



REPUBLIC OF LITHUANIA

2013 ARTICLE IV CONSULTATION

March 2013

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 2013 Article IV consultation with Lithuania, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 11, 2013, with the officials of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 7, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice (PIN)** summarizing the views of the Executive Board as expressed during its March 22, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for 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.

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REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

March 7, 2013

KEY ISSUES

Outlook and risks. Significant macroeconomic rebalancing has taken place since the 2008–09 crisis and the recovery is well underway. But growth is expected to moderate to 3 percent in 2013 (from 3.6 percent in 2012), as the effects of a bumper harvest unwind. Over the medium term, growth should gradually rise toward its potential of around 3¾ percent, but this hinges on a recovery in investment. Risks have moderated, but remain on the downside as renewed financial stress or weak growth in Europe would adversely affect Lithuania.

Fiscal policy. The fiscal deficit has declined significantly, from 9½ percent of GDP in 2009 to an estimated 3 percent of GDP in 2012. The 2013 budget—with a deficit target of 2½ percent of GDP—appropriately balances supporting the recovery with the need for further consolidation. Going forward, further fiscal consolidation is needed to fully rebuild fiscal space. But, the composition of adjustment should shift to the revenue side, given Lithuania’s low revenue-to-GDP ratio and substantial scope to increase wealth taxation.

Financial stability. The mostly foreign-owned banking system is, overall, well-capitalized and liquid, but weaknesses in some domestically-owned banks had to be forcefully addressed. The Bank of Lithuania’s intervention of two domestically-owned banks and two credit unions underscores the importance of effective supervision.

Credit growth. The financial sector has an essential role to play in enabling sound credit expansion to support economic growth. While a balanced approach to credit policies is clearly important to avoid the excesses of the boom years, adequate credit expansion is needed to support investment. Reducing obstacles to the resolution of non-performing loans could help ease constraints on credit supply.

Competitiveness. Reaching potential growth will require that competitiveness gains since the crisis are preserved. Going forward, it will be critical to boost investment through improvements in the business climate and to address challenges in the labor market through training and active labor market policies.

Political situation. A new government took office in late 2012 and has advocated greater social inclusion, job creation, higher pensions and wages, and enhanced tax progressivity.

Approved By
Mahmood Pradhan
and Elliott Harris

Discussions were held in Vilnius during January 31-February 11, 2013. The team comprised Ms. Kozack (head), Messrs. Klingen and Agarwal, Mmes. Everaert and Geng (all EUR). Ms. Arust (OED) joined the discussions. Several meetings were coordinated with visiting teams from the EC and the ECB. The mission also briefly visited Stockholm to discuss banking sector linkages between Sweden and Lithuania.

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CONTEXT

1. Lithuania has achieved significant macroeconomic rebalancing since the 2008–09 crisis, and vulnerabilities have diminished.

The current account and fiscal deficits were substantially reduced, debt has fallen in most sectors of the economy, and wage compression quickly restored competitiveness. The latter laid the basis for a strong export-led recovery, which shifted the engine of growth to the tradable sector. Vulnerabilities have declined in the largely foreign-owned banking sector, as the loan-to-deposit (LTD) ratio has dropped markedly.

GDP per capita has recovered to its pre-crisis peak, although Lithuania's shrinking population also contributed to this.

Lithuania: Macroeconomic Rebalancing

	Peak	2012 Proj. 1/	Peak date
Fiscal balance (% of GDP)	-9.4	-3.0	2009
Current account balance (% of GDP)	-14.4	-0.9	2007
Loan-to-Deposit ratio (%)	187.0	121.0	2008
Unemployment (%)	18.3	13.0	2010 Q2
Unit labor cost (Index, 2001=100)	164.3	148.9	2008 Q3
Corporate leverage (%)	96.0	78.7	2008 Q2
Household indebtedness (% of income)	45.9	41.2	2009

Sources: BoL; MoF; Eurostat; and IMF staff estimates.

1/ Latest available observation, except for fiscal balance projection.

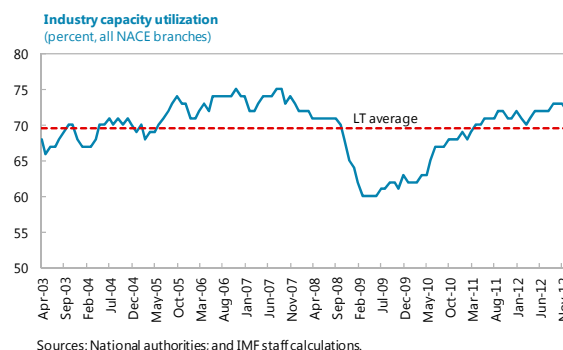
2. The main policy challenge is to complete the adjustment to secure robust and sustainable growth. With the unemployment rate still high (albeit much lower than its peak level), sustaining growth will be essential for job creation, which would help stem outward migration, especially of young and highly skilled labor. Meanwhile, the fiscal deficit and public debt still need to be further reduced to create space for fiscal policy to play its countercyclical role going forward. In the banking sector, nonperforming loans (NPLs)—a legacy of the crisis—have contributed to cautious lending. Going forward, boosting credit growth will be especially important as a rebound in investment is needed to sustain the recovery and preserve competitiveness.

3. A new government took office in late 2012. The authorities are still in the process of fully articulating their policy agenda, but the government program stresses social inclusion, job creation, higher pensions and wages, and greater tax progressivity. The government has publicly announced its goal to adopt the euro in 2015. Lithuania will hold the EU presidency in the second half of 2013.

RECENT DEVELOPMENTS

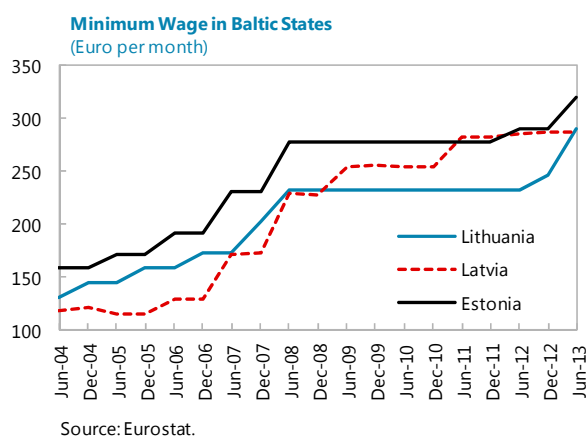
A. An Ongoing Recovery

4. The recovery continued in 2012 with growth reaching 3.6 percent. Growth was supported by increased private consumption—reflecting improved labor markets conditions, some pent-up demand, and rising consumer confidence—and strong



exports, which were further boosted by a bumper harvest (the harvest is estimated to have contributed about ¼ percentage point of GDP growth). Lingering uncertainty about the external and domestic environments kept investment low. As a result, capacity utilization is now above its long-term average.

5. Labor market conditions continued to improve. The unemployment rate fell to 13.2 percent in 2012, down from 15.3 a year before. Encouragingly, it fell across all segments, including for youth and the long-term unemployed, but remains high for both. Real wages are estimated to have increased moderately in 2012 for the first time in two years. After remaining frozen since early 2008, the minimum wage was increased in two steps, by 6.3 percent in July 2012 and by another 17.6 percent in January 2013, and is now in line with that of regional peers.



6. Inflation declined as the effects of rising global commodity prices moderated. The pass-through of higher food and energy prices continued in 2012, notably with a large increase in the heating price in July 2012. But this effect waned in the second half of the year, and energy prices even fell in late 2012. As a result, average inflation dropped from 4.1 percent in 2011 to 3.2 percent in 2012. Core inflation remained fairly subdued at 2 percent at end-2012.

7. The external position has improved, but debt remains high and reserve coverage low.

- **The trade balance turned positive and the current account improved.** Strong exports, a bumper harvest, and an improvement in the terms of trade—lower oil prices and high cereals prices—turned the trade balance (goods and services) slightly positive in 2012, from a deficit of 2.6 percent of GDP in 2011. This reduced the current account deficit, which was broadly offset by lower FDI (the highly profitable manufacturing sector paid out dividends rather than fully reinvest profits), lower net portfolio inflows, and repayments of parent bank loans in the first half of 2012.¹ The latter reflects the migration of deposits (about 3½ percent of GDP) from the intervened Snoras bank to foreign-owned banks, which used the extra funding to repay parent loans (Annex I, ¶10 and ¶22).
- **The real effective exchange rate is estimated to be broadly in line with fundamentals.** The CGER results are based on the CPI, while manufacturing ULCs have risen more moderately.

¹ Data and methodological improvements led to an upward revision in the current account deficit for 2009–10 of about 1 percentage point on average, implying that the external adjustment was initially slightly weaker, but this was fully financed through revisions in the financial account without materially affecting gross external debt or the IIP.

CGER Results			
	Macro balance approach (gap)	Equilib. real ER approach	Ext. sustain. approach
Over (+)/under(-)valuation	-6.8	6.2	-3.2

Source: Staff calculations.

- **External debt remains high and reserve coverage is low.** Reserves at end-2012 (€6.5 billion) were about 3 months of imports, 60 percent of short term external debt, and about €1.9 billion below the new reserve adequacy metric. Gross external debt (72 percent of GDP) and net international investment liabilities (48 percent of GDP) are still high, reflecting still significant parent bank loans and foreign-held government debt, as well as the importance of net inward FDI. The debt sustainability analysis suggests that external debt is sensitive to current account and growth shocks.

8. Financial market conditions have been favorable. The government successfully issued about €1¾ billion in Eurobonds in 2012 and a 5-year €0.4 billion Eurobond at a yield of 2.6 percent in early 2013. Five year sovereign CDS spreads reached post-crisis lows, at about 100 bps.

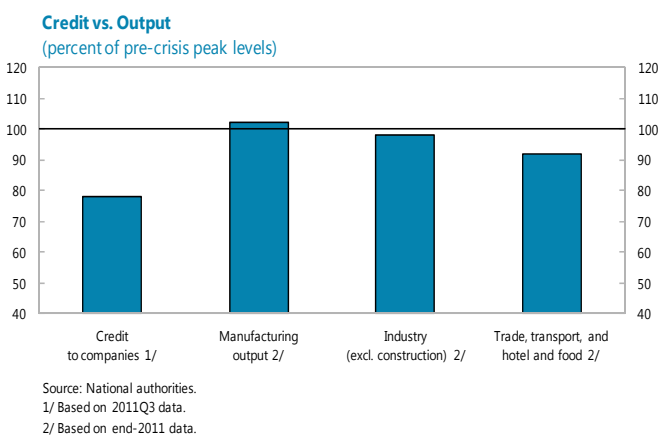
B. The Banking System

9. The largely foreign-owned banking system is, overall, well capitalized and liquid. Banks' capital was further strengthened in 2012 as dividends were not paid out: regulatory capital to risk-weighted assets improved from 13.9 percent at end-2011 to 14.2 percent at end-2012. The banking sector's liquidity ratio stood at 40.4 percent, well above the regulatory minimum (30 percent). Preliminary calculations by the Bank of Lithuania (BoL) indicate that banks are compliant with future Basel III requirements, with the Tier 1 capital ratio at 11.5 percent, leverage ratio at 8.6 percent, liquidity coverage ratio at 192 percent, and net stable funding ratio at 161 percent. NPLs fell to 13.9 percent at end-2012, down from 16.3 percent a year before. At the same time, bank profitability declined amid excess liquidity, slow credit growth, and low net interest margins. Return on equity fell from 15.2 percent at end-2011 to 6.6 percent at end-2012.

10. But four credit institutions were intervened since the last Article IV Consultation amid rising loan losses. Snoras bank—at the time the largest domestically-owned bank, third largest bank by deposits, and fifth largest by assets (10 percent of system assets)—was liquidated in late 2011, as the bank became insolvent due to alleged fraud and misappropriation of assets (Annex I). The government financed the payout of insured deposits through a loan to the deposit insurance agency, but is expected to be largely reimbursed by Snoras' bankruptcy estate. In late 2012/early 2013, two small credit unions were closed as rapid lending growth and some related-party lending had given rise to large loan losses and insolvency. On February 12, 2013, another domestically-owned bank (the largest after the liquidation of Snoras, with about 5 percent of system assets) was intervened and subsequently declared insolvent, after it was unable to raise sufficient capital to absorb losses and address problems of related-party lending. After an initial report by the

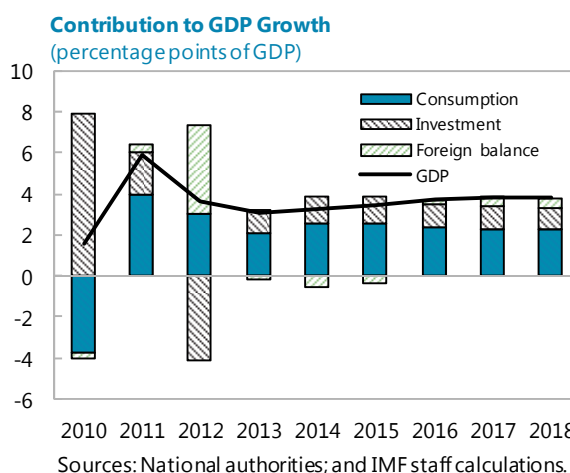
temporary administrator, a domestically-owned bank with significant EBRD participation signed an agreement to take over a portion of the intervened bank’s assets (the “good” assets) and liabilities (insured deposits) and to resume banking services by March 5, 2013. The value of the assets that were taken over was based on an external auditor’s initial report. A more comprehensive asset valuation exercise will be undertaken, with results expected in three months. The government is expected to provide a loan to the deposit insurance agency to cover the shortfall between good assets and insured deposits, which could amount to ¾ percent of GDP. In all cases, confidence in the banking system was maintained, largely as a consequence of the authorities’ clear and careful communication to the public and swift action to provide depositors with access to their funds.

11. Credit continued to stagnate in 2012. The economic recovery has continued despite nearly four years of negative private sector credit growth. Uncertainty about growth prospects both in Lithuania and abroad have no doubt hampered the demand for credit. At the same time, lending standards have been tight, caused by banks’ continued risk aversion, which seems to partly reflect lingering NPLs. Outflows to parent banks, which were especially sizeable in the first half of 2012, were largely matched by deposit growth. As a result of these developments, banks’ liquid assets increased to 25 percent of total assets.

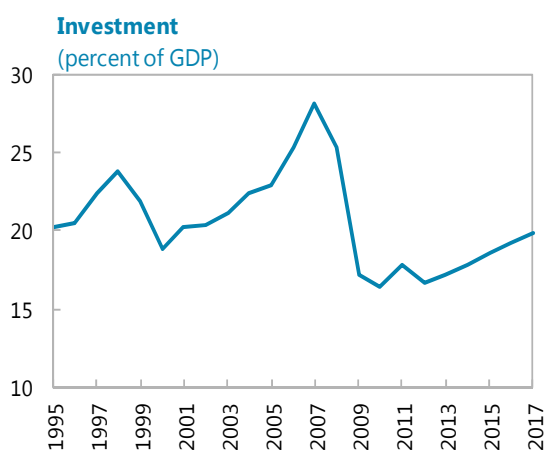


OUTLOOK AND RISKS

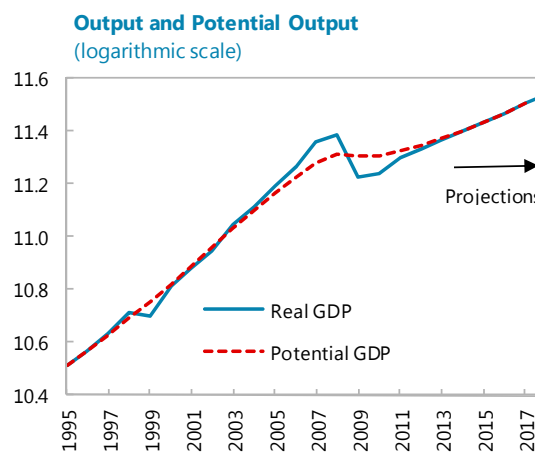
12. The economic recovery is expected to slow moderately in 2013. Growth is expected to reach 3 percent this year. Investment should be spurred by current high levels of capacity utilization, easing financial conditions, and dissipating uncertainty about the external environment. Exports would contribute less to growth in 2013 than in 2012, as the effects of last year’s very good harvest unwind. Inflation is projected to continue to decline to 2.1 percent in 2013, reflecting the lagged impact of lower global commodity prices and a moderate pass-through of higher wages to inflation, as high corporate profitability suggests there is room to absorb some increase in wage costs.



13. Over the medium term, growth should gradually rise toward its potential of around 3¾ percent. This hinges on a recovery in investment and a modest pick-up in consumption (supported by falling unemployment and moderate real wage increases) in the coming years. The contribution of net exports is projected to turn negative in the near term, as stronger domestic demand boosts imports. However, as the payoff from investment bears fruit later on, export growth should rise. The output gap is expected to close in 2014, but structural unemployment is expected to remain high, reflecting skill mismatches. The current account deficit is projected to remain relatively contained over the medium term, reaching about 2 percent of GDP, and financed mostly by FDI.



Sources: National authorities; and IMF staff calculations.



Source: Haver; and IMF staff calculations.

14. Risks to the outlook have moderated, but remain tilted to the downside. Financial conditions—both globally and in Lithuania—have improved markedly in the past six months, but risks continue to emanate from both external and domestic sources. Renewed financial stress or weak growth in Europe, which accounts for about two thirds of Lithuanian exports, would adversely affect Lithuania through trade and financial channels. A growth slowdown in other trading partners, such as Russia, would also weigh on Lithuania's exports. While risks of a renewed bout of parent bank funding withdrawal have moderated, Lithuania's largely foreign-owned banking system still has a LTD ratio of 120 percent on average. Econometric analysis confirms that the impact of shocks to trading partner growth and parent bank funding is quite sizeable (Box 1). Continued strong policy implementation can help ensure that Lithuania is well-placed to deal with these risks should they materialize. On the domestic side, the projected pickup in investment could fail to occur (possibly because credit does not recover as anticipated under the baseline) or competitiveness gains could be eroded by wage growth outpacing productivity growth—both of which would hamper the recovery.

