The Estonian Economy and Monetary Policy

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The Estonian Economy and Monetary Policy is an Eesti Pank review released four times a year that summarises the main recent events in the global and Estonian economies. The review also contains an economic forecast for Estonia.

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Information by telephone on +372 668 0998,
or by fax on +372 668 0954

or by email from trykis@eestipank.ee.

Review by Rasmus Kattai, Gerda Kirpson, Helen Ljadov, Lauri Matsulevitš, Kaspar Oja, Sulev Pert, Mari Pärnamäe, Taavi Raudsaar, Mari Rell, Heili Saia, Orsolya Soosaar, Birgit Strikholm, Anita Suurlaht-Donaldson, Katri Urke, Nils Vaikla.

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Layout and design Urmas Raidma

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INTRODUCTION

Growth in the global economy has beaten expectations this year despite trade tensions and a lack of certainty. The USA has postponed its tariffs or brought them in at a lower level than feared and the advance purchases made in anticipation of a deterioration in terms of trade helped the global economy to revive in the first half of the year, though that effect was only temporary. The outlook for the global economy in the next few years is modest though. The International Monetary Fund forecasts that growth overall in 2025 will slow and that it will not strengthen particularly in subsequent years. The global economy was growing by almost 4% a year on average before the pandemic, but it will now have to accept growth of around 3%. The reasons for this are quite clear because growth in productivity has slowed, international tensions have increased, and trade is fracturing. Growth in the working-age population has also slowed, and the impact of this can be felt throughout the global economy.

The Estonian economy has been moving in the direction of improvement for around a year by now. The GDP data do not directly reflect it, but industrial output, exports and retail sales have all been growing since last year. That the economy is recovering is also shown by a notable increase in borrowing activity, which has been encouraged further by cuts to interest rates and improved access to loans. Bank loans are an important source of funding for investment, and so companies may be expected to increase their purchases of fixed assets in the near term, and so give a boost to productivity growth, which has been weak of late. Productivity can be improved quickly in the near future because a large part of the equipment used by companies and some of their staff are underutilised or underemployed and can be quickly brought into action as demand and the economy bounce back.

Growth in the Estonian economy will be given a strong helping hand next year. The government has decided to increase spending on defence, flatten out the tax-free income threshold, and cancel the security tax, and this together will substantially increase the budget deficit while providing fiscal stimulus. Recovery in the economy will lead employment to grow and unemployment to fall. Companies tried to avoid redundancies and keep their staff on the payroll even when there was little activity, and so in return the reaction of the labour market to the improvement in the economy may be slow and only modest.

High inflation will come down. Tax rises and higher production costs this year will mean that inflation will be higher but will then fall in the second half of next year to close to 2%. The impact of the motor vehicle tax will disappear from the inflation indicators at the start of 2026, and it will be followed in the middle of the year by the effect of the rise in VAT and higher prices for administratively regulated medical services. Price pressures will be eased by growth in wages slowing, the euro appreciating, oil being cheaper than before, and prices for food commodities rising more moderately or even falling. The cost of living rising more slowly will combine with changes in the income tax law to give a strong lift to the real purchasing power of people, and the positive impact of this will be passed through consumption into the whole of the economy.

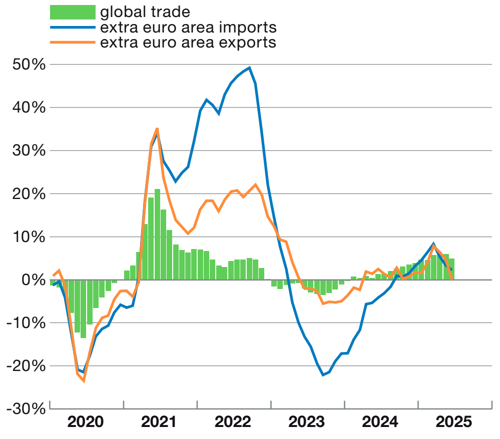
THE EXTERNAL ENVIRONMENT

THE GLOBAL ECONOMY

The global economy was buffeted by the volatility in trade policy. It grew faster in the second quarter than the IMF had forecast in spring despite the increased trade tensions and uncertainty[1]. The faster growth was supported by the US presidential administration postponing the high tariff rates announced in April and in some cases imposing them at lower levels than originally declared. Growth in international trade (see Figure 1) was boosted by temporary factors like purchases being brought forward in fear of higher tariff rates. The US and Chinese economies grew by more in the second quarter than markets expected. Growth in the US economy over the quarter accelerated to 0.8% in the second quarter, but growth in consumption slowed further. GDP grew by 0.3% in the United Kingdom, 0.1% in the euro area, and 0.3% in Japan for the fifth quarter in a row (see Table 1). The global economy also started the third quarter strongly despite the geopolitical uncertainty as the PMI[2] rose from 52.5 points to 52.9 in August (see Figure 2). The growth was driven mainly by the service sector, especially financial services. The outlook for manufacturing improved at the same time as both production volumes and numbers of new orders started to grow again.

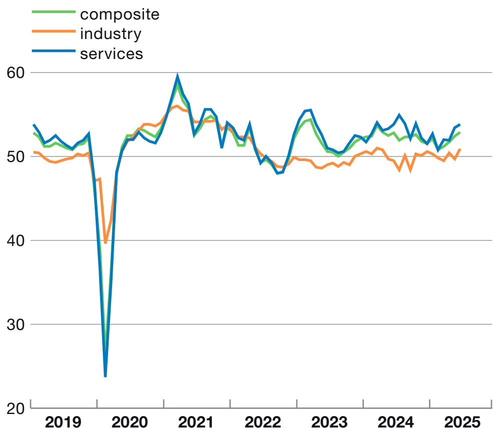
The full effect of the protectionist US tariffs has not yet been felt. The USA tightened its trade policy substantially in 2025, as the effective tariff rate applied to imports of goods had risen

Figure 1. Yearly growth in global and euro area trade, three-month moving average



Sources: CPB, Eurostat

Figure 2. Purchasing Managers Indexes



Sources: J.P.Morgan, S&P Global, Markit Economics Limited

Table 1. GDP growth in different regions in 2020- 2025 (change, %)*

	2020	2021	2022	2023	2024	Q1 20254	Q2 2025	2025
World	-3.1	6.0	3.4	3.5	3.3			3.0
Advanced economies	-4.5	5.2	2.7	1.8	1.8			1.5
Emerging markets and developing economies	-2.1	6.6	4.0	4.7	4.3			4.1
Euro area	-6.0	6.3	3.5	0.5	0.9	1.6 (0.6)	1.5 (0.1)	1.0
United States	-2.2	6.1	2.5	2.9	2.8	2.0 (0.0)	2.0 (0.8)	1.9
China	2.3	8.6	3.1	5.4	5.0	5.4 (1.2)	5.2 (1.1)	4.8
Japan	-4.3	2.1	1.0	1.4	0.2	1.8 (0.1)	1.2 (0.5)	0.7
United Kingdom	-10.3	8.6	4.8	0.4	1.1	1.3 (0.7)	1.2 (0.3)	1.2

* GDP at constant prices, quarterly growth over the previous quarter is in brackets
Sources: IMF World Economic Outlook Update (July 2025), OECD, Eurostat, national statistics; 2025 is IMF forecast

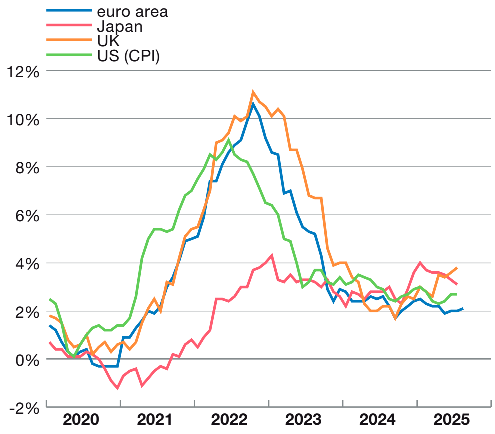
1 The IMF forecast for growth in the global economy was raised in its WEO July Update by 0.2 percentage point to 3.0% for 2025 and by 0.1 percentage point to 3.1% for 2026.

2 J.P.Morgan Global Composite PMI® Output Index.

by the start of September to 18.2% from 2.2% in January, meaning it was at its highest level since the 1930s[3]. The actual weighted average tariff rate, which is adjusted for the proportion of imports that are actually subject to the tariffs, was however much lower at 11.5%[4]. The difference arises because of delays in receipts of customs revenues, companies increasing their imports of goods before the tariffs applied, and new trade routes coming into use. International trade has been supported at the same time by uncertainty around trade policy declining from its peaks of the spring. The uncertainty has been eased by the USA rapidly signing preliminary trade agreements with Japan, Korea, Vietnam and the European Union, and by the US president deciding to postpone the introduction of the higher protectionist tariffs on China until 10 November. The future of international trade remains very uncertain though, as the impact of the tariffs will be felt gradually and the preliminary trade agreements are only framework agreements, and discussions are still ongoing about the details of them. This indicates that tensions between the USA and some trading partners could increase again. Uncertainty is also created by the ongoing court case in the US concerning the right of the president to apply tariffs, which the Supreme Court will give a final verdict on in November.

Inflation has come down slowly in most large countries except the USA. Inflation had mainly been pushed upwards in the larger industrialised countries by prices for food and services, but price pressures are gradually easing (see Figure 3). Inflation in the euro area was 2.1% in August, and in the United Kingdom it was 3.8%. Inflation remains at around 3% in Japan, and has spread further into services and wages. Consumer price inflation in the US rose to 2.9% in August, while core inflation hit 3.1%. This has happened because companies initially covered the costs of higher protectionist tariffs themselves, but they are now passing those costs gradually over to consumers. The labour market data for August also showed a substantial fall in the rate of job creation. The Federal Reserve faces a challenge because the

Figure 3. Inflation



Sources: Eurostat, Bloomberg

cooling economy is increasing the pressure to ease monetary policy, while the cumulative effect of the trade tariffs has not yet been felt in full and may cause additional price pressures. The Federal Reserve cut its base interest rates to 4.25% in September because the economy was cooling and the labour market deteriorating, and it indicated it may ease monetary policy further in future.

The Chinese economy continued to grow fast, but exports are increasingly affected by trade tensions. The Chinese economy grew by 5.2% over the year to the second quarter, which is slower than in earlier quarters but still more than markets expected. The growth was supported by exports, despite the tariffs introduced by the US, and by public sector spending. Signs appeared though in the third quarter that trade tensions were starting to restrain exports. Growth in exports fell to its lowest level of the past six months in August, with exports to the USA down 33% on a year earlier. Exports to Southeast Asia were up by 22.5% at the same time and those to the European Union by 10%, which illustrates how trade flows have been reoriented, helping to compensate to some extent for the fall in exports to the US market. Growth in the Chinese economy has in recent years been based mainly on exports, as domestic demand has remained poor. Expansion of production capacity and modest consumption

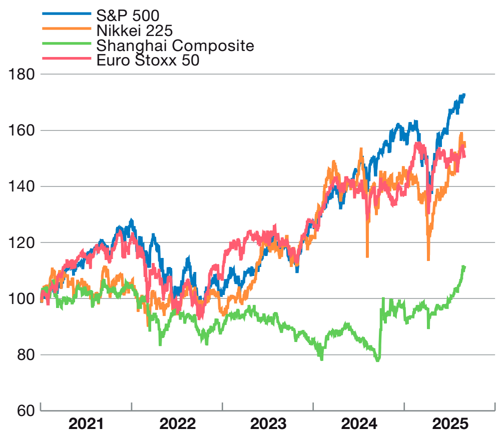
3 The President issued Executive Order 14257 (“Liberation Day Tariffs”) on 2 April 2025 setting a baseline tariff of 10% on most goods imported from all countries with a few limited exceptions such as some goods from Canada and Mexico as trade partners in the USMCA. On 4 June the tariffs on steel and aluminium were doubled under Section 232 from 25% to 50%, which particularly affected imports from Canada, Brazil, India and the European Union. A tariff of 50% on copper was announced on 9 July and came into force on 1 August. Additional tariffs of 10-15% were applied on 7 August to goods from several partners, including Japan, South Korea, Vietnam and the European Union. Section 232 was expanded on 18 August to cover more than 400 new steel and aluminium products that were also subject to a 50% tariff rate, which particularly affected imports from Canada, Brazil and India.

4 Yale Budget Lab, *Short-Run Effects of 2025 Tariffs So Far* (September 2025).

have caused producer prices to fall for three years. It is likely that domestic demand will remain weak moving forwards, and so it is probable that China will in future take advantage of its cheaper production costs to increase exports of goods to foreign markets.

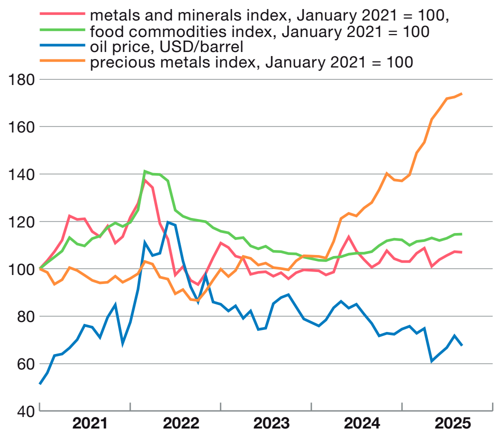
The leading stock markets in the USA, Japan and China climbed to record levels. The surge in US shares was led by the technology sector (see Figure 4), where companies reported good financial results in the second quarter. The recovery in stock markets after the trade tensions has been encouraged by retail investors looking to buy, and the expectation that the Federal Reserve will start to cut interest rates because of the weakness in the US labour market. European stock markets have not moved much recently, but shares in Japan have hit new records, with the Nikkei 225 passing the 44,000 mark for the first time. This rise was encouraged by the economy recovering, trade tensions with the US easing[5], and foreign investors showing an increased appetite to buy. Chinese stock markets have also continued to rise in recent months, and the Shanghai Composite index is at its highest level for 10 years. The rise has been supported by stimulus from the government and by institutional and local investors showing greater interest in buying.

World stock indexes, 01 January 2021 = 100



Last observation 01.09.2025
Source: Bloomberg

Figure 5. Commodity price indexes



Sources: The World Bank: Commodity Price Data (The Pink Sheet), Bloomberg, FAO

Bond markets rose in expectation of looser monetary policy from the Federal Reserve, and because of worries about fiscal policy in France. The yield on the US 10-year Treasury has fallen from around 4.8% at the start of the year to close to 4%. Yields have been pulled down by signs of the economy cooling, and the expectation that monetary policy will start to loosen. Investors have at the same time become concerned about the political declarations of the Trump administration about the monetary policy course taken by the Federal Reserve, and by the pressure it has put on governors to resign. Investors fear that such political intervention could threaten the independence of the bank and increase the risk of inflation. Returns on the German 10-year bond in the European bond market remained at around 2.7%, while the yield on French bonds rose to around 3.5%. This was because of political instability that has made markets worry more about the government's ability to reduce the increasing budget deficit. The consequence is that the interest rate spread between French and German bonds has widened from its usual level of around 20-40 basis points to around 90 basis points.

Commodities markets saw the price of oil fluctuate and that of gold rise rapidly. The Brent crude benchmark oil price rose to 78 dollars a barrel after Israel attacked Iran, but it then mainly stabilised at 65-70 dollars (see Figure 5). The oil price fell partly because the OPEC+ countries gradually increased their production volumes. Stocks of crude in the US have at the same time been larger than usual, which has helped put a lid on price pressures. The price of gold continued to rise and reached 3600 dollars an ounce by the start of September, having risen by around 40%

5 The USA and Japan signed a trade agreement on 22 July 2025 that came into force on 4 September. The agreement applied a tariff rate of 15% to imports from Japan. This did not cover steel and aluminium, which remain subject to higher tariffs.

since the start of the year. Prices of precious metals have been driven up by strong demand for safe assets as investors look for protection against geopolitical insecurity. Gold has also been made a more attractive investment by the weaker dollar and the fall in bond yields. Large central banks have offered additional support, especially the Chinese and Indian central banks, which have continued to buy gold to increase their reserves. Prices for food commodities continued to rise in the summer, led primarily by the prices of meat and coffee. The price of coffee has risen sharply, mainly because the harvest in Brazil was smaller than expected.

