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REPUBLIC OF LITHUANIA

May 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF LITHUANIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with the Republic of Lithuania, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 13, 2016 consideration of the staff report that concluded the Article IV consultation with Republic of Lithuania.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 13, 2016, following discussions that ended on March 16, 2016, with the officials of the Republic of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 28, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of Lithuania.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
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May 18, 2016

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with the Republic of Lithuania

On May 13, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Lithuania.

Economic growth suffered a temporary setback from a difficult external environment last year. Private consumption and investment expanded strongly, but exports were stagnant, reflecting sluggish demand from trading partners, particularly Russia. GDP grew by only 1.6 percent, compared to an average of 3.5 percent per year during 2012–14. Wages rose strongly in a tightening labor market, but inflation was nonetheless slightly negative on account of declining energy and food prices. Investment benefitted from high capacity utilization and a revival of credit growth. Weak exports also meant that the current account balance moved from a surplus into a moderate deficit.

Growth should pick up to 2.7 percent this year as the drag from external developments diminishes. Domestic demand is set to remain solid—wage growth continues to be robust and there still is pent-up demand for investment. Demand growth from export partners should be somewhat higher than last year, with Russia's recession easing and its importance for Lithuanian exports already diminished. That said, risks remain tilted to the downside, reflecting the global risks to which Lithuania's small open economy is highly exposed.

Executive Board Assessment[2]

Executive Directors commended the authorities for the recent gains in macroeconomic management, which have helped Lithuania advance income convergence with Western Europe and weather a difficult external environment in 2015. While medium-term growth prospects are

[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.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

favorable, continued economic progress will hinge on structural reforms geared toward productivity enhancement, safeguarding competitiveness in a tightening labor market, and addressing high income inequality while preserving fiscal gains.

Directors welcomed the completion of the multi-year fiscal consolidation effort, with the structural fiscal position reaching balance in 2015. It will be important to preserve these hard-won gains and to build fiscal buffers while supporting growth. In this regard, Directors cautioned against new unfunded spending initiatives or tax cuts. On the revenue side, they called for efforts to strengthen tax administration.

Directors underscored the importance of continued productivity gains for a sustainable improvement in living standards. They welcomed the steps taken to improve the business environment and the authorities' intention to modernize labor relations in a new labor code. In particular, Directors emphasized the need to improve the employability of labor by boosting training, addressing labor market mismatches, and lowering the tax wedge for low-income earners. Innovation policies, with a key focus on company upgrading, would also be essential to raise long-run growth.

Directors agreed that external competiveness remains intact, but underscored the need for vigilance in view of emerging pressures. While boosting productivity is the priority, containing wage growth until these efforts bear fruit is also critical. In this context, Directors recommended a cautious approach in minimum wage policies given the potential negative impact on competitiveness. The sharp increases since 2012 have significantly narrowed the gap between minimum and average wages, which could harm employment prospects for the low-skilled. Directors also urged close monitoring of non-price competiveness given the recent stagnation in export market shares.

Directors considered high income inequality as weighing on macroeconomic prospects. They urged the authorities to push ahead with measures that serve the dual purposes of boosting growth and helping the disadvantaged, with an emphasis on measures to improve the employability of labor. Redistribution policies, in the form of a more progressive tax system and higher social spending could also be considered, to the extent they are consistent with social preferences. Directors considered the "new social model" to be a step in the right direction, while calling for careful consideration of its social and financial implications.

Directors acknowledged that the financial system is sound and welcomed the nascent credit recovery. They urged the authorities to continue cooperating closely with banks' home-country authorities, adopt quickly legislation to address weaknesses in the small credit union sector, and continue to support credit to SMEs.

Republic of Lithuania: Selected Economic Indicators (2013–17)

	2013	2014	2015	2016	2017
				Proj.	
Real Economy			(Percent)		
Real GDP growth	3.5	3.0	1.6	2.7	3.1
HICP, period average (annual percentage change)	1.2	0.2	-0.7	0.6	1.9
HICP, end of period	0.5	-0.1	-0.3	1.4	2.3
Unemployment rate (year average, in percent of labor force)	11.8	10.7	9.1	8.6	8.5
Public Finance			(Percent of GDP)		
General government balance	-2.6	-0.7	-0.2	-1.1	-0.9
General government gross debt	38.8	40.7	42.7	42.3	41.4
Foreign currency-denominated public debt	27.1	29.7	30.8	29.5	27.8
Balance of Payments			(Percent of GDP, unless otherwise specified)		
Current account balance	1.5	3.6	-1.7	-2.1	-2.6
Gross official reserves (in billions of euros)	5.9	7.2	..	..	..
Exchange Rates			(local currency per U.S. dollar, unless otherwise specified)		
Exchange rate (end of period)	0.90	0.81	0.92	..	..
Exchange rate (period average)	0.83	0.75	0.90	..	..
Real effective exchange rate (2005=100, increase=appreciation)	118.5	120.2	118.4	..	..
Money and Credit			(Year-on-year percent change)		
Reserve money	4.9	20.9	..	..	..
Broad money	4.4	1.2	..	..	..
Private sector credit	-2.3	-0.9	4.1	3.1	3.4

Sources: Lithuanian authorities; and IMF staff estimates.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

April 28, 2016

KEY ISSUES

Context and outlook. Thanks to sound macroeconomic management and an overall favorable business climate, income convergence with Western Europe is advancing. In 2015, sharply contracting exports to Russia temporarily dragged down growth. Ensuring good economic progress over the medium term requires continued productivity improvements, safeguarding competitiveness in a tightening labor market, and beginning to address high income inequality.

Key policy issues. The Article IV discussions focused on policies to support inclusive income convergence with Western Europe.

- **Productivity growth.** Advance structural reforms, with a focus on improving the employability of labor, company upgrading, and further improvements in the business environment.
- **Securing continued competitiveness in a tightening labor market.** Containing wage pressures is critical for preserving price competitiveness in the near term. Minimum wage hikes should be paused for now, following large increases since 2012.
- **Protecting fiscal gains.** Thanks to a multi-year effort, the fiscal deficit has declined by almost 10 ppt of GDP to close to balance in 2015. Going forward, the structural deficit should be capped at ½ percent of GDP to ensure the gradual rebuilding of fiscal buffers.
- **Improving equity.** The initial focus should be on dual-purpose measures that redress income inequality, but also boost growth. Redistributive tax and expenditure measures should also be put on the agenda to strengthen economic opportunities for all.

Approved By
Philip Gerson and Steven Barnett

Discussions were held in Vilnius during March 3–16, 2016. The team comprised Mr. Klingen (head), Mr. Ioannou, Mr. Gudmundsson, and Ms. Raei (all EUR). Mr. Bartkus (OED) joined the mission. A conference call with SSM supervisory authorities was conducted in Vilnius, jointly with Bank of Lithuania representatives. Ms. Nicoletta Batini (EUR) supported the mission from headquarters. Ms. Nguyen provided research assistance.

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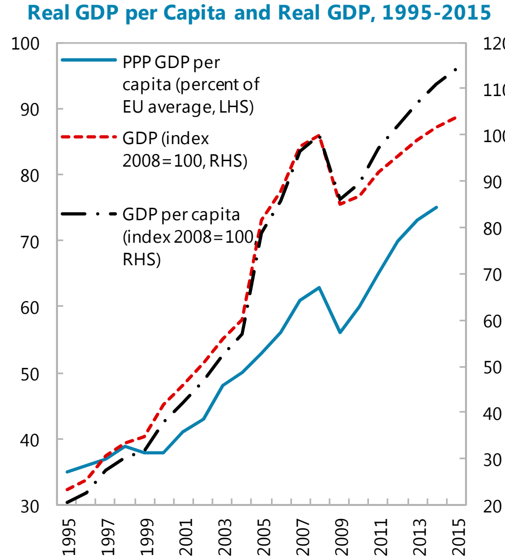
CONTEXT

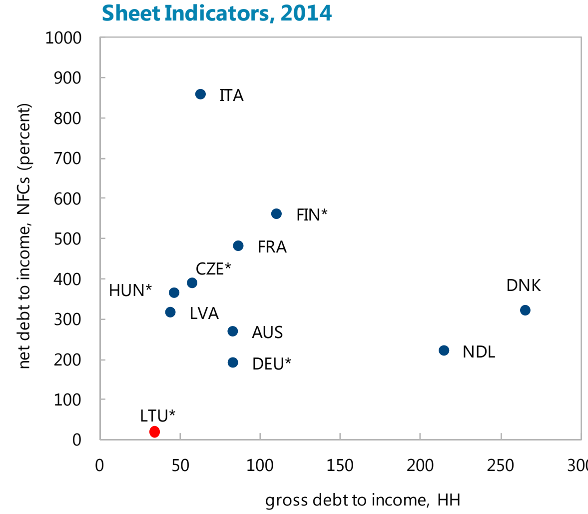
1. **Good policies and favorable business conditions have helped put Lithuania back on the convergence path with Western European living standards.** After the setback from the 2008/09 crisis, Lithuania's per capita income is advancing solidly again, reaching 75 percent of the EU average in PPP terms. But the income gap narrowed within a context of slower GDP growth in both Lithuania and the EU, breeding some discontent amongst low-wage earners and spurring emigration. Years of fiscal consolidation, financial deleveraging, and policy upgrades led to strong public and private balance sheets, and underpin internal and external balance. The financial sector is comfortably capitalized, debt servicing burdens of households, and companies are low, and public debt is relatively small (42.7 percent of GDP). Unemployment is close to its historical average (9.1 percent), core inflation is low (1.9 percent), and the current account deficit is moderate (1.7 percent of GDP). Euro area membership since 2015 has reinforced stability further.

Real GDP per Capita and Real GDP, 1995-2015



Sources: Eurostat and IMF staff calculations.

Household and Nonfinancial Corporate Balance Sheet Indicators, 2014



Source: Eurostat.
*Denotes 2013 data for net debt to income for NFCs.

2. **The main policy challenge remains to step up the advancement of living standards, while ensuring that benefits are broadly shared throughout society.** In addition to maintaining sound macroeconomic conditions, this requires pushing ahead with a comprehensive supply-side reform agenda to support productivity, protecting competitiveness in the face of mounting wage pressures, and improving economic opportunities and outcomes for all.

3. **Many reform elements are in train or under consideration, but the definition and implementation of a comprehensive package of measures will likely have to await the appointment of a new government after the elections in October.** The current administration led by the Social Democrats is focused on getting new labor legislation, along with adjustments to social benefits and pensions, through Parliament and containing populist pressures. Many of the

required reforms will be multi-year endeavors and will thus more likely need to be considered by the government that will take office in December.

RECENT DEVELOPMENTS

4. **Last year, growth took a temporary hit from the difficult external environment.** It fell to 1.6 percent, less than half its 2010–14 average. Exports to Russia contracted by some 40 percent, due to ruble depreciation, recession, and sanctions on selected EU exports—a shock of over 1½ percent of GDP, which was somewhat alleviated by export reorientation, primarily in the transport sector. Economic growth was driven by a 4.9 percent expansion of private consumption on the back of favorable wage developments and 10 percent higher investment, reflecting elevated capacity utilization, and a spike in EU-funds utilization. The labor market tightened, with unemployment falling nearly to its structural level and real wages advancing by 5.5 percent.

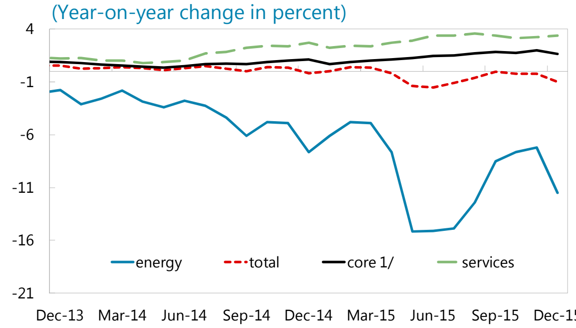
Impact of Lower Exports to Russia on GDP

	Nominal Growth	Real Growth (percent)	Share in GDP (percent)	Impact on GDP growth (ppts)
Impact in 2015 (a+b)				**-1.4**
Impact of shock (a)				**-1.6**
Exports of goods and services to Russia	-37	-33	17.2	
Exports of goods	-38	-34	13.9	
Goods of Lithuanian origin	-47	-43	1.6	**-0.7**
O/w under sanctions	-89	-85	0.4	-0.4
Exports of services	-32	-28	3.3	**-0.9**
Impact of export reorientation efforts (b) 1/				**0.3**
Impact in 2016 2/				**-0.4**
Goods of Lithuanian origin		-18	0.8	-0.2
Exports of services		-11	2.2	-0.3

Sources: Statistics Lithuania; Bank of Lithuania; and IMF staff calculations.
1/ Impact of efforts to reoriented the exports of transport services and goods of Lithuania origin to countries other than Russia are estimated from the difference between the actual growth rate in such exports and the expected growth rate implied by the decline of exports to Russia.
2/ The projected growth rates of Lithuanian exports to Russia are based on projections of Russian's import growth in 2016.

5. **External factors caused the price level to fall in 2015, but deflation is unlikely to take root.** The fall in global energy prices pushed down fuel and heating prices. And food prices, which had modestly contributed to inflation in 2014, were flat, partly due to excess supply related to Russia's embargo on many food imports. This improved consumers' purchasing power by an estimated 2 percent. While headline inflation fell to -0.7 percent, core inflation picked up to 1.9 percent as strong wage growth drove up services prices. With no signs of wages decelerating and balance sheets strong, the emergence of entrenched domestic deflationary dynamics remains only a remote possibility.

Inflation and Major Inflation Components
(Year-on-year change in percent)



Sources: Haver; and IMF staff calculations.
1/ Core excludes energy, food, alcohol, and tobacco.

6. **The external current account moved into moderate deficit in 2015 due to weak export markets and strong domestic demand.** Plummeting exports to Russia, as well as to the CIS more generally, and imports buoyed by strong machinery and equipment investment made for the first trade deficit in several years despite improving terms of trade. The income account also

deteriorated because of higher profits of foreign-owned companies and lower remittances. But thanks to the inflow of EU-funds, the capital account surplus more than fully covered the deficit in the current account. Accordingly, the Net International Investment Position improved somewhat to -45 percent of GDP.[1] The external balance assessment finds Lithuania's current account and exchange rate to be broadly aligned with fundamentals (Box 1).

7. **The fiscal deficit declined further last year, reaching structural balance and undershooting for the first time the level of ½ percent of GDP for the structural deficit long advocated by staff.** Despite the economic slowdown, the headline fiscal deficit declined from 0.7 percent of GDP in 2014 to 0.2 percent of GDP, about one percentage point of GDP less than planned in the budget. The revenue-friendly growth composition—key tax bases such as wage income and retail sales grew much faster than GDP—together with incipient results from better tax administration were chiefly responsible. Correcting for one-off and cyclical effects suggests a negative fiscal impulse of ¾ percent of GDP. But, on the other hand, the government's prefinancing of European Structural and Investment Funds for the private sector provided a sizable boost to the economy, which is not captured by fiscal stance and impulse calculations. Financing conditions continued to be favorable with spreads on long-term government bonds vis-à-vis Germany narrowing to less than 50 bps.

8. **Lithuania's largely Nordic-owned financial system is stable.** The CAR rose to 24.8 percent, the NPL ratio declined to 5.5 percent, the loan-to-deposit ratio has been halved since its 2008 peak, falling to 100 percent, and net parent bank funding is down to less than 4 percent of GDP. Thanks to cost-cutting measures, bank profitability has so far proven resilient despite revenue losses from euro adoption and negative interest rates, although performance varies across financial institutions. Recent capital injections into smaller domestic banks are welcome, but close monitoring of these institutions remains important. Measures to contain weaknesses in the small credit union sector are in place, but more fundamental reform still awaits parliamentary approval.

9. **Credit growth is resuming at a moderate pace.** For the first time since the 2008/09 crisis, private-sector credit growth moved convincingly back into positive territory, reaching 4.1 percent last year. A pickup in credit demand and strong borrower balance sheets rather than a material loosening of credit standards were responsible. Higher credit growth in support of investment is welcome, but lending is not typically reaching SMEs, where forays of banks remain exploratory. Continued support through government sponsored schemes using EU funds to improve SMEs' access to financing, remains therefore important. With credit growth moderate, real housing prices some 30 percent below their 2008 peak, and low financial depth, there is no evidence of imminent financial risks emerging. Were they to do so, a comprehensive macroprudential toolkit in now in place to address them. To maximize its traction, cooperation with banks' home-country authorities needs to be strong. It might take coordinated moral suasion to address run-away consumer loans

[1] Gross external debt would have also fallen in 2015 had it not been for accounting operations related to euro adoption that added some 10 percent of GDP in Bank of Lithuania external debt.

when banks are overcapitalized. Support from home-country authorities is also critical in the case of cross-border loans to corporates.

