NATIONAL AUDIT
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To: the Seimas of the Republic of Lithuania

Opinion on the endorsement of the economic development scenario

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Under the conditions of exceptional uncertainty, the Economic Development 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. The Fiscal Institution hereby endorses the Economic Development Scenario for 2020–2023, which was published on the website of the Ministry of Finance of the Republic of Lithuania on 20 March 2020. The Economic Development Scenario is suitable for the preparation of the Stability Programme of Lithuania for 2020. However, a risk exists that with the change of internal and external conditions, which might have a significant effect on the deterioration of the economic situation, the scenario may not materialize.

Lithuania's economic growth was balanced and higher than expected in 2019. The gross domestic product (GDP) increased by 3.9% and was positively contributed by growing final consumption expenditure, investments, and net exports. The average monthly gross earnings increased by 8.8% and remained as one of the key factors in supporting the growth of private consumption expenditure. The rise in private consumption expenditure was also contributed by optimistic consumer expectations and stable inflation which was lower than the growth of average gross earnings. For the first time since 1990, the net migration was positive. The number of employed persons increased by 0.3%. The rapid absorption of European Union financial support allowed the further growth of investments by 7.4% in the structure of which the greatest part was constituted of non-residential buildings and structures. The growth in real exports and imports reached 9.3% and 6.7%, respectively. Due to the disappearance of the 2018 draught effect, the increase in the cereal yield by approximately one-third significantly contributed to the exports of goods of Lithuanian origin that, excluding mineral products, increased by 6.1% in 2019. In addition, rapid growth was also noticed in the re-exports of goods (excluding mineral products) and the exports of services. Meanwhile, the rapid growth in imports was fostered by the strong domestic demand. The nominal GDP increased by 6.8%. The highest contribution to the growth of the nominal value added by the change in the general price level was observed in the activities of public administration and defence; compulsory social security; education; human health and social work.

In 2019, Lithuania's economy maintained a rather fast pace of growth. However, in the fourth quarter, signs of deceleration in the annual growth of real exports, industrial production, and trade turnover were observed. Internal situation and especially external macroeconomic environment are important for the small and open economy of Lithuania.

In 2020, the uncertainty in the geopolitical situation persists with added new external risks. The uncertainty concerning the so-called "hard Brexit" remains since the trade agreement between the United Kingdom and the European Union is not yet concluded. The external risk factors are supplemented by the Mobility Package, the implementation of which would have a negative impact on the Lithuanian exports.

The spread of COVID-19 virus, observed in the first quarter of 2020, is becoming the key factor deteriorating the growth forecasts of both the world economies and the economies of the European Union. COVID-19 virus, that originated in China at the end of 2019 and impacted its domestic consumption together with its external demand, started to spread around the world in the first quarter of 2020. The situation in the USA and the large Member States of the euro area (Germany, France, Italy, and Spain), that account for approximately 75% of GDP of the euro area, is tense: the industry sector is negatively affected by delayed orders and disturbed supply chains, while the domestic and external demand, as well as tourism flows, are decreasing. It needs to be mentioned, that before the spread of the virus, the industrial sector of Germany, one of the key export partners of Lithuania, was impacted by the uncertainty in the international environment: the US-China trade war and the unclear outcome of "Brexit". The debt of Italy, which is considered the centre of the spread of COVID-19 virus in the European Union, is limiting the corrective actions that can be applied in the fight with the virus. The situation in the European Union should be alleviated by the endorsement of the escape clause of the Stability and Growth Pact.

World central banks are taking measures to stimulate economic growth. Regarding the spread of COVID-19 virus, on 12 March 2020, ECB did not change the 0.0% base interest rate but announced the EUR 750-billion-worth Pandemic Emergency Purchase Programme and other additional measures for safeguarding liquidity. The Federal Reserve System has reduced the interest rate range to 0.0–0.25%. The interest rates were also lowered by the central banks of the United Kingdom, Canada, Australia, Norway and other countries.

