July 2010
IMF Country Report No. 10/201

Republic of Lithuania: 2010 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Lithuania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Lithuania, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 25, 2010, with the officials of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 14, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of July 6, 2010 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 6, 2010 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Lithuania.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with the Republic of Lithuania

Approved by Anne-Marie Gulde and Aasim Husain

July 6, 2010

Context: Lithuania is benefiting from the global recovery, with higher exports playing a crucial role in stabilizing the economy. However, domestic demand will remain subdued amid high unemployment, falling incomes, and weak credit prospects. Confidence in the banking system was maintained while sizeable fiscal adjustment was rewarded with continued market access, providing crucial support to Lithuania's long-standing currency board arrangement.

Challenges: While much has been achieved, the crisis has left three key policy challenges. The fiscal deficit remains high and public debt is growing rapidly, leaving Lithuania reliant on external financing. Meanwhile, deteriorating asset quality is a challenge for the financial sector. Growth needs to rebalance towards exports to sustain the recovery. The consultation focused on the policies to address these challenges which would also enhance prospects for euro adoption.

Authorities' response: The authorities agreed that further fiscal adjustment is needed to ensure sustainable public finances, and that the adjustment to meet the 3 percent of GDP Maastricht deficit criterion by 2012 should be broad-based. While acknowledging staff's assessment of remaining vulnerabilities in the banking sector from less well provisioned banks and lower prospective profits, they emphasized the system is sound and better equipped to deal with new challenges due to higher capital and liquidity ratios. Various structural reforms are underway and increased EU funds absorption is being targeted at programs that create jobs and promote growth.

Previous IMF advice: Policy formulation and implementation is characterized by a high degree of ownership, and has generally been consistent with Executive Board recommendations. The fiscal adjustment implemented in 2009 and 2010, was consistent with that envisaged in the last Article IV consultation, but financial sector recommendations on purchase and assumption frameworks, semi-annual audits, and preemptive increases in capital based on enhanced stress tests exercises, were viewed as operationally difficult to implement. The authorities also benefited from Fund technical cooperation on bank resolution, tax policy, social benefits reform, corporate and household bankruptcy frameworks.

Mission team: Ms. Purfield (Head), Messrs. Miniane, Vacher (all EUR), Cortavarria-Checkley (MCM), Piris (SPR) and Kangur (FAD). Staff met with Prime Minister Kubilius, Finance Minister Simonyte, Central Bank Governor Sarkinas, other senior officials, and representatives of Parliament, the private sector, and civil society. Mr. Bartkus (OED) also participated in meetings.

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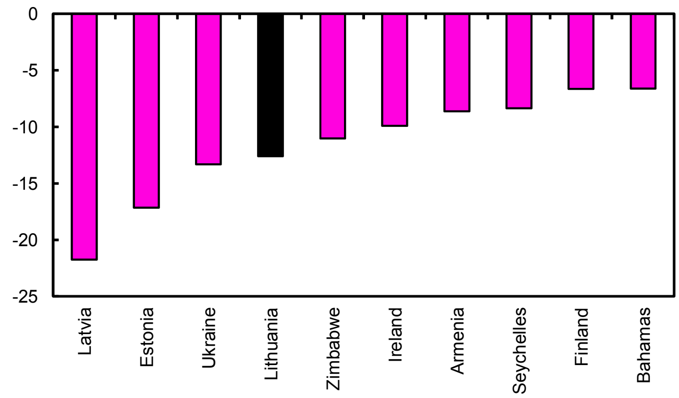
I. CONTEXT: LITHUANIA'S ONGOING RESPONSE TO THE GLOBAL CRISIS

A. Recent Economic and Policy Developments

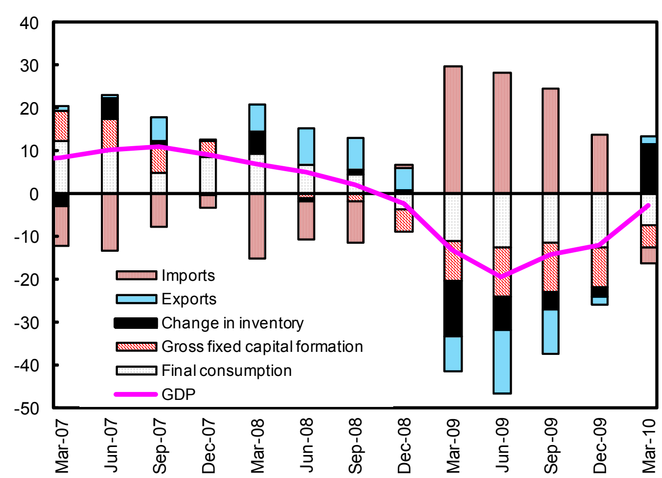
1. **Lithuania experienced a severe output decline in 2009.** The economy started contracting in the third quarter of 2008 as a reversal in capital flows led to a collapse of domestic demand and the global recession caused exports to fall. Output dropped by 14.8 percent in 2009 and by 20 percent from peak to trough.

The 10 Largest Output Declines in the World, 2008-09
(2008-09 cumulative percent changes)



Source: April 2010 WEO.

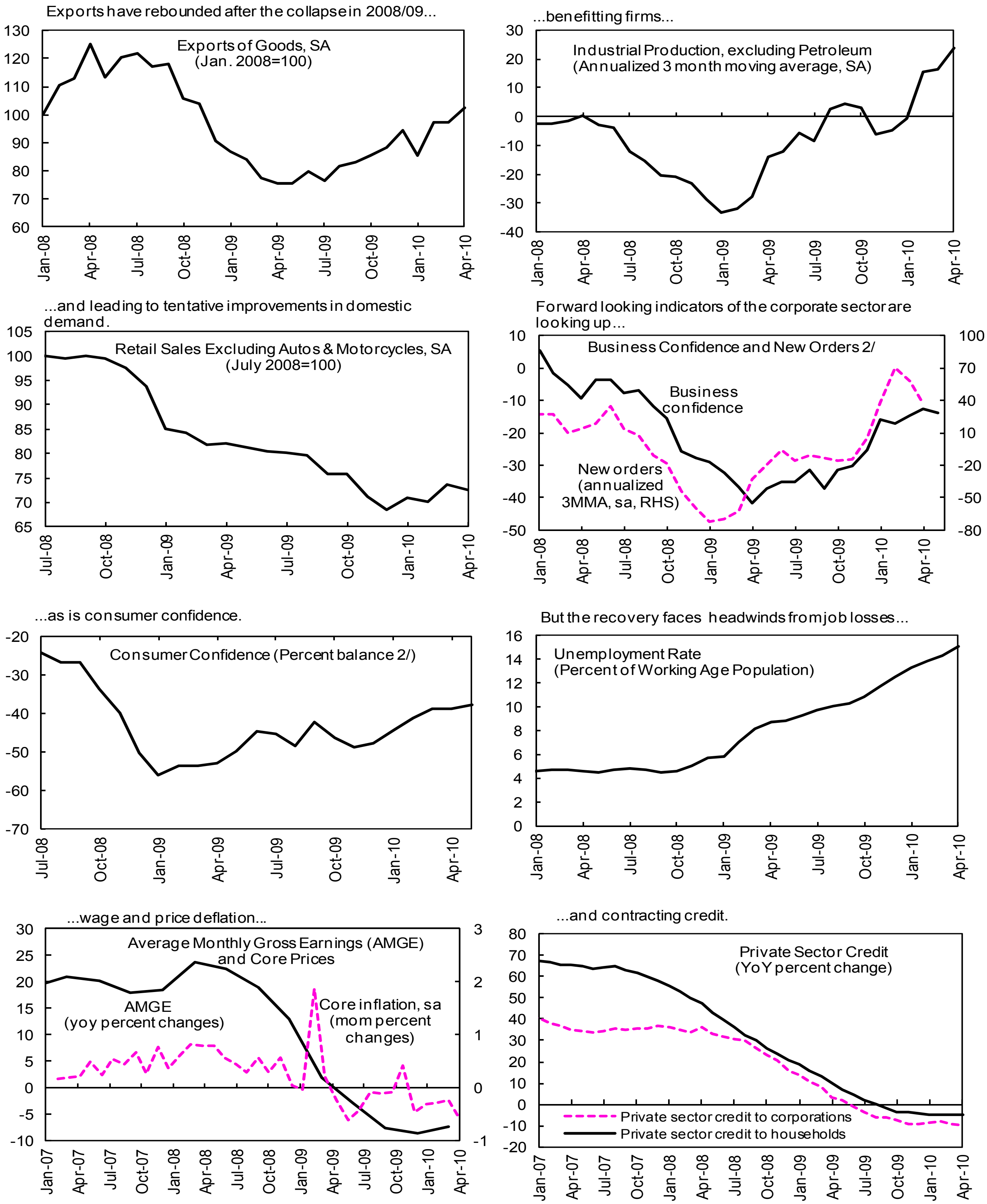
Contributions to GDP Growth by Components (YoY, percent)



Source: Haver.

2. **The economy is beginning to recover aided by exports and now inventories as well (Figure 1)**. Exports— led by capital and transport goods, pharmaceuticals, and oil derived products—rebounded strongly and real GDP showed signs of stabilizing during the second half of 2009. In the first quarter of 2010, real GDP contracted by a smaller than expected -2¾ percent y/y. Two factors explain the better than expected outcome: (i) the closure in January 2010 of the Ignalina nuclear power plant that generated about 70 percent of Lithuania's power was a less severe shock than anticipated, and (ii) a rebuilding of inventories that contributed 11.7 percentage points to growth, as stocks had fallen sharply in 2009. The export led recovery is filtering to business and consumer confidence, with retail sales growing modestly from early 2010. Housing prices are also showing tentative signs of bottoming out, while the stock market is up 100 percent from its March 2009 trough.

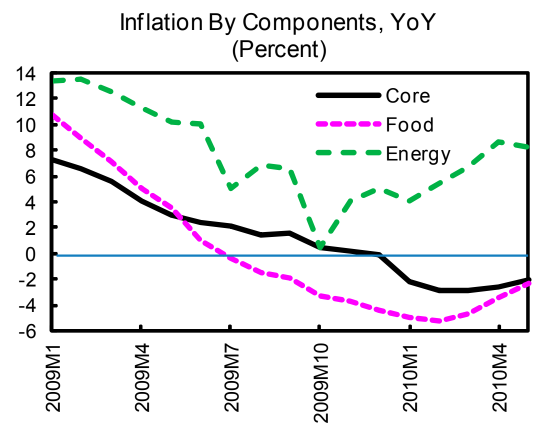
Figure 1. Lithuania: Real Sector Developments



Source: Haver; Eurostat; and IMF staff calculations.
1/ Unemployment rate is estimated as a percentage of the working age population.
2/ Percent balance equals percent of respondents reporting an increase minus the percent of respondents reporting a decrease.

3. **A rapid internal adjustment played a crucial role in stabilizing the economy, but unemployment has risen sharply (Tables 1–3):**

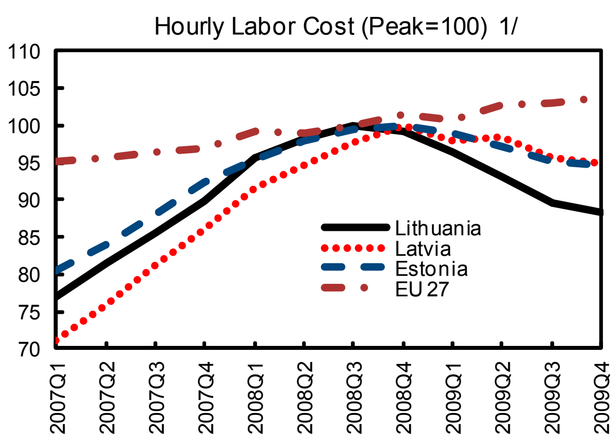
- *The current account adjusted rapidly*. It moved by around 19 percentage points of GDP to a surplus of nearly 4 percent of GDP end-2009 as the collapse in domestic demand caused imports to contract more than exports. This alleviated external financing needs and helped maintain reserves amid net capital outflows that amounted to 7.2 percent of GDP (Figure 2). Despite deleveraging in the private sector, the external debt-to-GDP ratio rose to 87 percent of GDP. Strong export trends continued in the first months of 2010, with imports showing signs of recovery (partly due to energy imports after the closure of Ignalina). Government debt issuance has partly compensated the continuing repayment of banks' foreign liabilities.



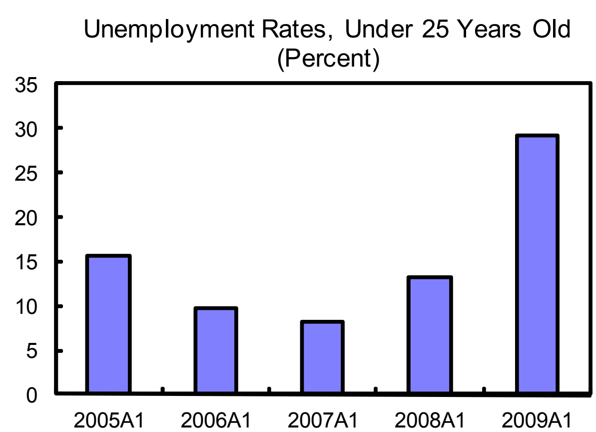
Source: Haver.

- *Inflation quickly ebbed and core inflation is now negative.* Headline inflation has fallen to 0.2 percent in April 2010 despite a 33 percent increase in electricity prices after Ignalina's closure and a VAT rate increase in fall 2009. Core prices have been falling for over a year.

- *Wages have fallen fast.* Average gross earnings have fallen by 12.4 percent from pre-crisis peaks, but in sectors such as construction and real estate services, labor costs are down 20–25 percent. Unemployment had reached 18.1 percent by end Q1 2010, with high levels of youth and long-term unemployment an increasing concern.

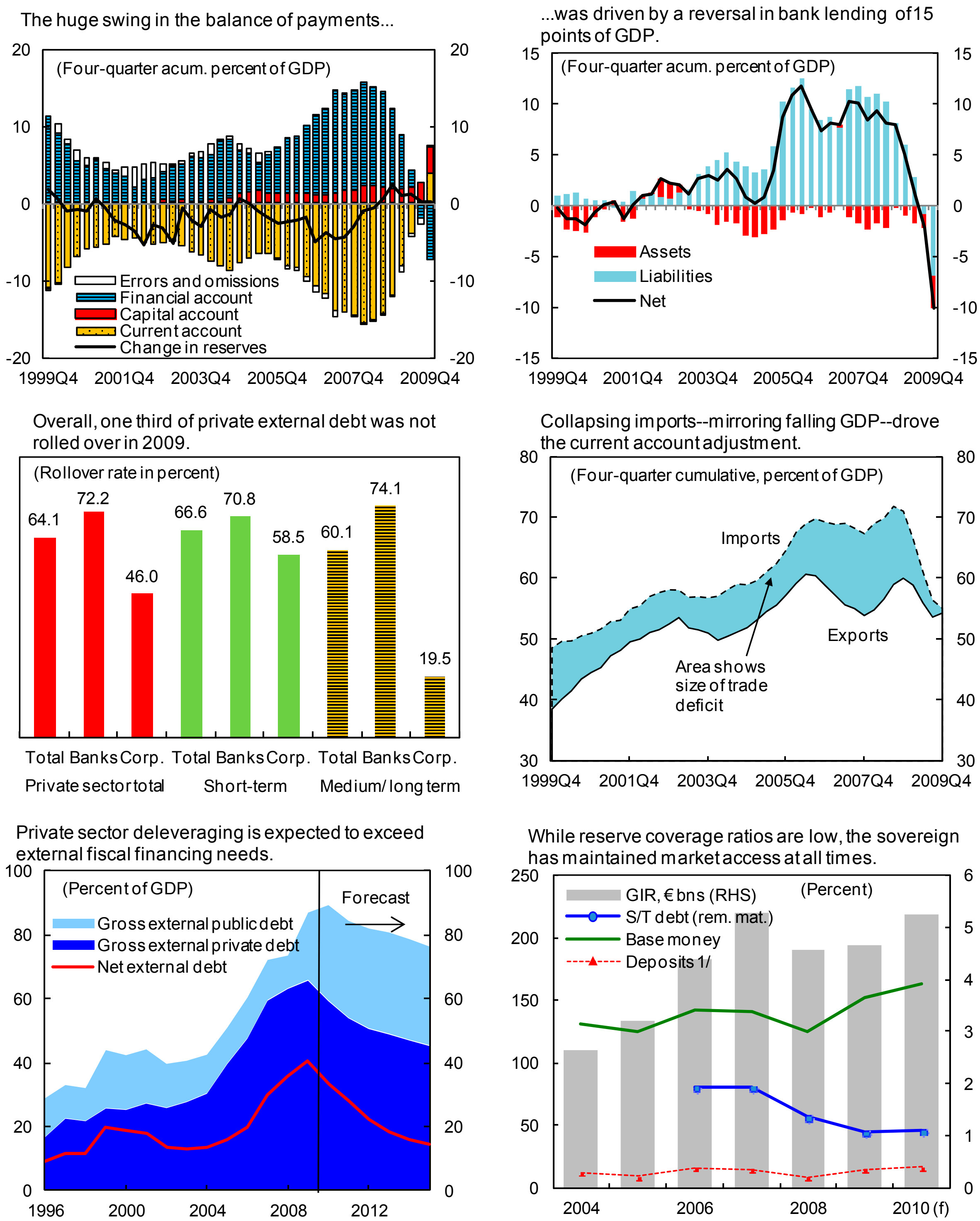


Source: Eurostat.
1/ EU27 has not peaked, so we use the same peak as Lithuania.



Source: Haver.

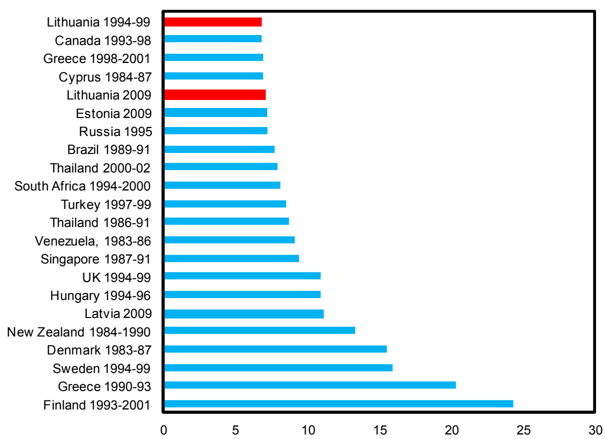
Figure 2. Lithuania: External Sector Developments



Source: Bank of Lithuania and staff calculations.
1/ Reserves minus base money to deposits.

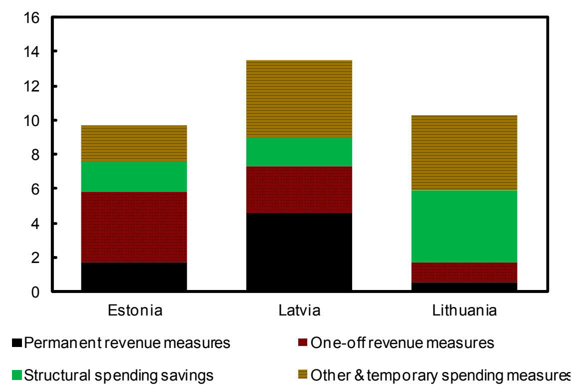
4. **A large consolidation contained the deterioration in the fiscal deficit and safeguarded market financing (Tables 4 and 5)**. The authorities implemented measures worth about 10 percent of GDP (staff's estimates of meaures' yields) in the 2009–10 budgets that were appropriately expenditure-led given the legacy of spending increases in the boom.[1] The initial focus on broad-based cuts gave way to more targeted and progressive reductions in wage, pension and benefit levels that were agreed with social partners. About 40 percent of the consolidation in the 2009 and 2010 budgets is temporary (wage cuts are set to expire at the end of 2010 and pension cuts in 2011), and the April 2010 constitutional court decision on pensions could unwind 0.6 percent of GDP in the adjustment.[2] Steps to increase VAT and excise rates and broaden their base played a complementary role in the adjustment. Overall, by end-2009, the fiscal deficit was contained to 8.9 percent of GDP (ESA 95 basis) with the early adjustment rewarded with access to international bond markets at declining cost. While still low by emerging market standards, the public debt burden—at 33 percent of GDP end-March 2010—is more than double its 2008 level. The improvement in the deficit continued in the first months of 2010, amid better revenues and containment of expenditure (Figure 3).