THE EURO AREA

Growth in the euro area economy slowed in the second quarter. The euro area economy grew to be 0.1% larger in the second quarter of 2025 than in the first despite the major uncertainty surrounding trade relations between the European Union and the USA. The growth was clearly slower than the 0.6% recorded in the first quarter, but it still beat the zero growth forecast by analysts[6]. The growth in total output in the euro area in the second quarter was 1.5% from the same quarter of last year. The faster growth in the first quarter was in any case temporary, as it came from an increase in exports in anticipation of the US tariffs. Growth was supported in the second quarter by stronger quarterly growth than expected in Spain at 0.7% and France at 0.3%, which helped to offset the declines in Germany and Italy. The Italian economy unexpectedly contracted by 0.1%, while the decline in Germany, the euro area's largest economy, was as much as 0.3%. Manufacturing in Germany, especially the automotive industry, is heavily dependent on exports and was hit hard by the wide-ranging tariffs imposed by the USA. The drop in German GDP was broadly based and came from declines in investment, exports and consumption. The USA and the European Union finally signed an agreement in summer that will see the US apply a 15% tariff to most imports from the European Union[7]. That is lower than the rate of 30% that the US threatened in the summer, but still higher than it was before. The agreement did at least help to ease a lot of the general uncertainty though.

Estimates of economic activity in the euro area improved. The purchasing managers index (PMI)[8] of activity in the euro area strengthened in August to 51 points from 50.9 in July. This is the highest figure since May 2024 and may indicate that economic growth picked up a little at the end of summer. The PMI for manufacturing also rose above 50 points to reach its highest level since March 2022. The main reason that the aggregate indicator rose was the improvement in manufacturing. The PMI for services was also above 50 points, but a little below where it was in the previous month. Overall there are signs of improvement in activity in both the industrial and services sectors. Surveys suggest that manufacturing in the euro area, especially in Germany, has been growing for some months by now. There were even signs of stabilisation in August in France, where activity declined in the industrial sector in June and July. A positive note is that the number of new orders rose in August after 14 months of decline, and that this occurred in both manufacturing and services. The number of new export orders fell further though, indicating that foreign demand has still not strengthened.

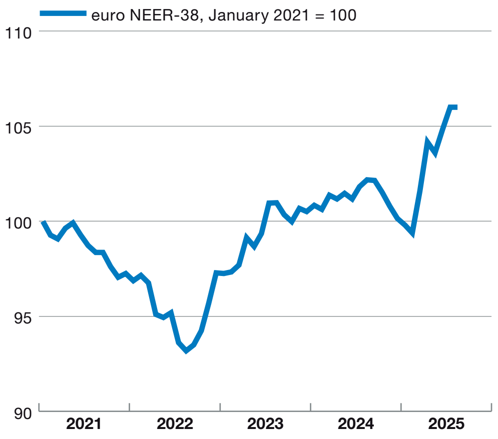
Both industrial output and retail sales volumes in the euro area continued to grow. Industrial output was 0.3% higher in July than in the previous month, showing a clear increase from June. Growth over the year was even more positive at 1.8%, which was quite a strong rate. It was fastest in July in capital goods and consumer goods, while output in energy dropped notably. Retail sales in the euro area were up by 2.2% over the year in July. This was quite fast, but still slower than the 3.5% recorded in June, which was the fastest rate of growth since autumn 2024. Retail sales volumes were down a little over the month, especially because sales of motor vehicles and food and alcohol fell. In general though, consumption has been quite resilient in the euro area despite the high level of uncertainty. The trade surplus of the euro area narrowed to 12.4 billion euros in July from 18.5 billion euros in July last year. The main reason for this was that the trade surplus with the USA decreased. At the same time, exports of goods to foreign markets were 0.4% larger than in July 2024, while imports were up by 3.1%, mainly from imports of chemical

6 Reuters.

7 This means that the USA will apply its highest tariff rates since the 1930s, 90 years ago, to imports from the European Union.

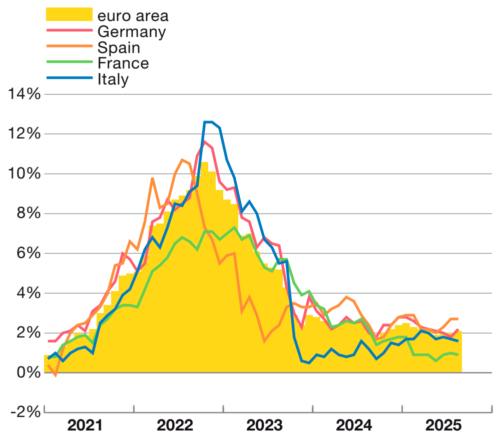
8 HCOB Eurozone Composite PMI Output Index.

Figure 6. Trade-weighted euro exchange rate



Source: European Central Bank

Figure 7. HICP inflation

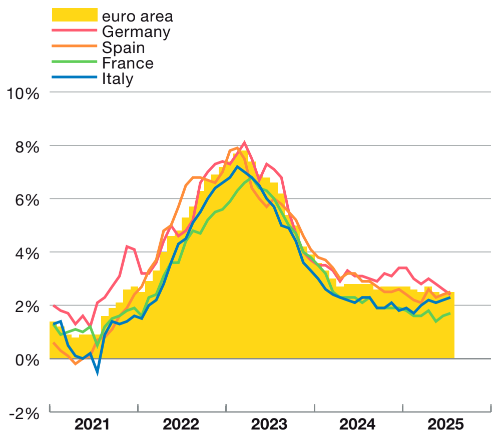


Source: Eurostat

products and machinery and equipment. The exchange rate of the euro (NEER) appreciated in the summer against the currencies of Estonia's main trading partners, including the US dollar (see Figure 6). This may in future make companies from the euro area less competitive in foreign markets. The earlier loosening of monetary policy (see Box 1) has however helped ease financing conditions, and has promoted investment.

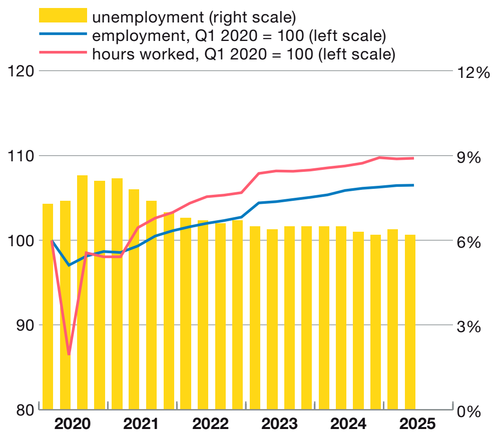
Inflation in the euro area picked up from 2% in July to 2.1% in August in the initial estimate. Energy prices were down by 1.9% over the year, but this was still a smaller fall than that in the previous month of 2.4%. Inflation for services slowed from 3.2% in July to 3.1%, and inflation for food, alcohol and tobacco also came down a touch. Inflation for manufactured goods was the same as in the previous month. The large countries in the euro area where inflation was closest to 2% were Germany and Italy. Inflation fell below 1% in France, mainly because energy prices were down and prices for services also came down in August (see Figure 7). Inflation in Spain picked up in contrast to 2.7%, mainly because energy prices rose, and because of the reference base effect. Core inflation, which leaves out volatile prices for energy, food, alcohol and tobacco, remained unchanged at 2.3%, which is the lowest level since January 2022 (see Figure 8). The labour market in the euro area remains good and the unemployment rate is at a record low level of 6.2%. The number of people in employment rose a little more slowly, increasing by 0.1% from the first quarter to the second (see Figure 9). Wage

Figure 8. Core inflation



Source: Eurostat

Figure 9. Employment and unemployment in the euro area



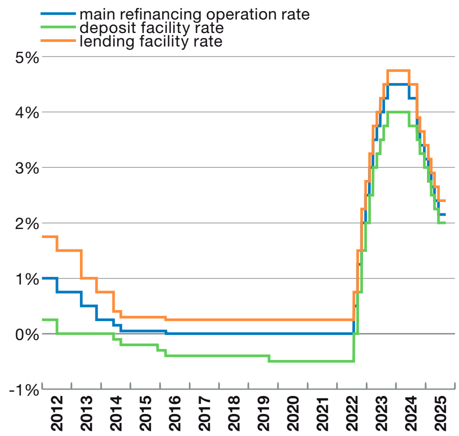
Source: Eurostat

growth in the euro area slowed a little at the same time to 4% in the second quarter, and the growth in the indicator of negotiated wage rates was also 4%. Domestic price pressures have generally eased, though producer prices have risen a little in recent months.

Box 1: Monetary policy in the euro area

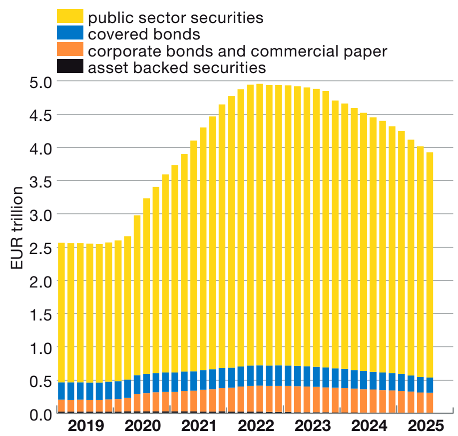
The primary objective of the Eurosystem monetary policy is to maintain price stability in the euro area. The European Central Bank defines price stability as annual inflation of 2% over the medium term. Inflation in the euro area has remained around this target of late. Food prices are rising more slowly and energy prices are lower than they were a year earlier, while wages are no longer rising as fast as they were. The September forecast by the European Central Bank expects inflation to average 2.1% this year, falling to 1.7% in 2026 and then picking up to 1.9% in 2027. The outlook for inflation shows the rate of it remaining very close to the target set by the central bank, and so the Governing Council of the European Central Bank did not change its monetary policy at its latest meetings.

Figure B1.1. Eurosystem key interest rates



Last observation 08.09.2025
Source: European Central Bank

Figure B1.2. Eurosystem holdings under asset purchase programmes (APP and PEPP)



Last observation 31.07.2025
Source: European Central Bank

The Governing Council decided at its meetings in July and September to leave its key interest rates unchanged (see Figure B1.1). The interest rate on main refinancing operations is 2.15%, the marginal lending rate is 2.40%, and the deposit facility rate is 2.0%. The Governing Council emphasised that it is not pre-committing to a particular rate path moving forwards. The uncertainty stemming from trade policy remains large and inflation may be affected in one direction or the other by various other factors. The Governing Council's policy rate decisions will continue to be determined by its assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission.

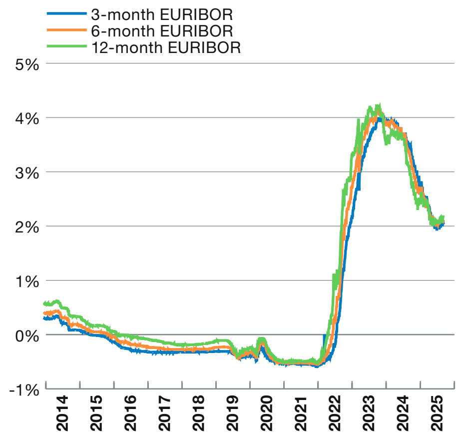
The balance sheet of the Eurosystem is shrinking. This was happening in earlier years because of the termination of the programmes of lending on favourable terms during the Covid-19 pandemic[9], but it is now happening because the portfolio of bonds bought under the various asset purchase programmes is maturing[10]. The total value of bonds purchased under the asset purchase programme (APP) and the pandemic emergency purchase programme (PEPP) on the balance sheet of the Eurosystem at the end of July was 3.9 trillion euros (see Figure B1.2).

9 The volume of longer-term refinancing operations on the balance sheet of the Eurosystem has fallen since the start of 2022 by around 2.2 trillion euros to 12 billion euros.

10 The Eurosystem is no longer reinvesting the principal repayments received from maturing securities. Reinvestment of bonds purchased under the asset purchase programme (APP) was discontinued in July 2023 and reinvestments under the pandemic emergency purchase programme (PEPP) were discontinued at the end of 2024.

As the Governing Council did not change its key interest rates at its most recent meetings and as market participants do not expect any major changes in monetary policy in the near future, the interest rates in the interbank money market have remained relatively stable (see Figure B1.3). As at 8 September the 3-month Euribor was at 2.03%, the 6-month Euribor was at 2.11%, and the 12-month Euribor was at 2.18%. The growth in the broader M3 indicator of the money supply in the euro area has slowed a little, and it was 3.4% over the year in July. Yearly growth in lending to the non-financial sector has accelerated in recent months though, and the volume of loans to businesses was 2.8% larger in July than a year earlier, while the volume of loans to households was 2.4% larger. The Governing Council considers that key interest rates at their current level will continue to support growth in lending moving forwards. The European Central Bank considers that the capitalisation and liquidity of the banks in the euro area remains strong.

Figure B1.3. Euro area money market interest rates



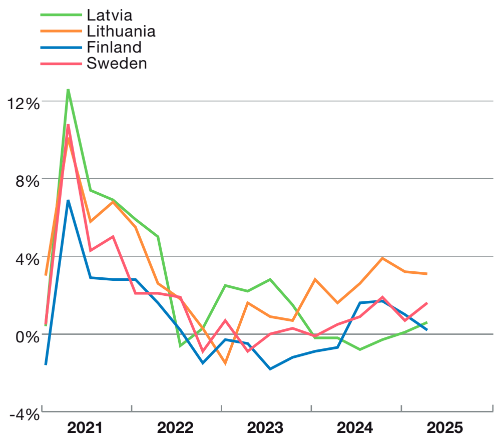
Last observation 08.09.2025
Source: Bloomberg

The Governing Council of the European Central Bank updated its monetary policy strategy in June, setting out the principles guiding the conduct of monetary policy. The inflation target was not changed and remains at 2%. The previous strategy review, which was completed in summer 2021, took place at a time of very low inflation and so focused more on monetary policy in circumstances where monetary policy interest rates have reached their effective lower bound. The new strategy emphasises that monetary policy must respond forcefully when inflation is either too low or too high. It still notes though that policy should only respond when it is evident that inflation is deviating from its target persistently and significantly in either direction. The current economic environment is characterised by numerous structural supply-side shocks that make inflation more volatile. Consequently the European Central Bank will in future rely more extensively in explaining its projections on different scenarios and risk assessments that can help describe possible deviations from the baseline scenario.

ESTONIA'S MAIN TRADING PARTNERS

Trends in the economies of Estonia's main trading partners were moving in different directions in the second quarter. Growth accelerated in the Swedish and Latvian economies and remained strong in Lithuania, but the Finnish economy declined. Quarterly GDP growth increased to 0.5% in Sweden and 0.4% in Latvia, largely because of investment and general government spending, with private consumption making an additional contribution to growth in Sweden. Foreign trade had a restraining effect in both countries however. Yearly growth in Latvian GDP turned positive again after three consecutive quarters of decline, and it reached 1.7% in the second quarter (see Figure 10).

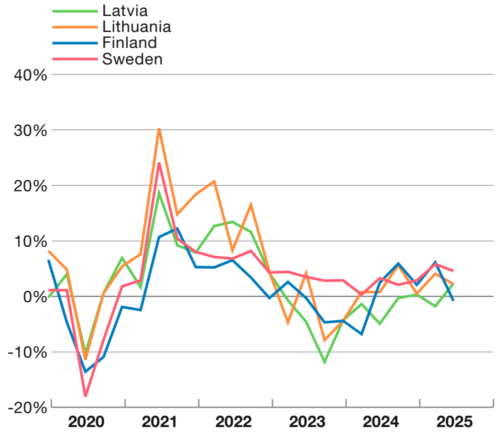
Figure 10. Yearly growth rates of GDP of trading partners



Source: Eurostat

The Finnish economy contracted by 0.4% meanwhile in the second quarter from the first, which was the first negative figure since the end of 2023. There were declines in both spending in the private and public sectors and exports (see Figure 11). The yearly change in GDP was close to zero for the second quarter in a row, indicating that the difficulties in the Finnish economy have not disappeared. The Lithuanian economy grew by 0.3% in the second quarter, but the rate of growth was a little slower than in the previous quarter. Private consumption continued to give good support to the economy, but the contributions of investment, public-sector spending, construction and manufacturing all diminished. Yearly growth in GDP in Lithuania was still the fastest among Estonia's trading partners though.

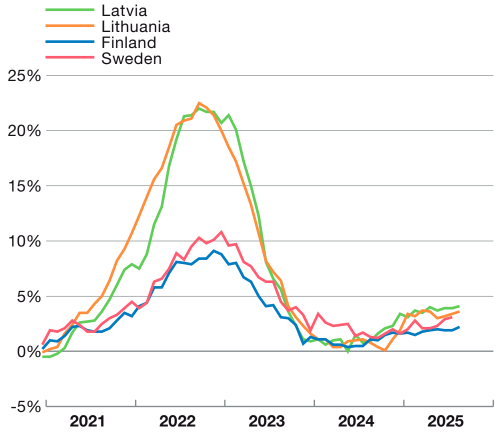
Figure 11. Yearly export growth of trading partners



Source: Eurostat

Indexes for activity and confidence improved after the second quarter in several of Estonia's trading partners. This happened largely because uncertainty around global trade eased as customs agreements were signed between major economic areas. A strong recovery in confidence in manufacturing in Sweden was particularly eye-catching in the survey as the PMI[11] rose to 55.3 points in August, which was its highest level since early 2022. Companies estimated that the rise in the index was driven primarily by increases in production volumes and new orders, and by an improvement in corporate sentiment. In the non-financial sector, the continued yearly growth in industrial output during the summer also confirmed the recovery in manufacturing in Sweden. Consumer confidence picked up a little in August, but households still remained relatively pessimistic about their own financial position. Manufacturing in Finland also showed signs of stabilising. Sentiment at production companies[12] rose to its highest level since 2022 and almost reached its long-term average, reflecting in that the stronger expectations for output and increased use of production capacity. Consumer confidence declined though, as there was greater pessimism about the outlook for the economy, and spending plans were cut back. The least optimistic picture was seen in Latvia, where confidence weakened in August for both businesses and consumers in reflection of the continuing general uncertainty. Retail sales volumes continued to grow slowly in the summer in both Finland and Latvia though, indicating that consumers are still providing backing for the economy. Confidence increased among both companies and consumers in Lithuania meanwhile, with consumer confidence climbing to its highest level of recent years. This shows households in Lithuania to be once again the most optimistic among the countries in the region. It is mainly consumption that is behind the growth in the Lithuanian economy at present.

