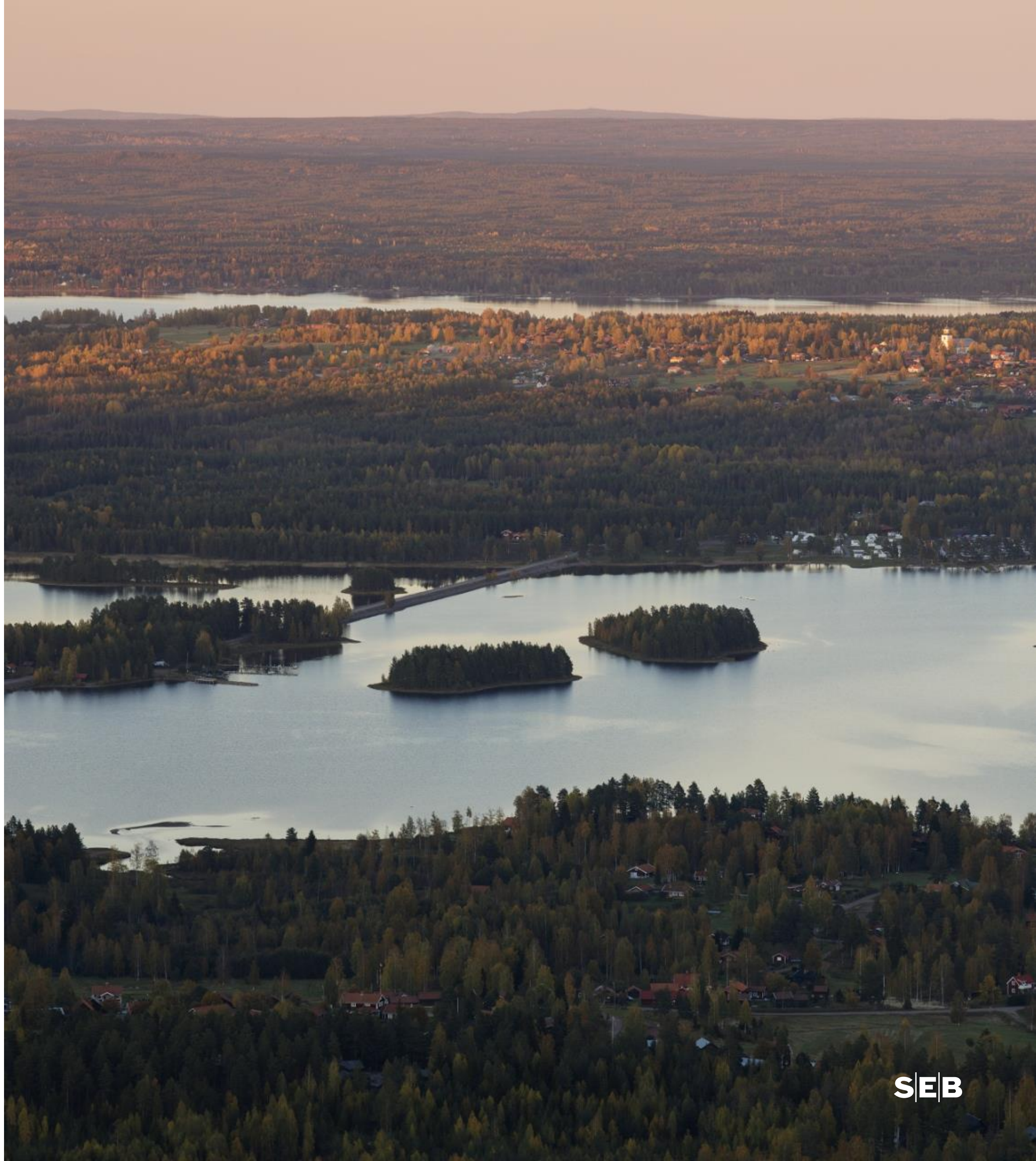
May 2022

Baltic Business Outlook special edition

Respondents

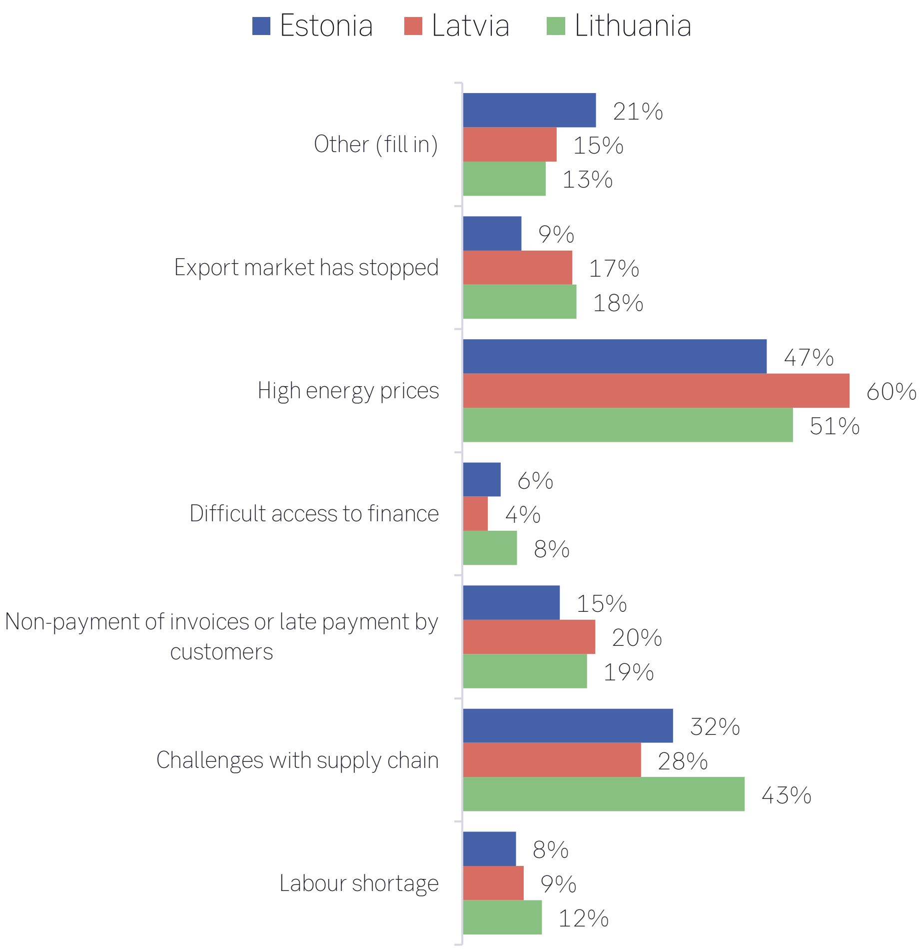
Lithuania	807
Latvia	454
Estonia	811
Total	2.072



Factors having an impact on financial results regarding war in Ukraine

- High energy prices were the greatest issue for Baltic SMEs in May ranging from 47% share in Estonia to 60% in Latvia, which is quite understandable regarding sharp growth in electricity, natural gas, heating or fuels prices. Just several examples: average diesel price jumped by 60% y/y in Lithuania, 54% in Latvia and 55% in Estonia (22 week of this year). Electricity price in Nord Pool was by 161% y/y higher in Lithuania's, by 160% in Latvia's and by 151% in Estonia's trading area. The prices are not only sharply higher y/y, but also from the beginning of the war. The share of energy costs in total expenses and the speed of the pass-through of higher energy prices into final prices of goods and services differ among sectors, but the answers clearly indicate that this is the most common issue for all Baltic SMEs.
- The second most relevant challenge for SMEs is supply chain problems (ranging from 28% in Latvia to 43% in Lithuania. It might be that the difference between the countries mainly comes from the fact that in Lithuania there is higher share of industry in economy and companies working with Russia, Belarus and Ukraine). Supply chain problems started several months after the outbreak of COVID-19 pandemics, when the demand of goods sharply increased (thanks to fiscal stimulus and the transition of expenses from services to goods) and even worsened after the outbreak of war in Ukraine. Sanctions to Russia and Belarus and voluntary retreat from those countries made the foreign trade with those countries much more difficult and incentivized to search for new suppliers, but that is of course not so easy and profitable.
- Thirdly, from 15 to 20% of companies in Baltics claimed that there are problems with the non-payments of invoices or late payments by customers. That is indeed negative indicator pointing to increasing issues with liquidity in some economic sectors as the need for working capital materially increased due to sharp jump in materials and other commodities leading to higher need of cash for inventories. Therefore, some companies attempt to save liquidity by being late on payments to suppliers. Besides, in some sectors the profitability sharply dropped (where the companies cannot pass-through costs to final price) and that also lead to falling liquidity and increasing non-payments.
- However, the fact that only from 4 to 8% of companies say that they have problems with access to finance confirm that credit sector responds quite well into the need of higher liquidity financing after the war broke out.
- Finally, from 9 to 18% of respondents in Baltics pointed out that export market has stopped. It probably means that up to 20% of companies had export exposure to Russia, Belarus or Ukraine and the sales to those markets were halted.
- Other answers include: no impact/increase the prices of other materials/uncertainty/banks policy on payments to RU and Belarus/reduction of order book.

