

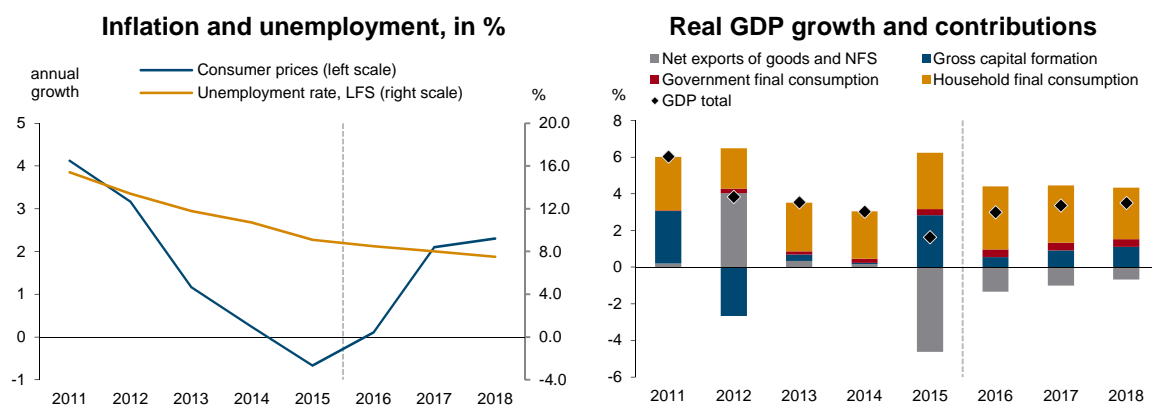


LITHUANIA: Successful reorientation

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The introduction of the euro and the management of the difficult geo-economic situation were arguably the major features of the Lithuanian economy in 2015. The successful reorientation of trade towards the West softened the negative demand shocks emanating from Russia. As household consumption increases, it will put the economy on a growth path leading from a GDP growth rate of 1.6% in 2015 to one of 3% over the years to come.

Figure 47 / Lithuania: main macroeconomic indicators



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

Although the first quarter of 2015 was marked by the lowest growth in five years (1.3%), GDP showed resilience to the negative external demand shocks. Despite the decrease in exports to Russia, GDP grew by 2% in the last quarter. Exports declined by more than 5% in nominal terms, but due to plummeting oil prices and their effect on production costs, as well as on the final demand of exported goods, a real decline was hardly present. The share of total exports to Russia declined steadily throughout the year and has reached 14% – the ten-year rock bottom. Local producers and firms were looking for new export markets and as a result exports to the EU grew by 6%. The shrinkage of imports was close to 1% in nominal terms. Due to import price deflation, real growth is estimated to be around 7%. Trade in services moved in a similar pattern last year. In spite of strong dependence on the CIS, exports of services grew by 6%. The value exported to the CIS decreased by 23%, but increased by 17% to the EU. Dwindling trade ties with the East and an improving situation in trade with the EU are expected to diminish the effect of decreasing Russian demand on the Lithuanian economy in 2016.

Since 2009 unemployment has been declining constantly. Despite the increasing wages, net emigration accelerated again, by 85% last year. The drop in unemployed persons per free vacancy will improve the bargaining power of employees even more. After being increased in January 2016, the minimum wage will be raised again in July, resulting in a 17% gain. It is expected that the overall real wage will increase by 6% this year. As households' confidence remains positive, their consumption is expected to rise by more than 5% this year and it will remain the main driver of economic growth in the foreseeable future.

To hinder the formation of a new real estate price bubble and to reduce the risk of high household indebtedness, the Lithuanian Central Bank introduced changes in the lending regulations to households. Those changes came into force in November 2015. The maturity of credit has been shortened to 30 years and the financial burden has to be calculated more strictly. Since the measures had been announced already by the end of March 2015, household borrowing began to grow in April, peaking at 66% in July and declining by 3% in December. In total, new euro loans to households rose by 33% last year.

