INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/113

REPUBLIC OF LITHUANIA

May 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF LITHUANIA

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 2014 Article IV consultation with the Republic of Lithuania, the following documents have been released and are included in this package:

- **Staff Report** prepared by a staff team of the IMF, for the Executive Board's consideration on May 5, 2014, following discussions that ended on March 3, 2014 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 April 16, 2014.
- **Informational Annex** prepared by the IMF.
- **Press Release** summarizing the views of the Executive Board as expressed during its May 5, 2014 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for the Republic of Lithuania.

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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

April 16, 2014

KEY ISSUES

Context and Outlook. The economy has entered a broadly favorable trajectory of healthy and balanced growth, thanks to a multi-year reform effort. Output should surpass its pre-crisis peak of 2008 for the first time this year, but now in a sustainable manner. Downside risks dominate however, reflecting primarily external factors. The income gap with Western Europe remains considerable, underscoring the need for continued policy discipline and reform. The momentum will need to come increasingly from structural changes as dividends from macroeconomic adjustment run their course. Analysis of key structural issues in this report draws on the companion Baltic Cluster Report.

Euro Adoption. Lithuania is well placed to adopt the euro next year, in terms of entry criteria, sustainability of low inflation and public finances, and external stability. It will be a welcome boon to the economy, enhancing financial stability and bringing integration gains. But upgrading supporting policy frameworks, especially to better control the business cycle, will be imperative for EMU membership to be a lasting success.

Fiscal Policy. The repair of public finances is well advanced but not yet complete. More consolidation is needed to reach the medium-term objective and materially bring down the debt ratio after its relentless post-crisis increase. It should come from high-quality revenue measures; a public expenditure review would help ensure spending efficiency within an overall tight envelope.

Financial Stability. Financial stability has improved further and the main challenge now is resuscitating private sector credit growth to support investment.

Structural Reforms. Tackling high structural unemployment, securing a vibrant export sector for the future, and pushing ahead with key infrastructure projects in energy and transport are important priorities.

Approved By
Reza Moghadam and Mark Flanagan

Discussions were held in Vilnius during February 20–March 3, preceded by a one-day visit to Sweden. The findings of the Baltic Cluster Report were discussed in a seminar in Riga on March 4. The team comprised Mr. Klingen (head) and Mses. Everaert, Geng, and Poirson (all EUR). Ms. Arust (OED) joined the mission. Partners from the EC attended some meetings as observers.

CONTENTS

ANNEXES

ANNEX FIGURES

ANNEX TABLES

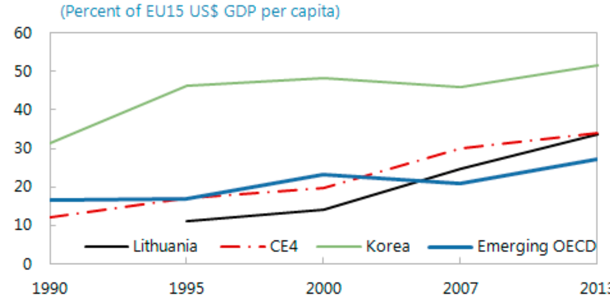
CONTEXT

1. The authorities remain on track with public finance repair and meeting conditions for euro adoption. Scope for bold reforms is limited in the four-party coalition led by the Social Democrats since late 2012, but two key projects are advancing well: (i) Prime Minister Butkevicius has staked his political survival on successfully adopting the euro next year, with the Lithuanian economy now well placed to do so, and (ii) fiscal consolidation is moving further ahead, with the public debt ratio now on the verge of starting to decline. Presidential and European elections are due in May. Incumbent President Grybauskaite is running as an independent and is leading opinion polls by a large margin.

2. The economy has entered a broadly favorable trajectory of healthy and balanced growth—output is set to surpass its 2008 peak for the first time this year. Determined reform efforts since the 2008/09 crisis have produced strong economic growth of more than 3 percent in each of the past three years. Similar prospects for 2014 will put real GDP above 2008 levels, but this time the current account is in slight surplus, inflationary pressures are absent, and the banking system's loan-to-deposit ratio is contained at not much above 100 percent.

3. Nonetheless, income convergence with Western Europe has a long way to go, underscoring the need for continued reforms, policy discipline, and consistently high investment. Despite strong progress since the mid-1990s, Lithuania's per capita GDP has advanced to only one-third of Western Europe's and, at 11.4 percent, unemployment is too high. With demographic headwinds building and dividends from macroeconomic adjustment running their course, the onus for driving future income convergence will increasingly shift toward structural reforms.

GDP per Capita
(Percent of EU15 US$ GDP per capita)



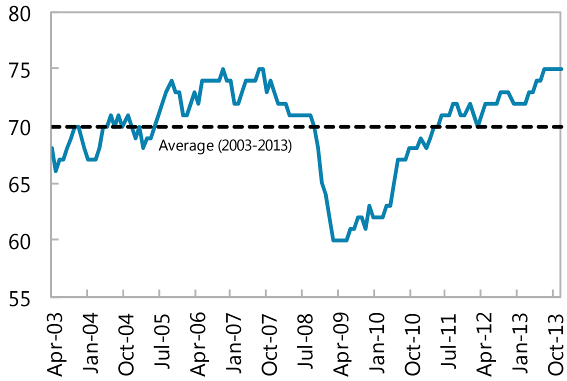
Sources: IMF WEO; and IMF staff calculations.

RECENT DEVELOPMENTS

4. Growth in 2013 remained solid, despite a difficult external environment. Largely driven by domestic demand, real GDP expanded by 3.3 percent, as rising real wages boosted private consumption and investment rebounded on the back of high capacity utilization, more public investment, and a recovery in construction. Export growth slowed in the second half of the year, reflecting a softening of trading partner demand and weaker agricultural export growth following the 2012 bumper harvest. Unemployment continued to fall, including for youth and the longer-term unemployed.

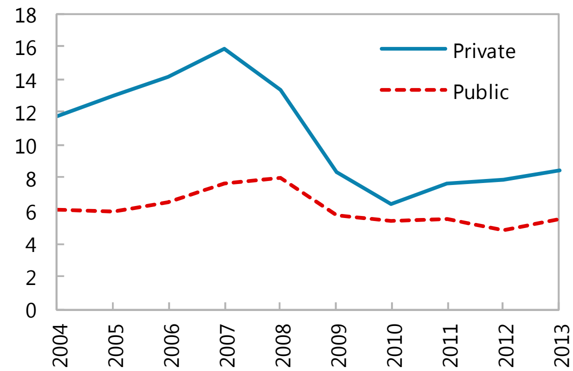
5. Global price developments further reduced inflation. Average inflation continued to moderate from 3.2 percent in 2012 to 1.2 percent in 2013, reflecting falling energy prices, food price disinflation, and global price trends. Average core inflation ran at a moderate 1.4 percent last year, despite a pickup of wage growth, partly reflecting the sizable one-off minimum wage increases in July 2012 and January 2013 for a cumulative 25 percent.

Production Capacity Utilization
(Percent)



Source: National authorities.

Investment in Tangible Fixed Assets
(Percent of GDP)



Source: National authorities.

6. **External stability is in place**, with the exchange rate broadly aligned with fundamentals, manageable external debt and international investment positions, and the current account in moderate surplus (Box 1). Despite slowing exports, Lithuania continued to gain world market share and the current account balance improved in 2013 on account of a pickup of current transfers from the EU. Lithuania has among the best absorption rates of EU funds, with 99 percent of funds from the 2007–13 framework contracted and 75 percent paid as of end-2013. Lithuania's international reserve coverage appears relatively low at some 70 percent of the Fund's reserve metric, but much of the external debt reflects inter-company loans and euro adoption would remove any remaining vulnerability.

Box 1: External Stability Assessment

Estimates indicate that the real effective exchange rate is broadly in line with fundamentals.

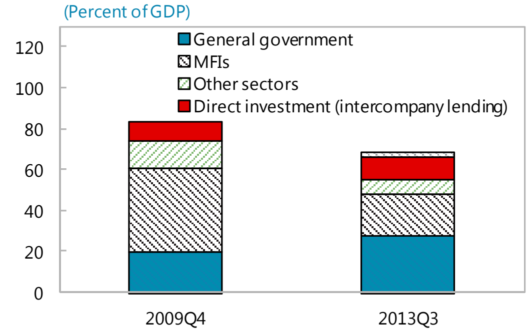
Results of Real Effective Exchange Rate Assessment Using Different Techniques

	Macro balance approach (gap)	Equilib. real ER approach	Ext. sustain. approach
Over (+)/under(-)valuation	-4.8	2.2	-4.8

The current account is broadly balanced. Adjustment from the large deficits of the 2003–08 boom period was primarily driven by a surge in exports, rather than a compression of imports, thus suggesting that the adjustment effort is sustainable. Staff projects the current account to swing into a deficit on the order of 1½–2 percent of GDP over the medium term as income levels converge with Western Europe. It would be more than fully covered by FDI.

Gross external debt has come down significantly in recent years and now stands at 65 percent of GDP. Standardized tests suggest that it would remain sustainable under a variety of adverse shocks (Figure 1A). Private external debt relative to GDP and gross external debt relative to exports remain below the customary vulnerability thresholds. Moreover, a significant share of external debt is owed to foreign parent companies and foreign banks and should therefore not be subject to disruptive withdrawal.

Gross Exteral Debt
(Percent of GDP)



The international investment position stands at negative 46 percent of GDP. The excess of inward over outward foreign direct investment together with net parent bank funding for Lithuanian subsidiaries fully explain this liability position.

International reserves stood at a relatively low €6 billion at end-2013, compared to an adequacy metric of €8.9 billion. Elevated short-term foreign debt is partly responsible, although much of it is owed to parent banks and companies. Nonetheless, reserves are also on the low side when related to GDP (17 percent) or months of imports (2½ months). But this will no longer be a source of vulnerability when Lithuania adopts the euro.

7. The repair of public finances continues to advance, but court rulings to correct some of the crisis-related expenditure cuts have yet to be implemented.

- **The 2013 fiscal deficit likely overperformed its 2½ percent of GDP target**. Tight expenditure allocations and control, as well as efforts to improve upon the sluggish tax collection in the first part of the year, reduced the deficit to an estimated 2.1 percent of GDP, following the abrogation of the EC's Excessive Deficit Procedure last June based on the 3.2-percent-of-GDP deficit in 2012.
- **The 2014 budget targets a deficit of 1.9 percent of GDP for the general government.** Forgoing generalized pension and wage increases drives the further consolidation. In a

loosening relative to recent years, other expenditure is allowed to grow roughly in line with nominal GDP. No significant tax policy changes are envisaged.

- **Recent Constitutional Court rulings mandate the restoration and compensation for wage and pension cuts to the extent that they were disproportionate across pensioners and government employees, respectively (Box 2).** Pension and wage restoration has already taken place and is reflected in the 2014 budget law. But compensation for wage and pension losses in the crisis years costing between 0.8 and 1.5 percent of GDP is not, pending decisions on the modalities and phasing of compensation payments.

Box 2. Constitutional Court Ruling on Pension and Wage Cuts

Background. In the wake of the 2008/09 crisis, wages for government employees and pensions were cut as part of the necessary fiscal consolidation effort. Cuts were larger and hence disproportionate for higher-wage and higher-pension earners.

Decisions. In two separate rulings, the Constitutional Court established that this disproportionality was unconstitutional. It mandates disproportionate cuts to be reversed and foregone income to be compensated. The rulings do not precisely pin down the modalities and timing of corrective actions.

Table. Constitutional Court Rulings on Restoration and Compensation of Disproportionate Public Sector Pension and Wage Cuts

	Constitutional Court Ruling (CCR)	Subject	Implementation status	Budgetary Impact
Wages	July 2013 CCR	Restoration	Restored in Oct 2013	LTL 34 million in 2013 and additional LTL 211 million in 2014 (0.19 ppt of GDP in total)
		Compensation	No concrete timetable for implementation specified yet.	0.2-0.6 ppt of GDP
Pensions	April 2010 CCR (February 2012 CCR re-iterated the April 2010 CCR; it also ruled that postponement of compensation of pension cuts is not unconstitutional.)	Restoration	Restored in 2012	LTL 500 million (or 0.5 ppt of GDP)
		Compensation	Compensation envisaged to begin in late 2014.	0.6-0.9 ppt of GDP

Next steps. Pension and wage restoration has already taken place. Compensation schemes remain under discussion, with decisions likely to be taken in a staggered manner and payments phased over several years. Once compensation payments have been approved by Parliament, their full amount will immediately be recognized as public expenditure, thereby increasing the accrual fiscal deficit as calculated by Eurostat. But as a one-off expenditure, it would not affect the structural fiscal balance. It may also be excluded or discounted when assessing compliance with SGP deficit limits.

8. **The financial system is stable, but credit growth remains sluggish**. Over 90 percent of the system is owned by Nordic cross-border banking groups. Capital adequacy rose further to a comfortable 17½ percent at end-2013 and liquidity indicators are well ahead of regulatory minima. While some smaller banks would benefit from bigger capital buffers—especially as the regulatory bar will rise with the implementation of global and European reforms—and credit unions are in need of reform, they do not pose material risk to overall financial stability because of their small size.

Despite good progress in reducing non-performing loans, private sector credit has yet to return decisively to positive growth, likely reflecting engrained post-crisis risk aversion on the part of both potential borrowers and banks, as well as debt overhang in many households.

OUTLOOK AND RISKS

9. Growth is expected to pick-up from 3.3 percent this year to 3¾ percent in the medium term and to remain balanced. Momentum in domestic demand will likely extend into 2014 (and is already evident in readings of high frequency indicators early in the year). High capacity utilization, territorial planning reform, and efforts to avoid a dip in the availability of EU funds in the transition to the new 7-year financial perspective should underpin strong investment and a continued recovery in the still low investment-to-GDP ratio. The rise of real wages in line with productivity should support robust private consumption. Externally, improving prospects for western export markets are likely to be offset by the clouded outlook for Russia and other CIS countries. With the output gap expected to close in 2014, future growth will mirror potential growth, which is projected to rise to some 3¾ percent over time.[1] Income convergence is likely to move the current account into a small deficit position and entail a slight pickup of inflation from its current historical lows.

10. Risks around this outlook remain tilted to the downside, primarily due to external factors. As a small, open economy with strong trade and financial linkages, Lithuania is susceptible to spillovers from abroad, although the balanced external position and the absence of domestic overheating provide a degree of protection. A protracted period of low growth in advanced and emerging economies would weigh on exports, which account for some 80 percent of GDP. Increasing geopolitical tensions surrounding Ukraine would affect Lithuania through trade, commodity price, and confidence channels.[2] Tighter global financial conditions could increase external borrowing costs and curtail parent bank funding. However, the tapering of unconventional monetary policy in the U.S. has not had significant repercussions for Lithuania so far. On the domestic front, the recent revival of investment could yet fizzle out for lack of credit.

Table. Exports of Lithuanian Origin by Destination 1/
(Percent of GDP)

	Goods	Services	Total
Intra-Baltic	8.1	1.1	9.2
CESEE	3.9	0.9	4.8
CIS	4.9	5.2	10.1
Nordics	4.2	1.4	5.6
Other Europe	16.0	4.4	20.4
Rest of the World	5.6	1.0	6.6
Total	42.8	13.9	56.7

1/ Excludes re-exports. Data for goods refer to 2013, for services 2012.
Sources: National authorities; and IMF staff calculations.

11. The authorities broadly shared staff's views on the outlook and risks. Their projections are similar, including the closing of the output gap in 2014, though they see inflation slightly lower

[1] The potential growth estimate is unchanged from last year's Article IV Consultation and informed by the research published in IMF Country Report No. 11/327.

[2] The baseline assumes real GDP growth for Russia and Ukraine as projected in the World Economic Outlook of April 2014, but no direct disruptions to trade and other cross-border activities.

than staff and the Ministry of Finance puts medium-term growth some ½ percent higher. They saw slower trading partner growth as the most important downside risk, but noted that exports were well diversified and that Russia was important primarily for Lithuanian transport companies rather than domestic manufacturers. They downplayed risks from tighter global financing conditions, considering limited external financing needs and little remaining reliance on parent bank funding, but noted susceptibility of parent banks to housing market developments in the Nordics. They agreed that sustained lack of credit growth could eventually undermine investment. Efficient use of EU funds was equally important to further investment for income convergence.

