



LIETUVOS BANKAS
EUROSISTEMA

Macroeconomic projections

September 2024

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Lithuania's economic development and outlook

17 September 2024

The global economy is recovering, but with uneven development trends. With prices rising less and real income slowly recovering, the services sector has strengthened in many regions of the world. It is benefiting not only from the favourable situation in the labour markets of various countries, which has contributed to a fairly significant rise in wages, but also from the continuing increase in demand for the services whose availability was limited during the pandemic. In the euro area and in some other regions, the expansion of the services sector accounts for the bulk of overall economic growth. The manufacturing sector is underperforming. The start of a decrease in stocks accumulated by enterprises and the growing purchasing power of the population led to a recovery of the manufacturing sector in the first half of 2024, however this recovery was not observed everywhere. The industry in the US and China picked up, but the euro area industry continued shrinking. In the euro area countries, industrial output has been decreasing since the beginning of 2023 and is currently only at the level observed in 2019. Surveys of purchasing managers suggest that the situation in the manufacturing sector in many regions of the world will be challenging in the near future due to a significant increase in the number of various restrictions on international trade and continued considerable geopolitical uncertainty. In both the euro area and other regions, manufacturing is not expected to expand in the short term.

Economic activity has also picked up in Lithuania. The services sector is the main driving force behind overall economic growth. For some considerable time now, information and communication activity has been growing to a significantly greater degree than the economy as a whole. Upon attracting an increasing number of workers over the past few years, it accounted for about a quarter of total economic growth in the first half of this year. During this period, the added value generated by information and communication activity was almost one tenth higher than a year ago. Other services, namely, professional, scientific, administrative and support services, which play an increasingly important role in economic development, also contribute rather significantly to overall economic development. Domestic trade is also expanding, with real household income rising markedly. Private consumption is now much higher than a year ago. Private consumption as a whole is actually influenced not only by higher wages and other income, but also by population growth. Real private consumption per capita has still not returned to the historical peak observed in early 2022, before the period of higher inflation rates set in. To a lesser extent than many other activities, manufacturing is nevertheless bolstering economic activity this year, although the sector shrank significantly last year. Stocks of manufactured goods have decreased considerably, while orders for industrial goods have increased. In all major manufacturing industries, the situation has improved, or at least is not substantially worse than a year ago.

The labour market situation remains good, but there are some unfavourable developments. The total number of persons employed has decreased over the last few months.¹ This is mainly due to economic activity in the transport sector. Excluding the latter, hiring remains at about the same level as a year ago. Other unemployment trends are also emerging. After starting to rise in 2022, the unemployment rate has not yet declined. It has risen by almost 2 percentage points in two years. Unemployment has increased in many social groups, namely, among both women and men, in urban and rural areas, and in different age groups. As the number of unemployed persons continues to grow, the duration of unemployment is increasing. Two years ago, the number of the unemployed mostly grew because of the short-term unemployed with up to 2 months out of work, while more recently the growth has been driven by the unemployed for 3 to 11 months. With growing unemployment, continued positive net international migration and a rather uneven recovery in various sectors of the economy, the labour shortage is less pronounced and the pressure on wages is easing. The growth of wages has been slowing down, especially in the private sector, for two years. Wage growth is also being held back by labour productivity, which has not yet recovered. The latter has not increased for the third consecutive year and is well behind the growth trajectory observed before the shocks of recent years, i.e. behind the trend observed

¹ Based on data of the State Social Insurance Fund Board under the Ministry of Social Security and Labour.

until 2019. The sluggish expansion of the exports sector, the continued higher prices for raw materials compared to prices a few years ago and the desire to retain existing workers in anticipation of a strengthening of demand (especially in foreign markets) in the longer term, all seem to be contributing factors to such productivity dynamics.²

Economic activity is projected to grow slowly. In the second half of 2024, Lithuania's economic development will be slower than in the first half of the year due to the weaker performance of foreign economies and is expected to pick up next year. Economic growth will be stimulated more by rising foreign demand. With prices rising less, real income of the population increasing and financing conditions improving, some economies (more specifically in the euro area) are expected to grow faster. As a result, demand for goods and services exported from Lithuania will rise more rapidly. The amount of European Union (EU) support funds available for investment is expected to increase next year. This will outstrip the rise in nominal gross domestic product (GDP), which will have a significant impact on economic development. The use of EU support funds, more robust domestic and foreign demand should lead to higher investment by both the public and private sectors, outweighing the temporary decline in investment observed in 2024. The favourable situation in the labour market should also contribute to economic growth, allowing for a rise in real personal income and consumption. Real GDP is projected to increase by 3.1% next year after growing by 2.2% this year. Faster economic development is also expected in the following years. In 2026, real GDP is projected to grow by 3.3%. However, it should be noted that the economic growth rate will not be as rapid as observed before the shocks that occurred in recent years. Economic development will be constrained by reduced opportunities to make increasingly inclusive use of existing labour resources, aggravating domestic demographic challenges, and the markets of major trading partners expanding less than in the previous decade.

