LITHUANIA: Cooling-down period expected to remain short

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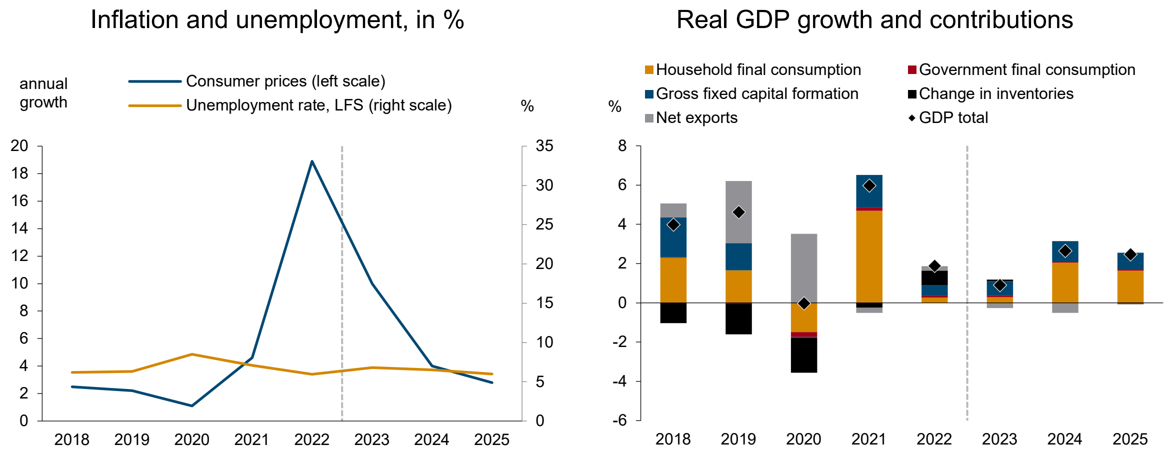
The economy dealt better than expected last year with the blow caused by Russia's invasion of Ukraine, although inflation reached almost 20%. The economy will shrink in the first half of 2023, but the evident stabilisation in household and business sentiment suggests that consumption and investment activity should pick up thereafter. The government is trying to counter the loss of households' purchasing power, and public investments should also go some way to supporting economic activity. We expect real GDP to grow by 0.9% in 2023; this will be followed by an upswing to 2.7% in 2024 and then 2.5% in 2025.

Figure 5.12 / Lithuania: Main macroeconomic indicators



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

The war in Ukraine resulted in escalating consumer price inflation (CPI) – with a 2022 average of 18.9%, the second-highest rate in the EU. In 2023, CPI is likely to continue in double digits. In March 2023, consumer inflation was still at 15.2%. To a large extent, this is due to housing (since the jump in energy costs has already filtered through), though foodstuffs, hospitality and durables are also increasingly playing a part. Given the upsurge in core inflation, any decline in price growth is likely to require longer than inflation took to rise in 2022. The steep price hikes resulted in a substantial decline in real incomes in 2022, despite rapidly advancing nominal wages. For this year, we expect real net wages to grow again slightly. In order to maintain the purchasing power of low-income earners, the government has implemented a 15% rise in the minimum wage from January 2023. Moreover, the budget envisages bigger wage hikes for some groups of public employees.

In the first half of 2022, the release of pent-up demand following the COVID-19-induced lockdowns resulted in a surge in private consumption; however, in the second half year we saw it decline. With the purchasing power of households already under pressure, we expect private consumption in 2023 again to increase by only 0.5% in real terms. Consumer surveys show confidence again improving month by month, following last autumn's low caused by high energy prices and the war in Ukraine. However, retail trade figures show a drop-off in household spending, especially on consumer durables. Since real incomes are likely to grow again in 2023, we expect retail trade to pick up in the second half of the year. But only in 2024 do we expect household consumption to regain its momentum.

