



LIETUVOS BANKAS
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At the end of 2024, Lithuania's economy was growing rapidly. This year, growth will continue unabated, driven by rising domestic and external demand.



Percentages



Economic activity

Economic growth accelerated in late 2024, mainly due to higher household consumption

Economic activity will increase this year on the back of growing household consumption, private investment and exports

Most relevant risks

Rising geopolitical risks due to the US-EU trade war could adversely affect foreign trade, foreign demand and public expectations

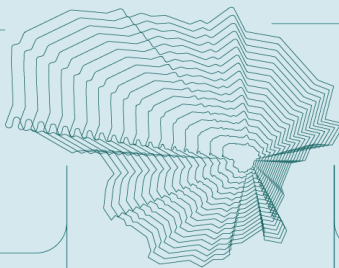
The choice of measures to ensure adequate funding of Lithuania's defence needs and the implementation of the reform of the 2nd pillar pension system may have both positive and negative effects on economic development

Labour market

At the end of 2024, the labour market remained robust

In late 2024, the labour force and employment levels were at their highest since Lithuania's accession to the EU

Unemployment is at its lowest level in the last two years, and further decline is expected in the future



Inflation

Inflation will be higher in 2025 than last year, as prices for energy resources and other commodities recover

Although inflation will be higher than last year, the household purchasing power will continue to grow, with wages rising faster than prices

In 2026, inflation should return to the normal level typical of an economy approaching the living standards of Western economies

Lithuania's economic development and outlook

12 March 2025

Uncertainty, which is at its peak in recent decades, weights on global economic growth. The global economy entered 2025 with a high degree of uncertainty about the future. Hard-to-predict decisions on trade policy, government finances and geopolitical conflicts have raised various uncertainty indicators to record highs. Such uncertainty about the future of economic development affects the decisions of both businesses and households. A particularly high reversal of expectations is observed in the US. While at the end of last year businesses were still very optimistic about the US economy, the latest Purchasing Managers' Index data recorded in February show considerably more pessimistic sentiment toward further economic development. The euro area also shows little optimism. Economic growth in the euro area, although slowly recovering, will be noticeably below its long-term rate this year. These trends in the euro area's economic development are strongly influenced by difficulties faced by Germany, the euro area's largest economy. Recent estimations suggest that a more significant recovery of this economy could not be expected until next year. This is mainly due to the structural challenges currently faced by Germany's industry and diminished competitiveness in global markets. Concerns over the economic development of the US and the difficulties of the euro area economy will put constraints on the growth of external demand for goods and services exported by Lithuania. It will remain at a lower level throughout the projection horizon compared to the decade before the COVID-19 pandemic.

Lithuania's economy remains resilient. In the second half of last year, the quarterly growth of Lithuania's economy approached its long-term growth rate, mainly owing to the increasing recovery of household consumption. It was 4.9% higher in the last quarter of 2024 than a year ago and significantly above the average for the last decade. Key contributors to this trend in household consumption are the recovery in consumption of non-durable goods and the continued growth in consumption of services. The development of investment, which is another factor of domestic demand, was less favourable. After demonstrating rapid growth between 2021 and 2023, investment declined last year. However, its volume, as compared to Lithuania's gross domestic product (GDP), remains at historically high levels. The main constraint on investment development in recent quarters has been the decline in investment in capital goods. Subdued investment did not hamper the development of exports. Although the drop in re-exports and exports of mineral products has led to a decline in total exports, exports of non-mineral products of Lithuanian origin, which generate higher added value, have been increasing significantly for half-year. This is particularly the case for exports of chemical products and plastics, however exports of engineering, wood and furniture products also showed an upward trend.

Economic growth increases employment and reduces unemployment. As Lithuania's population grew for three consecutive years, more and more workers are entering the labour market. At the end of last year, the number of persons employed was practically the highest since the start of data publication in 1995. The main contributors to the increase in the number of persons employed were government sector,¹ information and communications, as well as industry. With the labour force broadly unchanged, the rise in the number of persons employed is reducing unemployment. After a one-year pause, the unemployment rate returned to below 7.0% in the last quarter of last year. Following a substantial drop in the unemployment rate, the chances of supplementing the ranks of the employed are diminishing, with a growing share of the long-term unemployed, who find it more difficult to re-enter the labour market. At the end of 2024, the share of the long-term unemployed, compared to the total unemployed, was almost the highest since 2015. The renewed decline in the unemployment rate is increasing the pressure on wages. After slowing down for almost two years, wage growth stabilised in the second half of last year at an annual rate of around 9.0% in the private sector and 14% in the government sector. Developments in the latter sector were caused by the rapid increase in wages for education and health sector workers. Recovering labour productivity growth may provide some support for the sustainability of wage growth. In the last quarter of 2024, it was above the average of the last decade. However,

¹ Public administration and defence; education; human health and social work activities (activities O, P, Q of NACE).

labour costs are currently rising more than total nominal value added, which means that an increasing share of value added is being allocated to the persons employed. This puts upward pressure on prices and continues to undermine the competitiveness of less innovative enterprises.

Lithuania's economic growth is projected to further strengthen this year, but there are significant risks that could lead to a markedly different economic development. The economy grew by 2.7% last year and is expected to grow by 2.9% this year and at a similar pace in the coming years. Both domestic demand and exports of goods and services will contribute to such economic development. The development of exports will be largely influenced by a gradual increase in foreign demand for Lithuanian goods and services. Growing export volumes and the increasing utilisation of production capacity should stimulate a recovery in private sector investment. The development of investment will also benefit from the waning effect of previously tightened monetary policy and flows of European Union (EU) support funds. Against the backdrop of growing domestic economy, the demand for labour will continue to be robust, and wage growth will remain buoyant. With incomes rising more than consumption expenditure for quite some time now, there is considerable scope for households to increase consumption. However, the current global geopolitical situation is highly volatile and trade restrictions in the US and the EU could have an adverse effect on the Lithuanian economy, the extent of which will depend on trade policy decisions. Decisions of Lithuania's Government may also have a profound impact on the country's economic development. The choice of measures, for example, designed to ensure adequate funding of Lithuania's defence needs or implementation of the reform of 2nd pillar pension funds, can have both positive and negative effects on the country's economic development in the short and medium term.

The overall price level, which has not changed significantly for almost two years, is rising at a faster pace this year. Inflationary pressures are building up as the prices of many energy sources and other commodities recover and wages continue to grow rapidly. This, together with recovering consumption and tax increases in place since January, has led to a more profound rise in the overall price level since the beginning of this year, and a corresponding surge in annual inflation, which stood at 3.4% in January. Just as in the past, changes in annual inflation rates are mainly influenced by the development of energy prices. Energy prices, which have had a downward effect on annual inflation for a long time, were already higher in January than a year ago, owing to the rise in prices for energy sources and tax increases. Food prices, including prices for alcoholic beverages and tobacco, are also going up, driven both by the rise in the prices of food commodities and imported foodstuffs, and by higher excise duties on alcoholic beverages and tobacco. In contrast, the growth of prices for services, supported by rapidly rising wages, has remained broadly unchanged at nearly 6%. The rise in prices for services, which has outpaced the long-term average, remains the main driver of inflation. As wage growth shows no signs of a significant slowdown, services are projected to remain the main driver of inflation, even in the face of price hikes in other groups. Market prices for most energy sources and food commodities are projected to be on average higher this year than last year,² the euro exchange rate to be lower, and wages are expected to rise, albeit at a slightly slower but still rapid pace. The recovery of private consumption and tax increases above last year's level will also affect inflation trends. Against this background, average annual inflation is projected to reach 3.3% this year before declining next year, and to stand at 2.6% in both 2026 and 2027.

² The growth in electricity and gas prices will be the one to stand out: they are projected to be higher by one third and almost twice the last year's level respectively (ECB assumptions, 6 February information).

Outlook for Lithuania's economy

	March 2025 projection ^a				December 2024 projection			
	2024 ^b	2025 ^b	2026 ^b	2027 ^b	2024 ^b	2025 ^b	2026 ^b	2027 ^b
Price and cost developments (annual percentage change)								
Average annual HICP inflation ^e	0.9	3.3	2.6	2.6	0.8	2.3	2.6	2.6
GDP deflator ^c	2.9	3.7	3.0	3.0	3.8	3.3	3.1	3.1
Wages	10.2	9.2	8.3	7.7	10.3	8.7	8.1	7.5
Import deflator ^c	-1.3	2.3	2.3	2.1	-0.9	2.0	2.3	2.1
Export deflator ^c	1.0	2.9	2.3	2.1	1.2	2.2	2.4	2.2
Economic activity (constant prices; annual percentage change)								
GDP ^c	2.7	2.9	3.0	3.0	2.4	3.1	3.1	3.0
Private consumption expenditure ^c	3.7	4.1	3.7	3.7	3.0	3.7	3.7	3.7
General government consumption expenditure ^c	1.1	0.4	0.1	0.1	0.4	0.0	0.0	0.0
Gross fixed capital formation ^c	-1.1	6.6	5.5	3.1	-2.3	6.1	4.8	4.4
Exports of goods and services ^c	0.3	1.6	3.6	3.6	2.2	2.5	3.6	3.7
Imports of goods and services ^c	0.5	3.0	4.5	4.1	0.5	3.5	4.4	4.4
Labour market								
Unemployment rate (annual average as a percentage of labour force)	7.2	6.8	6.7	6.6	7.4	7.1	6.9	6.7
Employment (annual percentage change) ^d	1.7	0.3	-0.3	-0.2	1.8	-0.1	-0.3	-0.3
External sector (percentage of GDP)								
Balance of goods and services	5.2	4.5	3.9	3.6	6.4	5.8	5.4	4.9
Current account balance	2.1	1.3	1.1	0.5	3.2	3.0	2.4	1.9
Current and capital account balance	3.7	3.6	2.8	1.3	4.3	5.2	4.2	2.6

^a The macroeconomic projections are based on external assumptions, constructed using information made available by 6 February 2025, and other data and information made available by 28 February 2025.

^b Projection.

^c Adjusted for seasonal and workday effects.

^d National accounts data; employment in domestic concept.

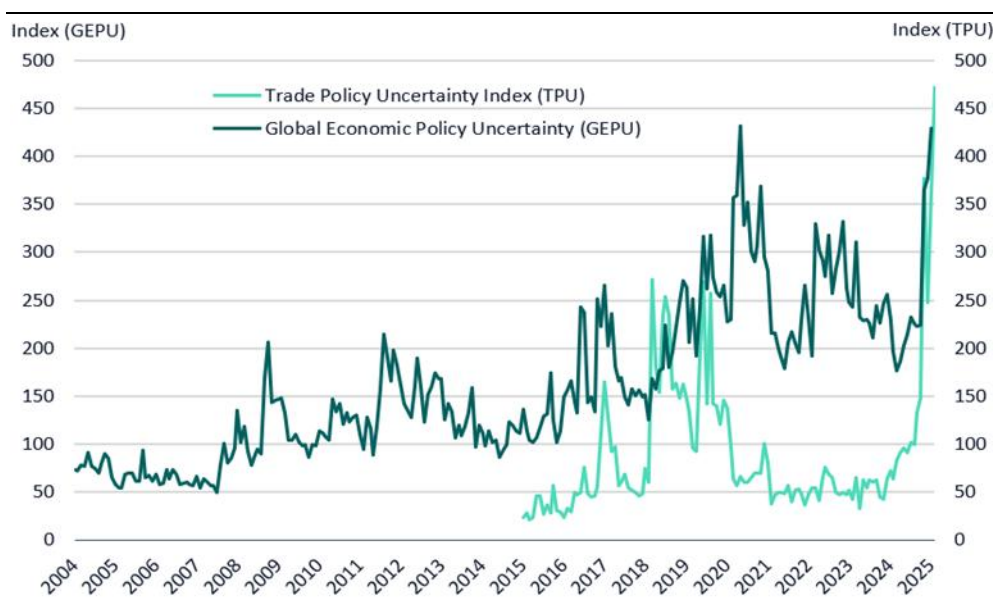
^e Harmonised Index of Consumer Prices.

1. International environment

The global economy continues to grow moderately, but trade policy uncertainty and structural challenges in major economies are weighing on the outlook.³ According to the January projections of the IMF, global GDP is expected to grow by 3.3% this year and the next.⁴ The changing geopolitical environment and protectionist trends are among the biggest downside risks to global GDP development (see Chart 1) but to varying degrees across countries. The gap between the economic development in the US and the euro area is becoming more pronounced in global economic projections. This year, GDP growth in the US will be significantly faster than previously expected (2.7% or up by 0.5 percentage points), while that in the euro area will be slower (1.0% or down by 0.2 percentage points). In the short term, the fiscal stimulus and deregulation in the US should boost GDP growth and slow disinflation. The outlook for the euro area has been downgraded due to significantly weaker indicators of Germany and France.

Global uncertainty is increasing rapidly

Chart 1. Global trade and economic policy uncertainty



Sources: Economic Policy Uncertainty, <http://www.policyuncertainty.com/>, www.matteoiacoviello.com.

Global inflation continues its steady decline although services inflation remains high in advanced economies driven by rapidly rising wages.⁵ The impact of the new US administration's policies on global inflation is expected to be stronger compared to Trump's first term: the cyclical position of the major economies is now more favourable to higher inflation, while restrictions on specific and difficult-to-substitute goods and raw materials may have an enormous impact on inflation.

Owing to robust demand, a less restrictive monetary policy and favourable financing conditions, in anticipation of business-friendly policies, the US economy will expand by around 3% for the third consecutive year, exceeding the last decade's average growth rate. The US economy will grow by 2.7% this year (0.5 percentage points faster) and growth should return to the potential of 2.1% next year (0.1 percentage

³ Declining competitiveness of the euro area on global markets, unfavourable demographic situation in China, migration policies in the USA, global supply chain disruptions.

⁴ The IMF projected the global economy to grow by 3.2% in 2025 in the autumn of 2024 and 3.3% in the summer. The European Commission's 2024 autumn and spring forecast projects growth at 3.3%.

⁵ According to the January projections of the IMF, inflation is expected to be at 4.2% this year and 3.5% next year, with the target of central banks in advanced economies to be reached by 2026.

points higher). In the short term, easing regulation and tax cuts will support the growth of the US economy but in the longer term this will require more significant fiscal consolidation.

Despite the ongoing decline of the real estate sector, low consumer confidence and deflationary pressures, the Chinese economy will maintain growth rates similar to those observed in recent years. The GDP growth projections for this year were revised upwards to 4.6% on the back of the fiscal package of €1.4 billion announced in November, which offsets the negative impact on investment of heightened trade policy uncertainty and the declining real estate market. Growth is projected to remain stable at 4.5% in 2026 as the impact of trade policy uncertainty will fade⁶ and the extension of the retirement age will slow down the decline in labour supply.

Geopolitical uncertainty and declining competitiveness of the euro area in global markets are dampening the euro area's growth outlook. This year and next year the euro area economy will grow at a slower pace than expected, by 0.9% and 1.2% respectively (0.2 percentage points slower).⁷ Over the medium term, growth will be supported by rising household income, resilient labour market, improving consumer confidence, easing financing conditions and cyclically increasing labour productivity.⁸ Private consumption will be the main driver of economic growth on the back of the corresponding wage growth and declining inflation (2.3% in 2025, 1.9% in 2026) despite a higher savings rate (14.7% in 2025, 14.4% in 2026).

A more significant recovery in Germany, the euro area's largest economy, can only be expected in 2026.

GDP growth will reach 0.2% this year and 0.8% next year.⁹ Economic growth is expected to be boosted by a gradual recovery of exports on the back of rising foreign demand. However, the German industrial sector is currently facing serious structural challenges and reduced competitiveness in global markets. Private consumption, which has been growing moderately, will not drive the anticipated economic recovery as previously expected. Private consumption is constrained by the temporary weakening of the labour market¹⁰ and the much slower wage growth. Inflation remains high despite the slow economic growth and will not reach the target of 2% until 2026.

Driven by domestic demand and public investment, Poland's economic growth will be among the fastest in the EU. GDP growth will be 3.4% this year and slow down to 2.8% next year.¹¹ Private consumption growth is driven by rising nominal wages and declining inflation, with average annual inflation falling from 11.4% in 2023 to 3.7% in 2024. However, in a tight labour market, inflation will remain high over the projection horizon (5.6% in 2025 and 2.7% in 2026). The main contributors to high inflation will be the lifting of energy price caps in the fourth quarter of 2025¹² and significant wage growth, especially in the public sector.

The outlook for the neighbouring Baltic countries is optimistic: after a recession in 2024, the economies of Estonia and Latvia are recovering on the back of rising demand from their main trading partners and the resulting improvement in export outlook. Government spending is currently the main pillar of growth in Latvia, but rising exports are expected to provide a boost in the medium term. GDP will grow by 2.1% this year and 3.0% next year.¹³ Inflation will remain low over the projection horizon (1.4% in 2025 and 1.5% in 2026), driven by slowing wage growth which will offset the impact of the government's tax increases. Estonia's economic

⁶ The IMF projections assume that the impact of heightened trade policy uncertainty will be temporary and will fade away in a year's time, but the IMF projections do not take into account the potential economic impact of trade and fiscal policies of the new US administration.

⁷ According to the ECB's December 2024 projections, growth will be 1.1% in 2025 and 1.4% in 2026.

⁸ Macroeconomic projections of the ECB, March 2025.

⁹ Macroeconomic projections of Deutsche Bundesbank, December 2024.

¹⁰ For the third consecutive year, Germany has experienced a significant decline in job vacancies and a rising unemployment rate.

¹¹ Macroeconomic projections of Narodowy Bank Polski, November 2024.

¹² For individual consumers, the electricity price cap will remain in place until 30 September 2025.

¹³ Macroeconomic projections of Latvijas Banka, December 2024.

recovery (1.6% in 2025 and 2.9% in 2026¹⁴) will be supported by rising exports and declining borrowing costs. Inflation is expected to be 3.4% this year and fall to 2.6% next year due to additional income taxation and indirect tax increases.

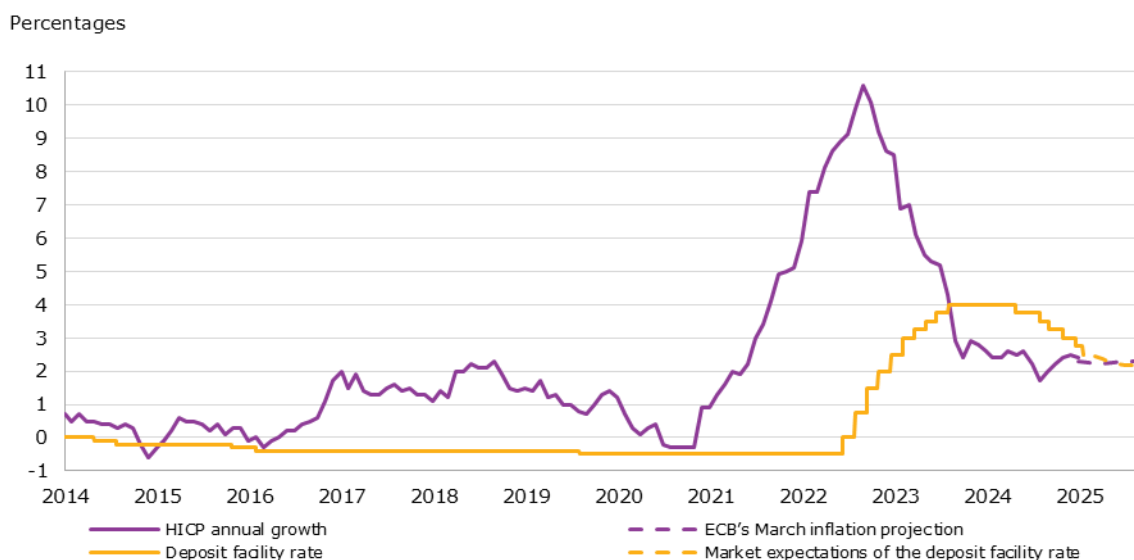
2. Monetary policy of the Eurosystem

The Governing Council of the ECB has continued its gradual monetary policy easing. Taking into account the current development of underlying inflation in the euro area, inflation projections and monetary policy transmission, the ECB Governing Council cut the deposit facility rate four times since October 2024 to 2.50%. From the peak of 4% in 2023, interest rates have been cut by a total of 150 basis points. Declining inflation provides reassurance that the price stability objective will be achieved with a less restrictive monetary policy stance. In the medium term, the ECB interest rates should reach a level where the monetary policy stance is neither restrictive nor stimulating, provided that the economy faces no new shocks. It should be noted that this level of interest rates is difficult to measure and depends on fundamental calculation assumptions and factors such as demographics, productivity or degree of risk aversion.¹⁵

Inflation in the euro area continues to decline in line with the projected trajectory and is expected to return to the ECB’s medium-term objective of 2%. In February 2025, inflation in the euro area fell to 2.4%, down from over 10% in October 2022 (see Chart 2). Although inflation is currently still above the ECB’s price stability target, it is expected to reach around 2% in 2026. This will be driven both by the impact of past interest rate hikes and keeping them at significantly less restrictive level. Financial market participants expect interest rates to continue to be positive as inflation approaches the target level. However, the ECB Governing Council will take decisions at each meeting following a data-dependent approach.

Key ECB interest rates continue to drop.

Chart 2. Actual data on interest rates and inflation in the euro area and market expectations



Sources: ECB and LSEG Datastream.
Note: Data as of 5 February.

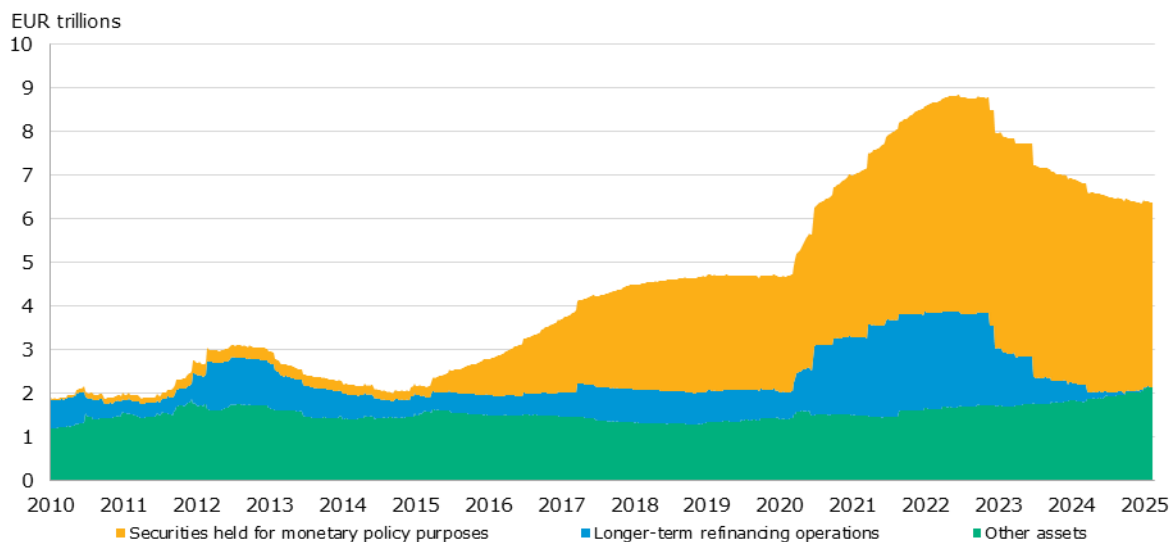
¹⁴ Macroeconomic projections of Eesti Pank, December 2024.

¹⁵ For more on the natural rate, see “[Natural rate estimates for the euro area: insights, uncertainties and shortcomings](#)”, *Economic Bulletin*, Issue 1, ECB, 2025.

