

Estonia

By Irina Markitanova, Luminor Group

IN A NUTSHELL

- GDP fell by 3.1%.
- Mortgage market turnover stabilised after two years of very high activity.
- Housing prices increased moderately.

MACROECONOMIC OVERVIEW

GDP decreased by 3.1%. This was the second year of fall after previous strong post-pandemic growth. Private consumption has been falling and private investments remain at a low level. The government budget is in deficit, offering some support to the economy.

The almost two-year period of high inflation finished in 2023. Consumer prices were 9.2% higher than in 2022 mainly because of base effects. Price changes related to food and non-alcoholic beverages and housing expenditures had the biggest impact on consumer prices. Inflation during 2023 remained at 4-5%, out of which almost half was related to the end of the energy subsidies in April.

Two years of high inflation decreased the purchasing power of households as wages increased less than prices. This changed in 2023. Nominal wages increased by 11.4%, exceeding inflation and restoring purchasing power. As some of the savings were spent and there is need to restore them to previous levels and as interest rates support savings, consumption decreased, and deposits increased.

Hopes of economic recovery, low real wages and fewer younger people entering the labour market has kept unemployment under control. Unemployment increased by 0.8 pps to 6.4%, mainly due to the inclusion of Ukrainian refugees in the official statistics. Unemployment of permanent residents increased marginally. Employment levels remained close to historic peak levels.

The government budget is in deficit with 3.4%. Government debt is the lowest in Europe at 19.6% of GDP and is has been stable because of strong nominal GDP growth.

HOUSING MARKET

Demand in the housing market boomed in early 2022. According to Statistics Estonia, residential real estate prices increased by 22.2% in 2022 and the speed slowed down to 5.9% in 2023 with the slowdown in market activity and a decreased number of transactions. Such a small increase in prices was last seen in 2018. The ability of households to buy real estate decreased substantially because the real estate market is sensitive to money market interest rates as a large majority of mortgages are linked to 6 months Euribor. Therefore, the fast increase in interest rates has reduced demand which can be seen in price dynamics and turnover.

On the supply side, construction volume decreased by 12.3%. The number of completed dwellings was 8,424, an increase of 29.2% y-o-y, reflecting the previous boom. The number of building permits fell by 17% to 5,612, reflecting the slowdown in the building activity. The number of transactions decreased by 15% to 32,923.

MORTGAGE MARKETS

Despite the lower demand for mortgages (the number of new mortgages issued decreased by 17% according to Bank of Estonia), due to increased interest rates and the economic slowdown the volume outstanding continued to grow, by 6% to EUR 11,106 mn, an historic high equal to 30% of GDP. The average loan grew by 6.2% to EUR 57,915. The housing loan portfolio grew faster than GDP and household real incomes, so the debt burden of households increased.

Their average interest rate increased to 5.36% at year end.

The share of borrowers with high loan service costs relative to their incomes has increased remarkably according to Bank of Estonia. The DSTI requirement states that the ratio of the payments due on the borrower's total liabilities to their net income may not exceed 50% at the time of the loan decision. The share of loans where the DSTI of the borrower is 45-50% or higher is increasing.

Mortgages are granted mainly by commercial banks. Housing loans account for approximately 41% of the aggregate loan and lease portfolio of banks according to the Bank of Estonia. The banking sector is well capitalised, and the quality of the housing loans remained good. Only 0.3% of housing loans are overdue by more than 60 days at year-end as reported by the Bank of Estonia. The importance and volume of this type of loans reflect the preference of households for homeownership over renting.

NON-MARKET LED INITIATIVES

The Bank of Estonia's macroprudential policies remained broadly unchanged. Macroprudential measures are applied when necessary to prevent risks to the functioning of the financial sector and to increase its resilience. The Bank of Estonia kept the requirements for issuing housing loans unchanged, setting the maximum LTV of 85% (and up to 90% if they qualify for the housing guarantee programme supported by the government), DSTI of 50% and a maximum maturity of 30 years which have been in place since 2015. The housing loan requirements of the Bank of Estonia need the borrowing capacity of the household to be assessed assuming an interest rate of at least 6%.

Credit institutions must comply with the following macroprudential requirements of the Central Bank: (1) systemically important banks must maintain an additional capital buffer of 2% of risk-weighted assets; (2) banks using the internal ratings-based method for risk weighting must apply the minimum risk weight floor for mortgages in their capital calculations; (3) all banks must comply with borrower-specific requirements for issuing housing loans; and (4) a countercyclical capital buffer requirement of 1.5%. The Bank of Estonia

raised the countercyclical capital buffer rate to 1.5% because of the risks following the rapid growth in credit in 2021-2022. The new rate applied from 1 December 2023. Although borrowing has now eased, it is still necessary to maintain the buffers to protect against the risks that accumulated earlier.

The systemic risk buffer rate remains at 0%. But if banks registered in Estonia have granted mortgage loans to residents of Lithuania, then a 2% systemic risk buffer is applied from 1st July 2022 to those exposures.

MORTGAGE FUNDING

The lending policy of banks for housing loans did not change particularly in 2023. The most important source of funds continues to be deposits. As deposits have grown strongly in recent years, they have been sufficient to finance the demand for credits. The ratio of loans to deposits was around 90% at yearend.

The share of market-based funding increased during 2023. At year-end Estonian banks had EUR 2,250 bn covered bonds outstanding of which EUR 1,000 bn were retained by the issuer and EUR 1,250 bn sold to the public. There were no new public issuances in 2023.

	ESTONIA 2022	ESTONIA 2023	EU 27 2023
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-0.5	-3.0	0.4
Unemployment Rate (LSF), annual average (%) (1)	5.6	6.4	6.1
HICP inflation (%) (1)	19.4	9.1	6.4
HOUSING MARKET			
Owner occupation rate (%) (1)	82.0	80.7	69.2
Gross Fixed Investment in Housing (annual change) (1)	4.8	14.1	-3.1
Building Permits (2015=100) (2)	121.0	100.4	94.0
House Price Index - country (2015=100) (2)	186.6	197.7	170.2*
House Price Index - capital (2015=100) (2)	n/a	n/a	165.1*
Nominal house price growth (%) (2)	22.2	5.9	3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	10,492	11,106	6,782,375
Outstanding Residential Loans per capita over Total Population (EUR) (2)	7,878	8,131	15,114
Outstanding Residential Loans to disposable income ratio (%) (1) (2)	56.4	53.7	71.3
Gross residential lending, annual growth (%) (2)	16.2	-19.2	-26.6
Typical mortgage rate, annual average (%) (2)	2.7	5.4	4.7

* Please note that this value is a simple average of the available values in 2023.

Sources:

(1) Eurostat.

(2) European Mortgage Federation - Hyposstat 2024, Statistical Tables.

ESTONIA FACT TABLE

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?

Mortgage market consists mainly of commercial banks. The five banks that issued most of the housing loans in 2022 were Swedbank, SEB Pank, LHV Pank, Luminor and Coop Pank. LHV increased its market share from 9% to 11%. Luminor and Coop Pank market shares remained the same (11% and 4% respectively). The market shares of Swedbank and SEB Pank decreased slightly (43% and 28% respectively). Swedbank and SEB Pank remained the leaders in the market for housing loans.

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 payment.