

Baltic Report: Baltics Enter a Stronger 2026

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January 2026

Executive summary

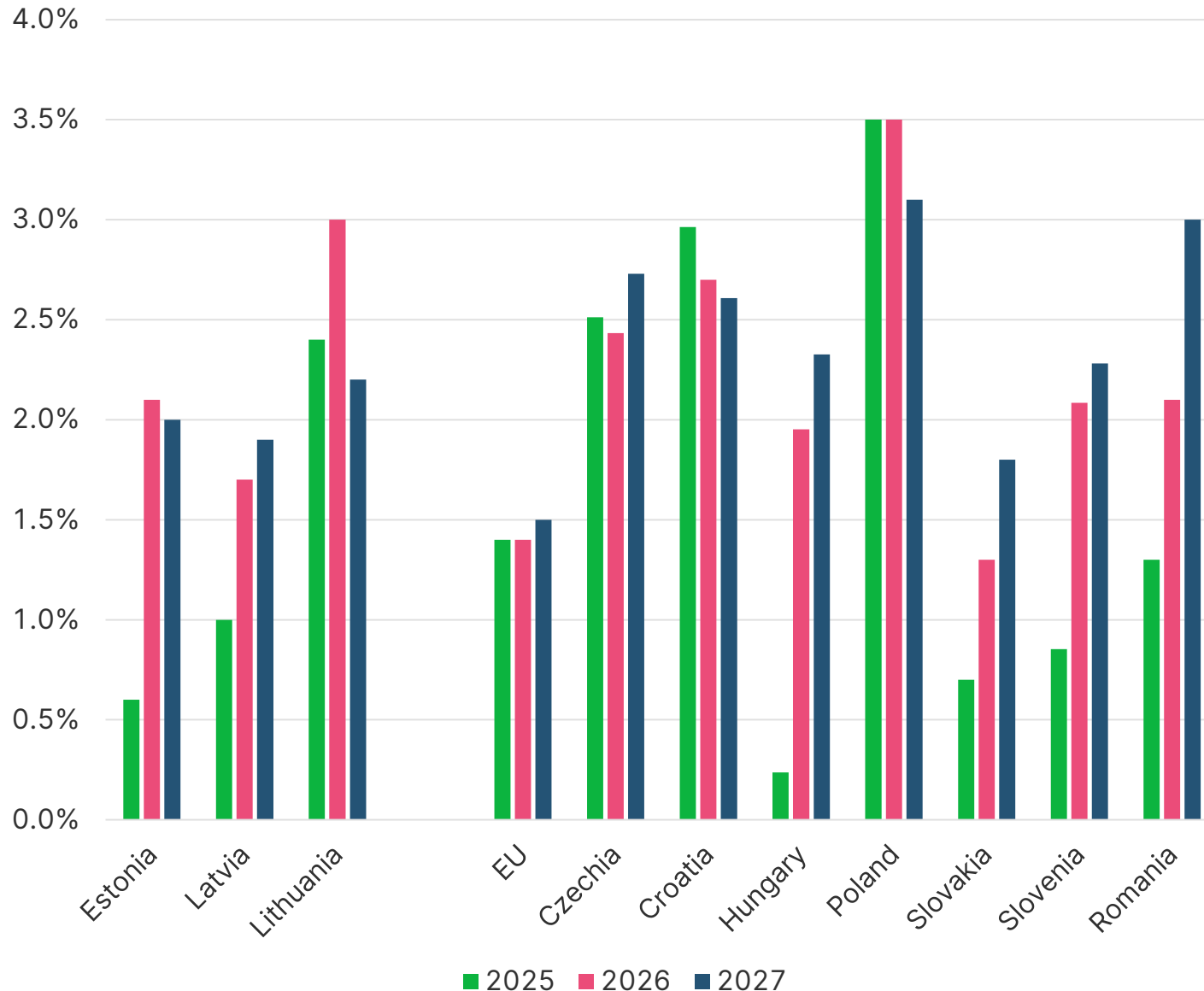
1. **Baltic growth diverged in 2025:** Lithuania showed solid resilience while Estonia and Latvia recorded only modest recoveries after years of contraction.
2. **Stronger regional rebound expected in 2026:** All three economies are forecasted to accelerate above the EU average, converging toward ~2% growth by 2027. Lower borrowing costs and substantial EU/RRF funding fuel strong investment, while consumption patterns diverge—Lithuania booming, Estonia & Latvia recover more gradually.
3. **Inflation cooling but country-specific anomalies persist:** Estonia's VAT-driven spike, Latvia's energy-cost pressures, and Lithuania's excise effects gradually normalize toward 2.2–2.8% in 2026.
4. **Labor markets loosen but wages remain strong:** High Baltic unemployment relative to the EU contrasts with robust wage growth driven by minimum wage hikes and tax reforms.
5. **Industrial and retail performance diverge:** Lithuania leads the Baltics in long-term industrial output and retail growth; Estonia remains below pre-invasion levels for both, while Latvia shows promising late-year growth momentum.
6. **Fiscal pressures intensify:** All three countries face rising deficits and public debt through 2027 due to defense spending increases, tax adjustments, and major infrastructure commitments. However, there is still moderate to substantial fiscal space.
7. **RRF and green transition progress uneven:** Estonia and Latvia advanced with their RRF plans, while Lithuania awaits new disbursements; major green infrastructure projects (e.g., hybrid renewable parks, wind farms, Rail Baltica) drive long-term sustainability and growth.

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Main economic developments



Annual GDP growth

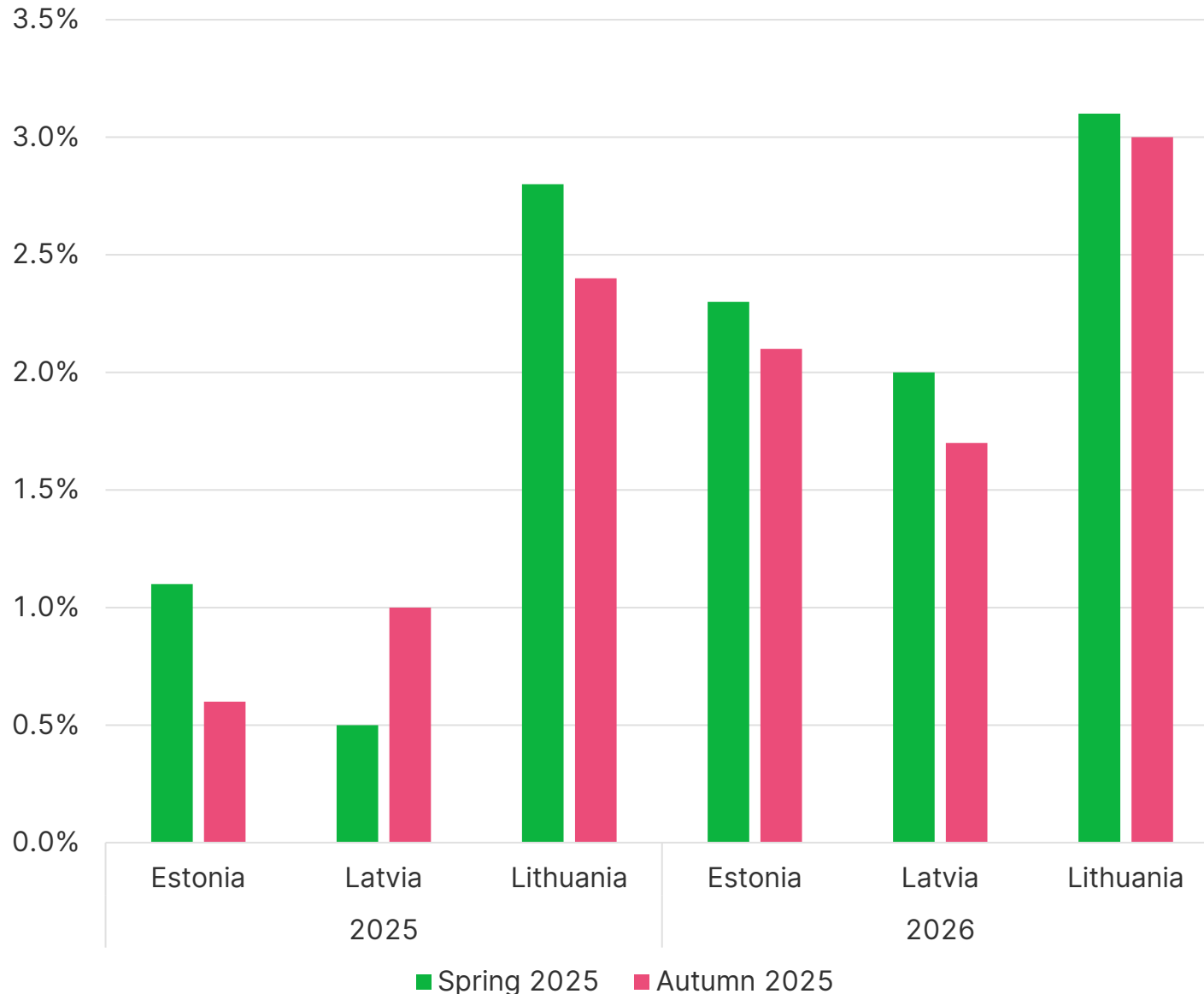


Much stronger year ahead

Economic performance in the Baltic region was subdued in 2025, with only Lithuania showing resilience at an estimated 2.4% growth rate. In contrast, Estonia is experiencing a fragile recovery, with projected growth of just 0.6%. Nonetheless, it is still a significant turning point, as we expect the first positive figure following three years of contraction; an unprecedented period of economic decline. Similarly, Latvia is expected to grow by 1% in 2025, marking a return to expansion after two years of struggles.