Box 1. External Linkages and Spillovers From the Global Economy¹

As a small open economy, Lithuania is highly exposed to external spillovers.

Its export-to-GDP ratio was nearly 80 percent in 2011, making it vulnerable to changes in external demand.

Lithuania is also susceptible to financial spillovers: its largely foreign-owned financial system continues to rely on funding from Nordic parent banks, which remain exposed to global wholesale markets. FDI (which is related to trade and financial linkages, given the countries of origin of Lithuania’s inward FDI) is yet a third spillover channel.

Lithuania: External Linkages with Major Partners, 2011

Partners	Exports		Inward FDI (stock)		Banks	
	Value (billion USD)	Share (pct. of total)	Value (billion USD)	Share (pct. of total)	Value (billion USD)	Share (pct. of total)
World	27.5	100	14.9	100	18.5	100
Subtotal (top 10 destinations)	20.5	74.3	7.6	50.9	17.5	94.7
<i>of which: (ranking as exports destinations in parenthesis)</i>						
Russia (1st)	4.6	16.7	..	..	..	..
Latvia (2nd)	2.9	10.4	..	..	..	..
Germany (3rd)	2.6	9.5	1.5	10.1	1.0	5.2
Poland (4th)	2.0	7.1	1.9	12.5	..	..
Netherlands (6th)	1.7	6.2	1.2	7.7	..	..
Sweden (10th)	1.1	4.1	3.1	20.6	16.5	89.5

Source: Statistics Lithuania, BIS and staff calculations

This box assesses the impact of shocks to trading partner growth and parent bank funding. A Bayesian Vector Autoregression (BVAR) (Villani, 2009) was used, with a sample covering 1998Q1-2012Q3. The BVAR has the advantage of improving the estimation efficiency and, given the short sample period, is particularly appropriate.

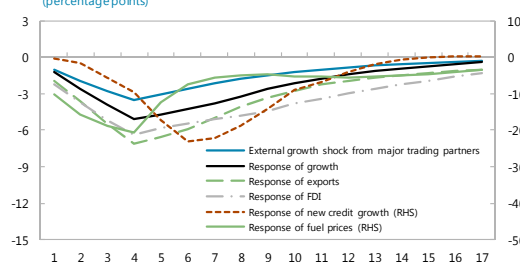
First, we assess the impact of a shock to trading partner growth. As these trading partners also have the strongest FDI and financial sector links, we evaluate the spillover impact of an external growth shock through trade, FDI, financial and other (such as energy price) channels. Second, we focus specifically on spillovers from a financial sector shock.

Trading partner growth has a strong impact on Lithuania’s GDP, mainly through trade and financial channels. Econometric analysis suggests that a one percentage point adverse shock to trading partner growth would cause Lithuania’s growth to decline by 1¼ percentage points, with the spillover impact peaking after four quarters. Trade linkages explain a major part of the spillovers during the first four quarters immediately after the shock, with the financial (credit) channel playing a dominant role thereafter. FDI and fuel price channels have a more limited impact.

A shock to parent bank funding also has a strong impact on growth, mainly through financial and FDI channels. A one percent of GDP drop in quarterly parent bank funding flows causes GDP growth to drop by 0.8 percentage point, with the impact peaking after four quarters.

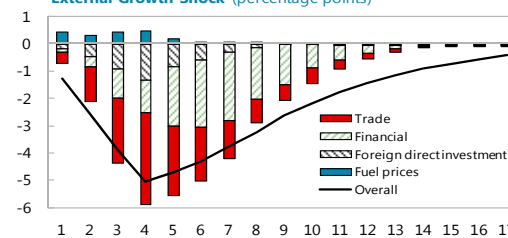
These econometric results need to be interpreted with some caution. Due to the short sample period, the econometric results here may also capture the boom and bust cycle and hence may overestimate the impact of spillovers.

Impulse Responses to an External Growth Shock from Major Trading Partners (percentage points)



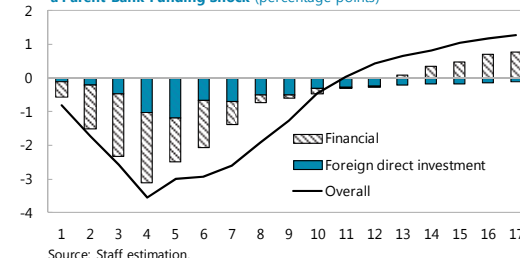
Sources: Staff estimation.

Decomposition of Spillover Channels from External Growth Shock (percentage points)



Source: Staff estimation.

Decomposition of Spillover Channels from a Parent Bank Funding Shock (percentage points)



Source: Staff estimation.

¹ Prepared by Nan Geng.

Lithuania: Risk Assessment Matrix²

Risk	Relative Likelihood	Impact if Realized
1. Protracted period of slower European growth.	Medium The adverse impact of the ongoing public and private sector deleveraging on the real economy may be larger than currently expected, leaving large output gaps and potentially spurring debt-deflation dynamics. Job skills could become obsolete due to long unemployment spells, and investment remains subdued, reducing potential output.	Medium As a highly open economy with strong ties to Europe, Lithuania would be adversely affected by a protracted growth slowdown in Europe. The effects could be partly mitigated by the diversification of Lithuania's export base.
2. Stalled or incomplete delivery of Euro area policy commitments.	Medium As a result of stalled or incomplete delivery of policy commitments at the national or Euro area level, or adverse developments in some peripheral countries, financial stress could re-emerge and bank-sovereign-real economy links re-intensify.	Medium Uncertainty could raise borrowing costs and dampen export prospects. Nordic parent banks could deleverage more quickly, hampering credit, investment, and growth.
3. Renewed bank deleveraging and credit crunch.	Low Nordic parent banks have re-stated their commitment to the Baltic region and LTD ratios have fallen considerably. But high NPLs and banks' risk aversion may weigh on credit growth.	Medium A renewed bout of deleveraging could stall the economic recovery by further reducing credit expansion.
4. Global oil shock triggered by geopolitical events.	Low Geopolitical risks in the Middle East could precipitate a sharp fall in oil supply, leading to a price of \$140 per barrel.	Medium Lithuania's energy intensity is relatively high, suggesting that an oil shock would have adverse effects on inflation and growth. A mitigating factor would be the impact on Lithuania from stronger growth in Russia.
5. Slowdown in trading partner growth outside Europe.	Medium A growth slowdown in Russia or Belarus—key trading partners outside the EU—could arise from lower oil prices (Russia) or renewed political tensions (Belarus).	Medium Lithuania's economic recovery would be adversely affected, as exports would suffer.
6. Rapid economy-wide wage increases with erosion of competitiveness as a result.	Medium Large minimum wage increases can escalate through the wage structure, potentially outpacing productivity growth.	Medium A loss in competitiveness would undermine the macroeconomic rebalancing that has taken place to date and pose risks to Lithuania's recovery.

² The RAM shows relatively low probability events that could materially alter the baseline discussed in this report. The relative likelihood of risks listed is the staff's subjective assessment of risks surrounding this baseline.

Authorities' views

15. The authorities broadly agreed with staff's assessment of the outlook and risks. They shared the view that growth and inflation would moderate this year. Their growth forecasts were similar to staff's, and they agreed that investment would need to become the driver of growth. However, they viewed credit to be less of a constraint on investment, given the availability of EU funds and large liquidity buffers in the corporate sector. On inflation, the authorities' projections were slightly higher than staff's, given uncertainty over how fast falling global commodity prices would translate into lower inflation and how higher minimum wages would affect core inflation.

POLICY DISCUSSIONS

A. Securing Fiscal Space

16. The fiscal deficit is expected to decline to 3 percent of GDP in 2012, down from 9½ percent of GDP in 2009. This also represents a decline of some 2½ percentage points of GDP compared with 2011, mainly owing to the continued freeze of public sector wages and other cuts in primary expenditure. Large one-off dividend payments from state-owned enterprises (SOEs) also helped, and over-performance of CIT partly offset lower-than-expected VAT and excise duties (likely the result of tax administration weaknesses).

17. The authorities' deficit target of 2½ percent of GDP in 2013 is appropriate, but staff underscored the need for high quality measures. Given that the recovery is slowing, the deficit target balances the need for further deficit reduction and support for the recovery. This translates into a structural adjustment of about ½ percent of GDP (taking into account the one-off measures on SOE dividends in 2012). However, the quality of fiscal measures has weakened over time and the consolidation in 2013 relies mainly on extensions of temporary measures (Box 2).

18. Fiscal consolidation should continue over the medium term to fully rebuild fiscal buffers. Lithuania is a small, open economy that is highly susceptible to external shocks. Moreover, it lacks monetary policy tools under its Currency Board Arrangement (CBA) and, thus, must rely on fiscal policy to provide support to the economy during downturns. It is, therefore, important that the structural fiscal deficit and public debt ratio continue to be reduced. This would bolster fiscal buffers and create space to allow automatic stabilizers to operate during future periods of weak growth. It will also help address external vulnerabilities by reducing reliance on foreign financing. The pace of consolidation going forward should balance supporting the recovery with the need to reach the authorities' medium-term objective (MTO) of a small structural surplus.

19. Staff welcomed the authorities' focus on tax reform, and emphasized that the composition of fiscal adjustment should shift to the revenue side. There is significant scope to implement high quality revenue measures to complete the fiscal adjustment in the medium term. The authorities have established working groups on tax policy and revenue administration to develop options for tax reform. The wide-ranging membership of the working groups, which include social partners and business representatives, could help achieve broad support for reforms. Staff

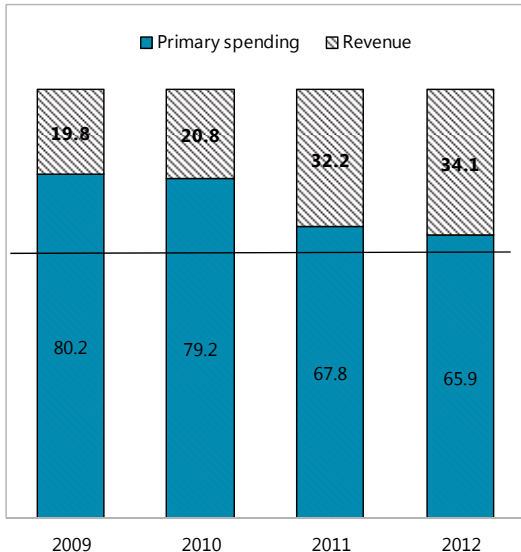
supported the creation of the working groups, and underscored that the case for shifting the composition of adjustment to revenue side is strong, based on the following points.

- **There is scope to increase revenue in Lithuania.** So far, most of the fiscal consolidation has taken place on the expenditure side. Partly as a result of this strategy, Lithuania's revenue- and expenditure-to-GDP ratios were the lowest in the EU in 2011. Hence, future fiscal adjustment should aim to raise revenue.
- **Capital and wealth taxes and further base broadening can generate additional revenue.** A comparison of Lithuania's tax system with EU averages shows that the share of capital and wealth taxes in total tax revenue is very low in Lithuania (9 percent), compared with EU averages (20 percent). This suggests that Lithuania has significant room to expand these taxes in order to generate additional revenue. Also, within the current system, there is scope to broaden the bases for corporate and personal income tax by removing exemptions and closing loopholes.
- **Apart from raising revenue, these tax changes have added benefits, including their potential to better protect lower-income earners.** Wealth and capital taxes are less distortionary, less cyclical, and can be designed to ensure that higher-wealth and higher-income individuals contribute most to revenue generation, hence improving the progressivity of the tax system. Staff analysis suggests that the social benefits system contributes far more to the reduction in inequality than the tax system. At the same time, Lithuania's income inequality, as measured by the Gini coefficient, remains one of the highest in the EU, suggesting that it is possible to complement the progressivity in the social security system with added progressivity in the tax system (see Box 3).
- **To reap the benefits of this strategy, staff urged the authorities to improve tax administration.** This would help ensure that any changes in taxation ultimately bear fruit in terms of revenue generation and boost tax compliance more broadly. Recent legislative amendments to allow faster collection of tax arrears and reduce the ability to pay taxes in cash are welcome, as are efforts to enforce the use of cash-registers and reduce border smuggling.
- **Expenditure growth should remain prudent.** To ensure that the fiscal adjustment is completed, expenditure growth should be consistent with achieving the MTO after taking into account the impact of measures to increase revenue.

Box 2. The Composition of Fiscal Consolidation in Lithuania¹

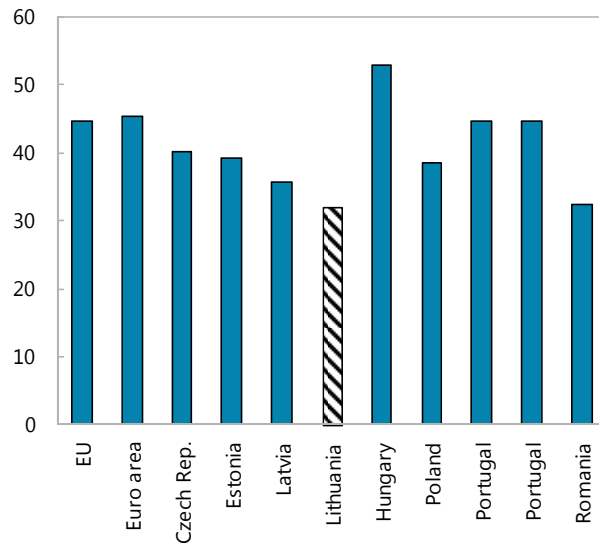
Lithuania’s fiscal adjustment since 2009 has mainly relied on expenditure measures. Although the role of revenue measures has risen over time, expenditure cuts accounted for around 70 percent of the total adjustment. As a result, Lithuania has one of the lowest expenditure- and revenue-to-GDP ratios in the EU.

Figure 2.1. Composition of Cumulative Fiscal Adjustment after Crisis: Revenue vs. Expenditure - Based
(Excl. temporary measures on transfers to Pillar II)



Black line (Source: April 2012 Fiscal Monitor): average composition of fiscal adjustment after 2008 crisis in eight European Countries (Iceland, Ireland, Greece, Latvia, Lithuania, Portugal, Romania and Spain).
Sources: WEO; and IMF staff estimates.

Figure 2.2. Size of Public Sector, 2011
(General government revenue as percent of GDP)



Sources: Eurostat, and IMF staff estimates.

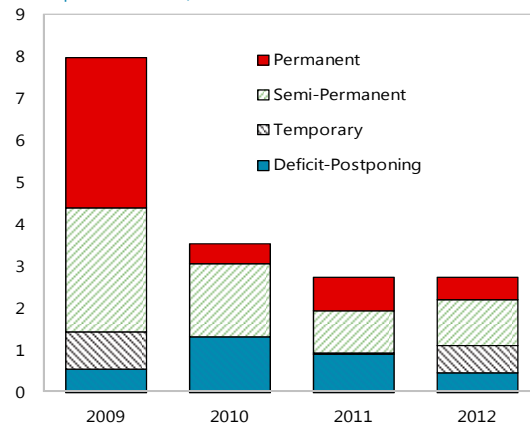
While expenditure measures have been broad based, this was not so for revenue measures.

Spending cuts were roughly proportional to the importance of each spending category. However, on the revenue side, measures focused mainly on indirect taxes and one-off measures, while direct taxes, especially wealth taxes, were virtually untouched. The exceptions were a base broadening of social security contribution and a reduction of the PIT. The latter was partly offset by an increase in health insurance contributions, the burden of which is now shared between employee and employer.

The quality of measures also deteriorated somewhat over time.

Less than one third of the measures undertaken since 2009 were permanent and about one fifth postponed deficits into the future.

Figure 2.3. Composition of Fiscal Adjustment since 2009: Permanent vs. Temporary 1/
(newly introduced measures in each year, in percent of GDP)



Sources: Authorities data and Staff analysis and estimates.
1/ Temporary measures are reversed in next year’s budget. Semi-permanent measures have an explicit expiry date or are temporary measures that are repeatedly extended. Deficit postponing measures imply a future cost to the budget beyond their temporary nature.

¹ Prepared by Nan Geng.

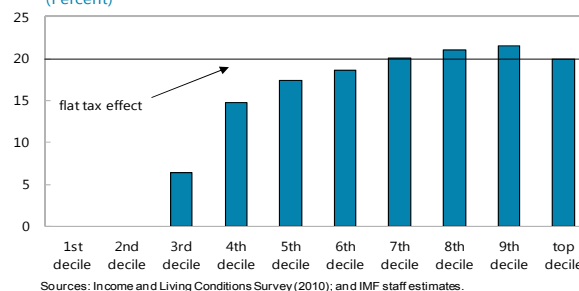
Box 3. The Scope for Raising Revenue in Lithuania¹

Given the need and desirability to shift the burden of fiscal adjustment to the revenue side, a key question is how to best raise revenue in Lithuania. This box takes a close look at Lithuania’s tax system, which suggests there is scope for raising revenue by increasing wealth taxation. At the same time, tax administration improvements should ensure that taxpayers cannot easily evade taxes and that tax collection is efficient.

Lithuania’s tax system relies heavily on labor and consumption taxes, with low wealth taxes.

Compared to the EU average, the share of taxes from consumption in total tax revenue is very high (42 percent in Lithuania, vs. 29 percent in the EU), and that of capital and wealth low (9 percent in Lithuania, vs. 20 percent in the EU). The total share of taxes on labor income is close to the EU average (49 percent in Lithuania vs. 51 percent in the EU), but labor is also relatively more mobile in Lithuania and the grey economy is large.

