

Eesti Pank  
Bank of Estonia



# Eesti Pank's economic forecast

22 October 2008



## What has changed compared to spring?

- The economic slowdown has been expected and it is necessary for the economic balance to improve
- However - external demand is deteriorating and the financial environment is fickle

Commodity prices are volatile in the global market, but recent developments have been favourable for us

# The yet unknown results of the financial crisis make forecasting complicated



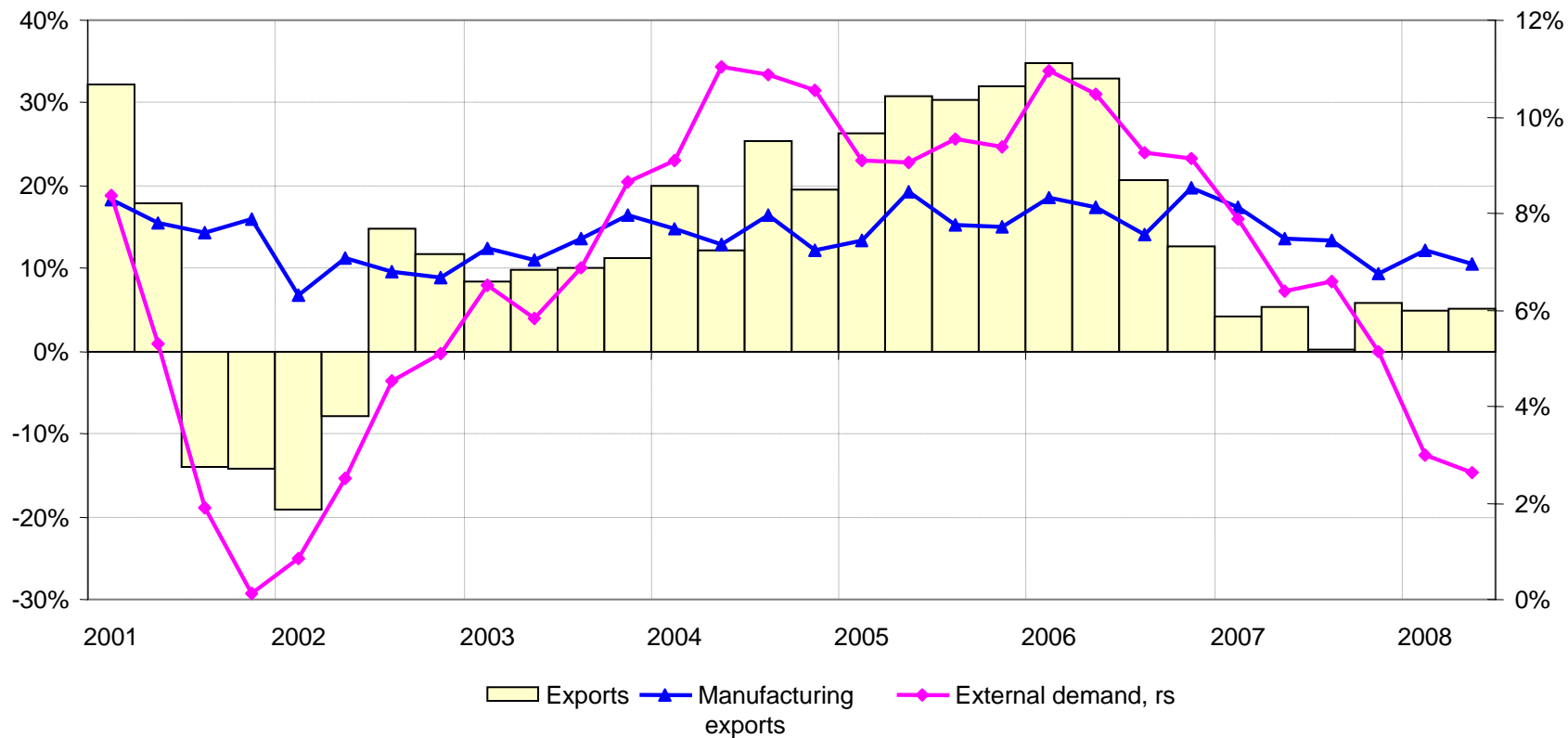
- It is difficult to forecast the actual impact of the financial crisis
- In the base scenario, we expect the impact will not be very prolonged
  - Market confidence should be restored within the next months
  - There will be no substantial difficulties as to financing investment
  - The impact on the real economy will thus be short-lived
- In the case of negative external environment developments, we must be ready for the materialisation of the risk scenario
  - External demand is weaker than expected
  - It has become more difficult to borrow money

