

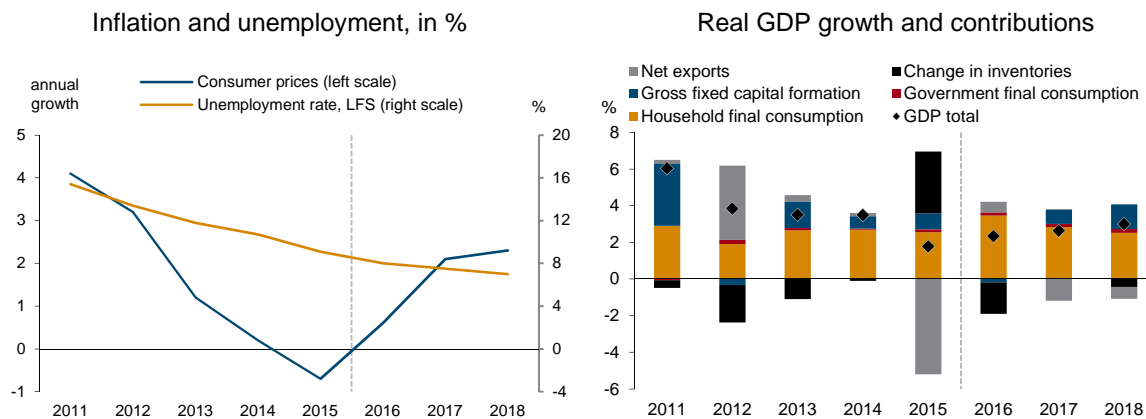


LITHUANIA: Wage increases push consumption

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Throughout 2016 economic growth in Lithuania has continued to be dampened by the slump in external demand both from the CIS economies and for oil products. Moreover, public investment has reached its nadir before fresh funds from the EU bring about an upswing in 2017. That notwithstanding, stable growth in terms of employment and rapid wage increases has resulted in consumer demand developing at a swift pace. For 2016, we forecast a moderate GDP growth rate of 2.3%, followed by an upswing to 2.6% and 3% in 2017 and 2018, respectively.

Figure 34 / Lithuania: Main macroeconomic indicators



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

Following a revival in the first months of 2016, trade became stagnant again in the 2nd and 3rd quarters of this year. Rising exports to Nordic countries and the United States can only compensate for the still declining volumes destined for Russia. After a slump in exports to the Eastern neighbour of about 40% in nominal terms in 2015, we expect a stabilisation towards the end of the current year. A strong recovery of the Russian economy and thus a swift upswing of Lithuanian exports from 2017 onwards are, however, not likely. Another reason for stagnating exports was the slump in external demand for refined oil products and the fall in prices, squeezing the profits of the Lithuanian refinery Mazeiku Nafta, which accounts for about a third of the country's total exports. The transport sector, being strongly exposed to Russian transit trade, is currently hit less than expected. Moreover, also tourism exports developed at a fast pace in the first half of 2016. Although household demand evolves well, imports

increase – in value added terms – below the rate of exports due to low investment activity this year. While the current account deficit is likely to decline in 2016, over the medium term it will attain 3% of GDP.

Gross fixed capital investment dropped by more than 3% in real terms in the first half of 2016. This is mainly a result of the decline in public capital expenditures – a reduction of about 10% from the 2015 level was envisaged in the 2016 budget. Similar to other new EU Member States, Lithuania is experiencing a depression phase of the investment cycle driven by EU structural funds. However, for 2017 the budget 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 railway network. The construction of dwellings started to increase gradually in the second quarter of 2016 and the rising number of building permits indicates that the upswing will continue next year as well. Also, the mortgage loan portfolio of households started to grow again more swiftly in the first half of this year after having stagnated since 2008.

