

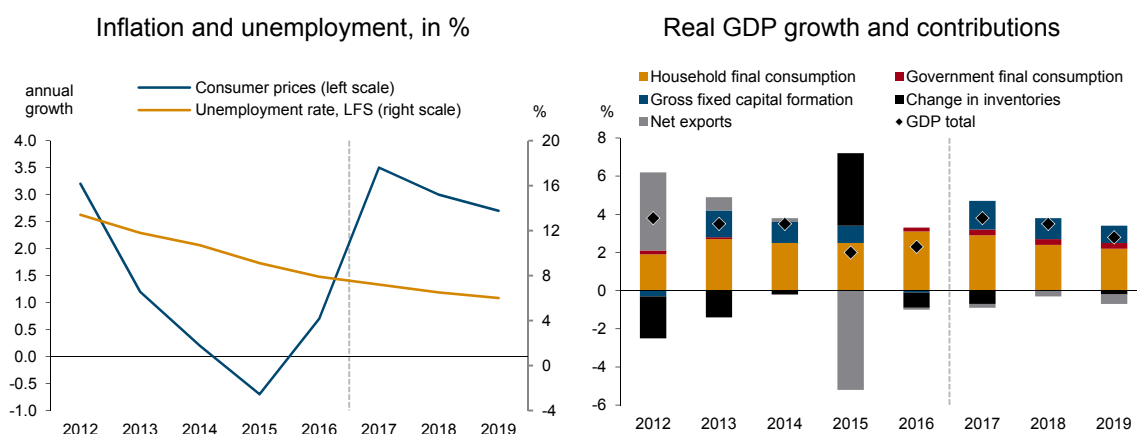


## LITHUANIA: Upswing in the investment cycle and foreign demand

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In 2017, economic growth in Lithuania is being driven by a resurgence in external demand, particularly from the CIS, and also for oil products. Moreover, strong growth in investment is underpinned by fresh funds from the EU and by private housing construction. The ongoing decline in unemployment and rapid wage increases have resulted in steady, strong growth in consumer demand. For 2017, we forecast a greater upswing in the GDP growth rate to 3.8%, followed by 3.4% in 2018 and 2.8% in 2019.

Figure 41 / Lithuania: Main macroeconomic indicators



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

**After stagnation in goods exports in 2016, a strong revival is underway to all destinations this year.** Exports to the CIS region increased by almost 30% nominally year on year in the first half of 2017. The recovery of the economy of Russia, Lithuania's most important individual trading partner, will back the upswing in exports further on. Moreover, external demand from the EU partners in general and from the Baltic states in particular is boosted by an upswing in the European investment and trade cycle. In addition, services exports have been growing more strongly this year, and will continue to do so in the coming years, particularly due to increasing transit trade to Russia. Tourism exports are also growing at a good pace in 2017: quarterly figures show that an increase of about 10% in overnight stays is likely. Since household demand keeps on flourishing and investment activity is strongly reviving this year,

imports in 2017 are increasing at a high rate in line with exports. Nevertheless, we expect the current account deficit to remain again below 1% of GDP and increase only gradually in the medium term.

**Gross fixed capital investment is reviving, growing by 6.9% in real terms year on year in the first half of 2017.** The inflow of fresh EU funds from the 2014-2020 programming period allows the government to increase capital spending. Investment is particularly foreseen in energy, as well as in the road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European rail network. The construction of new dwellings but also refurbishment co-financed by public sources has started to increase as swiftly as expected this year, and the rising number of building permits indicates that the upswing will continue in 2018. In addition, the stock of mortgage loans granted to households is growing again at a faster pace, by 10% from August 2016 to August 2017.

**Following deflationary developments in 2016, rising prices for imports, particularly of oil and gas, resulted in consumer prices to increase gradually during 2017.** Apart from energy, also prices for food started to grow more swiftly. In addition, inflation is fuelled by higher excise duties, and the ongoing strong increase in wages pushes up core inflation. In nominal terms, gross wages grew by more than 8% on average and still by 5.6% in real terms in the first half of 2017 year on year. The economic stimulus in the rest of the EU and higher investment activity will lead to consumer inflation of about 3% in both 2018 and 2019.

