Fiskālās disciplīnas padome

Opinion of the Fiscal Discipline Council on the Ministry of Finance's Macroeconomic Forecasts for the

Medium-Term Budgetary Framework 2026–2029

Preamble

This document presents the opinion of the Fiscal Discipline Council (hereinafter – the Council) on the macroeconomic forecasts prepared by the Ministry of Finance (hereinafter – MoF) for the years 2025 and 2026–2029. These forecasts form the basis for the development of the Medium-Term Budget Framework (hereinafter – MTBF) for the period 2026–2029, which is scheduled for submission to the Cabinet of Ministers in October 2025. To support the government's budget planning process, an agreement was reached to provide the Council with the macroeconomic forecasts for early endorsement.

Under the cooperation agreement signed on 8 February 2016, the Council is responsible for endorsing the macroeconomic forecasts prepared by the MoF. During the endorsement procedure, the Council received detailed forecast data from the MoF, including scenarios for the development of gross domestic product (GDP) and its main components.

On 9 June 2025, the MoF presented the updated macroeconomic forecasts, including the underlying assumptions and changes since February 2025, as well as an overview of the current state of the national economy. The Council raised questions regarding the forecasting assumptions and the justification for certain indicators.

In accordance with Article 20 of the Fiscal Discipline Law, the Council is required to provide an opinion on macroeconomic indicators (a summary of which is presented in Table 3 at the end of this document). Following a review of the data and explanations provided by the MoF and based on internal discussions, the Council decided to endorse the forecasts.[1]

Situation Report

The Ministry of Finance's updated forecasts for real GDP growth suggest that Latvia's economic expansion will remain modest over the 2025–2029 period, averaging 1.9% annually.

Inflation is projected to remain above the European Central Bank's 2% target, with consumer prices expected to increase at an average rate of 2.5% over the five-year period.

Table 1 provides a comparison of the Ministry of Finance's revised forecasts[2] with the most recent macroeconomic projections from other institutions, including the Bank of Latvia (BoL) [3], the European Commission (EC) [4], and the International Monetary Fund (IMF) [5].

Since February, the MoF has slightly downgraded its 2025 GDP growth forecast, now projecting 1.1% growth for this year and 2.1% in 2026. For 2025, the main drivers of growth are expected to be government consumption (contributing 4.4%) and investment (3.7%),

[1]Council meeting minutes No. 5 (80) [download]
[2]Economic Analysis | Ministry of Finance
[3]Bank of Latvia, Macroeconomics forecasts Macroeconomic forecasts | June 2025 | Bank of Latvia
[4]European Commission Macroeconomics forecasts - European Economic Forecast . Spring 2025
[5]International Monetary Fund, World Economic Outlook Database , April 2025

while export growth is projected to contribute 1.9%. In 2026, government consumption is again expected to play a significant role (3%), with investment providing the largest contribution to growth (4.5%), alongside a recovery in both exports and domestic consumption.

For comparison, the Bank of Latvia's latest macroeconomic forecasts, published on 10 June 2025, project GDP growth of 1.2% in 2025 — 0.1 percentage points higher than the Ministry of Finance's estimate. According to the Bank of Latvia, this growth will be mainly driven by government consumption (3.1%) and exports (2.2%) amid improving external demand. In 2026, the Bank forecasts GDP growth of 2.8% or 0.7 percentage points above the Ministry's projection — supported by a recovery in private consumption and a strong investment contribution of 5.4%. The European Commission's forecast, released on 19 May, is the most conservative among those currently available.

