BUDGET MONITORING

To the Seimas of the Republic of Lithuania

OPINION ON THE ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

19 September 2024 No. BPE–5

Vilnius

THE ECONOMIC DEVELOPMENT SCENARIO FOR 2024–2027 IS APPROPRIATE FOR THE PREPARATION OF THE DRAFT STATE BUDGET

The National Audit Office implementing the function of a fiscal institution (hereinafter – NAO FI), submits to the Seimas its opinion on the Economic Development Scenario (EDS) for 2024–2027 published by the Ministry of Finance (MoF) on 11 September. The opinion is based on the Constitutional Law on the Implementation of the Fiscal Treaty.

The NAO FI endorses the Economic Development Scenario for 2024–2027, published in September. It is consistent with the specified assumptions and is based on relevant statistical data. The views of the NAO FI and the MoF on economic outlook of Lithuania are similar.

Key messages of the opinion:

- **Following the assessment, the NAO FI endorses the Economic Development Scenario for 2024–2027 published by the Ministry of Finance in September.**
- **Risks to the Lithuanian economy remain mainly related to the geopolitical situation and international trade.**
- **Real GDP may grow faster in 2024 than expected in the summer. In 2025, the recovery in production and consumption abroad is expected to boost Lithuania's economic growth more vigorously than this year.**
- **Labour productivity, which had reached record highs during the pandemic, has been declining since 2022 - boosting the growth of high technology manufacturing is essential for the country to remain competitive.**
- **In order to make three-year budget plans more realistic, indicators, coefficients and other variables affecting the state budget should be projected for a period of at least three years.**

ASSESSMENT AND ENDORSEMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

Using a variety of analytical methods[1] , the NAO FI carried out an assessment of the Economic Development Scenario for 2024–2027 published in September. The NAO FI analysed the macroeconomic environment and the EDS assumptions, compared the scenario projections with those of the NAO FI and other institutions, used the endorsement range method and expert judgement.

There are no significant differences in the projections of the main macroeconomic indicators for the period 2024–2027 between the MoF and the NAO FI. In view of the results for the first half of 2024 and updated assumptions, the MoF and the NAO FI slightly increase the 2024 real GDP projections. Both institutions project the economy to grow by more than 2%, driven mainly by household consumption and positive net exports. The country's economic growth is projected to accelerate to around 3% between 2025 and 2027. GDP expansion in this period will be driven mainly by real exports, which will benefit from the recovery in external demand. Investment and household consumption will also contribute to economic growth, driven by the strengthening purchasing power of the population. Both institutions project wages and employment to be higher in 2024 than expected in June, while the labour market situation will remain stable between 2025 and 2027, with a steady decline in the unemployment rate and continued growth in average wages.

The NAO FI and the MoF project inflation to be close to 1% in 2024 and above 2% in the medium term. Between 2024 and 2027, GDP at current prices is projected to grow at an annual rate of more than 5%, but at a slower rate than in 2023. A more detailed description of the NAO FI forecasts is provided in Part 2 of the opinion, and the projections table is in Annex 1. The September 2024 EDS is presented in Annex 2. It is noted that there may be differences between the NAO FI's and the Ministry of Finance's estimated indicators.

The NAO FI forecasts are used as a *benchmark* using the endorsement range method. On this basis, the NAO FI has produced uncertainty graphs for the following EDS indicators[2] for the period 2024–2026: changes in GDP at current and constant prices, real household consumption expenditure, average gross monthly earnings (AME) and number of employed persons (Annex 3). The projections for all indicators fall within the 40% confidence intervals. They represent the central range of the probability intervals, which is closest to the reference point (mode) for the projections of the NAO FI. It should be noted that the endorsement ranges are based on historical errors and therefore may not necessarily be fully indicative of future uncertainty.

In line with the approach used in the NAO FI's assessment of potential GDP to test the consistency of medium-term projections, the EDS projection of real GDP in 2027 is considered plausible. According to the NAO FI's assessment, potential GDP[3] is expected to increase on average by around 2.8% annually between 2024 and 2027 (Annex 1). The Ministry of Finance projects real GDP growth at 2.9% in 2027. This is close to the NAO FI's estimate of potential GDP growth of 2.5% in 2027.

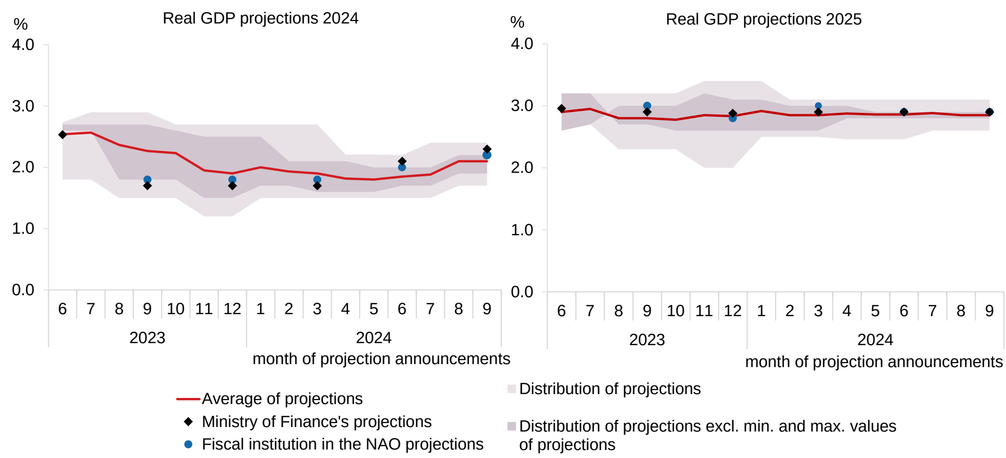
[1] The evaluation and endorsement process and the methods used by NAO FI are defined in the Description of Evaluation and Endorsement of the EDS of the NAO FI. Available online: https://www.valstybeskontrole.lt/TVS/Content/Biudzeto_stebesena/ERS_vertinimo_ir_tvirtinimo_aprasas.pdf.

[2] These key indicators are the most important for the NAO FI when deciding on the endorsement of the EDS, but projections of other EDS indicators are also analysed to ensure consistency between the projections of the scenario indicators.

[3] The potential GDP estimate uses the latest Ministry of Finance EDS projections. It should be noted that due to differences in estimation assumptions and model specifications, the estimates of the potential GDP and output gap may differ between the NAO FI and the MoF.

The September 2024 EDS projections of real GDP for the period 2024–2025 are close to the average of other institutions and the uncertainty about economic development is lower than observed in the spring. The average of other institutions' real GDP projections is 2.1% in 2024 and 2.9% in 2025 (Figure 1). It should be noted that most of the institutions publishing macroeconomic forecasts for Lithuania updated them by July 2024 (Annex 4), before the favourable GDP results for Q2 2024 were announced. It should be noted that, compared to the spring, the spread of projections is narrower and there may be less uncertainty about economic development.

