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## **Lithuania**

### **Reviving Investments drive recovery**

***In 2011 we expect economic growth to reach 5% in real terms. Gross capital formation will again be the strongest driver of the upswing. However, also a slight increase in household consumption will back up domestic demand. With the move of the current account into deficit, net trade again starts to contribute negatively to overall growth. Economic activity is likely to abate somewhat in 2012 and 2013 compared to this year. The strong revival of exports will subside, but domestic demand should regain some momentum due to rising wages and a revival of lending activity. Thus we expect GDP to grow by 4.4% and 4.6% respectively in real terms in the subsequent two years.***

With 6.9% growth in the first quarter of 2011, Lithuania was the second fastest growing economy in the European Union after Estonia. This was predominantly caused by an enormous surge in gross fixed capital investment, by more than 40% year on year in real terms, and the restocking activity. In Lithuania not only investments in transport equipment and machinery, but also in dwellings and other buildings rebounded. Therefore construction activity grew as well, by nearly 16% in the first quarter of 2011.

Also household consumption, which had declined until the fourth quarter of 2010, resumed growth and rose by 5.5% in real terms in the first quarter of 2011. Wages had started to recover already in the second half of 2010, nevertheless rising consumer prices caused real incomes of households to keep declining. Given the slow recovery in the labour market we expect consumption to develop less swiftly throughout 2011; it will rise only gradually in the next two years, by 3.3% and 4% respectively.

As in Estonia, Lithuanian goods exports continued their fast expansion in the first months of 2011. The nominal growth of almost 50% in the first quarter of the year is to a large degree driven by the revival of prices for oil products, which represent Lithuania's most important export product. Moreover, external demand developed above average also for chemical products and transport equipment as well as for food products. The upswing furthermore triggered overall industrial production, which grew by about 15% in the first

quarter in real terms. However, also imports rebounded strongly along with the rise of domestic demand, by 27% year on year in real terms according to national accounts figures. With the revival of economic activity the trade deficit has started to widen again and the current account deficit is likely to reach at least 2% of GDP on average in 2011.

Also in Lithuania the rise of food and energy prices resulted in inflation to rise again (3.2% in the first quarter of 2011). However, also core inflation started to pick up slightly. Therefore we expect consumer prices to increase by 4.5% this year and inflation to remain at this level during 2012 and 2013.

Although economic activity has started to revive strongly, growth in employment remains sluggish, particularly in manufacturing and construction where job losses were the most dramatic during the crisis. Only in the private services sectors is employment creation gaining some momentum. In the first quarter of 2011 the unemployment rate still amounts to 17.2%. In the coming three years an amelioration of the situation in the labour market will take place only gradually, with emigration again playing a role in reducing unemployment figures. First results of the Lithuanian 2011 Household and Population Census show that the resident population of Lithuania has been reduced much more than expected by emigration since the EU accession. Thus population figures have to be revised downwards from 3.2 million to only 3 million.

As opposed to the case of Latvia, the Lithuanian government does not stick to the demanding aim of joining the eurozone as early as in 2014. The consolidation path in Lithuania foresees a reduction of the deficit to 5.3% in 2011. The revival of economic growth and the increases in VAT rates will most likely permit to attain this goal. However, the aim to move towards a deficit of 3% in 2012 seems overambitious, at least without implementing further expenditure cuts and measures on the revenue side. The government discusses the introduction of wealth taxes on residential real estate and motor vehicles, a further increase in excise duties and an acceleration of the ongoing pension reforms. It is unclear however when these measures will become effective and how long the freeze of wages in the public sector (which have been cut substantially during the crisis) can be sustained. We therefore expect the budget deficit to decline to 4% of GDP in 2012 and to fall slightly below the 3% line only in 2013, provided a strengthening of domestic demand.

In 2011 we expect economic growth to reach 5% in real terms. Gross capital formation will again be the strongest driver of the upswing. However, also a slight increase in household consumption will back up domestic demand. With the move of the current account into

deficit, net trade again starts to contribute negatively to overall growth. Economic activity is likely to abate somewhat in 2012 and 2013 compared to this year. The strong revival of exports will subside, but domestic demand should regain some momentum due to rising wages and a revival of lending activity. Thus we expect GDP to grow by 4.4% and 4.6% respectively in real terms in the subsequent two years.