# We have managed well under the current circumstances



- Economic adjustment in Estonia started earlier, which has made things easier for us in the current situation
  - Export income has been satisfactory
  - Debt growth has decreased and the Estonian banking sector is well prepared for setbacks
  - Signs of a reallocation of resources appeared already in the course of the previous adjustment
  - We have made corrections to our behaviour and are better prepared for less favourable times

# Export developments have been good so far



# Eesti Pank's autumn forecast 2008-2010



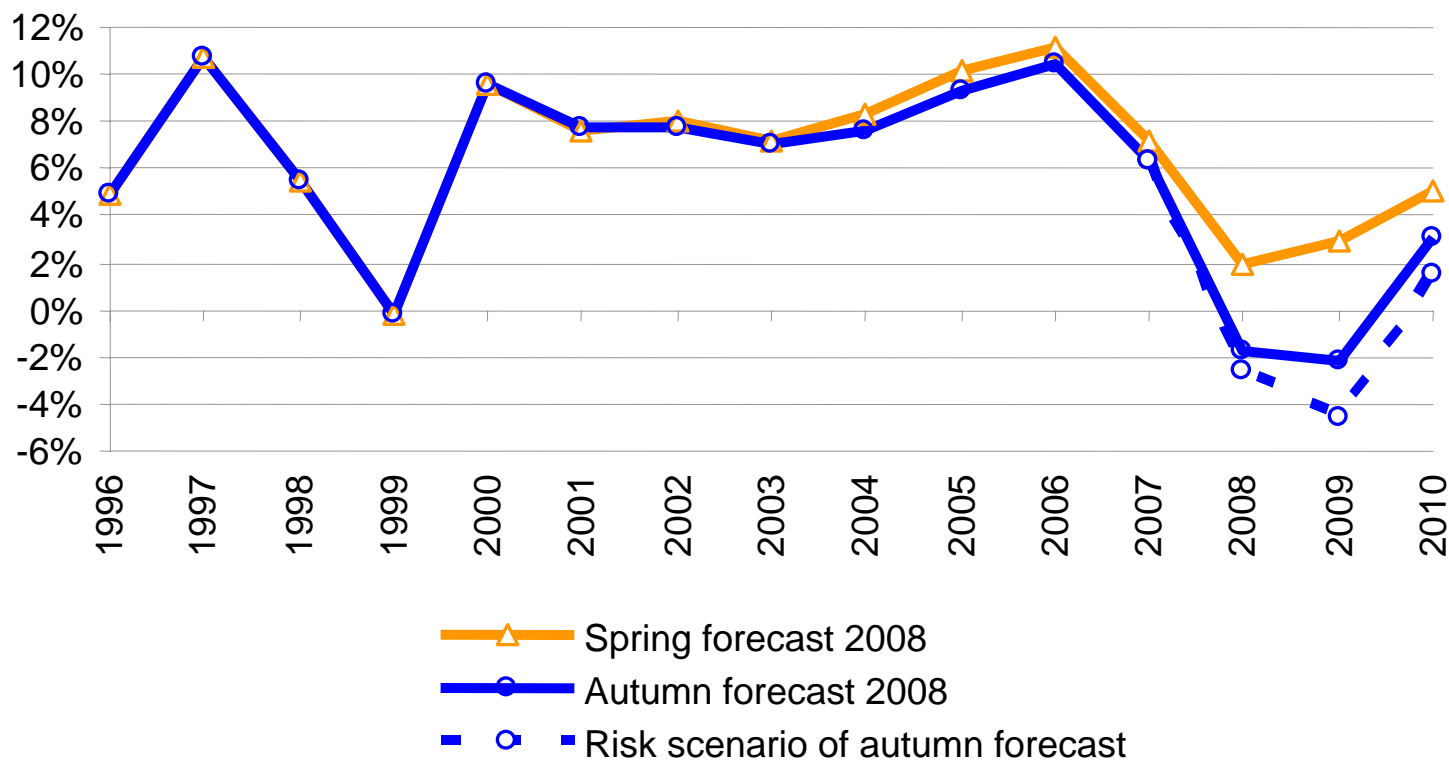
## BASE FORECAST SCENARIO

	<b>2008</b>	<b>2009</b>	<b>2010</b>
GDP (EEK bn)	255.9	265.5	282
