

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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INTRODUCTION

The global economy is being rocked by tensions in commodities markets, while at the same time it is being enlivened by the race to invest in artificial intelligence and the consequent increase in economic activity. Demand from Estonia's trading partners has grown faster than was expected in the forecast published in June, and that has supported growth in Estonian exports.

Commodities markets appeared to be calming in the summer, but prices rose sharply for motor fuels and natural gas at the end of August and the start of September. This shows how fragile the current situation is and how serious a risk could be posed by rising energy prices. It is notable in this that there are wide differences between the prices of different fuels, as prices have risen more for gas and motor fuels than for oil. More expensive energy had a limited impact on the Estonian economy in the summer, but it will cause greater pain as the weather cools and heating costs rise. Food prices, in contrast to energy prices, have so far been generally falling and have been restraining inflation. Energy being more expensive will in the longer term drive food prices up too, though that effect will appear only after some time.

A second factor steering the Estonian economy besides the movements in foreign markets has been the very large fiscal stimulus that arose from the change in the income tax system as what was known as the tax hump was eliminated at the start of 2026, while spending on defence increased sharply.

Eliminating the tax hump increased the purchasing power of households, though the additional money will enter the economy slowly and will lift consumption growth in autumn 2026 and the other years of the forecast. Increased spending on defence will have a modest effect on economic growth, as a large part of the additional funds will go on goods bought from abroad. The extra investment in defence and the purchases of additional equipment will increase imports, which will be reflected in a widening current account deficit.

Although the larger fiscal deficit will boost economic growth, it should be noted that this growth will come at the expense of the state. Over time this will mean larger interest payments and a greater burden for taxpayers. The longer the delay in reducing the fiscal deficit, the harder it will become to do it because of the growing interest burden.

The growth in the Estonian economy as it recovers has been built on using spare production capacity more intensively. This means though that further growth will need new investment and improved skills for employees.

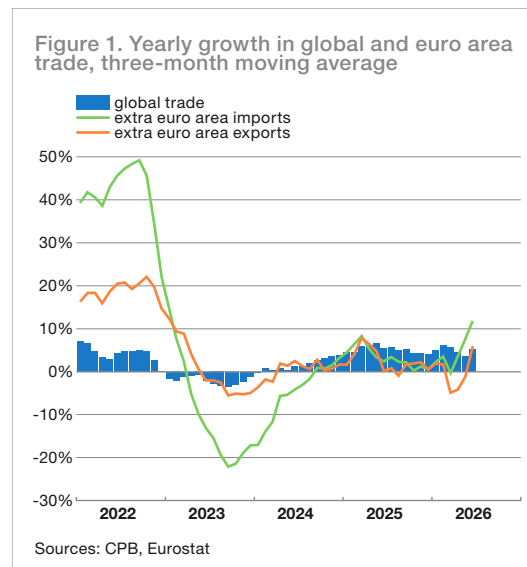
This report contains the usual box on monetary policy in the euro area, and three others as well. They consider how changes to the pension saving system affected saving by households, changes in productivity across sectors, and the reasons that inflation fell in the middle of 2026.

THE EXTERNAL ENVIRONMENT

THE GLOBAL ECONOMY

The global economy proved more resilient than expected during the summer despite the ongoing geopolitical tensions and high energy prices, though uncertainty has been raised again in the autumn by the increased tensions in the Middle East. Economic activity has remained stronger in larger countries than was forecast in the spring by many international institutions. The impact of higher energy prices has so far been offset by strong demand for investment and improved private consumption in several countries. The growth has been uneven across states and sectors though, and a large part of the increase in activity has come from rapidly growing investment in technology and infrastructure. Enduring price pressures have at the same time kept monetary policy relatively tight and the outlook is for monetary policy to become stricter in several large countries.

Growth in investment related to artificial intelligence in the USA is keeping global demand strong for high-technology equipment and components. These investments are highly import intensive, as an estimated 90% of the equipment used in the hi-tech sector in the US comes from abroad¹. This means that East Asian countries are benefiting particularly from the increased demand, as a large part of the value chain for production of infrastructure for artificial intelligence is concentrated there. The most advanced processors are made in Taiwan and the most powerful memory chips in South Korea, while Malaysia, Singapore, Thailand and Vietnam all have important roles in making and putting together electronic components and equipment. Exports of semiconductors from South Korea in August were more than triple what they were a year earlier for example. This reflects the current stage of development of artificial intelligence, as the BIS estimates that the macroeconomic impact of artificial intelligence is currently coming primarily through capital spending, while the broader impact on productivity will come gradually, and the extent and timing of that impact remain uncertain.



International trade was particularly supported in the first half of the year by strong demand in the technology sector, on top of which were pre-emptive purchases of goods in fear of possible disruptions to supply. Data from the World Trade Organisation show that the value of global trade in goods related to artificial intelligence including chips, servers and other technological equipment was up by over 40% on the year in the first quarter, while the total value of trade in goods increased by 11% (see Figure 1)². International value chains in which components often move through several countries before the final product is ready have amplified the impact on trade of the investment in technology. Flows of goods were temporarily boosted further by pre-emptive purchases of consumables and intermediate goods in the US before customs tariffs were changed, and by stocking up of energy-intensive inputs in fear of disruptions to supply from the Middle East. Higher tariffs, especially between the US and China, restricted the growth in trade at the same time though, as did the transport and energy costs that arose from geopolitical tensions. Tensions in supply chains tightened during the first half of the year, though they have eased a little in recent months.

The war in the Middle East affected the global economy less than feared in the summer

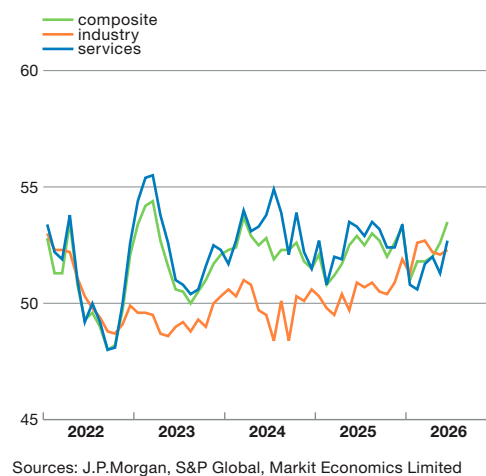
1 Fiori et al. (2026). *Technology Shocks, the AI Boom, and the U.S. Current Account*. FEDS Notes, Federal Reserve Board, 14.07.2026.