What has the most impact for your company's financial results regarding war in Ukraine?



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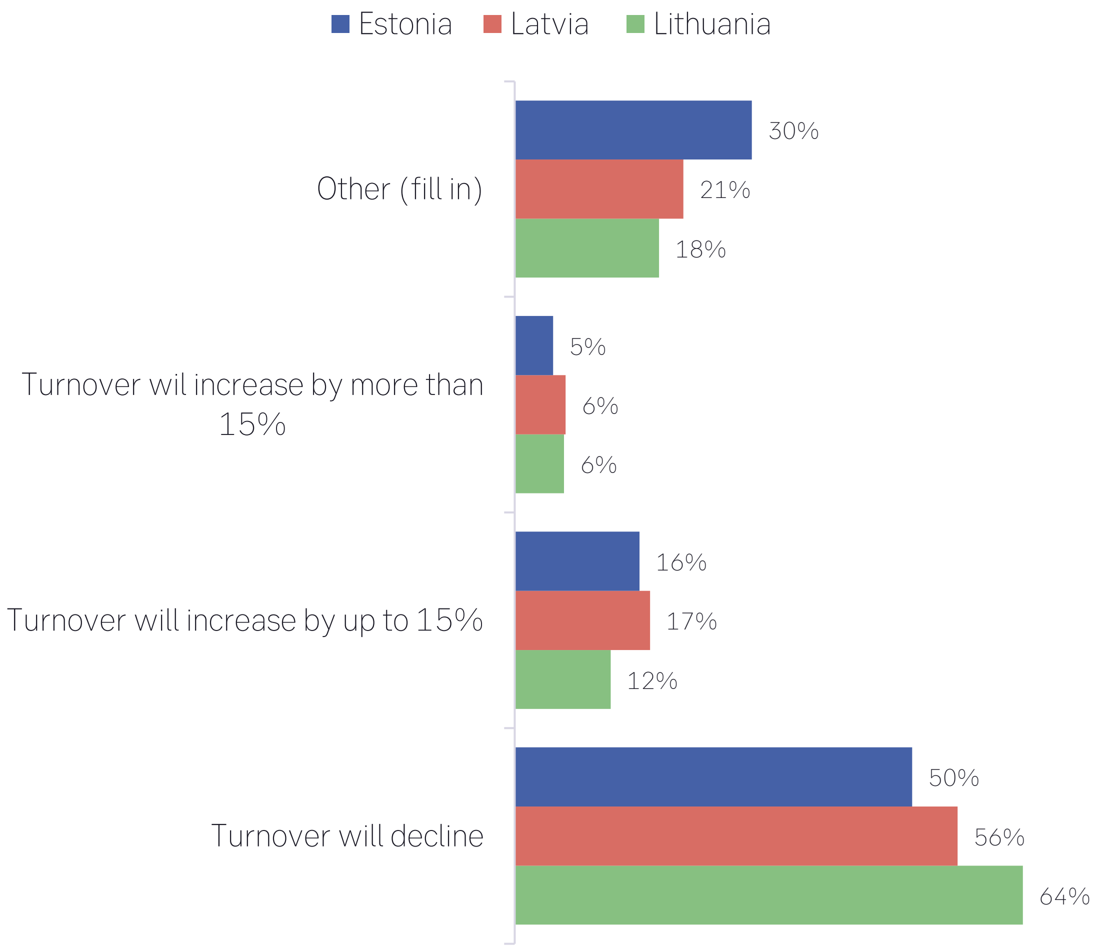
The impact of war to company's turnover

