LITHUANIA: EU funds foster growth at full potential

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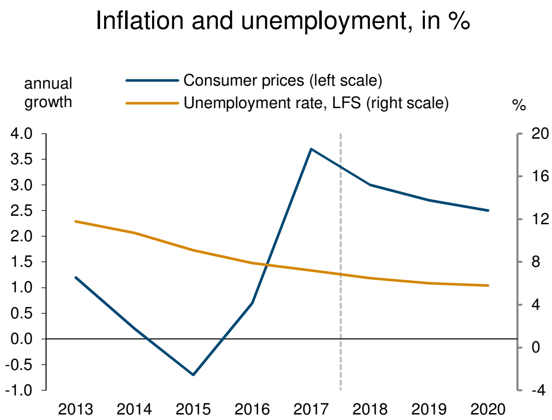
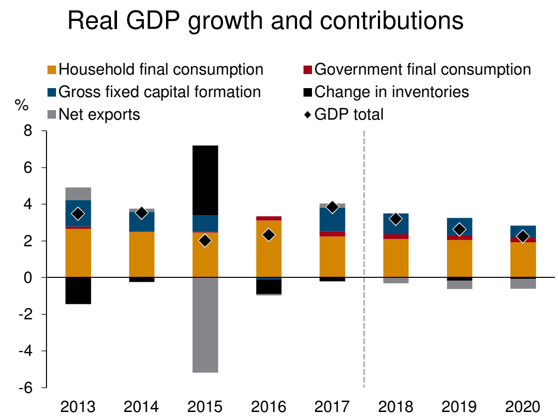
In 2018, economic growth in Lithuania will be driven by ongoing strong public investment, underpinned by fresh funds from the EU. The continued decline in unemployment and rapid wage growth mean steady, strong growth in household consumption. External demand activity, having seen a remarkable revival, particularly from the CIS last year, will remain buoyant in 2018. For 2018, we forecast GDP to grow by 3.2% at potential, followed by 2.6% in 2019 and 2.2% in 2020.

Figure 51 / Lithuania: Main macroeconomic indicators





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

After stagnation in goods exports in 2016, in 2017 Lithuanian exporters experienced a strong revival to all destinations. Exports to the CIS region increased by almost 30% nominally year on year. In 2018, the further upswing in trade to Russia, Lithuania's single most important trading partner, will be attenuated, given the expected slight slowdown in economic growth in the neighbouring country. External demand from the EU partners in general, and from the Baltic States in particular, will still be buoyant, driven by the ongoing upswing in the European investment cycle. In addition, services exports grew more strongly in 2017, and will continue to do so in the coming years, also thanks to lively transit trade to Russia. Tourism exports grew at a good pace in 2017, and quarterly figures show that an increase of about 10% in overnight stays is likely in 2018. Since household demand keeps on flourishing, and investment activity is undergoing a strong revival, imports in 2018 are expected to increase even faster than exports. Nevertheless, we expect the current account deficit to remain at below 2% of GDP and to increase only gradually over the medium term.

Gross fixed capital investment revived by about 7% in 2017 in real terms year on year, and is likely to maintain that pace in 2018. The inflow of fresh EU funds from the 2014-2020 programming period allows the government to increase capital spending. Investment is particularly expected in energy, as well as in the road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European rail network. By the end of 2017, Lithuania was the EU-CEE country that had used its structural funds fastest, having already spent 19% of the money assigned to it in the programming period 2014-2020. The construction of new dwellings and refurbishment co-financed by public sources started to increase swiftly in 2017, and the rising number of building permits indicates that the upswing will continue in 2018. In addition, the stock of mortgage loans granted to households is continuing to grow by about 8% annually.

Rising prices for imports, particularly oil and gas, resulted in consumer prices increasing more swiftly, by 3.7% in 2017. Apart from energy, the price of food also started to grow faster. In addition, inflation was fuelled by higher excise duties. The ongoing robust increase in wages is pushing up core inflation. In real terms, gross and net wages grew by almost 7% in 2017. In January 2018, the minimum wage was increased by 5% to EUR 400; thus we expect overall real wages to rise by another 5.5% this year. The economic stimulus in the rest of the EU and high investment activity will keep economic activity vibrant. However, since the effect of rising import prices and tax hikes will abate this year, we expect consumer inflation to decline to about 3% in both 2018 and 2019.

Employment is expected to remain stagnant in 2018, after a decline of 0.5% last year, although the employment rate is rising. Demographic developments are resulting in a steadily shrinking working-age population in Lithuania, although net outward migration is declining. However, in manufacturing and most service sectors, robust economic activity still resulted in an increase in jobs in 2017. In Lithuania, the employment rate among those aged 15-64 already climbed above 70% in the second quarter of last year, almost the level of Austria, and the unemployment rate dropped to close to 7% of the labour force in 2017.

The government plans to attain a budget surplus in 2018. Buoyant state revenues will allow the government to increase social spending more considerably this year. However, a large part of the rising government outlays will be devoted to defence spending, which will increase to 2% of GDP in 2018. The European Commission and the OECD have recently emphasised that not only is income inequality in Lithuania among the highest in the EU, but it has also been rising continuously since 2012. One of the reasons is that the tax wedge for low-income earners is much higher than the average of EU countries. Apart from that, the level of public expenditure is one of the lowest in the EU. Moreover, the Lithuanian welfare system cannot prevent its citizens from suffering poverty in the case of major life risks, like disability. The policy recommendation is thus to build up a proper welfare state that can offer its citizens a better standard of living, in order to reduce emigration.

