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Lithuania: Exports trigger cyclical downturn

In Lithuania, the slowdown of growth in exports and corporate investments that could be observed towards the end of 2011 will continue throughout 2012. In spite of parliamentary elections to be held in October 2012, the government reinforced austerity measures in order to reduce the budget deficit to below 4% of GDP. This will curb domestic demand throughout the year. Thus, the situation on the labour market will remain strained and outward migration especially of young people will continue. A revival of GDP growth to be expected in 2013 and 2014 should be backed by an external demand stimulus.

The revival of domestic demand triggered the high growth of GDP of 5.9% in real terms in 2011. Both household consumption and gross fixed capital investment recovered after a substantial decline lasting for more than two years. Although external demand remained lively, overall growth figures of exports shrank compared to 2010. Due to the strong growth of internal demand imports rose again faster than external demand, thus the current account moved into deficit for the first time after the crisis amounting to -1.7% of GDP in 2011.

Throughout the past year export growth figures declined steadily, dropping to single digits in nominal terms in the 4th quarter of 2011. Moreover, more than a third of the export growth last year can be attributed to mineral fuels triggered by rising oil prices. However, external demand developed quite strongly from the Baltic neighbours Estonia and Latvia, from Russia and Belarus as well as from the Netherlands, Sweden and France. Given the decline in economic activity in the Northern and Western European countries, Lithuanian export growth is going to decline considerable in 2012 and to revive only gradually thereafter.

Gross fixed capital investment showed a strong upswing in the first half of 2011 which triggered also some revival of activity in the construction sector. About three quarters of total investments went into the manufacturing sector, most prominently investments in the Lithuanian refinery of Mazeiku Nafta. However, already in the 3rd quarter of last year investment activity started to flatten out. With low output growth in the manufacturing

sector, investment growth is expected to remain rather low, most likely at about 5% year on year in 2012 at best. Corporations as well as households are deleveraging quite strongly, the stock of outstanding loans to the private non-financial sector declined from the end of 2010 until the end of 2011 once again by about 7%. Moreover, the share of non-performing loans (overdue more than 60 days) declined throughout 2011 from almost 20% to about 16%.

In January 2012 the state-owned company Klaipėdos Nafta, operator of the port in Klaipėda, announced that it will build an offshore platform for imports of liquefied natural gas (LNG) in cooperation with the Norwegian company Hoegh LNG by the end of 2014. The Ministry of Energy has already submitted a draft resolution to permit the building of the floating storage and regasification unit. The Lithuanian government is eager to reduce its dependency on Russian gas supplies. Accordingly, in February 2012 it was announced that the Polish and Lithuanian gas grid operators plan to build a 560 km pipeline until the end of 2018, which would then connect the grids of the Baltic States with Central Europe.

Consumption of households increased surprisingly strongly in 2011, by 5.8% in real terms, although the revival in the labour market was meagre and real wages were still on the decline last year. However, due to strongly increased outward migration, workers' remittances rose as well and 'envelope payments' – which were common in Lithuania even before the crisis in order to reduce the tax wedge – account for a rising share in total income. Nevertheless, the dynamic of consumption growth will decline in 2012, given the reduced growth of external demand. We therefore expect household consumption to increase by only 2.5% in real term this year.

Although household consumption revived quite strongly and exports developed not too bad, the growth of industrial production remained below potential and rose by only 7.4% in real terms in 2011. In the 4th quarter of last year output already declined by 1% year on year.

The situation of the labour market remained disappointing in the year 2011. After a fall of employment of more than 12% during the economic crisis, the number of jobs increased by only 2% last year. Accordingly average gross wages rose by just 2% in nominal terms but declined for another year by 2% in real terms. As in Latvia, outward migration was one of the few possibilities especially for young Lithuanians to cope with the crisis. According to LFS statistics about 15% of those aged 15 to 30 years left the country between the end of 2008 and the end of 2011.

Given the revival in domestic demand and the rise in prices for imported fossil fuels, consumer price increases – 4.1% on average in 2011 – remained below expectations. This reflects the strained situation on the labour market and thus the subdued development of gross wages. With overall economic activity levelling off, inflation will slow down to about 2.5% in 2012.

