EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 23 May 2018

Assessment of the 2018 Stability Programme for

Lithuania

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 30 April 2018, Lithuania submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2021. The government approved the programme on 25 April and later it was presented in the Parliament's Committee on the European Affairs.

Lithuania is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the Medium-Term Budgetary Objective (MTO).

This document complements the Country Report published on 7 March and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Lithuania's 2018 Stability Programme's macroeconomic scenario covers the years 2018-2021. In 2017, economic growth reached 3.8% and was driven by a boost in exports and private investment, while strong wage growth supported private consumption. GDP growth is forecast to moderate to 3.2% in 2018 and 2.8% in 2019. Investment is set to remain an important growth factor as enterprises will have to further address the need to expand their operational capacities and increasing labour shortages, while the usage of EU funds should intensify. GDP growth is expected to be 2½ % for the years 2020-2021.

Compared to the macroeconomic projections included in 2017 Stability Programme, GDP growth has been revised upwards by 0.6 percentage point for 2018 and 0.3 percentage point for 2019. This is due to higher investment and export growth projections.

The positive output gap, as recalculated by the Commission based on the information in the programme, following the commonly agreed methodology, peaked in 2017 (at 2.7%), and is set to decrease before turning negative in 2021 (-0.1% of GDP). According to the Commission forecast, the output gap in 2018 should be slightly higher compared to 2017 due to more notable negative labour contribution.

Overall, the programme's macroeconomic projections of real GDP growth in 2018 and 2019 are close to the 3.1% and 2.7% growth forecast by the Commission. Though according to the programme's underlying scenario, private consumption and export growth is slightly higher compared to the Commission forecast, the Commission envisages somewhat higher public consumption. According to the Stability Programme, inflation is slightly higher in 2018 and 2019 compared to the Commission forecast, while it projects more cautious dynamics of the unemployment rate. To conclude, the Stability Programme is based on the plausible macroeconomic assumptions.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.8	3.8	3.1	3.2	2.7	2.8	2.5	2.5
Private consumption (% change)	3.9	3.9	3.4	4.0	3.3	3.8	3.8	3.5
Gross fixed capital formation (% change)	7.3	7.3	7.3	7.6	4.7	5.3	4.8	4.0
Exports of goods and services (% change)	13.2	13.2	5.5	7.0	4.4	5.7	5.0	4.7
Imports of goods and services (% change)	12.8	12.8	6.5	7.6	5.2	6.5	5.5	5.2
Contributions to real GDP growth:								
- Final domestic demand	4.1	4.2	3.8	4.3	3.3	3.8	3.7	3.4
- Change in inventories	-0.7		0.0		0.0			
- Net exports	0.5	0.5	-0.7	-0.4	-0.5	-0.6	-0.4	-0.4
Output gap[1]	2.6	2.7	2.7	2.3	2.2	1.3	0.4	-0.1
Employment (% change)	-0.5	-0.5	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5
Unemployment rate (%)	7.1	7.1	6.8	6.5	6.7	6.1	5.9	5.9
Labour productivity (% change)	4.4	4.4	3.5	3.7	3.1	3.4	3.0	3.1
HICP inflation (%)	3.7	3.7	2.7	2.9	2.3	2.4	2.5	2.5
GDP deflator (% change)	4.3	4.3	2.7	2.6	2.3	2.0	1.7	1.7
Comp. of employees (per head, % change)	9.1	9.1	6.6	6.6	6.0	6.2	6.0	6.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-0.3	1.9	-1.1	1.8	-1.8	1.6	1.1	0.6

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

For the second year in a row, Lithuania achieved a general government surplus. This amounted to 0.5% of GDP in 2017, compared to 0.3% of GDP a year before. The 2017 outcome was substantially better than the 0.4% of GDP deficit target set in the 2017 Stability Programme and the 0.1% surplus target in the 2018 Draft Budgetary Plan (DBP).

The 2017 result was mainly determined by government underspending which amounted to approximately 2% of GDP, though at the same time general government revenues were 1.5% of GDP lower compared to the planned amount. Also, the social security funds benefited from a strong collection of the social security contributions on the back of strong wage growth which together with lower social expenses in good economic times resulted in surplus of 0.2% of GDP. The surplus of the local government came out at 0.2% of GDP, which is slightly lower than envisaged in the 2018 DBP.

