Q4 2014

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Abstracts

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Core Views

We believe Estonia is on a sustainable growth trajectory following the deep recession brought on by the eurozone debt crisis, with economic growth to average 3.0% from 2015-2017 before gradually settling towards long-term trend growth of 2.7%. Domestic demand will be the main driver of growth over the medium term, as sluggish regional economic activity hinders faster export growth

Estonia's external accounts pose few risks to macroeconomic stability. Low current account deficits in the coming years will be comfortably financed, and will not be associated with an unsustainable build up of short-term foreign liabilities, as in the pre-financial crisis era. We maintain a positive view towards Estonia's fiscal trajectory, with total public debt to remain the lowest in Europe by a comfortable margin.

Major Forecast Changes

We have revised down our 2014 growth forecast, from 2.0% to 0.9%, as a sluggish recovery in external demand is weighing on the short-term growth outlook. However, we continue to expect a more robust recovery in 2015, as economic recoveries in the eurozone and Nordics gain traction and begin to spur higher regional trade volumes.

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CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Ukraine Crisis Boosts Ruling Party's Appeal

Estonia's ruling Reform Party is likely to remain the largest party in parliament following the 2015 general elections, and retain its coalition with the Social Democrats. The Reform Party's fortunes have been boosted by its tough stance towards Russia over Crimea.

Although fiscal policy will be loosened, we see no risks to Estonia's stable public finances.

Table: political overview

Long-Term Political Outlook

Few Risks To Structural Stability Over Long Term

Estonia is among the most structurally stable countries in emerging markets, as reflected in its very high 84.8 (out of 100) BMI long-term political risk rating. Having fully converged to all major multilateral European institutions (European Union, European Monetary Union and Schengen Agreement), Estonia will continue to benefit from a strong policy anchor and high degree of institutional capacity over the long run. The country's often fractious relationship with neighbouring Russia, undermined by domestic divisions between ethnic Estonian and ethnic Russians, presents the one key risk to stability.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Growth Slowdown Has Bottomed Out

While our forecast for 0.9% real GDP growth in Estonia in 2014 is below official

estimates from the European Commission and IMF, we nonetheless believe the worst of the country's economic slowdown has now passed. We expect growth to accelerate to 2.8% and 3.2% in 2015 and 2016 respectively, driven by private consumption and fixed investment.

Table: GDP By Expenditure

Fiscal Policy

Widening Deficit Poses No Risk To Public Finances

While slower economic growth, expanded social benefits and higher defence spending will lead to a widening of the fiscal deficit, we do not expect a significant deterioration of Estonia's stable public finances. We forecast the budget deficit to remain below 1.0% of GDP over our five year forecast period, and for public debt to remain the lowest in the European Union by a comfortable margin.

Table: Fiscal Policy

Balance Of Payments

Current Account Deficit To Remain At Sustainable Levels

Estonia's current account will fall further into deficit in the coming years on the back of a growing shortfall in the goods and income accounts. A rising services surplus will keep the deficit at sustainable levels, however, with stable inflows of foreign direct investment underpinning external financing requirements. From 1.4% of GDP in 2014, we forecast the current account deficit to peak at 2.0% of GDP in 2017.

Table: Balance Of Payments

Regional Economic Outlook

Assessing The Aftermath Of ECB Policy Action

The European Central Bank (ECB) has delivered on nearly all of the policy options that we were expecting for the June 5 meeting. This is a step in the right direction in terms of warding off the risk of deflation and will be positive for European equities and sovereign bonds. However, we warn - as we have done countless times during previous easing rounds - that the efficacy of ECB policy action will be limited absent structural reforms in the eurozone at the national and federal level.

CHAPTER 3: 10-YEAR FORECAST

The Estonian Economy To 2023

Trend Growth To Average Much Less In 2017-2023

Trend average growth in Estonia is forecast to average 2.7% between 2017-2023, well

below the 7.6% from 2001-2007. That said, we stress that the worst effects of the 2008-2010 recession are now passed and the economy is well positioned for sustainable long-term growth.

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