

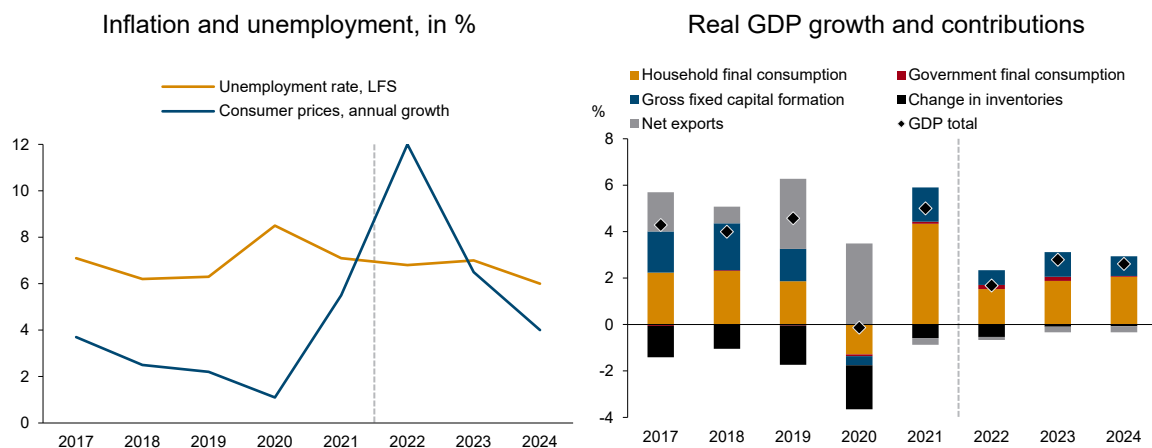


## LITHUANIA: At the frontline of economic sanctions

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Following a strong recovery last year, economic growth in Lithuania has been dealt a blow by Russia's invasion of Ukraine. Big rises in the price of energy and other imported inputs for industrial production are hitting economies worldwide. In addition, the trade linkages with Russia, Belarus and Ukraine are obviously more intensive in the Baltics than in other parts of the EU. A decline in household and business sentiment alike means that consumption and investment activity will lose momentum in 2022. The government is trying to counter the loss of households' purchasing power with an anti-inflationary package, and it should manage to keep economic activity afloat with its planned public investments. In our main scenario, we expect real GDP to grow by 1.7% in 2022, followed by an upswing of 2.8% in 2023 and 2.6% in 2024.

Figure 4.12 / Lithuania: Main macroeconomic indicators



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

**The Lithuanian government and the political community are seeking an end to the Russian war against Ukraine. However, the means that are proposed will also result in Lithuania's own economy paying a high price.** Together with Estonia, Latvia and Poland, Lithuania is pushing for additional sanctions to be imposed on Russia – for example, a ban on Russian and Belarusian road freight transport and on the entry of vessels from those two countries into EU ports. Moreover, that group of countries is pushing for an EU embargo of Russian energy products, including oil, gas and coal, arguing that the utmost economic pressure needs to be brought to bear on Russia to get it to stop its aggression.

**Compared to other EU countries, trade linkages between Russia and the Baltics states are relatively close – and that is particularly true of Lithuania.** However, a reorientation of trade was already under way even before Russia's annexation of Crimea and the war in Donbas; but since 2014, that process has gathered pace. The share of Lithuania's exports to Russia in its total exports fell from about 20% in 2014 to 10% in 2021. Russia is still the most important export destination for Lithuania, but most of its trade with Russia is transit trade. When it comes to the export of goods of Lithuanian origin, Russia's share is below 3%. Adding up the exports of Lithuanian goods to Russia, Belarus and Ukraine, it is clear that Lithuanian producers can expect a loss of more than 5% of total exports in 2022. Moreover, the transport sector, which has profited from the transit to and from Lithuanian ports of goods destined for the country's eastern neighbours (or exported by them), will also suffer a severe blow.

**The downturn in sentiment among businesses across Europe is likely to act as a drag on external demand for Lithuanian goods elsewhere, too.** Following a swift post-pandemic revival in trade last year, we expect export growth to be substantially down in real terms in 2022. We anticipate a gradual revival of export activity in 2023, although that does depend on de-escalation of the conflict in Ukraine.

**The opening in 2014 of the liquefied natural gas (LNG) terminal in the port of Klaipėda made the country technically independent of Russian gas.** Thus, Lithuania has been able to ban Russian gas imports from the beginning of April this year. Gas is supplied by Norway, as well as by the US (through fracking). However, the capacity of the terminal means that it cannot also cope with the total demands of neighbouring Latvia and Estonia in the coming winter period. Thus, those Baltic states are planning an additional LNG terminal, to be built at Paldiski on the northern coast of Estonia, in cooperation with Finland.