Real GDP growth (%)	-1.8	-2.1	3.0
Real private consumption growth (%)	-1.5	-1.7	3.9
Real investment growth (%)	-5.6	-10.4	6.4
Inflation (%)	10.7	4.8	2.8
Current account (% of GDP)	-11.1	-6.5	-7.1



# Real GDP growth is slow to recover

## Real GDP growth



# Economic growth will start to recover either at the end of 2009 or at the beginning of 2010

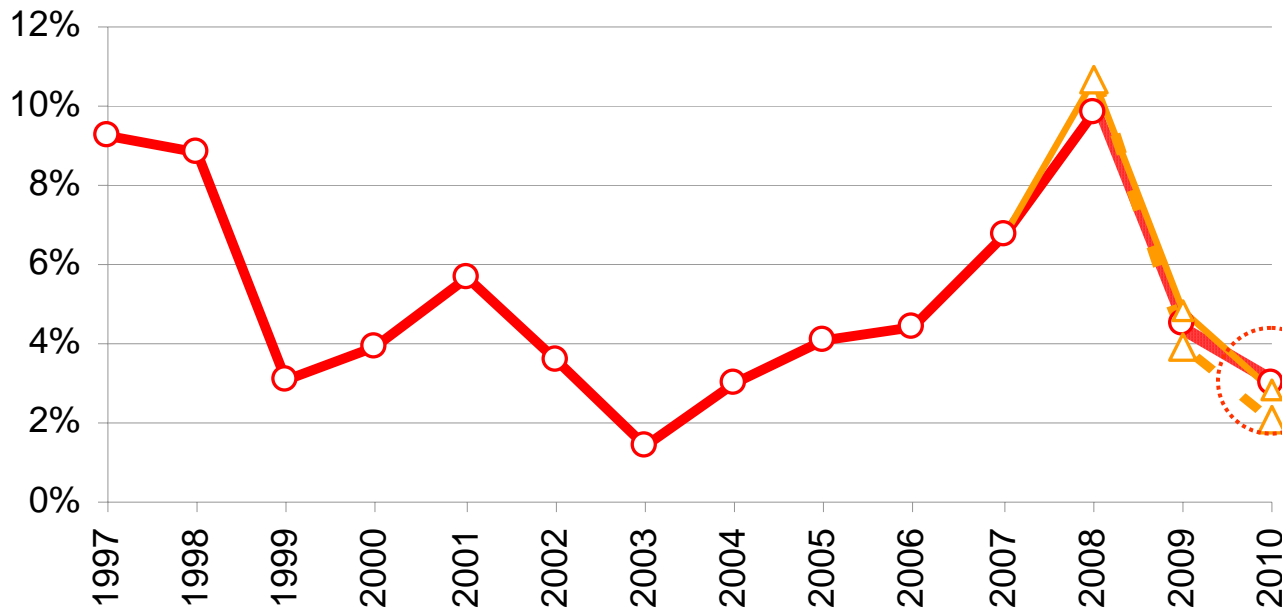


- Domestic adjustment is expected to continue also in 2009, because:
  - There is still room for adjustment as regards investment
  - When uncertainty withdraws, consumption will pick up again
- In order for the economic growth to recover, wages and productivity must be balanced
- When the discrepancies vanish, economic growth will recover

