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Republic of Lithuania: 2007 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with the Republic of Lithuania, the following documents have been released and are included in this package:

- the staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on January 30, 2007, with the officials of the Republic of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 9, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF; and

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 26, 2007 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with the Republic of Lithuania

Approved by Poul Thomsen and G. Russell Kincaid

March 9, 2007

EXECUTIVE SUMMARY

Challenges. Real wage growth is running at rates well above growth of labor productivity. The government is under pressure to lower taxes, through further exemptions and a cut in the personal income tax (PIT) rate. Notwithstanding the banking sector's strengths, rapid credit expansion, associated with the greater-than-projected widening of the current account deficit, requires continued vigilance.

Staff views. Fiscal consolidation remains the only tool available to cool the economy. A front-loaded consolidation would mitigate the risk of continued upward pressure on wages and a loss of competitiveness. Eliminating tax exemptions will broaden the tax base and improve the fairness of the tax system. An Earned Income Tax Credit can increase the incentives of young and low-skill workers to participate in the labor force. Despite the decline in the capital adequacy ratio from earlier in the decade, financial buffers appear sufficient to cover nonsystemic risks. Nevertheless, the authorities must maintain their efforts to contain financial vulnerabilities.

Authorities' views. The authorities place a lower probability than does staff on the risk of a loss of competitiveness and a consequent hard landing. They remain committed to fiscal consolidation over the medium term but do not see scope for ambitious front loading. They are concerned about the proliferation of exemptions and agreed that further PIT cuts should be placed in the context of a broader tax reform package. But they stressed that specific tax and expenditure reforms would be based on political feasibility. They judge the financial sector to be productive and stable.

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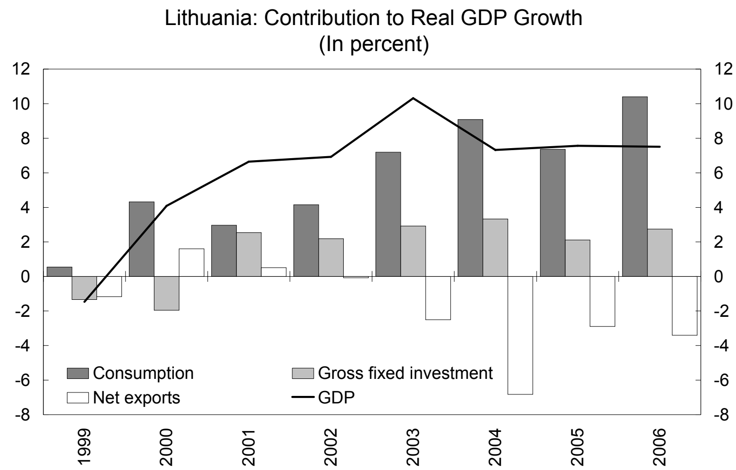
I. Introduction

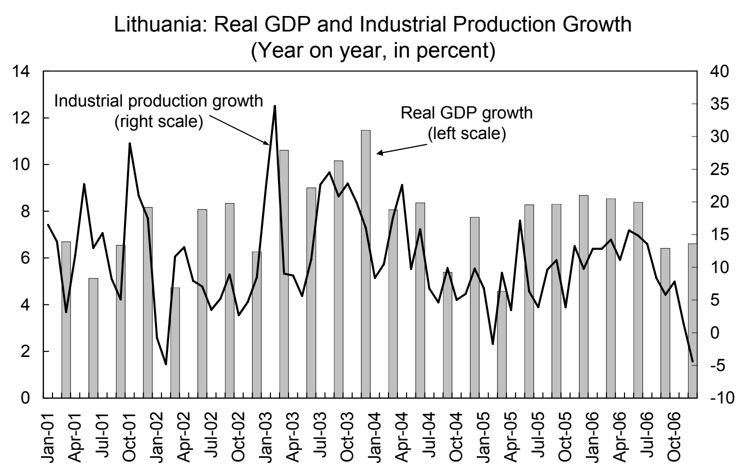
1. **The policy challenges faced today by the Lithuanian authorities are the outcome of much success.** The catch-up in per capita income toward the European average, underpinned by robust productivity growth, has been impressive. Following a decade-long effort at establishing a market economy, the momentum accelerated in 2003 as accession to the European Union (EU) drew closer. With this success, imbalances have also appeared. On the demand side, growth has been maintained by the nexus of consumption growth, rising real wages, and declining unemployment (text figure). High growth may, however, be unsustainable if rising wages erode international competitiveness. The inflation rate, anchored at a modest level by the currency board, has picked up and will likely remain above the Maastricht reference value as long as demand pressures continue and prices converge to European levels. Euro adoption has, for now, receded. Notwithstanding the banking sector's strengths, rapid credit expansion, associated with the greater-than-projected widening of the current account deficit, requires continued vigilance. Because the policy options for dealing with these challenges are constrained by the forces integrating Lithuanian product and capital markets with those of Europe, broad, anticipatory measures are needed.



Source: Statistics Lithuania; and IMF staff estimates.

II. Recent Economic Developments

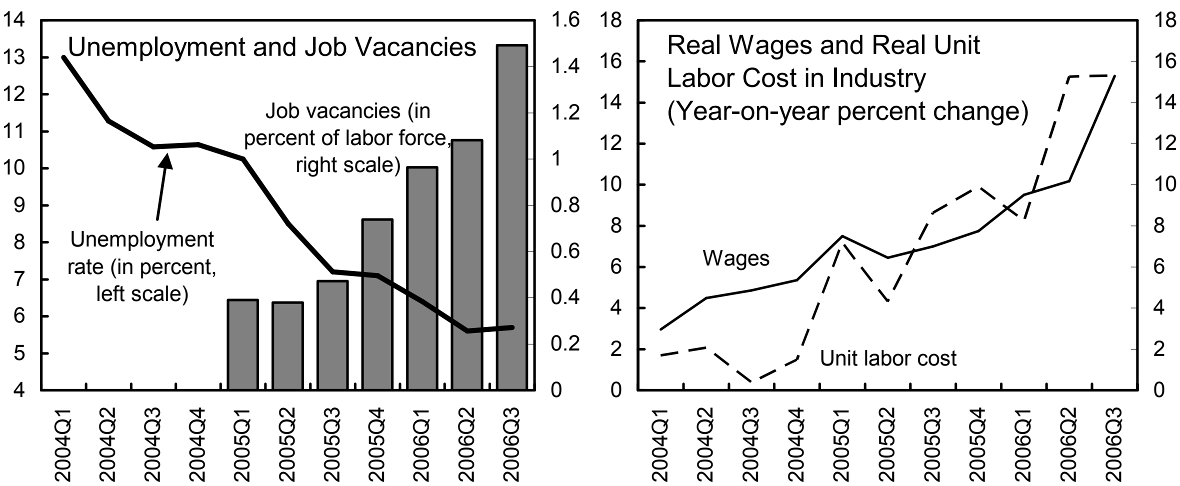
2. **Rapid growth has helped to tighten labor markets and escalate wage claims.** Following torrid GDP growth of an annual rate of 8.5 percent in the second half of 2005 and the first half of 2006, one-off effects acted to dampen growth. Growth slowed in the second half of 2006 to an annual rate of 6.5 percent (text figure) with production disruptions at Mazeikiu Nafta (the oil refinery) and a weak agricultural harvest. Nevertheless, unemployment continued to fall and, in the third quarter, the unemployment rate was at a low of 5.7 percent,



Source: Eurostat; Statistics Lithuania; and IMF staff estimates.

vacancies jumped to 1½ percent of the labor force (text figure below and Table 1a), and real wage growth accelerated to an annual rate of 15¼ percent. Because labor productivity has been growing at about 5½ percent a year, unit labor costs are now rising at their fastest rate in recent years.

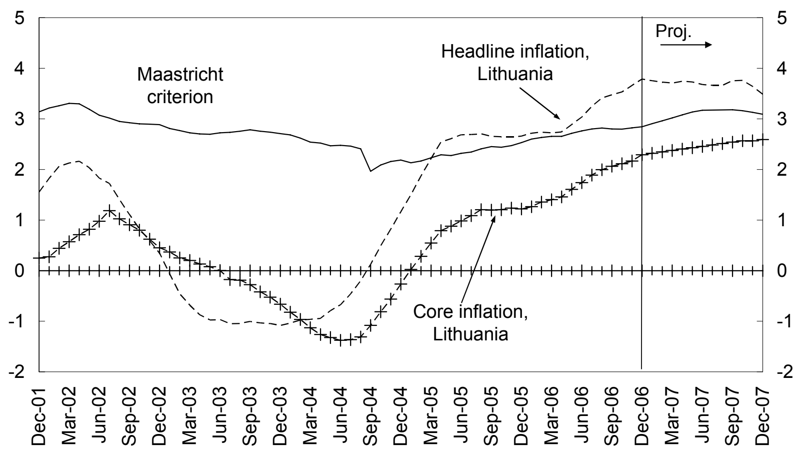
Lithuania: Labor Market Developments, 2004-06



Source: Statistics Lithuania.

3. **Inflation has risen since Lithuania's unsuccessful application for euro adoption.** In December 2006, average annual inflation was 3.8 percent, up from 2.7 percent in March 2006, when Lithuania applied for euro adoption (text figure). Though the expected rise in energy prices failed to materialize (as oil prices fell during the third quarter of 2006), food prices, accounting for more than one-third of the harmonized consumer price index (HICP) basket, increased rapidly as a result of the summer drought and continuing demand pressures. Although precise estimation is difficult, the potential growth rate of 5¾ percent would imply an excess demand of about 3½ percent of GDP. With the rising labor costs, particularly for nontraded goods, core inflation has been on the rise since mid-2004 and reached 2¼ percent at end-December 2006.

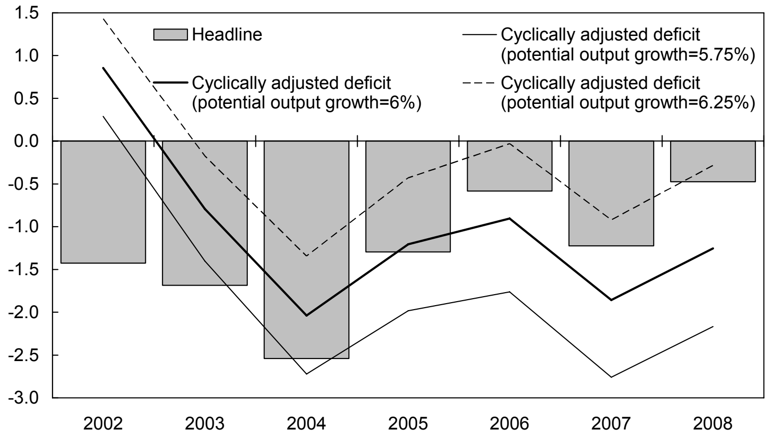
Lithuania: Inflation and the Maastricht Criterion
(Twelve month average percent change)



Sources: Eurostat; and IMF staff estimates.

4. **The fiscal stance has added to demand pressures.** Preliminary estimates suggest that the 2006 budget deficit (including restitution payments) was about 0.6 percent of GDP (text table). Because of strong GDP growth, the cyclically adjusted budget deficit was likely 1.8 percent of GDP (Table 2). If the recent growth performance reflects a higher growth potential, rather than unsustainable exuberance, the cyclically adjusted deficit may be lower (text figure). However, when the impact of EU funds is included, the aggregate of government and EU-related operations continued to provide in 2006 an economic stimulus of about 0.5 percent of GDP.

Lithuania: Headline and Cyclically Adjusted General Government Balance (in percent of GDP)



Source: Ministry of Finance; and IMF staff estimates.

Lithuania. Demand Impact from Fiscal Operations and EU Funds
(In percent of GDP)

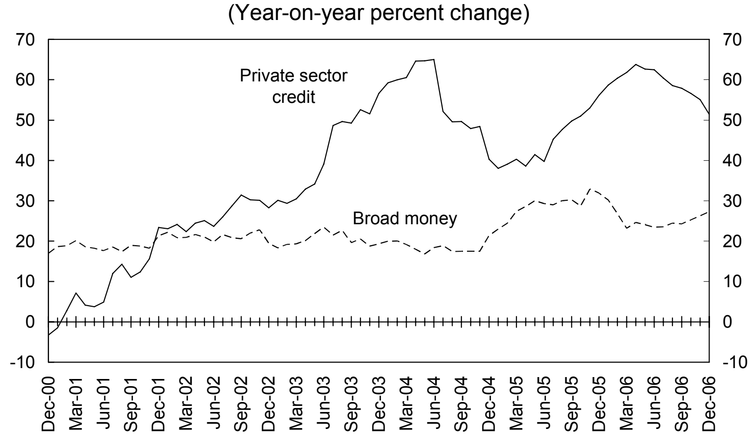
	2003	2004	2005	Q1-Q3 2005	Q1-Q3 2006	2006	2007
Deficit (ESA 95 terms)	1.2	1.4	0.4	-0.2	-1.5	-0.3	0.0
Savings and property restitution payments	0.5	1.1	0.8	0.5	0.8	0.9	1.3
Deficit (including restitution payments)	1.7	2.5	1.2	0.3	-0.7	0.6	1.2
Cyclically adjusted deficit							
(including restitution payments)	1.4	2.7	2.0	...	...	1.8	2.8
EU funds 1/	0.7	0.6	1.5	...	...	2.1	3.3
Demand impulse from fiscal operations and EU funds	1.2	1.2	0.1	...	...	0.5	2.1

Sources: Ministry of Finance; and IMF staff estimates.

1/ Spending of EU funds minus contributions to the EU budget. Includes all EU funds to capture full effect of EU funds on domestic demand.

5. **Private consumption has been supported by rapid, though somewhat slowing, credit growth.** Credit from the banking system grew by 51½ percent year on year in December (text figure and Table 3). The share of credit to households in the total outstanding stock of private sector loans rose from 37 percent to 41 percent of all loans (over the year until December) (Table 4). The recent slowdown in credit growth (from the 63¾ percent peak rate in April) partly reflects the cooling of the housing market and moderating of mortgage lending. Net foreign

Lithuania: Broad Money and Private Sector Credit Growth
(Year-on-year percent change)

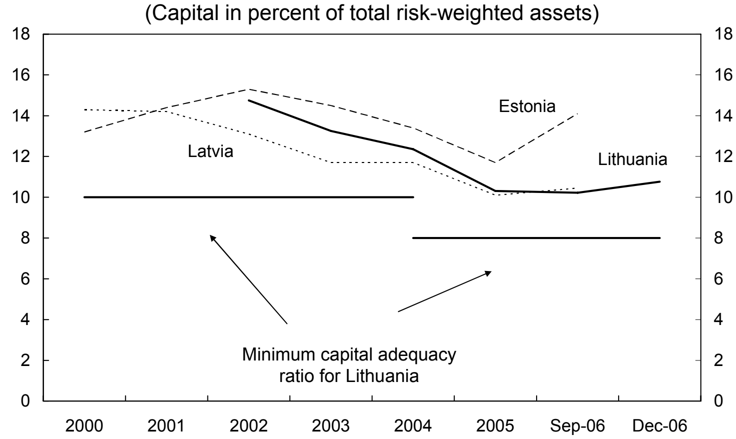


Source: Bank of Lithuania; and IMF staff estimates.

borrowing financed more than half of the new lending in 2006, in contrast to deposit growth, which dominated in 2005 (Figure 1). Parent banks contributed about three–fourths of the net foreign borrowing.

6. **Despite the decline in the capital adequacy ratio from earlier in the decade, financial buffers appear sufficient to cover nonsystemic risks.** Following the high rate of credit growth, the ratio of capital to risk-weighted assets declined steadily, reaching 9¾ percent in June. However, at the urging of the supervisory authority, injection of capital has raised this ratio, which currently stands at 10¾ percent (text figure and Table 5). Nonperforming loans, which were redefined to include only loans overdue by 60 days in December 2005, have modestly increased since that time to about 1 percent of all loans. The deterioration was of a nonsystemic nature, mainly reflecting bankruptcy proceedings at a single electronics manufacturer. Aggregate stress tests indicate that a three- to fivefold increase in nonperforming loans would not reduce the banking system's capital below the regulatory minimum. Recent bank-by-bank stress tests, undertaken by the authorities, confirm that this would also be the case for systemically important banks (see also accompanying selected issues paper). Also, domestic banks are adopting best practices in risk management, reflecting the methods of their reputed parent banks, who have an incentive to protect their high credit ratings.

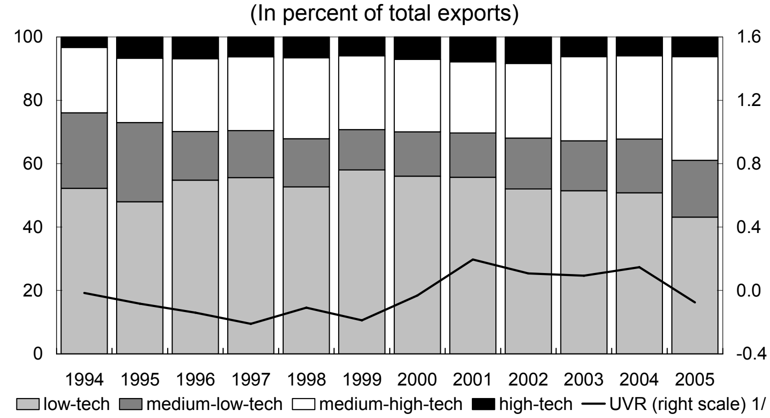
Baltics: Bank Capital Adequacy Ratio
(Capital in percent of total risk-weighted assets)



Source: Bank of Lithuania; and IMF staff estimates.

7. **The 2006 current account deficit widened significantly.** The deficit widened by about 5 percentage points of GDP, compared with a year earlier, to 12¼ percent of GDP (Figure 2). The decline in exports from the oil refinery contributed about ¾ percentage point of GDP of the widening. However, the principal cause of the larger deficit was a higher-than-anticipated growth in nominal imports. Despite the production shortfalls at the oil refinery, export performance was strong with rising export market share (Figure 3) and a continued switch from low- to medium-technology goods (text figure). Equilibrium exchange rates are notoriously difficult to compute when significant structural changes are

Lithuania: Composition of Exports
(In percent of total exports)



Source: UN Comtrade database; and IMF staff calculations.
1/ UVR is the unit value of a country's exports divided by the unit value of world exports. Expressed in logarithm so that a value of zero means country unit value equals world unit value.

ongoing. However, staff estimates suggest that the effective exchange rate may be approximately in equilibrium.[1] Nevertheless, rising unit labor costs are a concern and were, hence, the focus in the consultation.

