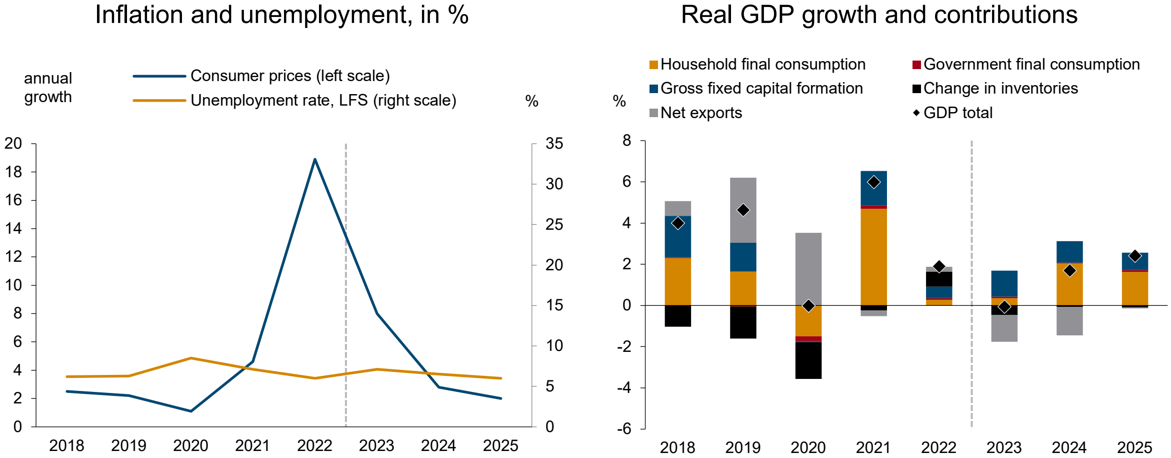
LITHUANIA: Stagnation to last longer than expected

SEBASTIAN LEITNER

The economy performed worse than expected in H1 2023, and we do not foresee any significant upswing before the end of the year. Since inflation has been declining considerably, real income will pick up again in H2 2023; this will support household consumption – after four consecutive quarters of decline. However, it is only in 2024 that the rise in real incomes will gain momentum. Despite the stagnation, the labour market remains robust. Private investment activity is declining, since external demand is in the doldrums, while the government has considerably raised infrastructure investment. We expect real GDP to decline by 0.1% in 2023; this will be followed by a modest upswing to 1.7% in 2024 and then 2.4% in 2025.

Figure 6.12 / Lithuania: Main macroeconomic indicators



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

Exports declined substantially in the first seven months of 2023, and we do not foresee any upswing before the end of the year. The fall in oil prices up to July depressed the profits of the refining sector; but exporters in the chemical, plastics and furniture industries are also ailing and have started to cut back on staff. The sluggish EU-wide economic development is likely to result in a stagnating Lithuanian manufacturing sector in the coming months. Lithuania is continuing to disentangle its economic ties with Russia, but still that neighbouring country is Lithuania’s fourth most important trade partner in terms of exports (imports from Russia have become negligible). We anticipate a gradual revival of export activity only in 2024; however, this will depend on the monetary and fiscal policy stance of the European Central Bank (ECB) and the EU, respectively, in the coming months. At the moment, however, the signs do not suggest that a speedy economic recovery is imminent. Given the reduction in transit trade, the transport sector – which used to profit from shipments between Lithuanian ports and the country's eastern neighbours of Russia and Belarus – is facing a permanent diminution in importance. Nevertheless, overall service exports are still developing well, thanks to tourism, IT, etc.

Inflation has recently been falling continuously and considerably, which will support the growth of household income and consumption in H2 2023. In August 2023, the inflation rate was still 6.4% year on year, and overall, in 2023 consumer price inflation (CPI) is expected to be 8%. At the moment, we see the costs of housing and energy in general dropping, while the prices of foodstuffs, hospitality and recreation are still rising inexorably. Given the recent upsurge in core inflation, we do not expect the CPI to fall much below 3% in 2024. In H1 2023, the substantial price hikes resulted in a stagnation of real incomes, following a substantial decline in 2022. However, for H2 we expect real net wages to grow again significantly. After four consecutive quarters of decline, this will bolster household consumption in the second half of the year. In order to maintain the purchasing power of low earners, the government introduced a 15% rise in the minimum wage from January 2023; and another 10% hike has been agreed for next year. Moreover, the net income of low-wage earners will be bolstered by a 20% rise in the non-taxable income threshold. Still, we do not expect household consumption to regain its previous momentum before 2024.

