# 15. LITHUANIA
Growth approaches a plateau

Recovering investment is set to increase GDP growth from 2.0% in 2016 to 2.7% in 2017. However, higher inflation is forecast to dampen private consumption which will increasingly weigh on growth in 2017 and 2018. Employment growth is expected to slow down considerably as labour supply nears its potential. Public finances are on track to achieve fiscal targets.

Weak investment growth weighs on strong performance elsewhere

Real GDP grew around 2% in the first three quarters of 2016, somewhat more than last year but below expectations. Despite continued strong private consumption growth, domestic demand was dampened by weak investment, which suffered severely from an interruption in EU funds flow. Investment, however, is expected to pick up by the end of the year as EU-funded projects gather pace. Exports have recovered from a difficult 2015 and are set to grow by some 3% in 2016. Meanwhile, import growth slowed down markedly, largely due to weak investment growth.

Graph II.15.1: **Lithuania - Real GDP growth and contributions, output gap**
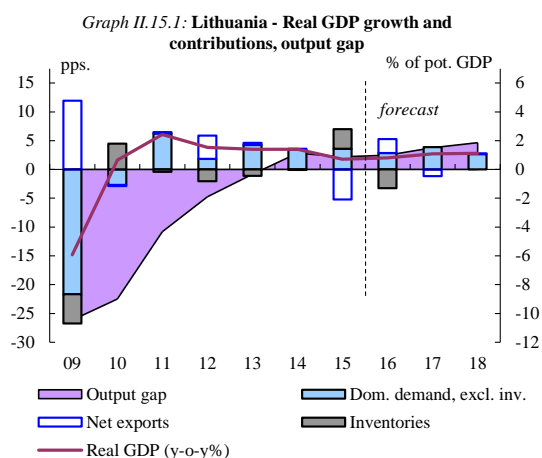
Recovering inflation and slowing employment growth curb private consumption

Real GDP growth is forecast to climb from 2.0% in 2016 to 2.7% in 2017 and 2.8% in 2018. Even though wage growth is expected to remain strong, little room for employment growth and rising inflation should mean disposable income growth and hence household consumption growth will slow down in 2017 and 2018. A rapid recovery in EU fund spending is set to boost investment growth in 2017 before slowing down somewhat in 2018. Increases in defence and social spending are set to increase government consumption slightly.

Export growth is expected to be modest in both 2017 and 2018 because constantly rising real unit labour costs will make it increasingly hard to gain market share, on the back of weak external demand growth. Meanwhile, import growth is expected to recover in step with investment in 2017 and then to slow down somewhat in 2018. The growth contribution of net exports is expected to turn negative in 2017 before balancing out in 2018.

The unemployment rate is set to fall sharply on the back of strong employment growth in 2016. The situation should further improve in 2017 and 2018 but a shrinking labour force will be the main driver of the decline. While in 2016 the tight labour market attracted more people to join the labour force, labour supply constraints are set to become increasingly binding in the coming years as the growth of the labour force in 2016 has come mostly from people at or beyond the retirement age. Labour market tightening will mean the acceleration in wage growth is unlikely to see any respite over the forecast horizon.

Risks to the forecast are balanced as uncertainty related to 'Brexit' negotiations and the prolongation of sanctions against Russia are balanced by the possibility that the supply of idle labour could be sufficient to provide room for further employment growth.

Energy prices drive inflation

Annual HICP inflation is projected at 0.7% in 2016 as effects from lower oil prices and steadily rising service prices work in opposite directions. However, an expected recovery in oil prices in 2017 is about to gradually reverse the trend in energy price inflation. This development, together with steady service price growth, is forecast to bring inflation up to around 2% in 2017 and 2018.

Fiscal targets are achievable

Lithuania's general government deficit is set to increase to 0.6% of GDP in 2016 from 0.2% of

GDP in 2015, thus staying well below the government's initial deficit target of 1.2%. The deficit is expected to widen due to an increase in non-taxable incomes, pensions and some public wages, as well as fading one-off revenues from the deposit insurance scheme's surpluses. Continued strong wage growth should lift tax revenues above the government's plan despite weaker-than-expected GDP growth.