LITHUANIA: RISK ASSESSMENT MATRIX

Source of Risk	Relative Likelihood	Impact if Realized
Side-effects from global financial conditions: surges in global financial market volatility.	**High** UMP exit may lead to economic and fiscal stress, and constraints on country policy settings.	**Low** Borrowing costs could rise and export markets weaken. Parent bank funding and credit could tighten, but reliance on such funding is limited.
Protracted period of slower growth in advanced and emerging economies: • **Advanced economies.** • **Emerging markets.**	**High (in Europe)** For advanced economies, it could imply more deleveraging or lower potential growth. Medium (elsewhere) Earlier maturing of the cycle and incomplete structural reforms entailing prolonged low growth.	**Medium** As a small open economy, Lithuania's own growth would be substantially impacted through the trade channel. Protracted slow growth in advanced Europe, Poland, and Russia would have the largest adverse effects.
Financial stress in the Euro area re-emerges.	**Medium** This could be triggered by stalled or incomplete delivery of national and euro area policy commitments.	**Low/Medium** Lithuania has little direct exposure to the euro area periphery, but stress that affects the euro area core would spill over through financial and trade linkages.
Increasing geopolitical tensions surrounding Ukraine.	**Medium** Disruptions in financial, trade, and commodity markets.	**High** Russia remains an important export market and the only natural gas supplier. Increasing tensions would also affect sentiment, depressing investment and consumption.
Protracted period of unduly low credit growth.	**Medium** Structural factors hamper access to credit for productive investment, especially SMEs and startups.	**Medium/High** Investment and new-firm formation would be crimped at a time when capitalization is high, undermining long-term growth prospects.

POLICY DISCUSSIONS

12. Discussions focused on policies to further advance income convergence with Western Europe: the planned euro adoption would spur economic integration and entail a strengthening of policy frameworks; fiscal policy could pay dividends from raising the quality of public spending and continuing with its disciplined approach; with financial stability in place, the focus is shifting to ensuring sufficient credit to fund productive investment; and structural reforms would help raise economic efficiency. The authorities are open to the Fund's policy advice and have implemented many past recommendations (Box 3).

Box 3. Implementation of Past Fund Advice

Fiscal Policy. The authorities have been pushing ahead with the recommended fiscal consolidation and appear to have met the euro entry criterion on the fiscal deficit with a good safety margin. However, consolidation remains biased to the expenditure side. Suggestions to consider higher recurrent taxation of wealth and property remain under discussion.

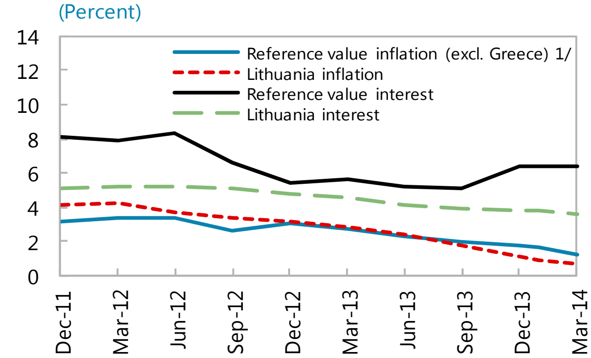
Financial Sector Policy. The Fund's past advice has focused on addressing weaknesses in the domestic banking system. The authorities have meanwhile intervened and closed the two largest domestic banks, thereby removing risks to financial stability. Attention has now turned to issues in the small credit union sector. MCM has provided technical assistance for reform.

Structural Policy. The authorities share the Fund's view that price competitiveness gains from post-crisis adjustment need to be preserved. They have taken steps to further improve the business climate, including through simplification of territorial planning rules. Migration policies to help address challenges from demographic aging are under consideration. There has also been some progress with improving frameworks to work out debt.

A. Adopting the Euro and Improving Policy Frameworks

13. Lithuania appears on track to meet the entry criteria for euro adoption. The fiscal deficit and public debt are well below Maastricht thresholds; the exchange rate has long been fixed under the currency board arrangement, and inflation and interest rates run at less than the reference values—the average of the three "best-performing" EU economies plus a margin of 1.5 and 2 percentage points, respectively. Prospects for sustaining good fiscal performance and low inflation in the longer run are favorable, provided policies remain supportive (Boxes 4 and 5). European institutions will take a final decision on

Inflation and Interest Rate Criteria for Euro Adoption
(Percent)



Sources: Haver; ECB; and IMF staff calculations.
1/ Refernce values for March2014 are calculated using Bulgaria, Latvia and Cyprus. Greece is excluded from the best inflation performers at any point in the chart.

Lithuania's euro adoption application in July, based on the convergence reports of the EC and the ECB, to be published in June.

14. After two decades of a currency board arrangement, the economy is well prepared for EMU, but supporting policy frameworks would benefit from further strengthening. Lithuania has demonstrated economic flexibility and political grit to deal with shocks and deliver adjustment—most recently in the wake of the 2008/09 crisis, but also during the Russia crisis of 1998 and following 2002 when the currency board was re-pegged from a weak U.S. dollar to a strengthening euro. But controlling the business and financial cycles has proved more challenging, as evidenced by the large boom-bust cycle during 2003–10. It will therefore be essential to preserve and build upon economic flexibility while strengthening countercyclical policy frameworks to make EMU membership a lasting success.

- The **fiscal framework** will be strengthened by the Fiscal Compact, but it should be supplemented by a countercyclical fiscal rule to ensure that fiscal buffers are built in good times, to provide the space needed for economic stabilizers to operate freely in downturns. Integration with the compact's correction mechanism is important to avoid potential inconsistencies and fragmentation in public financial management. The planned establishment of a fiscal council in the National Audit Office should be expedited to allow sufficient time to build expertise.
- The **financial framework** will benefit from establishing macro-prudential powers for the Bank of Lithuania, with related legislation currently before Parliament. This will allow leaning against the wind when financial cycles cannot be addressed adequately by common monetary policy. Close cooperation of home and host country authorities of cross-border banks remains important—the Nordic-Baltic cooperation forums are valuable platforms that should be preserved, built upon, and adapted to the emerging European banking union.
- There have been tangible reforms to the **restructuring and insolvency frameworks** and more are in the pipeline. This will not only facilitate dealing with existing debt overhangs, but can also help guard against debt-deflation problems in future, potentially arising from asymmetric shocks inside the currency union. Court rulings have established precedents that clarify implementation and application of the law and this has helped speed up resolution of non-performing loans. Speedier and more widespread use of the household insolvency law that came into effect in early 2013 would be desirable.[3] Recent changes to the corporate insolvency framework are helpful but the limited effectiveness of the framework for going-concern restructurings is yet to be tackled.
- **Labor market flexibility should be safeguarded and built upon**. Large flows in and out of unemployment and high cross-border mobility attest to a flexible labor market, with moderate unemployment benefits and contained minimum wages. Yet, skill mismatches in the labor

[3] Some 120 cases of personal bankruptcy have been initiated under the regime but only a handful of cases have progressed to agreement on payment plans. Yet, close to 20 percent of mortgages remain underwater.

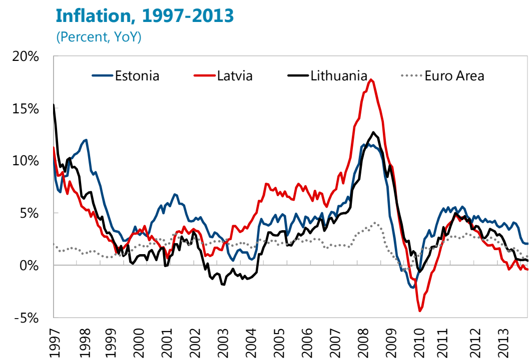
market, overly restrictive provisions in the labor code, and a high tax wedge make for high structural unemployment (see below).

15. Euro adoption would be a welcome boon for the economy. While not a sea change from the euro-based currency board, it will shift several factors in Lithuania's favor: a relatively low reserve cover will be replaced by access to ECB liquidity, thereby enhancing financial stability and putting downward pressure on risk premiums; and, if accompanied by the right policies, even closer integration with the euro area could help foster trade, involvement in global value chains, and foreign direct investment—a welcome impetus given the importance to secure a vibrant export sector for future (see below and Baltic Cluster Report).

16. The authorities feel ready for euro adoption and are firmly committed to the project. They recognize that there is no room for complacency once inside EMU and saw no tangible risk of undue relaxation of policies—this has not been Lithuania's track record. The European framework imposes many checks and balances, wage formation is market driven, and external price competitiveness is high. The Bank of Lithuania underscored the importance of the forthcoming macroprudencial policy tools. Their effectiveness would further strengthen with improved home-host cooperation under the European banking union. But successful macroeconomic management requires support from fiscal policy. The Ministry of Finance is committed to complete full alignment of the fiscal framework with all EU and euro area requirements in the near future, although work on an explicit countercyclical fiscal rule seems to be left for later.

Box 4. Sustainability of Low Inflation*

Lithuania's inflation track record is reassuring. It has maintained comparatively low inflation since 1999 with an annual average inflation differential to the euro area (EA) of just 0.8 percentage points—one-third that of Latvia and less than half that of Estonia. Since mid-2013, inflation has converged to euro area levels and the differential turned negative in mid-2013. However, inflation has been much more volatile than in the EA, primarily reflecting the pronounced boom-bust cycle of the Baltic economies during 2003–10. With negative output gaps now closing, a harder test for containing inflation lies ahead.



Source: Eurostat.

Income convergence implies somewhat higher inflation in Lithuania than in the EA. Catching-up economies are characterized by higher productivity growth in the tradable sector but not necessarily in the nontradable sector than richer economies. International price equalization for tradable goods and wage equalization within countries across tradable and nontradable sectors then imply a positive inflation differential in catching-up countries—the so-called Balassa-Samuelson (BS) effect. A simple accounting exercise confirms this pattern of relative productivity growth for Lithuania compared to the EA and puts the BS effects at about 0.7 percentage points, or 73 percent of the observed inflation differential with the EA since 2000. Econometric estimates, accounting also for inflation persistence, the impact of commodity prices, and short-run cyclical factors, suggest a long-run BS effect of some 1.1 percentage points annually. The analysis finds no empirical support for the presence of price convergence channels over and above the BS effect.

In the short-run, business cycle divergence, asymmetric effects of global commodity price movements, and idiosyncrasies in wage dynamics can easily swamp the underlying BS dynamics. Econometric analysis suggests that a one-standard-deviation shock to commodity price growth would cause Lithuania's inflation differential with the EA to increase on impact by 0.2 percentage points, i.e., two times as much as the short-run BS effect. An output gap or real manufacturing wage growth shock (relative to the EA) would increase the inflation differential by 0.4 and 0.5 percentage points, i.e., 4 times and 5 times as much as the short-term BS, respectively. Credit and fiscal variables, as well as housing prices, had no significant inflationary impact once the BS effect, real wages, and global price shocks are accounted for.

Estimates of Inflationary Shocks on Inflation Differential

	Short-run elasticity	One standard-deviation shock 1/	Impact on inflation 1/
Commodity prices	0.011	22.6	0.2
Output gap	0.119	3.5	0.4
Real wages	0.068	7.1	0.5

Note: all variables including inflation are relative to the euro area. Last column shows the short-run impact of a one-std deviation shock.
1/ In percentage points.
Sources: Haver; national authorities; WEO; and IMF staff calculations.

This econometric evidence suggests an annual inflation differential of about 0.7 percentage points vis-à-vis the EA over the next five years. This is contingent on maintaining policy discipline and thus having strong supporting frameworks in place. It assumes unchanged wage formation processes, historical productivity differentials, gradually closing output gaps, and commodity prices in line with the IMF's World Economic Outlook. In addition, there may be a small one-off inflationary impact from the switch over to the euro of 0.2 to 0.4 percentage points.

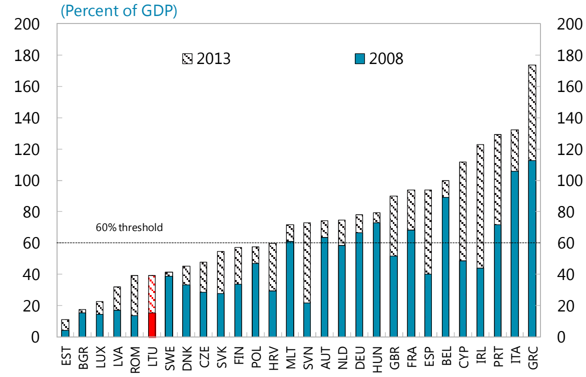
____

*/ Prepared by Hélène Poirson based on Selected Issues Paper "Inflation in Lithuania: Track-Record and Prospects."

Box 5. Fiscal Sustainability*

Lithuania's traditionally prudent fiscal policy suffered a major setback in the 2008/09 crisis but it was followed by a determined multi-year consolidation response. Public debt stood at a mere 15 percent of GDP on the eve of the crisis, but the deficit deteriorated sharply to 9.4 percent of GDP in the 2009 recession, despite strong consolidation measures. Determined subsequent adjustment achieved exit from EDP in spring 2013 and a deficit near 2 percent of GDP for 2013.

General Government Gross Debt
(Percent of GDP)

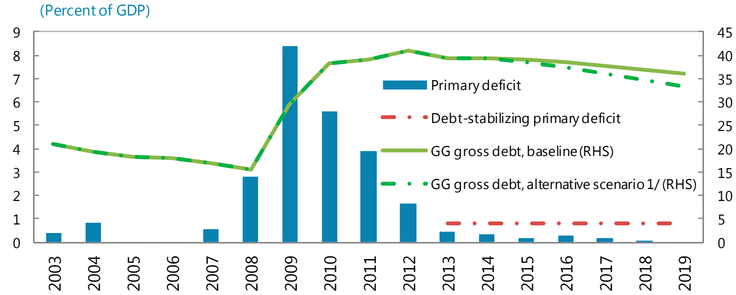


Sources: IMF World Economic Outlook; and IMF staff calculations.

Lithuania's public debt-to-GDP ratio remains low by EU standards and is set to decline further. The debt ratio has now stabilized at some 40 percent of GDP and would gently decline even in a passive scenario with no further consolidation measures beyond those embedded in the 2014 budget. The authorities are rightly committed to much more aggressive debt reduction, with the precise target path to be updated in their 2014 Convergence Program. Rollover, interest-rate, and exchange-rate risks to Lithuania's public debt stock are all well contained.

Downside risks to the fiscal baseline projections are limited, except for long-run ageing-related spending. Extensive post-crisis expenditure compression is more an issue of spending quality rather than a challenge to overall sustainability. Spending overruns by local governments need to be addressed, but their size is too small to derail overall debt dynamics. Government loans to the deposit insurance fund in the context of the interventions of two banks (Snoras and Ukio) are likely to be repaid and relatively modest in any event at around 2 percent of GDP. Court-mandated compensation for past pension and wage cuts have yet to be made, but would be a one-off expense of 0.8–1.5 percent of GDP. This leaves costs related to demographic ageing as the only material concern, which could add 5–6 percent of GDP to public spending by 2060 in the absence of pension reform.

General Government Gross Debt and Primary Deficit
(Percent of GDP)



Sources: Eurostat; Ministry of Finance of Lithuania; and IMF staff calculations.
1/ Assumes annual structural adjustment of 0.5% of GDP until a structural deficit of 1% of GDP is reached.

There is substantial potential to strengthen public finances, especially on the revenue side. At around 26 percent of GDP, Lithuania's overall tax-to-GDP ratio is the lowest in the EU—some 13, 6, and 4 percentage points of GDP lower than the EU, CEE, and the other Baltics average, respectively. This gap largely reflects generous allowances, exemptions, and preferential rates in Lithuania's tax system. The recurrent taxation of wealth and property is underdeveloped. In addition, the estimated share of the shadow economy (28.5 percent of GDP) is one of the largest in the EU, but bound to retreat with income convergence.

____

*/ Prepared by Nan Geng based on Selected Issues Paper "Sustainability of Lithuania's Public Finances."

B. Completing Public Finance Repair and Locking in Gains

17. The repair of public finances is well advanced but not yet complete. If the fiscal over performance in 2013 is confirmed, a further moderate deficit reduction of ½ percent of GDP in structural terms in 2014 would seem sufficient. This would ensure further steady progress toward the medium-term objective (MTO) of a broadly balanced budget, no undue drag on the economy that is just returning to full capacity and a genuine decline of the public-debt-to-GDP ratio for the first time since the 2008/09 crisis. To achieve this consolidation, measures over and above those in the 2014 budget may be required.[4]

18. In the medium run, the authorities would be well advised to temporarily drive consolidation beyond their MTO. The authorities' 2013 convergence report sets a structural deficit of 1 percent of GDP. While sufficient to ensure sound public finances in the long run, it still implies a rather slow reduction of the public debt ratio that has more than doubled since the crisis (see second figure in Box 5). A temporarily more ambitious target would be needed to demonstrate the ability to not only stabilize debt ratios but to materially bring them down after a setback and build the fiscal buffers to fall back on in the next downturn. Achieving this will require taking measures—the deficit on current policies (i.e., approved measures) would only decline marginally beyond 2014 (see "passive fiscal projections" in Tables 1 and 2).

