

Macro Monitor

Estonia

- On the following pages we present an updated outlook on the Estonian economy taking into account the latest economic releases for May and June. The Estonian economy was one of the most affected within the Euro area by the global credit crunch but is now recovering quite rapidly, particularly in the export area.
- The good performance of Estonian industrial production was largely the result of a positive base effect. However, it is clear that other positive factors such as rising external demand have also contributed to growth in manufacturing activities.
- GDP growth improved to -2% y/y in Q1 10 from -9.5% y/y in Q4 09 and we expect the Estonian recovery to continue in the coming quarters. We expect average GDP growth of 0.3% y/y in 2010 and 2.0% y/y in 2011. Return to the trend growth rate is expected in 2011.
- Inflation has accelerated significantly in recent months partly due to one-off effects related to rise in mobile communication prices and partly due to upside in energy prices. We now expect inflation to rise to close to 2.5% by the end of the year.
- The current account is expected to turn to less positive during H2 10 as growth picks up speed during H2 10 and in 2011, we look for increasing trade and current account balance deficits.

Macro forecasts

Year	Gdp ¹	Private cons ¹	Fixed Inv ¹	Export ¹	Import ¹
2009	-14.1	-18.8	-34.4	-11.3	-26.7
2010	0.3	-2.9	-2.6	20.8	15.0
2011	2.0	0.9	5.7	13.5	12.8
2012	3.6	3.2	6.1	8.9	9.9

1) Average % y/y 2) % of GDP 3) % of total work force 4) Export and import prices, EUR

Source: Reuters Ecowin and Danske Markets

Macro forecasts

Year	Trade Balance ^{2,4}	Current acc. ^{2,4}	Industrial prod. ¹	Unemployment ³	Wages ¹	Inflation ¹
2009	-4.1	4.6	-26.2	15.5	-4.6	-0.1
2010	-5.4	1.6	15.4	20.6	-1.5	2.5
2011	-9.1	-1.3	20.5	17.9	-1.1	3.3
2012	-12.6	-5.2	12.3	16.5	1.7	2.7

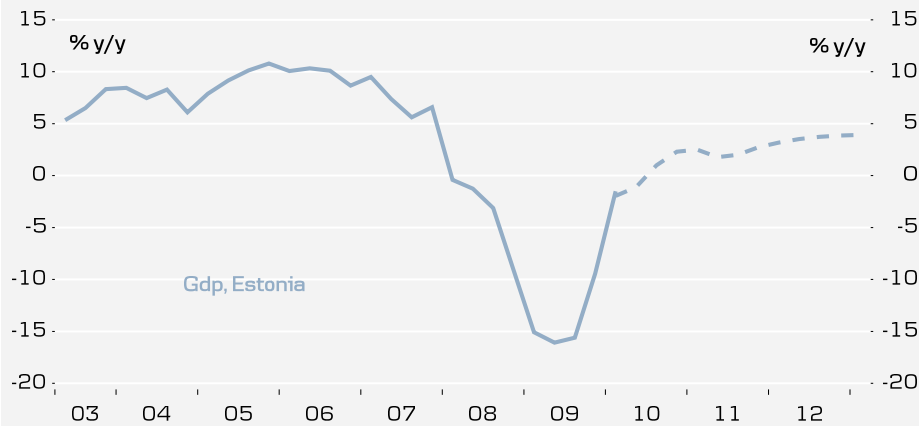
Source: Reuters Ecowin and Danske Markets