Large Scale Fiscal Adjustments
(Change in the Primary Banance, percent of GDP) 1/



Sources: Fiscal Adjustment Database, Fiscal Affairs Department, IMF.
1/ For the Baltics in 2009, adjustment is measured relative to unchanged policies and, net of the impact of rate reductions in PIT and CIT or of spending increases.

Fiscal Adjustment in the Baltics, 2009-10
(Percent of GDP) 1/

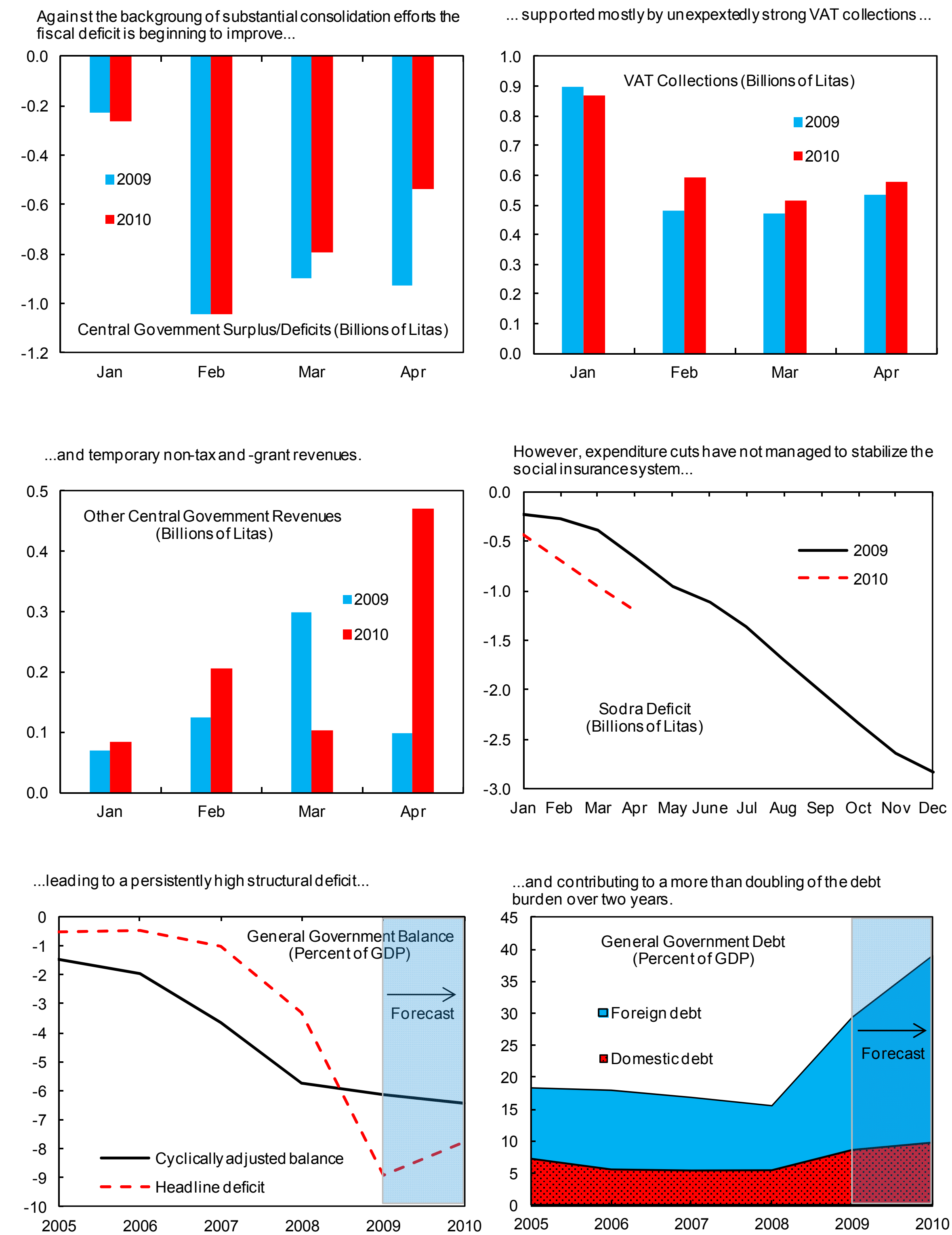


Source: IMF staff estimates.
1/ Measures implemented net of the impact of rate reductions in PIT and CIT or of spending increases. Gross adjustment was larger. For Estonia and Latvia, measured on a cash-basis; for Lithuania, on a ESA 95 basis.

[1] Excluding rate reductions in corporate and personal income taxes.

[2] The ruling requires that cuts in working pensions be made proportional to those in other pensions and that the pension cuts be compensated when the economy recovers, though the amount and timing of compensation are flexible.

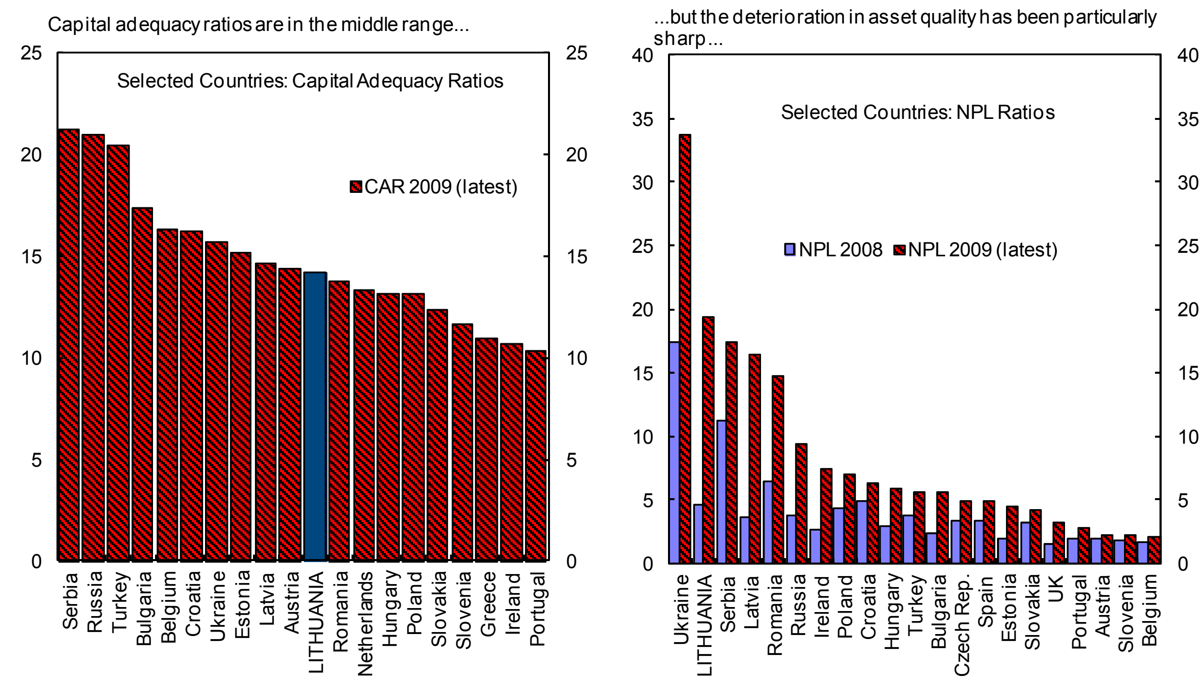
Figure 3. Lithuania: Fiscal Developments



Source: Haver; Eurostat; Sodra and IMF staff calculations.

5. **The financial sector weathered the crisis but faces sizeable non-performing loans (NPLs).** To preserve financial stability, reserve requirements were lowered, the deposit insurance coverage raised, liquidity support procedures streamlined, and the 2009 Financial Stability Law was adopted. Banks improved their liquidity positions, with subsidiaries of international banks benefiting from parent support at the height of the global turmoil. Asset quality has suffered, with the level of non-performing loans (defined as past due more than 60 days plus impaired loans) rising almost four-fold from end-2008 to March 2010 and banks making large losses in 2009 (Figure 4). However, capital and liquidity indicators improved to 15 percent and 45 percent, respectively by end-March 2010 (Table 6). Provisions increased to cover 7½ percent of gross loans but the ratio of provisions to NPLs at almost 40 percent of NPLs, is still lower than most international comparators. Credit to the private sector is down 9.7 percent from its peak while parent bank funding (net of capital injections) fell by an estimated 8.5 percent in 2009, reflecting in part lower loan demand (Box 1). The loan-to-deposit ratio has fallen to below 150 percent while interbank rates have returned to pre-crisis levels, although as before, transactions at longer maturities are limited.

Figure 4. Lithuania: Financial Sector Developments



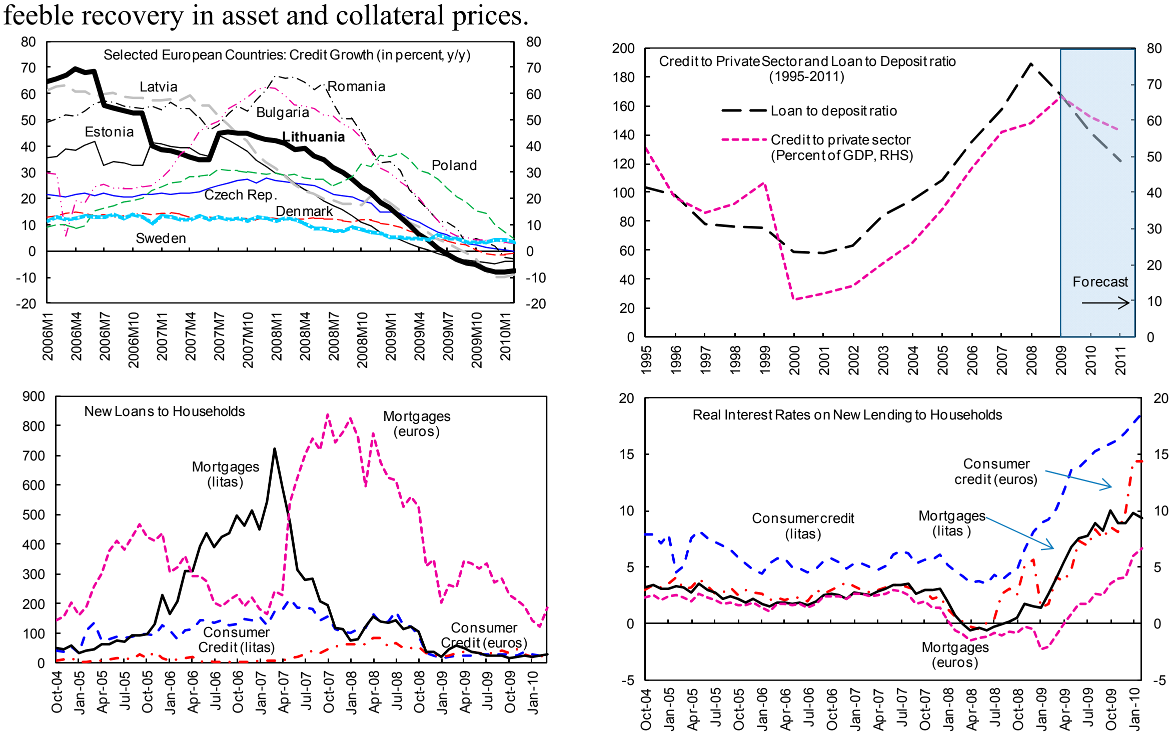
Source: Bank of Lithuania and Global Financial Stability Report, 2010.

Box 1. Credit Contraction and Deleveraging[1/]

Post-crisis deleveraging can be protracted, delaying the recovery in credit. Recent studies indicate that countries with (i) high bank credit growth prior to the crisis, (ii) suffering from a stronger demand contraction after the Lehman brothers shock, (iii) with high financial integration with respect to the rest of the world, and (iv) with weaker countercyclical monetary policy response experienced on average lower growth rates of bank credit post crisis.[2/] Because the contraction in nominal GDP was large in Lithuania in 2009, the ratio of credit-to-GDP will only decrease in 2010.

The contraction in credit in Lithuania started in December 2008 reflecting the legacy of a strong credit boom and lack of demand. By end-2009, the nominal stock of credit to the private sector declined by 8 percent from its November 2008 peak, the fastest pace in Emerging Europe. As a proportion of GDP, the stock of credit grew particularly rapidly and late in the international cycle—with implications for the subsequent deterioration in asset quality. Audited data suggest banks have adjusted their lending patterns but some banks have maintained or even increased their gross loan exposure to sectors such as construction, real estate, or transportation. Overall, quantifying the contributions of demand and supply factors is challenging. Lending surveys suggest lower demand played an important role in explaining the decline in credit, with evidence of potential supply effects more mixed.

Short term risks for the outlook are tilted to the downside. Banks are more liquid (the deposit base has stabilized and broad money is increasing), while investment might pick up in 2010, supported by exports. However, new loans to households and corporates remain at very low levels, with few signs of improvement. Downside risks include: high real interest rates, a further deterioration in asset quality, low consumer demand if unemployment and wages deteriorate further, delays in recapitalization, and a feeble recovery in asset and collateral prices.



Source: Bank of Lithuania and IMF Staff estimates

1/ See Selected Issues paper.
2/Aisen A. and Franken M. (2009): "Bank Credit and the 2008 Financial Crisis: A Cross-Country Comparison", Central Bank of Chile, Working Paper 532, December 2009.

B. Near-Term Outlook

6. **Exports and inventories are expected to lead the recovery in 2010 (Text Table).** Staff projects that real GDP will grow by 2 percent in 2010, with the recovery dependent on exports that are forecast to grow by about 9 percent in real terms. Stronger external demand and the higher absorption of EU funds will help private consumption and gross fixed capital formation expand during 2010 on a quarter-on-quarter basis—though not on a year-on-year basis due to strong base effects. Moreover, the large decline in inventories in 2009 creates the potential for a large contribution in the 2010 forecast, were inventories to stabilize. Growth in domestic demand will however be modest, hampered by high unemployment, falling incomes, and weak credit prospects. This in turn will constrain import growth, although higher than forecast energy imports in the wake of the closure of Ignalina or a swifter recomposition of inventories would risk imports rising faster than expected. The output gap of about -5 percent implies that deflation in core CPI is expected to persist through 2010, although higher energy and food prices will leave headline inflation close to zero.

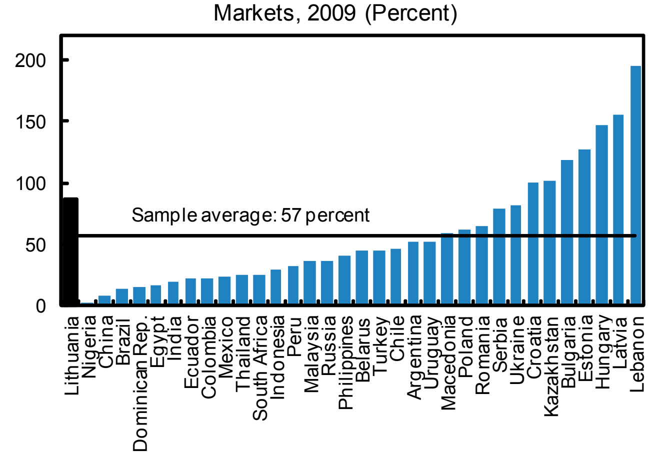
Contributions to GDP Growth: 2006-11

	2006	2007	2008	2009	2010	2011
GDP	7.8	9.8	2.8	-14.8	2.1	3.3
Domestic demand	10.3	15.8	3.5	-28.8	-0.5	3.0
Consumption	7.9	8.8	4.0	-11.9	-4.2	1.1
of which public consumption	0.7	0.6	1.3	-0.2	-0.5	-0.7
of which private consumption	7.2	8.4	2.5	-12.1	-3.4	1.8
Investment	2.4	7.0	-0.4	-17.0	3.7	1.8
of which gross fixed capital formation	4.6	6.0	-1.9	-10.4	-1.5	1.1
of which change in inventories	-2.2	1.0	1.5	-6.5	5.3	0.8
Net exports	-2.8	-6.3	-1.1	15.2	2.5	0.3
Exports	7.0	1.8	6.9	-8.9	6.1	4.0
Imports	-9.8	-8.1	-8.0	24.0	-3.6	-3.7
Statistical discrepancy	0.4	0.4	0.3	-1.1	0.0	0.0

Source: Statistics Lithuania; and IMF staff calculations.

7. **External surpluses are expected to moderate as domestic demand recovers, but deleveraging by the banking sector will weigh on capital flows**. Strong export and current transfers are expected to keep the current account in surplus in 2010. Private sector deleveraging is expected to continue through 2010, with the stock of credit to the private sector as a percent of GDP declining further. Nonetheless, rollover rates on external credit lines will improve substantially given the already sharp downward adjustment in 2009. With capital transfers, FDI and government debt issuance is helping compensate the outflows, and

External Debt -to-GDP Ratios for Select Emerging Markets, 2009 (Percent)



Source: WEO

reserves are expected to rise. Despite deleveraging, the external debt-to-GDP ratio is expected to peak only this year, at close to 90 percent, before declining over the medium term. Still, the external debt dynamics remain particularly sensitive to shocks. (Appendix 1).

8. **Risks to the near-term outlook are broadly balanced, although tail risks remain.**

- On the upside, global demand could be stronger than expected. The recent depreciation of the euro, if it persists, could stimulate net exports to non-EU trading partners, more than offsetting the adverse effect of energy prices. The impetus to domestic demand provided by exports and EU funds could also be stronger but would contribute to narrowing the current account surplus. At 40 percent of GDP, household debt remains low relative to other EU countries suggesting deleveraging may be less prolonged.

- On the downside, uncertainty in international markets remains a source of risk, while poor asset quality in banks could hamper the recovery. Prolonged stress in Southern Europe could impact trading partner growth, and risk tensions in financial markets with possible implications for Lithuania's sovereign financing costs that have so far declined. In an extreme event where markets would freeze as in the fall of 2008, the government could rely on its deposits that currently cover 5 months of expected cash requirements, and on domestic debt issues as it did in early 2009. Direct financial linkages to Southern European countries are limited, as is the exposure of the Nordic parent banks who supported their subsidiaries through 2009. Further deleveraging could take place, however, if conditions on wholesale funding markets become difficult. A shock to growth, or to the current account, stemming from lower growth in trading partners could also push external debt on an upward trajectory. Beside the external risks, pressures on the banking system from poor asset quality or problems in weaker banks, heavier debt burdens arising from further deflationary pressure, and a weaker supply of credit could hamper the recovery, although the comparatively lower debt burden and high degree of openness may alleviate some deflationary pressure.