The fall in prices for imports, particularly of oil and gas, still drags on overall price developments in Lithuania. Producer prices fell by more than 8% in the first half of 2016, while consumer inflation is stagnant. This is particularly remarkable as average gross wages continued to increase substantially; in the first half of 2016 by almost 7% year on year in real terms. Stronger economic stimulus in the rest of the EU and higher investment activity are going to lead to rising consumer inflation in 2017 and 2018. Employment is expected to increase this year by close to 2%. Apart from construction, agriculture and transport (the latter two being hit by the Russian crisis and embargo), job growth is eminent in all sectors of the economy, particularly in recreational and business services. Simultaneously, however, net outward migration is continuing and likely to attain about 1% of the Lithuanian labour force also in 2016. The employment rate of those aged 15-64 reached 76%, almost the level of Germany, and the unemployment rate is likely to drop to about 8% of the labour force.

In September 2016 the parliament finally enacted the laws of the 'New social model', a comprehensive reform package of the labour law and complementary laws concerning the social protection and pension system which was intensively contested this and past year. The core of the new laws is the liberalisation of labour contracts: notice periods for dismissals and severance payments have been reduced and the possibility of atypical work and overtime expanded. Labour unions have opposed the new laws, arguing that these result in a reduction of guarantees for employees in general and for working parents in particular. Apart from a reduction of employers' social contributions, the reforms also foresee an indexation of public pensions to the average wage development.

The resistance of the public against the labour market liberalisation package proved to be disastrous for the incumbent Social Democrats and its coalition partners in the parliamentary elections which took place in October 2016. The centre-conservative 'Peasant and Greens Union' party won a landslide victory and will most probably form a government with the conservative 'Homeland Union'. The political and economic guidelines of the incoming coalition do not differ substantially from those of the leaving government. The budget proposal of the outgoing government for 2017 foresees increased expenditures due to the enactment of the 'New social model', a further increase of the minimum wage and the non-taxable income bracket and another hike in the defence budget with the aim to attain a level of 2% of GDP by 2018.

Given the improving situation in the labour market and strongly rising incomes, household consumption remains the most important driver of growth for the Lithuanian economy in 2016 and the years thereafter. Slightly reducing our July forecast, we expect GDP to expand by 2.3% in 2016, followed by an upswing to 2.6% in 2017 and 3% in 2018. The assumed drivers of that growth are an economic stabilisation in the eastern neighbourhood and growth in the euro area gaining momentum. Moreover, public investment activity should be facilitated by inflows of EU funds from the 2014-2020 planning period. The budget deficit will fall below 1% of GDP already in 2016 due to tax revenues being above expectations. In the years to follow it will drop even further, resulting in a continuously falling public debt to GDP ratio.

