

INVESTORS' CONFIDENCE INDEX FOR LITHUANIA (11), QUARTER IV, 2017

Investors' Confidence Index for Lithuania (ICIL) reflects attitudes and expectations regarding business and investment climate in the country. The purpose of this index is to evaluate country's business environment and the attractiveness of Lithuanian economy to foreign investors based on the experiences and observations of market players, which already operate in Lithuania.

ICIL also serves as a tool for identifying the most influential factors which shape these conditions. It provides potential investors and other stakeholders with principal information about Lithuanian economy, national market and short-term prospects for business development.

The index consists of three indicators which provide an overview of the business environment, factors which have the effect in business and investment plans of companies operating in the country. When measuring ICIL, priority is given to adequate and relevant information which reflects real market trends. With this in mind, only the heads of foreign companies and top tier management are invited to participate in the survey.

The ICIL survey is carried out by Investors' Forum, association of Lithuania's largest investors. Total of 61 Lithuania's foreign capital businesses participated in this quarter's survey.

Index value	Interpretation
ICIL=2 (maximum value)	All participants indicate positive expectations (absolutely positive expectations).
ICIL >1	The percentage of participants with positive expectations exceeds the percentage of respondents with negative expectations.
ICIL =1	Equal numbers of participants indicate positive and negative expectations.
ICIL <1	The percentage of participants with negative expectations exceeds the percentage of respondents with positive expectations.
ICIL =0 (minimum value)	All participants indicate negative expectations (absolutely negative expectations).

Fig 1. Index values and descriptions

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SUMMARY AND CONCLUSIONS

THE 11TH ICIL SURVEY: DESPITE THE SLOWDOWN, ICIL RESULTS REMAIN HIGH

ICIL_{Q4, 2017} = 1,216

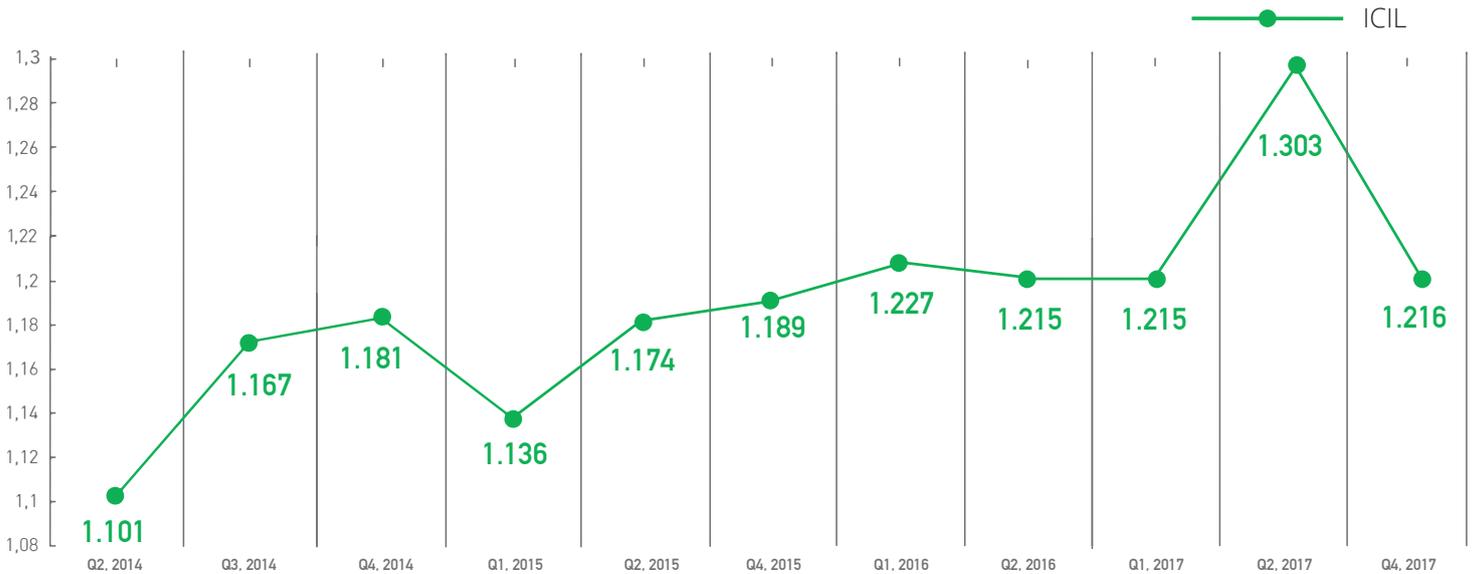


Fig. 2 – ICIL dynamics, ICIL 2017 Q4

The fourth quarter of the year resulted in the slowdown of investors expectations, however, the final result if ICIL remains very high. This quarter's value of Investors' Confidence Index for Lithuania (ICIL) Q4 reached 1,216 (2 maximum value).

Changes in perception of political stability and efficiency of tax system caused negative change for the final value of ICIL. On the other hand, investors' positive attitude towards telecommunications system in Lithuania, as well as the expected growth of demand in the upcoming quarter were the key reasons why ICIL result stayed high.

