



## Economic Outlook for Lithuania

23 February 2012

**The economy of Lithuania is entering the stage of a slower growth.** Up to now, the domestic economy grew very rapidly, however, there are increasing signs of less favourable prospects. Owing to a slower global economic development, lower economic growth is projected in the main trade partners of Lithuania, whereas confidence indicators in Lithuania and foreign countries are also deteriorating in the context of uncertainty related to indebtedness problems in some euro area countries. Such situation dampens the expectations of the Lithuanian households and enterprises, limits investment plans of enterprises, constrains employment growth and strengthens household saving. These factors contribute to the assessment that the real sector of Lithuania will grow slower in the near term. The suspended activity of AB bankas SNORAS will also have a negative impact on the development of Lithuania's economy. Although the direct impact of this bankruptcy on the economic development will be low due to relatively small amount of uninsured deposits, the indirect impact is still projected. It is forecasted that the real GDP of Lithuania, which grew by 5.8 per cent in 2011, will increase by 2.2 per cent in 2012 and by 3.3 per cent in 2013.

**An important factor of the real GDP growth is private consumption.** It is pushed up by the household income that grew for some time both due to wage rise and employment growth. As indicated by the data of retail trade enterprises, households spend much more money for house equipment, car fuel and food. Still, owing to rising prices and declining confidence, the private consumption expenditure should not grow as fast in the short run. As enterprises undertake new investments more cautiously, the number of new jobs created will be lower and wages will be raised more moderately, and this will limit the increase in household income and thus private consumption. After a rapid growth in 2011 (5.6 per cent), private consumption should grow slower in 2012 and 2013 – by 2.5 per cent and 2.6 per cent, respectively.

**Another domestic demand component – gross fixed capital formation – is growing noticeably less than earlier.** Decisions of enterprises regarding investment are affected by the unclear further domestic and global economic development. Investments in non-residential buildings and constructions are larger, whereas investments in residential buildings, vehicles, machinery and equipment are lower than a year ago. Enterprises are investing less into production capacity expansion than in several previous quarters, and this fact will affect the domestic economic development during the projection period. Owing to less favourable economic development prospects, investments in gross fixed capital should grow less in 2012 than they grew on average up to now (it is projected that they will increase by 5.0%), while in 2013 they should grow more – by 7.9 per cent.

**The situation in the labour market is still improving, albeit slower.** The assessment of the changes over the year shows that the unemployment is declining in the country and more people are employed. Over the year, especially large growth of the number of the employed was observed in the largest sector in terms of employment – the services sector, particularly in trade, transport and storage activities. The number of the employed also increased in construction and industry. However, it should be noted that, according to seasonally adjusted data, the number of the employed has not been growing recently. According to this data, the number of those employed on a part-time basis is slightly higher than earlier, whereas the number of those employed on a full-time basis is lower. Owing to a cautious assessment of economic prospects by enterprises, it is likely that the employment will grow only slightly during the projection period.

**Lithuania's foreign trade is becoming less buoyant.** According to seasonally adjusted data, only the export of oil products has been growing recently, while the export of the majority of other products is stabilising. The trade in passenger cars in the markets of the CIS countries is contributing to export developments less favourably, therefore, according to seasonally adjusted data, re-export is not growing. Still, when assessing longer-term data, it is noticeable that our country's export is growing more than the import of the main foreign trade partners – EU states and Russia, while Lithuania's exporters gain a

larger market share in these countries. It is projected that the import demand in the mentioned countries will weaken further gradually, therefore, Lithuania's export will grow slower. After growing by 13.6 per cent in 2011, the real export of goods and services should increase by 3.9 per cent in 2012 and 5.8 per cent in 2013.

**Partially owing to a more favourable trade in oil products, the foreign trade balance is improving.** The overall surplus of the trade in goods and services, compared to the GDP, has recently been one of the largest since the beginning of data collection. **Jointly with lower profitability of foreign capital enterprises, this determines a surplus in the current account.** Current transfers, other important component, exert further positive influence on the current account due to both higher inflows from the EU funds and strong remittances of emigrants. Foreign trade and current account balances should be less favourable in the nearest time, however, assuming that domestic demand will rise moderately, these balances should not deteriorate strongly.

#### Outlook of Lithuania's Economy in 2011-2013

	February 2012			November 2011		
	2011*	2012*	2013*	2011*	2012*	2013*
<b>Price and Cost Developments (annual percentage changes)</b>						
Average annual inflation (based on HICP)	4.1	2.1	2.4	4.2	3.0	-
GDP deflator	5.1	2.5	2.6	4.6	3.2	-
Wages (compensation per employee)	3.9	1.6	2.5	4.0	3.0	-
Import deflator	12.8	2.5	2.3	12.6	2.4	-
Export deflator	11.9	2.6	2.2	11.3	2.4	-
<b>Economic Activity (constant prices; annual percentage changes)</b>						
Gross domestic product**	5.8	2.2	3.3	6.2	3.5	-
Private consumption expenditure	5.6	2.5	2.6	6.3	3.5	-
General government consumption expenditure	1.2	0.6	1.9	0.3	0.2	-
Gross fixed capital formation	15.9	5.0	7.9	17.7	9.1	-
Exports of goods and services	13.6	3.9	5.8	13.2	5.3	-
Imports of goods and services	13.3	4.1	6.1	14.0	5.6	-
<b>Labour Market</b>						
Unemployment rate (annual average as a percentage of labour force)	15.4	14.2	12.9	15.4	13.6	-
Employment (annual percentage changes)	2.0	0.7	1.2	3.1	1.6	-
<b>External Sector (as a percentage of GDP)</b>						
Balance of goods and services	-1.5	-2.1	-2.4	-2.7	-3.3	-
Current account balance	-0.3	-1.2	-1.6	-1.3	-2.0	-
Current and capital account balance	2.1	0.9	0.1	1.1	0.2	-

\* Projection.

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

**Annual inflation is declining gradually.** This is mostly determined by food price changes, which have been influenced by the trends in the global food commodity markets with a delay. In the beginning of the year, global food prices were record high and significantly higher than a year ago; later they declined and became lower than a year ago at the end of the year. With a slower rise of global food prices, food price growth decelerates in Lithuania too, and this reduces inflation noticeably. Nevertheless, the rise of food prices at the end of the year remained the main factor of inflation. Quite significant contribution was made by administered prices. Due to a continued growth of heat energy prices, administered prices were significantly higher than a year ago. Fuel prices grew significantly slower at the end of the year, owing to a lower increase in the oil price over the year. With the deterioration of the situation of the global economy, it is not expected that food and energy commodity prices will grow, therefore, there should be no external pressure on prices in Lithuania. Several administrative decisions, which will increase prices, were made: electricity price was increased and excise duties for cigarettes will be increased, however, their impact on inflation will not be large. Annual core inflation, which is mostly related to domestic consumption, remains low, whereas domestic consumption should not stimulate price growth, as the growth of wages and employment will be sluggish in the nearest time. Owing to slower economic development and lower external pressure on prices, lower inflation is expected in 2012 (2.1%). In 2013, when the economic growth will start strengthening again, the prices should also increase faster (2.4%).