Economic Development Scenario 2023–2026

June 2023

The economic development scenario (hereinafter – the scenario) has been developed considering the actual Lithuania's economic development during the first months of the year 2023[1], the changes in the monetary policy and external environment that took place after the scenario was published by the Ministry of Finance in March 2023. The assumptions of the scenario about external environment are in line with the economic forecast published by the European Commission[2] (hereinafter – the EC) in May this year.

The economic forecast published by the EC in May 2023 foresees that gross domestic product (GDP) of the European Union (EU) will grow 1 % in 2023 (in February 2023 the foreseen growth was 0.8 %), and in 2024 – 1.7 % (in February, 1.6% was foreseen). According to the EC, significantly lower energy prices have a positive effect on the economy, and a strong labour market increases the resilience of the EU economy, but due to persistently high inflation, financing conditions will continue to tighten and, as a result, investment growth will slow down. The EC notes that the risk of a slowdown in economic development has increased. Prolonged high net inflation could further limit household purchasing power, continued uncertainty over Russia's ongoing invasion of Ukraine, and turmoil in the banking sector or heightened geopolitical tensions could pose new challenges to the global economy.

At the beginning of 2023, the activity of the Lithuanian economy was decreasing, and with two consecutive quarters of falling GDP in Lithuania, a technical recession was recorded at the beginning of the year. Last year, a 0.4 % annual GDP decline recorded at the end of the year increased to 2.5 % in the first quarter of this year. The biggest influence on this decline was the decrease in the added value created in the economic activities of manufacturing (–8.5%), wholesale and retail trade, transport, accommodation and catering services (–3.2%), the contraction of exports of goods and services (–2 %) and decreased household expenditure on consumer goods and services (–1.8%).

Based on the information available during the preparation of the scenario, it may be presumed that a moderate recovery of economic activity is expected in the second half of this year, but it will not be enough for the Lithuanian economy to avoid an annual decline after the technical recession experienced at the beginning of the year. It is expected that the GDP of Lithuania will shrink by 1 % this year, and with the strengthening of the purchasing power of households in the domestic and foreign markets and the increase in foreign demand, economic recovery can be expected next year – GDP in 2024 could grow by 2.5 %, and in 2025-2026, GDP growth could accelerate on average to 3 % per year.

[1] The date of inclusion of statistical data and other information in the scenario – 9 June 2023, inclusive

[2] EC Spring Forecast Spring 2023 Economic Forecast: an improved outlook amid persistent challenges (europa.eu).

The data of the Labour Force Survey conducted by the State Data Agency shows that in the first quarter of 2023, the situation of the labour market worsened. The unemployment rate rose to 7.7 % and was by 1.4 percentage points higher than in the previous year. Unemployment among the most vulnerable age groups – youth (aged 15-24) and elderly population (aged 55-64) – has increased significantly, as well as long-term unemployment (up to 3%). As the unemployment rate increased, the number of employed population decreased by 1.4 % compared to the previous quarter and by 4 % compared to the third quarter of 2022, when the number of employed population reached the peak of the last 15 years. However, compared to the corresponding period a year ago, the number of the employed was still higher by 1 % due to the low comparative statistical base. Positive net migration, which was mainly contributed by relatively active immigration of foreign nationals, and the participation rate of the working-age population, which remained close to record highs, resulted in the country's labour force being 2.5 % higher in the first quarter than in the corresponding period a year ago. A high labour force participation rate and a high labour supply may have contributed to the rising unemployment rate. Residents were encouraged to participate in the labour market by a large supply of vacancies, which, together with the increased unemployment rate, indicates a strong mismatch between the qualifications of the available labour force and the demand. In the first quarter, the number of vacancies increased by 16.7 % compared to the previous quarter, and was almost as high as recorded a year ago. The biggest improvement in vacancy trends was in manufacturing and transport and storage activities, where vacancies were the highest since 2008. The high number and level of vacancies (1.9%) shows that the situation in individual economic activities is heterogeneous, and businesses do not expect a long-term economic slowdown and are in a hurry to find qualified workers, who will continue to be in short supply in the labour market in the near future. The scenario predicts that in 2023 the unemployment rate, calculated according to the Labour Force Survey Methodology, will increase to 7.3 %. As economic activity recovers in the later years of the medium term, the unemployment rate will begin to decline, and in 2024 it will make up 6.9 %, in 2025 – 6.5 %, and in 2026 will approach the natural level of unemployment and will amount to 6.3 %. The scenario is based on Eurostat's demographic projections published in March 2023. They foresee that from 2025 mainly due to the negative natural population change, the number of the working-age population in Lithuania will start to decrease. Due to the shrinking supply of workers, there will be little room for growth in the employed population. It is expected that in 2023 the number of employed population will decrease by 0.8 %, and from 2024 with the recovery of economic activity, the growth of the employed population will be slow (0.1 % per year in 2024-2025), in 2026 no growth is expected (a decrease of 0.2 % is expected).

