INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/242

# REPUBLIC OF LITHUANIA

## 2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

July 2024

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 2024 Article IV consultation with the Republic of Lithuania, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on June 7, 2024, 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 June 27, 2024.
- An **Informational Annex** prepared by the IMF staff.

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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PRESS RELEASE

PR 24/284

# IMF Executive Board Concludes 2024 Article IV Consultation with the Republic of Lithuania

**FOR IMMEDIATE RELEASE**

**Washington, DC** – **July 24, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Lithuania and endorsed the staff appraisal on a lapse-of-time basis without a meeting.

After a short and shallow recession, the Lithuanian economy has started to recover supported by strong disinflation. After recording one of the highest rates of inflation in 2022—at around 20 percent, twice the euro area average—inflation more than halved in 2023 and is now below the euro area average. The strong disinflationary momentum continued in early-2024 and reflects lower commodity prices, tighter monetary conditions, and a contractionary fiscal stance. Core inflation, however, remains elevated due to high energy pass-through, services inflation and nominal wage growth. The labor market has remained tight with declining labor productivity as firms held on to workers during the downturn. The banking system continues to be well capitalized and highly profitable while the real estate market has partially corrected imbalances built in the post-covid, pre-war period.

The economy is expected to continue the recovery path supported by high real wage growth and public investment while external demand is expected to gain momentum throughout the year. Headline inflation will remain close to 1 percent this year before converging to above 2 percent, but core inflation will experience larger persistence due to the tight labor market and strong real wage growth. However, global fragmentation, long-term spending pressures, eroded corporate profitability, and pre-existing structural challenges in education, healthcare and the labor market continue weighing on productivity and the medium-term growth outlook.

Risks to the short-term outlook have become more balanced as inflation risks have dissipated and a quicker pickup in external demand or higher investment could increase the speed of the recovery. Geopolitical risks, in contrast, could harm growth, as could slow progress in implementing politically difficult but needed structural reforms in pensions, education, and healthcare.

**Executive Board Assessment[2]**

In concluding the 2024 Article IV Consultation with the Republic of Lithuania, Executive Directors endorsed staff's appraisal, as follows:

The Lithuanian economy is recovering from a shallow recession and high inflation. Inflation more than halved last year supported by lower energy prices and is now below the eurozone average. Core inflation has also moderated but remains elevated due to high energy pass-through, nominal wage growth and services inflation. The strong disinflationary momentum

[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] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

reflects lower commodity prices, tighter monetary conditions, and a contractionary fiscal stance. Risks have become more balanced.

After a strong performance last year, the fiscal position is expected to become moderately expansionary this year but less than the budget would imply. Remarkably, the structural fiscal position has barely deteriorated compared to the pre-pandemic period. Given that the output gap is small and decreasing as the recovery is gaining strength, a broadly neutral fiscal stance seems appropriate. To that end, any unused spending buffers or revenue overperformance should be saved, particularly if the economy surprises to the upside.

Lithuania is facing large spending pressures from defense and higher borrowing costs that add to long-term pressures from aging and climate. These pressures could add between 5 and 10 percent of GDP to spending. Addressing these pressures will require a comprehensive strategy with the aim to avoid introducing distortions that would worsen the growth potential; preserve fiscal sustainability; and maintain a pro-active fiscal policy. There are four elements to this strategy: (i) pension reform; (ii) education and healthcare reforms; (iii) revenue mobilization; and (iv) resetting the fiscal targets around current levels preserving a strong fiscal position.

Despite declining interest margins, banks' profitability will remain elevated. With deposit rates gradually increasing and policy rates expected to continue decreasing, net interest income is easing from very high levels. The banking system remains liquid and well capitalized providing large buffers to absorb potential losses arising from unexpected shocks. Balance sheet risks associated with higher interest rates have not materialized so far. The public investment agency INVEGA will play an important role intermediating RRF loans. To avoid crowding out lending from private banks and to ensure efficient operations void of political interference, the agency should keep its mandate explicit and narrow, and ensure effective monitoring and transparency.

Given heightened uncertainty, the emphasis should remain on mitigating non-systemic risks to financial stability. While the real estate market has stabilized recently, there are pockets of vulnerability in the commercial real estate market that warrant vigilance. No new risks have emerged, and the financial cycle is undergoing a soft-landing. Thus, the authorities have adopted an appropriate neutral macroprudential stance. If risks materialize, the relaxation of capital-based measures would be appropriate in response to credit supply disruptions while targeted adjustment to borrower-based measures can be used to deal with a disorderly correction of the real estate market to support lending to the real economy.

The levy on banks should be phased out. Given its careful design, the levy has had little disincentive effects. However, the decision to extend the levy one more year raises questions about the future taxation of the sector that is already subject to higher tax rates. Thus, the levy should be let expire, and no other levy should be introduced to avoid being perceived as a tax on foreign investment—the sector is overwhelmingly dominated by foreign banks—and to minimize the negative impact on efficiency that would accrue over time.

There has been significant progress in strengthening the AML/CFT supervision framework that needs to continue to reduce heightened ML/TF risks. The authorities have effectively implemented measures including: (i) deepening their understanding of the country's non-resident ML/TF risks; (ii) increasing BoL's AML/CFT supervisory resources; (iii) updating ML/FT risk assessment methodology; (iv) strengthening VASPs market entry controls; and (v) strengthening AML/CFT controls to access CENTROlink. The BoL should continue to mitigate

ML/TF risks, including continuing preparations to begin supervising VASPs as of the end of 2024 and developing further CENTROlink AML/CFT assessment guidelines.

Lithuania's external position was broadly in line with fundamentals in 2023. It entered the recent shock in 2021 with an undervalued REER, which helped absorb permanently higher input costs from high inflation.

Solid fundamentals have allowed Lithuania to absorb the recent competitiveness shock without a significant impact on its growth potential. The recent loss in market shares for goods was largely driven by sanctions on Russia and Belarus, while exports of services have continued to grow strongly. With negative inflation differentials with trading partners and labor productivity expected to recover, there should be no further losses of competitiveness in the near-term. However, long-term spending pressures and long-standing structural challenges will weigh on productivity at a time of domestic and global headwinds.

Persistent structural inefficiencies in the labor market and the education system should be addressed. Active labor market policies need to be more responsive to cyclical conditions while employment subsidies should concentrate on the most disadvantaged. Education reforms are necessary to foster vocational training, but funding is locked in a large tertiary education system that does not produce the skills the labor market demands.

Susceptible to risks associated with climate change, Lithuania needs to accelerate the green transition, particularly for adaptation. An introduction of an economy-wide carbon tax on fossil fuels, alongside the EU's emission trading system, would facilitate faster decarbonization, incentivize renewable investments, and provide resources to protect vulnerable households and strengthen the physical infrastructure against climate change.

## Table 1. Lithuania: Selected Economic Indicators, 2020–29[1]

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Projections | | | |
| **Output** | | | | | | | | | | |
| Real GDP growth (annual percentage change) | 0.1 | 6.2 | 2.4 | -0.3 | 2.4 | 2.6 | 2.4 | 2.2 | 2.2 | 2.2 |
| Domestic demand growth (year-on-year, in percent) | -3.6 | 7.3 | 2.1 | -1.6 | 1.7 | 3.1 | 2.8 | 2.4 | 2.3 | 2.2 |
| Private consumption growth (year-on-year, in percent) | -3.1 | 7.8 | 2.0 | -1.0 | 3.0 | 2.5 | 2.2 | 2.1 | 2.1 | 3.3 |
| Domestic fixed investment growth (year-on-year, in percent) | -0.5 | 9.4 | 3.6 | 10.6 | 1.9 | 4.3 | 4.3 | 3.5 | 2.8 | 5.4 |
| Inventories (contribution to growth) | -1.0 | -0.1 | -0.1 | -3.4 | -1.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 3.4 | -0.5 | 0.7 | 1.2 | 0.9 | -0.1 | -0.1 | 0.1 | 0.1 | 0.0 |
| Nominal GDP (in billions of euro) | 49.8 | 56.5 | 67.5 | 72.0 | 75.9 | 80.3 | 84.5 | 88.5 | 92.7 | 97.0 |
| Output gap (percent of potential GDP) | -1.2 | 1.6 | 1.8 | -0.7 | -0.5 | -0.2 | 0.1 | 0.1 | 0.1 | 0.0 |
| **Employment** | | | | | | | | | | |
| Unemployment rate (year average, in percent of labor force) | 8.5 | 7.1 | 6.0 | 6.9 | 7.3 | 7.1 | 6.5 | 6.1 | 6.0 | 6.0 |
| Average monthly gross earnings (annual percentage change) | 10.1 | 10.5 | 13.3 | 12.2 | 8.4 | 5.1 | 5.0 | 5.1 | 5.0 | 5.0 |
| Average monthly gross earnings, real (CPI-deflated, annual percentage change) | 9.0 | 5.6 | -4.6 | 3.5 | 7.2 | 2.8 | 2.6 | 2.7 | 2.6 | 2.7 |
| Labor productivity (annual percentage change) | 1.6 | 5.4 | -1.3 | -1.7 | 1.4 | 3.0 | 2.8 | 2.9 | 3.2 | 3.2 |
| **Prices** | | | | | | | | | | |
| HICP, period average (annual percentage change) | 1.1 | 4.6 | 18.9 | 8.7 | 1.2 | 2.3 | 2.4 | 2.4 | 2.4 | 2.4 |
| HICP core, period average (annual percentage change) | 2.5 | 3.2 | 13.6 | 10.7 | 2.9 | 2.5 | 2.2 | 2.2 | 2.2 | 2.2 |
| HICP, end of period (year-on-year percentage change) | -0.1 | 10.7 | 20.0 | 0.6 | 2.4 | 2.1 | 2.2 | 2.4 | 2.4 | 2.4 |
| GDP deflator (year-on-year percentage change) | 1.7 | 6.8 | 16.6 | 6.9 | 3.0 | 3.0 | 2.8 | 2.5 | 2.4 | 2.4 |
| **General government finances** | | | | | | | | | | |
| Fiscal balance (percent of GDP) | -6.5 | -1.1 | -0.7 | -0.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | -1.2 |
| Fiscal balance excl. one-offs (percent of GDP) | -6.5 | -1.2 | -0.7 | -0.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | -1.2 |
| Structural fiscal balance (percent of potential GDP) | -5.3 | -1.3 | -1.3 | -0.2 | -1.0 | -1.1 | -1.0 | -1.1 | -0.9 | -0.7 |
| Revenue (percent of GDP) | 36.3 | 36.3 | 35.7 | 37.4 | 39.2 | 39.1 | 38.4 | 37.3 | 37.2 | 37.1 |
| *Of which EU grants* | 0.7 | 0.6 | 0.6 | 0.7 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 |
| Expenditure (percent of GDP) | 42.8 | 37.4 | 36.3 | 38.2 | 40.7 | 40.7 | 39.8 | 38.8 | 38.6 | 38.3 |
| *Of which:* Non-interest | 42.1 | 37.0 | 36.0 | 37.6 | 40.0 | 39.7 | 38.7 | 37.7 | 37.5 | 37.0 |
| Interest | 0.7 | 0.4 | 0.4 | 0.6 | 0.8 | 1.0 | 1.1 | 1.1 | 1.1 | 1.2 |
| General government gross debt (percent of GDP) | 46.3 | 43.4 | 38.0 | 38.3 | 38.1 | 38.0 | 37.8 | 37.7 | 37.5 | 37.0 |
| *Of which:* Foreign currency-denominated | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Balance of payments** | | | | | | | | | | |
| Current account balance (percent of GDP) | 7.3 | 1.1 | -5.5 | 1.9 | 2.8 | 2.9 | 3.0 | 2.8 | 2.8 | 2.8 |
| Current account balance (billions of euros) | 3.6 | 0.6 | -3.7 | 1.4 | 2.1 | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 |

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

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

INTERNATIONAL MONETARY FUND

# REPUBLIC OF LITHUANIA

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

June 27, 2024

## KEY ISSUES

**Context.** Lithuania has experienced fast income convergence over the past two decades and the economy is projected to return to growth this year after a shallow recession. However, higher inflation differentials following the shock triggered by Russia's invasion of Ukraine have had an impact on competitiveness, even though Lithuania entered this crisis with an undervalued real effective exchange rate. At the same time, global fragmentation, long-term spending pressures, eroded corporate profitability, and pre-existing structural challenges in education, healthcare and the labor market continue weighing on productivity and growth. Thus, Lithuania needs prudent policies and decisive structural reforms to support sustained productivity growth and ensure higher living standards and continued convergence.

**Key Policy Recommendations.** Prudent policies and the flexibility of the economy, particularly in the labor market, will help preserve macroeconomic and financial stability, a pre-requisite for sustained growth particularly given heightened volatility.

- **Fiscal policy**: over the short-term, a broadly neutral fiscal stance would be appropriate. Over the medium-term, policies need to find the right balance between accommodating spending pressures, improving spending efficiency and preserving a strong fiscal position and attractive tax environment.

- **Support productivity growth:** this is the only way to have high wage growth going forward without hurting competitiveness.

  - Reforms in ***education and healthcare*** are needed to improve poor outcomes and raise human capital by focusing on improving quality and efficiency.
  - ***Pension and tax policy*** reform need to be ambitious to address spending pressures, ensure fiscal sustainability and improve the efficiency of the economy.
  - ***Labor market*** reform should focus on improving active labor market policies to upskill the labor force, reduce skill mismatches and increase participation.

- **Fintech and AML:** Continue efforts to address risks associated with the high value and volume of cross-border financial flows by strengthening regulation and AML/CFT supervision of non-resident cross-border payments.

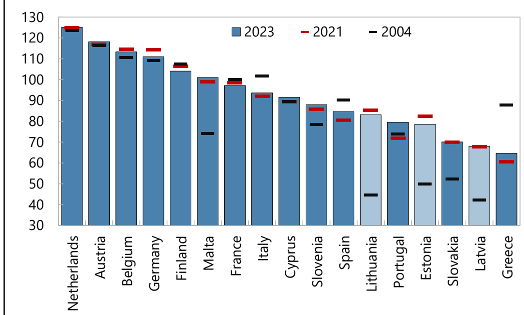
| Approved By | |
|---|---|
| **Helge Berger (EUR) and Bergljot Barkbu (SPR)** | Discussions were held in Vilnius during May 24–June 7, 2024. The team comprised Mr. Borja Gracia (head), Ms. Kazuko Shirono (incoming head joined the mission in the second week), Ms. Saioa Armendariz, Mr. Lukas Boer, and Mr. Serhan Cevik (all EUR). Mr. Vitas Vasiliauskas (OED) participated in most of the meetings. Ms. Kelly MacKinnon, Ms. Sadhna Naik (all EUR) and Alex Malden (LEG) supported the mission from headquarters. |

# CONTENTS

# CONTEXT: SUCCESSFUL CONVERGENCE THREATENED BY RECENT INFLATION SHOCK AND GLOBAL RISKS

**1. Lithuania experienced fast income convergence until the shock provoked by Russia's invasion of Ukraine.** The strong policy response to the global financial crisis (GFC) reinforced external competitiveness and raised income per capita from 40 percent in 2009 to 85 percent of the eurozone average in 2021, leading convergence in the Baltics. However, income per capita has stagnated since, on the back of the negative terms-of-trade shock in 2022 and subsequent high inflation.

**GDP per capita PPP**
(EA = 100)

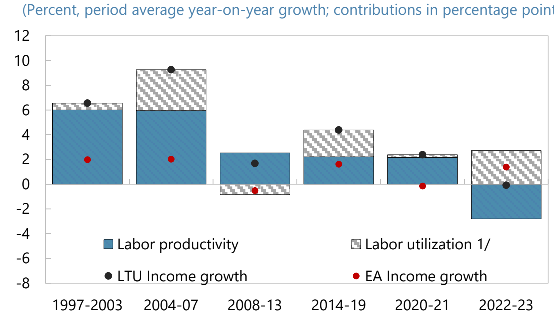



Sources: Eurostat; and IMF staff calculations.

**2. Large inflation differentials with trading partners over the last two years have undermined external competitiveness at a time of global and domestic structural headwinds.** Lithuania exited the pandemic with little visible scarring—GDP at end-2021 returned to the pre-pandemic trend—in large part due to the flexibility of the economy, ample buffers, and proactive fiscal policy. However, the inflation surge resulted in a 12 percent appreciation of the real effective exchange rate (REER) since 2021 and a loss of export market shares in goods. At the same time, labor productivity has fallen while labor utilization has increased in contrast to previous downturns when labor productivity increased, and labor utilization fell. While the terms-of-trade shock has largely reversed, permanently higher levels of prices and input costs could have a negative impact on competitiveness. Furthermore, global fragmentation, long-term spending pressures and pre-existing structural issues could weigh on productivity and growth going forward.

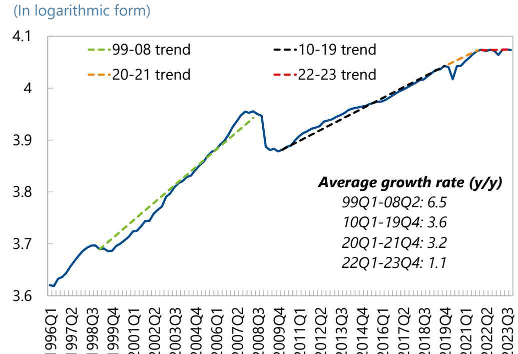
## Text Figure 1. Real Income and GDP

**Real Income Per Capita Growth**
(Percent, period average year-on-year growth; contributions in percentage points)




Sources: Haver Analytics; Eurostat; and IMF staff calculations.
1/ Labor utilization reflects developments in the activity rate, the employment rate and hours per employee.

**Real GDP**
(In logarithmic form)



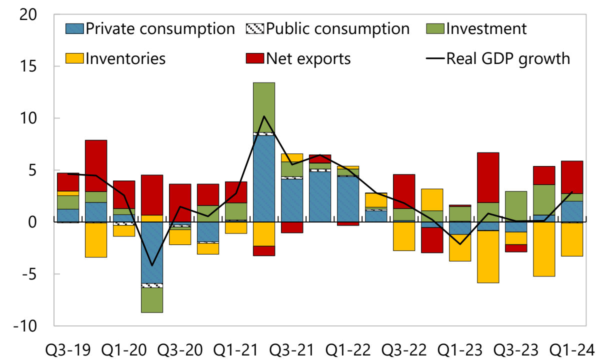

Sources: Statistics Lithuania; and IMF staff calculations.

# RECENT DEVELOPMENTS: DOMESTIC DEMAND LEADS THE RECOVERY AMIDST HEIGHTENED UNCERTAINTY

3. **The economy went through a mild contraction last year driven by weak consumption and, particularly, the correction of the inventory cycle triggered by the war and high inflation.** Inflation eroded disposable income and negatively affected households' consumption that only started a gradual recovery by the end of the year. For firms, geopolitical risks, supply disruptions and high inflation in 2022 caused a strong accumulation of inventories that was almost fully reversed in 2023, subtracting around 3.5 percentage points of growth (1.5 percent). Domestic demand net of inventories gradually recovered during the year supported by the restoration of households' purchasing power—real wage growth turned positive in August—and strong investment boosted by European Union (EU) funds. Despite weak demand of key trading partners, exports of services remained strong, and some imports were substituted with inventories resulting in a positive contribution from the external sector to growth.

**Real GDP**

(Year-on-year percentage change; contributions in percentage points)



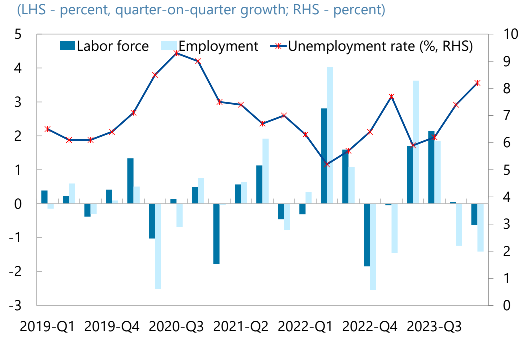

Sources: Haver Analytics; Eurostat; and IMF staff calculations.

4. **The labor market remained tight in 2023 even as the labor force grew given strong immigration from Ukraine.** The labor market remained historically tight in 2023 with vacancies per unemployed still above 2021 levels. Employment growth remained positive while the unemployment rate increased slightly. This was driven by an increase in the labor force given strong net migration—driven by Ukrainian citizens—of more than 1.5 percent of the total population.

## Text Figure 2. Labor Market and Population

**Labor Market**

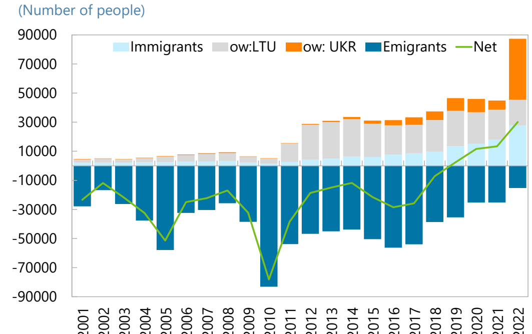
(LHS - percent, quarter-on-quarter growth; RHS - percent)




Sources: Statistics Lithuania; and Haver Analytics.

**Migration**

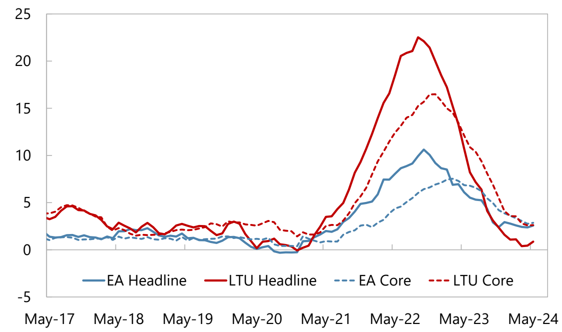
(Number of people)




Sources: Statistics Lithuania; and IMF staff calculations.

**5. Inflation decelerated faster than expected and is now below the eurozone average, but core inflation remains elevated due to high wage growth and services inflation.** After recording one of the highest rates in 2022 (around 20 percent, twice the eurozone average), inflation more than halved in 2023 supported by lower energy prices and base effects. Core inflation also moderated but as expected, remained above headline inflation due to energy pass-through and high nominal wage growth. The disinflationary momentum persisted in early-2024, with both headline and core inflation below the eurozone average. The strength of disinflation continued in early-2024 and reflects lower commodity prices, tighter monetary conditions, and a contractionary fiscal stance.

**Inflation**
(Year-on-year percentage change)

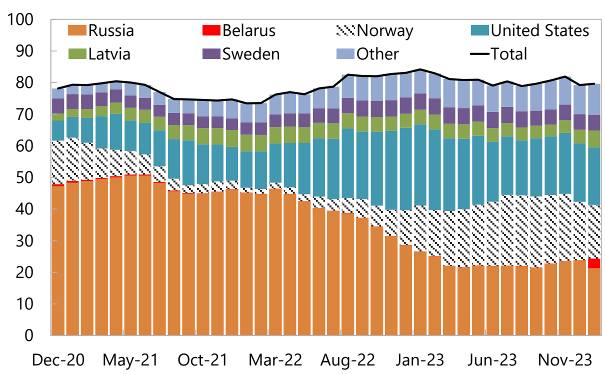



Sources: Statistics Lithuania; Eurostat; Haver Analytics; and IMF staff calculations.

**6. With energy prices back around pre-war levels, energy subsidies were phased out.** Lithuania depends heavily on energy imports— the net energy trade balance deteriorated from -4.9 percent of GDP in 2021 to -10.8 percent in 2022 and recovered to -4.5 percent last year. The country reduced by half energy imported from Russia last year—albeit at higher cost given the substitution of Russian gas with LNG. The authorities responded to higher energy prices by providing generalized but temporary subsidies to households and, to a much lesser extent, businesses. This prevented potentially costly macroeconomic disruptions from unprecedented and largely temporary increases in energy prices.

### Text Figure 3. Energy Imports and Energy Subsidies

**Imports of Fuel and Energy by Trading Partner**
(In natural thousand units, 12m accumulated)




Source: Statistics Lithuania.

**Energy Subsidy and Tariff**
(Electricity in EUR/kWh, gas in EUR/m3; unless otherwise specified)

| Period | Sector | Full Tariff | Tariff Faced by Consumer | Subsidized Part | Actual/Projected Costs (% of GDP) |
|---|---|---|---|---|---|
| 2022H2 | Gas | | | | |
| | Household | 3.46 | 1.02 | 2.44 | 0.5 |
| | Electricity | | | | |
| | Household | 0.46 | 0.24 | 0.23 | 0.6 |
| | Businesses | 0.46 | 0.35 | 0.12 | 0.2 |
| 2023H1 | Gas | | | | |
| | Household | 2.96 | 1.4 | 1.56 | 0.2 |
| | Electricity | | | | |
| | Household | 0.56 | 0.28 | 0.28 | 0.1 |
| | Businesses | 0.56 | 0.42 | 0.14 | 0.01 |
| 2023H2 | Gas | | | | |
| | Household | 2.03 | 1.36 | 0.67 | 0.07 |
| | Electricity | | *No Subsidy* | | |
| 2024 | Gas | | *No Subsidy* | | |
| | Electricity | | | | |

Source: National Energy Regulatory Council (VERT).
Notes: Natural gas supply is not regulated for businesses.

**7. Fiscal performance was stronger than expected in 2023 with a structural position that has barely deteriorated compared to the pre-pandemic period.** With an overall budget deficit of 0.8 percent of GDP—almost unchanged from 0.7 percent in 2022 but with a larger output gap—the fiscal policy stance was contractionary in 2023. This was largely due to revenue overperformance supported by still elevated inflation, the tax on banks and the faster-than-planned phaseout of energy subsidies that more than compensated for higher military outlays and interest payments. As a result, debt-to-GDP continued its downward trend falling 10 percentage points from the pandemic peak. Importantly, given the transitory and largely targeted support measures during the pandemic and the energy crisis, the underlying structural position remains strong—a deficit of 0.5 percent of potential GDP last year or a deterioration of 1 percent since 2019, half of which reflects permanently higher defense spending.

**2023 Budget Deficit**

(Overall budget balance in percent of GDP)

| *Budget* | *Outturn* | *Difference* |
|---|---|---|
| 4.9 | 0.8 | 4.1 |

**Contributing factors**

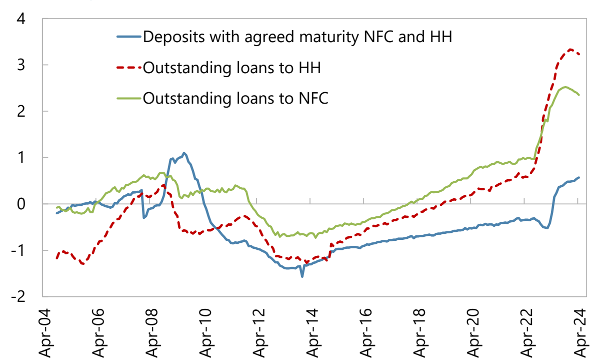
| | |
|---|---|
| Revenue overperformance | 1.4 |
| Energy subsidy underspending | 1.0 |
| Defense (accrual) underspending | 0.4 |
| Social security overperformance | 1.0 |
| Local government overperformance | 0.3 |
| Total | 4.1 |

Source: Ministry of Finance.

**8. The banking system remains very liquid, well capitalized, and highly profitable with low NPLs, despite the levy on banks.** With ample liquidity (342 percent liquidity coverage ratio by end-2023), banks' profitability benefitted from a faster transmission of higher interest rates on predominantly variable-rate loans than on deposits. Banks' interest income was also boosted by deposits at the European Central Bank (ECB), around 16 percent of banks' assets in 2023, remunerated at 3.4 percent. This, combined with one of the most cost-efficient systems in Europe, led to very high profitability (1.8 return on assets and 24.6 return on equity) even after paying the levy on banks (0.35 percent of GDP). High profitability last year—doubled over 2022—and high levels of capital (19.5 percent CAR) and asset quality (NPL ratio of 0.58 percent) provided ample buffers.

