Baltic Report:
Recovery slowly coming to the Baltics

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Executive summary

1. The Baltic economies are expected to see growth in 2025, with Latvia forecasted to have the slowest expansion at 0.5%, while Lithuania is expected to maintain a robust 2.8% growth rate.
2. Estonia records the highest inflation rate in the Euro area at 5.2% as of June 2025, driven by rising food prices, VAT increases, and economic activity. Inflation in Latvia and Lithuania is lower, for 2025 forecasted at 3.0% and 2.6% respectively.
3. Estonia's labor market shows a high participation rate with an unemployment rate of 7.7% in early 2025. Wage growth in Estonia and Latvia is expected to moderate, while Lithuania's wage growth remains elevated due to labor market mismatches.
4. Consumer sentiment is diverse in the Baltics; Lithuania’s consumers are the second-most optimistic in the EU, while Estonia reports second-worst figures. The retail sales are recovering in Estonia, struggling in Latvia and growing in Lithuania.
5. Fiscal deficits in 2024 were lower than expected across the Baltic states. However, Latvia is projected to have the highest deficit in 2025, driven by tax reforms and declining state-owned enterprise income.
6. Latvia and Lithuania have made significant progress in RRF disbursements, with Lithuania being allocated the largest portion of RRF funding in the Baltics. However, Estonia leads in milestones and targets, having secured two-thirds of its allocated funds.
7. Estonia outperforms the EU average in eight out of seventeen SDG categories, with strong performance in education. Latvia and Lithuania also show progress, with achievements in clean energy and education.

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Main economic developments

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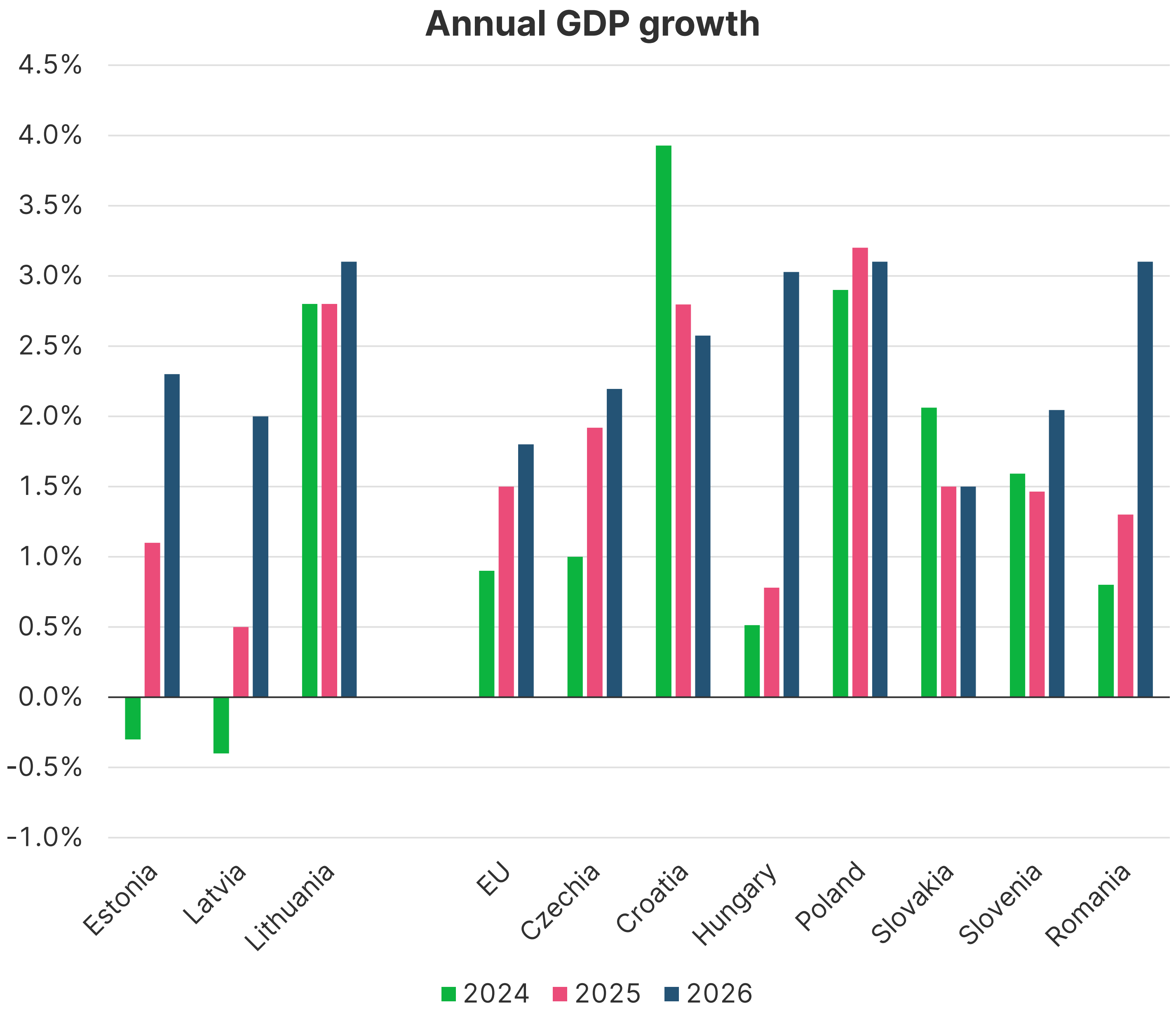


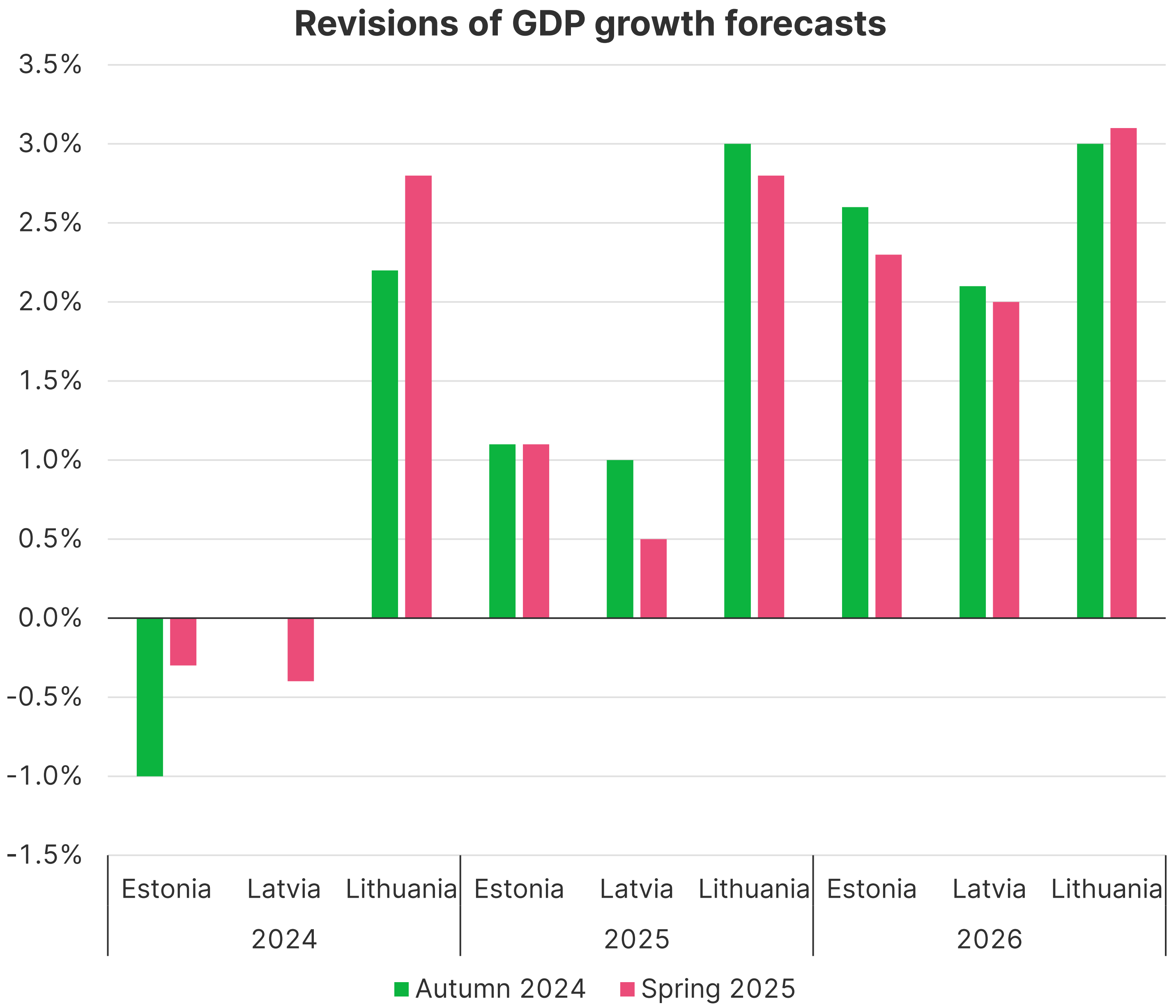
Source: European Commission, Erste Group

Back to growth

This year is expected to see growth in all three countries. According to the EC, Latvia is forecast to experience the slowest expansion, with GDP growth estimated at just 0.5%. However, domestic institutions offer a more optimistic outlook: Latvia's Ministry of Finance anticipates growth of 1.1%.