Price dynamics remain sluggish. For more than a year and a half, the overall level of consumer prices in Lithuania has been fairly stable. In the first seven months of this year, it exceeded the year-earlier figure by a meagre 0.9%. Price increases have been held back by economic recovery that has not been robust in all regions of the world, energy commodities that essentially have not become more expensive, a rise in the supply of food commodities, and a significant easing of tensions in global supply chains for goods and commodities. Partly as a result, energy and unprocessed food prices in Lithuania have been lower this year than a year ago, while prices of processed food and industrial goods (excluding energy) have risen only marginally. Overall consumer price increases in Lithuania are mainly stimulated by labour costs. For some considerable time now, wages have been rising much to a greater degree than labour productivity, creating continued pressure on prices, especially for services. So far, the slowdown in the rise of prices for services that are less sensitive to labour costs has been more significant, while prices for services that are more sensitive to labour costs are still rising at a rather fast pace. Core inflation, and hence prices for services, is also significantly affected by inflation inertia, which includes menu costs, the impact of price indexation taking into account previously high inflation rates, expectations and uncertainty about the future.³ Rising prices for services are expected to be the main driver of headline inflation throughout the projected period, as labour costs will continue to increase markedly. Over the longer term, as commodity prices stabilise and economic growth picks up in some regions of the world, energy as well as processed and unprocessed food prices will increasingly boost headline inflation. After falling to 1.0% this year, average annual headline inflation is projected to reach 2.5% next year and 2.6% in 2026.⁴

² This is known as labour hoarding.

³ For more information on core inflation, see Box 4 of the Lithuanian Economic Review of September 2024.

⁴ The impact on inflation of excise duties raised to meet the need to finance future defence expenditure is projected to be 0.3 percentage points per year between 2025 and 2026.

Table 1. Outlook for Lithuania's economy

	September 2024 projection ^a			June 2024 projection		
	2024 ^b	2025 ^b	2026 ^b	2024 ^b	2025 ^b	2026 ^b
Price and cost developments (annual percentage change)						
Average annual HICP inflation	1.0	2.5	2.6	1.2	2.4	2.4
GDP deflator ^c	3.4	3.1	3.1	3.0	2.9	3.0
Wages	9.8	8.5	8.1	10.2	8.5	8.1
Import deflator ^c	-0.8	1.8	2.3	0.4	2.6	2.5
Export deflator ^c	1.4	1.7	2.4	1.7	2.8	2.6
Economic activity (constant prices; annual percentage change)						
GDP ^c	2.2	3.1	3.3	1.9	3.1	3.3
Private consumption expenditure ^c	3.6	3.7	3.7	3.4	3.7	3.7
General government consumption expenditure ^c	0.2	0.0	0.0	0.1	0.0	0.0
Gross fixed capital formation ^c	-3.6	6.6	5.1	4.5	4.1	5.2
Exports of goods and services ^c	1.2	3.1	3.8	1.2	3.7	3.7
Imports of goods and services ^c	0.0	4.5	4.5	1.5	4.6	4.5
Labour market						
Unemployment rate (annual average as a percentage of labour force)	7.4	7.1	6.9	7.3	7.1	6.9
Employment (annual percentage change) ^d	1.6	-0.4	-0.3	0.5	-0.2	-0.3
External sector (percentage of GDP)						
Balance of goods and services	6.1	5.0	4.6	4.5	3.9	3.5
Current account balance	3.2	1.6	1.1	1.8	1.2	0.5
Current and capital account balance	5.1	3.7	2.7	4.1	4.0	2.7

^a The macroeconomic projections are based on assumptions about the international environment, constructed using information made available by 16 August 2024, and other data and information made available by 30 August 2024.

^b Projection.

^c Adjusted for seasonal and workday effects.

^d National accounts data; employment in domestic concept.

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ISSN 2783-557X (online)