
Lithuanian Economic Outlook

DNB

Despite geopolitical woes Lithuania's economy enjoys balanced growth

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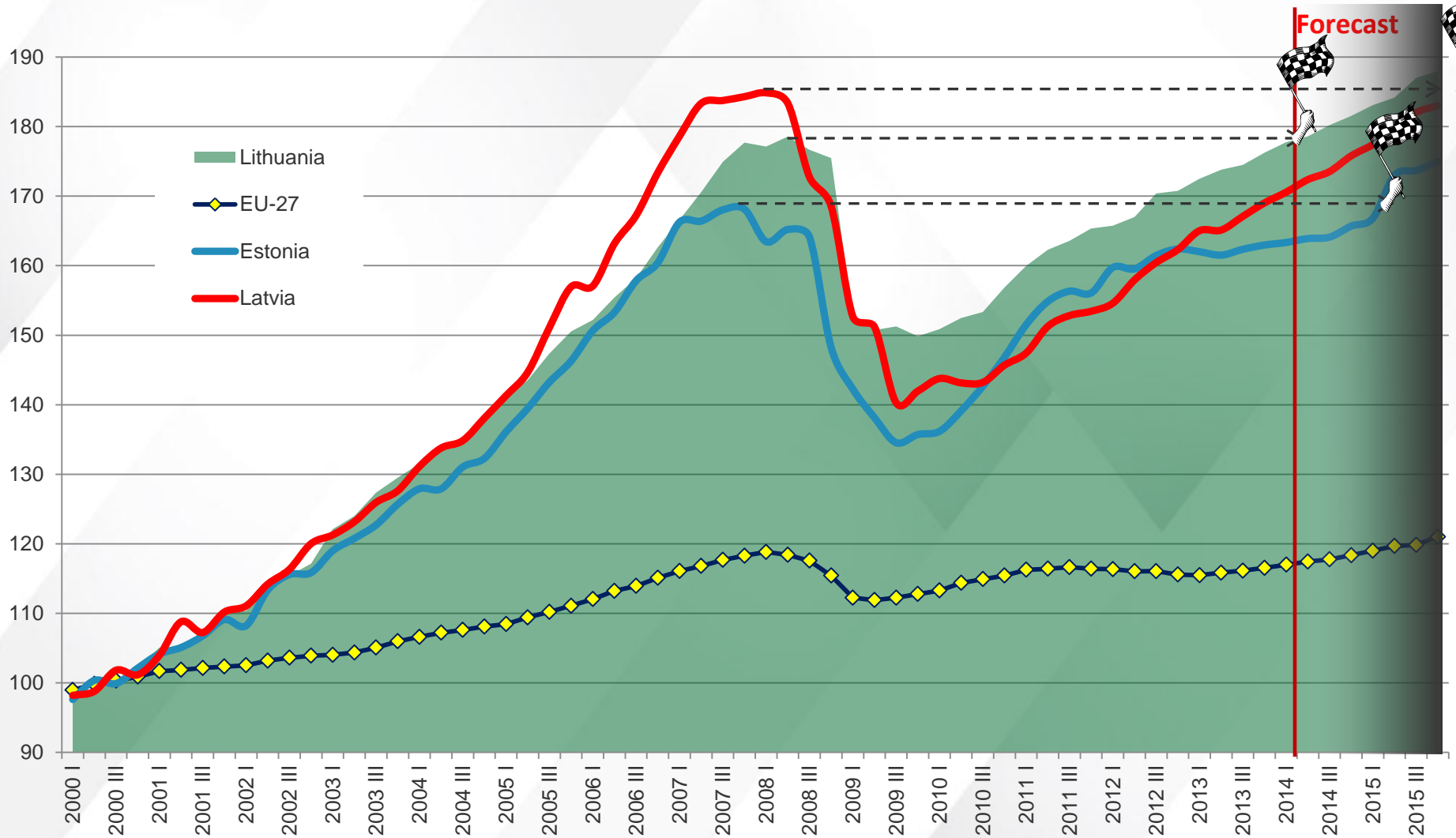
Chief analyst

Economic Research Department | DNB Markets

30th of May, 2014

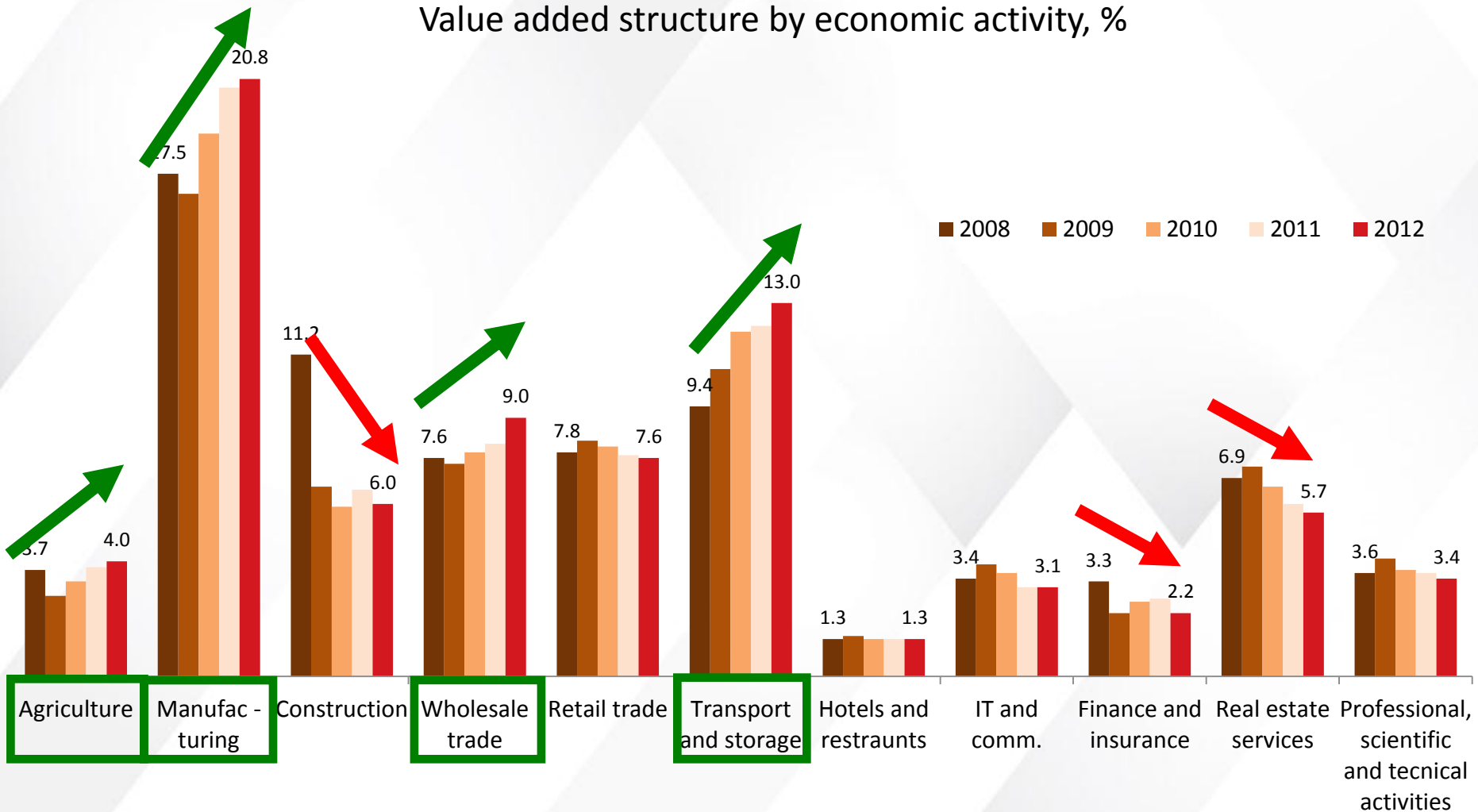
Lithuania will reach the pre-crisis peak in the beginning of this year

Real GDP index (sa & wda adjusted; 2000 = 100), %



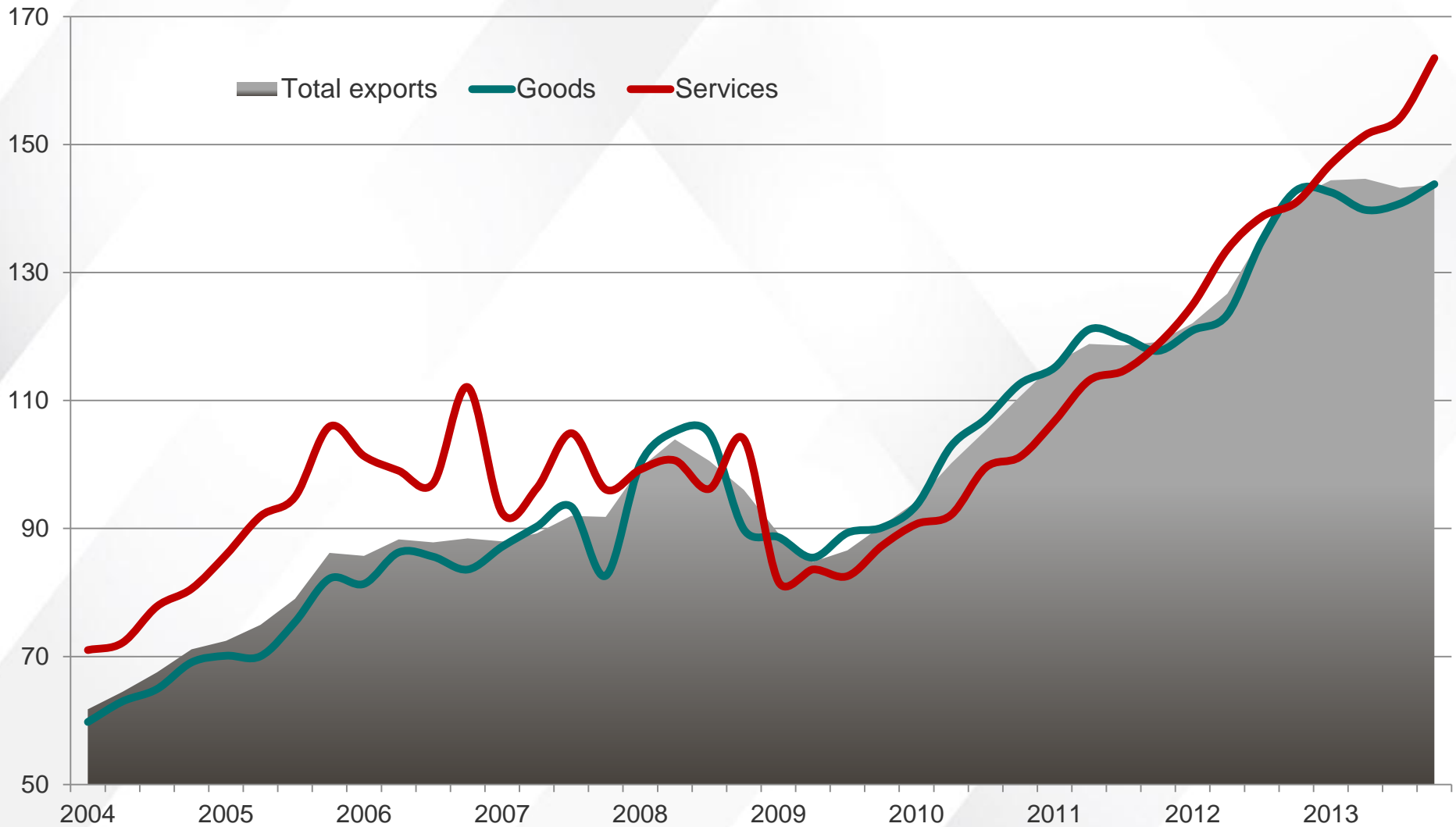
Externally oriented sectors gained weight

Value added structure by economic activity, %



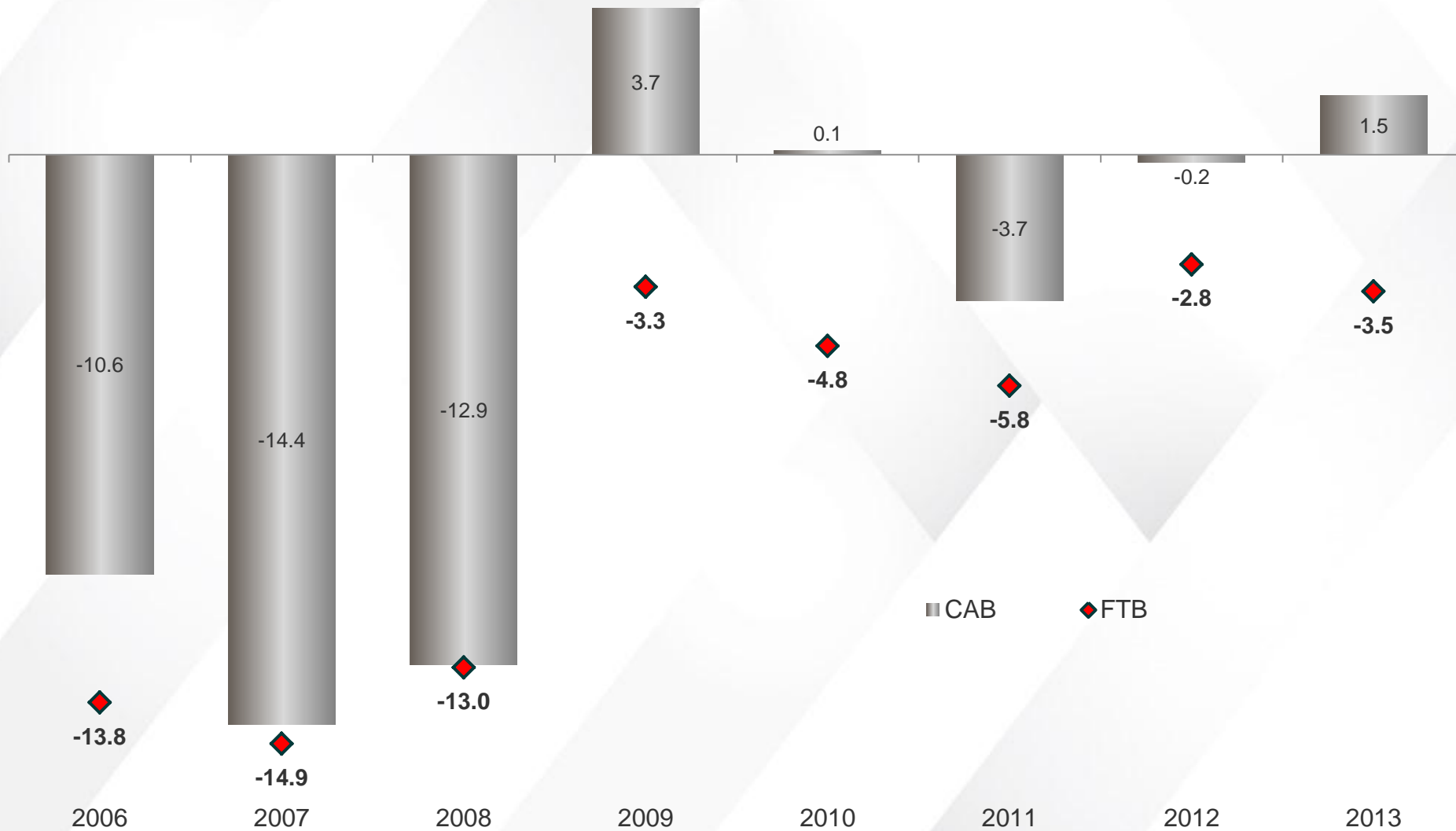
Exports – the main engine, which drove Lithuania out of recession

