



# Baltic Business Outlook

January 2016

## Foreword

*Encouraged by the success of previous years, in the autumn of 2015 the SEB Group in the Baltics carried out a survey to map the sentiment of the small and medium-sized enterprises (SMEs) for the business year 2016. The new edition of the Baltic Business Outlook sums up the project and provides insights from 5,119 Baltic SMEs participating in the survey. In addition to the SMEs, in September 2015 the SEB Group surveyed CFOs of the 239 largest Baltic companies. The main findings are also presented in this report, to assess the outlook of the large enterprises in the Baltics.*

## Executive Summary

- The SMEs in Estonia, Latvia and Lithuania show a cautious stance when assessing the outlook for 2016. The share of 'optimists', the companies expecting a turnover growth of at least 15% or more, is the highest in Lithuania (20%), but the other countries follow close behind. However, in Estonia and Latvia the number of pessimists has gone up to 28%.
- In 2016, approximately three quarters of respondents will focus on domestic markets. Of Latvian SMEs, 16% will be exploring new foreign markets, which means an 8 percentage point (pp) growth compared to the previous survey. In total, the share of companies targeting either new or existing export markets is quite equal across the region: in Lithuania 30%, Latvia 29% and Estonia 27%.
- Fewer companies are planning to hire staff in Estonia (down by 5 pp to 18%) compared to the year 2015, while Latvian companies (up by 7 pp to 20%) feel more optimistic about increasing staff in 2016. Most companies in all markets expect to have staff numbers unchanged.
- Products and services are the preferred field of innovation, with 39% of Estonian and Lithuanian and 36% of Latvian SMEs saying they will focus on that in 2016, followed by employee training. Business model innovation is not deemed as important and the share of innovating companies remains under 10% in each country.
- The number of companies planning to invest more than EUR 30,000 is decreasing, although not significantly. Of Lithuanian SMEs, 25% expect to invest up to EUR 30,000, while in the previous survey only 12% expressed that intention. Latvian companies are most reserved, with 40% saying they do not plan any investments in 2016.

SEB

## Key indicators

	Estonia	Latvia	Lithuania
<b>Population</b> (eop, 2015)	1.3 m	2.0 m	2.9 m
<b>Currency</b> (as of 1 January 2016)	Euro	Euro	Euro
<b>GDP per capita</b> (EU=100)	76	64	75
<b>Real GDP growth</b> (Q1–Q3 2015)	1.3%	2.6%	1.5%
<b>Inflation (HICP)</b> (2015)	0.1%	0.2%	-0.7%
<b>Unemployment level</b> (Q1–Q3 2015)	6.1%	9.9%	9.2%

Source of macroeconomic data: Eurostat

## Economic forecast 2016

	GDP growth	Inflation
<b>Estonia</b>	2.7%	2.3%
<b>Latvia</b>	2.7%	1.7%
<b>Lithuania</b>	2.8%	0.3%

Source: SEB Nordic Outlook, November 2015

## Methodology

### Turnover growth

In the survey, the companies expecting at least a 15% turnover growth in 2016 are labelled as *optimists* while the companies expecting growth figures below 15% are *moderate optimists* and the rest, seeing a decline in turnover, are termed *pessimists*.

### Employment

The employment outlook is divided into three groups: the companies hiring new staff in 2016, the ones keeping the headcount unchanged and the companies intending to cut back on personnel.

### Exports

The respondents are divided into three groups: companies planning to enter new markets in 2016, those intending to grow in existing export markets, followed by those companies focusing on the domestic market.

### Innovation

The analysis refers to two groups of companies: those planning innovations in 2016, be they in products, services, business models and/or employee development, or those not planning any of the above-mentioned.

### Investments

The threshold of major investments is set at EUR 30,000 for this survey, with the companies investing amounts above and below that constituting the first two groups, and the third group is composed of companies not planning any investments in 2016.

## Baltic views in brief

### Less optimism about turnover growth



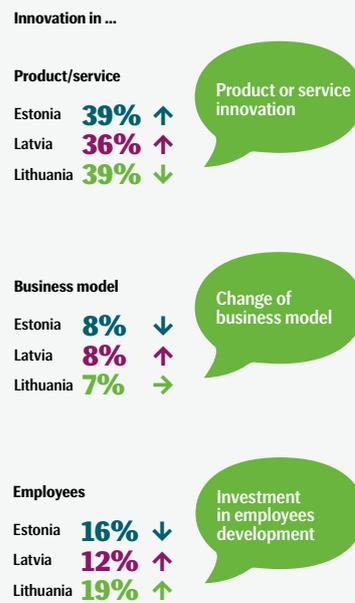
### Instead of entering new markets, companies focus on the domestic market



