

GENERAL
GOVERNMENT
DEBT • 2008

FOREWORD

For several recent years Lithuania has been experiencing a cycle of economic boom. However, after a complicated economic situation developed in the whole world, global trade and industry were damaged – the Lithuanian economy, likewise of other EU countries, is undergoing downturn. National gross domestic product, which was increasing on an average by about eight per cent every year, last year over the IVth quarter declined by 2.2 % (over the year it went up by 3 % as compared to the year 2007). Therefore, one of the major objectives of the Government of the Republic of Lithuania became to stop the economic downturn and essentially improve the situation in the areas that can ensure an economic breakthrough.

Subject to the Lithuanian economy being open and small, an accelerated growth of internal demand in recent years predetermined the increase in import and current account deficit. In 2008 the level of the current account deficit decreased from 14.6 % of GDP in 2007 to 11.6 % of GDP in 2008. This demonstrates that multi-annual economic unbalancing having formed due to a rapid economic development is sharply declining.

Although the Lithuanian economy underwent not the best times, the level of the general government debt in Lithuania still further remained one of the lowest among the EU Member States. Its ratio of GDP is decreasing for already eight years in turn. In end-2008 the general government debt made up LTL 17,374.8

million or represented 15.6 % of GDP. Over a year the debt increased by LTL 676.8 million, and due to GDP growth its ratio of GDP reduced by 1.4 percentage point (in 2007 the general government debt represented 17 % of GDP).

In end-2008 the general government debt was comprised of: central government debt – LTL 16,052.4 million, local government debt – LTL 1,236.5 million, and the debt of social security funds – LTL 85.9 million.

Following the Government Borrowing and Debt Management Strategy updated in September 2008, key objectives of the Government borrowing remained borrowing at the least possible costs, reduction of the risks related to undefined government debt liabilities, and striving for liquidity of Government securities. However, the confusion that arose on financial markets in the second half-year of the same year reduced the borrowing possibilities also for our country and increased the costs. In 2008 the Government borrowed LTL 3.1 billion, and that was by LTL 0.8 billion less than in 2007.

We believe that this publication will provide you with useful information on the Government borrowing and general government debt.

Ministry of Finance

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LITHUANIA'S ECONOMIC DEVELOPMENT

Macroeconomic Review

Until a year of 2008 Lithuania's economy was one of the fastest-growing in the European Union, but last year it moved to the stage of slowdown. As compared to GDP generated in 2007, a real GDP of 2008 increased by 3 %. The biggest decline in value added was observed in the last quarter of the previous year. Gross domestic product created in the country in 2008 amounted to LTL 111.50 billion.

In 2008 growth rate of value added in the sectors of financial intermediation and real estate (4.4 %), retail, hotels and restaurants, transportation and communication (4.4 %), as well as public service (3.2 %) were higher than the overall growth rate of GDP.

As the economy was cooling down, more moderate trends in a revenue growth were observed. Consumer spending and foreign trade balance were influenced respectively. Household consumption spending increased by 4.7 % in 2008 and the exports of goods and services grew faster (11.3 %) compared with imports (10 %). Stabilized wage growth of 20.6 % in 2008 (21.2 % in 2007), as well as increase in unemployment (5.8 %) led to moderate household consumption expenditure growth.

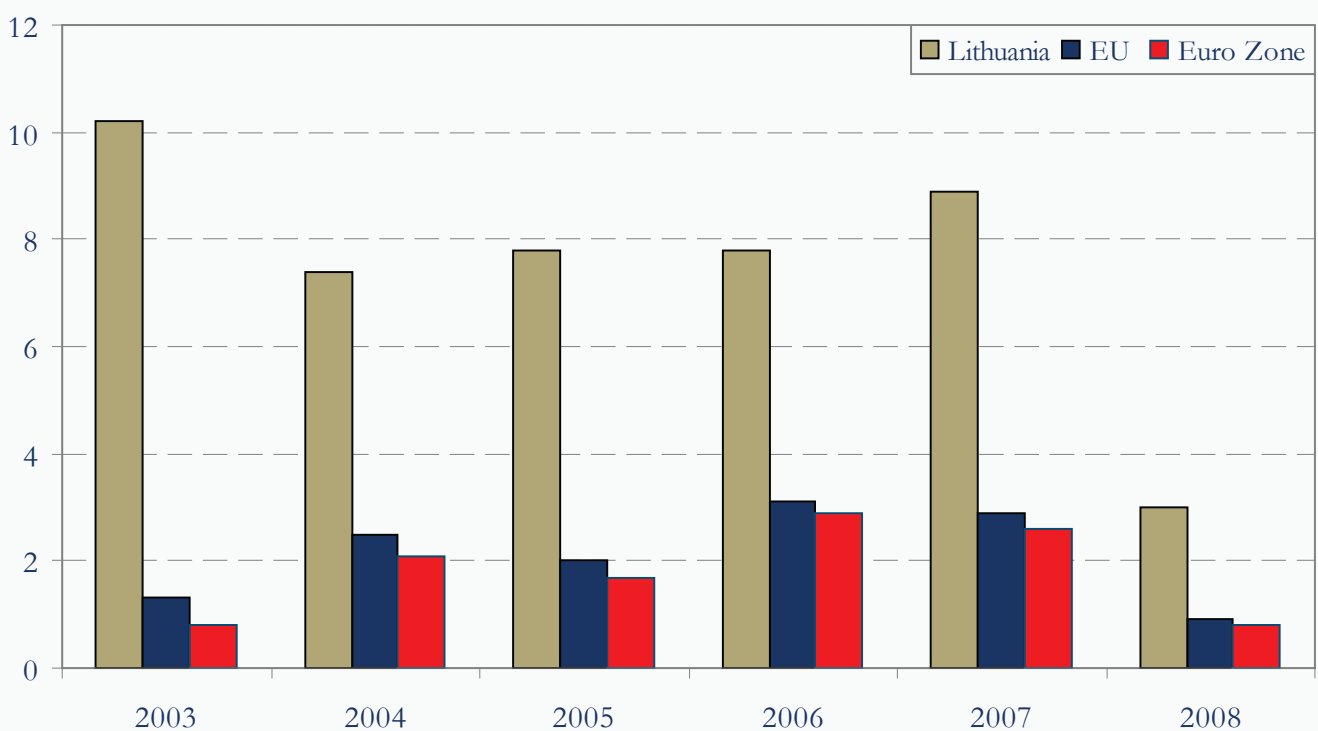
Because of the Government's prudent expenditure policies a real general government consumption expenditure increased moderately (4.3 %).

The general government debt decreased from 17.0 % of GDP in 2007 to 15.6 % of GDP in 2008 remaining one of the smallest in European Union and significantly below the level set by Maastricht criteria. Last year, the general government deficit in the European System of Accounts (ESS'95) methodology accounted for 3.2 % of GDP and slightly above the Maastricht criteria while the tax revenues because of the economy's slowdown were lower than projected.

Accelerated expansion of domestic demand in recent years due to an open and small Lithuanian economy caused an increase in imports and the current account deficit. In 2008, by preliminary estimates, the current account deficit went down to 13 % of GDP from 14.6 % of GDP in year 2007. It indicates declining economic imbalances.

Since July 2008, annual inflation in Lithuania has been declining an average of 0.7 percentage point per month. Deflation beginning in 2008 affected the price change in all the main groups of goods and services (state regulated price, food and beverages, fuel, services and industrial goods). According the currency board principles

Chart 1. GDP growth in Lithuania and the European Union, %



Source: Eurostat

fixed exchange rate ensures the long-term average inflation to remain close to the euro-zone inflation. Harmonised average annual inflation in 2008 was 11.1 %.

Lithuania's foreign trade deficit in 2008 amounted to LTL 17115.8 million and was by 6.5 % lower than in 2007. Lithuanian exports grew faster (28.4 %) compared to the imports of goods into Lithuania (18 %). The most significant impact on export growth was 2.4-

fold increase in exports of mineral products. Exports of goods excluding mineral products in 2008 increased by 11.6 % while imports by 0.2 %. Most of Lithuanian exports were directed to EU countries (60.3 % of total Lithuanian exports). In 2008, major Lithuanian export partners were Russia (16.1 %), Latvia (11.6 %), Germany (7.2 %), Poland (5.8 %). Major import partners - Russia (30.1 %), Germany (11.7 %), Poland (10 %), Latvia (5.2 %).

Table 1. Macroeconomic Indicators

Indicators	2003	2004	2005	2006	2007	2008
Real GDP growth, %	10.2	7.4	7.8	7.8	8.9	3.0
Inflation (average annual), %	-1.1	1.2	2.7	3.8	5.8	11.1
Inflation (annual), %	-1.3	2.9	3.0	4.5	8.2	8.5
Current account balance, % of GDP	-6.8	-7.7	-7.1	-10.6	-14.6	-11.6
Unemployment rate, % (acc. to the data of labour force survey)	12.4	11.4	8.3	5.6	4.3	5.8
Growth of exports of goods based on customs declaration data, %	11.2	21.4	26.9	18.7	11.1	28.4
Growth of imports of goods based on customs declaration data, %	7.1	16.8	25.5	23.5	15.4	18.0

Source: Department of Statistics, Bank of Lithuania

Credit Ratings

Credit rating is an important indicator in assessing the risk of default by the issuer (borrower). The rating provides investors (creditors) with focused information on the creditworthiness of the issuer. Thus, higher credit ratings assigned to the issuer reduce borrowing costs, i.e. enable to borrow with a lower risk premium.

In 2008, two international credit rating agencies - Standard & Poor's and Fitch Ratings - cut Lithuanian long-

term foreign currency rating by two notches - from the 'A' to 'BBB +' and left the negative rating outlook. The other rating agency - Moody's - changed the credit rating outlook from stable to negative, but the rating 'A2' remained unchanged. These include the most important reasons for the rating change - the increasing risk of significant economic downturn in Lithuania while facing global financial crisis, deteriorating public finances and increasing risk in external sector. It is also to be mentioned - although the ratings were cut Lithuania remains among the investment grade countries.

GOVERNMENT BORROWING STRATEGY

In September 2008 Government borrowing and debt management strategy was updated, the existing risk limits related to public debt were tightened (short-term debt by residual maturity and debt under floating interest rate) and set the new ones (weighted average term to maturity and financial *Macaulay* duration of debt).

The most important goal of the Government of Republic of Lithuania in borrowing as well as in public debt management policy in the medium-term is to ensure lowest possible costs and acceptable risk in accordance with the requirements applied to European Union Member States striving Euro adoption.

In 2008, the Government, in accordance with the bor-

rowing and debt management strategy, funded bulk part of the borrowing requirement by issuing securities in domestic and foreign markets. To balance the states cash flows short-term borrowing instruments were used as well.

The turmoil in foreign financial markets which began in the second half of 2008 and worsening economic situation of Lithuania influenced borrowing capabilities of government and the borrowing costs. Therefore the planned Eurobond issue was not launched, but in general government borrowing strategy remained unaltered.

It is foreseen to renew the Government medium-term borrowing and debt management strategy in 2009.

Government's medium-term borrowing and debt management objectives:

- 1) to maintain acceptable interest rate, refinancing and exchange rate risks in accordance with the international practice, the expected government borrowing requirement and the actual risk indicators;
- 2) to improve the liquidity of Government's securities (GS – thereafter);
- 3) to reduce the State risks associated with undetermined obligations;
- 4) effectively manage public financial resources;
- 5) to develop measures to collect the resources to repay debts of large scope in order to reduce refinancing risk in the future.

GOVERNMENT BORROWING

Government Borrowing Requirement

In 2008 the Government borrowing requirement amounted to LTL 3.1 billion (it was by LTL 0.8 billion lower than in 2007), while total amount of repaid loans made up LTL 2.9 billion. In 2008 the Government borrowing requirement was lower due to the accumulated larger cash balance at the end of 2007 in case to avoid refinancing risk caused by the redemption of Eurobonds in February 2008.

Borrowing in Financial Markets

In 2008, as in previous years, the Government borrowed on behalf of the State in domestic and foreign markets by issuing GS of the Republic of Lithuania and by taking loans from banks.

In borrowing the main strategic provisions on the Government debt management were observed, i.e. to borrow in litas, euro or other currency provided that after the application of financial derivatives, the liabilities in future would be executed in litas or euro. As in the previous year, the provision to reduce borrowing from international financial institutions and to increase a share of GS in total debt liabilities portfolio has been pursued.

In 2008 GS was the main instrument used by the Government of the Republic of Lithuania for borrowing in financial markets. On 31 December 2008 the Government debt for GS issued accounted for 94.7% of the total central government debt. As in the previous year, the main strategic goal in issuing GS was to enhance GS liquidity in the secondary market. To this end, the issues of securities launched in domestic market as previous years were tapped with the aim of increasing the volumes up to LTL 400–500 million. Whereas borrowing costs of the EU Member States on borrowing instrument market has been increasing in 2008, thus only one EUR 175 million GS issue was placed in foreign market.

T-bills and bonds issued in domestic market were used to balance the government cash flows.

In 2008 the Credit Line Agreement of EUR 60 million and Long Term Loan agreement of EUR 92 million were signed.

Borrowing in Domestic Market

In 2008 the government borrowed in Lithuania's domestic market by issuing Government bonds of the Republic of Lithuania and T-bills.

