

11. LITHUANIA

The COVID-19 pandemic forced a temporary closure of many economic activities in Lithuania. This is expected to cause a sizeable GDP contraction in 2020. Possible relaxation of lockdown measures in the second quarter of 2020 and the government's economic stimulus plans provide hope for a quick recovery over the forecast horizon. At the same time, this economic shock is projected to drive increases in the unemployment rate and the general government deficit.

A rollercoaster ride ahead

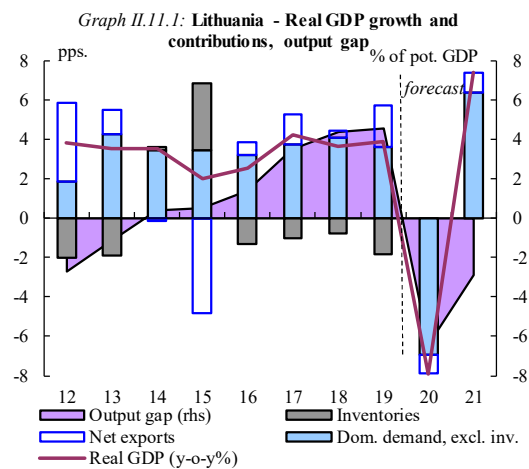
After a long period of above-potential growth, the sudden arrival of the COVID-19 pandemic in Europe swept away a scenario of gradual deceleration for Lithuania's economy. Since 16 March, the country has been in lockdown, with many economic activities effectively suspended. International and national travel restrictions have put a strain on accommodation services and related passenger transport and tourism. Declining international demand for goods in the EU has started to have a negative effect on producers and providers of transportation services which had supported growth over the past years.

Such an unprecedented suspension of economic activity will drag down Lithuania's GDP in the second quarter of 2020. The exact size of the dip depends on the length of the confinement period in the country and the exit strategies in Lithuania and abroad. Assuming the lockdown comes to an end in the second quarter, GDP growth is expected to stage a strong rebound in the third quarter as a result of base effects. However, output is expected to stay below the volume of the first quarter of 2020 as different factors will weigh on growth drivers.

Domestic demand is forecast to be negatively affected by declining household income and, as a consequence, limited possibilities to borrow. Investment activities are expected to be put on halt by many businesses due to liquidity issues and uncertainty in 2020. As a result of the confinement period, the implementation of EU-funded projects is also forecast to slow in 2020 and drop below the level of 2019. However, thanks to EU-level initiatives, the use of EU funds is expected to gain speed again in 2021.

Export recovery is projected to depend, in the short term, on the economic strength of Lithuania's Nordic trading partners, while demand in the southern EU Member States is expected to stay suppressed in the near term. On the other hand, a

combination of lower demand for refined oil products and a sharp decline in oil prices is set to put pressure both on Lithuania's imports and exports over the forecast horizon.



Lithuania's economic recovery is also expected to be supported by the government's 'Plan for Economic Stimulus and Mitigation of Consequences of COVID-19 Transmission'. The measures of this plan are projected to increase government consumption slightly in 2020 as a consequence of higher spending on healthcare.

Overall, Lithuania's GDP is forecast to decline by approximately 8% in 2020 and then rebound by 7½% in 2021.

Measures taken to reduce job losses

The introduction of quarantine requirements affected the employment of workers in the service sector and a large share of the self-employed. A number of companies took measures to limit hours worked while keeping people employed. In some cases, workers took unpaid leaves. With a view to job protection, the government proposed to pay subsidies to companies that would retain their employees during and after the quarantine period. Overall, the unemployment rate is forecast to

remain contained below 10% in 2020 and decline in 2021.

Lower inflation ahead

In 2020, lost business revenues, lower overall profitability and a larger supply of labour are expected to put downward pressure on wages and, consequently, on prices of some products and services. Furthermore, as a result of cheaper oil and gas, energy prices are forecast to be lower than in 2019. Together with the rebound of the economy in 2021, domestic inflationary pressures are expected to return slowly. Overall, headline inflation is forecast to stand at 0.8% and 1.5% in 2020 and 2021, respectively.

