Lithuania's economic development and outlook

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The global economy remains on a weak footing. Amid uncertainty in international trade, growth has been dampened by the US cyclical slowdown and the delayed recovery in emerging economies. This, in turn, weighs on manufacturing, investment and international trade. Global trade in goods is even weaker than a year ago, while deceleration in economic activity is becoming more widespread. Weaker performance has been observed not only in the manufacturing, but also the services sector. The latter continues to grow on the back of favourable labour market conditions, yet has lost some momentum, which only confirms the ongoing concerns that the negative spillovers from manufacturing will gradually start undermining the services sector. Weaker economic growth – slower than in previous years and even slower than previously projected – has been broad-based across many countries and regions, including the euro area, Lithuania's key trade partner. This is particularly the case in the manufacturing sector, where production has been scaling down. The car industry has remained in the doldrums as long-term factors, such as changing global demand for vehicles and its structure, continue to contribute to sluggish activity.

Growth in external demand has reached its three-year low, yet Lithuanian exports are on the rise. Such a divide between Lithuania's exporting sector and foreign markets has been prevalent for a number of years. Compared to external demand, this year export trends deviated even further. Exports of goods of Lithuanian origin (excluding oil products), re-exports and exports of services have been growing strongly, reflecting investment dynamics. In other words, faster business expansion is more so reinforced by the previous boost in production capacities and improved competitiveness than the growing foreign demand. Although some investment, namely investment in machinery and equipment, has stagnated in recent years, investment in intellectual property products and ICT equipment has been increasing steadily, further contributing to corporate growth.

Robust growth is partly supported by changes in international migration flows and rising employment. The migration balance, to some extent, is considerably improved by larger numbers of immigrants from non-EU countries. This, in turn, contributed to the expansion of the labour force in Lithuania as well as created better hiring conditions. Changes in international migration mainly reflect the acceleration in the transportation sector, which employs the majority of immigrants from non-EU countries. Due to employment of foreign nationals, the number of workers in the transportation sector has been increasing rather considerably. Higher immigration, however, also seems to affect other economic activities, which have recently seen slight increases in their workforce: on the one hand, some immigrants choose to work in activities other than transportation; on the other hand, pressure on others to take up transport activities is likely reducing.

Though still strong, economic growth has started to lose momentum. Until now the share of companies whose expansion was limited by insufficient demand has been decreasing, yet the downward trend has now levelled off. Labour income indicators show great volatility, however, labour income seems to be rising at a slower pace than a year ago, partly due to the significantly increased labour share. Wage developments are also likely to be affected by uncertainty regarding the economic outlook. It seems that these factors account for a rather broad-based slowdown in economic expansion, which is already evident in the manufacturing and services sectors. Without agriculture, which benefited from better harvest, growth in the remaining economy has recently decreased by roughly 1 percentage point compared to the first half of 2019.

Economic activity should continue on a downward trend. Low and disappointing global growth prompts careful planning of investment in the tradable sector. Even though exports have been rising at a much faster rate than foreign markets, there are still uncertainties as to whether exports will continue growing with the same impetus. Both investment and exports – the real economic indicators that have been posting the largest increase in recent years – are expected to moderate next year. It is also assumed that investment growth will be dampened by less intensive use of EU funds. In addition, economic activity will be constrained by changes in labour market conditions. Companies have less and less room for significant increases in wages, while recruitment is likely to suffer from internal demographic factors. This, however, does not mean that household income will come to a halt. Although at a slower pace, it will rise considerably, further restricting private consumption growth which has already been on the decline. Having increased by 3.7% in 2019, Lithuania's real GDP is projected to increase by 2.5% in 2020.

Outlook for Lithuania's economy

	December 2019 projection[a]			September 2019 projection		
	2018	2019[b]	2020[b]	2018	2019[b]	2020[b]
Price and cost developments (annual percentage change)						
Average annual HICP inflation	2.5	2.3	2.3	2.5	2.3	2.2
GDP deflator[c]	3.3	2.8	2.4	3.3	2.8	2.2
Wages[d]	10.0	8.5	6.7	10.0	8.5	6.7
Import deflator[c]	4.7	1.0	1.7	4.7	2.0	1.8
Export deflator[c]	3.6	2.1	1.6	3.8	2.2	1.7
Economic activity (constant prices; annual percentage change)						
Gross domestic product[c]	3.7	3.7	2.5	3.5	3.7	2.5
Private consumption expenditure[c]	3.7	3.6	3.4	3.9	4.0	3.6
General government consumption expenditure[c]	0.5	1.2	0.4	0.8	0.9	0.6
Gross fixed capital formation[c]	8.5	7.0	4.7	6.7	6.9	4.1
Exports of goods and services[c]	6.4	8.8	4.0	5.0	4.6	3.5
Imports of goods and services[c]	6.1	6.9	4.5	4.4	4.6	4.3
Labour market						
Unemployment rate (annual average as a percentage of labour force)	6.1	6.2	6.2	6.1	5.8	5.7
Employment (annual percentage change)[e]	1.5	0.5	0.0	1.5	1.1	0.0
External sector (percentage of GDP)						
Balance of goods and services	1.8	4.0	3.6	2.7	2.7	1.9
Current account balance	0.3	2.0	1.5	1.6	0.8	–0.4
Current and capital account balance	1.8	3.8	3.4	3.1	2.5	1.3

[a] The projections are based on information made available by 25 November 2019.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] The wage projection for 2019 excludes corrections made due to changes in the tax and pension systems.
[e] National accounts data; employment in domestic concept.

Annual headline inflation has remained relatively stable, yet its components have changed this year. In 2019, food prices were growing stronger than the year before. This was mainly led by higher vegetable prices, which in the spring and summer months have likely increased due to adverse agro-climatic conditions. The overall increase in food prices was also determined by changes in global food commodity prices that were pushed up by insufficient supply of agricultural and food products in some parts of the world as well as increased demand. Unlike food prices, energy commodity prices declined, thus offsetting, to some extent, a more significant rise in food prices. The year 2019 also saw a decrease in fuel prices, while heat energy prices went further down compared to last year. Headline inflation is mainly influenced by service prices, which are most closely related to domestic economic trends and continue to rise at least at the same pace as last year due to a rather significant increase in unit labour costs. Headline inflation is projected to remain close to the current rate, to stand at 2.3% both in 2019 and 2020. Even though global food commodity prices are expected to grow at a slower pace in the near term, the anticipated higher increases in indirect taxes should put upward pressure on headline inflation. As in recent years, changes in the overall price level will be mainly influenced by prices of services, as labour costs are expected to continue rising substantially.