Figure 1. The September 2024 EDS real GDP projections for 2024–2025 are close to the average of other institutions



The institutions involved in the distribution of the projections are the European Commission (EC), the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the Bank of Lithuania, Swedbank AB and SEB AB.

Source: calculations by the National Audit Office, implementing the function of a fiscal institution

The assumptions used in the September 2024 EDS are reasonable, and the main risks to Lithuania's economic development remain related to the geopolitical situation and international trade. In the assessment of the NAO FI, the September EDS is based on up-to-date assumptions on the evolution of the global economy and the economies of the main export partners, commodity prices, and exchange rate. The main downside risks that could affect the development of the Lithuanian economy are related to the geopolitical situation and foreign demand. More favourable economic developments could be driven by an improved labour market situation, faster investment growth, higher household consumption, which would be influenced by changes in personal savings. A more detailed description of the macroeconomic environment, assumptions, and risks is provided in Part 1 of the Opinion.

The NAO FI endorses the Economic Development Scenario 2024–2027 published by the Ministry of Finance in September 2024. According to the Council of the European Union Directive[4], budgetary planning must be based on the most likely or more prudent macrofiscal scenario. In view of the remaining uncertainties and taking into account the results of the above-mentioned methods, the NAO FI endorses the Economic Development Scenario 2024–2027 published in September 2024.

On August 26, 2024, the Ministry of Finance submitted a draft EDS to the institutions for coordination (copy to the NAO FI) and on September 3, 2024, a revised draft was submitted to the NAO FI. Details on the progress of coordination are provided in Annex 5. On the basis of the above methods, The NAO FI carried out an assessment of the draft EDS. On September 5, 2024, the NAO FI informed the MoF that it had no reason not to endorse the draft EDS.

[4] 29 April 2024 Council Directive 2024/1265/EU on requirements for budgetary frameworks of the Member States, Article 4(1) Available online: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:L_202401265.

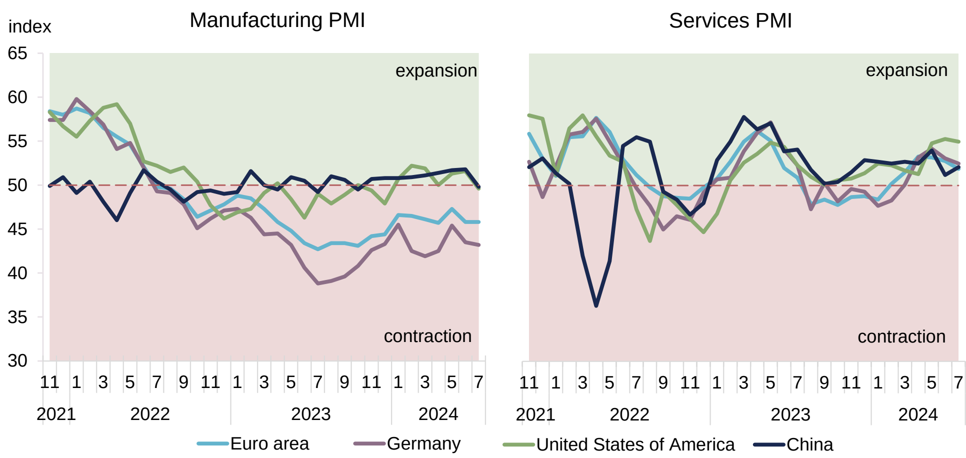
1. ANALYSIS OF THE MACROECONOMIC ENVIRONMENT AND EDS ASSUMPTIONS, RISKS TO LITHUANIAN ECONOMIC DEVELOPMENT

According to the assessment of the NAO FI, the September EDS is based on up-to-date assumptions on global and major export partner economic developments, commodity prices and exchange rate. In the absence of updated assumptions on global and EU growth by the European Commission since May, both the MoF and the NAO FI relied on the IMF's projections published in July. This information is up-to-date compared to other international institutions publishing such assumptions. From 2025 onwards, both the NAO FI and the MoF assume a faster recovery of export partners than in 2024. It is also relied on assumptions of a stable exchange rate of the euro against the US dollar and an oil price that is in line with the trajectory projected by other international institutions. In this context, the assumptions used by the MoF in the September EDS are in line with the latest known information and market expectations.

The main downside risks to the Lithuanian economy remain related to the geopolitical situation and international trade. The main risks that could affect its development in the medium term are:

- **Slower-than-expected recovery of Lithuania's export partners.** Germany's, Lithuania's main export partner's, economy contracted by 0.1% of GDP in the first half of 2024. In addition, leading indicators of economic activity in Q3, such as the purchasing managers' index, signalled continued sluggish global output in July (Figure 2). Stagnating industry in the euro area, especially in Germany, the difficulties of the Chinese economy due to the real estate sector, and the likelihood of a recession in the US could slow down the projected growth of these world economies. However, if interest rates continue to be cut more than expected, this would have a positive impact on these economies and thus on Lithuania.

Figure 2. EA business activity in the industrial sector remains contracting, while the service sector is growing



PMI - Purchasing Managers' Index

Source: https://www.pmi.spglobal.com

- **Challenges to national competitiveness.** After rising sharply during the pandemic and exceeding its multi-year trend, Lithuania's labour productivity has started to fall in 2022 (see more in Box). According to the recommendations of international institutions, increasing productivity is essential to maintain sustainable economic growth and competitiveness. Without increased investment and innovation in higher value-added sectors, the country could lose competitiveness.

- **Fiscal policy that is restrictive and does not stimulate economies.** In July, the European Council[5] issued a decision to open excessive deficit procedures in Belgium, France, Hungary, Italy, Malta, Poland and Slovakia following violations of the EU's fiscal discipline rules. Not only these countries, but also others with high debt levels or large deficits can start limiting their spending growth in order to achieve fiscal discipline. This could affect demand for Lithuanian exports. Lithuania also faces the challenge of being able to match its growing long-term liabilities with its available resources, in order to stay within the requirements of not only European Union but also national fiscal discipline rules. Restrictive fiscal policies may be needed in the future to reduce the budget deficit. In particular, inflation, household consumption and investment could be the most affected.

- **Increased geopolitical tensions.** The war in Ukraine could be a source of various unforeseen economic risks. In addition, tensions in the Middle East over the Israeli and Palestinian territories, trade wars with China or turmoil in the Red Sea are constant risks of rising energy prices and disruptions to international trade. An intensification of geopolitical tensions could not only lead to more uncertainty in the world, but also have a negative impact on global economies. This would likely lead to higher energy prices, which would fuel inflation in Lithuania.

- **Climate change risks.** According to the EC's Joint Research Centre[6], several European countries faced critical drought conditions in the first half of July. The increasingly evident impacts of climate change could have negative effects on supply chains, food prices and inflation. In Lithuania, climate change will manifest itself in more frequent and intense downpours, floods and cold snaps. All this will affect the wealth and health of the population[7]. However, investments in renewable energy and other green transition oriented solutions can not only help to combat climate change and build resilience, but also promote economic development and energy independence.

