LITHUANIA

Highlights

- **The economy has returned to its pre-Covid-19 crisis level.** Stable goods exports and a fast recovery in consumption meant that gross domestic product (GDP) in 2020 was similar to 2019 levels. A swift improvement in industry contributed to a broad recovery in the first half of 2021.
- **Developing wind and solar energy plants and rising digitalisation stand out as main priorities in the government's recovery plan.** It is projected that 38 per cent of the €2.2 billion plan, financed through the European Union (EU)'s Recovery and Resilience Facility (RRF), will be invested in clean energy and an increasing share of energy efficient transport. A broader high-speed internet network will support an increase in digitalisation.
- **The government introduced new incentives for scaling up investments.** To strengthen competitiveness, special tax-exempt conditions, including a corporate tax exemption for a period of up to 20 years, will be offered to large-scale investors in strategic business areas, such as the manufacturing, information and communication technology (ICT) and science sectors.

Key priorities for 2022

- **Social and labour disparities should be better addressed.** Priorities include further investment in education in rural regions, re-training and increasing digital services and teleworking.
- **Energy sustainability needs further strengthening.** Following the need to increase the domestic production of electricity, important aspects of the country's energy strategy include implementing the announced offshore wind farms in the Baltic Sea and promoting renewable energy sources.
- **The five-year development plan for the fintech sector should be implemented vigorously.** After a steadily growing number of licences for electronic money institutions, the Ministry of Finance has announced the creation of a development plan for the fintech sector. Successful implementation could attract new investment and strengthen competencies in supervisory institutions, with an emphasis on anti-money laundering and counter-terrorist financing by strengthening governance, internal controls and the compliance culture.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.3	4.0	4.6	-0.1	4.5
Inflation (average)	3.7	2.5	2.2	1.1	3.0
Government balance/GDP	0.4	0.5	0.5	-7.2	-5.2
Current account balance/GDP	0.5	0.3	3.5	7.3	6.7
Net FDI/GDP [neg. sign = inflows]	-2.0	-0.5	-2.3	-1.1	-1.3
External debt/GDP	82.6	78.3	70.1	75.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	41.0	40.5	39.6	37.8	n.a.

CONTINUES

Covid-19: macroeconomic implications

After one of the mildest GDP downturns in the EU in 2020, the economy is recovering strongly in 2021. Due to Lithuania's stable export sector and targeted government measures, annual GDP was similar to 2019 levels, with a decline of just 0.1 per cent in 2020. A recovery in domestic demand, together with the strengthening of manufacturing and exports, drove strong GDP growth of 5.0 per cent year-on-year in the first half of 2021. Industrial production in the second quarter of 2021 was also above the level seen in 2019. Retail trade turnover, which fell during 2020, has bounced back strongly.

A shortage of skilled labour contributed to higher wages and inflation. Unemployment reached 9.9 per cent in September 2020, falling to 7.2 per cent by August 2021 but still above pre-Covid-19 crisis levels. Labour market mismatches have led to a lack of skilled labour, putting a strong pressure on wages and contributing to an elevated inflation rate. However, the current sharp increase in annual inflation, which stood at 6.4 per cent in September 2021, is mostly driven by external factors.

After four consecutive years of surplus, the general government balance turned negative in 2020. Increased government expenditure, especially on social protection, healthcare and subsidies, contributed to a general government deficit of 7.2 per cent of GDP in 2020. Public debt increased to 46.6 per cent of GDP as of the end of 2020, versus 35.9 per cent in 2019. As the economy and tax revenues are growing again, the government plans to increase its expenditure, with additional funds allocated to social protection and government sector wage increases. The government aims to return to a balanced budget in the medium term, projecting a 0.5 per cent of GDP deficit in 2024.

Investment is likely to support the economic recovery. GDP growth is likely to reach 4.5 per cent this year, boosted by accelerated public sector investment, and to slow somewhat to 4.0 per cent in 2022. However, exports, especially of services, are likely to be further negatively affected by the sanctions placed on Belarus by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury in August 2021. About one-third of all freight at Lithuanian ports is from Belarus, in particular, potassium chloride, which is used in fertiliser production; its loss is estimated to cost Lithuania approximately 0.4 per cent of GDP.

