

## Lithuania's economic development and outlook

12 September 2016

**At the beginning of the year, global economic growth matched projections.** The growth of advanced economies was in line with forecasts, while developing economies even surpassed them. Due to the pursued accommodative policy, the economic situation in China exceeded growth expectations, whereas Russia's economic health deteriorated less than expected.

**The results of the UK referendum on membership in the European Union, however, weighted on the economic growth outlook for the upcoming few years.** Uncertainty over the future of economic and financial relations between the United Kingdom (UK) and the European Union (EU) as well as the underlying implications for their development and that of the global economy already does and will for quite some time impact the confidence of economic entities. This will have a dampening effect on economic activity, primarily in the UK. The spillover effect will be felt in other countries and regions as well. It is projected that advanced European economies, which are of high importance to domestic exporters, will experience the most adverse impact. Hence, the outlook for the international economic environment is seen as downgraded.

**So far, Lithuania's export sector is in a better state than last year.** Having been at a halt the previous year, real exports showed a year-on-year increase of 4.3 per cent during the first half-year of 2016. In the wake of a downturn and a reorientation into the West, the transport sector is expanding. The manufacturing sector, excluding oil refining, also sees increases in its output. In tandem with other branches of manufacturing, the food industry also supports growth in the sector. In the second half of 2015, the former started its recovery after the downturn it suffered when Russia imposed import sanctions. Nonetheless, export growth might follow a less favourable path in the remaining months of this year. Manufacturing, which will grow more sluggishly due to reconstruction in the chemical industry, might put a lid on export development. A deceleration in exports might also stem from the projected poorer levels of grain harvest yields.

**There are other factors that are limiting and will limit economic growth in the near future.** One of the major ones is significantly lower use of EU funds. Funds from the previous (2007–2013) EU financial perspective are no longer used, whereas funds from the current (2014–2020) EU financial perspective so far are only used sparsely. In the first quarter of this year, 71.9 per cent less of EU funds, intended to form the capital, were received on a year on year basis; these funds should only be used more extensively in 2017. Such use of EU funds reduces the volume of construction works. The situation in the construction sector is also aggravated by the reducing residential investment levels.

**A major factor behind the growth of the domestic economy remains the household-favourable situation in the labour market.** Currently advances in real wages have been the highest since the start of economic recovery. Such developments are primarily underpinned by a lack of adequately qualified staff (now the unemployment rate among qualified persons amounts to a meagre 6.5%). The rise in minimum wage also bolsters the growth in wages — this year approximately a quarter of the growth in average wages has been driven by this rise. Even though the search for new employees is complicated, total employment is rising. All this provides a positive boost to household income, and, consequently, to improving private consumption.

**Private consumption will remain an important factor behind economic expansion during the projection horizon of 2016–2017.** The situation in the labour market suggests that labour income will continue its upward climb, which will propel private consumption. Exports are expected to expand as well. However, given the projected dynamics in the international economic environment, and, at least partially, uncertainty related to the outcome of the UK referendum, the projection for the 2017 indicator of export is revised significantly downwards. Uncertainty caused by the UK referendum will have implications for investment developments as well; as a result, the 2017 investment forecast is also downgraded. It is expected that uncertainty fuelled by the results of the UK referendum might pull down the Lithuanian real GDP growth rate by 0.1 p.p. this year and by 0.2 p.p. next year. According to current projections, Lithuania's real GDP will expand by 2.3 per cent (previous projection — 2.6%) in 2016 and by 2.9 per cent in 2017 (3.3%).

**The overall price level follows a moderate upward trend.** The overall price level of the first seven months of this year exceeded the year-earlier figure by a meagre 0.5 per cent. As in the previous year, it is mostly exacerbated by the falling fuel prices brought

about by the drop in global oil prices recorded this year. Administered prices continued their downward trajectory: electricity, gas and heat energy prices are all lower than a year ago. The previous forecasts did not account for the reduction of some administered prices, as decisions related to them were taken later; in part, this also attributed to the inflation projection being lower. Unlike the above-mentioned prices, service prices are increasing albeit not as much as before. This was underpinned by advances recorded in private consumption and labour costs. Food prices are also increasing somewhat. This year saw a rise not only in unprocessed food prices that generally fluctuate quite considerably, but also in processed food (excluding alcoholic beverages and tobacco) prices. Last year, however, amid setbacks in the food industry, the latter prices decreased more than in Estonia, Latvia and the euro area on average. Current estimations suggest that in the remaining months the overall price level will rise marginally. It is projected that inflation will stand at 0.7 per cent in 2016 (previous projection — 0.9%). In 2017 inflation rates should pick up, as so far it is projected that next year global prices for energy commodities will exceed those recorded this year.

#### Outlook for Lithuania's economy in 2016–2017

	September 2016 projection <sup>a</sup>			June 2016 projection		
	2015	2016 <sup>b</sup>	2017 <sup>b</sup>	2015	2016 <sup>b</sup>	2017 <sup>b</sup>
<b>Price and cost developments (annual percentage changes)</b>						
Average annual inflation, as measured by the HICP	-0.7	0.7	1.8	-0.7	0.9	1.9
GDP deflator <sup>c</sup>	0.3	0.8	2.0	0.3	0.9	2.0
Wages	5.4	6.8	5.6	5.1	5.7	5.5
Import deflator <sup>c</sup>	-6.9	-4.0	1.7	-6.9	-4.0	1.5
Export deflator <sup>c</sup>	-3.9	-3.6	1.6	-3.9	-3.2	1.4
<b>Economic activity (constant prices; annual percentage changes)</b>						
Gross domestic product <sup>c</sup>	1,6	2,3	2,9	1,6	2,6	3,3
Private consumption expenditure <sup>c</sup>	4,8	4,3	3,9	4,8	4,3	3,9
General government consumption expenditure <sup>c</sup>	1,9	1,3	1,3	1,9	1,2	1,2
Gross fixed capital formation <sup>c</sup>	10,9	-3,7	6,5	10,9	1,3	7,2
Exports of goods and services <sup>c</sup>	-0,1	3,3	3,5	-0,1	2,9	4,2
Imports of goods and services <sup>c</sup>	6,0	2,3	4,1	6,0	2,9	5,2
<b>Labour market</b>						
Unemployment rate (annual average as a percentage of labour force)	9,1	8,0	7,5	9,1	8,3	7,9
Employment <sup>d</sup> (annual percentage change)	1,3	1,5	0,0	1,3	0,7	0,0
<b>External sector (as a percentage of GDP)</b>						
Balance of goods and services	-0,4	0,5	-0,1	-0,2	0,4	-0,3
Current account balance	-1,7	-0,4	-0,8	-1,7	-0,1	-0,6
Current and capital account balance	1,3	1,3	1,9	1,3	1,9	1,8

<sup>a</sup> These projections of macroeconomic indicators are based on information made available by 12 August 2016

<sup>b</sup> Projection

<sup>c</sup> Adjusted for seasonal and workday effects

<sup>d</sup> National accounts data; employment in domestic concept