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Macroeconomic projections

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Lithuania's economic development and outlook

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The global economy continues to recover, however, the rate of recovery has slowed down recently. The deceleration of the global economic growth is mainly determined by the rising number of COVID-19 cases (which, even without stricter restrictions, has worsened household expectations) and the continuing supply chain bottlenecks. Although the number of vaccinated people is growing globally and the risk of restrictions that may have a significant negative impact on the economic development is declining, the rapid growth of the COVID-19 incidence rate and the appearance of the new omicron variant, which prompted the reintroduction of strict restrictions by some countries, increase uncertainty about the course of the pandemic. Tensions in supply chains still show no signs of normalisation, as, for example, delivery terms remained relatively close to historical highs. At the same time, it should be noted that, contrary to the beginning of the pandemic, when long delivery terms were related to supply-side restrictions, currently they are more linked to particularly strong demand for goods. On the one hand, it is expected that with the lifting of pandemic-related restrictions, households should increase their use of services in the nearest time. This would reduce the demand for goods and tensions related to their supply. On the other hand, the widening labour shortage and the rise in the prices of energy resources in global markets prompts the suspension of the production of certain goods (for example, some factories ceased their production in China and the United Kingdom), which entails an additional risk that tensions in supply chains may persist longer than expected. It is currently expected that supply chains will fully normalise only in 2023. All this also affects the economic activity and price developments in Lithuania through international trade and financial links.

The expansionary phase of Lithuania's economic cycle is noticeably higher than expected earlier. Revised national accounts data indicate that the value added created in Lithuania's economy has not declined in 2020 (the contraction of 0.8% was projected earlier). This means that Lithuania was the only European Union (EU) country (in addition to Ireland) whose gross domestic product (GDP) has not contracted in 2020. At the same time, Lithuania's economy grew faster in the first half of 2021 than previously indicated as well. The revised data of Lithuania's economic development also has a large impact on the assessment of the cyclical position of Lithuania's economy, which analyses how efficiently labour and other production factors are used in Lithuania and whether they do not cause excessive inflationary pressures and the formation of various imbalances in the economy. According to the previous data, Lithuania's economy should have been noticeably lower than its potential in 2020 and should have been close to it in 2021, while the latest data show that Lithuania's economy was close to its potential already in 2020 and should exceed it markedly in 2021. Thus, the latest data show that Lithuania's economy's output gap is noticeably bigger than projected earlier. Such assessment is also confirmed by the development of individual GDP components. For example, household consumption is growing faster this year than indicated previously, while investment that has a positive impact on potential GDP is growing noticeably slower. In Q3 2021, it was even lower by 5%[1] than in Q2, mainly due to increasing costs of investment projects and supply chain bottlenecks.

The labour market almost returned to its pre-pandemic state. In Q3 2021, the numbers of the unemployed and employed persons were already close to those recorded at the end of 2019. Although the unemployment rate is still around 0.5 percentage point higher than before the pandemic, the share of companies indicating labour shortage as a factor limiting their operations has reached the highest level since the beginning of the global financial crisis and is observed in all largest economic sectors: construction, industry, trade and services. The fact that the demand for employees is currently particularly high is evident in the job vacancy rate as well, which comprised 2.0% in Q3 2021[2].

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[1] Based on the data adjusted for seasonal and workday effects.

[2] Based on the data unadjusted for seasonal and workday effects.

Previously, such a high rate was recorded in 2008, i.e. in the period when Lithuania's positive output gap was extremely high. Although a part of these job vacancies may be linked to pandemic-related factors, for example, for some unemployed persons, the incentives to work were potentially reduced by the job search benefits paid during the quarantine or more difficult working conditions in some economic sectors, this still shows that the problem of labour shortage in Lithuania's economy has again become particularly acute. This is one of the most important reasons behind a particularly robust wage growth, which comprised 9.9% in Q3 year on year. Wages were growing rapidly both in the public sector and in the private sector. While wages were growing faster in the public sector in 2020, in the recent two quarters they grew faster in the private sector. The foundation for such fast wage growth in the country's economy was supported by the decisions made during the pandemic to increase operating efficiency and adapt to the new conditions, which allowed Lithuanian companies to boost labour productivity significantly. Its growth in Lithuania was one of the largest among the EU countries in 2020.

