

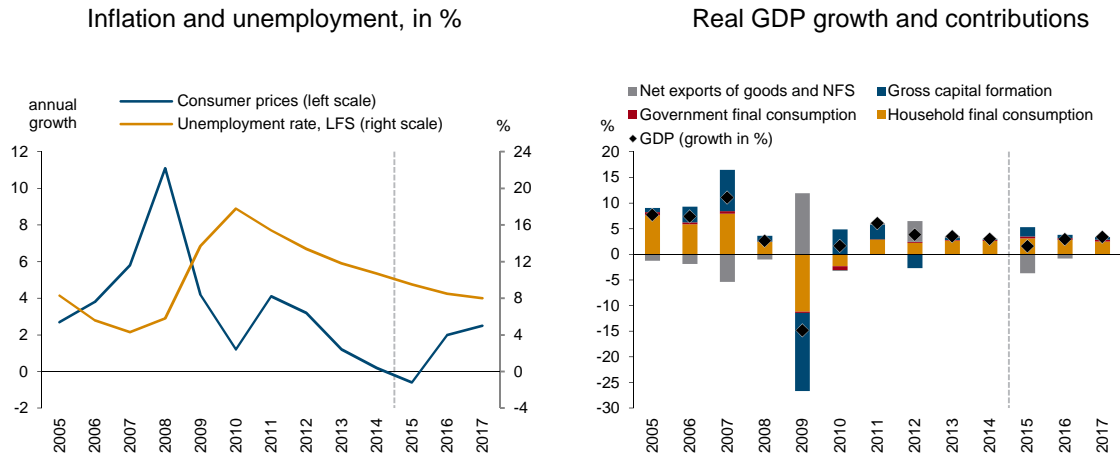


## LITHUANIA: Economic ties are changing

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Throughout 2015, growth of the Lithuanian economy has been dampened by a slump in external demand in the CIS countries and the lower demand for oil products. Only part of the shortfall can be offset by exports to the EU and Asian markets or growth in other product categories. Consumer demand has developed apace and investment activity is flourishing. We forecast a reasonable GDP growth rate of 2% for 2015 and an upswing to 3% and 3.4% for 2016 and 2017, respectively.

**Figure 50 / Lithuania: Main macroeconomic indicators**



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Lithuanian goods exports have kept declining throughout 2015 – in January to October 2015 by 3.6% in nominal terms year-on-year. The recession in Russia, but also in Belarus and Ukraine, drags down trade with these countries. Thus in the same period exports to Russia fell by 40% and no sign of stabilisation is in sight up to now. Lithuanian entrepreneurs have been successfully redirecting trade by conquering new markets most recently, particularly in the food sector; nevertheless, the shortfall in Russian demand could not be offset completely. However, the transport sector, being strongly exposed to Russian transit trade, as well as tourism were hit less than expected. The third reason for trade to decline was the slump in external demand for refined oil products and the fall in prices, squeezing the profits of the Lithuanian refinery Mazeiku Nafta, which accounts for about a third of the country's total exports. At the same time we see an increase in trade with the Northern and Western trading partners. In 2016 and thereafter

exports will probably gain momentum since the economic downturn will level off in the Eastern neighbours. Since domestic demand evolves at a good pace, imports are likely to increase by about 3% nominally in 2015 and net trade will drag down overall GDP growth.

Although export prospects are not too favourably at the moment, gross fixed investments started to pick up in the second quarter of 2015 throughout the economy. The construction of dwellings continues to increase gradually and public investment, particularly in energy infrastructure and road maintenance, will result in gross fixed investments growing by about 8% in 2015. By the end of this year, Lithuania will have taken some important steps to become more energy independent from Russia in terms of gas and electricity. NordBalt and LitPol, connecting the Lithuanian grid both with Sweden and Poland, are just being finalised which should also reduce the price of electricity for households by about 7% in 2016.

The fall in prices for imports, particularly for oil and gas, and the excess supply of food resulted in falling consumer prices in the first eight months of the year. Stronger economic stimulus in the rest of the EU is likely to lead to rising consumer prices in 2016 and 2017. Simultaneously, average real wages continue to increase substantially as in the previous year – in the first half of 2015 by almost 6% net year-on-year. Employment will increase by about 1% in 2015, strongly driven by higher labour demand in construction. Simultaneously, negative net migration and ongoing demographic developments are causing the unemployment rate to drop faster than expected: towards the end of 2015 already to about 9.5% of the labour force. However, those demographic developments pose risks for fiscal sustainability. The European Commission expects an adjustment effort in excess of 3% of GDP in the long term for Lithuania, the highest costs relative to GDP compared to all other EU countries.

