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Lithuania's Economic Outlook for 2017–2020

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The Economic Development Scenario was developed on the basis of the statistical data published by 1 March 2017 and the information obtained, which, following Government of the Republic of Lithuania Resolution No 369 On the Approval of the Description of the Procedure for Development and Publishing of the Economic Development Scenario of 13 April 2016, was presented by the Ministries of the Republic of Lithuania (of Environment, Social Security and Labour, Transport and Communications, Economy, Foreign Affairs, Agriculture). Key assumptions of the external economic environment (oil prices, EUR / USD exchange rate, European Union (hereinafter - the EU) and the euro area economic perspectives) correspond to the 2017 winter forecast estimates published by the European Commission (hereinafter - the EC).

Having evaluated the disposed information and Lithuania's economic situation after the end of 2016 while drafting the economic development scenario, we think that in medium term Lithuania's gross domestic product (hereinafter – the GDP) may grow on average 2.5 % per year. In short term – in 2017, after increased labour productivity, Lithuania's GDP may grow at even more accelerated pace – 2.7 % (the same projections were made half a year ago), while in 2018 the GDP growth may reach 2.6 %, and this is slightly faster than we projected half a year ago.

The position of employees in medium term will remain beneficent – their bargaining powers in the tense labour market will increase, and this will result in the growth of wages of at least 6 % on average.

The provisions of the new Labour Code of the Republic of Lithuania coming into force in the near future should promote job creation and higher wage agreements. This legal act establishes that a minimum average wage or minimum monthly wage (hereinafter – the MMW) is the lowest permissible remuneration for unskilled job for the employee respectively for one hour or full working time rate of the calendar month, i.e. a minimum wage may not be paid to the employees subject to certain skill requirements raised by the employer.

Though the projected acceleration of inflation in medium term will slightly diminish the purchasing power of the population, however the wages will grow at a more accelerated pace than inflation, thus the real disposable income of the population will grow, and the increase in consumption expenses of households will remain fairly robust – on average about 3.6 % per year (above the EU average) and will significantly contribute to the GDP growth.

In medium term, we expect to have a relatively intense investment process upheld by favourable banking credit conditions, use of alternative financing sources (peer-to-peer lending and crowdfunding platforms) and more active use of the European Fund for Strategic Investments and the EU investments. Gross fixed capital formation expenditure in medium term might grow about 5 % per year, while, for a comparison, there was no growth in the previous year.

For business the medium term will not be easy – upcoming challenges in connection with global demand fluctuations and the need to maintain international competitiveness. Under decreasing labour force resources and pursuit to keep skilled employees, business models based on cheap labour force will face more challenges. A flexible labour market, the

effective use of production facilities and labour force resources, also the expansion of investments (for innovations and upgrading of human resources) would help to enhance labour productivity and thus, to maintain a sufficient level of competitiveness even under rising prices of the labour force.

In order to enhance national resistance to external threats and due to ageing society, to be better prepared for financial challenges in the next decade, in medium term it is necessary to pursue responsible fiscal policy, to make efforts in reducing the government debt level and to increase the government financial resources in the Reserve (Stabilisation) Fund. The implementation of structural reforms, efficiency enhancement of public expenses and tax reliefs, accrued public asset management optimisation under external environmental uncertainties become one of the main fiscal policy elements.

The advancing implementation of the projects financed from the EU funds, approaching implementation of the projects financed from the European Fund for Strategic Investments and ongoing relatively active implementation of the investment projects financed from private funds in medium term will increase the investment level in the country. The share of expenditure of the gross fixed capital formation to GDP will steadily rise during the entire medium term, while in 2020 the value of this indicator will reach 20.7 % and will be close to the multi-annual average (20.8 %), however, it will still fall behind the pre-economic crisis level (in 2004–2008 this indicator on average represented 25.4 % of GDP). Though increased investments are still not a guarantee of higher economic growth, the purpose of the invested funds as well as efficiency of their use are also important. To date more than half of all investments in Lithuania is designated to the construction of dwellings, other buildings and structures (in 2016 they constituted 56.7 % of the gross fixed capital formation expenditure), while the construction activity results strongly correlate with the amount of the EU funds. In order to ensure a sustainable growth of investments and at the same time the growth of the whole economy (it will be of particular importance after expiry of the 2014–2020 EU financing period), more attention should be devoted to the projects which promote economic growth, create long-term jobs and ensure investment returns. In medium term, innovations, intellectual property products should become priority investment areas, and the allocation of funds to these areas should be stimulated also through targeted investments of the State budget funds.