19. Remaining consolidation should preferably come from the revenue side and the quality of spending should be reviewed. The bulk of the post-crisis consolidation came from emergency expenditure cuts, leaving Lithuania with one of the lowest expenditure ratios in the EU and a potentially suboptimal spending structure. Remaining consolidation should therefore be met by high-quality revenue measures, in particular hitherto underdeveloped recurrent wealth and capital taxation (Country Report No. 13/82). A public expenditure review could identify areas where past cuts have gone too far and where there is remaining slack, thereby helping increase the quality of spending within Lithuania's tight overall spending envelope. Pension reform and tax administration improvements are additional key projects to redress the looming costs of demographic aging.

20. The compensation schemes for past pension and wage cuts should be carefully designed, mindful of competing claims on scarce budgetary resources when transposing the court rulings into concrete proposals. Spreading payments over time would avoid a spike in public borrowing or derailment of the impending decline of the public debt ratio.

21. Local government finances require enhanced control. Past spending overruns and accumulation of arrears are a matter of concern, albeit not of macroeconomic proportions

[4] The 2014 budget targets a deficit of 1.9 percent of GDP and the 2013 deficit is estimated in the range 2 to 2½ percent of GDP, with 2.1 percent of GDP being staff's best point estimate. Gross public debt already declined in 2013 as a ratio to GDP, but this was driven by a drawdown of cash balances rather than a small budget deficit.

considering the small size of local governments.[5] Debt and borrowing limits for local governments are soft, as they are adjusted frequently and breaches remain essentially unsanctioned. Moreover, only spending related to special grants from the central government is independently audited. An increased revenue share for local governments from 2014 may help, but ultimately it will take hard budget constraints on their debt and borrowing limits that remain stable over time and independent scrutiny of their finances to instill better spending discipline and improve incentives to raise revenues locally.

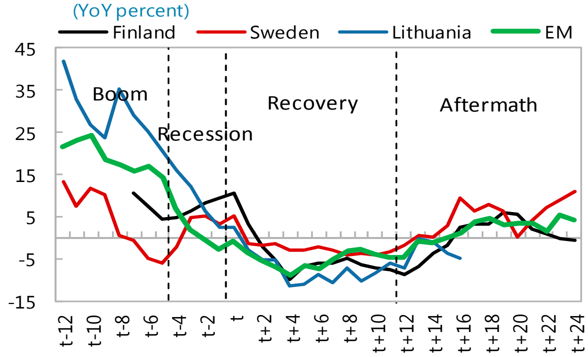
22. The authorities fully supported the debt reduction objective. They plan to lower the headline deficit by about one percentage point each year until a surplus of 1½ percent of GDP is reached in 2017 to visibly reduce the debt ratio, although concrete underpinning measures are yet to be specified. The introduction of a car tax was under active consideration but is unpopular. They plan to stagger compensation payments. Government officials noted that Lithuania already has several forums that review public spending, but saw potential merit in an independent overarching exercise that would cover the general government. The authorities agreed in principle with the need to better control local government finances, but noted that the existing framework of intergovernmental relations needed to be respected.

C. Maintaining a Sound Financial System that Supports Investment

23. Much progress has been made in working through crisis legacies. Non-performing loan ratios have been brought down from a peak of 20 percent to 11 percent, with one major bank reporting that it will essentially be done with addressing the aftermath of the crisis in the course of 2014. High reliance on parent bank funding has been consigned to the past as loan-to-deposit ratios fell to 107 percent—a level that parent banks generally feel comfortable with. But progress has been uneven across banks, meaning that supervisors need to remain vigilant. The authorities are rightly tackling governance and competency issues in the small credit union sector (2 percent of financial sector assets) through a combination of stop-gap measures and limited legislative changes until a broader reform of the sector can be put in place.

24. Yet, private sector credit shows only tepid signs of recovery at best. Staff analysis for the Baltic Cluster Report confirms that "creditless recoveries" are to be expected after large financial boom-bust cycles like those experienced by the Baltic economies. However, even by this benchmark, real private sector credit growth should have turned positive by now, but has not. Both credit demand

Real Credit Growth 1/
(YoY percent)



1/ Time t indicates start of economic recovery. Units are quarters.

[5] Local governments account for 9 percent of public spending (2.7 percent of GDP) and 4.1 percent of public debt (1.6 percent of GDP). The stock of their arrears stands at 1 percent of GDP.

and supply factors seem to be responsible, with strong risk aversion now entrenched in potential borrowers and banks. Accordingly, banks chase after perceived good credits—large and successful firms—while SMEs and new companies risk falling by the wayside. Credit developments require close monitoring. Further improvements in the insolvency frameworks could help support more credit to the economy.[6] And fostering more reliance on other sources for financing investment, such as capital market development and leasing, is worth considering.

25. The authorities broadly agreed with staff's assessment of the financial sector. They felt that the financial sector is characterized by a high degree of stability, following the successful intervention of two domestic banks in 2011 and 2013. Remaining areas of softness, such as the credit union sector, were well under control. A consultation paper on fundamental credit union reform had already been issued and the four most problematic credit unions (out of a total of some 80 credit unions) have been closed in the past two years. The authorities indicated that they intend to participate in the Asset Quality Review ahead of planned euro adoption. They thought that progress in reducing NPLs and loan-to-deposit ratios improved prospects for a resumption of credit growth, but agreed that investment could be hampered if it failed to materialize in the not-too-distant future. They agreed that capital markets played only a marginal financing role, in part due to shallow domestic markets failing to attract investor interest. Efforts to complete the already well-advanced regional integration of Baltic exchanges are underway.

D. Advancing Structural Reform to Further Income Convergence

26. Lithuania's export sector has been key to post-crisis recovery and all efforts should be made to extend its success. As documented in the Baltic Cluster Report, exports were a key driver in pulling the economy out of the 2009 recession and facilitating the correction of the large current account deficits. Longer-term, Lithuania has been gaining global market share, successfully upgraded product quality, and reoriented away from traditional CIS markets. Yet, success relied to a large extent on labor intensive exports, and was also facilitated by favorable trading partner growth and export price developments, while involvement in global value chains has been more limited. Future success can therefore not be taken for granted, especially as demographic aging becomes more acute. Cost competitiveness gains, instrumental for the post-crisis surge

Decomposition of ULC Change 2008-12
(Percent)

	Relative to Western Europe	Nominal ULC
Estonia		
Change in ULC	-10.5	-1.5
Labor compensation	-6.3	4.0
Labor productivity 1/	-4.6	-5.5
Latvia		
Change in ULC	-21.7	-13.9
Labor compensation	-10.3	-0.5
Labor productivity 1/	-14.6	-15.6
Lithuania		
Change in ULC	-14.2	-5.6
Labor compensation	-3.5	7.0
Labor productivity 1/	-12.4	-13.4

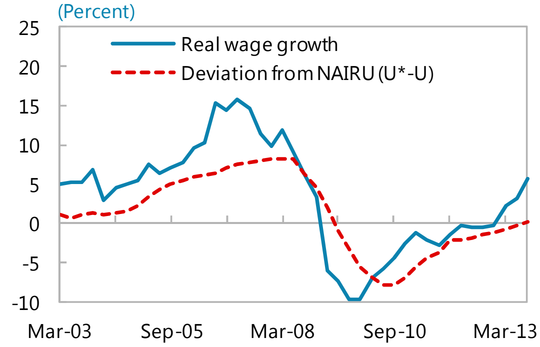
1/ Negative sign indicates negative impact on ULCs and an improvement in labor productivity.
Sources: Eurostat; and IMF staff calculations.

[6] Staff analysis suggests: (i) exploring whether the limited progress of household debt resolution under the law reflects teething problems or undue administrative hurdles; (ii) equipping the corporate restructuring law with the necessary tools for going-concern restructurings, such as protection for fresh money and lower voting thresholds to get creditor consent for restructuring plans; (iii) providing more scope for compromise in corporate enterprise bankruptcy to facilitate, e.g., debt-equity swaps and reduce reliance on auctions.

in exports, should be preserved and direct obstacles to global value chain involvement should be addressed. But much of the critical support for the export sector would need to come from more general structural reforms—to make the most of labor resources, upgrade key infrastructure, strive to advance the business climate further, and tap synergies from regional cooperation.

27. Labor resources need to be better utilized. As analyzed in the Baltic Cluster Report, high structural unemployment seems to coexist with otherwise fairly flexible labor markets. The current unemployment rate of 11.4 percent is found to be essentially entirely structural, with strong wage pressures emerging at materially lower rates. Reducing the significant skill mismatches ultimately requires reform of an education system that features one of the highest tertiary education rates in the EU, but where many graduates work in fields other than those of their study, emigrate, or take up work below their qualifications. Unemployment benefits are moderate by OECD standards, but the uncontrolled tapping of multiple benefit programs, along with relatively high labor taxation, could still create unemployment traps for workers with lower earning potential. In this context, bringing down high social security taxes would also be desirable, but needs to be imbedded in a comprehensive tax and pension reform to be fiscally neutral. Furthermore, there is room to improve the labor code, which currently forbids more than 8 hours of overtime per week and 120 hours per year, stipulates rather generous severance pay, and unduly restricts temporary work arrangements. Labor resources could also be augmented by fostering the return of emigrants and easing labor market access for non-EU citizens.

Real Wage Growth and Unemployment Deviation from NAIRU 1/
(Percent)



Sources: Haver; and IMF staff calculations.
1/ NAIRU estimated with a state-space model.

28. Upgrading the energy and transportation infrastructure remains a high priority. Important projects in the gas, electricity, and rail sectors are underway. Russia is currently the sole supplier of natural gas, and also an important provider of oil and electricity. Energy prices are high and scope for effective downstream competition limited. Railroad infrastructure is well suited for trade with the CIS, but there are few north-south lines and tracks with Western European gauge. Projects should be carried out in the context of a regional strategic plan, so as to share costs and exploit scope for synergies, and geared toward the ultimate objective of reducing user costs and increasing the efficiency of the economy.

29. Reform of public enterprises should be advanced, especially as they would play a key role in carrying out the large infrastructure projects. Already initiated governance reform of state-owned enterprises should be pushed forward—to achieve tangible results in terms of more independent directors on enterprise boards and faster progress toward return-on-equity targets—and broadened to also cover municipally-owned enterprises.

30. The authorities pointed to the many reform initiatives already underway on the structural front. While skeptical whether historical reliance on labor-intensive exports and limited involvement in global value chains necessarily create a problem for the future, they broadly concurred with the policy recommendations. Improving energy security and efficiency through new cross-border gas and electricity linkages has long been a policy priority and key projects, such as the LNG terminal, will become operational by year end. As staff, they consider current unemployment as mostly structural. A working group for a revamp of the labor code has already been formed and government recently adopted broad guidelines for migration policies, but comprehensive reform of social security taxation would be considered only after completion of euro adoption. They noted Lithuania's favorable ranking in the World Bank's "Ease of Doing Business" report. Recent further improvements to the business climate included reform of territorial planning and streamlining of business inspection regimes.

STAFF APPRAISAL

31. The economy has entered a broadly favorable trajectory of healthy and balanced growth, but income convergence with Western Europe has a long way to go. With output expanding at 3–3½ percent, peak income levels of 2008 are set to be surpassed this year, but this time in a sustainable manner. Nonetheless, the large income gap with Western Europe underscores the need to continue with the disciplined policy approach and persevere with reform to modernize the economy. The impetus will increasingly have to come from the structural front as dividends from macroeconomic adjustment run their course.

32. Euro adoption in 2015 would be the next logical step on Lithuania's European integration path. It would remove one of the few remaining vulnerabilities—low international reserve coverage, reduce risk premiums by strengthening financial stability, and bring integration gains from fostering trade, FDI, and global-value-chain involvement. Lithuania seems ready for euro adoption, in terms of meeting the entry criteria, sustainability of low inflation and public finances, and external stability.

33. Euro adoption is an opportunity to upgrade supporting policy frameworks and ensure that EMU membership is a lasting success. Two decades of operating under a currency board arrangement have amply demonstrated that Lithuania has the economic flexibility and political grit to deliver adjustment when needed without recourse to independent monetary policy. However, the business cycle was poorly controlled, pointing to gaps in policy frameworks. This will be addressed with the impending strengthening of macroprudential policy tools and the transposition of the fiscal compact, but a mechanism to reliably build fiscal buffers in economic upswings is still missing.

34. Much progress has been made in restoring healthy public finances but a final consolidation push is still needed. A determined multi-year effort has brought the fiscal deficit comfortably below Maastricht limits and the public debt ratio is now stabilizing. But the medium-term objective of a broadly balanced budget is not yet reached and the ability to materially reduce the debt ratio remains to be demonstrated. Consolidation has to continue. It should preferably come from the revenue side, with more reliance on hitherto underdeveloped recurrent taxation of wealth and capital. After extensive expenditure cuts since the crisis, a public expenditure review would help ensure that the overall tight spending envelope is efficiently used and sustainable.

35. Financial stability has strengthened further, with rising bank capitalization and the intervention of two insolvent banks in 2011 and 2013. Remaining areas of softness, such as those in the small credit union sector, are rightly being addressed with determination.

36. Delays in the recovery of credit are a potential area of concern that requires close monitoring. Progress with reducing non-performing loans and now well contained loan-to-deposit ratios should help lay the foundations for a resumption of credit growth, but it has yet to materialize and is delayed by historical standards. If it remained elusive for much longer, investment, critical for the modernization of the economy, could be constrained. Further strengthening of the insolvency and restructuring regimes should be considered, along with steps to foster capital market development.

37. Labor resources need to be better utilized. Structural unemployment is uncomfortably high, which is particularly problematic when considering the impeding onset of demographic aging and an external sector that thrives on labor-intensive exports. While Lithuanian labor institutions are fairly flexible, there is room to reform the labor code and improve the management of out-of-work benefits. Reducing high labor taxation would also be desirable, but would need to be imbedded in comprehensive tax and pension reform to be fiscally neutral. Addressing skill mismatches will ultimately require comprehensive education reform.

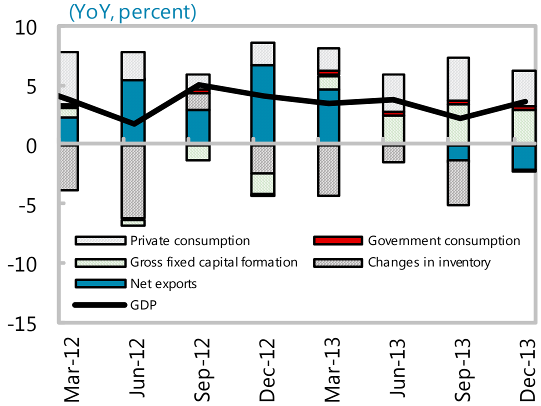
38. In other structural reforms, upgrading of the energy and transportation infrastructure remains a high priority. The many ongoing projects should be embedded in a regional strategic plan geared toward reducing user costs. Reform of state-owned enterprises—many of them responsible for the infrastructure projects—should be pushed ahead and broadened to municipally-owned enterprises.

39. It is recommended that the next Article IV Consultation be held on the twelve-month cycle.

Figure 1. Lithuania: Real Sector Developments

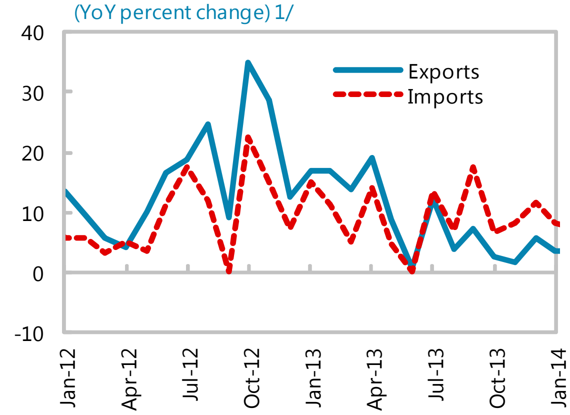
GDP growth remained robust ...