2 WTO, *Global goods trade resilient in the first quarter of 2026 despite war in Middle East* (31.07.2026).

months, but tensions and supply risks in the oil market increased again in September. The shock to the oil market was softened at first by the large oil reserves that had been built up before the crisis, notably in China. China increased its crude oil stocks by 111 million barrels in 2025, and these larger reserves allowed it to reduce its imports of oil substantially once the war started. The observable global oil reserves shrank from March to May by around 3.8 million barrels a day, which helped cover some of the supply shock from the Middle East³. Oil production also adapted quickly, as Saudi Arabia and the United Arab Emirates sent some of their exports through pipelines that avoid the Strait of Hormuz, while production increased beyond the Persian Gulf as well. Changes in demand also played a major part, as high prices restrained oil consumption in Asia particularly, and encouraged the use of other sources of energy. The oil market will have less capacity to soften supply shocks moving forward as the buffers have rapidly been used up, with the International Energy Agency estimating that national oil reserves were around 410 million barrels smaller by the end of July than when the war started, at below 7.9 billion barrels⁴.

Economic growth in the larger advanced economies remained moderate in the second quarter, while the latest survey data indicate increased activity at the start of the third quarter. The US economy grew by around 0.4% over the quarter in the second quarter (see Table 1). The strong labour market, rising incomes and increasing asset prices gave good backing to private consumption, and the growth in consumption was led increasingly by households

Figure 2. Purchasing Managers Indexes



with higher incomes that had benefited most from rising share prices. The United Kingdom and Japan also saw GDP grow by 0.4% over the second quarter. The global purchasing managers index (PMI) was 0.9 point higher in August than in July at 53.5 points, indicating that economic activity was increasing (see Figure 2). Activity was particularly strong in the US as the PMI there rose to 56.0 points in August, which was its highest level since April 2022. The British and Japanese economies also continued to revive, as was shown by the PMI rising to 52.5 in the United Kingdom and 53.5 in Japan.

Growth over the year in the Chinese economy slowed to 4.3% in the second quarter from 5.0% in the first. Domestic demand continues to be restrained by low consumer confidence, weakness in the labour market, and a slump in real

Table 1. GDP growth in different regions in 2020-2026 (change, %)*

	2021	2022	2023	2024	2025	Q4 2025	Q1 2026	2026
World	6.0	3.4	3.5	3.3	3.4			3.1
Advanced economies	5.2	2.7	1.8	1.8	1.9			1.8
Emerging markets and developing economies	6.6	4.0	4.7	4.3	4.4			3.9
Euro area	6.4	3.6	0.4	0.9	1.4	1.2 (0.2)	0.3 (-0.2)	1.1
United States	6.1	2.5	2.9	2.8	2.1	2.0 (0.1)	2.7 (0.4)	2.3
China	8.6	3.1	5.4	5.0	5.0	4.5 (1.2)	5.0 (1.3)	4.4
Japan	3.6	1.3	0.7	-0.2	1.1	0.2 (0.2)	0.6 (0.5)	0.7
United Kingdom	8.5	5.1	0.3	1.0	1.4	1.0 (0.2)	1.1 (0.6)	0.8

* GDP at constant prices, quarterly growth over the previous quarter is in brackets

Sources: IMF World Economic Outlook Update (July 2026), OECD, Eurostat, National Statistics; 2026 is IMF estimate

3 IEA, Oil Market Report (June 2026).

4 IEA, Oil Market Report (August 2026).

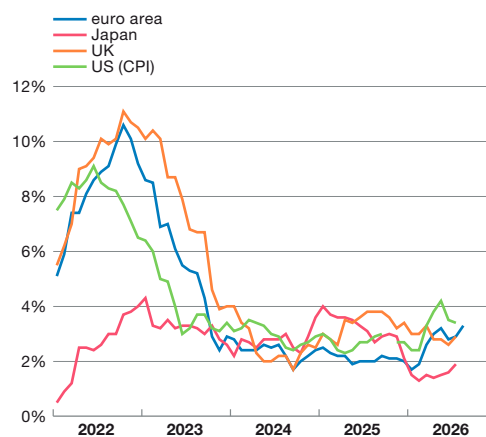
estate. Strong growth in exports was not able to offset this entirely, as investment and consumption remained weak and imports grew faster than exports in the first half of the year. Exports of goods were around 25% higher in July and August than a year earlier, with electric cars, batteries, solar panels and semiconductors taking the lead. Exports of industrial robots and 3D printers were up by over 50% in July. At the same time though, capital spending on artificial intelligence was estimated at only 0.3% of GDP in China in 2025, while the large US technology companies spent around 1.3% of US GDP on AI⁵.

Lasting price pressures made the outlook for the monetary policy of the Federal Reserve tighter than before.

The rise in energy prices in the spring pushed inflation up temporarily, but core inflation still remained high even after that effect faded, particularly for services. Inflation in the US has been coming down at a slower rate in recent months, and core inflation has remained at 2.5-2.9% since April. Enduring inflation pressures combined with strong economic activity increased expectations in the markets of new interest rate rises. Even though inflation has been higher than the target set by the central bank for several years now, the long-term inflation expectations in the US have remained generally stable, and a survey by the University of Michigan showed inflation expectations for 5-10 years rose to 3.9% in May, but came back down by August to 3.3%. The five-year inflation expectation of the New York Fed was 3.0% in August.

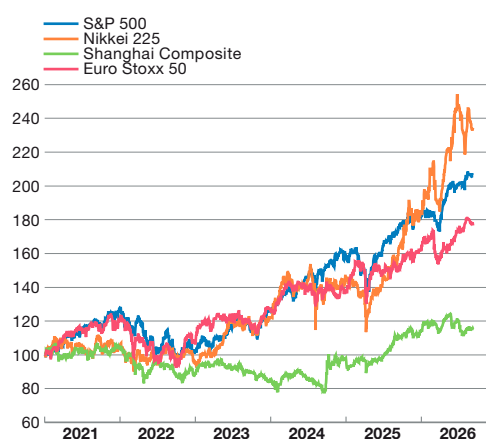
Financial markets also expect monetary policy to be tightened in other countries with large economies. Markets are accounting for higher interest rates because of inflation remaining stubbornly high in several countries including the United Kingdom, Japan and Canada (see Figure 3). Inflation has risen again in the United Kingdom, while wage growth remains strong and the rise in energy prices has passed through to consumers, leading to expectations that interest rates will rise. The Japanese central bank kept its short-term interest rates at 1%, but inflation rose to 1.9% and the weakness of the yen increased expectations in financial markets that base interest rates will rise further. The yen has lost around 35% of its value against the US dollar since the start of 2021. The weak yen increases price pressures in Japan

Figure 3. Inflation



Sources: Eurostat, Bloomberg

Figure 4. World stock indexes (01.01.2021 = 100)



Last observation 07.09.2026
Source: Bloomberg

and makes Japanese exports more competitive in the US market, and so at the end of July the Japanese and US authorities organised their first coordinated purchases of yen since 1998.

Global stock markets were volatile in the summer, but mainly ended August at close to record levels.