This type of investments is the fastest way for Lithuania to increase labour productivity which has been at stagnation during the recent years. The investment into the higher value added production would form the basis for long-term economic growth, contribute to the enhancement of national competitiveness and would help businesses to compete successfully on rapidly changing global markets. According to the data of 2015, the value added created by high and medium technologies in the manufacturing sector makes up about one fourth of the total value added created by manufacturing and is less than 5 % of GDP.

At present under a rapid growth of wages, businesses transfer the increasing share of the price rise of labour force to the prices of goods and services. In 2016 the prices of services increased by 3.2 %, foodstuffs – 1.3 %. This along with growing global prices of some raw materials starting from the second half of the year 2016 pushes up the inflation even at more

accelerated pace. The average annual core inflation (estimated according to the methodologically Harmonised Consumer Price Index (HCPI) with other EU Member States, excluding energy goods and raw foodstuffs) in 2016 accelerated up to 1.9 % (from 1.2 % in 2015) and gives a warning about the growing impact of internal factors on prices, in particular due to rapidly increasing labour costs.

Annual inflation estimated according to the HCPI in November 2016 represented 1.1 %, in December increased up to 2 %, and in January 2017 – up to 2.5 %. Higher annual inflation was caused by fuel prices of transport vehicles and prices of foodstuffs growing at more accelerated pace.

In 2016 the prices of foodstuffs and non-alcoholic beverages on average increased by 1.3 %, while in January 2017 – even by 3.6 % (as compared to a respective month of the previous year). In January peaked the prices of dairy products (6.3 %), oils and fats (7.4 %), vegetables (5.7 %). The rising prices of dairy products at the end of 2016 – beginning of 2017 was not unexpected – the information on the plans of dairy companies to increase prices of production became known in the middle of October 2016. The outlining reasons of the price increase – recovering demand for milk on the European market, lower quantities of raw milk on international market and increasing purchase prices of milk, which increase production costs. In January 2017 purchase prices of raw milk in Lithuania kept increasing for the seventh month in turn – the average purchase price of natural milk reached EUR 303.2 per ton – by 1.4 % higher than in December last year and by 34.4 % higher than in January last year. The dairy market participants expect the prices of raw material and production on the Lithuanian dairy market still to pick up slightly in the first half of the year 2017, while afterwards – to become stable.

Accelerated rise of fuel prices of transport vehicles in January 2017 (by 13.7 %, as compared to a respective month of the previous year) is not unexpected and interrelated with higher oil prices. In January, as compared to a respective month of the previous year, the change in price of *Brent* oil barrel (in euros) mainly caused by the statistical base effect (i.e. by a low price of a respective period of the previous year) constituted about 80 %. According to the EC 2017 winter forecast, in 2017 the price of *Brent* oil (in euros) should grow by 30.7 %. Hence, the annual price increase of fuel this year will remain, however from the middle of the year it will start diminishing. In 2018 the oil price is projected to be stable.

Starting from 1 March this year the increased rate of excise duty on anhydrous ethyl alcohol by almost one fourth and the rates of excise duties on alcoholic beverages – by almost twofold, also the increased rates of excise duties on tobacco products about one tenth, in 2017 will have the upward impact of 0.7 percentage point on inflation (as compared to the inflation projection of September 2016).

Due to the aforementioned one-off factors, the average annual inflation projection for 2017 is increased up to 3.4 %, for 2018 – up to 2.7 %. It is projected that in 2019 and 2020 the average annual inflation will be close to the average multi-annual net inflation and will constitute 2.5 %.

The tension on labour market will not defuse in medium term. Though at present labour activity is growing rapidly, business will find it more and more difficult to fill the created new vacancies for the occurrence of which the economic conditions in medium term will remain favourable. Labour force supply will diminish due to negative demographic trends and lack of suitably qualified employees. Therefore, in medium term, under unchanged migration trends, the number of the employed population has limited possibilities of growing. We project that in 2017 the number of the employed population might grow 0.8 %, in 2018 – 0.3 %, in 2019 – 0.2 %, in 2020 – 0.1 %. The unemployment rate will keep decreasing and in 2017 will represent 7 %, in 2018 – 6.4 %, in 2019 – 5.9 %, in 2020 – 5.4 %.

A positive effect on labour market in medium term will have pending amendments of the Labour Code which will offer better opportunities for new participants, e.g. for studying young people or parents with children, to enter the labour market. Attractiveness of the Lithuanian labour market will increase. This would have a positive effect either on labour activity or employment. Without the adoption of the amendments to the Labour Code, the number of the employed in medium term would start decreasing.