In 2018, the general government surplus is set to reach 0.6% of GDP according to the 2018 Stability Programme. This is in line with the 2018 DBP and 0.2 percentage point higher than targeted in the 2017 Stability Programme. The envisaged improvement in the general government balance is mostly linked to carry-over from the better than expected outturn in 2017.

Compared with the 2017 Stability Programme, the government has introduced some new discretionary fiscal measures in 2018. One the positive side, introduction of the minimum threshold to calculate social insurance contributions as well as efforts to improve tax administration are set to increase revenues. At the same time, increase in non-taxable allowance for individuals, the expansion of the corporate income tax exemption related to investment projects and the reduction of the VAT rate on particular medications are set to lower revenues.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The programme aims to achieve a headline surplus of 0.3% of GDP in 2021, which at face value would result in a structural surplus of 0.1% of GDP.

The 2018 Stability Programme envisages staying above the MTO (set at -1.0% of GDP) in 2018 and 2019, with a structural deficit improving from 0.3% in 2018 to 0.2% of GDP in 2019. Further consolidation should result in a structural surplus by 2020. The dynamics of the programme's structural balance taken at face value and recalculated structural balance[1] indicate a similar consolidation path.

According to the Commission 2018 spring forecast, the structural deficit is set to stay above the MTO in 2018 reaching 0.7% of GDP before decreasing to 0.6% of GDP in 2019. For both 2018 and 2019, the structural deficit is 0.5 percentage point higher than the (recalculated) structural deficit in the programme. The differences are mainly due to a slightly different forecast of the general government headline balance and the one-off expenditures as well as different output gap calculations.

While the Stability Programme foresees an increase of 2.6 percentage points in the expenditure ratio and 2.3 percentage points in the revenue ratio over the programme horizon, the Commission 2018 spring forecast assumes these ratios to remain stable in the coming years.

The programme maintains a MTO of a structural deficit of 1% of GDP, in line with the objectives of the Stability and Growth Pact.

In 2018, Lithuania benefits from allowances linked to the implementation of the systemic pension reform and of the structural reform (hereafter called 'The New Social Model') which amounts to 0.5% of GDP. According to the programme, the costs of the New Social Model should account for 0.6% of GDP in 2018 and 0.4% of GDP in 2019. Despite the possibility to use temporary deviation allowance, Lithuania overachieved its MTO in 2017 and envisages staying above the MTO in 2018 and 2019.

[1] Recalculated by the Commission according to the commonly agreed methodology.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**33.8**	**33.8**	**36.2**	**33.9**	**36.3**	**36.3**	**36.1**	**2.3**
of which:								
- Taxes on production and imports	11.7	11.7	11.7	11.8	11.7	11.7	11.8	0.1
- Current taxes on income, wealth, etc.	5.4	5.3	5.7	5.3	6.0	6.3	6.5	1.1
- Social contributions	12.7	12.8	13.1	12.8	13.3	13.0	13.2	0.5
- Other (residual)	4.0	4.0	5.7	4.0	5.3	5.3	4.6	0.6
Expenditure	**33.3**	**33.3**	**35.7**	**33.6**	**35.7**	**35.7**	**35.9**	**2.6**
of which:								
- Primary expenditure	32.1	32.5	34.8	32.7	34.8	35.0	35.3	3.1
of which:								
Compensation of employees	9.6	9.5	9.7	9.4	9.5	9.6	9.6	0.0
Intermediate consumption	4.6	4.6	5.1	4.7	5.2	5.3	5.2	0.6
Social payments	12.6	13.0	14.5	13.1	14.3	14.5	14.9	2.3
Subsidies	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0
Gross fixed capital formation	3.2	3.3	3.1	3.3	3.5	3.6	3.4	0.2
Other (residual)	1.8	1.8	2.0	1.9	2.0	1.8	1.9	0.1
- Interest expenditure	1.1	0.8	0.9	0.8	0.9	0.7	0.6	-0.5
General government balance (GGB)	**0.5**	**0.5**	**0.6**	**0.3**	**0.6**	**0.6**	**0.3**	**-0.2**
Primary balance	**1.7**	**1.3**	**1.5**	**1.2**	**1.5**	**1.2**	**0.8**	**-0.9**
One-off and other temporary	0.0	0.0	-0.1	0.1	0.1	0.1	0.0	0.0
GGB excl. one-offs	**0.5**	**0.5**	**0.7**	**0.3**	**0.5**	**0.5**	**0.3**	**-0.2**
Output gap[1]	2.6	2.7	2.3	2.2	1.3	0.4	-0.1	-2.7
Cyclically-adjusted balance[1]	-0.6	-0.6	-0.3	-0.6	0.0	0.4	0.3	0.9
Structural balance[2]	**-0.6**	**-0.7**	**-0.2**	**-0.6**	**-0.1**	**0.3**	**0.3**	**0.9**
Structural primary balance[2]	0.5	0.2	0.7	0.2	0.8	1.0	0.9	0.4