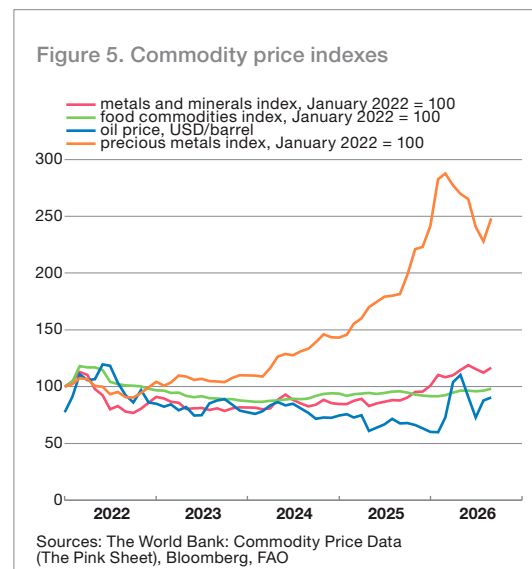
Strong growth in corporate profits in the US supported the market there (see Figure 4). Corporate profits at S&P 500 companies were up by around 52% over the year in the second quarter, and the majority of companies beat the profit expectations of analysts. The growth in profits was boosted substantially by the revenues from recalculation of investment by Alphabet and Amazon, but even without these the growth was around 32%. There was however a sharp

5 Citi Research (2026). *China's AI-Driven New Economy*, 16.04.2026; Allen, J. S. (2026). *Monitoring AI Adoption in the US Economy*. Federal Reserve Board, 03.04.2026

correction in July in the semiconductor industry, which had benefited from the artificial intelligence boom, and share prices for semiconductor producers dropped by around 30% from their peak in June. They partially recovered in August. The price movements in the summer indicated that investors are increasingly paying attention to whether the rapidly increasing investments in new technology are raising corporate productivity and revenues enough to justify the high expectations for growth in them. The rise in stock markets in Europe was led above all by banks, and markets in several countries ended August at close to record levels. Corporate results in China were more of a disappointment for investors, while the market in Japan was supported in August by companies reporting strong results.

Yields on government bonds rose sharply during the summer and reached their highest levels for many years. The yield on the US 10-year Treasury rose in early September by around 5% to its highest level for three years, while the yield on the German 10-year bond was its highest since 2009 at 3.5% and the yield on the equivalent Japanese bond hit its highest level of the past 30 years at 3%. The latest rise in yields in the bond market was driven by energy prices rising because of the war in the Middle East, which has increased inflation risks and the expectation that base interest rates will remain high. Large budget deficits are also keeping long-term yields high as they increase the term premium⁶ demanded by investors. The US Congressional Budget Office (CBO) forecasts for example that the US federal budget will remain in deficit in 2026–2036 by around 6% of GDP. The increased buybacks of long-dated US Treasuries have not managed to prevent yields rising either⁷. Long-term yields may be being held high by the large investments in energy and infrastructure relating to artificial intelligence, which are increasing demand for capital from the private sector and could consequently push real interest rates up. The bond markets have however not been remarkably volatile, indicating that interest levels are being re-assessed rather than that there is alarm in the market.

There were large price fluctuations in commodity markets in the summer and in



early September as a result of the war in the Middle East. Brent crude oil fell below 80 dollars a barrel in July, but rose back above 100 dollars in early September as hostilities again intensified between the US and Iran (see Figure 5). The flow of shipping through the Strait of Hormuz at the end of August was about a tenth of what it was before the war. Price fluctuations in other commodities markets were more moderate. Prices for industrial metals moved widely and remained volatile in early September. Copper prices rose in August and reached record levels at the start of September, but then started to fall again. Gold rose by around 10% in August but then retreated in early September under pressure from higher bond yields and a stronger dollar. Prices of fertilisers fell during the summer, easing some of the pressure on prices of inputs for agriculture. Prices started to rise faster for food commodities in August as the food price index of the FAO rose by 1.9% over the month to stand at 2.5% higher than a year earlier. Price pressures were increased by unfavourable weather and disruptions to supply in the Middle East and the Black Sea.

THE EURO AREA

The economy in the euro area proved resilient in the second quarter. Growth in the euro area economy fell to 0% in the first quarter, though this was not because of the war in the Middle East but rather because of the sharp contraction in the

⁶ The term premium is the extra yield that investors demand for holding long-term bonds because of the interest and inflation risks.

⁷ The US Treasury increased its buybacks of 10-30 year bonds from 9 September to support liquidity in the market for them. The amount purchased in the operations will have at least doubled by 4 November, and the ceiling for the operation on 10 September was 6 billion dollars.

Irish economy⁸, which substantially affected the aggregate figure for euro area GDP. Signs were then apparent of growth picking up in the second quarter despite the war continuing, as GDP growth returned to Ireland and quarterly growth in euro area GDP increased to 0.6%. This was the strongest quarterly growth in the euro area since the second quarter of 2022 and it was supported largely by foreign trade and domestic demand, and to a lesser extent by investment and public sector spending. Those factors helped offset the negative impact of the war in Iran and higher energy costs. Growth over the year in euro area GDP increased to 1.2% in the second quarter from 0.6% in the first.

Spain was again the leader among the countries with the largest economies in the euro area, as GDP increased over the quarter by 0.7%, beating several forecasts. The French economy rebounded a little after shrinking by 0.1% in the first quarter and GDP remained unchanged over the quarter with support from domestic demand and from household consumption strengthening a little. GDP grew by 0.3% in Germany and 0.2% in Italy. The extreme heat wave in the summer hit the euro area economy quite hard though, especially in the larger countries in the euro area. The water levels in a lot of major rivers were at record low levels, which was a major impediment to river transport and to several large power stations. This may reduce growth in the euro area economy in future, and increase price pressures.

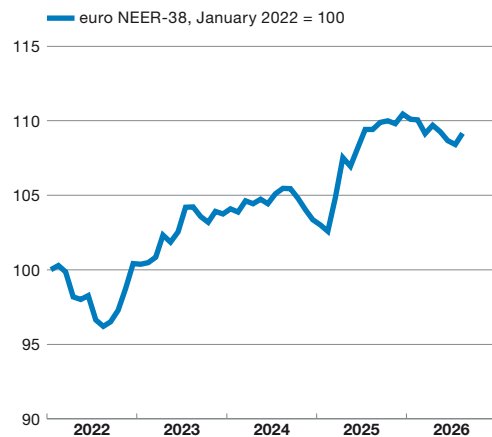
Estimates of economic activity remained at a good level in August. The composite PMI⁹ stood at 52 points in August and has held clearly above the 50-point level for some months. The figure for August was the best of the past eight months, suggesting that the euro area economy continued to grow in the third quarter. Production volumes increased in August while numbers of new orders rose at the same good rate as in July, meaning the improvement in demand in August was the largest since last November. The PMI data for industry and services also showed that there was broadly based growth in sales volumes. It is notable that new export orders in the euro area increased in August for the first time in four and a half years.

⁸ A large number of international technology and medical firms operate in Ireland, and their activities have a major impact on the national statistics.

⁹ S&P Global Eurozone Composite PMI®.

¹⁰ European Commission Economic Sentiment Indicator (ESI).

