

Lithuania Business Forecast Report Q3 2014

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Abstracts

Core Views

Recent growing geopolitical tensions between Russia and the West over Ukraine will darken investor sentiment in 2014, weighing on Lithuania's trade flows and domestic demand. We expect goods exports to expand by 6.5% in 2014, down from 7.0% growth in 2013. Lithuania's fiscal consolidation prospects remain in place with the budget deficit to narrow to 2.9% of GDP in 2014 and to 2.6% in 2015 from an estimated 3.3% 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 arrive at 3.3% in 2014 equal to the outturn for 2013, before slowing to 3.1% in 2015. We expect fixed investment to slow to 5.0% in 2014, and to 4.0% in 2015, down from 12.8% in 2013, as regional geopolitical tensions weigh on investor sentiment.

Major Forecast Changes

We have revised slightly our forecasts for Lithuania's budget deficit for 2014 to 2.9% of GDP from 2.4% previously as the government has pledged to ramp up military spending to 2.0% of GDP from the current 0.9% level. Nevertheless, we maintain that this will not jeopardise Lithuania's prospects of joining the eurozone by 2015.

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With the completion of Klaipeda's floating storage and regasification unit, Lithuania looks set to become the Baltic's first LNG importer. By diversifying away from its reliance on Russian energy imports, this significantly improves Lithuania's political risk profile, leaving it less exposed than some regional peers to pressure from Russia.

Table: Political Overview

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 2023.

CHAPTER 2: ECONOMIC OUTLOOK

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Real GDP in Lithuania will continue recovering from its 15% plunge in 2009 and expand by 3.3 % in 2014, equal to the pace of recovery in 2013, before slowing slightly to 3.1% in 2015. While the recovery in domestic demand will remain on track, it will moderate

slightly due to the ongoing deleveraging in the private sector and tensions in Ukraine, which will weigh on sentiment and the country's trade dynamics.

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We forecast Lithuania's budget deficit to narrow to 2.6% 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.

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We forecast Lithuania's surplus to decline to 0.9% of GDP in 2014, before narrowing to 0.1% in 2015 and flip back into a deficit of 0.2 %of GDP in 2016. Beyond this time horizon, we expect the Lithuanian economy to post modest external deficits of 0.7 % on average by

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