The 2012 budget foresees a reduction of the deficit to 3%. Due to the reduced growth forecast for 2012 the parliament had to amend additional austerity measures in order to further reduce the budget deficit which fell from 7.1% in 2010 to about 5.3% last year. Thus the budget stipulates a 4% cut in public expenditures. Apart from reducing outlays for investment projects of various ministries, the Lithuanian government will reduce the transfers from the social-security tax to private retirement funds. State-owned enterprises will have to divert a portion of their profits to the government budget and an increase in taxes on luxury goods and real estate was approved. Given the uncertainties concerning external demand developments in 2012, the target of a deficit close to 3% might be missed this year. However, if both the deficit and the inflation Maastricht criteria should be met in 2012 the Lithuanian government might stick to its announcement to apply for eurozone entry 'as soon as possible' and thus decide by the end of the year to envisage already 2014 as the preferred entry date, as its neighbour Latvia.

Parliamentary elections are scheduled for October 2012. As is mostly the case ahead of Lithuanian elections, start-up parties are in the line to pop up also this year. Vladimir Romanov, a Lithuanian billionaire and majority stakeholder of the fifth largest Lithuanian bank 'Ukio Bankas', wants to set up a populist, centre-oriented party; Kristina Brazauskienė, widow of the 2010 deceased Lithuanian President Algirdas Brazauskas, founded the 'Democratic Labour and Unity Party' in mid-February 2012. Moreover, the political landscape changed due to the split-up of the third largest party in the parliament, the 'National Resurrection Party', which is part of the centre-right coalition government led by Prime Minister Andrius Kubilius. The conservative wing formed the movement 'Christian Party' in January 2010, while the liberal wing of the 'Resurrection Party' merged into the 'Liberal and Centre Movement'. The strongest party by far in the government, the 'Homeland Union' led by PM Kubilius, is running low in the polls, thus the strongest opposition party, the 'Social Democratic Party of Lithuania', might have the chance to regain the post of the prime minister, which they held from 2004 to 2006.

One important issue will continue to attract public attention in the months to come: the aftermath of the nationalization to the rescue of the third largest Lithuanian credit institute, Snoras banka, which took place due to liquidity problems in November 2011. About

26 thousand clients have submitted their claims and have to be reimbursed to a large part by the Lithuanian deposit insurance fund. Since the assets of the fund are too low to compensate the depositors of Snoras, the government's borrowing needs will increase in the medium term.

For 2013 and 2014 we expect external demand, particularly for oil fuels, to revive again. Thus, after a year of slow GDP growth of only 2.1% in real terms in 2012, the subsequent two years should bring about a revival including also an increase in corporations' investments. Based on the assumption that the growth slowdown in 2012 will cause no major job cuts in the manufacturing sector, we also expect a faster rise in wages. Accordingly, the growth of household demand is likely to recover as well and GDP growth is expected to accelerate to 3.5% in 2013 and 4% in 2014.

