11. LITHUANIA

Lithuania's economy withstood the initial blow of the COVID-19 pandemic relatively well. Recent data point to a strong recovery in the second half of 2020, although the unemployment rate is forecast to remain elevated in the near term. A significant stimulus package has helped to preserve jobs but has inflated the deficit and public debt. Growth is expected to slow in the coming years due to the fragile situation of international trade and moderation in domestic demand.

GDP held up better than expected

Lithuania was the only euro area Member State that did not see real GDP decline in the first quarter of the year. Measures to stem the COVID-19 pandemic and general uncertainty took their toll in the second quarter when real GDP contracted by 5.9%. A decline in domestic demand was the key reason behind the slump. Private consumption was markedly affected by the closure of most retail shops and the catering sector during the lockdown and uncertainty about labour income, while a drop in investments was already recorded in the fourth quarter of 2019.

At the same time, net exports mitigated the situation as exports fell less than imports. One of the reasons for the resilience of exports was the relative stability of foreign demand for the lower value-added export goods that account for a considerable share of Lithuania's industrial production. In addition, Lithuania is less dependant on inbound tourism. Timely virus containment measures at the start of the pandemic helped the economy as well.

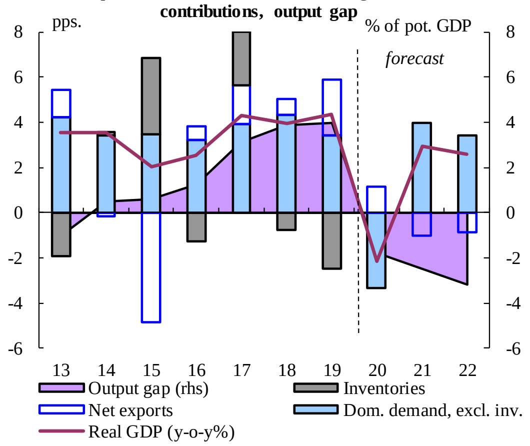
Private consumption started to recover as early as May, while industrial production picked up more considerably in June. This positive trend continued into the third quarter and is confirmed by improvements in sentiment indicators. Taking into account the good results expected in agriculture, real GDP in the third quarter is projected to rebound. However, a recent increase in the COVID-19 infection rate and corresponding measures to fight it are set to weigh on economic indicators. For the year 2020 as a whole, real GDP is projected to shrink by approximately 2¼%.

Moderate rebound in 2021 and 2022

Exports, including of transportation services, have been an important growth factor for Lithuania's economy in the last three to four years. However, the fragile situation in international trade and requirements stemming from reforms in the EU road transport sector are expected to cool this trend in coming years. Slower increases in minimum wages and salaries in the public sector and restrictions related to COVID-19, point to less dynamic consumption in the near term.

On the other hand, accelerated EU investment and additional projects initiated by the government in response to the COVID-19 crisis are projected to drive increases in overall gross capital formation. Overall, Lithuania's GDP growth is forecast to reach 3% in 2021 and then stay slightly above 2½% in 2022.

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



Positive net migration again

Net migration was positive for the first time in 2019 and is very likely to be so again in 2020, though it is still early to speak of a reversal of the long-standing trend. The available 2020 data points to an elevated flow of immigrants, among which approximately half are returning nationals. At the same time, the lockdown and the relatively better epidemiological situation in the country compared to many others could slightly reduce emigration of Lithuanians in 2020.

The pandemic has put a number of jobs at risk, especially in the service sector. The unemployment rate rose from 6.1% in January to 9.6% in August.

To mitigate the situation, the Lithuanian government introduced a number of measures to protect employment and provide additional support for job seekers. The pick-up in economic activity should bring the unemployment rate down gradually. It is set to decline from a forecast rate of 8.9% in 2020 to 8.0% in 2021 and should continue falling in 2022.

Service prices continue to drive inflation up

In 2020, HICP inflation is being pulled in opposite directions by energy and service prices. While the prices of oil, gas and biomass have dropped, service prices have risen, particularly for catering, social protection, services related to housing, and medical services. Food has become more expensive as well. Overall, headline inflation is forecast to stand at 1.3% in 2020. With the economic recovery, inflation is expected to rise to 1.5% and 1.7% in 2021 and 2022, respectively.