In medium term, as in the year 2016, a negative impact of immigration on labour force will be temporary compensated by huge labour activity stimulated by the accelerated pace of the growth of wages, extension of the retirement age. The unemployment rate in 2016 constituted 7.9 % and was by 1.2 percentage point lower than in the previous year. The long-term unemployment rate decreased by 0.9 percentage point down to 3 %. The unemployment rate was decreased by the employment which due to the strong labour force demand grew 2 %.

Though demographic trends continued to worsen, the number of labour force in 2016 grew by 0.6 %. Rapidly growing real wages and supply of job vacancies, which kept increasing in the majority of economic activities, encouraged the passive population to enter the labour market and to become active labour market participants – labour activity level in the 15–74 age group on average constituted 67.6 % and was by 1.3 percentage point higher than in 2015. A proud activity level caused the growth of the number of labour force in the country during the same period up to 8.6 thousand persons, or 0.6 %, and at national level it offset the labour force deprived due to a negative impact of demographic factors – the number of movers over 2016 exceeded the number entrants by 29.6 thousand, or by 32.2 % more than in 2015.

Though labour activity grew in majority of age groups, the number of labour force increased only in the 55 and older age group of the population, where the activity growth was the most accelerated. Due to gradually extended retirement age and changing composition of the population (the share of elderly people increases), the supply and demand for elderly people (in particular, in trade and service sectors oriented towards the domestic market) in medium term should rise. However, the activity growth of elderly population will be limited by poorer health of persons of this age group, as compared to other age groups, and possibilities of working intensively.

After increase in number of job vacancies by almost one fourth (23 %) and in the labour force activity level, the number of the employed population in 2016 grew in almost all economic activities and total increase in national economy represented 2 %. The number of elderly people (55

years of age and older, i.e. the persons whose activity has grown the most rapidly) has increased most – 30.7 thousand persons (11.6 %). In the 25–54 age group accounting for 70.5 % of the employed population of the national economy, the number of the employed decreased by 4.9 thousand persons (0.5 %). In the 15–24 age group the number of the employed population grew slightly – 0.6 thousand persons (0.6 %).

The employment grew in almost all economic activities, while the most considerable growth was observed in manufacturing and domestic-market oriented activities: trade, education, administrative and support service activities. Though the demand for labour force was high, the number of the employed population in transport and custodian as well as construction activities has slightly decreased. It is projected that a part of the employees in these activities consists of non-residents who are not included into the labour force survey. According to the data by the Lithuanian Labour Exchange, in I-III quarters of 2016 the number of work permits for non-EU citizens made up 14.6 thousand and, as compared to 2015, increased by 5.7 thousand, or 63.7 %. The major share of persons employed under these permits comprised Ukrainian (58 %) and Belorussian (32 %) citizens. Taking into consideration the fact that in February 2016 the Government of the Republic of Lithuania approved the list of 27 professions the specialists of which from non-EU countries are more easily recruited, it is expected that in medium term more and more non-residents will be recruited, therefore, more and more employed persons will not be included into the labour force survey.

A situation in the labour market favourable for employees – demand for labour force exceeding supply and diminishing unemployment – as well as enhancing negotiating powers of employees stimulated the growth of wages.

In 2016 the average monthly gross wages in the country (including individual enterprises) increased 7.9 % (in private sector – 9 %, public sector – 6.1 %) – this was the most accelerated growth of wages from 2009. Wages kept increasing in enterprises of all types of economic activities, in particular in those where wages were the lowest, and the nature of activity is related to provision of services: accommodation and catering services, artistic, entertainment and recreational, administrative and support services, also real estate transaction activities.

A significant impact was caused by a rapid MMW growth – from the beginning of 2015 the MMW was raised every half a year and from 1 July 2016 the MMW makes up EUR 380. Over 2016 the MMW increased by 16.8 %, and the impact of this increase on the growth of the average monthly gross wages in medium term represented about 2 percentage points. The effect increasing the growth of wages about 0.5 percentage point will remain also in 2017 (due to the MMW increase in the middle of 2016).