Contributions to GDP Growth and GDP Growth
(YoY, percent)



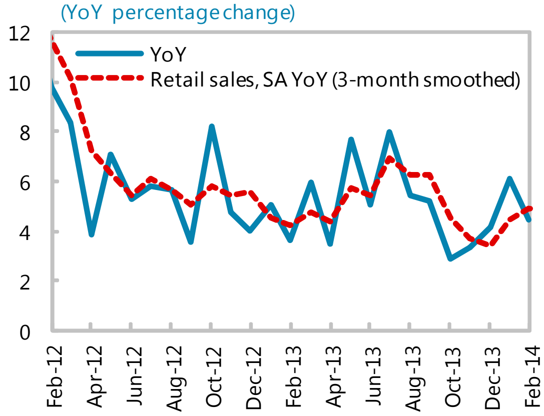
... despite slowing export growth ...

Trade of Goods excluding Mineral Products
(YoY percent change) 1/



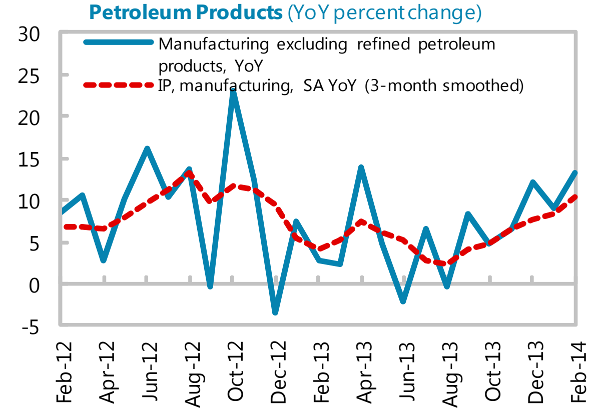
... as domestic consumption remained strong ...

Retail Sales excluding Autos and Motorcycles
(YoY percentage change)



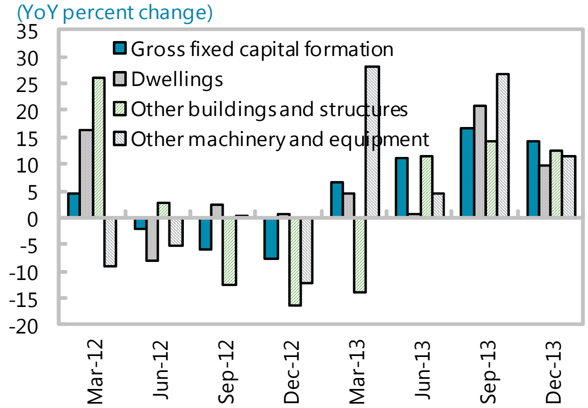
... and industrial production recovered after a slowdown in mid-year.

Industrial Producion excluding Refined Petroleum Products (YoY percent change)



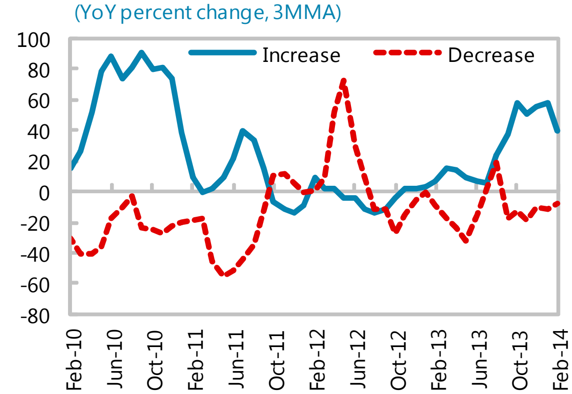
Investment is rebounding ...

Real Growth in Gross Fixed Capital Formation Components
(YoY percent change)



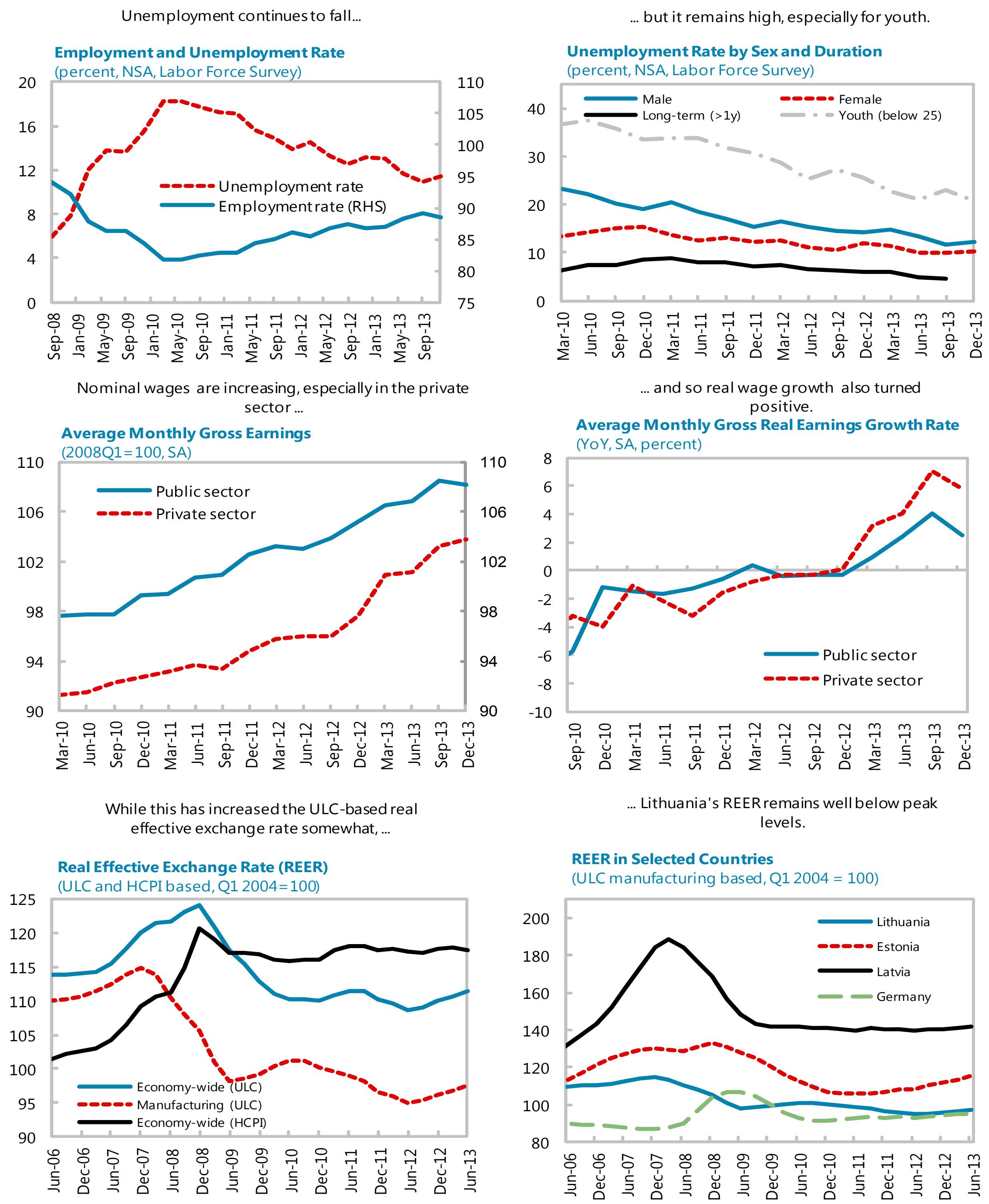
... and production expectations are improving.

Production Expectations
(YoY percent change, 3MMA)



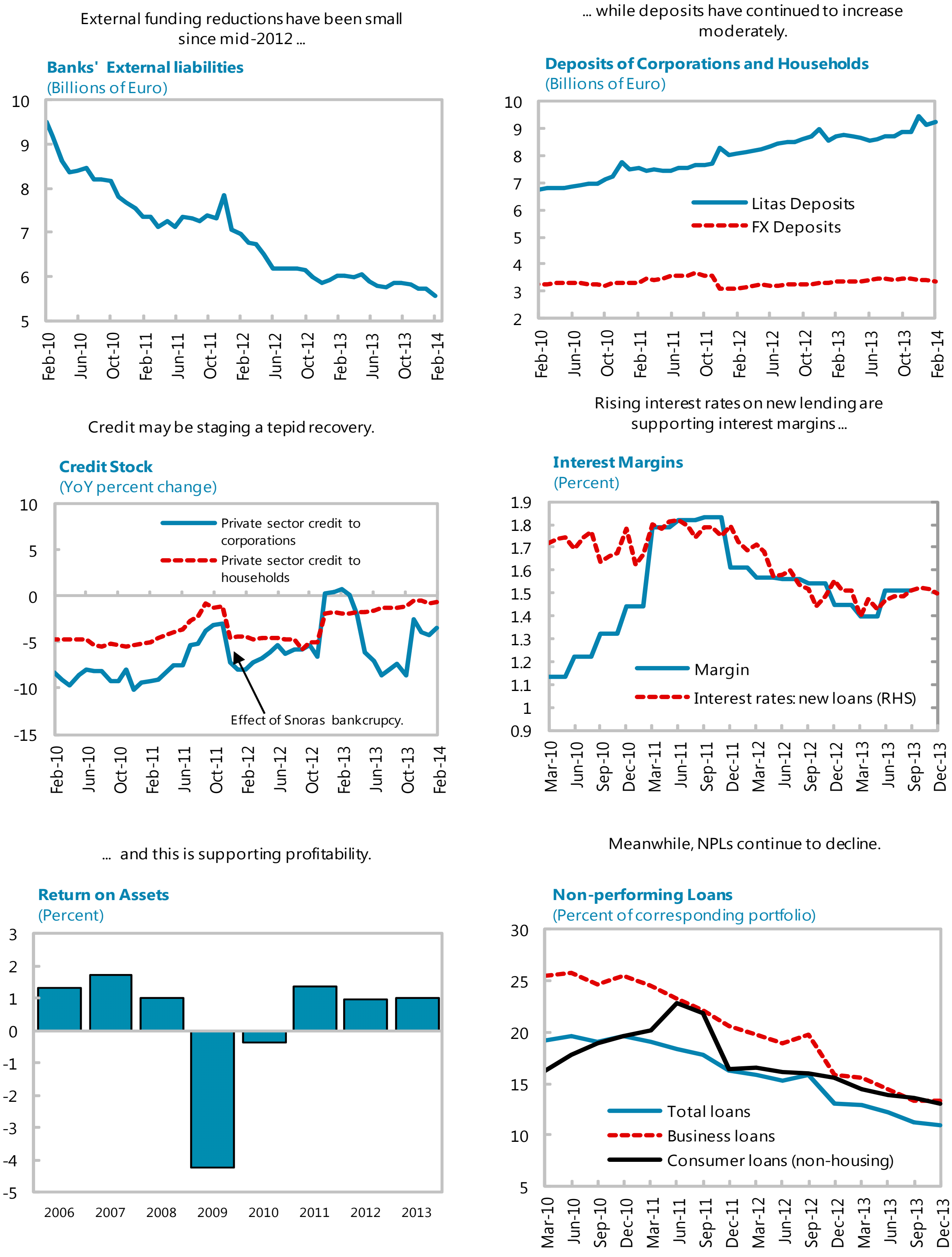
Sources: Haver; Lithuania Statistical Office; and Bank of Lithuania.
1/ The export and import data are measured in terms of F.O.B. and C.I.F., respectively.

Figure 2. Lithuania: Labor Market and Competitiveness Developments



Sources: Haver; Eurostat; Lithuania Statistical Office; and IMF staff estimates.

Figure 3. Lithuania: Banking Sector Developments

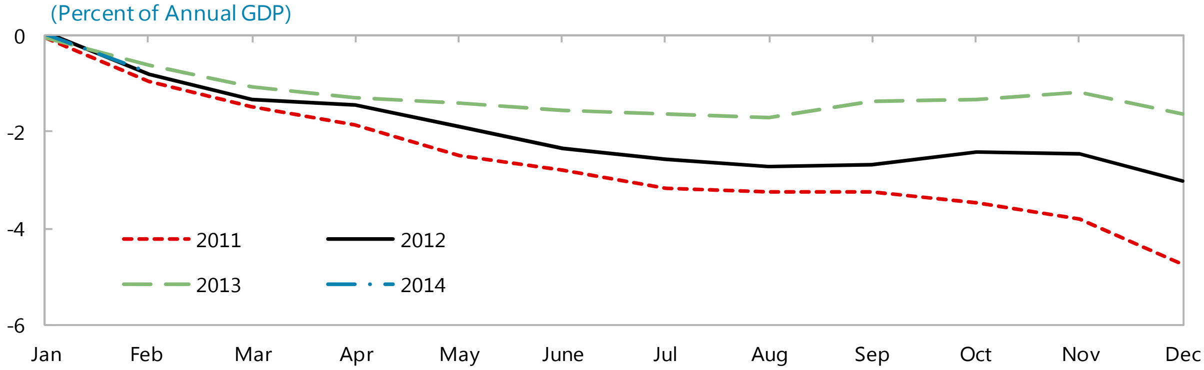


Sources: Dx Time; Bank of Lithuania; and IMF staff estimates.

Figure 4. Lithuania: Fiscal Sector Developments

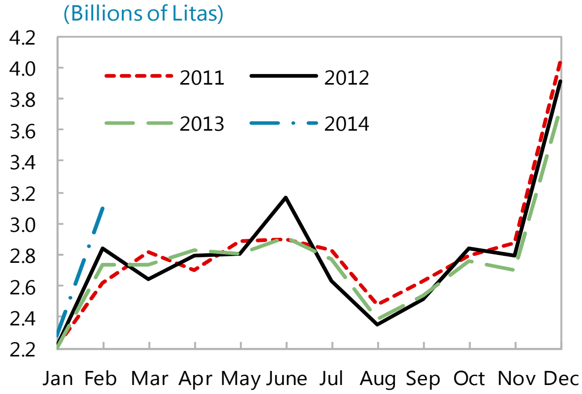
The central government cumulative cash deficit has continued to improve in 2013 ...

Cumulative Central Government Balance
(Percent of Annual GDP)



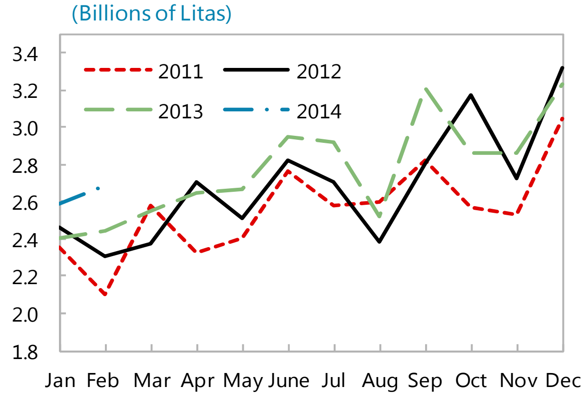
...reflecting strict expenditure restraint,...

Total Primary Expenditures
(Billions of Litas)



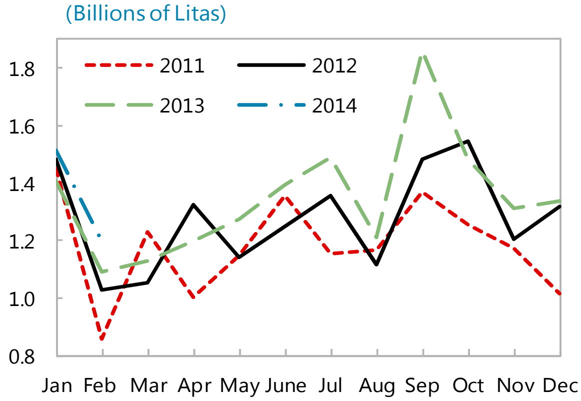
... and revenue overperformance,...

Revenues
(Billions of Litas)



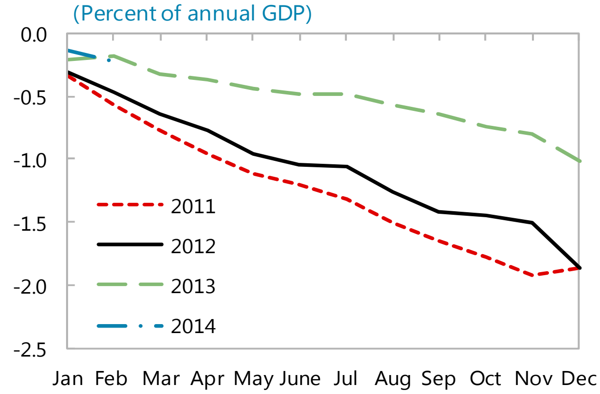
...especially after tax collection improved from May.

