

Jatta Kinnunen and Sebastian Leitner*

Lithuania: strong growth with modest inflationary pressures

The Lithuanian political scene witnessed remarkable events in 2004: President Rolandas Paksas was removed from office in April, ending a five-month political battle that paralysed the country – and tested the resilience of Lithuanian democracy. Mr. Paksas was accused of having dubious links with international criminal organizations. He was replaced by Valdas Adamkus, who had already acted as Lithuania's head of state from 1998 to 2003. The parliamentary elections held in October brought about another change: Lithuania's Labour Party, led by Russian-born millionaire Viktor Uspaskich, came out victorious after campaigning on a populist platform and promising to boost social welfare, raise living standards and lower taxes.

Lithuania was more severely hit by the Russian rouble crisis of 1998 than the other Baltic States, Estonia and Latvia. In the post-crisis period, a phenomenal economic recovery took place. In this period inflation was very modest (even negative in 2003, when GDP grew close to 10%).

It is worth mentioning that the fluctuations in world market prices of oil have had only a minor impact on the Lithuanian energy sector, which relies heavily on the country's Ignalina nuclear power station. Lithuania's EU-membership treaty stipulates that this Chernobyl-type power station be dismantled after an interim period. One of the two units of Ignalina has been decommissioned recently. According to President Adamkus, Lithuania should build a third unit that would supply the whole country with energy.

The period of vigorous economic growth has had a positive impact on the labour market. The unemployment rate dropped from 13.8% in 2002 to 11.4% in 2004. The services sector has been providing most of the new jobs.

Average gross monthly wage fell in real terms in 2000-2001, but have recovered since 2002. In 2004 the average real wage rose by 6.9%. However, growth in real wages in the previous three years lagged behind the GDP growth.

It is hardly surprising that the unusually strong demand expansion has been associated with a growing current account deficit (to 8.6% of the GDP in 2004). Rising imports from other EU countries reflect both the expansion of domestic consumption and the real appreciation of the national currency, the Lithuanian litas, LTL (especially vis-à-vis the currencies of other NMS). However, the deficit is lower than in other Baltic States. Oil

* Assistant at the Northern Dimension Research Centre (NORDI); Lappeenranta University of Technology, Finland.

products are the main trading commodity accounting for one fourth of total exports and one fifth of total imports. The remarkable rise in production of the Mazeiku Nafta oil refinery (which was reconstructed in 2003) as well as the high oil prices contributed to growing export revenues.

In 2004, FDI inflows exceeded EUR 700 million. The largest foreign investor was the Indonesian-based textile group Indorama Synthetics, with investments of nearly EUR 100 million. Besides, in January 2005 a 34% stake in Lithuania's natural gas company Lietuvos Dujos was sold to Russian Gazprom. After this acquisition, Gazprom is increasingly becoming an owner of natural gas utilities in the Baltic region, holding a 25% stake in Latvia's Latvian Gaze and a 37% stake in Estonia's Eesti Gaas (along with other major foreign shareholders, Germany's Ruhrgas and Finland's Fortum). It is expected that Gazprom's growing influence in the Baltics could serve as a staging ground for higher exports to the countries of the European Union. As there are no big Lithuanian companies on the privatization list, future FDI inflows will depend on greenfield projects. Naturally, it is possible that the 'post-Ignalina' restructuring of Lithuania's energy system will bring in direct investors from abroad.

In the early period of Lithuania's transition, a currency board system pegging the national currency against the US dollar was established. In 2002, the litas pegging was changed from dollar to euro. In June 2004, Lithuania joined the ERM II, with a LTL/EUR exchange rate of 3.45.

Lithuania's public sector debt is only about 22% of GDP. The general government deficit rose to 2.6% of GDP in 2004. As the government aims at reducing this figure gradually, to 1.5% by 2007, Lithuania will conveniently meet the Maastricht criteria.

With rising transfers from Brussels fuelling public investment and exports likely to develop favourably, GDP will probably grow by 7% in 2005. As a result of lower increases in household consumption, import growth as well as the current account deficit are likely to decline in the year 2006.