At the beginning of 2020, the price of "Brent" oil decreased. With the intensifying US-China trade conflict in the second half of 2019, the average price of oil was USD 60.0 a barrel at the end of 2019. Due to the unrest in Iraq, Saudi Arabia and Iran, starting from the end of 2019, the instability of oil price increased. On March 2020, its price fell below USD 30.0 a barrel. It was determined by 2 key reasons: the worldwide spread of COVID-19 virus and the failure to reach the deal on the reduction of oil supply between OPEC and Russia. While uncertainty prevails in the world, including fluctuations of oil price, the change in the investor sentiments is observed – the stock prices have reached the lowest point since 2008.

Internal risk factors are mostly related to domestic demand and demographic challenges. As the economy shrinks in 2020, it is foreseen that positive consumer expectations are likely to deteriorate and this is likely to encourage postponing consumption for the future. In addition, household consumption depends on possibilities to remain in the labour market during the period of quarantine, especially in case it is extended. Notwithstanding the threats of COVID-19 virus to the domestic demand, in the current demographic situation, the number of employed persons is likely to decrease in the medium term as the number of persons leaving the labour force will be higher than the number of those who supplement it.

In the presence of the before-mentioned internal and external risks, the contraction of Lithuania's real gross domestic product by 1.3% is foreseen in 2020. It can be determined by decreased growth of domestic consumption and investment as well as reduced exports. In the medium term, the temporarily contracted Lithuania's economy is believed to grow approximately by 2% each year. With the slowed-down growth of the general price level (GDP deflator), the slowed-down growth of GDP at current prices will be mostly determined by the dynamics of the real GDP. The growth of the average gross earnings by 5.6% can be positively contributed by the increase in the minimum monthly wage and the resolutions of the government on the increased wages in the public sector. However, the impact of COVID-19 virus and the forecast unemployment level of 8.1% are expected to exert pressure on the growth of wages and thus slow it down. In addition, the reduction in the number of employed persons by 2.0% is also foreseen. The intense situation in the labour market can be supplemented by negative demographic perspectives and the remaining non-compliance of the employee qualifications with the demand of the labour market. It can also impact household consumption accordingly.

Due to the expected shrinkage of trading partners' economies, the negative impact of the spread of COVID-19 virus on foreign and domestic demand, the implemented measures to mitigate the spread of the virus, and the effect of the comparative base, it is expected that in 2020 the country's real exports of goods and services will experience a drop of 2.4%, while the growth of imports will remain slightly positive. Based on the connection with the transport prices, the reduced oil price can partly determine the slowed-down growth of the harmonised index of consumer prices up to 1.8% in 2020. The increase in the prices of services will remain the key factor influencing the growth of inflation in the medium term. Higher value added generated in the activities of industry, trade and transport determined the increase in labour productivity (gross domestic product per one employed person) by 3.6% in the country last year. During the medium term, possibly due to the generated lower value added, the labour productivity will slow down. It might only reach 0.7% in 2020.

Due to exceptional circumstances and in order to respond to the rising challenges, on 16 March 2020, the Government of the Republic of Lithuania endorsed [1] the Economic stimulus plan meant for mitigating the negative effects of the economic downturn in Lithuania. If all the foreseen measures are implemented, their overall value for the stimulation of the economy, secure employment, health and security might be around EUR 2.5 billion. Moreover, the possibility is envisaged for the Government to additionally borrow EUR 5 billion or approximately 10% of GDP.

The National Audit Office of the Republic of Lithuania, implementing its functions of budget policy monitoring institution (hereinafter referred to as Fiscal Institution) set out in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania, has carried out an assessment and issued an opinion on the Economic Development Scenario for 2020–2023 prepared by the Ministry of Finance of the Republic of Lithuania and published on 20 March 2020. Pursuant to provisions of Paragraph 6 (3)

[1]The plan for economy stimulation and mitigation of the negative effects of COVID-19 virus was approved on 16 March 2020 by the Protocol No 14 of the meeting of the Government.

of Article 9 of the Law on National Audit Office, the Fiscal Institution hereby submits its opinion to the Seimas of the Republic of Lithuania. Pursuant to provisions of Paragraph 6 (4) of Article 9 of the Law on National Audit Office, the Fiscal Institution also submits its opinion on the compliance of the unusual event with the definition of exceptional circumstances.

Auditor General Arūnas Dulkys