Exports of goods and services index, swda, (2008 = 100), %

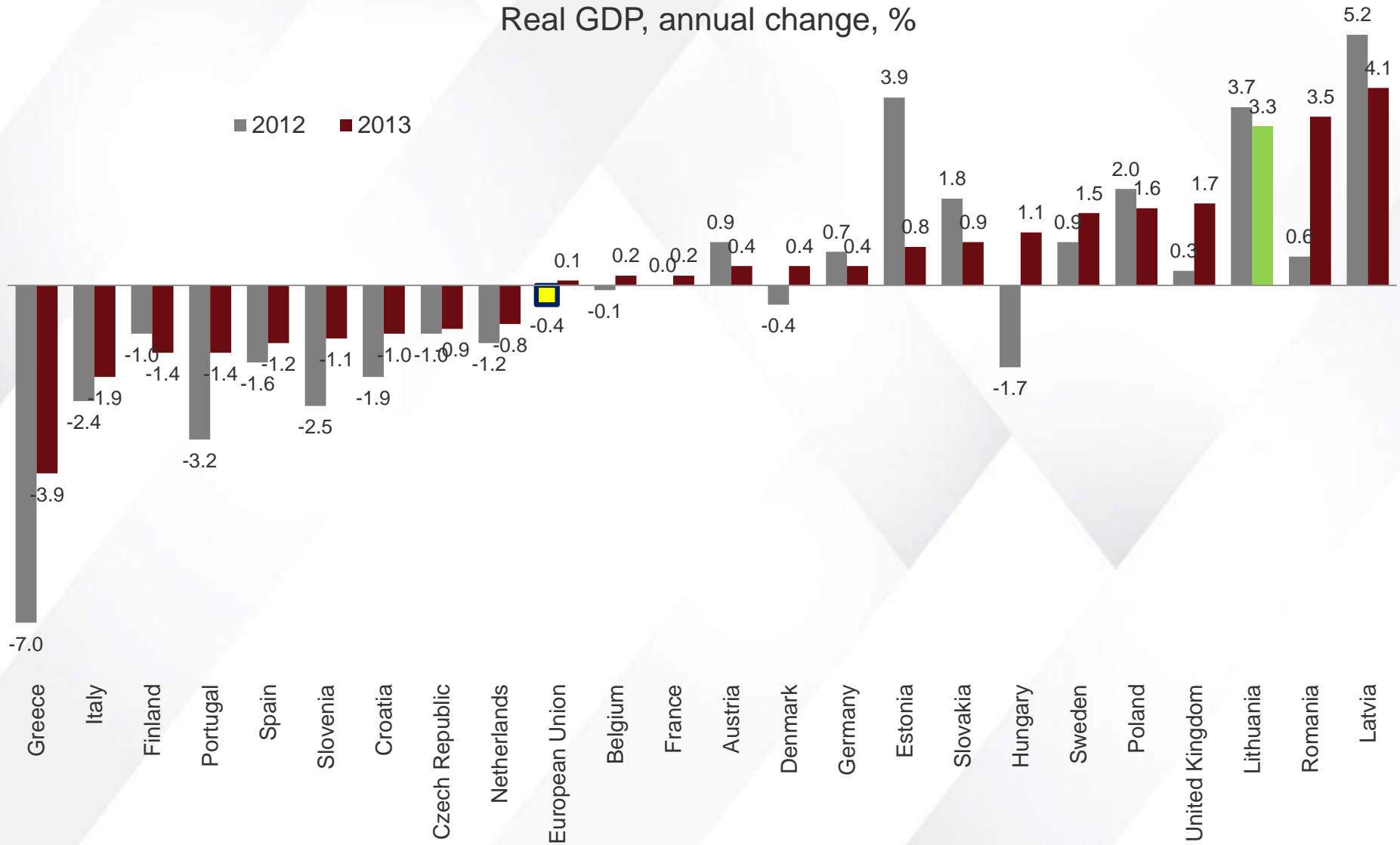


Lithuania started living according its means

Current account and foreign trade balance, ratio to GDP, %

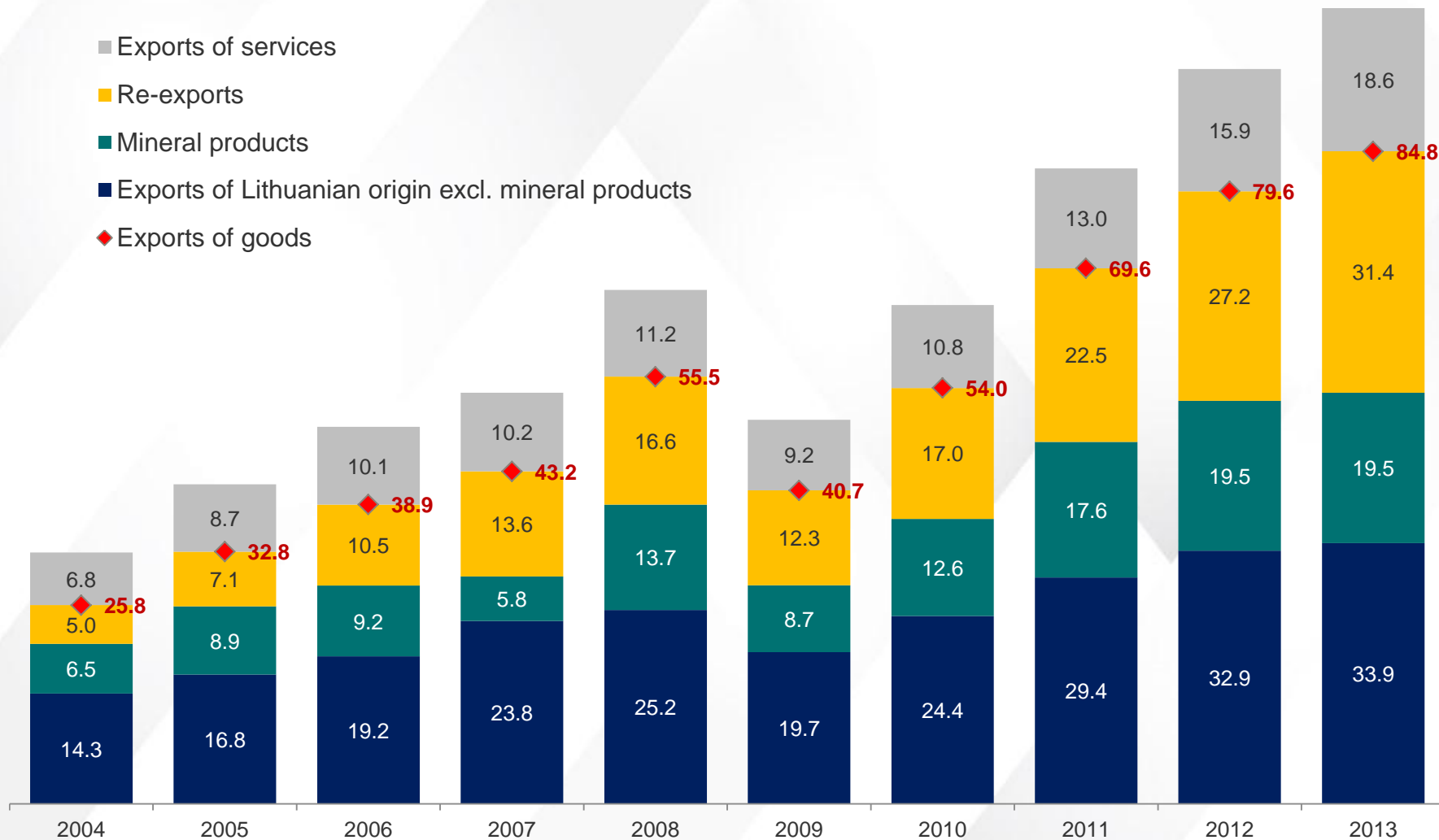


Lithuania ranks among the leaders of the EU according to the GDP growth



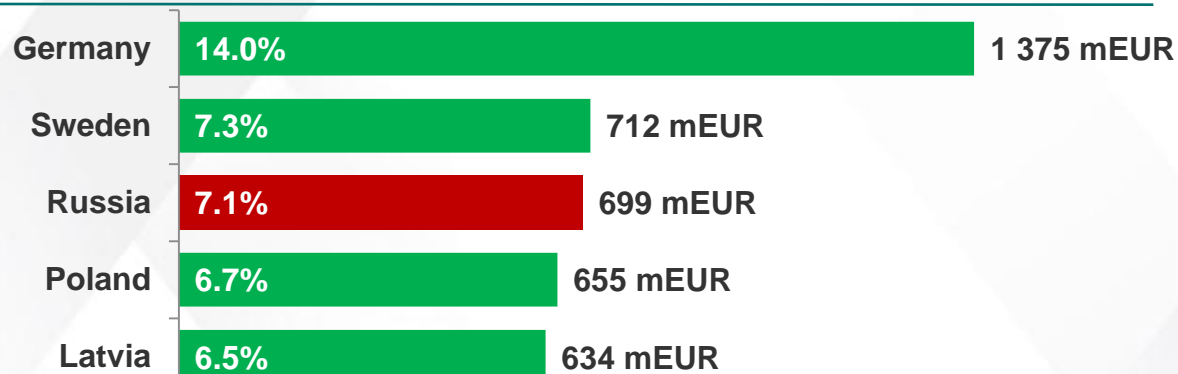
Re-exports surged the most

Exports structure, LTL bn



Key exports markets of Lithuanian goods and services

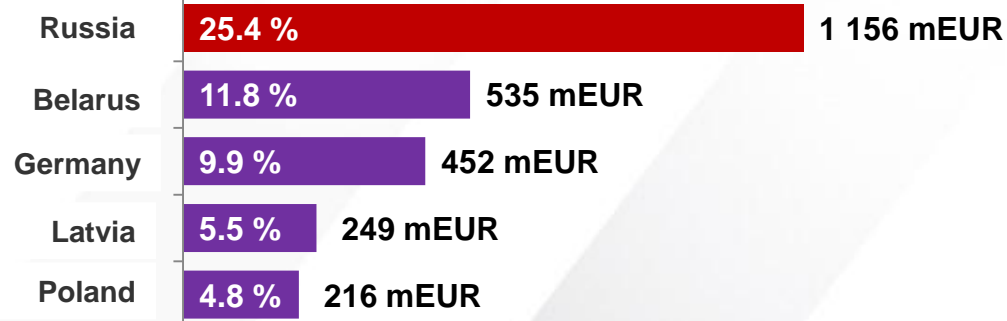
Lithuanian Origin Goods (excl. mineral products)



Re-exports of goods



Services



EXPORTS MARKETS OF LITHUANIA



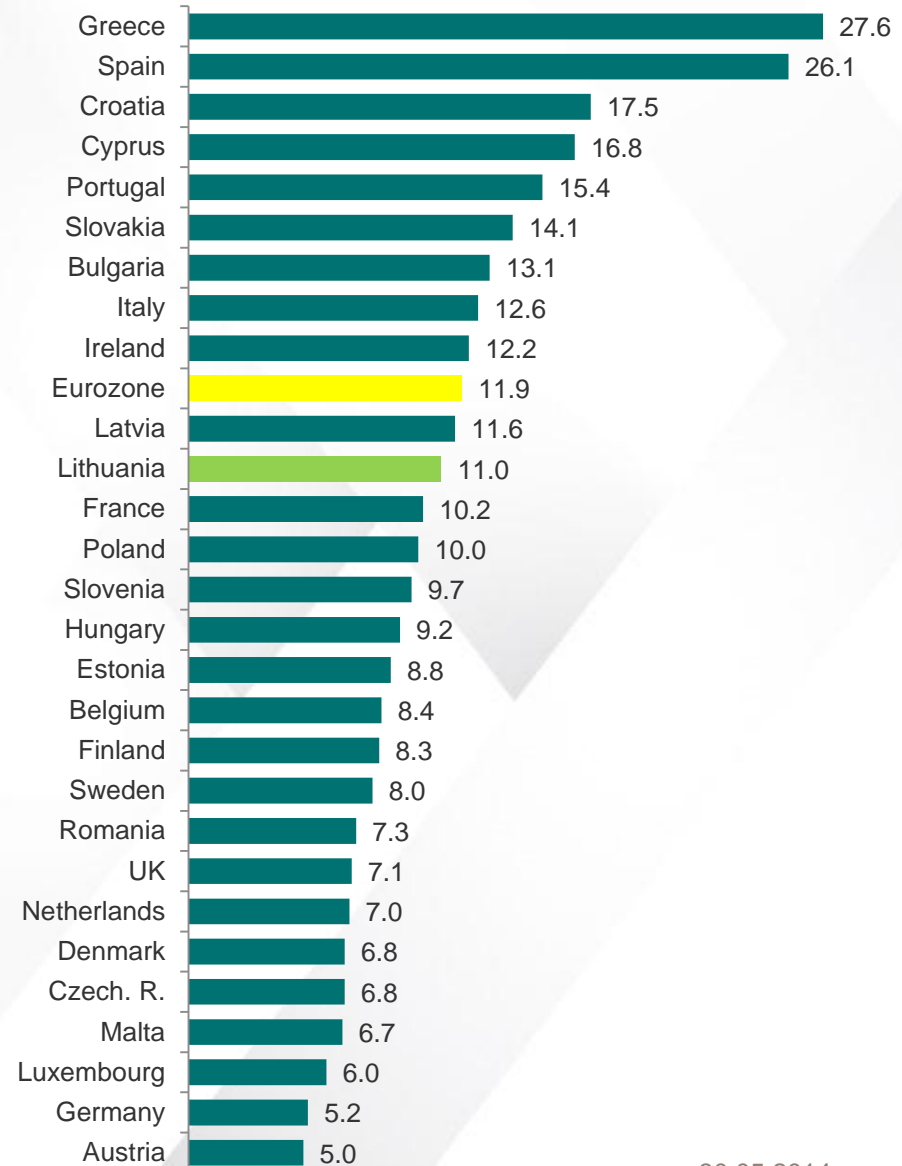
Situation in the EU still remains challenging



European Union

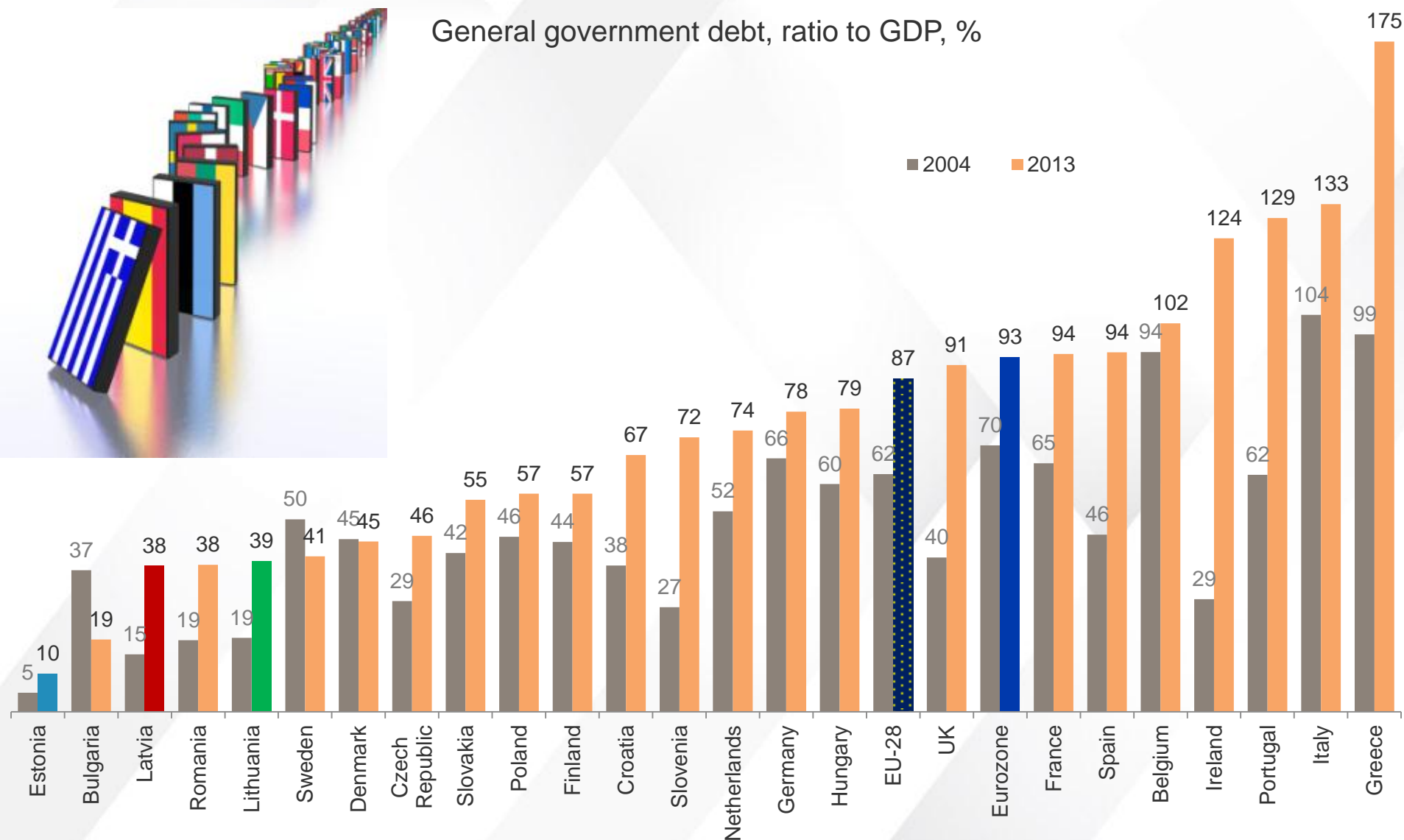
- **Economic engine is still sluggish** (GDP growth is seen at 1,6% in the EU)
- **Unemployment rate at its highs** – 10,5%; youth unemployment at 23%
- **Still weak domestic demand;** business and consumer confidence recovers slowly
- **Periphery's problems are not solved,** but the worst phase is behind
- **Stagnating economy** doesn't help to solve the fiscal imbalances.

