Baltic Business Outlook

January 2017

Foreword

Despite of modest GDP growth of recent years, Baltic economies have managed to avoid severe setbacks, even when signs in the 2016 European and global markets were rather mixed due to political turbulences and economic disruptions. To assess the sentiments in the wake of a new business year, SEB continued the tradition of holding a survey among small and medium-sized enterprises (SMEs) in the Baltics, to collect insights from the 4,542 Baltic SMEs in the survey, which is now outlined in the current issue of Baltic Business Outlook (BBO).

Special attention was paid to start-up companies — here defined as young business entities of up to three years of age. In Estonia and Lithuania, we polled those newly founded companies with a slightly different set of questions, in order to map their business sentiment in 2017.

While there are minor signs of deterioration in the overall business outlook for Baltic SMEs, the companies are focusing on their strengths, such as preferring the domestic market over exports if conditions do not seem favourable elsewhere, or keeping a stable pace in the field of investments, to improve competitiveness. Especially in the field of product and service development, numerous companies are aware of the importance of innovation, which is another crucial factor of sustainable business.

Anders Larsson
Head of Baltic Corporate Banking at SEB

Executive Summary

- Compared to the previous survey, the SMEs in Estonia, Latvia and Lithuania exhibit less optimism about the new business year. For 2017, the share of 'optimists' or companies that are expecting turnover growth of at least 15%, has fallen in all three countries; with the most positive stance noted in Lithuania with 15% being optimists. Unlike in Estonia and Lithuania, where less than 50% of respondents express pessimistic views, the share in Latvia is considerably higher (61%).
- Baltic SMEs will focus on domestic markets more clearly than before — 79% in Latvia, 76% in Estonia and 71% in Lithuania, which means that the share of companies targeting either new or existing export markets, ranges from Lithuania's 29% to Estonia's 24% and Latvia's 21%.
- Due to a less optimistic view on turnover growth in 2017, companies are restrained in hiring new staff — the indicators have fallen in all three countries, although 27% of Lithuanian companies still intend to bring new people on board. However, within Estonia 80% do not expect any changes in staff numbers, and in Latvia, 19% are planning to reduce staff.
- Products and services are still the preferred field of innovation, with 35% of Estonian, 32% of Lithuanian and 21% of Latvian SMEs saying they will focus on that in 2017 — however, in all countries, less interest is seen for innovation in this field. A slight increase can be noted in business model innovation in Lithuania, up from 7% to 11%, and employee innovation in Latvia, up from 12% to 16%.
- Investment appetite in 2017 seems promising: in Lithuania, 18% of SMEs expect to invest over 30,000 EUR, followed by Estonia and Latvia with 13% — all of these indicators remain close to last year's levels. Distinctly, under 50% of companies admit that they do not plan any investments in 2017: in Lithuania 20%, in Estonia 22% and in Latvia 40%.

Key indicators

	Estonia	Latvia	Lithuania
Population (January 2016)	1.32 m	1.97 m	2.89 m
Currency	Euro	Euro	Euro
GDP per capita PPS (EU=100, 2015)	75	64	75
Real GDP growth (2015)	1.4%	2.7%	1.8%
Inflation (2016)	0.8%	0.1%	0.7%
Unemployment rate (Q3 2016)	7.5%	9.5%	7.5%

Sources: SEB Nordic Outlook (November 2016), Eurostat

Economic forecast 2017

	GDP growth	Inflation
Estonia	2.2%	2.4%
Latvia	3.5%	2.1%
Lithuania	2.5%	1.5%

Source: SEB Nordic Outlook (November 2016)

Methodology

Turnover growth
In the survey, companies expecting at least 15% turnover growth in 2017 are labelled as *optimists* while the companies expecting growth figures below 15% are *moderate optimists* and the rest, predicting a decline in turnover, are termed *pessimists*.

Employment
The employment outlook is divided into three groups: companies hiring new staff in 2017, the ones keeping the headcount unchanged, and the companies intending to cut back on personnel.

Exports
The respondents are divided into three groups: companies planning to enter new markets in 2017, those intending to grow in existing export markets, and companies focusing on the domestic market.

Innovation
The analysis refers to two groups of companies: those planning innovations in 2017, be they in products, services, business models, and/or employee development, or those not planning any of the above-mentioned.

Investments
The threshold of major investments is set at 30,000 EUR for this survey, with the companies investing amounts above and below that constituting the first two groups, and the third group composed of companies not planning any investments in 2017.

Baltic views in brief

Strong optimism for turnover growth at three-year low

Optimists – Over 15% growth

Estonia	11%	↓
Latvia	8%	↓
Lithuania	15%	↓

Moderate optimists – Up to 15% growth

Estonia	58%	↑
Latvia	31%	↓
Lithuania	66%	↑

Pessimists – Decrease

Estonia	31%	↑
Latvia	61%	↑
Lithuania	19%	↓

Domestic market remains clear preference

New markets – Expand into new export markets

Estonia	8%	↓
Latvia	7%	↓
Lithuania	14%	→

Existing markets – Expand in current export markets

Estonia	16%	↑
Latvia	14%	↑
Lithuania	15%	↓

Domestic – Focused on domestic market

Estonia	76%	↑
Latvia	79%	↑
Lithuania	71%	↑

Hiring plans are more modest than before

Hiring staff – Plan to recruit more people

Estonia	14%	↓
Latvia	12%	↓
Lithuania	27%	↓

No changes – Keep the number of employees unchanged

Estonia	80%	↑
Latvia	69%	↓
Lithuania	64%	→

Reducing staff – Plan to decrease the number of employees

Estonia	5%	↓
Latvia	19%	↑
Lithuania	9%	↑

Product and service innovation most attractive

Innovation in...