**Interest Rates on Loans and Deposits**

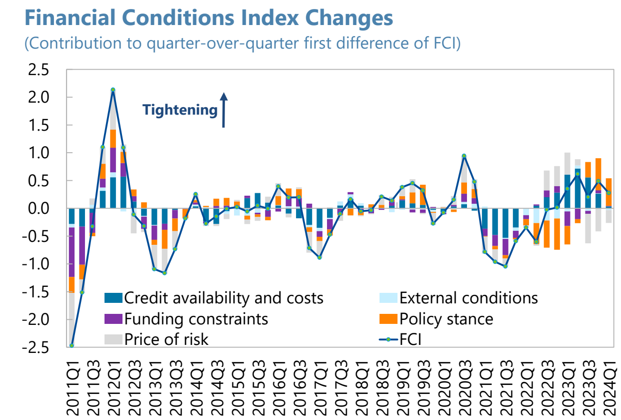
(Percentage points; differential with the Euro Area)




Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

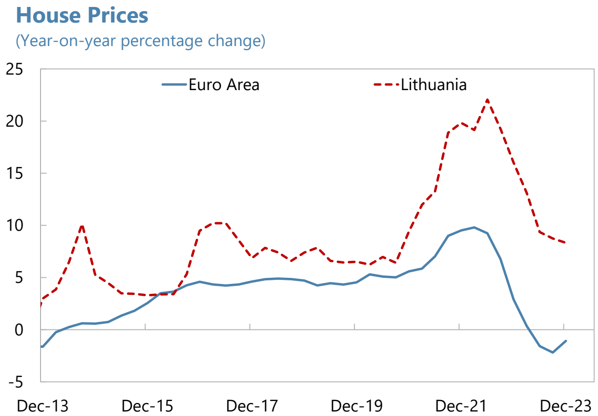
**9. The ECB assumed direct supervision of Revolut Bank in early 2024**. This expected decision reflects the rapid expansion of the bank since 2019—third largest bank with 18 percent of system-wide assets—and the institution's business model based almost exclusively on non-resident EU depositors. In parallel, the Bank of Lithuania (BoL) doubled Revolut's additional capital buffer requirement as systemically important institution to 2 percent effective July 1, 2024.

**10. With tightening financial conditions until recently, the real estate market has partially corrected imbalances built in the post-covid, pre-war period.** The rapid growth of real estate prices since 2020, fueled by accommodative monetary conditions, large fiscal support, supply chain disruptions and an overheating economy, eased in 2023. Higher borrowing costs and the erosion of households' purchasing power have supported a slowdown of nominal price growth in 2023 to 10 percent, from 19.1 percent in 2022. Consequently, prices are, so far, orderly moving closer to levels justified by fundamentals. However, affordability deteriorated in 2022 driven by large negative real wages—a trend that has reversed last year.

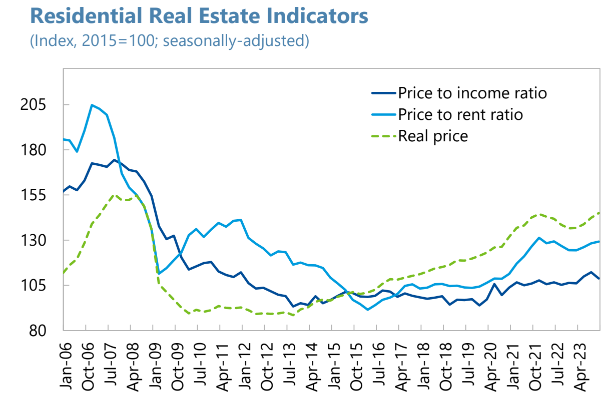


Source: Borraccia et al., 2023, IMF Working Paper 23/209.

**Text Figure 4. House Prices**



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.



Sources: Bank of International Settlements; Haver Analytics; Eurostat, and IMF staff calculations.

**11. Lithuania's external position in 2023 was broadly in line with fundamentals.** The current account balance increased strongly to a surplus of 2.6 percent of GDP in 2023 driven by a substantial decrease in net energy imports and an increase in the services balance to an all-time high. With the partial reversal of the terms-of-trade shock during 2023 weighing against the ongoing run-down in inventories, the current account is expected to remain in line with the norm under the current baseline.

# OUTLOOK AND RISKS: POLITICAL UNCERTAINTY AND LACK OF STRUCTURAL REFORMS

**12. The economy is set to continue the recovery path supported by domestic demand and the revival of foreign demand**:

- *Activity is recovering in 2024, supported by private consumption and investment.* Low inflation and high real wage growth sustain domestic demand, together with public investment financed by EU funds. External demand is expected to gain momentum throughout the year, reinforcing growth going forward. Over the long run, real GDP growth will stabilize at around 2.2 percent, but a shrinking labor force will slow growth over the longer-term.

- *Headline inflation is projected to fall below 2 percent this year, but core inflation will experience larger persistence due to a tight labor market and strong real wage growth*. Inflation will stabilize around 2-2.5 percent over the medium-term, above the eurozone average consistent with the convergence process.

**13. Risks to the outlook have become more balanced, amid heightened geopolitical tensions and political uncertainty ahead of parliamentary elections.** On the upside, risks related to higher inflation have decreased and a quicker pickup in external demand or higher investment could lead to a stronger recovery. Given low inflation, Lithuania has increased scope for fiscal policy to respond to adverse supply and demand shocks. Growth could be harmed if geopolitical tensions intensify further. There are domestic risks related to the slow progress in implementing politically difficult but needed structural reforms in pensions, education, and healthcare.

***Authorities' Views***

**14. The authorities broadly agree with staff's assessment of the outlook and risks and highlight the resilience of the labor market**. They acknowledge that persistent geopolitical risks weigh on investor's sentiment but consider risks more balanced compared to last year. They project a more gradual recovery of the external sector, with domestic demand expected to lead growth this year. They emphasized that the disinflationary momentum has continued this year and see limited inflationary risks going forward even as they expect elevated wage growth over the near-term. They expect productivity growth to turn positive as the recovery gains pace.

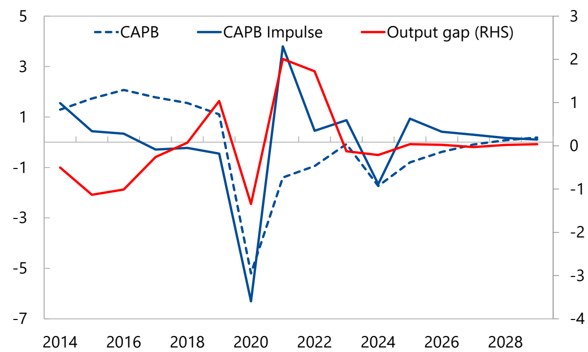
# POLICY DISCUSSIONS: ADDRESSING SPENDING PRESSURES AND SUPPORTING PRODUCTIVITY

*While the recent inflationary shock should have a limited impact on the economy's growth potential, Lithuania faces significant challenges from structural global headwinds, eroded corporate profitability and long-standing domestic structural issues. Fiscal policy faces a difficult balancing act between accommodating higher defense and aging-related expenditures while improving spending efficiency, maintaining the strong fiscal position, and preserving the attractiveness of the tax system. Over the medium term, reforms will be key to preserve competitiveness and support faster income convergence.*

### Policies to Preserve Stability and Accelerate Sustainable Growth

**15. Fiscal policy has played an important role in macroeconomic stabilization over the last decade.** Avoiding the pro-cyclical stance that characterized the years leading to the GFC, fiscal policy has taken a needed stabilization role since. During the pandemic and the energy crisis an unprecedented level of support was provided and in 2023 a negative fiscal impulse supported disinflation efforts even as economic activity weakened. This active policy role is key in a small open economy without independent monetary policy where fiscal policy is the only macroeconomic stabilization tool available.

**Fiscal Policy Stance**
(Percent of potential GDP)




Sources: Ministry of Finance; and IMF staff calculations.

**16. The fiscal stance in 2024 is projected to be expansionary, but less than what the budget implies.** With a mildly negative output gap, the deficit is projected to widen from 0.8 percent of GDP in 2023 to 1.6 percent in 2024—2.9 percent of GDP under the budget law that incorporates spending buffers, conservative revenue assumptions and worse macroeconomic projections than staff. This represents a structural loosening of around 1 percent of potential GDP excluding additional military spending (around 0.2 percent of GDP). Although low inflation and a negative output gap suggest that fiscal policy could be supportive, the output gap is small and decreasing and the recovery is gaining strength. Hence, a broadly neutral fiscal stance would be more appropriate.

**Lithuania: Fiscal Balance***

| | 2023 | 2024 | 2025 |
|---|---|---|---|
| Budget | -0.8 | -2.9 | |
| Staff baseline | -0.8 | -1.6 | -1.6 |
| *structural balance* | -0.1 | -1.1 | -1.4 |
| Staff recommendation | -0.8 | -1.1 | -0.8 |
| *structural balance* | -0.1 | -0.6 | -0.6 |

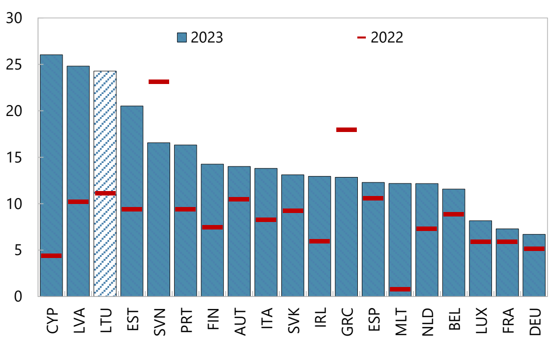
*Excluding extra military spending and energy subsidies

**17. Despite declining interest margins, banks' profitability will remain elevated.** With deposit rates gradually increasing and policy rates expected to decrease further, interest margins are expected to narrow. Still, profitability will remain above historical levels and higher than the eurozone average. Given the resilience of the labor market and the stabilization and gradual recovery of the property market, balance sheet risks associated with higher interest rates have not materialized so far.

**18. Large capital buffers and healthy profitability provide extensive buffers to absorb potential losses**. Under the BoL's severe downside scenario with cumulative GDP losses of 9 percent over three years, overall banks' capital would still exceed minimum requirements. Regarding liquidity, banks are currently able to cover around 36 percent decrease in deposits. The loan-to-deposit ratio remains below 60 percent with credit demand subdued due to higher interest rate, and heightened uncertainty. At the same time, the public investment agency INVEGA is taking a more active role in providing financial services including intermediating RRF funds. All in all, banks are well placed to support a credit expansion when demand recovers.

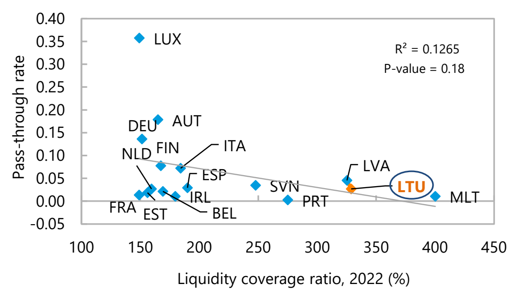
**Text Figure 5. Banking System Profitability**

**Return on Equity**
(Percent)




Sources: European Banking Authority; Haver Analytics; and IMF staff calculations.

**Pass-Through of 12-Month EURIBOR to HH Overnight Deposits and Liquidity Coverage Ratio in Euro Area**
(From July, 2022 to Aug, 2023)




Sources: Haver Analytics; and IMF staff calculations.
Note: Pass-through is calculated as the changes in deposit rates to the changes in the ECB's policy rate for the concerned time period.

**19. The temporary levy on banks has been extended one more year until 2025.** Given its intended temporary nature and by targeting net interest income of existing loans only, the levy has had little disincentive effects so far. Extraordinary profitability allowed banks to pay the levy, increase capitalization and distribute profits. However, the extension raises question about the future taxation of the sector. In addition, the current levy will deliver decreasing amounts of revenue—around a sixth of last year's revenues—as profitability declines. Therefore, to raise a meaningful amount of revenues, increasingly distortionary forms of taxation would be needed. Going forward, the levy should be let expire to avoid being perceived as a tax on foreign investment and to minimize the potential negative impact on efficiency.

**20. Given heightened uncertainty, the emphasis should remain on mitigating non-systemic financial stability risks.** No new risks have emerged, and the financial cycle is undergoing a soft-landing after the robust performance since 2020. Thus, the authorities have adopted an appropriate neutral macroprudential stance with no new measures after those introduced in 2022. While the real estate market has stabilized recently, there are segments of commercial real estate in the Vilnius area that could remain overvalued. Given persistent high interest rates, at times in excess of rental yields, refinancing non-systemic risks in some pockets of this market remain. If risks materialize, the relaxation of capital-based measures would be appropriate in response to credit supply disruptions while targeted adjustments to borrower-based measures can be used to deal with a disorderly correction of the real estate market to support lending to the real economy.

| Lithuania: Macroprudential Measures |
| --- |
| **Down payment** |
| *15 percent first loan* |
| *30 percent subsequent loans (introduced in 2022)* |
| **DTI** |
| *40 percent* |
| *50 percent under 5 percent interest rate scenario since 2015* |
| **Maturity** |
| *Maximum 30 years* |
| **Systemically Important Institution buffer** |
| *Swedbank 2 percent* |
| *SEB 2 percent* |
| *Revolut 1 percent (2 percent since July 2024)* |
| *Šiaulių 1 percent* |
| **Counter-cyclical capital buffer** |
| *1 percent effective October 2023* |
| **Capital conservation buffer** |
| *2.5 percent* |
| **Sectoral systemic risk buffer** |
| *2 percent applicable to housing loan portfolio since July 2022* |

**21. There has been significant progress in strengthening the AML/CFT framework, but further efforts are necessary to reduce heightened ML/TF risks.** This has been the result of a large increase in the value and volume of cross-border financial flows, including with higher risk jurisdictions since 2020 driven, in part, by the introduction of BoL's CENTROlink payment system for electronic money institutions (EMI) and payment institutions' (PI) for eurozone payments. Lithuania has also seen a substantial increase in the number of fintech companies (82 in 2016 and 276 in 2023). In response to this heightened risk environment, the authorities have effectively implemented measures consistent with past staff recommendations including (i) deepening their understanding of the country's non-resident ML/TF risks; (ii) increasing BoL's AML/CFT supervisory resources; (iii) increasing the number of on-site and off-site visits; (iv) updating ML/FT risk assessment methodology; (v) strengthening virtual asset service providers (VASPs) market entry controls; and (vi) strengthen AML/CFT controls to access CENTROlink. These AML/CFT reforms have resulted in a stabilization of the number of EMIs and PIs that have access to CENTROlink and the revoking of several licenses on AML/CFT grounds. The central bank should continue to mitigate ML/TF risks, including continuing preparations to begin supervising VASPs by end-2024 and strengthening CENTROlink AML/CFT assessment guidelines for operational use.

**Lithuania: AML/CFT**

| | Recommendations | Actions |
|---|---|---|
| **Cross-border and Non-resident ML/TF Risk Understanding** | • Expand the National Risk Assessment to cover analysis of ML/TF risks from non-resident activity and cross-border payments and reflect the evolution of the financial sector<br>• Develop and operationalize understanding of ML/TF higher-risk countries based on Lithuania-specific risk factors in coordination with all relevant AML/CFT agencies.<br>• Monitor the rapid and sizable increase in the value and volume of correspondent banking transactions from an ML/TF risk perspective | • BoL updated its ML/TF risk assessment methodology, addressing Lithuania-specific risk factors, and incorporated these country risk factors into risk assessment models (banking, EMI/PI sectors).<br>• BoL has developed a new tool to detect deviation of financial flows from economic fundamentals to improve the efficiency of surveillance of unusual flows. |
| **AML/CFT Supervision of Banks and Virtual Asset Service Provider** | • Broaden the AML/CFT supervisory coverage of the financial sector with a focus on risksensitive supervisory presence in the sector and a more detailed strategy for the risk-based supervision of banks<br>• Strengthen BOL's AML/CFT resources and capacity<br>• Increase AML/CFT controls to access the BoL payment system (CentroLink), including formalizing risk rating methodology to inform CentroLink onboarding decisions.<br>• Strengthen ongoing monitoring of PSP activity in CentroLink and fine-tune BoL's due diligence questionnaire to reflect Lithuania-specific ML/TF risks | • Board of the BoL approved the Financial Market Participants AML/CFT Supervisory Strategy which includes a minimum engagement model.<br>• As of Q1 2024, the BoL has increased FTEs in AML Division by 46% compared to 2022<br>• Number of on-site inspections in 2023 increased by 75% compared to 2022<br>• BoL established a committee making decisions regarding business relationships with existing and potential CentroLink participants. |

Note: From SIP in 2022 AIV consultation and recent regional Nordic-Baltic AML/CFT technical assistance project.

## A Difficult Balancing Act to Address Mounting Long-term Spending Pressures

22. **Lithuania is facing large spending pressures arising from security needs and higher cost of borrowing that add to long-term pressures particularly from aging.**[1] Notwithstanding the recent stabilization, Lithuania has experienced a shrinking population—from 3.7 million in 1991 to below 3 million in 2019. With a rapidly aging population, Lithuania's old-age dependency ratio will increase above 53 percent in 2050 and 67 percent by 2070—far above the EU average. Altogether, spending pressures over the next 25 years could amount to as 'little' as 5 percent of GDP and as much as 10 percent of GDP relative to the 2023 level over 2030-2050.

**Lithuania: Expenditure Pressures**
(Relative to 2023 baseline)

| | Lithuania | Euro Area | EU |
|---|---|---|---|
| Defense | 0.5 - 0.7 | | |
| Interest payments | 0.4 - 0.8 | | |
| Pensions | 3 - 5 | 0.6 - 0.9 | 0.4 - 0.7 |
| Healthcare and long-term care | 0.7 - 1.7 | 0.7 - 1.2 | 0.7 - 1.2 |
| Education | -0.4 | -0.4 | -0.4 |
| Green transition | 1 - 2 | 0.8 | |
| Total | 5.2 - 9.8 | | |

Sources: 2024 Aging Report; and IMF staff calculations.

- ***Defense spending*** has increased from 0.9 percent of GDP in 2010 to 2 percent in 2018 and over 2.5 percent in 2023. There is political consensus on the need for raising defense spending further to 3 percent of GDP over the medium-term. The temporary levy on banks

[1] See "Navigating Minefields and Headwinds: National Security, Demographic Shifts, Climate Change, and Fiscal Policy in Lithuania," Selected Issues Paper No. 24/[x].

has been used to finance part of the additional defense spending so far and a more comprehensive package of revenue measures has been approved that will provide long-term funding.

- ***Interest payments*** are gradually increasing from 0.4 percent of GDP in 2022 to about 1.2 percent by 2029. A low stock of debt with high average maturity will smooth the pass-through of tighter financial conditions to effective interest rates. This will gradually increase interest expenditure past the point when policy rates start declining.

- ***Pensions*** (see Annex VI). With the 2018 reform of the pay-as-you-go pillar, benefits were indexed to wages and the retirement age increased to 65 by 2026. However, given better-than-projected developments in the labor market, discretionary additional increases in benefits (up to 75 percent of short-term surpluses) and worse demographic projections have raised long-term entitlements—accrued total pension entitlements have increased from 217 percent of GDP in 2019 to 275 percent in 2021. The 2018 reform ensures the financial sustainability of the system but not its social sustainability with low and decreasing replacement ratios. Thus, pension spending is projected to increase by about 3 percent of GDP by 2050, from 1.3 percent of GDP projected in the 2021 Ageing Report. The balance of the pension system is projected to move into deficit by the end of this decade. Spending pressures could be even larger if the replacement ratio of the pay-as-you-go system were to remain constant which would require around 2 percent of GDP in additional spending.

- ***Other age-related spending pressures:*** Long-term care and healthcare spending pressures could gradually increase by 0.7 percent of GDP per year over the next two decades with long-term pressures up to 1.7 percent of GDP (2024 EU Ageing Report). At the same time and given aging, education spending could fall by around 0.3-0.4 percent of GDP per year.

- ***Green transition***. According to estimates by the European Investment Bank (EIB), gross costs could amount to around 2 percent of GDP by 2050.[2]

**23. Addressing long-term expenditure pressures will require a comprehensive strategy.** This strategy should include: (i) structural reforms to reduce some of these pressures, particularly pensions; (ii) improved spending efficiency in healthcare and education where the quality of outcomes lag peers; (iii) revenue mobilization; and (iv) recalibration of fiscal targets. The final goal should be to address these pressures without introducing distortions or disincentives that would worsen the growth potential; preserve fiscal sustainability; and maintain a pro-active fiscal policy.

**24. The pension system could be reformed to increase social sustainability while preserving fiscal soundness.** Reforms involved trade-offs between reigning fiscal costs and reducing old-age poverty, and between increasing redistribution—pensions in Lithuania are the most important tool available for redistribution—and ensuring participation and compliance. With these tradeoffs in mind,

[2] The EIB Investment Report 2020/2021: Building a smart and green Europe in the COVID-19 era.

- *Pillar I (pay-as-you-go):* Linking the statutory retirement age to longevity can help maintain actuarial balance—for illustrative purposes, increasing the retirement age to 75 by 2070 could maintain the replacement ratio at 40 percent in a budget-neutral way. Subjecting pensions to the standard personal income tax (PIT) could provide budgetary resources to support non-contributory basic pensions helping those receiving lower contributory pensions. While these reforms can deliver significant resources, replacement ratios high enough to meaningfully reduce old-age poverty would result in further costs. Since social security contributions are already high, higher budgetary transfers appear inevitable to increase replacement ratios.

- *Pillar II (defined-contribution system based on personal accounts):* Most of the investment of Pillar II funds is made abroad providing a welcome risk diversification. As it matures, this Pillar will stabilize the replacement ratio. Thus, strong incentives to participate in, ideally making participation mandatory, and strong disincentives to early withdrawals would help risk diversification and reduce the pressure on the state-funded Pillar I.

**25. Education and healthcare outcomes are worse than peers with comparable spending levels, indicating room for improving spending efficiency** (see Annex VI). Education reforms remain incomplete and previous efforts have not proven ambitious enough to deliver material improvement in outcomes. Although enrollment is high, Lithuania stands at the lower end of EU countries in performance. Rationalizing the extensive school network would provide savings that can be redirected to improve the quality of schools and help address skills mismatches in the labor market—the third largest in the EU. With one of the highest levels of preventable and treatable mortality in the EU, Lithuania scores poorly in the efficiency of public health. Although spending per capita is still relatively low, adverse demographic will exert upward pressure on spending. Hence, making the healthcare system more efficient could be achieved by focusing on preventive care and reducing the cost of pharmaceuticals and the hospitals network.

**Lithuania: Tax Revenue - Lithuania vs. Baltics and EU**

(Percent of GDP)

| | Lithuania | | | Estonia | | | Latvia | | | EU-27 | | | Differential with EU | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2022 | Share | 2019 | 2022 | Share | 2019 | 2022 | Share | 2019 | 2022 | Share | 2019 | 2022 | Share |
| Total tax revenues | 30.2 | 31.6 | 100 | 33.3 | 32.9 | 100 | 30.7 | 30.3 | 100 | 40.1 | 40.3 | 100 | -9.9 | -8.7 | 0.0 |
| PIT | 7.2 | 7.6 | 24.1 | 5.5 | 6.3 | 19.1 | 6.5 | 5.8 | 19.1 | 9.6 | 9.6 | 23.8 | -2.4 | -2.0 | 0.2 |
| CIT | 1.6 | 2.3 | 7.3 | 1.8 | 1.7 | 5.2 | 0.2 | 1.0 | 3.3 | 2.6 | 3.3 | 8.2 | -1.0 | -1.0 | -0.9 |
| VAT | 7.9 | 8.4 | 26.6 | 8.9 | 9.2 | 28.0 | 8.6 | 9.4 | 31.0 | 7.2 | 7.5 | 18.6 | 0.7 | 0.9 | 8.0 |
| Excise and consumption taxes | 3.0 | 2.4 | 7.6 | … | … | … | 3.5 | 2.9 | 9.6 | 2.0 | 1.5 | 3.7 | 1.0 | 0.9 | 3.9 |
| Taxes on land, buildings, and other structures | 0.2 | 0.2 | 0.6 | 0.2 | 0.2 | 0.6 | 0.7 | 0.6 | 2.0 | 1.1 | 0.9 | 2.2 | -0.9 | -0.7 | -1.6 |
| Social security contributions | 10.0 | 10.2 | 32.3 | 11.9 | 11.7 | 35.6 | 10.0 | 9.7 | 32.0 | 14.1 | 13.9 | 34.5 | -4.1 | -3.7 | -2.2 |
| Other | 0.3 | 0.5 | 1.6 | … | … | … | 1.2 | 0.9 | 3.0 | 3.5 | 3.6 | 8.9 | -3.2 | -3.1 | -7.4 |

Source: Eurostat; and European Commission.

**26. There is scope to increase tax revenues while preserving the competitive tax environment in Lithuania.** Lithuania collects less tax revenue, around 10 percent of GDP, than the EU average and the system is heavily tilted towards labor taxes—55 percent of total tax revenue. With a shrinking and aging population, the tax burden will increasingly fall on a smaller base of taxpayers, exacerbating economic distortions and causing a further drop in labor force participation.

- *Raising the corporate income tax (CIT) rate.* Although higher than in Estonia or Latvia, the CIT regime yields around 1 percent of GDP in revenues less than in the EU. There is room to raise the rate and/or eliminate exemptions, including the privileged PIT regime for the self-employed.

**Tax Rates**

| | Lithuania | Estonia | Latvia | Sweden | EU-28 |
|---|---|---|---|---|---|
| VAT | 21 | 20 | 21 | 25 | 21 |
| CIT | 16 | 20 | 15 | 22 | 22 |
| PIT | 20 | 20 | 23 | 25 | 34 |
| Real Estate | 0.5 - 3 | 2.5 | 3 | 2.8 | 4 |

Source: Eurostat; and IMF staff calculations.

- *Reducing tax expenditures.* Tax concessions and exemptions (excluding the non-taxable allowance) are around 3 percent of GDP and tend to benefit the wealthy. Reducing them could generate revenues while improving efficiency of the system.

**Tax Expenditures in 2022**

| | in EUR million | Percent of GDP |
|---|---|---|
| Value Added Tax | 489 | 0.7 |
| Excise Duty | 337 | 0.5 |
| Corporate Income Tax | 491 | 0.7 |
| Personal Income Tax | 1,702 | 2.5 |
| *of which from non-taxable income* | *1,030* | *1.5* |
| TOTAL | 3,018 | 4.5 |

Source: Ministry of Finance.

- *Introducing a carbon tax and increasing environmental taxes.* They currently amount to 1.5 percent of GDP, concentrated on transportation fuel, 1.3 percent of GDP. Introducing an economy-wide carbon tax of US$75 per metric ton of $CO_2$ emissions could raise 1.5 percent of GDP in revenues.

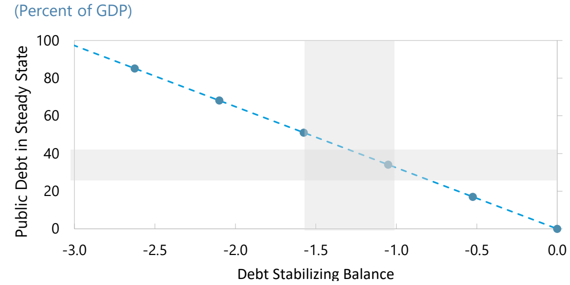
- *Modernizing the property tax regime.* These taxes are applied to high-value real estate and paid by a relatively small fraction of the population. Property tax revenue amounts to 0.2 percent of GDP, similar to Estonia but three times lower than Latvia and around 0.8 percent of GDP lower than the EU average.

- *Social security contributions and pensions.* While there is limited space to increase social security contributions, introducing pensions to the general tax system could be considered (see above).

- *Indirect taxes.* Lithuania relies heavily on VAT revenues, around 8.5 percent or a fourth of total tax revenues compare to an average of 7.5 percent of GDP in the EU. Thus, there is limited scope to increase VAT further.

27. **Fiscal targets can be set around current levels preserving a strong fiscal position that delivers a counter-cyclical stance.** The fiscal rule targets a structural balance of the general government. When the output gap is negative a deficit not exceeding the medium-term objective (currently at -1 percent of GDP) is allowed. While overly complex, the rule imposes a welcome counter-cyclical stance and has proven effective in securing fiscal discipline (including a surplus in the five years pre-pandemic). Given low debt and deficits, Lithuania complies with the reference values in the EU economic governance

**Overall Balance Target and Debt 1/**
(Percent of GDP)




Source: IMF staff calculations.
1/ Implied debt level for any given debt stabilizing balance assuming r-g around 0.6 percent with steady state growth at 2.2 and effective.

framework and the domestic rule anchors policy. Targets could be set to a moderate structural deficit of 1 percent of GDP in line with this year's projected outcome, above the deficit resilience safeguard in the EU framework. This is consistent with steady state debt below 40 percent of GDP and provides sufficient space to support the economy during downturns without exceeding the 3 percent of GDP deficit reference value in the EU framework.