Figure 12. HICP inflation of trading partners



Source: Eurostat

Inflation rose in August. Price pressures are stronger in the Baltic states than in the Nordic countries, which reflects the differences in demand conditions and cost pressures across the region. Yearly growth in consumer prices in Latvia[13] was the fastest in the region in August as it rose from 3.9% in July to 4.1%. It was second

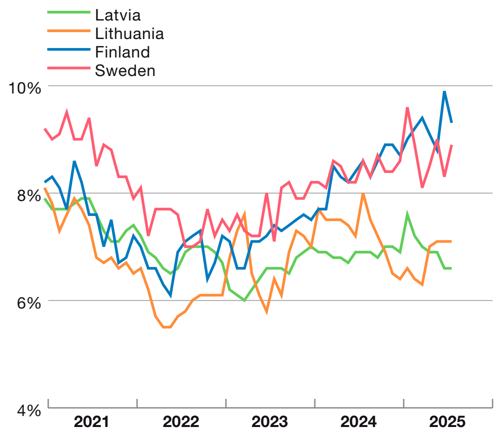
11 Swedbank Manufacturing PMI.

12 Confederation of Finnish Industries.

13 HICP.

fastest in Lithuania at 3.6%, which was also clearly above the euro area average (see Figure 12). It was mainly increases in food prices and household expenditures that pushed prices up in the Baltic states. Prices in Sweden continued to rise moderately in response to increased domestic demand, while inflation was lowest in Finland at 2.2%, though that was still above the 1.9% seen in July. Some positive signs are apparent in the labour market. Unemployment in Sweden and Finland, which had long held high at around 10%, fell in July to 8% in Sweden and 9.3% in Finland (see Figure 13). Growth in employment also picked up in Sweden. Unemployment remained at around 7–8% in Latvia and Lithuania.

Figure 13. Unemployment rates of trading partners



Source: Eurostat

THE ESTONIAN ECONOMY

ECONOMIC ACTIVITY

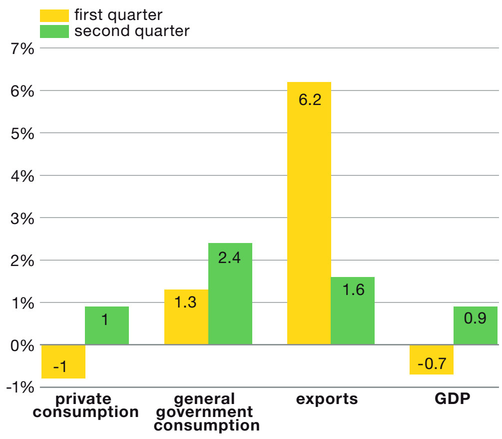
Data from Statistics Estonia show that Estonian GDP grew by 0.9% over the year to the second quarter, and by 0.6% from the first quarter. Growth was given a short-term boost by a revival in consumption (see Figure 14), though economic activity was restrained by the uncertain external environment.

Energy was the sector that made a major contribution to the economy in the second quarter (see Figure 15), though that is not directly reflected in the volume of energy produced. The increase in industrial output suggests there should have been stronger growth in value added from manufacturing. Taxes on production also had a notable impact on economic growth, which can be linked to the spike in consumption in anticipation of VAT going up. If net taxes are excluded, the economy grew by only 0.3% at constant prices.

A broader list of economic indicators shows that the economy has improved by more over the past year than can be concluded from GDP alone. Both exports and consumption were higher in the second quarter than they were a year earlier, and investment was broadly at the same level as a year earlier. Sales turnover in industry increased above all last year in markets in the euro area, but exports to countries outside the euro area also improved at the end of last year (see Figure 16). Manufacturing suffered a hit at the start of this year, which may be because of the uncertainty about trade barriers, but industrial output at the end of the second quarter was at about the same level as it was the end of last year, and notably higher than it was a year earlier, meaning there had been no new deep drop. Industrial output was still a little lower in July than it was in the preceding months, though such fluctuations from month to month have been seen before. Corporate expectations for the short term have become more pessimistic though, reflecting the uncertainty in foreign markets.

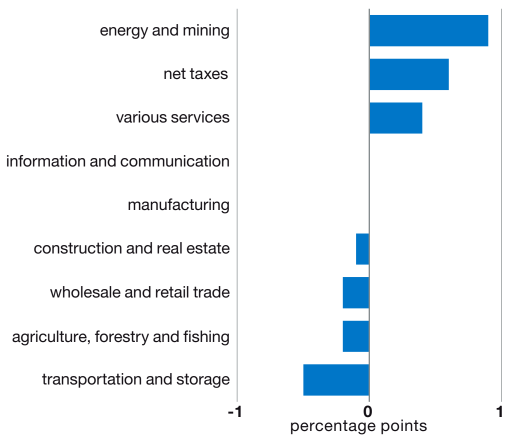
The long recession has set back the potential for growth in the economy. The ratio of installed capital to GDP increased during the recession, while the ratio of capital utilised to GDP remained relatively stable. This indicates that there is a lot of spare production capacity in the economy

Figure 14. Yearly growth in GDP and its components in the first half of 2025



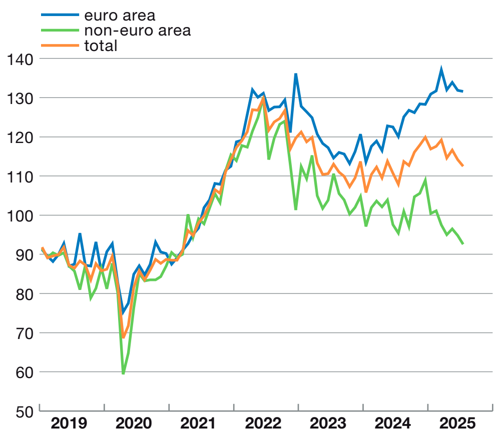
Source: Statistics Estonia

Figure 15. Contributions to GDP growth by sector in Q2 2025 from Q2 2024



Sources: Statistics Estonia, Eesti Pank

Figure 16. Manufacturing exports, 2021 = 100

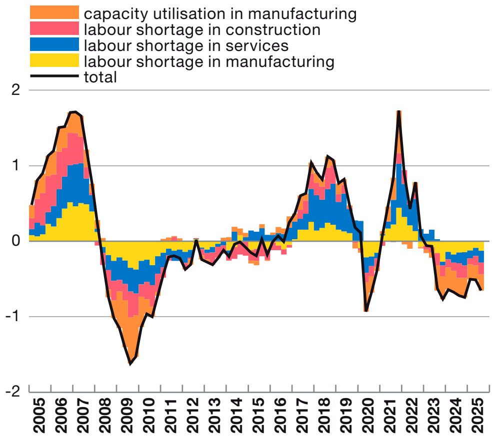


Source: Statistics Estonia

that can be rapidly brought into use if demand recovers, though some equipment may equally still remain unused. The amount of spare production capacity may consequently be overestimated in the statistics. See Box 2 for the supply-side and demand-side factors of economic growth.

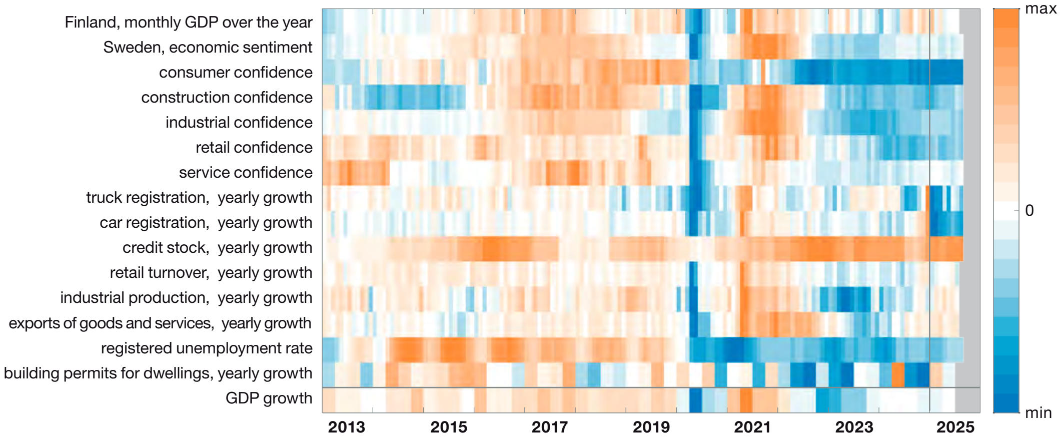
Estimates from corporate surveys of labour shortages and production capacity utilisation indicate that the economy remains at a low point, and one that may be even lower than at the start of the year. The business cycle is in a better position than it was a year ago though (see Figure 17). These conclusions however contradict the GDP figures, which show strong developments in recent quarters.

Figure 17. Standardised survey indicators of the business cycle



Sources: European Commission, Eesti Pank

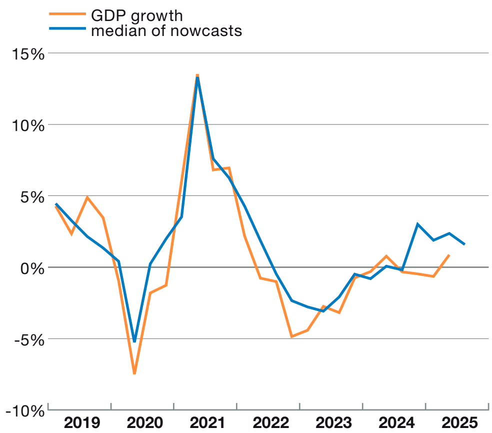
Figure 18. Heatmap of the Estonian economy



Sources: Reuters, European Commission, Eesti Pank, Statistics Estonia

Economic activity in the first months of the third quarter remained at about the same level as in the first half of the year (see Figure 18). Most of the indicators in the heatmap are still on the cool side, but the trend for the most important of them is upwards, and the economic climate is gradually improving in Estonia and in nearby neighbours. Activity in retail and manufacturing was down a little in July, but borrowing remained active and unemployment decreased. There were no major changes in sentiment. Figure 19 shows official GDP growth figures alongside the median forecast from the set of indicator models for economic activity used by Eesti Pank, which was already expecting positive growth at the end of last year and suggests that yearly growth in the third quarter will be similar to what it was in the first half of the year.

Figure 19. GDP growth and the median of Eesti Pank nowcasts



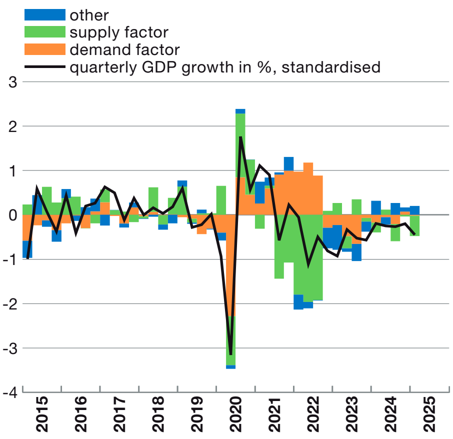
Sources: Statistics Estonia, Eesti Pank

Box 2: Demand and supply factors in economic growth

The Estonian economy has experienced several sharp increases and declines in recent years, reflecting how vulnerable a small and open economy is. The volatility of GDP has been caused by both demand and supply factors, and disentangling them is important for understanding long-term economic trends and for guiding monetary policy.

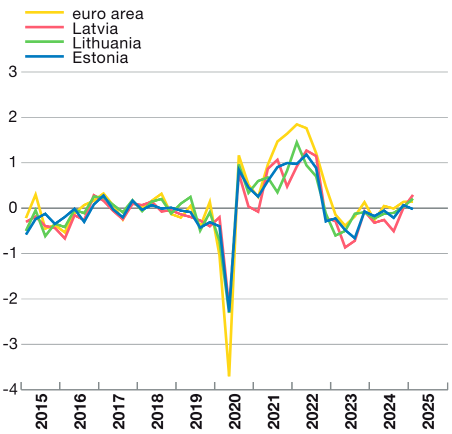
This box uses factor analysis with sign constraints to disentangle demand and supply factors[14]. This method allows the common factors in the evolution of a large number of macroeconomic indicators to be identified, while the sign restrictions link them to assumptions from economic theory. The first factor is interpreted as the demand factor and the second as the supply factor, which between them explain a large part of the variability in economic growth[15]. Factor analysis with sign constraints loads prices positively on the demand side and negatively on the supply side, while real indicators of economic activity like GDP and exports are loaded positively on both.

Figure B2.1. Contributions of demand and supply to GDP growth



Sources: Eurostat, Eesti Pank calculations

Figure B2.2. Demand factor by countries, contribution in percentage points



Source: Eesti Pank

The Covid-19 pandemic, the energy crisis and geopolitical tensions have all combined to make economic development in Estonia and other euro area countries quite volatile in recent years. The pandemic sparked a deep recession as both demand and supply contracted (see Figure B2.1). The economic contraction in Estonia at the peak of the pandemic in the second quarter of 2020 was smaller at 6.3% than the average in the countries of the euro area of 13.9%. Demand remained weak as the pandemic receded, but it still started to give gradual support to economic growth in 2021. The upswing of demand stalled abruptly however in the third quarter of 2023. This was probably because of a steep jump in the price level that ate into the purchasing power of consumers. Consumer confidence was indirectly squeezed by geopolitical tensions as well, particularly Russia's full-scale invasion of Ukraine.

Demand fell more steeply in Estonia than in the euro area on average, and it didn't hit the bottom until a couple of quarters later (see Figure B2.2). Demand has been holding GDP growth back in all three Baltic states in recent years, while in the euro area it has remained healthier. Slower growth in wages has started to restrain demand in Estonia recently. Wages in Estonia have risen by around 5% this year, which is below the rate of growth in Lithuania, where wages have risen

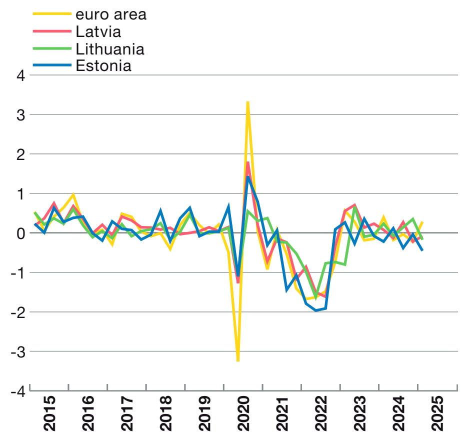
14 Based on research by Eva Spelman: Spelman, E. (2025). *Decomposing inflation into demand and supply factors: Estonia vs the other Baltic states*. Unpublished manuscript, supervised by Jaanika Meriküll.

15 The analysis used time series from Eurostat for price levels, production, trade, the labour market and fiscal indicators. The data set for each country contains 18 time series, which are first standardised. Factors were extracted using the principal component method.

by more than 10%. The average rise in wages in the euro area has remained close to 5%, which is also above the long-term average.

The pandemic and the energy crisis also put downwards pressure on supply (see Figure B2.3). The factor analysis reveals that supply declined even when demand remained strong for a while. There are also differences between countries in the changes in supply factors, as supply was hindered less in Lithuania for example than in the euro area on average. The rise in the producer price index and the consumer price index in 2021–2022 raised the cost of inputs substantially for companies in Estonia, and that probably made them less competitive.

Figure B2.3. Supply factor by countries, contribution in percentage points



Source: Eesti Pank

In total the results of the factor analysis show that supply-side factors are starting to become an important driver of disparities between countries in economic growth, though demand-side factors are strongly influential in certain periods. The Estonian economy has by now shrunk back in size to where it was before the pandemic, while the Latvian and Lithuanian economies are about a tenth larger than they were in 2019. Returning to a track of long-term growth will need Estonian companies to become more competitive.