The results of the empirical regional wage development study demonstrate that though in 2003–2015 the wages in the country grew at accelerated pace and the MMW increased, the relative gap between the highest and the lowest wage rates in municipalities during this period remained almost the same, thus, the gap in monetary terms increased. The results of the study demonstrate that in 2003 the distribution of the average monthly gross wage rates in municipalities was EUR 218–385 (excluding exclusively high wages in Visaginas Municipality), thus, the difference

between the highest and the lowest wage rates in municipalities was 1.8 times (EUR 167). In 2015, as compared to the year 2003, the lowest wages in municipalities increased by 2.3 times up to EUR 499, the highest – 2.2 times up to EUR 832, thus, the relative gap between them made up 1.7 times and remained similar to that in 2003, while the gap in monetary terms grew up to EUR 333. The results of the study also demonstrate that the wage rate in different regions is mainly related to the generated gross value added per capita in a respective region.

Decreasing unemployment rate and increasing prices in medium term will build up a pressure to increase wages. In 2017 the wage growth in the country will be accelerated also by the Republic of Lithuania Law on Payments for the Employees of State and Municipal Institutions which came into force on 1 February 2017 and the application of the provisions of which will increase wages of the lowest-paid professionals. Due to these reasons, the average monthly gross wage projection for 2017, as compared to the autumn projection of 2016, is increased up to 6.7 %. In 2018–2020 the changes in the average monthly gross wages will depend on the development of economic factors – labour force supply and demand, labour productivity, inflation, profitability of enterprises. On the one hand, decreasing unemployment will accelerate the wage growth pace, on the other hand, wage increase possibilities will be limited by the increasing wages share of GDP. We project that in 2018–2020 under the average pace of wage growth close to 6 % in medium term, in 2020 the wages for employees will constitute 47 % of GDP, what has never happened before in Lithuania. The wages will grow at the most accelerated pace in private sector – of the activities where the labour force demand is buoyant and wages remain to be the lowest. We project that the average monthly gross wages in the country in 2018 will increase by 6.1 %, in 2019 – by 6.2 %, in 2020 – by 6.3 %. The projected growth of wages at more accelerated pace than labour productivity reflects strengthening negotiating powers of employees and wage convergence towards the wage rates in the single EU labour market.

Improving financial situation of households in recent years and good consumer expectations fostered the growth of household consumption expenditure which in 2016 represented 5.6 % – this is the fastest growth rate during the last 9 years (faster growth rate was recorded only in 2007). The impact of households consumption expenditure on the GDP growth in 2016 was also significant – 3.6 percentage point. The population was encouraged to higher consumption not only by improving financial situation of households, but also by favourable consumer credit conditions. After a 7-year period, a rapid growth of consumer credits (5.7 %) was recorded in 2016.

The projected acceleration of inflation in medium term will slightly reduce the purchasing power of population, however under more rapid growth of real wages than inflation the consumption of households will remain rather high and will significantly contribute to the GDP growth. We project that in 2017 consumption expenses of households will grow 3.9 %, in 2018 – 3.6 %, in 2019 – 3.5 %, in 2020 – 3.5 %.

In medium term the Lithuanian exporters will further have to adapt to changing economic circumstances, continue making investments to promote competitiveness and to manage currency risk, make decisions on decrease of production costs, enhancement of operational efficiency and manufacturing capacities. A strong sustaining diversification of exports of goods creates certain optimism about export perspectives. A stable growth of exports of services since 2010, material

investments increasing in the manufacturing in the second half of 2016 create conditions for continuous development of exports in medium term.

Export performance for a number of years demonstrates that also under unfavourable conditions the Lithuanian companies are able to adapt and to increase exports of production. In 2016 the value of exports of goods (excluding mineral products on the value of which a negative effect was produced by fallen oil prices) increased by 1.8 %, while of goods of the Lithuanian origin (also excluding mineral products) – by 2.7 %. Increased exports of furniture, optical and medical devices, electrical machinery and equipment, metals, timber, plastics, foodstuffs, tobacco of the Lithuanian origin and re-exports of chemical products, transport vehicles had the major effect on the pace of growth of the export value. The major negative effect was caused by decreased exports of mineral products, fertilisers, rape of the Lithuanian origin as well as by re-exports of mineral products, fruit and vegetables. Further growth of exports of furniture, plastics, foodstuffs and agricultural products of the Lithuanian origin, export recovery of fertilisers and re-export growth of goods are expected in 2017. Better position on the European dairy products market, recovering corn exports will have a positive impact on exports of foodstuffs and agricultural products. Due to higher oil prices, the value of exports of mineral products will keep growing. Though in 2016 the pace of exports to the United Kingdom was spanking and reached 9.9 % (excluding mineral products), the decrease in exports of some significant goods (livestock products, ready-to-eat foodstuffs, plastics and rubber, timber, metals, furniture) to this country was observed in IV quarter. It is projected that a weakened pound will have an adverse effect on exports of goods to the United Kingdom.

