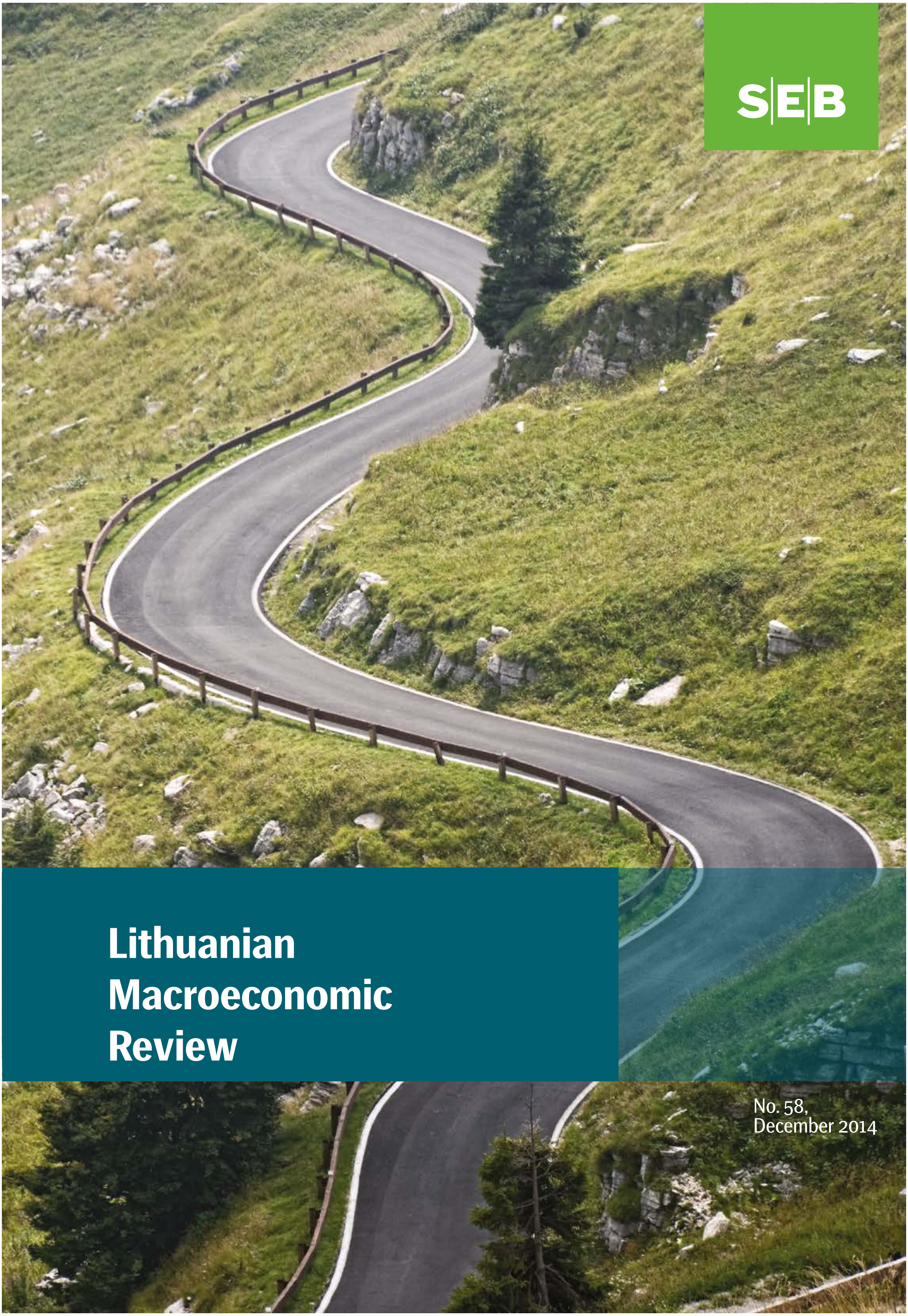

Lithuanian Macroeconomic Review

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Macroeconomic outlook and forecasts

General economic situation

The external environment of the Lithuanian economy is not very favourable at the moment but the situation does not resemble 2008 in any important aspect. Housing and financial bubbles are absent while domestic demand demonstrated sustainable growth over recent years. On the other hand, the prospects of the global economy and especially those of euro zone are not encouraging. Borrowing growth remains cautious, primarily due to continued deleveraging and weak credit demand.

According to preliminary data of Statistics Lithuania, the country's real GDP increased by 2.6 per cent on an annual basis in the third quarter of 2014. The growth slightly decelerated as compared with previous quarters albeit still was among the fastest in the European Union. Economic sentiment has somewhat weakened over the recent months in anticipation of more challenges. The struggling euro zone economy is of primary concern regarding the immediate future of Lithuanian economy. Germany, which used to be Lithuania's export partner No. 2, has already dropped to No. 4. Troubles in Russia also cast shadow on the prospects of the Lithuanian economy. However Russia remains Lithuania's export partner No.1 due to booming reexports. While Lithuanian-origin exports to Russia decreased due to latter's sanctions on exports of food products, reexports of machinery and equipment soared and therefore Russia's share in total exports has increased recently.

The effect of Russian sanctions on exports of food products has been limited thus far. Many producers started redirecting their production to alternative markets, e.g. Belarus, Saudi Arabia, Germany, Netherlands, United States, Italy, Hong Kong. Noteworthy, Belarus had bought large quantities of raw milk and probably used it for production of milk products which were sold in Russia. However, Russian market was favoured due its high profitability and consequently milk and meat processing companies are likely to lose a share of their income but will not go bankrupt.

The most Russia-vulnerable sectors in Lithuania now apply several defense strategies against the loss. The first measure is redirecting exports to other markets; second, reducing energy costs per production unit and improving competitiveness by increasing investment; third, reducing wages and salaries and fourth, saving costs by cutting staff. Up to date very few companies have reported layoffs due to loss of Russian market while the first strategy, i.e. redirection of exports, is used up at a full speed.

