

# Lithuania Business Forecast Report Q2 2014

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## Abstracts

### Core Views

Recent disagreement over wage growth between Lithuania's ruling coalition partners will likely see political tensions in Lithuania escalate in 2014. However, we do not expect this to derail Lithuania's path towards further EU integration or to jeopardise the government's position in power.

We forecast Lithuania's budget deficit to narrow to 2.4% of GDP in 2014-2015 from an estimated 2.9% in 2013. Despite the growing external public debts in recent years, the government's debt dynamics remain on a stable footing due to the government's fiscal consolidation efforts and the upcoming euro adoption which will bolster investor confidence and anchor borrowing costs.

Real GDP growth in Lithuania will accelerate to 3.6% in 2014 from an estimated 3.0% in 2013 due to the brightening domestic demand outlook. While export growth should accelerate in line with improving growth prospects in Lithuania's trading partners, this will be offset by import growth, making the net export contribution to overall growth negative.

### Major Forecast Changes

Although we estimate a current account surplus of 0.2% of GDP in 2013, it already appears to be on the verge of tipping back into deficit with improving domestic demand buoying imports. As such, we forecast the current account balance to flip back into deficit, to 0.6% of GDP in 2014 and 2015, and hover below 1.0% over a fiveyear time horizon.

### Key Risks To Outlook

Still-depressed business investment into traditional sectors of the economy, such as construction, do not bode well for a continuation of the ongoing trend in GFCF growth. Indeed, recent years have shown that this expenditure component of GDP has struggled to stay in positive growth territory, and we cannot rule out an erratic recovery in fixed investment going forward.

The recent push into surplus for the current account year-to-date in November 2013 could become a more permanent feature of a still-weak domestic economy and a stabilising external consumption picture. However, Lithuania's improving domestic demand picture means that import growth will move in tandem with export growth, precluding the probability for current account surpluses from 2014 onwards.

Years in underinvestment in infrastructure and social programmes could heighten pressure on the government to ramp up spending over the next few years, which would lead to a deterioration of Lithuania's fiscal accounts. However, we believe that the goal of euro adoption will take precedence and ensure the fiscal consolidation drive of the administration in 2014-2015.

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Recent disagreement over wage growth between Lithuania's ruling coalition partners will likely see political tensions in Lithuania escalate in 2014. However, we do not expect this to derail Lithuania's path towards further EU integration or to jeopardise the government's position in power.

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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 2023 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 2022.

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