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Lithuanian Economic Review analyses the developments of the real sector, prices, public finance and credit in Lithuania, as well as the projected development of the domestic economy. The material presented in the Review is the result of statistical data analysis, modelling and expert assessment. The Review is prepared by the Bank of Lithuania.

During the preparation of the Lithuanian Economic Review, the data of the Bank of Lithuania, Statistics Lithuania, the European Central Bank, Eurostat, the International Monetary Fund, *Bloomberg* and other data published up to 30 April 2012 were used.

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CIS	Commonwealth of Independent States
EBF	European Banking Federation
EC	European Commission
ECB	European Central Bank
EU	European Union
EURIBOR	euro inter-bank offered rate, the rate at which a prime bank is willing to lend funds in euro to another prime bank
Eurostat	statistical office of the European Union
FDI	foreign direct investment
GDP	gross domestic product
IMF	International Monetary Fund
LTL	Lithuanian litas
MFI	monetary financial institution
OPEC	Organization of Petroleum Exporting Countries
p.p.	percentage point
rh scale	right-hand scale
SAM	social accounting matrices
US	United States of America
VAT	value-added tax
VILIBOR	Vilnius inter-bank offered rate, average interbank interest rates at which banks are willing (ready) to lend funds in litas to other banks

ECONOMIC OUTLOOK

The economic development of Lithuania has decelerated, though the economy is growing stronger than expected. Domestic demand, in particular, the private consumption expenditure, is rising more than anticipated. In contrast to the previous months, expectations and confidence of the Lithuanian economic entities are not deteriorating any more. This is in part related to the stabilisation in the world economy. Although the world economic outlook is still surrounded by uncertainty (on-going resolution of the state and private sector debt problems, sharply rising energy commodity prices), economic outlook for Lithuania is now viewed more favourably mostly owing to the stronger than expected recent growth. It is projected that the real GDP of Lithuania will increase by 3.0 per cent in 2012 and 3.5 per cent in 2013.

Private consumption remains the most important factor of the real GDP growth. Private consumption growth in 2011 significantly exceeded the average growth since the beginning of data collection. The growth of consumption was determined by the labour market recovery and the resulting improvement in the financial situation of households. Consumption was also favourably affected by consumer confidence, which was higher throughout 2011 than a year ago. Unfortunately, this confidence is not improving anymore. Consumer sentiment is poorer than in the middle of last year. Owing to both lower consumer confidence and overall confidence of economic entities, it is projected that private consumption will increase less in the nearest time than in 2011, but more than earlier projected due to better than expected data of the end of 2011 and the beginning of 2012. It is forecasted that private consumption growth will be respectively 4.6 per cent and 3.1 per cent in 2012 and in 2013.

Rising investments in gross fixed capital also contribute to the economic growth. Although investments increased noticeably less at the end of the previous year than in the beginning of the year, they have been growing quite significantly up to now. They increased mainly due to larger investments in non-residential buildings and constructions, however investments in machinery and equipment are also growing. Decline of confidence of enterprises and deterioration of the global economic prospects last year had a more significant effect on investments into vehicles, which are declining. Confidence of enterprises is just stabilising, therefore, it is still difficult to expect stronger determination of enterprises to boost investment. It is forecasted that investment growth will be lower in 2012 than in 2011 and lower than the average growth since the beginning of data collection. It is projected that they will grow by 5.0 per cent this year, while in 2013 their growth will accelerate to 8.0 per cent.

Owing to the earlier decline of confidence, the labour market situation improves insignificantly. Unemployment remains an important problem. Overall unemployment and the related long-term and youth unemployment rates remain high. More than a half of the unemployed do not have a job for one year or longer. Almost one-third of young labour market participants search for a job. Last year the job creation intensified, however the growth of both occupied jobs and job vacancies declined. The number of employed persons is growing in the private sector, especially in manufacturing, wholesale and retail trade, however, there are activities, where the number of the employed is declining, for example, in finance and insurance, education and health care sectors. Further labour market recovery will be affected by confidence of enterprises and expectations concerning the domestic economic development, which, although not declining, are poorer than several quarters ago. It is forecasted that employment will grow quite insignificantly in 2012 and 2013 – respectively by 1.1 per cent and 1.4 per cent.

Expansion of Lithuania's foreign trade has decelerated significantly, however, the pace of trade growth is stabilising. The nominal value of goods exports and imports grows by more than 10 per cent per year. The annual exports growth is determined by both re-exports and the exports of goods of the Lithuanian origin almost equally. Growth of Lithuania's exports matches the imports developments in its main foreign trade partners: buoyant exports of Lithuania decelerated with the deceleration in imports growth in these countries. Exports are rising slightly more than the imports demand in the mentioned countries, whereas the export market share of our country is slightly expanding. It is foreseen that the foreign demand growth will be small in the nearest time, therefore it is projected that exports will rise quite moderately in 2012, while their growth will accelerate in the later part of the forecasting period.

As the exports and imports grow almost equally, the foreign trade balance is changing moderately. Although this balance slightly improved earlier due to a more favourable trade in energy products, it has deteriorated recently – again mainly due to the trade in energy products. **Current transfers are affecting current account changes more than usually.** Surplus of current transfers contracted due to uneven EU support payments and a lower net flow of remittances of individuals. In the nearest quarters the current account balance may be less stable. This balance should be favourably affected by the recovery of payments from the EU funds over the year. Nevertheless, the current account balance may be worsened by the imports growth exceeding the exports growth due to the rise in energy commodity prices, although higher prices of commodities should slightly subdue the imports.

Outlook of Lithuania's Economy in 2012–2013

	May 2012			February 2012		
	2011	**2012***	**2013***	**2011***	**2012***	**2013***
Price and Cost Developments (annual percentage changes)						
Average annual inflation (based on HICP)	4.1	2.9	2.7	4.1	2.1	2.4
GDP deflator	5.3	3.2	2.6	5.1	2.5	2.6
Wages (compensation per employee)	4.0	2.3	2.6	3.9	1.6	2.5
Import deflator	12.8	5.4	1.9	12.8	2.5	2.3
Export deflator	11.7	5.7	2.0	11.9	2.6	2.2
Economic Activity (constant prices; annual percentage changes)						
Gross domestic product**	5.9	3.0	3.5	5.8	2.2	3.3
Private consumption expenditure	6.1	4.6	3.1	5.6	2.5	2.6
General government consumption expenditure	0.2	0.6	1.9	1.2	0.6	1.9
Gross fixed capital formation	17.1	5.0	8.0	15.9	5.0	7.9
Exports of goods and services	14.1	5.3	5.8	13.6	3.9	5.8
Imports of goods and services	12.9	7.1	6.3	13.3	4.1	6.1
Labour Market						
Unemployment rate (annual average as a percentage of labour force	15.4	13.7	12.2	15.4	14.2	12.9
Employment (annual percentage changes)	2.0	1.1	1.4	2.0	0.7	1.2
External Sector (as a percentage of GDP)						
Balance of goods and services	–1.3	–2.8	–3.1	–1.5	–2.1	–2.4
Current account balance	–1.6	–3.0	–3.3	–0.3	–1.2	–1.6
Current and capital account balance	0.9	–1.0	–1.6	2.1	0.9	0.1

* Projection.
** Changes in inventories are not included in GDP components.

Annual inflation, which declined in the second half of 2011, still remains quite high. It remains mostly determined by external factors – the developments of the global commodity prices, whereas core inflation, which is mostly related to the internal situation, is low, owing to a slow recovery in the labour market. Global food prices rose gradually slower and were lower than a year ago already for several months, therefore, food prices rose noticeably less in Lithuania as well and their impact on inflation declined. On the contrary, the contribution of administered prices increased: their rise was stimulated by higher heat energy prices, which grew due to more expensive fuels (mostly imported natural gas), and, in the beginning of the year, by the rise in electricity price. Fuel prices increased rapidly with the rise of oil price, however, their contribution to inflation was comparatively small, since at the end of 2011 it declined significantly due to the base effect. External inflation pressure related to global commodity prices should be lower in Lithuania in 2012 than in 2011, since it is forecasted that food prices will grow significantly less. Still, the recent large rise in oil price due to geopolitical tensions in the Middle East and its potential further growth represent the risk of higher inflation, since fuel prices and administered prices may grow faster. Owing to a larger than expected rise of prices that depend on external factors, especially on the situation in the market of energy resources, higher inflation than forecasted earlier is expected in 2012 (2.9%). It is projected that there will be no significant pressure on core inflation, as wage growth will exceed productivity growth insignificantly, therefore unit labour costs will increase slowly over the whole forecasting period. Similar inflation is expected in 2013 (2.7%).

I. INTERNATIONAL ENVIRONMENT

The growth of global economic activity has been low. Economic growth in a number of countries is projected to be slow throughout 2012.

In the latter half of 2011, recovery in the global economy slowed down and in a number of advanced economies nearly came to a halt. Economic activity was dampened by tensions in international financial markets with the protracted and outspread euro area sovereign debt crisis posing a particularly great threat. The IMF projects deceleration of global real GDP growth to 3.5 per cent in 2012 (from 3.9% in 2011). The risk of further deceleration is high, however, growth is expected to be stronger at 4.1 per cent in 2013.

The most recent estimates point to the first signs of stabilisation in the first quarter of 2012.

The confidence indices, which reflect global economic development, pointed to moderate growth in the services sector, while activity in the manufacturing sector still fluctuated close to the expansion/contraction threshold of 50. In the outlook for individual countries, the US economy has shown more optimism, yet recovery in the euro area economy is only projected in the latter half of 2012.

The euro area sovereign debt crisis has still not been overcome. Tensions eased somewhat towards the end of the first quarter of 2012, however financial markets have remained highly sensitive with the deteriorated situation in Spain raising serious concerns.

Joint measures to overcome the crisis being implemented and stabilisation programmes undertaken in problem countries helped stabilising the situation in the euro area. In the restoration of market confidence, the decisions on increasing the lending limits of the European Financial Stability Facility and the European Stability Mechanism devised for funding euro area member states, restructuring the Greek government's debt as well as the long-term obligations of tightening fiscal discipline and strengthening financial sector supervision assumed by EU countries were of particular importance.

Central banks around the world eased financial sector tensions by increasing financial system liquidity and implementing accommodative monetary policy instruments.

The ECB, after decreasing its main interest rate on refinancing operations for two consecutive times in the fourth quarter of 2011, did not change its interest rate in January through April 2012, but increased financial sector liquidity by implementing additional special monetary policy instruments. In December 2011 and February 2012, the ECB carried out two refinancing operations of the longest term by now (3 years), lending banks over EUR 1 trillion under preferential terms. The US Federal Reserves, jointly with the central banks of five countries, reduced the price for USD swaps among central banks meant to provide financial market liquidity at the end of 2011, and extended this measure until 2013. The US Federal Open Market Committee confirmed in March 2012 that economic conditions allowed maintaining low interest rates at least by the end of 2014.

In aggregate terms, the price index for commodities remained broadly unchanged in the first quarter of 2012 year on year, increasing, however, by some 9 per cent from the beginning of the year.

Energy commodity prices underwent the most pronounced increases in 2012. After imposing an embargo on Iranian oil exports and amid strengthening geopolitical tensions, oil prices picked up in world markets. At the end of the first quarter, the average price of *Brent* crude oil reached USD 126 per barrel. The decision by the Organisation of the Petroleum Exporting Countries to increase oil production did not stop oil price increases. Food and other agricultural raw material prices have also been on a rise since mid-year, however, they still were significantly lower than a year ago.

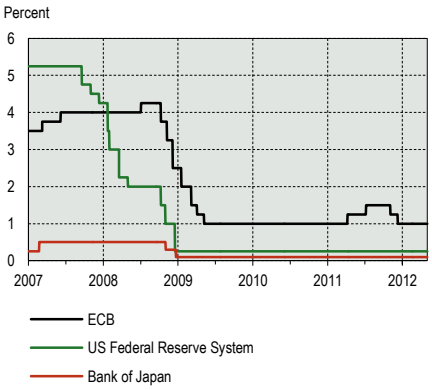
The outlook for economic expansion points to more signs of optimism emerging.

Chart 1. Global purchasing managers' indices (PMI)

Source: Markit.

Key interest rates remain historically low.

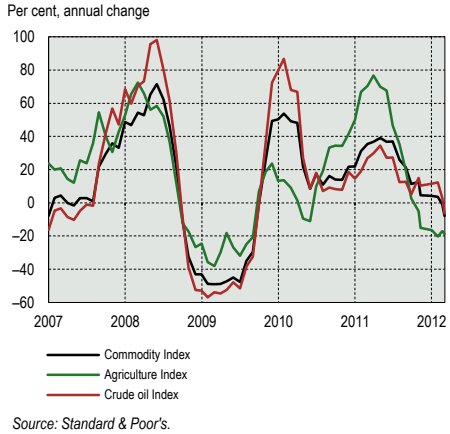
Chart 2. Key interest rates of central banks



Source: Bloomberg.

Oil prices rose in early 2012 and reached the heights recorded in April 2011 again.

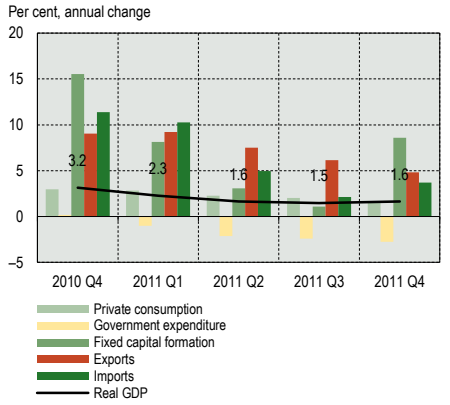
Chart 3. Global commodity prices in US dollars



Source: Standard & Poor's.

Recovery in the US economy has been gradually strengthening.

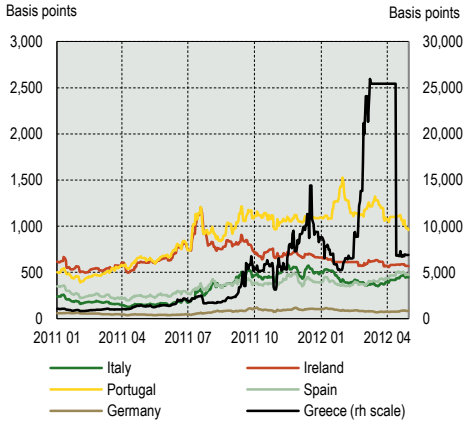
Chart 4. Annual change of real GDP, estimated by expenditure approach, in the US



Source: U.S. Bureau of Economic Analysis.

The cost of insuring against default on Greek debt has declined recently, while changes in a number of other euro area countries were insignificant.

Chart 5. Price of five-year credit default swaps in the euro area countries



Source: Bloomberg.

Economic growth in the Baltic States is projected to slow down markedly in 2012.

Table 1. Macroeconomic indicators of Estonia and Latvia

	Estonia	Latvia
Annual percentage change in real GDP		
2011 Q1	9.5	3.5
2011 Q2	8.4	5.6
2011 Q3	8.5	6.6
2011 Q4	4.5	5.7
2011	7.9	5.4
2012*	1.9	1.5
2013*	3.6	2.5
Average annual percentage change in HICP		
2011	5.1	4.2
2012*	2.8	2.1
2013*	2.9	2.0

Sources: Bank of Estonia, Bank of Latvia, ECB, IMF.

** Forecasts*

With the improvement of labour market and production sector indicators, increasingly more signs of recovery have been emerging in the US economy.

In the United States, real GDP rose by 1.6 per cent in the fourth quarter of 2011 year on year. Economic growth was stronger than in the previous quarter. The economy was fuelled by growth in household consumption, investment, and a positive contribution from net exports. Cutting of government expenditure had a negative contribution to GDP growth. Positive patterns in the US economy which began surfacing towards the end of 2011 continued into the first quarter of 2012. The improving labour market situation encouraged a recovery in domestic demand, activity in the services and industrial sectors increased; some signs that the construction sector was gaining momentum emerged as well.

In the EU, economic activity declined in the fourth quarter of 2011. The euro area economy is projected to experience a downturn in 2012.

