LIETUVOS BANKAS
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Macroeconomic projections

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Contents

Lithuania’s economic development and outlook

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Global economic developments were more favourable than expected at the beginning of this year. The biggest contributors to this global economic trend were the world’s two largest economies: following strict COVID-19-related restrictions, the reopening of China’s economy came out faster and stronger than expected, whereas the US labour market showed unexpected resilience and continued to support household consumption demand in spite of hawkish monetary policy decisions and the collapse of a few banks. It should be noted that the US banking concerns in early March this year heightened global financial market tensions only briefly, with losses recouped in most asset classes by mid-April. The current global economic activity growth is seen as being driven by the services industries, which are less reliant on trade, as well as household consumption developments. For the same reason, the better-than-expected global economic developments were not reflected in international trade indicators. Even though this is less favourable for small and open goods exporting economies like Lithuania, the weak international trade development simultaneously contributes to easing supply chain tensions. For instance, intermodal container transportation costs have already declined to pre-COVID-19 levels. Coupled with disinflationary pressures from decreasing energy prices (including natural gas and electricity prices in Europe) and cheaper food commodities, this has led to a reduction in overall inflation measures. Nevertheless, the apparent labour market resilience and its remaining tensions contribute to underlying inflationary pressures, so inflation is still bound to hover above the targets set by monetary policy institutions for some time to come.

The correction in Lithuania’s economic activity has been more pronounced than expected. In Q1 2023, Lithuania’s real gross domestic product (GDP) shrank by 2.1% year on year, one of the steepest declines on record. The main contributing factors were changes in inventories and dwindling exports of goods and services. Goods export volumes fell sharply for a second consecutive quarter, driven mainly by the troubles of the manufacturing sector. The value added generated by the sector has been on the decline for four quarters in a row. The trend is linked mainly to decreasing demand for reagents used for vaccine manufacturing, disruptions in supply chains as a result of the sanctions on the aggressor states waging the war against Ukraine, a surge in energy prices and a fall in demand for construction and furnishing products, which was significantly influenced by the diminishing activity of real estate markets in the wake of monetary policy tightening in many countries. These factors along with rapidly rising prices had an impact on the development of other business sectors as well. In addition, the quarterly value added generated in real estate operations and transport and trade activities has been declining for a prolonged period of time. The unfavourable trends in these sectors have only been partly offset by rising value added in other market service activities.

Decreasing economic activity in Lithuania has led to deceleration of employment growth and a rise in the unemployment rate. In Q1 2023, employment growth in Lithuania slowed down to 1.3%[1] year on year, while the unemployment rate rose to 7.6%[2]. The cooling down in the labour market affected a considerable share of the country’s economy and population, with slower increases in the number of employed people across economic activities and a rise in unemployment among many groups of people, especially among unskilled workers in rural areas. A significant drop in the share of companies that report staff shortages as an obstacle to business development, which now stands at just above the long-term average, also attests to declining demand for workforce as compared with 2022. Although the tightness in the Lithuanian labour market has decreased over the past few quarters, it remains significant. The labour market tightness indicator, which is calculated as the ratio of job vacancies to the unemployed, is still higher than before the COVID-19 pandemic. The uneasing labour market tightness is

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

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

caused by persistently large numbers of vacancies, which increased by almost 10% in the first quarter of this year despite growing unemployment. These labour market tensions are also contributing to robust wage growth, which came to 13.4[3]% in the Q1 2023 as compared with the year before. Wages in the private sector grew slightly faster than in the public sector, by 13.7% and 12.6%, respectively.