External demand remained strong until the last quarter of 2022, but export growth will stagnate in real terms this year. While Lithuania is still in the process of disengaging from Russia and Belarus in terms of trade, exports to the EU are developing better. In particular exporters in the chemical industry, plastics and the furniture industry could benefit from stronger demand in the EU at the moment. However, we will most likely see a downturn in both exports and imports in real terms in the first half of this year; an upswing in external demand for Lithuanian goods and services is expected towards the end of 2023. We anticipate a gradual revival of export activity in 2024; however, this depends on the monetary and fiscal policy stance of the European Central Bank (ECB) and the EU in the coming months. If these institutions act in a hawkish manner, that may yet stall the expected revival. Given the reduction in transit trade, the transport sector – which used to profit from goods trade between Lithuanian ports and the country's eastern neighbours – will suffer a permanent diminution in importance.

The ongoing stabilisation in business sentiment suggests that a gradual upswing in private investment is already on the cards this year. September 2022 saw a marked decline in confidence in all sectors for the second month in a row: investment plans were revised, and entrepreneurs ran down their stocks. Nevertheless, we expect a revival in the second half of 2023. The uncertainty surrounding personal income and the likelihood of ECB interest-rate hikes means that households are scaling back investment in dwellings. Following a rally that dates back to 2020 and COVID times, early 2022 brought housing prices to a juddering halt. The rise in interest rates is clearly a burden for households, but we do not expect the rate of non-performing loans to increase markedly. In this high-inflation situation, real interest rates are still negative, and the stocks of mortgages are depreciating. Figures on construction permits granted suggest that fewer residential and commercial buildings will be erected this year.

An even stronger driver of growth will be public infrastructure investment. EU funds (including the NextGenerationEU recovery package) will underpin those public expenses. For Lithuania, the biggest single investment project is Rail Baltica, the high-speed rail service linking the capital of Estonia (Tallinn) with Latvia, Lithuania and Poland. The main construction work on the Lithuanian section of the railway started in mid-2022. Given the huge increase in the cost of building materials, we would expect a slowdown in road construction this year.

The steeply rising prices resulted in booming state revenues in 2022. Thus, even though the government introduced extra measures to offset the energy price increase, the budget deficit still narrowed to 0.6% of GDP last year. The specific circumstances associated with inflation are going to fade in the coming months. The anti-inflationary measures to help households and enterprises will lead to further government expenditure: e.g. a rise in the non-taxable minimum income; increased benefits for families and pensioners; additional public investment in renewable energy sources and energy-saving buildings; direct support for enterprises. The deficit is thus expected to be substantially higher in 2023:

we expect it to rise to 5% of GDP, given the lower economic growth and increased expenditure plans – including the extra defence spending – envisaged in the budget plan.

Employment increased by almost 4% in 2022 and is expected to continue growing (albeit at a much lower rate) despite the near stagnation of the economy in 2023. Those sectors that were hit hard by the COVID-19 pandemic (such as hospitality, trade and transport) saw a substantial increase in jobs last year. The job vacancy rate remained high in most sectors and is not expected to decline, given the tight situation in the labour market generally. Unemployment in 2023 will increase to only 7% on average. The anticipated upswing in economic growth at the end of this year will again result in an improvement – we expect unemployment to fall back to 6% towards the end of the forecast period.

Up to the beginning of April, more than 80,000 Ukrainian refugees had been registered in Lithuania, or more than 2.5% of the population – one of the highest rates in the EU. Almost half of the refugees of working age have already found a job. In a situation of tight labour markets, businesses in Lithuania are glad of the additional workforce, particularly if they are on average highly skilled – as the (mostly female) workers from Ukraine are.

Considering the higher-than-expected inflation and the concomitant lower growth in private consumption, we have revised our GDP forecast for 2023 downwards, to 0.9%. However, in our baseline scenario, GDP growth will pick up in 2024 to 2.7% and will stay at 2.5% in 2025. Nevertheless, much will depend on the war in Ukraine and on how the cost of energy and other commodities evolves in the medium term.

