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Interim Surveillance Report on the 2026 Progress Report of Latvia's Fiscal Structural Plan for 2025–2028

Summary and main conclusions

Summary

The Council has assessed the 2026 Progress Report on Latvia's Fiscal Structural Plan for 2025–2028 and concludes that fiscal policy is facing particularly challenging environment. The risk of both a global and domestic economic slowdown is rising, and maintaining fiscal discipline will require carefully calibrated government action on both the revenue and expenditure sides. At the same time, there are some positive developments. In 2025, the economy returned to moderate growth, the general government budget balance was better than expected, and Latvia continues to hold an investment-grade credit rating and a relatively moderate level of public debt.

On the other hand, although both EU and national fiscal rules are currently being met, supported by the activation of the national escape clause, the medium-term fiscal outlook becomes significantly more challenging. Without policy changes, fiscal space is expected to turn negative from 2028 and deteriorate further in 2029, when the escape clause will no longer apply and a 1 percentage point transfer from the first to the second pension pillar (the funded scheme) will need to be reversed. At the same time, rising defense spending and related commitments are set to put additional pressure on the budget deficit and public debt, while economic growth remains too modest to offset these pressures on its own. In addition, geopolitical risks, higher energy prices, and several domestic fiscal risks could further weaken the government's financial position.

Therefore, the government will need to pursue an active, sustainability-focused fiscal policy in the coming years. This means strengthening the revenue base, improving the efficiency of public spending, and ensuring that the defense financing model does not undermine the stability and sustainability of public finances. Expenditure rationalization should begin now, so that a sharp fiscal consolidation is not required in 2029, which could weigh on economic growth. It is also important to significantly improve the governance of state-owned enterprises to prevent them from becoming a material fiscal burden.

- 1. The 2026 Progress Report on the Fiscal Structural Plan for 2025–2028 is based on the Ministry of Finance's (MoF) macroeconomic forecasts. These were approved by the Council on 13 February¹ 2026, and later technically updated by the MoF on 16 March² to reflect the actual national accounts data for 2025 published by the Central Statistical Office.** The baseline scenario assumes real GDP growth of 2.6% in 2026 and

¹ The Council Approves the Ministry of Finance's Macroeconomic Forecasts for the FSP PR 2026–2030 | Fiskālās disciplīnas padome

² On the revised February 2026 macroeconomic forecasts [[download](#)]

2.7% in 2027, with growth averaging around 2.6% by 2030. Nominal GDP is projected to grow by 6.1% in 2026 and by an average of 5.6% in the following years. Inflation is expected to reach 2.9% in 2026 and gradually decline to 2.3% by 2030. At the same time, the economy is expected to operate below its potential in the coming years, with the output gap remaining negative and only closing towards the end of the period.

2. The Council takes note of the Ministry of Finance's technical revision of the macroeconomic forecasts, as it does not affect the underlying assumptions about the path of macroeconomic development or the projected growth rates. At the same time, it leads to an improvement in several fiscal indicators expressed as a percentage of GDP. According to the revised forecasts, nominal GDP is projected to reach EUR 45,638 million in 2026, EUR 48,263 million in 2027, EUR 50,947 million in 2028, EUR 53,665 million in 2029, and EUR 56,542 million in 2030. The output gap is estimated at -1.0% of GDP in 2026, -0.4% in 2027, -0.1% in 2028, 0.0% in 2029, and +0.1% in 2030.
3. **According to the Ministry of Finance's forecasts, Latvia's general government debt is expected to continue rising, reaching around 52–53% of GDP in the coming years. At the same time, this outlook is more favorable than in earlier projections prepared for the medium-term budget framework for 2026–2028, when debt was expected to increase to 56% of GDP by 2029.** It should be noted that the current debt projection is based on the latest macroeconomic forecasts, which assume stronger GDP growth than previously expected. However, it does not take into account the potential impact of the conflict in the Middle East, including a sharp increase in energy prices and higher inflation. The forecast also excludes possible additional spending pressures related to the Rail Baltica project, as well as support for airBaltic and the healthcare and education sectors. Interest payments on government debt are projected at 1.3% of GDP in 2026, rising to 1.4% in 2027 and 2028, and reaching 1.6% of GDP in 2029 and 2030. In nominal terms, this corresponds to an increase from EUR 606 million in 2026 to EUR 901 million in 2030. However, if inflation in the euro area remains elevated, monetary policy by the ECB may become tighter, and higher interest rates would increase debt servicing costs.
4. **The Council emphasizes that downside risks to the macroeconomic outlook remain high.** These include geopolitical tensions—such as the war in Ukraine and the conflict in the Middle East—growing uncertainty in global trade, potential disruptions to supply chains, weaker external demand, declining consumer confidence, lower investment activity, and rising inflation. Given the elevated likelihood of these risks materializing, fiscal policy should remain prudent, with timely planning of measures to safeguard and improve fiscal space.
5. **The Council draws attention to the fact that rising price pressures may require additional support for households, which would in turn create**

