Foreword

After the positive outcome of the SME advisory project in 2012, when the experts of the SEB Group visited companies in Estonia, Latvia and Lithuania, a new edition took place in autumn 2013. The focus of 4,373 meetings was on the advisory of financial planning and management with the objective to share the bank’s expertise with SMEs for a mutually beneficial relationship. In the sidelines of meetings a survey was carried out, similar to the previous year when the SMEs were asked about the outlook for the upcoming business year.

Now the Baltic Business Outlook sums up the advisory project and provides insights from 3,680 Baltic SMEs participating in the survey. SMEs are a driving force behind entrepreneurship and employment all over the countries, thus a crucial part of the economies.

Executive Summary

• The SMEs in the Baltics remain upbeat about the economic and business outlook as the region is becoming more resistant to the fluctuations of the European economy.
• Positive news are expected in the company turnover, especially in Estonia with about 25% of the SMEs expecting sales increase of at least 15%. Turnover growth is seen also Lithuania and in lesser extent in Latvia.
• However in the Baltic countries higher turnover will be mainly driven by the domestic demand, not as much by the exports.
• About two-thirds of Estonian and Lithuanian and three-quarters of Latvian SMEs concentrate on the domestic market, with the ambitious minority eyeing the export markets, either by expanding the sales or entering the markets abroad.
• Although the Baltic SMEs expect considerable investment activity, less than a half of the companies expect to invest more than 30,000 euros: In Estonia 41%, in Latvia 27% and in Lithuania 22% of the companies.
• The same applies for innovations where less than one-third of the polled SMEs expect to make changes in business model or in products and services.
• For remaining competitive in the export markets, both higher investment and innovation activity would bolster the prospects of the companies.
• With a number of companies planning to hire, a large share will keep the headcount unchanged – 83% in Latvia, 75% in Lithuania and 69% in Estonia, indicating the stability of the job market.
• By sectors, in Estonia the industrial enterprises recorded the highest optimism while in Latvia and Lithuania the construction sector has the most promising outlook.
Key indicators

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<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
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<tbody>
<tr>
<td>Population</td>
<td>1.3m</td>
<td>2.0m</td>
<td>3.0m</td>
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<tr>
<td>Currency</td>
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<td>Euro</td>
<td>Litas (1 € = 3.45 litas)</td>
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<tr>
<td>GDP per capita (€, 2012)</td>
<td>13,495</td>
<td>10,858</td>
<td>11,025</td>
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<tr>
<td>Unemployment (%)</td>
<td>8.0</td>
<td>12.0</td>
<td>10.9</td>
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Economic forecast 2014

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<th></th>
<th>GDP growth</th>
<th>Inflation</th>
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<tbody>
<tr>
<td>Estonia</td>
<td>2.6%</td>
<td>2.0%</td>
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<tr>
<td>Latvia</td>
<td>4.8%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Lithuania</td>
<td>3.5%</td>
<td>2.8%</td>
</tr>
</tbody>
</table>

Source: SEB Nordic Outlook, November 2013

Methodology

Turnover growth
In the survey the companies expecting at least a 15% turnover growth in 2014 are labelled as "optimists" while the companies expecting growth figures below 15% are "moderate optimists" and the rest, seeing a decline in turnover, are "pessimists".

Employment
The employment outlook is divided in three groups: The companies hiring new staff, the ones keeping the headcount unchanged and the companies intending to cut back on personnel.

Exports
All respondents are divided into three groups: Companies planning to enter new markets, those intending to grow on existing export markets and then companies focusing on the domestic market.

Innovation
The result refers to two groups of companies: Those planning innovation in 2014, either in product or services, business model and those not planning any of the abovementioned.

Investments
The threshold of considerable investments is set on 30,000 euros, the companies investing amounts above and below that constitute the first two groups and the third group is composed of companies not planning any investments in 2014.
Modest expectations towards turnover growth this year...

