

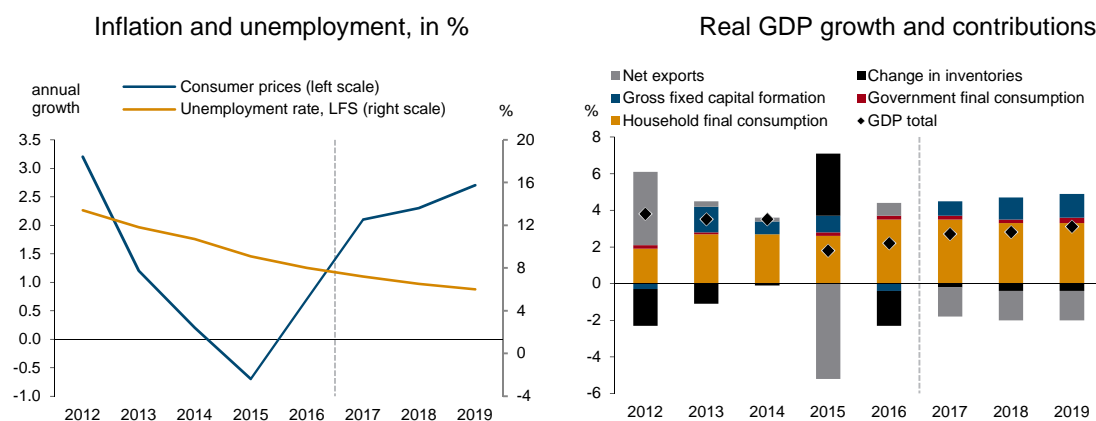


LITHUANIA: Still strong outward migration despite high wage growth

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Throughout 2017, economic growth in Lithuania will be driven by resurgence in external demand, particularly from the CIS and for oil products. Moreover, an upswing in public investment will be underpinned by fresh funds from the EU this year. The ongoing stable growth in terms of employment and rapid wage rises will result in robust increases in consumer demand. For 2017, we forecast a moderate upswing in the GDP growth rate to 2.7%, followed by 2.8% in 2018 and 3.1% in 2019.

Figure 44 / Lithuania: Main macroeconomic indicators



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

Following a revival in the early months of 2016, trade again stagnated towards the end of that year. Exports destined for Russia are still struggling. After a slump in trade with its Eastern neighbour of about 40% in nominal terms in 2015, Lithuanian exports stabilised in the second half of 2016. From now on, a recovery by the Russian economy is to be expected, and with it an upswing in Lithuanian exports. Another reason for recently stagnating exports is the slump in external demand and the fall in prices for refined oil products, which squeezed the profits of the Lithuanian refinery Mažeikių Nafta. These factors will fade in 2017. The transport sector, strongly exposed to Russian transit trade, was affected less badly than expected, and is currently strengthening again. Moreover, tourism exports are also expected to grow at a good pace in 2017: a further 5-10% increase in overnight stays is likely. Since household demand is improving and investment activity is set to revive this year, imports in 2017 will increase – in

value-added terms – at above the rate of exports. After a balanced current account in 2016, the deficit is again likely to widen to 1-2% of GDP in the medium term.

After having dropped by about 2% in real terms last year, gross fixed capital investment will revive in 2017. While public capital expenditure declined in 2016, the inflow of fresh EU funds from the 2014-2020 programming period will allow the government to increase capital spending. However, a large part of the rising government outlays will be devoted to defence, with an increase of 25% over 2016. However, for 2017, the budget also envisages a boost in investment in road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European rail network. The construction of dwellings started to increase gradually in 2016, and the rising number of building permits indicates that the upswing will continue in 2017. In addition, the mortgage loan portfolio of households started to grow again at a faster pace towards the end of 2016, after having stagnated since 2008.

The fall in prices for imports, particularly of oil and gas, is still a drag on overall price developments in Lithuania, but the consumer price index (CPI) is going to rise in 2017. Producer prices fell by more than 5% in the last quarter of 2016 year on year, while consumer inflation remained stagnant. This is quite remarkable, as average gross wages continued to increase substantially: in the last quarter of 2016 by about 7% year on year in real terms. Stronger economic stimulus in the rest of the EU and higher investment activity will lead to rising consumer inflation of more than 2% in both 2017 and 2018.

Employment is expected to increase this year by less than 1%. Apart from construction, agriculture and transport (the latter two being hit by the Russian crisis and embargo), job growth is evident in all sectors of the economy, particularly in recreational and business services. Simultaneously, however, net outward migration is continuing and is again likely to exceed 1% of the Lithuanian population in 2017. One reason for the renewed increase in emigration, particularly from 2015 onwards, has been the reintroduction of conscription, which young men prefer to avoid. The employment rate among those aged 15-64 reached 76% in 2016, almost the level of Germany, and the unemployment rate is likely to drop to almost 7% of the labour force in 2017.

In October 2016, the parliament enacted the laws of the 'New social model', a comprehensive reform package of labour and complementary laws covering the social protection and pension system. The package was bitterly contested by unions and opposition groups. At the core of the new laws is the liberalisation of labour contracts: the notice periods for dismissal have been cut, as have severance payments, and the possibility of atypical work and overtime has been expanded. As well as a reduction in employers' social contributions, the reforms also envisage the indexation of public pensions to the average wage. In the parliamentary elections last October, public resistance to the labour market liberalisation package proved disastrous for the then government's coalition partners, and the centre-conservative Farmers and Greens Union won a landslide victory. The programme put forward by the new coalition government – formed by the Farmers and Greens and the Social Democrats – emphasises anti-corruption measures and social and family policies in order to reduce emigration. The newly elected parliament decided to revise the 'New social model' laws and postpone their enforcement by at least six months.