- More than 50% of surveyed SMEs claimed that war in Ukraine will have a negative impact on companies' turnover. The largest share of such companies is in Lithuania, the smallest – in Estonia. That as the responses in other questions probably relates with relatively higher Lithuania's (or to be more precise the surveyed companies) exposure to Ukraine (as the country, where the war takes place) and Belarus with Russia (countries aggressors). Such huge share of companies expecting lower turnover seems to be very high and clearly sends negative warnings regarding short term business development (however, that might be exaggerated if companies are too pessimistic).
- From 12 to 17% of surveyed companies said that turnover will increase up to 15%. Meanwhile only 5-6% of companies in Baltics project higher than 15% growth in turnover. Considering that annual inflation in Baltics already exceeds 15%, for inflation will be the main driver of the turnover growth for some companies.
- It is quite difficult to compare the results of this question with the 2022 January BBO survey due to different formulation of the question and slightly different choices of answers (in May survey there is no choice of "no impact"). The fact that there was no such choice as "no impact" led to the fact that up to 30% Estonian companies chose "other" answer (21% of Latvian companies and 18% Latvian companies). That again proves that in case of Estonia fewer surveyed companies had exposure to Ukraine, Russia or Belarus compared to Lithuania.
- Just to remind, in January 2022, only 15% companies in Estonia, 21% in Latvia and 24% in Lithuania chose the answer that turnover will decrease in next 12 months.

Will the war in Ukraine affect your company's turnover?



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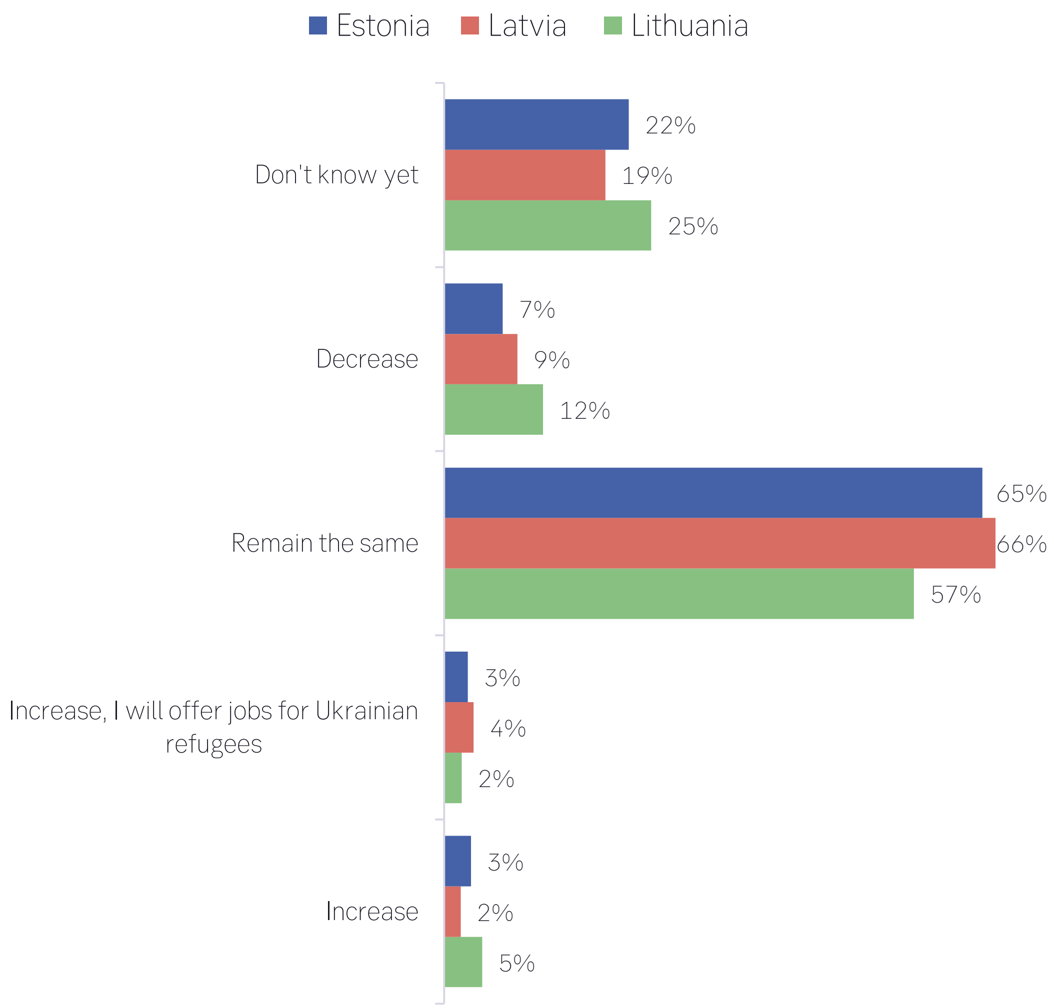
Expectations about the change in the number of employees

