

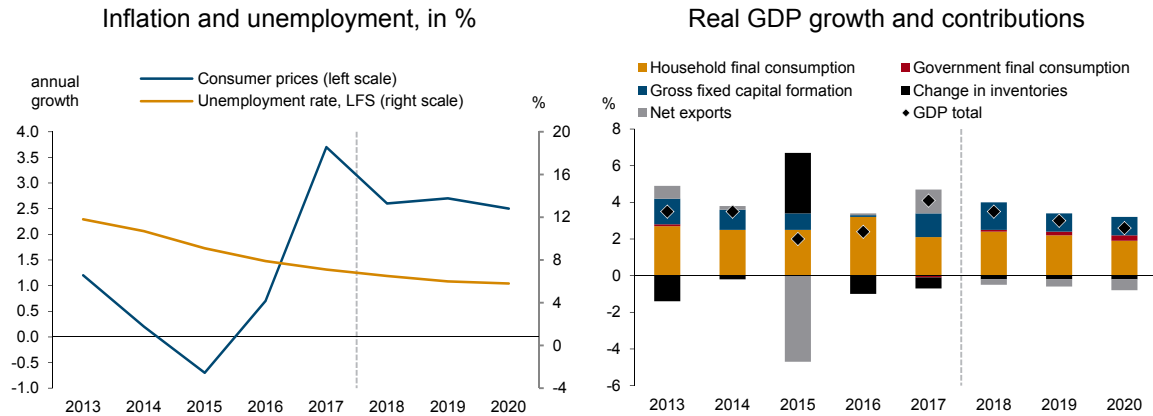


LITHUANIA: Brisk domestic demand fosters growth

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Public and private investment have driven growth in the Lithuanian economy for another year. A further decline in unemployment has resulted in rapid wage increases. Furthermore, the enacted income tax reform will foster steady, strong growth in household consumption. The increase in external demand has been stronger than expected in 2018, but is likely to abate slightly in the coming two years. For 2018, we expect real GDP to grow by 3.5%, followed by 3% in 2019 and 2.6% in 2020.

Figure 47 / Lithuania: Main macroeconomic indicators



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

The strong upswing of exports in particular to Russia last year was followed by lower growth rates in 2018. However, external demand for goods still remained strong, and is expected to increase by 6% in net terms, year on year. Growth in exports to Euro zone countries has evolved in an even more lively way. Overall trade figures are strongly driven by fluctuations in the oil price and energy demand since more than 20% of good exports of Lithuanian origin are processed petroleum products manufactured in the largest Lithuanian industrial complex, the Polish-owned OLEN Lietuva (formerly Mazeiku Nafta) refinery. The demand for other important export products of the country like foodstuffs, plastics and wood-based goods has also grown above average compared to overall trade this year. Trade in services has also continued to flourish in 2018, particularly due to transit with Russia and Western partners. Tourism is also evolving at a good pace: arrivals increased by 7% in the first half of

2018. Due to strong investment and consumption growth, imports are increasing faster than exports. As a result, the contribution of net exports to GDP growth is expected to be negative in 2018.

Figures for the second quarter of 2018 provide a further indication that gross fixed capital investment is likely to grow by another 8% this year. The inflow of fresh EU funds from the 2014-2020 programming period will allow the government to increase capital spending this year and during the rest of the forecast period. However, private investment has also risen strongly in 2018; the strong increases of investment in machinery and vehicles show that enterprises are upgrading their production infrastructure. The capacity utilisation rate has reached 78%, the highest level in Lithuania since independence. The construction of new dwellings rose strongly in the first half of 2018 while housing prices increased considerably in the cities. In the coming two years we expect construction growth figures to remain strong, albeit a bit below current levels, as indicated by the latest figures for building permits granted. In general, business and consumer sentiment indicators are very positive at the moment and increasing.