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

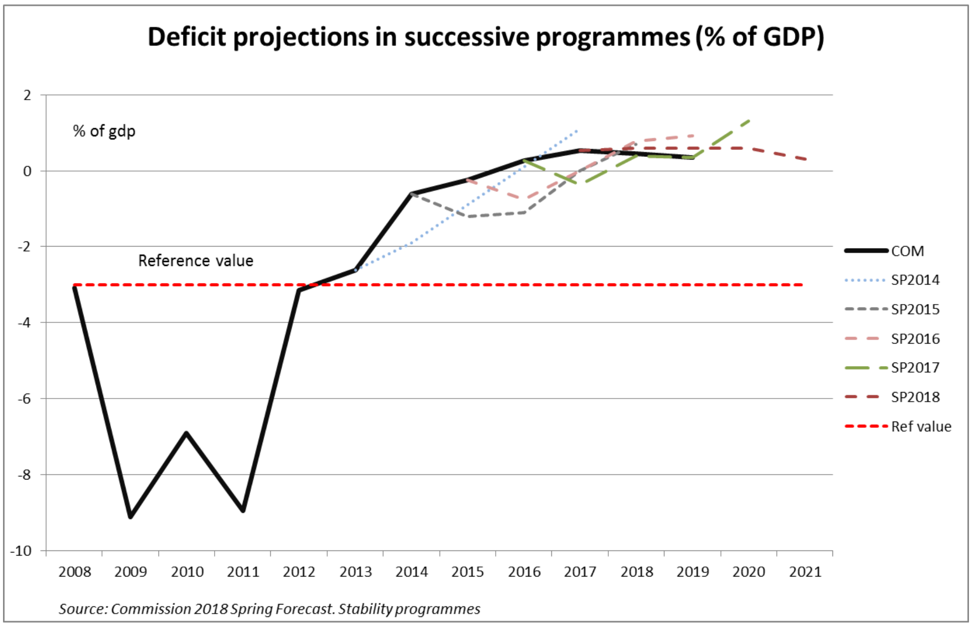
[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

In the past, Lithuania's stability programmes tended to have slightly less positive general government balance forecasts for the periods T+1 and the upward trend for the remaining years of the programmes. The 2017 and 2018 stability programmes have very similar projections for the year 2018 and 2019, though the 2018 Stability Programme does not keep the upward trend of the general government balance for the later years as the previous programme. In addition, Lithuania has overachieved its budgetary balance targets over the last four years.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

The programme specifies several measures on the revenue side, which can be split into one-off and permanent measures. For 2018, the programme estimates that new revenue measures should amount to approximately 0.3% of GDP, while efforts to improve tax collection should result in additional revenues of 0.4 % of GDP. The Commission forecasts a lower positive effect from these measures since it is difficult to disentangle their impact from a solid increase in tax rich components of GDP growth. According to the Stability Programme, in 2018, the discretionary expenditure measures should amount to 0.8% of GDP. Compared to the 2018 DBP, the new item on the expenditure side is increase in wages for specific groups of public employees (0.2% of GDP).

For 2019, the Stability Programme envisages the discretionary revenue measures amounting to 0.1% of GDP.

