To the Seimas of the Republic of Lithuania

OPINION ON THE ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

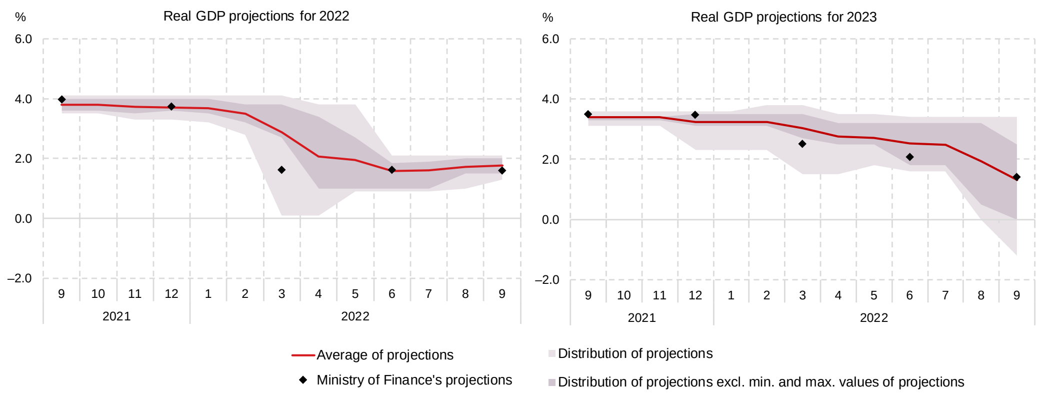
20 September 2022 No BPE–7

Vilnius

Under the conditions of exceptional uncertainty, the Economic Development Scenario (EDS) prepared by the Ministry of Finance of the Republic of Lithuania results from the identified assumptions and is based on the available statistical data. The Fiscal Institution, whose functions are implemented by the National Audit Office of Lithuania (hereinafter referred to as Fiscal Institution in the NAO), endorses[1] the Economic Development Scenario for 2022–2025 published by the Ministry of Finance on 12 September 2022, as it is suitable for the preparation of the budgets attributable to the general government.

The remaining uncertainty in 2022 and the growing uncertainty in 2023 is illustrated by the distribution of projections by institutions publishing Lithuania's GDP projections (Figure 1.). The September EDS's real GDP projections for 2022–2023 are in line with the average of the projections of the other institutions. In August–September, the other institutions' projections of real GDP for 2023 differ significantly, and their increased distribution indicates that currently it is particularly challenging to foresee the economic perspectives for 2023. Moreover, as the situation evolves rapidly, the institutions' projections for 2023 published between June and July differ from the latest ones published in recent months.

Figure 1. Distribution of real GDP projections for 2022–2023



The following institutions have been included in the calculation of projection distribution: European Commission, International Monetary Fund (IMF), Organisation for Economic Cooperation and Development (OECD), Bank of Lithuania, AB Swedbank, AB SEB, AB Luminor (horizontal axis corresponds to the month of publication of projections).

Source: calculations by the National Audit Office implementing the functions of the fiscal institution

[1] Decision on the endorsement is based on the data that was available until 01/09/2022. The Ministry of Finance is obliged to publish an updated Economic Scenario at least once a quarter until the exceptional circumstances are cancelled.

In this context, the opinion accompanying this document on the compliance of the current situation with the definition of exceptional circumstances cancels the exceptional circumstances declared due to the COVID-19 pandemic and endorses the exceptional circumstances due to the geopolitical situation. For these reasons, the Scenario may not materialise due to the change in internal and external conditions that have a significant effect on the change in the economic situation. A detailed assessment of the macroeconomic environment, risk factors, the September EDS's assumptions and projections are presented below.

MACROECONOMIC ENVIRONMENT, ASSUMPTIONS AND RISK FACTORS

Against the backdrop of the energy crisis in Europe, the assumptions of the September Economic Development Scenario for 2022–2025 are reviewed downwards (Table 1). In its summer economic forecasts, the European Commission (EC) updated the assumptions used by the Ministry of Finance for the EDS of September. The majority of the negative risks projected in spring 2022 have materialised. The EC estimates that the weaker exchange rate of the euro against the US dollar is projected for 2022–2025, global and European Union (EU) GDP growth will be slower and oil price higher than expected in the spring forecasts. Following the EC's downward revision of the assumptions, in the EDS of September the assumption for growth of Lithuania's main export markets between 2023 and 2025 was reduced. According to the baseline scenarios of other international institutions, the EA economy will grow in 2023, but at a slower pace than previously forecasted[2].