Box 1. External Sector Assessment

A moderate current account deficit of around 2½ percent of GDP seems appropriate for the medium term. After registering mostly surpluses during the adjustment period following the 2008/09 crisis, the current account moved to a deficit of 1.7 percent of GDP last year, as a result of collapsing Russian import demand. While ongoing trade diversification should erase most of this effect over time, other forces point to a widening of the external deficit. In particular, investment should rise as the recovery from the compressed post-crisis levels fully unwinds. However, current account deterioration must not go too far. Reasonable savings are required ahead of demographic aging and large EU funds will eventually run out. Elevated external debt (75 percent of GDP) and a sizable negative Net International Investment Position (-45 percent of GDP) also need to be taken into account, even though relatively large FDI and inter-company loan components mean that there are no immediate external stability concerns.

The exchange rate appears to be broadly in line with fundamentals. Direct estimation of the REER, through the Equilibrium Real Exchange Rate approach (ERER) indicates that Lithuania's REER is close to equilibrium, marginally overvalued at 3 percent. The External Sustainability Approach (ES) shows that compared to the current account that would stabilize Lithuania's net foreign asset position (-3.3 percent of GDP), the actual current account is somewhat better and the exchange rate is slightly undervalued by 2.6 percent.

The EBA-lite methodology indicates that Lithuania's policies are broadly appropriate, but finds a moderate real exchange rate undervaluation. The current account norm is estimated as -4.3 percent of GDP—a larger deficit than the -1.7 percent of GDP recorded for 2015. This result should be interpreted with caution. The estimation does not take into account the current period of relatively low investment to compensate for the excesses of the boom years up to 2008 and the need to save ahead of one of the largest demographic challenges in Europe.

Summary Table

CA-Actual	-1.7%	CA-Fitted	-3.6%
CA-Norm	-4.3%	Residual	1.9%
CA-Gap	2.6%	Policy gap	0.7%
Elasticity	-63.2%		0.0%
Real Exchange Rate Gap	-4.1%	Cyclical Contributions	0.1%
		Cyclically adjusted CA	-1.8%
		Cyclically adjusted CA Norm	-4.4%

OUTLOOK AND RISKS

10. With external drag diminishing, the near term outlook is favorable. Growth is projected to be domestic demand driven again and to rise to 2.7 percent this year. Consumption should benefit from solid wage growth and declining energy prices. Pent-up demand, high capacity utilization, and low interest rates should spur investment. In contrast to last year, the drag from weak exports to Russia is set to be smaller, with Russia's recession projected to ease and its importance as an export market already diminished. High frequency indicators for the first few months of 2016 also point to a growth pickup. Consumer inflation is projected to rise to 0.6 percent as the decline of import prices lessens. With imports growing faster than exports, the external current account will deteriorate somewhat.

11. Growth could climb to some 3½ percent over the medium run.[2] This would still be about 1 percentage point below the historical trend on account of worsening demographics and the narrower income gap relative to the global economic frontier. Still, these medium-term projections assume continued structural reforms supporting productivity and human capital development, as well as measures to safeguard competitiveness. As the output gap narrows and commodity prices begin to recover, inflation should rise and run again at a small premium over the euro area target of 2 percent, reflecting Balassa-Samuelson effects.[3] As a catching-up country, Lithuania is expected to run a moderate current account deficit.

12. Downside risks to the outlook dominate and mostly relate to external factors. Adverse developments in the global economy would spill over primarily through trade channels. Volatile financial conditions abroad could reach Lithuania indirectly via the foreign banks that dominate its financial system, curtailing credit supply. Regarding home grown risks, wage growth in excess of productivity gains could undermine external competitiveness going forward. On the upside, improving domestic prospects could trigger increased reverse migration, setting a virtuous circle of demand, productivity, and employment growth in motion.

13. The authorities broadly shared staff's views on the outlook and risks. The authorities were marginally more cautious about the prospects for a quick recovery this year. Like staff, they saw medium-term growth somewhat above 3 percent. As downside risks they highlighted developments in the euro area and Russia, as well as in China, which could affect Lithuania through third countries. But they also saw a fair amount of upside risk, including faster progress on trade diversification, bigger payoffs from current reforms, a jolt from the Juncker plan, and still lower energy prices. Because of energy prices, inflation could undershoot projections. Neither European supervisors nor the national competent authorities saw immediate risks to financial stability from spillovers of potential financial volatility abroad through the cross-border banks, pointing to healthy capitalization, ample liquidity, and much reduced parent bank funding. Potential risks to competitiveness are on the authorities' radar screen, but to some extent high wage growth is the natural outcome of labor market tightness, underscoring the need to boost productivity.

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[2] See "How Fast Can the Baltics Grow in the Medium Term?" in: IMF Country Report No. 11/327.

[3] See "Inflation in Lithuania: Track-Record and Prospects," in: IMF Country Report No. 14/114.

Republic of Lithuania: Risk Assessment Matrix			
Source of Risks	**Time Horizon**	**Impact if Realized**	**Policy Recommendations Mitigation/Response**
Medium **Tighter or more volatile global financial conditions:** • **Sharp asset price decline and decompression of credit spreads** as investors reassess underlying risk and respond to unanticipated changes in growth and financial fundamentals in large economies, Fed policy rate path, and increases in U.S. term premia, with poor market liquidity amplifying volatility.	**Short Term**	Low/Medium Direct exposure to global financial markets is limited, but potentially reduced access to funding of Nordic parent banks would lead to tighter lending conditions in their Lithuanian subsidiaries. Investment in Lithuania would suffer.	Euro area monetary policy would be the first line of defense. If needed, activate resolution and restructuring plans in coordination with home-country authorities.
Sharper-than-expected global growth slowdown: Medium • **Significant slowdown in other large EMs.** Turning of the credit cycle and fallout from excess household and corporate leverage (incl. in FX) as investors withdraw from EM corporate debt, generating disorderly deleveraging, with potential spillbacks to advanced economies. High/Medium • **Structurally weak growth in key advanced and emerging economies.** Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and persisting financial imbalances in the Euro area and Japan (high likelihood). Easy global financial conditions coming to an end and insufficient reform progress undermine medium-term growth in emerging markets and suppress commodity prices (medium likelihood).	**Short Term** **Medium Term**	High As a small open economy, Lithuania would be strongly affected through trade channels, with potential knock on effects for investment. A worse-than-expected performance in the euro area or the CIS would be particularly damaging.	Reinforce efforts to diversify exports. Coordinate policy response at the European level. Allow automatic stabilizers to operate. Allow discretionary easing of fiscal policy if the shock is large.
High **Dislocation in capital and labor flows:** • **Heightened risk of fragmentation/security dislocation mainly in part of Europe,** with negative global spillovers.	**Short Term**	Low/Medium Prolongation of Russia/Ukraine conflict would heighten risk aversion, weigh on investment, and depress transit trade services with Russia. Lithuania is not overly reliant on capital inflow or exposed to labor inflows.	Allow automatic stabilizers to operate. Allow discretionary easing of fiscal policy if the shock is large. Reassure investors of Lithuania's solid fundamentals.
Medium **Risks to competitiveness:** • Wage growth continues to significantly outstrip productivity growth for an extended period. • Emigration and aging create labor shortages, push up wages, and hamper productivity growth.	**Short to Medium Term**	High Income convergence, employment, and potential growth would suffer.	Pause minimum wage hikes as necessary. Boost productivity growth through structural reforms. Improve employability of labor and ease restrictions on non-EU immigration.

POLICY DISCUSSIONS

The overriding objective for Lithuania is to raise living standards through income convergence with Western Europe. In this context, the discussions focused on three main issues: (i) raising productivity growth through structural reforms; (ii) securing continued competitiveness as the labor market tightens; and (iii) going beyond structural policies to reduce income inequality through fiscal measures while maintaining a prudent policy stance. The authorities carefully consider all Fund analysis and advice at the highest political level, and have implemented many past recommendations (Box 2).

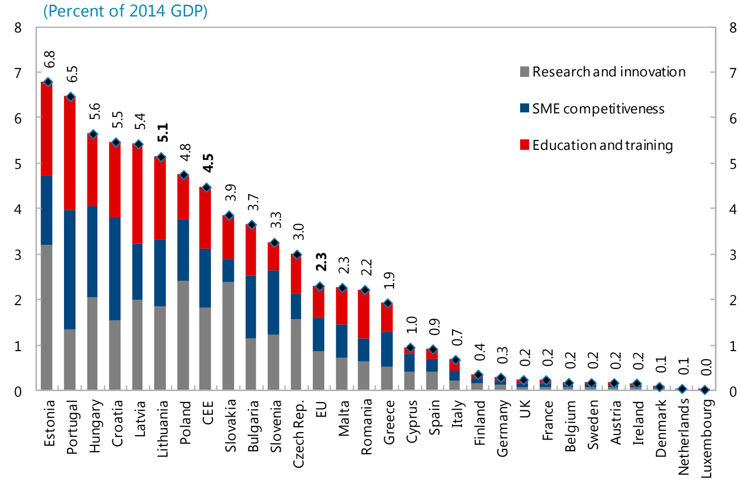
Box 2. Implementation of Past Fund Advice

- **Fiscal policy.** Fund advice focused on repairing public finances following the setback from the 2008/09 crisis. The authorities successfully reduced the deficit to a level consistent with the gradual restoration of fiscal buffers. They are increasingly pushing ahead with recommended tax administration reform. Calls for rebalancing taxation from labor to capital and improved spending quality have resonated, but action is still at an early stage due to the complexity of such reforms.
- **Structural reforms.** The authorities implemented a comprehensive list of recommended improvements to the business environment over the years. The long advocated overhaul of labor legislation is now underway. The authorities appreciated the Fund highlighting deficiencies in education, health care, and innovation policies, but related reforms are longer term in nature and mostly still at an early stage.
- **Financial sector policy.** The authorities and the Fund saw eye to eye regarding the need to improve oversight and macroprudential policies after the crisis. Related reforms have been implemented. There is also consensus on credit union reform, which is now under discussion in parliament.

A. Raising Productivity through Structural Reforms

14. Boosting productivity is a key to sustainably raise living standards, and policies should be framed in a coherent package to leverage impact. Total factor productivity growth averaged 3½ percent per year since 1995, but has been much slower recently. The authorities have rightly earmarked a large share of EU funds for corrective policies—equivalent to over 5 percent of GDP over seven years. Reforms fall into three broad categories, but should be assembled into a credible reform package to clearly communicate the way forward.

EU Countries: Pro-growth ESIF Spending, 2014-20[1/]
(Percent of 2014 GDP)



1/ Spending on thematic objectives 1 (research and innovation), 3 (SME competitiveness), and 10 (eductaion and training).
Sources: European Commission (https://cohesiondata.ec.europa.eu/); and IMF staff calculations.

15. There is room to improve the employability of labor. Upgrading skills, right grading skills, and lowering the tax wedge would help reduce still high structural unemployment, foster efficient use of talent, and combat the shadow economy.[4,5] Productivity would rise and economic opportunities would improve, especially for currently disadvantage parts of society.

- *Upgrading skills*. Resources devoted to active labor market programs (ALMPs) are less than half the EU average and seven times less than in leading Denmark. There is accordingly ample scope to ramp up spending while ensuring quality, and coverage should be extended to include those at risk of job loss. A program for life-long learning would be a valuable preventative complement.

- *Right grading skills*. Lithuania's tertiary education attainment rate (56 percent) is the highest in the EU, yet skill shortages are a key concern for employers. Chosen fields of study do not accord well with labor market needs and vocational training is underdeveloped. Building on the recently launched "job barometer," mandatory orientation for students that are provided government-paid study places could be considered. Government should also review the mix of the study places that it pays for to ensure value-for-money. The profile of vocational training should be raised and made less school-based.

- *Reducing the tax wedge*. The personal income tax rate of 15 percent seems low, but applies to all income above the basic allowance rather than being phased in. More importantly, social security contributions run at some 40 percent and apply from the first euro earned. Incentives for low-wage earners to go informal are accordingly high. There is also a risk of benefit traps even at modest benefit levels. A basic allowance for social security contributions could be considered. Phasing it out as incomes rise would contain its fiscal costs.

16. Company upgrading is instrumental for improved productivity. Lithuania ranks poorly on innovation indicators, occupying the forth place from the bottom on the European Innovation Score Board. The fragmentation of the innovation system and excessive emphasis on physical infrastructure needs addressing. More cross-border clusters and competence centers promise efficiency gains. Above all, more focus should be put on the promotion of more sophisticated products, better processes, better branding and marketing, new markets, etc. rather than on scientific breakthroughs that are difficult to commercialize. While supporting programs are already in place, these remain limited in size and scope.

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[4] Structural unemployment was estimated as close to the double digits. See "Unemployment in the Baltics," IMF Country Report No. 14/117.

[5] Estimates of the share of the shadow economy vary between 13 and 26 percent. See "Shadow Economy Index for the Baltic Countries 2009–14," The Centre for Sustainable Business at SSE Riga, 2015; and F. Schneider, 2015, "Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015: Different Developments," respectively. Around the world, informal players are found to operate at just half the average productivity level of formal companies in the same sector. See D. Farrell, 2004, "The Hidden Dangers of the Informal Economy," McKinsey Quarterly, June 2004.

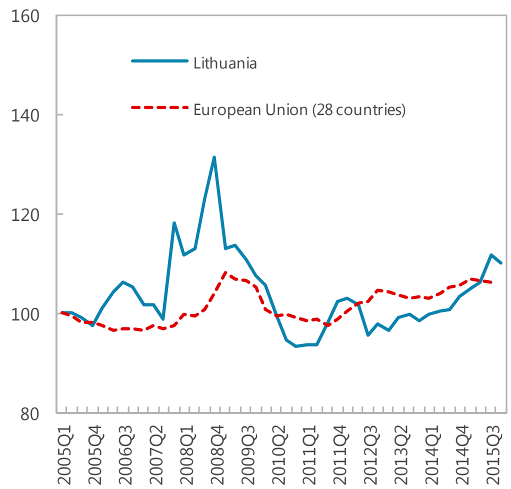
17. Lithuania's favorable business climate can be further improved. Lithuania ranks 20 out of 189 countries in the Doing Business Report's assessment of regulatory quality and efficiency—second only to Estonia in Central and Eastern Europe (CEE). An important remaining shortcoming is the outmoded labor code, which deters job creation and FDI. The new labor code proposed as part of the "New Social Model" currently before parliament is welcome. It would modernize labor relations. Key features include an up-to-date set of contracts; shorter notice periods and less severance pay; more wage transparency; better labor representation in firms; and more training opportunities. But the original proposal should not be unduly diluted—the establishment of a payroll tax financed severance pay fund would be counterproductive, considering Lithuania's already high labor tax wedge. Other areas for improvement in the business environment are bankruptcy procedures, which are lengthy with low recovery rates, and tight restrictions on immigration from non-EU countries. Government proposals for accelerated procedures to grant temporary resident permits for applicants with desirable occupations are welcome. "Labor market tests" could be dropped altogether for those with pertinent skills.

18. The authorities strongly agreed with staff's diagnoses and the thrust of the proposed reforms, but also underscored the complexity of the task. They were keenly aware that the education system must be better geared toward labor market needs. Some reforms are already in train, such as new curriculums in vocational training and initiation of apprentice programs, and, in higher education, better connected universities and streamlined study programs. But the reform process is complex because of the multitude of stakeholders that need to be brought on board. Passage of the new labor code is a key priority. The authorities took note with interest of the idea to introduce a basic social security contribution allowance, although a recent constitutional court ruling to make social security more insurance-based complicated matters. They saw the economic merits of streamlined bankruptcy procedures and more liberal rules for immigration from non-EU countries, but both issues were politically and socially sensitive.

B. Securing Continued Competitiveness in a Tightening Labor Market

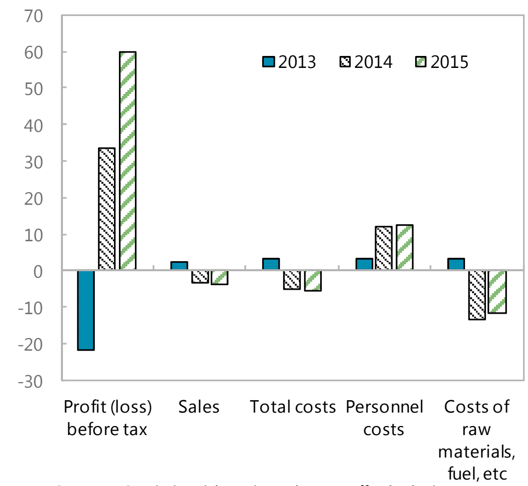
19. Price competitiveness remains intact for now, but will come under pressure on current wage and productivity trends. Because of fast wage growth and modest productivity gains in recent years, unit labor costs (ULCs) have risen much faster than in the EU. In the tradable sector, a cushion had built up in the post-crisis adjustment period when wages fell and productivity soared. Moreover, company profits recently received a windfall from lower input prices for raw materials, helping offset sharply higher wage costs. But these cushions now appear to have been largely exhausted, putting future price competitiveness at risk unless wage growth decelerates and productivity growth picks up substantially.

