

SUMMARY

- 1. Overall, from a fiscal perspective, 2025 can be considered a positive year, as the current estimate of the general government budget balance (GGBB) is (-2.4%) of GDP, or (-€1.0) billion, according to the European System of National and Regional Accounts (ESA) methodology. The budget law had projected a deficit of 2.9% of GDP. The official results will still be refined in accordance with the general government budget deficit notification. The deficit for 2025 is lower than forecast because larger advance payments related to defence sector procurements were made in 2025, which according to ESA methodology are not attributed to 2025. In addition, state-owned enterprises classified within the general government sector ended the year with a better balance than originally projected.**
- 2. The budget for 2026 approved in December foresees a general government budget deficit of 3.3% of GDP, real GDP growth of 2.1%, and inflation of 2.3%.** However, since the approval of the budget, macroeconomic indicators have improved, and at the meeting on 12 February the Fiscal Discipline Council (hereinafter – the Council) endorsed the macroeconomic forecasts¹ prepared by the Ministry of Finance, which will be used for the preparation of the Fiscal Structural Plan Progress Report for 2026–2030. According to the latest forecasts, GDP growth this year is expected to reach 2.6%, while inflation may also be higher, at around 2.9%. Changes in both indicators could slightly improve the fiscal outcomes for the year.
- 3. In February this year, the Council of the European Union formally approved financial assistance from the SAFE instrument, granting Latvia access to a loan of up to €3.5 billion, which will begin to be used already this year.** This decision marks an important turning point in the development of Latvia's defence capabilities, as SAFE is a dedicated EU financial instrument aimed at rapidly strengthening Member States' military capabilities by providing long-term loans at low interest rates for joint development of military capabilities and procurement. The loan has favourable conditions – a repayment period of up to 45 years and the possibility to defer principal repayments for up to 10 years.
- 4. In the political arena, discussions have re-emerged about the possibility of liberalising the rules allowing residents to access their second-pillar pension savings. The Council maintains the view that Latvia should not allow the early withdrawal of second-pillar pension savings.** Such a step would most likely generate only short-term gains in the form of increased consumption, while also leading to higher imports and thereby worsening the external trade balance. In the long term, it would increase risks to the sustainability of the pension system under growing demographic pressure. Already today, a large share of pensioners faces the risk of poverty, and if the volume of pension savings for the currently working generation were to decrease, these risks would become even more critical in the future. In the Council's view, a more rational approach in Latvia would be to strengthen contributions across all

¹ [Fiscal Discipline Council | Macroeconomic forecasts for the FSP PR for 2026-2030](#)

pension pillars, allowing withdrawals only in exceptional circumstances (for example, in cases of critical illness).

- 5. Latvia's GDP grew by 2.1% in 2025 in constant prices, exceeding the 1.1% growth forecast by the Ministry of Finance in June² of the previous year.** The main driver of growth was an increase in investment of 9.8%, largely supported by the inflow of EU funds into the economy. Household consumption (+0.8%) and exports (+1.0%) also made a moderate positive contribution, while faster growth in imports (+4.9%) limited overall growth. From a sectoral perspective, growth was mainly driven by construction, manufacturing, and information and communication services, while transport, agriculture, and certain service sectors showed weaker dynamics. In terms of the structure of investment, the largest contribution came from investment in machinery and equipment, reflecting technological modernisation by companies, as well as construction investment, particularly in civil engineering.
- 6. Economic growth in Latvia's main trading partner countries in 2025 remained overall low to moderate, creating a weak external demand environment for exports.** Economic activity was particularly weak in Germany and Estonia, where growth remained close to stagnation. At the same time, economic sentiment indicators at the end of 2025 and the beginning of 2026 remained cautious – in Germany and Estonia they were below or close to the neutral level, while sentiment in Lithuania and Sweden was somewhat more favourable.
- 7. In 2025, the growth of lending significantly supported economic activity.** The loan portfolio increased by 21.6% for enterprises and 11.6% for households. The volume of newly issued loans grew particularly rapidly – by 60.7% for enterprises and 49.8% for households. The expansion of lending was driven by declining interest rates and the easing of lending conditions.
- 8. In 2025, consumer price inflation in Latvia reached 3.7%, with price increases mainly driven by higher food and services prices.** Prices of food and non-alcoholic beverages rose by 6.2%, while service prices increased by 5.8%. Although wages continued to grow faster than inflation, the significant increase in essential daily expenses—housing maintenance, food, and healthcare services—continued to negatively affect consumer sentiment and the public perception of the cost of living.
- 9. The escalation of the conflict in the Middle East increases the risks of rising energy prices and may also affect inflation dynamics in Europe.** The European natural gas price (TTF) rose to around EUR 55/MWh in the first week of March. Compared with the previous year, the increase has already reached 34%. Risks are further amplified by supply disruptions from the Persian Gulf region, which accounts for a significant share of global oil and liquefied natural gas supplies. Although the current gas volume in storage in Latvia is sufficient to cover consumption during this heating season, as the next injection season approaches, prolonged tensions could mean purchasing gas at higher prices. This could later be reflected in energy prices, inflation, and the cost of living. Moreover, discussions about the need for government support for households may re-emerge, which would be challenging under conditions of limited fiscal space.