Table 1. The Ministry of Finance's assumptions for the Economic Development Scenario of September 2022

Indicator	2021	2022P	2023P	2024P	2025P
USD/EUR exchange rate*	1.18	1.06 (1.09) ▼	1.05 (1.08) ▼	1.05 (1.08) ▼	1.05 (1.08) ▼
Global (excl. EU) GDP growth, %*	5.9	3.0 (3.3) ▼	3.3 (3.7) ▼	3.3 (3.7) ▼	3.3 (3.7) ▼
European Union's GDP growth, %*	5.4	2.7 (2.7)	1.5 (2.3) ▼	1.5 (2.3) ▼	1.5 (2.3) ▼
Growth of the main Lithuania's export markets, %	5.3	1.9 (1.3) ▲	1.0 (2.2) ▼	1.0 (2.2) ▼	1.0 (2.2) ▼
Oil price (Brent, USD/barrel)*	70.7	108.2 (103.6) ▲	95.6 (93.5) ▲	95.6 (93.5) ▲	95.6 (93.5) ▲

▼ – negative review ▲ – positive review

*Technical assumption made public by the European Commission on 14 July 2022.

Source: Ministry of Finance

High prices of natural gas and other energy resources, easing but still persisting disruptions in supply chains and uncertainty in the geopolitical situation worsen the growth prospects of the global economy. In the United States, which accounts for more than a fifth of global GDP, labour market performance remains strong, but the economy is no longer growing for the second quarter in a row[3]. The US is less dependent on direct trade ties with Russia and imported energy resources, but the country is also witnessing negative sentiment among consumers and investors. This is due to geopolitical tensions in Europe, declining household consumption in the country because of accelerating inflation of goods and services, tightening monetary policy by the US Central bank and

[2] Compared with the previous projections, the European Central Bank (ECB) in its September 2022 projections reduced the EA growth rate for 2022–2023 by 0.3 p.p. and 1.2 p.p., respectively, the IMF in its July projections reduced the growth rates by 0.2 p.p. and 1.1 p.p., the OECD in its June projections by 1.7 p.p. and 0.9 p.p.

[3] According to seasonally and calendar adjusted data, the U.S. economy contracted by 0.4% in Q1 2022 compared to the previous quarter. In Q2 2022, the economy contracted by 0.1% compared to the previous quarter.

disruptions in supply chains. In August, compared to July, the US business activity indicators such as purchasing managers' indices (PMIs)[4] show that industry activity declined to 51.5 and services fell to 43.7, marking a contraction in the latter sector.

The global economic slowdown is also affected by China's[5], which is the world's second largest economy, applied restrictions related with the management of the COVID-19 pandemic, and therefore contributing to disruptions in supply chains. The situation is also exacerbated by the real estate market challenges linked to the debt crisis of builders, where the sector accounts for about 30% of China's GDP.

The EU economy grew in the first half of 2022[6], but the outlook is negatively affected by high prices of raw materials and energy resources, persistent disruptions in supply chains, declining purchasing power of households, and correspondingly weakening expectations of consumers and investors. In August, industrial PMI reached 49.6 and services 49.8. The industry of Germany, Lithuania's main export partner, has a significant influence on the development of the EA economy: the production of chemical industry and basic metals, as well as the manufacturing of machinery and equipment, which heavily depend on energy resources. In Q2 2022, production of chemicals and chemical products and basic metals also contracted in France, Italy, and Spain. Weakening economic indicators are also observed in other Lithuania's main trading partners[7], for example, Poland's economy fell by 2.1% in Q2 2022 compared to the corresponding period in 2021.

In 2021, gas imports from Russia into the EU accounted for almost half of its total gas imports, and in early September 2022, Russia halted the supply indefinitely. In order to reach the coordinate preparation of the EU for the upcoming winter seasons, in August 2022, EU countries voluntarily agreed to reduce natural gas consumption by 15.0%[8] and committed to fill gas storage facilities by at least 80% by 1 November of the same year. Although this commitment has been achieved earlier than expected, under unfavourable natural conditions and without decreasing gas consumption, existing gas storages will not be sufficient, which would lead to higher prices. Lithuania does not import gas from Russia, but the impact of the declined gas-dependent EA industry on the economy would be felt indirectly. In addition, gas is one of the most important components of electricity prices. The EA economy would contract to 0.9% in 2023 according to the European Central Bank's most pessimistic scenario of September forecasts for gas prices.

To mitigate inflation, central banks continue raising interest rates. The European Central Bank increases base interest rates by 0.75 p.p. in September. Such an increase will negatively affect consumption of households and investment decisions of businesses, both in Lithuania and the euro area. The US Central Bank continues to increase interest rates by 0.75 p.p. to range of 2.25–2.5%. Central banks of Poland, the United Kingdom, Norway and other countries continue to increase their interest rates[9].

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[4]A value of less than 50 PMIs indicates the contraction of the sector concerned.

[5] According to seasonally and calendar adjusted data, in Q1–Q2 2022, China's GDP grew by 4.8% and 0.4% respectively.