The Eurosystem’s balance sheet has been shrinking for some time now following the unwinding of the accommodative monetary policy operations (see Chart 3). This is due both to the expiry of the longer-term refinancing operations and the shrinking securities portfolio. Following the fading of the risks associated with COVID-19 to the monetary policy transmission and outlook for the euro area economy, the Eurosystem has suspended reinvestments under the Pandemic Emergency Purchase Programme (PEPP) from the beginning of 2025, which has led to an even more rapid decline of the bond portfolio. These developments allow for a consistent normalisation of the Eurosystem’s highly elevated balance sheet and provide room for the resumption of monetary policy stimulus measures in the future if necessary.

The Eurosystem’s balance sheet has been declining steadily.

Chart 3. Eurosystem’s balance sheet and key contributing monetary policy factors



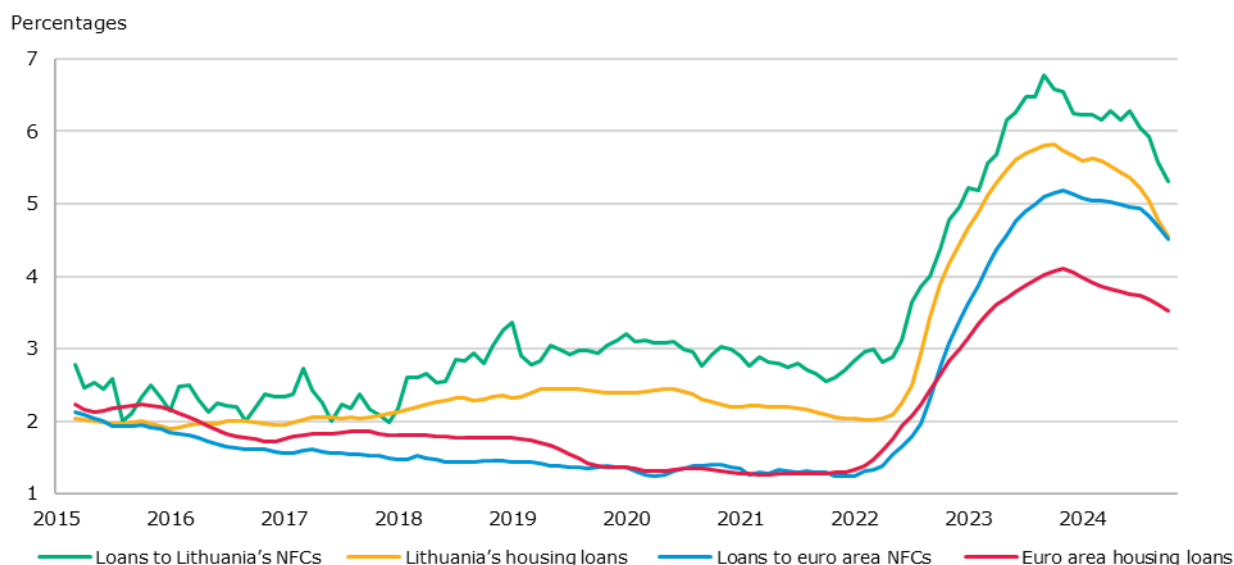
Source: ECB.

Note: Data as of 25 February.

Interest rates on private sector loans have been declining significantly in response to loosening monetary policy (see Chart 4). The rapid rise in new lending rates, which was replaced by a steady decline in 2024, is increasingly reflected in the development of interest rates on both housing and NFC loans in Lithuania and across the euro area. This has been driven by the ECB Governing Council’s decisions to lower interest rates and expectations of further rate cuts in the future. In Lithuania, interest rates on new housing loans are still above the euro area average (4.31% in Lithuania and 3.43% in the euro area in December 2024). The difference is partly explained by the fact that almost all housing loans in Lithuania (around 97%) have variable interest rates (usually 3, 6 or 12-month EURIBOR), while the euro area average is much lower (around 18%). As a result, Lithuanian borrowers were immediately affected by the rise in interest rates, while borrowers across the euro area were on average affected only when expectations of the longer-term direction of interest rates changed. This difference is therefore responsible for the currently faster decline of new borrowing rates in Lithuania. Since June 2024, when the ECB Governing Council started to lower the deposit facility rate, interest rates on housing loans have fallen by around 1.21 percentage points in Lithuania, compared to merely around 0.38 percentage points on average across the euro area. The future dynamics of interest rates on loans will depend on the nature of monetary policy and financial situation of the economy and banks.

Financing conditions in Lithuania, as in the rest of the euro area, remain quite tight but continue to ease.

Chart 4. Average interest rates on new MFI housing loans and loans to NFCs



Sources: ECB and Lietuvos bankas calculations.

Notes: 3-month moving average. Excluding revolving loans and overdrafts.

3. Real sector

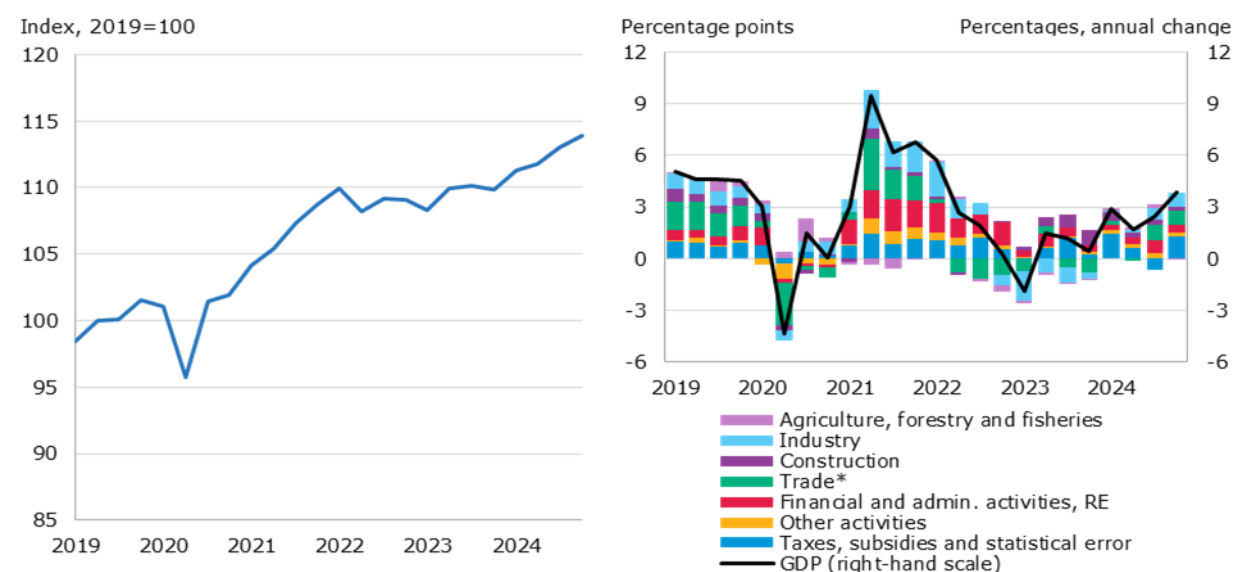
After two years of stagnation, the Lithuanian economy, which started to grow in the first half of 2024, continued to grow in the second half of the year (see Chart 5).¹⁶ In the third quarter of 2024 economic activity increased by 1.1% quarter on quarter and by 0.8% in the fourth quarter of 2024, exceeding the long-term average growth rate.¹⁷ These trends resulted in a 2.7% rise in Lithuania's GDP in 2024 compared to the previous year. The economic growth in the last six months was broad-based, with growth in value added in almost all industries, and was mainly driven by manufacturing and trade. Other services also had a significant impact. According to output sales data, most of the growth in manufacturing was driven by producers of chemicals, fabricated metal products other than machinery and equipment, and furniture. In contrast, oil refining activity, which is usually characterised by large fluctuations, contracted in the second half of last year. The increase in value added of trading companies was driven by strong growth of consumption, while for services, sales of information and communication, professional, scientific and technical as well as administrative and support service activities rose particularly rapidly. In contrast, transport and storage faced greater difficulties, with the recent stagnation of this industry caused by the sluggish development of the EU economy and the resulting transport overcapacity on Western markets.

¹⁶ Unless otherwise indicated, the indicators discussed in the chapter are adjusted for seasonal and workday effects.

¹⁷ Since 2004, average quarterly growth has been 0.8%.

After two years of stagnation, the Lithuanian economy, which started to grow in the first half of 2024, continued to expand in the second half of the year as well.

Chart 5. GDP development (left-hand panel) and GDP development and contributions (by production approach; right-hand panel)



Sources: State Data Agency and Lietuvos bankas calculations.

Note: Trade activities also include transport, accommodation and catering as well as information and communication activities.

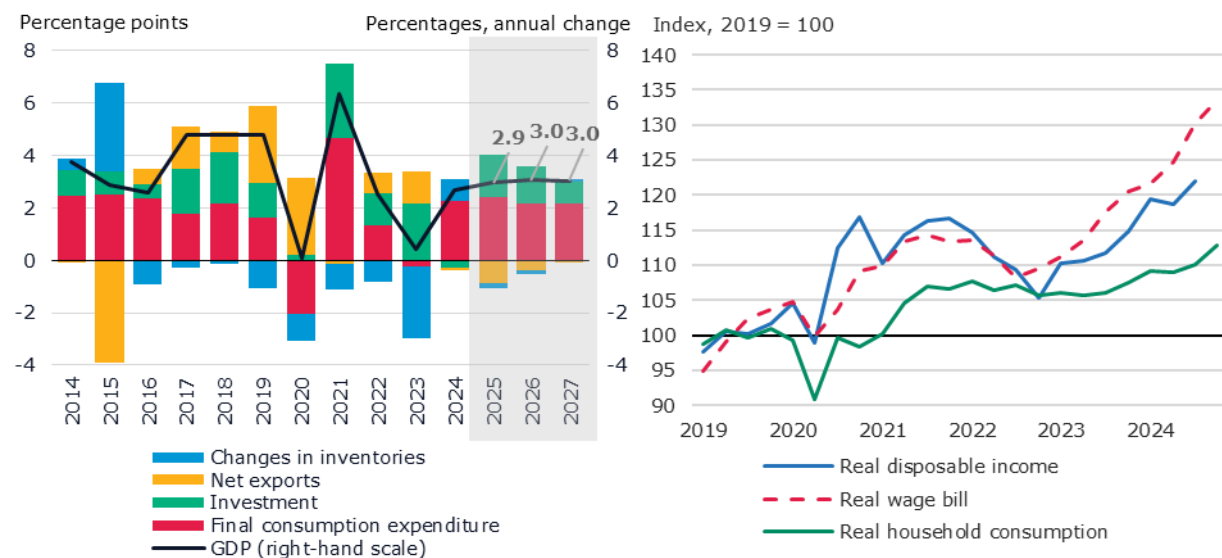
Looking ahead, the Lithuanian economy is expected to continue to expand and strengthen. This will be driven by a gradual recovery of external demand, further increase in the purchasing power of households which will stimulate consumption as well as growing investment due to the increasing flows of EU support funds and fading effects of previously tightened monetary policy. Real GDP is projected to be 2.9% higher this year than last year and to grow by 3.0% and 3.0% in 2026 and 2027 respectively (see Chart 6, left-hand panel).

With a rapid rise in the household purchasing power and favourable labour market situation, the growth of household consumption in Lithuania picked up pace in the second half of last year (see Chart 6, right-hand panel). Consumption in Lithuania grew by 1.1% quarter on quarter in the third quarter and by 2.5% in the fourth quarter, significantly above the long-term average. This led to a 3.7% increase in consumption last year which contributed most to economic growth from an expenditure approach (see Chart 6, left-hand panel). According to Lietuvos bankas estimations, real disposable income grew by 8.2% in 2024, mainly driven by a marked increase in real wages and social benefits after inflation subsided. Real disposable income is projected to continue to grow at a strong albeit slower pace of 4.9% this year. The contributing factors include the projected stronger price growth and slightly slower wage growth.¹⁸ In addition to income growth, consumption development continues to benefit from the good labour market situation and optimistic consumer expectations. For instance, the EC's consumer confidence indicator for Lithuania in the second half of last year was at its highest level since the global financial crisis and significantly above the indicators of other EU countries. It is also worth mentioning that the sentiment of intentions to make major purchases in the next 12 months is also well above the historical average. In addition, households have the most positive views on the current financial situation since the start of data publication. Against this background, household consumption is projected to grow by 4.1% this year and 3.7% in 2026 and 2027 respectively.

¹⁸ See Chapter 6 for more on price developments and Chapter 4 on the labour market.

Consumption increased rapidly in the second half of last year and was the main driver of economic growth.

Chart 6. Actual and projected GDP developments (expenditure approach, left-hand panel), real household consumption and income developments (right-hand panel)



Sources: State Data Agency and Lietuvos bankas calculations.

Although exports of non-mineral goods of Lithuanian origin grew in the second half of last year, boosting the industrial recovery, capacity utilisation levels which were still below the long-term average constrained investment growth. In the second half of last year, the overall level of exports of goods and services contracted. Exports of non-mineral goods of Lithuanian origin, which increased for the second consecutive quarter, prevented a further decline (see Chapter 5 for more on foreign trade). Growing exports of non-mineral goods of Lithuanian origin supported the industrial recovery, which in turn pushed up the utilisation rate of production capacities. With capacity utilisation rates rising and the effects of previously tightened monetary policy fading, investment in Lithuania increased by 3.0% quarter on quarter in the third quarter and 6.4% in the fourth quarter, following a significant increase in transport investment. However, due to the contraction of investment in the first half of 2024, overall investment in 2024 fell by 1.1% compared to the previous year. Investment in means of transport fell significantly last year. It was particularly affected by the transport overcapacity on the EU market in 2023, lower transport prices and tighter monetary policy. The increasing flows of EU support funds and further weakening impact of previously tightened monetary policy are expected to have a positive impact on investment, with investment expected to grow by 6.6% already this year and 5.5% and 3.1% in 2026 and 2027 respectively.

Box 1. Development of the Baltic economies in the aftermath of geopolitical and other shocks

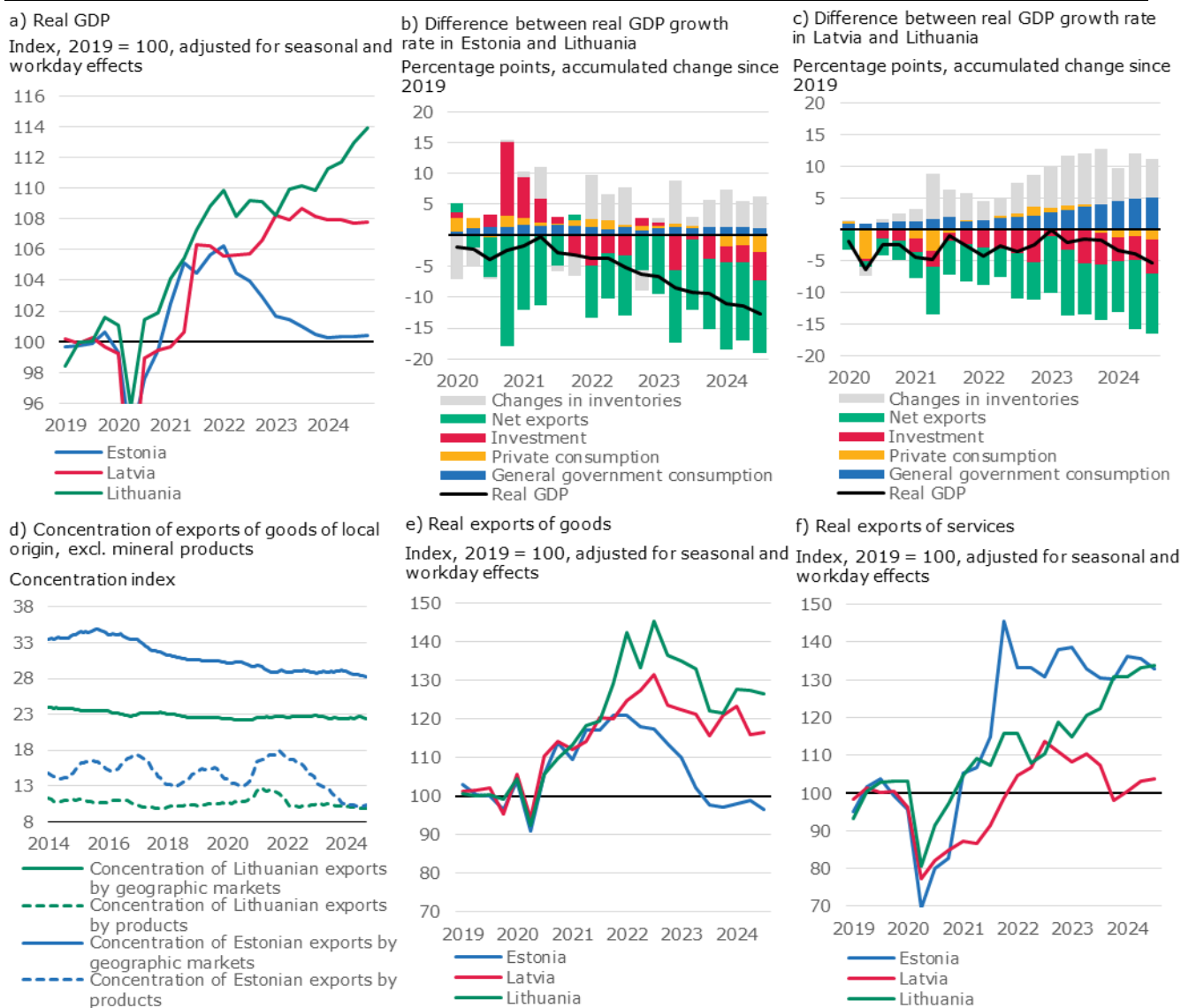
Prepared by Ernestas Virbickas¹⁹

Geopolitical and other significant events in recent years have had a strong impact on the development of the economy of Lithuania and many regions of the world, but economic changes varied across countries. The development of the Baltic economies has also been quite different. During the five years since 2019, when economic development was still not affected by the subsequent global pandemic, later intensification of

¹⁹ This box also includes material prepared by Kasparas Vasiliauskas.

russian aggression against Ukraine and sharp spike in commodity and other prices, the Lithuanian economy grew by 12.5% (see Chart A, panel a). During the same period, the Latvian economy grew to a smaller extent, by 7.9%, while the Estonian economy, which fluctuated considerably, did not grow at all. This box aims to identify what factors may have contributed to the divergence in the development of the Baltic economies.

Chart A. GDP and export indicators in the Baltic countries



Sources: Statistics Estonia, Eurostat, State Data Agency and Lietuvos bankas calculations.

The situation of Baltic exporters and net exports was probably the most divergent over the last few years of major shocks (see Chart A, panels b and c). **For many years, Lithuanian exports of goods have been characterised by greater diversification, both in terms of products exported and geographical destinations** to which the goods are exported (see Chart A, panel d²⁰, ²¹). This makes it easier to cope with unexpected changes in demand if they occur only in certain geographical or product markets. In a period of higher inflation, elevated interest rates and weaker purchasing power, Lithuanian exports of goods were relatively less affected than in some neighbouring countries (see Chart A, panel e). Lithuanian exporters of goods were able to keep almost intact the market shares they had previously gained. The considerable diversification of exports of goods

²⁰ A lower value of the concentration index reflects lower concentration (higher diversification) of exports of goods.

²¹ Due to the lack of data on Latvia's exports of goods of domestic origin, concentration indices for this country are not presented in this box.

has likely contributed to the resilience of exports and overall economic activity. The latter was also consistently boosted by a sustained increase in exports of services, such as information, communication, professional, administrative and transport services (see Chart A, panel f).

The demographic situation in the Baltic countries has evolved quite differently over the period under review. The previously negative balance of international migration in Lithuania has turned positive since 2019. It was particularly positive in 2022, when the large-scale Russian military invasion of Ukraine began. It was in 2022 that the Lithuanian population started to increase (see Chart B, panel a). Both the labour force and the number of employed persons expanded as a significant share of the incoming population was willing to work. In 2024, the number of employed people in Lithuania was 7.9% higher than in 2019.²² The change in the demographic situation has had a positive impact on economic activity, both on the supply side (due to an increase in the labour force) and on the demand side (due to a rise in the number of consumers). The demographic situation has also changed significantly in Estonia where the population, labour force and number of employed persons have also increased. In contrast to these two countries, Latvia has not experienced such favourable demographic developments. While the population in Latvia grew at the start of the large-scale Russian military invasion of Ukraine, it has recently declined compared to 2019, and the labour force and the number of employed people have also declined.

The development of household income in the Baltic countries has also been quite uneven. While real wages grew the most in Latvia between 2019 and 2024²³ total real labour income (real wage bill) has increased the most in Lithuania, due to a particularly large rise in the number of people in employment. In 2024, the real wage bill in Lithuania was 27.1% higher than in 2019 (see Chart B, panel b). The uneven changes in household income have not contributed much to the divergence in consumption developments (real private consumption increased by around 7–10% in all Baltic countries over the period under review; see Chart B, panel c). However, the stronger growth of labour income in Lithuania implies that the Lithuanian government has received more revenue, had more room to increase social benefits and remuneration of public sector employees as well as to finance other needs. This has also contributed to a greater improvement in the financial situation and confidence of Lithuanian households.

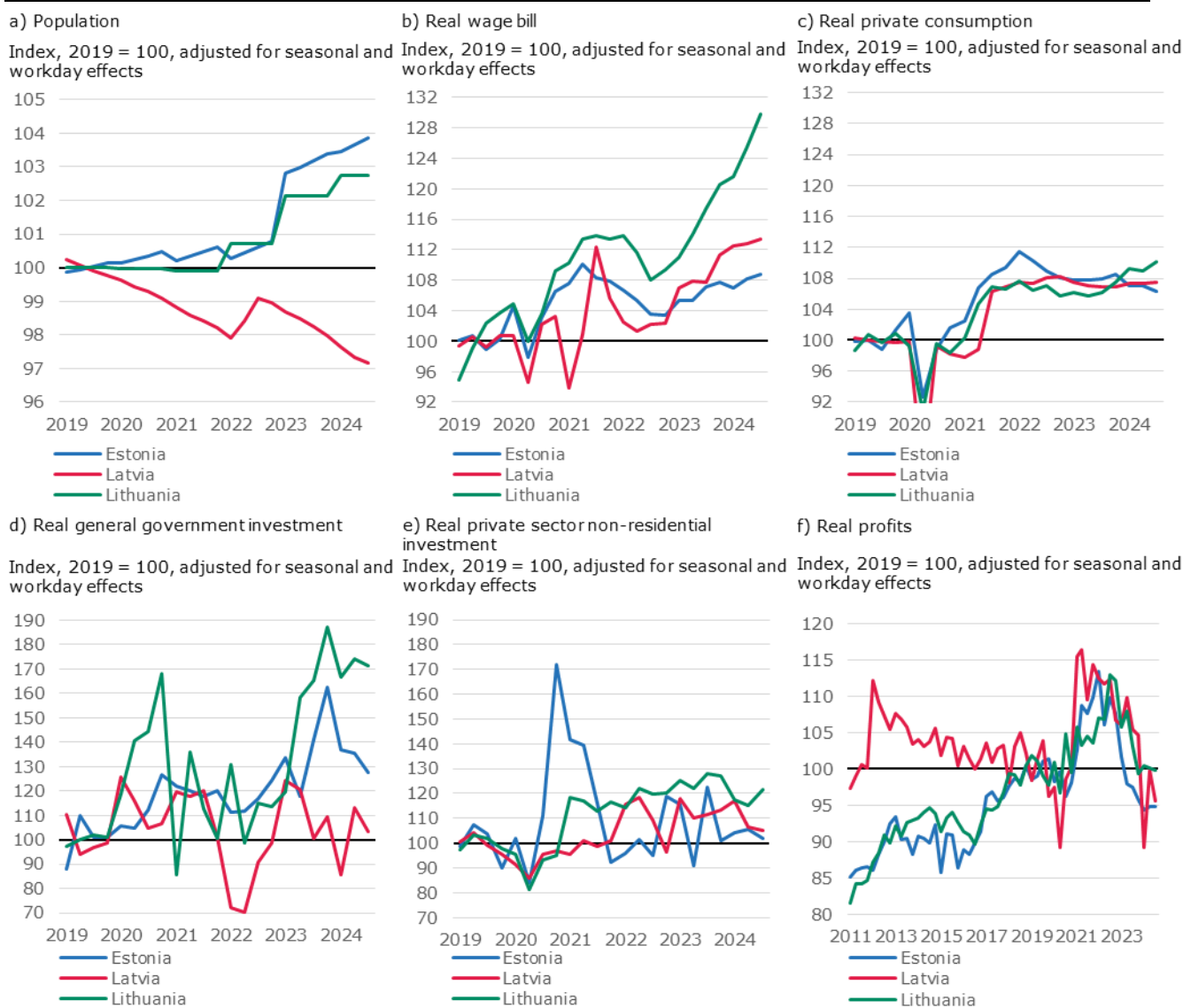
Investment processes in the Baltic countries have also developed differently. During the period under review, Lithuania saw the largest increase in investment. The growth of government investment was particularly strong (see Chart B, panel d) and much of it was financed by EU support funds. Private sector non-residential investment has also increased more than in neighbouring countries (see Chart B, panel e). Better performance of industry and entire export sector, more balanced economic development and relatively low levels of leverage among the companies compared to some neighbouring countries (e.g. Estonia) in an environment of higher interest rates are likely to have contributed to such change in investment. The latter was also positively affected by good financial standing of Lithuanian companies. During the period of high inflation, Lithuanian corporate profits increased more than the general price level, i.e. real corporate profits²⁴ grew (see Chart B, panel f). This has created a financial buffer for firms allowing them to invest more. Real corporate profits also increased in neighbouring countries but fell more than in Lithuania over the last few years.

