



ESTONIA

Economic growth slows

According to a preliminary estimate, Estonia's real GDP was up 4.1 % y-o-y in the second quarter of 2003. Despite continued economic difficulties globally, growth slowed only slightly. Retail trade continued to grow at 9 % y-o-y in the second quarter. Construction activity in Estonia accelerated to 9 %, mainly the result of an increase in construction of non-residential buildings. Growth of industrial production slowed somewhat in April-July, but still climbed at an impressive 8 % y-o-y. Rapid growth was seen in electricity, water and gas supply, as well as in the chemical and metal industries. After a hard winter, the transport sector recovered only slightly. In April-July, freight volumes in the Port of Tallinn were up 2 % y-o-y. Although the number of foreign passengers declined, tourists stayed in Estonia longer than earlier, so the contribution of tourism to GDP growth was likely positive.

Inflation remained low in the past two months. In August, annual inflation was 1.3 %.

Moderate inflation helped subdue nominal wage growth. In the second quarter, the average monthly gross wage amounted to €442 or 9 % more than a year ago. Wages grew steadily in most sectors. Fastest growth was in the hotel and restaurant sector (16 % y-o-y). The unemployment rate rose to 10.7 % (9.4 % in 2Q02) as the labour force increased. The number of employed persons also rose.

Current account deficit narrows slightly

In April-June, Estonia's current account deficit amounted to 10 % of estimated GDP according to monthly statistics. The deficit increased from the second quarter of 2002 but decreased compared to the first quarter of 2003. In the first half of 2003, the deficit was 15 % of estimated GDP.

The trade deficit increased 6 % y-o-y in 2Q03, as exports increased 9 % and imports grew 8 %. The income balance deficit also increased. The service sector surplus increased as service exports rose. FDI net inflows in the second quarter were sufficient to finance just 29 % of the current account deficit.

Exports to all main trading destinations increased in the second quarter. Finland remained the most important export destination, with exports to Finland increasing 15 % y-o-y. Exports to Russia increased 41 % and the share of exports going to CIS countries rose to 6 %. Some 69 % of exports went to EU states. The exports of the most important sector

– machinery and equipment – increased 8 % y-o-y. Exports of wood and wood products rose 20 %. With Galvex, a new US-owned steel galvanisation plant, on stream, exports of metals and metal products increased 35 %. Textile exports declined 6 % y-o-y. A number of small sectors, including mineral products (up 53 %), articles of plastics and rubber (35 %) and transport equipment (22 %), saw large jumps in their exports.

IMF recommends tight fiscal policy

An IMF mission visited Tallinn at the end of July. Due to weak global demand outlook, the IMF lowered its projections for GDP growth to 4.5 % for 2003. In 2004, the IMF expects the GDP to increase 5.5 %.

Despite an overall positive appraisal, the IMF was concerned about Estonia's large current account deficit. The country's reliance on its currency board arrangement makes tight fiscal policy the most important tool available for stabilising the economy. Thus, the mission urged Estonian authorities to focus on accumulating a substantial fiscal surplus in 2003 and forego implementation of tax cuts and increase benefits to parents of minor children that might otherwise threaten budgetary balance in 2004.

The Estonian government is expected to send the budget for 2004 to parliament on September 24. Under the current draft, budget revenues would rise 17 % y-o-y. The public sector surplus would amount to EEK 45 million (€3 million). The draft includes plans to reduce the personal income tax from 26 % to 24 %, raise tax-free income to 1,400 kroons per month and expand support to parents with minor children. On the other hand, the salaries in the public sector will be frozen to this year's level.

EU referendum set for on September 14

The latest polls show that about 70 % of eligible Estonians plan to vote in the upcoming non-binding referendum. Of those, 69 % say they will vote yes on EU membership.

Economics forecasts

	GDP, % change		CPI, % change	
	2003	2004	2003	2004
Estonia	5.2	5.8	2.0	2.7
Latvia	6.1	6.2	2.7	2.9
Lithuania	6.3	6.0	0.3	1.4

Source: Eastern Europe Consensus Forecasts

ESTONIA	1995	1996	1997	1998	1999	2000	2001	2002	2003	as of
GDP, %-growth	4.3	3.9	9.8	4.6	-0.6	7.3	6.5	6.0	5.2	Q1/03
Industrial production, %-growth	1.9	2.9	14.6	4.1	-3.4	14.6	7.8	4.6	9.4	1-7/03
Inflation, %-growth, end-year	28.9	14.8	12.5	6.5	3.9	5.0	4.2	2.7	1.3	8/03
General government budget balance, % GDP	-1.3	-1.9	2.2	-0.3	-4.7	-0.7	0.4	1.2		
Gross wage, € period average	158	195	227	262	284	314	352	393	442	Q2/03
Unemployment, % (end of period, LFS data)			9.8	10.2	12.9	13.9	11.9	11.3	10.7	Q2/03
Exports, € million	1242	1395	2035	2415	2364	3580	3748	3677	1931	1-6/03
Imports, € million	1728	2181	3036	3420	3137	4442	4630	4880	2630	1-6/03
Current account, % GDP	-4.4	-9.2	-12.1	-9.2	-4.7	-6.4	-6.5	-12.4	-21.9	Q1/03

Source: Statistical Office of Estonia, Bank of Estonia.