- **Stronger-than-expected domestic demand could underpin stronger growth.** Continued migration may contribute to higher employment. Changes in behaviour towards lower savings may have a positive impact on household consumption. Investment could be boosted by stronger-than-expected implementation of the *Recovery* and *Resilience Facility* (RRF) and other EU-funded projects, policy decisions to invest even more in defence or other areas, or by stronger private sector investment.

[5] Available online: https://www.consilium.europa.eu/en/press/press-releases/2024/07/26/stability-and-growth-pact-council-launches-excessive-deficit-procedures-against-seven-member-states/.

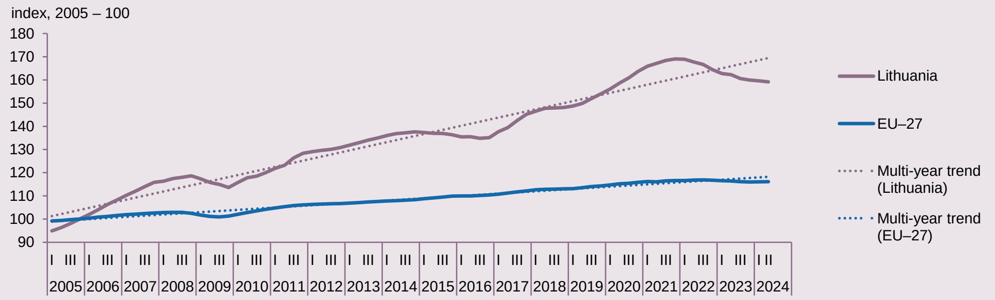
[6] Available online: https://joint-research-centre.ec.europa.eu/jrc-news-and-updates/severe-impacts-hot-conditions-south-2024-08-26_en.

[7] Available online: https://klimatokaita.lt/prisitaikymas-prie-pokyciu/issukiai-lietuvos-gyventojams/.

Box. Increasing labour productivity is key to remain competitive

Labour productivity, which had reached record highs during the pandemic, has been declining since 2022. Looking at data since 2017, there has been a significant increase in the productivity of the Lithuanian economy, compared to a moderate increase in the European Union (Box Figure 1). As supply chains were disrupted during the pandemic, foreign demand for goods for which Lithuania's industrial structure was favourable increased. This led to a record level of capacity utilisation and enabled a sharp increase in labour productivity, measured as gross value added per hour worked. However, it should be noted that in recent years, Lithuania's economic growth is likely to have been driven mainly by the rising number of employed people due to increased migration, refugees from Ukraine and their number of hours worked in lower value-added sectors, rather than by labour productivity growth. The energy crisis eased the pressure of strong export demand and led to a sharp decline in capacity utilisation, which could have had a negative impact on productivity. Notably, productivity declined in 2023 not only in Lithuania but also in the EU.

Box. Figure 1. Labour productivity* in Lithuania, which surged during the pandemic, is lagging behind the multi-year trend



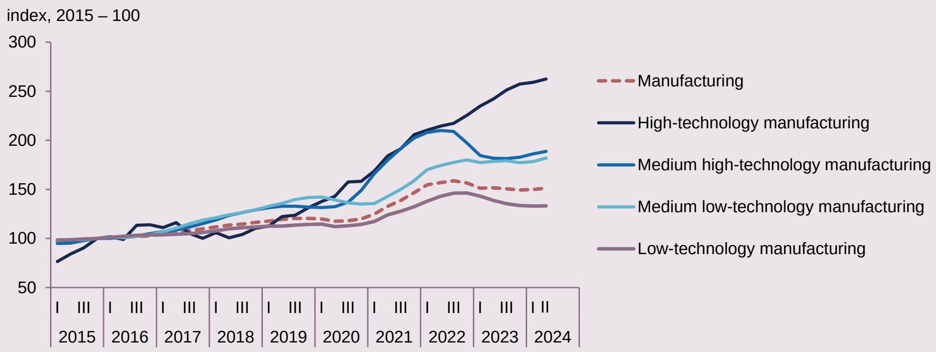
The figure below shows the labour productivity indices, which show the changes in the indicator over time. The index values are standardised to a value of 100 for the reference year (2005). The lines show the growth of labour productivity since 2005 in Lithuania and the EU.

* Real gross value added per hour worked, seasonally and calendar adjusted data, 4-quarter moving average of the index.

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

In order to increase the competitiveness of Lithuanian industry, it is essential to promote the growth of high technology manufacturing. Manufacturing accounts for around one fifth of Lithuania's gross domestic product. In the period 2021–2022, exports of Lithuanian origin have been one of the factors contributing to economic growth. Despite a significant increase in high-tech manufacturing[8], i.e. pharmaceuticals, computers, electronics and optical products, since 2019, the industry sector continues to be dominated by low-tech manufacturing (Box Figure 2,3).

Box. Figure 2. Although Lithuania is experiencing rapid growth in high-tech manufacturing, the impact of this indicator on the manufacturing sector is limited



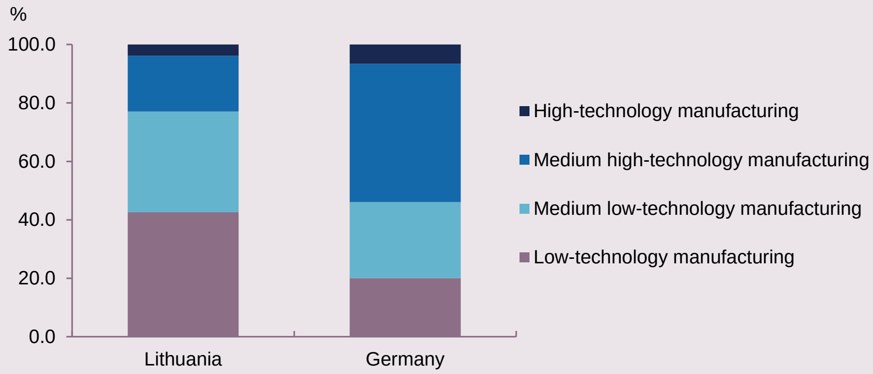
Industry (manufacturing) output data, seasonally and calendar adjusted, 4-quarter moving average of the index.

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

[8] Eurostat breakdown of manufacturing into high, medium and low technology activities. Available online: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:High-tech_classification_of_manufacturing_industries.

When analysing the dynamics of Germany's industrial production, it can be seen that medium high and high value-added manufacturing accounts for about half of all manufacturing production, while in Lithuania it is just over one fifth (Box Figure 3). It should be noted that high-tech manufacturing in Lithuania has not grown significantly over the past 20 years and is less than 5% of total manufacturing. As noted by the Bank of Lithuania[9], Lithuania's manufacturing investment intensity (ratio of investment to value added) is lower than in the EU. One of the factors explaining this is Lithuania's specialisation in the production of products whose manufacturing process is not capital-intensive and thus not investment-intensive.

Box. Figure 3. Compared to Germany, low and medium low technology manufacturing dominates in Lithuania



Structure of manufacturing by industrial output, 2019-2023 average.

