

Lithuania Business Forecast Report Q4 2014

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Abstracts

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Core Views

Recent growing geopolitical tensions between Russia and the West over Ukraine will dampen investor sentiment in 2014, weighing on Lithuania's trade flows and domestic demand. We expect goods exports to expand by 4.5% in 2014, down from 7.0% in 2013, before accelerating to 6.3% in 2015.

Although public support in Lithuania has shifted towards centreright opposition parties, we see no major threats to the centre-left coalition's term in power. The coalition has a comfortable majority in parliament, and is likely to smooth out potential sources of differences. Real GDP growth will slow in Lithuania in 2014 – to 2.9% from 3.3% in 2013 – due to the fallout from the Ukraine crisis. In addition, the weak inflation outlook will prolong the deleveraging process, further weighing on Lithuania's economic growth outlook.

Major Forecast Changes

We now expect Lithuania's current account surplus to narrow to 0.6% of GDP in 2014, from 1.5% previously as the fallout from the Ukraine crisis will weigh on the country's trade dynamics. We reiterate our view that the surplus will reverse into deficit by 2015.

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Although public support in Lithuania has shifted towards centre-right opposition parties, we see no major threats to the centre-left coalition's term in power. The coalition has a comfortable majority in parliament, and is likely to smooth out potential sources of differences.

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.

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Real GDP growth will slow in Lithuania in 2014 - to 2.9% from 3.3% in 2013 - due to the fallout from the Ukraine crisis. In addition, the weak inflation outlook will prolong the deleveraging process, further weighing on Lithuania's economic growth outlook.

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We forecast Lithuania's budget deficit to narrow to -1.2% of GDP in 2014 from -1.5% in 2013. Despite the growing external public debts in recent years, the government's debt dynamics remain on a stable footing due to its fiscal consolidation efforts and the upcoming euro adoption which will bolster investor confidence and anchor borrowing costs.

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Inflation Bottoming Out

Higher energy prices due to geopolitical risk premium and higher softs prices will bolster core inflation in Lithuania by year-end. As such, consumer price growth will accelerate moderately by end-2014, underpinned by stronger supply-side inflationary pressures, while demand-pull pressures will remain subdued.

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Current Account Surplus To Turn Into Deficit By 2015

With Lithuanian exports suffering from waning demand from Russia and the eurozone, we expect Lithuania's current account surplus to narrow to 0.9% of GDP in 2014, from 1.5% in 2013, before reversing to deficit of -0.1% in 2015. Beyond this time horizon, we expect the Lithuanian economy to post modest external deficits of 0.7% on average by 2023.

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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 2004-2007, we nonetheless maintain a positive view for the economy over the long term. While growth is unlikely to match the stellar outturns posted in the run-up to the recession, we forecast a

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