**COUNTRY PROFILE: REPUBLIC OF ESTONIA**
**DATED: MAY 2008**
**CREDIT GUARANTEE:**

| | *Country Rating* | *U/W Method* |
|---|---|---|
| ***Short-term*** | 2B | No Restrictions |

*Recent Political Highlights*

- Andrus Ansip was re-elected as prime minister in March 2007. His centre-right Reform Party won parliamentary polls and went on to form a coalition with the conservative Pro Patria-Res Publica and Social Democrats. While the three-party coalition government is currently stable and reasonably popular, its cohesiveness is likely to be put to the test as the economy slows and job insecurity increases. Parliamentary elections are scheduled for 2011, by which time hope is that the economy would have recovered and inflation would have returned to sufficiently low levels to make euro adoption possible. The EIU expects the coalition to collapse before the end of the parliamentary term in 2011. It however expects the country's generally free-market policy to remain unchanged, even if the coalition collapses.

*Recent Economic Highlights*

- With privatisation largely complete, the main economic policy issue is how to reduce inflation so that Estonia is able to meet the Maastricht inflation criterion and adopt the euro without harming prospects for economic growth. The long-awaited economic adjustment is underway in Estonia, but it is no longer as smooth as expected due to the less favourable external environment. The economy is expected to only pick again either at the end of 2009 or beginning of 2010.
- The economy is expected to lose further momentum in the short term and real GDP is expected to decline to 4.6% in 2008 from about 7.3% in 2007. Analysts have repeatedly said that Estonia needs a slowdown to steer it towards a 'soft landing' after years of growth driven by domestic demand as living standards 'catch up' with Western Europe. With a soft landing not yet assured, the Bank of Estonia has urged the government to be prepared to cut spending if tax revenues increase by less than planned in 2008, keeping the budget in a surplus of at least 2% of GDP rather than loosening policy in line with its budget target of 1.3%. The government looks set to introduce an expenditure-cutting supplementary budget.
- The Estonian central bank more than halved its 2008 economic growth forecast from 4.4% to 2%, citing global slowdown and high inflation. The finance ministry also slashed its forecast from 5.2% to 3.7%, on similar grounds. Both cuts are the latest sign of rising jitters in the Baltic state, which has enjoyed years of robust economic growth since independence from the Soviet Union in 1991. Last year the country's GDP grew 7.1%, after a national record of 11.2% in 2006, which was also the second-best rate in the entire EU. The finance ministry has predicted that growth should rebound in 2009 to 6% but the central bank forecasts it at 3% and 5% in 2009 and 2010 respectively.
- GDP contracted 1.9% in Q1'08 compared to Q1'07 and grew 0.4% on an annual basis, a sharp slowdown from 4.8% in Q4'07. The banking sector will be tested by the slowdown. While the system is well capitalised, it saw profitability being challenged by non-performing loans, slower loan growth and rises in global interest rates.
- Inflation is expected to climb higher in 2008 in response to hikes in excise duties, increase in global food prices and rapid growth in wage costs, averaging 9.8% this year from 6.6% in 2007. CPI rose on an annual rate of 11.4% in April after a slight dip in March. The result was higher that the previous record of 11.3% in February, which many economists had hoped would mark the end of the country's inflation spiral. The EIU forecasts it at 9.3% this year.
- Estonia's failure to keep inflation on target upset its drive to join the eurozone at the start of 2007. Although no new date has been set for making the switch from the national currency (the kroon) officials have suggested it may be possible by 2011. The currency board arrangement will continue to provide the key anchor to prices and price expectations. Some analysts have said that the Baltic countries could unilaterally adopt the euro as a way to manage a currency crisis as Estonia's economic growth stalls. However the IMF does not expect Estonia to consider unilateral adoption of the euro and foresees Estonia to be ready to adopt the euro only after 2011 or 2012.

*Latest Trade Developments*

- Main exports and imports: machinery and equipment, wood and paper, textiles, food products, furniture, metals and chemical products.
- Major trade partners: Finland, Germany, Russia, Sweden, Lithuania and Latvia.
- South African exports to Estonia totalled R60.8m in 2006 and R38.1m in 2007.

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