Given the EU funds flowing into the country, public investment and private and government consumption are the most important drivers of growth for the Lithuanian economy in 2018. The favourable situation in the labour market and the resultant rising incomes will keep household consumption flourishing this year and thereafter. Following the peak of GDP growth of 3.9% in 2017, we expect the economy to expand by another 3.2% in 2018. A slowdown in external demand activity and a flattening of the investment cycle are likely to result in an attenuation of GDP growth to 2.6% in 2019 and 2.2% in 2020. The general government finances will most probably remain in surplus over the whole forecast period. In the years to come, Lithuania will thus observe a steadily falling public debt to GDP ratio – down from the current 40% to about 35% in 2020.

Table 21 / Lithuania: Selected economic indicators

	2013	2014	2015	2016	2017 [1)]	2018	2019 Forecast	2020
Population, th pers., average	2,958	2,932	2,905	2,868	2,830	2,800	2,780	2,760
Gross domestic product, EUR mn, nom.	34,960	36,568	37,427	38,668	41,700	44,200	46,600	48,800
annual change in % (real)	3.5	3.5	2.0	2.3	3.9	3.2	2.6	2.2
GDP/capita (EUR at PPP)	19,600	20,800	21,700	22,000	23,200	.	.	.
Consumption of households, EUR mn, nom.	21,792	22,686	23,375	24,771	26,700	.	.	.
annual change in % (real)	4.3	4.0	4.0	5.0	4.0	3.3	3.2	3.0
Gross fixed capital form., EUR mn, nom.	6,455	6,906	7,325	7,314	8,100	.	.	.
annual change in % (real)	8.3	5.8	4.8	-0.5	7.0	6.0	5.0	3.5
Gross industrial production (sales)								
annual change in % (real)	3.2	0.1	4.9	2.8	7.2	6.0	4.5	4.0
Gross agricultural production								
annual change in % (real)	-1.8	8.4	8.6	-1.7	-1.9	.	.	.
Construction industry								
annual change in % (real)	11.3	17.0	-3.5	-9.4	9.6	.	.	.
Employed persons, LFS, th, average	1,293	1,319	1,335	1,361	1,358	1,353	1,350	1,350
annual change in %	1.3	2.0	1.2	2.0	-0.2	-0.4	-0.2	0.0
Unemployed persons, LFS, th, average	173	158	134	116	105	94	86	83
Unemployment rate, LFS, in %, average	11.8	10.7	9.1	7.9	7.2	6.5	6.0	5.8
Reg. unemployment rate, in %, eop [2)]	11.1	9.3	9.0	8.5	8.7	.	.	.
Average monthly gross wages, EUR [3)]	646.3	677.4	714.1	774.0	850.0	920	990	1,070
annual change in % (real, gross)	4.0	4.7	6.4	7.4	6.5	5.5	5.0	5.0
Average monthly net wages, EUR [3)]	501.1	527.2	553.9	602.3	670.0	730	790	850
annual change in % (real, net)	3.8	5.1	6.1	7.7	6.5	5.2	5.3	5.0
Consumer prices (HICP), % p.a.	1.2	0.2	-0.7	0.7	3.7	3.0	2.7	2.5
Producer prices in industry, % p.a.	-2.4	-4.9	-9.7	-4.3	4.9	3.5	3.5	3.5
General goverm.budget, EU-def., % of GDP								
Revenues	32.9	34.0	34.6	34.5	34.0	33.5	33.3	33.3
Expenditures	35.5	34.6	34.9	34.2	33.8	33.2	33.1	33.3
Net lending (+) / net borrowing (-)	-2.6	-0.6	-0.2	0.3	0.2	0.3	0.2	0.0
General gov.gross debt, EU def., % of GDP	38.8	40.5	42.6	40.1	41.0	38.0	36.0	34.0
Stock of loans of non-fin.private sector, % p.a.	-2.3	-0.9	4.1	7.1	4.5	.	.	.
Non-performing loans (NPL), in %, eop	11.0	6.5	5.5	3.8	3.2	.	.	.
Central bank policy rate, % p.a., eop [4)]	0.27	0.12	0.05	0.00	0.00	.	.	.
Current account, EUR mn	292	1,158	-1,050	-433	385	-900	-1,100	-1,095
Current account, % of GDP	0.8	3.2	-2.8	-1.1	0.9	-2.0	-2.4	-2.2
Exports of goods, BOP, EUR mn	23,998	23,750	22,309	21,922	25,753	28,500	30,200	31,710
annual change in %	7.0	-1.0	-6.1	-1.7	17.5	10.7	6.0	5.0
Imports of goods, BOP, EUR mn	24,918	24,686	24,296	23,690	27,814	30,700	33,200	34,860
annual change in %	5.9	-0.9	-1.6	-2.5	17.4	10.4	8.1	5.0
Exports of services, BOP, EUR mn	5,390	5,850	6,011	6,845	8,273	9,100	9,700	10,185
annual change in %	12.5	8.5	2.7	13.9	20.9	10.0	6.6	5.0
Imports of services, BOP, EUR mn	4,033	4,212	4,266	4,599	5,376	6,100	6,600	6,930
annual change in %	18.5	4.4	1.3	7.8	16.9	13.5	8.2	5.0
FDI liabilities, EUR mn	531	387	873	870	1,065	.	.	.
FDI assets, EUR mn	322	382	164	732	352	.	.	.
Gross reserves of NB excl. gold, EUR mn [5)]	5,705	6,991	1,376	2,263	3,509	.	.	.
Gross external debt, EUR mn	24,596	25,551	28,332	33,091	35,450	36,200	37,300	38,100
Gross external debt, % of GDP	70.4	69.9	75.7	85.6	85.0	82.0	80.0	78.0

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.