Taxes
(Billions of Litas)



The Social Security (Sodra) deficit, overperformed due to favorable revenue developments.

Cumulative Sodra Deficit
(Percent of annual GDP)



Source: Ministry of Finance.

Table 1: Lithuania: Selected Economic Indicators, 2011–19

Life expectancy at birth (2009): 78.3 years (women), 67.5 years (men)
Quota (current, % of total): 183.9 million SDR, 0.08 percent
Main products and exports: mineral, chemical, agricultural and wood products, machinery and equipment
Key export markets: Russia, Latvia, Germany, Poland

Per capita GDP (current US$, 2012): US$14,014
Per capita GDP (PPP, 2012): €17,700
Literacy rate (2011): 99.7 %
At-risk-of-poverty (after transfers), share of population (2011): 20 percent

	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Projections			
Output									
Real GDP growth (annual percentage change)	6.0	3.7	3.3	3.3	3.5	3.6	3.7	3.8	3.8
Domestic demand growth (year-on-year, in percent)	6.4	-0.9	3.4	3.9	4.2	4.2	4.1	4.2	4.2
Private consumption growth (year-on-year, in percent)	4.8	3.9	4.8	3.2	3.2	3.4	3.4	3.4	3.4
Domestic fixed investment growth (year-on-year, in percent)	20.7	-3.6	12.8	7.0	6.3	6.4	5.5	5.4	5.3
Inventories (contribution to growth)	-0.3	-2.7	-2.4	0.0	0.0	0.0	0.0	0.0	0.0
Net external demand (contribution to growth)	0.3	4.4	0.2	-0.5	-0.6	-0.5	-0.4	-0.4	-0.4
Nominal GDP (in billions of litai)	106.9	113.7	119.5	124.9	132.3	140.7	150.3	160.9	172.1
GDP (in billions of euros)	31.0	32.9	34.6	36.2	38.3	40.8	43.5	46.6	49.9
Output gap (percent of potential GDP)	-2.5	-0.9	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Employment									
Unemployment rate (year average, in percent of labor force)	15.4	13.4	11.8	10.8	10.5	10.5	10.5	10.5	10.5
Average monthly gross earnings (annual percentage change)	2.2	2.6	5.0	3.8	5.3	5.7	5.8	6.1	6.6
Labor productivity (annual percentage change)	5.5	1.9	1.9	2.8	3.4	3.7	3.5	3.8	4.3
Prices									
CPI, end of period (year-on-year percentage change)	3.5	2.9	0.5	1.7	1.8	2.1	2.2	2.2	2.2
GDP deflator (year-on-year percentage change)	5.4	2.6	1.7	1.2	2.4	2.7	3.0	3.1	3.1
CPI core, period average (annual percentage change)	0.3	2.0	1.4	1.5	2.3	2.4	2.8	3.0	3.0
CPI, period average (annual percentage change)	4.1	3.2	1.2	1.0	1.8	2.0	2.2	2.2	2.2
General government finances 1/									
Revenue (percent of GDP)	33.2	32.7	33.0	33.0	33.0	32.6	32.5	32.5	32.6
Of which EU grants	3.2	2.8	2.7	2.7	2.6	2.1	2.0	2.0	2.0
Expenditure (percent of GDP)	38.7	35.9	35.2	34.9	34.8	34.4	34.2	34.1	34.1
Of which: Non-interest	36.9	34.1	33.4	33.2	33.0	32.7	32.5	32.5	32.4
Interest	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.6
Fiscal balance (percent of GDP) 2/	-5.5	-3.2	-2.1	-1.9	-1.8	-1.8	-1.7	-1.6	-1.5
Structral Fiscal Balance (percent of potential GDP) 3/	-3.7	-2.4	-1.6	-1.4	-1.4	-1.5	-1.5	-1.5	-1.5
General government gross debt (percent of GDP)	39.2	41.0	39.3	39.5	39.1	38.6	37.8	37.0	36.0
Of which: Foreign currency-denominated	31.7	32.1	27.4	26.6	25.5	24.3	23.0	21.7	20.3
Money and credit									
Broad money (end of period, percent change)	5.0	7.2	4.5	11.1	9.8	..	..	..	..
Private sector credit (end of period, percent change)	-5.7	0.3	-3.0	2.5	4.1	..	..	..	..
3-month Treasury bill interest rate (percent)	1.7	1.1	0.7	..	..	..	..	..	..
Reserve money (end of period, percent change)	37.5	-6.4	4.9	5.8	6.7	..	..	..	..
Balance of payments (in percent of GDP, unless otherwise specified)									
Current account balance	-3.7	-0.2	1.5	0.6	0.2	-0.5	-0.8	-1.2	-1.6
Current account balance (billions of euros)	-1.2	-0.1	0.5	0.2	0.1	-0.2	-0.4	-0.6	-0.8
Trade balance for goods									
Exports of goods and services (volume change, in percent)	14.1	11.8	9.5	5.7	6.1	6.1	6.2	6.4	6.4
Imports of goods and services (volume change, in percent)	13.7	6.1	9.8	6.6	7.1	6.9	6.8	7.0	6.9
Foreign direct investment, net	3.2	0.7	0.9	1.2	1.5	1.7	1.9	2.2	2.3
Gross official reserves (in billions of euros)	6.4	6.5	6.0	6.4	6.8	7.0	7.2	7.3	7.2
Reserve cover (in months of imports of goods and services)	3.1	2.8	2.4	2.5	2.6	2.6	2.6	2.5	2.4
Gross external debt 4/	76.9	70.9	64.5	62.1	59.6	57.0	54.3	51.6	49.0
Exchange rates									
Real effective exchange rate (2005=100, +=appreciation) 5/	118.9	117.5	119.1	..	..	..	..	..	..
Exchange rate (litai per U.S. dollar, end of period)	2.67	2.61	2.43	..	..	..	..	..	..
Exchange rate (litai per U.S. dollar, period average)	2.48	2.69	2.51	..	..	..	..	..	..
Exchange rate (litai per euro, end of period)	3.45	3.45	3.45	..	..	..	..	..	..
Exchange rate (litai per euro, period average)	3.45	3.45	3.45	..	..	..	..	..	..
Saving-investment balance (in percent of GDP)									
Gross national saving	17.5	18.1	19.9	20.3	20.8	21.0	21.3	21.6	21.9
Gross national investment	21.3	18.3	18.5	19.8	20.6	21.4	22.1	22.8	23.5
Foreign net savings	3.7	0.2	-1.5	-0.6	-0.2	0.5	0.8	1.2	1.6

Sources: Lithuanian authorities; World Bank; Eurostat; and IMF staff estimates and projections.
1/ Passive projections from 2015 onward; incorporate only announced budgetary measures; budgetary impact of pension and wage compensation and their potential offsetting measures are not included.
2/ Fiscal balance for 2012 according to the definition for purposes of the Excessive Deficit Procedure (EDP).
3/ Calculation takes into account standard cyclical adjustments as well as absorption gap.
4/ Government external debt includes guaranteed loans.
5/ CPI-based, 2005 trade-weighted real effective exchange rate against 17 major trading partners.

Table 2. Lithuania: General Government Operations, 2011–19
(ESA 95 aggregates, in percent of GDP)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Projections 1/						
Statement of Operations									
Revenue	33.2	32.7	33.0	33.0	33.0	32.6	32.5	32.5	32.6
Revenue excluding EU grants	30.0	29.9	30.3	30.3	30.4	30.5	30.5	30.5	30.6
Tax revenue	15.9	16.0	16.0	16.0	16.0	16.1	16.2	16.3	16.4
Direct taxes	4.4	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.1
Personal income tax	3.5	3.5	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Corporate income tax	0.8	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Indirect taxes	11.5	11.1	11.0	10.9	11.0	11.1	11.2	11.3	11.4
VAT	7.8	7.5	7.5	7.5	7.4	7.5	7.5	7.6	7.7
Excises	3.0	2.9	2.9	2.9	2.9	3.0	3.0	3.0	3.0
Other	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Social contributions	11.6	11.3	11.8	11.8	11.8	11.8	11.7	11.6	11.6
Grants	3.2	2.8	2.7	2.7	2.6	2.1	2.0	2.0	2.0
Other revenue	2.5	2.7	2.5	2.6	2.6	2.6	2.6	2.6	2.6
Total expenditure	38.7	35.9	35.2	34.9	34.8	34.4	34.2	34.1	34.1
Current spending	34.6	32.5	31.5	31.2	31.1	30.8	30.6	30.5	30.5
Compensation of employees	10.3	9.8	9.3	9.2	9.2	9.1	9.1	9.1	9.1
Goods and services	5.2	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Interest payments	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.6
Foreign	1.5	1.6	1.6	1.4	1.2	1.1	1.1	1.1	1.1
Domestic	0.3	0.2	0.2	0.3	0.5	0.6	0.6	0.6	0.6
Subsidies	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Grants	0.7	0.8	0.8	0.8	0.6	0.6	0.6	0.6	0.6
Social benefits	14.6	13.9	13.2	13.1	13.1	13.0	12.9	12.8	12.8
Other expense	1.6	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Capital spending	4.0	3.5	3.6	3.7	3.7	3.6	3.6	3.6	3.6
Net lending (+) / borrowing (-)	-5.5	-3.2	-2.1	-1.9	-1.8	-1.8	-1.7	-1.6	-1.5
Net acquisition of financial assets	-0.6	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.1	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	-0.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.9	4.5	2.1	1.9	1.8	1.8	1.7	1.6	1.5
Domestic	1.5	1.4	3.8	1.5	1.5	1.5	1.5	1.5	1.4
Foreign	3.4	3.2	-1.7	0.4	0.3	0.4	0.3	0.2	0.1
Financial Balance Sheet									
Financial assets	27.0	26.5	..	..	..	..	..	..	..
Currency and deposits	3.5	5.8	..	..	..	..	..	..	..
Securities other than shares	0.0	0.0	..	..	..	..	..	..	..
Loans	3.1	2.3	..	..	..	..	..	..	..
Shares and other equity	15.2	14.0	..	..	..	..	..	..	..
Other financial assets	5.2	4.4	..	..	..	..	..	..	..
Financial liabilities	46.3	51.9	..	..	..	..	..	..	..
Currency and deposits	0.0	0.6	..	..	..	..	..	..	..
Securities other than shares	34.0	39.0	..	..	..	..	..	..	..
Loans	7.1	7.6	..	..	..	..	..	..	..
Other liabilities	5.2	4.7	..	..	..	..	..	..	..
Net financial worth	-19.3	-25.4	..	..	..	..	..	..	..
Memorandum items:									
GDP (in millions of litai)	106,893	113,735	119,469	124,871	132,281	140,749	150,342	160,860	172,149
General government debt (Maastricht def.)	39.2	41.0	39.3	39.5	39.1	38.6	37.8	37.0	36.0
Foreign debt	28.9	31.0	27.4	26.6	25.5	24.3	23.0	21.7	20.3
Domestic debt	10.3	10.0	11.9	12.8	13.6	14.2	14.8	15.3	15.7

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

1/ Passive projections from 2015 onward; incorporate only announced budgetary measures; budgetary impact of pension and wage compensation and their potential offsetting measures are not included.

Table 3. Lithuania: Balance of Payments, 2011–19
(Billions of Euro, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Projections						
Current account balance	-1.2	-0.1	0.5	0.2	0.1	-0.2	-0.4	-0.6	-0.8
Merchandise trade balance	-1.8	-0.9	-1.2	-1.5	-1.7	-1.8	-1.9	-1.9	-2.0
Exports (f.o.b.)	20.2	23.0	24.7	25.1	25.6	26.4	27.3	28.2	29.3
Imports (f.o.b.)	-22.0	-24.0	-25.9	-26.6	-27.2	-28.2	-29.1	-30.2	-31.2
Services balance	1.0	1.2	1.6	1.6	1.7	1.7	1.8	1.8	1.9
Exports of non-factor services	3.7	4.6	5.4	5.5	5.6	5.8	6.0	6.1	6.3
Imports of non-factor services	-2.7	-3.4	-3.8	-3.8	-3.9	-4.0	-4.2	-4.3	-4.4
Factor income balance	-1.4	-1.4	-1.3	-1.2	-1.1	-1.2	-1.3	-1.4	-1.6
Receipts	0.7	0.5	0.4	0.4	0.5	0.5	0.5	0.6	0.6
Payments	-2.1	-1.9	-1.7	-1.7	-1.5	-1.7	-1.8	-2.0	-2.2
Current transfer balance	1.1	1.0	1.5	1.3	1.1	1.1	1.0	0.9	0.9
Capital and financial account balance	2.5	0.2	-1.0	0.2	0.3	0.4	0.5	0.7	0.7
Capital transfer balance	0.8	0.7	0.8	0.6	0.5	0.5	0.5	0.5	0.5
Foreign direct investment balance	1.0	0.2	0.3	0.4	0.6	0.7	0.8	1.0	1.1
Portfolio investment balance	1.2	0.9	-1.4	-0.5	-0.5	-0.5	-0.6	-0.6	-0.7
Other investment balance	-0.5	-1.7	-0.6	-0.4	-0.3	-0.2	-0.2	-0.2	-0.2
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.4	0.1	-0.4	0.4	0.3	0.2	0.2	0.1	0.0
Financing	-1.4	-0.1	0.4	-0.4	-0.3	-0.2	-0.2	-0.1	0.0
Gross international reserves (increase: -)	-1.4	-0.1	0.4	-0.4	-0.3	-0.2	-0.2	-0.1	0.0
Use of Fund credit, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Prospective Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of GDP (unless indicated)									
Current account balance	-3.7	-0.2	1.5	0.6	0.2	-0.5	-0.8	-1.2	-1.6
Trade Balance of goods and services	-2.6	1.0	1.1	0.3	0.1	-0.1	-0.2	-0.2	-0.2
Exports	77.2	83.9	86.9	84.5	81.4	79.0	76.3	73.8	71.3
Imports	-79.8	-82.9	-85.8	-84.2	-81.3	-79.1	-76.5	-74.0	-71.5
Factor Income	-4.6	-4.1	-3.9	-3.4	-2.8	-2.9	-2.9	-3.0	-3.1
Current Transfers	3.5	3.0	4.2	3.7	2.9	2.6	2.3	2.0	1.8
Capital and financial account balance	8.2	0.7	-2.8	0.6	0.7	1.0	1.2	1.5	1.5
Capital transfers	2.5	2.2	2.2	1.7	1.4	1.3	1.1	1.1	1.0
Foreign direct investment balance	3.2	0.7	0.9	1.2	1.5	1.7	1.9	2.2	2.3
Portfolio investment balance	3.9	2.8	-4.1	-1.4	-1.4	-1.3	-1.4	-1.4	-1.3
Other investment balance	-1.5	-5.1	-1.9	-1.0	-0.7	-0.6	-0.5	-0.4	-0.4
Overall balance	4.4	0.4	-1.3	1.1	0.9	0.5	0.4	0.3	-0.1
Gross external debt 1/	76.9	70.9	64.5	62.1	59.6	57.0	54.3	51.6	48.9
Public	30.0	31.2	27.6	26.8	25.6	24.5	23.2	21.9	20.5
Short-term	1.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Long-term	28.9	31.2	27.4	26.6	25.5	24.3	23.1	21.7	20.4
Private	46.9	39.7	36.9	35.3	34.0	32.6	31.1	29.7	28.4
Short-term	14.1	19.5	18.3	17.7	17.4	17.1	16.8	16.4	16.1
Long-term	32.8	20.1	18.6	17.7	16.6	15.5	14.4	13.3	12.3
Gross external debt (in percent of GNFS exports)	102.0	84.5	74.1	73.5	73.3	72.2	71.2	70.0	68.7
Net external Debt	32.2	33.4	28.1	22.7	19.1	16.1	13.5	11.4	9.7
Net international investment position	-52.3	-52.8	-45.8	-41.5	-37.6	-34.6	-32.1	-30.1	-28.7
GIR (in billions of Euros)	6.4	6.5	6.0	6.4	6.8	7.0	7.2	7.3	7.2
GIR (in percent of short-term debt) 2/	54.3	71.3	60.5	62.8	64.4	64.8	64.6	63.8	61.5
GIR (in months of imports of goods and services	3.1	2.8	2.4	2.5	2.6	2.6	2.6	2.5	2.4
Merchandise export volume (percent change) 3/	14.1	11.8	9.5	5.7	6.1	6.1	6.2	6.4	6.4
Merchandise import volume (percent change) 3/	13.7	6.1	9.8	6.6	7.1	6.9	6.8	7.0	6.9
Merchandise export prices (percent change) 3/	11.7	3.5	-1.4	-4.0	-4.0	-2.5	-2.8	-2.7	-2.7
Merchandise import prices (percent change) 3/	12.8	4.2	-1.4	-3.6	-4.5	-3.0	-3.4	-3.2	-3.2
GDP (in billion of Euros)	31.0	32.9	34.6	36.2	38.3	40.8	43.5	46.6	49.9

Sources: Data provided by the Lithuanian authorities; IMF International Financial and Trade Statistics; and IMF staff estimates and projections.