	2025	2026	2027	2028	2029
Real GDP growth					
MoF (2025.g. Jun.)	1,1	2,1	2,2	2,2	2,2
BoL(2025.g. Jun.)	1,2	2,8	3,2	-	-
EC (2025.g. May.)	0,5	2,0	-	-	-
IMF (2025.g. Apr.)	2,0	2,5	2,5	2,5	2,5
Nominal GDP growth					
MoF (2025.g. Jun.)	4,4	4,7	4,7	4,6	4,7
BoL(2025.g. Jun.)	-	-	-	-	-
EC (2025.g. May.)	-	-	-	-	-
IMF (2025.g. Apr.)	5,2	5,6	5,4	5,1	5,1
Inflātion (CPI)					
MoF (2025.g. Jun.)	3,5	2,3	2,2	2,2	2,2
BoL(2025.g. Jun.)	3,4	2,1	2,8	-	-
EC (2025.g. May.)	3,0	1,7	-	-	-
IMF (2025.g. Apr.)	2,4	2,4	2,6	2,2	2,2
Deflator					
MoF (2025.g. Jun.)	3,3	2,5	2,5	2,4	2,4
BoL(2025.g. Jun.)	-	-	-	-	-
EC (2025.g. May.)	3,9	2,8	-	-	-
IMF (2025.g. Apr.)	3,1	3,1	2,8	2,6	2,6

1. Table of forecasts for key macroeconomic indicators of various institutions, %.

The EC forecasts 0.5% GDP growth for 2025, which is 0.6 percentage points less than the MoF estimate. For 2026, the EC forecast (2%) is 0.1 percentage points lower than the MoF.

The European Commission estimates that GDP growth in 2025 will be primarily driven by exports (contribution of 1.8%) and public consumption (1.7%), while the contribution from private consumption will be more modest (1%), and investment is expected to have a negative impact (–1.2%).

Regarding inflation, the Ministry of Finance's forecast reflects the current environment, in which consumer price growth has accelerated due to the easing of the ECB's monetary policy. The Ministry forecasts inflation at 3.5% in 2025. The Bank of Latvia's estimate is slightly lower at 3.4%, while the European Commission projects an even lower inflation rate of 3%, which is 0.5 percentage points below the Ministry's forecast. For 2026, the Ministry of Finance expects inflation to decline to 2.3%, which remains higher than the Bank of Latvia's forecast of 2.1% and the European Commission's forecast of 1.7%.

On May 8 of this year, the Ministry of Economics (MoE) presented a report to the Saeima titled "Proposals for Faster Growth of the Latvian Economy" [6] which also included economic forecasts for 2025 and 2026.

The Ministry of Economics (MoE) forecast for 2025 anticipates faster GDP growth (+2.1%) compared to the Ministry of Finance (MoF), which projects a more modest increase of +1.1%. This difference stems from the MoE's more optimistic outlook on private consumption (+2.2% vs. MoF's +0.2%), exports (+2.5% vs. +1.9%), and labor market demand. The MoE builds its scenario on expectations of an improved global economic environment, the stimulating

[6] MoE (2025), Proposals for Faster Growth of the Latvian Economy [Report]

effect of lower interest rates on consumption, a substantial inflow of EU funds, and planned reforms to labor taxation aimed at enhancing competitiveness. In contrast, the MoF takes a more cautious stance, identifying government consumption (+4.4%) and investment (+3.7%) as the main drivers of growth. Overall, the key difference between the two forecasts lies in their assumptions regarding the contributions of private and public consumption. For 2026, the MoE forecasts 2.4% GDP growth, exceeding the MoF's estimate by 0.4 percentage points.

The MoF forecast reflects a baseline scenario without policy changes, projecting an average annual GDP growth of 1.9% between 2025 and 2029. The MoE, however, presents a more optimistic scenario, assuming the active implementation of structural reforms. Under this assumption, economic growth could reach 2–3% annually over the next two years, despite ongoing geopolitical uncertainty. As the effects of the reforms take hold, the MoE expects growth to accelerate further, potentially reaching 4–5% annually in the medium term.

The forecast published by the Organisation for Economic Co-operation and Development (OECD) on 3 June projects GDP growth of 1.1% in 2025 and 2.1%[7], in 2026, fully aligning with the Ministry of Finance's projections for the same period.

In the OECD's view, the main driver of growth in both 2025 and 2026 will be government consumption (2025: +4.5%; 2026: +4.2%), while private consumption is expected to grow at a moderate pace (2025: +0.5%; 2026: +1.5%), reflecting ongoing consumer caution. Investment is projected to decline in 2025 (–0.8%), mirroring the European Commission's assumption, but is expected to recover in 2026 (+3.5%). Export growth is also assessed conservatively, particularly in 2025 (+1.3%), before gaining momentum in 2026 (+1.8%). Overall, the OECD forecasts present a balanced yet cautious outlook on Latvia's economic growth, underlining the strong role of government consumption and subdued private sector activity.

