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During the preparation of the Lithuanian Economic Review, the data of the Bank of Lithuania, Statistics Lithuania, the European Central Bank, Eurostat, the International Monetary Fund, *Bloomberg* and other data published up to 30 April 2014 were used.

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Abbreviations

%	per cent
CIS	Commonwealth of Independent States
ECB	European Central Bank
EU	European Union
Eurostat	statistical office of the European Union
FOMC	Federal Open Market Committee
GDP	gross domestic product
GS	government securities
HICP	harmonised index of consumer prices
IMF	International Monetary Fund
LTL	Lithuanian Litas
MFI	monetary financial institutions
p.p.	percentage point
rh scale	right-hand scale
US	United States of America
VAT	value added tax

ECONOMIC OUTLOOK

The external environment of Lithuania's economy has deteriorated. With the conflict between Russia and Ukraine continuing unabated, the economic outlook for Russia and the countries with close economic ties to Russia is getting gloomier. Already last year, the growth of domestic demand faltered in Russia. Private consumption was the only expanding component on the domestic demand side as the growth of investment stalled amid structural problems and toned-down expectations. Economic growth in Russia is expected to decelerate further this year amid heightened risks of a deeper decline in economic activity in the context of persistent geopolitical tensions and increased uncertainty.

Still, the effects of weaker economic growth in Russia on economic activity in Lithuania are expected to be minor. Closer economic ties with Russia exist in the country's transport sector, which provides approximately LTL 3 billion litas worth of services to Russia's entities annually, and this accounts for a sizeable proportion of the total transport services provided in Lithuania. Unlike the transport sector, the dependence of Lithuania's industrial undertakings on changes in Russia's economic development is relatively low. Exports to this country comprise just a few percentage points of Lithuania's industrial output. Economic ties between the non-tradable sector and Russia are rather limited, too. Aside from travel services, which are provided on a somewhat larger scale, the supply of financial intermediation, information and other services to Russia's entities is negligible.

The weakening outlook for the Eastern European trade partners is partly offset by the recovering economic growth in EU Member States. Economic confidence indicators in the EU are improving and domestic demand is starting to rebound. Some favourable developments are also observed in the labour market. EU-bound exports of certain Lithuanian industries have started to increase after a certain period of stagnation. These favourable changes in economic development in the EU are not expected to be short-lived; therefore, Lithuania's exports to this region should keep growing steadily, thus supporting activity in the manufacturing industry. However, the outlook for total exports is now weaker than expected, to some extent, due to the deteriorating outlook for the growth of Russia's economy, but, most importantly, due to challenging conditions for petroleum product production, which has been falling much faster than expected, due to unfavourable environment in the global market for oil refining.

Economic growth is mostly driven by domestic demand. Although certain confidence indicators have worsened slightly, the effects of changes in the external environment on private consumption or investment can still hardly be seen. Retail trade and, simultaneously, private consumption are growing at a healthy pace supported by the increase in real labour income. Most likely, the growth of investment has slowed down, as compared to 2013, which, however, is in line with expectations. Hence, the outlook for domestic demand has basically remained unchanged thus far. Still, there are heightened risks that private consumption and investment spending will grow at a slower pace than currently expected. This expenditure may be constrained by increased uncertainty in the tradable sector, which may affect wage development, new hiring and investment in the sector's undertakings, as well as by potential deterioration in expectations of other businesses and households.

The worse-than-expected developments in Lithuania's exports and their weaker outlook have led to a more cautious assessment of the prospects of the growth of the entire economy. Real GDP is projected to increase by 3.3 per cent this year (compared to the previous forecast of 3.6%) and by another 3.6 per cent in 2015 (previous forecast — 3.8%). Although growth projections have been revised down, economic activity is expected to continue growing steadily. Domestic demand should continue its gradual expansion, driven by income developments. Net exports are projected to be weaker than expected, which, however, will not produce any substantial adverse effects on economic growth.

Inflation remains low and its forecasts are stable. The average annual inflation rate is expected to reach 0.9 per cent this year before increasing to 1.5 per cent next year. Trends in the developments of the prices, which are related to the situation in the global markets for commodities and which have made the biggest contribution to the decline in inflation, should remain favourable for consumers. International institutions expect the global prices of food commodities to decrease this year. In addition, crude oil future data suggest that the prices of this commodity will drop as well. As before, domestic demand is not expected to create any significant inflationary pressures in particular, as the GDP is now close to its potential level and its envisaged growth is close to the estimated growth of potential GDP. The growth in unit labour costs, which picked up somewhat more in 2013 due to the increase in the minimum wage, should slow down considerably in the coming years; therefore, the rate of underlying inflation, as the component of inflation that is more dependent on domestic economic factors, will not grow substantially, either.

Outlook of Lithuania's economy in 2014–2015

	May 2014 projection			February 2014 projection		
	2013	2014*	2015*	2013*	2014*	2015*
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	1.2	0.9	1.5	1.2	0.9	1.5
GDP deflator	1.7	1.1	1.3	1.6	1.1	1.3
Wages (compensation per employee)	5.0	3.6	4.3	4.8	3.5	4.1
Import deflator	-1.5	0.3	0.8	-1.5	0.1	0.8
Export deflator	-1.4	0.6	0.9	-1.4	0.5	1.0
Economic activity (constant prices; annual percentage changes)						
Gross domestic product	3.3	3.3	3.6	3.2	3.6	3.8
Private consumption expenditure	4.7	3.5	3.6	4.3	3.5	3.6
General government consumption expenditure	1.9	1.7	1.7	2.1	1.7	1.7
Gross fixed capital formation	12.8	6.6	7.6	12.3	6.7	7.7
Exports of goods and services	10.3	3.9	6.1	9.3	6.3	6.7
Imports of goods and services	10.3	5.2	7.0	9.4	7.2	7.4
Labour market						
Unemployment rate (annual average as a percentage of labour force)	11.8	10.4	9.2	11.8	10.4	9.2
Employment (annual percentage change)	1.3	1.1	1.0	1.3	1.1	1.0
External sector (as a percentage of GDP)						
Balance of goods and services	1.1	0.2	-0.4	0.9	0.4	0.0
Current account balance	1.5	0.0	-1.0	0.9	0.1	-0.6
Current and capital account balance	3.7	2.2	1.1	3.1	1.9	1.3

* Projection.

I. INTERNATIONAL ENVIRONMENT

In 2013, as compared to 2012, the growth of the global economy virtually stopped decelerating and it remained relatively weak. The general global economic situation started mending in the second half of 2013, mostly with the contribution of advanced economies as the growth of the US economy picked up and the euro area economy returned to growth from the second quarter of 2013 after emerging from a year-and-a-half recession. Trends for the emerging market economies were worse and arguably the worst for Russia.

The global economy is growing at a rather slow pace; therefore, the major central banks continue to pursue accommodative monetary policy. Nevertheless, the US central bank was the first to start altering its monetary policy trajectory. Late last year, the Federal Reserve System decided to scale back its quantitative easing programmes from January 2014. The Bank is currently expected to end the schemes in the autumn. Other major global central banks, however, seem unlikely to move away from their current monetary policy course any time soon. For example, the ECB cut its key interest rate to a record low of 0.25 per cent in November 2013 and, with inflation in the euro area running very low, the biggest debate has been whether the Bank should add more stimuli. The Bank of Japan continues with its new asset purchase programme, commenced in the spring of 2013, and its governor argues that an exit from the accommodative policy would be premature since the Bank is still halfway to its inflation target of 2 per cent.

In 2013, the economic situation in the euro area improved gradually and in the fourth quarter the region recorded the first year-on-year rise in GDP after a nearly two-year break. Although the general sentiment about the economic growth outlook has improved and Cyprus should be the only euro area country to post a larger fall in GDP this year, the economic development of the entire region will remain slow for a while, dampened by high public and private debt loads, very high unemployment, rather slow progress in the structural reform effort, as well as very low inflation. With a negative inflation differential between vulnerable member states and their export markets, i.e. other euro area countries, being small, the competitiveness adjustment becomes more challenging. Geopolitical tensions surrounding Russia, which is a major trade partner for the region, in particular due to imports of energy commodities from this country by the euro area member states, has recently added to uncertainty about the economic outlook in the euro area.

