

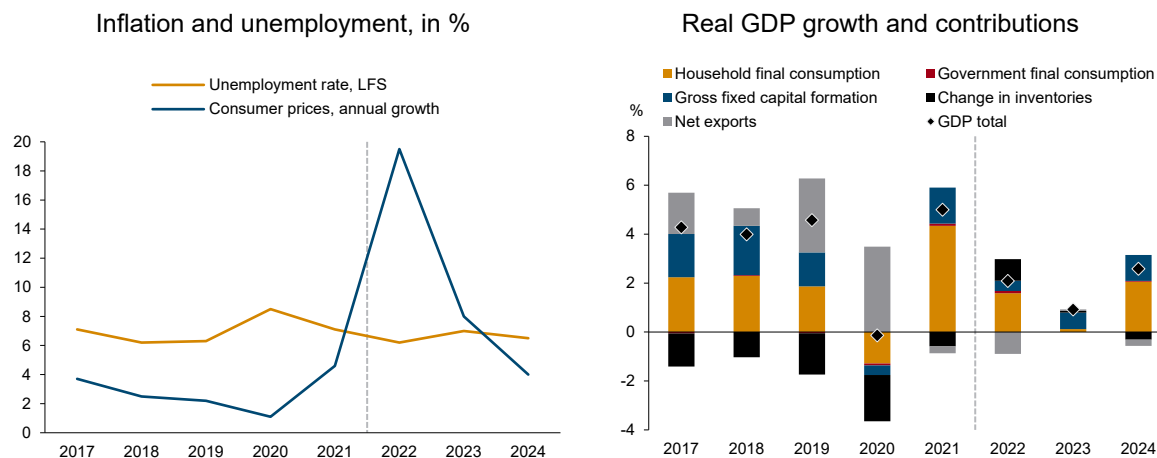


LITHUANIA: Keeping growth afloat in times of strain

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The economy has had to deal with the blow caused by Russia's invasion of Ukraine. Steep rises in the cost of energy and other imported inputs will push the inflation rate close to 20% this year. A decline in household and business sentiment alike means that consumption and investment activity will lose momentum in the second half of this year, and particularly in 2023. The government is trying to counter the loss of households' purchasing power and to assist enterprises with energy support measures. It should also manage to keep economic activity afloat with its planned public investments. We expect real GDP to grow by 2.1% in 2022, to be followed by a slump to 0.9% in 2023 and then an upswing to 2.6% in 2024.

Figure 6.12 / Lithuania: Main macroeconomic indicators



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

The war in Ukraine has dramatically exacerbated the surge in consumer prices that was already gaining momentum towards the end of 2021: in September 2022, the inflation rate climbed to 22.5% year on year. To a large extent, this rise has been driven by imports of energy, other production inputs and also food products. As a result, consumer prices will pick up by about 19.5% on average this year, and inflation is likely to remain elevated in 2023 and 2024. Thus, although nominal wages are rising rapidly, real incomes are going to decline this year and next (albeit to a lesser extent). In order to maintain the purchasing power of low-income earners, the government has announced a further 15% increase in the minimum wage from January 2023. In addition, the plan is to raise the non-taxable minimum income threshold substantially.

In the first half of 2022, the release of pent-up demand following the COVID-19-induced lockdowns still caused private consumption to surge, but a decline is on the cards in the second half of the year. With the purchasing power of households coming under pressure, we expect private consumption in 2022 to increase by only 2.7% in real terms. Consumer surveys show confidence declining month by month following last winter's energy price rises, and particularly since the start of the war in Ukraine. From this summer onwards, retail trade figures have shown a drop-off in household spending, especially on consumer durables. Since real incomes will continue to fall in 2023, we also expect consumption to stagnate next year. Only in 2024 do we expect household consumption to regain some of its momentum; however, smaller increases in income will limit that upswing.

External demand remained strong in the first half of 2022, but export growth declined thereafter. In the first six months of 2022, exporters in the chemical industry, plastics and the furniture industry could still benefit from buoyant demand in the EU. However, the recent downturn in sentiment among businesses across Europe is likely to act as a drag on external demand for Lithuanian goods and services. Next year, export growth will fall even further. We anticipate a gradual revival of export activity only in 2024, although that does depend on how well the EU succeeds in restoring energy security. The trade linkages with Russia and Belarus are being steadily loosened. Before the sanctions entered into force, many enterprises in Lithuania seized the chance to purchase cheap inputs from those two countries (steel, wood, fertilisers, etc.); however, imports will decline in the second half of the year. This will particularly hit the transport sector, which used to profit from the transit of goods between Lithuanian ports and the country's eastern neighbours.