² [Fiscal Discipline Council | Endorsement of the Ministry of Finance's Macroeconomic Forecasts](#)

- 10. Insufficient competition in certain sectors can be a significant factor influencing inflation and price dynamics.** In its Interim report on Latvia's Stability Programme for 2023–2026³, the Fiscal Discipline Council, referring to analysis by the Bank of Latvia, noted that around 30% of the increase in inflation could be explained by the so-called "greedflation" component, which is associated with low levels of market competition. In subsequent reports, the Council has repeatedly emphasised insufficient competition in sectors important to the national economy, and firm action against cartel activities is one of the key preconditions for improving competition.
- 11. According to the law "On the State Budget for 2025 and the Budget Framework for 2025, 2026 and 2027", consolidated general government tax revenues in 2025 were planned at €14,552.7 million. Actual tax revenues in 2025 were 1.3% or €183.3 million lower than planned.** The tax revenue target was not met mainly due to weaker private consumption and slower economic growth. Overall, tax revenues showed stable growth (5.6%), as they increased at a pace similar to nominal GDP (5.8%).
- 12. In Latvia, the tax-to-GDP ratio (34.7% of GDP) remains lower than the EU average (39.3% of GDP)⁴,** and one of the contributing factors is the shadow economy. It reduces tax revenues, which in turn limits the possibilities of the state budget and fiscal space. A performance audit⁵ by the State Audit Office concluded that the current approach to limiting the shadow economy is not sufficiently effective – the measures included in the Shadow Economy Restriction Plan for 2024–2027⁶ either have no direct impact on the shadow economy or have a limited effect on its main drivers, sectors with a higher share of shadow economy are not included as priorities, and there is a lack of a results-oriented and coordinated approach. **The Council considers that reducing the shadow economy is an important step in increasing the tax-to-GDP ratio and therefore calls on the government to improve and implement an effective approach to limiting the shadow economy and to regularly assess its results and impact.**
- 13. In 2025, consolidated general government budget revenues increased by 3.5%, which is a significantly smaller increase than observed in recent years.** The slower revenue dynamics were driven by more moderate growth in tax revenues, as well as lower revenues from EU funds and non-tax revenues. The decline in EU funds revenues can be explained by fluctuations in the EU funds investment cycle. Meanwhile, the decrease in non-tax revenues was mainly due to lower dividend revenues, as well as the fact that the mortgage credit borrower protection fee, which was in force in 2024, was no longer applied in 2025.
- 14. In 2025, consolidated general government budget expenditure increased by 9.2%, representing the fastest growth in spending in recent years.** The stronger increase in expenditure was mainly driven by more active implementation of EU Cohesion Policy funds and Recovery Fund projects, as well as higher defence spending – for example, purchases of specialised military vehicles were made, additional expenditures were incurred for the management and construction of defence

³ [Fiscal Discipline Council | Interim report on Stability program 2023/26](#)

⁴ [Eurostat database \[gov_10a_taxag\]](#), accessed on 03.03.2026.

⁵ [State Audit Office | Is the national policy to curbing the shadow economy effective?](#)

⁶ [Shadow Economy Restriction Plan for 2024–2027](#)

infrastructure, and compensation expenditure increased in connection with the rise in the number of soldiers.

