Macroeconomic projections

September 2023

Contents

Lithuania's economic development and outlook **2**

Table 1. Outlook for Lithuania's economy 3

Lithuania's economic development and outlook

26 September 2023

The global economic situation is deteriorating. Although falling, global inflation remains high and has an adverse impact on household purchasing power. Economic activity is also restrained by higher interest rates which weigh adversely not only on the private sector, but also on the general government sector, especially in developing countries, as it is now harder for them to finance the various investments needed. The manufacturing sector is the main contributor to the deteriorating economic performance, and the situation is particularly bad in the euro area. With the weaker growth in demand for consumer goods, considerable economic and geopolitical uncertainty and higher borrowing costs, businesses are limiting their investment plans. This translates into a negative effect on the industrial production and international trade in goods. The growth rate of the services sector has also recently moderated. This sector saw a significant upturn in the first half of 2023, as post-pandemic demand for various services was still increasing at the time. With population mobility returning to its pre-pandemic levels, there is less and less room for the services sector to grow, and the weakening overall economic activity also has a restraining effect on the demand for services. For these reasons, growth projections of many countries and regions are being revised down, especially for 2024.

The Lithuanian economy improved in the middle of the year, but economic activity remains subdued. Real GDP is expected to be slightly lower this year compared to last year. The main drag on economic activity is the fall in industrial output. The deteriorating international economic environment, the rise in interest rates and the drop in temporary orders following the pandemic are aggravating the situation in the industry. The production capacity utilisation rate in this activity is lagging considerably behind the long-term average. Economic activity is also being held back by falling private consumption. While labour income has recently been growing more than prices, residents remain cautious and are not inclined to increase consumption. Real private consumption is projected to be lower this year compared to last year. However, not all economic activities are undergoing a downturn. As projects funded under the new EU Financial Perspective and the EU Recovery and Resilience Facility are implemented, there is an uptick in construction work. In particular, the construction of engineering buildings is increasing. The situation has also recently improved in the transportation sector. While the international economic environment poses challenges, the volume of road freight has grown significantly.

The labour market situation remains relatively good. The unemployment rate is close to 6%. In other words, unemployment is no higher now than it was before the shocks of the recent years. Anticipating that economic activity will pick up in the coming years, companies are making efforts to retain their existing staff. As a result, the total number of employed persons remains almost unchanged. This behaviour by employers leads to a fall in the value added per worker which has declined by around 3.5% over the last two years. Hiring expectations, however, are becoming more cautious. They are worsening in all major economic activities, but especially in industry. The composite indicator of employment expectations is below its long-term average. However, the deterioration in hiring expectations is relatively weak. The labour market situation is not projected to change significantly in the near future.

Lithuania's economic growth outlook is deteriorating against the backdrop of weakening global economic developments. While the outlook for real GDP growth is revised upwards for 2023, the projections for 2024 are revised down. This reflects, first of all, the less favourable growth projections of trading partners, in particular euro area countries, which have a significant impact on the development of Lithuania's exports. The exporting sector was previously expected to start recovering between 2023 and 2024 but is now projected to start growing significantly only in the first half of next year. Although households remain cautious and are not yet inclined to increase their consumption, private consumption is expected to grow next year as real income rises, thus contributing to an increase in overall economic activity. Economic development will also be spurred by EU support flows, which are expected to enhance during the projection horizon. After rising by 1.9% last year, real GDP is projected to fall by 0.6% this year and increase by 2.1% next year. This outlook implies that economic development will remain rather subdued in the coming quarters.

Sluggish global developments are reducing pressure on prices. Global supply chains are normalising due to both supply and demand factors, and tensions have eased significantly. This year, global oil prices in euro are foreseen to be lower by around one fifth, gas prices in the euro area by around two thirds and food prices on the EU market by around 2.5% year on year. This has a dampening effect on price developments in Lithuania. Over the last six months, the general price level in Lithuania has barely changed.[1] However, prices that are more closely linked to domestic economic developments, in particular prices for services, continue to rise quite significantly. A substantial rise in wage expenditure is contributing to such changes in service prices. Over the projection horizon, the latter prices are expected to be the main contributor to overall price increases in Lithuania, although the growth rate of service prices will slow down as labour costs will not rise as much as they have recently. Average annual inflation, which stood at 18.9% last year, is projected to fall to 8.8% this year and to 2.6% next year.

Table 1. Outlook for Lithuania's economy

	September 2023 projection[a]			June 2023 projection		
	2022	**2023[b]**	**2024[b]**	**2022**	**2023[b]**	**2024[b]**
Price and cost developments (annual percentage change)						
Average annual HICP inflation	18.9	8.8	2.6	18.9	8.9	2.7
Gross domestic product deflator[c]	17.0	8.8	2.8	17.0	9.0	2.9
Wages	13.3	12.4	9.8	13.3	11.1	9.3
Import deflator[c]	24.8	-5.6	-0.1	24.8	0.1	1.0
Export deflator[c]	15.6	-1.5	0.5	15.6	3.9	1.8
Economic activity (constant prices; annual percentage change)						
Gross domestic product[c]	1.9	-0.6	2.1	1.9	-1.3	2.7
Private consumption expenditure[c]	0.5	-0.4	2.7	0.5	0.4	3.2
General government consumption expenditure[c]	0.5	0.4	0.0	0.5	-0.2	0.0
Gross fixed capital formation[c]	2.6	6.7	3.3	2.6	6.3	3.6
Exports of goods and services[c]	11.9	-2.4	2.4	11.9	-3.0	2.9
Imports of goods and services[c]	12.4	-4.3	3.1	12.4	0.0	3.1
Labour market						
Unemployment rate (annual average as a percentage of labour force)	5.9	6.7	6.5	5.9	7.8	7.5
Employment (annual percentage change)[d]	5.1	-0.4	-0.6	5.1	-1.3	0.1
External sector (percentage of GDP)						
Balance of goods and services	-1.9	3.1	3.0	-1.9	-1.2	-0.7
Current account balance	-5.1	0.0	-0.4	-5.0	-4.0	-4.3
Current and capital account balance	-3.6	1.6	1.4	-3.4	-1.0	-2.4

[a] The macroeconomic projections are based on external assumptions, constructed using information made available by 22 August 2023, and other data and information made available by 31 August 2023.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] National accounts data; employment in domestic concept.

[1] Based on seasonally adjusted data.

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