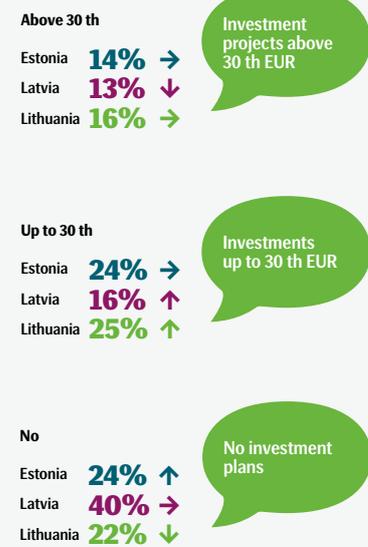
### No major changes planned in the staff



### Companies express more interest in product innovation and staff training



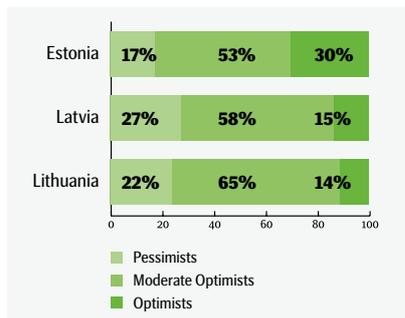
### Companies' investment plans have been reduced considerably



### Baltic businesses by sectors

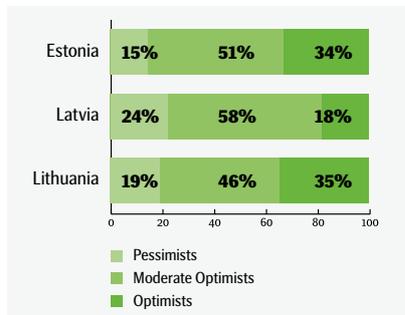
Of the five indicators surveyed during the SME advisory project, the outlook for turnover growth is the basis for assessing the business prospects for 2016. Defined as *optimistic* are the SMEs expecting their sales to grow at least 15% this year.

#### Trade



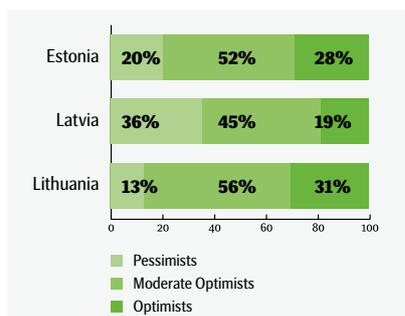
The trade sector is clearly shifting towards optimism. The **trade** companies are most optimistic in Estonia, at 30%, while in Latvia the indicator is at 15%, with the share of both optimists and pessimists increasing at the expense of moderate optimists, and in Lithuania it is 14%.

#### Transport and logistics



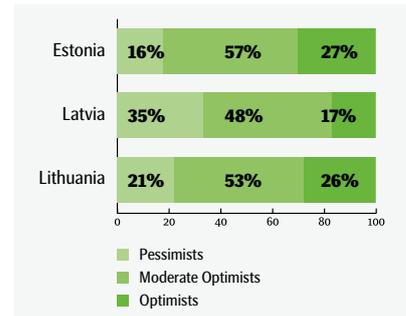
The outlook shows signs of improvement as the number of pessimists is decreasing substantially. Especially Lithuanian and Estonian SMEs look very confident in the **transport and logistics** sector, with 35% and 34% of the companies respectively expecting at least 15% sales growth in 2016, while in Latvia 18% have that same expectation. In all three Baltic countries, the number of pessimists has decreased substantially.

#### Construction



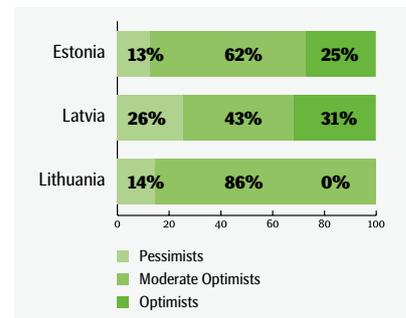
The **construction** sector is exhibiting a shift toward optimism: the outlook is strongest in Lithuania where the share of optimists amounts to 31%, followed by 28% in Estonia and 19% in Latvia. Compared to the other Baltic countries, the number of pessimists has increased substantially in Latvia (36%).

#### Manufacturing



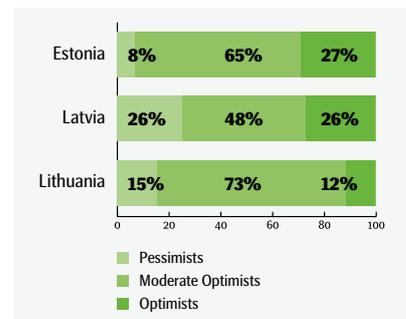
Of Estonian **manufacturing** companies, 27% have an optimistic outlook for 2016 and in Lithuania and Latvia, 26% and 17% respectively believe the turnover growth will exceed 15%. This sector has the most pessimistic outlook for 2016 in Latvia, at 35%.