Chart 2. Ratio of Government Securities Issued in 2008 against the Bids Received

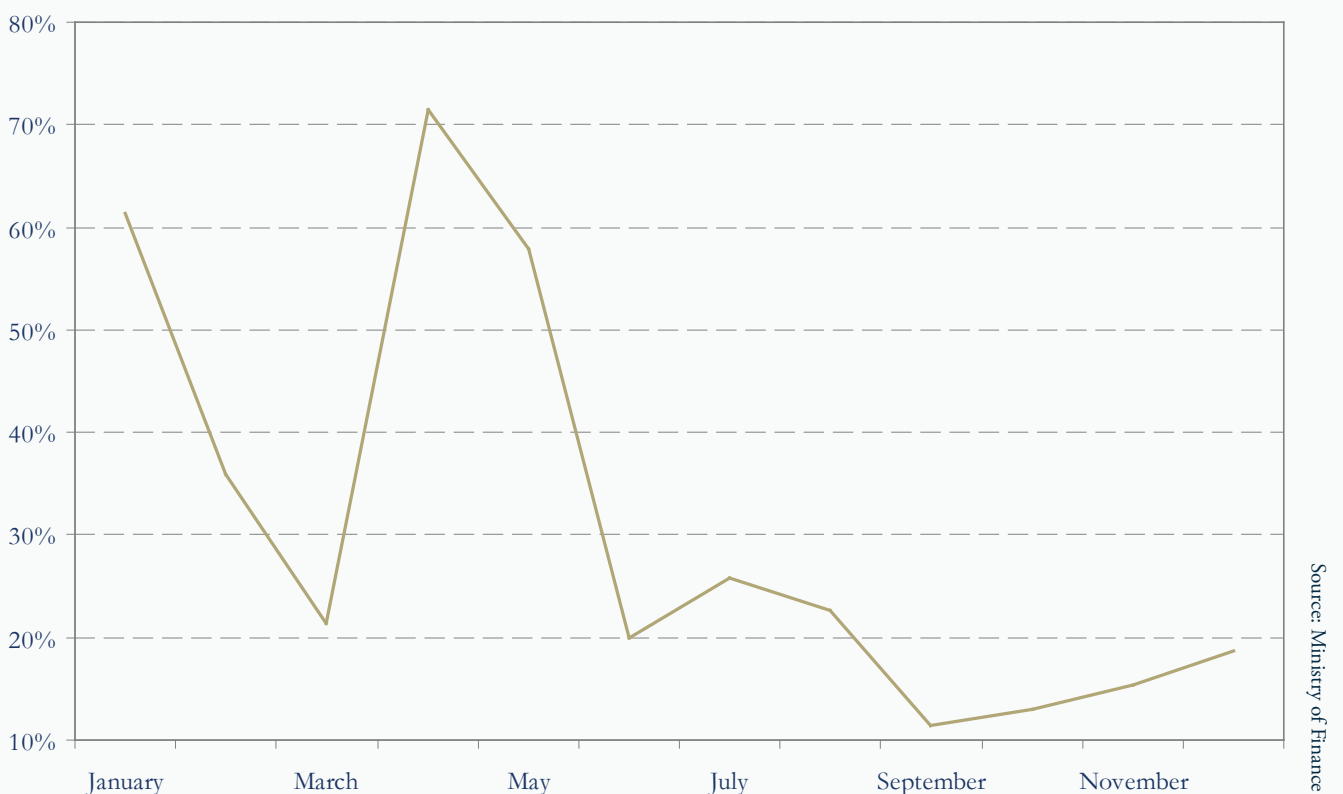
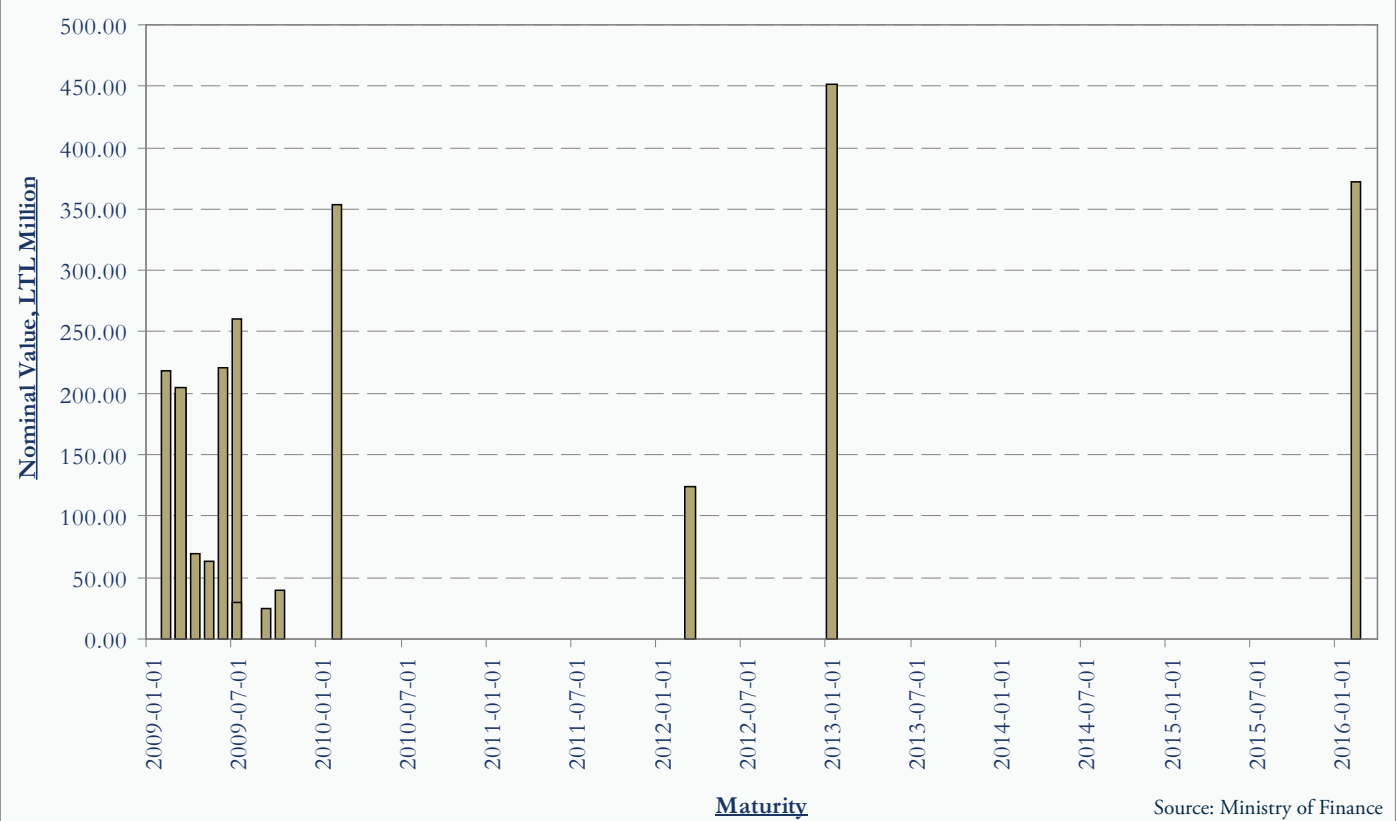


Chart 3. Outstanding Government Securities Issues at 31 December 2008


In 2008 GS of the Republic of Lithuania were distributed via auctions and private placements. GS auctions were planned and the characteristics of GS issued were established by the Ministry of Finance, while the actions were conducted by the Bank of Lithuania. The auctions were attended only by those national and foreign banks as well as financial brokerage companies, which have signed an auction participant agreement with the Bank of Lithuania and fulfilled the requirements set by the Bank of Lithuania for auction participants. In 2008 the agreements with the Bank of Lithuania were signed by 7 auction participants (all of them are residents).

Total value of bids submitted by auction participants, i.e. demand of GS at GS auctions over the year 2008, amounted to LTL 2,789.0 million.

T-bills were in the greatest demand at auctions, the greatest number of bids and those for the largest amounts were submitted at auctions of these short-term securities. In average, 39 bids, or LTL 89.9 million, per auction were received at T-bill auctions; and at bond auctions – 25 bids, or LTL 30.5 million, accordingly.

The greatest number of bids was received at the auction organised on 25 February 2008 (LTL 292.6 million), and the highest amount borrowed was at the auction conducted on 15 December 2008 (LTL 205.0 million). The highest ratio of GS issued at the auction against the bids received was during the auction held on 15 De-

cember 2008, where the bids amounted to LTL 207.4 million, and the value of GS distributed amounted to LTL 205.0 million (98.8 %). The lowest ratio was at the auction organised on 14 January 2008, where the bids amounted to LTL 105.9 million, and the value of GS distributed amounted to LTL 20 million (18.9 %). The number of auctions launched in 2008 was by 12 auctions (52.2 %) higher than in the year 2007. Such an increase in the number of auctions was determined by the pursuit of the best possible conditions for the acquisition of Government Securities for domestic and foreign investors.

In 2008 the Ministry of Finance announced 35 Government Securities auctions:

- 10-year nominal maturity bond issue taps – 5 auctions;
- 7-year nominal maturity bond issue taps – 1 auction;
- 12-month T-bill issue and its tapping – 15 auctions;
- 9-month maturity T-bill issue – 4 auctions;
- 6-month maturity T-bill issue – 9 auctions;
- 3-month maturity T-bill issue – 4 auctions.

The volume of outstanding litas-denominated short-term auctioned issues of GS over the year 2008 increased by 140.8 %, while the volume of long-term GS decreased by 28.4 % and at the end of 2008 it exceeded the volume of short-term GS (the value of long-term GS amounted to LTL 1,562.1 million and that of short-term GS made up LTL 1,071.5 million).

At the end of 2008 the debt volume of litas-denominated nominal maturity auctioned issues of GS amounted to LTL 2, 633.6 million.

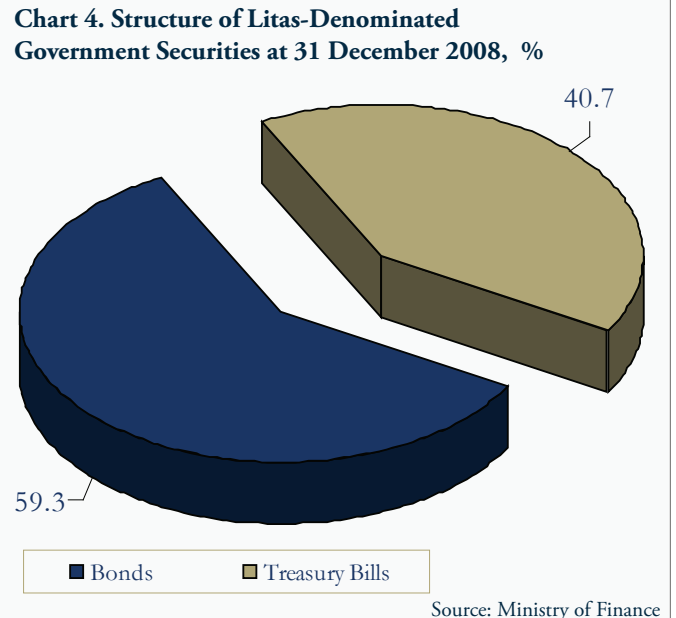
At the end of 2008, 14 unredeemed auctioned issues of GS were in circulation, of which 5 – bond - and 9 – T-bill issues.

As compared to the previous years, the number of issues has relatively decreased (there were 29 issues in 2002, 33 – in 2003, 30– in 2004, 27 – in 2005, 15 – in 2006, 13 – in 2007, accordingly), however, an increase in their volumes was observed, along with that the liquidity of issues enhanced.

At the end of 2008 the nominal value of bonds issued and outstanding of all maturities was LTL 1,562.1 million (59.3 % of total value of GS issued and at the end of 2007 outstanding GS), and T-bills – LTL 1 ,071.5 million (40.7 %) (see Chart 4).

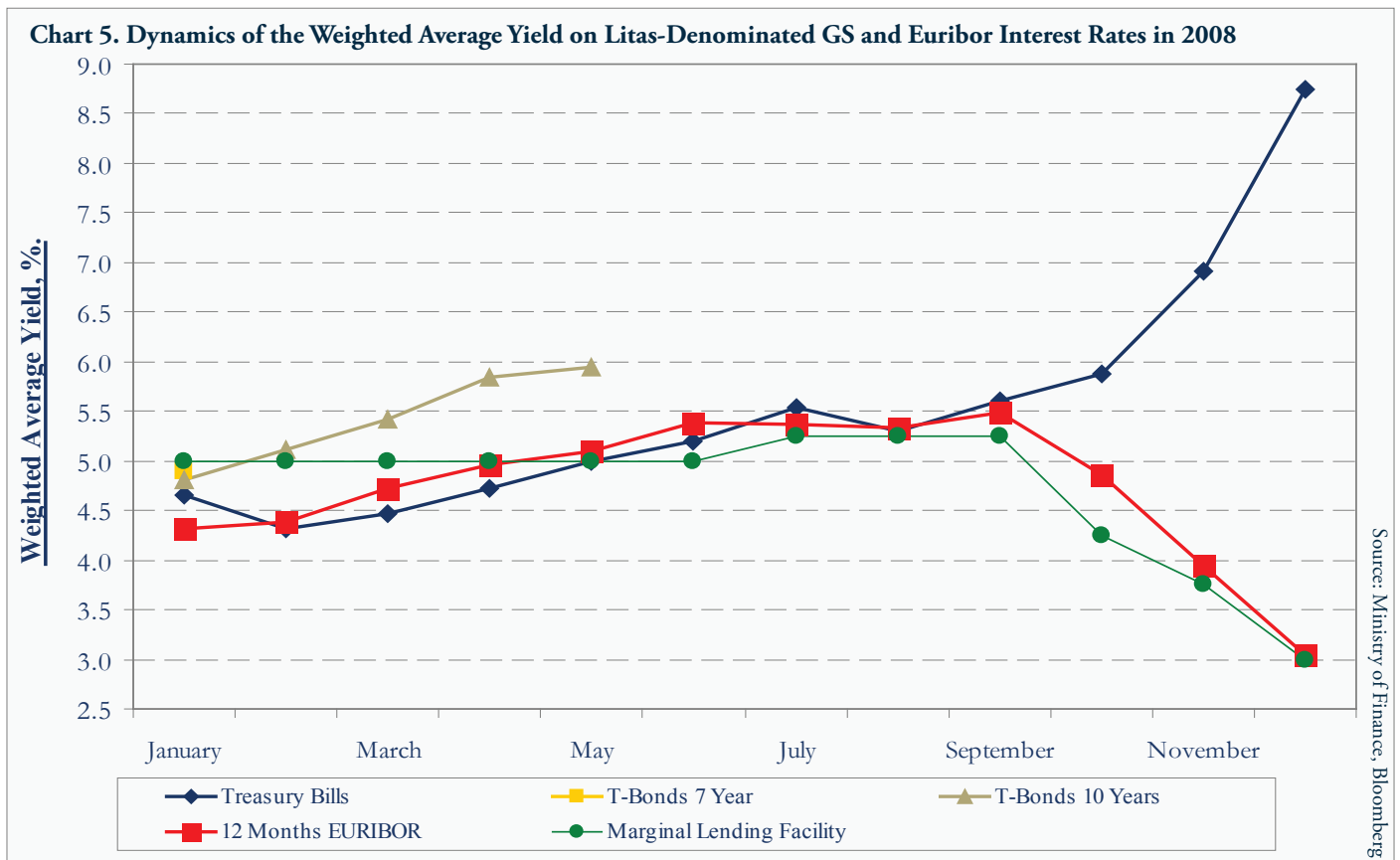
Aiming at the stability of the general government debt servicing costs, in 2008 the State further borrowed only at the fixed interest rates.