8. **While markets have financed growing external liabilities at historically low rates, continuation of such financing cannot be presumed.** FDI inflows (about 5½ percent of GDP) were boosted by the government's partial sale of the oil refinery to a Polish buyer, and EU funds contributed a further 1¼ percent of GDP. Some of the proceeds from the shares of the oil refinery were used to raise reserves, which increased to 57 percent of short-term debt in December 2006, up from 46 percent a year earlier. As such, the stock of gross external debt reached 56 percent of GDP at end-December 2006, up from 49 percent of GDP a year earlier (Table 6).

III. Policy Discussions

9. **The discussions centered on the size, timing, and political feasibility of precautionary measures.** Staff commended the authorities for continued efforts to secure the health of the economy. But staff also cautioned that the incipient imbalances needed to be taken seriously and stressed, in particular, that rising wages could compromise competitiveness, thereby slowing growth and heightening financial vulnerability. The authorities acknowledged staff's cautionary advice but maintained that, with its strong foundations, the economy should continue to perform well and withstand a wide range of shocks. In contrast to staff's call for early and ambitious steps to contain emerging vulnerabilities, they viewed more measured responses as appropriate and politically feasible. In this light, the discussions centered on four areas: (a) fiscal consolidation to prevent a hard landing from the recent buoyancy and to contain inflation; (b) complementary tax and expenditure reforms for medium-term fiscal sustainability; (c) containment of possible financial vulnerabilities; and (d) structural measures to moderate wages and enhance productivity to preserve competitiveness.

[1] To stabilize net foreign liabilities (at the currently modest 48 percent of GDP), a real depreciation of about 3-5 percent appears necessary, and less if EU funds and remittances increase.

Lithuania: Fund Policy Recommendations and Implementation

Policy Area	Status of Implementation
Fiscal consolidation	The 2006 fiscal deficit (European System of Accounts (ESA)'95 plus restitution payments) is, as recommended by staff, expected to be lower by about 1 percent of GDP than that projected at the time of the 2006 Article IV consultation.
Expenditure efficiency	The authorities concur with the thrust of the recommendations but have not yet initiated these reforms.
Fiscal Responsibility Act	Initial steps are under way to introduce a Fiscal Responsibility Act.
Financial sector	After a secular decline until mid-2006, the capital adequacy ratio has been raised.
Use of EU funds	The authorities tightened qualification procedures in 2006 to ensure project quality.
Labor market	There is limited political support to remove restrictions on flexibility of work hours. Much needs to be done to increase effectiveness of vocational training and tertiary education.

A. Outlook

10. **The growth outlook—a combination of the convergence process and some exuberance—is characterized by uncertainty.** Either potential growth has been underestimated or the "extra"—above-potential—growth is due to a temporary reinforcing dynamic of rapid consumption growth, wage acceleration, and falling unemployment rates. Such a dynamic cannot continue indefinitely because it will erode international competitiveness. However, it is hard to predict when the exuberance will subside.

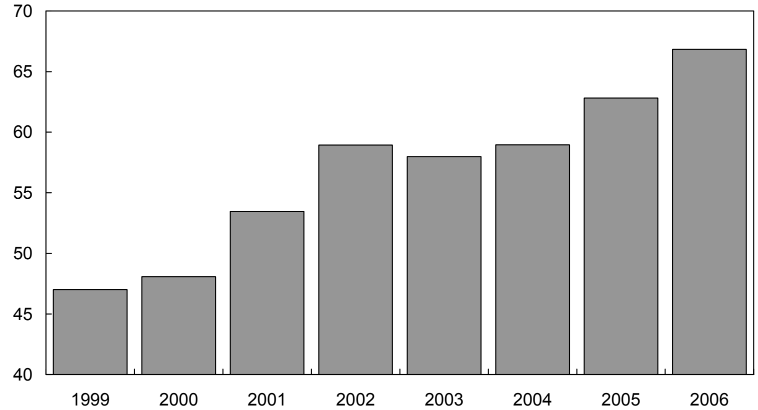
11. **The discussions centered on two scenarios, hinging on how labor market, especially wage, developments play out.** If wage pressures prove to be temporary or are resisted by employers, continued profitability and investment would maintain export competitiveness. Growth would moderate smoothly as the consumption-wage growth cycle weakens. The current account deficit would moderate, from 12¼ percent in 2007 to 10 percent of GDP in 2009 (Tables 7 and 8). While favoring this as the likely scenario, the authorities anticipate a somewhat sharper slowdown than does staff (Table 1a and text table). Even staff's benign scenario has risks, and the rising imports-to-domestic demand ratio (text figure), reflecting demand for a variety

Lithuania: Medium-Term Outlook Without Policy Response
(Year-on-year percent change, unless otherwise specified)

	2005	2006	2007	2008	2009
Scenario 1					
Real GDP	7.6	7.5	7.0	6.5	6.0
Domestic demand	8.9	12.9	9.1	5.1	5.0
of which: private	1.1	13.6	8.1	5.8	5.4
Unit labor cost (in U.S. dollar terms)	5.2	11.4	8.0	7.0	5.9
Unemployment rate (in percent)	8.3	5.4	5.3	5.3	5.3
Average monthly wage (in U.S. dollar terms)	10.3	16.6	11.3	9.8	10.7
Current account balance (in percent of GDP)	-7.1	-12.2	-12.3	-11.0	-10.1
General government balance (in percent of GDP) 1/	-1.3	-0.6	-1.2	-0.5	-0.1
Scenario 2					
Real GDP	7.6	7.5	8.0	5.0	3.5
Domestic demand	8.9	12.9	11.2	4.6	3.4
of which: private	1.1	13.1	10.9	4.8	3.2
Unit labor cost (in U.S. dollar terms)	5.2	11.4	12.1	6.0	5.5
Unemployment rate (in percent)	8.3	5.4	4.3	6.0	6.5
Average monthly wage (in U.S. dollar terms)	10.3	16.6	17.1	8.5	8.1
Current account balance (in percent of GDP)	-7.1	-12.2	-13.7	-13.2	-13.1
General government balance (in percent of GDP) 1/	-1.3	-0.6	-0.9	-0.7	-1.0
Memorandum items:					
Authorities' projection for real GDP growth	7.6	7.5	6.3-6.7	5.2-5.3	...
Authorities' projection for domestic demand growth	8.9	12.9	6.0-6.9	5.6	...

Sources: Lithuanian authorities; and IMF staff estimates.
1/ The general government balance in scenario 2 differs from that in scenario 1 only for cyclical reasons. The underlying policy stance is identical.

Lithuania: Ratio of Imports to Domestic Demand
(In real terms, in percent)



Source: Statistics Lithuania; and IMF staff estimates.

of higher quality products, might add to the pressure on the current account deficit. In the other, less benign scenario (scenario 2), growth could actually accelerate in 2007, especially if the projected fiscal stimulus materializes, but the cumulative wage growth would substantially weaken competitiveness (Table 1b). The ensuing fall in growth would be sharper than in the first scenario. Moreover, the weaker competitive position would keep the current account deficit at (or above) 13 percent of GDP. The risk of a further fall into a prolonged slump, as in Portugal, could not then be ruled out. Weakening growth would worsen the fiscal position. The high current account deficit would restrict fiscal policy options to reverse the slump.

12. **The authorities placed a low probability on the less benign scenario.** In particular, they viewed the most recent wage acceleration as due to one-off factors. These include a 10 percent increase in the minimum wage in July 2006, a 40 percent rise in salaries in the public health sector, and full payment of wage arrears to civil servants in June 2006. Also, they judged that the tax inspectorate's drive to increase personal income tax (PIT) and value-added tax (VAT) revenues had raised officially declared wages more than actual take-home pay of workers. At the same time, the data suggest that net emigration may have declined, as fewer people appear to have left in 2006 than in 2005 and there has been more immigration. Staff agreed that these factors were relevant for wage projections. While some wage moderation could occur, policies to dampen domestic demand would reinforce such self-correction.

13. **The short-term inflation outlook will be influenced by movements in energy prices and the inevitable catching up of prices to European levels.** In 2007, with the pass-through of Gazprom's price increases and higher excise taxes, the average annual inflation rate is likely to be about 3½ percent (text table). These influences may moderate in 2008. The authorities noted that the moderation, especially if accompanied by further downward shocks (due to energy prices or exchange rate

Lithuania: Components of HICP
(Year-on-year percent change)

	2005	2006	2007 Proj.	2008 Proj.	Weight in 2006
Average annual HICP	2.7	3.8	3.5	3.4	...
		(Year-on-year inflation)			
HICP	3.0	4.5	2.7	4.1	100
Energy 1/	10.3	7.1	-0.7	6.1	13
Food 2/	3.5	8.1	2.1	2.2	34
Other 3/	1.4	2.6	3.8	4.5	52
Of which: nontradables	3.9	5.6	...	...	
		(Contribution to year-on-year inflation)			
HICP	3.0	4.5	2.7	4.1	...
Energy	1.3	0.9	-0.1	0.8	...
Food	0.9	2.1	0.5	0.6	...
Other	0.8	1.5	2.2	2.7	...
Of which: nontradables	0.2	1.0	...	...	...

Source: Eurostat; and IMF staff estimates.
1/ Includes 30 percent price increases by Gazprom in January 2007, and 10 percent price increase by Gazprom in January 2008. In addition, excise taxes on diesel and fuel are assumed to be implemented in equal annual steps to the end of the derogation in 2011/2013.
2/ Food and non-alcoholic beverages.
3/ Includes increase in tobacco excise taxes in equal annual steps until the end of the derogation in 2010.

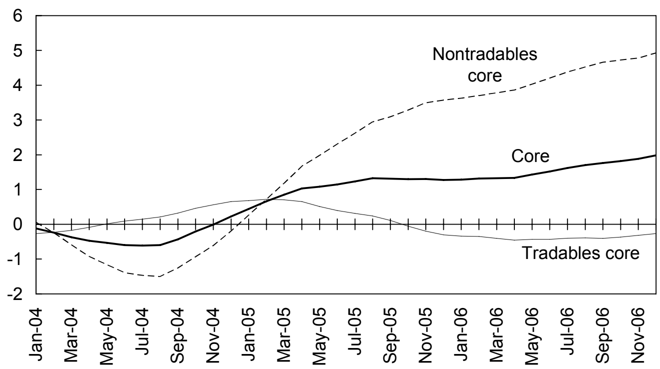
movements), could bring Lithuania close to the Maastricht reference inflation rate and, hence, in a position to try for euro adoption once again. However, they agreed that wage growth and the catch-up to European levels (Box 1) will keep upward pressure on prices.

Box 1. Price Convergence in Lithuania

Lithuania has achieved rapid income catch-up with a relatively slow pace of price catch-up—but that balance may be changing. Especially in 2003, price catch-up pressures were mitigated by one-off effects such as telecommunications privatization and nominal effective exchange rate appreciation. As these factors recede, the quantitative influence of price catch-up may become more prominent.

Staff analysis indicates declining policy leverage over inflation rates. Around the time of EU entry, with increased harmonization of standards and a more open trading environment, the process of price catch-up began to accelerate, first in tradable and then in non-tradable goods. Also, because the domestic business cycle effects on prices have decreased, the degrees of freedom available to policymakers have declined. Nevertheless, the rise in non-tradable inflation does reflect the influence of rapid wage increases, requiring policy measures to dampen domestic demand.

Lithuania: Composition of Core Inflation
(Average annual change, in percent)

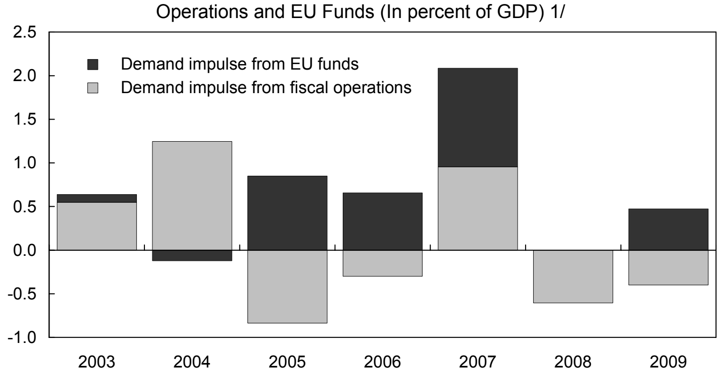


Source: Eurostat; and IMF staff estimates.

B. Fiscal Policy

14. **The 2007 budget implies a significant fiscal impulse.** The fiscal stimulus from fiscal operations (including restitution payments) and EU funds is projected at around 2.1 percent of GDP (text figure). The significant stimulus stems mainly from the authorities' decision to bring forward some of the restitution payments planned for 2008 to honor all outstanding obligations in 2007. Thus, under current projections, the fiscal stance in 2008 could be contractionary.

Lithuania: Demand Impulse from Fiscal
Operations and EU Funds (In percent of GDP) 1/



Source: Ministry of Finance; and IMF staff estimates.
1/ Demand impulse from EU funds defined as annual change in net EU funds inflows recorded in the balance of payments. Demand impulse from fiscal operations defined as annual change in the cyclically adjusted general government balance (including restitution payments).

15. **To prevent further fueling of the recent exuberance, staff recommended fiscal consolidation to eliminate the projected 2007 stimulus.** Under current projections, this would require a fiscal consolidation of 2 percent of GDP in 2007, leading to a headline surplus of about ¾ percent of GDP (including restitution payments). A somewhat less ambitious objective could be to balance the headline budget in 2007. Either choice of front-loaded consolidation to reduce macroeconomic imbalances should be integral to a medium-term objective of a structurally balanced budget by 2009, implying a consolidation of about 3 percent of GDP over three years. Fiscal consolidation would require use of all revenue overperformance for deficit reduction as well as expenditure restraint. In the spirit of the recent multiparty agreement, staff urged the authorities not to adopt a supplemental budget in mid-2007. Further consolidation of employee positions in the public sector remained an avenue for savings on the general government wage bill. Short-term expenditure moderation could also be achieved in goods and services.

16. **Staff noted four benefits from early fiscal consolidation.** First, cooling of the economy by balancing the budget in 2007 would help reduce the current account deficit immediately (text table). While growth in the next two years would be somewhat slower than without the consolidation, the measure would help keep the economy in the soft-landing framework of scenario 1; wage moderation would revive growth by 2009 along with a smaller medium-term current account deficit. Second, if a competitiveness-induced slump nevertheless materialized, the preemptive consolidation would allow for future stabilizing options. Third, while the links between fiscal policy and inflation are weak, a precautionary strategy, nevertheless, would contain the risk that inflation would be amplified through second-round price effects. Finally, continuing long-term pressures on the budget implied that creating fiscal space was important. As discussed in last year's staff report (IMF Country Report No. 06/162), skilled and semiskilled emigration would add to the burden of the pension system and the costs of health care. Space was also needed to narrow Lithuania's tax wedge, which the authorities recognized as a priority.[2] Without additional fiscal space, calls for a reduction of the PIT rate to 20 percent were untenable.

Lithuania: Medium-Term Outlook With Policy Response of Structural Balance
(Year-on-year percent change, unless otherwise specified)

	2005	2006	2007	2008	2009
Scenario 1					
Real GDP	7.6	7.5	6.3	5.7	6.0
Domestic demand	8.9	12.9	6.9	3.5	4.0
Unit labor cost (in U.S. dollar terms)	5.2	11.4	6.0	4.2	4.0
Unemployment rate (in percent)	8.3	5.4	5.5	5.6	5.3
Current account balance (in percent of GDP)	-7.1	-12.2	-11.1	-9.4	-8.5
General government balance (in percent of GDP)	-1.3	-0.6	0.0	1.0	1.7
Scenario 2					
Real GDP	7.6	7.5	7.2	4.0	4.5
Domestic demand	8.9	12.9	10.8	2.5	3.0
Unit labor cost (in U.S. dollar terms)	5.2	11.4	8.5	6.0	4.8
Unemployment rate (in percent)	8.3	5.4	4.8	6.5	6.2
Current account balance (in percent of GDP)	-7.1	-12.2	-12.8	-12.0	-10.5
General government balance (in percent of GDP)	-1.3	-0.6	0.0	0.5	0.8

Sources: Lithuanian authorities; and IMF staff estimates.

[2] The PIT rate is to be reduced to 24 percent on January 1, 2008.

17. **The authorities reaffirmed their commitment to fiscal consolidation, but one that was less front-loaded.** They argued that they were committed to a structurally balanced budget by 2010 in their convergence program. Since they placed a low probability on the hard-landing scenario, the value of early fiscal consolidation as a precautionary policy measure against macroeconomic imbalances appeared more than offset by the political cost of such consolidation, especially because of their goal to complete restitution payments.

C. Tax and Expenditure Reform

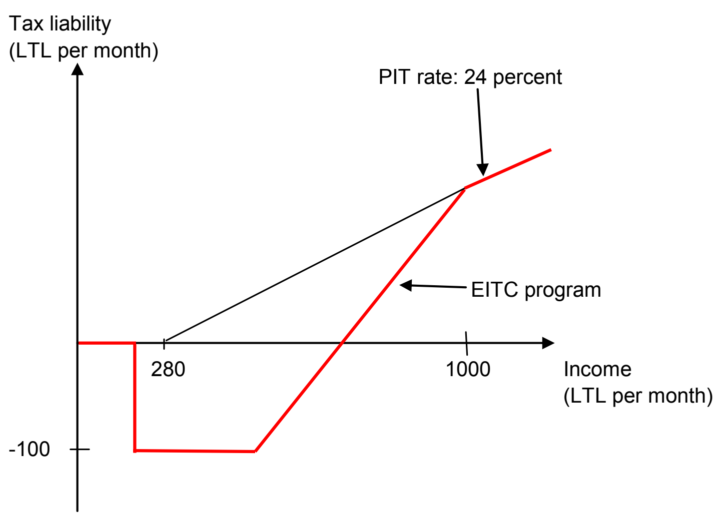
18. **The authorities recognize that eliminating tax exemptions will broaden the base and make the system fairer.** A variety of exemptions are granted to support the weaker sections of society but the benefits accrue in substantial measure to those who do not need the support. The culture of granting exemptions is being increasingly legitimized, and the pressure for further tax breaks appears set to exert a continuing influence on tax policy. Staff suggested that the distributive concerns that partly motivate these pressures are more effectively dealt with through the income tax. Also, a revenue gain from eliminating tax exemptions of about 1½ percent of GDP appears possible.