This quarter investors additionally evaluated tax amendments proposed by the Ministry of Finance and elaborated on possible outcomes of the introduction of social security tax cap.

INVESTMENT ENVIRONMENT IN LITHUANIA: LACK OF POLITICAL WILL TO IMPLEMENT REFORMS

Foreign investors indicate that current investment climate in Lithuania since the previous ICIL research has faced a decline. Nonetheless, the overall results of the research in this quarter illustrate one of the highest values since the beginning launch of ICIL. Better ICIL result were recorded only in the second quarter of 2017. Telecommunications, ability to apply second foreign language in work environment and ease of receiving a credit are the areas which have been evaluated most positively. However, political stability, level of transparency and efficiency of tax system received lowest evaluation.

Previous research indicates that investors have increased their positive attitude towards Lithuania's labor force ability to use foreign language. Such tendency was also indicated in Eurostat research. According on it, 97% of Lithuanians are able to use at least on foreign language, while in the EU the average is only 66%. This result puts Lithuania in a second position among all EU member states.

Currently, transparency of business environment, political stability and the efficiency of tax system have most negative effects on Lithuania's

investment environment. Moreover, this quarter 80% of respondent reveal that current level of political stability is average or low. This might reflect lack of political leadership and delay of adoption of reforms that are strategically important for the investment environment in Lithuania. Failure to implement the Social security contribution ceilings could be one of the recent examples.

Decrease of trust in Lithuania's economy and its perspectives was as well affected by lower perceived transparency level among business and the efficiency of tax system. Almost one third (31%) of respondents indicate that the level of Lithuania's business environment is low. This result is the lowest value since 2014 second quarter.

Another important element of lower ICIL value is the evaluation of Lithuania's tax system's efficiency. 85% of respondents rated it as average or low. This result might reflect the removal of Social security contribution cap from the tax amendment package that was presented together with the State budget.

2017 Q4 CURRENT LEVEL OF LITHUANIAN ECONOMY

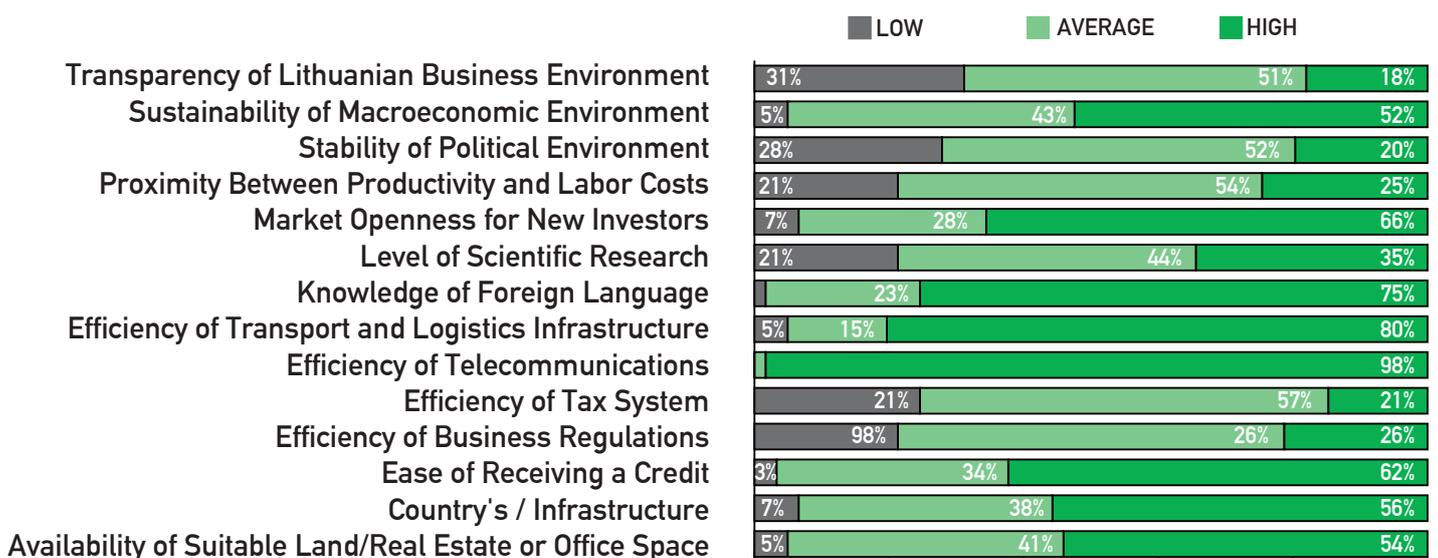


Fig. 3 - Evaluation of Current Business Environment in Lithuania, ICIL 2017 Q4

¹<https://www.weforum.org/agenda/2017/09/bilinguals-brains-dont-have-to-work-hard-to-switch-between-languages>