[6] In Q1–Q2 2022, during the year, EU GDP grew by 5.5% and 4.0% respectively, in the EA by 5.4% and 4.0% respectively.

[7] In the first half of 2022, the main export partners of goods of Lithuanian origin: Germany (10.0%), Poland (9.3%), the US (8.0%), Latvia (7.6%), the Netherlands (6.3%) and Sweden (6.3%).

[8] Internet access: https://www.consilium.europa.eu/en/press/press-releases/2022/08/05/council-adopts-regulation-on-reducing-gas-demand-by-15-this-winter/.

[9] The Central Bank of Poland increased the base interest rates by 0.25 p.p. to 6.75%, the United Kingdom and Norway by 0.5 p.p., to 1.75% and 1.85% respectively, in Denmark – by 0.75 p.p. to 0.65%. In Hungary – by 1 p.p. to 11.75%.

Changes are also taking place in the currency markets. By July 2022, the stronger euro against the US dollar started to weaken and depreciated by 4%. On 12 July, the exchange rate converged, but the ECB's decision to raise the base rate allowed the euro to slightly strengthen. The weakening of the EA common currency exchange rate leads to the price increase of imported goods, in particular energy commodities, which can contribute to inflation. In September, the exchange rate assumption for the period 2022–2025 is revised downwards (Table 1). According to the ECB's September projections for 2022–2023, the euro is projected to weaken against the US dollar, but according to futures[10] from 2023 the euro should strengthen.

The prices of oil and other raw materials, such as metals and wood, have been falling in recent months. This is mainly driven by negative expectations in the markets for a slowing global economy. Copper and steel prices fell by one third in early September compared to March and more than half for wood. Over the summer, Brent oil price fell 18.7% and returned to levels before the war began in Ukraine. This price change has also been accompanied by increased oil production, positive expectations for Iran's Nuclear Deal and a pandemic management measure in China. On the other hand, the current situation in the European energy market and the persisting imbalance in oil supply and demand have kept its price at a higher level than in 2019, which averaged USD 64.0 per barrel. Based on futures, Brent oil price is expected to reach USD 96.5 and USD 86.4 per barrel in 2022 and 2023 respectively[11], which is lower than in the September EDS's assumptions (Table 1).

Risk factors remain largely related to the geopolitical situation and rising interest rates. As global economic growth slows and uncertainty persists due to the course of the war in Ukraine, Lithuania's economic development will depend on the following risk factors:

- The challenges in the field of energy in Europe and the record high prices of energy resources, which would pressure more and more companies to restrict their activities, can have a stronger impact than expected on the production volume and the labour market both in Europe and in Lithuania, which would affect Lithuania's exports. Accordingly, private consumption would slow further as household purchasing power declines. It is possible that in such case the Lithuanian economy could shrink in 2023.
- Interest rates raised by the ECB and other central banks may reduce domestic demand more strongly than expected, thus further negatively affecting both Lithuania and the world economy growth, at least in the short term.
- The weakening of the euro against the US dollar may continue to increase the prices of imported raw materials. This would respectively worsen the current account deficit and accelerate external inflation.
- In Lithuania, medium-term risks remain linked to the implementation of structural reforms, especially in the areas of education and health, structural unemployment[12].
- There are also other risks related to new COVID-19 variants and continuing disruptions in supply chains.
- The decisions taken by the governments of the EU Member States and the structural changes and interventions considered by the EC, such as addressing high energy prices, can have a positive impact on the economic development of

[10] Under futures contracts, the exchange rate between the euro and the US dollar will be 1.00, 1.02, 1.04 and 1.05 for 2022–2025 period. Based on data from 24 August 2022 www.barchart.com.

[11] Based on 05/09/2022 data. Internet access: www.barchart.com.

[12] IMF Country Report to Lithuania of 28 June 2022. Internet access: https://www.imf.org/en/Publications/CR/Issues/2022/07/27/Republic-of-Lithuania-Selected-Issues-521365.

the Community as a whole. EU funds, the Recovery and Resilience Facility and other funds, both in Lithuania and the EU, are expected to have a positive impact.

ASSESSMENT AND ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO FOR 2022–2025

The Economic Development Scenario for 2022–2025 published by the Ministry of Finance on 12 September 2022, is endorsed as the projections (Table 2) of changes in GDP at constant and current prices, household consumption expenditure, average earnings and employment do not contradict the expert assessment of the National Audit Office implementing the functions of the fiscal institution.