The forecast by the University of Latvia think tank LV PEAK, presented on 6 June as part of the 'Economic Barometer', is slightly more optimistic than that of the Ministry of Finance, projecting GDP growth of 1.3% in 2025. However, it estimates a significantly lower inflation rate—2.8%—compared to the Ministry of Finance's projection.[8]

Main Changes in Economic Development Since the Beginning of 2025

According to seasonally and calendar-adjusted data from the Central Statistical Bureau, gross domestic product (GDP) decreased by 0.3% in the first quarter of 2025 compared to the same period of the previous year.

From the expenditure side, household consumption made a slightly negative contribution to GDP (–0.2%). In contrast, growth in the first quarter was primarily supported by investments (+1.5%) and exports (+1.2%). Government consumption also had a mildly positive effect (+0.7%).

From the production side, GDP dynamics were shaped by divergent sectoral trends. The strongest growth was observed in the construction sector, which expanded by 9.6% year-on-year, driven mainly by engineering construction and favourable weather conditions. Positive performance was also recorded in the information and communication services sector (+4.6%) and accommodation and food services (+4.5%).

[7] OECD Economic Outlook, Volume 2025 Issue 1: Latvia | OECD
[8] LV_PEAK_BAROMETER_No.7.pdf

However, these gains were offset by notable declines in other sectors. Despite generally favourable industrial output, manufacturing made a negative contribution to GDP (−0.9%), reflecting contractions in most sub-sectors. A particularly sharp drop occurred in other industrial activities, including the electricity and heat supply sector (−11.4%), which had a significant negative impact. Substantial declines were also recorded in the healthcare sector (−10.1%) and the arts and entertainment sector (−5.6%).

Consumer sentiment remained cautious in the first quarter, as retail trade turnover fell by 0.5%. Within this, food store turnover dropped by 3.7% due to persistently high food prices, while non-food retail increased slightly (+1.7%). Fuel sales were nearly unchanged, but a 2.4% decline was observed in online and mail order channels. However, the latest data for April show a 0.6% increase in retail turnover, possibly reflecting seasonal effects.

Industrial growth remained weak in the first quarter of 2025, with total output declining by 0.1%. This was mainly due to a notable drop in electricity and gas supply (−6.4%). Meanwhile, the extractive industry (+2.4%) and manufacturing (+1.3%) maintained moderately positive trends.

Growth within the manufacturing sector was uneven. In sectors more domestically oriented—such as food production—output continued to grow steadily (+7.1%). However, beverage production, an important part of the sector, recorded a decline (−2.9%). After a previous downturn, the timber industry showed signs of recovery (+5.9%), while the chemical industry saw a sharp contraction (−14.7%), signalling ongoing challenges in that segment. A strong increase was observed in the production of non-metallic mineral products (+19.1%), reflecting high construction activity.

In April, total industrial production rose by 1.9%. Within manufacturing, output increased by 5%, supported by growth in food production (+13.8%), beverage production (+12.6%), and the timber industry (+8.3%). The production of rubber and plastic goods, as well as construction materials, also showed robust growth—both exceeding 15%. Conversely, declines were recorded in the production of equipment and machinery (−11.8%), chemical products (−9%), and computers, electronics, and optical equipment (−6%).

Exports of goods showed moderate growth in the first quarter (+3.2%), which is a noticeable improvement from the previous quarter (+1%). Export flows to EU countries remained stable (+2.3%), while exports to CIS countries continued to decline significantly (−16%). However, exports to other countries increased by 13.2%. The latest data indicate a convincing recovery in export activity — in April, exports grew by 8.9% year-on-year. Specifically, exports to EU countries rose by 11.2%, exports to other countries by 11%, while exports to CIS countries dropped by 14.1%.