²² Based on national accounts data, employment in domestic concept.

²³ Based on national accounts data on compensation of the employee.

²⁴ Real corporate profits are calculated by dividing the gross operating surplus and gross mixed income by the GDP deflator.

Chart B. Demographic, consumption and investment indicators in the Baltic countries



Sources: Eurostat and Lietuvos bankas calculations.

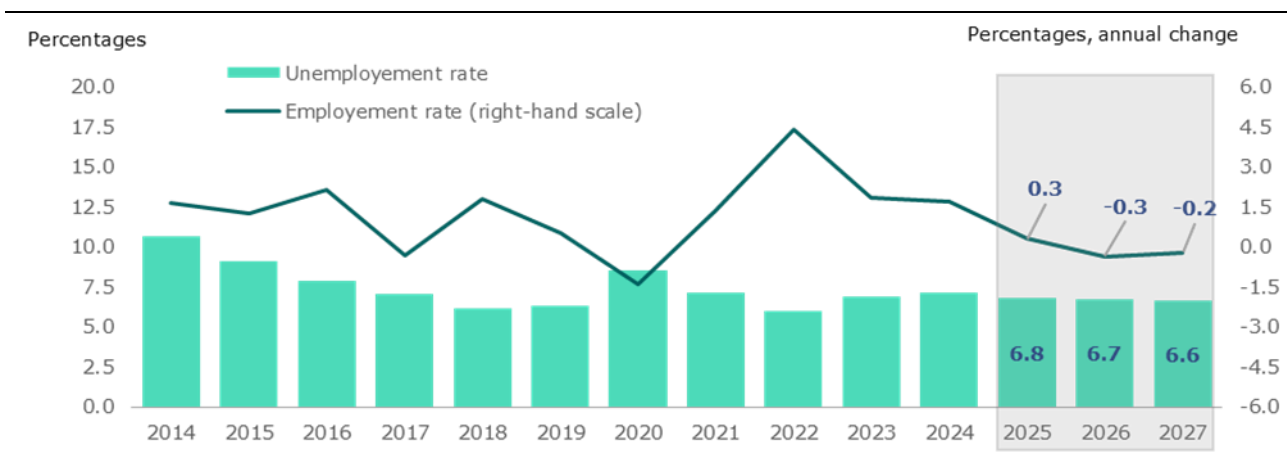
In summary, geopolitical and other shocks have had a tremendous impact on the economic development of the Baltic and other countries, but economic path has varied in different countries. Compared to its neighbours, Lithuania’s economy grew more over the last few years. It was particularly supported by the non-price competitiveness of exporters and considerable diversification of exports both in terms of products exported and geographical locations, which has strengthened the resilience of firms operating in foreign markets. Lithuania’s economic activity was boosted by considerable growth in population, labour force and number of workers, which had a positive impact not only on business development opportunities but also on the state of public sector finance and the capacity to increase social benefits, wages and other government spending. Lithuania’s economic development was also positively affected by higher public and private sector investment compared to the neighbouring countries, giving a boost to construction, industry and other economic activities. The strong financial state of companies and rising real corporate profits, among other factors, have also supported investment.

4. Labour market

The Lithuanian labour market situation continued to be strong at the end of 2024. Favourable migration trends of recent years have had a significant impact on labour market indicators. The labour force participation rate has reached heights last seen only around 2004, before the big wave of emigration following the EU accession. With population growth and more workers entering the labour market for the third consecutive year, the number of people in employment in Lithuania is at its highest level since 1998. Unemployment, which rose at the start of 2024, also fell and wages continue to rise at a double-digit pace.

The number of employed persons in Lithuania increased over the year, but employment trends vary across sectors. Last year, the total number of employed persons in the country was 1.464 million, 1.6% higher than in 2023. The number of employed persons was significantly boosted by the successful integration of foreigners into the Lithuanian labour market. Foreigners accounted for over half of the employment growth during the year (see Box 2 for more details). The main contributor to the employment growth was industry, whose labour demand was pushed up by recovering export volumes. Employment developments in Lithuania were particularly adversely affected by difficulties in the transport sector. The sluggishness of the EU economy and transport overcapacity in Western markets have contributed to the sector's stagnation. Lietuvos bankas projects that employment will increase by 0.3% this year and contract by 0.2% next year. (see Chart 7).

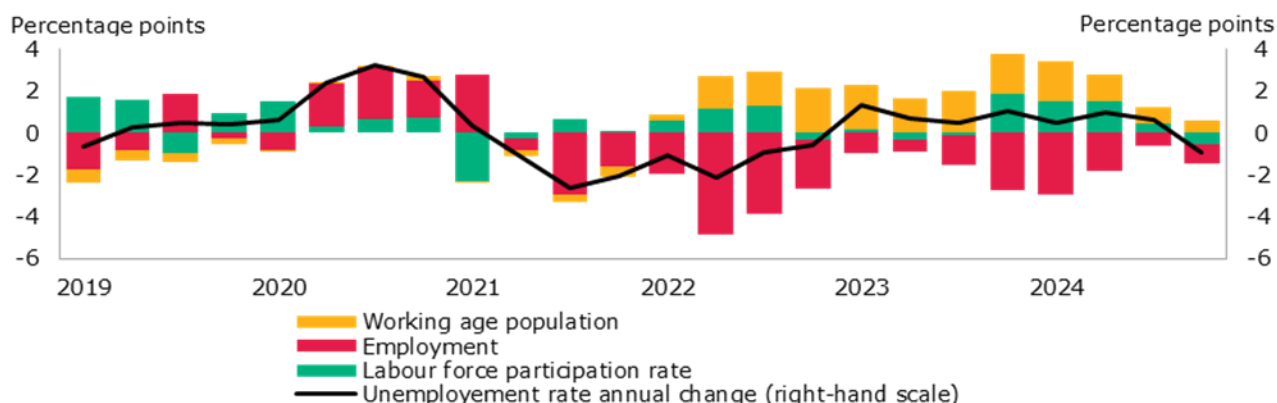
Chart 7. Unemployment rate and dynamics of the employed



Sources: State Data Agency and Lietuvos bankas calculations.

In the fourth quarter of 2024, the unemployment rate in Lithuania was 6.5%, down by 0.9 percentage points year on year. The main contributors to the fall in unemployment were the larger number of people in employment as well as the decline in the labour force participation rate (see Chart 8). These indicators reduced the unemployment rate by around 1.0 and 0.5 percentage points respectively. Data from other sources also confirm the downward trend of unemployment: registered unemployment published by the Employment Service in December 2024 was 9%, down by 0.3 percentage points year on year. It should be noted that the contraction of youth unemployment has greatly contributed to the overall decline in the unemployment rate: the drop of over 5 percentage points in the youth unemployment rate year on year accounted for around two-fifths of the overall unemployment contraction. On the other hand, the number of long-term unemployed went up. They now account for around 43% of all unemployed, the highest share since the end of 2021. Lietuvos bankas projects that the unemployment rate will be 6.8% this year and fall to 6.7% next year.

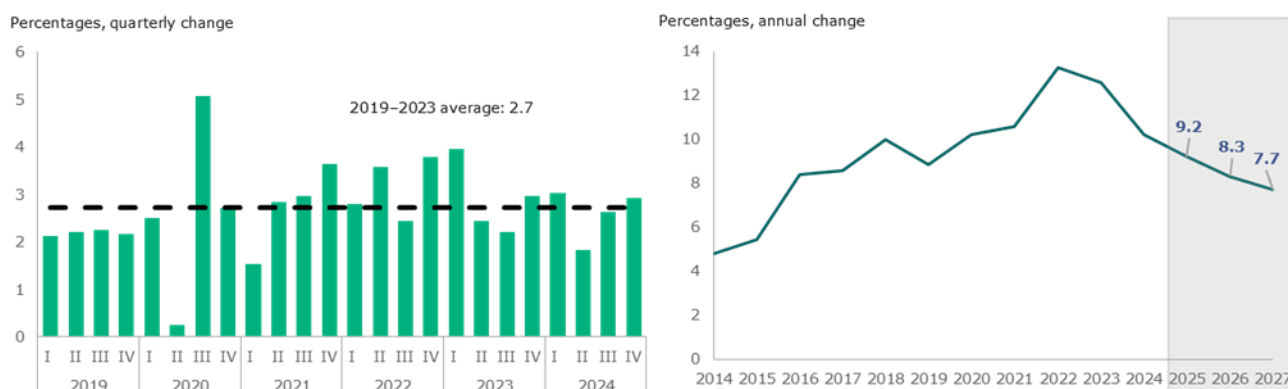
Chart 8. Unemployment rate change over the year and contributions



Sources: State Data Agency and Lietuvos bankas calculations.
 Note: The number of the employed is shown with an inverted sign.

Wage growth remains robust. Based on the fourth quarter data from the State Data Agency, wages in the national economy grew by 10.7%, while public sector wages continued to rise at a faster annual rate (14.5%) than in the private sector (8.9%). The main driving force behind the public sector wage growth is the rapid increase in wages for education and health workers. The strong wage growth in the public sector can be attributed to the increase in the minimum salary coefficients for employees of budgetary institutions at the beginning of the year. Historically, labour income growth continued to be robust (see Chart 9) and labour market tensions remained at historically high levels. This is also reflected in the vacancy rate which has been close to 2% for some time. Wage growth is projected at 9.2% this year, before slowing to 8.3% next year.

Chart 9. Quarterly developments of average insured income compared to the historical average (left-hand panel), annual development and projection of wages (right-hand panel)



Sources: State Social Insurance Fund, State Data Agency and Lietuvos bankas calculations.
 Note: Quarterly data are seasonally adjusted.

Box 2. Impact of migration trends on Lithuania's demographic indicators in 2024

Prepared by Bartas Baltušis

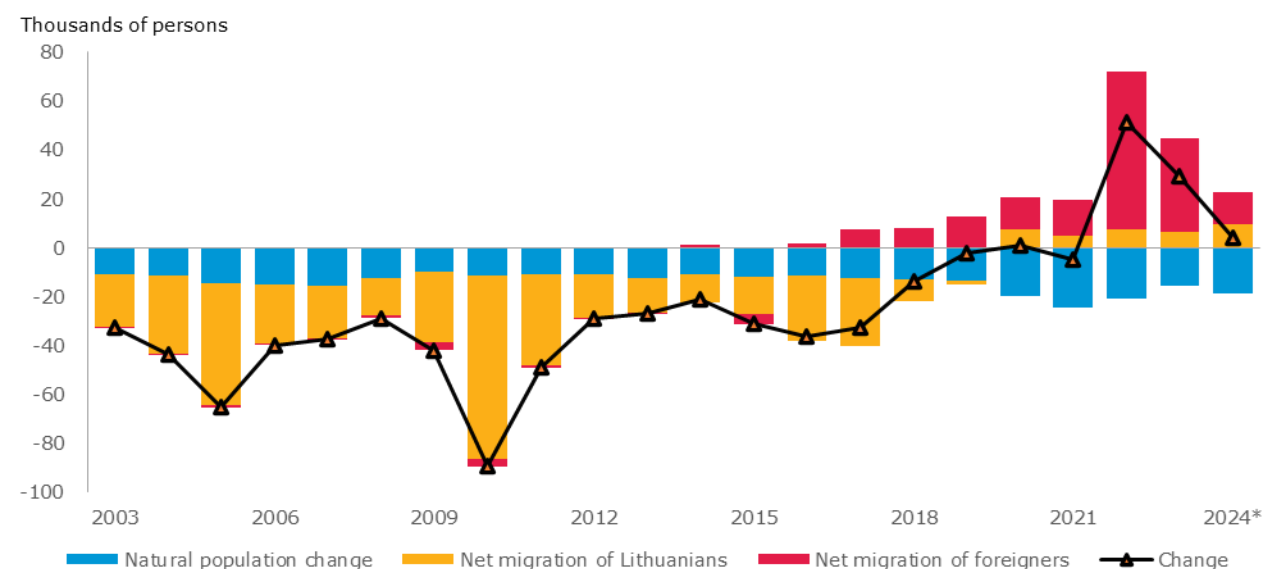
In 2024, Lithuania's population grew and the labour force was at its highest level since EU accession, but the fall in the birth rate is worrying. These demographic trends were mainly driven by positive net migration flows. Foreigners arriving in Lithuania have successfully entered the labour market and contributed positively to

the increase in the number of employed people. However, according to EC projections, Lithuania’s demographic outlook is more pessimistic due to a decline in the birth rate: the population may reach just over 2.6 million in 2050 due to the negative natural population change and slower net migration.

The number of habitual residents in Lithuania has increased for three consecutive years. According to preliminary data, Lithuania’s population grew by 4,300 persons in a year, totalling 2.89 million at the beginning of 2025. The increase in the population was underpinned by the fact that the number of immigrants, both Lithuanians and foreigners, exceeded the number of emigrants. In 2024, 23,000 more persons arrived in Lithuania than left. Net migration of Lithuanian citizens was the highest since the beginning of the data publication: it remained positive for the fifth consecutive year and amounted to 9,000 persons in 2024. Net migration of foreigners was around 13,000 persons. However, due to lower immigration of foreigners, population growth last year was slower than in 2023. Still, this migration balance was sufficient to offset the negative population change. In 2024, approximately 19,000 more people died in Lithuania than were born. The natural population change rate worsened over the year (for comparison, around 16,000 more people died in Lithuania than were born).

The positive migration balance offset the natural population change.

Chart A. Contributions to the change in the resident population of Lithuania in 2003–2024



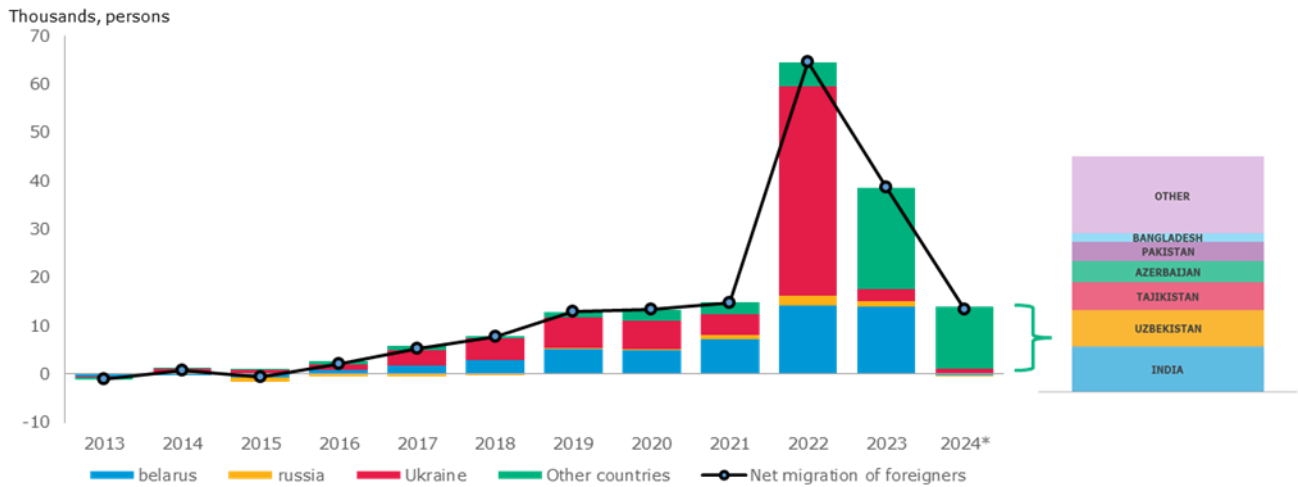
Sources: State Data Agency and Lietuvos bankas calculations.

Notes: State Data Agency’s data for 2024 are preliminary.

The structure of foreign migration flows has changed: positive migration flows are no longer mainly driven by belarus and Ukraine, but by Central and South-East Asia nationals. The record high migration balance recorded in 2022 dropped by nearly 70% in 2024. These changes were mainly due to a plunge in the net migration balance of Ukrainians fleeing the war and belarusian economic migrants (see Chart B). The balance of belarusian and Ukrainian migrants was around 57,000 in 2022 and less than 1,000 in 2024. This decrease was partly offset by migrants from Central and South-East Asia. Net migration from Central and South Asian countries, mainly India, Uzbekistan and Tajikistan, accounted for the largest share of the migration balance (around 10,000, or almost three-quarters of the total net migration of foreigners), but declined by two-fifths over the year.

In 2024, the decline in overall net migration in Lithuania was due to a massive drop in the level of migration of foreign nationals, mainly driven by a decrease in net migration from belarus.

Chart B. Balance of migration of foreigners by nationality



Sources: State Data Agency and Lietuvos bankas calculations.

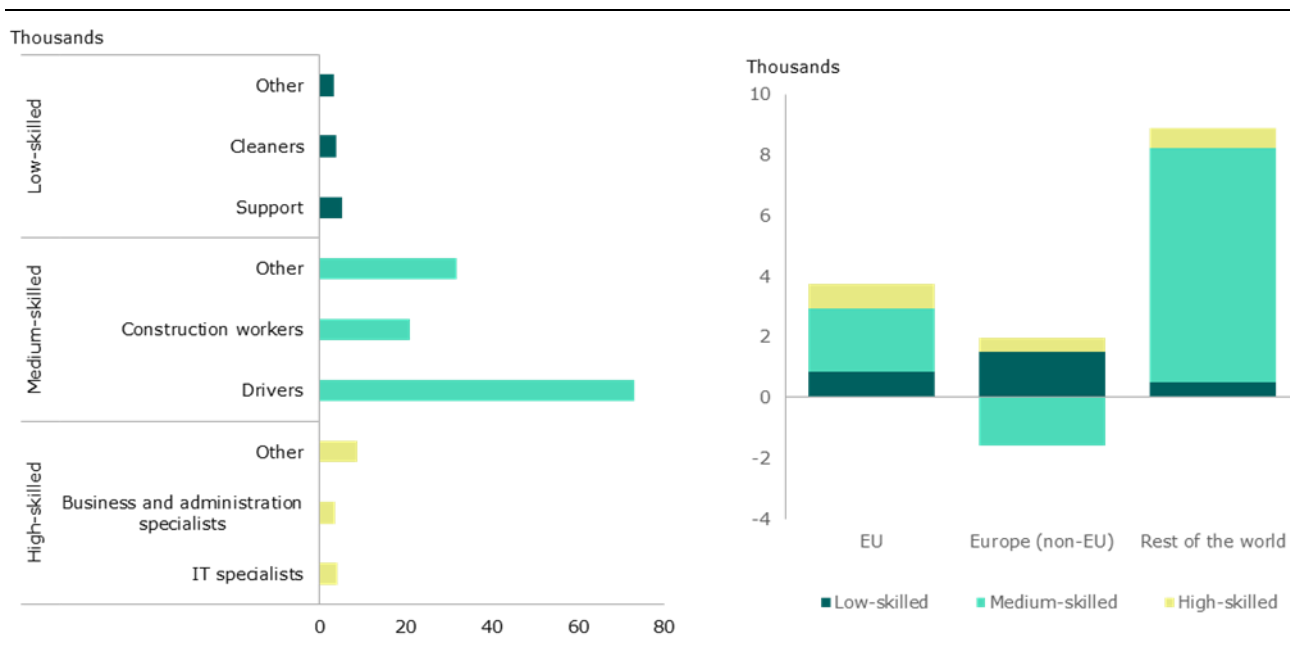
Note: State Data Agency's data for 2024 are preliminary.

Overall, more than 150,000 foreigners worked under employment contracts in Lithuania, just over a tenth of the total number of employees. More than four-fifths of them worked in medium-skilled jobs, mainly as drivers (73,000) and construction workers (21,000)²⁵ (see Chart C). The number of employed foreigners in Lithuania went up by around one tenth (13,000) over the year. Immigrants from India, Uzbekistan and Tajikistan were the main contributors to the increase in employment among non-Lithuanians. However, it was not only third-country nationals who boosted employment. EU nationals (mainly from Romania, Latvia and Poland) accounted for almost a third of the total foreign employment growth. This shows that Lithuania is becoming an attractive place to work and earn even for citizens of developed countries.

Over the year, the highest increase in the number of employed foreigners was in medium-skilled occupations.

²⁵ Occupational titles were abbreviated.

Chart C. Number of foreigners with employment contracts by qualification (left-hand panel) and annual change by qualification and region (right-hand panel)



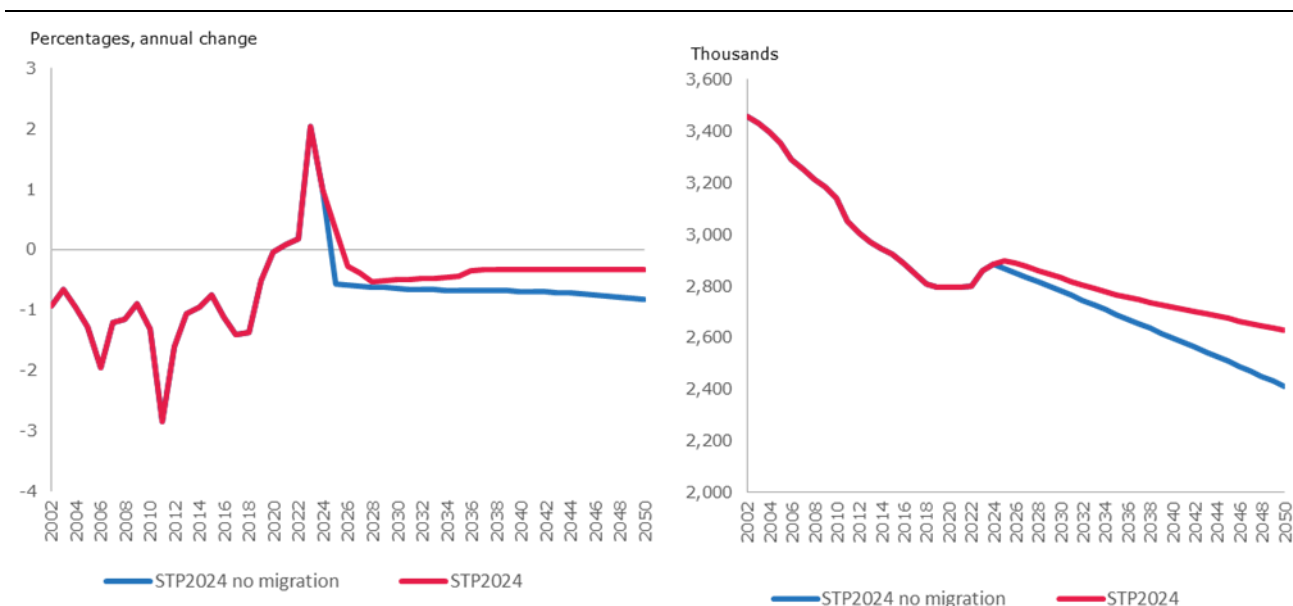
Sources: Employment Service and Lietuvos bankas calculations.