After evaluation of the fact that instability of the external environment will continue, and risks related to external demand will remain high, in medium term we project that in 2017 the real exports of goods and services will grow by 3.8 %, in 2018 – 3.9 %, in 2019 – 4 %, in 2020 – 4 %, respectively.

Risk for the Economic Development Scenario Fulfilment

Economic development perspectives in medium term will depend on global demand, in particular, in the basic Lithuanian export markets. Geopolitical tension still persists, slow growth of global economy, mutual Russian and EU sanctions extended till the year 2017 may be not removed for a longer period. The challenges oppressing the EU – the debt problem of some EU countries, problem of refugees invading Europe, tension in the EU banking sector, terrorism threat – have not diminished. Still there is a risk of political tension in the EU as well as manifestations of economic nationalism. All of this increases vulnerability of either global, euro zone or Lithuanian economy. Still not launched *Brexit* negotiations and unknown results of these negotiations as well as unpredictable outcome of the elections taking place in several EU countries create economic and political uncertainty, due to which currently existing trends in the Lithuanian economy and the perspectives of the basic economic indicators laid down in this scenario may change.

At present, under commenced accelerated growth of wages, the risk increased that if no measures enhancing labour productivity are taken and under growing labour productivity the gap between the growth of wages and labour productivity is not mastered, a sudden slowdown in the

growth of wages may occur. Also other negative risk exists that without enhanced labour productivity (without investment into more efficient labour facilities and upgrading of the employees), the growing labour costs will be mainly transferred to the prices of goods and services, thus causing a wage-price spiral. In such case, the inflation and wages would increase more than predicted in this scenario. In the event the presumption of the scenario concerning the developments in oil price does not come to fruition – the oil price rises more slowly, a lower inflation might be expected in 2017.

The evidence has become stronger that Lithuania in medium term risks to fall into low growth trap: under lack of investments and shrinking number of population, the potential national GDP growth is currently almost twofold lower than during the period before the economic crisis; the GDP per capita (in Purchasing Power Standard) is not increasing for a number of years in turn (in 2014–2015 set at 75 % of the EU level); wage growth exceeds the labour productivity growth; high income inequalities in the country and among separate national counties.

Growing uncertainty about the future influenced by external factors may encourage business to postpone the investment projects, and the households – to save up the major share of income and to refuse to purchase non-primary goods. Thus, the developments of consumption and investment costs specified in this scenario would change.

After the provisions of the new Labour Code of the Republic of Lithuania come into force, in medium term the investments in the country may increase at more accelerated pace than specified in this scenario. Thus, more jobs would be created in the country, and the GDP growth would be more accelerated. The GDP growth might be higher in case, if the economic growth on the key Lithuanian export markets were more rapid or labour productivity grew at more accelerated pace than projected while drafting this economic development scenario.

