

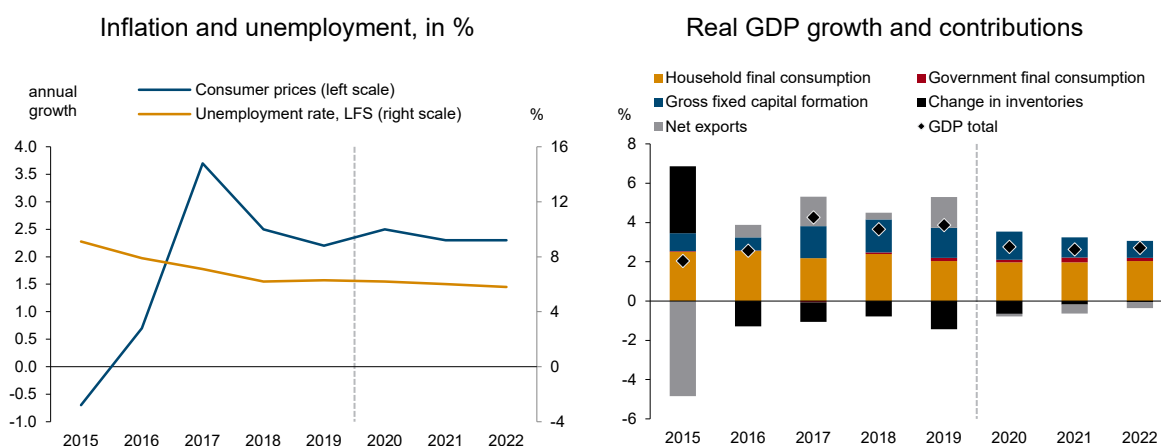


LITHUANIA: Continued growth, in a higher gear than expected

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A better-than-expected export performance and still swiftly rising gross fixed capital investment propelled growth in the Lithuanian economy in 2019 to 3.9% in real terms year on year. A further minimum wage hike and a reduction in the effective income tax rate for low earners will maintain the country's remarkable increase in the purchasing power of households. Thus, private consumption will continue to encourage the rapid growth of economic activity. External demand was strong in 2019, but is likely to abate in the next two years. For 2020, we expect real GDP to grow by 2.8%, followed by a small decline to 2.6% in 2021 and then 2.7% in 2022.

Figure 6.12 / Lithuania: Main macroeconomic indicators



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

The Latvian economy remained in a high gear throughout 2019. Its GDP growth rate of 3.9% in real terms year on year was even slightly above the figure for 2018. Despite a slowdown in global trade and economic activity in the euro area, exports of Lithuanian goods continued to grow by more than 6% in nominal terms in 2019. At the same time, growth in imports declined substantially (to about 3%), due to inventory depletion throughout the year. As a result, the current account surplus exceeded 3% of GDP and the contribution of net exports to GDP growth was strongly positive. While exports to Germany, Estonia, the whole euro area and the CIS increased at above average, external demand from Latvia and Poland stagnated – and in the case of another important trade partner, Sweden, actually declined. The fall in the price of crude oil led to a growth in export volumes of refined petroleum and oil products, such as chemicals, plastics and fertilisers. Exports of services (particularly business services) are growing swiftly: in 2019, an increase of more than 20% in nominal terms was reported.

Figures for 2019 show that gross fixed capital investment continued to grow rapidly – by 7.5% in real terms per annum. The influx of EU funds will allow the government to lift capital spending this year, too: the government budget envisages an increase from 3.6% of GDP in 2019 to 3.8% this year. The Rail Baltica high-speed train project will move from the design to the construction phase in 2020. Growth in private investment is likely to ease somewhat this year; however, upgrading of the production infrastructure will likely continue, as the business confidence of entrepreneurs in the construction and industrial sectors has declined only slightly in recent months. At the same time, in the service sector and in retail, the forward-looking sentiments are still quite stable and positive. The construction of new dwellings declined somewhat in 2019, while house prices rose considerably in the cities. In the coming quarters of 2020 and 2021, we expect construction growth – of dwellings and non-residential buildings alike – to revive, as indicated by the latest figures for building permits issued. The stock of mortgage loans of private households also shows a steady and substantial increase. With negative real interest rates, rapidly rising incomes and buoyant house prices, real estate seems like a good investment to more and more households.