19. **In tandem, a package of measures could increase after-tax incomes, especially of low-income workers, and narrow the tax wedge in a broadly revenue-neutral manner.** To encourage labor participation of younger and less educated workers, reduce the size of the informal sector, and provide targeted income support, an earned income tax credit (EITC) was discussed (Box 2). Staff analysis suggests that this could be largely financed by reducing the no-tax amount by about one-fourth from its current level. Because high-income individuals also benefit from the no-tax amount, reducing its level would raise significant revenues without unduly increasing disincentives to work. Separately, since social security benefits are capped, a cap on contributions to the pension plan at a suitable earnings level would be fair and would narrow the tax wedge at higher income levels. The budgetary implications would be contained, as employers' savings would raise corporate tax receipts and as independent workers would be brought more fully under the social security system.

Box 2. Earned Income Tax Credit

The EITC rewards labor force participation by providing cash payments or a tax rebate to low-income earners. Because the EITC is means-tested, it targets low-wage workers more effectively than general reductions in income tax rates. The accompanying selected issues paper shows an illustrative tax credit scenario in which the lowest qualifying income earners would receive a cash payment of LTL 100 per month, about one additional monthly salary per year. This cash payment would decrease, and eventually disappear, as the household's earned income rises to, say, LTL 1000 per month. To finance these tax breaks, a reduction in the no-tax amount by about one-fourth to LTL 280 per month would yield additional revenues of about 1 percent of GDP. Such a system, while adding to the complexity of the PIT administration, would be fairer and more efficient (and ultimately simpler) than the current tax and benefit system, which deals with social pressures through exemptions.

Lithuania: Illustrative Example of an Earned Income Tax Credit



Source: IMF staff calculations.

20. **The authorities pointed to some progress in the design of a Fiscal Responsibility Act (FRA).** The authorities agreed that the expenditure efficiency measures proposed in the 2006 Article IV consultation could prove valuable but noted their implementation needed strong political support. However, they see recent multiparty agreement as a precursor to an FRA. This agreement includes setting aside revenue overperformance for deficit reduction. Together with the established practice of seeking new revenue sources for additional spending initiatives, the authorities and staff agreed that further fiscal safeguards would constitute steps forward. These would include ensuring greater budget transparency and independent scrutiny of the budgeting process, possibly by enhancing the role of the State Audit Office and establishing expert reviews of the demand impact of fiscal policy. A more ambitious medium-term expenditure framework would include better integration of strategic expenditure planning and budgeting and greater scrutiny of the expenditure plans of line ministries and municipalities.

D. Financial Vulnerabilities

21. **The Bank of Lithuania (BoL) continues to view the financial system as stable—as does staff (text table).** Though the results of the diagnostic stress tests are reassuring, there remains the task of guarding against systemic risk arising from a macroeconomic slowdown. The concern is that exuberance may have encouraged poor credit decisions, which will be revealed as such growth slows. The magnitude of macroeconomic stress, with or without a significant price correction in real estate, is hard to assess. Nevertheless, further efforts to model macroeconomic risks, including in conjunction with the forthcoming Financial Sector Assessment Program (FSAP) update mission later this year, should provide useful estimates of the effects of such shocks.

Lithuania: Risks to the Financial System and Mitigating Factors

Risks	Mitigating Factors
Rapid credit growth lowers lending standards, especially for household lending.	Credit-GDP ratio is 44 percent of GDP, relative to the 68 percent estimated as equilibrium by Cottarelli and others (2003); households' indebtedness is relatively low. 1/
A collapse of the house price "bubble" will hurt banks' balance sheets and depress consumption and growth, with spillover effects on other banking assets.	Mortgage lending carries relatively low risk in normal circumstances. Moreover, it helps banks achieve a desirable portfolio diversification.
Significant reliance on external borrowing to expand credit creates the risk that parent banks may suddenly stop this flow, leading to a credit crunch and further knock-on effects.	Parent banks face significant reputation risk in discontinuing support for subsidiaries and branches. Especially compared with their typically low exposure in the Baltics, these reputational risks are large.

1/ Cottarelli, Carlo, et. al, 2003, "Early Birds, Late Risers, and Sleeping Beauties: Bank Credit Growth to the Private Sector in Central and Eastern Europe and in the Balkans", IMF Working Paper, No. 03/213.

22. **The authorities and staff agreed that continued active supervision of banks and wide information disclosure are called for.** The considerable variance in the strength and performance of banks implies the continued need for supervisory efforts to identify bank-specific capital requirements and raise them where needed, as in the past. The authorities have taken steps recently to maintain the integrity of the banking system by raising bank capitalization, as noted above. The authorities also noted their ongoing efforts to facilitate supervisory and crisis management cross-border arrangements, which include the recently concluded agreement with the Swedish Riksbank, the Bank of Latvia, and the Bank of Estonia. Staff welcomed steps to increase information disclosure by January 1, 2008 under pillar 3 of Basel II.

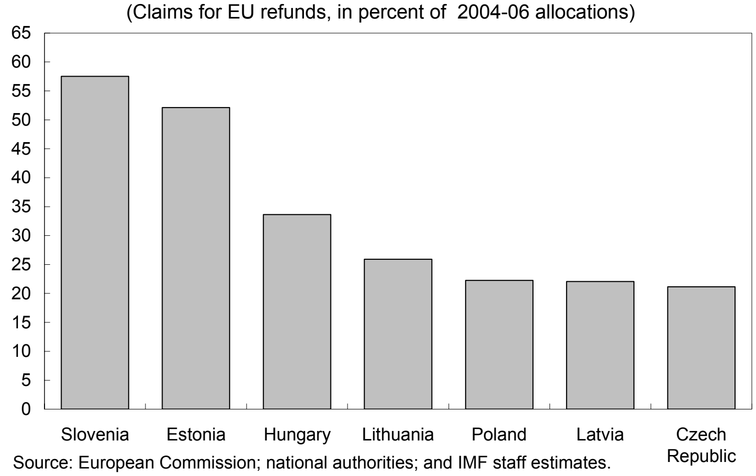
E. Structural Measures

23. **Perhaps the most important goal, that of raising productivity, is also the most difficult to induce reliably through policy measures.** Lithuania has done well in past years to improve its investment climate and ranks high on most measures of doing business

(Figure 5). Nevertheless, raising investment levels—including by attracting foreign investors—will require further improvements in the investment climate. In addition to the fiscal reforms discussed above, land and labor markets, as well as government services, deserve attention. In the labor market, restrictions on overtime and part-time work and on individual agreements on work hours and holidays limit the flexibility of small- and medium-scale production. Enhancing flexibility is important since a quick response to changing European demand is key to maintaining the competitive advantage of Lithuanian producers. Also, to alleviate labor market pressures, an important challenge for the authorities is to creatively explore the possibilities of migration of labor into Lithuania. The land restitution program introduced uncertainty in property rights, but even when it is completed, these uncertainties are likely to persist on account of cumbersome land-planning processes. Also, frequent and overlapping inspections of compliance with regulatory standards by government institutions create a burden for business. The government's plans to rationalize these regulatory services are therefore welcome.

24. **The authorities are pursuing a new balance between prudence and flexibility to better absorb EU funds.** Lithuania's utilization of structural funds stood close to the CEE-8 average at end-2006 (text figure). The current framework, designed to prevent the misuse of EU grants, although commendable, causes delays. The authorities' plans involve, first, a risk-based approach to verifying payment claims and more flexible procurement regulations, particularly where projects are small; and, second, project preselection within regional programs to ensure coherence in development policy. These initiatives are in line with practices elsewhere in Central and Eastern Europe. Staff recommended, and the authorities concurred, that flexibility should come in tandem with stronger coordination. This implied an enhanced role for the Ministry of Finance in project selection to ensure consistency between its decision-making powers and accountability before the European Commission. However, the implementation capacity of the line ministries needed strengthening. Finally, staff suggested that the carryover of unused cofinancing appropriations within so-called special programs should be limited to increase the incentives of line ministries for more accurate budgeting and timely implementation of EU projects.

CEE Countries: Cumulative Absorption of EU Structural Funds Since 2004
(Claims for EU refunds, in percent of 2004-06 allocations)



Source: European Commission; national authorities; and IMF staff estimates.

IV. Staff Appraisal

25. **Lithuania's economic prospects remain bright, but early precautionary measures could ensure that progress is not derailed.** The income catch-up potential remains large and the Lithuanian economy has demonstrated resilience to shocks and the ability to climb the technology and quality ladder. Growth, however, has been boosted by a

rapid increase in consumption, helped by wage acceleration and a falling unemployment rate. If wage growth continues to outpace productivity growth, competitiveness will be eroded, as the international experience shows. In a competitiveness-induced slump (with a weak fiscal position and a large current account deficit), policy options are limited. At the same time, the inflation rate has picked up and euro adoption in 2009 or 2010 remains a close call. To achieve sustainable growth and raise the prospects of euro adoption, precautionary measures in four areas are, therefore, desirable: fiscal consolidation; tax and expenditure reforms; containment of financial vulnerabilities; and structural measures to moderate wages and enhance productivity.

26. **Fiscal consolidation should be appropriately ambitious.** The authorities should not rely on market-based self-correction of the exuberance. A front-loaded consolidation should be integral to a medium-term objective of a structurally balanced budget by 2009. These efforts would help cool the economy, contain the macroeconomic imbalances, improve the prospects of euro adoption, and increase future policy flexibility (both to deal with a cyclical contraction and to make space for long-term fiscal pressures).

27. **A variety of tax, expenditure, and procedural fiscal reforms will help fiscal sustainability and accountability.** Eliminating existing exemptions will broaden the tax base and make the tax system fairer. Instead, implementing an earned income tax credit will help enhance the simplicity and efficiency of the tax system and benefit system, and raise the after-tax incomes of low-wage earners. Capping the value of contributions to the pension plan at a suitable earnings level will narrow the tax wedge at the higher end of the wage spectrum, and improve competitiveness in the international high-skilled labor market, while maintaining broad revenue neutrality. On the expenditure side, considerable scope exists for improving efficiency in social assistance and health delivery. Greater accountability can be achieved through a more ambitious medium-term expenditure framework, embedded in the framework of the Fiscal Responsibility Act. In turn, this act should include measures to enhance transparency, independent scrutiny of the budgeting process, public analysis of the macroeconomic impact of the budget and of expenditure efficiency, and a firm commitment to fiscal restraint.

28. **While financial buffers appear sufficient to cover nonsystemic risks, the authorities must maintain their efforts to contain financial vulnerabilities.** The FSAP update later this year will further examine these issues and delve also into the more difficult assessment of the risks from a macroeconomic slowdown, including through a correction in the real estate prices. Meanwhile, the considerable variance in the strength and performance of banks implies the continued need for supervisory efforts to identify bank-specific capital requirements and raise them where necessary, as in the past.

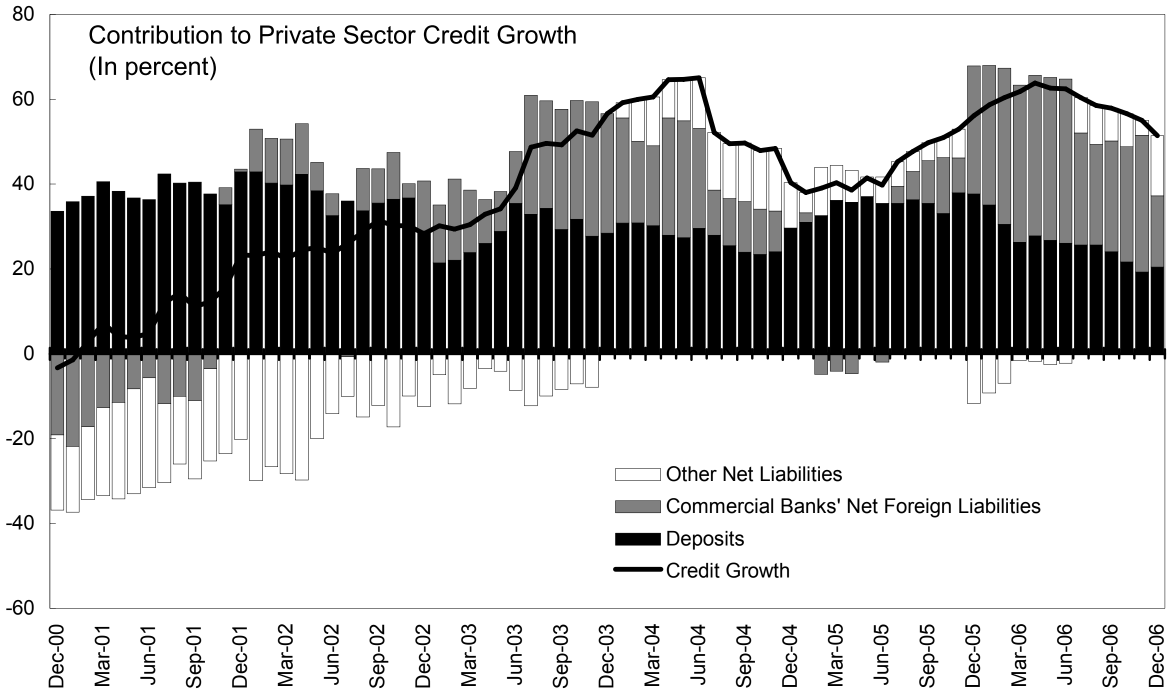
29. **Though much progress has been achieved, further improvements in the investment climate will help raise investment levels.** Among the priorities should be permitting greater scope for flexible work arrangements, exploring possibilities of migration of labor into Lithuania, reducing uncertainties in rights to land property, and streamlining the assessment of business' compliance with regulatory standards.

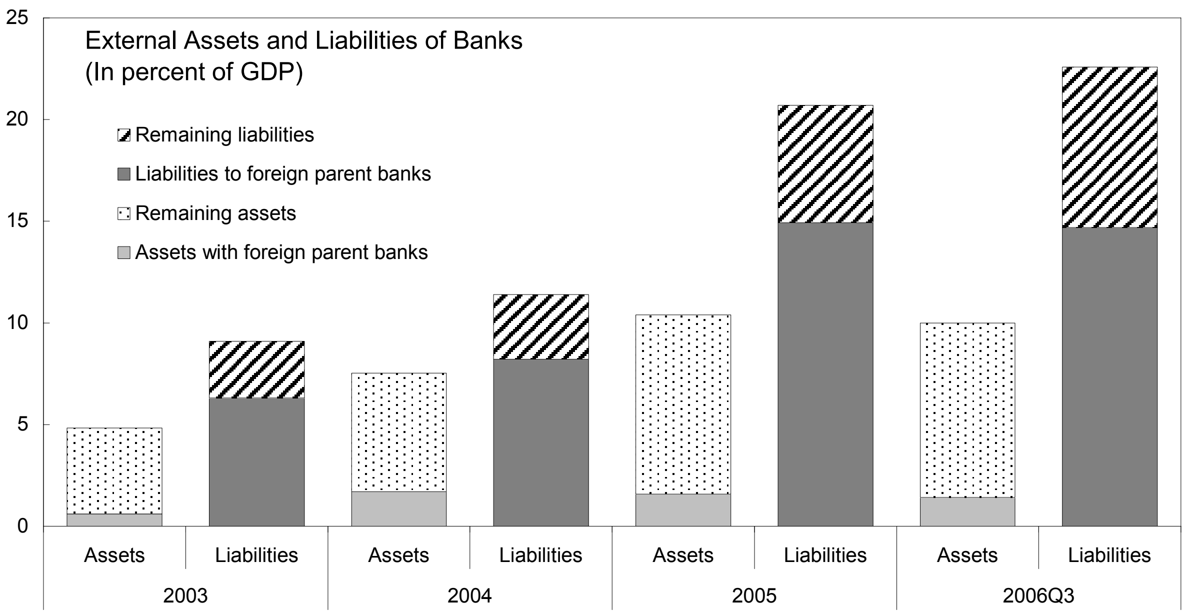
30. **The authorities' plans to improve the absorption of EU funds are welcome.** The authorities' plans to simplify claim verification and procurement regulations, particularly

where projects are small, are consistent with practices elsewhere in the region. With this greater flexibility, the role of the Ministry of Finance in project selection should be enhanced to ensure accountability.

31. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

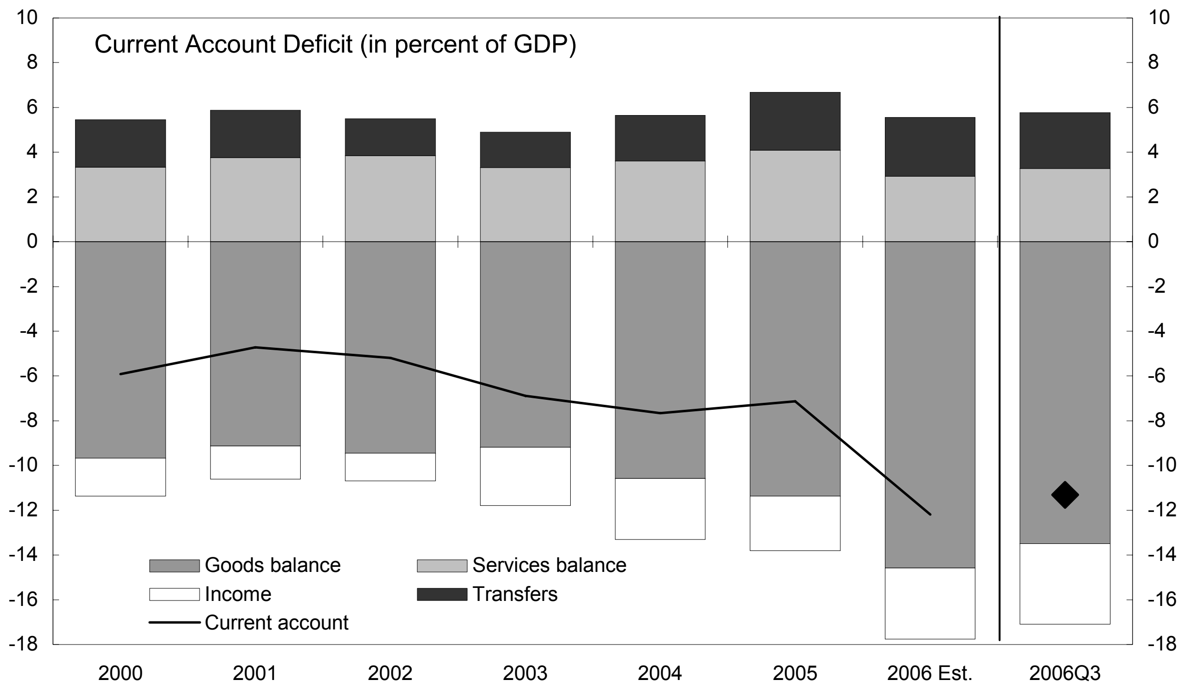
Figure 1. Lithuania: Financing of Credit Growth, 2000–06

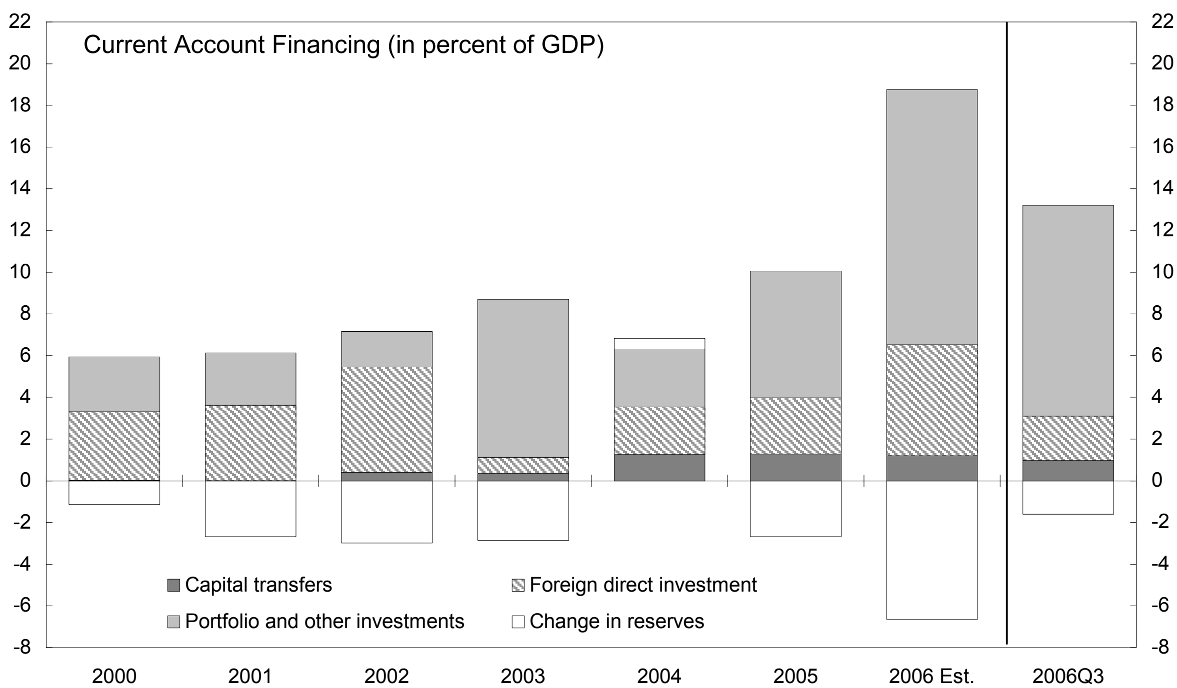




Source: Bank of Lithuania.

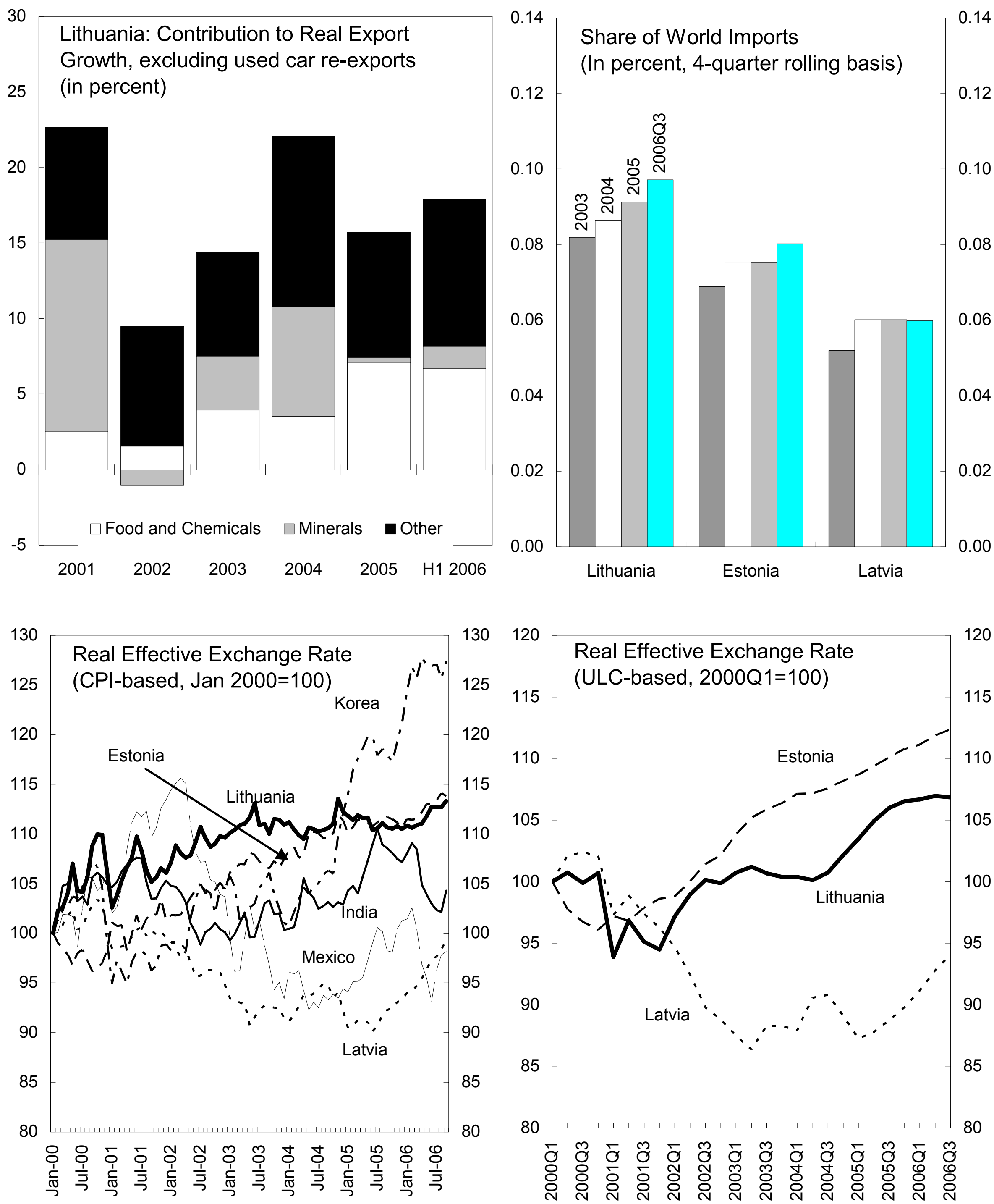
Figure 2. Lithuania: Current Account and Its Financing, 2000–06
(In percent of GDP)





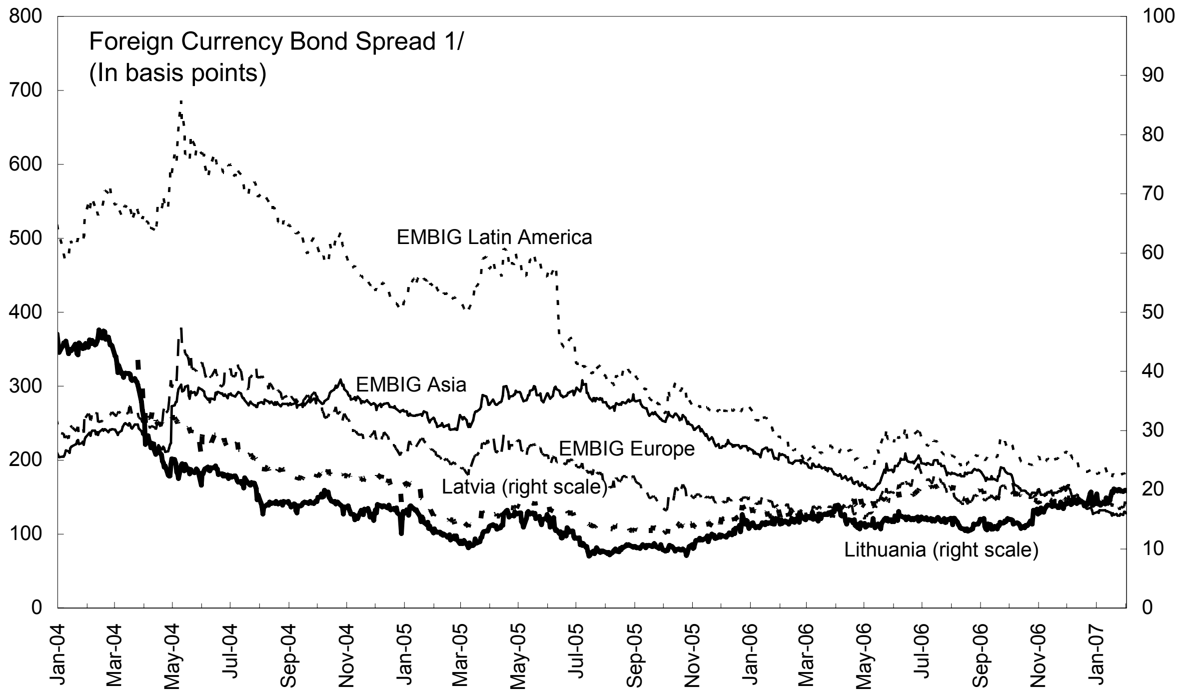
Sources: Bank of Lithuania; and Statistics Lithuania.

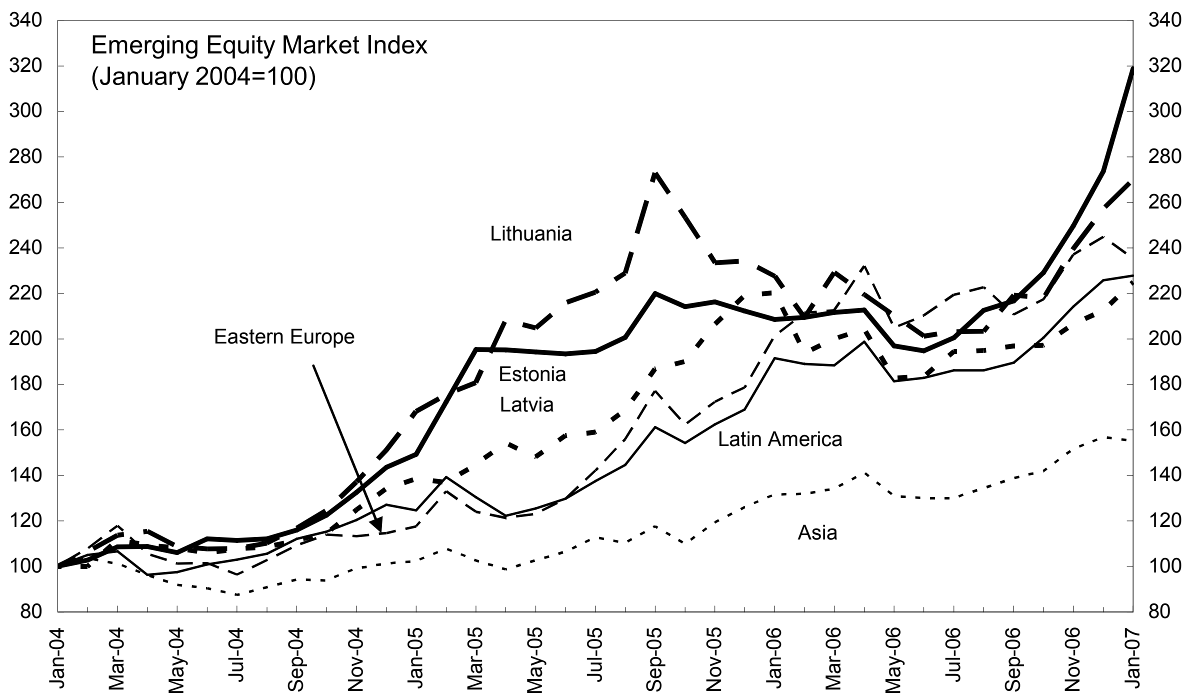
Figure 3. Competitiveness Indicators, 2000–06



Sources: Information Notice System; IMF staff estimates; Eurostat; and IMF, *Direction of Trade Statistics.*

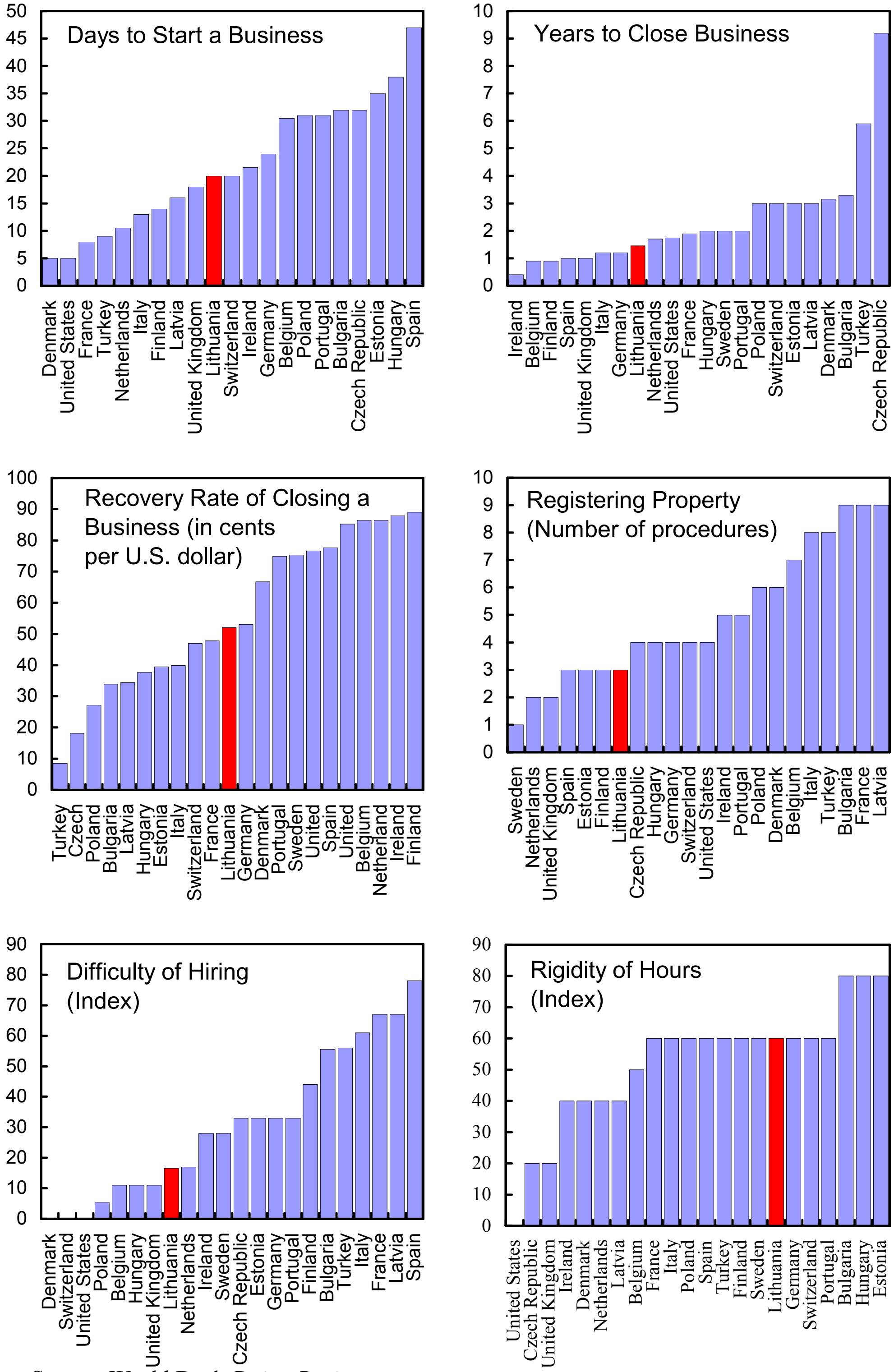
Figure 4. Baltic Countries: Financial Market Developments, 2004–07





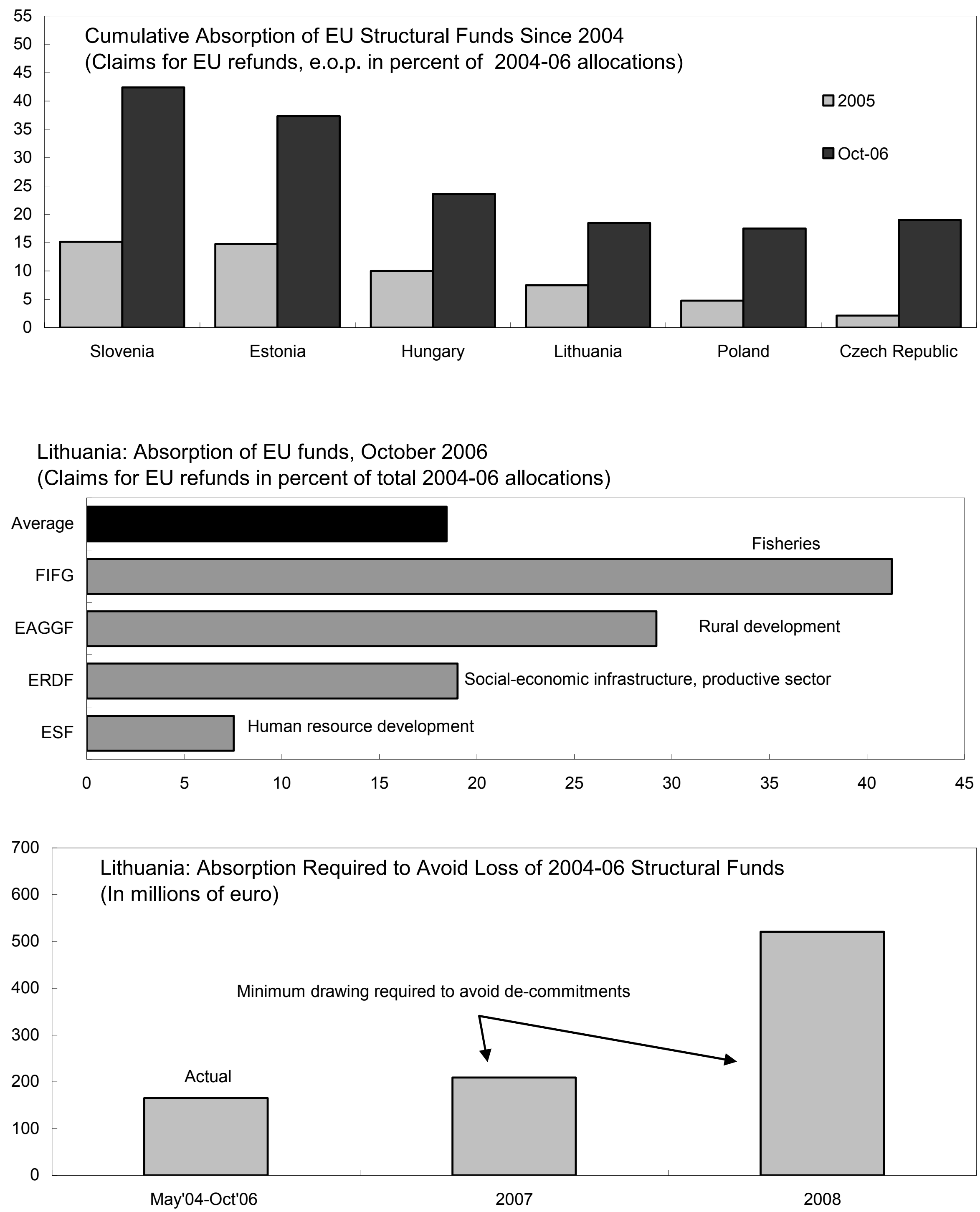
Source: Bloomberg.

