

The contents of this document are preliminary and subject to change.

GRAY/22/2328

August 26, 2022

**Statement by Mr. Massourakis and Ms. Cerami on Republic of Estonia  
(Preliminary)  
Executive Board Meeting 22/74  
August 29, 2022**

*We thank staff for a well-focused report and Mr. Pösö and Mr. Kraavik for their helpful Buff statement. The Estonian economy has proved remarkably resilient against the fallouts from the pandemic and the Russian war against Ukraine, but the geographical proximity to the conflict poses significant downside risks to the outlook. Continuing with policies to promote productivity growth and enhance labor supply remain key to keeping the economy on a sustainable growth path. We concur with the thrust of the staff's appraisal and associate ourselves with Mr. Buisse's statement. We therefore limit our remarks to the following specific points.*

- **The current expansionary fiscal policy stance is appropriate, but the authorities should prepare for a timely withdrawal of support to mitigate persistent inflationary pressures.** Strong fundamentals and policies have supported the resilience of the Estonian economy but risks to the outlook have clearly shifted to the downside, mainly because of the surge in energy prices. In this context, the authorities have appropriately used their fiscal space to mitigate higher energy costs, provide support to the Ukrainian refugees, strengthen energy security, and improve health conditions. Strengthening efficiency of spending and timely unwinding fiscal accommodation over the medium term will support monetary policy actions to preserve price stability.
- **Policies to boost productivity and enhance labor supply remain key to preserving competitiveness.** These policies will also be key to mitigating the risks of a wage-price spiral amidst persistent labor shortages, especially in skill-intensive sectors. In

this regard, the recent realignment of real wages with productivity growth is a favorable development that should be supported by the envisaged policies to increase R&D, consolidate digital advantages, reduce skill mismatches, and facilitate the integration of refugees. Further efforts to reduce inequality and gender pay gaps will also contribute to enhance labor supply and promote inclusive growth.

- **Accelerating the transition to renewable energy sources has become more urgent because of the need to enhance energy security.** We thank staff for the insightful analysis of recent developments in the gas and electricity markets in Estonia, which underscores the need for an effective coordination of infrastructure investments with the closely integrated Baltic and Nordic peers. We agree with staff that the EU funds for climate mitigation create an opportunity to reinvigorate the Estonia's European Green Deal commitment to achieve carbon neutrality by 2050, which may require phasing out the domestic oil shale sector. To this end, it is paramount to develop renewable energy generation, which should be supported by the windfall profits realized thanks to lower production costs and the marginal pricing system. We note that security and environmental concerns and resistance from the local community have slowed down the development of wind farms. *However, we wonder whether the authorities have assessed the full extent of actual and potential environmental damages from the oil shale sector, which also raises environmental concerns.*
- **The financial sector is overall robust and the macroprudential policy stance has been appropriately tightened.** The banking sector is well capitalized, profitable, and liquidity risks and asset quality have further improved. Like staff, we welcome the new countercyclical capital buffer and encourage strong vigilance of housing market developments, amidst sustained house prices and credit growth. We also emphasize the importance of strengthening cybersecurity frameworks. *We note that staff assess the increased competition within the banking sector and from the non-bank financial sector also as a source of higher risks. Can staff elaborate on these risks in the Estonian context?*