Product/service – Product or service innovation

Estonia	35%	↓
Latvia	21%	↓
Lithuania	32%	↓

Business model – Change of business model

Estonia	8%	→
Latvia	8%	→
Lithuania	11%	↑

Employees – Investment in employees development

Estonia	15%	↓
Latvia	16%	↑
Lithuania	19%	→

Investment activity expected to remain at same level

Investments over 30,000 EUR – Investment projects over 30,000 EUR

Estonia	13%	↓
Latvia	13%	→
Lithuania	18%	↑

Investments up to 30,000 EUR – Investments up to 30,000 EUR

Estonia	26%	↑
Latvia	23%	↑
Lithuania	27%	↑

No investments – No investment plans

Estonia	22%	↓
Latvia	40%	→
Lithuania	20%	↓

Business environment country-by-country

Estonian SMEs

- The outlook of Estonian SMEs has become slightly bleaker when only 11% of respondents project turnover growth of more than 15%, the lowest indicator of the last three years, whereas a decline in turnover is expected by 31% of respondents.
- Surprisingly, in agriculture the aggregate of optimists and moderate optimists is the highest among all sectors (76%), followed by education and healthcare (71%), housing and catering, and manufacturing (both 70%). Transport and logistics excel with the highest portion of pessimists (34%).
- The share of enterprises planning to enter foreign markets, or expand in the existing ones has declined slightly, from 27% to 24%, which means that domestic market is the key operations area for 76% of SMEs.
- The hiring outlook has not improved as only 14% of SMEs, down from last year's 18%, intend to bring new employees on board in 2017. It means that the vast majority, 80%, will keep headcounts unchanged, and only 5% are considering reductions.
- Nearly 40% of SMEs plan to invest and 13% of them plan investments of at least 30,000 EUR this year, while 26% intend to spend up to 30,000 EUR on investments — there are no significant changes during the last 12 months in this category.
- Of the Estonian SMEs in the sample, 64% are planning innovation activities, slightly down from 68% year ago. About 35% admit that their innovation will focus on product and service innovation.

SME quotes: In innovation, focus on hardware and machinery

- *"We will invest in production and product development, to add value to the products we work with scientists"*
- *"We are planning to expand the farm facilities, digitise the production"*
- *"We will invest in computer programs and hardware"*

Estonia: SME plans for 2017

80%	will keep the number of employees unchanged
76%	will remain focused on domestic market
43%	plan innovations in business model or products/service
40%	will make investment projects

Optimists and pessimists: Who are they?

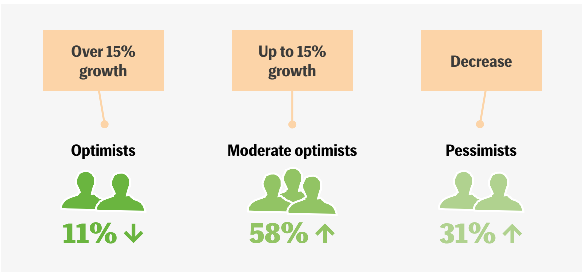
Optimists 11%

- Agriculture
- Harju county
- More than 10 employees
- Turnover up to 65,000–200,000 EUR

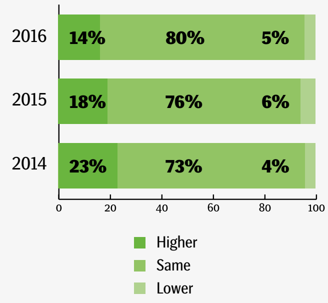
Pessimists 31%

- Professional, scientific and technical activities and transportation and storage sector
- Ida-Viru county, Pärnu county
- 1–9 employees
- Turnover up to 65,000 EUR

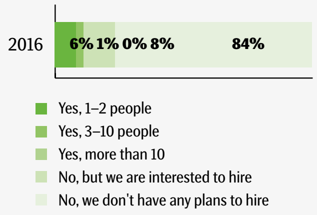
Turnover next year



Number of employees next year

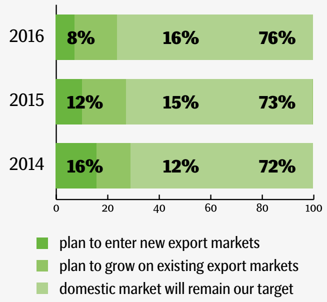


Number of employees from foreign countries



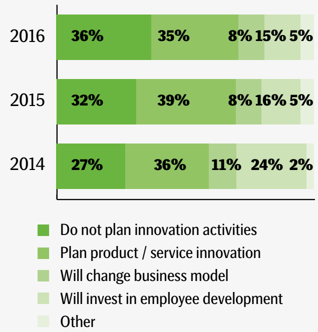
Of foreign employees are...