**Employment is expected to decrease this year by about 0.5%, although the employment rate is rising.** Demographic developments, particularly still high net outward migration, result in a continuously shrinking working-age population in Lithuania, in 2017 again by about 1%. About half of the emigrants having left the country in the period following the economic crisis went to the UK. In contrast to Polish citizens, for Lithuanians we can so far observe no migration-reducing Brexit effect. Based on British registration statistics for national insurance numbers, migration of Lithuanians to the UK remained nearly constant in the period July 2016 to June 2017 compared to the same term one year before. In Lithuania, the employment rate among those aged 15-64 already climbed above 70% in the second quarter of this year, almost the level of Austria, and the unemployment rate is likely to drop to close to 7% of the labour force in 2017.

**The government plans to attain a budget surplus also in 2018.** Buoyant state revenues will allow the government to increase social spending more considerably next year. However, a large part of the rising government outlays will be devoted to defence spending, increasing to 2% of GDP in 2018. The EU Commission and the OECD have recently emphasised that income inequality in Lithuania is not only one of the highest in the EU but has also been rising continuously since 2012. The reason for that is a tax and benefit system not redistributing enough between high- and low-income earners. Apart from Ireland, the level of public expenditures is the lowest in Lithuania compared to other EU countries. -----Moreover, the Lithuanian welfare system cannot prevent its citizens from getting poor in the case of major life risks, like disability. The policy recommendation is thus to build up a proper welfare state that can offer its citizens a more decent living, in order to reduce large scale emigration.

**Given the swift upswing in the EU funds driven public capital expenditures, investment but also foreign demand are the most important drivers of growth for the Lithuanian economy in 2017.**

However, also the improving situation in the labour market and rising incomes keep the household consumption flourishing this year and thereafter. Adjusting our forecast upwards, we expect GDP to expand by 3.8% in 2017, followed by a minor attenuation to 3.4% in 2018 and 2.8% in 2019. The assumed drivers of that growth are the economic upswing in Russia and growth gaining momentum in the euro area. Moreover, public investment activity should be facilitated by inflows of EU funds. The general government budget deficit will most probably not exceed 0.3% in 2017 due to revenues above expectation. In the years to follow the government plans a budget surplus, resulting in a continuously falling public debt to GDP ratio, which at present amounts to about 40% of GDP.