Optimists
- Estonia: 25% \(\uparrow\)
- Latvia: 13% \(\downarrow\)
- Lithuania: 19% \(\uparrow\)

Moderate optimists
- Estonia: 67% \(\downarrow\)
- Latvia: 74% \(\uparrow\)
- Lithuania: 69% \(\downarrow\)

Pessimists
- Estonia: 8% \(\rightarrow\)
- Latvia: 13% \(\uparrow\)
- Lithuania: 11% \(\rightarrow\)

Companies are more cautious about their export development compared to 2013

New markets
- Estonia: 15% \(\downarrow\)
- Latvia: 12% \(\downarrow\)
- Lithuania: 14% \(\rightarrow\)

Existing markets
- Estonia: 16% \(\downarrow\)
- Latvia: 14% \(\downarrow\)
- Lithuania: 17% \(\downarrow\)

Domestic
- Estonia: 69% \(\uparrow\)
- Latvia: 74% \(\uparrow\)
- Lithuania: 69% \(\uparrow\)

Companies planning rapid growth in their turnover intend to recruit more

Higher
- Estonia: 26% \(\rightarrow\)
- Latvia: 14% \(\downarrow\)
- Lithuania: 22% \(\rightarrow\)

Same
- Estonia: 69% \(\rightarrow\)
- Latvia: 83% \(\uparrow\)
- Lithuania: 75% \(\rightarrow\)

Lower
- Estonia: 5% \(\rightarrow\)
- Latvia: 3% \(\rightarrow\)
- Lithuania: 3% \(\rightarrow\)

Only 3-5 companies out of 10 are open to innovations and organisational developments

Product/service
- Estonia: 27% \(\rightarrow\)
- Latvia: 26% \(\downarrow\)
- Lithuania: 26% \(\rightarrow\)

Business model
- Estonia: 4% \(\rightarrow\)
- Latvia: 3% \(\rightarrow\)
- Lithuania: 2% \(\uparrow\)

Employees
- Estonia: 16% \(\uparrow\)
- Latvia: 8% \(\downarrow\)
- Lithuania: 4% \(\rightarrow\)

Turnover growth expectations are related to investment projects and higher competitiveness

Above 30th euros
- Estonia: 41% \(\downarrow\)
- Latvia: 27% \(\downarrow\)
- Lithuania: 22% \(\rightarrow\)

Below 30th euros
- Estonia: 20% \(\uparrow\)
- Latvia: 10% \(\uparrow\)
- Lithuania: 12% \(\rightarrow\)

No
- Estonia: 17% \(\rightarrow\)
- Latvia: 31% \(\uparrow\)
- Lithuania: 35% \(\downarrow\)
Baltic business by sectors

Of five indicators surveyed during the advisory project the outlook of the turnover growth is the basis for assessing the business prospects for 2014. Defined as “optimistic” are the SMEs expecting the sales to grow at least 15% this year.

Trade

The trade sector is in upbeat mood in Estonia with 29% being optimistic about the 2014 outlook, followed by Lithuania (21%) and Latvia (10%).

Transport and logistics

Estonian and Lithuanian transport and logistics companies see good prospects in 2014, with respectively 21% and 20% expecting the sales growing by 15% at least. In Latvia 5% are of the same opinion while a vast majority, 83%, see a moderate growth in 2014.

Construction

27% of Lithuanian and 22% the Estonian construction companies have an optimistic outlook for 2014, 20% in Latvia.

Manufacturing

The manufacturing sector is most optimistic in Estonia with 34%, followed by 19% in Latvia and 17% in Lithuania.

Agriculture

In agriculture and fishery the most optimistic mood is perceived in Estonia with 16% of respondents seeing the turnover increase of more than 15% in 2014 while both in Latvia and Lithuania the corresponding figure is 11%.

Housing and catering

In housing and catering the outlook for Estonian businesses is the best with the share of optimists amounting to 28%, followed by Lithuania and Latvia with 15% and 13%.

Other

Of other sectors, the optimism in Estonia is the strongest with 27%, followed by Lithuania and Latvia with 18% and 15% respectively.
**Business environment country-by-country**

**Estonia**

- In 2014 Estonian SMEs expect higher turnover and are increasingly targeting export markets.
- Investments and innovation are less prioritised, especially among the companies targeting the domestic market.
- However export-oriented companies should seriously focus on investments and innovation, to remain competitive.
- Manufacturing is the flagship sector of Estonian economy, characterised by growing turnover, supported by the export.
- Manufacturing sees a bulk of investments and innovation in 2014.
- Most complicated times are expected in the construction sector, where a modest outlook was recorded both in terms of turnover and export growth.