**Overall, goods from Russia still accounted for about 10% of Lithuania's total imports last year.** Apart from natural gas, crude oil, iron and steel, aluminium, fertilisers and timber were the most important inputs from Russia. Thus, the sectors engaged in construction, metal processing and furniture production will be among those worst affected. The Lithuanian government and the Polish-owned refinery Orlen are seeking to replace the Russian crude oil used up to now with supplies from Saudi Arabia. However, it is technically harder and definitely more expensive for Lithuania to become totally independent of Russia for its electricity supplies (although these have been reduced in recent years).

**In general, the war in Ukraine has dramatically exacerbated the upsurge in consumer prices that was already gaining momentum in the second half of 2021.** To a large extent, the rise has been driven by the aforementioned imports of energy and other production inputs. As a result, consumer prices will pick up to about 12% this year, and inflation is likely to remain elevated in 2023 and 2024. Thus, real wages are likely to stagnate in 2022, even though the government did increase the minimum wage in January 2022 by over 13%, to EUR 730 a month.

**Although the purchasing power of households is coming under pressure, the release of pent-up demand following the COVID lockdowns is likely to lead to private consumption increasing in 2022 by 2.6% in real terms.** Consumer surveys show confidence declining in March 2022; however, they also reveal that people are still planning to spend money on consumer durables. In 2023-2024, we expect household consumption to regain some of its momentum; however, smaller increases in income will limit that upswing.

**The latest business sentiment figures show that entrepreneurs are predicting tough times ahead.**

Confidence has fallen markedly in all sectors, and that will result in investment plans being revised or shelved. Even recently, labour shortages and flourishing demand were encouraging us to forecast another year of strong revival; but today only investment in public infrastructure, underpinned by EU funds (including the NextGenerationEU recovery package), can be taken for granted. 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 railway line starts this year. Given the big increase in the cost of construction materials, however, we would expect lower growth in volume terms in 2022 in both rail and road construction. Companies will run down their stocks, and overall investment will stagnate this year, before reviving in 2023. Given the uncertainty in terms of jobs and income development, households will reduce their investment in dwellings. However, we expect this expenditure to be only postponed for a while, given the ongoing demand for better and more living space.

**The Lithuanian government was planning to cut the budget deficit substantially this year; however, with the economic downswing and the surge in inflation, it is likely to end up at around 4% of GDP in 2022.** At the beginning of April, the government presented a package of anti-inflationary measures for households: 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; and caps on the cost of energy. An additional amendment to the state budget envisages a rise in defence spending from slightly above 2% of GDP in 2021 to almost 2.7% of GDP. Most likely, the additional expenditure on military equipment, etc. will not be reduced in the medium term.

**On average, the employment rate last year attained the pre-crisis level of 2019.** Only in domestic trade, accommodation and education was it still lower, while the gradual decline in agricultural employment is chronic. A substantial increase in the number of vacancies in the business sector indicated that at the beginning of this year demand for skilled labour was even higher than before the COVID pandemic. The unemployment rate in 2021 declined by more than expected, to 7.1% on average. The anticipated slowdown in economic growth will put the brakes on any revival in the labour market. Only in 2024 is the unemployment rate likely to fall to 6.5%.

**Up to the beginning of April, about 40,000 Ukrainian refugees had been registered in Lithuania, which amounts to somewhat over 1% of the population of the host country.** Until fairly recently, the Ukrainian community was not very large (again about 1% of the population); however, in the past few years Lithuania has tried to attract workers from Ukraine (and Belarus) with temporary work permits, in order to meet the demand for labour. The effects of the surge in refugees on the labour market will not be very marked in the short run. On 3 March, the EU activated its temporary refugee directive, which allows Ukrainian refugees temporary protection for three years. Thus, they are provided with direct access to the labour market, as well as accommodation, health care and education; and they are free to move within the EU, just like any other person with refugee status. However, about half of those who have registered in Lithuania are children, and a large proportion are women with care responsibilities. Thus, we would expect only a minority of the refugees to look for a job immediately, though in the medium-term things are likely to look rather different. Children are provided with places in kindergartens and schools. Depending on the humanitarian and economic situation in the Ukraine, longer-term settlement in an EU country will be an option both for those that are already in Lithuania, and for additional refugees, including men who are now engaged in fighting.

**Considering the overall effects of the war in Ukraine, we have had to revise our GDP forecast for 2022 substantially downwards, from 3.7% (interim report in January 2022) to 1.7%.** The deceleration of economic activity is affecting all channels and sectors. Growth in trade will decline most, and price rises will mean that households and enterprises have to revise their expenditure plans downwards. The government, however, is trying to bolster the purchasing power of households with anti-inflationary measures and to stimulate the investment climate through public investment. For the medium-term forecast, we are still optimistic that the economic slump will prove short lived, and that inflation will gradually decline. Thus, we expect GDP growth to revive to 2.8% in 2023 and 2.6% in 2024.