As part of measures to address the problems afflicting the region, the EU institutions continued making important political decisions, many of which are related to efforts to create a banking union. In October 2013, the Single Supervisory Mechanism, which will be launched in November 2014, was adopted officially as the first pillar of the banking union. A preliminary deal on the second pillar, i.e. the Single Resolution Mechanism, was reached in March 2014, and the European Parliament adopted the necessary legislation in April. The agreement in its current form will set up a single bank resolution authority and a resolution fund. The aim of these measures is to ensure better coordination of the resolution of troubled banks in a country that is part of the Single Supervisory Mechanism, to improve its efficiency and facilitate the process. Late in 2013, the EU Member States also agreed on a deposit guarantee scheme. Such systems in place in the Member States will be aligned although will remain national.

The US economy gained momentum in the second half of 2013, although preliminary estimates for the first quarter of 2014 were weaker than expected. Recent data has shown improvements in the labour market, an approximately ten per cent annual gain in US house prices as well as

In 2013, the global economy grew at a slow pace, but the situation started mending in the latter half of the year, mostly with the contribution of advanced economies.

Table 1. GDP and inflation developments in some of the advanced and emerging countries

	2013	2014*	2015*
Real GDP change, per cent			
Advanced economies	1.3	2.2	2.3
US	1.9	2.8	3.0
Euro area	-0.5	1.2	1.5
Emerging market and developing economies	4.7	4.9	5.3
China	7.7	7.5	7.3
Russia	1.3	0.2**	1.0**
Inflation, per cent			
Advanced economies	1.4	1.5	1.6
US	1.5	1.4	1.6
Euro area	1.3	0.9	1.2
Emerging market and developing economies	5.8	5.5	5.2
China	2.6	3.0	3.0
Russia	6.8	5.8	5.3

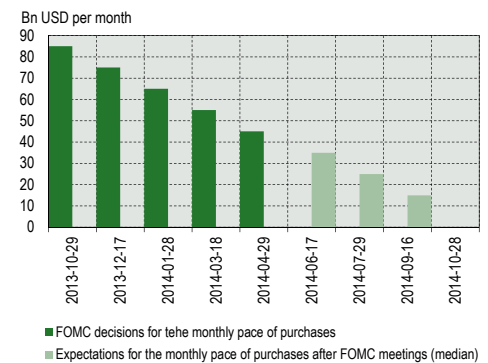
Source: IMF.

* Forecasts.

** Forecasts for Russia released in the concluding statement by the 2014 IMF mission.

The Federal Reserve System was the first among the major global central banks to start altering its monetary policy course. In January 2014, it started tapering its quantitative easing programmes.

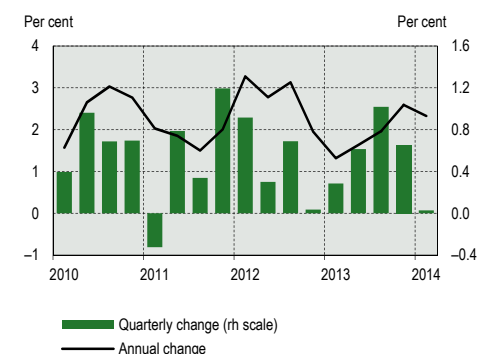
Chart 1. FOMC decisions and expectations for the size of the quantitative easing programs



Sources: Federal Reserve System, Federal Reserve Bank of New York.

Economic situation in the US is good; economic growth, which accelerated in the second half of 2013, should continue in the years ahead.

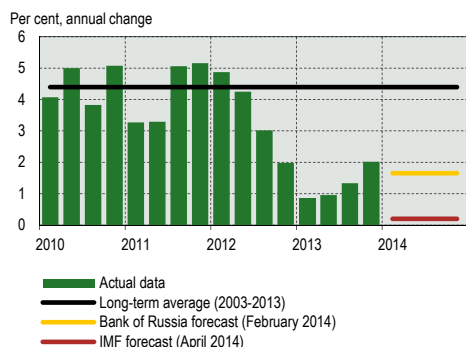
Chart 2. US real GDP development



Source: US Bureau of Economic Analysis.

Russia's economic growth is weak and the latest forecasts signal an even slower pace of development. Forecasts were primarily downgraded due to a Russia-Ukraine conflict.

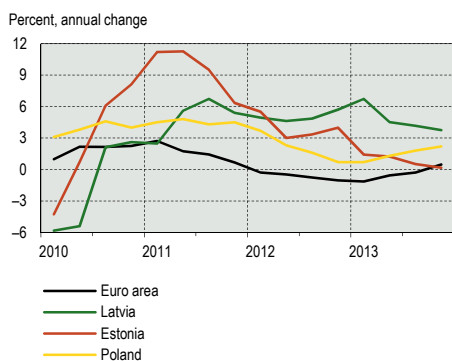
Chart 3. Russia's real GDP development and forecasts



Sources: Russian Federation Federal State Statistics Service, Bank of Russia, IMF and Bank of Lithuania calculations.

Economic trends in Latvia, Estonia and Poland are mixed. Estonia's economic growth has decelerated sharply, Latvia's economic growth has slowed down but still remains fast, whereas Poland has been regaining economic momentum. The effects of deterioration in Russia's economy will be more pronounced on the Baltic countries than on Poland due to close economic ties.

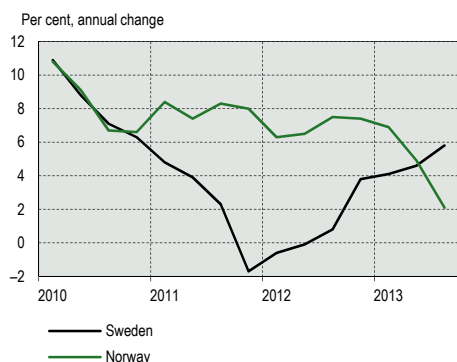
Chart 4. Real GDP development in Lithuania's major export partners, such as the euro area, Latvia, Estonia and Poland



Sources: Eurostat.

Improved economic trends in Sweden and Norway may be affected by substantial risks stemming from housing market developments. Norway entered a period of house price adjustment in the second half of 2013, whereas in Sweden the risks are exacerbated by high, and still rising, housing prices.

Chart 5. House price developments in Sweden and Norway



Source: Eurostat.

easing of lending standards for the country's enterprises and households. Economic growth in the US is expected to accelerate in 2014 and 2015, inter alia, thanks to final approval of fiscal decisions. In December 2013, i.e. more than two months late, the country's authorities reached a compromise on the US federal budget for fiscal years 2014 and 2015 and suspended the US debt ceiling for around a year, i.e. until 15 March 2015, in February 2014.

Russia's economic outlook continues to deteriorate, most recently mainly due to a Russia-Ukraine conflict. In 2013, Russia's GDP grew by just 1.3 per cent, which was less than one-third of the country's usual growth rates recorded in the past decade. Although the growth of Russia's economy was expected to accelerate in 2014, driven by more favourable global economic development, this likelihood has been increasingly diminishing. The conflict with Ukraine, which began early in 2014, has considerably heightened the uncertainty surrounding the country's further economic outlook. Russia's military actions negatively affected the country's financial market and the exchange rate of the rouble and triggered foreign capital flight. Around USD 50 billion in private capital left Russia in the first quarter of 2014 alone, which is rather close to the net outflow of USD 60 billion recorded in full 2013. Although the sanctions imposed against Russia by the EU and the US have thus far been more of a political nature and will not have any major effect on the country's economic development, they have hurt confidence considerably and heightened the general uncertainty. Moreover, domestic demand will also be weighed down by the decision of the country's central bank to raise its benchmark interest rate substantially in response to the rouble's weakening and high inflation. Therefore, the latest forecasts expect the growth of Russia's economy this year to remain almost unchanged from 2013 or even slower.

Economic trends in Lithuania's other major export partners, including Estonia, Latvia and Poland, are rather mixed. Estonia's economic growth decelerated sharply in 2013 and virtually came to a standstill in the final quarter. Low economic growth was mostly due to slower demand growth in the country's export markets. The pace of Latvia's economic growth slowed down as well but still remained the strongest among the EU countries. Despite expectations of positive effects from accelerating foreign demand, in particular the recovery of the euro area economy, on the economies of these countries in 2014, developments in Russia have considerably heightened the uncertainty surrounding further economic development. In contrast to the Baltic countries, Poland's economic growth is accelerating, supported by domestic demand. Poland's economic growth prospects are also better due to the fact that the country, unlike Latvia or Estonia, is less dependent on economic development in Russia.