Construction output increased by 9% in the first quarter, marking the first positive growth since late 2023. Engineering construction volumes rose significantly (+40.7%) due to projects in road, bridge, electricity supply, and telecommunications infrastructure — likely related to military infrastructure development. A more modest increase was observed in specialized construction (+2.6%), while building construction declined by 3.8%; however, this decrease was notably smaller than in previous quarters. Construction activity was also supported by favorable weather conditions, enabling an early start to works in winter. Construction costs rose by 1.9%, with wages for workers increasing by 5.8%, construction equipment rental by 3.1%, and construction material prices decreasing by 0.8%.

Consumer prices have fluctuated since the beginning of the year but have remained at or above 3%. Inflation stood at 3% in January, rose to 3.7% in February, slightly eased to 3.3% in March, and rose again to 3.9% in April. The April increase may partly reflect seasonal factors such as Easter and public holidays, which typically boost food consumption. However, food price inflation has become a significant socio-economic concern since autumn last year, severely impacting many households. In April, food prices had risen by 7.3% year-on-year.

Consumer prices increases were most pronounced in education services (+9.7%), recreation and culture (+5.3%), and miscellaneous goods and services (+5.4%). These developments are influenced by seasonal effects and cost pressures, including wage growth. Conversely, the lowest price increases were observed in housing (+1.2%), clothing and footwear (+1.4%), and transport services, where prices even declined (–1.3%).

Wages continued to grow, increasing by an average of 8.3% year-on-year in the first quarter. Growth was faster in the private sector (+9.4%), while it slowed significantly in the public sector (+5.8%).

Labour market indicators slightly deteriorated in Q1 2025. According to CSB data, the actual unemployment rate rose to 7.4% (up 0.5 percentage points compared to Q4 2024), and the employment rate declined to 63.2% (down 0.2 percentage points). At the same time, registered unemployment improved — falling to 5.1% by the end of April (a 0.4 percentage point decrease compared to March). The most significant decrease was seen in Kurzeme (–0.6 pp), followed by Latgale (–0.5 pp), and Vidzeme and Zemgale (both –0.4 pp); unemployment in Riga fell by 0.2 pp to 3.8%.

The persistent gap between actual and registered unemployment suggests low motivation among individuals to register as unemployed — especially those not receiving benefits or involved in the informal economy.

Business sentiment improved in May across several sectors, particularly in construction and manufacturing, indicating a potential strengthening of activity after the tentative recovery observed in Q1. The construction sector had already shown strong performance early in the year, supported by the surge in civil engineering and favorable weather. In May, sentiment in construction reached its highest level in three years.

In manufacturing, where Q1 production showed moderately positive growth, May recorded the highest confidence level since mid 2022. This improvement was driven by demand in construction materials, food, beverages, and woodworking.

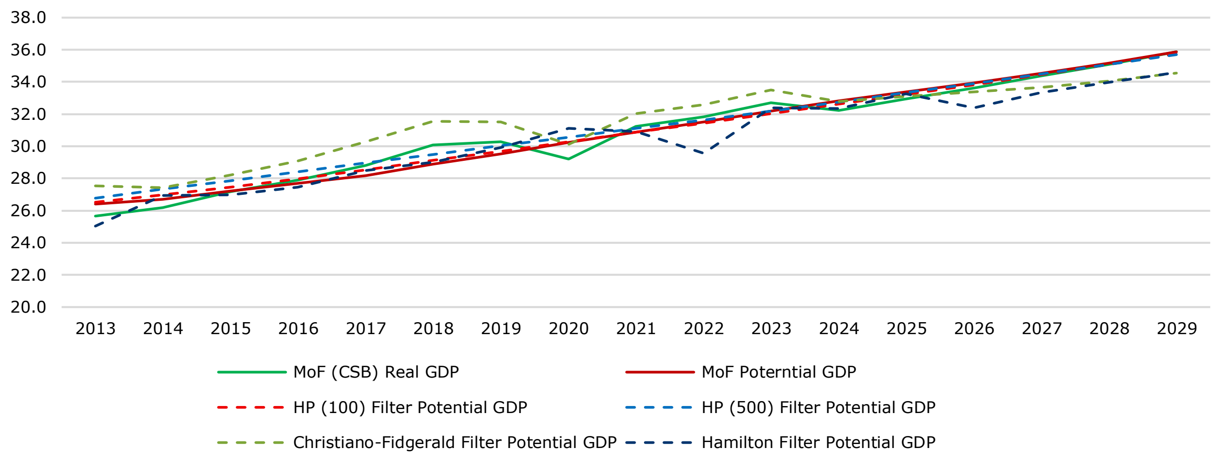
In retail and services, overall sentiment slightly deteriorated, especially in non-food trade and transport. However, sentiment improved in food and fuel retail segments. These shifts are occurring in the context of rising consumer prices, particularly for food, which has continued to erode purchasing power since last autumn.

