

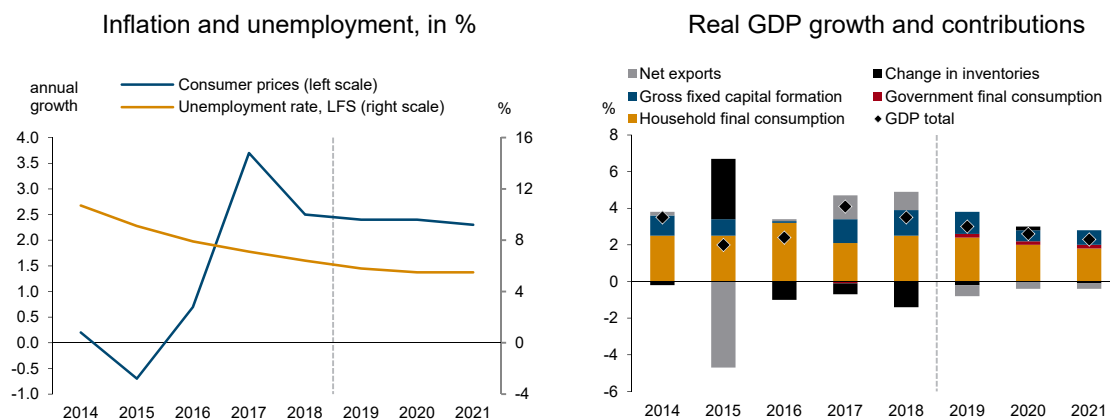


LITHUANIA: Domestic demand keeps growth buoyant

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External demand dynamic cooled off last year and is expected to continue abating in 2019 and the coming two years. Public and private investment will drive growth for another year. Thereafter we expect private investment activity to subside gradually. A further decline in unemployment is driving rapid wage increases. In addition, the implemented income tax reform will foster growth in household consumption. For 2019, we expect real GDP to grow by 3%, followed by 2.6% in 2020 and 2.3% in 2021.

Figure 6.12 / Lithuania: Main macroeconomic indicators



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

Growth in exports declined in 2018; however, the balance of goods and services still contributed remarkably to overall GDP growth. External demand for goods increased by 7% in net terms, year on year. Exports increased significantly to Poland, Sweden and the UK, while remaining almost stagnant to Russia. The external demand for the important goods categories petroleum products, chemicals and tobacco increased swiftly, while growth in machinery exports remained weak. Trade in services has also continued to flourish in 2018, particularly due to the export of transport services to euro area countries. In addition, tourism evolved at a good pace last year; the number of inbound visitors increased by about 10% compared to 2017. In 2019 and the following two years the deterioration of the external economic environment will result in further declining growth figures for Lithuanian exports. In addition, due to ongoing lively investment and consumption growth, imports will increase faster than exports. As a result, the contribution of net exports to GDP growth is expected to turn negative again from this year onwards.

Last year saw an upswing in gross fixed investment by 7.5% in real terms, whereas for 2019 we expect some slowdown of growth in capital spending. The co-financing from EU funds allows the

government to keep up public investment at 4% of GDP this year and 2020, respectively. By February 2019 Lithuania has already received a third of the payments from the EU structural and investment funds from the 2014-2020 programming period. Thus, it is a frontrunner in the group of new EU Member States together with Estonia. However, private investment has increased at an even swifter pace in 2018; the strong rise in capital spending in machinery and vehicles shows that enterprises are in need of upgrading their production infrastructure. The construction of new dwellings rose strongly in 2018 and housing prices increased considerably in the cities. While figures for building permits granted pointed towards a decline in dwellings construction in the last quarter of 2018, sentiment indicators of construction entrepreneurs showed a further upswing in prospects concerning business developments in the first two months of 2019. In addition, mortgage loans to households are still increasing at the beginning of this year. In the coming two years, however, we expect construction growth figures to subside. In general, business and consumer sentiment indicators are very positive at the moment and increasing.