Unemployment rate in 2013, end of period, %



Public indebtedness has swelled over the last 10 years

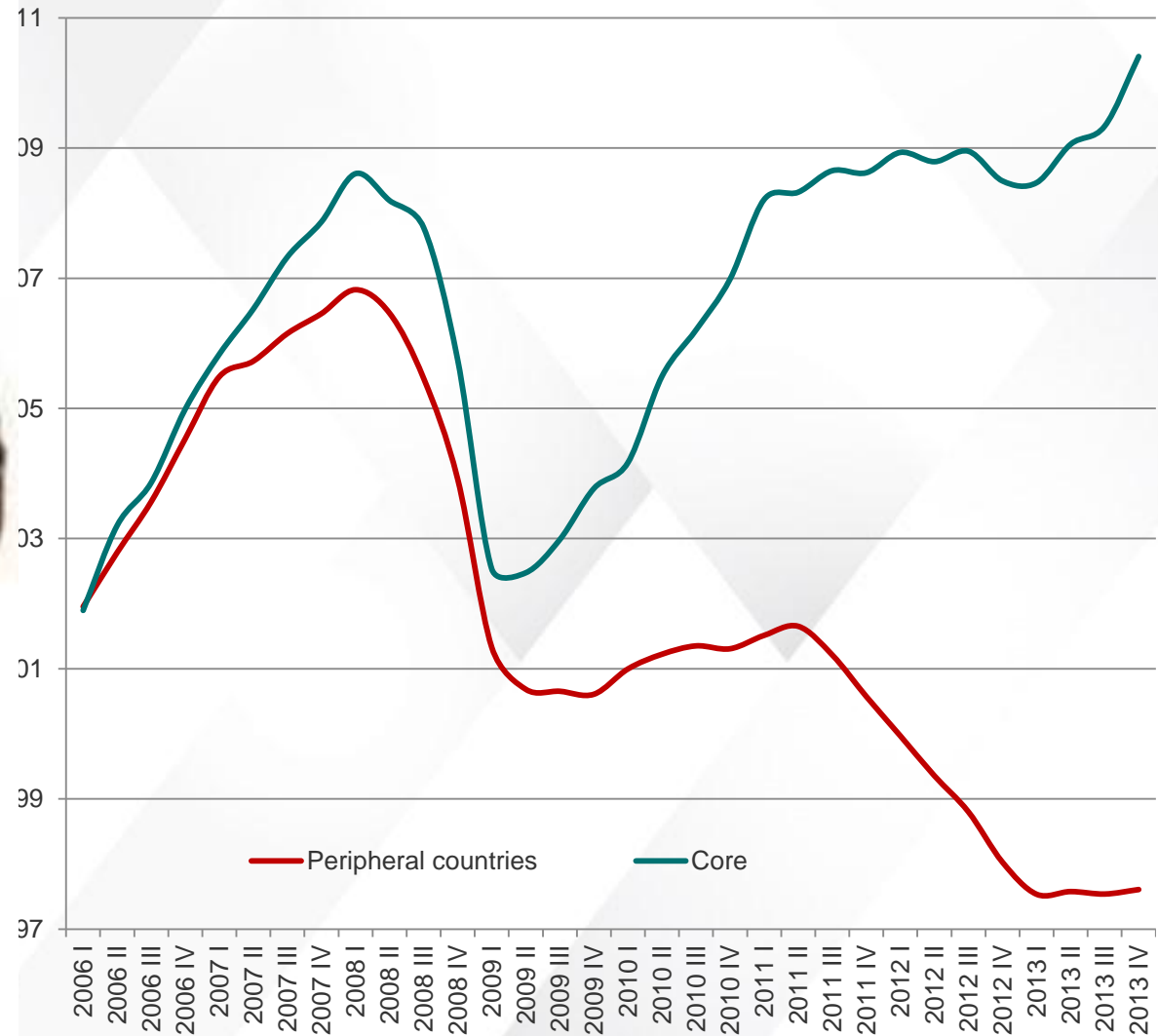
General government debt, ratio to GDP, %



Peripheral countries diverge from the core



Real value added index (2008 = 100; SWDA), %



Peripheral countries: Ireland, Greece, Spain, Italy, Cyprus, Portugal. Source: Eurostat, DNB 12 estimates.

Source: http://anwo.com/store/media/pig_toy_sow_w_piglets.jpg

ECB “doves” prevail due to fading inflation

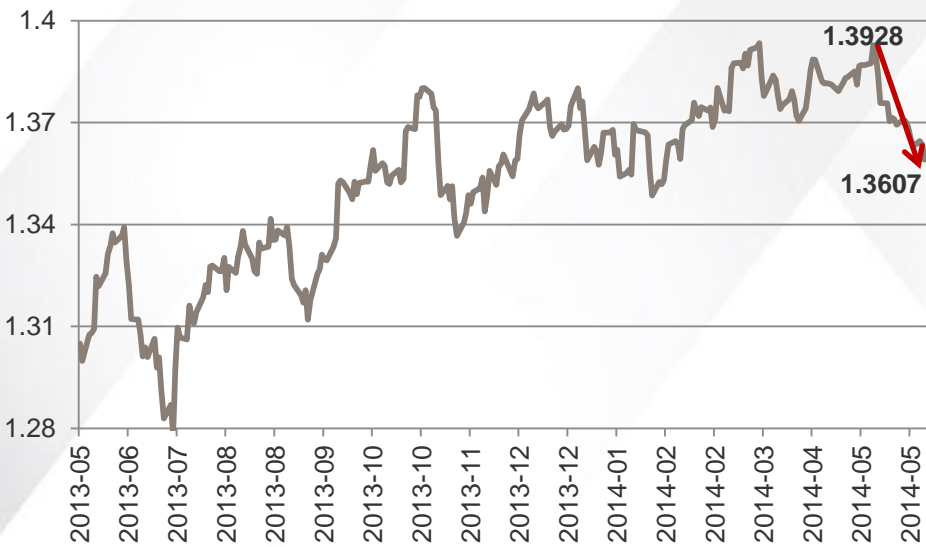
- **ECB kept tight monetary policy** comparing to its major peers. ECB’s mandate does not address fiscal euro area’s problems.
- **Well below target inflation forces ECB to act.** However, the effect of the ECB policies on the table (LTROs, key interest rate cuts, even QE) is seen to be limited.
- Nevertheless, all the easing efforts should keep euro area’s interest rates at the bottom for at least a couple of years.

Annual inflation in the Eurozone, %

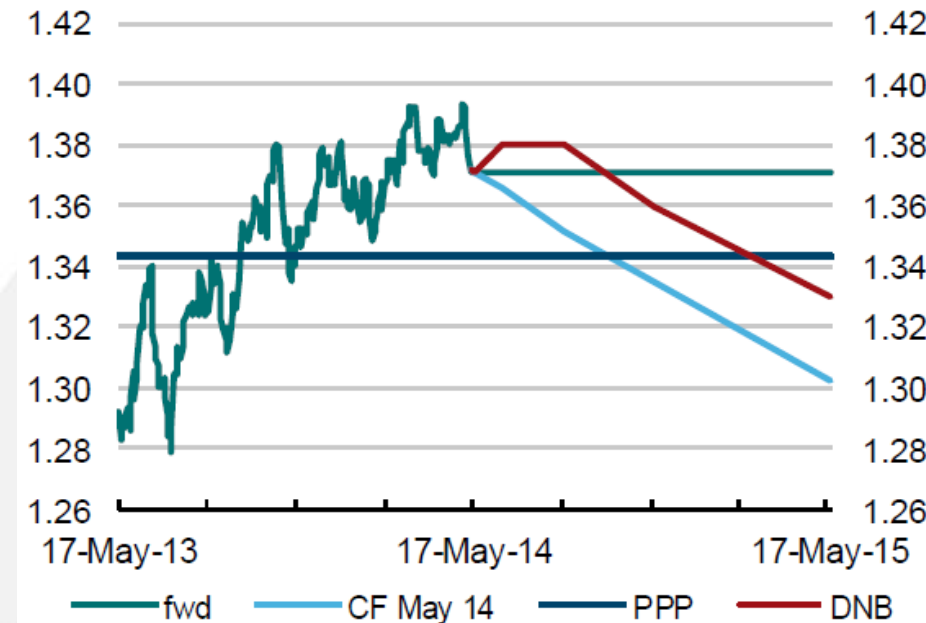


Markets have already priced in the expected stimulus from the ECB in June

EURUSD cross



EURUSD forecast

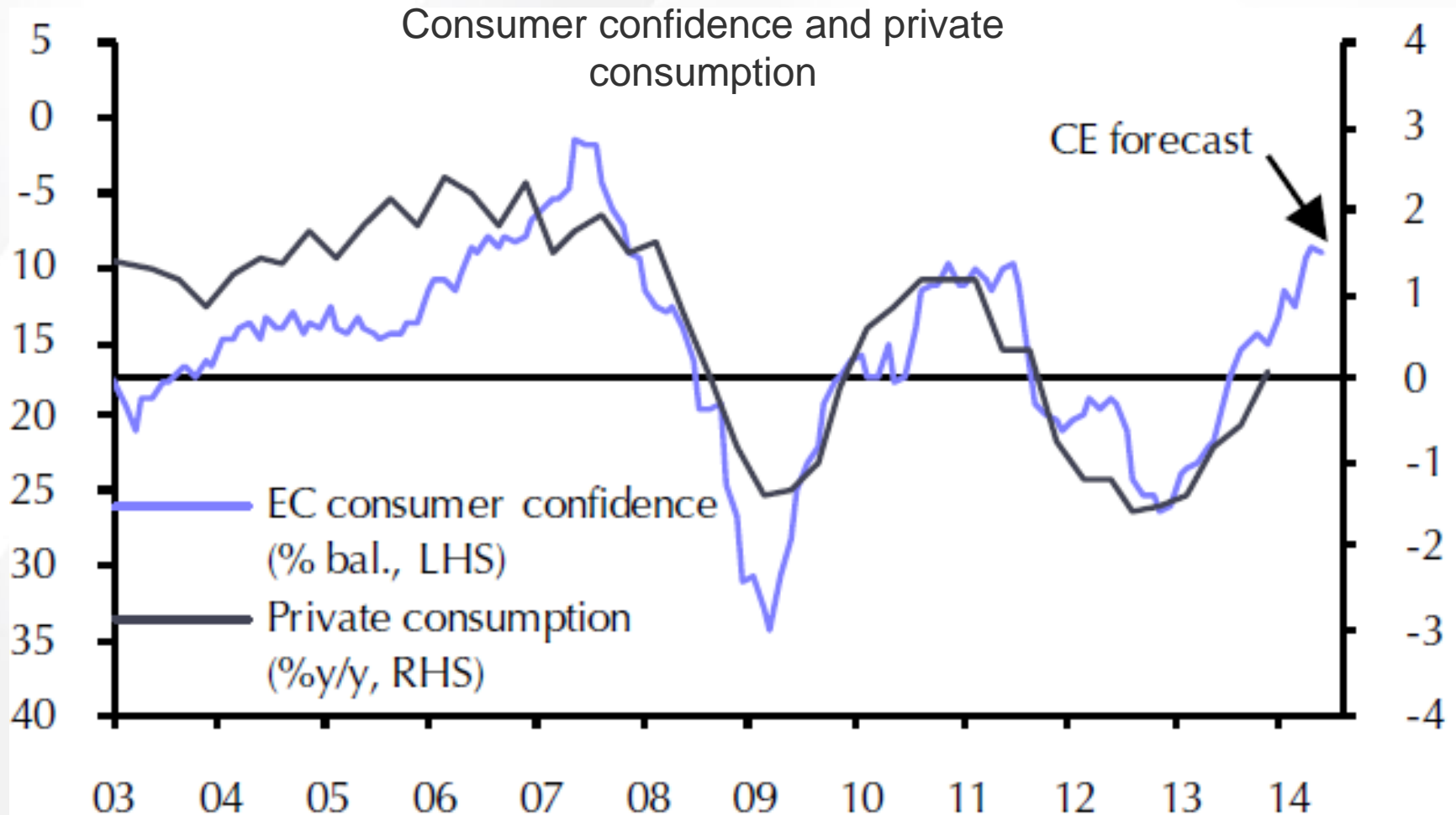


EUR is cursed to weaken eventually due to:

- Different macroeconomic conditions on both sides of the Atlantic. “**Japanese deflationary decade**” for the euro area vs. **energetic US recovery**
- More “hawkish” Fed – market participants expect Fed to **quit QE3** at the end of this year and **start raising interest rates** in the mid of 2015

