



LITHUANIA: Euro area within reach

SEBASTIAN LEITNER

In July 2014 the EU Council will most likely approve Lithuania's admission to the euro area, since the country fulfils all Maastricht criteria. For 2014 we expect GDP growth to rise to 3.6% and to further accelerate slightly in 2015 and 2016. An upswing of external demand this year and in 2015 and ongoing flourishing household consumption driven by strong wage developments bolster economic activity. From 2015 onwards public investments will provide for an additional impulse.

The pace of economic activity slowed down in the second half of 2013. Lithuanian firms face, after three years of high export growth, abating external demand developments. The reasons for that are manifold. The demand for two of the most important export commodities, fertilisers and oil products, slowed down remarkably last year and prices of the latter were on decline. The slowdown of GDP growth of Lithuania's main trading partner Russia and the import ban of Russian authorities on Lithuanian dairy products lasting from October last year to January 2014 both had a sizable negative impact.

Also the decline in industrial production was mainly affected by the output developments of Lithuania's refinery Mazeiku Nafta, the largest exporting firm in the country. Other sectors, particularly the wood industry, even showed an upswing in production in the second half of 2013. For 2014 we expect export demand to increase only slightly compared to last year. Oil prices are likely to fall further this year. However, an increase in the quantity of exported oil products is to be expected. The forecasts for growth developments in the North European trading partners are rosier for 2014 compared to last year and even for Russia a slight upswing is possible.

Although imports contracted in line with abating export growth, the contribution of net exports declined substantially last year compared to 2012. From 2014 onwards we expect that domestic demand will grow more strongly compared to that of Lithuania's trading partners except for neighbouring Latvia. Thus the current account balance will turn slightly negative again.

Public and private gross fixed investments developed well last year. In 2014 we expect them to grow slightly less vibrantly, since one-off effects provided in 2013 by construction and refurbishment relating to Lithuania's Presidency of the Council of the EU and high investments into transport equipment cease. However, construction activity will continue to increase given the plan of the government to renovate old Soviet-style dwelling houses. For the years 2015 and 2016 both private and public investment should gain more momentum, when EU structural funds of the new programming period 2014-2020 become available.

The final budget deficit figure is expected to amount to 2.8% for 2013. Although expenditures increased more strongly than planned by the former government last year, higher than envisaged revenues, particularly from income taxes, allowed the government to attain the 3% deficit criterion. The budget plan for 2014, a reduction of government net lending to 1.9%, seems to be slightly overambitious, but a substantial decline is possible if economic activity and thus revenues evolve as expected. Additional expenditures will be allocated for regional development, and the compensation of pensioners that suffered from income cuts in 2010 and 2011 will amount to 1% of GDP in the coming three years. From January 2014 onwards the non-taxable minimum income has been increased by about 20% and it is planned to be raised by another 20% in January 2015. The non-taxable amount for each child has also been doubled at the beginning of this year. The IMF highlighted in a report last year that the consolidation of the budget deficit conducted in the course of the economic crisis heavily relied on expenditure cuts in Lithuania while the tax structure remained almost unchanged. In the phase of the rebound thereafter the share of revenues is gradually declining, being already the lowest in the EU. The IMF recommends increasing taxes on capital and wealth and raising the progressivity of income taxation for the upper income deciles of the population.

Lithuania is most likely to become the 19th member of the euro area given that all Maastricht criteria will be met. In January this year Prime Minister Algirdas Butkevičius reiterated that if meeting the goal should fail, he and the government would take responsibility and resign. Public support for the euro introduction is however still quite low; a poll in November 2013 showed that 40% of the public is in favour of the accession while 49% oppose it.

Employment growth further slowed down last year while the construction sector experienced a revival in jobs. Although economic activity will develop at a good pace also in the coming years, job growth will abate due to a declining labour force. Figures of the Lithuanian statistical office indicated that return migration has increased, but net outflows still amounted to about 0.6% of the population in 2013. Last year gross wages started to rebound markedly in real terms. Given the amelioration in the labour market we expect incomes to increase more swiftly in 2014. Moreover, Finance Minister Šadžius announced the plan to raise minimum wages by 5% in January 2015. With the outbreak of the economic crisis the emigration of a substantial part of the workforce caused a significant increase of personal remittances inflows. With a most recent value of 3.5% of GDP Lithuania overtakes countries such as Bulgaria and Romania. However, these high inflows are likely to decline, particularly when young migrants start to settle down permanently in the host countries and start a family of their own.

The growth of consumer prices abated throughout 2013 to 0.4% in December. Apart from crude oil also administered prices declined in the second half of last year, showing the will of the Lithuanian government to fulfil the Maastricht criteria.

The above-mentioned factors, rising employment and wages, a decline in inflation and high remittance inflows substantially increased the purchasing power of households and their spending mood. Thus private consumption became the main driver of economic activity last year. This trend will continue in the forecast period. For the coming years we expect GDP growth to increase slightly to 3.6% in 2014, 3.8% in 2015 and 4% in 2016. The forecast is underpinned by the assumptions of a slight acceleration in external demand, ongoing stable investment activity first of all in the construction sector and an upswing of the latter in late 2015 and particularly 2016 when EU funds become available. Household consumption will further reinforce high grow rates.