Manufacturing: Unit Labor Costs
(2005Q1=100)



Sources: Eurostat and IMF staff calculations.

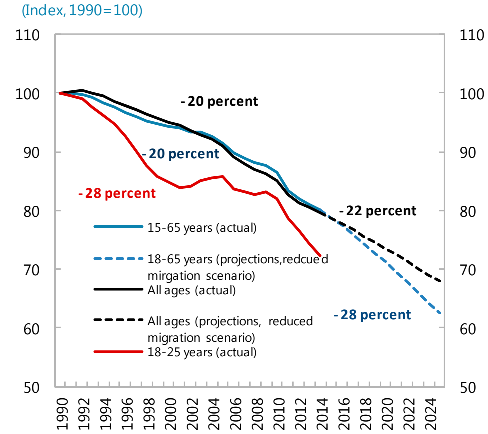
Manufacturing Sector: Profits, Sales and Costs of Companies
(Percent change)



Sources: Statistics Lithuania and IMF staff calculations.
Manufacruring sector excludes petrolum products.

20. Wage pressures could persist over the medium term. With much smaller cohorts born in the post-Soviet period entering the labor market, competition among employers for suitable workers is bound to remain intense, pushing up wages. On the other hand, recent fast real wage growth could also to some extent be the result of downward inflation surprises, meaning that real wages would decelerate when inflation picks up. Fortunately, Lithuania's labor market appears historically to have worked well, with wage and productivity developments aligned over longer periods, self-correcting transitory deviations.[6]

Population and Working Age Population, 1990-2025
(Index, 1990=100)



Source: Eurostat. Reduced migration scenario assumes 28,000 net emigrations per year through 2025. This is close to the historical average of 25,000.

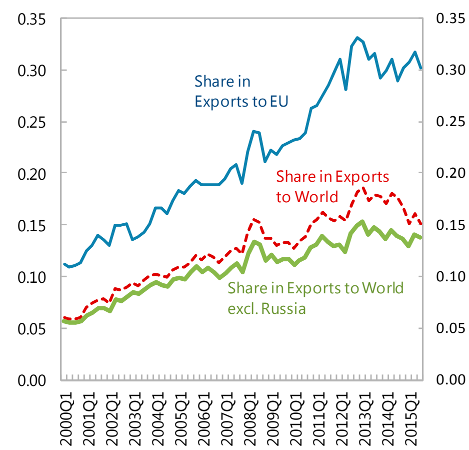
21. At this juncture, minimum wage increases should be paused following their sharp hikes in the past few years so as not to further fuel broader wage growth. Successive hikes since August 2012 have lifted the minimum wage by over 50 percent and it now stands at 47 percent of the average wage. A further increase for mid-2016 is under discussion. While wages in Lithuania are largely market determined, the government sets the minimum wage after non-binding tripartite consultations. Historically, a minimum wage hike of 10 percent has tended to push up overall wages by 3 percent. With the minimum wage incidence now significantly higher than in the past, this pass-through has likely increased. With wage growth already problematic from a competitiveness point of view, this is not the time for forceful minimum wage policies. Moreover, the level of the minimum wage relative to average wages is now unusually high by international

[6] See "It Takes Two to Tango: Wage and Productivity in Lithuania," IMF Country Report No. 15/139.

standards. Adverse effects on job opportunities, especially for marginal workers, are likely much stronger than historical experience would suggest. In general, economic considerations need to come into starker focus in minimum wage setting, while the limitations of minimum wages in addressing income inequality concerns need to be recognized. This could be achieved by depoliticizing the process and giving independent experts a formal role.

22. **Developments in non-price competitiveness warrant more attention.** Despite ULC-based price competitiveness remaining intact thus far, Lithuania's export market shares have started to stagnate in recent years, even excluding the Russian market. While exporters have demonstrated nimbleness in maneuvering a difficult external environment, stagnating market shares suggest that the prices that Lithuania's exports command are no longer rising faster than those of competitors. This in turn could well be an indication of stalled catching up with the frontier as far as product quality, mix, and sophistication is concerned. This underscores the urgency of the productivity enhancing agenda laid out above.

Exports Market Shares, 2000:Q1-2015:Q3
(Percent)



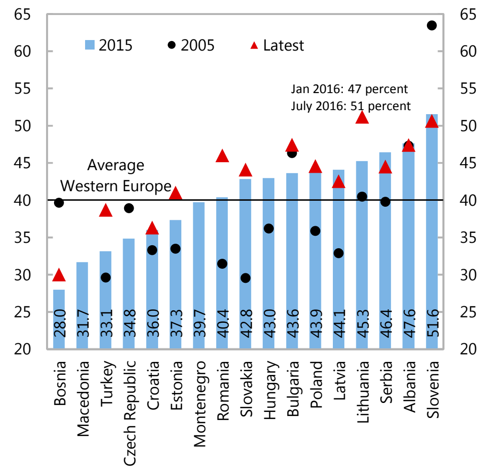
Source: IMF ,Direction of Trade Statistics.

23. **The authorities agreed that competiveness warranted close monitoring and were appreciative of staff's emphasis on non-price competitiveness.** The minimum wage was still lower than in neighboring countries and significant adverse side effects had not materialized, but the authorities agreed that it should not decouple from productivity developments, and intend to carefully weigh all the pros and cons before going ahead with further hikes. They shared concerns about recent disappointing productivity growth, though it could prove a temporary effect from weak external demand, which generated slack in some companies. Lithuanians should not be complacent about competitiveness—improving non-price competitivenss was particularly important as the country's future lay in producing higher value products rather than being simply a low-cost producer.

Box 3. Minimum Wage Developments in Lithuania in Regional Perspective[1]

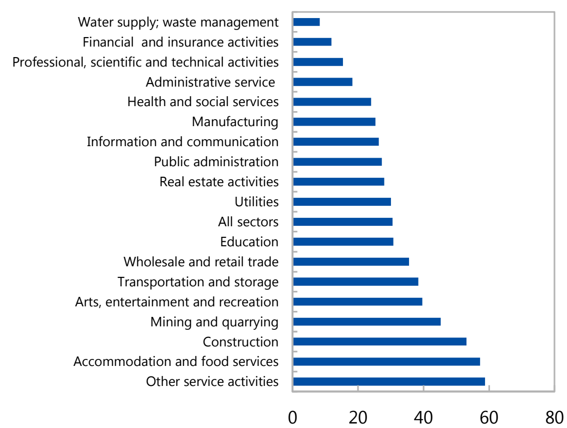
If Lithuania implemented the hike considered for this July, its minimum wage would be the highest in Central Eastern and South Eastern Europe (CESEE) relative to the average wage. Minimum wages were generally frozen in the post-crisis adjustment period throughout the region, but many countries implemented sharp increases when the recovery took hold. In Lithuania, minimum wages are up 50 percent from August 2012—and 60 percent if the increase considered for July is included. Minimum wages would then exceed 50 percent of average wages and affect around 20 percent of workers. Such minimum wage ratios are unprecedented in CESEE and would put Lithuania at par with the European record in France, where excessive minimum wages are seen as a factor behind high unemployment, together with other labor market rigidities. While minimum wages have their role in protecting low-wage earners, adverse side effects are increasingly likely to come to the fore as they rise relative to the productive capabilities of the economy.

CESEE Minimum Wages (Percent of average wages)



Minimum wage hikes are contributing to overall wage growth, which could hurt competitiveness. Minimum wage hikes are estimated to account for one third of overall wage growth during 2012–15. Economy wide, the elasticity of the average wages with respect to minimum wages stood at some 30 percent, with considerably larger effects in sectors with high minimum wage incidence. Analysis for CESEE shows that minimum wages tend to weigh on export performance of labor intensive sectors, as well as on profits and employment growth in the tradable sector.

Lithuania: Minimum Wage Pass-through
(Degree of pass through after a year, percent)



Sources: Eurostat, Statistics Lithuania, and IMF staff calculations.

At its current level, the minimum wage likely reduces employment prospects, especially for the low-skilled and young. At low levels, employment effects are small and statistically difficult to detect. But once minimum wages start to substantially exceed 40 percent of average wages, negative employment effects start to bite. For example, at a minimum wage ratio of 30 percent, a 10 percent minimum wage hike reduces youth employment by 0.4 percent, but at a ratio of 50 percent the reduction rises to 2.8 percent.

Minimum wage policy alone improves the income distribution by less than is commonly believed and needs to be supplemented by other policy tools. Minimum wage hikes may not raise actual remuneration as under-the-table wage supplements ("envelope payments") are regularized or official working hours reduced in response. Moreover, minimum-wage recipients may be second-income earners in relatively well-to-do households and the people truly at the bottom of the income distribution are likely not to be employed at all. Addressing legitimate inequality concerns, other policies need to be brought into play.

1/ Based on Cross-country Report on Minimum Wages: "Getting Minimum Wages Right in Central Eastern and South Eastern Europe."

C. Preserving Fiscal Gains and Tackling High Income Inequality

24. Based on the 2016 budget, the structural deficit is projected to be at a broadly appropriate level, but there is no room for new unfunded tax cuts or spending initiatives. Headline and structural deficits should reach 1.1 and 0.6 percent of GDP, respectively, essentially achieving the staff-recommended ½ percent of GDP for the structural deficit. This level would ensure a reliable gradual decline of the public debt ratio, beginning to reverse its sharp increase since the 2008/09 crisis and building fiscal buffers critical for a small open economy in a currency union.[7] It would also provide for a moderate fiscal stimulus of some ½ percent of GDP to help close the output gap. In addition, the government should allow automatic stabilizers to operate freely.

25. The policy focus should now be squarely on fiscal structural reforms to generate fiscal space. There is room to increase the quality of spending, notably in the areas of health and education where the infrastructure is oversized.[8] Tax administration is another area with ample scope for further improvements—Lithuania's overall revenue take relative to GDP is among the lowest in the EU and this is not only due to low income tax rates and limited wealth taxation.[9] The resulting fiscal space should be used for growth promotion and lowering income inequality.

26. Income inequality in Lithuania is among the highest in the EU and likely weighs on economic performance (Box 4). Over 20 percent of the population is estimated to be at-risk-of-poverty—a rate around 11 percent higher than the EU average, and considerably higher than other CEE countries. The Gini coefficient and wages earned in the top decile relative to the bottom decile also place Lithuania amongst the most unequal European societies. High income inequality may not only be socially undesirable, but can also undermine macroeconomic performance: low income households do not have the means to appropriately develop their potential and adverse shocks can easily derail their efforts. Furthermore, it can spur emigration if people see their opportunities curtailed at home. This weighs on potential growth and exacerbates output volatility.[10]

27. In addition to dual purpose measures that are also desirable in their own right, Lithuania should also begin to consider redistribution-focused fiscal measures depending on social preferences.

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[7] Gross public debt as a percent of GDP did not yet decline in 2015 because of projects eligible for EU funding under the Multiannual Financial Framework 2014–20 were pre-financed from domestic sources, adding to debt but not the deficit, which is recorded in accrual terms.

[8] See "From Expenditure Consolidation to Expenditure Efficiency: Addressing Public Expenditure Pressures in Lithuania," IMF Country Report No. 15/139; and OECD, 2016, OECD Economic Surveys—Lithuania, March 2016.

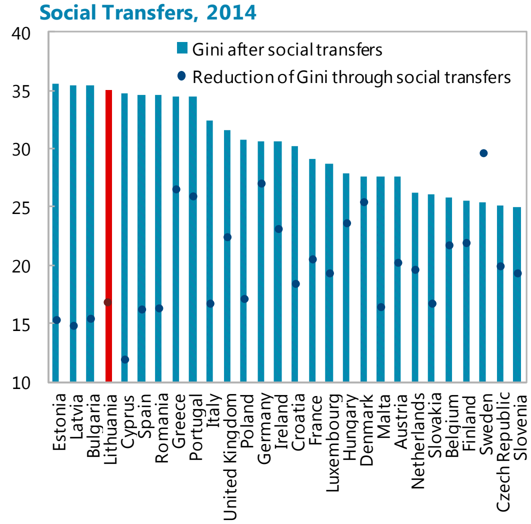
[9] The VAT compliance gap was estimated by the European Commission as one of the largest in the EU in 2013 and there is little evidence that it has significantly narrowed since.

[10] See Selected Issues Paper "Inequality and Income Distribution in Lithuania in an International Comparison: Trends, Causes, and Policies;" Dabla-Norris et al., 2015, "Causes and Consequences of Income Inequality: A Global Perspective," IMF SDN/15/13; and Ostry et al., 2014, "Redistribution, Inequality, and Growth," IMF SDN/14/02.

- *Dual purpose measures*. This agenda largely coincides with that to enhance the employability of labor, which would disproportionately benefit the less well off (¶15).

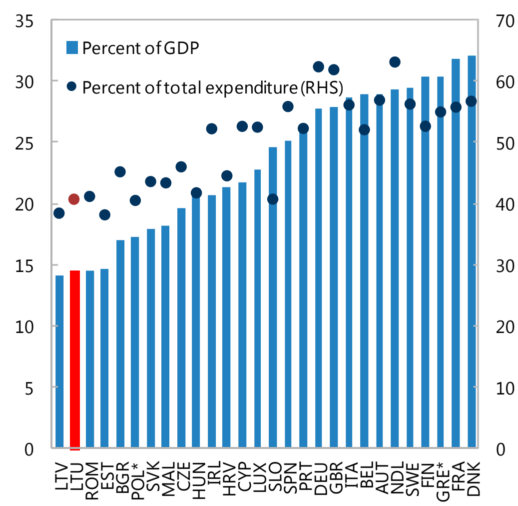
- *Redistribution-focused fiscal measures*. In Lithuania, the progressivity of the tax system is relatively low, reflecting strong reliance on indirect taxes and flat income taxes. Social protection spending is modest, because low revenues constrain all spending and also because its share in total expenditure is relatively small. Fiscal policy thus redresses market inequality by less than in most other countries. Rebalancing the tax system from indirect and labor taxes toward wealth and capital taxation, and higher income tax rates for high-income earners would improve income distribution. So would higher social protection spending, especially if directed at unemployment benefits to allow for proper job search, active labor market programs, and old-age pensions. These additional outlays could be covered by the space generated by fiscal structural reform and potential revenue gains from tax rebalancing, so as not to undermine overall fiscal performance.

GINI Coeffcient and Its Reduction Through Social Transfers, 2014



Sources: Eurostat and IMF staff calculations.

Social Protection Spending, 2013



Sources: Eurostat; and IMF staff calculations.
* Denotes 2012 data.

28. The "New Social Model" addresses distributional issues to some extent, but the financial and social implications of proposed measures need to be carefully considered. Apart from Labor Code reform, the legislative package under discussion in Parliament comprises social benefit and social security reform (¶17).

- *Social benefit reform*. The principal change is a welcome improvement in the unemployment insurance system—an extension of the benefit period from six months to nine and a higher cap on benefits. There are also small adjustments to parental benefits, sickness pay, and the accident insurance. Changes to social assistance are not envisaged.

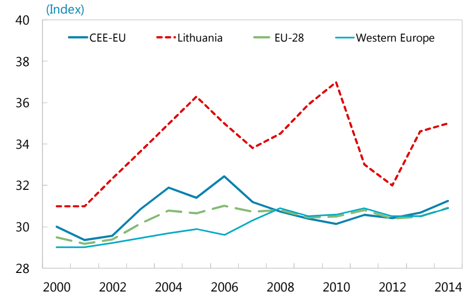
- *Social security reform*. Here the proposal would increase coverage to more of the self-employed, small farmers, and heads of micro companies, all of whom would become subject to contributions and eligible for benefits. This should reduce inequality. But at the heart of social security reform is a wide-ranging reorganization of the old-age pension system: a new pension formula, linking the statutory retirement age to life expectancy, indexing pensions to developments in the overall wage bill of the economy rather than relying on discretionary adjustments, shifting responsibility for basic pensions—the part of retirement benefits that is not earnings related—from the Social Security Fund to the State Budget, introducing a cap on social security contributions, and cutting contributions rates. The social and financial sustainability and distributional consequences of the original proposal and any amendments in the context of the parliamentary deliberations need to be considered with utmost care. Any agreed new arrangement should be subjected to careful scrutiny before it takes effect, even if this means that social security reform moves ahead more slowly than the other elements of the "New Social Model."