In 2025–2050, to offset the negative natural population change, the migration balance would need to be around 20,000. According to the latest projections of Eurostat (STP2024), the structure of Lithuania’s population will change over time, with a shrinking working-age population²⁶ and the total population of just over 2.6 million in 2050 (see Chart E). Based on these projections, net migration will remain positive in 2025–2050, averaging around 9,000 per year, but will not offset the natural population change (20,000 more deaths than births on average). If net migration were zero, Lithuania’s population would reach just over 2.4 million in 2050. Last year’s data also indicate that economic migrants contributed to the population count in Lithuania, which raises the question of how much migration is needed to keep the population from shrinking. According to the estimates of Lietuvos bankas and STP2024 assumptions, the migration balance would need to reach about 20,000 per year in 2025–2050 (about 11,000 more than currently projected) to compensate for the natural population change. Economic migrants would also increase the working-age population. According to the STP2024 projections, the share of the working-age population in the total population would be 2.1 percentage points lower in 2050 with net migration at zero. While third-country immigrants can help address labour market shortages, it is important to ensure that their recruitment process is strictly monitored. Immigration policy should focus on attracting high-skilled workers as this would further enhance Lithuania's economic growth potential.

²⁶ Individuals aged between 15 and 74.

Lithuania's population will steadily decline over the long term.

Chart D. Actual and projected annual population change (left-hand panel) and population level (right-hand panel)



Sources: EC, Eurostat and Lietuvos bankas calculations.

Notes: Actual values for 2002–2024, projections for 2025–2050, STP2024 – EC projection, STP2024 no migration – EC projection without migration flows.

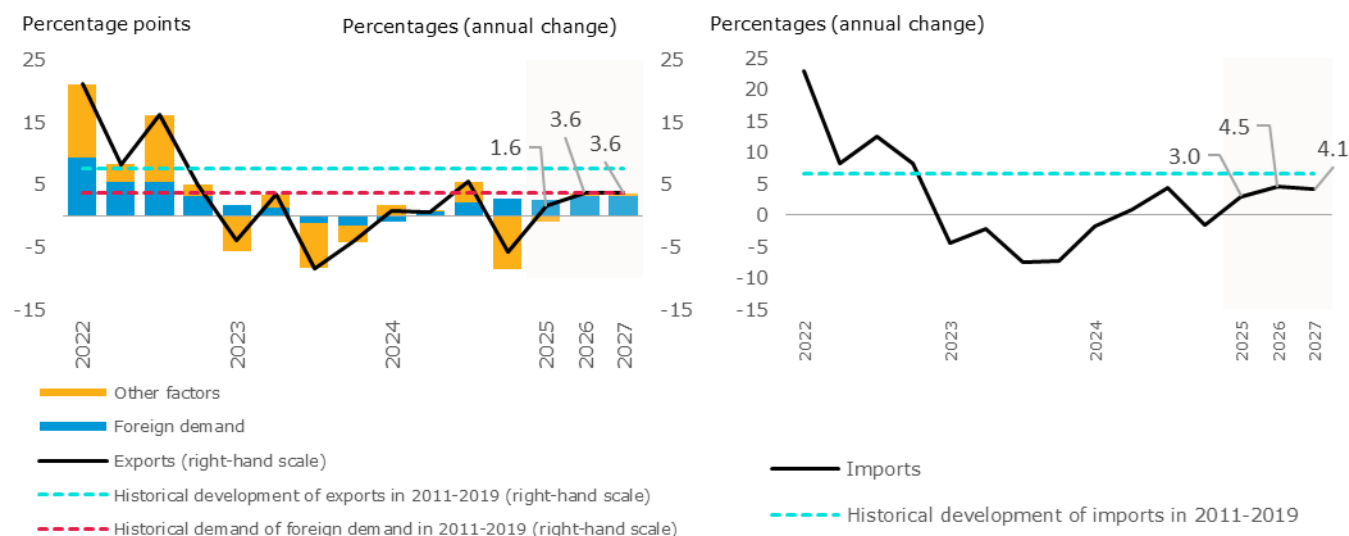
5. External sector

In the second half of 2024, export growth slowed down, whereas imports continued their gradual increase.

Exports were positively affected by rising foreign demand but other factors, mainly market share growth, put a halt on exports (see Chart 10, left-hand panel). Imports were boosted by the recovering domestic economy which supported imports of goods (see Chart 10, right-hand panel). As economic growth picks up, real imports are projected to recover in 2025 and increase faster than in 2024. Real exports are also projected to grow faster in 2025 than in 2024, but at a slower pace than imports and below the historical foreign demand development. In this context, real exports of goods and services are projected to grow by 1.6% in 2025, while real imports of goods and services are projected to increase by 3%. In the following years (2026–2027), exports will rise by 3.6% and 3.6% respectively, while imports will grow by 4.5% and 4.1%.

Export growth subsided, whereas imports continued to grow in the second half of 2024. Both exports and imports are projected to grow more rapidly in 2025–2027.

Chart 10. Historical development of real exports of goods and services (2-quarter moving averages) and projections for 2025–2027 (left-hand panel) as well as annual development of real imports of goods (2-quarter moving averages) and projections for 2025–2027 (right-hand panel)



Sources: State Data Agency, ECB, Lietuvos bankas and Lietuvos bankas calculations.

At the end of 2024, Lithuania's total nominal exports of goods were contracting due to continuing decline in re-exports and exports of mineral products exports. However, exports of non-mineral products of Lithuanian origin have already been growing significantly for the past six months (see Chart 11, left-hand panel). In both the third and fourth quarters of 2024, rising exports of chemical products and plastics were the main contributors to growth (see Chart 11, central panel). Stabilisation of natural gas prices and the easing of sanctions against Lifosa AB led to a recovery in exports of nitrogen and phosphate fertilisers. Exports of reagents grew, while the disruption of maritime transport flows in the Red Sea and reduced imports from Asia resulted in an increase in the price and demand for polyethylene terephthalate (PET) products in Europe, which in turn boosted exports of Lithuanian PET producers. As in the previous quarters, exports of engineering and wood and furniture products continued to grow. Re-exports were most negatively affected by the continued contraction of exports to the Commonwealth of Independent States (CIS) due to the restrictions imposed (see Chart 11, right-hand panel).

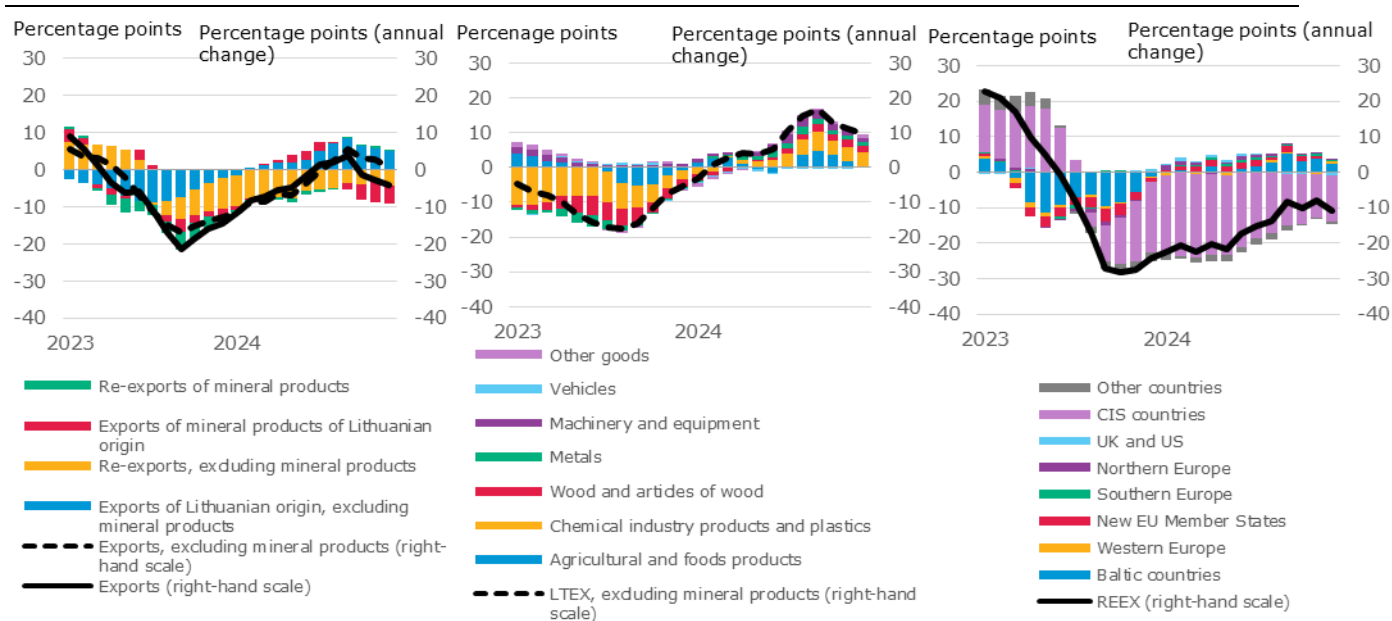
Looking ahead, exports of products of Lithuanian origin should continue to grow as foreign demand recovers, while re-exports should stabilise. The declining trade with the CIS is leading to a declining importance of re-exports in re-exports and total exports.²⁷ Meanwhile, re-exports to other countries have remained broadly stable in recent years. Therefore, it is likely that in the future the impact of declining re-exports to the CIS countries on re-export and export indicators will decrease, while total re-exports will gradually stabilise. As regards the outlook for exports of Lithuanian origin, it should be noted that the level of industrial capacity utilisation is currently below the historical average and there are no signs of a loss of competitiveness at this stage either as the market shares of exports of Lithuanian origin continue to be maintained. Thus, as foreign demand recovers, production and, consequently, exports of Lithuanian companies should increase. The most encouraging growth drivers are exports of mineral products, which are currently at a significantly reduced level, and exports of wood and furniture, for which foreign demand is expected to accelerate as interest rates go down and real estate market in the main partner countries recovers. However, as the risk of trade wars with the US increases, so does the uncertainty and, consequently, the risk of losing at least some access to the US

²⁷ At the end of 2024, the share of re-exports to the CIS was just over 6% of total exports of goods (calculated as the moving average of the last 12 months). Historically (since 2004), the share of re-exports to the CIS has been close to 17% of total exports of goods.

market, where a significant share of exports of Lithuanian origin is going. How this could affect overall export performance and GDP growth is examined in Box 4.

The most important export component, exports of non-mineral products of Lithuanian origin, has been growing and the recovery in foreign demand is likely to further increase the volume of these exports. With the share of re-exports to CIS countries decreasing, total re-exports should gradually stabilise.

Chart 11. Developments of nominal exports of goods (3-month moving averages) (left-hand panel), developments of exports of goods of Lithuanian origin (3-month moving averages) (central panel) and re-export developments (3-month moving averages) (right-hand panel)

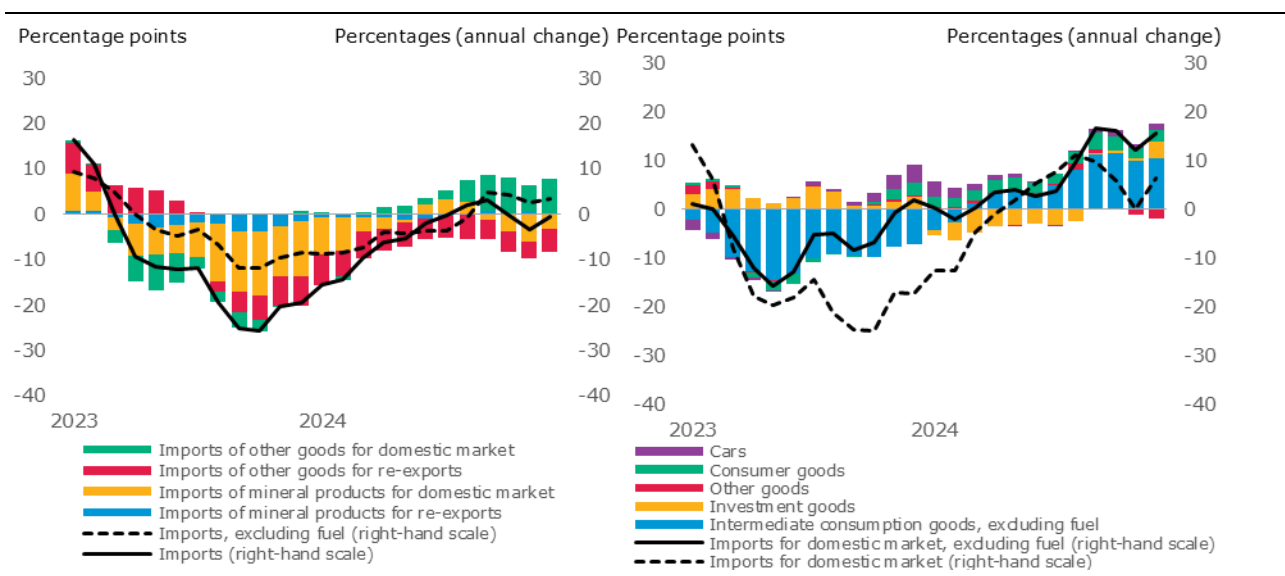


Sources: Eurostat, U.S. Census Bureau, HM Revenue & Customs, State Data Agency, Lietuvos bankas and Lietuvos bankas calculations.
Note: LTEX – exports of Lithuanian origin, REEX – re-exports.

At the end of 2024, nominal imports of goods were contracting mainly due to a decline in imports of mineral products and re-exports (see Chart 12, left-hand panel). Imports of mineral products declined due to a reduction in the processing demand for exports of these products. Imports of re-exported goods decreased due to the above-mentioned restrictions on exports of goods to CIS countries. The decline in imports of goods was contained by a recovery in imports of consumer, intermediate and investment goods intended for the domestic market, mainly attributable to rising domestic demand. Overall, imports of goods, excluding mineral products, for the domestic market have been on the rise since early 2024 (see Chart 12, right-hand panel). In this context, as domestic demand continues to grow and exports of mineral products recover, imports of goods for the domestic market are also likely to grow faster. The rise in imports is likely to be supported by stabilising re-exports.

Imports are expected to accelerate as domestic demand continues to grow and re-exports stabilise.

Chart 12. Annual developments of imports of goods (3-month moving averages) (left-hand panel) and imports of goods for the domestic market (3-month moving averages) (right-hand panel)



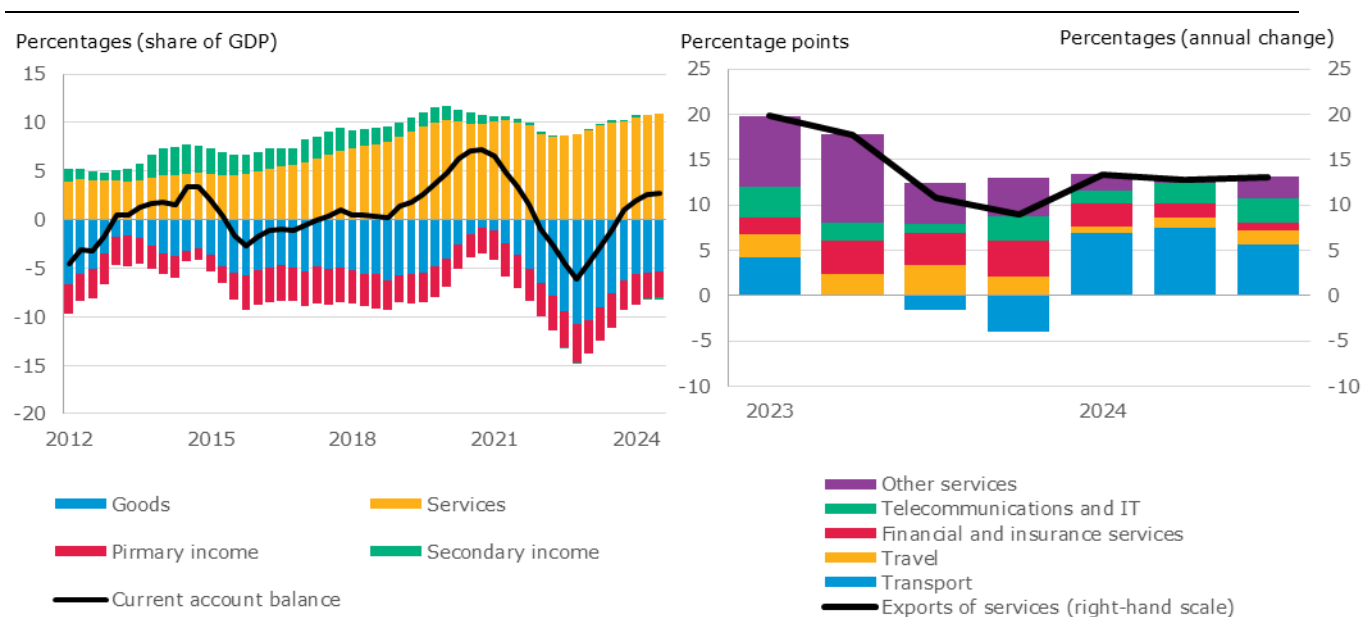
Sources: State Data Agency, Lietuvos bankas and Lietuvos bankas calculations.

Note: REEX – re-exports.

Exports of services continued to grow, while the development of the other components of the current account, that is primary and secondary income, did not change significantly in the third quarter of 2024 (see Chart 13, left-hand panel). Exports of services grew mainly on the back of rising exports of transport services and exports of telecommunications and IT services (see Chart 13, right-hand panel). The high-frequency monthly data suggest that the annual development of exports of transport, telecommunications and IT services was also positive in the fourth quarter of 2024. The impact of other components of the current account balance on the overall balance has little changed. In the short term, the growth of the current account balance will be held back by a faster recovery of imports of goods, which will widen the goods trade deficit. However, a widening services trade balance and a narrowing secondary income deficit should offset the rise in the goods trade deficit. The current account balance is projected to be 1.3% of GDP in 2025.

The current account balance has been recovering since the beginning of 2023, mainly on the back of a narrowing goods trade deficit and a rapidly widening services trade surplus.

Chart 13. Components of the current account balance (4-quarter moving averages) (left-hand panel) and services exports (right-hand panel)



Sources: State Data Agency, Lietuvos bankas and Lietuvos bankas calculations.

Box 3. Trade relations between Lithuania and the US, and implications of possible trade wars with the US for Lithuania's economy

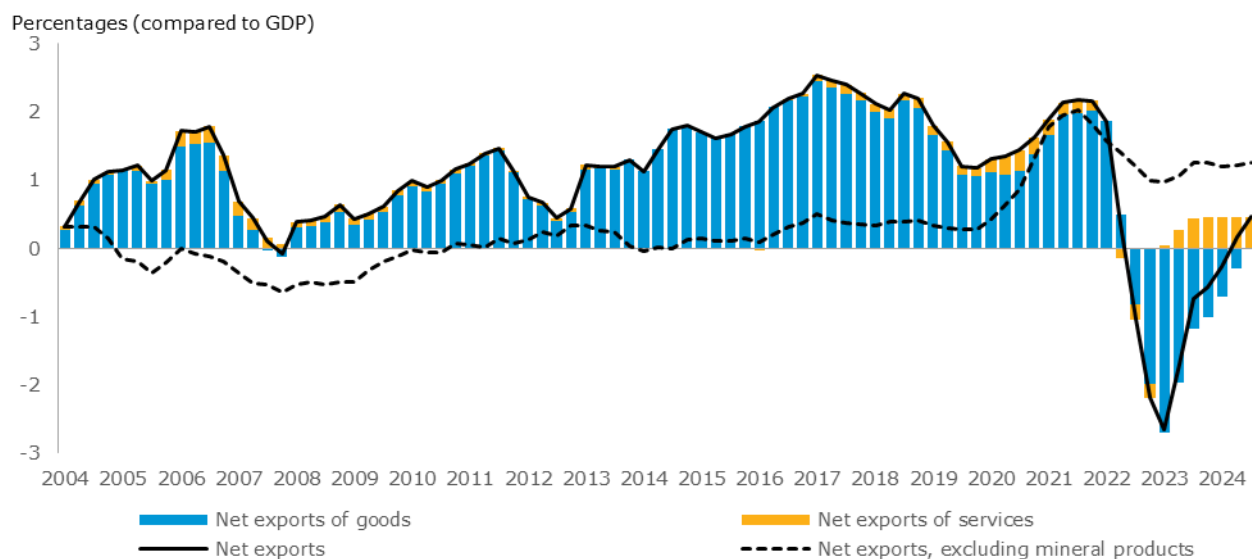
Prepared by Kasparas Vasiliauskas

For a small open economy like Lithuania, greater global integration involving a smooth cross-border movement of goods, services, ideas and capital, has been a cornerstone of economic transformation and success since the very beginning of the restoration of independence. However, recent geopolitical events, such as the UK's exit from the EU, the COVID-19 pandemic, russia's military invasion of Ukraine, have disrupted multilateral trade and transformed the scale of the global market. Another risk of potential trade wars between the EU and the US is now emerging. Against this background, this box provides an overview of trade relations with the US and assesses the impact that the EU-US trade war could have on the Lithuanian economy.

The US is one of Lithuania's largest trading partners, with which trade flows have steadily increased since the start of data publication. Lithuania has almost always had a trade surplus with the US (see Chart A). The trade surplus was mainly made of the surplus of trade in mineral products but there has been an increasing importance of trade in services since 2016 and in non-mineral products since 2020. From 2016, the surplus of goods trade started to decrease, following the installation of a natural gas terminal in Lithuania and imports of natural gas from the US. In 2022–2023, the trade balance already turned negative due to a goods trade deficit, mainly affected by the rise in energy prices following russia's military invasion of Ukraine and the corresponding widening of imports of petroleum products and natural gas from the US. However, as natural gas prices stabilised, the negative balance of goods trade narrowed and became positive again, while the balance of services continued to grow steadily. In the future, the trade balance is likely to widen as net exports of services and non-mineral products increase. However, the return of the surplus to the levels recorded in 2012–2016 will be hampered by increased imports of mineral products from the US and possible changes in tariff policy between the US and the EU.

Lithuania has historically enjoyed a trade surplus with the US, mainly due to goods trade. More recently, a growing trade surplus in services has been observed.