#### Agriculture



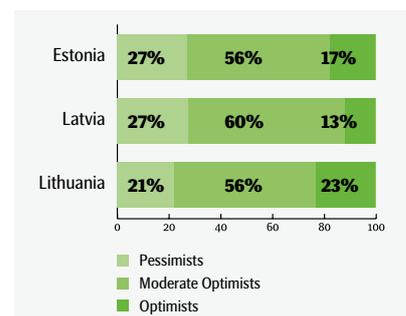
The **agriculture** and fishery sectors are the most optimistic in Latvia, at 31%, followed by 25% in Estonia, while none of respondents in Lithuania, which has a high number of moderate optimists, expects the turnover to increase more than 15% in 2016.

#### Housing and catering



In the **housing and catering** sectors, the outlook is strongest in Estonia where the share of optimists amounts to 27%, followed by Latvia and Lithuania at 26% and 12% respectively. In addition, the share of pessimists is increasing in all three countries.

#### Other



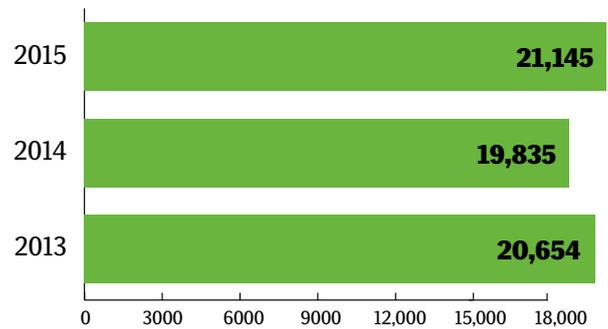
Among the companies in other sectors, optimism in Lithuania is the strongest at 23%, followed by Estonia and Latvia at 17% and 13% respectively.

## Business environment country-by-country

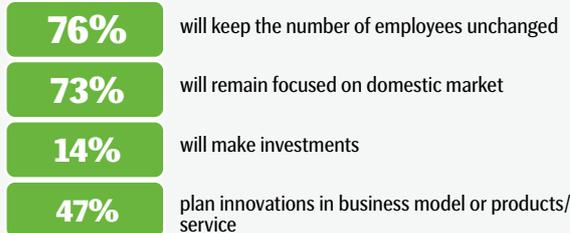
### Estonia

- As in the year before, Estonian SMEs are moderately optimistic about turnover growth, with the focus on the domestic market.
- Of Estonian SMEs, 17% expect their turnover to grow by more than 15%, while 28% see a decline in turnover; the most confident companies are in sectors such as trade, transport and logistics, construction and manufacturing.
- The share of enterprises planning to enter new markets or expand in the existing ones has remained the same, at 28%.
- A negative trend is seen in the field of investments: only 14% of the companies plan investments of at least EUR 30,000 in 2016, down from 16% the year before and from 42% in 2014.
- Of the polled SMEs, 18% intend to hire new people in 2016, while the share of enterprises planning workforce reduction has changed to 6%, from previous year's 4%.
- Sixty-eight per cent of the companies expect to put more emphasis on innovation, a slight decrease from 73% the year before.

### New companies established:



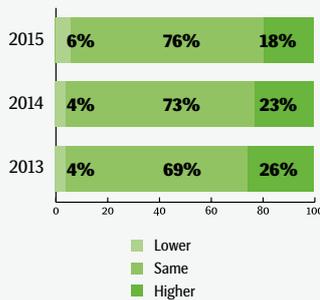
### Estonia: SME plans for 2016



### Up and down: Where are they?

- Optimists**
  - Trade, construction sectors
  - Ida-Viru county
  - Up to 9 or over 100 employees
  - Turnover up to 65,000–200 000 EUR
- Pessimists**
  - Transport and logistics sector
  - Hiiu county
  - 10–99 employees
  - Turnover 650,001–2 000 000 EUR

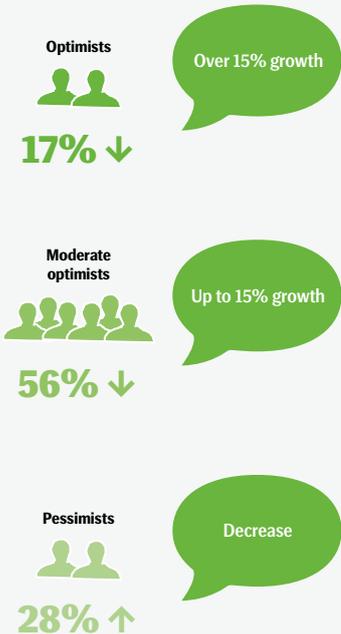
### Number of employees next year...



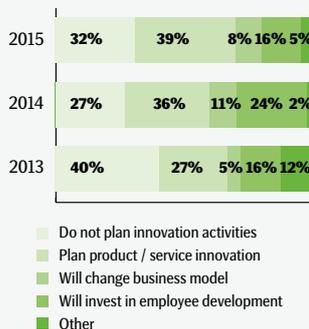
### Export markets



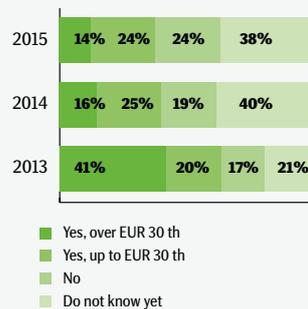
### Turnover next year...



