Macroeconomic projections

June 2024

Contents

Lithuania's economic development and outlook

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Global economic activity is gradually strengthening. An early indicator of economic development – the Purchasing Managers' Index (PMI) – has risen above the 50-point threshold, which indicates economic expansion, in all major global economies (the US, China, and the euro area) after a prolonged pause. It is anticipated that global economic growth will reach 3.0–3.5% in the next few years. It should be noted that this level of global economic growth is somewhat lower than the average of the past decade. The economy of Lithuania's main trading partner, the euro area, will also gradually recover. After subdued economic growth in 2023–2024, it will return to a more typical annual growth rate of around 1.5% in 2025–2026. This recovery will be mainly driven by rising household consumption, growing foreign demand, and gradually recovering business investment. Signs of recovery are visible not only in GDP growth but also in international trade. After a period of weak global trade growth, when people consumed more services after the pandemic, global trade in goods is recovering. These trends, observed both globally and in the euro area, are favourable for small open economies like Lithuania. Compared to the estimates published in March, foreign demand for goods and services produced in Lithuania is projected to grow faster than previously anticipated over the projection horizon.

After a prolonged break, the value added created in the Lithuanian economy picked up more noticeably. In the first quarter of 2024, the activity of many economic sectors grew. In recent months, sales in the manufacturing sector, excluding refined petroleum products, were the highest since mid-2022. Retail trade turnover, which reflects household consumption trends, grew at the fastest pace since mid-2021. After a pause at the turn of the year, construction work volumes increased. A larger part of the services sector activities remained on the growth path.

Lithuania's economic recovery is supported by renewed growth in household consumption and a high level of investment. In the first quarter of 2024, household consumption expenditure surpassed its peak before the surge in inflation. As inflation fell, rising household real income was the main driver of higher consumption. Increased household consumption was also driven by improving household sentiment and diminishing caution. According to the consumer survey results, households view the major purchases at present and statement on the financial situation of households as the most favourable since early 2022, while the financial situation over the next 12 months is almost the highest since the start of data publication in mid-2001. Favourable economic trends are also observed in investment development. The investment-to-GDP ratio in 2023 was the highest since the global financial crisis. This is a favourable trend, given that the capacity utilisation rate in the economy remains significantly below the long-term average. Such behaviour by companies indicates that, despite experiencing difficulties in recent years, businesses in Lithuania retained quite a favourable outlook and made decisions that have increased the volume and efficiency of the capital stock. It is important to note that a substantial part of this investment growth is linked to the increase in EU funds, in particular from the Recovery and Resilience Facility (RRF). During its implementation period, around €4 billion are expected to reach the Lithuanian economy, with the largest inflows planned for this year and the next.

The development of exports in goods and services has been more resilient than expected. After a decline in 2023, the volume of exports of goods and services is stabilising and exports of goods with more value added are strengthening. In the first quarter of this year, the real export of goods of Lithuanian origin was already higher than a year ago. Sales abroad of the hard-hit chemical industry are slowly recovering, exports of machinery and equipment continue to grow, and exports of metals and food products are showing stronger signs of growth. Although the wood industry and export trends remain less favourable, positive signs should gradually emerge in this area as central banks start easing monetary policy, which should boost the activity of real estate markets. This resilience in the export of Lithuanian-origin goods is largely due to maintained competitiveness. For example, the export market shares of key product groups produced in and exported from Lithuania, excluding chemical products, are gradually returning to pre-2023 levels. The situation is less favourable in another high value-added export sector – services. On the one hand, exports of financial and insurance services grew particularly strongly in 2023, significantly influenced by the expansion into foreign markets of one bank registered in Lithuania. However, these positive trends were offset by stagnation in the export of transport services, which was negatively affected by the sluggish economic developments in the euro area and the recent correction of transport services prices.

Tensions in the labour market are gradually easing. At the beginning of this year, Lithuania's labour force indicator reached a level last seen 20 years ago. The continued rapid growth in the number of economically active residents has been driven by an increase in labour force participation and rising population. The latter is still affected by favourable migration trends. Although the growing labour force has so far been quite effectively integrated into the Lithuanian labour market, the latest administrative data of Sodra indicates that the number of insured persons has started to gradually decline since April. More cautious hiring expectations of companies are also reflected in the employment expectations indicator, which is now close to its long-term average. With the labour force growing rapidly and employment stalling, the unemployment rate in Lithuania has increased. In the first quarter of 2024, the unemployment rate rose to 8.2% and was 0.5 percentage points higher than a year ago. However, the increase in the unemployment rate observed in recent quarters should not be prolonged, and the economic recovery should not lead to a decline in demand for labour. This expectation is supported by the data on the number of unemployed persons without a job for less than one month: it has significantly decreased at the beginning of this year. Such developments in key labour market indicators point to a gradual easing of tensions in the labour market, which also has an impact on the slowdown in wage growth. It increased by 10.3% in the first quarter of this year – the slowest pace in the past two years. Nonetheless, historically, such wage growth remains strong. Against the backdrop of sluggish productivity growth, this remains one of the major risks to Lithuania's competitiveness.