Chart A. Lithuania's trade balance with the US (4-quarter moving averages)



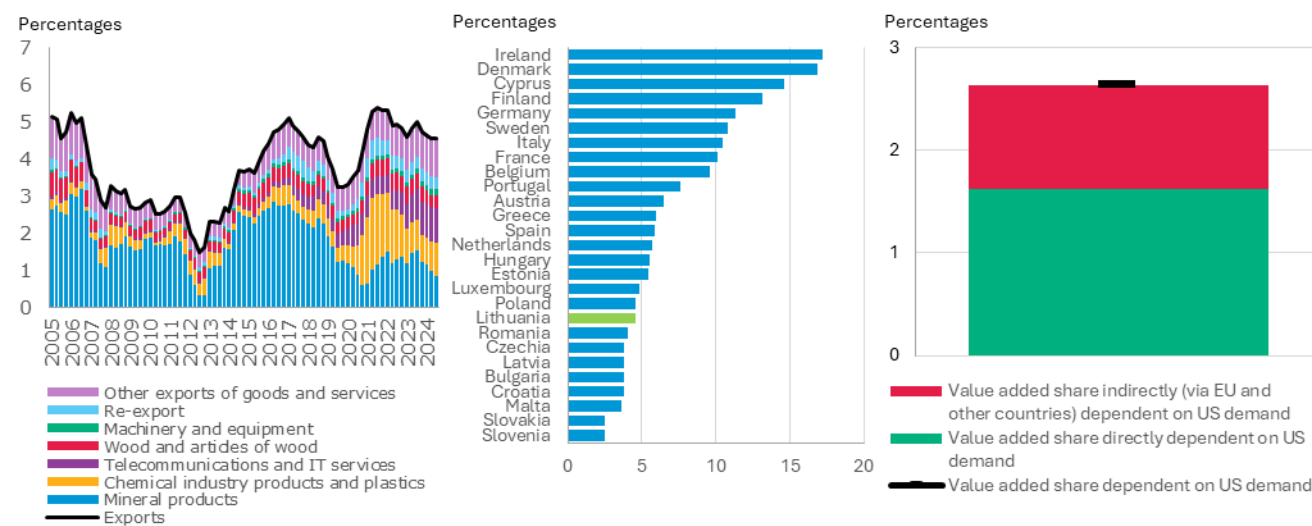
Sources: Eurostat and Lietuvos bankas calculations.

The analysis of exports of goods and services shows that the share of exports to the US in total exports has been increasing steadily since 2012. In 2023–2024, exports to the US accounted for nearly 5% of total exports. Lithuania mainly exports goods and services of Lithuanian origin, with re-exports accounting for a fraction of trade. Historically and in recent years, mineral products made up the largest share of exports (see Chart B, left-hand panel). Since 2020, a significant increase in exports of chemical products and plastics as well as telecommunications and IT services has been observed. The growth of chemical products and plastics can be mainly attributed to the activities of the US-capital company Thermo Fisher Scientific Baltics UAB during the COVID-19 pandemic and increased exports of reagents to the US. It was the rise and development of exports of these products to the US that contributed to the resilience of the Lithuanian economy during the COVID-19 pandemic. The growth in exports of telecommunications and IT services can be attributed to the expansion of innovative Lithuanian IT companies on the US market. Exports of wood and wood products as well as machinery and equipment also accounted for a relatively significant share of exports.

Although Lithuania's share of total exports to the US has grown steadily compared to other EU countries, it is still relatively small, with Ireland, Denmark, Cyprus, Finland, Germany and Sweden being most dependent on direct trade flows with the US. The share of the US in the export structure of these countries was more than 10% of total exports (see Chart B, central panel). Lithuania's direct dependence on trade with the US is therefore relatively lower than for other EU countries. However, it is important to note that Lithuanian producers are strongly integrated in the supply chains of the EU and other countries for exports to the US. Lithuania produces intermediate goods or provides services for EU and non-EU producers who integrate Lithuanian products and services into their output and then export to the US. Lithuania's integration into supply chains for exports to the US and, consequently, its indirect trade with the US results in closer real economic ties between Lithuania and the US than the direct trade data suggest. The latest data on trade in value added indicate that over 2.5% of all value added generated in Lithuania depends on the US demand (see Chart B, right-hand panel). 1.6% of value added created in Lithuania depend directly on the US demand and the rest on indirect trade with the US.

The US is the most important non-EU trading partner. Exports of mineral products and chemical products and plastics of domestic origin make up the largest share of trade with the US. The importance of the US is even greater due to the indirect trade flows through other countries.

Chart B. Structure of Lithuanian exports to the US and share in total global exports (left-hand panel), share of EU countries' exports to the US in total exports in Q4 2023–Q3 2024 (central panel) and share of value added dependent on the US demand compared to total value added created in Lithuania in 2015–2020 (right-hand panel)

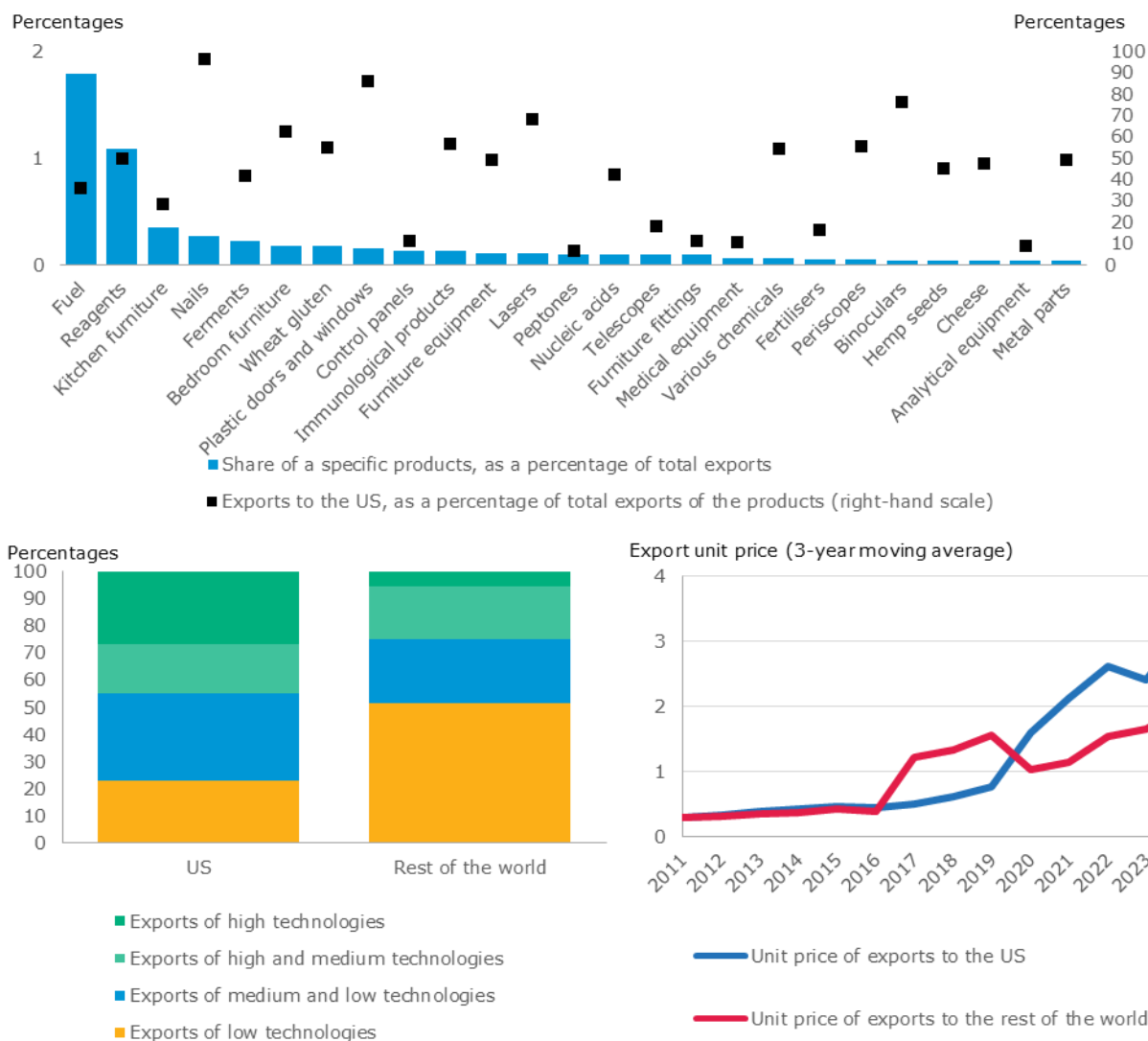


Sources: Eurostat, OECD, State Data Agency and Lietuvos bankas calculations.

A more in-depth analysis of exported goods revealed that the share of the US market in the exports of goods that are mainly exported to the US is very large (see Chart C above). This suggests that producers of products exported to the US are more tied to and thus dependent on the US market. Goods exported to the US are also relatively more technology-intensive than goods exported to other countries (see Chart C, bottom left-hand panel). This suggests that products exported to the US generate relatively more value added and are more profitable than Lithuanian products exported to the rest of the world. The higher profitability of exports to the US is also partly confirmed by a comparison of unit export prices. In 2024, the unit price of exports to the US was one and a half times higher than the unit price of the same products exported to the rest of the world (see Chart C, bottom right-hand panel).

Goods exported to the US are likely to create relatively more value added and are more profitable than goods exported to the rest of the world.

Chart C. Main exported goods of Lithuanian origin to the US and the US market share in exports of these goods in 2024 (top panel), technology intensity of exports of goods to the US and the rest of the world in 2024 (bottom left-hand panel)²⁸ and comparison of unit prices of exports to the US and the rest of the world (bottom right-hand panel)



Sources: Eurostat, State Data Agency and Lietuvos bankas calculations.

Currently, effective tariffs on US imports from the EU and Lithuania are not high (see Chart D, left-hand panel).²⁹ In 2024, the effective tariff on US imports from Lithuania was 1.1%, slightly lower than most of Lithuania’s major trading partners: the euro area, EU, Germany and Poland. Thus, introducing new tariffs up to, say, 10% or more would be a significant departure from the prevailing effective tariffs at present. The increased tariffs would be felt most acutely on the most important groups of goods exported from Lithuania to the US: mineral products, chemical products and plastics, wood and wood products. For these product groups, the increase in effective

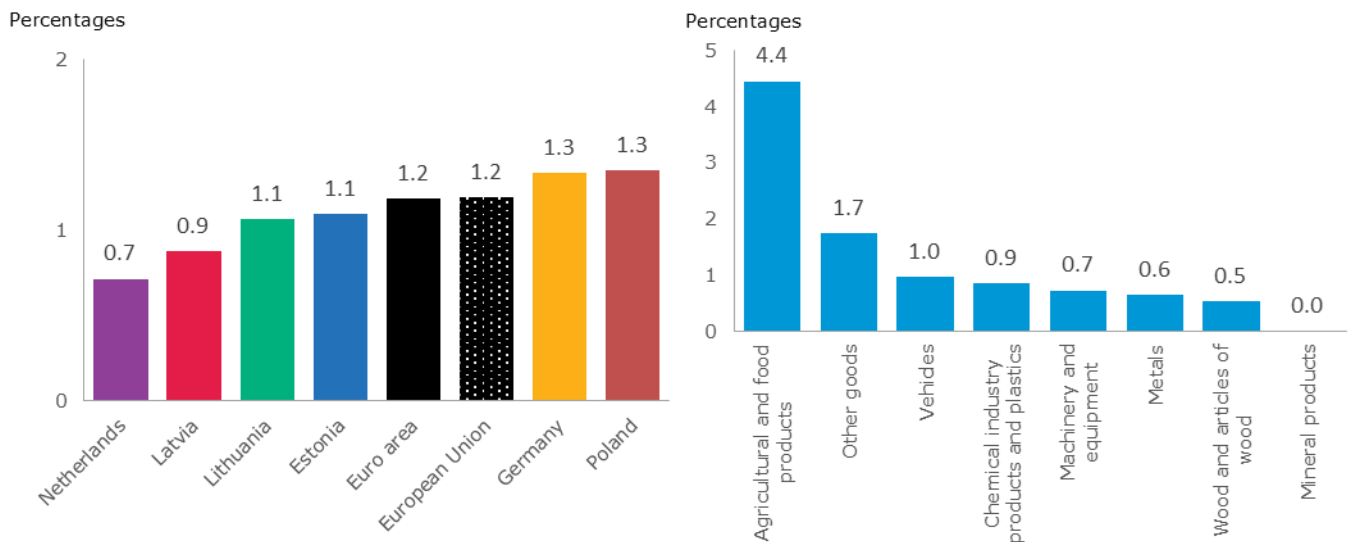
²⁸ The technology intensity of exported goods is calculated by reclassifying goods at the eight-digit level of the Combined Nomenclature into the classification of economic activities and aggregating all goods into the relevant technology intensity group according to the [classification adopted by the European Commission](#).

²⁹ Effective tariffs were calculated using the data of US Customs. The US Customs data provide information on the value of imports into the US and the estimated import tariff liability. The estimated import tariff liability was divided by the value of imports to obtain the effective tariff rate.

tariffs could exceed 8 percentage points or more (see Chart D, right-hand panel). While part of the impact of higher tariffs could potentially be absorbed by the margins of Lithuanian exporters to the US, higher tariffs would still have a negative impact on the country’s export performance and corporate profitability.

Currently, effective tariffs on US imports from Lithuania are low. Therefore, the imposition of higher tariffs would lead to a significant departure from the current terms of trade.

Chart D. Effective tariffs on US imports from EU countries in 2024 (left-hand panel) and effective tariffs on US imports and on individual groups of imports from Lithuania in 2024 (right-hand panel)

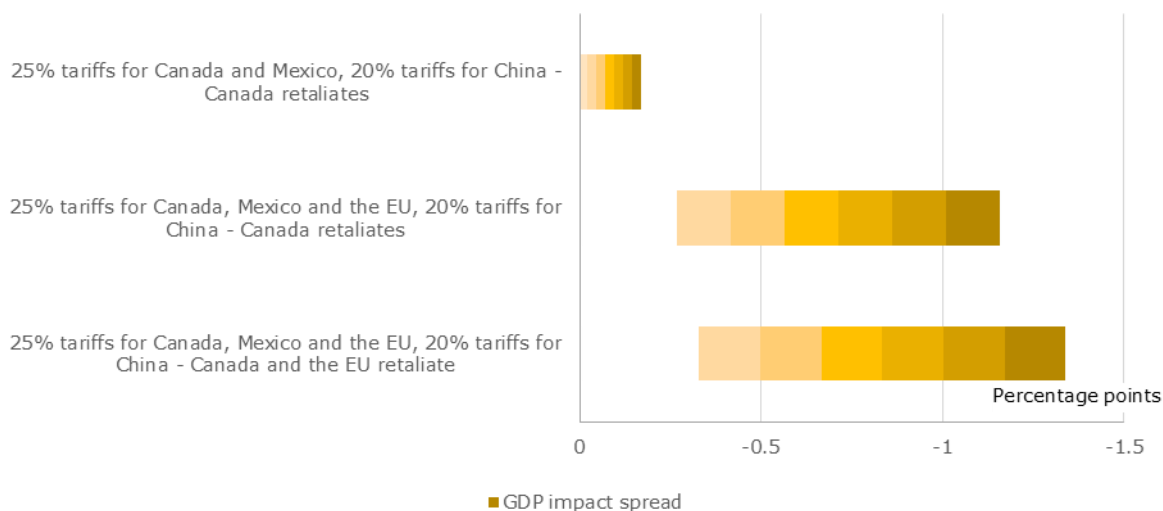


Sources: Eurostat, U.S. Census Bureau, State Data Agency, Lietuvos bankas and Lietuvos bankas calculations.

The fragmented nature of information on possible tariffs for the EU so far does not allow for an accurate assessment of the real economic impact. The final and precise channels and effects will depend on the extent and precise form of any US policy changes and how Lithuanian, EU and other authorities react to those US policies. If public statements regarding the US’ intention to impose tariffs on all imports from the EU, including Lithuania, are confirmed, Lithuanian exporting companies would be particularly affected. It would both reduce the direct demand for their products (both in the US and other countries) and reduce their price competitiveness. This would lead to a decline in their exports to the US and profitability. The more difficult access to the US market could prompt some companies to relocate their operations to other countries. The combination of these factors would have an impact on lower employment, investment and GDP level. Even if the US imposed tariffs only on imports from Canada, Mexico or China, while exempting the EU, this could still adversely impact the Lithuanian economy through indirect channels. Lietuvos bankas has modelled three scenarios of how US tariffs could affect the Lithuanian economy (see Chart E). Scenario 1 simulates that the US imposes tariffs of 25% on imports from Canada and Mexico, 20% on imports from China, and that Canada retaliates. Scenario 2 simulates that the US imposes tariffs of 25% on imports from Canada, and the EU, 20% on exports from China, and that Canada retaliates. Simulation under scenario 3 is similar to that of scenario 2 but with the additional assumption that the EU also retaliates. Preliminary calculations by Lietuvos bankas suggest that the impact on the Lithuanian economy of the tariffs to be imposed through the channels discussed above will not be significant in the first scenario. The growth rate of the Lithuanian economy could be reduced by up to 0.17 percentage points in 2025–2029. However, the impact is greater under scenarios 2 and 3. Lithuania’s growth rate would be between 0.27 and 1.16 percentage points lower in 2025–2029 under scenario 2 and between 0.33 and 1.34 percentage points lower under scenario 3.

Trade wars would undoubtedly disrupt the Lithuanian economy, but the magnitude of the impact would depend both on the level of tariffs to be imposed and on whether the countries retaliate.

Chart E. Cumulative impact of new US tariffs on Lithuania’s economic growth in 2025–2029



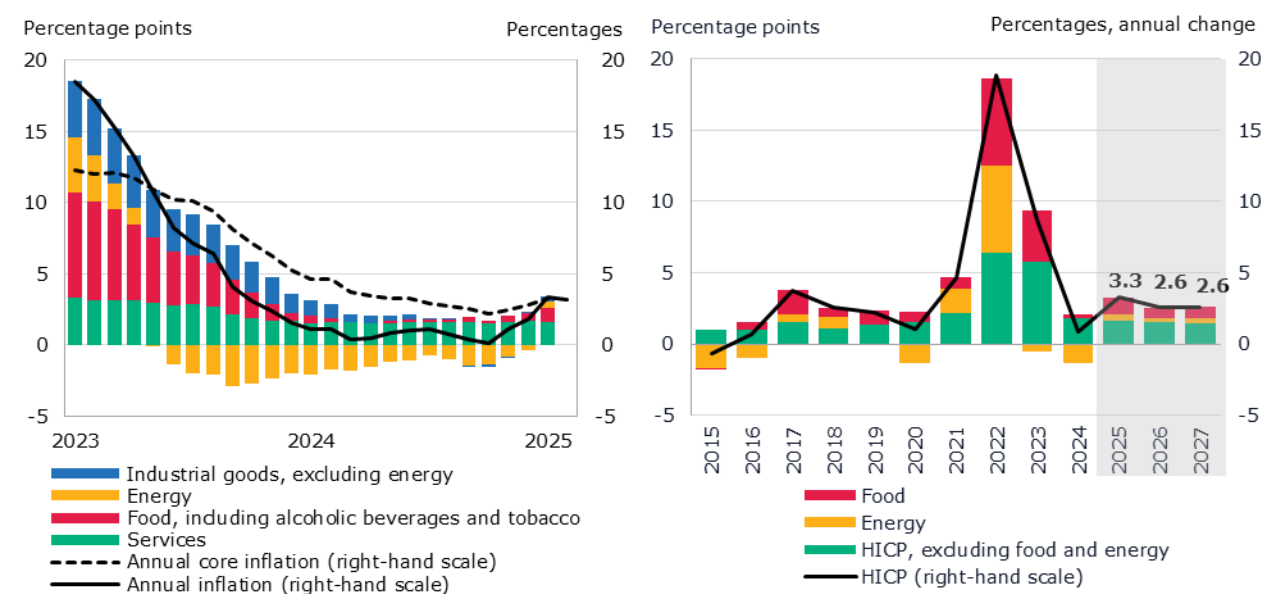
Source: Lietuvos bankas calculations.

6. Prices

Annual inflation in Lithuania has been rising as prices of energy and other commodities recover. After hitting its lowest point (0.1%) in almost four years in October, it has been rising and reached 3.4% in January. The increase in annual inflation was mainly driven by higher energy prices, while services continued to be the main driving factor (see Chart 14, left-hand panel). Market prices of energy resources and food commodities are expected to be on average higher this year than last year, the euro is expected to depreciate, and wages are expected to rise at a slower, albeit still strong, pace. A recovery in private consumption and higher tax increases than in 2024 will also weigh on inflation development. Against this background, average annual inflation is projected at 3.3% this year, before easing next year and reaching 2.6% in both 2026 and 2027 (see Chart 14, right-hand panel).

Annual inflation has risen, mainly driven by energy prices.

Chart 14. HICP inflation and its contributions



Sources: State Data Agency, Eurostat and Lietuvos bankas calculations.

Note: February headline inflation data are preliminary.

During the rest of the year, the price level is likely to increase more moderately than in January. Monthly inflation stood at 1.6% in January. In addition to higher energy resources and other commodity prices, an increase in the MMW and stronger demand, tax changes³⁰ also had a significant impact on monthly inflation which was higher than in recent years: monthly inflation in January stood at a mere 0.8% on a constant-rate tax basis. If the price level remains unchanged during the rest of the year and stays the same as in January, the average annual inflation rate would be 2.4% this year. On the other hand, if certain risks materialise, such as a more favourable environment for the pass-through of cost increases to final consumer prices or unfavourable external factors that could increase the prices of imported raw materials and products, average annual inflation in Lithuania could rise to slightly above 4%.³¹

Energy prices are already higher than a year ago. The fading of the downward effect of energy prices has mainly contributed to the increase in annual inflation. In October, when annual inflation was at its lowest level in recent years, energy prices were more than a tenth lower year on year, while in January they were already 3.9% higher. This energy price dynamic was mainly driven by higher fuel prices (see Chart 15), which were affected by higher oil prices due to the sanctions imposed on the Russian oil industry and depreciation of the euro as well as the tax changes that entered into force in January. Energy resources are expected³² to be on average more expensive this year than last year. Electricity and gas prices will rise particularly fast and will be by around a third and almost half as high as a year ago respectively. This will also influence energy prices for consumers, which, unlike last year, will not decrease this year.

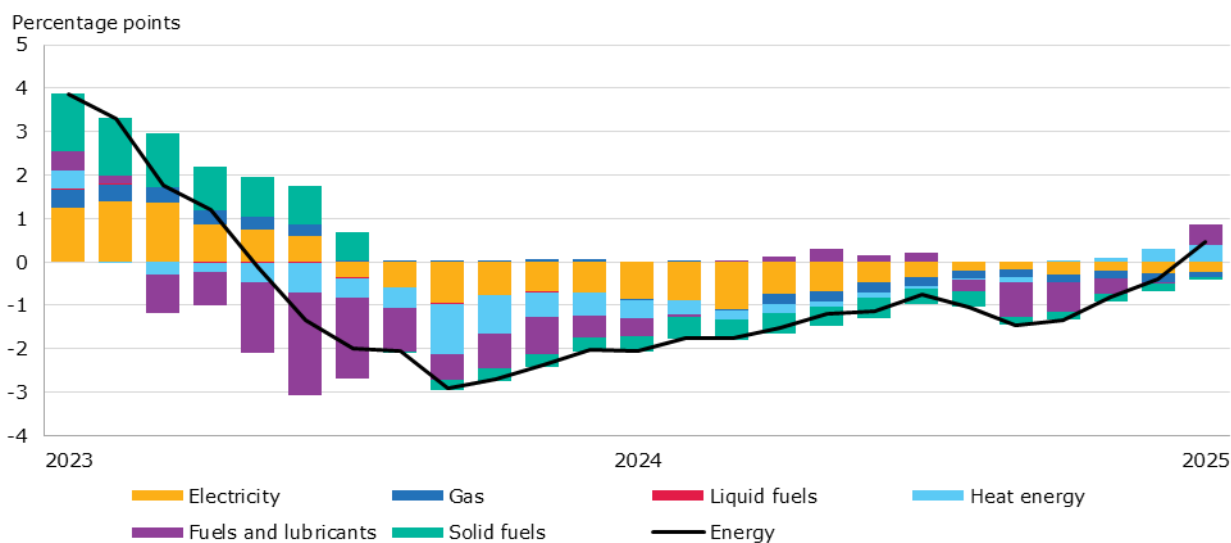
³⁰ Excise duties on alcoholic beverages, tobacco and diesel were raised, and a CO₂ component for various energy products was introduced.