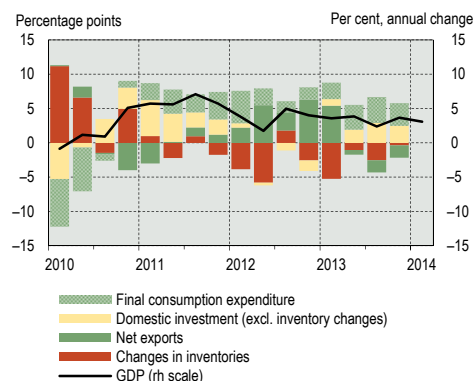
Economic development in Scandinavian countries, which are relevant for Lithuania's financial system, was sluggish. The best situation was observed in Sweden, which saw a rather unexpected rebound in economic growth in the fourth quarter of 2013 after a slowdown in the middle of the year. The rebound was triggered by private consumption, which should continue growing amid positive effects from low inflation, improvements in the labour market and plans to continue with expansionary fiscal policy. The biggest risks for the economic growth in Sweden stem from high private sector indebtedness and further growth in already high housing prices. In response, the country's central bank has tightened mortgage lending standards (and intend to tighten them further) in order to curb lending growth. In Norway, economic growth decelerated by a noticeable margin last year, primarily due to a fall in exports and far slower growth in household consumption. Similar to Sweden, major downside risks to future economic expansion in Norway stem from the level of private sector indebtedness. Moreover, in the second half of 2013 the country entered a period of housing price adjustment, which is expected to continue into 2014. The small and open economy of Denmark, which is strongly dependent on the economic situation in the euro area, entered the recovery

mode as late as in the latter half of 2013. This year, the Danish economy is expected to grow, capitalising on more favourable global economic development. Finland's economy was in the weakest state, compared to its Nordic neighbours. The country's economy is weighed down by weak external and domestic demand. Slow growth in wages, gradual increase in unemployment and fiscal consolidation measures, which the government implemented in 2013 and intends to continue this year, dampen the purchasing power of households.

II. REAL SECTOR

In 2013, domestic demand was the main driving force of economic growth.

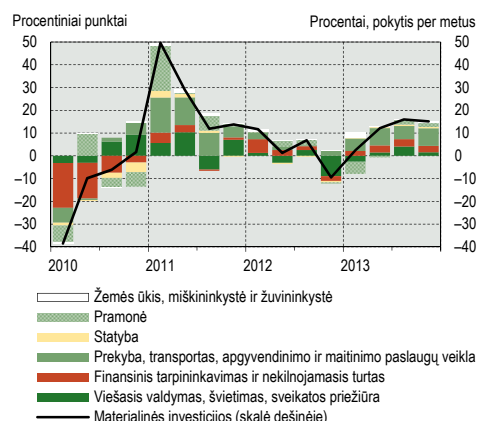
Chart 6. Contributions to the development of real GDP by expenditure approach



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Investment increased in many economic activities.

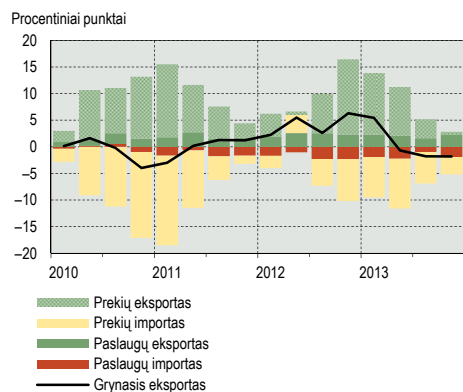
Chart 7. Investment into fixed tangible assets by economic activity (at constant prices)



Šaltiniai: Lietuvos statistikos departamentas ir Lietuvos banko skaičiavimai.

In the second half of 2013, net exports put a drag on GDP growth, which was last observed in the beginning of 2011.

Chart 8. Contribution of real net exports of goods and services to annual GDP growth



Šaltiniai: Eurostatas ir Lietuvos banko skaičiavimai.

Lithuania's economy continues to grow sustainably and at a relatively fast pace. As a result, the negative output gap, which built up during the downturn, was virtually eliminated at the end of 2013. Economic growth, in particular in the latter half of the year, was fuelled by more dynamic domestic demand, amid acceleration in the growth of both private consumption and investment. Domestic demand partly offset adverse effects from net exports, which arose from a substantial deceleration in export growth. Such trends proved to be sufficient for Lithuania to remain one of the fastest growing economies in the EU.

A rather high rate of production capacity utilisation, which has been observed for some time, coupled with a favourable view on the global economic outlook, are seen as one of the main drivers of corporate investment. Data for investment into fixed tangible assets indicates growth in investment into capital goods and buildings in many economic activities, with the fastest growth observed in the activities, which already in 2012 saw their capital output ratio fall to one of the lowest levels since the beginning of data collection. Most of this investment came from own resources or from EU funds. The second half of the year also brought a significant growth in investment in civil engineering structures, in particular road and rail infrastructure. This type of investment is most contingent on the decisions taken by the public sector. It should be noted that this investment also made a significant contribution to construction activity. Further development of investment is clouded by higher uncertainty. Exceptional circumstances in Eastern European countries may affect business expectations of future economic development and their investment decisions. Still, investment is expected to continue growing in the short term, although at a more subdued rate, as compared to 2013.

Favourable labour market developments, coupled with low inflation and household optimism, had a positive effect on private consumption. A pick-up in growth of employment and wages provided a significant boost to the pool of regular labour income, which is the key component of disposable household income. The incentive for households to consume is probably more affected by regular labour income than by any other type of disposable household income. Households stepped up consumption not only by saving less but also by taking a less active approach towards the reduction of their liabilities to MFIs. The development of private consumption followed changes in household sentiment, which, as shown by consumer survey indicators, was highly positive. For example, in late 2013, both the consumer confidence indicator and the household assessment of the financial situation reached their highest levels since the onset of economic downturn. The outlook for household consumption, same as the development of investment, is now surrounded by more uncertainty. Changes in the assessment of the economic outlook may affect household expectations, which in turn reduce their incentives to consume. Still, the latest high-frequency (monthly) economic indicators have not yet signalled any deterioration in development trends.

Net exports made a negative contribution to GDP in the second half of 2013, primarily due to the recovery of domestic demand and unfavourable developments in the global market for petroleum products. The recovery of domestic demand fuelled growth of imports, in particular of capital and consumer goods, whereas unfavourable developments in the global market for petroleum products undermined growth of exports. It should be noted that the positive effects on exports from agricultural harvest, observed late in 2012 and early in 2013, vanished as a result of a slight decrease in plant growing output, in particular grain and industrial crops, which mostly include rapeseed. These developments in domestic demand and the situation in the global market for petroleum products (for a detailed analysis of this factor see Chapter IV) will remain decisive in the development of net exports also in 2014.

III. LABOUR MARKET

As the main driving force of economic growth, domestic demand has led to fast growth in employment in the economic activities oriented towards the domestic market. In the second half of 2013, employment increased by 1.5 per cent, which was slightly above the growth rate (1.1%) recorded in the first half of the year. The expansion of employment was primarily due to a recovery in the construction sector, which recorded a fast growth in jobs amid increase in construction volumes. Another substantial contribution to the growth of employment came from the services sector, which stepped up its hiring activity in the second half of 2013 following a period of slow job growth, which was observed since the onset of economic recovery. A noticeable boost to this pick-up was brought by a one-off factor, i.e. the country's EU Council presidency in the second half of the year. The effects of the tradable sector, which includes manufacturing and agriculture, on employment have recently been negative. Last year, the growth of manufacturing, excluding oil refining, decelerated noticeably. This slowdown probably affected employment, which saw its growth decelerate in the first half of 2013 and fell below the year-earlier level in the latter half of the year.

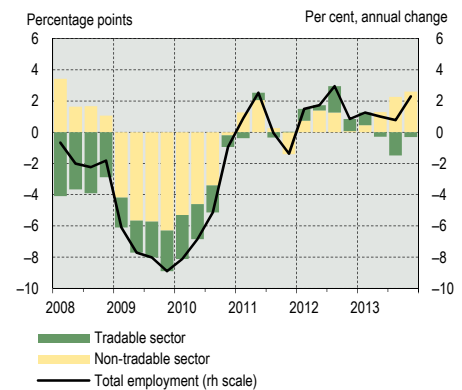
The unemployment rate decreased at a slightly more appreciable pace amid pickup in employment growth. In the second half of 2013, the unemployment rate was 11.2 per cent, i.e. 1.7 p.p. lower than in the same period of 2012. The fall in unemployment rate in rural areas, which was rather slow from the onset of economic recovery, picked up pace, although rural unemployment still remained nearly twice as high as the urban one. The youth unemployment rate decreased, as did the unemployment rate of lower-skilled workers. These rates, however, remain high at more than 20 per cent. More recently, the jobless ranks have been reduced substantially by the construction sector as the rise in construction employment has triggered a rapid fall in the number of unemployed workers who previously worked in that sector.