At the beginning of 2023, the trend of rapid wage growth continued. Average monthly gross wages in the country grew by 13.4 % in January-March 2023. Wages increased at double-digit rates in both the public (12.6%) and private sectors (13.7%). This year, wage growth is driven by a higher minimum monthly wages (in 2023 it increased by 15.1% and reaches EUR 840), the growth of wages of public sector employees due to the measures provided for in the Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets of the Republic of Lithuania for 2023, the remaining lack of qualified employees, and from July 1 part of the changes provided for in the civil service reform will enter into force. However, as business faces challenges – weak demand, increased costs and difficult financing options, wage growth should slow down during the year and throughout 2023 could grow by 10.4 %. With the prevailing economic uncertainty caused by the war in Ukraine and the continued tightening of monetary policy, it will be increasingly difficult for businesses to raise wages significantly, so in 2024, a more moderate wage growth rate is expected – 6.3 %. In the subsequent years of the medium term, the average monthly gross wages in the country could grow by 5 % each year (in 2025-2026).

Annual inflation, calculated on the basis of the harmonized index of consumer prices, in the first five months of 2023 was rapidly decreasing. In May, it fell to 10.7 %, and was more than twice lower compared to the peak reached in September 2022 (22.5 %). The disinflation[3], which has been going on for eight months, is caused by the sharp decrease in the prices of various types of energy raw materials (oil, natural gas, biofuel) on the international markets, which led to a reduction in the prices of vehicle fuel, thermal energy, and electricity for both households and businesses. Falling energy prices reduced production costs, which are reflected in lower production prices of Lithuanian producers, so already in June, annual inflation may become single-digit. Since the beginning of 2023, the annual net inflation[4] is also decreasing rapidly, reflecting the fading inflationary pressure in the country. Despite the reduced prices of food raw materials on the international and local markets (FAO's[5] general food price index in May was 21.4% lower than a year ago, and milk purchase prices in Lithuania were 31.2% lower than last May), food inflation still remains high, although disinflation is also gradually accelerating here. Inflation in non-energy industrial goods and services remains robust and has not yet shown any significant signs of slowing recently. In the first case, the development of the prices of imported goods is of great importance, and in the second case, double-digit wage growth and strong demand for services are still observed. The scenario predicts that in 2023 the average annual inflation will be 8.9 %, and not only more favourable energy prices will contribute to a more favourable price development, but also the normalization of global supply chains and the tightening of the monetary policy of the euro area by the European Central Bank. In 2024, as the inflationary pressure continues to decrease, the average annual inflation will decrease to 2.6 %. As the gas storage filling season approaches, the level of storage filling in the EU is good, so the risk of gas shortages and energy price spikes in the coming winter has decreased, and the rapid increase in renewable energy production in Lithuania and the EU will reduce the risk of renewed pressure on the prices of other types of energy. With energy prices falling rapidly, the expected improvement in the terms of trade will benefit all sectors – households, businesses and the public sector. Lower energy prices will again increase the real disposable income of households, reduce the cost of producing goods and services, and reduce the relatively significant burden of imported inflation on public finances as the cost of support measures to compensate for high energy prices decreases. From 2025 the inflation rate should come even closer to the European Central Bank's 2 % inflation target in the euro area, but higher excise duty

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[3] The process of declining inflation.
[4] Inflation excluding energy and unprocessed food.
[5] Food and Agriculture Organization of the United Nations.

rates for energy goods will have an increasing effect on the country's inflation this year and next year, so it is expected that inflation will amount to 2.3 %.