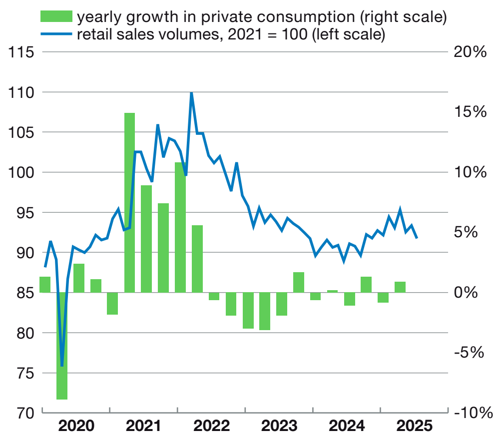
DOMESTIC DEMAND

Private consumption remains volatile, reacting constantly to tax changes. Consumption in the second quarter of 2025 was 0.9% higher than it was in the same quarter of 2024 (see Figure 20) and was back where it had been a year prior to that. This indicates that the retreat provoked by the introduction of the car tax was only short lived.

The growth in consumption was led primarily by increased purchases of goods. Sales of food were down but those of manufactured goods were up by 8%, suggesting that large purchases were being made ahead of the rise in VAT in July (for more on consumption of goods see Box 3). Spending abroad was also up a little, while there were fewer visits to restaurants and accommodation providers than a year previously, probably because prices in that sector had risen.

Car sales remained subdued because of the large number of purchases that were moved forward to the end of last year. The number of vehicles bought rose steadily month by month through the first half of the year towards its long-term average, but it fell again in July after VAT rose. Consumption

Figure 20. Private consumption and retail sales



Sources: Statistics Estonia, Eesti Pank

overall in the second quarter was still 2.7% below its most recent peak in the first quarter of 2022.

Investment in housing was also pushed up in the second quarter in anticipation of the rise in VAT. The number of initial purchases was up steeply over the year in June by as much as 67% as buyers tried to avoid the higher tax rate, but it fell back down again in July. Even without the volatility caused by tax policy, the real estate market has still revived this year and sales volumes have increased.

Corporate investment has varied from quarter to quarter, but it was still at more or less the same level in the first half of the year that it was in 2024, and so the three years of decline have ended (for more on investment see Box 4). Capital formation continued to grow in manufacturing in the second quarter, especially in food processing and production of metal products. More production capital than usual was also bought in agriculture. Investment volumes in the energy sector continued to decrease meanwhile though, after several large investments were made last year in production of renewable energy.

Investment in construction fell by most in the second quarter, especially in the corporate sector. Construction volumes have been falling since the start of 2022, and continued to do so in the second quarter of this year, when companies built around a third less they did a year earlier. That is partly because of the decrease in energy projects, but also partly because of the widespread uncertainty that affects large-scale expansion projects above all. A positive point is that investment has continued to grow at the same time in machinery, equipment and intellectual property, and so the structure of corporate investment has become more productive.

The banks report that demand for loans has increased, and estimates by businesses of the borrowing environment are more optimistic than in the past 12 years on average. Increased demand for loans, the good ability of banks to provide them, and falling interest rates all helped the stock of housing loans in Estonia to grow by 10% over the year at the end of July, while the stock of corporate loans increased by 8%. The growth in corporate borrowing was led by long-term investment loans. There was a small decline at the same time in short-term operating loans of less than one year. The sectors with the strongest growth in borrowing were real estate, and professional, scientific and technical activities. The growth in long-term loans to manufacturing companies has also increased to 10%. There has been quick growth in recent months in housing loans and consumption loans taken by households.

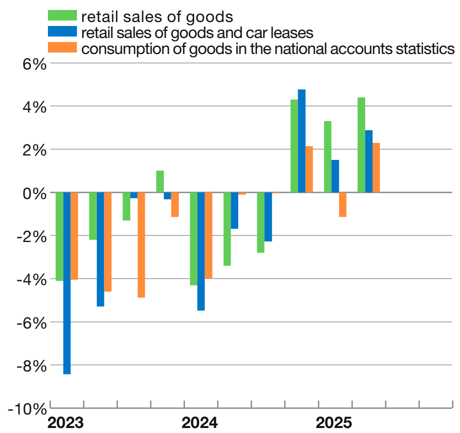
Inventories shrank in the second quarter, mainly because of the energy sector. In the manufacturing sector, inventories of food and timber producers shrank most. Merchandise purchased for sale at wholesalers and retailers increased meanwhile, which is in line with the more optimistic outlook of merchants in June.

Box 3: Consumption of goods from various data sources

Consumption by households has increased recently, but the national accounts show that it was still 2.7% lower at constant prices in the second quarter of 2025 than it was in the second quarter of 2022. It is consumption of goods that has declined, while consumption of services has increased at the same time. Consumption of goods can be observed from the retail statistics or the statistics on private consumption. This box compares those data sources and looks at how closely aligned they are.

There was a particularly steep fall in sales of cars in the first quarter of 2025, as they dropped as a proportion of private consumption from 1.54% to 0.74%. This was the source of a large part of the drop in consumption in the first quarter and it brought down total consumption of durable goods, which dropped by nearly 8% over the year.

Figure B3.1. Yearly growth in retail volumes and private consumption of goods



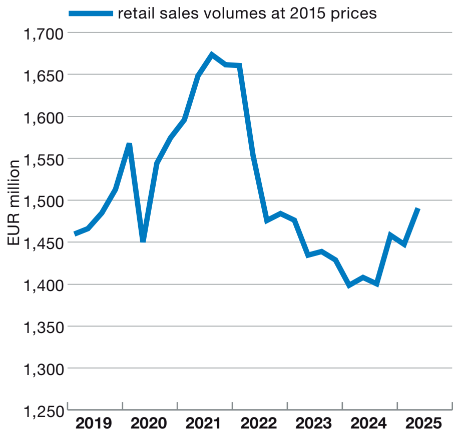
Sources: Statistics Estonia, Eesti Pank

The national accounts indicate that consumption of goods overall[16] was down by around 1% over the year (see Figure B3.1) and that it started to grow again in the second quarter.

Retail meanwhile has been on an upwards trajectory since the middle of 2024, as the sales revenues of retailers and the volumes of goods sold have been increasing[17]. Statistics on trade and on card payments for the first quarter show that although sales of cars were sharply down, households were buying more manufactured goods than previously. The yearly growth in the volume index of sales of goods also confirms the revival in consumption of goods (see Figure B3.1) in the fourth quarter of last year and in the first and second quarters of this year despite the fall in the sales of food goods, which are a relatively large part of spending. The recovery is also shown in the dynamics of retail sales of goods seasonally adjusted and taking account of price changes, which have been trending upwards since the third quarter of 2024 (see Figure B3.2).

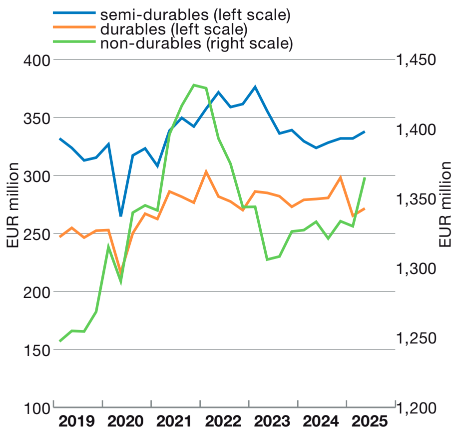
This indicator does not include sales of motor vehicles though. Seasonally adjusted sales data for motor vehicles are taken from the Eurostat time series by types of goods, where changes in sales of cars are recorded in the category of durable goods. This indicator rose at the end of 2024, but it fell back in the first quarter of 2025. At the same time consumption of non-durable goods, which are about 70% of the consumption of goods, and of semi-durables has been increasing gently since the middle of 2024 (see Figure B3.3).

Figure B3.2. Retail sales volumes at 2015 prices



Sources: Statistics Estonia, Eesti Pank

Figure B3.3. Consumption of goods by durability at 2015 prices



Sources: Statistics Estonia, Eesti Pank

One category of goods that is not recorded in the statistics on retail sales but is recorded under goods in the national accounts is energy, which includes the gas and electricity that is consumed by households but not bought from shops. Demand for energy fell in the first quarter because the weather was warmer, especially in January. Electricity and gas consequently declined by 0.5 percentage point as a share of consumption, and this may explain the larger discrepancy between the retail sales statistics for goods and the data on private consumption. Fuels and energy are non-durable goods and the decline in consumption of them at start of the year is reflected in the statistics on private consumption.

The data on retail sales do not always coincide entirely with the data in the national accounts on the consumption of goods, as a large part of the consumption basket consists of goods that

16 The retail statistics and the private consumption data for consumption of goods both include purchases in Estonia by non-residents as well as residents.

17 Sales revenues of retail companies and sales volumes are monthly indicators. Statistics Estonia releases the data on retail sales of goods with quarterly frequency, and records changes in the value and volume of goods sold.

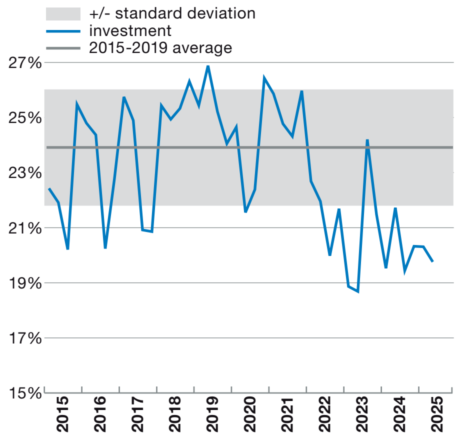
cannot be bought from shops or purchased online. It also contains goods that are ordered from abroad, and so do not show up in the retail statistics for Estonia.

Overall it is apparent that if the volatility caused by tax changes is left aside, the data on retail and on the retail sales of goods indicate that the lowest point for consumption of goods was passed last year. Consumers have gradually started to spend more in shops and although sales of cars dropped at the start of the year, the consumption of other goods continued to grow.

Box 4: The dynamics of corporate investment during the years of recession

Negative economic shocks affect the investment decisions of companies, as weaker demand leads them to reduce their plans for expansion, poorer financing conditions make investment projects more expensive, and increased uncertainty makes long-term planning harder and makes companies more cautious about investing. The pandemic in 2020 consequently set corporate investment back[18], causing it to drop by 30% over the year in the second quarter at constant prices.

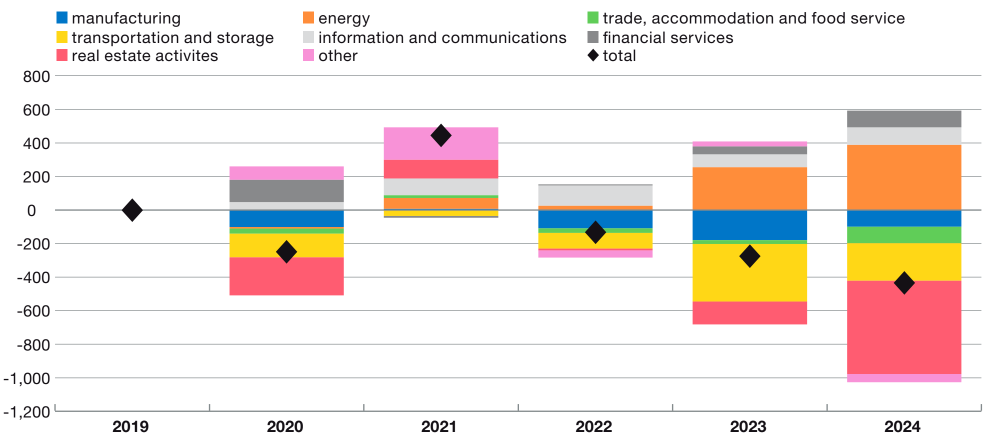
Figure B4.1. Corporate investment as a share of value added



Source: Statistics Estonia

The economy and investment recovered quite quickly from the pandemic, but Russia's invasion of Ukraine and the subsequent energy crisis have had a more lasting effect on the economy. Corporate investment was down by 18% in 2022–2024 in Estonia, and the average level last year was lower than the level of 2019. The decline in investment was larger than the deterioration in the financial results of companies, and so investment as a ratio to the value added of companies was below its average level of 2015-2019 (see Figure B4.1).

Figure B4.2. Investment, change from 2019 level at 2020 prices



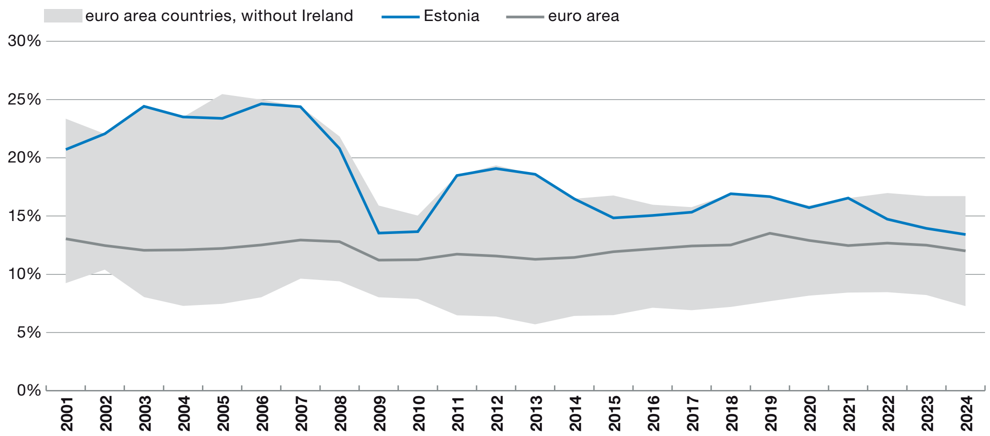
Source: Statistics Estonia

18 Corporate investment here is taken as gross fixed capital formation by financial and non-financial companies with the large transactions of one international group in 2020-2021 removed. Those transactions shaped the dynamics of GDP investment quite significantly, but did not have any actual fundamental impact on the economy.

Real estate activities, transportation and storage, and manufacturing accounted for a larger part of the drop in investment from 2019, before the series of crises (see Figure B4.2). Transportation and storage and manufacturing have lost competitiveness to a greater extent than other sectors, and the sustainability of the business models that worked well in past has become more doubtful. The drop in investment and the high degree of sensitivity to the business cycle are consequently to be expected. The decline in investment in real estate activities in 2024 may have arisen from a change in the statistics, as these are based on the quarterly corporate statistics for the previous calendar year, which may not be entirely comparable with earlier periods for some sectors[19].

Investment increased most in this period in the energy sector, where large-scale energy projects have been started because of changes in energy policy, the synchronisation of the electricity system with Western Europe, and efforts to ensure supply. Investment has also increased in information and communications, which was affected much less by the recession, and in the

Figure B4.3. Corporate investment as a share of GDP



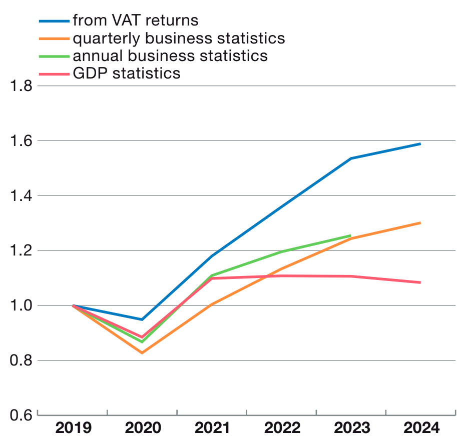
Source: Eurostat

financial sector, which generally gained from higher interest rates and so could improve working conditions by developing new office space.

Corporate investment in Estonia still remained quite large in international comparison during the recession. The share of corporate investment in the economy in Estonia was earlier one of the largest in the euro area, but in recent years it has retreated to the average level within the monetary union (see Figure B4.3).

Caution is needed when interpreting the aggregate figures because of the large revisions in the statistics for investment in GDP and the differences in the sources of data. It is only the GDP statistics that have shown developments in corporate investment to be modest at current prices since 2022 (see Figure B4.4).

Figure B4.4. Index of estimates of corporate investment at current prices, 2019 = 1



Sources: Statistics Estonia, Tax and Customs Board

19 Statistics Estonia regularly revises the GDP data based on quarterly statistics once the corporate statistics based on annual financial reports are released. The figures for investment that have been revised most in recent years are those for the real estate sector, which were lifted notably above the original estimate by the revisions in 2021, 2022 and 2023 for example. The sharp drop in 2024 may consequently have been caused by a change in the data source.