# The inflation forecast has not changed much: price growth is declining fast



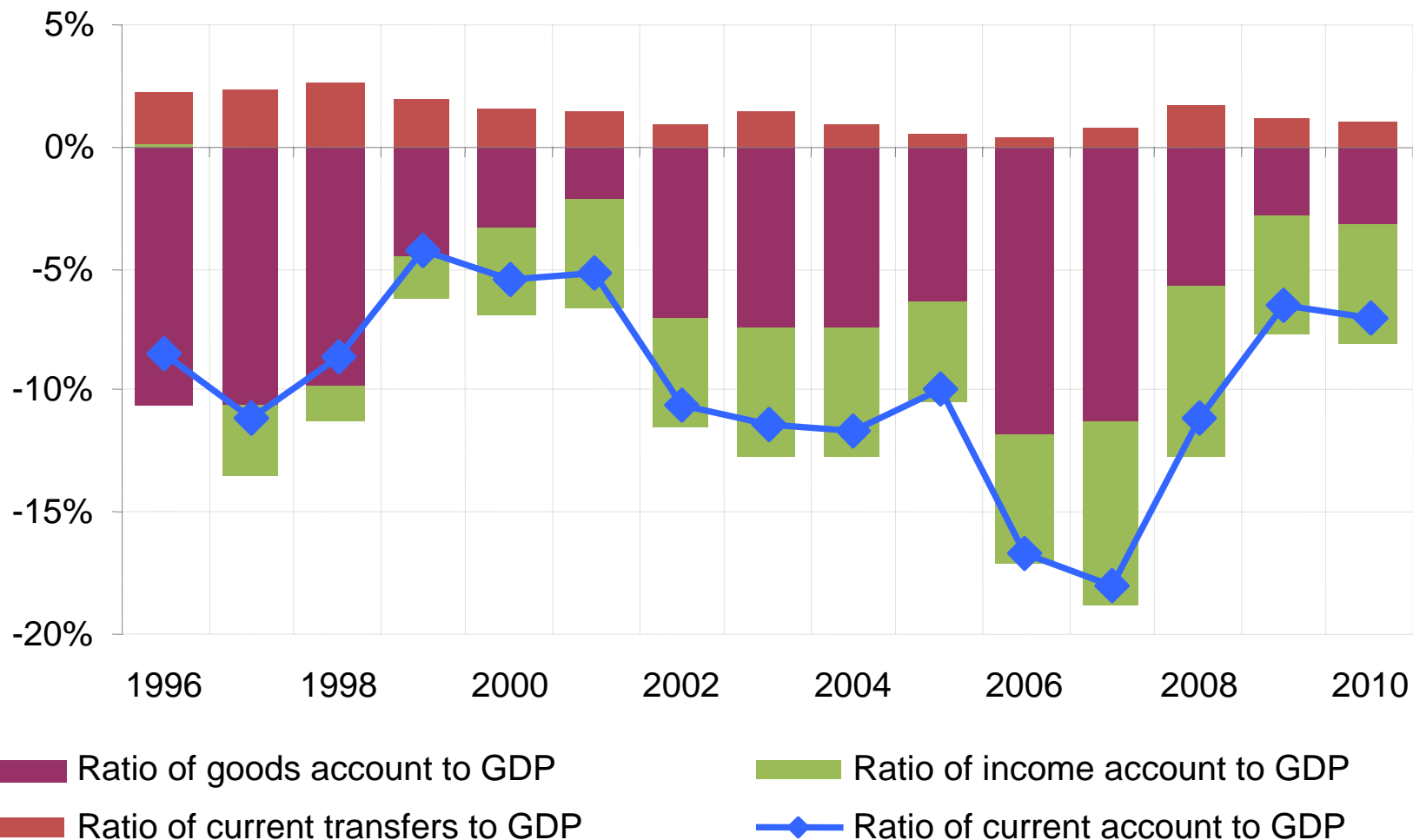
## Inflation



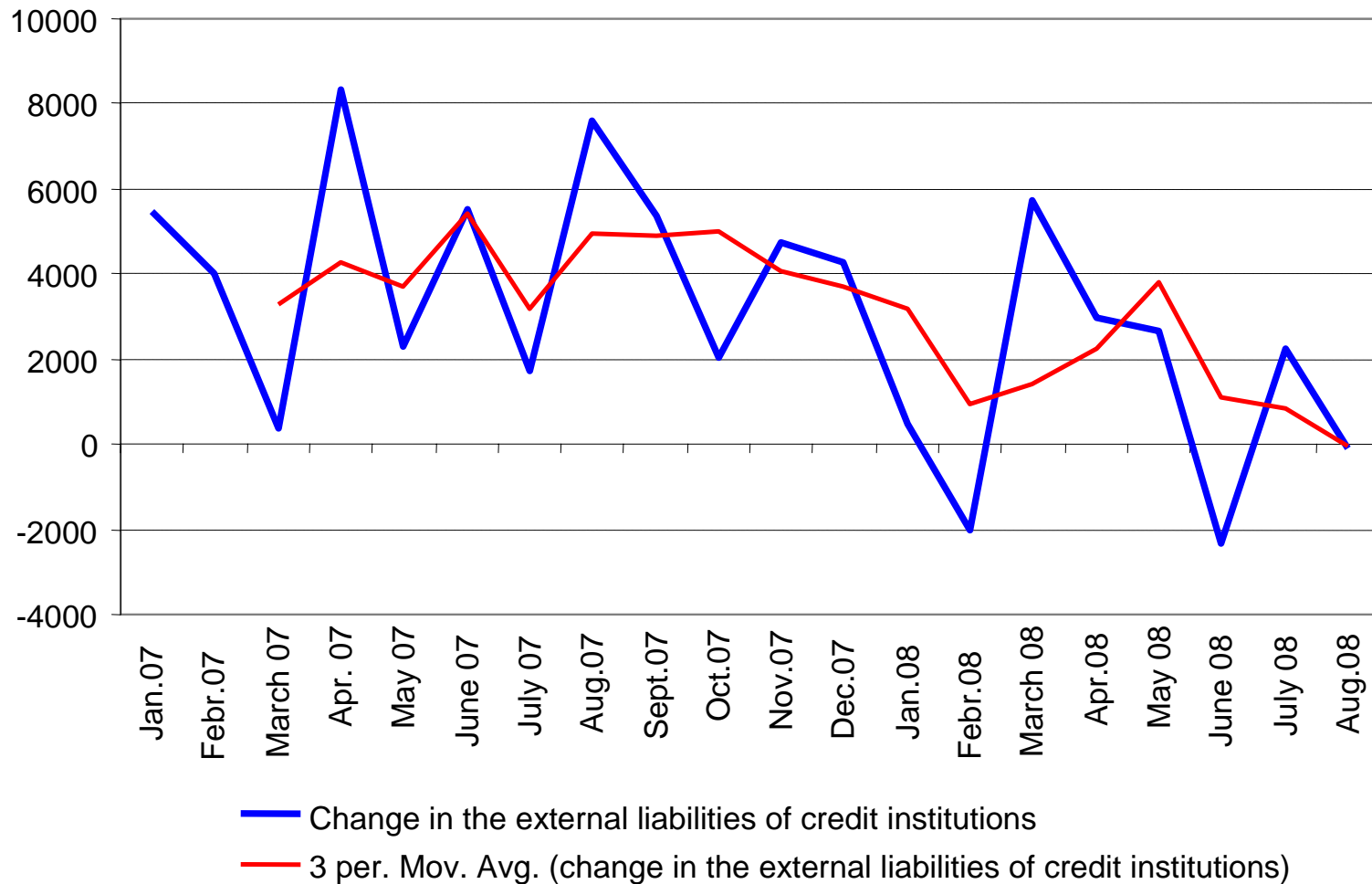
Meeting the  
Maastricht inflation  
criterion in 2010 has  
become more likely

- spring forecast 2008
- △— autumn forecast 2008
- △— Risk scenario of autumn forecast

# Slowing growth is accompanied by a rapid contraction of the current account deficit



# The banks' need for external financing has decreased



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# Conclusions

It is high time to support the start of a new growth cycle



- To ensure a new growth cycle, it is necessary to maintain a flexible and favourable economic environment
  - It is imperative that the discrepancies between wages and productivity disappear
  - The government's tax policy must be planned well ahead and support the business environment
  - Improving labour market flexibility is of critical significance, it is important to support the creation of new jobs



## Estonia's financial sector has managed well

- The conservative policies of Eesti Pank and the government in good times support the Estonian financial sector under less favourable conditions
  - The higher capital and liquidity requirements established by Eesti Pank help banks better cope with the current financial market turbulences
  - The buffers are sufficient for even worse times
- The parent banks of Estonia's commercial banks are doing well
  - The main problems in the financial markets are distrust and the lack of liquidity. In order to overcome these problems, close cross-border cooperation is very important.