The domestic market also starts feeling the pressure of mounting uncertainty. The growth of sales of non-necessity goods (household equipment, furniture, construction and decoration materials, textiles, clothing and footwear) slowed down in recent months as compared with the beginning of 2014. Fuel sales resisted the trend while growth of sales of first necessity goods was rather moderate. The geopolitical tensions, upcoming heating season as well as euro introduction also pushed up the confusion of consumers and may temporarily increase the propensity to save.

Manufacturing industry

In October 2014, **industrial production** increased by 0.3 per cent as compared with October 2013, of which production of manufacturing industry increased by 2.5 per cent and manufacturing industry excluding refined oil products by 6.4 per cent. Production of chemical products increased by 27.6 per cent, paper and paper products by 16.9 per cent, textiles by 11.8 per cent, food products by 9.6 per cent, furniture by 8.4 per cent, construction materials by 3.1 per cent, rubber and plastics by 2.4 per cent and electric equipment by 1.8 per cent. Production of basic metals decreased by 47.6 per cent, pharmaceuticals by 44.7 per cent, computer, electronic and optical equipment by 14.4 per cent and refined oil products by 8.2 per cent. In January-October of 2014, industrial production decreased by 1.2 per cent on an annual basis and adjusted for working-day and seasonal effect, it declined by 0.8 per cent. Industrial production growth has been accelerating throughout the year 2014, partially thanks to improving performance at oil refinery *Orlen Lietuva*. The latter, being the largest industrial company in Lithuania, started stumbling in autumn 2013, and therefore negative statistical base effect phased out in autumn 2014.

In January-September 2014, total exports to Russia increased by 9.1 per cent on an annual basis while exports of Lithuanian-origin goods decreased by 12.8 per cent. Exports of Lithuanian food products decreased at double-digit rates in August and September but reexports continued increasing even after the sanctions on exports of food products were applied. Reexports make up almost 90 per cent of total exports to Russia, therefore it is not surprising that total exports to Russia increased.

According to Lithuanian Confederation of Industrialists, the damage of EU-Russian bilateral sanctions and heightened tensions in the region to Lithuanian industrial companies will reach up to EUR 194 million of planned income and EUR 9.7 million of estimated profit. The effect encompasses the sanctions as well as loss in competitiveness due to weaker rouble and contract breaches due to poor economic situation in Russia. According to confederation's estimates, one-third of companies were affected indirectly due to damage to their trading partners which had their business in Russia.

One of countermeasures against external challenges is investment into new technologies which reduce unit production costs or improve the quality of production. On the one hand, postponing investment in Lithuania is rather widespread due to geopolitical uncertainty. On the other hand, the poll of Bank of Lithuania showed that 43 per cent of surveyed 120 industrial companies plan to purchase machinery and equipment, to rent, acquire or repair transport vehicles. 47 per cent of the industrial companies plan to rely on their own financial resources as they consider their own funds as large enough and the credit price as rather high. However, the share of borrowing-reluctant companies is decreasing, as compared with the previous year. Credit recovery is important not only for the financial sector but also for the whole economy as larger investment projects are hardly implementable without borrowed resources.

The developments in the mining and quarrying industry were quite positive in 2014, despite the failure of shale gas exploration project. The production of mining and quarrying industry increased by 8.1 per cent at constant prices in January-October 2014.

Energy sector

Energy sector continued shrinking further and its production decreased. One of the reasons behind was increase in energy saving both in the companies and in the households, which is positive as a reduction of energy consumption per unit of output. In January-October 2014, production of electric power, gas, steam and air conditioning decreased by 11.1 per cent on an annual basis.

National Commission for Energy Control and Prices increased its forecast for natural gas price up to EUR 451/thous. m^3 upon the average in 2015. One of the reasons behind the increase in price is the cost of construction of LNG terminal and rent of LNG vessel, which is expected to be covered by the consumers in approximately 10 years and reach up to EUR 0.61 billion (VAT excluded). However, the LNG terminal helped negotiating approximately 20 per cent lower gas price from *Gazprom*. In the near future, natural gas price in Lithuania will depend not only on price set by *Gazprom* but also on spot prices in LNG market, linked to UK National Balancing Point index. Average price of natural gas in Lithuania will also be affected by euro and US dollar exchange rate fluctuations what will likely contribute to increase in natural gas price in euro.

The price of electric power in will go down in 2015, mostly due to lower price of Public service obligations. The latter will go down by 9.5 per cent in 2015. The price for final consumers will go down by 2.8-3.3 per cent.

Retail trade

In January-October 2014, **retail trade** turnover increased by 5.4 per cent at constant prices on an annual basis. The sale of household equipment, construction materials and furniture increased by 12.2 per cent, textiles, clothing and footwear by 11.1 per cent, fuel by 6.5 per cent, food products, beverages and tobacco in supermarkets by 2.4 per cent. Meanwhile sale of food, beverages and tobacco in specialized shops decreased by 6.4 per cent.

The prospects of retail sector are quite vague. Fundamental economic factors, i.e. increase in wages and other income and decreasing unemployment remain rather firm. Nevertheless, consumer sentiment deteriorated this autumn due to geopolitical tensions, uncertainty related to euro introduction and winter heating season. Consequently, households may start limiting their spending, firstly on luxury goods, and increase their saving.

The growth of online shops market is no more explosive but still quite robust, mainly driven by overall retail market growth and rising purchasing power. The market newcomers are usually much better prepared than a few years ago. The number of specialized online shops is also rising and traditional shops launch online service as an alternative sales channel. Over the nearest years, market competition is likely to toughen what will encourage expansion of online shops to neighbouring markets.

Agriculture

Developments in the **agriculture sector** were divided between more successful cattle-breeding and less-well-off plant-growing. In January-October 2014, the purchasing of cattle increased by 9.5 per cent, milk by 7.6 per cent, birds by 5.0 per cent, cereal by 3.1 per cent, vegetables by 2.2 per cent, eggs by 0.9 per cent. The purchasing of fruit and berries decreased by 23.6 per cent, rape seeds by 18.3 per cent, potatoes by 14.2 per cent and pigs by 4.7 per cent.

