Lithuania

Highlights

- **Gross domestic product (GDP) fell in the first half of 2023.** The drop is largely the result of reduced industrial activity that reflects weak external demand, subdued consumption amid high inflation, and persistent uncertainty, which is affecting confidence.
- **The European Union's (EU) Recovery and Resilience Facility (RRF) funds have helped the country to boost investment.** The country received the first payment of €542 million under the RRF in May 2023, having fulfilled 31 out of 33 milestones required for the disbursement. In October 2023 Lithuania's Recovery and Resilience Plan (RRP) was being amended to include a new REPowerEU chapter and will be submitted to the European Commission by the end of 2023. In addition, Lithuania has requested that the RRP be supplemented with an additional €1.6 billion in loans to promote business investments in green, innovative and digital technologies, and in producing and exporting high value-added products.
- **In 2022 Lithuania stopped importing energy from Russia, marking an important step towards energy independence.** Lithuania continues to work towards an ambitious goal of meeting all of its domestic electricity needs with renewables by 2030.

Key priorities for 2024

- **Further measures to become fully independent from the Russian power system are being implemented.** A key step will be to disconnect from the Belarus, Russia, Estonia, Latvia and Lithuania (BRELL) power system and to synchronise the Baltic states' electricity systems with the synchronous area of continental Europe, planned to take place in February 2025.
- **Investments in offshore wind farms will help the country to become an energy exporter by 2030.** Successful completion of a tender in October 2023 for a €1.83 billion investment for the construction of an offshore wind farm would help reach the target of making it operational by 2030, with a capacity of 700 MW. Another tender for a wind farm, also with a capacity of 700 MW, is planned to be announced in January 2024, and it is expected that two offshore wind power plants will become operational by 2030.
- **Full use of all EU funds under the RRF is needed.** The concentration of domestic reforms and investments should be aimed at stimulating the economy and gradually eliminating structural weaknesses, along with a green and digital transition. The consolidation of four Lithuanian development agencies into one is well under way and could boost further mobilisation of the RRF funds.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.7	0.0	6.3	2.4	-0.5
Inflation (average)	2.2	1.1	4.6	18.9	9.0
Government balance/GDP	0.5	-6.5	-1.1	-0.7	-1.8
Current account balance/GDP	3.5	7.3	1.1	-5.5	0.5
Net FDI/GDP [neg. sign = inflows]	-2.3	-1.1	-2.2	-2.5	-2.0
External debt/GDP	70.0	80.7	78.9	67.6	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	39.6	37.5	37.4	35.9	n.a.

Macroeconomic developments and policy response

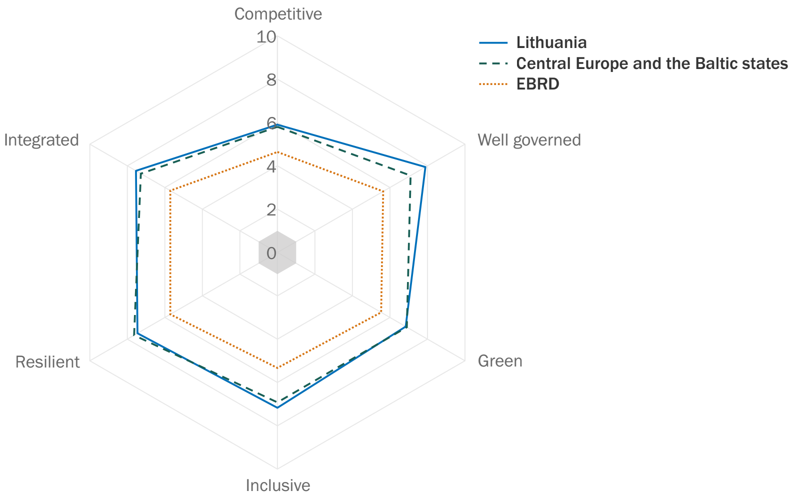
The economy is set to contract mildly in 2023, although a strong rebound of 2.4 per cent in the second quarter suggests there may be a recovery. Following a slowdown in GDP growth to 2.4 per cent in 2022, the economy shrank by 0.8 per cent on a year-on-year basis in the first half of 2023. Weak economic performance was largely driven by uncertainty related to Russia's war on Ukraine, inflationary pressures, tightening credit conditions and sluggish external demand, which affected industrial activity. Unemployment remains close to historically low levels, reaching 6.3 per cent in the second quarter of 2023. Despite elevated energy prices and weakness in the industrial sector, the labour market remains resilient.

Inflation has declined from high levels. After peaking at 24.1 per cent in September 2022, the inflation rate has been decreasing steadily, reaching 4.1 per cent in September thanks to lower food, transport and housing utility prices. Inflation should be on a further downward trend in 2024. Average wages continue to rise strongly, to double digits, surpassing the rate of inflation and supporting the recovery of households' purchasing power. The 15 per cent rise in the minimum wage in January 2023, along with the government's temporary subsidy programmes during the energy-price-shock period, provided substantial support for individuals at the lower end of the income distribution. The demand for household loans is on a downward trend, reflecting elevated uncertainty and high interest rates.