Throughout this year various ministries have worked intensively on a comprehensive reform of the labour law and complementary laws concerning the social protection system. The aim is to liberalise the labour market even further, with the hope to increase the number of jobs. First drafts have sparked protest of unions in September, opposing particularly the foreseen 3-day notice period for dismissal, the introduction of a maximum 60-hour week and the expansion of atypical work in general, a reduction of guarantees for working parents and restrictions to trade union activities. The discussions in the parliament on the comprehensive liberalisation package will become highly conflictive, even more so since Lithuania is heading towards parliamentary elections in autumn 2016. Up to now the polls show that the Social Democrats, the strongest party in the parliament, headed by Prime Minister Butkevičius, still enjoy stable public support; however, this could change in the coming months with disputes over the new labour code building up. Thus, the increase in the minimum wage by EUR 25 to EUR 350 (about EUR 580 in purchasing power parity terms) in January next year can be interpreted as a measure to ease off upcoming resistance. Moreover, the budget proposal of the government aims at increasing old-age pensions by 6% and at raising the non-taxable income bracket in 2016. Next year's defence budget will be increased by one third, thus amounting to 1.5% of GDP, compared to 0.8% in 2013. The government wants to attain a level of 2% of GDP in 2018 – thus the Russian intervention in Ukraine has resulted in a massive reallocation of resources towards military expenses in the whole Baltic Sea region.

Given the improving situation in the labour market and swiftly rising incomes, household consumption remains the most important driver of growth for the Lithuanian economy in 2015 and the years thereafter. However, its positive impact is gradually declining due to increased precautionary savings and it cannot completely offset the negative effects of the shortfall in external demand. Overall, we expect GDP to expand by 2% in 2015. For 2016 and 2017 we slightly raise our forecast for an

accelerated GDP growth to 3% and 3.4% growth rates, respectively. The assumed drivers of that development are an economic stabilisation in the eastern neighbours and growth in the euro area gaining momentum. Moreover, public investment activity should be facilitated by the availability of EU funds from the 2014-2020 planning period. The budget deficit, which declined substantially last year, will increase slightly to 1.4% in 2015 owing to tax revenues having remained below expectations. In the years to follow it will remain most probably at the same level, resulting in a continuously falling public debt to GDP ratio.