Employment increased unexpectedly strong by 0.8% in 2018. Jobs in trade, hotels and restaurants and the ICT sector, but also manufacturing increased above average. The unemployment rate dropped to 6.2% in 2018 and is likely to decline gradually to 5.5% in 2020. Eurostat projections suggest a strong decline in the working-age population (15-64) over the coming two decades if no policy changes are implemented. In the past 15 years the country already experienced a decline in that age group by almost 20%. In order to counteract the population shrinkage and the current skills shortage, the Lithuanian government adopted a more liberal attitude towards work migration. In the past two years, national visas on employment grounds were granted to a substantially greater number of foreigners, but the latter still accounted for only about 2% of the Lithuanian workforce in 2018. About 60% of those immigrants were Ukrainians; more than 20% were citizens from Belarus. Another measure to counteract the population shrinkage was the introduction of a general child benefit last year, which was almost doubled to EUR 50-70 in January 2019. However, net international migration is only gradually moving towards a balance (having previously been negative).

This year the reforms of the pension and personal income tax system are being implemented.

The latter comprises inter alia a reduction of the applied tax rates and social security contributions, but also the introduction of progressivity in the income tax scheme. Moreover, the government is introducing a package of measures to reduce the high share of shadow economy in Lithuania to below 20% of GDP in 2019. This includes not only the increase of penalties for future tax-related offences and easier banning of enterprises from public procurement competitions, but also a number of incentives to pay taxes voluntarily. These are e.g. amnesty periods to legalise former shadow activities or the possibility for citizens to deduct payments for officially paid household services from their tax burden. The additional tax income would be needed to increase the low level of social transfers in Lithuania. Concerning the pension reform, the IMF has recently highlighted that the enacted changes to the funded pillar of the pension system are inadequate to reduce old-age poverty.

The monthly minimum wage was increased by 7.5% in nominal terms, to EUR 430, from January 2019 onwards. However, since part of the social security contributions were transferred to the personal income tax scheme, the effective increase of the lowest incomes is more than 35%. This measure will contribute to pushing up the overall salaries in the economy by about 5.5% in real terms this year. The ongoing tightening in the labour market will keep growth rates high in the forecast period. As a result, household consumption will continue to be an important driver of growth for the Lithuanian economy and

is expected to increase by another 3.8% this year and 3% on average in the period 2020-2021. Despite swiftly rising wages, core inflation remains subdued. In 2019 and thereafter we even expect a slight decline in consumer prices to 2.4% p.a. This is due to the decline in import prices for crude oil and low growth of food prices.

The budget plan of the Lithuanian government foresees a surplus of 0.4% of GDP for 2019. We however expect public consumption and investment to grow more swiftly towards the next parliamentary elections scheduled for 2020. In general, the fiscal policy is projected to be broadly neutral in 2019-2021. Additional social spending will be partly offset by rising revenues from stricter tax administration and increases in excise taxes.

Despite rising external risks, we have kept our forecast for real GDP growth at 3% in 2019 unchanged compared to our Autumn 2018 Forecast. In the coming two years, however, external demand is going to lose momentum, which will result in the current account balance to turn negative again. Public investment activity will remain lively over the forecast period, facilitated by an ongoing inflow of EU funds. Private investment in residential buildings and machinery is still growing swiftly but is expected to subdue from 2019 onwards. At the beginning of 2019 sentiment indicators still show strong and rising confidence levels among both businesses and consumers, but a deteriorating international economic environment may result in sudden changes also in the domestic sphere. Rising household incomes, pushed up by a tightening labour market, will help private consumption to keep on rising steadily. However, the declining Lithuanian working-age population is a bottleneck for the economy, resulting in declining growth rates. Thus for 2020 and 2021, we forecast real GDP to grow at a somewhat lower pace, by 2.6% and 2.3% respectively.