Export markets

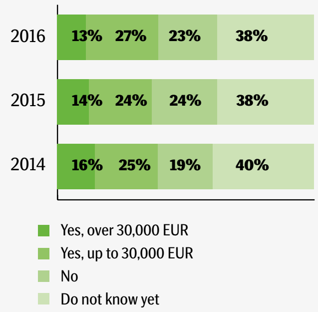


Most popular export markets:
Latvia, Sweden, Germany, Finland, Russia

Innovations and changes



Investment projects

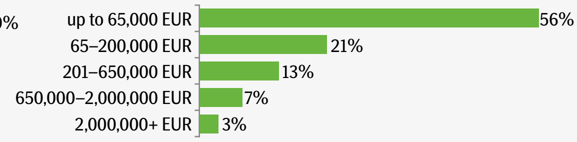


Profile of the Estonian survey

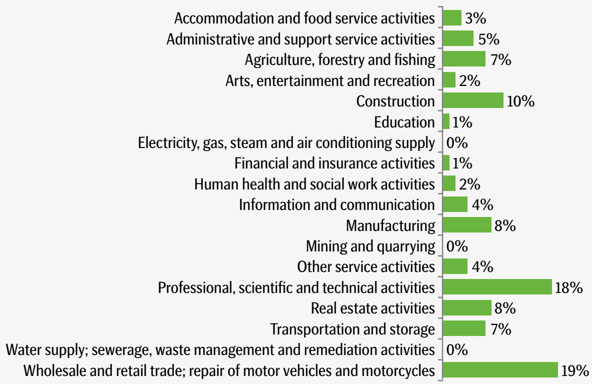
(2127 companies partcipated in total in year 2016)

Number of employees

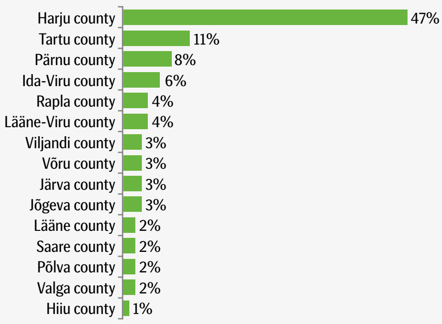
Annual turnover



Sector



Area



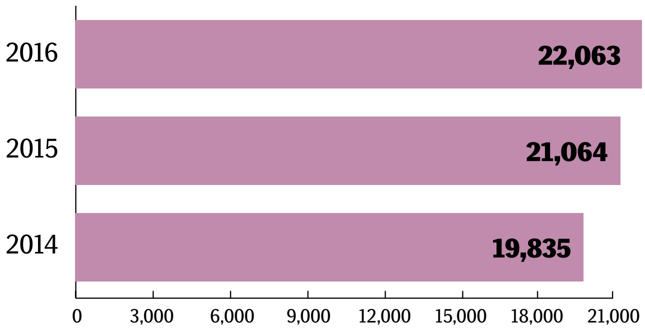
Estonian start-ups

Start-up companies are here defined as young business entities of up to three years of age.

Estonia: SME start-up plans for 2017

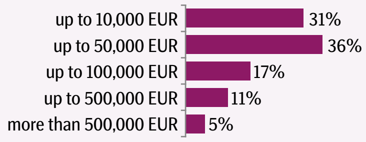
66%	will remain focused on domestic market
56%	will update products and services
39%	plan to increase number of employees

New companies established:



- Of the 1,099 polled Estonian start-up companies up to three-years-old, 67% expect turnover to go up to 50,000 EUR in 2017.

Turnover next year

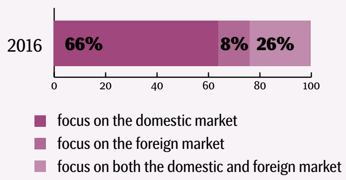


Where are they?

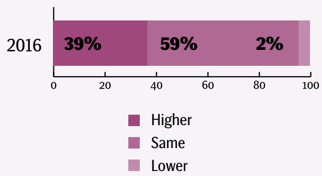
70%	have turnover less than 22,000 EUR
53%	located in Harju county (incl Tallinn)
16%	are active in wholesale and retail trade
15%	are active in professional, scientific and technical activities
11%	are active in construction sector

- Start-ups feel more secure on the domestic market, as indicated by 66% of respondents. Of foreign markets, the focus is on Finland, Latvia, Lithuania, USA, Croatia, Germany, Denmark, UK and Russia.

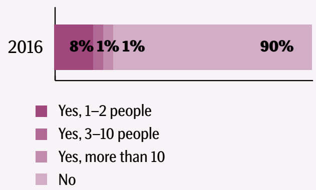
Focusing on foreign/domestic markets



Number of employees next year



Number of employees from foreign countries



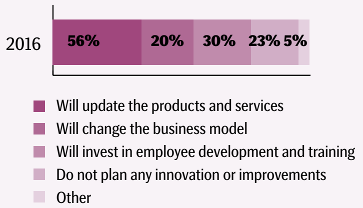
Of foreign employees are...

56%	specialists
30%	workers
27%	managers
10%	others

- Of Estonian start-ups, 39% expect to hire more staff in 2017 and only 2% contemplate cuts in workforce. About 10% have employees from foreign countries.

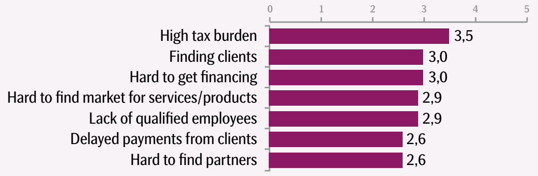
- Innovation in products and services, business models, employee development and training is planned by 77% of start-ups.

Innovations and improvements



- In 2017, the biggest challenges for Estonian start-ups are high tax burdens, difficulties finding clients, and securing financing. High taxes were also the biggest challenge when starting their own business.