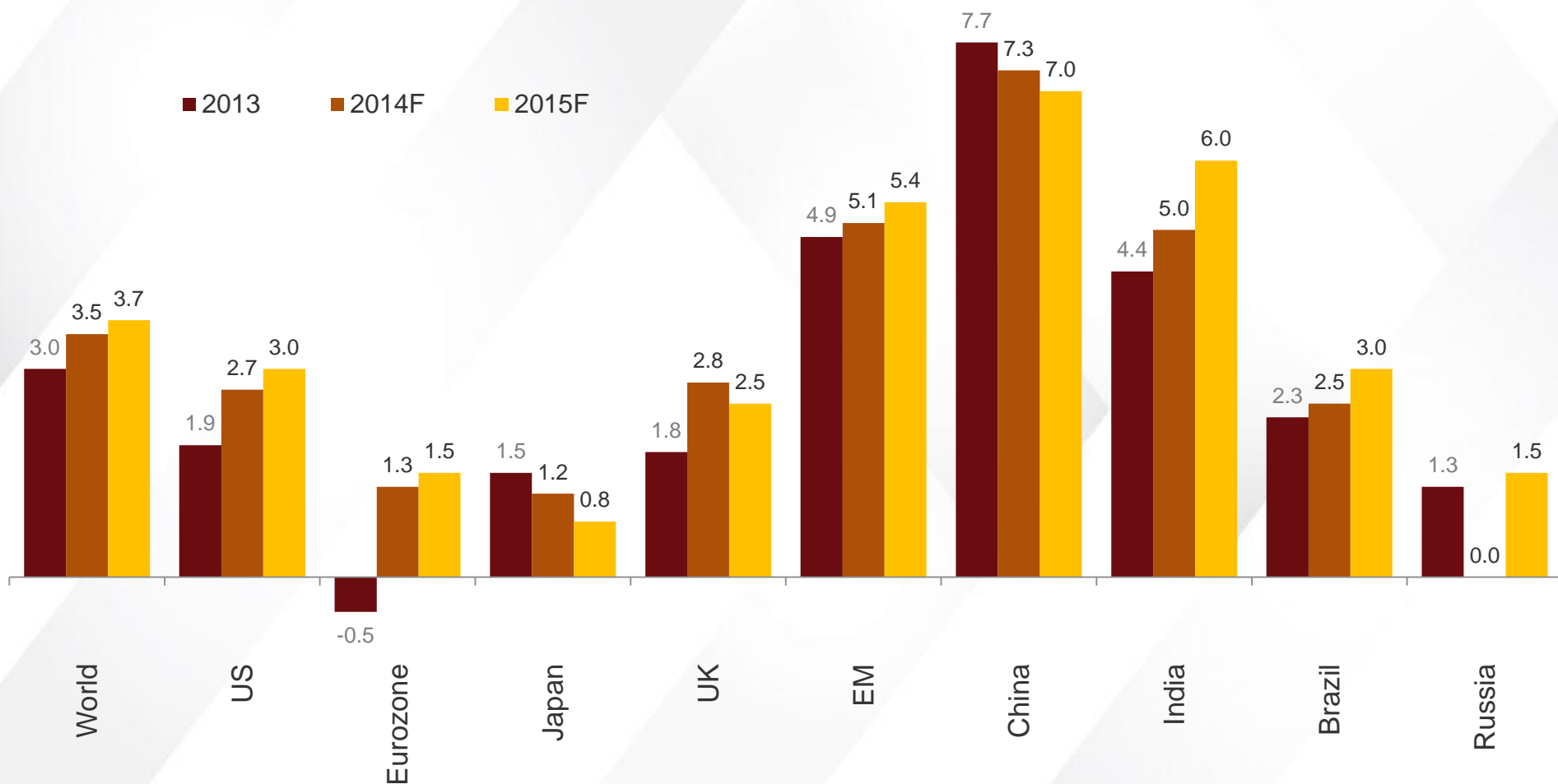
Rising consumer confidence lifts hopes

for gradual private consumption recovery



Faster global growth should give a hand to euro area's economy

Real GDP, annual change, %



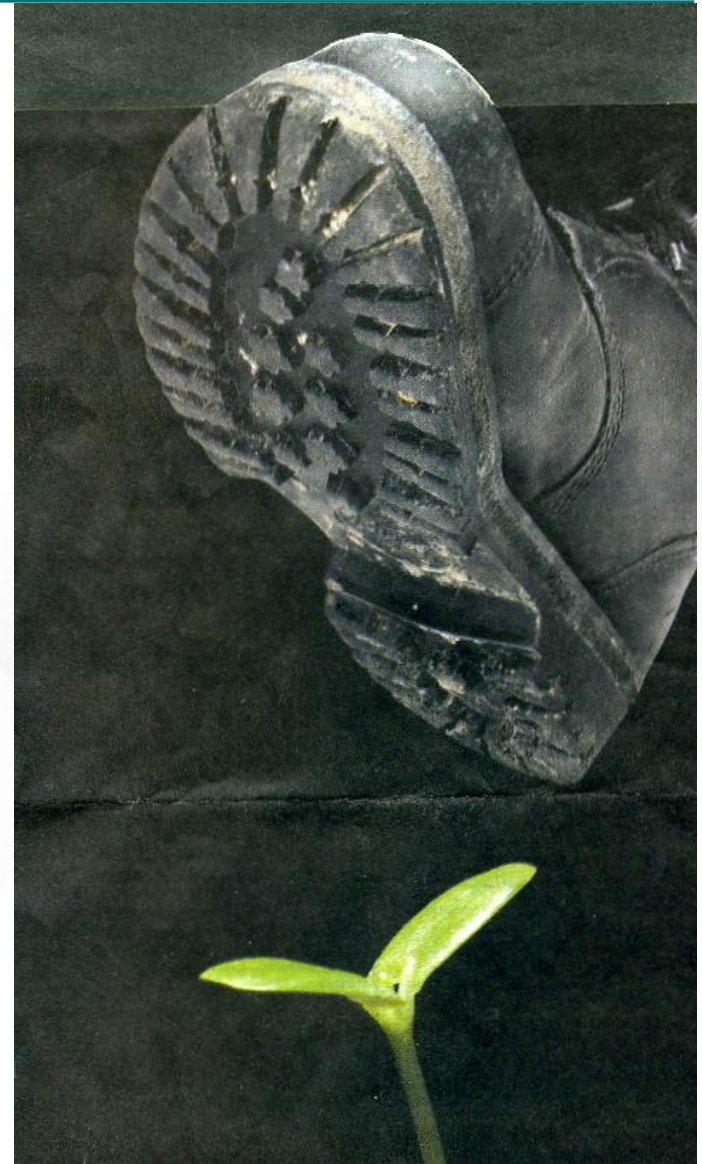
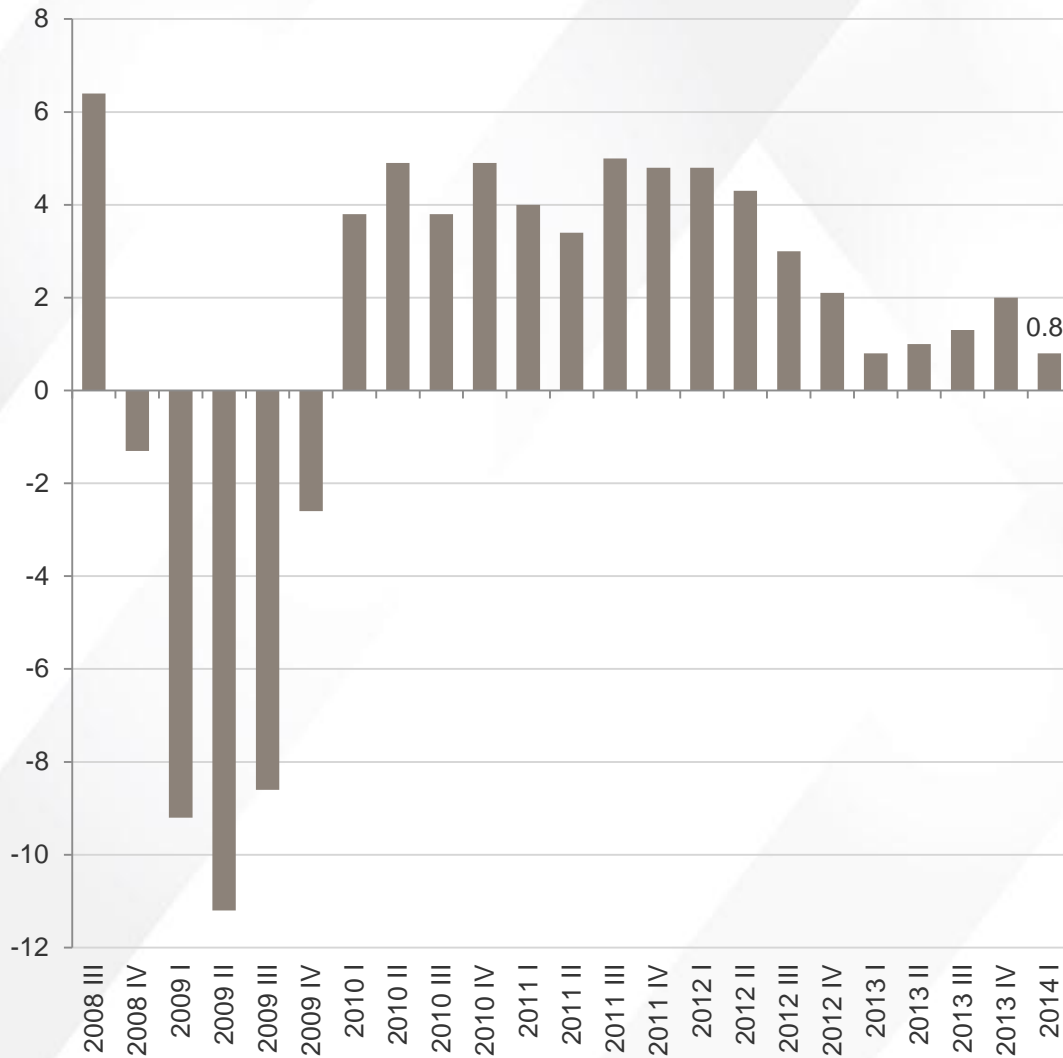
Lithuania's ties with Russia:

How vulnerable are we?



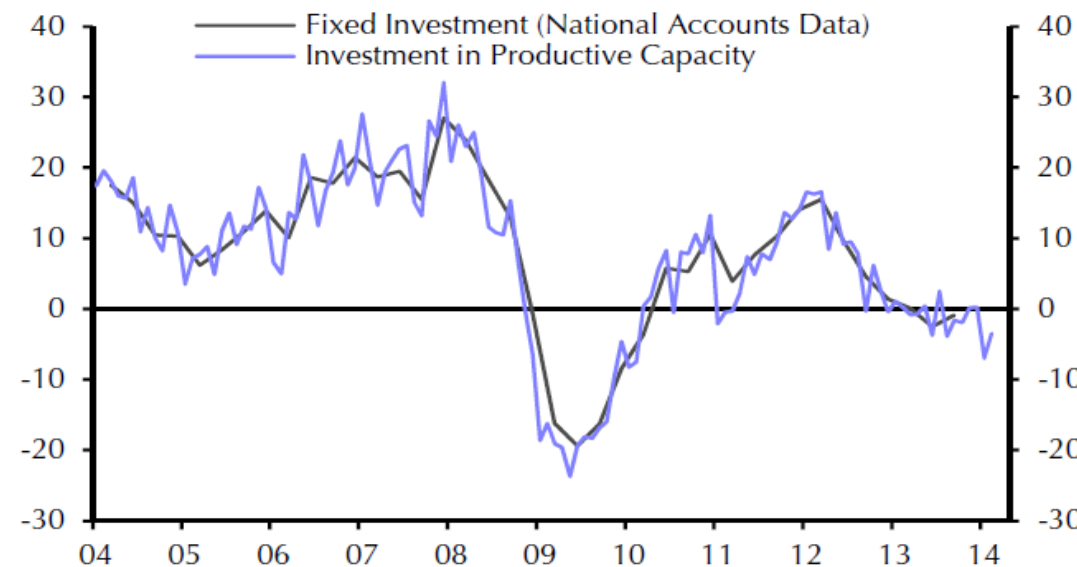
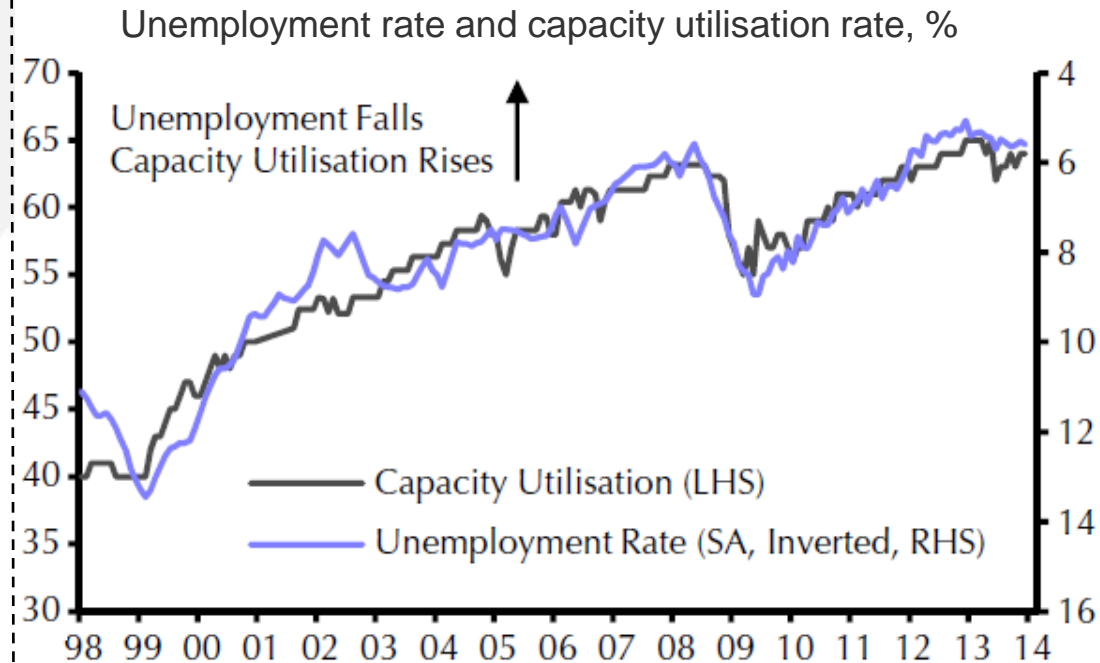
Russia's economy started to slow down even before the conflict

Real Russia's GDP, annual change, %



Russia chokes despite sweating at max capacity

- Russia's economy **has hit its production possibility frontier**.
- **Supply side is weak** and uncompetitive, while domestic consumption remains strong and feeds from imports.
- **Capital base cries** for renewal. **Lack of progress** on structural reforms.
- **Employment growth** potential almost **exhausted**, shortage of high-quality labour force.
- The CBR is caught **between higher inflation and weakening economy**



