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## Economic Outlook for Lithuania

10 May 2012

**The economic development of Lithuania has decelerated, though the economy is growing stronger than expected.**

Domestic demand, in particular, the private consumption expenditure, is rising more than anticipated. In contrast to the previous months, expectations and confidence of the Lithuanian economic entities are not deteriorating any more. This is in part related to the stabilisation in the world economy. Although the world economic outlook is still surrounded by uncertainty (on-going resolution of the state and private sector debt problems, sharply rising energy commodity prices), economic outlook for Lithuania is now viewed more favourably mostly owing to the stronger than expected recent growth. It is projected that the real GDP of Lithuania will increase by 3.0 per cent in 2012 and 3.5 per cent in 2013.

**Private consumption remains the most important factor of the real GDP growth.** Private consumption growth in 2011 significantly exceeded the average growth since the beginning of data collection. The growth of consumption was determined by the labour market recovery and the resulting improvement in the financial situation of households. Consumption was also favourably affected by consumer confidence, which was higher throughout 2011 than a year ago. Unfortunately, this confidence is not improving anymore. Consumer sentiment is poorer than in the middle of the last year. Owing to both lower consumer confidence and overall confidence of economic entities, it is projected that private consumption will increase less in the nearest time than in 2011, but more than earlier projected due to better than expected data of the end of 2011 and the beginning of 2012. It is forecasted that private consumption growth will be respectively 4.6 per cent and 3.1 per cent in 2012 and in 2013.

**Rising investments in gross fixed capital also contribute to the economic growth.** Although investments increased noticeably less at the end of the previous year than in the beginning of the year, they have been growing quite significantly up to now. They increased mainly due to larger investments in non-residential buildings and constructions, however investments in machinery and equipment are also growing. Decline of confidence of enterprises and deterioration of the global economic prospects last year had a more significant effect on investments into vehicles, which are declining. Confidence of enterprises is just stabilising, therefore, it is still difficult to expect stronger determination of enterprises to boost investment. It is forecasted that investment growth will be lower in 2012 than in 2011 and lower than the average growth since the beginning of data collection. It is projected that they will grow by 5.0 per cent this year, while in 2013 their growth will accelerate to 8.0 per cent.

**Owing to the earlier decline of confidence, the labour market situation improves insignificantly.** Unemployment remains an important problem. Overall unemployment and the related long-term and youth unemployment rates remain high. More than a half of the unemployed do not have a job for one year or longer. Almost one-third of young labour market participants search for a job. Last year the job creation intensified, however the growth of both occupied jobs and job vacancies declined. The number of employed persons is growing in the private sector, especially in manufacturing, wholesale and retail trade, however, there are activities, where the number of the employed is declining, for example, in finance and insurance, education and health care sectors. Further labour market recovery will be affected by confidence of enterprises and expectations concerning the domestic economic development, which, although not declining, are poorer than several quarters ago. It is forecasted that employment will grow quite insignificantly in 2012 and 2013 – respectively by 1.1 per cent and 1.4 per cent.

**Expansion of Lithuania's foreign trade has decelerated significantly, however, the pace of trade growth is stabilising.**

The nominal value of goods exports and imports grows by more than 10 per cent per year. The annual exports growth is determined by both re-exports and the exports of goods of the Lithuanian origin almost equally. Growth of Lithuania's exports matches the imports developments in its main foreign trade partners: buoyant exports of Lithuania decelerated with the deceleration in imports growth in these countries. Exports are rising slightly more than the imports demand in the mentioned countries, whereas the export market share of our country is slightly expanding. It is foreseen that the foreign demand growth will be small in the nearest time, therefore it is projected that exports will rise quite moderately in 2012, while their growth will

accelerate in the later part of the forecasting period.

**As the exports and imports grow almost equally, the foreign trade balance is changing moderately.** Although this balance slightly improved earlier due to a more favourable trade in energy products, it has deteriorated recently – again mainly due to the trade in energy products. **Current transfers are affecting current account changes more than usually.** Surplus of current transfers contracted due to uneven EU support payments and a lower net flow of remittances of individuals. In the nearest quarters the current account balance may be less stable. This balance should be favourably affected by the recovery of payments from the EU funds over the year. Nevertheless, the current account balance may be worsened by the imports growth exceeding the exports growth due to the rise in energy commodity prices, although higher prices of commodities should slightly subdue the imports.

### Outlook of Lithuania's Economy in 2012-2013

	May 2012			February 2012		
	2011	2012*	2013*	2011*	2012*	2013*
<b>Price and Cost Developments (annual percentage changes)</b>						
Average annual inflation (based on HICP)	4.1	2.9	2.7	4.1	2.1	2.4
GDP deflator	5.3	3.2	2.6	5.1	2.5	2.6
Wages (compensation per employee)	4.0	2.3	2.6	3.9	1.6	2.5
Import deflator	12.8	5.4	1.9	12.8	2.5	2.3
Export deflator	11.7	5.7	2.0	11.9	2.6	2.2
<b>Economic Activity (constant prices; annual percentage changes)</b>						
Gross domestic product**	5.9	3.0	3.5	5.8	2.2	3.3
Private consumption expenditure	6.1	4.6	3.1	5.6	2.5	2.6
General government consumption expenditure	0.2	0.6	1.9	1.2	0.6	1.9
Gross fixed capital formation	17.1	5.0	8.0	15.9	5.0	7.9
Exports of goods and services	14.1	5.3	5.8	13.6	3.9	5.8
Imports of goods and services	12.9	7.1	6.3	13.3	4.1	6.1
<b>Labour Market</b>						
Unemployment rate (annual average as a percentage of labour force)	15.4	13.7	12.2	15.4	14.2	12.9
Employment (annual percentage changes)	2.0	1.1	1.4	2.0	0.7	1.2
<b>External Sector (as a percentage of GDP)</b>						
Balance of goods and services	-1.3	-2.8	-3.1	-1.5	-2.1	-2.4
Current account balance	-1.6	-3.0	-3.3	-0.3	-1.2	-1.6
Current and capital account balance	0.9	-1.0	-1.6	2.1	0.9	0.1

\* Projection.

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

**Annual inflation, which declined in the second half of 2011, still remains quite high.** It remains mostly determined by external factors – the developments of the global commodity prices, whereas core inflation, which is mostly related to the internal situation, is low, owing to a slow recovery in the labour market. Global food prices rose gradually slower and were lower than a year ago already for several months, therefore, food prices rose noticeably less in Lithuania as well and their impact on inflation declined. On the contrary, the contribution of administered prices increased: their rise was stimulated by higher heat energy prices, which grew due to more expensive fuels (mostly imported natural gas), and, in the beginning of the year, by the rise in electricity price. Fuel prices increased rapidly with the rise of oil price, however, their contribution to inflation was comparatively small, since at the end of 2011 it declined significantly due to the base effect. External inflation pressure related to global commodity prices should be lower in Lithuania in 2012 than in 2011, since it is forecasted that food prices will grow significantly less. Still, the recent large rise in oil price due to geopolitical tensions in the Middle East and its potential further growth represent the risk of higher inflation, since fuel prices and administered prices may grow faster. Owing to a larger than expected rise of prices that depend on external factors, especially on the situation in the market of energy resources, higher inflation than forecasted earlier is expected in 2012 (2.9%). It is projected that there will be no significant pressure on core inflation, as wage growth will exceed productivity growth insignificantly, therefore unit labour costs will increase slowly over the whole forecasting period. Similar inflation is expected in 2013 (2.7%).