March 2005
IMF Country Report No. 05/123

Republic of Lithuania: 2004 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Lithuania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with the Republic of Lithuania, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 10, 2004, with the officials of the Republic of Lithuania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 9, 2005. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 23, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for the Republic of Lithuania.

The document listed below have 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.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for
the 2004 Consultation with the Republic of Lithuania

Approved by Poul Thomsen and Carlos Muniz

March 9, 2005

The Article IV discussions were held in Vilnius during December 1–10, 2004. The mission comprised Messrs. Mody (Head), Bonato, Kontolemis, and Leigh (all EUR) and was assisted by Ms. Brixiova, the Fund's Representative in Lithuania. Mr. Solheim (Executive Director) and Mr. Sidlauskas (Advisor to the Executive Director) joined the discussions. The mission met with President Adamkus, Prime Minister Brazauskas, Finance Minister Butkevicius, Central Bank Governor Sarkinas, members of the Budget Committee of the Parliament, leaders of political parties, trade unions, financial institutions, and foreign investors. The mission overlapped with FAD technical assistance missions on decentralization and treasury management issues.

Lithuania embarked on a Fund-supported program in March 2000 and by 2003 had achieved macroeconomic stability, while also making considerable progress in structural reforms. At the conclusion of the 2003 Article IV consultation, Executive Directors commended the authorities for Lithuania's success and graduation to a nonprogram relationship with the Fund. Nevertheless, Directors noted that unemployment and the external current account deficit remained relatively high. Directors urged the authorities to (a) limit the budget deficit to significantly below 3 percent of GDP; (b) develop a credible medium-term fiscal plan that took into account all outstanding fiscal liabilities, including costs associated with a rapidly aging population; (c) step up structural reforms to sustain long-term growth; (d) enhance the efficiency of the health sector; and (e) solve the underlying problems of municipalities. Some progress has been achieved, but these objectives should be actively pursued.

Lithuania has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions (Appendix I). In accordance with UN Security Council resolutions, Lithuania maintains restrictions and imposes sanctions against individuals, groups, and organizations associated with terrorism.

Lithuania subscribes to the Special Data Dissemination Standard. Data provision is timely and facilitates effective surveillance (Appendix II). The authorities have agreed to the publication of the staff report.

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EXECUTIVE SUMMARY

Background: Lithuania's impressive growth continued unabated in 2004, and GDP expanded by an estimated 6¾ percent, driven by vigorous private consumption and investment growth. Inflation remained low at 1¼ percent in 2004 but was on an accelerating trend toward year's end. The current account deficit widened in 2004 to about 8½ percent of GDP, and the budget deficit expanded from 1¾ percent in 2003 to 2¼ percent of GDP.

Outlook: GDP growth is forecast to reach 7 percent in 2005, underpinned by strong investment and consumption. Utilization of EU funds is expected to add to demand pressures in 2005–06. Increased demand for imports would lead to a further deterioration of the current account deficit, which staff estimates could widen to 9½ percent in 2005 before declining gradually to below 9 percent in the medium term. Inflation will reach some 3 percent in 2005, with some risk that strong domestic demand pressures, administrative price hikes, and higher oil prices could push it even higher. With a buoyant outlook in 2005, a general government deficit below 2 percent of GDP should be easily reachable.

Policy Discussions

Euro adoption: Lithuania is on course to adopt the euro in early 2007. The main risk arises from inflation shocks, which could set the inflation rate temporarily above the Maastricht limit. Bottlenecks in various segments of the economy are adding to demand pressures and to wage demands. The authorities thought it unlikely that accelerating inflation could breach the Maastricht criterion, though they recognized the risk. They took the view that domestic demand pressures would mainly spill over into a larger current account deficit and were concerned primarily about supply-side shocks. Staff argued that the impact of domestic demand pressures on nontradable goods should not be minimized.

Fiscal policy: Staff expressed concern that the authorities had left insufficient space for the operation of automatic stabilizers in the event of economic slowdown. Moreover, the trend decline in revenue/GDP ratio is worrisome, and EU-related cofinancing expenditures are likely to add to the expenditure pressures in 2005-06. In view of the upside risk to inflation, staff recommended a somewhat tighter fiscal stance than envisaged under the 2005 budget and saving of additional revenues in the event of stronger-than-anticipated growth.

Structural policies: Staff urged that the fiscal system be modernized to enhance incentives for increased employment and productivity growth, and supported the authorities' plan to lower the marginal income tax rate from the current 33 percent, though with the caution that the phased reduction should be part of a package that ensures revenue neutrality. The authorities and staff agreed that further measures were needed to improve the financial viability and effectiveness of the social safety and health systems. Efforts were also needed to increase the economy's competitiveness by improving the business climate, especially with respect to greater flexibility of labor contracts, effective deployment of EU transfers for small business development, and deregulation of the education and health sectors.

I. INTRODUCTION

1. **Following severe economic difficulties in 1999, Lithuania accelerated its efforts to make a transition towards a competitive market economy.** With its currency board already in place to provide monetary policy credibility, a major fiscal consolidation was undertaken. Together, these helped lower inflationary expectations, allowing interest rates to come down. A sustained privatization effort and measures to improve the business climate provided impetus for private entrepreneurship and high productivity growth. Lithuania achieved an enviable combination of high growth and low inflation (Figure 1). Important legacies of the central planning era, however, are structural unemployment and an inadequate social support system.

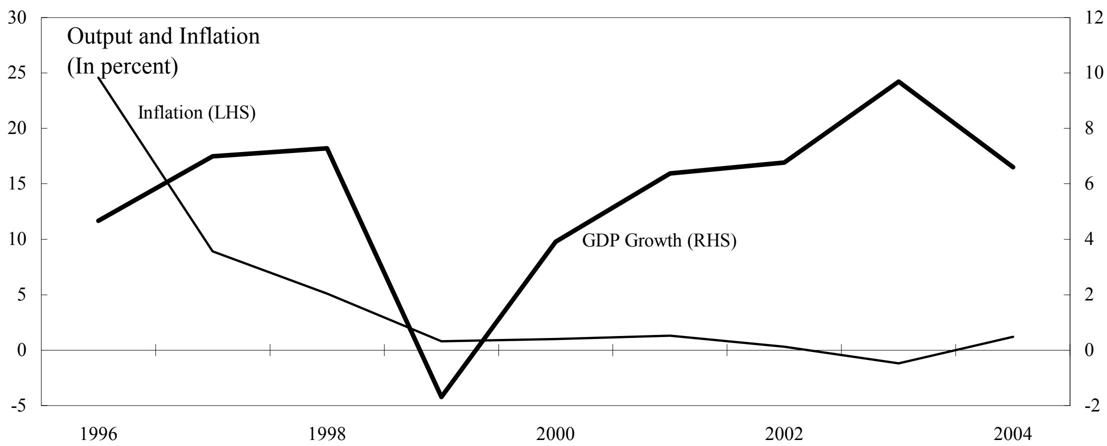
2. **With its accession to the European Union (EU), Lithuania has set itself the goal of achieving advanced European living standards.** Lithuania acceded to the EU on May 1, 2004 and entered the ERM II mechanism on June 28, 2004, as a prelude to possible euro adoption by early 2007. The discipline of the Maastricht criteria has added a further policy anchor to its currency board arrangement. This new anchor is effective because of the wide political support for euro adoption.

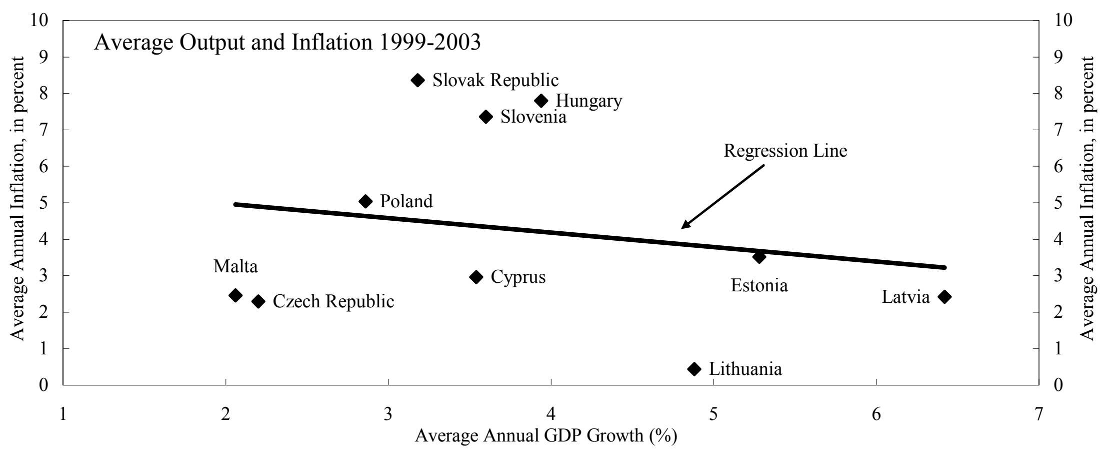
3. **However, the Maastricht quantitative benchmarks are an incomplete guide for the conduct of Lithuanian policies, and complementary domestic measures are required.** Short-term stability requires greater fiscal conservatism than necessary to meet the Maastricht budget deficit target, so as to allow for a safety margin if demand slows unexpectedly and to dampen the stimulating effect of EU funds. Long-term productivity growth requires important structural reforms, many closely tied to fiscal reform and modernization. Because fiscal policy is central to achieving stability and growth, mechanisms to contain competing claims for fiscal resources acquire particular importance.

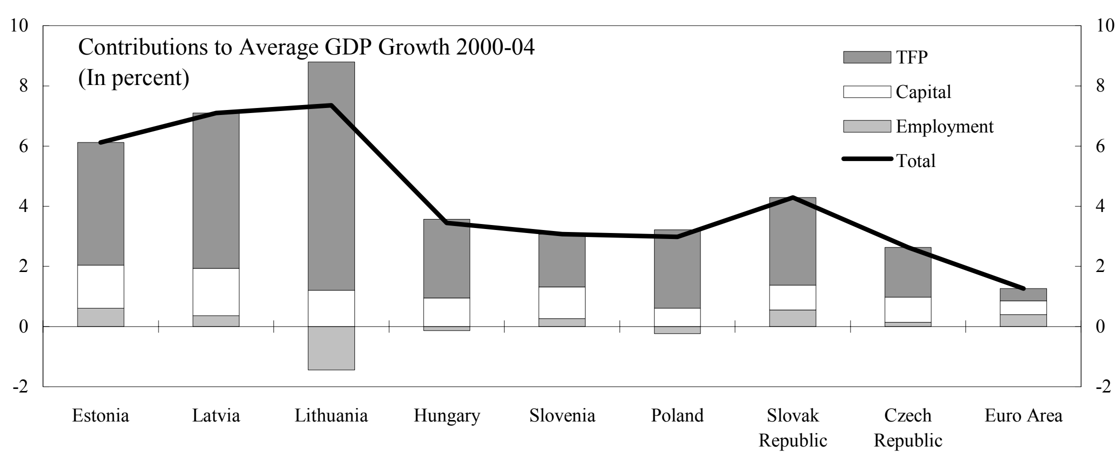
II. RECENT ECONOMIC DEVELOPMENTS

4. **A variety of indicators suggest limited slack in the economy.** Lithuania's impressive growth continued unabated in 2004. GDP expanded by an estimated 6¾ percent in 2004, driven by vigorous private consumption and investment growth (Figure 2). The Lithuanian business cycle has tended to move counter to the European cycle (Text Figure 1), and the recent low interest rates in the euro area have added impetus to the Lithuanian economy. The capacity utilization rate in manufacturing rose in 2004 to some 70 percent, the highest level since 2000. Labor market, inflation, credit, and current account developments also reflect demand pressures.

Figure 1. Lithuania's Impressive Structural Transformation, 1996-2004

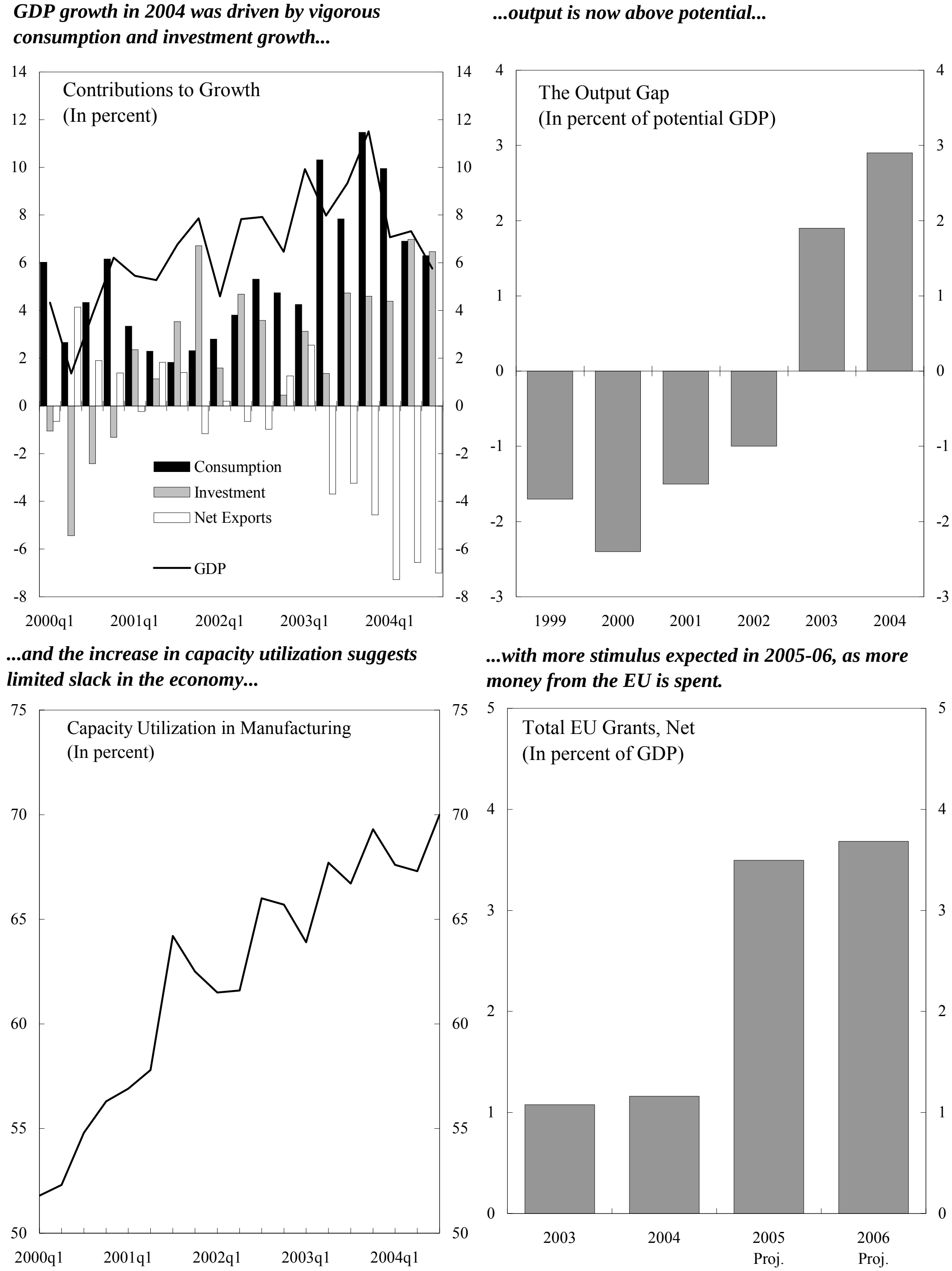






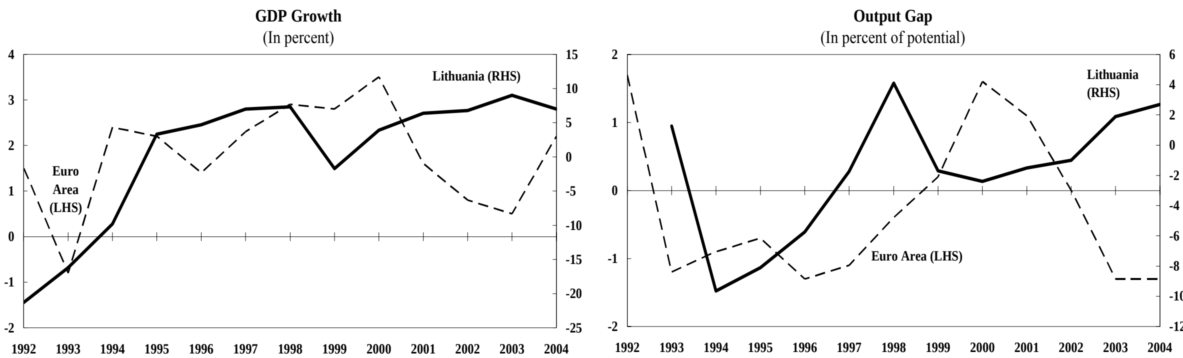
Sources: Lithuanian authorities; IMF staff estimates.

Figure 2. Lithuania: Growth and Cyclical Position, 1999-2006



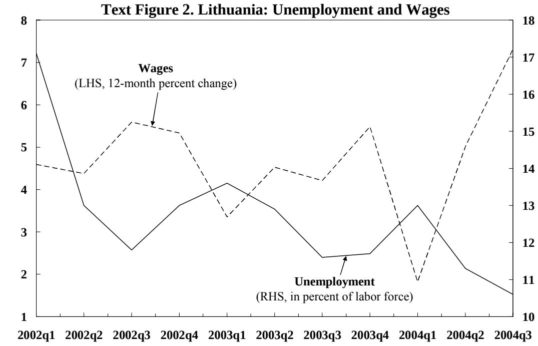
Sources: Lithuanian authorities; and IMF staff estimates.