Source: State Data Agency, German Federal Statistical Office, calculations by the National Audit Office, implementing the function of a fiscal institution

International organisations are also pointing to the need to boost Lithuania's productivity by encouraging investment. According to the European Commission[10], Lithuania's competitiveness is relatively stable, but it faces challenges such as skills mismatches, low levels of research and experimental development, etc. The EC notes that Lithuanian industry continues to face low resource productivity and the share of high-tech exports in total exports remains below the EU average. The IMF[11] stresses the need for prudent policies and structural reforms to maintain sustainable productivity and economic growth. Reforms should encourage investment to increase capital formation and mitigate the demographic situation. According to the World Bank's assessment[12], Lithuania is classified as an upper-income country. The report points out that upper-middle-income countries should not only focus on investment and the adoption of global technologies[13] - the main focus should be on innovation. Innovation can significantly raise a country's productivity levels. According to the Draghi report on EU competitiveness[14], the importance of research and innovation for productivity growth will increase in the future due to the acceleration of global innovation growth rates over the last decades. The report notes that the EU's weakening competitiveness is partly explained by the EU's lower investment in research and experimental development (R&D) than in the US, Japan or China. Few countries exceed the EU's 3% R&D investment target, and Lithuania is in the group of EU countries with less than 1% of GDP invested in this area.

[9] Box 1. Manufacturing structure's impact on investment, Bank of Lithuania, 2021. Available online: https://www.lb.lt/uploads/publications/docs/29228_7927e065ddff0979ed88e7c57c61710c.pdf.

[10] Available online: https://economy-finance.ec.europa.eu/document/download/b2eea0d9-a516-4153-82ac-66d150d1ce7e_en?filename=SWD_2024_615_1_EN_Lithuania.pdf.

[11] 24/07/2024 Staff Report for the 2024 Article IV Consultation. Available online: https://www.imf.org/-/media/Files/Publications/CR/2024/English/1LTUEA2024001.ashx.

[12] Available online: https://www.worldbank.org/en/publication/wdr2024.

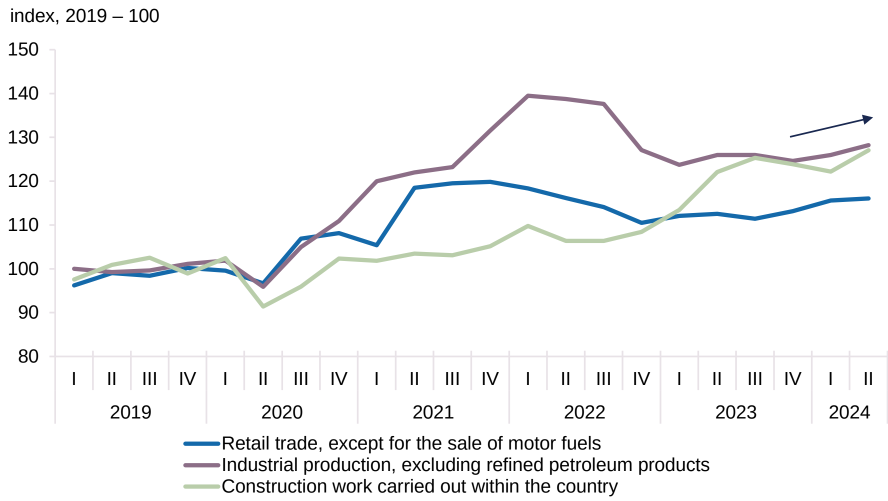
[13] *Infusion* is the introduction of technology from abroad into an economy.

[14] The future of European competitiveness, M. Draghi, 09/09/2024. Available online: https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en.

2. NAO FI ECONOMIC DEVELOPMENT FORECAST

With the recovery in industry and retail trade, the NAO FI revises upwards the 2024 real GDP projection. Based on the assumption of strengthening external demand, economic growth in 2025 is projected to be stronger than this year. Following a strong Q1 2024, the country's economic development in Q2 2024 was also stronger than expected. In that quarter, real GDP was 1.8% higher than a year earlier. This growth was mainly driven by household consumption. The recovery in several key sectors of the economy continues in Q2 2024 (Figure 3). Industrial production is growing for the second consecutive quarter, and with inflation significantly slowing down, retail turnover has been increasing since the end of 2023. Despite the pandemic and inflation shocks, industrial and retail trade activity remain almost 30% and 20% higher than in 2019, respectively. Also, the volume of construction work completed in the country continues to grow, mainly driven by the rapid expansion of civil engineering construction.

Figure 3. Q2 2024: industry and retail recovery continues, construction output grows



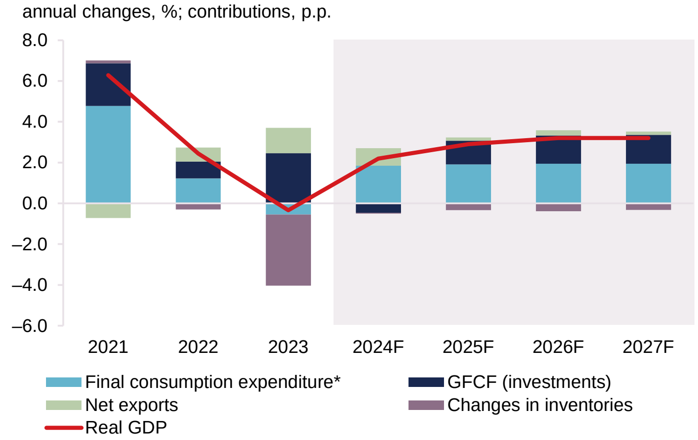
Seasonally and calendar adjusted.

Source: State Data Agency, calculations by the National Audit Office, implementing the function of a fiscal institution

In August Lithuanian industrial companies are still cautious about the demand for their products. Activity in the euro area remains subdued and expectations for production orders have not yet improved. For this reason, according to the NAO FI, the country's industry is less likely to grow faster in the second half of this year than in the first half. However, the economic development will be positively influenced by the cereal harvest, which is expected to be 5.3% higher than in 2023.

Taking into account the more favourable data of 2024 Q2 than expected in the summer, the NAO FI raises the real GDP growth projection for this year to 2.2%. In 2024, the expansion of the economy is projected to be driven mainly by household consumption, positively influenced by the rising purchasing power of the population (Figure 4). Positive net exports are also likely to contribute to economic growth. Following a contraction in investment in the first half of the year, it is expected to have a negative impact on real GDP in 2024. In 2025, the NAO FI projects economic expansion to accelerate to 2.9%. Stronger export growth is expected as Lithuania's main trade markets recover. The impact of investment is expected to turn positive again. Real GDP growth is likely to reach around 3.2% in 2026–2027.