An increase in the minimum wage led to the fastest growth in wages since the beginning of economic recovery. In the second half of 2013, the annual growth of wages came to 5.5 per cent and was somewhat faster than in the first half of the year (4.5%). The fast growth of wages was triggered by a 17.6 per cent increase (to LTL 1,000, from LTL 850) in the minimum wage in January 2013. In percentage terms, this hike in the minimum wage was the largest since 1998. It is likely that it also had indirect effects on wages, in particular as the remuneration of the workers earning slightly more than LTL 1,000 increased as well. Wages of those workers could have been raised in order to ensure that higher-skilled workers earn more than lower-skilled ones. Acceleration in the pace of wage growth is also driven by factors other than the minimum wage. For example, noticeable wage growth can be observed in the construction sector. Until the increase in the minimum wage, wages in the sector grew at a pace of around 2 per cent. However, they had risen by 13.3 per cent in the second half of 2013. This fast growth cannot be explained by the increase in the minimum wage alone since the share of minimum-wage workers in the construction sector is not exceptional. To a large extent, fast growth in wages in this sector is likely to be driven by the sector's recovery.

If the growth of the economy remains driven by domestic demand, the situation in the labour market should continue to improve. Last year's recovery in the construction sector coincided with a substantial improvement in the sector's confidence indicators. Early this year, they continued to improve and were stronger than in 2013. Apartment building renovation, which has gotten underway, is also expected to have positive effects on employment in the construction sector. The outlook for employment in the services sector is more cautious since the employment effects from the EU Council presidency were temporary.

The non-tradable sector makes the biggest contribution to increase in employment as a result of growth of domestic demand.

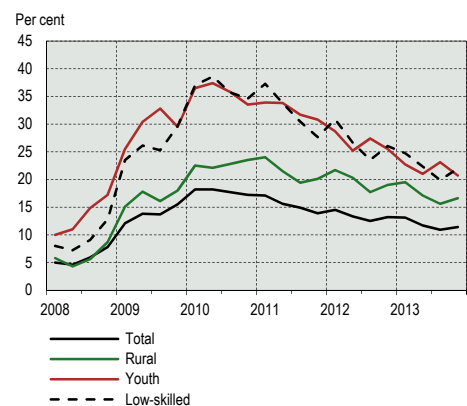
Chart 9. Employment in the tradable and non-tradable sectors



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Although unemployment rates for the youth, lower educated workers and rural areas have been decreasing at an appreciable pace, they remain high.

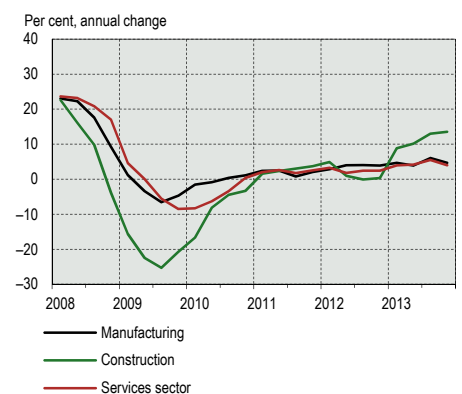
Chart 10. Unemployment rate



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Wage growth in the construction sector accelerated more than can be explained by the increase of the minimum wage.

Chart 11. Wages

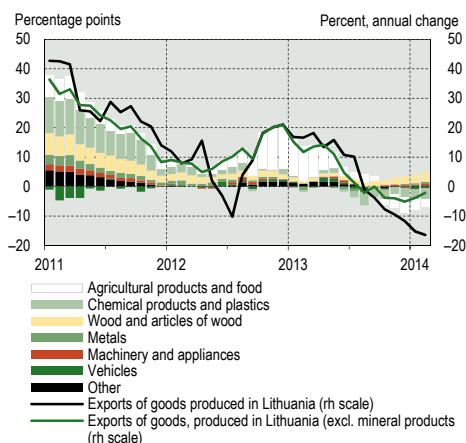


Sources: Statistics Lithuania and Bank of Lithuania calculations.

IV. EXTERNAL SECTOR¹

The decrease in exports of goods of Lithuanian origin is in particular driven by the exports of petroleum products, fertilizers and grain.

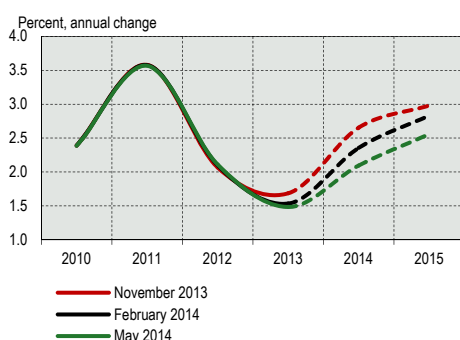
Chart 12. Contributions to the exports of goods of Lithuanian origin (three-month moving sum)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

The outlook for foreign demand in Lithuanian goods and services is more cautious. However, acceleration is still expected to materialise.

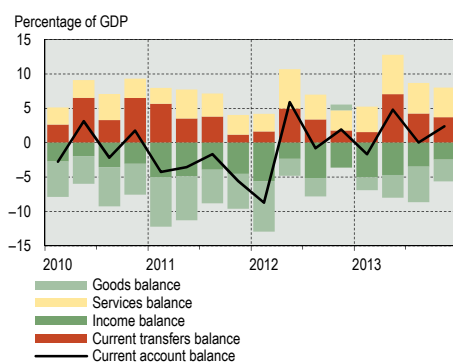
Chart 13. Developments in real GDP forecasts for Lithuania's main export partners



Sources: Bloomberg, Consensus Economics and Bank of Lithuania calculations.

In 2013, the current account showed a surplus.

Chart 14. Components of the current account balance



Sources: Statistics Lithuania, Bank of Lithuania and Bank of Lithuania

The performance of goods exports is deteriorating due to both weaker economic development in foreign trade partners and unfavourable developments in the markets for certain products. In 2013, the growth of exports was at least twice as slow as in the previous three years and the annual change in exports turned negative at the end of the period. That mainly resulted from still sluggish foreign demand, unfavourable environment in the markets for petroleum products and fertilizers and a fall in grain prices. Petroleum products, fertilizers and grain comprise more than one-fourth of total exports of goods, therefore, the performance of the exports of goods as a whole worsened substantially in the second half of the year amid a pronounced decrease in their foreign trade value. In the third quarter, exports showed an annual increase of just several per cent (3.4 %) and in the fourth quarter its volumes decreased (-3.4).² Restrictions on the exports of dairy products applied by Russia's services in the second half of 2013 and stepped-up checks of Lithuanian vehicles had a negligible impact on the general export performance in the abovementioned period.

Exports of goods of Lithuanian origin are in decline whereas re-exports continue to grow at a substantial pace. The performance of exports of goods of Lithuanian origin worsened consistently in the third and fourth quarter. In fact, this entire slump was driven by the abovementioned effects from petroleum products, fertilizers and grain. Export performance was mostly affected by a fall in refining margins in Europe in the second half of 2013, in particular in the fourth quarter. As a result, the nominal exports of the products manufactured by *AB ORLEN Lietuva* fell by approximately 15 per cent in the second half of the year from a year ago. This fall was triggered by both lower export quantities (due to changes in export incentives) and lower prices alike. In addition, some of fertilizer manufacturers scaled down their output due to a fall in prices for their products and high prices of commodities in the second half of 2013. Due to these reasons, Lithuania's fertilizer exports fell by more than 40 per cent during the last year. A decrease in nominal exports of grain was mostly triggered by price effects. The exports of other goods of Lithuanian origin were basically in line with foreign demand, i.e. their growth was very moderate but stable. It should be emphasised that the trends of re-exports were much more favourable. To some extent, such trends showed that a slowdown in the biggest re-export market (see Box 1), i.e. in Russia's economy, had moderate effects. However, the situation is likely to worsen in the future.