Text Figure 1. Business Cycles in Lithuania and the Euro Area



5. **Labor markets have tightened.** The unemployment rate is down to 10½ percent (Text Figure 2). Thus, while skill mismatches have kept the unemployment rate high in absolute terms, bottlenecks (in sectors such as construction, financial intermediation, and transportation) have contributed to wage inflation. Emigration is believed to have increased since 2001, and the expected continuation of this trend will have important implications for labor supply and wages.[1]

Text Figure 2. Lithuania: Unemployment and Wages



6. **With strong economic growth and low interest rates, credit has expanded rapidly.** Early in 2004, the speed of credit expansion briefly touched 70 percent on an annual basis but subsequently came down to a still very high 40 percent (Figure 3 and Table 3). Credit to households expanded at a more rapid rate than to the nonfinancial enterprise sector (Text Table 1); however, the bulk of the credit continues to be absorbed by nonfinancial enterprises.

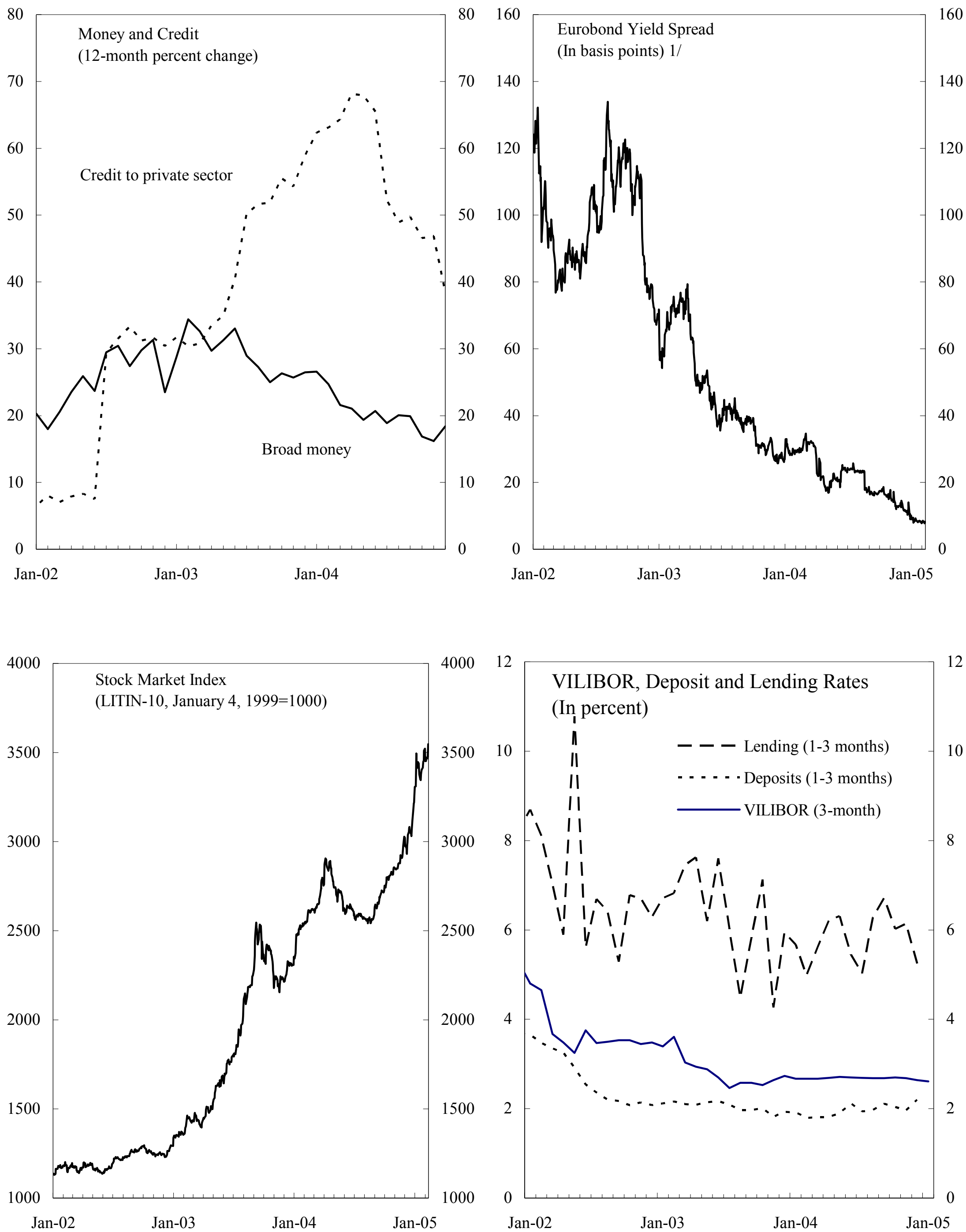
Text Table 1. Lithuania: New Loans to Enterprises and Individuals, 2000-04

	2000	2001	2002	2003	2004 1/
			(in LTL billion)		
Enterprises	3.6	4.5	6.1	7.8	6.6
Individuals	0.5	0.7	1.2	1.9	2.6
o/w: housing loans	0.2	0.4	0.7	1.2	1.6

1/ Data for ten months.

[1] Some 200,000 persons—a little over 10 percent of the active workforce–are thought to have emigrated since the early 1990s. Lithuanian doctors, computer programmers, and construction workers have been in high demand. As entry restrictions in Europe and the United States are relaxed, the pace of emigration could further accelerate.

Figure 3. Lithuania: Financial Indicators, 2002-05

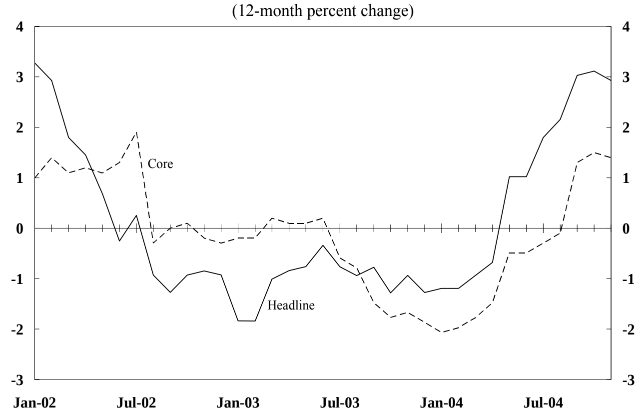


1/ Yield spread between Lithuanian Eurobond and German benchmark maturing in February 2008.

Source: Bloomberg.

7. **Inflation remained low in 2004 but was on an accelerating trend.** The consumer price index increased by 1¼ percent in 2004. Acceleration was evident in price increases toward the end of the year (Text Figure 3). Prices rose on the back of hikes in excise taxes, higher administered prices, and increasing oil prices. These fed into broader inflation, as reflected in core inflation, which increased at the same time. As in other countries that have acceded to the EU, Lithuanian real estate prices have risen sharply in recent years, and risks of price increases in other nontraded goods and services, especially those of utilities, remain.

Text Figure 3. Lithuania: Harmonized Consumer Price Index
(12-month percent change)



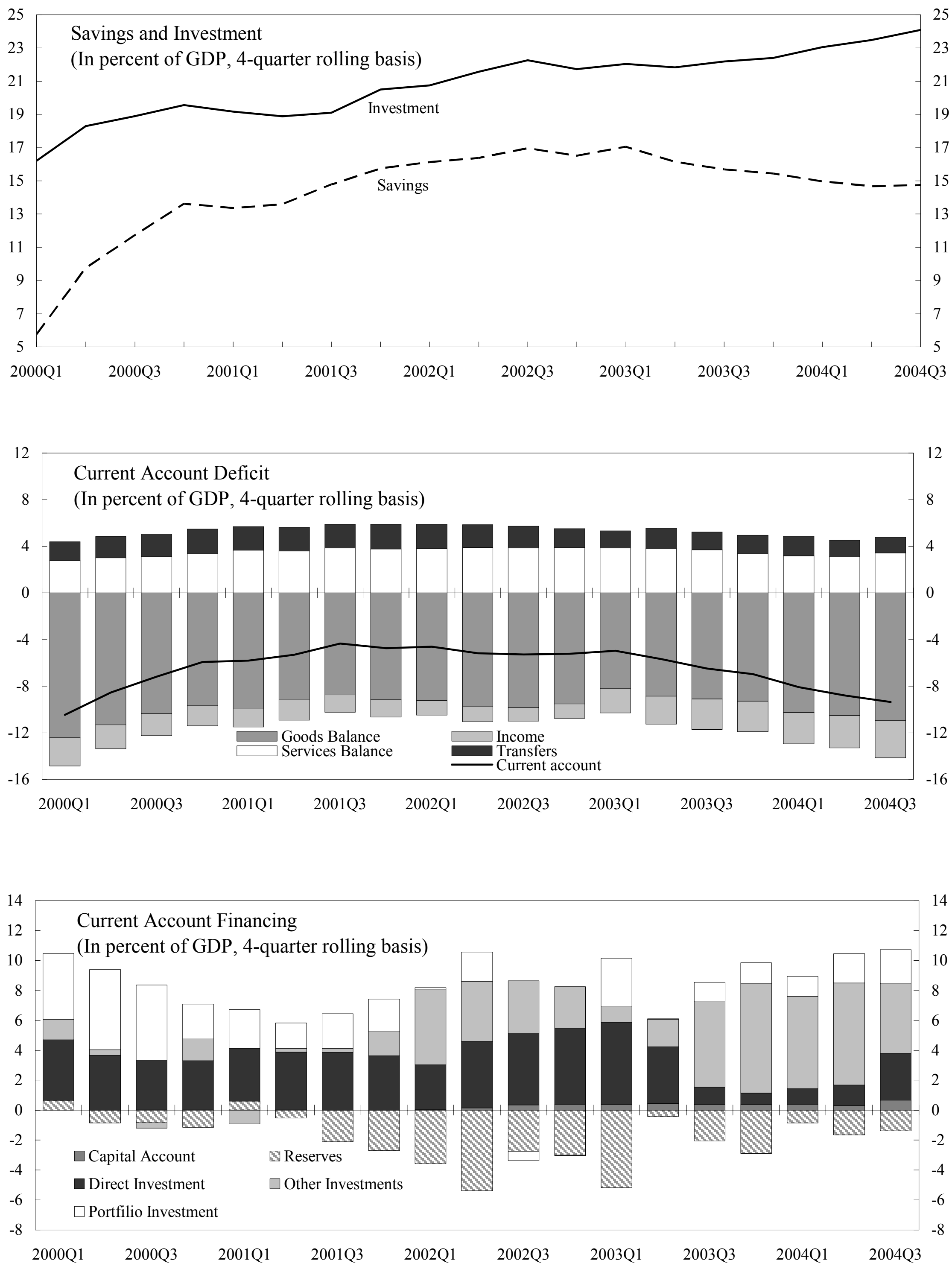
8. **The current account deficit deteriorated in 2004 to about 8½ percent of GDP (Text Table 2, Table 2, and Figure 4).** Because of the greater confidence in the future, savings rates continued to fall and investment rates continued to rise. While Lithuania had a stellar export performance during 2000–02, real export growth slowed to about 5 percent in 2004. Buoyant imports in recent years have been tied closely to domestic expansion, and, as growth further stimulated imports in 2004, the trade balance deteriorated by 1 percent of GDP. With larger dividends and repatriated earnings on past FDI, the negative income balance widened by 1½ percent of GDP in 2004.

Text Table 2. Lithuania: Level and Composition of Current Account Deficit

	2002	2003	2004 Proj.
(in percent of GDP)			
Balance of goods and services	-5.6	-5.9	-7.8
Trade balance	-9.5	-9.3	-10.5
Balance of services	3.9	3.3	2.7
Net factor income	-1.2	-2.6	-4.3
Current transfers	1.7	1.6	3.5
Current account balance	**-5.2**	**-7.0**	**-8.6**

9. **The budget deficit increased from 1¾ percent in 2003 to 2¼ percent of GDP in 2004, imparting an expansionary fiscal stance (Table 4)**. The 2004 widening reflected higher pension reform costs, discretionary expenditures in the midyear budget and prior to the elections in November, and end-of-year expenditures on real estate and savings restitution; EU-related cofinancing expenditures played a smaller-than-anticipated role. Higher-than-expected personal and corporate income tax revenues helped contain the deficit; however, receipts from the single largest revenue source, the value-added tax (VAT), fell short of projections by about 15 percent.

Figure 4. Lithuania: External Sector Indicators, 2000-04



Source: Lithuanian authorities.

III. Discussions With the Authorities

10. **The authorities reiterated their commitment to early euro adoption, a goal that staff strongly supported while also urging that attention be paid to challenges that lie beyond.** The authorities expressed confidence that the euro would be adopted as early as January 2007, and despite risks, staff believes that the likelihood of doing so remains good (Text Table 3). But staff emphasized that the observance of Maastricht limits may not be sufficient to secure short-term stability and ensure the durability of long-term productivity growth. Following a review of the macroeconomic outlook and risks, discussions focused on short-term fiscal policy, fiscal modernization, and other structural issues related to long-term competitiveness.

Text Table 3. Lithuania: The Maastricht Criteria

	2004		2005	
	Criterion	Estimate	Criterion	Forecast
Inflation 1/	2.3	1.2	2.8	2.9
Budget deficit (in percent of GDP)	3.0	2.2	3.0	1.9
Long-term interest rates 2/	5.7	4.6	...	...
Debt (in percent of GDP)	60.0	19.7	60.0	19.8

1/ 1.5 percentage points above best three performers.
2/ 200 basis points above the best three performers in terms of inflation.

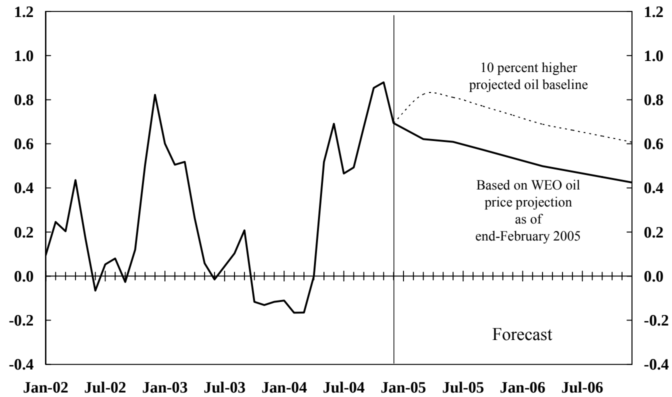
A. Macroeconomic Outlook

11. **There was agreement that Lithuania was emerging from a special period of rapid noninflationary growth and output was now above its potential (Figure 2).** Following its remarkable structural transformation, the path of the Lithuanian economy remains difficult to predict. The authorities and staff agreed that, given its catch-up potential, Lithuania could grow in the medium term at annual rates of around 5½–6 percent. Factors favorable to continued strong growth include Lithuania's human capital, institutional preparation, and geographic advantages. While the growth potential may be higher than 5½–6 percent a year, the authorities and staff agreed that short-term policy decisions should be based on a conservative view of the economy.

12. **Despite the medium-term uncertainties, the economy is expected to continue to grow strongly in 2005-06, with implications for wage pressures and the current account.** Staff stressed that utilization of EU funds would add significantly to demand pressures in 2005 and GDP growth could reach 7 percent. The authorities had a somewhat lower growth estimate (6½ percent) but agreed that capacity constraints would be more binding than in the past and that wage pressures would intensify in certain sectors. Staff estimates that the current account deficit would widen to 9½ percent in 2005 before declining gradually in the medium term (Tables 2 and 7).

13. **The authorities thought it unlikely that accelerating inflation could breach the Maastricht criterion, though they recognized the risk.** They took the view that domestic demand pressures would largely spill over into a larger current account deficit and were concerned primarily about supply-side shocks. They were mindful of potential one-off factors (e.g., hikes in electricity and other administered prices) that could hinder compliance with the convergence rules in 2005–06. Staff agreed with the authorities on the importance of supply-side shocks: if the 2005–07 oil prices were 10 percent higher than the WEO forecast, the direct impact on inflation would be an additional 0.3 percent (Text Figure 4); however, second-round effects could raise inflation by more than twice as much. Moreover, staff argued that the role of domestic demand pressures on nontradable goods should not be minimized. Domestic bottlenecks could raise short-term inflationary expectations and, hence, the inflation rate above the Maastricht limit.[2]

Text Figure 4. Lithuania: Contribution of Energy Component to HICP
(In percent)



14. **The current account deficit, although within the range implied by underlying fundamentals, is large.** The authorities and staff agreed that the deficit reflected confidence that the gap between Lithuanian and EU income levels would narrow at a relatively rapid pace. With strong growth prospects and financial deepening, private savings have declined for some years while rising investment rates have stimulated demand for imports of capital and intermediate goods (Text Table 4, Table 7, and Figure 4). Staff estimates that a current

Text Table 4. Lithuania: Imports of Main Groups of Goods, in 2000 Prices

	2000	2001	2002	2003	2004 1/
	(share in total)				
Total	100.0	100.0	100.0	100.0	100.0
Capital Goods	12.5	14.1	18.4	19.8	17.8
Intermediate Goods	61.9	58.7	55.3	55.4	58.7
Consumption Goods	18.7	19.1	17.3	17.6	17.6
Others	6.9	8.0	9.0	7.2	5.1
of which: transport equipment	4.0	6.1	7.1	5.9	5.1

1/ Data from January to November.

[2] An accompanying selected issues paper finds, in line with recent academic literature, that, while a currency board delivers lower inflation due to its high credibility, rapidly adjusting expectations may increase the risk of accelerating inflation in the short term.

account deficit of 8–9 percent of GDP is consistent with Lithuania's present income per capita relative to the EU and its growth prospects (Box 1).