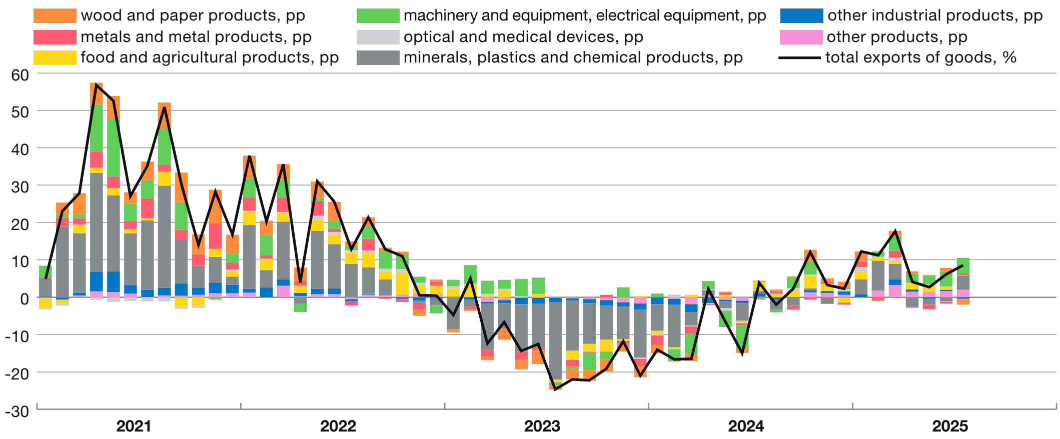
Quarterly and annual corporate statistics and VAT declarations show that corporate investment at current prices has actually increased in recent years. The greatest uncertainty surrounds the figures for 2024, which are currently still based on the quarterly flash statistics and will only be clarified next year when the annual financial reports for 2024 become available.

EXTERNAL BALANCE AND COMPETITIVENESS

Global trade grew a little in the first half of 2025, though this did not lead to any great improvement in foreign demand from Estonia's main trading partners. Exports of goods from Estonia started to recover last year, and they continued to do so in the first half of this year. Growth was slower in the second quarter than at the start of the year. The outlook for exports is still overshadowed by the uncertainty caused by the introduction of protectionist tariffs. The amount of goods and services exported increased by 1.7% during the second quarter, while imports were up by 2.5%.

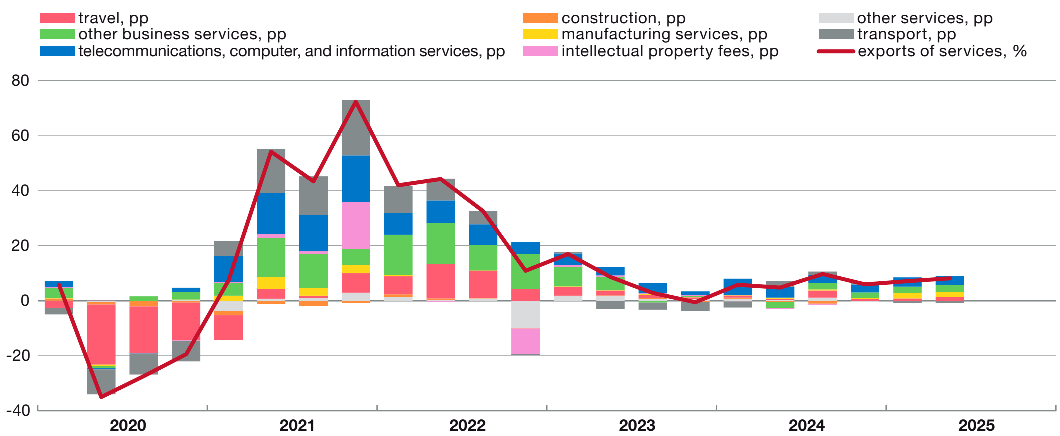
Exports of goods have revived in many sectors, and exporters have found new markets for their products. The turnover of exports of goods increased by 6.2% in the second quarter, which was smaller than the increase in the first quarter. The main target markets where

Figure 21. Exports of goods and contributions of groups of goods



Source: Statistics Estonia

Figure 22. Exports of services and contributions of groups of services



Source: Eesti Pank

Estonian exports grew most were Poland and Lithuania, while there was also some growth in the German market. A positive sign is that goods exports are finding more and more new markets, with sales increasing in France for example, and the set of important target markets has expanded. These export flows are principally replacing the exports that previously went to the Nordic countries, as demand continues to decline in the markets of Finland, Sweden and Norway. The groups of goods that made the biggest contribution to the growth were machinery and equipment, wood and wood products, and processed food products (see Figure 21).

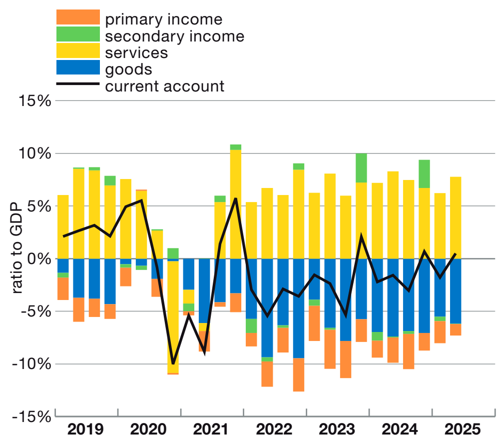
The recovery of manufacturing and the economy as a whole increased the need for inputs and raw materials and so boosted imports, and the turnover of imports of goods was consequently 3% more than a year earlier. The biggest contributors to growth were imports of machinery and equipment and of electronics. Goods imports were also affected in the first half of the year by one-off purchases of capital goods for national defence. The turnover of services imports also grew at the same time, and was 10% larger over the year.

Stable growth in exports of services continues to give support to the economy. The turnover of exports of services was up by 8% in the second quarter. This was led by two major groups of services, as the turnover of exports of telecommunications and computer services increased by 14% and that of exports of business services by 10%. The turnover of exports of travel services increased by 11% during the spring and summer tourism season but exports of transport services declined further, largely because of a drop in road transport of goods (see Figure 22).

The balance of payments showed the current account to be 52 million euros in surplus in the second quarter of 2025, or 0.5% of GDP. The current account improved because the deficit on the goods account was smaller than it was a year earlier, while the surplus on the services account was larger than a year earlier and than in the previous quarter (see Figure 23).

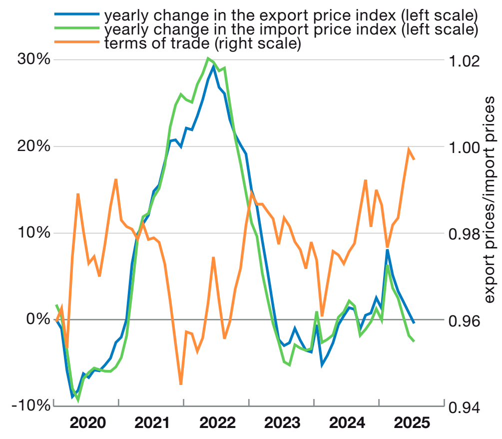
Terms of trade improved a little in the first half of the year, but this trend ended in later months. Export prices rose faster than import prices in the first half of the year (see Figure 24), but both prices moved at the same rate

Figure 23. The current account



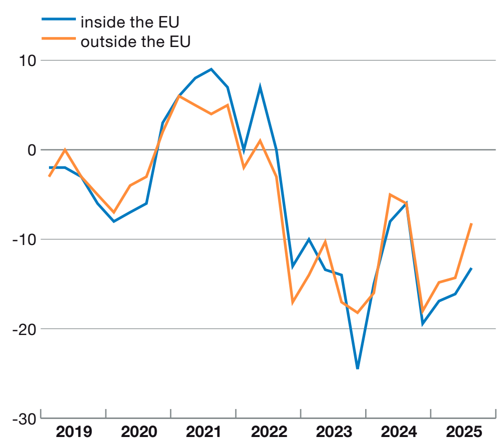
Sources: Statistics Estonia, Eesti Pank

Figure 24. Export and import price indexes



Sources: Statistics Estonia, Eesti Pank calculations

Figure 25. Assessment by businesses of their competitiveness in foreign markets



Source: European Commission

in the summer. Terms of trade improved for the economy as a whole and for manufacturing in the second quarter, as export prices rose a little while import prices remained unchanged from where they were a year before. Developments in export prices have varied across sectors and depend to a large extent on demand in target markets. Earlier experience has also shown that export prices change differently across countries, which may be due to various factors, though the main one is still demand in target markets. Differences between the export prices from the three Baltic states are discussed in Box 5.

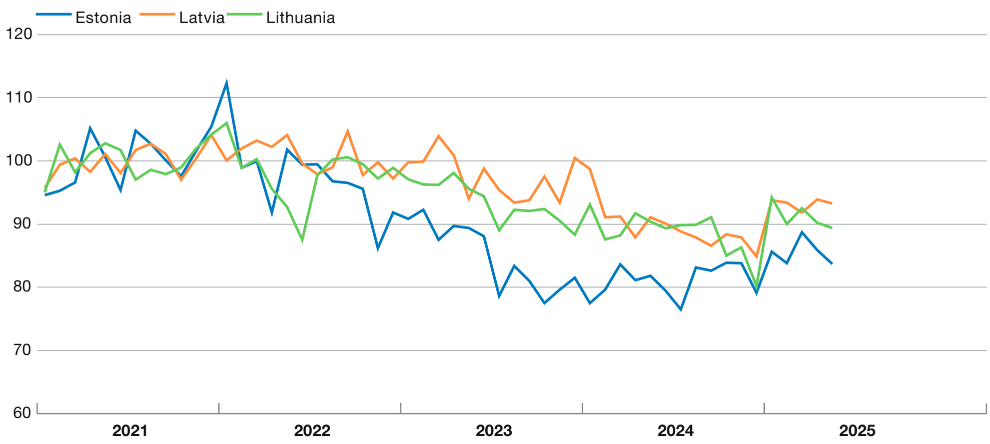
Companies consider that export orders are in a better place than at the start of the year, but their assessments remain pessimistic. There was a notable change in the summer in how companies estimated their own competitiveness, as they felt there had been some improvement in markets outside the European Union (see Figure 25).

Box 5: Prices of exports from the three Baltic states

Exports of goods from Estonia have performed worse than those from Latvia and Lithuania in recent years. Exports at current prices are above their average level of 2021 in all three Baltic states, by around a tenth in Estonia and by a little over 15% in Latvia and Lithuania. Exports by volume however have declined by around 14% from their average of 2021 in Estonia, by 8% in Lithuania and by 6% in Latvia (see Figure B5.1).

There may be several reasons for these differences in the developments of exports from the three countries. The main reason is that demand is different in different target markets for goods exports. Estonia's results are weak largely because demand has long been poor in the Nordic countries, which take a larger share of Estonian exports than of Latvian or Lithuanian exports. Western European markets figure more in the structure of the target markets for goods exported

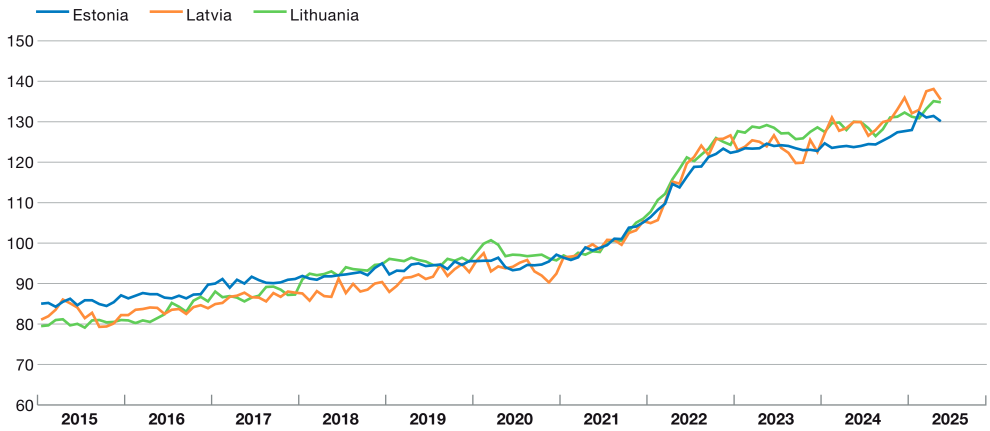
Figure B5.1. Volume index for exports of goods adjusted seasonally and for number of working days, 2021 = 100



Sources: Eurostat, Eesti Pank calculations

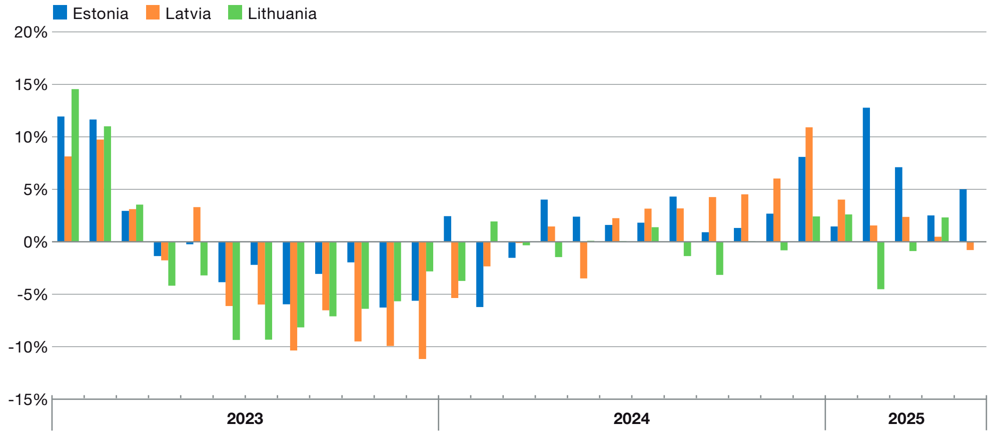
from Latvia and Lithuania, and demand has held up better there. Demand in target markets is also one of the main factors affecting the prices of exports. The dynamics of the export prices in the three Baltic states are quite different, as prices for Latvia and Estonia have on average been growing faster since the start of last year than those for Lithuania (see Figures B5.2 and B5.3).

Figure B5.2. Unit value index for goods exports, 2021 = 100



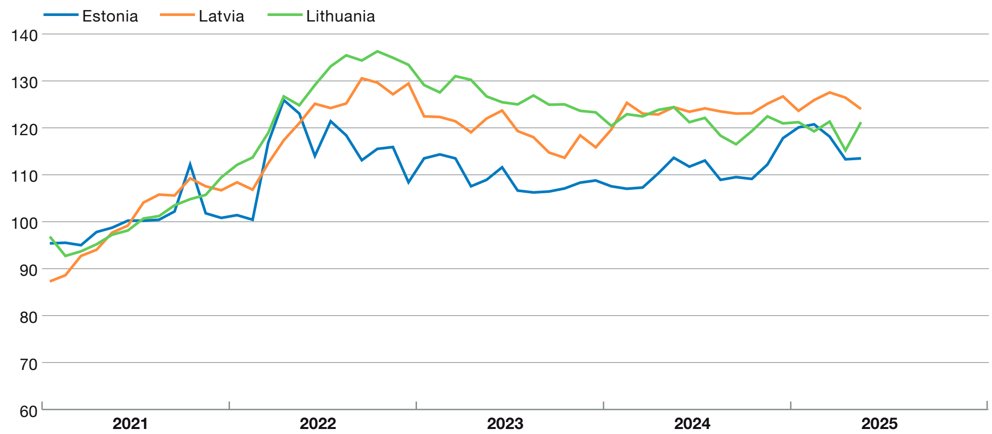
Sources: Eurostat, Eesti Pank calculations

Figure B5.3. Change in price for goods exports as the difference between change in value and change in volume



Sources: Eurostat, Eesti Pank calculations

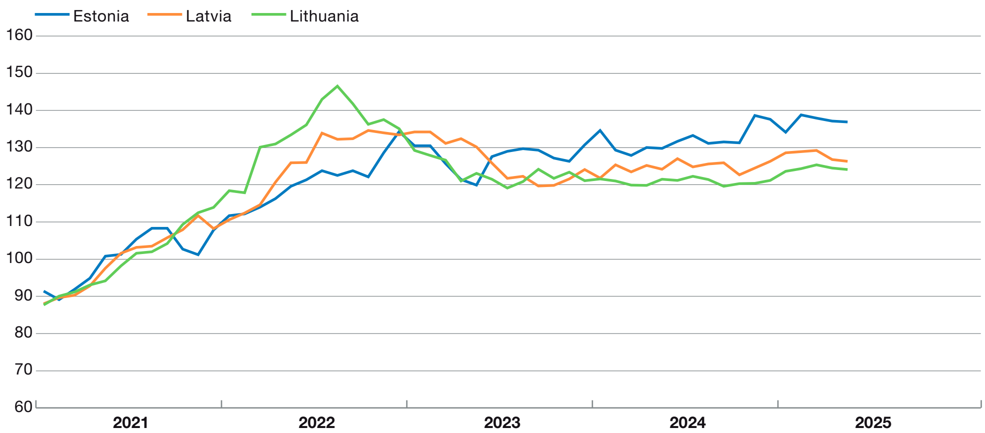
Figure B5.4. Unit value index for exports of goods outside the EU, 2021 = 100



Sources: Eurostat, Eesti Pank calculations

Prices of exports from the three countries moved to a similar beat in earlier years, but differences have appeared since 2021. The unit prices of Estonian exports outside the European Union have grown more slowly than those of exports from Latvia and Lithuania in recent years, while those within the European Union have grown faster (see Figures B5.4 and B5.5).