The weighted average yield on GS increased in 2008, however, its growth was determined by the increase in interbank offered rates at which the Lithuanian banks are ready to lend money in litas to other banks (VILIBOR) (see Chart 5).



In 2008 the lowest interest rate proposed at auctions was that on 12-month maturity T-bills and comprised for 4.16 % (the auction organised on 25 February 2008). The highest interest rate (under which bids were accepted in 2008) was 12.39 % (a 3-month maturity T-bills issue was issued at the auction organised on 15 December 2008).

The annual weighted average yield on GS of all maturities auctioned in litas over 2008, as compared to 2007, which was influenced by the increasing yield on borrowing instruments in international markets, increased from 4.25 to 6.23 % (see Chart 6). The annual



weighted average yield T-bills, as compared to 2007, increased from 4.18 % to 6.28 % and those on bonds – from 4.41 % to 5.32 %.

At the end of 2008 the average nominal maturity of outstanding GS issued in litas was 1,648 days, at the end of 2007 – 2,001 days. The decrease in the indica-

tor was caused by increased share of T-bills outstanding (in-end of 2008, T-bills accounted for 40.7 % of total outstanding auctioned issues of GS, as compared to end-2007 – 16.9 %).

The secondary trading in GS may be performed through and outside Vilnius Stock Exchange (according to its es-

Chart 6. Dynamics of the Annual Weighted Average Yield on Lit-denominated Government Securities in 2006-2008

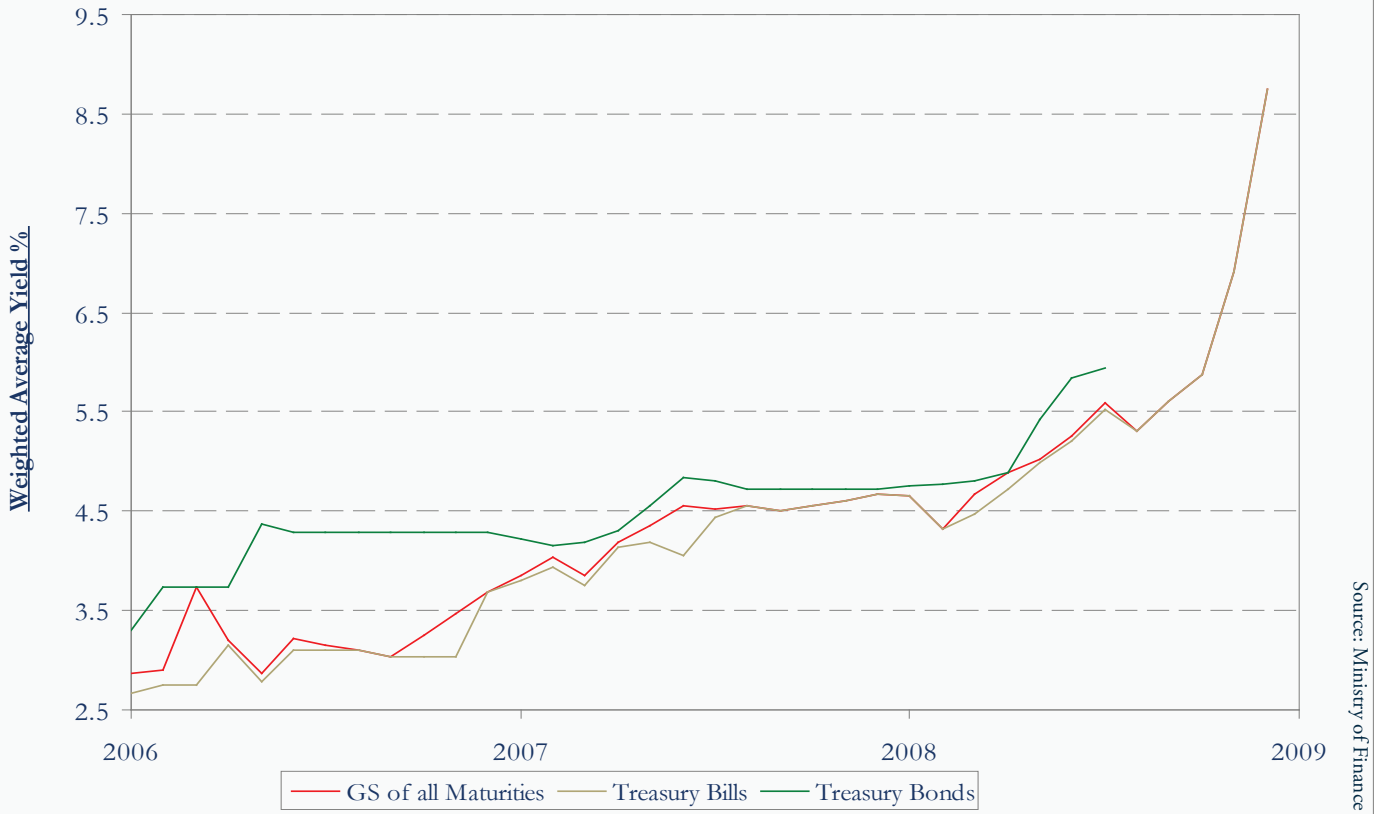


Chart 7. Distribution of GS by Nominal Maturity

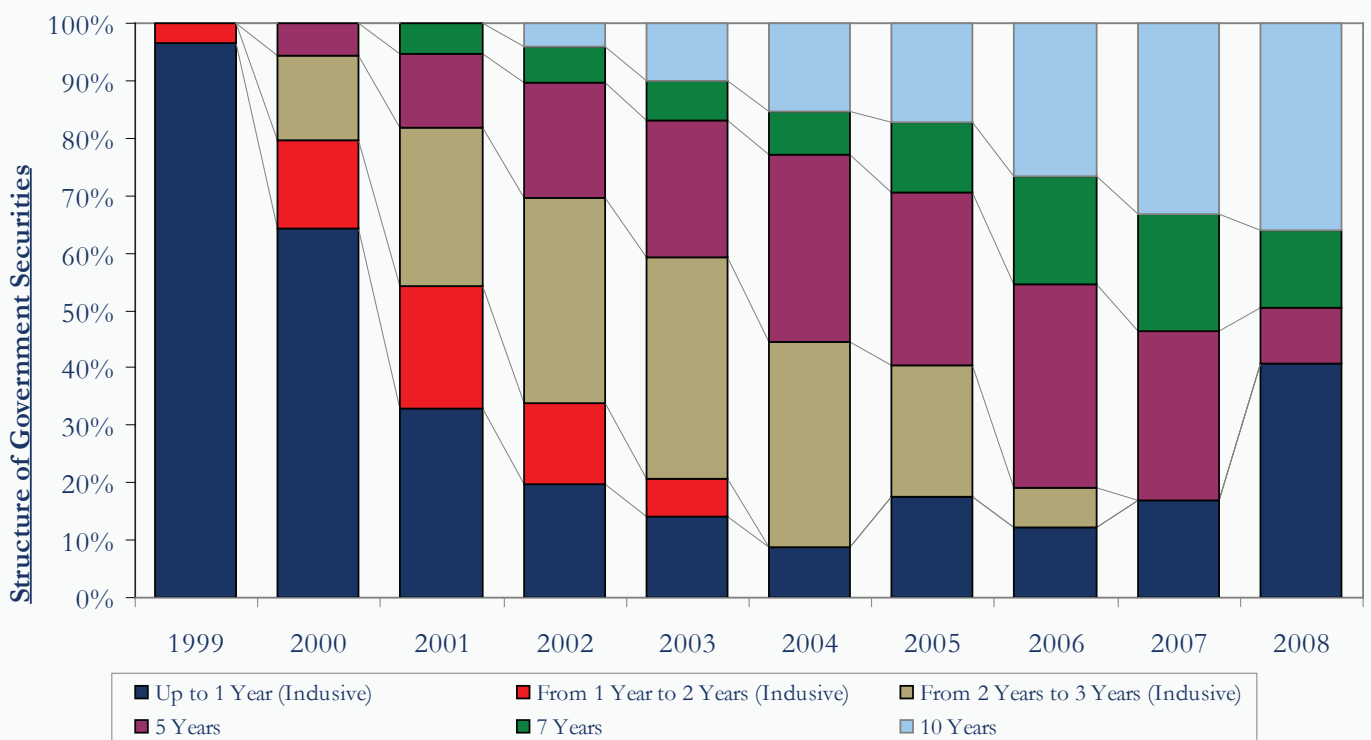
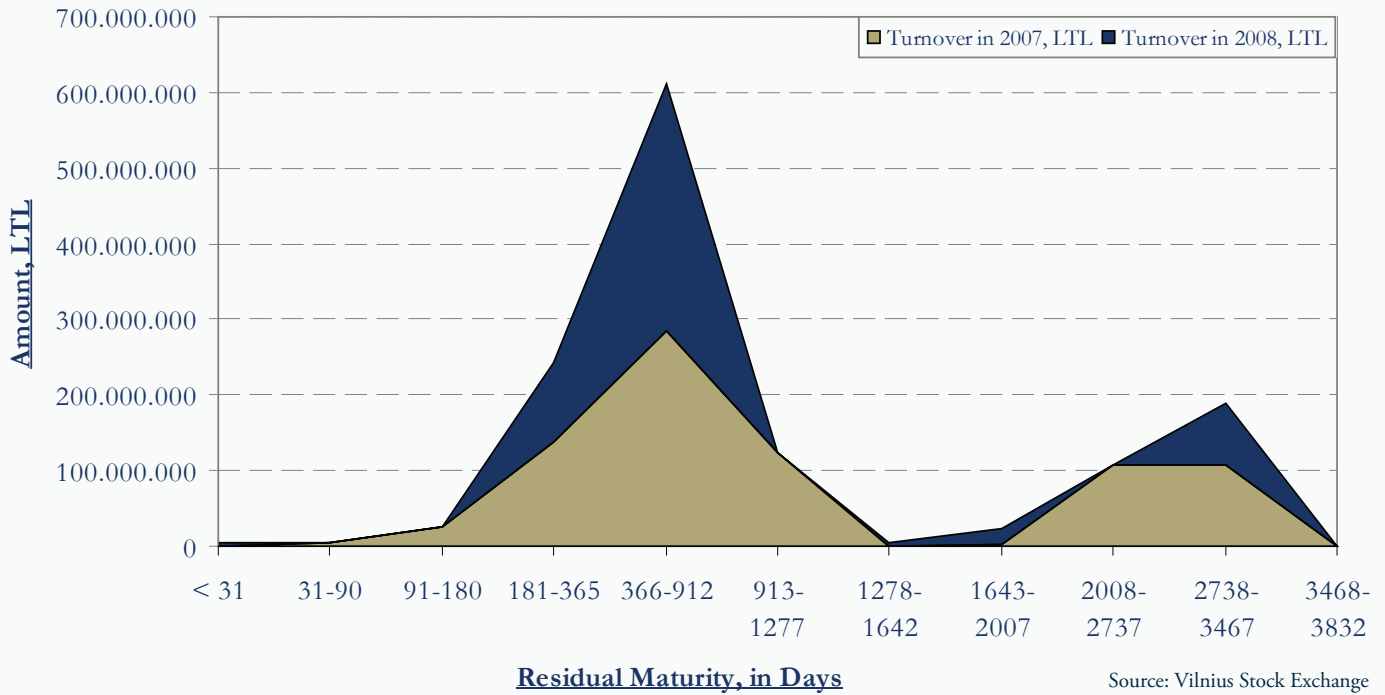


Chart 8. Government Securities Trading on the Vilnius Stock Exchange in 2007–2008 by Residual Maturity



established rules). In 2008 the secondary trading in GS performed through Vilnius Stock Exchange reached LTL 546.5 million, and as compared to 2007, decreased by LTL 244.2 million.

