Lithuania

Highlights

- **Robust domestic demand is driving an economic recovery in 2024.** The economy bounced back strongly in the first half of the year with real gross domestic product (GDP) growth of 2.3 per cent (year on year) but external markets remain weak.
- **The development of offshore wind energy is accelerating.** The energy regulator has granted a 41-year permit to Ignitis Renewables and Ocean Winds for a 735 MW wind farm project worth €1.8 billion, operational by 2030.
- **Parliament has mandated fixed-rate mortgage options and simplified refinancing to foster competition.** The new laws aim to mitigate interest rate risks and offer better loan conditions for customers.

Key priorities for 2025

- **The grid capacity needs to be constantly upgraded to accommodate increasing renewable energy generation and ambitious energy system development goals.** This would prevent market saturation and ensure reliable access for producers and consumers, aligning with European Union (EU) electricity grid synchronisation goals.
- **Transport reforms are needed to reduce regional inequalities and levels of pollution.** Key measures would be a multimodal public transport system and an annual car tax based on emissions. This would help to bridge the urban-rural divide and reduce pollution, aligning with EU environmental standards.
- **Further structural reforms in pensions, healthcare and education should be introduced.** Key reforms in these sectors are essential to preserve fiscal sustainability and support long-term economic growth, as highlighted by the International Monetary Fund (IMF)'s recent recommendations.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	0.0	6.4	2.5	0.3	2.3
Inflation (average)	1.1	4.6	18.9	8.7	1.0
Government balance/GDP	-6.5	-1.1	-0.6	-0.8	-1.6
Current account balance/GDP	7.2	1.4	-6.1	1.1	-2.0
Net FDI/GDP [neg. sign = inflows]	-1.1	-1.9	-4.6	-1.8	-3.0
External debt/GDP	79.9	77.4	66.8	69.2	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	37.3	37.2	35.8	34.8	na

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Macroeconomic developments and policy response

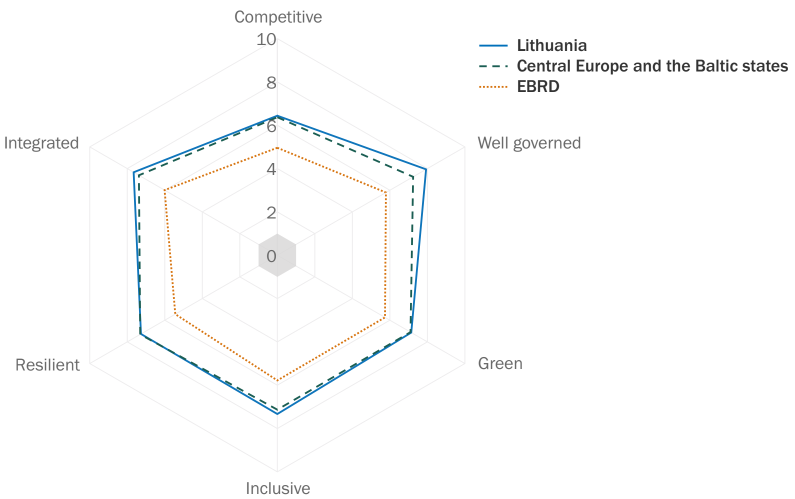
Solid household consumption, investment and services exports are fuelling growth. Following slow growth in 2023, the economy has begun to perform strongly, with real GDP growing at an impressive 2.3 per cent year on year in the first half of 2024. This economic recovery was powered by strong private consumption as households' disposable incomes continue to improve. Real gross wage growth reached 8.6 per cent year on year in the second quarter of 2024, continuing the trend of strong wage increases that had started the previous year. Rising labour costs are expected to inflate price levels somewhat, with services inflation at 6.2 per cent in September 2024. At the same time, the headline inflation rate was just 0.4 per cent and it is expected to stay at a low level throughout the remainder of 2024. Public investments, particularly in energy infrastructure and defence, have bolstered real GDP growth, aligning with Lithuania's ambitious plan to boost green energy production and increase defence spending. Service exports, especially financial and fintech-related activities, have shown resilience, and transport services, previously affected by global trade disruptions, are now rebounding.

Declining productivity has weakened external competitiveness. Since Russia's invasion of Ukraine in February 2022, the European Central Bank (ECB)'s Harmonised Competitiveness Indicator shows a nearly 9 per cent drop in Lithuania's international competitiveness, down by almost 12 per cent on pre-pandemic levels. Rising energy prices and falling labour productivity have temporarily affected the external balance, particularly in goods, even as service exports remain resilient. Since 2021, nominal labour costs have surged by over 40 per cent, while real productivity has declined by nearly 5 per cent (both measured in hours worked). The labour market remains tight, with registered unemployment at 8.7 per cent as of September 2024. Lithuania faces one of the highest skills mismatches in the EU, with a shortage of highly skilled workers and an oversupply of medium- and low-skilled workers. To address these mismatches, the government launched several programmes, including a smart specialisation multi-year programme for companies this year, along with financial incentives and targeted scholarships.