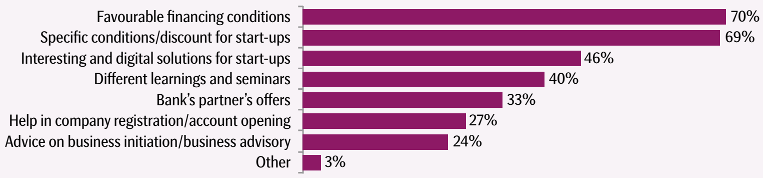
On a scale of 1–5, please evaluate what will be the biggest challenges for your company during year 2017?



On a scale of 1–5, please evaluate what were your biggest challenges when starting your own business?

- From banks, the start-ups expect favourable financing conditions (mentioned by 70% of respondents), as well as specific conditions and incentives for newly founded companies (69%).

How the banks could support start-ups?



Other: Lending products, favorable settlements for starting company, flexibility, more free of charge services (incl seminars and consultations)

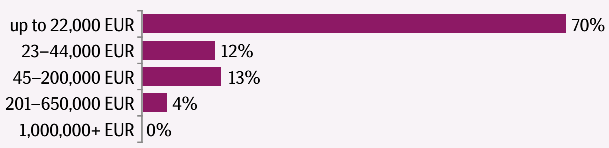
- The main driver behind setting up a company is the wish of being one's-own employer and boss (indicated by 35% of respondents), followed by the wish to improve one's living standard and achieve a higher income (26%).

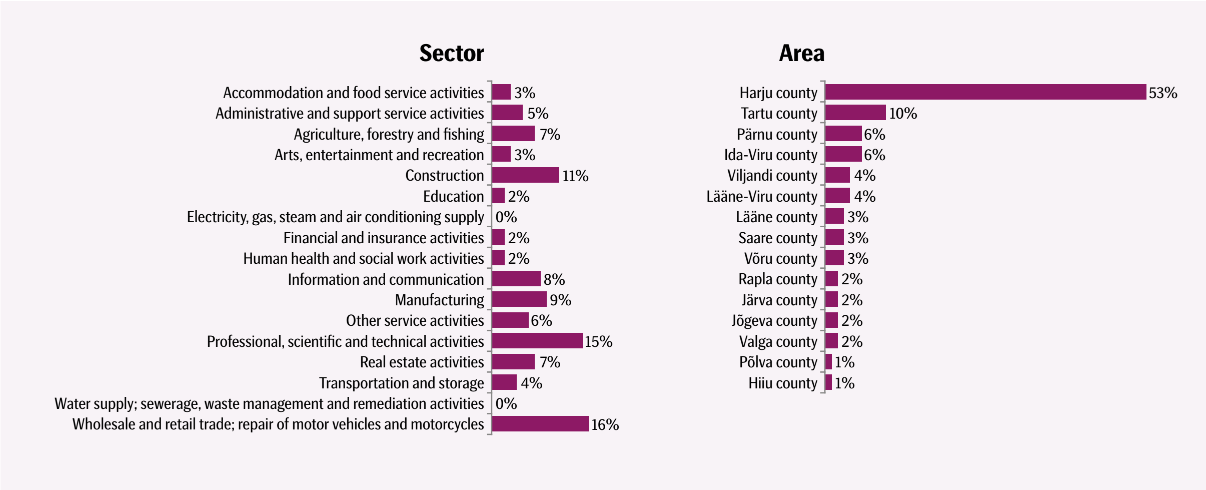
Why did you decide to start your own business?

Other reasons: Desire to act independently, new challenges, tax optimization, good ideas needed execution

Profile of the Estonian survey

Annual turnover





The Economist's View

Mihkel Nestor
Macroeconomist
SEB Estonia

The Estonian economy has kept a sluggish pace for two consecutive years. During the first three quarters of 2016, Estonian gross domestic product (GDP) increased by a meagre 1.2 per cent in real terms, compared to the same period of 2015.

Similarly to the previous year, low capital expenditures are the main culprit behind slow growth. Although in Q2, after eight quarters of negative growth, the gross fixed capital formation surged for the first time by 5.6%; however, it was annulled by a steep 8.4% decline in Q3. **Both public and business sectors have been conservative in investments.** However, taking into account the potentially larger disbursements from EU structural funds, and plans for grand infrastructure investments of the new governing coalition, at least **the public sector capital spending should pick up soon.** On the business side, the outlook remains more vague. In recent quarters, investments have tended to favour retail trade and real estate, while industry has been much more conservative. Relatively high capacity utilization and a recovering business sentiment nevertheless imply that some recovery may be expected. **At the same time, private households have been rather active in the real estate market.** At the end of November 2016, the number of outstanding mortgages stood at a level 2% higher than a year ago, while the total volume of mortgage loans had increased by 5%.

While in 2015, declining Estonian exports were blamed for paltry economic growth; at least in 2016 the total figures have improved. During first nine months, the export of goods and services has increased by 3.8%, up from a 0.6% decline in 2015. Unfortunately, the growth has not been broad-based. **Most of the growth in the trade of goods has come from the sale of electrical equipment, mainly telecommunication electronics, and from the energy sector.** Any increase in exports is, of course, positive, but it must be noted that both the electronics, and energy sectors are dominated by only a few large companies, which are not too well integrated with other Estonian businesses. Despite the fact that the total figures looked much better in 2016, the growth of exports has been slower than in 2015 in the large wood processing industry, and even negative in the metal industry, which are both very important employers.