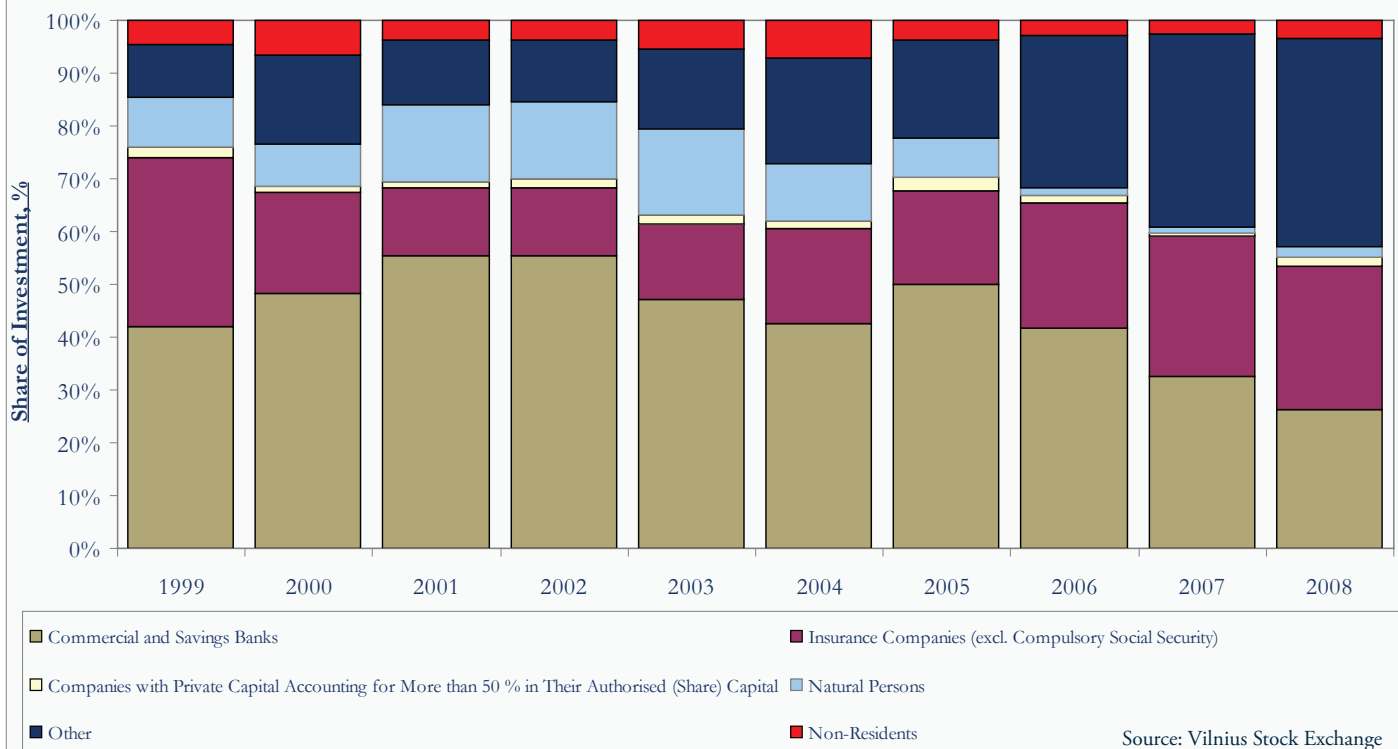
The secondary trading in GS via the stock exchange decreased, as the volume of GS in circulation decreased and a major part of investors that acquired GS, tried to keep GS till their redemption date, but not to trade them.

At the end of 2008 a share of Lithuanian GS acquired by

foreign investors, as compared to end-2007, decreased from 2.4 % to 2.1 % of total traded litas-denominated GS. At the end of 2008 the main foreign investors were investors from Estonia (GS in the value of LTL 55.4 million) and Latvia (GS in the value of LTL 3.0 million), investors from Great Britain acquired GS in the amount of LTL 0.12 million.

Among local investors, the major share of GS traded belonged to financial auxiliaries and insurance corporations as well as pension funds (with the exception of

Chart 9. Investment in Litai-Denominated Government Securities in 1999–2008



the State Social Insurance Fund). In 2008, as compared to 2007, the GS share held by financial auxiliaries increased from 26.2 % to 29.4 % and that held by insurance companies and pension funds increased from 26.5 % to 27.2 %

Borrowing in Foreign Financial Markets

Unstable situation in the capital markets in 2008 determined increased borrowing costs in foreign markets and changes in lending strategy. In 2008 the Ministry of Finance borrowed in foreign markets by taking loans and issuing GS via private placement.

At the end of 2008 the yield of GS of Central and Eastern European countries on the secondary market due to uncertainty of capital markets and the increased risk of the region has doubled.

The dynamics of the 10-11-year nominal maturity GS yield in secondary market and the comparison with other Eurobonds of a relevant maturity is shown in Chart 10. EUR 200 million Eurobond issue was redeemed in February 2008. All Eurobond issues by the Government are presented in the Table 2.

Table 2. Outstanding Eurobond Issues in End-2008

ISIN Code	Amount (million)	Currency	Issue Date	Redemption Date	Coupon (%)
XS0147459803	1000	EUR	2002 05 10	2012 05 10	5,875
XS0163880502	1000	EUR	2003 03 05	2013 03 05	4,500
XS0212170939	1000	EUR	2005 02 10	2016 02 10	3,750
XS0327304001	600	EUR	2007 10 29	2018 02 07	4,85

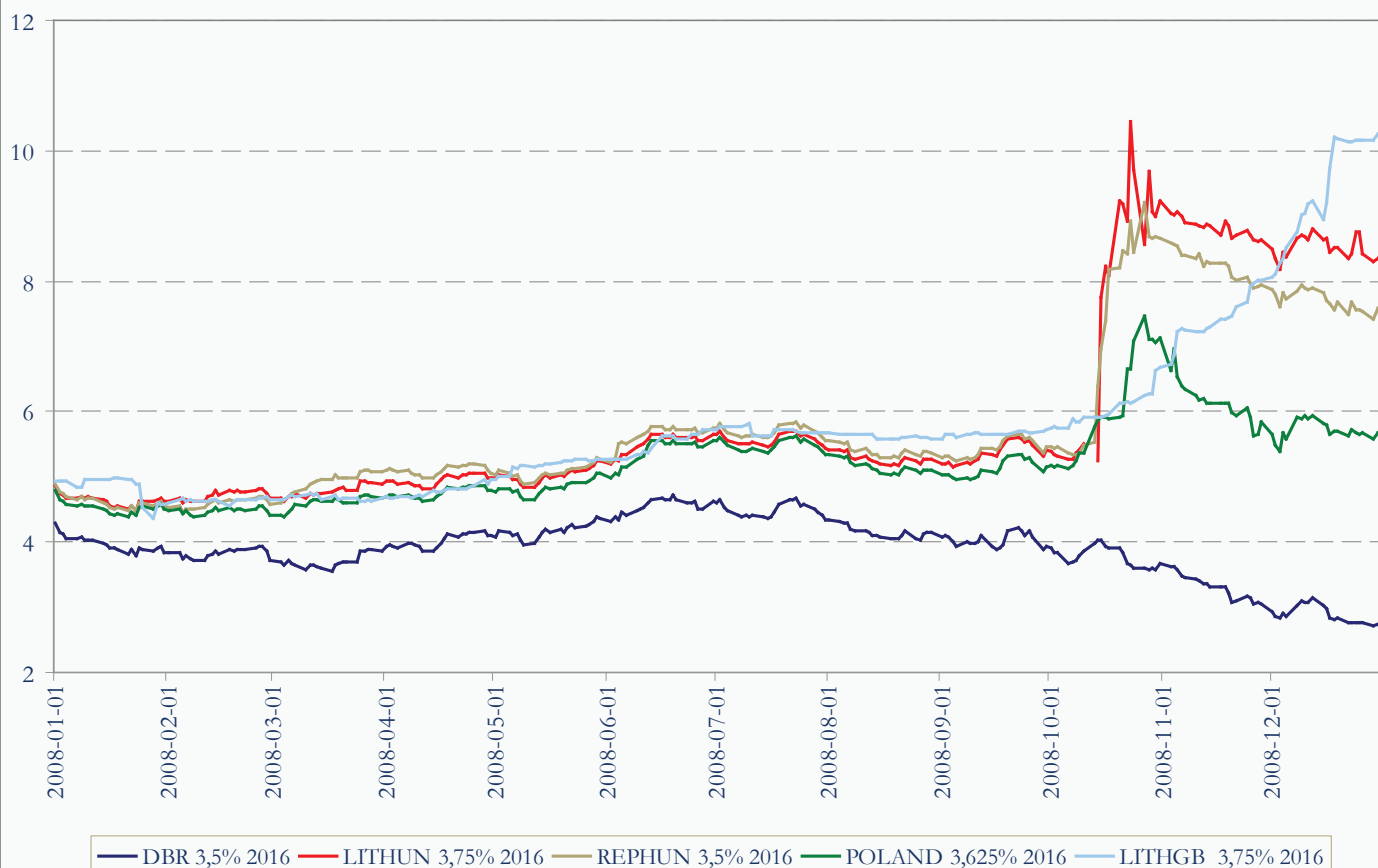
Source: Ministry of Finance

Borrowing from International Financial Institutions

In 2008 the Ministry of Finance did not sign any loan agreement with international financial institutions. The investment projects (programmes), which were launched in the previous year, have not been financed from loans of the aforementioned institutions.

In 2008 the outstanding amount of loans taken on behalf of the State from international financial institutions decreased by LTL 19.4 million.

Chart 10. Yield of Bonds to be Redeemed in 2016, %



¹ – DBR – German Bunds (of 10 –year nominal maturity), REPHUN – Hungarian Eurobonds (of 10 –year nominal maturity), POLAND – Polish Eurobonds (of 10 –year nominal maturity), LITHUN – Lithuanian Eurobonds (of 11 –year nominal maturity), LITHGB – Domestic GS of the Republic of Lithuania (of 11 –year nominal maturity).

Source: Bloomberg

At the end of 2008 the residual amount of loans outstanding to the European Investment Bank, Nordic Investment Bank and Council of Europe Development Bank made up LTL 302.7 million. At the end of 2008 this share of the central government debt to the aforementioned institutions represented 2.7 % of total central government foreign debt.

State Guarantees and Loans Extended

In 2008 no new State guarantees on loans were issued. The liabilities of the State under previously issued guarantees on loans on 31 December 2008 amounted to LTL 626.3 million, i.e. by LTL 43 million less than in end-2007. At the end of 2008 State guaranteed foreign loans of economic entities made up LTL 222.8 million or represented 35.6 % of total State guaranteed debt, and State guaranteed domestic loans amounted to LTL 403.5 million, or accounted for 64.4 % of total State guaranteed debt.

The liabilities of the State under the guarantees issued (liabilities of guarantee institutions included) amounted to LTL 1,284.6 million at the end of 2008.

In 2008 the loan of LTL 13.4 million with the State guarantee was issued only to the State enterprise Klaipėda State Seaport Directorate for financing of the investment project under the Financing Agreement on Renovation of the Klaipėda Seaport Gate signed in 2000.

In 2008 total repaid amount of the State guaranteed loans made up LTL 72.6 million, of which – LTL 71.5 million of loans to creditors were repaid by economic entities themselves, and the Ministry of Finance, fulfilling its guarantee liabilities, for debtors repaid the creditors LTL 1.1 million.

As mentioned previously, the liabilities of the State under the guarantees issued also cover liabilities under Guarantee Agreements of guarantee institutions established by the Government of the Republic of Lithuania

to credit institutions. At present, two guarantee institutions operate in the country: UAB Žemės ūkio paskolų garantijų fondas (Private Limited Company Rural Credit Guarantee Fund) and UAB Investicijų ir verslo garantijos (Private Limited Company Investment and Business Guarantees, INVEGA).

Each year, the Seimas (Parliament) sets, in the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets, a limit on liabilities of guarantee institutions, which is subsequently distributed by the Government to guarantee institutions. In 2008 the limit of LTL 718 million was set (LTL 408 million on liabilities of UAB Rural Credit Guarantee Fund and LTL 310 million on liabilities of UAB Investment and Business Guarantees, INVEGA), while real liabilities of guarantee institutions, that are subject to the limit set, at the end of 2008 amounted to LTL 581.6 million.

In 2009, taking into consideration the increased need for issuing guarantees on loans, designated for the implementation of the projects financed under EU financial assistance programmes, as well seeking to help a larger number of small and medium-sized business (SMEs) to get the necessary financing for business start-up or development, a larger limit on liabilities of guarantee institutions, namely, LTL 818 million, was set.

In 2008 the State on-lent 2 new loans to economic entities from resources borrowed on behalf of the State. The aforementioned on-lent loans have been granted to the Joint-Stock Company Turto Bankas, which used the funds to finance the renovation of the Office building of the General Prosecutor's of Republic of Lithuania and the administrative building of the Lithuanian State Security Department as well as the central administrative building, and its related structures.

At the end of 2008 the residual amount of loans issued in previous years to economic entities from resources borrowed on behalf of the State made up LTL 1,201.5 million, i.e. by LTL 15 million more than at the end of 2007.

DEBT LEVEL, STRUCTURE AND DYNAMICS

General Government Debt

At the end of 2008 the general government debt equalled LTL 17,374.8 million, and it represented 15.6 % of GDP. Over 2008, the general government debt relative to GDP decreased by 1.4 percentage point (in 2007 it was 17 % of GDP) and was one of the lowest ra-

tios among the EU Member States (in 2008 the government debt to GDP ratio of EU countries was 61.5 %). In 2008 the nominal value of the general government debt increased by LTL 676.8 million, or 4.1 % (at the beginning of the year the projected increase was LTL 1,372 million, or 8.2 %). The relatively small change in debt in 2008 was due to the complicated situation in financial markets: borrowed amounts were lower

Chart 11. General Government Debt Relative to GDP in the EU Member States at the End of 2008, %.

