Lithuania

Highlights

- **Gross domestic product (GDP) growth has slowed sharply.** The slowdown is largely the result of weakening domestic demand, especially household consumption, which has been hit by falling real disposable incomes amid soaring inflation.
- **Lithuania is set to turn from an electricity importer into an electricity exporter by 2030.** In June 2022 the government announced a massive €1 billion investment plan for green energy development and energy efficiency by 2030, with €604 million to be invested over the next 18 months.
- **Gas transmission security has been strengthened.** The improved capacity of interconnectors allows for gas transmission between the liquefied natural gas (LNG) terminal in Klaipeda, Lithuania and Poland and Latvia, including to the Latvian underground gas storage facility.

Key priorities for 2023

- **The shift away from fossil fuels should accelerate.** Plans are now in place for an ambitious green energy and energy efficiency programme over the coming years, but implementation will be key, not least private-sector investment.
- **The digital skills of citizens need further development.** Lithuania has dedicated nearly a third of its Recovery and Resilience Facility (RRF) funds to the digital transition. Its key short-term priority is to develop and improve new and existing digital services for businesses and citizens, as well as to centralise public information technology (IT) resources.
- **Steps are needed to mitigate the risks of poverty and social exclusion for vulnerable groups.** The share of people at risk of poverty or social exclusion has fallen since 2016, but remains well above the European Union (EU) average. The situation is being exacerbated by currently elevated food and energy prices. Short term, the government should focus on the provision of means-tested support measures for the most vulnerable groups.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	4.6	0.0	6.0	2.0
Inflation (average)	2.5	2.2	1.1	3.0	19.0
Government balance/GDP	0.5	0.5	-7.0	-1.0	-2.0
Current account balance/GDP	0.3	3.5	7.3	1.1	-1.6
Net FDI/GDP [neg. sign = inflows]	-0.5	-2.3	-1.1	-2.2	-2.3
External debt/GDP	78.3	70.1	75.3	77.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	40.5	39.6	37.6	37.5	n.a.

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Macroeconomic developments and policy response

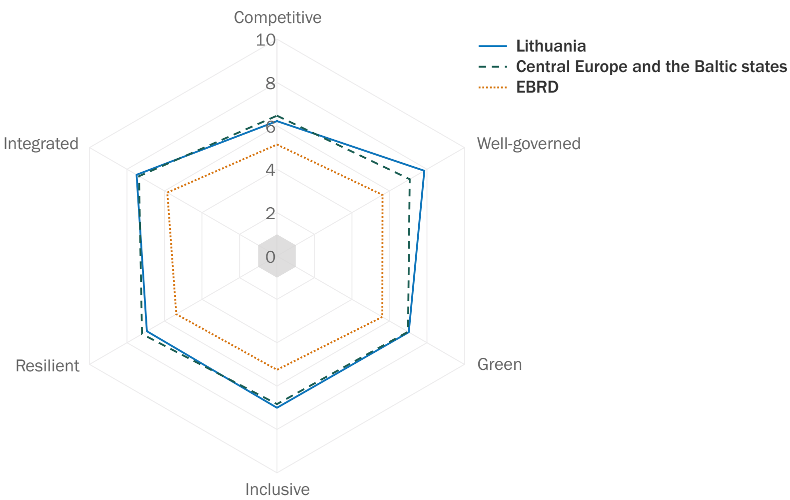
GDP growth has slowed sharply, but unemployment remains low. Following a strong rebound in economic activity in 2021, with GDP growth of 6.0 per cent, growth decelerated to 3.2 per cent in the first half of 2022. The slowdown was largely the result of weakening domestic demand, especially household consumption, which was hit by falling real disposable incomes amid soaring inflation. However, unemployment dropped to just 5.2 per cent in the second quarter of 2022, below pre-pandemic levels in the same quarter of 2019. To help Ukrainian refugees to start a business in Lithuania and to create new jobs, the government launched a cheaper loans programme for start-ups or working capital. These loans are available to Ukrainian-owned small and medium-sized enterprises established after 24 February 2022, when Russia invaded Ukraine.

Inflation is high and rising, prompting a government support package. In September 2022 the annual inflation rate jumped to 22.5 per cent year on year. The acceleration was largely triggered by rises in housing, food, energy and transport prices. To mitigate the effects of the price hikes on households, especially heating, in April 2022 the government approved a €2.26 billion package, which includes increases in non-taxable incomes, pensions and social benefits. Electricity and gas prices should not increase by more than 40 per cent in 2022 and the difference between end-user and market prices should be covered by the package.