Meanwhile purchasing prices of all agricultural products, except for sheep and goats, decreased over the mentioned period. For instance, purchasing price of milk decreased by as much as 33.1 per cent, fruit and berries by 33.0 per cent, sugar beets by 27.3 per cent, cereal by 19.4 per cent, pigs by 18.1 per cent, rape seeds by 14.1 per cent, potatoes by 14.0 per cent, cattle by 9.8 per cent, vegetables by 6.4 per cent, birds by 3.1 per cent, eggs by 2.7 per cent. Purchasing price of sheep and goats decreased by 3.7 per cent.

The farmers still have not received support from the budget of the European Union despite the fact that Russian's embargo on imports of food products has been applied for several months already. European Commission accepted the requirements from Lithuania's milk sector for loss compensation and admitted that Baltic States and Finland have suffered the most due to ban of milk exports. However, European Commission said it had not found appropriate way for the transferring the support. According to data from Chamber of Agriculture of Lithuania, milk sector lost EUR 46.3 million due to Russian sanctions and asked for targeted compensations equaling this amount. Obviously, direct payments and other traditional support from the national budget were not related to Russian sanctions. It helped balancing the financial flows, however, it did not cover the damage due to loss of the main export market for the milk producers. Small payments were offered for producers of vegetables and fruit but milk sector did not receive any targeted support.

According to the poll of agricultural companies, most of them worked into profit in 2014, despite a slump in prices of milk, cattle and cereal. The prices were high in the first half of 2014 while direct payments from the European Union helped absorbing the loss. If the prices stay low throughout 2015, the companies may record a loss this year. Most of agricultural companies have diversified their risk by running both plant-growing and animal-breeding activities. However, almost all the agricultural production went down in price in 2014.

Association of agricultural companies announced that the price of raw milk in January-September 2014 was by 24 per cent lower on an annual basis. Due to the decrease in price of milk, the total income of agricultural companies is expected to go down by 26.5 per cent. Animal breeding also suffered quite grave consequences of Russian sanctions. However, the largest drop in income of agricultural companies will be due to decrease in global price level of cereal.

Furthermore, an increase in bankruptcies of agricultural companies is not expected. The companies maintain their usual working routine and continue their search for alternative markets. The cereal is kept in storages waiting for a rise in grain prices. Exports of cattle to Turkey is expected to be renewed in the nearest future. Nevertheless, if the exports of meat start stumbling, the companies will be forced to experience a loss.

Transport

Transport sector did not show consistent trends lately. Overall, Klaipėda seaport operated successfully in 2014 but lower production volumes at oil refinery *Orlen Lietuva* had negative affect on cargo turnover. In the second half of the year, Russia's sanctions on exports of food products as well as application of stricter checking procedures for Lithuanian vehicles at the Russian customs had negative effect on the results of rail and road transport companies.

In January-October 2014, cargo turnover at Klaipėda seaport and Būtingė terminal increased by 1.1 per cent as compared with the same period of 2013, of which turnover at Klaipėda seaport increased by 7.3 per cent and at Būtingė terminal it decreased by 21.6 per cent. The handling of dry bulk goods increased by 25.5 per cent, that of general bulk goods by 7.3 per cent while handling of liquid bulk (mostly oil and oil products) decreased by 21.9 per cent. Cargo transportation by railways increased by 2.1 per cent, of which transportation by domestic routes decreased by 7.1 per cent but by international routes it increased by 6.4 per cent. In January-October 2014, the number of passengers at the airports increased by 8.9 per cent as compared with the same period of 2013, while the volume of cargo decreased by 13.6 per cent.

Road transport companies have faced challenges due to Russian sanctions on exports of food products as well as stricter checking procedures for Lithuanian vehicles on the Russian border, which started as of November 21, 2014. Russia accused Lithuania with carrying embargoed production while Lithuanian association of road carriers *Linava* said that troubles for Russian customs also arise due to Russia's abandonment of TIR system. Political reasons behind the stricter customs checks also should not be ruled out.

Construction and real estate market

According to data from Statistics Lithuania, the volume of **construction** works increased by 11.9 per cent on an annual basis at constant prices in the third quarter of 2014. The volume of construction of civil engineering objects increased by 7.2 per cent, that of non-residential buildings by 11.1 per cent, that of residential buildings by 47.5 per cent. In January-September 2014, the volume of total construction works increased by 17.6 per cent.

The number of buildings completed in third quarter of 2014 made up 1291, of which 1093 were residential buildings. The useful area of residential apartments increased by 34.2 per cent on an annual basis. 59.9 per cent of total finished apartments were completed in Vilnius county, 19.6 per cent in Kaunas county and 9.5 per cent in Klaipėda county. The number of non-residential buildings completed in the third quarter of 2014 made up 198, with their general area more than doubling over the year. The area of completed manufacturing, industry and storage buildings was the largest with administrative buildings following quite closely. 34.3 per cent of non-residential buildings were completed in Vilnius county, and 14.1 per cent both in Kaunas and Klaipėda counties.

In January-September 2014, the number of construction licenses for residential buildings decreased by 13.0 per cent and for non-residential buildings by 16.9 per cent on an annual basis. The supply of housing somewhat exceeds the demand and therefore the growth of residential construction is bound to slow down.

At the beginning of 2014, the real estate agencies and financial institutions were quite optimistic about the developments in the real estate market but the optimism is rather cautious at the moment. According to the poll of Bank of Lithuania, most of credit institutions expect that prices will not change while the number of those forecasting an increase has halved. However, 40 per cent of credit institutions responded that they expected an increase in prices of commercial real estate and new housing, while one-third of them predicted a decrease in price of old housing. This dichotomy has some economic rationale behind. The new housing is usually more energy efficient than the old housing. Currently, new housing should make up at least for energy class B, while starting with 2016, all new multi-storey buildings will have to bear the label "energy class A". The difference in the energy class makes up to 15 per cent difference in price due to additional investment into insulation of the building and ventilation systems.