INVESTORS' EXPECTATIONS: TELECOMMUNICATION INDUSTRY KEEPS ITS LEADERSHIP POSITION

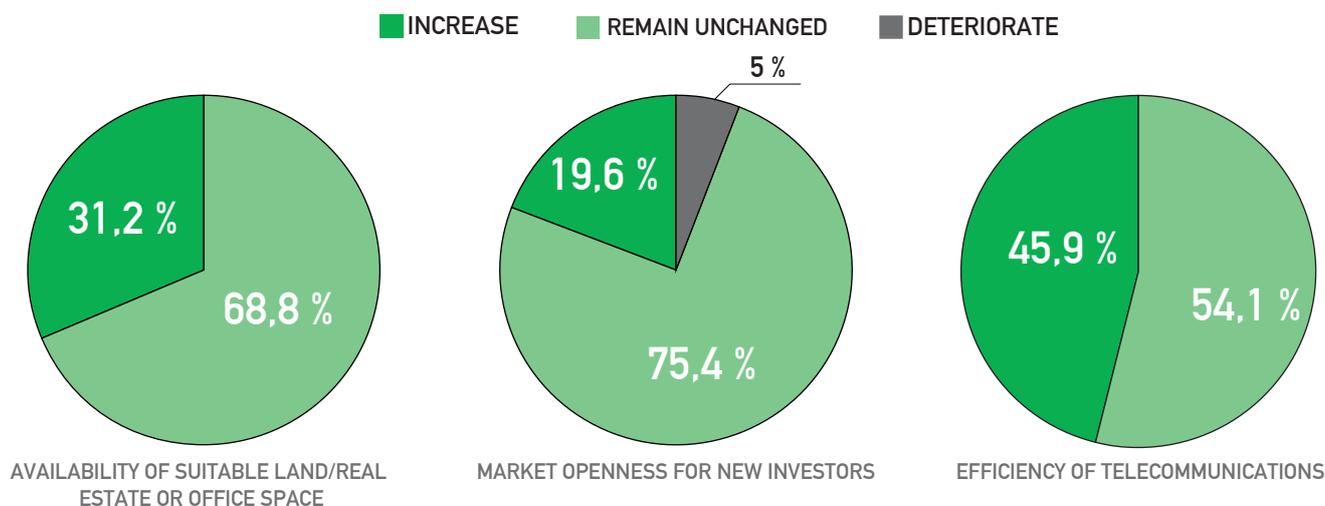


Fig. 4 - Highest Positive Investors' Expectations, ICIL 2017 Q4

Lithuania's investors expect positive change in the telecommunications, availability of suitable land, real estate or office space and in people's knowledge in foreign language. According to research results, 46% of respondents indicate that Lithuania's telecommunication industry will face further development. Telecommunications industry has been the leading category among all others since 2014 second quarter.

This quarter, investors are quite optimistic about the availability of suitable premises or land for their businesses. The expectation that it will increase were expressed by 31% of respondents. However, comparing current results with 2017 second quarter's, this perception has fallen by 17 percentage points.

Three quarters of respondents do not expect any changes in the field of knowledge in foreign languages and its application in working environment, while the rest 25% of investors indicate the situation will improve. Positive

approach towards this field has improved by 10 percentage points since previous research.

According to the 2017 ICIL survey of the last quarter, as much as 95% of investors believe that the level of openness of Lithuania to new investors will remain unchanged or even improve in the near future. These expectations are also supported by the results of the international Doing Business² study. In this study, Lithuania is in positioned in the 16th place and during the past year has risen by 5 positions.

It is worth mentioning that 11 different business areas are rated in the Doing Business index. The biggest positive change was recorded in the field of connection to electricity networks, in which Lithuania rose by 22 positions. According to the international study, such a positive change was the result of the improved approval process and the shortening of deadlines for issuing internal certificates for conducting electrical wiring.

LITHUANIA'S POSITION IN DOING BUSINESS INDEX

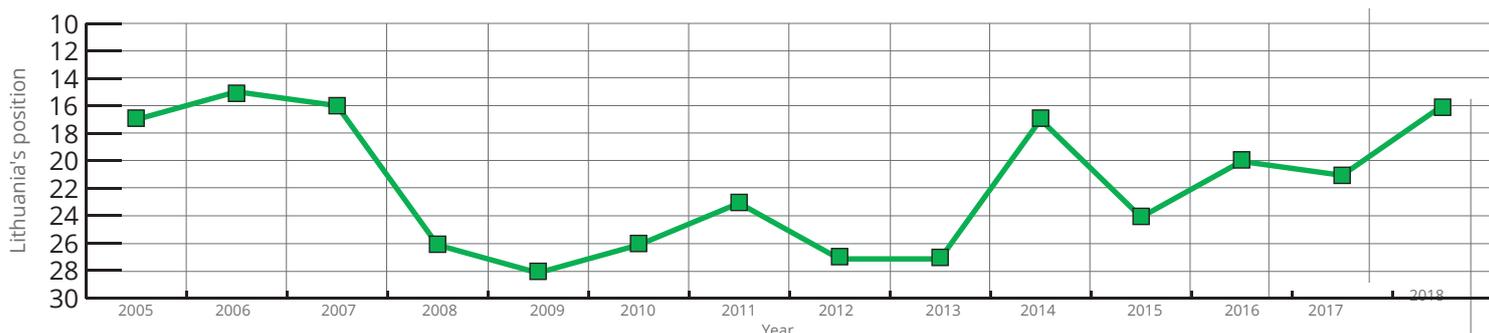


Fig. 5 - Lithuania's Position in Doing Business Index, ICIL 2017 Q4

² <http://www.doingbusiness.org/reports/global-reports/doing-business-2018>

Investors expect slowest improvement in country's political stability, the relationship between labor costs and productivity, and efficiency in the tax system. 46% of respondents indicate that political stability in Lithuania will be lower in the upcoming quarter. In the second quarter of this year, only 15% of investors had negative predictions for political stability in Lithuania.