Development of Key Economic Activities and Perspectives in the Medium Term

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
Wholesale and retail trade (18.2 %*)	<p>Under growing domestic demand and increasing income of households, at present trade is one of the basic stimuli for the GDP growth which caused the GDP growth of 0.7–0.9 percentage point.</p> <p>In 2016 the growth pace of the turnover in the retail trade in Lithuania was one of the most rapid in the EU (by 2.5 times higher than the EU average). In 2016 the retail trade turnover grew 7 %: retail of foodstuffs – 2.8 %, non-food goods – 5.5 %, fuel for motor vehicles – 18.8 %. Due to fallen oil prices, fuel prices for motor vehicles went down, thus increasing its demand. Due to this reason, in 2016 the trade in fuel for motor vehicles compiled almost half of the turnover growth in retail trade. Beyond the increased sales of the fuel for motor vehicles, the volume of retail sales grew 4.1 % in 2016.</p> <p>In January-February 2017 the business survey data of the Statistics Lithuania demonstrate that the trade confidence indicator diminished. Though trading companies has a positive evaluation of the future – a number of trading companies, which in the upcoming months foresee the improvement in business situation and increase in the number of employees, grows, the downturn in this indicator might be the result of the decreased number of companies which indicated that over the last months their business situation improved.</p> <p>In 2017 and during the entire medium term the trade volume expansion will be stimulated by the decreasing unemployment rate and rapidly growing wages, and suppressed by rising fuel prices for motor vehicles, and due to uncertainties for the future, there are possible changes in consumers' behaviour – postponed purchase of non-primary goods. Therefore, the expansion of the companies engaged in wholesale and retail trade will be more moderate than in 2016, while the growth of the value added of these activities in medium term might reach on average 2.5–3 % per year.</p>
Transportation and storage (11.7 %*)	<p>In 2016 transportation and storage activities have recovered after the recession in 2015 and resulted in about 0.6 percentage point of the GDP growth. In 2016 the income from sales of transportation and storage activities</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>grew 7.1 % – good results were caused by growing income of 14.2 % of road freight transport companies.</p> <p>In 2016 good results of transportation and storage activities were due to settling of the Lithuanian transporters into the EU market, relatively low fuel prices and renewed vehicle fleets. In I–III quarters of 2016 the exports of transportation services to the EU countries grew 23.2 % and represented 84.3 % (as compared to the year 2015 – 75.6 %, 2014 – 66.7 %) of total exports of road transportation services. The market of the road transportation exports is diversified – in 2015 the major part of services was supplied in Germany, France, Denmark, Austria, Latvia and the Netherlands. It is likely that these countries remained important partners also in 2016, however the detailed information on exports of road transportation services to the EU countries (excluding the data about exports of road transportation services to France and the Netherlands) and CIS countries is not published due to confidentiality of data (according to the Republic of Lithuania Law on Statistics, the data are confidential when from the data it is possible to identify a respondent and his activity results).</p> <p>According to the business survey data published by the Statistics Lithuania, in January-February 2017 almost all land transport companies evaluated their business situation as good or satisfactory, however for the first time since II quarter 2015 a number of companies projecting the decrease in demand for their services supplied in the upcoming months kept increasing.</p> <p>In medium term the expansion of companies supplying transportation and storage services will be stimulated by recovering demand in Russia and other CIS countries, and will be suppressed by rising fuel prices, growing labour costs, shortage of skilled labour force, consequences of the outcome of <i>Brexit</i> negotiations.</p> <p>In medium term the Ministry of Transport and Communications projects the expansion of transportation and storage activities. In medium term the growth of the value added of these activities might reach about 2.0–2.5 % on average per year.</p>
Accommodation and food services (1.5 %*)	<p>In 2016 the Lithuanian accommodation establishments received 2.7 million tourists, this is by 9.8 % more than in the previous year: a number of foreign (9.4 %) and local tourists (10.2 %) compiling about a half of the tourist flow increased. After a long period the tourist flows from one of the main inbound tourism markets –</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>Belorussia – increased. A number of accommodated tourists not only from Europe (Ukraine, Poland, Latvia, Belorussia, Spain, France, Estonia, Denmark, Germany and etc.), but also from Asian countries has rapidly increased.</p> <p>Growing awareness of Lithuania and due to constantly emerging air traffic directions, less complicated accessibility of the country (as compared to 2009, when there were approximately 30 air traffic directions, in 2016 it was possible to reach from Lithuania twice as many airports of other countries, while by 2020 it is planned to open more 30 new directions) will lead to the expansion of the accommodation services sector. Nevertheless, reconstruction works of the runway of Vilnius Airport for more than a month (the majority of companies will divert flights to Kaunas Airport, however several airlines will interrupt flight operations during the reconstruction) may have a negative impact on the expansion of this sector in 2017. Growing foreign tourist flows and increasing income of the Lithuanian population in 2016 stimulated the activities of companies supplying catering services – their turnover increased by 6.2 %. Growing expenses of foreign tourists contributed to good performance results of catering services – about one fifth of expenses of foreign tourists contain food and beverage expenses. According to the business survey data of Statistics Lithuania, in January-February 2017 almost all catering companies evaluated their business situation as good or satisfactory, and the majority of companies have not projected the decline in demand. The same tendencies are likely to sustain also in medium term, and the growth of the value added of accommodation and catering services might reach 4.5–5.5 % on average per year.</p>