LATVIA

Inflation picks up

Latvian real GDP was up 6.2 % y-o-y in the second quarter and 7.5 % in the first half of 2003. Exports increased briskly and domestic demand continued to grow, reflecting an improved employment situation and higher wages. The average gross monthly wage was 189 lats (€308) in the second quarter – a nominal increase of 12 % from a year earlier. Also loan stock continued to grow rapidly.

Retail trade, particularly, continued to benefit from increased domestic demand and was up 9 % y-o-y in the second quarter. In addition, the value of construction output was 10 % higher than a year ago. Construction of non-residential buildings and infrastructure rose rapidly. Industrial output increased 7 % y-o-y. Manufacture of wood and wood products, fabricated metal products and furniture increased rapidly. Production decreased in the textile and fish industries. Despite the ongoing shutdown of the crude oil pipeline, the outlook for the transport sector was relatively optimistic. The volumes of freight transported by rail and goods loaded in Latvian ports increased 10 % y-o-y in the second quarter of 2003. The decrease in crude oil shipments was compensated for by growth in oil products and dry cargoes. In July, the positive trend in the Latvian transport sector further strengthened.

Inflation has accelerated considerably since May. In August, 12-month inflation was 3.5 %. Food prices were 4.2 % higher than a year ago. Due to the rises of administratively regulated tariffs on natural gas, heating and rent, the costs of housing were 4.5 % higher in August than a year before.

Trade deficit widens in the second quarter

Latvian exports continued to show strong growth in the second quarter of 2003. According to the monthly statistics, the value of exports was 16 % higher than in the corresponding period in 2002. Exports to EU countries increased 29 % y-o-y (64 % share of total exports), while exports to CIS countries rose 16 % (10 % of exports). Germany remained Latvia's biggest trading partner both for exports and imports. Exports of wood and wood products, the country's most important export category, grew 32 %. Metals and metal products exports climbed 13 % and textile exports were up 11 % y-o-y. Imports to Latvia rose 20 %. Oil imports increased most in value terms.

Latvia's current account deficit typically increases towards the end of the year. This year, the current account deficit enlarged in the second quarter compared to the first quarter due to the higher trade deficit as imports grew faster than exports. Moreover, compared to 2Q02 and 1Q03, the income deficit increased and the service balance surplus shrank. As a result, the current account deficit widened to 10 % of GDP in the second quarter of 2003 and exceeded the deficit of the corresponding period in 2002. In the first

half of 2003, the deficit rose to 8 % of estimated GDP. FDI inflows to Latvia remained steady and were sufficient to cover nearly half of the current account deficit in the second quarter.

Government releases draft budget for 2004

The government presented its budget proposal for 2004 in July. Discussion on the proposal has been intensive among the coalition parties. The draft foresees expenditures of LVL 2.0 billion (€3.3 billion) and revenues LVL 1.9 billion (€3.0 billion). Revenues would increase 12 % and expenditure 8 % from 2003. The national budget deficit is not expected to exceed 2 % of GDP. In the expenditure side, approaching EU and NATO memberships cause the biggest changes. In the revenue side, the major amendment is the decrease of corporate income tax from 19 % to 15 % in 2004.

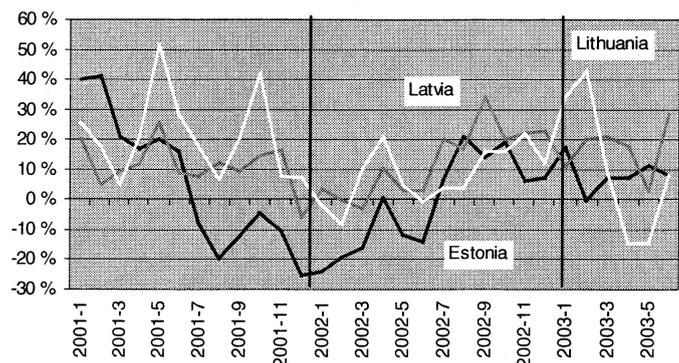
Rating agencies lift projections

The credit rating agency Fitch upgraded Latvia's long-term rating of foreign currency sovereigns from BBB to BBB+ in July. A week later, rating agency Standard and Poor's (S&P) revised its outlook for Latvian foreign currency sovereigns to positive from stable. S&P had raised its rating to BBB+ a year ago. The main reasons listed for the upgrades were approaching EU membership, stable economic growth, ongoing structural reforms and strong investments. Latvia was urged to tighten its fiscal policy in the coming years to keep the large net external debtor position and current account deficits under control.