# It is necessary to be prepared for the adoption of the euro



- According to Eesti Pank's forecast, it is possible Estonia will meet the Maastricht inflation criterion in 2010.
- Paradoxically, this is supported by the economic difficulties in the rest of the world
  - The global-market commodity price decline is reaching Estonia as well
- The euro would support the arrival of a new growth cycle
  - Recent developments have clearly shown the importance of the euro in the new growth cycle. The euro would alleviate the apprehension of analysts in respect to Estonia's economy.
- The government should carefully monitor the administrative steps that may influence the meeting of the inflation criterion



# The fiscal policy must look further ahead

- According to Eesti Pank's forecast, the budget will be in deficit in both 2008 and 2009
- In the current situation, a fiscal deficit may be acceptable, but under certain conditions:
  - If the deficit is temporary
  - If there is an explicit plan for balancing the 2010 budget
  - If it does not pose a threat to the adoption of the euro
- In the case of more negative developments, there is a clear risk that Estonia may not meet the Maastricht inflation criterion. Should this be the case, the government has to be ready to cut expenditure to remain within the 3% deficit.

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Thank you!

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# Eesti Pank's economic forecast by key indicators



	2005	2006	2007	2008	2009	2010	Difference from the spring forecast		
GDP (EEK bn)	173.5	205.0	238.9	255.9	265.5	282	-15.4	-26.1	-33.9
Real GDP growth (%)	9.3	10.4	6.3	-1.8	-2.1	3.0	-3.7	-5.1	-2.0
HICP growth (%)	4.1	4.5	6.8	10.7	4.8	2.8	0.9	0.3	-0.2
GDP deflator growth (%)	5.2	7.0	9.6	9.0	6.0	3.2	-0.5	1.6	-0.1
Current account (% of GDP)	-10.0	-16.7	-18.1	-11.1	-6.5	-7.1	-0.9	1.0	-0.5
Current account plus new capital account balance (% of GDP)	-9.2	-14.6	-16.9	-9.1	-4.8	-4.0	-0.8	1.3	-0.2
Real private consumption growth (%)	9.7	12.8	7.8	-1.5	-1.7	3.9	-4.2	-5.5	-0.6
Real government consumption growth (%)	1.9	1.8	3.9	2.6	-2.0	0.8	-2.0	-1.7	-0.8
Real investment growth (%)	9.4	19.5	4.8	-5.6	-10.4	6.4	4.1	-8.2	1.3
Real export growth (%)	20.9	11.6	0.0	-0.9	0.5	4.8	-3.1	-4.2	-1.7
Real import growth (%)	17.5	20.4	4.2	-5.9	-3.3	5.3	-4.1	-4.1	0.3
Unemployment rate (%)	7.9	5.9	4.7	4.8	7.0	8.3	-1.6	0.5	2.4
Change in the number of the employed (%)	2.0	6.4	1.4	-0.7	-2.5	-1.2	1.7	-2.3	-2.0
Value added growth per full-time employee (%)	7.3	4.5	5.9	0.2	-0.6	4.1	-2.9	-3.8	-0.5
Real wage growth (%)	7.7	11.6	11.6	3.8	0.0	1.8	-1.9	-2.7	-1.7
Average gross wage growth (%)	11.4	16.2	20.4	14.6	5.0	4.9	-0.3	-2.0	-2.1
Nominal money supply growth (%)	42.0	28.2	13.4	3.9	2.2	2.8	-7.7	-6.3	-6.0
Nominal credit growth (%)	50.4	51.6	30.2	10.2	4.1	6.4	0.9	-4.4	-1.8
External debt (% of GDP)	86.1	97.7	112.4	114.4	115.2	116.3	4.3	4.9	6.3
Budget balance (% of GDP)	1.3	3.3	2.7	-1.4	-2.5	-1.3	-0.1	-2.5	-1.3