15. **Two sources of external vulnerability were stressed.** Staff noted that, with foreign direct investment at about 3 percent of GDP in the medium term and EU financing around 2–3 percent of GDP, debt-creating flows to close the financing gap would make up 2–3 percent of GDP. Gross external debt is expected to reach about 43 percent and net external debt some 38 percent of GDP by 2009. While a debt sustainability analysis did not show a high degree of risk, staff cautioned that external reserves as a ratio of amortizations had fallen from 87 percent in 2001 to a relatively low 53 percent by end-2004 (Table 8). The authorities responded that the currency board arrangement had very large buffers (with the central bank's net foreign assets at over 140 percent of base money). The amortizations, they explained, reflected private transactions between Lithuanian and their parent banks overseas, as well as between exporters and trade credit suppliers.[3] A failure to roll over these loans would set back real activity, but confidence in the litas would be maintained because of the strong position of the currency board. Moreover, in light of current economic growth prospects, the authorities considered it unlikely that private loan transactions would not be rolled over. Vulnerability on account of a possible erosion in competitiveness was also discussed, as reported below.

B. Fiscal Policy

16. **The authorities viewed their fiscal consolidation effort as representing the appropriate balance between the need for prudence and the demands for social and infrastructure spending.** In line with their Convergence Program (CP), the authorities noted that they were targeting a 2½ percent deficit in 2005 and a gradual consolidation thereafter to 1½ percent of GDP in 2007. Between 2004 and 2007, revenues are expected to increase by 1½ percent of GDP. While current expenditures are expected to decline by ¾ percent of GDP, capital expenditures are to rise by just over 1½ percent of GDP, mainly due to EU-related investment spending. However, the authorities had not yet finalized specific measures to achieve the proposed reduction in current expenditures.

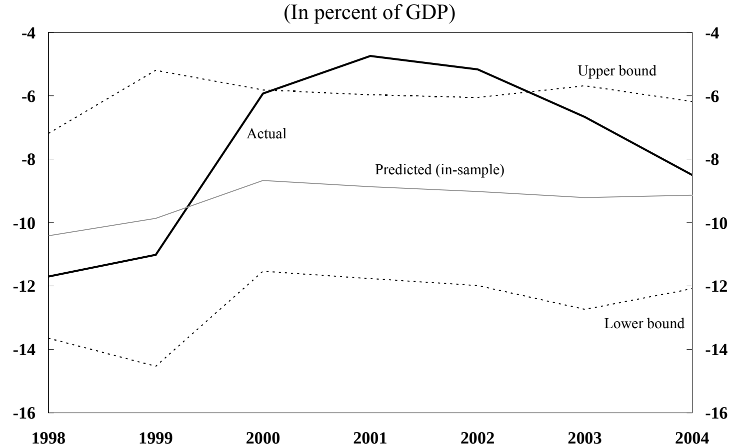
[3] The banking system comprises ten banks, two foreign bank branches, and three representative offices of foreign banks. Concentration is high, with three of the largest banks—all foreign owned—accounting for some 70 percent of assets. The share of banking capital held by foreign investors is close to 90 percent.

Box 1. Is the Current Account Deficit a Concern? An Intertemporal Perspective

Lithuania's current account deficit, at 8½ percent of GDP in 2004, is consistent with predictions of models based on intertemporal considerations. This proposition was tested, first, using a model of regional income convergence in which relatively poor countries converge ("catch up") with the income levels of their richer neighbors. Lower-income countries can finance their catch-up growth partly via external borrowing. Other things equal, a relatively low income level should be associated with a larger current account deficit and higher growth.

Using data on the EU-25 for the 1975–2004 period, a catch-up model predicted Lithuania's current account deficit in 2004 to be 9 percent of GDP, compared to the actual deficit of 8½ percent (see selected issues paper).

Predicted Current Account Versus the Actual
(In percent of GDP)



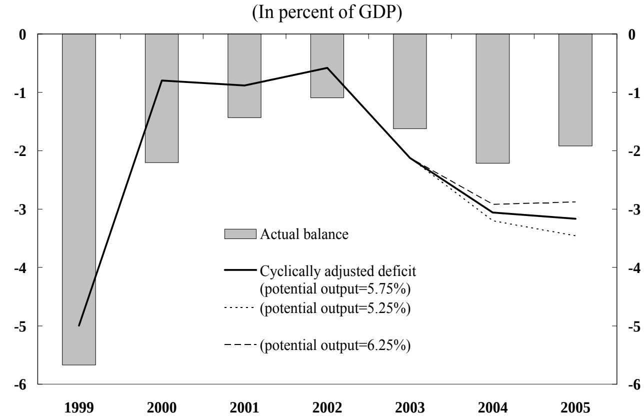
An alternative approach to assessing the current account deficit is based on a model of optimal consumption smoothing. Agents respond to an increase in permanent income by consuming more than their current income, thus raising the current account deficit. The results once again suggest that Lithuania's high future income prospects explain its current account deficit. By this measure, Lithuania's 2004 current account deficit was projected at 8.1 percent of GDP.

17. **Discussions centered around the ambition of, and risks to, the consolidation path.** First, did projected deficits leave sufficient space for the operation of automatic stabilizers in the event of a slowdown? Second, the trend decline in revenue/GDP ratios created the risk that projected revenue increases may not be achieved. Third, the government had outstanding obligations that would eventually have to be paid. Finally, EU-related cofinancing expenditures added to the expenditure pressures.

18. **The authorities agreed with staff estimates that the structural, or cyclically adjusted, deficit had widened to about 3 percent of GDP in 2004.** The structural deficit—which takes into account the favorable cyclical position—is expected to remain at about the

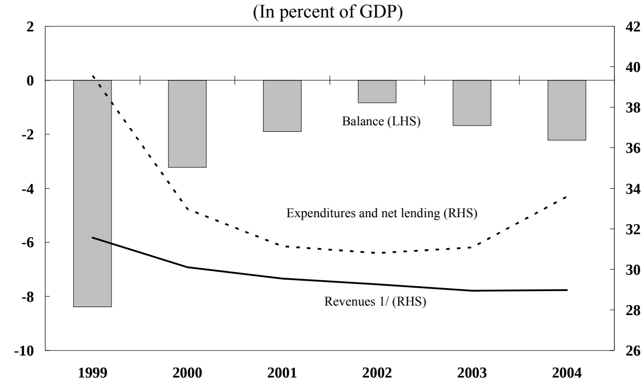
same level in 2005, after the deterioration in 2003–04 (Text Figure 5). Recognizing the imprecision in the measure of the cyclical position, staff conceded that the structural deficit could be somewhat lower. However, the main conclusion—that the fiscal stance in 2005 will, at best, remain neutral—would not change significantly. Moreover, since demand pressures may well be underestimated, staff argued for conservativism in the fiscal target. Staff believes that the authorities' 2005 growth assumption of 6½ percent may be somewhat low, but, even with this assumption, additional expenditure consolidation of some ½ percent of GDP is feasible, with the resulting deficit of about 2 percent providing a safety margin for the operation of automatic stabilizers.[4] In the event of higher growth, as projected by staff, a deficit of just below 2 percent could be attained simply by saving additional revenues; an even lower deficit could be achieved by also cutting expenditures. In either case, a discretionary opening of the budget at midyear would be undesirable. The authorities agreed with the thrust of the analysis but judged that, in view of expenditure compression in several areas and increased cofinancing needs in 2005, more consolidation may be difficult to achieve.

Text Figure 5. Lithuania: The Actual and Cyclically Adjusted Deficit
(In percent of GDP)



19. **The authorities recognized risks to the budget from the declining revenue ratio and outstanding obligations.** They noted that the tax reform of 2002–03 had helped, but tax loopholes, exemptions, and weaknesses in tax administration were the principal factors behind the declining revenue ratio (Text Figure 6).[5] Staff observed that poor collection of the VAT (some 85 percent of the budget plan) in 2004

Text Figure 6. Lithuania: General Government Finances
(In percent of GDP)



1/ Excludes grants.

[4] The authorities (Convergence Program for Lithuania) estimate the cyclical revenues for 2005 at about 0.6 percent of GDP, which would go up to about 1 percent if growth were close to 7 percent.

[5] Revenue data for 2004 show a strong performance for income and profit taxes (with a 107 percent execution rate). However, receipts from indirect taxes other than the VAT (the pollution tax, other excise duties, and taxes on international trade transactions) were relatively weak.

could only partially be explained by one-off changes related to EU accession since the VAT/GDP ratio had experienced a secular decline since 1998. The authorities acknowledged that differentiated VAT tax rates had made tax administration more difficult, while also distorting the incentives for resource allocation. With respect to claims on the budget, they recognized that the cost of pension reform had risen, owing to better-than-anticipated participation in the second pillar. Repayments on account of the real estate and savings restitution obligations, the authorities noted, would be undertaken in a way that was consistent with current fiscal plans and prevailing macroeconomic conditions.[6]

20. **Greater use of EU funds will increase the government's cofinancing obligations and, hence, the pressure on the budget.**[7] The authorities noted that the utilization of EU funds in 2004 had been disappointing (Text Table 5), as the approval process had slowed the flow of funds to Lithuania. Consequently, cofinancing expenditures were limited to ¼ percent of GDP in 2004. However, cofinancing is expected to rise to 1½ percent of GDP in 2005, and top-up payments to farmers will put further pressure on expenditures. Discussions focused on the implementation of mechanisms to ensure the efficient use of EU and confinancing funds and to control expenditures.

Text Table 5. Lithuania: EU-Related Revenue and Expenditure, 2004-06

	2004		2005	2006
	Plan	Execution	Plan	Plan
	(In percent of GDP)			
Revenue				
Preaccession instruments	0.97	0.69	0.32	0.05
Postaccession Total	2.13	1.19	4.29	4.69
of which				
Revenues for Agriculture	0.45	0.45	1.31	1.53
Total grants EU	3.09	1.87	4.61	4.74
Expenditure				
Spending of EU Grants	3.09	1.07	5.30	3.09
Additional EU-related spending	2.48	0.94	2.92	2.57
Cofinancing	1.07	0.23	1.33	1.33
National investments	0.20	0.00	0.15	0.01
Administrative capacity building	0.50	0.00	0.32	0.19
Payments to the EU	0.71	0.71	1.11	1.05
Total expenditure	5.57	2.01	8.22	5.66
Top-up payments for farmers	0.42	0.00	0.48	0.70

[6] Restitution payments amounted to some 1 percent of GDP in 2004; the authorities plan to spend an additional ½ percent of GDP in 2005. See IMF Country Report No. 03/55 for a detailed description of the savings and land restitution programs. Obligations under these programs and those due to VAT refunds add up to about 6½ percent of GDP.

[7] Among the new member states of the EU, Lithuania is likely to receive the highest assistance per capita (for 2004–06, €895 million from Structural Funds and €543 from the Cohesion Fund, and smaller amounts for specific functions, including the decommissioning of the Ignalina Nuclear Power Plant).

C. Fiscal Reforms and Modernization

21. **The authorities were mindful of the high tax on labor and discussed their plan to gradually lower the personal income (PIT) rate.** The PIT and the employee and employer pension contributions add up to one of the highest statutory rates and tax wedges among European economies.[8] This is not compatible with the need to include a larger fraction of the population in the labor force and to remain competitive in international markets (Box 2). Staff supported the authorities' plan to lower the marginal rate from its current high of 33 percent. The authorities and staff agreed on the importance of introducing a tax reform package that maintained revenue neutrality and kept Lithuania's fiscal consolidation effort on track.

22. **Several possibilities were discussed for making up revenues lost on account of lower PIT rates.** An immediate loss of some 1.1 percent of GDP of revenue from a lowering of the PIT rate to 25 percent could be partly offset through revenues from a new property tax (0.2 percent of GDP) and abolition of most income tax and VAT exemptions (which could amount to an additional 0.4–0.5 percent of GDP) (Text Table 6). The authorities noted that, since public sector employees stood to gain from reduced tax liabilities, public sector wage growth could be moderated. In the medium term, staff observed that reform was likely to encourage private savings and investment. The PIT rate cut could also raise tax revenue by improving compliance and discouraging avoidance, especially if accompanied by a strengthening of tax administration; however, caution was needed in assessing the likely impact on revenue.

Text Table 6. Lithuania: Fiscal Impact of Tax Reform

Possible Measures	**Impact** (millions of litai)	**Impact** (percent of GDP)
Lower Income Tax Rate from 33% to 25%	-932.5	-1.50
combined with abolishing 15% lower rate	-709.1	-1.14
Abolish Income Tax Exemptions	172.1	0.28
Mortgage Benefit	29.1	0.05
Education Allowance	27.1	0.04
Purchasing computers	18.3	0.03
Charity	37.4	0.06
3rd Pillar participation	60.2	0.10
Abolish 5% VAT rate	145.7	0.24
Meat Consumption	66.1	0.11
Hotels and Restaurants	79.7	0.13
Introduce Real Estate Tax	116.6	0.19

23. **Staff pointed to areas where improved public expenditure design and management would achieve greater transparency and control.** Government expenditures and cash flows are not documented in sufficient detail to allow for efficient fiscal management. In particular, contingencies and buffers for dealing with an unexpected requirement to reduce government expenditures are not explicitly identified. Therefore, if such a reduction were needed, economically valuable capital expenditures would be most likely to suffer. In conjunction with a technical assistance mission from the Fiscal Affairs

[8] OECD, *Labor Market and Social Policies in the Baltic Countries* (Paris: 2003).

Box 2. The Labor Market in Lithuania

In many respects, the Lithuanian labor market functions well. Continuing enterprise restructuring ensures high rates of job creation and turnover. Labor market institutions are, in general, flexible, with the significant exception of the tight regulation of working hours, which limits the use of part-time and overtime work.

The high tax wedge on labor income reduces work incentives and raises labor costs. The combination of personal income tax and employee social security contributions for a typical worker may be as high as 36 percent of gross salary, and employer social contributions and payroll taxes can add another 31 percent to labor costs.

The minimum wage, now close to 50 percent of the average gross salary, covers about 18 percent of workers, although these figures may be exaggerated by the underreporting of wages to avoid payment of tax and social security contributions. The 16 percent increase of the minimum wage in May 2004 was partly motivated by the goal of making work more attractive. However, this appears to have misread the unemployment problem as arising largely from low incentives to supply labor.

The high minimum wage is viewed as compensating for the absence of targeted income support. However, a countrywide uniform minimum wage aggravates the difficulties of poorer regions, which already suffer on account of low territorial mobility, contributing to the persistence of significant regional disparities and further straining the capacity of poorer municipalities to provide social assistance.

Department, staff urged consolidation of various government accounts into a single account and adoption of improved methods for cash control and budget planning. The authorities welcomed these suggestions.

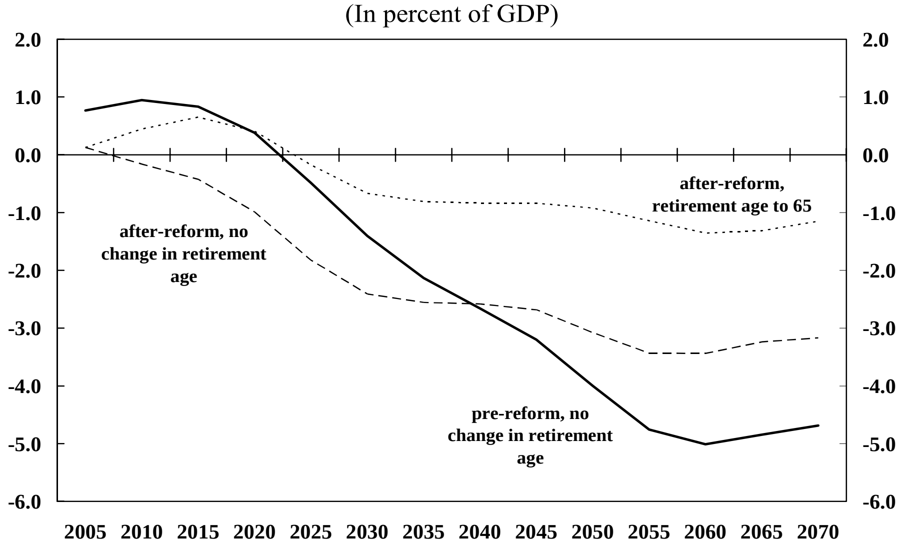
24. **Staff proposed measures to achieve more effective decentralization.** Another accompanying technical assistance mission from the Fiscal Affairs Department commented that municipal finances were too dependent on transfers from the state budget. The authorities pointed to the likely introduction of a property tax which would broaden the revenue base of municipalities and increase incentives for efficient operation. They noted that the borrowing framework for municipalities had strengthened in recent years, but staff proposed more consistency between borrowing limits and repayment capacity. To limit the liability of the central government, a formal bankruptcy procedure for municipalities could be introduced. Staff also recommended reducing substantially the number of targeted grants and strengthening capacity for financial management at the municipality level.

25. **The authorities and staff agreed that further reforms were needed to improve the financial viability of the social safety and health systems.** The authorities recognized that the recent reform of the pension system did not guarantee its long-term viability (Box 3). They agreed also on the need to sharpen the focus, reduce the gaps, and raise the quality of the numerous social assistance programs. They pointed to the move toward more targeted

Box 3. The Viability and Efficiency of the Social Security System

Despite recent reform, the viability of the pension system is not ensured. Between 2015 and 2060, the dependency ratio will almost double as the active population shrinks by about 30 percent. Moreover, the authorities have set the ambitious goal of raising the income replacement ratio to 60 percent by 2010. Following the introduction of a voluntary second pillar in 2004 (funded by 2.5 percent of social security contributions, to increase gradually to 5.5 percent in 2007), the transition costs worsen the financial balance until 2040, but improve it thereafter. Under current policies, the first pillar deficit will stabilize somewhat below 3 percent of GDP between 2050 and 2060. A gradual increase in the retirement age by 2020 to 65 years for both men and women will reduce the first pillar deficit to about 1 percent of GDP.