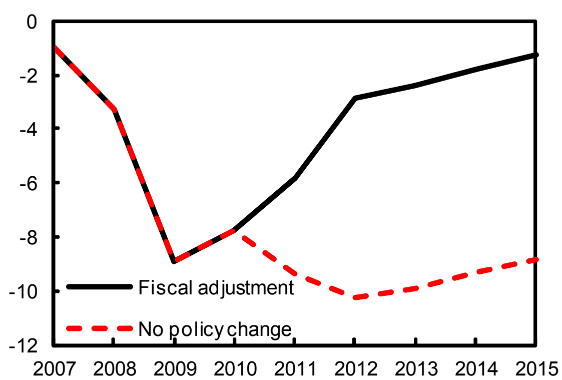
II. The Road Ahead

9. **Restoring fiscal sustainability and ensuring financial stability are the authorities' key economic objectives.** This supports the long standing currency board arrangement (CBA) and conditions for successful Euro adoption. The latter, would allow an orderly exit from the CBA, eliminate currency risks and reduce liquidity risk, a consideration given the high degree of euroization (over 70 percent of bank assets but just one-third of deposits). Realizing the ambitious 2014 timeline for euro adoption will require addressing three key challenges: putting the public finances back on a sustainable footing, safeguarding the health of the financial system, and rebalancing the economy towards tradables to foster more balanced growth and job creation.

A. Securing a Sustainable and Equitable Fiscal Consolidation

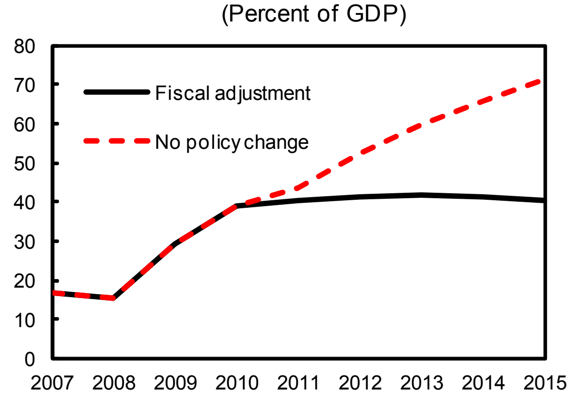
10. **High deficits and rising debt are generating vulnerabilities.** Despite economic growth and recent adjustment measures, the deficit is only expected to decline to 7¾ percent of GDP in 2010, reflecting the role of exports and inventories (both lightly taxed bases) in driving the recovery. The modest revenue gains are also partly offset by increased transfers for social assistance, support to job creation schemes, and compliance problems that have both reduced excise collections and given rise to municipal government arrears. The arrears reflect lower personal income tax revenues due to continued rise in unemployment and fall in wages. Beyond 2010, if no new measures are taken, deficits would rise to 9-10 percent of GDP, reflecting rising debt service costs, EU co-financing requirements, the expiration of temporary measures, and full reinstatement of transfers to Pillar II pensions. Public debt would breach the 60 percent Maastricht ceiling as early as 2013. Coupled with rising rollover needs, the government's gross financing need would reach 20 percent of GDP by 2015 while the public debt burden would remain very vulnerable to lower growth outturns (Appendix 1).

General Government Fiscal Deficit 1/
(Percent of GDP)



Source: Eurostat, and IMF staff calculations.
1/ ESA 95 Basis

General Government Debt Burden 1/
(Percent of GDP)



Source: Eurostat; and IMF staff calculations.
1/ ESA 95 Basis

11. **Additional fiscal consolidation is needed to secure sound public finances.** The convergence program (CP) targets reducing the deficit to 5.8 percent of GDP in 2011 and to 3 percent by 2012. While ambitious**,** this timeframe is appropriate as a more gradual

adjustment risks undermining market confidence as well as the euro adoption goal. More importantly, achieving these targets would substantially lower public debt and financing needs, while saving up to 1⅓ percent of GDP in interest costs over the medium term. Extending measures due to expire by 2011 (2½ percent of GDP) is a necessary start, but not enough. Some 5½ percent of GDP in additional measures—about half the consolidation achieved to date—is required. Economic growth cannot substitute for this consolidation: in the unlikely event that growth returns to its pre-crisis levels, the adjustment need would still amount to 3 percent of GDP.

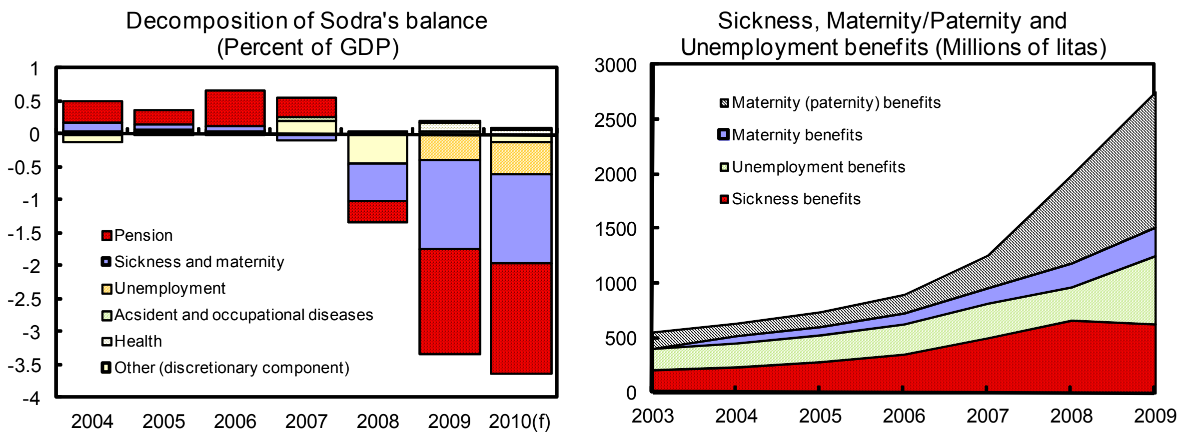
12. **A balanced consolidation will require insuring the sustainability of the social insurance system and broadening the tax base.** Given the size of adjustment already implemented, and the need for additional consolidation, a broad package of expenditure and revenue measures is required to sustainably reduce the deficit (Box 2). While many options are available, a broad-based package would help avoid further cuts in core public services generate resources pending gains from slower yielding structural reforms, while helping to reduce the impact on the poor. Quickly announcing concrete proposals would underpin the credibility of the fiscal targets and market confidence, especially ahead of the municipal and parliamentary elections in 2011 and 2012.

Box 2: Yields of Options for Revenue and Social Insurance-Led Adjustment

Instrument		Annual Short-term	Annual Medium-term
	Tax Policy	**2.4-3.0**	**2.9-3.5**
Capital / Wealth	Introduce immovable property tax on private residential housing	0.4-0.5	0.4-0.5
	Annual car licence fee graduated per engine capacity	0.3-0.5	0.3-0.5
	Expand land taxation	0.1	0.1
CIT	Withdraw the investment incentive	0.3	0.3
	Withdraw preferential rate on small companies, remove 6 year tax relief in free economic zones and shorten duration for preferential rate	0.1-0.3	0.1-0.3
PIT	Subject all pension payments to income tax	0.5	0.5
	Withdraw tax deductability of mortgage interest payments on mortgages contracted prior to 2009	0.1	0.1
	Consider removal of child allowances	0.1	0.1
VAT	Increase in statutory rate by 1 pp	0.3-0.4	0.3-0.4
Revenue administration	VAT compliance gap (including giving gvt seniority over creditors)	0.2	>0.7
	Mandatory declaration of income		
	Life-style surveys		
	Social Insurance	**1.7**	**2.1**
Contributions base	Expand the contributions base to include all earnings categories (self-employed, farmers, authors etc. at rate 37.5%)	0.3	0.3
Pensions	Increase in retirement age	0.0	<0.1
Disability insurance	More stringent certification of disability benefits	0.2	0.6
Maternity insurance	Individual cap on maternity benefit at 1.5 times the average wage	0.1	0.1
Maternity/paternity	Reduction in replacement rates	0.1	0.1
	Lower the maximum duration of benefits to 1 year and reduce incentives for employer-employee collusion 1/	0.6	0.6
	Individual cap on maternity/paternity benefit at 1.5 times the average wage 1/	0.3-0.4	0.3-0.4
Sickness insurance	Extend employer coverage from 2 to 7 days	0.1	0.1
	Improve monitoring of sickness certification proceedures, extend the reference period for calculation of average wage	0.2	0.2
Unemployment insurance	Raise replacement rates for unemployment over the medium term		-0.1
Total savings capacity		**4.3-4.9**	**5.2-5.8**

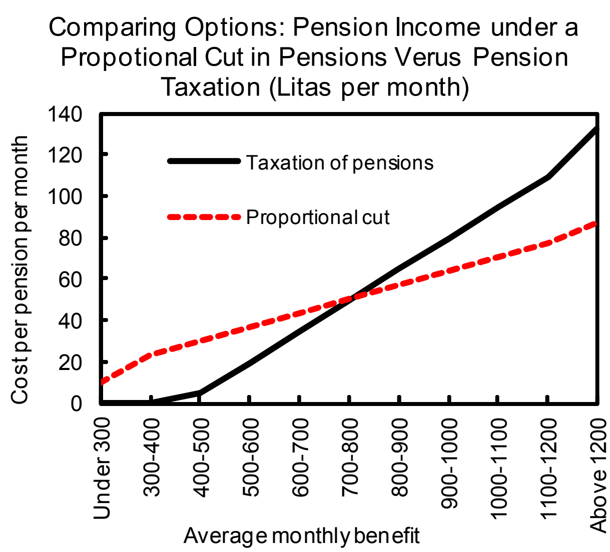
Source: IMF staff estimates.
1/ Estimated yields for the two proposed measures are mutually exclusive. Combined yield estimated at 0.7 percent of GDP.

13. **Reform of the social security system should be assigned the highest priority (Box 3).** The social security agency's (Sodra) deficit is forecast to reach 3½ percent of GDP in 2010, with almost half due to pensions and the rest reflecting rapidly increasing—and extremely generous by EU standards—parental benefits. Options for consolidating the latter include limiting the duration of benefits, introducing a benefit cap, lowering the replacement ratio, and eliminating duplicate payments. Tighter certification of sickness and disability benefits would also yield savings over time.



Source: Sodra, IMF staff calculations

14. **Restoring the financial viability in the pension system calls for far reaching reforms**. Increasing the retirement age and linking it to longevity will start addressing aging-related pressures. To reduce future liabilities and increase the link between contributions and benefits, it will also be necessary to rely more heavily on a mandatory funded system with the basic social pension financed by transfers from the state budget. However, such reforms yield savings slowly. In the meantime, aligning the tax treatment of pensions—which are currently taxed neither at the contribution nor payment stage—with other income could be an option to help restore financial viability and fund the social pension. Pension taxation would be more equitable than an alternative of reducing pension levels. About half of all pensioners—those on the lower end of the income distribution—would be better-off relative to an option that entailed an across-the-board cut in payments, and the poorest pensioners would be shielded by the income tax allowance. It



Source: Sodra; and IMF staff calculations.

would also bring those on higher incomes that contribute to the funded pillars and those with multiple or working pensions more fully into the tax net.

15. **Exploiting new revenue sources and closing existing tax loopholes would broaden the adjustment effort (Box 4)**. As a proportion of GDP, the overall tax burden is comparatively low, and wealth taxes are less than 25 percent of the EU average. A broad-based real estate tax on individual property at a low rate, and an annual registration fee on cars would yield substantial revenue. It would also limit the need for increases in profits or income taxes that could deter investment or job creation, while placing the burden of adjustment on wealthier households. Gradually phasing out the tax relief on mortgage interest payments and corporate tax incentives would reduce the bias towards debt finance and broaden the tax base. Meanwhile, there is scope to improve VAT compliance where the gap to EU benchmarks is high. Tax administration would also be strengthened through the introduction of mandatory income tax declarations and life-style surveys.

16. **Structural reforms in the education and health sectors will also generate savings over the longer-term.** Implementation of the World Bank recommendations to change financing formulae to ensure student-teacher ratios evolve in-line with the declining population will generate savings of over 1.3 percent of current GDP by 2020. With health costs set to increase by about 4 percent of GDP by 2050, encouraging consolidation within the dense hospital network and a greater reliance on primary care, out-patient services, and patient copayments would promote efficiency. On-going reforms in the procurement of pharmaceutical and other services should also help reduce the cost of health-related inputs.

17. **Improvements to the fiscal framework would support consolidation.** A more comprehensive reporting of contingent liabilities and tax expenditures is needed, as is a better monitoring and control of municipal arrears and finances. Formal mid-year budget reviews would also enhance the responsiveness of policies. Once the debt burden has been anchored at a sustainable level, changes to the fiscal rule to prevent pro-cyclical spending in good times, as set out in the authorities' convergence program, would allow fiscal policy to play a more effective stabilizing role in the management of economic cycles.

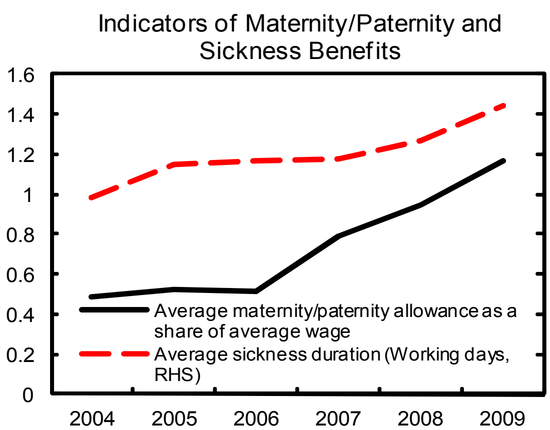
18. **The authorities are strongly committed to meeting their fiscal deficit targets.** They aim to design an ambitious adjustment package, comprising a few large reforms rather than a series of smaller measures. The various options that staff outlined are being considered, including the possibility of a greater reliance on funded pensions. This could be accompanied by a more gradual reinstatement of transfers to the second pillar to help compensate Sodra for the associated revenue loss, and by a possible VAT rate increase to fund the basic pension. The authorities are seeking broad political support for such a package and are actively seeking to explain the benefits of various measures, including new tax instruments. They are keen to avoid recourse to further wage and pension or across-the-board cuts that would harm the recovery, deepen deflation, and disproportionally impact the poor.

Box 3. Options for Social Insurance System Reform.

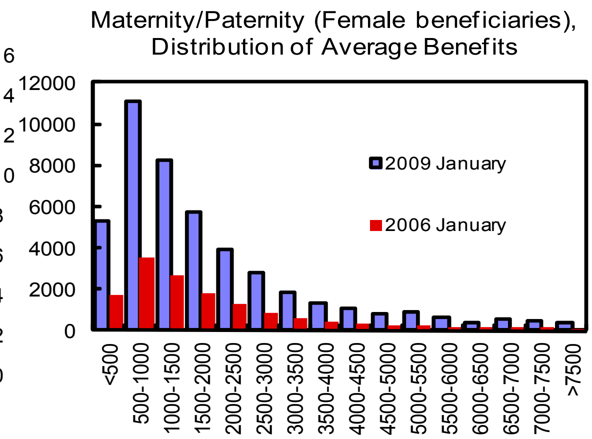
Social security system (Sodra) finances have deteriorated substantially. Contributions have fallen sharply as wages in the economy adjust to their new level after the boom. However, the large benefit increases granted in the boom leave Sodra's spending far in excess of its revenues. Steps are needed to align benefits with resources and to restore the long-term viability of the pension system.

Non-pension benefits. Exceed their earmarked contributions and incentives across unemployment, sickness and maternity/paternity benefit systems are not well-aligned:

- Maternity/paternity benefits are generous by EU standards. Payments are 120 percent the average economy-wide wage, increasingly benefit the better-off, and risk reducing female labor supply.
- Sickness benefits are still prone to moral hazard notwithstanding recent increases in the share paid by employers. Increasing employer coverage from 2 to 7 days and stricter monitoring would better align incentives.
- Unemployment benefits fail to provide adequate income support. In the medium term, replacement rates should be increased once fiscal space emerges.



Source: Sodra, IMF staff calculations



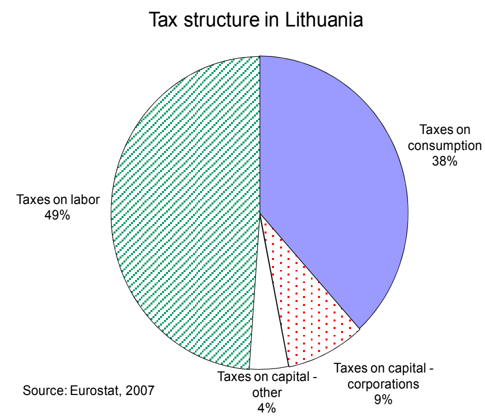
Source: Sodra.

Ensuring the long-term viability of the pension system. The current system is facing rising liabilities due to implicit and explicit entitlements that are not covered by contributions. To ensure long-term viability:

- Increasing the retirement age and linking it to the dependency ratio will help address the impact of aging and migration pressures.
- The pension system could rely more heavily on the funded component to reduce future liabilities—provided ways are found to compensate Sodra for the income lost in the transition.
- The basic minimum pension could be more efficiently funded by the budget given the government's ability to raise resources through sources which are broader and less distortive than contributions.
- Employers' social security contributions on behalf of employees escape the tax net. Taxing them at either the contributions or benefit stage would remove a double-tax benefit.
- Social insurance beneficiaries accrue entitlements without paying equivalent contributions and the pension formula overcompensates recent earnings. Rescaling the wage conversion parameters and automatic indexation to wage trends would make the system less discretionary.

Box 4. Options for Revenue-Supported Adjustment[1/]

Lithuania's tax structure remains very concentrated, with the most efficient tax instruments underutilized. Owing mainly to high social contribution rates, the share of labor taxes is similar to advanced euro area countries but the share of wealth taxes is low and many loopholes persist. There is thus ample scope to improve efficiency and equity while raising revenue.



Wealth taxes. Research by the OECD finds wealth taxes are the least distortive and harmful to growth compared to other tax instruments.[2/]

- There is considerable room to expand immovable property taxation to residential housing. Countries at Lithuania's income level generally collect about ¾ percent of GDP in such revenue. Given the distribution of housing values in Lithuania, generating such a yield would require a low-rate tax imposed on a broad-base. Exempting primary residences would significantly erode the base, duplicate the capital gains exemption, and favor middle and high income earners.
- Introducing an annual motor vehicle license fee, scaled according to engine size, would serve as a green tax besides taxing wealth, and fall more heavily on high income earners. Other countries typically generate about ½ percent of GDP from such fees.

Removing tax loopholes. While many tax exemptions have been abolished, those remaining are not compatible with the corporate tax code and enterprises still enjoy generous exemptions.

- The income tax codes provide many exemptions for property income, while asset price gains are not captured by the capitals gain tax. Personal income tax allowances for children combined with maternity/paternity benefits appear generous.
- Abolishing the zero corporate income tax in free-economic zones would help preclude leakage via transfer pricing. Incentives, like the reduced rate for small enterprises, have proved ineffective in other countries and could be reconsidered.

Tax compliance. There is indicative evidence of a large and pro-cyclical shadow economy. Strengthening tax compliance would maximize the gain from tax reforms.

- Low VAT efficiency in Lithuania is driven by a high compliance gap that is estimated to cost 2 percent of GDP. This has made VAT collections excessively volatile over the cycle: VAT arrears are now up by ½ percent of GDP compared to the boom years. Meanwhile smuggling and cross-border shopping have contributed to lower-than expected excise revenue. Closing half of the VAT compliance gap would yield up to ¾ percent of GDP over the medium-term.