Latvians vote on EU membership

The referendum will be held on September 20-21. Latvia's referendum is binding and the voter turnout have to reach at least 50 % of the October 2002 parliamentary election turnout, which was 71.4 %. The latest polls show that 56 % of Latvian citizens planning to participate the referendum favour EU membership. Another 24 % are against membership and 20 % are still undecided. Polls anticipate that voter turnout could reach 80 %.

Year-on-year changes in exports, (in local currency)



LATVIA	1995	1996	1997	1998	1999	2000	2001	2002	2003	as of
GDP, % growth	-0.8	3.3	8.6	3.9	2.8	6.8	7.7	6.1	7.5	H1/03
Industrial production, % growth	-6.3	1.4	6.1	2.0	-8.8	3.2	6.9	5.8	8.4	1-6/03
Inflation, % growth, end-year	23.1	13.1	7.0	2.8	3.2	1.8	3.2	1.4	3.5	8/03
General government budget balance, % GDP	-3.9	-1.7	0.1	-0.8	-4.0	-2.8	-2.1	-2.5	0.0	1-6/03
Gross wage, € period average	130	141	183	202	225	265	282	307	308	Q2/03
Unemployment, % (end of period, LFS data)		19.5	14.1	13.7	13.2	13.3	12.9	11.6	10.7	Q1/03
Exports, € million	1044	1172	1627	1796	1765	2237	2367	2570	1416	1-6/03
Imports, € million	1486	1800	2377	2804	2725	3387	3862	4008	2202	1-6/03
Current account, % GDP	-0.4	-5.5	-6.1	-10.6	-9.7	-6.9	-9.7	-7.8	-5.7	Q1/03

Source: Central Statistical Bureau of Latvia, Bank of Latvia.

LITHUANIA

Growth forecasts revised upwards

Preliminary statistics show that in real terms Lithuanian GDP rose 6.1 % y-o-y in the second quarter of 2003 and 7.7 % in the first half. The main contributors to the growth in the second quarter were agriculture, electricity production, construction, trade, and hotels and restaurants. Growth slowed less than expected and many analysts have recently raised their projections for GDP growth.

The total value of construction work performed in Lithuania increased 29 % y-o-y in the second quarter. Both renovation and reconstruction as well as construction of new buildings grew rapidly. 70 % of all construction occurred in the biggest cities, i.e. Vilnius, Kaunas and Klaipeda. Despite the brisk growth in construction, the total value of tangible investments in Lithuania increased only 4 % y-o-y in the second quarter as acquisition of buildings and equipment and machinery declined. The largest increases in investment were in the hotel and restaurant sector, and transport and storage.

Retail trade grew 12 % y-o-y in the second quarter. Private domestic demand was supported by a rise of 5 % in the nominal average gross salary. In addition, on-year growth of the loans to the private sector accelerated to 50 % in July.

The transport sector also continued to grow. The volume of goods transported by rail increased 12 % y-o-y in April-June. Cargo volumes at Lithuanian ports were also up.

The drop in industrial production reflected a scheduled maintenance work at the Mazeikiu Nafta oil refinery in April-May. Thus, on-year growth of industrial production slowed to 4 % in the second quarter. In addition to a 38 % y-o-y decline in oil refining, textile production was down 18 % and base metals production was off 49 %. On the other hand, manufacture of electrical equipment was up 67 % y-o-y, fabricated metal products 35 %, furniture 28 %, vehicles 41 % and electricity production 22 %. Growth in industrial production reaccelerated in July to 20 % y-o-y.

Deflation continues

The annual deflation rate in August was 1.1 %. The decline in consumer prices is mainly due to low prices for food, clothing and footwear. Lithuania has experienced modest deflation for a year now, yet it appears to have had almost no impact on the country's economic development. However, the finance ministry has warned about below-forecast VAT revenues resulting from deflation and on the other hand, rising nominal salaries in the public sector.

Producer prices also declined. Industrial prices in July were 1.7 % lower than a year earlier. Prices for manufactured goods fell 1.8 %, while electricity, gas and water supply were 0.6 % cheaper. Despite the rapid increase in construction, construction costs were only 1 % higher in July than a year ago.