GDP forecast for 2014-2016

Over the recent months, the economic climate has deteriorated, primarily due to weak recovery in the euro zone which is not expected to strengthen notably in 2015. The Russia's conflict with the West over the Ukraine has also played its negative role. Limited export expansion in the Western Europe and Russia will drive Lithuanian companies to new markets, what will mean extra marketing and penetration costs during the short term. Expectations in the domestic market have deteriorated and therefore consumption is likely to become more cautious. Taking into regard the latest trends, we reduce our forecast for GDP growth in 2015 from 3.2 per cent to 2.6 per cent and from 4.0 per cent to 3.5 per cent in 2016. We leave our forecast for GDP growth in 2014 unchanged at 2.7 per cent (see Diagram 1).

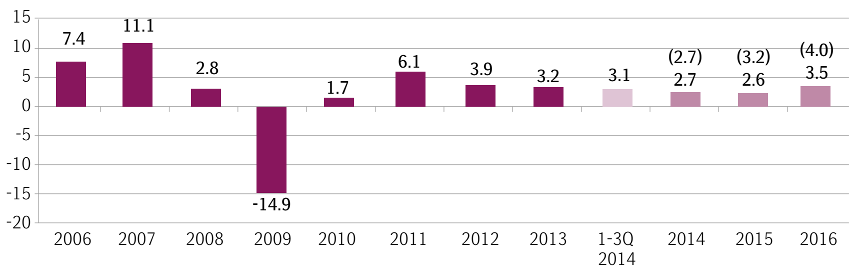
Public finance

Planning the **public finance** for 2015 was quite challenging due to changes in the economic environment during the planning process. The economic growth forecasts were downgraded during the planning process. However, the government has made in advance quite a lot of pledges for different society groups which made the expenditure plan less flexible. Municipality elections, scheduled for March 2015, have minimized the possibility of failing to fulfill the pledges.

Tackling the shadow economy is one of underused sources of budget revenue. State Tax Inspectorate has launched some new initiatives already in 2014, performing additional checks for wealthy persons who are shareholders or executives of large companies. The Tax Inspectorate also plans to introduce new smart tax administration system, which will include automatic connection of cash registers to Inspectorate's databases. This measure would mean more transparency in the trade sector and simplify accounting for small enterprises.

We leave our public sector deficit forecast unchanged at 1.5 per cent of GDP (see Diagram 2) for a while. Taking into mind mounting economic challenges, a balanced public sector budget in 2016 seems increasingly ambitious and therefore we reduced our forecast from 0 per cent of GDP to 0.5 per cent of GDP deficit.

Diagram 1. Annual change in real GDP (per cent)



* Previous forecast of SEB Bank given in parenthesis.

Inflation

In November 2014, monthly inflation of **consumer price** index made up 0.0 per cent. Decreasing prices of fuel, fruit, airline passenger services and increasing prices of central heating, alcoholic beverages, non-durable household goods, vegetables, sugar and sweets, other non-electrical personal equipment.

Annual inflation made up 0.2 per cent and was by 0.2 percentage points lower than in October 2013. Prices of consumer goods decreased by 0.3 per cent while those of services increased by 2.0 per cent. The inflation pattern is similar to that of Latvia and Estonia during the period of euro introduction.

Taking into regard the long-lasting decrease of oil prices, inflation should stay low in the near future. Under such circumstances, the price-wage spiral is not working and employees are not able to use the argument of inflation for a wage increase. On the other hand, the consumer perception of inflation is much higher than the actual inflation rate and inflation expectations are rather pessimistic. Many consumers doubt that prices will not go up after the euro introduction.

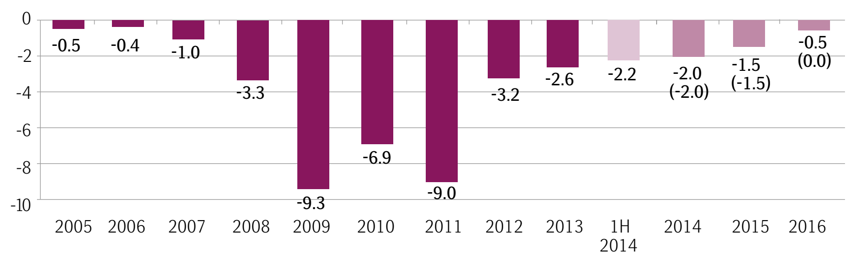
Considering the latest trends, we leave our forecast for average annual HICP inflation unchanged at 0.1 per cent in 2014 and reduce the forecast to 0.4 per cent in 2015 and 0.7 per cent in 2016 (see Diagram 3), not least due to sharp decrease in oil prices.

Balance of payments and foreign trade

Current account balance remained in surplus, despite the fact that exports struggled to grow in 2014, especially in the first half of the year. In January-September 2014, the surplus of current account made up 0.1 per cent of GDP while it made up 0.5 per cent of GDP. The surplus of services and secondary income (e.g. remittances and EU support) exceeded the deficit of goods and primary (investment) income.

The effect of the Russian sanctions on food exports on the total export volume was limited. Recession in Russia and lower demand for imported goods as well as stricter checks on the Russian border will probably have larger negative effect than the export sanctions. The period of stricter checking procedures is not defined therefore it is complicated to make estimates of its impact on exports. In 2009 and 2013, similar scrupulous customs' checks were applied in 2009 and 2013, when they lasted up to 1 month. If the history repeats itself and checks are softened soon, export damage will be rather small.

Diagram 2. Public balance (ESA'2010, per cent of GDP)



* Previous forecast of SEB Bank given in parenthesis.

