



## ESTONIA

### Highlights

- **After the 2020 recession, gross domestic product (GDP) has rebounded strongly in 2021.** A significant relaxation of anti-Covid-19 pandemic measures in the middle of 2021 has accompanied strong economic growth during the year and a return to the pre-pandemic level of output.
- **The government is prioritising green transition and broad digitalisation.** In addition to investing in digital public services and strengthening research and development as part of the €1 billion plan financed by the European Union (EU)'s Recovery and Resilience Facility (RRF), the government is investing in a green fund for enterprises. The fund will provide additional support to companies that develop green technologies.
- **Guarantees to boost exports have been increased.** The volume of export guarantees offered by the state financial aid fund KredEx has been raised from the current €192 million to €400 million, giving Estonian companies additional support in reaching foreign markets.

### Key priorities for 2022

- **The anti-money laundering/combating the financing of terrorism (AML/CFT) framework should be continuously strengthened.** Given the growing number of fintech companies and virtual currency providers registered in Estonia, supervisors in financial regulation should ensure the continued implementation and compliance with the AML/CFT agenda.
- **Reducing skills shortages and gender pay disparities remains a priority.** Active labour market policies such as re-training should raise the employability of workers with lower education. Further improvements in childcare services and removing “glass ceilings” should create a favourable economic environment for reducing the gender pay gap.
- **Exiting from oil shale electricity should be prioritised.** Concrete steps need to be taken to further diversify energy sources by increasing Estonia's links with the European electricity grid, strengthening renewables and encouraging the development of alternative economic sectors to oil shale-dependent areas.

#### Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	5.8	4.1	4.1	-3.0	9.0
Inflation (average)	3.7	3.4	2.3	-0.6	3.5
Government balance/GDP	-0.5	-0.6	0.1	-5.6	-2.9
Current account balance/GDP	2.3	0.8	2.5	-0.3	-1.8
Net FDI/GDP [neg. sign = inflows]	-3.9	-4.8	-3.9	-10.4	-7.5
External debt/GDP	83.4	78.2	76.3	91.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	64.4	62.6	60.2	65.2	n.a.

## **Covid-19: macroeconomic implications**

**After the downturn in 2020, the economy is recovering solidly in 2021.** GDP in 2020 contracted by 3.0 per cent, less sharply than the EU average. Due to the recovery of exports and investments and expanded government spending, GDP growth reached 8.5 per cent year-on-year in the first half of 2021. The increase in private consumption was also boosted by accumulated savings, while disposable income is expected to grow further due to the ongoing pension reform. Industrial production in the second quarter of 2021 increased by 3.2 per cent quarter-on-quarter and has already returned to 2019 levels. Significant growth in exports, primarily to Finland and Sweden, was noticeable in the first half of 2021 in the production of mineral oils, wood and electrical equipment. In contrast to most EU countries, Estonia recorded positive retail trade turnover year-on-year throughout 2020, which has continued in 2021.

**The labour market has still not fully recovered from the Covid-19 crisis but a rebound in labour demand is supporting wage growth.** The Covid-19 pandemic led to higher unemployment, which peaked at 7.7 per cent in the third quarter of 2020, falling to 6.9 per cent in the second quarter of 2021, still above the pre-crisis level. An increase in labour demand contributed to a 7.3 per cent year-on-year rise in the average wage in the second quarter of 2021. Together with the strengthening of economic activities, wage growth has contributed to inflationary pressures, with annual inflation reaching 6.4 per cent in September 2021.

**The fiscal deficit has widened due to Covid-19-related expenditures.** The general government deficit in 2020 reached 5.6 per cent of GDP and the gross debt level increased to 19 per cent of GDP, from 8.6 per cent in 2019. Contrary to expectations, the first half of 2021 was marked by a decrease in the total expenditure of state budget institutions, because fewer subsidies to the economy were needed and state payments to the second pension pillar are still suspended. Nevertheless, the deficit is still expected to exceed 6 per cent of GDP in 2021 before falling in 2022.