Exports off in second quarter

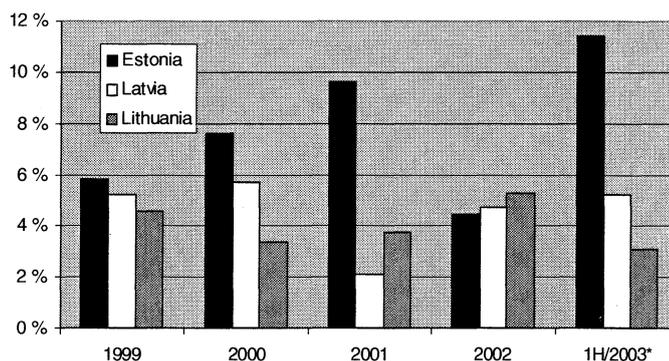
The maintenance break at the Mazeikiu Nafta oil refinery also affected Lithuanian exports. In the second quarter of 2003, exports contracted 8 % y-o-y. Textile exports also fell and, growth of exports slowed in many sectors. The share of exports going to EU countries declined to around 43 % as the refined oil is currently exported to Switzerland. The share of exports to CIS countries rose to 17 %. Due to a subdued demand for raw materials, imports to Lithuania decreased 2 % in the second quarter.

Despite a decline in imports, a large drop in exports widened the trade gap. The service balance surplus remained at the same level as in 2Q02, while transfers from the EU increased. Thus, the current account deficit widened compared to both the first and second quarters of 2002. The deficit amounted to 7 % of forecast GDP in April-June; for the first half of 2003, the deficit reached 6 % of GDP. Foreign direct investment decreased dramatically and was sufficient to cover less than 30 % of the current account deficit in the second quarter. The decline in FDI partly reflected postponement of difficult privatisation projects e.g. a natural gas distributor and a shipping company.

Private pension funds to start operating in 2004

From the beginning of next year, Lithuanian employees will be able to participate voluntarily in private pension funds. Thus, a part of contributions now going to the state-run social insurance fund, Sodra, can be directed to pension funds. Next year, employees must contribute 2.5 % of their income to pension funds. The requirement will rise incrementally to 5.5 % in 2007. The State Insurance Supervisory Authority last month issued pension fund operating permits to two Lithuanian banks, two insurance companies and a financial brokerage company. Other permit applications are under consideration. Pension funds, the "second pillar" of pension reform, are already operating in Estonia and Latvia.

Inflow of FDI as % of GDP



* Preliminary data

LITHUANIA	1995	1996	1997	1998	1999	2000	2001	2002	2003	as of
GDP, % growth	3.3	4.7	7.0	7.3	-1.8	4.0	6.5	6.7	9.4	Q1/03
Industrial production in sales, % growth	5.3	5.0	3.3	8.2	-11.2	5.3	15.9	7.5	12.2	1-7/03
Inflation, % growth, end-year	35.7	13.1	8.4	2.4	0.3	1.4	2.0	-1.0	-1.1	8/03
General government budget balance, % GDP	-4.5	-4.5	-1.8	-5.8	-8.2	-2.8	-1.9	-1.2		
Gross wage, € period average	92	122	173	208	231	264	296	332	337	Q2/03
Unemployment, % (end of period, LFS data)			14.1	12.6	15.3	16.1	17.5	13.0	13.6	Q1/03
Exports, € million	2066	2687	3710	3537	2941	4403	5432	6235	3286	1-6/03
Imports, € million	2599	3393	4726	4893	4254	5602	6663	7667	3826	1-6/03
Current account, % GDP	-10.2	-9.2	-10.2	-12.1	-11.2	-6.0	-4.8	-5.3	-3.6	Q1/03

Source: Statistics Lithuania, Bank of Lithuania.

Changing future expectations in Estonia, Latvia and Lithuania

by Juha Antila and Pekka Ylöstalo*

The following is a summary of the *Working Life Barometer in the Baltic Countries 2002*, which examines the state and trends of Latvian, Estonian and Lithuanian working life. A similar survey in 1998 allows us to identify and compare recent developments in the Baltics.

Future spending pressures

The 2002 Barometer found that expectations about employment trends in the coming twelve months rose in all three nations. The Latvians were more positive in this respect than the Estonians and Lithuanians. However, negative expectations outweighed the positive ones. The proportion of strongly negative expectations was especially large in Lithuania. Many expected the employment situation to be worse in a year's time, while a few thought it would be much better.