Real GDP in the euro area and in the EU declined by 0.3 per cent in the fourth quarter of 2011 quarter on quarter (annual growth in the euro area decelerated to 0.7% and in the EU to 0.9%; in the third quarter it was 1.3% and 1.4% respectively). Economic activity in the EU was held back by the euro area crisis generated tensions and fiscal consolidation conducted in a number of countries. In the fourth quarter, compared to the previous quarter, economic contraction was driven by a drop in domestic demand. Exports exceeded imports and therefore net exports contributed positively to GDP; inventories increased too. The economic downturn deepened in Greece and Portugal, real GDP started contracting in a number of other euro area countries as well. The European Commission projects the euro area economy will shrink by 0.3 per cent in 2012, while the projection by the IMF is more pessimistic (–0.5%). Prudent fiscal policy in the Nordic countries posted a positive contribution to their relatively high economic performance. With the onset of a downturn in the euro area, however, the economic expansion in the Nordic countries weakened as well on account of high level of integration of their foreign trade. The highest quarterly decline in real GDP (–1.1%) in the fourth quarter of 2011 was recoded in Sweden. Economic activity is projected to intensify in 2012 in all Nordic countries, while growth may be weaker than a year ago.

The pace of very dynamic economic growth in the Baltic States moderated in the fourth quarter of 2011.

In the fourth quarter of 2011, real GDP growth in Estonia and Latvia was driven by domestic demand. The decline in unemployment triggered a rebound in household income and consumption. The intensifying activity of industry, trade and many other sectors encouraged investment. The slowed down economic recovery in the main trading partner countries, particularly the European ones, entailed shrinkage in export growth. In Estonia and Latvia, imports growth outpaced exports growth, thus the contribution of net exports to GDP was negative in the fourth quarter. The Baltic States conducted fiscal consolidation. In Estonia, general government surplus stood at about 1 per cent of GDP in 2011. Latvia, which intends to adopt the euro in 2014, is seeking to reduce its budget deficit to 2.5 per cent of GDP in 2012 from over 4 per cent of GDP in 2011.

The Russian and other CIS economies experienced a negative contribution from a decline in external demand.

In Russia, real GDP rose by 4.8 per cent in the fourth quarter of 2011 year on year. Its economy was driven by domestic consumption; however, a moderation in export growth (over a third of Russia's exports accounts for the euro area) posted a negative contribution to the country's economic expansion. Other CIS countries also recorded a slowdown in economic growth, which, however, is expected to further remain quite strong. Liberalisation of international trade is likely to positively contribute to the regions' economy. In October 2011, eight CIS countries signed a free trade agreement and at the end of the year the World Trade Organization approved of Russia's membership in it.

II. REAL SECTOR

Growth of Lithuania's economy is gradually slowing down. Behind these shifts are not so favourable situation in the global economy and for some time deteriorating expectations in Lithuania.

In the first quarter of 2012, Lithuania's GDP growth shrank to 3.9 per cent. Data of the Statistics Lithuania published on a monthly basis allow to think that the GDP grew slower due to not so favourable changes of domestic demand – a slower growth was registered in both private consumption and domestic investment. Nevertheless, net exports pushed the GDP development up, although feebly.

After the revision of the data for the fourth quarter of 2011, the GDP growth rate changed marginally and made up 4.4 per cent. GDP grew mainly due to private consumption, which was encouraged by an improving financial situation and an increasing purchasing power of households. Domestic investment also pushed GDP up, however, less than private consumption. Investment grew in both private and public sectors. The contribution of net exports to GDP was insignificant. Because of a forecasted slower economic growth, enterprises optimised their inventories, therefore, changes in inventories had a particularly marked contribution to the slower growth of GDP.

In the fourth quarter, private consumption was the main contributor that increased GDP. It grew mainly because of an improving financial situation of households and increasing purchasing power. Moreover, consumption was encouraged by a better than a year ago assessment of the financial situation of households.

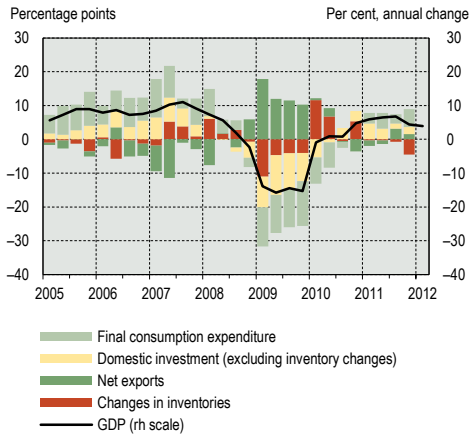
In the fourth quarter of 2011, private consumption grew by 8.0 per cent per annum, almost two times quicker compared to the previous quarter. An improving financial situation and increasing purchasing power of households stimulated the growth of private consumption most of all. According to data of consumer survey, households assessed their financial situation and its development in the future better than a year ago. This allowed households to save relatively less and simultaneously pushed consumption up. With it came the possibility for households to allocate a larger portion of their income for the acquisition of non-necessities. This trend is reflected in retail trade turnover data – the volume of sales in all groups of goods was growing. A particularly buoyant growth was registered in expenses for elements of the housing interior, furniture and domestic appliances. Sales of this group of goods were by almost one-third larger than a year ago. Sales of textile, wearing apparel and footwear and information technology equipment increased at a somewhat slower pace. Also a marked growth was observed in expenses for travels abroad.

Another domestic demand contributor – gross fixed capital formation – also pushed GDP up. Domestic investment grew largely due to civil and engineering structures built by the state and state owned enterprises, as well as private sector's production modernisation.

In the last quarter of 2011, domestic investment stepped up a bit more than 10 per cent. The largest increase was registered in investment into the construction of non-residential buildings and structures, especially civil and engineering structures, and into production facilities. Data on investment in tangible fixed assets indicate that the largest investment into the construction of non-residential buildings and structures were made by the state and state owned enterprises, while into production facilities – by the private sector, manufacturing enterprises in particular. In the context of prevailing uncertainty about a further global economic development at that time, enterprises' investment into production facilities grew slower than in

Growth of Lithuania's economy is gradually slowing down.

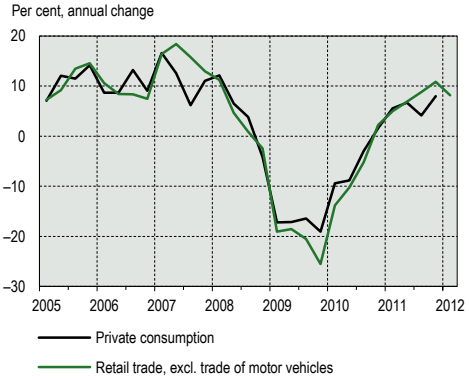
Chart 6. Real GDP growth and contributions (expenditure approach)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Improving financial situation of households leads to increasing consumption.

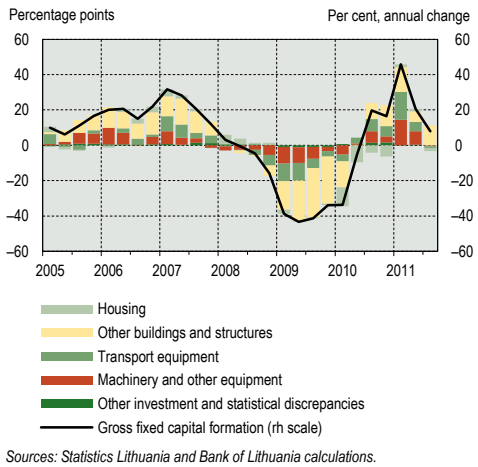
Chart 7. Development of private consumption and retail trade



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Domestic investment has been growing mostly due to higher expenditure on non-residential construction and modernisation of production facilities.

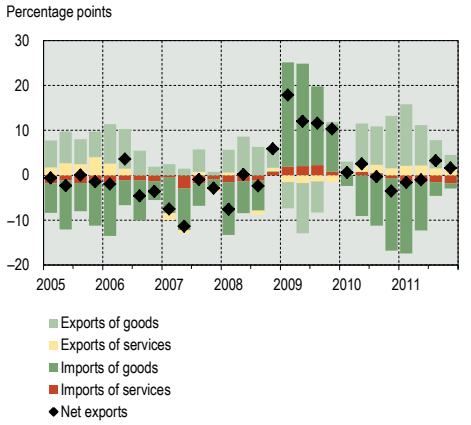
Chart 8. Gross fixed capital formation growth and contributions



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Real net exports of goods and services were pushing GDP up for a second quarter in a row.

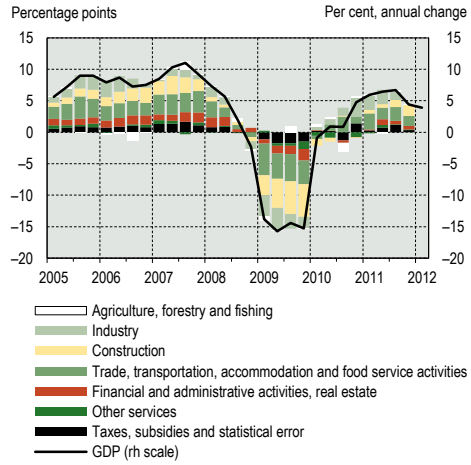
Chart 9. Contribution of real net exports of goods and services to annual GDP growth



Sources: Eurostat and Bank of Lithuania calculations.

In terms of the production approach, GDP grew due to a stronger activity of the non-tradable sector.

Chart 10. Real GDP growth and contributions (production approach)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

previous few quarters. Reduced incentives to invest are supported by the business tendency survey in industry which indicated that a larger share of enterprises held over-abundant stocks of finished products, while the production capacity utilisation level was only somewhat higher compared to the long-term average. The impact of other contributors to the domestic investment development – residential construction and vehicles – was substantially smaller. A non-recovering real estate market did not stimulate enterprises to start new projects for the construction of residential buildings, therefore, investment into this type of construction stepped up insignificantly. Investment in vehicles decreased as a result of the extreme jump of this type of investment a year ago and because of the unfavourable international environment.

Imports growth slowed more than exports, thus real net exports of goods and services also stimulated the development of GDP.

Real net exports of goods and services were pushing GDP up for a second quarter in turn, however, its positive impact decreased from 3.4 to 1.1 p.p. Similarly to the previous quarter, net exports of goods were positive, whereas of services – insignificant. Net exports of goods were influenced most of all by still persisting uncertainty surrounding a further economic development in Lithuania and abroad. Uncertain future pressed enterprises to further optimise inventories of finished or acquired goods, therefore, the growth of imports of intermediate and final consumption goods was not so buoyant.

In terms of the production approach, GDP grew due to a stronger activity of the non-tradable sector, construction and trade in particular. A shrinking tradable sector's value added was determined by unfavourable conditions in the international market.

A particularly intensive growth of value added in construction was entailed by several factors – civil and engineering projects implemented by the state and state owned enterprises, better than a year ago weather conditions and an especially small comparative base. A larger value added in trade was stimulated by an improving financial position of households and growing purchasing power. An increasing activity of these economic activities stimulated the development of other business servicing economic activities as well. The tradable sector activity slightly moderated. Such shifts were provoked by a slower growth of the economies of the main trading partners and their unfavourable prospects, also warmer than last year weather reducing electricity and gas supply.

Looking at a short-term prospect of Lithuania's economy, Lithuania's GDP is expected to grow at a slower rate because of a slackening global economy.

In the short run, due to a slower growth of economies of the main trading partners of Lithuania, Lithuania's exports are expected to increase at a slower peace, however, as in the previous review, its decrease is not expected. Unfavourable foreign demand forecasts will have a negative impact on the tradable sector's activity and will not stimulate domestic investment and the creation of jobs. This will reduce incentives to increase wages and hire new employees and at the same time will worsen household sentiment. The mentioned factors will exercise a negative effect on private consumption and non-tradable sector related to it. An expected slower growth of investment and private consumption, accompanied by an unfavourable situation in international markets will not stimulate the growth of imports, thus allowing expecting that net exports will make an insignificant impact on GDP.

III. LABOUR MARKET

The unemployment rate kept decreasing in the fourth quarter of 2011. However, unemployment remains an issue in Lithuania.

The rate of unemployment in the fourth quarter of 2011 made up 13.9 per cent in Lithuania and was 0.9 p.p. smaller quarter-on-quarter. The unemployment rate is one of the largest in the EU and sufficiently higher than the EU average (in the fourth quarter it was 9.9%). The average annual rate of unemployment dropped to 15.4 per cent in 2011 (in 2010 it was 17.8%) due to an increase of the number of the employed and decline in the labour force.

After increasing for several years, long-term unemployment (unemployment for 1 year and more) rate in the first quarter of 2011 reached its peak since the beginning of the recent economic downturn. In subsequent quarters this indicator was decreasing: in the fourth quarter, the rate of long-term unemployment made up 7.1 per cent. However, more than a half of the unemployed in Lithuania was looking for a job for one year or longer, and the rate of long-term unemployment in Lithuania remained one of the largest in the EU. In the third quarter, this indicator was higher than in Lithuania only in Greece, Spain, Ireland and Slovakia. The rate of the youth unemployment in the fourth quarter was still very high in Lithuania: approximately every third young job market participant (age group of 15–24) was unemployed. Moreover, skill mismatch that became particularly evident when creating jobs after the crisis, continued to be an issue as well.

Employment is growing at a slow pace – a more intensive creation of jobs is hindered by deteriorating expectations about economic development and more cautious assessment of the business expansion possibilities.

During all quarters of 2011, the number of the employed was larger year on year. In the fourth quarter this indicator increased by 0.9 per cent. A positive impact (1.3 p.p.) to employment growth was exercised by a rising number of the employed in the private sector, whereas changes in the public sector contributed negatively to employment growth (–0.4 p.p.). In the latter sector the number of the employed per annum was shrinking for two consecutive quarters. The decrease of less qualified specialists (junior specialists and technicians as well as junior servants) was especially large, whereas the number of higher qualification specialists increased. The strongest influence on the employment growth in Lithuania was made by the largest by employment – services – sector, while industry also contributed positively. The number of the employed curtailed per annum in construction and agriculture. The flexible forms of work – temporary and part-time employment – also stimulate employment growth.

According to seasonally adjusted data, employment was not increasing at the end of the year. This was due to a shrinking number of the employed in the public sector and a sluggishly growing number of the employed in the private sector in the second part of 2011.

Emigration flows decreased somewhat but persisted to be large.

In the fourth quarter of 2011, labour force contracted per annum (2.9%), mainly due to still persisting emigration. Monthly indicators of declared emigration suggest that in the fourth quarter 9.4 thousand of persons declared their departure from Lithuania. In 2011 the number of emigrants from Lithuania was substantially smaller (54 thousand of persons) compared to 2010 (83 thousand of persons). However, the emigration indicators might be influenced by the number of those who emigrated from Lithuania earlier but declared their departure only in 2010–2011. Available immigration data to the main target countries (the United Kingdom, Ireland, Spain, Germany and Norway) of January–September 2011 suggest that the number of Lithuania's citizens immigrating to these countries slightly dropped

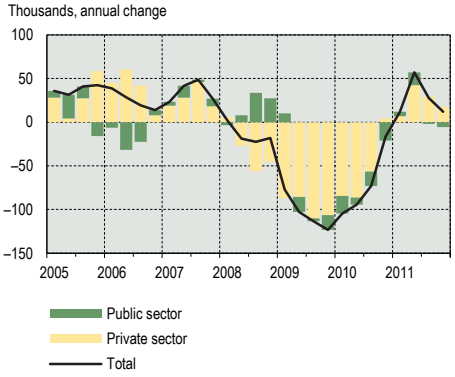
Unemployment continues to decrease, whereas the number of employed is increasing.

Chart 11. Employment and labour force, unemployment rate

Sources: Statistics Lithuania and Bank of Lithuania calculations.

Number of employed is increasing in the private sector but decreasing in the public sector.

