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Lithuania: Economy continues to recover

The new Lithuanian centre-left coalition government headed by the Social Democrats raised minimum wages considerably which will bolster growth of household consumption. Public investment in the transport infrastructure will further trigger domestic demand, while lively Russian demand keeps the current account deficit low. Focusing on demand-side growth policies and a reduction of in-work poverty the Lithuanian government refrains from aiming at euro area accession as early as possible.

The new centre-left coalition government which started to work in December last year had a turbulent start with headwinds from President Dalia Grybauskaitė. Moreover, the parliamentary immunity of three members of one of the coalition partners, the centre-populist Labour Party, has been lifted due to accusations of illegal party financing. But the coalition seems to have overcome these challenges and its will to stay in power will serve as glue. Government measures – either already introduced or being planned – will lift the income of low- to medium-wage earners and thus foster the growth of domestic demand. In addition, a rise in public and private investment and the still comparably favourable external conditions in the neighbourhood will result in a slight strengthening of economic activity in 2013 and thereafter.

After slowing down markedly at the beginning of 2012, growth in exports of goods speeded up again in the second half of last year. Almost half of the nominal increase in exports achieved in 2012 however accrued from the outstanding harvest, which was 25% higher in 2012 than a year earlier, and from higher revenues of the Mazeiku Nafta refinery resulting inter alia from rising prices of oil products. Since both circumstances will most likely be less favourable this year and external demand from the Baltic neighbours will also weaken slightly we expect Lithuania's growth in goods exports to decline as well. Nevertheless, falling crude oil prices will also reduce the nominal growth of imports and thus the contribution of net exports to overall GDP growth will still remain balanced.

Entrepreneurs were reluctant to expand investments last year given the uncertain prospects for external demand. Moreover, households and companies refrained from

taking up new credits to invest in dwellings and other construction activities. As a result, the construction output declined in 2012. As the Lithuanian refinery reduced its stock of crude oil in the phase of high prices, overall capital investment even declined. However, this year we expect private but even more so public investment activity to speed up again.

The new government led by the Social Democratic party has announced plans to step up investments in public infrastructure. Also considerable investments in the energy and transport infrastructure start being realized this year. With financial assistance from the EBRD and the Swedish bank group SEB an international container distribution centre will be constructed in Klaipeda, the most important Lithuanian port. To be finalized in 2015, the port will attract ocean-going container ships from all over the world which up to now have to reload their cargo to smaller vessels in German or Dutch ports in order to supply the eastern shores of the Baltic Sea. The handling volume is expected to increase up to four times. Another project, which will remove Lithuania's present complete dependency on Russian natural gas, is the planned LNG terminal also to be constructed in Klaipeda. In the future it will cover up to 25% of Lithuania's gas demand. The construction should start this year and will most probably be finalized at the beginning of 2015.

One of the first acts of the newly formed government was to deliver one of the main campaign pledges of the Social Democratic Prime Minister Algirdas Butkevicius, namely to raise the minimum gross wage of employees by 17% to EUR 289 (EUR 239 net). This affects about 200 thousand employees or 15% of the workforce. The minimum wage has persistently been criticized to be not only very low in nominal terms but also as compared to the national average of gross wages. For comparison, minimum gross wages in 2013 amount to EUR 320 in Estonia and EUR 282 in Latvia, while the average gross wage amounts to EUR 640 in Lithuania. The government has announced to allow small businesses delays in tax payment in order for them to be able to adapt to the new situation.

The increase in the purchasing power of low-income earners will further support the growth of domestic demand this year, which has already evolved swiftly in 2012. The Prime Minister moreover established an expert group in order to deliver suggestions for changes in the personal income tax system, inter alia with the aim to reduce the tax wedge of low-wage earners. However, whether the idea articulated by some Social Democrats prior to the elections that the flat tax system should be replaced by progressive income taxation will be realized is far from clear. A decision on the issue is looming towards the end of the year.

Employment rose substantially in 2012, by 1.8%, driven by job increases in industry, transport and the high-skill service sectors alike. The unemployment rate fell from more than 15% to about 13%. Although we expect that employment will continue to grow by 1.3% in 2013, we also expect labour supply to increase more strongly this year. Recent figures show that during the two years of deep recession almost 10% of the labour force left the country, which will be a detrimental factor for medium- to long-term economic growth. Assuming that the situation of the labour market improves in Lithuania within the next two years some of the migrant workers may return to their home country.

The budget for 2013, passed in October last year by the outgoing conservative government, foresees a reduction of the budget deficit to 2.5% of GDP. Since tax income is to continue to expand rather favourably and the refinancing costs of public debt are likely to fall, the target seems realistic. Thereafter the Lithuanian government may opt for a slower pace in reducing the budget deficit further.

In January Prime Minister Butkevicius reiterated that the new government will aim at joining the eurozone at the beginning of 2015 and announced that a concrete programme is to be worked out. However, it will become a difficult task to depress consumer inflation in order to conform to the Maastricht criteria. In 2012 consumer prices increased by 3.2%; for this year we even expect a slight acceleration. Depending on the decisions taken by the Ecofin council in the case of Latvia, the Lithuanian government may also try to solve this problem by lowering the VAT rate in mid-2013. It may however very well be that a postponement of the entry date will be announced towards the end of the year.