- Around 10% of surveyed companies (from 7% in Estonia to 12% in Lithuania) mentioned that war in Ukraine will have a negative impact on the number of employees. The differences among the Baltic countries are not very meaningful. On the one hand, the labor market remains very tight, and it might absorb the increase in lay-offs from those companies that suffer losses from the war in Ukraine. However, that scenario greatly depends on the overall economic development outlook in Baltics in short term, which is becoming less bright. The fact that around one fifth of respondents cannot evaluate the possible impact on the number of employees also show quite high uncertainty about the direct and indirect effect from war in Ukraine on the companies and their staff.
- We can remind that our last BBO survey in January 2022 revealed that from 4 to 11% of respondents (depending on country) expected the decrease in staff in 2022 and 16-24% projected the growth in the number of employees. Although the question if formulated slightly different and to comparing the results of May 2022 survey with January 2022 survey results might not be truly objective, but the answers of current survey indicates higher uncertainty among SME, which might lead to cooler labor market if the expectations become truth.
- The percentage of SME companies that employed Ukrainian refugees are very similar (2-4%) among all Baltic countries. Majority of companies that employed Ukrainians are from accommodation and catering, retail trade, manufacturing, administrative sectors. Working-age refugees are in high demand as they help companies to fill the gaps in staff. The number of refuges in Baltics ranged from 23 thousand in Latvia, 40 thousand in Estonia to 53 thousand in Lithuania (as of 25th May), but significant share of total refugees was children. Other surveys indicate that still many refugees are prepared to come back to Ukraine when situation gets better there, so companies also must understand that the help of Ukrainian refugees to our labour market is temporary.

How will the number of employees change regarding the war in Ukraine?



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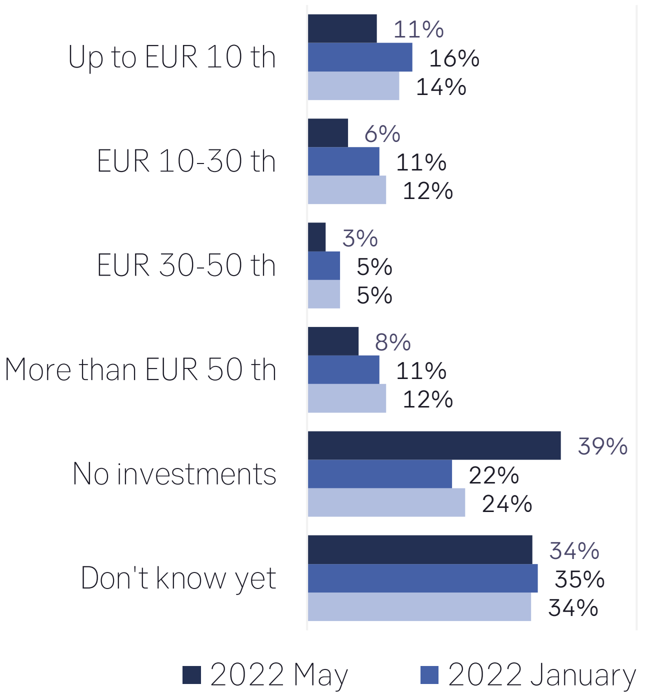
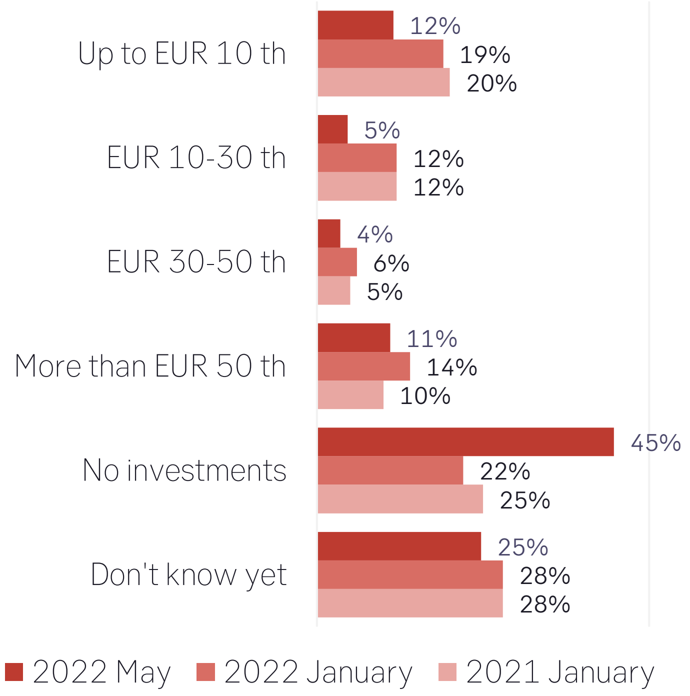
The plans regarding investments in 2022 materially went down after the war in Ukraine. Compared to January 2022 survey, there was a significant decrease in the number of companies that do not plan any investments later this year. In Estonia, the share of such companies increased from 22% to 39%, in Latvia from 22% to 45% and in Lithuania from 24% to 38%. Worse expectations regarding investments confirms more cautious approach from the companies towards short- and medium-term economic development in the Baltic and global economies. Besides, lower planned investments are also very likely related with the jump in construction costs and the prices of materials, therefore many companies decided to postpone the investments that are not crucial. Moreover, from the previous questions we saw increased problems with liquidity and that is another possible explanation (the need to save liquidity) why some companies decided to defer investments temporarily.