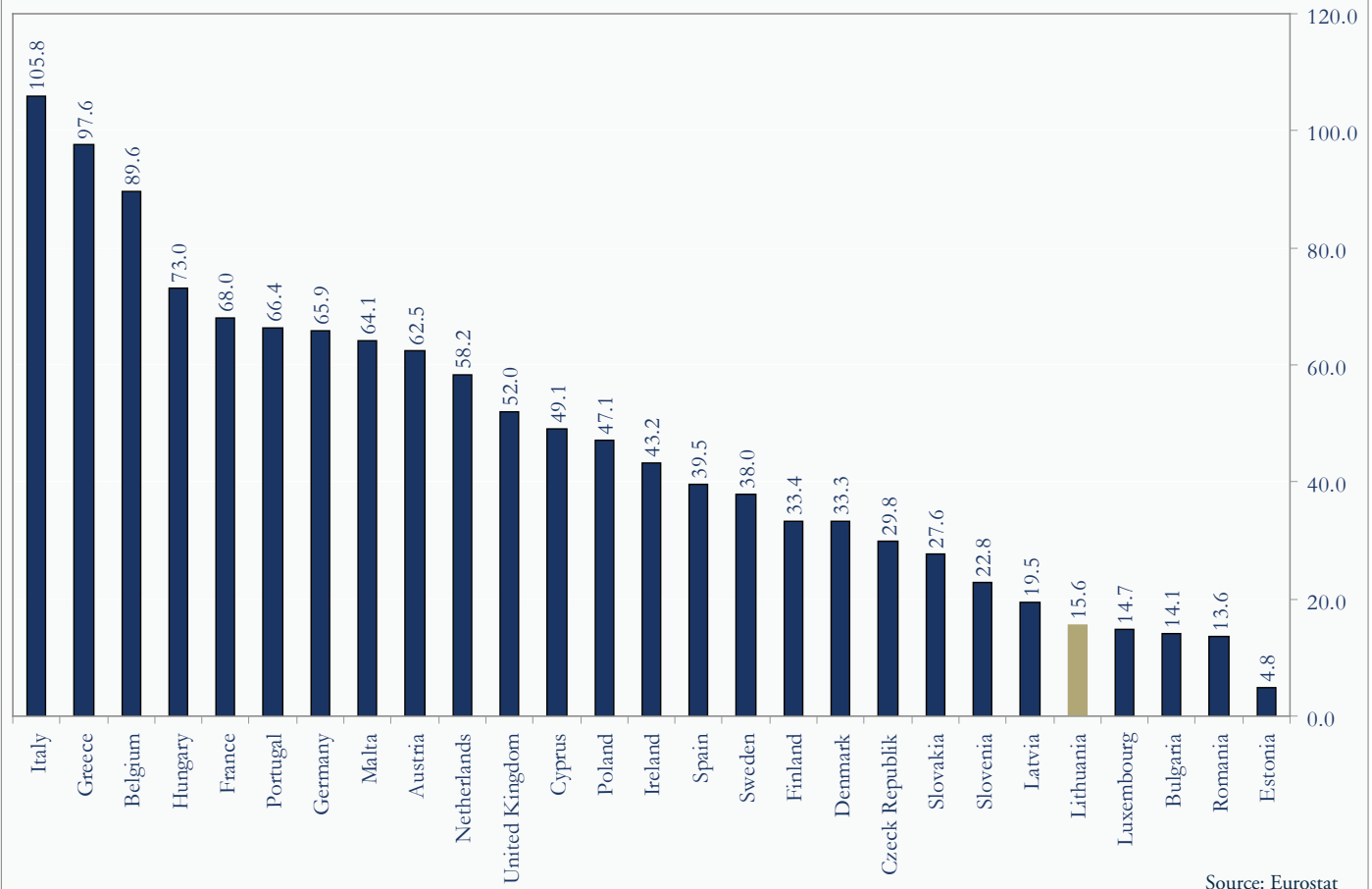
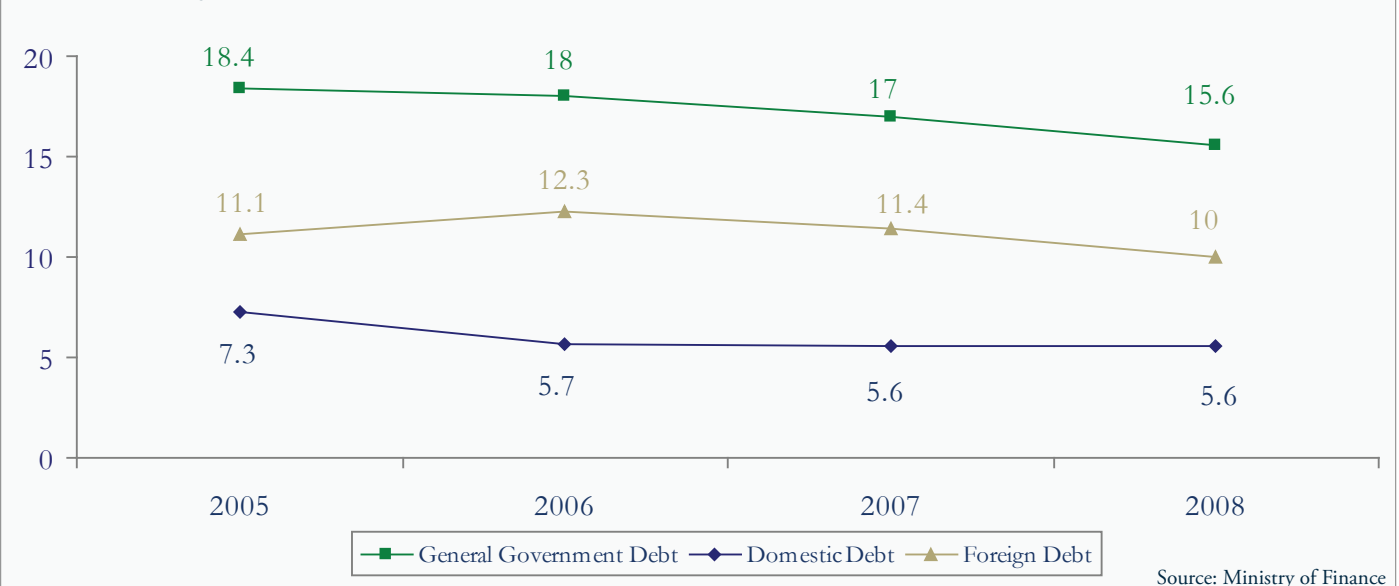


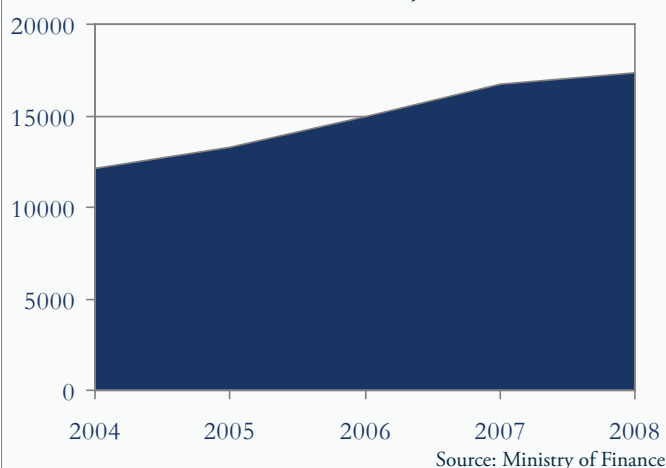
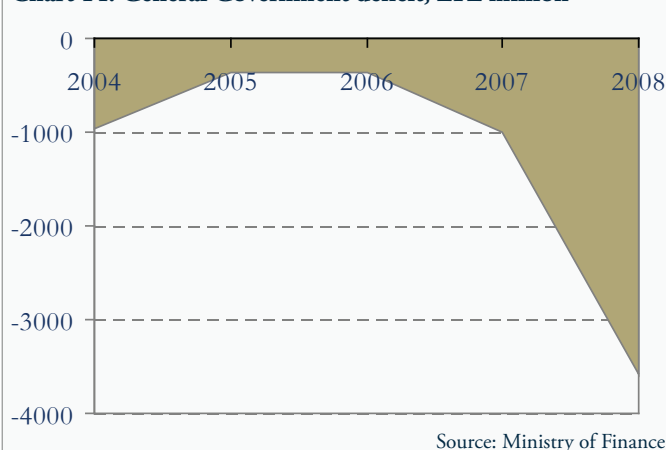
Chart 12. Change in General Government Debt Relative to GDP in 2005-2008, %.



than the planned ones. In 2008 total borrowed amount made up LTL 3.1 billion (the Government Borrowing Programme of 2008 envisaged a borrowing need of about LTL 5 billion). Lower borrowing amount in the year 2008 was also determined by the fact that a larger surplus of funds was accrued at the end of 2007 aiming at reduction of the refunding risk in redemption of the Eurobond issue in February 2008.

At the end of 2008 the general government debt consisted of the central government debt of LTL 16,052.4 million, local government debt of LTL 1,318.5 million (of which LTL 46.2 million – loans on-lent by the government and LTL 35.8 million – short-term loans from the State budget) and debt of social security funds of LTL 85,9 million. Consolidated liabilities between sub-sectors constituted LTL 82 million.

At the end of 2008 the general government domestic debt was LTL 6,213.5 million (over the year it increased by LTL 742 million), and it represented 35.8 % of the general government debt. At the end of the year the general government foreign debt amounted to LTL 11,161.3 million (over the year it decreased by LTL 65.3 million), and it accounted for 64.2 % of the general government debt.

Chart 13. General Government Debt, LTL million

Chart 14. General Government deficit, LTL million


Indicators	31 December 2007		31 December 2008		Change	
	LTL million	%	LTL million	%	LTL million	%
General government debt	16,698.0	100	17,374.8	100	676.8	-
Central government debt	15,800.6	94.6	16,052.4	92.4	251.8	-2.2
Debt of social security funds	23.8	0.2	85.9	0.5	62.1	0.3
Local government debt*	873.7	5.2	1,236.5	7.1	362.8	1.9

Table 3. General Government Debt by Sub-Sector

*Data on local government debt is indicated herein in the consolidated form, i.e. less loans issued by the government

Source: Ministry of Finance

Table 4. General Government Debt by Type of Instrument

Indicators	2007-12-31		2008-12-31	
	LTL million	%	LTL million	%
General government debt	16,698.0	100	17,374.8	100
Domestic debt	5,471.5	32.8	6,213.5	35.8
Long-term liabilities	5,060.9	30.3	4,840.6	27.9
Government Securities ^s	4,217.6	25.3	3,677.6	21.2
Loans	843.3	5.0	1,163.0	6.7
Short-term liabilities	410.6	2.5	1,372.9	7.9
Government Securities	375.1	2.2	1,029.8	5.9
Loans	35.5	0.2	343.1	2.0
Foreign debt	11,226.5	67.2	11,161.3	64.2
Long-term liabilities	11,226.5	67.2	11,161.3	64.2
Government Securities	10,865.6	65.1	10,501.4	60.4
Loans	360.9	2.2	659.8	3.8
Short-term liabilities	–	–	–	–
Government Securities	–	–	–	–
Loans	–	–	–	–

Source: Ministry of Finance

In 2008 long-term liabilities decreased by LTL 285.5 million and made up 92.1 % of total general government debt (i.e. LTL 16,001.9 million), and short-term liabilities increased by LTL 926.3 million and represented 7,9 % of the general government debt (i.e. LTL 1,372.9 million).

The amount of loans outstanding increased by LTL 926.3 million and in end-2008 made up LTL 2,166 million (i.e. 12.5 % of total debt), while over the year the nominal value of the securities issued decreased by LTL 249,5.9 million and at the end of the year amounted to LTL 15,208.8 million (i.e. 87.5 %).

Central Government Debt

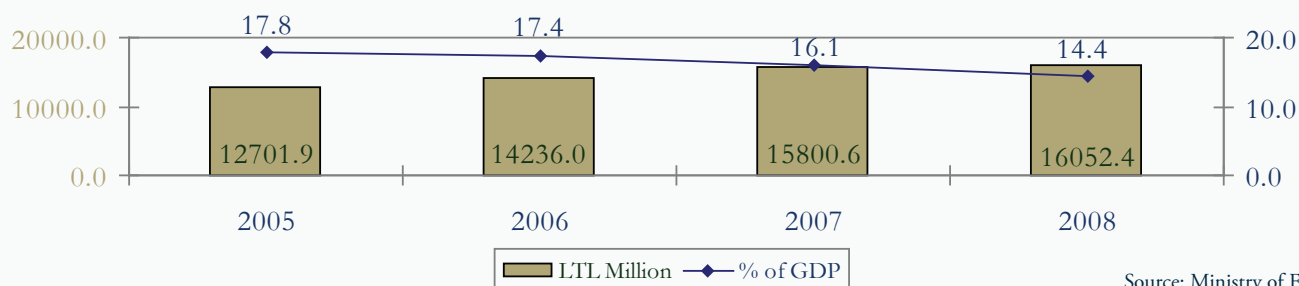
The major share of the general government debt (92.4 %) consisted of outstanding liabilities undertaken by central government to domestic and foreign creditors. At the end of 2008 the central government debt was

LTL 16,052.4 million – decreased relative to GDP and on 31 December 2008 was 14.4 % (on 31 December 2007 – 16.1 %), while the nominal value of the central government debt increased by LTL 251.8 million.

At the end of the year the central government domestic debt was LTL 4,926.6 million (over the year it increased by LTL 325.8million). In 2008 the central government foreign debt decreased by LTL 74 million and on 31 December it was LTL 11,125.8 million. As Chart 16 shows, at the end of 2008, as compared to 2007, the share of domestic and foreign debts increased inconsiderably.

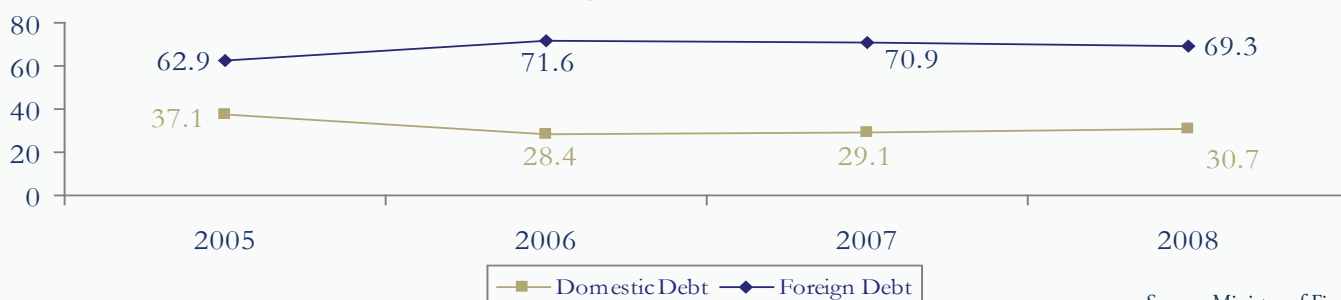
In 2008 the long-term central government debt decreased by LTL 616 million and at the end of the year was LTL 14,807.4 million, while the short-term debt increased by LTL 867.9 million and on 31 December constituted LTL 1,245 million. As Chart 17 shows, a share of the long-term central government debt, as

Chart 15. Central Government Debt in 2005-2008, %.



