



LIETUVOS BANKAS
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Macroeconomic projections

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Lithuania's economic development and outlook

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After a slower development at the beginning of the year, expansion in global economic activity is beginning to recover.

Fluctuations in economic activity continue to be influenced mainly by the COVID-19 pandemic, intensifying and declining outbreaks in different regions of the world and changing restrictions on the activity of the general public and businesses. However, these restrictions do not affect economic activity as much as they did at the beginning of the pandemic. As businesses and the general public gained knowledge on how to reduce the risk of contracting COVID-19, the second wave of the pandemic did not lead to a decline in manufacturing output in most of the countries, nor to a fall in world trade in goods. Services industries are more sensitive to economic and mobility restrictions, whereas their uneven development was the main reason for the slowdown in global economic activity at the beginning of the year. Global economic development is expected to pick up significantly in the near future, especially in the developed economies. This should be supported in particular by vaccination of the population, which should reduce the scale of the pandemic and thus the potential restrictions of economic activities. Economic activity will also be boosted by government support to citizens and businesses in various countries, such as the US and the EU Member States. It will affect macroeconomic developments not only in the coming quarters, but also in the longer term. Indirectly, through international trade and financial linkages, economic stimulus in the foreign countries will also affect economic activity in Lithuania.

After only a slight decline last year, the Lithuanian economy is showing relatively strong growth this year.

Despite relatively strict restrictions on the activity of residents and businesses in the first months of 2021, economic activity in Lithuania has picked up. In particular, manufacturing increased by 6.4% in the first quarter compared to the previous quarter¹. While most of the manufacturing sector branches have grown, the production of chemical products (mainly products used in the management of the pandemic) has been particularly marked, increasing by more than 29% during the quarter. The services sector also grew in the first quarter. In particular, professional, scientific, and administrative and support service activities have increased. The volume of these activities has fallen dramatically during the recession and has only recently returned to the pre-crisis level. Some other service-providing economic activities, such as real estate as well as information and communication activities, have also grown. The latter is currently demonstrating the highest activity, compared to the pre-crisis period (its current value added is almost 12% higher than in 2019). However, not all economic sectors grew at the beginning of the year, with some sectors functioning much worse than before the pandemic. The turnover of catering establishments in the first quarter of 2021 fell by more than 25% at constant prices on a quarter-on-quarter basis; it was more than 52% lower than in 2019.² The volume of arts, entertainment and other related activities also fell in the first quarter, and the value added generated by these activities is currently 21% lower than in 2019.

As economic activity picks up, the labour market situation is improving. During the second wave of the pandemic, the number of people employed in Lithuania remained largely unchanged, and it gradually increased in the first months of this year. However, as expected, the labour market recovery is not as strong as the recovery of overall economic activity. In the first quarter of 2021, the country's real GDP already exceeded the level observed in 2019, while the number of people employed was still lower than in 2019. This is likely to be supported by the capacity of companies to increase labour productivity and the need to make the best use of existing operational capacities, thereby postponing the recruitment of additional staff for the future. A faster labour market recovery has so far been hampered by the ongoing pandemic, which continues to constrain some economic activities, particularly in some services

¹ Based on the data of manufacturing production, adjusted for seasonal and workday effects.

² Based on turnover data of catering establishments, adjusted for seasonal and workday effects.

sectors. The current and projected improvement in the economic situation is also contributing to the continued rise in wages. In the first quarter of this year, an increase in wages was recorded in both the public and the private sector, on a quarter-on-quarter basis, despite the bad pandemic situation during the period under review, with a number of quite severe constraints on their operations. Looking retrospectively, a decline in wages during the pandemic was observed only in accommodation and food services, where wages remain almost 4% lower than in 2019. The previous and current good financial situation of businesses, their efforts to increase labour productivity, the rising wages in the public sector and the ongoing expectations that natural demographic patterns will lead to a shortage of labour force in the future seem to have contributed to the rise in overall wages during the pandemic.