Looking ahead to 2026, growth momentum is expected to accelerate across the board. Estonia is forecasted to expand by slightly more than 2%, while Lithuania is projected to reach 3%. Latvia is anticipated to record the region's most modest gains at 1.7%. All three Baltic countries are expected to outperform the EU average over the near term, before converging toward a growth rate of approximately 2% by 2027.

Revisions of GDP growth forecasts



Volatility in growth forecasts

The European Commission has revised its 2026 growth forecasts downward for all economies compared to its Spring projections; moreover, downward revisions were applied to the 2025 outlooks for Estonia and Lithuania. This adjustment is primarily attributed to a slower-than-anticipated revival in private consumption, driven by a persistent accumulation of household savings and slower wage growth.

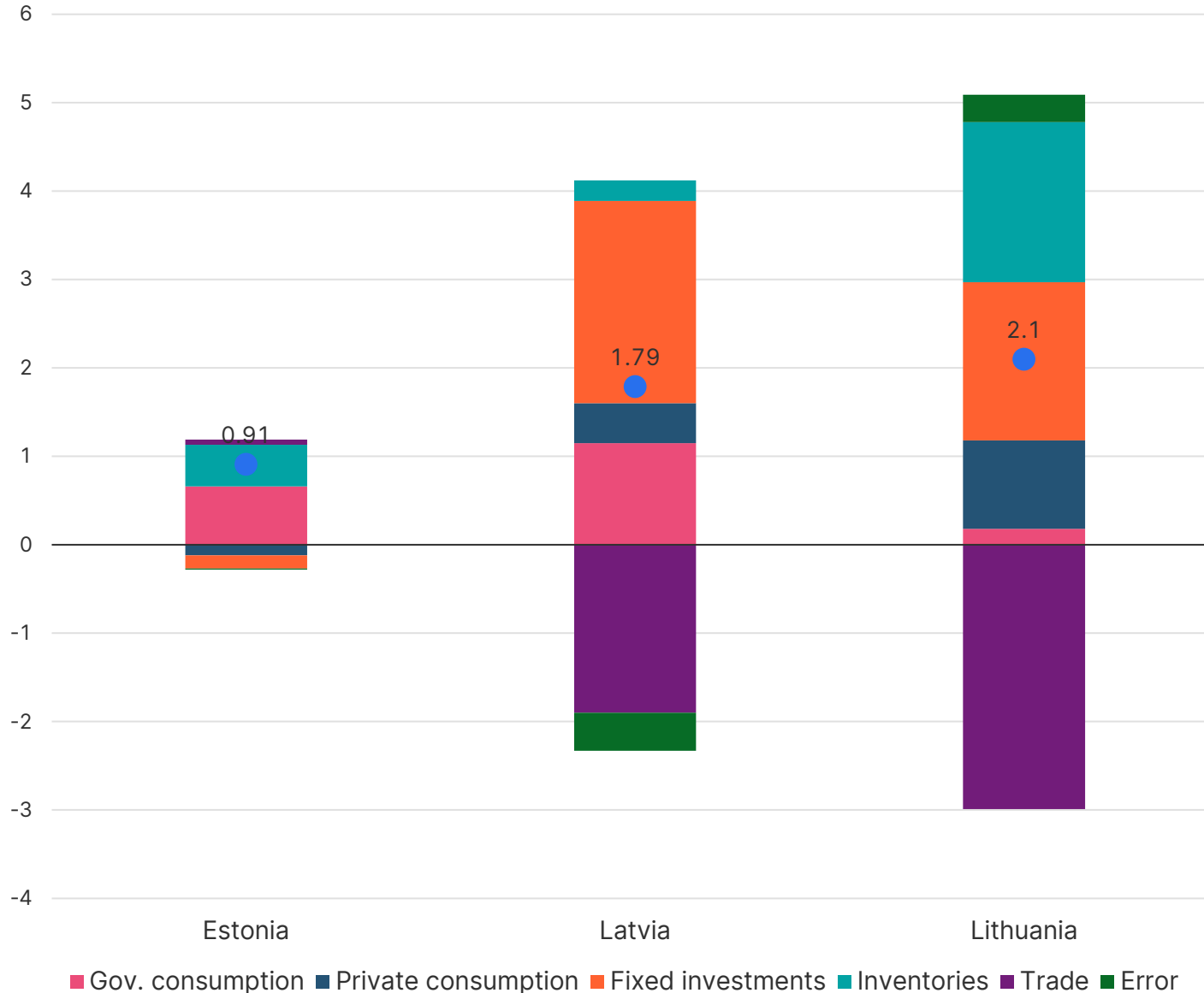
However, the Commission's 2026 projections appear conservative, particularly regarding Estonia and Latvia. For Estonia, the OECD forecasts robust growth of 2.9%, while the domestic central bank projects approximately 3% for both 2026 and 2027. In contrast, the IMF maintains a significantly more bearish outlook of 1.5%. A similar divergence exists for Latvia: while the EC expects a 1.7% expansion in 2026, the OECD anticipates 2.1%, and the Bank of Latvia forecasts 2.8%. For Lithuania, however, international institutions show greater consensus, aligning around a 3% growth rate for 2026.

Investments to push Latvia and Lithuania

The Baltic economies are slowly recovering, with Latvia and Lithuania being pushed by strong local investment rather than exports. Lower borrowing costs, EU and RRF funding, paired with increased defense spending are boosting investment activity across the two countries. However, imports are rising faster than exports, making trade a drag on overall growth.

Consumer spending sets the countries apart. Lithuania is expected to see a boom in 2026 as pension reforms unlock extra cash for households. In contrast, the recovery in Estonia and Latvia will be more gradual. Latvians are saving more due to security fears, while Estonians are holding back spending due to tax hikes. As a result, Lithuania's growth outlook remains stronger than its neighbors. However, government spending has the potential to boost Estonia's growth in 2026.

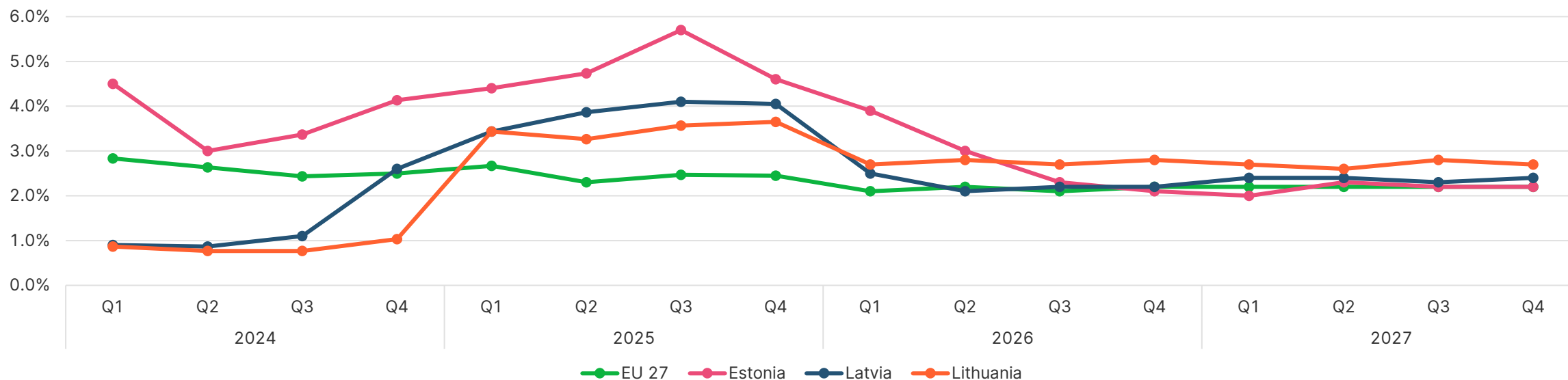
Contributions to annual GDP growth, Q3 2025



