15. LITHUANIA

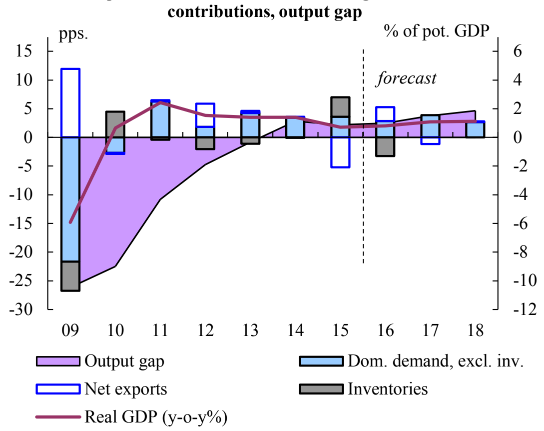
Investment set to drive growth in 2017

Investment and exports are set to raise GDP growth from 2.0% in 2016 to 2.9% in 2017. Meanwhile, private consumption growth is forecast to slow in 2017 and 2018 as rising inflation weighs on disposable incomes. Employment growth is expected to slow down considerably as labour supply nears its peak. The general government deficit is set to rise in 2017 as a result of structural reforms.

Private consumption drives growth in 2016

Real GDP is expected to have grown by 2.2% in 2016, improving upon 1.8% growth in 2015. While private consumption growth remained strong, investment was negatively affected by reduced disbursements due to the changeover in the EU fund planning period. A strong performance of the service sector drove export growth in 2016, while import growth was subdued. Inflation sped up markedly as energy price inflation turned positive again.

Graph II.15.1: **Lithuania - Real GDP growth and contributions, output gap**



Recovering investment set to lift growth

Real GDP growth is forecast to increase to 2.9% in 2017 and 2.8% in 2018. As the flow of investment projects co-financed by the EU returns to normal level, both private and public investment are forecast to rebound and drive growth in 2017. Private consumption growth, by contrast, is set to slow down in 2017, as the increase in disposable incomes linked to rapid wage growth and lower taxes is more than offset by limited employment growth and rising inflation.

The strong momentum in the growth of service export is expected to continue in 2017. Goods exports are also forecast to pick up as EU demand accelerates. However, constantly rising real unit labour costs will make it increasingly hard to gain market share. Meanwhile, import growth is expected to recover in step with investment and exports in 2017 and then to slow down somewhat in 2018. Overall, the growth contribution of net exports is expected to turn negative in 2017 before balancing out in 2018.

Risks to the forecast are tilted to the downside and mainly linked to European and global uncertainties, such as the future of negotiations between the EU and the United Kingdom.

The labour market is set to tighten further

Thanks to strong employment growth, the unemployment rate fell sharply in 2016. At the same time, the labour force expanded as more people continued working past their retirement age. While employment growth is expected to slow down considerably in 2017, the unemployment rate should further improve due to a shrinking labour force. Consequently, wage growth is unlikely to slow down over the forecast horizon.

Energy prices drive inflation

Annual HICP inflation is forecast to increase from 0.7% in 2016 to 2.1% in 2017 on the back of strong services inflation and recovering energy prices. While energy price inflation is expected to spike in 2017 before slowing down in 2018, the tightening labour market and growing wages are expected to keep service price inflation strong throughout over the forecast horizon.

Structural reform costs to increase the deficit

Lithuania's general government deficit is expected to increase to 0.5% of GDP in 2016 from 0.2% of GDP in 2015 due to an increase in non-taxable incomes, pensions and some public wages, as well as the loss of one-off revenues from the deposit insurance scheme's surpluses. Continued strong employment and wage growth has lifted tax revenues above the government's initial plan, cutting the planned headline deficit in half.

For 2017, the general government deficit is forecast to increase to 0.7% of GDP. The increase mostly results from the costs of structural reforms related to labour market and pensions (0.5% of GDP). Some new discretionary fiscal measures, in particular an increase in the non-taxable income threshold and in public wages and pensions, are also set to widen the deficit. On the revenue side, a set of tax increases and efforts to improve tax compliance are expected to offset part of revenues losses stemming from cuts in personal income taxes, while the boost in revenues from tax rich economic growth is set to offset part of the higher spending on public wages and pensions.