Further export development is particularly difficult to forecast in the current complicated geopolitical context. The aforementioned Russia-Ukraine conflict may negatively affect Lithuania's exporters. The performance of Lithuania's exports to Russia may also be affected by targeted restrictions. In addition, negative effects arise from a depreciation of Russia's currency (and the currencies of other CIS countries alike), which undermine the competitiveness of Lithuania's industrial products in that market. However, it should be pointed out that Russia accounts for less than 5 per cent of the goods of Lithuanian origin sold abroad, therefore, Lithuania's manufacturers would be less vulnerable to shocks in that market than re-exports. In addition, the performance of the exports of goods of Lithuanian origin is expected to improve on the back of the nascent recovery in the markets of euro area countries. However, a return to a substantial growth trajectory can hardly be expected unless the situation in the market for petroleum products changes radically.

¹ This section reviews nominal data of foreign trade in goods.

² It should be emphasised that price effects had a rather significant impact on the development of goods exports in the abovementioned period, i.e. in the third and the fourth quarter of 2013, price effects stripped 2.3 and 4.2 p.p., respectively, off the annual growth rates of the exports of goods.

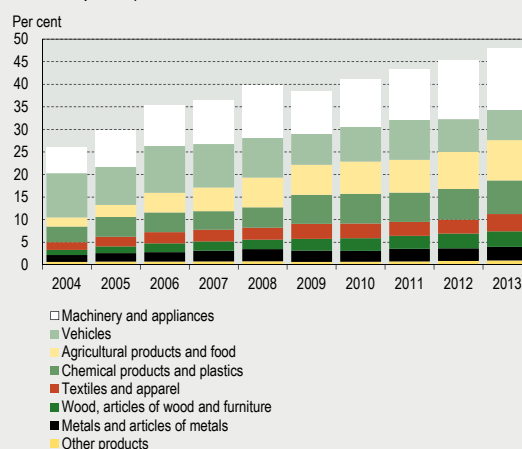
In 2013, the current account showed a surplus of 1.5 per cent of GDP. As compared to 2012, the current account balance improved as a result of increased surpluses in services and current transfers (by 29% and 49%, respectively). The balances of foreign merchandise trade and income remained virtually unchanged. In the second half of the year, the total current account surplus was smaller than in the previous six-month period and its development was smoother. To a larger extent, the fluctuations were driven by foreign merchandise trade due to the developments in the production of petroleum products and fertilizers, which were discussed earlier in this review.

Box 1. Structure and dynamics of Lithuania's re-exports

The economic literature defines “re-exports” as foreign goods that are exported in the same state as previously imported. Although re-exports are included in export/import flows, the factors driving the trends of their developments differ from the factors affecting the exports of goods of Lithuanian origin to some extent. For example, the exports of goods of Lithuanian origin are affected by the developments in unit labour costs in the country, but this factor is less relevant as far as re-exports are concerned. Re-export goods are manufactured outside of Lithuania; therefore, they partly distort the analysis of both export competitiveness and the structural indices relating to exports. The aim of this box is to analyse the structure and dynamics of re-exports in order to improve the understanding of their effects on exports.¹

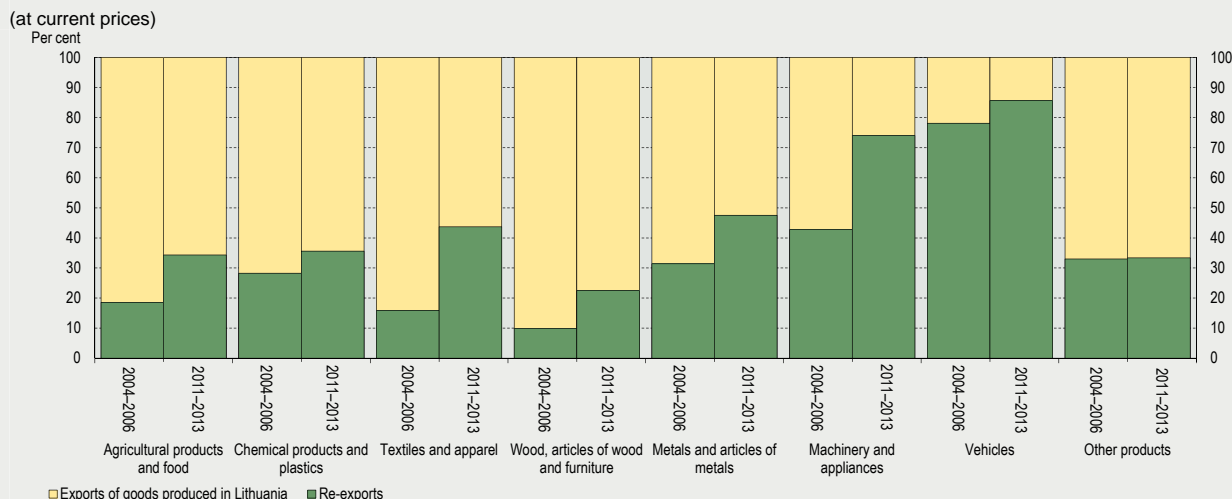
The analysis of export data reveals that the share of re-exports in total exports of goods grew continuously between 2004 and 2013 (see Chart A), with the exception of 2009 when a small decrease was recorded. The share of re-exports, which accounted for 26 per cent of the total exports of goods at the beginning of the analysis period, increased to more than 48 per cent over a decade. Fast growth of re-exports was mostly driven by re-exports of agricultural and food products, machinery and appliances as well as chemicals and plastics. At the end of the analysis period (in 2011–2013), re-exports of these goods also comprised a substantial share of the total exports of goods, i.e. re-exports of machinery and appliances accounted for 12.7 per cent, agricultural and food products — for 8.2 per cent, and chemicals and plastics — for 6.9 per cent. This general growth trend of re-exports excluded only re-exports of vehicles, which showed minor growth. The share of re-exports of these goods in the total exports of goods fell to nearly 8 per cent (in 2011–2013), from close to 10 per cent (in 2004–2006).

Chart A. Share of re-exports in total exports of goods by products (at current prices)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Chart B. Structure and dynamics of exports by groups of goods (at current prices)



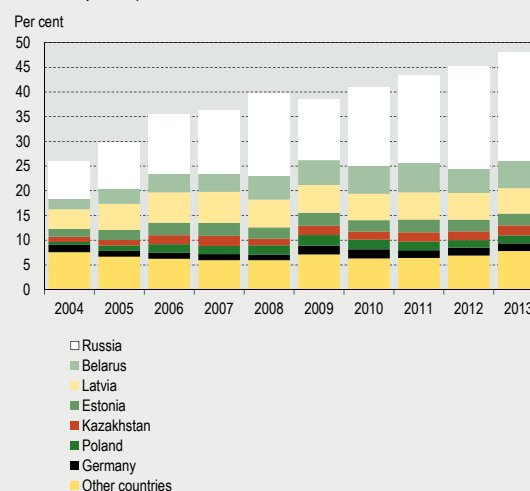
Sources: Statistics Lithuania and Bank of Lithuania calculations.

In addition to the general trends of re-exports and exports of goods of Lithuanian origin, the rise in the share of re-exports can also be seen from the analysis of more comprehensive data (see Chart B). The rise in the share of re-exports was particularly dynamic in the exports of machinery and appliances. In particular, re-exports of these goods increased to 74 per cent of their total exports at the end of the analysis period (in 2011–2013), from nearly 43 per cent at its beginning (in 2004–2006). This increase was mostly driven by re-exports of such goods as boilers, electrical machinery and equipment, sound recorders and reproducers, and parts thereof. Extra strong increase in the share of re-exports — of nearly 28 p.p. — was recorded for textiles and footwear, and re-exports of these goods accounted for nearly 44 per cent of their total exports at the end of the analysis period. The growth in this share was mostly propelled by re-exports of clothes and their accessories as well as footwear. The shares of re-exports of other groups of goods, including agricultural and food products, wood, articles of wood and furniture, metals and articles of metals, increased by 10–16 p.p. in the period covered by the analysis. The shares of re-exports of the former two groups of goods grew continuously throughout the period covered by the analysis. As far as the latter group of goods is concerned, the growth of its share of re-exports stalled between 2007 and 2011 but resumed again in 2012. Re-exports of wood, articles of wood and furniture were fuelled by steady growth in re-exports of the following three groups of goods during the entire period of analysis: furniture, including bedding and mattresses; paper and cardboard; and wood, articles of wood and charcoal. As far as the goods of the group of farm and food products are concerned, the growth of re-exports was uneven and the increase of the share of re-exports was driven by different products in different years. Still, the biggest contributions to the increase of the share of re-exports in the period of analysis were made by edible ices, vegetables and nuts. Somewhat smaller contributions came from soft drinks and alcoholic beverages. The dynamics of re-exports of metals and articles of metals was primarily based on ferrous metals and articles thereof. The shares of re-exports of other groups of goods, such as chemical products and plastics as well as vehicles, in the total exports of these goods increased as well but the rise was marginal.