Source: European Commission, Erste Group

Inflation to converge closer to the target

Inflation forecast



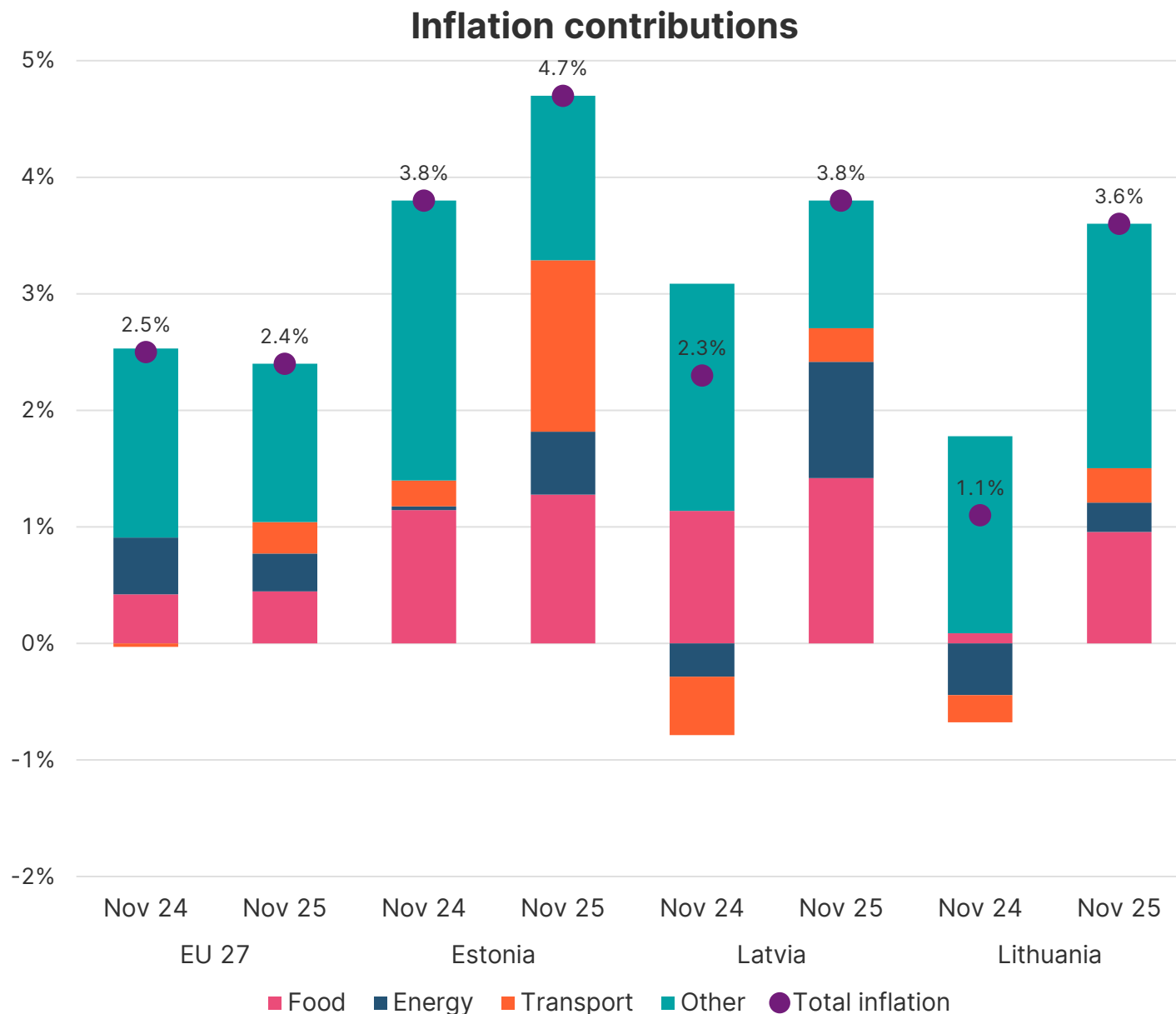
Source: European Commission, Erste Group

Inflationary pressures were elevated across the Baltics in 2025, though the specific drivers vary by country. Estonia is currently an outlier with the highest inflation rates, yet the trend will continue declining from the peak reached in Q3 2025 at 5.7%. The adverse base effect was largely caused by a sharp increase in VAT, with the inflation reaching 4.1% at the end of 2025. Meanwhile, Latvia and Lithuania face more moderate price growth of roughly 3-3.5%. In these two southern neighbors, the primary driver is strong wage growth, which is keeping the cost of services and food high, alongside specific excise duty hikes in Lithuania. By 2026, price growth is expected to cool significantly across the region as the impact of tax hikes fades and energy markets stabilize. All three countries are projected to converge toward inflation rates of approximately 2.2% to 2.8%. Moreover, looking ahead to 2027, the region has avoided an upside inflation risk, as the introduction of the new European emissions trading system (ETS2) has been postponed.

Country specific inflation pressures

While sticky services inflation explains a significant portion of the headline figures, we see some country-specific anomalies. According to HICP data, the transportation category in Estonia contributed nearly 1.5 percentage points to the total, driven by an annual price increase exceeding 10% as of November. A deeper dive shows that this rise stems primarily from a 250% surge in the cost of driver's licenses. Despite having a low weighting in the consumer basket, this item has disproportionately inflated the headline figure.

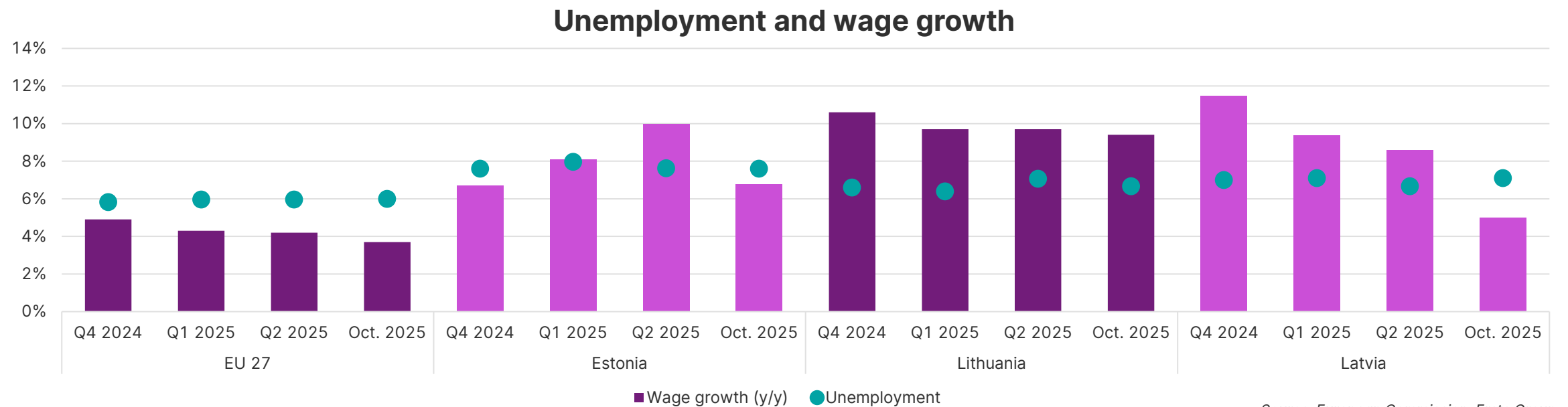
Housing and energy costs in Latvia are another outlier. Electricity prices rose 14% year-on-year due to base effects, while rents increased by 6.6%. Furthermore, households in Riga experienced a 12% rise in heating costs in October. Further energy price hikes are anticipated nationwide following the discontinuation of electricity subsidies on January 1st.