further fiscal challenges. Household consumption in Latvia is already constrained, reflecting the impact of the cost of living. In this context, the Fiscal Discipline Council has consistently emphasized that any support measures should be well targeted rather than broad-based. This is particularly important given the limited fiscal space: fiscal rules are currently being met largely due to the activation of the escape clause, and any further increase in the deficit would also lead to higher public debt.

- 6. The Latvian economy recorded moderate growth in 2025, with actual outcomes generally exceeding the Ministry of Finance's projections prepared for the medium-term budget framework for 2026–2028.³ According to the Central Statistical Office, real GDP grew by 2.1% in 2025, compared to the forecast of 1.1%, while nominal GDP increased by 5.8%, above the projected 4.4%.** Growth was mainly driven by gross fixed capital formation, which rose by 9.8%. In contrast, household consumption increased by only 0.8%, and exports of goods and services by 1.0%. At the same time, a 4.9% increase in imports weighed on overall GDP growth. From a sectoral perspective, the strongest growth in value added was recorded in construction (+9.0%), manufacturing (+4.7%), and information and communication services (+4.9%). Meanwhile, value added declined in agriculture (-3.2%) and in the transport and storage sector (-3.5%).
- 7. The Council notes that gross fixed capital formation in 2025 was largely driven by EU funding, investment in machinery and equipment, as well as civil engineering and major infrastructure projects.** At the same time, domestic consumption remained weak, with households continuing to act cautiously. Retail trade turnover increased by only 1.4% in 2025. Consumer sentiment remained pessimistic and stayed in negative territory in the first quarter of 2026 (-10.6), pointing to limited prospects for a recovery in private consumption. This is an important signal when assessing the drivers of growth in the coming years, especially given the expected decline in EU fund inflows and the weak external trade environment, which constrains export growth.
- 8. Inflation in Latvia reached 3.7% in 2025, mainly driven by a 5.8% increase in services prices and a 3.0% rise in goods prices.** In early 2026, inflation eased from 2.9% in January to 2.3% in February, although services inflation remained elevated at 4.9%. At the same time, price pressures on food and non-alcoholic beverages began to moderate. Compared to a year earlier, food prices increased by 2.8% in January and 1.6% in February, while prices for food and non-alcoholic beverages rose by 3.9% and 2.4%, respectively.
- 9. The Council draws particular attention to the fact that the February 2026 inflation data do not yet reflect the latest risks related to oil prices.** Following the escalation of the conflict in the Middle East, the price of Brent crude rose to around USD 109 per barrel in early April, an increase of

³ Endorsement of the Ministry of Finance's Macroeconomic Forecasts | Fiskālās disciplīnas padome

more than 55% over the year. Analysis by the Bank of Latvia suggests that a 10% increase in energy prices could raise the consumer price level in Latvia by around 0.6 percentage points⁴ in the medium term. In response to these developments, Saeima reduced the excise duty on diesel fuel from EUR 467 to EUR 396 per 1,000 litres for the period from 1 April to 30 June 2026, and on diesel used in agriculture from EUR 70.05 to EUR 21 per 1,000 litres. At this stage, the impact of these changes on consumer prices is difficult to assess, and there is a risk that the effect may be limited. The Council considers that the fiscal impact of this measure may be broadly neutral in the short term. However, it also carries risks of non-compliance with the Fiscal Discipline Law, particularly if the measure leads to a loss of revenue without corresponding government decisions on compensatory measures.