Lithuania's real GDP, driven by domestic demand, is projected to continue to grow in 2023, but at a slower pace than in 2022. After a strong economic development in the beginning of 2022, the development of the country's economy in the second quarter of this year has significantly slowed to 1.8% compared to the corresponding period a year ago[13]. Positive annual growth was driven by net exports and moderate household consumption expenditure. The gross value added during this period was mainly driven by manufacturing, the results of which were significantly contributed by the wood industry, the manufacturing of furniture and metal products. Wholesale and retail trade; results of transportation, accommodation and catering services companies negatively contributed to the gross value added. Following an increase in uncertainty due to the war in Ukraine, the annual growth in industrial production (excluding refined petroleum products) remained double-digit during the period of March–June 2022 (Annex 1). However, as demand for goods decreased and production costs increased due to the increase in energy prices, this indicator increased barely by 3.4% in July. The chemical industry and the repair and installation of machinery and equipment have reduced the results of manufacturing.

Table 2. The Ministry of Finance's September 2022 projections for the Economic Development Scenario

Indicator, %	2021	2022P	2023P	2024P	2025P
Key macroeconomic indicators, rate of change					
GDP at constant prices	5.0	1.6 (1.6)	1.4 (2.1) ▼	3.0 (3.0)	3.0 (3.0)
Household consumption expenditure	7.4	2.5 (2.5)	2.7 (3.2) ▼	3.4 (3.4)	3.4 (3.4)
General government consumption expenditure	0.5	0.6 (0.5) ▲	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
Gross fixed capital formation	7.0	3.0 (3.2) ▼	4.5 (4.8) ▼	5.4 (5.4)	5.4 (5.4)
Exports of goods and services	15.9	3.0 (−2.5) ▲	2.0 (2.8) ▼	3.7 (3.7)	3.7 (3.7)
Imports of goods and services	18.7	3.9 (−1.2) ▲	3.1 (4.0) ▼	4.1 (4.1)	4.1 (4.1)
GDP at current prices	11.9	18.0 (15.3) ▲	7.5 (8.2) ▼	5.1 (5.0) ▲	5.1 (5.0) ▲
Price indicators, rate of change					
GDP deflator	6.5	16.2 (13.5) ▲	6.0 (6.0)	2.0 (2.0)	2.0 (2.0)
Harmonised index of consumer prices (average annual)	4.6	17.8 (15.8) ▲	6.0 (6.0)	2.0 (2.0)	2.0 (2.0)
Labour market indicators					

[13] On seasonally and calendar adjusted terms, Lithuania's real GDP declined by 0.5% in Q2 2022 compared to Q1 2022.

Indicator, %	2021	2022P	2023P	2024P	2025P
Change in average gross monthly earnings	10.6	12.0 (13.2) ▼	8.1 (8.4) ▼	5.0 (5.0)	5.0 (5.0)
Unemployment rate (according to the Labour Force Survey methodology)	7.1	6.3 (7.0) ▼	6.8 (7.0) ▼	6.7 (6.7)	6.4 (6.4)
Change in the number of employed persons (according to the Labour Force Survey methodology	0.8	1.0 (0.7) ▲	0.0 (0.0)	−0.2 (−0.2)	−0.4 (−0.4)

*The Ministry of Finance's June 2022 projections for the Economic Development Scenario are presented in the brackets.
**According to the EDS assessment and endorsement description, the EDS indicators for approval by the Fiscal Institution in the NAO are marked on a purple background.

Source: Ministry of Finance

The tense situation in energy resource markets and the rapid increase in consumer prices, deteriorating business and consumers expectations, the worsening economic prospects of Lithuania's main international trading partners will create difficult conditions for the country's economy to grow in the second half of 2022 and early 2023. The comparative base effect that had a positive impact on annual economic growth in Q1 2022, will go in the opposite direction. Given the strong real GDP growth in the first half of 2022 (3.2%) and the above-mentioned indicators, in the September's EDS it is expected a 1.6% GDP growth rate in 2022. Meanwhile, the projections for real GDP growth are reduced to 1.4% in 2023. In the Scenario it is envisaged that the growth of this indicator will be driven by household consumption expenditure and investment throughout the medium term, while the contribution of net exports will be negative.

Lithuania's international trade results in the first half of 2022 was vigorous, but the growth of real exports and imports is projected to slow down between 2022 and 2023 due to unfavourable external factors. After very favourable results in Q1 2022, real exports and imports of goods and services reached 8.1% and 7.3% respectively in Q2 of this year compared to the corresponding period a year ago. In April–June, the annual growth in the value of exports of goods of Lithuanian origin[14] exceeded 20%. This was mainly influenced by exports of plastics and their articles, furniture, wood and their articles. Meanwhile, exports of mineral products of Lithuanian origin were negatively affected by the planned overhaul of AB ORLEN Lietuva. In Q2022, re-export of goods[14] increased by 4.8% per year. Domestic demand continued to boost the value of imports of goods[14] and services at 17.3% and 34.0% respectively in Q2 2022. After the end of the transitional period of EU sanctions in June, imports of raw materials from Belarus, such as wood, iron and steel, almost stopped. It should be noted that the rise in export and import prices also contributed to the growth of these international trade indicators.

