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Lithuania's economic development and outlook

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This year, global economic activity picked up steam. Confidence has reached elevated levels, international trade accelerated, and global production expanded significantly. This is attributable to the improved situation in many regions. Implementation of accommodative economic policy and development of infrastructure and other projects translated into stronger demand of imported goods in China. In the light of growing domestic demand and the reversal of accumulation of inventories, the US saw positive economic shifts, with confidence indicators improving in part due to future changes in general government finance. Higher domestic demand reinforced economic expansion in the euro area as well. With commodity prices no longer edging into negative territory, economic activity in countries exporting commodities began stabilising. Recovery in these countries, such as Russia, remains fragile; nevertheless, the economies have stopped shrinking, exerting a favourable impact on an international level.

The improved global economic situation had relatively swift implications for exporters in Lithuania. Having been contracting for several quarters, exports of goods shot up. Merchandise exports to Western and Eastern countries saw an upswing as economic development in various foreign countries enhanced. Exports of services also posted significant gains. Last year, exports of transport services, comprising the sheer bulk of exports of services, kept growing, since the transport sector, having bolstered investment, directed its activities towards the Western markets. This year, activity in the transport sector has continued intensifying.

International environment is not the only factor exerting strong pressure on economic activity. Economic development in Lithuania is still largely influenced by domestic demand, especially private consumption, which is driven by strong shifts in the labour market. Last year, wages rose by roughly 8 per cent. Much of the growth – no less than a quarter – was underpinned by higher minimum wage. With effects of the increase in minimum wage waning, a more moderate rise in wages was to be expected. Nonetheless, latest data shows that their growth rate remains high. In fact, it exceeded projections, attributing also to a stronger-than-expected growth in private consumption.

Robust wage growth is characteristic not only of individual employee groups. Wages of both lower- and higher-income residents recorded significant increases. In other words, wage growth is not strongly dependent on the wage level, reflecting tensions in the entire labour market – all employee groups. It is such tensions that drive this rapid wage growth.

The resulting situation in the labour market will be hard to overcome. Labour is a major factor behind corporate development, yet increasingly more enterprises indicate that the shortage of employees hinders their activities. The number of job vacancies is on the rise, while the number of unemployed persons per job opening is small and constantly dipping down. Until now, the resident participation rate, which has been rising for quite some time, has had an easing effect on the impact that demographic factors (past fall in birth rate and ongoing emigration) have on the overall population of working age – as a result, the labour force in Lithuania has not declined over the past few years. In the near future, however, the participation rate dynamics will fail to offset unfavourable demographic trends. Even if the resident participation rate follows a strong upward climb, labour force is expected to contract. This will put further pressure on possibilities to spur total employment, increasing tensions currently observed in the labour market.

An employee-conducive labour market will continue to bolster labour income; hence, private consumption will remain an important driver of economic growth. Nevertheless, it is expected that labour income will not rise as much as it has until now, since wage growth, which outpaces labour productivity, restrains corporate competitiveness. Such a large gap between wage and productivity dynamics is only possible in the shorter-term. Decelerating labour income should also put the brakes on the growth of household expenditure. Investment will be the mainstay of economic development. Having been subdued last year, in the projection horizon (2017–2018) it should see positive shifts, driven by rising demand both in the exporting and domestic demand-oriented sectors. Investment will also be spurred by recovering flows from the EU funds. It is projected that Lithuania's real GDP will expand by 3.3 per cent in 2017, and another 2.8 per cent in 2018.

Over the last few years, inflation in Lithuania has been rather low, partly on the back of international economic environment, which weighted on commodity prices. The rise in the latter triggered an increase in inflation, which was also pushed up by higher excise duties. At the beginning of the year, food prices saw significant increases. Excise duties on alcohol and tobacco, which have hiked up since March, exerted strong upward pressure on the general food price level. Growth in prices of food, excl. alcoholic beverages and tobacco, stabilised, even losing some of its momentum. Global oil price dynamics also have a significant impact on price developments: increases recorded last year determine not only higher fuel prices but also non-oil commodity import prices, which once again are following an upward trajectory. This might also propel consumer prices, e.g. industrial goods prices, which have remained basically unchanged for the past few years. Prices of services – a price group most related to domestic demand – also have a visible impact on headline inflation. This year prices of services are increasing more than expected, partly due to short-term drivers, e.g. changed developments in prices influenced by seasonal factors. Eliminating the most fluctuating prices of services, the overall rise in prices of services is rather stable yet relatively large. This is supported by increasing labour costs and strong domestic demand. The only price group that continues to weigh on headline inflation is administered prices. So far, heat energy, gas, and electricity prices have been lower on a year-on-year basis. In the near future, however, administered prices will boost headline inflation, partly as a result of the value added tax on heat energy which increased in June 2017. Such a ramp-up was not taken into account when making previous projections, to some extent attributing to the lift in inflation outlook. According to current projections, inflation will stand at 3.2 per cent in 2017.

The projected inflation levels for this year are much higher than they have been in the past few years, yet the upswing in inflation is seen as temporary. It is assumed that next year global oil prices will not rise, while global food commodity prices will show weak growth compared to this year. Hence, in 2018, Lithuania's inflation should decline and stand at 2.2 per cent.

Outlook for Lithuania's economy in 2017–2018

	June 2017 projection[a]			March 2017 projection		
	2016	2017[b]	2018[b]	2016[b]	2017[b]	2018[b]
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	0.7	3.2	2.2	0.7	2.8	2.2
GDP deflator[c]	1.2	2.5	2.2	0.6	2.4	2.2
Wages	7.9	6.5	5.7	7.9	6.1	5.7
Import deflator[c]	–4.3	5.0	1.9	–5.3	4.0	2.0
Export deflator[c]	–3.1	3.9	1.8	–4.8	2.8	1.9
Economic activity (constant prices; annual percentage changes)						
Gross domestic product[c]	2.2	3.3	2.8	2.3	2.6	2.8
Private consumption expenditure[c]	5.2	4.2	3.6	5.2	3.8	3.6
General government consumption expenditure[c]	1.4	1.5	1.2	1.2	1.2	1.2
Gross fixed capital formation[c]	0.1	5.5	5.7	–0.3	4.6	5.9
Exports of goods and services[c]	3.4	3.9	4.3	3.3	3.0	4.4
Imports of goods and services[c]	2.4	4.8	5.3	1.7	4.2	5.3
Labour market						
Unemployment rate (annual average as a percentage of labour force)	7.9	7.3	7.1	7.9	7.3	7.1
Employment (annual percentage change)[d]	2.0	0.0	0.0	2.0	0.0	0.0
External sector (as a percentage of GDP)						
Balance of goods and services	0.9	–0.5	–1.3	0.9	–0.7	–1.4
Current account balance	–0.9	–1.5	–2.1	–0.7	–1.7	–2.3
Current and capital account balance	0.6	0.4	0.4	0.7	0.7	0.3

[a] Projections of macroeconomic indicators are based on information made available by 17 May 2017

[b] Projection

[c] Adjusted for seasonal and workday effects

[d] National accounts data; employment in domestic concept