### Innovations and changes

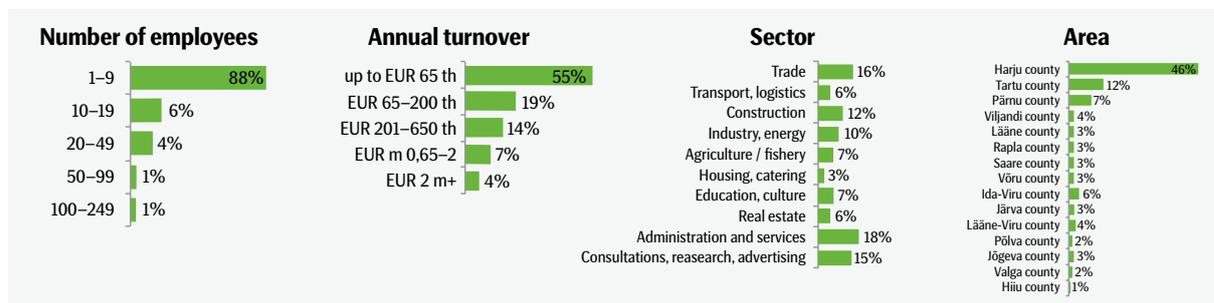


### Investment projects



## Profile of the Estonian survey

(3702 companies participated in total)



## The Economist's View



**Mihkel Nestor**  
Economist  
SEB Estonia

Due to Estonia's weak economic growth in recent quarters, expectations for the economy's healthy development have not been fulfilled. While in the beginning of 2015 most analysts forecasted a GDP growth between 2–2.5% for 2015, by the end of the year most of them had downgraded their estimates by a percentage point. Sluggish external demand and lacklustre investment activity have been the main reasons for the weak growth. Exports account for approximately 80% of Estonia's GDP, which means that a slowdown in international trade has a larger impact on the economy than in many other countries. Exports have been hampered by the Russian economic crisis and sanctions on foodstuffs, but also by stagnation of the Finnish economy. In growing markets, such as Sweden and Germany, Estonian exports have increased, but not as much as total imports of those countries, which means that companies are faced with significant competition.

From the employees' perspective, the situation in the labour market has been very favourable. The employment rate has reached historic highs and unemployment has shrunk to nearly 5%. As the labour supply has dried up, employees have gained significant bargaining power. Wage growth averaged nearly 6% in the first three quarters of 2015. Together with a deflationary environment, this has significantly increased the purchasing power of households. In addition, income tax cuts and an increase in many social benefits boosted real incomes. This positive phenomenon is reflected in household demand; the retail sale index has averaged 8% growth during 2015.

SEB's basic scenario is that in 2016 GDP growth will accelerate, mainly due to higher export levels. Estonia's largest trading partner, Sweden, is currently one of the fastest growing economies in Europe.

Although Estonian exports to Sweden are highly concentrated in the telecommunication electronics field, other sectors too, such as wood and furniture industry are playing an increasingly important role. The Finnish recession seems to have bottomed out and for 2016 modest growth is expected. Estonian companies have increased their market share in Finland during the last years and have projected that a 3.2% import growth in the Finnish economy hence would benefit Estonian exports more than before. Low oil prices and an unstable political situation will continue to undermine Russia's economy. However, Estonia's exports to the east will not decrease as rapidly as in 2015. Current forecasts show that the economies of other important target countries, such as Latvia, Lithuania, and Germany, will grow substantially, presenting good opportunities for Estonian companies.

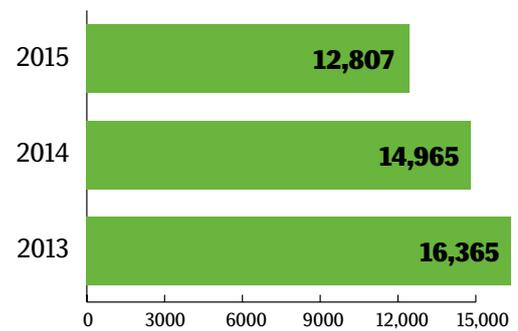
Although domestic demand is expected to remain strong in 2016, the growth rate will not reach levels as high as in 2015. The very low unemployment rate means that the available labour supply has dried up. The turnover of the business sector has decreased in the majority of recent quarters, meaning that the increase in labour costs has occurred at the expense of retained earnings and foregone investments. It is highly likely that the level has been reached today where further wage growth can only occur as a result of actual growth in sales revenues or through cutbacks in employee numbers. Thus, the business results for the first few months of the year will be decisive. Due to the very low level of unemployment, the pressure to increase wages is likely to persist, and specialists in their respective fields find themselves in a strong bargaining position. The need to control labour costs will drive employers towards efficiency, meaning that the same work will be expected to be performed by fewer employees.

