China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 27, No. 2 (LT)

March 2020

Weekly Briefing

Lithuania economy briefing:

Lithuania bracing itself for the economic recession due to the pandemic crisis

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Lithuania bracing itself for the economic recession due to the pandemic crisis

At the start of the year, the consumer sentiment in Lithuania was upbeat. Similar positive signals have been sent out by the leading retail banks which revised the growth projections upwards. In January in its Economic Outlook report, Swedbank stated that in the face of gloomier global prospects, consumer and business confidence remained remarkably stable. The bank analysts noted that, although industry confidence declined somewhat, retail, services and consumer confidence hovered close to the highest level in a decade, reflecting positive trends in the labour market and unwavering domestic demand. Two months later, the forecasts became reverse. In the Economic Outlook for March (completed and made available on 25 March) Swedbank already issued a revised forecast indicating that Lithuania's GDP growth is expected to contract by 10% in the second quarter of 2020 due to the disruptions of the economic activities caused by the pandemic. The Bank of Lithuania in its estimations went a step further by announcing that a fifth of the economy could be wiped out as the result of the impending crisis.

Below is a brief outline of the previous crises and the future scenarios prepared for Lithuania explaining the level of adversary impact that the impending crisis could wreck on the economy for the rest of the year. It tries to explain the main drivers, which can contribute to a significant contraction of the economy, and the possible strategies being considered and under implementation, which might shorten the downward curve.

The threatening 2020 crisis is the fourth economic or financial crisis which the Republic of Lithuania has experienced since the restoration of independence and sovereignty in 1990. The first one was the Lithuanian banking crisis which took place in 1995. It was an internal baking crisis caused by the adjustment of the former state-planned economy to the market economy. It resulted in the run on the fledgling private banks, reduced lending, loss of tax revenue collection, increased current account deficit and a sharp increase in unemployment. The long-term impact of this crisis was the creation of the stable banking sector owned by three large Nordic corporate banking groups (SEB, Swedbank and Luminor).

The second crisis arrived a few years after the Lithuanian banking crisis; it was caused by the Russian financial crisis in 1998. The crisis caused economic slowdown (the immediate effects were felt in 1999 when the economy sharply declined), and this increased the unemployment rate. A sharp drop in inflation has increased the state budget deficit. The long-term impact of this crisis was the economic migration and the brain drain, which resulted in more than 0,5 million active participants of the labour market relocating themselves to the more capital-rich economies which required labour. As a result, the unemployment rate in the country has subsided but restricted the potential growth of the internal consumption.

The third crisis came in 2008 and was caused by the global financial crisis. The complex financial crisis which turned into the economic crisis in 2009 has had a strong negative impact on a number of macroeconomic indicators of Lithuania. It caused a steady GDP decline, while the unemployment reached its highest level. The long-term impacts of this crisis has been the continuous out-migration of skilled labour and the growing social stratification of society.

The researchers, which studied the impact of all three crises on Lithuania's economy, tried to arrive at some measurable indicator that could help to put these outcomes into perspective. The proposed financial crisis index has been used for that purpose. According to one such analysis, the 1995 banking crisis had the lowest impact on the economy measured by the crisis index at the value of 91.54. The 1998 Russian financial crisis had an almost double impact (the impact's value estimated at 171.71), while the impact of the 2008 global financial crisis on Lithuania was estimated at 218.5 of the financial crisis index value. The crisis index value of the Great Depression 1930 financial crisis was estimated at 402.19.

The ever increasing negative impact of the economic and financial crises on Lithuania's economy corresponds to closer integration of Lithuania's economy into the global economic system. Since the latest crisis a decade ago, Lithuania has become even more closely intertwined with the core economies, which can result in the impact of higher-order state and uncertainty. The analysis provided by both Swedbank and the Bank of Lithuania indicates a similar direction.