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National account

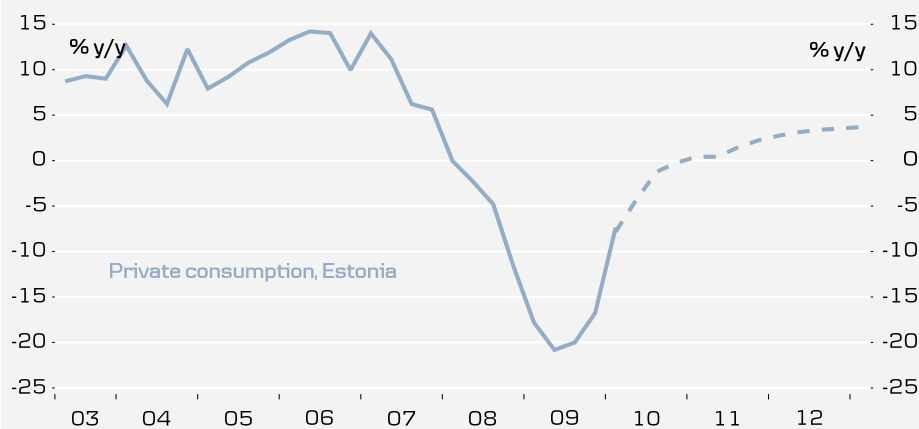
Gross domestic product



Source: Reuters Ecowin and Danske Markets

- The Estonian economy contracted sharply in 2009, but a recovery has been under way since Q4 09. We expect positive growth over the second half of this year, which should bring year-on-year average growth rates back into positive territory.
- We expect average GDP growth of 0.3% y/y in 2010 and 2.0% y/y in 2011.
- It should be noted that Estonia can only return to higher growth rates in the longer term if a significant improvement in productivity growth is seen.

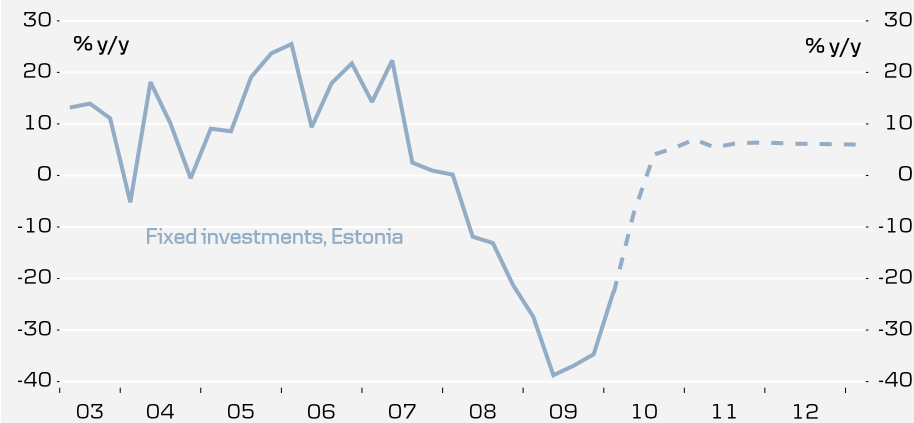
Private consumption



Source: Reuters Ecowin and Danske Markets

- The decline in private consumption slowed in Q1 10, but this was mostly due to a positive base effect.
- We expect private spending to remain sluggish this year and not to contribute to the positive economic trend.
- The fiscal tightening plan and a conservative banks' lending policy should lead to a relatively slow recovery in domestic demand trend.
- On average we expect private consumption to decline by 2.9% y/y in 2010 and advance by 0.9% y/y in 2011.