- 10. The lending environment improved markedly in 2025 for both households and businesses, supported by declining interest rates. At the same time, household savings increased, reflecting both the capacity to save and continued caution in consumption.** Lending to both businesses and households has been expanding since the end of 2024. By the end of 2025, annual growth in the loan portfolio reached 21.6% for businesses and 11.6% for households. The volume of new lending also rose sharply - by 49.8% for households and 60.7% for businesses - pointing to stronger borrowing activity and more favourable financing conditions. Household deposits increased to EUR 11.9 billion in 2025, up by 8.2%. This is consistent with subdued consumption and weak consumer confidence, suggesting that households continue to build up precautionary savings.
- 11. The labour market remained stable in 2025. The employment rate increased to 64.5%, with the number of employed reaching 883.1 thousand. The unemployment rate stood at 6.9%, while the number of economically inactive people declined by 9.2 thousand.** At the same time, wage growth remained strong. The average monthly gross wage rose to EUR 1,815, an increase of 7.7% compared to 2024, while net wages grew by 10.2% to EUR 1,346. However, labour productivity growth remained significantly more moderate than wage growth, creating cost pressures for businesses and weighing on competitiveness.
- 12. The general government budget balance in 2025 is estimated at -2.4% of GDP, or EUR -1,019.5 million, compared with a deficit of 2.9% of GDP planned in the budget law. The structural balance is estimated at -0.4% of GDP, compared to the initially planned -0.8%.** The stronger than expected fiscal outcome is mainly due to the fact that part of the advance payments for defense procurement, in line with the European System of National and Regional Accounts (ESA) methodology, were not recorded in 2025. It also reflects better performance of state-owned enterprises classified within

⁴ Tuvākajos mēnešos redzēsīm pakāpenisku inflācijas pieaugumu | Ekspertu komentāri | Makroekonomika

the general government sector, as well as lower social benefit expenditure than previously projected.

- 13. Consolidated general government revenue reached EUR 17.8 billion in 2025, an increase of 3.5% compared to 2024.** Tax revenue grew by 5.6%, although it fell short of the planned level by 1.3%, or EUR 183.3 million. The largest shortfalls were recorded in VAT revenue (EUR -145.8 million, or -3.4%) and excise duties (EUR -69.2 million, or -5.3%), reflecting a weaker recovery in private consumption. At the same time, corporate income tax (CIT) revenue exceeded the plan by EUR 96.9 million, or 14.0%, while personal income tax (PIT) revenue was higher by EUR 31.9 million, or 1.2%. Overall, tax revenue growth remained stable at 5.6%, broadly in line with nominal GDP growth of 5.8%.
- 14. Consolidated general government expenditure reached EUR 19.5 billion in 2025, an increase of 9.2%, or EUR 1.6 billion, compared to 2024.** Capital expenditure recorded the fastest growth, rising by 22.4% (EUR 347.6 million). Interest expenditure increased by 14.0% (EUR 51.9 million), spending on goods and services by 9.6% (EUR 203.6 million), and social benefits by 8.2% (EUR 427.5 million). Compensation of employees rose by 6.4% (EUR 262.4 million), exceeding the 2.6% growth benchmark, although this increase was significantly smaller than in the previous two years. The Council considers that controlling compensation expenditure in the public sector remains a key element of fiscal discipline.
- 15. The fiscal outlook becomes significantly more challenging from 2026 onwards.** According to the Law on the State Budget for 2026, the general government budget balance is planned at -3.3% of GDP in 2026, -3.9% in 2027, and -3.6% in 2028. At the same time, updated Ministry of Finance projections included in the 2026 Progress Report on the Fiscal Structural Plan for 2025–2028 suggest that, under unchanged policies, the deficit could reach 3.0% of GDP in 2026, 4.0% in 2027, 5.1% in 2028, 4.2% in 2029, and 3.4% in 2030. The higher deficit levels in the medium term are mainly driven by increased defense spending. The projections also reflect amendments to the National Defense Financing Law, which require that, from 2027 onwards, defense expenditure is maintained at no less than 5% of GDP for the respective year.
- 16. The main driver of the deterioration in the fiscal position is the increase in defense expenditure. Amendments to the Law on State Defense Financing⁵ stipulate that, from 2027 onwards, defense spending must be at least 5% of GDP.** To meet this requirement, the government is making use of the flexibility provided under the national escape clause. The SAFE instrument also provides an additional source of financing. Under the EU Council Decision of 17 February 2026⁶, Latvia has access to SAFE loans of up to EUR