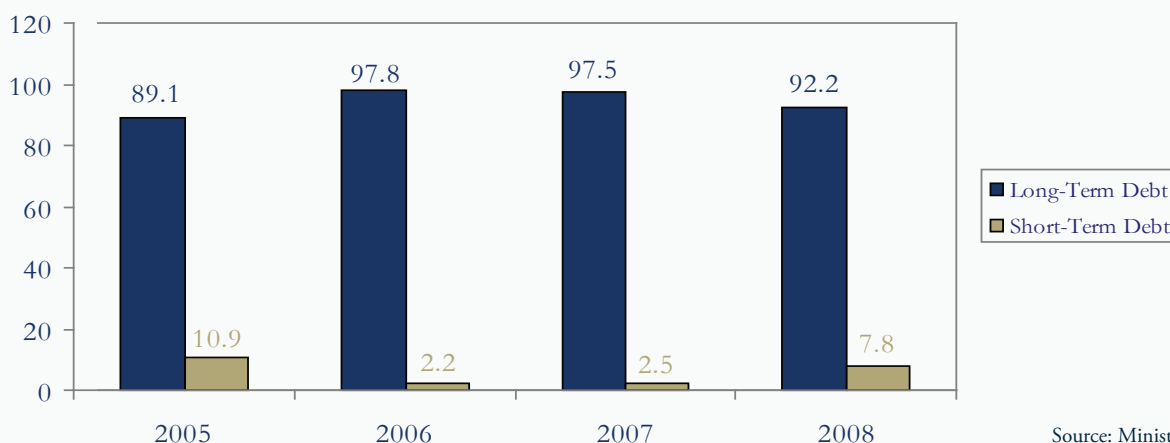
Source: Ministry of Finance

Chart 16. Central Government Domestic and Foreign Debt Proportions in 2005-2008, %.



Source: Ministry of Finance

Chart 17. Long-Term and Short-Term Central Government Debt Proportions in 2005-2008, %.



Source: Ministry of Finance

compared to the year 2007, decreased from 97.5 % to 92.2 %, and the share of the short-term debt increased from 2.5 % to 7.8 %, respectively.

The central government liabilities in loan category increased in 2008 and in end-year totalled LTL 843.6 million (5.3 %). The comparative weight of securities has decreased and in end-year accounted for 94.7 % of the central government debt (see Chart 18) or made up LTL 15,208.8 million.

At the end of 2008 fixed interest rate liabilities assumed on behalf of the State represented 96.4 %.

The major share of the central government debt is secured from exchange rate fluctuation risk: the debt in euros made up 85.5 % (on 31 December 2007 it was 85 %), in litas about 14.5 % (on 31 December 2007 - 15 %), in other currencies – 0.01 % of total central government debt (see Chart 19).

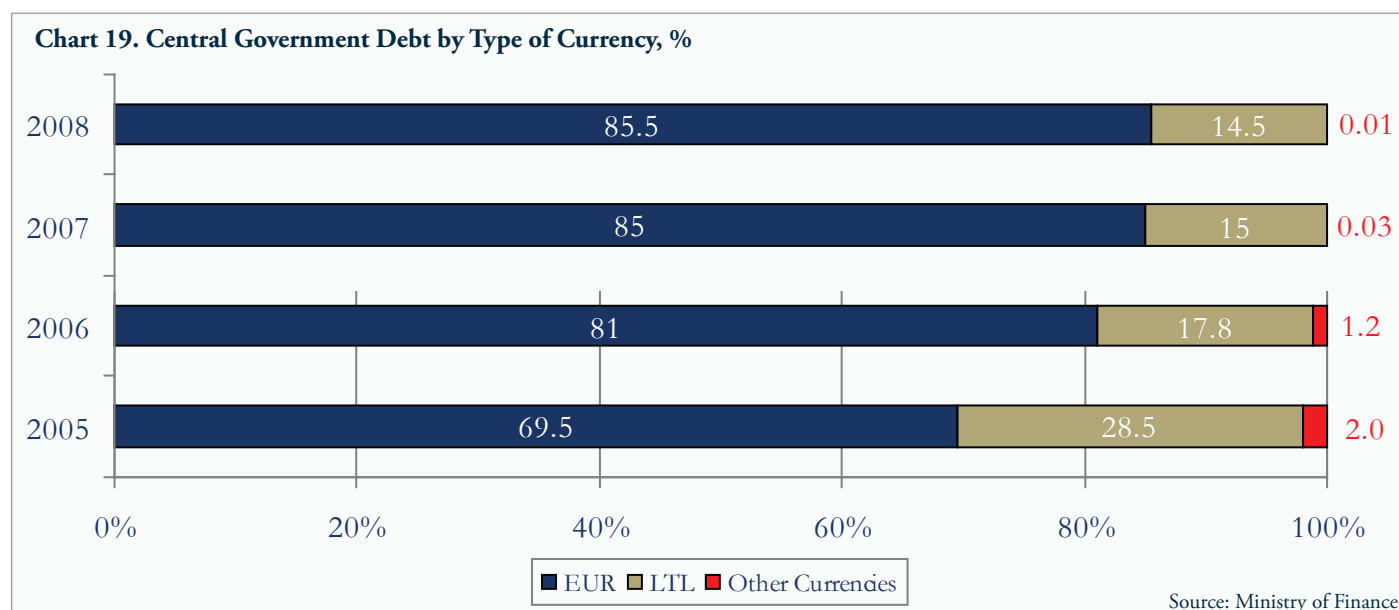
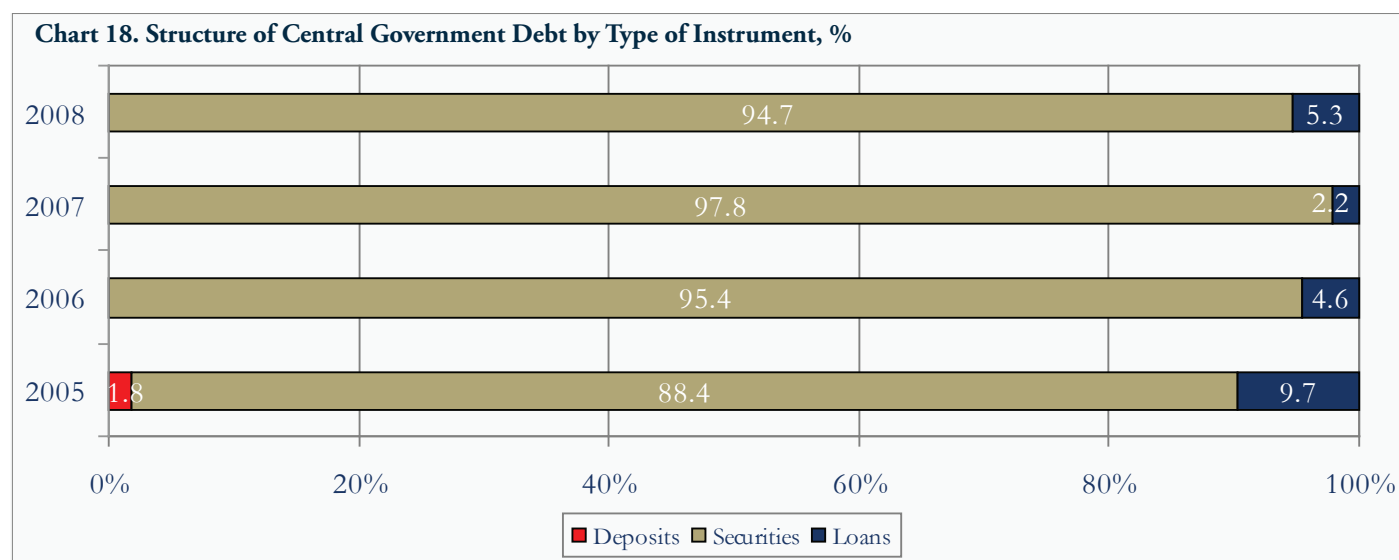


Table 5. Central Government Domestic Debt by Type of Instrument

Indicators	31 December 2007		31 December 2008	
	LTL million	%	LTL million	%
Domestic debt	4,600.8	100	4,926.6	100
Long-term	4,223.7	91.8	3,681.6	74.7
Government Securities	4,217.6	91.7	3,677.6	74.6
Loans	6.1	0.1	4.0	0.1
Short-term	377.1	8.2	1,245.0	25.3
Government Securities	375.1	8.2	1,029.8	20.9
Loans	2.0	0.0	215.2	4.4

Source: Ministry of Finance

Central Government Domestic Debt

At the end of the year the central government domestic debt was LTL 4,926.6 million (over the year increased by LTL 325.8 million), or represented 30.7 % of the total central government debt. In end-2008 long-term domestic debt liabilities made up LTL 3,681.6 million and short-term liabilities – LTL 1,245 million.

In 2008 the Government borrowed in domestic market by issuing short-term and long-term GS. Over the year the Government borrowed in domestic market by issuing LTL 1,473.9 million of nominal value T-bills and LTL 84.6 million of nominal value bonds. During the same period of time, the amount of redeemed nominal value T-bills made up LTL 847.4 million, of nominal value bonds – LTL 704.3 million. Besides, EUR 40 million of short-term nominal value GS and EUR 20.4 million of long-term nominal value GS have been issued in domestic market. Also LTL 790.7 million of short-term loans has been taken in domestic market to balance government cash flows, of which LTL 583.5 million has been repaid by the end of the year.

On 31 December 2008 the weighted average nominal maturity of GS auctioned in domestic market, as compared to 31 December 2007, decreased from 2,001 to 1,648 days, and the weighted average residual maturity reduced from 921 to 797 days. At the end of the year 2008 total nominal value of outstanding short-term auctioned issues of GS (by residual value) was higher by 2 % than that of long-term GS. As compared to the end of the year 2007, a share of T-bills in all auctioned issues of GS in the domestic market increased from 16.9 % to 40.7 %.

In 2008 borrowing costs of Lithuania and other EU Member States increased. The weighted average of the

annual interest rate of all auctioned issues of GS in Lithuania over the year 2008, as compared to 2007, increased from 4.25 % to 6.23 %. The weighted average of the annual interest rate of T-bills, as compared to 2007, increased from 4.18 % to 6.28 %, and that of bonds increased from 4.41 % to 5.32 %. The weighted average of the annual interest rate of T-bills only in December 2008 constituted 8.74 %.

At the end of 2008 central government was indebted to domestic creditors: financial sector – LTL 4,689.4 million, non-financial sector – LTL 174.3 million, other creditors – LTL 62.9 million (see Chart 21).

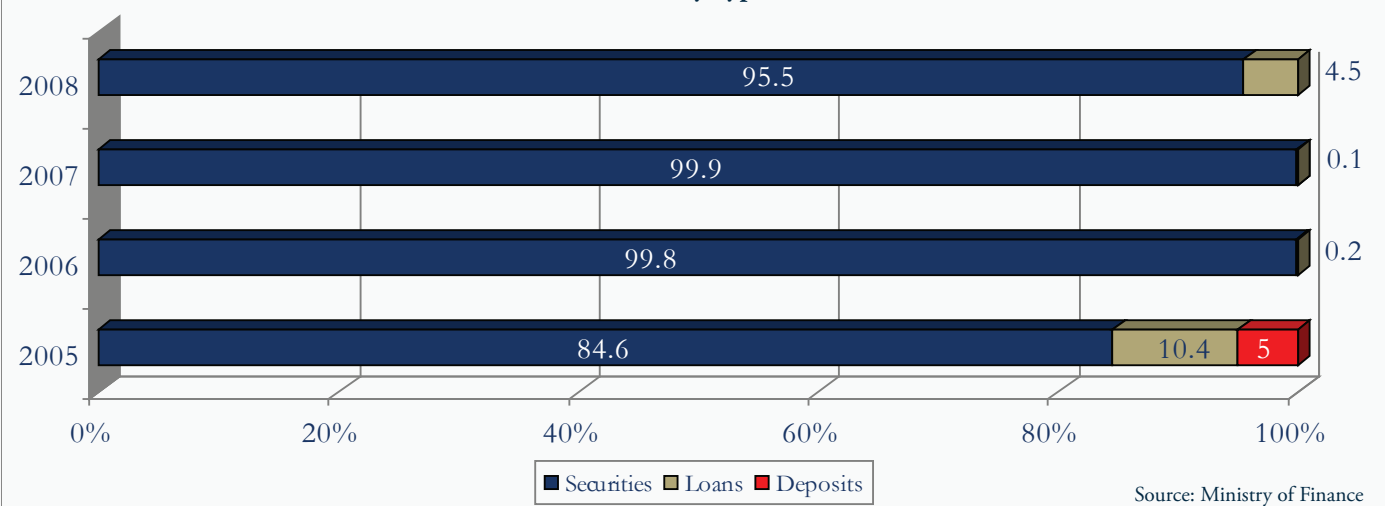
The central government debt has been reduced by LTL 322.2 million of nominal value GS which have been acquired by central government units. In year-end the Ministry of Finance possessed LTL 25 million nominal value GS, PI Ignalina NPP Decommissioning Fund – LTL 136.4 million nominal value GS, Compensation Fund of Licensed Warehouses – LTL 1.4 million nominal value GS, Guarantee Fund – LTL 65 million nominal value GS, Privatisation Fund – LTL 30 million nominal value GS and PI Turto bankas – LTL 64.4 million nominal value GS. Long-term securities represented 55.8 % and short-term securities accounted for 44.2 % of total central government securities.

Central Government Foreign Debt

On 31 December 2008 the central government foreign debt was LTL 11,125.8 million (over the year it decreased by LTL 74 million), or represented 69.3 % of the total central government debt. All foreign debt liabilities, in terms of nominal maturity, were only long-term liabilities.

In 2008 the Ministry of Finance sold a 13-year maturity

Chart 20. Structure of Central Government Domestic Debt by Type of Instrument, %.



EUR 75 million (LTL 259 million) nominal value bond issue to a private investor. EUR 200 million (LTL 690.6 million) bond issue, which was placed in international financial markets in 2001, has also been redeemed.

The Government borrowed abroad LTL 317.7 million, repaid loans to foreign creditors in the amount of LTL 27.4 million. The share of loans in the foreign debt increased from 3.0 % in 2007 to 5.6 % in 2008.

The repayment of long-term Government securities issued abroad determined the decrease in the share of securities in the foreign debt from 97 % in 2007 to 94.4 % in end-2008 (see Chart 22).