**Lithuania: Potential Measures to Address Spending Pressures**

| | Measures | Impact | Impact on economic efficiency | Distributional impact |
|---|---|---|---|---|
| **Pension reform** | Link retirement age to longevity | Partially Absorbs the impact of demographic changes on pension spending | Positive impact on participation rate | Not clear, it reduces years of retirement but could support higher pensions |
| | Increase payroll contributions | Narrows the pension deficit, but payroll taxes are already high | Decrease participation and increase non-compliance | Negative |
| | Subject pensions to PIT | Creates additional revenue that can help support low income pensioners | Neutral | Positive if resources are channeled to low income pensioners |
| **Efficiency reforms** | Education reform<br>Healthcare reform | Improving expenditure efficiency would partly address spending pressures in these areas | Would improve human capital and support productivity | Could disproportionately benefit low income households |
| **Revenue mobilization** | Raise the CIT rate | Up to 1 percent of GDP | Corporate income taxes are relatively inefficient | The ultimate incidence of the tax is unclear |
| | Reduce tax expenditures | Up to 3 percent of GDP | Tend to be inefficient and favor specific groups | They also tend to disproportionately favor less well off groups |
| | Introduce carbon tax/environmental taxes | Up to 1.5 percent of GDP | It reduces an externality increasing efficiency and generating revenue | Positive if resources rechanneled appropriately |
| | Enhance property taxes | Up to 0.8 percent of GDP | This is an economically efficient tax | Given large home ownership design should be careful to avoid negative distributional impact |
| | Increase the standard VAT rate | 0.3-0.5 percent of GDP per 1pp increase | Relatively efficient from an economic point of view | Tend to disproportionately affect the less better off |
| **Fiscal targets** | Moderately reduce the fiscal target | Up to 1 percent of GDP in structural terms | None as long as fiscal policy remains counter-cyclical | |

Note: The red, yellow, and green icons signal the favorability of each measure and indicate when a measure is assessed to be *not favorable*, *neutral* and *favorable* respectively.

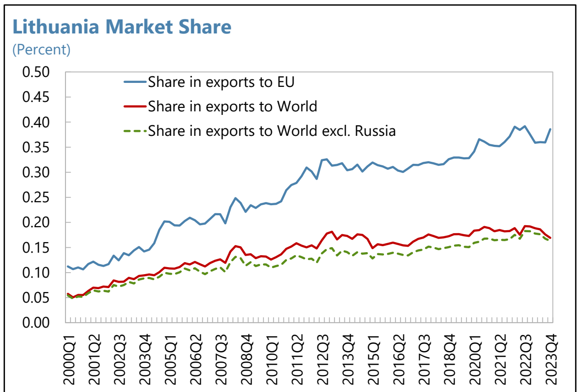
### *Authorities' Views*

**28. The authorities emphasize that the supportive fiscal stance this year is appropriate and underscore their commitment to prudent policies to address long-term spending pressures.** The projected deterioration in the fiscal position this year largely reflects additional defense spending and higher interest payments and supports the recovery underway. They agree that spending pressures over the medium- and long-term are mounting and will require reforms including in pensions, higher revenue mobilization and continuing reforms in healthcare and education. In this connection, they remain committed to a strong fiscal position that ensures sustainability and allows fiscal policy to play an active stabilization role key in the context of a common monetary policy.

**29. The authorities highlight that ample buffers in the banking sector provide stability and underline the significant progress in addressing risks and consolidating gains from the fintech sector.** They agree that the financial cycle has decelerated and is undergoing a soft landing but consider that, although declining, higher interest rates continue to represent a risk that could affect the quality of banks' portfolio. However, they consider that banks have sufficient buffers to withstand shocks. They stress that macroprudential actions have increased buffers and that risks from the real estate market have receded although the growth of real estate prices is gradually recovering. They emphasize that the levy on banks is temporary and has been designed to avoid distortions. Finally, they stress that developments in the fintech sector show the capacity of Lithuania to attract high tech industries and are determined to continue efforts to effectively address potential risks. They highlight progress made by the BoL in building supervisory resources and strengthen the regulatory framework as well as actively preparing to supervise VASPs at the end of this year.

**Towards a New Normal with Structural Reforms to Support Productivity**

**30. After strong post-GFC growth and remarkable resilience during the pandemic, income convergence has stalled.** The loss in market share, of 7 percent and mostly to Russia and Belarus, and higher energy prices translated in a deterioration of the external balance, particularly on goods, despite resilient exports of services. Contrary to the GFC, over this period the labor market remained tight despite weakening activity, resulting in negative labor productivity growth.



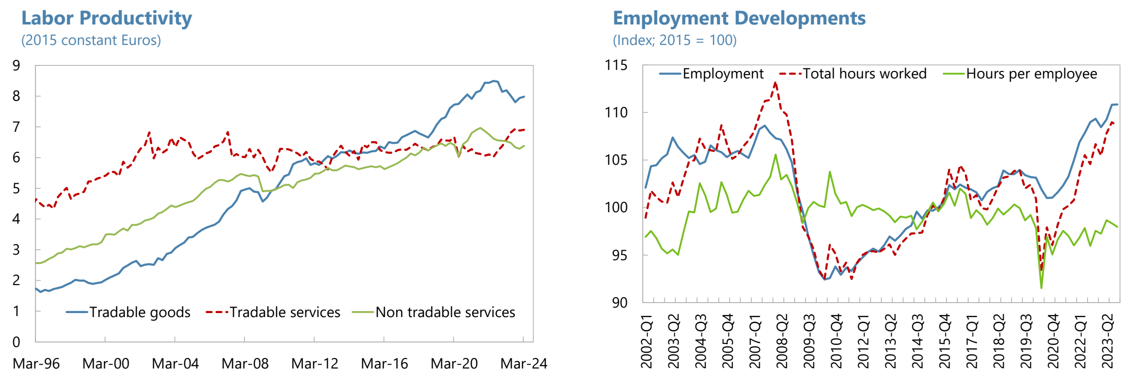
Sources: Direction of Trade Statistics, IMF; and IMF staff calculations.

**31. A large component of the negative performance of the last two years is non-structural, suggesting a limited impact on the growth potential of the economy.**[3] In particular,

- *The recent fall in labor productivity—seven consecutive quarters—is largely cyclical*. While firms have traditionally adjusted employment during downturns, in the recent episode employment reached historical highs while labor utilization has not yet recovered from the pandemic decrease, resulting in low unemployment. Several factors explain this behavior and suggest that, as the economy recovers, so will labor productivity: the perceived temporariness of the shock; structural features of Lithuania's labor market, including large skill mismatches and the scarcity of skilled labor; and the acceleration of automation in the manufacturing sector in response to the cost-shock.

[3] Selected Issues Paper No. 24/[x].

## Text Figure 6. Labor Market Developments

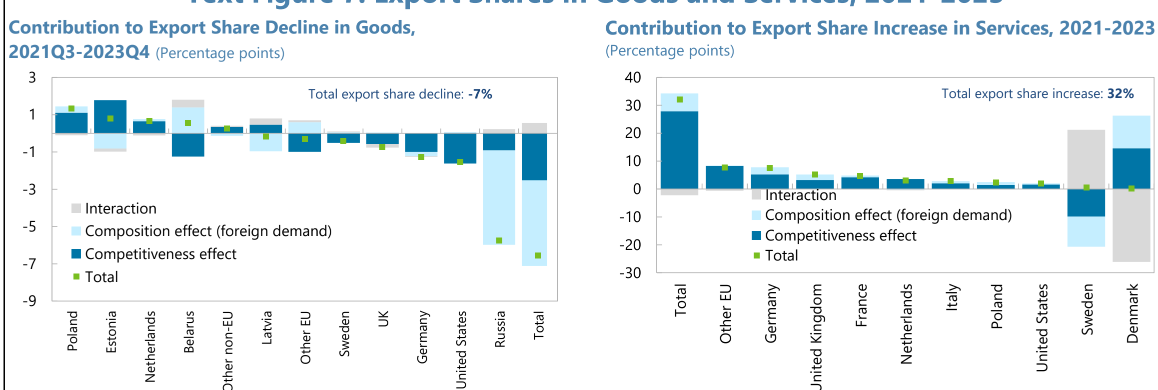



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

- *The large deterioration in the terms-of-trade of goods has largely reversed with a moderate improvement in the terms-of-trade of services over 2021-2023*. The recent terms-of-trade shock has been stronger in Lithuania than in peers. This reflects that, contrary to Estonia and Latvia, Lithuanian firms were able to absorb higher import costs without increasing export prices as much preserving export shares. This was possible by partly eroding buffers corporates had in 2021 in the form of elevated profits, a strong financial position, historically low leverage and abundant liquidity. Furthermore, the moderate loss in export shares of goods mostly reflects demand developments in trading partners—particularly the impact of sanctions on Russia and Belarus, a large share of which are re-exports with little value added—rather than competitiveness factors. On services, the performance has been positive over this period with increasing trade surpluses—now exceeding 10 percent of GDP.

## Text Figure 7. Export Shares in Goods and Services, 2021-2023

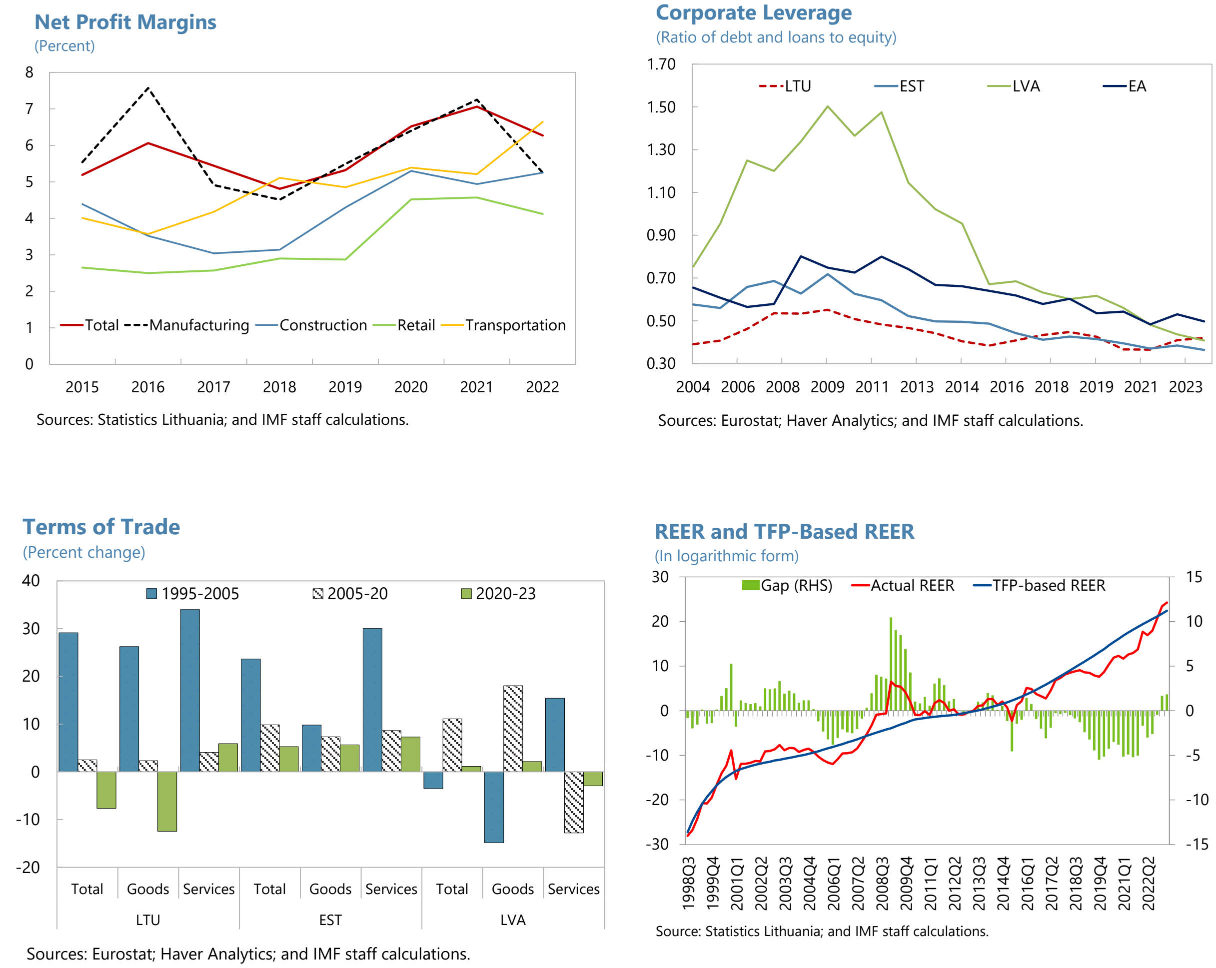



Sources: Direction of Trade Statistics, IMF; and IMF staff calculations.

Sources: Bank of Lithuania; and IMF staff calculations.

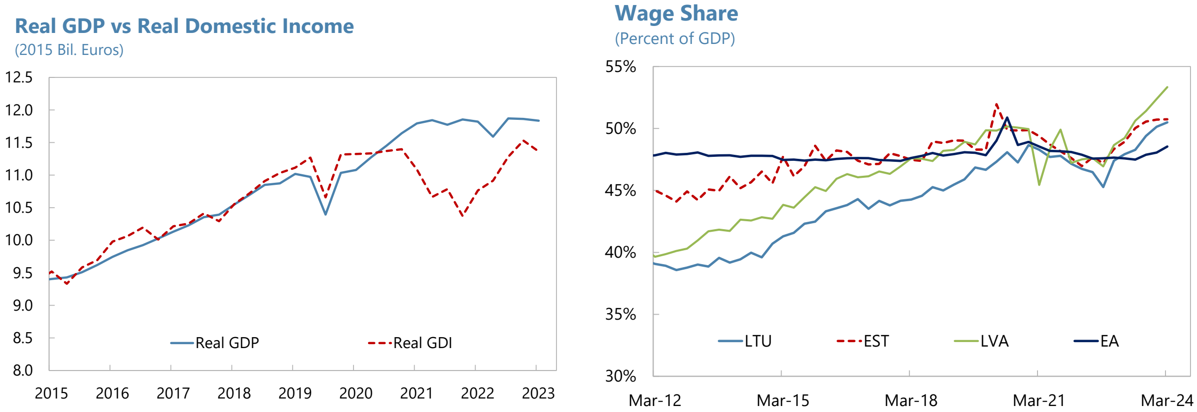
**32. The permanently higher level of input costs, including labor, has eliminated the undervaluation of the REER with which Lithuania entered the inflationary shock.** The external position was strong in 2021 with an undervalued REER. The large inflation differential with trading partners has resulted in an appreciation of the REER moving it closer to equilibrium. With negative inflation differential with the eurozone, and cyclical factors explaining the decline in labor productivity, no further REER appreciation is expected in the near-term.

### Text Figure 8. Competitiveness Developments




**33. Maintaining the competitiveness of the economy will require productivity-enhancing structural reforms.** Solid fundamentals have allowed Lithuania to absorb unprecedented negative shocks without a significant impact on its growth potential, despite the level shift recorded by GDP and domestic income. However, subdued corporate profitability, the lack of recent progress in implementing structural reforms combined with global structural headwinds from fragmentation and heightened geopolitical risks, could weigh on productivity growth. Thus, reforms are key to enhance private sector-led growth, promote investment to support further capital deepening and mitigate or reverse negative demographic dynamics.

**Text Figure 9. Domestic Income**




Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

**34. Persistent structural inefficiencies in the labor market should be addressed to reduce mismatches, increase participation, and further enhance flexibility.** Lithuania has one of the highest skill mismatches in Europe with a shortage of high-skilled workers and surplus of medium- and low-skilled workers. The common minimum wage disproportionately affects the young and other low productive workers in rural areas. Spending on and participation in active labor market policies is relatively low and it is not responsive to cyclical conditions, while employment subsidies should concentrate on the most disadvantage groups.[4] Education reforms are necessary to foster vocational training, but scarce funding is locked in a large and relatively inefficient tertiary education system. Immigration can play a limited role in expanding the labor force. The labor force participation gap between men and women is relatively low but could still be decreased as rates of enrollment in childcare are relatively low.

**35. Susceptible to risks associated with climate change, Lithuania needs to accelerate the green transition, particularly for adaptation.** An introduction of an economy-wide carbon tax on fossil fuels, alongside the EU's emission trading system, would facilitate faster decarbonization, providing resources to protect vulnerable households and strengthen the physical infrastructure against climate change. There is also a need to focus on improving climate change adaptation in public financial and investment management.

***Authorities' Views***

**36. The authorities agree that the recent shock should not reduce the growth potential of the economy and are committed to continuing implementing structural reforms.** This will unlock the country's growth potential and support further productivity growth. They highlight the resilience of the manufacturing sector to recent large cost shocks and the dynamism of the service sector that has continued to penetrate world markets even in the last few years. They stress their

[4] See "Skills Mismatch and Active Labor Market Policy in Lithuania". Selected Issues Paper No. 19/253.

determination to continue reforms in education and healthcare as well as innovation and green transition and emphasize that these reforms will help reduce regional disparities. Finally, they agree on promoting the transition towards a more technology-oriented economy.

# STAFF APPRAISAL

**37. The Lithuanian economy is recovering from a shallow recession and high inflation.** Inflation more than halved last year supported by lower energy prices and is now below the eurozone average. Core inflation has also moderated but remains elevated due to high energy pass-through, nominal wage growth and services inflation. The strong disinflationary momentum reflects lower commodity prices, tighter monetary conditions, and a contractionary fiscal stance. Risks have become more balanced.

**38. After a strong performance last year, the fiscal position is expected to become moderately expansionary this year but less than the budget would imply.** Remarkably, the structural fiscal position has barely deteriorated compared to the pre-pandemic period. Given that the output gap is small and decreasing as the recovery is gaining strength, a broadly neutral fiscal stance seems appropriate. To that end, any unused spending buffers or revenue overperformance should be saved, particularly if the economy surprises to the upside.

**39. Lithuania is facing large spending pressures from defense and higher borrowing costs that add to long-term pressures from aging and climate.** These pressures could add between 5 and 10 percent of GDP to spending. Addressing these pressures will require a comprehensive strategy with the aim to avoid introducing distortions that would worsen the growth potential; preserve fiscal sustainability; and maintain a pro-active fiscal policy. There are four elements to this strategy: (i) pension reform; (ii) education and healthcare reforms; (iii) revenue mobilization; and (iv) resetting the fiscal targets around current levels preserving a strong fiscal position.

**40. Despite declining interest margins, banks' profitability will remain elevated.** With deposit rates gradually increasing and policy rates expected to continue decreasing, net interest income is easing from very high levels. The banking system remains liquid and well capitalized providing large buffers to absorb potential losses arising from unexpected shocks. Balance sheet risks associated with higher interest rates have not materialized so far. The public investment agency INVEGA will play an important role intermediating RRF loans. To avoid crowding out lending from private banks and to ensure efficient operations void of political interference, the agency should keep its mandate explicit and narrow, and ensure effective monitoring and transparency.

**41. Given heightened uncertainty, the emphasis should remain on mitigating non-systemic risks to financial stability.** While the real estate market has stabilized recently, there are pockets of vulnerability in the commercial real estate market that warrant vigilance. No new risks have emerged, and the financial cycle is undergoing a soft-landing. Thus, the authorities have adopted an appropriate neutral macroprudential stance. If risks materialize, the relaxation of capital-based measures would be appropriate in response to credit supply disruptions while targeted adjustment to borrower-based measures can be used to deal with a disorderly correction of the real estate market to support lending to the real economy.

**42. The levy on banks should be phased out.** Given its careful design, the levy has had little disincentive effects. However, the decision to extend the levy one more year raises questions about the future taxation of the sector that is already subject to higher tax rates. Thus, the levy should be let expire, and no other levy should be introduced to avoid being perceived as a tax on foreign investment—the sector is overwhelmingly dominated by foreign banks—and to minimize the negative impact on efficiency that would accrue over time.

**43. There has been significant progress in strengthening the AML/CFT supervision framework that needs to continue to reduce heightened ML/TF risks.** The authorities have effectively implemented measures including: (i) deepening their understanding of the country's non-resident ML/TF risks; (ii) increasing BoL's AML/CFT supervisory resources; (iii) updating ML/FT risk assessment methodology; (iv) strengthening VASPs market entry controls; and (v) strengthening AML/CFT controls to access CENTROlink. The BoL should continue to mitigate ML/TF risks, including continuing preparations to begin supervising VASPs as of the end of 2024 and developing further CENTROlink AML/CFT assessment guidelines.

**44. Lithuania's external position was broadly in line with fundamentals in 2023 (Annex III).** It entered the recent shock in 2021 with an undervalued REER, which helped absorb permanently higher input costs from high inflation.

**45. Solid fundamentals have allowed Lithuania to absorb the recent competitiveness shock without a significant impact on its growth potential.** The recent loss in market shares for goods was largely driven by sanctions on Russia and Belarus, while exports of services have continued to grow strongly. With negative inflation differentials with trading partners and labor productivity expected to recover, there should be no further losses of competitiveness in the near-term. However, long-term spending pressures and long-standing structural challenges will weigh on productivity at a time of domestic and global headwinds.

**46. Persistent structural inefficiencies in the labor market and the education system should be addressed.** Active labor market policies need to be more responsive to cyclical conditions while employment subsidies should concentrate on the most disadvantaged. Education reforms are necessary to foster vocational training, but funding is locked in a large tertiary education system that does not produce the skills the labor market demands.

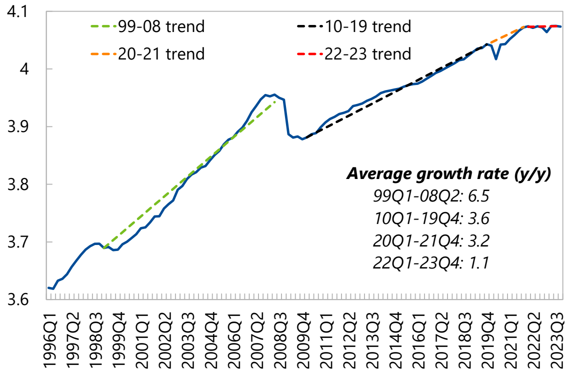
**47. Susceptible to risks associated with climate change, Lithuania needs to accelerate the green transition, particularly for adaptation.** An introduction of an economy-wide carbon tax on fossil fuels, alongside the EU's emission trading system, would facilitate faster decarbonization, incentivize renewable investments, and provide resources to protect vulnerable households and strengthen the physical infrastructure against climate change.

**48. The next Article IV consultation with Lithuania is expected to be conducted on the standard 12-month cycle.**

## Figure 1. Lithuania: Real Sector

*The external shocks of 2022 have eased economic growth…*

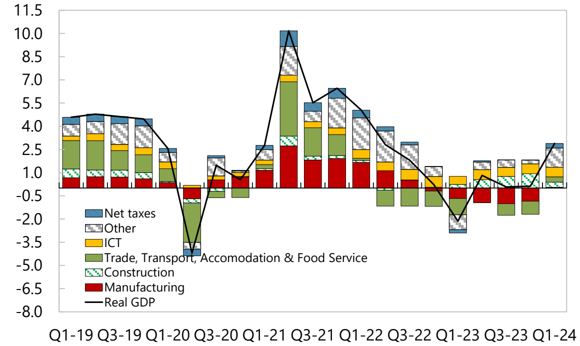
### Real GDP
(In logarithmic form)




Sources: Statistics Lithuania; and IMF staff calculations.

*…mostly affecting manufacturing, trade, and transport services*

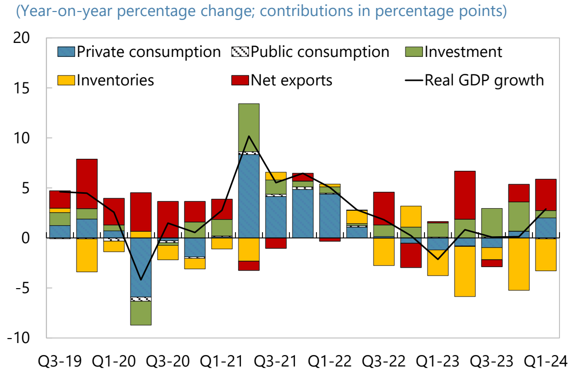
### Real GDP growth
(Year-on-year percentage change; contributions in percentage points)




Sources: Eurostat; Haver Analytics; and IMF staff calculations.

*Domestic demand recovered in the second half of 2023, supported by real wages and strong investment…*

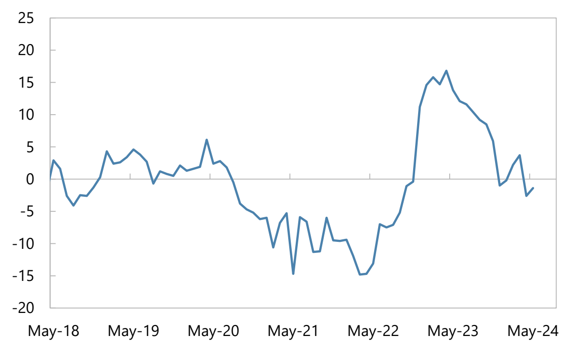
### Real GDP
(Year-on-year percentage change; contributions in percentage points)




Sources: Haver Analytics; Eurostat; and IMF staff calculations.

*…but the correction of inventories has kept GDP growth muted since Q2 2023.*

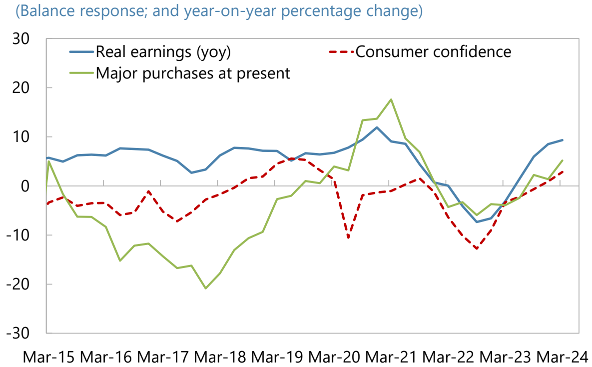
### Manufacturing: Stocks of Finished Products
(Percent balance)



Sources: European Commission; Haver Analytics; and IMF staff calculations.

*Consumer confidence is improving with increasing real wages, supporting private consumption…*

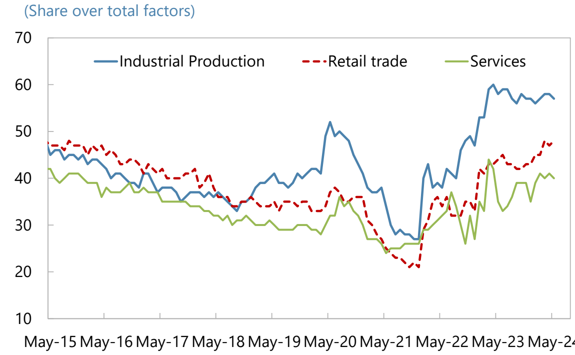
### Private Consumption Indicators
(Balance response; and year-on-year percentage change)




Sources: Directorate-General for Economic and Financial Affairs; Haver Analytics; and IMF staff calculations.

*…but weak external demand remains constraining growth, especially in manufacturing*

### Lack of Demand as a Factor Limiting Production
(Share over total factors)



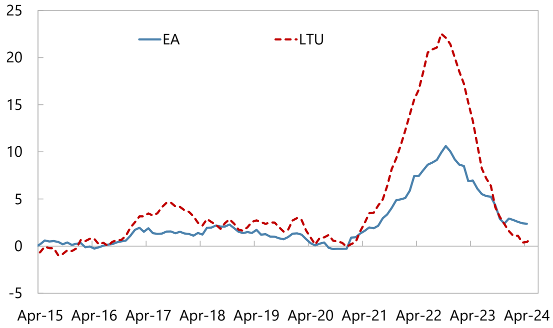

Sources: Directorate-General for Economic and Financial Affairs; Haver Analytics; and IMF staff calculations.