Favourable results in the first half of 2022 and with a cereal harvest projected[15] to be 10 percent better than in 2021 allow for an adjustment of the projections for 2022 for real exports and imports of goods and services in a positive direction (Table 2). However, the tense geopolitical situation in Europe and the difficult situation in energy resource markets will slow the growth of Lithuania's main export markets between 2022 and 2023. Challenges remain in industrial sectors that are vulnerable to energy prices, therefore the second half of 2022 is expected to be less favourable to international trade. In the September EDS, it is

[14] Excluding mineral products.
[15] Institute of Economics and Rural Development. Internet access: https://www.laei.lt/?mt=aktualijos&naujiena=596.

projected that the growth of Lithuania's real exports and imports will slow down between 2022 and 2023.

Cautious expectations may encourage some businesses to postpone investments, but a positive impact is expected from projects carried out by the public sector. In Q1 2022, the annual change in gross fixed capital formation (GFCF) amounted to 5.4%, but investment had not increased in Q2 2022. This was mainly due to the high comparative base and the decrease in expenditure on other buildings and structures (impact of –2.8 p.p.) and transport equipment (impact of –1.6 p.p.) in Q2 2022. According to the Business Trend Survey, business expectations in August were less affected than during the COVID-19 pandemic, however, an increasing number of companies state that their growth is being held back by lack of demand and financial problems. Energy-intensive industries face challenges [16] in the development of their activities. Thus, uncertainty about the geopolitical situation and the impact of the global economic slowdown on demand outlooks, as well as price increases, shortages of raw materials, equipment, liquidity problems, may have a negative impact on gross fixed capital formation.

On the other hand, increasing costs of energy can encourage investments in energy infrastructure, its consumption efficiency and renewable energy. The need for further investment projects is also reflected in the high utilisation of industrial production capacity, which was 79.0% in August. GFCF growth in 2022 and the acceleration in 2023 (Table 2) should be supported by public sector investments, which will benefit from the EU's Multiannual Financial Framework, Recovery and Resilience Facility and other measures.

Domestic consumption development in the first half of 2022 was uneven and inflation will continue to slow the growth in the remaining half of the year. Private consumption is expected to grow moderately in the context of the slowdown in increases of prices in 2023. Rapid growth (7.6%) at the beginning of this year was replaced by a slowdown to 0.6% in Q2 2022. Lower growth was influenced by a high comparative base, lower consumer expectations, inflation above population income growth and a contraction in domestic trade. Compared to the corresponding period in 2021, retail (excluding fuel) turnover decreased by 1.1% between April and June 2022, and by 4.2% in July 2022. During this period, the negative annual change in this indicator was due to a contraction in the sales of food products, while the decline in non-food products trade contributed to the situation in June–July. On the other hand, the consumption of catering services continues to grow.

High inflation reduces the purchasing power of the population, which, together with the deteriorating expectations of the population, will continue to negatively affect retail trade. The increase in interest rates will limit the consumption capacity of part of households. However, wage growth, Government's[17] measures to mitigate the effects of inflation and other measures will have a positive impact on households' disposable income. This, together with the savings accumulated during the pandemic period, will allow households to sustain consumption expenditure growth in 2022 and moderate inflation in 2023 will let it to grow at a slightly faster rate (Table 2). Fiscal Institution in the NAO notes that for

[16] In August, production capacity utilisation rate was 69.2% for chemicals and chemical products and 64.4% for rubber and plastic products.

[17] On 17 May 2022, renewed budget for 2022, which includes mitigation measures of inflation consequences, was endorsed, i.e. in order to increase old age pensions, other social benefits and adjustment of tax-exempt income. Internet access: https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/3d978f53d74911ecb1b39d276e924a5d.

private consumption estimates for 2022–2023, there are risks associated with lower-than-expected domestic demand in a context of deteriorating population expectations.

As energy resources and food prices continue to rise, in the EDS of September 2022 the growth of this year's Harmonised Index of Consumer Prices (HICP) is projected to reach 17.8%. In August, the HICP rose by 0.6% compared to July. Such a change is the lowest monthly change since August 2021. Compared to a year ago, the change in the HICP was 21.1%. The main contributors to this estimate were the housing, water, electricity, gas, and other fuels (6.3 p.p.), food and non-alcoholic beverages (6.1 p.p.) and transport (3.4 p.p.) components. In 2022, the high annual estimate of inflation will be driven by energy and food prices, which are largely affected by the situation in global markets. The impact of high energy commodity prices can also be felt due to the increase in the prime cost of other goods and services, which leads to an increase in their prices. However, strong wage growth also contributes to double-digit core and service inflation. As fertiliser prices rise[18], food price inflation may remain high in 2023 as well. On the other hand, the situation in energy markets is expected to stabilise. The Ministry of Finance projects that the HICP growth should slow down to 6.0% in 2023 and 2.0% in 2024–2025.