Figure 6. Trade-weighted euro exchange rate



Source: European Central Bank

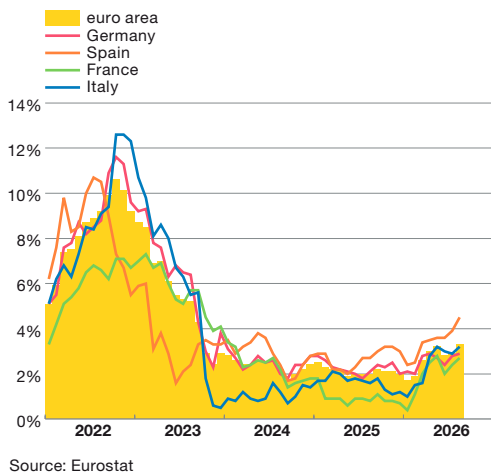
Manufacturing led the growth in orders, while foreign demand for services weakened a little. The result was that the growth in new export orders overall was still quite modest.

National PMI data show that the countries in the south of the euro area were again the main drivers of the improvement in economic activity in the euro area, as activity increased noticeably in both Spain and Italy.

Activity revived more modestly in Germany than in those two countries, though still at the fastest rate in August since March. The level of activity in France weakened again however. The PMI survey indicates that price pressures in the euro area were stable in August, as input costs rose a little more slowly while sales prices rose at the same rate as in July. Consumer confidence also strengthened in August¹⁰.

Industrial output and retail sales volumes grew little in the euro area. Industrial output from the euro area remained unchanged in July compared with the same period in previous year but fell over the month, as production of energy and capital goods declined. Yearly growth in retail sales remained positive in the euro area in July at 0.6%. Retail sales were down over the month however by the same amount, which was mainly due to a fall in sales of fuel and non-food goods. Uncertainty continues to prompt a lot of people to save and consumer confidence remains below its

Figure 7. HICP inflation



long-term average level, but it improved a little in August and gave some support to the economy in the euro area.

The trade surplus of the euro area increased.

It reached 14.2 billion euros over the year in July, which was the largest trade surplus since October 2025. Goods exports grew by 9% over the year, while imports grew more slowly and gained 7.9%. The balance of trade was 3.5 billion euros better than it was a year earlier with particular support coming from the large surplus from chemical products and other related products. Exports to all the main trading partners increased, with exports to the USA up by 10.7%, those to Switzerland by 14.2%, and those to the United Kingdom by 3.1%. The growth in imports was also broadly based. The nominal effective exchange rate of the euro (NEER) has started to strengthen again since August against the currencies of the euro area's main trading partners, including the US dollar (see Figure 6). This should make companies in the euro area a little less competitive in foreign markets. Monetary policy in the euro area has benefited financing conditions, aiding companies in the euro area in coping better during the uncertain times (see Box 1).

Inflation in the euro area picked up from 2.9% in July to 3.2% in August. This rise in inflation was the largest in two years and left it clearly above the target of the European Central Bank of 2%, mainly because of the impact of the sharp rise in energy prices as a result of the war in the Middle East (see Figure 7). Inflation for energy rose to 14.3%, which is the highest level it had been since January 2023. Inflation for unprocessed food and

Figure 8. Core inflation

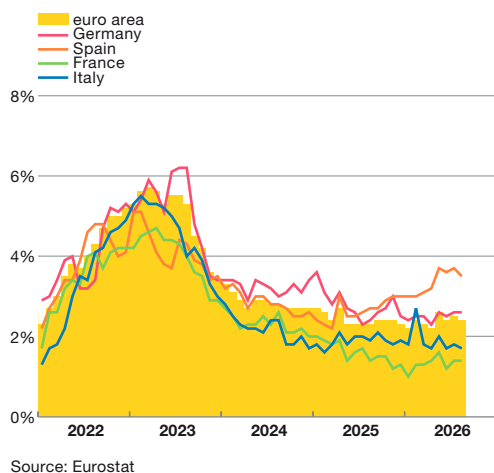
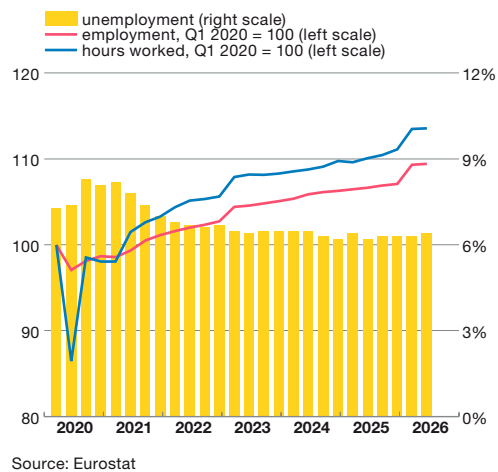


Figure 9. Employment and unemployment in the euro area



industrial goods also rose. Inflation for services fell to its lowest level for four months though at 3%, while core inflation excluding energy and food prices came down to 2.4% (see Figure 8). Inflation in the largest countries of the euro area rose most in Spain, where it reached 4.6%, and Italy, where it was 3.2%. It rose by less in Germany, where it was 2.9% in July, and in France, where it was 2.6%. Higher input prices meant that producer prices have started to rise faster in the euro area again, and in August they almost reached the level of 6% seen in April immediately after the war started in the Middle East.

The labour market in the euro area remains good for employees.

The unemployment rate was again low in July at 6.4% (see Figure 9), while the youth unemployment rate fell from 15.0% in the previous month to 14.9%, which is its lowest level

for around a year. The overall unemployment rate was highest among the larger economies in the euro area in Spain at 10.0%, France at 8.3%, and Italy at 7.8%. The employment rate in the euro area remains around its historical peak, and the number

of people in employment was 0.5% higher in the second quarter than a year earlier. Wage growth in the euro area remains around 3% but is gradually coming down, and growth in negotiated wages came down to 2.4% in the second quarter.

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. The war in the Middle East continues to cause inflation pressures and higher energy prices have again pushed aggregate inflation in the euro area up in recent months. The baseline scenario in the September forecast by the European Central Bank projects that inflation will average 3.0% this year, after which it will fall to 2.5% in 2027 and 2.1% in 2028. This means that inflation is expected to remain above its target of 2% for some time yet. To help bring inflation in the euro area down towards its target, the Governing Council of the European Central Bank decided at its meeting in September to tighten monetary policy.