³¹ Other scenarios for inflation development are also possible under different circumstances, however, less likely.

³² ECB assumptions, data as of 6 February.

Energy prices are already exerting an upward pressure on inflation, with fuel price developments being the main contributor.

Chart 15. Impact of energy prices on annual headline inflation



Sources: State Data Agency and Lietuvos bankas calculations.

The increasing price pressure in the food supply chain and January tax hikes are contributing to a faster rise of food prices, including alcoholic beverages and tobacco. The higher pressure on food prices is most evident in the first stage of the food supply chain, with farm gate prices in Lithuania in the fourth quarter of 2024 being 7.2% higher year on year. This is also reflected in food price developments, including alcoholic beverages and tobacco: the growth of these prices is accelerating on the back of a particularly strong effect of faster rising prices of dairy products.³³ Alcoholic beverages and tobacco products should also be mentioned as they are among the main drivers of price increases in this group and are significantly affected by higher excise duties. Given the increasing pressure on food prices and higher excise duties, the prices of food, including alcoholic beverages and tobacco, are expected to increase this year at a similar yet slightly faster pace than in 2017–2019, a typical period without the economic development challenges posed by war and pandemics.

Core inflation,³⁴ which stood at 2.2% in October, the lowest in the last three years, is recovering and reached 3.3% in January. The rise in core inflation was mainly driven by the developments of prices of industrial goods, which, after going down year on year in the previous months, were already 1% higher in January than a year earlier. These price dynamics of industrial goods were mainly affected by a slight strengthening of price pressures in the supply chain.³⁵ With no significant changes in the supply chain situation, the average annual growth of prices of industrial goods this year is expected to be close to that recorded in January. As regards the other component of headline inflation, that is services, its annual growth continues to hover around 6%. Services price growth is supported by stronger domestic demand (see Chapter 3 for more details), a 12% increase in the MMW introduced in January and, more generally, still rapid, albeit slightly slower, increase in wages. Wages rose by 10.7% at an annual rate in the fourth quarter of last year and are projected to grow by 9.2% this year. Given these trends, the prices of services will continue to increase at a relatively fast, albeit

³³ The prices of dairy products in January rose by 4.8% year on year, driven by record-high milk farm gate prices in Lithuania (they increased by around a third in the fourth quarter of 2024 year on year).

³⁴ Core inflation includes the prices of industrial goods and services but excludes the prices of more volatile goods, such as energy and food.

³⁵ The price level for manufacturing, excluding refined petroleum products, on the domestic market has remained broadly unchanged for about a year, that for imported intermediate goods for more than six months, while, for instance, the price level for imported non-durable goods has continued to increase moderately.

slightly slower, pace compared to last year owing to a slight slowdown in wage growth and the faded effect of the reimposed VAT on catering services.³⁶

Box 4. Distributional inflation effects on household wealth in Lithuania

Prepared by Karolis Bielskis

In 2022, Lithuania's annual inflation rate exceeded 20%, making it one of the highest in Europe. This box quantifies the various channels through which inflation is transmitted and affects the household balance sheet, highlighting the uneven impact on different households.

Economic literature highlights key channels through which inflation affects different households and their balance sheet, namely wealth, income, and consumption.

The first channel through which inflation exerts its effect is differences in household consumption patterns. Households whose consumption baskets are heavily weighted towards goods with higher inflation suffer more, as they have to allocate more resources to maintain their living standard (Coibion et al. (2017)).³⁷ Another study by Kaplan and Schulhofer-Wohl (2017)³⁸ has shown that most of the variation in household consumption comes not from differences in consumption baskets but rather from the fact that lower-income households opt for lower-priced goods, while higher-income households buy similar yet more expensive goods. This study is an important example because it demonstrates that once inflation takes hold, low-income households have no chance to adjust their consumption (they already consume the most affordable goods), while higher-income households can mitigate the inflationary effect by purchasing similar products at lower prices.

Another key channel through which inflation affects household wealth is the distinction between financial wealth and liabilities (wealth channel). Inflation reduces the real value of nominal assets, such as cash, savings, and bonds, while eroding the real burden of nominal liabilities, such as mortgages and consumer debt.

Finally, the income channel takes effect, since inflation reduces the purchasing power of nominal wages, pensions and social benefits, severely impacting low-income and fixed-income households. A study from Coibion et al. (2017)³⁹ examined how inflation disproportionately affects households with lower incomes and lower levels of education, hitting them harder and exacerbating financial wealth inequality.

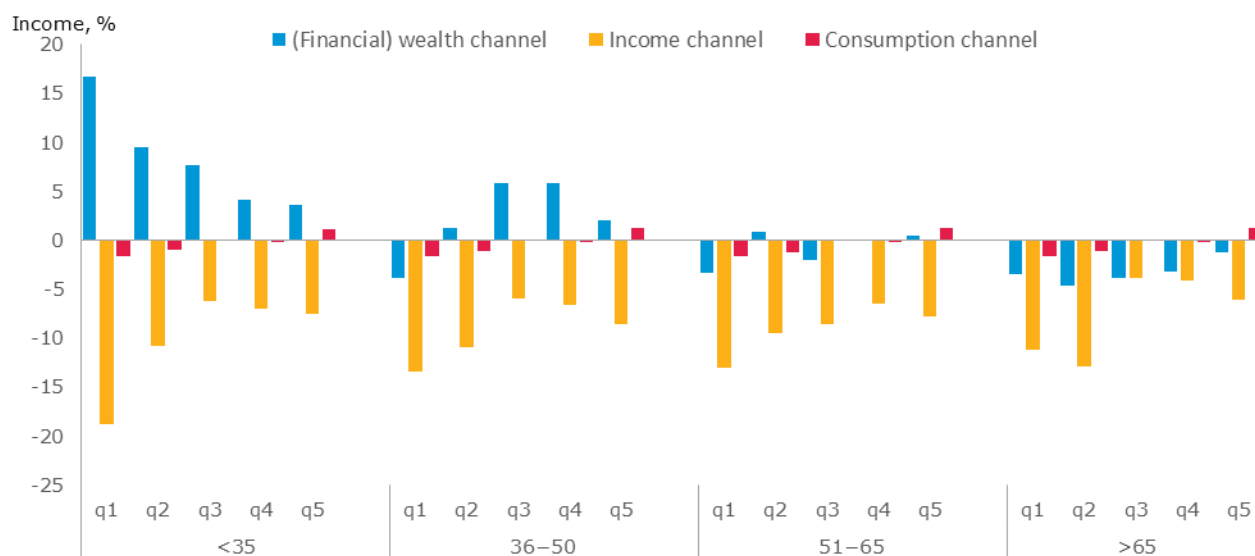
³⁶ The temporary VAT exemption for catering services expired in January 2024.

³⁷ Coibion, O., Gorodnichenko, Y., Kueng, L., & Silvia, J. (2017). Innocent Bystanders? Monetary policy and inequality. *Journal of Monetary Economics*, 88, 70-89.

³⁸ Kaplan, G., & Schulhofer-Wohl, S. (2017). Inflation at the household level. *Journal of Monetary Economics*, 91, 19-38.

³⁹ Coibion, O., Gorodnichenko, Y., Kueng, L., & Silvia, J. (2017). Innocent Bystanders? Monetary policy and inequality. *Journal of Monetary Economics*, 88, 70-89.

Chart A. Inflationary impact (through wealth, income, and consumption channels) on household financial wealth



Sources: Household Finance and Consumption Survey (HFCS) and Lietuvos bankas calculations.

Notes: The chart shows the inflationary effect as a percentage of annual household income. It demonstrates different inflationary effects across the age (under 36, 36-50, 51-65, and above 65) and income (quintiles q1 to q5) groups.

Chart A shows the channels through which inflation affects Lithuanian households that are divided into age and income groups. The main (financial) wealth effect is positive and strongest for the youngest households, while the oldest households are negatively affected by inflation. This comes as no surprise as the financial wealth of the oldest households is highly concentrated in deposits or current accounts, which are also strongly affected by inflation. In contrast to the financial wealth losses, households could improve their wealth balance with the value of their loans, which are deflated during the period of high inflation. However, slightly above 10% of households in Lithuania have a mortgage loan (Bielskis and Ciginas (2020)),⁴⁰ and this positive effect is mainly transferred to the younger households, improving the value of their wealth. The relative consumption channel was the most negative for the lower-income households and increased across the income distribution. However, the relative consumption effect was still smaller than the wealth or income effects. Finally, the income channel⁴¹ was negative for all households, but stronger for the low-income households, since their income (on average) was the least adjusted (indexed) against high inflation.

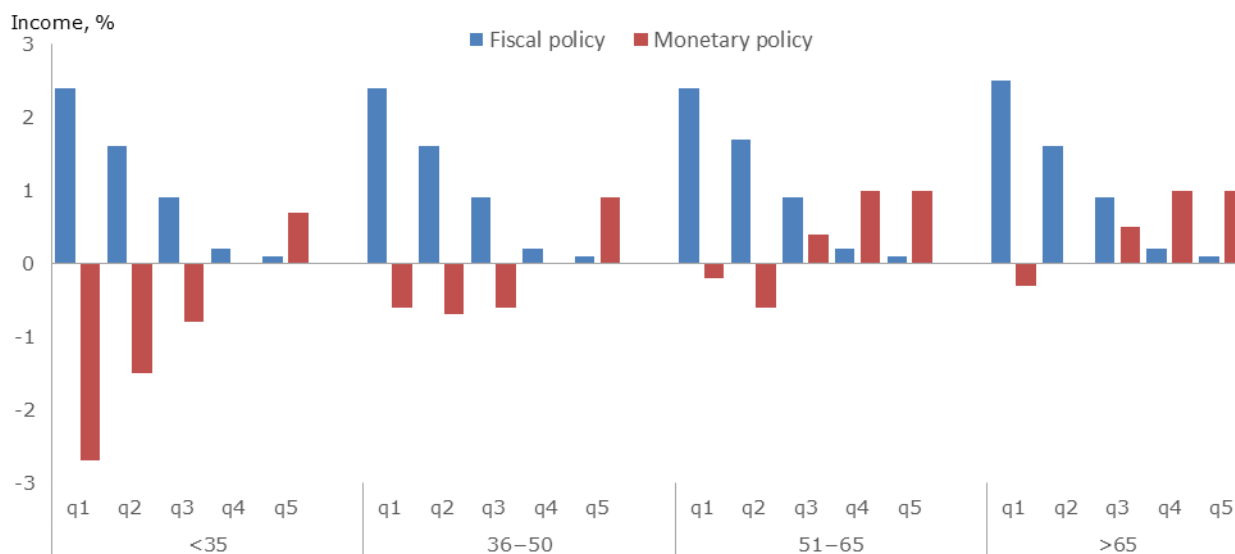
Various policy adjustments (fiscal and monetary) were introduced to mitigate the inflationary shock.

To counter the inflationary shock, euro area governments implemented measures to respond to rising prices, especially for energy consumption. In Lithuania, income-side adjustments (e.g. social benefits or support programmes for low-income households) were mostly implemented to offset part of the inflationary effect. The largest positive contributions to the incomes of the lower-income deciles came from additional indexations in public pensions as well as subsidies for energy consumption. In addition, social contributions were increased in order to boost the disposable income of households in the lowest income quintiles. In parallel with fiscal policy, monetary policy measures were implemented to curb high inflation. The European Central Bank (ECB) raised interest rates from zero to 2.5% in 2022, directly affecting the flow of interest income received or paid by households.

⁴⁰ Bielskis, K., & Ciginas, A. (2020). Household Wealth and Finances. Results for Households in Lithuania for 2017 (No 19). Lietuvos bankas.

⁴¹ This paper calculates the total income of a household/family from different sources. This may include wages and salaries, pensions, social benefits and other stable/permanent income. Wages and salaries are indexed to the different types of work activities and their fixed average wage growth, pensions are indexed to the average growth of pensions and social benefits are indexed to the average growth of social benefits.

Chart B. Fiscal and monetary policy adjustments to the household balance sheet in 2022



Sources: Household Finance and Consumption Survey (HFCS) and Lietuvos bankas calculations.

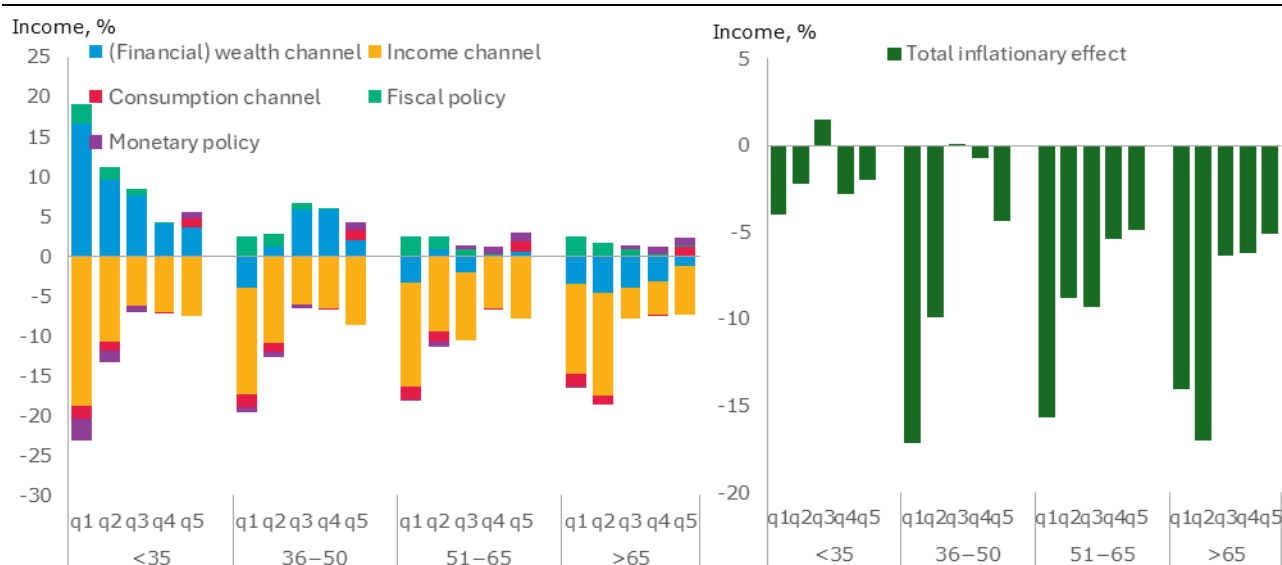
Notes: The figure shows fiscal and monetary policy adjustments as a percentage of annual household income. It demonstrates different inflationary effects across the age (under 36, 36–50, 51–65, and above 65) and income (quintiles q1 to q5) groups.

Chart B demonstrates that the fiscal policy reaction had a positive impact on all subgroups of households. However, the result was stronger for the poorest households and benefited them more than the wealthiest households (between 0–2.5% across households). In contrast, monetary policy reaction had more heterogeneous effects across households than fiscal adjustments. Older households experienced a positive effect because they have few liabilities and other assets (i.e. deposits) that are positively exposed to higher interest rates. The opposite is true for young households, whose wealth is closely related to their liabilities and who have been adversely affected by higher interest rates. Low-income and young households have lost an additional 3% of their annual income due to monetary policy changes, while high-income households have gained an additional 1% of their annual income.

In total, high inflation had a greater impact on the financial wealth of lower-income and older households in Lithuania compared to other groups.

Chart C suggests that the overall inflation effect was significantly lower for the youngest households (up to 35 years), mainly due to the positive effect of the wealth channel. The income channel was negative for all household groups, but it had the strongest negative impact on low-income households relative to their annual income. The consumption effect was also negative for low-income households and positive for high-income households. Overall, the three effects affected the purchasing power of households. Yet, those in the lower income quintiles were relatively more penalised. To counteract these inflationary effects, fiscal policy was more targeted at lower-income households and slightly adjusted the negative effect for them. Tighter monetary policy also played a role by positively affecting higher-income and older households, while creating additional negative effects for low-income households. However, the impact of fiscal and monetary policy was limited compared to the overall inflation effect.

Chart C. Total inflationary effect on household balance sheet and decomposition through various channels and policy adjustments in 2022



Sources: Household Finance and Consumption Survey (HFCS) and Lietuvos bankas calculations.

Notes: The chart shows the total inflationary effect as a percentage of annual household income. It demonstrates different inflationary effects across the age (under 36, 36–50, 51–65, and above 65) and income (quintiles q1 to q5) groups.

In summary, this box examines the surge of inflation in 2022 that has translated into a lower financial wealth of Lithuanian households. The overall effect (through different channels) of inflation reduced the financial wealth of households that is equal to 6–9% of their annual income. The youngest households experienced an overall effect between 0–5% due to deflated income, which has been offset by deflated liabilities (loans). In contrast, low-income and older households encountered a significantly higher total inflation effect of about 10–17% of their annual household income. This is primarily driven by their deflated income (wages, pensions, social payments, etc.), financial wealth⁴² (mostly deposits or savings), and a comparatively higher consumption effect. Finally, fiscal and monetary policy made minor positive adjustments for most vulnerable household groups; however, these adjustments were relatively small compared to the total inflation effect.

Box 5. Update on food price analysis: comparison of cost and price developments in key sectors of the food supply chain for the third quarter of 2024

Prepared by Darius Imbrasas and Laura Mociūnaitė

After a sharp increase in 2021–2022, the food price level did not change significantly in the last two years and only increased more markedly in January this year.⁴³ However, in the third quarter of 2024, food prices in Lithuania were around 48% higher than in 2020. Prices of some food commodities and inputs have also been declining or staying flat in recent years but have remained at a significantly higher level compared to 2020 (see

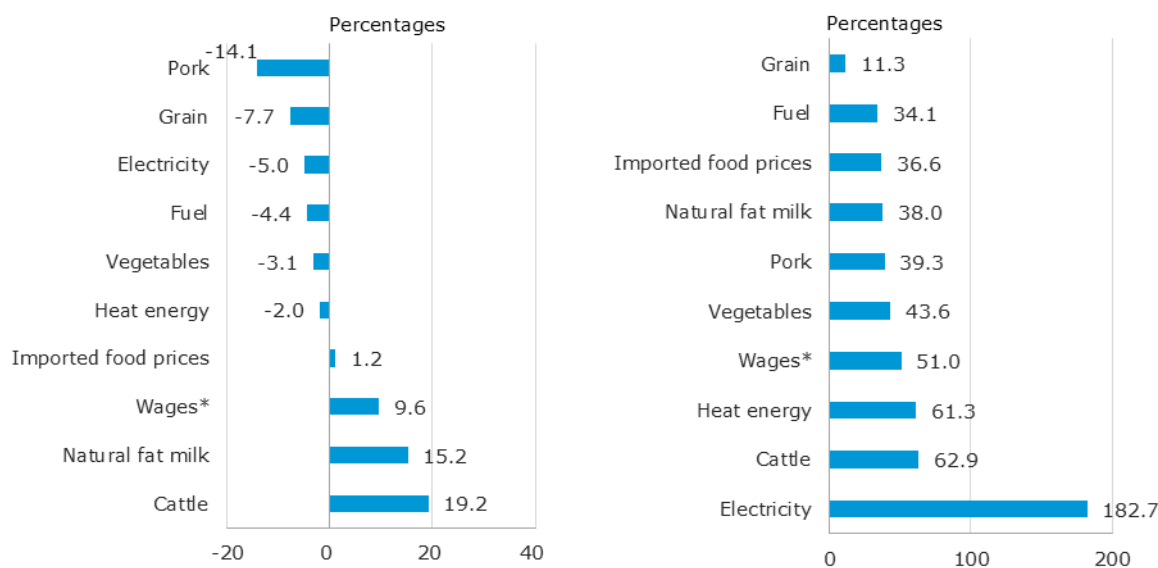
⁴² This study focused only on the direct channels of inflation, thus only financial assets are analysed. However, it is important to note that a large share of total household wealth in Lithuania is also concentrated in real estate (housing), which has also been positively appreciating during the period of inflation. This increase in house prices may also have had a positive asset value effect on households with housing, especially older households, for whom housing accounts for the majority of total asset value. However, this and similar spillover effects were not included in the results of the current study.

⁴³ See Chapter 6 for more on food price developments.

Chart A). This box provides an updated analysis of food prices,⁴⁴ looking at changes in costs and prices in key sectors of the food supply chain, such as agriculture, food industry and trade. The results of the updated analysis will allow to assess the recent evolution of costs and prices in each of these sectors. As in the past, the analysis of food prices is carried out using two approaches: input-output tables (approach 1) and business structure and financial indicators (approach 2). The detailed methodology for food price analysis can be found here. As in the first update of the analysis, this box does not present annual price changes but rather changes compared to 2020. The aim is to assess the overall outcome of both the exceptional price surge and the price stabilisation and contraction.

While the prices of some food cost components fell during the year, they remain significantly higher than in 2020.

Chart A. Annual price changes of some food cost components in the third quarter of 2024 (left-hand panel) and third quarter of 2024 compared to 2020 (right-hand panel).



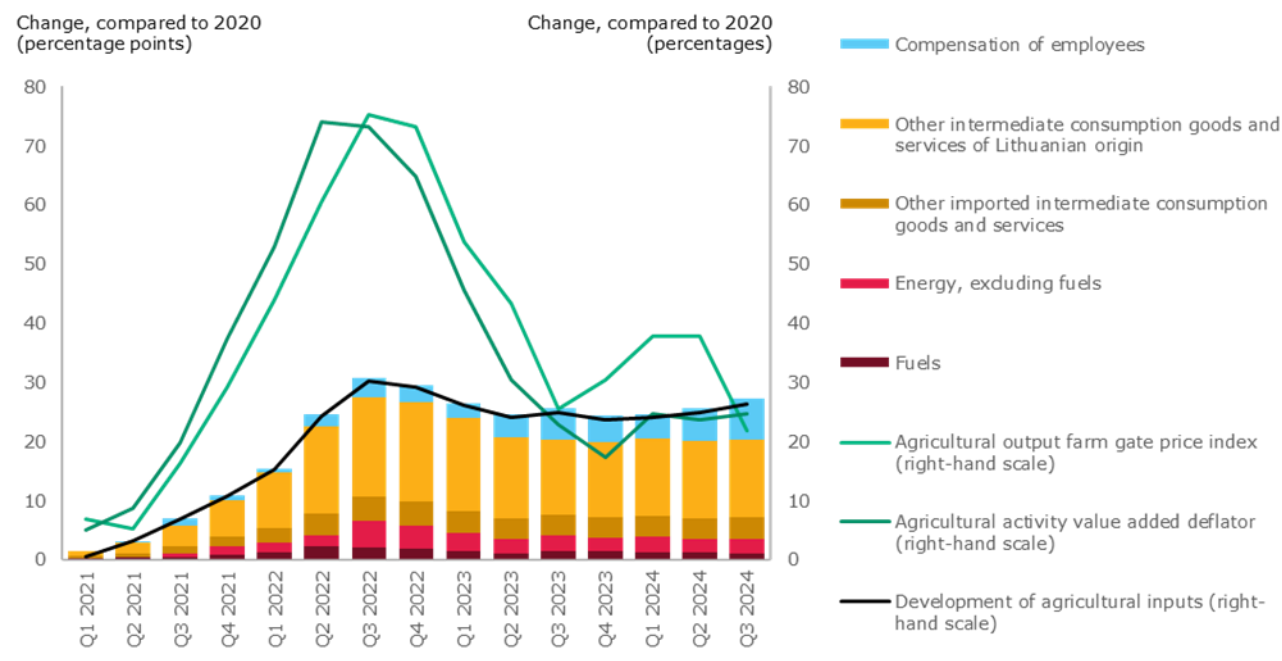
Sources: State Data Agency, Nord Pool and Lietuvos bankas calculations.
 Note: Wages cover the food industry.