Foreseeing a faster HICP rise, the projection of the general price level for 2022 was also revised in a positive direction. As the HICP grows, the deflator of household consumption expenditure is growing accordingly. The rise in energy prices is fuelling a particularly rapid increase in the deflator of imports. At the same time, export, GFCF and general government consumption deflators are expected to increase more than in 2021. The Ministry of Finance projects that the increase in the general price level will reach 16.2% in 2022 and slow down to 6.0% in 2023.

In the first half of 2022, the labour market situation remains stable, however, due to a possible economic slowdown, unemployment rate is projected to increase in 2023, while gross earnings are projected to grow at a slower pace than in 2022. Unemployment rate fell to 5.2% in Q2 2022 and was the lowest since 2008. The number of employed persons[19] in the first half of 2022 increased by 5.6% compared to the same period last year, while the average monthly gross earnings increased by 13%. The changes in both the unemployment rate and the average monthly gross earnings were partly due to the continuing shortage of labour force, which is reflected in the high number of job vacancies[20], which remained the same as a year ago. It is true that tensions in the country's labour market have been eased by Ukraine's war refugees, who have complemented Lithuania's labour force.

In the September EDS it is foreseen that the unemployment rate compared to 2021 in 2022 will decrease and the number of employed persons will increase. Falling demand on domestic and foreign markets, high energy prices for energy-intensive businesses and the inability for some companies to adapt to the changed situation may lead to an increase in unemployment rate in the short term. Strong economic growth in the first half of 2022, persistent pressure to increase wages due to shortage of labour force and high inflation indicate that the average monthly gross earnings growth rate will remain double-digit in 2022. In 2023, the average monthly gross earnings will grow at a slower pace than in 2022

[18] Agricultural Market Information System's (AMIS) report. Internet access: http://www.amis-outlook.org/news/detail/en/c/1155862/.

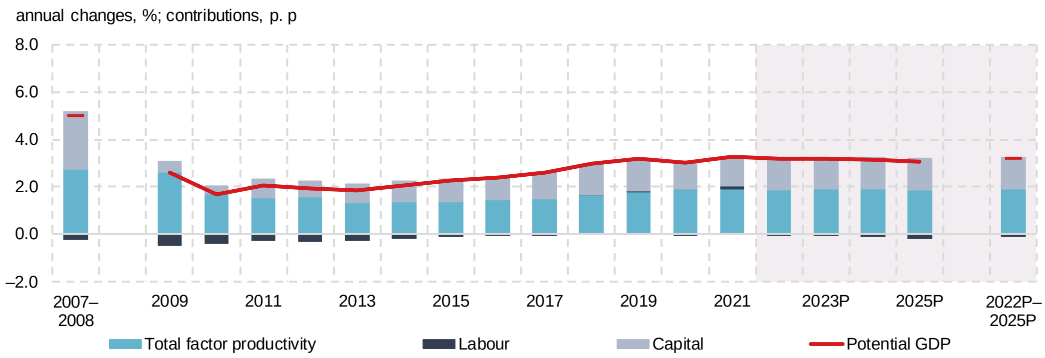
[19] In Q2 2022, the number of employed persons reached 1,436.2 thousand, increasing by 4.0% compared to the previous quarter.

[20] According to the Statistics Lithuania, the job vacancy rate in Q2 2022 was 1.9%, which is 0.5 p.p. higher than in Q2 2019.

due to the risks associated with the activities of private sector enterprises. On the other hand, when the Government adopts discretionary decisions (for example, on the minimum monthly and public sector wage increases), the growth of the average monthly gross earnings may be faster than projected (Table 2).

The National Audit Office, implementing the functions of the Fiscal Institution, projects potential GDP[21] to increase on average by around 3.1% annually between 2022 and 2025 (Figure 2.). Excluding the factors of change, the total factor productivity increases potential GDP growth by around 1.9 p.p. The contribution of capital, which is closely linked to the overall development of investment, contributes 1.3 p.p. The impact of the labour factor is negative and amounts to −0.1 p.p. According to the Fiscal Institution in the NAO, the output gap is expected to be 0.3% of potential GDP in 2022 and −1.4 % of GDP in 2023. The updated Heatmap of the Lithuanian Economy shows that the temperature of the economy is likely to remain high in Q3 2022 (Annex 2).