The economic growth has been sustained by a continuingly strong level of household consumption. Private consumption expenditures increased by 4.2% in real terms during the first three quarters of 2016, which again has been a boon for companies targeting the domestic consumer. **Households have been able to consume more thanks to rapidly increasing real wages**, which continue to grow despite slow economic growth. The growth of the average gross wage equated to 7.6% between Q1 to Q3 of 2016. Besides increased consumption, this has also left households with more money to save: The deposits of private individuals have increased with a steady 7 to 8% in Estonian banks. **For the employers, surging wages are a cause of concern**, especially taking into account the slow growth in revenues. Excluding financial institutions, the sales revenue of the Estonian business sector increased by a meagre 1.7%, while the total profit has dropped by 6.3% during first three quarters of 2016. The business environment seems to have been more unwelcoming for smaller enterprises, where revenue growth has been even slower.

Due to a rapidly increasing average salary and poor revenue growth, **the share of labour costs in GDP has surged to nearly 50%**. Although the business sentiment surveys show continuing optimism about hiring, in Q3 the unemployment rate jumped to 7.5% from 5.2% in Q3 2015. Although rapid deterioration of the labour market situation still seems unlikely, the need to adjust the surging labour costs to slow growth-environment is inevitable. As long as unemployment continues to be below the estimated natural unemployment level, pressure to increase wages remains high. The growth of real incomes will nevertheless be much slower, **as after two years of deflation, inflation has returned**.

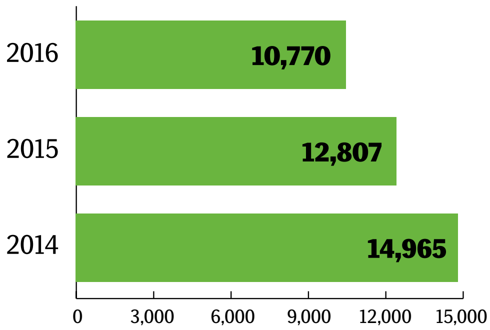
Latvian SMEs

- Latvian SMEs are the most reserved in the Baltics about the 2017 business year.
- The share of companies expecting a decline in turnover has jumped to 61% from 28% in the previous survey and only 8% of respondents are predicting at least a 15% turnover growth in 2017.
- Of the sectors, transport and logistics expressed faith in 2017 when the aggregate of optimists and moderate optimists goes up to 84%, followed by education and healthcare (80%). Housing and catering has the highest share of pessimists (33%).
- The domestic market dominates the plans of Latvian SMEs when only 21% are planning to enter new markets or expand in the existing ones, instead of 29% in the previous survey.
- The majority of companies (69%) expect employee numbers to remain unchanged. Staff increases are planned by 12% while 19% of respondents are considering workforce cuts.
- Like in the previous survey, 13% of Latvian SMEs are planning investments over 30,000 EUR but there are still 40% of respondents who do not predict any investments in 2017, and 24% have not yet decided.
- Innovation is not better rated when instead of the previous 51%, there is now only 49% of companies that are planning innovation activities, mainly in the field of products and services — envisaged by 21% of SMEs.

SME quotes: Strengthening a company's position

- *"Will make investments in employee development"*
- *"In 2017, company plans to purchase another vehicle for our operations"*
- *"Planning to find partners abroad to start exporting and expand production"*

New companies established:



Latvia: SME plans for 2017

79%	will remain focused on domestic market
69%	will keep the number of employees unchanged
45%	plan innovations in business model or products/service
37%	will make investments

Optimists and pessimists: Who are they?

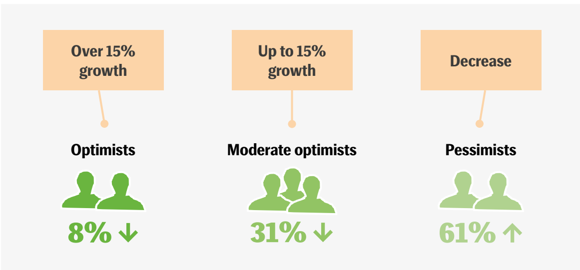
Optimists
8%

- Administration & Services; Housing & Catering; Other sectors
- Companies with more than 250 employees
- Turnover up to 65,000 EUR

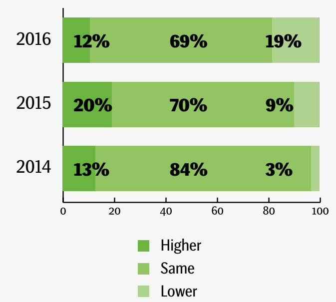
Pessimists
61%

- Housing & Catering; Industry & Energy; Trade sectors
- Companies with 1–9 employees
- Turnover from 200,000 to 650,000 EUR

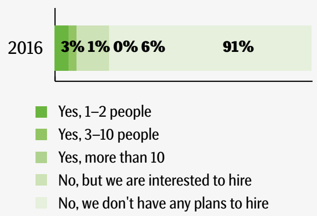
Turnover next year



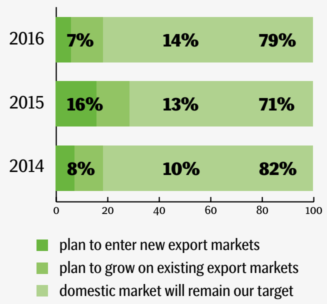
Number of employees next year



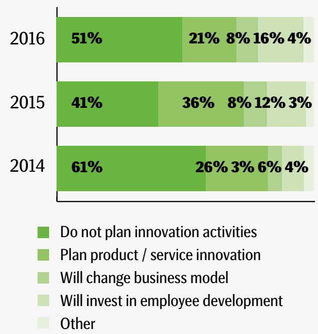
Number of employees from foreign countries