Inflation will recover mainly due to a lower reference base. Despite increasing the tax exempt minimum income, family support and the minimum wage, the government is no longer able to contribute significantly to the growth of incomes. Hence, retail traders should expect lower growth this year. However, what should finally get off the ground is the use of European Union structural funds, which would act as an incentive for Estonia's construction sector. In order to increase the level of investments in the business sector, a clear signal is needed that external demand is indeed improving.

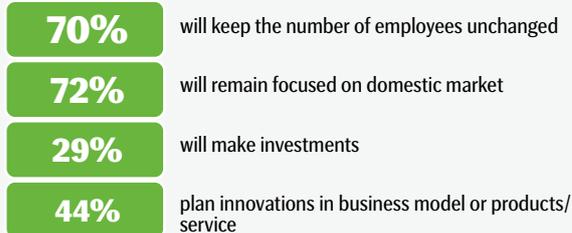
## Latvia

- For 2016, the Latvian SMEs forecast a moderate turnover growth and activity on export markets.
- The share of enterprises expecting at least a 15% turnover growth in 2016 has increased to 16% from last year's 10%, while the share of companies seeing a decline in turnover has grown even more, reaching to 28% (compared to 17% previously).
- Almost a third (29%) of the Latvian SMEs are planning to enter new markets or expand in the existing ones — a notable change from last year's 18%.
- The companies envisage their investment activity to be slightly lower than the year before as 13% (compared to 18% last year) of the companies plan investments of at least EUR 30,000.
- The majority of companies (70%) expect the employee numbers to remain unchanged. However more hiring is planned than in the year before, with the indicator going up from 13% to 20%.
- Fifty-nine per cent of the companies expect to put more emphasis on innovation, a significant increase from 39% the year before.

### New companies established:



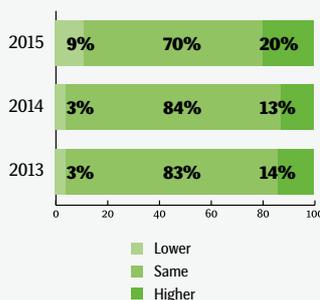
### Latvia: SME plans for 2016



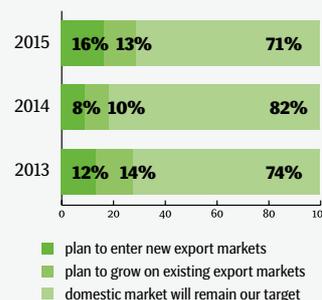
### Up and down: Where are they?

- Optimists**
  - Agriculture, Housing and Catering and Entertainment sectors
  - Companies with 1–9 employees
  - Turnover from 2 to 5 m EUR
- Pessimists**
  - Construction, Industry, Financing and Communication sectors
  - Companies with 100–249 employees
  - Turnover 200,000–650,000 EUR and more than 6,5 m EUR

