

Economic outlook for Lithuania

19 November, 2012

Recently, the development of Lithuanian economy was affected by one-off factors. Economic activity increased due to significantly higher value added in agriculture and industry. Changes in agriculture were a result of more abundant harvests, and in the industrial sector were due to increasingly rapid export development. This trade improvement, however, is short-lived. Economic growth in many Lithuanian foreign trade partners has weakened and is slower than expected. This is directly related to lower global economic growth as many countries, especially developed countries, pursue improvement of public and private sector balance sheets. With expectations of economic growth worsening worldwide, weaker economic prospects are expected in Lithuania as well. It is foreseen that the real GDP, having increased by 3.0 per cent in 2012, will grow next year by 3.1 per cent (previous forecasts were 3.0% and 3.4% respectively).

Less favourable development prospects are suggested by more cautious expectations. Lower levels of business activity compared to just a few months or a year ago are expected by trading and service companies. While having improved for quite some time, industry expectations are now becoming more pessimistic. Such assessment of outlook is significantly influenced by continued high uncertainty regarding the global economic situation. This significantly influences business expenditure for the investment. Although a large part of production capacity is already used, investment in machinery and equipment has been shrinking for some time. Investment in vehicles has also decreased. Over the projection period, investment growth should be moderate and it is expected that investment in 2012 will increase by 2.3 per cent, and in 2013—by 6.2 per cent, i.e., less than the average increase over the years after the start of data collection. Investment expenditure will be heavily dependent on external demand. If exports intensify, albeit gradually, this will promote the need to expand production capacity and contribute to the growth of expenditure for means of production.

Cautious business expectations are already affecting the labour market. While the number of employed persons in the country is growing and the unemployment rate is declining, the number of vacancies is lower than a year ago. Their decrease was particularly acute in the transport and storage sectors, manufacturing and construction. A prudent business approach is also demonstrated by the tendency to hire more part-time workers. In the short term, with the prevailing uncertainty regarding economic prospects, the labour market situation is only expected to change moderately. This insight is partially supported not only by the declining number of vacancies but also by the flow of newly unemployed remaining at similar levels. In the projected period, changes in the labour market will rely on the development of enterprises, especially in the tradable sector. Recently, the number of employed increased most in this particularly sector. While the economy becomes focused on the activity in the tradable sector, its development will significantly affect the outlook of entire economy.

Poor moods affect also the consumers. Both the future financial situation and the country's economic prospects are seen by consumers in a more unfavourable light than a year ago or a few months ago. This weakens the incentive to consume. Most noticeably there is less demand for non-food goods that mainly led to the growth in consumption in 2011. Consumption may continue to slow down and another negative factor affecting it will be the change of real labour income where the situation in the labour market, as mentioned above, might improve only moderately, while the expected rate of price increase will be almost the same as is observed now. With consumer confidence at less than its average level for more than a decade it is anticipated that private consumption will grow relatively slowly over the projection period—in 2012 it should increase by 4.4 per cent and in 2013 by 2.3 per cent.

Due to external factors, annual inflation had been previously declining, while more recently it increased somewhat. Most of these changes in inflation were determined by food prices dependent on worldwide market trends as their impact on inflation increased. Therefore, the overall impact of external factors remained highly significant. They may be linked to four-fifths of the total inflation: in addition to food prices, the greatest impact was due to administered prices and less noticeable due to fuel prices. The components of the consumer basket, linked specifically with the external environment, remain the source of the risk that inflation will

be higher in the coming years. After all, the prospects of commodity prices in global markets remain uncertain. Currently, only a small share of inflation depends on domestic conditions; core inflation remains low. In addition, if during the projection period relatively slow growth in unit labour costs prevails as expected, inflationary pressures should be limited. With increasing influence of external factors on prices, it is foreseen that inflation will be slightly higher than previously forecasted: it should stand at 3.2 per cent in 2012 and 2.8 per cent in 2013.

Outlook of Lithuania's economy in 2012-2013

	November 2012 projection			August 2012 projection		
	2011	2012*	2013*	2011	2012*	2013*
Price and cost developments (annual percentage changes)						
Average annual inflation (based on HICP)	4.1	3.2	2.8	4.1	2.9	2.4
GDP deflator	5.4	2.1	3.0	5.3	3.2	2.4
Wages (compensation per employee)	4.0	3.0	2.6	4.0	3.1	2.9
Import deflator	12.8	4.7	2.4	12.8	4.4	1.8
Export deflator	11.7	3.6	2.5	11.7	3.9	1.9
Economic activity (constant prices; annual percentage changes)						
Gross domestic product**	5.9	3.0	3.1	5.9	3.0	3.4
Private consumption expenditure	6.4	4.4	2.3	6.1	4.2	2.8
General government consumption expenditure	0.5	0.7	1.9	0.2	0.7	1.9
Gross fixed capital formation	18.3	2.3	6.2	17.1	4.5	7.6
Exports of goods and services	14.1	7.0	6.0	14.1	4.4	6.5
Imports of goods and services	13.7	5.0	6.5	12.9	5.3	7.2
Labour market						
Unemployment rate (annual average as a percentage of labour force)	15.4	13.3	11.6	15.4	13.4	11.9
Employment (annual percentage change)	2.0	1.8	1.4	2.0	1.4	1.5
External sector (as a percentage of GDP)						
Balance of goods and services	-2.6	-2.0	-2.6	-1.3	-2.3	-3.0
Current account balance	-3.7	-2.4	-2.9	-1.6	-3.1	-3.5
Current and capital account balance	-1.3	-0.4	-1.2	0.9	-1.1	-1.9

* Projection.

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