



Economic Outlook for Lithuania

14 May 2009

Due to the economic downturn in Lithuania, which began in the end of 2008, macroeconomic imbalances of several recent years are diminishing. In the first months of 2009, the current account become almost balanced, inflation and wage growth is decreasing significantly. The current downturn will be related to material structural changes; however, capability of enterprises and households to react flexibly to unfavourable economic shocks provides the grounds for a successful long-term economic development. Over the short-term, deflation in the labour and goods markets will form preconditions for wages to return to the levels corresponding to productivity and in that way will ensure a long-term competitiveness of the tradable sector in export markets.

According to the flash estimate of the Department of Statistics, in the first quarter of 2009 real GDP decreased by 12.6 per cent on annual basis compared to -2.2 per cent in the last quarter of 2008; it was the smallest decline among the Baltic States. This was reflected mainly in changes of domestic demand: at the beginning of 2009, the decrease in investment and consumption accelerated. The weakening demand – both domestic and foreign – has a negative impact on the number of new orders and volumes of the production sold. Therefore, development plans of enterprises have been suspended or postponed. Investment opportunities have also been limited by the deteriorating profit indicators and less favourable borrowing conditions in a number of sectors.

Along with the economic slowdown, labour market trends have changed. Lower demand for labour force was indicated by an increased number of unemployed and falling vacancy rate in almost all activities. In the fourth quarter of 2008, the annual wage growth decelerated sharply, while in some activities, such as construction and manufacturing of metals, wages have already reached a lower level than that attained a year ago.

A decline in the overall annual inflation in Lithuania was mostly determined by a slower growth of food prices and falling core inflation. It is expected that in the context of falling demand core inflation will decrease further – currently a fair proportion of industrial goods is cheaper than a year ago, and the annual growth rate of prices of most services is decelerating.

Compared to the projections in January, changes in macroeconomic indicators in the next few years are expected to be more significant. Taking into account revised statistics of the fourth quarter of 2008, the latest data of 2009, and more pessimistic estimations of a further dynamics of the economic activity, GDP is expected to drop by 15.6 per cent in 2009 and 4.5 per cent in 2010. The projection for 2010 is based on the presumption that external demand will start to recover in 2009. Stronger economic activity of foreign countries would contribute to the recovery of the growth rate of Lithuanian exports and more favourable trends of the country's GDP development. However, decreasing wages and rising unemployment in 2009 and 2010 will add to the decline of domestic demand.

In the next years, the reduction in demand will entail a lower growth of prices. The annual average inflation is projected to stand at 3,9 per cent in 2009 and at -2,1 per cent in 2010. Global trends in energy and food prices are envisaged to determine less dynamic changes of consumer prices in Lithuania, while easing domestic demand will contribute to more moderate core inflation developments.

ECONOMIC OUTLOOK FOR LITHUANIA IN 2009–2010

	May 2009 projection			January 2009 projection		
	2008	2009*	2010*	2008*	2009*	2010*
Price and Cost Developments (annual percentage changes)						
Average annual inflation (based on HICP)	11.1	3.9	-2.1	11.1	5.8	4.4
GDP deflator	10.3	-3.1	0.3	12.2	2.3	0.2
Wages (compensation per employee)	18.0	-12.3	-5.2	19.6	-0.2	-5.2
Import deflator	8.1	-6.1	3.4	8.6	-2.9	3.4
Export deflator	12.2	-5.5	3.9	13.1	-3.7	3.9
Economic Activity (constant prices; annual percentage changes)						
Gross Domestic Product	3.0	-15.6	-4.5	3.3	-4.9	-3.9
Private consumption expenditure	4.7	-17.5	-8.2	4.7	-11.7	-8.6
General government consumption expenditure	4.3	-14.9	-3.6	4.3	-9.4	1.8
Gross fixed capital formation	-6.1	-39.0	-8.5	-3.7	-14.6	-8.8
Exports of goods and services	11.3	-14.4	4.0	11.7	-0.5	4.0
Imports of goods and services	10.0	-28.0	-0.8	11.6	-12.3	-0.8
Labour Market						
Unemployment rate (as a percentage of labour force)	5.8	11.6	13.4	5.6	10.2	11.6
Employment (annual percentage changes)	-0.9	-7.1	-4.5	-1.3	-5.4	-4.0
External Sector (as a percentage of GDP)						
Balance of goods and services	-11.2	0.5	3.9	-11.6	-3.7	-0.7
Current account balance	-12.2	0.9	4.2	-13.1	-4.8	-2.0
Current and capital account balance	-10.5	2.8	6.7	-10.7	-2.6	1.4

*projection