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Lithuania’s economic development and outlook

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Global economic activity remains subdued. In the coming years, it is expected to remain slightly lower than over the past decade. Such developments in the world economy are still strongly influenced by the dampening effect of tighter monetary policy. It affects all major global economies – the US, China and the euro area – through tighter financing conditions and a gradually cooling labour market. The events in the Red Sea are deemed to have had only a limited impact on global economic developments thus far, and the delivery times of products have been only relatively slightly prolonged compared to 2021–2022, when global supply chain bottlenecks were particularly big. It is noteworthy that the economic development in the euro area, Lithuania’s most important trading partner, is the least favourable among the world’s major economies. In the first half of 2024, economic activity in the euro area will remain very sluggish due to the waning positive momentum of the reopening of the economy, competitiveness challenges, tight financing conditions and increased consumer uncertainty. However, rising household purchasing power, as a result of falling inflation and continued wage growth, as well as increasing government spending and recovering external demand should lead to a rebound in economic activity in the euro area in the second half of the year. Rising household income, increasing external demand and the fading effects of tighter monetary policy should also contribute to a further recovery of the euro area economy in the medium term. As a result of such economic developments in Lithuania’s most important trading partner, this year external demand for the goods and services produced in Lithuania will remain sluggish and should rise more rapidly from 2025 onwards. Nevertheless, the developments in external demand will be noticeably slower than the long-term average.

Lithuania’s economy has been sluggish for two years now, with the positive effects of slowly recovering domestic demand being offset by the challenges faced by exporters. The improving domestic demand is positively affected by both investments and household consumption. In 2023, investment was driven mainly by the general government and industry, where the reconstruction of an oil refinery accounted for around one-third of investment. The general government channelled a larger share of its funds towards construction projects, thereby affecting the rapid growth of investments in roads and electricity grid infrastructure. Investment in these two groups of structures accounted for more than two-thirds of the total increase in construction works last year. A significant share of these projects was financed by European funds. Household consumption started to pick up again in late 2023. Its recovery was mainly driven by the purchasing power which had been recovering for several quarters already, the continued favourable situation in the labour market and the gradually improving sentiment. Households remain cautious, however, and are still reluctant to take on higher financial costs.

The decline in exports of goods and services is affected by sluggish external demand, limited re-exports and a correction of export market shares. Re-export developments are strongly influenced by the tightening of checks of dual-use goods, which have significantly restricted re-export flows to the Commonwealth of Independent States. The correction of export market shares is mainly due to structural factors, which significantly affected only a few groups of goods. The exports of wood and furniture products were mainly affected by the drop in demand for these products as the tightening of the monetary policy slowed down the development of the real estate sector in major trading partners. Demand for chemical products was reduced by the retreat of the COVID-19 pandemic, while the reopening of China after the pandemic and the increased flow of these products from Asia also lowered the prices of chemical products. Furthermore, sanctions, which partially suspended the activities of AB Lifosa, allowed foreign producers of phosphate fertilisers to take over the available market share. The poorer agricultural harvest, the value of which was by one-fifth lower in 2023 than in 2022, also contributed to the correction in export market shares. Given the nature of these factors, the recent correction in export market shares should not be attributed solely to a loss of competitiveness of

Lithuanian exports, but the recent stabilisation of market shares suggests a gradual acceleration in the growth of Lithuanian exports as the above shocks subside.

The labour market continuous to be robust, and the number of people employed in Lithuania is currently the highest since the global financial crisis. The employment growth was influenced by a significant change in migration trends. In 2023, more foreigners and Lithuanians entered Lithuania than left. The positive migration balance outweighed the downward impact of natural population change, with the number of residents of Lithuania increasing by over 29,000 in 2023. As the labour force grew particularly rapidly, the unemployment rate slightly increased at the end of last year but, looking from the historical perspective, it is still low. But equally important is that, even as the number of people available for work has been growing rapidly, the job vacancy rate (the ratio of vacancies to total jobs) has not fallen significantly and remains close to historical highs. As Lithuania's economy has not grown for almost two years, continued hiring, low and relatively stable unemployment rate and the still high vacancy rate reveal that tensions in the labour market remain. These factors, together with the willingness of companies to retain their existing workforce, have led to continued strong wage growth, while labour productivity has not increased. Such situation is unsustainable: if there is no recovery in economic growth and productivity, it will be increasingly difficult for companies to retain the existing wage growth without reviewing the number of employees.