Figure B1.1. Eurosystem key interest rates

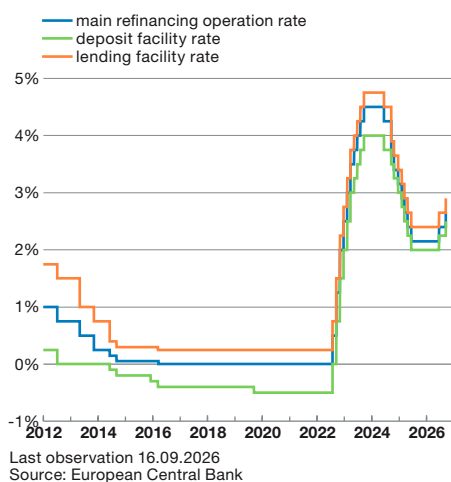
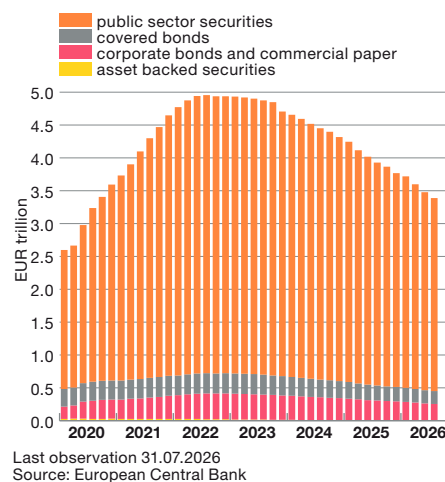


Figure B1.2. Eurosystem holdings under asset purchase programmes (APP and PEPP)



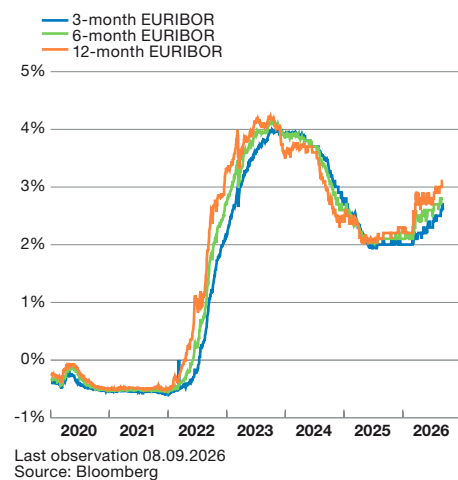
The Governing Council raised its three key interest rates by 0.25 percentage point in September (see Figure B1.1). The interest rate on main refinancing operations is now 2.65%, the marginal lending rate is 2.90%, and the deposit facility rate is 2.50%. Given the highly uncertain outlook, the Governing Council continued to emphasise that it is not pre-committing to a particular rate path moving forwards. The Governing Council's 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 because the bonds purchased under the various asset purchase programmes are gradually reaching maturity¹¹. 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 3.5 trillion euros (see Figure B1.2).

¹¹ 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.

Interest rates rose notably in the interbank money market during the summer, partly reflecting the expectation of market participants that monetary policy interest rates will be tightened (see Figure B1.3). As at 8 September the 3-month Euribor was at 2.64%, the 6-month Euribor was at 2.80%, and the 12-month Euribor was at 3.12%. The growth in the broader M3 indicator of the money supply in the euro area has increased in recent months, and stood at 3.4% over the year in July. Yearly growth in corporate borrowing has also picked up and reached 4.4% in July. The yearly growth in lending volumes to households remained a little above 3%. The Governing Council considers that the capital and liquidity positions of the banks in the euro area remain strong.

Figure B1.3. Euro area money market interest rates

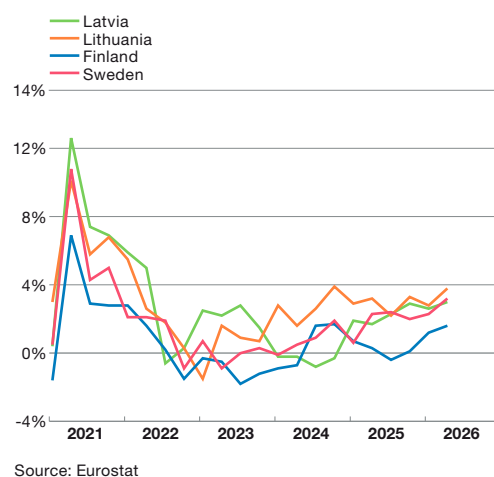


ESTONIA'S MAIN TRADING PARTNERS

The data for the second quarter point overall to the economic position in Sweden and the Baltic states strengthening. The rate of growth in the Finnish economy is still a little lower than those in the other countries and depends largely on foreign demand. The rates of economic growth and the structure of GDP also vary quite notably from country to country. Quarterly growth in GDP was 1.6% in Sweden after a minor dip in the first quarter, and yearly growth increased to 3.3%. Quarterly GDP growth in Finland fell from 0.8% in the first quarter to 0.4%, while yearly growth accelerated to 1.6%. Growth in both the Swedish and Finnish economies was supported by increased exports, but domestic demand provided quite different levels of support in the two countries. The growth in Sweden was more broadly based as investment increased strongly alongside foreign demand, notably in machinery and equipment and in national defence, while private consumption also increased. Growth in Finland was held back by private consumption meanwhile, especially household consumption, and also by a drop in investment.

Economic growth accelerated in both Latvia and Lithuania. The growth in Latvia was relatively broadly based, as activity increased notably not only in industry but also in information and communications and in the financial sector. Strong GDP growth in Lithuania in the second

Figure 10. Yearly growth rates of GDP of trading partners



quarter came particularly from the recovery in manufacturing, construction and services related to trade. Quarterly GDP growth in Latvia was 0.7%, while growth over the year was 3.0%, which is the best result for the country since 2022. The quarterly growth in Lithuania was again the fastest among all of Estonia's main trading partners as it reached 1.7% after a mild dip in the first quarter. The yearly GDP growth in Lithuania reached close to 4% (see Figure 10).

Indicators for economic activity and confidence in the Nordic and Baltic countries indicate that activity continues to improve. Corporate confidence in Finland weakened a little after hitting a four-year peak in July, but it still remained above the long-term average. A

deterioration in expectations for production there was balanced by some improvement in orders. Consumer confidence in Finland was at its strongest since 2022, reflecting more optimistic expectations for the national economy and for people's individual financial position, improved plans for consumption, and reduced worry about unemployment. The PMI for manufacturing in Sweden¹² rose further and remained clearly above the 50-point mark, indicating activity will increase further moving forwards. Growth in new orders and export orders slowed a little at the same time though, and pressure from the cost of inputs increased, but expectations for production remained positive. Consumer confidence also increased in Sweden, reaching its highest level since the end of 2024, which was mainly because assessments of the state of the economy improved.

The developments in sentiment indexes for the private sector in the Baltic states were uneven. There was some improvement in corporate confidence in Latvia and Lithuania, but consumer sentiment moved in different directions, as it weakened a little in Latvia but improved further in Lithuania and remained clearly positive. Consumer confidence in Lithuania continued to be buoyed by the impact of the reform of the second pension pillar and the good performance of the national economy. This was reflected in the continued growth in retail sales volumes in the summer, though the growth was a little slower than it had been in the spring. Retail sales volumes in Estonia's other trading partners also grew strongly, indicating that consumption is supporting the economy.