Figure 3.1 Average Effective Rate of Income Tax and SSC by Income Decile of All Lithuanian Households (Percent)



Taxes on labor and consumption exhibit limited or no progressivity for higher incomes, and the limited taxation of wealth reinforces this trend. The personal income tax does not feature any strong progressivity beyond the lowest income deciles. This reflects tax exempt thresholds for low income earners and the uniform flat tax for all others. Similarly, social security contributions are a uniform tax rate on the wage. The near-absence of wealth taxation further reinforces the trend of an overall tax system with limited progressivity. At the same time, it is important to note that Lithuania’s social security contributions are not capped while benefits are capped, thus imparting progressivity to the overall security system.

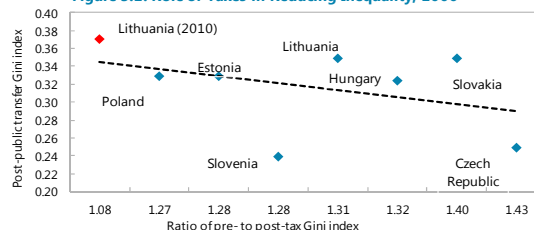
Taxes in Lithuania appear to play a limited role in income redistribution, especially of late.

This is apparent when comparing pre- and post-benefit and pre- and post-tax Gini coefficients. While social benefits helped reduce the Gini by about 50 percent in 2010, the tax system only reduced the Gini by 8 percent. Overall, the Gini after transfers (both taxes and benefits) remains among the highest in the EU. Recent Fund research suggests that societies with lower income inequality tend to experience more inclusive and sustainable growth.

Hence, tax policy changes should usefully focus on wealth and capital taxation.

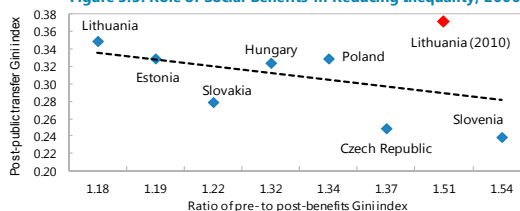
These taxes raise revenue, are less distortionary than other taxes, provide a stable source of revenue that is less subject to cyclical changes, and are more progressive than some other taxes. That said, tax administration improvements are important to ensure that tax changes yield their full potential.

Figure 3.2. Role of Taxes in Reducing Inequality, 2006



Sources: Staff calculations based on data from Lithuania 2010 Survey of Income and Living Conditions and Zaidi (2008), "Main Drivers of Income Inequality in EU8 Countries: Some Insights from Recent Household Survey Data".

Figure 3.3. Role of Social Benefits in Reducing Inequality, 2006



Sources: Staff calculations based on data from Lithuania 2010 Survey of Income and Living Conditions and Zaidi (2008), "Main Drivers of Income Inequality in EU8 Countries: Some Insights from Recent Household Survey Data".

¹ Prepared by Nan Geng. See also the forthcoming Selected Issues Paper, "Toward a Sustainable and Inclusive Consolidation in Lithuania."

Box 4. Tax Policy Recommendations¹

- **Wealth tax.** Introduce an annual motor vehicle tax, graduated per engine capacity (or by weight) in line with international best practice (0.4 percent of GDP).
- **Property tax.** Expand property taxes to include all residential properties (0.4 percent of GDP).
- **PIT base broadening.** (i) Eliminate tax exemptions on interest income (0.1 percent of GDP). (ii) Restrict the exemption from capital gains tax on housing only for the sale of primary residences and subject all short-term gains on financial assets (realization within three years of acquisition date) to a withholding tax at a rate of 15 percent. (iii) Subject all pension payments to income tax (0.5 percent of GDP).
- **CIT base broadening.** Consolidate reduced/preferential CIT rates on small companies and realized gains on security transactions up to three years into the standard 15 percent rate; remove CIT exemptions/preferential rates on investment incentives and tax holiday schemes in free economic zones (0.5 percent of GDP).

¹ Prepared by Nan Geng.

20. Deepening fiscal reforms would be desirable. A simple, clear, and comprehensive fiscal rule, alongside a fiscal council, would strengthen the fiscal framework. The rule could usefully enhance the counter-cyclicality of the existing expenditure rule, while also ensuring that debt is reduced. Further reform of the pension system to ensure its long-term sustainability is also needed, especially in light of rapid population ageing. Parametric pension reforms could usefully link future benefits to demographic factors, separate basic pensions from other pensions (to de-link the redistributive role of basic pensions from the insurance role of other pensions), and means test qualification for basic pensions.

Authorities' views

21. The authorities emphasized their commitment to continued fiscal prudence. They agreed that the composition of adjustment should shift to the revenue side, and stressed the importance of the working group on tax reform to provide options in this regard. They underscored, however, that job creation was a key priority and that they were still in the process of elaborating their policy agenda, including the future path for fiscal policy.

B. The Financial Sector—Playing its Supportive Role in Enabling Growth

22. Supervisory interventions have forcefully addressed weaknesses in some domestically-owned banks, thereby strengthening financial stability. The intervention of Snoras bank removed a major threat to financial stability, and the recent steps to rapidly address problems in two troubled credit unions and another domestically-owned bank underscore the importance of effective financial sector supervision. The BoL's stepped-up onsite inspections, careful monitoring of banks' loan loss provisions and ongoing efforts to strengthen the supervision of credit institutions

are essential for the continued health of the banking system. In this context, steps to strengthen Lithuania's AML/CFT regime are welcome, including additional dedicated supervisory staff at the BoL, more risk-based inspections, and new BoL guidelines for customer due diligence. In line with international standards, the operational independence and resources of the Financial Intelligence Unit should be strengthened.

23. The banking system as a whole appears resilient to shocks. BoL stress tests show that, under severe conditions—including large declines in exports (-20 percent) and output (-13 percent) and increases in interest rates (+370 bps)—aggregate capital adequacy would still remain at 11 percent, well above the regulatory minimum (8 percent). While provisions-to-NPL ratios are somewhat below regional peers, this partly reflects the BoL's more stringent definition of NPLs.³

24. The financial sector has an essential role to play in enabling sound credit expansion to support the recovery. Econometric analysis suggests that credit demand and credit supply have been weak in recent years, although supply side factors dominate somewhat in 2012 (Box 5). Given available liquidity in banks, supply constraints seem to emanate mainly from NPLs and banks' rebalancing of funding toward domestic sources, which have given rise to tight lending standards. While a balanced approach to risks and returns in new credit extension is clearly important to avoid the excesses of the boom years, sound credit growth is needed to support investment and the reallocation of resources to the tradable sector.

25. In this regard, staff urged the authorities to reduce obstacles to NPL resolution. A comprehensive review could usefully identify any legal, regulatory, or other obstacles to NPL resolution. In this context, the implementation of the new household insolvency regime in early 2013 is an important step. Recent changes to the corporate bankruptcy and restructuring regime have been helpful in simplifying procedures and allowing company's boards to initiate restructurings. But these changes have not yet been able to speed up lengthy delays— anecdotal evidence suggests that bankruptcy proceedings take significantly longer in Lithuania than in regional peers. In this regard, new proposals for appointing bankruptcy administrators, an area where appeals are common, are a step in the right direction.

26. Staff welcomed the consolidation of competencies under the BoL. The unification of financial supervision, in place since early 2012, is paying off, and further steps to bring macro-prudential policy under the competency of the BoL is welcome. In this regard, the BoL is preparing draft amendments to the BoL law. Going forward, it will be important to monitor the resource implications of increased responsibilities for the BoL.

³ The BoL defines NPLs as loans that are impaired or 60 days past due. Many countries define NPLs as loans that are 90 days past due.

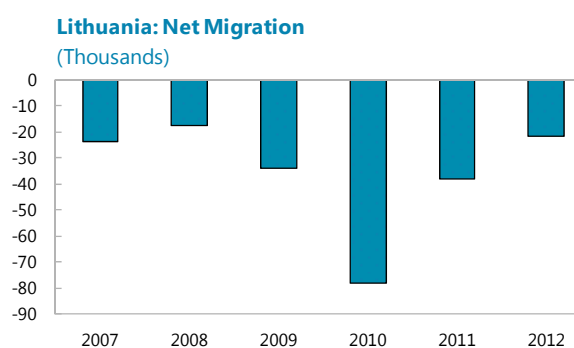
Authorities' views

27. The authorities broadly agreed with staff's assessment of the financial sector. They underscored that the interventions of the two banks and two credit unions were necessary to safeguard financial stability, and that confidence had been maintained. The BoL emphasized that it would continue its stepped-up monitoring of the financial sector to help ensure that risks were contained going forward. On NPLs, the authorities noted that improvements in the insolvency regime for households and corporations were important steps toward NPL resolution. On credit, they stressed that lending standards were too lax in the pre-crisis period and that some risk aversion by banks is welcome. In their view, ample liquidity suggested that banks did not face funding constraints.

C. Competitiveness—a Driver for Longer-Term Growth

28. Going forward, reaching potential growth requires that competitiveness gains are locked in. This will depend critically on boosting investment and addressing challenges in the labor market. It will also help avoid a resurfacing of large current account deficits and the related build-up of external debt.

- **Steps to improve the business environment can help spur investment.** Administrative burdens and zoning restrictions make doing business more difficult. The authorities' intention to review territorial planning regulations is welcome in this respect. Ongoing efforts to facilitate compliance with administrative regulations, allow waivers of fines for immaterial breaches on regulations for recently created companies, and coordinate inspections across several agencies are also valuable steps. Energy sector reforms continue to be important to reduce costs and improve efficiency in this sector.
- **Addressing high unemployment remains a key objective.** There is a need to help reduce structural unemployment. According to the latest census, Lithuania's population contracted by some 12 percent over the last decade, of which 75 percent was due to emigration (and over 60 percent of emigration is accounted for by 15–34 year olds). As a result, the average age of the population increased by four years. Outward migration is now slowing, but retaining young and highly skilled workers, further improving labor markets, and reducing unemployment continue to be essential. This implies addressing skill mismatches through training and active labor market policies (including by deploying EU funds in this area), reforming education, and removing obstacles in the benefits system that prevent workers from entering the formal labor force.



Source: Statistics Lithuania.

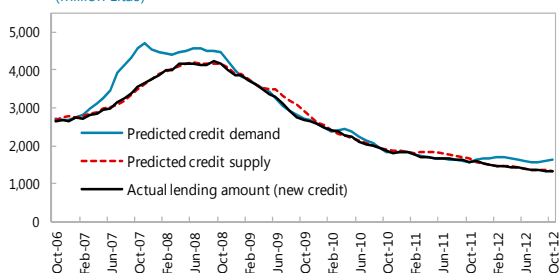
Box 5. Does Low Credit Growth Reflect a Lack of Demand or Supply?¹

While deleveraging and credit contraction have occurred in tandem in Lithuania, it is difficult to disentangle whether the observed credit contraction reflects credit demand or supply factors. Since early 2009, parent bank loans have fallen by nearly 50 percent while credit has contracted by almost 20 percent. On the one hand, the withdrawal of parent funding may have caused the credit contraction. On the other hand, a lack of demand for credit may have caused subsidiaries to use their excess liquidity to repay parent funding.

A disequilibrium model was used to identify whether demand or supply constraints drive low credit growth. A system of demand and supply equations for credit were estimated using maximum likelihood estimation, and actual credit is assumed to be the lesser of estimated demand or supply. Both price and non-price factors are allowed to play a role in the equations. Credit demand is modeled as a function of the cost of credit (interest rate), asset prices, future economic prospects (confidence, new orders, unemployment), economic and political uncertainty (variability of economic growth forecasts) and some proxies for borrowers' financial and profitability situation (credit constraints reported in industry surveys and corporate profit margins). Credit supply is estimated as a function of return on credit, lending capacity (deposits and parent funding), the quality of banks' loan portfolio (NPLs), status of the overall economic environment, future economic prospects and a Snoras dummy. Most explanatory variables are lagged by one period. Monthly data were used for the period 2006M10 – 2012M10. Quarterly available data were linearly interpolated. Credit is defined as the volume of new lending, expressed in real terms.

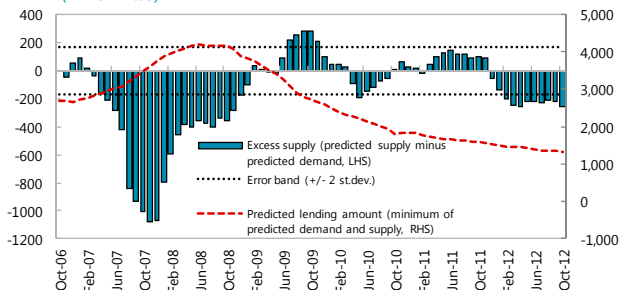
The model estimation intuitively captures the boom and deleveraging period, and suggests that credit supply may be constrained. Up to 2008Q4, there was strong excess demand, as supply could not keep pace with demand growth. The bust that started at end-2008 led to sharply falling demand. While some deleveraging took place in 2009, it was initially moderate, resulting in excess supply. Deleveraging subsequently accelerated in 2010 but demand was falling as well. For the recent period, the model identifies demand not to be the constraining factor, but rather supply. The lack of supply identified by the model coincides with ample liquidity in the banking sector, but since the model allows for non-price factors, this can be interpreted as tight lending standards or banks' high risk aversion, possibly on account of high NPLs.

Figure 5.1. Demand and Supply of Credit
(million Litās)



Sources: Central Bank of Lithuania; Haver; and IMF staff estimates.

Figure 5.2. Predicted Lending and Excess Supply
(million Litās)



Sources: Central Bank of Lithuania; Haver; and IMF staff estimates.

¹ Prepared by Nan Geng.

- **Wage growth should reflect productivity growth.** While the recent large increase in the minimum wage can probably be accommodated given past productivity gains, there is a risk that it will feed into general wages and inflation, and erode competitiveness. More generally, it will be important that wage growth does not outpace productivity growth going forward.

Authorities' views

29. The authorities shared the view that it was important to lock in competitiveness gains.

They attached high priority to job creation and addressing high unemployment. They also saw a need to boost investment to sustain the recovery. On minimum wages, they stressed that an increase was warranted as inflation had increased by over 20 percent since the beginning of 2008 while the minimum wage had remained flat until mid-2012. They were confident that the increase could be accommodated, given past productivity gains.

D. Euro Adoption

30. Euro adoption remains an important goal. The CBA withstood the 2008–09 crisis and liquidity pressures have fallen with reduced vulnerabilities in both foreign and domestic banks. However, euro adoption remains desirable to complete the path toward full EU integration, ensure an orderly exit from the CBA in the light of high euroization, reap benefits of lower borrowing costs, and gain access to ECB liquidity. Therefore, macroeconomic policies should continue to align with the Maastricht criteria to afford Lithuania the best chance of meeting all criteria for euro membership, taking into account the limited room to directly influence inflation.

Authorities' views

31. The authorities are firmly committed to the goal of euro adoption. They publicly stated their commitment to seek to join the euro area in 2015. A working group on euro adoption has been established to review potential impediments, highlight remaining issues, and prepare for a smooth transition.

STAFF APPRAISAL

32. Much has been achieved in Lithuania since the crisis of 2008–09. Significant rebalancing has taken place: the current account and fiscal deficits have been substantially reduced and banks' dependence on foreign funding has declined notably. A drop in unit labor costs led to quick competitiveness gains and laid the foundation for an export-led recovery. Debt has declined across most sectors of the economy.

33. Locking in these gains is essential for a robust and sustainable recovery. Despite a difficult external environment, the economy expanded strongly in the last two years, unemployment has fallen, and exports have grown rapidly. The recovery is expected to continue in 2013, but at a somewhat slower pace. Risks around this outlook have moderated but remain tilted to the downside, as renewed financial stress or weak growth in Europe would adversely affect Lithuania

through trade and financial channels. Looking farther ahead, growth should gradually rise toward its potential of around 3¾ percent, but this requires that recent competitiveness gains are preserved and that investment continues to recover.

34. Completing the fiscal adjustment is important to rebuild Lithuania's fiscal buffers. In light of the limited macroeconomic policy tools available under the CBA and Lithuania's vulnerability to external shocks, the structural fiscal deficit and public debt ratio should be further reduced. The 2013 budget appropriately targets a further reduction in the deficit to 2½ percent of GDP. Looking ahead, further reductions in the structural fiscal deficit will be needed in the medium term. To bolster the fiscal framework, a simple, clear, and comprehensive fiscal rule, alongside a fiscal council, should be considered. Further reform of the pension system to ensure its long-term sustainability is also needed.

35. The composition of fiscal adjustment should shift to the revenue side. So far, most of the fiscal consolidation has taken place on the expenditure side, while Lithuania's revenue-to-GDP ratio is the lowest in the EU. Therefore, taxation of wealth—notably real estate and motor vehicles—could be expanded to raise additional revenue. There is also scope to broaden the bases for corporate income tax and personal income tax by reducing exemptions. At the same time, it is essential that tax administration be improved to ensure that revenue collection does not continue to fall short.

36. Recent interventions have forcefully addressed weaknesses in domestic banks. The intervention of Snoras bank removed a major threat to financial stability, and the recent steps to rapidly address problems in two troubled credit unions and in another domestic bank underscore the importance of effective financial sector supervision. In this context, the BoL's stepped-up onsite inspections, strict stress testing, and careful monitoring of banks' loan loss provisions are essential for the continued health of the banking system. Ongoing efforts to strengthen the supervision of credit institutions are welcome.