**Estonia, Total Market 2011**

- Turnover 0-0.3 mEUR: 89%
- Turnover 0.3-1.5 mEUR: 7%
- Turnover above 1.5 mEUR: 4%

**New companies established:** 20,087 (2012) and 20,654 (2013)

**Estonia: SME plans for 2014**

- **69%** will keep the number of employees unchanged
- **69%** will remain focused on domestic market
- **41%** will make investments
- **31%** plan innovations in business model or products/services

**Export markets**

- 2013: 14% will plan to enter new export markets
- 2013: 16% plan to grow on existing export markets
- 2013: 69% internal market will remain our target

**Number of employees next year...**

- 2013:
  - 4% lower
  - 69% same
  - 26% higher
- 2012:
  - 4% lower
  - 69% same
  - 26% higher

**Export markets**

- 2013:
  - Plan to enter new export markets
  - Plan to grow on existing export markets
  - Internal market will remain our target

**Innovations and changes**

- 2013:
  - 40% do not plan innovation activities
  - 27% plan product / service innovation
  - 16% will change business model
  - 12% will invest in employee development
  - 11% Other
- 2012:
  - 36% do not plan innovation activities
  - 28% plan product / service innovation
  - 13% will change business model
  - 18% will invest in employee development
  - 3% Other

**Investment projects**

- 2013:
  - 41% yes, over EUR 30 th
  - 20% yes, up to EUR 30 th
  - 17% No
  - 13% Do not know yet
  - 21% Other
- 2012:
  - 48% yes, over EUR 30 th
  - 17% yes, up to EUR 30 th
  - 13% No
  - 13% Do not know yet
  - 21% Other

**Turnover next year...**

- **Optimists** over 15% growth over 30% growth: 25%
- **Moderate optimists** up to 5% growth 5-10% growth: 67%
- **Pessimists** decrease down to 5% over 5% decrease: 8%
Economist’s view

Ruta Arumäe
Chief Economist at SEB Estonia

Estonian economy is highly export oriented and dependent on export market performance. The size of exports measures to 90% of GDP. 18% of total exports are directed to Sweden, 15% to Finland, 13% to Russia and 11% to Latvia. The performance of the export markets will diverge in 2014. On Swedish market, a solid economic growth is expected to continue. That is favouring most of Estonian exports. The largest export article – electronics manufacturing – will depend on global economic recovery. Finnish and Russian economy will still struggle and show only very modest growth. That is constraining food industry’s export and machinery. Latvian economy is among the fastest growing in the EU and providing continuously export growth possibilities for several exporters and goods. Global economic recovery is the key for a more broad-based economic recovery in Estonia. So far it has been more domestic demand reliant.

Deflationary forces abroad pose challenges for Estonian exporters, while having to encounter inflationary forces domestically at the same time.

A main driver of economic growth continues to be domestic consumption that will benefit the most the retail and wholesale sector. Also other domestic consumption related sectors will likely continue to perform better than the average, similarly to the previous year. These include for example the information and telecommunications sector, which success is also based on being the most innovative sector.

Low interest rates will encourage investments. On the other hand, investments growth will be constrained by uncertainty of global demand recovery. Financing decrease, which is related to the EU structural funds temporary slump, is affecting negatively the investments into buildings. At the same time, low interest rate environment persistence may trigger more real estate investments and rapid real estate price increase continuation. Banks’ lending policy will prevent from new real estate bubble emerging at this point of time. Productivity-enhancing investments are expected to increase in order to mitigate the strains in the labour market and which are aimed to ease the pressure stemming from the limited availability of qualified labour force.

Labour market is the factor challenging all the companies the most. Lack of qualified labour force will haunt despite the economic growth rate going forward. Salary growth will be continuously rapid. The pressure of wage growth will persist, but will not accelerate. At the same time the factors keeping wage growth high persist: limited availability of qualified labour force, mismatch of the skills in the labour market and emigration. On the other hand, slow economic growth will keep wage growth from accelerating further. At the same time, wage growth will be more consistent with the productivity growth in 2014 than it was in 2013. This is fostered by accelerating economic growth rates, while employment will stay unchanged.
Latvia

- For 2014 Latvian SMEs expect turnover to increase but in a rather modest manner, up to 5%.
- Investment and innovation activity is expected to remain modest, primarily among the companies focused on the Latvian market.
- For the sake of competitiveness export-oriented companies have to pay more attention on investments and innovation.
- SMEs in trade and agricultural sectors are the most promising companies, forecasting optimistic prognosis in turnover and significant investments in growth.
- In 2014 Latvian SMEs prefer to stay in expectant position with modest growth, small investments and stable employment, but such an approach doesn’t contribute Latvian economy.