Figure 2. Potential GDP growth and its contributions



Source: Eurostat, calculations by the National Audit Office implementing the functions of the fiscal institution

The National Audit Office of the Republic of Lithuania, implementing its functions of a budget policy monitoring institution (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 2022–2025 prepared by the Ministry of Finance of the Republic of Lithuania and published on 12 September 2022. Pursuant to provisions of Article 8(7)(3) of the Law on National Audit Office of the Republic of Lithuania, the Fiscal Institution hereby submits its opinion to the Seimas of the Republic of Lithuania. This document is accompanied by the opinion on the compliance of the situation with the concept of exceptional circumstances.

Principal Economist of the Budget Monitoring Department,
Deputy Head of Department — Jaroslav Mečkovski

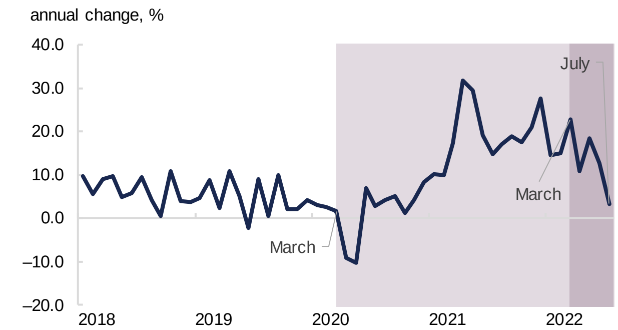
[21]The assessment methods are further detailed in the Description of the Assessment and Endorsement of the Economic Development Scenario. Internet access: https://www.valstybeskontrole.lt/TVS/Content/Biudzeto_stebesena/ERS_vertinimo_ir_tvirtinimo_aprasas.pdf.

ANNEXES

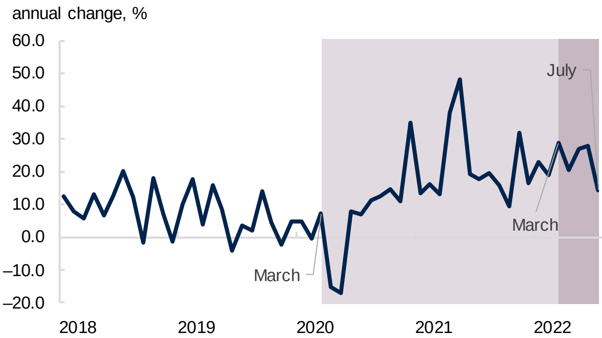
Opinion
On the Endorsement of the Economic
Development Scenario
Annex 1

DEVELOPMENTS IN THE LITHUANIAN ECONOMY DURING A PERIOD OF EXCEPTIONAL CIRCUMSTANCES

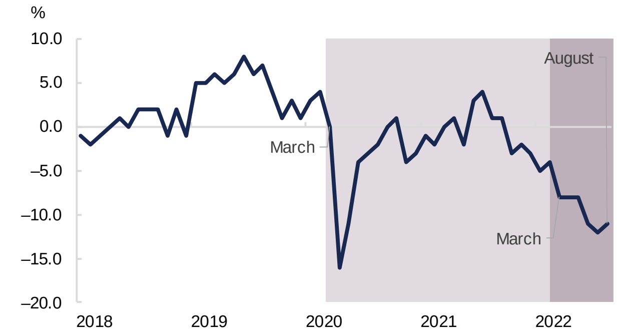
① Rising energy prices and declining demand for goods slow **industrial output**[1].



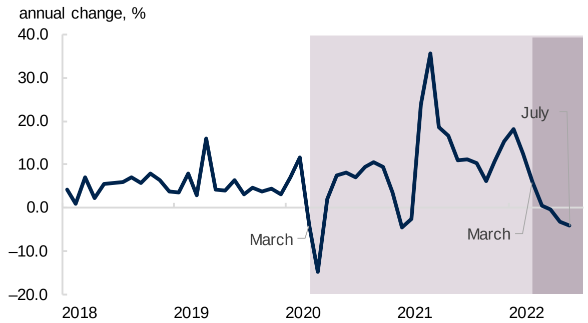
② In July, a slower increase in the value of **exports of goods of Lithuanian origin**[2] was observed.



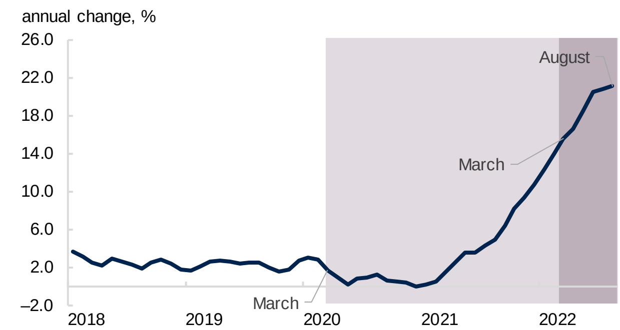
③ **Consumer expectations** remain negative in August 2022.



