GOVERNMENT DEBT SUSTAINABILITY: THE LITHUANIAN CASE

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Abstract. *The paper deals with some aspects of sustainability of the government debt of Lithuania for a long, medium and short time horizon. The purpose of the study is to investigate the sustainability of the debt with respect to the nominal GDP growth, the interest rate on the debt, and the primary budget deficit. The differential equations calculus technique is used for the analysis of the debt. A scenario approach is used to simulate the sensitivity of the debt to economic shocks. An inequality for a non-increasing debt over a medium term is applied for the possibility to restore the level of the debt to a pre-crisis level. The sensitivity of the debt to a short movement of interest rate, the GDP growth rate and the primary budget deficit is investigated. A rule of debt change in a short run by one percentage point is formulated.*

Key words: *government debt, budget deficit, primary budget balance, sustainability of debt, nominal GDP growth, interest rate on debt*

1. Introduction

Currently, the sustainability of the government debt receives much attention from both economists and politicians. Financial markets very closely observe and very dramatically react to the issues related to the government debts. The reaction of financial markets is very robust and implies an extremely high volatility of the interest rates. For the countries that have no independent monetary policy, the debt sustainability is even more relevant, because such countries have no monetary tools to amortise the debt-changing inflation targets. Just before introducing the Euro, the bond yields of the Eurozone countries' converged to the yields of Germany. Currently, the spreads of the yields of different countries are extremely large, and the volatility of spreads is as high as never before. The main reason for the turbulences of the financial markets is the increased credit risk, particularly a sovereign risk. A sovereign financial risk, which is defined as the country's ability to fulfil its financial obligations, depends mainly on the development of the government debt in the future. Therefore, the sustainability of the government debt is crucial for all the countries. The European Union's (EU) financial market is a single market; nonetheless, the credit risk for each country is an individual one. The

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