## Figure 2. Lithuania: Inflation

*Inflationary pressures have been large but temporary …*

### Headline Inflation

(Year-on-year percentage change)

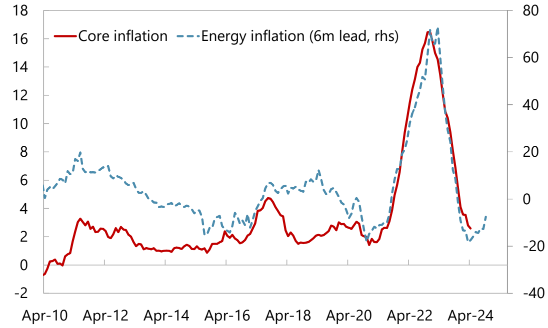



Sources: Eurostat; Statistics Lithuania; Haver Analytics; and IMF staff calculations.

*… with energy pass-through to core close to be completed.*

### Inflation: Pass-Through from Energy to Core

(Year-on-year percentage change)

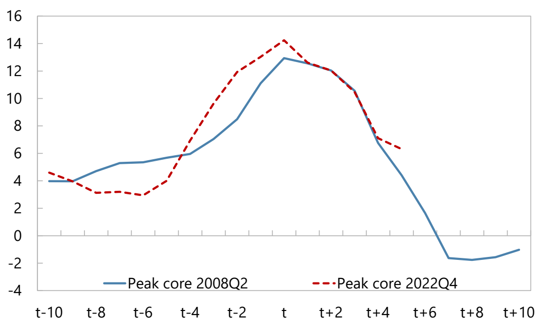



Sources: Statistics Lithuania; Haver Analytics; and IMF staff calculations.

*High services inflation is aligned with previous episodes…*

### Services Inflation

(Year-on-year percentage change)

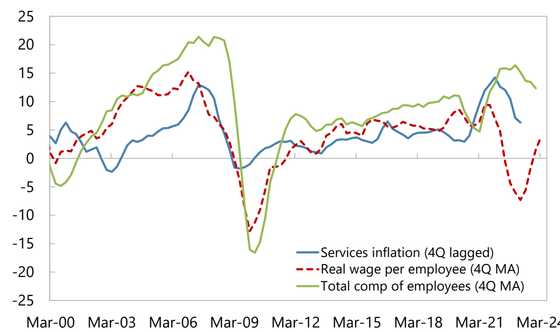



Sources: Eurostat; Haver Analytics; and IMF staff calculations.
Note: Based on quarterly data.

*… reflecting higher overall costs at a time when real wages were negative.*

### Services Inflation and Real Wages

(Year-on-year percentage change)

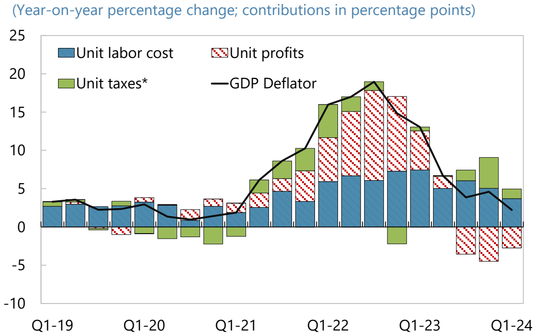



Sources: Statistics Lithuania; Haver Analytics; and IMF staff calculations.

*Inflation moderation came on the back of corporate's profits, partially offsetting higher wages…*

### GDP Deflator

(Year-on-year percentage change; contributions in percentage points)

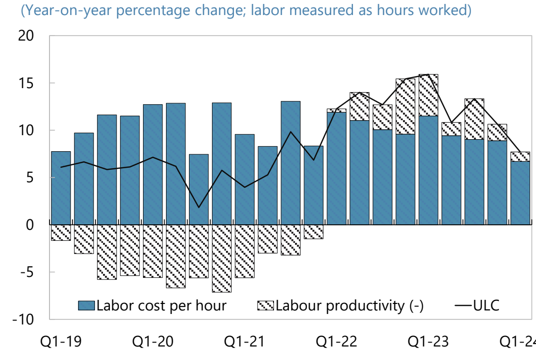



Sources: Eurostat; Haver Analytics; and IMF staff calculations.
(*) Indirect taxes net of subsidies

*… and the impact of falling productivity on final prices..*

### Unit Labor Cost

(Year-on-year percentage change; labor measured as hours worked)

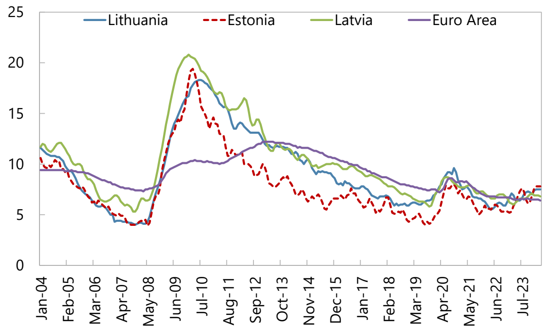



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

## Figure 3. Lithuania: Labor Market Developments

*With negative growth in 2023, unemployment increased over 2023 …*

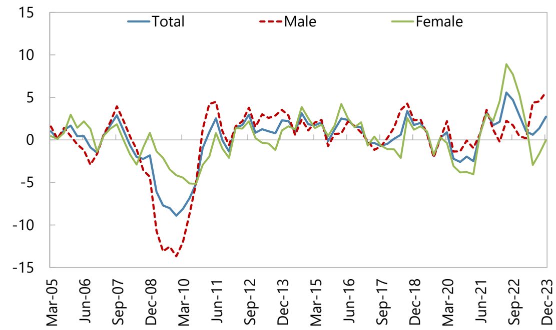
**Unemployment Rate**
(Percent, NSA)




Sources: Eurostat; and Haver Analytics.

*… as employment growth also increased, contracting for women and picking up for men.*

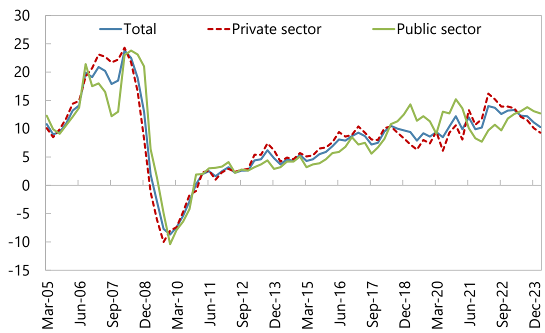
**Employment Growth**
(Year-on-year percentage change)




Sources: Eurostat; and Haver Analytics.

*Wage growth is moderating in the private sector but has picked up in the public sector…*

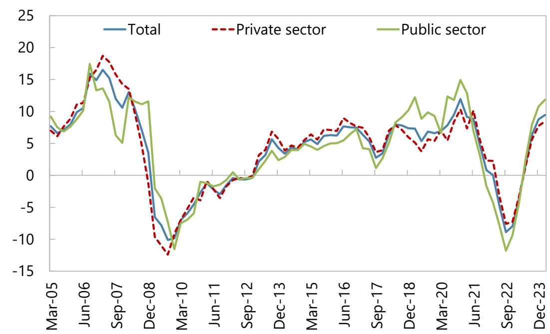
**Nominal Wage Growth**
(Year-on-year percentage change)




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

*… with real wages rising strongly as inflation came down.*

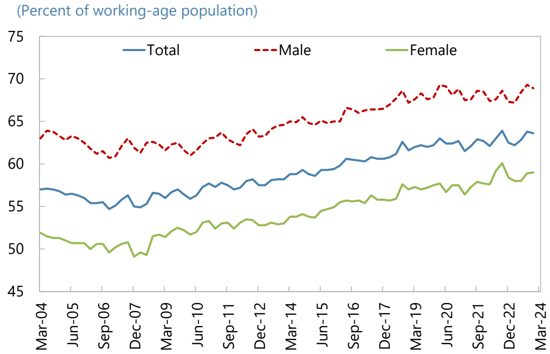
**Real Wage Growth**
(Year-on-year percentage change)




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

*The participation rate remains at a historical high…*

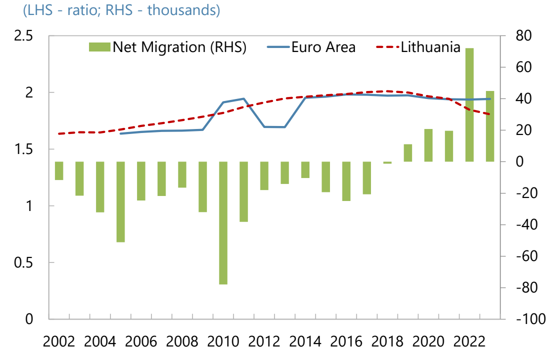
**Labor Force Participation Rate**
(Percent of working-age population)




Sources: Eurostat; and IMF staff calculations.

*…while the dependency ratio plateaus given positive net migration.*

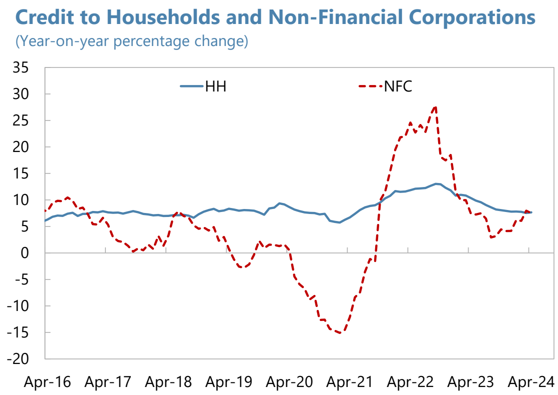
**Old Age Dependency Ratio**
(LHS - ratio; RHS - thousands)




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

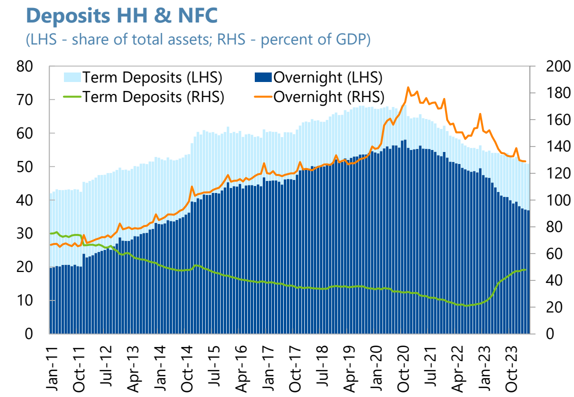
## Figure 4. Lithuania: Banking Sector Developments

*Credit growth has eased but remained positive in 2024 …*



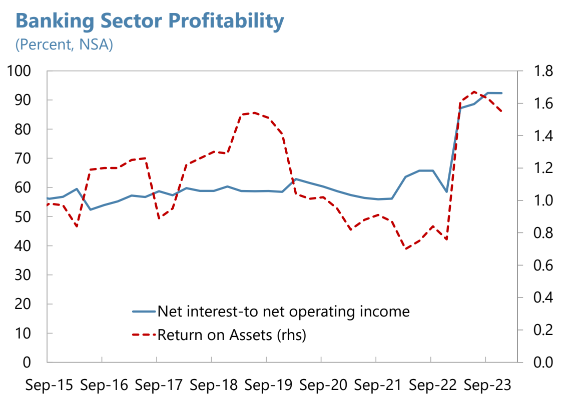

Sources: Bank of Lithuania; Haver Analytics; and IMF staff calculations.

*…and the strong pandemic-deposit accumulation is gradually normalizing, in both levels and composition*



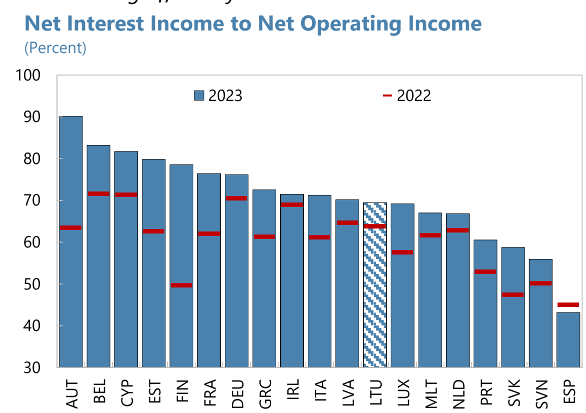

Sources: Bank of Lithuania; Haver Analytics; and IMF staff calculations.

*The banking sector in Lithuania reached record profits in 2023…*



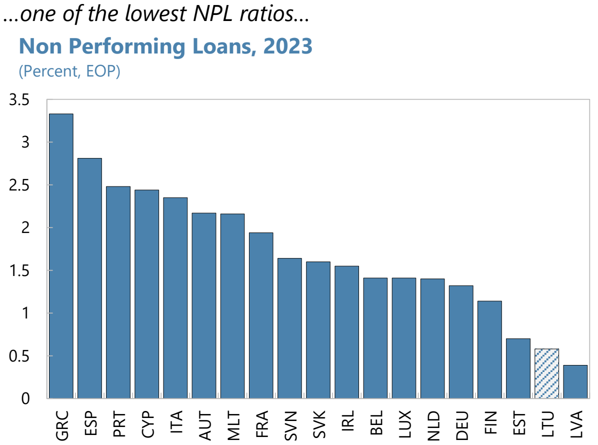

Sources: European Banking Authority; Haver Analytics; and IMF staff calculations.

*…benefitting from the change in monetary policy stance and its strong efficiency…*



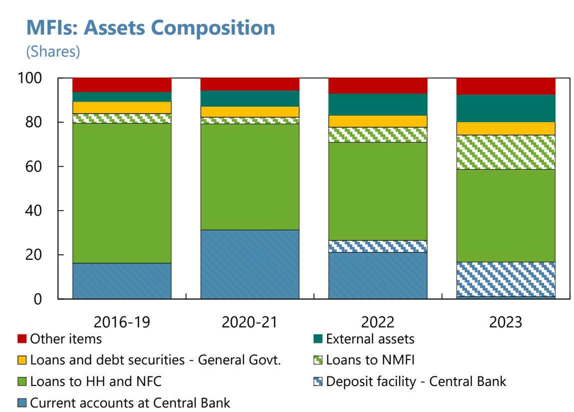

Sources: European Banking Authority; Haver Analytics; and IMF staff calculations.

*…one of the lowest NPL ratios…*




Sources: European Banking Authority; Haver Analytics; and IMF staff calculations.

*…and a changing structure of assets seeking higher yields*

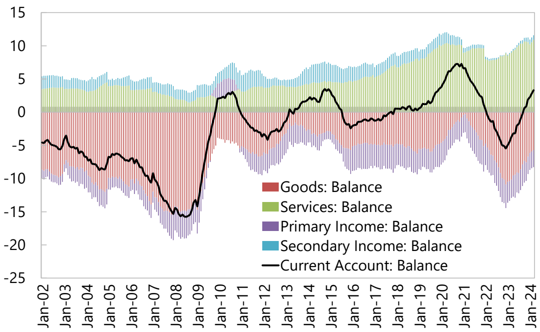



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

## Figure 5. Lithuania: External Developments

*The current account has turned positive driven by an ever-improving services balance and a shrinking trade deficit…*

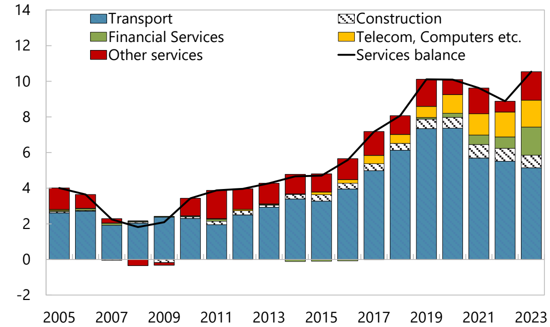
**Current Account Balance**
(Percent of GDP)




Sources: Bank of Lithuania; Haver Analytics; and IMF staff calculations.

*… with exports of financial services and telecom/computer services making up for the shrinking share in transports…*

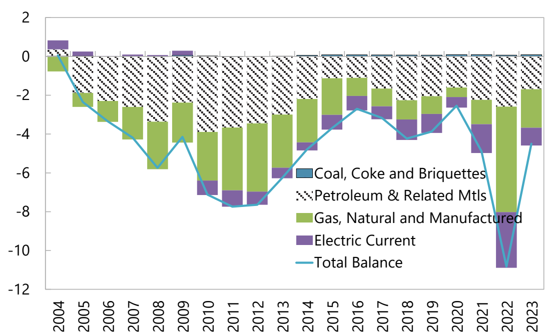
**Services Balance**
(Percent of GDP)




Sources: Bank of Lithuania; Haver Analytics; and IMF staff calculations.

*…and the energy trade balance deficit rebounding to its 2021 level…*

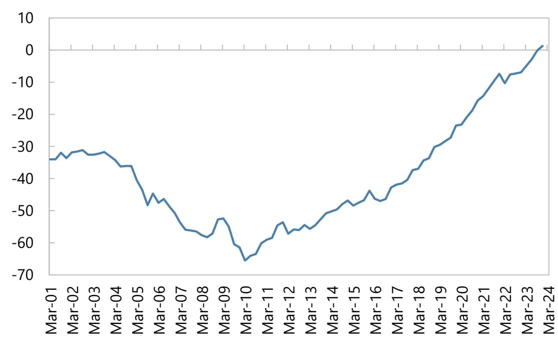
**Energy Trade Balance**
(Percent of GDP)




Sources: Statistics Lithuania; Haver Analytics; and IMF staff calculations.

*… while the NIIP turned positive for the first time in 2024.*

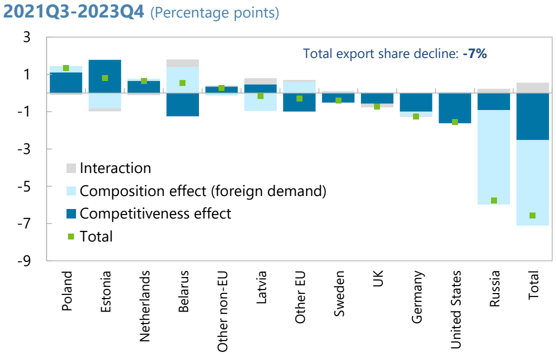
**Net International Investment Position**
(Percent of GDP)



Sources: Bank of Lithuania; and Haver Analytics.

*Most of the decrease in exports since 2021Q3 was due to lower exports to Russia and no competitiveness losses …*

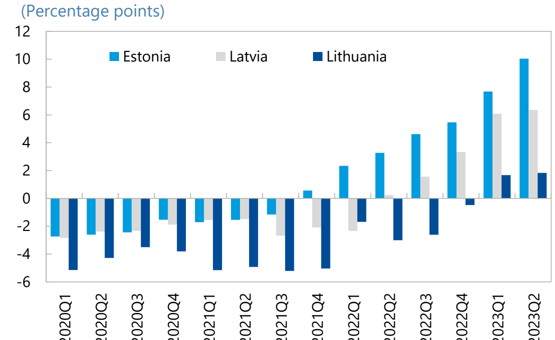
**Contribution to Export Share Decline in Goods, 2021Q3-2023Q4** (Percentage points)




Sources: Direction of Trade Statistics, IMF; and IMF staff calculations.

*… while the real exchange rate moved close to equilibrium from a previously undervalued position.*

**Actual and TFP-Based REER Differential**
(Percentage points)



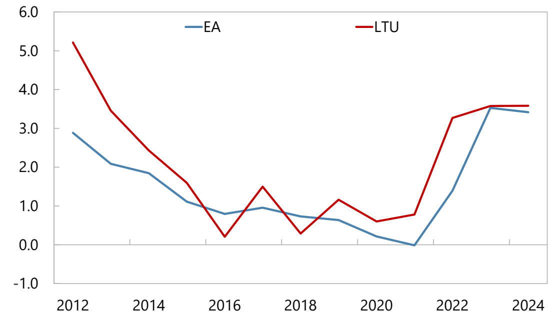

Source: Statistical Authorities; Haver Analytics; and IMF staff calculations.

## Figure 6. Lithuania: The Impact of Monetary Tightening on Sovereign Debt

*Monetary policy tightening has quickly passed through to sovereign bond markets, in both EA and LTU …*

**Government Debt Securities: Yields at Issuance**

(Percent)

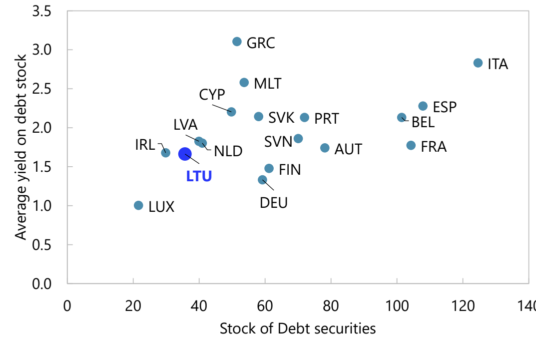



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.
Note: Data as of February, 2024.

*…but low debt has helped LTU maintain a relatively low effective interest rate compared to EA peers…*

**Government Debt and Yields**

(X axis - percent, Y axis - percentage points; as of Feb-2024)

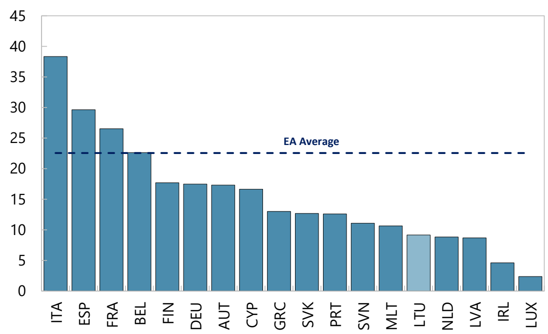



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

*Rollover risks remain low …*

**General Government: Debt Service Due in 2 Years**

(Percent of GDP; as of Feb-2024)

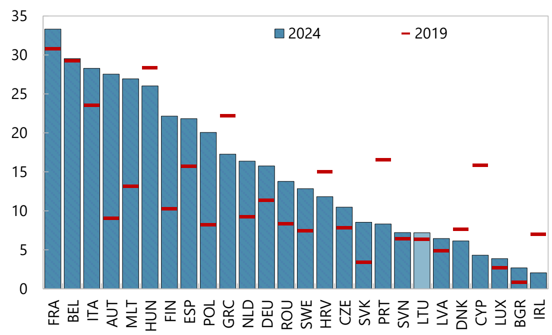



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

*…and GFNs are at 2019 levels, signaling no scarring effects on public accounts from 2020-22 shocks.*

**Debt Securities: Gross Issuance**

(Percent of GDP, 12m accumulated; as of Feb-2024)

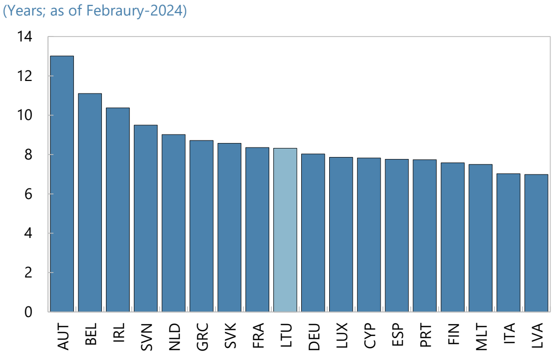



Sources: Eurostat; Haver Analytics; and IMF staff calculations

*High debt maturity will help smooth interest rate pass-through to interest expenditures …*

**Weighted Average Maturity**

(Years; as of Febraury-2024)

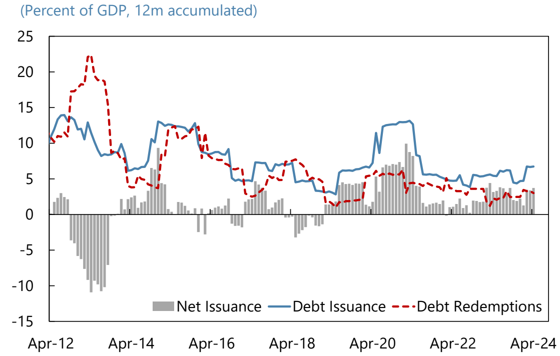



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

*…in the absence of primary deficits, the stock of debt should continue to decline.*

**Government Debt Securities Flows**

(Percent of GDP, 12m accumulated)

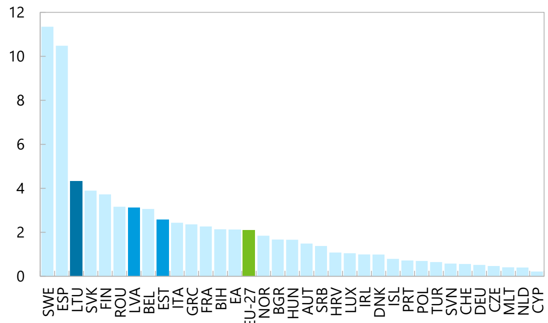



Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

## Figure 7. Lithuania: Structural Labor Market

*Lithuania has one of the largest skills mismatches in Europe ...*

**Skills Mismatch Index, 2023**

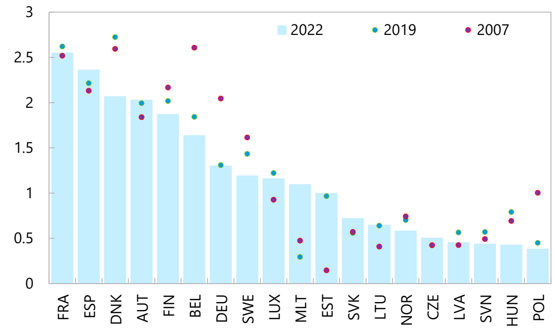



Source: Eurostat; and IMF staff calculations.

*...while expenditures on active labor market policies remain relatively low...*

**ALMP Expenditure**

(Percent of GDP)

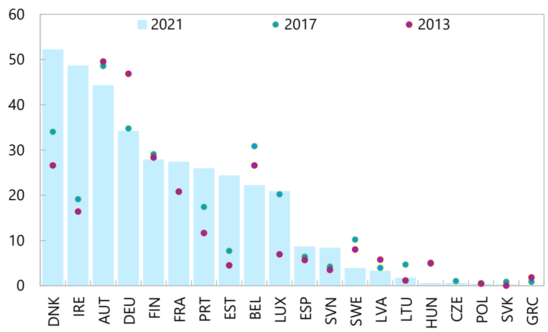



Sources: Eurostat; and IMF staff calculations.

*...and participation in training programs is very low.*

**Participants in Training Programs**

(Percent, share of total unemployment)

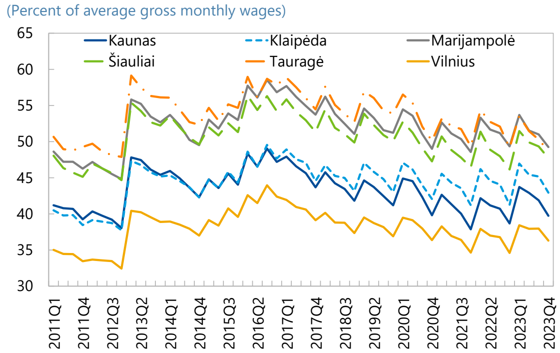



Sources: OECD; Eurostat; Haver Analytics; and IMF staff calculations.

*There is large variation in the nation-wide minimum wage relative to the average gross wage across regions...*

**Minimum Wage by Region**

(Percent of average gross monthly wages)

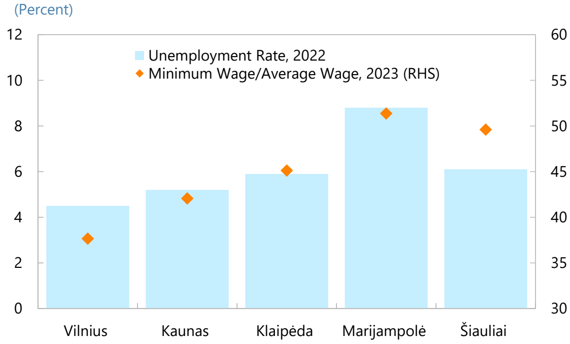



Sources: Statistics Lithuania; and IMF staff calculations.

*and the ratio displays a strong correlation with the regional unemployment rate...*

**Minimum Wage and Unemployment Rate by Region**

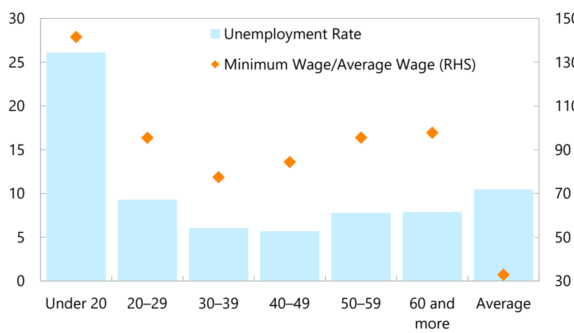
(Percent)




Sources: Statistics Lithuania; and IMF staff calculations.

