NATIONAL AUDIT OFFICE OF LITHUANIA

OPINION ON THE ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

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Vilnius

The National Audit Office, implementing the functions of the budget policy monitoring institution (hereinafter – the fiscal institution), assessed the Economic Development Scenario for 2018–2021 prepared by the Ministry of Finance and published on 21 March 2018, and hereby presents opinion. Pursuant to the Paragraph 3 of Article 9(6) of the Law on National Audit Office, the fiscal institution hereby submits its opinion to the Seimas of the Republic of Lithuania.

The scenario prepared by the Ministry of Finance of the Republic of Lithuania results from the assumptions chosen and identified, it is based on the available statistical data and does not contradict economic regularities. The fiscal institution hereby endorses the Economic Development Scenario for 2018-2021, which was published on the website of the Ministry of Finance of the Republic of Lithuania on 21 March 2018. The Economic Development Scenario is suitable for the preparation of the Stability Programme of Lithuania for 2018 and the budgets attributable to general government.

The fiscal institution notes that the heretofore prevailing negative balance of risks has been replaced by neutral for the first time. Considering the positive changes with regards to the trust of European Union's consumers and producers, it seems likely that the growth of EU's internal consumption and investment in 2018 will be stronger than specified in the assumptions applied to this scenario by the Ministry of Finance. This is a positive risk for revising the projections of the final growth of consumption, investment and export in Lithuania towards the positive direction. United Kingdom's exit from the European Union is causing uncertainties within the European Community. With negotiations still ongoing, the European Commission operates on the technical assumption that there shall be no changes with respect to the trade relations between the European Union and the United Kingdom. In case of *Hard* Brexit – i.e., the scenario where negotiations end without a new trade agreement being established between the parties – trade would take place in accordance with the international trade regime set by the World Trade Organisation. This would be a strong negative shock to the competitiveness of the export of Lithuanian products to the United Kingdom. Furthermore, the aforesaid shock would have an indirect impact via EU's other trade partners. Until a final agreement regarding United Kingdom's exit from the European Union is concluded, uncertainties within the European Union are bound to remain until 2020, which also means that trade conditions will likely stay undefined as of 2021. Uncertainty is also increased due to the processes taking place outside the EU: the position taken by the U.S. president regarding international trade; persistent geopolitical tensions in the East; and the potential hard landing scenario of the Chinese economy.

There have been no fundamental identifiable changes with regards to the monetary policy implemented by the Eurosystem so far. Changes to the monetary policies pursued by the Eurosystem are not expected at least until September 2018. However, the favourable credit conditions now available to residents of the Eurozone, which includes Lithuania, are not likely to change in the near future. The change of leadership in the Federal Reserve System of the United States and the People's Bank of China, which took place in 2018, brings a degree of uncertainty with regards to the monetary policy of the future, as well as its independence from political processes. This uncertainty also increases the risk of revision of technical assumptions from 2019.

In the Box A "Is the economy growing warmer or colder?" there is provided analysis of the three different institutions reasons of review of actual and potential output gap – the Ministry of Finance, the European Commission, and the fiscal Institution. The differences in the fiscal Institution's reviews of the projections of the potential GDP are the smallest. Reliable estimates of the output gap is a necessary precondition for implementing counter-cyclical fiscal policy. In practice, such estimates are typically subject to significant uncertainty, which increases the risk of choosing inappropriate fiscal policy measures and implementing them at a wrong time.

An analysis of the differences between the projections for 2017, endorsed by the fiscal Institution *a posteriori*, and the actual values of these indicators published by Statistics Lithuania has shown that scenarios developed by the Ministry of Finance were the most likely and the most congruent with the provisions set out in the Council Directive on Requirements for Budgetary Frameworks of the Member States. The analysis also showed that projections were more accurate for the second, rather than the first year, which constitutes the preconditions necessary to strengthen the Lithuanian medium-term expenditure planning system.

The Annex to the Opinion provides a review of the international context, risk factors, and assumptions; an analysis of the macroeconomic indicators and risk factors which support this Opinion; a retrospective analysis of the projections errors for 2017; and in the Box A – an analysis of the revisions of the output gap.

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