Main budgetary measures

Revenue	**Expenditure**
2018	
• Increase in non-taxable allowance (-0.2% of GDP) • Measures to improve collection of social insurance contributions (+0.1% of GDP) • Abolishment of the additional tax-free income allowance for children (+0.2% of GDP)	• Financial support to young families and families with children (+0.5% of GDP) • Increase in wages for specific groups of public employees (+0.2% of GDP)

• Introduction of the minimal threshold to calculate the social insurance contributions (+0.2% of GDP) • Measures to improve VAT collection (+0.2% of GDP)	
2019	
• One-off asset liquidation proceeds by the Deposit Insurance Fund (+0.1% of GDP)	
Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. DEBT DEVELOPMENTS

The Stability Programme envisages a gradual decline in gross government debt over the programme period (Table 3), from 39.7% of GDP in 2017 to 35.3% in 2021. This trend is driven by fiscal consolidation and helped by robust economic growth projections. In 2018 and 2020, a notable decrease in debt is projected due to pre-financed bond redemptions. The short-term future debt dynamics presented in the programme is similar to the one provided by the Commission in its 2018 spring forecast, although for 2019 the Commission forecasts a somewhat higher debt level. This is based on a no-policy-change assumption leading to a slightly lower surplus compared to the indication provided in the 2018 Stability Programme and a somewhat more moderate GDP growth forecast.

Lithuania's previous stability programmes generally predicted the short-term debt dynamics quite well. According to the 2016 and 2017 programmes, the medium-term debt levels were set to be somewhat higher compared to the Commission 2018 spring forecast estimates (Figure 2). All the projections and the outcomes always remained substantially below the 60% of GDP reference value of the Treaty.

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**40.4**	**39.7**	**36.0**	**35.8**	**38.2**	**38.1**	**36.6**	**35.3**
Change in the ratio	0.6	-0.4	-3.8	-3.9	2.3	2.3	-1.5	-1.3
Contributions [2] *:*								
1. Primary balance	**-0.4**	**-1.7**	**-1.3**	**-1.5**	**-1.2**	**-1.5**	**-1.2**	**-0.8**
2. "Snow-ball" effect	**0.0**	**-1.9**	**-1.4**	**-1.3**	**-0.9**	**-0.7**	**-0.9**	**-1.0**
Of which:								
Interest expenditure	1.6	1.1	0.8	0.9	0.8	0.9	0.6	0.5
Growth effect	-1.1	-1.4	-1.2	-1.2	-0.9	-1.0	-0.9	-0.9
Inflation effect	-0.5	-1.6	-1.0	-1.0	-0.8	-0.7	-0.6	-0.6
3. Stock-flow adjustment	**0.9**	**3.2**	**-1.1**	**-1.1**	**4.4**	**4.6**	**0.6**	**0.5**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

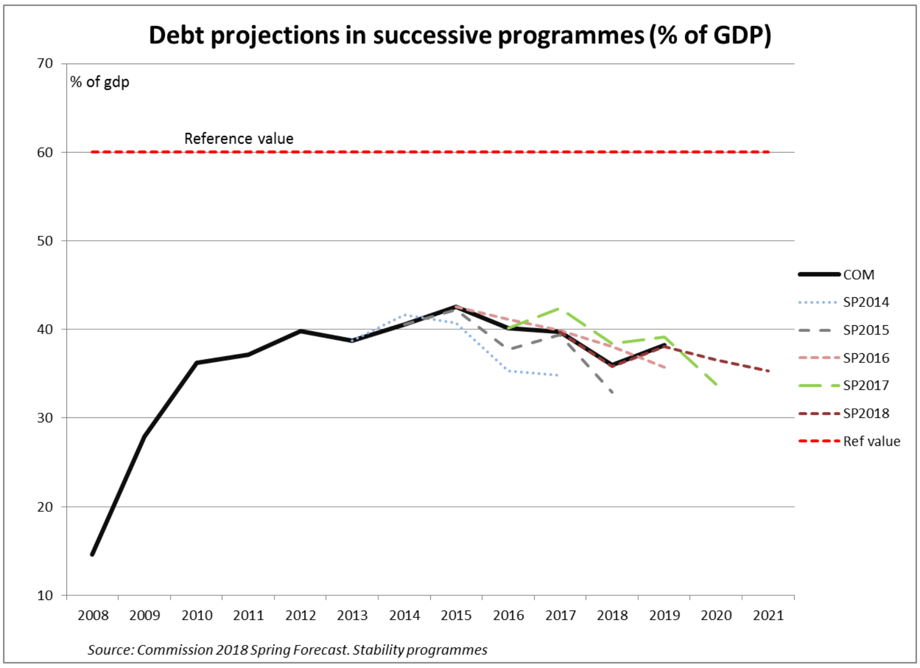
[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Comission calculations.