Latvia: SME plans for 2014

- 83% will keep the number of employees unchanged
- 74% will remain focused on domestic market
- 27% will make investments
- 28% plan innovations in business model or products/services

Export markets

- 2012: 2% lower, 73% same, 24% higher
- 2013: 12% lower, 14% same, 74% higher

- Plan to enter new export markets
- Plan to grow on existing export markets
- Internal market will remain our target

Innovations and changes

- 2012: 41% do not plan innovation activities, 37% plan product/service innovation, 11% will change business model, 11% will invest in employee development, 21% other
- 2013: 52% do not plan innovation activities, 26% plan product/service innovation, 8% will change business model, 8% will invest in employee development, 9% other

Investment projects

- 2012: 42% yes, over EUR 30 th, 12% yes, up to EUR 30 th, 22% no, 23% do not know yet
- 2013: 27% yes, over EUR 30 th, 19% yes, up to EUR 30 th, 31% no, 31% do not know yet

Turnover next year...

- Optimists: over 15% growth, over 30% growth (13%)
- Moderate optimists: up to 5% growth, 5-10% growth (74%)
- Pessimists: decrease down to 5%, over 5% decrease (13%)
In 2013, a slow-down in economic activity was observed, albeit more moderately than expected. GDP growth in 2013 might reach 4.3%. With exports and investments lagging slightly, households have become the main drivers of growth recently and will still play the main role this year. An increase in real income will be one of the preconditions. In view of global forecasts, exports should become more active in 2014. Moreover, in the second half of the year, alongside more positive trends in external markets and the delineation of new lines in the allocation of EU Funds, investment activity might also increase. Activity will be closely related with the decrease of uncertainty in the Eurozone and further growth prospects of the region.

Taking into account further step of global central banks and economic trends in the global economy, low interest rates will begin demonstrating a weak increase, although, under the influence of deflation risks and the ECB’s policy, this will happen to an even more limited extent. The current monetary policy of the ECB was beneficial to Latvian borrowers, since the low EURIBOR money market index rate allowed savings at the expense of monthly payments for housing loans. During 2013, the average interest rate on housing loans with a maturity of more than 5 years shrunk by 0.13 percentage points down to 2.54%, which is a historic low. It is expected that in 2014, the “cheap money” era will continue, but interest rates will not remain historically low for a long time. Therefore, in the foreseeable future an increase (to a limited extent) of EURIBOR can be expected, which would have to be taken into account by borrowers subject to variable interest rates.

So far demand for loans has been weak. However, investment needs are mounting as to improve competitiveness and raise capacity utilization. Entrepreneurs remain cautious and prefer refraining from borrowing, as uncertainty is at high level. Sustained by favourable conditions, low interest rates and clear priorities in EU funds distribution investment growth may pick up in the second half of this year.

This year, growth will continue within sectors of national economic importance such as sales and construction. The processing industry is also expected to make a contribution this year. If Liepājas Metalurgs returns to operation (most probably, with a more limited capacity than before the initiation of insolvency proceedings), growth might be much higher than in 2013. Growth can be expected in the commercial services sector as well. If the improvements observed in the foreign markets will continue to strengthen, this will be reflected in public sentiment and activity will also continue to grow in the real estate sector. Complications are possible in the field of transit, where both the speed of recovery of the euro-zone and geopolitical considerations, including the policy pursued by Russia and the Latvian industry capacity, will play big roles. During the next two years, overall growth might remain at 4.8%, which indicates that in many fields improvements will be gradual as well as uneven.