It is likely that such change was caused by slow implementation of the Government's reforms. Three years ago, in 2014³, 62% of investors expressed concern about the absence of sodra's contribution ceiling. According to them, lack of social insurance contribution ceiling in the economy is affecting companies which seek to recruit highly qualified, well-paid employees. 95% of investors are in favor of such introduction of the ceiling. (see fig. 12).

The ratio of labor costs and productivity also raises investors' concern. If in the second quarter of the

year there were only 13% of respondents expecting a decline in this area, this quarter 26% of investors believe that the gap between labor costs and productivity will increase by the end of the year. Finally, it is also worth noting that this quarter's pessimistic expectations were exceeding optimistic ones

One out of five investors believe that the efficiency of the tax system will decline in the near future. Though, the number of those who have this opinion has not increased since the second quarter of 2017. However, the number of those who expect positive increase in this field has declined by 10 p.p.

More than two thirds (69%) of respondents believe that the efficiency of the tax system will not change. Slowdown in the positive outlook could be explained by the unmet expectations about the tax reform, especially the postponed social security tax cap.

EXPECTATIONS FOR UPCOMING QUARTER

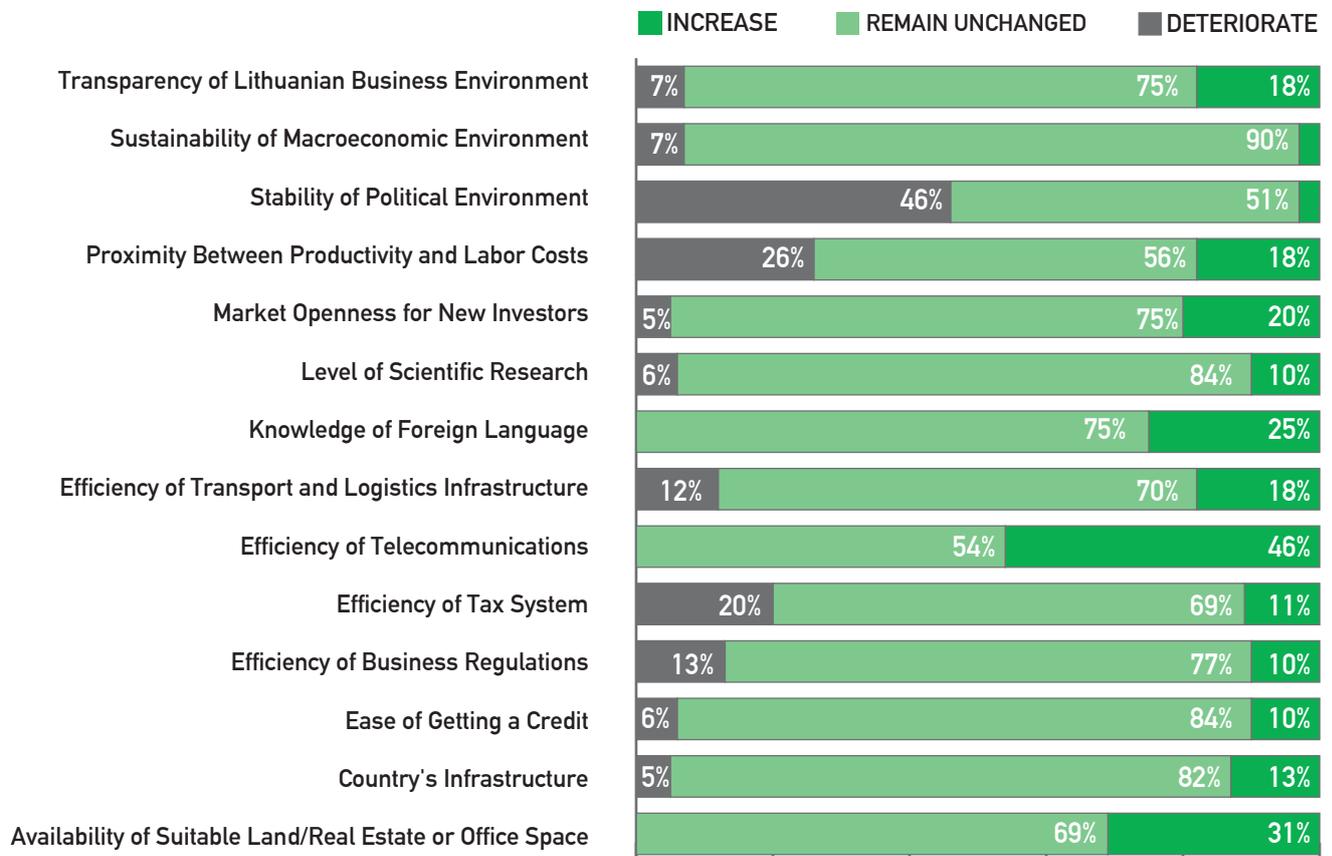


Fig. 6 - Investors' Expectations for 2017 Q4, ICIL 2017 Q4

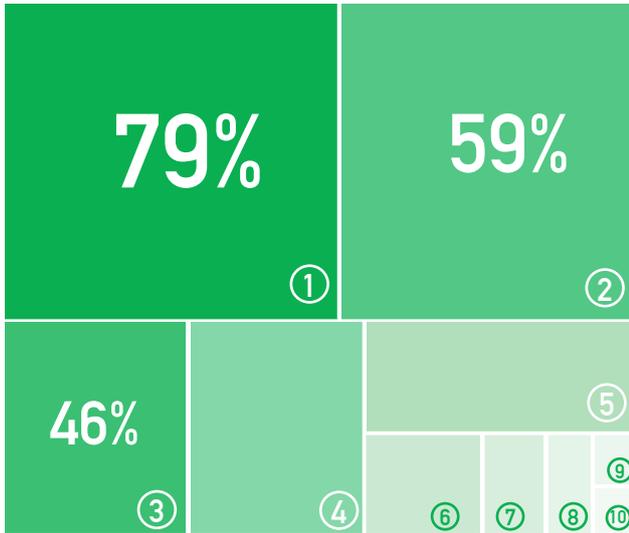
³ http://investorsforum.lt/wp-content/uploads/2014/11/LIPI_2014_IVketvirtis.pdf

CONCERNS ABOUT LABOR REGULATIONS ARE REPLACED WITH ATTENTION TO PROBLEMS IN EDUCATION SYSTEM