Consumer price deflation amounted to 0.7% last year, which was induced by the plummeting energy prices. Their 12% drop was partially offset by the inflation in services. Not only the rounding of prices after the euro introduction, but also the growth in wages led to a 3.4% increase in services prices. Core inflation is estimated to be 1.2%. Continuously increasing wages in 2016 will raise consumer demand, as well as the prices of services. The bottom-low oil prices are expected to have weaker but still dragging effects on inflation. Therefore, slightly positive inflation should be present this year. The change in producer prices will remain negative, as they are more affected by oil prices than by growing wages.

Gross industrial production grew by 5% last year and was mainly driven by export-intensive industries. Real growth of exported Lithuanian origin goods was 8% in 2015. Lithuanian manufacturers of wood and furniture products accounted for about one third of total growth of industrial production. The highest increase in demand for furniture and wood was observed in Sweden, Norway, Denmark and the Netherlands. Secondly, a significant role in growth of industrial production was played by the pharmaceutical industry. It expanded by a stunning 70%. In 2004, Sicom Biotech/Teva Baltics became a part of Teva – the largest generic drug manufacturer in the world. Only 1-2% of its products are sold in Lithuania, the rest is exported mainly to the United States and Japan. Last year, the products of Teva Baltics were introduced also into the Turkish market. South Africa and New Zealand are the countries targeted next. Favourable production tendencies are expected to prevail in the forthcoming years and industrial production should grow by 4-5% per annum.

The situation in the construction industry in 2015 was slightly worrying. Value added decreased gradually and employment growth was negative in the third quarter. However, the increase in building permits and high demand for construction workers show that the construction industry should recover this year. Last year's investment growth was driven by the private sector, which increased its investments by about 15%. Though the transportation and storage industry was hit by the Russian crisis, the slump was compensated by growth in other sectors. Manufacturers invested widely and generated about one third of total investment growth. Private investment into equipment, machinery and transport vehicles grew by about 17% in 2015 as compared to the year earlier. Also, renovation of residential buildings picked up last year: the number of buildings renovated was 3.5 times higher than in the entire last decade. The lack of qualified labour and the pressure of rising wages will push firms to optimise their

production lines and to invest more into personnel training. Positive private investment tendencies will prevail in 2016 and investment growth should be at about 6%.

On 9 October 2016 parliamentary elections will be held. In correlation with the forthcoming elections, the government budget deficit is expected to increase. On 1 January 2016 not only minimum wages were increased, but also the non-taxable income bracket was raised by 20%, pensions by 3%. Expenditures on defence are planned to rise again by 30%. The increase in expenditures will be partly offset by rising revenues. As the economic and political situation is stable, the Social Democrats are expected to remain the dominating party, followed by the Homeland Union and the Liberal Movement. Due to many controversies, neither of the latter two parties will want to form a coalition with the first one. On the other hand, the current coalition partners of the Social Democrats (the Labour Party, Order and Justice) are losing voters' trust and thus the same coalition structure as before will not be possible. In any case, we do not expect any major economic or political changes caused by the election outcome.

In the forthcoming years, household consumption will remain the driving force of positive GDP development. Also, the net export situation should improve as trade becomes more country-diversified. The GDP forecasts for 2016-2017 remain unchanged – 3% and 3.4%, respectively. We expect economic development to remain stable also in 2018 with an annual growth rate of around 3.5%.