Figure 4. In 2024, the NAO FI projects that household consumption will be the main driver of economic growth, while in 2025, recovering exports and investment will contribute to faster economic growth

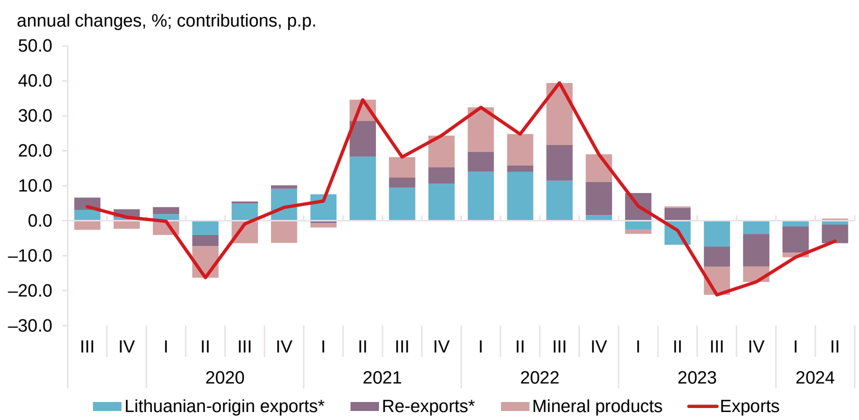


F - forecast

Source: State Data Agency, calculations by the National Audit Office, implementing the function of a fiscal institution

Real exports are expected to increase moderately this year. Growth is projected to accelerate in 2025–2027, boosted by Lithuania's recovering international trade markets. In Q2 2024, Lithuania's international trade performance contracted, with real exports 3.5% lower than a year earlier and imports 2.6% lower. The fall in goods exports was driven by a further decline in re-exports, which were influenced by the stricter sanctions control that came into force in July of last year (Figure 5). It should be noted that the value of re-exports to Eastern countries in Q2 2024 is lower than before the war in Ukraine (Annex 6). It is likely that due to the comparative base, the annual contraction in re-exports in the second half of 2024 may be slower than in the first half. With the recovery of the country's industrial production, the annual contraction of exports of goods of Lithuanian origin (excluding mineral products) continued to slow down in Q2 of this year, reaching 2.2%. Expectations of Lithuanian industry regarding export orders remain cautious, so it would be difficult to expect rapid growth of Lithuanian exports in second half. However, it should benefit from a higher-than-last-year expected cereal harvest. Based on international trade data for the first half of 2024, the NAO FI downgrades this year's projected growth in real exports of goods and services to 0.9%. Real imports are projected to be close to 2023 levels. Real exports and imports are projected to accelerate to 4.7% and 5% respectively in 2025 as external and domestic demand strengthens.

Figure 5. The fall in the value of goods exports (at current prices) in Q2 2024 is due to a further decline in re-exports



* excluding mineral products

Source: State Data Agency, calculations by the National Audit Office, implementing the function of a fiscal institution

Investment, which contracted in the first half of 2024, may not recover this year, but is projected to pick up from 2025. In the first half of 2024, real gross fixed capital formation (investment, GFCF) declined by 3.9% year-on-year. This change was mainly driven by a decline in spending on transport equipment, machinery and equipment. On the other hand, the impact of investment in construction (excluding the housing component), which accounts for the largest share in the GFCF structure, remained positive. In Q2 2024, data on tangible fixed investment showed a deepening decline in the private sector and sluggish growth in the public sector. Given the actual dynamics of the indicator in the first half of the year and the high comparative base, the NAO FI forecasts that gross fixed capital formation will contract by 1.8% in 2024. However, the faster absorption of EU funds, the faster inflow of the RRF loans into the economy and the defence investments that may reach Lithuania may contribute to a better-than-expected investment dynamic. With recovering external demand, improving credit conditions, rising defence financing and the continued need for productivity-enhancing measures, the growth rate of this indicator is projected at 4.7% in 2025 and 5.5% in 2026 and 2027.

Consumer price inflation is projected to be close to 1% in 2024 and above 2% in the medium term, following a decline in energy commodity prices. The annual growth rate of the Harmonised Index of Consumer Prices (HICP) in January–August was 0.8%. This development was driven by a decline in electricity, gas, solid fuels and heating energy prices. However, inflation is expected to pick up for the rest of the year as the base effect fades. NAO FI forecasts that it will reach 1.1% in 2024. HICP growth is expected to accelerate again in 2025 and to remain higher than previously projected over the rest of the medium term, driven by further increases in service prices and the impact of excise duties. Despite a significant slowdown in consumer price inflation in 2024, the acceleration in the overall price level in the country has led the NAO FI to raise its forecast for the GDP deflator in 2024. It is also revised upwards for the remaining years of the medium term, which implies stronger nominal GDP growth between 2025 and 2027. The GDP deflator is projected to grow above the HICP in the medium term, due to higher growth in the general government deflator and faster price increases for exports relative to imports.

Continued favourable migration trends are contributing to an upward revision of the employment outlook for 2024, but uncertainty remains for 2025. In the first half of this year, the number of employed persons increased by 2.3% compared to the same period last year. The labour force continued to grow and reached its highest level since 2005, driven by the growth of the resident population due to positive net migration and a historically high rate of labour force participation. However, declining immigration flows and assumptions of an ageing population are fuelling moderately declining employment projections for 2025–2027. The unemployment rate in the first half of the year was around 1 percentage point higher than a year earlier at 7.6%, but the increase can be attributed to the expansion in the labour force. The NAO FI projects the unemployment rate to decrease from 2025.

In the medium term, average wage growth is projected to moderate compared to 2024, but it is expected to remain relatively strong. Compared to developments over the last few years, the annual wage growth in the first half of 2024 has slowed down. This is most noticeable in the private sector. Nominal GDP growth in 2024–2027 is projected to be slower than that seen in the post-pandemic period, which may leave less room for such rapid wage increases in the future. On the other hand, employers' challenges in terms of staff shortages are reflected in the statistics: the vacancy rate reached 2.1% in Q2 2024, and according to the Lithuanian Employment Service, the search for workers also intensified in July. High vacancy rates and increased unemployment signal a potential skills mismatch of jobseekers, so the desire to retain existing workers and attract new skilled professionals will encourage employers to offer competitive wages. Increases in the minimum monthly wage, economic development and a decline in the unemployment rate will also contribute to the projected increase in the wages between 2025 and 2027.

With rising purchasing power of the population and a stable labour market situation, further growth in private consumption is expected in 2024 and over the medium term. In the first half of 2024, real household consumption expenditure grew by 2.8% year-on-year. Population expectations remain good, but some households are constrained by rising interest rates and are saving more. The change in household consumption expenditure in the second half of 2024 will be affected to an increasing extent by the low comparative base. According to the NAO FI's estimate, household consumption expenditure will grow by 3.2% in 2024. The increase will be driven by a favourable labour market situation, good consumer expectations, and slowing inflation. Disposable incomes of the population will be positively affected by the measures envisaged in the 2024 State Budget Law to increase personal income. Private consumption growth is projected at 3.4% in 2025. In the medium term, private consumption will increase at a similar pace, in line with continuing favourable labour market trends. However, higher-than-expected changes in the household saving rate may prompt a revision of household expenditure projections in the future.