Source: European Commission, Erste Group

January 2026

Unemployment remains higher than EU average



Source: European Commission, Erste Group

The Baltic labor markets are currently reporting on average higher unemployment rate than the CEE and the EU averages, despite demographic pressures and varying speeds of economic recovery. In Estonia, the unemployment rate reached 7.6% in the third quarter of 2025 and is projected to decline only modestly to 7.2% in 2026 and 7.1% in 2027 due to labor hoarding conducted in the past. Lithuania reports the lowest unemployment rate in the region at 6.6% but is forecast to edge up to 6.8% in 2026. Latvia’s unemployment is expected to dip to 6.6% in 2026. Across the region, shrinking labor supplies due to natural population decline remain a critical structural challenge; especially Lithuania faces a projected 30% decline in its working-age population by 2050, according to the OECD. Wage growth remains robust, with minimum wages set to rise in 2026 by 11% to €1153 in Lithuania and €780 in Latvia, while Estonia’s rate currently sits unmoved at €886, with unions and employers currently negotiating a rise. Thes wage dynamics and labor market are further influenced by upcoming policy shifts, such as Estonia’s 2026 tax reform which will boost net income, Latvia's new minimum wage calculation methodology, and Lithuania’s introduction of progressive income tax rates and a voluntary second-pillar pension system.

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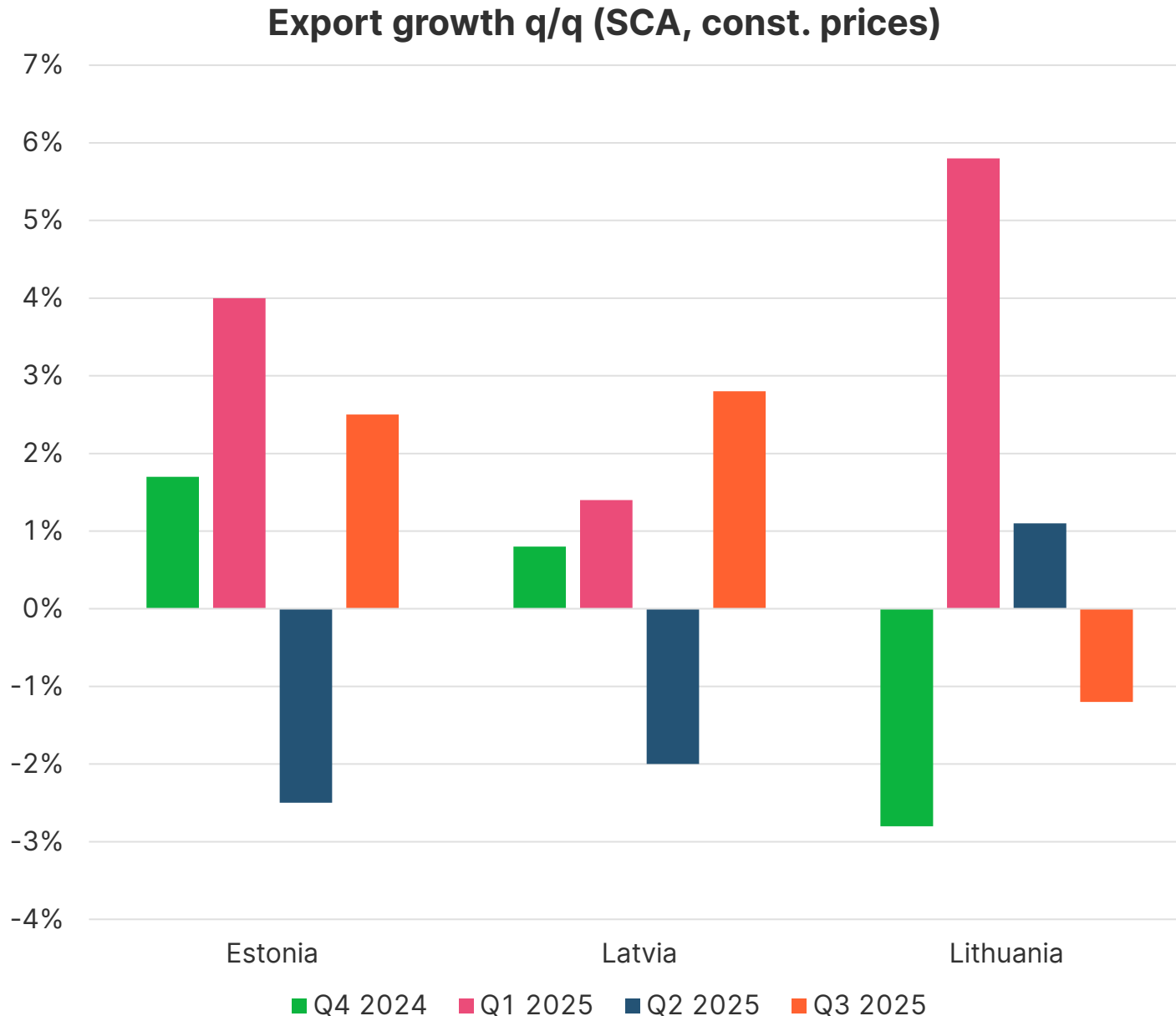
Retail and industrial development



Volatile exports in Baltics

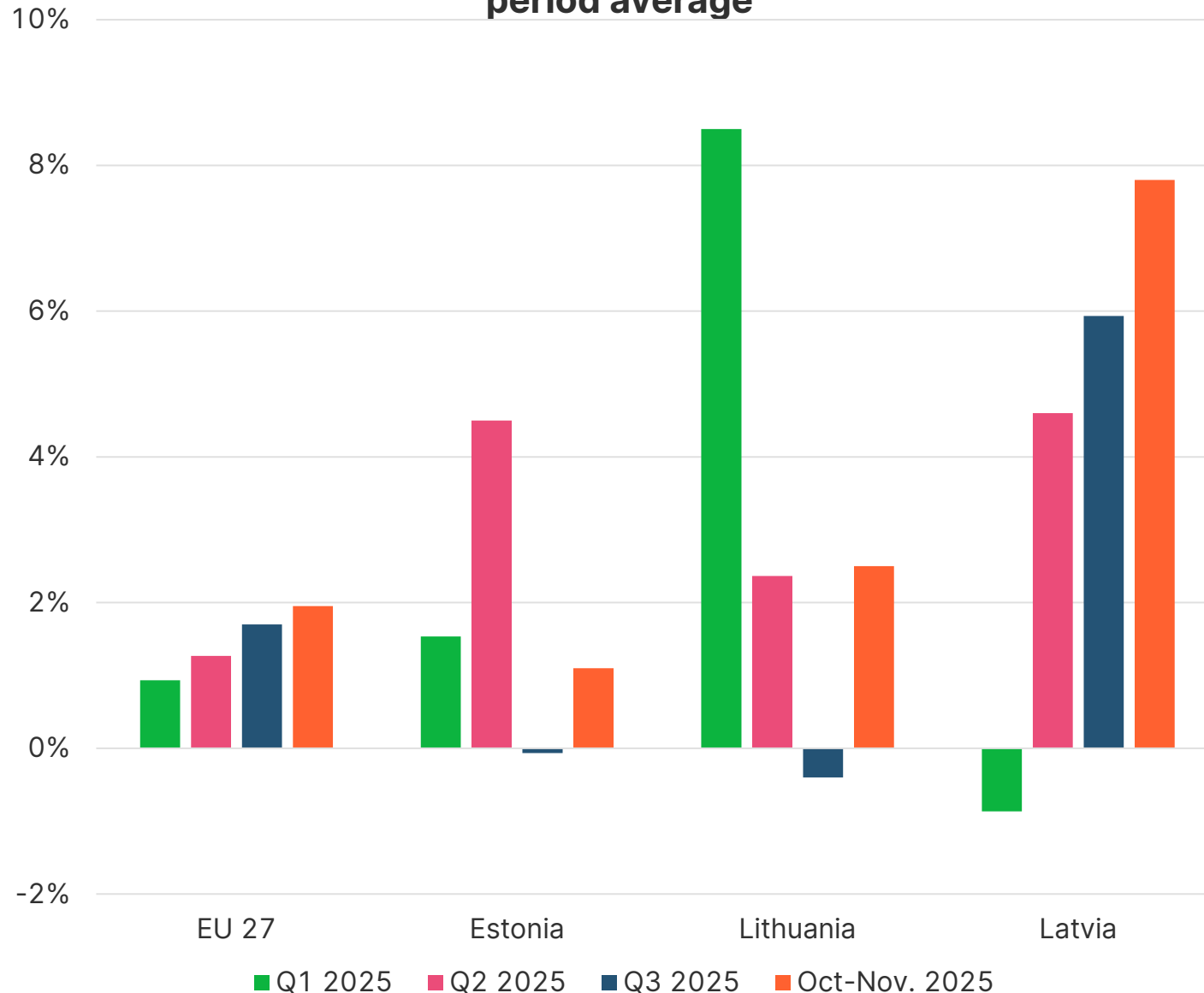
The external economic environment for the Baltic economies remains problematic. Primary trading partners are growing relatively slowly, with Finland's and Germany's GDP stagnating and Sweden growing at 1.5%. Russia, another main trading partner, becomes increasingly unreachable.