1/ Government external debt here includes guaranteed loans.

2/ Short-term debt at remaining maturity.

3/ Derived from national accounts data.

Table 4. Lithuania: Summary of Monetary Accounts, 2008–15

(Billions of Litai, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
							Projections	
Monetary Authority								
Gross foreign assets	15.6	15.8	17.8	22.1	22.1	20.6	22.8	23.9
Gross foreign liabilities	0.1	0.4	0.6	1.1	0.1	0.1	0.1	0.1
Net foreign assets	15.5	15.4	17.2	21.0	22.1	20.6	22.7	23.9
Gold	0.4	0.5	0.7	0.8	0.8	..	..	..
Net domestic assets	-2.8	-4.9	-4.7	-3.7	-5.9	-3.6	-5.0	-4.4
Net credit to government	-1.3	-2.6	-2.4	-1.4	-3.6	-1.6	-3.0	-3.0
Credit to banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items, net	-1.5	-2.3	-2.2	-2.3	-2.3	-2.0	-2.0	-1.4
Reserve money	12.7	10.5	12.6	17.3	16.2	17.0	18.0	19.1
Currency outside the central bank	9.6	7.9	8.8	10.8	11.4	11.9	13.5	14.6
Currency outside banks	8.5	7.0	7.8	9.7	10.3	10.9	12.3	13.4
Cash in vaults of banks	1.1	1.0	1.0	1.1	1.1	0.9	1.2	1.2
Deposit money banks' deposits with BoL	3.1	2.6	3.8	6.5	4.8	5.1	4.5	4.5
Banking Survey								
Net foreign assets	-15.6	-5.6	1.4	5.4	9.7	10.0	14.8	18.6
Monetary authority	15.5	15.4	17.2	21.0	22.1	20.6	22.7	23.9
Banks and other banking institutions	-31.1	-21.1	-15.8	-15.6	-12.3	-10.6	-7.9	-5.3
Net domestic assets	59.6	49.8	46.7	45.1	44.4	46.6	48.1	50.5
Net claims on government 1/	1.4	-2.6	0.7	-1.0	0.3	4.0	4.0	4.0
Monetary authority	-1.3	-2.6	-2.4	-1.4	-3.6	-1.6	-3.0	-3.0
Banks and other banking institutions	2.7	0.1	3.1	0.4	4.0	5.6	7.0	7.0
Credit to private sector	66.0	61.4	56.8	53.5	53.7	52.1	53.4	55.6
Credit to nonbank financial institutions	3.9	2.7	3.7	3.4	4.3	3.2	3.3	3.5
Other items, net	-11.7	-11.8	-14.4	-10.8	-13.9	-12.6	-12.6	-12.6
Broad money	44.1	44.2	48.1	50.5	54.2	56.6	62.9	69.0
Currency outside banks	8.5	7.0	7.8	9.7	10.3	10.9	12.3	13.4
Deposits	34.9	36.8	39.9	40.3	43.3	45.3	50.6	55.6
In national currency	26.0	25.0	28.5	29.5	31.8	33.2	37.1	40.7
In foreign currency	9.0	11.8	11.4	10.8	11.6	12.1	13.5	14.8
Memorandum items:								
Reserve money (yearly percent change)	-1.4	-17.2	19.4	37.5	-6.4	4.9	5.8	6.7
Broad money (yearly percent change)	-0.4	0.3	8.9	5.0	7.2	4.5	11.1	9.8
Private sector credit (yearly percent change)	17.8	-6.9	-7.6	-5.7	0.3	-3.0	2.5	4.1
Money multiplier	3.5	4.2	3.8	2.9	3.3	3.3	3.5	3.6
Currency outside banks, in percent of deposits	24.4	19.0	19.7	24.1	23.8	24.1	24.2	24.2
Foreign-currency deposits (percent of total deposits)	25.7	32.0	28.6	26.8	26.7	26.7	26.7	26.7
Foreign-currency loans (percent of total loans) 2/	64.7	73.5	74.6	74.3	72.8	72.1	72.0	72.0
Velocity of broad money	2.5	2.1	2.0	2.1	2.1	2.1	2.0	1.9
Gross official reserves (billions of U.S. dollars) 3/	6.4	6.6	6.6	8.2	8.5	8.1	8.9	9.5
Gross official reserves (billions of euros) 3/	4.6	4.6	5.0	6.3	6.4	5.9	6.4	6.8
Excess reserve coverage 4/	8.3	14.5	13.1	12.0	13.7	8.1	9.5	8.6
GDP	111.9	92.0	95.7	106.9	113.7	119.5	124.9	132.3

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

1/ Excludes local government deposits; includes counterpart funds.

2/ Loans to households and non-financial corporations.

3/ BOP basis. Differs from gross foreign assets as shown in the monetary authority's balance sheet because of valuation effects (BoP-basis official reserves include accrued interest on deposits and securities but exclude investments in shares and other equity).

4/ Bank of Lithuania's gross foreign assets less reserve money, in percent of banking system deposits.

Table 5. Lithuania: Financial Soundness Indicators, Banking System Data, 2007–13

(Percent, unless otherwise indicated)

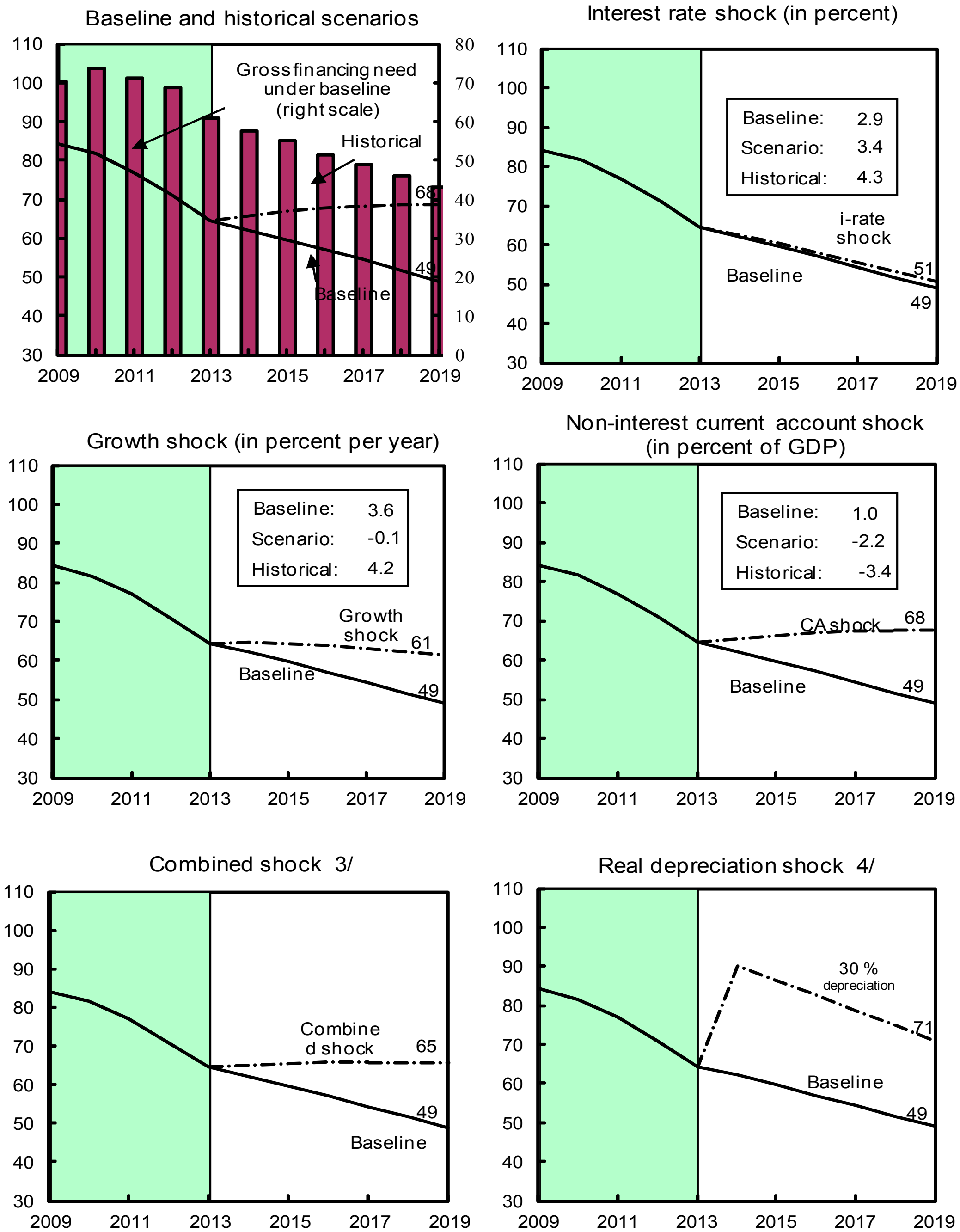
	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Capital adequacy							
Regulatory capital to risk-weighted assets 1/ 9/	10.9	11.6	12.9	14.8	14.2	15.7	17.6
Regulatory Tier 1 capital to risk-weighted assets 1/ 9/	7.7	9.1	9.3	10.8	12.0	14.6	17.1
Capital to assets 1/	7.9	8.9	9.4	10.9	10.2	11.4	11.5
Asset quality							
Nonperforming loans to capital 1/ 4/	..	41.8	198.8	174.7	109.8	79.4	59.6
o/w impaired loans to capital 1/ 4/	..	30.3	161.2	143.7	92.8	65.7	44.4
o/w non-impaired loans overdue more than 60 days to capital 1/ 4/	..	11.5	37.6	30.9	17.0	13.7	15.2
Nonperforming loans net of provisions to capital 1/ 4/ 13/	..	31.0	133.1	106.0	63.5	46.9	36.7
Nonperforming loans to total (non-interbank) loans 4/	..	4.7	19.7	19.9	16.6	13.6	11.0
o/w impaired loans to total (non-interbank) loans 4/	..	3.4	15.7	16.7	14.0	11.4	8.5
o/w non-impaired loans overdue more than 60 days to total (non-interbank) loans 4/	..	1.3	3.9	3.3	2.5	2.2	2.5
Impairment losses to total (non-interbank) loans 12/ 13/	0.7	1.3	6.7	8.0	7.0	5.6	4.2
Impairment losses to nonperforming loans 3/ 4/ 12/ 13/	72.2	26.8	33.9	40.2	42.2	40.8	37.9
Sectoral distribution of loans to total loans 6/							
Agriculture, hunting, forestry	1.7	2.1	1.9	1.9	..	..	..
Fishing	0.0	0.0	0.0	0.0	..	..	..
Mining and quarrying	0.1	0.2	0.2	0.3	..	..	..
Manufacturing	9.9	10.7	10.3	9.4	..	..	..
Electricity, gas and water supply	2.2	1.9	1.9	2.1	..	..	..
Construction	4.1	3.8	3.1	2.9	..	..	..
Wholesale and retail trade	10.7	10.7	9.7	8.8	..	..	..
Hotels and restaurants	1.4	1.6	1.7	1.5	..	..	..
Transport, storage and communication	2.2	2.5	2.6	2.3	..	..	..
Financial intermediation	5.5	6.3	4.0	5.6	..	..	..
Real estate, renting and other business activities	16.8	18.4	20.2	19.1	..	..	..
Public administration and defence; compulsory social security	1.3	2.1	2.2	3.7	..	..	..
Education	0.0	0.3	0.1	0.1	..	..	..
Health and social work	0.3	0.2	0.3	0.3	..	..	..
Other utilities, social and personal services	0.9	0.9	1.0	0.9	..	..	..
Other types of economic activities	0.0	0.0	0.0	0.0	..	..	..
Loans not attributed to economic activities	42.9	38.4	40.9	41.2	..	..	..
Residential real estate loans to total (non-interbank) loans	27.8	29.6	33.0	34.3	36.7	37.9	38.0
Large exposures to regulatory capital 1/ 5/	152.7	129.4	114.9	..	..	..	..
Earnings and profitability							
RoE 1/ 2/	25.9	11.8	-50.8	-3.9	15.8	7.7	8.9
RoA 2/	1.7	0.8	-3.8	-0.3	1.4	0.9	1.0
Interest margin to gross income	55.8	64.4	50.6	49.0	58.7	53.7	49.9
Noninterest expenses to gross income	49.8	54.6	60.3	64.4	60.2	61.9	61.9
Trading and foreign exchange gains (losses) to gross income	8.1	0.9	13.5	8.1	4.0	9.1	8.8
Personnel expenses to noninterest expenses	43.6	41.8	38.7	37.5	40.6	39.5	39.0
Liquidity							
Liquidity ratio (liquid assets to current liabilities) 7/	43.5	39.0	49.9	43.8	44.1	41.2	41.2
Liquid assets to total assets 7/	21.9	18.6	23.7	23.8	23.7	25.1	27.0
Current liabilities to total liabilities 7/	54.2	51.4	50.5	58.5	58.8	67.7	73.1
3-month VILIBOR-EURIBOR spread, b.p. 8/	229.6	699.8	320.0	49.4	30.4	49.0	18.0
Spread between highest and lowest interbank rate, b.p. 10/	690.0	1650.0	970.0	436.0	218.0	34.0	39.0
Customer deposits to total non-interbank loans	66.4	56.8	68.6	82.2	80.6	85.8	93.3
Foreign exchange risk							
Foreign-currency-denominated loans to total (non-interbank) loans 11/	55.6	64.6	73.9	74.0	72.4	72.4	68.7
Foreign-currency-denominated liabilities to total liabilities 11/	56.2	63.3	61.6	57.0	53.1	50.9	48.2
Net open position in foreign exchange to regulatory capital 1/ 9/	-2.4	1.0	1.0	0.5	0.6	0.3	0.4
Memo item							
Provisioning (in percent of NPLs)	..	25.9	33.0	39.3	42.2	41.0	38.4

Source: Bank of Lithuania & http://fsi.imf.org/

1/ Excluding foreign bank branches.
2/ Total profits (losses) after tax. Interim quarterly results are annualised.
3/ From end-2005 to Q1-2008, NPLs are loans overdue more than 60 days. Untill 2004 NPLs are loans in Substandard, Doubtful and Loss loans categories.
4/ Starting June 2008, non-performing loans are defined as the sum of impaired loans and non-impaired loans that are overdue more than 60 days.
5/ Large exposure means loans granted to the borrower the net value of which equals to, or exceeds, 10 per cent of bank capital.
6/ Credit registry data from 2005. According to Nace 1. Due to ongoing revisions to Nace 2, no data available for 2011-12.
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/ Data as of the end of period.
9/ As defined in Rules for Calculation of Capital Adequacy approved by Bank of Lithuania Board Resolution No. 138 of 9 November 2006.
10/ Information is based on interbank deals of all maturities (mostly overnights) made between resident banks in national currency within the last quarter of the period.
11/ The large majority of foreign currency loans and foreign currency liabilities are in euros, to which the national currency is pegged via a currency board arrangement.
12/ Specific provisions include provisions against general portfolio risk until end-2004. From end-2005, due to the change in definition of NPLs, specific provisions are not directly attributable to the NPLs. Therefore, the ratio may be negative.
13/ Specific provisions include allowances for both individually and collectively assessed loans.

Annex Figure 1A. Lithuania: External Debt Sustainability Analysis: Bound Tests 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Lithuanian authorities, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2014.