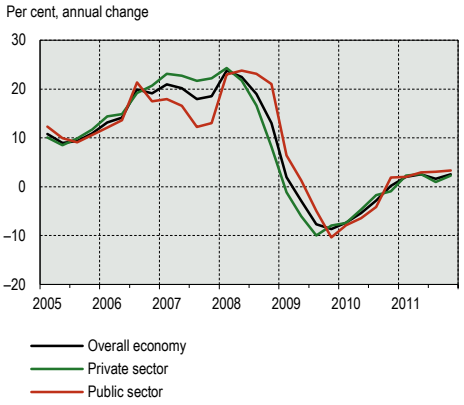
Chart 12. Employment by sectors



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Wages are increasing more rapidly in public sector than in private sector.

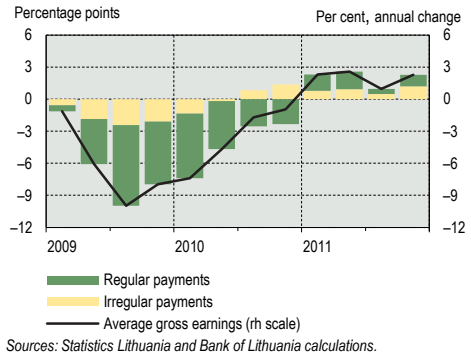
Chart 13. Average gross wages



Source: Statistics Lithuania.

At the end of 2011 more than a half of the overall wage increase in the private sector was determined by non-regular payments…

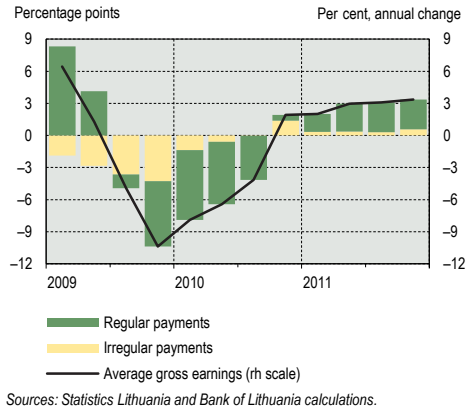
Chart 14. Average gross wages by regularity in private sector



Sources: Statistics Lithuania and Bank of Lithuania calculations.

… whereas in public sector – by increase of the fixed part of wages.

Chart 15. Average gross wages by regularity in public sector



Sources: Statistics Lithuania and Bank of Lithuania calculations.

compared to the same period of 2010, although remained large. The number of immigrants to the United Kingdom increased, but it was shrinking in Ireland, Norway, Spain and Germany.

Immigration to Lithuania in 2011 rose: 16 thousand persons, thrice more than in 2010, declared their arrival to Lithuania. Nine from ten persons declaring their arrival were returning persons who departed from Lithuania earlier.

Wages are rising, although insignificantly.

Because of the growing skill mismatch wages are growing in spite of high unemployment. The average gross wages in Lithuania's economy grew in the fourth quarter by 2.5 per cent per annum. Fixed part of wages increased slowly when more than one-third of the overall wage growth was determined by non-regular payments (one-off bonuses, extra pays, surcharges and other monetary payments). As in the previous quarters (excluding the first one), wages in the public sector were growing at a more rapid pace (3.3%) than in the private sector (2.3%).

The wage increase in the private sector was mostly influenced by rising wages in the services sector, particularly in trade, transportation and storage, as well as in information and communication activities. Wages were also rising in other private sector activities – in industry, construction and agriculture. More than a half of the wage growth in private sector was determined by increase in non-regular payments. It is expected that these payments increased substantially more than fixed part of wages due to cautious enterprise expectations – in the environment of uncertainty surrounding the economic development, enterprises promoted their employees more often by extra pays rather than increasing fixed part of wages.

In the public sector, wages grew mostly due to the increase in the fixed part of wages, while the contribution of non-regular payments was slight. The largest impact of the wage growth in this sector was attributed to their jump in activities of public services – health care, education and public administration.

At the beginning of 2012, the employment and wages should not grow buoyantly due to slowing economic growth and high rate of unemployment.

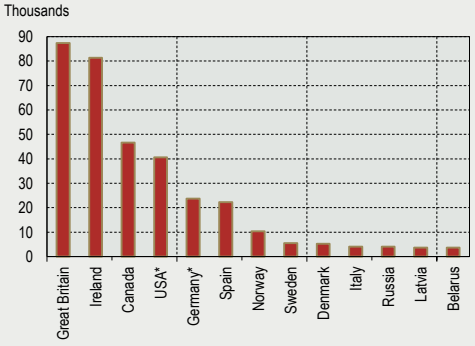
Prospects of slowing down economic development force enterprises to be more cautious in assessing their development possibilities. The survey performed by the Lithuanian Confederation of Industrialists[1] at the beginning of 2012 suggests that 70 per cent of industrial enterprises do not intend to increase the number of their employees in the nearest future and 78 per cent – to raise wages. Less than one-fifth (16%) of industrial enterprises have plans to increase the number of their employees. Thus, a slower industrial development and a high rate of unemployment should not exert upward pressure on wages. Besides, there should be no expectations about a buoyant increase of the number of employed. Similar trends as those in industry should dominate also in other private sector activities – services, construction and agriculture. Therefore, at the beginning of 2012 only moderate increase in employment and average wages is likely.

[1] Lithuanian Confederation of Industrialists "Expectations of the Industry", 1 March 2012, (http://www.lpk.lt/lt/naujienos/promones-lukesciai).

Box 1. Emigration from Lithuania: its directions and trends

One of the largest problems of recent years in Lithuania is emigration from the country. In the short run, labour force emigration reduces unemployment and pressure on the country's public finances. However, in the long run, labour force emigration may have a negative effect on public finances and its social development, as well on a sustainable GDP growth.

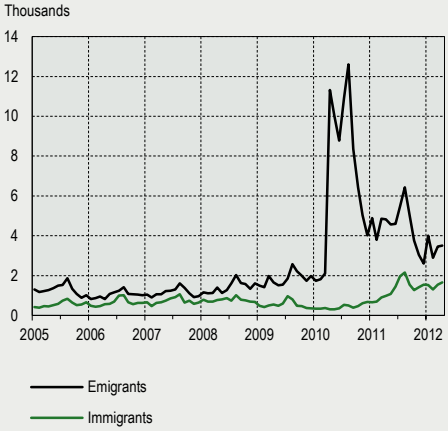
Chart A. Number of Lithuanian citizens living in foreign countries at the beginning of 2011



Source: Migration Department.
** Year 2008*

According to the standard definition emigrants from Lithuania are persons departing to a foreign state in order to live there one year and longer. At the end of 2011 Statistics Lithuania announced that from the restoration of Lithuania's independence in 1990, 536 thousand of the population left the country[1]. In 1990–1993, the largest flows of emigration were to Russia, the Ukraine, Belarus and other republics of the former Soviet Union. Starting with 1994, these flows changed their direction to the states of Western Europe and North America, and with Lithuania's joining the EU in 2004, the main direction of emigration became member states of the EU. The Migration Department of the Ministry of the Interior announces a smaller number of emigrants at the beginning of 2011: 352 thousand citizens of the Republic of Lithuania lived in foreign states. Three-quarters of emigrants lived in the countries of Europe, one-quarter – in the states of the North America. The largest number of the citizens of the Republic of Lithuania departed to the states of the Western Europe, in particular to the United Kingdom (25%), Ireland (23%), Germany (7%), Spain (6%) and Norway (3% of the total number of emigrants from Lithuania). The main target countries in the North America were Canada and the US (emigrants to these countries made up 13% and 11% respectively from the total number of emigrants).

Chart B. Declared emigration from Lithuania and immigration to Lithuania



Source: Statistics Lithuania.

The majority of emigrants were persons of working age and leaving the country to work. Thus, the main reasons behind emigration from Lithuania are economic – to depart to more attractive states in terms of employment and wages. With the start of the recent economic downturn, unfavourable economic development prospects, poor wage rise possibilities and an increasing rate of unemployment in Lithuania might have influenced the decision to emigrate. Besides economic reasons to emigrate, institutional factors, cultural compatibility and a favourable geographical situation are also important. Among the most important institutional factors allowing the citizens of the Republic of Lithuania to emigrate from the country is the right of free movement of labour force in the EU states. After Lithuania joined the EU in 2004, three EU old member states – the United Kingdom, Ireland and Sweden – did not apply temporary labour market protection measures restricting this right. Other EU old member states were concerned that the flow of relatively cheap labour force from the Central and Eastern Europe would worsen possibilities of local inhabitants to be employed. Thus, in order to protect their labour markets, these countries set temporary restrictions for new EU countries that joined the EU in 2004. Finland, Portugal, Italy, Spain, Greece, Netherlands and Luxembourg abandoned these restrictions in 2006–2007, France, Belgium and Denmark – in 2008–2009, while Austria and Germany applied the longest transitional period until May 2011.

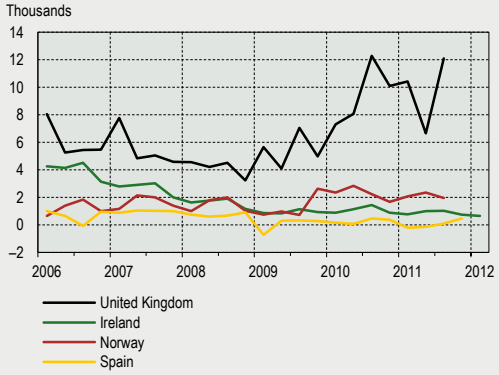
These economic and institutional factors determined the fact that the largest number of Lithuania's citizens live and work in the United Kingdom and Ireland. Declared emigration data announced by Statistics Lithuania at the end of 2011 suggest that from 2004 92.1 thousand Lithuania's citizens departed to the United Kingdom and 29.4 thousand – to Ireland. Among the other EU member states where the number of immigrants from Lithuania is the largest, are Germany and Spain – the countries which opened their labour markets later. In the period 2004–2011, 15.8 thousand and 10.9 thousand respectively of Lithuania's citizens emigrated to these states. As concerns other Western Europe countries, the largest flow of emigrating Lithuania's citizens was to Norway – in the period 2004–2011, 10.5 thousand persons from Lithuania departed to this country. Persons who departed to these five countries in 2004–2011 made up more than two-thirds from the total number of persons who declared emigration. In the period 2004–2011, the total of 233.2 thousand Lithuania's citizens emigrated to foreign states, the majority of them emigrated in 2009–2011. A part of persons who declared emigration in 2010–2011 had emigrated from Lithuania in earlier years but declared their departure after announcing the information that persons who did not declare their departure would be required to pay mandatory health insurance contributions on their own.

Immigration data to target countries suggests[2] that flows of emigrating Lithuanians were increasing in the environment of a slower growth of Lithuania's GDP and increasing rate of unemployment. In 2009–2010, the economic situation in Lithuania was relatively more complicated compared to other EU member states – the economic downturn, a high rate of unemployment, reduced social payments immensely stimulated emigration. A recovering Lithuanian economy and decreasing rate of unemployment in 2011 curtailed the number of emigrants somewhat, but emigration of 2009–2011 was the largest since the start of the immigration time series (2006).

The United Kingdom is the most attractive country for emigrating Lithuania's citizens. Throughout 2009, 21.7 thousand state social insurance numbers issued to the citizens of Lithuania were registered in the United Kingdom, and throughout 2010 – 37.7 thousand. Thus, the number of immigrants from Lithuania in 2010 was especially large compared to the average in 2006–2008 (20.9 thousand in a year on average). The United Kingdom immigration statistics indicate that 29.1 thousand new state social insurance numbers were registered in January–September 2011 – a bit more compared to 2010 year on year (27.7 thousand).

During the crisis period, the economic situation in Ireland, as in Lithuania, was relatively worse than in other EU member states. In 2009 Ireland's GDP dropped and the rate of unemployment soared. To this end, in 2009 the number of new state social insurance numbers issued to the Lithuanians was substantially less compared to the average in 2006–2008. Because of a sluggish economic recovery in Ireland in 2010 and a larger than the EU average rate of unemployment, the flow of immigrants from Lithuania was increasing insignificantly. The number of new social insurance numbers issued to Lithuanians in Ireland in 2011 curtailed again – it was by one-fifth smaller than in 2010. Similar trends as those in Ireland became dominant from 2009 in the labour market of Spain which was earlier attractive for emigrating citizens of the Republic of Lithuania. Immigration statistics of Spain suggest that in 2009 the number of the Lithuania's citizens who came to Spain exceeded the number of those departing from it only by 0.2 thousand. In 2010 this number was larger, however, this indicator was much smaller than the average in 2006–2008. In the environment of further aggravating economic development prospects of Spain and a further increase of the unemployment rate, data of January–September 2011 demonstrate that the number of departing Lithuania's ctizens is larger than that of new arrivals. Thus, emigrating Lithuania's citizens show a decreasing interest in labour markets of Ireland and Spain.

Chart C. Immigrants from Lithuania to the United Kingdom, Ireland, Norway and Spain



Sources: UK Department for Work and Pensions, Ireland Department of Social Protection, Norwegian Directorate of Immigration and Spanish Ministry of Labour and Immigration.

A worse economic situation in labour markets of Ireland and Spain stimulated the emigration of Lithuania's citizens to economically stronger countries, for instance, to Norway. The number of new labour permits issued to Lithuania's citizens in Norway soared already at the end of 2009 and 9.1 thousand of permits were issued in 2010 (in 2006–2009 – 5.6 thousand on average). The number of Lithuania's citizens emigrating to Norway was smaller in 2011 – in January–September 2011 this number amounted to 6.3 thousand (7.4 thousand in the corresponding period of 2010).

A large flow of new emigrants from Lithuania to German and Austrian labour markets that opened in May 2011 was not observed. Although the German Migration Service indicates that the flow of immigrants from the newly joined EU member states doubled, this trend was more influenced by the immigration of Poland, Romania, Bulgaria and Hungary's citizens rather than Lithuania's citizens. However, the 2011 monthly immigration data reflect that in May the number of arrivals from Lithuania increased somewhat (432 persons arrived, whereas in April – 254 persons arrived), but this number shrank in subsequent months.

A look at immigration flows to Lithuania reveals an interesting observation on reverse migration. In the context of a growing Lithuanian economy and decreasing rate of unemployment from 2005, flows of general immigration and reverse migration at the same time were soaring. In 2005, 4.7 thousand of the Lithuanians returned to the country, in 2008 this number increased already to 6.4 thousand. In 2009 and 2010, it shrank to 4.8 thousand and 4.1 thousand respectively. The year 2011 is characterised by a large increase of declared immigration – 14.0 thousand of persons declared reverse migration to the country. Thus, in 2004–2010 on average seven from ten immigrants were returning Lithuania's citizens, while in 2011 this indicator increased to nine from ten. However, the declared migration balance throughout all years after Lithuania joined the EU was negative, and compared to other countries, the ratio of emigrants to population in Lithuania is one of the largest in EU.

[1] In 1990–2005, 334 thousand persons departed, in 2006–2010 – 148 thousand, and in 2011– 54 thousand persons.

[2] Data used by the United Kingdom and Ireland is the number of state social security numbers newly issued to the Lithuania's citizens. After the registration in the national social security system, a person has a right to participate in it and is obliged to pay taxes on labour related income earned in this country. Data for Norway is the number of new labour permissions for Lithuania's citizens, and for Spain– the balance of arrivals to the country and departures from it. Data for Germany reflects the number of new arrivals of Lithuania's citizens to the country.

IV. EXTERNAL SECTOR

CURRENT ACCOUNT AND ITS FINANCING

Lithuanian current account had a deficit of 1.6 per cent of GDP in 2011.

The current account deficit stood at 3.8 per cent of GDP in the fourth quarter of 2011, the highest deficit that year. A decline in current transfers in the last quarter in combination with an over one-third increase in the deficit of trade in goods led to a widening in the current account deficit. The change in the income balance and in the balance of trade in services was negligible with these two factors offsetting each other in the current account. Thus the overall deficit of the balance of trade in goods and services widened on account of an increase in the deficit of goods, and the negative values of the income balance point to a rise in the profits of foreign capital enterprises since the beginning of the year.