Table 1 / Lithuania: Selected Economic Indicators

	2009	2010	2011	2012	2013 ¹⁾	2014	2015	2016
						Forecast		
Population, th pers., average ²⁾	3162.9	3097.3	3028.1	2987.8	2958.0	2928	2900	2875
Gross domestic product, LTL mn, nom.	92032	95676	106893	113735	119000	125100	133500	143000
annual change in % (real)	-14.8	1.6	6.0	3.7	3.4	3.6	3.8	4.0
GDP/capita (EUR at exchange rate)	8400	8900	10200	11000	11700	.	.	.
GDP/capita (EUR at PPP)	13600	15100	16900	18300	19400	.	.	.
Consumption of households, LTL mn, nom.	62807	61285	66894	71709	76200	.	.	.
annual change in % (real)	-17.8	-3.7	4.8	3.9	5.0	4.6	4.3	4.0
Gross fixed capital form., LTL mn, nom.	15807	15589	19270	18934	21500	.	.	.
annual change in % (real)	-39.5	1.9	20.7	-3.6	12.0	10.0	12.0	14.0
Gross industrial production (sales)								
annual change in % (real)	-13.8	6.4	6.4	3.7	3.4	5.0	8.0	7.0
Gross agricultural production								
annual change in % (real)	1.0	-7.2	10.3	14.2	-3.3	.	.	.
Construction industry								
annual change in % (real)	-48.3	-7.3	22.1	-7.3	8.5	.	.	.
Employed persons, LFS, th, average ³⁾	1415.9	1343.7	1370.9	1275.7	1292.8	1305	1312	1318
annual change in % ³⁾	-6.8	-5.1	2.0	1.8	1.3	0.9	0.5	0.5
Unemployed persons, LFS, th, average ³⁾	225.1	291.1	248.8	196.8	173.0	155	141	130
Unemployment rate, LFS, in %, average ³⁾	13.7	17.8	15.4	13.4	11.8	10.6	9.7	9.0
Reg. unemployment rate, in %, end of period ³⁾⁴⁾	12.5	14.4	11.0	11.4	11.1	.	.	.
Average monthly gross wages, LTL ⁵⁾	2056.0	1988.1	2045.9	2123.8	2234.0	.	.	.
annual change in % (real, gross)	-8.5	-4.6	-1.2	0.7	4.0	.	.	.
Average monthly net wages, LTL ⁵⁾	1602.0	1552.4	1594.6	1651.4	1732.0	.	.	.
annual change in % (real, net)	-7.2	-4.3	-1.4	0.5	3.7	.	.	.
Consumer prices (HICP), % p.a.	4.2	1.2	4.1	3.2	1.2	1.5	2.8	3.0
Producer prices in industry, % p.a.	-13.5	10.3	13.9	5.0	-2.4	.	.	.
General govern.budget, EU-def., % of GDP								
Revenues	35.5	35.0	33.2	32.7	32.2	32.0	31.5	31.3
Expenditures	44.9	42.3	38.7	36.1	35.0	34.2	33.5	33.0
Net lending (+) / net borrowing (-)	-9.4	-7.2	-5.5	-3.3	-2.8	-2.2	-2.0	-1.7
Public debt, EU-def., % of GDP	29.3	37.8	38.3	40.5	41.5	41.2	40.3	39.3
Central bank policy rate, % p.a., end of period ⁶⁾	1.57	1.07	1.24	0.52	0.27	.	.	.
Current account, EUR mn	996	20	-1151	-68	299	-100	-150	-200
Current account, % of GDP	3.7	0.1	-3.7	-0.2	0.9	-0.3	-0.4	-0.5
Exports of goods, BOP, EUR mn	11797	15651	20151	23048	24528	27200	30500	33600
annual change in %	-26.6	32.7	28.8	14.4	6.4	10.9	12.1	10.2
Imports of goods, BOP, EUR mn	12688	16990	21958	23960	25575	28400	32000	35700
annual change in %	-37.4	33.9	29.2	9.1	6.7	11.0	12.7	11.6
Exports of services, BOP, EUR mn	2629	3088	3738	4589	5329	6140	7310	8630
annual change in %	-18.9	17.5	21.0	22.8	16.1	15.2	19.1	18.1
Imports of services, BOP, EUR mn	2192	2274	2742	3358	4000	4670	5510	6390
annual change in %	-22.7	3.7	20.6	22.5	19.1	16.8	18.0	16.0
FDI inflow, EUR mn	-9	604	1040	545	675	.	.	.
FDI outflow, EUR mn	143	-4	40	305	-78	.	.	.
Gross reserves of NB excl. gold, EUR mn	4472	4788	6120	6203	5705	.	.	.
Gross external debt, EUR mn	22363	22976	23976	24830	23600	.	.	.
Gross external debt, % of GDP	83.9	82.9	77.4	75.4	68.5	.	.	.
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	2.1399	2.0416	2.0838	2.0814	2.0715	.	.	.

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

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