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Economic growth slowdown and future prospects: an analysis of forecasts for Lithuania

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Lithuania's pursuit of geopolitical stabilization and the effective use of financial resources is crucial for its economic recovery. The European Commission's forecasts for 2023 suggest a slowdown in economic growth due to persistent inflation. However, there are more optimistic prospects for 2024, which anticipate greater economic growth due to lower inflation, increased demand, and investments financed by the Recovery and Resilience Facility. As a result, real GDP growth is expected to be about 2.7%. It is also predicted that in 2024 the budget deficit will fall to 1.4% of GDP as a result of the gradual withdrawal of measures mitigating the effects of high energy prices.

Economic growth slowdown. Russia's attack on Ukraine in 2022 brought numerous consequences, weakening and affecting various aspects of Lithuania's economic activity. Disruptions in the supply chain, which put pressure on costs, limited productivity, reduced the competitiveness of some sectors, and slowed down investments, were some of the key issues („Komentarze IEŚ", nr 862). Another serious problem was the decline in private consumption, especially in the last three quarters of 2022, caused by a drop in consumer confidence and household disposable income. As a result, Lithuania's economic growth in the fourth quarter of 2022 was negative, and annual growth slowed to 1.9%. Prospects for 2023 suggest that economic activity will continue to be burdened by economic and geopolitical uncertainty. Nevertheless, some recovery in private consumption is expected due to the easing of price pressures and an improvement in purchasing power. However, high prices for basic consumer goods, such as food and energy, will continue to limit consumer spending. It is optimistic, nevertheless, that investments financed by the EU, including by the Recovery and Resilience Facility (RRF), are expected to accelerate, compensating for the anticipated weak performance of some sectors and contributing to moderate economic growth.

Reduction in the number of job vacancies. At the turn of 2022 and 2023, there were some signs of a downturn in the labour market in the form of a decrease in the number of job vacancies and a slight increase in the unemployment rate. It is expected that the slowdown in GDP growth will negatively affect employment and lead to an increase in unemployment. In 2023, this is expected to result in an overall decline in employment by 0.6%, accompanied by an unemployment rate of 6.6%. However, with the acceleration of GDP growth in 2024, changes in the labour market are expected, partly due to demographic factors, which will nevertheless lead to a slight decrease in the unemployment rate to 6.5%.

The Recovery and Resilience Facility in Lithuania. Reforms and investments foreseen in the recovery and resilience plan approved by the European Parliament and the EU Council aim to help Lithuania become an economy that is more balanced, resilient, and better prepared for the challenges and opportunities related to green and digital transformation. To this end, the plan envisages the implementation of 30 actions covering investments and reforms backed by grants amounting to 2.22 billion euros; 37.8% of the plan will support climate objectives, while 31.5% will support the digital transition. According to the analysis presented in the plan, Lithuania faces challenges in the area of climate and environmental policy related to the low proportion of renewable energy sources in its energy usage and the need for a significant improvement in energy efficiency („Prace IEŚ", nr 5/2020). Other key challenges in this area include efficient resource management in the construction, transport, and industry sectors; reducing its overall carbon footprint; and promoting sustainable innovation, including developing green skills, for instance, in pollution prevention and natural environment reclamation and ecosystem management. There is also a call for improving the circular economy, enhancing air and water quality, and protecting biodiversity. In terms of Lithuania's digital challenges outlined in the plan; delayed 5G implementation, a persistent and significant digital divide between urban and rural areas in terms of broadband infrastructure, a low level of digital skills and a lack of ICT specialists, and the limited digitalization and uptake of advanced technologies in Lithuanian small and medium-sized enterprises as well as startups. However, it should be added that Lithuania achieves relatively good results in terms of the number of startups among EU countries. According to the „State of European Tech 2021" report, Lithuania, with 523 startups per million inhabitants, was above the EU average, which was 237 at the time („Prace IEŚ", nr 7/2022).

The budget deficit is set to increase in 2023. In 2022, the budget deficit sector in Lithuania decreased to -0.6% of GDP, partly due to lower-than-expected expenditure on energy support. Taking into account macroeconomic stability, the magnitude of Lithuania's deficit should be assessed positively. High deficits can curb economic growth, increase interest rates, displace private investments, and lead to an increase in public debt. Furthermore, according to the applicable regulations, all EU countries are obliged to maintain a budget deficit below 3%, and a public debt-to-GDP ratio below 60%. However, these are thresholds that many countries currently exceed, partly due to expansionary fiscal policies aimed at mitigating the effects of the COVID-19 pandemic, the ongoing Russian invasion of Ukraine, and the energy crisis. For example, in 2022, as many as 20 EU member states reported deficits. The highest deficits were recorded in Italy (-8.0%), Hungary and Romania (both at -6.2%), and Malta (-5.8%). Twelve member states had deficits higher than 3% of GDP. Six member states reported surpluses, with the largest surpluses noted in Denmark (3.3%), Cyprus (2.1%), and Ireland (1.6%). The Netherlands reported that the revenue and expenditure of its budget was balanced.

In 2023, Lithuania's deficit is expected to rise to -1.7% of GDP, despite the anticipated decline in energy prices, which results in reduced budgetary costs of energy support, and the gradual phasing out of temporary pandemic-related assistance measures. The expected increase in the deficit is due to the fact that the government plans, among other things, to implement several projects that were partially scheduled for 2022, additional expenditure on social benefits, and the indexation of pensions. It is assumed that in 2024, the deficit will decrease to -1.4% of GDP as a result of a gradual withdrawal of measures designed to mitigate the effects of high energy prices. However, it is expected that permanent expenses such as raising social benefits and pensions, and increased interest expenditure, will determine the public sector balance over a longer period. The good news is the forecast of a relatively low public debt, which in 2023 is expected to reach 37.1% of GDP, and in 2024 is expected to decrease slightly - to 36.6%.

Economic forecasts for 2023 and 2024. The European Commission's economic forecasts published in May 2023 for EU member states, titled "European Economic Forecast. Spring 2023", covering the years 2022-2024, indicate that Lithuania's real GDP will grow by only 0.5% in 2023. This indicates a slowdown in the pace of economic growth, which is largely also a result of the persistent rise in price levels. Inflation, especially its impact on private consumption, is one of the most significant factors determining Lithuania's economic situation. The prospects for 2024 seem slightly more optimistic; it is expected that prices of raw materials and consumer goods will rise more slowly, which, combined with a recovery in domestic and foreign demand, should contribute to stimulating the economy. It is also expected that the increase in investments funded by the Recovery and Resilience Facility will continue to have a positive impact on Lithuania's economic activity. An increase in real GDP to 2.7% is forecasted.

Conclusions. For the recovery of the Lithuanian economy, striving for geopolitical stabilization and the effective use of available financial resources may well be the key factors. It will be necessary to increase competitiveness and invest in innovation. Consistent in this respect is the plan of reforms and investments for Lithuania, funded by the Recovery and Resilience Facility, which aims to transform the economy to be more sustainable, digital, and resilient to the effects of climate change. The key challenges are improving energy efficiency, developing broadband infrastructure, and increasing digital skills. According to the European Commission's forecasts, Lithuania can expect a slowdown in economic growth in 2023, mainly due to persistent inflation. However, the prospects for 2024 are more optimistic – economic growth is forecasted due to a projected slower pace of price hikes, a recovery in demand, and an acceleration of investments financed by the Recovery and Resilience Facility, which may contribute to an increase in real GDP to 2.7%. It is forecasted that in 2023, Lithuania's deficit will rise to -1.7% of GDP, despite the expected drop in energy prices and the gradual phasing out of extraordinary measures related to COVID-19.