We expect employment to have increased by 0.5% in 2018 as a whole. In general, the structure of employment has been shifting somewhat faster towards higher-skilled services than the EU average since 2010. Eurostat projections on demographic developments in EU countries indicate that the loss in the working-age population (15-64) could be highest in Lithuania, with a decline of 28% projected between 2015 and 2030 if no policy changes are implemented. In order to counteract the population shrinkage, the Lithuanian government introduced general child benefits of between EUR 30 and EUR 60 per month at the beginning of 2018. Previously only low-income families were eligible to those welfare benefits. In addition, work permits are also increasingly being offered to foreign workers, for example from Ukraine. However, net international migration is only gradually moving towards a balance (having previously been negative). The unemployment rate is likely to drop to 6.5% in 2018 and 5.8% in 2020. An increase in the minimum wage by 5% to EUR 400 from January 2018 onwards will push up the overall growth rate of salaries to about 6% in real terms this year. The government indicated a stronger rise in the minimum wage of 7% from 2019, meaning that incomes will continue to rise strongly. As a result, household consumption growth is likely to be relatively high during the whole forecast period.

In June 2018 the Lithuanian parliament adopted tax and pension reforms to be introduced in 2019. The taxation on labour will be reduced for low-income earners and will become more progressive in general. However, the effects of the measures will only be modest in terms of reducing inequality and poverty, as even the IMF and the central bank have acknowledged. They emphasise that, in order to tackle these problems, the Lithuanian government should instead raise budget revenues. Higher social expenditures combined with lower taxes on low-income groups should also help to further reduce emigration. The proposed measure to reach this goal is, in particular, the broadening of the real estate tax base to all private residences. The enacted changes to the funded pillar of the pension system are inadequate to reduce old-age poverty.

In July 2018 Lithuania finally joined its Baltic neighbours in the OECD. In its latest economic survey on the country, the OECD highlighted the need for productivity catch-up, inclusiveness and tackling the problems of a rapidly ageing society. The budget plan of the Lithuanian government foresees a surplus of 0.6% of GDP for 2019; we however expect public consumption and investment to grow more swiftly towards the next parliamentary elections scheduled for 2020.

Compared to our Summer Forecast we have become slightly more optimistic, increasing our forecast for real GDP growth to 3.5% in 2018. Private consumption in particular has picked up strongly while exports have also performed better than expected. Private investment in residential buildings and machinery is growing swiftly and sentiment indicators show strong confidence levels among both businesses and consumers. A sustained upswing in public investment, not only this year, but also in 2019 and 2020, will be facilitated by an increasing inflow of EU funds. Rising household incomes, pushed upwards by a tightening labour market and tax cuts, will help private consumption to keep on growing steadily. In the coming two years, however, external demand is likely to lose momentum. Thus for 2019 and 2020, we forecast real GDP to grow at somewhat lower paces, by 3% and 2.6% respectively.