The increase in economic activity continues to push up wages, which increased by 5.1% in the third quarter, as compared to the same quarter of the previous year. The increase in wages in the public sector was 5.3%, including the general government sector, where it reached 6.2%. It was closely followed by the private sector, where the increase was 5%. The slightly larger increase of wages in public administration is in line with projected trends, and there is reason to believe that a similar trend will continue in the future as well. The strong grip of austerity loosens, and preconditions for the wage increases improve. Those who work in local governments and public and municipal capital companies have far more chance of having their wages increased. The State budget will not be able to satisfy all the demands for wage increases for quite some time. Wages in the private sector will be contingent upon the profitability of each individual sector and company as well as labour market conditions. Part of the potential increase will partly dissolve in the shadow economy. Therefore, variations between sectors and companies will continue to be very uneven and different in pace, as a result of which quite a large share of workers will not experience any change in their wages this year either. Accordingly, the wage increases will not be comprehensive, but rather selective for the time being. It will depend on the development and staff policy of each individual company and the labour market situation. Sector specialists and workers in rapidly developing sectors will be in a better situation. Evidence suggests that in the mid-term, the pressure to increase wages will only increase, and this will pose risks to competitiveness in the longer term. Weak inflation will continue to have a positive impact on purchasing power. So far wage growth is in line with productivity growth and poses no risks to the economy. However, if investments in productivity will lag in a longer term this may raise risks to competitiveness.
Lithuania

- Plans and expectations of companies for 2014 are somewhat more optimistic than a year ago.
- The majority of companies expect moderate growth in their turnover, up to 10%.
- Anyway, companies are more cautious about their export development compared to 2012.
- The majority of companies continue to be reserved about planning any major novelties or innovations in their activities in 2014, and the share of those planning such novelties has even shrunk.
- 22% of companies intend to undertake investment projects, and this share has remained unchanged since 2012.

Lithuanian: SME plans for 2014

75% will keep the number of employees unchanged
69% will remain focused on domestic market
22% will make investments
28% plan innovations in business model or products/services

Up and down: Where are they?

- in construction sector
- Vilnius county
- companies with 1-9 employees
- turnover up to 200 000 EUR
- turnover over EUR 3 M

- Klaipėdos & Šiaulių counties
- transport & logistic sectors
- companies with 50-99 employees

Number of employees next year...

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<th>Year</th>
<th>Lower</th>
<th>Same</th>
<th>Higher</th>
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<tr>
<td>2013</td>
<td>3%</td>
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<tr>
<td>2012</td>
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<td>75%</td>
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Export markets

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<th>Internal market will remain our target</th>
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<tr>
<td>2013</td>
<td>13% 17% 69%</td>
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<tr>
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<td>14% 24% 61%</td>
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Innovations and changes

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<th>will change business model</th>
<th>will invest in employee development</th>
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<tr>
<td>2013</td>
<td>58% 25% 4%</td>
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<td></td>
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<tr>
<td>2012</td>
<td>56% 33% 4%</td>
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Investment projects

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<th>Year</th>
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<th>Yes, up to EUR 30 th</th>
<th>No</th>
<th>Do not know yet</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>22% 12% 35% 29%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>22% 12% 39% 26%</td>
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</table>
Labour costs will put pressure on production competitiveness oriented sectors, mainly manufacturing. Rising energy and the year 2014 most probably will be more challenging to export compared with 2013. Chemical products (mostly fertilizers) predict a better year as rising domestic market. Among industrial sectors, producers of providers also are likely to be among those benefiting from the Year 2013, is likely to strengthen more notably this year. Service in construction and real estate markets, which was quite timid and employment will support growth of retail trade. Recovery to perform better than the tradable sectors. Increasing income Therefore, the sectors oriented to domestic market are likely In 2014, domestic demand should take the lead over exports. While labour shortage problem will create additional problems. The country’s largest manufacturing plant, oil refinery Orlen Lietuva, claims that it is suffering from low processing margins on the European market which may continue in 2014. Having in mind the fact that refinery takes up around 30 per cent of total industrial production, it may affect overall figure for industrial growth to a large extent.

Credit interest rates for companies remain close to all-time bottom in both euro and national currency (e.g., in November 2013, new loans to companies were issued at 4.78 per cent and 3.09 per cent in Lithuanian market, respectively). However, credit growth is rather modest due to sluggish borrowing demand. Investment growth was weak for several years after the crisis, capacity utilization in manufacturing is high and therefore the need for investment is pressing. Nevertheless, companies remain cautious and prefer refraining from borrowing, if they are able to finance the investment from their own resources. On the other hand, business confidence has been gradually improving and the optimism in the construction and real estate market is rising. Helped by continually low interest rates, investment growth may turn to be stronger in 2014.

