



Economic outlook for Lithuania

21 February, 2013

The growth of the Lithuanian economy is rather stable, it continues to be positively affected by foreign trade. For about half a year already, export has been accelerating. In the beginning, re-export hiked, while now export of Lithuanian-origin goods is continuously increasing. This is especially related to a good harvest—food and agricultural products now determine the expansion of Lithuanian-origin export. Export of industrial goods, excluding food products, is increasing slower, but the value added created by industry still significantly increases GDP. In the short term, export of agricultural and food products might continue increasing, therefore, the expansion of export in the nearest quarters should be rather substantial. In the medium term, the growth of export should slow down and stay more in line with the changes of external demand. **Such developments of foreign trade will affect the real GDP more positively than was projected, however, its forecast is unchanged due to a slightly poorer outlook for other GDP components, mainly investments.** It is expected that in 2013 the real GDP will increase by 3.1 per cent, and its growth will accelerate in the further projected period.

For some time the investments have ceased to increase. Previously rapidly rising investment in infrastructure and non-residential buildings are now declining. Although investments into machinery and other equipment are now higher than a year ago, they are lower than a few months before. Only investments into transport vehicles rose more noticeably; however, their substantial fluctuations are common. **It is expected that investments, especially in industry, will begin to grow, although at a slower rate than was projected before.** Industrial companies now use a large share—about three quarters—of their production capacity, meaning that with the expansion of production, which will be gradually encouraged by both external and internal demand, the demand for investment will increase. Decisions on investments should be favourably affected by the stabilised, and in some economic activities—even improved assessment of the economic outlook. This is probably related to the slightly improved confidence indicators in the world: although world economic activity is still expected to increase relatively slightly, the expectations of its decline have diminished. It is projected that the investments, which barely changed in 2012, will increase by 4.6 per cent in 2013 and their growth will accelerate in the coming years.

The situation in the labour market has improved, although partly due to temporary factors. In the second half of the previous year, the number of employed rose significantly. The increase was especially large in the agricultural sector, where good harvest led to a rise in economic activity. Employment in industry has increased as well. The value added created by industry is already higher than before the economic downturn, while the number of employed is still lower by one-sixth, therefore, a faster increase in the number of employed in this economic activity was expected. The number of employed in the non-tradable sector is growing more slowly, while in some economic activities (e.g. public administration, accommodation and catering services) it is decreasing. Wage developments in the tradable and non-tradable sectors also differ. In the tradable sector, wages rose almost twice faster than in non-tradable. During the economic recovery, in the tradable sector wages rose by one-tenth, while in the non-tradable sector—by about 6 per cent, although during the recession in the latter sector wages dropped more than in the tradable one. These trends are explained by different economic developments of these sectors: over the past three years, economic activity and labour productivity in the tradable sector increased more and the shortage of labour was more noticeable. Strengthening of the labour market should continue to be highly dependent on the tradable sector. Both employment and wage developments should be significantly affected by changes in external demand, while the situation of the tradable sector will affect the non-tradable one.

Private consumption is in line with the previous forecast—its growth rate is decelerating, but only slightly. In the middle of the last year, with the household income rising more modestly and confidence deteriorating, private consumption growth decreased significantly, and at the end of the year remained almost unchanged. The impact on such developments, apparently, was due to a change in household sentiment—their assessment of economic prospects improved significantly. Although it is difficult to estimate how much the volatility of expectations is reasonable, favourable expectations may positively affect private consumption in the near future as well. **Therefore, in 2013 private consumption is expected to grow at a similar pace as in the end of 2012, i.e. the growth should not slow down.** It is projected that private consumption will rise more in later years, when external and internal

demand becomes more active and household income rises as well.

Inflation in 2012 was mainly driven by food and administered prices, thus it was related to external factors. Prices of industrial goods and market services, largely dependent on domestic demand, had little impact. In general, at the end of 2012 inflation trends were more favourable for consumers than expected: the annual inflation rate decreased with a significant slowdown in the growth of heat energy and fuel prices. This partly contributed to the reduction in inflation forecast for 2013; however, a more significant contribution was the extension of reduced VAT rates for heat energy and reimbursable pharmaceuticals until 2014. The increase in prices due to the expiration of reduced VAT rates, which was previously included in the 2013 inflation projections, is now moved to the inflation forecast for 2014. Thus, it is expected that inflation will be 2.4 per cent in 2013, and 3.0 per cent in 2014. The upward risk of inflation is associated with global commodity prices: significant fluctuations in commodity prices are likely and can noticeably affect prices in Lithuania, mostly related to the external environment (e.g. food, fuel and administered prices).

Outlook of Lithuania's economy in 2012-2014

	February 2013 projection			November 2012 projection		
	2012*	2013*	2014*	2012*	2013*	2014*
Price and cost developments (annual percentage changes)						
Average annual inflation (based on HICP)	3.2	2.4	3.0	3.2	2.8	-
GDP deflator	2.0	2.6	3.6	2.1	3.0	-
Wages (compensation per employee)	3.0	4.4	3.7	3.0	2.6	-
Import deflator	4.4	3.0	1.9	4.7	2.4	-
Export deflator	3.6	3.0	1.6	3.6	2.5	-
Economic activity (constant prices; annual percentage changes)						
Gross domestic product**	3.6	3.1	3.8	3.0	3.1	-
Private consumption expenditure	4.6	2.5	3.3	4.4	2.3	-
General government consumption expenditure	1.3	1.3	2.4	0.7	1.9	-
Gross fixed capital formation	-0.9	4.6	7.4	2.3	6.2	-
Exports of goods and services	10.5	5.8	6.0	7.0	6.0	-
Imports of goods and services	6.0	6.1	6.5	5.0	6.5	-
Labour market						
Unemployment rate (annual average as a percentage of labour force)	13.2	11.6	10.0	13.3	11.6	-
Employment (annual percentage change)	1.8	1.4	1.8	1.8	1.4	-
External sector (as a percentage of GDP)						
Balance of goods and services	0.0	-0.3	-0.9	-2.0	-2.6	-
Current account balance	-1.8	-2.0	-2.6	-2.4	-2.9	-
Current and capital account balance	0.3	-0.3	-1.1	-0.4	-1.2	-

* Projection.

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