

# Estonia

By Kaire Husu, Luminor Group

## IN A NUTSHELL

- GDP fell by 1.3%, after 8.0% post-Covid recover 2021.
- Mortgage market continued to grow, with outstanding housing loans increased by 11%.
- Housing prices were rising until early autumn and have been stable since then.

## MACROECONOMIC OVERVIEW

GDP decreased by 1.3%. This followed a very strong rebound of 8.0% in 2021 after the pandemic. Economic activity declined as trade growth slowed, investments were postponed and private consumption dropped in the second half of the year. Private consumption levels remained high supported by the reform of the second pension pillar that made the participation voluntary and allowed people to withdraw money.

Despite the fall in economic activity, unemployment declined to 5.6%. Employment levels reached a new record, exceeding pre-pandemic peaks. This is especially encouraging in the light of an ageing society as more people are involved in the labour market. Although nominal wages increased by 8.9%, real purchasing power declined as prices increased twice as much.

Consumer prices increased strongly until August 2022 when energy prices peaked. The pace of the energy price increase slowed down from August as demand decreased through weather conditions and supportive government policies. Overall average prices in 2022 were 19.4% higher than the year before.

The government budget deficit continued to decline, reaching 0.9% of GDP. Government debt is the lowest in Europe at 18.4% of GDP.

## HOUSING MARKETS

Demand in the housing market boomed in early 2022 despite geopolitical tensions. According to Statistics Estonia, residential real estate prices were 22% higher than the year before. Most of the increase took place in late 2021 and until summer 2022. After the summer, the overall price level remained unchanged. The ability of households to buy real estate declined until summer but has improved since with more stable price levels and wage increases in the second half of the year.

On the supply side, the construction volume decreased by 1% in 2022. The number of completed dwellings was 6,521, a decline of 3% y-o-y. The majority (65%) of new dwellings are blocks of flats according to Statistics Estonia. The number of building permits issued decreased by 23% to 6,763. The number of transactions decreased by 15% to 61,092.

## MORTGAGE MARKETS

High activity in the real estate market and rising prices are reflected in the strong growth in housing loans. In 2022 the mortgage market grew by 11% to EUR 10,488 mn, an historic high and equal to 30% of GDP. The average loan grew by 9.4% to EUR 54,586. The housing loan portfolio grew faster than GDP and household real incomes, so the debt burden of households increased.

Housing loans have maturities up to 30 years. Their average interest rate increased to 2.68% at year end. Borrowers can ask up to 85% of the property value with a standard contact structure and up to 90% if they qualify for the housing guarantee program 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 DSTI requirement states that the ratio of the payments due on 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. More than a quarter of all the new loans issued in 2022 had a DSTI in this range according to Bank of Estonia.

There was also a small rise in the share of loans with a high LTV, due to the sharp rise in real estate prices.

The mortgage market consists mainly of commercial banks. Housing loans account for approximately 44% of the aggregated 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 2022. Only 0.1% 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, as well as the concentration of the domestic market.

## 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 the resilience of the sector. The Bank of Estonia kept the requirements for issuing housing loans unchanged. The requirements setting the maximum LTV of 85%, DSTI of 50% and a maximum maturity of 30 years 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%. 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: (1) systemically important banks must maintain additional capital buffers of between 1% and 2% of risk-weighted assets; (2) banks using internal ratings-based method must apply the minimum risk weight floor for mortgages in their capital calculations; and

(3) all banks must comply with borrower-specific requirements for issuing housing loans. The systemic risk buffer rate remains at 0%. But if banks registered in Estonia has granted mortgage loans to residents of Lithuania, then a 2 % systemic risk buffer is applied from 1 July 2022.

The Bank of Estonia raised the countercyclical capital buffer requirement in autumn 2022 by 0.5% from 1% to 1.5% with effect from December 2023 as loan growth remains relatively strong even as economic activity has declined. This will ensure that sufficient capital is held to cover the risks that come from the earlier rapid growth in lending. The Estonian banking sector remains well capitalized, above the required level, so the change in regulation is currently not expected to need any response from the banking sector.

## MORTGAGE FUNDING

The lending policy of banks for housing loans did not change particularly in 2022. 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 credits. The ratio of loans to deposits was around 80% at the end of 2022.

The share of market-based funding increased during 2022 compared to 2021. At the end of 2022 Estonia had EUR 2,100 bn covered bonds outstanding from which EUR 750 mn was issued as retained covered bonds and EUR 500 mn as public issuance in addition to earlier years.

	ESTONIA 2021	ESTONIA 2022	EU 27 2022
<b>MACROECONOMIC VARIABLES</b>			
Real GDP growth (%) (1)	8.0	-1.3	3.5
Unemployment Rate (LSF), annual average (%) (1)	6.2	5.6	6.2
HICP inflation (%) (1)	4.5	19.4	9.2
<b>HOUSING MARKET</b>			
Owner occupation rate (%) (1)	81.6	82.0	69.1
Gross Fixed Investment in Housing (annual change)(1)	-7.7	6.5	1.5
Building Permits (2015=100) (2)	157.0	121.0	125.8
House Price Index – country (2015=100) (2)	152.8	186.8	164.6*
House Price Index – capital (2015=100) (2)	n/a	n/a	163.8*
Nominal house price growth (%) (2)	15.1	22.2	10.6*
<b>MORTGAGE MARKET</b>			
Outstanding Residential Loans (mn EUR) (2)	9,449	10,488	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	8,816	9,779	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	57.3	54.9	71.5
Gross residential lending, annual growth (%) (2)	38.8	16.1	-6.5
Typical mortgage rate, annual average (%) (2)	2.2	2.7	3.1

\*Please note that this value is the simple average of the available values in 2022.

Sources:

(1) Eurostat

(2) European Mortgage Federation – Hypostat 2023, 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.