

Estonia

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IN A NUTSHELL

- GDP grew by 8.3%, one of the strongest recoveries in Europe.
- The mortgage market grew with outstanding housing increasing by 9.2%.
- Housing prices continued to rise.

MACROECONOMIC OVERVIEW

The economy rebounded strongly from the pandemic, growing by 8.3%. Growth was fueled by expansion in trade, investments, private consumption and government policies. Private consumption was supported in the second half of the year by the reform of the second pension pillar that made participation voluntary and allowed people to withdraw money.

The recovery was broad-based. Unemployment averaged 6.2% for the year and reached 5.2% in the last quarter. Employment levels are high, but have not yet reached pre-pandemic peaks, leaving some room for increase in the activity rates especially among the young and the elderly. Wages increased by 6.8% as the labour market gained strength.

Consumer prices started to increase from the beginning of the year but increased more rapidly at the end of the year as electricity, gas prices increased. The average price level in 2021 was 4.5% higher than the year before but reflects only partially the price increase in the last month of the year.

The Government budget deficit declined compared to the 2020 levels, but public spending was still higher than income, so the deficit stood at 2.7% from the GDP. Government debt level is still among the lowest in Europe (18.1% GDP). Estonia also benefitted from the expansionary stance of the euro area monetary policy.

HOUSING MARKETS

Demand in the housing market increased in 2021 because of the sharp rise in confidence and the strong growth in income and savings. Activity was particularly evident in the secondary market for apartments, which is where the much of the money withdrawn from pension assets were spent.

Increasing demand pushed up prices for residential property at a fast pace. Data from Statistics Estonia show that the dwelling price index increased on average by 15.1%. Apartments were around 15% more expensive than a year earlier, and houses were up 16%. Prices rose faster in the secondary market for apartments in Tallinn.

In 2021, the Owner-Occupied Housing Price Index increased by 11% according to Statistics Estonia.

At the end of 2021, Estonia had a stock of 739,000 dwellings, compared to 730,000 in 2020 and 724,000 in 2019.

On the supply side, construction increased by 10% in 2021. The number of

completed dwellings was 6,735 units a decline of 11% y-o-y. The majority (62%) of new dwellings are blocks of flats. The number of building permits issued decreased by 0.7% to 8,773. The number of transactions increased by 19.2% to 71,732.

MORTGAGE MARKETS

Increased activity in the real estate market and rising prices caused strong growth in housing loans. The mortgage market grew by 9.2% to EUR 9.4 bn, the highest level ever. This is equivalent to 31% of GDP. The average outstanding loan grew by 9.0% to EUR 49,902. Housing loans grew faster than GDP or household incomes meaning that the debt burden of households increased.

Housing loans are offered in euros and have maturities up to 30 years. The average interest rate on new origination fell to an average value of 2.15% at the end of 2021 due to the tight competition between banks. Borrowers can ask up to 85% of a property value with a standard contact structure and up to 90% if they qualify for the housing guarantee programme supported by the government.

The share of borrowers with high loan service costs relative to their incomes has increased according to Bank of Estonia. The debt service-to-income (DSTI) requirement states that the ratio of the total liabilities of the borrower to their net income may not exceed 50% at the time of loan decision. The share of loans where the DSTI of the borrower is close to the limit at 45-50% is increasing. Around a quarter of all the new loans issued in the final quarter of 2021 had a DSTI in this range according to the Bank of Estonia.

There was also a small rise in the share of loans with a high loan-to-value (LTV) ratio due to the sharp rise in real estate prices, which made it harder for borrowers to save money for the down payment on a housing loan.

The mortgage market consists mainly of housing loans granted by commercial banks, which account for approximately 42% of the aggregate loan and lease portfolio of the banks according to the Bank of Estonia. The banking sector is well capitalised and the quality of the housing loans remained good in 2021. Only 0.1% of housing loans are overdue by more than 90 days at the end of 2021.

NON-MARKET LED INITIATIVES

Bank of Estonia macroprudential policies remained broadly unchanged. These measures are applied when necessary to prevent risks to the financial sector building and subsequently increase the resilience of the sector. The Bank of Estonia kept the requirements for issuing housing loans constant. The requirements setting the maximum loan-to-value (LTV) of 85%, debt service-to-income (DSTI) of 50% and a maximum maturity of 30 years have been in place since 2015. The Bank of Estonia requires the borrowing capacity of households to be assessed assuming an interest rate of at least 6%, thus reducing the risk from a possible rise in interest rates from the current low rate environment. The Bank of Estonia has set up a limit of 50% of the DSTI

ratio calculated in this way.