*as well as with the unemployment rate across different age groups.*

**Minimum Wage and Unemployment Rate by Age Group, 2023** (Percent of 2018 average gross monthly wages)




Sources: Statistics Lithuania; and IMF staff calculations.

## Table 1. Lithuania: Selected Economic Indicators, 2020–2029

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Projections | | | | | |
| **Output** | | | | | | | | | | |
| Real GDP growth (annual percentage change) | 0.1 | 6.2 | 2.4 | -0.3 | 2.4 | 2.6 | 2.4 | 2.2 | 2.2 | 2.2 |
| Domestic demand (contribution to growth) | -3.3 | 6.7 | 1.7 | -1.5 | 1.5 | 2.8 | 2.5 | 2.2 | 2.1 | 2.2 |
| Domestic demand growth (year-on-year, in percent) | -3.6 | 7.3 | 2.1 | -1.6 | 1.7 | 3.1 | 2.8 | 2.4 | 2.3 | 2.2 |
| Private consumption growth (year-on-year, in percent) | -3.1 | 7.8 | 2.0 | -1.0 | 3.0 | 2.5 | 2.2 | 2.1 | 2.1 | 3.3 |
| Domestic fixed investment growth (year-on-year, in percent) | -0.5 | 9.4 | 3.6 | 10.6 | 1.9 | 4.3 | 4.3 | 3.5 | 2.8 | 5.4 |
| Inventories (contribution to growth) | -1.0 | -0.1 | -0.1 | -3.4 | -1.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net external demand (contribution to growth) | 3.4 | -0.5 | 0.7 | 1.2 | 0.9 | -0.1 | -0.1 | 0.1 | 0.1 | 0.0 |
| Export growth (year-on-year, in percent) | -0.2 | 17.4 | 12.2 | -3.3 | 4.0 | 4.5 | 3.6 | 3.7 | 4.0 | 4.0 |
| Import growth (year-on-year, in percent) | -4.5 | 20.0 | 12.4 | -4.9 | 3.4 | 5.2 | 4.1 | 4.0 | 4.3 | 4.2 |
| Nominal GDP (in billions of euro) | 49.8 | 56.5 | 67.5 | 72.0 | 75.9 | 80.3 | 84.5 | 88.5 | 92.7 | 97.0 |
| Potential GDP growth | 1.9 | 3.2 | 2.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Output gap (percent of potential GDP) | -1.2 | 1.6 | 1.8 | -0.7 | -0.5 | -0.2 | 0.1 | 0.1 | 0.1 | 0.0 |
| **Employment** | | | | | | | | | | |
| Employment (annual percentage change) | -1.5 | 0.8 | 3.8 | 1.4 | 1.0 | -0.4 | -0.4 | -0.6 | -1.0 | -1.0 |
| Unemployment rate (year average, in percent of labor force) | 8.5 | 7.1 | 6.0 | 6.9 | 7.3 | 7.1 | 6.5 | 6.1 | 6.0 | 6.0 |
| Average monthly gross earnings (annual percentage change) 1/ | 10.1 | 10.5 | 13.3 | 12.2 | 8.4 | 5.1 | 5.0 | 5.1 | 5.0 | 5.0 |
| Average monthly gross earnings, real (annual percentage | 9.0 | 5.6 | -4.6 | 3.5 | 7.2 | 2.8 | 2.6 | 2.7 | 2.6 | 2.7 |
| Labor productivity (annual percentage change) | 1.6 | 5.4 | -1.3 | -1.7 | 1.4 | 3.0 | 2.8 | 2.9 | 3.2 | 3.2 |
| **Prices** | | | | | | | | | | |
| HICP, period average (annual percentage change) | 1.1 | 4.6 | 18.9 | 8.7 | 1.2 | 2.3 | 2.4 | 2.4 | 2.4 | 2.4 |
| HICP core, period average (annual percentage change) | 2.5 | 3.2 | 13.6 | 10.7 | 2.9 | 2.5 | 2.2 | 2.2 | 2.2 | 2.2 |
| HICP, end of period (year-on-year percentage change) | -0.1 | 10.7 | 20.0 | 0.6 | 2.4 | 2.1 | 2.2 | 2.4 | 2.4 | 2.4 |
| GDP deflator (year-on-year percentage change) | 1.7 | 6.8 | 16.6 | 6.9 | 3.0 | 3.0 | 2.8 | 2.5 | 2.4 | 2.4 |
| **General Government Finances** | | | | | | | | | | |
| Revenue (percent of GDP) | 36.3 | 36.3 | 35.7 | 37.4 | 39.2 | 39.1 | 38.4 | 37.3 | 37.2 | 37.1 |
| *Of which EU grants* | 0.7 | 0.6 | 0.6 | 0.7 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 |
| Expenditure (percent of GDP) | 42.8 | 37.4 | 36.3 | 38.2 | 40.7 | 40.7 | 39.8 | 38.8 | 38.6 | 38.3 |
| *Of which:* Non-interest | 42.1 | 37.0 | 36.0 | 37.6 | 40.0 | 39.7 | 38.7 | 37.7 | 37.5 | 37.0 |
| Interest | 0.7 | 0.4 | 0.4 | 0.6 | 0.8 | 1.0 | 1.1 | 1.1 | 1.1 | 1.2 |
| Fiscal balance (percent of GDP) | -6.5 | -1.1 | -0.7 | -0.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | -1.2 |
| Fiscal balance excl. one-offs (percent of GDP) | -6.5 | -1.2 | -0.7 | -0.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | -1.2 |
| Structural fiscal balance (percent of potential GDP) 2/ | -5.3 | -1.3 | -1.3 | -0.2 | -1.0 | -1.1 | -1.0 | -1.1 | -0.9 | -0.7 |
| General government gross debt (percent of GDP) | 46.3 | 43.4 | 38.0 | 38.3 | 38.1 | 38.0 | 37.8 | 37.7 | 37.5 | 37.0 |
| *Of which:* Foreign currency-denominated | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Balance of Payments (in percent of GDP, unless otherwise specified)** | | | | | | | | | | |
| Current account balance | 7.3 | 1.1 | -5.5 | 1.9 | 2.8 | 2.9 | 3.0 | 2.8 | 2.8 | 2.8 |
| Current account balance (billions of euros) | 3.6 | 0.6 | -3.7 | 1.4 | 2.1 | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 |
| **Saving-Investment Balance (in percent of GDP)** | | | | | | | | | | |
| Gross national saving | 21.8 | 21.7 | 21.6 | 21.7 | 22.8 | 22.7 | 23.1 | 23.3 | 23.8 | 24.2 |
| Gross national investment | 14.5 | 20.5 | 27.1 | 19.8 | 20.0 | 19.7 | 20.1 | 20.5 | 21.0 | 21.4 |
| Foreign net savings | -7.3 | -1.1 | 5.5 | -1.9 | -2.8 | -2.9 | -3.0 | -2.8 | -2.8 | -2.8 |

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

Note: Data are presented on ESA2010, and BPM6 manuals basis.

1/ 2019 adjusted for tax reforms.

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

## Table 2. Lithuania: General Government Operations, 2020–2029

(ESA 2010 aggregates, in percent of GDP)

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Projections | | | | | |
| **Statement of Operations** | | | | | | | | | | |
| **Revenue** | 36.3 | 36.3 | 35.7 | 37.4 | 39.2 | 39.1 | 38.4 | 37.3 | 37.2 | 37.1 |
| Revenue excluding EU grants | 35.5 | 35.7 | 35.0 | 36.7 | 38.3 | 38.2 | 37.5 | 36.5 | 36.4 | 36.3 |
| Tax revenue | 20.8 | 21.5 | 21.4 | 22.0 | 22.2 | 22.3 | 22.2 | 22.1 | 22.1 | 22.2 |
| Direct taxes | 9.0 | 9.6 | 10.0 | 10.7 | 10.8 | 10.7 | 10.6 | 10.6 | 10.5 | 10.6 |
| Personal income tax | 7.1 | 7.4 | 7.6 | 8.0 | 8.3 | 8.1 | 8.1 | 8.0 | 8.0 | 8.0 |
| Corporate income tax | 1.6 | 2.1 | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Other | 0.4 | 0.1 | 0.0 | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Indirect taxes | 11.8 | 11.9 | 11.4 | 11.3 | 11.4 | 11.6 | 11.6 | 11.5 | 11.6 | 11.6 |
| VAT | 8.0 | 8.3 | 8.4 | 8.2 | 8.1 | 8.3 | 8.2 | 8.2 | 8.2 | 8.2 |
| Excises | 3.1 | 2.9 | 2.5 | 2.4 | 2.6 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 |
| Other | 0.6 | 0.6 | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Social contributions | 10.6 | 10.5 | 10.2 | 10.8 | 11.2 | 11.1 | 11.0 | 11.0 | 10.9 | 10.8 |
| Grants | 0.7 | 0.6 | 0.6 | 0.7 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 |
| Other revenue | 4.1 | 3.7 | 3.4 | 3.8 | 4.9 | 4.9 | 4.3 | 3.4 | 3.4 | 3.3 |
| **Total Expenditure** | 42.8 | 37.4 | 36.3 | 38.2 | 40.7 | 40.7 | 39.8 | 38.8 | 38.6 | 38.3 |
| Current spending | 37.9 | 34.1 | 33.1 | 34.0 | 36.2 | 36.6 | 36.1 | 35.4 | 35.3 | 35.2 |
| Compensation of employees | 11.3 | 10.7 | 10.1 | 10.7 | 11.0 | 10.9 | 10.9 | 10.7 | 10.7 | 10.6 |
| Goods and services | 4.5 | 4.3 | 4.3 | 4.1 | 4.8 | 4.8 | 4.8 | 4.5 | 4.5 | 4.4 |
| Interest payments | 0.7 | 0.4 | 0.4 | 0.6 | 0.8 | 1.0 | 1.1 | 1.1 | 1.1 | 1.2 |
| Foreign | 0.2 | 0.1 | 0.2 | 0.4 | 0.5 | 0.7 | 0.8 | 0.6 | 0.5 | 0.6 |
| Domestic | 0.5 | 0.4 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.6 | 0.6 | 0.7 |
| Subsidies | 2.4 | 1.6 | 1.7 | 0.7 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Grants | 1.1 | 0.9 | 0.7 | 0.6 | 1.0 | 0.8 | 0.7 | 0.7 | 0.7 | 0.7 |
| Social benefits | 16.4 | 14.9 | 14.0 | 15.2 | 15.6 | 16.2 | 15.8 | 16.0 | 16.0 | 16.0 |
| Other expense | 1.6 | 1.2 | 1.9 | 2.1 | 2.7 | 2.6 | 2.4 | 2.1 | 2.1 | 2.0 |
| Capital spending | 4.8 | 3.3 | 3.3 | 4.2 | 4.5 | 4.1 | 3.8 | 3.4 | 3.3 | 3.1 |
| **Overall Budget Balance** | -6.5 | -1.1 | -0.7 | -0.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | -1.2 |
| Net acquisition of financial assets | 4.5 | 1.8 | 0.7 | 0.6 | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| Domestic | 5.9 | 1.8 | 0.7 | 0.6 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 |
| Foreign | -1.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net incurrence of liabilities | 11.0 | 2.9 | 1.4 | 1.4 | 1.9 | 1.9 | 1.7 | 1.6 | 1.5 | 1.2 |
| Domestic | 5.9 | 3.7 | 5.4 | 1.1 | 1.8 | 1.8 | 1.7 | 1.7 | 1.6 | 1.3 |
| Foreign | 5.2 | -0.8 | -4.0 | 0.3 | 0.0 | 0.1 | 0.0 | -0.1 | -0.1 | -0.1 |
| **Financial Balance Sheet** | | | | | | | | | | |
| Financial assets | 34.7 | 33.6 | 28.6 | 30.0 | ... | ... | ... | ... | ... | ... |
| Currency and deposits | 13.0 | 12.9 | 9.9 | 12.0 | ... | ... | ... | ... | ... | ... |
| Securities other than shares | 0.4 | 0.5 | 1.5 | 1.8 | ... | ... | ... | ... | ... | ... |
| Loans | 1.9 | 2.2 | 2.6 | 3.0 | ... | ... | ... | ... | ... | ... |
| Shares and other equity | 13.3 | 12.7 | 10.4 | 9.9 | ... | ... | ... | ... | ... | ... |
| Other financial assets | 6.1 | 5.3 | 4.1 | 3.4 | ... | ... | ... | ... | ... | ... |
| Financial liabilities | 55.2 | 50.4 | 37.8 | 37.7 | ... | ... | ... | ... | ... | ... |
| Currency and deposits | 0.2 | 0.2 | 0.0 | 0.0 | ... | ... | ... | ... | ... | ... |
| Securities other than shares | 42.0 | 36.8 | 26.4 | 26.4 | ... | ... | ... | ... | ... | ... |
| Loans | 8.0 | 8.4 | 7.0 | 7.0 | ... | ... | ... | ... | ... | ... |
| Other liabilities | 4.9 | 4.9 | 4.3 | 4.3 | ... | ... | ... | ... | ... | ... |
| Net financial worth | -20.6 | -16.8 | -9.3 | -9.2 | ... | ... | ... | ... | ... | ... |
| **Memorandum Items:** | | | | | | | | | | |
| GDP (in millions of euros) | 49,833 | 56,496 | 67,498 | 71,972 | 75,934 | 80,299 | 84,513 | 88,535 | 92,657 | 96,952 |
| General government debt (Maastricht def.) | 46.3 | 43.4 | 38.0 | 38.3 | 38.1 | 38.0 | 37.8 | 37.7 | 37.5 | 37.0 |
| Foreign debt | 37.7 | 32.5 | 23.2 | 22.0 | 20.9 | 19.9 | 18.9 | 17.9 | 17.0 | 16.2 |
| Domestic debt | 8.5 | 10.9 | 14.9 | 16.3 | 17.2 | 18.1 | 18.9 | 19.7 | 20.4 | 20.8 |

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

Note: Passive projections from 2024 onward. Projections incorporate only announced budgetary measures.

## Table 3. Lithuania: Balance of Payments, 2020–2029

(Billions of Euros, unless otherwise indicated)

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Projections | | | |
| **Current Account Balance** | 3.6 | 0.6 | -3.7 | 1.4 | 2.1 | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 |
| Merchandise trade balance | -0.4 | -2.9 | -7.3 | -4.8 | -3.8 | -3.4 | -3.1 | -3.2 | -3.1 | -3.0 |
| Exports (f.o.b.) | 25.5 | 31.6 | 41.1 | 36.3 | 39.2 | 41.6 | 43.4 | 45.2 | 47.3 | 49.6 |
| Imports (f.o.b.) | 25.9 | 34.5 | 48.5 | 41.2 | 43.0 | 45.0 | 46.4 | 48.4 | 50.4 | 52.6 |
| Services balance | 5.0 | 5.4 | 6.0 | 7.6 | 7.5 | 8.2 | 8.4 | 8.8 | 8.9 | 9.1 |
| Exports | 10.9 | 13.6 | 17.4 | 20.2 | 21.7 | 23.0 | 24.0 | 25.0 | 26.2 | 27.4 |
| Imports | 5.9 | 8.1 | 11.4 | 12.6 | 14.2 | 14.8 | 15.6 | 16.2 | 17.3 | 18.3 |
| Primary income balance | -1.4 | -2.2 | -2.4 | -1.9 | -2.0 | -2.8 | -3.2 | -3.3 | -3.4 | -3.5 |
| Receipts | 1.1 | 1.3 | 1.3 | 2.7 | 2.8 | 2.9 | 2.8 | 3.0 | 3.3 | 3.6 |
| Payments | 2.6 | 3.5 | 3.7 | 4.6 | 4.8 | 5.7 | 6.0 | 6.3 | 6.7 | 7.1 |
| Secondary income balance | 0.4 | 0.3 | 0.1 | 0.5 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| **Capital and Financial Account Balance** | -3.2 | -0.1 | 3.2 | -2.5 | -3.5 | 0.5 | 2.2 | 2.6 | 4.0 | 4.3 |
| Capital account balance | 0.9 | 0.9 | 1.0 | 1.4 | 2.1 | 2.5 | 2.2 | 0.9 | 1.1 | 1.1 |
| Foreign direct investment balance | -0.6 | -1.2 | -1.7 | -0.8 | -0.8 | -0.8 | -0.9 | -1.1 | -1.2 | -1.3 |
| Portfolio investment balance | -1.8 | 1.8 | 1.9 | 1.3 | 2.2 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Financial derivatives | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Other investment balance | 6.5 | 0.6 | -2.2 | 3.5 | 4.2 | 1.7 | -0.3 | -1.8 | -3.0 | -3.1 |
| Errors and omissions | -1.0 | 0.2 | 0.6 | 1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Overall Balance** | -0.6 | 0.7 | 0.1 | 0.6 | -1.4 | 2.8 | 4.7 | 5.1 | 6.6 | 7.1 |
| **Financing** | 0.4 | -0.6 | 0.0 | -0.6 | 1.4 | -2.8 | -4.7 | -5.1 | -6.6 | -7.1 |
| Gross international reserves (increase: -) | … | … | … | … | … | … | … | … | … | … |
| Use of Fund credit, net | 0.0 | 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 | 0.0 |
| **In Percent of GDP (unless indicated)** | | | | | | | | | | |
| **Current Account Balance** | 7.3 | 1.1 | -5.5 | 1.9 | 2.8 | 2.9 | 3.0 | 2.8 | 2.8 | 2.8 |
| Trade balance of goods and services | 9.3 | 4.5 | -2.0 | 3.8 | 4.9 | 6.0 | 6.3 | 6.4 | 6.3 | 6.3 |
| Exports | 73.2 | 80.0 | 86.7 | 78.5 | 80.2 | 80.5 | 79.8 | 79.3 | 79.3 | 79.4 |
| Imports | 63.9 | 75.5 | 88.7 | 74.7 | 75.3 | 74.5 | 73.4 | 72.9 | 73.0 | 73.1 |
| Primary income | -2.9 | -3.8 | -3.5 | -2.6 | -2.6 | -3.5 | -3.8 | -3.7 | -3.6 | -3.6 |
| Secondary income | 0.9 | 0.5 | 0.1 | 0.7 | 0.4 | 0.4 | 0.4 | 0.2 | 0.2 | 0.2 |
| **Capital and Financial Account Balance** | -6.4 | -0.1 | 4.7 | -3.5 | -4.6 | 0.6 | 2.6 | 2.9 | 4.3 | 4.5 |
| Capital account balance | 1.9 | 1.7 | 1.5 | 2.0 | 2.8 | 3.1 | 2.6 | 1.0 | 1.1 | 1.1 |
| Foreign direct investment balance | -1.1 | -2.2 | -2.5 | -1.1 | -1.0 | -1.0 | -1.1 | -1.2 | -1.3 | -1.4 |
| Portfolio investment balance | -3.5 | 3.2 | 2.8 | 1.8 | 2.9 | 1.6 | 1.5 | 1.4 | 1.4 | 1.3 |
| Financial derivatives balance | 0.0 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Other investment balance | 13.0 | 1.0 | -3.2 | 4.9 | 5.5 | 2.1 | -0.4 | -2.1 | -3.2 | -3.2 |
| **Overall Balance** | -1.1 | 1.3 | 0.1 | 0.9 | -1.8 | 3.5 | 5.6 | 5.7 | 7.2 | 7.3 |
| **Gross External Debt 1/** | 80.5 | 78.8 | 67.8 | 66.2 | 66.1 | 65.6 | 65.3 | 65.3 | 65.2 | 65.2 |
| Public | 46.0 | 43.5 | 30.1 | 26.8 | 25.1 | 23.6 | 22.3 | 21.1 | 19.9 | 18.8 |
| Short-term | 11.0 | 13.1 | 8.3 | 7.1 | 6.4 | 5.8 | 5.4 | 5.0 | 4.7 | 4.4 |
| Long-term | 35.0 | 30.4 | 21.7 | 19.7 | 18.7 | 17.7 | 16.9 | 16.0 | 15.2 | 14.4 |
| Private | 34.5 | 35.3 | 37.7 | 39.5 | 41.0 | 42.0 | 43.1 | 44.2 | 45.3 | 46.3 |
| Short-term | 20.5 | 21.7 | 26.7 | 28.0 | 29.3 | 30.2 | 31.0 | 31.9 | 38.0 | 38.7 |
| Long-term | 14.0 | 13.6 | 11.0 | 11.5 | 11.7 | 11.9 | 12.1 | 12.3 | 7.3 | 7.6 |
| Gross external debt (in percent of GS exports) | 110.1 | 98.4 | 78.1 | 84.3 | 82.4 | 81.5 | 81.9 | 82.3 | 82.2 | 82.1 |
| Net external debt | 0.3 | -5.7 | -14.6 | -13.3 | -21.5 | -29.5 | -36.8 | -42.2 | -47.5 | -52.2 |
| Net international investment position | -15.7 | -7.4 | 0.0 | 0.0 | 7.4 | 13.6 | 19.2 | 22.7 | 26.2 | 29.0 |
| Merchandise export volume (percent change) 2/ | -0.2 | 17.4 | 12.2 | -3.3 | 4.0 | 4.5 | 3.6 | 3.7 | 4.0 | 4.0 |
| Merchandise import volume (percent change) 2/ | -4.5 | 20.0 | 12.4 | -4.9 | 3.4 | 5.2 | 4.1 | 4.0 | 4.3 | 4.2 |
| Merchandise export prices (percent change) 2/ | -3.6 | 5.8 | 15.4 | -0.2 | 3.7 | 1.5 | 0.7 | 0.5 | 0.6 | 0.7 |
| Merchandise import prices (percent change) 2/ | -5.8 | 12.0 | 24.9 | -5.6 | 3.0 | -0.5 | -0.4 | 0.1 | 0.5 | 0.5 |
| GDP (in billion of Euros) | 49.8 | 56.5 | 67.5 | 72.0 | 75.9 | 80.3 | 84.5 | 88.5 | 92.7 | 97.0 |

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/ Derived from national accounts data.

## Table 4. Lithuania: Summary of Monetary Accounts, 2013–2023

(Billions of Euros, unless otherwise indicated)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Monetary Authority** | | | | | | | | | | | |
| Gross foreign assets | 6.0 | 7.9 | 2.9 | 3.0 | 4.2 | 5.7 | 5.3 | 4.7 | 5.9 | 5.2 | 5.2 |
| Gross foreign liabilities | 0.0 | 0.1 | 0.2 | 0.2 | 0.2 | 0.3 | 0.5 | 1.2 | 3.2 | 2.6 | 2.4 |
| Net foreign assets | 6.0 | 7.8 | 2.7 | 2.8 | 4.0 | 5.3 | 4.7 | 3.5 | 2.6 | 2.5 | 2.8 |
| Net domestic assets | -1.0 | -1.9 | 6.5 | 9.8 | 11.7 | 13.4 | 10.8 | 17.0 | 22.1 | 24.4 | 23.3 |
| Net credit to government | -0.5 | -1.2 | 0.0 | 1.0 | -0.1 | 1.2 | 0.3 | 10.1 | 8.9 | 9.1 | 9.0 |
| Credit to banks | 0.0 | 0.0 | 1.0 | 0.7 | 0.6 | 0.5 | 0.3 | 6.3 | 16.8 | 15.6 | 15.3 |
| Credit to private sector | 0.0 | 0.0 | 1.7 | 4.8 | 8.0 | 8.9 | 8.2 | 0.5 | 0.4 | 0.2 | 0.2 |
| Other items, net | -0.6 | -0.7 | 3.8 | 3.3 | 3.3 | 2.9 | 1.9 | 0.2 | -3.9 | -0.6 | -1.2 |
| Reserve money | 4.9 | 5.9 | 9.1 | 12.6 | 15.7 | 18.8 | 15.5 | 20.6 | 24.8 | 26.9 | 26.0 |
| Currency outside the central bank | 3.4 | 1.7 | 6.1 | 6.2 | 6.4 | 6.8 | 7.1 | 7.8 | 8.4 | 8.3 | 8.4 |
| Currency outside banks | 3.2 | 1.4 | 5.7 | 5.8 | 6.0 | 6.3 | 6.6 | 7.3 | 7.8 | 7.7 | 7.5 |
| Cash in vaults of banks | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 0.4 | 0.5 | 0.6 | 0.8 |
| Deposit money banks' deposits with BoL | 1.5 | 4.3 | 3.1 | 6.4 | 9.3 | 12.0 | 8.5 | 12.8 | 16.4 | 18.6 | 17.7 |
| **Banking Survey** | | | | | | | | | | | |
| Net foreign assets | 2.9 | 4.5 | -2.3 | -3.5 | -2.7 | -2.2 | -1.8 | -3.5 | -5.2 | -4.6 | -4.5 |
| Monetary authority | 6.0 | 7.8 | 2.7 | 2.8 | 4.0 | 5.3 | 4.7 | 3.5 | 2.6 | 2.5 | 2.8 |
| Banks and other banking institutions | -3.1 | -3.3 | -5.0 | -6.2 | -6.7 | -7.5 | -6.5 | -7.0 | -7.8 | -7.1 | -7.3 |
| Net domestic assets | 13.5 | 12.1 | 24.3 | 27.1 | 27.7 | 30.0 | 32.5 | 44.1 | 51.3 | 49.5 | 48.7 |
| Net claims on government 1/ | 1.7 | 0.5 | 1.7 | 2.3 | 0.7 | 1.9 | 1.0 | 10.4 | 10.0 | 10.2 | 10.0 |
| Monetary authority | -0.5 | -1.2 | 0.0 | 1.0 | -0.1 | 1.2 | 0.3 | 10.1 | 8.9 | 9.1 | 9.0 |
| Banks and other banking institutions | 2.1 | 1.7 | 1.8 | 1.3 | 0.8 | 0.8 | 0.6 | 0.3 | 1.1 | 1.1 | 1.0 |
| Credit to private sector | 14.9 | 14.8 | 17.1 | 21.3 | 25.2 | 27.2 | 27.1 | 19.0 | 21.4 | 21.7 | 21.7 |
| Credit to nonbank financial institutions | 0.9 | 0.9 | 3.1 | 6.5 | 9.9 | 11.2 | 10.4 | 2.3 | 2.5 | 2.3 | 2.3 |
| Other items, net | -4.0 | -4.1 | 2.5 | -3.1 | -8.1 | -10.3 | -5.9 | 12.3 | 17.4 | 15.4 | 14.5 |
| **Broad Money** | 16.4 | 16.6 | 22.0 | 23.6 | 25.0 | 27.8 | 30.7 | 40.6 | 46.1 | 50.2 | 53.7 |
| Currency outside banks | 3.2 | 1.4 | 5.7 | 5.8 | 6.0 | 6.3 | 6.6 | 7.3 | 7.8 | 7.7 | 7.5 |
| Deposits | 13.2 | 15.2 | 16.3 | 17.8 | 19.0 | 21.5 | 24.1 | 33.3 | 38.2 | 37.2 | 36.6 |
| In national currency | 9.7 | 11.3 | 15.4 | 16.9 | 18.1 | 20.6 | 23.1 | 31.7 | 36.3 | 35.4 | 34.7 |
| In foreign currency | 3.5 | 4.0 | 0.9 | 0.9 | 0.9 | 0.9 | 1.0 | 1.6 | 1.9 | 1.9 | 1.9 |
| **Memorandum Items:** | | | | | | | | | | | |
| Reserve money (yearly percent change) | 4.9 | 20.9 | 53.3 | 38.4 | 24.9 | 19.3 | -17.4 | 32.4 | 20.5 | 8.8 | -3.3 |
| Broad money (yearly percent change) | 4.4 | 1.2 | 32.9 | 7.2 | 5.8 | 11.4 | 10.4 | 32.1 | 13.5 | -2.5 | -1.7 |
| Private sector credit (yearly percent change) | -2.3 | -0.9 | 4.1 | 7.1 | 4.5 | 6.0 | 3.3 | -1.8 | 13.4 | 2.1 | 0.9 |
| Money multiplier | 3.3 | 2.8 | 2.4 | 1.9 | 1.6 | 1.5 | 2.0 | 2.0 | 1.9 | 1.7 | 1.7 |
| Currency outside banks, in percent of deposits | 24.0 | 8.9 | 34.9 | 32.5 | 31.6 | 29.3 | 27.3 | 22.0 | 20.5 | 20.7 | 20.6 |
| Foreign-currency deposits (percent of total deposits) | 26.5 | 26.0 | 5.5 | 5.1 | 4.8 | 4.1 | 4.1 | 4.7 | 5.0 | 5.0 | 5.2 |
| Foreign-currency loans (percent of total loans) 2/ | 72.1 | 72.7 | 0.9 | 0.6 | 0.5 | 0.4 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Velocity of broad money | 2.1 | 2.2 | 1.7 | 1.6 | 1.7 | 1.6 | 1.6 | 1.2 | 1.2 | 1.5 | 1.6 |
| Gross official reserves (billions of U.S. dollars) 3/ | 8.0 | 8.8 | 1.9 | 3.0 | 4.6 | 4.9 | 5.6 | 4.9 | 6.1 | 6.4 | 6.3 |
| Gross official reserves (billions of euros) 3/ | 6.0 | 7.9 | 2.9 | 3.0 | 4.2 | 5.7 | 5.3 | 4.7 | 5.9 | 5.2 | 5.2 |
| GDP | 35.1 | 36.6 | 37.3 | 38.9 | 42.2 | 45.6 | 49.0 | 49.8 | 56.5 | 67.5 | 72.0 |

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).