Fluctuations in current transfers are affected by uneven transfers of EU structural support and by unprecedentedly high outflows of private remittances abroad.

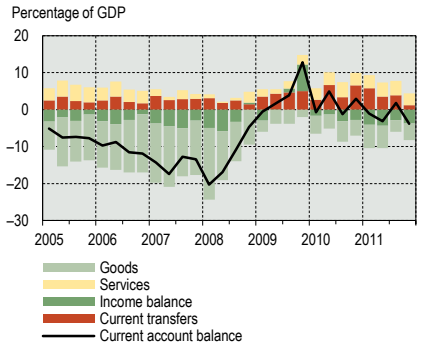
In the fourth quarter of 2011, EU transfers halved quarter on quarter. The amounts of EU support and other payments (including the Ignalina Nuclear Power Plant closure programme) vary subject to the schedule for project implementation and other circumstances, however average annual amounts do not change significantly: EU structural support that was transferred in 2011 was 3 per cent lower than in 2010. Private remittances abroad increased sizeably towards the end of the year and almost equalled emigrants' remittances to Lithuania. In the quarter to come, the flows of current transfers are likely to be influenced by suspended payments of EU structural support funds[2]. Thus, if the flow of private transfers abroad is similar to that during the previous months, there are no important preconditions for current transfers to increase.

At the end of 2011, the aggregate balance of the capital and financial accounts was positive. Government borrowing and the increase in banks' foreign assets led to a significant rise in portfolio investment whose impact was only partly offset by the country's growing international reserves.

A deficit on Lithuanian current account in the fourth quarter of 2011 led to a net financial inflow. It was induced by several individual components of the financial account, i.e., a sizeable net inflow of portfolio investment and a slightly decreased net outflow of other investment[3]. The inflow of portfolio investment was basically driven by the state's borrowing in international financial markets and by value increase of domestic banks' foreign equity securities. The net outflows of other investment contracted by a third, yet general patterns remain steady – domestic banks have been decreasing their foreign liabilities (long-term in particular) further. Other components of the financial account, while posting a negative contribution to its balance, did not outweigh the general trend. The impact of the four times smaller net FDI inflow to Lithuania (mainly on account of local enterprises lowering their debts to foreign investors) on the financial account was highly insignificant, while the increase of official foreign reserve assets (in the balance of payments an increase is recorded with a minus) was suppressed by the flow of portfolio investment in the opposite direction. The net capital account inflow, which consists of the EU's support for investment projects, as was expected in the previous review, contracted in the fourth quarter of 2011 but corresponded to the average of the recent two years. In the first quarter of 2012, the capital account, similarly to current transfers, will be affected by the European Commission's decision to suspend payments of structural support funds and therefore are likely to be lower.

The current account has a negative balance, still it remains close to balanced.

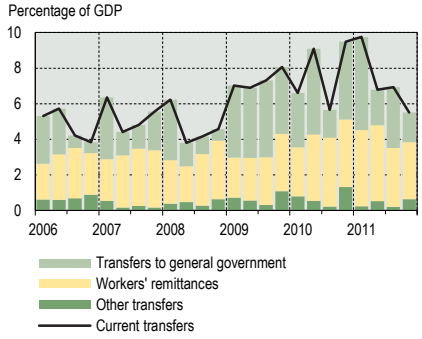
Chart 16. Components of the current account balance



Sources: Statistics Lithuania and Bank of Lithuania calculations.

The inflow of current transfers to Lithuania fluctuated in 2011 on account of uneven transfers of EU funds (see "Transfers to general government" in Chart 17), but their annual level is close to the average of previous several years.

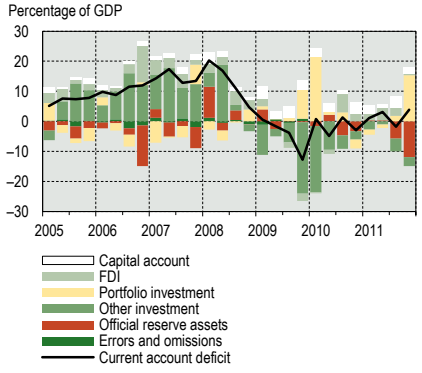
Chart 17. Current transfers to Lithuania



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Commercial banks have been reducing debts to their parent banks (see "Other investments" in Chart 18) and in the fourth quarter of 2011, the net financial flow to Lithuania was driven by portfolio investment inflows.

Chart 18. Current account deficit and its financing



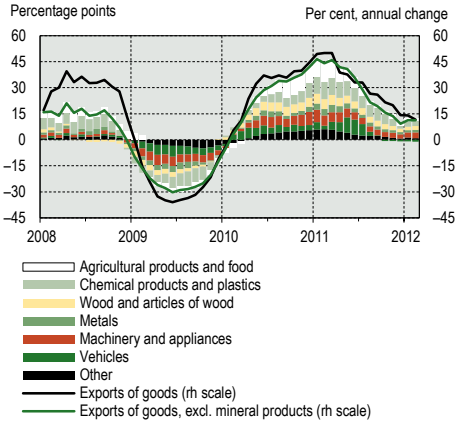
Sources: Statistics Lithuania and Bank of Lithuania calculations.

[2] On 10 February 2012 the EC temporarily suspended payments from the European Regional Development Fund and the Cohesion Funds to Lithuania due to allegations of irregularities in the country's use of EU money in implementing EU support projects. The payment freeze will be lifted either when Lithuania proves that tolerable error rate set by the EU regulations was not breached or when it works out a plan to avoid such irregularities in the future.

[3] Other investments are the ones that do not subscribe to the categories of direct investment, portfolio investment, financial derivatives or reserve assets. Other investment includes debts for goods and services, deposits, loans, cash and current accounts, as well as other foreign assets (liabilities).

After declining throughout 2011, the pace of export growth stabilised towards the end of the year.

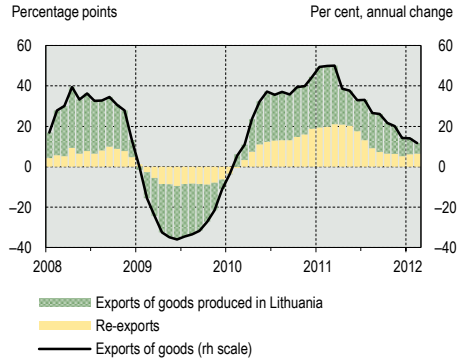
Chart 19. Contributions to export growth by product group
(three-month moving sums)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Recently export growth has been equally supported by re-exports and exports of goods of Lithuanian origin.

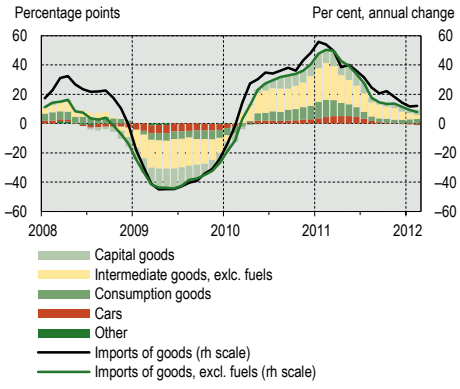
Chart 20. Contributions to export growth by goods' origin
(three-month moving sums)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Import developments are similar to that of export – expansion has been decelerating lately, this is mainly due to lower demand for intermediate goods.

Chart 21. Contributions to import growth by macroeconomic categories
(three-month moving sums)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

FOREIGN TRADE AND COMPETITIVENESS

Foreign trade[4] deficit remains significantly unchanged, averaging the value during the recent two years. The rise in imported energy resources prices is significantly widening the deficit of trade in mineral products, but this is partly offset by higher exports of food and furniture industry products.

Foreign trade deficit increased somewhat in the fourth quarter of 2011. The strongest influence on the negative change in the balance of trade came from a significant increase in the consumption of natural gas during the cold season. The surplus of trade in furniture and food increased, though quite moderately, while changes in the balances of other groups of goods were modest. Trade performance for January–February 2012 suggests that aggregate data for the first quarter will point to no significant changes in the balance of trade.

Annual export development has been stabilising. It is, however, highly subdued compared to early 2011.

Exports grew by 14.2 per cent in the fourth quarter of 2011 in annual terms, i.e., the growth was almost twice as weak as in the previous quarter. Only food exports recoded stronger growth, the growth in all other categories was losing momentum, while the exports of apparel and passenger cars dropped year on year. Both re-exports and exports of goods of Lithuanian origin contribute to the overall growth almost equally. The data for January–February 2012 suggests that export growth has been stabilising and, at least in the first quarter, the volume of export growth will be similar to that recorded in late 2011.

Lithuanian exporters keep increasing their market share in major trading partners' markets, however the increase has been somewhat more significant in the EU, while the share of Lithuanian exports in the Russian market has been stabilising.

Lithuanian exports expanded by approximately a fifth year on year both to the EU and Russian markets in the fourth quarter 2011. The share of Lithuanian exports in major trading partners' market expanded further, although to a lesser extent than during the previous quarters of the year, whereas in Russia the share remained unchanged. This is also in line with the conclusions of the analysis of export, which is estimated while processing chained-linked volume data, according to which our country's export expansion corresponded to the increase in foreign demand in the last quarter, i.e., unlike during the previous quarters, it did not exceed it. With regard to structural changes in Lithuanian export, in the fourth quarter of 2011, 62.5 per cent of Lithuania's entire exports were oriented to the EU, 2.7 p.p. ahead of the figure for a year ago (exports increased mainly to the Baltic States), and 28.1 per cent to the CIS, i.e., the overall share of exports to these markets shrank by 1.4 p.p. (for the main part, they declined to Belarus and Kazakhstan).

Import growth has been more subdued than export growth, but it still remains at above 10 per cent in annual terms. This is partly driven by increasing production and a recovery in domestic demand, however substantially more by the increase in the cost of energy resources.

Imports grew at the same pace as exports at the end of 2011 with 14.4 per cent annual growth recorded in the fourth quarter. It was mainly driven by increasing demand for natural gas and for crude oil by refinery AB ORLEN Lietuva. These volume increases partly result from the price factor too, i.e. energy product price increases in world markets. In addition, a positive contribution to import growth also came from the imports of intermediate goods and slightly less from the imports of capital and consumer goods. Meanwhile the imports of passenger cars dropped by nearly a tenth, reflecting lower re-exports to the CIS countries and the base effect. Available data for the first months of 2012 suggests that import growth is likely to subside slightly in the first quarter of the year.

[4] Foreign trade data of exports of goods and imports of goods in nominal values are reviewed in this section.

Box 2. Analysis of foreign demand

World trade and other globalisation processes led to a high level of integration of world economies. As a result, structural changes in the domestic demand and trade of major countries inevitably, directly or through interrelated secondary effects, affect less significant world trade players. Lithuania is a small open economy whose exports of goods and services accounted for 50 per cent of GDP in 2001 and 77 per cent of GDP in 2011. Thus, Lithuania is becoming increasingly reliant on developments of the world economy and the economic situation in its major trading partner countries. It is very important to adequately assess the impact of external environment on the economic processes in Lithuania. Among the most intuitive ways to do it is to carry out an evaluation of the foreign demand for the exports of Lithuanian goods and services. Employing the foreign demand indicator, one can observe contributions to Lithuanian export developments and assess changes in the country's international competitiveness.

The impact of an individual trading partner country on Lithuanian exports is directly related to the domestic demand in that country. This impact can be calculated by weighing imports from that country subject to its volume of trade with Lithuania. Intuitively, imports from Lithuania's largest trading partners (e.g., Russia, Germany and the Baltic States) exert the highest impact on Lithuanian exports, while the effects of developments in the imports from countries to which Lithuania exports very little are insignificant. Thus, we can calculate the indicator of foreign trade by aggregating weighted import developments in Lithuania's major export partners, neglecting the countries with which trade volumes are low. To calculate the indicator of Lithuania's foreign demand using the method described above, it was chosen to evaluate economic indicators of Lithuania's trade partners, which are comparable to Lithuanian export volumes data. Seasonally adjusted data of national accounts published by Eurostat and Russia's Federal State Statistics Service are used for the calculations. Quarterly data on the imports of goods and services have been weighted subject to the Lithuanian export values presented in the Eurostat's "ComExt" database. Having defined the sample of Lithuania's trading partners[1], annual change in the country's foreign demand can be calculated with following equation:

$$g_t^* = \sum_{i=0}^{n} g_{it}^l \alpha_{it-4},$$

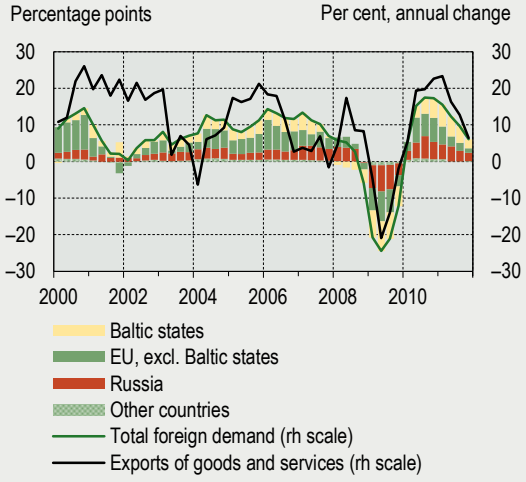
where g_t^* is the change in Lithuania's foreign demand during the period t, g_{it}^l is annual import growth in the country i during the same period t, and α_{it-4} is the coefficient of export weight, i.e. the share of Lithuania's exports to the country i relative to Lithuanian exports to all the countries of the sample.

Quarterly data on changes in foreign demand are calculated using the same algorithm. The obtained changes in the indicator in annual and quarterly terms are presented in Chart A.

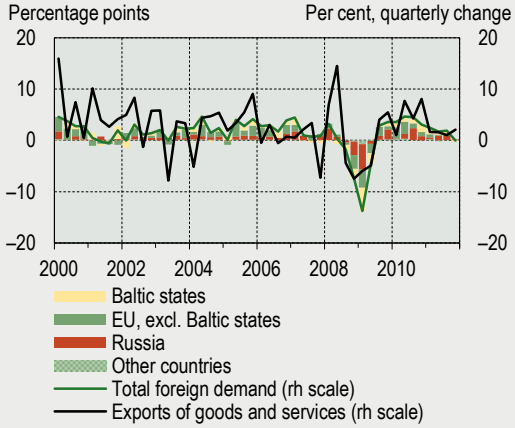
The calculated indicator of foreign demand is one of the possible measures to define the contributions to the development of Lithuania's export, and thus to the development of its economy. Despite certain methodical limitations which will be discussed further on, there is a clear link between the change in Lithuania's foreign demand and its exports. Since the early 2000's the development of Lithuania's foreign demand as its entire economy alike has been volatile. During the first years after the Russian crisis, the EU was a driver behind the development of Lithuania's foreign demand, with Russia's contribution relatively low, although it started increasing from 2007. The Baltic states are other very important trading partners of Lithuania and their aggregate contribution to Lithuania's foreign demand increased, particularly during the period of the highest economic growth in those countries (the period 2004–2007). From early 2008, domestic demand in Latvia and Estonia started declining, thus the influence of these countries on the demand for Lithuanian exports became negative. Foreign demand dropped in the last quarter of 2008 – for the first time from the beginning of data collection. The onset of recession in the EU countries and Russia, and thus the drying up of their domestic demand, contributed negatively to Lithuania's foreign demand. Lithuania entered a new stage of increase in its foreign demand in early 2010 only, with a particularly favourable contribution stemming from a recovery in the domestic markets of

Chart A. Developments in the demand for exports of Lithuanian goods and services and drivers behind it

(A.1.) Annual changes

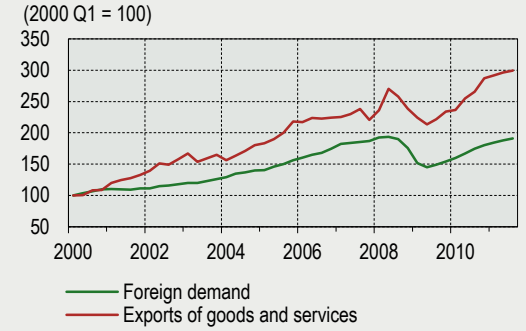


(A.2.) Quarterly changes



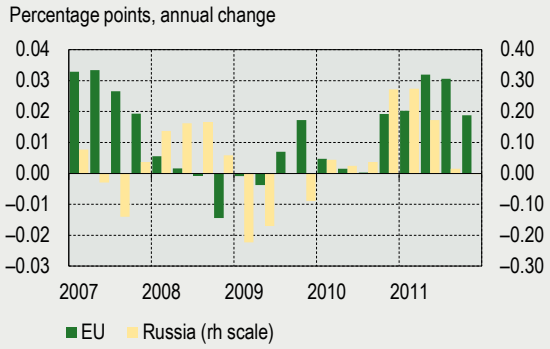
Sources: Eurostat, Russian Federal State Statistics Service, Statistics Lithuania and Bank of Lithuania calculations.