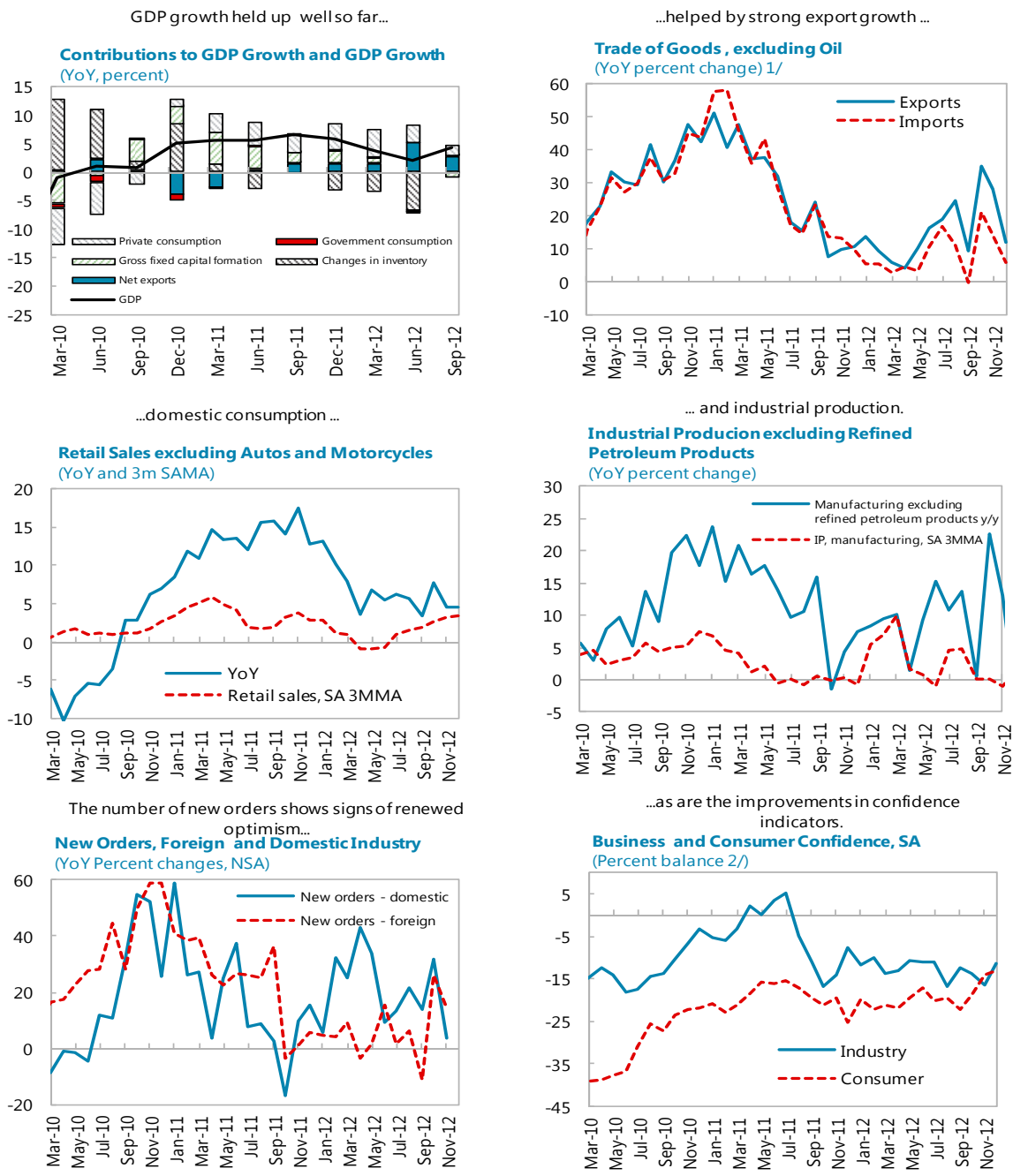
37. The financial sector has an essential role to play in supporting a robust and sustainable recovery. The banking system as a whole is well-capitalized and liquid, but NPLs remain high. While Lithuania has so far been able to continue its economic recovery despite negative private sector credit growth for nearly four years, it is important that credit is not unduly constrained going forward. In this regard, a review of obstacles to timely NPL resolution would be a welcome step toward ensuring that credit supply is not constrained. The new household insolvency regime and recent proposals to modify the corporate insolvency regime are welcome.

38. Reducing unemployment and boosting investment are essential for medium-term growth. Job creation should be supported through training and active labor market policies, including by deploying EU funds in this area. While the recent large increase in the minimum wage can probably be accommodated given past productivity gains, it will be important that wage growth does not outpace productivity growth going forward. Efforts to improve the business climate by reducing administrative burdens and streamlining territorial planning procedures are essential to boosting investment. Energy sector reforms are needed to reduce costs and improve efficiency in

this sector. The government's announcement to seek euro adoption in the near future is welcome, but will require a well-articulated policy agenda aimed at preserving Lithuania's competitiveness.

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

Figure 1. Lithuania: Real Sector, 2010–12



Sources: Haver; Lithuania Statistical Office; Bank of Lithuania.

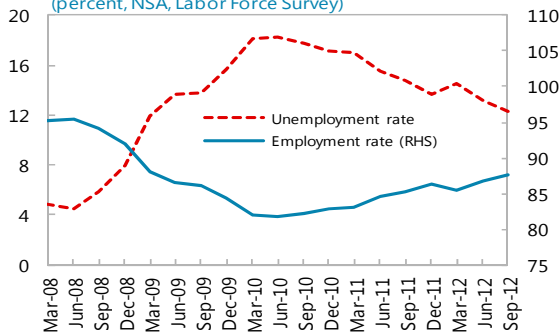
1/ The export and import data are measured in terms of F.O.B and C.I.F respectively.

2/ Percent balance equals percent of respondents reporting an increase minus the percent of respondents reporting a decrease.

Figure 2. Lithuania: Labor Market and Competitiveness, 2008–12

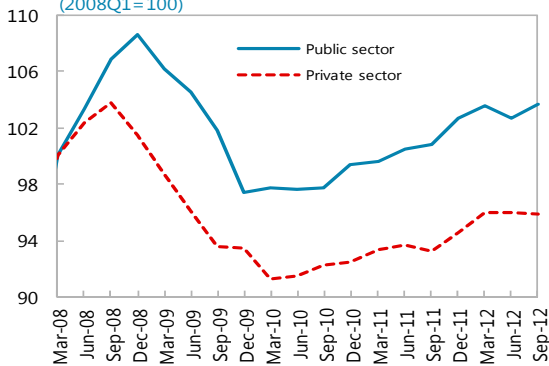
Unemployment is falling...

Employment and Unemployment Rate
(percent, NSA, Labor Force Survey)



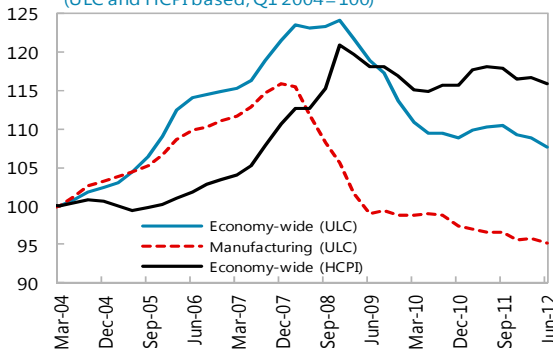
Job growth was facilitated by moderate earnings growth ...

Average Monthly Gross Earnings, SA
(2008Q1=100)



The real effective exchange rate has depreciated, especially when measured by unit labor costs, ...

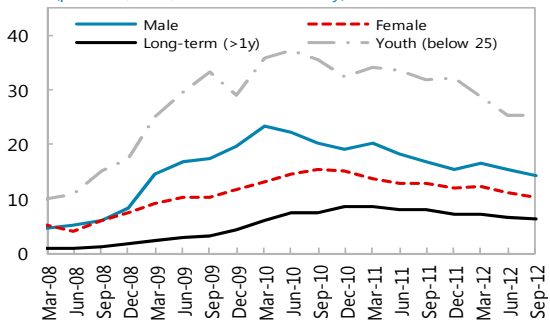
Real Effective Exchange Rate
(ULC and HCPI based, Q1 2004=100)



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

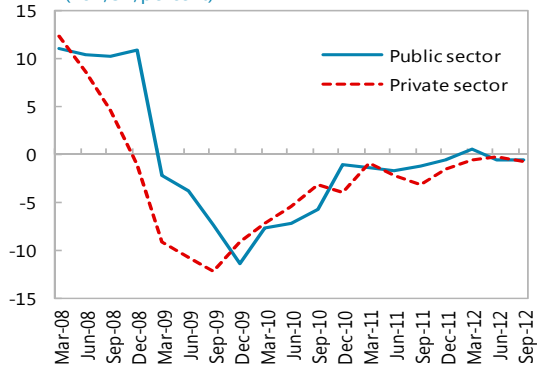
...especially for youth and males, where unemployment is high.

Unemployment Rate by Sex and Duration
(percent, NSA, Labor Force Survey)



... which was close to being negative in real terms.

Average Monthly Gross Real Earnings Growth Rate
(YoY, SA, percent)



... and more so than in other Baltic countries or Germany.

Real Effective Exchange Rate
(ULC manufacturing based, Q1 2004 = 100)

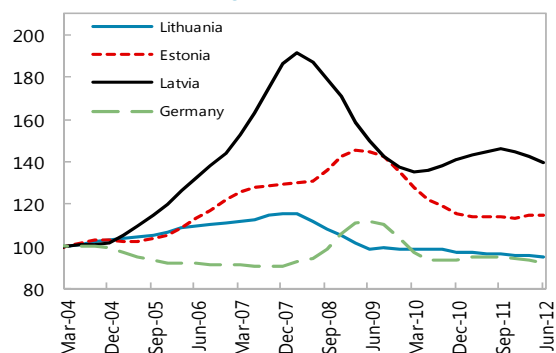
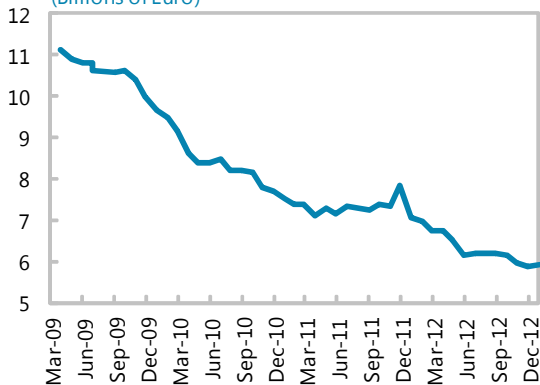


Figure 3. Lithuania: Banking Sector, 2009–12

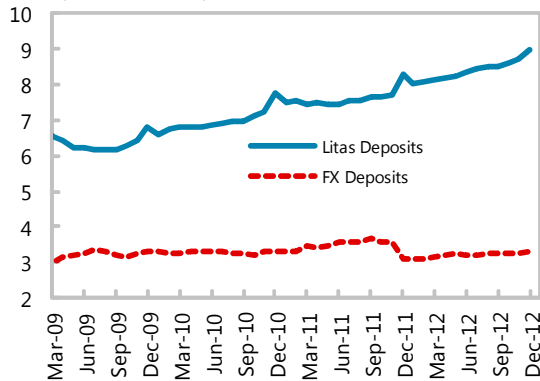
After a period of sharp deleveraging outflows have stabilized...

Banks' External liabilities
(Billions of Euro)



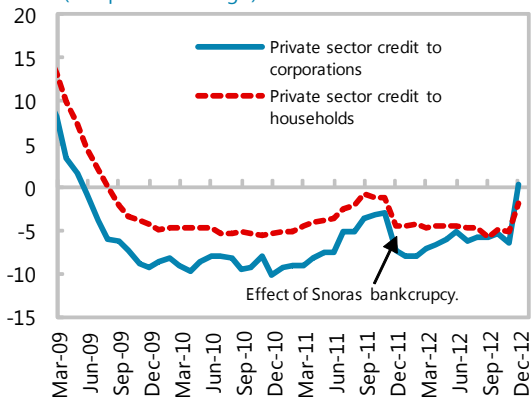
...while deposits have continued a moderate increase.

Deposits of Corporations and Households
(Billions of Euro)



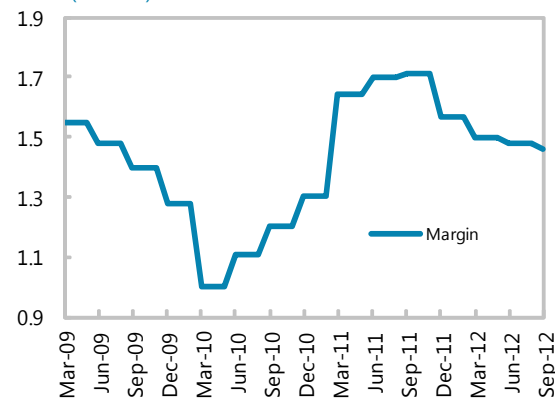
As a result, credit growth is negative.

Credit Stock
(YoY percent change)



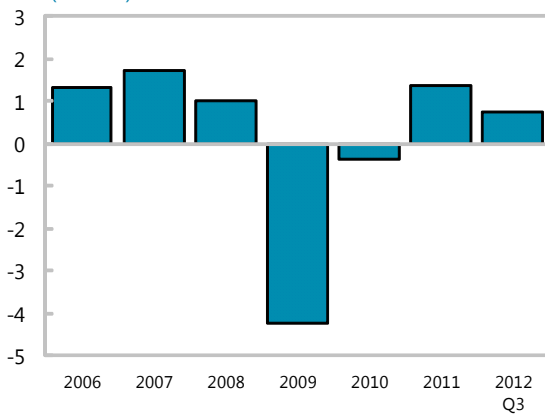
In addition, a shrinking interest margin....

Interest Rate Margin
(Percent)



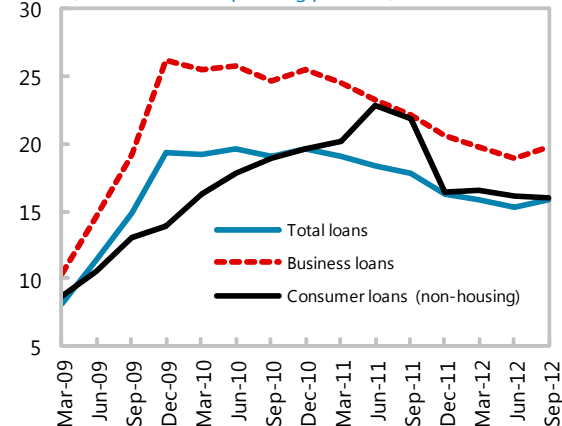
... is hurting profitability.

Return on Assets
(Percent)



Meanwhile, NPLs remain high.

Non-performing Loans
(Percent of corresponding portfolio)

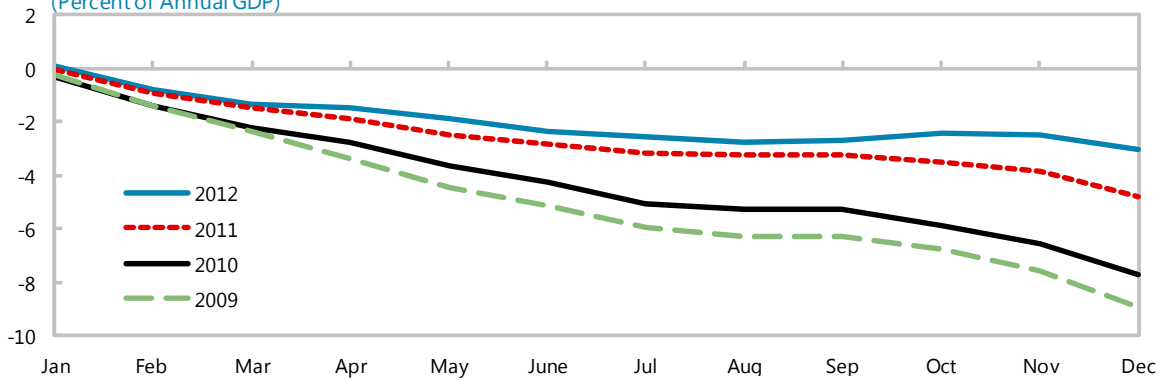


Source: Dx Time; Bank of Lithuania; and IMF staff estimates.

Figure 4. Lithuania: Recent Fiscal Developments, 2009–12

The central government cumulative cash deficit has continued to improve, especially since October...

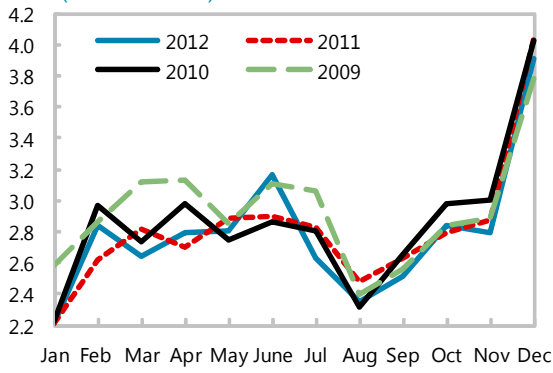
Cumulative Central Government Balance
(Percent of Annual GDP)



...because of strict expenditure restraint,...

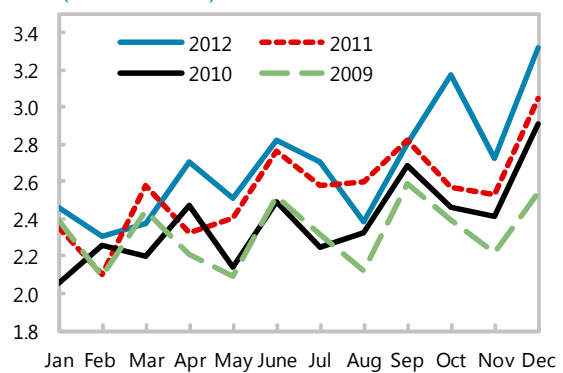
... large dividend inflows in October...

