# 11. LITHUANIA
## Continued GDP growth despite global slowdown

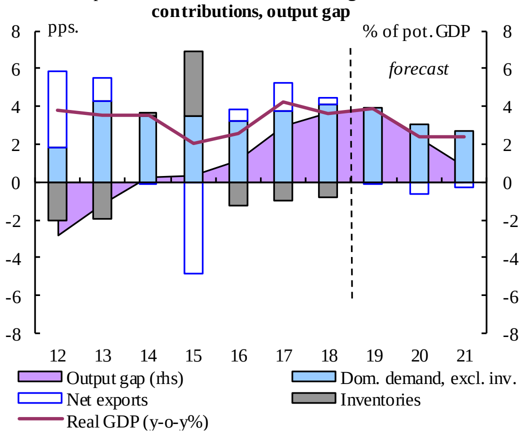
*Real GDP growth is projected to pick up slightly in 2019, as strong domestic demand and resilient exports continue to support the Lithuanian economy. Due to the weak outlook in major trading partners, however, growth will depend increasingly on domestic demand in 2020 and 2021. Inflation is forecast to moderate marginally in the coming years. Increasing government expenditure is set to reduce the general government surplus to zero.*

### The momentum of broad-based growth

In the first half of 2019, Lithuania's real GDP grew by 4.2% (y-o-y) thanks to a combination of favourable factors. Growth in gross fixed capital formation was supported by investment in equipment and non-residential construction, which is partly linked to an acceleration in the use of EU funds. This, combined with an increase in public sector wages, contributed to government consumption growth. Furthermore, increasing employment and solid wage growth together with lower labour taxation and positive household expectations, have kept the real growth of private consumption above 3% y-o-y.

At the same time, despite a deceleration in the exports of goods in the second quarter of 2019, double-digit growth of trade in services kept net exports positive. This together with a positive balance of secondary income, helped the current account to remain in surplus.

*Graph II.11.1:* **Lithuania - Real GDP growth and contributions, output gap**




### Domestic demand as the main driver of growth

After a solid performance in the first half of 2019, annual real GDP growth is forecast to reach 3.8%, which is somewhat higher than in 2018. This is also partly due to projected better outcomes of the agricultural sector compared with last year's results.

However, given the weak external environment expected in 2020 and 2021, growth is forecast to rely on domestic demand developments and is therefore projected to moderate to 2.4%. Private consumption growth is expected to remain strong, on the back of an increase in the untaxed allowance for personal income, pension indexation, as well as rising minimum wages and a strong labour market. Consumption growth is expected to remain above three percent over the forecast horizon.

EU-funded investments seem to have reached cruising speed this year and are projected to continue at a similar pace in 2020 and 2021. Private investment in equipment and intellectual property is set to remain an important growth factor as businesses continue to face labour shortages and a high level of capacity utilisation. Due to less favourable financing conditions, residential construction is forecast to contribute less to investment growth in the coming years.

A bleaker economic outlook in some of Lithuania's trading partners suggests a likely slowdown in export growth. Due to the high import content of exports and the dependence of investment on capital goods imports, the overall contribution of net exports to GDP growth is expected to be slightly negative in 2020 and 2021.

### Positive net migration

After a substantial increase in 2018, employment growth is expected to continue in 2019 and 2020. The main source of improvement is the historically high level of immigration, which is set to exceed the also high level of emigration. Though the number of vacancies remains high, to some extent, workers from non-EU countries are helping to ease labour shortages, especially in the transportation and construction sectors. Overall, the unemployment rate, after declining significantly in 2018, is projected to stand at 6.2% over the forecast horizon. At the same time, increases in the minimum wage and the tight labour market situation are expected to drive wages up, albeit more slowly than in 2018.

### Slightly lower inflation ahead

Compared to 2018, HICP inflation is forecast to decline marginally to 2.4% in 2019. Higher prices of some food products, coupled with increases in service prices, should prevent any sudden drop in inflation. In the coming years, wages should continue growing strongly enough to maintain a rise in service prices. However, this effect, together with scheduled increases in excise duties on alcohol and tobacco products, is expected to be somewhat counterbalanced by a projected fall in oil prices. Overall, in 2020 and 2021, HICP inflation is forecast to decrease slightly to 2.2% and 2.1%, respectively.

### Modest fiscal outlook

After three years in surplus, the general government budget is forecast to move into balance from 2019 onwards. The decline in the nominal balance in 2019 is linked to higher-than-planned government expenditures, particularly on wages and social benefits, as well as some other unplanned additional expenses. At the same time, the government revenue side is being negatively affected by the labour taxation reform.

Compared to 2018, the structural balance is projected to deteriorate substantially to -1½% in 2019, followed by a gradual improvement to -½% in 2021 as the positive output gap diminishes.