Estonia is also poised to return to growth following two consecutive years of economic contraction. The current baseline forecast suggests a 1.1% increase in GDP for 2025. Local projections are again more favorable, with the central bank expecting 1.5% growth and the Ministry of Finance projecting 1.7%.

Lithuania, which led the region with a robust 2.8% growth rate in 2024, is expected to maintain this momentum in 2025 with another 2.8% expansion. Looking ahead to 2026, all three Baltic economies are expected to achieve growth rates of at least 2%, with Lithuania exceeding 3%.

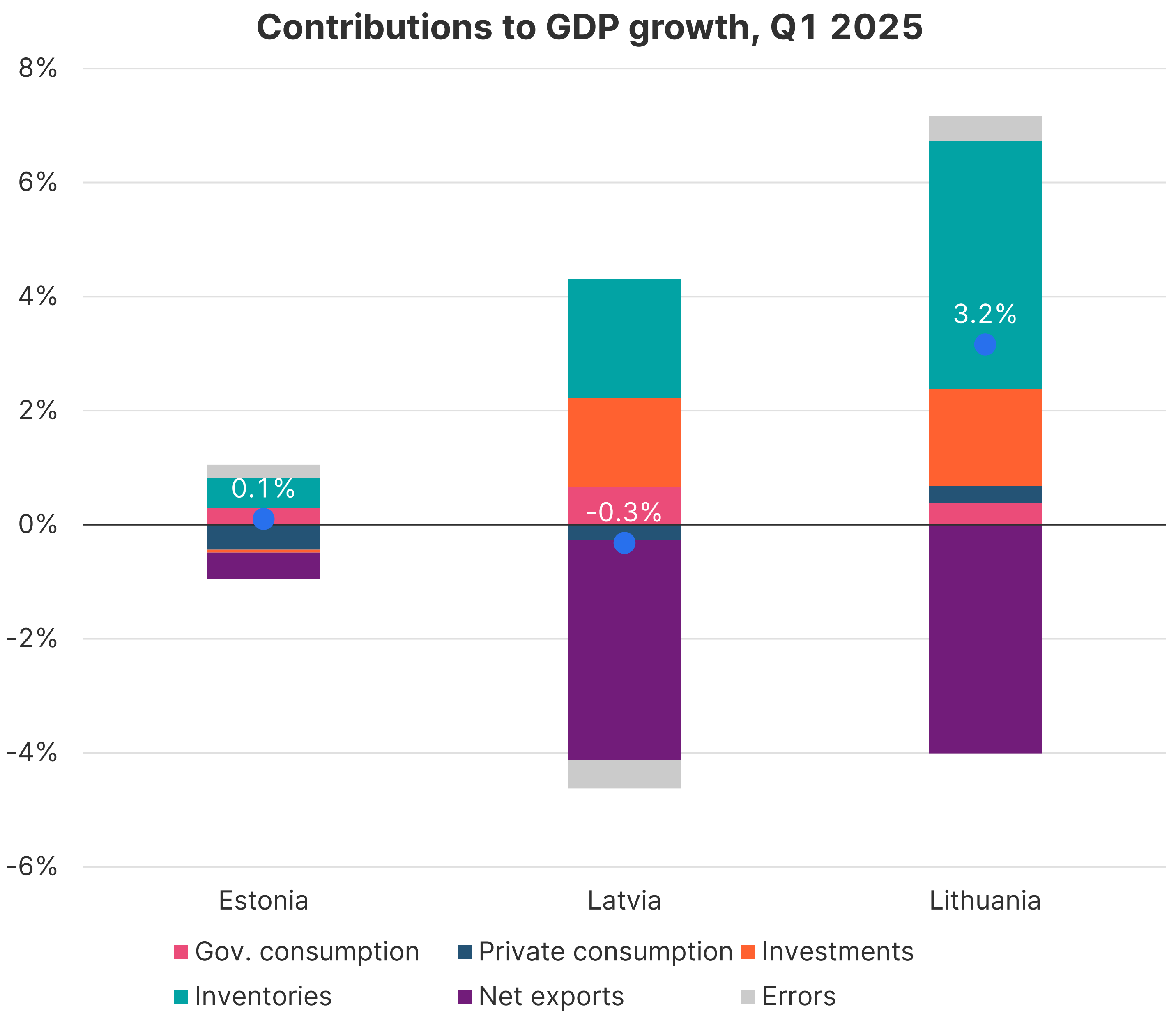


Source: European Commission, Erste Group

Minor revisions for 2026

As opposed to the projections made during the Autumn 2024 forecasting round, the economic performance of Estonia and Lithuania in 2024 exceeded expectations. In contrast, Latvia, which had been anticipated to stagnate, ultimately recorded a contraction of 0.4% for the year.

As for the revisions to the 2025 outlook, the most significant adjustment concerns Latvia. The Commission has halved its growth forecast compared to the previous round, likely reflecting the carry-over effects from weaker-than-expected growth in the final quarters of 2024. Forecasts for 2026 have remained relatively stable, with only minor revisions. The prevailing narrative continues to emphasize an improving domestic and external environment, alongside increased investment activity supported by inflows of EU funds.



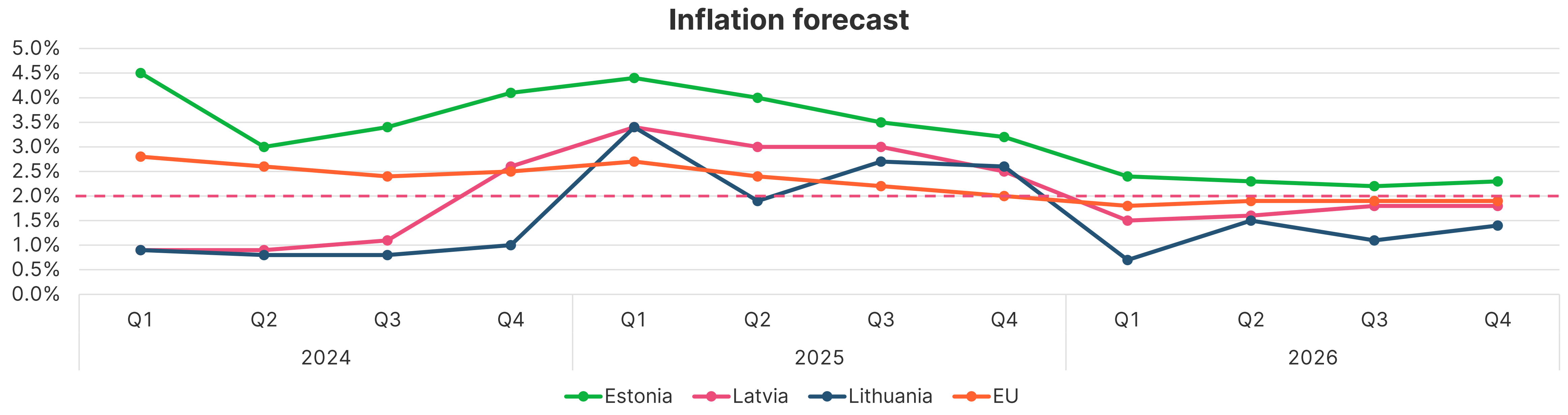
Source: European Commission, Erste Group

Inventories carried Q1 growth

The composition of economic growth in the first quarter of 2025 varied across the Baltic states. In Estonia, both positive and negative contributions were relatively modest in Q1, resulting in an annual GDP increase of just 0.1%. In contrast, Latvia and Lithuania experienced a significant drag from net exports. At the same time, inventories played a prominent role, contributing 4.4pp to GDP growth in Lithuania. It was the highest contribution since the second quarter of 2015, according to Eurostat.

Private consumption presents a potential concern, as its contribution to growth in Q1 was relatively small. While the EC projects Lithuania's private consumption to grow by 4.2% in 2025, the first quarter saw only a 0.5% y/y increase. Investment activity should be a key driver of growth this year, showing positive momentum in Q1 particularly in Latvia and Lithuania.

