

# Economic Development Scenario 2020–2023

September 2020

The Economic Development Scenario (hereinafter – the scenario) was developed considering the actual Lithuania's economic development in the first eight months of the current year<sup>1</sup> and changes in the external environment. The assumptions about the external environment in the medium term are in line with the forecast published by international institutions<sup>2</sup> in summer this year.

In the first half of 2020 the national economy showed resilience to challenges caused by the COVID-19 pandemic – after the economic closure shock in April, already from May a higher economic activity has been observed, while population's expenditure on goods returned to the level of the previous year. The latest statistical data shows that economic recovery continued also in the first months of the second half of the year: statisticians recorded growing turnover of retail trade, better consumer and business expectations, positive changes of the industrial production, and cereal farmers informed about a high yield. This will positively affect the economic development results in the third quarter.

Based on the information disposable during the development of the scenario, most of the countries in the world were still affected by the global COVID-19 pandemic, and the epidemiological situation both in Lithuania and in major foreign trade partners of Lithuania had worsened. A verified effective vaccine against this infection was still unavailable. Also, there was no scientific evidence that individuals, who have had COVID-19 disease, gain long-term immunity. Therefore, the scenario was developed without changing the assumption made in summer that the virus will spread globally among people for at least several years. Also, the assumption remains unchanged that both Lithuania and other EU countries will have effectively used the economic closure period which demanded extremely large resources to contain the spread of the COVID-19 virus – strengthened institutions managing health systems and epidemiological situation and are ready to manage the spread of the COVID-19 virus by taking measures with less adverse effect on the economy.

When drafting the scenario there was no reliable information on the infection spread trends in the country in autumn and winter, however the experience already gained by other countries shows that the virus spread is more active in the cool weather season, and under growing incidence even without taking the infection spread containment measures the economic activity declines. Therefore, the assumption was made that in the fourth quarter an adverse effect of the pandemic on the economy will increase.

We anticipate that due to the shock related to the COVID-19 virus crisis, this year Lithuania's economy will shrink by 1.5 % – this is substantially lower than it was projected in summer (7 %),

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<sup>1</sup> The Economic Development Scenario was developed on the basis of the information published until 31 August or presented until 15 August following the provisions of Government of the Republic of Lithuania Resolution No. 369 of 13 April 2016.

<sup>2</sup> The European Commission and International Monetary Fund

while in 2021 GDP is expected to grow 3.3 %. In the later medium-term years GDP could grow on average 2.3 % per year.

Labour market statistics shows that despite the virus pandemic and quarantine, in the second quarter of 2020 the situation on the labour market in majority of economic activities remained relatively satisfactory. The COVID-19 virus pandemic and restriction of economic activity caused lower employment, higher unemployment and decreased wages in the private sector over the second quarter. Though the annual development of the number of employed population in the second quarter this year was negative and constituted  $-2.2\%$ , gross wages grew even  $8.5\%$ , therefore in the period of the low inflation rate the purchasing power of population remained strong. The situation on the labour market was the most significantly deteriorated in accommodation and food service activities, where, as compared with a respective quarter of the previous year, the number of the employed declined  $23.2\%$ , and wages  $-10.3\%$ . The youth unemployment surged most steeply accounting for  $21.1\%$  in the group aged 15–24 in the second quarter and over the year increased twofold. This is due to the fact that a large number of young people is employed in trade and servicing activities which suffered most. Moreover, during crises the youth is more vulnerable as has less professional experience.

Considering the trends of the first half of the year, we anticipate that in 2020 the number of employed population will shrink by  $1.9\%$ , and the unemployment rate calculated based on the labour force survey methodology will increase up to  $8.8\%$ . This year the Government subsidies to enterprises for downtime and assistance for self-employed as well as capability of enterprises to adapt to perform activities under abnormal pandemic conditions will have a cushioning effect on changes in the number of jobs and unemployment in the country. Under recovery of economic activity in 2021 and higher labour force demand, the unemployment rate will decrease down to  $7.9\%$ ; however it will be still higher than the rate in 2019. In outer medium-term years the unemployment rate will keep decreasing at less accelerated pace and at the end of the medium term will constitute  $6.6\%$ .

The effects induced by the pandemic on the labour market will subdue the wage growth rate. This year wages will grow most rapidly in the public sector. The wage development will be less favourable for a part of enterprises in the private sector, especially operating in accommodation and food service activities, which faced contracting demand and supply as well as imposed downtime.

We predict that this year the average monthly gross wages in the country will grow  $6.5\%$ , and in 2021 the growth rate will decelerate down to  $3.3\%$ . In outer medium-term years under decreasing unemployment rate and increasing labour force demand we anticipate that the wage growth rate in the country will gradually accelerate and at the end of the period will be close to  $5\%$ .