According to the calculations made based on the input-output tables, from the third quarter of 2023 onwards, agricultural costs have increased in line with the prices of output sold. In 2021–2022, output prices rose by a significantly larger margin than agricultural costs. The development of prices and costs has converged with a significant decrease in farm gate prices for agricultural products. Agricultural input costs stopped increasing from the third quarter of 2022. Since then, even with a slight decrease, agricultural costs have been about a quarter higher than in 2020, similar to the level of agricultural output prices (see Chart B).

In the third quarter of 2024, the increase in agricultural output prices was similar to that of inputs.

⁴⁴ The February 2023 analysis can be found [here](#) and the first update in August 2023 [here](#).

Chart B. Developments of agricultural costs and output (farm gate) prices (approach 1)

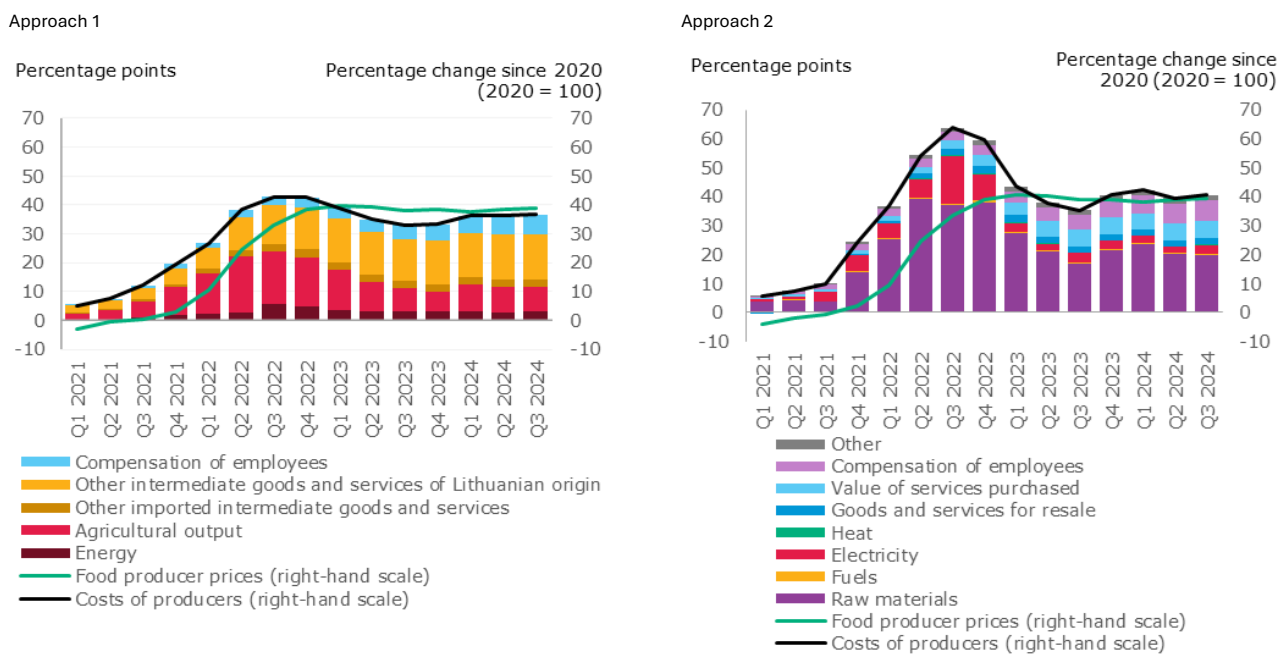


Sources: State Data Agency, Eurostat and Lietuvos bankas calculations.

Input costs of the food industry have risen at a similar rate to the output prices of producers. Following a significant fall in the prices of food commodities (approaches 1 and 2) and electricity (approach 2), costs of food producers fell sharply in early 2023. The slight increase in costs of food producers in 2024 did not lead to a significant change for almost two years, but the costs were more than a third higher than in 2020. Despite their decrease, raw material costs continued to represent the bulk of total costs. As output prices of food producers stopped rising, their increase was in line with the growth in producer costs in the third quarter of 2024.

Input costs of the food industry have risen at a similar rate to output prices.

Chart C. Development of food producer costs and output prices



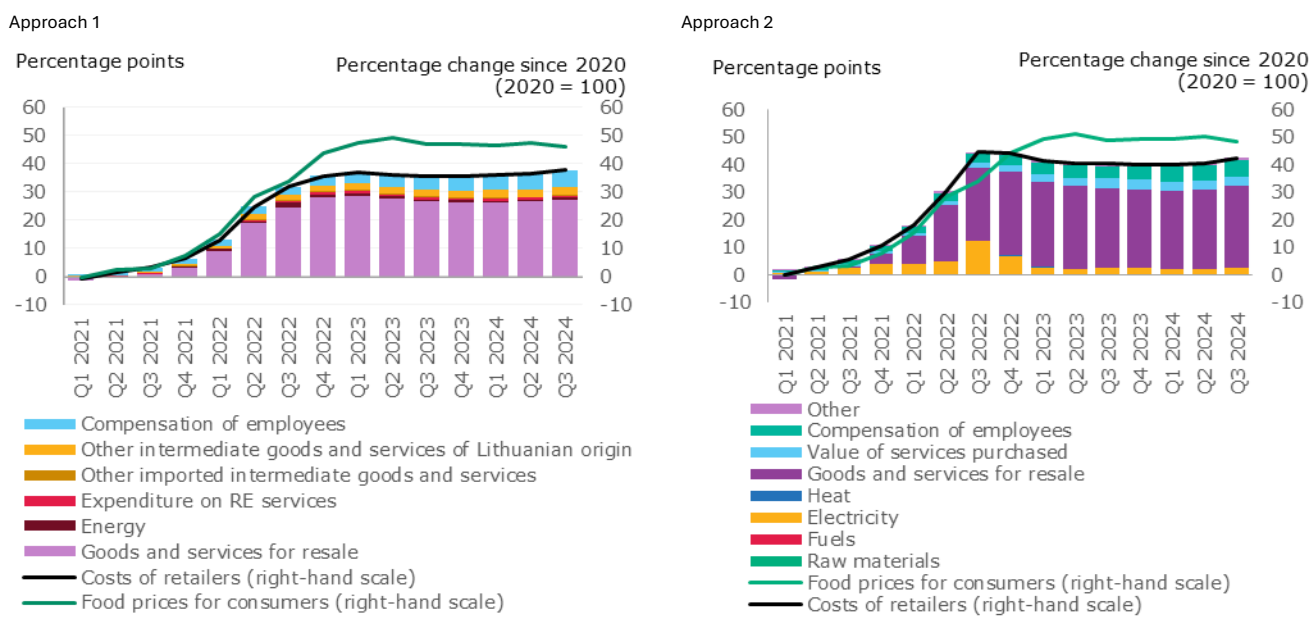
Sources: State Data Agency, Eurostat, Nord Pool and Lietuvos bankas calculations.

Food prices for consumers have increased slightly more than the costs of retailers, but the gap is closing.

With the stabilisation of the cost of goods for resale and energy resource prices, the costs of retailers have not changed significantly since 2023. They grew slightly only due to rising wage costs (see Chart D). Prices of goods for resale continued to account for the most (more than two-thirds) of the increase in costs from 2020 onwards. Since 2023, food prices for consumers also have remained stable and even a slight decrease in the level of food prices was observed in 2024. This development of food prices for consumers and costs of retailers has meant that the increase in food prices for consumers was still higher than the increase in costs of retailers in the third quarter of 2024, but the gap was closing.

Food prices for consumers have increased slightly more than the costs of retailers, but the gap is closing.

Chart D. Development of retailer costs and food prices for consumers

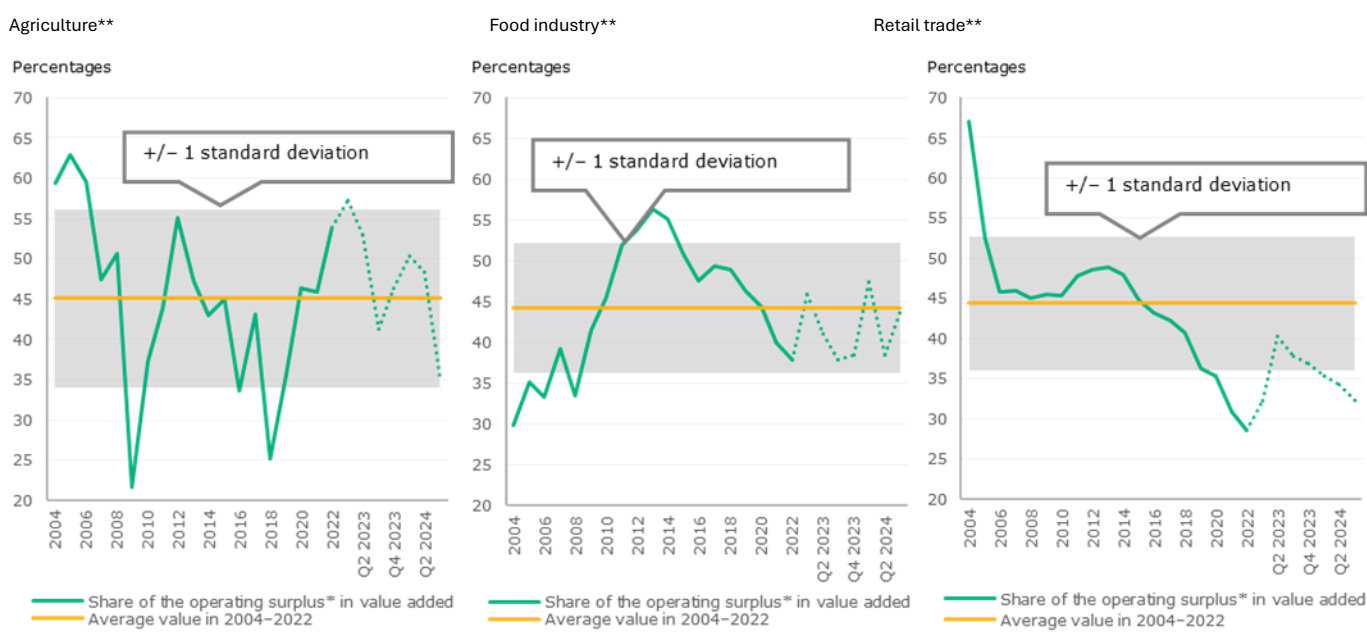


Sources: State Data Agency, Eurostat, Nord Pool and Lietuvos bankas calculations.

No exceptionally high levels of return on equity were observed in the activities relevant to food supply in the third quarter of 2024 (see Chart E). In agriculture, these estimates show that over the period under review the share of agricultural return on equity in value added has fallen below its long-term average due to the fall in agricultural prices. However, this decrease is not exceptional, its deviation from the long-term average is not greater than one standard deviation, i.e. the limit up to which the fluctuations are considered a typical variation determined by the nature of the activity. In the food industry, the return on equity in value added was also relatively stable in 2023–2024, although slightly below its long-term average, as producer costs and output prices stabilised. In retail trade, the return on equity in value added, after a short-term increase in the first half of 2023, resumed its downward trend. Since the beginning of 2024, it has been again more than one standard deviation below the long-term average. However, in retail trade, the share of return on equity in value added has been declining since 2015. This may be an indication of structural changes taking place in this economic activity, which will bring the distribution of value added between the return on equity and compensation of employees to a new equilibrium.

No exceptionally high levels of return on equity were observed in the activities relevant to food supply in the third quarter of 2024.

Chart E. Development of the share of the operating surplus* in value added (2004–2022) and calculated estimates (Q1 2023 to Q3 2024)



Sources: State Data Agency, Eurostat and Lietuvos bankas calculations.

* The indicator includes the following national accounts data series: operating surplus and mixed income (national accounts code B2A3N), other subsidies (D.39) and other production taxes (D.29).

** Agriculture corresponds to the activity listed in the statistical classification of economic activities of the European Communities as crop and animal production, hunting and related service activities (code A.01), food production – manufacture of food, beverages and tobacco (C.10–12), retail trade – retail trade, except of motor vehicles and motorcycles (G.47).

In conclusion, the analysis carried out on the basis of business structure and financial indicators and input-output tables showed that in the third quarter of 2024, compared to 2020, the input and output prices of the agricultural sector and food producers were likely to have increased to a similar extent, whereas food prices for consumers went up slightly more than the costs of retailers and this gap was closing. Furthermore, no exceptionally high levels of return on equity were observed in the activities relevant to food supply in the third quarter of 2024.

7. Financing of the economy

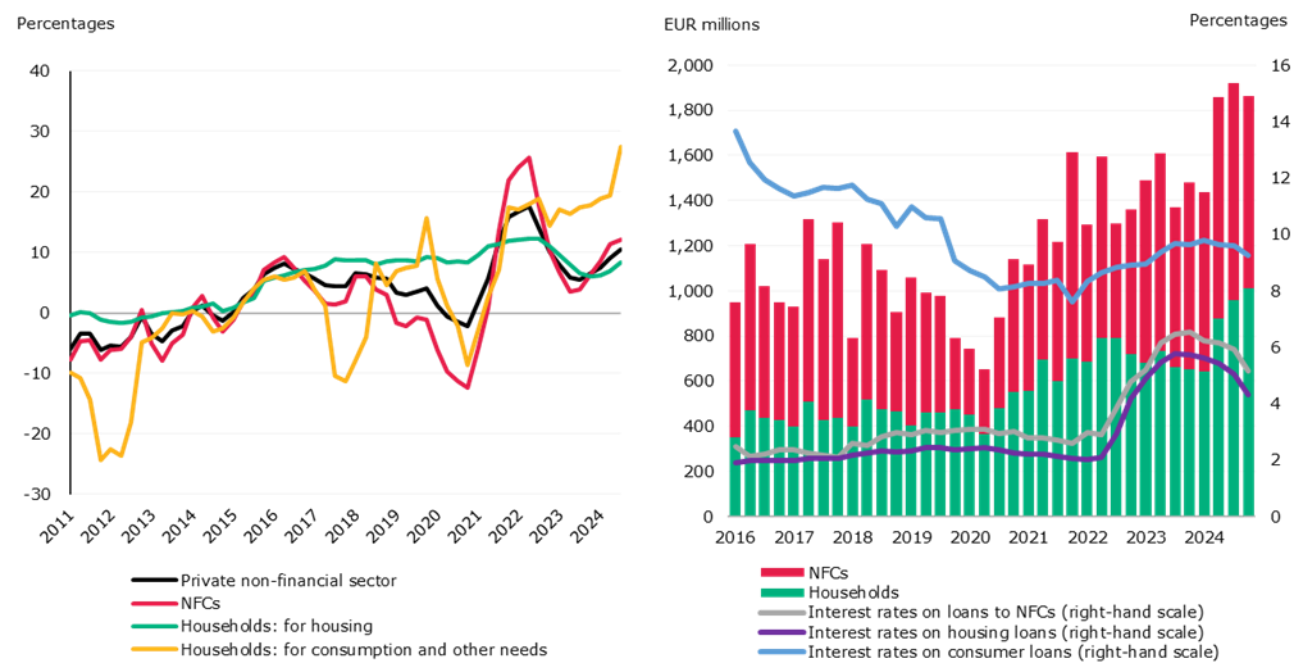
As debt servicing costs declined, financial liabilities of individuals and businesses increased rapidly, but net financial assets continued to grow. Despite the accelerating growth of financial liabilities, net financial assets of Lithuanian households increased by a tenth year on year to €59 billion in the third quarter of 2024, while those of NFCs rose by €20 billion (30% annual growth). The increase in term deposits, assets in pension funds and accounts receivable⁴⁵ has led to a 13% year-on-year increase in financial assets of households, while their liabilities rose by 25%. The latter was mainly driven by a rise in trade credit and accounts payable portfolio. Corporate liabilities grew at a slower pace, with annual growth of 5% in the third quarter of 2024, driven by increased funding through long-term loans from banks and other NFCs and short-term trade credit. Corporate

⁴⁵ Financial claims created as a result of the timing difference between accrued transactions and payments made in respect of wages and salaries, taxes and social contributions, dividends, rent, etc.

financial assets increased by almost €8 billion over the period (9% annual growth), almost half of which was driven by the expansion of the unlisted shares portfolio.

Against the backdrop of falling interest rates and recovering macroeconomic environment, the annual growth of the MFI credit portfolio has accelerated, with the consumer loan portfolio growing at the fastest pace.

Chart 16. Annual change in the portfolio of MFI loans to Lithuanian NFCs and households (left-hand panel) and quarterly flows of loans and average interest rates on new loans (right-hand panel)



Source: Lietuvos bankas.

With falling loan interest rates and consumers maintaining strong confidence in the euro, both the household loan portfolio and new lending flows continued to grow. While margins on new housing loans barely declined over the past six months (median margins of 1.5% at the end of 2024), the ECB's continued interest rate cuts reduced the interest rate on new housing loans from 5.4% to 4.1%. This led to a strong credit expansion, with the housing loan portfolio growing at an annual rate of 8% at the end of 2024 (see Chart 16, left-hand panel) and the number and value of new loans being more than one and a half times the level of a year earlier (see Chart 16, right-hand panel). In the second half of 2024, households actively negotiated more favourable terms for their existing housing loans and in total re-negotiated 9% of the total housing loan portfolio in 2024, mostly for more favourable loan margins (a decline of around 0.4 percentage points was recorded). Consumer credit also grew rapidly in line with active borrowing for durable goods. At the end of 2024 the quarterly flow of new consumer loans granted to Lithuanian residents was 51% higher than a year earlier (see Chart 16, right-hand panel). Despite the accelerating lending, the gap between the ratio of household loan portfolio to GDP and the long-term trend remains negative (-2 percentage points), so lending poses no risks to the financial stability of Lithuania. The [Bank Lending Survey](#) of Lietuvos bankas indicates that household credit standards did not change significantly in the fourth quarter of 2024, while lending conditions for housing loans slightly eased. According to the banks, the continuing decline of interest rates should further push up household demand for housing loans, but no changes in demand for consumer and other loans is expected.

As demand for credit increases, corporate lending continues unabated. The portfolio of loans to NFCs grew by 12% year on year at the end of 2024 (see Chart 16, left-hand panel), compared to a meagre 1% in the euro area. Although the number of new loans granted was slightly lower than a year earlier, quarterly loan flows remained strong due to higher value of loans and were 3% above the previous year's level at the end of 2024 (see

Chart 16, right-hand panel). The corporate credit-to-GDP ratio reached its lowest level since 2004 (standing at 15% at the end of the third quarter 2024) and remains among the lowest in the euro area, so there is plenty of room for further portfolio growth. The results of the [Bank Lending Survey](#) show that the demand for corporate loans increased for the second consecutive quarter due to lower borrowing costs, with demand expected to grow in the SME segment in the first quarter of 2025. The [results of Survey of Non-Financial Corporations](#) carried out by Lietuvos bankas showed that the share of rejected or partially granted corporate loan applications in 2024 reached a historical high during the survey period, but the share of companies facing borrowing difficulties in general has remained stable in recent years, with companies borrowing from other sources. Banks indicated a slight tightening of lending standards to companies in the fourth quarter of 2024, but the share of rejected loan applications of companies, according to them, remained unchanged for the second consecutive quarter. Banks consider that the financial health of companies in the accommodation and food services sector is the worst, the perception of the financial health of transport companies improved during the quarter, but banks continued to be the most restrictive in lending to the latter sectors. However, banks remain relatively optimistic and view the development of the financial situation of all companies as stable or improving.

In 2024, the number of corporate bankruptcies slightly increased, but the level of non-performing loans for both companies and households remains low. The level of non-performing housing and consumer loans remained unchanged over the six months and stood at 0.8% and 2.8% respectively in the third quarter of 2024, while that of companies even improved to 1.4%. The transport sector faced more challenges as the level of non-performing loans increased (0.75 percentage points in six months) and the number of bankruptcies in this segment being at its highest level since 2019. However, the overall number of corporate bankruptcies is still well below the pre-pandemic level and the anticipation of a recovery in foreign demand improved expectations of companies at the end of 2024.

8. General government finance

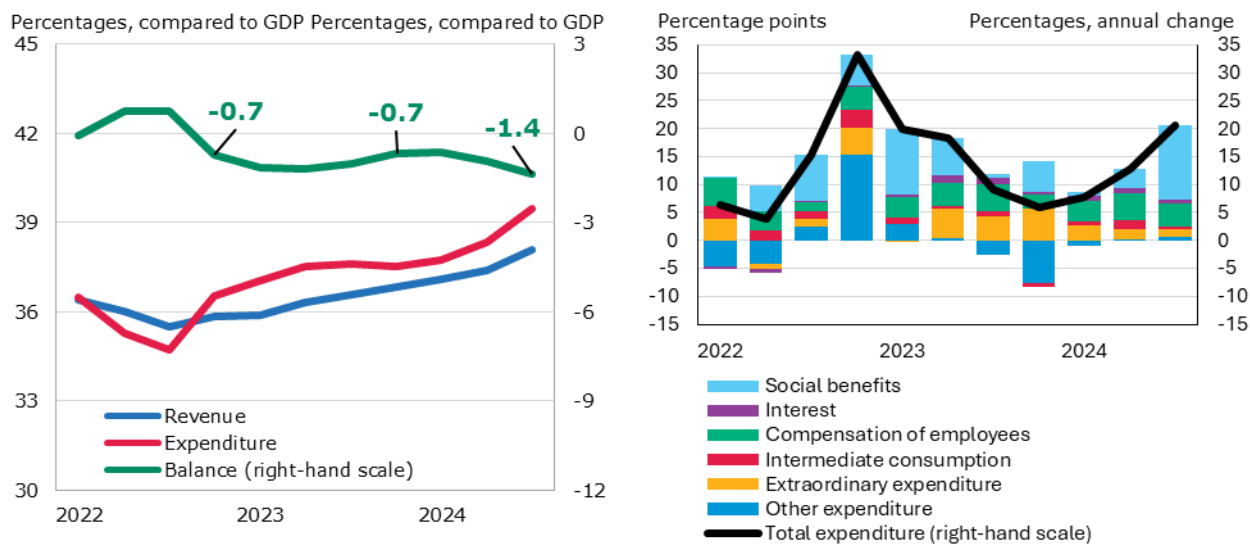
Because general government spending grew faster than revenue, the financial position of general government was worse in 2024 than in 2023. Data for the third quarter show that since the start of 2024, general government spending has been almost by a sixth higher than a year ago, while revenues have increased less (by a tenth) over the same period. This has led to a deterioration in the ratio of general government balance to GDP (measured on a four-quarter moving sum) which stood at -1.4% of GDP in the third quarter (see Chart 17, left-hand panel). The latest monthly data of central government indicate that general government revenues are likely to have grown more slowly in the fourth quarter of 2024 than in the third quarter, but at a rate close to the growth rate of general government revenues recorded in the first two quarters. In the fourth quarter, general government expenditure is likely to have grown by around a tenth, mainly due to increases in social benefits, compensation of employees and intermediate consumption expenditure. These revenue and expenditure developments should have led to a further slight deterioration of the ratio of general government balance to GDP to -1.6% in the fourth quarter of 2024. In this case, as recorded in the past few years, the general government deficit of 2024 would again be significantly lower than the deficit projected in the 2024⁴⁶ and 2025⁴⁷ budgets, which provided for a deficit of -3.0% and -2.2% of GDP respectively.