Despite these headwinds, Estonia and Latvia have recorded quarterly growth in exports in three of the last four quarters, while Lithuania registered a substantial surge in activity during Q1 2025. However, in real terms, trade volumes for the former two economies remain below 2022 levels. In contrast, Lithuania has successfully grown its real export volumes, a performance driven largely by its booming services sector.



Source: European Commission, Erste Group

Industrial production development, y/y period average

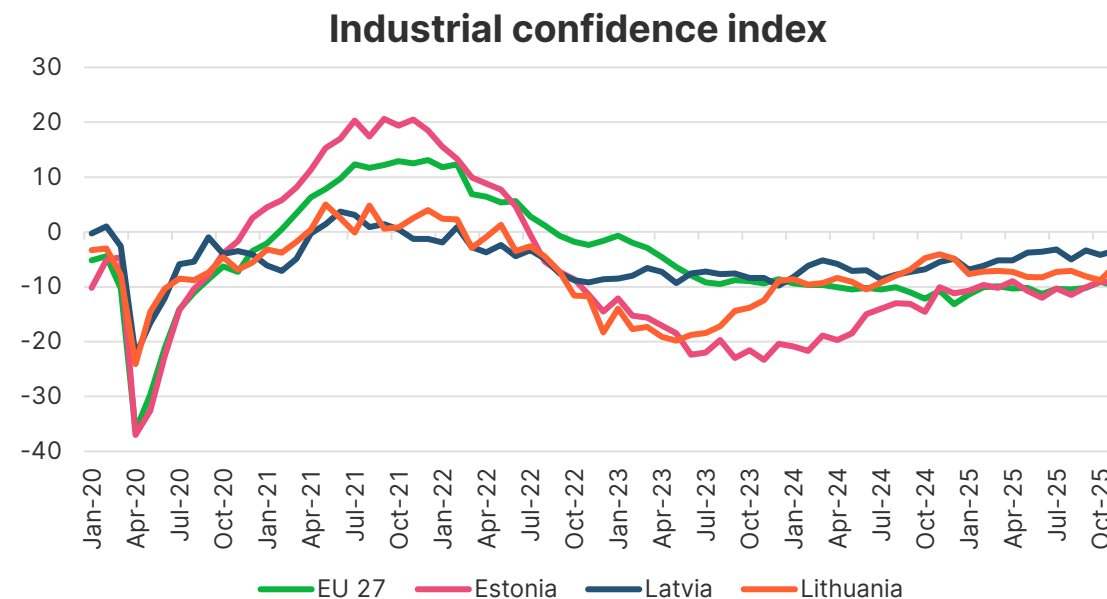
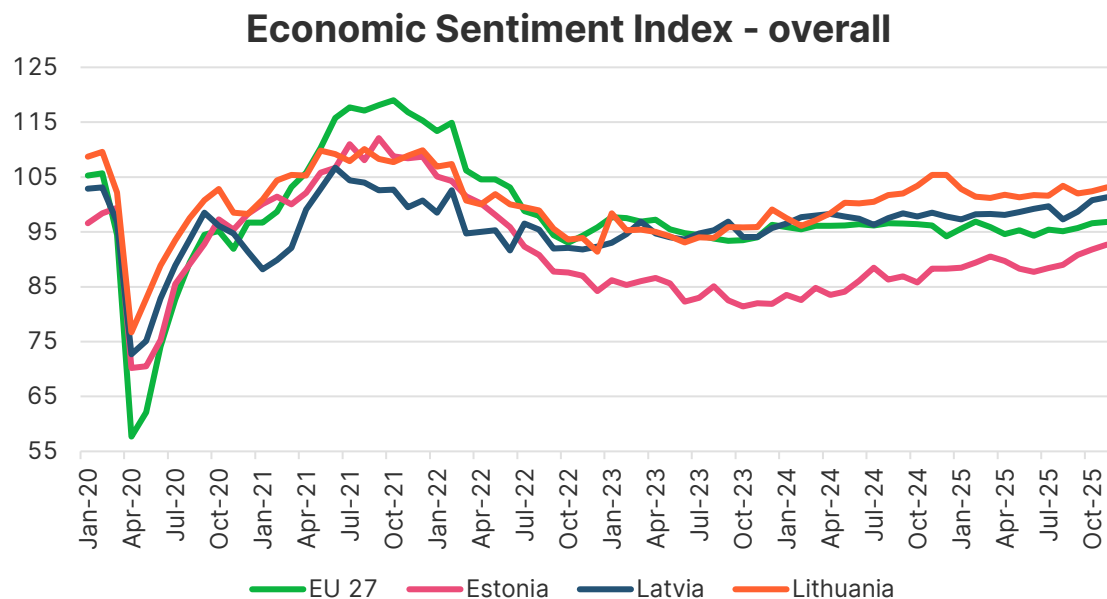


RETAIL AND INDUSTRIAL DEVELOPMENT

Latvia's industry rebounds

Industrial performance across the Baltic region shows significant divergence in annual terms. Estonia is currently recording the weakest figures, with aggregate output trailing 2021 levels by approximately 6%. In Latvia, the picture is mixed. While the in annual terms, the industrial index has seen a robust rebound since Q2 2025, it remains below the 2021 baseline. Nevertheless, the manufacturing sub-sector has supported this trend, successfully expanding to register a 4% increase over the reference period. Lithuania is the clear regional leader. Despite a softer third quarter, total production stands 9% above 2021 levels, driven by a 12% surge in manufacturing activity. We attribute these superior results, in part, to positive economic spillovers from neighboring Poland.