The recent results of ICIL index reveal that the adoption of the new Labor Code was positively accepted by investors. For the past two years, labor relationship regulation, has been consistently indicated as one of most problematic

areas in Lithuania. This quarter it ranked only as the 4th area in the need of urgent improvement. Full effect of newly introduced Labor Code will be seen in a couple years' time.

MOST ATTENTION REQUIRING FIELDS



- ① Education
- ② Public sector efficiency
- ③ Talent Migration
- ④ Regulation of employment relationships
- ⑤ Transparency
- ⑥ Tax system
- ⑦ Permits and building regulations
- ⑧ Business Interesting Legal Regulation
- ⑨ Transport and logistics infrastructure
- ⑩ Energy market
- ⑪ Telecommunications infrastructure

Fig. 7 – 2017 Q4 Most Attention Requiring Fields, ICIL 2017 Q4

Currently, Lithuania's education system is the area which worries investors the most. 79% of respondents expressed their concerns about this area. Since the previous quarter attention towards this field increased by 23 p.p.

Another area of particular interest is the efficiency of the public sector. 59% of investors expressed support for Government plans and actions to increase efficiency of the sector.

The challenge of talent migration also receives a great deal of attention. 46% of investors indicate that this problem must be solved as urgently as possible. The recognition of the importance of talent migration is also reflected in the investors' concerns about the lack of skilled labor (see Fig. 8). Such concerns are not without grounds: the decreasing population and high emigration flows are evident in the official statistics⁴ (Fig. 9).

AVAILABILITY OF QUALIFIED LABOR FORCE

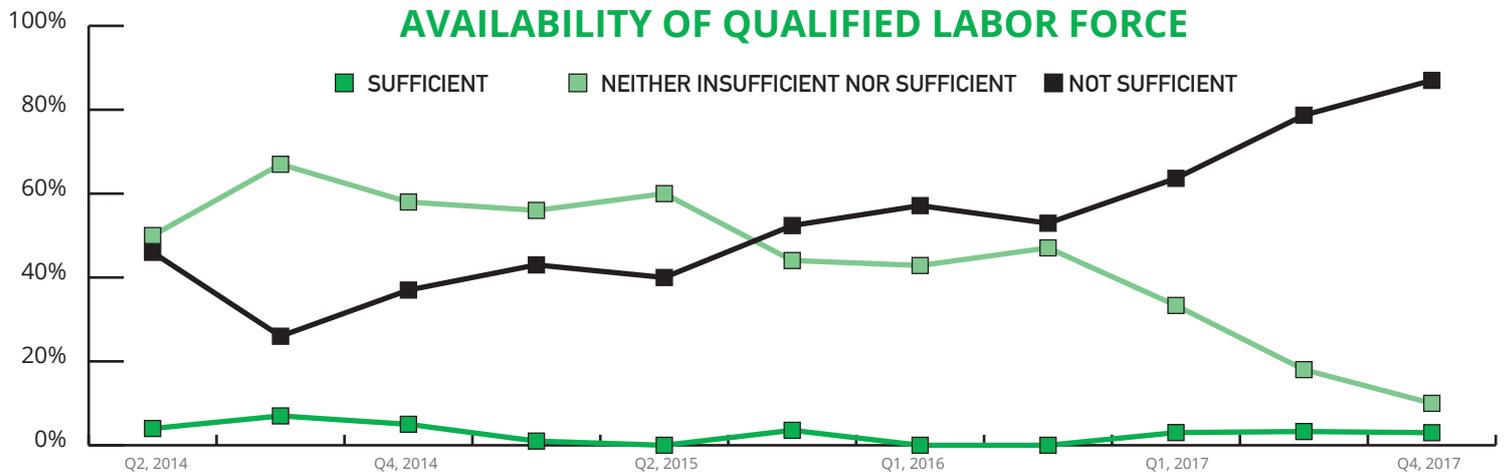
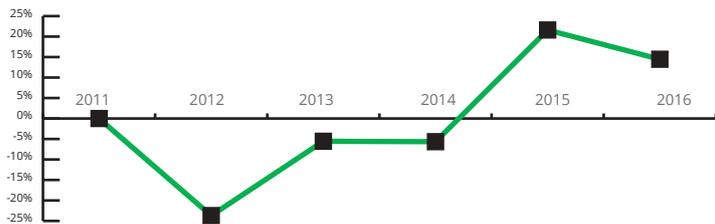