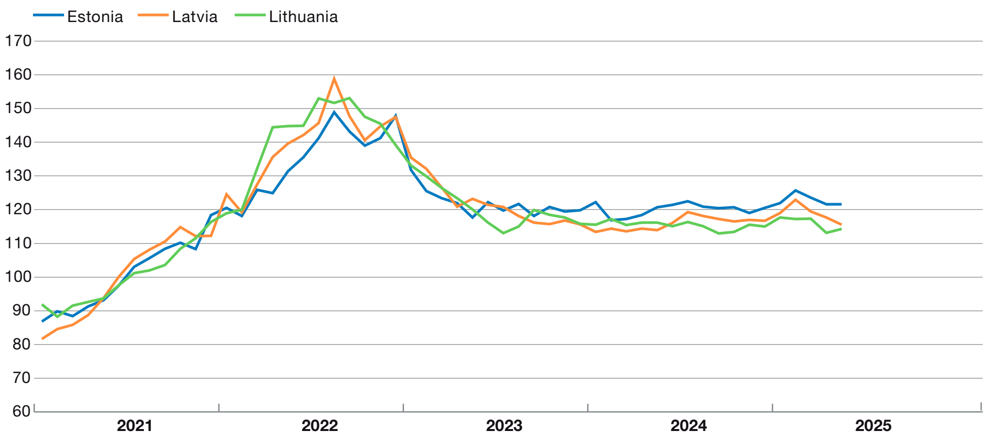
Figure B5.5. Unit value index for exports within the EU, 2021 = 100



Sources: Eurostat, Eesti Pank calculations

The price dynamics for the larger categories of goods are also different (see Figures B5.6-B5.9) both over a longer period and over the past half year. Exports of intermediate goods predominated within the exports from all three countries, and account for more than half of goods exports[20]. Intermediate goods are various types of industrial commodities, including products that are used as inputs in subsequent production processes in other countries.

Figure B5.6. Unit value index for exports of intermediate goods, 2021 = 100

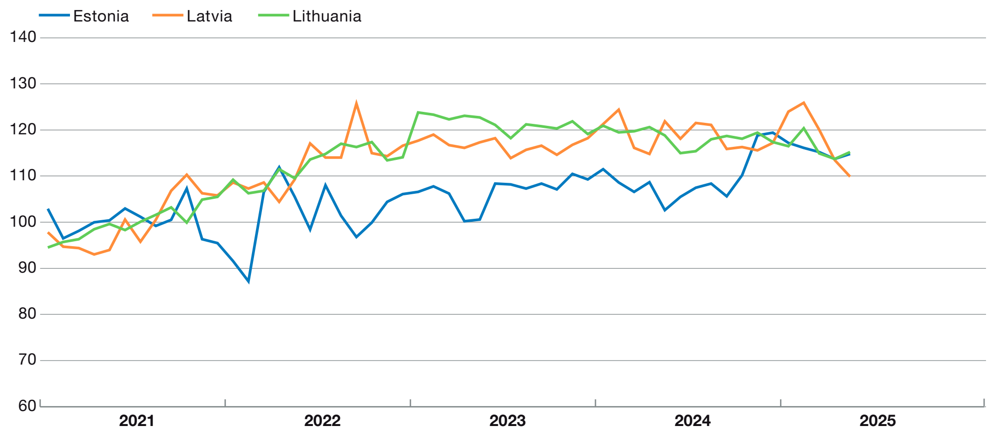


Sources: Eurostat, Eesti Pank calculations

Prices for Latvia and Estonia have risen similarly by around 4% over the past six months, while prices for Lithuanian exports have fallen (see Figures B5.6-B5.9). The biggest difference appears

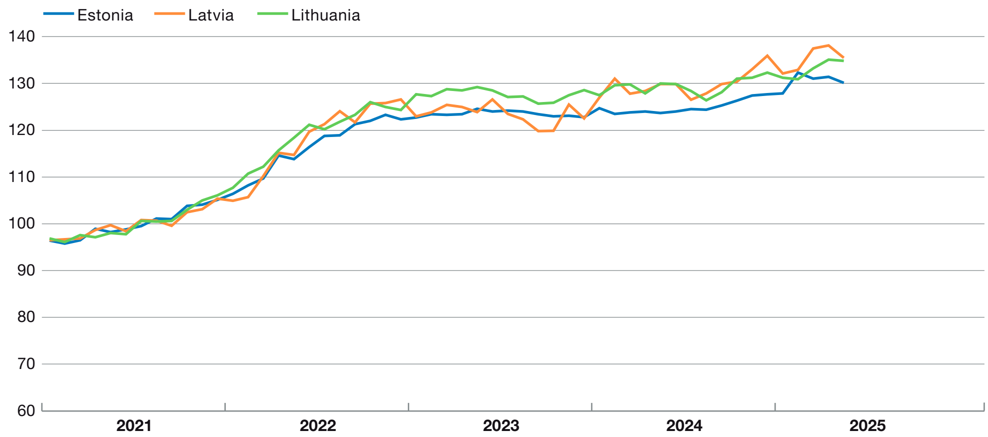
20 Data from Eurostat on the unit prices of exports of goods allow the price developments of exports within and outside the European Union to be compared by BEC category and by larger categories of goods such as intermediate goods, capital goods, consumption goods, motor fuels and other goods.

Figure B5.7. Unit value index for exports of capital goods, 2021 = 100



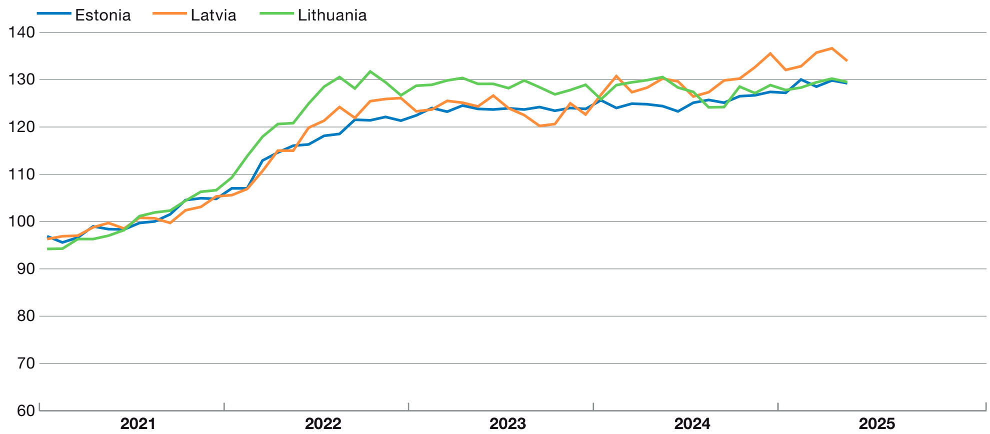
Sources: Eurostat, Eesti Pank calculations

Figure B5.8. Unit value index for exports of consumer goods, 2021 = 100



Sources: Eurostat, Eesti Pank calculations

Figure B5.9. Unit value index for exports of other consumer goods and fuels, 2021 = 100



Sources: Eurostat, Eesti Pank calculations in the development of prices for capital goods[21], as Estonian prices have risen by 7.6%, with capital goods providing around 15% of Estonian exports, while export prices for capital goods from Latvia and Lithuania have fallen. Prices for consumption goods have risen similarly for all three countries by between 3% and 5%. Export prices for fuels have risen by 3-4% for Estonia and Latvia but by only 0.2% for Lithuania.

It can be said in summary that there are two main reasons why the developments in the volumes of exports from the three Baltic countries differ. The first is that there are differences in the exports of intermediate consumption goods, which are particularly sensitive to changes in demand in target markets. How target markets affect this was described in The Estonian Economy and Monetary Policy at the end of last year[22]. The second reason is that there are differences in the exports of capital goods by volume and by turnover that are mainly caused by price differences. Demand for capital goods depends on changes in investment activity, which in turn depends on confidence among businesses and the general economic climate. The structure of the capital goods also plays a part in this. A notable factor in this is that Estonia does not produce capital goods and those exports from Estonia are mostly re-exports. The prices of the goods exported are consequently affected more by import prices or by agreements for individual transactions. This means that the differences in prices do not directly reflect differences in how competitive businesses are.

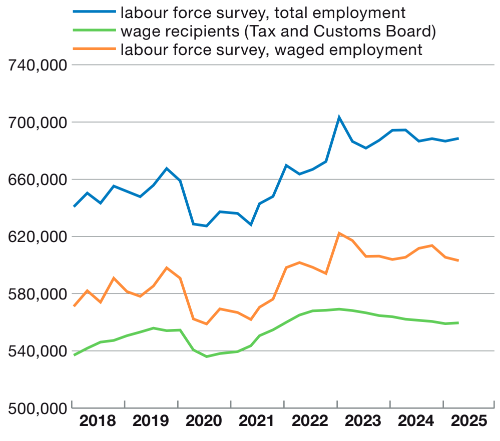
21 Two large groups under capital goods are BEC41 Machinery and other capital goods (except transport equipment) and BEC521 Transport equipment other than passenger motor vehicles, industrial.

22 https://www.eestipank.ee/en/publications/estonian-economy-and-monetary-policy/2024/estonian-economy-and-monetary-policy-42024

THE LABOUR MARKET

The labour market was below its historical average strength in the second quarter of 2025 as the economy remained weak. Survey data and register data both showed that employment was down over the year. The figures in the labour force survey were unexpectedly weak in the first quarter as a fall in employment raised the unemployment rate to 8.6%, though this was not a change in trend and the second quarter saw stronger figures than the first. Data from the Tax and Customs Board show there were fewer people receiving a declared wage in the second quarter than a year earlier, but more than in the first quarter. This was mainly because the figure for the first quarter was unusually low though, as the rise in income tax caused wage payments to be shifted from January into December (see Figure 26).

Figure 26. Employment at Estonian companies and institutions, seasonally adjusted



Sources: Statistics Estonia, Tax and Customs Board, Eesti Pank calculations

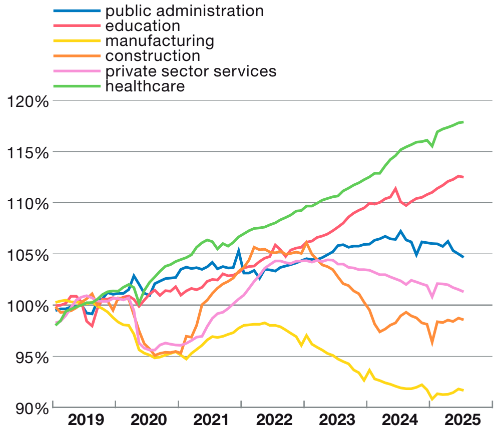
Companies avoided reducing their workforce during the recession at the same rate that their production declined. Revised GDP data show that the real value added in manufacturing in the first half of 2025 was 10% smaller than it was in the first half of 2022, while the volume of output was down by 12%. The number of people receiving a wage in manufacturing was only 7% below its peak from before the recession. In construction meanwhile, value added was down by 17%, construction volumes by 17%, and employment by 7%. The decline in the number of employees has been smaller than those in value added and output volumes, which should indicate that companies have the space to increase their production capacity without hiring additional staff.

Employment has changed in different ways in the private and public sectors. Register data show that there were fewer people receiving a declared wage in the private sector in the first half of 2025 than there were a year earlier, but without the outlier of January there were also slightly fewer in the second quarter than in the first quarter. The number receiving a wage in the government sector increased overall, but it has fallen in public administration since the start of the year, probably because of efforts to make savings in state budget expenditures. The number receiving a wage in education continued to rise, but notably more slowly than previously. The increase in the number of school and kindergarten teachers is in line with changes in the population, as although the number of births has fallen in recent years, the number of people aged 3-19 increased each year from 2013 to 2023 by 0.5-1.5%, and a total of 5.4% more were added in 2022 by Ukrainian refugees from the war. The size of this age group did not change any further in 2024. The number of people working in healthcare and social insurance, where the private sector plays a larger role than in education, continued to rise rapidly. There were fewer people receiving a wage in manufacturing in the private sector in the second quarter of 2025 than there were a year earlier, but there were no fewer than in the first quarter. Employment continued to fall in construction and services in the second quarter however (see Figure 27).

The expectations of companies for employment became more optimistic than before in the third quarter, but they are still below the long-term average except in manufacturing (see Figure 28). Expectations have varied quite widely this year, possibly because of the uncertainty caused by the trade war and tax changes that are making companies cautious in their hiring decisions. Töötukassa had more jobs on offer in the first half of the year than it did a year earlier, and the number of jobs was up by 6.7% in the second quarter. In contrast to the corporate sentiment surveys however, the number of vacancies point to employment weakening in July and August.

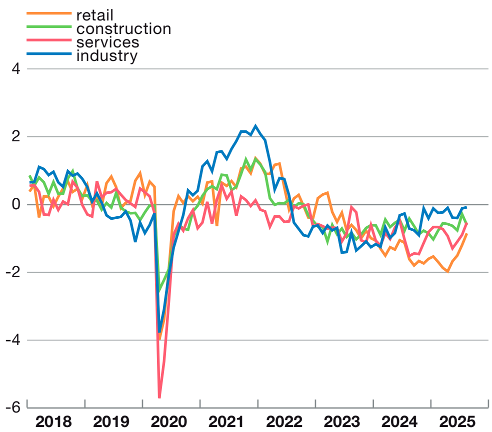
The unemployment rate fell to 7.8% in the second quarter of 2025 having been exceptionally high at 8.6% in the previous quarter. The labour force survey put the three-month average number of people unemployed at 60,000, but by July 2025 this had fallen to the average level of last year (see Figure 29). Unemployment may have been at an extraordinarily high level at the start

Figure 27. Declared wage recipients
seasonally adjusted, 2019 = 100%



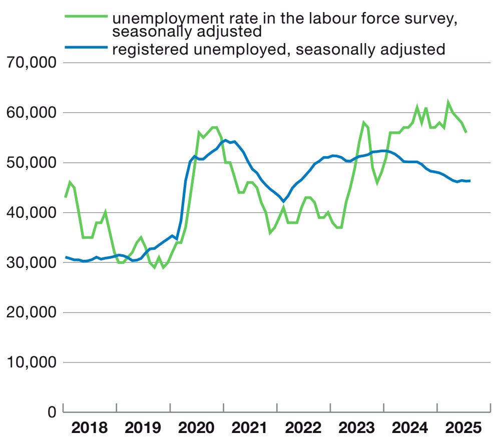
Sources: Tax and Customs Board, Eesti Pank calculations

Figure 28. Employment expectations, standardised



Sources: European Commission, Eesti Pank calculations

Figure 29. Unemployment



Sources: Statistics Estonia, Töötukassa, Eesti Pank of the year partly because of a random statistical fluctuation, but it has still risen notably since the start of the recession and is above its natural rate or NAWRU[23]. The number of people registered as unemployed continued to fall slowly in the first half of 2025, though this may have been because the average period of unemployment increased and unemployment benefits ended, reducing the motivation to sign on with Töötukassa.

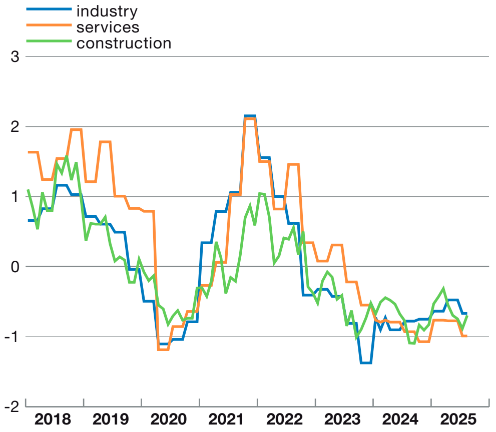
The share of employers who consider that labour shortages are an obstacle to expanding production remains below the historical average (see Figure 30). This is because there is more labour available in the labour market than usual, and it is easier for companies to find new employees. It may also be because a lot of companies have not yet started to hire additional workers. Wage pressures arising from labour shortages should consequently remain weaker than the average.

Growth in the average wage continued to slow in the second quarter of 2025. The average wage increased by 6.1% in the first quarter, but by 5.9% in the second quarter, and the average gross monthly wage was 2126 euros in the second quarter. Wage growth was weaker in the public sector, especially in institutions under local governments, where the average wage rose by only 2.7%. This is because a new collective agreement came into force in healthcare under which the base rate for the hourly pay of medical staff will rise by 1.5% this year, and also because wage rises for teachers were smaller. Wage growth in the private sector has also slowed over the longer term. Wages at Estonian-owned companies rose at the same rate in the second quarter that they did in the first quarter, while wage growth at foreign-owned companies increased. Wages in services have risen faster in recent years than those in manufacturing and construction, but the growth in the average wage was fastest in the first half of the year in manufacturing (see Figure 31).

