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Lithuania's economic development and outlook

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Economic activity in Lithuania has been gradually picking up. Positive shifts were visible in both tradable and non-tradable sectors. Following the previous slowdown, transport activity fully regained its strength and is still continuing on its upward climb, thus providing a major positive boost to export of services. Such developments in the transport sector are underpinned, among other things, by foreign demand, which is increasing less than the scale of activity of transport companies. These companies take up an increasingly larger share in export markets, where they compete with carriers from other countries. Manufacturing, excluding mineral products, has also picked up steam: recently the volume of production sold in domestic and foreign markets has been growing.

Other economic activities have seen positive developments as well. For several years, information and communication services have been greatly expanding. As demand increases, activity in professional, administration and other services is intensifying. Growing housing market reinforced development of real estate activities. After deteriorating for more than a year, the situation in the construction sector started showing signs of upward momentum at the end of last year as the flow of EU funds began to stabilise.

Growing economy is triggering problems in the labour market. An increasingly larger share of enterprises find it hard to expand their activities due to insufficient labour resources. It was difficult to source new employees even during the recent economic slowdown (2015–2016). For several years the job vacancy rate has been rising, while the number of unemployed persons per job opening was dipping down. There are not only less qualified unemployed persons, but also less unqualified persons looking for a job.

All this has significant implications for the majority of macroeconomic indicators. Firstly, wage dynamics come under pressure. Last year, the average wage showed the highest increase since the economic recovery after the global financial crisis. One should note that minimum wage was also rising, yet wage development was vigorous even having eliminated its effect. It is important to note that wages are rising more than labour productivity. Unit labour costs, which show the difference between average wage and labour productivity growth, have been growing more noticeably since the end of 2014. Labour share in total value added has been increasing as well. It has surpassed its historical average for more than two years.

The labour market will remain in the doldrums in the projection horizon. Since increasingly less young residents enter the labour market each year and a considerable number of persons are emigrating, labour shortage will continue to be a prevalent issue in the future. This will dampen the enterprise expansion outlook, continue to put further pressure on wage dynamics and elevate the need to find new solutions to enhance corporate competitiveness.

Consumer-conducive labour market, increasing domestic demand and export markets will be major factors stimulating economic activity in the upcoming years. Rising labour income will translate into higher household consumption. However, consumption should not boost as much as in recent years, since prices are projected to continue their upward climb, whereas growth in labour income is expected to be less pronounced given the static growth in minimum wage. Economic activity will be also driven by another domestic demand component, namely investment. The flow of EU funds intended for capital formation is projected to expand considerably, hence investment expenditure should intensify, spurring further recovery in construction. In addition to domestic demand, international economic environment will also provide a positive boost to economic development. Current estimations suggest that this year imports of Lithuania's trade partners will rise in both the euro and non-euro area, potentially stimulating activity in Lithuania's exporting sector. According to current projections, Lithuania's real GDP will be 2.6 per cent larger year on year. Next year its growth rate will reach 2.8 per cent.

At the end of 2016, inflation shot up and should continue rising this year. For a long time, the decline in global oil prices was favourable to consumers, scaling down inflation. Nonetheless, as the Organization of the Petroleum Exporting Countries (OPEC) undertook to curb oil extraction, energy resource prices rose, boosting consumer price levels, primarily fuel prices, in Lithuania as of November 2016. Higher oil prices will also have an impact on prices of other goods and services. For example, a plunge in administered prices in 2016 weighted significantly on inflation. Due to higher oil prices, the impact of administrated prices on inflation will be less negative in 2017. Moreover, steeper energy prices affect production costs for the majority of goods on the back of increased fuel and transport costs, while food prices will be influenced by fertilizer prices as well. Finally, an upsurge in food prices in

Lithuania stemmed from rising global food commodity prices and poor harvest in Southern Europe at the end of 2016. According to the projections of the Food and Agriculture Organisation of the United Nations, global food commodity prices will continue following a moderate upward trajectory in 2017. Hence consumer food prices should rise even more in the near future. Core inflation, excluding food, fuel and administered prices, is close to 2 per cent and changing moderately. It is propelled by increasing labour costs and domestic demand, yet prices of industrial goods, which are posting only moderate increases due to international economic trends, drags it down. It is projected that inflation will stand at 2.8 per cent in 2017. Such a surge is seen to be short-term. As of now, greater growth in global commodity prices in 2018 is not expected. Thus inflation rate is projected to decline next year, amounting to 2.2 per cent in 2018.

Outlook for Lithuania's economy in 2016–2018

	March 2017 projection[a]			December 2016 projection		
	2016[b]	2017[b]	2018[b]	2016[b]	2017[b]	2018[b]
Price and cost developments (annual percentage changes)						
Average annual inflation, as measured by the HICP	0.7	2.8	2.2	0.6	1.9	–
GDP deflator[c]	0.6	2.4	2.2	0.7	2.0	–
Wages	7.9	6.1	5.7	7.3	5.7	–
Import deflator[c]	–5.3	4.0	2.0	–4.9	2.3	–
Export deflator[c]	–4.8	2.8	1.9	–4.2	1.9	–
Economic activity (constant prices; annual percentage changes)						
Gross domestic product[c]	2.3	2.6	2.8	2.0	2.4	–
Private consumption expenditure[c]	5.2	3.8	3.6	4.8	3.8	–
General government consumption expenditure[c]	1.2	1.2	1.2	1.2	1.2	–
Gross fixed capital formation[c]	–0.3	4.6	5.9	–1.0	2.1	–
Exports of goods and services[c]	3.3	3.0	4.4	3.0	3.0	–
Imports of goods and services[c]	1.7	4.2	5.3	2.0	3.4	–
Labour market						
Unemployment rate (annual average as a percentage of labour force)	7.9	7.3	7.1	8.0	7.4	–
Employment (annual percentage change)[d]	2.0	0.0	0.0	2.0	0.0	–
External sector (as a percentage of GDP)						
Balance of goods and services	0.9	–0.7	–1.4	0.6	–0.1	–
Current account balance	–0.7	–1.7	–2.3	–0.7	–0.7	–
Current and capital account balance	0.7	0.7	0.3	0.5	1.3	–

[a] These projections of macroeconomic indicators are based on information made available by 15 February 2017
[b] Projection
[c] Adjusted for seasonal and workday effects
[d] National accounts data; employment in domestic concept