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. RISK ASSESSMENT

The economic growth and fiscal projections of the 2018 Stability Programme are broadly in line with the Commission 2018 spring forecast. However, the projected consolidation path beyond 2018 for the general government and structural balances are subject to some risks on the revenue as well as the expenditure side.

The Stability Programme projects a sharp increase in the revenue ratio of 2.3 percentage points over the programme period, which is concentrated in 2018. A similar increase was already targeted for 2017, but eventually no increase in the revenue ratio was recorded. Given this historical track record and the fact that the increase is strongly linked to measures with an uncertain yield, such as an improved tax administration, there is a downward risk to revenues over the programme period.

In April 2018, the government presented its intentions to adjust the taxation system, but at the time of submission of the programme, the proposals were still under public discussion. As the proposal essentially plans to reduce labour taxation, the outcome of this taxation reform could result in lower tax revenues in coming years compared to the Stability Programme.

Risks on the expenditure side are mostly on the upside. The targeted expenditure ratio of the Stability Programme already foresees a much stronger expenditure growth than the Commission forecasts and similar targeted expenditure growth over the past years has not materialised.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Lithuania is currently under the preventive arm of the Stability and Growth Pact.

Box 1. Council Recommendations addressed to Lithuania

"*On 11 July, the Council addressed recommendations to Lithuania in the context of the European Semester. In particular, in the area of public finances the Council recommended to Lithuania to pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which entails remaining at its medium term budgetary objective in 2018, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms for which a temporary deviation is granted.*"

4.1. Compliance with the MTO

For 2017, Lithuania benefits from a temporary deviation of 0.5% of GDP from the MTO (set at -1.0% of GDP) linked to the pension reform and structural reform clauses. As the temporary deviations are carried forward for a period of three years, the allowed temporary deviations amount to 0.5 % of GDP in 2018 and 2019.

In 2017, Lithuania's structural balance stood at -0.6% of GDP, i.e. Lithuania remained above its MTO. At the same time, net expenditure growth complied with the benchmark.

For 2018, the Stability Programme plans to remain above the MTO as the recalculated structural deficit is projected to be at 0.2% of GDP. The Commission 2018 spring forecast also projects a structural deficit to remain above the MTO, i.e. at 0.7% of GDP.

For 2019, the recalculated structural balance based on the 2018 Stability Programme is set to slightly improve to -0.1% of GDP. According to the 2018 Commission forecast, the structural balance is expected to improve to -0.6% of GDP. Therefore, both assessments point to the overachievement of the MTO.

Overall, Lithuania complied with the provisions of the SGP in 2017 and is projected to comply with them in 2018 and 2019.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	-0.6	-0.7		-0.6	
Structural balance based on freezing (COM)	-0.9	-0.7		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliance				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment [7]					
Two-year average deviation from the required adjustment [7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
Two-year deviation adjusted for one-offs[9]					
PER MEMORIAM: One-year deviation [10]					
PER MEMORIAM: Two-year average deviation [10]					

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Convergence Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

Lithuania does not appear to face fiscal sustainability risks in the short run.[2] Based on Commission 2018 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 39.7% of GDP in 2017, is expected to decline to 36.2% in 2028, thus remaining below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to have peaked in 2017. Sensitivity analysis shows similar risks.[3] Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a more clearly decreasing path by 2028, thus remaining below the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1 is at -1.5 percentage points of GDP, primarily due to the relatively low public debt, thus indicating low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -2.9 percentage points of GDP, leading to an even lower medium-term risk. Overall risks to fiscal sustainability over the medium term are, therefore, low. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 0.7 percentage point of GDP. In the long term, Lithuania therefore appears to face low fiscal sustainability risks given the limited projected increase in overall ageing costs, which contribute 0.4 percentage points of GDP. Full implementation of the programme would put the S2 indicator at 0.2 percentage point of GDP, leading to an even lower long-term risk.