A better-than-expected start to the year allows to expect a faster economic growth this year. Lithuania's GDP is projected to increase by 1.9% in 2024, before accelerating to 3.1% and 3.3% in 2025–2026, respectively. Household consumption expenditure will be the main driver of economic activity. The growth in expenditure will be driven by the continued strong increase in household income, it will also be supported by slower price growth, improving household sentiment, and a favourable labour market situation for employees. While a more balanced development of labour demand and supply implies a slowdown in average wage growth, its pace will remain solid. In addition, the unemployment rate, which has been increasing for several quarters, is expected to start decreasing again. This development will be influenced by growing exports of goods and services. Export development will benefit from maintained competitiveness and recovering foreign demand. However, it should be noted that in 2024–2026 foreign demand will grow at a slower pace than the long-term average, which should also lead to a more subdued expansion of exports than before the COVID-19 pandemic. Investments will also contribute to GDP growth. This year, the increase in the flow of EU funds should make a significant contribution to investment developments, while in the medium term they will be positively influenced by the growing economy. In this outlook for the economy, the distribution of risks around the economic growth profile in 2024 is balanced, while in 2025–2026 they are tilted to the downside. Slower than currently anticipated economic growth in the medium term could be influenced by less favourable economic developments in major trading partners, lower flows of EU funds, or a further escalation of global geopolitical tensions.

As the external factors that contributed to rising prices faded, the price level has remained relatively stable for a year. Owing to the fall in energy and other commodity prices, and the fading-out of the post-pandemic reopening effects, annual headline inflation remains subdued: it reached 0.4% in April and, driven by base effects, rose to 0.8% in May, according to preliminary data from the State Data

Agency. Within the structure of inflation, two components stand out: energy, which continues to put downward pressure on inflation due to cheaper energy resources, and services, which, significantly influenced by domestic factors, remain the main factor driving inflation. While labour market tensions are gradually receding and wage growth has moderated, it still remains high in the historical perspective. Unfavourable labour productivity trends only amplify the impact of rising labour costs. Considering these factors, it is expected that service prices will continue to rise at a similar annual rate (they increased by 6% in April) and will be the main factor driving inflation. With the situation in the raw materials market not changing significantly and the tensions in the labour market gradually receding, monthly price developments are projected to be close to typical developments. Taking into account these factors and slightly lower-than-expected data at the beginning of the year, it is projected that headline inflation in 2024 will stand at 1.2%. As the deflationary impact of commodity prices fades, inflation will increase to 2.4% in 2025 and 2026. Prices will rise for Lithuania, as a converging economy, at a typical pace. Core inflation, supported by domestic factors, will remain above pre-pandemic levels at 3.5% this year, before falling to 2.6% and 2.3% in 2025 and 2026, respectively.

Table 1. Outlook for Lithuania's economy

	June 2024 projection[a]			March 2024 projection		
	2024[b]	2025[b]	2026[b]	2024[b]	2025[b]	2026[b]
Price and cost developments (annual percentage change)						
Average annual HICP inflation	1.2	2.4	2.4	1.6	2.4	2.4
Gross domestic product deflator[c]	3.0	2.9	3.0	2.4	3.1	3.0
Wages	10.2	8.5	8.1	10.3	8.5	8.1
Import deflator[c]	0.4	2.6	2.5	0.8	2.9	2.7
Export deflator[c]	1.7	2.8	2.6	1.4	3.0	2.8
Economic activity (constant prices; annual percentage change)						
Gross domestic product[c]	1.9	3.1	3.3	1.6	3.1	3.3
Private consumption expenditure[c]	3.4	3.7	3.7	3.0	3.7	3.7
General government consumption expenditure[c]	0.1	0.0	0.0	0.1	-0.5	0.0
Gross fixed capital formation[c]	4.5	4.1	5.2	4.5	3.4	6.0
Exports of goods and services[c]	1.2	3.7	3.7	0.2	3.3	3.5
Imports of goods and services[c]	1.5	4.6	4.5	1.3	3.9	4.7
Labour market						
Unemployment rate (annual average as a percentage of labour force)	7.3	7.1	6.9	7.0	6.8	6.6
Employment (%, annual percentage change)[d]	0.5	-0.2	-0.3	-0.2	-0.3	-0.3
External sector (percentage of GDP)						
Balance of goods and services	4.5	3.9	3.5	3.6	3.2	2.5
Current account balance	1.8	1.2	0.5	0.5	0.2	0.1
Current and capital account balance	4.1	4.0	2.7	2.8	3.0	2.2

[a] The macroeconomic projections are based on external assumptions, constructed using information made available by 15 May 2024, and other data and information made available by 22 May 2024.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] National accounts data; employment in domestic concept.

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