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# Lithuania's economic development and outlook

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**Global economic expansion has picked up steam.** Despite growth-thwarting headwinds and heightened stability concerns (various geopolitical risks, disagreements on international trade, and uncertainty surrounding the impact of the changing financing conditions and Brexit), global economic activity is projected to remain robust. This is mainly underpinned by strengthening investment, manufacturing and external trade, which exert a positive impact on both advanced and developing countries. Economic development in advanced economies has been also spurred by improvements in labour market conditions, a rather moderate unemployment rate, favourable financing conditions and investment in the energy sector, which has gained momentum on the back of rising energy commodity prices. Economic growth should also benefit from the US fiscal stimulus, which will both boost economic activity within the States and drive the outlook for international trade. The upswing in emerging market economies, where activity in the recent past was dampened by a slump in commodity prices, reflects a number of factors: changes in the international environment, economic reforms implemented thus far, and improvement in global capital flows.

**In contrast to expectations, the euro area – Lithuania's most important trade partner – has had a somewhat weaker start to the year.** The euro area economy was saddled with strikes in the metal industries, bad weather conditions that put a lid on domestic demand, and fading fiscal efforts. Hence in the first quarter of the year, economic activity in the region was weaker than expected, although continued at an overall solid pace. Real GDP grew past its potential. Such developments in the euro area, as well as other parts of the world, were driven by the improving situation in the labour market, still unexploited labour resources, more supportive international environment and ongoing monetary accommodation.

**Weakening external demand weighed on Lithuanian exports at the start of the year.** Growth in exports of Lithuanian-origin goods, which is mainly directed towards Western countries, has scaled down markedly across many groups. This suggests that the deceleration in exports was influenced by foreign demand. Re-exports have also lost momentum. Yet this did not come as a surprise given that last year a surge in re-exports was driven by burgeoning Russian imports, which grew by roughly a sixth on account of inventory restocking after the recession. Following such a significant increase, import growth in Russia has moderated, which puts downward pressure on re-exports.

**Although on a year-on-year basis export growth is less pronounced, Lithuania's cyclical assessment remains unchanged – economic activity continues at a pace above potential.** A rather low unemployment rate and a relatively high level of job vacancies have led to significant wage pressures. Nowadays the labour share is quite high, exceeding the historical average. This reflects imbalances in the labour market – demand for employees has outpaced the supply of job seekers. Nonetheless, the recovery of investment in 2018 and the year before helps to ease the situation: it boosts production capacities, i.e. the potential level of economic activity, thus reducing mounting tensions. Part of investments, however, is oriented towards construction, which spurs demand for supplies in the short term, in turn widening economic imbalances. It is assumed that in 2018 the economy might see a larger inflow of EU funds, which in the past two years were contracting. This will bolster activity in many sectors, especially construction. In other words, although in the upcoming years growth in the exporting sector should be weaker than last year, certain factors will continue to stimulate economic activity, keeping it at levels above potential. Having increased by 3.9% in 2017, real GDP is projected to firm further, growing by 3.2% in 2018 and 2.7% in 2019.

**Annual headline inflation has scaled down, yet shows signs of rather strong volatility.** In Lithuania, like many other countries, the level of inflation is highly dependent on changes in commodity markets. For example, the significant rise in food commodity prices (end of 2016–2017) was matched with a faster increase in consumer prices for food. As the former started to decelerate, changes in consumer prices also became more moderate. Compared to last year, growth in consumer prices of milk and dairy products has slowed by nearly 25%, the growth rate of meat consumer prices has almost halved, while that of prices for food (excluding alcohol and tobacco) has reduced by roughly a sixth. Developments in headline inflation are also driven by fluctuations in oil prices. In 2017 the oil price in euro has increased by approximately one fifth, while in the first months of this year it was roughly one tenth higher than a year before. As a result, consumer fuel prices at the start of the year were following a more moderate upward path. The situation took a different turn in May this year, when high uncertainty started to cloud the outlook for oil supply due to the situation with respect to Iran. This led to an increase in global oil prices and, in turn, the overall consumer price level. Dynamics of service prices (prices that are most related to domestic economic progress) are relatively more stable. With a pick-up in labour costs and domestic demand, prices of services are growing quite considerably. Even though the overall rise in service prices has been slower than last year, with the impact of the most volatile prices eliminated the growth rate of service prices is rather stable, which also points to elevated economic activity in the country.

**Projections for 2018 remain unchanged: annual headline inflation in Lithuania is anticipated to slide below the level recorded last year.** Although global oil prices have risen steeply, which leads to the assumption that their annual growth rate in 2018 will not lag behind the year-earlier figure, increases in other commodity prices, notably food, are expected to be less pronounced. More restrained increases in excise duties and somewhat weaker rise in prices of services will put downward pressure on inflation. Average annual inflation is expected to fall from 3.7% in 2017 to 2.7% in 2018.

**Outlook for Lithuania's economy in 2018–2019**

| | June 2018 projection[a] | | | March 2018 projection | | |
|---|---|---|---|---|---|---|
| | **2017** | **2018[b]** | **2019[b]** | **2017[b]** | **2018[b]** | **2019[b]** |
| **Price and cost developments (annual percentage changes)** | | | | | | |
| Average annual inflation, as measured by the HICP | 3.7 | 2.7 | 2.2 | 3.7 | 2.7 | 2.2 |
| GDP deflator[c] | 4.3 | 2.6 | 2.2 | 4.0 | 2.6 | 2.2 |
| Wages | 8.6 | 7.6 | 6.0 | 8.5 | 6.7 | 6.0 |
| Import deflator[c] | 4.4 | 2.8 | 1.7 | 4.1 | 2.6 | 1.7 |
| Export deflator[c] | 5.4 | 2.5 | 1.6 | 5.8 | 2.3 | 1.6 |
| **Economic activity (constant prices; annual percentage changes)** | | | | | | |
| Gross domestic product[c] | 3.9 | 3.2 | 2.7 | 3.9 | 3.2 | 2.7 |
| Private consumption expenditure[c] | 4.1 | 3.8 | 3.5 | 4.2 | 3.7 | 3.5 |
| General government consumption expenditure[c] | 1.0 | 1.1 | 1.1 | 1.5 | 1.1 | 1.1 |
| Gross fixed capital formation[c] | 6.7 | 6.9 | 5.2 | 5.1 | 6.3 | 5.5 |
| Exports of goods and services[c] | 13.7 | 5.7 | 4.6 | 11.0 | 5.7 | 4.6 |
| Imports of goods and services[c] | 13.6 | 6.9 | 5.4 | 13.2 | 6.0 | 5.4 |
| **Labour market** | | | | | | |
| Unemployment rate (annual average as a percentage of labour force) | 7.1 | 6.7 | 6.6 | 7.1 | 6.7 | 6.6 |
| Employment (annual percentage changes)[d] | –0.5 | –0.1 | –0.3 | –0.5 | –0.3 | –0.3 |
| **External sector (percentage of GDP)** | | | | | | |
| Balance of goods and services | 2.3 | 1.2 | 0.5 | 1.1 | 0.6 | –0.1 |
| Current account balance | 0.7 | –0.2 | –1.0 | –0.1 | –0.8 | –1.6 |
| Current and capital account balance | 1.9 | 1.6 | 1.2 | 1.1 | 1.1 | 0.6 |

[a] These projections of macroeconomic indicators are based on information made available by 22 May 2018
[b] Projection
[c] Adjusted for seasonal and workday effects
[d] National accounts data; employment in domestic concept