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Statement by Mr. Hendrick and Ms. Bustillo on Republic of Lithuania (Preliminary) Executive Board Meeting August 28, 2023

We thank the staff for a detailed report and Mr. Vasiliauskas and Mr. Kraavik for their helpful Buff statement.

1. **Lithuania recovered rapidly from the pandemic and weathered well successive external shocks owing to a decisive policy response.** However, supply side bottlenecks and increases in commodity prices have resulted in high inflation and, in the last quarter of 2022 and early 2023, the economy contracted. We agree that the policy priority should be to mitigate inflationary pressures and address key structural challenges, including supporting productivity gains, and mitigating demographic trends. We concur with the main findings of the report, as well as with the thrust of its recommendations, and would like to offer the following comments for emphasis.

2. **Fiscal policy should support the disinflationary effort.** We agree with staff that fiscal policy has a significant role to play in containing inflation risks, but close attention should be paid to the evolution of economic activity. We thus welcome that the fiscal adjustment will strike a balance between facilitating disinflation and supporting growth, as noted in the Buff statement. In this context, saving any revenue overperformance and savings from lower-than-budgeted energy subsidies in 2023 will be key. Going forward, fiscal policies should be aimed at ensuring sustainability in the medium term, which highlights the need for additional revenue measures to offset structural increases in current expenditures. We welcome the proposed tax reform, including the broadening of the tax base and measures to support the environment.

3. **We see merit in the Bank of Lithuania's view that the evidence on the monetary conditions being too loose is not conclusive and is not easy to measure.** As explained in the Buff, Lithuania is still a converging euro area member state, with very rapid income growth. The arguments about the difficulties of the calculation of the appropriate monetary conditions, valid for any country, are real and more complex for countries belonging to a monetary union. We take note that the assessment about the external position being weaker than fundamentals in 2022 is largely a temporary factor, as stated by staff and the authorities.

4. **Preserving financial stability is a key priority**. Banks remain highly liquid, well capitalized, and profitable but vulnerabilities associated with a weakening economy and higher interest rates should be monitored in a context of still high uncertainty. We concur with staff that the levy on banks should be temporary to minimize potential negative impacts on efficiency. In this regard, it is reassuring that the authorities emphasize its temporary nature and its non-distortionary design. Finally, we welcome the authorities' commitment and steps taken to continue monitoring risks associated with the expansion and evolution of the fintech sector, including the National Development Plan for the Fintech-Sector 2023-2028.

5. **Structural reforms to further enhance productivity growth and support higher living standards.** We welcome the authorities' reform efforts in health, education, innovation, and green transition. In particular, we concur with staff that accelerating ongoing reforms is critical to improve the country's growth potential and social outcomes in the context of population aging. In addition, we welcome the ambitious green transition, including the goal of renewables fully covering the domestic electricity demand by 2030.