3. FOCUS ON THE THREE-YEAR BUDGET PLANS

In order to make three-year budget plans more realistic, indicators, coefficients and other variables affecting the state budget should be projected for a period of at least three years. In October 2024, a draft budget law will be presented for the first time on the basis of the updated Law on the Budget Structure [15] (BSL). One of the strengths of the updated BSL is the requirement that the values of indicators, coefficients and other values established by law should be set or forecasted for a period of at least three budgetary years[16]. Rates that are projected for the entire medium term would allow for more accurate and transparent planning of draft budgets, a more appropriate assessment of the impact of decisions taken on future budgets, and the identification of risks to compliance with fiscal discipline rules. In the view of the NAO FI, clearer guidelines for rates such as the minimum monthly wage could also help to forecast macroeconomic indicators more accurately, which is why it is important for the responsible institutions to make such rates publicly available at the beginning of the budget preparation cycle. As budgetary planning is based on Economic Development Scenario, more accurate macroeconomic forecasts would also contribute to more realistic budgetary plans.

The National Audit Office of the Republic of Lithuania, implementing the functions of the budget policy monitoring 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 2024–2027 prepared by the Ministry of Finance of the Republic of Lithuania and published on 11 September 2024. In accordance with Article 7(3) of the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania and Article 8(7)(3) of the Law on the National Audit Office, the National Audit Office submits its opinion to the Seimas of the Republic of Lithuania.

Head of Budget Monitoring Department — Jurga Rukšėnaitė

[16] Article 6(4) of the BSL: "The values of the indicators, coefficients and other values established by laws and/or regulations, on the basis of which the planned appropriations for the 3 budgetary years concerned are calculated, shall be set for a period of at least 3 budgetary years. If, for objective reasons, the values of the indicators, coefficients and other values established by laws and/or other legal acts are not set for the 3 budgetary years, the body responsible for calculating and/or setting the values of such indicators, coefficients and other values shall forecast the values for the second and third budgetary years, publish them on its website and submit the information on these values to the Ministry of Finance in accordance with the procedure laid down by the Government."

ANNEXES

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FISCAL INSTITUTION'S MACROECONOMIC FORECAST FOR 2024–2027 AND MAIN ASSUMPTIONS

Table 1. Macroeconomic projections of the NAO FI for 2024–2027

Indicator	2023	2024F	2025F	2026F	2027F
Key macroeconomic indicators					
Change in GDP at constant prices, %	−0.3	2.2 (2.0) ▲	2.9 (2.9)	3.2 (3.2)	3.2 (3.2)
GDP at constant prices, EUR million	47 145.2	48 182.4	49 579.7	51 166.3	52 803.6
Change in GDP at current prices, %	6.7	5.3 (4.4) ▲	5.5 (5.5)	5.9 (5.6) ▲	5.7 (5.7)
GDP at current prices, EUR million	71 986.2	75 793.9	79 997.1	84 682.0	89 550.4
Change in labour productivity, %	−1.7	1.1 (1.3) ▼	3.2 (3.1) ▲	3.4 (3.5) ▼	3.3 (3.4) ▼
Components of GDP at constant prices, rate of change, %					
Household consumption expenditure	−1.0	3.2 (3.4) ▼	3.4 (3.4)	3.5 (3.5)	3.5 (3.5)
General government consumption expenditure	0.2	0.4 (0.2) ▲	0.1 (0.1)	0.1 (0.1)	0.1 (0.1)
Gross fixed capital formation	10.6	−1.8 (2.2) ▼	4.7 (5.7) ▼	5.5 (5.5)	5.5 (5.5)
Exports of goods and services	−3.3	0.9 (3.6) ▼	4.7 (5.5) ▼	4.7 (5.5) ▼	4.7 (5.5) ▼
Imports of goods and services	−4.9	0.1 (3.9) ▼	5.0 (5.4) ▼	4.9 (5.3) ▼	5.0 (5.3) ▼
Price indicators, rate of change, %					
GDP deflator	7.1	3.0 (2.3) ▲	2.6 (2.5) ▲	2.6 (2.4) ▲	2.5 (2.4) ▲
Household consumption expenditure deflator	8.6	1.1 (1.6) ▼	2.5 (2.3) ▲	2.5 (2.3) ▲	2.4 (2.3) ▲
Government consumption expenditure deflator	12.6	10.9 (9.3) ▲	5.3 (5.3)	4.5 (4.5)	4.4 (4.4)
Gross fixed capital formation deflator	5.1	2.3 (2.3)	2.4 (2.4)	2.1 (2.1)	2.1 (2.1)
Export (goods and services) deflator	−0.2	1.0 (1.5) ▼	0.8 (0.8)	1.6 (1.6)	1.4 (1.4)
Import (goods and services) deflator	−5.6	−0.2 (1.1) ▼	0.1 (0.0) ▲	1.3 (1.3)	1.3 (1.3)
Harmonised index of consumer prices (annual average)	8.7	1.1 (1.6) ▼	2.5 (2.3) ▲	2.5 (2.3) ▲	2.4 (2.3) ▲
Labour market indicators					
Number of employed persons (according to the Labour Force Survey methodology), thousand	1441.1	1457.5	1452.8	1450.1	1449.1
Change in the number of employed persons, %	1.4	1.1 (0.7) ▲	−0.3 (−0.2) ▼	−0.2 (−0.3) ▲	−0.1 (−0.1)
Unemployment rate (according to the Labour Force Survey methodology), %	6.8	7.3 (7.3)	7.0 (6.9) ▲	6.8 (6.9) ▼	6.5 (6.7) ▼
Average monthly gross earnings, EUR	2013.8	2209.1	2388.1	2558.1	2720.5
Change in average monthly gross earnings, %	12.6	9.7 (9.1) ▲	8.1 (8.4) ▼	7.1 (7.0) ▲	6.3 (5.5) ▲
Wage bill, million EUR	27 842.2	30 889.9	33 286.1	35 587.7	37 820.8
Change in the wage bill, %	13.4	10.9 (9.9) ▲	7.8 (8.3) ▼	6.9 (6.6) ▲	6.3 (5.4) ▲
Changes in potential GDP and the output gap					
Change in potential GDP, %	3.2	3.1 (3.2) ▼	2.9 (3.0) ▼	2.7 (2.8) ▼	2.5 (2.6) ▼
Output gap (% of potential GDP)	−1.1	−2.0 (−2.4) ▲	−2.1 (−2.6) ▲	−1.9 (−2.6) ▲	−1.6 (−2.3) ▲

The projections in parentheses are the July 2024 NAO FI projections.
According to the description of the procedure for EDS Evaluation and Endorsement, the indicators based on which the NAO FI decides on the EDS endorsement are presented in the purple background.
The projections are based on information and data published up to 30 August 2024.
F - forecast
Source: State Data Agency, calculations by the National Audit Office, implementing the function of a fiscal institution