Table 22 / Lithuania: Selected economic indicators

	2014	2015	2016	2017 ¹⁾	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	2,932	2,905	2,868	2,830	2,826	2,800	2,800	2,780	2,760
Gross domestic product, EUR mn, nom.	36,568	37,434	38,849	42,191	19,828	21,134	44,800	47,400	49,800
annual change in % (real)	3.5	2.0	2.4	4.1	4.6	3.8	3.5	3.0	2.6
GDP/capita (EUR at PPP)	20,800	21,700	22,100	23,600	.	.	.	.	.
Consumption of households, EUR mn, nom.	22,686	23,372	24,783	26,468	12,729	13,589	.	.	.
annual change in % (real)	4.0	4.0	5.1	3.4	4.6	3.9	3.8	3.5	3.0
Gross fixed capital form., EUR mn, nom.	6,906	7,330	7,506	8,098	3,636	3,933	.	.	.
annual change in % (real)	5.8	4.9	0.3	6.8	5.7	8.0	8.0	5.5	5.5
Gross industrial production (sales)									
annual change in % (real)	0.1	4.5	2.9	6.9	6.6	5.0	6.0	4.5	4.0
Gross agricultural production									
annual change in % (real)	8.4	8.6	-1.7	1.0	.	.	.	.	.
Construction industry									
annual change in % (real)	17.1	-3.5	-9.3	8.9	7.6	18.1	.	.	.
Employed persons, LFS, th, average	1,319	1,335	1,361	1,355	1,354	1,359	1,361	1,363	1,365
annual change in %	2.0	1.2	2.0	-0.5	-0.4	0.4	0.5	0.1	0.1
Unemployed persons, LFS, th, average	158	134	116	103	110	95.0	95	87	84
Unemployment rate, LFS, in %, average	10.7	9.1	7.9	7.1	7.6	6.6	6.5	6.0	5.8
Reg. unemployment rate, in %, eop ²⁾	9.3	9.0	8.5	8.7	7.3	8.3	.	.	.
Average monthly gross wages, EUR ³⁾	677.4	714.1	774.0	840.4	819.4	903.3	910	980	1,050
annual change in % (real, gross)	4.7	6.4	7.4	4.7	6.0	7.0	6.0	5.0	5.0
Average monthly net wages, EUR ³⁾	527.2	553.9	602.3	660.2	645.7	705.8	720	780	840
annual change in % (real, net)	5.1	6.1	7.7	5.7	7.1	6.1	6.0	5.3	5.0
Consumer prices (HICP), % p.a.	0.2	-0.7	0.7	3.7	3.2	2.8	2.6	2.7	2.5
Producer prices in industry, % p.a.	-5.0	-9.7	-4.3	4.9	6.2	4.0	6.0	4.0	2.2
General government budget, EU-def., % of GDP									
Revenues	34.0	34.6	34.3	33.5	.	.	33.5	33.3	33.3
Expenditures	34.6	34.9	34.0	33.0	.	.	33.2	33.3	33.3
Net lending (+) / net borrowing (-)	-0.6	-0.2	0.3	0.5	.	.	0.3	0.0	0.0
General gov.gross debt, EU def., % of GDP	40.5	42.6	39.9	39.4	.	.	37.0	36.0	35.0
Stock of loans of non-fin.private sector, % p.a.	-0.9	4.1	7.1	4.5	5.1	7.4	.	.	.
Non-performing loans (NPL), in %, eop	6.5	5.5	3.8	3.1	.	.	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.12	0.05	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	1,158	-847	-300	371	-277	-284	-530	-630	-690
Current account, % of GDP	3.2	-2.3	-0.8	0.9	-1.4	-1.3	-1.2	-1.3	-1.4
Exports of goods, BOP, EUR mn	23,750	22,309	21,922	25,724	12,280	13,025	27,270	28,770	30,210
annual change in %	-1.0	-6.1	-1.7	17.3	18.0	6.1	6.0	5.5	5.0
Imports of goods, BOP, EUR mn	24,686	24,296	23,690	27,673	13,383	14,519	30,200	32,300	34,100
annual change in %	-0.9	-1.6	-2.5	16.8	17.0	8.5	9.1	7.0	5.6
Exports of services, BOP, EUR mn	5,850	6,011	6,845	8,405	3,936	4,536	9,500	10,300	11,000
annual change in %	8.5	2.8	13.9	22.8	21.5	15.3	13.0	8.4	6.8
Imports of services, BOP, EUR mn	4,212	4,267	4,602	5,283	2,513	2,731	5,800	6,100	6,500
annual change in %	4.4	1.3	7.9	14.8	15.0	8.7	9.8	5.2	6.6
FDI liabilities, EUR mn	387	873	870	1,024	193	334	1,220	.	.
FDI assets, EUR mn	382	164	732	474	-157	366	800	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	6,991	1,376	2,263	3,509	1,093	4,361	.	.	.
Gross external debt, EUR mn	25,551	28,331	33,087	35,271	33,586	35,258	35,800	37,900	39,800
Gross external debt, % of GDP	69.9	75.7	85.2	83.6	79.6	78.7	80.0	80.0	80.0

1) Preliminary. - 2) In % of working age population. - 3) Including 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.