<u>Assessment of the Latvian economic cycle</u>

The Council's experts have evaluated Latvia's position within its economic cycle using several statistical filtering methods, including the Hodrick-Prescott (HP) filter with smoothing parameters of 100 and 500, the Christiano-Fitzgerald filter, and the Hamilton filter. These methods help to separate short-term fluctuations from long-term trends in GDP and estimate the economy's potential output, enabling a comparison with the Ministry of Finance forecasts.

As illustrated in Figure 1, the HP (100) filter produces a potential GDP estimate most closely aligned with the MoF's own calculation for the 2013–2029 period. In contrast, the Hamilton filter yields the most divergent results, showing a sharper drop in potential GDP in 2022—reflecting the impact of the energy price shock—and a noticeably lower potential GDP level in the medium term after 2026.

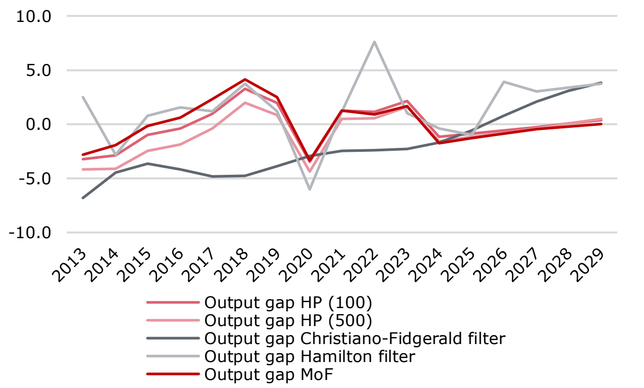
Figure 1. Real GDP (Actual and Forecast), MoF Estimate of Potential GDP, and Council Estimates Using Statistical Filter Methods (HP 100, HP 500, CF, and Hamilton)



Source: MoF and Council calculations

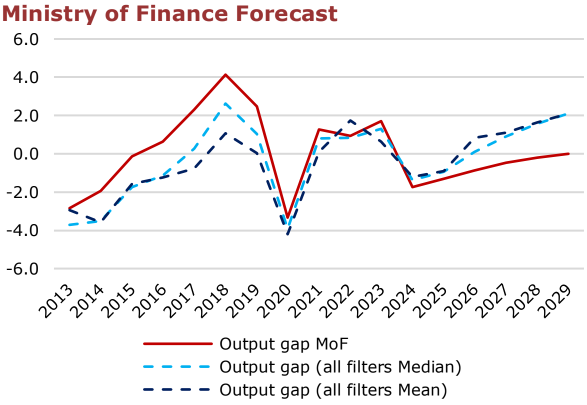
Using the statistical filter approach, alternative output gap estimates were derived. The results show that for the period from 2013 to 2029, the output gap trajectories calculated using different statistical filters—except for the Christiano-Fitzgerald (CF) filter—broadly align with those of the Ministry of Finance (MoF). The Hamilton filter produces higher and more positive output gap values, while the gaps calculated with the HP (100) and HP (500) filters deviate only slightly from the MoF estimates (see Figure 2). Numerically, the output gaps derived using the HP 100 and HP 500 filters are also close to the MoF projections, indicating a negative output gap until 2027, followed by a marginally positive gap thereafter.

Figure 2. Output Gap Estimates: Comparison of Three Statistical Filters with the Ministry of Finance Forecast



Source: MoF and Council calculations

Figure 3. Output Gap Estimates: Average and Median of Statistical Filters Compared to the Ministry of Finance Forecast



Source: MoF and Council calculations

Figure 3 presents the median and mean output gap estimates derived from all applied statistical filters, alongside the Ministry of Finance's (MoF) output gap assessment. Both the median and mean values confirm a negative output gap in 2025 (see Table 2). Given the current economic risk environment and persistent global uncertainty, the scope for a robust long-term assessment of the output gap remains limited. The Council agrees with the MoF's assessment, which aligns with the current state of the economy. In consultation with Bank of

Latvia (BoL) experts, it was concluded that BoL's output gap estimates are also broadly consistent with those of the MoF. However, unlike the MoF, the BoL projects the output gap to close already in 2027.