29. The authorities agreed that more focus on income inequality issues is warranted, but pointed to a number of constraints. They agreed that fiscal consolidation had been successful, but cautioned that further efforts might still be necessary under EU rules, because of a different take on the business cycle position and hence the fiscal structural balance. Moreover, aiming for fiscal surpluses in the longer run may be prudent. Regarding income inequality, the authorities were most concerned about the low absolute level of income of those at the bottom of the distribution rather than their position relative to those well off. Accordingly, they largely subscribed to the desirability of the dual purpose measures suggested by staff, but were not ready for a major redistributive overhaul of the tax system. Smaller tax changes had already been implemented and there was scope for further strengthening capital and wealth taxation in the medium term. They also saw constraints on the ability to expand social protection spending significantly, because of limited scope for further expenditure cuts in other areas and for raising additional revenue, other than through better tax administration. Regarding the "New Social Model," they considered pension indexation beneficial for reducing income equality. They agreed on the need for careful analysis of the effects of pension reform, including after amendments by Parliament, and for phased implementation to contain costs.

Box 4. Income Inequality in Lithuania[1]

Transition to a market economy increased income inequality by more in Lithuania than in other Central and Eastern European (CEE) countries. Income inequality kept rising through the mid-2000s until the economic boom and the associated fall in unemployment briefly reduced it. But the 2008/09 crisis erased the gains and inequality has hovered around high levels since then. Today, Lithuania is the fourth most unequal country in the EU, after Bulgaria, Estonia, and Latvia. Upward social mobility is also relatively low while downward mobility is higher than elsewhere.

GINI Coefficients in the EU
(Index)

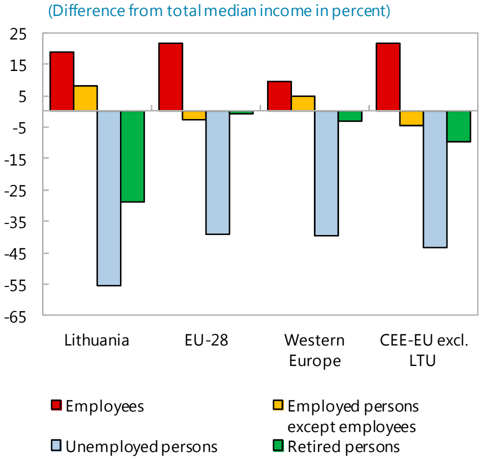


Sources: World Development Indicators and IMF staff calculations.

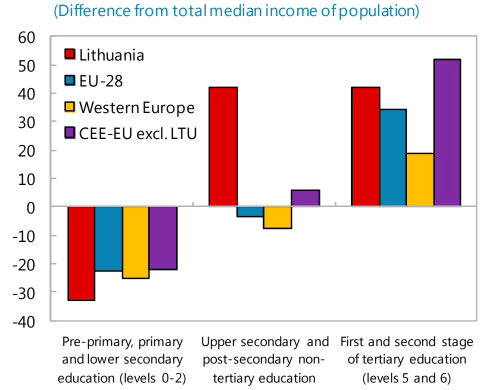
Income inequality pervades all sources of income. Income from dependent employment, self-employment income, and earnings from wealth and capital are all more unequally distributed than the EU or CEE average. However, income from wealth and capital accounts for a smaller share of total income than elsewhere and, because it is typically the most unequally distributed income component, contributes relatively less to overall inequality.

Lithuania's income inequality is concentrated at the tail ends of the distribution and particularly pronounced among the unemployed, retired, and unskilled. Comparing income deciles shows that the contrast between what the top 20 percent earn relative to the bottom 20 percent is particularly stark in Lithuania. The rest of income distribution is less out of line with peers. Dissecting by various population characteristics reveals a concentration of income inequality among the unemployed, retired, and less educated that is stronger than in the EU and CEE. Gender and age also make a difference. These population characteristics jointly account for a larger share of inequality that elsewhere, although they are not the full story of inequality by far. They jointly explain only about a third of Lithuania's income inequality.

Median Income by Activity Status
(Difference from total median income in percent)



Median Income by Educational Attainment
(Difference from total median income of population)



Sources: Eurostat and IMF staff calculations.

1\ Based on Selected Issues Paper "Inequality and Income Distribution in Lithuania in an International Comparison: Trends, Causes, and Policies."

STAFF APPRAISAL

30. Strong economic fundamentals and a favorable business environment should ensure solid growth going forward. Growth is projected to rebound to 2.7 percent this year as the external drag, notably from trade with Russia, eases and the expansion of domestic demand remains strong. Risks are tilted to the downside, reflecting primarily the global risk balance. Assuming the maintenance of sound macroeconomic and business conditions, and counting on continued structural reforms supporting productivity and human capital development, growth should rise to some 3½ percent over the medium-term.

31. Multi-year fiscal consolidation has come to fruition with the structural fiscal deficit reaching balance in 2015. These gains should be protected by capping the structural fiscal deficit at ½ percent of GDP going forward, to begin reversing the sharp rise in the public debt ratio since 2008, thereby reliably rebuilding fiscal buffers critical for a small open economy in a currency union. The 2016 budget essentially achieves this goal, but new unfunded spending initiatives or tax cuts should be avoided. Public finances are strong enough to let automatic stabilizers operate freely.

32. Productivity enhancing reforms remain the principal vehicle for sustainably raising living standards and should be framed in a coherent package to leverage their impact. The focus should be on improving the employability of labor by boosting training, addressing labor market mismatches, and lowering the tax wedge for low-income earners. Innovation policies should emphasize company upgrading more. As drafted, the proposed new Labor Code would address a key shortcoming in Lithuania's otherwise favorable business environment. The authorities should guard against amendments that would weaken it.

33. External competitiveness is intact, but could come under pressure. Productivity gains have fallen short of fast real wage growth in recent years, unwinding previous competitiveness gains. Buffers in the tradable sector have now been all but exhausted up. While boosting productivity growth is the priority, wage growth will also have to slow. In this context, minimum wage hikes should be paused for now. The apparent recent stagnation of non-price competitiveness also needs monitoring.

34. Lithuania's high income inequality needs to be addressed. Beyond its social implications, high inequality is also likely to weigh on macroeconomic prospects. Dual purpose measures that boost growth and especially benefit the disadvantaged should be pursued. Depending on social preferences, more redistributive fiscal policies could also be considered, which would aim making the tax system more progressive and lifting low social protection spending. Reforms proposed under the "New Social Model" initiative would the improve distribution to some extent, but far-reaching changes to old age pensions need more scrutiny before becoming law. Minimum wages have their role to play in income distribution. At current levels though further increases risk compromising employment and competitiveness.

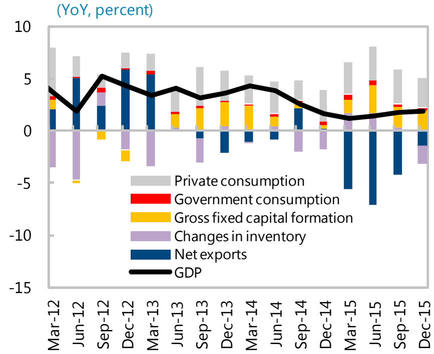
35. The financial system is sound and the resumption of credit growth is a welcome development. Financial soundness indicators are solid and access to ECB liquidity since euro adoption in 2015 further reduced vulnerabilities. Legislation to fundamentally address weaknesses in the (small) credit union sector is now overdue. The recent revival of credit growth is a boon for the economic outlook, even though SMEs will continue to require support from government sponsored schemes. There are currently no signs of financial excess on the horizon. Should they emerge a comprehensive macroprudential toolkit is in place to address them. Close cooperation with banks' home-country authorities increases the traction of potential measures.

36. It is recommended that the next Article IV Consultation be held on the 12-month cycle.

Figure 1. Republic of Lithuania: Real Sector Developments

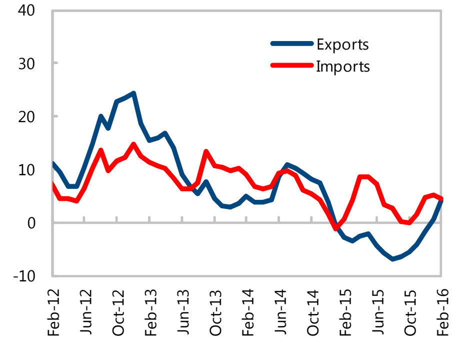
GDP growth has slowd down somewhat...

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



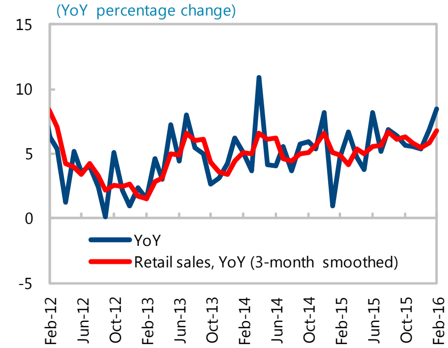
... because of a challenging external environment,...

Trade of Goods excluding Mineral Products
(YoY percent change, 3-month smoothed) 1/



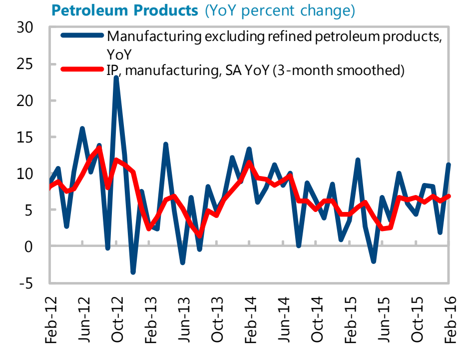
...but domestic consumption...

Retail Sales excluding Autos and Motorcycles
(YoY percentage change)



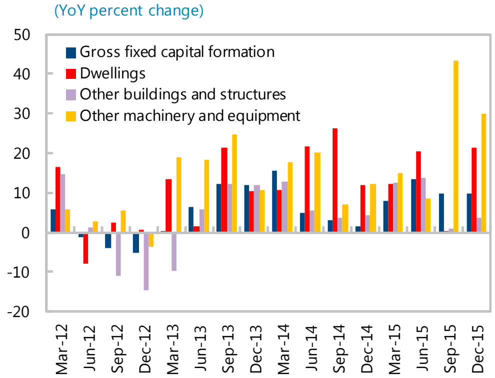
... and industrial production remained strong.

Industrial Producion excluding Refined Petroleum Products (YoY percent change)



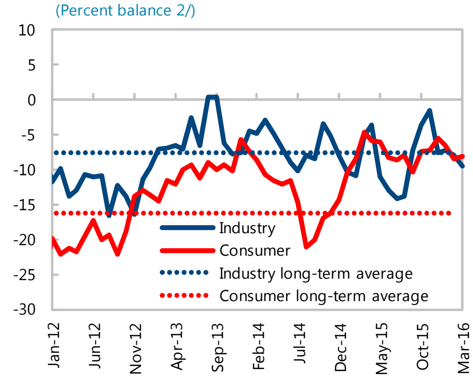
Investment is now recovering...

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



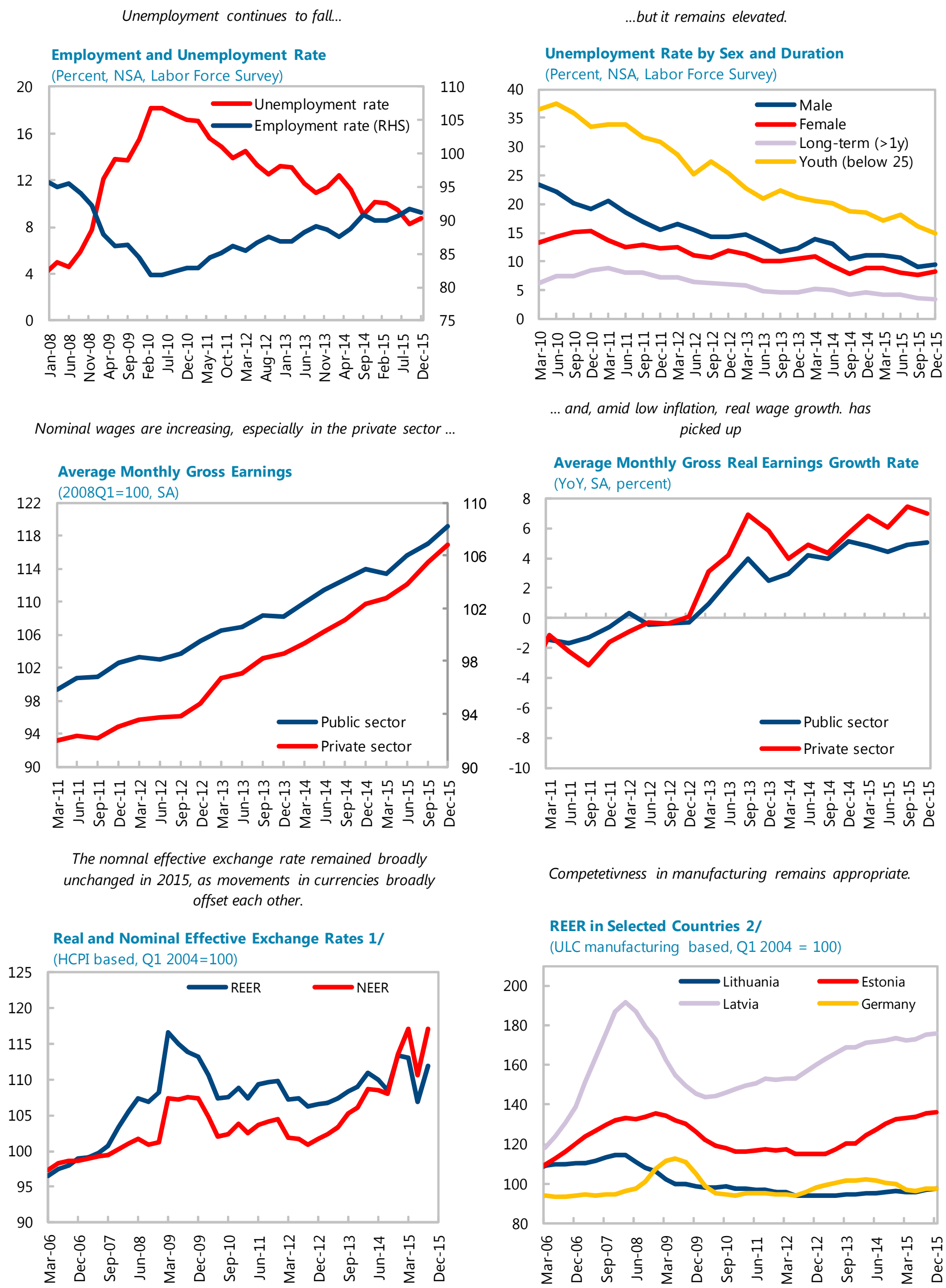
...and industry confidence is picking up, supported by strong consumer sentiment.

Business and Consumer Confidence, SA
(Percent balance 2/)



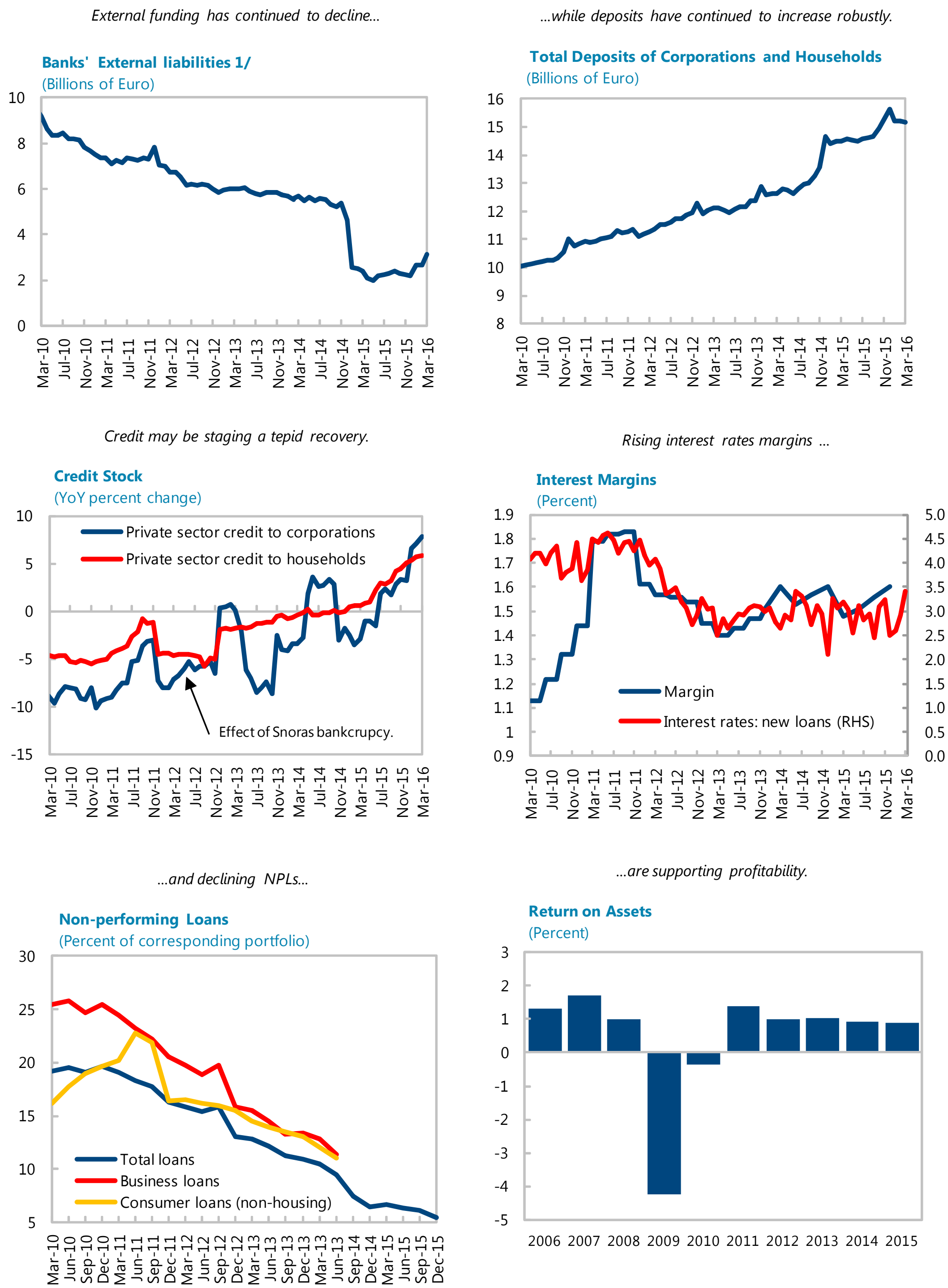
Sources: Haver; Lithuania Statistical Office; and Bank of Lithuania.
1/ The export and import data are measured in terms of F.O.B. and C.I.F., respectively.
2/ Percent balance equals percent of respondents reporting an increase minus the percent of respondents reporting a decrease.