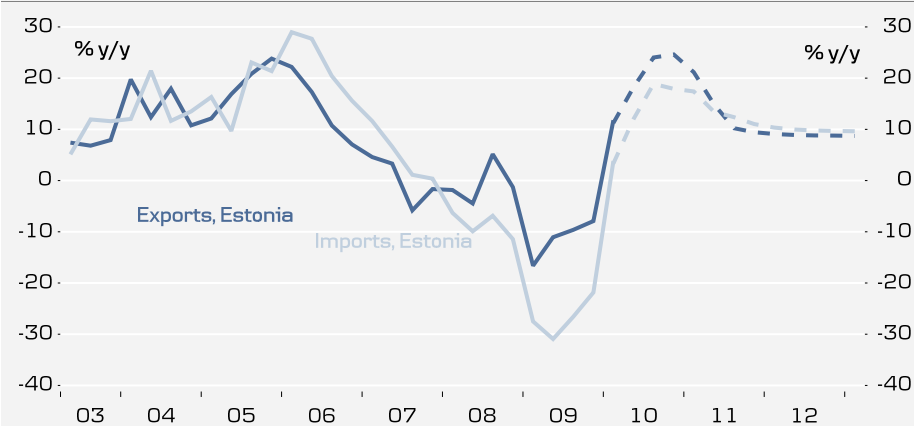
Investments



Source: Reuters Ecowin and Danske Markets

- Certain factors may lead to both more optimistic and pessimistic investment development.
- In particular, greater confidence in the Estonian economy on future membership of the eurozone could encourage capital inflows into the country and higher public investment (based on EU structural assistance) could contribute to a more positive investment outlook.
- On the other hand, the banking sector remains weak and this factor may remain a key obstacle for investment recovery.
- In general we believe that the deleveraging process could take a long time and investment growth therefore will be well below pre-crisis levels for a considerable period. Investments are expected to drop 2.6% y/y in 2010 and grow 5.7% y/y in 2011.

Net exports

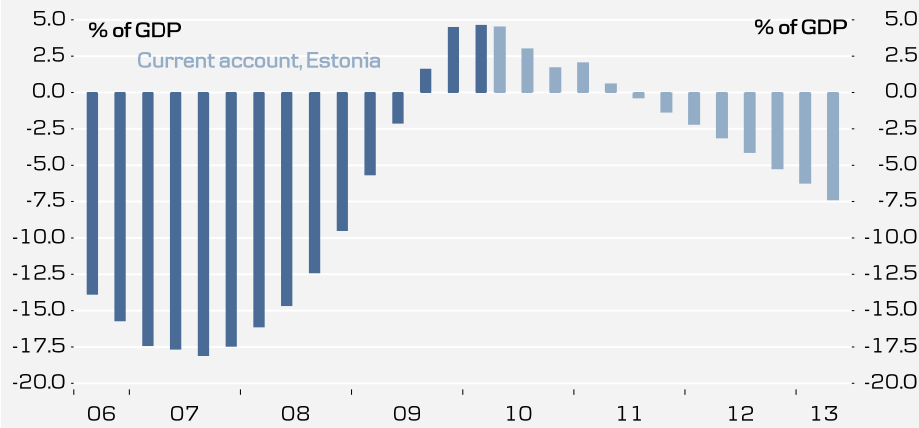


Source: Reuters Ecowin and Danske Markets

- External demand growth has positively contributed to the export outlook. Export growth has been accelerating in recent months, which gives hope for positive GDP growth this year.
- There are a couple of risks associated with the deterioration in the external environment, as well as a number of uncertainties concerning foreign competitiveness.