Estonia with the highest inflation in Eurozone



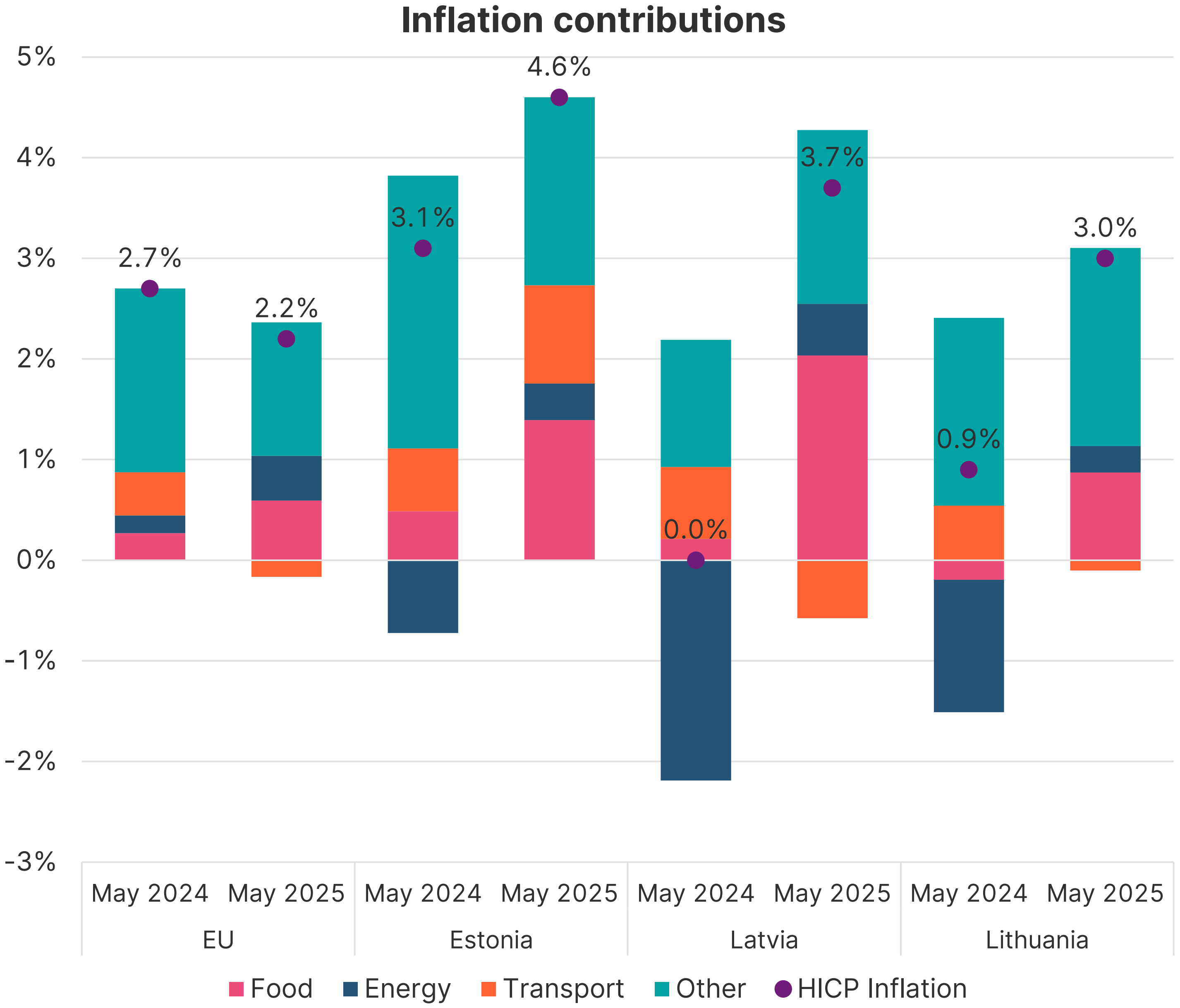
Source: European Commission, Erste Group

As of June 2025, Estonia records the highest HICP inflation rate in the Euro area, with an annual increase of 5.2% y/y. This places it 0.6pp above Slovakia, which holds the second-highest inflation rate within the EMU. Key drivers of inflation in Estonia include rising food prices, an increase in the VAT rate, the introduction of a motor vehicle registration fee, and strengthening economic activity. According to the Commission, Estonia's annual inflation rate is expected to average 3.8% in 2025. Latvia and Lithuania will experience lower inflation, at 3.0% and 2.6% respectively. In 2026, inflationary pressures are anticipated to ease further, with projected rates of 2.3% in Estonia, 1.7% in Latvia, and 1.2% in Lithuania. However, national institutions present a more varied outlook. Estonia's Ministry of Finance forecasts a significantly higher inflation rate of approximately 5% for 2025. Similarly, the Bank of Latvia has revised its 2025 inflation forecast upward to 3.4%.

Latvia suffers from high food inflation

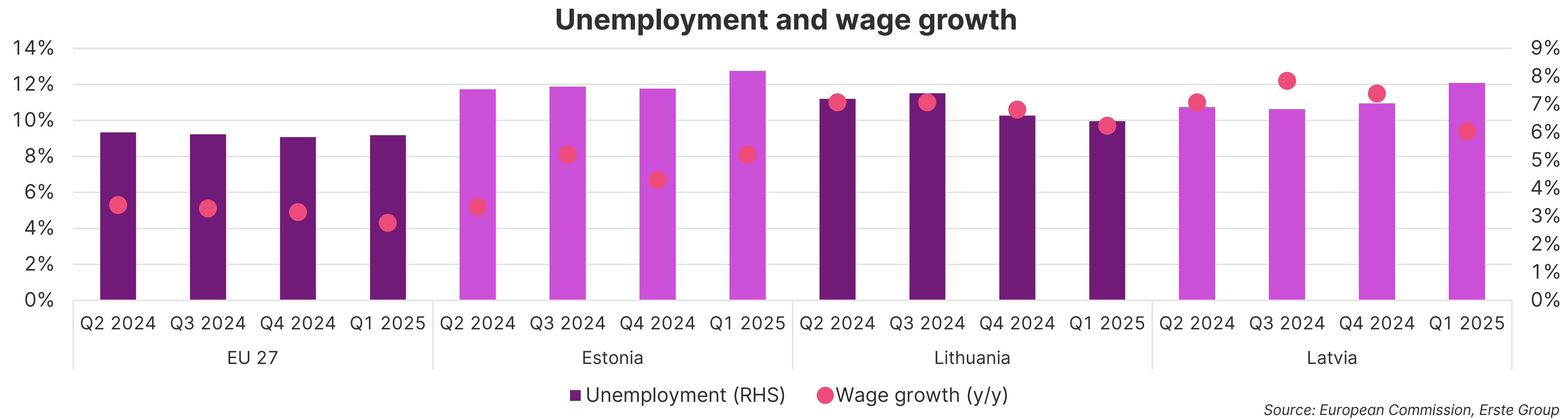
The base effect from declining energy prices in the previous year has now dissipated and energy prices are now positively contributing to inflation. In addition, food inflation has surged significantly, particularly in Latvia. During the first four months of 2025, food prices in Latvia rose by 6.1%. While this increase is partly attributable to rising global commodity prices, the magnitude of the food price surge in Latvia has been higher than in neighboring countries.

Other key contributors to inflation include rising service prices, driven by strong wage growth and recent tax increases. As already mentioned, inflation has been amplified by a higher VAT in Estonia. Meanwhile, Lithuania has introduced increased excise duties on petrol, alcohol, and tobacco products.



Source: European Commission, Erste Group

Salary growth to decelerate in 2025



Source: European Commission, Erste Group

Estonia's labor market continues to report a particularly high participation rate, with the unemployment rate standing at 7.7% in early 2025. Despite the return to economic growth, employment levels are not expected to rise significantly, largely due to labor hoarding observed in recent years. Across the Baltic region, unemployment rates are projected to decline slightly in both 2025 and 2026. Wage growth in Estonia and Latvia is expected to moderate from the elevated levels of 8–9% year-on-year to approximately 4–5% over the next year. Lithuania presents an exception to this trend. The country has experienced a visible influx of Ukrainian refugees, which has influenced labor market dynamics. Persistent mismatches between labor supply and demand, particularly in terms of skills, are expected to sustain elevated wage growth; estimated at around 7.5% in 2025, before gradually easing to approximately 7% in 2026.