Fig. 8 – Tendencies of Qualified Labor Force in Lithuania, ICIL 2017 Q4

⁴ <https://osp.stat.gov.lt/informacini-ai-pranesimai?eventId=143259>

PERCENTAGE CHANGE OF EMIGRANTS



PERCENTAGE CHANGE OF LOCAL RESIDENTS

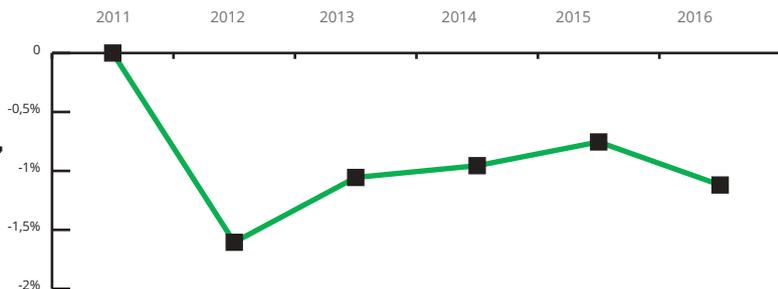


Fig. 9 – Demographic Changes in Lithuania, ICIL 2017 Q4

INVESTORS' FUTURE PLANS:

INCREASED PROFITS, HIGHER SALARIES & NEW JOBS

This quarter more foreign direct investment companies are planning to experience growing profits. There is a 44% of respondents who expect higher profit. The plans of foreign investors to increase the salaries and create new, well-paid jobs are also predicted for upcoming fourth quarter of the year. The growth of salaries is also reported by the Bank of Lithuania in 2017 their report – "Review of Lithuanian Economy". The report emphasizes that the wage growth is characteristic not to specific group of employees, but rather to the general labor market.

A fourth quarter ICIL survey reveals that a larger share of foreign investors are determined to focus on reinvesting increased profits not to technological renewal but to create jobs and raise wages. This quarter 67% of respondents intend to raise their employees' wages in the next three months. At the same time, 67% investors predict the growth in demand for their products or services.