The manufacturing and exporting sector in Estonia's trading partners has continued to perform quite well despite the headwinds coming from the external environment. Industrial output in Finland was 4.5% larger in volume in July than it was a year earlier. Finnish industry has been supported by strong growth in orders, especially in metalworking and shipbuilding. Industrial output in Latvia was however 0.2% smaller in volume in July than a year earlier, as production of electricity declined and the growth in output from mining slowed. The exporting sectors of Estonia's trading partners are also generally doing well (see Figure 11). Exports of goods from Sweden continued to grow quite fast,

Figure 11. Yearly export growth of trading partners

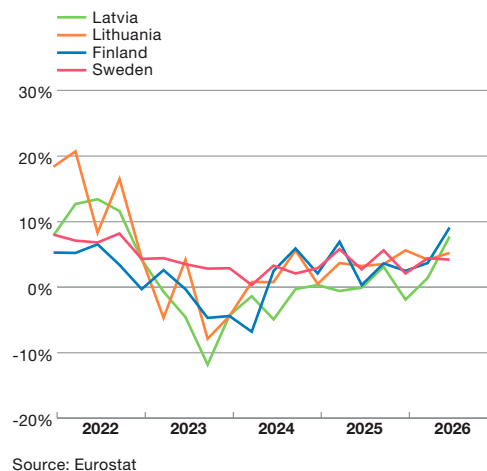
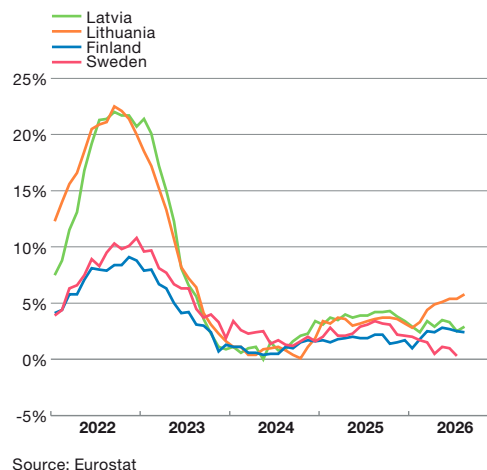


Figure 12. HICP inflation of trading partners



though imports grew even faster in July. Exports from Finland were down by more than 13% over the year in July, though this was largely because of the high reference base from last year¹³. Finnish exports continue to be supported by industrial orders in metalworking, electronics and chemical production. The yearly growth in exports of goods from Latvia and Lithuania accelerated sharply in July. This was driven above all by exports of machinery and electrical equipment from Latvia, and of mineral products from Lithuania.

Inflation rates again varied across Estonia's trading partners. Inflation in Finland fell to 2.4% in August, while in Latvia it increased to 3.0%, and the rate of 5.6% in Lithuania was the highest in the euro area (see Figure 12). Inflation remains notably

¹² Sweden's Swedbank Manufacturing PMI.

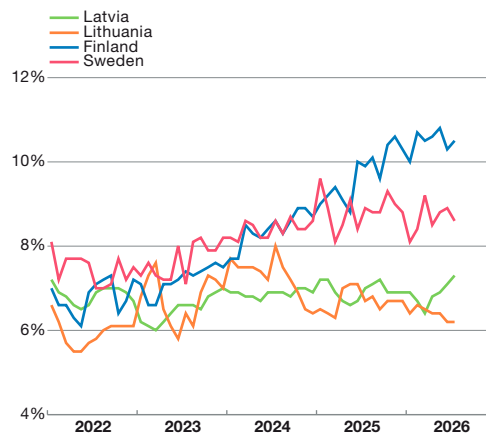
¹³ The statistics for July 2025 were affected substantially by the completion and export of a large cruise ship, though this affected the quarterly result less.

higher in Latvia and Lithuania than in Estonia's other trading partners because of large rises in transport costs, which are particularly affected by the higher prices of fuels on global markets. Inflation in Lithuania has also been pushed up by strong domestic demand. Inflation in Sweden was only 0.3%¹⁴ however, which is largely a consequence of temporary fiscal policy measures. The Swedish central bank consequently kept its base interest rates at 1.75% in August, though it observed that stronger economic growth and higher inflation than expected combined with supply-side price pressures mean it remains possible that interest rates will rise in the second half of the year. Low interest rates have however helped the housing market in Sweden recover from its enduring slump. The purchasing power of households in the Baltic states continues to be supported by rising wages, though the growth in real incomes has been reduced by high inflation, especially in Lithuania.

There is equally a lot of variation between labour markets across the countries.

Unemployment remains high in Finland, though it has come down since the start of the year. The unemployment rate in Finland was still at 10% in July (see Figure 13), and the youth unemployment

Figure 13. Unemployment rates of trading partners



Source: Eurostat

rate was around 17%. The poor state of the labour market has sharply limited household consumption in Finland, reducing confidence and discouraging activity in the housing market. The unemployment rate in Sweden fell to 7.8% in July, though high unemployment among young people remains a problem there. The unemployment rate in Latvia in July was 7% and unemployment in Lithuania has generally remained lower than in the Nordic countries.

14 HICP for July.

THE ESTONIAN ECONOMY

ECONOMIC ACTIVITY

Estonian GDP grew by 1.8% over the year in the second quarter, and by 0.3% over the quarter. The main driver of the growth in the economy was exports of goods to markets in the euro area. Demand in the domestic market was quite weak however, which was probably partly a consequence of the war in the Middle East. Consumption grew by less than it did in the first quarter, and investment fell (see Figure 14).

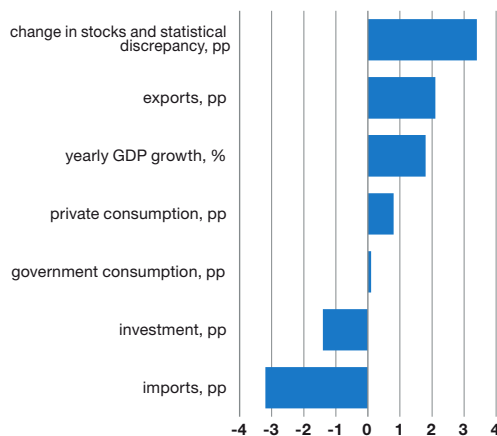
Developments in the economy across sectors reflected quite well what was happening in the demand components of GDP. Manufacturing, which is the main branch of the economy producing goods for export, made the largest contribution to GDP growth. Growth in the value added of services, which are aimed at the domestic market, was weak though. This is because the cost of production rose relatively fast, indicating that domestic price pressures may remain a significant factor despite consumer prices rising more slowly. Value added in several sectors such as trade and public administration was substantially higher at current prices than a year earlier, but high inflation meant that it fell at constant prices (see Figure 15).

Monthly indicators for economic activity have been contradictory, but the majority of them still show growth in industrial output.