15. The review of budget expenditure in Latvia is a regular part of the budgetary process. Often, a mechanical approach is used to reduce budget expenditure rather than an approach based on the usefulness and results of spending. As a result, the potential for generating savings is not fully utilised. Currently, a reform of the public procurement system is being advanced in Latvia. Given the potential of this reform to generate savings, it is important to assess as soon as possible the impact of the new public procurement regulation on savings in public funds and to ensure that changes in the procurement system promote greater competition, efficiency, and transparency in the use of public resources. **The Council calls for strengthening the audit of budget expenditure and implementing a transition to performance-based budgeting so that expenditure reviews serve not only to create short-term fiscal space but also to improve the efficiency of public finances in the long term.**
16. **Wages in 2025 grew faster than labour productivity, increasing labour cost pressures for companies.** The average monthly gross wage increased by 7.7%, while the net wage rose by 10.2%, partly influenced by changes introduced through the tax reform. Wage growth was observed in both the private and public sectors, where the average gross wage increased by 7.0% and 8.1% respectively, gradually narrowing the difference in dynamics between the two sectors. At the same time, labour productivity grew more slowly – by 5.5% per employee and by 4.7% per hour worked.
17. **Latvia’s labour market remained stable in 2025, although structural challenges persist in the composition of the economically inactive population.** The employment rate reached 64.5% (+0.5 percentage points compared with 2024), and the total number of employed persons increased to 883.1 thousand, while the unemployment rate remained at 6.9%. Registered unemployment according to the State Employment Agency (SEA) fluctuated between 4.7% and 5.7% during the year, while the share of long-term unemployed rose to 33.9% of all unemployed persons. Economically inactive persons accounted for 30.7% of the population, or 420.1 thousand people aged 15–74, of whom 38.7% were in the 65–74 age group. This age significantly exceeds the number of healthy life years typical for Latvia, which according to Eurostat data was only 52.7 years in 2023 (the lowest figure in the EU). The total number of economically inactive persons decreased by 9.2 thousand, or 2.1%, over the year.
18. **Latvia’s general government debt remained relatively low in 2025; however, an upward debt trajectory is projected in the medium term.** In the third quarter of 2025, debt reached 45.2% of GDP, which is significantly below the Maastricht criterion threshold (60%). According to forecasts by the Ministry of Finance, debt will increase from around 49% of GDP in 2025 to 51% in 2026 and reach approximately 55% of GDP in 2027–2028. This upward trend is driven by the projected increase in the budget deficit—to 3.3% of GDP in 2026, 3.9% in 2027, and 3.6% in 2028—as well as by rising debt servicing costs. According to the Ministry of Finance forecasts, interest payments will increase from 1.2% of GDP or €484 million in 2025 to 1.3% of GDP or €584 million in 2026, 1.4% or €643 million in 2027, and 1.5% or €722 million in 2028.
19. **The new model for improving the local government finance equalization submitted to the government may enhance the fairness of the fiscal redistribution mechanism, but its impact on reducing regional development**

disparities will be limited. The new model aims to reduce differences in municipal revenues and more closely link funding to the service burden of municipalities, while at the same time increasing fiscal autonomy, particularly with regard to the property tax. However, spatial data on GDP, wages and population density indicate that Latvia's economic structure remains strongly monocentric, with tax potential concentrated in the capital and its functional area.

- 20. The Council has previously noted that fiscal policy in advanced economies has become structurally less responsible since the COVID-19 crisis. Political decisions have fostered reliance on permanent government support among both society and businesses, making fiscal discipline politically "toxic". This, in turn, has contributed to chronic budget deficits and rapidly rising public debt, increasing the risk of currency depreciation and potentially threatening the stability of the global financial system.** Particularly concerning is the trajectory of U.S. debt, as the U.S. dollar continues to serve as the world's main reserve currency, yet confidence in it is declining — public debt already exceeds USD 38 trillion and may reach USD 52 trillion or 118% of GDP by 2035 (CBO), while the dollar's share in global reserves has fallen from 72% in 1999 to 57% today, signalling accelerating de-dollarisation. Financial markets increasingly reflect these concerns, with investors seeking refuge in real assets - the price of gold has exceeded USD 5,000 per ounce, flows into gold ETFs and the weakening of the U.S. dollar index indicate a retreat from fiat currencies, while bitcoin is strengthening as a diversification tool against rising U.S. sovereign risk. Analysts note that the more than 65% increase in gold prices over the past year reflects growing scepticism about the direction of U.S. fiscal policy. Overall, these trends point to deep, gradual but potentially uncontrollable changes in the global financial architecture, where the U.S. dollar, despite its dominance, faces pressure from exploding debt, political uncertainty, declining reserve shares and the rise of alternative assets — factors that significantly increase the risk of a systemic crisis. The challenge for the Latvian government is to avoid the spread of the global fiscal "toxicity" virus to Latvia, particularly in an election year.