

Lithuania's economic development and outlook

19 December 2016

This year, Lithuania's economic development was marked by considerable changes. Some economic activities, the situation of which was less favourable last year, found 2016 to be more successful, while the state of other economic activities deteriorated. Hence the entire economy showed sluggish acceleration in 2016. Nevertheless, the labour market continued to show evident developments, which first emerged several years ago: hiring intensified, shortage of qualified employees became more persistent, and pressures on wages were still strong.

In 2016, the export sector saw positive shifts. As the export market in Russia and other CIS countries shrunk, some exporters, primarily transport companies, had to seek new business opportunities. With Russia imposing trade restrictions and its economy suffering hefty losses, the volume of the activities of Lithuanian undertakings transporting cargo by road shrunk approximately by a sixth. Later, as provision of transport services picked up steam in other markets (largely in the EU), activity within the transport sector returned to its previous level. Slightly more pronounced economic expansion in 2016 was mainly supported by transport activities.

Advances in manufacturing (excluding mineral products) volumes in Lithuania were propelled by the boosting economy of major European trade partners, given that a large share of manufacturing output is exported. As in previous years, growth in manufacturing volumes was largely influenced by furniture production and manufacturing of wood products. Food and plastic product industries also saw positive developments, even though last year their volumes contracted.

So far, exports are expected to follow a consistent upward trend. It is projected that, in the coming years, global economic development, especially that of emerging market economies, will boost somewhat, as rising commodity prices will enhance economic growth in some countries. Economic expansion is also expected in advanced economies, including the euro area, where domestic demand is recovering, labour markets are regaining strength, and accommodative monetary policy is still ongoing, maintaining low interest rates and favourable credit terms.

However, there is risk that prospects for the export sector may be less favourable. For quite some time, such risk has been underpinned by expectations of less sustainable economic growth in Asian countries (namely, China). These countries may not necessarily be of high importance to Lithuanian exporters, yet they might be relevant to Lithuania's trade partners. Uncertainty over global external trade is also fuelled by protectionist ideas.

Risk related to trends of domestic economic development also becomes increasingly more paramount. Wages, which are increasing more than labour productivity, may have significant implications for enterprise competitiveness, especially if current trends in the labour market prevail. Such a scenario for labour market developments should not be discarded, as structural issues within Lithuania's economy have an impact on the labour market. With the birth rate in Lithuania falling significantly two decades ago, each year an increasingly smaller share of the younger population enters the domestic labour market. Such a negative trend will hold for at least several years, i.e. for some time fewer young employees will integrate into the domestic labour market. Moreover, emigration is still on an upswing. It shows no signs of abating; on the contrary, in recent years emigration even showed signs of upward momentum. Combating such economic problems is difficult and requires a lot of time. This means that in the near future shortage of staff will not be tackled, thus pushing up wages.

Recovering exports and the consumer-favourable situation in the labour market will be major factors behind economic expansion. Lower rate of unemployment and pronounced shortage of staff will continue to provide a positive boost to wages, which, in turn, enhance the prospects of households to consume. Prices, which will rise slightly more than this year, however, will probably eat into household purchasing power. In addition to exports and private consumption, investment will also fuel economic growth. As funds from the previous (2007–2013) EU financial perspective had no longer been used, the flow of EU funds to Lithuania reduced, since the implementation of projects financed with funds from the current (2014–2020) EU financial perspective has not yet gathered momentum. As a result, this year, total investment volume contracted, exerting strong downward pressure on construction activity. Construction production in 2016 plummeted more significantly than last year; it seems to have been weighing on the 2016 economic expansion the most. EU funds are projected to be used more extensively already in 2017, supporting recovery in investment. This

will add to stronger economic growth starting from 2017. According to current projections, Lithuania's real GDP will be 2.0 per cent higher than last year, whereas in 2017 its growth rate will increase to 2.4 per cent.

Unlike last year, inflation this year is positive and should boost further in the following year. Inflation is projected to stand at 0.6 per cent in 2016 and 1.9 per cent in 2017. As in recent years, price dynamics will be mainly driven by the changing trends in global commodity markets. Amid ample supply and not as high demand, global prices for energy sources had been falling until the beginning of 2016, before turning to an upward path later. It is projected that in 2017 these prices will rise partly owing to agreements to reduce oil production volumes. This means that energy source prices, which until now have had a dampening effect on inflation, will begin to raise it. The overall price level will increase further on the back of global food commodity and food prices. In the past few years, on account of large supply and accumulating reserves, these prices had dropped, yet this year, due to bad weather conditions, they began their upward climb. This swiftly hit consumer food prices in many countries, including Lithuania. In 2016, they followed a moderate upward trajectory, and should rise further in the next year. This year, underlying inflation, encompassing service and industrial goods prices, was higher than headline inflation; however, unlike in the previous two years, its growth rates were at a halt. With a rise in labour costs and substantial growth in domestic demand, underlying inflation should remain in the positive zone. It is projected to reach almost the same level as in 2016.

Outlook for Lithuania's economy in 2016–2017

	December 2016 projection ^a			September 2016 projection		
	2015	2016 ^b	2017 ^b	2015	2016 ^b	2017 ^b
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	-0.7	0.6	1.9	-0.7	0.7	1.8
GDP deflator ^c	0.3	0.7	2.0	0.3	0.8	2.0
Wages	5.4	7.3	5.7	5.4	6.8	5.6
Import deflator ^c	-6.7	-4.9	2.3	-6.9	-4.0	1.7
Export deflator ^c	-3.7	-4.2	1.9	-3.9	-3.6	1.6
Economic activity (constant prices; annual percentage changes)						
Gross domestic product ^c	1.7	2.0	2.4	1,6	2,3	2,9
Private consumption expenditure ^c	4.1	4.8	3.8	4,8	4,3	3,9
General government consumption expenditure ^c	0.9	1.2	1.2	1,9	1,3	1,3
Gross fixed capital formation ^c	5.0	-1.0	2.1	10,9	-3,7	6,5
Exports of goods and services ^c	-0.4	3.0	3.0	-0,1	3,3	3,5
Imports of goods and services ^c	6.2	2.0	3.4	6,0	2,3	4,1
Labour market						
Unemployment rate (annual average as a percentage of labour force)	9.0	8.0	7.4	9,1	8,0	7,5
Employment (annual percentage change) ^d	1.3	2.0	0.0	1,3	1,5	0,0
External sector (as a percentage of GDP)						
Balance of goods and services	-0.7	0.6	-0.1	-0,4	0,5	-0,1
Current account balance	-2.3	-0.7	-0.7	-1,7	-0,4	-0,8
Current and capital account balance	0.7	0.5	1.3	1,3	1,3	1,9

^a These projections of macroeconomic indicators are based on information made available by 18 November 2016

^b Projection

^c Adjusted for seasonal and workday effects

^d National accounts data; employment in domestic concept