



## Economic Outlook for Lithuania

4 November 2010

**The state of the global economy improved markedly compared to the year ago, however, there are signs of slowing economic recovery, particularly in the advanced economies.** To restore economic growth, monetary and fiscal stimulus measures have been widely used in recent years; later on, the recovery was accelerated also by the short-term impact of the inventory cycle. As these effects fade and the need to tighten fiscal policy (in the EU, in particular) remains, global economic recovery is losing momentum. In response to that, central banks of the advanced economies – US in the first place – are planning to further pursue the expansionary monetary policy.

Two main trends are observed in the economy of Lithuania: macroeconomic indicators related to the domestic demand have started to stabilise only recently while these related to foreign markets are increasing for a year or even longer. In the third quarter of 2010, these trends stayed unchanged and the real GDP growth (0.6% over the year) was mostly prompted by the main activities of the tradable sector, i.e. industry and transport. That was in line with previous expectations and the **real GDP projections of the Bank of Lithuania remained the same as in the August projections: GDP is forecasted to increase by 0.5% this year and by 3.1% next year.**

Private consumption developments are weaker than expected. In the second quarter of 2010, household expenditures were by almost a tenth lower than a year ago, according to retail trade (except motor vehicles) data, third quarter does not provide optimism as well. Thus private consumption is expected to decrease by 5.7% this year and increase by 1.9% next year. In the second quarter, compared to the previous one, real domestic investment rebounded considerably. Apart from recovering investments into the means of production, investment into non-residential buildings also grew substantially, it is likely related to construction, in which EU support funds are used. Investment developments were stronger than expected, therefore in 2010 investment will fall less than projected in August, i.e. 5.3%. Projections for the next year remained broadly unchanged.

The latest foreign trade data is more promising than projected in August: both real exports and imports are growing faster. The recovery of exports was particularly robust: in the second quarter, it was only slightly lower than the peak two years ago. Favourable export developments are also proved by industry data: the growing turnover in manufacturing is stimulated by sales in foreign markets while the turnover in domestic market is still sluggish. As the domestic consumption remains subdued, the recovery of imports is mostly supported by investment goods and intermediate goods closely related to the export trends.

**Compared to August, projections for the external sector improved: the current account is forecasted to be in surplus this year and the next year (2.1% and 0.2% of GDP, respectively).** The current account balance has been positive for already five consecutive quarters. It accounted for 3.1% of GDP in the first half of 2010: notwithstanding that the closure of Ignalina nuclear power plant increased the trade deficit, this negative impact on the current account was outweighed by current transfers to Lithuania (mainly EU support funds and workers' remittances) and increased surplus of services (transport in particular). Still, positive balance will be of a short-term nature, since due to the economic recovery the imports will grow and foreign enterprises operating in Lithuania will start to work profitably. This will increase the deficit of both trade and income.

**Recently, labour market in Lithuania has been stabilising. This is in line with previous expectations that the unemployment will start to gradually decrease after the second quarter of 2010, therefore the projections for this indicator for 2010 and 2011 stayed unchanged (17.9% and 16.5%, respectively).** Nonetheless, the situation in the labour market remains complicated and will be one of the main challenges for economic policy in the years ahead. First, the

number of the long-term unemployed has been growing in recent quarters, they are likely to lose their qualifications and motivation to work, therefore the level of unemployment might decrease at a slower pace than projected. Second, emigration has risen recently. Although emigration reduces unemployment level in the short term, it makes negative impact on the potential economic growth over the longer term.

The inflation is estimated to make up 1.2% in 2010 and to reach 2.3% next year. Recently, consumer prices in Lithuania have changed moderately and mostly due to the seasonal factors, therefore the projection of this year remained almost unchanged. However, the prices in 2011 are likely to grow more than projected in August due to higher food and energy prices. Owing to adverse weather conditions, poor harvest, and export restrictions in the leading cereal exporters, prices of cereal grew strongly in international markets in the summer of 2010; prices of other agricultural products also increased. Such trends of global food prices are likely to have stronger impact on Lithuania's inflation next year.

#### ECONOMIC OUTLOOK FOR LITHUANIA IN 2010–2011

	November 2010 projection			August 2010 projection		
	2009	2010*	2011*	2009	2010*	2011*
<b>Price and Cost Developments (annual percentage changes)</b>						
Average annual inflation (based on HICP)	4.2	1.2	2.3	4.2	1.0	1.7
GDP deflator	-3.7	1.2	1.2	-2.9	1.7	1.2
Wages (compensation per employee)	-11.6	-0.2	1.8	-8.3	-5.5	2.9
Import deflator	-10.4	8.7	4.4	-10.2	8.5	5.7
Export deflator	-14.2	9.7	5.0	-13.7	12.9	5.7
<b>Economic Activity (constant prices; annual percentage changes)</b>						
Gross Domestic Product**	-14.7	0.5	3.1	-14.8	0.5	3.1
Private consumption expenditure	-17.7	-5.7	1.9	-16.8	-2.7	3.2
General government consumption expenditure	-1.9	-0.7	-0.2	-1.2	-1.7	-0.6
Gross fixed capital formation	-40.0	-5.3	13.9	-39.1	-15.0	16.0
Exports of goods and services	-12.7	13.6	5.2	-14.3	7.4	4.5
Imports of goods and services	-28.4	15.3	6.8	-29.4	10.6	5.0
<b>Labour Market</b>						
Unemployment rate (annual average as a percentage of labour force)	13.7	17.9	16.5	13.7	17.9	16.4
Employment (annual percentage changes)	-6.9	-5.7	1.2	-6.9	-5.4	1.3
<b>External Sector (as a percentage of GDP)</b>						
Balance of goods and services	-1.2	-1.7	-3.0	-0.7	-0.7	-1.1
Current account balance	4.3	2.1	0.2	3.8	1.4	-0.4
Current and capital account balance	7.7	5.1	3.2	7.2	4.9	2.2

Note: due to data revision, data for 2009 may differ in November and August projections.

\* Projection.

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