Figure 2. Republic of Lithuania: Labor Market and Competitiveness Developments



Sources: Haver; Eurostat; Lithuania Statistical Office; and IMF staff calculations.
1/ REER and NEER against a group of 42 trading partners including Russia.
2/ Manufacturing ULC-based REER agianst a group of 38 trading partners not including Russia.

Figure 3. Republic of Lithuania: Banking Sector Developments

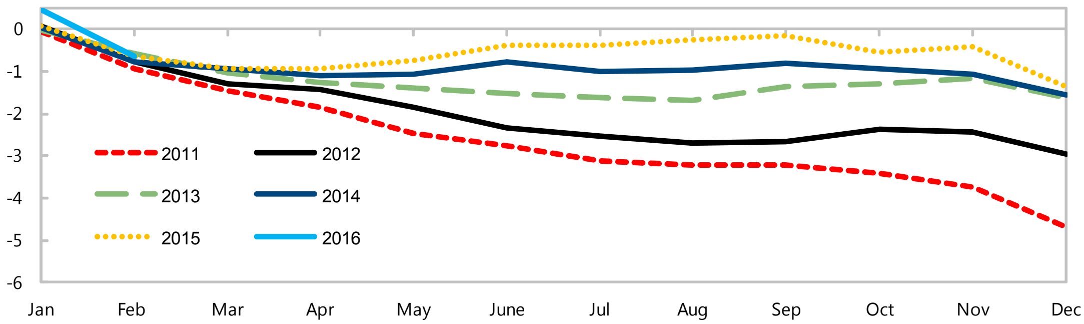


Sources: Dx Time; Bank of Lithuania; and IMF staff calculations.
1/ From January 2015 onwards, banks' external liabilities are redefined as those towards non-euro area countries.

Figure 4. Republic of Lithuania: Fiscal Sector Developments

The central government cash deficit continued to improve slightly in 2015...

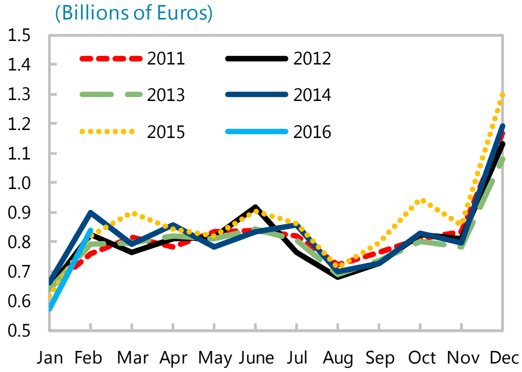
Cumulative Central Government Cash Balance
(Percent of Annual GDP)



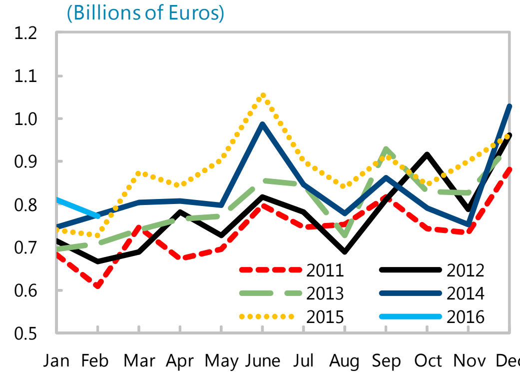
...as somewhat higher spending,...

...was more than offset by strong revenues.

Total Primary Expenditures
(Billions of Euros)



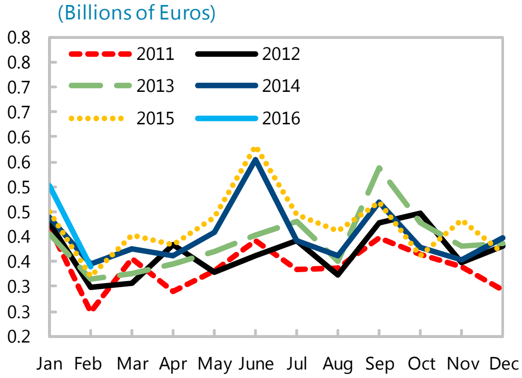
Revenues
(Billions of Euros)



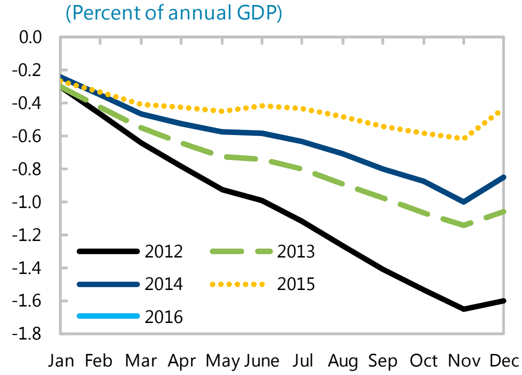
Taxes performed reasonably well...

...but the Social Security (Sodra) deficit ended up slightly higher.

Taxes
(Billions of Euros)



Cumulative Sodra Deficit
(Percent of annual GDP)



Source: Ministry of Finance.

Table 1. Republic of Lithuania: Selected Economic Indicators, 2013–21 1/

Quota (current, % of total): 183.9 million SDR, 0.08 percent
Main products and exports: mineral, chemical, agricultural and wood products, machinery and equipment, textiles
Key export markets: Russia, Latvia, Estonia, Poland, Germany

Per capita GDP (PPP, 2014): € 20,088
Literacy rate (2011): 99.7 %
At-risk-of-poverty (after transfers), share of population (2013): 20.6 percent

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projections					
Output									
Real GDP growth (annual percentage change)	3.5	3.0	1.6	2.7	3.1	3.4	3.6	3.6	3.3
Domestic demand growth (year-on-year, in percent)	3.3	3.0	6.1	4.6	4.0	3.9	3.7	3.6	3.2
Private consumption growth (year-on-year, in percent)	4.3	4.1	4.9	4.7	4.0	3.7	3.5	3.2	3.0
Domestic fixed investment growth (year-on-year, in percent)	8.3	5.4	10.3	6.0	5.1	5.2	5.3	5.3	4.5
Inventories (contribution to growth)	-1.2	-1.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Net external demand (contribution to growth)	0.5	0.2	-4.6	-2.0	-1.0	-0.6	-0.3	-0.2	-0.1
Nominal GDP (in billions of euro)	35.0	36.4	37.2	38.7	40.6	42.9	45.5	48.2	51.0
Output gap (percent of potential GDP)	-1.0	-0.4	-1.4	-1.4	-1.0	-0.4	0.0	0.0	0.0
Employment									
Unemployment rate (year average, in percent of labor force)	11.8	10.7	9.1	8.6	8.5	8.4	8.2	8.1	8.0
Average monthly gross earnings (annual percentage change)	5.0	4.5	4.8	5.9	5.5	5.9	6.1	6.0	5.8
Average monthly gross earnings, real (CPI-deflated, annual percent	3.8	4.3	5.5	5.2	3.5	3.5	3.7	3.6	3.4
Labor productivity (annual percentage change)	2.2	1.0	0.1	2.5	3.1	3.4	3.6	3.6	3.4
Prices									
HICP, end of period (year-on-year percentage change)	0.5	-0.1	-0.3	1.4	2.3	2.3	2.3	2.3	2.3
GDP deflator (year-on-year percentage change)	1.3	1.2	0.4	1.4	1.5	2.2	2.3	2.4	2.4
HICP core, period average (annual percentage change)	1.4	0.7	1.9	2.2	2.3	2.3	2.3	2.3	2.3
HICP, period average (annual percentage change)	1.2	0.2	-0.7	0.6	1.9	2.3	2.3	2.3	2.3
General government finances 2/									
Revenue (percent of GDP)	32.8	34.1	34.9	34.6	34.7	34.9	35.0	35.0	35.1
Of which EU grants	1.9	2.8	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Expenditure (percent of GDP)	35.5	34.8	35.1	35.7	35.7	35.6	35.6	35.6	35.6
Of which: Non-interest	33.7	33.2	33.6	34.2	34.1	34.0	34.0	34.0	34.1
Fiscal balance (percent of GDP) 3/	-2.6	-0.7	-0.2	-1.1	-0.9	-0.7	-0.6	-0.6	-0.6
Fiscal balance excl. one-offs (percent of GDP)	-2.2	-1.1	-0.5	-1.1	-0.9	-0.7	-0.6	-0.6	-0.6
Structural fiscal balance (percent of potential GDP) 4/	-1.7	-0.8	0.0	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
General government gross debt (percent of GDP)	38.8	40.7	42.7	42.3	41.4	40.1	38.5	36.9	35.4
Of which: Foreign currency-denominated	27.1	29.7	30.8	29.5	27.8	26.1	24.3	22.6	21.0
Money and credit									
Broad money (end of period, percent change)	4.4	1.2	32.9	…	…	…	…	…	…
Private sector credit (end of period, percent change)	-2.3	-0.9	4.1	3.1	3.4	4.1	…	…	…
Long-term lending rate to private sector	5.9	7.0	8.0	…	…	…	…	…	…
Reserve money (end of period, percent change)	4.9	20.9	53.3	…	…	…	…	…	…
Balance of payments (in percent of GDP, unless otherwise specified)									
Current account balance	1.5	3.6	-1.7	-2.1	-2.6	-2.8	-2.8	-2.7	-2.7
Trade balance for goods									
Exports of goods and services (volume change, in percent)	9.6	3.0	1.2	3.4	3.6	4.2	4.4	3.7	3.4
Imports of goods and services (volume change, in percent)	9.3	2.9	7.0	5.7	4.6	4.8	4.5	3.6	3.3
Foreign direct investment, net	-0.6	0.4	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Gross official reserves (in billions of euros)	5.9	7.2	..	..	..	..	..	..	..
Reserve cover (in months of imports of goods and services)	2.4	3.0	..	..	..	..	..	..	..
Reserve cover (in percent of short-term debt)	47.4	57.0	..	..	..	..	..	..	..
Short-term debt at original maturity	26.6	22.8	27.0	28.4	29.2	29.8	30.5	31.1	32.0
Gross external debt 5/	70.4	70.7	75.3	73.4	71.6	69.2	66.6	64.1	62.0
Exchange rates									
Real effective exchange rate (2005=100, +=appreciation)	118.5	120.2	118.4	..	..	..	..	..	..
Exchange rate (euro per U.S. dollar, end of period)	0.90	0.81	0.92	..	..	..	..	..	..
Exchange rate (euro per U.S. dollar, period average)	0.83	0.75	0.90	..	..	..	..	..	..
Saving-investment balance (in percent of GDP)									
Gross national saving	20.7	21.9	16.9	16.7	16.8	17.2	17.6	18.1	18.5
Gross national investment	19.1	18.3	18.6	18.9	19.5	19.9	20.4	20.9	21.2
Foreign net savings	-1.5	-3.6	1.7	2.1	2.6	2.8	2.8	2.7	2.7

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

1/ Data are presented on ESA2010, and BPM6 manuals basis.

2/ The projections for 2014 include 302 million euros (0.8 percent of GDP) in compensation payments for past pension cuts on accrued basis. The payments are spread over 2014-16, affecting the debt profile for these years. ESM contributions are spread over 2015-19 and also increase debt. Passive projections from 2016 onward; incorporate only announced budgetary measures; budgetary impact of further defense spending, wage compensation and their potential offsetting measures are not included .

3/ Fiscal balance for 2012 according to the definition for purposes of the Excessive Deficit Procedure (EDP).

4/ Calculation takes into account standard cyclical adjustments as well as absorption gap.

5/ Government external debt includes guaranteed loans.

Table 2. Republic of Lithuania: General Government Operations, 2013–21

(ESA 2010 aggregates, in percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projections					
Statement of Operations									
Revenue	32.8	34.1	34.9	34.6	34.7	34.9	35.0	35.0	35.1
Revenue excluding EU grants	30.9	31.4	33.0	32.6	32.8	32.8	33.0	33.1	33.1
Tax revenue	16.1	16.4	17.3	17.1	17.3	17.3	17.5	17.6	17.6
Direct taxes	5.0	5.1	5.5	5.5	5.5	5.6	5.6	5.7	5.7
Personal income tax	3.6	3.6	3.9	3.9	3.9	3.9	4.0	4.0	4.0
Corporate income tax	1.4	1.4	1.5	1.5	1.6	1.6	1.6	1.6	1.6
Indirect taxes	11.1	11.3	11.8	11.6	11.7	11.7	11.8	11.9	11.9
VAT	7.5	7.6	7.8	7.8	7.8	7.9	8.0	8.0	8.0
Excises	2.8	2.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Other	0.8	0.8	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Social contributions	11.0	11.3	12.0	12.0	12.0	12.0	12.0	12.0	12.0
Grants	1.9	2.8	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Other revenue	3.8	3.7	3.7	3.5	3.5	3.5	3.5	3.5	3.5
Total expenditure	35.5	34.8	35.1	35.7	35.7	35.6	35.6	35.6	35.6
Current spending	32.1	31.5	31.5	32.3	32.3	32.3	32.3	32.3	32.3
Compensation of employees	9.5	9.5	9.7	10.0	10.0	10.0	10.0	10.0	10.0
Goods and services	4.7	4.8	5.2	4.8	4.8	4.8	4.8	4.8	4.8
Interest payments	1.8	1.6	1.5	1.5	1.5	1.6	1.6	1.6	1.5
Foreign	1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.1
Domestic	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4
Subsidies	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Grants	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Social benefits	12.9	12.5	12.6	12.7	12.7	12.7	12.7	12.7	12.7
Other expense	2.0	2.0	1.3	2.0	2.0	2.0	2.0	2.0	2.0
Capital spending	3.3	3.3	3.6	3.4	3.4	3.3	3.3	3.3	3.3
Net lending (+) / borrowing (-)	-2.6	-0.7	-0.2	-1.1	-0.9	-0.7	-0.6	-0.6	-0.6
Net lending (+) / borrowing (-) excl. one-offs	-2.2	-1.1	-0.5	-1.1	-0.9	-0.7	-0.6	-0.6	-0.6
Net acquisition of financial assets	-1.2	3.4	0.9	0.2	0.2	0.2	0.1	0.0	0.0
Domestic	-1.8	3.2	0.8	0.0	0.0	0.0	0.0	-0.1	-0.1
Foreign	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net incurrence of liabilities	1.4	4.0	1.2	1.3	1.1	0.9	0.7	0.6	0.6
Domestic	2.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Foreign	-1.4	3.4	0.6	0.7	0.5	0.3	0.1	0.0	-0.1
Financial Balance Sheet									
Financial assets	21.9	27.4	…	…	…	…	…	…	…
Currency and deposits	3.9	7.4	…	…	…	…	…	…	…
Securities other than shares	0.0	0.1	…	…	…	…	…	…	…
Loans	0.3	0.3	…	…	…	…	…	…	…
Shares and other equity	12.7	14.3	…	…	…	…	…	…	…
Other financial assets	5.1	5.2	…	…	…	…	…	…	…
Financial liabilities	47.8	52.6	…	…	…	…	…	…	…
Currency and deposits	0.7	0.8	…	…	…	…	…	…	…
Securities other than shares	34.3	38.3	…	…	…	…	…	…	…
Loans	8.1	7.8	…	…	…	…	…	…	…
Other liabilities	4.7	5.7	…	…	…	…	…	…	…
Net financial worth	-25.9	-25.2	…	…	…	…	…	…	…
Memorandum items:									
GDP (in millions of euros)	34,962	36,444	37,190	38,736	40,568	42,888	45,482	48,224	51,022
General government debt (Maastricht def.)	38.8	40.7	42.7	42.3	41.4	40.1	38.5	36.9	35.4
Foreign debt	27.1	29.7	30.8	30.3	29.4	28.1	26.6	25.0	23.6
Domestic debt	11.6	11.0	11.9	12.0	12.1	12.0	11.9	11.9	11.8

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

1/ Passive projections from 2016 onward; incorporate only announced budgetary measures; budgetary impact of wage compensation and its potential offsetting measures are not included.