**Table 17 / Lithuania: Selected economic indicators**

	2011	2012	2013	2014 <sup>1)</sup>	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average <sup>2)</sup>	3,028	2,988	2,958	2,932	.	.	2,900	2,875	2,860
Gross domestic product, EUR-LTL mn, nom. <sup>3)</sup>	31,263	33,335	34,962	36,444	17,390	17,617	36,800	38,700	41,000
annual change in % (real)	6.0	3.8	3.5	3.0	4.1	0.4	1.6	3.0	3.4
GDP/capita (EUR at exchange rate) <sup>3)</sup>	10,300	11,200	11,800	12,400	.	.	12,700	13,500	14,300
GDP/capita (EUR at PPP) <sup>3)</sup>	17,000	18,300	19,400	20,200	.	.	.	.	.
Consumption of households, EUR-LTL mn, nom. <sup>3)</sup>	19,471	20,786	21,885	22,817	10,944	11,351	.	.	.
annual change in % (real)	4.6	3.6	4.3	4.2	4.5	6.1	5.0	4.5	4.0
Gross fixed capital form., EUR-LTL mn, nom. <sup>3)</sup>	5,781	5,788	6,457	6,894	3,078	3,466	.	.	.
annual change in % (real)	20.1	-1.8	8.3	5.4	9.5	10.9	8.0	10.0	9.0
Gross industrial production (sales)									
annual change in % (real)	6.4	3.7	3.3	-0.1	-2.2	4.5	4.6	6.0	7.0
Gross agricultural production									
annual change in % (real)	10.3	14.2	-1.8	6.2	.	.	.	.	.
Construction industry									
annual change in % (real)	22.1	-7.1	11.3	17.0	23.8	7.6	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	1,371	1,276	1,293	1,319	1,302	1,327	1,330	1,340	1,350
annual change in %	2.0	1.8	1.3	2.0	1.6	1.9	0.8	0.8	0.7
Unemployed persons, LFS, th, average <sup>4)</sup>	249	197	173	158	174	142	140	124	117
Unemployment rate, LFS, in %, average <sup>4)</sup>	15.4	13.4	11.8	10.7	11.8	9.7	9.5	8.5	8.0
Reg. unemployment rate, in %, end of period <sup>2)5)</sup>	12.0	11.4	11.1	9.3	8.6	8.5	.	.	.
Average monthly gross wages, EUR-LTL <sup>6)</sup>	593	615	646	677	676	707	710	770	840
annual change in % (real, gross)	-1.2	0.7	4.0	4.7	4.0	5.7	6.0	6.5	6.0
Average monthly net wages, EUR-LTL <sup>6)</sup>	462	478	501	527	527	549	550	590	630
annual change in % (real, net)	-1.3	0.5	3.8	5.1	4.4	5.4	5.8	4.8	4.3
Consumer prices (HICP), % p.a.	4.1	3.2	1.2	0.2	0.3	-0.8	-0.6	2.0	2.5
Producer prices in industry, % p.a.	13.9	5.0	-2.4	-4.9	-4.0	-9.0	-8.0	0.0	1.0
General government budget, EU-def., % of GDP									
Revenues	33.5	33.0	32.9	34.1	.	.	33.5	33.2	33.0
Expenditures	42.5	36.1	35.5	34.8	.	.	34.9	34.4	34.2
Net lending (+) / net borrowing (-)	-8.9	-3.1	-2.6	-0.7	.	.	-1.4	-1.2	-1.2
Public debt, EU-def., % of GDP	37.2	39.8	38.8	40.7	.	.	43.0	40.0	39.0
Central bank policy rate, % p.a., end of period <sup>7)</sup>	1.24	0.52	0.27	0.12	0.26	0.05	0.05	0.05	0.20
Current account, EUR mn <sup>8)</sup>	-1,209	-393	539	1,305	88	-873	-1,500	-1,800	-2,000
Current account, % of GDP <sup>8)</sup>	-3.9	-1.2	1.5	3.6	0.5	-5.0	-4.1	-4.7	-4.9
Exports of goods, BOP, EUR mn <sup>8)</sup>	19,422	22,427	23,998	23,750	11,174	10,787	22,840	23,750	25,410
annual change in %	30.4	15.5	7.0	-1.0	-3.8	-3.5	-3.8	4.0	7.0
Imports of goods, BOP, EUR mn <sup>8)</sup>	21,487	23,530	24,918	24,686	11,758	12,044	25,550	26,700	28,430
annual change in %	29.9	9.5	5.9	-0.9	-0.8	2.4	3.5	4.5	6.5
Exports of services, BOP, EUR mn <sup>8)</sup>	4,033	4,793	5,390	5,850	2,789	2,845	6,130	6,560	7,220
annual change in %	17.8	18.8	12.5	8.5	10.5	2.0	4.8	7.0	10.1
Imports of services, BOP, EUR mn <sup>8)</sup>	2,766	3,404	4,033	4,212	2,022	2,015	4,470	4,830	5,410
annual change in %	20.2	23.1	18.5	4.4	7.5	-0.3	6.1	8.1	12.0
FDI liabilities (inflow), EUR mn <sup>8)</sup>	1,095	454	531	270	195	101	800	.	.
FDI assets (outflow), EUR mn <sup>8)</sup>	94	215	322	433	160	61	300	.	.
Gross reserves of NB excl. gold, EUR mn <sup>9)</sup>	6,120	6,203	5,705	6,991	6,009	1,910	.	.	.
Gross external debt, EUR mn <sup>8)</sup>	25,149	26,031	24,596	25,723	25,164	28,483	28,700	29,400	30,300
Gross external debt, % of GDP <sup>8)</sup>	80.4	78.1	70.4	70.6	69.0	77.4	78.0	76.0	74.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LTL/EUR	0.6070	0.6089	0.6086	0.6160	.	.	.	.	.

Note: Lithuania has introduced the Euro from 1 January 2015. Up to and including 2014 all-time series in LTL as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 3.4528 (LTL per EUR) to achieve euro-fixed series (EUR-LTL).

- 1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) In % of working age population. - 6) Including earnings of sole proprietors. - 7) From 2015 official refinancing operation rate for euro area (ECB), VILIBOR one-month interbank offered rate before (Lithuania had a currency board until Euro introduction). - 8) BOP 6th edition. - 9) From January 2015 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.