# Table 5. Lithuania: Financial Soundness Indicators, 2013–2023
(In percent)

| | Dec-13 | Dec-14 | Dec-15 | Dec-16 | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 | Dec-22 | Dec-23 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Capital adequacy** | | | | | | | | | | | |
| Regulatory capital to risk-weighted assets 1/ 2/ | 17.6 | 21.3 | 24.9 | 19.4 | 19.1 | 18.6 | 23.7 | 24.0 | 23.5 | 20.4 | 19.9 |
| Regulatory Tier 1 capital to risk-weighted assets 1/ 2/ | 17.1 | 20.9 | 24.3 | 19.1 | 18.8 | 18.5 | 23.3 | 23.6 | 23.2 | 20.2 | 18.6 |
| Capital to assets 1/ | 12.6 | 12.9 | 11.1 | 10.4 | 9.4 | 8.6 | 9.1 | 8.1 | 7.1 | 6.0 | 6.7 |
| | | | | | | | | | | | |
| **Asset quality** | | | | | | | | | | | |
| Nonperforming loans to capital 1/ 3/ | 42.6 | 46.9 | 38.3 | 35.5 | 28.6 | 26.9 | 15.2 | 15.0 | 8.6 | 7.2 | 7.3 |
| Nonperforming loans net of provisions to capital 1/ 3/ | 19.7 | 29.8 | 25.0 | 23.2 | 18.8 | 20.0 | 10.5 | 10.4 | 6.0 | 4.6 | 4.5 |
| Nonperforming loans to total (non-interbank) loans 1/ 3/ | 11.6 | 7.0 | 5.7 | 4.1 | 3.1 | 2.5 | 1.5 | 1.4 | 0.7 | 0.6 | 0.6 |
| | | | | | | | | | | | |
| Nonperforming loans to capital 1/ 3/ 4/ | 42.6 | 46.9 | 38.3 | 35.5 | 28.6 | 26.9 | 15.2 | 15.0 | 8.6 | 7.2 | 7.3 |
| o/w impaired loans to capital 1/ 3/ 4/ | 27.4 | 29.1 | 23.4 | 23.1 | 18.4 | 26.0 | 14.3 | 14.2 | 7.7 | 6.9 | 6.9 |
| o/w non-impaired loans overdue more than 60 days to capital 1/ 3/ 4/ 14/ | 15.2 | 8.0 | 6.4 | 7.9 | 5.8 | .. | .. | .. | .. | .. | .. |
| Nonperforming loans net of provisions to capital 1/ 3/ 4/ 5/ | 19.7 | 29.8 | 25.0 | 23.2 | 22.9 | 20.0 | 10.5 | 10.4 | 6.0 | 4.6 | 4.5 |
| | | | | | | | | | | | |
| Nonperforming loans to total (non-interbank) loans 3/ 4/ | 11.0 | 7.0 | 5.7 | 4.1 | 4.1 | 2.5 | 1.5 | 1.4 | 0.7 | 0.6 | 0.6 |
| o/w impaired loans to total (non-interbank) loans 4/ | 8.5 | 4.7 | 3.8 | 3.1 | 2.2 | 2.4 | 1.4 | 1.3 | 0.6 | 0.5 | 0.6 |
| o/w non-impaired loans overdue more than 60 days to total (non-interbank) loans 4/ 14 | 2.5 | 1.2 | 1.0 | 0.9 | 0.6 | .. | .. | .. | .. | .. | .. |
| | | | | | | | | | | | |
| Impairment losses to total (non-interbank) loans 6/ 7/ | 4.2 | 2.5 | 2.0 | 1.4 | 1.1 | 0.8 | 0.6 | 0.6 | 0.4 | 0.4 | 0.6 |
| | | | | | | | | | | | |
| Impairment losses to nonperforming loans 3/ 4/ 6/ 7/ | 53.7 | 36.5 | 34.7 | 34.7 | 30.8 | 33.4 | 39.4 | 43.8 | 56.8 | 77.7 | 89.8 |
| | | | | | | | | | | | |
| **Sectoral distribution of corporate loans 8/** | | | | | | | | | | | |
| Agriculture, forestry and fishing | 2.8 | 2.9 | 3.6 | 3.7 | 3.6 | 3.6 | 3.2 | 3.5 | 3.0 | 2.8 | 2.7 |
| Mining and quarrying | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| Manufacturing | 17.9 | 15.7 | 14.7 | 14.2 | 14.3 | 14.0 | 14.9 | 14.7 | 14.6 | 14.3 | 13.3 |
| Electricity, gas, steam and air conditioning supply | 7.6 | 9.5 | 11.0 | 8.7 | 4.7 | 5.3 | 7.4 | 5.7 | 5.3 | 7.2 | 7.2 |
| Water supply; sewerage, waste management and remediation activities | 0.8 | 1.0 | 1.0 | 0.9 | 0.8 | 0.6 | 0.6 | 0.7 | 1.0 | 1.0 | 1.0 |
| Construction | 8.6 | 7.3 | 6.1 | 5.4 | 5.2 | 3.7 | 3.1 | 2.9 | 3.1 | 4.0 | 5.3 |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | 19.3 | 20.3 | 21.9 | 21.3 | 22.7 | 25.4 | 23.0 | 19.4 | 21.3 | 20.3 | 19.4 |
| Transportation and storage | 5.7 | 5.0 | 5.8 | 5.8 | 6.1 | 8.7 | 9.3 | 9.0 | 8.1 | 5.4 | 6.0 |
| Accommodation and food service activities | 2.7 | 2.6 | 2.4 | 2.4 | 2.4 | 3.0 | 2.6 | 3.1 | 2.3 | 1.9 | 2.1 |
| Information and communication | 0.8 | 0.9 | 0.8 | 2.4 | 2.4 | 2.0 | 1.8 | 1.1 | 0.8 | 1.0 | 1.1 |
| Real estate activities | 28.3 | 27.8 | 26.3 | 26.6 | 25.8 | 25.0 | 27.0 | 31.9 | 32.5 | 32.2 | 30.7 |
| Professional, scientific and technical activities | 2.6 | 3.7 | 2.6 | 3.2 | 5.0 | 2.6 | 1.8 | 2.2 | 3.0 | 3.3 | 3.8 |
| Administrative and support service activities | 1.0 | 1.8 | 2.0 | 3.0 | 4.4 | 2.6 | 2.4 | 2.9 | 2.6 | 3.6 | 3.8 |
| Remaining activities | 1.2 | 1.1 | 1.3 | 1.8 | 2.2 | 3.0 | 2.6 | 2.5 | 2.2 | 2.8 | 0.0 |
| | | | | | | | | | | | |
| Residential real estate loans to total (non-interbank) loans | 38.0 | 28.7 | 29.8 | 31.3 | 31.3 | 31.1 | 30.1 | 27.8 | 24.5 | 22.4 | 22.6 |
| | | | | | | | | | | | |
| **Earnings and profitability** | | | | | | | | | | | |
| RoE 1/ 9/ | 8.9 | 8.1 | 9.0 | 14.0 | 12.5 | 12.7 | 12.3 | 10.7 | 10.3 | 10.6 | 23.6 |
| RoA 9/ | 1.2 | 1.3 | 0.9 | 1.0 | 1.1 | 1.3 | 1.1 | 0.8 | 0.8 | 0.9 | 1.7 |
| Interest margin to gross income | 24.3 | 49.9 | 49.7 | 50.3 | 53.3 | 53.7 | 52.2 | 53.9 | 51.2 | 46.1 | 59.2 |
| Noninterest expenses to gross income | 60.5 | 56.6 | 55.3 | 50.9 | 53.2 | 50.5 | 47.5 | 52.7 | 55.7 | 60.8 | 60.5 |
| Trading and foreign exchange gains (losses) to gross income | 9.9 | 8.2 | 6.2 | 4.3 | 7.2 | 6.2 | 6.2 | 6.3 | 7.4 | 10.5 | 2.7 |
| Personnel expenses to noninterest expenses | 38.3 | 38.7 | 42.7 | 43.6 | 41.7 | 42.2 | 43.2 | 43.5 | 41.3 | 23.3 | 14.4 |
| | | | | | | | | | | | |
| **Liquidity** | | | | | | | | | | | |
| Liquidity coverage ratio | .. | .. | .. | 266.3 | 281.9 | 254.2 | 272.4 | 743.3 | 392.3 | 389.6 | 342.0 |
| Liquidity ratio (liquid assets to current liabilities) 10/ | 41.2 | 43.6 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Liquid assets to total assets 10/ | 24.0 | 29.3 | .. | 15.3 | 23.6 | 25.6 | 28.9 | 37.0 | 43.7 | 40.5 | 36.1 |
| Current liabilities to total liabilities 10/ | 73.1 | 81.6 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| 3-month VILIBOR-EURIBOR spread, b.p. 8/ | 12.0 | 10.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Spread between highest and lowest interbank rate, b.p. 10/ | 39.0 | 25.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Loan to deposit ratio in the banking sector 11/ | 121.5 | 101.6 | 98.6 | 99.0 | 94.6 | 89.3 | 81.9 | 61.4 | 64.0 | 55.9 | 54.2 |
| | | | | | | | | | | | |
| **Foreign exchange risk** | | | | | | | | | | | |
| Foreign-currency-denominated loans to total (non-interbank) loans 12/ | 68.7 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Foreign-currency-denominated liabilities to total liabilities 12/ | 48.2 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Net open position in foreign exchange to regulatory capital 1/ 13/ | 0.4 | 0.4 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | .. | .. | .. | .. |
| | | | | | | | | | | | |
| **Memo item** | | | | | | | | | | | |
| Provisions to nonperforming loans 15/ | 29.1 | 27.3 | 40.1 | 41.2 | 34.4 | 33.4 | 64.5 | 64.7 | 83.3 | 113.7 | 117.7 |

Sources: Bank of Lithuania; and Financial Soundness Indicators Database, IMF.

**General notes:**

**A. Banking system data was compiled by aggregating banks solo (i.e. no cross-border cross-sector consolidation) data.**

**B. No intra-sector adjustments were made.**

**C. FSIs were mostly derived from supervisory data and comprise all banks and foreign bank branches incorporated in Lithuania, except if stated otherwise.**

**D. Starting 2008, bank financial data is collected through FINREP tables (EU-wide common reporting templates). This might have some influence on the values of the indicors compiled.**
The fact should be considered when making straightforward comparison of time series.

1/ Excluding foreign bank branches.
2/ As defined in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/20
3/ Consolidated data are used. Due to changes in consolidation methodology, data from Q1 2014 are not entirely comparable with previous.
2015 Q3 - 2016 Q1 data were adjusted eliminating accounting changes due to the transaction between Swedbank, AB, and Danske Bank A/S Lithuania Branch.
4/ 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.
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/ Specific provisions include allowances for both individually and collectively assessed loans.
6/ 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.
7/ Specific provisions include allowances for both individually and collectively assessed loans.
8/ According to Nace 1 up to Sept 2011. Data according to Nace 2 thereafter.
9/ Total profits (losses) after tax. Interim quarterly results are annualised.
10/ 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.
11/ Consolidated data; due to changes in data consolidation methodology, data from Q1 2014 are not entirely comparable with previous data.
12/ The large majority of foreign currency loans and foreign currency liabilities were in euros, to which the national currency 'litas' was pegged via a currency board arrangement until 2015 when the euro was introduced as a
13/ As defined in Rules for Calculation of Capital Adequacy approved by Bank of Lithuania Board Resolution No. 138 of 9 November 2006.
14/ As of 2018, breakdown for loans that are overdue more than 60 days is no longer available in FINREP.
15/ Data as of 2023Q3.

# Annex I. Risk Assessment Matrix[1]

| Source of Risks, Likelihood, and Time Horizon | Impact on Lithuania | Recommended Policy Response |
|---|---|---|
| **External Risks** | | |
| **High (Short-term)**<br>**Intensification of regional conflict(s).** Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows. | **High**<br>The direct trade impact with Russia, Ukraine and Belarus will be small. The main impact will come through rising commodity prices and from a weaker global outlook and confidence effects. | Use fiscal space to provide targeted relief to firms and households and let automatic stabilizers work fully provided that both inflation and growth are negatively affected. |
| **High (Short-term)**<br>**Social discontent.** High inflation, real income loss, spillovers from conflicts (including migration), worsening inequality, and disputed elections cause social unrest and detrimental populist policies. This exacerbates imbalances, slows growth, and leads to policy uncertainty and market repricing. | **Low**<br>The economy has shown resilience to pandemic related shocks, while price increases and shortages linked to the War in Ukraine are unlikely to result in social discontent given broad consensus on support for Ukraine. | Provide targeted support to ameliorate the impact of higher food/energy prices on vulnerable households. |
| **Medium (Short-term)**<br>**Commodity price volatility.** A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability. | **High/Medium**<br>Further increases in energy and food prices will put additional pressure on consumers and firms. However, their balance sheets are strong, and the government has fiscal space to provide support. | Allow price signals to work and provided targeted support to vulnerable groups and those most affected. |
| **High (Short-term)**<br>**Abrupt global slowdown or recession.** Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. | **High**<br>A marked slowdown in the global economy will impact Lithuania through its impact on the global economy, and to key EU trading partners. | Allow automatic stabilizers to work and depending on the magnitude of the slowdown and given weak social safety net, provide targeted support to the most vulnerable. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

| Source of Risks, Likelihood, and Time Horizon | Impact on Lithuania | Recommended Policy Response |
|---|---|---|
| **Medium (Short-term)**<br>**Monetary policy miscalibration.** Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks. | **Low**<br>Whereas nominal wage growth remains elevated, both headline and core inflation are below the euro area and inflation expectations are well anchored. Thus, there is limited risk of recurring high inflation. | If inflationary pressures reemerge fiscal policy will have to be more proactive and adopt a tighter stance. |
| **Medium (Short-term)**<br>**Systemic financial instability.** High interest rates, risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs. | **Medium**<br>Banks have enough capital and liquidity buffers to absorb shocks, but there are potential pockets of vulnerability and the risk of a disorderly correction of the real estate market | Risks and vulnerabilities require monitoring. If there are credit supply disruptions or a disorderly correction of the real estate market, macroprudential policies will have to be relaxed. |
| **High (Long-term)**<br>**Deepening geo-economic fragmentation.** Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth. | **Medium**<br>The slowdown in global growth and trade will affect Lithuania's overall trade prospects weakening the labor market. | Continue EU trade integration to secure access to a large market. Pursue education and healthcare reform to shift the labor force to higher value-added sectors with fast growing labor demand. |
| **Medium (Short-term)**<br>**Cyberthreats.** Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability. | **Medium**<br>Credit growth and investment could be impaired, though high liquidity in the economy could limit the impact. | Step up collaboration with home country supervisors and strengthen crisis preparedness. |
| **Medium (Long-term)**<br>**Extreme climate events.** Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability. | **Medium**<br>While Lithuania could benefit from higher temperatures, associated increased volatility entails risks to biodiversity, food production, infrastructure, and weather sensitive activities. | Continue to strengthen climate-related policies along with energy security, including increasing the share of renewables. |
| **Domestic Risks** | | |
| **Low/Medium (Long-term)**<br>**Risks to competitiveness.** Wage growth exceeds productivity growth in tradeable sectors for an extended period. Low absorption of EU funds. | **Medium**<br>Competitiveness and growth potential would suffer. However, real wages and productivity have traditionally been closely linked and temporary deviations have been self-correcting. | Proactively use fiscal policy to reduce inflationary pressures. Redouble efforts to implement structural reform programs. Avoid large minimum wage increases. Accelerate EU funds absorption. |

| Source of Risks, Likelihood, and Time Horizon | Impact on Lithuania | Recommended Policy Response |
|---|---|---|
| **High (Medium-term)**<br>**Failure to implement structural reforms.** Elusive implementation of reforms in critical areas, including education and health care, limit opportunities to increase potential growth and productivity. | **High**<br>Lithuania would be vulnerable to a middle-income trap and face continued social demands without commensurate growth and revenue. | Accelerate the implementation of elusive structural reforms and elaborate a medium- term fiscal plan that raises potential and meets social needs. |
| **Medium (Medium/Long-term)**<br>**Addressing long-term spending pressures.** Failure to implement adequate fiscal reforms given additional spending pressures related to aging, climate, and defense. | **High**<br>Higher public debt would increase concerns of debt sustainability and macro-financial stability. | Implement pension reform, healthcare and education reforms to improve efficiency and tax policy changes to increase revenue collection. |

# Annex II. Implementation of Past IMF Recommendations

| | |
|---|---|
| | **Education** |
| **Issue** | Oversized system does not reflect demographics resulting in high spending and poor outcomes. System leads to mismatch of education and occupational choices. |
| **Recommendations** | Address overcapacities (reduce number of teachers and consolidate school and university infrastructure). Review nexus between universities, financial incentives, and quality standards. |
| **Authorities' actions** | Parliament approved a decision on the amendments to the rules in 2021 that is broadly in line with recommendations and the new requirements entered into force in 2022 for general education schools and higher education. But implementation was largely decentralized, especially for the reforms in higher education. The pandemic and war have further delayed reform efforts. |
| | **Healthcare** |
| **Issue** | The system remains hospital-care centered while out-patient and long-term care for elderly lag. |
| **Recommendations** | Continue reorganizing and rationalizing the hospital sector, improve out-patient and long-term care, and expand role of primary care. Develop a copayments system to incentivize cost efficiency. Strengthen accountability, particularly at municipal level. |
| **Authorities' actions** | The authorities diverted more financial resources to the health sector during covid and renewed implementation efforts, including introduction of legal changes to allow for joint ownership of hospitals with municipalities. The government approved two programs for 2022-2030 to improve the quality and efficiency of the health care system in the country. |
| | **Tax Policy** |
| **Issue** | Low overall tax collection with high labor tax wedge and low wealth and environmental-related taxes. Tax system has limited redistributive impact. |
| **Recommendations** | Reduce social security contributions for low wage earners. Rebalance tax system from indirect and labor taxes towards wealth, capital and environmental taxes. Reduce tax exemptions and privileged regimes. |
| **Authorities' actions** | The authorities recently proposed tax reform is in the right direction, but the revenue gains would be low and not strong enough to achieve climate goals. |
| | **Labor Market** |
| **Issue** | Flexible labor market with high skill-mismatches and labor shortages mostly in high-skill industries. High minimum wage introduces distortions in regional areas with low wages. |
| **Recommendations** | Reduce the tax wedge. Strengthen ALMPs, including life-long learning and apprenticeships, and increase its funding. Reduce barriers to non-EU migration and increase retirement age. Pause minimum wage increase and consider having differentiated minimum wage across regions. |
| **Authorities' actions** | Enhanced ALMPs (introduced internships, mobility support, recognition of self-education). Increased minimum wage by 15 percent in 2022 to 50 percent of average wage. Restrictions on immigration were eased and migration from Ukraine has been facilitated. |
| | |
| **Issue** | Low and falling replacement ratios for a rapidly aging population. Highly redistributive—currently the most effective redistributive policy tool—but not targeted at the poor. |

| | |
|---|---|
| **Recommendations** | Link retirement age to life expectancy and tighten early retirement. Raise gross pensions (to at least preserve replacement ratios) and subject them to progressive PIT. Strengthen multi-pillar system by funding non-contributory basic pensions through general revenues and by making payments to second pillar compulsory. Scale back incidence of disability pensions. |
| **Authorities' actions** | Multi-pillar system was strengthened as basic pension and commensurate social contributions were transferred to the state budget. Participation in Pillar II became mandatory with limited opting-out. A ceiling on social contributions was established and a new PIT bracket was introduced. A ceiling on private pension fund fees was introduced and the minimum amount to purchase an annuity reduced. The retirement age has not been increased. One-off increases in pension benefits outside of the indexation formula are commonly introduced with possibility to undermine the system's financial sustainability. In 2021, two third pillar pension funds were established with environmental sustainability goals. |
| | **Green Transformation** |
| **Issue** | Lithuania is increasingly vulnerable to climate change, while geopolitical tensions have brought energy security to the fore. |
| **Recommendations** | A comprehensive carbon tax is necessary to achieve the authorities' emission Reduction objectives for 2030 and reduce energy imports by (i) reducing fossil fuels, (ii) investing in low-emission transportation, and (iii) raising energy efficiency. The introduction of an economy-wide carbon tax—set to gradually increase to EUR50 per metric ton of $CO_2$ emissions by 2030—would help achieve these goals. |
| **Authorities' actions** | The authorities have proposed new environmental taxes, but these are not ambitious enough to deliver the climate objectives and still being discussed in parliament. |

# Annex III. External Sector Assessment

**Overall Assessment:** The external position of Lithuania in 2023 was broadly in line with the level implied by fundamentals and desirable policies. This was due to the decrease in energy prices and related improvement in the terms of trade that led to a lower goods balance deficit and the increase in the services surplus to an all-time high. Over the medium-term and under the policies expected under the baseline scenario with a continuing strong services balance, Lithuania's current account balance is expected to remain in the vicinity of the norm. Therefore, there is no concern about long-term misalignments.

**Potential Policy Responses:** The energy transition strategy by the government is essential to reduce fuel energy imports which could potentially rise if regional conflicts and global trade tensions escalate.

## Foreign Assets and Liabilities: Position and Trajectory

**Background.** Between 2009 and 2023, the NIIP has strengthened almost every year by a total of more than 50 percentage points of GDP, turning positive at the end of 2023 at 1.3 percent of GDP from -7.0 percent of GDP in 2022. Gross assets increased to 113.4 percent of GDP, while liabilities increased to 112.2 percent of GDP. The trend improvement over the past 15 years reflects the improvement in international competitiveness.

**Assessment.** The current NIIP and its projected path do not imply risks to external sustainability.

| | | | | | |
|---|---|---|---|---|---|
| 2023 (% GDP) | NIIP: 1.3 | Gross Assets: 113.4 | Debt Assets: 48.8 | Gross Liab.: 112.2 | Debt Liab.: 35.8 |

## Current Account

**Background.** The 2023 current account turned into a surplus of 1.9 percent of GDP from a deficit of -5.5 percent of GDP in 2022 and a surplus of 1.1 percent of GDP in 2021. The increase to a surplus, as also observed over the years 2017 to 2021, is explained by an improvement in the energy trade deficit from -10.5 percent of GDP in 2022 to -4.3 percent in 2023 and an increase in the services balance from 8.6 percent of GDP in 2022 to 10.5 percent in 2023.

**Assessment.** The EBA-lite CA model estimates that the current account gap is -0.7 percent while the norm envisages a surplus of 2.7 percent of GDP. Lower fiscal deficits and public health expenditures relative to the rest of the world weigh against the model's residual to produce the small gap.

**Lithuania: EBA-lite Model Results, 2023**

| | CA model [1] | REER model [1] |
|---|---|---|
| | (in percent of GDP) | |
| **CA-Actual** | **1.9** | |
| Cyclical contributions (from model) (-) | 0.0 | |
| Additional temporary/statistical factors (-) | | |
| Natural disasters and conflicts (-) | 0.0 | |
| **Adjusted CA** | **2.0** | |
| | | |
| **CA Norm** (from model) [2] | **2.7** | |
| Adjustments to the norm (+) | 0.0 | |
| **Adjusted CA Norm** | **2.7** | |

**Lithuania: EBA-lite Model Results, 2023 (concluded)**

| | | |
|---|---|---|
| **CA Gap** | **-0.7** | **-1.7** |
| o/w Relative policy gap | 4.3 | |
| Elasticity | -0.5 | |
| **REER Gap** (in percent) | **1.34** | **3.2** |

[1] Based on the EBA-lite 3.0 methodology

[2] Cyclically adjusted, including multilateral consistency adjustments.

## Real Exchange Rate

**Background.** The real effective exchange rate appreciated by almost 6 percent in 2023, and about 17 since 2019. As of February, it has appreciated by 2.2 percent relative to the 2023 average level.

**Assessment.** Given the small CA gap, the CA model suggests a REER gap of 1.3 percent. The REER model estimates a REER gap of 3.2 percent, implying a current account gap of -1.7 percent of GDP. The real appreciation during 2023 reflects the positive inflation differentials with trading partners.

## Capital and Financial Accounts: Flows and Policy Measures

**Background.** After a one-time period of capital inflows in 2022 due to the financing needs related to energy prices, Lithuania experienced strong capital outflows during 2023. The outflows were driven by a strong increase in net other investment inflows, continued net portfolio investment inflows while net FDI inflows continued to be negative in 2023.

**Assessment.** Gross debt remains at a reasonable level of less than one third of gross liabilities while risks are ameliorated by the holding of significant assets, with the increased holdings of 7.7 percent of GDP of currency and deposits assets by the central bank.

## FX Intervention and Reserves Level

**Background.** The euro has the status of a global reserve currency.

**Assessment.** Reserves in the euro area tend to be low relative to standard metrics, but the currency is free floating.