Challenging times for public finances

In 2019, the general government recorded a nominal surplus of 0.3% of GDP. An improvement of the general government balance amounting to 0.6 pps. came from the fact that some military equipment ordered in 2019 is expected to be delivered in coming years, and, therefore, expenditure recording will be done at a later stage.

With regard to the COVID-19 pandemic, the

declared size of government measures to increase funding for healthcare and to help safeguard jobs and disposable incomes amounts to EUR 1 billion or 2½% of GDP in 2020. In addition, the government decided to increase provision of state guarantees to businesses by EUR 1 billion to help companies preserve liquidity.

Overall, the implementation of the fiscal stimulus plan and impact of automatic stabilisers are forecast to push the general government deficit close to 7% of GDP in 2020. Due to the greater financing needs expected, the government has increased the country's borrowing limits by EUR 5 billion or approximately 12½% of GDP in 2020. In 2021, based on a no-policy-change assumption, the government deficit is projected to decline to 2¾% of GDP.

Due to a large general government deficit in 2020, the debt-to-GDP ratio is expected to rise from 36.3% in 2019 to approximately 48½%. This increase also comprises an accumulation of pre-financing needed for upcoming bond redemptions at the beginning of 2021. The debt-to-GDP ratio is projected to remain at a similar level in 2021.

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	3.9	-7.9	7.4
Private Consumption	28.0	61.8		4.4	4.0	3.5	3.7	3.2	-9.9	7.8
Public Consumption	7.5	16.5		1.0	0.1	-0.3	0.5	0.7	1.0	0.5
Gross fixed capital formation	9.3	20.5		4.8	3.4	8.2	8.4	7.4	-5.0	7.9
of which: equipment	3.3	7.3		6.6	14.6	9.2	7.3	4.6	-15.4	16.7
Exports (goods and services)	34.2	75.6		9.5	4.9	13.6	6.3	9.3	-12.5	13.5
Imports (goods and services)	33.4	73.7		8.7	4.0	11.5	6.0	6.7	-12.0	12.8
GNI (GDP deflator)	43.8	96.8		4.0	2.5	4.2	4.2	4.1	-8.6	8.2
Contribution to GDP growth:										
Domestic demand				4.3	3.2	3.8	4.1	3.6	-6.9	6.4
Inventories				0.2	-1.3	-1.0	-0.8	-1.8	0.0	0.0
Net exports				-0.2	0.6	1.5	0.4	2.1	-1.0	1.0
Employment				-0.5	2.3	-0.7	1.4	0.5	-3.5	2.0
Unemployment rate (a)				11.7	7.9	7.1	6.2	6.3	9.7	7.9
Compensation of employees / head				6.8	6.4	9.5	7.7	9.5	-8.2	7.4
Unit labour costs whole economy				2.0	6.1	4.3	5.3	5.9	-3.8	2.0
Real unit labour cost				-0.7	4.4	0.1	1.9	3.1	-5.6	-0.6
Saving rate of households (b)				3.4	2.9	0.3	-1.2	1.6	8.4	4.2
GDP deflator				2.7	1.6	4.3	3.3	2.8	1.9	2.7
Harmonised index of consumer prices				2.4	0.7	3.7	2.5	2.2	0.8	1.5
Terms of trade goods				0.9	1.8	0.5	-1.0	1.3	0.5	-0.4
Trade balance (goods) (c)				-8.5	-4.9	-4.9	-6.1	-4.5	-4.2	-4.4
Current-account balance (c)				-4.7	-1.1	0.5	0.3	3.5	2.2	2.9
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.8	0.3	1.7	1.8	5.1	4.2	5.0
General government balance (c)				-3.0	0.2	0.5	0.6	0.3	-6.9	-2.7
Cyclically-adjusted budget balance (d)				-2.6	-0.3	-1.0	-1.2	-1.6	-4.4	-1.6
Structural budget balance (d)				-	-0.5	-1.0	-1.2	-1.6	-4.4	-1.6
General government gross debt (c)				27.3	39.7	39.1	33.8	36.3	48.5	48.4

(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.