To the Seimas of the Republic of Lithuania

OPINION ON THE ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

20 September 2018 No. BP-5
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 12 September 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.

According to the fiscal institution, Lithuania's economic growth was balanced in the first half of 2018, as it was positively contributed by domestic demand and net exports. As in the rest of the Baltic States, the value-added in the construction sector grew at the fastest pace. Industry, trade, transport, information and communication services were also actively developing. Private consumption was driven by a sharp increase in average wages and reduced inflation. During the past year, Lithuanian wages grew more rapidly than productivity, which resulted in rising unit labour costs. In order to maintain the competitiveness of Lithuania, a further increase in productive investments and transition from a business model based on a cheap labour to the one based on high value-added are needed.

Neutral balance of external risk factors is replaced by a negative one. Tension in international trade and the increased probability of a hard Brexit as well as possible fluctuations in the global financial market are further aggravated by the risk of contagion of the Turkey's financial crisis to the EU Member States and the plans of the newly formed Italian government to pursue unsustainable fiscal policies in the face of one of the highest levels of debt in the EU.

Domestic risk factors are mainly related to negative demographic changes, income inequality and poverty. This was emphasised in the national report issued by the European Commission on 7 March 2018. Unfavourable demographic trends are caused not only by negative net migration, but also by high mortality rate. On the other hand, the development of the Lithuanian economy in the medium-term is likely to be driven by domestic demand resulting from the Government decisions related with measures to increase in personal income and to strengthening incentives to invest, as well as foreign direct investment and European Union assistance and support projects implementation.

Other factors, which are caused by tension in the labour market, are as follows: investment into automation, new technologies, innovation, and other measures intended for increasing performance efficiency and labour productivity.

Stronger domestic demand allows to increase the growth of the real Lithuanian gross domestic product in 2018. The projections of the growth of private consumption in Lithuania could be increased for 2018-2019 due to better situation for workers in the labour market and higher disposable income projections because of higher non-taxable income threshold in 2019. Lithuania's consumer expectations for the next 12-months are relatively optimistic and signal that cycle of aggregate demand in 2018 may not decrease.

The report "On the Endorsement of the Economic Development Scenario" provides an analysis of macroeconomic indicators, the international context, risk factors, and assumptions which support this opinion; a review of economic development which took place during the first half of 2018; and the heat map of Lithuania's economy (see Box A).

The heat map of Lithuania's economy, which allows monitoring the changes in macroeconomic indicators and the determination of the development of potential imbalances, demonstrates the presence of remaining tension in the labour market and excess level of production capacity utilisation. An assessment of the composite index, which consists of select statistical indicators, shows that since 2016 the temperature of Lithuania's economy has been slowly rising. Trends observed in the evolution of prices, as well as the assessments provided by enterprise managers, indicate that the economic cycle might not have yet reached its peak.

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 12 September 2018. The Economic Development Scenario is suitable for the preparation of the 2019 draft budget of the general government.

Auditor General Arūnas Dulkys