Russia-Ukraine conflict triggered off substantial capital flight



-12%



-16%

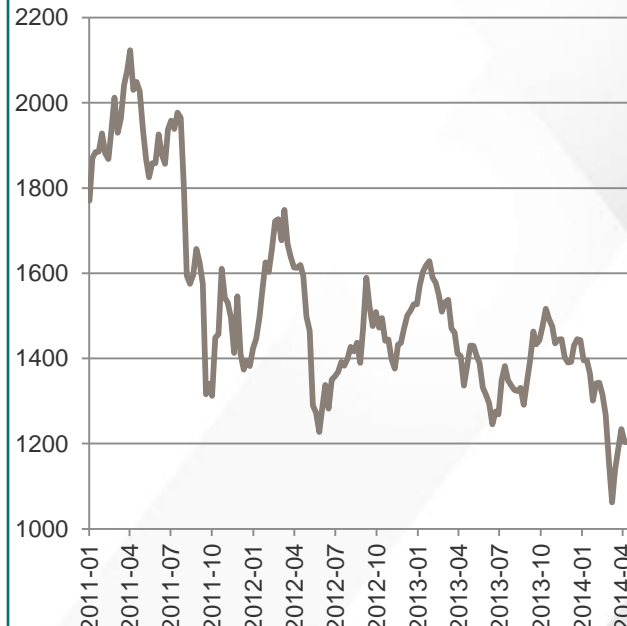


-USD48bn

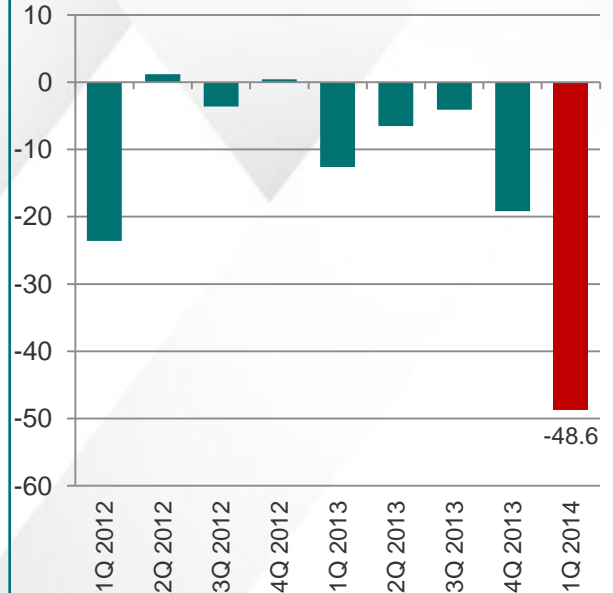
EURRUB



RTSI\$ Index



Russia's financial account flows USD bn

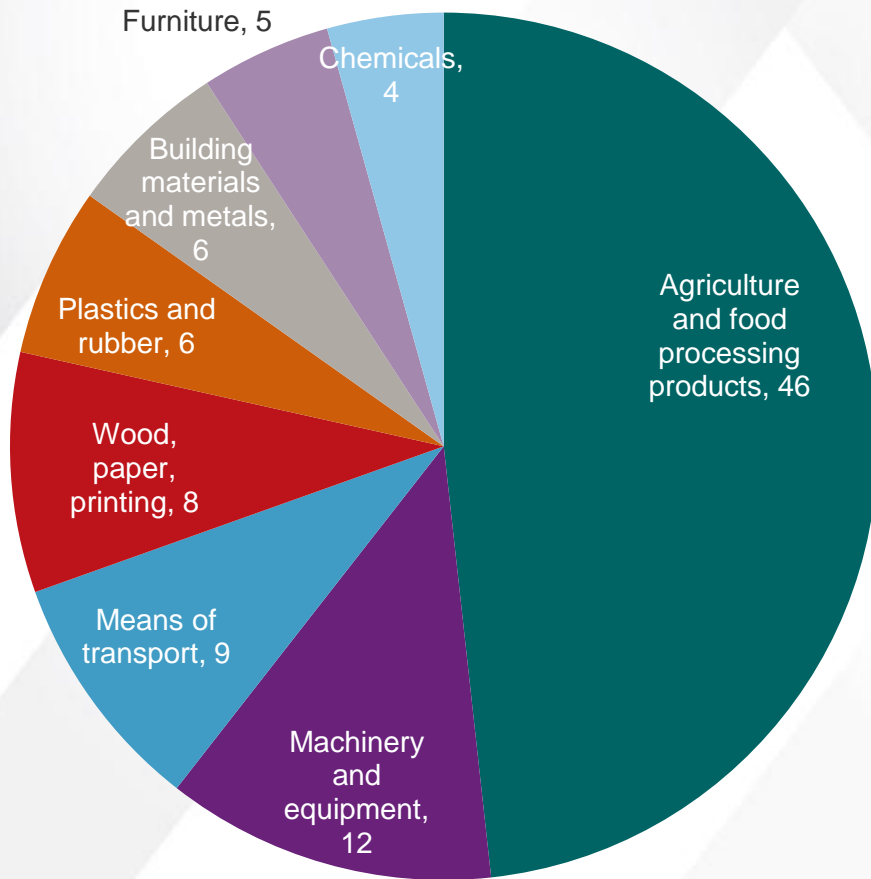


Channels for spillover effect on Lithuania

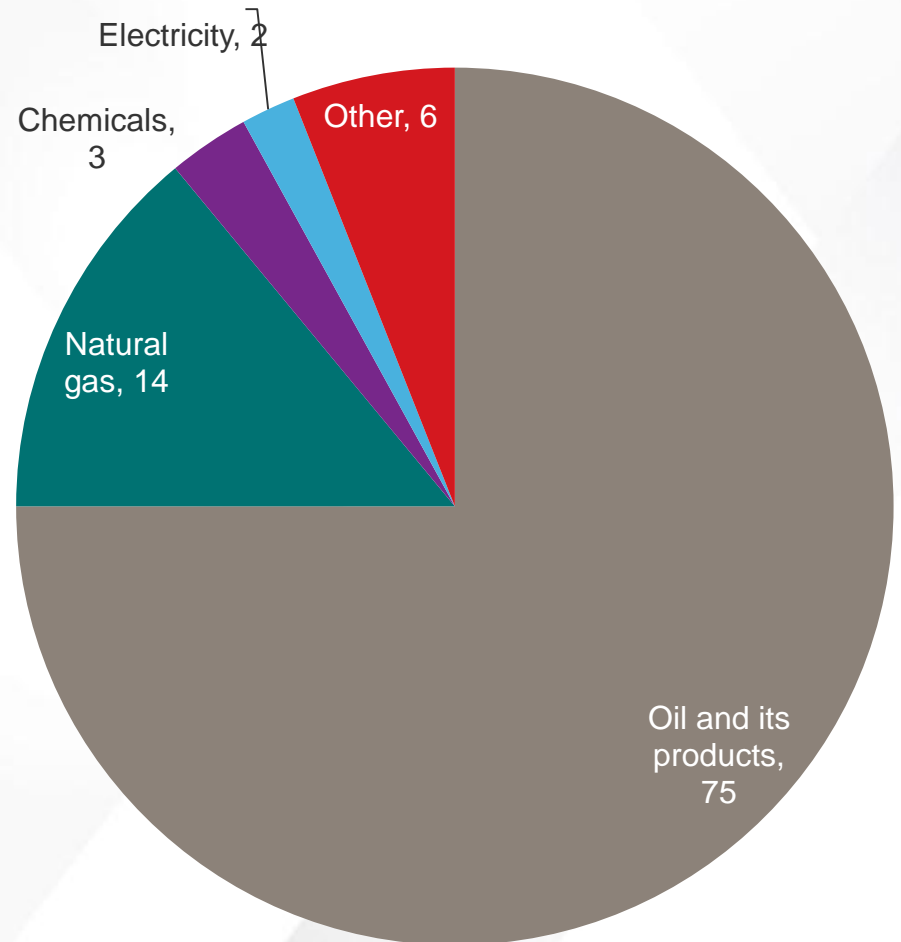


Lithuania exports mostly food, while imports mainly energy

Structure of Lithuanian origin exports to Russia in 2013, %



Lithuania's imports from Russia in 2013 by product, %

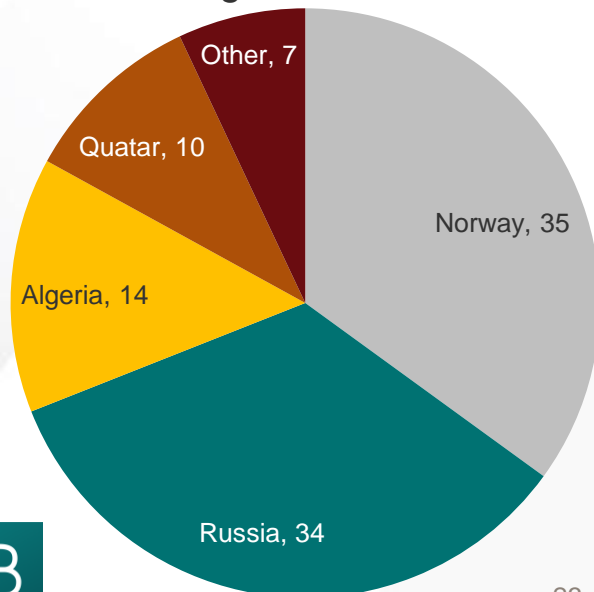


The EU has several sources for natural gas

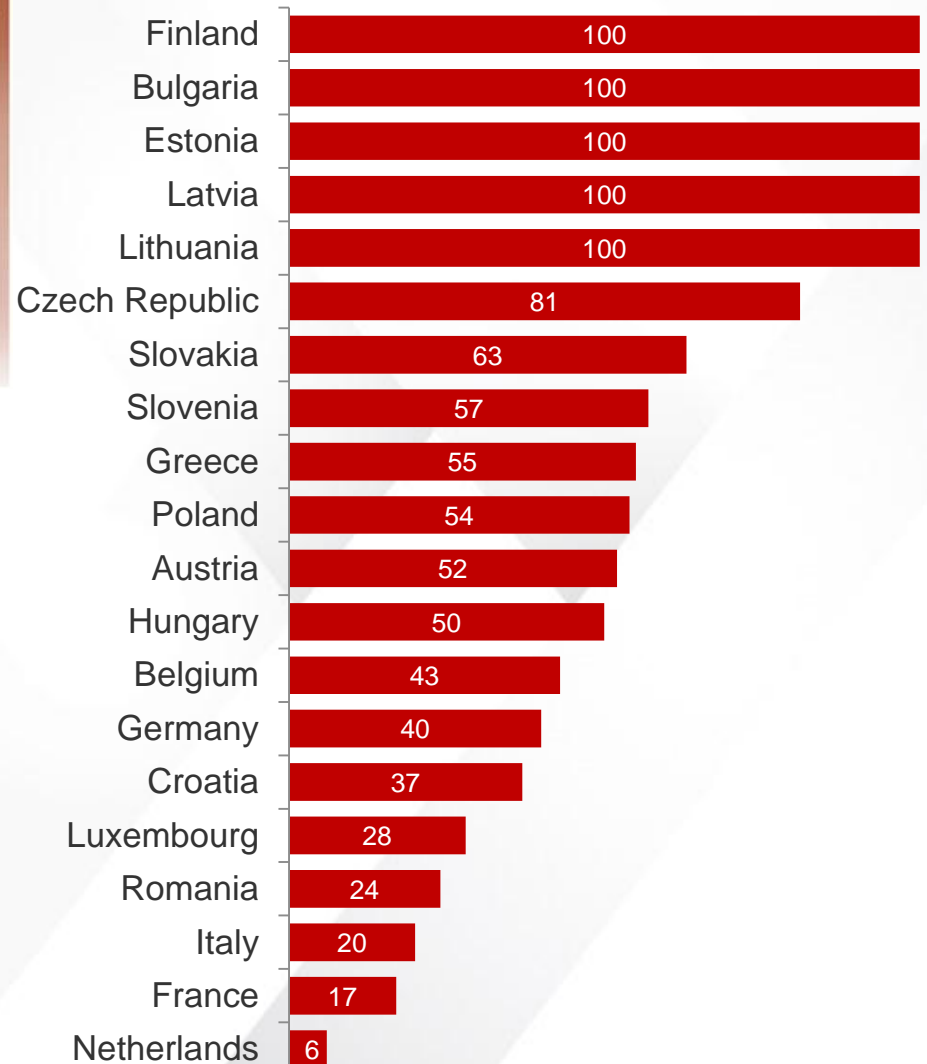
However, Lithuania is among those who are totally dependent on Russia



Natural gas imports of the EU by country of origin in 2012, %



Natural gas imports from Russia in 2012, share of domestic consumption, %



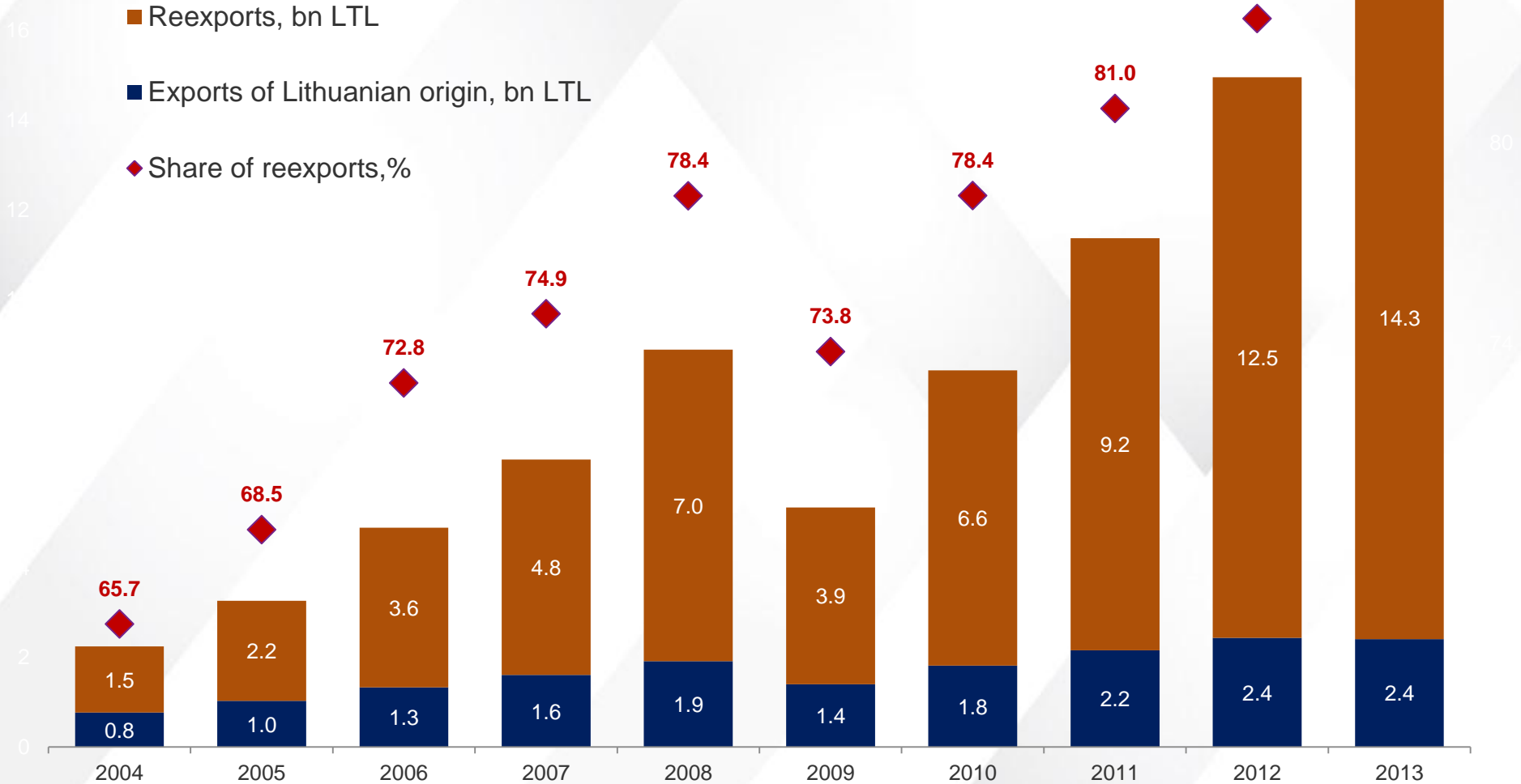
Re-exports to Russia more than doubled since 2008