Table 2. Main assumptions of the macroeconomic forecasts of the NAO FI

Indicator	2023	2024F	2025F	2026F	2027F
US dollar to euro exchange rate*	1.08	1.08 (1.07) ▲	1.09 (1.07) ▲	1.09 (1.07) ▲	1.09 (1.07) ▲
World (excl. EU) GDP growth, %**	3.6	3.5 (3.5)	3.6 (3.6)	3.6 (3.6)	3.6 (3.6)
European Union GDP growth, %**	0.6	1.2 (1.0) ▲	1.8 (1.6) ▲	1.8 (1.6) ▲	1.8 (1.6) ▲
Growth of Lithuania's main export markets, %***	1.2	1.5 (1.4) ▲	1.9 (1.8) ▲	1.9 (1.8) ▲	1.9 (1.8) ▲
Oil prices (*Brent*, USD per barrel)****	82.5	82.1 (85.4) ▼	75.4 (80.0) ▼	72.7 (76.2) ▼	70.9 (73.3) ▼

* The exchange rate during the forecast period remains at the exchange rate recorded between 29 July and 9 August 2024.
** Based on information from the International Monetary Fund made public on 16 July 2024.
*** Based on the methodology applied by the NAO FI.
**** Average of 10 business days futures contracts from 29 July to 9 August 2024.
The main assumptions of the July 2024 projections of the NAO FI are shown in parentheses.
F - forecast
Source: National Audit Office, implementing the function of a fiscal institution

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PROJECTIONS AND KEY ASSUMPTIONS FOR THE ECONOMIC DEVELOPMENT SCENARIO FOR 2024–2027 BY THE MINISTRY OF FINANCE

Table 1. Projections for the Economic Development Scenario dated September 2024 by the Ministry of Finance

Indicator, %	2023	2024F	2025F	2026F	2027F
Key macroeconomic indicators, change					
GDP at constant prices	–0.3	2.3 (2.1) ▲	2.9 (2.9)	2.9 (2.9)	2.9 (2.9)
Household consumption expenditure	–1.0	3.3 (3.3)	3.6 (3.4) ▲	3.4 (3.4)	3.4 (3.4)
General government consumption expenditure	0.2	0.5 (0.5)	0.1 (0.1)	0.1 (0.1)	0.1 (0.1)
Gross fixed capital formation	10.6	1.1 (3.5) ▼	5.6 (5.4) ▲	5.8 (5.4) ▲	5.4 (5.4)
Exports of goods and services	–3.3	1.2 (2.3) ▼	3.9 (4.1) ▼	4.2 (4.2)	4.2 (4.2)
Imports of goods and services	–4.9	0.3 (2.4) ▼	4.7 (4.9) ▼	4.9 (4.9)	4.9 (4.9)
GDP at current prices	6.7	5.5 (5.0) ▲	5.4 (5.4)	5.7 (5.4) ▲	5.5 (5.4) ▲
Price indices, change					
GDP deflator	7.1	3.2 (2.8) ▲	2.5 (2.5)	2.7 (2.5) ▲	2.6 (2.5) ▲
Harmonised index of consumer prices (annual average)	8.7	1.0 (1.1) ▼	2.5 (2.2) ▲	2.7 (2.2) ▲	2.6 (2.2) ▲
Labour market indicators					
Change in average monthly gross earnings	12.6	10.1 (9.5) ▲	7.6 (6.4) ▲	6.5 (6.4) ▲	5.5 (5.5)
Unemployment rate (according to the Labour Force Survey methodology)	6.8	7.3 (7.2) ▲	7.1 (6.9) ▲	6.7 (6.6) ▲	6.4 (6.3) ▲
Change in the number of employed persons (according to the Labour Force Survey methodology)	1.4	1.4 (1.4)	0.2 (0.2)	0.0 (–0.1) ▲	–0.3 (–0.3)

According to the MoF, the date for the inclusion of statistics in the scenarios is 30 August 2024, and for other information up to and including 2 September 2024.
The projections for the 20/06/2024 Economic Development Scenario are in parentheses.
According to the description of the procedure for EDS Evaluation and Endorsement, the indicators based on which the NAO FI decides on the EDS endorsement are presented in the purple background.
F - forecast
Source: Ministry of Finance

Table 2. Main assumptions for the September 2024 Economic Development Scenario of the Ministry of Finance

Indicator	2023	2024F	2025F	2026F	2027F
US dollar to euro exchange rate*	1.08	1.08 (1.07) ▲	1.08 (1.07) ▲	1.08 (1.07) ▲	1.08 (1.07) ▲
World (excl. EU) GDP growth, %**	3.8	3.5 (3.5)	3.6 (3.6)	3.6 (3.6)	3.6 (3.6)
European Union GDP growth, %***	0.6	1.2 (1.0) ▲	1.8 (1.6) ▲	1.8 (1.6) ▲	1.8 (1.6) ▲
Growth of Lithuania's main export markets, %****	1.8	2.0 (1.9) ▲	2.4 (2.3) ▲	2.4 (2.3) ▲	2.4 (2.3) ▲
Oil prices (*Brent*, USD per barrel)*****	82.5	81.6 (85.4) ▼	76.2 (80.0) ▼	76.2 (80.0) ▼	76.2 (80.0) ▼

* Technical assumption made public by the European Central Bank in June 2024.
** International Monetary Fund (July 2024), Ministry of Finance calculations.
*** International Monetary Fund (July 2024).
**** Ministry of Finance calculations.
***** European Commission (May 2024), *Macrobond*, Ministry of Finance calculations. Calculations based on the arithmetic average of the last 10 days of futures prices available on 21 August 2024.
The assumptions for the June 2024 EDS are shown in parentheses.
F - forecast
Source: Ministry of Finance

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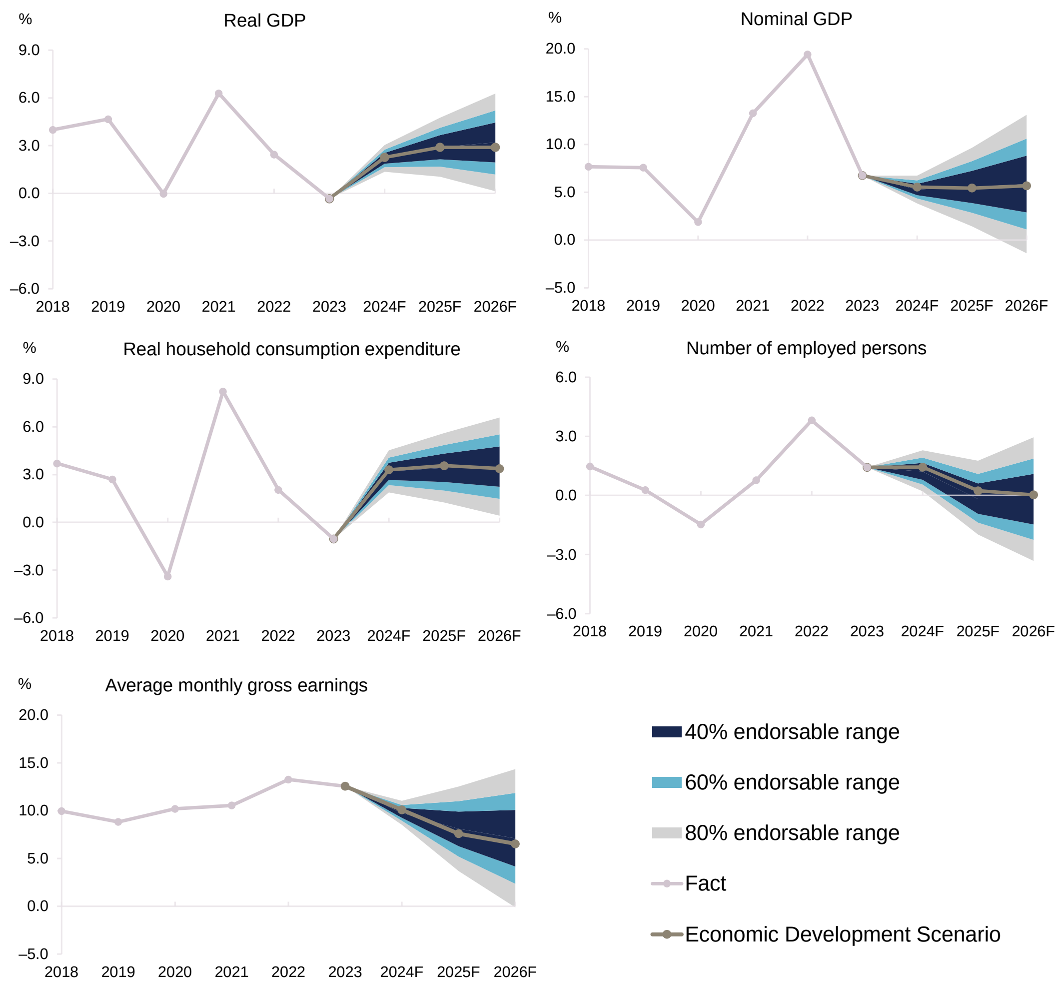
EDS ENDORSEMENT RANGES ESTIMATED BY THE NAO FI