### Number of employees next year...



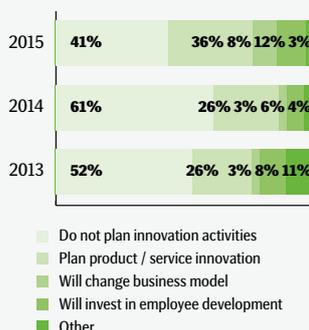
### Export markets



### Turnover next year...



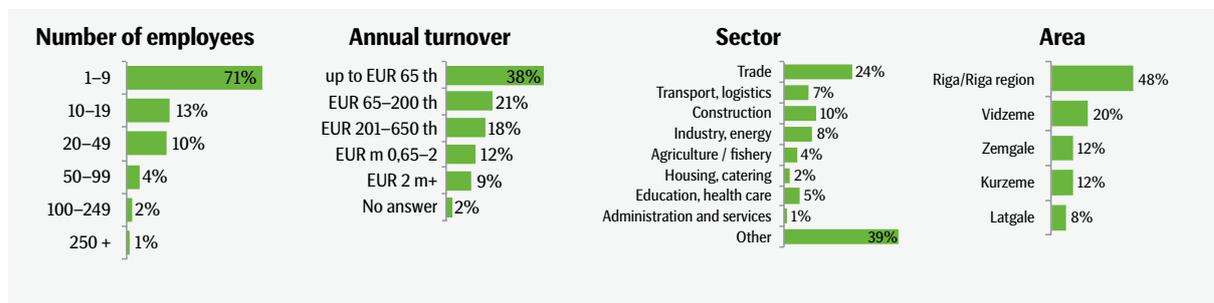
### Innovations and changes



### Investment projects



## Profile of the Latvian survey (886 companies participated in total)



## The Economist's View



**Dainis Gašpuitis**  
Economist  
SEB Latvia

The Latvian economy's outlook for the next two years looks decent, although growth is going to be moderate. Such an assessment results from projected global economic prospects, which incorporate high uncertainty, both economically and geopolitically. In 2015 GDP growth was better than expected, mainly due to the successful development of manufacturing. Favourable conditions remained also for consumption activity. At the same time the transportation and storage sectors were able to manage arising challenges relatively successfully. In coming years complicated conditions will prevail, which is why an absence of growth this year is more likely. In the coming quarters SEB expects a moderate increase in the real estate market, as lending policy will become more supportive. After two quarters of decline, growth returned in construction, but further development will depend on the availability of EU funds. Favourable conditions remain for the accommodation and food service sectors, as well as for entertainment and leisure service expansion. The third quarter of the last year was marked by the activation of investment. The situation in export markets will remain strained. The biggest anticipation for export development is associated with the improving situation in the euro area, the UK and the Nordic countries, and meanwhile the diversification efforts in export markets will continue. For the next two years, consumption will continue to accelerate. However, the most important issue will be the timely availability of EU funds. The successful absorption of EU funds will help improve capital spending, but delays will create a drag on economic activity. It is expected that GDP growth in 2015 may reach up to 2.9%. This year provides opportunities for faster growth. However, the external environment and the ability to access EU funds will be very decisive. Because of the high level of risks, the next year's growth forecast is at 2.7%. Due to diminishing geopolitical tensions, growth in 2017 will accelerate to 3.5%. However, in coming years incumbent risks will not disappear.

Despite relatively subdued economic growth, wage growth in 2015 proceeded at a fairly brisk pace (7–8%), maintaining a strong inertia. It is expected that growth will continue in 2016, however the growth rate could balance out at around 6%, which clearly exceeds the pace of economic development. The increase in wages for public employees and the minimum wage increase will have a substantial impact. But rapid wage growth will be observed also in the private sector, although it will be heterogeneous.

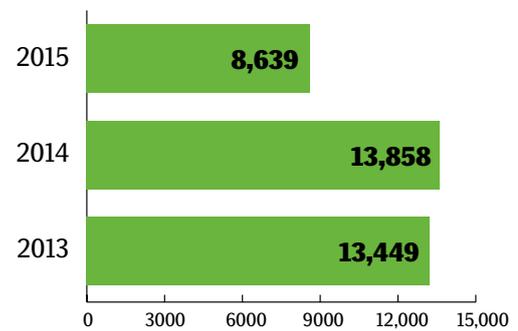
Annual inflation in 2015 was only 0.2%. Such a weak result is determined by many factors, but is primarily due to a food and energy price decline. Low oil prices will continue to weaken inflation further. In the near future upward changes for food prices are not expected. Possibly for some groups of goods, the prices may decline even further, especially those related to the Turkish products that are no longer allowed into the Russian market. Meanwhile, prices for certain products could recover somewhat. Modest growth will act as a drag on the rise in the price of services, although growth in this segment will be more prominent, accounting for a large part of the public perception of inflation. Inflation will recover slightly, mainly owing to the wage pressure. However, the low prices of commodities, and subdued economic activity will act as a limiting factor. This year changes in taxes will make inflation a bit more vigorous. However, inflation will not be a threat to further purchasing power increases. This year's inflation forecast is 0.8%, while next year's is 2.2%.

As expected, the modest pace of growth in 2015 was related to a slower decline in unemployment, although in general the trend remained positive. In last year's third quarter, the unemployment rate stood at 9.7%. This year further improvements will depend on the ability to accelerate growth. However, unemployment will fall rather slowly; it could perhaps even stagnate for a certain period. In the third quarter, the share of long-term unemployed in the total number of unemployed persons stood at 50.6% and was 48,500. Many of these potential employees face difficulties which will not be easy to overcome. This is affected by mobility and the lack of appropriate skills, as well as a lack of motivation. Therefore, even though the unemployment rate will remain relatively high, the competition for qualified and motivated employees will be fierce, especially in regional centres.

## Lithuania

- In Lithuania, the SMEs expect a year of moderate turnover growth with a strong focus on the domestic market.
- Compared to last year, the share of optimists and moderate optimists has increased. A fifth of enterprises forecast more than 15% turnover growth, and 59% believe that their turnover growth will rise to 15%.
- Export activity remains largely the same as approximately one-third of the SMEs say they are either planning to enter new markets or expand in the existing ones.
- A fourth of the enterprises plan to investments up to EUR 30,000, a significant increase from last year's 12%.
- Of the polled SMEs, 30% plan to hire people in 2016, while the majority (64%) expect that their staff number will remain unchanged.
- Innovation activities are planned by 70% of the companies in Lithuania and the focus, projected by 26%, lies in the product and service segment.

