

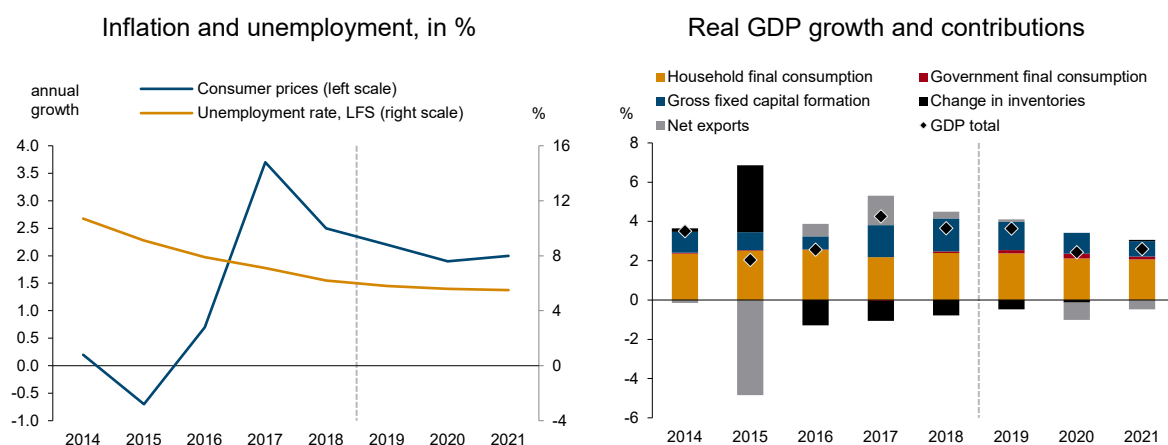


LITHUANIA: Still growing swiftly, but slowdown ahead

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Growth accelerated again in 2019, underpinned in particular by public and private investment. A further decline in unemployment, a minimum wage hike and a reduction of the effective income tax rate have resulted in rapid increases in the purchasing power of households. External demand has been stronger than expected in 2019 but is likely to abate in the coming two years. For 2019, we estimate real GDP growth of 3.6%, followed by a projected slowdown to 2.4% in 2020 and 2.6% in 2021.

Figure 5.12 / Lithuania: Main macroeconomic indicators



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

Overall GDP growth remained unchanged in the first half of 2019, increasing by 4.2% in real terms year on year. Despite a slowdown of economic activity in the Euro Area, exports increased even faster in the first half of the year from 6.2% in 2018 in nominal terms to 9.5% in 2019. While exports to the main trade partners Latvia and Russia are growing slowly, those to Germany and the whole Euro Area increased by more than 8% year on year in nominal terms. Despite a decline in the oil price nominal growth of exports of the most important Lithuanian merchandise group, refined petroleum and oil products like chemicals, plastics and fertilizers, remained lively. However, the demand for foodstuff and wood-based goods has abated.

Trade in services has also continued to flourish in 2019, particularly due to transit which amounts to more than half of the service exports of Lithuania. However, the transport sector, which accounts for 12% of total Lithuanian jobs, is expected to shrink somewhat in terms of employment over the coming years. The EU Mobility package, concluded in the EU parliament in April 2019, increases the compulsory wages of workers posted abroad and improves working conditions like mandatory rest

times. Thus 'social dumping' in the sector should be reduced, biting into Lithuania's competitive position in this market. Furthermore, exports in the field of business services are growing swiftly. Due to strong investment and consumption growth, imports are increasing as fast as exports. As a result, the contribution of net exports to GDP growth is expected to be balanced in 2019. However, in 2020 we expect the slowdown in the Euro Area to also affect the Lithuanian export sector more negatively, dragging down the GDP growth rate.

Figures for the second quarter of 2019 provide a further indication that gross fixed capital investment is likely to grow even faster compared to last year, by 7.5% per annum. The inflow of EU funds also allows the government to increase capital spending this year. The Rail Baltica high speed train project is still in the design phase in Lithuania. However, construction work will start in 2020. In addition, private investment continued to increase in real terms in 2019; the increases of investment in machinery and vehicles show that enterprises are upgrading their production infrastructure. The construction of new dwellings rose strongly in the first half of 2019 while housing prices increased considerably in the cities. In the coming two years we expect construction growth to remain strong, as indicated by the latest figures for building permits granted. In general, business and consumer sentiment indicators are still rather positive concerning the current situation and the near future.