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Retail and industrial development

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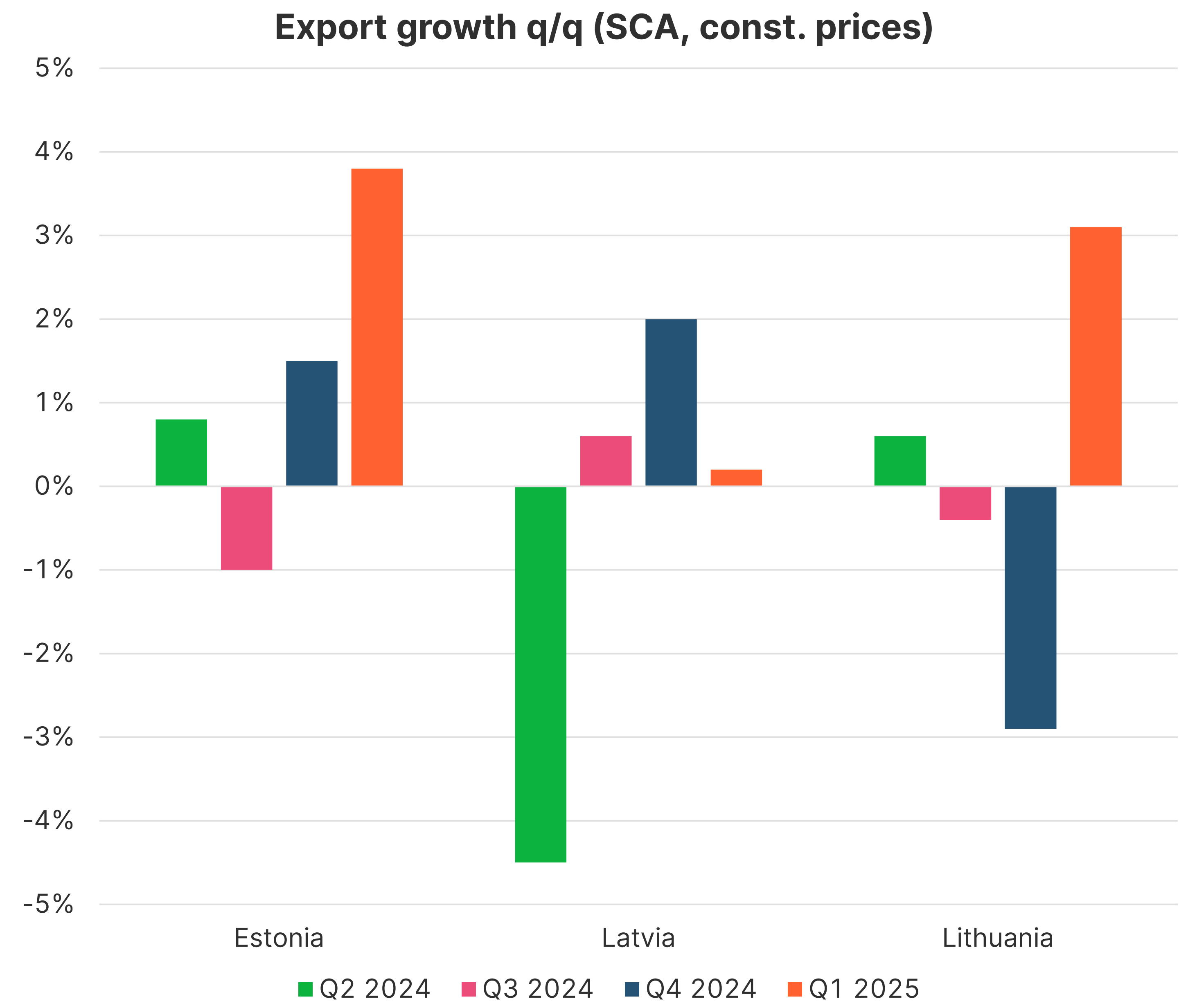
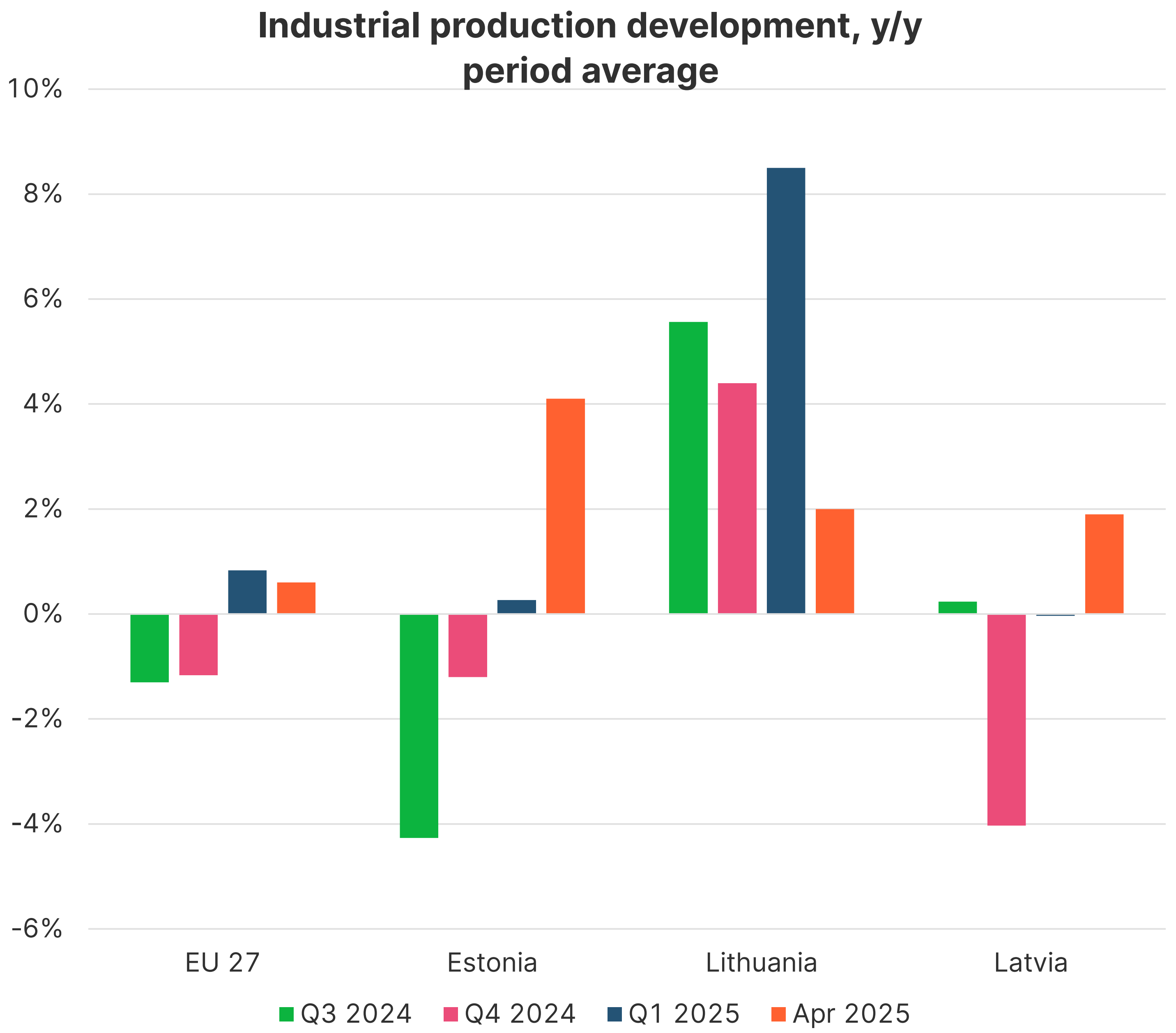
Global uncertainty to determine exports



Source: European Commission, Erste Group

As seen in other EU countries, exports in Estonia and Lithuania have grown significantly on a quarterly basis. This surge may reflect a response to the U.S. president's announced tariffs, prompting manufacturers to accelerate shipments ahead of their implementation.

Latvia stands out as an exception, with its export sector facing major challenges. The weak performance is largely attributable to declines in chemical and vehicle exports. Despite limited direct exposure to the U.S., the Baltic economies are not immune to global headwinds. Estonia seems quite vulnerable, with approximately 3.5% of its total value added being imported by the U.S.; a share comparable to Hungary and higher than that of other CEE countries.