Table 2

Output Gap Estimates: Comparison of MoF Calculations with the Mean and Median of Statistical Filter Results

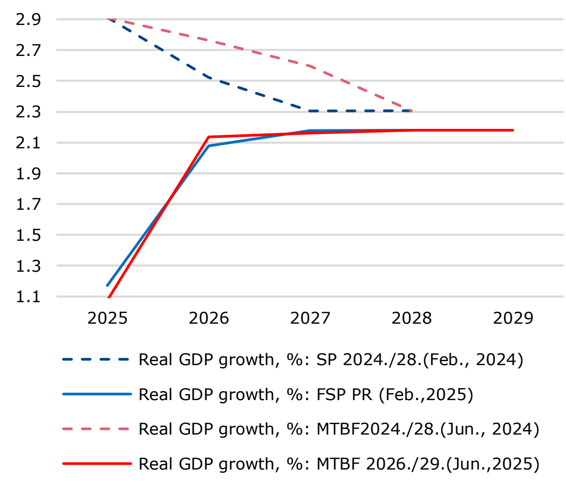
	Output gap MoF	Output gap (all filters median)	Output gap (all filters average)
2025	-1.3	-0.9	-0.9
2026	-0.9	0.1	0.8
2027	-0.5	0.9	1.1
2028	-0.2	1.6	1.6
2029	0.0	2.1	2.1

Source: MoF and Council calculations

Comparison of Current and Previous MoF Forecasts

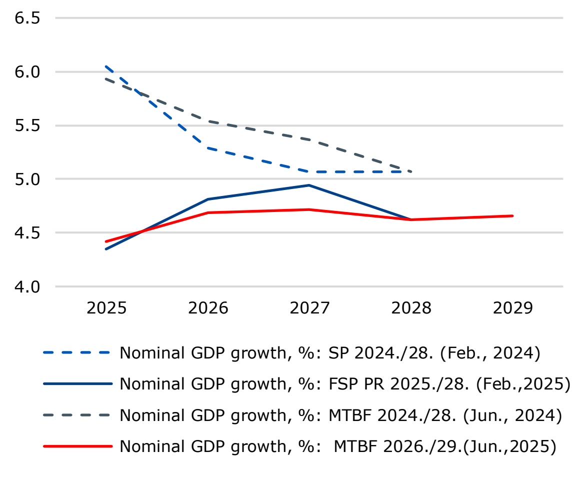
The following section presents a comparison between the macroeconomic forecasts issued in February 2025 (FSP PR 2025/2028) and the most recent forecasts for 2025 and the MTBF period 2026–2029. Based on current economic trends and the underlying assumptions of the Ministry of Finance (MoF), the **Council has decided to approve the updated forecasts. The Council endorses the real GDP growth forecast for the five-year period from 2025 to 2029.** Compared to the February 2025 forecast (FSP PR 2025/28), the GDP growth projection for 2025 has been revised downward by 0.1 percentage points, while the forecast for 2026 has been slightly raised by 0.1 percentage points. Forecasts for 2027 and 2028 remain unchanged at 2.2%, and the 2029 forecast also projects GDP growth at 2.2% (see Figure 4).