Private Consumption Based VAT Efficiency Decomposition

	Effective rate	Efficiency	Compliance gap	Policy gap
Estonia	16.18	0.90	0.08	0.02
Ireland	16.67	0.79	0.02	0.19
Greece	9.73	0.51	0.30	0.27
Spain	10.81	0.68	0.02	0.31
France	12.49	0.64	0.07	0.32
Italy	10.38	0.52	0.22	0.33
Latvia	12.89	0.72	0.22	0.08
Lithuania	11.59	0.64	0.22	0.17
Hungary	13.83	0.69	0.23	0.10
Finland	16.52	0.75	0.05	0.21
Sweden	18.90	0.76	0.03	0.22
United Kingdom	10.08	0.58	0.17	0.31
Average (advanced)	13.94	0.71	0.09	0.22
Average (CEE)	13.66	0.71	0.17	0.14
Average (all)	13.85	0.71	0.12	0.20

Source: Reckon (2009), IMF staff computations.
Note: all estimates and calculations refer to year 2006.

1/See Selected Issues paper.

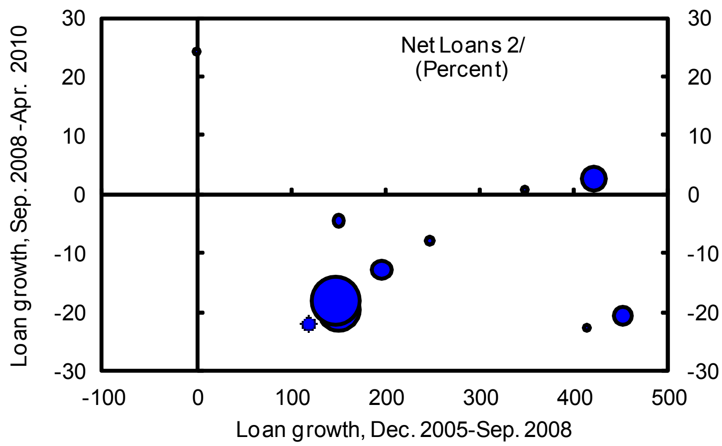
2/ Arnold, Jens, 2008, *OECD Working Paper No. 643*.

B. Enhancing Financial Stability: Promoting Loss Recognition and Capitalization

19. **The overall banking system is sound but the outlook will continue to be challenging.** The high level of unemployment will entail an increasing share of households facing financial distress with implications for credit risk, while the level of corporate bankruptcies has risen sharply (up by 45 percent in 2009). Thus, even under current expectations of modest recovery, NPLs could rise further, albeit at a declining pace, peaking at about 23 percent in 2010 according to BoL simulations under baseline stress test scenarios. Still, the banking system reports high capital levels—with Tier I capital accounting for two thirds of total capital—that leaves system-wide capital levels more resilient to potential shocks. BoL stress tests suggest that even under a severely adverse scenario which would result in NPLs exceeding 30 percent by 2011, the system-wide CAR would remain above the regulatory 8 percent minimum.

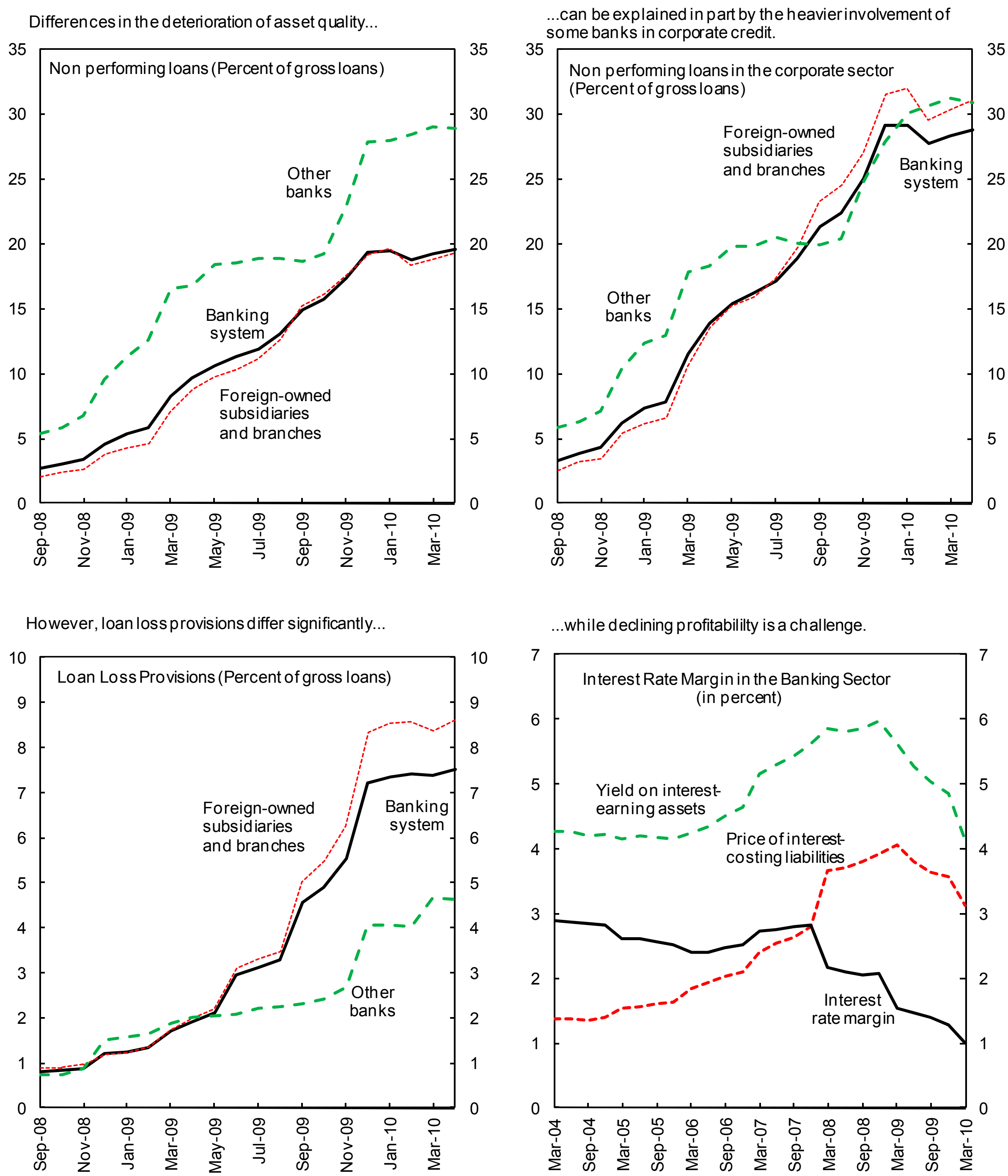
20. **Aggregate financial soundness indicators mask substantial divergences across the system (Figure 5).** Internationally-owned banks have injected new capital worth about 2 percent of GDP, bringing their CAR to an average of 16 percent, and increased the cover of provisions to more than 40 percent of NPLs by March 2010. However, audited financial statements suggest that the remainder group of banks—that account for about 18 percent of total assets and almost 30 percent of household deposits—has made more limited capital injections, mainly in the form of subordinated debt (Tier II capital). The CAR of these banks had risen to 12 percent by end-March 2010. NPLs in these banks, in part explained by a heavier involvement in corporate credit, accounted for almost 30 percent of gross loans and the coverage of loan-loss provisions was just over 15 percent (4 percent of gross loans). This suggests a greater reliance on collateral to mitigate potential losses, at a time when collateral is particularly difficult to value and realize given the sharp correction and limited activity in asset markets. Moreover, some of these banks have recently resumed lending, including to distressed sectors such as construction or real estate.

Adjustment of Banks' Lending from Boom to Bust 1/



Source: Association of Lithuanian Banks; and IMF Staff Estimates.
1/ Size of each bubble reflects the corresponding bank's share in total deposits.
2/ Loans net of provisions.

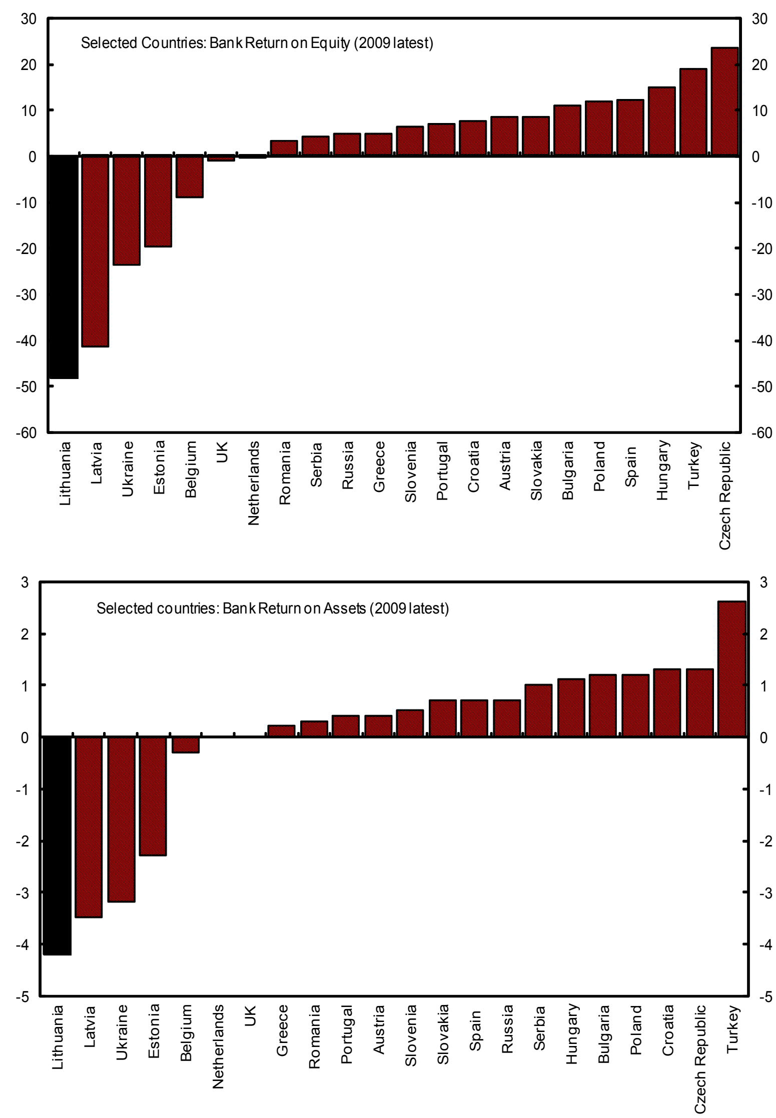
Figure 5. Lithuania: Financial Sector Policy Challenges



Source: Commercial banks' audited statements and Bank of Lithuania.

21. **Looking ahead, banks' capacity to generate capital from profits will remain limited.** Interest rate margins have narrowed, and at this stage of the cycle, with further asset deterioration still a possibility, a return to rapid loan growth risks adding to non-performing loans. Banks that bolstered liquidity through a strategy of attracting high-cost deposits, maintained or increased their exposure to distressed sectors and relied more heavily on collateral to limit potential losses will face particular challenges in generating future income and may need new capital infusions. Using published data, staff stress tests indicate that for this group of banks a further increase in NPLs by 20 percent—with loan recovery through collateral foreclosure assumed to be made at 30 percent—would require additional capital injections of about 1 percent of GDP. If problems were to arise in a bank, systemic risks nonetheless appear limited, with significant spillovers to the liquidity of the wider system unlikely given the relatively small size of these banks and strong parent bank support for the largest banks.

Indicators of Bank Profitablility



Source: IMF Global Financial Stability Report (April 2010), central banks and supervisory authorities.

22. **Addressing these challenges will require a more forward looking approach.** To proactively ensure bank viability, especially from less capitalized and provisioned institutions, the BoL should request banks to provide forward-looking business plans under a common stress scenario. The plans would show each bank's capacity to meet minimum prudential standards (including solvency and liquidity), and generate reasonable level of cash income (before loan provisioning) over a 24-month period. Should some banks show financial weaknesses, a restructuring plan would accordingly be required. Staff also recommends an independent professional assessment of the consistency of collateral valuation across institutions to identify areas for further improvement, especially considering shortcomings in collateral

foreclosure due to market illiquidity and the reported rise in fraudulent bankruptcies. Moving to a semi-annual audit schedule for two years, and rotating external auditing teams within firms as early as feasible would also enhance the incentives for more timely recognition of loan losses.

23. **Given the high level of nonperforming loans, ongoing efforts to fine-tune the legal framework to facilitate voluntary debt restructuring are essential**. Efforts underway to strengthen the corporate bankruptcy law, and introduce a personal bankruptcy act are welcome. Corporate debt restructuring procedures could be enhanced by addressing legal and institutional shortcomings for the treatment of fraudulent bankruptcies, clarifying the roles of courts and bankruptcy administrators and training sufficient staff, and granting senior creditor status to new financing. Restructuring efforts should continue to be based on a voluntary approach. Mandatory moratoriums on debt payments risk increasing the level of non-performing loans in the banking system and delaying the recovery of solvent borrowers.

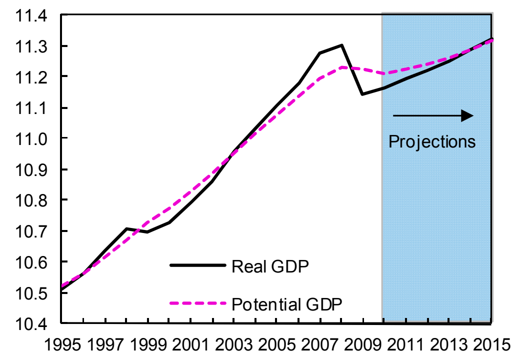
24. **In line with global initiatives, steps to enhance contingency planning and resolution frameworks should continue**. The by-laws for the 2009 Financial Stability Law are now awaiting European Commission approval. Earlier IMF recommendations to expand the resolution tool-kit to allow a purchase and assumption transaction and the creation of bridge banks are pending on-going discussions at the EU-level. Beyond appropriate legal tools, it is important to run regular crisis drills to identify weaknesses and bottlenecks in crisis management, communication, intervention, and resolution procedures. In this regard, staff welcomes Lithuania's forthcoming participation in the Nordic Baltic Cross Border Crisis Group and the recent MOU on crisis planning that set outs the rules and procedures governing the exchange of information between the Ministry of Finance, BoL and Financial Securities Regulator.

25. **The authorities saw the banking system as a whole as well equipped to deal with new challenges given high capital and liquidity ratios, but views differed on the risks posed by less-capitalized and provisioned institutions.** They observed that the stricter definition of NPLs in Lithuania should be taken into account when comparing provisioning coverage levels across countries. The supervisory department stressed its ongoing efforts to ensure banks' inject additional capital if needed under specific time-bound plans following annual on-site inspections, as well as the requirement that banks prepare stress test scenarios to identify capital shortages (although these use banks' own assumptions). The authorities acknowledged the dispersion of soundness indicators across banks. The fact that some banks had lower levels of provisioning than others was viewed by the supervisory department as the consequence of higher collateral requirements in particular on corporate credit. Moreover, collateral valuations were deemed conservative, validated by auditors and cross-checked by the supervisor's in-house expert. The supervisor viewed semi-annual audits and the rotation of audit teams as risking an increase in the regulatory burden and cost on banks and stretching audit firms' human resource capacity.

C. Fostering Long-Run Growth

26. **Export performance will be a key determinant of medium-term growth.** A return to pre-crisis growth rates is unlikely as the expansion largely reflected an unsustainable domestic demand-driven boom in non-tradable sectors, financed by external borrowing. Going forward, domestic demand will likely remain subdued for some time as the private sector deleverages, unemployment remains high and the corporate sector restructures, putting the onus on exports to drive the economy. Overall, medium-term potential growth is expected to be in the 3½ percent range (the pre-crisis estimated rate was 6 percent). Given this, real GDP would only recover its pre-crisis levels in 2014/15. With the output gap only closing then, inflation pressures will remain muted while the gradual recovery in domestic demand slowly reduces the current account surplus.

Output and Potential Output 1/



Source: Haver; and IMF staff calculations.
1/ In logs.

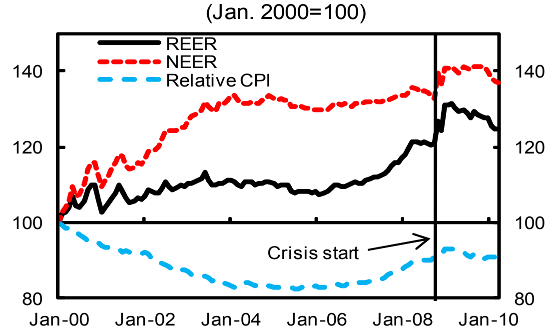
27. **Amid improving competitiveness indicators, Lithuania's export prospects appear promising (Box 5).** Lithuania was able to contain costs in the tradable sector during the boom, despite wage and price inflation in non-tradable sectors. This helped more than double Lithuania's share of global exports over the decade, including in relatively high value-added sectors. To date, the export recovery has been brisk which, combined with steep adjustment in wage costs during the crisis, suggest competitiveness is improving. At this juncture, overvaluation does not appear to present a significant policy challenge, with CGER overvaluation estimates at modest levels. Moreover, CGER is based on the CPI rather than the manufacturing-ULC REER, which is more relevant for competitiveness and which rose less during the boom.

Box 5. Competitiveness[1/]

Competitiveness was not seriously eroded during the boom and ongoing wage declines help allay concerns that internal costs are too high.

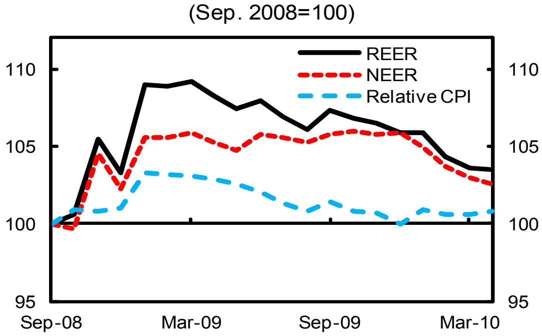
Lithuania's CPI-based real effective exchange rate (REER) appreciated by 15 percent between 2000 and October 2008, driven firstly by nominal exchange rate changes and then, in the second half of the decade, by rising wage and price inflation in non-tradable sectors. The REER appreciated a further 8 percent in the following six months as floating rate partner currencies depreciated sharply (notably Russia and Poland). While this has since partially reversed, deflation has not yet had an impact, and the closure of Ignalina will delay the correction further by raising energy prices.

CPI-based Real Effective Exchange Rate
(Jan. 2000=100)



Source: INS.

Detail from Sept. 2008
(Sep. 2008=100)



Source: INS.

Analysis using CGER methodologies suggest moderate and declining overvaluation, yielding an average estimate over the three methods of 6.6 percent. The macroeconomic balance and external sustainability estimates are sensitive to the impact of the (highly uncertain) medium-term current account forecast, while the equilibrium real exchange rate approach may exaggerate estimated over-valuation if structural changes are not well captured in the data.

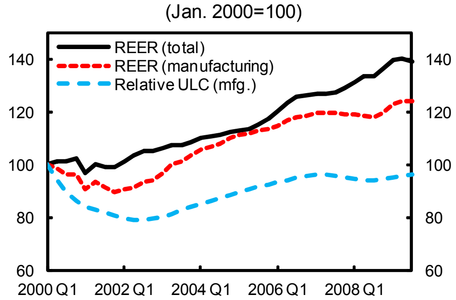
CGER-style Misalignment Estimates, 2009 (Percent)

Macroeconomic balance	-2.4
External sustainability	6.4
Equilibrium real exchange rate	15.7

Source: IMF staff calculations.