Swedbank forecasts that the GDP level could reach the pre-pandemic level at the end of 2022. During the period of the subsequent three years, as it is predicted, the worst affected sectors, as it is the case in many other countries, will be tourism, accommodation, catering, and entertainment industries. More importantly, transport, which makes up a significant share in the economy, will be severely impacted. The manufacturing, which makes up a quarter of the GDP, will be under stress due to the quarantine requirements and the disruption of the supply chains, especially those connected to the non-EU countries. However, due to the trade surplus, current account surplus and high levels of housing affordability and a budget surplus (which had been run prudently by the government for four years), it is predicted that GDP might decrease only 5%.

It is expected that the contraction of the economy will be cushioned with the help of a fiscal package, amounting to 5% in the form of support to temporarily unneeded workers, tax credits, loan guarantees and the fast-tracking of EU funds and investments. Swedbank foresees that these measures provide a sufficient cushion to amortize the shock until the end of April. If the quarantine extends beyond that date, the need to enlarge a fiscal package would be evident. In the best-case scenario, the public sector deficit is expected to reach around 6% of GDP this year. Swedbank expects 25 000 employees to lose their jobs and unemployment to increase to 8% and "to get back to normal" only in 2022.

However, the Bank of Lithuania was less optimistic in providing the forecasts of three possible scenarios of the economic development of the country during and in the aftermath of the pandemic crisis. On 26 March in the public briefing, the Chairman of the Board of the central bank presented a much bleaker picture in suggesting that the country is in for a bumpy road, which might be more challenging than has been estimated so far. The stress tests performed by the bank used three scenarios. According to the V-shaped recession scenario which assumes that the duration of the quarantine will be two months (which is indeed very unlikely given the estimations provided by the international health organisations and the experience of the countries which have experienced the coronavirus for a longer period of times), the exports will go down by 4,7%.

According to the U-shaped recession scenario (which is based on the same duration of the quarantine – two months), the economy will contract by 13%, but the rebound of the economy will take longer due to the weakened domestic consumption. Finally, according to what is presented as the worst-case scenario (but perhaps meant to be the most realistic one), the extended U-shaped recession scenario (based on the assumption that the quarantine measures will be in effect for four months), the economy will be impacted at the level of the 2008-2009 crisis, in which case the economy might decrease altogether by 20,8%. In this scenario, the unemployment level could reach 16% in 2020 and 19,8% resulting in a decrease of wages by 12,2% in 2020 and 2,5% in 2021. However, the country, according to the central bank, is well prepared to weather the crisis comparing to the previous crises. In the worst-case scenario, the income of the banking sector would decrease by 36,1%, yet, as is predicted, would not impact the capital requirements for banks.

The Government has already announced a support package in order to preclude the worst-case scenario. The economic stimulus package amounts to 5 billion euros and is aimed to help mitigate the negative impact of the coronavirus crisis on workers and businesses. The plan earmarks 1 billion euros for boosting the economy, and 500 million euros for shoring up the healthcare system, for preserving jobs and for maintaining business liquidity each.

The plan includes the following measures. The government's net borrowing limit to be raised from 900 million euros to 5.4 billion euros. Up to 60% of the cost of paying a worker for downtime will be covered by the state (up to the sum equal to the minimum monthly wage, which is 555 euros). Self-employed people will receive the support of up to 250 euros per month. Households will be able to defer payments on electricity and gas or pay them in instalments. The plan provides for deferring or rescheduling tax payments for businesses as well as for exempting taxpayers from fines and penalties. Resources from EU investment funds will be reallocated towards health, employment and business. The guarantee limits for the state-owned credit agencies will be significantly increased. Investment programmes will be accelerated by speeding up payments and increasing the intensity of funding. The plan foresees unfreezing funds under the Climate Change and Road Maintenance and Development Programmes and for accelerating the apartment buildings' renovation programme. All these measures indicate that the involvement of the state in helping to minimize adverse effects of the pandemic crisis on capital and labour will be stepped up and might result in a welfare state.

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