Table 5.12 / Lithuania: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,794	2,795	2,801	2,833	2,840	2,840	2,830
Gross domestic product, EUR m, nom.	48,916	49,829	56,154	66,833	74,200	79,200	83,400
annual change in % (real)	4.6	0.0	6.0	1.9	0.9	2.6	2.5
GDP/capita (EUR at PPP)	26,360	26,320	28,960	31,620	.	.	.
Consumption of households, EUR m, nom.	29,282	28,867	32,637	38,944	.	.	.
annual change in % (real)	2.7	-2.5	8.1	0.5	0.5	3.5	2.8
Gross fixed capital form., EUR m, nom.	10,482	10,616	12,017	14,006	.	.	.
annual change in % (real)	6.6	-0.2	7.8	2.6	3.5	5.0	4.0
Gross industrial production (sales)							
annual change in % (real)	3.0	-1.3	19.5	9.6	2.0	6.0	7.0
Gross agricultural production							
annual change in % (real)	10.1	10.3	-4.5	9.2	.	.	.
Construction industry							
annual change in % (real)	8.4	-1.6	4.6	4.6	.	.	.
Employed persons, LFS, th, average 2)	1,378	1,358	1,369	1,421	1,440	1,450	1,460
annual change in %	0.3	-1.5	0.8	3.8	1.0	0.8	1.0
Unemployed persons, LFS, th, average 2)	92	126	105	90	105	101	93
Unemployment rate, LFS, in %, average 2)	6.3	8.5	7.1	6.0	6.8	6.5	6.0
Reg. unemployment rate, in %, eop 3)	8.7	16.1	10.2	8.9	.	.	.
Average monthly gross wages, EUR 4)	1,296	1,429	1,579	1,785	2,000	2,140	2,280
annual change in % (real, gross)	6.4	8.9	5.6	-5.6	2.0	3.0	3.5
Average monthly net wages, EUR 4)	822	913	1,002	1,119	1,260	1,350	1,440
annual change in % (real, net)	11.6	9.8	4.8	-6.7	2.0	3.0	3.5
Consumer prices (HICP), % p.a.	2.2	1.1	4.6	18.9	10.0	4.0	2.8
Producer prices in industry, % p.a.	0.0	-9.0	9.5	26.1	10.0	2.0	0.0
General governm. budget, EUdef., % of GDP							
Revenues	35.2	35.6	36.5	40.0	37.0	36.0	36.0
Expenditures	34.7	42.7	37.5	42.0	42.0	39.0	38.0
Net lending (+) / net borrowing (-)	0.5	-7.0	-1.0	-2.0	-5.0	-3.0	-2.0
General gov. gross debt, EU def., % of GDP	35.8	46.3	43.7	39.2	42.0	40.0	39.0
Stock of loans of non-fin. private sector, % p.a.	3.3	-1.8	13.4	14.0	.	.	.
Non-performing loans (NPL), in %, eop	1.6	1.3	0.7	0.5	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	1,733	3,633	641	-3,396	-3,600	-3,800	-3,900
Current account, % of GDP	3.5	7.3	1.1	-5.1	-4.9	-4.8	-4.7
Exports of goods, BOP, EUR m	25,954	25,536	31,648	41,086	43,600	45,800	47,600
annual change in %	5.7	-1.6	23.9	29.8	6.1	5.0	3.9
Imports of goods, BOP, EUR m	28,303	25,940	34,544	48,428	52,600	55,300	57,500
annual change in %	3.3	-8.3	33.2	40.2	8.6	5.1	4.0
Exports of services, BOP, EUR m	11,864	10,921	13,571	17,397	18,500	19,400	20,200
annual change in %	22.6	-8.0	24.3	28.2	6.3	4.9	4.1
Imports of services, BOP, EUR m	6,914	5,886	8,137	11,378	12,400	13,200	13,700
annual change in %	15.1	-14.9	38.2	39.8	9.0	6.5	3.8
FDI liabilities, EUR m	3,060	4,002	2,534	580	.	.	.
FDI assets, EUR m	1,921	3,438	1,286	-1,073	.	.	.
Gross reserves of CB excl. gold, EUR m	4,273	3,662	4,626	4,715	.	.	.
Gross external debt, EUR m	34,267	40,233	44,565	45,340	44,500	45,900	47,500
Gross external debt, % of GDP	70.1	80.8	79.3	67.8	60.0	58.0	57.0

1) Preliminary and wiiw estimates. - 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.