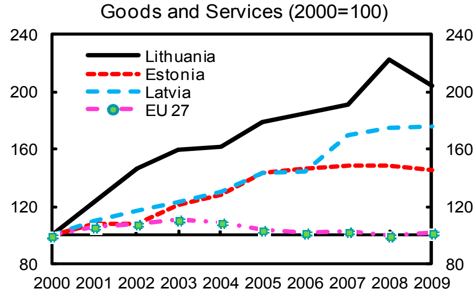
Economy-wide unit labor cost-based REER measures have appreciated by about 40 percent between the first quarter of 2000 and the last of 2008. However, this was entirely driven by non-tradable sectors. In contrast to its Baltic neighbors, Lithuania managed wage restraint in export sectors such as manufacturing where costs relative to trade partners actually fell between 2000 and 2008 and its export market share more than doubled, with gains particularly marked in some high valued-added areas such as capital goods.

ULC-based REERs, 2000-09
(Jan. 2000=100)



Source: DG EC FIN and staff calculations

Share of Global Exports
Goods and Services (2000=100)



Source: WEO.

Recent wage declines have been most pronounced in sectors such as construction or real estate services, but even in manufacturing labor costs have fallen by some 10 percent. This bodes well for the country's future competitiveness.

1/ See Selected Issues paper

28. **The high level of unemployment calls for decisive policy action.** Proposals in parliament to expand fixed-term contracts, ease dismissal requirements and allow greater flexibility in overtime will, if implemented, further increase labor market flexibility and encourage firms to hire earlier in the recovery. Plans to support job creation via EU funds and by lowering social contributions for one year to 7.7 percent on first time hires could help alleviate youth unemployment and bolster employment more generally. However, enhancing coordination across government agencies and easing administrative and procurement bottlenecks will help realize the ambitious targets for EU fund absorption.

29. **Wide-ranging efforts to improve the business climate could promote new investment.** The administrative and reporting burden on firms will be eased, by inter alia clustering and then merging the 76 public agencies tasked with supervising firms' operations. The government is proactively seeking to boost FDI, and its efforts have resulted in a number of high profile investments. Reform of state-owned enterprises through the disinvestment of non-core activities and the attraction of strategic investors could reinforce this effort.

30. **The authorities see structural reform as essential to sustain the recovery.** They are optimistic that on-going efforts to improve the business climate and enhance flexibility in the labor code will make Lithuania a more attractive investment destination. Increased absorption of EU funds is key to their efforts to create jobs and promote investment. Measures are being taken to simplify and increase the effectiveness of the EU funds' administration system, to strengthen administrative capacities of the institutions managing EU funds programs and to provide technical support for beneficiaries in preparing and implementing projects. The authorities viewed any estimates of the remaining overvaluation of the exchange rate as lacking significance particularly given the uncertainty surrounding such estimates. The gains in world market share and recovery in exports this year, combined with the on-going wage adjustment suggest in their view that exchange rate competitiveness is not a significant policy challenge.

III. Staff Appraisal

31. **The economy is recovering supported by a determined policy response and the global upturn.** The authorities' decisive financial sector and fiscal policies helped Lithuania to weather the crisis and generate conditions for recovery. Staff expects real GDP to grow modestly in 2010, with broadly balanced risks around the forecast. Looking ahead, medium term growth is expected to be lower than in the boom, with real GDP only recovering its pre-crisis levels in 2014/15.

32. **Further fiscal consolidation is needed to place deficits and debt on a sustainable path**. The debt burden could break the Maastricht ceiling as early as 2013, if no new measures are taken. Some 5½ percent of GDP in additional effort is required suggesting a comprehensive package of expenditure and revenue measures will be needed. Early announcement of specific measures would underpin the credibility of the fiscal targets. Given the large adjustment to date, there is a need to strike a balance between a broadening of the

tax base to yield greater revenues on one side, and insuring the sustainability of the social insurance system on the other, in ways that protect the most vulnerable.

33. **Tackling the deficit in the social security system and expanding the revenue base would achieve adjustment in a sustainable, pro-growth, and equitable manner.** Sodra's deficit is large, reflecting in roughly equal measure overly generous parental benefits and an unsustainable pension system. Reducing parental benefits to EU standards—along with a comprehensive pension reform that raises the retirement age, moves to a more funded system, and provides adequate funding of the minimum basic pension—would sustainably reduce Sodra's deficit. Exploiting new revenue sources, such as a real estate tax on personal property and annual car tax, would help raise revenue in the least distortionary way. It would also ensure the wealthier bear a greater share of the adjustment burden. There is also substantial scope to bolster revenues over time by enhancing tax compliance.

34. **The banking system has weathered the crisis but challenges remain.** Capital and liquidity indicators have improved but the level of non-performing loans is high. Audited accounts suggest the effort to provision for expected losses has been uneven across the system, while banks' capital and capacity to generate cash income will likely remain under pressure.

35. **A more forward looking approach would increase incentives to recognize losses and increase provisions and capital across the system.** Regulators should continue to closely monitor the sufficiency of banks' loan loss provisions and request banks increase their capital as needed under a strict timeframe. Requiring banks to prepare forward-looking business plans under a common stress scenario would help assess their viability. This effort should be complemented with an independent professional assessment of the consistency of collateral valuation across institutions, a semi-annual audit schedule, and rotation of external auditing teams within audit firms. To ensure the recovery of viable borrowers and the adequate protection of creditors, on-going reforms to strengthen the legal framework for voluntary debt restructuring is key and should remain the preferred procedure.

36. **A sustained recovery also hinges on the ability of the economy to rebalance towards tradables.** Prospects for the export sector are encouraging. During the boom years, Lithuania was able to contain costs in the export sector and gain world market share, despite rapid wage and price inflation in non-tradables. This, combined with a significant fall in wage costs in the downturn, is supporting competitiveness and staff considers than any residual overvaluation is modest.

37. **The rising level of unemployment is a growing social and economic challenge, making it imperative to advance with structural reforms**. Recent packages to support employment generation through increased absorption of EU funds are welcome, as are the new proposals to further enhance labor market flexibility. Steps to improve the business climate and the performance of state-owned enterprises could help stimulate investment.

38. **It is proposed to hold the next Article IV consultation on the regular 12-month cycle.**

Table 1. Lithuania: Selected Economic and Social Indicators, 2007–15

Population (2009): 3.32 million
GDP per capita, at purchasing power parity (2009): USD 15,803
Life expectancy at birth (2008): 77.6 years (women), 66.3 years (men)
At-risk-of-poverty, share of population (2008): 20 percent

	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
Real economy									
Nominal GDP (in billions of litai)	98.7	111.2	92.0	94.3	98.0	101.8	107.0	112.9	119.4
GDP (in billions of euros)	28.6	32.2	26.6	27.3	28.4	29.5	31.0	32.7	34.6
Real GDP (annual percentage change)	9.8	2.8	-14.8	2.1	3.3	2.6	3.2	3.5	3.6
CPI, period average (annual percentage change)	5.8	11.1	4.2	0.1	0.2	1.0	1.3	1.4	1.4
CPI, end of period (year-on-year percentage change)	8.2	8.5	1.2	-0.1	0.6	1.3	1.4	1.5	1.4
Average monthly gross earnings (annual percentage change)	19.3	19.3	-4.4	-5.0	0.2	1.1	2.7	3.3	3.9
Average monthly gross earnings (eop, annual percentage change)	18.5	13.0	-8.7	…	…	…	…	…	…
Unemployment rate (year average, in percent of labor force)	4.0	5.9	13.7	18.0	15.5	13.5	11.5	10.0	8.5
Saving-investment balance (in percent of GDP)									
Gross national saving	15.8	15.1	14.4	16.7	18.3	19.0	19.1	19.3	19.5
Gross national investment 1/	30.9	27.0	10.5	16.1	18.2	19.3	20.4	21.6	23.0
Foreign net savings	15.1	11.9	-3.8	-0.6	-0.2	0.3	1.3	2.2	3.4
Fiscal sector (in percent of GDP) 2/									
General government balance	-1.0	-3.3	-8.9	-7.8	-5.8	-2.9	-2.4	-1.8	-1.2
Revenue	33.8	34.2	34.3	34.0	33.8	33.4	32.5	31.9	32.0
Of which EU grants	1.5	1.1	1.7	3.7	3.5	3.2	2.3	1.5	1.5
Expenditure	34.8	37.4	43.2	41.8	42.8	41.7	40.0	38.5	37.8
Of which: Non-interest	34.1	36.8	42.2	40.1	40.4	39.2	37.6	36.2	35.5
Interest	0.7	0.6	1.0	1.7	2.4	2.5	2.5	2.4	2.3
Unidentified savings (cumulative) 3/					3.2	5.4	5.1	4.8	4.6
General government gross debt 4/	16.9	15.6	29.5	39.1	40.2	41.5	41.9	41.4	40.4
Of which: Foreign currency-denominated	14.1	12.9	27.0	35.2	34.5	34.9	34.3	33.1	32.3
External sector (in percent of GDP, unless otherwise specified)									
Current account balance									
in percent of GDP	-14.5	-11.9	3.8	0.6	0.2	-0.3	-1.3	-2.2	-3.4
in billions of euros	-4.1	-3.8	1.0	0.2	0.0	-0.1	-0.4	-0.7	-1.2
Exports of goods and services (volume change, in percent)	3.0	12.2	-14.3	9.7	6.0	4.6	5.1	5.4	5.8
Imports of goods and services (volume change, in percent)	10.7	10.5	-29.4	5.3	5.2	4.4	5.8	6.1	6.7
Foreign direct investment, net 5/	3.6	3.1	0.4	2.6	1.3	1.7	2.0	2.2	2.4
Gross official reserves (in billions of euros)	5.2	4.4	4.6	5.2	5.4	5.7	6.2	6.3	5.9
Reserve cover in months of imports of goods and services	3.3	2.4	3.8	3.5	3.2	3.3	3.3	3.1	2.7
Reserve cover in percent of short-term debt at remaining maturity	89.5	53.0	46.5	39.7	63.6	66.7	73.9	77.1	65.0
Gross external debt 6/	72.2	73.5	87.2	89.5	84.5	82.4	80.9	78.9	76.6
Short-term debt at original maturity	18.5	18.0	15.6	12.1	10.1	9.8	9.9	10.0	10.1
Exchange rates									
Exchange rate (litai per U.S. dollar, end of period)	2.4	2.5	2.4	…	…	…	…	…	…
Exchange rate (litai per U.S. dollar, period average)	2.5	2.4	2.5	…	…	…	…	…	…
Exchange rate (litai per euro, end of period)	3.5	3.5	3.5	…	…	…	…	…	…
Real effective exchange rate (2000=100, increase=appreciation) 7/	107.1	114.9	122.8	119.2	…	…	…	…	…
Money and credit									
Reserve money (year-on-year change, in percent)	21.1	-1.4	-17.2	5.7	4.8	…	…	…	…
Broad money (year-on-year change, in percent)	21.7	-0.4	0.3	9.4	11.9	…	…	…	…
Private sector credit (year-on-year change, in percent)	45.3	17.8	-6.9	-6.4	-2.7	…	…	…	…
Currency outside banks, in percent of deposits	22.8	24.4	19.0	19.0	18.0	…	…	…	…

Sources: Lithuanian authorities; World Bank; Eurostat; and IMF staff estimates and projections.
1/ More than half of the decline in the investment/GDP ratio in 2009 is accounted for by the large (in absolute terms) decline in inventories. As such, the decline in the ratio overstates the decline in gross fixed capital formation.
2/ Including unidentified measures quantified below.
3/ The decline post-2012 is due to the growth in nominal GDP.
4/ Excluding guarantees.
5/ FDI in 2009-11 includes funds for recapitalization of foreign banks' subsidiaries.
6/ Includes loans guaranteed by the government.
7/ CPI-based, 2000 trade-weighted real effective exchange rate against 17 major trading partners. For 2010, average January-April.

Table 2. Lithuania: Balance of Payments, 2007–15
(In billions of euros, unless otherwise indicated)

	2007	2008	2009	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.
Current account balance	**-4.1**	**-3.8**	**1.0**	**0.2**	**0.0**	**-0.1**	**-0.4**	**-0.7**	**-1.2**
Merchandise trade balance	-4.3	-3.9	-0.8	-0.5	-0.4	-0.4	-0.5	-0.6	-0.9
Exports (f.o.b.)	12.5	16.1	11.8	15.0	16.5	17.5	18.6	19.9	21.3
Imports (f.o.b.)	-16.8	-19.9	-12.6	-15.5	-16.9	-17.8	-19.1	-20.5	-22.1
Services balance	0.5	0.4	0.6	0.6	0.6	0.6	0.6	0.5	0.5
Exports of non-factor services	2.9	3.3	2.7	3.3	3.5	3.7	3.9	4.1	4.3
Imports of non-factor services	-2.5	-3.0	-2.1	-2.7	-2.9	-3.1	-3.3	-3.6	-3.8
Factor income balance	-1.2	-1.1	0.1	-0.7	-0.9	-1.1	-1.1	-1.2	-1.3
Receipts	0.6	0.7	0.5	0.6	0.8	0.8	0.9	1.0	1.1
Payments	-1.8	-1.8	-0.4	-1.3	-1.7	-1.9	-2.1	-2.2	-2.3
Current transfer balance	0.8	0.7	1.1	0.8	0.8	0.7	0.7	0.5	0.5
Capital and financial account balance	**5.0**	**3.1**	**-1.1**	**0.4**	**0.1**	**0.4**	**0.9**	**0.8**	**0.8**
Capital transfer balance	0.5	0.6	0.9	1.1	1.1	1.0	0.8	0.5	0.4
Foreign direct investment balance 1/	1.0	1.0	0.1	0.7	0.4	0.5	0.6	0.7	0.8
Portfolio investment balance 1/	-0.2	-0.1	0.7	1.6	-0.3	0.1	0.1	0.1	0.1
Other investment balance 1/	3.7	1.6	-2.8	-3.0	-1.1	-1.2	-0.6	-0.5	-0.5
Errors and omissions	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**0.9**	**-0.8**	**-0.1**	**0.6**	**0.1**	**0.3**	**0.5**	**0.0**	**-0.4**
Financing	**-0.9**	**0.8**	**0.1**	**-0.6**	**-0.1**	**-0.3**	**-0.5**	**0.0**	**0.4**
Gross international reserves (increase: -)	-0.9	0.8	0.1	-0.6	-0.1	-0.3	-0.5	0.0	0.4
Use of Fund credit, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:				(In percent of GDP)					
Current account balance	-14.5	-11.9	3.8	0.6	0.2	-0.3	-1.3	-2.2	-3.4
Trade Balance of goods and services	-13.4	-10.9	-0.7	0.5	0.8	0.8	0.3	-0.3	-1.1
Exports	54.0	60.2	54.4	67.0	70.5	71.7	72.5	73.3	73.9
Imports	-67.4	-71.1	-55.1	-66.5	-69.8	-70.8	-72.3	-73.6	-75.1
Factor Income	-4.1	-3.3	0.4	-2.7	-3.3	-3.6	-3.7	-3.6	-3.7
Current Transfers	3.0	2.3	4.1	2.8	2.7	2.5	2.1	1.7	1.4
Capital and financial account balance	17.6	9.8	-4.1	1.6	0.2	1.5	3.0	2.3	2.3
Capital transfers	1.7	1.8	3.4	4.1	3.8	3.4	2.5	1.4	1.1
Foreign direct investment balance 1/	3.6	3.2	0.4	2.6	1.3	1.7	2.0	2.2	2.4
Portfolio investment balance 1/	-0.8	-0.3	2.6	5.9	-1.1	0.2	0.3	0.2	0.2
Other investment balance 1/	13.0	5.0	-10.5	-11.1	-3.8	-3.9	-1.8	-1.6	-1.5
Gross external debt	72.0	73.3	86.8	89.1	84.2	82.1	80.6	78.6	76.3
Public	12.5	10.2	21.0	29.7	30.2	31.2	31.6	31.4	30.8
Short-term	1.1	0.1	0.5	0.7	0.9	1.1	1.3	1.5	1.7
Long-term	11.4	10.0	20.6	29.0	29.3	30.1	30.3	29.9	29.2
Private	59.5	63.2	65.8	59.3	54.0	50.8	49.0	47.1	45.5
Short-term	21.2	22.3	20.5	23.3	20.8	20.0	19.5	19.0	18.5
Long-term	38.3	40.9	45.3	36.0	33.1	30.8	29.5	28.2	27.0
Net external Debt	25.4	29.4	40.6	33.1	27.9	22.7	18.8	16.5	15.4
Net international investment position	-56.1	-52.2	-58.9	-49.7	-42.3	-36.0	-31.2	-28.9	-28.0
				(Annual percentage change)					
Merchandise export volume	3.0	12.2	-14.3	9.7	6.0	4.6	5.1	5.4	5.8
Merchandise import volume	10.7	10.5	-29.4	5.3	5.2	4.4	5.8	6.1	6.7
Merchandise export prices	6.0	11.9	-13.7	16.1	3.6	1.2	1.4	1.4	1.4
Merchandise import prices	4.8	8.4	-10.2	17.1	3.6	1.0	1.3	1.3	1.1
GIR (in billions of Euros)	5.3	4.6	4.6	5.2	5.4	5.7	6.2	6.3	5.9
GIR (in billions of US dollars)	7.7	6.2	6.8	6.7	6.8	7.2	7.8	7.8	7.3
GIR (in percent of GDP)	18.4	14.2	17.4	19.2	18.9	19.3	20.1	19.2	17.0
GIR (in percent of short-term debt) 2/	65.7	44.2	40.2	62.6	63.0	67.8	77.1	69.5	63.8
GIR (in months of next year's imports)	3.3	3.8	3.0	3.1	3.0	3.0	3.1	2.9	2.6
Gross external debt (in % of GNFS exports)	133.2	121.8	159.4	133.0	119.4	114.5	111.0	107.1	103.2
GDP (in billion of Euros)	28.6	32.2	26.6	27.3	28.4	29.5	31.0	32.7	34.6

Sources: Data provided by the Lithuanian authorities; IMF International Financial and Trade Statistics; and Fund staff estimates and projections.
1/ The 2010 projections assume average rollover rates of 90 percent for foreign banks, 74 percent for domestic banks, and 80 percent for corporates; 5 percent deposit outflows for nonresidents; and FDI (excluding bank recapitalizations) declining 50 percent. The overall FDI figures includes some further recapitalization of subsidiaries by parent banks in 2010.
2/ Short-term debt at remaining maturity.