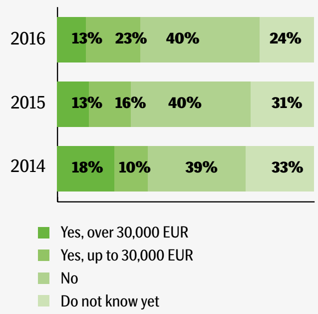
Export markets



Innovations and changes



Investment projects

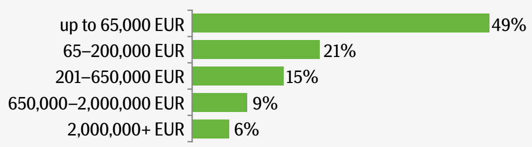


Profile of the Latvian survey

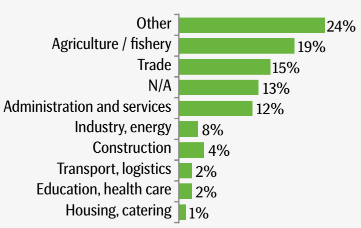
(1,554 companies partcipated in total)

Number of employees

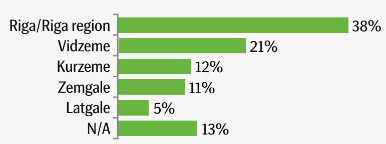
Annual turnover



Sector



Area



The Economist's View

Dainis Gašpuitis
Economist
SEB Latvia

In the third quarter of 2016, year-on-year GDP growth reached a surprisingly low 0.8%, due to new disappointments in private consumption, construction and other sectors. This will affect the full-year outcome. For 2016, **SEB is forecasting GDP to increase 1.6% and that growth will accelerate to 3.5% in 2017 and 2018** thanks to EU-financed projects. In coming years, Latvia must ensure that it preserves or improves its competitiveness, implements structural reforms and gradually makes its economy less dependent on EU funds beyond 2020. Downside risks to growth predominate, due to a continued uncertainty regarding the impact of Brexit and the geopolitical situation. Big question marks related to key national elections in Europe during 2017 will also increase the risk of lower capital spending and consumption.

In 2016, hopes that better access to EU funds would lead to greater momentum in construction and other capital spending did not materialise. Private consumption has also been weaker than expected. Mediocre international growth and heightened geopolitical uncertainty have contributed to the downturn in Latvia's economic growth rate.

Latvia has left deflation behind, and the pace of price increases will trend higher in the next few months. SEB expects inflation to reach about 2% early in 2017. **CPI inflation in 2016 was 0.1%, and will climb to 2.1% in 2017 and reach 1.8% in 2018** — partly due to rising service sector inflation, as well energy prices.

There is persistent pressure for higher wages and salaries, which employers find difficult to resist. **SEB expects an annual pay growth of 4%** over the next couple of years. The labour supply is worsening, due to such factors as demographics (ageing population) and emigration, which increase economic strains on social insurance systems.

SEB expects unemployment to fall from 8.9% in 2016 to 7.2% by the end of 2018. Labour market trends combined with expected real wage hikes will help sustain a recovery in private consumption during 2017-2018. Latvian companies are struggling with **weak productivity growth** and the resultant increase in cost pressure, but so far, they show good performance; production is increasing in such key sectors as wood and wood products, fabricated metal products, and electronic goods.

Lower economic activity so far during 2016 is at odds with Latvia's **continued positive trend of tax revenue**. During the first nine months of 2016, authorities collected 7.4% more taxes than a year earlier. One reason behind the trend relates to the actions to prevent tax evasion and curtail the unofficial economy. In the best case, public finances may be an indication that in practice, GDP growth is higher than reported so far.

The government budget showed a deficit of 1.3% of GDP in 2015. We expect the deficit to stay at this level in 2016 and then gradually decrease to 1% in 2018. Latvia has the potential to achieve a balanced budget. Public debt is expected to fall slightly from today's 36% of GDP. The government's main priorities during 2017 will be healthcare, defence and education. In a medium-term perspective, demographic challenges must be addressed. Achieving healthy public finances will require a balancing act. There is thus a lingering **risk that tax hikes may be necessary**.

Credit growth is slowly accelerating. This is expected to help sustain economic expansion. Outstanding loans, to both households and businesses are now growing at about 2% yearly. This slow pace reflects a continued debt restructuring process, while demand for loans according to various metrics is relatively low. Looking ahead, ECB's expansionary monetary policy is expected to boost credit growth.

Lithuanian SMEs

- Compared to Baltic neighbours, Lithuanian SMEs are slightly more upbeat about the business outlook in 2017.
- Although the share of optimists has fallen from 20% to 15% in the Lithuanian sample, in the Pan-Baltic comparison the optimism in the southernmost Baltic country is the strongest in the region. In total, 81% of respondents were optimists or moderate optimists, which is a sign of better business sentiment in Lithuania.
- Like in other Baltic countries, SMEs in Lithuania prefer the domestic market, as indicated by 71% of respondents. The activities in export markets are unchanged compared to the previous year.
- Although less intensively than in the previous survey, Lithuanian SMEs are planning to hire new people when 27% intend to increase headcounts; 64% plan to keep staff numbers unchanged, and only 9% indicate redundancies.
- With 45%, the share of investing SMEs is the highest in Lithuania of the last five years and about 27% of enterprises are planning investments up to 30,000 EUR.
- Innovation activities are planned by 67% of the companies in Lithuania and the focus lies in the product and service segmented, mentioned by 32% in the survey sample.