Financial Balance of the First Pillar, 2005-70
(In percent of GDP)



Social assistance is not well targeted. Income testing is limited. “Categorical” benefits, given regardless of the income status of the beneficiary, amount to some 1 percent of GDP, half of which are provided to families with children. At the same time, the long-term unemployed are not adequately protected, and social assistance that will not compromise work incentives may be needed. The 2004 laws on child benefits and support of low-income families are steps in the right direction.

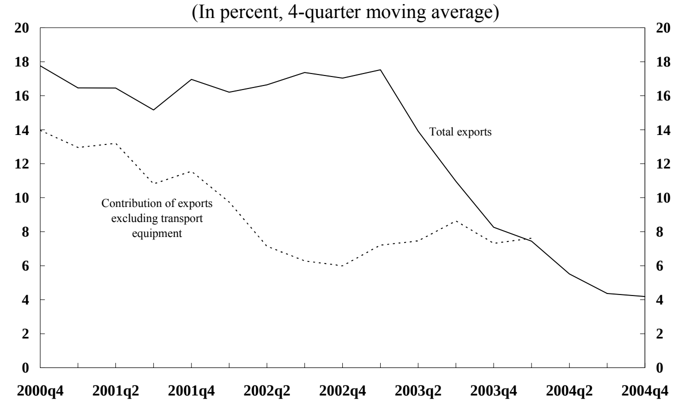
support, with new laws on child benefits and family income support, but acknowledged that more progress was needed (Box 3). They were especially aware of the need to restructure hospitals to reduce overcapacity and to impose stricter expenditure controls on pharmaceuticals and other consumables. Staff noted that the 2005 budget of the Health Insurance Fund did not adequately restrain expenditures.

26. **To consolidate the full range of tax and expenditure reforms, and to limit the political competition for resources, staff recommended the adoption of a Fiscal Responsibility Act.** Such an act could encompass detailed rules on budget execution and fiscal targets, rules outlining revenue forecasting and revisions, regulations permitting only revenue-neutral tax reforms, and limits on public debt and credit operations.[9] The rules would enhance transparency and clarity in fiscal policymaking, while underpinning the implementation of commitments vis-à-vis the EU. Parliamentarians and the government showed considerable interest in the proposal.

D. Competitiveness and Other Structural Issues

27. **In light of the fixed parity of the litas vis-à-vis the euro, discussions focused on the real effective exchange rate and the recent decline in export growth.** The real effective exchange rate based on the CPI measure has appreciated by about 9 percent since 2000. In terms of relative unit labor costs, the real exchange rate has recently stabilized following a period of significant depreciation (Figure 5). By either measure, Lithuania's real exchange rate has appreciated by less than the appreciation experienced by most new EU members. The authorities explained that the slowdown of exports since 2003 reflected, in part, a fall in exports of transport equipment to Russia following changes in the tariff structure in October 2002. However, staff expressed concern since even excluding transport equipment, exports have trended down since 2000, though the short time period does not allow a definitive assessment (Text Figure 7). The authorities acknowledged the effect of competition from lower-wage economies, but noted that Lithuanian companies continued to move up the "quality ladder."[10] The share of Lithuanian exports in total world imports has continued to edge upward (Figure 5). Overall, the authorities viewed Lithuania's exchange rate as consistent with fundamentals. Staff

Text Figure 7. Lithuania: Growth of Goods Exports 1/
(In percent, 4-quarter moving average)

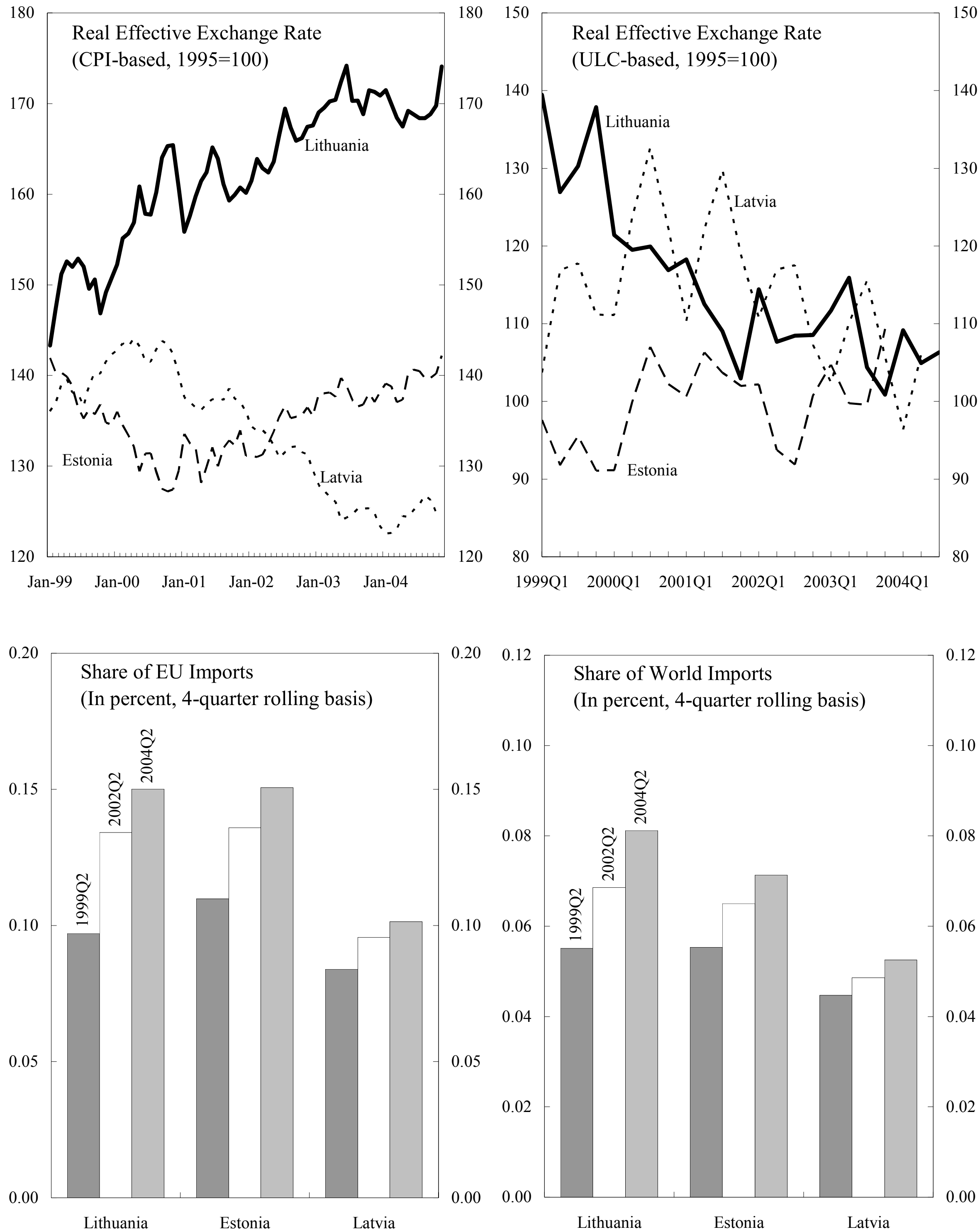


1/ Excluding minerals.

[9] The Brazilian Fiscal Responsibility Law (http://www.planejamento.gov.br/lrf/index.asp), implements many such provisions.

[10] Encouragingly, Lithuania has diversified toward higher-value-added goods. While exports of unprocessed wood products declined, those of furniture increased. The share of transport equipment and machinery and electrical equipment in Lithuanian exports has risen sharply. Moreover, exporters have enjoyed increasing profit margins over the past five years.

Figure 5. Competitiveness Indicators, 1999-2004



Sources: Information Notice System, IMF staff estimates, *Direction of Trade Statistics.*

calculations (based on a framework incorporating the Balassa-Samuelson effect within a balance of payments approach) suggest that the real exchange rate is close to its equilibrium value. While export trends indicate increased competitive pressures, recent history suggests that Lithuanian exporters have responded to such challenges.

28. **Private sector representatives praised improvements in the business environment but pointed to areas where further progress was needed.** Lithuania has made significant strides in improving its business climate but remains behind leaders such as Ireland (Box 4). In addition to the widespread concern with regard to labor taxes, the restrictions on the use of flexible employment contracts were highlighted as a constraint, as was the regulation and compensation premium for overtime work (Box 2). The business environment remains challenging for small and medium-sized enterprises (SMEs), which have to deal with complex and time-consuming regulations, especially those related to land use and construction. The authorities noted plans to use EU funds to support SMEs. Private sector representatives and the authorities highlighted the importance of deregulating the health and education sectors to stem the emigration of highly skilled, but underpaid, public sector workers and to improve the quality of these services. Finally, authorities observed that privatization was almost complete, with only the National Railway, the Eastern Distribution Company, and Lithuanian Air remaining under government ownership.[11]

29. **The authorities recognized that rapid growth was driving demand for credit but were confident that the expansion would not compromise the stability of the financial sector, which was well cushioned and well regulated.** Though no serious vulnerabilities were revealed by the 2002 FSAP and the 2003 update, the mission discussed recent credit trends and foreign currency exposure of the banking system (the share of foreign currency loans in total loans was 59 percent as of end-2004 (Table 6)). The authorities are closely monitoring credit expansion and have stepped up supervision both on- and off-site, while cooperating with supervisors from Nordic countries. Although specific loan provisioning by banks has not kept up with the growth in credit, the authorities pointed out that the share of nonperforming loans had declined significantly and bank profitability was strong (Table 6). They noted that the foreign currency exposure of the banking system was natural, given the move toward the euro. Moreover, the ratio of the banks' net open position in foreign currencies (other than the euro) to total capital remains below the Bank of Lithuania's 25 percent aggregate limit. Staff observed that foreign currency exposure of enterprise and household balance sheets, though in the same range over the past few years, had increased somewhat in the past year. In line with the FSAP recommendations, the mission emphasized the value of encouraging specific loan provisioning and maintaining a forward-looking perspective on currency exposure developments.

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[11] Privatization receipts are expected to be 1/3 percent of GDP in 2005.

Box 4. Real Convergence with EU: Some Comparative Lessons

Lithuania's per capita GDP stands at some 40 percent of the EU average. This presents a large catch-up possibility with the potential of annual growth rates of about 5½ percent. However, to achieve that potential—and, perhaps, to exceed it—requires a strong business environment that encourages investment and productivity enhancement.

A comparison with the recent experience of Ireland and Greece is instructive. During the 1990s, while Ireland grew by about 7 percent a year, Greece grew at a more modest pace of about 2 percent. A recent comparative study (IMF Country Report No. 05/43) attributes Ireland's success in large part to the reform of public finances—particularly expenditure control—which allowed reductions in tax rates while removing tax loopholes and consolidating expenditures. Greece's continued high tax rates reduced competitiveness, and its fiscal policy magnified economic cycles, which slowed real convergence with the EU. Greece was also handicapped by a weaker business climate, resulting from rigidities in the labor market, excessive regulation, and infrastructure and judicial system inadequacies.

Lithuania has demonstrated the capacity to influence how fast it moves toward the living standards of advanced economies. Despite a per capita income just over 55 percent of Greece's, Lithuania has equaled or moved ahead in some dimensions of business climate and development (Box Table below). Sustained efforts to move closer to Irish levels of business climate indicators should provide a sizable growth dividend.

Select Business Environment Indicators

	Greece	Latvia	Lithuania	Estonia	Ireland
National business environment rank, 2004	42	48	35	24	22
Procedures to start a business (number)	15	7	8	6	4
Time to start a business (days)	38	26	38	18	24
Total employment rate of older workers (50-64) percentage	42	44	45	52	49
Youth education [1/] (ages 20-24)	82	74	82	81	86
Total R&D expenditures (% of GDP)	0.64	0.42	0.68	0.77	1.15

Sources: Department of Statistics, "Economic and Social Development in Lithuania," 2004/10, pp. 148-49; World Economic Forum, *Global Competitiveness Report*; and World Bank, *Doing Business*.
1/ Percentage of people in age group 20-24 with attainment of at least upper higher secondary education.

30. **The authorities expressed concern about energy security.** While adequate supplies exist to meet domestic demand for electric power following the closure of the first unit of the Ignalina nuclear power plant on December 31, 2004, the closure does reduce electric power exports. The authorities are exploring access to additional sources of power to achieve greater energy security.

31. **Mazeikiu Nafta, the Lithuanian oil refinery, has not yet been affected by the financial difficulties of Yukos, one of its principal owners.** Mazeikiu relies on a Yukos-controlled pipeline for the delivery of the oil that it refines. Despite the financial reorganization of Yukos, supplies have been maintained, and the refinery has been operating at a higher-than-normal capacity utilization rate. The new owner of Mazeikiu is expected to maintain supplies. The authorities expect that, in the event of a temporary disruption, alternative but more expensive supplies will be available.

32. **Upon accession to the EU, Lithuania adopted the EU's common commercial and agricultural policy.** Lithuania has applied all EU bilateral trade agreements, the common external tariff, and the EU trade defense measures. Since Lithuania's trade regime has gradually changed to conform with EU standards, accession with the EU will not in itself have a major impact on Lithuanian or global trade.

IV. Staff Appraisal

33. **Lithuania's impressive growth can continue, but the strategy needs to adapt to the changed circumstances.** The plan for early euro adoption appears solidly on course. To further reduce the risk of breaching Maastricht limits and to achieve successful economic performance following euro adoption, three areas deserve priority. First, greater attention than in the past is required to deal with short-term risks. Second, a forceful fiscal modernization will improve government efficiency and augment private incentives to increase employment and enhance productivity. Finally, a broader set of structural reforms will be required to sustain external competitiveness.

34. **Short-term risks need monitoring.** Though high or persistent inflation is highly unlikely, the temporary breaching of the demanding Maastricht inflation criterion cannot be ruled out. From a medium-term perspective, the size of the current account deficit is within the range implied by underlying fundamentals. However, the large size of the current account deficit remains a concern in view of the relatively high rollover requirements of short-term debt and risks of shifts in capital market sentiments.

35. **Current conditions call for more ambitious fiscal restraint than required by the Maastricht criteria.** With all indicators suggesting that output will remain above potential in 2005, continued fiscal stimulus would add to inflationary pressures and to the current account deficit, without contributing to long-term growth. Under the authorities' growth projection, the 2005 deficit is targeted at 2.5 percent of GDP. Expenditure reduction to achieve a deficit lower than 2 percent and a faster consolidation thereafter would aid stability and medium-term growth. Expenditure cuts of some ½ percent of GDP are feasible, particularly

in the areas of goods and services, public sector wages, and health. The staff's higher growth projection suggests that a deficit of under 2 percent is likely even without the expenditure cuts, although these would remain desirable for countercyclical reasons. A midyear reopening of the budget to allow additional expenditures should be avoided. With the deployment of EU funds for enhancing agricultural productivity and EU income transfers to farmers, the need for additional topping-up payments to farmers is reduced.

36. **Tax reforms are needed to reduce exemptions, lower rates, and improve administration.** The importance of VAT revenues calls for renewed efforts to improve collection. The reduction in the marginal rate of the PIT has deservedly been on the government's agenda. On balance, staff views as appropriate creating a single lower rate, while maintaining the current exemption threshold. The unification of the rate would broaden the tax base and help raise additional revenues. The rate reduction should be phased in with appropriate complementary measures to minimize the impact on revenue. Staff concurs with the authorities' proposal to institute a more wide-ranging property tax.

37. **Reforms of public expenditure need to be guided by several objectives.** First, greater transparency and control are essential. Second, more effective decentralization will improve efficiency of operations. And third, the social protection system—including the pension system, social assistance programs, and the health sector—needs further attention, with a view to improving effectiveness and achieving financial viability.

38. **To ensure that these long-term fiscal reforms are undertaken and maintained, the government should consider proposing a Fiscal Responsibility Act to parliament.** With a currency board already providing discipline to monetary policy and the commitment to the Convergence Program guiding the medium-term fiscal objectives, adoption of such an act by parliament would provide a comprehensive and transparent framework for efficiently conducting fiscal policy at all levels of government and ensure the credibility of fiscal commitments.

39. **The expansion of credit needs monitoring.** The mainly foreign-owned Lithuanian banking system has a relatively low credit-to-GDP ratio and maintains adequate protection from shocks; the regulation and supervision of banking and securities markets are well developed. However, the trend growth in consumer borrowing (without an accompanying step-up in specific loan provisioning) and significant foreign currency exposure of the private sector require close monitoring of credit quality to track vulnerabilities. An FSAP update under consideration would examine these issues.

40. **While Lithuania has acquired important competitive strengths, structural reforms necessary to raise export growth and ensure efficient investment should be accelerated.** The recent decline in export growth may well turn out to be temporary following a period of robust growth. But in light of the fixed parity of the litas vis-à-vis the euro and upward pressure on prices, early steps could prevent the emergence of a competitiveness problem. Besides lower labor taxes, specific steps that could help include introducing greater flexibility in short-term labor contracts, easing construction and land use

regulations, fostering SMEs through EU business development funds, and deregulating the health and education sectors.