Chart B. Indices of Lithuania's foreign demand and export



Sources: Eurostat, Russian Federal State Statistics Service, Statistics Lithuania and Bank of Lithuania calculations.

Chart C. Market shares of exports of Lithuanian goods in the EU and Russia



Sources: Eurostat, Russian Federal Customs Service, Statistics Lithuania and Bank of Lithuania calculations.
Note: nominal foreign trade data; oil products are excluded from the calculations.

major EU countries and Russia, including, from the middle of that year, the Baltic States. The rate of increase in foreign demand was less strong during the last two quarters of 2011, mainly due a weaker growth in major EU countries, but a recovery in the domestic demand in the Baltic States still had a stimulating effect.

The index of foreign demand (see Chart B) shows that at the end of 2011 Lithuania's foreign demand had already nearly achieved the highest, pre-crisis level; however, since early 2011, its changes have been quite moderate. The index of Lithuanian exports also shows that exports rose to their highest volumes in the latter half of 2011, and were a fifth ahead of the figure for the highest performance quarter in 2008.

With regard to foreign demand and export developments, it is important to note that the correlation analysis has certain limitations and foreign demand cannot explain the entire dynamics of exports. The export development analysis conducted has not taken into account other contributions to export, such as the structure of foreign trade and the level of competitiveness of Lithuanian exports. The higher the similarity between the structures, the lower will be the difference between foreign demand and export developments. Moreover, the expanding market shares of Lithuanian exports in its trading partner countries may indicate growth of competitiveness of Lithuanian exports. With the competitiveness effect being positive, export growth outpaces foreign demand growth, and vice versa. Stronger export growth compared to growth in foreign demand from 2010 and the increase in the market shares of Lithuanian exports in its major trading partner countries during the same period (especially the EU, see Chart C) might point to the growing competitiveness of Lithuanian exports.

[1] The sample of calculation of the indicator of foreign demand includes twenty Lithuania's foreign trading partners. The sample's criterion is set to define significant trading partners, which stipulates that Lithuanian exports to a particular trade partner should be at least 1 per cent of Lithuania's total exports during the period 2005–2010. This criterion is met by the following countries: Russia, Latvia, Germany, Poland, Estonia, the United Kingdom, France, Belarus, Holland, Denmark, Sweden, the USA, Ukraine, Norway, Italy, Spain, Belgium, Kazakhstan, Canada, Finland and Singapore (due to a lack of reliable data, Belarus, Ukraine, Kazakhstan, Canada and Singapore were not included in the calculations). The following potentially important Lithuania's foreign trading partner countries, which did not meet the defined criterion at the time of the calculations, were included in the sample of countries additionally: Turkey, the Czech Republic, Hungary and Austria.

V. PRICES AND COSTS

Annual inflation mainly declined in the second half of 2011 and changed moderately in early 2012.

From mid-2011 to the end of the year inflation declined, mainly reflecting weaker growth in food prices over the year. In January 2012, inflation decreased slightly. It increased by 0.3 p.p. in February (to 3.7%), mainly on account of a rise in annual core inflation and stronger growth in administered prices. In March, inflation remained unchanged. A pick up in food prices previously was the major contribution to annual inflation, whereas in February and March their impact was much the same as that of administered prices. The impact of fuel prices, annual growth of which moderated strongly towards the end of 2011, was already lower compared to the impact of domestic demand related prices included in the calculation of core inflation rate.

The growth of producer prices in the domestic market was less pronounced at the end of 2011 and the beginning of 2012 (7.3% in March), however, it was still mainly determined by energy products, which account for the biggest share of the producer price index (almost 50%). The impact of non-durable goods, which account for around a fourth of sold production, was small, and that of durable goods, which account for a small share of the index, almost imperceptible. These preliminary consumer price indicators suggest moderate development of core inflation in the near term.

Analysis of structural factors behind inflation confirms that inflationary pressures of both internal and external factors are limited. Amid labour productivity growth outpacing that of gross wages, unit labour costs stayed lower than a year ago in the fourth quarter of 2011, suggesting that labour cost developments were favourable for price stability. The weakening impact of external factors on inflation is reflected by import price developments: import price growth of non-durable goods has recently been weaker, while prices of durable goods increased only slightly year on year in the beginning of 2012 after being constantly lower than a year ago in 2011.

Annual core inflation remained low in early 2012.

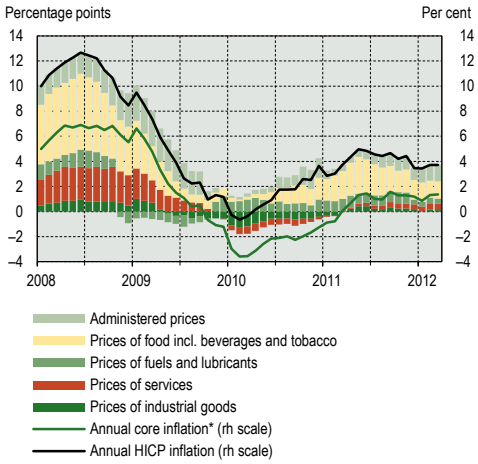
The prices of industrial goods and market services grew modestly in 2011. In early 2012, this trend did not change and core inflation stayed low. Thus domestic demand driven price pressures were insignificant, although the turnover of retail trade was strongly on a rise in 2011. The growth of the economy is expected to be rather weak in 2012, thus core inflation is not likely to increase significantly.

Annual food price growth in Lithuania decelerated reflecting weaker rise in global food prices. From December 2011 global food prices were already lower than a year ago.

According to provisional data, global food prices were approximately 7 per cent lower in March 2012 year on year. The prices of dairy products recorded the most pronounced declines over the year (16%), however, the prices of cereals, sugar and oils dropped significantly as well. Meat prices were slightly higher year on year. While global food prices were much lower than a year ago, they increased during the recent few months. Food and Agriculture Organization of the United Nations pointed out that in February this was determined by a rise in sugar, oil and cereals, especially wheat, prices. In the sugar market, concerns were raised by poor weather conditions in Brazil, which is the largest producer and exporter of sugar in the world, and, in the wheat market, by the likely effects of cold weather on the crops in Europe and the CIS. Price increases in the oil group were driven by an expected mismatch between the demand and supply of vegetable oils for the 2011–2012 season.

In early 2012, inflation changed only slightly.

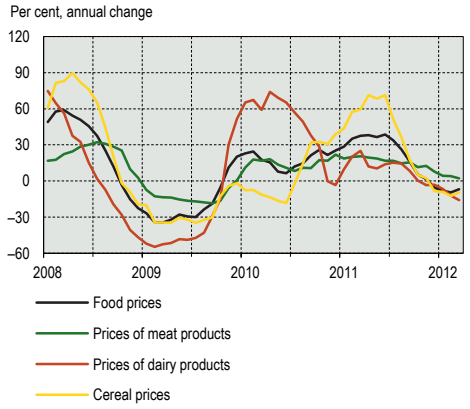
Chart 22. Contributions to annual inflation



Sources: Statistics Lithuania and Bank of Lithuania calculations.
** Change in HICP, excl. food, fuels and lubricants, and administered prices.*

From late 2011, global food prices were lower than a year ago.

Chart 23. Global food prices



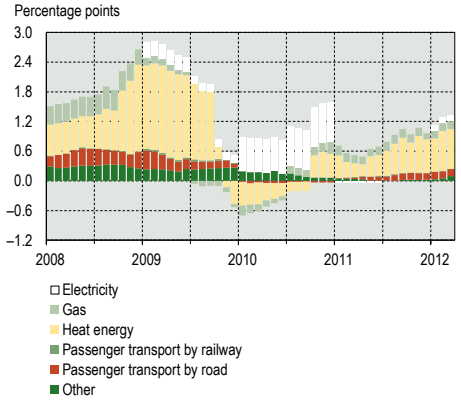
Sources: Food and Agriculture Organization of the United Nations and Bank of Lithuania calculations.

As growth of food prices decelerated in Lithuania, their impact on inflation weakened. Compared to a very strong rise in the prices of food and non-alcoholic beverages in Lithuania in May (11.1% in annual terms), it decreased by more than a half and stood at 4.3 per cent in March 2012. The influence of alcoholic beverages and tobacco products on inflation was small. In 2011, their prices were just approximately 1 per cent higher than in 2010. The excise duty on cigarettes was increased in March 2012. On account of cigarette reserves, tobacco prices increased only slightly in March, but they are to increase in the months to come.

Heat energy prices grew during 2011 and early 2012, the electricity price for households rose in January 2012.

In January 2012, administered price growth accelerated due to higher electricity price.

Chart 24. Contributions of administered prices to annual inflation



Sources: Statistics Lithuania and Bank of Lithuania calculations.

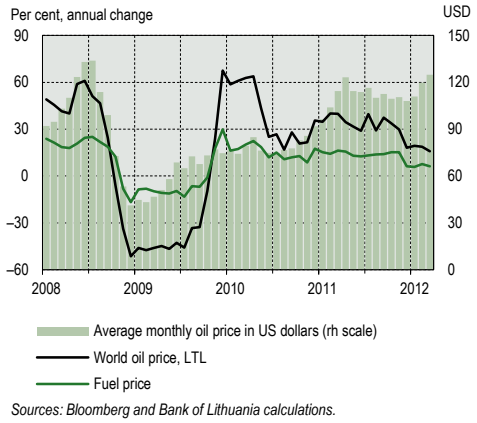
The annual growth of administered prices strengthened from mid-2011 (with the exception of some months), fuelled mainly by higher increases in the price of heat energy, and, in January 2012, also by the rise in electricity price from the beginning of the year (by 3.8%). According to the data for March, heating prices picked up by roughly 22 per cent over the year, the most in approximately 2.5 years. The pick-up in the prices was driven by higher prices for fuel which is used for heat production, mainly imported natural gas. The price of imported natural gas declined somewhat in January and February, but in March it increased again.

The pick-up in heating prices over February was the highest in approximately half a year – 3 per cent, with the highest increase recorded in Panevėžys (11%), as heating price in this city had not been changed since mid-2011; however, they rose in other cities as well. In March, the rise in heating price was negligible.

The National Control Commission for Prices and Energy reported in March that the different dynamics of heating prices in Lithuanian cities was partly driven by the frequency of recalculation of heating prices amid changes in fuel prices, as amid little fluctuations in fuel prices heating prices could be unchanged. From the beginning of 2012 heating prices are to be recalculated on a monthly basis, thus the differences in their dynamics will decline and will only depend on the decisions to invest into the heating sector and on the type of fuel used.

Oil price increased substantially in February 2012 triggered by geopolitical tensions.

Chart 25. Crude oil price and fuel prices in Lithuania



Sources: Bloomberg and Bank of Lithuania calculations.

In the first quarter of 2012, global oil price increased strongly and triggered fuel price growth in Lithuania.

In 2011, oil price denominated in US dollars grew by almost 40 per cent year on year. In early 2012, it rose strongly, especially in February. Based on the oil market report published by the International Energy Agency in March, oil price has recently been on a rise amid concerns over its supply disruptions. Problems of geopolitical nature in Syria, Southern Sudan and Yemen have already disrupted oil supply of these countries. A possible drop in supply related to the situation in Iran, the second largest OPEC oil producer, added some uncertainty to supply forecasts in the months to come.

Annual growth of fuel prices in Lithuania was strong during most of 2011, with the rise in the prices averaging 13.7 per cent over the year. Annual growth moderated particularly (to approximately 6%) in the end of the year, mainly due to a base effect. Strong oil price increases in early 2012 entailed marked fuel price growth – of approximately 6.5 per cent during January to March. Annual growth of fuel prices was reduced by the base effect and relatively weak (6.1% in March).

VI. CREDIT AND DEPOSITS

In the first two months of 2012, the banking loan portfolio[5] decreased following its growth in the second half of 2011.

Credit demand recovered in the second half of 2011 driven by economic growth and improved financial situation in the private sector supported by easing of credit standards and relatively low interest rates. From July to October 2011, the banking loan portfolio grew by LTL 1.1 billion or 2.0 per cent (an increase in the loan portfolio value accounted for one-fifth of this increase[6]). But increasing concern over the ability of some Europe countries to properly proceed with their former liabilities, triggered uncertainties in Lithuania's major trading partners: towards the end of the year, economic sentiment of non-financial enterprises became negative and the consumer confidence shrank too. Despite improvements in the borrowers' financial situation, future outlook deteriorated followed by a decrease in the banking loan portfolio during the first two months of 2012 due to a decreasing indebtedness in all sectors.

The financial situation of non-financial corporations continued to improve in 2011, but their profit went down towards the end of the year.

Profit earned by businesses before taxes during 2011 totalled LTL 8.4 billion, an increase of 57.8 per cent compared to 2010, while sales profitability by corporations reached the level observed before the recent recession (4.4%) and businesses have curtailed financing of their operations via debt (a reduction in financial leverage was observed). In the context of increasing demand in foreign markets, a rapid growth in profits of export-oriented economic activities (agriculture, industry, transport) was observed. Furthermore, in 2011 earnings by trading companies reached the highest level since 2009 as a result of recovering consumption within the domestic market.

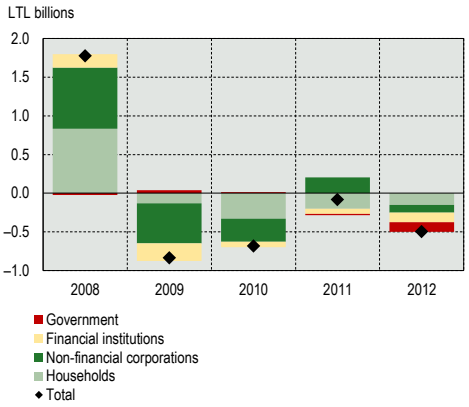
However, growing concerns about economic development within the domestic and foreign markets triggered deterioration in businesses' expectations and reduced their liabilities to banks.

A more rapid expansion of company operations increased the demand for new investments, for some of which borrowed funds were used. However, due to both seasonal factors (reduction of non-financial corporations' liabilities to banks at the end of the year) and possibly lower demand (non-financial corporations in Lithuania tend to use internal financing for their activities, which means that credit demand decreases, if the profit goes up) or doubtful prospects for investments non-financial corporations continued to curtail their liabilities to the banking sector in December 2011 and in January to February 2012. During the reviewed period the portfolio of loans to non-financial corporations shrank by LTL 0.6 billion or 2.5 per cent. At the end of 2011, the biggest impact on changes in non-financial corporations' liabilities to the banks was made by the major debtors: liabilities were reduced by construction and trading companies, while manufacturing firms boosted their liabilities.

Many of non-financial corporations have encountered a shortage in labour force as their business activity continued to be high, which contributed to the growth of wages and strengthening of the financial standing of households.

At the beginning of 2012, all sectors decreased their indebtedness to banks.

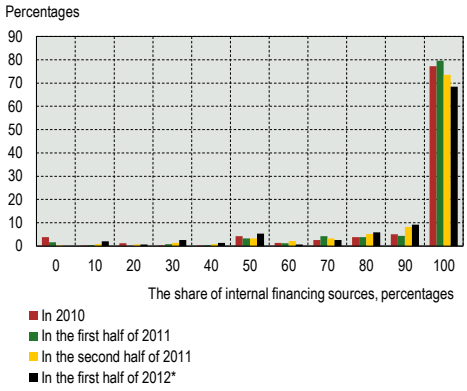
Chart 26. Contributions to changes in banking loan portfolio in January–February



Source: Bank of Lithuania calculations.