Sentiment indicators slightly improve

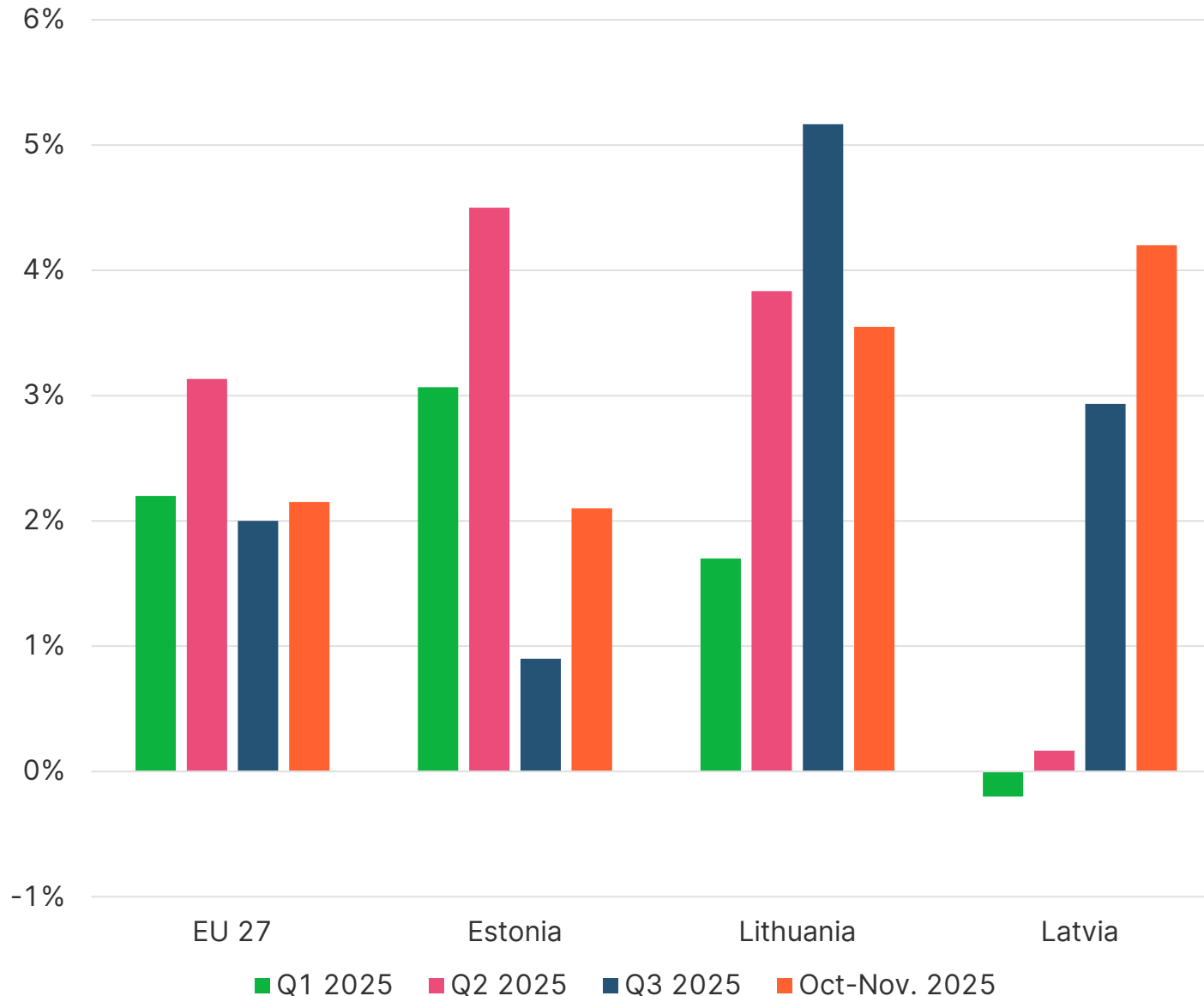


Source: European Commission, Erste Group

Economic sentiment across the Baltics is showing signs of recovery, a trend most visible in Estonia. Since the turnaround last summer, Estonian confidence has been driven primarily by improvements in the consumer and services sectors. Latvia is following a similar upward trajectory, despite a temporary third-quarter dip caused by a decline in consumer confidence. Lithuania, which has been the regional frontrunner, is currently plateauing, with stability maintained largely by positive sentiment in the retail sector.

Industrial sentiment converged across the region together in January 2025 and has remained relatively stable since. One of the few improvements reports Estonia, where order books are increasing across both domestic and export markets. Forward-looking production expectations remained largely static over the past year, reflecting a lack of economic momentum among key trading partners, with the exception of Poland.

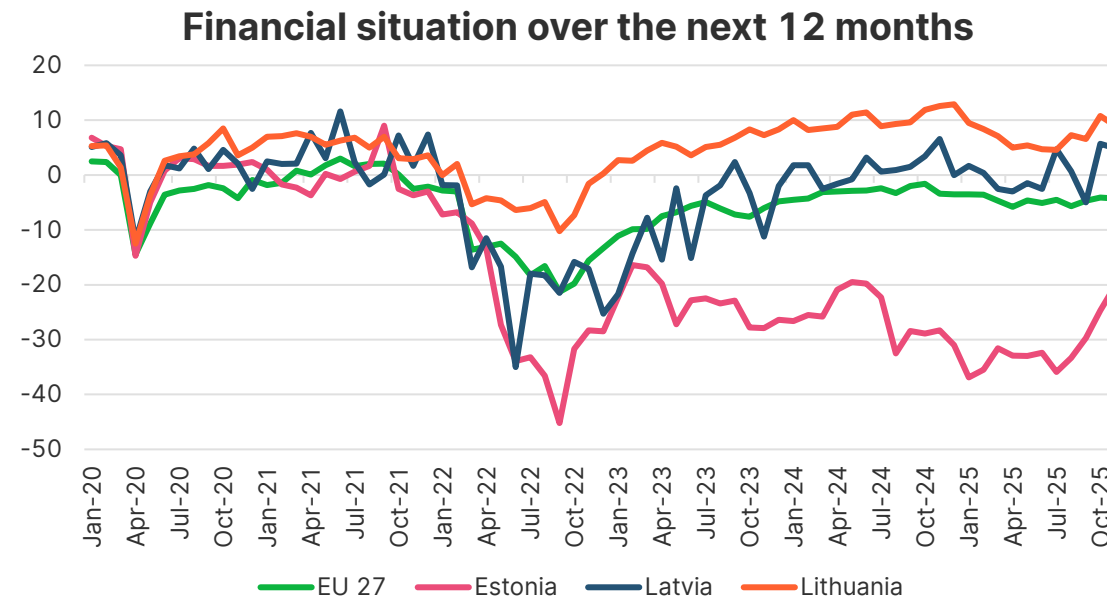
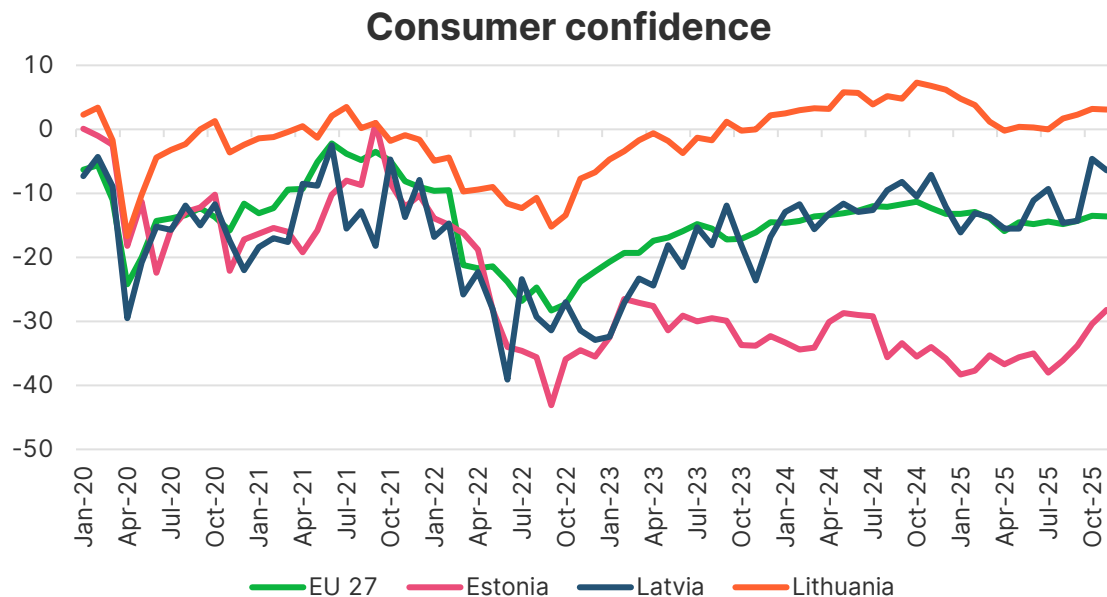
Retail sales development, y/y period average



Estonia's retail still struggles

Estonia remains the sole Baltic country where the retail sector has yet to recover to pre-invasion real turnover volumes. While annual growth rates remain positive, bridging the 6.8% deficit accumulated since 2021 will require significant time. Furthermore, sales performance in Q3 2025 was dampened by rising inflation and a visible deceleration in wage growth. On the other hand, Lithuania's retail sector is expanding robustly, driven by a solid increase in real wages. However, current projections suggest that Latvia will record the region's strongest turnover growth in Q4, maintaining performance levels significantly above pre-war benchmarks. Moreover, the base effect from the year-before will support stronger growth rates also in the next quarters.

Lithuania's consumers the most confident



Source: European Commission, Erste Group

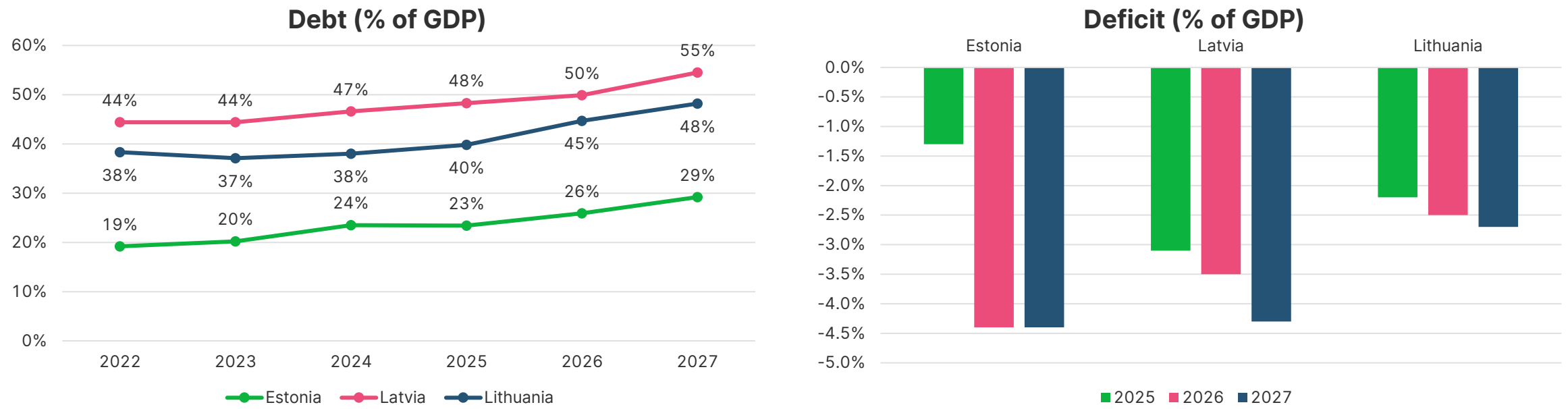
A distinct divergence is evident in Baltic consumer sentiment. While confidence levels in Latvia roughly align with the EU average, Lithuania shows significantly higher optimism, whereas Estonia remains largely negative despite a recent uptick. In terms of behavior, Lithuanian consumers demonstrate the strongest intent to undertake major purchases at present and also in the future. Conversely, Estonian households continue to express dissatisfaction with their financial situation in 2025, while Lithuanians are much more satisfied than the EU average. Regarding savings, expectations for the coming year are lowest in Estonia and very volatile in Latvia, while inflation forecasts remain broadly comparable across the entire region. The economic expectations of consumers mirror the overall index, as Estonians are the most negative but keep improving their expectations, while Lithuanians are the most positive.