Table 3. Lithuania: Summary of Monetary Accounts, 2007–11
(In billions of litai; unless otherwise specified)

	2007	2008	2009	2010 Jan	2010 Feb	2010 March	2010 April	2010 Projections	2011 Projections
Monetary Authority									
Gross foreign assets	18.0	15.6	15.8	16.4	19.3	16.3	16.2	17.9	18.3
Gross foreign liabilities	1.1	0.1	0.4	0.1	0.4	0.3	0.3	0.4	0.4
Of which: Use of Fund credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Nonresident deposits	1.1	0.1	0.4	0.1	0.4	0.3	0.3	0.4	0.4
Net foreign assets	17.0	15.5	15.4	16.3	18.8	16.0	15.9	17.5	17.9
Gold	0.4	0.4	0.5	0.5	0.5	0.5	0.6	…	…
Net domestic assets	-4.1	-2.8	-4.9	-5.8	-8.5	-6.1	-5.5	-6.4	-6.4
Net credit to government	-3.0	-1.3	-2.6	-3.4	-6.0	-3.6	-3.3	-4.0	-4.0
Credit to banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to non-bank financial institutions	...	...	...	...	...	...	...	...	...
Other items, net	-1.0	-1.5	-2.3	-2.4	-2.5	-2.6	-2.2	-2.4	-2.4
Reserve money	12.9	12.7	10.5	10.5	10.3	9.9	10.4	11.1	11.7
Currency outside the central bank	9.2	9.6	7.9	7.7	7.8	7.8	8.0	8.6	9.2
Currency outside banks	8.1	8.5	7.0	6.9	6.9	6.9	7.1	7.7	8.3
Cash in vaults of banks	1.1	1.1	1.0	0.8	0.9	0.9	0.9	0.9	0.9
Deposit money banks' deposits	3.7	3.1	2.6	2.8	2.5	2.1	2.5	2.5	2.5
Banking Survey									
Net foreign assets	-3.8	-15.6	-5.6	-4.9	-1.1	-2.5	-1.9	3.0	9.0
Monetary authority	17.0	15.5	15.4	16.3	18.8	16.0	15.9	17.5	17.9
Banks and other banking institutions	-20.8	-31.1	-21.1	-21.2	-19.9	-18.5	-17.8	-14.5	-8.9
Net domestic assets	48.1	59.6	49.8	48.1	45.0	46.5	46.5	45.3	45.1
Net claims on government 1/	-2.3	1.4	-2.6	0.2	-0.9	-3.4	-1.2	0.0	1.2
Monetary authority	-3.0	-1.3	-2.6	-3.4	-6.0	-3.6	-3.3	-4.0	-4.0
Banks and other banking institutions	0.7	2.7	0.0	3.6	5.1	0.1	2.1	4.0	5.2
Credit to private sector	56.0	66.0	61.5	61.3	61.0	60.3	59.9	57.5	56.0
Credit to nonbank financial institutions	3.2	3.9	2.7	2.5	2.7	2.5	2.5	2.8	2.9
Other items, net	-8.8	-11.7	-11.8	-15.9	-17.8	-12.9	-14.7	-15.0	-15.0
Broad money	44.2	44.1	44.2	43.2	43.9	44.0	44.6	48.4	54.1
Currency outside banks	8.1	8.5	7.0	6.9	6.9	6.9	7.1	7.7	8.3
Deposits	35.6	34.9	36.8	35.9	36.5	36.6	37.1	40.6	45.9
In national currency	28.3	26.0	25.0	24.1	24.9	25.0	25.3	27.2	29.4
Savings deposits	10.9	13.7	13.6	13.5	13.8	13.6	13.2	14.8	16.0
Demand deposits	17.4	12.3	11.4	10.6	11.1	11.4	12.1	12.4	13.4
In foreign currency	7.3	9.0	11.8	11.8	11.6	11.5	11.8	13.4	16.5
Memorandum items:									
Reserve money (yearly percent change)	21.1	-1.4	-17.2	-9.6	-11.6	-9.9	-1.2	5.7	4.8
Broad money (yearly percent change)	21.7	-0.4	0.3	-0.1	2.0	4.5	6.1	9.4	11.9
Private sector credit (yearly percent change)	45.3	17.8	-6.9	-6.7	-6.4	-6.9	-7.2	-6.4	-2.7
Money multiplier	3.4	3.5	4.2	4.1	4.2	4.4	4.3	4.3	4.6
Currency outside banks, in percent of deposits	22.8	24.4	19.0	19.2	19.0	19.0	19.0	19.0	18.0
Foreign-currency deposits (percent of total deposits)	21.0	25.6	31.1	31.5	30.3	31.8	32.3	33.0	36.0
Foreign-currency loans (percent of total loans)	54.8	64.0	72.4	72.6	72.5	73.2	73.3	74.0	75.0
Velocity of broad money	2.2	2.5	2.1	…	…	…	…	2.0	1.8
Gross official reserves (billions of U.S. dollars) 2/	7.7	6.4	6.7	6.7	7.6	6.4	6.3	*6.7*	*6.8*
Gross foreign assets (billions of U.S. dollars) 3/	*7.6*	*6.4*	*6.6*	*6.7*	*7.5*	*6.4*	*6.2*	*6.7*	*6.8*
Gross official reserves (billions of euros) 2/	5.3	4.6	4.6	4.8	5.6	4.8	4.7	5.2	5.4
Gross foreign assets (billions of euros) 3/	*5.2*	*4.5*	*4.6*	*4.7*	*5.6*	*4.7*	*4.7*	*5.2*	*5.3*
Excess reserve coverage 3/	14.4	8.3	14.5	16.3	24.5	17.5	15.5	16.8	14.5
GDP	98.7	111.2	92.0					94.3	98.0

Sources: Bank of Lithuania; and Fund staff estimates and projections.
1/ Excludes local government deposits; includes counterpart funds.
2/ BOP basis. Differs from gross foreign assets as shown in the monetary authority's balance sheet because of valuation effects
(BOP-basis official reserves include accrued interest on deposits and securities but exclude investments in shares and other equity).
3/ Bank of Lithuania's gross foreign assets less reserve money, in percent of banking system deposits.
Excess reserves for lending to commercial banks are determined based on net foreign reserves, and represent the equivalent of 4 percent of bank deposits.

Table 4: Lithuania: General Government Operations, 2007-15

	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
(ESA 95 aggregates, in percent of GDP)									
Revenue	33.8	34.2	34.3	34.0	33.8	33.4	32.5	31.9	32.0
Revenue excluding EU grants	32.3	33.1	32.6	30.3	30.3	30.3	30.2	30.4	30.5
Tax revenue	20.8	20.9	17.4	16.3	16.6	16.6	16.8	16.9	17.1
Direct taxes	9.2	9.4	6.0	5.0	5.1	5.1	5.2	5.3	5.3
Personal income tax	6.6	6.6	4.1	3.7	3.7	3.7	3.7	3.7	3.7
Corporate income tax	2.6	2.8	1.9	1.3	1.4	1.4	1.5	1.5	1.6
Indirect taxes	11.5	11.5	11.4	11.3	11.5	11.5	11.6	11.7	11.8
VAT	8.0	7.9	7.2	7.3	7.6	7.6	7.7	7.7	7.8
Excises	2.9	3.0	3.5	3.4	3.3	3.2	3.2	3.3	3.3
Other	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Social contributions	8.9	9.4	12.0	10.6	10.5	10.4	10.4	10.4	10.4
Grants	1.5	1.1	1.7	3.7	3.5	3.2	2.3	1.5	1.5
Other revenue	2.7	2.8	3.2	3.4	3.2	3.2	3.0	3.0	3.0
Total expenditure	34.8	37.4	43.2	41.8	42.8	41.7	40.0	38.5	37.8
Current spending	29.6	32.4	40.9	36.9	37.5	36.8	36.0	35.1	34.3
Compensation of employees	9.9	10.8	12.8	11.5	11.2	11.1	11.1	11.0	11.0
Goods and services	5.3	5.7	5.8	5.4	5.0	5.0	4.8	4.7	4.6
Interest payments	0.7	0.6	1.0	1.7	2.4	2.5	2.5	2.4	2.3
Foreign	0.4	0.4	0.7	1.2	1.8	1.8	1.8	1.7	1.7
Domestic	0.3	0.2	0.3	0.5	0.6	0.7	0.7	0.6	0.6
Subsidies	0.9	0.7	0.7	0.6	0.7	0.7	0.6	0.6	0.6
Grants	0.7	0.8	0.9	0.9	0.7	0.5	0.5	0.5	0.3
Social benefits	10.7	12.8	17.1	15.4	16.1	15.7	15.0	14.5	14.1
Other expense	1.4	1.0	1.1	1.4	1.4	1.4	1.4	1.4	1.4
Capital spending	5.2	5.0	3.9	4.9	5.3	4.9	4.0	3.4	3.5
EU funds	5.2	5.0	2.3	3.0	3.1	2.8	2.0	1.4	1.3
Co-financing and other own sources			1.6	1.8	2.2	2.1	2.0	2.0	2.1
Unidentified measures (cumulative deficit-reducing)				0.0	3.2	5.4	5.1	4.8	4.6
Net lending (+) / borrowing (-) 1/	-1.0	-3.3	-8.9	-7.8	-5.8	-2.9	-2.4	-1.8	-1.2
Net acquisition of financial assets	0.9	-2.0	2.3	2.6	-6.5	0.0	0.0	0.0	0.0
Domestic	0.1	-2.6	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.8	0.7	1.1	2.6	-6.5	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.9	1.3	11.2	10.3	2.5	2.9	2.4	1.8	1.2
Domestic	0.2	1.4	2.4	1.4	1.2	1.0	0.8	0.6	0.4
Foreign	1.7	-0.1	8.8	9.0	1.3	1.9	1.6	1.2	0.8
Identified financing	1.7	-0.1	8.8	9.0	1.3	1.9	1.6	1.2	0.8
Memorandum items:									
GDP (in millions of litai)	98,669	111,190	92,016	94,288	97,967	101,773	106,999	112,932	119,449
General government debt	16.9	15.6	29.5	39.1	40.2	41.5	41.9	41.4	40.4
Foreign debt	11.4	10.0	20.7	29.2	29.4	30.2	30.3	29.9	29.1
Domestic debt	5.5	5.6	8.8	9.9	10.7	11.3	11.5	11.5	11.3
Privatization receipts (in millions of litai)	247	63	691	50	0	0	0	0	0
Net lending (+) / borrowing (-) net of pillar II transfer cuts 1/	-1.0	-3.3	-9.4	-8.3	-5.8	-2.9	-2.4	-1.8	-1.2

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

1/ Including payments not transfered by SODRA to private pension accounts.

Table 7. Lithuania: Fiscal Impulse and Cyclically-Adjusted Balance, 2007–15

(in percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
Revenue	33.8	34.2	34.3	34.0	34.9	35.3	34.3	33.6	33.5
Expenditure	34.8	37.4	43.2	41.8	40.7	38.1	36.7	35.3	34.8
Of which: one-off and other temporary measures	0.6	0.0	0.5	0.5	0.0	0.0	0.0	0.0	0.0
Net lending (+)/borrowing (−)	-1.0	-3.3	-8.9	-7.8	-5.8	-2.9	-2.4	-1.8	-1.2
Cyclically adjusted net lending (+)/borrowing (−), IMF staff methodology 1/	-3.7	-5.7	-6.1	-6.5	-5.1	-2.3	-2.2	-1.8	-1.4
Cyclically adjusted net lending (+)/borrowing (−) net of pillar II transfer cuts 2/	-3.7	-5.7	-6.6	-7.0	-5.1	-2.3	-2.2	-1.8	-1.4
Demand impulse from fiscal operations	1.7	2.0	0.4	0.3	-1.4	-2.7	-0.2	-0.3	-0.4
EU structural funds	1.5	1.1	1.7	3.7	3.5	3.2	2.3	1.5	1.5
Demand impulse from EU funds	0.4	-0.4	0.5	2.1	-0.2	-0.4	-0.9	-0.8	-0.1
Cyclically adjusted net lending (+)/borrowing (−): European Commission 3/	-3.3	-5.3	-6.8	-6.6	-5.1	-2.4	-2.2	-1.8	-1.3
Demand impulse from fiscal operations 3/	1.6	2.0	1.4	-0.2	-1.5	-2.8	-0.2	-0.4	-0.5
Cyclically adjusted net lending (+)/borrowing (−): European Commission/Bank of Lithuania 4/	-3.8	-5.8	-6.3	-6.3	-4.9	-2.2	-2.1	-1.8	-1.3
Demand impulse from fiscal operations 4/	1.8	2.0	0.5	0.0	-1.4	-2.7	-0.1	-0.4	-0.4
Memorandum items:									
Output gap (in percent of potential GDP)	8.5	7.5	-8.0	-4.5	-2.7	-1.9	-0.7	0.0	0.2

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

1/ Based on disaggregated elasticities for different revenue and expenditure components.
2/ Including social contributions retransferred from private pension accounts to PAYG pillar in 2009 and 2010.
3/ Based on the European Commission's aggregated approach and a budget sensitivity parameter of 0.27, estimated by the EC (2009).
4/ Based on the European Commission's aggregated approach and a budget sensitivity parameter of 0.33, estimated by the Bank of Lithuania (2009).

Table 6: Financial Soundness Indicators, 2004-10, Banking System Data

	2004	2005	2006	2007	2008	2009	March 2010
Capital adequacy							
Regulatory capital to risk-weighted assets [1]	12.4	10.3	10.8	10.9	12.9	14.2	15.1
Regulatory Tier 1 capital to risk-weighted assets [1]	10.2	8.9	7.8	7.7	10.2	10.4	10.7
Capital to assets [1]	9.5	7.9	7.6	7.9	9.2	7.9	8.4
Asset quality							
Nonperforming loans to capital [1, 3]	15.5	5.7	9.1	10.0	...	...	...
Nonperforming loans net of provisions to capital [1, 3, 7, 8]	9.2	-2.5	0.7	2.9	...	...	...
Nonperforming loans to total (non-interbank) loans [3]	2.2	0.6	1.0	1.0	...	...	...
Nonperforming loans to capital [1, 4]	...	...	...	...	42.4	202.9	191.5
o/w impaired loans to capital [1, 4]	...	...	...	...	31.8	168.6	157.7
o/w non-impaired loans overdue more than 60 days to capital [1, 4]	...	...	...	...	10.7	34.4	33.8
Nonperforming loans net of provisions to capital [1, 4, 8]	...	...	...	...	31.6	128.5	119.9
Nonperforming loans to total (non-interbank) loans [4]	...	...	...	...	4.6	19.3	19.2
o/w impaired loans to total (non-interbank) loans [4]	...	...	...	...	3.4	15.8	15.8
o/w non-impaired loans overdue more than 60 days to total (non-interbank) loans [4]	...	...	...	...	1.1	3.5	3.4
Impairment losses to total (non-interbank) loans7[, 8]	0.86	0.89	0.89	0.74	1.20	7.2	7.4
Impairment losses to nonperforming loans [3, 4, 7, 8]	39.9	146.5	92.5	72.2	26.46	37.1	38.5
Sectoral distribution of loans to total loans							
Agriculture, hunting, forestry	2.0	2.0	1.9	1.7	2.1	1.9	1.9
Fishing	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Mining and quarrying	0.2	0.2	0.1	0.1	0.2	0.2	0.2
Manufacturing	17.5	15.2	11.9	9.9	10.7	10.3	10.3
Electricity, gas and water supply	6.4	4.2	2.5	2.2	1.9	1.9	1.9
Construction	2.9	3.9	5.7	4.1	3.8	3.1	3.2
Wholesale and retail trade; repair of motor vehicles, motorcycles; personal & household appliances	15.7	13.0	12.8	10.7	10.7	9.7	9.5
Hotels and restaurants	1.6	1.5	1.6	1.4	1.6	1.7	1.7
Transport, storage and communication	2.3	2.6	2.5	2.2	2.5	2.6	2.6
Financial intermediation	10.8	14.6	7.3	5.5	6.3	4.0	3.8
Real estate, renting and other business activities	9.8	12.5	14.5	16.8	18.4	20.2	20.0
Public administration and defence; compulsory social security	4.1	3.3	1.5	1.3	2.1	2.2	2.3
Education	0.1	0.1	0.0	0.0	0.3	0.1	0.1
Health and social work	0.8	0.5	0.3	0.3	0.2	0.3	0.3
Other utilities, social and personal services	0.9	0.7	0.9	0.9	0.9	1.0	1.0
Other types of economic activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans not attributed to economic activities	24.9	25.8	36.4	42.9	38.4	40.9	41.5
Residential real estate loans to total (non-interbank) loans	18.4	21.3	24.7	27.8	29.1	33.2	33.6
Large exposures to regulatory capital [1]	199.6	239.0	189.6	152.7	129.4	114.9	109.6
Earnings and profitability							
RoE [1, 2]	13.52	13.58	20.29	25.93	13.54	-48.4	-16.6
RoA [2]	1.20	1.04	1.32	1.71	1.01	-4.2	-1.1
Interest margin to gross income	48.1	50.8	52.0	55.8	62.2	50.4	39.3
Noninterest expenses to gross income	69.2	64.4	56.3	49.8	52.7	59.0	58.6
Trading and foreign exchange gains (losses) to gross income	8.6	8.3	9.0	8.1	3.2	14.1	10.5
Personnel expenses to noninterest expenses	40.5	41.2	41.4	43.6	42.4	39.8	41.1
Liquidity							
Liquidity ratio (liquid assets to current liabilities)	41.7	42.9	41.9	43.5	39.0	49.9	45.1
Liquid assets to total assets	28.3	26.9	24.1	21.9	18.6	23.7	22.7
Current liabilities to total liabilities	74.2	67.5	61.9	54.2	51.4	50.5	54.0
3-month VILIBOR-EURIBOR spread, b.p. 5	49	5	7	230	700	320.0	109.6
Spread between highest and lowest interbank rate, b.p. 6	170	330	277	690	1650	970.0	975.0
Customer deposits to total non-interbank loans	102.5	88.2	77.8	66.4	53.5	66.9	69.0
Foreign exchange risk							
Foreign-currency-denominated loans to total (non-interbank) loans	58.3	65.8	52.8	55.6	64.6	73.9	74.1
Foreign-currency-denominated liabilities to total liabilities	45.5	51.6	51.9	56.2	63.3	61.6	60.8
Net open position in foreign exchange to regulatory capital [1]	-1.88	-0.96	-1.39	-2.43	0.39	0.8	0.9

Source: Bank of Lithuania.

1/ Without foreign bank branches.
2/ Total profits (losses) after tax. Interim quarterly results are annualised.
3/ From end-2005 to Q1-2008, NPLs are loans with payments on which are overdue more than 60 days. Until 2004 NPLs are loans in Substandard, Doubtful and Loss loans categories.
4/ Non-performing loans are defined as the sum of the impaired loans and those non-impaired loans that are overdue more than 60 days. New series not comparable to the previous ones.
5/ Data as of the end of period.
6/ Information is based on interbank deals of all maturities (mostly overnights) made between resident banks in Litai within the last quarter of the period.
7/ 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 turn negative.
8/ Specific provisions include allowances for both individually and collectively assessed loans.