An improvement of financial situation of non-financial corporations could constrain demand for banking loans because businesses tend to finance their activities from internal funds.

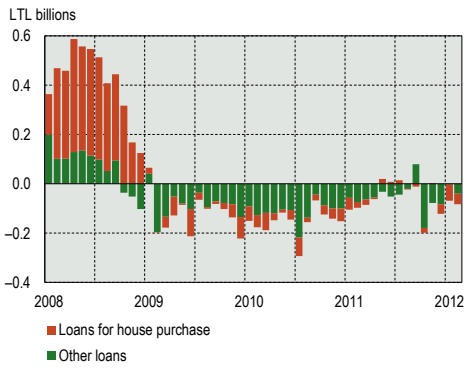
Chart 27. Breakdown of enterprises by the source of satisfying business financing needs



Sources: Survey of Non-Financial Enterprises on Business Financing ordered by Bank of Lithuania and Bank of Lithuania calculations.
** Enterprises planning business expansion.*

Households are further cautious about new borrowing.

Chart 28. Changes in loan portfolio to households per month



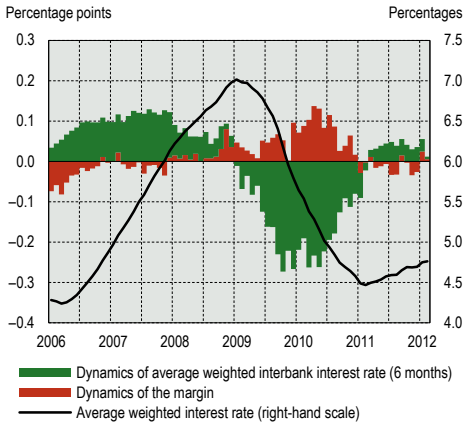
Source: Bank of Lithuania calculations.

[5] The Bank of Lithuania revoked the licence of AB bankas SNORAS in 24 November 2011. To ensure the data comparability and the accuracy of the analysis, the development of the Lithuanian banking sector loans and deposit holdings is presented excluding the data of AB bankas SNORAS.

[6] Hereinafter the loan portfolio development is assessed notwithstanding the development of loan value.

To borrow from banks became more expensive due to conservative assessment of risk.

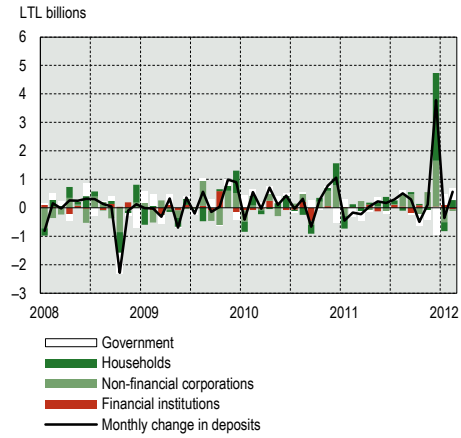
Chart 29. Contributions to changes in weighted average interest rate on new loans to private sector (twelve-month moving average)



Sources: www.euribor.org and Bank of Lithuania calculations.

Traditional withdrawal of deposits at the beginning of the year was replaced by an increase in February that was mainly determined by the households and government sector.

Chart 30. Contributions to changes in deposits in banking sector per month



Source: Bank of Lithuania calculations.

In the environment of improving financial situation of households and consumer confidence indicator, an increase in households' borrowing from banks was registered in some months of 2011. But in the fourth quarter of 2011 the households' sentiment deteriorated as it may have been affected by increased uncertainty about economic development and company profit which stopped growing. Households reduced their liabilities to banks by LTL 0.6 billion or 2.3 per cent in the period between October 2011 and February 2012. As in previous periods this was driven mainly by more rapid repayment of other than housing loans.

Concerns about growing prices in the euro area were replaced by fears about decelerating economic growth and deepening sovereign debt crisis, which led to easing of monetary policy stance by the ECB.

Tensions within the interbank market receded and loans became less expensive following the ECB move by which it cut key interest rates up to 1 per cent in December 2011 and made longer-term lending available. Till the mid-January 2012, a decrease was observed both in the interbank borrowing price within the euro zone and in the interbank borrowing price in Lithuania. However, the trends in interbank interest rate development subsequently diverged: EURIBOR declined further, and VILIBOR stabilised at a level observed a year ago. In Lithuania, three-quarters of the private sector liabilities to banks are in euro. Due to a conservative approach by banks towards the credit risk and debt margin increase interest rates on loans to private sector grew at a moderate pace in January 2012 as lower interbank interest rate offset half of the margin increase. In January 2012, weighted average interest rates on new loans to the private sector made up 4.7 per cent, an increase of 0.7 p.p. compared with the period one year ago.

The private sector deposits increased in February following traditional withdrawals at the beginning of the year, but the biggest contribution to the growth of bank deposits in two months of 2012 was by general government.

The financial situation of the private sector was improving, but it did not rush to make new consumption or investment decisions due to the expected moderation in economic growth, which could lead to an increase in deposits within the banking sector. Caution should be exercised in interpreting a sudden increase in bank deposits in December 2011, as it could reflect the repayment of insured deposits of the bankrupt AB bankas SNORAS performed by deposit insurance fund VĮ Indėlių ir investicijų draudimas. In January 2012, a decrease in household deposits was observed, as usually in the beginning of the year, but they grew again in February. This was likely related in part to a record high interest rate in latter year. In the first two months of 2012, bank deposits grew by LTL 0.2 billion (following a fall of LTL 0.6 bn during a corresponding period a year ago) with the general government being the biggest contributor to it.

VII. GENERAL GOVERNMENT FINANCE

Increasing revenues and limited expenditure contributed to the improvement in public finances: in the fourth quarter the general government deficit contracted year on year by 1.7 p.p.

The ratio of four-quarter general government deficit to GDP made up 5.5 per cent. Both expenditure-to-GDP and revenue-to-GDP ratio continued to decline in the fourth quarter. Regarding the expenditure, it was related to expenditure restraint and a rapid growth of GDP. Regarding the revenues, the decline in revenue-to-GDP ratio was most likely related to the elasticity of public revenues with respect to the growth in economic activity. It decreased significantly since the beginning of the economic downturn: between 2000 and 2008 this indicator was 1.4, while in the period between 2009 and 2011 it contracted to 0.8. This means that in recent quarters a fast enough economic growth rate has generated a slower increase in the general government revenues.

Social contributions continued to grow fast in the fourth quarter representing the main factor behind the growth of general government revenues.

The annual increase in social contributions was among the highest over the last few years. They climbed mainly due to increasing social insurance contributions paid by insurers and the insured, while the most rapid annual growth was observed in social contributions paid by self-employed. According to the data for January to March 2012 by the State Social Insurance Fund's Board, the annual increase in social contributions during the first quarter of 2012 should be similar to that in the fourth quarter.

Indirect tax income which grew triggered by increased VAT revenues was one of the most significant contributors to the growth of the general government revenues in the last quarter of 2011.

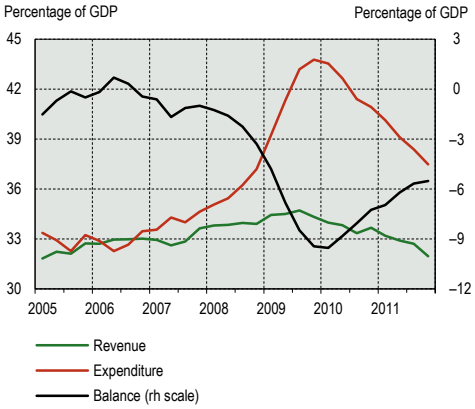
However, compared to previous quarters, an increase in indirect tax revenues over the year was significantly lower mainly due to VAT revenues. This is partly related to the growth in retail sales at constant prices, including motor vehicles, which was slower than in previous quarters, and a smaller effect of inflation. However, the base effect had the biggest impact on a slower growth in VAT revenues and, according to the data of the Ministry of Finance of the Republic of Lithuania, the tax arrears and tax overpayment dynamics. Tax arrears as a factor which usually stand behind an increase in VAT revenues estimated on the accruals basis declined during the last quarter of 2011. Overpaid tax amount was higher compared to the period a year ago mainly due to an increase in export, as export is not subject to VAT. The latter however is deductible on acquisitions. The revenues from other indirect taxes except VAT, mainly excise tax, decreased over the year by almost one-tenth driven mainly by real estate and environment pollution taxes. Excise tax revenues remained largely unchanged during the year. Most likely, excise tax collected by the Lithuanian customs grew driven by higher import, while the amount of excise tax collected by the State Tax Inspectorate was lower than a year ago. The biggest decrease was observed in excise taxes on energy products and alcoholic beverages. In the fourth quarter, non-tax revenues declined because of lower capital transfers from the EU. The revenues raised from indirect taxes in the first quarter of 2012 are expected to increase with similar growth rate as in the last quarter, taking into account the data in the national budget for January to March 2012.

A year-on-year decrease in direct tax revenues for the fourth quarter was due to a one-sixth slump in profit tax revenues.

The fall in direct tax revenues was contained by personal income tax revenues which grew by approximately 2 per cent following an

Lithuanian public finances improved due to increase in revenues and restrained expenditure.

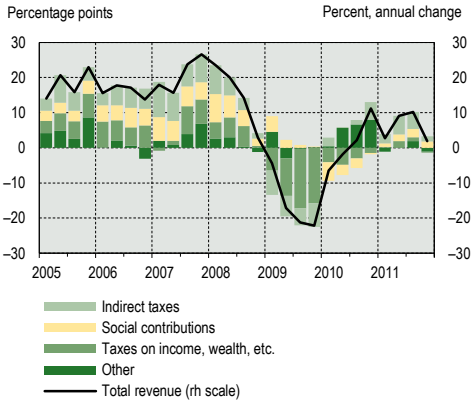
Chart 31. General government revenue, spending and balance



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Economic growth increased general government revenues, however, the annual growth rate slowed down.

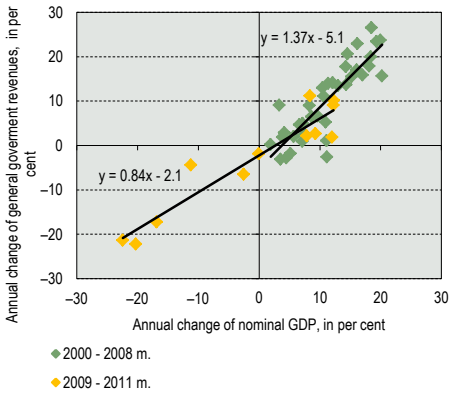
Chart 32. General government revenue growth and contributions



Sources: Statistics Lithuania and Bank of Lithuania calculations.

As a result of less favourable composition effect, elasticity of general government revenue with respect to GDP decreased in 2009–2011.

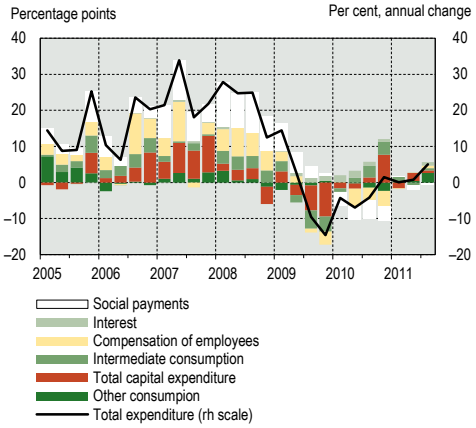
Chart 33. Elasticity of general government revenues in 2000–2011



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Due to continued expenditure restraint an increase in expenditure was moderate

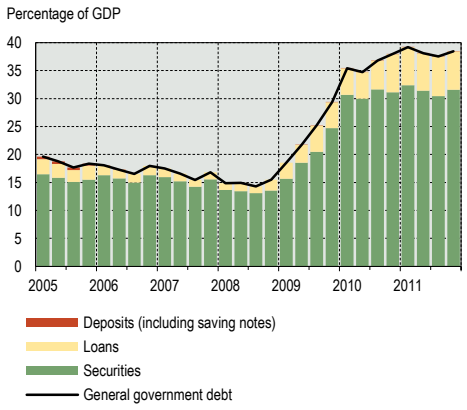
Chart 34. General government spending growth and contributions



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Public debt rose due to central government's borrowing abroad.

Chart 35. Breakdown of general government debt



Sources: Ministry of Finance of the Republic of Lithuania and Bank of Lithuania calculations.

approximately 3 per cent increase in the wage fund within the economy. This was influenced by higher wages and higher number of the employed. As in the previous period, a lower tax rate was the reason behind the decline in the fourth-quarter profit tax. The tax base for profit tax – taxable profit in 2010 – grew over the year by more than one tenth along with an increase in the number of profitably operating companies. Furthermore, in the context of improving profitability expectations, increasingly more companies preferred paying advance profit tax based on the operational results in the previous year. The national budget data for January to March 2012 imply an increase in direct tax in the first quarter of 2012 because of the growth in the collection of personal income tax and lower decrease of profit tax revenue.

The general government expenditure in the fourth quarter grew largely due to the compensation for employees and other expenditure.

Annual increase in expenditure made up around 2 per cent. In the fourth quarter, compensation to employees grew by 5 per cent, more rapidly than in the third quarter. The biggest increase in the compensation to employees was reported by government-financed agricultural, forestry and fishery, professional, scientific research and technical, health care and social work activities. As the number of the employed in general government continued to decrease, compensation to employees expenditure was most likely driven by higher wages. Wage costs hiked due to a one-tenth increase in the number of higher skill professionals with higher wages. Moreover, public sector employees were paid for extra work, as in the previous quarter. Other expenditure grew driven mainly by capital transfers, while public investment was lower by one-sixth compared with the previous year. Furthermore, current transfers of general government grew as a result of increased funding for other current purposes.

Lower investments (by one-sixth) and spending for intermediate goods and services (by one-tenth) were major contributors to the decrease in general government expenditure in the fourth quarter. The fall in the latter was driven mainly by lower expenditure for current repair of long-term tangible assets and other services, and lower funds transferred to appropriations holders for performing the functions entrusted to them. Higher energy prices in the fourth quarter led to an increase in heating and transport maintenance expenses. These factors prevented a stronger decline in intermediary consumption expenditure. Social payments for the fourth quarter were also lower compared with the period a year ago. They declined mainly due to a decrease in unemployment benefits, sick leave and maternity allowances, and old age pensions. Interest payments for the fourth quarter grew year on year by one-sixth.

A bond issue in international markets was the major contributor to the growth of public debt in the fourth quarter.

The general government debt-to-GDP ratio grew to 38.5 per cent in the fourth quarter of 2011. The debt amount increased over the quarter by LTL 2.1 billion to LTL 40.8 billion. The biggest increase was observed in central government debt. This was largely due to the November placement of the USD 1.5 billion bond issue. As expected in the previous review, the debt of social security funds grew significantly to LTL 7.6 billion or 7.2 per cent of GDP at the end of the year. Long-term loans accounted for the biggest portion of the increase. The latest data by the Ministry of Finance of the Republic of Lithuania indicate a significant increase in the central government and social security funds' debt at the end of February as a result of the USD 1.5 million bond issue. Debt-to-GDP ratio made up 38.3 per cent following 36.3 per cent at the end of December. Consequently, the new bond issue will contribute to a significant increase in general government debt for the first quarter of 2012.

Box 3. The balance sheet of the general government sector: structural position and impact on Lithuania's economy in 1999 to 2011

Excessive borrowing by governments in order to finance expenditures contributes to domestic demand and inflationary pressures within the economy. This makes national central bank to set interest rate at a higher level than it would be necessary to ensure price stability. Large public finance deficits lead to a rapid growth in public debt making investors' confidence to go down and increase the risk for private investments to be crowded out. After a country joins the EU, in particular the Economic and Monetary Union, its fiscal discipline often weakens and a risk of deficit bias arises. This is mainly associated with the elimination of exchange rate risk and lower interest rate risk premium as investors usually look upon the euro area members as lower risk countries. Recognizing that the Maastricht Treaty does not ensure fiscal discipline and a threat exists to the existence of the Economic and Monetary Union, the European Council signed the Stability and Growth Pact (SGP) in Amsterdam in 1997.

