



Economic outlook for Lithuania

5 February 2009

Compared to the projections of the Bank of Lithuania for October, outlook for economic development in 2009 and 2010 is less favourable. According to preliminary data, annual GDP growth was negative in Q4 2008, and economic cycle of the country turned to the downturn. Following extensive changes in economic development in 2008, negative GDP growth is projected for the two coming years. Domestic demand will continue to slow down, however, net exports growth will be positive. At the same time, both inflation and current account deficit will fall rapidly. GDP is expected to reach its lowest level in the second half of 2010.

GDP growth should be supported by positive dynamics of net exports growth in 2009 and 2010. Although both imports and exports are expected to drop, negative development in imports growth will be more pronounced. This development will be determined by weakening domestic demand, which in turn is related to easing labour market and less favourable borrowing terms. The non-decreasing market shares of Lithuania in major export markets suggest that exports excluding mineral products are mainly driven by fluctuations in foreign demand.

Inflation forecasts for 2009 and 2010 have been adjusted downwards mainly due to markedly lower external price pressures. Decline in oil prices that started in the middle of 2008 is further stimulated by a notably weaker global demand for energy resources. Taking into consideration pessimistic general market expectations about recovery of commodity prices, developments of consumption prices in Lithuania are expected to be rather favourable in the two coming years. However, the probability of abrupt short-term fluctuations of commodity prices remains high. Price developments in 2009 and 2010 are projected to moderate owing among other things to subdued domestic demand. Overall, as a result of both external and domestic factors, the headline inflation is expected to moderate over the projection horizon.

The risks to this projection are mainly related to global economic growth and economic policy of the country. Probability of downward revisions of growth projections in the main export markets of Lithuania remains high and might contribute to a more negative assessment of the outlook for Lithuanian economy during the forthcoming projection.

Current projections are based on the no change in economic policy assumption. A deviation from this assumption would result in a different scenario of macroeconomic development. As the uncertainties with respect to the economic outlook of Lithuania are elevated, the government budget revenue might be lower than projected, which would imply further tightening of fiscal policy. On the other hand, more favourable financing conditions in the international markets might result in easing of fiscal policy.

ECONOMIC OUTLOOK FOR LITHUANIA IN 2009–2010

	January 2009 projection			October 2008 projection		
	2008*	2009*	2010*	2008*	2009*	2010*
Price and Cost Developments (annual percentage changes)						
Average annual inflation (based on HICP)	11.1	5.8	4.4	11.6	6.9	-
GDP deflator	12.2	2.3	0.2	11.9	2.7	-
Wages (compensation per employee)	19.6	-0.2	-5.2	21.6	3.5	-
Import deflator	8.6	-2.9	3.4	8.8	1.0	-
Export deflator	13.1	-3.7	3.9	12.6	1.4	-
Economic Activity (constant prices; annual percentage changes)						
Gross Domestic Product	3.3	-4.9	-3.9	4.2	1.2	-
Private consumption expenditure	4.7	-11.7	-8.6	4.8	-4.7	-
General government consumption expenditure	4.3	-9.4	1.8	5.7	2.2	-
Gross fixed capital formation	-3.7	-14.6	-8.8	-3.7	-6.7	-
Exports of goods and services	11.7	-0.5	4.0	12.3	3.8	-
Imports of goods and services	11.6	-12.3	-0.8	12.0	-4.5	-
Labour Market						
Unemployment rate (as a percentage of labour force)	5.6	10.2	11.6	5.4	7.9	-
Employment (annual percentage changes)	-1.3	-5.4	-4.0	-1.9	-2.9	-
External sector (as a percentage of GDP)						
Balance of goods and services	-11.6	-3.7	-0.7	-11.8	-6.0	-
Current account balance	-13.1	-4.8	-2.0	-13.0	-6.2	-
Current and capital account balance	-10.7	-2.6	1.4	-10.6	-4.1	-

*projection