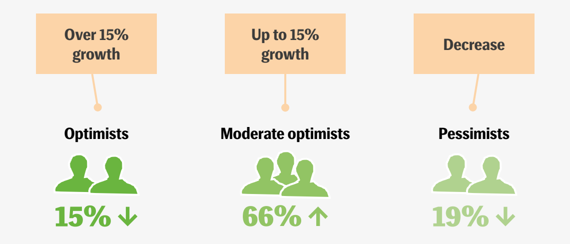
SME quotes: ambitions of getting better

- *"We will improve our business model, strengthen the retail and service and improve accounting"*
- *"New software installation and increase of labour efficiency"*
- *"To grow, import, sell more goods and services"*

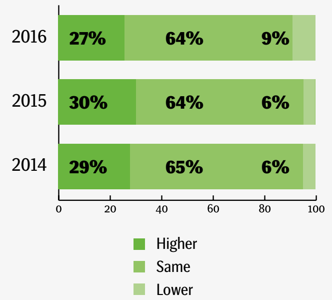
Lithuania: SME plans for 2017

71%	will remain focused on domestic market
64%	will keep the number of employees unchanged
45%	will make investments
43%	plan innovations in business model or products/service

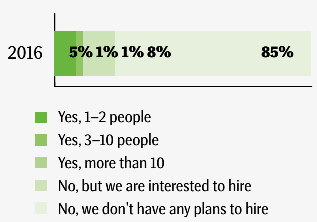
Turnover next year



Number of employees next year



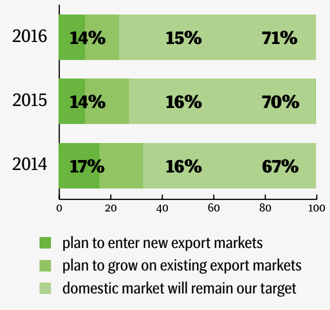
Number of employees from foreign countries



Of foreign employees are...

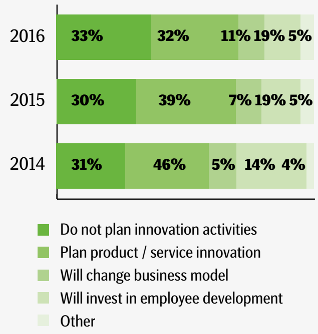
37%	managers
34%	specialists
24%	workers
5%	others

Export markets

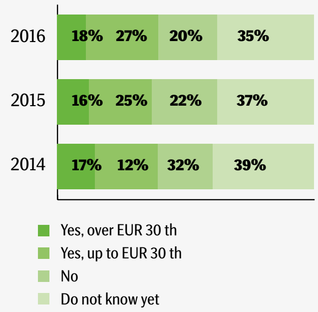


Most popular export markets:
EU countries; Latvia, Norway, Sweden, Germany, Russia, Belarussia

Innovations and changes



Investment projects



Lithuanian start-ups

Start-up companies are here defined as young business entities of up to three years of age.

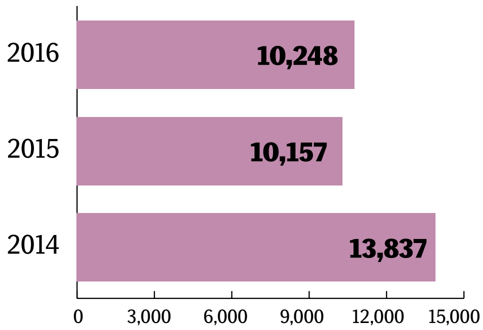
Lithuania: SME start-up plans for 2017

63% will remain focused on domestic market

50% plan to increase number of employees

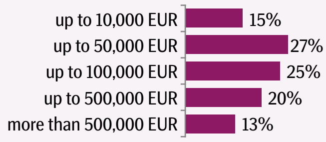
47% will update products and services

New companies established:



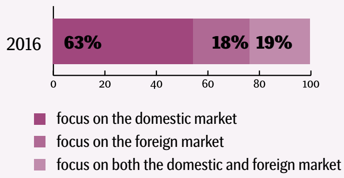
- Of the 191 Lithuanian start-up companies that were polled, 42% expect turnover up to 50,000 EUR in 2017. However, about 13% have ambitions of bringing turnover above half a million euros.

Turnover next year



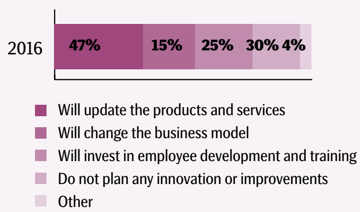
- Lithuanian start-ups are primarily eyeing the domestic market, as mentioned by 63% of respondents.

Focusing on foreign/domestic markets

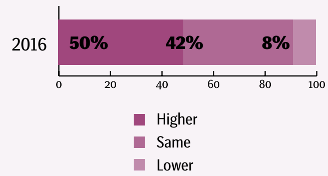


- Innovation in products and services, business model, employee development, and training is planned by 70% of start-ups.

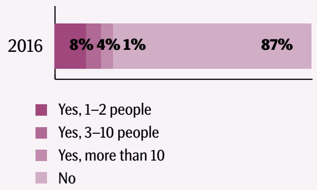
Innovations and improvements



Number of employees next year



Number of employees from foreign countries



Of foreign employees are...

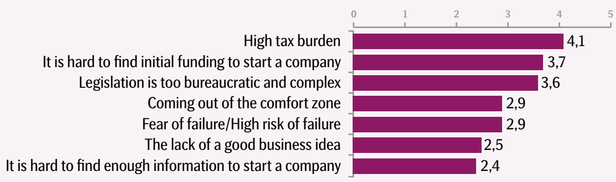
- In 2017, 50% of Lithuanian start-ups expect to bring more staff on board and only 8% are thinking of staff cuts; about 13% have employees from foreign countries.