The reference point (mode) of the endorsement ranges are the forecasts produced by the NAO FI.
The methodology for the development of the endorsement ranges is set out in more detail in the description of the procedure for the Assessment and Endorsement of the Economic Development Scenario. Available online:
https://www.valstybeskontrole.lt/TVS/Content/Biudzeto_stebesena/ERS_vertinimo_ir_tvirtinimo_aprasas.pdf.
F - forecast

Source: Ministry of Finance, calculations by the National Audit Office, implementing the function of a fiscal institution

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PROJECTIONS OF REAL GDP BY OTHER INSTITUTIONS

Institution	Date of publication	2024F	2025F
Bank of Lithuania*	11/06/2024 (19/03/2024)	1.9 (1.6) ▲	3.1 (3.1)
OECD	02/05/2024 (29/11/2023)	1.7 (1.7)	3.1 (3.1)
European Commission	15/05/2024 (15/02/2024)	2.0 (2.1) ▼	2.9 (3.0) ▼
IMF	24/07/2024 (16/04/2024)	2.4 (2.2) ▲	2.6 (2.5) ▲
AB SEB	27/08/2024 (02/05/2024)	2.4 (1.5) ▲	2.6 (2.8) ▼
AB Swedbank	27/08/2024 (18/04/2024)	2.2 (1.8) ▲	2.8 (2.8)
Average of institutions	–	2.1 (1.8) ▲	2.9 (2.9)
Ministry of Finance	11/09/2024 (20/06/2024)	2.3 (2.1) ▲	2.9 (2.9)
NAO FI	19/09/2024 (02/07/2024)	2.2 (2.0) ▲	2.9 (2.9)

The previous forecasts of the institutions are provided in parentheses.

* Seasonally and calendar adjusted.

F - forecast

Source: projections by the institutions listed in the table, calculations by the National Audit Office, implementing the function of a fiscal institution

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PROCESS OF EVALUATION OF THE EDS PUBLISHED IN SEPTEMBER 2024

26 August	The NAO FI has produced its macroeconomic projections for 2024–2027*.
26 August	**The draft EDS was submitted by the MoF to the institutions for coordination (copy to the NAO FI).**
27 August.	A meeting between the Bank of Lithuania and the NAO FI was held to discuss Lithuania's economic development.
28 August	The MoF responded to the questions posed by the NAO FI.
30 August	The State Data Agency has published its second estimate of GDP for Q2 2024. In the light of the new statistical data published, the NAO FI has revised and updated the macroeconomic projections related to the GDP components. The NAO FI submitted comments and proposals on the draft EDS to the MoF.
3 September	**The revised draft EDS was submitted by the MoF to the NAO FI for coordination.**
5 September	The NAO FI informed the MoF that it had no reasons not to endorse the draft EDS.
11 September	The MoF has made the September 2024–2027 EDS publicly available on its website.
19 September	The NAO FI has made public on its website its opinion on the endorsement of the EDS 2024–2027, published in September. At the same time, the macroeconomic forecasts of the NAO FI were published.

* In order to ensure an independent assessment of the draft EDS presented by the Ministry of Finance, the draft scenario is only started to be examined after the NAO FI has finalised its forecasts.

Source: the National Audit Office, implementing the function of a fiscal institution

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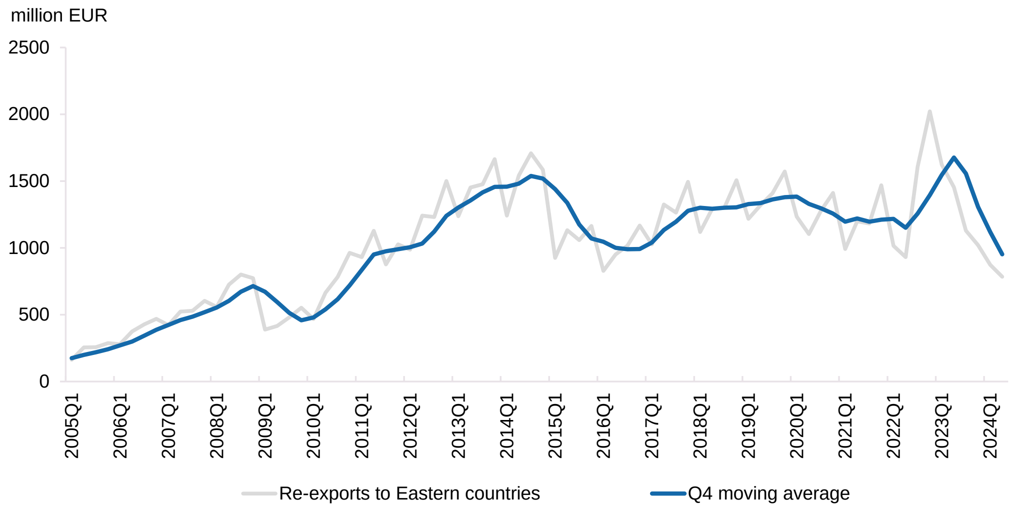
VALUE OF RE-EXPORTS TO EASTERN COUNTRIES

The value of re-exports (at current prices) to Eastern* countries in Q2 2024 is already lower than before the war in Ukraine



* Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russia, Tajikistan, Uzbekistan.

Source: State Data Agency, calculations by the National Audit Office, implementing the function of a fiscal institution