The government introduced subsidies for energy and gas prices. To mitigate the economic and social impacts of high energy prices, the government adopted a new support package worth €557 million at the start of 2023, introducing subsidies on energy and gas for households and businesses. As the energy market stabilises, the energy support measures have been gradually withdrawn: the partial subsidy on electricity prices for businesses was terminated in the first quarter of 2023; the electricity support scheme for households was discontinued in the second half of 2023; and gas subsidies for households and business will not continue beyond the end of 2023. The drop in wholesale gas and energy prices has resulted in the government spending significantly less than planned on these schemes, and the budget deficit is now expected at 1.9 per cent of GDP in 2023. No support measures are planned for 2024.

Negative growth in 2023 should be followed by a modest recovery in 2024. GDP is projected to grow by 1.5 per cent in 2024, driven by recovering household consumption, as wage growth will substantially outpace inflation. This growth will also be driven by better external demand for Lithuanian exports. EU funds directed towards public investment will also contribute to increased economic activity. However, downside risks remain, associated mostly with geopolitical developments and main trading partners' economic conditions.

Assessment of transition qualities (1-10)



Structural reform developments

The government presented and submitted a tax reform to parliament for discussion. The tax reform aims to provide a tax system that is more balanced, supports growth and improves social fairness. The package responds to some of the key recommendations made over the years by international organisations and financial institutions, such as broadening the tax base and addressing the complexity of the various forms of economic activity. Among the measures in the package aimed at stimulating growth are the immediate depreciation deduction for fixed assets to encourage productive investments, and the increase in the annual income threshold for businesses to register as value-added tax (VAT) payers. The reform also proposed expanding the scope of real-estate tax, introducing more consistent progressivity on high-income earners and bringing the taxation of self-employed workers' incomes closer to that of workers in standard employment, thus broadening the coverage of social security guarantees.

The pan-Baltic capital market is set to benefit from single index classification. The new single index, which was launched at the same time as the August 2023 Index Review, will allow the three markets to be integrated into the Morgan Stanley Capital International (MSCI) universe and will raise the region's profile among international investors who track MSCI indices. The approach is in line with the efforts made by the ministries of finance in Estonia, Latvia and Lithuania, the European Bank for Reconstruction and Development, the European Commission and Nasdaq Baltic to create a single pan-Baltic capital market, as outlined by a memorandum of understanding signed in November 2017. The approach is also a building block of the EU's capital markets union initiative.

Lithuania successfully cut off fossil-fuel imports from Russia. Following the opening of the Poland-Lithuania gas interconnection in May 2022, Lithuania strengthened its links with Latvia by completing a gas interconnection in December 2022. Moreover, Lithuania, together with Estonia and Latvia, took measures to synchronise with the western European power system and disconnect from the BRELL power system. The country has installed four large-scale electricity storage facilities in Vilnius, Siauliai, Alytus and Utena with a total capacity of 200 MW to provide a reserve of energy. According to the Ministry of Energy, the country is on track to notify BRELL counterparts in August 2024 of its disconnection, and to cut off the eastern power system by early 2025.

New EU funds are being added to foster green transition and digitalisation. In June 2023 the authorities requested a REPowerEU chapter to be added to Lithuania's RRP. In addition, the government plans to expand the RRP with an additional €1.6 billion in loans to promote business investments in green, innovative and digital technologies, and in producing and exporting high value-added products. Lithuania expects amendments to be adopted by the end of this year.

In May 2023 the country received the first payment of €542 million under the RRF. Once all conditions are met, a further payment of €260 million is expected before the end of 2023. The funds are directed at supporting climate objectives and fostering the digital transition. According to the European Commission, the country satisfactorily fulfilled 31 out of 33 milestones before receiving the payment.

Excise tax reform is contributing to the green transition. In May 2023 the parliament approved a package of fuel excises discouraging the use of the environmentally harmful fuels. The package includes withdrawing (narrowing) subsidies for fossil fuels, and introducing CO_2 components to the excise duty structure, which will support the country's green transition.

Renewable energy is being developed. In March 2023 the Lithuanian National Energy Regulatory Council (VERT) opened the tender process for the construction of an offshore wind farm. The investment will amount to €1.83 billion, with an estimated capacity to provide up to a quarter (700 MW) of the country's total electricity needs. The wind farm is expected to be operational by 2030. In 2022 wind power production in Lithuania accounted for 13.5 per cent of total consumed energy. In the longer term, Lithuania has set an ambitious target for renewables (mainly offshore wind and solar) to cover all domestic electricity demand by 2030.