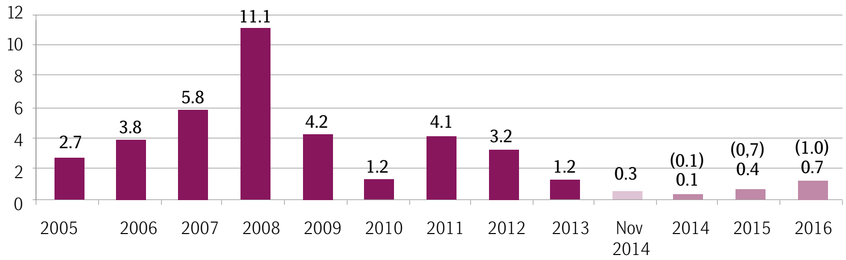
In August-September 2014 (i.e. after Russian sanctions on food exports), Lithuania's exports of goods increased by 1.0 per cent while exports to Russia increased by 18.1 per cent on an annual basis. In January-September 2014, total exports decreased by 1.5 per cent but increased by 9.1 per cent to Russia (see Table 4 in the Appendix). Thus, the exports share to Russia increased despite the sanctions. The main reason behind the latter increase was a 63.1 per cent increase in exports of machinery and equipment (mainly, reexports of telecommunication cables, vacuum-moulding and other thermoforming machines, discs for laser reading systems, printers etc.). Excluding this increase, exports to Russia in August-September 2014 decreased by 9.3 per cent on an annual basis while total exports of Lithuania decreased by 3.9 per cent.

The exports of agricultural and food products to Russia decreased by 38.9 per cent in August-September 2014, of which dairy products decreased by 92.8 per cent, vegetables 87.1 per cent, fruit 71.2 per cent, food products from meat and fish by 63.9 per cent. Based on data from Statistics Lithuania, increase in exports of dairy products and fruit to Belarus made up to one-tenth of export loss in Russia. Year-on-year decrease in exports of dairy products will be lower starting from October 2014, as exports of Lithuanian dairy products to Russia were banned in autumn 2013 as well. Total exports of food products dropped in August but increased again in September as exports of cereal, beverages and fish production increased.

Actually exports of most of goods continued increasing quite robustly (see Diagram 3), except for problematic groups which face external challenges (agricultural and food products, refined oil products and transport vehicles). In January-September 2014, strong annual growth was demonstrated by exports of machinery and equipment (primarily due to reexports to Russia), furniture, wood and paper as well as chemical products.

Export growth most likely will face a range of challenges. Russian market is expected to go through recession in 2015, ruble has sharply weakened while Russian sanctions remain in place thus far. Euro zone economy, another important export partner, will also grow slowly. Nevertheless, exporters are already actively searching for new alternative markets. Exports will be positively affected by euro introduction as it will enhance price comparability across the countries and lower the price of international financial transfers. Given that Russian sanctions remain *status quo*, exports should slightly increase in 2015.

Diagram 3. Annual average HICP Inflation (per cent)



* Previous forecast of SEB Bank given in parenthesis.

Taking into regard recent developments in exports and current account, we changed the forecast for the current account balance from 0 per cent of GDP to 1.5 per cent of GDP surplus (see Diagram 4). Higher uncertainty will have negative impact on the recovery of domestic market, therefore we reduce the forecast for current account deficit from 2 per cent of GDP to 1 per cent of GDP in 2015 and from 3 per cent of GDP to 2 per cent of GDP in 2016.

Unemployment

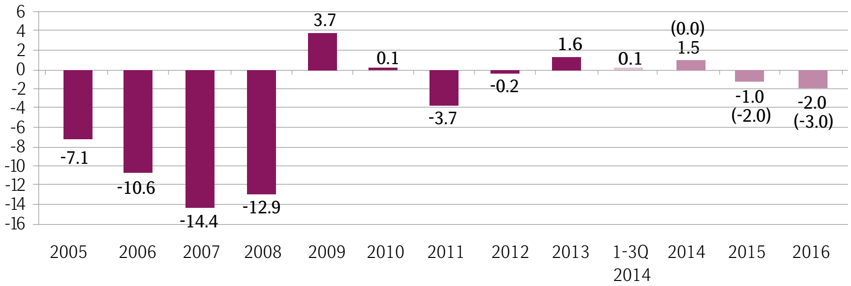
In the third quarter of 2014, **unemployment rate** made up 9.1 per cent and was by 2.1 percentage points lower on a quarterly basis and by 1.8 percentage points lower on an annual basis. The decrease was driven mainly by seasonal factors, i.e. temporary increase in employment in retail trade, agriculture, accommodation and catering and construction sectors. Most likely, the unemployment rate will not decrease further in the fourth quarter of 2014 and the beginning of 2015.

The weakening of the Russian economy and sanctions had limited effect on the labour market thus far. Transport companies and food industry were affected the most. In transport companies, the immigrant employees from the Eastern countries face higher risk of being fired than Lithuanian residents. However, the sanctions' effect on the rate of unemployment will also depend on decisions of the laid-off employees to join Labour Exchange or emigrate etc. In the wake of increased uncertainty, the businesses also may get more cautious in hiring new employees.

The signs of structural unemployment remain strong. In the third quarter of 2014, long-term unemployment rate made up 4.3 per cent and decreased by 0.7 percentage points over the year and by 0.3 percentage points over the quarter, i.e. notably less than the average unemployment rate.

Based on our expectations that unemployment will increase in the fourth quarter of 2014, we slightly reduce our forecast for average unemployment rate from 11.5 per cent to 11.0 per cent in 2014 (see Diagram 5). We leave unchanged the forecasts for unemployment rate in 2015 and 2016 at 10.5 per cent and 10 per cent, respectively.

Diagram 4. Current account balance (per cent of GDP)



* Previous forecast of SEB Bank given in parenthesis.

Wages and salaries

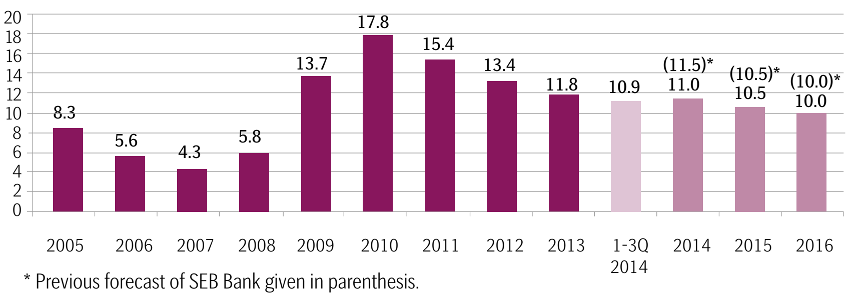
Gross wages and salaries made up EUR 696.7 upon the average in the third quarter of 2014 and were by 4.3 per cent higher on an annual basis. Wages and salaries increased the most in IT and communications (9.6 per cent), agriculture (8.2 per cent), public administration (6.8 per cent). Wages and salaries increased by 4.6 per cent in real terms.

