



Economic Outlook for Lithuania

19 August 2010

Compared to the previous year the situation in global economy improved. Real sector rebound, particularly in Europe, financial support to Greece and ECB efforts to ensure financial stability positively affected financial markets. However, public finance situation still remains a concern. Thus a wide-scope fiscal consolidation is planned in many EU Member States. Along with dissipating effect of policy stimulus in different countries and slowing Chinese economy it may induce a setback in the global recovery in the coming years.

Projections for real GDP of Lithuania stayed unchanged. The growth of 0.5% and 3.1% is expected for this and the coming year respectively. Forecast for 2010 have not been changed since the data for GDP in the second quarter was broadly in line with the expectations: in the second quarter, annual GDP growth was positive for the first time after one year and a half. As expected, quarterly decline in the first quarter, in large part related to the effects of the closure of Ignalina nuclear power plant, was short-lived. In the second quarter, compared to the first one, GDP grew by nearly 3% and confirmed the expectations of more sustainable economic recovery.

Although the projections for GDP growth remained the same, forecast for the dynamics of GDP components was changed. In the first quarter of 2010, real domestic investment, particularly investment in construction, fell more than previously expected. Construction should not recover rapidly, therefore, even growing investment into the means of production will not offset the effect of plunging investment into construction on total investment. Thus, decline of real domestic investment in 2010 (15.0%) will be considerably stronger compared to the projections in May. As investment will start to increase from the low level (corresponding that of 2002 and 2003), its growth is expected to be double-digit in 2011.

Compared to May, projections for private consumption in 2010 were revised upwards. This basically offsets the negative impact of reduced investment projections on domestic demand. According to the revised data of Statistics Lithuania, private consumption expenditure reached its trough at the end of 2009. More positive trends might also be proved by a continued improvement in retail trade in the second quarter of 2010. However, growth of private consumption will be relatively slow: it will be impeded by high unemployment, sluggish wage growth and increased saving of consumers as they became wary of the economic outlook and personal income prospects. In 2011, household expenditure is expected to reach just the level of the second half of 2005.

The recovering private consumption will foster import growth within the projection horizon. In the first quarter of 2010, import was already higher than a year ago, and preliminary data of the second quarter indicates further growth. Increasing real import was the main factor behind reduced projections for net export. Projections for real export were unchanged: it developed in line with the expectations and projections for economic growth of the main trading partners have not been revised recently.

Compared to May, the unemployment rate is expected to be slightly higher in 2010 (17.9%). However, it is anticipated that this indicator has peaked already in the middle of this year. Data of the Labour Exchange for the second quarter confirms these expectations: the number of registered unemployed, which increased in April due to numerous registrations to obtain mandatory health insurance, stabilised in later months. Wages are also expected to stabilise – compensation per employee should stop falling in the coming quarters. However, it will be lower by 5.5% on average in 2010 and will increase (by 2.9%) only in 2011.

Although the economy has reached its turning point, unemployment is expected to decline slowly. This is related to inertia of

labour market and to the sectoral allocation of labour force in the period of rapid economic growth – at that time the economy was oriented towards the sector, which satisfied domestic demand needs, i.e. construction and real estate, and this could not ensure a long-term growth. However, restructuring to the tradable sector increases the likelihood of structural unemployment, long-term unemployment disrupts professional skills and motivation of the unemployed and may weaken GDP growth in the long-run.

In 2010, consumer prices should increase more than was expected in May: average inflation will stand at 1.0%. Over the recent months, food prices increased considerably while prices of market services and industrial goods (which composes the core inflation indicator) almost stopped falling, which indicates that downward pressure of domestic demand on prices has actually eased. As private consumption is recovering more rapidly than was expected in May, these prices, which depend mostly on the domestic demand developments, are unlikely to decrease sharply. Changes in global commodity prices, i.e. those of energy and agricultural products, could lead to different than projected price development.

ECONOMIC OUTLOOK FOR LITHUANIA IN 2010–2011

	August 2010 projection			May 2010 projection		
	2009	2010*	2011*	2009	2010*	2011*
Price and Cost Developments (annual percentage changes)						
Average annual inflation (based on HICP)	4.2	1.0	1.7	4.2	0.4	1.7
GDP deflator	-2.9	1.7	1.2	-2.9	1.0	1.8
Wages (compensation per employee)	-8.3	-5.5	2.9	-8.3	-7.8	2.9
Import deflator	-10.2	8.5	5.7	-10.2	8.4	3.8
Export deflator	-13.7	12.9	5.7	-13.7	4.7	3.1
Economic Activity (constant prices; annual percentage changes)						
Gross Domestic Product**	-14.8	0.5	3.1	-14.8	0.5	3.1
Private consumption expenditure	-16.8	-2.7	3.2	-16.8	-7.9	2.3
General government consumption expenditure	-1.2	-1.7	-0.6	-1.2	-2.1	0.9
Gross fixed capital formation	-39.1	-15.0	16.0	-39.1	-1.7	11.6
Exports of goods and services	-14.3	7.4	4.5	-14.3	7.1	4.2
Imports of goods and services	-29.4	10.6	5.0	-29.4	2.4	4.2
Labour Market						
Unemployment rate (annual average as a percentage of labour force)	13.7	17.9	16.4	13.7	17.1	15.9
Employment (annual percentage changes)	-6.9	-5.4	1.3	-6.9	-4.6	0.9
External Sector (as a percentage of GDP)						
Balance of goods and services	-0.7	-0.7	-1.1	-0.7	-0.6	-1.0
Current account balance	3.8	1.4	-0.4	3.8	1.5	-0.6
Current and capital account balance	7.2	4.9	2.2	7.2	5.2	2.9

* Projection.

** Changes in inventories are not included in GDP components.