Figure 5. Selected European Countries: Indicators of Business Climate, 2005



Source: World Bank *Doing Business.*

Figure 6. Lithuania: Utilization of EU Structural Funds, 2004-06



Source: Data provided by national authorities and staff estimates.

Table 1a. Lithuania: Selected Macroeconomic Indicators—Scenario 1, 2002–09

	2002	2003	2004	2005	2006	2007	2008	2009
					Est.		Projection	
National income, prices, and wages								
Nominal GDP (in millions of litai)	51,971	56,804	62,587	71,200	81,974	92,874	102,470	111,435
GDP (in millions of U.S. dollars)	14,134	18,558	22,508	25,667	29,784	35,370	39,172	42,776
Real GDP growth (year-on-year, in percent)	6.9	10.3	7.3	7.6	7.5	7.0	6.5	6.0
Average CPI (year-on-year change, in percent)	0.3	-1.1	1.2	2.7	3.8	3.5	3.4	2.5
End-of-period CPI (year-on-year change, in percent)	-0.9	-1.3	2.8	3.0	4.5	2.7	4.1	2.5
GDP deflator (year-on-year change, in percent)	0.1	-0.9	2.7	5.8	7.1	5.9	3.6	2.7
Average monthly wage (in U.S. dollars)	304.2	381.6	444.1	489.7	571.1	635.5	697.5	772.1
Unemployment rate (in percent) 1/	13.8	12.4	11.4	8.3	5.4	5.3	5.3	5.3
Labor productivity (annual percent change)	2.8	7.9	7.4	4.8	4.6	4.6	4.5	4.5
Unit labor cost (annual percent change)	11.1	16.3	8.3	5.2	11.4	8.0	7.0	5.9
Saving-investment balance (in percent of GDP)								
Gross national saving	16.9	16.4	16.3	17.9	15.9	15.3	16.0	16.3
General government	1.5	1.5	0.7	2.1	3.0	2.7	3.5	4.3
Nongovernment	15.4	14.9	15.6	15.8	12.9	12.6	12.5	12.0
Gross national investment	22.1	23.2	24.0	25.1	28.1	27.7	27.0	26.4
General government	2.9	3.1	3.2	3.4	3.5	3.9	4.1	4.4
Nongovernment	19.2	20.1	20.7	21.6	24.5	23.7	22.9	22.0
Foreign saving	5.2	6.9	7.7	7.1	12.2	12.3	11.0	10.1
Nongovernment net savings	-3.8	-5.2	-5.1	-5.8	-11.6	-11.1	-10.4	-10.0
General government fiscal balance 2/ 3/	-1.4	-1.7	-2.5	-1.3	-0.6	-1.2	-0.5	-0.1
External sector (in percent of GDP, unless otherwise specified)								
Current account balance								
in percent of GDP	-5.2	-6.9	-7.7	-7.1	-12.2	-12.3	-11.0	-10.1
in millions of U.S. dollars	-734	-1,278	-1,724	-1,831	-3,632	-4,356	-4,299	-4,320
Exports of goods and services (volume change, in percent)	19.4	6.9	4.4	14.5	13.7	10.0	8.9	6.7
Imports of goods and services (volume change, in percent)	17.7	10.4	14.9	16.0	15.7	10.5	6.4	5.0
Gross official reserves (in millions of U.S. dollars)	2,413	3,450	3,594	3,816	5,773	6,818	7,947	8,661
Reserve cover of short-term debt at remaining maturity	0.8	0.8	0.7	0.5	0.6	0.6	0.6	0.6
Gross external debt (in percent of GDP)	43.9	44.9	46.5	48.9	55.4	55.7	58.9	61.6
Short-term debt at original maturity	15.0	17.7	16.7	19.0	24.5	26.2	26.2	26.2
Exchange rates								
Exchange rate (litas/U.S. dollar, period average)	3.7	3.1	2.8	2.8	2.8	2.6	2.6	2.6
Exchange rate (litas/euro, period average)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Real effective exchange rate (2000=100, increase=appreciation) 4/	97.9	101.2	102.1	105.8	107.0	107.0	107.0	107.0
Money and credit								
Reserve money (year-on-year change, in percent)	20.8	26.6	7.1	27.6	19.3	15.4	13.6	...
Broad money (year-on-year change, in percent)	19.4	19.4	21.4	31.9	21.5	37.1	21.6	...
Private sector credit (year-on-year change, in percent)	28.3	56.6	40.3	56.1	51.4	45.4	13.5	...
Money multiplier	3.0	2.8	3.2	3.3	3.4	4.0	4.3	...
Currency/deposits (in percent)	32.2	33.6	29.7	26.2	25.4	22.2	19.4	...
Foreign currency deposits/ litas deposits (in percent)	44.8	33.1	32.7	35.0	26.1	24.8	23.6	...
Memorandum items:								
Authorities' projection for real GDP growth (in percent)	6.9	10.3	7.3	7.6	7.5	6.3-6.7	5.2-5.3	...
Authorities' projection for unemployment rate (in percent)	13.8	12.4	11.4	8.3	5.5-5.6	4.6-5.5	4.9-5.5	...

Sources: Lithuanian authorities; Information Notice System; and IMF staff estimates and projections.

1/ Based on labor force data.
2/ The figures for 2003 include the early repurchase of Lithuania's EFF by the BoL in net lending.
3/ Includes savings and property restitution payments.
4/ Unit labor cost-based, trade-weighted real effective exchange rate against 34 major trading partners.

Table 1b. Lithuania: Selected Economic and Social Indicators—Scenario 2, 2002–09

	2002	2003	2004	2005	2006	2007	2008	2009
					Est.		Projection	
Real economy								
Nominal GDP (in millions of litai)	51,971	56,804	62,587	71,200	81,974	93,836	102,023	108,421
GDP (in millions of U.S. dollars)	14,134	18,558	22,508	25,667	29,784	35,736	39,001	41,619
Real GDP growth (year-on-year, in percent)	6.9	10.3	7.3	7.6	7.5	8.0	5.0	3.5
Average CPI (year-on-year change, in percent)	0.3	-1.1	1.2	2.7	3.8	3.5	3.4	2.5
End-of-period CPI (year-on-year change, in percent)	-0.9	-1.3	2.8	3.0	4.5	2.7	4.1	2.5
GDP deflator (year-on-year change, in percent)	0.1	-0.9	2.7	5.8	7.1	5.9	3.6	2.7
Average monthly wage (in U.S. dollars)	304.2	381.6	444.1	489.7	571.1	669.0	725.7	784.4
Unemployment rate (in percent) 1/	13.8	12.4	11.3	8.3	5.4	4.3	5.4	6.3
Labor productivity (annual percent change)	2.8	7.9	7.4	4.8	4.6	4.5	4.2	4.0
Unit labor cost (annual percent change)	11.1	16.3	8.3	5.2	11.4	12.1	6.0	5.5
Saving-investment balance (in percent of GDP)								
Gross national saving	16.9	16.4	16.3	17.9	15.9	15.8	16.2	16.0
General government	1.5	1.5	0.7	2.1	3.0	3.0	3.4	3.4
Nongovernment	15.4	14.9	15.6	15.8	12.9	12.8	12.8	12.6
Gross national investment	22.1	23.2	24.0	25.1	28.1	29.5	29.4	29.1
General government	2.9	3.1	3.2	3.4	3.5	3.9	4.1	4.4
Nongovernment	19.2	20.1	20.7	21.6	24.5	25.6	25.3	24.7
Foreign saving	5.2	6.9	7.7	7.1	12.2	13.7	13.2	13.1
Nongovernment net savings	-3.8	-5.2	-5.1	-5.8	-11.6	-12.8	-12.5	-12.1
General government fiscal balance 2/ 3/	-1.4	-1.7	-2.5	-1.3	-0.6	-0.9	-0.7	-1.0
External sector (in percent of GDP, unless otherwise specified)								
Current account balance								
in percent of GDP	-5.2	-6.9	-7.7	-7.1	-12.2	-13.7	-13.2	-13.1
in millions of U.S. dollars	-734	-1,278	-1,724	-1,831	-3,632	-4,899	-5,158	-5,454
Exports of goods and services (volume change, in percent)	19.4	6.9	4.4	14.5	13.7	10.0	6.8	3.7
Imports of goods and services (volume change, in percent)	17.7	10.4	14.9	16.0	15.7	13.0	5.8	3.5
Gross official reserves (in millions of U.S. dollars)	2,413	3,450	3,594	3,816	5,773	6,170	6,360	5,943
Reserve cover of short-term debt at remaining maturity	0.8	0.8	0.7	0.5	0.6	0.5	0.5	0.5
Gross external debt (in percent of GDP)	43.9	44.9	46.5	48.9	55.4	55.2	59.0	63.1
Short-term debt at original maturity	15.0	17.7	16.7	19.0	24.5	26.2	26.2	26.2
Exchange rates								
Exchange rate (litas/U.S. dollar, period average)	3.7	3.1	2.8	2.8	2.8	2.6	2.6	2.6
Exchange rate (litas/euro, period average)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Real effective exchange rate (2000=100, increase=appreciation) 4/	97.9	101.2	102.1	105.8	107.0	109.6	109.6	109.6
Money and credit								
Reserve money (year-on-year change, in percent)	20.8	26.6	7.1	27.6	19.3	18.0	5.2	...
Broad money (year-on-year change, in percent)	19.4	19.4	21.4	31.9	21.5	44.6	16.1	...
Private sector credit (year-on-year change, in percent)	28.3	56.6	40.3	56.1	51.4	54.8	11.5	...
Money multiplier	3.0	2.8	3.2	3.3	3.4	4.1	4.5	...
Currency/deposits (in percent)	32.2	33.6	29.7	26.2	25.4	22.2	19.4	...
Foreign currency deposits/ litas deposits (in percent)	44.8	33.1	32.7	35.0	26.1	24.8	23.6	...

Sources: Lithuanian authorities; Information Notice System; and IMF staff estimates and projections.

1/ Based on labor force data.
2/ The figures for 2003 include the early repurchase of Lithuania's EFF by the BoL in net lending.
3/ Includes savings and property restitution payments.
4/ Unit labor cost-based, trade-weighted real effective exchange rate against 34 major trading partners.

Table 2. Lithuania: Summary of Consolidated General Government Operations, 2002–12

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.			Projection			
					(in millions of litai)						
Revenue	16,466	17,726	19,938	23,731	28,358	32,065	34,006	37,284	40,301	43,386	46,865
Tax revenue	10,455	11,230	12,379	14,439	17,547	19,715	20,582	22,354	24,212	26,240	28,438
Taxes on income and profits	3,870	4,515	5,429	6,461	8,286	8,832	8,491	9,261	10,036	10,926	11,884
Income tax	3,568	3,731	4,260	4,959	5,794	5,990	5,724	6,252	6,767	7,371	8,017
Corporate profit tax	302	785	1,169	1,502	2,492	2,842	2,767	3,009	3,269	3,555	3,867
Taxes on goods and services	6,181	6,301	6,599	7,704	8,936	10,518	11,689	12,658	13,705	14,802	15,990
VAT	3,843	3,836	4,006	4,842	6,108	7,313	8,154	8,813	9,527	10,259	11,049
Excises	1,750	1,872	1,905	2,040	1,950	2,210	2,438	2,651	2,881	3,133	3,407
Other	588	594	688	822	878	995	1,098	1,194	1,297	1,411	1,534
Other tax revenue	405	413	351	275	325	366	402	435	471	512	564
Social security contributions	4,493	4,851	5,746	6,450	7,778	8,697	9,192	10,001	10,826	11,556	12,354
Grants 2/	301	389	560	705	729	1,110	1,433	1,890	1,966	2,012	2,188
Other revenue	1,217	1,256	1,253	2,137	2,304	2,543	2,799	3,039	3,297	3,579	3,886
Expense	16,327	17,545	20,181	23,105	26,961	30,712	31,664	33,887	36,692	39,514	42,467
Wages and salaries, incl. contributions to SoDra	4,768	4,990	5,545	7,151	8,210	9,215	9,944	10,648	11,561	12,550	13,554
Goods and services	2,798	3,182	2,956	3,903	4,600	5,218	5,560	5,937	6,442	7,004	7,668
Grants	3	3	332	547	740	849	945	1,034	1,131	1,237	1,352
Subsidies	126	164	434	593	643	729	782	850	924	1,005	1,093
Interest payments	719	722	624	599	824	920	927	935	909	870	826
Foreign	491	480	426	403	476	533	538	542	526	502	476
Domestic	228	242	197	219	343	381	383	386	376	360	342
Social benefits	6,856	7,171	7,770	7,496	8,516	9,436	10,004	10,674	11,551	12,309	13,037
Other expense (incl. restitution payments)	1,059	1,314	2,520	2,817	3,428	4,346	3,502	3,808	4,175	4,539	4,937
Net acquisition of nonfinancial assets	881	1,137	1,348	1,547	1,882	2,487	2,903	3,472	3,608	3,872	4,397
Net lending/borrowing (borrowing (-))	-741	-957	-1,591	-922	-486	-1,134	-561	-74	0	0	0
Net acquisition of financial assets	358	-493	-646	363	...	...	...	...	...	... ...	
Net incurrence of liabilities	1,099	464	945	1,285	486	1,134	561	74	0	0	0
					(in percent of GDP; unless otherwise specified)						
Revenue	31.7	31.2	31.9	33.3	34.6	34.5	33.2	33.5	33.3	33.0	32.7
Tax revenue	20.1	19.8	19.8	20.3	21.4	21.2	20.1	20.1	20.0	19.9	19.9
Taxes on income and profits	7.4	7.9	8.7	9.1	10.1	9.5	8.3	8.3	8.3	8.3	8.3
Income tax	6.9	6.6	6.8	7.0	7.1	6.4	5.6	5.6	5.6	5.6	5.6
Corporate profit tax	0.6	1.4	1.9	2.1	3.0	3.1	2.7	2.7	2.7	2.7	2.7
Taxes on goods and services	11.9	11.1	10.5	10.8	10.9	11.3	11.4	11.4	11.3	11.2	11.2
VAT	7.4	6.8	6.4	6.8	7.5	7.9	8.0	7.9	7.9	7.8	7.7
Excises	3.4	3.3	3.0	2.9	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Other	1.1	1.0	1.1	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Other tax revenue	0.8	0.7	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social security contributions	8.6	8.5	9.2	9.1	9.5	9.4	9.0	9.0	8.9	8.8	8.6
Grants 2/	0.6	0.7	0.9	1.0	0.9	1.2	1.4	1.7	1.6	1.5	1.5
Other revenue	2.3	2.2	2.0	3.0	2.8	2.7	2.7	2.7	2.7	2.7	2.7
Expense	31.4	30.9	32.2	32.5	32.9	33.1	30.9	30.4	30.3	30.0	29.7
Wages and salaries, incl. contributions to SoDra	9.2	8.8	8.9	10.0	10.0	9.9	9.7	9.6	9.5	9.5	9.5
Goods and services	5.4	5.6	4.7	5.5	5.6	5.6	5.4	5.3	5.3	5.3	5.4
Grants	0.0	0.0	0.5	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Subsidies	0.2	0.3	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Interest payments	1.4	1.3	1.0	0.8	1.0	1.0	0.9	0.8	0.8	0.7	0.6
Foreign	0.9	0.8	0.7	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.3
Domestic	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Social benefits	13.2	12.6	12.4	10.5	10.4	10.2	9.8	9.6	9.5	9.3	9.1
Other expense (incl. restitution payments)	2.0	2.3	4.0	4.0	4.2	4.7	3.4	3.4	3.4	3.4	3.4
Net acquisition of nonfinancial assets	1.7	2.0	2.2	2.2	2.3	2.7	2.8	3.1	3.0	2.9	3.1
Net lending/borrowing (borrowing (-)) 2/	-1.4	-1.7	-2.5	-1.3	-0.6	-1.2	-0.5	-0.1	0.0	0.0	0.0
Net acquisition of financial assets	0.7	-0.9	-1.0	0.5	...	...	...	...	...	... ...	
Net incurrence of liabilities	2.1	0.8	1.5	1.8	0.6	1.2	0.5	0.1	0.0	0.0	0.0
Memorandum items:											
GDP (in millions of litai)	51,971	56,804	62,587	71,200	81,974	92,874	102,470	111,435	121,084	131,664	143,198
General government balance (excl. restitution payments)	-1.3	-1.2	-1.4	-0.4	0.3	0.0	-0.5	-0.1	0.0	0.0	0.0
General government debt	22.3	21.2	19.4	18.7	16.3	14.7	13.4	11.9	10.4	9.1	7.8
Foreign debt	13.4	12.9	11.9	11.2	9.8	8.8	8.0	7.1	6.2	5.4	4.7
Domestic debt	8.9	8.3	7.5	7.5	6.5	5.9	5.3	4.7	4.2	3.6	3.1
Cyclically adjusted general government balance (incl. restitution)	0.3	-1.4	-2.7	-2.0	-1.8	-2.8	-2.2	-1.8	-1.7	-1.7	-1.7
Potential GDP (in millions of litai, chainlinked volume)	54,864	58,019	61,355	64,883	68,646	72,627	76,840	81,296	86,012	91,000	96,278

Sources: Ministry of Finance; Ministry of Social Security; and IMF staff estimates.

