

Estonian Economy

Increasing Estonian exports' market share in Finland will be more challenging

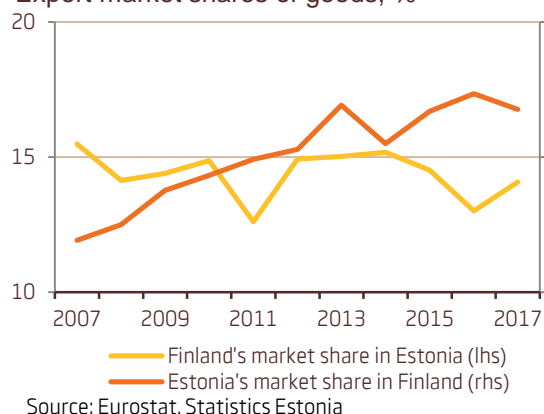
- ◇ Estonia's exports to Finland are the most diversified among the largest trade partners
- ◇ Exported goods from Estonia have gained market share on the Finnish market
- ◇ Estonia is losing its price competitiveness against Finland

Finland is Estonia's largest export partner. Among the 10 largest trade partners, Estonia's exports of goods¹ to Finland are the most diversified. The recovery in import demand from Finland has given more export opportunities, and the number of enterprises exporting goods to Finland has increased during the last two years. Since 2015, the share of the Finnish market in total exports of goods from Estonia has increased; however, it is still lower than the level before 2011. Exported goods from Estonia lost some market share in Finland in 2017, but the longer time series show a more positive picture: Estonia has gradually gained market share in Finland since 2008. Despite the expected moderate slowdown in 2018-2019 of Finnish economic growth, its import demand should be relatively strong and Finland should remain among the largest contributors in foreign demand for Estonian exports, at least in the near future. At the same time, we have to consider that, because Finland has been able to limit the growth of its unit labour costs in recent years, Estonia is losing its price competitiveness against it. Despite Estonian prices of goods have been relatively flat compared to the Finnish average in the last 10 years (primarily due to the faster price growth of capital goods in Finland), Estonian general price level of the total economy has converged closer to the Finnish prices. Thus, investing more in product development and productive capital and improving corporate management, work organisation, and supply chains are needed for Estonia to halt its decline in competitiveness on the Finnish market.

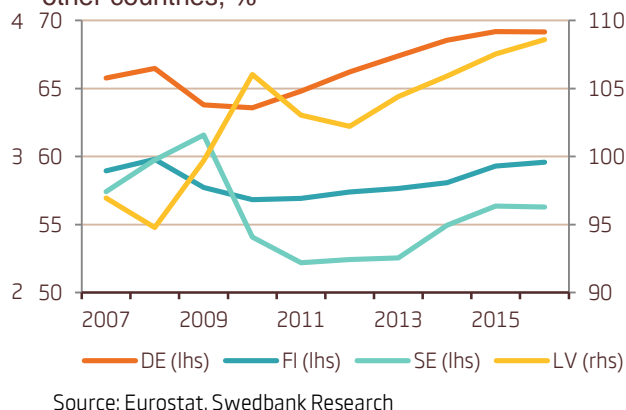
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Export market shares of goods, %



Estonian GDP price level compared to other countries, %



¹ The current analysis is of exports of goods. Although the share of goods in total exports to Finland (56% in 2017) is considerably lower than the average of all countries, the share has increased since 2015. Another reason for analysing exports of goods is the availability of more detailed data.

Finland is Estonia's largest export partner

Finland is Estonia's largest export partner. In 2017, Estonia exported EUR 2.1 billion (including EUR 1.7 billion of Estonian origin) goods to Finland (in nominal terms). Exports of goods to Sweden exceeded exports to Finland in 2011-2016; however, the main reason was the robust acceleration of exports of mobile equipment to Sweden. Excluding the exports of these goods, Finland has been Estonia's largest export market (see Appendix). The average share of goods of Estonian origin exported to Finland was 82% during the last five years (2013-2017). The respective average share of all Estonia's export markets was 71%. However, although the share of Finland in total exports of goods has increased since 2015, it is still lower than it was before 2011. In 2017, the share of Estonia's exports of goods to Finland was 16%, whereas the share of export of goods of Estonian origin was even higher, at 18.5%.