Table 16 / Lithuania: Selected economic indicators

	2013	2014	2015	2016 <sup>1)</sup>	2016 January-June	2017	2017 Forecast	2018 Forecast	2019
Population, th pers., average	2,958	2,932	2,905	2,868	2,870	2,822	2,860	2,840	2,820
Gross domestic product, EUR mn, nom.	34,960	36,568	37,427	38,668	18,171	19,694	41,500	44,200	46,700
annual change in % (real)	3.5	3.5	2.0	2.3	2.0	4.1	3.8	3.5	2.8
GDP/capita (EUR at PPP)	19,600	20,700	21,600	21,900	.	.	.	.	.
Consumption of households, EUR mn, nom.	21,792	22,686	23,375	24,771	11,833	12,800	.	.	.
annual change in % (real)	4.3	4.0	4.0	5.0	5.1	4.8	4.5	3.8	3.5
Gross fixed capital form., EUR mn, nom.	6,455	6,906	7,325	7,314	3,308	3,502	.	.	.
annual change in % (real)	8.3	5.8	4.8	-0.5	-2.6	5.7	8.0	6.0	5.0
Gross industrial production (sales)									
annual change in % (real)	3.2	0.1	4.9	2.8	2.8	7.0	7.0	6.0	4.5
Gross agricultural production									
annual change in % (real)	-1.8	8.4	8.6	-4.4	.	.	.	.	.
Construction industry									
annual change in % (real)	11.3	17.0	-3.5	-9.4	-16.3	6.7	.	.	.
Employed persons, LFS, th, average	1,293	1,319	1,335	1,361	1,359	1,354	1,358	1,360	1,365
annual change in %	1.3	2.0	1.2	2.0	2.4	-0.4	-0.2	0.1	0.4
Unemployed persons, LFS, th, average	173	158	134	116	121	110	105	95	87
Unemployment rate, LFS, in %, average	11.8	10.7	9.1	7.9	8.2	7.6	7.2	6.5	6.0
Reg. unemployment rate, in %, eop <sup>2)</sup>	11.1	9.3	9.0	8.5	7.4	7.3	.	.	.
Average monthly gross wages, EUR <sup>3)</sup>	646.3	677.4	714.1	774.0	760.0	828.2	850	920	990
annual change in % (real, gross)	4.0	4.7	6.4	7.4	6.6	5.6	6.0	5.5	5.0
Average monthly net wages, EUR <sup>3)</sup>	501.1	527.2	553.9	602.3	592.4	651.8	660	720	780
annual change in % (real, net)	3.8	5.1	6.1	7.7	7.0	6.7	6.0	5.2	5.3
Consumer prices (HICP), % p.a.	1.2	0.2	-0.7	0.7	0.5	3.2	3.5	3.0	2.7
Producer prices in industry, % p.a.	-2.4	-4.9	-9.7	-4.3	-8.1	6.2	5.0	3.5	3.5
General govern.budget, EU-def., % of GDP									
Revenues	33.0	34.1	34.8	34.4	.	.	34.0	33.5	33.3
Expenditures	35.6	34.8	35.0	34.2	.	.	33.8	33.2	33.1
Net lending (+) / net borrowing (-)	-2.6	-0.7	-0.2	0.3	.	.	0.2	0.3	0.2
Public debt, EU-def., % of GDP	38.8	40.5	42.6	40.2	.	.	41.0	38.0	36.0
Stock of loans of non-fin.private sector, % p.a	-2.3	-0.9	4.1	7.1	8.9	2.7	.	.	.
Non-performing loans (NPL), in %, eop	11.0	6.5	5.5	3.8	4.7	3.5	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	0.27	0.12	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	292	1,158	-1,050	-433	-531	-386	-600	-900	-1,100
Current account, % of GDP	0.8	3.2	-2.8	-1.1	-2.9	-2.0	-1.4	-2.0	-2.4
Exports of goods, BOP, EUR mn	23,998	23,750	22,309	21,922	10,407	12,282	25,900	28,500	30,200
annual change in %	7.0	-1.0	-6.1	-1.7	-2.6	18.0	18.0	10.0	6.0
Imports of goods, BOP, EUR mn	24,918	24,686	24,296	23,690	11,435	13,510	27,700	30,700	33,200
annual change in %	5.9	-0.9	-1.6	-2.5	-4.5	18.1	17.0	11.0	8.0
Exports of services, BOP, EUR mn	5,390	5,850	6,011	6,845	3,239	3,894	8,100	9,100	9,700
annual change in %	12.5	8.5	2.7	13.9	14.2	20.2	18.0	12.0	7.0
Imports of services, BOP, EUR mn	4,033	4,212	4,266	4,599	2,182	2,503	5,400	6,100	6,600
annual change in %	18.5	4.4	1.3	7.8	6.4	14.7	17.0	13.0	8.5
FDI liabilities, EUR mn	531	387	873	870	109	52	600	.	.
FDI assets, EUR mn	322	382	164	732	557	-265	0	.	.
Gross reserves of NB excl. gold, EUR mn <sup>5)</sup>	5,705	6,991	1,376	2,263	2,043	1,093	.	.	.
Gross external debt, EUR mn	24,596	25,551	28,332	33,091	31,418	33,132	35,300	38,500	42,000
Gross external debt, % of GDP	70.36	69.87	75.70	85.58	81.25	79.84	85.0	87.0	90.0

1) Preliminary. - 2) In % of working age population. - 3) Annual data include earnings of sole proprietors. - 4) 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). - 5) 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.