Table 3. Republic of Lithuania: Balance of Payments, 2013–21

(BPM6, Billions of Euros, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projections					
Current account balance	0.5	1.3	-0.6	-0.8	-1.1	-1.2	-1.3	-1.3	-1.4
Merchandise trade balance	-0.9	-0.9	-1.9	-2.1	-2.7	-3.1	-3.3	-3.4	-3.5
Exports (f.o.b.)	24.0	23.7	22.4	22.2	24.0	25.7	27.4	28.6	30.0
Imports (f.o.b.)	24.9	24.7	24.3	24.3	26.7	28.7	30.7	32.1	33.5
Services balance	1.4	1.6	1.8	1.8	1.9	2.0	2.1	2.2	2.3
Exports of non-factor services	5.4	5.8	6.0	6.3	6.8	7.3	7.8	8.1	8.5
Imports of non-factor services	4.0	4.2	4.2	4.5	4.9	5.3	5.7	5.9	6.2
Primary income balance	-0.9	-0.5	-1.4	-1.5	-1.2	-1.2	-1.2	-1.2	-1.2
Receipts	0.9	0.8	0.7	0.7	0.7	0.8	0.8	0.9	0.9
Payments	1.8	1.3	2.1	2.2	2.0	2.0	2.0	2.0	2.1
Secondary income balance	1.0	1.1	0.9	1.0	1.0	1.1	1.1	1.1	1.0
Capital and financial account balance	-0.6	1.6	-0.8	0.3	0.5	0.6	0.7	0.7	0.7
Capital account balance	1.1	1.0	1.1	0.6	0.8	0.8	0.9	0.9	0.9
Foreign direct investment balance	-0.2	0.2	-0.8	-0.8	-0.8	-0.9	-1.0	-1.0	-1.0
Portfolio investment balance	1.4	-1.2	-0.2	0.0	0.2	0.2	0.3	0.4	0.5
Financial derivatives	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2
Other investment balance	0.5	0.4	3.0	1.2	1.1	1.1	1.1	1.0	1.0
Errors and omissions	-0.4	-1.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.4	1.3	-1.3	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7
Financing	0.4	-1.3	1.3	0.5	0.5	0.6	0.6	0.7	0.7
Gross international reserves (increase: -)	0.4	-1.3	…	…	…	…	…	…	…
Use of Fund credit, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Prospective Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of GDP (unless indicated)									
Current account balance	1.5	3.6	-1.7	-2.1	-2.6	-2.8	-2.8	-2.7	-2.7
Trade Balance of goods and services	1.3	1.9	-0.3	-0.8	-2.1	-2.5	-2.6	-2.6	-2.4
Exports	84.1	81.2	76.3	73.5	75.8	76.8	77.2	76.2	75.4
Imports	82.8	79.3	76.6	74.3	77.9	79.4	79.9	78.8	77.8
Primary Income	-2.5	-1.5	-3.9	-3.8	-3.1	-2.8	-2.6	-2.4	-2.3
Secondary Income	2.7	3.1	2.5	2.5	2.5	2.5	2.4	2.2	2.0
Capital and financial account balance	-1.6	4.4	-2.0	0.8	1.3	1.3	1.4	1.4	1.3
Capital account balance	3.1	2.7	3.0	1.6	2.1	1.9	2.1	2.0	1.8
Foreign direct investment balance	-0.6	0.4	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Portfolio investment balance	4.0	-3.2	-0.5	0.1	0.4	0.6	0.8	0.9	0.9
Financial derivatives balance	0.0	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other investment balance	1.3	1.1	7.9	3.1	2.8	2.5	2.3	2.2	2.0
Overall balance	-1.2	3.5	-3.5	-1.3	-1.3	-1.5	-1.4	-1.4	-1.3
Gross external debt 1/	70.4	70.7	75.3	73.4	71.6	69.2	66.6	64.1	62.0
Public	33.7	38.7	49.4	50.3	51.2	51.3	51.1	50.9	50.7
Short-term	3.4	3.6	12.5	14.7	16.7	18.5	20.1	21.6	23.0
Long-term	30.3	35.1	36.9	35.6	34.5	32.9	31.1	29.3	27.6
Private	36.6	32.0	25.9	23.1	20.5	17.9	15.5	13.3	11.3
Short-term	29.4	24.9	19.3	17.0	14.9	12.8	11.0	9.3	7.8
Long-term	7.3	7.1	6.6	6.1	5.6	5.0	4.5	4.0	3.5
Gross external debt (in percent of GNFS exports)	83.7	87.0	98.7	100.0	94.5	90.1	86.2	84.1	82.3
Net external Debt	29.2	28.7	26.5	23.0	20.8	18.8	16.7	14.6	12.9
Net international investment position	-47.0	-46.2	-45.1	-44.4	-43.5	-42.4	-41.2	-40.0	-38.9
GIR (in billions of Euros)	5.9	7.1	…	…	…	…	…	…	…
GIR (in percent of short-term debt) 2/	47.4	56.6	…	…	…	…	…	…	…
GIR (in months of imports of goods and services	2.4	3.0	…	…	…	…	…	…	…
Merchandise export volume (percent change) 3/	9.6	3.0	1.2	3.4	3.6	4.2	4.4	3.7	3.4
Merchandise import volume (percent change) 3/	9.3	2.9	7.0	5.7	4.6	4.8	4.5	3.6	3.3
Merchandise export prices (percent change) 3/	-1.5	-2.3	-4.0	-4.2	4.4	2.8	2.1	0.9	1.1
Merchandise import prices (percent change) 3/	-1.7	-3.0	-6.9	-5.4	5.0	2.8	2.1	0.9	1.1
GDP (in billion of Euros)	35.0	36.4	37.2	38.7	40.6	42.9	45.5	48.2	51.0

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

1/ Government external debt does not include guaranteed loans.

2/ Short-term debt at remaining maturity.

3/ Derived from national accounts data.

Table 4. Republic of Lithuania: Summary of Monetary Accounts, 2010–15

(Billions of Euro, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015
Monetary Authority						
Gross foreign assets	5.2	6.4	6.4	6.0	7.9	..
Gross foreign liabilities	0.2	0.3	0.0	0.0	0.1	..
Net foreign assets	5.0	6.1	6.4	6.0	7.8	..
Gold	0.2	0.2	0.2	..	..	..
Net domestic assets	-1.4	-1.1	-1.7	-1.0	-1.9	..
Net credit to government	-0.7	-0.4	-1.1	-0.5	-1.2	..
Credit to banks	0.0	0.0	0.0	0.0	0.0	..
Credit to private sector	0.0	0.0	0.0	0.0	0.0	..
Other items, net	-0.6	-0.7	-0.7	-0.6	-0.7	..
Reserve money	3.6	5.0	4.7	4.9	5.9	..
Currency outside the central bank	2.6	3.1	3.3	3.4	1.7	..
Currency outside banks	2.3	2.8	3.0	3.2	1.4	..
Cash in vaults of banks	0.3	0.3	0.3	0.3	0.3	..
Deposit money banks' deposits with BoL	1.1	1.9	1.4	1.5	4.3	..
Banking Survey						
Net foreign assets	0.4	1.6	2.8	2.9	4.5	..
Monetary authority	5.0	6.1	6.4	6.0	7.8	..
Banks and other banking institutions	-4.6	-4.5	-3.6	-3.1	-3.3	-5.0
Net domestic assets	13.5	13.1	12.9	13.5	12.1	..
Net claims on government 1/	0.2	1.2	0.3	1.7	0.5	..
Monetary authority	-0.7	-0.4	-1.1	-0.5	-1.2	..
Banks and other banking institutions	0.9	1.6	1.4	2.1	1.7	1.8
Credit to private sector	16.3	15.4	15.3	14.9	14.8	17.1
Credit to nonbank financial institutions	1.1	1.0	1.3	0.9	0.9	3.1
Other items, net	-4.1	-4.5	-4.0	-4.0	-4.1	..
Broad money	13.9	14.6	15.7	16.4	16.6	..
Currency outside banks	2.3	2.8	3.0	3.2	1.4	..
Deposits	11.7	11.8	12.7	13.2	15.2	16.3
In national currency	8.4	8.7	9.3	9.7	11.3	15.4
In foreign currency	3.3	3.1	3.4	3.5	4.0	0.9
Memorandum items:						
Reserve money (yearly percent change)	19.4	37.5	-6.4	4.9	20.9	..
Broad money (yearly percent change)	8.9	5.0	7.2	4.4	1.2	..
Private sector credit (yearly percent change)	-7.9	-5.9	-0.8	-2.3	-0.9	4.1
Money multiplier	3.8	2.9	3.3	3.3	2.8	..
Currency outside banks, in percent of deposits	19.5	23.8	23.6	24.0	8.9	..
Foreign-currency deposits (percent of total depos	28.4	26.4	26.4	26.5	26.0	..
Foreign-currency loans (percent of total loans) 2/	74.4	72.9	72.7	72.1	72.7	..
Velocity of broad money	2.0	2.1	2.1	2.1	2.2	..
Gross official reserves (billions of U.S. dollars) 3/	6.6	8.4	8.4	8.0	8.8	..
Gross official reserves (billions of euros) 3/	5.2	6.4	6.4	6.0	7.9	..
GDP	28.0	31.3	33.3	35.0	36.4	37.2

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

1/ Excludes local government deposits; includes counterpart funds.

2/ Loans to households and non-financial corporations.

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

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

Table 5. Republic of Lithuania: Financial Soundness Indicators, 2008–15

(In percent, unless otherwise indicated)

	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15
Capital adequacy								
Regulatory capital to risk-weighted assets 1/ 7/	11.6	12.9	14.8	14.2	15.7	17.6	21.3	24.8
Regulatory Tier 1 capital to risk-weighted assets 1/ 7/	9.1	9.3	10.8	12.0	14.6	17.1	20.9	24.3
Capital to assets 1/	8.2	7.3	8.5	10.8	12.3	12.6	11.5	11.7
Asset quality								
Nonperforming loans to capital 1/ 4/	41.8	198.8	174.7	109.8	79.4	59.6	46.9	38.3
o/w impaired loans to capital 1/ 4/	30.3	161.2	143.7	92.8	65.7	44.4	29.1	23.4
o/w non-impaired loans overdue more than 60 days to capital 1/ 4/	11.5	37.6	30.9	17.0	13.7	15.2	8.0	..
Nonperforming loans net of provisions to capital 1/ 4/ 10/	31.0	133.1	106.0	63.5	46.9	36.7	29.8	25.0
Nonperforming loans to total (non-interbank) loans 4/	4.7	19.7	19.9	16.6	13.6	11.0	8.8	7.3
o/w impaired loans to total (non-interbank) loans 4/	3.4	15.7	16.7	14.0	11.4	8.5	5.5	4.5
o/w non-impaired loans overdue more than 60 days to total (non-interbank) loans 4/	1.3	3.9	3.3	2.5	2.2	2.5	1.2	..
Impairment losses to total (non-interbank) loans 9/ 10/	1.3	6.7	8.0	7.0	5.6	4.2	3.2	2.5
Impairment losses to nonperforming loans 3/ 4/ 9/ 10/	26.8	33.9	40.2	42.2	40.8	37.9	36.5	34.7
Sectoral distribution of corporate loans 5/								
Agriculture, forestry and fishing	2.1	1.9	1.9	2.4	2.3	2.8	2.9	3.6
Mining and quarrying	0.2	0.2	0.3	0.4	0.6	0.5	0.5	0.5
Manufacturing	10.7	10.3	9.4	17.4	18.3	17.9	15.7	14.7
Electricity, gas, steam and air conditioning supply	1.9	1.9	2.1	5.0	6.8	7.6	9.5	11.0
Water supply; sewerage, waste management and remediation activities	10.7	9.7	8.8	0.7	0.7	0.8	1.0	1.0
Construction	3.8	3.1	2.9	12.8	10.4	8.6	7.3	6.1
Wholesale and retail trade; repair of motor vehicles and motorcycles	10.7	9.7	8.8	19.3	19.7	19.3	20.3	22.0
Transportation and storage	2.5	2.6	2.3	4.3	4.0	5.7	5.0	5.8
Accommodation and food service activities	1.6	1.7	1.5	2.8	2.8	2.7	2.6	2.4
Information and communication	..	..	..	0.9	0.8	0.8	0.9	0.8
Real estate activities	18.4	20.2	19.1	28.9	27.8	28.3	27.8	26.2
Professional, scientific and technical activities	..	..	..	2.8	4.0	2.6	3.7	2.6
Administrative and support service activities	..	..	..	1.1	0.9	1.0	1.8	2.0
Remaining activities	0.0	0.0	0.0	1.2	1.1	1.2	1.1	1.3
Residential real estate loans to total (non-interbank) loans	29.6	33.0	34.3	36.7	37.9	38.0	38.9	37.3
Earnings and profitability								
RoE 1/ 2/	11.8	-50.8	-3.9	15.8	7.7	8.9	8.1	9.0
RoA 2/	0.8	-3.8	-0.3	1.4	0.9	1.0	0.9	0.9
Interest margin to gross income	64.4	50.6	49.0	58.7	53.7	49.9	50.7	52.6
Noninterest expenses to gross income	54.6	60.3	64.4	60.2	61.9	61.9	35.0	33.0
Trading and foreign exchange gains (losses) to gross income	0.9	13.5	8.1	4.0	9.1	8.8	8.6	7.5
Personnel expenses to noninterest expenses	41.8	38.7	37.5	40.6	39.5	39.0	67.4	73.2
Liquidity								
Liquidity coverage ratio	..	..	..	..	..	..	252.0	362.0
Liquidity ratio (liquid assets to current liabilities) 6/	39.0	49.9	43.8	44.1	41.2	41.2	43.6	..
Liquid assets to total assets 6/	18.6	23.7	23.8	23.7	25.1	27.0	31.9	..
Current liabilities to total liabilities 6/	51.4	50.5	58.5	58.8	67.7	73.1	81.6	..
Customer deposits to total non-interbank loans	56.8	68.6	82.2	80.6	85.8	93.3	110.4	113.2
Foreign exchange risk								
Foreign-currency-denominated loans to total (non-interbank) loans 8/	64.6	73.9	74.0	72.4	72.4	68.7	..	..
Foreign-currency-denominated liabilities to total liabilities 8/	63.3	61.6	57.0	53.1	50.9	48.1	..	..
Net open position in foreign exchange to regulatory capital 1/ 7/	1.0	1.0	0.5	0.6	0.3	0.4	0.4	..
Memo item								
Provisioning (in percent of NPLs)	25.9	33.0	39.3	26.3	21.3	16.5	..	..

Sources: Bank of Lithuania and http://fsi.imf.org/.

1/ Excluding foreign bank branches.
2/ Total profits (losses) after tax. Interim quarterly results are annualised.
3/ From end-2005 to Q1-2008, NPLs are loans overdue more than 60 days. Untill 2004 NPLs are loans in Substandard, Doubtful and Loss loans categories.
4/ Starting June 2008, non-performing loans are defined as the sum of impaired loans and non-impaired loans that are overdue more than 60 days.
5/ According to Nace 1 up to Sept 2011. Data according to Nace 2 thereafter.
6/ Composition of liquid assets and current liabilities is defined in the Liquidity Ratio Calculation Rules approved by Resolution No. 1 of the Board of the Bank of Lithuania of 29 January 2004.
7/ As defined in Rules for Calculation of Capital Adequacy approved by Bank of Lithuania Board Resolution No. 138 of 9 November 2006.
8/ The large majority of foreign currency loans and foreign currency liabilities are in euros, to which the national currency is pegged via a currency board arrangement.
9/ Specific provisions include provisions against general portfolio risk until end-2004. From end-2005, due to the change in definition of NPLs, specific provisions are not directly attributable to the NPLs. Therefore, the ratio may be negative.
10/ Specific provisions include allowances for both individually and collectively assessed loans.

