

KEY POINTS OF EESTI PANK'S ECONOMIC FORECASTS IN 2008

Eesti Pank publishes economic forecasts twice a year – the spring forecast in May and the autumn forecast in November. To this end, the baseline and risk scenarios are prepared, covering the current year's economic developments and projections for the following two years.

From 2005 to 2007, Estonia's economic growth was driven by strong demand based on active lending, with resources mostly servicing domestic demand. In the spring forecast of 2008 we presumed that growth would slow mostly on account of domestic demand. The decrease in real estate investment was to be expected, but there was also a rapid correction in private consumption. In the first six months, external demand was still quite favourable for exports. In these conditions Estonia's economy would have grown about 2% in 2008, but the forecast risk scenario also included the risk of economic decline.

By the time of the autumn forecast, the situation of the global economy had deteriorated abruptly and external demand did not support exports that much any longer. According to preliminary data, Estonia's GDP decreased 9.4% in the fourth quarter of 2008 and 3.5% in annual terms. For 2009, market participants expect an even more pronounced contraction of the global economy.⁷ According to the flash estimate of Eesti Pank published in February, Estonia's GDP would decrease even more than expected in the autumn forecast of 2009; that is, up to 9%.⁸ Long-term forecasts are surrounded by a large degree of uncertainty, considering the unfavourable developments of both the domestic and external factors.

The beginning of a new growth cycle depends on when the global economic crisis ends and confidence in the financial sector is restored. The economic policy stimuli of countries should start

to have an effect in 2010 at the latest. In addition to the recovery of export demand, also credit availability is necessary for productivity-based growth in Estonia. Moreover, part of the workforce currently serving domestic demand must be relocated to export-oriented sectors. Otherwise, Estonia might be facing a long period of slow growth.

Estonia's price level rose 10.4% in 2008, which is in line with the forecasts prepared in 2007. The double-digit inflation rate largely arose from an increase in global energy and food prices. In the second half of 2008, price pressures abated in domestic as well as global economy. The decline in energy and commodity prices will fully pass through to consumer prices during 2009. In addition, the impact of administrative inflation factors is expected to decrease. If the price of oil stays at 30–40 dollars per barrel, the average price increase will be very low in 2009. The deflation risk cannot be excluded either. Estonia may be able to meet the Maastricht inflation criterion already in the fourth quarter of 2009 or at the beginning of 2010.

In 2008, there was a large degree of uncertainty surrounding both the Estonian and global economy, and not only in the medium term, but also in respect of near-future developments. Global financial and commodity markets are extremely volatile, which will have a strong impact also on the developments of the non-financial sector in the coming years. Because of this uncertainty, the central bank growth expectations have become much more pessimistic. The crisis of confidence in the financial system might have a great impact on the movement of savings between regions and in the global economy as a whole. It is important for Estonia's development that there would be enough savings (capital) in order to make investments. At the same time, it is vital that both Estonia and its neighbouring regions would maintain the ability to raise foreign capital.

⁷ According to IMF, global growth figures for 2009 will be the lowest since the end of World War II. IMF, „World Economic Outlook Update”, 28/2/2009.

⁸ Eesti Pank, “Estimates of Estonia's economy in light of deepening global financial crisis”, 5/2/2009.