41. Staff recommends that the next Article IV consultation with Lithuania be held on the standard 12-month cycle.

Table 1: Lithuania: Selected Macroeconomic Indicators, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
						Est.	Proj.
National income, prices, and wages							
Nominal GDP (in millions of litai)	43,359	45,526	48,379	51,643	56,179	61,983	68,709
GDP (in millions of U.S. dollars)	10,840	11,381	12,095	14,045	18,354	22,291	24,710
Real GDP growth (year-on-year, in percent)	-1.7	3.9	6.4	6.8	9.7	6.6	7.0
Average CPI (year-on-year change, in percent)	0.7	1.0	1.3	0.3	-1.2	1.2	2.9
End-of-period CPI (year-on-year change, in percent)	0.2	1.4	2.0	-1.0	-1.3	3.3	3.0
GDP deflator (year-on-year change, in percent)	-0.6	1.0	-0.1	0.0	-0.8	3.5	3.6
Average monthly wages (in litai)	...	1073.2	1087.1	1145.1	1207.9	1327.5	1460.2
Unemployment rate (in percent) 1/	14.6	16.4	17.4	13.8	12.4	11.3	11.3
Saving-investment balance (in percent of GDP)							
Gross national saving	11.4	13.6	15.8	16.5	15.4	13.3	13.5
General government	-3.9	-0.6	0.2	2.1	1.5	1.4	3.3
Nongovernment	15.3	14.3	15.6	14.5	14.0	11.9	10.2
Gross national investment	22.5	19.6	20.5	21.7	22.4	21.9	23.0
General government	2.2	1.9	1.9	3.1	3.4	3.6	5.2
Nongovernment	20.2	17.6	18.6	18.7	19.0	18.3	17.8
Foreign saving	11.0	5.9	4.7	5.2	7.0	8.6	9.5
General government fiscal balance (in percent of GDP) 2/	-8.4	-3.2	-1.9	-0.8	-1.7	-2.2	-1.9
External sector							
Current account balance							
in percent of GDP	-11.0	-5.9	-4.7	-5.2	-7.0	-8.6	-9.5
in millions of U.S. dollars	-1194.1	-674.8	-573.7	-733.9	-1278.5	-1922.8	-2338.1
Gross official reserves (in millions of U.S. dollars)	1242.1	1358.6	1669.2	2412.8	3449.7	3594.0	3751.5
Gross external debt (in percent of GDP) 3/	41.8	42.7	43.6	44.1	45.4	43.2	43.2
Real effective exchange rate (1995=100, "+"=appreciation) 4/	140.4	149.5	149.1	156.0	159.1	162.1	...
Money and credit							
Reserve money (year-on-year change, in percent)	-4.0	-3.3	8.3	20.8	26.6	7.1	...
Broad money (year-on-year change, in percent)	7.7	16.5	21.4	16.9	18.2	24.1	...
Private sector credit (year-on-year change, in percent) 5/	13.8	-6.1	6.3	30.4	58.8	39.8	...
Money multiplier	2.2	2.6	3.0	2.9	2.7	3.1	...
Currency/deposits, in percent	43.9	34.1	29.9	33.9	35.9	30.8	...
Foreign currency deposits/ litas deposits, in percent	77.7	83.8	74.8	48.4	36.2	35.0	...

Sources: Lithuanian authorities; and IMF staff estimates and projections.

1/ Based on Labor Force Survey.
2/ The figures for 2003 include the early repurchase of Lithuania's EFF by the BoL in net lending.
3/ External liabilities minus foreign equity investment in Lithuania.
4/ CPI-based, 2000–01 trade-weighted real effective exchange rate against 21 major trading partners.
5/ December 2000 is adjusted for reclassification of LTL 270 million of DMB's claims on private sector, which were removed from balance sheets in July 2000. Also, December 2001 numbers have been adjusted to reflect LTL 785 million of reclassified assets in July 2001.

Table 2a. Lithuania: Balance of Payments, 1999-2004

	1999	2000	2001	2002	2003	2004 Proj.
	(In millions of US dollars)					
Current account	-1,194	-675	-574	-734	-1,278	-1,923
Trade balance	-1,405	-1,104	-1,108	-1,337	-1,704	-2,341
Exports (f.o.b.)	3,147	4,050	4,889	6,031	7,658	8,615
Imports (f.o.b.)	4,551	5,154	5,997	7,368	9,363	10,956
Nonfactor services, net	305	380	457	543	614	596
Credits	1,092	1,059	1,157	1,479	1,878	2,075
Debits	786	679	700	935	1,264	1,479
Factor income, net	-258	-194	-180	-174	-482	-950
Current transfers, net	163	243	258	233	294	772
Capital and financial account	1,720	923	859	1,306	1,111	1,923
Capital transfers, net	-3	2	1	57	68	278
Financial account	1,245	546	419	535	1,044	1,644
Direct investment, net	478	375	439	714	142	371
Assets	-9	-4	-7	-18	-37	180
Liabilities	486	379	446	732	179	191
Portfolio investment, net	511	265	264	-3	252	289
Inflows	513	406	238	123	222	257
Outflows	-2	-141	26	-126	30	32
Other capital inflows, net	61	37	41	246	1,181	856
Inflows	243	-3	267	89	1,310	990
Outflows	-183	40	-225	160	-101	-102
Net errors and omissions	-48	127	154	143	167	...
Change in official reserves (-=increase)	196	-131	-325	-423	-531	144
Gross official reserves	1,242	1,359	1,669	2,413	3,450	3,594
Gross external debt 1/	4,528	4,857	5,268	6,199	8,338	9,639
Public and publicly guaranteed	2,383	2,364	2,332	2,429	2,793	2,792
Private	2,120	2,339	2,561	3,116	3,738	4,632
Net external debt 2/	3,349	3,688	3,827	4,572	6,214	7,508
Public and publicly guaranteed	2,383	2,364	2,332	2,429	2,793	2,792
Private	966	1,324	1,495	2,143	3,421	4,716
Short-term gross external debt	1,101	1,114	1,558	2,123	3,277	3,575
On an original maturity basis						
Of which:						
Trade credit	692	732	862	1,163	1,437	1,717
Currency and deposits at banks	189	148	166	219	388	474
Short-term net external debt 3/	221	234	530	740	1,452	1,384
Debt service 4/	...	1,301	2,123	4,238	6,071	7,018
Gross amortization	...	1,086	1,922	4,033	5,831	6,741
Interest payments	...	214	200	205	240	277
	(In percent of GDP)					
Current account	-11.0	-5.9	-4.7	-5.2	-7.0	-8.6
Trade balance of goods and services	-10.1	-6.4	-5.4	-5.6	-5.9	-7.8
Trade balance, goods	-13.0	-9.7	-9.2	-9.5	-9.3	-10.5
Trade balance, services	2.8	3.3	3.8	3.9	3.3	2.7
Factor income, net	-2.4	-1.7	-1.5	-1.2	-2.6	-4.3
Current transfers, net	1.5	2.1	2.1	1.7	1.6	3.5
Capital and financial account	15.9	8.1	7.1	9.3	6.1	8.6
Capital transfers	0.0	0.0	0.0	0.4	0.4	1.2
Financial account	11.5	4.8	3.5	3.8	5.7	7.4
Direct investment, net	4.4	3.3	3.6	5.1	0.8	1.7
Portfolio investment, net	4.7	2.3	2.2	0.0	1.4	1.3
Other investment, net	0.6	0.3	0.3	1.8	6.4	3.8
Gross external debt 1/	41.8	42.7	43.6	44.1	45.4	43.2
Public and publicly guaranteed	22.0	20.8	19.3	17.3	15.2	12.5
Private	19.6	20.5	21.2	22.2	20.4	20.8
Net external debt 2/	30.9	32.4	31.6	32.6	33.9	33.7
Public and publicly guaranteed	22.0	20.8	19.3	17.3	15.2	12.5
Private	8.9	11.6	12.4	15.3	18.6	21.2
Short-term net external debt 3/	2.0	2.1	4.4	5.3	7.9	6.2
Debt service, in percent of exports of GNFS 4/	...	25.5	35.1	56.4	63.7	65.7
Gross amortization	...	21.3	31.8	53.7	61.1	63.1
Interest payments	...	4.2	3.3	2.7	2.5	2.6
Memorandum items:						
Nominal GDP (millions of U.S. dollars)	10,840	11,381	12,095	14,045	18,354	22,291
Exports of GNFS (nominal percent change, y-o-y)	-20.6	28.7	20.7	23.4	27.0	12.5
Imports of GNFS (nominal percent change, y-o-y)	-16.9	13.2	16.4	22.9	27.1	17.0
USD Exchange Rate (period average)	4.0	4.0	4.0	3.7	3.1	2.8
Crude oil price (US$/bll)	18.0	28.2	24.3	25.0	28.9	38.5

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ External liabilities minus foreign equity investment.

2/ Gross external debt minus debt securities held abroad and other investments abroad.

3/ Total short-term liabilities excluding trade credits minus currency and deposits held abroad.

4/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities. The peak in 2001-02 reflects large-scale amortization of dollar-denominated debt immediately before and after the repegging of the litas.

Table 2b. Lithuania: Balance of Payments, 2005-09

	2005	2006	2007	2008	2009
			Proj.		
(In millions of US dollars)					
Current account	-2,338	-2,495	-2,623	-2,754	-2,879
Trade balance	-3,132	-3,357	-3,497	-3,638	-3,772
Exports (f.o.b.)	9,705	11,015	12,227	13,450	14,795
Imports (f.o.b.)	12,837	14,373	15,724	17,088	18,567
Nonfactor services, net	605	713	823	933	1,058
Credits	2,338	2,653	2,945	3,240	3,564
Debits	1,733	1,940	2,122	2,306	2,506
Factor income, net	-1,068	-1,196	-1,335	-1,477	-1,633
Current transfers, net	1,256	1,345	1,386	1,427	1,469
Capital and financial account	2,338	2,495	2,623	2,754	2,879
Capital transfers, net	760	863	882	900	919
Financial account	1,578	1,632	1,742	1,854	1,959
Direct investment, net	512	667	836	917	1,006
Assets	250	327	412	452	496
Liabilities	262	340	425	465	510
Portfolio investment, net	320	354	391	429	470
Inflows	284	315	347	381	417
Outflows	36	40	44	48	53
Other capital inflows, net	588	421	291	250	188
Inflows	741	597	493	477	443
Outflows	-117	-137	-158	-180	-204
Net errors and omissions	...	...	...	...	...
Change in official reserves (-=increase)	157	189	223	258	296
Gross official reserves	3,751	3,941	4,164	4,422	4,718
Gross external debt 1/	10,682	11,702	12,864	14,100	15,419
Public and publicly guaranteed	3,026	3,285	3,571	3,884	4,228
Private	5,198	5,874	6,669	7,541	8,497
Net external debt 2/	8,631	9,745	11,020	12,385	13,852
Public and publicly guaranteed	3,026	3,285	3,571	3,884	4,228
Private	5,605	6,460	7,449	8,501	9,624
Short-term gross external debt	4,126	4,552	5,009	5,472	5,943
On an original maturity basis					
Of which:					
Trade credit	2,027	2,370	2,749	3,164	3,619
Currency and deposits at banks	569	674	791	918	1,058
Short-term net external debt 3/	1,530	1,507	1,469	1,389	1,266
Debt service 4/	7,777	8,520	9,366	10,266	11,227
Gross amortization	7,471	8,184	8,997	9,861	10,784
Interest payments	307	336	370	405	443
(In percent of GDP)					
Current account	-9.5	-9.1	-8.7	-8.3	-7.9
Trade balance of goods and services	-10.2	-9.7	-8.9	-8.2	-7.5
Trade balance, goods	-12.7	-12.3	-11.6	-11.0	-10.4
Trade balance, services	2.4	2.6	2.7	2.8	2.9
Factor income, net	-4.3	-4.4	-4.4	-4.5	-4.5
Current transfers, net	5.1	4.9	4.6	4.3	4.1
Capital and financial account	9.5	9.1	8.7	8.3	7.9
Capital transfers	3.1	3.2	2.9	2.7	2.5
Financial account	6.4	6.0	5.8	5.6	5.4
Direct investment, net	2.1	2.4	2.8	2.8	2.8
Portfolio investment, net	1.3	1.3	1.3	1.3	1.3
Other investment, net	2.4	1.5	1.0	0.8	0.5
Gross external debt 1/	43.2	42.8	42.6	42.6	42.5
Public and publicly guaranteed	12.2	12.0	11.8	11.7	11.7
Private	21.0	21.5	22.1	22.8	23.4
Net external debt 2/	34.9	35.6	36.5	37.5	38.2
Public and publicly guaranteed	12.2	12.0	11.8	11.7	11.7
Private	22.7	23.6	24.7	25.7	26.6
Short-term net external debt 3/	6.2	5.5	4.9	4.2	3.5
Debt service, in percent of exports of GNFS 4/	64.6	62.3	61.7	61.5	61.2
Gross amortization	62.0	59.9	59.3	59.1	58.7
Interest payments	2.5	2.5	2.4	2.4	2.4
Memorandum items:					
Nominal GDP (millions of U.S. dollars)	24,710	27,341	30,166	33,065	36,242
Exports of GNFS (nominal percent change, y-o-y)	12.7	13.5	11.0	10.0	10.0
Imports of GNFS (nominal percent change, y-o-y)	17.2	12.0	9.4	8.7	8.7
USD Exchange Rate (period average)	...	...	...	...	...
Crude oil price (US$/bll)	42.75	38.25	36	35	34

Sources: Lithuanian authorities; and Fund staff estimates and projections.

1/ External liabilities minus foreign equity investment.

2/ Gross external debt minus debt securities held abroad and other investments abroad.

3/ Total short-term liabilities excluding trade credits minus currency and deposits held abroad.

4/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities. The peak in 2001-02 reflects large-scale amortization of dollar-denominated debt immediately before and after the repegging of the litas.

Table 3. Lithuania: Summary Monetary Accounts, 1999-2004

	1999	2000	2001	2002	2003	2004
Monetary Authority			In millions of litai			
Gross foreign assets (new definition)	4,976	5,376	6,629	7,932	9,448	9,028
Gross foreign assets (adjusted)	4,976	5,376	6,423	7,739	9,263	9,028
Gross foreign liabilities (new definition)	923	768	811	594	309	76
Of which: Use of Fund credit	922	767	604	399	123	66
Net Foreign Assets	4,054	4,607	5,818	7,339	9,139	8,952
NDA as residual from calculated NFA						
Net Domestic Assets	35	-655	-1,538	-2,171	-2,599	-1,951
o/w: Net credit to government	-326	-804	-1,510	-1,972	-2,237	-1,496
Credit to banks	30	24	15	16	10	10
Credit to private sector	6	6	6	8	10	11
Credit to non-bank financial institutions	20	0	0	0	0	0
Other items, net	305	120	-50	-222	-381	-475
Reserve Money	4,088	3,953	4,280	5,168	6,540	7,002
Currency outside the central bank	2,972	2,904	3,263	4,218	5,132	5,590
Currency outside banks	2,739	2,658	2,920	3,756	4,632	5,121
Cash in vaults of banks	233	246	343	461	500	468
Deposit money banks' deposits	1,109	1,037	1,000	930	1,389	1,389
Transaction and required reserves accounts in litas	445	621	584	591	991	885
Time and special deposits	229	0	0	0	0	0
Required reserves in foreign currency	436	416	417	339	398	504
Private and nonmonetary financial institutions	7	12	17	20	19	23
Banking Survey						
Net Foreign Assets	3,656	5,368	6,426	6,996	6,682	6,731
Monetary authority	4,054	4,607	5,818	7,339	9,139	8,952
Banks and other banking institutions	-398	761	608	-343	-2,457	-2,221
Net Domestic Assets	5,316	5,087	6,265	7,839	10,855	15,034
Net claims on government 1/	199	569	947	808	159	519
Monetary authority 2/	-326	-804	-1,510	-1,972	-2,237	-1,496
Banks and other banking institutions	525	1,373	2,456	2,780	2,397	2,015
Credit to non-financial public enterprises	277	304	253	198	148	88
Credit to private sector	5,545	5,209	5,538	7,221	11,470	16,030
Credit to nonbank financial institutions	468	513	791	980	1,358	1,896
Other items, net	-1,173	-1,509	-1,265	-1,369	-2,280	-3,498
Broad Money	8,972	10,455	12,691	14,835	17,537	21,765
Currency outside banks	2,739	2,658	2,920	3,756	4,632	5,121
Deposits	6,233	7,797	9,771	11,078	12,905	16,644
In national currency	3,509	4,243	5,589	7,465	9,478	12,325
Savings deposits	972	1,228	1,765	2,892	3,575	4,974
Demand deposits	2,536	3,014	3,824	4,573	5,903	7,351
In foreign currency	2,725	3,554	4,181	3,614	3,427	4,320
Memorandum items:						
Reserve money (yearly percent change)	-4	-3	8	21	27	7
Broad money (yearly percent change)	8	17	21	17	18	24
Private sector credit (yearly percent change)	14	-6	6	30	59	40
Money multiplier	2	3	3	3	3	3
Currency / deposits, in percent	44	34	30	34	36	31
Foreign currency / litai deposits, in percent	78	84	75	48	36	35
Gross official reserves, in US$ mln. 3/	1,244	1,344	1,657	2,335	3,354	3,502
Gross official reserves, in euros	1,441	1,557	1,920	2,297	2,736	2,615
GDP	43,359	45,526	48,379	51,643	56,179	61,983

Sources: Bank of Lithuania; and Fund staff estimates and projections.
1/ Excludes local government deposits; includes counterpart funds.
2/ Data for 2001 onward include treasury accounts that were moved from commercial banks to the BoL at end-June 2001.
3/ Gross official reserves for historic data differ from the balance of payments table because of valuation differences.