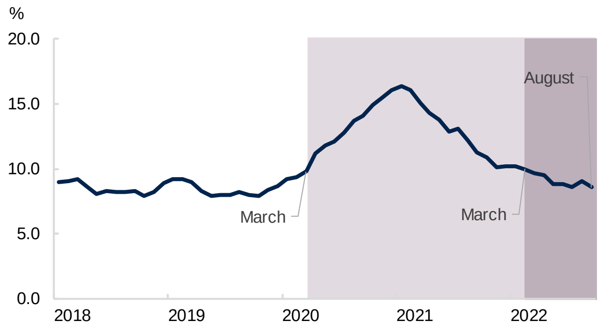
④ The contraction in the food trade led to a drop in **retail turnover**[3] in July.



⑤ Annual **inflation** reached 21.1% in August, but the change of 0.6% compared to July is the lowest since August 2021.



⑥ **Unemployment recorded** in August is close to the average level in 2019.



[1] except refined petroleum products / [2] except mineral products / [3] except the sale of automotive fuels

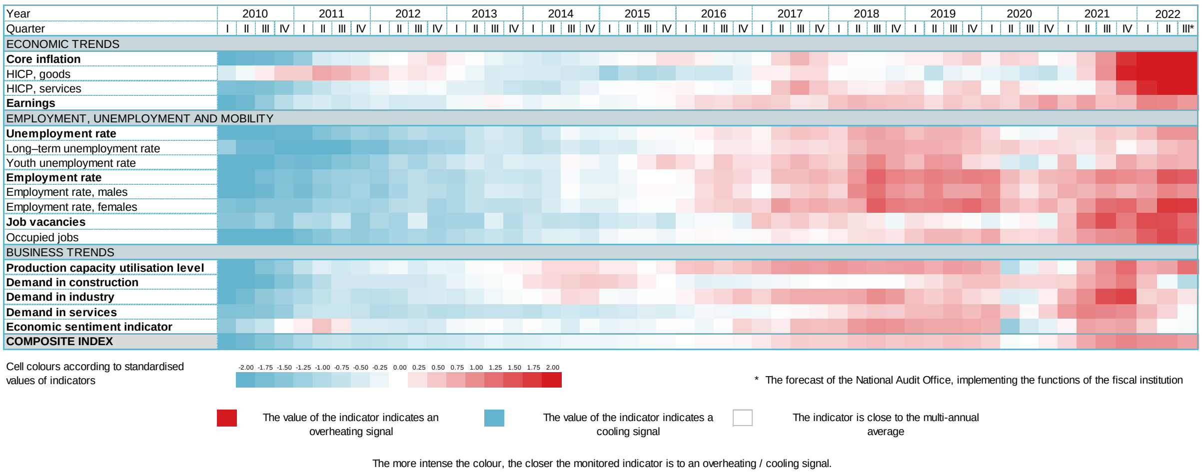
*Purple background highlights the period of exceptional circumstances. Russia's war in Ukraine is marked separately by the darker colour.

Source: Statistics Lithuania, Employment Service, calculations by the National Audit Office implementing the functions of the Fiscal Institution

Opinion
On the Endorsement of the Economic Development Scenario
Annex 2

THE HEATMAP OF LITHUANIA'S ECONOMY

The Heatmap of Lithuania's Economy



Source: Eurostat, Statistics Lithuania, calculations by the National Audit Office implementing the functions of the fiscal institution

The monitoring of macroeconomic imbalances [22] **shows that high inflation and a favourable labour market situation keep the temperature of the Lithuanian economy high in Q3 2022** [23]**.** Given the dynamics of recent registered unemployment[24], the unemployment rate in Q3 2022 is likely to remain at a similar level to the previous quarter. According to the data of *Sodra* in July, the average monthly earnings increased by 11.6% compared to the corresponding period the year before, therefore, it is projected that the average monthly gross earnings will continue to increase in Q3 2022. The economic slowdown is likely to contribute to declining demand for construction, industry, and services.

[22] The methodology for drawing up the map and the description of the indicators are set out in the Fiscal Institution's Opinion No BP–5 "On the Endorsement of the Economic Development Scenario" of 20 September 2018. The map shows the deviations from the long-term average. The 05/04/2022 Opinion "On the Endorsement of the Economic Development Scenario" contains a description of the calculation of the construction demand indicator.

[23] Some of the statistical indicators used in the map for Q3 2022 are provisional. Core inflation, the July-August change in the HICP indices of goods and services compared with the corresponding period of the previous year and equated to Q3. Unemployment and employment rates, job vacancies, and jobs occupied in Q3 are estimated using econometric models, taking into account data available from Statistics Lithuania, the Employment Service and *Sodra* (State Social Insurance Fund).

[24] According to the data of The Employment Service, the registered unemployment in July and August 2022 were 9.1% and 8.6%, respectively.