The fact is that average wages and salaries still are among the lowest in the European Union and the lowest in the euro zone. In Germany, private sector earnings are roughly 5 times higher than in Lithuania. On the one hand, this gap has narrowed from 8-9 times back in 2004, when Lithuania joined European Union. In addition, the share of shadow wages and salaries is larger than in Western European countries. On the other hand, the lion's share of the convergence process took place in 2004-2007 but reversed during the crisis. If the wages and salaries in Lithuania increase by one-tenth each year, they would reach Germany's level in 20 years. Real wage growth in Lithuania is 4 times as fast as in Germany at the moment, but the convergence cannot be instant. One should also bear in mind that higher wages mean more expensive services, which are notably cheaper in Lithuania as compared with more advanced countries.

There are several reasons why the convergence of wages and salaries has slowed down and wage growth remains relatively sluggish. The companies continue working in a cautious mode after the crisis while lower earnings help attract more foreign investment. Productivity growth also slowed down recently and the number of the unemployed is rather high. Several sectors face labour shortage but are not able to tackle this problem by simply raising the wages.

We maintain our forecast of growth of average wages and salaries for 2014 at 4.5 per cent (see Table 1 in the Appendix). Having in mind weaker economic prospects, we reduce the forecasts for 2015 and 2016 to 4.2 per cent and 4.8 per cent, respectively. The increase in the minimum wage from EUR 300 to EUR 325 as of July 1, 2015, is included in the forecast.

Diagram 5. Unemployment level (survey data, average, per cent)



* Previous forecast of SEB Bank given in parenthesis.

Loan portfolio

Any increase in **loan portfolio** is hardly evident in Lithuania. Both businesses and households continue deleveraging and cutting their liabilities. Various polls of businessmen reveal that they would prefer spending extra income for repaying the loans in advance rather than for investment or wage increase. The appetite for credit as well as investment remains low. Despite the fact that issuing of new loans started picking up, the growth of loan portfolio will remain slow due to high amortization of loans in the near future.

In 2015, Lithuania will start absorbing the 2014-2020 portion of the EU structural funds, what will lead to higher co-financing need. Another potentially beneficial factor is the Juncker plan, which could also lead to higher demand for corporate credits. However, the success of the Juncker plan is not guaranteed and depends on the support of private investors while it may take several years until the plan starts bearing the fruit.

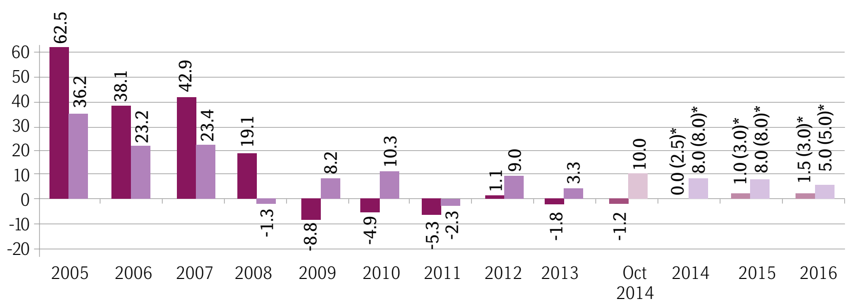
Early repayment of the loans and sluggish borrowing demand means rather gloomy prospects for credit recovery. We reduce our forecasts for credit growth from 2.5 per cent to 0 per cent in 2014, from 3 per cent to 1 per cent in 2015 and from 3 per cent to 1.5 per cent in 2016 (see Diagram 6).

Deposit portfolio

Just as in other euro zone countries, euro introduction was a dominant factor behind the **deposit** growth recently. In October 2014, as compared with December 2013, cash in circulation decreased by 26 per cent while monetary aggregate M1 increased by 1.9 per cent over the same period.

The growing sum of the deposits and slow credit growth forced the banks to use the liquidity absorbing measures offered by the central bank. One of these was auctions of term deposits. The term initially was 7 days in May 2014, but it reached as much as 77 days by the end of 2014. Meanwhile the amount of auctioned deposits decreased from EUR 0.7 bn to zero in December. The interest rates in the auctions were rather stable at 0.01-0.06 per cent since mid-summer 2014.

Diagram 6. Annual change in stock of loans and deposits



Annual change in load portfolio (per cent)

Annual change in portfolio of deposits and letters of credit (per cent)

* Previous forecast of SEB Bank given in parenthesis.

Credit interest rates

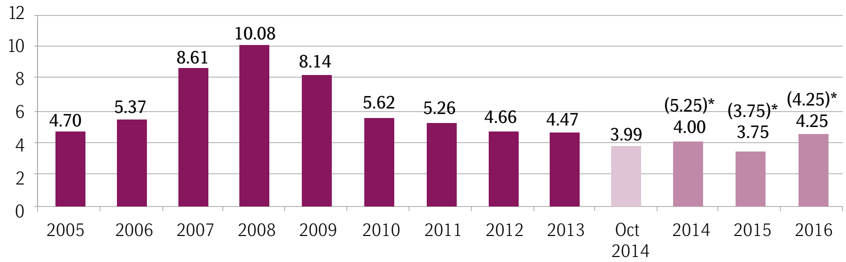
Over the nearest years, the deposit growth will continue exceeding credit growth. We do not change our forecasts for deposit growth in 2014, 2015 and 2016 and leave them at 8 per cent, 8 per cent and 5 per cent, respectively (see Diagram 6), while we admit that the risk to the 2015 forecast lies on the downside.