Figure 4. Real GDP growth forecast



Source: MoF

Figure 5. Nominal GDP growth forecast

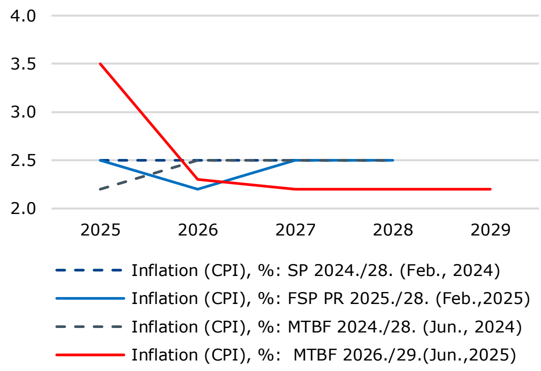


Source: MoF

The Council approves the nominal GDP growth forecast for the five-year period from 2025 to 2029. Compared to the previous forecast (FSP PR 2025/28), the nominal GDP growth projection for 2025 has been revised upward by 0.1 percentage points. The forecast for 2026 has been adjusted downward by 0.1 percentage points, while the estimate for 2027 has been reduced by 0.2 percentage points. The projection for 2028 remains unchanged at 4.6%, and for 2029, the nominal GDP growth is forecast at 4.7% (see Figure 5).

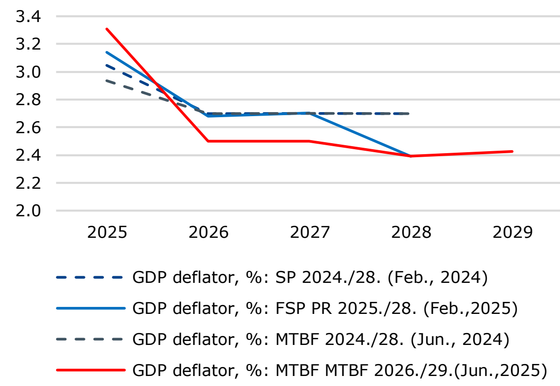
The Council also endorses the inflation forecast for the five-year period from 2025 to 2029. Relative to the previous forecast (FSP PR 2025/28), the inflation estimate for 2025 has been raised by 1 percentage point, and for 2026 by 0.1 percentage point. Forecasts for 2027 and 2028 have been revised downward by 0.3 percentage points and are set at 2.2% for both years. The inflation forecast for 2029 also stands at 2.2%. Throughout the entire forecast period, inflation is expected to remain above the European Central Bank's 2% target (see Figure 6).

Figure 6. Inflation (CPI) forecast



Source: MoF

Figure 7. GDP deflator forecast



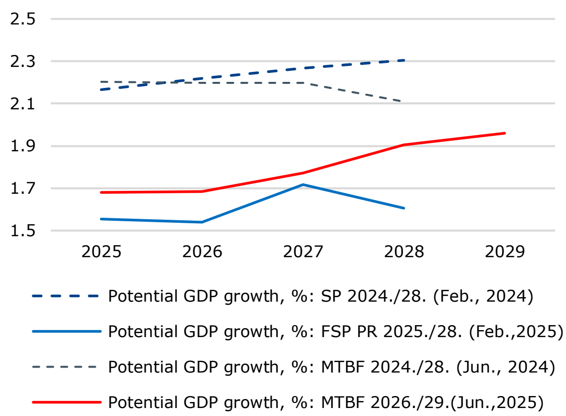
Source: MoF

The Council approves the GDP deflator forecast for the five-year period from 2025 to 2029. Compared to the previous forecast (FSP PR 2025/28), the deflator for 2025 has been revised upward by 0.2 percentage points. The forecasts for 2026 and 2027 have been adjusted downward by 0.2 percentage points. The estimate for 2028 remains unchanged at 2.4%, and the GDP deflator for 2029 is also projected at 2.4% (see Figure 7).

The Council also endorses the potential GDP growth forecast for the 2025–2029 period. Compared to the previous projection (FSP PR 2025/28), the forecasts for 2025, 2026, and 2027 have been revised upward by 0.1 percentage points. The forecast for 2028 has been increased by 0.3 percentage points, reaching 1.9%, while the estimate for 2029 is set at 2.0% (see Figure 8).