External balances

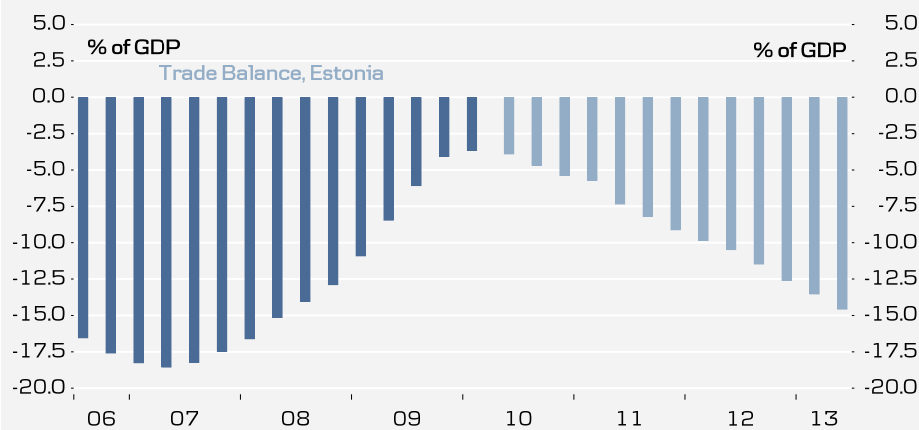
Current account



Source: Reuters Ecowin and Danske Markets

- The current account has improved over recent years as domestic demand has dropped significantly.
- Going forward however the current account is likely to deteriorate on the back of a gradual recovery in domestic demand. We expect a current account surplus of 1.6% of GDP in 2010 to turn to deficit of -1.3% of GDP in 2011.

Trade balance

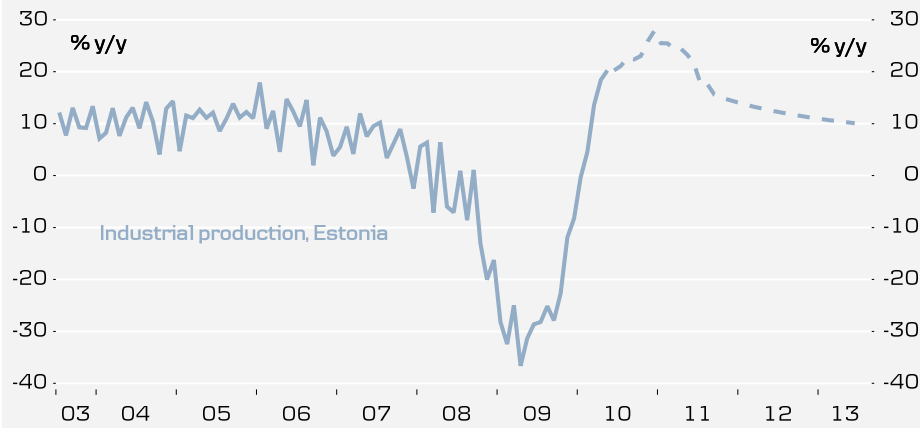


Source: Reuters Ecowin and Danske Markets

- Overall the trade balance has improved compared with 2007-08, and this can largely be attributed to the sharp drop in domestic demand.
- We do not expect the trade balance to improve much further in the coming quarters and it should stay at level of -5% of GDP this year.

Production and labour market

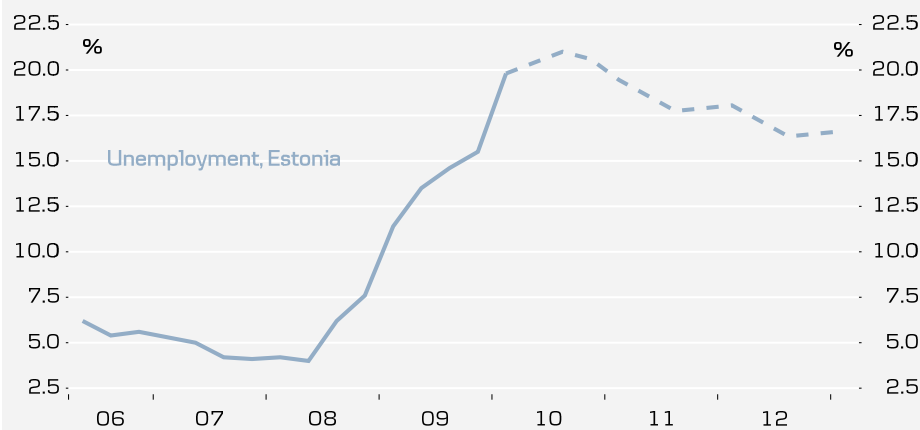
Industrial production



Source: Reuters Ecowin and Danske Markets

- Estonian industrial production (IP) growth slowed to 17% y/y in May, but still it posted the highest growth among EU economies.
- Domestic sales continue to be weak while export sales rise at a record pace.
- We expect industrial production to grow by 15.4% y/y in 2010 and by 20.5% y/y in 2011.