Total Primary Expenditures
(Billions of Litas)



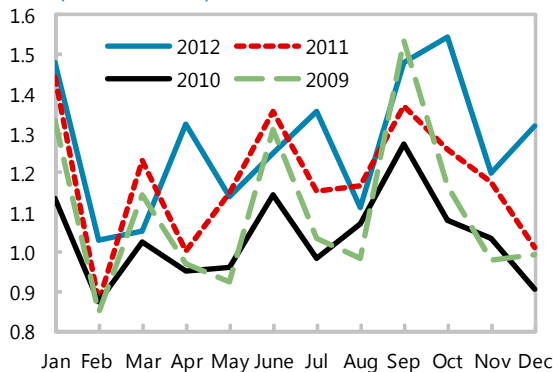
...and a recent pickup in tax revenue after earlier mixed performance.

Revenues
(Billions of Litas)

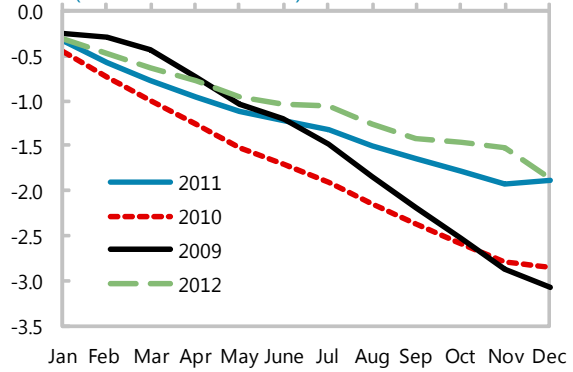


The Sodra deficit, meanwhile, was also better than budgeted.

Taxes
(Billions of Litas)



Cumulative Sodra Deficit
(Percent of annual GDP)



Source: Ministry of Finance.

Table 1. Lithuania: Selected Economic Indicators, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Projections								
Output									
Real GDP growth (annual percentage change)	1.5	5.9	3.6	3.0	3.3	3.5	3.7	3.8	3.8
Nominal GDP (in billions of litai)	95.3	106.4	113.2	119.6	127.5	135.8	144.9	154.7	165.1
GDP (in billions of euros)	27.6	30.8	32.8	34.6	36.9	39.3	42.0	44.8	47.8
Output gap (percent of potential GDP)	-6.2	-2.7	-1.2	-0.6	0.0	0.0	0.0	0.0	0.0
Domestic demand growth (year-on-year, in percent)	4.2	6.0	-1.1	3.3	3.9	4.0	3.5	3.5	3.4
Private consumption growth (year-on-year, in percent)	-4.7	6.4	4.7	3.1	3.1	3.2	2.9	2.8	2.8
Domestic fixed investment growth (year-on-year, in percent)	1.9	18.3	-2.5	3.7	6.0	6.0	5.7	5.5	5.5
Inventories (contribution to growth)	7.5	-1.3	-3.6	0.5	0.1	0.2	0.0	0.0	-0.1
Net external demand (contribution to growth)	-0.3	0.3	4.3	-0.2	-0.5	-0.4	0.2	0.4	0.5
Employment									
Unemployment rate (year average, in percent of labor force) 1/	17.8	15.2	13.2	12.0	11.0	10.0	10.0	10.0	10.0
Average monthly gross earnings (annual percentage change)	-3.9	2.2	3.7	4.8	5.2	5.2	5.7	5.5	5.8
Labor productivity (annual percentage change)	7.0	13.2	1.8	2.1	2.6	2.8	3.1	3.3	3.2
Prices									
CPI, end of period (year-on-year percentage change)	3.6	3.5	2.9	2.7	2.3	2.4	2.4	2.4	2.4
GDP deflator (year-on-year percentage change)	2.0	5.4	2.7	2.5	3.3	2.9	2.8	2.8	2.8
CPI, period average (annual percentage change)	1.2	4.1	3.2	2.1	2.5	2.3	2.4	2.4	2.4
General government finances									
Revenue (percent of GDP)	33.6	31.9	32.9	32.6	32.5	32.1	31.5	31.2	31.1
<i>Of which EU grants</i>	2.7	2.3	2.4	2.4	2.4	2.1	1.7	1.6	1.5
Expenditure (percent of GDP)	40.8	37.4	35.9	35.1	34.8	34.4	33.6	33.3	33.0
<i>Of which: Non-interest</i>	39.0	35.5	34.0	33.4	33.0	32.6	31.8	31.5	31.1
Interest	1.8	1.9	1.9	1.8	1.8	1.7	1.8	1.9	1.9
Fiscal balance (percent of GDP)	-7.2	-5.5	-3.0	-2.6	-2.3	-2.3	-2.1	-2.1	-1.9
Structural Fiscal Balance (percent of potential GDP) 2/	-4.7	-3.6	-2.3	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
General government gross debt (Maastricht def., percent of GDP)	37.9	38.5	39.6	40.0	39.8	39.7	39.3	38.9	38.4
<i>Of which: Foreign currency-denominated</i>	34.1	33.1	33.3	32.8	31.9	31.7	31.5	31.1	30.7
Money and credit									
Broad money (end of period, percent change)	8.9	4.9	7.2	8.8	8.3	..	..	..	..
Private sector credit (end of period, percent change)	-7.6	-5.7	0.3	3.4	2.8	..	..	..	..
3-month Treasury bill interest rate (percent)	1.8	1.7	1.1	..	..	..	..	..	..
Reserve money (end of period, percent change)	19.4	37.5	-6.4	5.5	5.5	..	..	..	..
Balance of payments (in percent of GDP, unless otherwise specified)									
Current account balance	0.1	-3.7	-0.9	-1.3	-1.7	-2.3	-2.2	-2.0	-1.8
Exports of goods and services (volume change, in percent)	17.4	14.1	11.2	4.2	5.7	5.8	6.1	6.3	6.3
Imports of goods and services (volume change, in percent)	18.0	13.7	5.6	4.6	6.7	6.6	6.0	6.1	6.1
Foreign direct investment, net	2.2	3.3	2.2	2.4	2.4	2.6	2.6	2.5	2.5
Gross official reserves (in billions of euros)	5.0	6.4	6.5	6.7	6.9	7.1	7.6	8.1	9.0
Reserve cover (in months of imports of goods and services)	3.1	3.1	2.9	3.0	2.9	2.8	2.9	2.9	3.1
Reserve cover (in percent of short-term debt) 3/	54.6	51.2	60.3	66.4	64.9	65.5	68.0	71.4	76.7
Reserve adequacy metric (in billions of US\$)	10.6	11.5	11.2	10.8	..	..	..	..	..
Short-term debt at original maturity	15.2	13.9	8.3	6.3	5.1	4.7	4.3	4.0	3.6
Gross external debt 4/	81.9	77.3	71.5	67.4	63.3	60.3	57.5	54.8	51.9
Exchange rates									
Real effective exchange rate (2005=100, +=appreciation) 5/	113.2	114.8	113.1	..	..	..	..	..	..
Exchange rate (litai per U.S. dollar, end of period)	2.6	2.6	2.6	..	..	..	..	..	..
Exchange rate (litai per U.S. dollar, period average)	2.6	2.5	2.7	..	..	..	..	..	..
Exchange rate (litai per euro, end of period)	3.5	3.5	3.5	..	..	..	..	..	..
Saving-investment balance (in percent of GDP)									
Gross national saving	17.7	16.6	16.5	17.0	17.4	17.8	18.7	19.7	20.6
Gross national investment	17.7	20.3	17.4	18.3	19.1	20.1	21.0	21.7	22.4
Foreign net savings	-0.1	3.7	0.9	1.3	1.7	2.3	2.2	2.0	1.8

Sources: Lithuanian authorities; World Bank; Eurostat; and IMF staff estimates and projections.

1/ The latest population census has resulted in updated labor force survey (LFS) statistics for 2010-11 only. Further revisions for 2003-09 data are in progress.

2/ Calculation takes into account standard cyclical adjustments as well as absorption gap and output composition effects (based on FAD Structural Fiscal Balance Template).

3/ Short-term debt at remaining maturity.

4/ Government external debt here includes guaranteed loans.

5/ CPI-based, 2005 trade-weighted real effective exchange rate against 17 major trading partners.

Table 2. Lithuania: General Government Operations, 2010–18

(ESA 95 aggregates, in percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Proj.						
Statement of Operations									
Revenue	33.6	31.9	32.9	32.6	32.6	32.1	31.5	31.3	31.1
Revenue excluding EU grants	30.9	29.6	30.5	30.2	30.2	30.0	29.8	29.7	29.7
Tax revenue	16.4	16.0	16.2	16.1	16.1	16.0	15.9	15.9	15.9
Direct taxes	4.7	4.4	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Personal income tax	3.6	3.5	3.5	3.6	3.6	3.6	3.5	3.6	3.6
Corporate income tax	1.0	0.8	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Indirect taxes	11.8	11.6	11.5	11.4	11.4	11.3	11.2	11.2	11.2
VAT	7.8	7.8	7.6	7.6	7.5	7.5	7.4	7.3	7.3
Excises	3.2	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Other	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Social contributions	10.7	10.1	10.1	10.2	10.2	10.1	10.0	9.9	9.9
Grants	2.7	2.3	2.4	2.4	2.4	2.1	1.7	1.6	1.5
Other revenue	3.8	3.5	4.2	3.9	3.9	3.9	3.9	3.9	3.9
Total expenditure	40.8	37.4	35.9	35.1	34.9	34.4	33.6	33.4	33.0
Current spending	36.3	33.3	32.1	31.4	31.1	30.8	30.3	30.1	29.9
Compensation of employees 1/	11.1	10.3	9.4	9.2	9.1	9.0	8.9	8.8	8.7
Goods and services	6.4	5.2	5.3	5.3	5.4	5.4	5.3	5.3	5.3
Interest payments	1.8	1.9	1.9	1.8	1.8	1.7	1.8	1.9	1.9
Foreign	1.2	1.4	1.4	1.3	1.3	1.2	1.2	1.3	1.3
Domestic	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6
Subsidies	0.5	0.4	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Grants	0.7	0.7	0.6	0.6	0.6	0.4	0.4	0.4	0.4
Social benefits	14.9	13.2	13.3	12.8	12.6	12.7	12.3	12.2	12.1
Other expense	1.0	1.4	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Capital spending	4.5	4.1	3.7	3.7	3.7	3.6	3.3	3.2	3.2
Net lending (+) / borrowing (-)	-7.2	-5.5	-3.0	-2.6	-2.3	-2.3	-2.1	-2.1	-1.9
Net acquisition of financial assets	2.3	-1.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.6	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.7	-1.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	9.5	4.7	3.4	2.6	2.3	2.3	2.1	2.1	1.9
Domestic	1.0	1.5	1.4	1.3	1.3	1.2	1.1	1.1	1.1
Foreign	8.5	3.2	2.0	1.3	1.0	1.1	1.0	1.0	0.8
Financial Balance Sheet									
Financial assets	31.9	27.3	...	...	...	...	...	...	...
Currency and deposits	7.9	3.7	...	...	...	...	...	...	...
Securities other than shares	0.1	0.0	...	...	...	...	...	...	...
Loans	1.0	3.1	...	...	...	...	...	...	...
Shares and other equity	17.8	15.5	...	...	...	...	...	...	...
Other financial assets	5.1	4.9	...	...	...	...	...	...	...
Financial liabilities	46.6	46.4	...	...	...	...	...	...	...
Currency and deposits	0.0	0.0	...	...	...	...	...	...	...
Securities other than shares	34.2	34.2	...	...	...	...	...	...	...
Loans	6.9	7.0	...	...	...	...	...	...	...
Other liabilities	5.5	5.2	...	...	...	...	...	...	...
Net financial worth	-14.7	-19.2	...	...	...	...	...	...	...
Memorandum items:									
GDP (in millions of litai)	95,323	106,370	113,189	119,521	127,490	135,790	144,803	154,621	165,022
General government debt (Maastricht definition)	37.9	38.5	39.6	40.0	39.8	39.7	39.3	38.9	38.4
Foreign debt	28.3	29.1	29.3	29.0	28.2	27.6	26.8	26.1	25.2
Domestic debt	9.6	9.5	10.3	11.0	11.6	12.1	12.5	12.8	13.2
Net lending/borrowing net of pillar II transfer cuts 2/	-7.8	-6.0	-3.5	-2.9	-2.7	-2.7	-2.6	-2.5	-2.4

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

1/ The projections are based on the assumption that the returning of reduced salaries paid from state and local budgets back to the level of 2008 (as set out in the decision of the Constitutional Court on April 20, 2010) will start to happen gradually from 2014 onward.

2/ General government deficit including payments not transferred by SODRA to private pension accounts.

Table 3. Lithuania: Balance of Payments, 2010–18

(Billions of Euro, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	3/					Projections			
Current account balance	0.0	-1.2	-0.3	-0.5	-0.6	-0.9	-0.9	-0.9	-0.9
Merchandise trade balance	-1.3	-1.8	-1.2	-1.3	-1.4	-1.6	-1.6	-1.6	-1.5
Exports (f.o.b.)	15.7	20.2	22.9	22.9	24.0	25.3	26.8	28.5	30.3
Imports (f.o.b.)	-17.0	-22.0	-24.1	-24.2	-25.5	-26.9	-28.5	-30.1	-31.8
Services balance	0.8	1.0	1.3	1.3	1.4	1.4	1.4	1.5	1.6
Exports of non-factor services	3.1	3.7	4.2	4.2	4.4	4.5	4.7	5.0	5.3
Imports of non-factor services	-2.3	-2.7	-2.9	-2.9	-3.0	-3.1	-3.3	-3.5	-3.7
Factor income balance	-0.8	-1.4	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.6
Receipts	0.5	0.7	0.6	0.7	0.7	0.7	0.8	0.8	0.9
Payments	-1.3	-2.1	-2.1	-2.1	-2.2	-2.2	-2.3	-2.4	-2.4
Current transfer balance	1.3	1.1	1.1	1.0	0.9	0.8	0.7	0.7	0.6
Capital and financial account balance	0.3	2.5	0.5	0.6	0.8	1.1	1.4	1.5	1.8
Capital transfer balance	0.7	0.8	0.7	0.6	0.6	0.5	0.5	0.5	0.5
Foreign direct investment balance	0.6	1.0	0.7	0.8	0.9	1.0	1.1	1.1	1.2
Portfolio investment balance	1.6	1.2	1.0	0.0	-0.1	-0.1	0.0	0.0	-0.2
Other investment balance	-2.5	-0.5	-1.9	-0.8	-0.6	-0.3	-0.2	-0.1	0.3
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.4	1.4	0.2	0.2	0.2	0.2	0.5	0.6	0.9
Financing	-0.4	-1.4	-0.2	-0.2	-0.2	-0.2	-0.5	-0.6	-0.9
Gross international reserves (increase: -)	-0.4	-1.4	-0.2	-0.2	-0.2	-0.2	-0.5	-0.6	-0.9
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	0.1	-3.7	-0.9	-1.3	-1.7	-2.3	-2.2	-2.0	-1.8
Trade Balance of goods and services	-1.9	-2.6	0.4	-0.1	-0.2	-0.5	-0.4	-0.1	0.2
Exports	67.9	77.5	82.7	78.2	76.9	75.9	75.3	74.9	74.5
Imports	-69.8	-80.2	-82.4	-78.3	-77.1	-76.4	-75.7	-75.0	-74.3
Factor Income	-2.8	-4.6	-4.5	-4.2	-4.0	-3.8	-3.5	-3.4	-3.3
Current Transfers	4.8	3.5	3.2	3.0	2.6	2.0	1.7	1.5	1.3
Capital and financial account balance	1.2	8.2	1.5	1.8	2.1	2.8	3.3	3.4	3.7
Capital transfers	2.7	2.5	2.2	1.7	1.5	1.2	1.2	1.2	1.1
Foreign direct investment balance	2.2	3.3	2.2	2.4	2.4	2.6	2.6	2.5	2.5
Portfolio investment balance	5.8	4.0	3.0	-0.1	-0.2	-0.2	0.0	-0.1	-0.4
Other investment balance	-9.2	-1.5	-5.9	-2.3	-1.6	-0.7	-0.4	-0.1	0.6
Overall balance	1.3	4.5	0.6	0.5	0.4	0.6	1.1	1.4	1.9
Gross external debt 1/	81.9	77.3	71.5	67.4	63.3	60.3	57.6	54.8	51.9
Public	28.8	30.1	31.3	30.3	28.9	27.9	26.9	25.9	24.8
Short-term	0.7	1.1	0.0	-0.6	-1.0	-1.2	-1.4	-1.6	-1.8
Long-term	28.2	29.1	31.3	30.9	30.0	29.2	28.4	27.5	26.6
Private	53.1	47.2	40.2	37.2	34.4	32.4	30.6	28.9	27.2
Short-term	15.9	14.0	9.4	8.1	7.2	7.0	6.8	6.6	6.4
Long-term	37.2	33.2	30.8	29.1	27.1	25.4	23.9	22.3	20.8
Gross external debt (in percent of GNFS exports)	120.7	99.7	86.4	86.2	82.3	79.4	76.5	73.2	69.7
Net external Debt	35.5	32.3	27.1	23.5	20.4	18.3	16.3	14.4	12.4
Net international investment position	-55.4	-52.6	-48.1	-45.1	-42.5	-40.9	-39.4	-37.7	-36.0
GIR (in billions of Euros)	5.0	6.4	6.5	6.7	6.9	7.1	7.6	8.2	9.1
GIR (in percent of short-term debt) 2/	54.6	51.2	60.3	66.4	64.9	65.5	68.0	71.9	77.9
GIR (in months of imports of goods and services)	3.1	3.1	2.9	3.0	2.9	2.8	2.9	2.9	3.1
Merchandise export volume (percent change)	17.4	14.1	11.2	4.2	5.7	5.8	6.1	6.3	6.3
Merchandise import volume (percent change)	18.0	13.7	5.6	4.6	6.7	6.6	6.0	6.1	6.1
Merchandise export prices (percent change)	10.6	11.7	4.7	-4.2	-0.7	-0.4	-0.1	-0.1	-0.1
Merchandise import prices (percent change)	9.7	12.8	4.3	-4.0	-1.4	-0.8	-0.3	-0.3	-0.3
GDP (in billion of Euros)	27.6	30.8	32.8	34.6	36.9	39.3	41.9	44.8	47.8

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

1/ Government external debt here includes guaranteed loans.

2/ Short-term debt at remaining maturity.

3/ Data revisions for 2010 reflect methodological improvements.

Table 4. Lithuania: Summary of Monetary Accounts, 2007–14

(Billions of Litai, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014
							Projections	
Monetary Authority								
Gross foreign assets	18.0	15.6	15.8	17.8	22.1	22.1	22.8	23.3
Gross foreign liabilities	1.1	0.1	0.4	0.6	1.1	0.1	0.1	0.1
Net foreign assets	17.0	15.5	15.4	17.2	21.0	22.1	22.7	23.3
Gold	0.4	0.4	0.5	0.7	0.8	0.8	...	...
Net domestic assets								
Net credit to government	-3.0	-1.3	-2.6	-2.4	-1.4	-3.6	-2.5	-1.5
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	-1.0	-1.5	-2.3	-2.2	-2.3	-2.3	-2.4	-2.4
Reserve money								
Currency outside the central bank	9.2	9.6	7.9	8.8	10.8	11.4	12.6	13.5
Currency outside banks	8.1	8.5	7.0	7.8	9.7	10.3	11.4	12.3
Cash in vaults of banks	1.1	1.1	1.0	1.0	1.1	1.1	1.2	1.2
Deposit money banks' deposits with BoL	3.7	3.1	2.6	3.8	6.5	4.8	4.5	4.5
Banking Survey								
Net foreign assets								
Monetary authority	17.0	15.5	15.4	17.2	21.0	22.1	22.7	23.3
Banks and other banking institutions	-20.8	-31.1	-21.1	-15.8	-15.6	-12.3	-10.2	-8.4
Net domestic assets								
Net claims on government 1/	-2.3	1.4	-2.6	0.7	-1.0	0.3	1.5	2.2
Monetary authority	-3.0	-1.3	-2.6	-2.4	-1.4	-3.6	-2.5	-1.5
Banks and other banking institutions	0.7	2.7	0.1	3.1	0.4	4.0	4.0	3.7
Credit to private sector	56.0	66.0	61.4	56.8	53.5	53.7	55.5	57.1
Credit to nonbank financial institutions	3.2	3.9	2.7	3.7	3.4	4.3	4.6	4.9
Other items, net	-8.8	-11.7	-11.8	-14.4	-10.8	-14.0	-15.2	-15.2
Broad money								
Currency outside banks	8.1	8.5	7.0	7.8	9.7	10.3	11.4	12.3
Deposits	35.6	34.9	36.8	39.9	40.3	43.3	47.5	51.5
In national currency	28.3	26.0	25.0	28.5	29.5	31.8	34.9	37.8
In foreign currency	7.3	9.0	11.8	11.4	10.8	11.6	12.6	13.6
Memorandum items:								
Reserve money (yearly percent change)	21.1	-1.4	-17.2	19.4	37.5	-6.4	5.5	5.5
Broad money (yearly percent change)	21.7	-0.4	0.3	8.9	4.9	7.2	8.8	8.3
Private sector credit (yearly percent change)	45.3	17.8	-6.9	-7.6	-5.7	0.3	3.4	2.8
Money multiplier	3.4	3.5	4.2	3.8	2.9	3.3	3.5	3.5
Currency outside banks, in percent of deposits	22.8	24.4	19.0	19.7	24.0	23.7	23.9	23.9
Foreign-currency deposits (percent of total deposits)	20.6	25.7	32.0	28.6	26.8	26.7	26.5	26.5
Foreign-currency loans (percent of total loans) 2/	54.8	64.7	73.5	74.6	74.3	72.8	72.4	72.0
Velocity of broad money	2.2	2.5	2.1	2.0	2.1	2.09	2.0	2.0
Gross official reserves (billions of U.S. dollars) 3/	7.7	6.4	6.6	6.6	8.2	8.5	8.9	9.0
Gross official reserves (billions of euros) 3/	5.3	4.6	4.6	5.0	6.3	6.4	6.7	6.9
Excess reserve coverage 4/	14.4	8.3	14.5	13.1	12.0	13.7	12.0	10.3
GDP	99.2	111.9	92.0	95.3	106.4	113.2	119.6	127.5

Sources: Bank of Lithuania; and Fund 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, 2006–12

(Percent, unless otherwise indicated)

	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12
Capital adequacy							
Regulatory capital to risk-weighted assets 1/ 9/	10.8	10.9	12.9	14.2	15.6	13.9	14.2
Regulatory Tier 1 capital to risk-weighted assets 1/ 9/	7.8	7.7	10.2	10.4	11.6	12.0	13.4
Capital to assets 1/	7.6	7.9	9.2	7.9	8.9	10.7	11.7
Asset quality							
Nonperforming loans to capital 1/ 4/	...	...	42.4	202.9	179.9	115.0	88.8
o/w impaired loans to capital 1/ 4/	...	...	31.8	168.6	151.0	97.1	74.5
o/w non-impaired loans overdue more than 60 days to capital 1/ 4/	...	...	10.7	34.4	28.9	17.9	14.3
Nonperforming loans net of provisions to capital 1/ 4/ 13/	...	...	31.6	128.5	109.1	66.6	52.5
Nonperforming loans to total (non-interbank) loans 4/	...	...	4.6	19.3	19.7	16.3	13.9
o/w impaired loans to total (non-interbank) loans 4/	...	...	3.4	15.8	16.7	13.8	11.7
o/w non-impaired loans overdue more than 60 days to total (non-interbank) loans 4/	...	...	1.1	3.5	3.0	2.5	2.1
Impairment losses to total (non-interbank) loans 12/ 13/	0.9	0.7	1.2	7.2	7.9	6.9	5.7
Impairment losses to nonperforming loans 3/ 4/ 12/ 13/	92.5	72.2	26.5	37.1	40.2	42.2	40.8
Sectoral distribution of loans to total loans 6/							
Agriculture, hunting, forestry	1.9	1.7	2.1	1.9	1.9	...	...
Fishing	0.1	0.0	0.0	0.0	0.0	...	...
Mining and quarrying	0.1	0.1	0.2	0.2	0.3	...	...
Manufacturing	11.9	9.9	10.7	10.3	9.4	...	...
Electricity, gas and water supply	2.5	2.2	1.9	1.9	2.1	...	...
Construction	5.7	4.1	3.8	3.1	2.9	...	...
Wholesale and retail trade	12.8	10.7	10.7	9.7	8.8	...	...
Hotels and restaurants	1.6	1.4	1.6	1.7	1.5	...	...
Transport, storage and communication	2.5	2.2	2.5	2.6	2.3	...	...
Financial intermediation	7.3	5.5	6.3	4.0	5.6	...	...
Real estate, renting and other business activities	14.5	16.8	18.4	20.2	19.1	...	...
Public administration and defence; compulsory social security	1.5	1.3	2.1	2.2	3.7	...	...
Education	0.0	0.0	0.3	0.1	0.1	...	...
Health and social work	0.3	0.3	0.2	0.3	0.3	...	...
Other utilities, social and personal services	0.9	0.9	0.9	1.0	0.9	...	...
Other types of economic activities	0.0	0.0	0.0	0.0	0.0	...	...
Loans not attributed to economic activities	36.4	42.9	38.4	40.9	41.2	...	...
Residential real estate loans to total (non-interbank) loans	24.7	27.8	29.1	33.2	34.0	36.2	35.3
Large exposures to regulatory capital 1/ 5/	189.6	152.7	129.4	114.9	...	...	...
Earnings and profitability							
RoE 1/ 2/	20.3	25.9	13.5	-48.4	-4.7	15.2	6.6
RoA 2/	1.3	1.7	1.0	-4.2	-0.3	1.4	0.8
Interest margin to gross income	52.0	55.8	62.2	50.4	49.5	58.2	52.4
Noninterest expenses to gross income	56.3	49.8	52.7	59.0	66.7	62.4	65.7
Trading and foreign exchange gains (losses) to gross income	9.0	8.1	3.2	14.1	8.1	4.5	9.9
Personnel expenses to noninterest expenses	41.4	43.6	42.4	39.8	36.8	41.0	39.6
Liquidity							
Liquidity ratio (liquid assets to current liabilities) 7/	41.9	43.5	39.0	49.9	42.8	44.1	40.4
Liquid assets to total assets 7/	24.1	21.9	18.6	23.7	24.1	24.4	25.2
Current liabilities to total liabilities 7/	61.9	54.2	51.4	50.5	60.8	60.8	69.0
3-month VILIBOR-EURIBOR spread, b.p. 8/	6.5	229.6	699.8	320.0	49.4	30.4	49.0
Spread between highest and lowest interbank rate, b.p. 10/	277.0	690.0	1650.0	970.0	436.0	218.0	34.0
Customer deposits to total non-interbank loans	77.8	66.4	53.5	66.9	77.9	79.9	86.1
Foreign exchange risk							
Foreign-currency-denominated loans to total (non-interbank) loans 11/	52.8	55.6	64.6	73.9	74.0	72.4	71.7
Foreign-currency-denominated liabilities to total liabilities 11/	51.9	56.2	63.3	61.6	57.0	53.1	50.4
Net open position in foreign exchange to regulatory capital 1/ 9/	-1.4	-2.4	0.4	0.8	0.4	0.7	0.4
Memo item							
Provisioning (in percent of NPLs)	...	...	25.5	36.7	39.3	42.1	40.9

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. Until 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.

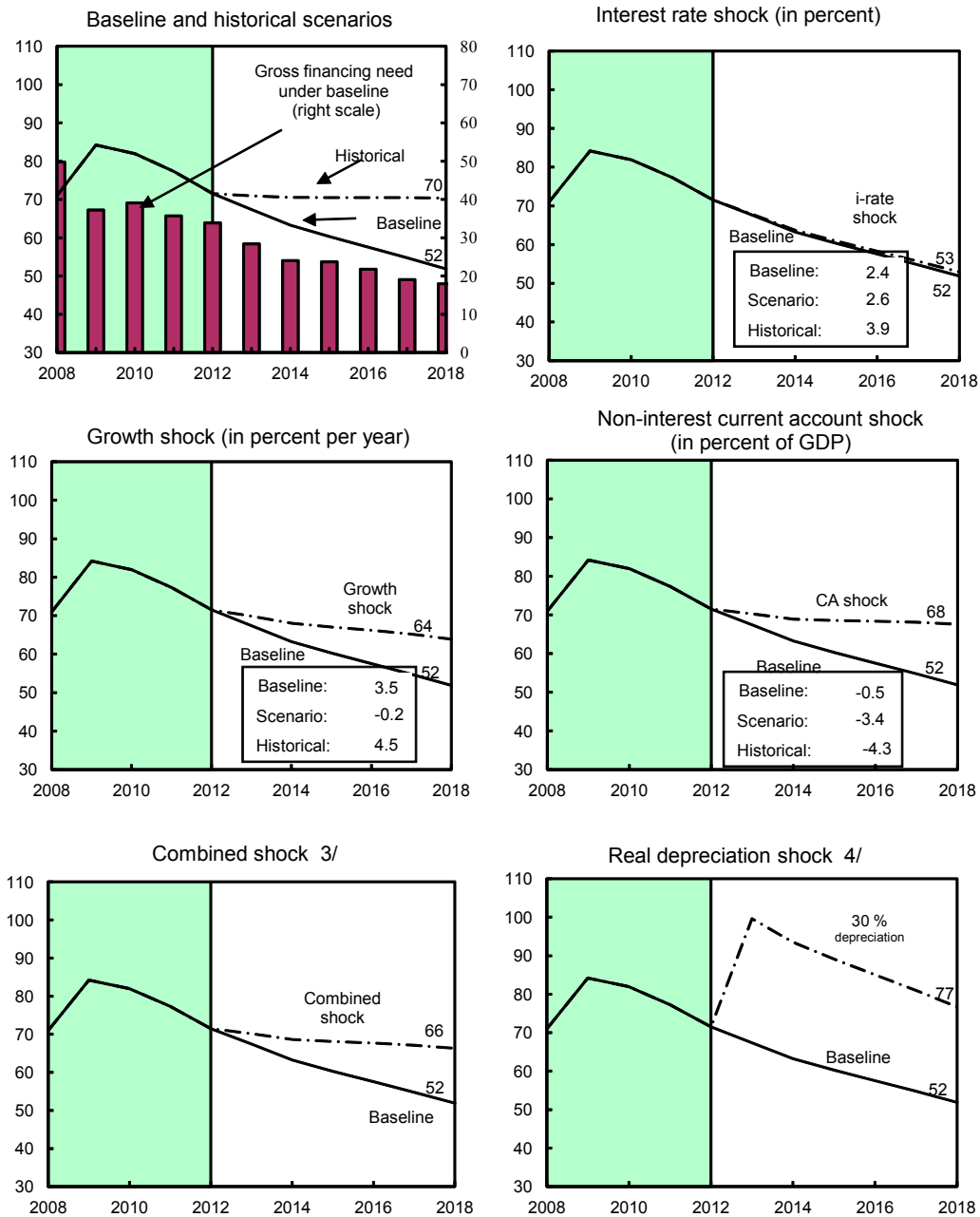
10/ Information is based on interbank deals of all maturities (mostly overnight) made between resident banks in national currency within the last quarter of the period.

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.

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 2013.

Table 1A. Lithuania: External Debt Sustainability Framework, 2007–18

(in percent of GDP, unless otherwise indicated)

	2007	2008	Actual			Projections							Debt-stabilizing non-interest current account 6/ -3.8
			2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Baseline: External debt	71.5	71.0	84.2	81.9	77.3	71.5	67.4	63.3	60.3	57.5	54.8	51.9	
Change in external debt	11.6	-0.5	13.2	-2.2	-4.6	-5.8	-4.1	-4.1	-3.0	-2.7	-2.8	-2.9	
Identified external debt-creating flows (4+8+9)	4.0	3.4	13.3	-2.7	-7.2	-3.0	-2.4	-2.2	-1.8	-1.7	-1.9	-1.9	
Current account deficit, excluding interest payments	12.0	9.6	-6.7	-2.8	1.0	-0.9	-0.2	0.4	0.9	0.9	0.7	0.5	
Deficit in balance of goods and services	13.3	11.7	1.7	1.9	2.6	-0.4	0.1	0.2	0.5	0.4	0.1	-0.2	
Exports	53.7	59.6	54.1	67.9	77.5	82.7	78.2	76.9	75.9	75.3	74.8	74.5	
Imports	67.0	71.3	55.8	69.8	80.2	82.4	78.3	77.1	76.4	75.7	74.9	74.2	
Net non-debt creating capital inflows (negative)	-0.7	-1.4	1.7	0.3	-2.4	-1.2	-1.7	-1.8	-2.0	-1.8	-1.8	-1.8	
Automatic debt dynamics 1/	-7.3	-4.8	18.3	-0.2	-5.8	-0.8	-0.5	-0.7	-0.7	-0.8	-0.7	-0.6	
Contribution from nominal interest rate	2.4	3.3	2.9	2.7	2.7	1.8	1.5	1.4	1.4	1.3	1.3	1.3	
Contribution from real GDP growth	-4.9	-1.8	12.8	-1.2	-4.3	-2.6	-2.1	-2.1	-2.1	-2.1	-2.1	-1.9	
Contribution from price and exchange rate changes 2/	-4.7	-6.3	2.5	-1.7	-4.2	...	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	7.5	-4.0	-0.1	0.4	2.5	-2.8	-1.7	-2.0	-1.2	-1.0	-0.9	-1.0	
External debt-to-exports ratio (in percent)	133.1	119.1	155.6	120.7	99.7	86.4	86.2	82.3	79.4	76.5	73.2	69.7	
Gross external financing need (in billions of Euro) 4/ in percent of GDP	15.0 52.1	16.1 49.8	9.9 37.2	10.8 39.1	11.0 35.7	11.1 33.9	9.8 28.4	8.9 24.0	9.3 23.7	9.2 21.8	8.6 19.1	8.6 18.0	
Scenario with key variables at their historical averages 5/						71.5	71.0	70.5	70.5	70.5	70.5	70.4	-4.9
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	9.8	2.9	-14.8	1.5	5.9	3.6	3.0	3.3	3.5	3.7	3.8	3.8	
GDP deflator in Euro (change in percent)	8.6	9.6	-3.4	2.0	5.4	2.7	2.5	3.3	2.9	2.8	2.8	2.8	
Nominal external interest rate (in percent)	4.8	5.2	3.4	3.4	3.7	2.5	2.3	2.1	2.3	2.4	2.5	2.6	
Growth of exports (Euro terms, in percent)	9.2	25.1	-25.3	29.9	27.5	13.6	-0.2	4.8	5.2	5.7	6.2	6.2	
Growth of imports (Euro terms, in percent)	15.9	20.0	-35.6	29.5	28.2	9.3	0.4	5.1	5.6	5.6	5.7	5.7	
Current account balance, excluding interest payments	-12.0	-9.6	6.7	2.8	-1.0	0.9	0.2	-0.4	-0.9	-0.9	-0.7	-0.5	
Net non-debt creating capital inflows	0.7	1.4	-1.7	-0.3	2.4	1.2	1.7	1.8	2.0	1.8	1.8	1.8	

1/ Derived as $[r - g - \rho(1+g) + \epsilon\alpha(1+r)] / (1+g+\rho+g)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

ϵ = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \epsilon\alpha(1+r)] / (1+g+\rho+g)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\epsilon > 0$) and rising inflation (based on GDP deflator).

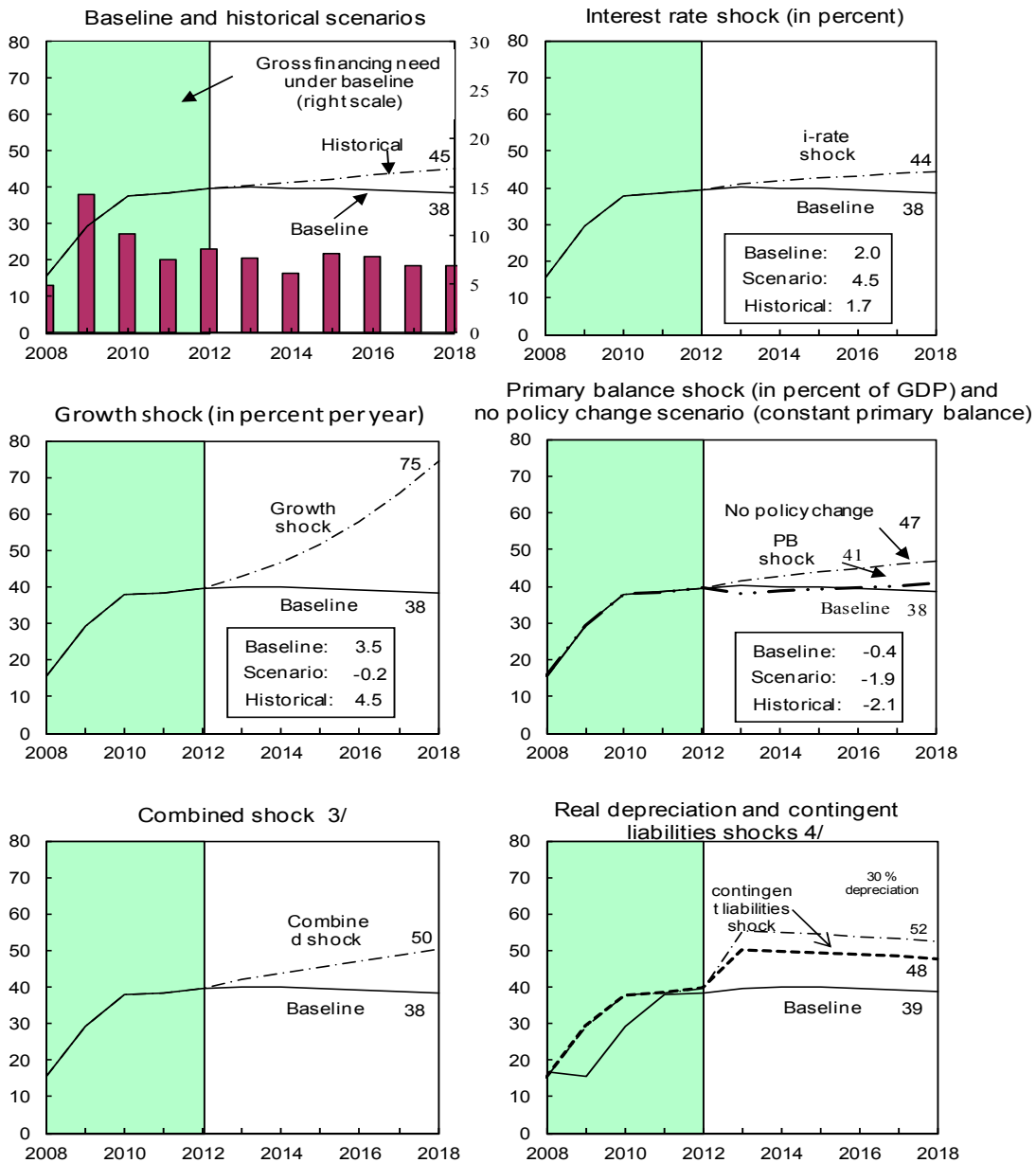
3/ For projection, line includes the impact of price and exchange rate changes.

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.

Figure 2A. Lithuania: Public Debt Sustainability: Bound Tests 1/ 2/ 5/
(Public 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 primary balance.
 4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
 5/ The charts are based on ESA data for general government.

Table 2A: Lithuania: Public Sector Debt Sustainability Framework, 2007–18

(in percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing primary balance 9/
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Baseline: Public sector debt 1/ o/w foreign-currency denominated	16.8	15.5	29.3	37.9	38.5	39.6	40.0	39.8	39.7	39.3	38.9	38.4	-0.5
Change in public sector debt	-1.1	-1.3	13.8	8.6	0.6	1.1	0.5	-0.2	-0.2	-0.3	-0.4	-0.5	
Identified debt-creating flows (4+7+12)	-3.4	1.8	11.5	9.0	0.1	0.6	0.5	-0.2	-0.2	-0.3	-0.4	-0.5	
Primary deficit	0.3	2.6	8.2	5.4	3.6	1.1	0.8	0.5	0.5	0.3	0.2	0.0	
Revenue and grants	33.6	33.9	34.3	33.6	31.9	32.9	32.6	32.6	32.1	31.5	31.3	31.1	
Primary (noninterest) expenditure	33.9	36.6	42.4	39.0	35.5	34.0	33.4	33.0	32.6	31.8	31.5	31.1	
Automatic debt dynamics 2/	-3.5	-0.7	4.0	3.6	-3.5	-0.4	-0.3	-0.7	-0.7	-0.7	-0.6	-0.5	
Contribution from interest rate/growth differential 3/	-2.2	-1.2	4.6	0.8	-2.0	-0.4	-0.3	-0.7	-0.7	-0.7	-0.6	-0.5	
Of which contribution from real interest rate	-0.7	-0.8	1.8	1.2	0.0	0.9	0.8	0.5	0.6	0.7	0.8	0.8	
Of which contribution from real GDP growth	-1.5	-0.4	2.8	-0.4	-2.0	-1.3	-1.1	-1.2	-1.3	-1.4	-1.4	-1.4	
Contribution from exchange rate depreciation 4/	-1.3	0.5	-0.6	2.8	-1.5	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.2	-0.1	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.2	-0.1	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.3	-3.1	2.3	-0.4	0.5	0.4	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	50.0	45.7	85.5	112.9	120.8	120.3	122.9	122.4	123.5	125.0	124.6	123.3	
Gross financing need 6/ in billions of U.S. dollars	2.8	5.0	14.3	10.2	7.6	8.6	7.8	6.2	8.2	7.8	7.0	6.9	
	1.1	2.4	5.3	3.7	3.2	3.6	3.6	3.0	4.2	4.3	4.1	4.3	
Scenario with key variables at their historical averages 7/						39.6	40.6	41.5	42.5	43.4	44.3	45.1	-1.2
Scenario with no policy change (constant primary balance) in 2012-2017						39.6	38.1	38.6	39.1	39.7	40.1	40.7	-0.6
Key Macroeconomic and Fiscal Assumptions Underlying Baseline													
Real GDP growth (in percent)	9.8	2.9	-14.8	1.5	5.9	3.6	3.0	3.3	3.5	3.7	3.8	3.8	
Average nominal interest rate on public debt (in percent) 8/	4.6	4.5	6.7	6.4	5.7	5.2	4.7	4.9	4.7	4.8	5.1	5.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.0	-5.0	10.1	4.4	0.3	2.5	2.2	1.6	1.7	2.0	2.2	2.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	11.6	-3.8	3.6	-9.5	4.9	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.6	9.6	-3.4	2.0	5.4	2.7	2.5	3.3	2.9	2.8	2.8	2.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	14.0	10.9	-1.1	-6.7	-3.8	-0.7	1.1	2.2	2.3	1.1	2.7	2.6	
Primary deficit	0.3	2.6	8.2	5.4	3.6	1.1	0.8	0.5	0.5	0.3	0.2	0.0	

1/ The coverage of public sector is general government, and gross debt is used. Data in the table are based on ESA data for general government.

2/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix: The Rise and Fall of Snoras Bank¹

1. Snoras was an important domestic player in the Lithuanian banking sector. In a market dominated by foreign-owned banks, Snoras was the largest domestic bank, with majority stakes taken by the bank's two principal owners (68 and 25 percent of the bank's ownership). Snoras used its unique network of over 230 kiosk-style mini-banks to expand into areas not serviced by foreign-owned banks and attract a wide depositor base. As such, the bank grew from a small regional bank in the early 1990s to the 3rd largest bank by depositors and 5th largest by assets as of September 2011 (assets amounted to 7¾ percent of GDP and 9¾ percent of system-wide assets). The bank was a leading market player in retail lending and credit card issuance, with more than 1,000 employees. Among its subsidiaries were the Lithuanian Finasta bank and the Latvian Krajbanka.

Snoras Bank Balance Sheet
(Millions of Litas)

	Total Assets				Total Liabilities		
	end-2009	end-2010	end-Sept 2011		end-2009	end-2010	end-Sept 2011
Loans	3,270	4,220	3,567	Deposits	4,994	6,347	6,055
To government or related 1/	..	..	156	Of government or related 1/	..	..	429
To private legal entities	..	..	2,391	Of private legal entities	..	..	1,480
To individuals	..	..	701	Of individuals	..	..	4,035
Cash and cash equivalents	1,357	1,400	..	Equity	505	597	..
Financial assets 2/	871	1,298	..	Due to credit institutions	179	366	..
Other				Other			
Total	6,343	7,656	8,141	Total	6,343	7,656	8,141
Memorandum Item							
Loan-to-Deposit ratio (pct.)	65.5	66.5	58.9				

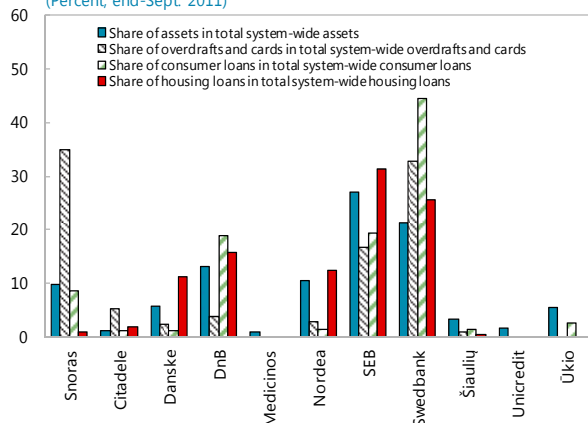
1/ Includes deposits from state-owned entities and municipalities.

2/ At fair value through profit and loss.

Source: Audited Financial Statements (end-2009/2010 data) and Lithuanian Banking Association (end-September 2011 data).

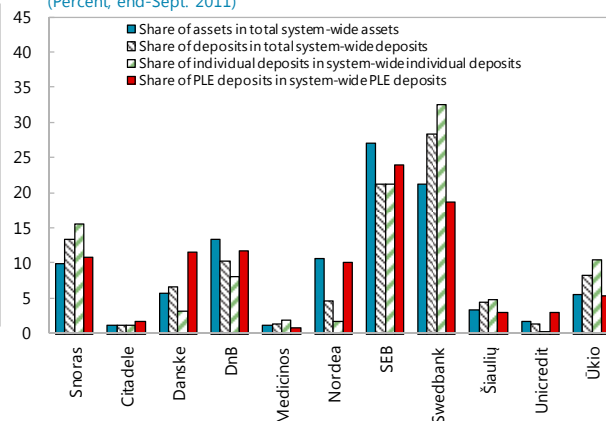
¹ Prepared by Greetje Everaert.

Figure 1. Loans to Individuals by Type and Bank
(Percent, end-Sept. 2011)



Source: Banking Association of Lithuania.

Figure 2. Deposits by Type and Bank
(Percent, end-Sept. 2011)



Source: Banking Association of Lithuania.

2. While an investigation is ongoing, preliminary findings are that misuse and misappropriation of assets caused the bank’s insolvency. Suspicions of fraud and money laundering came to light as the Bank of Lithuania (BoL) sought to verify the value of some financial assets that Snoras reportedly held abroad, but which appeared to be missing. While investigations are ongoing, some preliminary findings are that (i) various assets recorded in Snoras’ balance sheet had been transferred out of Snoras ownership; (ii) Snoras’ assets had been provided to other banks as collateral for loans to companies allegedly related to key individuals related to Snoras (this collateral was called upon at the time Snoras entered bankruptcy, causing significant loss); and (iii) certain assets had been purchased at above market value from companies allegedly related to key individuals related to Snoras, thereby overstating the value on Snoras’ balance sheet. As a result of this, the bankruptcy administrator’s adjustments as of December 7, 2011 to account for fair value of assets brought the bank’s equity down from LTL 804 million pre-bankruptcy to LTL -3,303 million—a loss of about €1.2 billion—implying that the bank was insolvent.

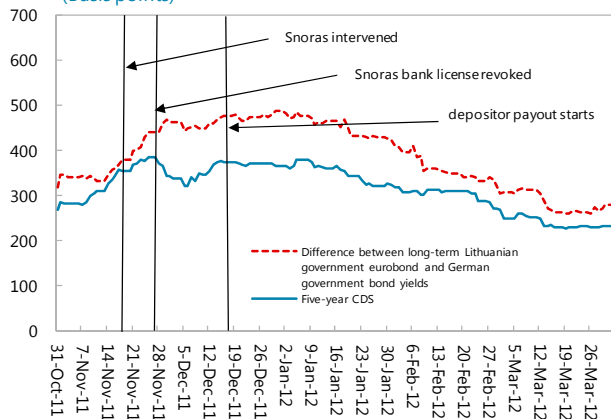
3. The authorities intervened the bank on November 16, 2011. While the authorities had been taking several steps to address their concerns around Snoras bank since early 2011—these included, among others, imposing a time limit for increasing capital—intervention was accelerated by press leaks on November 15, 2011 about problems in domestic banks. The authorities intervened the next day, imposed a moratorium, and appointed a temporary administrator. Depositor accounts were frozen for about one week, but small withdrawals were allowed after that. The authorities considered several restructuring options, and even passed additional legislation in December 2011 to allow for a good bank-bad bank approach. However, in the light of the criminal allegations facing the bank, and the authorities’ assessment that a merger or P&A would unlikely be successful,

especially not under the given time constraint, the authorities chose liquidation, and on November 24, Snoras’ banking license was revoked. This triggered the activation of the deposit insurance, and depositors were paid out up to the guaranteed LTL 345,280 (€100,000) from December 14 onward for a total of LTL 4 billion (€1.2 billion or 4 percent of GDP). The government financed this by tapping into the reserves of the Deposit and Investment Insurance (DII) which amounted to LTL 1.7 billion, and by using cash reserves supposed to pre-finance an early 2012 government bond redemption, which were on-lent to the DII for a total of LTL 3.1 billion. The loan of the government to the DII is for 6 years at zero interest. After a lengthy juridical process, the final decision on bankruptcy was made by the creditor committee on July 19 and approved by court on August 22. A detailed overview of the events is elaborated in the timeline below.

4. The banking system showed marked resilience immediately following the intervention.

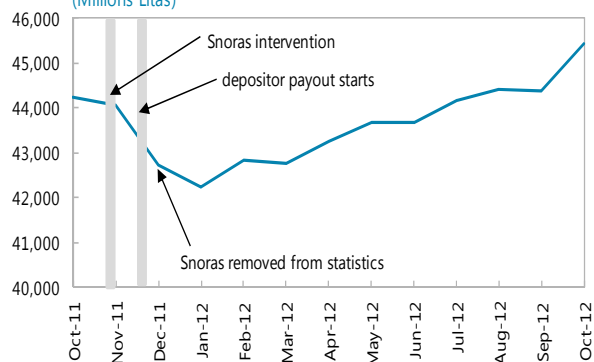
While there were some initial depositor withdrawals, mostly but not exclusively in domestic banks, banking system confidence was generally maintained. As soon as Snoras’ depositors were paid out (about 77 percent of deposits were transferred to the accounts in banks and only 23 percent of them were paid in cash, reflecting continued trust in the banking system), foreign-owned banks absorbed the majority of this liquidity, while domestic banks also gradually restored deposits to pre-Snoras intervention levels. CDS and government bond spreads rose only moderately and soon returned to pre-intervention levels. From mid-December onward, the BoL temporarily engaged in open market operations of Lithuania to tackle temporary liquidity imbalances across the banking system. These operations consisted of liquidity-absorbing term deposit auctions, liquidity-providing repo auctions and auctions for outright purchases of eligible securities. The size of these interventions was small and any liquidity provision was well within the precautionary buffer that the BoL has for liquidity provision under the currency board arrangement. These temporary operations ended by mid-April 2012.

Figure 3. Market Indicators
(Basis points)



Sources: Bloomberg; and Bank of Lithuania calculations.

Figure 4. Resident deposits of Other MFIs
(Millions Lit)



Source: Central Bank of Lithuania.

5. The intervention impacted the financial landscape, but had also other repercussions.

With Snoras gone, the banking system became 90 percent foreign-owned, with no single domestic player accountable for more than 5 percent of system deposits. With the removal of Snoras' banking license in November 2011, the monetary accounts do not take into account any Snoras assets or liabilities from December 2011 onward. In terms of fiscal accounts, the intervention is expected to be treated as a below the line operation whereby the government's increase in liabilities to facilitate the depositor payout is matched by an increase in assets, consisting of the loan to the DII. The repayment of this loan is expected through the DII's claims on Snoras bank.

6. Asset recovery may fall slightly short of compensating priority claims, including the depositor insurance. Recovery prospects are uncertain at this stage, being largely dependent on default levels on the loan book, the cost of realization of the loan book, the outcome of the asset sale process and of financial assets under investigation for misappropriation, and the costs of the bankruptcy process itself. However, based on preliminary data, the value of total assets just about covers the claim of the depositor insurance, i.e. before the costs of the bankruptcy process are taken into account.

Snoras. Recovery Prospects	
(Millions of Litas)	
Total assets 1/	3,913.3
Value of claims approved by court on March 22, 2012 (in order of priority):	
employment related claims (1)	9.2
state through the depositor insurance (2)	3,798.7
other state (3) 2/	11.1
general unsecured creditors (4)	2,363.3
shareholders (5)	0.9
Total assets net off priority claims ((1)+(2))	105.5

Source: Report of the bankruptcy administrator June 8, 2012.

1/ Valuation as of December 7, 2011 by bankruptcy administrator.

2/ Taxes, social security payments, state guaranteed loans.

Timeline

- Summer 2011: Value of some financial assets held abroad found to be missing.
- July 19, 2011: Snoras shareholders asked to deposit allegedly missing assets under the Lithuanian Depository of Securities by September 15.
- September 15, 2011: Only a fraction of financial assets deposited. These are subsequently withdrawn.
- November 8, 2011: Government issues a €750 million bond issue.
- November 15, 2011: Lithuanian press reports on concerns about domestic banks.
- November 16, 2011: BoL Board of the Bank of Lithuania decides to impose a moratorium, and appoint a temporary administrator.
- November 21, 2011: Latvian regulators intervene Krajbanka.
- November 24, 2011: BoL withdraws Snoras' banking license and issues an application to the court for the bankruptcy of Snoras. This is the insured event for depositors and forces the government to reimburse deposits up to €100,000 or LTL 345,280 within 20 working days from the day of an insured event.
- Late November/
Early December, 2011: Government provides a loan to DII for 6 years at zero interest.
- December 7, 2011: Vilnius court rules to initiate bankruptcy proceedings against Snoras. Neil Cooper is put in place as bankruptcy administrator.
- December 13, 2011: First deposit insurance payments made by depositor insurance. SEB bank handles the depositor payout, and starts making payments from December 14, 2011 onward.
- December 20, 2011: Court ruling to initiate bankruptcy proceedings comes into effect. Creditors have a one-month term for filing financial claims.
- January 20, 2012: Period for filing financial claims extended to February 10, 2012.
- March 14, 2012: Financial claims are reviewed and processed and submitted to the court.
- March 22, 2012: Court decides on number and value of claims for an amount of LTL 6.5 billion, of which 4.053 billion on behalf of the deposit and investment insurance (DII). Some claim disputes and appeals follow.
- April 3, 2012: Appeal lodged against claim by the DII.
- April 27, 2012: Initial judgment on appeal against deposit insurance claim.
- May 18, 2012: Claim against principal shareholders brought in the English high court. A world wide freezing order sought and granted against the principal shareholder (up to €492 million).

Timeline (Concluded)

- June 12, 2012: First creditor's meeting takes place and appoints the creditors' committee, consisting of a total of 9 people, of which representing the DII (4), Sodra (1), the former Snoras' employees (1), and corporate or individual creditors (3).
- July 13, 2012: Bankruptcy recognized in Switzerland. This is an important step for the recovery of assets, including the CHF 2.8 million of financial assets held in Snoras correspondent accounts at Swiss banks.
- July 19, 2012: Creditors committee decides to liquidate the bank.
- August 6, 2012: Bankruptcy administrator asks the court to declare Snoras bankrupt.
- August 22, 2012: Court declares Snoras bankrupt.



REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 7, 2013

Prepared By

European Department

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FUND RELATIONS

(As of January 31, 2013)

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				
	2012	2013	2014	2015	2016
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 November 16, 2011. The Executive Board assessment is available at <http://www.imf.org/external/np/sec/pn/2011/pn11141.htm> and the staff report and other mission documents at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=25365.0>

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):**LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1999–2011**

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

Resident Representative: Mark Allen (stationed in Warsaw, Poland).

Anti-Money Laundering and Combating Financing of Terrorism: Lithuania's compliance with the international AML/CFT standard, the Financial Action Task Force's (FATF) 40+9 Recommendations, was assessed by MONEYVAL, the FATF-style regional body of which it is a member, in January 2006. The assessment report indicated several deficiencies and the authorities have taken steps to address them. A new assessment by MONEYVAL is expected to be published in early 2013.

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.

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 are 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 February 26, 2013

	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	February 25, 2013	February 25, 2013	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	January 2013	February 7, 2013	M	M	M		
Reserve/Base Money	January 2013	February 14, 2013	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	January 2013	February 14, 2013	M	M	M		
Central Bank Balance Sheet	January 2013	February 14, 2013	M	M	M		
Consolidated Balance Sheet of the Banking System	December 2012	January 29, 2013	M	M	M		
Interest Rates ²	January 2013	February 25, 2013	M	M	M		
Consumer Price Index	January 2013	February 18, 2013	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Q3/2012	December 27, 2012	Q	Q	Q	LO, LO, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	December 2012	January 28, 2013	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	December 2012	January 28, 2013	M	M	M		
External Current Account Balance	Q3/2013	December 27, 2012	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	December 2012	February 12, 2013	M	M	M		
GDP/GNP	Q3/2012	November 29, 2012	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q3/2012	December 20, 2012	Q	Q	Q		
International Investment Position ⁶	Q3/2012	December 20, 2012	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

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 13/34
FOR IMMEDIATE RELEASE
March 28, 2013

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

IMF Executive Board Concludes 2013 Article IV Consultation with Republic of Lithuania

On March 22, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lithuania.¹

Background

Since the 2008-09 crisis, significant progress has been made in reducing macroeconomic imbalances, and the economic recovery is well underway. Growth registered 3½ percent in 2012, supported by strong exports and a bumper harvest. Private consumption was also robust, reflecting rising consumer confidence and improving labor market conditions. Unemployment fell to 13.2 percent and has been on a declining trend for both youth and the long-term unemployed. Inflation slowed to 3.2 percent in 2012 as the effects of rising global commodity prices moderated. Core inflation, meanwhile, remained fairly subdued at 2 percent. Strong export growth and an improvement in the terms of trade helped reduce the current account deficit to 0.9 percent of GDP in 2012.

The fiscal deficit narrowed from 9½ percent of GDP in 2009 to 5½ percent of GDP in 2011, and to an estimated 3 percent of GDP in 2012. The government successfully raised about €1¼ billion in international markets in 2012 and redeemed €1 billion maturing in early March.

The largely foreign-owned banking system, overall, remained well capitalized, liquid, and profitable. Credit growth remains weak and nonperforming loans, while declining, are still high. Along with falling interest rate margins, this led to a decline in bank profitability.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Four credit institutions were intervened since the last Article IV consultation—two domestically-owned banks and two credit unions—due to insolvency. This has removed an important threat to financial stability and strengthened the overall soundness of the financial system, while accesses to guaranteed deposits and financial stability have been maintained.

The government has announced its intention to seek euro adoption in 2015.

Executive Board Assessment

Executive Directors welcomed the ongoing recovery and the impressive macroeconomic rebalancing since the 2008–09 crisis. The reduction in the fiscal and current account deficits has significantly reduced vulnerabilities, and competitiveness gains have laid the foundation for an export-led recovery. Directors agreed that investment and continued structural reforms will be critical to sustain competitiveness gains, reduce unemployment, and support growth in the medium term.

Directors commended the strong fiscal adjustment undertaken to date. They noted that the 2013 budget balances the need to support the recovery with further consolidation. Looking ahead, Directors agreed that further reductions in the structural fiscal deficit will be needed to rebuild buffers. They encouraged the authorities to shift the composition of fiscal adjustment to the revenue side, and stressed the importance of high quality measures to ensure sustainability while reducing income inequality. They saw merit in expanding wealth and property taxes and broadening the tax base, noting that improvements in tax administration should accompany any new revenue measures. Directors also called for strengthening the fiscal framework and further reform of the pension system.

Directors commended the authorities for the intervention in four insolvent credit institutions which has strengthened the overall soundness of the financial system. They underscored the importance of continuing enhanced supervision, including stepped-up on-site inspections, strict stress testing, and close monitoring of banks' loan loss provisions. Directors agreed that the financial sector has an essential role to play in supporting growth and investment, and emphasized that credit should not be unduly constrained going forward. To foster sound credit growth, they supported a review of obstacles to timely resolution of nonperforming loans and welcomed steps to improve the insolvency framework.

Directors stressed that maintaining competitiveness, addressing labor market inefficiencies, and enhancing the business and investment environment will be key to sustain growth and reduce unemployment over the medium term. They underscored that future wage growth should not outpace productivity growth. They encouraged the authorities to support job creation through training, active labor market policies, and addressing any disincentives to work in the benefits system. Efforts are also needed to reduce administrative burdens and improve energy

efficiency. Directors welcomed the authorities' goal of joining the euro area in 2015 from a strong and sustainable base.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2013 Article IV Consultation with Lithuania is also available

Republic of Lithuania: Selected Economic Indicators

	2009	2010	2011	2012 Est.	2013 Proj.
Real Economy					
Real GDP growth	-14.8	1.5	5.9	3.6	3.0
CPI, period average (annual percentage change)	4.2	1.2	4.1	3.2	2.1
CPI inflation, end of period	1.2	3.6	3.5	2.9	2.7
Unemployment rate (year average, in percent of labor force)	13.7	17.8	15.2	13.2	12.0
Public Finance					
	(In percent of GDP)				
General government balance	-9.4	-7.2	-5.5	-3.0	-2.6
General government gross debt	29.3	37.9	38.5	39.6	40.0
Foreign currency-denominated public debt	27.0	34.1	33.1	33.3	32.8
Balance of Payments					
	(In percent of GDP, unless otherwise specified)				
Current account balance	3.7	0.1	-3.7	-0.9	-1.3
Gross official reserves (in billions of euros)	4.6	5.0	6.4	6.5	6.7
Exchange Rates					
	(Litai per U.S. dollar, unless otherwise specified)				
Exchange rate (end of period)	2.37	2.61	2.62	2.62	...
Exchange rate (period average)	2.48	2.60	2.48	2.68	...
Real effective exchange rate (2005=100, increase=appreciation)	118.4	113.2	114.8	113.1	...
Money and Credit					
	(Year-on-year percent change)				
Reserve money	-17.2	19.4	37.5	-6.4	5.5
Broad money	0.3	8.9	4.9	7.2	8.8
Private sector credit	-6.9	-7.6	-5.7	0.3	3.4

Sources: Lithuanian authorities; and IMF staff estimates.

**Statement by Mr. Audun Groenn, Executive Director on Republic of Lithuania
and Ms. Ramune Arust, Advisor to Executive Director**

My Lithuanian authorities thank staff for the frank and constructive discussions as well as valuable policy advice. The authorities broadly agree with staff's findings and analysis in the report and thoroughly consider the recommendations.

The GDP growth remains strong

Lithuania's economy has, after the vibrant recovery in 2011, returned to a more sustainable growth path. Nevertheless, the real GDP growth rate at 3.6 percent in 2012 remained the second highest in the EU. The solid economic growth has been led by the export sector supported by improving competitiveness and adjusting unit labour costs. Lithuania's relative advantage is its diversified export base. Two thirds of Lithuanian exports go to the EU partners, mostly more robust economies, such as Germany, Poland, the Netherlands, and the Baltic peers; about one third of trade is with the CIS countries.

The contribution of investment to economic growth was moderate in 2012, but it is expected to strengthen with increasing manufacturing capacity utilization and stabilising expectations. The industry survey shows that the industrial companies now use a historically large share – about three quarters – of their production capacity and some businesses are starting to face shortage of inventories. However, the non-financial corporate sector still remains cautious about making new investments and follows news regarding global financial uncertainties.

The growth in 2013 is expected to slow down, but will remain among the strongest in the EU. In line with IMF and other international financial institutions, the Ministry of Finance (MoF) and the Bank of Lithuania (BoL) projects that the real GDP growth will be at about 3 percent in 2013. The deteriorating export growth prospects are behind the expected deceleration of economic growth.

Inflation is slowing down

The average annual inflation rate declined from 4.1 percent in 2011 to 3.2 percent in 2012. The decrease in inflation was driven by external factors, foremost by slower growth of food and fuel prices in international markets. The prices of industrial goods and market services, which mostly depend on domestic factors, slightly increased but had an insignificant influence on inflation. For 2013, the forecast is for headline inflation to decline to 2.4 percent, though subject to developments in global commodity prices.

The Government expects that the minimum wage increase will have a minimal effect on inflation and competitiveness due to a substantial increase in productivity over the past years. The decision to raise the minimum wage was made only after extensive consultations with employers, who did not see major difficulties for the increase. Only

SMEs were more concerned, therefore, the Government has foreseen support measures for SMEs at the initial stage.

External sector balances improved

Lithuania's export development has positively affected the current account balance. As export growth outpaced import growth, the trade balance has become positive in 2012. Only larger reinvested earnings of the foreign capital enterprises led to an income account and subsequently to a current account deficit.

Gross foreign reserves increased by 1.4 percent in 2012 and accumulated by more than 40 percent since the 2008 crisis. Foreign reserves (in absolute terms) are currently at their highest historical level. In 2012, the reserve coverage in percent of short-term debt increased by 9 percentage points, surpassing 60 percent.

The unemployment and business environment has been improving

Strong growth in the domestic economy in the past two years led to an improvement of the labor market. In 2012, the unemployment rate stood at 13.2 percent or 2.1 percentage points lower than a year earlier. Employment has been growing mainly due to a rise in the number of employed persons in the private and, in particular, the tradable sector. Public sector employment remains almost unchanged. Long-term unemployment has been decreasing for more than a year, however, about half of the unemployed are long-term and this ratio has not changed since the end of 2010.

The reduction in unemployment, with a particular focus on youth unemployment, remains the Government's top priority. For this reason, the Government has started a revival of the housing renovation program. The expected benefits of the housing renovation program are not only a reduction of imported energy consumption, but also creation of jobs and at the same time stimulation of the construction sector, which suffered the most during the crisis. The longer-term measures aimed at reducing unemployment and youth unemployment, in particular, focus on improving the balance between the specialist supply and labor market demands, increasing vocational training, providing support for self-employed and start-ups, as well as increasing flexibility in labor regulation.

In addition, the Government is revising the rules for registering business and territorial planning, as well as insolvency procedures to improve the business environment. The initiated energy sector reforms also play an important role here. Therefore, it is expected that these measures, alongside with continuing economic growth, will gradually improve the situation in the labor market.

Responsible fiscal policies are oriented towards growth

During the last three years Lithuania has undertaken substantial fiscal consolidation measures, bringing the general government deficit from 9.4 percent of GDP in 2009 to the expected 3 percent of GDP in 2012. The 2013 budget aims to reduce the deficit to

2.5 percent. Fiscal consolidation was focused on the expenditure side, including sizable cuts in wages. These measures were necessary to restore market confidence, regain competitiveness, and to put the public finances on the sustainable path.

The Government remains committed to strictly adhering to the Law on fiscal discipline adopted in 2007 and observing medium-term fiscal targets as set in the 2012 Convergence Program. However, the Government's key priorities now are to encourage economic growth, reduce unemployment and to put the economy on a strong and sustainable growth path. To achieve these goals, the Government intends to pursue active investment policies. For this reason, in addition to improving the business environment, the Government intends to intensify the use of available EU funding and financing provided by the international financial institutions as well as to devote more budget funds for investments.

The Government agrees that further fiscal consolidation should shift from the expenditure to the revenue side. In this regard, the authorities are determined to improve the tax administration and compliance measures as well as to revise the tax system. A working group for this purpose has been established with the task to prepare recommendations on the tax system reform by June of this year. The Fund's suggestions will be considered.

The resilience of the financial sector has been tested and strengthened

The resilience of the banking system continued to improve. The NPLs have been decreasing and the quality of the loan portfolio has improved. The capital adequacy and liquidity ratios have strengthened and are above the Basel III requirements. The loan-to-deposit ratio is gradually approaching 100 percent due to a considerably faster growth in deposits, compared to a subdued rebound of the loan portfolio. Low interest rates and an improving financial position of the private sector are expected to strengthen credit demand. The recent bank lending survey shows that the demand for credit is expected to increase and banks do not plan on tightening their lending conditions.

The depositors' confidence was maintained during the authorities' interventions in two smaller size banks. The interventions addressed the residual risks, strengthened the financial sector going forwards, and testified to the authorities' supervisory vigilance. The effects on confidence indicators were only very limited. The interbank rates continued to decrease and the CDS rates stand at the pre-crisis levels. There was no impact on the real economy. SNORAS bank was announced insolvent and liquidated, whereas the healthy share of UKIO bank assets with matching liabilities was transferred to another bank operating in Lithuania.

During the last three years, the authorities have carried a complete overhaul of the institutional set-up for micro- and macro- prudential supervision. Both tasks are planned to be assigned to the BoL. Microprudential supervision of banking, insurance and financial markets have already been consolidated and enhanced by customers' rights protection. To strengthen the macroprudential supervision, a new Financial Stability Department, with more analytical capacities, has been established at the central bank and

has been in operation since May 2012. To entitle legal powers to the BoL for macroprudential supervision, an amendment to the Law of the BoL is foreseen for 2013. With that, the reforms to the micro- and macro- prudential institutional set-up will be fully completed.

The authorities continue to enhance micro- and macroprudential policies in order to strengthen financial stability. At the end of 2011, the BoL adopted the Responsible Lending regulations and defined the mandatory limit on loan-to-value and debt-to-income ratios. Currently, a number of measures, such as requirements for the qualification of the heads of credit unions, limitations on maximum loan per borrower, tightening the liquidity and the capital adequacy ratios, were introduced to strengthen the credit union sector.

Preparations for euro adoption are ongoing

The authorities remain committed to introduce the euro from a strong and sustainable base after the convergence criteria are fulfilled. The newly elected Government has reconfirmed the euro introduction target and re-launched the necessary preparatory work.