Annex Table 1A. Lithuania: External Debt Sustainability Framework, 2008–19

(in percent of GDP, unless otherwise indicated)

	Actual					Projections							
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	71.0	84.2	81.6	76.9	70.9	64.5	62.1	59.6	57.0	54.3	51.6	49.0	-3.1
Change in external debt	-0.5	13.2	-2.5	-4.7	-6.0	-6.5	-2.3	-2.5	-2.6	-2.7	-2.7	-2.7	
Identified external debt-creating flows (4+8+9)	3.4	11.5	-3.0	-7.2	-4.0	-4.1	-3.3	-3.1	-2.6	-2.4	-2.1	-1.8	
Current account deficit, excluding interest payments	9.6	-9.8	-2.8	1.0	-2.5	-3.8	-2.4	-1.6	-1.0	-0.7	-0.4	-0.1	
Deficit in balance of goods and services	11.7	1.7	1.9	2.6	-1.0	-1.1	-0.3	-0.1	0.1	0.2	0.2	0.2	
Exports	59.6	54.1	67.6	77.2	83.9	86.9	84.5	81.4	79.0	76.3	73.8	71.3	
Imports	71.3	55.8	69.5	79.8	82.9	85.8	84.2	81.3	79.1	76.5	74.0	71.5	
Net non-debt creating capital inflows (negative)	-1.4	-0.1	0.3	-2.4	0.4	-0.4	-0.7	-0.9	-1.1	-1.2	-1.4	-1.5	
Net foreign direct investment, equity	1.3	1.0	0.8	2.9	0.2	0.7	1.0	1.2	1.4	1.5	1.7	1.8	
Net portfolio investment,equity	0.1	-1.0	-1.1	-0.5	-0.6	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	
Automatic debt dynamics 1/	-4.8	21.4	-0.5	-5.9	-1.9	0.1	-0.2	-0.6	-0.5	-0.4	-0.3	-0.1	
Contribution from nominal interest rate	3.3	6.0	2.7	2.7	2.7	2.3	1.8	1.4	1.5	1.5	1.6	1.7	
Contribution from real GDP growth	-1.8	12.8	-1.3	-4.4	-2.6	-2.2	-2.0	-2.0	-2.0	-2.0	-1.9	-1.8	
Contribution from price and exchange rate changes 2/	-6.3	2.5	-1.9	-4.1	-2.0	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-4.0	1.7	0.4	2.5	-2.0	-2.3	0.9	0.6	0.0	-0.3	-0.6	-0.9	
External debt-to-exports ratio (in percent)	119.1	155.6	120.7	99.7	84.5	74.1	73.5	73.3	72.2	71.2	70.0	68.7	
Gross external financing need (in billions of Euro) 4/	25.0	18.7	20.3	22.0	22.6	21.0	20.8	21.1	21.0	21.2	21.4	21.6	
in percent of GDP	77.1	70.1	73.4	71.0	68.6	60.7	57.6	55.1	51.4	48.7	45.8	43.3	
Scenario with key variables at their historical averages 5/						64.5	65.5	66.8	67.7	68.2	68.5	68.4	-4.1
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	2.9	-14.8	1.6	6.0	3.7	3.3	3.3	3.5	3.6	3.7	3.8	3.8	
GDP deflator in Euro (change in percent)	9.6	-3.4	2.3	5.4	2.6	1.7	1.2	2.4	2.7	3.0	3.1	3.1	
Nominal external interest rate (in percent)	5.2	7.0	3.4	3.7	3.8	3.4	2.9	2.4	2.7	2.8	3.2	3.5	
Growth of exports (Euro terms, in percent)	25.1	-25.3	29.9	27.5	15.7	8.8	1.6	2.0	3.3	3.2	3.4	3.4	
Growth of imports (Euro terms, in percent)	20.0	-35.6	29.5	28.2	10.6	8.7	2.6	2.2	3.6	3.2	3.5	3.5	
Current account balance, excluding interest payments	-9.6	9.8	2.8	-1.0	2.5	3.8	2.4	1.6	1.0	0.7	0.4	0.1	
Net non-debt creating capital inflows	1.4	0.1	-0.3	2.4	-0.4	0.4	0.7	0.9	1.1	1.2	1.4	1.5	

1/ 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.

2/ 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).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ 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.

6/ 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.

Annex Figure 2A. Public Debt Sustainability Analysis – Baseline

(in percent of GDP unless otherwise indicated)

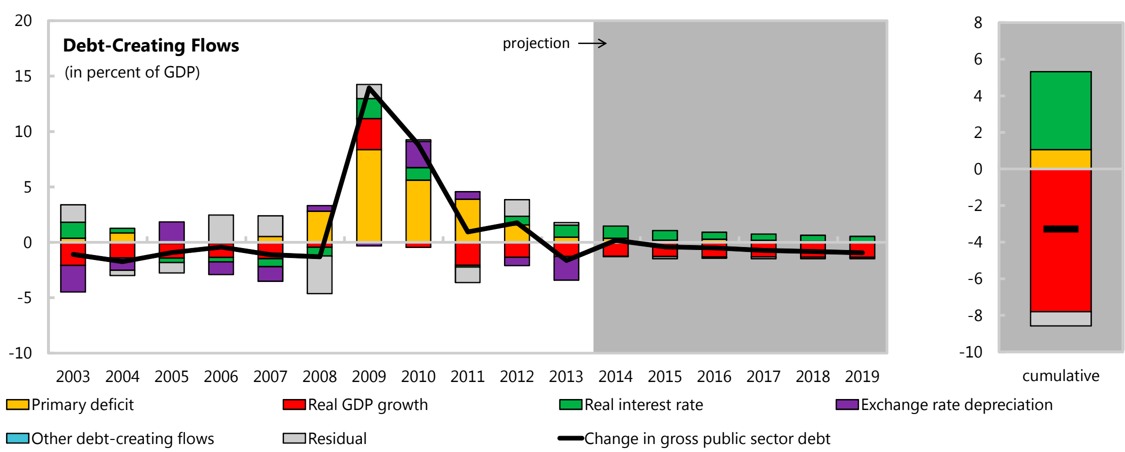
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	24.0	41.0	39.3	39.5	39.1	38.6	37.8	37.0	36.0
Public gross financing needs	7.0	8.6	7.5	4.6	7.9	7.3	6.0	7.9	4.6
Real GDP growth (in percent)	4.3	3.7	3.3	3.3	3.5	3.6	3.7	3.8	3.8
Inflation (GDP deflator, in percent)	4.1	2.6	1.7	1.2	2.4	2.7	3.0	3.1	3.1
Nominal GDP growth (in percent)	8.8	6.4	5.0	4.5	5.9	6.4	6.8	7.0	7.0
Effective interest rate (in percent) [4/]	5.3	4.9	4.6	4.2	4.8	4.5	4.7	4.8	4.8

As of April 16, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		194
5Y CDS (bp)		137
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	A-	A-
Fitch	BBB+	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.9	1.8	-1.6	0.2	-0.4	-0.5	-0.7	-0.8	-0.9	-3.3	
Identified debt-creating flows	1.8	0.3	-1.9	0.2	-0.2	-0.4	-0.6	-0.7	-0.8	-2.5	
Primary deficit	2.5	1.6	0.5	0.4	0.2	0.3	0.2	0.1	0.0	1.1	-0.8
Primary (noninterest) revenue and grants	33.1	32.6	32.9	32.9	32.8	32.5	32.4	32.4	32.5	195.3	
Primary (noninterest) expenditure	35.6	34.1	33.4	33.2	33.0	32.7	32.5	32.5	32.4	196.4	
Automatic debt dynamics [5/]	-0.7	-1.3	-2.3	-0.1	-0.4	-0.7	-0.8	-0.8	-0.8	-3.5	
Interest rate/growth differential [6/]	-0.6	-0.6	-0.2	-0.1	-0.4	-0.7	-0.8	-0.8	-0.8	-3.5	
Of which: real interest rate	0.3	0.8	1.1	1.1	0.8	0.6	0.6	0.6	0.5	4.3	
Of which: real GDP growth	-0.9	-1.3	-1.3	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-7.8	
Exchange rate depreciation [7/]	-0.1	-0.7	-2.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of dep	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroare	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.1	1.5	0.2	-0.1	-0.2	-0.1	-0.2	-0.1	-0.1	-0.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = 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).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

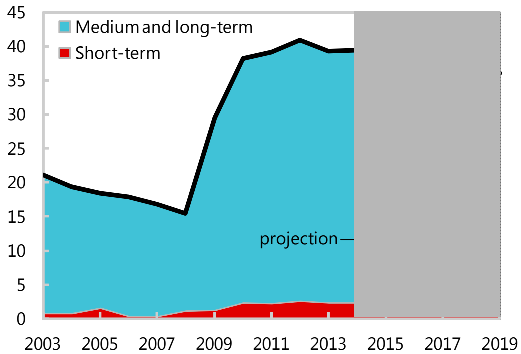
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

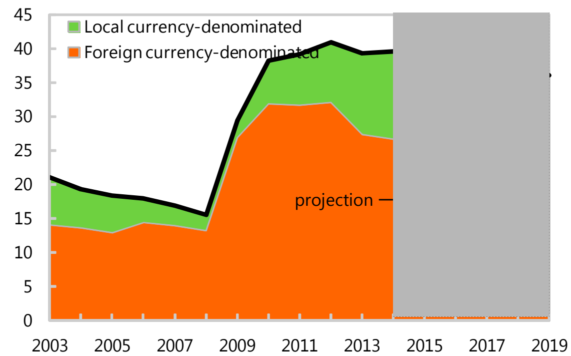
Annex Table 2A. Lithuania: Public Debt Sustainability – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



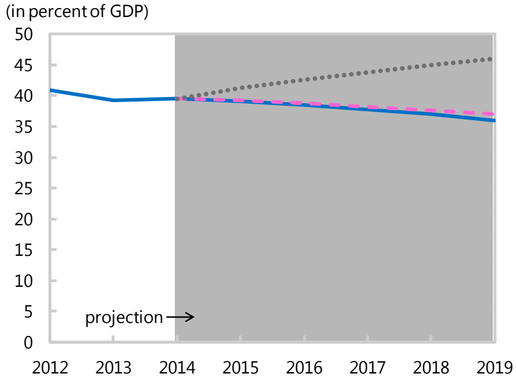
By Currency
(in percent of GDP)



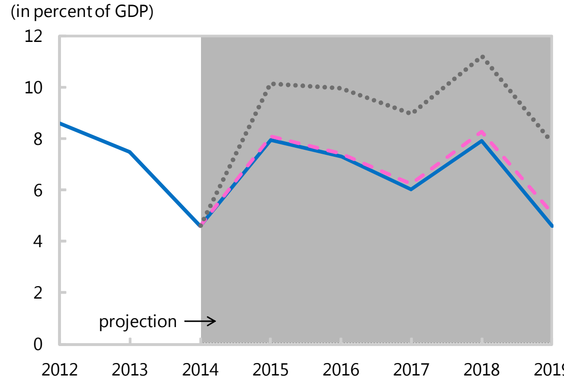
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	3.5	3.6	3.7	3.8	3.8
Inflation	1.2	2.4	2.7	3.0	3.1	3.1
Primary Balance	-0.4	-0.2	-0.3	-0.2	-0.1	0.0
Effective interest rate	4.2	4.8	4.5	4.7	4.8	4.8
Constant Primary Balance Scenario						
Real GDP growth	3.3	3.5	3.6	3.7	3.8	3.8
Inflation	1.2	2.4	2.7	3.0	3.1	3.1
Primary Balance	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	4.2	4.8	4.5	4.7	4.8	4.8

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	3.5	3.5	3.5	3.5	3.5
Inflation	1.2	2.4	2.7	3.0	3.1	3.1
Primary Balance	-0.4	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	4.2	4.8	4.3	4.2	4.2	4.1

Source: IMF staff.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 16, 2014

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of February 28, 2014)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	183.90	100.00
Fund holdings of currency (Exchange Rate)	183.88	99.99
Reserve Tranche Position	0.03	0.02

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	137.24	100.00
Holdings	137.31	100.05

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Aug 30, 2001	Mar 29, 2003	86.52	0.00
Stand-By	Mar 08, 2000	Jun 07, 2001	61.80	0.00
Stand-By	Oct 24, 1994	Oct 23, 1997	134.55	134.55

Projected Payments to Fund:

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	**2015**	**2016**	**2017**	**2018**
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

Implementation of HIPC Initiative:
Not applicable

Implementation of MDRI Assistance:
Not applicable

Implementation of Post-Catastrophe Debt Relief (PCDR):
Not applicable

Exchange Rate Arrangement:
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 Articles 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).

Previous Article IV Consultation:
Lithuania is on the 12-month consultation cycle. The last Article IV consultation was concluded on March 22, 2013. The Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2013/pn1334.htm and the staff report and other mission documents at http://www.imf.org/external/pubs/cat/longres.aspx?sk=40423.0

Safeguards Assessment:
Under the Fund's safeguards assessment policy, the Bank of Lithuania (BOL) was subject to and completed a safeguards assessment with respect to the Stand-By Arrangement, (the SBA was approved on August 30, 2001 and expired on March 29, 2003) on December 10, 2001. The assessment identified certain weaknesses and proposed appropriate recommendations as reported in EBS/01/211. The BOL has implemented these recommendations.

FSAP Participation and ROSCs:
An FSAP Update mission was completed on November 19, 2007. Fiscal and statistics ROSCs were completed in November 2002 and December 2002, respectively.

Technical Assistance: Technical Assistance (Date):

Republic of Lithuania: Technical Assistance from the Fund, 1999–2014

Department	Issue	Action	Date	Counterpart
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
MCM	Stress testing	Mr. Miguel A. Segoviano Basurto	June 11–21, 2007	Bank of Lithuania
STA	External debt statistics	Mission	November 8–19, 2007	Bank of Lithuania
FAD	Public expenditure review	WB mission / Ms. Budina (FAD) participation	April 14–24, 2009	Ministry of Finance
FAD	Tax Administration	Mission	Aug 26–Sept. 8, 2009	Ministry of Finance
MCM/LEG	Bank Resolution/Banking Law	Mission	Sept. 28–Oct. 6, 2009	Bank of Lithuania/Ministry of Finance
FAD	Reform of Social Security and Health Funds	Mission	April 6–20, 2010	Ministry of Finance/State Social Insurance Fund Board
LEG	Personal Bankruptcy Reform	Mission	April 30–May8, 2010	Ministry of Economy
FAD	Tax Administration	Mission	July 14–27, 2010	Ministry of Finance
FAD	General Tax Policy	Mission	October 19–25, 2010	Ministry of Finance
STA	GFS 2001 Statistics	Mission	February 11–22, 2013	Ministry of Finance
MCM	Credit Unions	Mission	November 18–29, 2013	Bank of Lithuania
MCM	Stress Testing	Mission	December 16–18, 2013	Bank of Lithuania

Resident Representative:
James Roaf (stationed in Warsaw, Poland).

Anti-Money Laundering and Combating Financing of Terrorism: Lithuania's compliance with the Financial Action Task Force (FATF) standard, was last assessed by MONEYVAL, the FATF-style regional body of which it is a member, in April 2012. The assessment report was published in December 2012 and indicates several deficiencies, in particular with respect to the money laundering offense, customer due diligence measures, politically exposed persons, transparency of beneficial ownership of legal persons, and the financial intelligence unit. In response, the authorities reported to Moneyval that measures have been undertaken to amend the Criminal Code to properly criminalize the financing and support of terrorism, broaden the definition of money laundering, and enhance capacity and autonomy of the Financial Crime Investigation Unit.

STATISTICAL ISSUES

General: Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are adequate for surveillance purposes. 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 economic and financial 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. Data provision to the Fund for surveillance purposes is considered adequate.

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 using both 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 separately in the published figures as the discrepancies are included in the estimates of changes in inventories. The annual and the quarterly national accounts are compiled at previous year prices and chain-linked to 2000. In general, good data sources and sound methods are used for the compilation of the national accounts, but measuring activity during the volatile environment of the 2008/09 crisis proved challenging. Moreover, difficulties remain in measuring the economic activity of the informal sector. These estimates are compiled at detailed levels of economic activity using fixed coefficients derived from a benchmark surveys conducted in 1996 and 2003, and updated in 2006, and in 2011. According to the most recent updates, the informal sector was estimated to be 13 percent of GDP in 2008.

Price Statistics: 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.

Government Finance Statistics: Data on the central government budget execution are available at a monthly and quarterly frequency, 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). In addition, the MoF has been reporting quarterly and monthly data in the GFSM 2001 format for publication in the IFS.

Monetary Statistics: 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). Following Lithuania's accession to the European

Union, the BoL implemented the ECB framework for compiling and reporting monetary data reflecting the ECB regulations and ESA 95 on sectorization, valuation and classification of financial instruments.

Balance of Payments: 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.

