



Economic Outlook for Lithuania

8 September 2014

Lithuania's economic development is still stable. The significant growth of domestic demand is stimulated by the recovering labour market and increasing wages, which are growing much more than prices. The positive effect of domestic demand is felt by almost all economic activities: construction is particularly intensifying, real estate activities are expanding, manufacturing and trade are growing. The growth of construction is very closely related to the continued rise in investment: spending on residential buildings, infrastructure objects and other buildings is significantly increasing. Such a rise in investment is larger than expected. There is also a greater-than-expected growth in the private consumption: demand for products of many categories — non-durable consumer goods, various services — is increasing.

Risks to sustainable economic development noticeably increased. The expectations of economic agents significantly deteriorated even before the trade restrictions with Russia came into force. The prospects are being assessed more negatively by households and enterprises in all sectors — manufacturing, construction, trade and services. In the environment of geopolitical tensions, expectations can deteriorate even more, and this would negatively affect economic development: households would be encouraged to limit expenditure and save more, while enterprises — to postpone investment projects and hiring decisions.

Economic development will be negatively affected by trade restrictions with Russia. The restrictions, enforced in August 2014, are applied to nearly a fifth of Lithuania's exports (including re-exported goods) to Russia. The annual exports of products, which are currently subject to the restrictions on trade, to Russia amount to more than LTL 3 billion, or around 4 per cent of Lithuania's total exports of goods. This is a rather significant share of Lithuania's exports, but only about a fourth of these exports are of Lithuanian origin, while three-fourths are re-exported goods. The restrictions are applied to trade in agricultural and food products, therefore a direct negative effect will be felt in agriculture and food industry. A large part of Lithuanian-origin products, to which these restrictions are applied, are dairy and meat products. The export of both dairy and meat products to Russia has until now accounted for more than a tenth of the production of the aforementioned industries. In addition to those economic activities, a significant impact will be experienced by transport sector, which earn a large share of its income through the storage and transportation of goods for the Russian market. It is assessed that the restrictions of trade with Russia will decrease the growth of Lithuania's real GDP by up to 0.4 percentage points this year. The negative effect will be felt not only by the exporting sector but also by economic activities oriented towards the domestic market. Private consumption, investment, the labour market will be negatively affected.

The restrictions of foreign trade, deteriorated expectations and increased uncertainty in regards to the further international environment leads to lower economic growth projections for Lithuania. It is projected that the real GDP will increase by 2.9 per cent this year (according to earlier projections — 3.3%) and by 3.3 per cent in 2015 (earlier projection — 3.6%). Economic growth projections are lower, but nevertheless it is expected that economic activity will continue to rise. A large part of Lithuanian-origin goods are exported not to Eastern, but to the EU countries. Economic growth is currently very low in the EU countries, but it is projected to gradually recover and contribute to the rise of Lithuania's exporting sector. With the expansion of the tradable sector, the domestic demand-oriented economic activities will also consistently increase. It is projected that both the private consumption and investment will continue to grow, although less than last year. This year the impact of net exports on real GDP growth will be more negative than was previously projected, in part due to the trade restrictions; however, in the further period this effect will gradually decrease.

The currently projected inflation is lower than indicated in earlier projections. Inflation is projected to amount to 0.4 per cent this year and to 1.2 per cent next year. Projection revision is mainly driven by the fact that recently inflation has been lower than expected: the change of administered prices deviated the most from the projections, because the price of heating suddenly decreased in several of the largest cities. The price of natural gas for households, which dropped by a fifth in the middle of the year, also has some influence on the projection revision (a modest influence, as the weight of gas in the consumer basket is small), because while preparing the earlier projections the lower prices still had not been approved. Administered prices have dropped, motor fuel prices have also fallen, therefore positive annual inflation has already for a while been supported only by the higher than a

year ago food prices and positive core inflation — the part of inflation more related to domestic demand. Core inflation is not expected to increase significantly in the near future, because only limited growth of unit labour costs is projected. Projections for external factors, such as the global commodity prices and inflation in the euro area, also allow expecting that inflation in Lithuania will remain low.

Outlook of Lithuania's economy in 2014–2015

	September 2014 projection			May 2014 projection		
	2013	2014*	2015*	2013	2014*	2015*
Price and cost developments (annual percentage changes)						
Average annual inflation, based on HICP	1.2	0.4	1.2	1.2	0.9	1.5
GDP deflator	1.7	0.6	1.3	1.7	1.1	1.3
Wages (compensation per employee)	5.0	4.2	4.3	5.0	3.6	4.3
Import deflator	-1.5	-2.2	0.5	-1.5	0.3	0.8
Export deflator	-1.4	-2.0	0.5	-1.4	0.6	0.9
Economic activity (constant prices; annual percentage changes)						
Gross domestic product	3.3	2.9	3.3	3.3	3.3	3.6
Private consumption expenditure	4.7	4.7	3.6	4.7	3.5	3.6
General government consumption expenditure	1.9	1.9	1.7	1.9	1.7	1.7
Gross fixed capital formation	12.8	8.4	4.9	12.8	6.6	7.6
Exports of goods and services	10.3	0.2	5.3	10.3	3.9	6.1
Imports of goods and services	10.3	2.1	6.4	10.3	5.2	7.0
Labour Market						
Unemployment rate (annual average as a percentage of labour force)	11.8	11.2	9.9	11.8	10.4	9.2
Employment (annual percentage change)	1.3	1.2	1.0	1.3	1.1	1.0
External sector (as a percentage of GDP)						
Balance of goods and services	1.0	-0.4	-1.3	1.1	0.2	-0.4
Current account balance	1.5	1.2	-0.3	1.5	0.0	-1.0
Current and capital account balance	3.7	3.4	1.9	3.7	2.2	1.1

* Projection