⁵ [Grozījums Valsts aizsardzības finansēšanas likumā](#)

⁶ eur-lex.europa.eu/legal-content/LV/TXT/PDF/?uri=CELEX:52026PC0057

3.5 billion. The Council recognizes that strengthening defense capabilities is a national priority. However, it stresses that such expenditure should not be financed solely through increasing debt over the long term. A structural and sustainable solution therefore needs to be identified in a timely manner.

- 17. Fiscal space in the coming years is very limited and is expected to deteriorate rapidly. Under unchanged policies, it is projected to amount to only EUR 80.3 million in 2027, before turning negative in subsequent years: EUR -153.3 million in 2028, EUR -191.1 million in 2029, and reaching EUR -883.5 million by 2030.** The Council draws attention to the fact that these estimates do not include measures endorsed by the Cabinet for which no financing sources have yet been identified. The fiscal impact of such measures amounts to EUR 208.8 million in 2027, EUR 271.9 million in 2028, EUR 335.8 million in 2029, and EUR 402.4 million annually thereafter. The most significant of these measures include the Oncology Care Improvement Plan for 2025–2027 (EUR 69.8 million in 2027)⁷, the implementation of the schedule for increasing the minimum salary rate for teachers (EUR 56.0 million in 2027)⁸, and the Action Plan for Improving Cardiovascular Health for 2026–2027 (EUR 42.2 million in 2027)⁹. The Council reiterates that approving measures without fully identified sources of financing is not consistent with sound budgetary management practices.
- 18. In Latvia, one-off measures were approved in previous medium-term budget frameworks (2023–2025 and 2024–2026). The Council has repeatedly pointed out that expenditure related to strengthening internal and external security should not be treated as one-off, as it represents a long-term fiscal commitment. Classifying such spending as one-off and excluding it from the calculation of the structural balance may distort the overall picture, artificially improving the reported indicators.** It should be noted that no new one-off measures are planned in the most recent medium-term budget frameworks (2025–2027 and 2026–2028), and the fiscal impact of previously adopted measures is gradually declining. However, given that the existing one-off measures are largely related to security financing, and that the delivery schedule of defense procurement has shifted, their fiscal impact is being redistributed to years in which such expenditure was not originally planned. According to the Ministry of Finance, one-off measures are currently projected at 1.8% of GDP in 2026, 1.7% in 2027, 1.8% in 2028, 1.1% in 2029, and 0.4% in 2030. At the same time, the structural balance targets—under a policy scenario that complies with all fiscal rules—are set at -0.8% of GDP in 2026, -2.3% in 2027, -3.1% in 2028, -2.8% in 2029, and -1.6% in 2030.

⁷ MK sēde 21.10.2025. protokols Nr.44 33.§ [Par Veselības aprūpes pakalpojumu onkoloģijas jomā uzlabošanas plānu 2025.–2027. gadam]

⁸ MK sēde 22.12.2025. protokols Nr.53 98.§ [Par pedagogu zemākās darba samaksas likmes pieauguma grafiku laikposmam no 2026. Gada 1. janvāra līdz 2030. gada 31. decembrim]

⁹ MK sēde 10.03.2026. protokols Nr.14 64.§ [Par Sirds un asinsvadu veselības uzlabošanas rīcības plānu 2026.–2027. gadam]