- In 2017, a high tax burden is clearly the biggest challenge for Lithuanian start-ups, followed by difficulties securing financing, and a lack of qualified employees.

On a scale of 1–5, please evaluate what will be the biggest challenges for your company during year 2017?

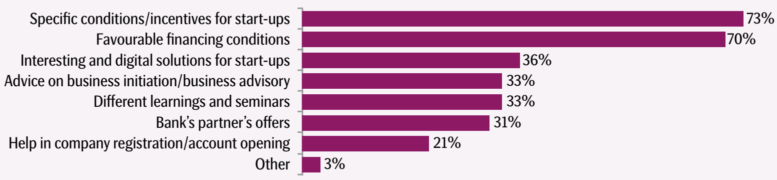
- Difficulties in finding initial funding was pointed out as the biggest problem when starting one's own business. Legislation that is too bureaucratic and complex is another factor that affects newly founded companies.

On a scale of 1–5, please evaluate what were your biggest challenges when starting your own business?



- From banks, the start-ups expect support in the form of specific conditions and incentives (noted by 73% of respondents) and favourable financing conditions (70%).

How the banks could support start-ups?



- The main driver for setting up a company is the wish to improve one's living standard and achieve a higher income (35%), followed by status change, i.e. becoming one's own employer and boss (30%).

Why did you decide to start your own business?

The Economist's View

Tadas Povilauskas
Senior Analyst
SEB Lithuania

The annual growth of Lithuania's GDP totalled to 2% in the period of the first nine months of 2016, and was lower than expected a year before. The fall in gross value added to the construction and agriculture sectors had the largest negative effect on the GDP growth, which was slower than projected. Construction output fell because of a drop in public investments, due to the financing gap experienced after the completion of strategic projects in 2015, and before the launch of projects co-financed by EU funds in 2017 and 2018. **The agriculture sector suffered from a poor grain harvest, and lower milk production in 2016.**

The economy will most likely expand slightly faster in 2017, fuelled by recovering public investments and a higher export of goods. **GDP will improve by 2.5% in 2017 and will go up by 3.0% next year**. Even though private consumption will increase at a slower pace in 2017, it will remain the main driver of GDP growth. Average wage will rise slower this year due to the fact that no increase of minimum wages is planned, contrary to the two hikes seen in 2016. However, **falling unemployment and the lack of qualified labour will keep supporting the growth of labour costs**. Businesses will continue to try to solve the problem of a lack of labour by hiring employees from third countries. Although we hope that the pace of emigration from Lithuania will slow down this year, it will remain historically high, putting pressure on the domestic demand as the consumers leave the country.

Inflation is likely to accelerate above 2% in 2017 on higher energy prices and labour costs. It will have negative impact on real wage growth this year, too. The Government will also contribute to higher inflation by sharply hiking excise duties starting on the 1st of March 2017 and making alcoholic beverages around 15% more expensive.

Export in nominal terms dropped in 2016 due to lower prices of exported goods. We believe that the **export figures will be slightly better in 2017 from a rather healthy situation in the main export markets.** However, the geopolitical uncertainties of the world may rapidly change the economic conditions in foreign markets, thus the external markets are even less predictable this year. We foresee that dairy, meat; furniture and fabricated metal producers have the largest potential to increase exports in 2017.

Additionally, the recovery in the Russian economy allows the expectation of better re-export figures. The US dollar will remain historically strong against the euro, supporting the export of Lithuanian goods to US dollar countries. The skills of Lithuanian exporters to search for new export markets should also bear some fruit this year. Contrary to the export of goods, the **export of services broke records in 2016, led by the great results of the export of road transport, financial and manufacturing services.** We hope that the export of services has a chance to climb further this year, but it will severely face the lack of employees in the labour market.

Businesses increased capital investments by around 10% in 2016. We believe that a similar trend will prevail in 2017, because the current capacity utilisation among manufacturers is close to record high, companies understand the need to increase labour productivity, and borrowing costs are still cheap. However, the uncertainty that surrounds export markets has delayed more intense expansion in some businesses. It also leads to higher pay out of dividends among the companies that will most likely remain common practice in 2017, too. **Profitability among companies will suffer from higher labour costs, and higher energy and material costs.**

The property market will remain vibrant in Vilnius. Although the number of apartment transactions will be, perhaps, smaller in 2017, prices will climb up to 5% in 2017. A positive trend in tourists' accommodation statistics has encouraged **the formation of a great pipeline of hotel developments** that should help to attract even more tourists to Lithuania in the following years.

Baltic SMEs are valuing sustainable business

The SEB Group asked Baltic SMEs about their views on the main drivers of sustainable business. The preferences have not changed during 12 months: for the polled companies, responsible business activities remain the most significant. This consists of factors such as responsible sales and consultations, transparent financial reporting, brand and reputation and avoiding risks in the supply chain — in Lithuania, it got an average of 4.45 out of 5.0, in Estonia 4.3 and in Latvia 4.2.

The second most important issue for Baltic SMEs is the contribution to employees and the community. This includes greater loyalty, inclusion of employees, smaller employee turnover, greater productivity and the contribution to the community and had the highest merits in Lithuania (4.1), followed by Estonia and Latvia (both at 3.9).

A responsible attitude towards natural resources, which refers to resource-efficient spending and environmentally sustainable production, received the least support with the marks remaining at 3.6–3.7 points across the region.