

Lithuania Business Forecast Report Q1 2015

<https://marketpublishers.com/r/L8397474014EN.html>

Date: October 2014

Pages: 37

Price: US\$ 1,195.00 (Single User License)

ID: L8397474014EN

Abstracts

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Core Views

The escalating trade war between Russia and the EU has prompted us to revise down our forecast for growth in Lithuania for 2014. Growth will accelerate in 2013, as geopolitical tensions in the region disperse, trade restrictions get lifted, and overall external demand improves.

Lithuania's current account surplus will swing back into deficit in 2014 as the trade war between Russia and the EU will deepen the Baltic state's trade deficit. Going forward, we forecast modest current account deficits, underpinned by persistent trade and income deficits, and mitigated by growing services surplus, while resumption in foreign direct investment flows will ensure the country meets its external financing requirements.

Despite the recent expulsion of a junior coalition partner out of the Lithuanian government, the centre-left cabinet of Prime Minister Algirdas Butkevicius maintains a solid majority in parliament, ensuring it will remain in power for the duration of its term ending 2016. Following the expulsion of the ethnic Polish party, we expect two energy deals between Lithuania and Poland to proceed less smoothly.

Major Forecast Changes

The escalating trade war between Russia and the EU will exacerbate the slowdown in economic growth in Lithuania that we anticipated, prompting us to revise down our 2014 growth forecast – to 2.6% from 2.9% previously.

We see slight near-term risks to Lithuania's budget deficit for 2014- 2015 in light of geopolitical tensions between Russia and the EU over Ukraine. The fallout of the Ukraine crisis has suppressed tax revenues for the Baltic state and has prompted policymakers to ramp up military spending. As a result, we have adjusted our forecast for the budget gap to widen to 1.5% of GDP in 2014, from 1.3% previously. For 2015 we expect the shortfall to remain at 1.5%, against our previous forecast of 1.4%.

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Algirdas Butkevicius maintains a solid majority in parliament, ensuring it will remain in power for the duration of its term ending 2016.

Following the expulsion of the ethnic Polish party, we expect two energy deals between Lithuania and Poland to proceed less smoothly.

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Long-Term Political Outlook

Convergence By No Means Assured

While Lithuania's long-term political outlook remains among the most stable in the emerging Europe region, we nevertheless caution

that the country's convergence with Western political and economic institutions through 2024 is by no means assured. In particular,

we highlight the aftermath of 2009's financial crisis as putting the country at a critical juncture. Indeed, dealing with an economy which

is set to post significantly lower trend growth over the long term (compared to pre-crisis levels), while balancing the need to pursue a

more pragmatic foreign policy with Russia and the demands of an increasingly nationalist electorate, will pose significant challenges for

Lithuanian governments to 2024.

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The escalating trade war between Russia and the EU has prompted us to revise down our forecast for growth in Lithuania for 2014.

Growth will accelerate in 2015, as geopolitical tensions in the region disperse, trade restrictions get lifted, and overall external demand improves.

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Lithuania's current account surplus will swing back into deficit this year as the trade war between Russia and the EU will deepen the Baltic state's trade deficit. Going forward, we forecast modest current account deficits, underpinned by persistent trade and income deficits, and mitigated by growing services surplus, while resumption in foreign direct investment flows will ensure the country meets its external financing requirements.

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