For the first time since 1991, the resident population of Lithuania increased again in 2019 (albeit by only about 100 people). While the natural change in the population remains negative, emigration is declining, and immigration is growing. About half of the incomers are returning Lithuanians; about half of the foreigners are from Ukraine, about 30% from Belarus and 5% from Russia. Due to demographic changes, however, the working-age population is continuing to decline, resulting in a tightening labour market.

We expect overall employment to stagnate both in 2020 and in the following two years. The number of jobs in ICT services, accommodation and domestic trade rose sharply last year and will continue to rise, while skilled labour is becoming ever scarcer. However, both the industrial sector and agriculture are gradually shedding jobs. The unemployment rate inched up to 6.3% in 2019. In the next two years we expect unemployment to fall only slightly towards 5.8% in 2022 on average.

The 9.4% rise in the minimum wage (to EUR 607 a month) from January 2020 will result in gross salaries again growing by about 6% in real terms this year. Moreover, labour taxation has been reduced by increasing the non-taxable income to EUR 400 a month from January 2020; this amount will be lifted to EUR 500 in 2021. At the same time, the rate of income tax paid by high earners (roughly 15% of taxpayers) was raised from January 2020 to 32% (the standard rate is 20%). In 2021 the income threshold for the 32% tax bracket will be lowered, thus a larger share of the population will be affected. The overall strong growth of incomes means that household consumption will remain a driver of growth not only in 2020, but throughout the forecast period 2021-2022.

Although wages rose more rapidly, consumer price inflation fell to 2.2% in 2019. For the year 2020, we expect a slight increase towards 2.6%, due to domestic factors. Excise duties are being raised (particularly on diesel and tobacco) and the price of electricity will rise. At the same time, however, import price inflation is expected to fall further. While the cost of services will increase more swiftly, overall consumer price inflation is expected to decline again to 2.3% in both 2021 and 2022.

Since our 2019 Autumn Forecast, we have become more optimistic and have increased our forecast for real GDP growth from 2.4% to 2.8% in 2020. We expect growth figures in exports to decrease only slightly compared to last year. Investment in dwellings and non-residential buildings will

pick up, as will outlays on publicly financed infrastructure – not only in 2020, but also the following year. Sentiment indicators still show strong confidence levels among both businesses and consumers. Strongly rising household incomes, pushed upwards by a tightening labour market and tax cuts, will help private consumption to keep on growing steadily. Based on the assumption that the oil price remains stable, we expect export growth – particularly of the most important Lithuanian group of goods (refined petroleum products) – to lose momentum in nominal terms in 2021 and 2022. This may also result in weaker investment activity in the private sector. Thus, for 2021 and 2022, we forecast real GDP to grow at a slower pace of 2.6% and 2.7%, respectively.