At the beginning of 2023, the income of the population was still growing more slowly than the prices of goods and services, and the ability of the population to purchase the desired goods and services was reduced. Household consumption expenditure in January-March 2023 was by 1.8 % lower than in the corresponding period a year ago. Retail trade data shows that residents continued to reduce spending on goods at the beginning of the second quarter as well. In April, the turnover of retail trade decreased by 4.1 %. The sales turnover of almost all essential groups of goods decreased in April, the fastest decrease was in the turnover of information and communication technology equipment, cultural and recreational goods, watches, jewellery (–14.8%). The still high level of prices and the continuation of increase in interest rates on loans lead to changes in the behaviour of the population, and together with the prevailing uncertainty about the future, the mood of consumers is also affected – after a 7-month consecutive period of optimistic expectations, the consumer confidence index fell by 1 percentage point over a month. However, considering the fact that in the course of the year the purchasing power of the population will strengthen as price growth slows down, and the financial reserve of the population accumulated during the pandemic is still large (judging by the deposit statistics, household deposits still exceed the pre-pandemic level and amount to EUR 21 billion), we expect that household consumption expenditure on goods and services in 2023 would increase in the second half of the year, and the indicator for the entire year could be at a similar level as last year (the rate of change would be 0%). In the medium term, as prices no longer have such a strong impact on the purchasing power of the population, and as income continues to grow, household consumption expenditure should also recover, and in 2024-2026 it could grow by 3.4% each year.

Trends in domestic demand components in the first quarter of 2023 were different. In January-March of 2023, final consumption expenditure decreased by 1.6 %, gross capital formation expenditure fell by 10.9 %, but the expenditure for the gross fixed capital formation (hereinafter - GFCF) grew by 12.3 % and had a positive effect on the change in the country's GDP. In the first quarter of 2023, all main components of GFCF grew. Investments in other buildings and structures increased by 16.8% and contributed significantly (4.9 percentage points) to the change in GFCF, these investments were encouraged by the accelerated implementation of projects financed by EU funds. Investment costs increased both for the implementation of construction projects and for measures that increase productivity and efficiency. It is likely that some of these investments may have been completed plans from earlier periods. The latest data shows that business expectations for the future have been deteriorating recently, and industry – one of the most investing economic activities in Lithuania – is facing difficulties (industrial output has been decreasing for 5 consecutive months). As interest rates rise, the burden of financial obligations on businesses and households increases and reduces investment opportunities. For these reasons, the rapid growth of investments observed in the first quarter of this year is unlikely to continue in the following quarters. In the course of the year, the development of investments should be more moderate, and throughout 2023 the expenditure of GFCF could be by 6.3 % higher compared to 2022. The influence of the tightening monetary policy will slow down the business investment process in the coming year as well – in 2024, a 4.5 % increase in expenditure of GFCF is foreseen. In the subsequent years of the medium term, expecting a successful adaptation to the changed financing conditions, a more stable external environment, and due to the recently strengthened need to increase operational efficiency and labour productivity, expenditure on GFCF could grow by 5.4 % each year.

The beginning of this year was complicated for the Lithuanian exporters. According to the data of national accounts, the exports of goods and services fell by 2 % (it grew by 20.9% in the same period last year). The biggest influence on such a result was made by the companies exporting chemical, furniture, plastic and wood industry products of Lithuanian origin that were facing difficulties. At the same time, Lithuanian engineering industry and companies exporting food products and goods re-exporting companies continued to increase their export volume. The first quarter was also successful for exporters of services – the exports of services (at constant prices) grew by 7.2 %.