Table 4. Lithuania: Summary of Consolidated General Government Operations, 2000-09

	2000 1/	2001 2/	2002 3/	2003	2004	2005	2006	2007	2008	2009
					Proj.					
					In millions of litai					
Revenue and grants	13,707	14,296	15,445	16,880	19,449	23,147	25,448	27,516	29,710	32,270
Grants 4/			333	615	1,489	3,496	4,002	3,804	3,804	3,804
Revenue	13,707	14,296	15,112	16,265	17,960	19,651	21,446	23,713	25,906	28,466
Tax revenue	12,841	13,154	13,975	15,056	16,721	18,406	20,121	22,276	24,358	26,794
Taxes on income and profits	3,835	3,785	3,875	4,515	4,994	5,603	6,173	6,875	7,456	8,241
Payroll tax (social security tax)	3,194	3,265	3,431	3,740	4,308	4,795	5,265	5,849	6,459	7,133
Taxes on goods and services	5,157	5,474	5,981	6,152	6,712	7,224	7,836	8,638	9,460	10,362
Other tax revenue	655	630	688	649	707	784	847	915	983	1,057
Non-tax Revenue	866	1,142	1,137	1,209	1,239	1,245	1,325	1,436	1,548	1,672
Expenditure and net lending	15,011	15,065	15,907	17,461	20,823	24,448	26,578	28,344	29,916	31,812
Expenditure	14,711	14,989	16,011	17,612	20,823	24,448	26,578	28,344	29,916	31,812
Current expenditure 5/	13,839	14,072	14,417	15,686	18,611	20,887	22,380	23,678	24,845	26,260
Wages and salaries, excl. contributions to SoDra	3,450	3,509	3,685	3,841	4,137	4,496	4,863	5,223	5,527	5,790
Goods and services	4,088	4,100	4,244	4,728	5,112	5,632	5,880	5,924	5,946	6,249
Transfers to EU	0	0	0	0	440	766	747	824	903	990
Transfers to households	5,401	5,586	5,610	6,014	7,432	8,457	9,191	9,931	10,655	11,443
Subsidies	103	81	126	164	309	610	744	772	801	777
Interest payments	782	781	687	673	681	675	705	753	763	762
Savings restitution program	15	15	65	266	500	250	250	250	250	250
Capital expenditure	872	918	1,594	1,926	2,213	3,561	4,198	4,667	5,071	5,552
Fiscal balance (deficit (-)) 6/	-1,466	-918	-430	-943	-1,374	-1,302	-1,130	-828	-207	458
Financing 5/	1,466	918	430	943	1,357	1,302	1,130	828	207	-458
Net domestic	161	139	21	141	781	616	880	728	107	-508
Bank financing	-485	-438	-1,046	-79	921	466	780	678	57	-558
Nonbank financing	646	577	1,067	220	-140	150	100	50	50	50
Net foreign	502	281	163	11	425	386	50	0	0	0
Privatization proceeds	803	498	246	791	151	300	200	100	100	50
					In percent of GDP					
Revenue and grants	30.1	29.6	29.9	30.0	31.4	33.7	33.5	32.8	32.3	32.0
Grants 4/	0.0	0.0	0.6	1.1	2.4	5.1	5.3	4.5	4.1	3.8
Revenue	30.1	29.6	29.3	29.0	29.0	28.6	28.2	28.3	28.2	28.2
Tax revenue	28.2	27.2	27.1	26.8	27.0	26.8	26.5	26.6	26.5	26.6
Taxes on income and profits	8.4	7.8	7.5	8.0	8.1	8.2	8.1	8.2	8.1	8.2
Payroll tax (social security tax)	7.0	6.7	6.6	6.7	6.9	7.0	6.9	7.0	7.0	7.1
Taxes on goods and services	11.3	11.3	11.6	11.0	10.8	10.5	10.3	10.3	10.3	10.3
Other tax revenue	1.4	1.3	1.3	1.2	1.1	1.1	1.1	1.1	1.1	1.0
Nontax Revenue	1.9	2.4	2.2	2.2	2.0	1.8	1.7	1.7	1.7	1.7
Expenditure and net lending	33.0	31.1	30.8	31.1	33.6	35.6	35.0	33.8	32.5	31.6
Expenditure	32.3	31.0	31.0	31.3	33.6	35.6	35.0	33.8	32.5	31.6
Current expenditure 5/	30.4	29.1	27.9	27.9	30.0	30.4	29.4	28.2	27.0	26.1
Wages and salaries, excl. contributions to SoDra	7.6	7.3	7.1	6.8	6.7	6.5	6.4	6.2	6.0	5.7
Goods and services	9.0	8.5	8.2	8.4	8.2	8.2	7.7	7.1	6.5	6.2
Transfers to EU	0.0	0.0	0.0	0.0	0.7	1.1	1.0	1.0	1.0	1.0
Transfers to households	11.9	11.5	10.9	10.7	12.0	12.3	12.1	11.8	11.6	11.4
Subsidies	0.2	0.2	0.2	0.3	0.5	0.9	1.0	0.9	0.9	0.8
Interest payments	1.7	1.6	1.3	1.2	1.1	1.0	0.9	0.9	0.8	0.8
Savings restitution program	0.0	0.0	0.1	0.5	0.8	0.4	0.3	0.3	0.3	0.2
Capital expenditure	1.9	1.9	3.1	3.4	3.6	5.2	5.5	5.6	5.5	5.5
Fiscal balance (deficit (-)) 6/	-3.2	-1.9	-0.8	-1.7	-2.2	-1.9	-1.5	-1.0	-0.2	0.5
Financing 5/	3.2	1.9	0.8	1.7	2.2	1.9	1.5	1.0	0.2	-0.5
Net domestic	0.4	0.3	0.0	0.3	1.3	0.9	1.2	0.9	0.1	-0.5
Bank financing	-1.1	-0.9	-2.0	-0.1	1.5	0.7	1.0	0.8	0.1	-0.6
Non-bank financing	1.4	1.2	2.1	0.4	-0.2	0.2	0.1	0.1	0.1	0.0
Net foreign	1.1	0.6	0.3	0.0	0.7	0.6	0.1	0.0	0.0	0.0
Privatization proceeds	1.8	1.0	0.5	1.4	0.2	0.4	0.3	0.1	0.1	0.0
Memorandum Items:										
General government debt	23.8	22.9	22.4	21.4	19.7	19.8	18.8	18.5	18.3	18.1
Foreign debt	16.2	14.8	13.5	13.2	12.7	13.4	12.3	11.8	11.4	10.9
Domestic debt	7.6	8.1	9.0	8.3	7.0	6.4	6.5	6.7	6.9	7.1
GDP in mln. LTL	45,525.9	48,378.7	51,642.9	56,179.1	61,982.9	68,709.3	76,023.3	83,879.6	91,939.4	100,773.7

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

1/ From 2000 onward, five new extrabudgetary funds, which had not been reported before, were added.

2/ From 2001 onward, fees paid to educational establishments and their spending (LTL128 million) were added to general government operations.

3/ From 2002 onward, fees paid by trucks crossing the borders of the country were added. In addition, following the new organic budget law, revenue of state institutions for provided services was included in municipal budget.

4/ Grants from EU and related expenditures are not included prior to 2002.

5/ For 2001, current expenditure and nonbank financing include LTL72 million of pharmaceutical arrears rescheduled in December 2001 (according to the definition in IMF Country Report No. 02/8. The entire amount was repaid in March 2002 through a commercial bank loan contracted by the Health Insurance Fund. The latter operations are recorded in 2002Q1 as domestic bank borrowing for LTL 72 million, and amortization to the nonbank sector by the same amount. The terms of the loan include repayments in eight equal tranches of LTL 9 million, starting in 2003, with the final payment due on December 31, 2006.

6/ The early repurchase on January 2, 2003 lowered the 2003 budgeted deficit by SDR 39.244 million, everything else being equal, as this amount, which was previously on-lent to the monetary authorities, is treated as a repayment in net lending.

Table 5. Lithuania: Indicators of External and Financial Vulnerability, 1999-2004

	1999	2000	2001	2002	2003	2004	Date of
						Est.	Actuals
Financial indicators							
Broad money (year-on-year change in percent)	7.7	16.5	21.4	16.9	18.2	24.1	
Broad money in percent of gross official reserves	180.3	194.5	191.4	187.0	185.6	241.1	
Private sector credit (year-on-year change in percent)	13.8	-6.1	6.3	30.4	58.8	39.8	
External indicators							
Current account balance in percent of GDP	-11.0	-5.9	-4.7	-5.2	-7.0	-8.6	
Exports of GNFS (in millions of U.S. dollars)	4,238	5,109	6,046	7,510	9,536	10,690	
Exports of GNFS (year-on-year change in percent)	-20.6	28.7	20.7	23.4	27.0	12.5	
Imports of GNFS (year-on-year change in percent)	-16.9	13.2	16.4	22.9	27.1	17.0	
Capital and financial account balance in percent of GDP	15.9	8.1	7.1	9.3	6.1	8.6	
Gross official reserves (in millions of U.S. dollars) 1/	1,242	1,359	1,669	2,413	3,450	3,594	
Gross official reserves/short-term debt 2/	1.1	0.7	0.4	0.4	0.5	0.5	
Gross official reserves/short-term debt 3/	1.1	1.2	1.1	1.1	1.1	1.0	
Gross official reserves/reserve money	121.5	137.5	156.0	171.7	161.4	142.7	
Gross official reserves in months of imports of GNFS over the following year	2.6	2.4	2.4	2.7	3.3	3.0	
Total gross external debt (in millions of U.S. dollars)	4,528	4,857	5,268	6,199	8,338	9,639	
in percent of GDP	41.8	42.7	43.6	44.1	45.4	43.2	
of which: Public sector debt (in millions of U.S. dollars)	2,383	2,364	2,332	2,429	2,793	2,792	
in percent of GDP	22.0	20.8	19.3	17.3	15.2	12.5	
of which: Short-term external debt (in millions of U.S. dollars) 3/	1,101	1,114	1,558	2,123	3,277	3,575	
in percent of gross international reserves	88.7	82.0	93.4	88.0	95.0	99.5	
in percent of GDP	10.2	9.8	12.9	15.1	17.9	16.0	
of which: excluding short-term liabilities of the commercial banks	892	832	1,033	1,379	1,829	1,955	
Total net external debt (in millions of U.S. dollars) 4/	3,349	3,688	3,827	4,572	6,214	7,508	
in percent of GDP	30.9	32.4	31.6	32.6	33.9	33.7	
of which: Public sector debt (in millions of U.S. dollars)	2,383	2,364	2,332	2,429	2,793	2,792	
in percent of GDP	22.0	20.8	19.3	17.3	15.2	12.5	
Total net external short-term debt (in millions of U.S. dollars) 5/	221	234	530	740	1,452	1,384	
in percent of GDP	2.0	2.1	4.4	5.3	7.9	6.2	
External interest payments in percent of exports GNFS	...	4.2	3.3	2.7	2.5	2.6	
External amortization payments in percent of exports GNFS	...	21.3	31.8	53.7	61.1	63.1	
Debt service as percent of exports of GNFS 6/	...	25.5	35.1	56.4	63.7	65.7	
Real effective exchange rate (year-on-year change in percent, "+" = appreciation) 7/	6.9	6.5	-0.3	4.6	2.0	1.89	11/2004
Financial market indicators							
Stock market index, end of period 8/	1,147	1,137	1,145	1,338	2,354	3,308	
Foreign currency debt rating 9/	BBB-	BBB-	BBB-	BBB	BBB+	A-	2/2004
Memorandum item:							
Nominal exchange rate (litai/U.S. dollar, end-of-period)	4.0	4.0	4.0	3.3	2.8	2.5	
Nominal exchange rate (litai/euro, end-of-period)	4.0	3.7	3.5	3.5	3.5	3.5	

Sources: Bank of Lithuania, Ministry of Finance, Department of Statistics, National Stock Exchange of Lithuania, Bloomberg, and Information Notice System.

1/ Gross official reserves reported here differ from the monetary table due to valuation differences.

2/ On a remaining maturity basis.

3/ On an original maturity basis.

4/ Total external liabilities minus total external assets, excluding foreign direct investment, equity investment and reserve assets.

5/ Total short-term liabilities excluding trade credits minus currency and deposits held abroad.

6/ Debt service comprises interest and repayment on external loans, and interest and repayment on debt securities.

7/ CPI-based REER against the 21 major trading partners in 1999.

8/ LITIN10 price index

9/ S&P investment grade rating.

Table 6. Lithuania: Financial Sector Indicators, 1999-2004
(In percent, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004
Private sector credit (percentage change, year-on-year) 1/	13.8	-6.1	6.3	30.4	58.8	39.8
Loans to private enterprises (Lithuanian residents, in millions of litai)	3,858	3,715	4,549	5,697	8,505	11,006
of which: share of foreign currency loans	65.2	70.0	63.8	55.8	63.0	64.1
Loans to private enterprises (Lithuanian residents, percentage change, year-on-year)	10.4	-3.7	22.5	25.2	49.3	29.4
Share of loans to private enterprises (Lithuanian residents) in total lending	65.3	62.8	62.5	63.9	62.8	58.4
Loans to individuals (Lithuanian residents)	660	573	714	1,216	2,396	4,425
of which: share of foreign currency loans	31.6	49.7	45.9	27.7	30.9	44.2
Loans to individuals\ (Lithuanian residents, percentage change, year-on-year)	26.0	-13.2	24.6	70.4	97.0	84.7
Share of loans to individuals (Lithuanian residents) in total lending	11.2	9.7	9.8	13.6	17.7	23.5
Required reserves (in percent of total reserves)	69.8	71.6	83.2	84.8	69.1	88.9
Official risk indicators 2/						
Share of nonperforming loans in total loans 3/	12.5	11.3	8.2	6.5	3.0	2.3
Risk-weighted capital asset ratio (capital over risk-weighted assets) 4/	17.4	16.3	15.7	14.8	13.3	12.3
Leverage ratio 5/	11.1	10.2	9.8	10.7	10.4	9.5
Financial sector risk factors of DMB's						
Share of foreign currency loans in total lending	61.6	66.8	60.6	51.1	54.9	58.5
Share of foreign currency deposits in total deposits	48.8	49.5	49.1	42.2	41.8	42.2
Short-term loans in percent of total loans	41.0	37.9	31.9	27.7	24.1	19.5
Demand deposits in percent of total deposits	51.4	48.9	46.5	47.2	47.6	49.0
Bank profitability						
Return on Assets	...	0.5	-0.1	1.0	1.4	1.3
Return on Equity	...	5.0	-1.1	9.8	13.4	13.4
Market assessment						
Spread between VILIBID and VILIBOR 6/ 7/	295.9	233.3	194.0	134.2	87.3	47.5
Open position in foreign exchange 8/ 9/	6.0	3.8	1.9	-1.5	10.8	-1.9
Total loans (in millions of litai)	5,911	5,916	7,284	8,922	13,548	18,848
Total deposits (in millions of litai)	7,450	9,176	11,659	13,484	16,985	22,373
Average annual interest rate on litas loans to enterprises	12.95	11.82	8.20	5.97	4.83	4.98
Average annual interest rate on litas loans to individuals	13.25	12.65	8.48	6.38	5.75	7.49

Sources: Bank of Lithuania and National Stock Exchange of Lithuania.

1/ 2001 has been adjusted by LTL 785 million of reclassified assets.
2/ Prudential standards are broadly at international levels, and there is a full program of on-site and off-site supervision. Foreign bank branches are not included.
3/ Includes loans overdue for 31 days. The classification of loans may be adjusted according to the borrower's standing, loan restructuring and refinancing. (Resolution on the Board of the Bank of Lithuania on the Approval of the Regulations for Classification of Doubtful Assets, April 24, 1997 No. 87).
4/ The compilation of the minimum capital adequacy ratio was aligned with the basle methodology on January 1, 1997.
5/ Defined as the ratio of total capital to total liabilities.
6/ Interbank rates; basis points.
7/ As of January 1, 1999, the spread between the average overnight Vilnius Interbank Offered rate (VILIBOR) and the average overnight Vilnius Interbank Bid rate (VILIBID) during the respective month; before January 1, 1999, the spread between the average of the highest and lowest VILBOR and the average between the highest and lowest VILIBID.
8/ Open position includes off-balance exposure.
9/ Maximum open position requirements have been reduced as of June 1, 2000. Maximum in foreign currency and precious metals is 25 percent of a bank's capital, while earlier it was 30 percent. Maximum in each currency is 15 percent, while earlier it was 20 percent.

Table 7. Lithuania: Macroeconomic Framework, 1999-2009
(In percent of GDP, unless stated otherwise)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
								Proj.			
Gross national saving	11.4	13.6	15.8	16.5	15.4	13.3	13.5	15.2	16.3	17.3	18.3
General government	-3.9	-0.6	0.2	2.1	1.5	1.4	3.3	4.0	4.6	5.3	6.0
Nongovernment	15.3	14.3	15.6	14.5	14.0	11.9	10.2	11.2	11.7	12.0	12.3
Gross national investment	22.5	19.6	20.5	21.7	22.4	21.9	23.0	24.4	25.0	25.6	26.2
Foreign saving 1/	11.0	5.9	4.7	5.2	7.0	8.6	9.5	9.1	8.7	8.3	7.9
Consolidated general government fiscal balance 2/	-8.4	-3.2	-1.9	-0.8	-1.7	-2.2	-1.9	-1.5	-1.0	-0.2	0.5
Current account balance	-11.0	-5.9	-4.7	-5.2	-7.0	-8.6	-9.5	-9.1	-8.7	-8.3	-7.9
External debt 3/	41.8	42.7	43.6	44.1	45.4	43.2	43.2	42.8	42.6	42.6	42.5
Debt service (in percent of exports of GNFS)	...	25.5	35.1	56.4	63.7	65.7	64.6	62.3	61.7	61.5	61.2
Nominal GDP (in millions of litai)	43,359	45,526	48,379	51,643	56,179	61,983	68,709	76,023	83,880	91,939	100,774
Real GDP growth (annual percentage change)	-1.7	3.9	6.4	6.8	9.7	6.6	7.0	6.8	6.5	5.8	5.8
Average CPI inflation (annual percentage change)	0.7	1.0	1.3	0.3	-1.2	1.2	2.9	3.0	3.0	3.0	3.0
End-of-period CPI inflation (annual percentage change)	0.2	1.4	2.0	-1.0	-1.3	3.3	3.0	3.0	3.0	3.0	3.0

Sources: Lithuanian authorities; and Fund staff calculations.

1/ Negative current account balance.
2/ Includes discrepancy between above- and below-the-line estimates of the financial balance and balances of budgetary organizations not recorded in the above-the-line number. Also includes savings restitution payments in 1999.
3/ External liabilities minus equity investment in Lithuania. Includes public, publicly guaranteed, and private external debt.