Interest rate level was very low throughout the 2014, primarily thanks to expansionary ECB monetary policy. The overnight VILIBOR interbank rates fluctuated close to zero, hitting 0.10 per cent on September 1, 2014, and 0.08 per cent on October 1, November 3 and December 1. Longer maturity rates decreased somewhat more notably. 6-month VILIBOR made up 0.38 per cent, 0.28 per cent, 0.27 per cent and 0.27 per cent on respective dates, and 1-year VILIBOR 0.55 per cent, 0.43 per cent, 0.43 per cent and 0.42 per cent.

The interest rates on loans in litas decreased to record-low levels while interest rates on loans in euro decreased less notably. In July 2014, average interest rates on loans in litas made up 5.21 per cent, in August 5.17 per cent, in September 4.19 per cent, and in October 3.99 per cent. The respective euro interest rates were 3.31 per cent, 3.11 per cent, 2.73 per cent and 3.11 per cent. Therefore, the gap between litas and euro credit interest rates made up 1.9 percentage points in July, 2.06 in August, 1.46 in September and 0.88 in October.

The convergence between credit interest rates in litas and euro took place faster than expected, therefore we reduce our forecast for interest rates on loans in litas to 4.00 per cent at the end of 2014 (see Diagram 7). We maintain our previous forecasts for interest rates at the end of 2015 and 2016 at 3.75 per cent and 4.25 per cent, respectively.

Diagram 7. Average interest rate on loans in litas (end of year, per cent)



* Previous forecast of SEB Bank given in parenthesis.

APPENDIX

Table 1. Main Macroeconomic and Financial Indicators in 2005-2016

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 (actual)	2014 (forecast)	2015 (forecast)	2016 (forecast)
Annual change in real GDP (seasonally and working-day adjusted, %)	-*	7.4	11.1	2.8	-14.9	1.7	6.1	3.9	3.2	3.1 (1-3Q)	2.7	2.6	3.5
Nominal GDP (EUR billion)	21.002	24.079	29.041	32.696	26.935	28.001	31.247	33.314	34.956	27.053 (1-3Q)	35.934	37.012	38.567
Public sector balance (ESA'2010, % of GDP)	-0.5	-0.4	-1.0	-3.3	-9.3	-6.9	-9.0	-3.2	-2.6	-2.2 (1H)	-2.0	-1.5	-0.5
Annual average HICP inflation (%)	2.7	3.8	5.8	11.1	4.2	1.2	4.1	3.2	1.2	0.3 (Nov)	0.1	0.4	0.7
Current account balance (% of GDP)	-7.1	-10.6	-14.4	-12.9	3.7	0.1	-3.7	-0.2	1.6	0.1 (1-3Q)	1.5	-1.0	-2.0
Average gross monthly wages and salaries (excl. entrepreneurships, 4Q, EUR)	421	502	594.3	671.7	613.5	614.4	629.9	646.4	677.8	696.7 (3Q)	708.3	738.0	773.4
Annual change in average gross monthly wages and salaries (excl. entrepreneurships, 4Q, %)	10.9	19.1	18.5	13.0	-8.7	0.2	2.5	2.6	4.8	4.3 (3Q)	4.5	4.2	4.8
Unemployment level (survey data, average, %)	8.3	5.6	4.3	5.8	13.7	17.8	15.4	13.4	11.8	9.1 (3Q)	11.0	10.5	10.0
Loan portfolio of commercial banks (end of period, EUR billion)	8.760	12.098	17.294	20.598	18.781	17.867	16.921	17.100	16.790	16.677 (Oct)	16.790	16.958	17.212
Annual change in loan portfolio (%)	62.5	38.1	42.9	19.1	-8.8	-4.9	-5.3	1.1	-1.8	-1.2 (Oct)	0.0	1.0	1.5
Portfolio of deposits and letters of credit (end of period, EUR billion)	7.016	8.646	10.665	10.524	11.392	12.561	12.274	13.373	13.815	14.790 (Oct)	14.920	16.113	16.919
Annual change in portfolio of deposits and letters of credit (%)	36.2	23.2	23.4	-1.3	8.2	10.3	-2.3	9.0	3.3	10.0 (Oct)	8.0	8.0	5.0
Average interest rate on loans in national currency (end of period, %)	4.70	5.37	8.61	10.08	8.14	5.62	5.26	4.66	4.47	3.99 (Oct)	4.00	3.75	4.25

* Regarding the change in methodology of national accounts to ESA 2010, Statistics Lithuania will announce GDP data up to 2005 in 2015.

Table 2. Breakdown and Development Rates of Value Added by Economic Activity

	Share of total value added (%)					Annual change at chain-linked volume (%)				
	1-3Q 2010	1-3Q 2011	1-3Q 2012	1-3Q 2013	1-3Q 2014	1-3Q 2010	1-3Q 2011	1-3Q 2012	1-3Q 2013	1-3Q 2014
Gross value added*	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**0.4**	**6.2**	**3.7**	**3.3**	**3.1**
Agriculture, hunting and forestry	3.7	4.4	5.0	4.4	4.1	-8.3	9.1	12.9	-2.9	7.5
Mining and energy	4.5	4.3	4.2	4.1	3.6	-1.6	-1.4	-5.0	-2.5	-4.8
Manufacturing industry	18.4	20.4	20.5	20.2	20.0	4.9	13.2	3.3	5.0	3.3
Construction	5.8	6.1	5.8	6.2	7.2	-9.4	13.7	-2.7	7.4	17.0
Domestic trade; transport; accomodation&food service	30.9	30.9	31.6	32.3	32.4	4.2	7.4	6.4	4.3	2.7
Information and communication	3.7	3.1	3.0	3.0	3.0	2.1	-5.6	3.2	3.3	1.5
Financial&insurance activities	2.8	2.7	2.2	2.2	2.2	7.5	11.1	-5.7	1.2	1.8
Real estate activities	6.7	6.2	6.1	6.1	6.0	-1.3	0.0	2.0	1.0	1.3
Professional, scientific&technical activities	5.8	5.5	5.7	5.8	5.7	-1.1	2.8	4.3	3.9	1.2
Public administration and defence; education; compulsory social security	15.8	14.6	14.1	13.9	14.0	-1.8	0.0	1.9	1.5	1.0
Arts&entertainment; household services	1.9	1.7	1.8	1.8	1.8	-5.4	3.2	6.2	1.6	1.5

* GDP equals the sum of all values added (total value added) plus taxes on products minus subsidies.