1/ Grants from EU and related expenditures are not included prior to 2002.

2/ 2006 includes supplemental budget.

Table 3. Lithuania: Summary of Monetary Accounts, 2002–08
(In millions of litas; unless otherwise specified)

	2002	2003	2004	2005	2006	2007 Proj.	2008 Proj.
Monetary Authority							
Gross foreign assets	7,848	9,367	8,963	10,974	14,942	17,678	20,622
Gross foreign liabilities	372	188	12	28	236	236	236
Net foreign assets	7,476	9,179	8,951	10,946	14,706	17,442	20,386
Gold	161	185	0	0	0	0	0
Net domestic assets	-2,308	-2,638	-1,949	-2,013	-4,052	-5,150	-6,418
o/w: Net credit to government	-1,944	-2,208	-1,467	-1,399	-3,432	-4,530	-5,798
Credit to banks	16	10	10	0	0		0
Credit to private sector	13	15	16	15	12	12	12
Credit to non-bank financial institutions	0	0	0	0	0	0	0
Other items, net	-393	-455	-508	-629	-632	-632	-632
Reserve money	5,168	6,540	7,002	8,934	10,654	12,292	13,968
Currency outside the central bank	4,218	5,132	5,590	6,710	8,050	9,777	10,719
Currency outside banks	3,756	4,632	5,121	6,119	7,245	8,914	9,704
Cash in vaults of banks	462	500	468	591	805	863	1,015
Deposit money banks' deposits	930	1,397	1,396	2,211	2,593	2,503	3,237
Private and non monetary financial institutions	20	11	16	13	12	12	12
Banking Survey							
Net foreign assets	7,144	6,758	6,534	3,601	3,084	-1,961	983
Monetary authority	7,476	9,179	8,951	10,946	14,706	17,442	20,386
Banks and other banking institutions	-332	-2,421	-2,417	-7,345	-11,621	-19,403	-19,403
Net domestic assets	8,289	11,661	15,820	25,887	32,737	51,060	58,715
Net claims on government 1/	991	483	1,103	1,562	-918	-918	-918
Monetary authority 2/	-1,944	-2,208	-1,467	-1,399	-3,432	-4,530	-5,798
Banks and other banking institutions	2,934	2,691	2,569	2,961	2,514	3,612	4,880
Credit to private sector	7,420	11,620	16,303	25,455	38,545	56,048	63,625
Credit to non-bank financial institutions	984	1,362	1,723	4,033	2,894	3,714	3,792
Other items, net	-1,105	-1,803	-3,309	-5,163	-7,784	-7,784	-7,784
Broad money	15,433	18,419	22,354	29,488	35,821	49,099	59,698
Currency outside banks	3,756	4,632	5,121	6,119	7,245	8,914	9,704
Deposits	11,676	13,787	17,233	23,369	28,577	40,185	49,994
In national currency	8,063	10,360	12,989	17,314	22,662	32,202	40,463
Savings deposits	3,324	4,139	4,538	5,353	7,524	10,692	13,435
Demand deposits	4,738	6,221	8,451	11,961	15,138	21,510	27,029
In foreign currency	3,614	3,427	4,244	6,055	5,915	7,984	9,531
Memorandum items:							
Reserve money (yearly percent change)	20.8	26.6	7.1	27.6	19.3	15.4	13.6
Broad money (yearly percent change)	19.4	19.4	21.4	31.9	21.5	37.1	21.6
Private sector credit (yearly percent change)	28.3	56.6	40.3	56.1	51.4	45.4	13.5
Money multiplier	3.0	2.8	3.2	3.3	3.4	4.0	4.3
Currency / deposits (percent)	32.2	33.6	29.7	26.2	25.4	22.2	19.4
Foreign currency / litas deposits (percent)	44.8	33.1	32.7	35.0	26.1	24.8	23.6
Velocity of broad money	3.4	3.1	2.8	2.4	2.3	1.9	1.7
Gross official reserves (millions of U.S. dollars) 3/	2,310	3,325	3,476	3,768	5,720	6,818	7,947
Gross official reserves (millions of euros)	2,273	2,713	2,596	3,178	4,327	5,120	5,973

Sources: Bank of Lithuania; and Fund staff estimates and projections.

1/ Excludes local government deposits; includes counterpart funds.
2/ Data for 2001 onwards include Treasury accounts, which were moved from commercial banks to the BoL at end-June, 2001.
3/ Gross official reserves for historic data differ from the BOP table because of valuation differences.

Table 4. Lithuania: Financial Sector Indicators, 2002–06

(In percent, unless otherwise indicated)

	2002	2003	2004	2005	2006
Private sector credit (year-on-year change) 1/	28.3	56.6	40.3	56.1	51.4
Claims on private enterprises (in millions of litas)	6,125	9,059	11,285	16,091	22,701
of which: share of foreign currency loans	55.6	61.9	64.8	67.9	58.2
Claims on private enterprises (year-on-year change)	21.9	47.9	24.6	42.6	41.1
Share of claims on private enterprises in total private sector credit	82.6	78.0	69.2	63.2	58.9
Claims on individuals (in millions of litas)	1,295	2,561	5,019	9,363	15,844
of which: share of foreign currency loans	26.6	29.2	42.8	54.7	43.9
Claims on individuals (year-on-year change)	70.4	97.8	96.0	86.6	69.2
Share of claims on individuals in total private sector credit	17.4	22.0	30.8	36.8	41.1
Official risk indicators					
Nonperforming loans to total gross loans 2/	5.3	2.4	2.2	0.6	1.0
Regulatory capital to risk-weighted assets 3/	14.8	13.3	12.4	10.3	10.8
Liquid assets to current liabilities	42.0	42.4	41.7	42.9	41.9
Financial sector risk factors of deposit money banks					
Share of foreign currency private sector credit in total private sector	50.4	54.6	58.0	63.1	52.3
Share of foreign currency deposits in total deposits	33.3	27.1	27.0	28.0	22.4
Short-term private sector credit in percent of total private sector credit	71.4	76.9	81.1	84.5	86.2
Demand deposits in percent of total deposits	48.4	45.1	43.3	38.3	40.7
Bank profitability 4/					
Return on Assets	0.9	1.2	1.3	1.1	1.5
Return on Equity	9.1	11.8	13.5	13.8	21.3
Market assessment					
Spread between VILIBID and VILIBOR 5/	185	86	40	23	...
Net open position in foreign exchange to regulatory capital 6/	-1.5	10.8	-1.9	-1.0	-1.4
Total private sector credit (in millions of litas) 7/	7,420	11,620	16,303	25,455	38,545
Total resident deposits (in millions of litas) 7/	11,676	13,787	17,233	23,369	28,577
Average annual interest rate on litas loans to enterprises 8/	6.6	6.5	5.7	5.0	5.0
Average annual interest rate on litas loans to households 8/	10.9	7.0	6.4	5.8	5.2

Sources: Bank of Lithuania and National Stock Exchange of Lithuania.

1/ Includes credit to private enterprises, households, and nonprofit institutions by monetary authorities, deposit money banks, and other banking institutions.

2/ Includes foreign bank branches. From 2005, defined as loans overdue for 31 or more days, previously defined as substandard and doubtful loans and loan losses. Unconsolidated data.

3/ Foreign bank branches are excluded.

4/ Net income before extraordinary items and taxes.

5/ Interbank rates; basis points. End-year spread between the overnight Vilnius Interbank Offered rate (VILIBOR) and the overnight Vilnius Interbank Bid rate (VILIBID).

6/ Excluding foreign bank branches. Since June 1, 2000, maximum in foreign currency and precious metals is 25 percent of a bank's capital. Maximum in each currency is 15 percent.

7/ From banking survey, including monetary authorities, deposit money banks, and other banking institutions.

8/ Average annual interest rate on 1-3 month loans in litai. From 2005, average annual rate on new 0-1 year loans in litai.

Table 5. Lithuania: Financial Soundness Indicators, 2002–06 (all banking system)
(In percent, unless otherwise specified)

	2002	2003	2004	2005	2006
Capital adequacy					
Regulatory capital to risk-weighted assets [1]	14.8	13.3	12.4	10.3	10.8
Regulatory tier I capital to risk-weighted assets [1]	12.1	11.1	10.2	8.9	7.8
Capital to assets [2]	10.5	9.8	8.7	7.2	7.1
Asset quality					
Nonperforming loans net of provisions to capital [2, 3, 10]	21.1	11.7	12.6	5.7	9.7
Nonperforming loans to total (non-interbank) loans [10]	5.3	2.4	2.2	0.6	1.0
Sectoral distribution of loans to total loans [11]					
Agriculture, hunting, forestry	2.0	1.8	2.0	2.0	1.9
Fishing	0.2	0.1	0.1	0.1	0.1
Mining and quarrying	0.4	0.3	0.2	0.2	0.1
Manufacturing	21.4	21.8	17.5	15.2	11.9
Electricity, gas and water supply	7.3	7.6	6.4	4.2	2.5
Construction	4.0	3.2	2.9	3.9	5.7
Wholesale and retail trade; repair of motor vehicles, motorcycles; personal and ho	20.2	19.2	15.7	13.0	12.8
Hotels and restaurants	1.6	1.7	1.6	1.5	1.6
Transport, storage and communication	5.0	2.9	2.3	2.6	2.5
Financial intermediation	10.6	10.7	10.8	14.6	7.3
Real estate, renting and other business activities	6.8	7.6	9.8	12.5	14.5
Public administration and defence; compulsory social security	4.3	2.4	4.1	3.3	1.5
Education	0.2	0.1	0.1	0.1	0.0
Health and social work	0.4	0.6	0.8	0.5	0.3
Other utilities, social and personal services	1.4	1.1	0.9	0.7	0.9
Other types of economic activities	0.0	0.0	0.0	0.0	0.0
Loans not attributed to economic activities	14.4	18.9	24.9	25.8	36.4
Residential real estate loans to total (non-interbank) loans	11.2	14.3	18.4	21.2	24.7
All large exposures to regulatory capital [1,5]	194.7	213.1	199.6	239.0	189.3
Earnings and profitability					
Return on equity (Net income to average capital) [2,4]	9.1	11.8	13.5	13.8	21.3
Return on assets (Net income to average total assets) [4]	0.9	1.2	1.3	1.1	1.5
Interest margin to gross income	51.3	49.1	51.0	53.8	54.6
Noninterest expenses to gross income	82.7	81.6	70.9	66.6	58.7
Trading and foreign exchange gains (losses) to gross income	14.1	10.3	8.1	7.8	8.5
Personnel expenses to noninterest expenses	42.0	38.3	37.3	37.4	37.5
Spread between reference lending and reference deposit rate [6]	5.2	4.2	3.6	3.3	3.5
Liquidity					
Liquid assets to total assets [7]	29.3	27.7	28.3	26.9	24.1
Liquid assets to current liabilities [7]	42.0	42.4	41.7	42.9	41.9
Spread between highest and lowest interbank rate [8]	9.0	3.9	1.7	3.3	2.8
Customer deposits to total non-interbank loans	132.1	101.7	95.7	83.3	72.5
Foreign exchange risk					
Foreign-currency-denominated loans to total (non-interbank) loans [9]	51.5	54.6	58.3	65.8	52.8
Foreign-currency-denominated liabilities to total liabilities [9]	44.5	46.1	45.6	51.6	52.0
Net open position in foreign exchange to regulatory capital [1,12]	-1.5	10.8	-1.9	-1.0	-1.4
Equity risk and exposure to derivatives					
On balance (assets) position in equities to capital [2]	11.7	12.2	12.2	14.9	13.2
Gross assets position in financial derivatives to capital [2]	0.3	0.5	0.8	1.2	4.5
Gross liabilities position in financial derivatives to capital [2]	2.0	2.1	0.8	0.7	4.9

Source: Bank of Lithuania.

Notes: Banking system data was compiled by aggregating banks solo (i.e. no cross-border cross-sector consolidation) data. No intra-sector adjustments were made. At the present date, the discrepancy between consolidated and unconsolidated data is minor, but unconsolidated data is available on a more timely basis. FSIs were mostly derived from supervisory data and comprise all banks and foreign bank branches, incorporated in Lithuania.

1/ Without foreign bank branches.

2/ Capital is defined as banks shareholders' equity and foreign bank branches funds received from the head office.

3/ From end-2005 FSI is Nonperforming loans to capital.

4/ Net income before extraordinary items and taxes.

5/ Large exposure - means loans granted to the borrower the net value of which equals to, or exceeds, 10 per cent of bank capital that is calculated having regard to the national Rules for Calculating Capital Adequacy. In this particular case Loan - means all bank's monetary claims to the borrower, acquired shares (contributions or other portions of equity), reflected in the bank balance-sheet and off-balance sheet items, also monetary obligations of the bank recognised in the bank's off-balance.

6/ Excluding loans and deposits to / from credit and financial institutions.

7/ Composition of liquid assets and current liabilities is defined in the Liquidity Ratio Calculation Rules approved by Resolution No. 1 of the Board of the Bank of Lithuania of 29 January 2004.

8/ Information is based on interbank deals of all maturities (mostly overnights) made between resident banks in national currency Litas within the last quarter of the period.

9/ From 2005, the major part of foreign currency loans and foreign currency liabilities are in Euros.

10/ From end-2005, NPLs are loans with payments on which are overdue more than 60 days. Until 2004 NPLs are loans in Substandard, Doubtful and Loss loans categories.

11/ Credit registry data from 2005, therefore, it is considered as estimate of actual sectoral distribution.

12/ As defined in Rules for Calculation of Capital Adequacy approved by Bank of Lithuania Board Resolution No. 172 of 21 December 2000.

Table 6. Lithuania: Indicators of External and Financial Vulnerability, 2002–06

	2002	2003	2004	2005	2006 Est.	Latest Actual	Date of Observation
Financial indicators							
Broad money (year-on-year change in percent)	19.4	19.4	21.4	31.9	21.5	21.5	Dec. 2006
Broad money in percent of gross official reserves	196.7	196.7	249.4	268.7	239.7	239.7	Dec. 2006
Private sector credit (year-on-year change in percent)	28.3	56.6	40.3	56.1	51.4	51.4	Dec. 2006
External indicators							
Current account balance in percent of GDP	-5.2	-6.9	-7.7	-7.1	-12.2	-13.1	Q3 2006
Exports of GNFS (in millions of U.S. dollars)	7,510	9,536	11,749	14,880	17,049	4,602	Q3 2006
Exports of GNFS (year-on-year change in percent)	24.2	27.0	23.2	26.6	14.6	18.7	Q3 2006
Imports of GNFS (year-on-year change in percent)	24.0	28.0	25.3	25.7	22.5	35.9	Q3 2006
Capital and financial account balance in percent of GDP	4.2	6.0	6.8	7.3	12.2	13.9	Q3 2006
Gross official reserves (in millions of U.S. dollars) 1/	2,413	3,450	3,594	3,816	5,773	4,435	Q3 2006
Gross official reserves/short-term debt 2/	0.8	0.8	0.7	0.5	0.6	0.4	Q3 2006
Gross official reserves/short-term debt 3/	1.1	1.1	1.0	0.8	0.8	0.8	Q3 2006
Gross official reserves/reserve money	171.7	161.4	142.7	118.5	149.1	149.1	Dec. 2006
Gross official reserves in months of imports of GNFS over the following year	2.7	3.1	2.6	2.2	3.0	3.1	Q3 2006
Total gross external debt (in millions of U.S. dollars)	6,199	8,338	10,472	12,560	16,501	16,329	Q3 2006
in percent of GDP	43.9	44.9	46.5	48.9	55.4	54.8	Q3 2006
of which: Public sector debt (in millions of U.S. dollars)	2,429	2,793	3,136	2,879	2,936	3,306	Q3 2006
in percent of GDP	17.2	15.0	13.9	11.2	9.9	11.1	Q3 2006
of which: Short-term external debt (in millions of U.S. dollars) 3/	2,123	3,277	3,766	4,872	7,283	5,418	Q3 2006
in percent of gross international reserves	88.0	95.0	104.8	127.7	126.2	122.2	Q3 2006
in percent of GDP	15.0	17.7	16.7	19.0	24.5	18.2	Q3 2006
of which: excluding short-term liabilities of commercial banks	1,379	1,829	1,999	2,241	2,732	2,533	Q3 2006
Total net external debt (in millions of U.S. dollars) 4/	4,463	6,202	7,112	8,198	11,423	11,292	Q3 2006
in percent of GDP	31.6	33.4	31.6	31.9	38.4	37.9	Q3 2006
of which: Public sector debt (in millions of U.S. dollars)	2,429	2,793	3,136	2,879	2,936	3,306	Q3 2006
in percent of GDP	17.2	15.0	13.9	11.2	9.9	11.1	Q3 2006
Total net external short-term debt (in millions of U.S. dollars) 5/	740	1,452	1,427	2,141	3,827	2,196	Q3 2006
in percent of GDP	5.2	7.8	6.3	8.3	12.8	18.2	Q3 2006
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 7/	4.8	3.4	0.9	3.6	1.2	1.7	H1 2006
Financial market indicators							
Stock market index, end of period 8/	85	174	289	449	493	493	Dec 31, 2006
Foreign currency debt rating 9/	BBB	BBB+	A-	A	A	A	Dec. 2006
Memorandum item:							
Nominal exchange rate (litai/U.S. dollar, end-of-period)	3.3	2.8	2.5	2.9	...	2.6	Dec. 2006
Nominal exchange rate (litai/euro, end-of-period)	3.5	3.5	3.5	3.5	3.5	3.5	Dec. 2006

Sources: Bank of Lithuania, Ministry of Finance, Statistics Lithuania, National Stock Exchange of Lithuania, Bloomberg, and Information Notice System.