Table 6.12 / Lithuania: Selected economic indicators

	2014	2015	2016	2017	2018 ¹⁾	2019	2020	2021
						Forecast		
Population, th pers., average	2,932	2,905	2,868	2,828	2,800	2,780	2,760	2,740
Gross domestic product, EUR mn, nom.	36,568	37,434	38,849	42,191	44,800	47,200	49,600	51,900
annual change in % (real)	3.5	2.0	2.4	4.1	3.5	3.0	2.6	2.3
GDP/capita (EUR at PPP)	20,800	21,700	22,000	23,500	24,900	.	.	.
Consumption of households, EUR mn, nom.	22,686	23,372	24,783	26,468	28,200	.	.	.
annual change in % (real)	4.0	4.0	5.1	3.4	4.0	3.8	3.2	2.9
Gross fixed capital form., EUR mn, nom.	6,906	7,330	7,506	8,098	8,900	.	.	.
annual change in % (real)	5.8	4.9	0.3	6.8	7.5	6.0	3.0	4.0
Gross industrial production (sales)								
annual change in % (real)	0.1	4.5	2.9	6.9	4.7	4.0	3.5	4.0
Gross agricultural production								
annual change in % (real)	8.4	8.6	-1.7	2.6	-10.9	.	.	.
Construction industry								
annual change in % (real)	17.1	-3.5	-9.3	8.9	13.8	.	.	.
Employed persons, LFS, th, average	1,319	1,335	1,361	1,355	1,366	1,373	1,378	1,380
annual change in %	2.0	1.2	2.0	-0.5	0.8	0.5	0.4	0.1
Unemployed persons, LFS, th, average	158	134	116	103	91	85	80	80
Unemployment rate, LFS, in %, average	10.7	9.1	7.9	7.1	6.4	5.8	5.5	5.5
Reg. unemployment rate, in %, eop ²⁾	9.3	9.0	8.5	8.7	8.9	.	.	.
Average monthly gross wages, EUR ³⁾	677.4	714.1	774.0	840.4	920.0	990	1,060	1,130
annual change in % (real, gross)	4.7	6.4	7.4	4.7	6.5	5.5	4.5	4.0
Average monthly net wages, EUR ³⁾	527.2	553.9	602.3	660.2	720.0	780	840	890
annual change in % (real, net)	5.1	6.1	7.7	5.7	6.0	5.5	4.8	4.0
Consumer prices (HICP), % p.a.	0.2	-0.7	0.7	3.7	2.5	2.4	2.4	2.3
Producer prices in industry, % p.a.	-5.0	-9.7	-4.3	4.9	5.5	1.0	0.5	2.0
General government budget, EU-def., % of GDP								
Revenues	34.0	34.6	34.4	33.6	34.5	35.0	34.7	34.8
Expenditures	34.6	34.9	34.1	33.1	34.2	34.9	34.7	34.5
Net lending (+) / net borrowing (-)	-0.6	-0.3	0.3	0.5	0.3	0.1	0.0	-0.2
General gov.gross debt, EU def., % of GDP	40.5	42.6	39.9	39.4	36.5	37.5	36.5	35.0
Stock of loans of non-fin.private sector, % p.a.	-0.9	4.1	7.1	4.5	6.0	.	.	.
Non-performing loans (NPL), in %, eop	6.5	5.5	3.8	3.1	2.5	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	0.12	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	1,158	-847	-300	371	410	-100	-150	-300
Current account, % of GDP	3.2	-2.3	-0.8	0.9	0.9	-0.2	-0.3	-0.6
Exports of goods, BOP, EUR mn	23,750	22,309	21,922	25,724	27,450	28,200	28,700	29,400
annual change in %	-1.0	-6.1	-1.7	17.3	6.7	2.7	1.8	2.4
Imports of goods, BOP, EUR mn	24,686	24,296	23,690	27,673	30,100	31,100	31,800	32,700
annual change in %	-0.9	-1.6	-2.5	16.8	8.8	3.3	2.3	2.8
Exports of services, BOP, EUR mn	5,850	6,011	6,845	8,405	9,600	10,200	10,850	11,600
annual change in %	8.5	2.8	13.9	22.8	14.2	6.3	6.4	6.9
Imports of services, BOP, EUR mn	4,212	4,267	4,602	5,283	5,700	6,100	6,500	7,000
annual change in %	4.4	1.3	7.9	14.8	7.9	7.0	6.6	7.7
FDI liabilities, EUR mn	387	873	870	1,024	950	.	.	.
FDI assets, EUR mn	382	164	732	474	600	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	6,991	1,376	2,263	3,509	4,831	.	.	.
Gross external debt, EUR mn	25,551	28,331	33,087	35,271	35,800	36,800	37,700	38,900
Gross external debt, % of GDP	69.9	75.7	85.2	83.6	79.9	78.0	76.0	75.0

1) Preliminary and wiiw estimates. - 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.