For some time now, the liquefied natural gas (LNG) terminal in the port of Klaipėda has allowed the country to be technically independent of Russian gas, should that be necessary. Gas is supplied by Norway, as well as by the US (shale gas). The move to become independent of energy supplies from Russia and Belarus finally resulted in Lithuania ceasing to import not only Russian gas, but also Russian oil and electricity at the end of May 2022. In the case of Belarus, Lithuania had already ceased purchasing electricity by the end of 2021. The Lithuanian government opposed the commissioning of the Astravets nuclear power plant in Belarus, viewing it as an imminent danger to the health and safety of its people.

The ongoing deterioration in business sentiment suggests tough times ahead, but this will be partly offset by public infrastructure investment. September 2022 saw a marked decline in confidence in all sectors for the second month in a row. Thus, investment plans will be revised, and entrepreneurs will run down their stocks in the coming months. While private investment is slowing down, public investment in 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 Lithuanian section of the railway started in mid-2022. Given the huge increase in the cost of building materials, we would expect a slowdown in road construction next year. And the uncertainty in terms of income and interest-rate development means that households will also reduce their investment in dwellings. Figures on construction permits granted show that fewer residential and commercial buildings will be erected in 2023. Overall investment is expected to revive more substantially only in 2024.

Contrary to earlier government plans, the economic downturn and the measures taken to offset the energy price increase will likely result in a budget deficit of around 4% of GDP in 2022. At the beginning of April, the government presented a package of anti-inflationary measures for households and enterprises, and in the months since it has expanded further: 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 gas and electricity. In addition, the poorest 110,000 households can apply for an additional energy support benefit. Even before the war in Ukraine, energy poverty was an important issue in Lithuania: in 2021, 22.5% of households reported being unable to keep the home adequately heated over the winter period (in the other Baltic states, the figure was below 5%).

Following the positive economic developments of 2021 and the beginning of this year, the employment rate even topped the pre-crisis level of 2019. Those sectors that were hit hard by the COVID-19 pandemic (such as hospitality, trade and transport) saw a substantial increase in jobs. The job vacancy rate in a couple of sectors remains high and is not expected to decline, given the tight situation in the labour market generally. Unemployment in 2022 will decline further to 6.2% on average. The anticipated slowdown in economic growth will put the brakes on further labour market improvement; however, the rise in the unemployment rate will be small – 7% in 2023. Thereafter we expect a further tightening to come soon.

Up to the beginning of October, more than 65,000 Ukrainian refugees had been registered in Lithuania – a figure that amounts to almost 2.5% of the population. Over the past few years, Lithuania has attracted numerous workers from Ukraine (and Belarus) on temporary work permits, in order to meet the demand for labour. Since the labour market is rather tight in Lithuania, enterprises are glad of the additional work force. As a result, half of the arriving refugees of working age – the majority of them women – are already in employment.

In light of the still positive growth dynamics in the second quarter of the year, we have revised our GDP forecast for 2022 upwards somewhat, to 2.1%. However, the effects of the war in Ukraine will bring a deceleration in economic activity in all sectors and via all channels. Thus, we forecast GDP growth to decline to 0.9% in 2023, and then to revive to 2.6% in 2024.