The general government deficit has widened. After registering a general government deficit of just 1 per cent of GDP in 2021, the fiscal gap is expected to increase this year to 2 per cent, driven by government's measures to support households and businesses amid high inflation, assistance for Ukrainian refugees and greater spending on defence. However, general government gross debt remains moderate, falling from 43 per cent of GDP in 2021 to below 40 per cent of GDP in 2022, according to the finance ministry.

Reduced trade with Lithuania's non-EU neighbours will weigh on economic activity. Amid reduced exports to Belarus, Russia and Ukraine and weakening demand in the EU, GDP growth in Lithuania is expected to slow to 2.0 per cent in 2022 and 1.5 per cent in 2023. The inflation-driven reduction in households' real disposable income will continue to hamper consumption. Trade tensions with China could also negatively affect Lithuania's economic activity, but the bilateral trade volumes are rather small. Last year, Lithuania's exports to China constituted around one per cent of Lithuania's total exports. On the positive side, investments under the RRF will positively stimulate GDP growth.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Further investments have been made to promote the green transition. In June 2022 the government announced a massive €1 billion investment plan for green energy development and energy efficiency by 2030, with €604 million to be invested over the next 18 months. The objective of the plan is to turn Lithuania from an electricity importer into an electricity exporter by 2030. Currently, imports account for 65 per cent of the country's electricity, while the rest is produced from wind and solar. By 2025 about 50 per cent of electricity consumed should be produced domestically. The government plans to allocate €118 million to households to partially compensate for the purchase of heat pumps, car charging stations and solar energy storage units. The estimated cost of Lithuania's green economic transition over the next decade is €14 billion, with €4 billion to be invested by the private sector. Furthermore, in August 2022 Orlen Lietuva, an oil refining and import company, embarked on €641 million of modernisation investments, which envisages the construction of a residue conversion unit. This project is expected to last until 2024 and to improve refining efficiency by 20 per cent.

Gas transmission security is being strengthened. Since November 2022 gas transmission capacity from Lithuania to the Latvian gas system has increased by one-third to 90 GWh per day, under the Enhancement of Lithuania-Latvia Interconnection (ELLI) project launched in 2017. The interconnectors also allow for gas transmission between Latvia and the LNG terminal in Klaipeda, Lithuania and from Poland to Latvia, including to the Latvian underground gas storage facility. Completion of the project, expected by the end of 2023, will lead to a doubling of the transmission of natural gas capacity between Lithuania and Latvia.

Electricity market liberalisation for the smallest consumers has been postponed. The first and second stages of liberalising retail electricity supply for households consuming more than 5,000 kWh and 1,000-5,000 kWh of electricity per year were completed at the end of 2020 and in July 2022, respectively. The government has postponed the final stage, for households consuming less than 1,000 kWh of electricity per year, until the end of 2025. Its intention is to reduce electricity costs for consumers through market liberalisation, but the current electricity price spike on the global markets, linked to Russia's invasion of Ukraine, has prompted the government to postpone this objective.

Energy resilience and efficiency are advancing. The project to synchronise the Baltic power grid with the continental European network received €170 million in EU funding in June 2022, to be used for network upgrades, frequency management and information system equipment worth a total of €227 million, adding to the already allocated more than €1 billion of EU funding in the previous years. The project was planned to be completed by 2025 but the synchronisation with the continental European network could be launched earlier if the Baltic States are disconnected from the electricity grid with Belarus and Russia (BRELL). Other sources of electricity include a power interconnection with Sweden (NordBalt) and a power interconnection between Finland and Estonia (Estlink) through Latvia to Lithuania. Meanwhile the government has earmarked more than €1 billion for investments in the renovation of buildings, the development of charging stations, the installation of solar panels, the replacement of fossil-fuel boilers with more advanced technology and the promotion of green energy solutions, including hydrogen and biofuel technologies.

Funds under the RRF are targeting the green and digital agendas. Two-thirds of investments envisaged under the RRF are expected to start this year. The first payment of RRF funds, €565 million out of the total €2.25 billion, is expected to be transferred to Lithuania in autumn 2022, following the €289 million of pre-financing paid out in September 2021. Key projects being funded under the RRF support climate objectives and the digital transition.

Trade with China has been disrupted, prompting the European Commission to support Lithuania. In April 2022 the European Commission approved a €130 million state aid scheme for companies affected by China's trade restrictions on Lithuania, which were imposed in reaction to the opening of a Taipei China representative office in Vilnius in late 2021. The scheme envisages loans of up to €5 million for affected companies, excluding the finance, agriculture and forestry, and fisheries and aquaculture sectors. Lithuania is preparing for an opening of a trade representative office in Taipei China, with a trade representative being nominated in September 2022. According to the European Commission, Lithuania is a victim of Chinese trade coercion, and has taken a trade discrimination case to the World Trade Organisation.