Given the improving situation in the labour market and sharply rising incomes, household consumption will remain the most important driver of growth for the Lithuanian economy in 2017 and the years thereafter. Adjusting our forecast only slightly, we expect GDP to expand by 2.7% in 2017, followed by a minor upswing to 2.8% in 2018 and 3.1% in 2019. The assumed drivers of that growth are economic stabilisation in Russia and growth gaining momentum in the euro area. Moreover, public investment activity should be facilitated by inflows of EU funds. The government plans a budget deficit of 0.8% in 2017. In the years to follow it will drop even further, resulting in a continuously falling public debt to GDP ratio.

Table 15 / Lithuania: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017 Forecast	2018 Forecast	2019
Population, th pers., average	2,988	2,958	2,932	2,905	2,880	2,860	2,840	2,820
Gross domestic product, EUR mn, nom.	33,348	35,002	36,590	37,331	38,560	40,400	42,500	45,000
annual change in % (real)	3.8	3.5	3.5	1.8	2.2	2.7	2.8	3.1
GDP/capita (EUR at PPP)	18,600	19,600	20,700	21,600	22,300	.	.	.
Consumption of households, EUR mn, nom.	20,690	21,792	22,762	23,486	24,802	.	.	.
annual change in % (real)	3.1	4.3	4.3	4.1	5.6	5.5	5.3	5.3
Gross fixed capital form., EUR mn, nom.	5,788	6,458	6,770	7,195	7,051	.	.	.
annual change in % (real)	-1.8	8.3	3.7	4.7	-2.0	4.0	6.0	7.0
Gross industrial production (sales)								
annual change in % (real)	3.7	3.4	0.0	4.8	2.3	5.0	4.0	4.5
Gross agricultural production								
annual change in % (real)	14.2	-1.8	8.4	8.6	-3.4	.	.	.
Construction industry								
annual change in % (real)	-7.2	11.3	17.0	-3.5	-9.4	.	.	.
Employed persons, LFS, th, average	1,276	1,293	1,319	1,335	1,360	1,370	1,375	1,380
annual change in %	1.8	1.3	2.0	1.2	1.9	0.7	0.4	0.4
Unemployed persons, LFS, th, average	197	173	158	134	118	106	96	88
Unemployment rate, LFS, in %, average	13.4	11.8	10.7	9.1	8.0	7.2	6.5	6.0
Reg. unemployment rate, in %, end of period ²⁾	11.4	11.1	9.3	9.0	8.5	.	.	.
Average monthly gross wages, EUR ³⁾	615	646	677	714	770	840	910	990
annual change in % (real, gross)	0.7	4.0	4.7	6.4	6.9	6.5	5.7	5.5
Average monthly net wages, EUR ³⁾	478	501	527	554	600	650	700	760
annual change in % (real, net)	0.5	3.8	5.1	6.1	7.4	6.3	5.5	5.3
Consumer prices (HICP), % p.a.	3.2	1.2	0.2	-0.7	0.7	2.1	2.3	2.7
Producer prices in industry, % p.a.	5.0	-2.4	-4.9	-9.7	-4.3	2.5	3.5	4.5
General govern.budget, EU-def., % of GDP								
Revenues	33.0	32.9	34.0	34.9	34.0	33.4	33.0	34.0
Expenditures	36.1	35.5	34.7	35.1	34.9	34.2	33.6	34.5
Net lending (+) / net borrowing (-)	-3.1	-2.6	-0.7	-0.2	-0.9	-0.8	-0.6	-0.5
Public debt, EU-def., % of GDP	39.8	38.7	40.5	42.7	41.0	40.0	39.0	38.0
Stock of loans of non-fin.private sector, % p.a	-0.8	-2.3	-0.9	4.1	7.6	.	.	.
Non-performing loans (NPL), in %, Dec	13.6	11.0	6.5	5.5	4.2	.	.	.
Central bank policy rate, % p.a., end of period ⁴⁾	0.52	0.27	0.12	0.05	0.00	.	.	.
Current account, EUR mn	-393	539	1,317	-872	128	-500	-600	-800
Current account, % of GDP	-1.2	1.5	3.6	-2.3	0.3	-1.2	-1.4	-1.8
Exports of goods, BOP, EUR mn	22,426	23,998	23,750	22,310	21,830	22,700	24,200	25,800
annual change in %	15.5	7.0	-1.0	-6.1	-2.2	4.2	6.7	6.7
Imports of goods, BOP, EUR mn	23,529	24,917	24,686	24,296	23,497	24,500	26,100	27,800
annual change in %	9.5	5.9	-0.9	-1.6	-3.3	4.3	6.6	6.6
Exports of services, BOP, EUR mn	4,793	5,390	5,850	6,011	6,750	7,500	8,400	9,400
annual change in %	18.8	12.5	8.5	2.7	12.3	10.4	12.1	11.8
Imports of services, BOP, EUR mn	3,404	4,033	4,212	4,266	4,550	5,000	5,600	6,300
annual change in %	23.1	18.5	4.4	1.3	6.6	9.0	12.5	12.7
FDI liabilities, EUR mn	454	531	387	873	-95	.	.	.
FDI assets, EUR mn	215	322	382	164	377	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	6,203	5,705	6,991	1,376	2,263	.	.	.
Gross external debt, EUR mn	26,031	24,596	25,551	28,332	31,500	34,300	37,000	40,500
Gross external debt, % of GDP	78.1	70.3	69.8	75.9	81.7	85.0	87.0	90.0

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Annual data include 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.