Slower growth in wages is in line with the economy being weak and there being more labour available in the labour market than usual. Growth in real gross wages also slowed in the second quarter and was only 1.2% because of inflation as well as the slower growth in wages (see Figure 32).

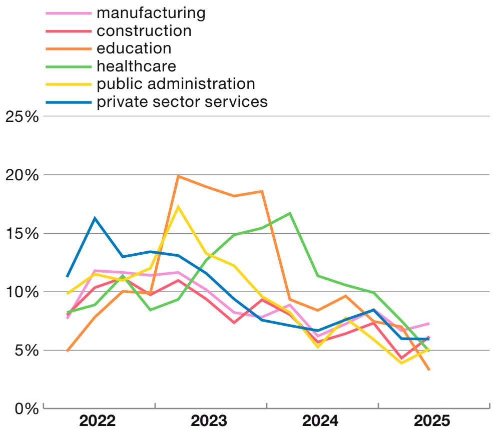
The national accounts show that the total payroll in the economy grew by 5.5% in the

Figure 30. Labour shortages, standardised



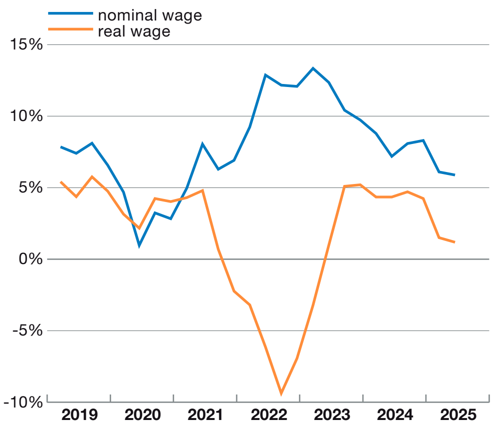
Sources: European Commission, Eesti Pank calculations

Figure 31. Yearly change in average wages



Sources: Statistics Estonia, Eesti Pank

Figure 32. Yearly change in average wages*



* Structural break in 2022; series for 2019-2021 adjusted by Eesti Pank
Sources: Statistics Estonia, Eesti Pank

23 The non-accelerating wage rate of unemployment (NAWRU) is the level of unemployment where labour shortages in the labour market do not put upwards pressure on wages.

second quarter of 2025, while GDP at current prices grew by 5.2%. This means that wage income was a larger share of GDP than it was a year earlier (see Figure 33). This figure was a little smaller than in the second half of 2024 because the growth in wages slowed. Labour costs increase as a share of value added during a recession as companies prefer to hold on to their employees even during difficult times so they are better able to increase production rapidly when demand revives. The opposite then happens when the economy recovers as corporate profits increase first, while the labour share gradually decreases.

PRICES

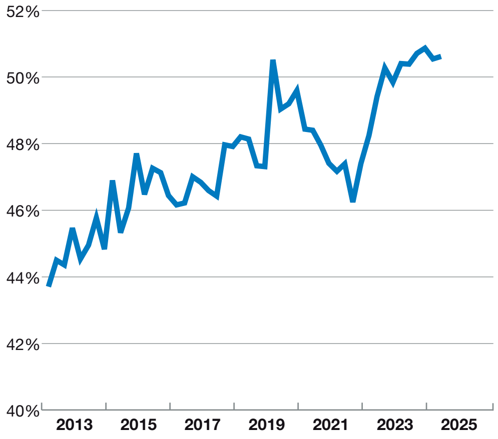
Inflation continued to rise in the third quarter of this year. Higher prices for food and services pushed inflation in August up to 6.1%. Overall inflation was however restrained a little at the same time by cheaper energy (see Figure 34).

A rise in VAT added to price pressures in the third quarter. The price of the consumer basket rose by only 0.6% during the month of July even though the VAT rate rose by two percentage points. If the tax rise had been passed through immediately and in full into prices, then those prices would have risen by around 1.5%. Inflation was partly restrained by seasonal factors, and also because the rise in VAT did not affect all prices. Rent, healthcare and social services, insurance, and air tickets are not subject to VAT for example, and together they are more than one tenth of the consumer basket.

Volatility in the exchange price for electricity has meant that energy prices have fluctuated this year. The electricity price was at its lowest of recent years in the second quarter, though it rose back at the end of August to close to 100 euros per MWh (see Figure 35). This was because of maintenance work at power stations and on the cables connecting Estonia and Finland. Motor fuels were also cheaper in August than a year earlier, and petrol stations started to cut their prices even further in early September. One large chain of filling stations stopped offering promotional prices for customers with loyalty cards and instead cut its prices for all customers.

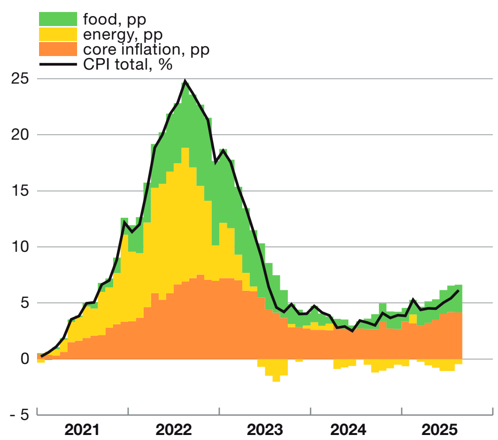
The rate of inflation for food prices in Estonia has been among the highest in the euro area in recent months. Part of the rise in VAT

Figure 33. The labour share in GDP, seasonally adjusted



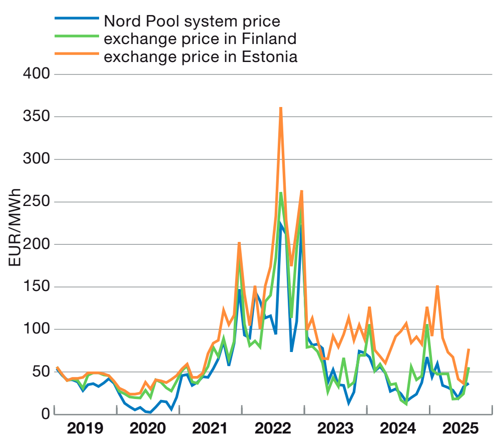
Sources: Statistics Estonia, Eesti Pank calculations

Figure 34. CPI growth



Sources: Statistics Estonia, Eesti Pank

Figure 35. Electricity exchange prices



Source: Nord Pool

may have passed into food prices earlier, and the impact of the rise will continue to be felt in the coming months. Alcohol and tobacco products became 3.6% more expensive during the month of July, as excises rose at the same time as VAT.

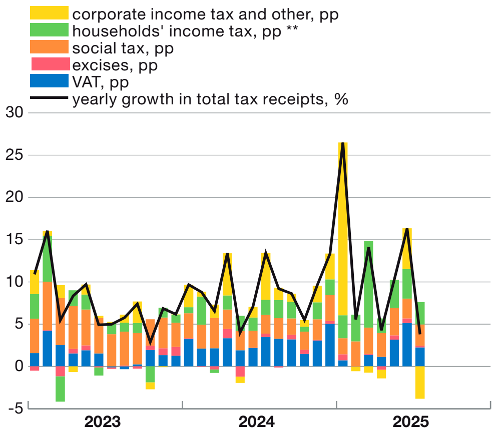
Inflation for services has been affected this year by rises in several administered prices. Inflation has been held higher all year by the introduction of the motor vehicle registration fee. Private sector prices have seen inflation for tourism services accelerate. The rise in VAT in July was particularly reflected in prices for services, where competition is weaker. Prices for various communal services and communications rose as a consequence of the tax increase for example. Service price inflation was up at around 12% in August.

The price growth of industrial goods has been slowed by import prices, which have become more affordable for consumers. Prices for manufactured goods have risen by an average of 2% in recent months. Inflation has been driven above all by cars and home furnishings, while prices have fallen for computers and home electronics.

GENERAL GOVERNMENT FINANCING

Various tax changes helped increase tax revenues in the second quarter. Tax revenues received in the state budget were up 10.4% on the year (see Figure 36), but the increase was smaller than that in the first quarter, when large one-off receipts of corporate income tax boosted revenue substantially. Two factors affected tax receipts in the second quarter. The first was that the motor vehicle tax had to be paid for the first time in June, bringing more than 50 million euros into the state budget and boosting the growth in tax revenues in the second quarter by almost 1.5 percentage points. The second was that consumption was shifted earlier in anticipation of the rise in VAT on 1 July, giving a lift to VAT receipts. Receipts of personal income tax are also up throughout 2025 following the increase of 10% in the income tax rate at the start of the year from 20% to 22%. Wages continue to grow quite quickly as well, increasing receipts of social tax.

Figure 36. Tax revenues in the state budget*



* Accrual accounting
** Including PIT transferred to local governments
Source: Statistics Estonia

Preliminary data show that increases over the year in the main components of general government expenditures such as social benefits paid in cash, investment, the payroll, and intermediate consumption were smaller in the second quarter than in the first. The data currently available show that the yearly growth in the money paid out as social benefits slowed substantially for example. This was mainly because indexing of pensions on 1 April meant the growth in them was smaller than in the previous year. A large fall in the number of births also reduced the amount paid out in child support and family benefits.

Yearly growth in general government investment slowed in the second quarter to 11.9%, having exceeded 25% in the first quarter. Investment in national defence was the main source of the growth, as spending on other machinery and defence equipment was three times what it was a year earlier. Investment in construction by contrast was 10.3% less in the second quarter than a year earlier. The accounting data of entities in the general government sector also show that it was national defence that contributed most to the growth in the acquisition of fixed assets in the second quarter.

More than half of general government spending on final consumption goes on wage costs, and the rate of growth in those wage costs maintained the downward trajectory it had been following since the end of 2023. Data from Statistics Estonia show that the payroll increased by 4.5% over the year, which was partly because wages in healthcare and education increased more slowly than before. The growth in total final consumption spending by the general government increased a little in the second quarter to 5.8% despite wages rising more slowly. This was mainly because of an increase in spending on intermediate consumption, which mainly covers economic expenses, but also includes spending on defence such as purchases of ammunition. These expenditures grew by 6.4% over the year, which was almost twice as fast as they did in the first quarter.

THE EESTI PANK ECONOMIC FORECAST FOR 2025-2027

The Eesti Pank economic forecast is produced jointly by experts from the central bank's Economics and Research Department and Financial Stability Department. This forecast takes account of new information received since the forecast published in June on the economies of Estonia and other countries. The forecast is shaped by revisions to published data and statistics, and also by updated assumptions about the exchange rate, the financial sector, commodities and export markets, and the state budget, and these are shown below. The Eesti Pank forecasts are compiled and consistency between the economic indicators is ensured using EMMA, the macro-model of the Estonian economy developed and constantly updated by Eesti Pank. The model forecast is produced by extending economic relations and processes that have already been defined into the future, with economists from the central bank making adjustments such as structural changes or expected temporary deviations where necessary.

THE INTERNATIONAL ECONOMIC ENVIRONMENT

The global economy

Growth in the global economy slowed in 2025 but is expected to recover moderately in the coming years. The forecast by the International Monetary Fund (IMF) expects the global economy to grow by 3.0% in 2025, 3.1% in 2026, and 3.2% in 2027[24]. The IMF estimates the long-term average rate of growth at around 3% a year, which is notably below the average of 3.8% in 2000-2019, and also below the rate of 3.6% forecast in early 2020. The previous forecasts of faster economic growth were not realised because the capacity for growth in the global economy has been reduced since the pandemic by declining productivity, geopolitical tensions and fragmentation of trade, which have all been made worse by the slowing growth in the working-age population. The forecasts by the IMF for the recovery of the global economy from the Covid-19 pandemic also proved too optimistic, as they assumed a fast rate of growth but overestimated the actual capacity of several countries, particularly China, to recover and underestimated the extent and persistence of global inflation.

Fiscal stimulus in the USA will support the economy, but tariffs will limit the growth in international trade. The IMF estimates that growth in the US economy will fall to 1.9% in 2025, mainly because of the high tariffs and weakening consumption. Growth may increase again to 2.0% in 2026 as tax measures encourage corporate investment and so help to offset the negative impact of the trade restrictions. Growth of 1.2% in the euro area and of 1.4% for the United Kingdom is forecast for 2026 as low interest rates and falling inflation increase the purchasing power of households. Emerging markets will see faster growth than advanced economies, but it will still fall to 4.1% in 2025 and 4.0% in 2026. Growth in the Chinese economy will drop from 4.8% in 2025 to 4.2% in 2026, as weak domestic consumption and investment restricts it. Temporary factors like imports being brought forward in advance of higher tariff rates and new trade agreements being signed have supported growth in international trade this year. These factors will no longer support growth in the future, as the tariff rates will remain at historically high levels and the global trading environment will remain tense.

Inflation will continue to fall around the world. The IMF forecasts that inflation globally will be a little over 4% in 2025 and will fall in 2026 to around 3.5%. Inflation in advanced economies will average a little above 2%. It will be higher in the USA at around 3% as tariffs on imports start to have an increasing impact by raising the prices of imported goods and dialling up price pressures. Central banks will pay close attention to the dynamics of prices and may be expected to ease their monetary policy gradually in the coming years if price pressures soften and inflation falls. Should trade restrictions or higher energy prices cause inflation to rise however, interest rates may stop falling and monetary policy could even be tightened.

The euro area

Growth will remain weak in the euro area economy in the nearer term. The introduction of protectionist tariffs by the US promoted stocking up of goods from the euro area, which

24 IMF World Economic Outlook Update, July 2025.

supported the economy in the first quarter but has now ended, and growth is again slowing. The agreement signed between the European Union and the USA in the summer will now see a tariff of 15% apply to a large part of the exports from the European Union. This is clearly better than the preceding uncertainty, and will lay the foundations for some of the trade between the two large economic areas, but the agreed tariff rate remains higher than what was assumed by various forecasts in the spring and may restrict the rate of growth in the euro area economy. There has been no change in the structural challenges facing the euro area economy, such as a lack of competitiveness, an ageing population, adaptation to climate change, security of energy supplies, and the need to build defence capacity. Growth in GDP in the euro area will consequently be 1.2% this year, 1.0% in 2026 and 1.3% in 2027[25].

Fiscal stimulus is supporting the defence industry in the euro area. Stronger activity indexes in recent months point to a modest recovery in industry in the euro area. The trade agreement signed between the European Union and the USA has given companies in the industrial and exporting sector greater confidence to make the investments and production decisions that had been put on hold. Increasing investment activity in the public sector is also making an important contribution, especially investment in defence. At the same time the rapid growth in debt in the countries of the euro area in recent years has put limits on further increases in budgetary expenditures. Economic growth is currently uneven across the countries of the euro area and is stronger in countries like Spain where the economy is focused on services. It is expected though that large-scale budgetary expenditures on defence industries and infrastructure will give a substantial boost to the sluggish growth in the German economy, which is notably dependent on industry[26]. This would equally support the economy across the whole of the euro area.

The labour market in the euro area remains in good shape. Unemployment remains at a record low level in the euro area, as the employers that experienced labour shortages during the pandemic have been in no hurry to make their staff redundant quite as lightly. Employment has been increasing more slowly of late, but continues to rise and so support the recovery in the economy. Looser monetary policy in the euro area has reduced the costs of loans for households, while inflation falling towards the target of the European Central Bank has helped disposable income to grow gently. This all supports consumption and the economy. Inflation for services has shown signs of falling recently but it still remains high. Prices for food and energy are rising more slowly though, and so the inflation forecast for the euro area is 2.1% in 2025, 1.7% in 2026, and 1.9% in 2027.

Estonia's main trading partners

Growth in the Swedish economy is modest, but the outlook for growth is good, while the Finnish economy is struggling. The Swedish economy suffered a quite unexpected drop in the first quarter of the year, as households proved cautious in their consumption decisions, largely because of a rise in unemployment and the general uncertainty. Growth is expected to increase in the second half of the year though, as a looser monetary policy will reduce the costs of loans, real wages will increase, and a supportive fiscal policy will encourage consumption. Inflation has peaked meanwhile and will probably fall further.

The Finnish economy by contrast is depressed. Cuts in interest rates have given a little support, but the high unemployment rate, the weakness in the real estate market, and budgetary cuts and tax rises continue to drag on demand. Consumption and exports are expected to bounce back a little in the second half of the year, but the overall outlook for the country remains weak. The exporting sectors of both countries continue to be at risk from their quite heavy dependence on the USA, which is felt primarily in car production in Sweden, and machinery and equipment in Finland.

The Lithuanian and Latvian economies are growing at different rates. Growth in the Lithuanian economy will increase further moving forwards as consumption by households increases and is supported largely by withdrawals

25 The September 2025 forecast of the European Central Bank (https://www.ecb.europa.eu/press/projections/html/ecb.projections202509_ecbstaff~c0da697d54.en.html).