Export of goods of Estonian origin is relatively concentrated by country, i.e., more than one-third of exports (36%) go to only two countries (Finland and Sweden), and roughly half go to four countries (Finland, Sweden, Germany and Latvia). Therefore, the majority of Estonia's exports are dependent on the economic conditions of, and import demand from, relatively few countries. Although Estonian enterprises have proven their adaptability and ability to redirect at least some share of their exports to other markets, if necessary, an economic shock and/or sharp drop of demand in these major export partners could have a considerable negative impact on the Estonian economy.

At the same time, Estonian exports of goods to Finland are the most diversified among the ten largest export partners. The largest product groups exported to Finland are electrical equipment, furniture, and articles of iron or steel (see Appendix). The share of the largest 5 products out of 1210 in exports of goods to Finland (CN 4-digit code) was 21% in 2017. The respective share of the largest 20 products was 50%.

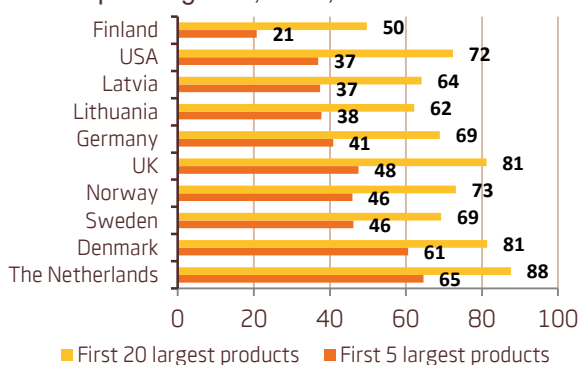
Finnish import demand is expected to remain strong in 2018

Since 2015, the growth of exports of goods to Finland has gradually picked up, along with the recovery of Finland's GDP growth and import demand. Last year, exports of goods to Finland increased 8.5% (export of goods of Estonian origin 9%) in nominal terms. Roughly two-thirds of the growth came from four product groups: electrical equipment, machinery and mechanical appliances, articles of iron and steel, and furniture.

In 2017, economic growth in Finland accelerated to 3%, the fastest pace of the last nine years. According to our forecast, Finland's GDP growth rate peaked last year and will slow in 2018 and 2019. However, we expect that in 2018 Finnish import demand will remain relatively strong and it should, at least in the near future, be among the largest contributors in foreign demand for Estonian exports of goods.

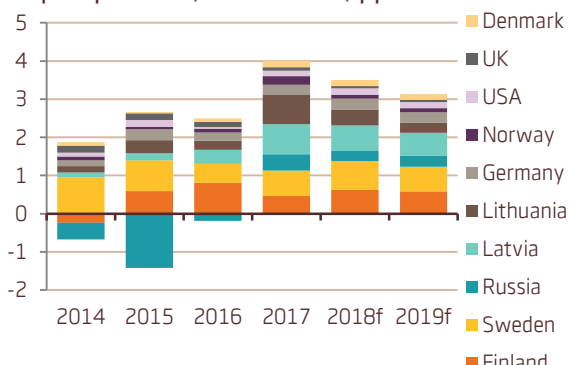
Production capacity and the turnover in Finland's business sector have expanded, whereas improved price competitiveness and stronger foreign demand are contributing to export growth. An increase in new orders in manufacturing confirms the continuation of both export growth momentum and import demand,

The share of the largest products in total export of goods, 2017, %



Source: Statistics Estonia, Swedbank Research

Import growth of Estonia's major export partners, contribution, pp



Source: Swedbank Research, European Commission

at least in the short term. Investment growth in construction is decelerating, while strong foreign demand, expanded production, and several major industrial projects will maintain robust growth in private investments. Private consumption has increased on account of households' diminishing saving rate. Increased consumer confidence, gradually rising employment, and decreasing unemployment rates are expected to maintain moderate household consumption.

