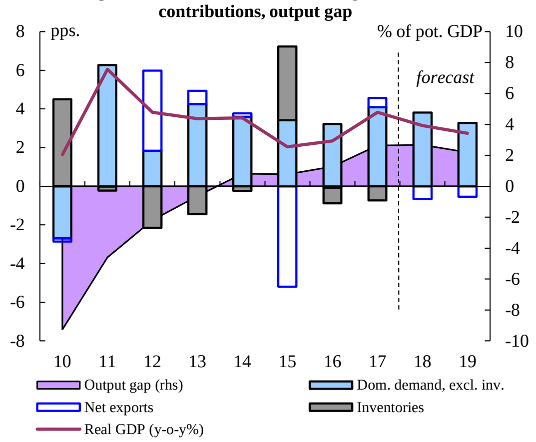
15. LITHUANIA
Higher investment to drive GDP growth

A strong rebound in investment, flourishing exports, and the continuing strength of private consumption pushed GDP growth to 3.8% in 2017. While investment activity is expected to stay strong, export growth will ease this year and next, slowing GDP growth to 3.1% in 2018 and 2.7% in 2019. After peaking in 2017, inflation is forecast to moderate, supporting private consumption. The shrinking labour force will continue to drive down unemployment and drive up wages. Lithuania is expected to maintain a general government surplus over the forecast horizon.

Strong and broad-based growth in 2017

Economic growth reached 3.8% in 2017, the highest rate since 2012. This good performance was driven by a boost in exports and strong investment growth, despite the lower-than-expected use of EU funds. The manufacturing and transport sectors increased their investment in equipment in order to build-up productive capacity. Together with stronger foreign demand, this capacity effect had a positive impact on exports, which increased by 13.2% in 2017. Driven by high wage growth, private consumption continued to perform well but was somewhat dampened by high inflation and the shrinking population.

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



High investment activity drives growth

Economic growth is forecast to remain strong but is expected to slow down somewhat to 3.1% in 2018 and 2.7% in 2019, in line with the slowdown in export growth as external demand is expected to ease.

Investment – private and public – is expected to remain an important growth driver as companies strive to satisfy strong domestic and foreign demand in the context of high capacity utilisation and increasing labour shortages. This should support productivity growth, which started to recover in 2017, countering strong wage increases. As a result, the growth of unit labour costs is expected to slow down, improving the cost-competitiveness of the Lithuanian economy. After a sluggish performance in the last two years, the implementation of EU-funded projects is also expected to pick up in 2018.

At the same time, investment remains a driving force behind the strong demand for the import of capital goods. On the export side, ICT and transport services are expected to contribute substantially to export growth. Overall, the combination of a slowdown in export growth and the continued strong performance of domestic demand with a high import content is projected to lead to a negative contribution of net trade to GDP growth over the forecast horizon.

As Lithuania is a small and open economy, risks to the forecast are tilted to the downside, mainly due to possible indirect effects of negative geopolitical developments affecting its main trading partners.

Shrinking labour force

In 2017, due to negative demographic trends and emigration, the labour force contracted by 1.3%, which is the most notable decrease in the last six years. As a result, the number of employed persons shrunk by 0.5%, while the employment rate reached a record-high and unemployment fell further. This trend is forecast to continue in 2018 and 2019. However, labour market tensions are seeing some relief from workers coming from neighbouring non-EU countries who are not captured in the labour force survey. According to administrative data, the number of non-EU resident workers increased notably in 2017. Overall, demand for labour is expected to remain strong, and the unemployment rate is expected to remain below 7% over the forecast horizon.

Inflation expected to moderate

After reaching a six-year high and peaking at 3.7% in 2017, HICP inflation is expected to moderate to 2.7% in 2018 and 2.3% in 2019. The slowdown partly reflects the fading effects of significant excise duties hikes in 2017. The rising price of services, driven by continuously growing labour costs and sustained by increasing household disposable income, will remain one of the main drivers of consumer inflation. However, the pace of their increase is expected to slow down as the effect of the minimum wage increases dissipate, wage growth slightly moderates and the effects of one-off factors (such as a hike in prices of transport services due to the reconstruction of the Vilnius Airport runway in summer 2017) disappears. Lower inflation in the coming period should increase real disposable income and support private consumption.