Are you planning any investments for 2022?

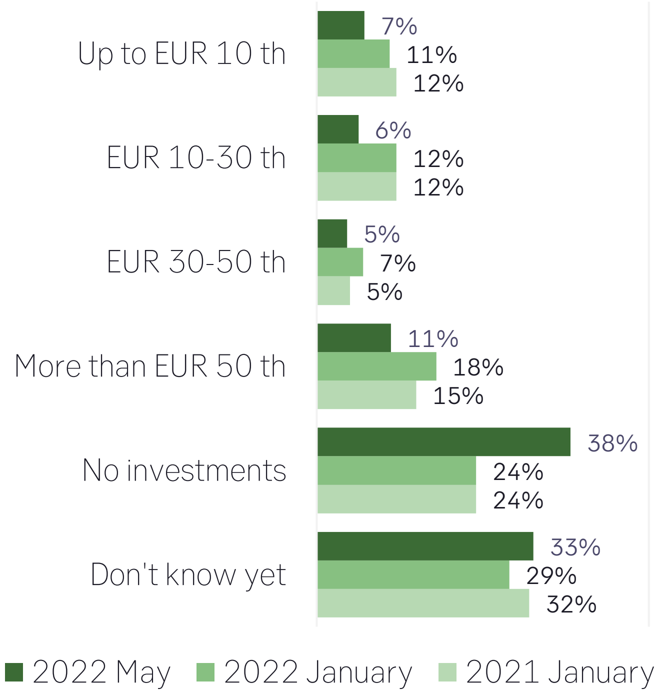
Estonia



Latvia



Lithuania



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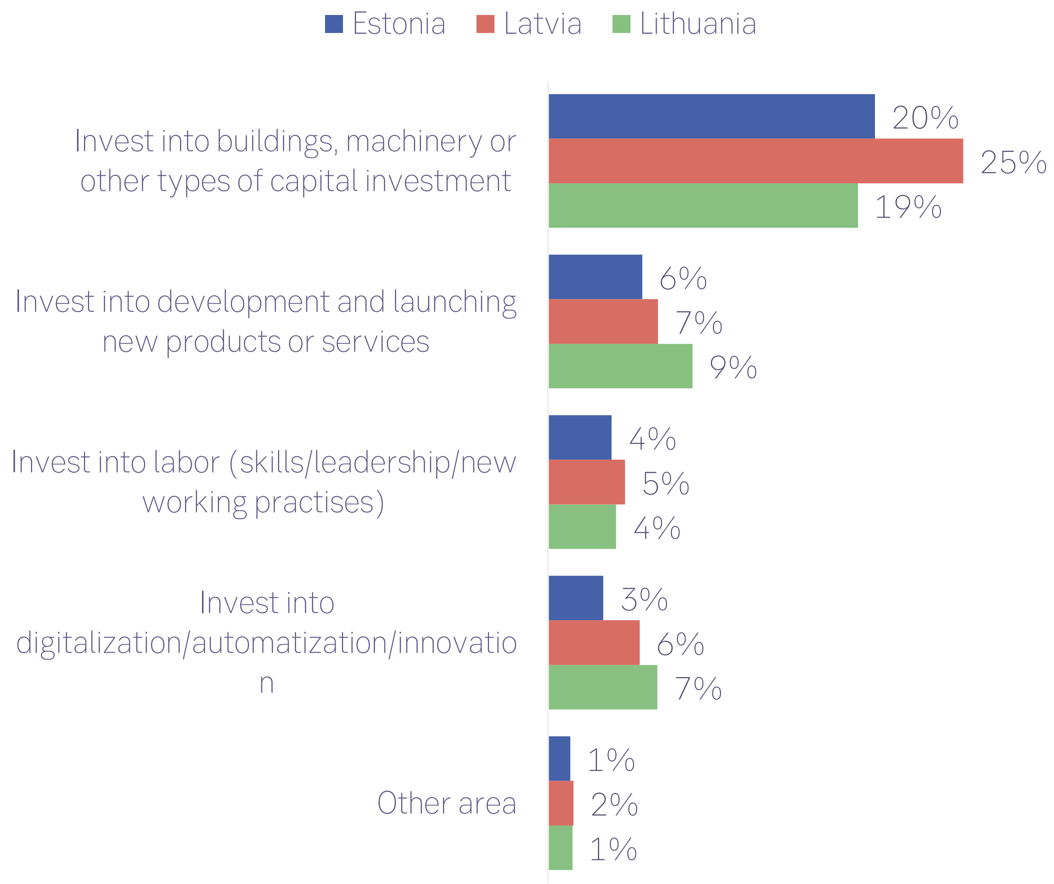
Where do companies plan to invest in 2022?

- Most companies that plan investments in 2022 are prepared to invest into buildings, machinery or other "hard stuff". Latvian companies are the first with the largest share of SMEs projecting such kind of investments. In Estonia and Lithuania, the share of such companies is a little bit smaller. Usually, the investments into buildings or machinery relate with the projected increase in production capacity or the needs for higher productivity and indicate the business sentiments about the medium- and longer-term outlook on economy. Utilization of production capacity in industry in Baltics remain historically high , but it starts trending down this year. Besides, jump in construction costs and materials are also having negative impact on the plans of capital investments.
- Significantly smaller number of SMEs plan to invest into development and launching news products or services. Even less companies are projecting the investments into digitalization/automatization and innovation, which is not positive factor for longer-term growth.

Where do you plan to invest in 2022? (from total companies surveyed)



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Export plans

