

Lithuania's economic development and outlook

15 December 2015

Compared to the past few years, the pace of Lithuania's economic growth has roughly halved this year, primarily due to the downside effects of the international environment. Stubbornly low prices for energy commodities and continuing economic sanctions have dragged down economic activity in Russia and in the countries with economic and financial ties to Russia. Real GDP is presumed to have contracted by approximately 4 per cent in Russia this year and the health of other CIS economies has also taken a noticeable turn for the worse. A substantial fall in these countries' imports and depreciated currencies act as a drag on the performance of Lithuania's transport, storage and wholesale undertakings involved in re-export operations in particular as transport of freight to the Eastern countries accounts for a significant part of services provided by these businesses.

Even so, export dynamics are not too grim. Real merchandise exports only fell slightly as compared to last year when Russia's economic downturn started to take hold. The decline in exports to the Eastern countries is offset to a large extent by the growth of exports to other countries, in particular the EU, which is driven *inter alia* by improvements in economic well-being in the European countries and by exporters' efforts to discover new markets. It is noteworthy that the real exports of services continued to increase. A decline in eastward exports of transport services, which represent a large share of the total exports of services, was accompanied by an increase in such services provided to other countries, which mitigated the effects from the changed international environment.

The international context is not the only factor behind the softer performance of the economy. In particular, the pace of growth in the construction sector has slowed down this year. The annual rate of growth in the value added created in this sector almost halved in the first half of this year, from approximately 14 per cent recorded last year. The slowdown is due to infrastructure and non-residential construction, which has stopped growing. Home construction is the only segment to show sizeable growth. Investment in residential buildings, unlike investment in other construction facilities, has already recovered to the pre-downturn level. However, this investment also remains surrounded by some uncertainty. The growth of activity in the housing market is likely to moderate from the pace observed in recent months and the supply of newly built homes is relatively abundant. Less intensive development of residential investment would further dampen activity in the construction sector.

As in the past few years, private consumption continues to underpin economic growth. The labour market has remained immune to the slowdown in the country's economic development. Employment in transport and trading enterprises, i.e. in the economic entities that have been hardest hit by the economic downturn in Russia, has lost its previous growth pace but is not falling, either. Elsewhere in the economy, jobs are growing significantly in number. Hence the demand for labour has not decreased, which has a positive effect on wage dynamics. With the number of vacancies climbing and unemployment falling, wage growth, which is also supported by the increase of the minimum monthly wage, continues broadly unchanged from last year, which paves the way for households to step up consumption. The growth of consumption is rather strong, despite continuing uncertainty over the country's economic outlook, which has been getting gloomier for quite a while.

Domestic demand is expected to keep growing at a robust pace in the forecast period. However, the pace of economic growth will still remain affected by the external environment. Foreign demand, i.e. the imports of trade partners, is forecast to rebound in 2016 after this year's fall hence the growth of Lithuania's exports should pick up somewhat next year. Expected improvements in the international environment should also lead to faster growth of the entire economy. Lithuania's real GDP is projected to grow by 1.7 per cent in 2015 and by another 2.9 per cent next year. The forecast of economic growth in 2016 has been revised down (from 3.2%) due to a more cautious approach to the outlook for the international environment and, in particular, Russia's outlook. Downside risks to Lithuania's economic growth continue to mount amid lingering uncertainty over Russia's economic development and concerns about the growth outlook in other emerging economies. Weaker than expected global economic growth would have negative implications, both direct and indirect, for the growth of Lithuania's economy as it would lead to a worsening of the outlook for economic growth in foreign trade partners.

Trends in prices remain favourable for consumers. Annual inflation has been negative, i.e. prices have been lower than their year-earlier levels, since the end of 2014. The year 2015 is coming to an end and it is therefore obvious that the average annual inflation rate this year will also have a negative sign and is projected to be -0.6 per cent. The fall in prices this year has mainly been

driven by prices for energy, in particular fuel, which have tumbled, pulled down by the slump in crude oil prices late last year and early this year. Annual inflation should return to positive territory in the near future as the base effect from the previous fall in crude oil prices fades out. However, inflation next year should be low given the continued environment of low inflation and will therefore have virtually no eroding effect on household purchasing power. In 2016, the average annual inflation rate is projected to be 1.4 per cent. In particular, the upward trajectory of non-energy prices will not be steep while prices for energy may continue to fall, albeit at a much slower pace than this year.

Outlook of Lithuania's economy in 2015–2016

	December 2015 projection ^a			September 2015 projection		
	2014	2015 ^b	2016 ^b	2014	2015 ^b	2016 ^b
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	0.2	-0.6	1.4	0.2	-0.5	1.5
GDP deflator ^c	1.2	-0.3	1.2	0.9	-0.3	1.3
Wages	4.7	4.8	5.0	4.7	4.5	4.9
Import deflator ^c	-3.0	-4.8	0.2	-3.1	-4.9	1.4
Export deflator ^c	-2.5	-2.9	0.1	-2.5	-3.4	1.3
Economic activity (constant prices; annual percentage changes)						
Gross domestic product ^c	3.0	1.7	2.9	3.0	1.6	3.2
Private consumption expenditure ^c	4.1	4.6	4.1	5.6	4.0	4.0
General government consumption expenditure ^c	1.2	1.8	0.9	1.6	1.8	1.2
Gross fixed capital formation ^c	5.3	7.5	2.6	7.8	5.9	3.3
Exports of goods and services ^c	2.9	0.8	3.3	3.4	0.7	4.0
Imports of goods and services ^c	2.8	7.3	3.6	5.6	3.4	4.2
Labour market						
Unemployment rate (annual average as a percentage of labour force)	10.7	9.4	9.0	10.7	9.6	9.1
Employment ^d (annual percentage change)	2.0	1.2	0.2	2.0	1.3	0.3
External sector (as a percentage of GDP)						
Balance of goods and services	1.9	-1.5	-1.9	0.0	-0.9	-1.1
Current account balance	3.3	-2.5	-3.5	0.1	-1.9	-2.8
Current and capital account balance	6.0	0.2	-1.6	2.9	0.8	-0.9

^a These projections of macroeconomic indicators are based on information made available by 13 November 2015.

^b Projection

^c Adjusted for seasonal and workday effects

^d National accounts data; employment in domestic concept