Table 17 / Lithuania: Selected economic indicators

	2012	2013	2014	2015 ¹⁾	2015 January-June	2016	2016 Forecast	2017 Forecast	2018
Population, th pers., average	2,988	2,958	2,932	2,905	.	.	2,880	2,860	2,840
Gross domestic product, EUR-LTL mn, nom.	33,348	35,002	36,590	37,331	17,680	18,154	38,400	40,200	42,400
annual change in % (real)	3.8	3.5	3.5	1.8	1.6	2.1	2.3	2.6	3.0
GDP/capita (EUR at exchange rate)	11,200	11,800	12,500	12,900	.	.	13,300	14,100	14,900
GDP/capita (EUR at PPP)	18,500	19,600	20,700	21,300	.	.	.	.	.
Consumption of households, EUR-LTL mn, nom.	20,690	21,792	22,762	23,486	11,224	11,978	.	.	.
annual change in % (real)	3.1	4.3	4.3	4.1	3.5	5.8	5.5	4.5	4.0
Gross fixed capital form., EUR-LTL mn, nom.	5,788	6,458	6,770	7,195	3,238	3,208	.	.	.
annual change in % (real)	-1.8	8.3	3.7	4.7	6.0	-1.2	-1.0	4.0	7.0
Gross industrial production (sales)									
annual change in % (real)	3.7	3.4	0.0	4.8	5.1	2.7	3.5	5.0	4.0
Gross agricultural production									
annual change in % (real)	14.2	-1.8	8.4	5.3	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.2	11.3	17.0	-3.5	8.2	-14.8	.	.	.
Employed persons, LFS, th, average	1,276	1,293	1,319	1,335	1,327	1,359	1,360	1,370	1,375
annual change in %	1.8	1.3	2.0	1.2	1.9	2.4	1.9	0.7	0.4
Unemployed persons, LFS, th, average	197	173	158	134	142	121	118	111	103
Unemployment rate, LFS, in %, average	13.4	11.8	10.7	9.1	9.7	8.2	8.0	7.5	7.0
Reg. unemployment rate, in %, end of period ²⁾	11.4	11.1	9.3	9.0	8.5	7.4	.	.	.
Average monthly gross wages, EUR-LTL ³⁾	615	646	677	714	706	760	770	830	900
annual change in % (real, gross)	0.7	4.0	4.7	6.4	5.7	6.7	6.5	6.0	5.7
Average monthly net wages, EUR-LTL ³⁾	478	501	527	554	549	592	590	640	690
annual change in % (real, net)	0.5	3.8	5.1	6.1	5.4	7.0	6.3	5.8	5.3
Consumer prices (HICP), % p.a.	3.2	1.2	0.2	-0.7	-0.8	0.5	0.6	2.1	2.3
Producer prices in industry, % p.a.	5.0	-2.4	-4.9	-9.7	-9.0	-8.1	-7.0	2.5	3.5
General government budget, EU-def., % of GDP									
Revenues	33.0	32.9	34.0	34.8	.	.	34.0	33.4	33.0
Expenditures	36.1	35.5	34.7	35.0	.	.	34.9	34.0	33.5
Net lending (+) / net borrowing (-)	-3.1	-2.6	-0.7	-0.2	.	.	-0.9	-0.6	-0.5
Public debt, EU-def., % of GDP	39.8	38.7	40.5	42.5	.	.	41.0	40.0	39.0
Central bank policy rate, % p.a., end of period ⁴⁾	0.52	0.27	0.12	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-393	539	1,317	-872	-987	-417	-850	-1,130	-1,250
Current account, % of GDP	-1.2	1.5	3.6	-2.3	-5.6	-2.3	-2.2	-2.8	-2.9
Exports of goods, BOP, EUR mn	22,426	23,998	23,750	22,310	10,681	10,391	22,100	23,400	25,000
annual change in %	15.5	7.0	-1.0	-6.1	-4.4	-2.7	-0.9	5.9	6.8
Imports of goods, BOP, EUR mn	23,529	24,917	24,686	24,296	11,977	11,360	23,800	25,500	27,300
annual change in %	9.5	5.9	-0.9	-1.6	1.9	-5.2	-2.0	7.1	7.1
Exports of services, BOP, EUR mn	4,793	5,390	5,850	6,011	2,837	3,169	6,700	7,400	8,300
annual change in %	18.8	12.5	8.5	2.7	1.7	11.7	11.5	10.4	12.2
Imports of services, BOP, EUR mn	3,404	4,033	4,212	4,266	2,051	2,137	4,400	4,800	5,400
annual change in %	23.1	18.5	4.4	1.3	1.5	4.2	3.1	9.1	12.5
FDI liabilities (inflow), EUR mn	454	531	387	873	295	-254	0	.	.
FDI assets (outflow), EUR mn	215	322	382	164	-128	364	450	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	6,203	5,705	6,991	1,376	1,910	2,043	.	.	.
Gross external debt, EUR mn	26,031	24,596	25,551	28,332	28,564	31,394	30,700	34,200	36,000
Gross external debt, % of GDP	78.1	70.3	69.8	75.9	76.5	81.8	80.0	85.0	85.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LTL/EUR	0.6027	0.6042	0.6033	0.6047	.	.	.	.	.

Note: Lithuania has introduced the Euro from 1 January 2015. Up to and including 2014 all time series in LTL as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 3.4528 (LTL per EUR) to achieve euro-fixed series (EUR-LTL).

1) Preliminary. - 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.