



Economic Outlook for Lithuania

10 November 2011

The economy of Lithuania is recovering further, however, the expectations of both households and enterprises regarding future growth are starting to deteriorate. The growth of real GDP has been accelerating recently, the value added and employment increased in most economic activities over the year, and the unemployment rate declined. However, some segments of the economy, namely those related to foreign demand, grew slower. The volume of industrial production sold in foreign countries has been growing slower already for some time. Lithuania's exports of goods and services also grew more moderately both in terms of exports of the Lithuanian origin and in terms of total exports from Lithuania. Such development of economic indicators is related to less favourable demand for imports in trading partners that are important for Lithuania, such as Russia, Germany, Poland, and Estonia. The short-term outlook is assessed more poorly than several months ago by Lithuania's households as well as enterprises in the main economic activities, such as industry, trade and other services. Therefore, it is projected that the growth of Lithuania's real GDP will slow down. It is expected to stand at 6.2 per cent in 2011 and at 3.5 per cent in 2012.

Currently, the real GDP growth is mostly stimulated by private consumption expenditure. Expenditure started to grow at the end of the last year and its growth accelerated up to now. At first, private consumption was encouraged by the improvement of household expectations, while recently it has been positively affected by the labour market recovery (increasing employment and wages). The recovery of private consumption is also reflected by the rising retail trade: the sales of both non-durable and durable goods are increasing. However, the deteriorating situation in the global economy is starting to worsen the expectations of households regarding the future economic situation in Lithuania and the situation in the labour market. Therefore, the growth of private consumption is expected to stop accelerating already at the end of the year and to decelerate afterwards. It is projected that private consumption will grow by 3.5 per cent in 2012, after growing by 6.3 per cent in 2011.

Investment into gross fixed capital has been increasing quite significantly. This was mainly related to private sector investments into transport and means of production. Up to now, the increase of investment in this sector was encouraged by the rising production capacity utilization rate, which in some industrial branches (such as chemical, wood, textiles industry) reached the level observed before the downturn. Investment in transport has been increasing at an exceptionally high rate, however, this could be expected, since during the recession these investments dropped the most. Growing economy of Lithuania also contributed to the construction of buildings and structures. However, the projected less favourable economic outlook will also affect the development of the gross fixed capital formation. The future decline of investment growth is suggested by the weaker growth of the import of investment goods, which has been observed already for around a half of the year.

The situation in the labour market has apparently improved recently. The unemployment is declining, as well as the rates of long-term and youth unemployment, which increased rapidly during the recession. The growth of employment is mostly determined by the services sector but other activities, such as industry and construction, also contribute to it. Employment is largely stimulated by the larger private sector, however, it has been growing already for several quarters in the public sector as well. Employment is also favourably affected by employment forms that demonstrate labour market flexibility, such as part-time and temporary employment. Thus, the rise in employment is not related to a single activity or sector but is broad-based. It is forecasted that in 2011 and 2012 employment will rise (by 3.1 and 1.6 per cent, respectively), whereas the unemployment rate will decline but will remain higher than its average since the beginning of data publication.

Not only employment but also wage indicators are changing. With the rise of activity and a shortage of employees with suitable qualification in some economic activities, the average wage is rising in the country. The annual growth of wages was largely determined by the services sector, however, wages are also rising in other sectors. The average wage is projected to rise further over the forecast horizon. It should increase by 4.0 per cent in 2011 and 3.0 per cent in 2012.

Recent foreign trade developments are mostly determined by re-exports. Re-exports remain larger than a year ago, however, it fell during the last several months according to seasonally adjusted data. It decreased due to a large decline in the sales of

passenger cars. This development affected general trends of both exports and imports of goods. The exports of goods of the Lithuanian origin are also higher than a year ago. Recently, however, this type of exports was not rising (according to seasonally adjusted data): the export volumes of most goods remained stable. As mentioned, such export developments are determined by a more sluggish demand for imports in foreign countries. It is important to note that at the same time Lithuania's export market shares continue to increase. External demand should grow less in the future, therefore, it is projected that the exports will grow at a slower rate as well. Real exports of goods and services are expected to increase by 13.2 per cent in 2011 and 5.3 per cent in 2012.

Foreign trade deficit changed less significantly. In the second quarter of 2011, balance of goods, as well as balance of services (both measured as a share of GDP), was similar to the value of the beginning of the year. The income balance also changed insignificantly. **However, the current account deficit widened due to a lower surplus of current transfers.** This surplus went down due to a decline in payments from the EU funds. These payments should be restored in the nearest quarters. In addition, the balance of current transfers should be further positively affected by a continued growth of workers' remittances.

ECONOMIC OUTLOOK FOR LITHUANIA IN 2011–2012

	November 2011			August 2011		
	2010	2011*	2012*	2010	2011*	2012*
Price and Cost Developments (annual percentage changes)						
Average annual inflation (based on HICP)	1.2	4.2	3.0	1.2	4.4	4.1
GDP deflator	2.0	4.6	3.2	2.1	5.6	4.0
Wages (compensation per employee)	0.3	4.0	3.0	-0.1	3.8	5.3
Import deflator	9.7	12.6	2.4	9.2	13.6	2.6
Export deflator	10.6	11.3	2.4	10.9	12.6	2.4
Economic Activity (constant prices; annual percentage changes)						
Gross domestic product**	1.4	6.2	3.5	1.3	6.2	4.8
Private consumption expenditure	-4.9	6.3	3.5	-4.5	6.1	5.2
General government consumption expenditure	-3.3	0.3	0.2	-3.4	-0.4	2.9
Gross fixed capital formation	1.0	17.7	9.1	0.0	17.7	11.7
Exports of goods and services	17.4	13.2	5.3	17.4	12.0	5.7
Imports of goods and services	17.3	14.0	5.6	17.9	14.9	6.2
Labour market						
Unemployment rate (annual average as a percentage of labour force)	17.8	15.4	13.6	17.8	15.5	13.0
Employment (annual percentage changes)	-5.1	3.1	1.6	-5.1	2.3	2.7
External Sector (as a percentage of GDP)						
Balance of goods and services	-1.1	-2.7	-3.3	-0.7	-3.0	-4.2
Current account balance	1.5	-1.3	-2.0	1.8	-1.5	-2.7
Current and capital account balance	4.2	1.1	0.2	4.5	0.9	-0.6

* Projection.

** Changes in inventories are not included in GDP components.

After reaching the highest level in the recent two years, the annual inflation declined slightly, owing to a slower food price growth and lower annual core inflation. Food prices' increase over the year remains the main driver behind inflation in Lithuania, however, its influence is decreasing as a result of a slower growth of global food prices. With the increasing concern about the prospects of the global economy, oil price growth decelerated, therefore, the annual increase in fuel prices in Lithuania slowed down and the influence of fuels on inflation declined. The impact of administered prices, on the contrary, is increasing. These prices are mostly pushed up by more expensive heat energy determined by the growing price of imported fuel. The prices of industrial goods and market services, which depend on the developments of domestic consumption and are included in the calculation of the core inflation measure, have a low impact on inflation. In the nearest future, this impact should not grow strongly, since the risk that Lithuania's economy will grow slower as a result of deteriorating situation in the global economy is increasing. Thus, owing to a less favourable assessment of the economic development of foreign countries and Lithuania, inflation is projected to be lower in both 2011 and 2012 standing at 4.2 and 3.0 per cent, respectively.