



Economic outlook for Lithuania

23 May, 2013

The economy of Lithuania still exhibits strong growth, but it has slowed down slightly. In the second half of last year exports had risen exceptionally strongly, especially due to a good agricultural harvest and intensive re-export, but currently export growth has decelerated. As expected, with the decrease in reserves, the export of agricultural and food products is not rising as much as before; foreign trade in other products is also noticeably decelerating, because foreign demand is growing less. The development of these indicators had an impact on the development of manufacturing — production by its main groupings is growing much less. **Such changes were expected in the tradable sector.** It was projected that export in 2013 will grow less than in 2012. This outlook does not change: it is expected that in the upcoming quarters the development of export will be slower and more in line with the development of external demand.

Nevertheless, economic growth is lower than expected. This is, first of all, related to the further decrease in investment. Compared to other EU countries, Lithuania's share of investment in non-residential buildings and structures, compared with GDP, remains rather large; however, in Lithuania a decline in this type of spending mainly contributes to lower general investment. **Among the most rapidly decreasing — government financed investment in infrastructure objects. A lot less investment is made in machinery and other equipment.** It should be noted that only about a fourth of investment spending on machinery and equipment is made by manufacturing. A rather large part of spending on this investment category is made by retail and wholesale trade and construction, i.e. economic activities, the future prospects of which were assessed particularly cautiously last year. This negatively affected the decisions of these economic activity enterprises on development. This year investment in machinery and other equipment should also not increase by much. Such an assumption is the result of foreign trade partner prospects being worse despite presently better confidence indicators of Lithuania's enterprises. The development of investment in the nearest quarters will be significantly affected by government expenditure on infrastructure objects. As these expenditures increase to the level planned in the state investment programme, general domestic investment should stabilise.

Slower economic growth has an effect on the labour market. The increase in the number of employed in the second half of last year was due to an increase in activity in the tradable sector. There was particularly an increase in the number of employed in agriculture. In the non-tradable sector employment rose less, while in some kinds of economic activities it dropped. Since development of the tradable sector is gradually slowing down, employment in the country's economy should grow less, too. This insight is confirmed by the most recent unemployment data — the number of newly unemployed persons is no longer decreasing. The change in economic activity will affect wage developments as well. Unemployment is still only approaching the natural unemployment rate; therefore pressure on wages should remain moderate. As was recently, due to a lack of qualified employees, wages should increase only in some economic activities. However, this year, average wages should grow due to the minimum wage that was increased in the beginning of the year, and which will be the driving force behind the larger than last year rise in unit labour costs. It is expected that in the further forecasting horizon, when the effect of the minimum wage increase will disappear, these costs will again rise less.

Changes in the labour market lead to a lower increase of household income. The growth in private consumption, as was projected, is stabilising. Nevertheless, it has been rising substantially — it is supported by household income other than wages, for example, property income, as well as prices increasing less than before. It is projected that in the nearest quarters the development of private consumption will not change significantly. Although average wages will rise due to the increased minimum wage, this will, in turn, limit the growth of employment. Disposable income of households will depend largely on the development of the tradable sector, which is expected to be more moderate than in several previous years. This will affect the ability of households to consume. **Domestic demand, covering consumption and investment, will nevertheless be the key factor in real GDP growth in the entire forecasting horizon.** As long as cautious assessment of the outlook dominates in Lithuania and foreign countries, this demand will rise less, while in further projected years it should grow more. **It is projected that real GDP, which last year grew 3.7 per cent, this year will rise by 2.8 per cent, and in 2014 — by 3.5 per cent.**

Changes in economic activity in Lithuania and globally have a dampening effect on consumer prices too. Compared to the end of last year, overall inflation was mostly reduced by the trends of prices, more favourable to consumers, related to external factors: there was a significant slowdown in the annual growth of food and administered prices, while fuel prices now are lower than a year ago. This is related to global commodity prices: food commodity and oil prices are lower than a year ago; imported natural gas became cheaper, while due to the latter, prices of heating and natural gas for Lithuanian consumers decreased. Although inflation was reduced most by developments in prices related to external factors, the prices of industrial goods and market services, depending more on the domestic situation, also rose slower. Overall, in the beginning of the year, inflation decreased more than was expected. **If global price trends continue to be favourable, it can be expected that inflation will be much lower than in several previous years. In 2013 inflation is projected to be 2.0 per cent, while in 2014 — 2.4 per cent.** Regardless, the risk related to global commodity prices remains relevant: the stocks of some agricultural raw materials are very small, while for the oil market geopolitical risk is still significant. In addition, inflation can be affected by increased minimum wage, having an effect on the development of unit labour costs.

Outlook of Lithuania's economy for 2013-2014

	May 2013 projection			February 2013 projection		
	2012	2013*	2014*	2012*	2013*	2014*
Price and cost developments (annual percentage changes)						
Average annual inflation (based on HICP)	3.2	2.0	2.4	3.2	2.4	3.0
GDP deflator	2.8	2.2	2.9	2.0	2.6	3.6
Wages (compensation per employee)	3.2	4.1	3.3	3.0	4.4	3.7
Import deflator	4.2	2.0	1.7	4.4	3.0	1.9
Export deflator	3.5	1.8	1.5	3.6	3.0	1.6
Economic activity (constant prices; annual percentage changes)						
Gross domestic product**	3.7	2.8	3.5	3.6	3.1	3.8
Private consumption expenditure	4.3	2.5	3.2	4.6	2.5	3.3
General government consumption expenditure	0.4	1.2	2.4	1.3	1.3	2.4
Gross fixed capital formation	-2.5	2.6	6.2	-0.9	4.6	7.4
Exports of goods and services	11.9	5.8	5.9	10.5	5.8	6.0
Imports of goods and services	6.6	5.9	6.3	6.0	6.1	6.5
Labour market						
Unemployment rate (annual average as a percentage of labour force)	13.2	11.6	10.1	13.2	11.6	10.0
Employment (annual percentage change)	1.8	1.4	1.7	1.8	1.4	1.8
External sector (as a percentage of GDP)						
Balance of goods and services	0.7	0.1	-0.3	0.0	-0.3	-0.9
Current account balance	-0.4	-1.8	-2.1	-1.8	-2.0	-2.6
Current and capital account balance	1.8	-0.1	-0.5	0.3	-0.3	-1.1

* Projection.

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