As indicated in the 2018 Country Report[4], the pension reform package, which entered fully into force in 2018, mitigated medium-term fiscal sustainability risks. On the other hand, current legislation is not specific regarding the measures to address the falling adequacy of the pensions in the future, thus leaving Lithuania exposed to long-term sustainability risks.

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[2] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

[3] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[4] European Commission. (2018). Country Report – Lithuania. Retrieved from https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-lithuania-en.pdf

Table 5 . Fiscal Sustainability Assessment
Lithuania

Time horizon			Commission Scenario		Stability / Convergence Programme Scenario	
Short Term			**LOW risk**			
S0 indicator [1]			0.2			
Fiscal subindex			0.0	LOW risk		
Financial & competitiveness subindex			0.3	LOW risk		
Medium Term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-1.5	LOW risk	-2.9	LOW risk
of which						
	Initial Budgetary Position		-0.4		-1.3	
	Debt Requirement		-1.6		-2.1	
	Cost of Ageing		0.5		0.5	
	of which					
		Pensions	0.1		0.0	
		Health-care	0.2		0.1	
		Long-term care	0.2		0.2	
		Other	0.1		0.2	
Long Term			**LOW risk**		**LOW risk**	
S2 indicator [4]			0.7		0.2	
of which						
	Initial Budgetary Position		0.3		-0.3	
	Cost of Ageing		0.4		0.5	
	of which					
		Pensions	-1.0		-1.0	
		Health-care	0.3		0.3	
		Long-term care	0.8		0.8	
		Other	0.3		0.4	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

As indicated in the Country Report 2018, Lithuania further refined the application of the national fiscal rules and the reporting on meeting fiscal targets and also started to upgrade its medium-term budgetary planning system. In March 2018, the Lithuanian Parliament decided to set the MTO at -1% of GDP for 2019-2021, i.e. it remains unchanged over the programme period.

According to the national fiscal rules, the structural balance should improve each year when the real economic growth exceeds potential. In addition, there is a rule limiting the expenditure growth depending on the average of the general government balance of the last five years. However, this rule would not be applied if certain conditions are met. From 2018, the National Health Insurance Fund and larger municipalities are obliged to adopt structurally balanced budgets.

According to the data provided in the 2018 Stability Programme, Lithuania's structural balance, as in the previous year, improved and remained above the MTO. Therefore, Lithuania adhered to its national structural balance rule. The 2018 Stability Programme envisages further improvement in structural balance over the programme horizon.

The above-mentioned expenditure rule was not applied for 2017 and 2018 as, according to the Ministry of Finance, the escape clauses indicated in the legislation were met. The Independent Fiscal Institution, which is set up in the National Audit Office (NOA), was of a different opinion regarding the application of the escape clause for the expenditure rule for 2018.

In November 2017, the NOA completed the assessment of the 2018 draft budget and submitted its opinion on the compliance with the structural improvement target to the Parliament. According to the NOA, given that the structural balance was expected to be above the MTO in 2018, the government had valid reasons not to envisage a structural improvement.

Based on the information provided in the 2018 Stability Programme, previous Stability Programmes and draft budgetary plans, the fiscal performance in Lithuania appears to broadly comply with the requirements of the applicable national numerical fiscal rules.

On 27 March 2018, the NOA presented its opinion[5] to the Parliament endorsing the economic development scenario underpinning the 2018 Stability Programme. The Ministry of Finance had published the economic development scenario on March 21. The NOA assessed that the 2018 economic scenario was based on the recent available statistical data and did not contradict economic trends.

Finally, Lithuania considers its Stability Programme as its national medium-term fiscal plan in the sense of the Two-Pack Regulation 473/2013. The national medium-term fiscal plan includes indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact as required by Article 4(1) of the above-mentioned regulation.

[5] Lietuvos Respublikos valstybės kontrolė. (2018). *Išvada dėl ekonominės raidos scenarijaus tvirtinimo*. Retrieved from http://www.ifi.lt/isvada.aspx?id=10223

7. SUMMARY

In 2017, Lithuania maintained the structural balance above its MTO and complied with the requirements of the preventive arm of the Stability and Growth Pact.