Future economic developments in Lithuania will continue to be driven by the management of the pandemic situation, the increasingly recovering domestic demand and the development of export-oriented activities. The scale of and adaptation to the pandemic will continue to have a decisive impact on economic activity, both in Lithuania and abroad. These projections make an assumption that the vaccination in Lithuania will be successfully continued in the coming months. This together with other measures will limit the number of new COVID-19 cases and allow avoiding activity restrictions for residents and companies, which could significantly affect economic activity. Households should take advantage of increased possibilities to use previously restricted services. Although the rise in their purchasing power will be slowed down by higher inflation, household consumption should nevertheless grow significantly faster than before the pandemic. Such household consumption developments should be determined by the growth of disposable income, which should exceed the inflation rate, and gradually returning to pre-pandemic levels saving rate. It is projected that similar household consumption developments will be observed in Lithuania's most important trade partners, which will positively affect the demand for Lithuanian goods and services and contribute to the further growth of exports of Lithuanian goods and services. On the other hand, export growth will be partially restricted by unfavourable factors in 2022, such as the sanctions imposed on Belarus exports or the production capacity utilisation level reaching the highest level since the beginning of data publication. However, due to the planned investment growth driven by production capacity and labour shortage as well as a more intensive flow of EU support funds, most unfavourable factors should limit exports growth only in the short term. All these factors should lead to 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 3.6% in 2022.

Persistent tensions in supply chains and the rise in the prices of energy resources boost inflation in Lithuania. Inflation stood at 9.3% in November. However, only around one-third of this inflation is determined by the factors related to Lithuania's domestic economic developments, while two-thirds are determined by the factors related to the changes in global markets. High inflationary pressures are observed not only in Lithuania, as inflation reached the highest level since the global financial crisis both in Latvia and Estonia, as well as in the euro area and the US. Inflationary pressures are rising globally due to persistent tensions in the global supply chains and the rise in the prices of various raw materials and energy resources. They are responsible for the rapid growth of the prices of energy and industrial goods as well as administered prices (heating, gas, electricity). Although it is projected that tensions in supply chains may remain for the entire next year, inflationary pressures should be reduced by the decline in the prices of energy resources, as futures contracts show that the prices of electricity and natural gas should decline significantly already in the first half of the next year. Factors related to Lithuania's domestic economic development are mainly affecting the prices of services. Due to fast wage growth and comparative base effects, the prices of services also grew rapidly in November (by 7.2%). It is projected that inflation in Lithuania will stand at 4.5% this year. Compared to the previous year, inflation will increase by 3.4 percentage points, mainly as a result of the rising prices of energy products and industrial goods. Next year, inflation will remain elevated and stand at 5.1%. It will be 2.5 percentage points higher than projected previously. This revision was mainly determined by the changes in the energy component, as the prices of energy resources rose significantly in the market. However, higher inflation will also be affected by the inclusion of higher excise duties on alcohol beverages, the projected higher food prices and persistent tensions in supply chains. Nevertheless, the Bank of Lithuania has not changed its assessment that the rise in inflation is temporary: it is projected that although inflation will remain high in the beginning of 2022, it will subside in the second half of the year.

Table 1. Outlook for Lithuania's economy

	December 2021 projection[a]			September 2021 projection		
	2020	2021[b]	2022[b]	2020	2021[b]	2022[b]
Price and cost developments (annual percentage changes)						
Average annual HICP inflation	1.1	4.5	5.1	1.1	3.3	2.6
Gross domestic product deflator[c]	1.3	4.5	3.4	1.1	3.9	2.5
Wages	10.2	10.0	8.2	10.2	9.4	7.6
Import deflator[c]	-5.2	8.5	5.4	-5.2	4.3	1.8
Export deflator[c]	-3.7	4.2	4.9	-3.5	2.9	2.1
Economic activity (constant prices; annual percentage change)						
Gross domestic product[c]	0.0	5.1	3.6	-0.8	4.9	3.5
Private consumption expenditure[c]	-2.1	6.1	5.8	-2.1	5.6	6.6
General government consumption expenditure[c]	-0.5	0.3	0.0	0.5	0.1	0.0
Gross fixed capital formation[c]	-1.9	8.7	6.3	0.1	11.1	6.3
Exports of goods and services[c]	0.4	12.6	4.8	0.0	11.4	4.6
Imports of goods and services[c]	-4.8	16.2	6.6	-5.7	14.8	7.4
Labour market						
Unemployment rate (annual average as a percentage of labour force)	8.6	7.1	6.7	8.6	7.2	6.8
Employment (annual percentage change)[d]	-1.7	0.7	0.2	-1.7	0.6	0.2
External sector (percentage of GDP)						
Balance of goods and services	9.5	5.1	3.6	10.0	7.4	5.8
Current account balance	7.4	2.3	1.3	8.3	5.4	3.6
Current and capital account balance	9.1	4.2	4.1	10.4	8.0	6.3

[a] The projections for macroeconomic indicators are based on international environment assumptions based on information published by 26 November 2021 as well as other data and information made available before 1 December 2021.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] National accounts data; employment in domestic concept.

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