INVESTORS' PROJECTIONS FOR 2017 Q4

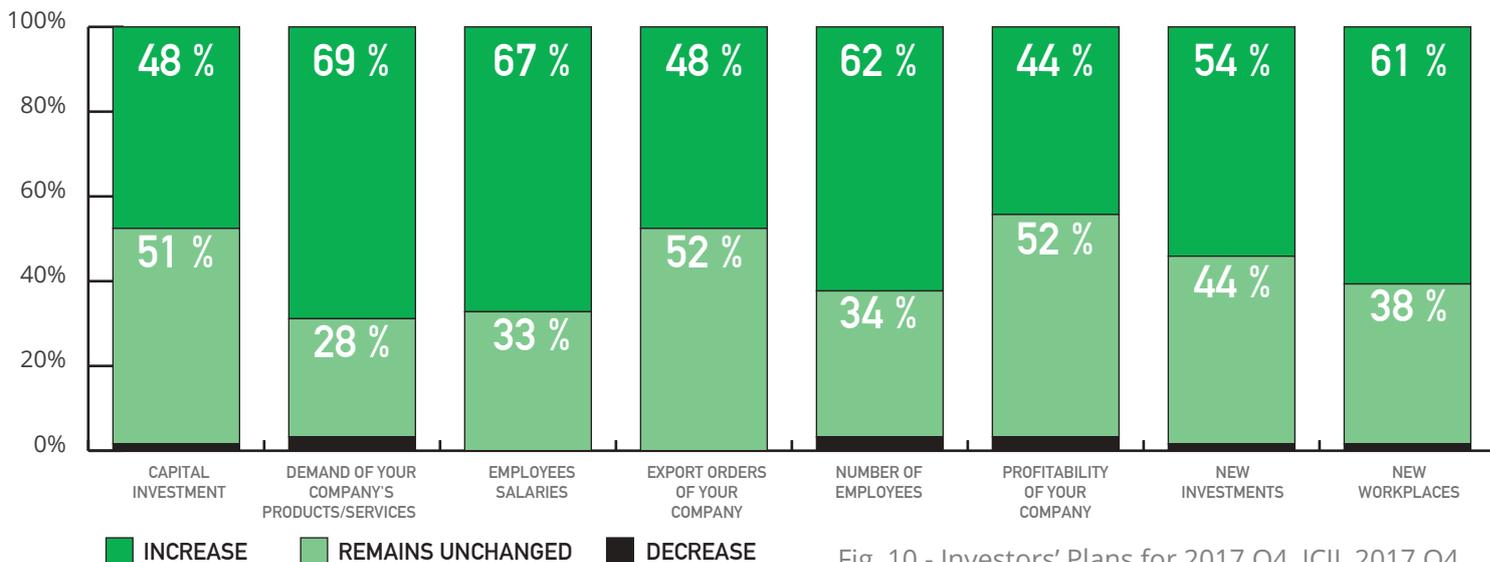


Fig. 10 - Investors' Plans for 2017 Q4, ICIL 2017 Q4

ADDITIONAL QUESTIONS:

Traditionally, the ICIL research is complemented by relevant issues and topics of the period. In the fourth quarter of this year, investors were asked to evaluate the impact of the reforms proposed by the Ministry of Finance on the investment climate and to express their position on the social insurance contribution ceilings.

INVESTMENT ENVIRONMENT: SMALL STEPS IN THE RIGHT DIRECTION

Investors expressed favorable opinion regarding the plans of the Ministry of Finance to expand the list of activities to which financial relief would be applicable in free economic zones. More than a half (57%) of respondents expect it to have a positive impact on the investment environment, the remaining 43% believe that the situation will remain in status quo.

Investors also positively evaluated the Government's proposition to implement social insurance contribution ceiling which would be equal to 120 annual average salaries. 52% of respondents indicate that this reform would benefit investment climate. All other expect status quo, due to the fact that the proposed limit of the ceiling is high. This topic is elaborated in the final part of the research. The Ministry of Finance is also planning changes to Value added tax (VAT) in many areas: for example, 5% VAT rate for non-reimbursable prescription medicines, passenger services, publications and books, 15% (instead of 9%) rate for accommodation services and for both centralized heating and

hot water supply. Investors' opinion about these and other changes to VAT application is rather critical: 62% of respondents believe that such changes will not have great impact on the country's investment attractiveness, one third (34%) indicate that the proposed changes will have a positive impact on the investment climate, and 3% are confident that reform will have negative effects.

The proposal to set a 5% VAT rate for the commercialization of patentable inventions is highly appreciated. This initiative is supported by 97% respondents.

Although investors generally are in favor of the new tax changes, the overall assessment of the efficiency of the tax system is rather low (Fig. 3). This might be because of the fact that investors believe that legislative changes are made in the right direction, yet there is a lack of determination and political will.

IMPACT ON INVESTING ENVIRONMENT

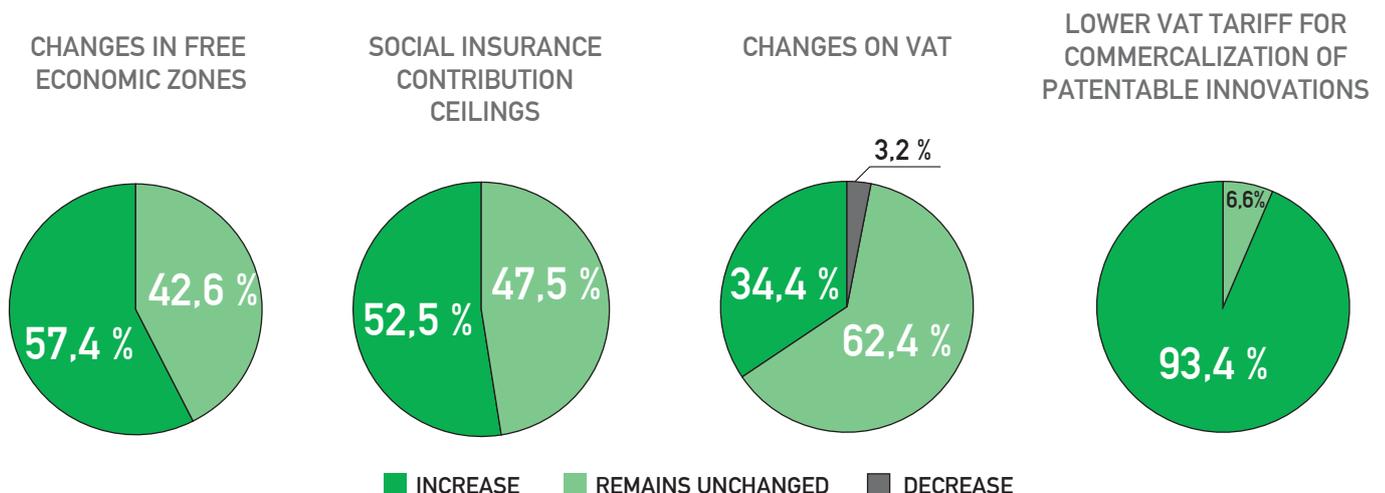


Fig. 11 – Evaluation of the Reforms Introduced by the Ministry of Finance, ICIL 2017 Q4