Based on the provisions of the SGP, the EU Member States have committed themselves to have their general government (in this box referred to as GG) balances close to balance or in surplus, and decided that in pursue of anti-cyclical policy the general government deficit should not exceed 3 per cent of GDP. In 2005, the European Council approved amendments to the SGP made to facilitate in principle the implementation of the pact requirements: fiscal position of Member States is now assessed on the individual basis and with respect to each Member State's economic and budget situation. It was agreed that GG balance is not the most appropriate indicator to be used to judge about the country's public finances and fiscal policy. There are two main reasons for it. First, GG balance is subject to many factors some of which are independent of government decisions. The main of them is fluctuations of economic activity. Cyclical fluctuations of economic activity make direct effect on GG revenues and expenditure, but because of their short-term nature there is no need for changing fiscal policy because of automatic stabilisers, which have to operate. Discretionary decisions by government usually have a lasting effect on GG revenues and expenditure because of fiscal inertia. Therefore it is important to distinguish between fiscal balance changes due to economy's cyclical fluctuations and changes that are most often caused by discretionary decisions of government institutions, i.e. to assess a cyclically adjusted (or structural)[1] GG balance. Second, received and paid interest is recorded in the GG general balance. But for the purposes of estimation of the extent to which fiscal policy is consistent with economic environment interest expenditure is not very important as it depends on public debt, which is the result of the fiscal policy in the previous period. Therefore, when analysing the fiscal policy impact on economy, interest should be subtracted from the GG balance (it is subtracted from revenues and expenditure) and the primary balance should be adjusted for cyclical fluctuations in economic activity. After doing this we obtain a primary structural balance which shows the public finances position when the economic activity growth is consistent with the long-term trend. The annual change of primary structural balance is consistent with the impact of GG finance on economic activity.

The GG structural balance is an indicator widely used by international institutions (ECB, EC, IMF, OECD). It became even more relevant when European leaders, excluding UK and Czech Republic, signed on 2 March 2012 the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The major elements in the treaty aim at fiscal discipline, coordination of economic policy and governance in the euro area. Regarding fiscal discipline, the most important aspects are the obligation of a balanced budget rule and national anchoring of automatic correction mechanisms for excessive deficits. The balanced budget rule means that Member States take an obligation to have their GG budgets balanced or in surplus and their medium-term objective must not exceed a structural deficit of 0.5 per cent of GDP[2]. According to the rule, automatic correction mechanisms should be also envisaged, which would start operating in case the actual GG balance deviated notably from the set medium-term objective. Therefore, the aim of this box is to calculate Lithuania's GG primary structural balance and assess the impact of fiscal policy on the economy in 1999 to 2011.

The ECB in cooperation with national central banks have worked out a method for disaggregating the GG primary balance[3] to be reviewed briefly here. Structural balance for period *t* is obtained by decomposing GG primary balance (B_t) into two components: cyclical one ($B_{c,t}$), related to the work of automatic stabilisers, and structural one ($B_{s,t}$), related to discretionary government decisions. This is shown in equation 1:

$$B_{s,t} = B_t - B_{c,t}. \quad (1)$$

Annual change in $B_{s,t}$ is used to estimate the country's fiscal position. i.e. the continued fiscal policy trend formed by discretionary decisions of government institutions. Fiscal position may be loosening, tightening or neutral. Cyclical component $B_{c,t}$ of the primary balance is calculated as a difference between cyclical components of GG revenues ($R_{c,t}$) and expenditure ($E_{c,t}$). This is shown in equation 2:

$$B_{c,t} = R_{c,t} - E_{c,t}. \quad (2)$$

To estimate $R_{c,t}$ and $E_{c,t}$ first it is necessary to identify those components of GG revenues and expenditure, which are related to economic cycle through a tax base. Later, their elasticity with respect to the tax base, and finally, cycles of revenue and expenditure components by applying average long-term gaps of tax base must be calculated. The ECB, when working on this method identified four revenue items and one expenditure item that can be distinguished as being

dependent on economic cycle in all EU countries. On the revenue side, these are direct taxes paid by households working in private sector (GPM), direct taxes paid by companies (PM), indirect taxes related to private consumption (NTM), and social contributions paid by private sector (SOC). Unemployment benefits (NED) make up the only expenditure item which is related to economic cycle. According to a generally-approved assumption, the elasticity of other revenue and expenditure items with respect to economic cycle is zero. Cyclical components of revenues and expenditure formally could be written as in equations 3 and 4:

$$R_{c,t} = GPM_{c,t} + PM_{c,t} + NTM_{c,t} + SOC_{c,t}, \quad (3)$$

$$E_{c,t} = NED_{c,t}. \quad (4)$$

For these revenue and expenditure items macroeconomic bases were selected most showing corresponding tax bases. Direct taxes on households and social contributions paid by private sector are associated with the wage bill in private sector (W^P). As GG compensation for employees and social insurance contributions do not depend on economic cycle and thus are inelastic with respect to it, wage bill in private sector is used. Private consumption expenditure (PCN) is a macroeconomic base for indirect taxes, gross operating surplus (F) is a tax base for corporate direct taxes, and the number of the unemployed (U) is a macroeconomic base for unemployment benefits. Using the above mentioned macroeconomic bases, cyclical components of revenues and expenditure can be rewritten as a sum of products of actual values of components during period *t*, their elasticities with respect to a tax base (ε)[4], and cyclical component of a tax base ($W^P_{c,t}$, $F_{c,t}$, $PCN_{c,t}$, $W^P_{c,t}$ ir $U_{c,t}$). This is shown in equations 5 and 6.

$$R_{c,t} = GPM_t \cdot \varepsilon_{GPM;W^P} \cdot W^P_{c,t} + PM_t \cdot \varepsilon_{PM;F} \cdot F_{c,t} + NTM_t \cdot \varepsilon_{NTM;PCN} \cdot PCN_{c,t} + SOC_t \cdot \varepsilon_{SOC;W^P} \cdot W^P_{c,t}, \quad (5)$$

$$E_{c,t} = NED_t \cdot \varepsilon_{NED;U} \cdot U_{c,t}. \quad (6)$$

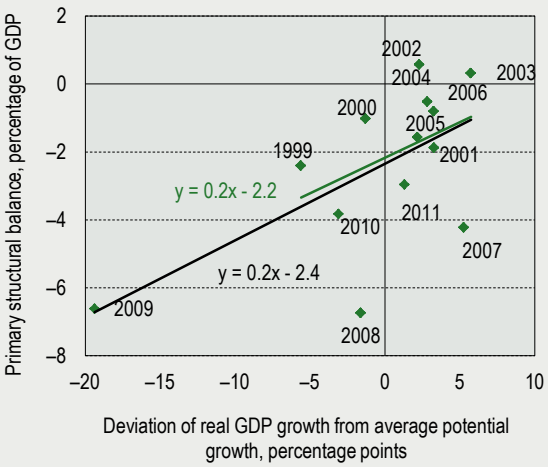
A cyclical component of a corresponding tax base is calculated using *Hodrick-Prescott* filter as a gap between a tax base and its long-term trend. The smoothing parameter value λ is equal to 100, and the "end point" problem is solved by including into calculations three-year forecasts for macroeconomic bases. It should be noted that a cyclical component is calculated based on real values of the tax base excluding inflation effect. This is based on the goal of the entire process, which is to estimate fiscal position with respect to the real economy cycle rather than the price cycle. Estimates for the elasticity of each revenue and expenditure item with respect to a tax base are different for each Member State. This was done after estimating regressions between annual changes in a particular item and the actual value of the corresponding tax base. The obtained values are revaluated every five years.

The above described analysis of individual GG revenues, expenditure, and their tax bases, and the cyclical position evaluation is one of the major benefits of the ECB method compared to more frequent cyclically adjusted balance estimation using the aggregate output gap and GG overall balance elasticity with respect to the output gap. The estimation of the cyclical position of individual tax bases makes it possible to take into account composition effects arising from different factors leading to the growth in economic activity. Two hypothetical scenarios for GDP growth could serve an example to this: in one case, the major factor for GDP growth is net export, and in another case GDP growth is stimulated by private consumption. In the first case, direct impact from GDP growth on GG revenues should be relatively low due to the fact that export is not taxed. Most likely GG revenues would grow due to secondary effects, i.e., due to higher revenues from direct taxes and social contributions which would grow because of higher household income, and increased profit tax revenues which would grow because of a higher corporate profit. In the second case, the same size increase in GDP would have a more significant effect on GG revenues due to private consumption, the rapid growth of which would result in an increase of indirect tax revenues. Cyclically adjusted GG balances should match based on the assumption that the GDP growth is the same in both cases, and after applying an estimate of aggregate output gap and similar elasticity of GG balance with respect to output gap. However, this would be in principal an erroneous conclusion, since in the first case the cyclic component of GG balance would be noticeably overestimated due to the fact that a significant portion of GG revenues would be wrongly considered as being cyclical due to the export-determined increase in the output gap.

The Lithuania's GG primary structural balances for 1999 to 2011 were calculated based on the above described method. This offers a possibility to find out the fiscal policy impact on the growth of economy. A linear regression provides an interesting insight into mean relationship between GG primary structural balance and the gap between real GDP growth and potential GDP growth (average real GDP trend growth was 4.5 per cent in 1999 to 2011). To estimate the GDP gap an assumption is made that actual economic activity fluctuates around the potential one. Chart A shows that the real GDP growth which exceeds the potential growth by 1 percentage point, has improved the GG primary structural balance on average by 0.2 per cent of GDP. GG sector becomes balanced only if the economy grows annually by more than one-tenth. And when the growth is smaller, the GG deficit increases. Based on this, the Lithuania's fiscal policy during the reference period can be seen as subject to strong deficit bias. The constant estimate provides an illustration for this, as GG deficit makes up on average 2.4 per cent of GDP when the GDP change corresponds to the potential one. Exceptional macroeconomic situation and real GDP and GG balance indicators during the economic downturn period (especially in 2009) may distort the results, but after the observation period was shortened up to 2008, no principal changes were noticed in primary conclusions, and GG deficit on average makes up 2.2 per cent of GDP (green line,

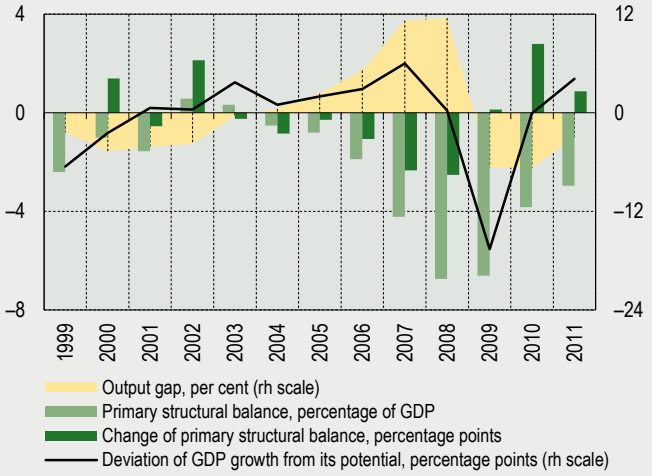
Chart A). According to Ch. Wyplosz and S. Krogstrup[5], the deficit bias could be considered to have formed as a result of a "common pool" problem which arises when interested economic agents compete for public expenditure. The deficit bias emerge also when government fails to take full account of debt service costs in future or is not sure about its victory in the nearest elections.

Chart A. Primary structural balance and the output gap



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Chart B. Primary structural balance and the output gap in 1999–2011



Sources: Statistics Lithuania and Bank of Lithuania calculations.

A simple linear regression would not be enough to find out the impact of fiscal policy on the economy over the review period. The country's fiscal policy evaluation is inaccurate because of changes in the pursued policy and economic cycle. A year by year analysis of the fiscal policy impact on economic cycle could be more appropriate. The ECB describes this impact taking into account the relationship between the GDP gap and fiscal impulse. Fiscal impulse is measured by a change in GG primary structural balance. A positive fiscal impulse during an economic upturn (when the GDP gap is positive) and negative during an economic downturn (when the GDP gap is negative) show a pro-cyclical fiscal policy. Anti-cyclical fiscal policy helps to reduce economic fluctuations: fiscal impulse and GDP gap are of opposite signs.

Chart B shows that real GDP in 1999 to 2002 was below the potential level and was growing at a lower rate. In 2000, the GG primary structural deficit decreased, in 2001, it remained largely unchanged, and a year later a small surplus was accumulated. The above ECB definitions therefore suggest that the fiscal impulse in 2000 was negative and the fiscal policy might be seen as pro-cyclical as it hampered economic recovery. In 2001, because of the absence of additional fiscal impulse its impact on economic cycle was neutral. Later, small structural surplus were recorded in the GG sector. The negative fiscal impulse surged up again in 2002 while economic activity just started approaching a potential level or running into recovery phase as evidenced by the growth rate. Amid GDP gap in 2002, which was negative, the structural deficit turned into a surplus, which means the fiscal policy was pro-cyclical. In 2003, a change in the structural balance was insignificant; therefore the fiscal policy should be seen as close to neutral, as a minor GG structural surplus prevented the accelerated growth of economic activity. The pro-cyclical nature of the fiscal policy showed itself again in 2004, and was especially pronounced in 2006 to 2008, when the GG structural deficit grew by 2 percentage points of GDP every year. In this period, GG expenditure was increasingly growing above revenues, which means that the fiscal impulse was positive giving an additional boost to economic activity. At that time, the national fiscal policy failed to comply with the EU requirements for strengthening fiscal consolidation during the economic upturn and use extra revenue generated during the upswing in the economic cycle to cut budget deficit and reduce debt rather than to boost current expenditure. As the GG structural deficit was gradually growing during this period, the country's fiscal position should be seen as constantly loosening. This situation lasted until 2009, when the GG revenues fell significantly following a deep recession of the economy, while the reduction of expenditure started only in the second half of the year. Although this reduction did not match (was markedly lower) the decline in revenues, but together with higher taxes it helped to stabilise the growth of structural deficit keeping the fiscal impulse broadly unchanged. Therefore, the 2009 fiscal policy should be seen as neutral. However, Chart B shows that the real GDP was well below the potential one and, from macroeconomic point of view, the higher GG consumption expenditure had a positive impact on GDP as it partly offset a decline in private consumption and investments. Lithuania's fiscal policy in 2010 is seen as pro-cyclical because of a negative fiscal impulse for the economy as a result of a decline in the GG structural deficit over the year and the real GDP remaining lower than the potential one. The initiated excessive deficit procedure for Lithuania and attempts to secure international funding for debt servicing were main reasons for the government to retrench expenditure. Social payments and compensation to GG employees were the main drivers behind the expenditure reduction. Lithuania's economy recovered in 2011, but the GDP gap continued to be negative. The fiscal impulse was also negative because of the decreased

structural deficit. Higher revenues were the main contributor to the structural deficit decrease as only a small portion of their increase should be considered cyclical due to the favourable composition effect. No extra decisions have been made, which could lead to a further reduction in expenditures. But improved situation in the labour market led to the reduction of unemployment benefits. Therefore, the fiscal policy for this period should be seen as pro-cyclical.

To sum it up, one can conclude that the reference period from 1999 to 2011 in principle can be divided into three phases. In the period from 1999 to 2003, the fiscal policy impact on the economy was heterogeneous. Between 2001 and 2003, fiscal policy was close to neutral, while in 2000 to 2002 it was pro-cyclical preventing economic activity from gaining momentum. The second phase, which is characterised by continuous increase in the policy pro-cyclicality, spans from 2004 to 2008. A high degree of pro-cyclicality of fiscal policy during this period was characteristic also for other EU countries, the euro area included. According to S. Deroose, M. Larch and A. Schaechter (2008)[6], a degree of the pro-cyclicality in the euro area countries in 1999 to 2007 was higher than in the US. Too optimistic approach by policy makers to the rapid recovery of national economy or its fast growth in the future is mentioned as one of the major reasons for the above said. The third phase, which is characterised by a rapid decrease in structural deficit, spans from 2009 to 2011, but the fiscal policy impact should be seen as pro-cyclical. During the said period, it was characteristic of many European countries. Saving measures to consolidate public finances were introduced in many of them after financial crisis developed into a sovereign debt crisis and economic activity was well below its potential.