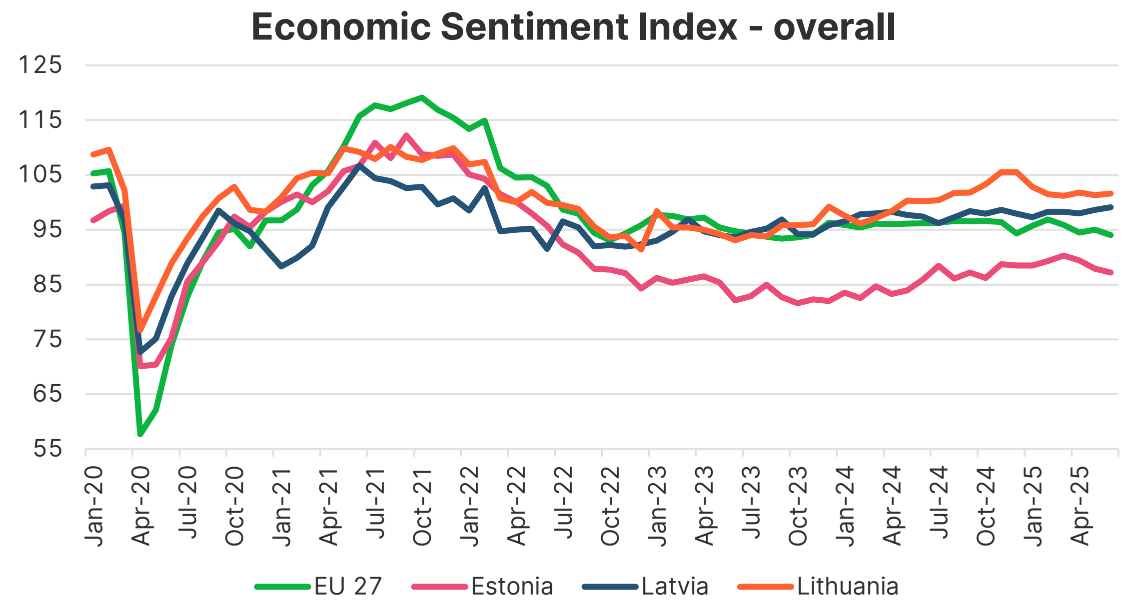
Source: European Commission, Erste Group

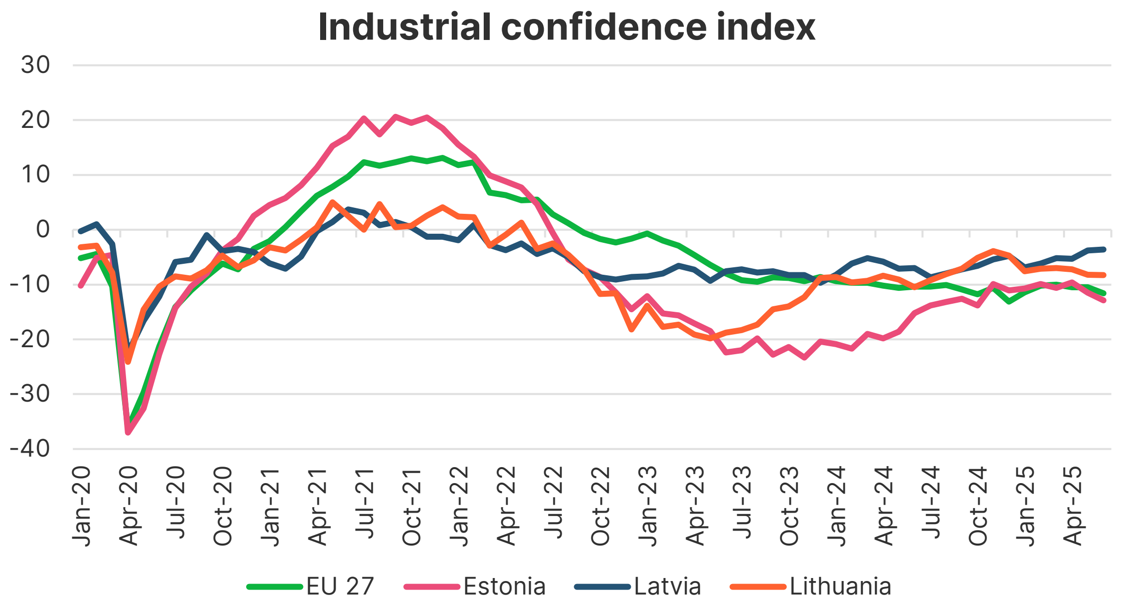
Lithuania's industry in the lead

Industrial production in Estonia is gradually recovering. However, the pace of growth is somewhat overstated due to the low base effect, as output bottomed out in the first half of 2024. Despite the recent improvement, manufacturing output remains at levels last seen around 2018, as the decline has been extensive.

In contrast, Lithuania's manufacturing sector has remained robust, expanding by nearly 9% in the first quarter. Export orders have strengthened, and the recovery is broad-based, with strong growth in the production of pharmaceuticals, electronics, fertilizers and metals.

Sentiment indicators remain static



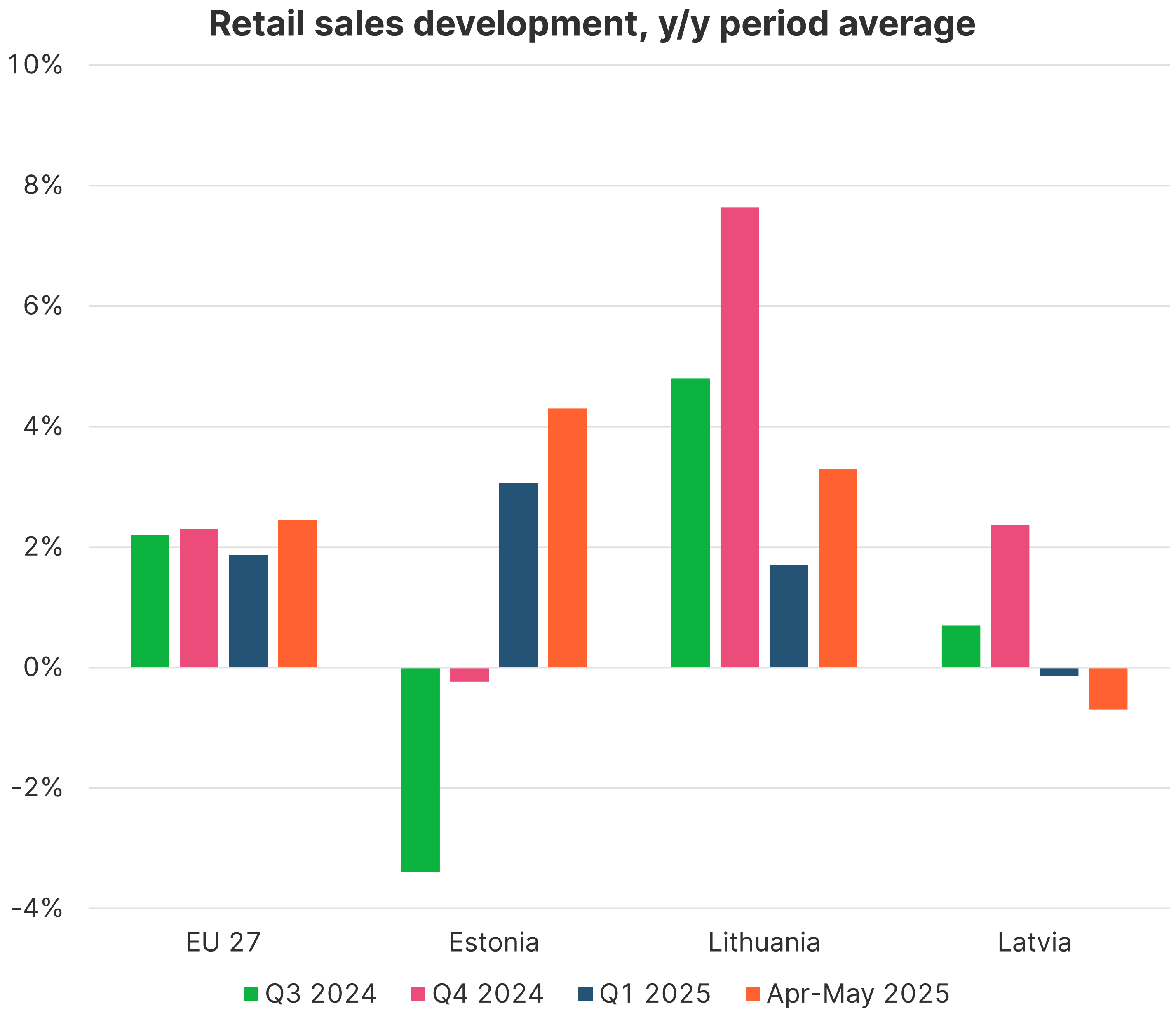


Source: European Commission, Erste Group

In recent months, the Economic Sentiment Indicator has shown limited movement across the region. Estonia continues to record the lowest values, with the previously modest upward trend being reversed in the first quarter. In contrast, Latvia's ESI remains above the EU average, despite ongoing economic challenges. Lithuania consistently reports the highest sentiment levels among the Baltic states, although a decline was observed at the end of 2024. Looking ahead, global uncertainty may hinder further improvements in the index in the near term.

At first glance, the relatively high values of the Industrial Confidence Index in Latvia appear puzzling, given the sector's ongoing performance challenges. However, the recent increase in the index is primarily driven by improvements in order book levels, which serve as a forward-looking indicator. This suggests the potential for a near-term recovery in Latvia's industrial sector.