The GDP data showed rapid growth in the second quarter in value added in manufacturing, but the volume index for manufacturing output was around 4% lower in the second quarter than a year earlier. The volume index for industrial output showed that production of fuel oil for heating was almost a quarter smaller than a year before, but the tonnage of oil-shale oil produced was around 8% higher in the second quarter than a year earlier. Various sentiment indicators have also strengthened and show the position of the economy to be improving. It should be noted though with the improvement in sentiment indicators that the data for them are now collected by Statistics Estonia rather than the Estonian Institute of Economic Research, and some of the improvement may come from the new methodology used for collecting the data.

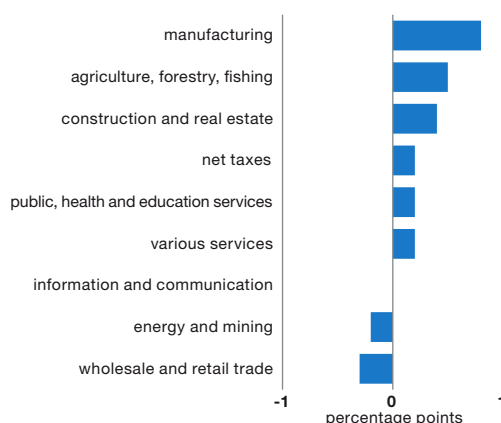
The output gap has narrowed, but the size of the economy has not yet returned to its long-term trend (see Figure 16). The growth in

Figure 14. Contributions to GDP growth in Q2 2026



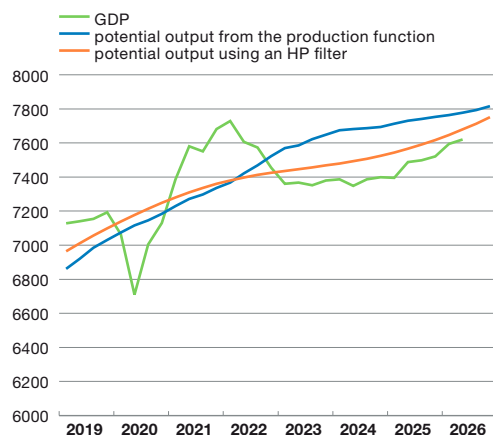
Sources: Statistics Estonia, Eesti Pank

Figure 15. Contributions to GDP growth by sector in Q2 2026



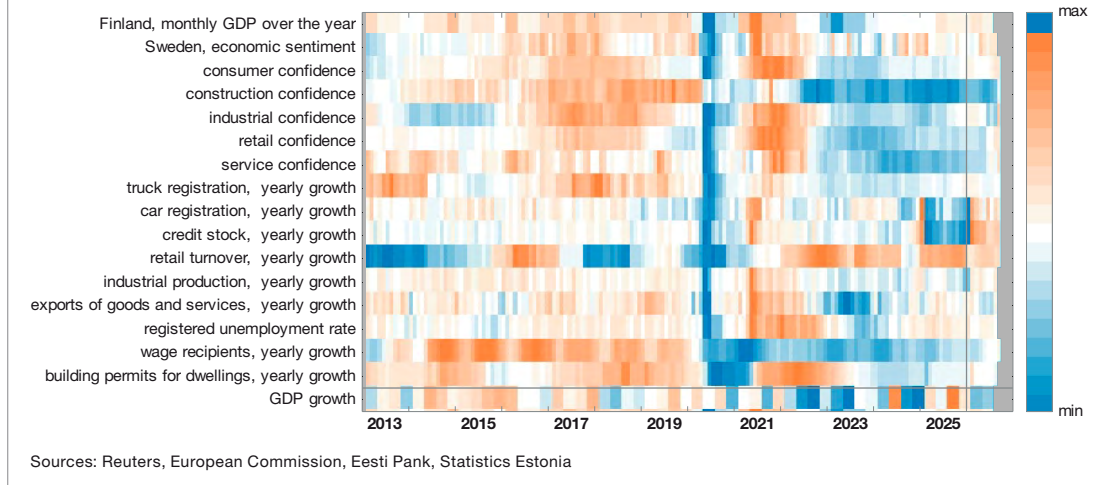
Sources: Statistics Estonia, Eesti Pank

Figure 16. GDP and potential output at 2020 prices, million euros



Sources: Statistics Estonia, Eesti Pank

Figure 17. Heatmap of the Estonian economy



the economy has exceeded that in production capacity for the past year and this has narrowed the output gap. This is confirmed by the rapid improvement this year in the level of capacity utilisation. Calculations show the economy was still smaller in size than its long-term equilibrium level and there remains available production capacity in the economy that can be used to grow faster in the years ahead.

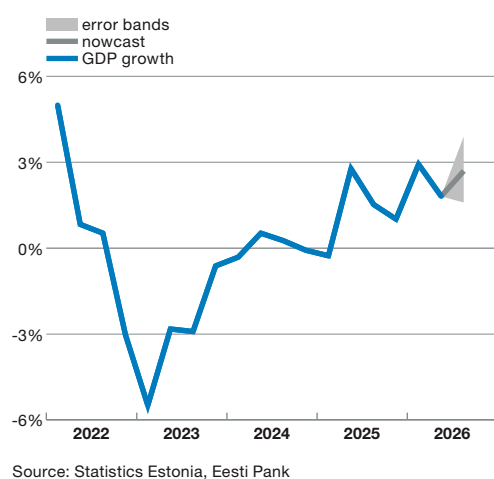
The heatmap for the third quarter is showing slightly warmer tones than that for the second quarter (see Figure 17). The sentiment indicators among the soft indicators were more positive than those for the second quarter, as sentiment¹⁵ has improved notably in all sectors. Among the hard indicators, the volume indexes for retail and manufacturing were better in July this year than last July, registered unemployment continued to fall, and the banking sector continued to give good support to the economy.

The nowcast of economic growth in the third quarter based on monthly inputs¹⁶ indicates that yearly GDP growth is a little faster in the third quarter than it was in the second (see Figure 18).

DOMESTIC DEMAND

Private consumption was at the same level in the second quarter as in the first, though

Figure 18. GDP growth and current quarter nowcast



it had increased in volume over the year by 1.6%. The biggest increase was in purchases of durable goods, including household goods, while spending on leisure time activities and culture also increased.

Purchasing power has been boosted this year by the introduction of the uniform tax-free income allowance, though a large part of the additional income went to people with higher incomes, who save more of the additional money than the average. The rise in incomes is a permanent one and so in the longer term

¹⁵ Statistics Estonia started compiling sentiment barometers from May 2026 that use indicators for confidence in four business sectors and among private consumers. The new values are not entirely comparable with the earlier data, (see <https://stat.ee/en/news/latest-business-and-consumer-survey-results-published-statistics-estonia>) and the European Commission will not publish the seasonally adjusted values for Estonia for some time. The heatmap in Figure 17 uses the new unsmoothed values as the best approximation available, and the seasonal coefficient from the same month of last year, which is the difference between the smoothed and unsmoothed series, is subtracted from them.