Table 8. Lithuania: External Debt Sustainability Framework, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Projections					
	1999	2000	2001	2002	2003			2004 4/	2005	2006	2007	2008	2009
										I. Baseline Projections			
1 **External debt**	41.8	42.7	43.6	44.1	45.4			**43.2**	**43.2**	**42.8**	**42.6**	**42.6**	**42.5**
2 Change in external debt	8.1	0.9	0.9	0.6	1.3			-2.2	0.0	-0.4	-0.2	0.0	-0.1
3 Identified external debt-creating flows (4+8+9)	7.4	0.7	-1.4	-5.9	-4.2			-2.2	0.0	-0.4	-0.2	0.0	-0.1
4 Current account deficit, excluding interest payments	11.0	4.0	3.1	3.8	5.7			7.4	8.2	7.9	7.5	7.1	6.7
5 Deficit in balance of goods and services	20.2	15.7	15.0	16.2	16.2			17.1	19.7	19.4	18.6	18.0	17.3
6 Exports	29.0	35.6	40.4	42.9	41.7			38.6	39.3	40.3	40.5	40.7	40.8
7 Imports	49.2	51.2	55.4	59.1	57.9			55.8	59.0	59.7	59.2	58.7	58.1
8 Net non-debt creating capital inflows (negative)	-4.4	-3.3	-3.6	-5.1	-0.8			-1.7	-2.1	-2.4	-2.8	-2.8	-2.8
9 Automatic debt dynamics 1/	0.8	-0.1	-0.9	-4.6	-9.1			-7.9	-6.2	-5.9	-4.9	-4.3	-4.1
10 Contribution from nominal interest rate	0.0	1.9	1.7	1.5	1.3			1.2	1.2	1.2	1.2	1.2	1.2
11 Contribution from real GDP growth	0.6	-1.6	-2.6	-2.5	-3.3			-2.5	-2.7	-2.7	-2.5	-2.3	-2.3
12 Contribution from price and exchange rate changes 2/	0.2	-0.4	0.0	-3.5	-7.1			-6.7	-4.7	-4.5	-3.6	-3.3	-3.0
13 Residual, incl. change in gross foreign assets (2-3)	0.6	0.2	2.3	6.5	5.5			0.0	0.0	0.0	0.0	0.0	0.0
External debt-to-exports ratio (in percent)	143.9	119.9	107.8	102.8	108.9			111.9	110.1	106.2	105.2	104.8	104.2
Gross external financing need (in millions of US dollars) 3/	2236.3	1761.2	2496.1	4767.3	7109.6			8663.8	9808.6	10678.4	11620.1	12615.6	13662.5
in percent of GDP	20.6	15.5	20.6	33.9	38.7	8-Year Historical Average	8-Year Standard Deviation	38.9	39.7	39.1	38.5	38.2	37.7
Key Macroeconomic Assumptions													
Real GDP growth (in percent)	-1.7	3.9	6.4	6.8	9.7	5.5	3.4	6.6	7.0	6.8	6.5	5.8	5.8
Exchange rate appreciation (US dollar value of local currency, change in percent)	0.0	0.0	0.0	8.8	20.1	3.8	6.9	10.1	0.0	0.0	0.0	0.0	0.0
GDP deflator in US dollars (change in percent)	-0.6	1.0	-0.1	8.8	19.1	8.5	8.6	13.9	3.6	3.6	3.6	3.6	3.6
Nominal external interest rate (in percent)	0.0	4.7	4.1	3.9	3.9	2.4	2.2	3.3	3.2	3.1	3.2	3.1	3.1
Growth of exports (US dollar terms, in percent)	-20.6	28.7	20.7	23.4	27.0	15.6	17.8	12.5	12.7	13.5	11.0	10.0	10.0
Growth of imports (US dollar terms, in percent)	-15.9	9.3	14.8	24.0	28.0	17.2	17.9	17.0	17.2	12.0	9.4	8.7	8.7
Current account balance, excluding interest payments	-11.0	-4.0	-3.1	-3.8	-5.7	-7.3	3.5	-7.4	-8.2	-7.9	-7.5	-7.1	-6.7
Net non-debt creating capital inflows	4.4	3.3	3.6	5.1	0.8	3.8	2.3	1.7	2.1	2.4	2.8	2.8	2.8
Bound Tests										**II. Stress Tests for External Debt Ratio**			
1. Nominal interest rate is at baseline level plus a two percent shock in 2005. The shock dies out gradually over 2006-2009.								**43.2**	**44.0**	**44.2**	**44.6**	**45.1**	**45.4**
2. Real GDP growth is at baseline level minus a four percent shock in 2005. The shock dies out gradually over 2006-2009.								**43.2**	**44.7**	**45.5**	**46.2**	**46.8**	**47.1**
3. Change in US dollar GDP deflator is at historical average minus a one percent shock in 2005. The shock dies out gradually over 2006-2009.								**43.2**	**43.6**	**43.5**	**43.5**	**43.7**	**43.6**
4. Non-interest current account is at historical average minus a three percent shock in 2005. The shock dies out gradually over 2006-2009.								**43.2**	**46.2**	**48.3**	**50.2**	**52.0**	**53.3**
5. Combination of 1-4: all shocks.								**43.2**	**48.9**	**53.4**	**57.4**	**60.9**	**63.7**
6. One time 30 percent nominal depreciation in 2005.								**43.2**	**59.6**	**57.0**	**54.8**	**52.9**	**51.0**

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, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
4/ Includes preliminary data as well as estimates.

Table 9. Lithuania: Public Sector Debt Sustainability Framework, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual 1999	2000	2001	2002	2003	6-Year Historical Average	6-Year Standard Deviation	Projections 2004	2005	2006	2007	2008	2009
								I. Baseline Projections					
1 **Public sector debt 1/**	23.0	23.8	22.9	22.4	21.4			**19.7**	**19.8**	**18.8**	**18.5**	**18.3**	**18.1**
o/w foreign-currency denominated	6.3	7.6	8.1	9.0	8.3			7.0	6.4	6.5	6.7	6.9	7.1
2 Change in public sector debt	6.2	0.8	-0.9	-0.5	-1.0			-1.7	0.1	-1.0	-0.4	-0.2	-0.2
3 Identified debt-creating flows (4+7+12)	7.0	1.3	0.7	-1.2	-2.6			0.3	-0.3	-0.5	-0.8	-1.4	-2.1
4 Primary deficit	4.7	1.2	0.3	0.0	0.1			1.0	0.8	0.5	0.1	-0.6	-1.2
5 Revenue and grants	31.6	30.1	29.6	29.9	30.0			31.4	33.7	33.5	32.8	32.3	32.0
6 Primary (noninterest) expenditure	36.2	31.4	29.8	29.9	30.2			32.3	34.5	34.0	32.9	31.7	30.8
7 Automatic debt dynamics 2/	1.4	-0.1	-0.2	-1.9	-2.1			-0.7	-0.8	-0.9	-0.9	-0.8	-0.8
8 Contribution from interest rate/growth differential 3/	1.4	-0.1	-0.2	-0.4	-0.6			-0.7	-0.8	-0.9	-0.9	-0.8	-0.8
9 Of which contribution from real interest rate	1.1	0.7	1.2	1.1	1.4			0.5	0.4	0.3	0.3	0.2	0.1
10 Of which contribution from real GDP growth	0.3	-0.9	-1.4	-1.5	-2.0			-1.3	-1.2	-1.2	-1.1	-1.0	-1.0
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	-1.5	-1.5			...	...	...	...	...	...
12 Other identified debt-creating flows	1.0	0.2	0.6	0.7	-0.5			0.0	-0.2	-0.1	-0.1	-0.1	0.0
13 Privatization receipts (negative)	-1.1	-1.8	-1.0	-0.5	-1.4			-0.2	-0.4	-0.3	-0.1	-0.1	0.0
14 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
15 Other (specify, e.g. bank recapitalization)	2.1	2.0	1.7	1.2	0.9			0.3	0.2	0.1	0.1	0.1	0.0
Public sector debt-to-revenue ratio 1/	72.8	79.1	77.6	75.0	71.4			62.8	58.8	56.3	56.3	56.5	56.4
Gross financing need 5/	18.5	20.4	13.5	7.6	8.1			8.8	6.6	5.6	4.1	2.8	2.6
in billions of U.S. dollars	2.0	2.3	1.6	1.1	1.5			2.0	1.6	1.5	1.2	0.9	0.9
Key Macroeconomic and Fiscal Assumptions													
Real GDP growth (in percent)	-1.7	3.9	6.4	6.8	9.7	5.4	3.9	6.6	7.0	6.8	6.5	5.8	5.8
Average nominal interest rate on public debt (in percent) 6/	5.9	4.4	5.2	5.1	5.8	5.9	1.6	6.5	6.2	5.6	5.3	4.9	4.5
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.5	3.3	5.3	5.1	6.6	4.8	1.3	3.0	2.6	2.0	1.7	1.3	0.9
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	20.8	19.9	0.0	0.0	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-0.6	1.0	-0.1	0.0	-0.8	0.8	2.2	3.5	3.6	3.6	3.6	3.6	3.6
Growth of real primary spending (deflated by GDP deflator, in percent)	4.2	-10.1	1.2	7.1	10.6	7.1	13.2	14.3	14.1	5.2	3.1	2.0	2.8
Primary deficit	4.7	1.2	0.3	0.0	0.1	1.5	1.8	1.0	0.8	0.5	0.1	-0.6	-1.2
								II. Stress Tests for Public Debt Ratio					
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2005-09 7/								**19.7**	**21.2**	**21.9**	**23.7**	**26.2**	**29.4**
B. Bound Tests													
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**19.7**	**20.6**	**20.7**	**20.2**	**19.9**	**19.6**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**19.7**	**25.0**	**32.8**	**38.5**	**44.1**	**49.3**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**19.7**	**24.2**	**27.7**	**26.9**	**26.3**	**25.8**
B4. Combination of B1-B3 using one standard deviation shocks								**19.7**	**24.0**	**27.8**	**27.1**	**26.6**	**26.2**
B5. Onetime 30 percent real depreciation in 2005 8/								**19.7**	**23.4**	**22.3**	**21.8**	**21.4**	**21.1**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**19.7**	**29.8**	**28.4**	**27.6**	**27.0**	**26.4**

1/ Gross debt for general government.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ Defined as public sector deficit, plus amortization of medium- and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

LITHUANIA: FUND RELATIONS
(As of January 31, 2005)

I. Membership Status: Joined: 4/29/1992; Article VIII.

II. General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	144.20	100.00
Fund holdings of currency	160.14	111.06
Reserve position in Fund	0.02	0.01

III. SDR Department:	**SDR Million**	**Percent of Allocation**
Holdings	0.21	N.A.

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
Extended arrangements	15.96	11.07

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

	Forthcoming			
	2005	2005	2006	2008
Principal	8.63	5.18	2.16	...
Charges/Interest	0.44	0.19	0.04	...
Total	9.07	5.36	2.2	...

VII. Implementation of HIPC Initiative:

N/A

VIII. Current Status of Safeguards Assessments:

Under the Fund's safeguards assessment policy, Bank of Lithuania (BOL) was subject to an assessment with respect to the Stand-By Arrangement, which was approved on August 30, 2001 and expired on March 29, 2003. A safeguards assessment of the BOL was completed on December 10, 2001. The assessment identified certain weaknesses and proposed appropriate recommendations as reported in IMF Country Report No. 02/8. The BOL has decided to implement these recommendations under a timetable agreed with the Fund.

IX. 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 Article of Agreement and maintains an exchange system free of restrictions on the making of payment and transfers for current international transactions.

X. Article IV Consultation:

Lithuania is on the 12-month consultation cycle.

XI. FSAP Participation and ROSCs:

FSAP work program is completed. STA ROSC and Fiscal ROSC have been completed.

XII. Technical Assistance:

The following table summarizes the technical assistance missions provided by the Fund to Lithuania since February 1997. [12]

LITHUANIA: TECHNICAL ASSISTANCE FROM THE FUND, 1997-2001

Department	Issue	Action	Date	Counterpart
FAD	Treasury operations	Mr. Ramachandran	Feb/Mar. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Jun. 1997	Ministry of Finance
FAD	Treasury operations	Mr. Ramachandran	Aug/Sep. 1997	Ministry of Finance
STA	Balance of payments statistics	Mr. Allen	Aug/Sep. 1997	Department of Statistics
FAD	Treasury operations	Mr. Ramachandran	Nov/Dec. 1997	Ministry of Finance
MAE	Monetary policy and banking supervision	Mission	Dec. 1997	Bank of Lithuania
STA	National accounts and balance of payments	Mr. Gschwindt de Gyor	Dec. 1997	Department of Statistics

[12] For technical assistance before 1997, see previous reports.

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

XIII. Resident Representative:

NA

LITHUANIA: STATUS OF STATISTICAL DATABASE

42. Over the past several years, Lithuania has made good progress in establishing a macroeconomic database. Official data for all sectors are generally of sufficiently good quality to support economic analysis. However, frequent and large revisions of national accounts data, though necessary for improving the accuracy and reliability of the data, tend to complicate the analysis of economic developments.

43. In general, the data are available on a timely basis, and the authorities have given the staff ready access to all available data (see the attached matrix). An IFS page for Lithuania was introduced in December 1995. Lithuania meets the Special Data Dissemination Standard (SDDS) specifications for coverage, periodicity and timeliness of the data, and for the dissemination of the advance release calendars. Lithuania subscribed to the Special Data Dissemination Standard in May 1996, and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (DSBB) on the Internet since April 1997. A significant amount of information is now available on various websites through the Internet (see section on Dissemination of Statistics, below).

National Accounts

44. The national accounts are compiled by the Department of Statistics (DOS) 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 both from the production and expenditure approaches. GDP estimates by production are considered to be more reliable than the corresponding estimates by expenditure, but no statistical discrepancies between these two estimates are shown in the published figures as the discrepancies are included in the estimates of changes in inventories. Good data sources and sound methods are used, in general, for the compilation of the national accounts, but difficulties remain in measuring the economic activity of the informal sector. These latter estimates are compiled at detailed levels of economic activity using fixed coefficients derived from a benchmark survey conducted in 1996. The base year for the fixed price series was changed to 2000 in early 2003.

Price Data

45. Since December 1998, the CPI weights have been updated each year. 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

46. Data on the central government budget execution are available quarterly, although these data are subject to frequent revisions. The ongoing treasury project is expected to improve fiscal data quality substantially. The budget data are only compiled on a cash basis; compilation of the budget data on an accrual basis would allow for better monitoring of arrears and facilitate forecasting of future budgetary flows. Monthly and quarterly data on consolidated central government are still on the different recording bases and they are not reconciled; MoF plans to introduce unified recording/accounting based on actual expenditure (not allocations that is the case in monthly data now) in 2005. Further work is needed to clarify the treatment of public health care providers and of EU transactions, and the consolidation procedure for government operations. Monthly and quarterly data on the consolidated central government are not reconciled because they are on different recording bases. A new classification, incorporating the GFSM2001, was approved in mid-2003.

Money and Banking

47. The Bank of Lithuania (BoL) reports monetary and financial statistics (MFS) to STA on a timely and regular basis. However, there is room to improve the consistency between Monetary and Financial Statistics Manual (MFSM) and statistical methodology employed in such areas as the analytical accounts of the banking sector.

External Sector

48. The BoL is responsible for compiling the balance of payments, the international investment position, the external debt and the international reserves statistics. The BoL compiles balance of payments statistics on a quarterly basis using the format recommended in the *Balance of Payments Manual*, fifth edition (BPM5). In 1999, BoL set in motion plans to develop and produce monthly balance of payments statistics to meet the requirements of the European Central Bank following Lithuania's application for membership of the EU and, subsequently, of the euro area. Hence, in addition to quarterly balance of payments data, the BoL has started publishing monthly balance of payments statistics since January 2002. 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 according to the operational guidelines and is hyperlinked to the Fund’s DSBB.

Dissemination of Statistics

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

- Lithuania's 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) provides data on monetary statistics, treasury bill auction results, balance of payments, the international investment position, and main economic indicators;

- The DOS website (http://www.std.lt) provides quarterly information on economic and social development indicators;

- The Ministry of Finance (http://www.finmin.lt) home page includes data on the national budget, as well as information on laws and privatization; and

- The National Stock Exchange website (http://www.nse.lt) has information on stock trading.

LITHUANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF FEBRUARY 16, 2005

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]	Memo Items:	
						Data Quality – Methodological soundness[2]	Data Quality Accuracy and reliability[3]
Exchange Rates	Jan. 31/05	Feb. 7/05	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[4]	Jan. 31/05	Feb. 7/05	M	M	M		
Reserve/Base Money	Nov.30/04	Jan. 5/05	M	M	M	O, LO, LO, LO	O, O, LO, O, O
Broad Money	Nov. 30/04	Jan. 5/05	M	M	M		
Central Bank Balance Sheet	Nov. 30/04	Jan. 5/05					
Consolidated Balance Sheet of the Banking System	Nov. 30/04	Jan. 5/05					
Interest Rates[5]	Jan. 31/05	Feb. 9/05	M	M	M		
Consumer Price Index	Dec./04	Jan. 05	M	M	M	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[6] – General Government[7]							
Revenue, Expenditure, Balance and Composition of Financing[6]– Central Government	Q3/04	Q3/04	Q	Q	Q	LO	LO
Stocks of Central Government and Central Government-Guaranteed Debt[8]	Dec/04	1/31/05	M	M	M		
External Current Account Balance	Q3/04	12/29/04	Q	Q	Q		
Exports and Imports of Goods and Services	Dec/04	2/11/05	M	M	M	O, O, LO, O	O, O, O, O, O
GDP/GNP	Q3/04	12/30/04	Q	Q	Q	O, LO, O, LO	O, LO, LO, LO, O
Gross External Debt	Q3/04	Sept. 25/04	Q	Q	Q		

[1] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).
[2] These columns should only be included for countries for which a Data ROSC (or a Substantive Update) has been prepared.
[3] Reflects the assessment provided in the data ROSC or the Substantive Update (published on November 2002, and based on the findings of the respective missions that took place during 2003-04) 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).
[4] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[5] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[6] Foreign, domestic bank, and domestic nonbank financing.
[7] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[8] Including currency and maturity composition.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 05/46
FOR IMMEDIATE RELEASE
March 31, 2005

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

IMF Executive Board Concludes 2004 Article IV Consultation with the Republic of Lithuania

On March, 23, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Lithuania.[1]

Background

Following severe economic difficulties in 1999, Lithuania accelerated its efforts to make a transition towards a competitive market economy. Lithuania acceded to the European Union on May 1, 2004 and entered ERM II on June 28, 2004, as a prelude to possible euro adoption by early 2007. With its accession to the EU, Lithuania has now embarked on another ambitious transition, this time to advanced European living standards. The discipline of the Maastricht criteria has added a further policy anchor to its existing currency board arrangement. This additional anchor is important and effective because of the wide political support for euro adoption.