We expect employment to increase by another 1% in 2019 as a whole. Jobs in business services, accommodation and domestic trade have been strongly on the rise in the first half of this year. However, the construction sector has further created new employment as well. The unemployment rate is likely to drop to 5.8% in 2019. In order to counteract the shortage of skilled labour caused by the shrinkage of the working age population, the Lithuanian government allows higher immigration of workers, particularly from Ukraine and Belarus. The number of issued labour permits almost doubled in the first nine months of 2019 year on year. Further, monthly figures show that net international migration will be positive in 2019 for the first time in many years. An increase in the minimum wage to EUR 555 from January 2019 onwards supported the pushing up of the overall growth rate of net salaries to about 10% in real terms this year. The government announced an even stronger rise in the minimum wage of 9.4% from 2020 to EUR 607. Moreover, a reduction of labour taxation will take place, since the non-taxable income will be increased to EUR 400 in 2020 and to EUR 500 in 2021. Thus, household consumption is likely to remain a driver of growth not only in 2019, but also in the forecast period 2020-2021.

Although wages are rising more rapidly, consumer price inflation is declining to 2.2% in 2019.

The main reason is the most recently falling price of energy raw materials. Also, in the coming two years, the subdued international economic environment will hold down the import prices. While prices for services will increase more swiftly, overall consumer price inflation is expected to hover around 2% both in 2020 and 2021.

Compared to our Summer Forecast we have become slightly more optimistic, increasing our forecast for real GDP growth from 3.2% to 3.6% in 2019. Investment in residential buildings and machinery has even picked up, while exports have also performed better than expected. Sentiment indicators still show strong confidence levels among both businesses and consumers. A sustained upswing in public investment, not only this year, but also in 2020 and 2021, will be facilitated by an ongoing inflow of EU funds. Strongly 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, which may also result in weaker investment activity by the private sector. Thus for 2020 and 2021, we forecast real GDP to grow at lower paces, by 2.4% and 2.6% respectively.