Lithuania's exports (excl. mineral products) to Russia

■ Reexports, bn LTL

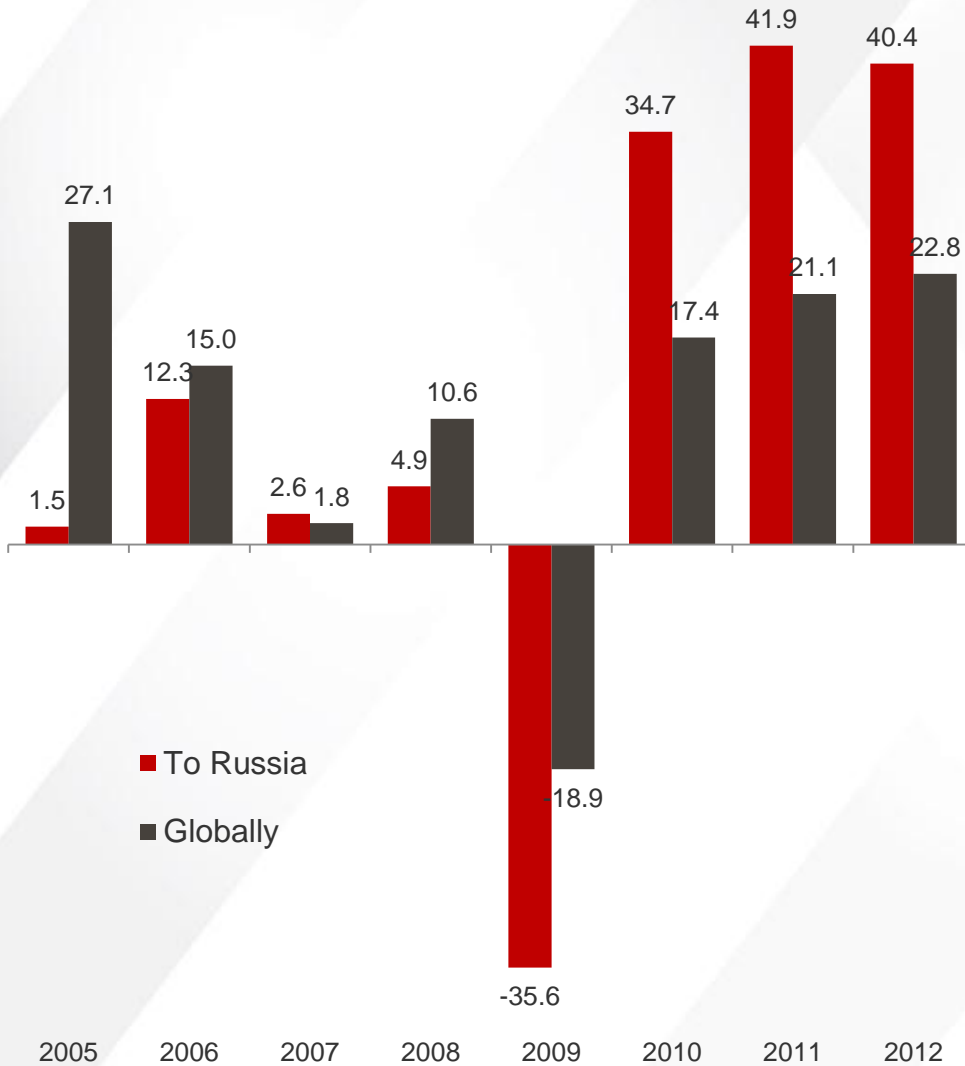
■ Exports of Lithuanian origin, bn LTL

◆ Share of reexports, %

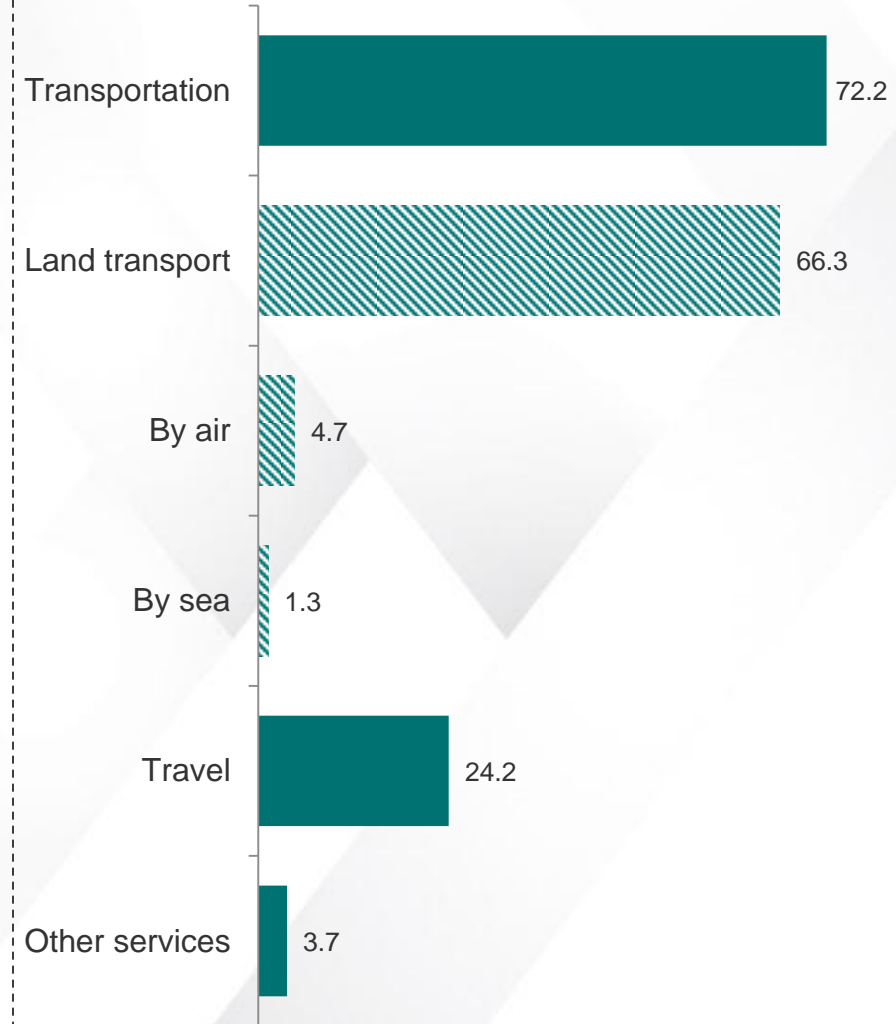


Russia has been absorbing Lithuania's service exports greedily

Exports of services, annual change, %



Structure of exports of services to Russia in 2012, %



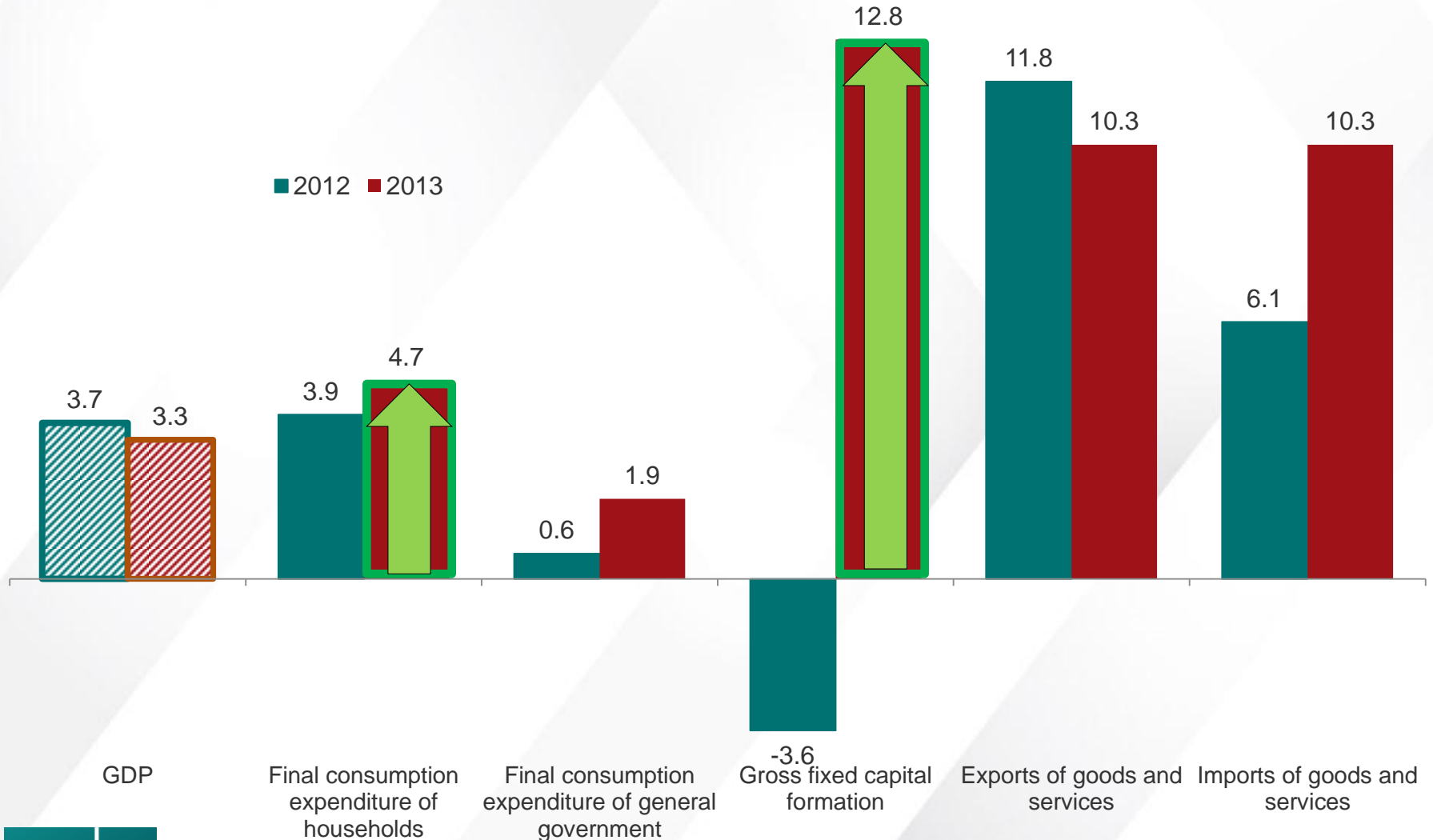
DOMESTIC DEMAND TRENDS



Lithuania is changing the gear:

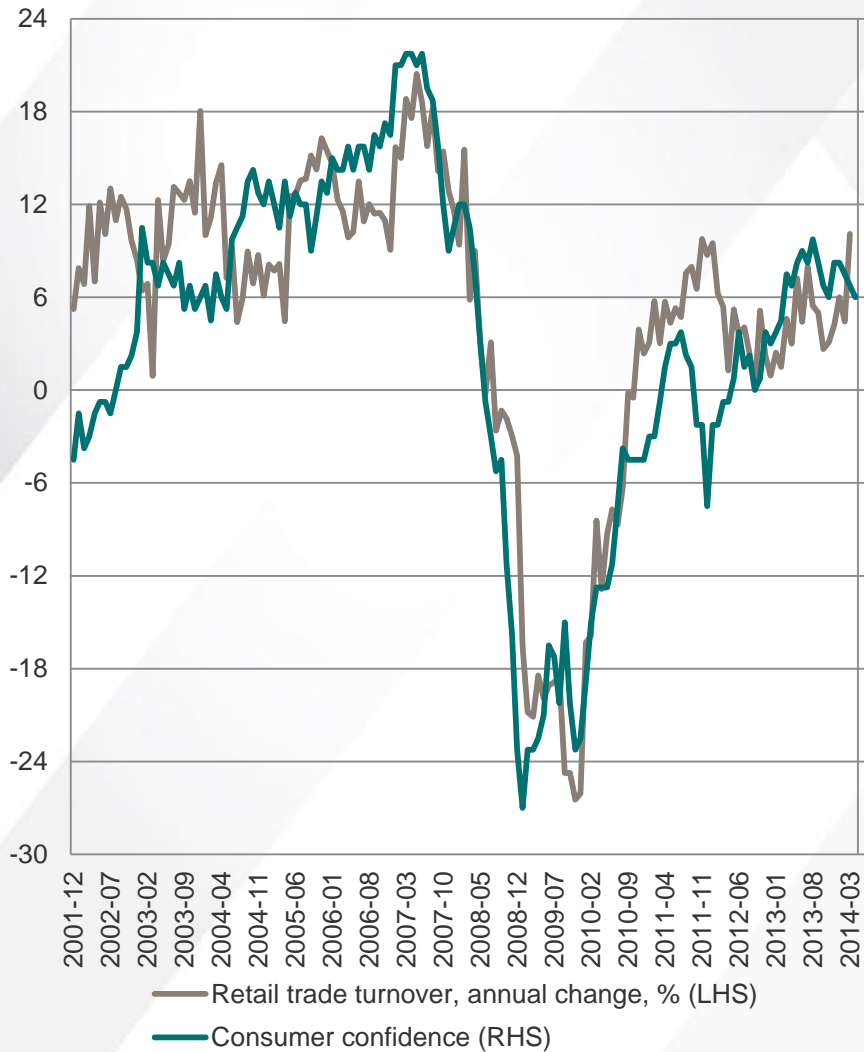
recovering domestic demand replaces weaker exports