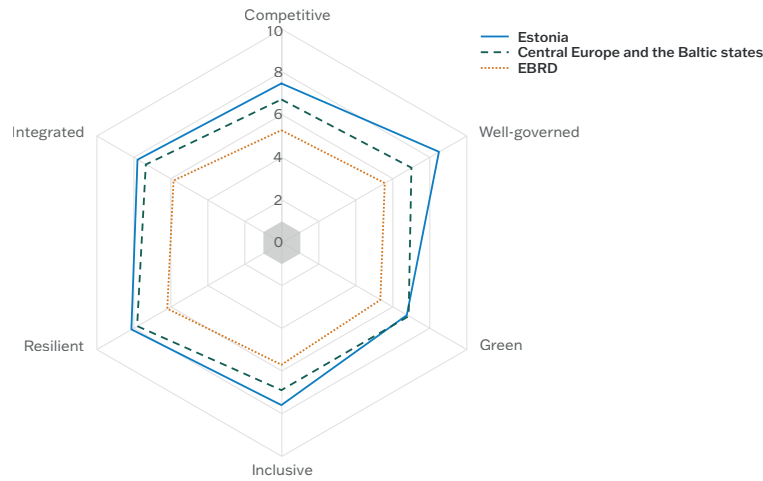
**GDP growth is expected to continue to rebound strongly in the short term.** Amid higher government expenditures, household consumption improved substantially and this trend is expected to gain in magnitude in the coming quarters. Household disposable income jumped by nearly €1 billion due to a withdrawal of the second pension pillar in September 2021. EU funds, including from the RRF, are expected to further boost investment, especially in infrastructure. Overall, GDP growth is forecast to reach 9.0 per cent this year, before slowing to 4.0 per cent in 2022.

## **Policy response to Covid-19**

**A supplement to the 2021 budget aims to mitigate some of the crisis effects.**

In March 2021 parliament approved a bill for a €641 million supplementary budget, similar to a measure taken a year previously. According to the government's plan, additional costs in the health sector, such as the need for further medical facilities, Covid-19 testing and vaccinations, will be covered by an additional €150 million. To support employment and education and to reduce social exclusion, subsidies continue to be paid to partly cover labour costs if employees' working hours or wages have been reduced. As part of the additional budget from 2020 remained unspent, a decision was made that those subsidies could be used until the end of 2021.

**Assessment of transition qualities (1-10)**



**Structural reform developments**

**The “Estonia 2035” action plan was approved.** With this action plan, which the government approved in October 2020, a long-term development strategy is now in place for the next 15 years. In addition to regaining competitiveness, the emphasis is placed on five areas: people (increasing labour market participation and lifelong learning); society (reducing relative poverty and promoting inclusion); economy (investing in research and development and a favourable business environment); living environment (promoting safe living and overall well-being); and governance (promoting efficiency of public services and participation in decision-making).

**Estonia will receive €1 billion from the RRF.** The requested allocation should enhance post-Covid-19 pandemic recovery by supporting green transition and digital capacities, primarily e-services, accompanied by investments in infrastructure, energy efficiency renovation and the decarbonisation of public transport. The goal of the envisaged reforms and investments is to achieve balanced regional development and make economic growth more resilient to future crises.

**Estonia and Finland signed a memorandum of understanding in the area of infrastructure.** The agreement, signed in April 2021, promotes the integration of the two Baltic countries through projects such as Rail Baltica, the Helsinki-Tallinn Tunnel, the Trans-European Transport Network and the North Sea-Baltic Corridor. A joint Helsinki-Tallinn Tunnel working group is being relaunched to make the proposed tunnel eligible for EU funding via the Trans-European Transport Network programme.

**A new state budget strategy for 2022-25 will lead to higher investment.** In April 2021 the government approved a new strategy to decrease the expenditure of ministries by 5 per cent, with savings used to support government sector investments of at least €2 billion a year, as well as to make the budget more transparent and easier to understand. Among other measures, the budget approval process will be shortened from two to one budgetary negotiation per year.

**The government has announced an exit from oil shale electricity but implementation details remain unclear.** The government declared two phase-out dates: exiting oil shale electricity by 2035 and shale oil production by 2040 at the latest. However, details on the alternatives remain to be fully developed. An amount of €340 million from the EU's Just Transition Fund for the period 2021-27 will be mostly allocated to the north-eastern Ida-Viru region, which has relied strongly on the oil shale sector, in order to facilitate its economic diversification.

**The Estonian start-up economy recorded strong growth despite the Covid-19 pandemic.** According to data for the first quarter of 2021, the overall turnover of Estonian start-ups increased by 26 per cent year-on-year following a recovery of business activities shortly after the Covid-19 pandemic started. Start-ups are mainly concentrated in the IT software and services industry, product development and financial technology. They can profit from favourable loans and subsidies provided by the "Startup Estonia" state programme, which has been cooperating with the state financial aid fund KredEx since 2016.

