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Lithuania Business Forecast Report Q2 2014

https://marketpublishers.com/r/L9907DB0745EN.html
Date: January 2014
Pages: 33
Price: US$ 1,195.00 (Single User License)
ID: L9907DB0745EN

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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will be offset by import growth, making the net export contribution to overall growth negative.

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Balance Of Payments

Modest Current Account Deficits Ahead

We forecast persistent, albeit modest current account deficits for the Lithuanian economy from 2014 onwards, underpinned by structural goods trade and income balance deficits. The country will continue to finance its external needs predominantly through its capital account in 2014-2015, such as EU structural funds and multilateral help due to insufficient financial account inflows.

Table: CURRENT ACCOUNT

Fiscal Policy

Euro Adoption Prospects To Ensure Fiscal Probity

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.

Table: FISCAL POLICY

Monitor Policy

Inflation Bottoming Out

We reiterate our view that inflation in Lithuania bottomed out in end-2013, and demand-pull inflationary pressures will accelerate in 2014. Nevertheless, we have adjusted slightly down our forecast for growth in the consumer price index as the sharp drop in inflation signals that domestic demand might be on weaker grounds than we had previously projected

Table: INFLATION

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Although the outlook for the Lithuanian economy over the coming decade is certainly less than inspiring compared to average real GDP growth of 7.2% between 2004 and 2007, we nonetheless maintain a positive view for the economy over the long term. Indeed, while growth is unlikely to match the stellar outturns posted in the run-up to the recession, we forecast a more moderate, but sustainable 3.2% annual average growth rate for 2017-2023.

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