A moderate recovery is anticipated in the Lithuanian economic activity after a correction in the first half of the year. This trend in the national economy is anticipated due to the increasing purchasing power of households, rising investment and the improving situation of external trade partners. The purchasing power of households is projected to rise due to subsiding inflation, continuing rapid wage growth, and the 2023 national budget decisions aimed at supporting household incomes. Given the prevailing positive consumer sentiment, which has been discouraging households from saving more, the increase in purchasing power should stimulate a recovery in household consumption. Investment should also boost economic activity this year. It will rise mainly through general government investment, much of which will be financed from European Union support funds. The further development of the Lithuanian economy should also be aided by the improving dynamics in the economies of main trading partners. It is anticipated that, in the second half of the year, the growth of external demand for Lithuania's exported goods and services should reach the pace observed before the COVID-19 pandemic. This should have a positive impact on Lithuania's exporting sector, which is currently facing challenges. It is expected that due to these factors the Lithuanian economy will start growing in the coming quarters; nevertheless, due to the sharp correction in economic activity in the first quarter of this year, the country's GDP should shrink in 2023 compared to last year. Lithuania's real GDP is projected to decrease by 1.3% in 2023 and rise by 2.7% in 2024.

Annual inflation is expected to continue subsiding due to waning inflationary pressure. Annual inflation is falling sharply in Lithuania as the May figure was only half of the peak recorded in September last year. The main contributing factor was a fall in annual energy price growth, caused both by a higher comparative base and a decrease in the actual level of energy prices. In September last year, energy prices soared by 73% year on year, whereas in May 2023 they were 1% lower than a year earlier. Generally, the annual price growth for all major components of inflation has already peaked. Annual inflation is expected to continue subsiding due to waning inflationary pressure. It will be driven by subsiding prices of energy resources, food and other commodities, as well as decreasing costs of transportation by intermodal containers, which have already dropped to pre-pandemic levels. A more thorough supply chain analysis shows that changes in manufacturers' prices confirm a decrease in inflationary pressure: the manufacturers' prices, except for the price of refined petroleum products, on the domestic market in May were 1.5% higher year on year, compared to 32% annual growth recorded in July last year. The price growth of all the main components of the inflation index is projected to continue subsiding. Of particular note will be energy prices, which are projected to be by about one-seventh lower in the second quarter of the year as compared with the same 2022 period. Meanwhile, the prices of services are still expected to rise rather quickly this year, albeit not as fast as before. This trend will be driven by significantly growing unit labour costs. Average annual inflation is projected at 8.9% in 2023, to be followed by a drop to 2.7% in 2024.

[3] Based on the data comprising the whole economy including individual enterprises.

Outlook for Lithuania's economy

	June 2023 projection[a]			March 2023 projection		
	2022	**2023[b]**	**2024[b]**	**2022[b]**	**2023[b]**	**2024[b]**
Price and cost developments (annual percentage change)						
Average annual HICP inflation	18.9	8.9	2.7	18.9	9.0	2.7
Gross domestic product deflator[c]	17.0	9.0	2.9	17.2	9.3	3.0
Wages	13.3	11.1	9.3	13.0	10.0	8.4
Import deflator[c]	24.8	0.1	1.0	25.1	1.3	1.5
Export deflator[c]	15.6	3.9	1.8	16.1	4.4	2.2
Economic activity (constant prices; annual percentage change)						
Gross domestic product[c]	1.9	-1.3	2.7	1.9	1.3	3.2
Private consumption expenditure[c]	0.5	0.4	3.2	0.5	0.0	3.1
General government consumption expenditure[c]	0.5	-0.2	0.0	0.3	0.0	0.0
Gross fixed capital formation[c]	2.6	6.3	3.6	2.6	4.5	4.5
Exports of goods and services[c]	11.9	-3.0	2.9	11.7	1.7	4.7
Imports of goods and services[c]	12.4	0.0	3.1	11.1	2.3	4.7
Labour market						
Unemployment rate (annual average as a percentage of labour force)	5.9	7.8	7.5	5.9	6.6	6.4
Employment (%, annual percentage change)[d]	5.1	-1.3	0.1	5.1	-0.5	-0.4
External sector (percentage of GDP)						
Balance of goods and services	-1.9	-1.2	-0.7	-1.0	1.1	1.6
Current account balance	-5.0	-4.0	-4.3	-5.5	-2.5	-2.2
Current and capital account balance	-3.4	-1.0	-2.4	-4.0	0.2	-0.1

[a] The macroeconomic projections are based on external assumptions, constructed using information made available by 24 May 2023, and other data and information made available by 31 May 2023.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] National accounts data; employment in domestic concept

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