

Economic Outlook for Lithuania

08 September 2015

Having decelerated at the beginning of the year, Lithuania's economic growth remains low. Domestic demand contributes most to economic growth. Private consumption is increasing rather significantly. At the beginning of the year, with the adoption of the new currency, private consumption for a short time decreased, and at that time the performance of the economic development became poorer. Now, despite the expectations of consumers being slightly worse, household saving is not increasing; therefore, with growing income and consistently decreasing prices, private consumption is growing.

Investment is exhibiting particularly strong growth. Currently, investment of all types is increasing — investment in means of production, residential buildings, non-residential buildings and structures. For an already rather long time investment in machinery and equipment have been confidently rising. Compared to the period prior to the economic crisis, they increased more than all the other types. This can first of all be related to the trend that during the period of economic recovery the tradable sector grew more than the economy as a whole and, compared to the period prior to the economic crisis, now creates approximately a sixth more value added, while the country's real GDP is only slightly greater than the level it had reached before the crisis. However, investment in machinery and equipment is also increased by other factors, such as intensively implemented infrastructure projects.

Another significantly increased type of investment — real estate construction. Currently there are approximately as much of these investments as there were prior to the economic crisis. Such development of investments is a result of various factors — improved state of the economy, increasing household income, favourable conditions for borrowing from banks. Construction of residential buildings for an already long time has rather significantly contributed to the enlargement of the construction economic activity — last year it resulted in approximately a fourth of the annual growth of this activity (this year — approximately two thirds).

Investment is increasing much more than was expected, but this does not reduce the uncertainty for their development. There is still uncertainty due to the economic development of important foreign trade partners. Quite a lot depends of how stable and rapid economic recovery will be in the European countries, where recently the rise in domestic demand was lower than expected. The economic expansion of trade partners could be unfavourably impacted by increasingly lower economic growth in developing economies; the projections for this have been worsened for some time. Russia's economic development could also be poorer than expected, as global commodity prices continue to drop and this country's economic growth potential is limited by investment that has been declining for quite some time. Lower than projected economic development of foreign trade partners would negatively impact the development of investment, particularly of means of production, in Lithuania.

Still remains uncertainty regarding investment in residential buildings. Their further growth may be limited by barely growing activity in the residential housing market and the relatively abundant supply of newly-built residential housing. Less vigorous investment in the development of residential buildings would impact various economic indicators, primarily construction economic activity, labour market, etc.

Domestic demand, growing in the projected period, will continue to be an important factor in economic growth. In 2015, domestic demand will grow more than was projected in previous macroeconomic indicator forecasts. This is particularly true about investment. However, the contribution of net exports to economic development is much worse than was expected; therefore, this year's economic growth projections are decreased to 1.6 per cent (the earlier projection was 2.0%). Export will not increase by much this year. More vigorous growth is expected next year, when import to Lithuania's foreign trade partners will strengthen, and it will strengthen as a result of favourable global financial conditions, low commodity prices and improving short-term prospects in some regions of the world, particularly developed countries. This should contribute to greater economic activity in Lithuania. It is projected that in 2016 Lithuania's economic growth will accelerate to 3.2 per cent.

Consumer prices continue to drop, but much more slowly than at the beginning of the year, when they were greatly decreased by the trends in the oil market. The price of oil in euro in the international markets at that time had been about half as low as a year ago, while fuel prices in Lithuania were lower by a fifth. Although mid-year oil prices were still lower, they weren't by as much — only by about a third over the year. Therefore, the drop in fuel prices also decreased, while overall inflation, although

remaining negative, came closer to zero. Nevertheless, in the near future it should still remain negative, as consumer-friendly price dynamics will continue to be supported by cheaper energy and slightly increasing non-energy prices. Compared to earlier forecasts, expected inflation is even slightly decreased, as oil and food commodity prices in the world are lower than was expected. It is projected that in 2015 inflation will amount to –0.5 per cent, while in 2016 it will already be positive, although low (1.5%), since energy, which impacted the drop in prices this year, next year would no longer go cheaper, while the growth of other prices should accelerate.

Outlook of Lithuania's economy in 2015–2016

	September 2015 projection ^a			June 2015 projection		
	2014	2015 ^b	2016 ^b	2014	2015 ^b	2016 ^b
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	0.2	–0.5	1.5	0.2	–0.3	1.6
GDP deflator ^c	0.9	–0.3	1.3	0.9	0.1	1.4
Wages	4.7	4.5	4.9	4.7	4.9	4.9
Import deflator ^c	–3.1	–4.9	1.4	–2.9	–3.8	0.9
Export deflator ^c	–2.5	–3.4	1.3	–2.4	–2.5	0.2
Economic activity (constant prices; annual percentage changes)						
Gross domestic product ^c	3.0	1.6	3.2	3.0	2.0	3.4
Private consumption expenditure ^c	5.6	4.0	4.0	4.6	3.4	4.0
General government consumption expenditure ^c	1.6	1.8	1.2	1.4	1.3	1.2
Gross fixed capital formation ^c	7.8	5.9	3.3	7.8	3.0	4.0
Exports of goods and services ^c	3.4	0.7	4.0	3.3	0.1	4.3
Imports of goods and services ^c	5.6	3.4	4.2	5.4	1.5	4.5
Labour market						
Unemployment rate (annual average as a percentage of labour force)	10.7	9.6	9.1	10.7	10.0	9.2
Employment ^d (annual percentage change)	2.0	1.3	0.3	2.0	0.6	0.5
External sector (as a percentage of GDP)						
Balance of goods and services	0.0	–0.9	–1.1	0.0	0.0	–0.7
Current account balance	0.1	–1.9	–2.8	0.2	0.0	–1.8
Current and capital account balance	2.9	0.8	–0.9	2.9	2.8	0.1

^aThese projections of macroeconomic indicators are based on information made available by 14 August 2015.

^bProjection

^cAdjusted for seasonal and workday effects

^dNational accounts data; employment in domestic concept