Table 6.12 / Lithuania: Selected economic indicators

	2019	2020	2021 ¹⁾	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average	2,794	2,795	2,801	.	.	2,820	2,830	2,820
Gross domestic product, EUR m, nom.	48,860	49,507	55,383	25,467	30,452	67,600	73,700	78,600
annual change in % (real)	4.6	-0.1	5.0	5.0	3.2	2.1	0.9	2.6
GDP/capita (EUR at PPP)	26,220	25,980	28,400	.	.	.	.	.
Consumption of households, EUR m, nom.	29,347	28,958	32,524	14,971	18,030	.	.	.
annual change in % (real)	3.0	-2.1	7.4	7.2	3.9	2.7	0.2	3.5
Gross fixed capital form., EUR m, nom.	10,482	10,424	11,691	5,356	6,130	.	.	.
annual change in % (real)	6.6	-1.8	7.0	14.3	2.4	2.0	3.2	5.0
Gross industrial production (sales)								
annual change in % (real)	3.0	-1.3	19.5	18.1	16.3	12.0	3.0	6.0
Gross agricultural production								
annual change in % (real)	10.1	10.3	-5.5	.	.	.	.	.
Construction industry								
annual change in % (real)	8.4	-1.6	4.6	6.2	3.1	.	.	.
Employed persons, LFS, th, average ²⁾	1,378	1,358	1,369	1,356	1,408	1,410	1,420	1,430
annual change in %	0.3	-1.5	0.8	-0.9	3.9	3.0	1.0	0.8
Unemployed persons, LFS, th, average ²⁾	92	126	105	109	86	93	107	99
Unemployment rate, LFS, in %, average ²⁾	6.3	8.5	7.1	7.5	5.9	6.2	7.0	6.5
Reg. unemployment rate, in %, eop ³⁾	8.7	16.1	10.2	12.9	8.6	.	.	.
Average monthly gross wages, EUR ⁴⁾	1,296	1,429	1,579	1,530	1,743	1,820	1,960	1,920
annual change in % (real, gross)	6.4	8.9	5.6	8.8	-2.2	-3.8	-0.5	1.6
Average monthly net wages, EUR ⁴⁾	822	913	1,002	974	1,095	1,150	1,070	1,210
annual change in % (real, net)	11.6	9.8	4.8	8.7	-3.5	-4.2	-0.5	1.2
Consumer prices (HICP), % p.a.	2.2	1.1	4.6	2.0	16.3	19.5	8.0	4.0
Producer prices in industry, % p.a.	0.0	-9.0	9.5	4.2	25.5	28.0	9.0	3.0
General governm. budget, EUdef., % of GDP								
Revenues	35.2	35.7	37.7	.	.	38.0	37.0	36.0
Expenditures	34.8	42.9	38.7	.	.	41.0	39.5	38.0
Net lending (+) / net borrowing (-)	0.5	-7.3	-1.0	.	.	-3.0	-2.5	-2.0
General gov. gross debt, EU def., % of GDP	35.9	46.6	44.3	.	.	42.0	42.0	40.0
Stock of loans of non-fin. private sector, % p.a.	3.3	-1.8	13.4	3.1	16.7	.	.	.
Non-performing loans (NPL), in %, eop	1.6	1.3	0.7	0.9	0.6	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	1,733	3,637	631	481	-1,943	-4,200	-4,400	-4,200
Current account, % of GDP	3.5	7.3	1.1	1.9	-6.4	-6.2	-6.0	-5.3
Exports of goods, BOP, EUR m	25,954	25,535	31,648	14,322	18,911	38,600	41,500	44,500
annual change in %	5.7	-1.6	23.9	22.2	32.0	22.0	7.5	7.2
Imports of goods, BOP, EUR m	28,303	25,940	34,544	15,567	22,326	45,700	50,100	53,400
annual change in %	3.3	-8.3	33.2	29.0	43.4	32.3	9.6	6.6
Exports of services, BOP, EUR m	11,864	10,921	13,571	6,325	7,897	16,500	17,800	19,100
annual change in %	22.6	-8.0	24.3	20.3	24.9	21.6	7.9	7.3
Imports of services, BOP, EUR m	6,914	5,886	8,137	3,515	5,003	10,800	11,800	12,600
annual change in %	15.1	-14.9	38.2	22.7	42.3	32.7	9.3	6.8
FDI liabilities, EUR m	3,060	3,979	2,512	724	83	1,000	.	.
FDI assets, EUR m	1,921	3,438	1,296	348	-1,008	-1,700	.	.
Gross reserves of CB excl. gold, EUR m	4,273	3,662	4,626	4,244	4,846	.	.	.
Gross external debt, EUR m	34,267	37,493	43,239	39,029	42,007	41,900	44,200	45,600
Gross external debt, % of GDP	70.1	75.7	78.1	70.5	62.1	62.0	60.0	58.0

1) Preliminary. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of working age population. - 4) Including the employers' social security contribution and earnings of sole proprietors. - 5) Official refinancing operation rate for euro area (ECB).

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