1/ Gross official reserves reported here differ from the monetary table due to valuation differences.
2/ On an remaining maturity basis, estimated as short-term debt at year-end plus amortization of medium- and long-term debt of the following year.
3/ On an original maturity basis.
4/ Gross external debt minus debt securities held abroad and other investments abroad.
5/ Short-term gross external debt excluding trade credits and currency and deposits held abroad.
6/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities.
7/ ULC-based REER against the 34 major trading partners in 2000.
8/ VILSE index.
9/ S&P investment grade rating.

Table 7. Lithuania: Balance of Payments, 2002–12

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.			Projection			
					(In millions of US dollars)						
Current account	-734	-1,278	-1,724	-1,831	-3,632	-4,356	-4,299	-4,320	-4,277	-4,306	-4,338
Trade balance	-1,337	-1,704	-2,382	-2,916	-4,343	-5,012	-5,065	-5,166	-5,273	-5,437	-5,611
Exports (f.o.b.)	6,031	7,658	9,305	11,776	13,492	15,420	17,365	19,113	21,044	23,182	25,488
Imports (f.o.b.)	7,368	9,363	11,688	14,692	17,835	20,432	22,430	24,278	26,317	28,620	31,100
Non-factor services, net	543	614	812	1,050	869	1,052	1,270	1,459	1,667	1,891	2,134
Credits	1,479	1,878	2,444	3,105	3,557	4,065	4,578	5,039	5,548	6,112	6,720
Debits	935	1,264	1,632	2,055	2,688	3,013	3,308	3,580	3,881	4,221	4,586
Factor income, net	-174	-482	-612	-627	-944	-1,166	-1,312	-1,450	-1,603	-1,780	-1,977
Current transfers, net	233	294	458	662	786	770	808	837	933	1,019	1,116
Capital and financial account	591	1,111	1,533	1,881	3,632	4,356	4,299	4,320	4,277	4,310	4,346
Capital transfers, net	57	68	287	331	356	913	1,260	1,541	1,293	1,303	1,446
Financial account	535	1,044	1,245	1,550	3,277	3,443	3,039	2,779	2,983	3,007	2,901
Direct investment, net	714	142	510	689	1,585	1,597	1,394	1,285	1,254	1,368	1,593
Assets	-18	-37	-263	-343	-361	-398	-418	-440	-464	-489	-516
Liabilities	732	179	773	1,032	1,947	1,995	1,812	1,725	1,718	1,857	2,109
Portfolio investment, net	-3	252	211	-237	-240	126	218	186	192	217	310
Inflows	123	222	431	542	213	472	439	353	360	400	510
Outflows	-126	30	-220	-779	-453	-346	-220	-167	-169	-183	-200
Other investment and financial derivatives, net	246	1,181	400	1,784	3,889	2,765	2,526	2,015	2,119	2,105	1,987
Inflows	89	1,310	1,081	2,557	4,501	3,235	2,999	2,488	2,602	2,598	2,492
Outflows	160	-101	-684	-786	-615	-482	-486	-487	-498	-511	-523
Net errors and omissions	143	167	192	-49	-61	...	...	...	...	...	...
Change in official reserves (-=increase)	-423	-531	124	-687	-1,957	-1,045	-1,099	-708	-582	-683	-989
Gross official reserves	2,413	3,450	3,594	3,816	5,773	6,818	7,916	8,624	9,206	9,888	10,878
Gross external debt	6,199	8,338	10,472	12,560	16,501	19,701	23,073	26,350	29,598	32,814	35,780
Public and publicly guaranteed	2,429	2,793	3,136	2,879	2,936	3,156	3,173	3,086	2,963	2,832	2,689
Private 2/	3,116	3,738	4,489	4,548	6,308	7,779	8,887	9,791	10,515	11,277	12,178
Net external debt 3/	4,463	6,202	7,112	8,198	11,423	13,933	16,610	19,246	21,842	24,380	26,640
Public and publicly guaranteed	2,429	2,793	3,136	2,879	2,936	3,156	3,173	3,086	2,963	2,832	2,689
Private	2,034	3,409	3,976	5,319	8,487	10,776	13,437	16,160	18,880	21,548	23,951
Short-term gross external debt	2,123	3,277	3,766	4,872	7,283	9,216	11,732	14,459	17,232	19,883	22,049
On an original maturity basis											
Of which:											
Trade credit	1,163	1,437	1,644	1,946	2,489	2,796	3,002	3,165	3,246	3,327	3,409
Currency and deposits at banks	219	388	695	786	967	1,182	1,252	1,295	1,341	1,392	1,448
Short-term net external debt 4/	740	1,452	1,427	2,141	3,827	5,237	7,478	10,000	12,644	15,163	17,192
Current account	-5.2	-6.9	-7.7	-7.1	-12.2	-12.3	-11.0	-10.1	-9.1	-8.4	-7.7
Trade balance of goods and services	-5.6	-5.9	-7.0	-7.3	-11.7	-11.2	-9.7	-8.7	-7.7	-6.9	-6.2
Trade balance, goods	-9.5	-9.2	-10.6	-11.4	-14.6	-14.2	-12.9	-12.1	-11.3	-10.6	-10.0
Trade balance, services	3.8	3.3	3.6	4.1	2.9	3.0	3.2	3.4	3.6	3.7	3.8
Factor income, net	-1.2	-2.6	-2.7	-2.4	-3.2	-3.3	-3.4	-3.4	-3.4	-3.5	-3.5
Current transfers, net	1.6	1.6	2.0	2.6	2.6	2.2	2.1	2.0	2.0	2.0	2.0
Capital and financial account	4.2	6.0	6.8	7.3	12.2	12.3	11.0	10.1	9.1	8.4	7.7
Capital transfers	0.4	0.4	1.3	1.3	1.2	2.6	3.2	3.6	2.8	2.5	2.6
Financial account	3.8	5.6	5.5	6.0	11.0	9.7	7.8	6.5	6.4	5.9	5.2
Direct investment, net	5.1	0.8	2.3	2.7	5.3	4.5	3.6	3.0	2.7	2.7	2.8
Portfolio investment, net	0.0	1.4	0.9	-0.9	-0.8	0.4	0.6	0.4	0.4	0.4	0.6
Other investment, net	1.7	6.4	1.8	7.0	13.1	7.8	6.4	4.7	4.5	4.1	3.5
Gross external debt 1/	43.9	44.9	46.5	48.9	55.4	55.7	58.9	61.6	63.3	64.0	63.6
Public and publicly guaranteed	17.2	15.0	13.9	11.2	9.9	8.9	8.1	7.2	6.3	5.5	4.8
Private 2/	22.0	20.1	19.9	17.7	21.2	22.0	22.7	22.9	22.5	22.0	21.6
Net external debt 3/	31.6	33.4	31.6	31.9	38.4	39.4	42.4	45.0	46.7	47.6	47.4
Public and publicly guaranteed	17.2	15.0	13.9	11.2	9.9	8.9	8.1	7.2	6.3	5.5	4.8
Private	14.4	18.4	17.7	20.7	28.5	30.5	34.3	37.8	40.4	42.0	42.6
Short-term net external debt 4/	5.2	7.8	6.3	8.3	12.8	14.8	19.1	23.4	27.0	29.6	30.6
Memorandum items:											
Nominal GDP (millions of U.S. dollars)	14,134	18,558	22,508	25,667	29,784	35,370	39,172	42,776	46,759	51,272	56,257
Exports of GNFS (nominal percent change, y-o-y)	24.2	27.0	23.2	26.6	14.6	14.3	12.6	10.1	10.1	10.2	9.9
Imports of GNFS (nominal percent change, y-o-y)	24.0	28.0	25.3	25.7	22.5	14.2	9.8	8.2	8.4	8.7	8.7
USD Exchange Rate (period average)	3.7	3.1	2.8	2.8	2.8	2.6	2.6	2.6	2.6	2.6	2.5
Short-term external debt at remaining maturity (millions of U.S.dollars)	3,160	5,086	6,630	8,009	10,414	11,434	11,997	11,449	10,532	10,390	13,707
Reserve cover of short-term external debt 6/	0.8	0.7	0.5	0.5	0.6	0.6	0.7	0.8	0.9	1.0	...
Short-term external debt (in percent of gross external debt) 6/	51.0	61.0	63.3	63.8	63.1	58.0	52.0	43.4	35.6	31.7	...
Crude oil price (US$/barrel)	25.0	28.9	37.8	53.4	64.3	54.0	57.0	57.5	57.8	58.0	58.3

Source: Data provided by the Lithuanian authorities; Information Notice System; and Fund staff estimates and projections.

1/ Including public debt and debt by banks, monetary authorities, other sectors, and related to direct investment.
2/ Including debt by other sector and related to direct investment.
3/ Gross external debt minus debt securities held abroad and other investments abroad.
4/ Short-term gross external debt excluding trade credits and currency and deposits held by banks and monetary authorities abroad.
5/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities. Includes Fund staff's estimate of amortization of short-term bank debt to parent banks in 2005.
6/ Short-term debt at remaining maturity.

Table 8. Lithuania: Macroeconomic Framework, 2002–12
(In percent of GDP; unless otherwise specified)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Projection					
Gross national saving	16.9	16.4	16.3	17.9	15.9	15.3	16.0	16.3	16.6	17.2	17.8
General government	1.5	1.5	0.7	2.1	3.0	2.7	3.5	4.3	4.2	4.2	4.3
Nongovernment	15.4	14.9	15.6	15.8	12.9	12.6	12.5	12.0	12.3	13.0	13.5
Gross national investment	22.1	23.2	24.0	25.1	28.1	27.7	27.0	26.4	25.7	25.6	25.5
Foreign saving 1/	5.2	6.9	7.7	7.1	12.2	12.3	11.0	10.1	9.1	8.4	7.7
Consolidated general government fiscal balance 2/	-1.4	-1.7	-2.5	-1.3	-0.6	-1.2	-0.5	-0.1	0.0	0.0	0.0
Current account balance	-5.2	-6.9	-7.7	-7.1	-12.2	-12.3	-11.0	-10.1	-9.1	-8.4	-7.7
Gross external debt	43.9	44.9	46.5	48.9	55.4	55.7	58.9	61.6	63.3	64.0	63.6
Memorandum items:											
Nominal GDP (in millions of litas)	51,971	56,804	62,587	71,200	81,974	92,874	102,470	111,435	121,084	131,664	143,198
Real GDP growth (year-on-year, in percent)	6.9	10.3	7.3	7.6	7.5	7.0	6.5	6.0	5.8	5.8	5.8
Average CPI (year-on-year change, in percent)	0.3	-1.1	1.2	2.7	3.8	3.5	3.4	2.5	2.5	2.5	2.5
End-of-period CPI (year-on-year change, in percent)	-0.9	-1.3	2.8	3.0	4.5	2.7	4.1	2.5	2.5	2.5	2.5

Sources: Lithuanian authorities; and IMF staff estimates and projections.

1/ Negative current account balance
2/ General government net lending/borrowing (ESA95) and including savings and restitution payments.

Table 9. Lithuania: External Debt Sustainability Framework, 2002–12
(In percent of GDP, unless otherwise indicated)

	Actual				Est.	Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Debt-stabilizing non-interest current account 6/
Baseline: External debt	43.9	44.9	46.5	48.9	55.4	**55.7**	**58.9**	**61.6**	**63.3**	**64.0**	**63.6**	**-6.7**
Change in external debt	0.5	1.1	1.6	2.4	6.5	0.3	3.2	2.7	1.7	0.7	-0.4	
Identified external debt-creating flows (4+8+9)	-6.0	-4.3	-2.4	-1.1	1.2	-0.6	1.7	1.9	1.0	-0.1	-1.2	
Current account deficit, excluding interest payments	3.7	5.6	6.5	6.1	10.8	10.6	9.3	8.3	7.3	6.5	5.8	
Deficit in balance of goods and services	5.6	5.9	7.0	7.3	11.7	11.2	9.7	8.7	7.7	6.9	6.2	
Exports	53.1	51.4	52.2	58.0	57.2	55.1	56.0	56.5	56.9	57.1	57.3	
Imports	58.7	57.3	59.2	65.2	68.9	66.3	65.7	65.1	64.6	64.1	63.4	
Net non-debt creating capital inflows (negative)	-5.1	-0.8	-2.2	-2.5	-4.3	-4.2	-3.9	-3.2	-2.9	-2.9	-3.2	
Automatic debt dynamics 2/	-4.7	-9.2	-6.8	-4.7	-5.4	-7.0	-3.7	-3.2	-3.4	-3.7	-3.8	
Contribution from nominal interest rate	1.4	1.3	1.1	1.0	1.4	1.7	1.7	1.8	1.8	1.9	1.9	
Contribution from real GDP growth	-2.6	-3.4	-2.7	-3.1	-3.2	-3.3	-3.3	-3.2	-3.3	-3.3	-3.4	
Contribution from price and exchange rate changes 3/	-3.5	-7.0	-5.2	-2.6	-3.6	-5.5	-2.1	-1.7	-2.0	-2.2	-2.3	
Residual, incl. change in gross foreign assets (2-3) 4/	6.5	5.4	4.0	3.5	5.3	0.9	1.4	0.8	0.7	0.7	0.8	
External debt-to-exports ratio (in percent)	82.5	87.4	89.1	84.4	96.8	101.1	105.1	109.1	111.3	112.0	111.1	
Gross external financing need (in billions of US dollars) 5/	6.3	9.2	11.9	12.3	17.3	22.2	25.8	30.1	34.5	39.1	43.3	
in percent of GDP	44.8	49.7	52.8	47.9	58.1	62.6	65.9	70.3	73.7	76.0	76.8	
Scenario with key variables at their historical averages 6/						**54.4**	**53.9**	**52.9**	**51.8**	**50.8**	**49.9**	**-8.4**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.9	10.3	7.3	7.6	7.5	7.0	6.5	6.0	5.8	5.8	5.8	
GDP deflator in US dollars (change in percent)	8.8	19.0	13.0	6.0	7.9	11.0	4.0	3.1	3.4	3.8	3.8	
Nominal external interest rate (in percent)	3.9	3.9	3.0	2.5	3.3	3.7	3.4	3.3	3.3	3.3	3.2	
Growth of exports (US dollar terms, in percent)	24.2	27.0	23.2	26.6	14.6	14.3	12.6	10.1	10.1	10.2	9.9	
Growth of imports (US dollar terms, in percent)	24.0	28.0	25.3	25.7	22.5	14.2	9.8	8.2	8.4	8.7	8.7	
Current account balance, excluding interest payments	-3.7	-5.6	-6.5	-6.1	-10.8	-10.6	-9.3	-8.3	-7.3	-6.5	-5.8	
Net non-debt creating capital inflows	5.1	0.8	2.2	2.5	4.3	4.2	3.9	3.2	2.9	2.9	3.2	
B. Bound Tests												
Non-interest current account is at historical average minus one standard deviations						**57.1**	**61.6**	**65.5**	**68.3**	**70.1**	**70.7**	**-7.0**

Source: IMF staff calculations.

1/ The projections of the stock of external debt were substantially revised upward between the 2005 Article IV consultation and the 2006 Article IV consultation.
2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
4/ For projection, line includes the impact of price and exchange rate changes.
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 10. Lithuania: Public Sector Debt Sustainability Framework, 2002–12
(In percent of GDP, unless otherwise indicated)

	Actual				Est.	Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	22.3	21.2	19.4	18.7	16.3	**14.7**	**13.4**	**11.9**	**10.4**	**9.1**	**7.8**	**-0.7**
o/w foreign-currency denominated	14.9	13.8	13.7	13.2	11.5	10.3	9.4	8.4	7.3	6.4	5.5	
Change in public sector debt	-0.5	-1.1	-1.8	-0.7	-2.4	-1.6	-1.3	-1.5	-1.4	-1.3	-1.2	
Identified debt-creating flows (4+7+12)	-1.7	-2.8	-0.2	1.1	-2.4	-1.6	-1.3	-1.5	-1.4	-1.3	-1.2	
Primary deficit	0.0	0.4	1.5	0.5	-0.4	0.2	-0.4	-0.8	-0.8	-0.7	-0.6	
Revenue and grants	31.7	31.2	31.9	33.3	34.6	34.5	33.2	33.5	33.3	33.0	32.7	
Primary (noninterest) expenditure	31.7	31.6	33.4	33.8	34.2	34.8	32.8	32.7	32.5	32.3	32.2	
Automatic debt dynamics 2/	-3.0	-3.0	-2.0	0.4	-1.5	-1.4	-0.5	-0.3	-0.2	-0.2	-0.2	
Contribution from interest rate/growth differential 3/	-0.1	-0.6	-1.0	-1.5	-1.5	-0.9	-0.5	-0.3	-0.2	-0.2	-0.2	
Of which contribution from real interest rate	1.4	1.5	0.4	-0.2	-0.2	0.1	0.4	0.5	0.4	0.4	0.3	
Of which contribution from real GDP growth	-1.5	-2.1	-1.4	-1.3	-1.2	-1.0	-0.9	-0.7	-0.6	-0.6	-0.5	
Contribution from exchange rate depreciation 4/	-2.9	-2.4	-1.1	1.9	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.3	-0.2	0.3	0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	
Privatization receipts (negative)	-0.5	-1.6	-0.7	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	1.7	1.4	1.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.1	1.7	-1.6	-1.8	-0.1	-0.5	0.0	0.0	0.0	-0.1	-0.1	
Public sector debt-to-revenue ratio 1/	70.4	68.0	61.0	56.1	47.1	42.5	40.3	35.4	31.3	27.5	23.9	
Gross financing need 6/	7.1	7.7	9.2	-0.2	1.9	2.4	1.2	1.4	1.2	1.1	1.0	
in billions of U.S. dollars	1.0	1.4	2.1	0.0	0.6	0.8	0.5	0.6	0.5	0.6	0.6	
Scenario with key variables at their historical averages 7/						**16.7**	**17.6**	**18.5**	**19.4**	**20.2**	**21.0**	**-0.7**
Scenario with no policy change (constant primary balance) in 2005-2010						**14.0**	**12.7**	**11.6**	**10.5**	**9.4**	**8.3**	**-0.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.9	10.3	7.3	7.6	7.5	7.0	6.5	6.0	5.8	5.8	5.8	
Average nominal interest rate on public debt (in percent) 8/	6.5	6.2	5.2	4.9	6.2	6.9	6.8	6.8	6.9	6.9	6.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.4	7.2	2.5	-0.8	-0.9	1.0	3.2	4.1	4.1	4.0	4.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	20.8	19.9	9.0	-12.9	0.8	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	0.1	-0.9	2.7	5.8	7.1	5.9	3.6	2.7	2.8	2.9	2.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.5	9.9	13.4	8.8	8.8	8.8	0.6	5.4	5.2	4.9	5.2	
Primary deficit	0.0	0.4	1.5	0.5	-0.4	0.2	-0.4	-0.8	-0.8	-0.7	-0.6	

Source: IMF staff estimates.