# Annex IV. Debt Sustainability Analysis

## Annex IV. Figure 1. Lithuania: Risk of Sovereign Stress

| Horizon | Mechanical signal | Final assessment | Comments |
|---|---|---|---|
| **Overall** | ... | Low | The overall risk of sovereign stress is low, with low levels of vulnerability in<br>the near- and medium-term and moderate in the long-term. |
| **Near-term 1/** | | | |
| **Medium-term** | Low | Low | Medium-term risks are assessed as low in line with the mechanical low signal on the basis of the strength of institutions and prudent policies, the low level of public debt as a share of GDP, the access to wider pool of investors in Europe, and the ECB's stabilizing role. |
| Fanchart | Moderate | ... | |
| GFN | Low | ... | |
| Stress test | | ... | |
| **Long-term** | ... | Moderate | Long-term risks are moderate as aging-related expenditures on health and social security will eventually feed into debt dynamics. |
| **Sustainability assessment 2/** | Not required for surveillance countries | Not required for surveillance countries | The projected debt path is expected to stabilize and GFNs will remain at manageable levels, especially with the reinstatement of the domestic fiscal rule. Therefore debt is assessed as sustainable. |
| **Debt stabilization in the baseline** | | | Yes |

### DSA Summary Assessment

Commentary: Lithuania is at a low overall risk of sovereign stress with sustainable public debt. Most indicators have normalized after the pandemic and the inflationary shock caused by Russia's war in Ukraine. Accordingly, public debt is expected to remain firmly on a downward path over the medium term, with no difficulty in financing. Over the longer run, Lithuania should continue with structural reforms to tackle risks arising from climate change and population aging. Even in that case, the debt-to-GDP ratio is expected to remain comfortably below the EU debt threshold of 60 percent.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

## Annex IV. Figure 2. Lithuania: Debt Coverage and Disclosures

| | CG | GG | NFPS | CPS | Other | Comments |
|---|---|---|---|---|---|---|
| **1. Debt coverage in the DSA: 1/** | CG | GG | NFPS | CPS | Other | |
| **1a. If central government, are non-central government entities insignificant?** | | | | | n.a. | |

**2. Subsectors included in the chosen coverage in (1) above:**

| | | | | # | Subsectors captured in the baseline | Inclusion | Comments |
|---|---|---|---|---|---|---|---|
| CPS | NFPS | GG: expected | CG | 1 | Budgetary central government | Yes | |
| | | | | 2 | Extra budgetary funds (EBFs) | No | Not applicable |
| | | | | 3 | Social security funds (SSFs) | Yes | |
| | | | | 4 | State governments | No | Not applicable |
| | | | | 5 | Local governments | Yes | |
| | | | | 6 | Public nonfinancial corporations | Yes | |
| | | | | 7 | Central bank | Yes | |
| | | | | 8 | Other public financial corporations | Yes | |

**3. Instrument coverage:**

| Currency & deposits | Loans | Debt securities | Oth acct. payable 2/ | IPSGSs 3/ |
|---|---|---|---|---|

**4. Accounting principles:**

| Basis of recording | | Valuation of debt stock | | |
|---|---|---|---|---|
| Non-cash basis 4/ | Cash basis | Nominal value 5/ | Face value 6/ | Market value 7/ |

**5. Debt consolidation across sectors:**

| Consolidated | Non-consolidated |
|---|---|

**Color code:** chosen coverage | Missing from recommended coverage | Not applicable

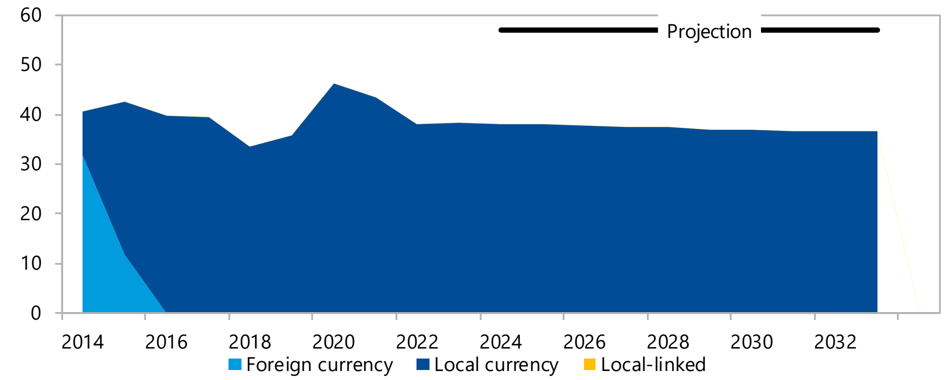
**Reporting on Intra-Government Debt Holdings**

| | | | | # | Issuer \ Holder | Budget. central govt | Extra-budget. funds | Social security funds | State govt. | Local govt. | Nonfin. pub. corp. | Central bank | Oth. pub. fin corp | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CPS | NFPS | GG: expected | CG | 1 | Budget. central govt | | | | | | | | | 0 |
| | | | | 2 | Extra-budget. funds | | | | | | | | | 0 |
| | | | | 3 | Social security funds | | | | | | | | | 0 |
| | | | | 4 | State govt. | | | | | | | | | 0 |
| | | | | 5 | Local govt. | | | | | | | | | 0 |
| | | | | 6 | Nonfin pub. corp. | | | | | | | | | 0 |
| | | | | 7 | Central bank | | | | | | | | | 0 |
| | | | | 8 | Oth. pub. fin. corp | | | | | | | | | 0 |
| | | | | | Total | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

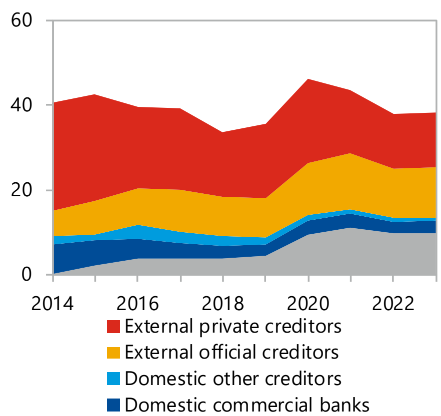
## Annex IV. Figure 3. Lithuania: Public Debt Structure Indicators

**Debt by Currency** (Percent of GDP)



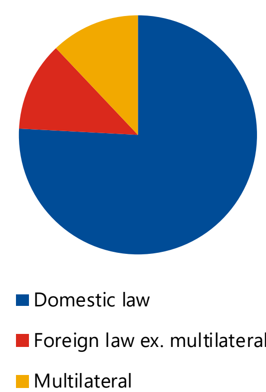

Note: The perimeter shown is general government.

**Public Debt by Holder** (Percent of GDP)



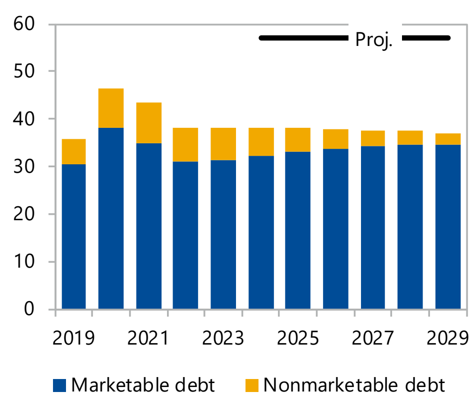

Note: The perimeter shown is general government.

**Public Debt by Governing Law, 2023** (Percent)



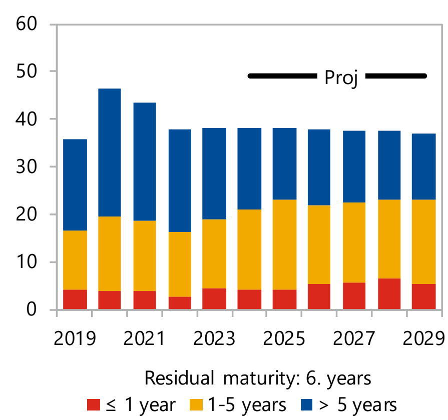

Note: The perimeter shown is general government.

**Debt by Instruments** (Percent of GDP)




Note: The perimeter shown is general government.

**Public Debt by Maturity** (Percent of GDP)




Note: The perimeter shown is general government.

Commentary: Since the Euro introduction, Lithuania does not hold any foreign-currency denominanted debt.

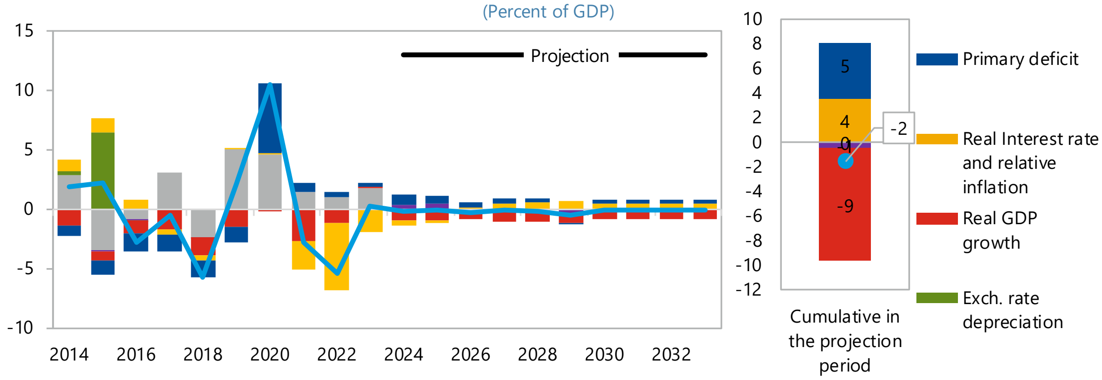
## Annex IV. Figure 4. Lithuania: Baseline Scenario

(Percent of GDP unless indicated otherwise)

| | Actual | Medium-term projection | | | | | | Extended projection | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 |
| Public debt | 38.3 | 38.1 | 38.0 | 37.8 | 37.6 | 37.5 | 36.9 | 36.8 | 36.8 | 36.7 | 36.7 |
| Change in public debt | 0.3 | -0.2 | 0.0 | -0.3 | -0.1 | -0.2 | -0.5 | -0.1 | -0.1 | -0.1 | 0.0 |
| Contribution of identified flows | -1.6 | -0.2 | 0.0 | -0.3 | -0.1 | -0.2 | -0.5 | -0.1 | -0.1 | -0.1 | 0.0 |
| Primary deficit | 0.3 | 0.9 | 0.7 | 0.4 | 0.5 | 0.4 | 0.0 | 0.3 | 0.3 | 0.3 | 0.3 |
| Noninterest revenues | 37.3 | 39.1 | 39.0 | 38.3 | 37.2 | 37.1 | 37.0 | 37.0 | 37.0 | 37.0 | 37.0 |
| Noninterest expenditures | 37.6 | 40.0 | 39.7 | 38.7 | 37.7 | 37.5 | 37.0 | 37.4 | 37.4 | 37.4 | 37.4 |
| Automatic debt dynamics | -1.8 | -1.4 | -1.2 | -0.7 | -0.4 | -0.3 | -0.1 | -0.3 | -0.3 | -0.3 | -0.3 |
| Real interest rate and relative inflation | -1.9 | -0.5 | -0.2 | 0.2 | 0.4 | 0.5 | 0.7 | 0.5 | 0.5 | 0.5 | 0.5 |
| Real interest rate | -1.9 | -0.5 | -0.2 | 0.2 | 0.4 | 0.5 | 0.7 | 0.5 | 0.5 | 0.5 | 0.5 |
| Relative inflation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Real growth rate | 0.1 | -0.9 | -1.0 | -0.9 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 |
| Real exchange rate | 0.0 | … | … | … | … | … | … | … | … | … | … |
| Other identified flows | -0.1 | 0.3 | 0.4 | 0.0 | -0.2 | -0.3 | -0.4 | -0.1 | -0.1 | -0.1 | -0.1 |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| (minus) Interest Revenues | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Other transactions | 0.0 | 0.4 | 0.5 | 0.1 | -0.1 | -0.2 | -0.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Contribution of residual | 1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | | | | | | | | |
| Gross financing needs | 4.9 | 5.7 | 5.9 | 6.0 | 7.5 | 7.8 | 8.3 | 7.3 | 7.5 | 8.0 | 7.8 |
| of which: debt service | 4.7 | 4.9 | 5.2 | 5.7 | 7.1 | 7.5 | 8.3 | 7.1 | 7.3 | 7.8 | 7.6 |
| Local currency | 4.5 | 4.9 | 5.2 | 5.7 | 7.1 | 7.5 | 8.3 | 7.1 | 7.3 | 7.8 | 7.6 |
| Foreign currency | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Memo: | | | | | | | | | | | |
| Real GDP growth (percent) | -0.3 | 2.4 | 2.6 | 2.4 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Inflation (GDP deflator; percent) | 6.9 | 3.0 | 3.0 | 2.8 | 2.5 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Nominal GDP growth (percent) | 6.6 | 5.5 | 5.7 | 5.2 | 4.8 | 4.7 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| Effective interest rate (percent) | 1.2 | 1.5 | 2.5 | 3.2 | 3.6 | 3.9 | 4.2 | 3.7 | 3.8 | 3.8 | 3.9 |

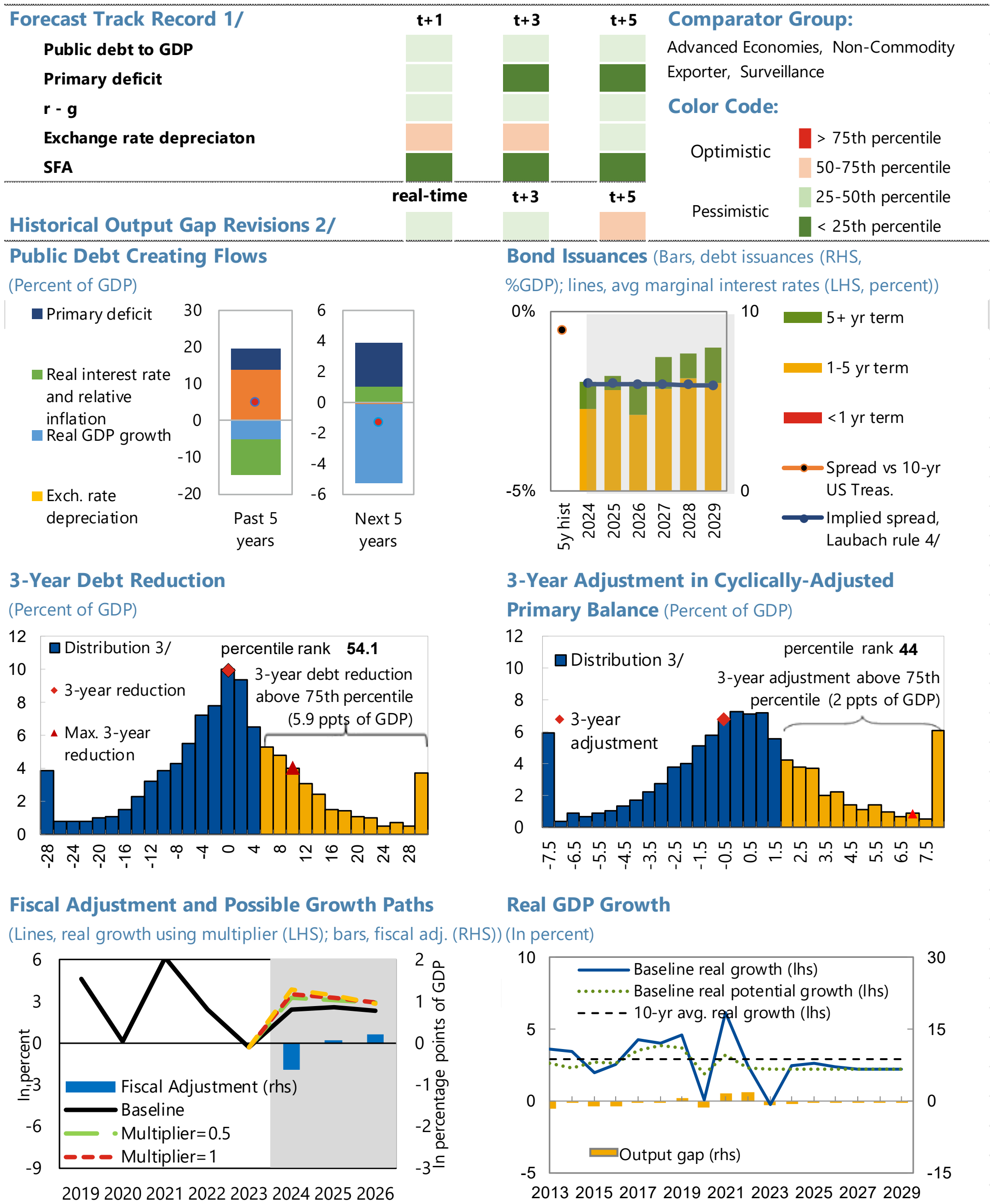
### Contribution to Change in Public Debt

(Percent of GDP)




Commentary: Public debt is projected to decline over the medium term as well as during the extended projection period, reflecting expectations of a narrowing of primary deficits and stable economic conditions.

## Annex IV. Figure 5. Lithuania: Realism of Baseline Assumptions




Commentary: Realism analysis does not point to major concerns.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

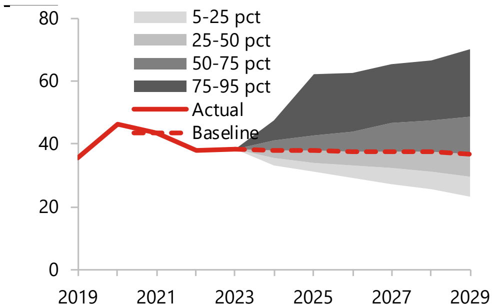
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

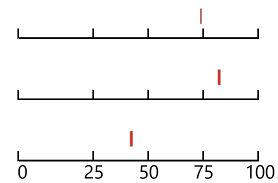
## Annex IV. Figure 6. Lithuania: Medium-Term Risk Assessment

**Final Fanchart** (Percent of GDP)

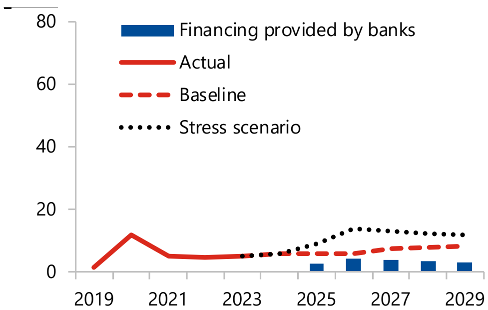



**Debt fanchart module**

| | Value | Contrib 1/ | Percentile in peer group 2/ |
|---|---|---|---|
| Fanchart width *(percent of GDP)* | 46.8 | 0.7 | |
| Probability of debt non-stabilizaiton *(percent)* | 40.3 | 0.3 | |
| Terminal debt-to-GDP x institutions index | 10.8 | 0.2 | |
| **Debt fanchart index (DFI)** | | 1.3 | |
| **Risk signal: 3/** | | Moderate | |

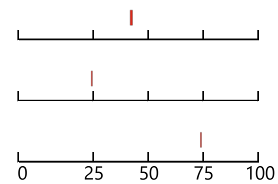



**Gross Financing Needs** (Percent of GDP)




**Gross financing needs (GFN) module**

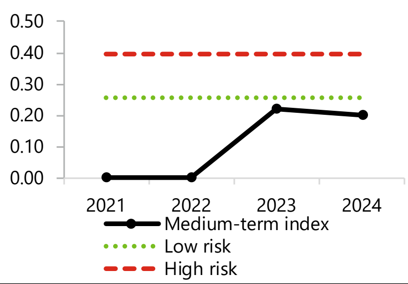
| | Value | Contrib 1/ | Percentile in peer group 2/ |
|---|---|---|---|
| Average baseline GFN *(percent of GDP)* | 6.8 | 2.3 | |
| Initial Banks' claims on the gen. govt *(pct bank assets)* | 3.4 | 1.1 | |
| Chg. In banks' claims in stress *(pct banks' assets)* | 8.8 | 2.9 | |
| **GFN financeability index (GFI)** | | 6.4 | |
| **Risk signal: 4/** | | Low | |




Triggered stress tests (stress tests not activated in gray)

Banking crisis    Commodity prices    Exchange rate    Contingent liab.    Natural disaster

**Medium-Term Index** (Index Number)




Medium-term risk analysis

| | Value | Value (normalized) | Weight | Contribution |
|---|---|---|---|---|
| Debt fanchart index | 1.3 | 0.3 | 0.5 | 0.1 |
| GFN finaceability index | 6.4 | 0.1 | 0.5 | 0.1 |
| **Medium-term index** | | 0.2 | | |
| **Risk signal: 5/** | | Low | | |
| **Final assessment:** | | Low | | |

Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 54.5 pct.

Commentary: Medium-term risk assessment does not piont to major concerns.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

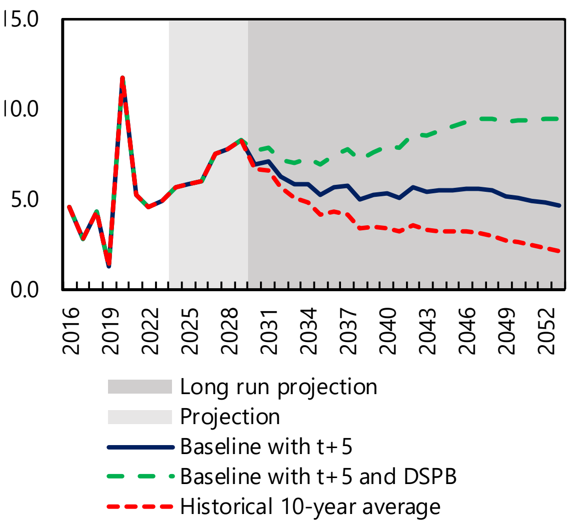
## Annex IV. Figure 7. Lithuania: Triggered Modules

| | | | |
|---|---|---|---|
| **Large amortizations** | Pensions | Climate change: Adaptation | Natural Resources |
| | **Health** | Climate change: Mitigation | |

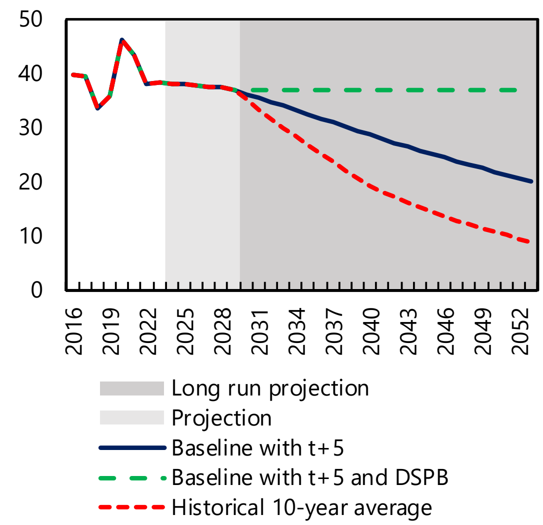
### Lithuania: Long-Term Risk Assessment: Large Amortization

| **Projection** | **Variable** | **Risk Indication** |
|---|---|---|
| Medium-term extrapolation | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |
| Medium-term extrapolation with debt stabilizing primary balance | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |
| Historical average assumptions | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |
| Overall Risk Indication | | |

**GFN-to-GDP Ratio**



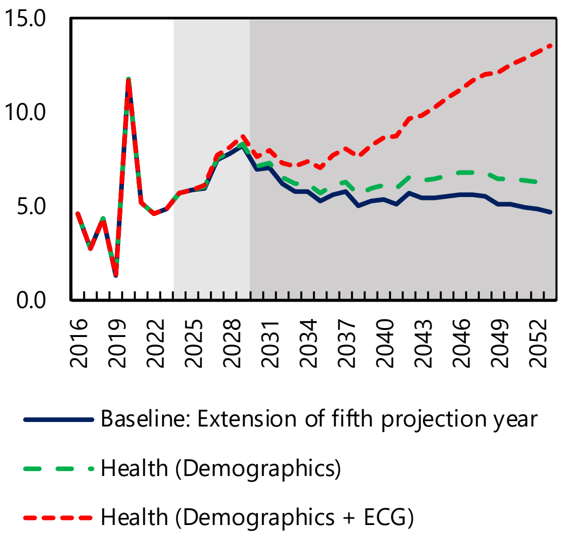

**Total Public Debt-to-GDP Ratio**



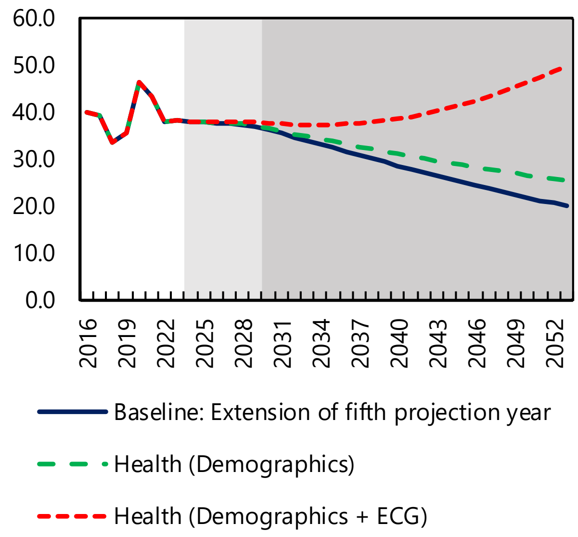

**Commentary:** Assuming a continuation of the baseline scenario or an evolution in line with the historical average for the long-term, both debt and gross-financing needs relative to GDP will decrease and remain within reasonable intervals posing no considerable risk. The above indication of risks results from the methodology's assessment of GFN and amortization relative to Lithuania's historical trajectory, which is very low, rather than peers. In any case, in the medium-term GFN increases slightly but remains low and manageable.

## Annex IV. Figure 8. Lithuania: Demographics: Health

**GFN-to-GDP Ratio**




**Total Public Debt-to-GDP Ratio**




**Commentary:** Including ECG (external, contingent and government) liabilities in health expenditures in line with expected demographic trends, GFN-to-GDP and Debt-to-GDP ratios will rise over the long-term given no change in the system and on the revenue side.

# Annex IV. Data Issues

## Annex IV. Table 1. Lithuania: Data Adequacy Assessment for Surveillance

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Data Adequacy Assessment Rating 1/ | | | | | | | |
| A | | | | | | | |
| Questionnaire Results 2/ | | | | | | | |
| **Assessment** | National Accounts | Prices | Government Finance Statistics | External Sector Statistics | Monetary and Financial Statistics | Inter-sectoral Consistency | Median Rating |
| | B | A | A | A | A | A | A |
| Detailed Questionnaire Results | | | | | | | |
| **Data Quality Characteristics** | | | | | | | |
| Coverage | B | A | A | A | A | | |
| Granularity 3/ | B | | A | A | A | | |
| | | | A | | A | | |
| Consistency | | | A | B | | A | |
| Frequency and Timeliness | A | A | A | A | A | | |

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

| | |
|---|---|
| A | The data provided to the Fund is adequate for surveillance. |
| B | The data provided to the Fund has some shortcomings but is broadly adequate for surveillance. |
| C | The data provided to the Fund has some shortcomings that somewhat hamper surveillance. |
| D | The data provided to the Fund has serious shortcomings that significantly hamper surveillance. |

**Rationale for staff assessment**. Data collection and dissemination is overall adequate for surveillance. Some open issues remain: i) Sectoral breakdown of non-financial accounts at quarterly basis are not produced which hampers surveillance, ii) there are significant net errors and omissions in the BoP, iii) there seems to be mismeasurement of inventories, as their contributions to growth have been negative for several years now.

**Changes since the last Article IV consultation**. No changes.

**Corrective actions and capacity development priorities**. There exists no plan to produce quarterly data for the non-financial accounts. Apart from this item, there are no macro-critical needs for adjustments.

**Use of data and/or estimates different from official statistics in the Article IV consultation**. No surveillance need for third-party data.

**Other data gaps**. The release of the quarterly non-financial accounts at the sectoral level would enhance surveillance, while facilitating the understanding of investment and saving decisions of private sectors. While being not mandatory by Eurostat, it would also complete the picture from the National Accounts.

## Annex IV. Table 2. Lithuania: Data Standards Initiatives

Lithuania adheres to the Special Data Dissemination Standard (SDDS) Plus since July 2018 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

## Annex IV. Table 3. Lithuania: Table of Common Indicators Required for Surveillance

| | Data Provision to the Fund | | | | Publication under the Data Standards Initiatives through the National Summary Data Page | | | |
|---|---|---|---|---|---|---|---|---|
| | Date of Latest Observation | Date Received | Frequency of Data[6] | Frequency of Reporting[6] | Expected Frequency[6,7] | Lithuania[8] | Expected Timeliness[6,7] | Lithuania[8] |
| Exchange Rates | 24-Jun-24 | 24-Jun-24 | D | D | D | ... | ... | ... |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | May-24 | Jun-24 | M | M | M | 30 | 1W | 10 |
| Reserve/Base Money | May-24 | Jun-24 | M | M | M | 30 | 2W | 14 |
| Broad Money | May-24 | Jun-24 | M | M | M | 30 | 1M | 30 |
| Central Bank Balance Sheet | Apr-24 | May-24 | M | M | M | 30 | 2W | 14 |
| Consolidated Balance Sheet of the Banking System | Apr-24 | May-24 | M | M | M | 30 | 1M | 30 |
| Interest Rates[2] | 24-Jun-24 | 24-Jun-24 | D | D | D | ... | ... | ... |
| Consumer Price Index | May-24 | Jun-24 | M | M | M | 30 | 1M | 10 |
| Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4] | Dec-23 | Mar-24 | Q | Q | A/Q | 90 | 2Q/12M | 120 |
| Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government | Dec-23 | Mar-24 | Q | Q | M | 30 | 1M | 30 |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | Dec-23 | Mar-24 | Q | Q | Q | 30 | 1Q | 30 |
| External Current Account Balance | Dec-23 | Mar-24 | Q | Q | Q | 90 | 1Q | 84 |
| Exports and Imports of Goods and Services | Dec-23 | Mar-24 | Q | Q | M | 30 | 8W | 40 |
| GDP/GNP | Mar-24 | May-24 | Q | Q | Q | 90 | 1Q | 60 |
| Gross External Debt | Dec-23 | Mar-24 | Q | Q | Q | 90 | 1Q | 90 |
| International Investment Position | Dec-23 | Mar-24 | Q | Q | Q | 90 | 1Q | 84 |

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

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

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

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

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("I") irregular; and ("NA") not available.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

# Annex V. Lithuania's Pension System

**1. The pension system consists of three pillars.** While the design of the first pillar is rather standard, the second and third pillars differ slightly from other countries:

- ***Pillar I*** is a classic pay-as-you-go system, administered by the State social insurance fund board (Sodra). It currently comprises of a base part—a fixed benefit paid to any individual with at least 30 years of contribution expected to increase to 35 years by 2027—the supplementary part linked to income and length of service, and an individual part depending on the accrued number of pension points. Because it exhibits a relatively weak link between contributions and benefits, it has a large redistributive component. However, Pillar I has insufficiently addressed old age poverty.