Table 5.12 / Lithuania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 ¹⁾ | 2018 January-June | 2019 | 2019 Forecast | 2020 Forecast | 2021 |
|---|--------|--------|--------|--------------------|----------------------|---------|------------------|------------------|--------|
| Population, th pers., average | 2,905 | 2,868 | 2,828 | 2,801 | 2,801 | 2,792 | 2,780 | 2,760 | 2,740 |
| Gross domestic product, EUR mn, nom. | 37,322 | 38,893 | 42,269 | 45,264 | 21,197 | 22,772 | 47,900 | 50,000 | 52,300 |
| annual change in % (real) | 2.0 | 2.6 | 4.2 | 3.6 | 3.8 | 4.0 | 3.6 | 2.4 | 2.6 |
| GDP/capita (EUR at PPP) | 21,700 | 22,100 | 23,500 | 25,000 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 23,250 | 24,430 | 26,174 | 27,891 | 13,417 | 14,128 | . | . | . |
| annual change in % (real) | 4.1 | 4.1 | 3.5 | 3.9 | 3.6 | 3.3 | 3.8 | 3.4 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 7,324 | 7,723 | 8,449 | 9,300 | 4,208 | 4,649 | . | . | . |
| annual change in % (real) | 4.9 | 3.4 | 8.2 | 8.4 | 9.5 | 8.1 | 7.5 | 5.5 | 4.5 |
| Gross industrial production (sales) | | | | | | | | | |
| annual change in % (real) | 4.4 | 2.8 | 7.0 | 4.8 | 5.6 | 4.8 | 4.0 | 3.5 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 8.6 | -1.7 | 2.6 | -11.1 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -3.5 | -9.3 | 8.9 | 13.8 | 17.0 | 12.2 | . | . | . |
| Employed persons, LFS, th, average | 1,335 | 1,361 | 1,355 | 1,375 | 1,359 | 1,378 | 1,390 | 1,400 | 1,405 |
| annual change in % | 1.2 | 2.0 | -0.5 | 1.5 | 0.4 | 1.4 | 1.1 | 0.7 | 0.4 |
| Unemployed persons, LFS, th, average | 134 | 116 | 103 | 90 | 95 | 92.7 | 86 | 83 | 82 |
| Unemployment rate, LFS, in %, average | 9.1 | 7.9 | 7.1 | 6.2 | 6.6 | 6.4 | 5.8 | 5.6 | 5.5 |
| Reg. unemployment rate, in %, eop ²⁾ | 9.0 | 8.5 | 8.7 | 8.9 | 8.3 | 8.0 | 8.0 | . | . |
| Average monthly gross wages, EUR ³⁾ | 714.1 | 774.0 | 840.4 | 920.0 | 903.3 | 1,265.0 | 1,310 | 1,390 | 1,470 |
| annual change in % (real, gross) | 6.4 | 7.4 | 4.7 | 6.5 | 7.0 | 6.1 | 8.2 | 4.5 | 4.0 |
| Average monthly net wages, EUR ³⁾ | 553.9 | 602.3 | 660.2 | 720.0 | 705.8 | 804.0 | 820 | 880 | 930 |
| annual change in % (real, net) | 6.1 | 7.7 | 5.7 | 6.0 | 6.1 | 11.2 | 12.0 | 4.8 | 4.0 |
| Consumer prices (HICP), % p.a. | -0.7 | 0.7 | 3.7 | 2.5 | 2.8 | 2.3 | 2.2 | 1.9 | 2.0 |
| Producer prices in industry, % p.a. | -9.7 | -4.4 | 5.1 | 5.6 | 4.1 | 2.2 | 1.0 | 0.0 | 1.0 |
| General govern.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 34.7 | 34.3 | 33.5 | 34.6 | . | . | 35.0 | 34.7 | 34.8 |
| Expenditures | 35.0 | 34.1 | 33.0 | 33.9 | . | . | 34.9 | 34.7 | 34.5 |
| Net lending (+) / net borrowing (-) | -0.3 | 0.2 | 0.5 | 0.7 | . | . | 0.1 | 0.0 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 42.7 | 39.9 | 39.3 | 34.1 | . | . | 37.5 | 36.5 | 35.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.1 | 7.1 | 4.5 | 6.0 | 7.4 | 2.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 5.5 | 3.8 | 3.1 | 2.4 | 2.9 | 2.1 | . | . | . |
| Central bank policy rate, % p.a., eop ⁴⁾ | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -910 | -434 | 213 | 131 | -387 | 349 | 400 | 100 | 0 |
| Current account, % of GDP | -2.4 | -1.1 | 0.5 | 0.3 | -1.8 | 1.5 | 0.8 | 0.2 | 0.0 |
| Exports of goods, BOP, EUR mn | 19,655 | 19,470 | 22,763 | 24,552 | 11,627 | 12,726 | 26,400 | 27,600 | 28,800 |
| annual change in % | -4.4 | -0.9 | 16.9 | 7.9 | 6.2 | 9.5 | 7.5 | 4.5 | 4.3 |
| Imports of goods, BOP, EUR mn | 21,785 | 21,362 | 24,815 | 27,333 | 13,136 | 13,981 | 28,700 | 30,000 | 31,300 |
| annual change in % | 0.9 | -1.9 | 16.2 | 10.1 | 8.6 | 6.4 | 5.0 | 4.5 | 4.3 |
| Exports of services, BOP, EUR mn | 6,030 | 6,814 | 8,349 | 9,678 | 4,498 | 5,537 | 10,000 | 10,600 | 11,300 |
| annual change in % | 2.5 | 13.0 | 22.5 | 15.9 | 15.0 | 23.1 | 3.3 | 6.0 | 6.6 |
| Imports of services, BOP, EUR mn | 4,273 | 4,619 | 5,290 | 6,018 | 2,833 | 3,292 | 6,500 | 7,000 | 7,400 |
| annual change in % | 2.3 | 8.1 | 14.5 | 13.8 | 12.6 | 16.2 | 8.0 | 7.7 | 5.7 |
| FDI liabilities, EUR mn | 942 | 1,190 | 1,204 | 1,201 | 561 | 616 | 1,000 | 1,000 | 1,000 |
| FDI assets, EUR mn | 325 | 842 | 353 | 844 | 815 | 522 | 600 | 600 | 600 |
| Gross reserves of NB excl. gold, EUR mn | 1,376 | 2,263 | 3,509 | 4,831 | 4,361 | 4,634 | . | . | . |
| Gross external debt, EUR mn | 28,331 | 33,087 | 35,271 | 35,400 | 35,404 | 34,109 | 35,900 | 35,000 | 35,600 |
| Gross external debt, % of GDP | 75.9 | 85.1 | 83.4 | 78.2 | 78.2 | 71.2 | 75.0 | 70.0 | 68.0 |

1) Preliminary. - 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.