A sustained budget surplus

Lithuania's general government surplus increased from 0.3% of GDP in 2016 to 0.5% in 2017. This was achieved thanks to a strong collection of the payroll taxes combined with limited government expenditure growth. The general government surplus is set to remain at a similar level in 2018 and 2019 as revenues from tax-rich economic growth and revisions of some taxes and efforts to improve the tax administration are expected to offset higher social spending.

Risks to the public finance forecast are tilted to the upside, due to expectations of robust growth in the tax base, but may materialise only as long as the government maintains discipline in expenditure growth.

The structural deficit is expected to stand at around ¾% of GDP in 2018 and ½% in 2019. This is slightly worse compared to 2016 mostly because of the increase in the positive output gap.

The general government debt is set to decrease from 39.7% of GDP in 2017 to 36.0% in 2018. This expected decline mostly relies on the redemption of EUR 1.33 billion of Eurobonds in February 2018, for which the pre-financing was secured by the end of 2017. The debt-to-GDP ratio is set to increase again in 2019 to 38.2% due to the planned pre-financing of forthcoming bond redemptions in 2020.

Table II.15.1

Main features of country forecast - LITHUANIA

	2016		Annual percentage change						
	bn EUR Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP	38.7	100.0	4.2	3.5	2.0	2.3	**3.8**	**3.1**	**2.7**
Private Consumption	24.9	64.3	4.6	4.0	4.0	4.9	**3.9**	**3.4**	**3.3**
Public Consumption	6.6	17.2	1.0	0.3	0.2	1.3	**1.2**	**1.6**	**1.5**
Gross fixed capital formation	7.3	18.9	5.0	5.8	4.8	-0.5	**7.3**	**7.3**	**4.7**
of which: equipment	2.7	6.9	6.6	-0.2	13.4	9.0	**8.9**	**9.5**	**5.2**
Exports (goods and services)	28.8	74.5	8.8	3.3	-0.4	3.5	**13.2**	**5.5**	**4.4**
Imports (goods and services)	28.3	73.2	8.0	3.1	6.2	3.5	**12.8**	**6.5**	**5.2**
GNI (GDP deflator)	37.1	96.1	4.1	4.9	-0.8	2.5	**4.2**	**3.3**	**2.8**
Contribution to GDP growth: Domestic demand			4.5	3.6	3.4	3.2	**4.1**	**3.8**	**3.3**
Inventories			-0.1	-0.2	3.8	-0.8	**-0.7**	**0.0**	**0.0**
Net exports			0.0	0.2	-5.2	-0.1	**0.5**	**-0.7**	**-0.5**
Employment			-1.0	2.0	1.3	2.0	**-0.5**	**-0.4**	**-0.4**
Unemployment rate (a)			12.2	10.7	9.1	7.9	**7.1**	**6.8**	**6.7**
Compensation of employees / head			7.2	4.7	5.8	6.2	**9.1**	**6.6**	**6.0**
Unit labour costs whole economy			2.0	3.2	5.0	5.9	**4.6**	**3.0**	**2.8**
Real unit labour cost			-0.7	2.1	4.7	4.9	**0.3**	**0.3**	**0.5**
Saving rate of households (b)			3.9	0.2	0.0	-0.5	**-4.6**	**-5.1**	**-5.6**
GDP deflator			2.8	1.0	0.3	1.0	**4.3**	**2.7**	**2.3**
Harmonised index of consumer prices			2.9	0.2	-0.7	0.7	**3.7**	**2.7**	**2.3**
Terms of trade goods			0.7	0.8	3.2	2.4	**0.5**	**-0.2**	**-0.2**
Trade balance (goods) (c)			-9.8	-2.6	-5.3	-4.6	**-4.9**	**-6.0**	**-6.7**
Current-account balance (c)			-6.2	4.0	-2.0	-0.6	**-1.5**	**-2.3**	**-2.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-4.6	6.6	1.0	0.9	**-0.3**	**-1.1**	**-1.8**
General government balance (c)			-3.3	-0.6	-0.2	0.3	**0.5**	**0.5**	**0.3**
Cyclically-adjusted budget balance (d)			-3.0	-1.0	-0.6	-0.3	**-0.6**	**-0.6**	**-0.6**
Structural budget balance (d)			-	-1.4	-0.7	-0.3	**-0.6**	**-0.7**	**-0.6**
General government gross debt (c)			24.5	40.5	42.6	40.1	**39.7**	**36.0**	**38.2**

(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.