Higher deficits to fuel a sharp increase in debt

In response to the COVID-19 crisis, the government adopted a sizeable stimulus package in March and added more measures later in the year. It is expected that additional spending, which mainly consist of various subsidies, benefits and investment projects, will amount to almost 6% of GDP in 2020. Overall, increased expenditure and automatic stabilisers are forecast to drive the general government deficit to 8½% of GDP in 2020.

While most COVID-19 related measures expire in 2020, the 2021 draft budget contains new expenditure measures amounting to almost 2% of GDP. For example, the government has decided to increase wages in the public sector and has also suggested some legal changes that would allow pension indexation, which would not be possible under the current rules. Overall, due to the gradual reduction in stimulus, the deficit in 2021 is forecast to amount to 6% of GDP, of which 1.5 pps. is expected to be eventually financed by the Recovery and Resilience Facility. In 2022, under a no-policy change assumption, the general government balance is forecast to stand at -2¾%.

Due to the large deficits projected, the debt-to-GDP ratio is expected to rise from 35.9% in 2019 to approximately 47¼% in 2020 and then further to 50¾% in 2021.

Table II.11.1:

Main features of country forecast - LITHUANIA

	2019		Annual percentage change						
	bn EUR Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	48.8	100.0	4.1	4.3	3.9	4.3	**-2.2**	**3.0**	**2.6**
Private Consumption	29.5	60.5	4.3	3.5	3.7	3.4	**-3.5**	**3.2**	**3.3**
Public Consumption	8.2	16.8	1.0	-0.3	0.2	0.1	**3.8**	**1.1**	**-1.0**
Gross fixed capital formation	10.4	21.4	5.5	8.9	10.0	6.2	**-8.5**	**9.6**	**7.9**
of which: equipment	3.4	7.0	7.5	9.2	8.0	3.6	**-13.1**	**10.7**	**6.4**
Exports (goods and services)	37.8	77.5	8.9	13.5	6.8	9.5	**-4.9**	**6.8**	**4.9**
Imports (goods and services)	35.3	72.2	8.5	11.1	6.0	6.3	**-6.8**	**9.1**	**6.6**
GNI (GDP deflator)	47.1	96.5	3.9	4.2	4.5	4.0	**-2.6**	**3.3**	**2.7**
Contribution to GDP growth: Domestic demand			4.3	-0.1	4.3	3.4	**-3.3**	**4.0**	**3.4**
Inventories			0.2	2.6	-1.1	-1.5	**0.0**	**0.0**	**0.0**
Net exports			-0.3	1.7	0.7	2.5	**1.2**	**-1.0**	**-0.9**
Employment			-0.1	-0.7	1.4	0.5	**-2.8**	**0.3**	**0.5**
Unemployment rate (a)			11.2	7.1	6.2	6.3	**8.9**	**8.0**	**6.9**
Compensation of employees / head			7.2	9.5	7.9	10.2	**3.0**	**3.3**	**2.5**
Unit labour costs whole economy			2.9	4.3	5.2	6.1	**2.3**	**0.6**	**0.4**
Real unit labour cost			0.1	0.0	1.6	3.2	**0.8**	**-1.7**	**-2.2**
Saving rate of households (b)			3.2	0.1	0.2	4.1	**10.6**	**8.7**	**5.9**
GDP deflator			2.7	4.2	3.5	2.8	**1.5**	**2.4**	**2.6**
Harmonised index of consumer prices			2.4	3.7	2.5	2.2	**1.3**	**1.5**	**1.7**
Terms of trade goods			0.6	0.4	-1.0	1.3	**1.0**	**0.3**	**0.2**
Trade balance (goods) (c)			-8.2	-4.9	-6.1	-4.8	**-2.1**	**-3.3**	**-4.1**
Current-account balance (c)			-4.5	0.5	0.3	3.3	**4.6**	**3.7**	**2.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-2.4	1.8	1.9	5.2	**6.7**	**6.0**	**5.3**
General government balance (c)			-2.3	0.5	0.6	0.3	**-8.4**	**-6.0**	**-2.8**
Cyclically-adjusted budget balance (d)			-2.1	-0.8	-1.0	-1.3	**-7.7**	**-5.0**	**-1.5**
Structural budget balance (d)			-	-0.8	-1.0	-1.3	**-7.7**	**-5.0**	**-1.5**
General government gross debt (c)			28.3	39.1	33.7	35.9	**47.2**	**50.7**	**49.5**

(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.