Manufacturing (19.0 %)	<p>In 2016 the value added growth of manufacturing grew at more accelerated pace than in 2015 and was a significant GDP growth stimulus – grew 3.4 % and resulted in one third of the GDP evolution in 2016.</p> <p>In 2016 the manufacturing production grew 3.1 % (excluding refined petroleum products – 5.6 %). The production of refined petroleum products constitutes about one fifth of total manufacturing production, therefore, the overall manufacturing outcome fluctuates due to the production outcome of these products. The production of majority of other manufacturing sectors kept growing, therefore, it seems that they have not yet encountered with demand decreasing problems.</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>Though manufacture of metal products made up only 3.7 % of manufacturing products, the production growth of this branch (17 %) had the major impact (0.6 percentage point) on the growth of manufacturing production. Good results of production of chemicals and chemical products (0.5 percentage point), timber and timber products (0.4 percentage point), computer, electronic and optical devices (production of laser equipment for medical treatments is also attributed to this group) (0.4 percentage point) had also a positive impact on the growth. One of the major customers of such manufacturing branches as production of other non-metal mineral products (production of concrete and other construction materials is attributed to this group), metal products, electrical equipment is the construction sector which in IV quarter 2016 recovered after a five-quarter downturn.</p> <p>In January-February 2017 the results of the business survey data of Statistics Lithuania demonstrate that industrial confidence indicator is growing – the majority of companies evaluate the demand as good and project the growth in the upcoming months.</p> <p>According to the data of the Ministry of Economy, in medium term the volumes of the manufacture of textiles are projected to be annually higher on average by 3 % and on average by 3.4 % – volumes of production of metal products, the produced volumes of timber and its products will stay about the same, a moderate growth of volumes of about 1 % is projected in production of furniture and in the group of other non-metal mineral products. In 2017 it is projected that the production of chemicals and chemical products will be higher by one fifth, and from the year 2018 the production of these products will decrease or stay unchanged.</p> <p>Manufacturing is one of the mostly outward oriented activities – about two thirds of manufacturing production is sold on non-Lithuanian market, therefore, the manufacturing outcome is strongly influenced by the situation on foreign markets. Changes in export demand and competition on export markets will be the basic factors which will influence the development of manufacturing and all industry in medium term. After evaluation of the information disposed while drafting the economic development scenario, in medium term the growth of the value added of manufacturing might reach on average 3.5–4 % per year. However, the perspectives of this activity may be worsened by a lower external sector</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>demand than projected while drafting the economic development scenario. Under predominating greater economic uncertainty, increasing labour costs, for the companies involved in manufacturing activities trying to remain competitive it will be extremely important to invest into the instruments increasing labour productivity. Under rapid change of external environment, the Lithuanian manufacturers may require the reconsideration of their export market structures and business development trends. A better access for the Lithuanian manufacturers to the markets of the third countries will be created by already made and coordinated trade regime changes of the EU and other countries.</p>
Construction (6.6 %)	<p>In IV quarter 2016 construction activities recovered after a 5-quarter downturn – the value added grew 2 %, however, annual results were negative – in 2016 the value added created by construction decreased by 8.1 % and mitigated the GDP growth pace by 0.5 percentage point.</p> <p>In 2016 construction works performed in the country decreased by 9.4 %, mainly due to the decreased number of engineering structures by 17.9 % and construction works of non-residential buildings – 8 %. Engineering structures are the most EU-assistance dependent type of structures, which in 2015–2016 occurred in trap after expiry of one EU structural assistance period (2007–2013), and assistance of the new investment period (2014–2020) has not reached the market yet. The construction of non-residential buildings was supported by construction works of business centres (in 2016 solely in Vilnius the largest rented area of business centres was offered since 2009), however, it was suppressed by construction works of industrial buildings and warehouses, educational and health treatment institutions, buildings for cultural and sport events. Due to intense construction works of new residential buildings, the construction remained to be the only segment which grew in 2016 (by 10.4 %), and these works constituted one fifth of total construction works made in the country.</p> <p>A part of companies engaged in construction activities diversified the risk and, after decrease in a number of orders of construction works in Lithuania, developed their business abroad. In 2016 the value of construction works performed abroad grew 14.4 % (in I-III of 2016 grew about 15 %, while in IV quarter shrunk by 1.5 %). In I-III of 2016 the Lithuanian construction companies implemented the largest number of orders in</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>Sweden, Norway, Estonia and Germany.</p> <p>In January-February 2017 the business study data of Statistics Lithuania demonstrates that a part of construction companies, which project the rising number of work orders in the upcoming months, increases, also the period for which the construction companies have work orders lengthens.</p> <p>In medium term the construction activity will be supported by the implementation of projects for construction and development of engineering structures and for modernisation and renovation of buildings financed from the 2014–2020 EU Funds assistance as well of the projects not related to the EU Funds assistance; and by the development of hotels and shipping centres. However, the impact of construction works of new residential houses on overall results of construction activities will diminish. In medium term the value added created in construction activities might grow about 6 % on average per year.</p>
Agriculture (3.3 %)	<p>In 2016 the value added created in agricultural activities shrunk by 3.5 % and reduced the GDP growth pace by 0.1 percentage point. Though the value added created in these activities decreased only in III quarter, however the results of agricultural activities in III quarter are extremely significant – more than a half of the annual value added of agriculture is created during this period, thus having a dominant influence on annual results. Negative results of agricultural activities in III quarter were the result of the poorer cereal harvest by 12.4 %. The main reason for the poorer cereal harvest – a significantly decreased yield (16 %), due to prolonged rainy weather at the time of harvest (due to this reason, even 7 % of cereal crop area have not been threshed).</p> <p>Due to rising prices of products of livestock sector and increasing consumption of meat in recent years, it is likely that this sector will support the overall outcome of agricultural activities in medium term. However, the crop production mainly consisting of cereals constitutes about 60 % of total agricultural production. In recent years cereal growers, due to accrued stocks and rich global supply, encountered with low purchase and export prices. The Food and Agriculture Organisation of the United Nations (FAO) projects that in 2017 the purchase prices will be the same as in 2015–2016, however, they may be influenced by currency fluctuations, prices of energy resources.</p> <p>According to the data of the Ministry of</p>

