LIETUVOS BANKAS

# Lithuania's economic development and outlook

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**Lithuania's economy continues to grow at a healthy pace supported by domestic demand and, in particular, by the growth of private consumption.** The latter, in its turn, is fuelled by continued improvements in the labour market (growth of employment, coupled with a decline in unemployment) and the growth of real wages, which has accelerated since a substantial fall in inflation in the middle of 2013. Real wage growth is driven, inter alia, by a decline in unemployment, which paves the way for salaries to keep going up rather substantially even after the effect from the increase of the minimum monthly wage has faded out. An incentive to consume is also provided by low interest rates. Investment, another key component of domestic demand, is supported by high capacity utilization, which well exceeds its long-term average level and keeps growing, as well as by ongoing infrastructure projects. Growing investment in infrastructure and other construction projects spurs construction activity; its value added has been growing rapidly for more than a year. Positive effects from the growth of domestic demand spill over into other economic activities as well. However, the growth of certain activities was driven by exceptional factors. For example, the growth of value added in the agricultural sector was noticeably increased by this year's abundant harvest.

**Nonetheless, the growth of domestic demand is gradually losing steam.** However, the deceleration was expected, due to deterioration in both household and business expectations, which has been observed for a while. Concerned about geopolitical uncertainty, households tend to be more cautious about spending and businesses more wary about investing. The latest data shows that the developments of domestic demand are getting closer to their long-term trends. In the first half of this year, the growth of this demand exceeded the pace of GDP growth way more than usual. By now, however, this gap has narrowed and is expected to remain at this lower level as the domestic demand will grow broadly in line with GDP and its ratio to GDP will essentially stabilise after the recent steady rise.

**Export developments have not been worse than expected thus far.** As expected, import restrictions imposed by Russia on certain categories of foods (milk, meat, fruit, vegetables, etc.) in August dealt a heavy blow to the exports of food from Lithuania to Russia, which fell by half in two months from the introduction of these sanctions. However, this adverse effect was partly offset by a sudden pickup in Russia-bound exports of certain non-food products early in summer. Still, there are substantial risks that this sudden spike may be short-lived and the exports of these goods may fall back to their previous level wiping out any gains. The risks of slower than currently expected growth of exports also relate to the economic outlook in the euro area, which tops the list of Lithuania's foreign trade partners. The forecasts of economic growth in the euro area have already been trimmed down from what was previously anticipated, which is expected to add to the dampening effect on the prospects of Lithuania's exports in 2015.

**GDP is expected to continue growing steadily.** The economy is projected to grow by 2.9 per cent in 2014 and by a further 3.1 per cent in 2015. Despite an expected deceleration from this year's pace, domestic demand will remain a major driving force of economic growth next year. Demand will be driven by improvements in the labour market, low inflation and ongoing investment needs. Net exports will have a minor effect on the growth of GDP over the entire forecast period.

**Inflation has been very low and stable for a while now**, mostly as a result of consumer-friendly developments in the prices for commodities in the global market and low inflation environment in the euro area. The current and the anticipated levels of global commodity prices are way lower than previously expected. For example, the price of crude has plunged by one-fifth from its year-earlier level in recent months. The estimates for inflation in the euro area in 2014 and 2015 have also been revised down. Such revisions to the projections relating to external factors suggest that inflation in Lithuania may be lower than previously forecasted and, therefore, the inflation is expected to be 0.3 per cent this year and 0.9 per cent next year. Russia's restrictions on the imports of food have not yet triggered any need for the inflation forecasts to be revised down substantially. Although these sanctions have caused a fall in the purchase prices for farm commodities, they have not yet produced any major effect on consumer prices in Lithuania. Domestic factors, such as growing labour costs, do not create stronger pressure on core inflation, i.e. a component of inflation that is more dependent on domestic demand, and are not expected to do so in the near future.

Outlook of Lithuania's economy in 2014–2015

| | December 2014 projection | | | September 2014 projection | | |
|---|---|---|---|---|---|---|
| | 2013 | 2014[a] | 2015[a] | 2013 | 2014[a] | 2015[a] |
| **Price and cost developments (annual percentage changes)** | | | | | | |
| Average annual inflation, as measured by the HICP | 1.2 | 0.3 | 0.9 | 1.2 | 0.4 | 1.2 |
| GDP deflator | 2.1[b] | 0.9[b] | 1.5[b] | 1.7 | 0.6 | 1.3 |
| Wages | 5.1[c] | 4.5[c] | 5.1[c] | 5.0[d] | 4.2[d] | 4.3[d] |
| Import deflator | –1.2[b] | –2.5[b] | –0.3[b] | –1.5 | –2.2 | 0.5 |
| Export deflator | 0.0[b] | –3.6[b] | –0.6[b] | –1.4 | –2.0 | 0.5 |
| **Economic activity (at constant prices; annual percentage changes)** | | | | | | |
| Gross domestic product | 3.2[b] | 2.9[b] | 3.1[b] | 3.3 | 2.9 | 3.3 |
| Private consumption expenditure | 5.3[b] | 4.7[b] | 3.6[b] | 4.7 | 4.7 | 3.6 |
| General government consumption expenditure | 1.7[b] | 1.2[b] | 1.5[b] | 1.9 | 1.9 | 1.7 |
| Gross fixed capital formation | 6.3[b] | 8.4[b] | 3.1[b] | 12.8 | 8.4 | 4.9 |
| Exports of goods and services | 9.4[b] | 3.4[b] | 4.4[b] | 10.3 | 0.2 | 5.3 |
| Imports of goods and services | 10.8[b] | 3.7[b] | 4.4[b] | 10.3 | 2.1 | 6.4 |
| **Labour market** | | | | | | |
| Unemployment rate (annual average as a percentage of labour force) | 11.8 | 10.6 | 9.7 | 11.8 | 11.2 | 9.9 |
| Employment (annual percentage change) | 1.3[e] | 1.9[e] | 0.6[e] | 1.3 | 1.2 | 1.0 |
| **External sector (as a percentage of GDP)** | | | | | | |
| Balance of goods and services | 1.2 | 0.0 | –0.2 | 1.0 | –0.4 | –1.3 |
| Current account balance | 1.6 | 0.7 | 0.2 | 1.5 | 1.2 | –0.3 |
| Current and capital account balance | 4.6 | 3.7 | 3.0 | 3.7 | 3.4 | 1.9 |

[a] Projection
[b] Adjusted for seasonal and workday effects
[c] Average wages
[d] Compensation per head
[e] National accounts data; employment in domestic concept