Fiscal performance surpassed expectations last year. The general government deficit was at 0.7 per cent of GDP in 2023. Revenue growth, driven by elevated inflation, the windfall profit tax on banks and the expedited phaseout of energy subsidies, offset the increase in military and interest expenditures. As a result, government debt continued its downward trajectory, decreasing from 45.9 per cent of GDP in 2020 to 37.9 per cent of GDP in 2023. The IMF expects the general government deficit to widen to 1.6 per cent of GDP in 2024, driven primarily by increases in pensions, social benefits and public-sector wages. Increased defence spending, rising to 3.2 per cent of GDP in 2024, will be partially funded through the extension of the windfall tax on banks, an increase in the corporate tax rate and higher excise duties.

Robust growth is forecast in the short term. The key driver is expected to be household consumption, supported by significant increases in the minimum and overall wage growth. The labour market remains stable, supported by net migration inflows, including refugees. Anticipated interest rate reductions by the ECB, coupled with a revival in external demand, should bolster business confidence and, in turn, stimulate private investment. Increased defence spending and higher investments in the green transition are also expected to contribute to economic growth. However, in the short term, skills mismatches in the labour market may continue to exert wage pressure, potentially leading to a slight uptick in inflation. Growth is forecast at 2.3 per cent this year and 2.5 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

The government revised its recovery and resilience plan. In July 2024, the government approved a revision of its national recovery and resilience plan (NRRP) to submit a second payment request under the EU's Recovery and Resilience Facility (RRF) in September 2024. This decision aims to bring forward the formal deadlines of already achieved indicators and unify the implementation timelines for poverty reduction and income inequality reforms. The revised plan, valued at €3.85 billion, includes €2.3 billion in grants and €1.55 billion in loans. To date, more than two-thirds of the envisaged reforms have been implemented, with €1.36 billion already disbursed by the European Commission.

Offshore wind energy is advancing. In February 2024 the National Energy Regulatory Council (VERT) granted a 41-year permit to Offshore Wind Park 1 - Ignitis Renewables and Ocean Winds to construct the country's first offshore wind farm in the Baltic Sea. The project, valued at €1.8 billion, will have an installed capacity of 735 MW and is expected to become operational between 2028 and 2030. This development follows a successful tender by Ignitis Group and Ocean Winds in 2023, in which they offered €20 million as a development fee to the state. The authorities plan to build two wind farms in the Baltic Sea by 2030, each with a capacity of 700 MW. These two offshore farms would provide around half of the country's current electricity demand.

The Baltic states are exiting the Russian power grid. In July 2024 the electricity transmission system operators (TSOs) of Estonia, Latvia and Lithuania signed a declaration of non-renewal of the BRELL (Belarus, Russia, Estonia, Latvia and Lithuania) agreement, informing Russian and Belarusian operators of their withdrawal from the electricity ring. On 8 February 2025 the Baltic TSOs will disconnect the Estonian, Latvian and Lithuanian electricity systems from the Russia-controlled electricity system IPS/UPS and start a joint isolated operation test. Afterwards, on 9 February 2025, they will synchronise with the electricity network of continental Europe. The EU has committed €l.2 billion to support this transition, covering about three-quarters of the costs.

Parliament has mandated fixed-rate mortgage options to mitigate interest rate risks, and simplified mortgage refinancing to foster competition among banks. In June 2024 parliament passed a bill obliging banks to provide housing loan borrowers with a choice between at least a five-year fixed interest rate or a variable interest rate. This move, effective from May 2025, aims to mitigate the risk of interest rate fluctuations for borrowers, who previously had limited options. In addition, the law mandates credit institutions to offer measures to manage interest rate risks if they cannot provide a fixed-rate option. Also, in October 2024, parliament approved a new simplified refinancing procedure. It aims to foster competition among mortgage credit providers and encourage consumers to shop around in order to get the best deal on their loans.

Artificial intelligence (AI) is advancing. In July 2024, the Ministry of the Economy and Innovation prepared draft amendments to create a favourable environment for AI technology, aligning with the EU's new AI law. The amendments will empower two national authorities: the Innovation Agency, responsible for a pilot regulatory environment, and the Regulatory Communications Authority, overseeing AI market surveillance. Lithuania's AI strategy, established in 2019, aims to make the country a regional leader in AI. The Ministry has launched financial measures, including a €15 million budget to support AI start-ups and €110 million for digitalising public services. Lithuania has been emerging as one of the main fintech hubs in Europe (the third in terms of size and the leader in terms of licences), with the fintech strategy 2023-28 to continue supporting further development of the sector.

Lithuania is set to increase defence spending to 3 per cent of GDP for 2025-30, financed through various tax hikes. In August 2024, the finance ministry proposed an additional €130 million for weapons systems procurement, raising defence spending to 3.2 per cent of GDP for the year. The government also announced €250 million in soft loans for firms in the defence and security sectors, aiming to attract investors and boost competitiveness. Significant growth in this sector, with a 14 per cent increase in employment and a near doubling of turnover to €700 million over the past five years, suggests potential spillovers for other sectors, enhancing innovation and competitiveness. In addition, Lithuania and Rheinmetall signed an agreement for a €180 million artillery ammunition factory in Radviliskis, expected to create 150 jobs and further bolster the defence industry.