⁴⁶ Ministry of Finance “[The 2024 budget at a glance](#)”, 19 March 2024.

⁴⁷ Ministry of Finance “[Overview of the draft budget for 2025–2027](#)”, 31 October 2024.

The deterioration of the general government balance was caused by an acceleration in expenditure growth driven by a surge in social benefits due to the nature of statistical accounting of persons insured by the state budget.

Chart 17. Development of general government revenue, expenditure and balance (four-quarter moving sums) (left-hand panel); annual development of general government expenditure and its contributions (right-hand panel)



Sources: State Data Agency and Lietuvos bankas calculations.

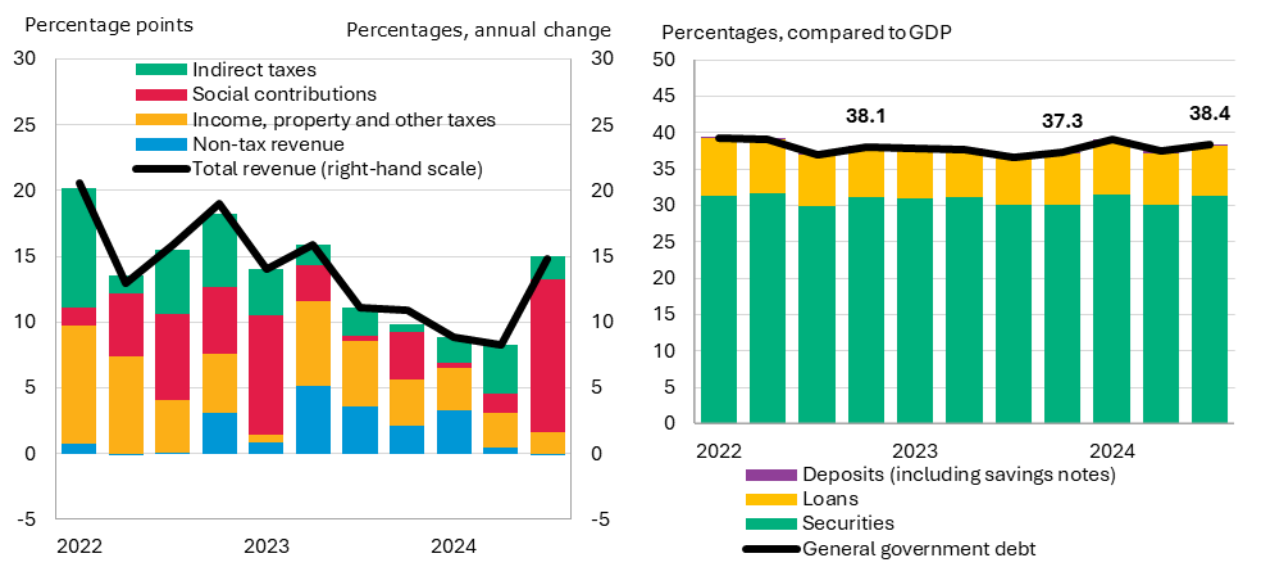
In 2024, the growth of general government spending accelerated significantly, but this was strongly affected by a one-off factor. In the third quarter of 2024, general government expenditure grew by almost 21% year on year, i.e. markedly faster than in the first half of the year (10%). The surge in general government spending in the third quarter was mainly driven by a one-third increase in social benefits and an almost one-sixth rise in employee compensation (see Chart 17, right-hand panel). Investment and interest payments were also higher than a year earlier. Social benefits grew mostly due to the nature of statistical accounting of persons insured by the state budget (benefits received by these persons are disclosed in the statistics during the period of receipt of contributions for these persons). Employee compensation increased mainly due to a rise of around one-sixth of the average wage (especially for employees in education and health and social work) and an increase in the number of employed persons. Monthly data published by the State Data Agency and State Social Insurance Fund and the estimates of Lietuvos bankas based on these data show that the increase in general government expenditure in the fourth quarter was smaller (around 10%), mainly driven by growth in social benefits, employee compensation and intermediate consumption expenditure.

The increase in general government revenue is supported by a still rapidly growing wage bill and nominal consumption but, excluding the impact of a one-off factor, its growth has been moderating for the fifth consecutive quarter (see Chart 18, left-hand panel). In the third quarter of 2024, general government revenue grew by 15% year on year, which is a significant acceleration compared to the growth observed in the first half of 2024 (around 9%). The continued increase in the average wage boosted personal income tax revenues as well as social contributions, but the latter have also been significantly affected by the above-mentioned nature of statistical accounting of persons insured by the state budget. The rising wage bill, improving household expectations and their stable financial situation have also contributed to an increase in consumption and revenues from VAT and excise duties. For the second consecutive quarter, corporate income tax revenues (together with the temporary solidarity contribution) were lower than a year earlier. Monthly data of central government published by the State Data Agency and estimates of Lietuvos bankas indicate that general

government revenues grew more slowly in the fourth quarter of 2024 than in the third quarter, but at a rate likely close to the growth rate of general government revenues recorded in the first two quarters.

The growth of general government revenue was supported by a rapid increase in direct tax revenue.

Chart 18. Annual growth of general government revenue and its contributions (left-hand panel), development of the ratio of general government debt to GDP (right-hand panel)



Sources: State Data Agency and Lietuvos bankas calculations.

As a result of positive net borrowing, the ratio of general government debt to GDP increased to 38.4% of GDP in the third quarter of 2024 and is likely to remain unchanged in the fourth quarter (see Chart 18, right-hand panel). The increase of 1 percentage point in the ratio of general government debt to GDP in the third quarter was driven by the growth in the volume of general government debt which was faster than nominal GDP growth due to a bond issue of €1 billion in July. According to the latest borrowing and debt repayment statistics, net borrowing of the Lithuanian Government amounted to around €450 million in the fourth quarter. Taking into account the historical correlation between the change in net borrowing of the Lithuanian Government and the change in the general government debt as well as the latest GDP data, the debt to GDP ratio is estimated to have remained unchanged at 38.4% in the last quarter. If that is the case, then not only the general government deficit but also the debt to GDP ratio was significantly lower in 2024 than projected in the 202414 and 202515 budgets, which provided for the debt to GDP ratio of 39.9% and 39.4% of GDP in 2024. Given the latest decision of the National Defence Council to allocate between 5 and 6% of GDP to national defence over the next five years, the lower-than-expected ratio of general government debt to GDP in 2024 is good news as it creates additional fiscal space for the implementation of defence needs.

Box 6. Personal income tax fiscal drag and its contributions

Prepared by Vaidotas Tuzikas

Fiscal drag is an important topic for fiscal policy analysis as it affects projections of personal income tax revenue, considerations on the optimal design of income tax and its impact on the distribution of disposable income of the population across the country. This box presents preliminary estimates of fiscal drag (or its potential) for Lithuania carried out using a microsimulation approach in collaboration with colleagues from the ESCB Network on Microsimulation Modelling in the context of analysis of the personal income tax fiscal drag in

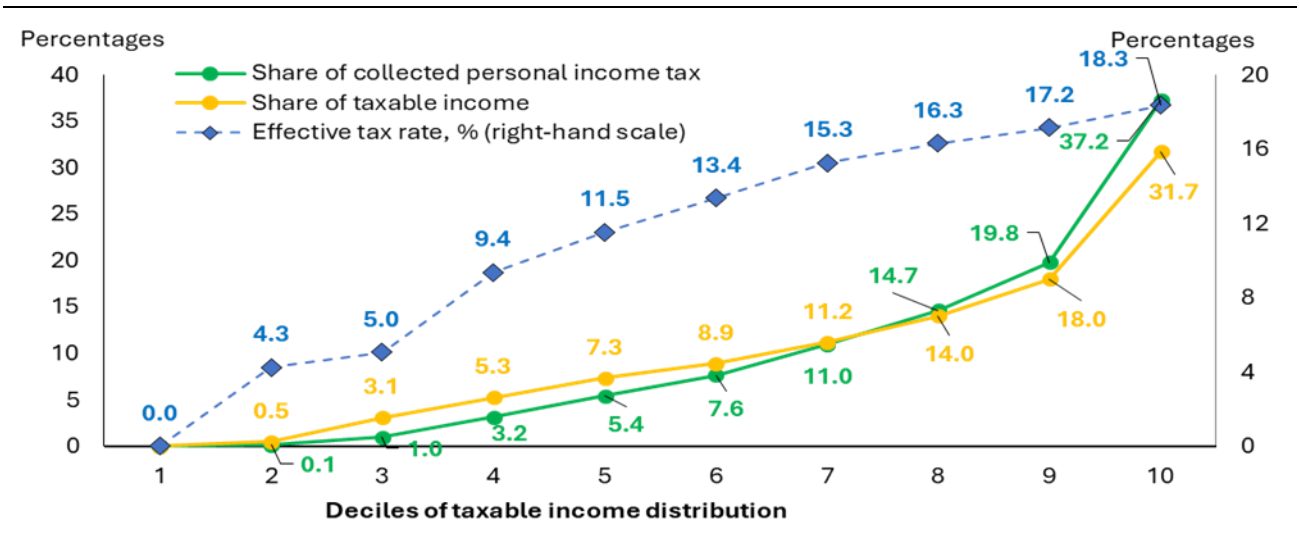
EU countries. The calculations were carried out using the EUROMOD⁴⁸ tool based on the EU-SILC micro dataset on income for 2020.

The fiscal drag of personal income tax can have a significant impact on tax revenues and distribution of household disposable incomes, especially in circumstances where nominal incomes are rising rapidly in the face of high inflation, while the tax parameters remain stable. Fiscal drag implies an increase in income tax revenue that is faster than the growth of the tax base. It occurs when the nominal tax base (i.e. taxable income and/or wage bill) grows but the parameters of tax legislation, which are expressed in the euro (such as thresholds for non-taxable income, progressive tax rates, tax credits, etc.), are not indexed. The potential of fiscal drag can also be considered as a general measure of progressiveness of a given income tax system, as its strength is directly affected by both the abundance of exemptions for non-taxable income and the number of progressive rates in the system. The potential of fiscal drag (i.e. the extent to which personal income tax revenues could potentially increase with a growing tax base and unchanged tax parameters) can be measured by estimating the elasticity of revenue to tax income (ERTI), which can be written in formula (1). The fiscal drag occurs when, holding personal income tax parameters constant, taxable revenue increases by 1% and personal income tax revenue by more than 1%. It should be noted that in practice (including in Lithuania), this fiscal drag is limited (or completely eliminated) by changing income tax parameters (indexing according to the selected indicator, usually the change in taxable income, inflation of the previous or current year, etc.) such as the maximum TEI, income threshold for the higher tax rate, etc.

$$ERTI = \frac{\Delta(\text{Personal income tax revenue})}{\Delta(\text{Taxable income})} > 1 \quad (1)$$

Most of the total amount of personal income tax revenue collected in 2023 is taxable income concentrated in deciles 8 to 10 of the distribution.

Chart A. Distribution of taxable income and personal income tax paid in 2023



Sources: Eurostat, ESCB and Lietuvos bankas calculations.

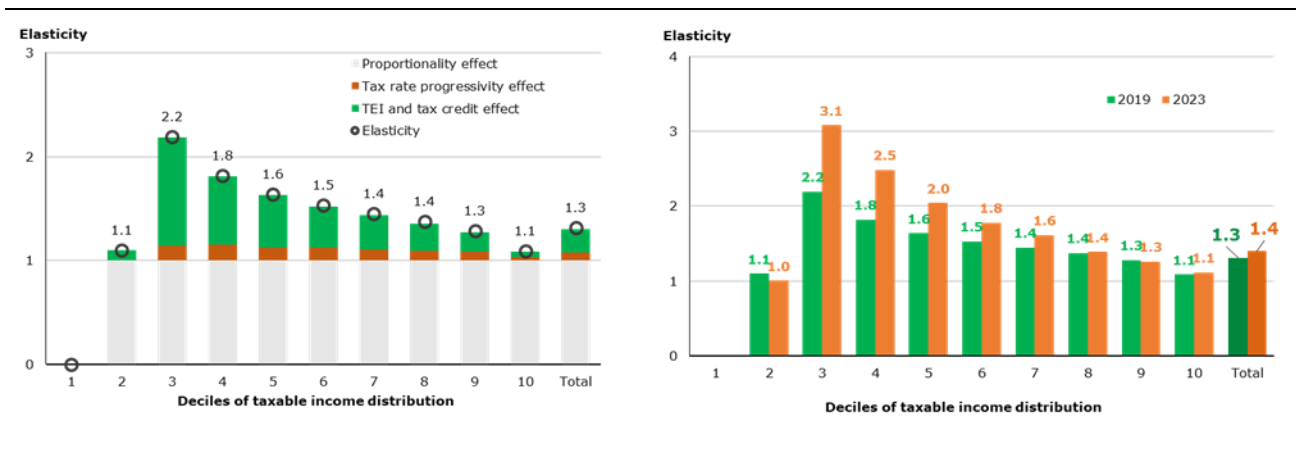
It should be noted that in Lithuania in 2023, two-thirds of all personal income tax revenue was collected from the top third of taxable income (see Chart A). The data of taxable income and personal income tax revenue collected used in the analysis show that almost two-thirds of the total amount of taxable income is concentrated in deciles 8–10 of the distribution and that this income accounts for around 70% of the total personal income tax collected. However, the share of taxable revenue increases quite steadily as income rises:

⁴⁸ EUROMOD is developed and maintained by the Joint Research Centre (JRC) of the European Commission. This tool is the tax-benefit microsimulation model for the EU that enables researchers and policymakers to calculate the effects of taxes and benefits on household incomes and work incentives in each EU country and for the EU as a whole. Find out more [here](#).

the effective rate of personal income tax (i.e. the ratio of personal income tax revenue to taxable income in a given decile) calculated within the deciles at the beginning of the distribution of taxable income is around 4% and it continues to rise steadily to almost 18% in the last decile. Chart A shows that this effective rate increases more rapidly in deciles 1–4 compared to the increase in this ratio in deciles 5–10. This is due to the fact that the taxation of income at this point in the distribution is subject to a fixed TEI and tax credit, which increase the progressiveness of the tax in this part of the income distribution. In deciles where income is not subject to tax exemptions, the effective tax rate changes evenly. It should be noted that the calculations did not use the original income distribution in its entirety but rather a slightly narrowed⁴⁹ version of it, which includes all the main types of income subject to personal income tax: labour income, severance pay, maternity, paternity, unemployment and long-term employment, sickness benefits as well as benefits from private pension funds, self-employment income, income from property and investments.

The elasticity of personal income tax revenue with respect to income in Lithuania was 1.3–1.4 and remained broadly unchanged in 2019–2023.

Chart B. Personal income tax revenue elasticity in 2019 by decile and its contributions (left-hand panel), comparison of personal income tax revenue elasticities in 2019 and 2023 (right-hand panel)



Sources: Eurostat, ESCB and Lietuvos bankas calculations.

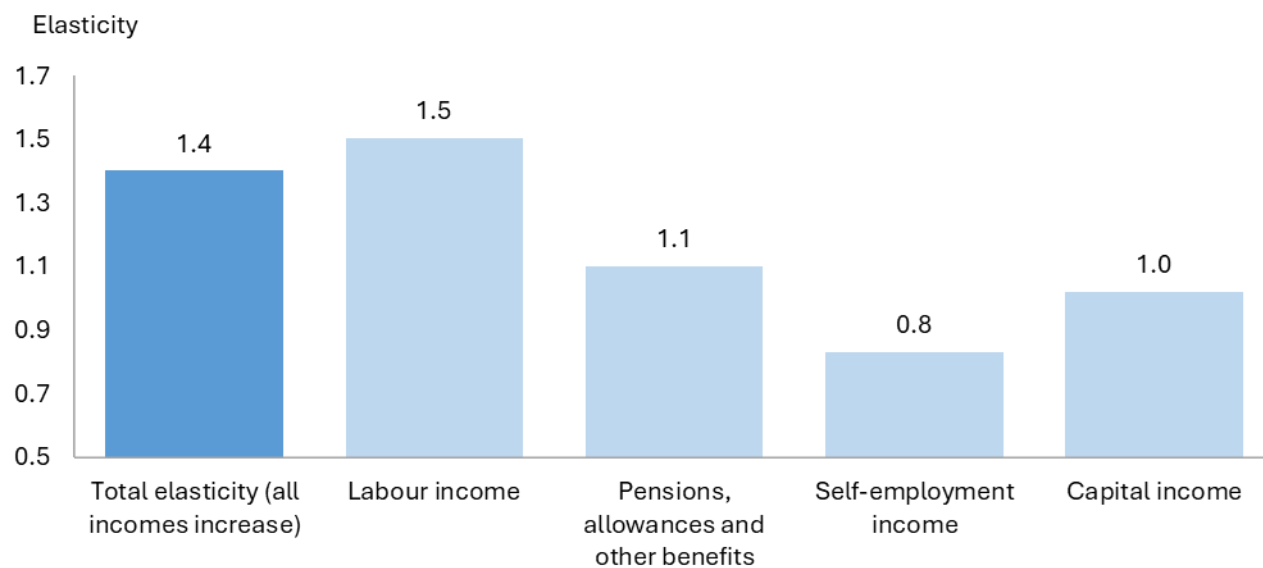
Notes: The proportionality effect refers to the increase in tax revenue and its tax base (taxable income) at the same rate of growth; the rate progressiveness effect refers to the extent to which income tax revenue increases faster than the growth of the tax base due to the fact that higher income is subject to higher income tax rates; the TEI and tax credit effect refers to the extent to which income tax revenue increases faster than the growth of the tax base due to the fact that the increase in revenue reduces the amount of non-taxable income subject to it.

If the personal income tax parameters were unchanged, then, as taxable income increases, the personal income tax collection in Lithuania would increase at a rate of around 1.3 times faster. The calculations show that the general elasticity of personal income tax revenue with respect to a 1% increase in taxable income in Lithuania is around 1.3–1.4% and remained broadly unchanged in 2019–2023 (see Chart B). Compared to other countries participating in the ESCB Network of Microsimulation Modelling, Lithuania has one of the lowest fiscal drag potentials and its impact on the growth of personal income tax revenue is eliminated each year by indexing the TEI to the growth of the lowest income. A constant TEI would allow for the full manifestation of fiscal drag but would result in an increase in the effective rate of personal income tax for the lowest income earners. However, elasticities vary quite significantly across deciles of the taxable income distribution, with the highest elasticities recorded in deciles 3 to 5 and the lowest elasticities estimated in decile 2 and the last decile of the distribution. The highest elasticity of personal income tax revenue at the beginning of the distribution should not be surprising as this income is most affected by the application of the TEI (for those working under an employment contract) and tax credit for the self-employed. The maximum TEI (€300 in 2019) applies to MMW earners and steadily

⁴⁹ It should be noted that, when the original income distribution used by EUROMOD for the fiscal drag analysis is slightly narrowed down, the first decile does not contain any entities that generated income in 2020. This is due to the fact that in the original EUROMOD income distribution, the lowest income decile includes those with very low incomes (e.g. various payments during the COVID-19 pandemic, etc.), which are not normal sources of income.

decreases as the wages rise until the individual's wages reach the threshold for applying the TEI (which in 2019 was equal to 2 average wages) This is the reason why the TEI is the main elasticity factor for the taxable income distribution in the low- and middle-income bracket (from MMW to 2 average wages) as a 1% increase in income in this bracket leads to a rise in the additional tax payable of between 1.6 and 2.2%. Chart B (see Chart B, right-hand panel) shows that elasticities of personal income tax in deciles 3 to 6 of the distribution increased significantly in 2023. This was caused by the change in the formula for calculating the TEI: with the introduction of two TEI calculation formulas, elasticity (or progressiveness) of personal income tax rose significantly in the income bracket from the MMW to 0.5 average wage, while the threshold for the application of the TEI calculated under the second formula fell to 1.5 average wages (from 2 average wages in 2019).

Chart C. Elasticity of personal income tax revenue by type of income



Sources: Eurostat, ESCB and Lietuvos bankas calculations.

In terms of type of income, the highest elasticity of personal income tax revenue was estimated for labour income and the lowest for self-employment income (see Chart C). There is a consensus in the economic literature that the elasticity of labour income tends to be higher than that of capital income, pensions and benefits. Elasticities of capital income and pensions and benefits are lower in most countries due to the lower tax rates (in Lithuania, pensions are not taxed at all) and the number of tax exemptions applicable to these types of income. The elasticity of self-employment income varies considerably from country to country, depending mainly on the labour market structure (i.e. the prevalence of self-employment) and progressiveness of taxation applied to this income. In the case of Lithuania, the general elasticity of personal income tax with respect to self-employment income was 0.7 in 2019, which means that a 1% increase in this type of income results in a 0.7% increase in income tax liability. This is most likely due to the more favourable taxation scheme for the self-employed in Lithuania compared to those working under employment contracts: self-employed persons engaged in certain activities can do so by purchasing a business certificate at the fixed price which does not depend on their income (provided that the annual income does not exceed the threshold of €45,000). According to the data of the State Tax Inspectorate, 89,000 persons declared income from individual activity under a business certificate in 2023,⁵⁰ and the income received by business certificate holders accounted for approximately one-sixth of the total income from individual activity, which is why this activity is a popular form of business among the self-employed.

The estimated potential of fiscal drag, which is reflected by elasticity, is one of the characteristics of an income tax system. However, it is neither inherently good nor bad as it depends fundamentally on public

⁵⁰ State Tax Inspectorate “[Report on the analysis of the administration of personal income tax](#)”, 10 November 2024.

choice. As already mentioned, elasticity can be considered as a general measure of progressiveness of a given income tax system, as its strength is directly affected by both the abundance of exemptions for non-taxable income and the number of progressive rates in the system. In the case of Lithuania, elasticity of 1.3–1.4 reflects the low progressiveness of the income tax system compared to other countries,⁵¹ as it depends on the applicable TEI, income tax credit for self-employment income and multiple income tax rates (5–15%, 20% and 32%). Countries with a higher potential of fiscal drag have more elements of income tax progressiveness. In general, the actual extent of progressiveness is decided by the citizens of a given country. Higher levels of progressiveness are likely to reduce the challenges related to income inequality and reinforce the “ability to pay” principle and potentially increase the sense of fairness in society. In addition, economic literature⁵² suggests that fiscal drag can act as an automatic fiscal stabiliser in good economic times since an increasing share of income is captured in the form of taxes as incomes rise rapidly, so that excess household consumption grows at a slower pace which reduces the heating of the economy and slows down inflationary processes. However, fiscal drag may have less favourable consequences as it may leave real personal incomes of the population unchanged, limit the economy’s transition to the activation phase despite the faster growth of gross income during that phase. In addition, high fiscal drag and high progressiveness of income taxation may have a negative impact on the incentives of high-income earners to work and invest, and may increase the incentive to relocate their business to lower-tax countries.

⁵¹ C. Leventi, A. Mazzon, F. Orlandi “Indexing wages to inflation in the EU: fiscal drag and benefit erosion effects”, RC Working Paper No 8, 2024.

⁵² H. Immervoll “Fiscal Drag – An Automatic Stabiliser?”, *Micro-Simulation in Action*, 2006, p. 141–163.

Abbreviations

GDP	gross domestic product
ECB	European Central Bank
ESCB	European System of Central Banks
EC	European Commission
EU	European Union
Eurosystem	European Central Bank and euro area central banks
US	United States of America
MMW	minimum monthly wage
TEI	tax-exempt income
RE	real estate
CIS	Commonwealth of Independent States
MFI	monetary financial institution
HICP	Harmonised Index of Consumer Prices
IMF	international Monetary Fund

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