Impressive growth continued unabated in 2004. GDP expanded by an estimated 6¾ percent in 2004, driven by vigorous private consumption and investment growth. The unemployment rate declined to 10½ percent of the labor force but bottlenecks have developed in certain sectors, exacerbated by migration flows to the EU and the United States. Inflation remained low, with the consumer price index reaching 1¼ percent in 2004. However, increases in excise taxes and energy prices, coupled with strong demand, caused inflation to accelerate rapidly in the second half of the year.

The current account deficit widened in 2004 to about 8½ percent of GDP owing to a deterioration of the trade balance of some 1 percent of GDP. Larger dividends and repatriated earnings on past

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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. This PIN summarizes the views of the Executive Board as expressed during the Executive Board discussion based on the staff report.

foreign direct investment aggravated the negative income balance, which also worsened by 1½ percent of GDP in 2004.

With strong economic growth and low interest rates, credit expanded rapidly in 2004. Early in the year, the speed of credit expansion briefly touched 70 percent on an annual basis before coming down to a still high 40 percent. Credit to households expanded at a more rapid rate than to the enterprise sector; however, the bulk of the credit continued to be absorbed by the productive enterprises.

The budget deficit widened appreciably from 1¾ percent in 2003 to 2¼ percent of GDP in 2004, imparting an expansionary fiscal stance. The widening reflected higher-than-expected pension reform costs, discretionary expenditures in the midyear budget and prior to the elections in November, and end-of-year spending on savings and real estate restitution; EU-related cofinancing expenditures played a smaller-than-anticipated role. Higher-than-expected personal and corporate income tax revenues helped contain the deficit; however, the single largest source of revenue, the value-added tax provided receipts that fell short of projections by about 15 percent.

Structural reforms continued in 2004, but deeper reforms remain necessary to keep Lithuania on a real convergence path with the EU. Further changes are needed to improve the financial viability of the social safety and health systems, and to enhance the focus, reduce the gaps, and raise the quality of the numerous social assistance programs. EU funds should be used effectively to help restructure the agricultural sector, and more generally to enhance the supply side of the economy. Continued efforts to make the economy more competitive by improving the business climate are also called for.

Executive Board Assessment

Executive Directors complimented the Lithuanian authorities for the implementation of sound macroeconomic policies and structural reforms. These efforts have helped achieve a lasting transformation of the economy, rapid growth, and low inflation, paving the way to EU accession and continued prosperity. Directors welcomed Lithuania's entry into ERM II and noted that the economy appears broadly on course to meet the Maastricht criteria and adopt the euro in early 2007.

Directors cautioned, however, that challenges remain for both the near- and the long term. A variety of indicators suggest limited slack in the economy. The current account deficit has widened appreciably in 2004 and is forecast to deteriorate further. Inflation, though low, has accelerated, and domestic bottlenecks and higher oil prices could raise the inflation rate temporarily above the Maastricht limit. In addition, a key long-term challenge is to ensure the implementation of reforms aimed at continued high productivity growth.

With indicators suggesting that output will remain above potential in 2005, an expansionary fiscal stance could add to inflationary pressures and the current account deficit. Short-term stability requires a more cautious fiscal policy than that contemplated by the authorities to allow for automatic stabilizers to operate, and Directors encouraged the authorities to build a safety margin to be used in the event of a slowdown. In this connection, a mid-year reopening of the budget to allow additional expenditures should be avoided, and a few Directors suggested that there is room for cutbacks in current expenditure.

Directors welcomed the authorities' plan to lower the personal income tax rate so as to improve incentives to raise employment and productivity. However, they emphasized that tax cuts should be phased in together with complementary measures so as not to jeopardize fiscal consolidation. In this context, the proposals to reduce tax exemptions, introduce a more wide-ranging property tax, and improve tax administration were seen as appropriate steps.

Directors noted that public expenditure reforms should be undertaken at both the central and local government levels, aimed at increasing transparency and control. They emphasized that the social protection system—including pensions, social assistance programs, and the health sector—needed further attention, with a view to improving their effectiveness and ensuring financial viability.

Directors supported the staff's proposal for enacting a Fiscal Responsibility Act. This, together with the currency board and the commitment to the Convergence Program, would provide a comprehensive and transparent framework for efficiently implementing fiscal policy at all levels of government within a multi-year setting.

While recognizing that an expansion of the deficit could be expected during the income convergence process, some Directors expressed concern about the widening of the current account deficit in the context of the relatively high rollover requirements of short-term debt, and risks of shifts in capital market sentiments. They emphasized the importance of close monitoring of the current account and its financing, and of the need to promote additional flows of FDI.

Directors noted that the regulation and supervision of banking and securities markets are well developed. They recognized that the mainly foreign-owned banking system has a low credit-to-GDP ratio and maintains adequate protection from shocks. However, Directors stressed that the trend growth in consumer borrowing and significant foreign currency exposure of the private sector require close monitoring of credit quality to track vulnerabilities. They encouraged the authorities to proceed with an FSAP update, which would examine these issues.

Directors encouraged the authorities to accelerate structural reforms necessary to support increased productivity, competitiveness, and long-run growth. In addition to lowering labor taxes, the authorities should take specific steps to introduce greater flexibility in short-term labor contracts, improve training, and ease construction and land use regulations. It will also be important to improve the business environment by fostering small and medium-sized enterprises through EU business development funds, as well as by promoting Research and Development and innovation, and deregulating the health and education sectors.

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 Macroeconomic Indicators

	2001	2002	2003	2004 Est.
Real Economy				
Real GDP growth (year-on-year, in percent)	6.4	6.8	9.7	6.6
CPI (end of period, year-on-year, in percent)	2.0	-1.0	-1.3	3.3
Unemployment rate (end of year)	17.4	13.8	12.4	11.3
Public Finance				
In percent of GDP				
General government fiscal balance	-1.9	-0.8	-1.7	-2.2
Total government debt	22.9	22.4	21.4	19.7
External government debt	16.2	14.8	13.5	13.2
Money and credit				
Year-on-year change, in percent				
Reserve money	8.3	20.8	26.6	7.1
Broad money	21.4	16.9	18.2	24.1
Private sector credit	6.3	30.4	58.8	39.8
Balance of Payments				
In percent of GDP				
Trade balance	-9.2	-9.5	-9.3	-10.5
Current account balance	-4.7	-5.2	-7.0	-8.6
Gross official reserves (in millions of U.S. dollars)	1,669.2	2,412.8	3,449.7	3,594.0
Exchange Rates				
Litas per U.S. dollar				
Exchange rate (period average)	4.0	3.7	3.1	2.8
Exchange rate (end period)	3.6	3.4	2.8	2.5

Sources: Lithuanian authorities; and IMF Staff estimates.

Statement by Jon A. Solheim, Executive Director for Republic of Lithuania and Giedrius Sidlauskas, Advisor to Executive Director
March 23, 2005

On behalf of our Lithuanian authorities, we would like to express our appreciation to the staff for the constructive discussions in Vilnius and for an interesting and useful set of papers for the 2004 Article IV consultation. Though the authorities broadly share staff's analysis and recommendations, their latest official growth forecasts are more cautious than staff's with important consequences for the assessment of the fiscal policy stance.

Following a prolonged period with stability-oriented macroeconomic policies and far reaching structural reforms, Lithuania became member of the European Union on May 1, 2004, making this the first Article IV consultation with Lithuania as an EU member. The authorities take an active part in the current activities of the EU, and bring an example of rapid reforms and flexibility. Over a very short period of time, Lithuania had to harmonize laws with EU legislation and rebuild the economy in order to be able to operate under free market conditions. This required political will and flexibility, as well as determination of the Lithuanian people to accept difficult and sometimes painful reforms.

While one important milepost has been passed with the EU membership, our authorities are well aware that this achievement is not reason for complacency and that many challenges lay ahead, including important short-term risks as noted by staff. The Lithuanian authorities remain fully committed to ensure continued rapid real and nominal convergence with the economic and social standards of the EU. Above all, the Lithuanian authorities are firmly committed to ensure policies consistent with their objective of joining the Euro Area by January 1, 2007, as further elaborated in the January 2005 update of the convergence program of Lithuania.

Growth in Lithuania has remained brisk, resulting in continued catching up with the Euro Area average. In 2003, growth reached one of the highest levels in the world - 9.7 percent - and in 2004 settled to a level closer to the long-term growth potential with 6.7 percent growth. The authorities have taken a prudent stance in projecting future GDP growth and adjusted fiscal policy accordingly to preserve their fiscal consolidation targets. The macroeconomic scenario in the authorities' updated convergence program from January 2005 shows real GDP growth of 6.5 percent in 2005 and a slightly decelerating growth thereafter to 6 percent in 2007, whereas staff, as noted in their report, expects even stronger growth, that could reach 7 percent in 2005. Further economic growth is expected to be supported by robust domestic demand and some fiscal stimulus due to government co-financing of transfers from the EU, which are projected in the order of 3.4 percent of GDP in 2005 and 4.4 percent of GDP in 2006. The ECOFIN Council in its opinion of March 8, 2005 found the authorities' macroeconomic scenario to reflect plausible growth assumptions.

Fiscal Policy

The key objective of the medium-term fiscal strategy is the approximation to a cyclically balanced general government budget in line with the principles of the Stability and Growth Pact.

Preliminary figures show a general government deficit in 2004 of 2.5 percent of GDP, i.e. lower than the 2.7 percent budgeted in May 2004, thanks to better than expected revenues. At the same time, our authorities have decided to maintain their deficit targets for 2005-07, despite the downward revision of GDP growth, thereby emphasizing the importance they attach to continued ambitious fiscal restraint. The authorities foresee the general government deficit to remain at 2.5 percent of GDP in 2005 and to decline gradually to 1.8 percent in 2006 and 1.5 percent in 2007. Consolidation is planned to be achieved mainly by a continued increase of revenues from a low base and, from 2005, also the expenditure side contributes. A significant public investment program is being implemented, which lifts public investments from 3.4 percent of GDP in 2004 to 5 percent in 2007.

Our authorities very much appreciate the constructive dialogue with staff on fiscal policy challenges and staff's useful specific advice, including from the Fiscal Affairs Department. While being in broad agreement with staff's recommendations, our authorities would like to emphasize that a possibly higher GDP growth rate, as expected by staff, does not necessarily make it easier to implement the necessary strict fiscal consolidation policy. Too optimistic GDP growth and public revenue projections could complicate their efforts to introduce measures to compensate for an abolishment of the Road Tax and provide room for future cuts in personal income taxes. Lower taxes are seen as important in order to suppress Lithuania's shadow economy and provide better conditions for the implementation of the authorities' social policy.

In case growth would be stronger than projected due to higher EU transfers, additional pressure would be put on the fiscal deficit reduction efforts as the government would incur higher co-financing expenditures that cannot be compensated for through higher tax revenues.

In assessing the overall soundness of fiscal policy, due account must be devoted to the public debt, which declined to 19.7 percent of GDP in 2004, with long-term debt accounting for 94 percent of the debt. In the medium term, general government debt should settle at about 20 percent of GDP. Government debt guarantees have stayed at about 2 percent of GDP and are expected to decline to 1.2 percent of GDP over the medium term. No guarantees on new loans have been issued since 2003. As a further element of prudent fiscal policy, the government has accumulated funds in the Stability Fund corresponding to 1.7 percent of GDP, which could be drawn upon in case of need to cover the government's liabilities in the event of unattractive borrowing conditions in the financial markets. The authorities are fully aware that to prepare for an ageing population is important in their fiscal planning. However, the relatively low debt ratio and a successful introduction of a third pension pillar puts Lithuania in a relatively good position to address these and other social policy challenges.

The authorities are ready to maintain the good track record in meeting fiscal targets and to redistribute expenditures to meet budget deficit limits in case co-financing of the EU projects will require more funds than allocated in the budget. The authorities are committed to follow the EU Broad Economic Policy Guidelines (BEPG) and to direct extra budgetary revenues for further reduction of the fiscal deficit. Above all, they are fully committed to a fiscal policy stance consistent with their objective of joining the Euro Area in 2007. They are cognizant that to achieve a high degree of sustainable convergence, it will be necessary to ensure a sound fiscal consolidation path and an environment conducive to price stability.

Monetary and Exchange Rate Policy

Lithuania joined ERM II at the end of June 2004. Following a careful assessment by the ERM II authorities, it was supported that Lithuania would join the exchange rate mechanism with the standard fluctuation band, but with its existing currency board in place as a unilateral commitment. The experience of more than a decade of fixed exchange rate policy proved that a fixed exchange rate is a valuable anchor for macroeconomic stability and non-inflationary economic growth.

The litas has not deviated from its central rate vis-à-vis the euro, and the continued high confidence in the exchange rate policy is reflected in low and relatively stable interest rate differentials to the Euro Area. In fact, the short-term interest rate differential against the three month EURIBOR has been small and continued to decline since the ERM II entry (from almost 0.6 to around 0.4 percentage points at the end-2004). Long-term interest rates of relevance for the convergence assessment have been below 5 percent since ERM II entry, and have stayed significantly below the reference value for the interest rate convergence criteria. Furthermore, the recent eleven-year Eurobond issue was heavily oversubscribed with a record low interest rate and a yield spread of only 22 basispoints above comparable German government securities. Taken together, these indicators are clear evidence of financial markets' high confidence in the authorities' commitment to a continued strong macroeconomic track record.

The authorities recognize that also legal changes for the central bank are necessary before Lithuania can join the Euro Area. In December 2004, the Bank of Lithuania approved an action plan with respect to the adoption of the euro covering the next two years, including an outline of the necessary measures for the alignment of the legal framework.

Our authorities concur with staff that short term risks concerning inflation need close monitoring. They stand ready to adjust economic policies as appropriate to maintain an environment conducive to price stability consistent with their objective of joining the Euro Area in 2007. The continuous boom of oil prices, rising food prices and changes in administered prices, as well as adjustment of indirect taxes to promote convergence within the EU, led to a reversal of an almost two-year period with negative inflation. Inflation through 2004 is estimated at 2.9 percent (average annual inflation 1.2 percent) and is forecasted to stay at 2.9 percent in 2005, before declining to 2.5 percent in 2006 according to the convergence program. In February 2005, inflation reached 3.3 per cent amid rising oil prices, which influenced relatively strongly Lithuania's price developments. The latter is partly due to the fact that the weight of energy items in Lithuania's HICP is almost two times bigger than the corresponding average in the EU. At the same time, other factors are expected to put downward pressure on inflation over the medium term, including increased competition in the telecommunication sector and the retail sector. This reflects continued integration in the EU markets and continued strong productivity growth in line with significant flows of FDI and strong domestic investments. Moreover, a high degree of decentralization of the Lithuanian labor market and relatively high wage flexibility should diminish the risks of second round effects of unfavorable one-off price hikes.

External Sector

The current account deficit increased from 6.9 percent of GDP in 2003 to an estimated 8.3 percent of GDP in 2004 due to rapid growth in consumer demand and investments. The authorities recognize that the size of the current account deficit needs close monitoring. They also agree with staff that the level of the current account deficit are within the range implied by the underlying fundamentals and can be explained by the rapid catching up of the economy. While staff has emphasized risks of shift in capital market sentiments, the authorities would like to underscore that the current account deficit to a significant extent is financed by debt-neutral sources, such as foreign direct investments and EU transfers. Furthermore, a significant share (about 70 percent) of the short-term debt is made up of loans from parent foreign banks to their banks in Lithuania. Moreover, Lithuania's net external debt level remains relatively low – at about 33 percent of GDP.

Some Structural Issues

The banking sector has remained sound and profitable and supervision prudent. However, our authorities agree with staff that credit expansion needs continued close monitoring. Credit growth in banking has remained robust driven by low interest rates and high demand for housing credit, although the increase of lending by banks slowed from 53 percent in 2003 to 40 percent in 2004. At the same time, loan provisions increased slightly, mainly due to stricter regulations. The authorities look forward to a forthcoming FSAP update.

Affected by the strong growth and an active employment promotion policy, unemployment has declined steadily. Registered unemployment declined by 1.3 percentage points to 6.8 percent in 2004. Data from the much more comprehensive employment survey shows a similar trend with unemployment falling from 12.4 percent in 2003 to 11.4 percent in 2004. The problem of structural unemployment due to skill mismatches has remained, with some economy sectors having started to feel shortages of labor.

The government has set a plan to restructure and develop health care institutions with the support of the EU Structural Fund. The personal healthcare network is being streamlined as well as the network of the specialized healthcare institutions. The authorities also envisage coherent measures to ensure a more efficient use of energy resources, thus reducing reliance on imported oil products for domestic use.