Table LT

**Lithuania: Selected Economic Indicators**

	2007	2008	2009	2010 <sup>1)</sup>	2010 1st quarter	2011	2011 Forecast	2012 Forecast	2013
Population, th pers., average	3375.6	3358.1	3339.5	3286.5	.	.	3240	3210	3180
Gross domestic product, LTL mn, nom.	98669.1	111482.6	91525.9	94641.9	20421.2	22991.3	103800	112800	123200
annual change in % (real)	9.8	2.9	-14.7	1.3	-2.0	6.9	5	4.5	4.5
GDP/capita (EUR at exchange rate)	8500	9600	7900	8300	.	.	.	.	.
GDP/capita (EUR at PPP)	14700	15300	12900	14200	.	.	.	.	.
Consumption of households, LTL mn, nom.	63508.4	73027.2	62814.5	60841.0	13953.6	15191.4	.	.	.
annual change in % (real)	12.0	3.7	-17.7	-4.5	-8.9	5.5	2.5	3.3	4
Gross fixed capital form., LTL mn, nom.	27918.8	28370.0	15666.9	15198.5	2248.0	3202.3	.	.	.
annual change in % (real)	23.0	-5.2	-40.0	0.0	-30.0	41.0	20	13	12
Gross industrial production (sales)									
annual change in % (real)	2.4	5.5	-14.6	6.7	-2.8	14.8	13	10	8
Gross agricultural production									
annual change in % (real)	8.2	8.8	1.0	-6.3	.	.	.	.	.
Construction industry									
annual change in % (real)	22.2	4.0	-48.5	-7.7	-42.9	15.9	.	.	.
Employed persons - LFS, th, average	1534.2	1520.0	1415.9	1343.7	1328.4	1340.4	1360	1400	1430
annual change in %	2.3	-0.9	-6.8	-5.1	-7.3	0.9	1.2	2.9	2.1
Unemployed persons - LFS, th, average	69.0	94.3	225.1	291.1	293.4	277.6	.	.	.
Unemployment rate - LFS, in %, average	4.3	5.8	13.7	17.8	18.1	17.2	16	14	12.5
Reg. unemployment rate, in %, end of period <sup>2)</sup>	3.3	4.4	12.5	14.4	14.3	13.6	.	.	.
Average gross monthly wages, LTL	1802.4	2151.7	2056.0	1988.1	2031.2	2071.6	.	.	.
annual change in % (real, net)	17.0	10.1	-7.2	-4.3	-6.7	-1.4	.	.	.
Consumer prices (HICP), % p.a.	5.8	11.1	4.2	1.2	-0.4	3.2	4.5	4	4.5
Producer prices in industry, % p.a.	7.0	18.2	-13.5	10.3	6.3	15.4	.	.	.
General government budget, EU-def., % GDP									
Revenues	33.8	34.1	34.5	34.2	.	.	33.7	34.0	34.6
Expenditures	34.8	37.4	44.0	41.3	.	.	39.0	38.0	37.4
Net lending (+) / net borrowing (-)	-1.0	-3.3	-9.5	-7.1	.	.	-5.3	-4.0	-2.8
Public debt, EU-def., in % of GDP	16.9	15.6	29.5	38.2	.	.	40.5	42.5	43.0
Central bank policy rate, % p.a., end of period <sup>3)</sup>	6.8	7.8	1.6	1.1	0.9	1.1	.	.	.
Current account, EUR mn	-4149	-4227	1128	506	16	-33	-600	-1000	-1500
Current account in % of GDP	-14.5	-13.1	4.3	1.8	0.3	-0.5	-2.0	-3.1	-4.2
Exports of goods, BOP, EUR mn	12509	16077	11797	15717	3055	4573	20400	24500	29600
annual growth rate in %	11.1	28.5	-26.6	33.2	11.1	49.7	30	20	21
Imports of goods, BOP, EUR mn	16788	20263	12628	16896	3333	4990	22000	26800	33000
annual growth rate in %	15.0	20.7	-37.7	33.8	13.5	49.7	30	22	23
Exports of services, BOP, EUR mn	2931	3240	2657	3115	626	776	3200	3400	3700
annual growth rate in %	1.8	10.5	-18.0	17.2	9.1	24.0	3	6	9
Imports of services, BOP, EUR mn	2471	2835	2140	2136	434	514	2400	2600	2900
annual growth rate in %	22.4	14.7	-24.5	-0.2	-3.9	18.4	12	8	12
FDI inflow, EUR mn	1473	1396	124	475	-27	232	700	.	.
FDI outflow, EUR mn	437	229	157	96	-7	-8	.	.	.
Gross reserves of NB excl. gold, EUR mn	5165	4458	4495	4968	4608	4941	.	.	.
Gross external debt, EUR mn	20547	23032	23125	23584	23935	23838	.	.	.
Gross external debt in % of GDP	71.9	71.3	87.2	86.0	87.3	79.2	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/EUR	1.9822	2.1714	2.1324	2.0317	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2.

1) Preliminary. - 2) In % of working age population. - 3) VILIBOR one-month interbank offered rate (Lithuania has a currency board).

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