Table 16 / Lithuania: selected economic indicators

	2011	2012	2013	2014	2015 ¹⁾	2016 Forecast	2017 Forecast	2018
Population, th pers., average	3,028	2,988	2,958	2,932	2,905	2,880	2,860	2,840
Gross domestic product, EUR-LTL mn, nom.	31,263	33,335	34,962	36,444	37,190	38,300	40,400	42,800
annual change in % (real)	6.0	3.8	3.5	3.0	1.6	3.0	3.4	3.5
GDP/capita (EUR at exchange rate)	10,300	11,200	11,800	12,400	12,800	13,300	14,100	15,100
GDP/capita (EUR at PPP)	17,000	18,500	19,600	20,600	21,700	.	.	.
Consumption of households, EUR-LTL mn, nom.	19,471	20,786	21,885	22,817	23,714	.	.	.
annual change in % (real)	4.6	3.6	4.3	4.2	4.9	5.5	5.0	4.5
Gross fixed capital form., EUR-LTL mn, nom.	5,781	5,788	6,457	6,894	7,706	.	.	.
annual change in % (real)	20.1	-1.8	8.3	5.4	10.3	6.0	7.0	7.0
Gross industrial production (sales)	.	.	.	.	.	.	.	.
annual change in % (real)	6.4	3.7	3.3	-0.1	4.9	5.0	5.0	4.0
Gross agricultural production	.	.	.	.	.	.	.	.
annual change in % (real)	10.3	14.2	-1.8	8.4	5.3	.	.	.
Construction industry	.	.	.	.	.	.	.	.
annual change in % (real)	22.1	-7.1	11.3	17.0	-3.5	.	.	.
Employed persons, LFS, th, average ²⁾	1,371	1,276	1,293	1,319	1,335	1,345	1,355	1,360
annual change in %	2.0	1.8	1.3	2.0	1.2	0.7	0.7	0.4
Unemployed persons, LFS, th, average ²⁾	249	197	173	158	134	125	118	110
Unemployment rate, LFS, in %, average ²⁾	15.4	13.4	11.8	10.7	9.1	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period ³⁾	12.0	11.4	11.1	9.3	9.0	.	.	.
Average monthly gross wages, EUR-LTL ⁴⁾	593	615	646	677	710	760	820	890
annual change in % (real, gross)	-1.2	0.7	4.0	4.7	6.0	6.5	6.0	5.7
Average monthly net wages, EUR-LTL ⁴⁾	462	478	501	527	550	590	640	690
annual change in % (real, net)	-1.3	0.5	3.8	5.1	5.8	6.3	5.8	5.3
Consumer prices (HICP), % p.a.	4.1	3.2	1.2	0.2	-0.7	0.1	2.1	2.3
Producer prices in industry, % p.a.	13.9	5.0	-2.4	-4.9	-9.7	-3.5	2.5	3.5
General government budget, EU-def., % of GDP	.	.	.	.	.	.	.	.
Revenues	33.5	33.0	32.9	34.1	34.6	34.8	34.4	34.0
Expenditures	42.5	36.1	35.6	34.8	35.6	36.0	35.0	34.5
Net lending (+) / net borrowing (-)	-8.9	-3.1	-2.6	-0.7	-1.0	-1.2	-0.6	-0.5
Public debt, EU-def., % of GDP	37.2	39.8	38.8	40.7	42.5	42.0	40.0	39.0
Central bank policy rate, % p.a., end of period ⁵⁾	1.24	0.52	0.27	0.12	0.05	.	.	.
Current account, EUR mn	-1,209	-393	539	1,305	-934	-1,000	-1,200	-1,400
Current account, % of GDP	-3.9	-1.2	1.5	3.6	-2.5	-2.6	-3.0	-3.3
Exports of goods, BOP, EUR mn	19,422	22,427	23,998	23,750	22,544	23,100	24,300	25,500
annual change in %	30.4	15.5	7.0	-1.0	-5.1	2.5	5.0	5.0
Imports of goods, BOP, EUR mn	21,487	23,530	24,918	24,686	24,412	25,300	26,700	28,300
annual change in %	29.9	9.5	5.9	-0.9	-1.1	3.5	5.5	6.0
Exports of services, BOP, EUR mn	4,033	4,793	5,390	5,850	6,201	6,700	7,400	8,300
annual change in %	17.8	18.8	12.5	8.5	6.0	7.5	10.0	12.5
Imports of services, BOP, EUR mn	2,766	3,404	4,033	4,212	4,377	4,600	5,000	5,600
annual change in %	20.2	23.1	18.5	4.4	3.9	6.0	9.0	11.0
FDI liabilities (inflow), EUR mn	1,095	454	531	270	557	.	.	.
FDI assets (outflow), EUR mn	94	215	322	433	97	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁶⁾	6,120	6,203	5,705	6,991	1,376	.	.	.
Gross external debt, EUR mn	25,149	26,031	24,596	25,723	28,700	29,200	30,000	30,900
Gross external debt, % of GDP	80.4	78.1	70.4	70.6	77.2	76.0	74.0	72.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LTL/EUR	0.6071	0.6027	0.6042	0.6033	0.5896	.	.	.

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 and wiiw estimates. - 2) From 2012 according to census March 2011. - 3) In % of working age population. -

4) Including earnings of sole proprietors. - 5) 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). - 6) 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.