A still rather favourable development of external demand from the Baltic neighbours and Russia, an expected upswing in investments and robustly evolving household demand is to result in GDP growth by 3.8% in 2013. The scenario for the years to come is based on the assumptions of an acceleration of overall external demand next year, while domestic demand, including expenditures for the public wage bill and investments, will speed up slightly. Thus, we expect GDP growth to increase to 4% in 2014 and 4.2% in 2015.

Table LT

Lithuania: Selected Economic Indicators

	2008	2009	2010	2011	2012 ¹⁾	2013	2014 Forecast	2015
Population, th pers., average ²⁾	3358.1	3339.5	3286.8	3029.3	2993.6	2979	2964	2949
Gross domestic product, LTL mn, nom.	111920	92032	95323	106370	112411	121100	130400	140800
annual change in % (real)	2.9	-14.8	1.5	5.9	3.6	3.8	4.0	4.2
GDP/capita (EUR at exchange rate)	9700	8000	8400	10200	10900	.	.	.
GDP/capita (EUR at PPP)	15400	12800	14100	16600	17700	.	.	.
Consumption of households, LTL mn, nom.	73097	62807	60586	67150	72400	.	.	.
annual change in % (real)	3.7	-17.8	-4.8	6.3	4.5	5.0	4.5	4.5
Gross fixed capital form., LTL mn, nom.	28369	15807	15589	18901	19700	.	.	.
annual change in % (real)	-5.2	-39.5	1.9	18.4	1.0	7.0	10.0	12.0
Gross industrial production (sales)								
annual change in % (real)	5.5	-14.6	6.7	7.4	4.6	6.0	8.0	8.0
Gross agricultural production (EAA)								
annual change in % (real)	8.8	1.0	-7.2	10.3	10.0	.	.	.
Construction industry								
annual change in % (real)	4.0	-48.5	-7.7	22.2	-3.5	.	.	.
Employed persons, LFS, th, average ³⁾	1520.0	1415.9	1343.7	1370.9	1278.5	1295	1315	1330
annual change in %	-0.9	-6.8	-5.1	2.0	1.8	1.3	1.5	1.1
Unemployed persons, LFS, th, average ³⁾	94.3	225.1	291.1	248.8	195.2	177	163	148
Unemployment rate, LFS, in %, average ³⁾	5.8	13.7	17.8	15.4	13.2	12.0	11.0	10.0
Reg. unemployment rate, in %, end of period ⁴⁾	4.4	12.5	14.4	11.0	11.4	.	.	.
Average gross monthly wages, LTL ⁵⁾	2151.7	2056.0	1988.1	2045.9	2137.0	.	.	.
annual change in % (real, net)	10.1	-7.2	-4.3	-1.4	1.0	.	.	.
Consumer prices (HICP), % p.a.	11.1	4.2	1.2	4.1	3.2	3.8	3.5	3.6
Producer prices in industry, % p.a.	18.2	-13.5	10.3	13.9	5.0	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	34.0	34.3	33.6	31.9	31.5	32.2	32.0	32.0
Expenditures	37.2	43.7	40.8	37.4	34.3	34.5	34.0	34.0
Net lending (+) / net borrowing (-)	-3.3	-9.4	-7.2	-5.5	-2.8	-2.3	-2.0	-2.0
Public debt, EU-def., % of GDP	15.5	29.3	37.9	38.5	40.5	39.5	38.0	36.0
Central bank policy rate, % p.a., end of period ⁶⁾	7.84	1.57	1.07	1.24	0.52	.	.	.
Current account, EUR mn	-4194	996	20	-1151	-370	-700	-700	-800
Current account, % of GDP	-12.9	3.7	0.1	-3.7	-1.1	-2.0	-1.9	-2.0
Exports of goods, BOP, EUR mn	16077	11797	15651	20151	22900	24500	28000	32000
annual growth rate in %	28.5	-26.6	32.7	28.8	13.6	7.0	14.3	14.3
Imports of goods, BOP, EUR mn	20280	12688	16990	21958	24000	26000	30000	34000
annual growth rate in %	20.8	-37.4	33.9	29.2	9.3	8.3	15.4	13.3
Exports of services, BOP, EUR mn	3240	2629	3088	3738	4500	5250	6350	7800
annual growth rate in %	10.5	-18.9	17.5	21.0	20.4	16.7	21.0	22.8
Imports of services, BOP, EUR mn	2835	2192	2274	2742	3220	3700	4300	4900
annual growth rate in %	14.7	-22.7	3.7	20.6	17.4	14.9	16.2	14.0
FDI inflow, EUR mn	1341	-9	604	1040	800	1000	.	.
FDI outflow, EUR mn	229	143	-4	40	10	50	.	.
Gross reserves of NB excl. gold, EUR mn	4458	4472	4788	6120	6203	.	.	.
Gross external debt, EUR mn	23009	22363	22976	23976	26000	.	.	.
Gross external debt, % of GDP	71.0	83.9	83.2	77.8	79.9	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
Purchasing power parity LTL/EUR	2.1710	2.1363	2.0627	2.1198	2.1270	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) From 2012 according to census March 2011. - 4) In % of working age population. - 5) Annual data include earnings of sole proprietors. - 6) VILIBOR one-month interbank offered rate (Lithuania has a currency board).

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