Revival of Estonian retail sales

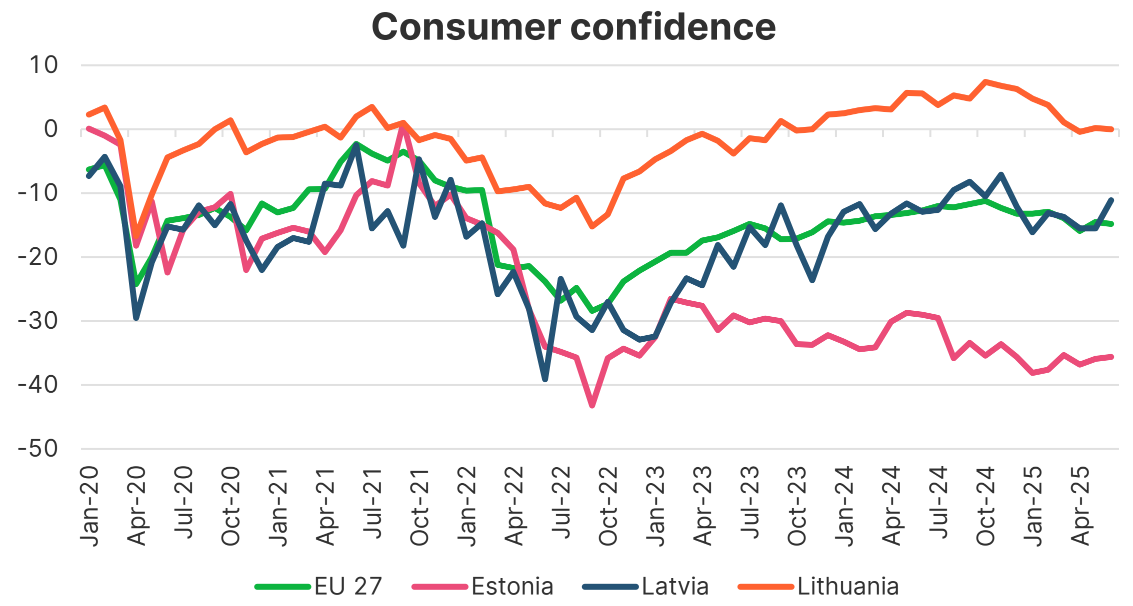


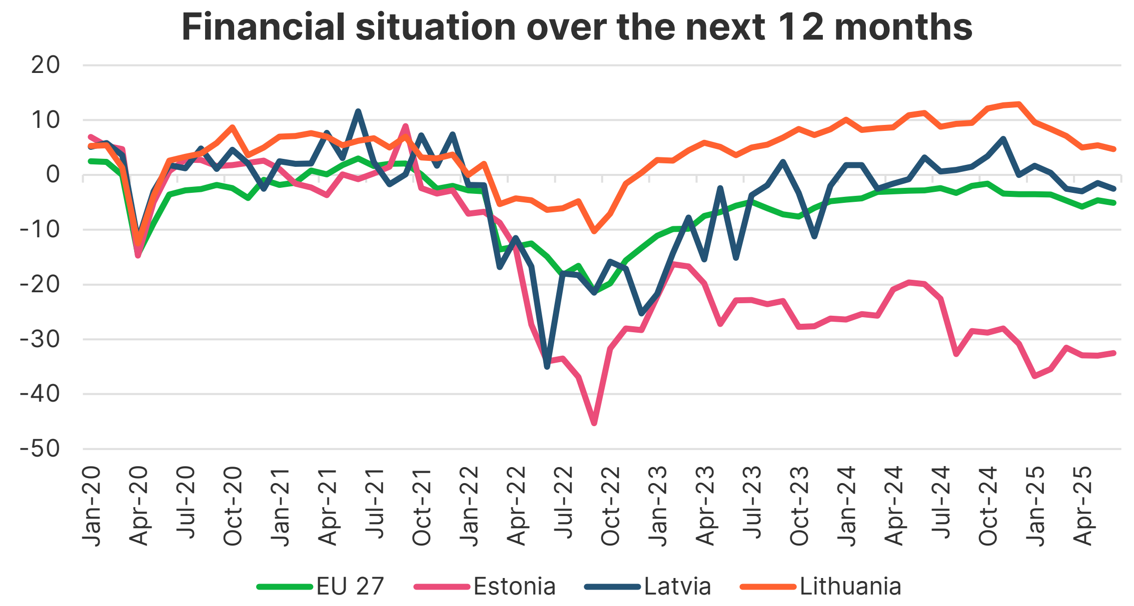
Source: European Commission, Erste Group

While retail sales growth across the European Union remains relatively stable overall, significant volatility persists both between and within individual member states. At first glance, Estonia's retail sector appears to be doing well; however, this growth is largely attributable to a low base effect from the previous year. In real terms, the volume of retail sales in Estonia remains approximately 7% below 2021 levels.

In Latvia, the retail sector continues to face challenges on an annual basis, with sales volumes hovering around the same levels as in 2021. In contrast, Lithuania’s retail sector maintains a steady upward trajectory, having recorded consistent year-on-year growth every month over the past 18 months.

Lithuania's consumers the most confident





Source: European Commission, Erste Group

A clear divergence is evident among surveyed consumers in the Baltic region. Estonia reports by far the most negative consumer outlook in Baltics, with a downward trajectory persisting for over two years. Although recent data suggest a degree of stabilization, consumer confidence in Estonia remains the second-lowest in the EU. In contrast, despite a decline in consumer sentiment in Lithuania, current levels remain the second-highest in the EU, surpassed only by Poland.

The consumers in Estonia remain pessimistic regarding future expectations. Once again, Estonia records the second-lowest confidence levels within the EU, in stark contrast to Lithuania, which ranks among the most optimistic. However, there is potential for a gradual improvement in Estonian consumer outlook toward the end of the year, driven by a more pronounced slowdown in inflation and an anticipated acceleration in economic growth.

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Fiscal situation and SDG

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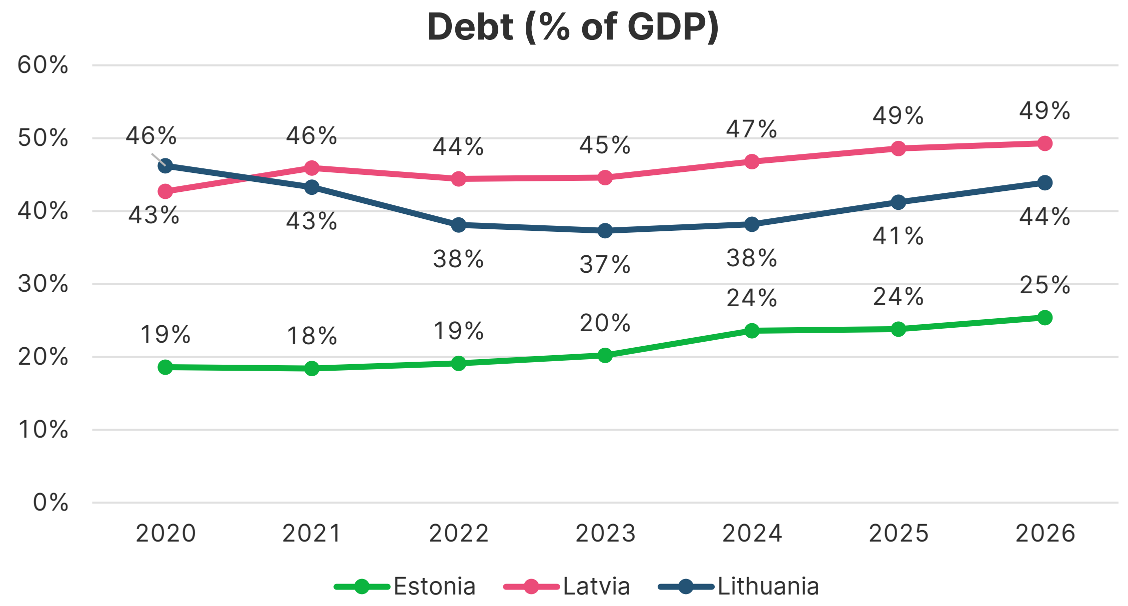
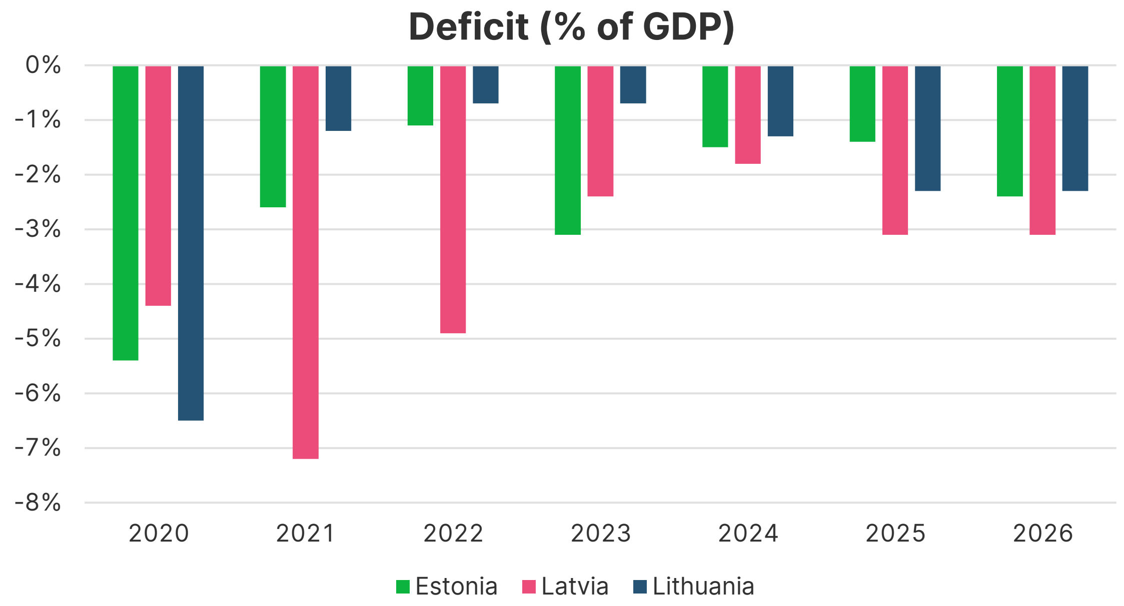
Positive fiscal surprise in 2024, yet deficits bound to rise