Annex I. Debt Sustainability Analysis (DSA)

Republic of Lithuania: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP, unless otherwise indicated)

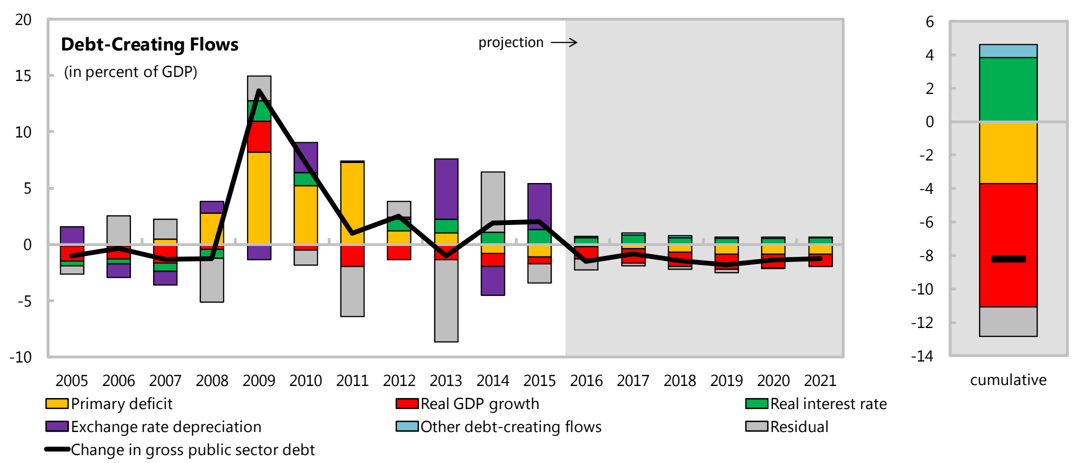
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	27.7	40.7	42.7	41.2	40.4	38.9	37.2	35.8	34.5
Public gross financing needs	8.4	4.5	6.6	8.2	5.6	10.9	7.4	11.3	9.2
Real GDP growth (in percent)	3.2	3.0	1.6	2.7	3.1	3.4	3.6	3.6	3.3
Inflation (GDP deflator, in percent)	4.5	1.2	0.4	1.4	1.5	2.2	2.3	2.4	2.4
Nominal GDP growth (in percent)	8.1	4.2	2.0	4.2	4.7	5.7	6.0	6.0	5.8
Effective interest rate (in percent) [4/]	5.3	4.2	3.8	2.9	3.8	4.0	4.0	4.1	4.2

As of April 27, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		34
5Y CDS (bp)		71
Ratings	Foreign	Local
Moody's	A3	A3
S&Ps	A-	A-
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.2	1.9	2.0	-1.5	-0.9	-1.4	-1.8	-1.4	-1.3	-8.2	
Identified debt-creating flows	3.3	-3.4	3.7	-0.5	-0.6	-1.2	-1.5	-1.4	-1.3	-6.4	
Primary deficit	2.9	-0.8	-1.1	-0.2	-0.4	-0.6	-0.9	-0.8	-0.8	-3.7	-0.5
Primary (noninterest) revenue and grant	33.9	34.0	34.7	34.4	34.5	34.7	34.8	34.9	34.9	208.2	
Primary (noninterest) expenditure	36.8	33.2	33.6	34.2	34.1	34.0	34.0	34.0	34.1	204.5	
Automatic debt dynamics [5/]	0.3	-2.6	4.8	-0.5	-0.3	-0.7	-0.8	-0.7	-0.5	-3.5	
Interest rate/growth differential [6/]	-0.5	0.0	0.7	-0.5	-0.3	-0.7	-0.8	-0.7	-0.5	-3.5	
Of which: real interest rate	0.3	1.1	1.3	0.6	0.9	0.6	0.6	0.6	0.6	3.9	
Of which: real GDP growth	-0.8	-1.1	-0.6	-1.1	-1.2	-1.3	-1.3	-1.3	-1.1	-7.4	
Exchange rate depreciation [7/]	0.8	-2.6	4.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.0	0.8	
Please specify (1) (e.g., drawdown of d	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroa	0.0	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.0	0.8	
Residual, including asset changes [8/]	-1.1	5.3	-1.7	-1.0	-0.3	-0.3	-0.3	0.0	0.1	-1.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

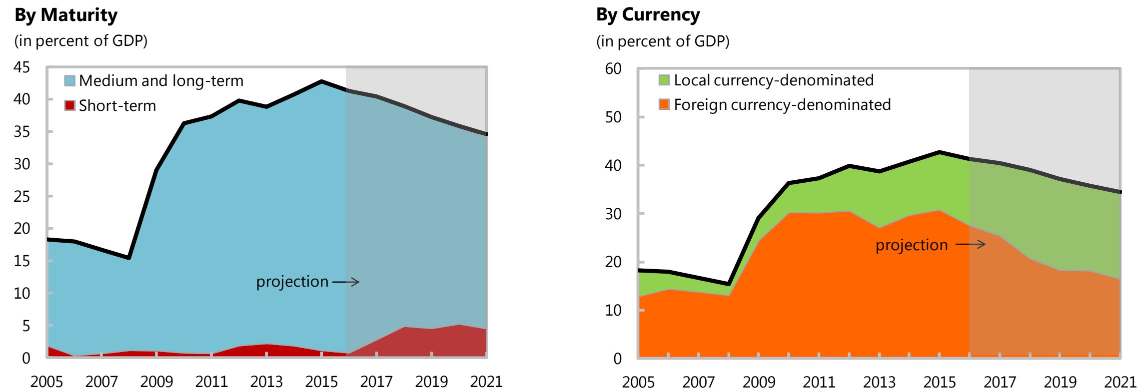
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

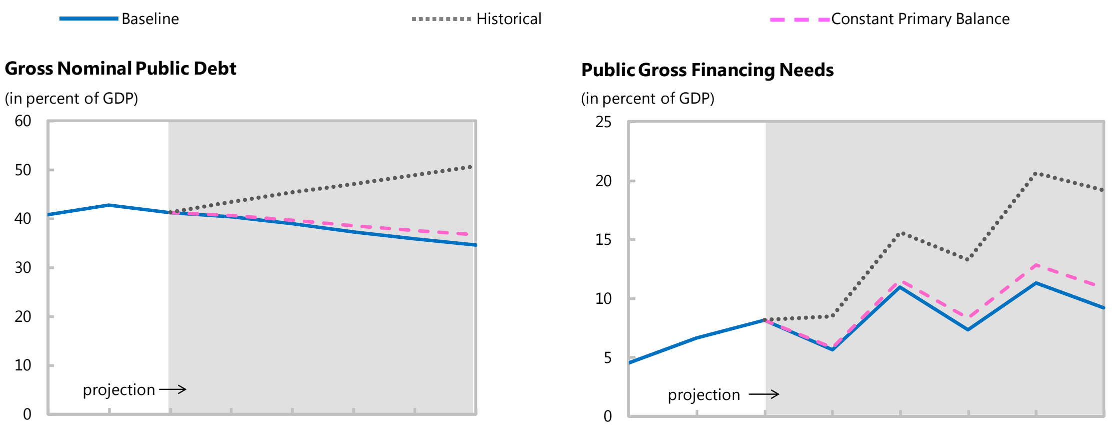
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Republic of Lithuania: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.7	3.1	3.4	3.6	3.6	3.3
Inflation	1.4	1.5	2.2	2.3	2.4	2.4
Primary Balance	0.2	0.4	0.6	0.9	0.8	0.8
Effective interest rate	2.9	3.8	4.0	4.0	4.1	4.2
Constant Primary Balance Scenario						
Real GDP growth	2.7	3.1	3.4	3.6	3.6	3.3
Inflation	1.4	1.5	2.2	2.3	2.4	2.4
Primary Balance	0.2	0.2	0.2	0.2	0.2	0.2
Effective interest rate	2.9	3.8	4.0	3.9	4.0	4.2

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.7	2.6	2.6	2.6	2.6	2.6
Inflation	1.4	1.5	2.2	2.3	2.4	2.4
Primary Balance	0.2	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	2.9	3.8	3.9	3.8	3.8	4.0

Source: IMF staff.

Republic of Lithuania: External Debt Sustainability Framework, 2010–21

(in percent of GDP, unless otherwise indicated)

	Actual					Projections							
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
Baseline: External debt	86.7	81.3	78.1	70.4	70.7	75.3	73.4	71.6	69.2	66.6	64.1	62.0	-4.6
Change in external debt	0.0	-5.5	-3.1	-7.8	0.3	4.6	-1.9	-1.8	-2.4	-2.6	-2.5	-2.1	
Identified external debt-creating flows (4+8+9)	-3.8	-8.1	-4.0	-5.5	-6.9	-1.3	-2.2	-1.7	-1.4	-1.4	-1.4	-1.1	
Current account deficit, excluding interest payments	-2.3	1.2	-1.4	-3.7	-5.6	0.0	0.5	1.7	2.0	2.2	2.2	2.1	
Deficit in balance of goods and services	1.9	2.6	-0.9	-1.3	-1.9	0.3	0.8	2.1	2.5	2.6	2.6	2.4	
Exports	65.3	75.0	81.7	84.1	81.2	76.3	73.5	75.8	76.8	77.2	76.2	75.4	
Imports	67.2	77.6	80.8	82.8	79.3	76.6	74.3	77.9	79.4	79.9	78.8	77.8	
Net non-debt creating capital inflows (negative)	-0.8	-3.0	-0.1	-0.4	-0.5	-1.9	-2.3	-2.2	-1.9	-1.9	-1.9	-1.7	
Automatic debt dynamics 1/	-0.7	-6.3	-2.4	-1.5	-0.9	0.6	-0.3	-1.3	-1.5	-1.8	-1.7	-1.5	
Contribution from nominal interest rate	2.7	2.7	2.6	2.1	2.0	1.7	1.6	0.9	0.8	0.6	0.5	0.5	
Contribution from real GDP growth	-1.4	-4.7	-2.9	-2.6	-2.0	-1.1	-2.0	-2.2	-2.3	-2.4	-2.2	-2.0	
Contribution from price and exchange rate changes 2/	-2.0	-4.3	-2.1	-1.0	-0.8	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.9	2.6	0.8	-2.2	7.3	5.9	0.4	-0.1	-1.1	-1.2	-1.1	-1.0	
External debt-to-exports ratio (in percent)	132.8	108.3	95.7	83.7	87.0	98.7	100.0	94.5	90.1	86.2	84.1	82.3	
Gross external financing need (in billions of Euro) 4/	15.4	15.4	15.3	12.9	11.3	13.2	15.7	16.2	18.2	17.7	19.0	20.2	
in percent of GDP	55.1	49.2	45.9	37.0	31.1	35.4	40.5	40.0	42.4	38.9	39.5	39.5	
Scenario with key variables at their historical averages 5/						75.3	74.8	73.9	72.6	71.3	70.0	68.8	-3.7
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	1.6	6.0	3.8	3.5	3.0	1.6	2.7	3.1	3.4	3.6	3.6	3.3	
GDP deflator in Euro (change in percent)	2.4	5.2	2.7	1.3	1.2	0.4	1.4	1.5	2.2	2.3	2.4	2.4	
Nominal external interest rate (in percent)	3.2	3.4	3.4	2.9	2.9	2.5	2.3	1.3	1.2	0.9	0.8	0.9	
Growth of exports (Euro terms, in percent)	30.9	28.1	16.1	8.0	0.7	-4.1	0.3	8.1	7.1	6.6	4.7	4.6	
Growth of imports (Euro terms, in percent)	30.5	28.7	11.1	7.5	-0.2	-1.4	1.0	9.8	7.7	6.7	4.6	4.4	
Current account balance, excluding interest payments	2.3	-1.2	1.4	3.7	5.6	0.0	-0.5	-1.7	-2.0	-2.2	-2.2	-2.1	
Net non-debt creating capital inflows	0.8	3.0	0.1	0.4	0.5	1.9	2.3	2.2	1.9	1.9	1.9	1.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

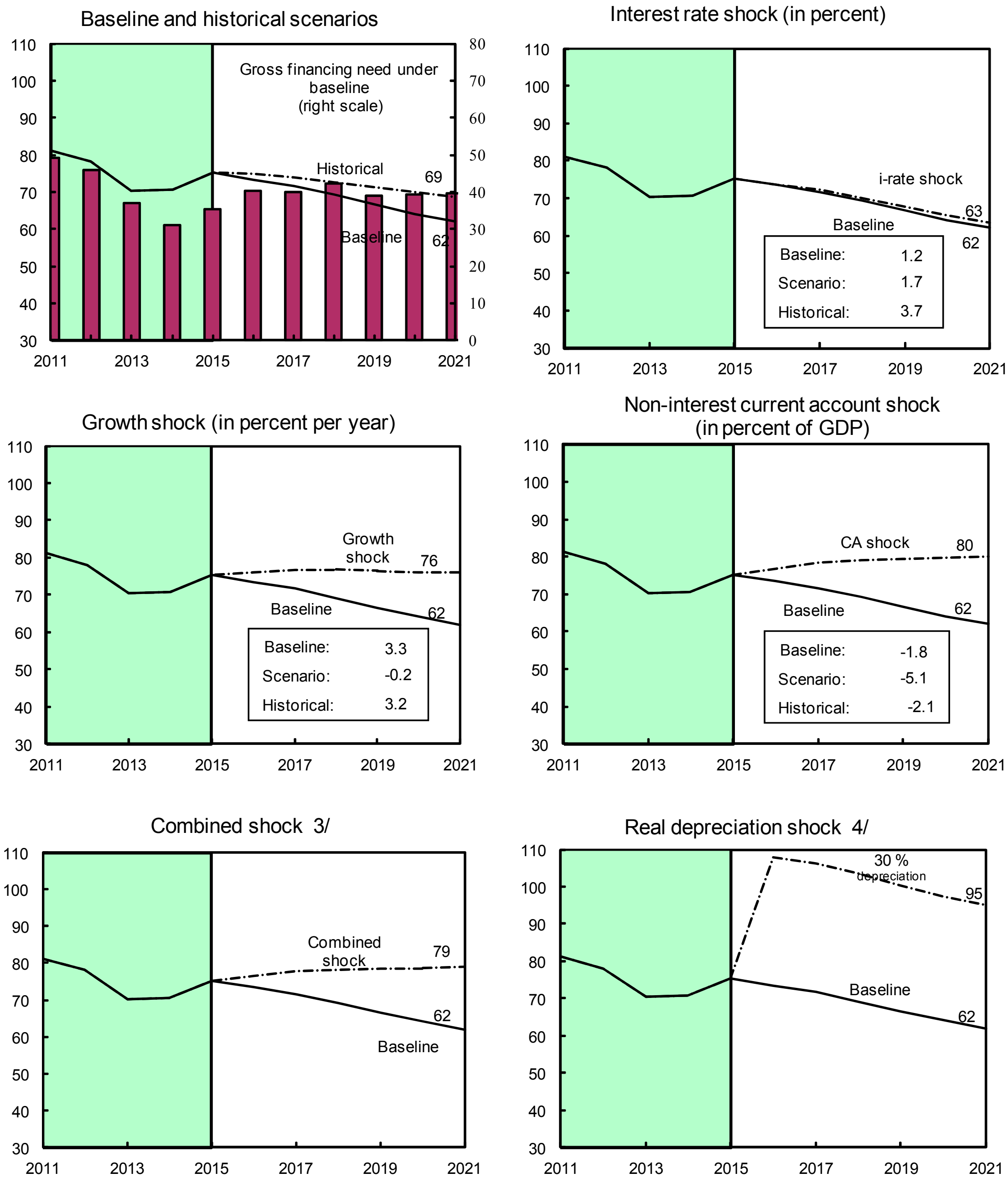
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Republic of Lithuania: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Lithuanian authorities, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 28, 2016

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of February 29, 2016)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	441.60	100.00
Fund holdings of currency (Exchange Rate)	441.58	100.00
Reserve Tranche Position	0.03	0.01

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	137.24	100.00
Holdings	137.30	100.05

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund:

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

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

Implementation of HIPC Initiative: Not applicable.

Implementation of MDRI Assistance: Not applicable.

Implementation of Catastrophe Containment and Relief (CCR): Not applicable.

Exchange Rate Arrangement:

As of January 1, 2015, the currency of Lithuania is the euro, which floats freely and independently against other currencies. Prior to 2015, the currency of Lithuania was 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. From February 2, 2002 to Dec 31, 2014, the litas was pegged to the euro at LTL 3.4528 per euro. Lithuania joined the European Union (EU) on May 1, 2004, and ERM II on June 28, 2004. Lithuania has accepted the obligations of Article VIII of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on the making of payment and transfers for current international transactions except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Previous Article IV Consultation:

Lithuania is on the 12-month consultation cycle. The last Article IV consultation was concluded on May 28, 2015. The Executive Board assessment is available at http://www.imf.org/external/np/sec/pr/2015/pr15246.htm and the staff report and other mission documents at http://www.imf.org/external/pubs/cat/longres.aspx?sk=42970.0.