Economic activity will remain sluggish in the short term, while a more marked recovery is expected only in the second half of this year. Economic activity will be mainly subdued by the sluggish export growth, which will be constrained by a modest increase in external demand and limited opportunities for re-exports. The unfavourable trends in the external environment should be outweighed by the gradually increasing domestic demand, particularly household consumption. Household consumption, which picked up at the end of last year, is expected to follow this trend, as real household income is projected to rise substantially, the labour market situation will remain favourable for the employed, and uncertainty about the future will diminish. Economic activity should be further boosted by investment, and its development will continue to be driven by increasing flows from European Union (EU) support funds. While investment is not expected to develop as vigorously as last year, investment volumes will remain at historically high levels. Taking it into account, Lithuania's economy is projected to grow by 1.6% in 2024 and accelerate to 3.1% and 3.3% in 2025 and 2026 respectively. In this economic outlook, the risks surrounding Lithuania's growth projections are tilted to the downside. Slower-than-expected economic growth could be determined by less favourable economic developments in major trading partners, a weaker recovery in household consumption, or a return to heightened global geopolitical tensions. On the other hand, if the absorption of EU support funds would be better than expected, it could result in more favourable economic developments in Lithuania than anticipated.

Inflationary pressures remain subdued following a fall in energy and other commodity prices. This, together with subdued domestic consumption, has led to a further decline in annual inflation, which remained unchanged at 1.1% in February compared with January, even after a significant weakening of the base effect. Core inflation, which excludes the more externally-driven energy and food prices, also declined, but remained significantly above headline inflation amid rapid labour cost increases. In February, core inflation exceeded headline inflation by more than four times. Prices of services, which are more driven by domestic factors than other groups, have risen at the fastest annual rate in recent months and were the main driver of headline inflation. While the unrest in the Red Sea poses a risk of upward pressure on commodity prices in the event of an increase in delivery costs, the price level of imported goods has not changed significantly, and markets continue to anticipate favourable developments in energy and commodity prices. Compared with previous projections, the high level of gas inventories, expectations of avoiding major supply bottlenecks during the cold season and the growing renewable electricity generation have led to a significant improvement in the assessment of the evolution of gas and electricity prices in the markets, resulting in a reduction of gas and electricity price assumptions by a third for this year, compared to the December projections. Taking this into account, average annual headline inflation is projected to fall to 1.6% this year and to stand at 2.4% in 2025–2026. As a result of the recovery in private consumption and the rise in labour costs at a slower albeit rapid pace, core inflation will outpace headline inflation this year. The average annual core inflation is projected to stand at 3.1% this year and at 2.4% in 2025–2026.

Table 1. Outlook for Lithuania's economy

	March 2024 projection[a]				December 2023 projection			
	2023	**2024[b]**	**2025[b]**	**2026[b]**	**2023[b]**	**2024[b]**	**2025[b]**	**2026[b]**
Price and cost developments (annual percentage change)								
Average annual HICP inflation	8.7	1.6	2.4	2.4	8.8	2.5	2.5	2.4
Gross domestic product deflator[c]	7.1	2.4	3.1	3.0	7.7	2.9	2.9	2.9
Wages	12.6	10.3	8.5	8.1	12.2	9.4	8.7	8.3
Import deflator[c]	-5.8	0.8	2.9	2.7	-5.5	0.0	2.9	2.5
Export deflator[c]	-0.2	1.4	3.0	2.8	0.0	1.1	2.9	2.5
Economic activity (constant prices; annual percentage change)								
Gross domestic product[c]	-0.3	1.6	3.1	3.3	-0.2	1.8	3.1	3.3
Private consumption expenditure[c]	-1.1	3.0	3.7	3.7	-1.7	2.4	3.5	3.6
General government consumption expenditure[c]	0.3	0.1	-0.5	0.0	0.3	0.2	0.0	0.0
Gross fixed capital formation[c]	10.6	4.5	3.4	6.0	8.6	3.9	4.0	6.0
Exports of goods and services[c]	-4.8	0.2	3.3	3.5	-5.3	0.5	3.2	3.4
Imports of goods and services[c]	-6.6	1.3	3.9	4.7	-7.2	1.4	3.6	4.3
Labour market								
Unemployment rate (annual average as a percentage of labour force)	6.8	7.0	6.8	6.6	6.7	6.5	6.4	6.3
Employment (annual percentage change)[d]	1.5	-0.2	-0.3	-0.3	1.0	-0.1	-0.5	-0.5
External sector (as a percentage of GDP)								
Balance of goods and services	4.0	3.6	3.2	2.5	4.0	4.0	3.7	3.1
Current account balance	1.2[b]	0.5	0.2	0.1	1.3	0.9	0.6	0.0
Current and capital account balance	3.0[b]	2.8	3.0	2.2	2.8	2.6	2.7	1.4

[a] The macroeconomic projections are based on external assumptions, constructed using information made available by 12 February 2024, and other data and information made available by 1 March 2024.
[b] Projection.
[c] Adjusted for seasonal and workday effects.
[d] National accounts data; employment in domestic concept

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