For 2017, the general government deficit is forecast to increase to 0.8% of GDP in line with the deficit target of the outgoing government. A set of small tax increases and efforts to improve tax compliance roughly matches lost revenues due to the increase in non-taxable incomes and the reduction of social insurance contributions. The boost in revenues from tax rich economic growth, however, is set to cover only part of expenses due to pension indexation, increased social payments and public wages costs.

Assuming no policy changes, the general government deficit is forecast to fall to 0.7% of GDP in 2018, mainly on the back of solid economic growth and expectations that the increase in expenditure will be limited.

Risks to the public finance forecast are tilted to the upside due expectations of robust growth in the tax base, but only if expenditure is contained after the 2016 electoral cycle.

Lithuania's structural deficit is expected to increase to about 1% of GDP in 2016 and about 1½% of GDP in 2017 due to the additional expenditure measures, staying at around 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 43.3% of GDP due to the end of year pre-financing of forthcoming bond redemptions, while in 2018 it is expected to fall again to 40.2%.

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	2.0	2.7	2.8
Private Consumption	23.6	63.2	4.7	4.3	4.3	4.1	4.4	3.7	2.6
Public Consumption	6.6	17.6	1.3	0.7	0.3	0.9	1.5	2.2	2.1
Gross fixed capital formation	7.2	19.3	6.0	8.3	3.7	4.7	-0.9	6.0	3.0
of which: equipment	2.3	6.2	7.9	12.5	0.5	6.0	8.0	6.0	3.0
Exports (goods and services)	28.3	75.9	9.5	9.6	3.5	-0.4	4.1	2.8	3.4
Imports (goods and services)	28.6	76.5	9.1	9.3	3.3	6.2	0.9	4.5	3.2
GNI (GDP deflator)	35.8	96.0	4.3	4.0	4.9	-1.0	2.3	2.8	2.9
Contribution to GDP growth: Domestic demand			4.9	4.3	3.4	3.6	2.9	3.9	2.6
Inventories			0.2	-1.1	-0.1	3.4	-3.2	0.0	0.0
Net exports			-0.4	0.3	0.2	-5.2	2.4	-1.2	0.2
Employment			-1.0	1.3	2.0	1.3	2.3	0.3	0.1
Unemployment rate (a)			11.9	11.8	10.7	9.1	7.6	7.4	7.0
Compensation of employees / head			8.3	5.4	4.7	5.3	5.4	6.1	6.3
Unit labour costs whole economy			2.6	3.1	3.2	4.8	5.7	3.6	3.5
Real unit labour cost			-0.7	1.7	2.2	4.6	4.3	1.9	0.8
Saving rate of households (b)			3.9	2.1	-0.6	-1.9	-0.9	0.4	1.4
GDP deflator			3.4	1.4	1.0	0.2	1.4	1.6	2.7
Harmonised index of consumer prices			3.5	1.2	0.2	-0.7	0.7	1.7	2.1
Terms of trade goods			1.0	0.0	0.6	3.2	-0.5	-0.7	0.3
Trade balance (goods) (c)			-10.4	-2.6	-2.6	-5.3	-3.9	-5.5	-5.1
Current-account balance (c)			-6.9	1.4	3.8	-2.2	0.1	-1.2	-0.7
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-5.5	4.5	6.5	0.8	1.2	0.5	1.1
General government balance (c)			-3.8	-2.6	-0.7	-0.2	-0.6	-0.8	-0.7
Cyclically-adjusted budget balance (d)			-3.7	-2.5	-1.1	-0.5	-1.0	-1.4	-1.5
Structural budget balance (d)			-	-2.0	-1.5	-0.7	-0.9	-1.4	-1.5
General government gross debt (c)			23.1	38.7	40.5	42.7	40.8	43.3	40.2

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