SOCIAL SECURITY TAX CAP (SODRA CEILINGS)

At the end of 2014 62% of investors have expressed the opinion that the efficiency and investment attractiveness of a country's tax system is undermined by the fact that there is no salary cap for social security contributions. Three years later, an increasing share of foreign capital representatives believe that such implementation is necessary. According to the fourth quarter of 2017, 95% of investors approve social security tax cap.

SHOULD GOVERNMENT IMPLEMENT SOCIAL INSURANCE CONTRIBUTION CEILINGS?

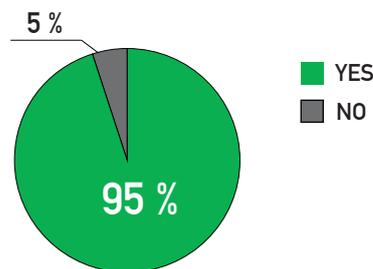


Fig. 12 – Investors' Opinion About Social Insurance Contribution Ceilings, ICIL 2017 Q4

The largest share of investors (59%) believe that social security tax cap of 6 average monthly salaries would have the biggest impact on the business environment and the investment climate. About half, (49%) of investors are convinced that the introduction of social insurance contribution ceilings would increase employees' salaries of employees and reduce shadow economy.

WHERE SHOULD SOCIAL INSURANCE CONTRIBUTION CEILINGS START?

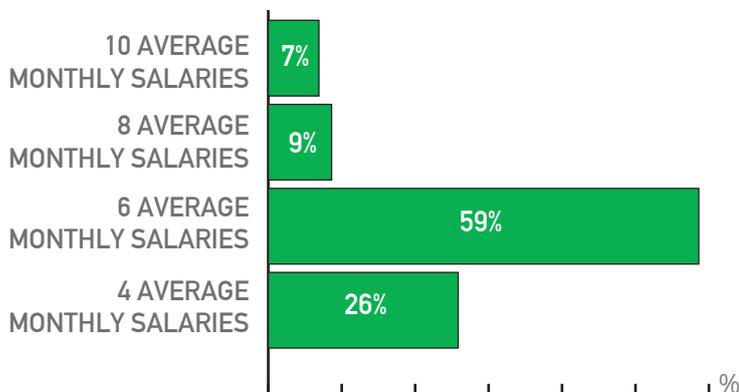


Fig. 13 – Size of Social Insurance Contribution Ceilings, ICIL 2017Q4

In addition, 59% of respondents believe that this decision would help to attract foreign direct investment to Lithuania. Most of respondents (72%) are convinced that Lithuania would become more attractive to highly qualified labor force.

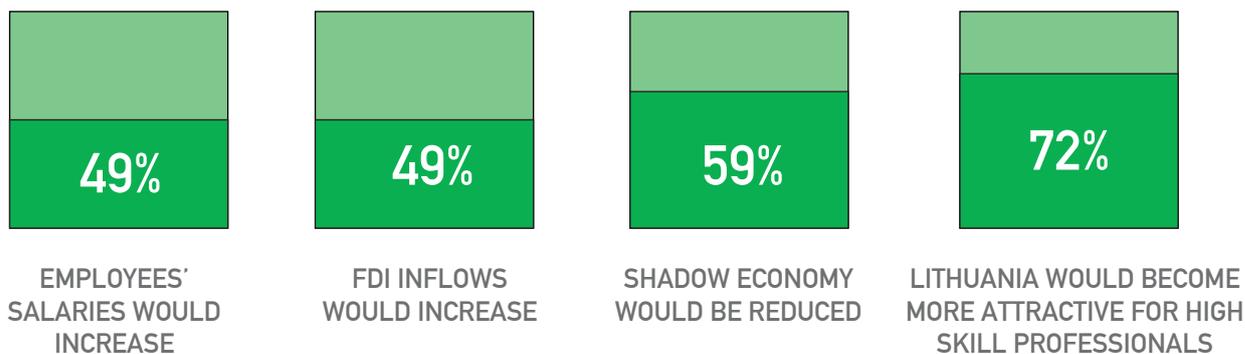


Fig. 14 – Effects of Social Insurance Contribution Ceilings on Lithuania's Economy, ICIL 2017 Q4

According to international Deloitte study⁶, having social insurance contribution ceiling, would benefit Lithuania. The country would become the first one in the Baltic region to have this type of system and join other 17 European countries where similar ceilings already exist. It would provide a competitive advantage in attracting international foreign investment in the region.

⁶ https://www2.deloitte.com/content/dam/Deloitte/be/Documents/tax/TaxStudiesAndSurveys/Comparative%20Benefits%20Study_2017.pdf