During the post-crisis period, wages and salaries in Lithuania continued decreasing in real terms and the trend reversed in 2013 only, when real wages started picking up. However, last year real wages and salaries still remained by roughly one-tenth lower as compared with pre-crisis peak. Acceleration of wage growth in 2013 owes a lot to increase in minimum wage as of the beginning of 2013 by almost 18 per cent. 2013 only, when real wages started picking up. However, last year real wages and salaries still remained by roughly one-tenth lower as compared with pre-crisis peak. Acceleration of wage growth in 2013 only, when real wages started picking up. However, last year real wages and salaries still remained by roughly one-tenth lower as compared with pre-crisis peak. Acceleration of wage growth in 2013 owes a lot to increase in minimum wage as of the beginning of 2013 by almost 18 per cent.

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In 2014, as no minimum wage increase is envisaged, the wage growth should somewhat slow down. SEB Bank’s wage growth forecast for 2014 stands at 5.5 per cent, down from 6.0 per cent in 2013. Decreasing unemployment and labour shortage problems in some sectors, stable profitability of companies as well as pent-up increase in wages will be the main macroeconomic factors behind the increase in earnings. On the one hand, increase in wages and salaries will hurt export competitiveness, on the other hand, it will support recovery of domestic demand. In 2013, for the first time in 4 years, wages and salaries started rising faster than labour productivity but the loss of competitiveness remained small.

In 2014, most of Lithuania’s export markets are expected to grow faster than in 2013 but the development will be still quite slow. Russia, Lithuania’s export target No. 1, will continue struggling as its growth will slightly accelerate but remain below its potential. In 2013, for the first time in 4 years, wages and salaries started rising faster than labour productivity but the loss of economic factors behind the increase in earnings. On the one hand, well as pent-up increase in wages will be the main macroeconomic factors behind the increase in earnings. On the one hand, increase in wages and salaries will hurt export competitiveness, on the other hand, it will support recovery of domestic demand. In 2013, for the first time in 4 years, wages and salaries started rising faster than labour productivity but the loss of competitiveness remained small.
Current affairs Baltic economies

Estonia: Higher inflation has eroded competitiveness

During 2013, Estonian path has somewhat diverged from its Baltic neighbours. Its consumer price inflation was 2.8%, while being close to zero in Latvia and Lithuania. Higher inflation has pushed up wage growth expectations, along with the post-crisis hangover in consumers’ purchasing power. Real wages were severely cut during the crisis and their recovery has been really modest, until the middle of 2013. That is contributing to rising wage demands.

Higher inflation has pushed up the real exchange rate in Estonia, which increased rapidly in 2013, while in Latvia it has stayed the same and in Lithuania rose only modestly. The rise in real exchange rate in Estonia has been triggered both by more rapid consumer price inflation and also by rapid wage growth. Rising real exchange rate means decreasing competitiveness. The cost advantage, which was gained during the economic crises, has been dried up during past couple of post-crisis years.

Another related indicator revealing decreasing competitiveness is unit labour cost, which also showed the fastest rise in the EU in 2013, exceeding 7% y-o-y growth. In Latvia the unit labour cost increased 1.7% and Lithuania 2.5%.

Estonian pay growth has accelerated to over 8% in 2013 and is a bit worrisome, both because of its actual speed and because wage and salaries rose relatively fast last year even though there was a lot of slack in the economy. Estonia’s unemployment rate of about 8% is at its estimated level that can be described as structural. If the pay growth gets stuck close to 8 per cent, long term productivity growth will be exceeded. If so, Estonia risks a resumption of cost pressures and resulting competitiveness problems.

Weak productivity growth, which has prevailed last couple of years, poses some inflationary risks. Wage growth has exceeded productivity growth continuously since 2011. The picture is going to re-balance a bit in 2014, with rising productivity and slowing wage growth.

Elevated inflation in Estonia compared to its Baltic peers has eroded Estonian competitiveness in last couple of years. Inflation has rapidly slowed down at the end of 2013 and is likely to remain low also during 2014. As a result, the cost pressure for enterprises and also the pressure for wage hikes will ease. Lower inflation will ease the competitiveness erosion deterioration in 2014 and stop the gap widening with its Baltic neighbours.

Latvia: First conclusions about the euro adoption

On January 1 2014 Latvia became the 18th member of the Eurozone. Euro changeover in Latvia was carried out very smoothly, as there were no substantial setbacks and the problems that created negative repercussions. That was ensured by timely and comprehensive preparation by all of the involved parties. This also helped easier for consumers to overcome dual circulation period, though it caused some inconveniences for elderly people. Despite this, according to TNS polls support for euro in Latvia increased to 52%, or up by 6 percentage points from before the transition. Most probably support will rise further as people will get accustomed with the new price nominals and face advantages of the new currency. Meantime the technical changeover is passing swiftly. After ten days the amount of cash euro in circulation exceeded that of lati. But still quite substantial amount of cash lati is in circulation.