The analysis of re-export structure in terms of trade partners reveals that those countries are geographically close to Lithuania and the changes in the key re-export markets were minor in the period covered by the analysis. Russia's market accounts for the biggest share of re-exports (for nearly 45 per cent of the total volumes of goods re-exported between 2011 and 2013). In the same period, sizeable shares of re-export goods were also shipped to Belarus (12%), Latvia (12%) and Estonia (5%). The structure of re-exports to all these markets is rather similar and dominated by re-exports of machinery and appliances, land vehicles, plastics and articles thereof as well as pharmaceutical products. The only notable exception that is worth a mention concerns edible vegetables and fruit, which were mostly exported to Russia. Re-exports of other products taken to these markets accounted for a relatively small share of total re-exports. The share of re-export goods, as compared to total exports, increased in all trade partners. However, the change was relatively negligible in many of these countries, with the only exceptions of Russia and Belarus. During the period covered by the analysis, re-exports to Russia, as a share of Lithuania's total exports of goods, increased to slightly more than 20 per cent (in 2009–2011), from nearly 10 per cent (in 2004–2006), and re-exports of Belarus — to 5.5 per cent from 3 per cent.

To sum up, re-exports made a significant contribution to the growth of exports in the period of the analysis and were among the key factors of growth in the exports of certain groups of goods, such as vehicles or machinery and appliances. Hence the results of any analyses of Lithuania's export competitiveness or export development should be interpreted cautiously with due consideration given to the effects of re-exports. This is particularly relevant in the analysis of exports of certain groups of goods, which include a sizeable share of re-exports.

Chart C. Share of re-exports in total exports by countries (at current prices)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

¹ The analysis is based on the Combined Nomenclature (CN) classification. Mineral fuels, mineral oils and products of their distillation as well as bituminous substances and mineral waxes (CN Chapter 23) are excluded from the data of total exports and the exports of goods of Lithuanian origin so as to avoid extreme fluctuations in structural indices caused by the effects of price developments in this group of products on the value of exports.

V. PRICES AND COSTS

Early in 2014, annual HICP inflation fell further from already low levels. It decreased to meagre 0.3 per cent in the first quarter of 2014, from around 0.5 per cent in the second half of 2013, mostly due to a larger fall in administered prices. In general, the current period of low inflation is attributable to consumer favourable global trends in prices for commodities: the prices for food commodities and crude oil are lower than a year before. The effects of such trends on consumer prices are also seen in other countries. Lately, the inflation has fallen substantially in many EU Member States (however, such changes in some of those countries are also driven by a decline in domestic demand, in addition to commodity prices); therefore, low inflation in Lithuania does not look so different among EU countries.

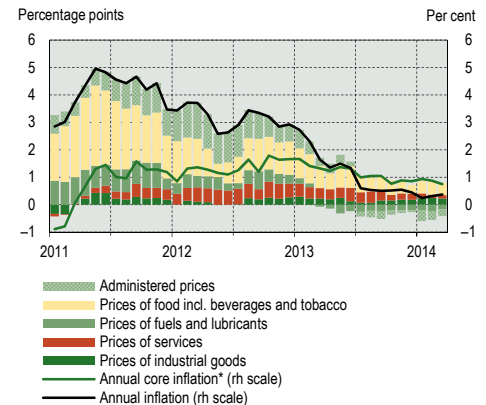
Different indicators related to consumer prices give rise to expectations that the inflation rate will remain low in the near term. Both import prices and industrial producer prices in the domestic market have recently been lower than a year before. Forecasts of global commodity prices, i.e. the forecasts of food commodity prices published by international institutions and the expected prices of crude oil derived from crude oil futures, are conducive to low inflation as well. Both food commodities and crude oil are expected to cost less in 2014 than they did in 2013. Pressure on consumer prices in Lithuania stemming from domestic demand is not expected to be pronounced, either. The GDP is now close to its potential level and the near-term growth of the economy will approximate the potential GDP growth rate, as estimated by the Bank of Lithuania. The wages, which jumped in 2013 due to the increase in the minimum wage, are expected to grow at a slower pace in 2014 while the growth of labour productivity is expected not to decelerate. Therefore, the increase in unit labour costs will be much less pronounced than in 2013. Limited anticipated growth of unit labour costs leads to expectations that core inflation will increase substantially.

Global prices of food commodities remain lower than a year earlier. Still, their fall is now less pronounced than before. According to the data of the Food and Agriculture Organization of the United Nations, the annual decrease in global food commodity prices narrowed to 1 per cent in March 2014, from nearly 5 per cent in January. In March, the fall was lower due to a smaller decrease in prices for grain and sugar and a reversal of the downward trend in the prices for oils. Such changes in the prices for these commodities stem from the trends observed in the past several months. For example, the growth of grain prices (and the reduction of their annual pace of decline) was fuelled by strong demand and several supply constraints, such as unfavourable weather conditions in the US and Brazil, as well as unrest in the Black Sea region. Sugar prices rose due to concerns about diminishing export supply in Brazil and Thailand, and the prices of oils — due to a dry spell in Southeast Asia, low inventories in Malaysia and increased demand in Indonesia.

Same as previously, the prices of different food commodities changed at various annual rates. The grain group was the only category of commodities to show a substantial year-on-year fall in prices. In particular, the prices of grain in March were 14 per cent below their level a year earlier. Several groups of commodities showed minor changes in prices. In particular, sugar prices decreased slightly over the year, meat prices remained unchanged and prices for oils showed a modest increase. As an exception, the prices of dairy products increased by approximately one-sixth in March 2014 from a year earlier due to lingering effects from the surge in prices observed in the spring of 2013 due to a substantial de-crease in milk supply in Oceania as a result of dry and hot weather.

Annual inflation rates are now even lower than in the second half of 2013.

Chart 15. Contributions to annual HICP inflation

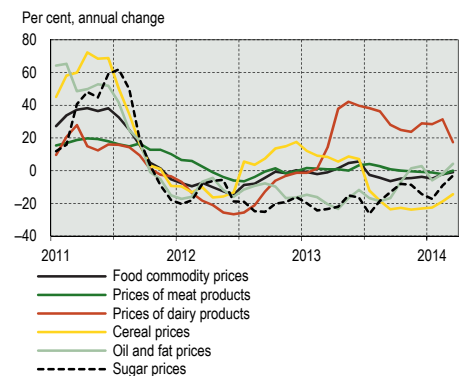


Sources: Statistics Lithuania and Bank of Lithuania calculations.

* Change in HICP excl. food, fuels and lubricants, and administered prices.

Global food commodity prices remain lower than a year ago.

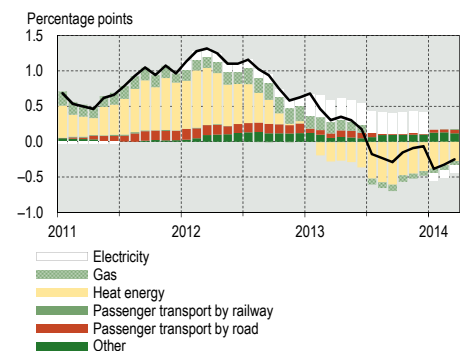
Chart 16. Global food commodity prices



Sources: Food and Agriculture Organization of the United Nations and Bank of Lithuania calculations.

Electricity prices for household consumers are now lower than a year ago and have a negative contribution to inflation.

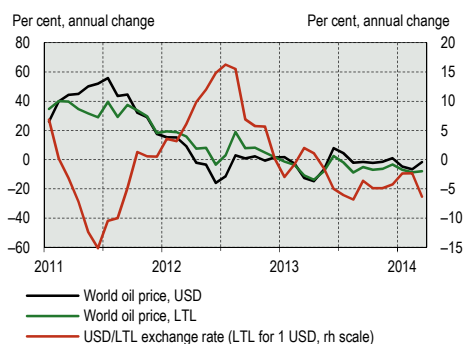
Chart 17. Contributions of administered prices to annual inflation



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Crude oil prices fell during the year (more steeply when expressed in LTL than when expressed in USD due to the development of USD/LTL exchange rate).

Chart 18. Global crude oil prices and US dollar rate



Sources: Bloomberg and Bank of Lithuania calculations.