19. The tax revenue outlook for 2026 is generally assessed as realistic, but without a meaningful safety buffer. The 2026 Budget Law projects tax revenue of EUR 15,219.8 million, while the updated Ministry of Finance forecast stands at EUR 15,221.4 million. The Fiscal Discipline Council's assessment is broadly in line with these projections. In the first two months of the year, tax revenue increased by 6.2%, suggesting that the target could be met, provided there are no significant external shocks. At the same time, structural fiscal challenges persist, as the tax-to-GDP ratio in Latvia remains below the EU average¹⁰.
20. **The Council highlights the fiscal risks associated with state-owned enterprises, in particular JSC "Air Baltic Corporation".** The company recorded a loss of EUR 118.2 million in 2024 and EUR 44.3¹¹ million in 2025. Its equity remained negative in 2025 (EUR -183.6 million)¹², and its credit rating was downgraded to CCC+¹³. These developments are also reflected in financial markets, where yields on airBaltic bonds have reached around 58%, indicating a high risk premium demanded by investors¹⁴. The company is currently requesting a short-term state loan of EUR 30 million, while its financing needs for the upcoming winter season could reach EUR 100–150 million¹⁵. **In its 2025 audit report¹⁶, the State Audit Office concluded that the state has so far acted more as a provider of financing than as an active and demanding shareholder. Strengthening the company's governance is therefore essential.**
21. **Another significant fiscal risk relates to the financing of the Rail Baltica project. While a funding gap of EUR 3-4 billion¹⁷ has been publicly cited, an up-to-date and officially confirmed cost estimate is still lacking.** The Council calls for the total cost of the project to be clarified as soon as possible and for a fiscally responsible financing plan to be developed.
22. The Council once again draws attention to the operation of the Maintenance Guarantee Fund. Over the past five years, maintenance payments have averaged EUR 53.2 million per year, of which, on average, 80.8% has been financed through state budget grants¹⁸. At the same time, the total debt of maintenance defaulters to the Fund reached EUR 572.9 million¹⁹ at the end of 2024. In comparison, the fiscal cost of similar policies in Lithuania²⁰ and Estonia²¹ is significantly lower.
23. **Budget expenditure reviews in Latvia remain largely based on a mechanical approach rather than on performance-based budgeting.**

¹⁰ Eurostat datu bāze [gov_10a_taxag]

¹¹ AirBaltic 2025. gada pārskats

¹² AirBaltic 2025. gada pārskats

¹³ Air Baltic Corporation AS Credit Ratings :: Fitch Ratings

¹⁴ XS280067822 Bond Price and Chart — TRADEGATE:XS280067822 — TradingView [07.04.2026]

¹⁵ LSM | Valdība lūgs Saeimu apstiprināt 30 miljonu eiro īstermiņa aizdevumu "airBaltic"

¹⁶ Kā valsts uzraudzīja Covid-19 laikā veikto ieguldījumu airBaltic? | Valsts Kontrole

¹⁷ Kas notiek ar «Rail Baltica»? Ar piešķirtnēm 600 miljoniem eiro pietiek ceturtdalai pamatprasēs, trūkst vismaz 4 miljardu / Raksts

¹⁸ Publikācijas un pārskati | Uzturīdzekļu garantiju fonda administrācija

¹⁹ Grozījumi Uzturīdzekļu garantiju fonda likumā

²⁰ Sodra pays benefits in the event of parental failure: EUR 20 million per year for Sodra

²¹ Statistika | Sotsiaalkindlustusamet

Over the past ten years, the savings identified through such reviews have averaged around 0.7% of total expenditure, or 0.3% of GDP²². This is insufficient in the context of rising pressures from defense, healthcare, social protection, and debt servicing costs. The Council therefore calls on the government to set more ambitious expenditure reduction targets, accelerate the shift towards performance-based budgeting, and avoid relying on temporary fiscal flexibility as a substitute for structural reforms.

- 24.** When shaping fiscal policy, the broader international context also needs to be considered. The European Commission's Debt Sustainability Report²³ classifies Latvia as a medium-risk country in both the medium and long term. Additional risks stem from the weakening sustainability of US public finances and potential instability in the global financial system. In this context, it is particularly important for Latvia to strengthen its resilience in a timely manner by ensuring adequate fiscal space, sustainable public debt dynamics, and the capacity to respond effectively to external shocks.

²² FDP | Uzraudzības ziņojums par valsts budžetu 2026. gadam un vidēja termiņa budžeta ietvaru 2026., 2027. un 2028. gadam

²³ Debt Sustainability Monitor 2025