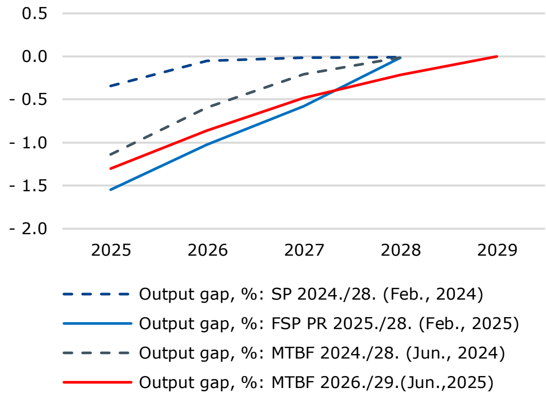
The Council approves the output gap forecast for the five-year period from 2025 to 2029. Relative to the previous forecast (FSP PR 2025/28), the output gap for 2025 and 2026 has been adjusted upward by 0.2 percentage points, and by 0.1 percentage points for 2027. The forecast for 2028 has been revised downward by 0.2 percentage points. In 2029, real GDP and potential GDP are projected to converge, resulting in an output gap of 0% (see Figure 9).

Figure 8. Potential GDP growth forecast,%



Source: MoF

Figure 9. Output gap forecast, % of potential GDP



Source: MoF

Conclusions

The Council approves the updated macroeconomic forecasts of the Ministry of Finance for 2025 and the Medium-Term Budgetary Framework (MTBF) period from 2026 to 2029. While most alternative forecasts for 2025 suggest potential GDP growth in the range of 1–2%, a weaker economic outcome—such as the 0.5% growth forecast by the European Commission—cannot be ruled out. The latest assessment by the International Monetary Fund (IMF) estimates GDP growth at 1%[9] this year, while the most recent forecast by the Organisation for Economic Co-operation and Development (OECD) projects 1.1% growth in 2025 and 2.1% in 2026, aligning with the Ministry of Finance's estimates for the same period.

Table 3

Indicators of macroeconomic forecasts approved by the Council,%

Macroeconomic indicators	2025	2026	2027	2028	2029
Real GDP growth	1.1	2.1	2.2	2.2	2.2
Nominal GDP growth	4.4	4.7	4.7	4.6	4.7
Inflation (consumer prices)	3.5	2.3	2.2	2.2	2.2
GDP deflator	3.3	2.5	2.5	2.4	2.4
Potential GDP growth	1.7	1.7	1.8	1.9	2.0
Output gap	-1.3	-0.9	-0.5	-0.2	0.0

Source: MoF

The Council acknowledges the high level of uncertainty and, in light of this, draws attention to the current set of risks that may negatively impact the growth trajectory projected by the Ministry of Finance.

Current risks to economic growth

1. **Geopolitical Tension in the Region.** Heightened risks of hybrid threats across the EU, including Latvia (e.g., cyberattacks and border provocations), may undermine investor confidence and consumer sentiment, while also requiring a redirection of substantial fiscal resources toward national security priorities.

[9] Republic of Latvia: Staff Concluding Statement of the 2025 Article IV Mission

2. **Global Economic Slowdown.** Protectionist trade policies in the United States (e.g., new tariffs), sluggish growth in the European Union, and the potential for trade conflicts could weaken Latvian export performance. While the impact is indirect, it would affect Latvia through key trade partners such as Germany and Poland.
3. **Raw Material Availability and Supply Chain Disruptions.** Intensified global competition for raw materials may result in unpredictable supply chain disruptions, particularly affecting the manufacturing and construction sectors.
4. **Weak Private Consumption.** Household spending remains subdued due to cautious consumer behavior, rising inflation expectations, and ongoing food price pressures—all of which are constraining GDP growth.
5. **Labor Market Tensions.** Despite economic stagnation, unemployment remains low. A shortage of skilled labor and mismatches between labor supply and demand are already constraining growth in key sectors such as construction, ICT, and manufacturing. These structural labor market issues could become more acute as economic activity picks up.
6. **Overheating of the Construction Sector.** The rapid absorption of EU funds in 2025–2026 risks creating unbalanced growth. Labor shortages and capacity constraints in construction could lead to wage pressures and rising costs.
7. **Fiscal Risks Related to State-Owned Companies.** Continued financial support needs for companies such as AirBaltic, Latvian Railways, and the Rail Baltica infrastructure project represent ongoing fiscal and reputational risks.

A similar set of risks—particularly when considering their likelihood—has been highlighted in the consensus assessment by experts from the University of Latvia's think tank *LV PEAK*[10].

[10] LV_PEAK_BAROMETER_No.7.pdf