26 The Bundesbank estimates that the cumulative impact of increased defence and infrastructure investment on growth in the German economy will be 0.75 percentage point from the second quarter of 2025 to 2027 (https://publikationen.bundesbank.de/publikationen-en/reports-studies/monthly-reports/monthly-report-june-2025-958724?article=forecast-for-germany-us-tariffs-initially-weigh-on-economic-growth-fiscal-policy-provides-impetus-with-a-delay-958718).

from the second pillar pension funds, while low interest rates and inflows of European Union funds will encourage investment. The housing market is also reviving, though strong domestic demand will keep inflation quite high next year as well.

The confidence of households in Latvia by contrast will continue to be pulled down by prices remaining high, although strong growth in real wages and increased investment by companies will support growth in the economy. Some degree of recovery in industry and exports is also to be expected. Inflation has probably peaked, and should come down next year. Latvia and Lithuania are both affected much less than the Nordic countries by the high tariffs imposed by the USA.

TECHNICAL ASSUMPTIONS USED IN THE FORECAST

Assumptions for the external economy

There is currently less uncertainty around foreign trade than there was when the June forecast was produced. The tariffs imposed by the USA on goods from the countries of the European Union have proved higher than was forecast in June 2025, as they are 15% rather than the expected 10%, but the announcement of the preliminary trade agreement and the extension of the pause in tariffs between the USA and China has reduced the uncertainty around trade policy.

Uncertainty still remains at a higher level than it was at the start of the year though. The direct impact of US tariff policy on Estonian exports and so on growth in the Estonian economy is limited but the indirect impact is larger, for example from reduced demand in Estonia's main target markets, and from changes in confidence and in financial and other indicators. Growth in demand in Estonia's main export markets is forecast at 2.4% in 2025, the same as it was in June. Growth in demand will be 0.1 percentage point lower than expected in the next two years though, at 2.1% and 2.9% (see Table 2).

Cheaper energy and lower interest rates than before will support the economy. The expectations for interest rates found from future transactions in the money markets are essentially unchanged from the June forecast, with the three-month Euribor expected to be only 0.1 percentage point higher this year than forecast in June, at the same level of 1.9% next year, and 0.1 percentage point lower in 2027. The larger cuts in interest rates have by now been made, but the impact of the earlier cuts is only passing through in full into the loan costs of households. A substantially larger share of loans in Estonia than in the euro area on average are linked to short-term interest rates, and so interest rate cuts reach borrowers in Estonia more quickly.

The US dollar has weakened against the euro, partly because of the introduction of tariffs, and so a higher rate for the euro against the dollar is used than in the June forecast. Future transactions suggest a higher price for oil in dollars than in the June forecast, but this is offset by the appreciation of the euro. Expectations of price rises for food commodities are smaller than they were in the earlier forecast (see Table 2).

Assumptions for general government financing

The assumptions for tax policy in this forecast take account of all the tax changes that have been passed. These cover the motor vehicle tax that came into force in 2025 and the rise in personal and corporate income tax rates to

Table 2. External assumptions in the forecast [1)]

					June 2025 projection		
	2024	**2025**	**2026**	**2027**	**2025**	**2026**	**2027**
Foreign demand growth (%) [2)]	1.2	2.4	2.1	2.9	2.4	2.2	3.0
USD/EUR exchange rate	1.082	1.107	1.126	1.126	1.107	1.126	1.126
Interest rate (three-month EURIBOR, %)	3.6	2.2	1.9	2.1	2.1	1.9	2.2
Oil price (USD/barrel)	81.2	69.7	65.1	65.1	66.7	62.8	64.2
Price growth for food commodities (EUR, %) [3)]	-1.3	4.3	-0.3	2.5	4.9	1.0	2.2

1) Cut off date of technical assumptions is 28 August 2025 2) Weighted growth of imports of trading partners 3) Food commodity price index by the European Commission Directorate-General for Agriculture and Rural Development (DG AGRI)
Source: European Central Bank

Table 3. Forecast assumptions for government finances

	2025	2026	2027
Government sector GFCF (EUR billion)	2.8	3.6	3.5
Government sector intermediate consumption (EUR billion)	2.6	3.0	3.1
Government sector non-tax revenues (EUR billion)	2.5	2.7	2.4

Sources: Ministry of Finance, Eesti Pank

22%. This forecast does not reflect the suggestion of the government discussed during the planning of the 2026 budget that the rise in income tax could be cancelled and some other spending increased further. It has been taken into account that the security tax in its original form has been cancelled and the additional 2% rate of tax on personal income and corporate profit from the first euro will not be applied from 2026, but the income tax rate will be permanently raised to 24% from 2026 instead. This change will reduce the forecast tax revenue by around 0.4% of GDP or around 170 million euros after accounting for the macroeconomic adjustment. The forecast for the state finances uses the assumptions for revenues and expenditures in the summer economic forecast of the Ministry of Finance for investment, intermediate consumption, and non-tax revenues. This means that the forecast takes account of the increase in spending on defence to above 5% of GDP (see the main assumptions for general government financing in Table 3).

ECONOMIC GROWTH

The forecast for growth in the Estonian economy in 2025 is more modest than it was in June, which is mainly because the

Table 4. Economic forecast by key indicators[1)]

	2023	2024	2025	2026	2027
Nominal GDP (EUR billion)	38.35	39.83	41.73	44.27	47.04
GDP volume[2)]	-2.8	-0.1	0.6	3.2	3.5
Private consumption expenditures[3)]	-1.7	0.2	0.6	3.2	3.3
Government consumption expenditures	0.5	1.9	1.4	2.5	0.9
Gross fixed capital formation	2.4	-6.0	4.4	9.5	2.1
Exports	-9.1	-1.5	3.1	2.2	3.4
Imports	-7.2	0.2	3.0	4.3	2.2
Output gap (% of potential GDP)	-3.0	-4.0	-4.2	-2.5	-1.1
CPI	9.2	3.5	5.3	3.1	2.3
HICP	9.1	3.7	5.3	3.4	2.2
GDP deflator	8.8	3.9	4.1	2.8	2.7
Unemployment rate (% of the labour force)	6.4	7.6	7.8	7.2	6.4
Employment[4)]	3.2	0.2	-0.5	0.1	0.4
Average gross wage (EUR)	1832	1980	2095	2201	2312
Average gross wage growth	11.4	8.1	5.8	5.1	5.0
Median gross wage (EUR)	1501	1633	1726	1820	1918
Median gross wage	12.0	8.8	5.7	5.5	5.4
GDP per employee	-5.8	-0.3	1.2	3.0	3.1
Current account (% of GDP)	-1.6	-1.2	-0.3	-1.9	-0.8
Budget balance (% of GDP)	-3.1	-1.5	-1.3	-3.8	-3.6

1) Numbers reported are annual rates of change in per cent, if not noted otherwise, 2) GDP and its components are chain-linked, 3) including NPISH, 4) employment by domestic production units
Sources: Statistics Estonia, Eesti Pank

Table 5. Estonian economic forecasts by other institutions

	GDP real growth, %					CPI inflation, %				
	2023	**2024**	**2025**	**2026**	**2027**	**2023**	**2024**	**2025**	**2026**	**2027**
Eesti Pank	-2.8	-0.1	0.6	3.2	3.5	9.2 9.1*	3.5 3.7*	5.3 5.3*	3.1 3.4*	2.3 2.2*
Ministry of Finance	-2.7	-0.1	0.8	2.5	2.3	9.2 9.1*	3.5 3.7*	5.4 5.3*	3.5 3.5*	2.4 2.5*
European Commission	-3.1	-0.3	1.1	2.3		9.1*	3.7*	3.8*	2.3*	
IMF	-3.0	-0.3	0.7	1.8	1.8	9.1*	3.7*	5.8*	3.9*	3.2*
OECD	-3.1	-0.2	1.5	2.0		9.1*	3.7*	4.2*	2.3*	
Consensus Economics	-3.0	-0.3	1.2	2.4		9.2	3.5	5.0	3.3	
Luminor	-2.8	-0.1	1.0	2.0	3.0	9.2	3.5	6.0	3.0	2.0
SEB	-3.0	-0.3	1.2	2.5	2.8	9.1*	3.7*	5.2*	3.2*	2.8*
Swedbank	-3.0	-0.3	0.6	2.0	2.3	9.2	3.5	5.5	3.7	2.5

* HICP
Sources: Eesti Pank, September forecast, 23.09.2025; MoF, Summer 2025 forecast, 26.08.2025; European Commission. European Economic Forecast. Spring 2025, 19.05.2025; IMF, WEO, April 2025, 22.04.2025; OECD, Economic Outlook, Volume 2025 Issue 1, 03.06.2025; Consensus Economics, Eastern Europe Consensus Forecasts, September 2025, 18.09.2025; Luminor forecast, 17.09.2025; SEB, Nordic Outlook, August 2025, 26.08.2025; Swedbank Economic Outlook, 26.08.2025

GDP statistics have been revised. The latest estimate by Statistics Estonia is that growth in the economy was slower in the first quarter of 2025 than was indicated by the initial flash estimate that was used for the forecast in June. Data for the level of GDP in 2024 and the quarterly profile of it have also changed notably, and this has reduced the expected growth in 2025 for technical reasons. Output indexes like that for industrial output volumes still show the economy has been recovering for some time, even though this is not yet apparent in the GDP figures.

Growth in the economy will pick up as several earlier problems are overcome. Growth will exceed 3% a year in 2026 and 2027 (see Table 4 and comparison with forecasts by other institutions in Table 5). The problems that have held growth back in recent years like the rapid rise in energy prices, high interest rates, and weakness in foreign markets have dissipated and foreign markets are gradually strengthening. This allows the exporting sector to increase its production volumes and will drive the economy forward. The long recession means that businesses have a lot of production capacity that is not in use, and so growth may in the short term exceed the potential growth in the economy.

Economic growth will be boosted further in the short term by the increased fiscal stimulus. It will be pushed up not only by the general recovery in the economy, but also by increased spending by the general government and a reduction in the tax burden. The budget deficit in 2026 will be larger than that in 2025 by 2.5% of GDP, which will give a substantial lift to domestic demand. Growth will increase in the coming years, but it should be noted that the potential for growth in the economy is smaller than it was in earlier decades. This is mainly because growth in productivity has slowed.

The economy recovering during the forecast horizon will improve the position of the labour market, though the labour market reacts to increased economic activity with something of a lag. Companies avoided making redundancies during the recession to the same degree that their value added and output declined, and so they will at first be able to increase their production without hiring new employees. There will also be greater caution than usual about hiring decisions because there is greater uncertainty than usual in the economic environment.

The labour supply will shrink a little in the coming years. The sluggish recovery in demand for labour will reduce the motivation to hire labour from abroad, while emigration will be increased by the departure of some Ukrainian refugees from the war. Immigration will continue to exceed emigration, but will not be enough to offset entirely the natural decline in the number of people of working age. The labour force participation rate has been very high in recent years in international comparison and compared to its own rising trend, but it fell back towards its long-term trend in the second half of 2024 and in early 2025. It is not forecast to fall further though, as better health and a higher retirement age mean that older people are leaving the labour market later and later, and so labour force participation will increase.

Labour costs as a share of value added created in the economy increased during the recession but will now decline again and the corporate profit share will increase. Wage growth will slow towards a level that is better aligned with labour productivity and inflation. The growth in wages in 2025 will be affected above all by the smaller rises for general government employees in healthcare, education and public administration. Rises in income tax and VAT will affect the wage expectations of employees in the private sector in their negotiations with employers. Pressure on wage costs will ease in 2026 as the tax hump is eliminated, which will benefit the majority of employees by reducing their effective tax rate.

The rise in the VAT rate in the middle of the year will reduce consumption in the second half of it. Purchases were brought forward into the second quarter in anticipation of the rise in VAT, and the latest data for retail and for card payments indicate that quarterly growth in consumption slowed in the third quarter. The upwards trend in retail, which has been building since last summer, will probably recover in short order. The purchases brought forward to avoid the tax rise were mainly concentrated on durable goods and large purchases, though budget limits mean these cannot have been very extensive. Consumption has also been supported since the start of last year by a fall in the effective income tax rate and a sharp jump in incomes and purchasing power.

Exports of goods will continue to grow across a broad base, though there may be some volatility across sectors and destinations in the short term. Faster growth in the exports of goods will be hindered by the uncertainty caused by protectionist tariffs, the continuing rise in production costs, and the restrained performance of the economies in Estonia's main trading partners, especially the weak demand in the Nordic countries. Exports at constant prices are forecast to grow by 3.1% in 2025, with exports of goods growing by 4% while exports of services continue to grow at the same time by a moderate but stable 2-3%. Stable growth in exports of services will be aided by a good demand environment and the good competitive position of Estonian service providers, especially in ICT.

Exporters give a better assessment of their own competitiveness. This is shown in survey data and in the entry of exporters to new markets and the expansion of the group of main trading partners for Estonia. Greater improvement in competitiveness is hindered by the ongoing pressure from input costs, especially the growth in wages, while prices of imported inputs have risen more slowly, or in some cases even fallen.

The growth in corporate investment will become more broadly based across the forecast horizon. Investment has been led in recent years by individual large sectors such as energy, information and communications technology, and financial services, but growth in export revenues and profits will in future be made possible by an increase in production capital in manufacturing as well, and by the related transportation and storage sector. The price of capital stabilising at a substantially lower level after the high interest rates of earlier years will also support investment activity.

Uncertainty about international trade has eased but is still higher than usual and will continue to restrain faster growth in investment for some time yet. The framework agreement on trade that was signed between the USA and the European Union brought some clarity to the conditions of international trade, but it is still far from coming into force. Uncertainty about the details of the agreement and changes in international trade flows make it more difficult to take long-term investment decisions.

Access to bank loans will remain good throughout the forecast horizon. This is because of the ambitions of the banks to grow, and because the banks are of different sizes and have different focuses. Interest rates on loans will not change particularly in the coming years. The expectations of market participants may bring Euribor down a little in 2026, then it will start to rise again gradually. The interest margin on housing loans in Estonia has fallen to the average level in the euro area, and will probably hold steady at that level. The interest margin on corporate loans is high in Estonia in international comparison, but whether it comes down depends on whether competition pressures pass through from other lending conditions into the interest margin or not.

PRICES

Inflation will remain high until the end of this year, but it will come down a long way next year. Inflation will fall below 2% in the second half of 2026. Inflation coming down will need growth in the economy to accelerate and productivity to increase, as this will help offset the cost pressures coming from higher wages and higher prices for other inputs.

The downward trend in energy prices that started after the energy crisis will continue in the years ahead. The price of electricity may fall as new production capacity is added, though there is a risk that network fees will rise. Electricity prices are volatile because of the weather, but also because of maintenance and repairs at power stations and in the transmission network. How companies set prices in the fuel market has changed, and the elimination of favourable prices for clients with loyalty cards will be reflected in the consumer price statistics as a fall in price. Markets predict that the price of gas in Europe will be relatively low in winter, and so the prices of heating energy will continue to fall.

Annual inflation for food products will fall gradually during the forecast horizon. Price pressures will be eased as international commodities prices stabilise, but prices will still remain at a notably higher level than before they started rising in 2022. The prices of individual goods may equally fall, though the wave of disease hitting pig farms may affect the price of pork and so cause some temporary volatility in prices.

Inflation for services has also passed its peak and will start to fall in the coming months. As wages rise more slowly, so the high inflation for tourism and leisure services will come down. The price of oil being lower than in earlier years will reduce cost pressures in the transport sector. Rent prices will continue to rise as the real estate market revives. Rises in administrative prices will have less impact during the forecast horizon, as the car tax will pass out of the inflation calculation next year.

Inflation for manufactured goods will however increase. Prices of imported goods have passed their lowest point, and the impact of the euro appreciating will start to fade. Domestic factors, including the markups of merchants, will cause a large part of the inflation for manufactured goods.

THE GENERAL GOVERNMENT FISCAL POSITION

The fiscal position of the general government will deteriorate. The budget deficit in 2025 will be 1.3% of GDP, which is in line with the June forecast. The deficit in the forecasts is however half what was expected when the budget for 2025 was originally written. This is partly because of a large one-off inflow of corporate income tax at the start of this year. The budget deficit of the general government will widen sharply next year, and is currently forecast to be 3.8% of GDP in 2026. This is firstly because expenditures will increase in order to raise spending on defence above 5% of GDP, and secondly because income tax revenues will fall and the aggregate growth in tax revenues will slow as the currently regressive tax-free income ceiling is abolished and is raised for all people of working age to 700 euros a month. Tax revenues will also be smaller than was forecast in June because the security tax in its initial form has been cancelled and replaced with a rise in the income tax rate to 24%. Growth in expenditures will be slower moving forward, and the budget deficit is forecast to fall to 3.6% of GDP in 2027 as the economy expands. If parliament passes an act to cancel the rise in income tax, as the government has indicated it wants, and if spending is increased as was discussed in the budget negotiations, the deficit in 2026 would reach 4.5% of GDP. The deficit in 2027 would also be larger.