This year, administered prices have been falling at a faster rate compared to late 2013. This development is mainly related to electricity: the calculations of annual changes in prices no longer include a substantial increase in the prices of electricity for household consumers early in 2013 (the prices rose by nearly one-tenth); in addition, the prices of electricity fell in January 2014 (by approximately 5%). In the first quarter of 2014, the key administered prices, such as heat, electricity and gas prices, were all below their year-earlier levels, and the biggest downward effect still came from heat energy, which is a component of the group of administered prices, having the biggest weight in the consumer basket. In March, the prices for heat energy fell by nearly 7 per cent year-on-year. Such trends are driven by falling prices for fuels used for heat production, in particular prices for imported natural gas, which is the main heat production fuel in Lithuania. Current developments in administered prices are highly favourable for consumers. However, an increase in prices for drinking water supply and wastewater management by as much as one-third in Vilnius in May will produce a certain upward effect (as estimated by the Bank of Lithuania, this will add approximately 0.1 p.p. to the annual inflation rate in May). These prices will increase due to the costs of newly commissioned sludge treatment installations, an increase in maintenance costs for the expanded water sector (new pipelines, wells and pumps), etc.

As of lately, the price of crude oil in litas has remained below its year-earlier level (by 8% in March). Therefore, the annual change of fuel prices in Lithuania, related to the developments in this price, remained negative (in March, fuel prices were 2.5% lower than a year before). However, the annual fall in the price of crude oil in litas is more pronounced than the fall in the price expressed in US dollars (this price was approximately 2% lower than a year earlier in March). This gap relates to the developments in the US dollar rate against the litas: the US dollar rate now is much lower than it was a year before. The analysis of changes in shorter, not annual, periods reveals signs of stabilisation in crude oil prices: the price of crude oil increased in the third quarter of 2013, as compared to the previous quarter, amid geopolitical tensions in certain Middle Eastern and North African countries (Egypt, Syria, Libya) and concerns about their spread across the region, but later remained relatively stable. In the recent six-month period (between October 2013 and March 2014) the price of crude oil ranged between USD 107 and 111 per barrel.

VI. CREDIT AND DEPOSITS³

In 2013, the portfolio of loans issued by the MFIs decreased by 1.8 per cent, or LTL 1.1 billion, mainly due to the repayment of loans by the private sector⁴, which was somewhat offset by an increase in lending to the central government. The loan portfolio of MFIs changed in structure in November 2013. In the present period, the amount of loans issued to financial intermediaries has decreased and the amount of loans extended to non-financial corporations has increased, as one bank has integrated its leasing subsidiary into its structure.

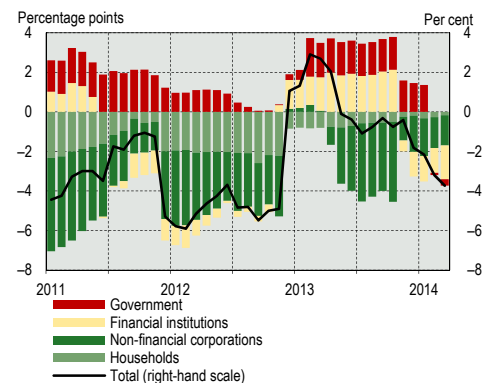
The financial health of the banks' top borrowers — businesses and residents — improved but only some of them resorted to borrowing. In 2013, sales revenues of non-financial corporations reached their highest point since the beginning of data collection and the profit earned over the year hit the highest level since the economic downturn. Profitable companies accounted for nearly two-thirds of all businesses and expectations by non-financial corporations, halfway through 2013, were positive and higher than the long-term average. Fast growth in activity of non-financial corporations left some of them with a shortage of adequately skilled labour force. This improved the situation in the labour market and contributed to the strengthening in the financial position of households. In the fourth quarter of 2013, as compared to a respective period in the previous year, the number of employed increased by 2.3 per cent and the average gross monthly wages rose by 4.8 per cent. The consumer confidence indicator exceeded the 10-year average in 2013 amid improvements in the financial situation of households. As a result, households became more optimistic in their expectations and the proportion of households, which intend to purchase a durable item (housing, a car) or to build housing within the next twelve months, had increased. In 2013, the portfolio of loans extended to the private sector decreased⁴ by LTL 1.2 billion (and by further LTL 0.3 billion in the first quarter of 2014), however, the amount of consumer loans and housing loans extended to households increased.

There are increasing signs that the loan portfolio may be expected to recover gradually in the future. For example, the financial health of households and non-financial corporations is improving and their expectations about future economic development are becoming more positive. Moreover, interest rates have been low for the recent several years and the lending standards are becoming more lax.⁵ These factors may encourage consumption and/or investment from borrowed funds. However, geopolitical risks in the Eastern Europe may undermine the inclination of households and businesses to borrow.

In 2013, interest rates on new loans issued by the MFIs to the private sector remained virtually unchanged. Interest rates on new loans are mostly fixed for less than one year; therefore, a substantial impact on still-low interest rates came from accommodative monetary policy in the euro area. On the other hand, the situation started to change in the latter half of 2013 and the beginning of 2014 and the banks started increasing their margins for new loans for households and non-financial corporations. In March 2014, the interest rates on new loans to the private sector were 3.3 per cent.

The loan portfolio of MFIs recovered slightly early in 2014, although the annual change remained negative.

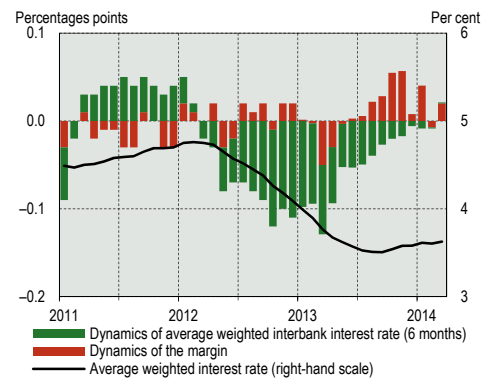
Chart 19. Contributions to annual changes in MFIs' loan portfolio



Source: Bank of Lithuania calculations.

New loan interest rates started to increase halfway through 2013.

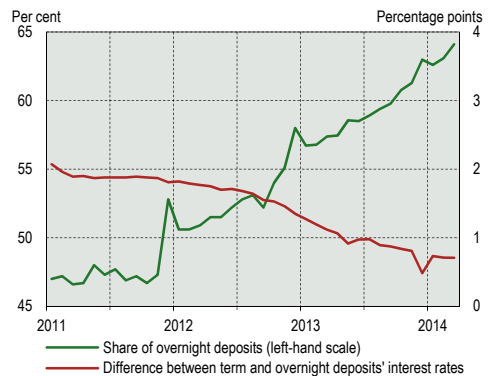
Chart 20. Contributions to changes in interest rates on new loans to the private sector (12-month moving average)



Sources: www.euribor-ebf.eu and Bank of Lithuania calculations.

Interest rates, which remain extremely low, trigger changes in the structure of private sector's deposits with banks.

Chart 21. The development in the structure of private sector's bank deposits and the spread in interest rates



Source: Bank of Lithuania calculations.

³ In this section, the data used for the evaluation of loans and deposits include the data for MFIs provided by the Statistics Department of the Economics and Financial Stability Service at the Bank of Lithuania. It may differ from the data collected from banks for supervisory purposes (e.g. this data shows a 0.4 per cent increase in the loan book in 2013).

⁴ As the Bank of Lithuania announced insolvency of *AB Ūkio bankas* and the Lithuanian branch of *AS Unicredit Bank* withdrew from the market, the loan portfolio of MFIs had decreased due to the exclusion of those institutions from the official statistics.

⁵ Bank surveys on lending terms and conditions carried out by the Bank of Lithuania.

At the end of March 2014, the amount of residential deposits with the MFIs totalled LTL 47.9 billion and was the biggest in twenty years.

At the end of the abovementioned period, the growth of deposits was mostly driven by an obvious increase in household deposits. Interest rates on all new deposits of the private sector (with maturity of over one month) increased from mid-2013 and reached 0.5 per cent in March 2014. However, the narrowing in the spread between interest rates on term and overnight deposits continued modifying the structure of the deposit book, which was reflected in a decrease of term deposits with banks.