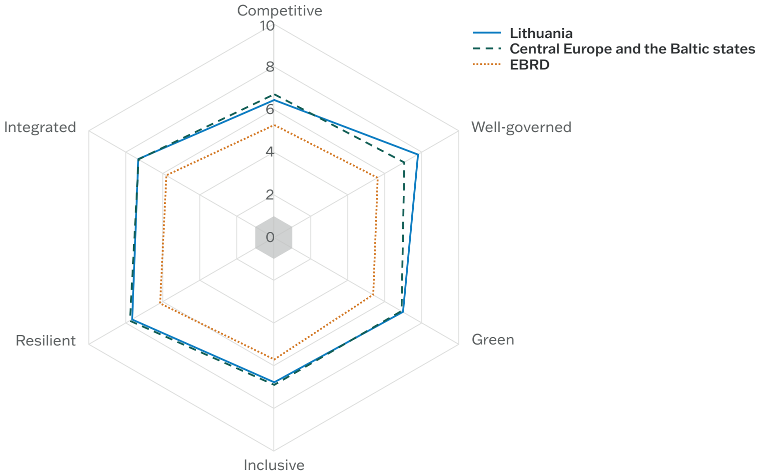
Policy response to Covid-19

The government's policy response to Covid-19 has been comprehensive. With the fiscal support packages implemented in 2020, which accounted for around 6 per cent of GDP, Lithuania has managed to support the health system and compensate for most of the losses in affected sectors, such as the services sector. Employment was supported by job retention schemes, subsidised rates for enterprises and allowances for the self-employed. At the same time, vulnerable groups, such as pensioners, the unemployed and social benefit recipients, received a one-off payment of €200. A temporary deferral of credit obligations for private clients affected by the Covid-19 crisis remained in place until March 2021.

The 2021 budget has earmarked around €1.7 billion to support the post-Covid-19 crisis recovery. In December 2020 parliament adopted the 2021 budget, which included almost 6 per cent of GDP for the mitigation of Covid-19 pandemic effects and financial recovery support. The largest part of it was dedicated to subsidies during downtime and sickness for workers and the self-employed. Additional grants, soft loans and partial interest compensation were offered to crisis-affected companies, and funds for medical bonuses and the purchase of Covid-19 vaccines and tests and medical equipment were also provided. The national budget was revised in May 2021 and an additional €581 million was allocated to the healthcare sector and social security. In July 2021 the government issued a 30-year Eurobond worth €750 million, with the annual coupon set at 0.75 per cent.

CONTINUES

Assessment of transition qualities (1-10)



Structural reform developments

Lithuania's RRF plan aims to support long-term sustainable growth. It is projected that 38 per cent of the €2.2 billion in grants will be invested in meeting climate targets through developing offshore and onshore wind and solar power and storage facilities (€242 million), increasing the share of clean public transport from 9 to 18 per cent, and bringing about a 15-fold growth of charging points for electrical cars. Digitalisation will be additionally addressed through an allocation of €70 million for broadening the high-speed network and 5G development. Long-term challenges related to learning outcomes, vocational education and upskilling will be addressed with projects worth a combined €312 million.

The Centre of Excellence in Anti-Money Laundering has begun its work. As a model of public- and private-sector collaboration in identifying and managing the risks of money laundering, the Centre of Excellence in Anti-Money Laundering started its activities in May 2021. It was collectively established by the Ministry of Finance, the Bank of Lithuania and other commercial banks, with the aim of collecting, analysing and sharing information on types of money laundering and terrorist financing (ML/TF) typologies through a special information platform at the national level. The centre will work, among other priorities, on guidelines and policy proposals to tackle ML/TF activities, as well as organise training programmes and strengthen the competencies of the public and private sectors in the ML/TF field.

New measures to attract foreign direct investment (FDI) are in place. In April 2021 the government approved a comprehensive mechanism that will ease administrative procedures for investors. Large investors in manufacturing, ICT or data processing that create at least 150 jobs and invest €20 million in fixed assets outside of the capital city, or create 200 jobs and put €30 million in fixed assets in Vilnius, can benefit from a corporate tax exemption for 20 years.

Support to small and medium-sized enterprises (SMEs) has been stepped up. The SME sector accounts for 99.6 per cent of all enterprises and more than 70 per cent of total employees. With a growing share of micro enterprises, companies operate mostly in the trade and transport sectors. SMEs in Lithuania tend to use traditional funding measures and, according to a Bank of Lithuania survey in 2019, more than 50 per cent of SMEs were not satisfied with credit conditions and access to capital. Following the signing of two guarantee agreements with the European Investment Fund for a maximum of €50 million in April 2021, the financial intermediary PayRay Bank will be able to offer SME financing for a period of three months to 10 years, with a loan amount per entity of up to €6 million.

CONTINUES

The government adopted the Renovation Strategy 2050. Together with the long-term strategy Lithuania 2050, the authorities are targeting climate-neutral building renovation, while preserving biodiversity. In line with the country's green transition goals, the Lithuanian Public Investment Development Agency (VIPA) signed a €67.5 million loan with the European Bank for Reconstruction and Development (EBRD) in August 2021. It is expected that the energy efficiency of old residential buildings in Lithuania will increase by at least 40 per cent.

Energy security and sustainability stand high on the national and regional agenda. Together with Estonia and Latvia, Lithuania continues to integrate its power system into Continental Europe's. After European Energy began building a wind farm of 49.5 MW capacity in August 2021, the government approved legislation which will enable the development of a 700 MW offshore wind farm in the Baltic Sea, with a possible first tender in 2023. By 2030 the government plans to produce 70 per cent of the country's electricity needs domestically.