In preparation for an upcoming bond redemption in early 2020, Lithuania has been accumulating pre-financing in 2019. Consequently, this is projected to drive the debt-to-GDP ratio to 36.3%, compared with 34.1% in 2018. The positive effect of the scheduled bond redemption is set to be somewhat counterbalanced by a continuous accumulation of necessary funds for the same exercise in 2021 and 2022. Therefore, the debt-to-GDP ratio is forecast to remain rather stable in the coming years.

*Table II.11.1:*

**Main features of country forecast - LITHUANIA**

| | 2018 | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **bn EUR Curr. prices** | **% GDP** | **00-15** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** |
| GDP | 45.3 | 100.0 | 4.1 | 2.6 | 4.2 | 3.6 | **3.8** | **2.4** | **2.4** |
| Private Consumption | 28.0 | 61.8 | 4.4 | 4.0 | 3.5 | 3.7 | **3.3** | **3.2** | **3.1** |
| Public Consumption | 7.5 | 16.5 | 1.0 | 0.1 | -0.3 | 0.5 | **1.4** | **0.8** | **0.5** |
| Gross fixed capital formation | 9.3 | 20.5 | 4.8 | 3.4 | 8.2 | 8.4 | **8.0** | **4.4** | **3.5** |
| of which: equipment | 3.3 | 7.3 | 6.6 | 14.6 | 9.2 | 7.3 | **3.4** | **3.0** | **2.7** |
| Exports (goods and services) | 34.2 | 75.6 | 9.5 | 4.9 | 13.6 | 6.3 | **6.8** | **3.6** | **3.0** |
| Imports (goods and services) | 33.4 | 73.7 | 8.7 | 4.0 | 11.5 | 6.0 | **7.1** | **4.6** | **3.4** |
| GNI (GDP deflator) | 43.8 | 96.8 | 4.0 | 2.5 | 4.2 | 4.2 | **4.1** | **2.5** | **2.5** |
| Contribution to GDP growth: Domestic demand | | | 4.3 | 3.2 | 3.8 | 4.1 | **3.9** | **3.0** | **2.7** |
| Inventories | | | 0.2 | -1.3 | -1.0 | -0.8 | **0.0** | **0.0** | **0.0** |
| Net exports | | | -0.2 | 0.6 | 1.5 | 0.4 | **0.0** | **-0.6** | **-0.3** |
| Employment | | | -0.5 | 2.3 | -0.7 | 1.4 | **0.2** | **0.1** | **0.0** |
| Unemployment rate (a) | | | 11.7 | 7.9 | 7.1 | 6.2 | **6.2** | **6.2** | **6.2** |
| Compensation of employees / head | | | 6.8 | 6.4 | 9.5 | 7.7 | **7.0** | **4.4** | **4.0** |
| Unit labour costs whole economy | | | 2.0 | 6.1 | 4.3 | 5.3 | **3.3** | **2.1** | **1.6** |
| Real unit labour cost | | | -0.7 | 4.4 | 0.1 | 1.9 | **-0.3** | **-1.2** | **-0.8** |
| Saving rate of households (b) | | | 3.4 | 2.9 | 0.3 | -1.2 | **-0.6** | **-2.0** | **-1.7** |
| GDP deflator | | | 2.7 | 1.6 | 4.3 | 3.3 | **3.6** | **3.3** | **2.4** |
| Harmonised index of consumer prices | | | 2.4 | 0.7 | 3.7 | 2.5 | **2.4** | **2.2** | **2.1** |
| Terms of trade goods | | | 0.9 | 1.8 | 0.5 | -1.0 | **1.1** | **1.2** | **0.8** |
| Trade balance (goods) (c) | | | -8.5 | -4.9 | -4.9 | -6.1 | **-6.5** | **-6.9** | **-7.2** |
| Current-account balance (c) | | | -4.7 | -1.1 | 0.5 | 0.3 | **1.2** | **1.5** | **1.8** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | -2.8 | 0.3 | 1.7 | 1.8 | **2.8** | **3.2** | **3.6** |
| General government balance (c) | | | -3.0 | 0.2 | 0.5 | 0.6 | **0.0** | **0.0** | **0.0** |
| Cyclically-adjusted budget balance (d) | | | -2.5 | -0.2 | -0.7 | -0.9 | **-1.5** | **-0.9** | **-0.3** |
| Structural budget balance (d) | | | - | -0.4 | -0.8 | -0.8 | **-1.6** | **-0.9** | **-0.3** |
| General government gross debt (c) | | | 27.3 | 39.9 | 39.3 | 34.1 | **36.3** | **35.1** | **34.8** |

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.