Table 3. Exports by Commodity Groups (EUR million)

	Exports								Foreign trade balance at *f.o.b.* prices (%)*	
	2009	2010	2011	2012	2013	1-3Q 2014	Relative share in 1-3Q 2014 (%)	Annual change in 1-3Q 2014 (%)	1-3Q 2013	1-3Q 2014
Total	**11797**	**15651**	**20151**	**23048**	**24554**	**17889**	**100.0**	**-1.6**	**-0.6**	**-1.2**
Agricultural and food products	2311	2812	3339	4240	4697	3359	18.8	0.8	13.5	12.0
Mineral products	2533	3688	5144	5690	5729	3171	17.7	-28.6	-14.0	-19.3
Machinery and equipment	1181	1634	2089	2624	2925	2727	15.2	30.6	-7.7	-5.6
Chemical products	1070	1273	1846	2038	1997	1616	9.0	6.8	-9.7	-9.7
Plastics, rubber and their products	696	833	1028	1236	1364	1154	6.5	1.6	13.5	9.7
Furniture	856	1215	1546	1490	1493	1147	6.4	15.3	72.2	67.0
Textile and textile articles	580	840	1036	1101	1226	972	5.4	5.1	12.7	10.1
Wood, paper and their products	760	934	1063	1088	1216	954	5.3	6.8	18.0	15.7
Transport vehicles	797	1065	1250	1386	1518	935	5.2	-16.9	-15.4	-17.2
Metals and their products	526	701	946	1059	1119	866	4.8	6.8	-7.7	-8.9
Other goods	486	654	863	1094	1272	990	5.5	8.2	4.4	0.3

* As a percentage of the turnover of trade in a certain commodity group.

Table 4. Main Foreign Trade Partners of Lithuania in 1-3Q 2014

	Exports			Imports			Foreign trade balance at *f.o.b.* prices (%)*	
	LTL million	Share (%)	Annual change (%)	LTL million	Share (%)	Annual change (%)	1-3Q 2013	1-3Q 2014
Total	**17888.9**	**100.0**	**-1.6**	**19304.3**	**100.0**	**-0.2**	**-0.6**	**-1.2**
European Union	**9881.1**	**55.2**	**-4.1**	**12463.4**	**64.6**	**8.0**	**-3.1**	**-9.0**
CIS**	**5198.6**	**29.1**	**4.4**	**5208.5**	**27.0**	**-17.5**	**-9.3**	**2.5**
Other countries	**2809.2**	**15.7**	**-2.7**	**1632.4**	**8.5**	**9.5**	**34.2**	**28.9**
Russia	3840.6	21.5	9.1	4280.2	22.2	-24.0	-20.6	-2.9
Latvia	1650.1	9.2	-8.4	1315.2	6.8	11.9	23.5	13.8
Poland	1462.6	8.2	8.4	1844.1	9.6	0.4	-12.8	-9.0
Germany	1310.2	7.3	-1.3	2113.3	10.9	2.8	-19.1	-21.0
Netherlands	821.4	4.6	-3.5	956.9	5.0	-4.6	-5.6	-5.1
Belarus	809.5	4.5	-11.6	586.9	3.0	0.4	24.5	18.4
Estonia	795.8	4.4	-22.3	511.5	2.6	-9.7	31.1	24.2
UK	693.1	3.9	-32.4	830.8	4.3	90.3	42.4	-6.5
US	655.2	3.7	53.5	236.3	1.2	21.0	39.4	49.0
Sweden	635.8	3.6	8.0	609.0	3.2	-2.0	-0.1	4.7
Ukraine	601.8	3.4	5.5	182.5	0.9	11.2	57.1	55.3
France	456.5	2.6	2.2	527.0	2.7	0.2	-5.6	-4.6
Denmark	421.6	2.4	11.6	306.2	1.6	-8.3	8.7	18.3
Norway	411.0	2.3	7.8	65.8	0.3	-4.0	70.8	73.6
Italy	333.7	1.9	9.8	930.1	4.8	29.9	-38.2	-45.2
Kazakhstan	291.6	1.6	-7.1	313.3	1.6	4.6 times	66.1	-1.0
Belgium	273.1	1.5	13.0	702.2	3.6	6.0	-44.5	-41.9
Finland	241.5	1.3	-5.1	394.1	2.0	5.4	-16.5	-21.6
Czech Rep.	164.0	0.9	22.0	309.9	1.6	4.0	-35.6	-28.4
Spain	145.4	0.8	7.6	367.1	1.9	23.1	-35.4	-41.1
Canada	133.4	0.7	2.6 times	15.0	0.1	30.5	64.6	80.7
Iran	122.9	0.7	-17.5	2.6	0.0	-26.4	95.6	96.1
Turkey	111.1	0.6	12.3	92.3	0.5	10.7	11.1	11.8
Hungary	100.2	0.6	16.5	137.0	0.7	2.4	-19.3	-13.0
China	71.8	0.4	11.6	495.1	2.6	17.4	-72.4	-73.5
Switzerland	68.1	0.4	41.3	63.1	0.3	-18.6	-20.9	6.3
Uzbekistan	67.7	0.4	31.1	5.3	0.0	-63.6	57.7	86.2
Kyrgyzstan	67.3	0.4	8.1	9.7	0.1	72.5	84.1	75.8
Austria	62.2	0.3	4.5	172.9	0.9	5.0	-44.9	-45.1
Portugal	60.4	0.3	50.4	34.4	0.2	26.9	21.9	29.8
Saudi Arabia	60.1	0.3	-37.3	5.1	0.0	90.4	94.9	85.2
Slovakia	57.5	0.3	11.3	106.9	0.6	15.8	-25.8	-27.7

* As a percentage of the turnover of trade with a certain country or country group.
** Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan.