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Republic of Lithuania: Staff Report for the 2009 Article IV Consultation

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on June 23, 2009 with the officials of the Republic of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 23, 2009. 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.

- A staff statement

- A Public Information Notice (PIN).

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REPUBLIC OF LITHUANIA

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with
The Republic of Lithuania

Approved by Anne-Marie Gulde and Tessa van der Willigen

July 23, 2009

Discussions: Vilnius, June 11–23, 2009. The mission (C. Purfield (Head), J. Vacher, J. Miniane, A. Kangur (all EUR), E. Cerutti (SPR), L. Cortavarria-Checkley, D. Parker (MCM), and N. Budina (FAD)) met Prime Minister Kubilius; Finance Minister Šemeta; Bank of Lithuania Governor Šarkinas; Minister of Economy Kreivys; other high level officials, parliamentarians, and representatives of the private sector. Mr. Abazorius (OED) also joined the discussions. The mission concluded with a press conference.

Previous consultations: The risks associated with large external imbalances and reliance on capital inflows under the Currency Board Arrangement (CBA) were highlighted by earlier Article IV Consultations. The expansionary stance of fiscal policy in 2008 was in contrast to the tightening planned and additional consolidation recommended by Directors to build a fiscal cushion. Now that the hard-landing has materialized, this expansionary stance largely precludes the scope for the counter-cyclical fiscal policy advocated in the previous Consultation. More recent steps to remove VAT exemptions and cut current spending were in line with Fund recommendations. Consistent with the 2008 FSAP Update, the Bank of Lithuania (BOL) updated its lender of last resort procedures and strengthened its contingency planning framework. It also required banks' to retain 2008 profits to bolster capital.

2009 policy advice: The discussions focused on the immediate impact of the global crisis on Lithuania and policies needed to ensure financial, fiscal, and external sustainability, address risks, pave the way for a healthy recovery and secure speedy euro adoption. Staff advocated a sizeable fiscal consolidation to ensure that public debt is sustainable, augmentation of banks' capital buffers to address prospective losses with complementary efforts to enhance crisis prevention and contingency frameworks, and further wage adjustment and structural reforms to support the currency board and raise growth potential.

The authorities' position: Keenly aware of the challenges ahead and adjustment required to support the currency board, the new government in place since late-2008 emphasized its ongoing efforts aimed at a substantial fiscal adjustment—which carries the support of Parliament and social partners at large—a strengthening of the financial system, and an overhaul of business and labor regulations to improve the investment climate, as key elements of its strategy to ensure the euro is adopted from a position of strength.

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I. Staff Appraisal and Executive Summary

1. **The economy grew rapidly over the past decade but the surge in capital inflows post-EU accession generated significant risks that have now materialized**. Between 1998 and 2008, real per capita incomes rose from about 40 percent to two-thirds of the EU average reflecting the rebound from the 1998 crisis and rapidly rising productivity (Figure 1). However, the capital inflows that followed EU accession were mostly channeled to the non-tradable sector, stoking an asset and consumption boom that had its counterpart in growing external indebtedness (Figure 2). Rapid wage growth began to erode competitiveness while loose fiscal policy added to demand pressures (Figure 3).

2. **The Lithuanian economy is now undergoing a painful adjustment.** The reversal in capital flows in the wake of the global financial crisis has triggered a hard landing starting in late 2008. The downturn in domestic activity–by far the most severe since Independence—is also being compounded by the global economic contraction.

3. **The sizable adjustment in policies since the onset of the downturn will have to continue**. The original and May supplementary budgets implemented substantial fiscal adjustment, and timely measures have been taken to stabilize the financial system. However, the fiscal adjustment roughly offsets the impact of past expansionary policies and more is needed to underpin the credibility of the CBA and the strategy of rapid euro adoption going forward. A clearly articulated plan that outlines the multi-year reform strategy will be key to galvanize public support for the still substantial adjustment ahead.

4. **Fiscal consolidation should be guided by the need to:**

- sustainably bring spending to more affordable levels, primarily through savings in social benefits and public sector wage bill which have grown at an unsustainable pace in recent years;

- broaden the tax base, improve compliance, and raise some tax rates, including personal income tax and VAT rates;

- strengthen fiscal institutions including frameworks for monitoring fiscal developments and setting rules to enhance fiscal discipline;

- protect the most vulnerable including through rationalization of generous benefit programs.

5. **Efforts to enhance soundness of the banking system and crisis preparedness must continue including through:**

- Accelerating loan loss provisioning and raising banks' capital, seeking more explicit commitments from parent banks to pledge the necessary liquidity and capital support to their subsidiaries, and increasing surveillance particularly of banks with shorter-term and high cost funding profiles;

- Augmenting contingency planning frameworks through enhanced communication and drill exercises; and

- Expanding the tool kit to deal with potential bank difficulties by allowing alternatives to its full acquisition by the government, such as a bridge bank, to help protect the taxpayer from potential hidden losses or contingencies.

6. The crisis only underscores the imperative for structural reforms to improve longer-term growth prospects where risks to the outlook are on the downside. Private sector wages have shown flexibility but steps to improve the business environment including reducing administrative burdens in business planning, land regulation, and public procurement could help attract FDI.

7. Despite the ongoing adjustment and the fact that the currency board has acted as a useful anchor, there are risks. The CBA places the burden of adjustment squarely on domestic policies. Further substantial fiscal consolidation is needed to secure euro adoption, which may prove challenging. Moreover, the large fiscal contraction could exacerbate the downturn and in turn increase the size of the needed adjustment, all compounded in a context of price deflation and deleveraging of the economy. Adverse shocks could, given the limited excess international reserves, add to risks. Finally, while wages in the private sector are adjusting, production costs will need to come down further for a switch to a more tradeables-based economy to be achieved and to improve growth prospects.

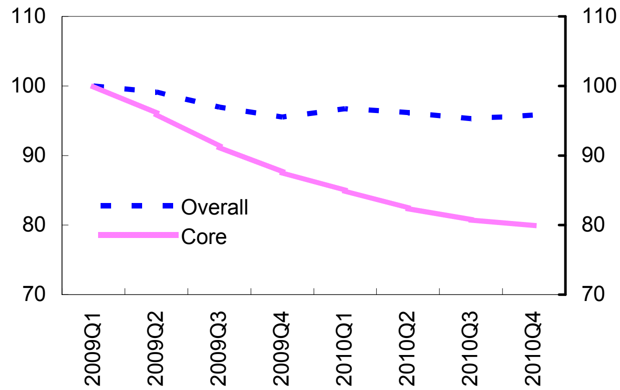
8. The authorities broadly shared staff's diagnosis of the challenges ahead but emphasized the strong adjustment being implemented to safeguard macroeconomic stability. They underscored the importance of maintaining the currency board as the key anchor for external and domestic stability, particularly in the current difficult economic environment, and pointed to the strong adjustment in private and public sectors underway that support it. They see fiscal consolidation as necessary to complement the adjustment in the private sector and underpin the CBA and euro adoption strategy. They stressed the size and quality of fiscal measures already taken in 2009 and emphasized that their medium-term consolidation is to be driven by structural reforms. While acknowledging the usefulness of building preemptive capital buffers in the banking system, they noted the steps already taken to intensify oversight of banks, the relatively high capital adequacy ratio, the sizable role of foreign banks in the system, and the results of recent stress tests as also providing assurances that the deterioration in asset quality over the downturn is manageable. The also pointed to other measures taken to strengthen contingency planning frameworks including the increase in deposit insurance as well as a new law that strengthens the bank resolution framework.

II. Outlook and Key Challenges

9. A long and painful recession is underway (Tables 1–3, Figures 4–6). The reversal in capital inflows has come at the cost of a domestic downturn that ranks amongst the most severe in the region. Quarterly GDP was 12 percent lower in 2009 Q1 than in 2008 Q2 (peak), and although lead indicators show tentative signs of bottoming out they remain very weak. Real GDP is forecast to decline by 16 percent in 2009 and 3¾ percent in 2010 driven by the contraction in domestic demand. Associated with this, unemployment is likely to average 16½ percent in 2010, up from 6 percent in 2008. The end-2009 closure of the Ignalina nuclear power plant contributes to the continued contraction in 2010.[1]

10. In this context, staff expect strong deflation. Core consumer prices—which account for just over half of total CPI—are expected to fall by a cumulative 20 percentage points over 2009–10. This is consistent with ongoing sharp declines in private sector wages—gross earnings in the private sector fell by 8 percent (q/q) non-annualized in the 2009Q1—as well as with past international experience with deep adjustment in flexible economies with pegged exchange rate regimes.[2] Headline CPI is expected to fall by a more modest 5 percentage points over this period, partly on account of food prices moving in line with international trends, but also due to expected increases in energy costs following the decommissioning of Ignalina.

Inflation Forecasts: CPI and Components 1/



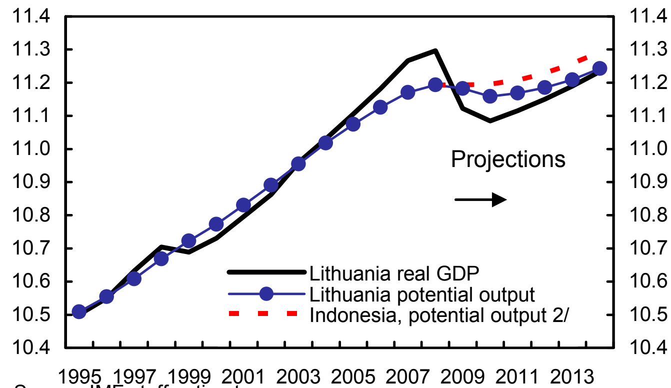
Source: IMF staff estimates.
1/ 2009Q1 = 100

[1] Ignalina's closure is expected to reduce the GDP level by about 0.8 percent, and increase imports by about 0.5–1 percent of GDP.

[2] For instance, between August 1998 and February 2004, the deflation process in Hong Kong saw core prices fall by a cumulative 20 percent. The long period of decline reflected the impact of three "successive" shocks—the Asian crisis, the global IT bust, and SARS—but it also points to the risk that deflation in Lithuania could be longer lasting than expected in the baseline.

11. In the medium term, staff see a slow return to a more sustainable pace of growth. A recovery is expected to take hold in 2011 with growth returning to positive territory, and gradually rising to 4–4½ percent over the medium-term. Driving this recovery is the ongoing adjustment in factor costs, which together with recent and planned structural reforms would help improve competitiveness and allow the economy to become more export-driven. Even then, potential output growth is likely to be significantly lower going forward, reflecting weaker investment (Table 2)—with much of the decline in investment in the baseline reflecting the correction in the inflated construction sector— the destruction of potentially viable firms in the downturn, and the negative impact of Ignalina's closure. As such, potential growth could decline by at least 1½–2 percentage points relative to its peak of 6 percent in 2004–06. All in all, potential output is expected to be around 15 percent lower by 2014 than it would have been absent the crisis, a larger loss in potential than experienced during the Asian crisis, including in Indonesia.

Real and Potential GDP 1/

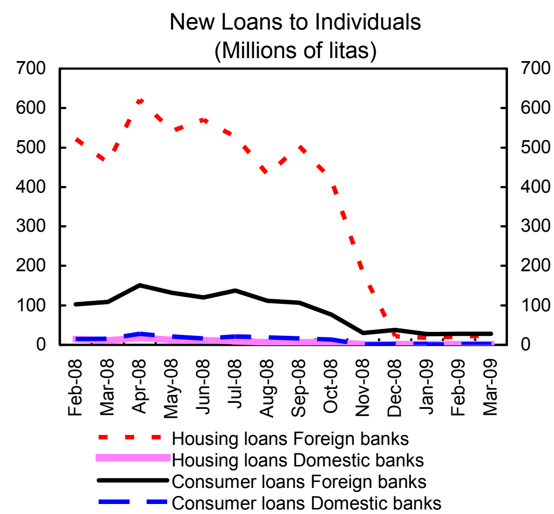


Source: IMF staff estimates.
1/ In log terms. Potential output for Lithuania estimated using a production function approach.
2/ For Indonesia, HP filter estimate of potential for 1997-2003, normalized at Lithuania's 2008 level. Indonesia is chosen as a benchmark as it was the country most severely impacted by the 1997 Asian Crisis.

12. Uncertainty around these medium-term forecasts is unusually large, but risks are on the downside. Forecasting medium-term headline and potential growth in a context of double digit contraction is fraught with difficulties. The outlook could also prove worse than staff's baseline: (i) the global recovery could be delayed, (ii) factor costs still have a ways to adjust to fully regain competitiveness, and (iii) resolving the debt overhang in a deflationary context may take longer than expected, with the banking system impaired by rising non-performing loans (NPLs) acting as a drag on growth. If downside risks to medium-term growth were to materialize, other elements of the baseline such as the fiscal path would naturally be affected.

13. Against the backdrop of a sizeable economic contraction, the current account is expected to be in a temporary surplus (Table 4). The current account is forecast to be in surplus in 2009 (0.6 percent of GDP) as the reduction in imports (about 36 percent) outpaces that of exports (about 26 percent). Over the medium-term, the current account is expected to revert to a deficit as the economy recovers and electricity-related imports to replace Ignalina's output rise. However, the forecast 9 percent improvement in the real effective exchange rate over the projection period, together with the economic recovery in trade partners, contributes to gradually increasing export volumes. Inflows are likely to remain at lower levels than the recent past which would help stabilize external debt after 2011 (Annex 1).

14. However, the economy is left with significant debt and subject to a funding contraction (Box 1). External liabilities are not being fully rolled over. Net private capital outflows are forecast to reach 12 percent of GDP in 2009 reflecting declines in trade credit and rollover rates of 80 percent in banks (85 percent in foreign banks) and 75 percent in the corporate sector.[3] These outflows are partly mitigated by capital inflows to the public sector reflecting the front-loading of EU structural funds, and the increase in EIB and eurobond funding. Capital injections by foreign banks into their subsidiaries is assumed to occur over the remainder of 2009–10 through FDI. All together, net inflows (estimated recapitalization needs net of repayments to parent banks) by foreign banks in 2009–10 are assumed to amount to 1.7 percent of GDP.

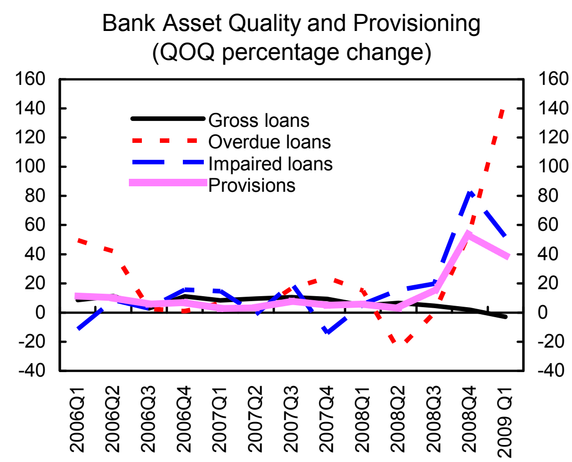


Source: Association of Lithuanian Banks; and IMF staff estimates.

15. The economy is consequently in the midst of a credit contraction reflecting deteriorating asset quality, as well as lower funding and credit demand.

- The depth of the ongoing credit crunch is evidenced by the lack of issuance of new loans. The stock of credit to the private sector has already declined by 3.3 percent in the first five months of 2009.

- The capital adequacy ratio (CAR) of 13.9 percent is above the 8 percent regulatory minimum (Table 5). However, the stock of NPLs nearly doubled between Q4 2008 and Q1 2009 to 8.2 percent, with the overdue but not impaired component increasing at a much faster rate.[4] Loan loss provisioning is not keeping pace, covering only about 20 percent of NPLs, and NPLs net of provisions account for 70 percent of bank equity.



Source: Bank of Lithuania; and IMF staff estimates.

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[3] The stock of funding from parent banks has declined by 6 percent in 2009 H1.

[4] Although real estate prices have fallen by an estimated 20 percent since 2008 (Vilnius), NPLs constitute about 3.2 percent of household mortgages. Corporates loans represent about 70 percent of the total NPL stock.

Capital buffers are likely to thin as the recession proceeds, already evidenced by negative profitability in 2009 Q1.[5]

- Liquidity risk requires close monitoring. In October 2008, a deposit run drained 6½ percent of total deposits. While liquidity has since stabilized, deposits have shifted increasingly into foreign currencies (FX deposits account for about 31 of deposits compared to about 25 percent at end-2008). Funding and access to contingent sources in case of deposit stress remains a challenge. Parent bank funding of subsidiaries has declined, while domestic banks face pressure from the interbank market— where maturities have shortened, funding has decreased, and rates have increased sharply— as well as increased competition for deposits. Moreover, nonresident deposits, which represent a modest 7 percent of deposits of the system have contracted sharply by 41 percent since end 2007 as the economic situation deteriorated in neighboring countries.

16. **The BoL has reacted swiftly to these challenges**. Since October 2008 it reduced reserve requirements from 6 to 4 percent to help ease liquidity pressures, and has implemented 2008 FSAP Update recommendations to improve internal guidelines for lender of last resort operations (LoLR) and collateral valuation procedures, while monitoring daily bank-by-bank deposits and liquidity positions. The deposit insurance limit was raised to €100,000 and bank resolution tools are also being enhanced through the draft Financial Stability Law in Parliament. The new framework provides for government guarantees of interbank lending (Litas 3 billion, 3.4 percent of GDP), and public support for bank recapitalization and asset purchases. The government has also established a financial crisis preparedness committee to enhance coordination and contingency planning.

17. **Government finances are also under considerable strain reflecting the legacy of the sizable structural deficit amassed in the boom (Tables 6–7)**:

- The cyclically adjusted deficit had risen to 6½ percent of GDP by end-2008, a near threefold increase from 2006.[6] This reflected generous wage and social benefit increases, which grew in real terms by nearly 13 and 50 percent, respectively, between 2006–08.

- The headline central government fiscal deficit widened to 4.6 percent of staff's full-year GDP estimate by end-May 2009 as tax revenues contracted by 28 percent (y/y). Indirect taxes have come under particular pressure from cross-border shopping—notably for food products and diesel—as neighboring countries' currencies have depreciated. Budget financing, particularly domestic financing in the t-bill market, has become more short-term

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[5] In 1995, NPLs peaked at 32 percent, albeit in the context of a systemic bank crisis and with different measures of asset quality and growth outlook.

[6] Table 7 presents a range of cyclically-adjusted estimates given the uncertainty surrounding output gap estimates in the current context and the likely structural break in tax compliance in a recession.

and private placements have become more common, with borrowing costs rising to an average 7–9 percent, as sovereign debt ratings, although still investment grade, have been gradually downgraded. The general government debt burden has risen from very low levels to 23 percent of GDP.

18. The authorities have responded proactively to contain the deterioration in the fiscal deficit. The original and May 2009 supplementary budgets implemented a sizeable adjustment of 7.3 percent of GDP. The consolidation being realized is largely expenditure-based—in line with international experience from successful fiscal adjustments (Occasional Paper No. 246) and reflecting the surge in the expenditure-to-GDP ratio in the recent past. Current spending allocations were adjusted downward given the backdrop of deflation, investment was protected by utilizing front-loaded EU funds to replace domestically funded-capital projects that would otherwise been shelved, and wage cuts were targeted at higher-paid civil servants. The adjustment has also permanently raised various tax rates and broadened the VAT base to protect the revenue base. The package also included a temporary and less desirable reduction in transfers to the second pension pillar and the cut in the personal income tax rates added to revenue pressures although it helped garner support for the adjustment. European Investment Bank (EIB) financing and the successful June €500 million eurobond issue helped alleviate immediate fiscal financing needs, lessened reliance on domestic financing sources, and reopened access to international capital markets.[7]

[7] The eurobond was issued at a coupon of 9.375 percent and 5-year maturity.

Fiscal adjustment in Lithuania, 2009

	Yield (LTL, million)	Yield (% of GDP)	Contribution (percent)	Description
Revenue measures	**1417**	**1.6**	**21.7**	
2009 original budget	1291	1.5	19.8	
VAT	649	0.73	9.9	General rate increase from 18 to 19 percent. Lower rates abolished, except for heating, medicine, books and non-periodicals.
Excises	451	0.51	6.9	Increase in excises on fuel, tobacco (up to full compliance with *acquis communautaire)* and a increase in excises on alcohol.
Corporate Income Tax	339	0.38	5.2	Increase in CIT rate from 15 to 20 percent, increased taxation of dividends and agricultural partnerships
Other minor taxes / revenue	72	0.08	1.1	
Personal Income Tax	-221	-0.25	-3.4	Reduction of PIT tax rate from 24 to 15 percent, mortgage interest deductions abolished
May supplementary budget	126	0.14	1.9	
Other minor taxes / revenue	126	0.14	1.9	e.g. increase in special tax for forestry companies, BoL profit transfer
Expenditure measures	**5118**	**5.8**	**78.3**	
2009 original budget	2266	2.5	34.7	
Wage bill	914	1.03	14.0	12 percent reduction of wage bill of civil servants (excluded teachers, police, medical workers)
Current expenditure	881	0.99	13.5	15 percent reduction in current expenditure
Investment	336	0.38	5.1	Abolishment or scaling back of state investment projects (to be replaced by EU funds)
Social benefits	134	0.15	2.1	Lowered social transfers, including school lunch payments
May supplementary budget	2852	3.2	43.6	
Current expenditure	1314	1.48	20.1	e.g. reduction in appropriations, cuts in transport subsidies and municipalities' spending on own functions
Investment	997	1.12	15.3	Reduction of investment financed from the state budget
Social benefits	379	0.43	5.8	Reform of sickness payments to lower state share of payment in first 3 days, and savings on medical services, investment and purchases
Wage bill	162	0.18	2.5	Up to 10 percent cut of wage bill targeted at high paid civil servants (excluded teachers, police, medical workers)
Total deficit adjustment	**6534**	**7.3**	**100**	
Financing measures	**580**	**0.65**	**100**	
Pillar II transfer cuts	480	0.54	82.8	Transfers of pillar II of the pension system cut from 5.5 to 3 (January) to 2 percent (May)
Pension postponement	100	0.11	17.2	Postponement of pension repayments to working pensioners for 1995-2002 (neutral to 2009 deficit in ESA terms).

Source: Ministry of Finance; and IMF staff estimates.

19. **Risks to the outlook going forward are to the downside.** The ongoing contraction and related deflation, risks in the financial system, and public finances could negatively reinforce each other more than envisioned. Global deleveraging could accelerate the decline in parent bank funding and exacerbate the credit crunch. External shocks could also trigger confidence problems in the banking system and pressures on the CBA through contagion

effects.[8] Looking beyond the crisis, a slower than expected recovery in key trading partners such as Russia, Latvia, and Ukraine could also delay exit from the recession.

20. Excess external reserves buffers to address tail risks are relatively low. By end-May 2009, international reserves were down about 8 percent from end-2008 causing reserve money to shrink by roughly the same amount and domestic interest rates to rise considerably. They cover only 3 months of imports and about 46 percent of short-term debt (remaining maturity). Excess reserves (foreign reserves above the monetary base) that are available for lending to commercial banks are sufficient to cover about 4 percent of total deposits or 16 percent of domestic banks' deposits.

III. Policy Discussions

21. The authorities see maintaining the CBA as critical to external and macroeconomic stability, as well as to Lithuania's aspirations to adopt the euro. Not only has the currency board been a confidence anchor—including in the episode of stress that followed the 1998 ruble crisis—the authorities view it as an indispensable element in their strategy of securing a rapid and orderly exit from the peg via euro adoption. Given the objective of complying with the Maastricht convergence criterion by 2011 to qualify for euro adoption by 2013 and the challenges the crisis has presented, discussions focused on short and medium-term policies needed to safeguard external and domestic stability under the CBA, as well as the associated risks to the strategy.

22. The magnitude of the external shock has underlined the need to restore competitiveness, with the CBA placing the burden of adjustment firmly on domestic policies. Removing the real exchange rate overvaluation will require reducing production factors' costs relative to those of trading partners (Box 2), many of which have recently gained competitiveness through nominal depreciation. Staff's average estimate suggests the real effective exchange rate is moderately overvalued. However, engineering this factor price reduction will be challenging. The CBA precludes the use of monetary and interest rate policy to mitigate the downturn and places the burden of adjustment on fiscal policy—which risks aggravating the downturn—and on domestic demand in general.

23. The authorities are fully cognizant of these trade offs and are strongly committed to the peg as a nominal anchor and the policies needed to sustain it. The maintenance of the currency board is seen as the key anchor for external and domestic stability, particularly in the current difficult economic environment. They noted that the large declines seen in private sector wages should help improve competitiveness. They also stressed that recent fiscal consolidation testifies to their will and ability to implement the

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[8] Lithuania's CDS and sovereign bond spreads are highly correlated with those of other regional currency boards.

necessary policies, while reductions in public sector wages will complement the private sector-led adjustment. This, combined with ongoing structural reforms to improve the business environment, could enhance Lithuania's potential growth prospects as a full member of the eurozone.

24. **Conversely, the authorities believe that a devaluation would exacerbate the contraction while delivering limited gains.** Imported intermediate goods account for over 60 percent of total costs in several of Lithuania's key exports (e.g. refined oil products or fertilizers) while labor and other non-tradeables account for around a third or less. Moreover, at this juncture of the economic downturn—with Lithuania's main export partners in recession—a devaluation would unlikely promote rapid export growth. In the authorities' view, a devaluation would risk severe disruption in the banking system and the loss of credibility from abandoning the currency board would be followed by downgrades of credit ratings, the freezing of access to international financial markets, and would jettison Lithuania's ambition to adopt the euro. Corporate and household debt burdens would rise quickly with a devaluation, overwhelming existing debt restructuring mechanisms and risking defaults among exporters and non-exporters, with negative feedback loops on asset prices and banks' balance sheets. Staff agreed that the net impact of a devaluation is unclear. Staff also underscored that the decision to maintain the CBA imposed constraints and challenges.

25. **The authorities agreed that addressing the challenges within the CBA going forward will require sustaining the remarkable adjustment of recent months including through:**

- A further sizeable consolidation in the fiscal sector to ensure debt sustainability and timely qualification for euro adoption;

- The building of additional buffers in the financial system to address liquidity and credit risk; and

- Further wage adjustment and structural reforms to re-orientate output towards tradable sectors helping to improve medium-term growth prospects.

A. Securing Fiscal Sustainability

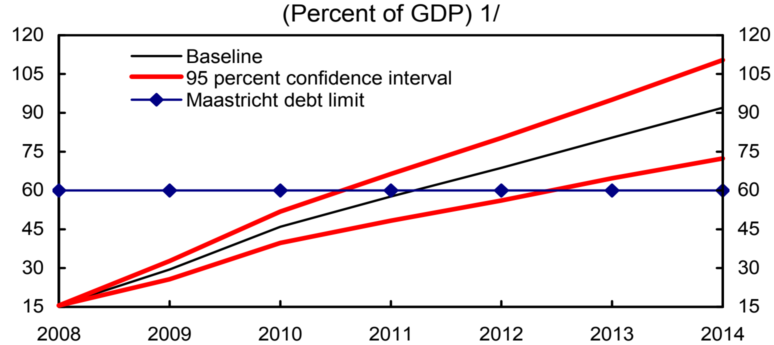
26. **The authorities see reducing the large structural deficit and securing fiscal sustainability as a key imperative.** The general government deficit would have risen to 17 percent of GDP in 2009, if the impact of 2008 policies had not been unwound through the adjustment undertaken through May 2009. This adjustment places the estimated 2009 headline deficit at about 9.7 percent of GDP (½ percentage point higher if net of pillar II transfer cuts) and has helped contain the deterioration in the cyclically-adjusted deficit. However, under unchanged policies, the 2010 deficit would rise to 13 percent of GDP. To help reduce the 2009 and 2010 deficit further, a second supplementary budget was submitted

to Parliament in June targeting further reductions in spending and increase in tax rates effective from August 2009. Parliamentary debate on this package is ongoing.

27. The authorities' objective of targeting ambitious upfront fiscal adjustment is appropriate.

- The government's ability to finance wider deficits remains constrained, as evidenced by recent domestic financing in small increments at short maturities, and high cost, and some failed domestic t-bill auctions.

No Further Fiscal Adjustment Scenario
(Percent of GDP) 1/



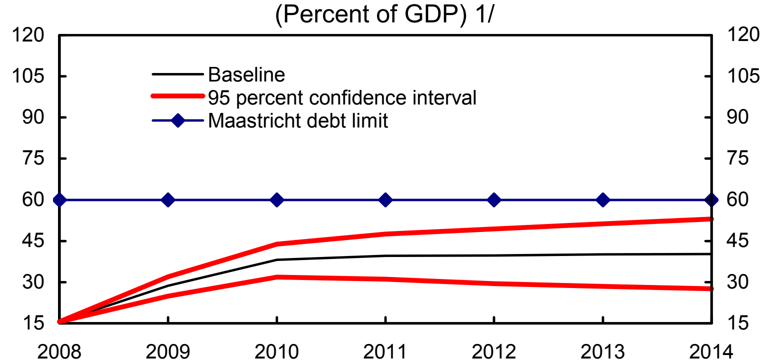
Source: Statistics Lithuania; Ministry of Finance; and IMF staff calculations.
1/ Assumes no further fiscal adjustment beyond May 2009. The underlying deficit rises from 9.7 percent of GDP in 2009 to 13.1 percent of GDP in 2010 before declining somewhat to about 12 percent of GDP with the recovery in growth. Based on 5000 random realizations of real GDP growth, interest rates, and the exchange rate using their historical volatility to derive distribution of future debt stocks.

- Allowing the deficit to widen would compromise fiscal sustainability and the euro adoption strategy. Without a change in policies, the debt burden would rise rapidly to over 90 percent of GDP by end-2014. Illustrative stochastic simulations based on historical measures of volatility show debt would likely breach the Maastricht debt benchmark as early as 2011.

- Given that part of the decline in revenue is likely to be permanent (Box 3), expenditure needs to adjust to more affordable levels and additional tax measures are needed to create space for enhanced social safety nets and bank restructuring costs.

28. Passage of the June supplementary budget is crucial not only to rein in the deficit to a financeable level but also to frontload some of the needed structural fiscal reform. The package strikes a balance between structural measures that realign high public sector costs (a grade-differentiated pay cut for all public workers and reduction in overly generous maternity benefits) and measures to raise revenue (increase in VAT rate from 19 to 21 percent).

Fiscal Adjustment Scenario
(Percent of GDP) 1/



Source: Statistics Lithuania; Ministry of Finance; and IMF staff calculations.
1/ Adjustment to bring the general government fiscal deficit to 3 percent of GDP by 2011 in line with the staff's scenario presented in table 5.

If approved, these measures would yield ¾ percent of GDP in 2009 (1¾ percent of GDP annualized), helping contain the 2009 budget deficit to about 9 percent of GDP (9½ percent net of pillar II transfer cuts), a level that should be financeable, and would reduce the structural deficit to 6½–7½ percent of GDP (Table 7).

29. Staff agreed that additional sizeable fiscal consolidation would still be needed in 2010–11 to safeguard debt sustainability and underpin the euro-adoption. In 2010, even including the impact of the June 2009 supplementary budget measures, the fiscal deficit could rise to 11.2 percent of GDP (½ percent greater net of pillar II transfer cuts) due to the continued fall in GDP, with the Ministry of Finance's working estimates of the fiscal deficit broadly in the same range. This implies additional fiscal consolidation of about 7 percent of GDP in 2010/11 is needed to achieve the authorities' deficit target of 3 percent of GDP in 2011, the target date set recently under the EU excessive deficit procedure. This would stabilize the debt burden at a more sustainable 40 percent of GDP (Annex 1), and secure compliance with the Maastricht debt criterion. However even with the adjustment, the anticipated 2010 deficit may still require significant financing.

30. Staff shared the authorities' view that the adjustment should be anchored in structural reforms to reduce expenditures that are unsustainably high. The authorities' plans—drawing on the recent World Bank Public Expenditure Review—for a comprehensive reform to be implemented with the 2010 budget are welcome. The scope for savings appear to be greatest in social benefits (Box 4) and civil service pay which combined account for two-thirds of spending. To bring benefits in line with contributions and restore full funding of the second pension pillar, reforms should seek to gradually raise the retirement age, remove the scope for discretionary increases for the formulae for basic and contributory pensions, tighten eligibility for child, disability and sickness benefits, and decrease the term of maternity benefits to international levels. Reform of civil service pay structures could yield substantial savings: the public-private pay differential, inclusive of bonuses, was 40 percent in 2008. There is also scope for savings in the education sector where an aging population has left Lithuania with a very low student-teacher ratio.

31. Given the magnitude of the adjustment it would also be prudent to raise the tax-to-GDP ratio, including by broadening the base, strengthening administration, and raising tax rates. Steps to broaden the tax base, including via real estate and motor vehicle taxation, are under consideration, and the authorities are receiving IMF technical assistance to bolster tax administration. Staff suggested a comprehensive review of the tax system to improve its efficiency and to streamline tax incentives. It may also be necessary to raise tax rates, and in addition to the VAT rate increases already in-train, consideration should also be given to reversing the recent PIT rate reduction. However, the authorities prefer to increase the social contribution rate as this would directly improve SoDra's finances.

32. There is also scope to strengthen fiscal institutions and promote fiscal discipline. Fiscal risks stemming from government guarantees associated with the business stimulus package, PPPs, or the Financial Stability Law should be closely monitored, managed, and integrated into fiscal policy analysis. The fiscal framework needs to be revamped to avoid pro-cyclicality, promote discipline and savings in good times, and ultimately create a greater cushion for future downturns. The authorities are formulating reforms to ground the annual budgets in a multi-year framework and targets in cyclically-adjusted terms.

33. In the context of such a large scale economic adjustment, it will be important but challenging to provide space for social safety nets. The World Bank recommendations to extend the term of unemployment benefits and broaden the coverage of the existing well-targeted social assistance programs could be accommodated through the rationalization of overly generous contributory benefit schemes.

B. Safeguarding Banking System Soundness

34. The authorities acknowledge the risks in the financial sector but see them as manageable. The large presence of foreign owned banks is viewed as a stabilizing factor, with parent banks and home countries expected to provide continuous support to their Lithuanian operations. In that context, the decrease in parent bank funding is largely viewed as a response to the lack of lending opportunities and credit demand. Recent stress tests indicated that under a baseline scenario banks may need to raise between ¼ and 2.4 percent of GDP by the end of 2010 to cover expected to unexpected losses.[9] Stress tests conducted at the Sveriges Riksbank suggest that Swedish banks, which constitute 60 percent of banks' assets in Lithuania, could withstand large shocks to their capital from 10 percent per year loan losses related to their exposure in the Baltic States.[10] The authorities saw the results of these tests as indications that risks to the financial sector are manageable.

35. The BoL has taken steps to increase capital buffers in the banking system. For example, it requested banks to capitalize their full 2008 profits. Additionally, it conducts well-targeted on site examinations to ensure the timely build-up of loan loss provisioning. Precautionary measures are also being adopted to ensure the safety and soundness of the banking system: temporary protection of depositors up to €100,000 is being made permanent, in line with EU guidelines.

36. However, additional action is needed to ensure that financial institutions remain solvent and well-capitalized to cope with the contraction in economic activity. Staff see the ongoing downturn as potentially having more serious effects on banks' capital needs than

[9] BoL stress tests were conducted on the five largest banks representing 76 percent of the loan portfolio and 84 percent of deposits. Shocks included a further large fall in real estate prices, an increase in interest rates and unemployment. Liquidity stress tests were carried out on 9 banks and 6 foreign bank branches and differed depending on parent bank reactions (See http://www.lb.lt/eng/publications/index.html).

[10] Sveriges Riksbank, Financial Stability Report 2009.

quantified by recent stress tests given the risk of further rises in unemployment, the difficulty in estimating the impact of rising interest rates on asset quality, and challenges in estimating bank specific probabilities of default. Therefore to ensure that banks remain solvent and problem banks are quickly resolved, staff encouraged:

- Accelerated loan loss provisioning, full semi-annual audits, and preemptive increases in bank capital based on enhanced stress tests exercises.

- Securing explicit commitments from parent banks to pledge the necessary liquidity and capital support to their subsidiaries. The authorities have already received general commitments from parent banks and are coordinating with other supervisors in the region, but it may be useful to coordinate commitments of parent banks and that of their respective supervisors across the Baltics to ensure the equitable sharing of the deleveraging burden going forward.

- The running of liquidity stress tests on a consolidated basis to ensure that the risk of contamination arising from problems in subsidiaries of Lithuanian banks abroad is properly factored in, and that more pessimistic scenarios are devised to test tail risks.

- Further enhancement of the crisis preparedness regime, including drill crisis exercises to strengthen potential weak areas with respect to triggers and coordinating procedures.

- Incorporating in the draft Financial Stability Law additional measures to protect the State from contingent or hidden losses in case it needs to take over a bank. Since the draft law only permits bank recapitalization through the acquisition of bank shares, there is a risk that shareholders may benefit from public assistance. Putting a bank into receivership and performing a "bridge" bank purchase and assumption option would help to mitigate such risks and provide flexibility to cover depositors and perhaps other creditors.

- Ensuring implementing regulations of the draft Financial Stability Law are ready for immediate passage. The regulations should seek to clarify the procedures for: (i) valuing bank shares; (ii) acquiring assets from banks in a transparent manner creating a proper vehicle for their management; and (iii) specifying the agency responsible for securing and inventorying a problem-bank's assets and preparing final financial statements in the event of closure.

- Enhanced supervision of banks with shorter and significantly costlier funding profiles to safeguard the deposit insurance scheme.

- Proposals to overhaul the supervisory framework and merge financial supervisory agencies are premature given the already demanding agenda.

37. The authorities welcomed these recommendations but saw challenges in implementing some of them. They noted that banks are being asked to raise capital, hold the distribution of retained earnings, and to determine loan provisioning based on International Financial Reporting Standards. They also noted that their existing stress tests encompass pessimistic scenarios of liquidity and credit risk and that their participation in the IMF-coordinated stress test of banking systems in Central and South East Europe should help lend confidence to their findings. The authorities expressed particular interest in exploring the feasibility of allowing for a bridge bank option under the bank resolution framework, although legal opinion was divided if such an option is consistent with the Constitution.

38. Speedy corporate and household debt restructuring will also be key to the recovery. While the legal framework for debt restructuring is generally in line with international standards, it will be tested by the downturn. Voluntary agreements between banks and their customers should remain the preferred route to ensure effective debt work outs. Following the experience in resolving bankruptcies over the coming months, a general review of the bankruptcy framework could then be undertaken to examine the need and scope to enhance the legal framework by including inter alia the approval of pre-packaged restructuring plans by a qualified majority of creditors, the assignment of priority repayment status to creditors providing new financing during the restructuring, the introduction of mechanisms to protect the interests of secured creditors, and the swift conversion of bankruptcy into restructuring proceedings to the extent that firms are still viable. To deal with the increased workload, expedited training programs in commercial issues could better equip the judiciary. The authorities concurred with the need to closely monitor how current corporate and household debt restructuring processes fare in the months ahead to determine the need for changes in the legal framework.

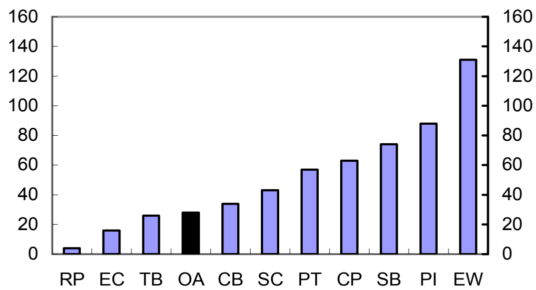
C. Enhancing Longer-Term Growth Potential

39. Adjusting costs will be important to regain competitiveness. Lithuania has a high degree of wage flexibility: it has one of the highest shares of intra-firm wage bargaining—and less collective bargaining—and one of the highest frequencies of changes in base wages in the EU.[11] Real private sector gross earnings are falling quickly: wage costs in the construction sector are down by 20 percent (3-month percent change, annualized) as of May 2009.

[11] ECB Monetary bulletin, February 2009.

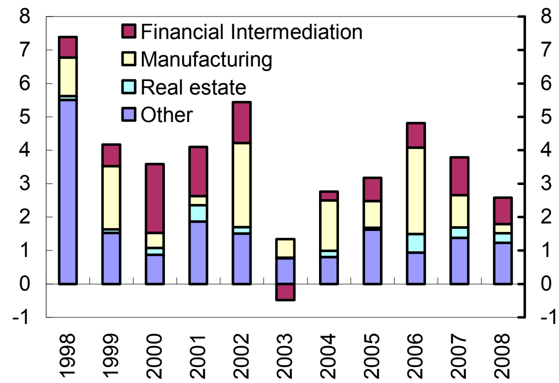
Beyond labor costs, improvements to the business environment are needed. Notwithstanding the need to interpret *Doing Business Indicators* with caution, those suggest Lithuania's business environment ranks reasonably high—28th out of 181 countries—but it lags in some key areas. Land regulations are strict and unpredictable and securing construction permits can be an arduous process. Such bottlenecks may help explain why Lithuania has been less successful than others in the region in attracting FDI, particularly to tradable sectors.

Lithuania: World Rankings, Doing Business Report 1/



Source: World Bank, Doing Business Report.
1/ In the X-axis, OA stands for overall index; SB for starting a business, CP for construction permits, EW for employing workers, RP for registering property, SC for securing credit, PI for protecting investors, PT for paying taxes, TB for trading across borders, EC for enforcing contracts, and CB for closing a business.

FDI Inflows (Percent of GDP)



Source: Statistics Lithuania.

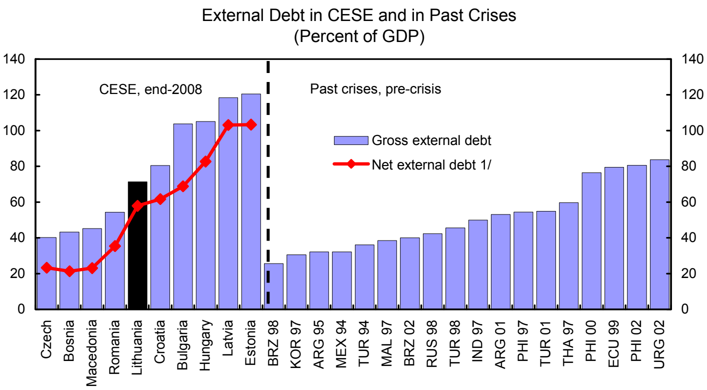
40. **The authorities are undertaking a wide range of structural reforms.** Lithuania has sought and received a substantial front loading of EU funds for infrastructure investment and the promotion of small-and medium-sized enterprises and exporters. Full and effective utilization of these funds, while challenging, is essential to offset the impact of the ongoing reversal in private capital flows. Steps to reduce administrative burdens and bottlenecks in business planning, land regulation, and public procurement recommended by the government-sponsored "Sunrise Commission" on structural reform should facilitate investment. Amendments to the Labor Code in Parliament, if approved, would enhance flexibility in the areas of working hours or dismissal arrangements. The recent higher education reform that seeks to increase competition between colleges and universities for public funds is expected to spur research and development. Investments in energy efficiency, supported by the EIB and EBRD, should reduce the impact of rising energy prices after Ignalina's closure.

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

Box 1: Balance Sheet Exposures

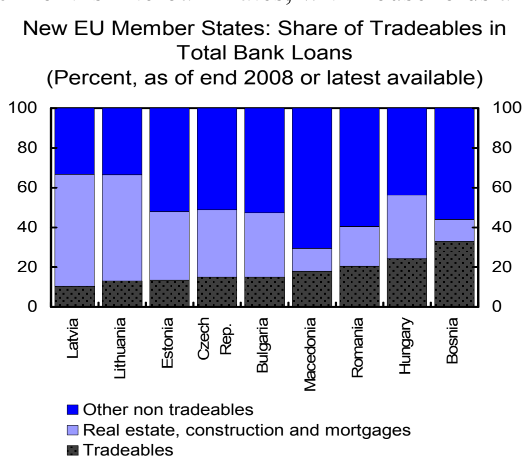
The gross external debt burden in Lithuania rose sharply post EU-accession to 71.4 percent of GDP at end-2008. External debt net of reserves represented about 57 percent of GDP. Lithuania's external and domestic debt remains below many Eastern European counterparts but is higher than that seen prior to previous crisis elsewhere.

Driving the rise in indebtedness was the ease of credit availability and perceived absence of exchange rate risk. The stock of credit rose rapidly to nearly 60 percent of GDP by end-2008, from 26 percent in 2004, with foreign parent banks financing around three-quarters of net new bank lending in 2007–08. Most lending was directed to non-tradable investment in real estate and construction. Over 70 percent of lending is FX denominated reflecting widening interest differentials and increased preference for euro borrowing.

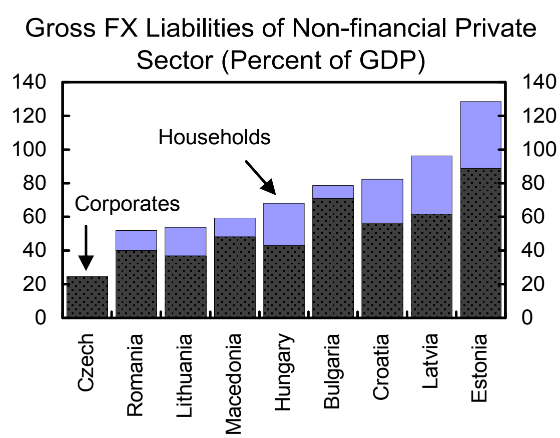


Source: IMF staff estimates.
1/ Gross external debt minus gross international reserves.

Gross non-financial private sector indebtedness rose sharply. Household debt reached almost 40 percent of GDP by end-2008 up from about 8 percent in 2004. However, households held sizeable assets worth almost 70 percent of GDP at end-2008. About half of household loans are mortgages, with foreign banks instrumental in expanding the mortgage market, benefiting in particular from their availability of medium term funding at low cost. Mortgage loans were granted–on aggregate–at reasonable loan-to-value ratios (54 percent for new loans in Q1 2009, with the existing stock being estimated at 45 percent loan-to-value). Moreover, only 11 percent of households, mainly in upper income brackets, hold mortgages. The stock of loans held by the nonfinancial corporates also rose, albeit less rapidly, to 53 percent of GDP. Corporate and household gross FX denominated debt is estimated at about 54 percent of GDP, while FX assets are estimated at 9½ percent of GDP. Loans are predominantly in euro at variable interest rates, based on 3 to 6 months interbank rates, with households and corporates bearing most of the interest risk.



Source: IMF staff estimates.



Source: IMF staff estimates.

Box 2. Exchange Rate Assessment

The standard CGER procedures point towards a moderate overvaluation of the real exchange rate, but estimations need to be interpreted with caution given the wide range of results and uncertainty regarding key variables used in the calculations. Both the macroeconomic balance approach (MB) and the external sustainability approach (ES), which measure the overvaluation of the exchange rate as a function of the gap between the underlying current account—the current account stripped of temporary factors—and the equilibrium current account—a balance that is consistent with medium term fundamentals—are at the lower end of the overvaluation estimates, averaging from 2 to 7¼ percent as of December 2008.[1] Nevertheless, in the current context of a severe recession, the estimations used in both methods to calculate the underlying current account are very sensitive to the estimated output gaps (of Lithuania and its trade partners) and/or to the medium term current account projections. The equilibrium exchange rate (ERER) method avoids these problems by estimating directly the equilibrium real exchange rate as a function of economic fundamentals.[2] It estimates an overvaluation of 26 percent, but the method is not free of significant problems (e.g. the proxy used for accounting for differences in relative productivity is not accurate enough and lags) and likely overestimates the disequilibrium in an economy undergoing rapid structural changes. An additional approach that uses the average CPI-based and manufacturing ULC-based REER deviation from their five year averages shows a 9 percent overvaluation.

Lithuania: CGER-type Estimates of Real Exchange Rate Overvaluation based on end-2008 data (in percent)

Macrobalance Approach	**2.1**
Elasticities-based method 1/	5.5
Projection-based method 2/	-1.4
External Sustainability Approach	**7.2**
Elasticities-based method 1/	10.6
Projection-based method 2/	3.7
Equilibrium Real Exchange Rate Approach (ERER) 3/	**26.0**
REER (Moving Average Approach) 4/	**9.2**
Average across approaches	***11***
Average excluding ERER approach	***6***

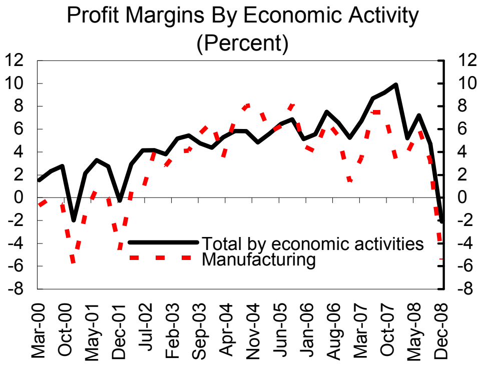
1/ Uses the coefficients of Isard and Faruquee (1998) to estimate the underlying CA, stripping out cyclical influences and adding in the lagged impact of the past appreciation of the real exchange rate.

2/ Uses the end-point 2014 projection (corrected for output gaps) as the underlying CA

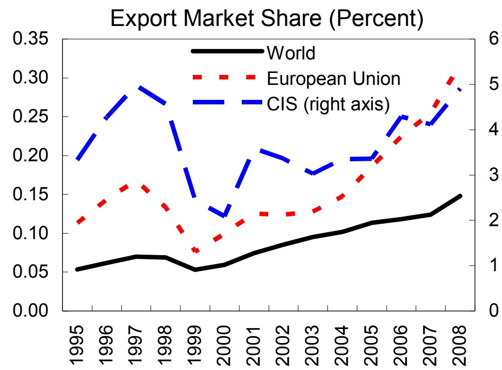
3/ The overvaluation estimate using the ERER approach with May 2009 REER data is equal to 31 percent.

4/ Average CPI-based and manufacturing ULC-based REER deviation from their five year, monthly and quarterly averages, respectively. ULC-based REER data is available until July 2008. Using May 2009 CPI-based REER, the overvaluation would be equal to 11 percent.

Wage productivity differentials also suggest moderate overvaluation but the impact on export market share and firms' profitability has been limited. The real exchange rate using the unit wage cost in the manufacturing sector as the deflator shows a rising trend increasing by 4 percent and 12 percent from 2007 and 2005 until July 2008. Unlike some other Eastern European countries, Lithuania has experienced gains in export market shares at a worldwide level as well as among European Union and CIS countries groups, even after discounting the recent increase in oil production and exports. The profitability of firms in tradable sectors, such as manufacturing, only decreased in 2008 QIV as the global economy contracted.

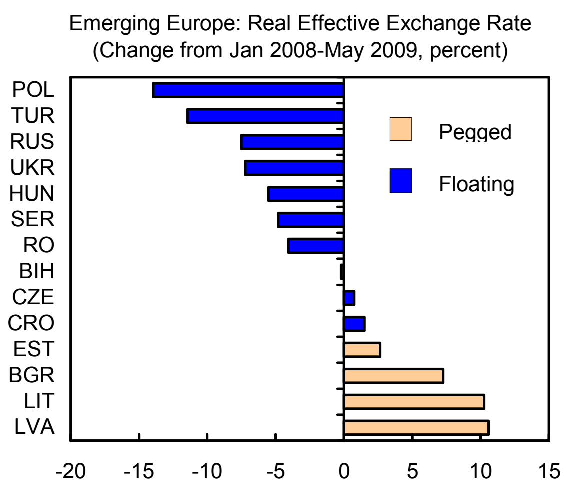


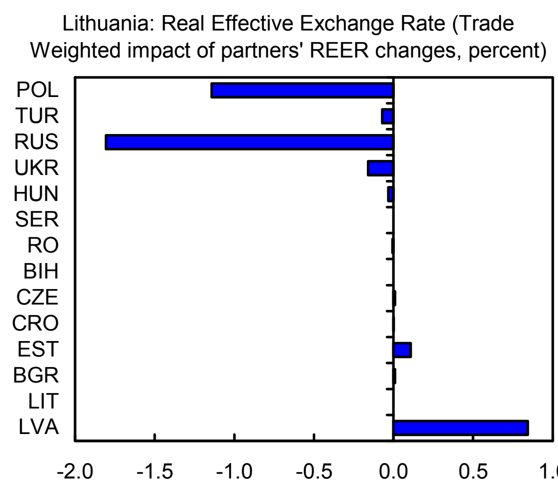
Source: Statistics Lithuania.



Source: Direction of Trade Statistics; and the IMF.

The REER appreciation accelerated in 2009 due to the sharp nominal exchange rate depreciation of non-pegged partner countries, but it has stabilized and started to reverse in recent months. The speed of REER adjustment through prices and wages in Lithuania was overtaken by the sharp nominal exchange rate adjustment of most floaters in 2009 and highlights the potential vulnerability to large nominal exchange rate adjustments in a large group of trade partners.





Source: IFS.

[1/] The underlying current account is calculated by stripping out cyclical influences on the actual current account in both approaches, plus adding the lagged impact of the past appreciation of the real exchange rate appreciation in the elasticity-based approach, and an adjustment for expected fiscal consolidation in the projection-based approach. Given the balancing of the current account, the ES results do not change substantially if the December 2008 NFA or the projected 2014 NFA level is used to determine the NFA-stabilizing balance. See Selected Issues, IMF Country Report No. 08/140 for further methodological details on the application of CGER type procedures in the case of Lithuania.

[2/] The terms of trade impact associated with the closure of Ignalina prolongs the adjustment in the REER and is incorporated in the analysis through staff's medium term projections.

Box 3: Revenue Performance Post Boom

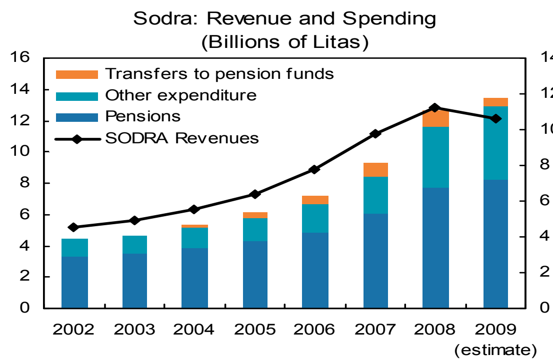
The abrupt end to the boom has major implications for tax revenue collections. High imports boosted indirect tax receipts, and rising wages buoyed PIT and social security tax collections. Early evidence from the adjustments in other Baltic countries, where the economic downturn preceded Lithuania's, suggest tax receipts will fall significantly in Lithuania because of:

Lower effective tax rates and a declining tax base: Effective VAT collections have fallen substantially from their peak in Estonia and Latvia with about 1-2½ percent of GDP reflecting the unwinding of windfall receipts from the boom. In Lithuania, because the increase in consumption during the boom was not as pronounced as in the rest of the Baltics, regression analyses suggest an underlying fall of about 1 percent of GDP could be expected, absent the increase in rates. Effective corporate income tax (CIT) rates which previously exhibited steady increases reflecting earlier build up of profit margins are also likely to fall. In the boom, revenue buoyancy facilitated cuts in PIT rates. Now, as wages correct, Lithuania could lose between 0.6–0.8 percent of GDP in PIT receipts.

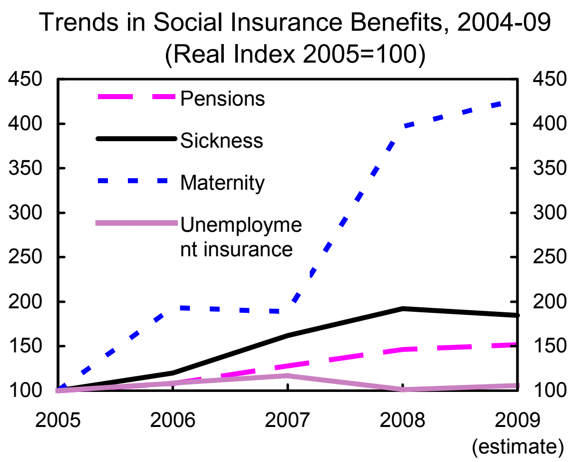
Worsening tax compliance: Independent assessments indicate that the share of unpaid taxes to total tax collection increased from about 1 percent in 2007 to just above 2 percent in the first quarter of 2009, with about half attributable to VAT. There was some evidence of pre-existing problems in administration. VAT arrears have been on a upward trend since 2007 and the C-ratio (ratio of net VAT proceeds over the maximum collectible at the headline rate) of 70 percent in the boom was well in excess of the EU average of 63 percent, boosted by unpaid VAT refunds (about 1 percent of GDP).

Box 4: The Social Security System (SoDra).

SoDra's finances are in a precarious state. In 2008, spending on social insurance benefits increased by 35 percent and SoDra's deficit rose to 1 percent of GDP. In 2009, SoDra's deficit is projected to rise to 3 percent of GDP, and 4-5 percent of GDP by 2014. SoDra's deficit has been financed by short-term borrowing and cuts in transfers to the second pillar. Only a small part of the deficit reflects anticipated increases in unemployment outlays—average unemployment benefits at 21 percent of the average wage are among the lowest in the EU.



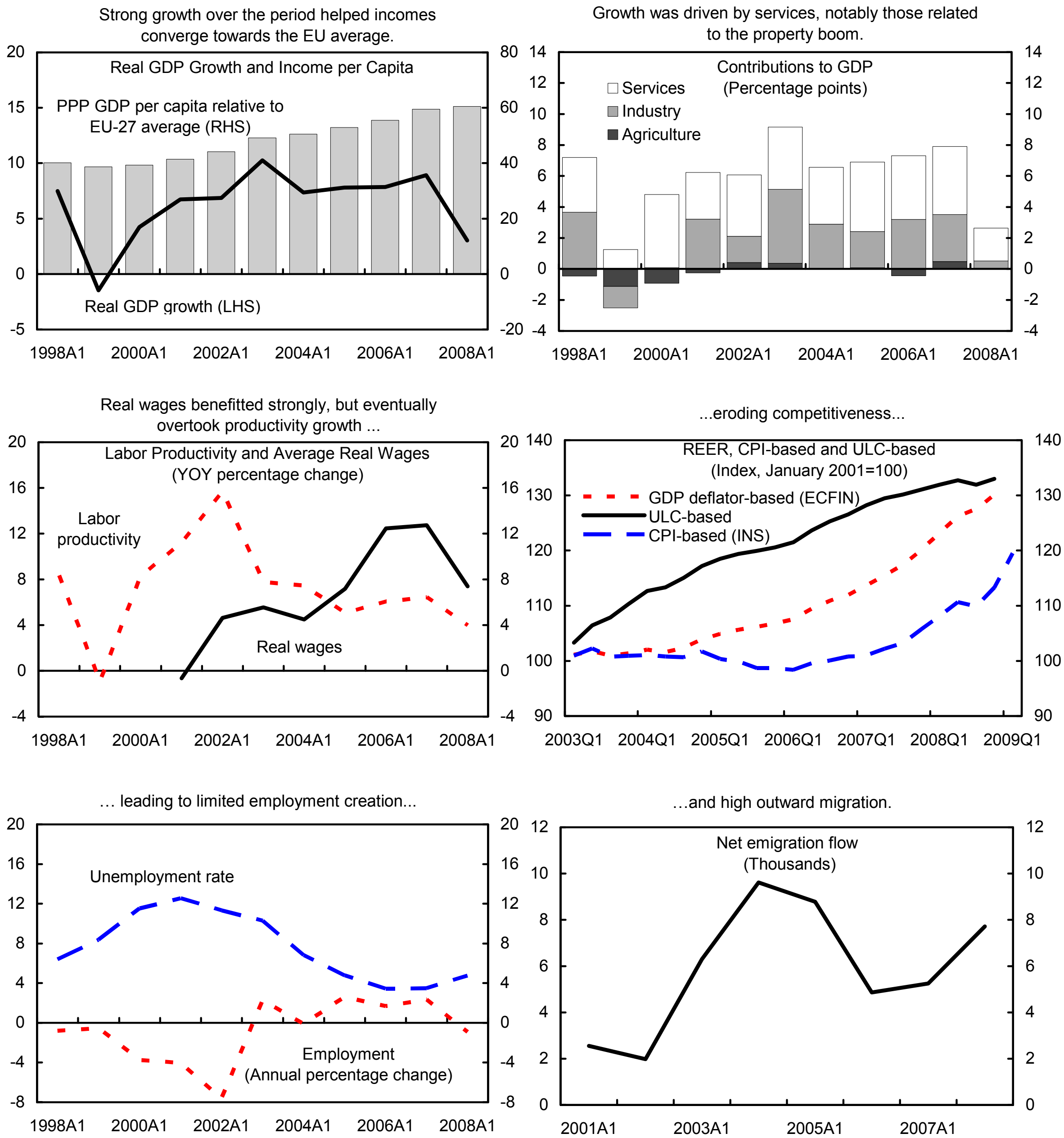
Source: the World Bank.



Source: Ministry of Finance and Sodra.

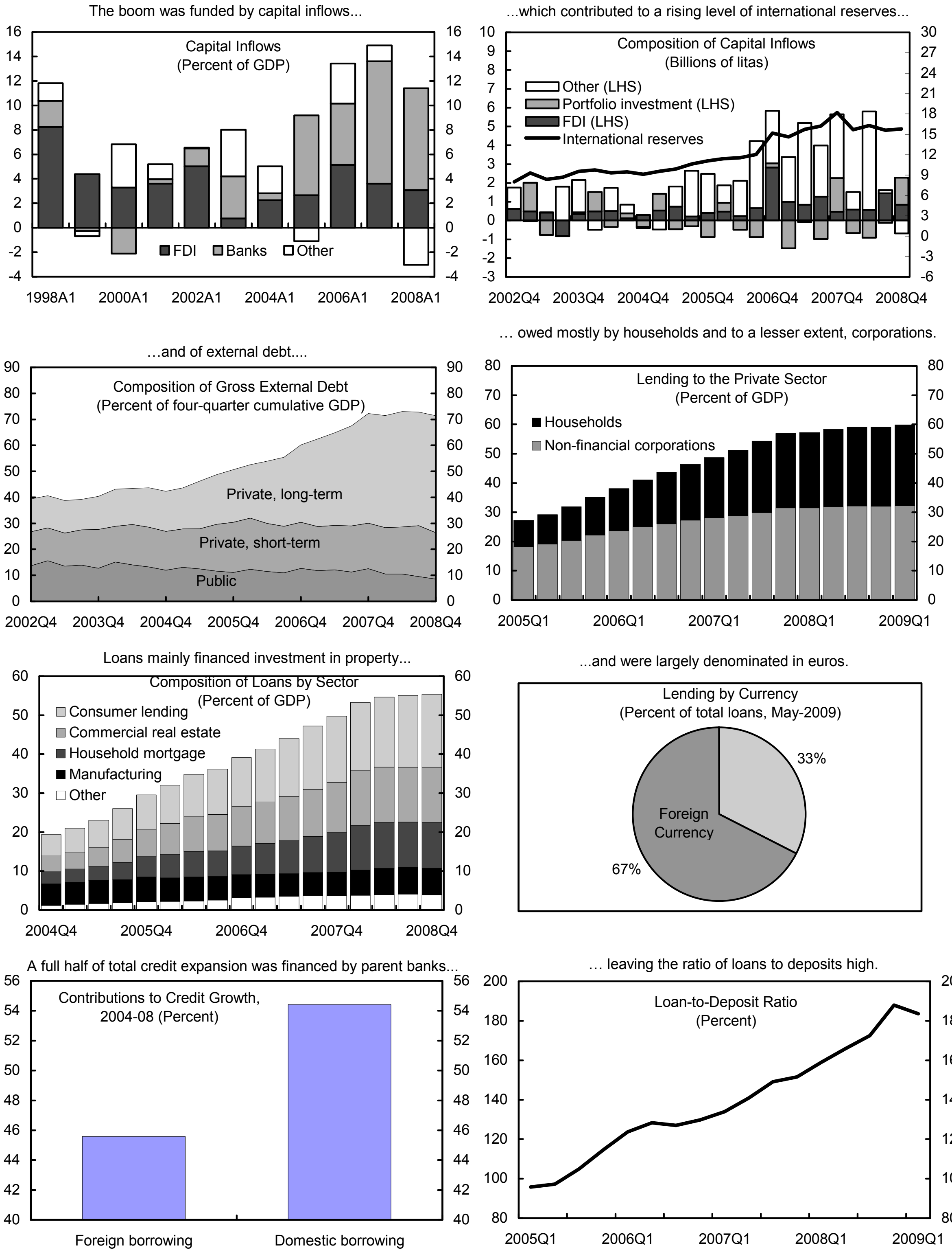
The deficit largely reflects unsustainable increases in pension, maternity, and sick leave benefits. Spending on social benefits of 11 percent of GDP in 2008 was above the Baltic average (10 percent of GDP). Social benefit outlays expanded by 44 percent in real terms through 2006–08 while pension outlays grew by 36 percent as a result of ad hoc increases in 'non-contributory' base pensions while the mandatory retirement ages for men (62.5) and women (60) remained below the OECD average (65). Spending on sickness and maternity benefits rose from 1.0 percent of GDP in 2006 to an estimated 2.2 percent in 2009. Spending on sickness benefits grew in real terms by 61 percent between 2006–08, underpinned by strong wage growth and an increase in claimants due to lax certification. Spending on maternity benefits more than doubled in real terms reflecting the extension in leave to 2 years and an effective replacement rate in excess of 100 percent, making it one of the most generous benefits in the EU.

Figure 1. Lithuania: The Upswing: Real Sector Indicators



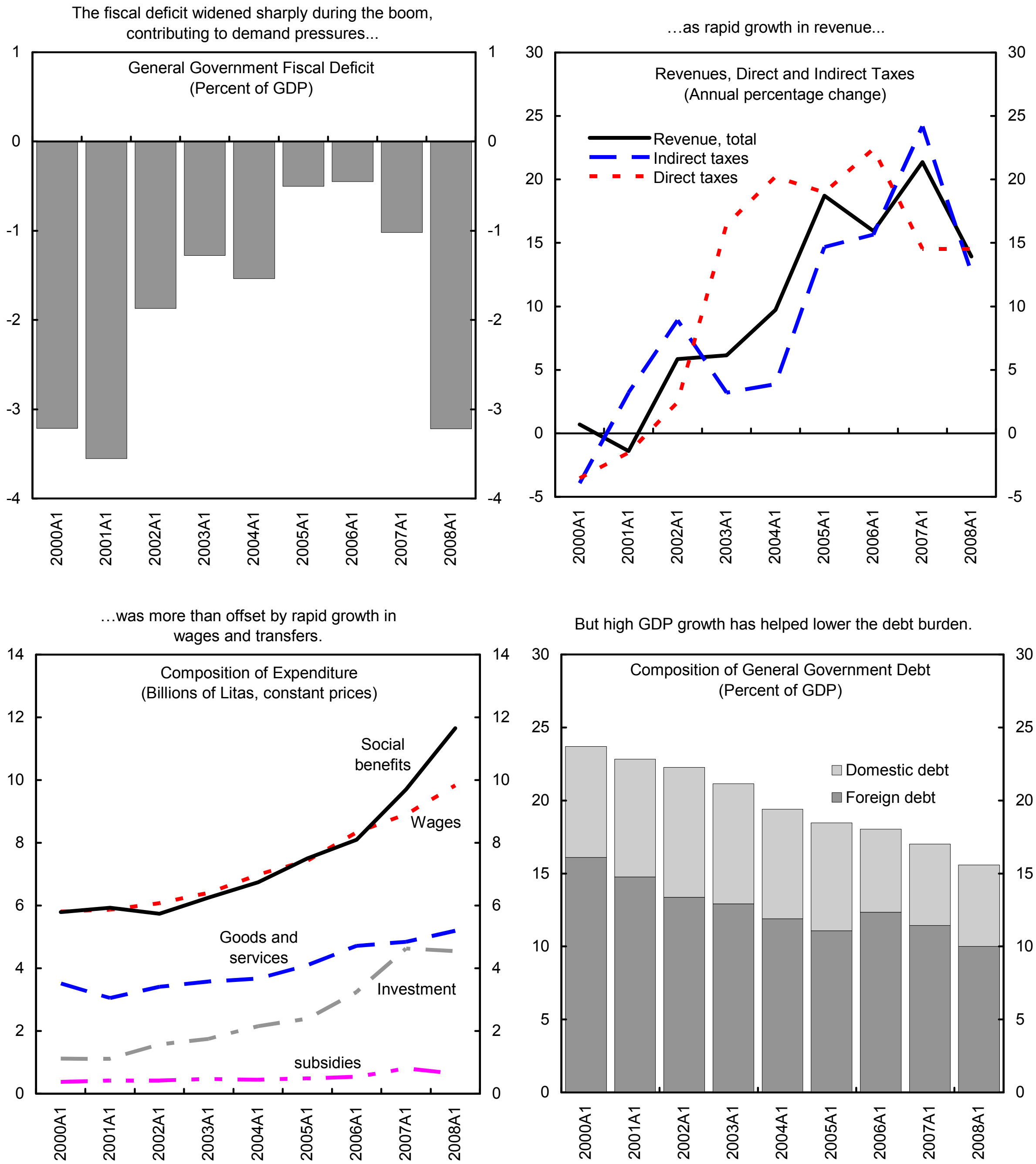
Source: Statistics Lithuania; Haver Analytics.

Figure 2. Lithuania: The Upswing: Financial and Balance Sheet Indicators



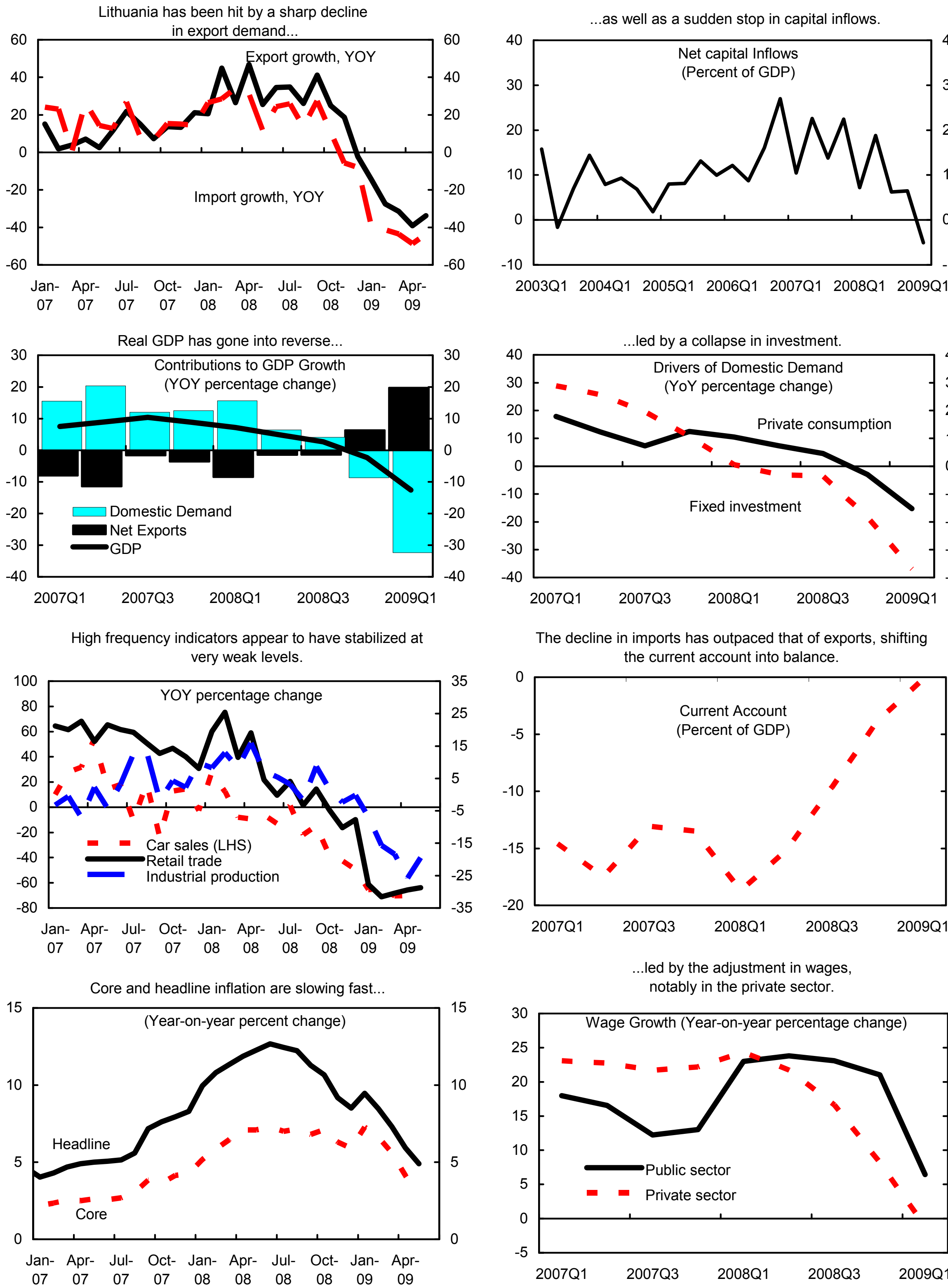
Source: Statistics Lithuania; Haver Analytics.

Figure 3. Lithuania: The Upswing: Fiscal Indicators



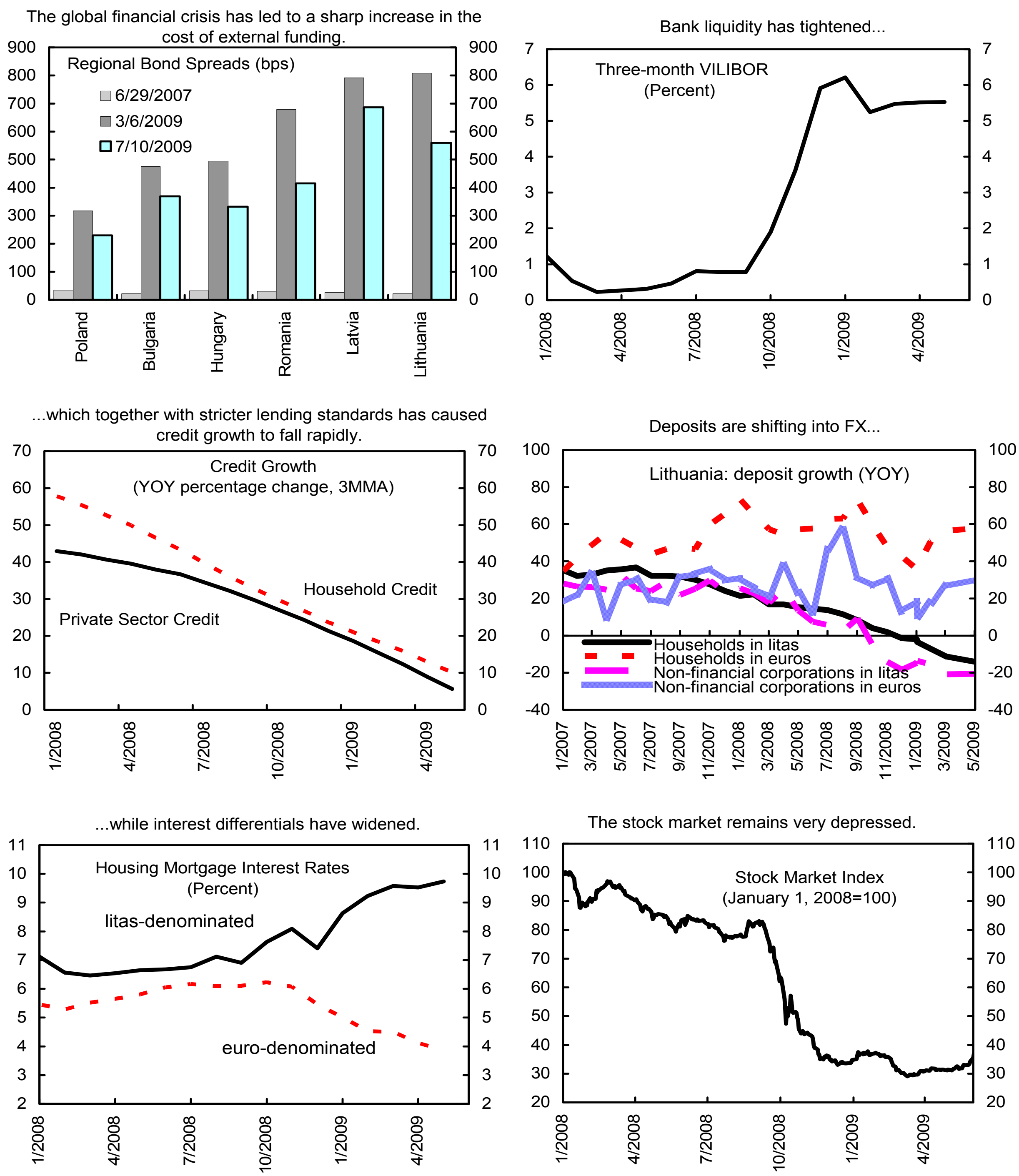
Sources: Statistics Lithuania; Ministry of Finance; and IMF staff estimates.

Figure 4. Lithuania: The Bust: Macroeconomic Indicators in the Recession



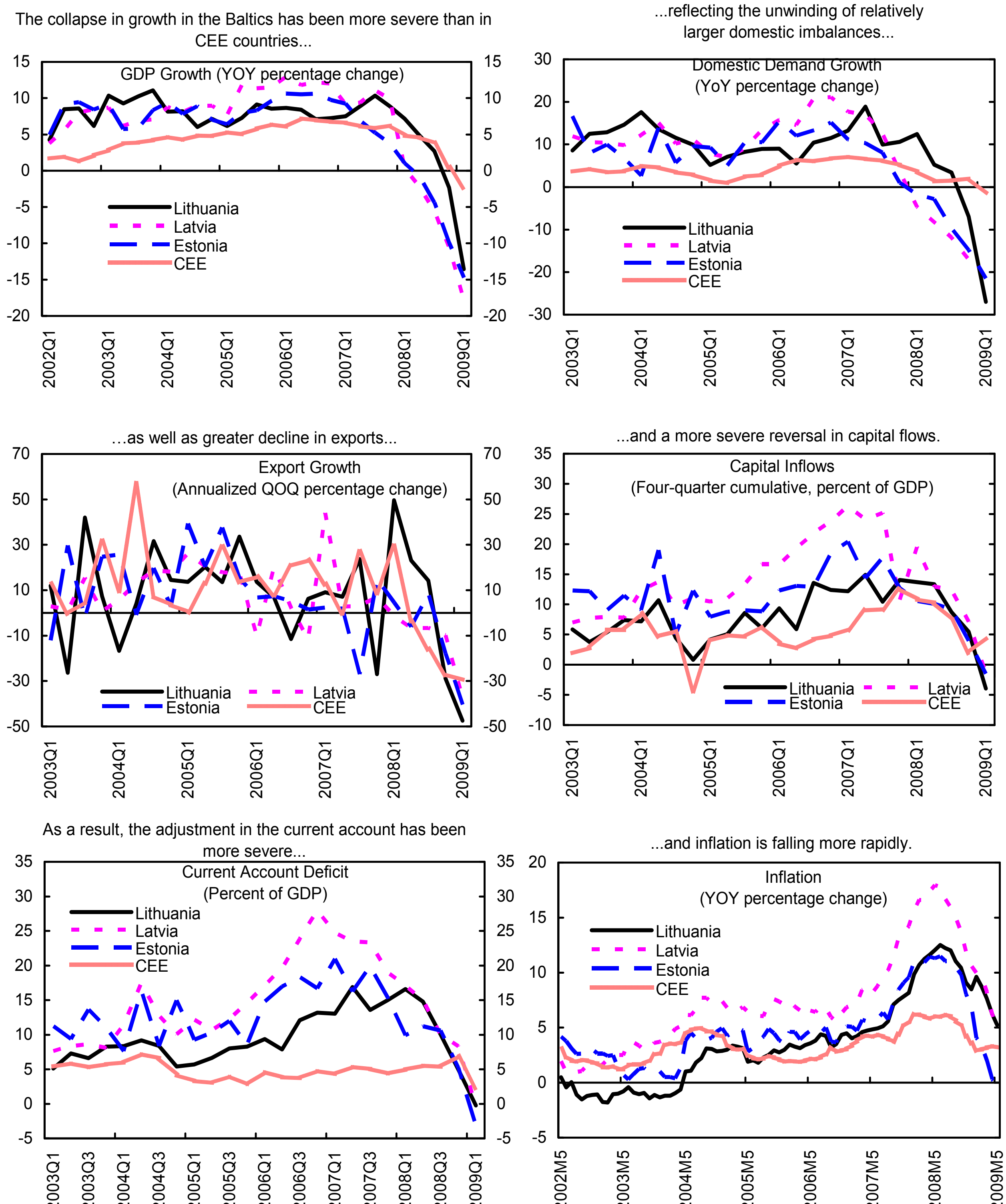
Sources: Statistics Lithuania; and Bank of Lithuania.

Figure 5. Lithuania: Financial Indicators, 2004-09



Source: Bloomberg.
1/ JP Morgan Euro EMBI Global sovereign spreads. Data for Latvia are spreads of bond maturing on 4/2/14 versus comparable maturity of German Bunds.
2/ Gaps signify that no transaction took place.

Figure 6. Lithuania's Recession in a Regional Context 1/



Sources: Statistics Lithuania; and Bank of Lithuania.

1/ The data on CEE countries are of the average of Czech Rep., Hungary and Poland.

Table 1. Lithuania: Selected Economic and Social Indicators, 2004–10

	2004	2005	2006	2007	2008	2009	2010
						Projections	
Real economy							
Nominal GDP (in billions of litai)	62.7	72.1	82.8	98.1	111.5	89.0	83.7
GDP (in billions of euros)	18.2	20.9	24.0	28.4	32.3	25.8	24.2
Real GDP (annual percentage change)	7.4	7.8	7.8	8.9	3.0	-16.0	-3.7
CPI, period average (annual percentage change)	1.2	2.7	3.8	5.8	11.1	2.7	-1.9
CPI, end of period (year-on-year percentage change)	2.8	3.0	4.5	8.2	8.5	-2.8	0.7
Average monthly wage, nominal (annual percentage change)	5.7	10.0	16.7	19.3	19.3	-9.6	-4.5
Average monthly wage, real (CPI-deflated, annual percentage change)	4.5	7.2	12.4	12.8	7.4	-12.0	-2.6
Unemployment rate (year average, in percent of labor force) 1/	11.4	8.3	5.6	4.3	5.8	14.5	16.5
Saving-investment balance (in percent of GDP)							
Gross national saving	15.2	16.8	16.0	15.4	15.6	12.7	11.4
Gross national investment	22.7	23.9	26.3	30.5	26.6	12.1	11.2
Foreign net savings	7.5	7.1	10.4	15.1	11.1	-0.6	-0.2
Fiscal sector (in percent of GDP) 2/							
General government balance	-1.5	-0.5	-0.4	-1.0	-3.2	-9.1	-7.2
Revenue	31.8	32.8	33.1	33.9	34.0	37.0	37.2
Of which EU grants	0.9	0.8	1.0	1.5	1.1	6.2	6.7
Expenditure	33.3	33.3	33.6	34.9	37.2	46.1	44.4
Of which: Non-interest	32.4	32.5	32.8	34.2	36.6	44.8	42.3
Interest	0.9	0.8	0.7	0.7	0.6	1.3	2.0
General government gross debt 3/	19.4	18.4	18.0	17.0	15.6	27.8	38.0
Of which: Foreign currency-denominated	13.7	13.0	14.5	14.2	12.8	19.5	26.6
External sector (in percent of GDP, unless otherwise specified)							
Current account balance							
in percent of GDP	-7.7	-7.1	-10.6	-14.6	-11.6	0.6	0.2
in billions of euros	-1.4	-1.5	-2.6	-4.1	-3.7	0.2	0.0
Exports of goods and services (volume change, in percent)	4.4	17.7	12.0	4.3	11.3	-15.3	1.1
Imports of goods and services (volume change, in percent)	14.9	16.4	13.7	11.6	10.0	-26.7	0.9
Foreign direct investment, net 4/	2.3	2.7	5.2	3.6	3.1	2.0	2.8
Gross official reserves (in billions of euros)	2.6	3.2	4.4	5.2	4.4	3.9	4.0
Reserve cover of short-term debt at remaining maturity	…	0.6	0.7	0.7	0.5	0.5	0.6
Gross external debt 5/	43.0	51.3	60.6	72.5	71.6	88.4	96.0
Short-term debt at original maturity	15.2	19.7	18.0	18.6	18.0	17.0	16.1
Exchange rates							
Exchange rate (litai per U.S. dollar, end of period)	2.5	2.9	2.6	2.4	2.5	…	…
Exchange rate (litai per U.S. dollar, period average)	2.8	2.8	2.8	2.5	2.4	…	…
Exchange rate (litai per euro, end of period)	3.5	3.5	3.5	3.5	3.5	…	…
Real effective exchange rate (2000=100, increase=appreciation) 6/	105.0	103.3	103.6	107.0	114.8	…	…
Money and credit							
Reserve money (year-on-year change, in percent)	7.0	27.7	19.3	21.1	-1.4	-19.7	-1.9
Broad money (year-on-year change, in percent)	22.3	32.4	21.8	21.7	-0.4	-14.1	-5.9
Private sector credit (year-on-year change, in percent)	40.3	56.1	51.4	45.3	17.8	-16.1	-14.6
Currency outside banks, in percent of deposits	29.7	26.2	25.4	22.8	24.4	21.5	21.5

Sources: Lithuanian authorities; and IMF staff estimates and projections.
1/ Based on labor force data.
2/ ESA 95 methodology. For 2009, including measures currently in Parliament expected to yield 0.6 percent of GDP in savings. For 2010, including the annual yield of the 2009 measures estimated at 1.8 percent of GDP, plus an additional 4 percent of GDP in yet to be identified savings.
3/ Excluding guarantees.
4/ FDI in 2009/10 includes funds for recapitalization of foreign banks' subsidiaries.
5/ Includes loans guaranteed by the government.
6/ CPI-based, 2000 trade-weighted real effective exchange rate against 17 major trading partners.

Table 2. Lithuania: Medium Term Framework, 2005–14

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
					Projections					
Real economy										
GDP (in billions of euros)	20.9	24.0	28.4	32.3	25.8	24.2	25.2	26.5	28.1	29.9
Real GDP (annual percentage change)	7.8	7.8	8.9	3.0	-16.0	-3.7	3.2	3.5	4.0	4.5
CPI, period average (annual percentage change)	2.7	3.8	5.8	11.1	2.7	-1.9	0.5	1.5	1.6	1.6
Average monthly wage, nominal (annual percentage change)	10.0	16.7	19.3	19.3	-9.6	-4.5	1.1	2.1	3.0	5.0
Unemployment rate (year average, in percent of labor force) 1/	8.3	5.6	4.3	5.8	14.5	16.5	12.0	9.0	7.5	6.5
Saving-investment balance (in percent of GDP)										
Gross national saving	16.8	16.0	15.4	15.6	12.7	11.4	11.4	11.9	11.3	10.6
Gross national investment	23.9	26.3	30.5	26.6	12.1	11.2	12.4	12.8	13.1	13.5
Foreign net savings	7.1	10.4	15.1	11.1	-0.6	-0.2	1.0	0.9	1.9	2.9
Fiscal sector (in percent of GDP) 2/										
General government balance	-0.5	-0.4	-1.0	-3.2	-9.1	-7.2	-3.0	-2.2	-2.8	-2.5
Revenue	32.8	33.1	33.9	34.0	37.0	37.2	37.6	37.7	36.8	36.9
Expenditure	33.3	33.6	34.9	37.2	46.1	44.4	40.6	40.0	39.5	39.5
General government gross debt 3/	18.4	18.0	17.0	15.6	27.8	38.0	39.5	39.8	40.4	40.5
External sector (in percent of GDP, unless otherwise specified)										
Current account balance	-7.1	-10.6	-14.6	-11.6	0.6	0.2	-1.0	-0.9	-1.9	-2.9
Gross official reserves (in billions of euros)	3.2	4.4	5.2	4.4	3.9	4.0	5.7	7.2	8.4	9.5
Reserve cover of short-term debt at remaining maturity	0.6	0.7	0.7	0.5	0.5	0.5	0.6	0.8	0.9	1.0
Gross external debt 4/	51.3	60.6	72.5	71.6	88.4	96.0	95.4	93.1	90.5	87.6
Short-term debt at original maturity	19.7	18.0	18.6	18.0	17.1	16.2	16.9	16.9	16.9	16.7

Sources: Lithuanian authorities; and IMF staff estimates and projections.
1/ Based on labor force data.
2/ESA 95 methodology. Including additional savings of 0.6 percent, 4 percent, and 3.1 percent of GDP in 2009, 2010, and 2011 respectively.
3/ Includes staff estimates' of bank recapitalization needs in 2009 and 2010 but excludes guarantees that been issued but not called.
4/ Includes loans guaranteed by the government.

Table 3. Lithuania: Summary of Monetary Accounts, 2007–10
(In billions of litai; unless otherwise specified)

	2007	2008	2009 Jan	2009 Feb	2009 March	2009 April	2009 May	2009 Baseline	2010 Baseline
Monetary Authority									
Gross foreign assets	18.0	15.6	14.9	14.5	14.7	14.2	14.3	13.8	14.2
Gross foreign liabilities	1.1	0.1	0.4	0.1	0.1	0.0	0.1	0.1	0.1
Of which: Use of Fund credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Nonresident deposits	1.1	0.1	0.4	0.1	0.1	0.0	0.1	0.1	0.1
Net foreign assets	17.0	15.5	14.5	14.4	14.6	14.2	14.2	13.7	14.0
Gold	0.4	0.4	0.5	0.5	0.4	0.4	0.5	…	…
Net domestic assets	-4.1	-2.8	-2.9	-2.7	-3.6	-3.6	-3.5	-3.5	-3.9
Net credit to government	-3.0	-1.3	-1.2	-1.0	-2.1	-2.0	-1.9	-1.9	-2.3
Credit to banks	0.0	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	0.0
Credit to non-bank financial institutions	...	...	...	...	...	...	...	...	...
Other items, net	-1.0	-1.5	-1.7	-1.8	-1.5	-1.6	-1.6	-1.6	-1.6
Reserve money	12.9	12.7	11.6	11.7	11.0	10.6	10.8	10.2	10.0
Currency outside the central bank	9.2	9.6	9.1	9.0	8.3	8.3	8.1	7.8	7.5
Currency outside banks	8.1	8.5	8.2	8.0	7.4	7.3	7.2	6.7	6.3
Cash in vaults of banks	1.1	1.1	0.9	1.0	0.9	1.1	0.9	1.1	1.2
Deposit money banks' deposits	3.7	3.1	2.5	2.7	2.7	2.2	2.7	2.4	2.5
Banking Survey									
Net foreign assets	-3.8	-15.6	-15.5	-15.4	-14.4	-13.9	-13.8	-11.8	-8.2
Monetary authority	17.0	15.5	14.5	14.4	14.6	14.2	14.2	13.7	14.0
Banks and other banking institutions	-20.8	-31.1	-30.0	-29.8	-29.0	-28.1	-28.1	-25.5	-22.3
Net domestic assets	48.1	59.6	58.7	58.5	56.5	55.9	55.4	49.6	43.9
Net claims on government 1/	-2.3	1.4	1.8	2.0	2.0	0.8	0.6	3.7	6.2
Monetary authority	-3.0	-1.3	-1.2	-1.0	-2.1	-2.0	-1.9	-1.9	-2.3
Banks and other banking institutions	0.7	2.7	3.0	3.0	4.2	2.8	2.5	5.6	8.5
Credit to private sector	56.0	66.0	65.7	65.2	64.8	64.6	63.8	55.4	47.3
Credit to nonbank financial institutions	3.2	3.9	3.8	3.8	3.0	2.8	2.7	3.1	2.9
Other items, net	-8.8	-11.7	-12.6	-12.5	-13.3	-12.3	-11.8	-12.5	-12.5
Broad money	44.2	44.1	43.2	43.0	42.1	42.1	41.5	37.9	35.6
Currency outside banks	8.1	8.5	8.2	8.0	7.4	7.3	7.2	6.7	6.3
Deposits	35.6	34.9	34.5	34.5	34.2	34.3	33.9	31.2	29.3
In national currency	28.3	26.0	25.2	25.2	23.9	23.4	22.8	21.9	20.4
Savings deposits	10.9	13.7	13.9	14.2	13.2	12.9	12.4	11.9	11.0
Demand deposits	17.4	12.3	11.3	11.0	10.7	10.6	10.5	10.1	9.3
In foreign currency	7.3	9.0	9.3	9.3	10.3	10.9	11.1	9.2	9.0
Memorandum items:									
Reserve money (yearly percent change)	21.1	-1.4	-0.6	-0.5	-5.7	-14.0	-7.8	-19.7	-1.9
Broad money (yearly percent change)	21.7	-0.4	0.1	-1.1	-3.6	-5.9	-7.9	-14.1	-5.9
Private sector credit (yearly percent change)	45.3	17.8	15.8	12.9	10.2	6.3	4.1	-16.1	-14.6
Money multiplier	3.4	3.5	3.7	3.7	3.8	4.0	3.9	3.7	3.6
Currency outside banks, in percent of deposits	22.8	24.4	23.8	23.1	21.8	21.1	21.3	21.5	21.5
Foreign-currency deposits (percent of total deposits)	21.0	25.6	26.5	26.5	29.4	30.5	31.5	42.0	44.0
Foreign-currency loans (percent of total loans)	54.8	64.0	64.9	65.7	66.2	66.9	67.4	69.0	72.0
Velocity of broad money	2.2	2.5	…	…	…	…	…	2.4	2.4
Gross official reserves (billions of U.S. dollars) 2/	7.7	6.4	5.7	5.4	5.7	5.5	5.8	5.4	5.0
Gross foreign assets (billions of U.S. dollars) 3/	*7.6*	*6.4*	*5.6*	*5.4*	*5.6*	*5.4*	*5.7*	*5.4*	*5.5*
Gross official reserves (billions of euros) 2/	5.3	4.6	4.3	4.3	4.3	4.2	4.2	3.9	4.0
Gross foreign assets (billions of euros) 3/	*5.2*	*4.5*	*4.3*	*4.2*	*4.2*	*4.1*	*4.2*	*4.0*	*4.1*
Excess reserve coverage 3/	14.4	8.3	9.4	8.3	10.8	10.7	10.5	…	…

Sources: Bank of Lithuania; and Fund staff estimates and projections.
1/ Excludes local government deposits; includes counterpart funds.
2/ 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).
3/ Bank of Lithuania's gross foreign assets less reserve money, in percent of banking system deposits.
Excess reserves available for lending to commercial banks are determined based on net foreign reserves, and represent the equivalent of 4 percent of bank deposits.

Table 4. Lithuania: Balance of Payments, Baseline 2007–14
(In billions of euros, unless otherwise indicated)

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
Current account balance	**-4.1**	**-3.7**	**0.2**	**0.0**	**-0.2**	**-0.2**	**-0.5**	**-0.9**
Merchandise trade balance	-4.3	-3.8	-0.8	-0.8	-0.9	-1.0	-1.1	-1.3
Exports (f.o.b.)	12.5	16.1	11.9	12.8	13.6	14.6	15.7	17.0
Imports (f.o.b.)	-16.8	-19.8	-12.7	-13.6	-14.5	-15.6	-16.8	-18.3
Services balance	0.5	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Exports of non-factor services	2.9	3.3	2.4	2.5	2.7	2.8	3.0	3.3
Imports of non-factor services	-2.5	-3.0	-2.1	-2.3	-2.4	-2.6	-2.8	-3.0
Factor income balance	-1.2	-1.1	-0.2	-0.5	-0.7	-0.7	-0.7	-0.8
Receipts	0.6	0.7	0.6	0.6	0.7	0.8	0.9	1.0
Payments	-1.8	-1.8	-0.8	-1.1	-1.4	-1.4	-1.6	-1.7
Current transfer balance	0.8	0.7	0.9	1.1	1.1	1.2	1.1	0.9
Capital and financial account balance	**5.0**	**3.1**	**-0.9**	**0.0**	**2.0**	**1.7**	**1.7**	**2.0**
Capital transfer balance	0.5	0.6	0.5	0.8	0.9	0.8	0.6	0.7
Foreign direct investment balance 1/	1.0	1.0	0.5	0.7	0.3	0.4	0.5	0.6
Portfolio investment balance 1/	-0.2	-0.1	0.3	0.3	0.1	0.0	0.0	0.0
Other investment balance 1/	3.7	1.6	-2.3	-1.7	0.7	0.6	0.6	0.6
Errors and omissions	0.0	-0.2	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	**0.9**	**-0.8**	**-0.6**	**0.1**	**1.7**	**1.5**	**1.1**	**1.1**
Financing	**-0.9**	**0.8**	**0.6**	**-0.1**	**-1.7**	**-1.5**	**-1.1**	**-1.1**
Gross international reserves (increase: -)	-0.9	0.8	0.6	-0.1	-1.7	-1.5	-1.1	-1.1
Use of Fund credit, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:			(In percent of GDP)					
Current account balance	-14.6	-11.6	0.6	0.2	-1.0	-0.9	-1.9	-2.9
Trade Balance of goods and services	-13.4	-10.5	-2.0	-2.3	-2.6	-2.8	-3.2	-3.5
Exports	54.3	60.0	55.5	63.0	64.7	65.8	66.8	67.9
Imports	-67.8	-70.5	-57.5	-65.3	-67.2	-68.6	-69.9	-71.4
Factor Income	-4.1	-3.3	-0.7	-2.1	-2.7	-2.5	-2.5	-2.5
Current Transfers	3.0	2.3	3.4	4.6	4.3	4.4	3.8	3.1
Capital and financial account balance	17.7	9.7	-3.6	0.2	7.9	6.6	5.9	6.6
Capital transfers	1.8	1.8	2.0	3.2	3.6	2.9	2.1	2.4
Foreign direct investment balance 1/	3.6	3.1	2.1	2.8	1.3	1.6	1.6	1.9
Portfolio investment balance 1/	-0.8	-0.2	1.3	1.2	0.2	0.0	0.0	0.1
Other investment balance 1/	13.1	5.0	-9.0	-7.0	2.8	2.1	2.2	2.1
Gross external debt	72.3	71.4	88.1	95.7	95.1	92.9	90.3	87.3
Public	12.5	10.1	17.5	24.1	24.6	24.8	24.8	24.5
Short-term	1.1	0.1	0.9	1.2	1.2	1.2	1.2	1.2
Long-term	11.4	10.0	16.6	22.9	23.4	23.6	23.6	23.4
Private	59.8	61.2	70.6	71.7	70.5	68.1	65.5	62.8
Short-term	21.3	20.6	21.6	20.8	21.2	21.0	20.7	20.3
Long-term	38.4	40.6	49.0	50.9	49.2	47.1	44.8	42.5
Net external Debt	25.5	29.1	38.5	34.6	29.7	25.0	22.2	19.8
Net international investment position	-56.4	-51.8	-59.9	-58.0	-52.8	-47.5	-43.9	-40.9
			(Annual percentage change)					
Merchandise export volume	4.3	11.3	-15.3	1.1	4.2	5.0	5.6	6.3
Merchandise import volume	11.6	10.0	-26.7	0.9	4.4	5.2	5.9	6.6
Merchandise export prices	4.6	12.2	-12.3	5.8	2.4	2.0	1.9	1.9
Merchandise import prices	4.0	8.1	-12.4	5.7	2.5	2.1	2.0	2.0
GIR (in billions of Euros)	5.3	4.6	3.9	4.0	5.8	7.3	8.4	9.5
GIR (in billions of US dollars)	7.7	6.2	5.4	5.5	7.9	10.0	11.5	13.0
GIR (in percent of GDP)	18.5	14.2	15.3	16.6	22.9	27.4	29.9	31.8
GIR (in percent of short-term debt) 2/	65.7	47.5	45.9	48.9	62.1	76.1	95.2	104.4
GIR (in months of next year's imports)	3.3	3.8	3.1	3.0	4.0	4.7	5.0	5.2
Gross external debt (in % of GNFS exports)	133.1	119.0	158.8	151.9	147.1	141.2	135.3	128.6
GDP (in billion of Euros)	28.4	32.3	25.8	24.2	25.2	26.5	28.1	29.9

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

1/ The 2009 projections assume rollover rates of 85 percent for foreign banks, 50 percent for domestic banks, and 75 percent for corporates; 5 percent deposit outflows for nonresidents; and FDI (excluding bank recapitalizations) declining 75 percent. The 2010 projections assume rollover rates of 95 percent for foreign banks, 75 percent for domestic banks, and 85 percent for corporates; 5 percent deposit outflows for nonresidents; and FDI (excluding bank recapitalizations) declining 75 percent with respect to 2008. The overall FDI figures include the recapitalization of subsidiaries by their parent bank in both 2009-10.

2/ Short-term debt at remaining maturity.

Table 5: Lithuania: Financial Soundness Indicators, 2005–09, banking system data

(In percent, unless otherwise specified)

	2005	2006	2007	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1
Capital adequacy								
Regulatory capital to risk-weighted assets [1]	10.3	10.7	10.9	12.7	12.0	12.8	12.9	13.9
Regulatory tier I capital to risk-weighted assets [1]	8.9	7.8	7.6	9.4	9.4	10.1	10.2	11.3
Capital to assets [2]	7.2	7.1	7.3	7.5	7.6	7.6	7.6	7.7
Asset quality								
Nonperforming loans net of provisions to capital [2, 3, 11]	5.7	9.7	10.5	11.5	...	...	...	...
Nonperforming loans to total (non-interbank) loans [11]	0.6	1.0	1.0	1.1	...	...	...	...
Impaired loans to capital [6]	...	...	...	...	17.1	19.8	36.3	54.9
Non-impaired loans overdue more than 60 days to capital [6]	...	...	...	...	8.1	7.8	12.2	29.9
Impaired loans to total (non-interbank) loans [6]	...	...	...	...	1.7	1.9	3.4	5.3
Non-impaired loans overdue more than 60 days to total (non-interban	...	...	...	...	0.8	0.7	1.1	2.9
Sectoral distribution of loans to total loans, o/w [12]								
Manufacturing	15.2	11.9	9.9	10.6	10.6	11.0	10.7	10.9
Construction	3.9	5.7	4.1	4.7	3.9	3.9	3.8	3.0
Wholesale and retail trade	13.0	12.8	10.7	11.8	11.5	11.5	10.7	10.7
Financial intermediation	14.6	7.3	5.5	6.2	6.2	6.0	6.3	4.7
Real estate, renting and other business activities	12.5	14.5	16.8	18.6	18.8	18.3	18.4	19.3
Residential real estate loans to total (non-interbank) loans	21.2	24.7	27.8	28.1	28.3	28.6	29.1	30.1
All large exposures to regulatory capital [1, 5]	239.0	189.6	152.7	111.9	134.5	124.4	129.4	118.2
Earnings and profitability								
Return on equity (Net income to average capital) [2, 4]	13.8	21.4	27.3	25.4	23.7	21.2	16.1	-1.0
Return on assets (Net income to average total assets) [4]	1.1	1.5	2.0	1.9	1.8	1.6	1.2	-0.1
Interest margin to gross income	50.8	52.0	55.8	59.9	56.0	59.9	59.3	60.6
Noninterest expenses to gross income	64.4	56.3	49.8	54.2	49.8	54.2	56.7	57.2
Trading and foreign exchange gains (losses) to gross income	8.3	9.0	8.1	1.6	7.9	1.6	5.5	4.5
Personnel expenses to noninterest expenses	41.2	41.4	43.6	43.3	43.9	43.3	40.8	39.9
Liquidity								
Liquid assets to total assets [7]	26.9	24.1	21.9	20.7	19.0	19.6	18.6	19.3
Liquid assets to current liabilities [7, 8]	42.9	41.9	43.5	42.8	37.8	37.6	39.0	42.4
Spread between highest and lowest interbank rate [9]	3.3	2.8	6.9	6.7	4.7	4.4	16.5	14.8
Customer deposits to total non-interbank loans	88.2	77.8	66.4	63.0	60.3	58.2	53.5	55.1
Foreign exchange risk								
Foreign-currency-denominated loans to total (non-interbank) loans [10]	65.8	52.8	55.6	60.7	62.9	63.3	64.6	66.8
Foreign-currency-denominated liabilities to total liabilities [10]	51.6	52.0	56.4	57.3	57.1	60.8	63.3	65.1
Net open position in foreign exchange to regulatory capital [1, 13]	-1.0	-1.4	-2.4	0.3	1.8	0.4	0.4	0.3
Equity risk and exposure to derivatives								
On balance (assets) position in equities to capital [2]	14.9	13.2	8.6	8.1	7.5	6.9	6.0	6.0
Gross assets position in financial derivatives to capital [2]	1.2	4.5	9.7	6.3	6.2	3.5	3.7	5.4
Gross liabilities position in financial derivatives to capital [2]	0.7	4.9	7.7	5.9	3.8	3.0	6.2	8.8

Source: Bank of Lithuania.

1/ Without foreign bank branches.

2/ Capital is the item in banks balance sheet under Shareholders' Equity and Foreign Bank Branches Funds Received from the Head Office (the latter untill end-2007).

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

4/ Net income before taxes.

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

6/ From June 2008, the data on loan portfolio quality is collected through FINREP tables (EU common reporting templates). By this, overdue non-impaired loans and the impaired loans are separated. The sum of these loans could be considered as non-performing loans, however the new series of non-performing loans are not comparable to the previous ones.

7/ Composition of liquid assets 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/ Composition of 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.

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

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

11/ From end-2005 to Q1-2008, NPLs are loans with payments on which are overdue more than 60 days. Untill 2004 NPLs are loans in Substandard, Doubtful and Loss loans categories.

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

13/ As defined in Rules for Calculation of Capital Adequacy approved by Bank of Lithuania Board Resolution No. 138 of 9 November 2006.

Table 6: Lithuania: General Government Operations, 2005-11

	2005	2006	2007	2008	2009	2009	2010	2011
					Budget 1/	Projections		
(ESA 95 aggregates, in millions of litai)								
Revenue	23,662	27,433	33,295	37,935	41,036	32,957	31,114	32,763
Revenue excluding EU grants	23,079	26,585	31,847	36,693	37,074	27,468	25,504	27,094
Tax revenue	14,439	17,139	20,518	23,279	22,279	15,788	14,616	15,572
Direct taxes	6,486	7,940	9,094	10,416	8,106	5,660	4,936	5,511
Indirect taxes	7,951	9,195	11,418	12,857	14,459	10,349	9,889	10,277
Social contributions	6,080	7,226	8,775	10,404	12,907	10,090	9,392	9,966
Grants	583	848	1,448	1,241.8	3,961	5,489	5,610	5,669
Other revenue	2,560	2,220	2,554	3,010	1,889	1,590.1	1,496	1,556
Total expenditure	24,024	27,804	34,296	41,524	43,409	41,023	37,160	35,368
Current spending	21,636	24,443	29,214	36,002	37,522	35,182	34,736	36,379
Compensation of employees	7,434	8,647	9,776	11,990	11,732	11,283	10,839	11,289
Goods and services	4,096	4,895	5,321	6,338	6,174	4,897	4,607	4,790
Interest payments	582	607	690	722	1,044	1,127	1,714	2,236
Subsidies	490	559	887	775	516	480	452	470
Grants	547	632	680	869	915	915	861	895
Social benefits	7,505	8,404	10,654	14,216	15,907	15,246	15,102	15,492
Other expense	983	698	1,207	1,092	1,234	1,234	1,161	1,207
Capital spending	2,388	3,361	5,082	5,523	5,887	5,842	5,774	5,039
Unidentified measures (deficit-reducing)							-3,350	-2,700
Net lending (+) / borrowing (-) 2/	-362	-371	-1,001	-3,590	-2,373	-8,067	-6,046	-2,605
Net acquisition of financial assets	401	453	875	-2,202	...	-686	1,000	0
Domestic	382	320	868	-2,052	...	5	1,000	0
Foreign	19	133	7	-150	...	-691	0	0
Net incurrence of liabilities	767	707	1,882	1,394	...	7,381	7,046	2,605
Domestic	87	-2,634	158	1,677	...	3,062	2,500	1,305
Foreign	679	3,341	1,724	-283	...	4,319	4,546	1,300
Identified financing	679	3,341	1,724	-283	...	4,319	2,120	1,300
Other budget support 3/	...	...	...	...	...	0	2,426	0
(ESA 95 aggregates, in percent of GDP)								
Revenue	32.8	33.1	33.9	34.0	35.8	37.0	37.2	37.6
Revenue excluding EU grants	32.0	32.1	32.5	32.9	32.3	30.9	30.5	31.1
Tax revenue	20.0	20.7	20.9	20.9	19.4	17.7	17.5	17.9
Direct taxes	9.0	9.6	9.3	9.3	7.1	6.4	5.9	6.3
Personal income tax	6.9	6.8	6.7	6.6	4.3	4.2	4.1	4.3
Corporate income tax	2.1	2.8	2.6	2.5	2.5	1.9	1.4	1.7
Other	0.0	0.0	0.0	0.3	0.3	0.3	0.4	0.4
Indirect taxes	11.0	11.1	11.6	11.5	12.6	11.6	11.8	11.8
VAT	7.0	7.5	8.0	7.9	8.1	7.0	7.1	7.1
Excises	2.9	2.9	2.9	3.0	3.5	3.7	3.7	3.7
Other	1.1	0.7	0.7	0.7	1.0	1.0	1.0	1.0
Social contributions	8.4	8.7	8.9	9.3	11.2	11.3	11.2	11.5
Grants	0.8	1.0	1.5	1.1	3.5	6.2	6.7	6.5
Other revenue	3.6	2.7	2.6	2.7	1.6	1.8	1.8	1.8
Total expenditure	33.3	33.6	34.9	37.2	37.8	46.1	44.4	40.6
Current spending	30.0	29.5	29.8	32.3	32.7	39.5	41.5	41.8
Compensation of employees	10.3	10.4	10.0	10.8	10.2	12.7	12.9	13.0
Goods and services	5.7	5.9	5.4	5.7	5.4	5.5	5.5	5.5
Interest payments	0.8	0.7	0.7	0.6	0.9	1.3	2.0	2.6
Foreign	0.5	0.5	0.4	0.4	0.6	0.8	1.3	1.6
Domestic	0.3	0.2	0.3	0.2	0.3	0.5	0.8	1.0
Subsidies	0.7	0.7	0.9	0.7	0.5	0.5	0.5	0.5
Grants	0.8	0.8	0.7	0.8	0.8	1.0	1.0	1.0
Social benefits	10.4	10.2	10.9	12.8	13.9	17.1	18.0	17.8
Other expense	1.4	0.8	1.2	1.0	1.1	1.4	1.4	1.4
Capital spending	3.3	4.1	5.2	5.0	5.1	6.6	6.9	5.8
Unidentified measures (cumulative deficit-reducing)	…	…	…	…	…	…	-4.0	-3.1
Net lending (+) / borrowing (-) 2/	-0.5	-0.4	-1.0	-3.2	-2.1	-9.1	-7.2	-3.0
Net acquisition of financial assets	0.6	0.5	0.9	-2.0	...	-0.8	1.2	0.0
Domestic	0.5	0.4	0.9	-1.8	...	0.0	1.2	0.0
Foreign	0.0	0.2	0.0	-0.1	...	-0.8	0.0	0.0
Net incurrence of liabilities	1.1	0.9	1.9	1.3	...	8.3	8.4	3.0
Domestic	0.1	-3.2	0.2	1.5	...	3.4	3.0	1.5
Foreign	0.9	4.0	1.8	-0.3	...	4.9	5.4	1.5
Identified financing	0.9	4.0	1.8	-0.3	...	4.9	2.5	1.5
Other budget support 3/	...	...	...	...	...	0.0	2.9	0.0
Memorandum items:								
GDP (in millions of litai)	72,060	82,793	98,139	111,499	114,766	88,976	83,713	87,040
General government debt	18.4	18.0	17.0	15.6	16.9	27.8	38.0	39.5
Foreign debt	11.1	12.3	11.4	10.0	...	17.4	23.9	24.5
Domestic debt	7.3	5.7	5.6	5.6	...	10.4	14.1	15.0
Privatization receipts (in millions of litai)	315	200	247	63	...	691	0	0
Net lending (+) / borrowing (-) net of pillar II transfer cuts 4/	-0.5	-0.4	-1.0	-3.2	…	-9.6	-7.8	-3.5

Sources: Ministry of Finance, Ministry of Social Security and Fund staff estimates.

1/ As presented in the 2008 Convergence Programme (approved in January 2009).
2/ For 2009, including 600ml litai in yet to be approved savings measures, worth an annual yield of 1.5bn litai in 2010/11 and already distributed in the appropriate line items. For 2010/11, also including yet to be approved unidentified savings measures worth 3.35bn and 2.7bn litai, respectively
3/ In the projection, unidentified financing.
4/ General government deficit including 0.55 percent of GDP not transferred by SODRA to private pension accounts in 2009-2011.

Table 7. Lithuania: Fiscal Impulse and Cyclically-Adjusted Balance, 2004–10
(in percent of GDP)

	2004	2005	2006	2007	2008	2009	2010
Revenue	31.8	32.8	33.1	33.9	34.0	37.0	37.2
Expenditure	33.3	33.3	33.6	34.9	37.2	46.1	44.4
Net lending (+)/borrowing (−)	-1.5	-0.5	-0.4	-1.0	-3.2	-9.1	-7.2
Cyclically adjusted net lending (+)/borrowing (−), IMF staff methodology 1/	-2.0	-1.5	-2.2	-4.0	-6.4	-6.1	-4.3
Cyclically adjusted net lending (+)/borrowing (−) net of pillar II transfer cuts 2/	-2.0	-1.5	-2.2	-4.0	-6.4	-6.6	-4.9
Demand impulse from fiscal operations	0.5	-0.5	0.7	1.8	2.4	-0.3	-1.8
EU funds	0.5	0.8	1.0	1.5	1.1	6.2	6.7
Demand impulse from EU funds	0.5	0.3	0.2	0.5	-0.4	5.1	0.5
Cyclically adjusted net lending (+)/borrowing (−): European Commission 3/	-1.9	-1.4	-1.9	-3.6	-6.0	-7.3	-5.0
Demand impulse from fiscal operations 3/	0.5	-0.5	0.6	1.7	2.4	1.3	-2.3
Cyclically adjusted net lending (+)/borrowing (−): European Commission/Bank of Lithuania 4/	-2.0	-1.5	-2.3	-4.2	-6.6	-6.9	-4.5
Demand impulse from fiscal operations 4/	0.5	-0.4	0.7	1.9	2.4	0.2	-2.4
Memorandum items:							
Output gap (in percent of potential GDP)	1.3	3.1	5.5	9.7	10.3	-6.7	-8.4

Sources: Statistics Lithuania; Ministry of Finance; and Fund staff estimates.

1/ Based on disaggregated elasticities for different revenue and expenditure components.
2/ Including 0.55 percent of GDP not transferred by SODRA to private pension accounts in 2009 and 2010.
3/ Based on the European Commission's aggregated approach and a budget sensitivity parameter of 0.27, estimated by the EC.
4/ Based on the European Commission's aggregated approach and a budget sensitivity parameter of 0.33, estimated by the Bank of Lithuania.

Annex I Table 1. Lithuania: External Debt Sustainability Framework, 2004–14

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
Baseline: External debt	43.0	51.3	60.6	72.5	71.6	88.4	96.0	95.4	93.1	90.5	87.6	-7.8
Change in external debt	1.5	8.2	9.3	12.0	-1.0	16.8	7.6	-0.6	-2.3	-2.6	-3.0	
Identified external debt-creating flows (4+8+9)	0.4	-2.2	-1.5	1.1	-2.4	9.2	-3.1	-7.0	-6.7	-5.3	-5.2	
Current account deficit, excluding interest payments	6.9	6.4	10.0	13.9	10.8	-1.6	-1.8	-1.0	-1.0	-0.1	1.1	
Deficit in balance of goods and services	7.0	7.2	10.3	13.4	10.5	2.0	2.3	2.6	2.8	3.2	3.5	
Exports	52.0	57.5	59.0	54.3	60.0	55.5	63.0	64.7	65.8	66.8	67.9	
Imports	59.0	64.7	69.3	67.8	70.5	57.5	65.3	67.2	68.6	69.9	71.4	
Net non-debt creating capital inflows (negative)	-3.5	-3.7	-5.5	-4.0	-5.3	-4.5	-6.4	-5.0	-4.5	-3.7	-4.3	
Automatic debt dynamics 1/	-3.0	-4.9	-6.0	-8.8	-7.9	15.3	5.1	-1.0	-1.2	-1.6	-2.0	
Contribution from nominal interest rate	0.8	0.7	0.6	0.7	0.8	1.0	1.7	2.0	2.0	1.9	1.8	
Contribution from real GDP growth	-2.8	-2.9	-3.5	-4.6	-1.9	14.3	3.5	-3.0	-3.2	-3.5	-3.8	
Contribution from price and exchange rate changes 2/	-1.0	-2.7	-3.1	-4.9	-6.8	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.1	10.4	10.8	10.9	1.4	7.6	10.8	6.3	4.5	2.7	2.2	
External debt-to-exports ratio (in percent)	82.7	89.2	102.7	133.5	119.3	159.2	152.3	147.5	141.6	135.6	128.9	
Gross external financing need (in billions of euros) 4/	8.0	8.8	14.3	19.3	16.9	17.0	14.6	14.5	15.9	16.7	16.5	
Percent of GDP	43.9	42.3	59.7	67.9	52.3	66.1	60.4	57.6	59.9	59.3	55.3	
Scenario with key variables at their historical averages 5/						88.4	90.7	90.9	90.1	88.0	85.5	-12.5
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	7.4	7.8	7.8	8.9	3.0	-16.0	-3.7	3.2	3.5	4.0	4.5	
GDP deflator in euros (change in percent)	2.5	6.6	6.5	8.8	10.3	-5.0	-2.3	0.8	1.7	1.8	1.8	
Nominal external interest rate (in percent)	2.1	1.8	1.4	1.4	1.2	1.1	1.8	2.2	2.2	2.2	2.2	
Growth of exports (euro terms, in percent)	12.0	27.0	17.9	9.2	25.4	-26.2	6.9	6.6	7.1	7.5	8.2	
Growth of imports (euro terms, in percent)	14.2	26.1	23.1	15.9	18.3	-34.9	6.8	7.0	7.4	8.0	8.7	
Current account balance, excluding interest payments	-6.9	-6.4	-10.0	-13.9	-10.8	1.6	1.8	1.0	1.0	0.1	-1.1	
Net non-debt creating capital inflows	3.5	3.7	5.5	4.0	5.3	4.5	6.4	5.0	4.5	3.7	4.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in euro terms, g = real GDP growth rate, ε = nominal appreciation (increase in euro 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

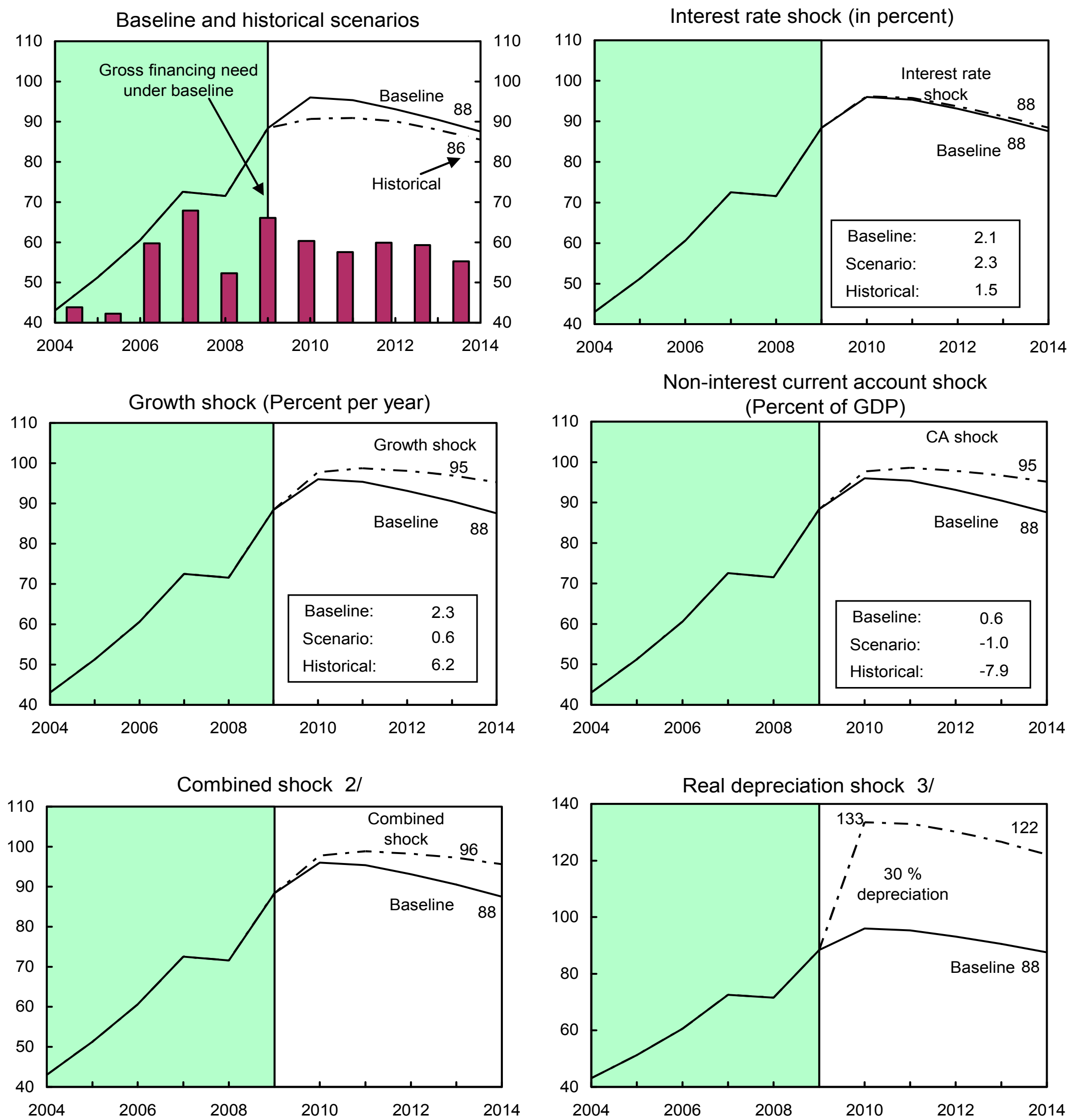
3/ For projection, line includes the impact of price and exchange rate changes.

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; euro 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, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex 1 Figure 1. Lithuania: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009.

Annex I Table 2. Lithuania: Public Sector Debt Sustainability Framework, 2004–14

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 10/
Baseline: Public sector debt 1/	19.4	18.5	18.0	17.0	15.6	27.8	38.0	39.5	39.8	40.4	40.5	0.1
o/w foreign-currency denominated	13.7	13.0	14.5	14.5	13.2	19.5	26.6	27.7	27.8	28.3	28.3	
Change in public sector debt	-1.7	-0.9	-0.4	-1.0	-1.4	12.2	10.2	1.5	0.2	0.6	0.1	
Identified debt-creating flows (4+7+12)	-1.2	0.1	-3.3	-3.4	0.3	12.8	10.2	1.5	0.2	0.6	0.1	
Primary deficit	0.6	-0.3	-0.3	0.3	2.6	7.8	5.2	0.4	-0.4	0.2	0.1	
Revenue and grants	31.8	32.8	33.1	33.9	34.0	37.0	37.2	37.6	37.7	36.8	36.9	
Primary (noninterest) expenditure	32.4	32.5	32.8	34.2	36.6	44.8	42.3	38.1	37.4	37.0	37.0	
Automatic debt dynamics 2/	-2.1	0.1	-2.8	-3.4	-2.3	5.2	3.8	1.1	0.6	0.3	0.0	
Contribution from interest rate/growth differential 3/	-1.0	-1.7	-1.7	-2.1	-1.4	5.2	3.8	1.1	0.6	0.3	0.0	
Of which contribution from real interest rate	0.4	-0.4	-0.4	-0.8	-0.9	2.1	2.7	2.3	1.9	1.9	1.7	
Of which contribution from real GDP growth	-1.4	-1.3	-1.3	-1.4	-0.5	3.1	1.1	-1.2	-1.3	-1.5	-1.7	
Contribution from exchange rate depreciation 4/	-1.1	1.8	-1.1	-1.3	-0.9	...	...	...	...	...	...	
Other identified debt-creating flows	0.3	0.3	-0.2	-0.3	-0.1	-0.2	1.2	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.7	-0.4	-0.2	-0.3	-0.1	-0.8	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	
Other (specify, e.g. bank recapitalization) 5/	1.0	0.7	0.0	0.0	0.0	0.6	1.2	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 6/	-0.6	-1.0	2.9	2.3	-1.7	-0.6	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	61.0	56.2	54.5	50.2	45.8	75.1	102.2	105.0	105.4	109.8	109.5	
Gross financing need 7/	8.2	3.9	4.3	3.4	5.7	13.8	13.8	7.9	7.3	8.6	5.6	
Billions of U.S. dollars	1.8	1.0	1.3	1.3	2.7	4.8	4.6	2.7	2.7	3.3	2.3	
Scenario with key variables at their historical averages 8/						27.8	29.1	29.3	29.4	29.5	29.6	-1.2
Scenario with no policy change (constant primary balance) in 2009–14						27.8	40.6	49.6	58.2	66.5	74.3	0.1
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	7.4	7.8	7.8	8.9	3.0	-16.0	-3.7	3.2	3.5	4.0	4.5	
Average nominal interest rate on public debt (in percent) 9/	4.9	4.8	4.6	4.6	4.3	6.5	6.9	7.0	6.9	6.8	6.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.3	-1.8	-2.0	-4.2	-6.0	11.5	9.2	6.3	5.2	5.0	4.6	
Nominal appreciation (increase in US dollar value of local currency, in percent)	9.0	-12.9	10.6	11.6	7.1	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.5	6.6	6.5	8.8	10.3	-5.0	-2.3	0.8	1.7	1.8	1.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	8.9	8.3	8.9	13.5	10.1	2.9	-9.1	-7.2	1.6	2.9	4.6	
Primary deficit	0.6	-0.3	-0.3	0.3	2.6	7.8	5.2	0.4	-0.4	0.2	0.1	

1/ General government gross debt.

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

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

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

5/ Includes staff estimates of the costs of bank restructuring.

6/ For projections, this line includes exchange rate changes, if applicable.

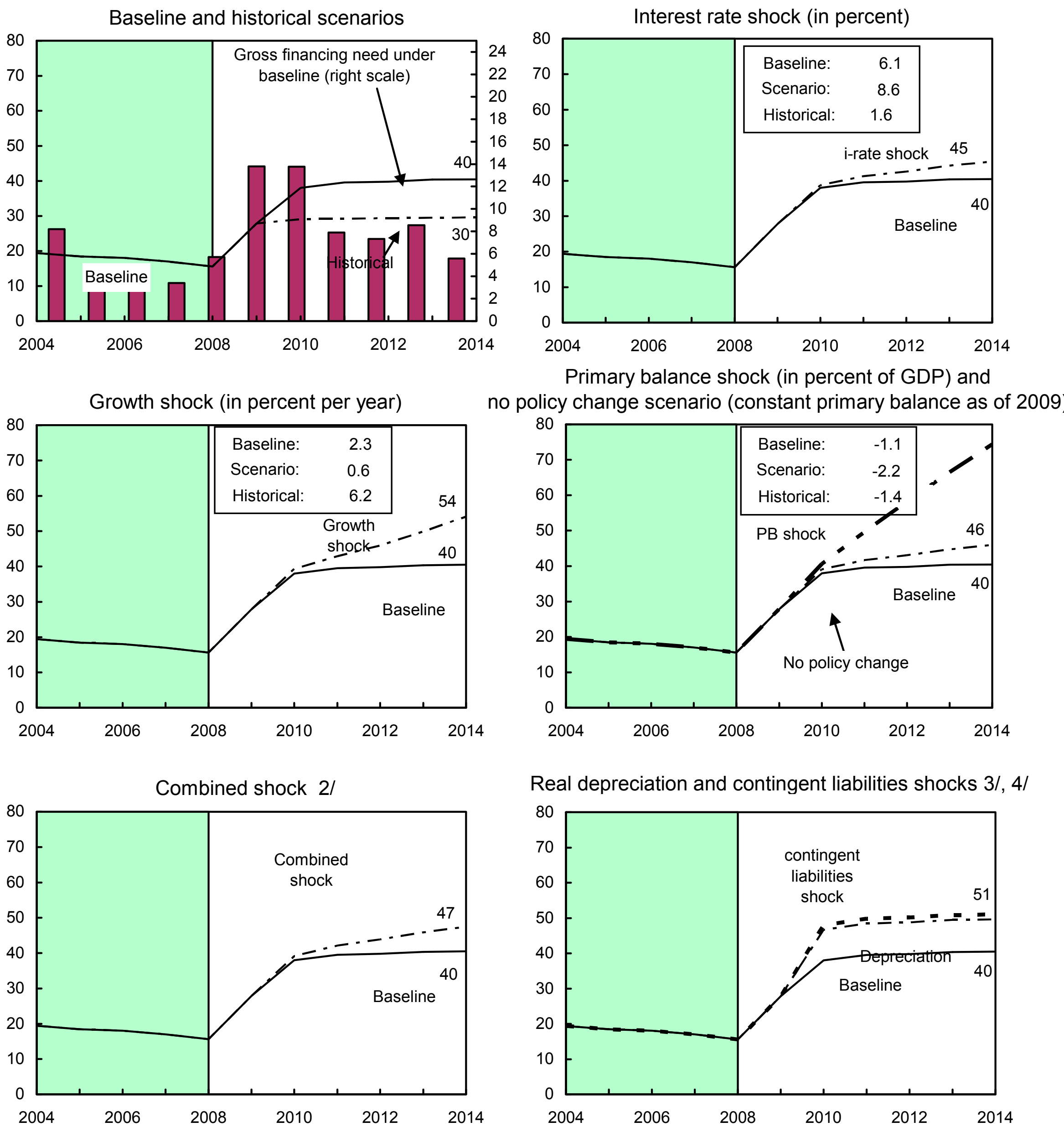
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

Annex Figure 2: Lithuania: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ 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).

4/ The one time shock of 10 percent realization of contingent liabilities is well above 4 percent of GDP, which is the estimated face value of the state guarantees (possible issue of new guanratees related to Financial Stability Law of up to LTL 3 billion, INVEGA guanrantees for SMEs and agricultural sector of up to LTL 450 and existing student loan guarantees of LTL 100 million).

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the European Department

July 23, 2009

Contents Page

Appendices

APPENDIX I. LITHUANIA: FUND RELATIONS
(As of June 30, 2009)

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

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

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

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

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

VI. Projected Payments to Fund: None

VII. Implementation of HIPC Initiative: Not applicable.

VIII. Implementation of MDRI Assistance: Not applicable.

IX. Current Status of Safeguards Assessments:

Under the Fund's safeguards assessment policy, 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.

X. Exchange Arrangements:

The currency of Lithuania is the litas. From April 1, 1994 to February 1, 2002, the litas was pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement. Since February 2, 2002 the litas has been pegged to the euro at LTL 3.4528 per euro. Lithuania joined the European Union (EU) on May 1, 2004, and ERM II on June 28, 2004. Lithuania has accepted the obligations of Article VIII of the Fund's 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).

XI. Article IV Consultation:

Lithuania is on the 12-month consultation cycle. The last Article IV consultation was concluded on April 16, 2008. The Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2008/pn0847.htm and the staff report and other mission documents at http://www.imf.org/external/pubs/cat/longres.cfm?sk=20625.0.

XII. 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.

XII. Technical Assistance:

The table on the following page summarizes the technical assistance missions provided by the Fund to Lithuania since 1998.

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

XIV. Anti-money laundering and combating financing of terrorism:

The money laundering prevention framework is based on the amended Law on the Prevention of Money Laundering and Terrorist Financing, Resolutions of the Government, and Prevention Guidelines for credit institutions confirmed by a Resolution of the Board of the Bank of Lithuania. In 2006, MONEYVAL evaluated Lithuania's AML/CFT framework and concluded that the system was quite sound while suggesting improvements in the implementation of AML/CFT measures. An amended Law on Prevention of Money Laundering and Terrorist Financing was adopted in January 2008. It transposes the Third Anti-Money Laundering and Terrorist Financing Directive 2005/60/EC and Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC and Regulation (EC) No 1781/2006 relating to information on the payer accompanying transfers of funds. It also incorporates the previous law's provisions that transpose Regulation (EC) No 1889/2005 on controls of cash entering or leaving the European Community as well as 40+9 FATF recommendations.

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1998–2009

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

APPENDIX II: LITHUANIA: WORLD BANK RELATIONS

Lithuania graduated from World Bank financing in Fall 2006, and became an IDA donor during the IDA 15 replenishment. The last Country Partnership Strategy (CPS) was launched at the time of Lithuania's accession to the EU in May 2004. The CPS supported capacity-building for the public sector, sustaining growth through an improved business environment as well as rural development, and reducing social vulnerability. All Bank-financed projects under the last CPS have closed. The last two closed in December 2008—the Klaipeda Port Project which enhanced the efficiency and safety of the Klaipeda port operations, and the Vilnius Heat Demand Management Project (GEF-financed) which contributed to reducing greenhouse gas emissions from the Vilnius District Heating system.

Following graduation, Lithuania maintained an active dialogue with the Bank and made use of the Bank's post-graduation TA which expired in fiscal 2009. The Bank provided technical assistance to the Government of Lithuania on strengthening support to rural regions to assist the implementation of the EU's rural development programs. More recently, the Lithuanian authorities requested use of Bank-financed technical assistance to assist the Ministry of Education and Science in producing and absorbing innovation, research and development to compete more effectively in the European market. Bank engagement has also included the development of a public private partnership framework as well as the development of the consumer protection and pension annuities being undertaken region-wide.

The Bank has recently launched two pieces of crisis-related analytical work with the Lithuanian authorities, which would underpin any future engagement. These are a public expenditure review and a financial sector vulnerability assessment.

Public Expenditure Review

A rapid-response public expenditure review focusing on social sectors and public administration was delivered in May 2009 to help the government in their preparation for the June 2009 budget amendment and beyond. The Public Expenditure Review (PER) looks at both short run fiscal consolidation measures as well as efficiency-enhancing reforms that could eventually generate fiscal savings and reduce the fiscal deficit over the medium term. In particular, in the context of increased social needs arising from the crisis, the report also tries to identify the changes needed in social assistance benefits to better protect the poor and vulnerable during the crisis and beyond in a cost-efficient way. The PER also analyses the public administration, the public wage bill and the civil service.

Financial Sector Vulnerability Assessment

The work was launched in June 2009 as a piece of sector work. This banking assessment sector work focuses on the overall credit portfolio and liquidity condition of banks as well as the regulatory framework and institutional measures and the role of bank supervisors including availability of discretionary (Pillar 2, Basel II) powers to mandate system-wide regulations to prevent sector deterioration. The study also examines corporate debt issues and reviews both the judicial and extra-judicial procedures for corporate debt restructuring and corporate bankruptcy processes, and assesses the viability of implementing efficient out-of-court procedures to facilitate sound debt restructuring frameworks.

APPENDIX III. LITHUANIA: STATISTICAL ISSUES

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 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 in the current volatile environment is proving very challenging, resulting in large published inventory changes. 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. A further update of the size of the informal sector as of 2008 is expected to be released in late 2010-early 2011.

Price Data

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

Public Finance

Data on the central government budget execution are available 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 and Financial 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.

External Sector

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

Dissemination of Statistics

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

- 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.lbank.lt/eng/statistic/index.html) provides data on monetary statistics, treasury bill auction results, balance of payments, IIP, external debt and other main economic indicators;

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

- the MoF (http://www.finmin.lt) home page includes data on the national budget, as well as information on laws and privatization; and government finance statistics (deficit, debt).
- NASDAQ OMX Baltic website (http://www.lt.omxgroupnasdaqomxbaltic.com./?lang=en) has includes information on stock trading at NASDAQ OMX Baltic stock Exchange in Vilnius (the former Vilnius Stock Exchange).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 09/104
FOR IMMEDIATE RELEASE
August 11, 2009

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

IMF Executive Board Concludes 2009 Article IV Consultation with the Republic of Lithuania

On August 7, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Lithuania.[1]

Background

The Lithuanian economy is undergoing a severe adjustment, after years of rapid economic growth and financial integration. With the global financial crisis, the unwinding of the imbalances accumulated during the boom has led to a sharp economic contraction. Capital inflows came to a halt in late 2008 and reversed in 2009, and the current account deficit turned into a surplus. GDP growth for the first half of the year has been provisionally assessed at -18.1 percent (y/y). Price and wage pressures have quickly abated with inflation going down to 4.2 percent as of June, and wages in the private sector are adjusting rapidly.

Government finances have come under considerable strain with the legacy of a sizable structural deficit built up during the boom and the sharp correction in economic activity. By end-2008, the cyclically adjusted balance had risen to 6½ percent of GDP, notably reflecting generous wage and social benefit increases.

As tax revenues contracted by 28 percent (y/y), the headline central government fiscal deficit widened to 4.6 percent of full-year GDP by end-May 2009. The general government debt

[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.

burden has risen from very low levels to 23 percent of GDP. The expansion of budget financing needs has been associated with shortening maturities and rising borrowing costs. Faced with a deterioration of the fiscal deficit and debt sustainability, the authorities have responded with a sizeable adjustment. The original budget together with the May and July 2009 supplementary budgets implemented a fiscal adjustment exceeding 7½ percent of GDP through a combination of spending cuts and tax increases but also a temporary reduction in transfers to the second pension pillar. Financial assistance from the European Investment Bank and a successful €500 million eurobond issue in June helped ease immediate fiscal financing needs, and the latter reopened access to international capital markets. The eurobond also helped to boost international reserves: by end-June international reserves stood at €4.45 billion, up from €4.2 billion end-May but still down from end-2008 levels. Although international reserves cover 145 percent of the central bank's total liabilities in domestic currency, they only cover 3 months of imports and about 46 percent of short-term debt (remaining maturity.

The banking system is in the midst of a pronounced credit contraction reflecting deteriorating asset quality, lower funding, and lack of credit demand. The stock of credit to the private sector has already declined by 4.1 percent in the first six months of 2009. The banking system remains well capitalized overall—with a capital adequacy ratio (CAR) at 13.9 percent as of Q1 2009—but the stock of non performing loans increased rapidly to 8.2 percent while loan loss provisioning increased, albeit, at a lower pace. In October 2008, a deposit run drained 6½ percent of total deposits and while liquidity has since stabilized, deposits have shifted increasingly into foreign currencies. The Bank of Lithuania (BoL) has reacted swiftly to these challenges. Since October 2008 it reduced reserve requirements from 6 to 4 percent to help ease liquidity pressures, and improved internal guidelines for lender of last resort operations (LoLR), while monitoring daily bank-by-bank deposits and liquidity positions. The deposit insurance limit was raised to €100,000 and bank resolution tools are also being enhanced through the Financial Stability Law, which provides for government guarantees of interbank lending, as well as public support for bank recapitalization and asset purchases. The government has also established a financial crisis preparedness committee to enhance coordination.

Executive Board Assessment

Executive Directors noted that the Lithuanian economy is undergoing a painful adjustment from overheating fueled by large capital inflows and expansionary fiscal policy. The reversal in capital flows following the global crisis has led to an unprecedented economic contraction with recovery expected to take hold only in 2011. Directors considered that uncertainty around the outlook remains but with downside risks.

Directors recognized the authorities' strong commitment to maintain the currency board arrangement, which has served as a useful macroeconomic anchor. They noted the staff's assessment that the real effective exchange rate is moderately overvalued, while acknowledging the uncertainties surrounding these estimates. Moreover, under the currency board arrangement, the adjustment burden falls directly on domestic policies, in particular sizable fiscal consolidation, and structural reforms to improve the functioning of labor and product markets. Policies to safeguard financial stability are also crucial.

Directors praised the sizable fiscal consolidation implemented since late-2008, including the recent supplementary budgets, and the medium-term fiscal consolidation plans. Notwithstanding the ongoing economic contraction and risks of exacerbating the downturn, they recognized that fiscal adjustment is necessary to offset past expansionary policies and underpin the credibility of the currency board arrangement and the authorities' Euro adoption strategy. Directors concurred that fiscal adjustment be achieved by front-loaded structural reform. Spending needs to be reduced to more affordable levels, primarily through wage and social benefit reform, and additional revenue measures need to be introduced, including broadening the tax base and improving compliance. Directors encouraged the targeting of social assistance programs to protect the most vulnerable, and considered that institutional reforms, such as multi-year budgeting, could also aid adjustment.

Directors observed that the banking system is well capitalized, but that liquidity and capital buffers could suffer in the recession. They commended steps taken by the authorities to respond to the crisis, including passage of the Financial Stability Law and the increase in the deposit guarantee. Noting the rise in non-performing loans, Directors advocated greater buffers in the financial system, including through accelerated loan-loss provisioning and preemptive increases in bank capital based on stress tests, as well as contingency planning. They encouraged the authorities to seek further explicit commitments from parent banks to provide necessary capital and liquidity support to their subsidiaries. Directors saw scope for closer supervision of banks with costlier funding profiles and the introduction of a purchase and assumption option to enhance bank resolution tools. They also encouraged the speedy restructuring of corporate and household debt to facilitate the recovery.

Directors saw the strength of the recovery and medium-term growth as hinging on improved competitiveness and reorientation of production towards tradables. Private sector wage adjustment, complemented by public wage reductions, is necessary to reduce costs economy-wide. Directors commended recent reforms to enhance labor market flexibility and reduce regulations. They called for further efforts to improve the business environment, including by reducing administrative burdens in business planning and land regulation, and through efficiency gains in the energy sector.

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.

Republic of Lithuania: Selected Economic Indicators

	2004	2005	2006	2007	2008
Real Economy	(In percent)				
Real GDP growth	7.4	7.8	7.8	8.9	3.0
CPI inflation, end of period	2.8	3.0	4.5	8.2	8.5
Unemployment rate (year average, in percent of labor force) 1/	11.4	8.3	5.6	4.3	5.8
Public Finance	(In percent of GDP)				
General government balance	-1.5	-0.5	-0.4	-1.0	-3.2
General government gross debt	19.4	18.5	18.0	17.0	15.6
Foreign currency-denominated public debt	13.7	13.0	14.5	14.5	13.2
Balance of Payments	(In percent of GDP, unless otherwise specified)				
Trade balance for goods	-10.6	-11.2	-14.0	-15.1	-11.6
Current account balance	-7.7	-7.1	-10.6	-14.6	-11.6
Gross official reserves (in billions of euros)	2.6	3.2	4.4	5.2	4.4
Exchange Rates	(Litai per U.S. dollar)				
Exchange rate (end of period)	2.5	2.9	2.6	2.4	2.5
Exchange rate (period average)	2.8	2.8	2.8	2.5	2.4
Money and Credit	(Year-on-year percent change)				
Reserve money	7.0	27.7	19.3	21.1	-1.4
Broad money	22.3	32.4	21.8	21.7	-0.4
Private sector credit	40.3	56.1	51.4	45.3	17.8

Sources: Lithuanian authorities; and IMF staff estimates.

LITHUANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE - AS OF JULY 9TH, 2009

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	July 9th, 09	July 9th, 09	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	June 09	July 7th, 09	M	M	M		
Reserve/Base Money	May 09	June 15th, 09	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	May 09	June 30th, 09	M	M	M		
Central Bank Balance Sheet	May 09	June 15th, 09	M	M	M		
Consolidated Balance Sheet of the Banking System	May 09	June 30th, 09	M	M	M		
Interest Rates[2]	July 9th, 09	July 9th, 09	M	M	M		
Consumer Price Index	June 09	July 9th, 09	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q1/09	June 26th, 09	Q	Q	Q	LO,LO,LO,O	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	May 09	June 30th, 09	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	May 09	June 30th, 09	M	M	M		
External Current Account Balance	Q1/09	June 30th, 09	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	April 09	June 12th, 09	M	M	M		
GDP/GNP	Q1/09	May 28th, 09	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q1/09	June 30th, 09	Q	Q	Q		
International Investment Position	Q1/09	June 30th, 09	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 discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

Statement by the IMF Staff Representative
August 7, 2009

1. This statement reports on key data releases and measures undertaken by the authorities since the staff report was issued. The new information does not alter the thrust of the staff appraisal.

Policy developments

2. **Parliament adopted a second revision to the 2009 budget on July 23**. The package comprises (i) on the tax side, an increase in the standard VAT rate from 19 to 21 percent effective September 1, an increase in the VAT rate for heating from 5 percent to 9 percent (albeit less than previously planned), and a decrease in diesel excise taxes; and, (ii) on the expenditure side, a cut of 5 percent cut in the basic wage of civil servants combined with progressive cuts in wage scale coefficients and bonuses, as well as a 8 percent reduction in teachers, police, and health workers' wages reflecting similar changes to that implemented for civil servants, with changes for both categories of worker effective through end-2010. A 10 percent cut in maternity and paternity benefits was also approved but subsequently vetoed by the President of the Republic given concerns about its implications on existing benefit recipients, although the reduction in the maternity allowance replacement rate for new recipients to 90 percent for the first year, and 75 percent for the second year from July 2010 onwards was cleared. As measures are being implemented later than previously expected and the yield from some is smaller than anticipated, the authorities' have reduced their estimate of the net savings from the package from the 0.7 percent of GDP noted in the staff report to 0.4 percent of GDP in 2009 (and from 1.7 to 1.2 percent of GDP annualized). On the basis of the GDP forecasts presented in the staff report, these savings would place the fiscal deficit in the range of about 9½ percent of GDP in 2009.

3. **Parliament also adopted the Financial Stability Law and an amended Deposit Insurance Law**. The former further strengthens the capacity of the government to speedily address potential problem banks, should the need arise, by providing the government the power to intervene a bank. However, due to constraints in Lithuania's legal framework, the new Financial Stability Law does not provide for more flexible alternatives such as the purchase and assumption of problem banks. A working group comprising government and Bank of Lithuania representatives has been created to facilitate the rapid formulation of the implementing regulations for this law. In addition, the law on deposit insurance was amended to render permanent the increase in deposit insurance up to €100 000—consistent with EU directives— and to shorten the compensation period for payments to depositors to a maximum of 20 business days from the day of the insured event.

Recent macroeconomic indicators

4. **Provisional flash GDP estimates for the second quarter revealed a deeper-than-expected contraction in economic activity.** For the second quarter, the flash estimate of headline GDP growth was assessed by Statistics Lithuania at -22.4 percent (y/y), a substantially higher contraction than anticipated by consensus and staff forecasts (the latter at -15.5 percent), while revisions to the first quarter GDP data were relatively minor.

5. **The flash GDP estimate underscores the downside risks to the forecasts in the staff report**. The depth of the decline in GDP was sharper than suggested by certain higher-frequency indicators which had which signaled a tentative stabilization of activity, albeit at a very weak level. Seasonally adjusted, industrial production had begun to move upwards on a month-on-month basis during the second quarter, and the same for retail sales on a year-on-year basis. Given the uncertainty surrounding the flash estimates—including the large role played by statistical discrepancies in driving the first quarter GDP outturn—and the fact that the components of GDP will only be available end-August, the growth projection presented in the staff report remains staff's most recent estimate. However, should the GDP flash estimates be confirmed, staff would reappraise its GDP growth forecast to be in the range of -20 percent for 2009, with a preliminary assessment suggesting a worsening in the general government deficit of at least of 1.0 percent of GDP for 2009 to around 10½ percent of GDP (9.1 percent of GDP in the staff report) and an increase in the 2010 financing need of about 1¾ percent of GDP.

6. **Recent monetary data point to continued tightening in monetary conditions while the recent eurobond issue helped boost international reserves.** End-June data show reserve money contracted by 14¾ percent (y/y) and broad money by 7.6 percent (y/y). By end-June 2009, international reserves stood at €4.45 billion, showing an improvement relative to end-May (€4.2 billion) and reflecting the impact of the €500 million eurobond issue.

7. **Reflecting the ongoing credit contraction, private sector credit growth decelerated to 1.5 percent year-on-year in June, from 17.8 percent as of end-2008.** Over the six months since December, credit to the private sector has decreased by 4.1 percent. The adjustment has been particularly sharp in household credit, with new loans extended falling by 55 percent (y/y). The share of foreign currency denominated loans and deposits has risen to 68 and 31.9 percent, respectively.

8. **Preliminary data show the half year central government deficit measured on a cash basis widened to 5.3 percent of staff's full-year GDP estimate, as the decline in revenue outpaced spending.** Tax revenues were down about 29 percent (y/y). Although spending in the first half was up by about 10 percent (y/y) in nominal terms relative to the same period in 2008, this in part reflects higher interest outlays, and base effects. Relative to the second half of 2008, spending excluding interest was down over 3 percent in nominal terms.