Assuming a no-policy-change scenario, the general government deficit is forecast to stay at 0.7% of GDP in 2018.

Risks to the public finance forecast are tilted to the upside, due to expectations of robust growth in the tax base, but only if expenditure growth is contained.

Lithuania’s structural deficit is expected to increase to 1% of GDP in 2016 and to about 1½% of GDP in 2017 due to the costs of the structural reforms. It is expected to stay at 1½% of GDP in 2018.

General government debt is set to fall from 42.7% of GDP in 2015 to 40.8% in 2016. In 2017, debt is forecast to increase to 43.5% of GDP due to the end of year pre-financing of forthcoming bond redemptions in 2018 but should fall back to 39.6% in 2018.

Table II.15.1:

Main features of country forecast - LITHUANIA

		2015		Annual percentage change						
	bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		37.3	100.0	4.5	3.5	3.5	1.8	**2.2**	**2.9**	**2.8**
Private Consumption		23.6	63.2	4.7	4.3	4.3	4.1	**5.3**	**4.0**	**2.6**
Public Consumption		6.6	17.6	1.3	0.7	0.3	0.9	**1.1**	**2.2**	**2.1**
Gross fixed capital formation		7.2	19.3	6.0	8.3	3.7	4.7	**-1.2**	**6.0**	**3.0**
of which: equipment		2.3	6.2	7.9	12.5	0.5	6.0	**8.0**	**6.1**	**3.0**
Exports (goods and services)		28.3	75.9	9.5	9.6	3.5	-0.4	**2.6**	**3.4**	**3.7**
Imports (goods and services)		28.6	76.5	9.1	9.3	3.3	6.2	**2.2**	**5.1**	**3.5**
GNI (GDP deflator)		35.8	96.0	4.3	4.0	4.9	-1.0	**2.5**	**3.0**	**2.9**
Contribution to GDP growth:	Domestic demand			4.9	4.3	3.4	3.6	**3.3**	**4.1**	**2.6**
	Inventories			0.2	-1.1	-0.1	3.4	**-1.4**	**0.0**	**0.0**
	Net exports			-0.4	0.3	0.2	-5.2	**0.3**	**-1.2**	**0.1**
Employment				-1.0	1.3	2.0	1.3	**1.8**	**0.5**	**0.1**
Unemployment rate (a)				11.9	11.8	10.7	9.1	**8.0**	**7.5**	**7.1**
Compensation of employees / head				8.3	5.4	4.7	5.3	**5.5**	**6.1**	**6.3**
Unit labour costs whole economy				2.6	3.1	3.2	4.8	**5.1**	**3.7**	**3.6**
Real unit labour cost				-0.7	1.7	2.2	4.6	**3.3**	**1.5**	**1.2**
Saving rate of households (b)				3.9	2.1	-0.6	-1.9	**-2.4**	**-1.8**	**-0.5**
GDP deflator				3.4	1.4	1.0	0.2	**1.7**	**2.1**	**2.3**
Harmonised index of consumer prices				3.5	1.2	0.2	-0.7	**0.7**	**2.1**	**1.9**
Terms of trade goods				1.0	0.0	0.6	3.2	**0.0**	**-0.5**	**-0.1**
Trade balance (goods) (c)				-10.4	-2.6	-2.6	-5.3	**-5.3**	**-7.0**	**-7.0**
Current-account balance (c)				-6.9	1.4	3.8	-2.2	**-1.6**	**-2.9**	**-2.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-5.5	4.5	6.5	0.8	**-0.5**	**-1.3**	**-0.8**
General government balance (c)				-3.8	-2.6	-0.7	-0.2	**-0.5**	**-0.7**	**-0.7**
Cyclically-adjusted budget balance (d)				-3.7	-2.5	-1.1	-0.5	**-0.9**	**-1.4**	**-1.5**
Structural budget balance (d)				-	-2.1	-1.5	-0.6	**-1.0**	**-1.4**	**-1.5**
General government gross debt (c)				23.1	38.7	40.5	42.7	**40.8**	**43.5**	**39.6**

(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.