Safeguards Assessment:

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

FSAP Participation and ROSCs:

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

Republic of Lithuania: Technical Assistance from the Fund, 1999–2015				
Department	**Issue**	**Action**	**Date**	**Counterpart**
STA	Balance of payments statistics (also covering Latvia)	Mr. Buxton	Resident Advisor, Oct. 1999–Oct. 2000	Bank of Lithuania
LEG	Bankruptcy legislation	Mr. Dimitrachkov	Mar. 2000	Ministry of Economy
FAD	Establishment of Fiscal Reserve Fund	Mission	Jul. 2000	State Privatization Fund
MAE	Multi-topic	Mission	Mar. 2001	Bank of Lithuania
FAD	Tax policy issues	Mission	Jun. 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	Jul. 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	Jun. 11–21, 2007	Bank of Lithuania
STA	External debt statistics	Mission	Nov. 8–19, 2007	Bank of Lithuania
FAD	Public expenditure review	WB mission / Ms. Budina (FAD) participation	Apr. 14–24, 2009	Ministry of Finance
FAD	Tax Administration	Mission	Aug. 26–Sep. 8, 2009	Ministry of Finance
MCM/LEG	Bank Resolution/Banking Law	Mission	Sep. 28–Oct. 6, 2009	Bank of Lithuania/Ministry of Finance
FAD	Reform of Social Security and Health Funds	Mission	Apr. 6–20, 2010	Ministry of Finance/State Social Insurance Fund Board
LEG	Personal Bankruptcy Reform	Mission	Apr. 30–May 8, 2010	Ministry of Economy
FAD	Tax Administration	Mission	Jul. 14–27, 2010	Ministry of Finance
FAD	General Tax Policy	Mission	Oct. 19–25, 2010	Ministry of Finance
STA	GFS 2001 Statistics	Mission	Feb. 11–22, 2013	Ministry of Finance
MCM	Credit Unions	Mission	Nov. 18–29, 2013	Bank of Lithuania
MCM	Stress Testing	Mission	Dec. 16–18, 2013	Bank of Lithuania
FAD	Local Government Finance	Mission	Dec. 9–16, 2014	Ministry of Finance

Resident Representative:

None

Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT): Lithuania's compliance with the Financial Action Task Force (FATF) standard, was last assessed by MONEYVAL, the FATF-style regional body of which it is a member, in April 2012. The assessment report was published in December 2012. Lithuania was rated partially compliant on nineteen FATF Recommendations, leading to the application of the first stage of the Compliance Enhancing Procedure (CEP). In response, the authorities amended the Criminal Code and the AML/CFT Law and put in place secondary legislation and guidelines. This extended the list of punishable activities, criminalized financing of terrorism, reorganized the suspicious transactions reporting system, strengthened customer due diligence, and extended record keeping requirements. Lithuania has submitted to date three compliance reports under the CEP procedure. In recognition of the progress achieved in the key areas of concern, MONEYVAL ended the CEP at step 1 in April 2015, but recommended that the authorities address the remaining deficiencies and ensure effective implementation of its AML/CFT framework in order to exit the regular follow-up procedures. At the 50th Plenary meeting in April 2016, the Moneyval Secretariat acknowledged progress made by Lithuania but noted that further progress is needed with respect to R.5, R.13/SR.IV and SR.III. A decision to exit follow-up procedures is now expected in December 2016. Lithuania is scheduled to undergo the fifth round of mutual evaluation under the revised FATF methodology in the second quarter of 2017.

STATISTICAL ISSUES

General: Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are adequate for surveillance purposes. Lithuania subscribed to the Special Data Dissemination Standard (SDDS) in May 1996, and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since April 1997. Lithuania meets the SDDS specifications for coverage, periodicity and timeliness of the data, and for the dissemination of the advance release calendars. A significant amount of economic and financial information is now available on various websites through the Internet (see section on Dissemination of Statistics, below). A ROSC data module was published in November 2002. Data provision to the Fund for surveillance purposes is considered adequate.

National Accounts: The national accounts are compiled by Statistics Lithuania (SL) in accordance with the guidelines of the European System of Accounts 2010 (ESA 2010) from 2005 data onwards (data before 2005 still follow the European System of Accounts 1995, ESA 95). Quarterly GDP estimates at current and at constant prices are compiled using the production, expenditure and income approaches. GDP estimates by production are considered to be more reliable than the corresponding estimates by expenditure and income, but no statistical discrepancies between these three estimates are shown separately in the published figures as the discrepancies are included in the estimates of changes in inventories (expenditure approach) and operating surplus and mixed income (income approach). The annual and the quarterly national accounts are compiled at previous year prices and chain-linked to 2010. In general, good data sources and sound methods are used for the compilation of the national accounts, but measuring activity during the volatile environment of the 2008/09 crisis proved challenging. Moreover, difficulties remain in measuring the non-observed economy. These estimates are compiled at detailed levels of economic activity using fixed coefficients derived from a benchmark surveys conducted in 1996 and 2003, and updated in 2006, and in 2011. According to the most recent updates, the non-observed economy was estimated to be 28.5 percent of GDP in 2012.

Price Statistics: The main statistical data source for the production of the CPI is a monthly statistical survey on prices for consumer goods and services. Information published in the legal acts of state institutions, catalogues, pricelists, and on enterprises' websites is also used. The price survey covers the entire territory of the country, and data is collected in small, medium, and large towns. The CPI covers consumption expenditure of the residents of the country and is the main instrument of indexation. The authorities also produce the Harmonized Index of Consumer Prices (HICP) which is used to measure inflation in the EU and is fully comparable across countries. In addition to the consumption expenditure of residents, the HICP covers also consumption expenditure of non-residents and foreign visitors but excludes financial intermediation services and games of chance. Differences in coverage and hence weighting account for most of the differences in the value of the CPI and HICP. Since December 1998, CPI weights have been updated annually. The base period for the CPI is 2010 and for the HICP is 2005 (first year of data availability). The monthly CPI and HICP are available in the second week following the reference month. The producer price index is calculated according to the chain-linked Laspeyres formula with weights updated every year.

Government Finance Statistics: Data on the central government budget execution are available at a monthly and quarterly frequency. 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 methodology, incorporating the GFSM 2014, was adopted in October 2014. Annual and quarterly historical data have been converted into the GFSM 2014 format back to 2010, with data before 2010 still in the GFSM 2001 format. Administrative data sources include the Ministry of Finance, State Social Insurance Fund Board (Sodra), Compulsory Health Insurance Fund, Employment Fund, and financial statements of enterprises. The MoF is reporting to STA general government's annual data on an accrual and cash basis for publication in the Government Finance Statistics Yearbook (GFSY). In addition, the MoF is reporting quarterly and monthly data for publication in the IFS.

Monetary Statistics: The Bank of Lithuania (BoL) reports monetary and financial statistics (MFS) to STA on a timely and regular basis. The scope, concepts and definitions of the MFS are broadly in line with the guidelines of the Monetary and Financial Statistics Manual (MFSM). Following Lithuania's accession to the European Union, the BoL implemented the ECB framework for compiling and reporting monetary data reflecting the ECB regulations and ESA 2010 on sectorization, valuation and classification of financial instruments.

Balance of Payments: The BoL is responsible for compiling balance of payments, international investment position (IIP), external debt and international reserves statistics. The BoL reports quarterly data on balance of payments, IIP and monthly international reserves to STA on a timely and regular basis. Balance of payments data (on a monthly and quarterly basis) are compiled using the format recommended in the Balance of Payments Manual, sixth edition (BPM6) from 2004 data onwards (data before 2004 still follow the BPM5 methodology). The monthly data correspond to several key balance of payments components, compiled on the basis of a sample survey covering the public sector, commercial banks, and some nonfinancial private sector institutions. The Data Template on International Reserves and Foreign Currency Liquidity is disseminated monthly according to the operational guidelines and is hyperlinked to the Fund's DSBB. Since late 2004, the BoL disseminates quarterly external debt data in the World Bank's Quarterly External Debt Statistics (QEDS) database.

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

- metadata for data categories defined by the Special Data Dissemination Standard are posted on the IMF's DSBB (http://dsbb.imf.org);
- the BoL website (http://www.lb.lt/statistical_data_tree) provides data on monetary statistics, treasury bill auction results, balance of payments, IIP, external debt and other main economic indicators;
- the SL website (http://osp.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.nasdaqomxbaltic.com/market/?lang=en) includes information on stock trading at NASDAQ OMX Baltic stock Exchange in Vilnius (the former Vilnius Stock Exchange).

Republic of Lithuania: Table of Common Indicators Required for Surveillance

As of April 5, 2016

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	April 5, 2016	April 5, 2016	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec 2015	March 21, 2016	M	M	M		
Reserve/Base Money	February 2016	March 29, 2016	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	February 2016	March 29, 2016	M	M	M		
Central Bank Balance Sheet	February 2016	March 29, 2016	M	M	M		
Consolidated Balance Sheet of the Banking System	February 2016	March 29, 2016	M	M	M		
Interest Rates[2]	February 2016	March 29, 2016	M	M	M		
Consumer Price Index	February 2016	March 8, 2016	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3/2015	December 12, 2015	Q	Q	Q	LO, LO, LO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Q3/2015	March 31, 2016	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	February 2016	March 31, 2016	M	M	M		
External Current Account Balance	Q4/2015	March 21, 2016	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	January 2016	March 21, 2016	M	M	M		
GDP/GNP	Q4/2015	February 29, 2016	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q4/2015	March 21, 2016	Q	Q	Q		
International Investment Position[6]	Q4/2015	March 21, 2016	Q	Q	Q		

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

[2] Both market-based and officially-determined, including deposit and lending rates, discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability position vis-à-vis nonresidents.

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

[8] Reflects the assessment provided in the data ROSC published in July 2004, the findings of the mission that took place during September 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Thomas Ostros, Executive Director for the Repulic of Lithuania and Rimtautas Bartkus, Senior Advisor
May 13, 2016

The Lithuanian authorities highly appreciate the engaging discussions with the IMF staff and their well-articulated policy advice that is taken into consideration in policy design. The authorities have made significant progress over the recent years in enhancing the economic and financial resilience, correcting the past imbalances, and upgrading the policy frameworks. The macroeconomic stability has been restored and Lithuania has joined the euro area from a position of strength. The authorities have subscribed to the enhanced economic policy coordination of the euro area, anchoring their commitments to policy prudence that is of essence for successful functioning in the currency union.

Economic outlook

Due to the unfavourable external environment, the economic growth decelerated to 1.6 percent in 2015, though it is expected to improve going forward. Low energy prices had an overall positive effect on the economy, but the recessional environment in the CIS region, together with the sanctions applied by the Russian Federation took a toll on the export performance. In 2015, the merchandise export to the CIS region contracted by almost a third and the services export shrunk by a fourth. A successful export reorientation somewhat mitigated the external demand shock and the real exports of goods and services turned out even higher than a year ago, though the domestic demand remained the principle driver of the economy.

The business sentiment fluctuated through the year, but did not deteriorate. Investment has been encouraged by high capacity utilization, increased absorption of EU structural funds, and activity in the real-estate sector. Higher real disposable income and improvement in the labour market boosted consumer confidence. Wages have increased by 5.1 percent as a result of higher minimum wage and increasing wage pressures in some sectors. The unemployment rate has declined to 9.1 percent in 2015 and is projected to improve by further 0.6 percentage points in 2016. The inflation forecast has been revised downwards due to stronger than anticipated decline in energy prices and only a modest 0.5 percent increase in prices is expected this year.

As the external drag softens, economic growth is expected to reach 2.5 percent in 2016, narrowing the output gap. The risks to the outlook, however, remain tilted to the downside and mostly relate to the external side, notably a possible increase in the commodity prices and developments in the key export markets. The entrenchment of low inflation environment in the euro area, higher volatility in global financial markets, renewed pressures in the Schengen area, and political instability in the EU are other risk factors. On the upside, possible depreciation of the euro would support exports and the external demand may turn out generally stronger. The shrinking labour force is a more inherent policy challenge. The authorities contemplate measures that should contribute to raising economic growth potential, will strengthen the long-term fiscal sustainability and alleviate effects of current demographic trends.

Economic policies

The fiscal outturn over-performed the 2015 budget plan by a significant margin as the key tax bases grew faster than the GDP. The headline deficit declined to 0.2 percent of GDP in 2015 and is expected to increase to around 0.8 percent of GDP this year. The 2016 budget includes measures supporting the low income earners – an increase in the minimum wage, the basic income tax allowance, pensions and public sector wages. In fulfilling external obligations, the authorities have also reached a broad political agreement on the accelerated increase in the defence expenditure. On the revenue side, the authorities increased excise taxes, adjusted the capital taxation, and made progress in tax administration.

Close-to-balanced public finances facilitate implementation of structural reforms. Lithuania maintains one of the lowest levels of tax revenue to GDP in the EU, though some of the public functions are underfinanced and the income inequality is high. The authorities aim to alter this balance over the medium term, shifting towards a more appropriate level of redistribution that is sufficient to provide adequate social services and reduce income inequality. In addition, Lithuania has accelerated accumulation of the fiscal buffer based on the amended State Treasury Law and respective parliamentary resolution, enforced since the beginning of 2016. From this year onwards, half of the state budget revenue generated from assets-related transactions will be transferred to the Reserve Fund.

Smart implementation of fiscal structural reforms requires well-sequenced, multifaceted policy efforts that, among other things, reallocate resources towards a more productive use, for example by addressing the oversized infrastructure in the health care and education sectors. At the current juncture, the authorities' attention is focused on the labour market, education, and social security reforms that aim to improve labour market flexibility, non-price competitiveness, develop higher productivity sectors, address skill mismatches, and increase social inclusion. The 2016 stability program and the national reform agenda also recognize the need to gradually increase the environmental taxation.

In June 2015, the Government approved the legislative reforms of the social sector, the so-called New Social Model. The reform package that is currently under consideration by the Parliament proposes amendments to the Labour Code, the Employment Law, the Unemployment Social Insurance Law, the State Social Insurance Pensions Law, and other laws. These reforms aim to balance the multiple objectives: increase the adequacy of social safety nets, enhance labour market flexibility, facilitate integration in the labour market through better use of active labour market policies, and reduce incentives for informal work. The New Social Model also aims to amend the pension formula, introducing the well-defined pension indexation, strengthening the link between benefits and contributions, separating the basic pension from the social insurance and transferring it to the state budget. The authorities estimate that the envisaged reform measures should allow for securing a long-term balance in the pension system.

Financial sector

The Lithuanian banking sector is well capitalized and liquid, profitability remains stable, and the prudential requirements are met with comfortable margins. The statutory liquidity requirement is exceeded by nearly a third, at 24.8 percent the capital adequacy ratio is also more than twice the regulatory requirement. Even under the severe shock scenario the banking sector would stay above the capital requirement. The quality of the banks' capital is high, consisting almost entirely of the core tier one capital. Banks have limited external exposures and are predominantly funded through domestic deposits, with the loan-to-deposit ratio at 100 percent. Since joining the euro area, the banks have also gained access to the Eurosystem liquidity. The banking sector's profitability has been supported by further cost optimization, offsetting the changeover related losses in the commission income and falling net interest income. Despite the low interest rate environment, the net interest rate margins have remained stable.

The credit growth has resumed in 2015 and the quality of the loan portfolio continued to improve. During the five years of deleveraging the private sector loan portfolio shrunk by 25 percentage points to 41 percent of GDP – the lowest level in the euro area. The level of NPLs has been reduced almost fourfold from its peak in 2010 and currently stands at 5.5 percent. The recognition of previous losses is largely complete and the quality of the loan portfolio is further enhanced by the improved financial standing of the borrowers. The credit to private sector increased by 4.1 percent in 2015. The results of the lending surveys, high capacity utilization in the corporate sector, and an increasing demand for durable goods among the households allow expecting the positive trends in crediting to be sustained in 2016. The situation in the housing sector is viewed as balanced; the average prices have increased by 3.4 percent on an annual basis. There are no signs of pressures or imbalances; most of the transactions are financed from own funds, with only less than a third of the transactions requiring credit financing.

In implementing its macro-prudential mandate, the Bank of Lithuania (BoL) approved the macro-prudential policy strategy, clarifying the policy objectives and the decision making processes. Aiming to safeguard the borrowers from excessive debt accumulation in the low interest rate environment, the BoL amended the Responsible Lending Regulations. The maximum loan maturity was shortened from 40 to 30 years. The interest rate sensitivity of the DSTI requirement has been reduced, while providing limited flexibility to apply a higher DSTI ratio under specific circumstances without compromising the macro-prudential objectives. After transposing the CRD IV directive into the national law, the BoL activated a 2.5 percent capital conservation buffer and set the countercyclical capital buffer. Given the absence of the cyclical imbalances in the credit market, the countercyclical capital buffer was set at 0 percent. The BoL also calibrated the O-SII buffers for the 4 systemically important banks that will come into force in December 2016.

A comprehensive systemic reform of the credit union sector has been prepared and currently awaits the final approval by the Parliament. The BoL has also introduced the capital requirement for the credit unions highly exposed to the corporate sector, strengthened the liquidity requirements for the fast growing entities, and adopted a regulation limiting the market risk associated with investment in debt securities.