APPENDIX: DEBT SUSTAINABILITY ANALYSIS

Table 1. Lithuania: Public Sector Debt Sustainability Framework, 2005-2015
(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	18.4	18.0	16.9	15.6	29.5	**39.1**	**40.2**	**41.5**	**41.9**	**41.4**	**40.4**	**0.2**
o/w foreign-currency denominated	13.0	14.5	14.1	12.9	27.0	35.2	34.5	34.9	34.3	33.1	32.3	
Change in public sector debt	-1.0	-0.4	-1.1	-1.3	13.8	9.6	1.1	1.4	0.3	-0.4	-1.0	
Identified debt-creating flows (4+7+12)	-0.6	-3.3	-3.5	1.8	10.9	7.1	4.4	1.4	0.3	-0.4	-1.0	
Primary deficit	-0.3	-0.3	0.3	2.6	7.9	6.1	3.4	0.4	-0.1	-0.6	-1.1	
Revenue and grants	32.8	33.1	33.8	34.2	34.3	34.0	34.9	35.3	34.3	33.6	33.5	
Primary (noninterest) expenditure	32.5	32.8	34.1	36.8	42.2	40.1	38.3	35.6	34.2	33.0	32.5	
Automatic debt dynamics 2/	0.1	-2.8	-3.5	-0.7	3.7	1.0	0.9	1.0	0.4	0.2	0.1	
Contribution from interest rate/growth differential 3/	-1.7	-1.7	-2.2	-1.3	4.3	1.0	0.9	1.0	0.4	0.2	0.1	
Of which contribution from real interest rate	-0.4	-0.4	-0.7	-0.8	1.5	1.6	2.2	2.0	1.7	1.5	1.5	
Of which contribution from real GDP growth	-1.3	-1.3	-1.5	-0.4	2.8	-0.6	-1.2	-1.0	-1.3	-1.4	-1.4	
Contribution from exchange rate depreciation 4/	1.8	-1.1	-1.3	0.5	-0.6	...	...	...	...	...	...	
Other identified debt-creating flows	-0.4	-0.2	-0.3	-0.1	-0.8	0.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.4	-0.2	-0.3	-0.1	-0.8	0.1	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.4	2.9	2.3	-3.1	3.0	2.5	-3.3	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	56.1	54.5	50.0	45.7	86.0	115.0	115.2	117.7	122.1	123.4	120.5	
Gross financing need 6/	4.8	5.9	3.2	6.4	14.7	12.6	11.8	11.6	11.2	9.1	10.4	
in billions of U.S. dollars	1.2	1.8	1.2	3.0	5.5	4.7	4.5	4.6	4.6	3.9	4.7	
Scenario with key variables at their historical averages 7/						**39.1**	**36.4**	**37.1**	**37.7**	**38.4**	**39.0**	**-0.7**
Scenario with no policy change (constant primary balance) in 2010-2015						**39.1**	**41.4**	**48.5**	**55.1**	**61.4**	**67.7**	**0.4**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	7.8	7.8	9.8	2.8	-14.8	2.1	3.3	2.6	3.2	3.5	3.6	
Average nominal interest rate on public debt (in percent) 8/	4.8	4.6	4.6	4.3	5.4	5.9	6.4	6.4	6.3	5.9	5.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.8	-2.0	-3.9	-5.3	8.3	5.5	5.8	5.2	4.4	4.0	3.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-12.9	10.6	11.6	-3.8	3.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	6.6	6.5	8.5	9.7	-2.9	0.4	0.6	1.3	1.8	2.0	2.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	8.3	8.9	14.1	10.8	-2.4	-3.0	-1.2	-4.6	-1.0	-0.2	2.0	
Primary deficit	-0.3	-0.3	0.3	2.6	7.9	6.1	3.4	0.4	-0.1	-0.6	-1.1	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

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

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

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

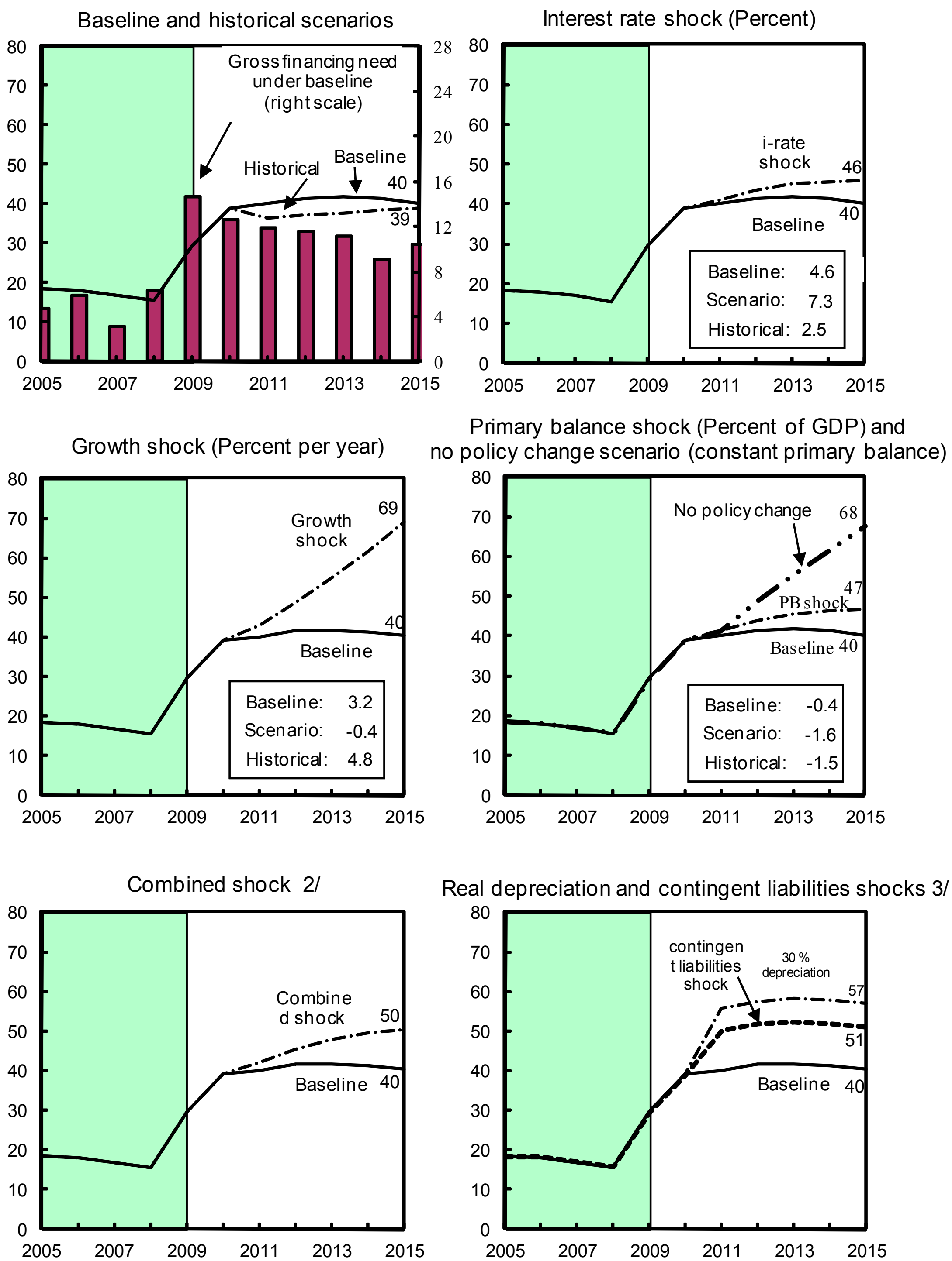
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

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



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 2. Lithuania: External Debt Sustainability Framework, 2005-2015
(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	51.3	60.6	72.2	73.5	87.2	**89.5**	**84.5**	**82.4**	**80.9**	**78.9**	**76.6**	**-4.5**
Change in external debt	8.2	9.3	11.6	1.3	13.6	2.3	-4.9	-2.1	-1.5	-2.0	-2.3	
Identified external debt-creating flows (4+8+9)	-0.3	-0.7	4.0	2.5	13.4	-3.1	-2.9	-2.8	-2.8	-2.5	-1.6	
Current account deficit, excluding interest payments	6.4	10.0	13.8	11.1	-4.9	-2.3	-2.5	-2.0	-1.0	0.0	1.3	
Deficit in balance of goods and services	7.2	10.3	13.4	10.9	0.7	-0.5	-0.8	-0.8	-0.3	0.3	1.1	
Exports	57.5	59.0	54.0	60.2	54.4	67.0	70.5	71.7	72.6	73.3	74.0	
Imports	64.7	69.3	67.4	71.1	55.1	66.5	69.8	70.8	72.3	73.6	75.1	
Net non-debt creating capital inflows (negative)	-1.8	-4.7	-0.7	-1.3	1.9	-0.7	0.1	-1.0	-1.6	-2.1	-2.3	
Automatic debt dynamics 1/	-4.9	-6.0	-9.0	-7.4	16.4	-0.1	-0.5	0.2	-0.2	-0.5	-0.5	
Contribution from nominal interest rate	0.7	0.6	0.7	0.8	1.1	1.6	2.3	2.3	2.3	2.2	2.1	
Contribution from real GDP growth	-2.9	-3.5	-5.0	-1.8	13.1	-1.8	-2.8	-2.1	-2.5	-2.7	-2.7	
Contribution from price and exchange rate changes 2/	-2.7	-3.1	-4.7	-6.4	2.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	8.5	10.0	7.6	-1.2	0.3	5.4	-2.0	0.7	1.3	0.5	-0.6	
External debt-to-exports ratio (in percent)	89.2	102.7	133.7	122.2	160.1	133.6	119.9	115.0	111.5	107.6	103.6	
Gross external financing need (in billions of US dollars) 4/	6.1	10.3	15.0	15.9	10.8	11.3	10.4	10.7	9.0	9.0	10.4	
in percent of GDP	29.0	42.8	52.4	49.3	40.6	41.2	36.7	36.3	29.0	27.5	30.0	
Scenario with key variables at their historical averages 5/						**89.5**	**85.1**	**84.0**	**83.9**	**83.0**	**81.4**	**-8.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	7.8	7.8	9.8	2.8	-14.8	2.1	3.3	2.6	3.2	3.5	3.6	
GDP deflator in US dollars (change in percent)	6.6	6.5	8.5	9.7	-2.9	0.4	0.6	1.3	1.8	2.0	2.1	
Nominal external interest rate (in percent)	1.8	1.4	1.4	1.2	1.2	1.9	2.7	2.9	2.9	2.9	2.9	
Growth of exports (US dollar terms, in percent)	27.0	17.9	9.2	25.5	-25.2	26.1	9.4	5.6	6.4	6.7	6.7	
Growth of imports (US dollar terms, in percent)	26.1	23.1	15.9	18.9	-35.8	23.6	9.0	5.5	7.3	7.5	7.9	
Current account balance, excluding interest payments	-6.4	-10.0	-13.8	-11.1	4.9	2.3	2.5	2.0	1.0	0.0	-1.3	
Net non-debt creating capital inflows	1.8	4.7	0.7	1.3	-1.9	0.7	-0.1	1.0	1.6	2.1	2.3	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

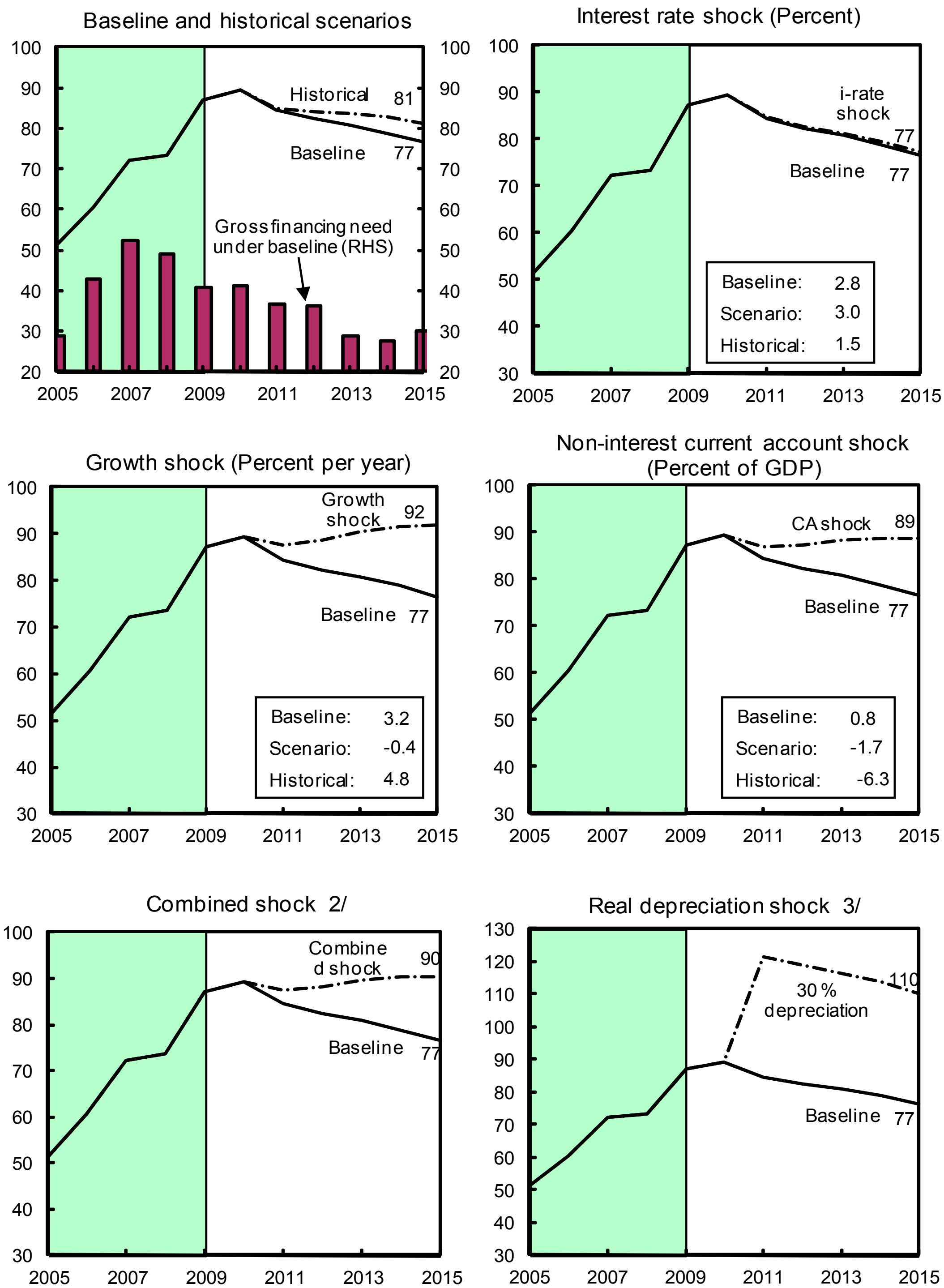
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the European Department

July 6, 2010

Contents | Page

APPENDIX I. LITHUANIA: FUND RELATIONS

(As of April 30, 2010)

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

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

III. SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	137.24	100.00
Holdings	137.31	100.05

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

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

VI. Projected Payments to Fund: None

VII. Implementation of HIPC Initiative: Not applicable.

VIII. Implementation of MDRI Assistance: Not applicable.

IX. Current Status of Safeguards Assessments:

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

X. Exchange Arrangements:

The currency of Lithuania is the litas. From April 1, 1994 to February 1, 2002, the litas was pegged to the U.S. dollar at LTL 4 per U.S. dollar under a currency board arrangement. Since February 2, 2002 the litas has been pegged to the euro at LTL 3.4528 per euro. Lithuania joined the European Union (EU) on May 1, 2004, and ERM II on June 28, 2004. Lithuania has accepted the obligations of Article VIII of the Fund’s Articles of Agreement and maintains an exchange system free of restrictions on the making of payment and transfers for current international transactions except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

XI. Article IV Consultation:

Lithuania is on the 12-month consultation cycle. The last Article IV consultation was concluded on August 7, 2009. The Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2009/pn09104.htm and the staff report and other mission documents at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23437.0

XII. FSAP Participation and ROSCs:

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

XII. Technical Assistance:

The table on the following page summarizes the technical assistance missions provided by the Fund to Lithuania since 2000.

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

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

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

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1998–2010

Department	Issue	Action	Date	Counterpart
STA	Balance of payments statistics (also covering Latvia)	Mr. Buxton	Resident Advisor, October 1999–October 2000	Bank of Lithuania
LEG	Bankruptcy legislation	Mr. Dimitrachkov	March 2000	Ministry of Economy
FAD	Establishment of Fiscal Reserve Fund	Mission	July 2000	State Privatization Fund
MAE	Multi-topic	Mission	March 2001	Bank of Lithuania
FAD	Tax policy issues	Mission	June 13–26, 2001	Ministry of Finance
STA	ROSC	Mission	May 8–22, 2002	Department of Statistics, Ministry of Finance, and Bank of Lithuania
FAD	ROSC	Mission	July 10–23, 2002	Ministry of Finance
FAD	Treasury Operations	Mr. Ramachandran	Nov 22–Dec 5, 2004	Ministry of Finance
FAD	Decentralization	Mission	Dec 3–15, 2004	Ministry of Finance
STA	External debt statistics	Mission	Aug 2–4, 2006	Bank of Lithuania
MCM	Stress testing	Mr. Miguel A. Segoviano Basurto	June 11–21, 2007	Bank of Lithuania
STA	External debt statistics	Mission	November 8–19, 2007	Bank of Lithuania
FAD	Public expenditure review	WB mission / Ms. Budina (FAD) participation	April 14–24, 2009	Ministry of Finance
FAD	Tax Administration	Mission	Aug 26–Sept. 8, 2009	Ministry of Finance
MCM/LEG	Bank Resolution/Banking Law	Mission	Sept. 28–Oct. 6, 2009	Bank of Lithuania/Ministry of Finance
FAD	Reform of Social Security and Health Funds	Mission	April 6-20, 2010	Ministry of Finance/State Social Insurance Fund Board
LEG	Capacity Building	Mission	April 30–May8, 2010	

APPENDIX II: LITHUANIA: WORLD BANK RELATIONS

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

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

More recently, in response to the global crisis, the Bank delivered a number of analytical works to support the Government of Lithuania's efforts to manage the economic downturn. A rapid-response public expenditure review of the social sectors was prepared in May 2009 to help the government prepare the 2010 budget and protect vulnerable citizens through the social safety net. The report recommends fiscal consolidation and reforms that would generate immediate fiscal savings while making social sector spending more efficient and equitable. This work was followed by related technical assistance to help the Ministry of Health identify options to reduce pharmaceutical expenditure. In addition, the Bank prepared a Financial Sector Vulnerability Assessment in early 2010 focusing on the overall credit portfolio and liquidity condition of banks as well as the regulatory framework and institutional measures and the role of bank supervisors.

APPENDIX III. LITHUANIA: STATISTICAL ISSUES

Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are adequate for surveillance purposes.

Lithuania subscribed to the Special Data Dissemination Standard (SDDS) in May 1996, and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) since April 1997. Lithuania meets the SDDS specifications for coverage, periodicity and timeliness of the data, and for the dissemination of the advance release calendars. A significant amount of economic and financial information is now available on various websites through the Internet (see section on Dissemination of Statistics, below). A ROSC data module was published in November 2002.

National Accounts

The national accounts are compiled by Statistics Lithuania (SL) (the former Department of Statistics) in accordance with the guidelines of the *European System of Accounts 1995* (*ESA 95*). Quarterly GDP estimates at current and at constant prices are compiled using both the production and expenditure approaches. GDP estimates by production are considered to be more reliable than the corresponding estimates by expenditure, but no statistical discrepancies between these two estimates are shown separately in the published figures as the discrepancies are included in the estimates of changes in inventories. The annual and the quarterly national accounts are compiled at previous year prices and chain-linked to 2000. In general, good data sources and sound methods are used for the compilation of the national accounts, but measuring activity in the current volatile environment is proving very challenging. Moreover, difficulties remain in measuring the economic activity of the informal sector. These estimates are compiled at detailed levels of economic activity using fixed coefficients derived from a benchmark surveys conducted in 1996 and 2003, and updated in 2006. A further update of the size of the informal sector is expected to be released in late 2010-early 2011.

Price Data

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

Public Finance

Data on the central government budget execution are available at a monthly and quarterly frequency, although these data are subject to frequent revisions. The ongoing treasury project is expected to improve fiscal data quality substantially. However, further work is needed to clarify the treatment of public health care providers and of EU transactions, and the consolidation procedure for government operations. A new classification, incorporating the *GFSM2001* was approved in mid-2003. Since then, the MoF has been reporting to STA general government's annual data on an accrual and cash basis (except for local governments, which are still on a cash basis) for publication in the *Government Finance Statistics Yearbook* (GFSY). In addition, the MoF has been reporting quarterly and monthly data in the GFSM 2001 format for publication in the IFS.

