

Lithuania's economic development and outlook

13 March 2015

The outlook for the domestic economy is affected by significant changes in the international economic environment. The sharp fall in prices for energy commodities and continuing geopolitical tensions are affecting Russia's economy. A decrease of investment and deceleration of consumption were observed in that country as early as in 2013–2014. Domestic consumption in Russia is expected to slide again this year, which will entail a substantial fall in imports. The demand for import goods will also be dampened by the weakened Russian rouble, which was hit particularly hard late in 2014. Russia's economic slowdown will also affect growth of the economies maintaining commercial and financial ties with Russia, in particular those of the Commonwealth of Independent States (CIS). The economic growth of Lithuania's key trade partners, such as Estonia, Latvia, Poland or Belarus, will be adversely affected as well.

Trade relations between Lithuania and Russia have undergone changes, but remain important. Food trade restrictions introduced by Russia last August affect approximately 4 per cent of Lithuania's total merchandise exports, including re-exports. As a result, the exports of food to Russia have more than halved from their pre-restrictions level. However, the exports of other goods (other than food) to Russia have not decreased, but increased instead. The share of merchandise exports to Russia decreased rather marginally in the latter half of last year: from approximately 22 per cent of the total merchandise exports in the middle of last year to around 19 per cent at the end of the year. However, same as before, re-exported merchandise continues to account for the bulk of exports to Russia. The added value derived from their exports is inferior to the added value created by the exports of goods of Lithuanian origin.

In addition to external demand developments, the dynamics of Lithuania's exports will also depend on the exporters' ability to discover new markets. Lithuania's producers have partly offset the fallout from Russia's food import restrictions with increased exports to other states, such as the European Union (EU) or CIS countries. However, it is not easy to refocus on other markets. If the economic situation in Russia continued to worsen, big challenges in finding new markets would be faced by transport services providers, which are actively involved in merchandise re-exports. Freight volumes carried to Russia comprise approximately one-fifth (in ton-kilometres) of the total freight volumes transported by Lithuania's haulers on international routes. Difficulties in refocusing would also be encountered by the providers of storage services, which are closely related to goods traffic operations.

Changes in the international economic environment will not derail Lithuania's economic growth, which is expected to continue. The economic outlook has only worsened in Russia and other Eastern countries. The prospects of economic growth in the euro area and the entire EU are not weaker than expected. External demand is expected to pick up gradually, which should promote export growth. That growth of exports, in its turn, will act as an important investment driver as it will fuel the need to expand production capacity. The rate of capacity utilization, which is already high, continues to increase. In line with previous trends, a substantial contribution to economic growth should be made by private consumption, which would be supported by improvements in the labour market, including a big increase in employment partially affecting the growth of wages. Consumption should also benefit from price developments. Prices for consumers are not expected to increase this year. Lithuania's economy is projected to grow by 2.7 per cent in 2015. The growth forecast has been revised down from the previous estimate in the context of a less favourable outlook for the tradable sector of the Lithuanian economy. In 2016, the pace of the country's economic growth should pick up amid the expected revival in economic development of the country's trade partners.

Recent developments in consumer prices have mostly been driven by falling prices for energy commodities. In the past several months, oil prices have plunged by one-third amid abundant supply and tepid demand. As a result, fuel prices in Lithuania have fallen by nearly one-sixth. Meanwhile, the prices excluding energy are growing, though moderately as a result of consumer-friendly trends in global markets for food commodities and falling import prices, which are not limited to prices of energy commodities and energy products. Price developments are expected to remain broadly unchanged in the near term. With oil prices hovering at a low level, the average annual inflation in Lithuania is expected to be negative this year (–0.3 per cent). However, it would be much higher if oil prices spiked up suddenly. On the other hand, there are certain downside risks to this inflation forecast, e.g., a potential decrease in prices for various energy products, such as heat energy or natural gas, which follow the changes in oil prices, or a

spillover effect of cheap oil on prices of other goods, which require substantial inputs of energy commodities for their production.

Outlook of Lithuania's economy in 2014–2016

	March 2015 projection ^a			December 2014 projection		
	2014 ^b	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	0.3	0.9	-
GDP deflator ^c	0.8	0.1	1.5	0.9	1.5	-
Wages	4.9	4.9	4.9	4.5	5.1	-
Import deflator ^c	-2.8	-4.0	0.8	-2.5	-0.3	-
Export deflator ^c	-2.8	-3.6	0.2	-3.6	-0.6	-
Economic activity (at constant prices; annual percentage changes)						
Gross domestic product ^c	2.9	2.7	3.5	2.9	3.1	-
Private consumption expenditure ^c	4.7	3.4	4.0	4.7	3.6	-
General government consumption expenditure ^c	1.2	1.2	1.2	1.2	1.5	-
Gross fixed capital formation ^c	8.1	3.0	4.0	8.4	3.1	-
Exports of goods and services ^c	3.7	3.8	5.0	3.4	4.4	-
Imports of goods and services ^c	4.9	4.0	5.3	3.7	4.4	-
Labour market						
Unemployment rate (annual average as a percentage of labour force)	10.7	9.9	9.2	10.6	9.7	-
Employment ^d (annual percentage change)	2.0	0.6	0.5	1.9	0.6	-
External sector (as a percentage of GDP)						
Balance of goods and services	0.2	0.2	-0.5	0.0	-0.2	-
Current account balance	0.0	0.0	-1.4	0.7	0.2	-
Current and capital account balance	2.9	3.1	0.4	3.7	3.0	-

^a Macroeconomic projections are based on the information available up to 13 February 2015

^b Projection

^c Seasonally and working day adjusted

^d National accounts data; employment in domestic concept