Euro adoption is very important geopolitical step for Latvia towards further integration in Europe. So far one can observe heightened interest from international media and investors that still needs to be converted into raising investment inflows and economic activity. One of the main fears that held back support for the euro was raising inflation. So far selective practice of rounding up prices is observed, but it is expected that it will not exceed the expected addition to inflation of 0.2-0.3 percentage points.

Latvia’s determination to join the euro zone is paying off. On January 14, Latvia in a status of a euro area member sold 7 year eurobonds worth one billion euro. The fixed rate of those bonds was 2.625 percent, the yield 2.815 percent. The demand for eurobonds exceeded the supply four times. The borrowing will allow refinancing current debt at lower interest rates. The successful issue of eurobonds confirmed credibility of foreign investors over Latvia’s economic achievements managing the crisis and the determination to join the euro zone.

Euro is one of the bricks that will strengthen Latvian economy and society in a long term, however, it will not solve all challenges Latvia is facing. Presumed benefits will materialize only if Latvian government and society will manage to use potential advantages properly.
Lithuania: Knocking on the euro zone’s door

A European Union member for 10 years already, Lithuania intends to join euro zone as of January 1, 2015. With less than a year remaining until the expected euro introduction, there is a lot of work to do.

First of all, this spring Lithuania has to pass the examination of its economic and financial indicators in relation to the five Maastricht criteria. Lithuania has been meeting all the requirements without any particular effort in recent months. The criteria of currency stability, government debt and long-term interest raise no concern for several years already. Meanwhile, the chances of meeting inflation and public deficit requirements have substantially improved lately.

As opposed to 2006, when Lithuania failed to meet inflation criterion by a meagre of 0.1 percentage point, in 2014 inflation is likely to pass safely. Stable global energy prices and weak demand pressures have driven inflation to the lowest levels in three years. Actually, Lithuania has been meeting the criterion for 1.5 years already and the safety gap has notably widened in recent months. Budget collection has been improving over the second half of 2013 and looks promising. Therefore, the likelihood of euro introduction in Lithuania in 2015 has increased markedly.

In the meantime, Lithuania already is on one-leg in the euro zone. The country has fixed exchange rate regime (and no independent monetary policy) for two decades already. For 12 years, Lithuania's national exchange rate is immovably pegged to euro. For a small and open economy with extensive trade ties in the euro region and an already fixed exchange rate, economic benefits of euro zone membership are obvious. Euro introduction should give a boost to exports due to vanishing exchange costs, lower market entry costs and higher market transparency as well as simpler accounting. Furthermore, a decline in credit interest rates is anticipated which would help to save tangible amounts of money for households, companies and government. In the medium term, euro introduction is expected to add 0.2-0.3 percentage points to GDP growth rate every year.

Undoubtedly, the main public concern regarding the euro introduction is an increase in prices. According to recent opinion poll, 86 per cent of Lithuanians fear that prices will go up after the euro introduction. This is the main reason behind negative public opinion towards the euro introduction itself. Late in 2013, 49 per cent of Lithuanians expressed their disfavour to euro.

Other public concerns include contributions to the European Stability Fund. However, in a case of bad luck, Lithuania could benefit from the fund's resources as well. At the moment of Lithuania’s entrance to the euro zone, single banking supervision mechanism may have already started functioning and contribute to greater financial stability in the country. In that case, the three largest Lithuania's banks would immediately fall under the direct supervision of European Central Bank.

One of common themes regarding euro introduction is Lithuania's comparison to Latvia and Estonia which already have euro in their pockets. Indeed, in economic terms it would be plausible to share common currency across the Baltic region. Besides, Lithuania may draw the best introduction practices from the other two Baltic countries.

Lithuania has recovered quite fast after the crisis and therefore its convergence with the Western European Union countries accelerated. During 10 years in the European Union, the living standard in Lithuania and euro zone has converged notably. Therefore the country's ambitions to become a euro zone member seem to be rightly justified. If all goes well, Lithuania will become the nineteenth euro zone member and, as a consequence, even bring alterations in ECB council voting mechanism.