Unemployment

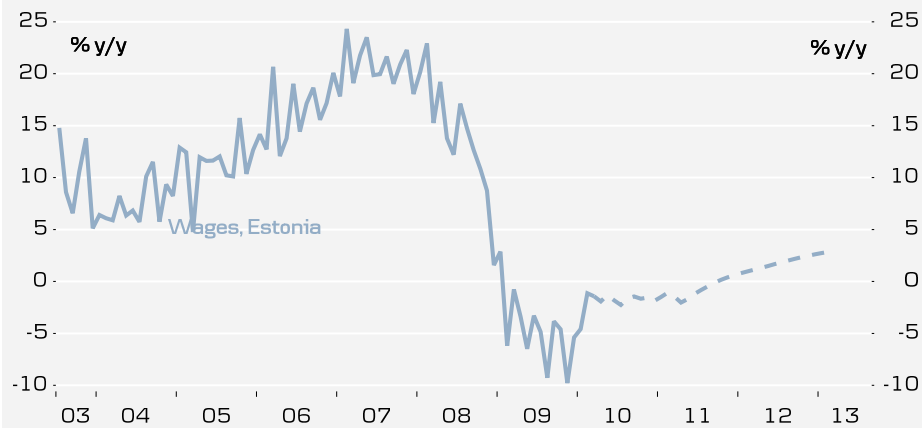


Source: Reuters Ecowin and Danske Markets

- The Estonian unemployment rate rose to 19.8% in Q1 10. Over one-third of the unemployed have been unemployed for a year or more.
- The structural nature of Estonian unemployment indicates there is a high risk that the high level of unemployment could persist for a couple of years.
- Unemployment rates might not decline significantly until GDP growth has returned to its potential level.
- On the other hand it should be noted that the overall mobility of the Estonian labour force is generally high and this can lead to a much more rapid pace of decline in unemployment than our model assumes.

Wages and prices

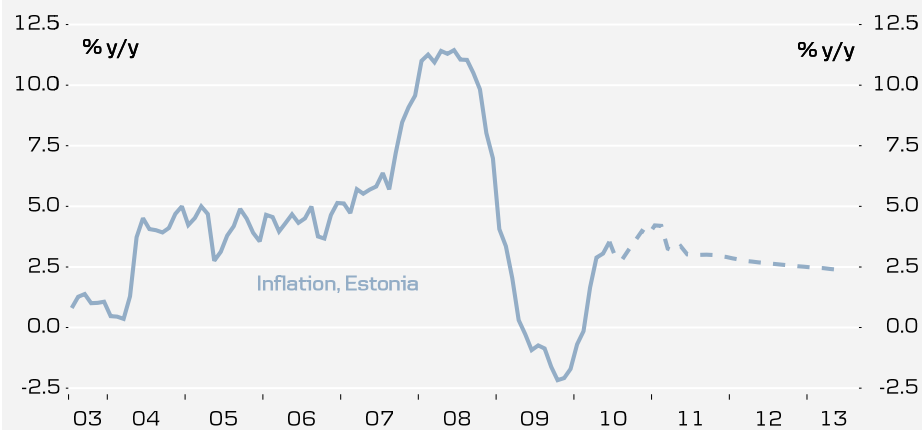
Wages



Source: Reuters Ecowin and Danske Markets

- The high flexibility of real wages also indicates that the overall ability of the Estonian labour market to absorb shocks remains high.
- Going forward we expect to see a continuation of wage correction.

Inflation



Source: Reuters Ecowin and Danske Markets

- Despite the continued slowdown in domestic demand, inflation in Estonia has accelerated.
- The risk to Estonian inflation could come from both the external outlook as well as inefficiencies in the domestic market.
- We expect Estonian inflation to remain at a relatively high level for the rest of 2010 and even accelerate for 2011 averaging 3.3 % y/y.

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All EM research is available on Bloomberg DDEM

Disclosure

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