Economic activity (a proportion of the gross value added in 2016)	Development and Perspectives
	<p>Agriculture, the growth of volumes of agricultural products will be higher by 3 % in 2017, while in 2018–2020 the volumes of total agricultural production will grow 1.1–1.4 % annually. Higher growth of crop production – about 4 % is projected in 2017, afterwards on average about 1 % annually. In the livestock sector the growth of production capacities of up to 1 % is projected in 2017, and starting from 2018 – 1.5–2 % annually.</p> <p>In medium term the growth of the value added of agricultural activities might reach about 1 % on average per year.</p>

Sources: Statistics Lithuania, Eurostat, Ministry of Foreign Affairs, Ministry of Economy, Ministry of Transport and Communications, Ministry of Agriculture, Bank of Lithuania, PI Enterprise Lithuania, Lithuanian Real Estate Development Association, Lithuanian Institute of Agrarian Economics, Lithuanian Carriers Union, Food and Agriculture Organisation of the United Nations.

* Data of 2015.

Comparison of Estimates of Key Macroeconomic Indicators for 2017–2018

Indicator	Year	Ministry of Finance March 2017	EC Winter 2017	Difference in p.p (Projections of the Ministry of Finance and EC forecasts)
Change in GDP, %	2017	2.7	2.9	-0.2
	2018	2.6	2.8	-0.2
Change in GDP deflator, %	2017	2.3	2.1	0.2
	2018	1.8	2.3	-0.5
Change in gross fixed capital formation, %	2017	5.9	6.0	-0.1
	2018	5.4	3.0	2.4
Change in household consumption expenditure, %	2017	3.9	4.0*	-0.1
	2018	3.6	2.6*	1.0
Change in harmonised index of consumer prices, %	2017	3.4	2.1	1.3
	2018	2.7	1.9	0.8
Unemployment rate, %	2017	7.0	7.5	-0.5
	2018	6.4	7.1	-0.7
Change in average gross monthly wages, %	2017	6.7	6.1**	0.6
	2018	6.1	6.3**	-0.2

* Private consumption (change, %) consisting of household consumption expenditure and NPI serving households.

** Compensation to employees.

The estimates of a part of indicators presented in the economic development scenario for March 2017 by the Ministry of Finance differ from the latest available EC forecasts. After evaluation of the fact that the assumptions about the external environment in the EC scenario and the scenario of the Ministry of Finance coincide, and without available detailed information on the reasons of the estimates of respective indicators of the EC winter forecast, it is likely that a different attitude towards the developments of investments, prices and unemployment rate was caused by the fact that the Ministry of Finance foresees additional stimulus for investments in 2018 from the European Strategic Investment Fund, from the resources of which high value projects will be implemented. While projecting the inflation estimate, the Ministry of Finance took into consideration the rate of excise duty on anhydrous ethyl alcohol increased by almost one fourth starting from 1 March this year, rates of excise duty on alcoholic beverages and their intermediate products increased by almost twofold, increased rates of excise duties on tobacco products about one tenth and more accelerated growth of prices for foodstuffs. While projecting the development of the labour market, the Ministry of Finance took into consideration the new Labour Code to come into force from 1 July 2017, the amendments of which should promote job creation and higher wage agreements. Due to these reasons, the activeness of the population on labour market in medium term should remain high.