The number of enterprises exporting to Finland has increased

The recovery of import demand from Finland has given export opportunities to more enterprises. The number of enterprises that export goods to Finland has increased during the last two years, reaching 1,756 in 2017 (see Appendix). This is approximately one-fourth of all Estonian enterprises exporting goods. The number of enterprises that import goods from Finland (1,952 in 2017) has always exceeded the number of exporting units. In 2017, the largest number of enterprises exported machinery and mechanical appliances (431), articles of plastics (412), and articles of iron and steel (390), whereas the largest average value per enterprise was in exports of electrical machinery and equipment and furniture. The least average value per enterprise was in exports of plastics and paper products.

Exported goods from Estonia have gained market share on the Finnish market

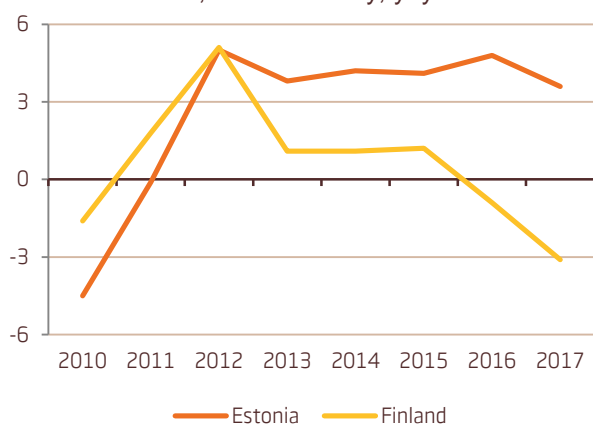
Although exported goods from Estonia lost some market share in Finland in 2017, the longer time series show a more positive picture. Estonia has gradually gained market share in Finland since 2008 – whereas in 2007 the share of Estonian exports of goods in Finland was 2.4%, in 2017 it increased to 3.4%. During the same period, imported goods from Finland did not gain market share in Estonia (the share was 14.1% in 2017) (see graph on the first page).

Estonia is losing its price competitiveness against Finland

In recent years, Finland has been able to limit the growth of its labour costs. Compared with Estonia's fast growth of labour costs, labour costs in Finland have been relatively stable (see Appendix). The gap between the growth of unit labour costs (the difference between labour costs and labour productivity) in Estonia and Finland has widened, as well. Finland has been especially successful in decreasing its unit labour costs and improving its price competitiveness against its trade partners.

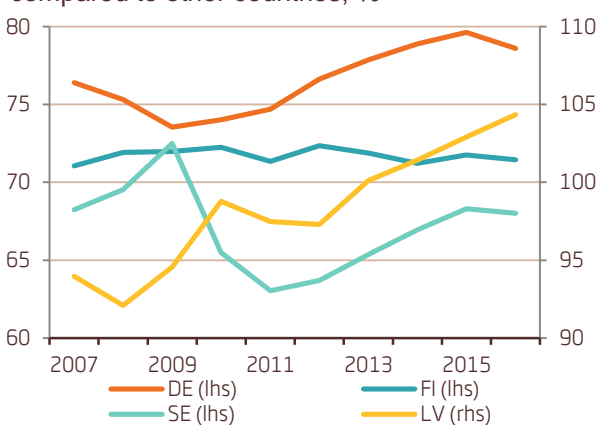
Estonian prices of goods have not converged closer to the Finnish average between 2007 and 2016, but it has lost its price competitiveness towards other major trade partners (e.g. Sweden, Germany and Latvia). Estonian prices of goods have stood at around 71-72% of the Finnish level². The main reason is that Estonian prices of capital goods have become cheaper than in Finland, while prices of consumer goods have converged closer to the Finnish average during that period. At the same time, Estonia has lost its