In its 2018 Stability Programme Lithuania plans to remain above the MTO over the period 2018-2021. Based on the Commission 2018 spring forecast, the structural balance is projected to respect the MTO in 2018 and 2019. Therefore, Lithuania is expected to be compliant with the provisions of the Stability and Growth Pact in both 2018 and in 2019.

8. ANNEXES

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	6.8	2.8	3.7	2.0	2.3	3.8	3.1	2.7
Output gap [1]	-2.0	2.4	-3.2	0.8	1.3	2.6	2.7	2.2
HICP (annual % change)	0.6	5.5	2.0	-0.7	0.7	3.7	2.7	2.3
Domestic demand (annual % change) [2]	7.5	2.2	2.7	7.4	2.4	3.4	3.9	3.3
Unemployment rate (% of labour force) [3]	14.2	7.6	13.8	9.1	7.9	7.1	6.8	6.7
Gross fixed capital formation (% of GDP)	21.0	24.4	18.0	19.6	18.9	18.8	19.5	19.8
Gross national saving (% of GDP)	14.6	16.0	19.6	18.6	16.6	15.9	15.9	15.7
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.2**	**-2.7**	**-4.4**	**-0.2**	**0.3**	**0.5**	**0.5**	**0.3**
Gross debt	**21.5**	**18.7**	**38.5**	**42.6**	**40.1**	**39.7**	**36.0**	**38.2**
Net financial assets	**9.9**	**6.8**	**-22.2**	**-23.9**	**-22.2**	**n.a**	**n.a**	**n.a**
Total revenue	33.6	34.6	33.8	34.6	34.5	33.8	33.8	33.9
Total expenditure	35.8	37.3	38.2	34.9	34.2	33.3	33.3	33.6
of which: Interest	1.3	0.8	1.8	1.5	1.3	1.1	0.8	0.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.7**	**-2.4**	**7.9**	**5.0**	**5.1**	**5.8**	**5.5**	**5.1**
Net financial assets; non-financial corporations	**-85.2**	**-98.1**	**-83.9**	**-81.7**	**-84.2**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-1.8**	**-0.7**	**1.8**	**2.1**	**1.1**	**n.a**	**n.a**	**n.a**
Gross capital formation	13.9	16.1	11.8	12.5	9.7	9.9	10.7	11.0
Gross operating surplus	31.2	32.9	37.8	34.9	33.1	33.7	34.2	34.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**0.2**	**-1.4**	**-0.2**	**-3.8**	**-4.5**	**-6.8**	**-7.1**	**-7.3**
Net financial assets	**41.7**	**39.6**	**53.9**	**59.7**	**62.0**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	31.2	34.2	31.6	32.9	34.3	34.6	34.6	34.8
Net property income	18.1	13.9	14.8	12.4	12.7	12.5	12.3	12.4
Current transfers received	12.1	15.0	16.6	15.1	15.3	13.2	13.6	13.7
Gross saving	3.4	1.4	2.2	0.0	-0.3	-2.8	-3.1	-3.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-5.7**	**-6.5**	**3.2**	**1.0**	**0.9**	**-0.3**	**-1.1**	**-1.8**
Net financial assets	**35.7**	**52.8**	**51.1**	**44.2**	**43.7**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-6.0	-8.8	0.0	-0.5	1.3	2.0	1.1	0.4
Net primary income from the rest of the world	-1.7	-1.7	-2.5	-4.1	-3.9	-3.6	-3.5	-3.4
Net capital transactions	0.3	2.2	3.1	3.0	1.5	1.2	1.2	1.1
Tradable sector	55.4	52.7	56.6	54.9	54.6	55.1	n.a	n.a
Non tradable sector	33.9	37.4	33.7	35.2	35.4	34.7	n.a	n.a
of which: Building and construction sector	5.8	8.3	5.8	6.5	5.9	6.1	n.a	n.a
Real effective exchange rate (index, 2000=100)	86.9	105.8	100.9	106.2	111.7	116.5	119.3	120.3
Terms of trade goods and services (index, 2000=100)	94.7	101.1	98.9	102.2	104.7	105.1	104.9	104.7
Market performance of exports (index, 2000=100)	68.8	85.2	114.6	118.9	117.6	126.0	125.9	125.9

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2018 spring forecast