1/ General government gross debt.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP. 8-year historical averages due to lack of consistent general government debt data for 1995-1996
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2007 Article IV Consultation—Informational Annexes

Prepared by the European Department

March 9, 2007

Contents Page

ANNEX I. LITHUANIA: FUND RELATIONS
(As of December 31, 2006)

Mission: January 18–30, 2007. The concluding statement of the mission is available at http://www.imf.org/external/np/ms/2007/013007.htm.

Staff team: Mr. Mody (head), Ms. Ohnsorge, and Ms. Stolz (all EUR), and Mr. Krelove (FAD). Mr. Sierhej, Regional Representative Office, Warsaw, joined the mission during January 24-26. Messrs. Sigurgeirsson and Minkevicius (both from the Executive Director's office) also joined the mission.

Country interlocutors: Minister of Finance and Governor of the Bank of Lithuania. Officials at the Ministry of Finance, the Bank of Lithuania, the President's Palace, the Prime Minister's Office, the Ministry of Social Security and Labor, the Ministry of Economy, the Ministry of Interior, the Social Security Fund, the Securities Commission, the Insurance Supervisory Commission, and the Energy Price Commission. Representatives of Parliament, commercial banks, the stock exchange, insurance companies, asset management companies, the Free Market Institute, the Employers' Association, the European Commission and the diplomatic community.

Fund relations: The previous consultation took place during February 1–14, 2006. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2006/pn0651.htm and the staff report and other mission documents at http://www.imf.org/external/pubs/cat/longres.cfm?sk=19197.0. Lithuania has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on the making of payments and transfers on current international transactions except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Data: Lithuania subscribes to the Fund's Special Data Dissemination Standard, and comprehensive economic data are available on a timely basis (Appendix II).

Anti-money laundering and combating financing of terrorism: In 2006, MONEYVAL evaluated Lithuania's anti-money laundering (AML) and combating the financing of terrorism (CFT) system and concluded that the system was quite sound on paper; however, the report raised questions about the implementation of AML/CFT measures. A draft law on the Prevention of Money Laundering has been circulated to the relevant authorities for their comments.

I. Membership Status: Joined April 29, 1992; Article VIII.

II. General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	144.20	100.00
Fund holdings of currency	144.18	99.99
Reserve position	0.03	0.02

III. SDR Department:	**SDR Million**	**Percent of Allocation**
Holdings	0.07	N/A

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	8/30/2001	3/29/2003	86.52	0.00
Stand-by	3/8/2000	6/7/2001	61.80	0.00
EFF	10/24/1994	10/23/1997	134.55	134.55

VI. Projected Payments to Fund: None

VII. Implementation of HIPC Initiative: Not applicable.

VIII. Implementation of MDRI Assistance: Not applicable.

IX. Current Status of Safeguards Assessments:

Under the Fund's safeguards assessment policy, Bank of Lithuania (BOL) was subject to an assessment with respect to the Stand-By Arrangement, which was approved on August 30, 2001 and expired on March 29, 2003. A safeguards assessment of the BOL was completed on December 10, 2001. The assessment identified certain weaknesses and proposed appropriate recommendations as reported in the IMF Country Report No. 01/160. The BOL has decided to implement these recommendations under a timetable agreed with the Fund.

X. Exchange Arrangements:

The currency of Lithuania is the litas. From April 1, 1994 to February 1, 2002, the litas was pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement. Since February 2, 2002 the litas has been pegged to the euro at LTL 3.4528 per euro. Lithuania joined the European Union (EU) on May 1, 2004, and ERM II on June 28, 2004. Lithuania has accepted the obligations of Article VIII of the Fund’s Article of Agreement and maintains an exchange system free of restrictions on the making of payment and transfers for current international transactions except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

X. Article IV Consultation:

Lithuania is on the 12-month consultation cycle.

XI. FSAP Participation and ROSCs:

FSAP work program was completed in February 2002. An FSAP update is planned for September 2007. STA ROSC, and Fiscal ROSC were completed in December 2002 and November 2002, respectively.

XII. Technical Assistance:

The following table summarizes the technical assistance missions provided by the Fund to Lithuania since February 1997.

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1997–2004

Department	Issue	Action	Date	Counterpart
FAD	Treasury operations	Mr. Ramachandran	Feb/Mar. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Jun. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Aug/Sep. 1997	Ministry of Finance
STA	Balance of payments statistics	Mr. Allen	Aug/Sep. 1997	Department of Statistics
FAD	Treasury operations	Mr. Ramachandran	Nov/Dec. 1997	Ministry of Finance
MAE	Monetary policy and banking supervision	Mission	Dec. 1997	Bank of Lithuania
STA	National accounts and balance of payments	Mr. Gschwindt de Gyor	Dec. 1997	Department of Statistics
FAD	Treasury operations	Mr. Ramachandran	Jan. and April 1998	Ministry of Finance
STA	Multipurpose statistics	Mr. Allen	Resident Advisor, 1997-98	Department of Statistics, Bank of Lithuania, and Ministry of Finance
STA	Balance of payments	Mr. Gschwindt de Gyor	April 1999	Department of Statistics and Bank of Lithuania
FAD	Expenditure policy	Mission	June/July 99	Ministry of Finance
FAD	Treasury operations	Mission	November 1999	Ministry of Finance
MAE	Monetary policy	Mr. Ketterer	Resident Advisor, May 1997-November 1999	Bank of Lithuania
STA	Balance of payments statistics (also covering Latvia)	Mr. Buxton	Resident Advisor, October 1999–October 2000	Bank of Lithuania
LEG	Bankruptcy legislation	Mr. Dimitrachkov	March 2000	Ministry of Economy
FAD	Establishment of Fiscal Reserve Fund	Mission	July 2000	State Privatization Fund
MAE	Multi-topic	Mission	March 2001	Bank of Lithuania
FAD	Tax policy issues	Mission	June 13-26, 2001	Ministry of Finance
STA	ROSC	Mission	May 8-22, 2002	Department of Statistics, Ministry of Finance, and Bank of Lithuania
FAD	ROSC	Mission	July 10-23, 2002	Ministry of Finance
FAD	Treasury Operations	Mr. Ramachandran	Nov 22-Dec 5 2004	Ministry of Finance
FAD	Decentralization	Mission	Dec 3-Dec 15 2004	Ministry of Finance
STA	External debt statistics	Mission	Aug 2-4, 2006	Bank of Lithuania

XIII. Resident Representative: Christoph Rosenberg (stationed in Warsaw, Poland)

ANNEX II. LITHUANIA: STATISTICAL ISSUES

Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are generally of sufficiently good quality to support economic analysis.

Lithuania subscribed to the Special Data Dissemination Standard (SDDS) in May 1996, and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since April 1997. Lithuania meets the SDDS specifications for coverage, periodicity and timeliness of the data, and for the dissemination of the advance release calendars. A significant amount of information is now available on various websites through the Internet (see section on Dissemination of Statistics, below). A ROSC data module was published in November 2002.

National Accounts

The national accounts are compiled by Statistics Lithuania (SL) (the former Department of Statistics) in accordance with the guidelines of the *European System of Accounts 1995* (*ESA 95*). Quarterly GDP estimates at current and at constant prices are compiled both from the production and expenditure approaches. GDP estimates by production are considered to be more reliable than the corresponding estimates by expenditure, but no statistical discrepancies between these two estimates are shown in the published figures as the discrepancies are included in the estimates of changes in inventories. In general, good data sources and sound methods are used, for the compilation of the national accounts, but difficulties remain in measuring the economic activity of the informal sector. These latter estimates are compiled at detailed levels of economic activity using fixed coefficients derived from a benchmark survey conducted in 1996. The base year for the fixed price series was changed to 2000 in early 2003.

Price Data

Since December 1998, CPI weights have been updated annually. The monthly CPI is available in the second week following the reference month. The producer price index is calculated according to the chain-linked Laspeyres formula with weights updated every year.

Public Finance

Data on the central government budget execution are available quarterly, although these data are subject to frequent revisions. The ongoing treasury project is expected to improve fiscal data quality substantially. However, further work is needed to clarify the treatment of public health care providers and of EU transactions, and the consolidation procedure for government operations. A new classification, incorporating the *GFSM2001* was approved in mid-2003. Since then, the MoF has been reporting to STA general government's annual data on an accrual and cash basis (except for local governments, which are still on a cash basis) for publication in the *Government Finance Statistics Yearbook* (GFSY).

Money and Banking

The Bank of Lithuania (BoL) reports monetary and financial statistics (MFS) to STA on a timely and regular basis. The scope, concepts and definitions of the MFS are broadly in line with the guidelines of the *Monetary and Financial Statistics Manual (MFSM)*. In compliance with the ECB requirements on pre-accession countries, the BoL's Banking and Monetary Statistics Division generally follows ECB regulations (*1995 ESA*) on sectorization, valuation and classification of financial instruments.

External Sector

The BoL is responsible for compiling balance of payments, international investment position (IIP), external debt and international reserves statistics. The BoL reports quarterly data on balance of payments, IIP and monthly international reserves to STA on a timely and regular basis. Balance of payments data (on a monthly and quarterly basis) are compiled using the format recommended in the *Balance of Payments Manual*, fifth edition (*BPM5*). The monthly data correspond to several key balance of payments components, compiled on the basis of a sample survey covering the public sector, commercial banks, and some nonfinancial private sector institutions. The Data Template on International Reserves and Foreign Currency Liquidity is disseminated monthly according to the operational guidelines and is hyperlinked to the Fund's DSBB. Since late 2004, the BoL disseminates quarterly external debt data in the World Bank's Quarterly External Debt Statistics (QEDS) database.

Dissemination of Statistics

The authorities publish a range of economic statistics through a number of publications, including the SL's monthly publication, *Economic and Social Developments,* and the BoL's monthly *Bulletin*. A significant amount of data are available on the Internet:

- Lithuania's metadata for data categories defined by the Special Data Dissemination Standard are posted on the IMF's DSBB (http://dsbb.imf.org);

- the BoL website (http://www.lb.lt) provides data on monetary statistics, treasury bill auction results, balance of payments, IIP, external debt and other main economic indicators;

- the SL website (http://www.stat.gov.lt) provides monthly and quarterly information on economic and social development indicators;

- the MoF (http://www.finmin.lt) home page includes data on the national budget, as well as information on laws and privatization; and

- the Vilnius Stock Exchange website (http://www.lt.omxgroup.com.?lang=en) has information on stock trading.

LITHUANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF FEBRUARY 22, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	Feb 22, 07	Feb 22, 07	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jan. 31, 07	Feb. 5, 07	M	M	M		
Reserve/Base Money	Dec. 31, 06	Jan. 15, 07	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	Dec. 31, 06	Feb. 15, 07	M	M	M		
Central Bank Balance Sheet	Dec. 31, 06	Jan. 15, 07	M	M	M		
Consolidated Balance Sheet of the Banking System	Dec. 31, 06	Feb. 15, 07	M	M	M		
Interest Rates[2]	Feb. 22, 07	Feb 22, 07	M	M	M		
Consumer Price Index	Jan. 07	Feb. 07	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3/06	Dec. 06	Q	Q	Q	LO,LO,LO,O	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Q3/06	Dec. 06	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q3/06	Dec. 06	M	M	M		
External Current Account Balance	Q3/06	Jan. 07	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	Dec. 06	Jan. 07	M	M	M		
GDP/GNP	Q4/06	Feb. 07	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q3/06	Dec. 06	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 07/43
FOR IMMEDIATE RELEASE
April 3, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with the Republic of Lithuania

On March 26, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Lithuania.[1]

Background

The catch-up in per capita income toward the European average, underpinned by robust productivity growth, has been impressive. With this success, however, imbalances have also appeared. On the demand side, growth has been maintained by the nexus of consumption growth, rising real wages, and declining unemployment. Recent growth rates of 7½ percent may be unsustainable if rising wages erode international competitiveness. The annual average inflation rate has picked up to 3¾ percent and will likely remain above the Maastricht reference value as long as demand pressures continue and prices converge to European levels.

The fiscal stance has added to demand pressures. Strong revenue overperformance contributed to a small narrowing of the general government deficit on a cyclically adjusted basis. However, when the impact of EU funds is included, the aggregate of government and EU-related operations continued to provide an economic stimulus of ½ percent of GDP in 2006.

The current account deficit widened significantly to 12¼ percent of GDP in 2006. The principal cause was rapid growth in nominal imports, but production shortfalls at the oil refinery also

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

contributed to the widening deficit. Nevertheless, export performance was strong with rising export market share and a continued switch from low- to medium-technology goods. FDI inflows (about 5½ percent of GDP) were boosted by the government's partial sale of the oil refinery and EU funds financed a further 1¼ percent of GDP of the current account deficit. Reserves increased to 57 percent of short-term debt in December 2006.

Despite continued rapid credit growth, buffers in the financial system appear sufficient to cover bank-specific risks. Banks' capital adequacy ratio has increased to 10¾ percent of risk-weighted assets following capital injections in late 2006. Nonperforming loans have modestly increased to 1 percent of total loans at end-2006, but the deterioration was of a nonsystemic nature. Aggregate stress tests indicate that a three-to-five-fold increase in nonperforming loans would not reduce the banking system's capital below the regulatory minimum.

Executive Board Assessment

Executive Directors welcomed the continued bright prospects of the Lithuanian economy, its potential for income catchup with other EU countries, its resilience to shocks, and its ability to climb the technology and quality ladder.

Directors noted that early precautionary measures could ensure that the substantial progress made so far is preserved. GDP growth has been maintained by the nexus of consumption growth, rising real wages, and falling unemployment. Directors expressed concern that the high rate of growth may be unsustainable, if wage increases outpace productivity growth and undermine international competitiveness. Pointing to rising inflation, Directors cautioned that euro adoption in 2009 or 2010 remains uncertain, and advised adoption of a more precautionary stance in four areas: fiscal consolidation; tax and expenditure reforms; measures to further strengthen the financial sector; and structural measures to moderate wage growth and enhance productivity growth.

Directors generally recommended a more ambitious fiscal adjustment, with most advocating a front-loaded fiscal consolidation, combined with a move to medium-term structural balance. Such a consolidation would help cool the economy, contain macroeconomic imbalances, improve prospects of euro adoption, and increase future policy flexibility.

Directors advised a variety of tax, expenditure, and procedural fiscal reforms to enhance fiscal sustainability and accountability. They noted that eliminating tax exemptions—which currently accrue in substantial measure to those who do not need support—would broaden the tax base and make the tax system fairer. Consideration could also be given to an earned income tax credit, which if properly designed, could enhance the simplicity and efficiency of the tax and social benefit system, while better targeting income support to low-income families. Directors reiterated the need for improving expenditure efficiency in the social sector, especially health care and the social benefit system. Directors welcomed the authorities' plans to introduce a Fiscal Responsibility Act (FRA), especially if it includes greater budget transparency and scrutiny of the budgeting process. They recommended that a more ambitious medium-term expenditure framework be embedded into any FRA.

Directors agreed that buffers in the financial system appear sufficient to cover nonsystemic risks. Nevertheless, they expected the Financial Sector Assessment Program update in late 2007 to provide further analysis of the effects on the financial sector of a macroeconomic slowdown, including a correction in the real estate market. Directors also cautioned that the variance in the strength and performance of banks requires continued vigilance in supervision.

Directors noted that further improvements in the business climate are needed to increase investment. These should focus on strengthening labor market flexibility, clarifying land property rights and land use procedures, and streamlining assessments of business compliance with regulatory standards.

Directors praised the authorities' plans to enhance the absorption of EU funds. They noted that the planned simplification of claim verification and procurement regulation, especially for small projects, is in line with practices in other countries in the region. Complementing these measures with an enhanced role of the Ministry of Finance in project selection would increase accountability.

Republic of Lithuania: Selected Economic Indicators

	2002	2003	2004	2005	2006
Real Economy			(In percent)		
Real GDP growth	6.9	10.3	7.3	7.6	7.5
CPI inflation (end of period)	-0.9	-1.3	2.8	3.0	4.5
Unemployment rate (end of year)	13.8	12.4	11.4	8.3	5.4
Public Finance			(In percent of GDP)		
General government overall balance	-1.4	-1.7	-2.5	-1.3	-0.6
Total general government debt	22.3	21.2	19.4	18.7	16.3
Public and publicly guaranteed external general government debt	17.2	15.0	13.9	11.2	9.9
Money and Credit			(Year-on-year percent change)		
Reserve money	20.8	26.6	7.1	27.6	19.3
Broad money	19.4	19.4	21.4	31.9	21.5
Private sector credit	28.3	56.6	40.3	56.1	51.4
Balance of Payments			(In percent of GDP; unless otherwise specified)		
Trade balance	-5.6	-5.9	-7.0	-7.3	-11.7
Current account balance	-5.2	-6.9	-7.7	-7.1	-12.2
Gross international reserves (in millions of U.S. dollars)	2,413	3,450	3,594	3,816	5,773
Exchange Rates			(Litai per U.S. dollar)		
Exchange rate (period average)	3.7	3.1	2.8	2.8	2.8
Exchange rate (end of period)	3.3	2.8	2.5	2.9	2.6

Sources: Lithuanian authorities; and IMF staff estimates.