There was considerable scepticism in 1998 as regards development of employment in Lithuania. The situation somewhat evened out in the following four years. In 2002, the overall expectations in Estonia concerning employment turned out to be more negative than in the other Baltic countries. Only 15 % of Estonians expected that employment would improve during the coming year; 50 % believed it would deteriorate. Just 1 % expected the situation to be much better in a year's time. By contrast, it was more common to believe that the situation would be much worse.

Men's and women's expectations about the employment situation differed only slightly. In all three countries, male and female workers were less likely to feel that the general employment situation was getting worse. The percentage of negative expectations in Estonia concerning employment fell in all the age groups. The situation in Latvia is generally similar with the exception that people over 50 were clearly more pessimistic than before. A linear correlation prevailed in Lithuania; the younger the respondent, the more positive his or her response.

Workplace expectations

People were much more optimistic about development in their own workplace during the coming year than the general employment situation. Workplace economy expectations were also most positive in Latvia. Future trends in this aspect were clearly most unfavourable in Lithuania.

Men in all three nations were somewhat more optimistic than women about the outlook at their own workplace. The link between age and the nature of the assessment prevailed in all three countries but it was not linear. In Estonia, the greatest positive changes had been in the youngest age group and perhaps surprisingly, in the oldest. In Latvia, trend directions varied among age groups. The economy expectations of the youngest and oldest age groups were more negative than earlier. Those of the middle age group, i.e. those in the "prime" of their careers, had changed in a positive direction. In Lithuania, negativity had definitely risen among all age groups. The shift was somewhat greater for young workers than for the old workers.

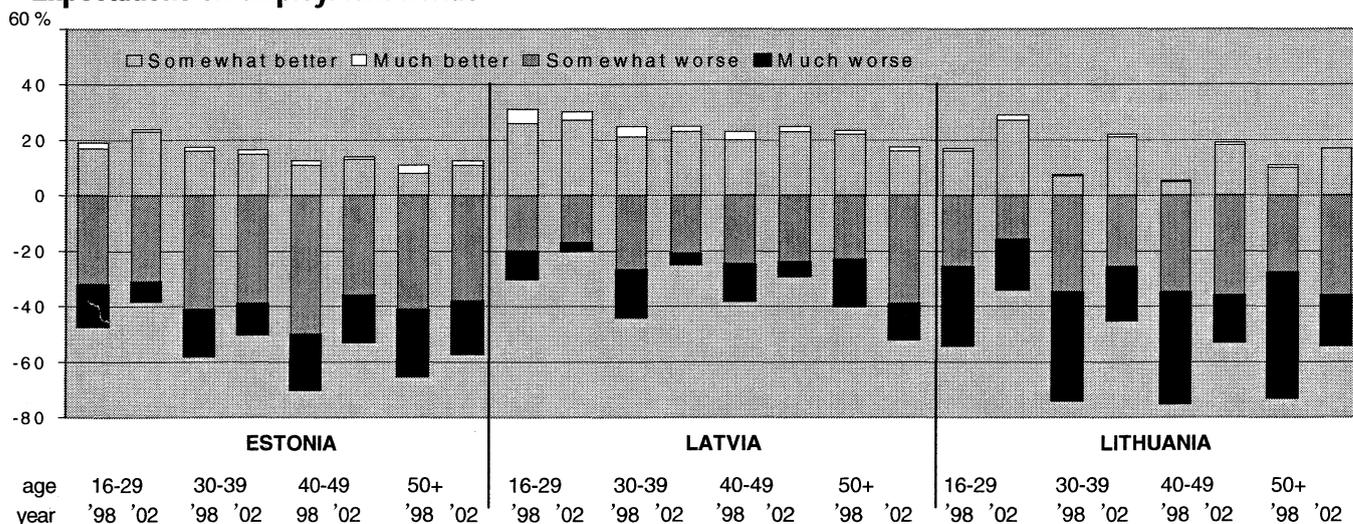
Several interesting findings

According to the survey, working people in the Baltic countries in 2002 had negative expectations on the future. Only a few people believed the employment trends would improve in 2003. Latvians also seemed to generally be more optimistic – their expectations were more positive than Estonians or Lithuanians in both the 1998 and 2002 surveys. The future prospects of Lithuanians, however, improved considerably from 1998 to 2002. Another interesting finding was that men seem to have more faith in their own chances in the labour market than women.

The complete survey results are posted at:
<http://www.mol.fi/julkaisut/baltiabarometer.pdf>

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Expectations on employment trends



BALTIC ECONOMIES

Bimonthly Review

5/2003, 12 September 2003

ISSN 1456-4963 (print)

ISSN 1456-5900 (online)

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Information herein is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information.