According to the EC spring forecasts, the economies of many Lithuania's trading partners in the European Union will experience stagnation this year, and the purchasing power of the population in these countries, which decreased last year due to high inflation, will not significantly recover in the short term. Due to changes in monetary policy and the consequences of the war in Ukraine, the global demand for exports from Lithuania will be subdued this year, and the possibilities of increasing the volume of exports will depend on the flexibility of exporting companies and decisions to invest in technological progress and productivity-enhancing measures. The scenario predicts that in 2023 the annual change in the exports of Lithuanian goods and services (at constant prices) will be –0.7 %. In the later years of the medium term, after the recovery of foreign demand, the average annual growth of 4.8% per year is expected.

The scenario has been developed in a context of still increased instability in the external environment and economic uncertainty, ongoing tightening of global monetary policy, and military actions in Ukraine.

In the wake of the ongoing war in Ukraine, uncertainty about the evolution of energy commodity prices remains extremely high. Technical assumptions for energy commodity prices in 2023-2024 in the scenario were based on the Brent oil price assumptions published by the EC in May 2023 (76.3 USD/bar in 2023, 72.1 USD/bar in 2024) and natural gas price assumptions (48.0 EUR/MWh in 2023, 55.4 EUR/MWh in 2024). From 2025 onwards, there is a technical assumption that these energy commodity prices will remain stable. Changes in these technical assumptions would change the outlook for inflation development. Inflation estimates could also change due to other factors, including possible Government of Lithuania decisions in the area of administered prices and changes in monetary, fiscal and labour market policies.

The demographic development projections of the scenario were based on publicly available updated demographic projections by Eurostat. Changes in demographic projections, trends in international migration or assumptions about labour force activity rates would change the outlook for labour market indicators.

The increased needs for strengthening energy independence due to the unfavourable geopolitical situation, the accelerated implementation of the European Green Deal projects could speed up the investment process in the country at a faster pace than foreseen in this scenario.

The estimates of the indicators presented in the scenario are to a large extent determined by the relevant actual statistical data available at the time of the development of the scenario, which recently change significantly following reviews and/or revisions carried out by the State Data Agency.

If the underlying assumptions, based on which this scenario was developed, do not realise, the estimates for many of the indicators in this scenario would change.

Key indicators of the economic development scenario

Title of the indicator	2022	2023[P]	2024[P]	2025[P]	2026[P]
GDP (at current prices), MEUR	66,791	72,363	76,130	80,168	84,456
GDP (at constant prices) rate of change, %	1.9	–1.0 (0.5)	2.5 (3.0)	3.0 (3.0)	3.0 (3.0)
Harmonised index of consumer prices (average annual), rate of change, %	18.9	8.9 (8.5)	2.6 (2.3)	2.3 (2.0)	2.3 (2.0)
Investment (at constant prices), rate of change, %	2.6	6.3 (2.7)	4.5 (5.4)	5.4 (5.4)	5.4 (5.4)
Exports of goods and services (at constant prices), rate of change, %	11.9	–0.7 (0.0)	4.5 (4.9)	4.9 (4.9)	4.9 (4.9)
Unemployment rate (based on the definition of the Labour Force Survey), %	5.9	7.3 (7.0)	6.9 (6.8)	6.5 (6.5)	6.3 (6.3)
Average monthly gross wage, rate of change, %	13.3	10.4 (9.1)	6.3 (5.0)	5.0 (5.0)	5.0 (5.0)
Number of employed persons, rate of change, %	3.8	–0.8 (–0.7)	0.1 (0.0)	0.1 (–0.1)	–0.2 (–0.2)

Sources: Ministry of Finance, State Data Agency.

[P] – projection. An estimate of a relevant indicator of the economic development scenario published in December 2022 is presented in brackets.