Investment in public infrastructure will be the strongest driver of GDP growth in 2023. EU funds (including the NextGenerationEU recovery package) have to be used now for planned and approved projects. Thus, construction activity is under way on roads and energy grids. For Lithuania, the biggest single investment project is Rail Baltica, the high-speed rail service linking Tallinn, the capital of Estonia, with Latvia, Lithuania and Poland. The main construction work on the Lithuanian section of the railway began in mid-2022. Rail Baltica is due to commence operations in 2026.

The decline in business sentiment suggests that a gradual upswing in private investment will take longer than expected. Disappointing developments in the main export destinations in the EU are putting a strain on confidence in all sectors, apart from retail trade. Businesses are running down their stocks and investment plans are being revised downwards. The ongoing ECB interest-rate hikes have resulted in households scaling back investment in their dwellings. As yet, there has been no fall in house prices; however, there is stagnation. The rise in interest rates is clearly a burden on households, but we do not expect the rate of non-performing loans to increase markedly. The labour market is not expected to deteriorate, and households are not as overburdened as they were in 2008, on the cusp of the financial crisis. The figures for construction permits granted suggest that fewer residential and commercial buildings will be erected next year. We expect only a slow revival of private investment in 2024.

High inflation brought extra revenue into the government budget even in H1. Thus, following an almost balanced budget last year (with a deficit of just 0.6% of GDP), in 2023 the deficit will remain quite low (2% of GDP), bearing in mind the ongoing stagnation. The specific circumstances associated with inflation, however, are going to fade in the coming months. The anti-inflationary measures to help households and enterprises are being phased out this year. On the other hand, 2024 will bring another rise in the non-taxable minimum income, as well as increased benefits for families and pensioners, and additional public investment in renewable energy sources and energy-saving buildings – just a few of the measures that will result in higher government expenditure levels.

Employment increased in H1 2023 and is expected to continue to grow, despite the stagnation in the second half of the year (albeit at a lower rate). The substantial influx of Ukrainian refugees offers a considerable additional supply of well-educated workers. More than 20,000 of the 80,000 Ukrainians in the country have already found a job. Looking at sectoral developments of employment growth, we see that private services have substantially increased the number of jobs. Meanwhile employment in manufacturing is stagnating, and agriculture is gradually shedding workers. Although the economy is projected to stagnate this year, the unemployment rate will likely increase by only 1 percentage point, to 7.1% on average in 2023. In the following two years we expect unemployment to fall back to 6%.

Considering the lower-than-expected external demand and private investment, we have revised our GDP forecast for 2023 downwards, to -0.1%. Moreover, we have changed our baseline scenario for the coming two years, in expectation of a slower upswing. GDP growth will pick up in 2024 to 1.7%, and then to 2.4% in 2025. Nevertheless, much will depend on the war in Ukraine and on how economic activity evolves in Western Europe and the Scandinavian countries, in particular.