### New companies established:



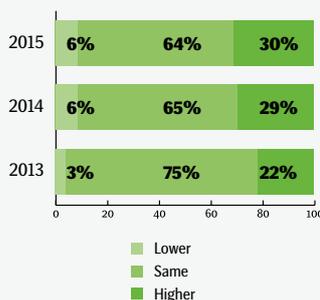
### Lithuania: SME plans for 2016



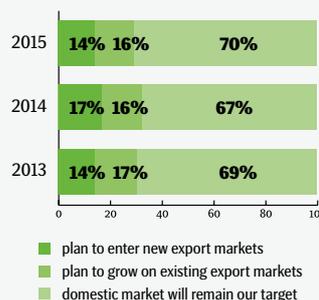
### Up and down: Where are they?

- Optimists**
  - IT and telecommunications, construction sectors
  - The smallest (up to 20 employees) and the largest (over 250) companies
  - Vilnius and Kauno counties
  - Turnover up to 65,000 EUR
- Pessimists**
  - Trade sector
  - Up to 9 employees
  - Panevėžio county
  - Turnover up to 65,000 EUR

### Number of employees next year...



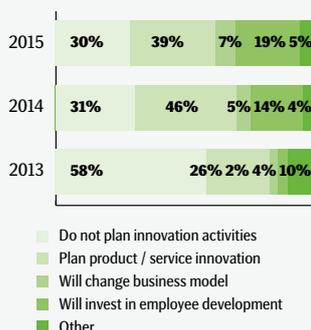
### Export markets



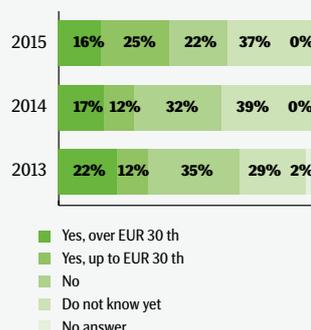
### Turnover next year...



### Innovations and changes

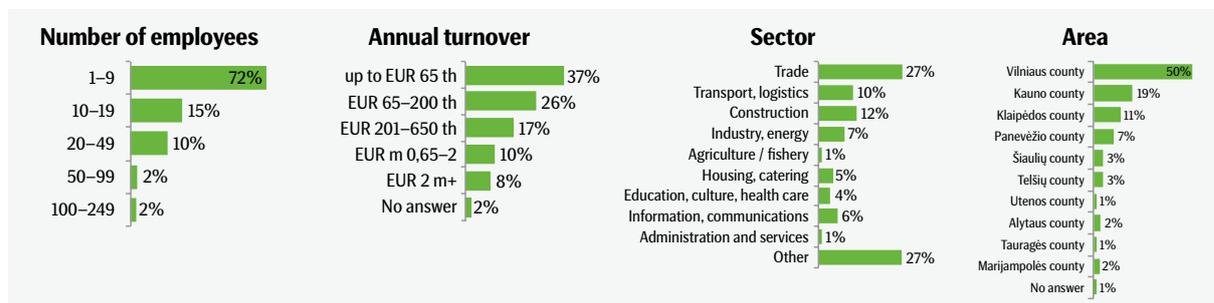


### Investment projects



## Profile of the Lithuanian survey

(531 companies participated in total)



## The Economist's View



**Tadas Povilauskas**  
Senior Economist  
SEB Lithuania

The year 2015 brought lower economic growth for Lithuania, mainly due to the negative impact of the drastic drop in external trade activities with the Russian Federation. However, private consumption, supported by the falling unemployment level and increasing real wages, remained rather firm. This in turn directly stimulated the growth of the retail and services markets. The adoption of the euro as the new currency in Lithuania went smoothly enough. As was expected, the rounding of prices in litas up to the next highest whole number in euros had a significant effect on the prices of some products and services, but lower energy prices pushed the consumer price index to deep deflation in 2015.

This year the expectations for Lithuania's economic development are more positive and the SEB bank forecasts a 2.8% growth in GDP. The continuing downturn of the Russian economy will have a much lower impact, while the stronger recovery of the EU economy will play a more important role for Lithuanian businesses. The year 2015 has demonstrated that Lithuanian companies already managed to increase exports to the EU. The conditions for export growth this year are certainly not worse. Efforts to expand exports to still unpenetrated markets are surely welcome and there are already good examples of export growth present (i.e. Georgia, Israel or Mexico). In addition, the euro is expected to remain weak against the US dollar in 2016, thus US dollar markets must be in the close horizon for the exporting companies. In addition, retail sales will keep on increasing at a similar pace this year despite the remaining negative demographic tendencies in Lithuania. The expected inflation in the prices of services will also benefit businesses with operations and activities in these markets.

A falling unemployment level creates a positive impact on the sales revenues of the companies, but at the same time, without a doubt, increasing labour costs put pressure on profitability, especially when the increase in average wages in Lithuania is expected to be higher than the growth of productivity. The further sharp rise in the minimum wage in Lithuania (which will reach EUR 380 per month starting July 1st) is most sensitive for companies in the services industry, and thus there will be natural attempts to raise the prices of final products or services for the clients.

The lack of skilled labour has already become a serious problem for businesses and it seems that this year it will get even more severe. That inevitably will place a drag on the expansion of some businesses if they do not find alternative employees from abroad. On the other hand, such tendencies in the labour market will stimulate capital expenditure, especially among manufacturing export companies.