- ***Pillar II*** is a defined-contribution pension system based on personal accounts. Other countries often established Pillar II as a mandatory defined-contribution scheme to complement the defined-benefit Pillar I. In the 2013 reform, while all the new participants were applied the "2+2+2" formula—later changed to the equivalent "4+2" after the 2019 tax reform—the existing participants, more than 60 percent of all participants as of 2017, could opt out to have only 2 percent of their social contributions transferred to private pension funds. At the time of retirement, depending on the accumulated funds, individuals can convert pension entitlements into annuities or a lump sum. Those with accumulated returns lower than a certain threshold would only receive lump sum amounts. Having Pillar II allows for diversification of the pension system. Shortfalls in Pillar I contributions due to economic conditions can be partially offset by capital gains in the Pillar II system, including from foreign assets. Because Pillar II entitlements depend solely on the voluntary contribution that are proportional to wages, Pillar II does not have any redistributive effects. In fact, more financially savvy individuals could choose private pension funds with better performance and get higher returns. The number of participants in the system in 2023 was 760,000 or about half of the labor force.

- ***Pillar III*** is a voluntary supplementary pension accumulation system. Contributions are paid by an individual or an employer with accompanying tax benefits. Pillar III is considered regressive.

**2. The 2018 reform aimed to ensure financial sustainability but does not ensure a socially sustainable level of benefits.** Pensions were indexed to the overall wage bill and the retirement age was gradually increased to 65 by 2026 for both men and women. Furthermore, if the indexation formula results in a deficit, the law established that pensions would be left unchanged. Given demographic dynamics, this would result in declining replacement ratios. The current replacement rate at about 30 percent is already lower than the ILO recommended minimum of 40 percent and the replacement ratios for workers opting out of Pillar II would decline to slightly above 20 percent by 2050. In fact, given better-than-projected developments in the labor market, discretionary additional increases in benefits (up to 75 percent of short-term surpluses of the social security) have been approved at the cost of permanent long-term entitlements—accrued total pension entitlements have increased from 217 percent of GDP in 2019 to 275 percent in 2021.

# Annex VI. Education and Healthcare Reforms

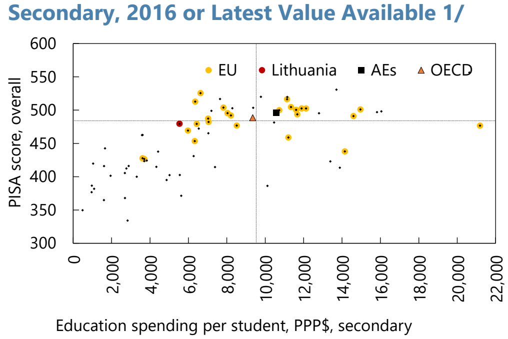
1. **Public spending on education and health is evaluated using the Expenditure Assessment Tool (EAT) developed by the IMF.** This tool captures the relative efficiency of a country in translating spending into measurable outcomes (Garcia-Escribano and Liu, 2017). The EAT framework benchmarks a country's public spending and outcomes against comparators and thereby shows how far away any given country is from the efficiency frontier.

2. **Health expenditure in Lithuania is comparable to that of peers but composition differs and outcomes lag.** The share of public expenditure on healthcare is also comparable. However, the share of out-of-pocket spending over the total health expenditure is 15 percentage points higher than its peers', suggesting a high burden of health care costs on patients which could be increasingly difficult for households to shoulder. Within this amount, Lithuania invests significantly more in hospital beds than other countries, with more than 7 beds per 1000 people while the rest of Europe has on average less than 5 beds per 1000 people. However, Lithuania has adopted similar policies as other EU countries to gradually reduce this ratio, focusing more on outpatient care.

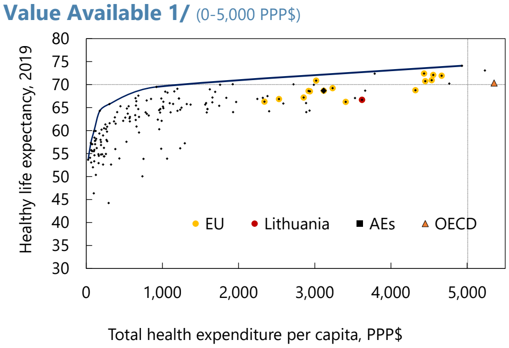
3. **In terms of staffing, Lithuania has more doctors but fewer nurses per capita than the regional average.** As of 2017, for every 1000 people, Lithuania employs one additional physician but almost 2 fewer nurses compared to peers. In addition, over the past 10 years, while neighboring countries have had relatively stable ratios of physicians per capita, Lithuania has seen an uptick. This is mainly due to the secular decline in population since independence. There is also a large dispersion in the coverage of medical staff between urban and rural areas and a decline in the number of nurses per capita. The health reform package in 2019 identified the right priorities including the excessive capacities in rural areas but implementation failed to deliver in several sensitive areas, particularly network rationalization, due to the lack of buy-in from municipalities and the upfront wage increases adopted.

**Expenditure Efficiency**

**Government Education Spending and Outcome, Secondary, 2016 or Latest Value Available 1/**




**Health Efficiency Frontier, 2022 or Latest Value Available 1/** (0-5,000 PPP$)



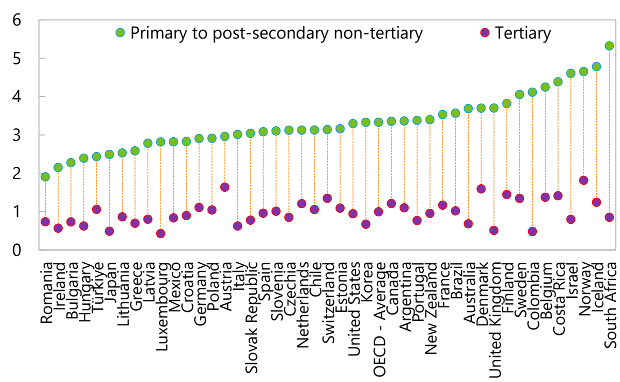

Source: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.
1/ Dashed lines are the average of the EU.

**4. Lithuania is far from the healthy expectancy frontier suggesting that there is substantial scope to improve outcomes within the same spending envelope.** For example, Lithuania particularly lags in behavior-related diseases and ranks the lowest in the EU in terms of healthy life expectancy. It has higher rates of smoking, alcohol, heart, and circulatory system related diseases as well as suicides. Where Lithuania has achieved better outcomes than the EU average is with regard to lowering the number of maternal deaths. Given the preventable nature of these diseases, the stronger focus on primary care and mental health as envisioned in recent reform plans is appropriate. There is room for more extensive public health initiatives to improve healthy lifestyles, especially among the elderly. Increases in excise taxes, particularly alcohol and tobacco, can be considered to discourage unhealthy behavior. These measures can potentially increase the healthy life expectancy in Lithuania to that of peer countries (some 7 years higher) even within a similar spending envelope. Further, improved health outcomes not only improve public spending efficiency but could support potential growth through a healthier and more productive population.

**5. Education spending in Lithuania is about 0.5 percent of GDP lower than the euro area.** Expenditure per student, after adjusting for PPP, is also below the EU average. Within this budget, compared to its peers, the government has allocated more towards tertiary education. In fact, the share of public spending on primary and secondary education is the seventh lowest among 45 OECD countries while spending on tertiary education is close to the OECD average. It is, however, not clear that tertiary education has a stronger impact on productivity than other levels of education while its impact on redistribution is the smallest if not negative.

**Public Spending on Education**

(Percent of GDP; 2020 or latest available)




Source: OECD.

**6. The education outcome for Lithuania is mixed, with good quantitative outcomes but poor qualitative ones.** Due to the accessibility of schools and classes, enrollment is very high, putting Lithuania right at the frontier. When looking at the performance outcome of the students by international standards such as the PISA scores, Lithuania is among the bottom 25 percent of EU countries. Students in Lithuania also perform worse in financial literacy controlling for performance in mathematics and reading, raising curricular issues. Outcomes of tertiary education also lag those of other EU countries. This is reflected in Lithuania having the third highest level of skills mismatch in the labor market. As rightly emphasized in the education reform package of 2019, Lithuania is focusing on increasing the quality of education as well as the efficiency of the school network. These are steps in the right direction but have not proven ambitious enough to deliver material outcomes. Rationalization of the extensive school network will provide savings that can be redirected to improving school quality, especially for elementary and secondary education. These efforts will help Lithuania catch up with peers and prepare a more productive labor force.

# Annex VII. Potential Output in Lithuania

**1. This annex estimates Lithuania's potential output—the maximum level of output that an economy can sustain without generating inflationary pressures—with a multivariate filter.** It uses the multivariate filter estimation from Alichi et al. (2015)[1] and judgement to account for the unprecedented shock from the pandemic and associated lockdowns. The multivariate filter adds economic structure to the estimates of potential output by conditioning them on basic theoretical relationships as the Philipps curve and Okun's law. Thereby, it improves upon simpler univariate filters like the HP filter that estimate a measure of trend growth rather than potential.[2] Still, also the multivariate filter has its limitations, and thus the estimates are a useful starting point to be complemented by judgement.

**2. The filter relates economic observables to underlying structural economic equations including potential growth and the output gap.** It requires data on annual GDP, the CPI, and the unemployment rate. It specifies a system of equations that relates these three observables to latent variables and shocks. The level of potential output evolves according to potential growth and three shock terms: a potential level shock-term, a business-cycle shock and a transitory shock to potential growth. To identify the three shocks, the model is augmented by a Philipps curve linking the output gap to inflation and an Okun's law relationship, linking the output gap to the unemployment gap, as well as further structural equations for the evolution of the equilibrium unemployment rate. Parameter values and the variances of shock terms are estimated using Bayesian estimation techniques and the prior specifications follow Alichi et al. (2015).[3] The steady state growth rates for output and the unemployment rate which are relevant for the projection horizon are set in line with staff estimates of the NAIRU (at around 6 percent) and expectations of somewhat slower income convergence to the EU average going forward (2.3 percent steady state growth).

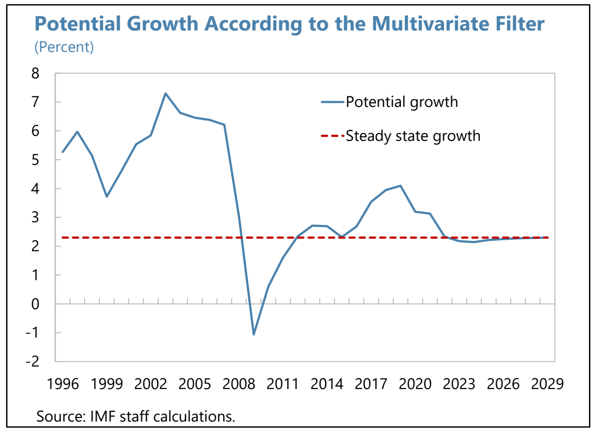
**3. The multivariate filter estimates potential growth and the output gap reasonably well.** The filter picks up the overheating of the Lithuanian economy prior to 2009—visible in inflation, output, and unemployment—as a strong increase in the output gap which subsequently turned into a large negative output gap during the crisis. In line with the economy's sharp adjustments during the crisis and the consequent recovery, potential growth increased in the following years—however, to levels below the pre-GFC period as for most European emerging market economies— and the

[1] Alichi, A., O. Bizimana, S. Domit, E. Fernández-Corugedo, D. Laxton, K. Tanyeri, H. Wang, and F. Zhang, 2015, "Multivariate Filter Estimation of Potential Output for the Euro Area and the United States," IMF Working Paper No. 15/253.

[2] As further drawbacks, the HP filter forces the output gap to be mean zero and it depends on specifying a smoothing parameter. Moreover, it suffers from an 'end-of-sample' problem which is, however, to a certain extent also relevant for the multivariate filter used here.

[3] For example, for the Philipps Curve $\pi_t = \lambda E_t \pi_{t+1} + (1-\lambda)\pi_{t-1} + \beta y_t + \varepsilon_t^{\pi}$ the prior modes of λ and β are specified as 0.25 and the posterior modes are estimated as 0.5 and 0.2, respectively.

output gap recovered. Since 2019, the filter picks up a downward trend in potential growth in line with the sequence of shocks related to the global pandemic in 2020 and Russia's invasion of Ukraine in 2022.




**4. The effects of the pandemic are, however, difficult to adequately assess for a filter that relies on only a few macroeconomic time series.** Lithuania's economy weathered the pandemic episode relatively well; after a short-lived fall in GDP in 2020Q2, the economy overheated in 2021 with unemployment returning to pre-pandemic levels, double-digit wage growth and core inflation rising more than twice as fast as the eurozone average (see IMF 2022).[4] The filter estimates potential growth at similar levels for 2020 and 2021. This seems unreasonable given that two government lockdowns and behavioral changes in 2020 and early 2021—not adequately reflected by GDP, inflation and unemployment numbers—should have reduced potential growth which then should have picked up again throughout 2021. Thus, based on staff judgement potential growth is assessed to be lower than the filter's estimates in 2020 (see the Table).

**Output Gap and Potential Growth Estimates**

| Year | GDP growth | Potential Growth (MVF) | Output Gap (MVF) | Potential Growth (HP) | Output Gap (HP) | Potential Growth (final) | Output Gap (final) |
|---|---|---|---|---|---|---|---|
| 2019 | 4.7 | 4.10 | 1.53 | 2.9 | 2.1 | 3.7 | 1.2 |
| 2020 | 0.0 | 3.19 | -1.61 | 2.8 | -0.6 | 1.9 | -1.2 |
| 2021 | 6.3 | 3.13 | 1.41 | 2.7 | 2.7 | 3.2 | 1.6 |
| 2022 | 2.4 | 2.33 | 1.48 | 2.6 | 2.5 | 2.3 | 1.8 |
| 2023 | -0.3 | 2.18 | -0.98 | 2.5 | -0.3 | 2.2 | -0.7 |
| 2024 | 2.4* | 2.14 | -0.92 | 2.4 | -0.5 | 2.2 | -0.5 |

Notes: MVF is the multivariate filter. HP estimates are based on a two-sided HP filter with smoothing parameter 100 and an extended sample until 2029 using WEO GDP projections.

*refers to the current IMF projection.

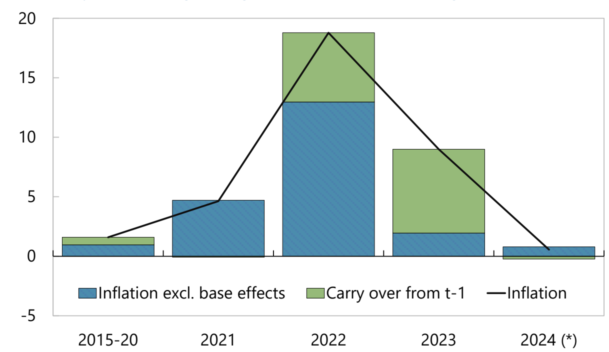
[4] IMF, 2022, "Republic of Lithuania, 2022 Article IV Consultation", IMF Country Report No. 22/251.

# Annex VIII. Inflation in Lithuania and the Baltics: Latest Trends

1. **The disinflationary process has been faster than expected, especially at the end of 2023 and beginning of 2024**. In the same way that large base effects played a key role given the sudden and strong price increases in 2022, they are now driving current disinflation as they fade out. The surge of the latest inflation episode started in the second half of 2021, automatically translating into a large increase of inflation in 2022, the so-called *carry-over* that amounted to 5.8 percentage points of 2022 inflation. The second round of energy price increases in 2022 added to 2021 carry-over, resulting in an average inflation rate for the year of 19 percent. Similarly, the acceleration of energy prices in 2022 carried over 7 percentage points of inflation into 2023, partly masking the undergoing easing of inflationary pressures since mid-year. On the other hand, the moderation of inflation in 2023 will bring a modest negative carry-over of inflation in 2024 by -0.2 percentage points. Core inflation has followed a similar path but, as expected, its increase was more moderate and its decline slower.

**Headline Inflation Decomposition**

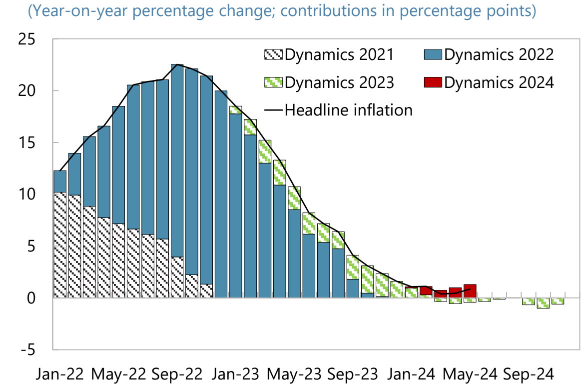
(Year-on-year percentage change; contributions in percentage points)




Sources: Eurostat; Haver Analytics; and IMF staff calculations.
(*) Jan. - Mar. inflation excluding base effects.

**Headline Inflation**

(Year-on-year percentage change; contributions in percentage points)

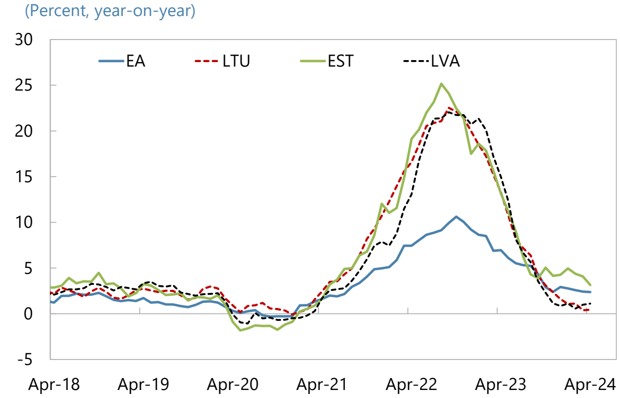



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

2. **The disinflationary momentum in the Baltics has eased in 2024**. After recording a strong drop in 2023, inflation in the Baltics has shown a more moderate correction in the first months of 2024, converging to euro area peers. Since January, headline inflation has decreased in Lithuania

**Headline Inflation**

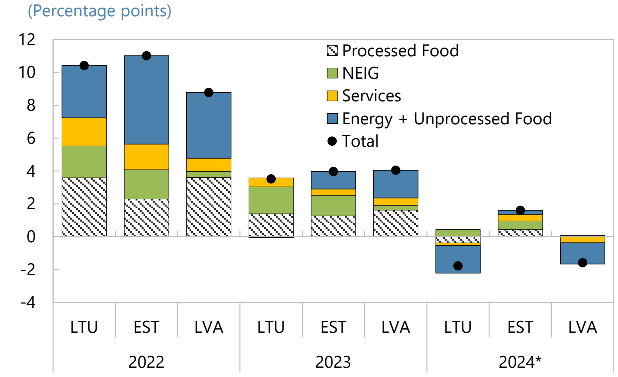
(Percent, year-on-year)




Sources: Haver Analytics, Eurostat and IMF staff calculations

**Inflation Gap with EA**

(Percentage points)




Sources: Haver Analytics, Eurostat and IMF staff calculations
*Average Jan-Apr 2024

(from 1.1 percent to 0.4 percent in April) and Estonia (from 5 percent to 3.1 percent), and remained constant in Latvia at 1.1 percent. Among the three economies, only Estonia maintains a positive inflation gap with the euro area, driven by all main components including, notably, energy prices that help explain most of the negative differential for Lithuania and Latvia.

**3. What are the drivers of inflation so far in 2024?** To answer this question, and to clean up the series from 2023 base effects, we separate carry-over effects from overall headline inflation and calculate the contribution of the different components between January and April 2024:[1]

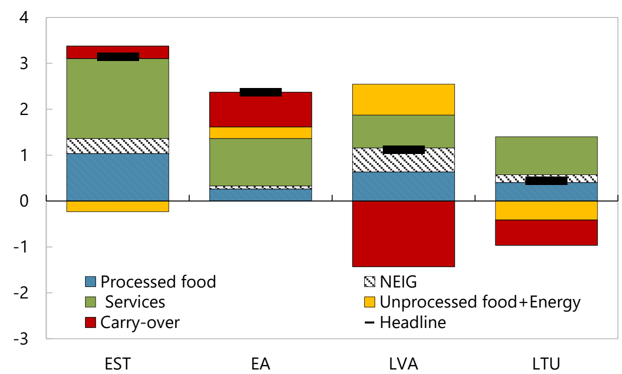
- Headline inflation still benefits from negative 2023 carry over in Lithuania and, particularly, Latvia.

- Processed food inflation is still significant in the Baltics, particularly Estonia, with growth rates above the euro area. Unprocessed food contribution is still relatively high in Latvia and somewhat in Estonia.

- While services inflation is still high overall, it is particularly high in Estonia. Indeed, services inflation is the key factor explaining the recent acceleration of core inflation in Estonia in contrast to a more moderate profile in Latvia and Lithuania.

**Headline Inflation Composition in April 2024**

(Year-on-year percentage change; contributions in percentage points)



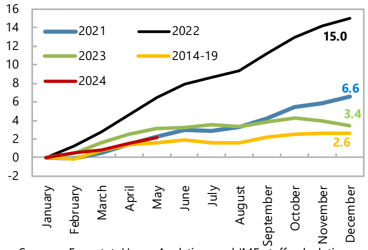

Sources: Haver Analytics; Eurostat; and IMF staff calculations.

**4. Core inflation has eased compared to previous years, but persistency is heterogeneous across the Baltics**. Accumulated inflation between January and April confirms that core inflation dynamics are well below 2022 but, in the case of Estonia the path so far is consistent with that of 2023. In the case of Latvia and particularly Lithuania, core inflation has remained below or around the historical path recorded pre-pandemic (average over 2015-2019).

**5. From a purely statistical perspective, average core inflation is projected to ease in 2024 and to stabilize in 2025**. If we assume that monthly core inflation follows a seasonal autoregressive path based on the 2015-19 performance, core inflation is projected to ease this year in all three Baltics. However, while it will fall to 3 percent for Latvia and Lithuania, it will remain high in Estonia averaging 5.8 percent and going below 3 percent only in 2025.

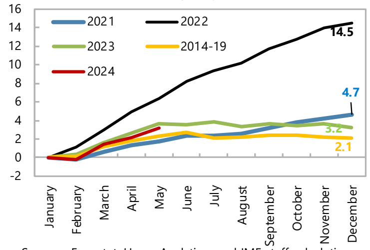
[1] The calculations follow the *Ribe* methodology described in the HICP methodological note. In the case of Estonia, current high inflation is partially explained by the VAT increase implemented in January 2024 from 20 to 22 percent.

**Core Inflation in Lithuania**
(Accumulated inflation during the year)



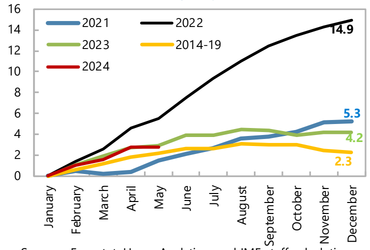

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

**Core Inflation in Latvia**
(Accumulated inflation during the year)




Sources: Eurostat; Haver Analytics; and IMF staff calculations.

**Core Inflation in Estonia**
(Accumulated inflation during the year)




Sources: Eurostat; Haver Analytics; and IMF staff calculations.

INTERNATIONAL MONETARY FUND

# REPUBLIC OF LITHUANIA

June 27, 2024

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by European Department

## CONTENTS

# FUND RELATIONS

*(As of May 31, 2024)*

**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) | 323.92 | 73.35 |
| Reserve Tranche Position | 117.70 | 26.65 |

**SDR Department:**

| | SDR Million | Percent of Allocation |
|---|---|---|
| Net cumulative allocation | 560.49 | 100.00 |
| Holdings | 580.15 | 103.51 |

**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 | | | | |
|---|---|---|---|---|---|
| | 2023 | 2024 | 2025 | 2026 | 2027 |
| Principal | | | | | |
| Charges/Interest | -0.27 | -0.60 | -0.80 | -0.80 | -0.80 |
| Total | -0.27 | -0.60 | -0.80 | -0.80 | -0.80 |

**Implementation of HIPC Initiative:** Not applicable.

**Implementation of MDRI Assistance:** Not applicable.

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

**Exchange Rate Arrangement:**

The currency of Lithuania is the euro. The exchange rate arrangement of the euro area is free floating. Lithuania participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies. Lithuania has accepted the obligations of Article VIII, Sections 2(a), 3 and 4 of the IMF's Articles of Agreement and maintains an exchange system free of multiple currency practices and restrictions on the making of payments 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 July 18, 2023. The staff report and other related documents are available at: https://www.imf.org/en/Publications/CR/Issues/2023/09/05/Republic-of-Lithuania-2023-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-538769

**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.

**Table 1: Lithuania: Technical Assistance from the Fund, 2001–24**

| Department | Issue | Action | Date | Counterpart |
|---|---|---|---|---|
| FAD | Tax policy issues | Mission | Jun. 3–26, 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. 3–15, 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 |
| FAD | Fiscal Transparency | Mission | Nov. 28–Dec. 11, 2018 | Ministry of Finance |
| FAD | Value Added Tax Gap | Mission | Oct. 23–Nov. 6, 2019<br>Feb. 27–Mar. 5, 2020<br>May 3–Nov. 26, 2021 | State Tax Inspectorate |
| FAD | High Wealth Individuals Management | Mission | Feb. 25–Mar. 30, 2021<br>May 20–25, 2021<br>Jul. 28–30, 2021<br>Jan. 10–20, 2022<br>Feb. 8–9, 2022<br>Sep. 26 – Oct. 5 2022 | State Tax Inspectorate |

**Table 1: Lithuania: Technical Assistance from the Fund, 2001–24** (concluded)

| Department | Issue | Action | Date | Counterpart |
|---|---|---|---|---|
| | | | Nov. 23 – Dec. 9, 2022<br>Feb. 20 – Mar. 15, 2023<br>Apr. 7 – Apr. 28, 2023 | |
| LEG | AML/CFT Framework | Mission | May 2–6, 2022<br>May 25–Jun. 2, 2022 | Bank of Lithuania/Financial Intelligence Unit |
| FAD | Compliance Gap Integration | Mission | Mar. 1 – Apr. 28, 2023 | State Tax Inspectorate |

**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 assessed by MONEYVAL, the FATF-style regional body of which it is a member, in April 2012 and December 2018.

The 2018 MONEYVAL assessment rated Lithuania's AML/CFT regime as insufficiently effective in ten out of eleven pillars of an effective system, including moderate effectiveness of AML/CFT supervision, preventive measures by reporting entities, and ML/TF risk understanding and domestic coordination. Given the results of the assessment, Lithuania was placed in an enhanced follow-up process. Following the MONEYVAL assessment, Lithuania has strengthened its legislative and regulatory framework and taken steps to enhance its AML/CFT effectiveness.

In December 2023 Lithuania's fourth enhanced follow-up report was adopted, in which the country was re-rated from 'Partially Compliant' to 'Largely Compliant' for Recommendation 2 (National cooperation and coordination). The rating was upgraded following recent amendments that increased national cooperation related to countering proliferation financing. Lithuania is now 'Compliant' or 'Largely Compliant' on 36 of the 40 FATF Recommendations.

The government has established an AML Centre of Excellence, which is designed to facilitate information sharing and strengthen collaboration among key stakeholders. A National Risk Assessment (NRA) was completed in 2019 and the report was published in 2020. Based on the NRA report, a plan for the measures to mitigate the risk of ML/TF for 2021–2023 was prepared in consultation with competent authorities. The Bank of Lithuania has also approved a new policy for AML/CFT supervision and the ML/TF Risk Scoring Methodology against ML/TF risks.

Lithuania transposed the 5th Anti Money Laundering and Terrorist Financing Directive on January 10, 2020. The new legislation, among other things, makes public the registers of beneficial owners of companies (and under some conditions trusts) operating within the EU and improves interconnectedness of member countries' national registers. The amendment of the Law on the Prevention of Money Laundering and Terrorist Financing VIII–275, which emphasizes the prevention, detection, investigation, or prosecution of serious criminal offences, was adopted by the Seimas and entered into force on August 1, 2021. Virtual currencies and custodian wallet providers were included into the scope of the AML/CFT Law amendments. Further draft amendments to the AMLCFT law are currently being considered that would address remaining risks in the VASP sector and enhance the regulation and supervision of designated non-financial businesses and professions.