- Companies retained quite unchanged export plans after the war in Ukraine and the distribution of the answers was quite like what we saw in January 2022 survey. Companies keep on preferring targeting domestic market (76% in Latvia, 77% in Lithuania and 81% in Estonia). That is not surprising considering that economic situation in Baltics in first half of this year has been indeed strong. Moreover, household consumption was sharply up y/y despite much higher inflation. There are also indications that businesses in domestic market manage quite swiftly to pass-through higher expenses, contrary to the sales in export markets. The share of the companies that plan to expand at current or enter new export markets was almost unchanged since January, too. Of course, it is always preferrable that more companies from Baltics will plan the expansion abroad if they want to have faster growth.
- What was interesting to see – it was the share of companies that plans or already exited Russia and Belarus. And in Lithuania the share was the largest (9% in case of Russia), while in Latvia it was 5%, in Estonia 2%. That shows not just the willingness to leave Russia or Belarus, but it reveals that in Lithuania more SMEs were exporting goods or services to Russia and Belarus before the war in Ukraine and now they are leaving or are forced to leave (do to sanctions or voluntary). Of course, it is difficult to evaluate from the answers, what the share of companies that is not planning to leave (in case the exported goods are not sanctioned) is, but it is most likely quite small.

How the war in Ukraine affects your export plans?