On 31 December 2008 central government was indebted to foreign creditors: foreign commercial banks and financial institutions – LTL 10,823.1 million (97.3 % of foreign debt), international organisations – LTL 302.7 million (2.7 % of foreign debt) (see Chart 23).

Debt Servicing Costs

The general government debt servicing costs consist of interest payable on the debt of central government, local government and social security funds as well as other borrowing related costs. The decision on the amount of debt servicing costs of central government and social security funds is adopted by the Seimas of Republic of

Chart 21. Central Government Domestic Debt by Creditor, %.

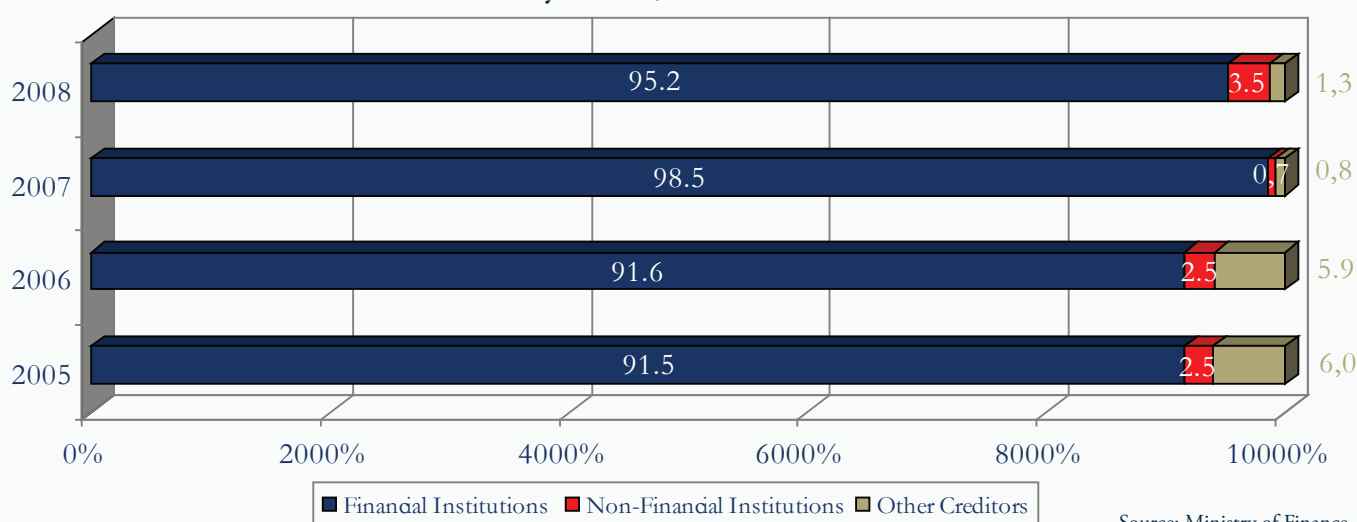
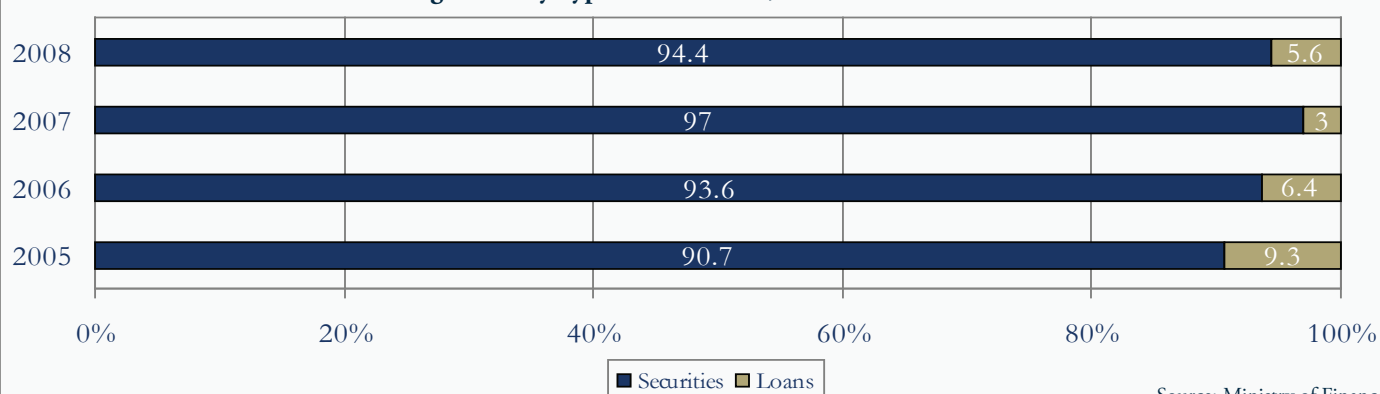


Table 6. Central Government Foreign Debt by Type of Instrument

Source: Ministry of Finance

Indicator	2007-12-31		2008-12-31	
	LTL million	%	LTL million	%
Foreign debt	11199,8	100	11125,8	100
Long-term	11199,8	100	11125,8	100
Government Securities	10865,7	97,0	10501,4	94,4
Loans	334,1	3,0	624,4	5,6
Short-term	–	–	–	–
Government Securities	–	–	–	–
Loans	–	–	–	–

Chart 22. Central Government Foreign Debt by Type of Instrument, %



Lithuania in approving relevant laws on budgets, while the municipal councils make decisions on debt servicing costs of local governments.

In estimating the amount of debt servicing costs, the ratio of the interest paid on general government debt to the general government revenue is an important indicator (see Chart 24). This indicator from the year 2001 to 2006 had been constantly decreasing. In 2007 remained of the same low rate as in the year 2006 – 2.3 % (2006 – 2.2 %), and in 2008 it continued to decline and amounted to 1.9 per cent.²

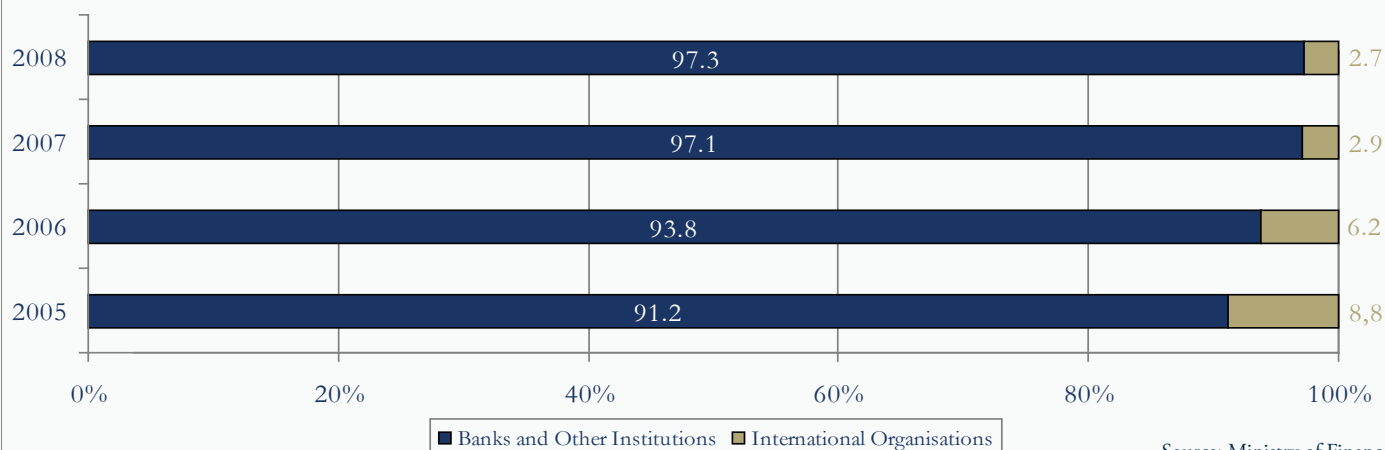
The central government debt servicing costs mainly consist of interest on debt, the rest is expenditure on borrowing on behalf of the State (see Chart 25). This expenditure is approved in the State budget under a separate programme which shows in detail interest payments on the debt on behalf of the State to residents

² - In this case the interest paid and general government revenue are calculated on accrual basis according to ESA'95 methodology. Other amounts are calculated on cash basis.

and non-residents, commission charges and other payments for borrowing in domestic and foreign markets. Till the year 2004 debt servicing costs included also amounts payable to creditors for defaulting debtors who have been granted loans on behalf of the State or State guaranteed loans. As of the year 2004 the aforementioned amounts are included into debt payments.

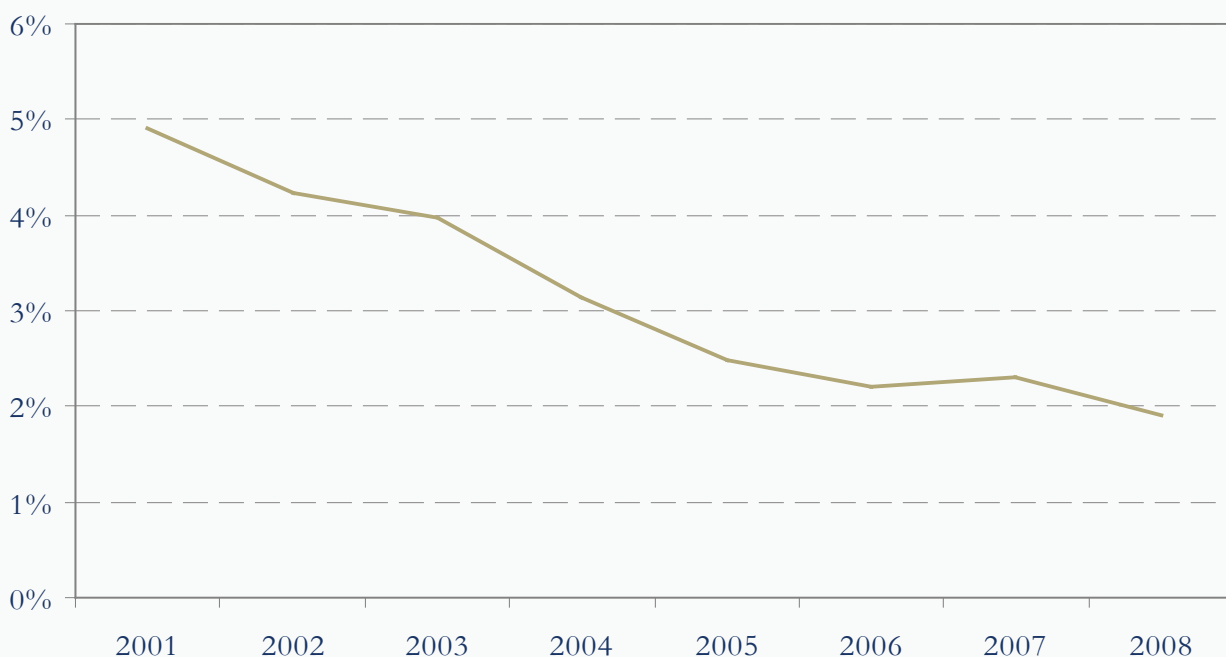
In 2008 debt servicing costs of the debt on behalf of the State amounted to LTL 781 million, where the interest on loans taken on behalf of the State and GS issued made up LTL 711 million, in 2007 – LTL 711 million and LTL 696 million, respectively. It should be mentioned that in 2008 the cost of debt management on behalf of the State (excluding interest payments) in-

Chart 23. Central Government Foreign Debt by Creditor, %



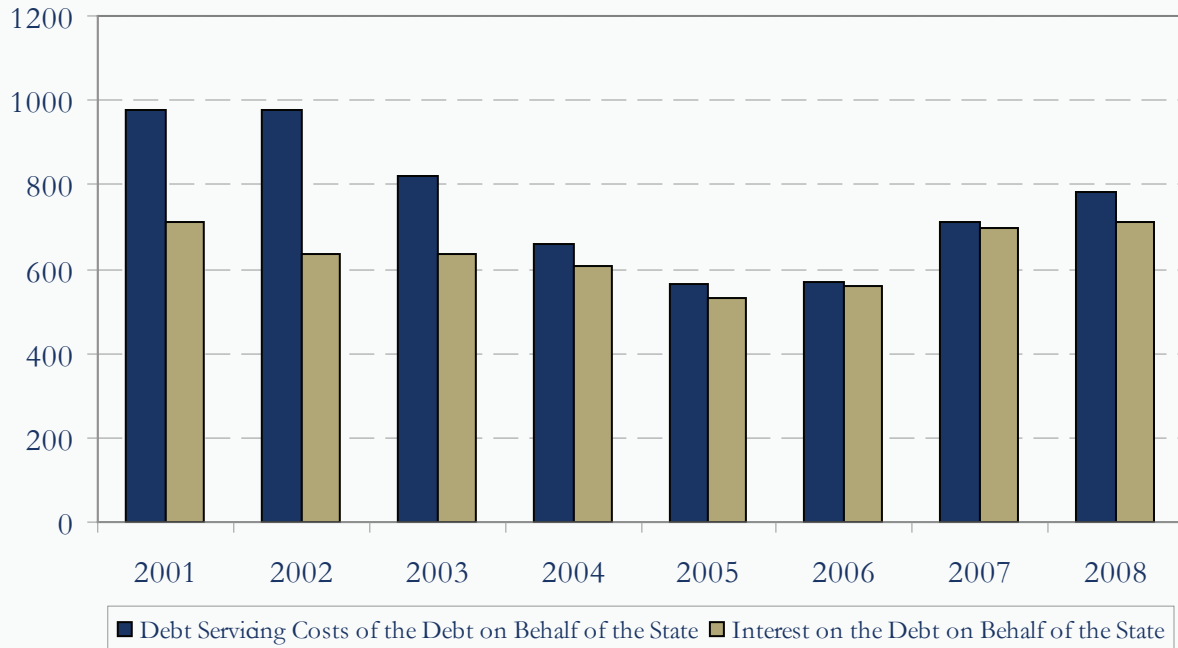
Source: Ministry of Finance

Chart 24. Ratio of Interest Paid on General Government Debt to General Government Revenue, %



Source: Ministry of Finance

Chart 25. State Budget Expenditure Related to General Government Debt and Interest on Debt on Behalf of the State, LTL million



Source: Ministry of Finance

³ - In 2006 data on debt servicing costs and interest are presented without estimation of the premium received and interest accrued (LTL 244 million).

creased because of the expenses (refundable) related to the debt risk management while using financial derivatives in borrowing. In the meantime interest expense alone in 2008 compared to 2007 increased only slightly over 2%. Without taking in to consideration debt risk management expense mentioned above, in 2008 debt

management expenses of the debt on behalf of the State amounted to LTL 730 million and were by 19 million LTL or 2.5 per cent higher than in 2007. Debt management expenses in 2008 increased mainly because of the adverse change in international financial markets and nominal growth of public debt.