Table 6.12 / Lithuania: Selected economic indicators

	2015	2016	2017	2018	2019 ¹⁾	2020	2021	2022
						Forecast		
Population, th pers., average	2,905	2,868	2,828	2,802	2,780	2,760	2,740	2,730
Gross domestic product, EUR mn, nom.	37,322	38,893	42,269	45,264	48,000	50,600	53,100	55,800
annual change in % (real)	2.0	2.6	4.2	3.6	3.9	2.8	2.6	2.7
GDP/capita (EUR at PPP)	21,700	22,100	23,600	24,900	26,400	.	.	.
Consumption of households, EUR mn, nom.	23,250	24,430	26,174	27,891	29,400	.	.	.
annual change in % (real)	4.1	4.1	3.5	3.9	3.6	3.2	3.2	3.3
Gross fixed capital form., EUR mn, nom.	7,324	7,723	8,449	9,300	10,200	.	.	.
annual change in % (real)	4.9	3.4	8.2	8.4	7.5	7.0	5.0	4.2
Gross industrial production (sales)								
annual change in % (real)	4.4	2.8	7.0	4.8	3.4	3.0	3.5	3.7
Gross agricultural production								
annual change in % (real)	8.6	-1.7	2.6	-10.0	6.6	.	.	.
Construction industry								
annual change in % (real)	-3.5	-9.3	8.9	13.8	8.4	.	.	.
Employed persons, LFS, th, average	1,335	1,361	1,355	1,375	1,378	1,380	1,382	1,385
annual change in %	1.2	2.0	-0.5	1.5	0.3	0.1	0.1	0.2
Unemployed persons, LFS, th, average	134	116	103	90	92	91	88	85
Unemployment rate, LFS, in %, average	9.1	7.9	7.1	6.2	6.3	6.2	6.0	5.8
Reg. unemployment rate, in %, eop ²⁾	9.0	8.5	8.7	8.9	8.7	.	.	.
Average monthly gross wages, EUR ³⁾	714.1	774.0	840.4	924.1	1,300.0	1,410	1,510	1,630
annual change in % (real, gross)	6.4	7.4	4.7	6.5	6.0	6.0	5.0	5.5
Average monthly net wages, EUR ³⁾	553.9	602.3	660.2	720.0	810.0	880	940	1,010
annual change in % (real, net)	6.1	7.7	5.7	6.0	10.0	6.0	4.5	5.0
Consumer prices (HICP), % p.a.	-0.7	0.7	3.7	2.5	2.2	2.5	2.3	2.3
Producer prices in industry, % p.a.	-9.7	-4.4	5.1	5.6	0.0	0.0	1.0	1.0
General government budget, EU-def., % of GDP								
Revenues	34.8	34.4	33.6	34.6	35.0	35.5	34.8	34.8
Expenditures	35.1	34.2	33.2	34.0	34.9	35.2	34.6	34.5
Net lending (+) / net borrowing (-)	-0.3	0.2	0.5	0.6	0.1	0.3	0.2	0.0
General gov. gross debt, EU def., % of GDP	42.7	39.9	39.3	34.1	36.0	35.0	33.5	32.0
Stock of loans of non-fin. private sector, % p.a.	4.1	7.1	4.5	6.0	3.0	.	.	.
Non-performing loans (NPL), in %, eop	5.5	3.8	3.1	2.4	2.0	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.05	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	-910	-434	213	131	233	1,500	1,300	1,800
Current account, % of GDP	-2.4	-1.1	0.5	0.3	0.5	3.0	2.4	3.2
Exports of goods, BOP, EUR mn	19,655	19,470	22,763	24,552	26,065	27,300	28,400	29,800
annual change in %	-4.4	-0.9	16.9	7.9	6.2	4.7	4.0	4.9
Imports of goods, BOP, EUR mn	21,785	21,362	24,815	27,333	28,247	30,000	31,300	32,700
annual change in %	0.9	-1.9	16.2	10.1	3.3	6.2	4.3	4.5
Exports of services, BOP, EUR mn	6,030	6,814	8,349	9,678	11,679	13,000	13,700	14,600
annual change in %	2.5	13.0	22.5	15.9	20.7	11.3	5.4	6.6
Imports of services, BOP, EUR mn	4,273	4,619	5,290	6,018	7,093	7,700	8,100	8,500
annual change in %	2.3	8.1	14.5	13.8	17.9	8.6	5.2	4.9
FDI liabilities, EUR mn	942	1,190	1,204	1,201	1,362	1,000	.	.
FDI assets, EUR mn	325	842	353	844	739	800	.	.
Gross reserves of NB excl. gold, EUR mn	1,376	2,263	3,509	4,831	4,273	.	.	.
Gross external debt, EUR mn	28,674	33,515	35,448	35,533	33,600	34,400	34,500	34,600
Gross external debt, % of GDP	76.8	86.2	83.9	78.5	70.0	68.0	65.0	62.0

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Including earnings of sole proprietors. From 2019 the employer's social security contribution (28.9%) was transferred to the employees; real growth in 2019 estimated by wiiw. - 4) Official refinancing operation rate for euro area (ECB).

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