Table LT

Lithuania: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 ¹⁾	2005 forecast	2006 forecast
Population, th pers., mid-year ²⁾	3549.3	3524.2	3499.5	3481.3	3469.1	3454.2	3435.8	.	.
Gross domestic product, LTL mn, nom.	44377.4	43359.4	45525.9	48378.7	51643.0	56179.0	61801.0	67100	72200
annual change in % (real)	7.3	-1.7	3.9	6.4	6.8	9.7	6.6	7	6.5
GDP/capita (EUR at exchange rate)	2783	2881	3517	3876	4302	4710	5210	.	.
GDP/capita (EUR at PPP - wiiw)	6900	6980	7610	8340	8980	9780	10860	.	.
Gross industrial production ²⁾									
annual change in % (real)	8.2	-11.2	2.2	16.0	3.1	16.1	10.3	10	9.5
Gross agricultural production									
annual change in % (real)	-5.2	-14.5	5.4	-5.4	8.0	8.9	2.0	.	.
Construction industry ³⁾									
annual change in % (real)	15.9	-10.5	-17.8	7.5	21.8	26.8	4.9	.	.
Consumption of households, LTL mn, nom.	27344.8	28315.5	29530.6	31352.6	33096.4	36283.3	.	.	.
annual change in % (real)	.	3.2	6.4	4.0	5.8	12.5	10	.	.
Gross fixed capital form., LTL bn, nom.	10723.1	9614.2	8565.3	9784.6	10549.2	12024.1	.	.	.
annual change in % (real)	21.8	-6.1	-9.0	13.5	11.1	14.0	14.0	15	12
LFS - employed persons, th, avg. ⁴⁾	1597.6	1598.4	1397.8	1351.8	1405.9	1438.0	1435	.	.
annual change in %	1.7	0.1	-12.6	-3.3	4.0	2.3	-0.2	.	.
LFS - employed pers. in industry, th, avg. ⁴⁾	339.4	330.3	290.8	281.1	293.3	297.5	297	.	.
annual change in %	0.1	-2.7	-12.0	-3.3	4.3	1.4	-0.2	.	.
LFS - unemployed, th pers., average ⁴⁾	244.9	263.3	273.7	284.0	224.4	203.9	185	.	.
LFS - unemployment rate in %, average ⁴⁾	13.3	14.1	16.4	17.4	13.8	12.4	11.4	11	10
Reg. unemployment rate in %, end of period	6.9	10.0	12.6	12.9	10.9	7.7	6.5	6.3	6
Average gross monthly wages, LTL	930	987	971	982	1014	1073	1158	.	.
annual change in % (real, gross)	12.8	4.8	-5.1	-0.3	3.8	9.3	6.9	.	.
Consumer prices, % p.a.	5.1	0.8	1.0	1.3	0.3	-1.2	1.2	1.5	1
Producer prices in industry, % p.a.	-4.4	1.7	16.0	-3.0	-2.8	-0.5	5.0	3	2
General govern.budget, EU-def., % GDP ⁵⁾									
Revenues	37.4	37.3	35.8	33.0	32.8	32.3	33.2	33.7	33.2
Expenditures	40.3	42.8	38.3	35.0	34.2	34.1	35.7	36.2	35.1
Deficit (-) / surplus (+)	-3.0	-5.5	-2.5	-2.0	-1.5	-1.9	-2.6	-2.5	-1.9
Public debt in % of GDP ⁵⁾	.	.	23.8	22.9	22.4	21.4	21.1	21.7	21.3
Money market rate, % p.a., end of period ⁶⁾	.	15.9	7.5	4.5	3.3	2.4	2.3	.	.
Current account, EUR mn	-1156	-1118	-730	-639	-772	-1116	-1483	-1590	-1520
Current account in % of GDP	-11.7	-11.0	-5.9	-4.7	-5.2	-6.9	-8.3	-8.2	-7.3
Total reserves minus gold, EUR mn	1200	1187	1410	1835	2253	2697	3000	.	.
Gross external debt, EUR mn	3203	4499	5221	5974	5945	6905	8300	.	.
FDI inflow, EUR mn		457	412	499	772	160	812	.	.
FDI outflow, EUR mn		8	4	8	18	34	63	.	.
Exports of goods, BOP, EUR mn	3527	2951	4395	5461	6363	6773	7512	7980	8860
annual growth rate in %	.	-16.3	48.9	24.3	16.5	6.4	10.9	8	11
Imports of goods, BOP, EUR mn	4879	4275	5603	6697	7770	8262	9309	10060	10870
annual growth rate in %	.	-12.4	31.1	19.5	16.0	6.3	12.7	9	8
Exports of services, BOP, EUR mn	987	1026	1149	1293	1560	1661	1935	.	.
annual growth rate in %	.	3.9	12.0	12.5	20.7	6.5	16.5	.	.
Imports of services, BOP, EUR mn	773	739	735	783	986	1114	1304	.	.
annual growth rate in %	.	-4.4	-0.5	6.5	25.9	13.0	17.0	.	.
Average exchange rate LTL/USD	4.00	4.00	4.00	4.00	3.67	3.06	2.78	.	.
Average exchange rate LTL/EUR (ECU)	4.49	4.27	3.70	3.58	3.46	3.45	3.45	3.45	3.45
Purchasing power parity LTL/USD, wiiw	1.57	1.54	1.51	1.46	1.47	1.45	1.47	.	.
Purchasing power parity LTL/EUR, wiiw	1.81	1.76	1.71	1.67	1.66	1.66	1.66	.	.

Notes: 1) Preliminary. - 2) Sales of industrial production. - 3) Enterprises with more than 20 employees. - 4) From 2002 persons aged 15-74, up to 2002 persons aged 15 and over. - 5) According to ESA 95, excessive deficit procedure. - 6) VILIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; AMECO Database; forecasts by wiiw and European Commission.