Euler Hermes Economic Research

Country Report

Lithuania

Recovery in investment should boost growth in 2017

General Information

GDP	USD41.2bn (World ranking 88, World Bank 2015)
Population	2.9mn (World ranking 138, World Bank 2015)
Form of state	Parliamentary Democracy
Head of government	Saulius SKVERNELIS (Prime Minister)
Next elections	May 2019, presidential

Strengths

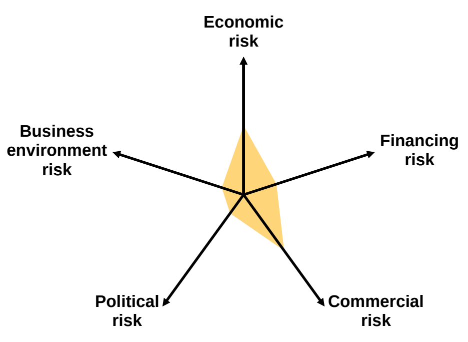
- Low systemic political risk
- Good international relations, EU and NATO membership
- Eurozone membership provides for low transfer and convertibility risk
- Adequate public finances and access to international capital markets
- Strong business environment

Weaknesses

- High external debt burden
- The industry is dominated by one large refinery complex, Orlen Lietuva (formerly known as Mazeikiu Nafta), which accounts for around 20% of total industrial output and 25% of total exports
- Banking sector vulnerability
- High export and import dependence on Russia, especially on crude oil imports

Country Rating

BB2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Russia	20%	1	23%	Russia
Belarus	10%	2	10%	Germany
Latvia	9%	3	9%	Poland
Poland	8%	4	8%	Latvia
Germany	5%	5	5%	China

By product (% of total)

Exports		Rank		Imports
Refined Petroleum Products	17%	1	17%	Crude Oil
Plastic Articles	5%	2	5%	Refined Petroleum Products
Furniture	5%	3	4%	Plastic Articles
Other Edible Agricultural Prod	4%	4	4%	Natural Gas
Electrical Apparatus	4%	5	3%	Pharmaceuticals

Source: Chelem (2014)

Economic Overview

Weak investment dampens growth

Real GDP growth decelerated to +1.7% y/y in Q3 2016, down from an average +2.1% in H1 and +1.8% in full-year 2015. This took the average of the first three quarters of 2016 to +2% y/y, which was mainly driven by domestic consumption and net exports. Consumer spending growth strengthened to +5.7% y/y and public spending was up by +1.1% y/y in Q1-Q3. Fixed investment decreased by -2.9% y/y and inventories subtracted -2.1pps from Q1-Q3 growth as the use of EU funds for investment fell markedly. However, export growth recovered to +3.9% y/y, outpacing imports at +2.7% y/) so that net exports added +0.9pps to Q1-Q3 growth.

Looking ahead, investment should rebound in line with a recovery in the absorption of EU funding. Higher inflation is likely to dampen consumer spending somewhat but strengthening public spending thanks to rises in defense and social spending should compensate for this. Overall, full-year real GDP growth is forecast to accelerate from an expected +1.9% in 2016 to around +2.3% in 2017 and +2.5% in 2018. Further delays in the use of EU funds pose a downside risk to this forecast.

Sound macroeconomic fundamentals

As expected, deflation gave way to modest inflation in 2016. Consumer prices began to increase at the start of the year and headline inflation averaged +0.8% y/y in January-October. Euler Hermes forecasts it to climb further to about +1.2% in 2017. Meanwhile, private sector credit growth which moved into positive territory in early 2015 has gained momentum and stood at +8.7% y/y in August, indicating that private sector deleveraging has largely abated and should not curtail consumption and investment anymore.

Public finances remain sound. Euler Hermes expects annual fiscal deficits of no more than -1% of GDP in 2016-2018 and public debt should stabilize at just over 40% of GDP.

Current account deficits are manageable. Low energy prices should lead to a narrowing of the annual shortfall from -2.3% of GDP in 2015 to -0.5% or so in 2016. As energy prices are set to pick up gradually, slight increases to still modest external deficits of up to -1.5% are forecast for 2017-2018.

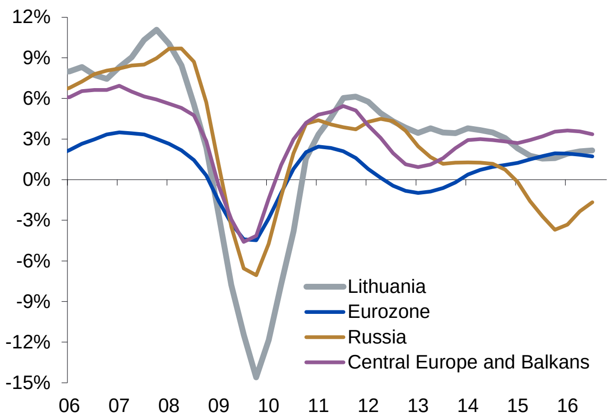
Gross external debt remains relatively high. It surged to a worrisome level of 87% of GDP in 2009, built up by earlier large current account deficits. The ratio declined to 70% in 2013-2014, but has since grown again and stood at 83% in mid-2016. Hence external debt remains a cause of some concern and close monitoring is appropriate.

Key economic forecasts

	2015	2016e	2017f	2018f
GDP growth (% change)	1.8	1.9	2.3	2.5
Inflation (%, end-year)	-0.2	0.6	1.5	2.2
Fiscal balance (% of GDP)	-0.2	-0.7	-0.9	-1.0
Public debt (% of GDP)	42.7	41.0	43.0	40.5
Current account (% of GDP)	-2.3	-0.5	-1.0	-1.5
External debt (% of GDP)	75.9	83.0	85.0	87.0

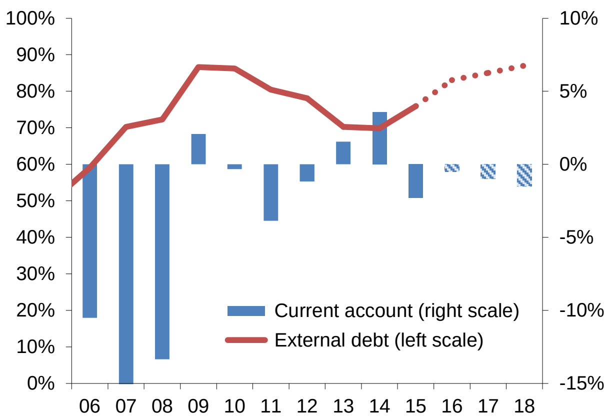
Sources: National statistics, IHS, Euler Hermes

GDP growth (% y/y, 4 qtrs cumulated)



Sources: National statistics, IHS, Euler Hermes

Current account and external debt (% of GDP)



Sources: National statistics, IHS, Euler Hermes

Last review: 2016-12-08
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