

COUNTRY PROFILE: REPUBLIC OF ESTONIA**DATED: MAY 2007****CREDIT GUARANTEE:**

| | <i>Country Rating</i> | <i>U/W Method</i> |
|-------------------|-----------------------|-------------------|
| <i>Short-term</i> | 2B | No Restrictions |

Recent Political Highlights

- The Reform Party won the March 2007 parliamentary election and has formed a coalition with two other parties. Although all three parties have agreed a programme for the government, the EIU expects the coalition to crumble before the end of the four-year parliamentary term.

Recent Economic Highlights

- Estonia is considered one of the most liberal economies in the world, ranking 12th out of 161 countries in the 2007 Index of Economic Freedom and 5th out of 41 European countries. Its liberal economic policies and macroeconomic stability have fostered strong growth and better living standards than most new EU member states.
- The economy grew 11.4% in 2006, only second in the EU to Latvia, and unemployment fell below 6% for the first time in fifteen years. Real GDP is set to slow down to 9.4% in 2007 and 7.4% in 2008 due to tightening of lending conditions by banks and a cooling house market. The Central Bank cut its economic growth forecast for 2008 to 6.5% from 7.6% and its forecast for 2007 is 8.4%. Analysts predict that Estonia's \$15.1bn economy, the second smallest in the EU behind Malta, may have reached its capacity after it posted double digit growth in the past seven quarters on robust consumer spending.
- Inflation accelerated in March, to the fastest pace in more than five years as food, fuel and housing costs increased, reaching 5.7% from 4.7% in February. Rising inflation and a growing current account gap forced Fitch Ratings to issue a warning that the economy of Estonia, along with those of Latvia and Lithuania, may overheat. The Finance Ministry forecasts that Estonia's inflation rate would exceed the euro-adoption criterion until 2011, likely postponing the currency switch beyond 2012. In February, the EU limit in the 27-nation bloc was 2.93% compared with Estonia's 12-month rate of 4.5%. Policy makers forecast inflation at 5.1% in 2007 and they have few tools to control price rises beyond reining in spending or tightening lending rules as the local currency, the kroon, is pegged to the euro.
- Andrus Ansip's new government, sworn in on April 5, has promised to make the currency switch a priority and is aiming to slow inflation by producing budget surpluses and tying wage increases to productivity rises. The government is aiming for a budget surplus of 1.5% of GDP from 2008-2011 but the IMF says the target does not match the strong fiscal outturn projected for the four years and surpluses in the range of 2-3% of GDP would be more appropriate.
- The current account deficit increased to a record 14.8% of GDP in 2006 and is forecast at 15.2% of GDP in 2007 and 13.8% of GDP in 2008.
- OECD countries agreed to invite Chile, Estonia, Israel, Russia and Slovenia to open discussions for the membership of the Organisation.
- Estonian products are no longer welcome in Russia. The row over the removal of a Soviet-era war monument and the remains of soldiers from a central square in the Estonian capital prompted a diplomatic war of words, looting and civil unrest. The Mayor of Moscow urged businesses and consumers to shun Estonian goods and sever all ties with enterprises, even cultural ones. The first deputy prime minister also said Russians should stop vacationing in the Baltic nation. Boycotts, along with import ban or other economic sanctions, have become standard Russian reactions during disagreements with its neighbours. Russia plans to abandon a rail link with Estonia only weeks after it resumed the service citing economic viability as the major concern but analysts say the decision is politically motivated. Estonia's share in Russia's total trade turnover accounts for 0.7% but Estonia's food industry, which exports 23% of its output to Russia, could also take a serious blow as a result of an embargo. About 300,000 of Estonia's 1.3 million inhabitants are ethnic Russians. They have persistently complained of discrimination, and say they have been marginalised ever since Estonia won independence from the Soviet Union in 1991.

Latest Trade Developments

- Main exports: machinery and equipment, wood and paper, textiles, food products, furniture, metals and chemical products.
- Main imports: machinery and equipment, chemical products, textiles, foodstuffs and transportation equipment.
- Major trade partners: Finland, Germany, Russia, Sweden, Lithuania and Latvia.
- South African exports to Estonia totalled R60.8m in 2006 and were R13.9m in the year-to-date-to-March.