VII. GENERAL GOVERNMENT FINANCE

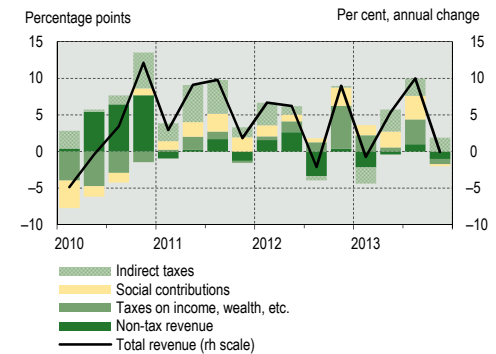
The financial situation of the general government improved, as compared to the first half of the year. At the end of 2013, the ratio of four-quarter general government deficit to GDP was 2.2 per cent. The decrease in deficit was due to both a 4.5 per cent annual increase in the general government revenue in the second half of the year and a 1.6 per cent annual decrease in expenditure. The ratio of four-quarter general government revenue to GDP shows that the growth of general government revenue in the second half of the year was broadly in line with the growth of GDP at current prices. The latter ratio was 32.2 per cent at the end of the second half of 2013 and was almost unchanged from the value observed in the first half of the year. The ratio of four-quarter general government expenditure to GDP continued to decrease. In particular, it contracted by more than 1 p.p. from the first half of the year to reach 34.4 per cent at the end of the second half. According to preliminary estimations broken down by institutional sectors, in the second half of the year, the decrease in general government deficit was mostly triggered by the surplus of the central government budget⁶, which replaced the deficit recorded in the first half of the year. An additional contribution to the decrease of general government deficit came from a fall (as a result of continued improvements in the labour market) in the deficit of social security funds in the second half of the year, as compared to the previous six-month period. Local governments were the only general government subsector to show an increase in deficit in the second half of the year from the first half-year. The increase in the deficit of local governments, which is observed each year in its second half, may be related to a tendency to undertake additional liabilities, which grows stronger whenever the revenue exceeds the target. This view is corroborated by the data of the State Tax Inspectorate, which shows that actual revenues of local authorities exceeded the planned amount by 4.2 per cent in the first three quarter of 2013.

In the second half of the year, the growth of general government revenue was mostly driven by the tax revenues supported by the positive effects stemming from an increase in payroll fund and the resulting rise in private consumption, as well as by a nearly 10 per cent increase in taxable profits. The analysis of revenues from individual taxes shows that the growth in general government revenue in the second half of the year was mostly driven by VAT revenue, which grew at a faster rate than in the first half of the year. Presumably, this acceleration was mostly due to the measures to improve the efficiency of tax administration taken by the Finance Ministry of the Republic of Lithuania in response to weaker than expected VAT collection in the first half of the year. This assumption may be supported by the fact that the growth of private consumption in the first and the second half of the year was relatively steady. The measures to improve the efficiency of tax administration might also have contributed to the collection of excise duty revenue, which grew at a faster rate in the second half of the year, compared to the first half, in particular the revenue on energy products and manufactured tobacco. In addition, stronger positive effects on the excise duty revenue in the second half of the year came from the increase in excise duty rates for diesel fuel and tobacco in the first quarter of 2013, as well as from a rise in diesel volume sales. Annual growth in the general government revenue from direct taxes slowed down noticeably in the second half of the year from the first half, mostly due to a smaller increase in revenue from the personal income tax. According to the latest national budget data, in the first months of 2014, tax revenues grew at a

⁶ Central government budget is a framework of revenues and appropriations of the central government budget adopted by the Seimas of the Republic of Lithuania for a budget year. Appropriations of the central government budget are managed by the authorities designated in Article 4 of the Republic of Lithuania Law on the Budget Structure.

In the second half of the year, the growth of general government revenue was mostly driven by larger tax revenues and social contributions.

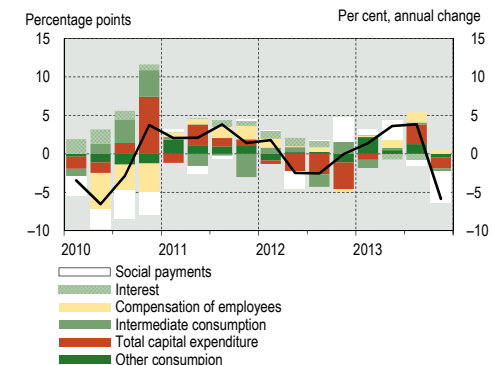
Chart 22. Contributions to the development of general government revenue



Sources: Statistics Lithuania and Bank of Lithuania calculations.

General government expenditure fell sharply in the second half of the year due to year-on-year decreases in social benefits and intermediate consumption.

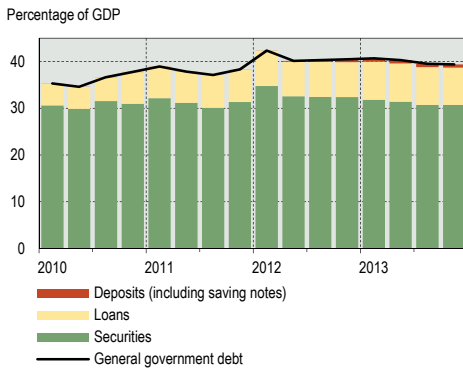
Chart 23. Contributions to the development of general government expenditure



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Following four years of growth, the government debt-to-GDP ratio decreased in 2013, mostly due to favourable macroeconomic circumstances.

Chart 24. General government debt



Sources: Ministry of Finance and Bank of Lithuania calculations.

faster rate than in the second half of 2013, but still missed the target. The total national budget revenue target was only met as a result of above-target budget revenue of local governments and revenue from property transactions.

In the second half of 2013, the decrease in general government expenditure was mostly due to a sharp fall in social benefits and intermediate consumption. Social benefits decreased as a result of a nearly 10 per cent fall in spending on pensions and maternity/paternity insurance. A decline in retirement benefits in the second half of the year is hard to explain in particular as the authorities did not adopt any decisions reducing these benefits in 2013. This decline may partly be attributed to a rather sizeable increase in these benefits at the end of 2012 and the resulting substantial decrease in benefits in the fourth quarter of 2013.

Presumably, the decrease in maternity/paternity benefits was affected by amendments to their payment provisions made in previous years, as well as by the lowering of the benefit ceiling. Intermediate consumption was down due to a substantial decrease in spending on heat, which most probably resulted from a decline in heating prices triggered by a fall in natural gas prices, as well as by higher than usual temperatures in the winter months. The main factors driving up the general government expenditure included a more than 3 per cent annual increase in worker remuneration in the second half of the year and a twofold surge in capital transfers. The remuneration of workers increased partly due to length-of-service bonuses paid to public officers, as well as the restoration of basic salary coefficients of public officers and qualification bonuses to the level of 2009 pursuant to the ruling of the Constitutional Court in October. The growth of capital transfers was driven by derecognised loans. The latest monthly central government data shows that the growth of general government expenditure has accelerated of lately, as compared to late 2013. This is mostly due to a pick-up in the growth of interest payments, intermediate consumption and social benefits. Acceleration in the growth of interest payments is triggered by calendar shifts in interest payments where the government securities are redeemed at the end of the year using the money raised in the beginning of the year.

General government debt increased by approximately LTL 0.2 billion in the second half of the year, but its ratio with the aggregate amount of four-quarter GDP decreased to 39.4 per cent as a result of fast growth in gross domestic product. Long-term government securities issued in the domestic market accounted for three-fourth of the increase in debt. The number of saving notes increased as well. A breakdown by institutional sectors shows the biggest increase in debt for social security funds in the second half of the year as a result of loans obtained from domestic commercial banks. That debt accounted for 9.2 per cent of GDP at the end of 2013 and this ratio increased by 0.7 p.p. compared to in 2012. The latest monthly data shows that the general government debt should increase in the first quarter of 2014 due to a new EUR 500 million bond placed on the international market. The bulk of receipts from this issue will be used to redeem the 2009 Eurobond in June 2014. Hence, the general government debt should decrease again in the second quarter.

⁷ This means that the "snowball" effect, which indicates the effect of interest rate paid for the debt and the growth of the economy's output to the government debt to GDP ratio, was favourable. The law of motion of the debt-to-GDP ratio is usually defined as follows: $d_t = (1 + r) / (1 + g) d_{t-1} - p_t + a_t$, where: d — the debt-to-GDP ratio, p — the general government primary deficit to GDP ratio, a — the general government balance and debt change difference (also called debt change adjustment) to GDP ratio, $(1 + r) / (1 + g)$ — the "snowball", where r — interest paid for the debt, g — growth of economic output.