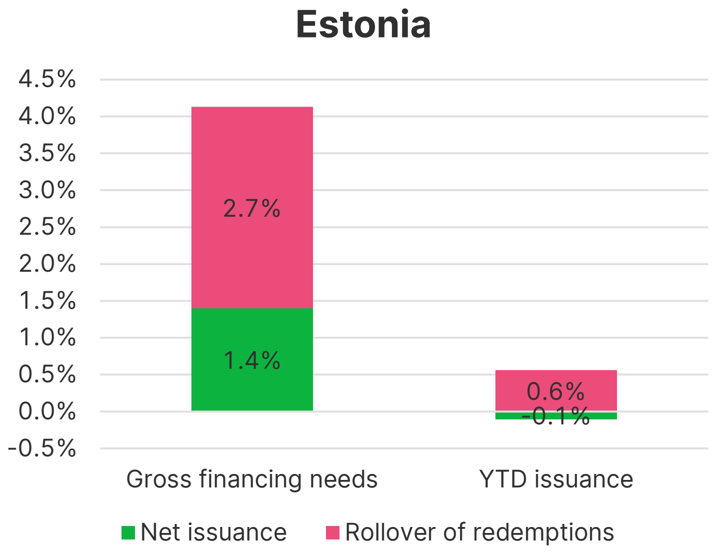


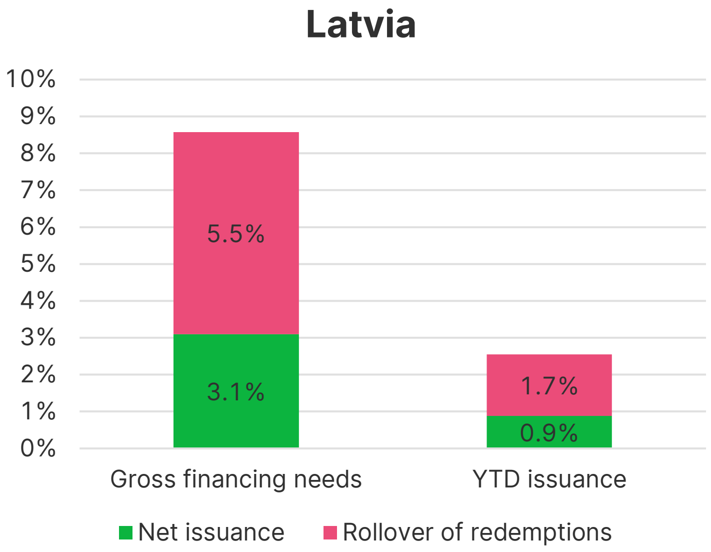


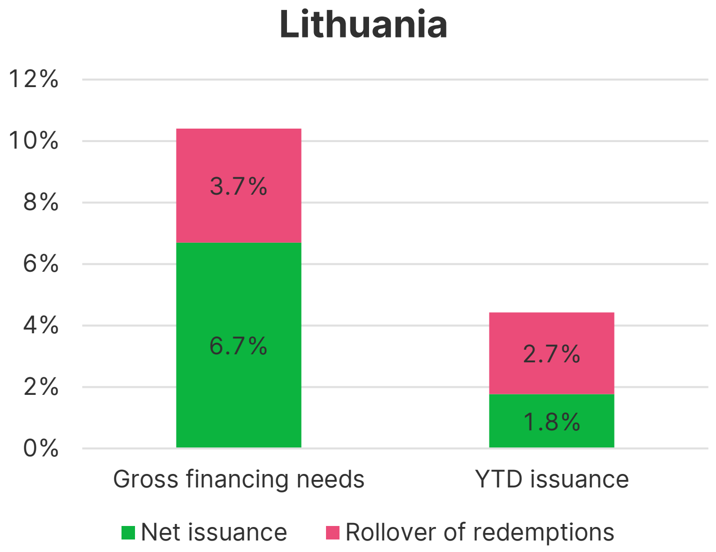
Source: European Commission, Erste Group

Fiscal deficits in 2024 positively surprised across all three Baltic states. In its Autumn 2024 forecast, the European Commission projected a 3% deficit for Estonia, yet the final figure was just half of that. Revenue growth was supported by higher consumption taxes, while planned increases in defense, social benefits, and local government spending were only partially implemented. Latvia followed a similar pattern, with the deficit coming in at 1.8% versus a forecast of 2.8%. Lithuania saw the smallest revision, with the deficit 0.7 percentage points below projections. For 2025, Latvia is expected to record the highest deficit, slightly exceeding the Maastricht threshold of 3%, driven by personal income tax reform and declining state-owned enterprise income. On the expenditure side, rising employee compensation, interest payments, and social transfers are key contributors. Estonia and Lithuania are projected to maintain moderate deficits, though both are expected to marginally widen in 2026.

Financing needs on track







Source: European Commission, Erste Group, own calculations

As a result of the higher financial reserves at the end of 2024, the Treasury has projected a gross funding need of around 1.5 billion for 2025. Negative cash flows will first be covered by liquidity reserves. The funding plan also includes the rollover of outstanding T-bills, alongside a potential 500 million long-term bond issuance.

The estimated gross financing needs for Latvia are at around 8% of GDP, predominantly due to the rollover of expiring bonds. The Treasury has not been very active up until now, issuing only a 1 billion bond in May.

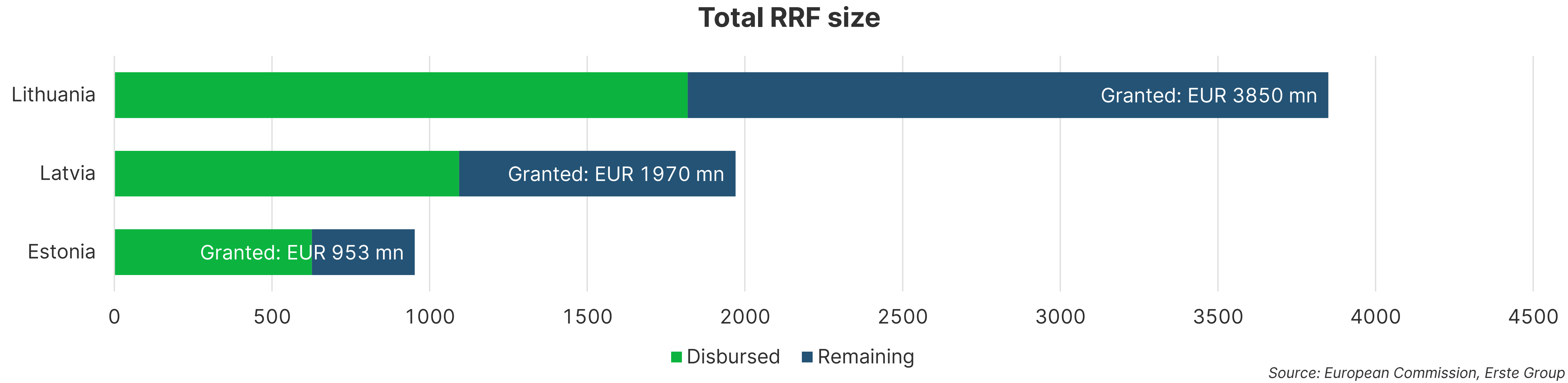
According to the Treasury, the financing requirement for the state budget deficit is estimated at €5.6 billion, or approximately 6.7% of GDP. This is higher than the EC's ESA-based deficit forecast of 2.3%. Such discrepancy is likely attributable to military equipment orders, which are recorded on an accrual basis under ESA methodology.

