Estonia

Country note, July 2019

Key messages:

- **Economic growth is expected to slow from close to 4% in 2018 to 3% in 2019**
- **The government recorded a structural deficit of 1.4% in 2018 and it is targeting structural deficits in 2019 and 2020**
- **In the current phase of the economic cycle the Fiscal Council finds it is not justified to have structural deficits in 2019 and 2020**

Macroeconomic outlook

Economic growth is expected to slow from 3.9% in 2018 to 3.1% in 2019, mainly because of weaker foreign demand (see Figure 1). The Ministry of Finance expects growth to remain slightly below its long-term sustainable rate of around 3% in 2020-2023, while the output gap will steadily decline to around zero in 2023. The Ministry's latest macroeconomic forecast was endorsed by the Fiscal Council.

Fiscal outlook

In 2018, the general government recorded a deficit of 0.5% of GDP in nominal terms and a deficit of 1.4% of GDP in structural terms, according to the latest estimate by the Ministry. The Ministry forecasts a nominal deficit of 0.4% in 2019 and structural deficits of 1.1% in 2019 and 0.4% in 2020. This year is the fourth year in a row that the general government fiscal position has been in nominal and structural deficit. The Ministry forecasts structural balance in 2021 and small structural surpluses in 2022 and 2023.

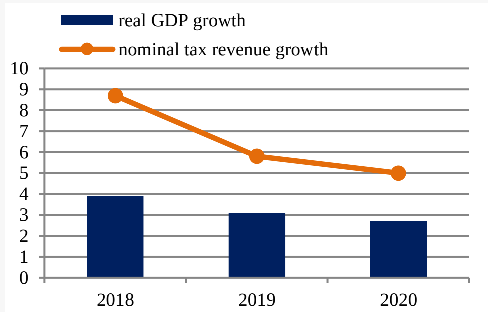
The fiscal position of the general government has been revised downwards in the state budget strategy relative to the spring forecast mainly because of the cut in the alcohol excise tax which takes effect in July, and the postponement of sales of frequency licences. The structural position for 2019 is currently forecast at -1.1%, which is 0.2 percentage point below its target. The Ministry of Finance says that additional measures to achieve the target will be decided in the autumn. The Fiscal Council cannot be sure that the fiscal position will be sufficiently improved enough that the fiscal rules will be respected in 2019.

Fiscal framework and national fiscal rules

The Ministry is targeting a structural deficit of 0.9% of GDP in 2019 and of 0.4% in 2020. These objectives correspond to the minimum structural adjustment under the current fiscal rules. Given the strong state of the economy, the Fiscal Council finds it is not justified to have structural deficits in 2019 and 2020 and recommends that structural balance be achieved in 2019 (see Figures 2 and 3).

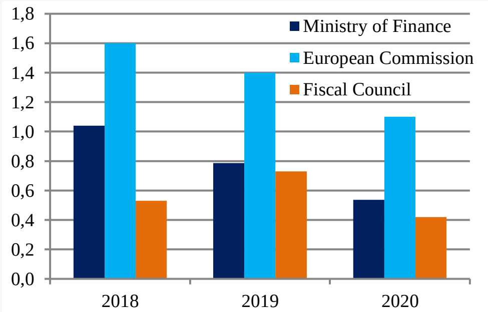
The State Budget Act has a compensation mechanism that requires structural surpluses to be planned to compensate for past deficits. Under this rule, surpluses of at least 0.5% of GDP should be planned in 2022 and 2023. To avoid conflict with the current legislation, the government plans to change the State Budget Act by abandoning the requirement for surpluses. The Fiscal Council considers that it is not advisable to change the fiscal rules so often as it hurts the credibility of fiscal policy and hinders the ability of companies and households to plan for the long term.

Figure 1: Yearly growth in the economy and tax revenues (%)



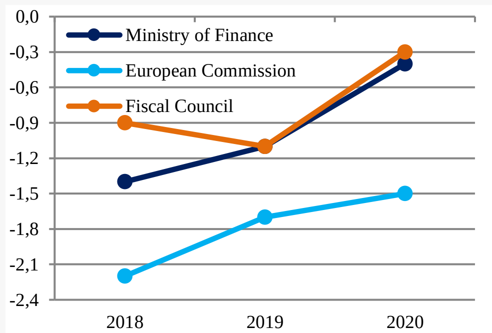
Source: Ministry of Finance

Figure 2: Estimates of the cyclical component (% of GDP)



Sources: Ministry of Finance, European Commission, Fiscal Council

Figure 3: Estimates of structural balance (% of GDP)



Sources: Ministry of Finance, European Commission, Fiscal Council

Key indicator forecast

		2018	2019 f	2020 f	2021 f	2022 f	2023 f
Real GDP growth	[% y-o-y]	3.9	3.1	2.7	2.7	2.6	2.5
Output gap	[% of pot. GDP]	2.1	1.6	1.1	0.7	0.3	–0.1
GG nominal balance	[% of GDP]	–0.5	–0.4	0.1	0.4	0.3	0.2
GG structural balance	[% of GDP]	–1.4	-1.1	-0.4	0.0	0.2	0.2
GG debt	[% of GDP]	7.9	8.2	7.7	7.1	6.5	5.9

Source: Ministry of Finance (Spring forecast 2019, State Budget Strategy 2020-2023)

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