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Fiscal situation and SDG

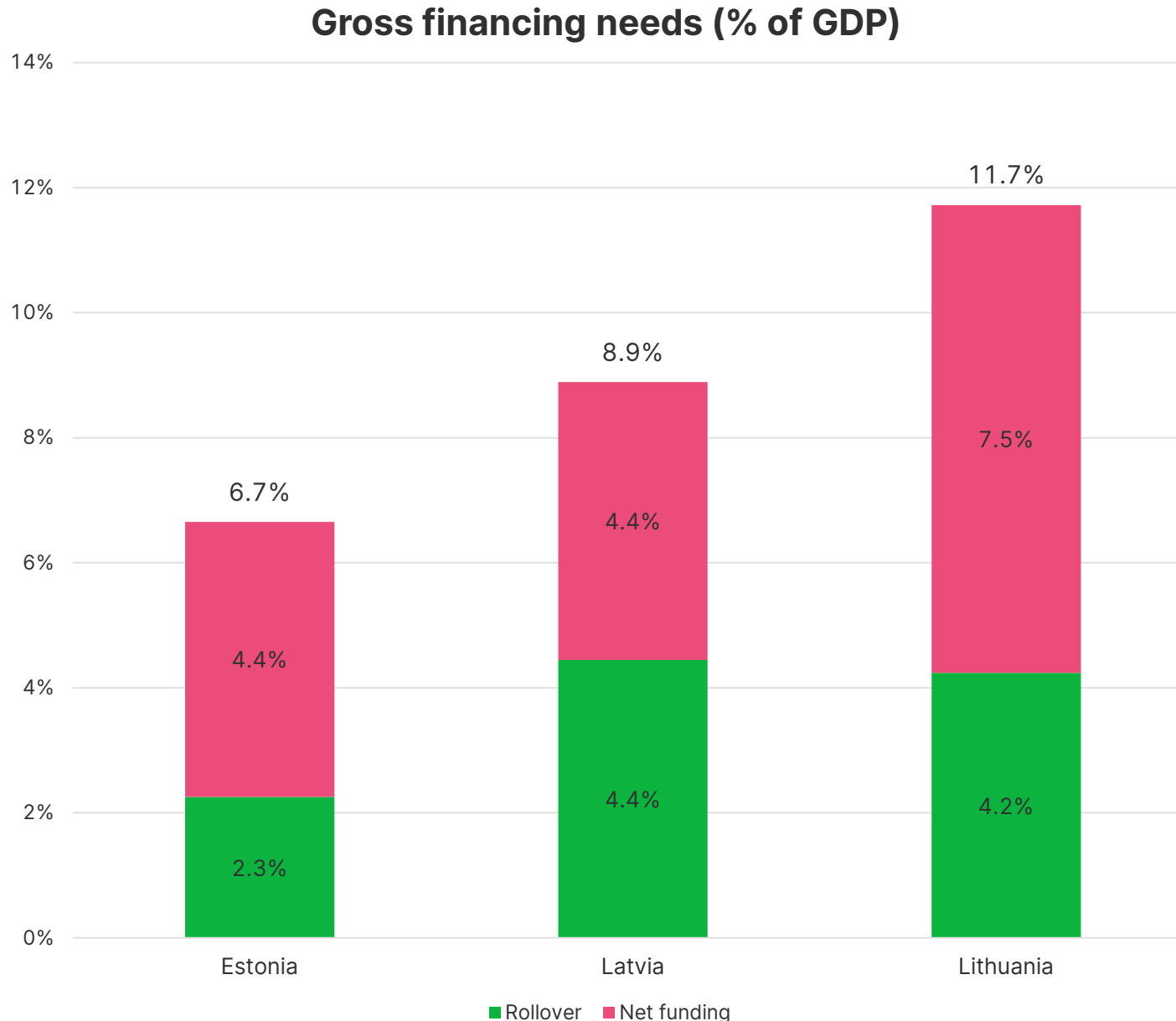


Increasing deficits and debt on the horizon



Source: European Commission, Erste Group

The fiscal outlook for the Baltics through 2027 is defined by widening budget deficits and rising public debt. Estonia projects a sharp increase in its general government deficit from 1.3% of GDP in 2025 to 4.4% and 4.5% in 2026 and 2027, primarily to accommodate defense spending reaching 5% of GDP and major infrastructure projects like Rail Baltica and highway construction. To manage the spending, the Estonian government has increased VAT to 24% and raised income tax rates to 22%, among other measures. Latvia faces a similar trajectory, with its deficit projected to rise from approximately 3.1% in 2025 to 4.3% by 2027 as it also targets a 5% defense spending benchmark. As a result, Latvia's gross public debt is expected to reach 55% by 2027, up from 49% in 2025. Lithuania maintains a deficit projection of 2.2% in 2025 rising to 2.7% by 2027, although it might now fully account for the record military procurements worth 5.4% of GDP. Lithuania's public debt is set to rise from nearly 40% in 2025 to over 48% by 2027, driven by high social spending, interest payments, and a pension reform allowing voluntary withdrawals. To bolster revenue, Lithuania has adopted a progressive three-tier income tax, increased corporate tax to 17%, and applied a bank solidarity levy alongside higher excise duties on polluting fuels.



Financing needs increased in 2026

Out of the Baltic region, Lithuania has the most clearly defined gross borrowing program for 2026, planning to raise approximately €10.9 billion. This total requirement is designed to finance a €6.4 billion budget deficit and €3.8 billion in debt repayments. To meet these needs, Lithuania plans to raise €4.5 billion through Eurobond issues in international markets, €2.8 billion from the domestic market via government securities, and €3.6 billion through loans from the EC and other IFIs. Latvia plans to borrow €3.8 billion in 2026 and €4.3 billion in 2027, which in terms of GDP is a slight rise compared to 2025. Finally, Estonia will primarily roll over T-bills as in the previous years. However, with the net financing needs increasing by 1.7pp of GDP and the €200 million 2-year bond expiring in September, longer-term issuance is likely as well.

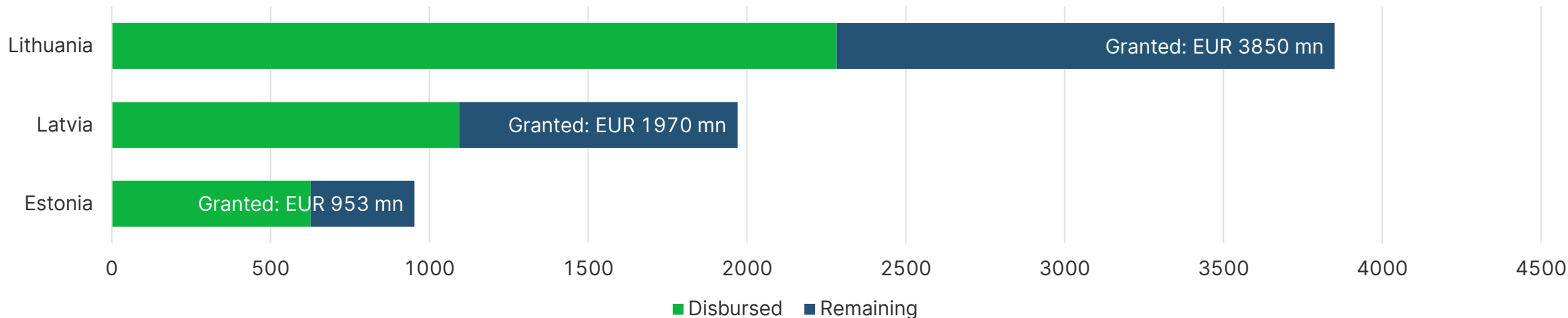
No movement on the rating front

Sovereign credit reviews for the Baltics throughout 2025 were characterized by affirmations at investment-grade levels, reflecting a general resilience to the structural decoupling from Russian energy and trade networks alongside necessary shifts in fiscal priorities due to regional security concerns. In 2025, Estonia saw its ratings affirmed as A+ by Fitch and A1 by Moody's, with analysts noting its status as a net external creditor and its historically low debt-to-GDP ratio as key strengths. Latvia's credit standing was maintained at A/A- by S&P and Fitch in late 2025, supported by a credible economic policy framework and a sharp rebound in real investment growth to 14%, although fiscal challenges persist. Lithuania emerged as the regional economic leader with 2025 rating affirmations at the A/A2 level from major agencies, underpinned by a high-growth convergence trajectory and a resilient service export sector that has outperformed its neighbors. For Estonia, a negative rating action this year could happen if planned tax measures fail to stabilize the debt burden, while Latvia's rating trajectory depends on the successful execution of Rail Baltica. Furthermore, the agencies warn that Lithuania's rating trajectory depends on the outcome of its pension reform.