DEBT LIMITS AND RISK MANAGEMENT

Risk management of debt liabilities assumed by the Government on behalf of the State and government cash resources covers exchange rate, interest rate, credit, liquidity (refinancing) and operational risks. Risk management plays an important role in the implementation of the primary goal of debt management, i.e. to ensure financing of the Government borrowing requirement at the lowest costs possible and acceptable risk.

Limits

The Government net borrowing limit is set by the Seimas in approving the Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets for the Year Concerned. Limits of debt liabilities assumed by the Government on behalf of the State (debt portfolio structure and interest payable) are set in the Government Medium-Term Borrowing and Debt

Management Strategy approved by the Government. In 2008 all statutory limits were not breached.

Exchange Rate Risk

A share of the debt on behalf of the State in the currencies, the exchange rates of which are not fixed with respect to the litas and the euro, is exposed to exchange rate fluctuations that may cause undesirable movements in debt servicing costs and debt repayments. The main parameters defining the exchange rate risk are the share of the debt portfolio in the currencies, the exchange rates of which are not fixed with respect to the litas and the euro, and likely exchange rate fluctuations within a certain period in future. At the end of 2008, 99.99 % of debt liabilities assumed on behalf of the State were in litas and euros, 0.01 % - in other currencies (see Chart 27). In 2008 the share of the debt in

Table 7. Execution of Government Borrowing Limits Based on Status of 31 December 2008

Limit	2008-12-31		2007-12-31	
	Limit set	Factual	Limit set	Factual
Government net borrowing, LTL million*	1,630	281	5,300	1,612.5
Short-term debt liabilities assumed on behalf of the State, i.e. liabilities the residual maturity of which is less than one year, of total debt liabilities on behalf of the State	20	11,1	30 %	11.7 %
Debt liabilities assumed on behalf of the State with floating interest rate of all debt liabilities assumed on behalf of the State	10	3,6	25 %	0.8 %
Expenditure on interest on loans taken on behalf of the State, Government securities issued and other debt liabilities assumed on behalf of the State of the annual amount of taxes collected to the State budget of the Republic of Lithuania, %	10	4	10 %	4.5 %
The weighted average term to maturity of the debt on behalf of the State, years	>4	5,2	-	5,5
Financial Macaulay duration, years	3-5,5	4,3	-	4,8
The sum of guarantees and State guaranteed institutions obligations, million LTL	718	581,6	605,0	460,6
Agricultural Credit Guarantee Fund UAB liabilities, million LTL	408	349,7	395	295,4
INVEGA obligations (considering the amount re-guaranteed by the European Investment fund), million LTL	310	231,9	210	165,2
Total INVEGA obligations	-	308,5	-	268,2

* - In 2007 the limit was increased envisaging possible borrowing for acquisition of the shares of Mažeikių Nafta AB. The planned Government net borrowing, excluding possible borrowing for acquisition of the shares of Mažeikių Nafta AB – LTL 2.300 million.

Source: Ministry of Finance

other currencies (not in euros and litas) decreased from 0.03 % to 0.01 % (from LTL 3.7 million to LTL 1.45 million, respectively).

Interest Rate and Refinancing Risks

Interest rate risk is the debt portfolio risk resulting from interest rate fluctuations in the market. The interest rate fluctuations determine fluctuations in servicing costs of the floating interest rate debt portfolio. As floating (short-term) interest rates are lower than fixed (long-term) interest rates, thus debt servicing costs are reduced by assuming more debt liabilities with floating interest rate, however, the interest rate risk increases.

In estimating the interest rate fluctuation risk, the share of the debt portfolio, for which the interest rate is to be re-fixed within a year, is an important parameter. This share covers all debt liabilities with floating interest rates, as well as debt liabilities, the residual maturity of which is shorter than or equals one year. At the end of 2008 this parameter equaled to 13.49 % of total funds borrowed on behalf of the State, where – 3.64 % debts with floating interest rate and 11.12 % – short-term debts by residual maturity⁴. The latter parameter also shows refinancing risk. The weighted average duration of the debt by residual maturity was 5.2 years at the end of 2008.

⁴ - A share of the debt portfolio (1.27%) is with floating interest rate and is redeemed within the period of one year, therefore, the interest rate risk of this share is counted in only once.

Other parameter indicating sensitivity of the debt portfolio consisting of Government securities issued to interest rate fluctuations is financial Macaulay duration. The financial duration shows the weighted average duration by which the interest rate of the portfolio is fixed. Assuming that short-term interest rates are lower than long-term interest rates, a short duration usually determines lower costs. On the other side, a short duration

means higher interest rate risk, as after a short period of time the interest rate on a large share of the portfolio is re-fixed, and it causes a risk. Thus, financial Macaulay duration shows the interrelation between debt portfolio and costs. At the end of 2008 financial Macaulay duration of the general government portfolio consisting of Government securities⁵ issued was 4.3 years.

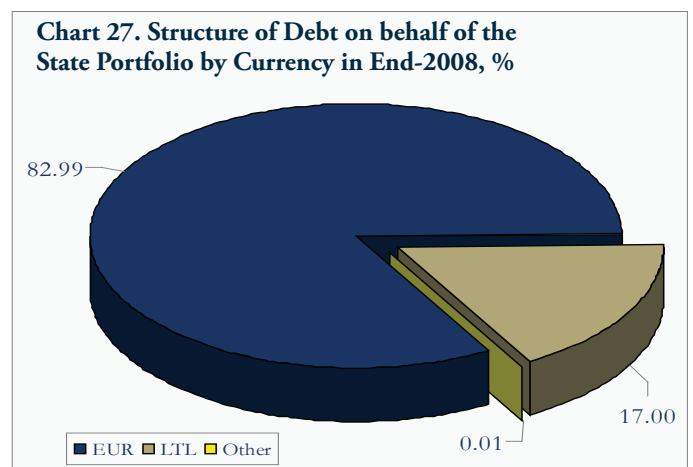
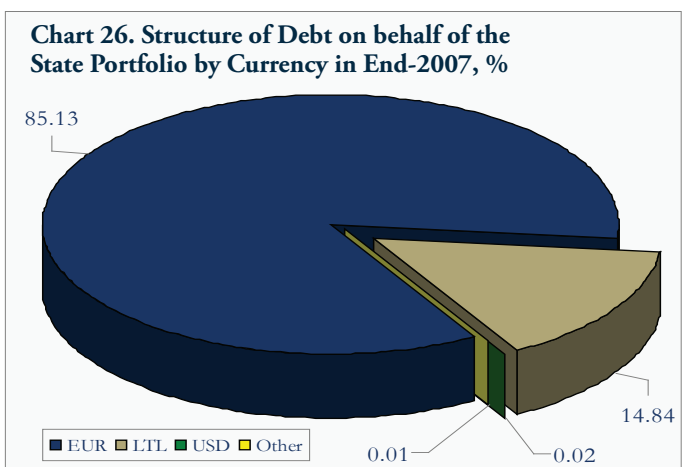
⁵ - In 2007 the debt on behalf of the State, following the issue of Government securities, accounted for 95 % of total debt liabilities assumed on behalf of the State.

To manage refinancing and interest rate risks the Government Medium-Term Borrowing and Debt management Strategy envisages a short-term debt limit – 20 % of total debt portfolio, and a limit of debt with floating interest rates – 10 % of total debt portfolio. In 2009, the Government Medium-Term Borrowing and Debt Management Strategy will be renewed.

Market Risk Management Models

Till 2008 the debt portfolio deterministic simulation model was used in the Ministry of Finance for market risk management, which allows assessing debt portfolio parameters in case of several different exchange rate, interest rate and borrowing requirement scenarios. The debt portfolio is shaped by establishing what instruments, currencies, interest rates and maturity will be applied in borrowing within the period concerned. The sensitivity of the portfolio to external factors is measured by employing the most likely, pessimistic and optimistic exchange rate, interest rate, risk premium, borrowing requirement alteration scenarios.

The stochastic simulation model established in 2008 is based on a Cost-at-Risk Method and allows estimation of not only average debt servicing costs, but also risks associated with them, i.e. the largest possible deviation from average debt on behalf of the State management costs with a certain probability.



Source: Ministry of Finance

GLOSSARY

Central government sector covers state budgetary institutions, extra-budgetary funds, state enterprises that are non-market producers, public institutions that are non-market producers and are controlled and financed mainly by the central government.

Deterministic simulation model is a model allowing to make a comparison between several borrowing strategies and to evaluate debt portfolio parameters under different exchange rate, interest rate and borrowing requirement scenarios.

Issuer is a legal person who issues or has issued its own securities.

Financial Macaulay duration is the weighted average duration of cash flows of debt liabilities assumed on behalf of the State by issuing Government securities, which also indicates the medium term during which the payments for the debt portfolio do not depend on changes in the interest rate level.

Financial sector covers enterprises and companies mainly engaged in financial intermediation and/or auxiliary financial activity (a central bank, commercial banks, credit unions, other financial intermediaries, financial auxiliary enterprises and companies, insurance companies and enterprises, and pension funds).

Financial derivative is a financial instrument (a future, forward or other transaction), the value or price whereof is linked with the value or price of the goods underlying the instrument, as well as a financial instrument (a future, forward or other transaction), the value or price whereof is linked with the price of securities, exchange rate, interest rate, stock exchange index, credit rating or other variable.

Liquidity is a quality attributable to investments, giving a possibility for the investor, with a minimum value depreciation risk, whenever he wants, to sell his investments at market or close to the market price.

Non-financial sector covers enterprises and companies, whose principal activities are the production of goods and rendering of non-financial services with the goal of making a profit (public non-financial corporations, national private corporations and foreign controlled non-financial corporations).

Resident is a legal or natural person who has economic interests in Lithuania, is engaged in any economic or other activity that is not prohibited by laws, and operates or lives in Lithuania on a permanent or temporary (more than one year) basis.

Market producer is a producer which sells most of its output at economically significant prices.

Non-market producer is a producer which provides most of its output to others for free or at prices that are not economically significant. Prices are treated to be economically significant when more than 50% of the production costs are covered by income from the sale of the output (goods and services).

Debt portfolio is funds borrowed by the Ministry of Finance of the Republic of Lithuania representing the Government of the Republic of Lithuania following the procedure established by the Government, received by issuing GS, signing loan agreements and other binding debt documents.

Social security funds sector covers “SoDra” (State Social Insurance Fund), the budget of the Compulsory Health Insurance Fund, and the Employment Fund.

Stochastic simulation model is a model, when according to mathematic techniques a probability of debt servicing costs and their deviation from the average in cases of different borrowing strategies is simulated.

General government consists of central government, local government and social security funds sub-sectors.

General government debt is the consolidated amount of assumed but still outstanding liabilities of entities attributable to the general government, that have the borrowing right, to creditors to repay funds borrowed by issuing GS, signing loan agreements, leasing (financial lease) agreements and other binding debt documents.

Local government sector covers municipal budgetary institutions, municipal enterprises that are non-market producers, public institutions that are non-market producers and are controlled and financed mainly by the local government.

LEGAL FRAMEWORK

Republic of Lithuania Law on State Debt (Official Gazette 1996, No. 86-2045; 2005, No. 83-3041) regulates the borrowing by the Government of the Republic of Lithuania on behalf of the State, issuing State guarantees, relations associated with the claim right of the State to borrowers and to the borrowers the fulfillment of whose obligations is guaranteed by the State.

Rules for the Issue of and Trading in the Republic of Lithuania Government Securities approved by Government of the Republic of Lithuania Resolution No 1329 of 3 December 1997 (Official Gazette 1997, No. 112-2838; 2004, No. 22-663) regulate the arrangement of sale, settlements, accounting, trade and redemption of litas-denominated GS of the Republic of Lithuania in domestic market, as well as rights and duties of intermediaries in public trading and redemption of securities.

Rules for the Issue of the Republic of Lithuania Government Securities in Foreign Markets, Taking Loans on Behalf of the State and Signature of Other Binding Debt Documents⁵, approved by Government of the Republic of Lithuania Resolution No. 1377 of 20 November 2001 (Official Gazette 2001, No. 98-3491; 2006, No. 29-982) regulate the borrowing by the Government of the Republic of Lithuania on behalf of the State - the issue of the Government Securities in foreign markets, the borrowing on behalf of the State in domestic, foreign markets and from international financial organizations, signature of other

binding debt documents and documents related to the borrowing by the Government on behalf of the State in domestic and foreign markets (with the exception of the documents related to trading of Government Securities in domestic market).

Rules for Granting Loans from Funds Borrowed on Behalf of the State and Issuing State Guarantees and Repayment of Loans Granted approved by Government of the Republic of Lithuania Resolution No. 667 of 4 June 2001 (Official Gazette 2001, No. 49-1713; 2005, No. 105-3882) regulate supervision procedures for granting loans from funds borrowed on behalf of the State and issuing State guarantees to creditors for their granted loans, granted on-lent loans and State guarantees administration, supervision of loans for which the creditors were granted the State guarantee and repayment of on-lent loans. The on-lent loans are granted to finance the investment projects included into the Public Investment Programme, to cover debt obligations of social security funds and balance cash flows of these funds, as well as to renovation of the real estate of the State which has been included into the list of the State real estate to be refurbished. The guarantees of the State are granted only for loans used to finance the investment projects of the public investment programme.

⁵ - In 2006 these Rules were supplemented by establishing uniform procedures for taking loans from domestic and foreign markets and harmonising the provisions of the Rules with the provisions of the Republic of Lithuania Law on the State Debt in revised version of 2005.

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