GDP components according to expenditure approach, annual change, %

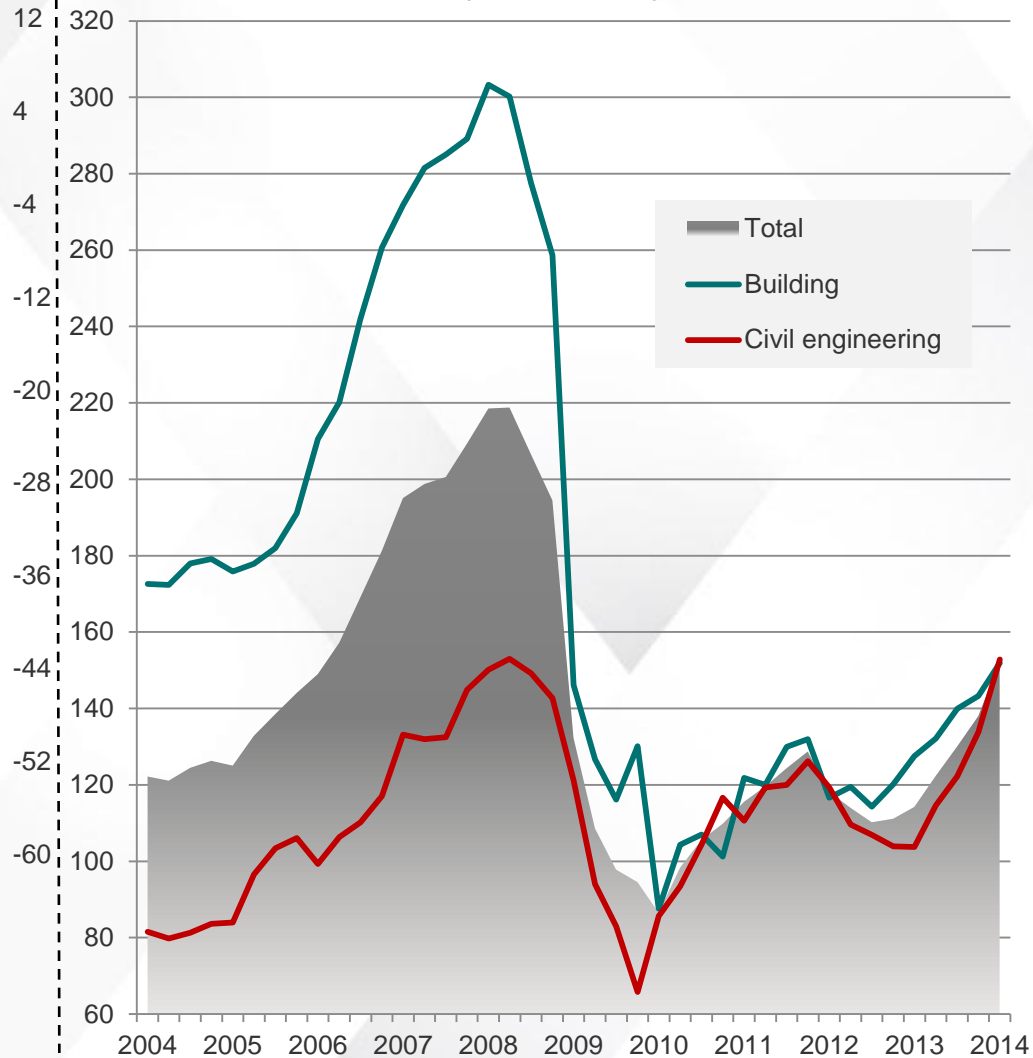


Domestically oriented economic activities grow rapidly

Dynamics of retail trade turnover and consumer confidence

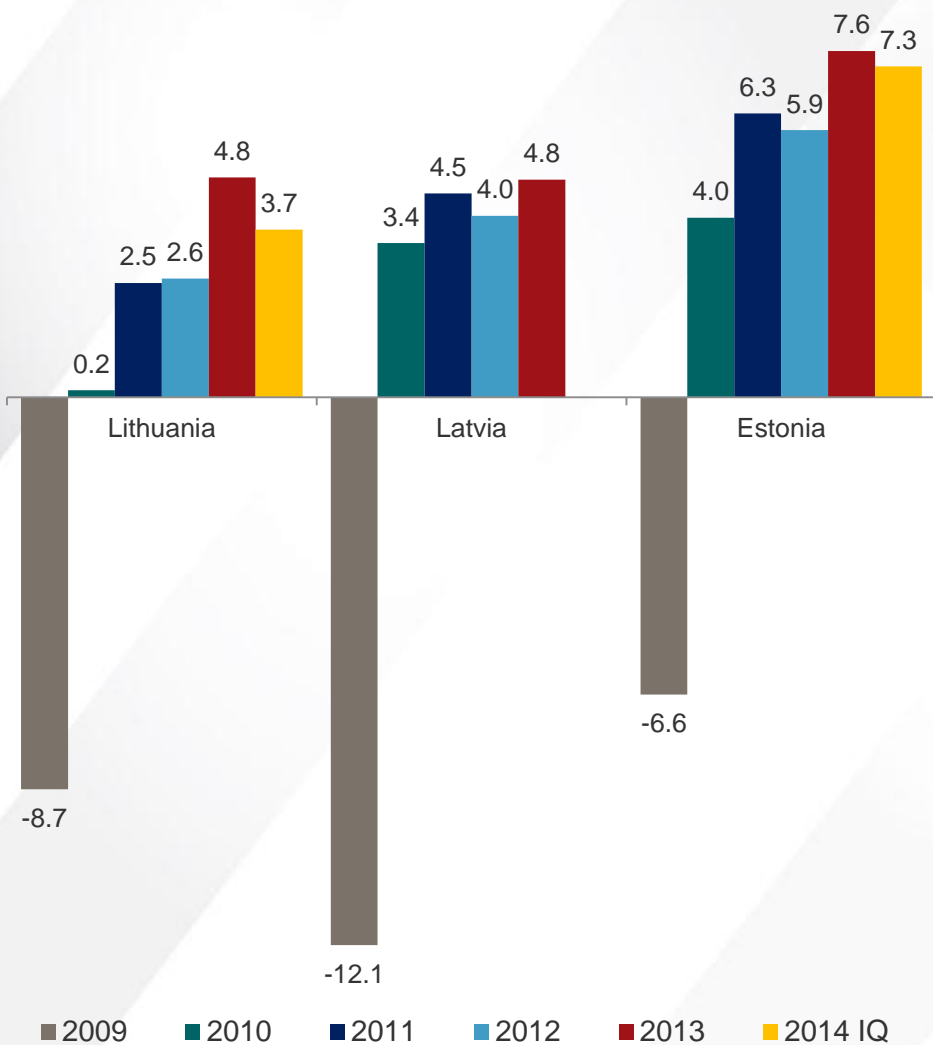


Construction output at constant prices (2010=100), %

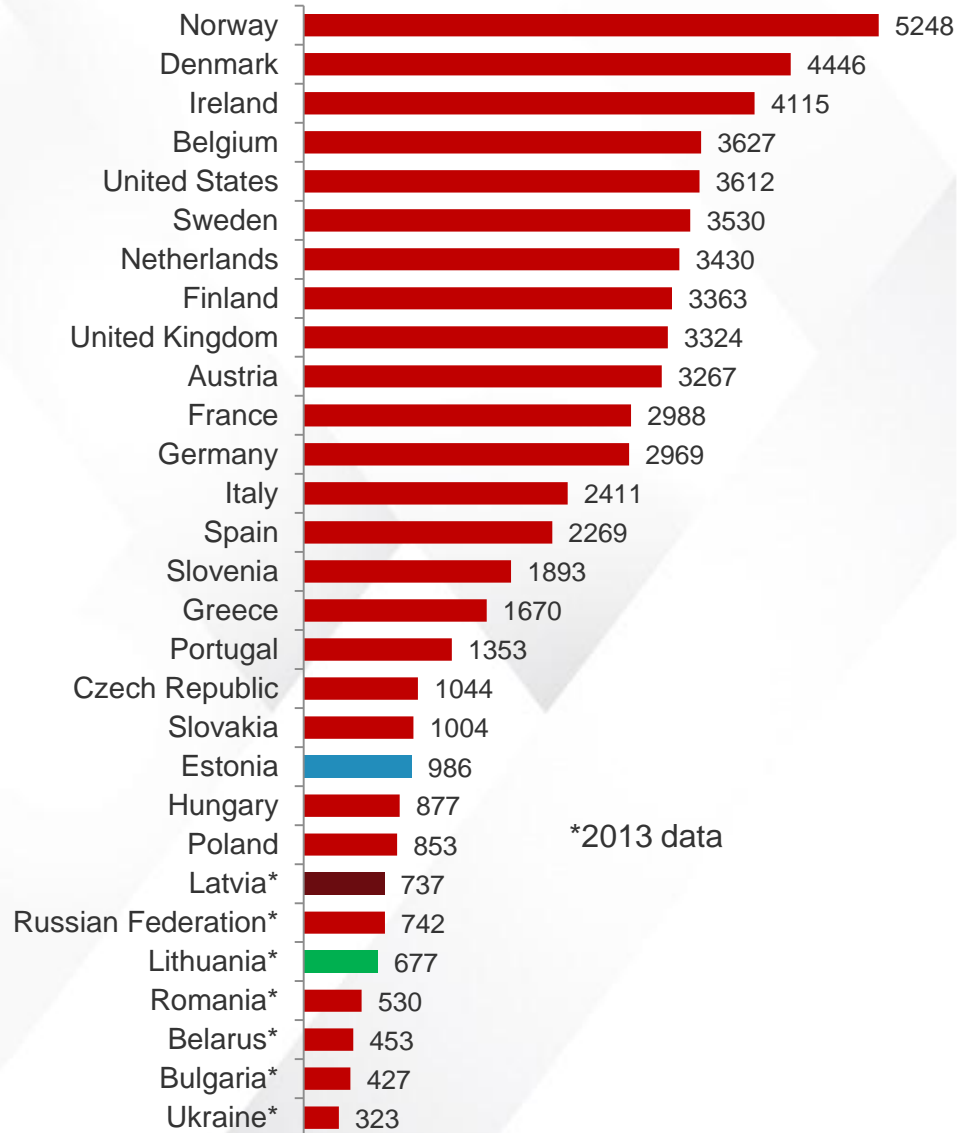


Real wages started to recover in Lithuania only in 2013

Average gross monthly wages, annual change, %

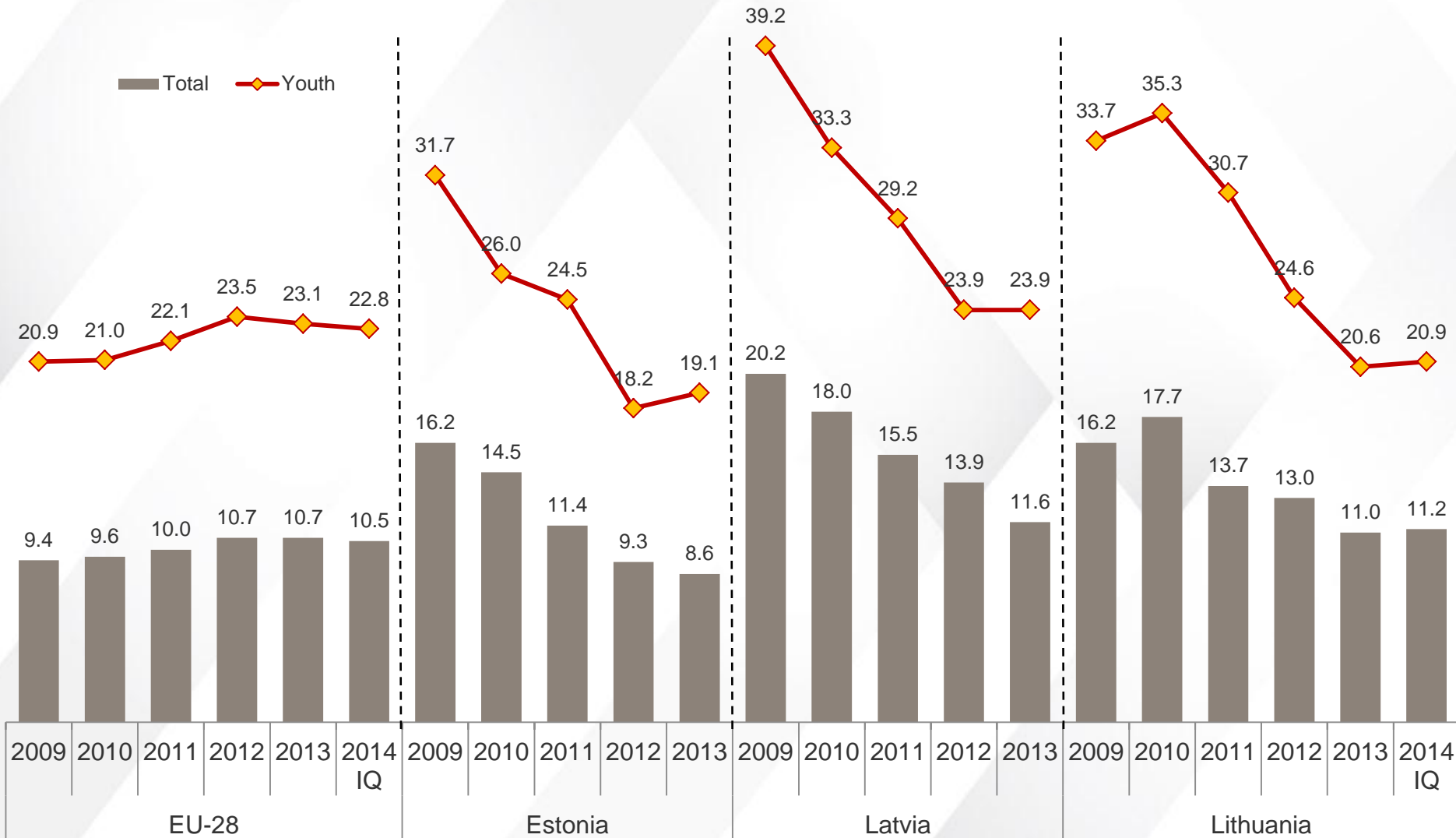


Average monthly gross wages, 2012, EUR



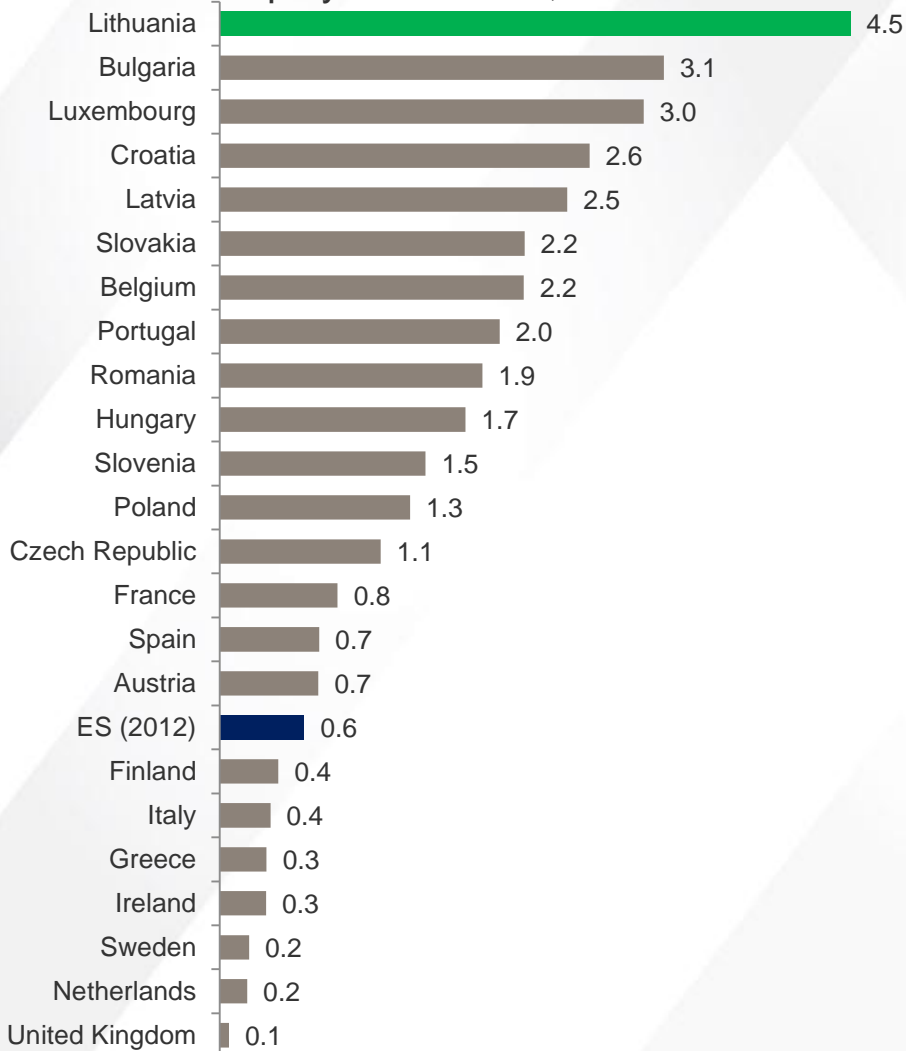
The bottlenecks in the labour market have emerged