	Estonia		Latvia		Lithuania	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
S&P	NR	-	A	Stable	A	Stable
Moody's	A1	Stable	A3	Stable	A2	Stable
Fitch	A+	Stable	A-	Stable	A	Stable

RRF utilization around 50%, but more acceleration needed

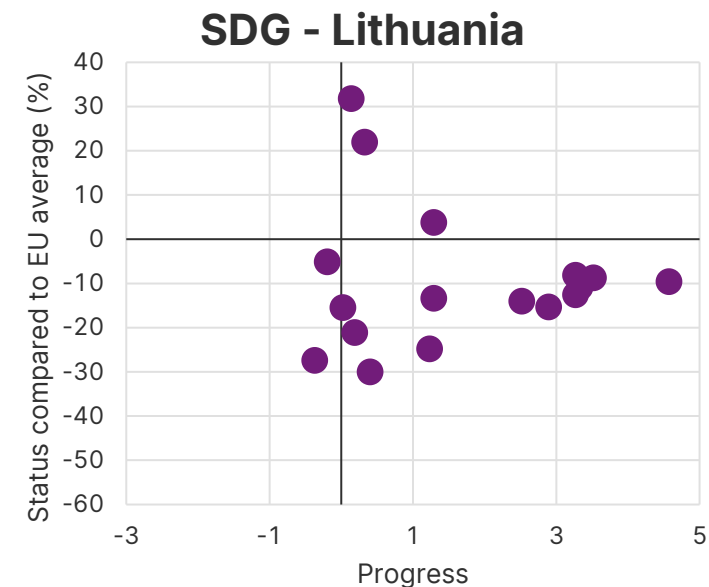
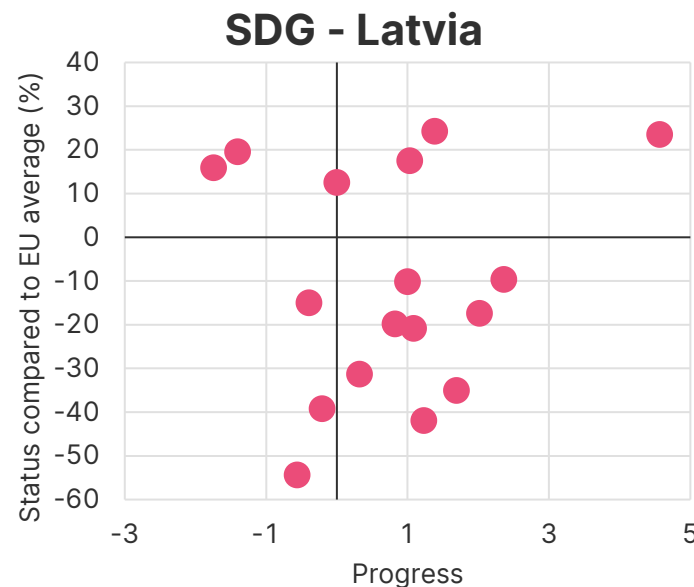
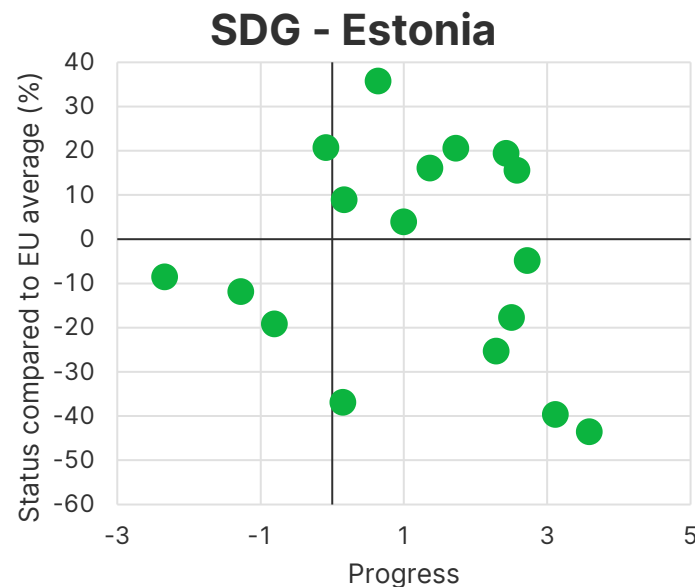
Total RRF size



Source: European Commission, Erste Group

Over the past year, Estonia received its third payment of €122 million, surpassing the 50% withdrawal threshold. Although this disbursement occurred already in March, no subsequent payment requests were submitted, despite the approval of a modified plan in November. Latvia demonstrated higher activity levels; following the receipt of its third tranche (€293 million) in May, the government successfully submitted a modified plan and requested the subsequent tranche of €360 million. On the other hand, while Lithuania received no payments in 2025, it submitted requests for both the fourth and fifth tranches during the year. The fourth payment was disbursed in January 2026, with the fifth anticipated in March or April. Significant effort is still required from all three countries, as the final withdrawal deadline is August 2026. Furthermore, all three nations have applied for loans under the new EU SAFE program. Allocations include €2.66 billion for Estonia (~5.8% of GDP), €6.38 billion for Lithuania (~7.1% of GDP), and a substantial €5.68 billion for Latvia (~12.6% of GDP). While pre-financing for these loans is expected to arrive this year, the precise schedule remains unclear.

Large green investments incoming



Source: European Commission, Erste Group

Estonia is accelerating its sustainable transition through significant green infrastructure initiatives, including offshore wind farms and a national hydrogen ecosystem. At the same time, Latvia is developing its first hybrid renewable energy park in Valmiera, representing an investment of approximately €100 million. It is designed to integrate solar, wind, and battery storage by 2028. Similarly, Lithuania aims to double its green generation capacity between 2025 and 2028, pushed by the construction of the Kelmė wind farm, which is set to become the largest in the region. However, the most ambitious undertaking in the region is Rail Baltica, an extensive 'greenfield' infrastructure investment designed to integrate the Baltics into the European rail network. While the current target for completion is 2030, full operational readiness for some sections may extend to 2035. Upon completion, the line will facilitate passenger speeds of up to 250 km/h, establishing it as the fastest transport link connecting the three Baltic capitals.

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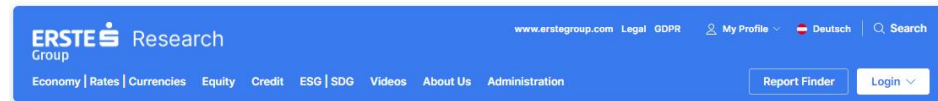


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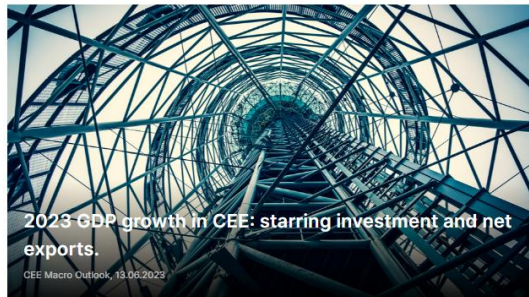


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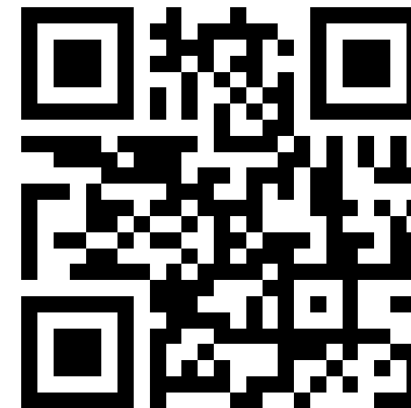
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