Further economic development will be driven by the management of the pandemic situation, the increasingly recovering domestic demand and the development of export-oriented activities. As in recent quarters, the scale of and adaptation to the pandemic will have a decisive impact on economic activity, both in Lithuania and abroad. It is assumed that vaccination of the population will continue to be successfully implemented in the coming months, which, together with other measures, will reduce the number of new cases of COVID-19, leading to the relaxation of operational restrictions of the general public and businesses. This should have a positive impact on many economic activities, especially those related to services. Greater access to regular points of sale should increase expenditure by households. The latter has declined during the difficult period not so much due to voluntary as to forced savings, and household consumption should increase significantly as a result of the easing of various restrictions related to the management of the pandemic. The household savings ratio (the share of saved income) is projected to decline over the forecast period, moving towards the pre-pandemic levels. Investment growth is also projected to contribute to economic activity. Investment in the private sector, which has declined significantly over the past year, is expected to pick up in the near future. Investment will also be boosted by increasing flows of EU funds. It is expected that, with the pandemic under control, the economic development will gradually improve not only in Lithuania, but also in its main foreign trade partners, which will have a beneficial effect on exporters. It is estimated that foreign demand could increase this year by around the same amount as it declined last year (around 8%), with a smaller increase in subsequent years. In addition to recovering foreign economies, new products developed by exporters related to the management of the pandemic should act as a boost to Lithuania's exports. All these factors may lead to a relatively significant economic growth in the coming years. It is projected that Lithuania's real GDP will expand by 5.1% in 2021, and by 4.1% in 2022.

The improving global economic situation is pushing inflation up. This is particularly evident in the raw materials markets. The recovery in demand and the restrictions of the supply of this raw material by oil-producing countries have led to significant increases in oil prices. Oil prices in euro are expected to be around 47% higher this year than last year. This has an upward effect on the prices of energy products and an indirect effect on the prices of other products, as transport and other costs increase. Higher oil prices, and hence higher fuel prices, have so far been the main contributor to higher inflation in Lithuania. Other raw materials, such as metals, also become more expensive. This is compounded by supply disruptions (partly due to operational constraints linked to the pandemic situation in the commodity-producing countries) and strong demand, particularly in China. This has so far had only a limited impact on final consumer prices, but there is a risk that the impact will increase. Agricultural products are also becoming more expensive around the world, because of a high demand for these products and problems with timely delivery. However, food prices in Lithuania have been growing relatively moderately so far, apparently partly due to the good harvest of the last year. Prices of services, which are the most linked to domestic economic developments, are rising more strongly, but at a lower rate than in the past few years. The weaker performance of services-related economic activities is likely to have contributed to the slowdown in these price increases. The recovery in economic activity could have an upward effect on the prices of services, but their growth may be limited by falling value added tax on some services. It is projected that inflation in Lithuania will stand at 2.2% this year. Compared to

the previous year, inflation will increase by 1.1 percentage point, mainly as a result of the rising price of energy. Inflation is not expected to change significantly next year, but its components are expected to change. Inflation will no longer be driven so much by energy product prices, but will be more strongly influenced by domestic demand and prices more closely related to the domestic economic development. Rising food prices may also increase inflation further next year. It is projected that inflation will stand at 2.1% in 2022.

Table 1. Outlook for Lithuania's economy

	June 2021 projection ^a			March 2021 projection		
	2020	2021 ^b	2022 ^b	2020 ^b	2021 ^b	2022 ^b
Price and cost developments (annual percentage changes)						
Average annual HICP inflation	1.1	2.2	2.1	1.1	1.6	1.9
Gross domestic product deflator ^c	1.1	2.0	2.0	0.7	1.8	2.0
Wages	10.2	7.0	5.9	10.2	6.3	5.5
Import deflator ^c	-5.2	3.9	1.5	-5.2	3.4	1.7
Export deflator ^c	-3.5	2.8	1.3	-3.5	2.8	1.5
Economic activity (constant prices; annual percentage change)						
Gross domestic product ^c	-0.8	5.1	4.1	-0.8	2.9	5.1
Private consumption expenditure ^c	-2.1	6.2	6.5	-1.5	4.8	6.7
General government consumption expenditure ^c	0.5	0.3	0.0	0.1	0.0	0.0
Gross fixed capital formation ^c	0.1	8.5	5.5	0.1	5.0	5.0
Exports of goods and services ^c	0.0	8.2	5.9	-1.3	5.9	5.9
Imports of goods and services ^c	-5.7	11.4	7.9	-6.4	9.8	6.7
Labour market						
Unemployment rate (annual average as a percentage of labour force)	8.5	7.1	6.6	8.5	8.4	7.0
Employment (annual percentage change)	-1.5	0.7	0.4	-1.5	0.5	1.5
External sector (percentage of GDP)						
Balance of goods and services	10.0	7.7	6.3	9.5	7.0	6.4
Current account balance	8.4	5.6	3.6	7.9	5.3	4.0
Current and capital account balance	10.4	8.2	6.3	10.0	8.1	6.6

^a The projections for macroeconomic indicators are based on assumptions about the international environment and other data and information published by 19 May 2021.

^b Projection.

^c Adjusted for seasonal and workday effects.

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