Table 6.12 / Lithuania: Selected economic indicators

	2020	2021	2022 1)	2022 January-June	2023 January-June	2023 Forecast	2024 Forecast	2025 Forecast
Population, th pers., average	2,795	2,801	2,832	2,828	2,863	2,870	2,900	2,890
Gross domestic product, EUR m, nom.	49,829	56,154	66,791	30,789	33,781	72,100	75,400	78,800
annual change in % (real)	0.0	6.0	1.9	3.2	-0.8	-0.1	1.7	2.4
GDP/capita (EUR at PPP)	26,320	28,950	31,480	.	.	.	.	.
Consumption of households, EUR m, nom.	28,867	32,637	38,979	18,090	20,261	.	.	.
annual change in % (real)	-2.5	8.1	0.5	3.5	-1.7	0.6	3.5	2.8
Gross fixed capital form., EUR m, nom.	10,616	12,017	14,006	6,236	7,446	.	.	.
annual change in % (real)	-0.2	7.8	2.6	1.8	10.4	6.0	5.0	4.0
Gross industrial production (sales)								
annual change in % (real)	-1.3	19.5	9.6	16.7	-5.5	-1.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	10.3	-4.5	6.2	.	.	.	.	.
Construction industry								
annual change in % (real)	-1.6	4.6	4.6	7.1	11.1	.	.	.
Employed persons, LFS, th, average 2)	1,358	1,369	1,421	1,408	1,420	1,440	1,450	1,460
annual change in %	-1.5	0.8	3.8	3.9	0.8	1.0	0.8	1.0
Unemployed persons, LFS, th, average 2)	126	105	90	86	105	110	101	93
Unemployment rate, LFS, in %, average 2)	8.5	7.1	6.0	5.9	6.9	7.1	6.5	6.0
Reg. unemployment rate, in %, eop 3)	16.1	10.2	8.9	8.6	8.1	.	.	.
Average monthly gross wages, EUR 4)	1,429	1,579	1,789	1,743	1,968	1,970	2,090	2,210
annual change in % (real, gross)	8.9	5.6	-5.6	-2.2	-1.8	2.0	3.0	3.5
Average monthly net wages, EUR 4)	913	1,002	1,121	1,095	1,223	1,240	1,310	1,380
annual change in % (real, net)	9.8	4.8	-6.7	-3.5	-2.9	2.0	3.0	3.5
Consumer prices (HICP), % p.a.	1.1	4.6	18.9	16.3	13.7	8.0	2.8	2.0
Producer prices in industry, % p.a.	-9.0	9.5	26.1	25.5	3.4	-1.0	2.0	0.0
General governm. budget, EUdef., % of GDP								
Revenues	36.1	36.4	35.8	.	.	37.0	36.0	36.0
Expenditures	42.6	37.5	36.5	.	.	39.0	37.8	37.5
Net lending (+) / net borrowing (-)	-6.5	-1.2	-0.6	.	.	-2.0	-1.8	-1.5
General gov. gross debt, EU def., % of GDP	46.3	43.7	38.4	.	.	39.0	39.0	38.0
Stock of loans of non-fin. private sector, % p.a.	-1.6	13.2	14.0	16.8	7.6	.	.	.
Non-performing loans (NPL), in %, eop	1.3	0.7	0.5	.	.	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	2.50	0.00	4.00	.	.	.
Current account, EUR m	3,633	641	-3,396	-1,908	641	-800	-600	-700
Current account, % of GDP	7.3	1.1	-5.1	-6.2	1.9	-1.1	-0.8	-0.9
Exports of goods, BOP, EUR m	25,536	31,648	41,086	18,948	18,349	41,500	43,200	44,900
annual change in %	-1.6	23.9	29.8	32.3	-3.2	1.0	4.1	3.9
Imports of goods, BOP, EUR m	25,940	34,544	48,428	22,249	20,720	48,200	50,100	52,100
annual change in %	-8.3	33.2	40.2	42.9	-6.9	-0.5	3.9	4.0
Exports of services, BOP, EUR m	10,921	13,571	17,397	7,875	8,816	17,600	18,300	19,000
annual change in %	-8.0	24.3	28.2	24.5	12.0	1.2	4.0	3.8
Imports of services, BOP, EUR m	5,886	8,137	11,378	5,188	5,386	11,300	12,000	12,500
annual change in %	-14.9	38.2	39.8	47.6	3.8	-0.7	6.2	4.2
FDI liabilities, EUR m	4,002	2,534	580	-171	1,098	1,000	.	.
FDI assets, EUR m	3,438	1,286	-1,073	-929	704	1,000	.	.
Gross reserves of CB excl. gold, EUR m	3,662	4,626	4,715	4,846	5,079	.	.	.
Gross external debt, EUR m	40,233	44,565	45,565	43,567	48,963	43,300	43,700	44,900
Gross external debt, % of GDP	80.7	79.4	68.2	65.2	67.3	60.0	58.0	57.0

1) Preliminary. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of working age population. - 4) Including the employers' social security contribution and earnings of sole proprietors. - 5) Official refinancing operation rate for euro area (ECB).

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