[1] Under the assumption that temporary and one off measures are absent.
[2] This margin can be raised to 1 per cent of GDP only for the countries in which the GG debt is significantly lower than 60 per cent of GDP and forecast dynamics is sustainable in the long-term.
[3] Bouthevillian C., Cour-Thimann P., Van den Dool G., De Cos P. H., Langenus G., Mohr M., Momigliano S., Tujula M. (2001) Cyclically adjusted budget balances: an alternative approach, ECB Work Paper, No. 077.
[4] In this box elasticity is understood as the ratio of the analysed GG revenue (or expenditure) item and average annual changes in its macroeconomic base.
[5] Wyplosz Ch., Krogstrup S. (2009) A common pool theory of supranational deficit ceilings. Author's accepted manuscript, p. 3–4.
[6] Deroose S., Larch M., Schaechter A. (2008) Constricted, lame and pro-cyclical? Fiscal policy in the euro area revisited, Economic Papers, Nr. 353, p. 25–26.

ANNEX

FURTHER ANALYSIS OF SOCIAL ACCOUNTING MATRICES (SAM): FLOW OF FINANCIAL FUNDS TABLE

For the analysis of the flow of financial funds in the economy, e. g., means of household saving, financing of public deficit, sources of enterprise borrowing, etc., the table of flow of financial funds is often used. A description of the main compilation principles and entries of this table, as well as a possible case of its application will be given below.

The number of accounts used in the table depends on its purpose. However, the flow of financial funds table most often covers two main account groups – domestic institutions and rest of the world. The first group covers households, general government, central bank, financial corporations, excluding the central bank (hereinafter referred to as banks), and non-financial enterprises (hereinafter referred to as enterprises). The main statistical source of the flow of financial funds table is financial accounts compiled and published by the Bank of Lithuania. Financial accounts are a composite part of the system of national accounts.

The columns of the flow of financial funds table reflect changes of the assets of respective institutions, while rows show changes of liabilities. Table A presents the main financial transactions between separate accounts. For example, asset changes in government account due to financial transactions (G account column), should be interpreted in the following way: public sector may issue loans to the same sector (e.g., central government has issued loans to social security funds), and make transactions in deposit accounts that are open in central bank and commercial banks, as well as foreign institutions. From the end of 2008, public institutions started to carry out financial derivatives transactions in domestic commercial banks and abroad. In the table, they fall under the entry of debt securities (hereinafter referred to as DS). Public sector has also issued loans to non-financial enterprises (e.g., state enterprises), it may also buy and sell shares of the companies. Other accounts receivable reflect changes of government financial claims to non-financial companies, banks and foreign institutions.

The same principle is used to interpret the changes in government liabilities (row of G account): public institutions may receive loans from the same sector (e.g., social security funds have loans from the central government), also from commercial banks and foreign institutions. Households, companies, banks and foreign institutions carry out transactions in government DS, households also have a possibility to acquire government saving notes. Finally, there are also other accounts payable: in the case of enterprises, most often these are changes of trade credits and advances payable by public sector institutions, in the case of households and foreign institutions – other financial liabilities (claims)[7].

Turning to the central bank account, basically all central bank liabilities (the row of CB account) are comprised of cash and bank deposits (requirement reserves of banks and their surplus). All banknotes and coins in circulation are central bank liabilities to respective accounts (cash is hold by households, banks and other enterprises). Moreover, apart from the commercial banks, government and foreign institutions also have accounts in the central bank.

Transactions of these liabilities are outlined in the table of flow of financial funds (table A). Almost all asset transactions of central bank (the column of CB account) lie in the account of rest of the world: transactions in monetary gold held abroad and Special Drawing Rights (SDRs), transactions in DS of foreign institutions, as well as flows of deposits and loans[8] are entered here. Overall, in the context of a fixed exchange rate system in the country, the balance sheet of the assets side of the central bank is basically only foreign reserve assets.

[7] This entry occurs due to time differences between accumulated transactions and executed payments, e. g., payable (receivable) taxes, also insurance contributions, wages, dividends, etc.

[8] Two entries of transactions (of deposits and loans) in both cases are mainly central bank deposits held abroad. Different entries occur due to methodological specifics.

Table A. Entries of the main flows of financial funds table

		Accounts of domestic institutions					Rest of the world account
		G (govern-ment)	**H** (households)	**CB** (central bank)	**B** (banks and other financial institutions)	**F** (enterprises)	**ROW** (rest of the world)
Accounts of domestic institutions	**G** (govern-ment)	Loans	Saving notes Debt securities Other accounts payable (receivable)		Loans Debt securities	Debt securities Other accounts receivable (payable)	Loans Debt securities (eurobonds) Other accounts receivable (payable)
	H (house-holds)				Loans Other accounts receivable (payable)	Other accounts receivable (payable)	
	CB (central bank)	Deposits	Cash		Cash Required reserves (and their surplus)	Cash	Deposits of foreign institutions
	B (banks and other financial institutions)	Deposits Debt securities	Deposits Shares and debt securities Insurance technical reserves[9]	Loans	Deposits Loans Shares and debt securities Insurance technical reserves	Deposits Shares and debt securities Other accounts receivable (payable) Insurance technical reserves	Deposits Loans Shares and debt securities Other accounts receivable (payable)
	F (enter-prises)	Loans Shares Other accounts receivable (payable)	Shares and debt securities Other accounts receivable (payable)		Loans Shares and debt securities Other accounts receivable (payable)	Loans Shares and debt securities Other accounts receivable (payable)	Loans Shares and debt securities Other accounts receivable (payable)
Rest of the world account	**ROW** (rest of the world)	Deposits Debt securities Other accounts receivable (payable)	Deposits Shares and debt securities	Deposits Loans Debt securities Monetary gold and SDRs	Cash in foreign exchange Deposits and loans Shares and debt securities Insurance technical reserves	Deposits Loans Shares and debt securities Other accounts receivable (payable)	

[9] Insurance technical reserves are funds accumulated in life and non-life insurance reserves.

Flow of financial funds table in 2010

Because of its convenient form and aggregated information, the table of flow of financial funds is useful for the assessment of the financial situation in the country. Besides, monthly financial data may be used for the approximate analysis of the current situation when aggregate quarterly macroeconomic statistics is still unavailable.

The flow of financial funds in 2010 is presented in Table B. It indicates that private sector debt decreased the most: banks returned about LTL 10 billion of loans to their parent banks abroad, this flow was financed by the repayment of loans by corporate sector and households (about LTL 7 billion), also by attracting more deposits to the banks from other domestic sectors (enterprises, households and government). Public sector increased the deposits held in the central bank and abroad mainly by issuing Eurobonds (i.e. by borrowing abroad). Moreover, in 2010 the households were rather active in selling shares of enterprises (unquoted in particular) to other private sectors. This may be related to their complicated financial situation. Difficult economic conditions were also a reason of a significant reduction of the authorised capital of the enterprises.

Below is the description of the main liability transactions of each account[10]:

1. **Government.** In 2010, the central government issued long-term loans, the majority of which (about 97%) were allocated to social security funds and the other part – to local government. Public sector (mainly central government) also received loans (over LTL 2 bn): approximately LTL 1 billion of short-term loans from domestic commercial banks and more than LTL 1 billion long-term loans – from abroad or, to be more precise, from the European Investment Bank (this is a part of the loan obtained in accordance with the loan agreement signed in March 2009, which guaranteed the funds for the government to co-finance the EU-funded projects). Nonetheless, public sector liabilities increased mostly (almost by LTL 6 bn) due to the Eurobond issues of the central government.
2. **Households.** In 2010, households returned to banks almost LTL 1.7 billion of loans, most of them was long-term.
3. **Central bank.** Cash in circulation in 2010 increased by about LTL 0.8 billion, it was held by households. Besides, commercial bank reserves held at the Bank of Lithuania grew by approximately LTL 1.2 billion.
4. **Banks.** Throughout 2010, domestic institutions quite strongly (in total about LTL 4 bn) increased their deposits in the banking system. Public sector deposits in the banking system rose by about LTL 0.9 billion, household deposits – by 1.4 and deposits of non-financial enterprises grew by LTL 1.9 billion. At the same time, the banks reduced their foreign liabilities, in large part – by repaying loans to their parent institutions (due to methodological specifics these amounts may be shown as loans or deposits). Total reduction of the banks' foreign liabilities accounted for almost LTL 11 billion.
5. **Enterprises.** Non-financial enterprises reduced their liabilities at a rapid pace as well. They repaid to banks and other financial intermediaries (e.g., leasing companies) loans of more than LTL 5 billion. Corporate sector liabilities to households dropped by about LTL 5.8 billion: partly because of the fact that households sold company shares to other institutions (e.g., enterprises, banks and foreign institutions bought shares amounting LTL 3.6 bn), also because of a reduction of the authorised capital of enterprises. Non-financial corporate sector, however, increased their other financial liabilities abroad (by about LTL 2 bn), mainly as debt for goods and services (trade credit).
6. **Rest of the world.** Although commercial banks reduced their deposits held abroad in 2010, the deposits of other sectors increased (by LTL 0.8 bn held by the Bank of Lithuania, by LTL 0.6 bn held by the public sector and by LTL 0.5 bn held by non-financial enterprises). Quite a large amount (LTL 1.2 bn) is reflected in the entry of foreign shares owned by domestic banking sector – these were mostly pension fund investments. Other liabilities of the foreign institutions rose by almost LTL 2 billion: liabilities to enterprises reflect trade credits and advances, liabilities to public sector mostly indicate the EU funds payable to agriculture.

The last row of the table (the difference between financial transactions of assets and liabilities) reflects net lending (borrowing): in 2010, the largest amount – almost LTL 11 billion – was saved by non-financial enterprises, while public sector was the largest borrower (the deficit of LTL 6.8 bn). Net savings (LTL 5.3 bn) of the domestic institutions is equal to the surplus of the current and capital accounts.

[10] Asset transactions are not described due to repeating entries: in the table, assets of one institution are liabilities of another.

Table B. Table of flow of financial funds in Lithuania, 2010
(LTL mln.)

		G (government)	H (households)	CB (central bank)	B (banks)	F (enterprises)	ROW (rest of the world)	Total
G (govern-ment)	Cash in circulation							
	Deposits							
	Loans	1708			1009		1201	**3918**
	Shares							
	Debt securities		659		609	–223	5928	**6974**
	Insurance technical reserves							
	Other accounts receivable (payable)					–268	182	**–86**
	Total	**1708**	**659**	**0**	**1618**	**–491**	**7311**	**10805**
H (house-holds)	Cash in circulation							
	Deposits							
	Loans				–1651			**–1651**
	Shares							
	Debt securities							
	Insurance technical reserves							
	Other accounts receivable (payable)					575		**575**
	Total	**0**	**0**	**0**	**–1651**	**575**	**0**	**–1076**
CB (central bank)	Cash in circulation		836					**836**
	Deposits	–191			1238		164	**1210**
	Loans							
	Shares							
	Debt securities							
	Insurance technical reserves							
	Other accounts receivable (payable)							
	Total	**–191**	**836**	**0**	**1238**	**0**	**164**	**2047**
B (banks)	Cash in circulation							
	Deposits	859	1438		–124	1876	–6526	**–2477**
	Loans				385		–3411	**–3026**
	Shares		164		218	231	–138	**475**
	Debt securities	63	–650		–180	–223	–349	**–1338**
	Insurance technical reserves		153			–138		**16**
	Other accounts receivable (payable)					335	–330	**5**
	Total	**922**	**1106**	**0**	**300**	**2082**	**–10754**	**–6345**
F (enter-prises)	Cash in circulation							
	Deposits							
	Loans	–178			–5125	557	95	**–4651**
	Shares	–52	–5794		777	2094	717	**–2258**
	Debt securities				–250			**–250**
	Insurance technical reserves							
	Other accounts receivable (payable)	343	437			–544	2051	**2286**
	Total	**113**	**–5357**	**0**	**–4599**	**2107**	**2862**	**–4873**
ROW (rest of the world)	Monetary gold and SDRs							
	Deposits	627		784	–1881	521		**50**
	Loans			1315	370			**1685**
	Shares		433		1167	72		**1673**
	Debt securities	–140	–143		–321	124		**–480**
	Insurance technical reserves							
	Other accounts receivable (payable)	1013				946		**1959**
	Total	**1500**	**290**	**2099**	**–665**	**1663**	**0**	**4887**
	Transactions in financial assets	**4051**	**–2465**	**2099**	**–3760**	**5937**	**–417**	**5446**
	Transactions in financial liabilities	**10805**	**–1076**	**2047**	**–6345**	**–4873**	**4887**	**5446**
	Difference*	–6754	–1389	52	2585	10810	–5304	0

* A positive number indicates net lending (savings), a negative one – net borrowing.

Note: to simplify the table of flow of financial funds, the entries up to LTL 50 million were excluded.

Application of the flow of financial funds table for the economic analysis: an example

The Economics Department of the Bank of Lithuania uses a simplified table of flow of financial funds as one of the methods to asses general government balance due to a late (3 months after the end of a reporting period) publication of quarterly general government financial data. The analysis uses monthly data of the central bank and other MFI balance sheets, balance of payments, deposits of residents (except MFIs) with other MFIs, loans of other MFIs to residents (except MFIs), also the monthly statistics of the government borrowing, published by the Ministry of Finance of the Republic of Lithuania.

General government liabilities (see Table C) rose by LTL 4.5 billion in January–February 2012. The largest part of liability increase occurred due of the Eurobond issue in the foreign markets (more than LTL 4.2 bn). Within the first two months of 2012, public sector received about LTL 360 million loans from foreign institutions, but more than LTL 100 million was repaid to domestic commercial banks. The deposit row indicates saving notes bought by Lithuania's households (in two months of this year – for almost LTL 30 m).

Table C. Simplified table of general government flow of financial funds, January–February 2012 (LTL mln.)

		G (government)	H (households)	CB (central bank)	B (banks)	F (enterprises)	ROW (rest of the world)	Total
G (govern-ment)	Deposits		29					**29**
	Loans				–110		357	**247**
	Debt securities			41	144	–188	4242	**4240**
	Total	**0**	**29**	**41**	**34**	**–188**	**4599**	**4516**
H (households)	Deposits							
	Loans							
	Debt securities							
	Total	**0**						
CB (central bank)	Deposits	3445						
	Loans							
	Debt securities							
	Total	**3445**						
B (banks)	Deposits	658						
	Loans							
	Debt securities							
	Total	**658**						
F (enterprises)	Deposits							
	Loans							
	Debt securities							
	Total	**0**						
ROW (rest of the world)	Deposits	–449						
	Loans							
	Debt securities							
	Total	**–449**						
Transactions in financial assets		**3654**						
Transactions in financial liabilities		**4516**						
Difference		–862						

In January–February 2012, the general government assets have increased. Although deposits held by public institutions abroad have declined, those held in the central bank (by more than LTL 3.4 bn) and the commercial banks (by about LTL 660 m) have increased substantially. The difference between transactions of general government financial assets and liabilities allows roughly estimating its balance, which accounted for LTL 860 million or 0.8 per cent of the projected annual GDP in January–February 2012. It should also be noted, however, that there are several reasons why the actual general government balance of the first quarter will differ from the estimated balance based on the monthly data. Firstly, the statistics for March is still unavailable; secondly, there is no monthly data of other government financial liabilities and claims (i.e. other accounts receivable (payable)). Moreover, there also are some methodological issues (most of the statistical indicators are calculated on the accrual basis; however, monthly government borrowing data is compiled on the cash-flow principle).