Table LT

Lithuania: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 ¹⁾	2012	2013	2014
	Forecast								
Population, th pers., average ²⁾	3394.1	3375.6	3358.1	3339.5	3286.8	3053.8	3023	3008	2993
Gross domestic product, LTL mn, nom.	83227.1	99229.3	112083.7	91914.0	95074.3	105712.5	110600	117900	126900
annual change in % (real)	7.8	9.8	2.9	-14.8	1.4	5.9	2.1	3.5	4
GDP/capita (EUR at exchange rate)	7100	8500	9700	8000	8400	10000	.	.	.
GDP/capita (EUR at PPP)	13100	14800	15400	12800	14000	16200	.	.	.
Consumption of households, LTL mn, nom.	53911.5	63540.4	73406.1	63308.6	60994.3	67400	.	.	.
annual change in % (real)	9.9	11.3	4.2	-17.4	-5.0	5.8	2.5	3	4
Gross fixed capital form., LTL mn, nom.	21038.0	27918.8	28370.0	15807.9	15488.5	18930	.	.	.
annual change in % (real)	19.3	21.8	-5.2	-39.5	1.0	15.5	5	7	9
Gross industrial production (sales)									
annual change in % (real)	6.5	2.4	5.5	-14.6	6.7	7.4	3	5	7
Gross agricultural production (EAA)									
annual change in % (real)	-4.1	8.2	8.8	1.0	-7.2	3.5	.	.	.
Construction industry									
annual change in % (real)	21.7	22.2	4.0	-48.5	-7.7	22.2	.	.	.
Employed persons - LFS, th, average	1499.0	1534.2	1520.0	1415.9	1343.7	1370.9	1380	1395	1410
annual change in %	1.7	2.3	-0.9	-6.8	-5.1	2.0	1	1	1
Unemployed persons - LFS, th, average	89.4	69.0	94.3	225.1	291.1	248.8	.	.	.
Unemployment rate - LFS, in %, average	5.6	4.3	5.8	13.7	17.8	15.4	15	14	13
Reg. unemployment rate, in %, end of period ³⁾	3.7	3.3	4.4	12.5	14.4	11.0	.	.	.
Average gross monthly wages, LTL	1495.7	1802.4	2151.7	2056.0	1988.1	2028	.	.	.
annual change in % (real, net)	14.9	17.0	10.1	-7.2	-4.3	-2.0	.	.	.
Consumer prices (HICP), % p.a.	3.8	5.8	11.1	4.2	1.2	4.1	2.5	3	3.5
Producer prices in industry, % p.a.	7.3	7.0	18.2	-13.5	10.3	13.9	.	.	.
General govern.budget, EU-def., % GDP									
Revenues	33.0	33.6	33.9	34.3	33.8	32.8	32.5	33.2	34.0
Expenditures	33.5	34.6	37.2	43.8	40.9	38.1	35.8	36.0	36.5
Net lending (+) / net borrowing (-)	-0.4	-1.0	-3.3	-9.5	-7.1	-5.3	-3.3	-2.8	-2.5
Public debt, EU-def., in % of GDP	17.9	16.8	15.5	29.4	38.0	37.5	37.0	35.7	34.0
Central bank policy rate, % p.a., end of period ⁴⁾	3.65	6.80	7.84	1.57	1.07	1.24	.	.	.
Current account, EUR mn	-2551	-4149	-4194	1182	410	-517	-800	-1000	-1500
Current account in % of GDP	-10.6	-14.4	-12.9	4.4	1.5	-1.7	-2.5	-2.9	-4.1
Exports of goods, BOP, EUR mn	11262	12509	16077	11797	15651	20173	21600	25000	29600
annual growth rate in %	18.7	11.1	28.5	-26.6	32.7	29	7	16	18
Imports of goods, BOP, EUR mn	14600	16788	20280	12648	16921	21647	23600	27200	32500
annual growth rate in %	23.2	15.0	20.8	-37.6	33.8	28	9	15	19
Exports of services, BOP, EUR mn	2879	2931	3240	2657	3115	3628	3900	4300	4800
annual growth rate in %	15.0	1.8	10.5	-18.0	17.2	16	8	10	12
Imports of services, BOP, EUR mn	2018	2471	2835	2140	2141	2578	2800	3100	3550
annual growth rate in %	21.9	22.4	14.7	-24.5	0.0	20	9	11	15
FDI inflow, EUR mn	1448	1473	1341	47	568	1012	.	.	.
FDI outflow, EUR mn	232	437	229	157	60	121	.	.	.
Gross reserves of NB excl. gold, EUR mn	4308	5159	4458	4472	4788	6120	.	.	.
Gross external debt, EUR mn	14442	20547	23009	23163	24071	24550	.	.	.
Gross external debt in % of GDP	59.9	71.5	70.9	87.0	87.4	80.2	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
Purchasing power parity LTL/EUR	1.8661	1.9824	2.1710	2.1498	2.0621	2.1211	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) In % of working age population. - 4) VILIBOR one-month interbank offered rate (Lithuania has a currency board).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.