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Lithuania's economic development and outlook

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The growth of the domestic economy has decelerated due to the challenging external environment. Lithuania's exports to Russia fell by approximately one-fourth in the first months of this year as a result of economic deterioration in that country. As compared to late 2014, the decline in exports to Russia became more pronounced due to a substantial depreciation of the Russian rouble. Real disposable household income in that country continued to decrease, dragging down the retail sector and, in contrast to previous periods, private consumption. Although a substantial economic deterioration in Russia was anticipated, its imports have been falling much faster than expected, acting as a drag on exports performance in Lithuania and in other countries involved in trade with Russia. As a result, the outlook for exports has become gloomier not just in Lithuania, but also in its important trade partner countries, such as the Baltic States.

The fall of exports to Russia have substantial negative repercussions for the transport sector. Recently, re-exports, i.e. goods produced outside Lithuania, have accounted for more than 90 per cent of goods' exports to Russia. Most of the negative effects from the decrease of re-exports are experienced by transportation services providers, merchants and warehousing services suppliers. Freight transportation to Russia accounts for a substantial proportion (of more than one tenth) of transport services provided in Lithuania. Hence the recession in Russia has a noticeable impact on transport economic activity.

Another segment of the tradable sector, i.e. industry, appears healthier as the country's manufacturers export the bulk of their output to the European Union's (EU) markets. A gradual pickup of economic development in these countries fuels continued growth of exports of the Lithuanian corporates to these markets and, simultaneously, the growth of export market share in the EU. Manufacturing performance is also supported by domestic demand. For more than a year, the expanding domestic market has been contributing about half of the growth observed in manufacturing, excluding petroleum products.

Domestic demand remains the key factor of economic growth in the country, with the biggest contribution coming from private consumption, which has been growing amid gradual increase in household income and non-increasing saving as household expectations remain robust. Private consumption is expected to continue strengthening consistently as the growth of wages and employment will augment household income. Consumption possibilities will also be enhanced by the fall in prices, in particular for fuel, which leaves the consumers with more money to spend on other goods or services. At the same time, it cannot be ruled out that the consumers may be reluctant to spend the money saved due to cheaper fuel as they may expect the prices to rise again after recent slumps.

Up till now, economic activity has also been driven by investment projects. Changes in the real estate market and corporate development have thus far fuelled the construction of residential and non-residential properties. In addition, the public sector has been developing a range of infrastructure projects. Investment is expected to continue growing in the nearest future, to some extent due to the take-up of funds from the previous EU's financial framework. However, the outlook for investment is clouded by high uncertainty. The worsened international environment may force many companies to put off their investment projects. Negative effects for investment may stem both from the weakened state of economy in Eastern European countries and from the uncertainty over the sustainability of economic growth in the developed markets as the assessment of the economic outlook in some of these countries has become more cautious.

Growing domestic demand will continue as the biggest contributor to overall economic growth in the nearest future. The outlook for domestic demand remains unchanged as compared to previous macroeconomic forecasts. However, the forecast of this year's economic growth is nevertheless revised down to 2.0 per cent against the backdrop of worse-than-expected exports performance. The growth of exports is only expected to resume in the second half of the year with the recovery of the growth of imports by Lithuania's foreign trade partners. Gradual economic improvements in these countries should contribute to the acceleration of Lithuania's economic growth. Hence Lithuania's real GDP is forecast to grow by 3.4 per cent in 2016.

The consumer price level remains below the one observed a year-earlier, mainly due to a slump in prices for energy commodities. Global oil prices have increased somewhat in recent months, but not enough to offset the fall recorded in the second half of last year. Oil prices are kept lower by both weak demand for this energy commodity and by a supply glut. Hence this fall in crude oil prices is likely to be longer-lived. Stripping out energy costs, the growth of consumer prices has been marginal. For example, the growth of food prices has slowed down dramatically against the backdrop of a downward trend in world food commodity prices, which has been observed for a while, and a decline in food producer prices in the domestic market. At the same time, however, prices for services have been on an upward path due to sustained growth of domestic demand. The outlook for price developments remains unchanged as compared to previous macroeconomic forecasts. Prices related to energy commodities are expected to stay depressed and act as a drag on annual inflation in the near time while the growth of other prices will remain broadly stable. The average annual inflation rate in Lithuania is projected to be –0.3 per cent this year. Next year, it is forecasted to increase as no further falls in energy prices are envisaged.

Outlook of Lithuania's economy in 2015–2016

	June 2015 projection[a]			March 2015 projection		
	2014	**2015[b]**	**2016[b]**	**2014[b]**	**2015[b]**	**2016[b]**
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	0.2	–0.3	1.6	0.2	–0.3	1.6
GDP deflator[c]	0.9	0.1	1.4	0.8	0.1	1.5
Wages	4.7	4.9	4.9	4.9	4.9	4.9
Import deflator[c]	–2.9	–3.8	0.9	–2.8	–4.0	0.8
Export deflator[c]	–2.4	–2.5	0.2	–2.8	–3.6	0.2
Economic activity (constant prices; annual percentage changes)						
Gross domestic product[c]	3.0	2.0	3.4	2.9	2.7	3.5
Private consumption expenditure[c]	4.6	3.4	4.0	4.7	3.4	4.0
General government consumption expenditure[c]	1.4	1.3	1.2	1.2	1.2	1.2
Gross fixed capital formation[c]	7.8	3.0	4.0	8.1	3.0	4.0
Exports of goods and services[c]	3.3	0.1	4.3	3.7	3.8	5.0
Imports of goods and services[c]	5.4	1.5	4.5	4.9	4.0	5.3
Labour market						
Unemployment rate (annual average as a percentage of labour force)	10.7	10.0	9.2	10.7	9.9	9.2
Employment[d] (annual percentage change)	2.0	0.6	0.5	2.0	0.6	0.5
External sector (as a percentage of GDP)						
Balance of goods and services	0.0	0.0	–0.7	0.2	0.2	–0.5
Current account balance	0.2	0.0	–1.8	0.0	0.0	–1.4
Current and capital account balance	2.9	2.8	0.1	2.9	3.1	0.4

[a] These projections of macroeconomic indicators are based on information made available by 20 May 2015.
[b] Projection
[c] Adjusted for seasonal and workday effects
[d] National accounts data; employment in domestic concept