Monetary and Financial Statistics

The Bank of Lithuania (BoL) reports monetary and financial statistics (MFS) to STA on a timely and regular basis. The scope, concepts and definitions of the MFS are broadly in line with the guidelines of the *Monetary and Financial Statistics Manual (MFSM)*. Following Lithuania's accession to the European Union, the BoL implemented the ECB framework for compiling and reporting monetary data reflecting the ECB regulations and *ESA 95* on sectorization, valuation and classification of financial instruments.

External Sector

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

Dissemination of Statistics

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

- metadata for data categories defined by the Special Data Dissemination Standard are posted on the IMF's DSBB (http://dsbb.imf.org);

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

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

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

LITHUANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE—AS OF JULY 2ND, 2010

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	July 2nd, 10	July 2nd, 10	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 10	July 7th, 10	M	M	M		
Reserve/Base Money	May 10	June 14th, 10	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	May 10	June 29th, 10	M	M	M		
Central Bank Balance Sheet	May 10	June 14th, 10	M	M	M		
Consolidated Balance Sheet of the Banking System	May 10	June 29th, 10	M	M	M		
Interest Rates[2]	July 2nd, 10	July 2nd, 10	M	M	M		
Consumer Price Index	June 10	July 8th, 10	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q1/10	June 22nd, 10	Q	Q	Q	LO,LO,LO,O	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	May 10	June 30th, 10	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	May 10	June 30th, 10	M	M	M		
External Current Account Balance	Q1/10	June 19th, 10	Q	Q	Q	O, O, LO, O	O, O, O, O, O
Exports and Imports of Goods and Services	April 10	June 9th, 10	M	M	M		
GDP/GNP	Q1/10	May 28th, 10	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q1/10	June 19th, 10	Q	Q	Q		
International Investment Position	Q1/10	June 19th, 10	Q	Q	Q		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Reflects the assessment provided in the data ROSC (published on November 22, 2002, and based on the findings of the respective missions that took place during May 8-22, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO)

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/80
FOR IMMEDIATE RELEASE
July 8, 2010

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

IMF Executive Board Concludes 2010 Article IV Consultation with the Republic of Lithuania

On July, 06, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Lithuania.[1]

Background

A determined policy response helped Lithuania weather the crisis. The country experienced a severe output decline in 2009 as a reversal in capital flows led to a collapse of domestic demand and the global recession caused exports to fall. Output dropped by 14.8 percent in 2009 and by 20 percent from peak to trough. The adjustment of the economy has been large and swift. The current account swung from a sizeable double-digit deficit to a surplus of nearly 4 percent of GDP in 2009. Inflation quickly ebbed, with core prices now falling for over a year. Wages have also declined sharply and unemployment rose to very high levels.

A large fiscal consolidation with measures worth about 10 percent of GDP in the 2009–10 budgets contained the fiscal deficit to 8.9 percent of GDP in 2009. The early and sizeable

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

fiscal adjustment was rewarded with access to international bond markets at declining cost. Still, the public debt burden has doubled, reaching 33 percent of GDP at end-March 2010. In the financial sector, capital and liquidity indicators have improved aided by new capital injections. However, asset quality has suffered. The non-performing loan ratio rose almost four-fold from end-2008 to 19.2 percent by end-March 2010. Provisions in the system increased to about 40 percent of the non-performing loan stock but banks are making large losses and credit is contracting.

Lithuania is now benefitting from the global recovery. Recent data are encouraging, with signs that an economic recovery is starting to take hold. In 2010, real GDP is expected to grow by 2 percent on the back of an export-led recovery. Deflation in core CPI is expected to persist, although higher energy and food prices will leave headline inflation close to zero. Over the medium term, domestic demand is likely to remain subdued amid high unemployment, falling incomes, and weak credit prospects. As such, a return to pre-crisis growth rates is unlikely and real GDP is only expected to recover its pre-crisis levels in 2014/15.

Executive Board Assessment

Executive Directors commended the authorities for their decisive fiscal and financial sector policies during the crisis, which helped stabilize the economy and generate a recovery. Notwithstanding encouraging signs, the Lithuanian economy faces important challenges of high fiscal deficits and rapidly growing public debt as well as a high stock of non-performing bank loans. In addition, growth needs to rebalance towards exports. Addressing these challenges will sustain the recovery and facilitate euro adoption.

Directors commended the large fiscal consolidation implemented in the 2009 and 2010 budgets. Nevertheless, further consolidation is critical to maintain confidence, reduce borrowing needs, and place debt on a sustainable path. Directors recommended a timely announcement of a package of specific expenditure and revenue measures so as to underpin the credibility of the consolidation path and ensure that it is achieved in a sustainable, growth-friendly, and equitable manner.

Directors emphasized that far-reaching reform of the social insurance system will be necessary to tackle its large deficit. They saw scope to reduce generous social benefits and restore the viability of the pension system by increasing the retirement age and gradually moving towards a mandatory funded system, while ensuring adequate funding for the minimum basic pension. Expenditure adjustment will need to be complemented with revenue enhancing measures as part of a broad-based package. In particular, it will be important to exploit new, less distortive revenue sources, such as wealth taxes and to strengthen tax compliance.

Directors noted that, overall the financial sector had weathered the crisis well, with both liquidity and capital indicators improving despite rising levels of non-performing loans. They cautioned however that some banks are not as well provisioned and capitalized, and also face pressure on interest rate margins. Directors considered it important that banks be subjected to forward-looking stress tests to ensure their viability. They commended the ongoing efforts to fine-tune the legal framework to facilitate voluntary debt restructuring and cautioned against mandatory moratoriums on debt payments that risk increasing the level of non-performing loans in the banking system.

Directors emphasized that export performance would be key to future growth. They noted that Lithuania's success in preserving cost competitiveness during the boom was supported also by adjustment and on-going decline in wages. This has contributed to the credibility of the currency board arrangement as an anchor for macroeconomic policy. Directors nevertheless emphasized that continued progress in structural reforms was needed to reorient the economy towards tradeables as a source of growth.

Directors stressed that high and rising levels of unemployment call for decisive action. They supported the plans to enhance labor market flexibility and proposals in parliament to expand fixed-term contracts, ease dismissal requirements, and allow greater flexibility in overtime. Effective use of European Union funds to support job creation will be crucial. Directors also welcomed initiatives to improve the business climate and attract foreign direct investment. These initiatives, coupled with ongoing structural reforms, would enhance medium-term growth prospects.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Republic of Lithuania: Selected Economic Indicators

	2007	2008	2009	2010 Projections
Real Economy				
Real GDP growth	9.8	2.8	-14.8	2.1
CPI inflation, end of period	8.2	8.5	1.2	-0.1
Unemployment rate (year average, in percent of labor force)	4.0	5.9	13.7	18.0
Public Finance	(In percent of GDP)			
General government balance	-1.0	-3.3	-8.9	-7.8
General government gross debt	16.9	15.6	29.5	39.1
Foreign currency-denominated public debt	14.1	12.9	27.0	35.2
Balance of Payments	(In percent of GDP, unless otherwise specified)			
Trade balance for goods	-15.0	-12.1	-2.9	-1.7
Current account balance	-14.5	-11.9	3.8	0.6
Gross official reserves (in billions of euros)	5.2	4.4	4.6	5.2
Exchange Rates	(Litai per U.S. dollar, unless otherwise specified)			
Exchange rate (end of period)	2.36	2.45	2.37	…
Exchange rate (period average)	2.52	2.36	2.48	…
Real effective exchange rate (2000=100, increase=appreciation)	107.1	114.9	122.8	…
Money and Credit	(Year-on-year percent change)			
Reserve money	21.1	-1.4	-17.2	5.7
Broad money	21.7	-0.4	0.3	9.4
Private sector credit	45.3	17.8	-6.9	-6.4

Sources: Lithuanian authorities; and IMF staff estimates.

Statement by Mr. Per Callesen, Executive Director for the Republic of Lithuania and Mr. Rimtautas Bartkus, Advisor to the Executive Director
July 6, 2010

The Lithuanian authorities extend high appreciation to Ms. Purfield and her team for their distinguished cooperation and well-written report. The authorities highly value staff's assessment of the country's economic and financial policies and their professional advice, which they take into account when considering policy options.

Economic outlook

Lithuania experienced sharp output contraction in 2009 as the global financial and economic crisis deepened the cyclical economic downturn. Domestic demand plunged due to undergoing internal adjustment after a period of excessive growth in the non-tradable sector, whereas exports were negatively affected by the global recession. Private consumption shrank reflecting reduced economic sentiment, tighter credit conditions, and lower household disposable income. Investment fell on account of the increased economic uncertainty, changed financial conditions, and deterioration in the real estate market.

The economy started to show clear signs of stabilization in the second half of 2009 and modest recovery is on the way in 2010. Positive quarterly output growth was recorded for the last two quarters of 2009. Although this welcomed trend was temporarily interrupted in the first quarter of 2010, in large part due to the impact of the closure of the Ignalina Nuclear Power Plant (INPP), it is expected to resume as early as from the next quarter. Exports staged a strong recovery, as the external demand has improved, and were 17.2 percent higher for the first four months of 2010, compared with the same period a year ago. Confidence indicators strengthened markedly, retail sales stabilized and lately started to increase, housing prices are bottoming-out as well. Increased absorption of the EU structural funds shall further support economic recovery and re-orientation towards the tradable sector. The authorities project the economy to expand by 0.5–1.6 percent this year, with more pronounced real GDP growth (about 3 percent) expected in 2011.

Substantial external adjustment occurred in 2009 and the current account reversed from a large deficit into surplus. Changes in the current account were mostly driven by considerably lower trade deficit and higher EU related current transfers. The authorities project the current account balance to remain positive (1.5 percent of GDP) in 2010 and turn slightly negative in 2011–12 to -0.6 and -1.3 percent of GDP, respectively.

Lithuania maintained external competitiveness, which is best illustrated by the developments in export market shares. Export market shares temporary contracted in the first half of 2009 as currencies in some of the export markets experienced steep depreciation, but fully recovered later on and reached, or even exceeded, the level of 2007–08. The Lithuanian industries reacted to changed internal and external economic conditions by re-orientating from domestic demand and successfully finding new export markets. The fastest recovery has been observed in the manufacturing sectors, having higher intensity to modern technologies. Lithuania more than doubled its share in global exports over the last decade and its tradable sector already comprises a high share of GDP (about 40 percent).

Fiscal consolidation and structural expenditure reforms

In response to the worsening revenue outlook and increasing expenditure pressures, the authorities implemented ambitious fiscal consolidation in 2009–10. Forceful policy measures, amounting to 12 percent of GDP, helped to contain deterioration in public finances and limited accumulation of debt. By facilitating orderly adjustment in the economy it also provided necessary support to the credibility of the currency board. Convincing consolidation measures helped to enhance market confidence, as has been demonstrated by the successful issuance of government bonds during periods of heightened market uncertainty, also by general narrowing of spreads, CDS risk premiums and improved outlook for sovereign credit ratings in early 2010.

The authorities carefully considered the design of measures being implemented, with particular emphasis given to their quality and social sensitiveness. Approximately 1/5 of the measures undertaken were revenue increasing, with the rest falling on expenditures. Most important revenue measures were the abolishment of reduced VAT rates and a general rate increase, also changes to excises. These measures have lower impact on the tradable sector and therefore could be seen as contributing to economic reorientation. After initial cuts more targeted and progressive cuts in the public sector wages, pensions, and social benefits followed. Some of the cuts, for example in parental benefits, were reversing previous unsustainable increases in the level of benefits. While part of the measures implemented are considered to be temporary, such as reduced transfers to private pension funds (Pillar II) and, to some extent, wage and pension cuts, they will be extended until permanent solutions are found.

Increased absorption of the EU structural funds plays an important non-deficit increasing role in stimulating the Lithuanian economy. The absorption of EU funds was almost 5 times higher in 2009, compared with 2008, and is expected to reach its peak in 2010–11. A signed loan agreement with the European Investment Bank provides additional EUR 1.1 billion available for national co-financing of the EU supported investment projects in the public sector, thereby reducing domestic financing constrains.

The authorities are fully aware that despite substantial measures already implemented, further consolidation efforts will be needed to meet their 3 percent of GDP fiscal deficit target by 2012 and to stabilize debt at a sustainable low level. The authorities are strongly committed to undertake further measures to tackle the remaining challenges and recognize that the most important challenges are in the social sector. The authorities are already well advanced in implementing comprehensive efficiency-enhancing structural expenditure reforms in education and health care sectors, whereas the reform of the social security and pension system is under way. Initial guidelines of the public administration reform were also introduced to society. The authorities are confident that successful implementation of these reform plans will put the economy on a stronger footing and will contribute to its competitiveness.

In June, the government approved the concept of comprehensive social security and pension system reform, which discusses proposals to enhance efficiency and long term sustainability of the social security and pension system, while maintaining an adequate level of benefits. It is expected to reach an agreement on the key reform measures through 2010. Proposals for the pension system reform seek to address aging related challenges, increase transparency and predictability of the system, reduce its vulnerability, and provide better incentives for the participants. The most important measures include strengthening the link between contributions and benefits, amending indexation rules and simplifying the pension formula, eliminating duplicate payments, and making clearer delineation between funded part of the system and basic social pension, with the latter being financed from the budget.

The first phase of the reform has already started as the government submitted a package of proposals to the parliament that foresee gradual increase in the retirement age starting from 2012, elimination of some duplicate payments, further extension of previously introduced cuts in the public sector wages and reduction in the level of sickness benefit. It is also proposed to cap generous parental benefits, while providing more flexibility to choose the duration of the benefit. Reduced transfers to Pillar II will remain in place as an interim measure until a generally improving economic situation and implemented reform measures will reduce tensions in the pension system to an acceptable level.

The authorities are also considering revenue enhancing measures proposed by staff and measures to strengthen the fiscal framework. Based on the guidelines prepared by the Ministry of Finance, the authorities started public discussions with social partners on the feasibility and timing of the possible broad-based real estate tax to natural persons. The authorities also stepped up efforts to enhance tax administration and compliance. Conceptual proposals to strengthen the budget planning and execution framework have been drafted by the authorities. It is proposed to introduce fiscal stance and impulse indicators in the budgetary planning process, also binding rules for anti-inflationary fiscal policy, taking into account the assessment of the output gap. Expenditure execution framework should be enhanced by more stringent expenditure evaluation criteria, improved cost-benefit analysis, and strategic planning.

Monetary and financial sector issues

Lithuania's financial system weathered the impact from the global financial crisis and is well positioned to withstand further potential shocks. Lithuania benefited from deep financial integration in the Nordic-Baltic region, with strong presence of reputable Scandinavian banks, holding 80 percent of the total banking system assets, contributing to systemic stability. Banks operating in Lithuania follow a more conservative retail-banking business model and supervision of credit institutions is in line with international standards, as has been so noted in the 2007 FSAP update. The risk of debt overhang as an impediment to economic recovery and reorientation towards the tradable sector is comparably lower in Lithuania, given, by regional standards, low private sector indebtedness (68 percent of GDP). The currency board arrangement provided an additional source of stability during the times of heightened global uncertainty and remains an important monetary anchor. The authorities see an eventual introduction of the euro as the most credible exit strategy from the currency board and plan their policies in accordance with this objective.

Deterioration of asset quality in the financial institutions mirrors sizeable output contraction and ongoing restructuring in the economy, however despite rapid increase in NPLs all financial institutions were able to absorb incurring losses and none have requested support from the state. The largest shock to the banking system has already been absorbed and the level of NPLs is expected to start stabilizing in the second half of 2010 as the economic growth strengthens. Although the 2010 data indicate that the quality of loan portfolio has been still slightly decreasing, stabilization is getting noticeable. The level of NPLs itself to a large extent could be explained by the structure of the loan portfolio and stricter definition of the non-performing loan category in Lithuania, compared with other countries.

Stability in the banking system as a whole and in individual institutions has improved, since banks have strengthened their capital base and risk management. Last year, the loan portfolio in the banking sector was reassessed conservatively and historically large provisions were made by banks. Notwithstanding large credit losses incurred by banks, the compliance with prudential requirements as well as the resilience to shocks has been improving. Capital adequacy and liquidity ratios of the banking system has reached one of the highest levels in recent years, respectively 15.1 and 45.1 percent (compared with 8 and 30 percent prudential requirements). Developments in deposits also reflect confidence in the banking system. Despite substantially lower interest rates, deposits increased to previously unseen highs, allowing banks to reduce dependence on parent bank funding and increasing liquidity in domestic banks.

The Bank of Lithuania has been monitoring the situation in the banking system closely, with particular emphasis given to the developments in asset quality and banks' shock absorption capacity. Stress-testing has been enhanced and its frequency increased. Banks were asked to update stress-tests semi-annually, with unified stress-testing scenarios being prepared. The contingency and business plans of banks are carefully evaluated based on the stress-testing results and banks will be asked to adjust their business plans if the results of a unified stress-testing will so require. The results of stress-tests carried out this May showed that the capital buffers in the banking system are sufficient to absorb credit losses even under the worst-case scenarios. However, in the worst-case scenario some individual banks would require additional capital injection. The banks plan to increase their capital already this year. The authorities will continue to monitor liquidity, capital adequacy and credit risks closely and will request banks to inject additional capital if needed. Based on the capital strengthening measures currently being implemented and planned for the nearest future, banks will manage to ensure sufficient level of capital without the need for support from the state.

Going forward supervisors will further concentrate their efforts on strengthening the risk management processes in credit institutions. The Bank of Lithuania paid particular attention to risk management and strengthening of capital basis. The Bank of Lithuania has already approved the legal act based on which banks will have to additionally assess their liquidity situation and to ensure sufficient liquidity buffers as well as to evaluate the liquidity counterbalance capacity in order to withstand a liquidity stress in a short, medium and long timeframe. In 2010, new requirements for calculating capital adequacy ratio will enter into effect, which should ensure better assessment of banks capital for covering the risks. New legal acts have been drafted to supplement limitations and management of the concentration risk. Every year, the Supervisory Review and Evaluation Process (SREP) is carried out, and a close assessment is made to evaluate whether banks properly ensure risk management and have sufficient capital to cover it. An SREP for banks that belong to foreign banking groups is performed in cooperation with the foreign supervisory authorities, what allows to assess risks and management methods for the overall banking group.

Additional efforts were undertaken by the authorities to enhance operational preparedness for crisis prevention and management. Contingency planning has been strengthened by adopting the Financial Crises Prevention and Management Plan, which has clarified the role of relevant institutions in crisis prevention and management, enhanced information exchange and established a Crisis Management and Prevention Commission. The crisis resolution framework was further improved by the acceptance of the Financial Stability Law, which defined measures for possible state support and intervention in the financial institutions. More recently, operational by-laws were drafted to support the implementation of the Financial Stability Law and await approval by the European Commission. Cross-border cooperation with the home supervisors of foreign banks operating in Lithuania has been strengthened by signing multiple Memorandums of Understanding, enhancing cooperation in information exchange, jointly participating in the supervisory colleges, and carrying out joint on-site inspections.

The authorities are also putting efforts to facilitate orderly debt restructuring in the private sector. The existing legal framework for corporate restructuring and bankruptcy shall be strengthened, with the aim to provide more flexibility, while strengthening prevention of fraudulent bankruptcies and securing creditors' rights. Based on the technical assistance provided by the Fund, the framework for natural persons' bankruptcy is also under preparation.