Unit labour cost, total economy, yoy %



Source: Eurostat

Estonian price level of goods compared to other countries, %



Source: Eurostat, Swedbank Research

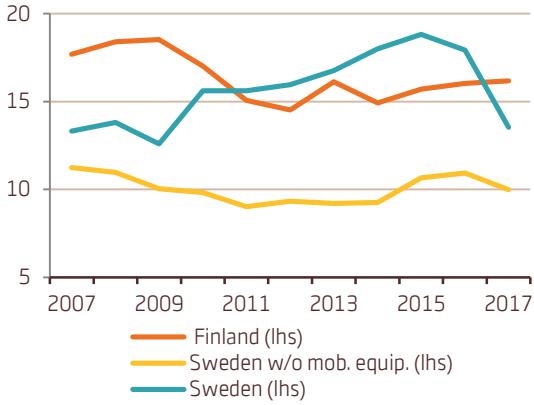
² The price comparison has been calculated based on the respective countries' price level indices, EU28=100

price competitiveness of capital goods compared to Latvia, Sweden and Germany. Services' prices made a U-turn in 2011 and have subsequently moved closer to services' prices in Finland. The gap between services' prices in Estonia and Finland is considerably wider than the difference in the prices of goods. If we look at more generally – the total economy – Estonian GDP price level has gradually converged closer to the Finnish average in the last years (see graph on the first page).

Estonia has gradually lost its price competitiveness against Finland and raising its exported goods' share on that market may gradually become more challenging. Thus, investing more in product development and productive capital and improving corporate management, work organisation, and supply chains are needed to halt Estonia's decline in price competitiveness on the Finnish market—let alone improve it.

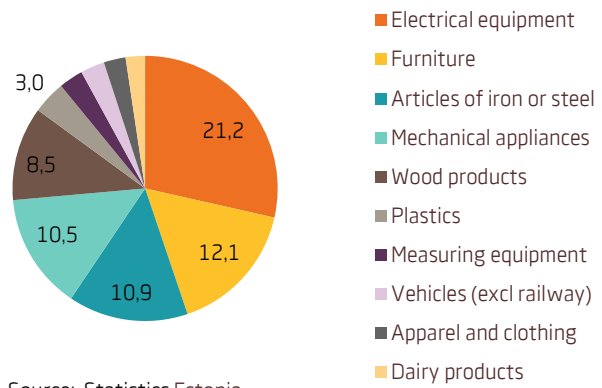
Appendix

Estonian export share of goods, %



Source: Statistics Estonia

Major goods exported from Estonia to Finland (local production) in 2017, %



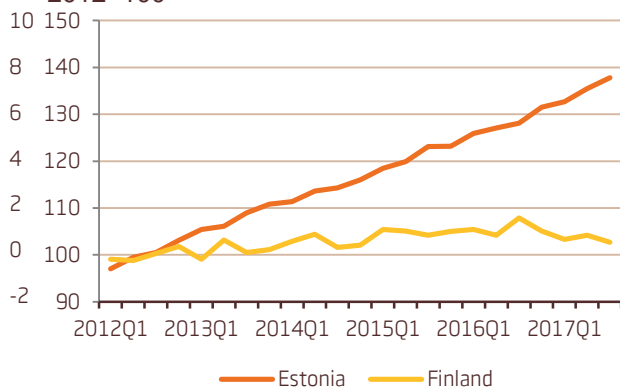
Source: Statistics Estonia

Exports and GDP real growth, %



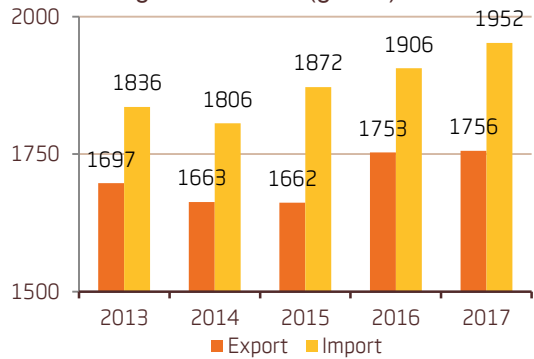
Source: Statistics Estonia, Eurostat, Swedbank Research

Labour costs in manufacturing, 2012=100



Source: Eurostat

The number of enterprises in Estonia trading with Finland (goods)



Source: Statistics Estonia

The number of enterprises exporting to Finland



Source: Statistics Estonia

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