Unemployment rate, seasonally adjusted, end of period, %

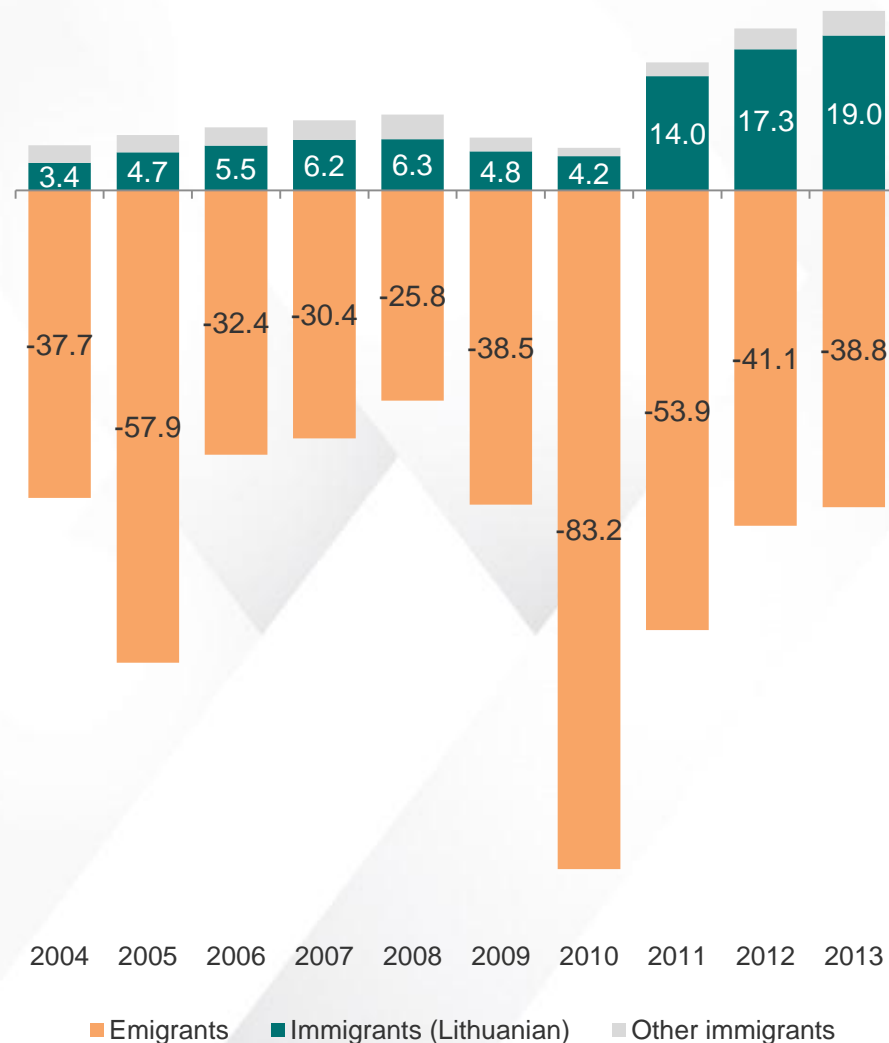


Demographic pressure persists, however re-emigration picked-up in 2013

Workers' remittances and compensation of employees in 2013, % of GDP



Migration dynamics in Lithuania, thousands

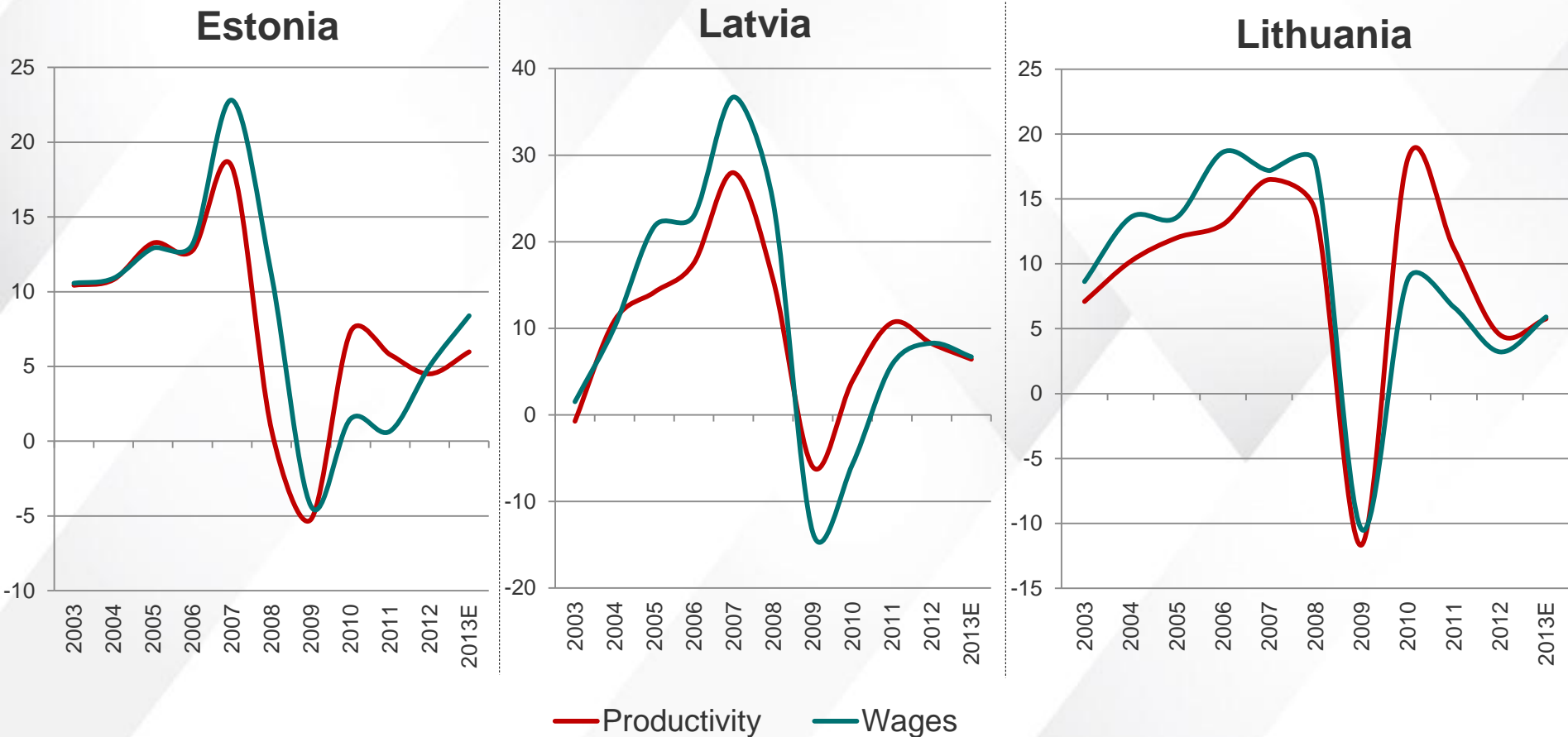


Source: Eurostat, Statistics Lithuania

Gap between wage and productivity growth is nearly bridged

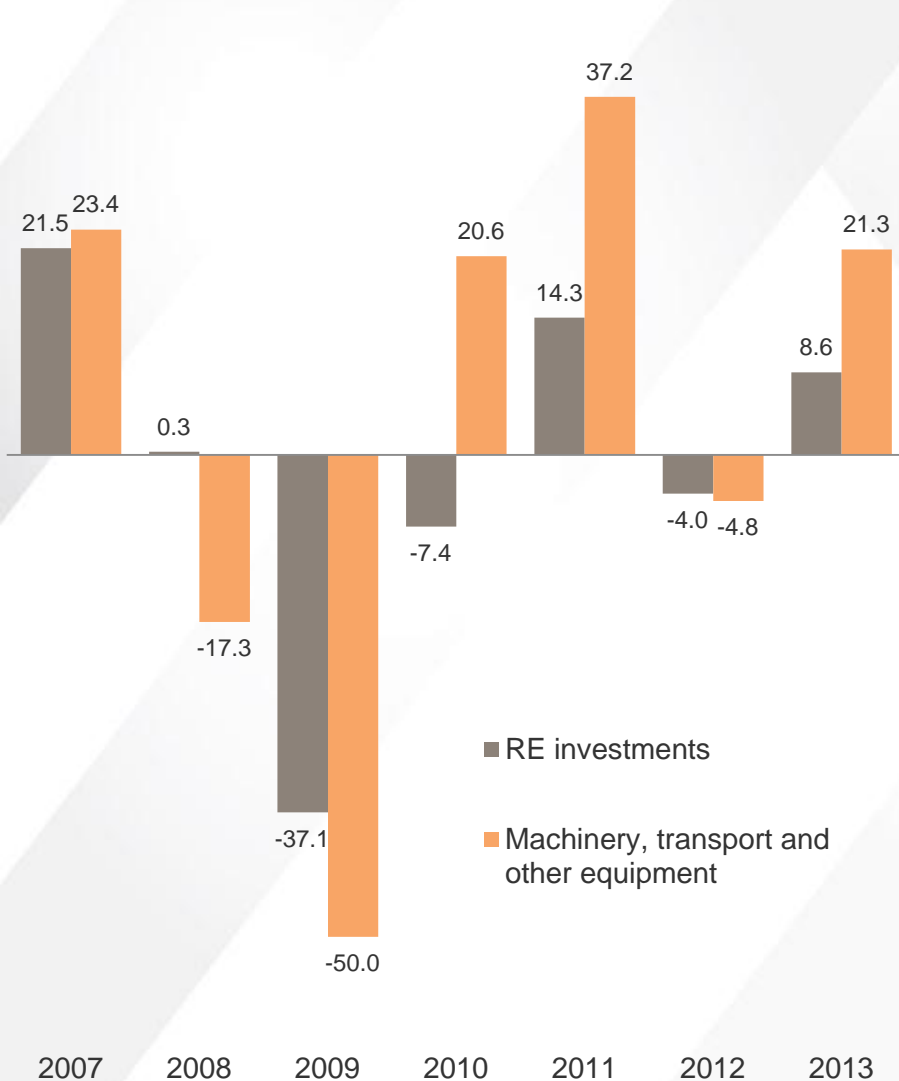
Rapid wage growth is a threat for the competitiveness of the Baltics

Gross value added and compensation per worker, annual change, %

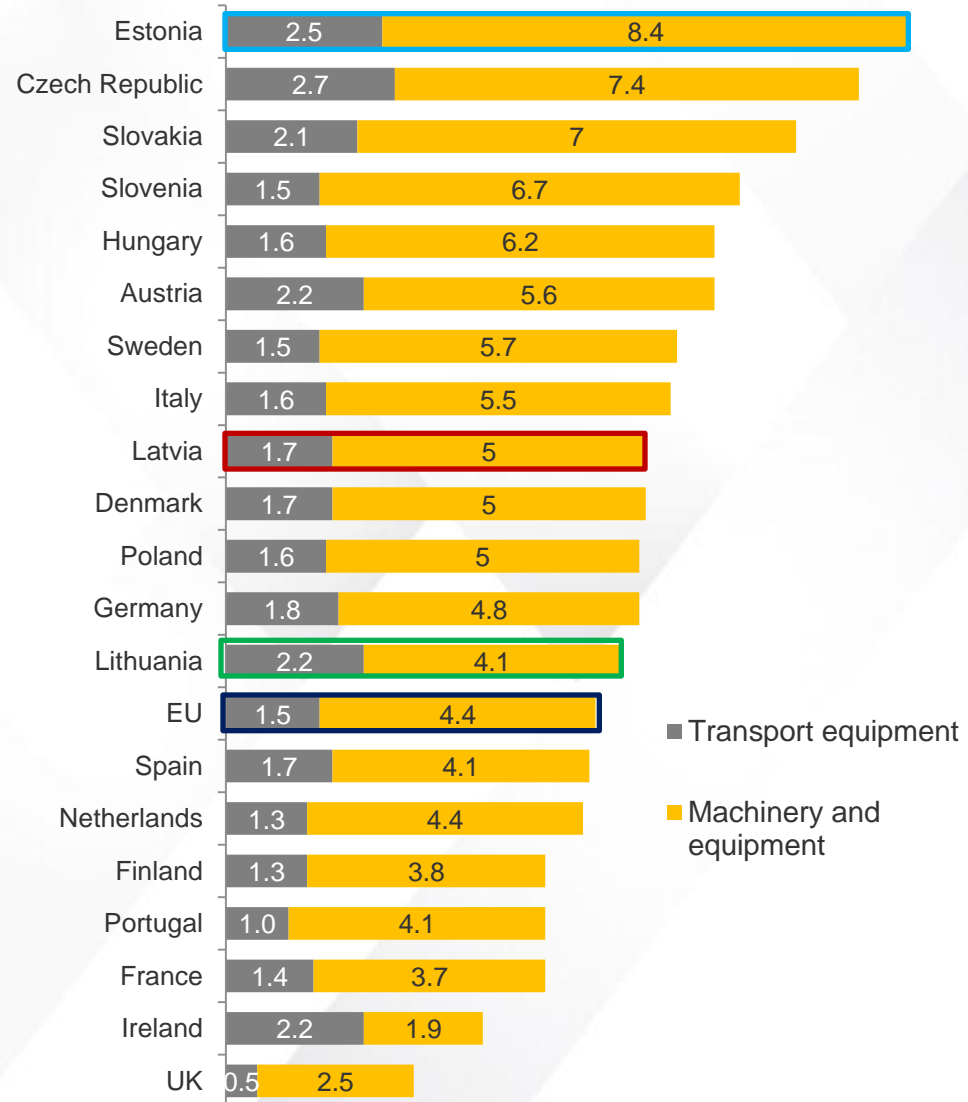


Lithuania finally exceeded the EU average investments to GDP level

Real investments, annual change, %



Gross fixed capital formation expenditure, ratio to GDP, %



Lithuania safely complies with Maastricht criteria

There are no objective reasons that would prevent Lithuania to introduce the euro in Jan-2015, however official acceptance by European authorities is required.



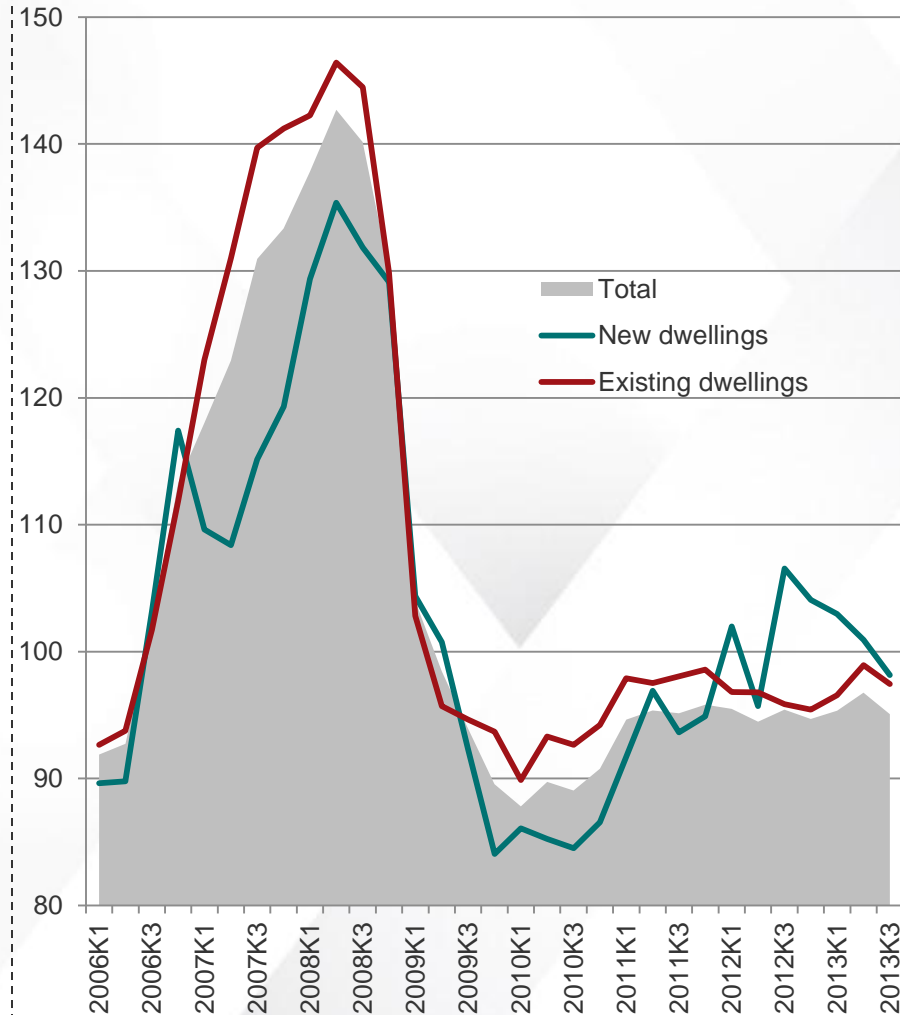
	Criterion	Ratios in April
Long-term government bond yield, percent	5,4 - 6,5	3,6
Government debt to GDP, percent	60	39,4
Price stability, percent	1,1 – 1,7	0,6
Government budget deficit to GDP, percent	3	2,7

Expected currency changeover adds fuel to the housing market

Residential RE transactions



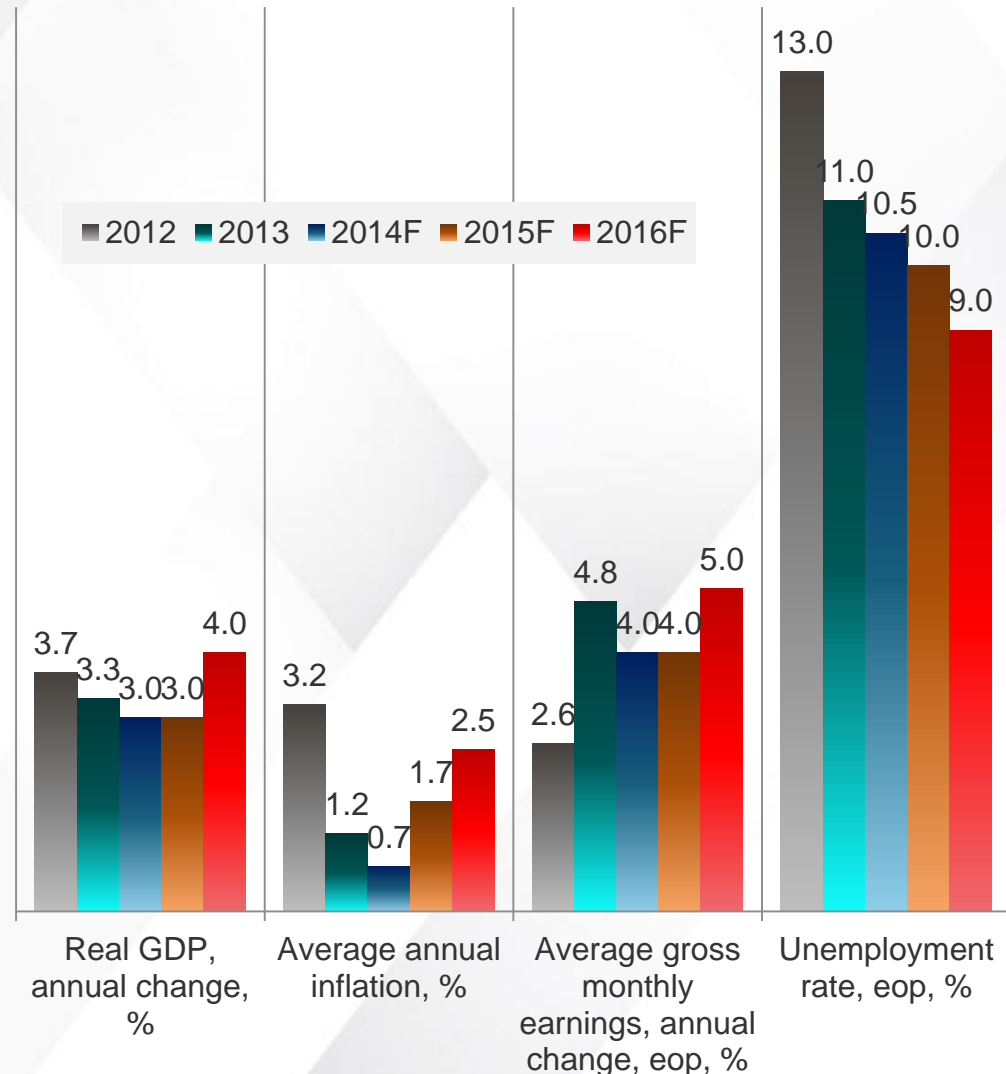
House price index (2006 = 100)



Lithuania's macroeconomic outlook

- Export-led growth model makes the country **exposed to external shocks**, given its high degree of trade and financial openness. Need for export diversification.
- Easing fiscal austerity and benevolent inflationary climate fuelled **domestic demand recovery**.
- **Businesses increase investments to avoid internal imbalances** (demographic, emerging labour market bottlenecks, etc.) and to remain competitive.
- **The adoption of Euro** would provide Lithuania with the access to the ECB's liquidity, enhanced financial stability will raise confidence in the eyes of foreign investors.

Key macroeconomic indicators, %



Thank you!



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