Data Standards and Quality: 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 is available on the Internet:

- 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/statistical_data_tree) 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/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 government finance statistics (deficit, debt).
- NASDAQ OMX Baltic website (http://www.nasdaqomxbaltic.com/market/?lang=en) includes information on stock trading at NASDAQ OMX Baltic stock Exchange in Vilnius (the former Vilnius Stock Exchange)

Republic of Lithuania: Table of Common Indicators Required for Surveillance

As of March 31, 2014

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	March 31, 2014	March 31, 2014	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 2014	March 14, 2014	M	M	M		
Reserve/Base Money	February 2014	March 14, 2014	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	February 2014	March 14, 2014	M	M	M		
Central Bank Balance Sheet	February 2014	March 14, 2014	M	M	M		
Consolidated Balance Sheet of the Banking System	February 2014	March 28–31, 2014	M	M	M		
Interest Rates[2]	February 2014	March 28–31, 2014	M	M	M		
Consumer Price Index	February 2014	March 12, 2014	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3/2013	December 30, 2013	Q	Q	Q	LO, LO, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	February 2014	March 31, 2014	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	February 2014	March 31, 2014	M	M	M		
External Current Account Balance	Q4/2013	March 20, 2014	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	January 2014	March 18, 2014	M	M	M		
GDP/GNP	Q4/2013	February 28, 2014	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q4/2013	March 20, 2014	Q	Q	Q		
International Investment Position[6]	Q4/2013	March 20, 2014	Q	Q	Q		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means

[2] Both market-based and officially-determined, including deposit and lending rates, 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] Includes external gross financial asset and liability position vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published in July 2004, the findings of the mission that took place during September 2003 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] Same as footnote 8, except referring to 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.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/206
FOR IMMEDIATE RELEASE
May 8, 2014

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

IMF Executive Board Concludes 2014 Article IV Consultation with the Republic of Lithuania

On May 5, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Lithuania.

The economy has entered a broadly favorable trajectory of healthy and balanced growth, but income convergence with Western Europe has a long way to go. With growth above three percent in each of the past three years and similar prospects, real GDP is set to surpass the peak level of 2008 for the first time this year, but now free of external and internal imbalances. Nonetheless, per capita income remains considerably below Western European levels and structural unemployment is uncomfortably high.

Lithuania targets to adopt the euro next year to further deepen integration with Western Europe. With inflation at historical lows and well-advanced repair of public finances damaged by the 2008/09 crisis, meeting the entry criteria seems on track. The Economic and Financial Affairs Council of the European Union will take a final decision about EMU membership this July, based on convergence reports by the European Commission and the European Central Bank.

A determined multi-year consolidation effort has reduced the fiscal deficit to close to 2 percent of GDP in 2013. Public debt is now on the verge of starting to decline as a ratio to GDP. At around 40 percent of GDP it is relatively low compared to other EU countries.

Financial stability has improved further in 2013, with the capital adequacy ratio exceeding 17 percent and steady progress in reducing non-performing loans. The main challenge is now resuscitating sluggish private sector credit growth, which could undermine investment and the recovery if it continued for much longer.

[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.

Executive Board Assessment[2]

Executive Directors noted that the pursuit of prudent policies has led to robust balanced growth, falling inflation, and strengthened public finances, thereby placing Lithuania on track for euro adoption in January 2015. Looking ahead, with risks still tilted to the downside, Directors recommended the consolidation of recent macroeconomic gains, and a deepening of structural reforms to provide the impetus for sustainable job-creating growth and income convergence with Western Europe.

Directors commended the strengthening of the public finances in recent years, but noted that expenditure compression is reaching its practical limits after bearing the burden of recent adjustment. They called for further, well-calibrated fiscal consolidation through enhanced revenue mobilization, to help achieve a structural budget balance in the medium term and reduce the public debt-to-GDP ratio. Recurrent taxation of wealth and capital could be improved, the tax base broadened and tax administration strengthened. Directors also considered that a public expenditure review would help promote efficiency and sustainability.

With sound public finances and low inflation, as well as external stability, Directors agreed that the Lithuanian economy is well prepared for euro adoption, which could deliver significant benefits by strengthening financial stability, reducing risk premiums, and fostering further integration with the euro area. Directors recommended strong supporting policy frameworks and macro policy tools to help underpin a successful euro area membership. While Lithuania has demonstrated the ability to deliver economic adjustment when needed, Directors advised strengthening countercyclical tools to rebuild buffers in good economic times. In this regard, they welcomed the impending strengthening of macroprudential powers of the Bank of Lithuania and the planned transposition of the Fiscal Compact. Directors advised improving the accountability and control framework for local government finances and noted that pension reform was needed to enhance fiscal sustainability.

Directors considered that decisive action and effective supervision have improved overall financial sector stability and welcomed efforts to tackle remaining areas of softness, such as in the small credit union sector. They advised that these efforts be sustained, and looked forward to a review of banks' asset quality. Directors called for a revival of credit growth in support of investment, through further strengthening of insolvency and restructuring frameworks and fostering non-bank sources of finance.

Directors recommended continued implementation of structural reforms to further improve competitiveness and the business climate and tackle high structural unemployment. Wage

---

[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

increases should be aligned with productivity growth, and the management of out-of-work benefits and other key aspects of the labor code strengthened. Reducing Lithuania's relatively high social security taxes in a fiscally-neutral manner would be desirable, as well as redressing skill mismatches through education reform.

Directors welcomed the emphasis on upgrading energy and transportation infrastructure, and advised that ongoing projects should be embedded in a regional strategy to reduce user costs. They supported reform of state- and municipally-owned enterprises—with many of the former tasked with implementing key infrastructure projects.

Republic of Lithuania: Selected Economic Indicators, 2010–14

	2010	2011	2012	2013 Est.	2014 Proj.
Real Economy			(Percent)		
Real GDP growth	1.6	6.0	3.7	3.3	3.3
CPI, period average (annual percentage change)	1.2	4.1	3.2	1.2	1.0
CPI inflation, end of period	3.6	3.5	2.9	0.5	1.7
Unemployment rate (year average, in percent of labor force)	17.8	15.4	13.4	11.8	10.8
Public Finance			(Percent of GDP)		
General government balance	-7.2	-5.5	-3.2	-2.1	-1.9
General government gross debt	38.3	39.2	41.0	39.3	39.5
Foreign currency-denominated public debt	31.9	31.7	32.1	27.4	26.6
Balance of Payments			(Percent of GDP, unless otherwise specified)		
Current account balance	0.1	-3.7	-0.2	1.5	0.6
Gross official reserves (in billions of euros)	5.0	6.4	6.5	6.0	6.4
Exchange Rates			(Litai per U.S. dollar, unless otherwise specified)		
Exchange rate (end of period)	2.61	2.67	2.61	2.43	..
Exchange rate (period average)	2.61	2.48	2.69	2.51	..
Real effective exchange rate (2005=100, increase=appreciation)	117.4	118.9	117.5	119.1	..
Money and Credit			(Year-on-year percent change)		
Reserve money	19.4	37.5	-6.4	4.9	5.8
Broad money	8.9	5.0	7.2	4.5	11.1
Private sector credit	-7.6	-5.7	0.3	-3.0	2.5

Sources: Lithuanian authorities; and IMF staff estimates.

Statement by Mr. Audun Groenn, Executive Director for the Republic of Lithuania and by Ms. Ramune Arust, Advisor to the Executive Director
May 5, 2014

Our Lithuanian authorities appreciate the constructive and forward-looking discussions with the staff mission team and thank them for a well-balanced Article IV Report. They broadly share its analysis and assessment of the country's economic outlook, as well as staff's view of the challenges to be addressed to make the prospective euro area membership a lasting success.

Strong GDP growth continues on a healthy and balanced path

Since 2011, Lithuania has remained one of the fastest growing economies in the European Union, and last year was no exception. GDP, which at the end of 2013 was 2 percent below the pre-crisis level, is expected to reach that pre-crisis level this year, on a more robust footing. At the beginning of this year, high-frequency economic indicators show that strong growth continues as expected. More importantly, economic growth has become more balanced and sustainable, with the tradable sector obtaining higher weight in overall economic activity. The composition of GDP is also becoming more broad-based. While exports remained traditionally strong, private consumption picked up significantly and was the main driver for economic growth in 2013.

Our authorities broadly share staff's view of the economic outlook and expect a strong and balanced economic growth this year and in the medium term. Strengthened domestic demand is expected to be the main factor driving future growth, since the private consumption is supported by an improving situation in the labor market and low inflation. Investments are also set to increase in view of capacity utilization being at a record high. However, moderate economic growth for Lithuania's trading partners and a fluid geopolitical situation in the region create elevated risks for exports.

Positive impulse is expected from the prospective Euro adoption

Lithuania aims at sustainable fulfillment of the Maastricht criteria with a target date to adopt the euro on January 1, 2015. The goal to introduce the euro is based on a legal obligation under the EU Treaty, policy consistency, proven economic flexibility and capacity to operate under the fixed exchange rate regime, as well as the high level trade and financial integration with the euro area.

The economy is on a solid and sustainable recovery path. The crisis response proved to be efficient and imbalances have been corrected. With the lack of clear pressure in the labor market and with commodity prices continuing to drop, consumer prices are rising only slightly and less than expected. Fiscal policy has been put on a sustainable path. The authorities have learned their lessons from the past and have been focused on building a balanced and competitive economy. To ensure stable economic growth and further convergence, the authorities have introduced new and more powerful macro-policy tools. The Fiscal Discipline Law was enacted to ensure fiscal discipline. To increase the resilience of the financial sector, macro-prudential instruments (85 percent loan-to-value ratio (LTV) and 40 percent debt service-to-income ratio (DSTI)) were introduced by the Bank of Lithuania (BoL).

At the same time, the authorities are fully aware that policy prudence, especially on the fiscal side, will remain a key prerequisite for successful functioning in the euro area, helping to avoid the emergence of macroeconomic imbalance.

Adoption of the euro is expected to have a significant positive effect on Lithuania's economy through the enhancement of economic integration. A quantitative assessment of the likely impact of the adoption of the euro shows that the positive effect of introducing the euro will be felt by citizens, businesses, and government finances. In the medium term, a successful integration into the euro zone is expected to boost Lithuania's real GDP on average by 1.8 percent.

The level of public debt has stabilized

A prudent fiscal policy underpinned by the law on Fiscal Discipline and the Stability and Growth pact is at the core of Lithuania's policy framework to ensure macroeconomic stability. Lithuania continues to strengthen its fiscal framework through transposing the provisions of the Treaty on Stability, Coordination and Governance in EMU ("Fiscal Compact") into its national legal system, including the constitutional law on the implementation of the fiscal treaty that lays down commitment to sustainability of general government finances.

Last year the fiscal budget deficit turned out to be markedly smaller than expected (2.2 percent instead of the planned 2.5 percent of GDP). This improvement in the country's fiscal position was driven by accelerating revenues from corporate and household income taxes. A steadily decreasing budget deficit since the crisis firmly stabilized the ratio of public debt to GDP just below 40 percent of GDP and is expected to start decreasing after 2014.

The authorities are committed to continuing a growth-friendly fiscal consolidation at a pace aiming to reach a structural budget surplus of 0.9 percent of GDP in 2017. According to the government's program, a further budget consolidation will be based on strengthening tax administration and rising revenues through initiatives that support economic growth and create new jobs. There are a number of major legal initiatives and conventional measures coming to tackle the shadow economy and improve tax administration. The government has already proposed amendments to the laws regulating tax administration and the value added tax (VAT). Besides, the consolidated view is being applied and specific measures are envisaged with a focus on ensuring the VAT, excise duty obligation compliance, as well as on strengthening collection of taxes on personal income. In addition, discussions on a comprehensive review of the tax system will continue, with particular emphasis on reviewing taxation on labor and the application of reduced VAT rates.

On the expenditure side, particular attention is paid to the efficient use of resources and prioritization. No cuts to productive, job-creating expenditures, such as investment and expenditures on research and development, are foreseen.

The authorities share staff's concerns about the deficiencies in the control framework of local government finances and are ready to address them. The government is considering asking the Fund to provide technical assistance to improve the accountability and control framework of local government finances. The initial talks with the Fund on such assistance have already started.

The financial sector is stable and resilient

Lithuania's financial system remains stable and resilient. The banking sector is well capitalized and liquid. In 2013 the capital adequacy ratio improved by 2 percentage points and reached 17.6 percent. This higher capital adequacy ratio was achieved by retaining profits. The liquidity ratio at 41.2 percent was well above the required level of 30 percent. The continuously improving quality of loan portfolios as well as measures undertaken by the authorities to improve the legal and regulatory framework for NPL resolutions are also yielding results. In 2013, NPLs decreased to 11 percent.

Although the stock of outstanding credit has not been increasing, credit flows to the economy continue at a steady pace. In 2013, new loans to non-financial corporations and households amounted to 15.9 billion litas (16.0 billion litas in 2012) or 13.3 percent of GDP, of which 70 percent was lent to non-financial corporations. Commercial banks in Lithuania expect a 2–3 percent growth in their loan portfolio this year.

The financial sector supervision is focused on identification of risks and decision making at an early stage. The BoL has shifted to a risk-based supervisory process by concentrating on systemically important and high risk financial market participants.

The government together with the BoL devotes substantial efforts to strengthen and reform credit union regulation. The current reform aims to make the credit union sector strong, sustainable, and able to effectively complement the existing banking sector. To reform this sector, an inter-institutional working group (comprised of representatives from the Ministry of Finance, the BoL, the Central Credit Union of Lithuania, and credit union associations) has prepared draft laws for the regulation of credit union activities. This draft legislation has been submitted to parliament for discussion and subsequent approval.

Alongside these efforts, the BoL has prepared a document for public discussion on how to reform the credit union sector. Particular attention is given to eliminating the moral hazard problem and aligning shareholders' incentives with prudent risk taking. The reform proposals draw extensively upon Lithuania's own experience and international best practice. The document also incorporates recommendations provided by the Fund's technical assistance, which is highly appreciated by the authorities.

On other supervisory matters, the authorities are working on the implementation of CRD IV into national laws. The preliminary assessment shows that, due to the high quality of Tier I capital of the banks, reduced capital requirements for FX positions (if the euro is adopted), decreasing of risk weights for small and medium enterprises exposures, the introduction of releasing regime for exposures secured by mortgages on residential property and other measures, the implementation of the new requirements would contribute to increasing the capital adequacy ratio.

The government and the BoL are also preparing for changes to the financial sector's supervisory framework related to the prospective euro area membership, including the asset quality review (AQR) exercise and necessary adjustments of legal acts. In December 2013, the Board of the BoL approved the position of the BoL on participation in the Banking Union. The base case scenario is that Lithuania joins the Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM) in 2015, together with the accession in the euro area. It is expected that after joining the SSM, the ECB would take supervision of the 3 largest banks (71 percent of the market share), while other banks would remain under the direct supervision of the BoL.

The process of broadening the BoL's mandate to include macro-prudential policy is nearly complete. The relevant amendments to the Law of the Bank of Lithuania granting the macro-prudential mandate is expected to be adopted during the Spring parliamentary session ending in June 2014. Currently, the BoL indirectly pursues macro-prudential policy by empowering the Responsible Lending Regulations approved in 2011. In addition to LTV and DSTI, a wide macroprudential toolkit specified in the EU level legislation is envisaged to apply once CRD IV is transposed into the national legislation. It is expected that countercyclical capital buffer application will become fully operational in the end of 2014, whereas an interim decision has been made to apply a 2.5 percent capital conservation buffer starting in 2015.

Structural reforms aim to create more jobs

The government is continuing its policies of promoting pro-growth structural policy measures, such as improving the business environment and reducing high unemployment.

Despite significant improvement in employment trends over the recent years, unemployment remains high, especially for the youth and the long-term unemployed. This is a priority area for the authorities. To address this situation, the government is taking measures on both the labor demand and supply sides. On the labor demand side, the authorities continue to support a number of investment projects expected to raise the supply side potential of the economy. The housing renovation project has advanced considerably since its start in 2012. The energy sector reforms are also very high on the agenda. The Liquid Gas Terminal (LNG) in Klaipėda is expected to be completed by the end of this year.

On the labor supply side, the government is taking active measures to realign worker skills with employer needs. Active labor market policies, training and dialogue with educational institutions has been enhanced. To reduce the administrative burden of labor market regulations, a number of amendments to the Labor Code have been submitted to parliament for approval. Also, a working group has been established for a comprehensive review of the Labor Code.

Lithuania has further improved its business environment. In 2013 Lithuania moved to the 17th position among all countries and the 6th position among EU countries in the World Bank "Ease of doing business report 2014". The adopted new territorial planning laws, together with labor market flexibility, technological innovations, and high participation of women in the workforce, have all contributed to these high rankings.