Credit institutions operating in Estonia must currently comply with the following macroprudential requirements of the central bank: large, systemically important banks must maintain larger capital buffers (between 1% and 2%), the minimum risk weight for mortgages is subject to a floor and all banks must apply borrower-specific requirements before issuing housing loans.

No additional capital is required to be held for systemic risks apart from loans to residents of Lithuania which attract an additional 2%.

The Bank of Estonia has announced that it will require a 1% countercyclical capital buffer from December 2022 in order to set the buffer above zero as the amount of credit in the economy, relative to GDP is below the long term average. The Estonian banking sector remains well capitalised, above the required level, so the change in regulation is not expected to have any response currently from the banking sector.

MORTGAGE FUNDING

The lending policy of banks for housing loans did not change particularly in 2021. The most important source of funds for the Estonian banking sector continues to be deposits. As deposits have grown strongly in recent years, they have been sufficient to finance the demand for credit. The ratio of loans to deposits was 80% at the end of 2021.

The share of market-based funding remained constant. At the end of 2021 Estonian banks had EUR 850 mn covered bonds outstanding which were first issued in 2020.

| | ESTONIA 2020 | ESTONIA 2021 | EU 27 2021 |
|--|-----------------|-----------------|---------------|
| MACROECONOMIC VARIABLES | | | |
| Real GDP growth (%) (1) | -3.0 | 8.3 | 5.4 |
| Unemployment Rate (LSF), annual average (%) (1) | 6.8 | 6.2 | 7.0 |
| HICP inflation (%) (1) | -0.6 | 4.5 | 3.0 |
| HOUSING MARKET | | | |
| Owner occupation rate (%) (1) | 81.4 | 81.6 | 70.0 |
| Gross Fixed Investment in Housing (annual change)(1) | 14.0 | -7.7 | 6.6 |
| Building Permits (2015=100) (2) | 158.1 | 157.0 | 134.0 |
| House Price Index – country (2015=100) (2) | 84.8 | 97.6 | 145.2* |
| House Price Index – capital (2015=100) (2) | n/a | n/a | 146.1* |
| Nominal house price growth (%) (2) | 6.0 | 15.1 | 10.3* |
| MORTGAGE MARKET | | | |
| Outstanding Residential Loans (mn EUR) (2) | 8,656 | 9,449 | 6,508,621 |
| Outstanding Residential Loans per capita over 18 (EUR) (2) | 8,075 | 8,816 | 17,782 |
| Outstanding Residential Loans to disposable income ratio (%) (2) | 55.5 | 57.3 | 62.8* |
| Gross residential lending, annual growth (%) (2) | -2.2 | 38.8 | 12.2 |
| Typical mortgage rate, annual average (%) (2) | 2.5 | 2.2 | 2.0 |

* Please note that this value is the simple average of the available values in 2021.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hyostat 2022, Statistical Tables.



ESTONIA FACT TABLE

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| Which entities can issue mortgage loans in your country? | No limitation to issuers, financial and non-financial entities can offer loans, however, the small market in Estonia means that there have always been few suppliers of housing loans. |
| What is the market share of new mortgage issuances between these entities? | The mortgage market consists mainly of commercial banks. The four banks that issued most of the housing loans in 2021 were Swedbank, SEB Pank, LHV Pank and Coop Pank. Coop Pank increased its market share from 3% to 4%. The market shares of Swedbank, SEB Pank and LHV remained the same (45%, 29% and 9% respectively). Swedbank and SEB Pank remained the leaders in the market for housing loans. Luminor market share declined to 11%. |
| Which entities hold what proportion of outstanding mortgage loans in your country? | Commercial banks hold the majority of outstanding mortgage loans. |
| What is the typical LTV ratio on residential mortgage loans in your country? | Eesti Pank has set a LTV limit of 85%. |
| How is the distinction made between loans for residential and non-residential purposes in your country? | Not available |
| What is/are the most common mortgage product(s) in your country? | 30 year mortgage loan with floating interest rate. |
| What is the typical/average maturity for a mortgage in your country? | Eesti Pank has set maximum mortgage maturity of 30 years. |
| What is/are the most common ways to fund mortgage lending in your country? | Commercial banks lending activities are covered mainly with domestic deposits. |
| What is the level of costs associated with house purchase in your country (taxes and other transaction costs)? | Not available |
| What is the level (if any) of government subsidies for house purchases in your country? | KredEx offers loan guarantees with state guarantee for purchasing and renovating homes. Additionally, loan payments can be partly subtracted from income tax payments. |