It remains a favourable time for businesses to invest, because the interest rate on loans will remain historically low as the ECB will keep on executing its quantitative easing programme. In Lithuania the portfolio of loans both to corporations and households increased last year. The growth of lending by banks is expected this year as well for higher capital investments by companies, and there will be a greater willingness by the banks to employ money more profitably. However, volatile financial markets and various global uncertainties still remain as drags on quicker recovery for lending.

In 2016 Lithuanian companies will further benefit from low energy prices as the average crude oil price will most likely be lower than it was in 2015. In addition, electricity prices for businesses are also expected to be lower this year and this naturally increases the competitiveness of Lithuanian companies. Such tendencies are favourable for businesses with a relatively high proportion of energy costs. There were no essential changes in tax rates for companies since the start of 2016, and this can be assessed as relatively good news. Business people are still eagerly awaiting the approval of the new labour tax code, which seems to have struggled in the Parliament. However, the changes in the code are inevitable even though its adoption will be protracted by the terms of the new Parliament.

## Large enterprises in Lithuania most confident, says *Baltic CFO Outlook*

The autumn 2015 edition of the *Baltic CFO Outlook*, SEB's survey of the CFOs of the largest enterprises in the Baltics, in which CFOs from a total of 239 of the largest Baltic companies were polled, indicated that Lithuanian businesses remained the most positive when assessing both their current financial position and the expected changes in business conditions in the upcoming months, despite having the slowest economic growth in the Baltics in 2015.

In September 2015, Lithuanian businesses showed the most positive attitudes toward business conditions, as more than 57% of respondents expected favourable or very favourable conditions for their business activities in the period of the next six months. However, the greatest growth in optimism was identified among Estonian businesses: the number of those who predict favourable or very favourable conditions increased from 23% to 36%. The distribution of the response structure of Latvian businesses did not change noticeably, except for a slight increase in the share of those expecting conditions to worsen.

CFOs of Lithuanian enterprises, who were the most positive about their companies' financial position the previous autumn, became even more confident in September 2015. Only 2% of the Lithuanian respondents assessed the financial position of their enterprises as unfavourable or very unfavourable. In Latvia, the proportion of businesses that considered their financial situation as favourable or very favourable slightly increased. In Estonia, any significant changes in the assessments since last autumn were not identified. About the cash flow outlook, Lithuanian and Estonian businesses are the most positive.

The shortage of skilled workers and increasing labour costs are the main concerns of Baltic businesses: in all three countries anxiety regarding the lack of skilled labour has increased. The largest jump occurred in the Lithuanian and Latvian business environments, which might be explained by the statistical data demonstrating a quite rapid drop in the unemployment level and the persistently slow drop in long-term unemployment in the those countries. Estonia encountered the same problem slightly earlier and it has now resulted in rapidly growing labour costs.

An expectation of a further decrease in the unemployment levels in the next 6 months prevails in all three Baltic countries. The ratio between those businesses planning to increase and those planning to decrease the number of their employees remained above 1. The ratio was the highest in Lithuania and the lowest in Latvia.

The concern about changes in demand within the next 6 months remained the most important issue for companies in all three Baltic countries. This concern once again increased in Lithuania, but dropped among Latvian and Estonian businesses. The demand in the domestic markets is not the main concern; rather the problems are connected to the global economy and the main export markets. Concern over Russia-related sanctions — the main topic in last year's survey — faded and it is already clear that the sanctions had a negative impact only on a limited number of companies.

Access to capital is a burning issue only to a small number of businesses. The banking system is clearly indicating its willingness to lend money to financially stable companies, and the problem of access to capital concerns mostly those companies that are in poor financial condition and with a less favourable outlook. Compared to last year, the number of CFOs who predict a rise in interest rates in the next 12 months evidently increased and the highest prevalence of this belief was among Estonian CFOs.

Optimism regarding the growth of M&A market activities has increased in Lithuania with more than half of the respondents believing that corporate acquisitions and divestments will increase.

### Baltic SMEs are valuing sustainable business

Assuming that sustainability in business is gaining importance not only among large enterprises, SEB Group asked the Baltic SMEs about their views on main drivers of sustainable business. For the polled companies, most significant are responsible business activities, which includes responsible sales and consultations, transparent financial reporting, strong brand and reputation and lower risks in the supply chain. In a scale going from one to five, this aspect was most valued in Lithuania (4.5 points), followed by Estonian and Latvia (4.3).

Almost as important for the Baltic SMEs is contribution to employees and the community. This approach is reflected in greater loyalty and inclusion of employees, smaller employee turnover, greater productivity, contribution to the community, etc. In this field, again Lithuania leads the ranking (4.1) before Estonia (3.9) and Latvia (3.8).

Responsible attitude towards natural resources, which refers to resource-efficient spending and environmentally sustainable production, received the least support with the marks remaining at 3.5 points across the region.