Estonia

Country note, January 2019

Key messages:

- **Economic growth is expected to slow from close to 5% in 2017 to 3% in 2019**
- **The government is targeting a structurally balanced budgetary position for 2018 and 2019**
- **The Fiscal Council endorsed the macro forecast, but suggested a small structural surplus should be targeted for 2019**

Macroeconomic outlook

After reaching close to 5% in 2017, economic growth is expected to slow down in 2018, mainly because of the weaker external environment. The Ministry of Finance expects growth to remain close to its long-term sustainable rate of around 3% after 2018 (see Chart 1). Growth in the main tax bases is projected to exceed GDP growth in 2018−2019, supporting healthy tax revenue growth. Estimates of the economy's output gap by various institutions lie in the positive range of 1.4−3% of GDP for 2018 and 1.3–2.6% of GDP for 2019.

The Ministry's latest macroeconomic forecast was endorsed by the Fiscal Council, which considered the risks to the growth outlook to be balanced.

Fiscal outlook

In 2017, the general government recorded a deficit of 0.4% of GDP in nominal terms and a deficit of 0.7% of GDP in structural terms, according to the latest estimate by the Ministry. The Ministry projects a return to a structurally balanced budgetary position in 2018, and that the budget will remain in balance in 2019, based on the Draft Budgetary Plan. The independent estimate of the Fiscal Council for the cyclical component of the budget leads to only a slightly weaker outlook for the structural balance (see Charts 2 and 3).

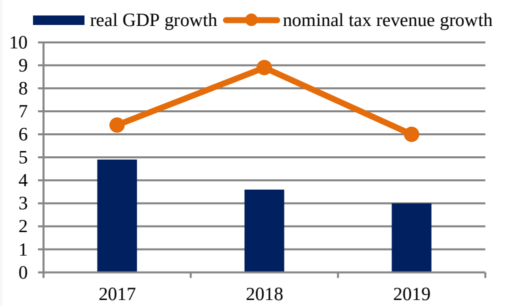
While the structural balance target for 2019 is in compliance with the national fiscal rule, the Council's recommendation was to target a small structural surplus for 2019, in order to avoid loosening the fiscal policy stance and to build up fiscal buffers in peak cyclical conditions.

Fiscal framework and national fiscal rules

The national fiscal framework, amended in 2017, now permits structural deficits if structural surpluses of the same amount have previously been accumulated. This should ensure that structural balance is maintained on average over the medium term. The maximum deficit allowed annually is up to 0.5% of GDP, and a correction mechanism activates when the deviation from the maximum allowed budgetary position is larger than 0.5% of GDP.

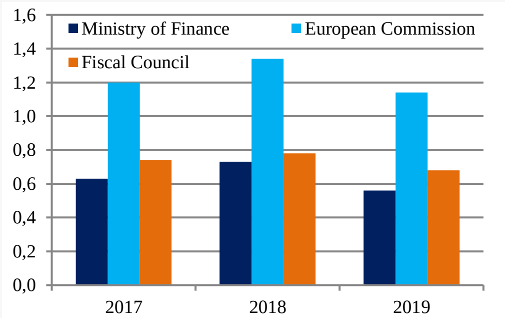
The *cumulative* structural position, accumulated between 2014 and 2017, amounts to a surplus of 0.7% of GDP. With the expectation of structural balance for 2018, this means that modest fiscal buffers will be available in spring 2019, when general elections will be held and a new state budget strategy for the next four years will be formulated.

Chart 1: Growth in the economy and tax revenues (% y-o-y)



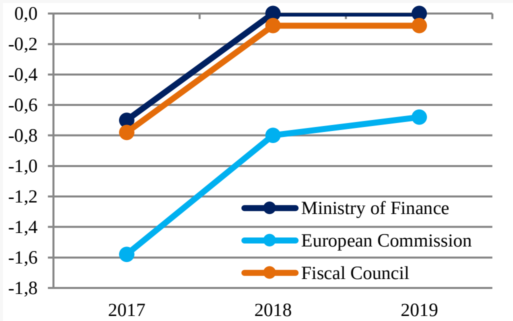
Source: Ministry of Finance

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



Sources: Ministry of Finance, European Commission, Fiscal Council

Chart 3: Estimates of the structural balance (% of GDP)



Sources: Ministry of Finance, European Commission, Fiscal Council

Key indicator forecast

		2017	2018 f	2019 f	2020 f	2021 f	2022 f
Real GDP growth	[% y-o-y]	4.9	3.6	3.0	2.9	2.8	2.7
Output gap	[% of pot. GDP]	1.4	1.7	1.3	0.8	0.4	0.0
GG nominal balance	[% of GDP]	−0.4	0.6	0.5	0.2	−0.2	−0.3
GG structural balance	[% of GDP]	−0.7	0.0	0.0	−0.1	−0.4	−0.3
GG debt	[% of GDP]	8.7	8.1	7.4	6.7	6.1	6.2

Source: Ministry of Finance (Summer forecast 2018, Draft Budgetary Plan 2019)

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