The inflation rate in the second half of the year 2020 should remain slowed down due to lower prices of oil and other energy goods as well as more favourable foodstuff prices. The pressure for foodstuff prices to grow this year should remain sluggish due to deteriorated demand for food supply services and increased food stocks in the world related to the COVID-19 pandemic and economic difficulties. The annual growth rate of prices of certain consumer services (recreation, transport) at the middle of the year is weakened as a result of a lower demand related to the virus pandemic and less expensive fuel. However the growth rate of prices of the majority of other services this year will be further supported by wage growth and administrative decisions (e.g. higher waste collection rates on average by a quarter), therefore we do not expect a substantial slowdown in growth of prices of services this year.

We anticipate that in 2020 the average annual inflation will shrink down to 0.9 % (in 2019 it reached 2.2 %). We do not expect the decrease in prices of energy goods in 2021, therefore the inflation rate will accelerate up to 1.8 %, and at the end of the medium term period – to 2 %. Price development in the medium term will be mainly affected by global prices, especially of energy and foodstuffs, changes, situation on the national labour market and decisions on administered prices.

Retail trade turnover results show that domestic demand after the shock in April have started to recover quickly and already in June exceeded the results of June 2019 by 6.5 % (in July the retail trade turnover kept growing at accelerated – 6.8 % – pace). The decline in consumption expenditure was not particularly drastic – household consumption expenditure in the second quarter of 2020 decreased by 7 %, when during the crisis in 2009 this expenditure dropped by more than 17 %.

Household consumption will be stimulated this year by measures taken by the Government to protect personal income. Uncertainty about further development of the pandemic may cause a bigger adverse effect on the decision to acquire goods and services at the end of the year, as compared with the summer period. Therefore, change in annual household consumption expenditure will remain negative and will constitute 3 %. Household consumption expenditure in 2021–2023 could grow on average by 2.8 % per year. In the medium term household consumption expenditure trends will be mainly determined by consumer expectations and related feasible changes in behaviour, development of disposable income and demographic developments in the country.

The investment process in the country decelerated in the first half of this year. Expenditure on gross fixed capital formation grew scarcely 1.6 % over the first quarter, and in the second quarter slumped by 13 %. In the second quarter the most substantial decrease was recorded in investment in transport equipment (71.2 %). The transport sector has previously invested heavily in renewal and development, and considering also worse foreign demand situation as well as new challenges arising due to the Mobility Package, it is likely that the investment in this sector in the near future will remain sluggish. When business faced activity restrictions during the pandemic, the need arose to adapt e-commerce solutions, and rapidly increased teleworking and distance learning instigated to invest in additional equipment. Investment in information and communication technologies in the second quarter of 2020 grew 48.8 %, and in intellectual property products increased by 17.8 %.

Under prevailing uncertainty due to pandemic development in both Lithuania and external environment, a more significant acceleration of the investment process in the near future is unlikely to occur. After the intentions of the private sector to invest diminished, the investment process in the country will be supported by acceleration of the projects implemented from the EU Funds and the implementation of the measures under the Plan for the DNA of the Future Economy. These measures should promote investment in human capital, digital economy and business, innovation and research, economic infrastructure and climate change as well as energy.

We anticipate that expenditure on gross fixed capital formation in 2020 could shrink by 6 %. Over the rest of the years of the medium term (i.e. 2021–2023) the investment development in the country will be affected by business expectations about the future, situation in markets of foreign trade partners – after their recovery the investment process in Lithuania would step up – the need to increase productivity and invest in activity efficiency would increase, the endeavour to move towards green economy would arise. During 2021–2023 gross fixed capital formation on average could grow 3.7 % per year.

As a result of the bad foreign trade market situation, this year the Lithuanian export of goods and services (at constant prices) will slump by 7.2 %. Based on assumptions about the recovery of foreign demand in 2021, the export of goods and services is likely to grow 7.9 %. In later years of the medium term the export of goods and services could grow on average about 5 % per year.

Uncertainty caused by the pandemic, risk due to renewal of tension in global trade, considerable uncertainty about global economic recovery and increased geopolitical tension – are the key risk factors which may change the estimates for the main indicators specified in this scenario.

The estimates for economic indicators indicated in the scenario may also be changed by the second revisionary stage of the national accounts indicators implemented this year as well as update of the statistical base (national accounts indicators for 2019) based on which the Economic Development Scenario has been developed. Statistics Lithuania intends to publish the updated statistical data in October this year.

### Key indicators of the economic development scenario

Title of the indicator	2019	2020P	2021P	2022P	2023P
GDP (at current prices), MEUR	48,433	48,165	50,657	52,885	55,195
GDP (at constant prices), rate of change, %	3.9	-1.5	3.3	2.3	2.3
Harmonised index of consumer prices (average annual)	2.2	0.9	1.8	2.0	2.0
Investment (at constant prices), rate of change, %	7.4	-6.0	3.8	3.6	3.6
Export of goods and services (at constant prices), rate of change, %	9.6	-7.2	7.9	4.9	4.9
Unemployment rate (based on definition of the labour force survey), %	6.3	8.8	7.9	7.0	6.6
Average monthly gross wage, rate of change, %	8.8	6.5	3.3	3.8	4.5
Employed persons, rate of change, %	0.3	-1.9	1.3	0.7	-0.1

Sources: Ministry of Finance, Statistics Lithuania