No movement on the rating front

Following last year's downgrade by S&P for all three countries, which occurred due to heightened global risks, there have been no subsequent changes to their credit grades. The only exception is Estonia, which voluntarily withdrew its S&P rating towards the end of 2024. In 2025, all three countries received affirmations from the three major credit rating agencies. The agencies commended their fiscal prudence, particularly in comparison to other eurozone members. However, they also noted that, over the medium term, fiscal space is expected to narrow due to increased investment in defense capabilities. Geopolitical risks, particularly those stemming from Russia, remain the primary concern for the agencies. Nevertheless, none of the agencies anticipates that Russian aggression will extend into the territories of the rated countries. The rating agencies' economic growth forecasts are broadly aligned with those of the European Commission, projecting stronger growth in the foreseeable future.

	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-	Positive	A	Stable

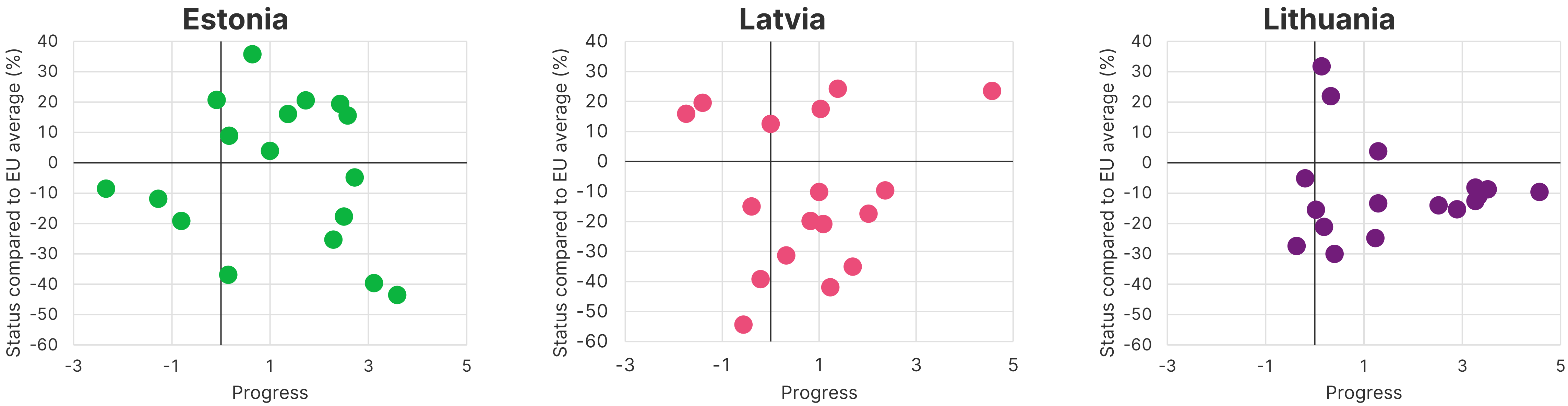
RRF utilization around 50%, but more acceleration needed



Source: European Commission, Erste Group

With the 2026 deadline approaching for beneficiaries of the Recovery and Resilience Facility, Estonia stands out as the best performing from the three Baltic states in meeting its milestones and targets. Despite having access only to grants, Estonia has successfully secured approximately two-thirds of its allocated funds, with the most recent disbursement of €122 million received in March. At present, no additional payment requests have been submitted. Latvia received a €293 million disbursement in May, bringing its total RRF receipts to over €1 billion; more than 50% of its total allocation, which is all in the form of grants. Lithuania has been allocated the largest share of RRF funding in the Baltic region, both in nominal terms (approximately €3.8 billion) and relative to GDP (5.2%). This includes €1.5 billion in loans, in addition to grants. However, Lithuania has experienced the slowest disbursement pace, with the most recent payment of €463 million made in December 2024. That said, the revised recovery plan was approved in June, paving the way for further disbursements in the near future.

Education in the Baltics above the EU average



Source: European Commission, Erste Group

Estonia also leads Baltics in the 2025 edition of the SDG* assessment, outperforming the EU average in eight out of seventeen categories. Its strongest performance is in the quality of education. The most significant progress has been made in responsible consumption and gender equality, although both remain significantly below the EU average.

Latvia trails slightly behind Estonia, with six SDGs exceeding the EU average. As in Estonia, the strongest performance is in the quality of education. The most significant progress has been made in clean and affordable energy, which also ranks above the EU average. The weakest area remains health and well-being, which has recently deteriorated further.

Lithuania exceeds the EU average in only three SDGs, with the best performers being the “Life Below Water" and "Quality Education." Nevertheless, the country is demonstrating progress across nearly all SDGs, with the exception of two areas—"Clean Water and Sanitation" and "Zero Hunger"—where a deterioration was reported.

**Sustainable Development Goals*

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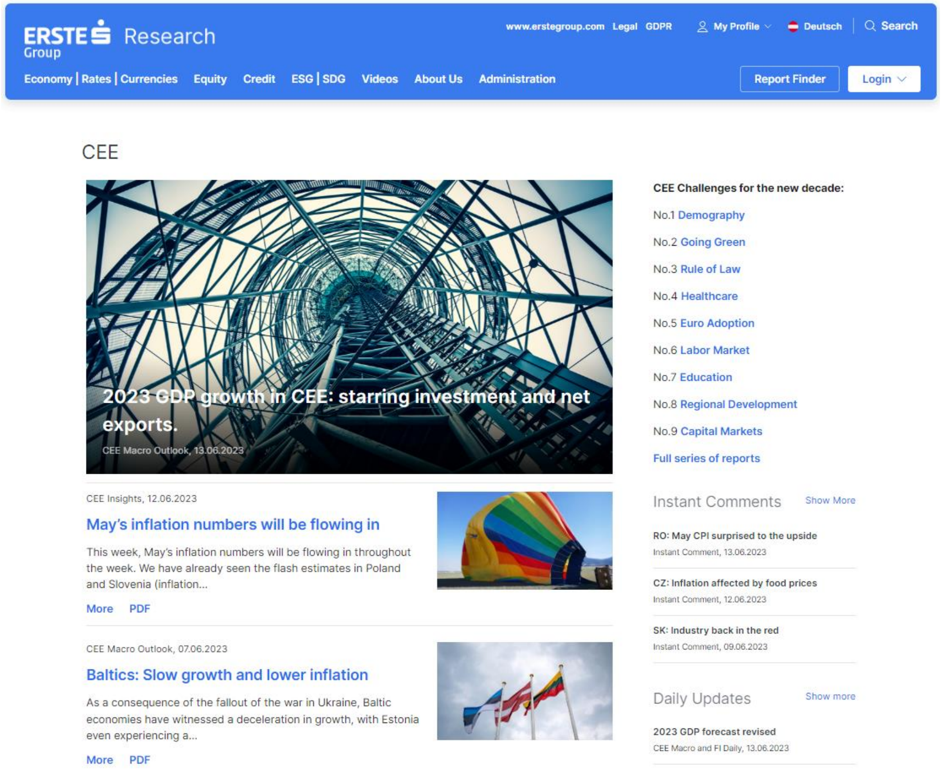

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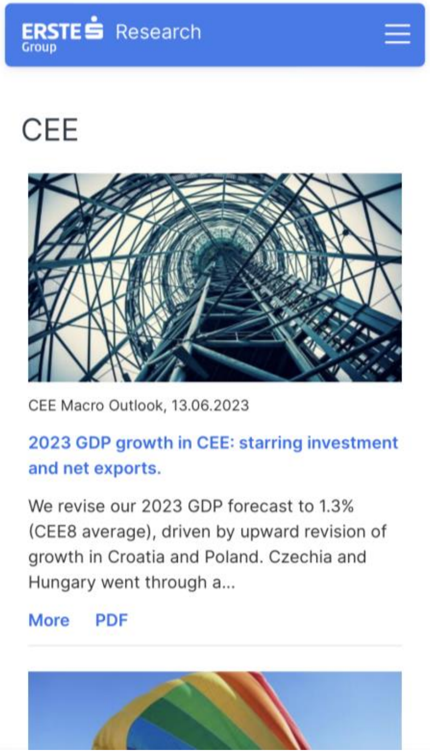

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