**Table 4.12 / Lithuania: Selected economic indicators**

	2018	2019	2020	2021 <sup>1)</sup>	2022	2023	2024
					Forecast		
Population, th pers., average	2,802	2,794	2,795	2,795	2,820	2,830	2,820
Gross domestic product, EUR m, nom.	45,515	48,860	49,507	55,383	63,100	69,100	73,700
annual change in % (real)	4.0	4.6	-0.1	5.0	1.7	2.8	2.6
GDP/capita (EUR at PPP)	24,670	26,220	25,980	28,490	.	.	.
Consumption of households, EUR m, nom.	27,890	29,347	28,958	32,524	.	.	.
annual change in % (real)	3.7	3.0	-2.1	7.4	2.6	3.2	3.5
Gross fixed capital form., EUR m, nom.	9,531	10,482	10,424	11,691	.	.	.
annual change in % (real)	10.0	6.6	-1.8	7.0	3.0	5.0	4.0
Gross industrial production (sales)							
annual change in % (real)	5.5	3.0	-1.3	19.5	8.0	4.0	6.0
Gross agricultural production							
annual change in % (real)	-10.0	10.1	10.3	-5.5	.	.	.
Construction industry							
annual change in % (real)	13.8	8.4	-1.6	4.6	.	.	.
Employed persons, LFS, th, average	1,375	1,378	1,358	1,369	1,380	1,390	1,400
annual change in %	1.5	0.3	-1.5	0.8	0.5	1.0	0.8
Unemployed persons, LFS, th, average	90	92	126	105	101	105	89
Unemployment rate, LFS, in %, average	6.2	6.3	8.5	7.1	6.8	7.0	6.0
Reg. unemployment rate, in %, eop <sup>2)</sup>	8.9	8.7	16.1	10.2	.	.	.
Average monthly gross wages, EUR <sup>3)</sup>	924	1,296	1,429	1,568	1,770	1,910	1,870
annual change in % (real, gross)	7.1	6.4	8.9	4.8	1.0	1.5	1.8
Average monthly net wages, EUR <sup>3)</sup>	720	822	913	995	1,120	1,090	1,180
annual change in % (real, net)	6.2	11.6	9.8	4.1	0.5	1.0	1.2
Consumer prices (HICP), % p.a.	2.5	2.2	1.1	5.5	12.0	6.5	4.0
Producer prices in industry, % p.a.	5.6	0.0	-9.0	9.5	17.0	6.0	3.0
General governm. budget, EU def., % of GDP							
Revenues	34.5	35.2	35.7	38.5	38.0	37.0	36.0
Expenditures	34.0	34.8	42.9	41.1	42.0	40.0	38.0
Net lending (+) / net borrowing (-)	0.5	0.5	-7.2	-2.6	-4.0	-3.0	-2.0
General gov. gross debt, EU def., % of GDP	33.7	35.9	46.6	45.0	48.0	50.0	48.0
Stock of loans of non-fin. private sector, % p.a.	6.0	3.3	-1.8	13.4	.	.	.
Non-performing loans (NPL), in %, eop	2.4	1.6	1.3	0.7	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	132	1,702	3,633	788	500	300	400
Current account, % of GDP	0.3	3.5	7.3	1.4	0.8	0.4	0.5
Exports of goods, BOP, EUR m	24,552	25,954	25,536	31,656	37,300	40,900	43,800
annual change in %	7.9	5.7	-1.6	24.0	17.8	9.7	7.1
Imports of goods, BOP, EUR m	27,398	28,303	25,938	34,532	41,900	46,200	49,300
annual change in %	10.4	3.3	-8.4	33.1	21.3	10.3	6.7
Exports of services, BOP, EUR m	9,678	11,822	10,853	12,864	15,200	16,700	17,900
annual change in %	15.9	22.2	-8.2	18.5	18.2	9.9	7.2
Imports of services, BOP, EUR m	6,003	6,902	5,854	7,661	9,300	10,300	11,000
annual change in %	12.9	15.0	-15.2	30.9	21.4	10.8	6.8
FDI liabilities, EUR m	1,096	3,060	3,979	1,605	.	.	.
FDI assets, EUR m	866	1,921	3,438	429	.	.	.
Gross reserves of CB excl. gold, EUR m	4,831	4,273	3,662	4,626	.	.	.
Gross external debt, EUR m	35,619	34,266	37,457	42,448	49,200	52,500	54,500
Gross external debt, % of GDP	78.3	70.1	75.7	76.6	78.0	76.0	74.0

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Including earnings of sole proprietors. From 2019 income tax reform and transfer of the employer's social security contribution (28.9%) to 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.