¹⁶ The nowcast produced by the Eesti Pank indicator model is a technical regression-based forecast that takes in data as they are received. There are fifteen models in the set and the indicator forecast is the median of the individual forecasts. The uncertainty surrounding the forecast is represented by the average of the historical absolute errors of the current estimate.

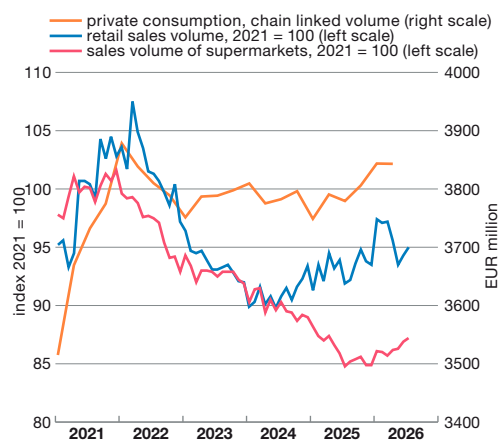
consumption should adapt to it, though this will happen slowly.

Household spending abroad was less than in the second quarter of last year. The number of passengers travelling by air increased rapidly in the first half of the year, but there was less travel to neighbouring countries, which are a larger share of the destinations for residents of Estonia. There was also a fall in the number of overnight stays on foreign trips.

In retail trade, sales volumes at supermarkets have finally started to grow (see Figure 19). The growth in retail sales last year was led by manufactured goods and by sales of vehicle fuels, which were boosted by drivers from other countries crossing the border to fill up. Inflation for food goods dropped sharply at the start of this year, and prices started to fall in the summer. This then helped increase the sales volumes at food stores, which had long been in decline. Trade, especially sales of manufactured goods and clothing, should be encouraged further by the additional tax on online purchases from third countries, which has already reduced orders of small packages, especially from Asia. The turnover of card payments to foreign online stores grew more slowly in July than in earlier months, and it fell in several categories such as internet supermarkets and general goods. Data from the Tax and Customs Board equally show a dramatic drop in the number of small packages received from China.

The options for borrowing for companies and households have remained good despite the rise in Euribor. This is confirmed by survey data and by the relatively fast growth in lending. Competition has been relatively tight in the lending market compared to what it was in the past decade, and the improved outlook for the economy has probably made the banks more ready to lend. Corporate assessments of the lending environment are better than the average of the past decade despite Euribor rising. Demand for real estate loans remains strong and the stock of housing loans was around 10% larger at the end of July than a year earlier, while the stock of loans to real estate and construction companies was 12% larger. The stock of loans to other companies is increasing, but the rate of increase slowed from 6% in spring to 3.5% by the end of July.

Figure 19. Private consumption and retail sales



Source: Statistics Estonia, Eurostat

The decline in corporate investment in the first half of the year indicates that there remains uncertainty, which is restraining expansion plans. Corporate investment was less than depreciation in the first half of the year, and so the volume of capital in the economy shrank. Investment in intangible fixed assets continuing to grow was a positive sign, and those assets are by now almost a quarter of all corporate capital formation. Intangible fixed assets, the largest part of which are capitalised costs for research and development and software development, are particularly needed if productivity is to be increased through digitalisation and the use of artificial intelligence.

Value added in most sectors has grown, but not by enough to allow bolder investment decisions. Investment declined broadly across sectors in both the first and second quarters, as investment volumes increased over the year only in ICT and other professional services. Investment volumes in manufacturing, transportation and storage, and trade have been falling for several years in a row. Data from VAT declarations confirm the weakness of investment activity in manufacturing. Unlike the GDP statistics however, the VAT declarations show that yearly growth in investment has been increasing steadily since the second quarter of 2025.

There was little transaction activity in the housing market in the first half of the year. Fewer new properties are coming to the market than before, and the number of transactions in the primary market is about 15% lower than it was in

the first half of last year. The fall in the number of transactions in the primary market was driven in the first half of 2026 above all by the real estate market in Tallinn, where recent years have seen the completion of a lot of new developments in the higher price classes that are affordable for only a limited number of buyers. The number of transactions in the secondary market still remains higher than it was last year and the average square metre price of real estate rose by an average of 3.6% from January to July, and so the total number of transactions in the housing market has risen a little this year. The purchasing power of the average net wage in the housing market is better than it was a year earlier, as the boost from the income tax reform means that

the growth in net wages has been notably faster than that in prices for apartments.

Companies continued to increase their inventories in the second quarter, but the growth was slower than at the start of the year, when warehouses were being stocked rapidly. Purchases of goods held for sale slowed in wholesale and retail trade, as did stocking up of raw materials and inputs in manufacturing. Estimates by manufacturing companies for demand and new orders were better in the second quarter than in the first though, indicating that inventory management is behind the change rather than weak demand.

Box 2. How the saving behaviour of households has been affected by increased contributions to the second pension pillar

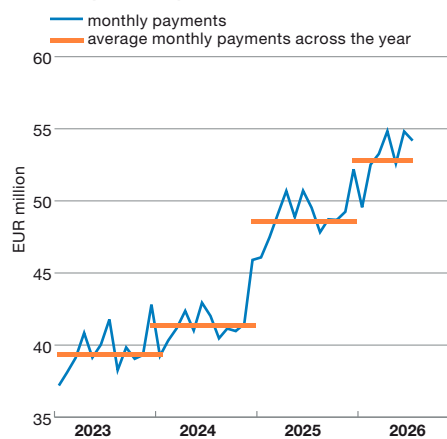
The change to make the second pension pillar voluntary and the large payouts five years ago to savers before they reached retirement age reduced the total financial investment of households in shares and investment funds. However, the state later gave an additional incentive in 2025 to people who save in the second pillar, allowing them to raise the share of their pre-tax wage income that they contribute to the pension fund to 4% or 6%.

Data from the Pensionikeskus pension register show that contributions to the second pillar funds increased after the changes in 2025 by over 17% to 583 million euros¹⁷. Contributions in the previous year had totalled 496 million euros. The option of increasing their contributions was used by 74,000 people last year, with some

two thirds of those who changed their contribution rate raising it to 6%. The average monthly contribution also increased (see Figure B2.1). The average of total monthly payments to second pillar funds was 39 million euros in 2023¹⁸ and 41 million in 2024, but once it became possible to raise the contribution to up to 6% in 2025, the total amount paid in each month rose to an average of 48.5 million euros.

The increase in the payments to the second pillar is estimated to have raised the household saving rate last year by 0.3%. If payments to the second pillar had increased at the same rate as the payroll did, the yearly growth in them would have been around 28 million euros, but they actually increased by 86 million euros, and that at a time when the number of participants in the second pillar fell a little. This meant that households saved about 60 million euros more last year

Figure B2.1. Monthly payments to the second pension pillar



Sources: Eurostat, Eesti Pank

¹⁷ Including pension investment accounts.

¹⁸ The figure for payments in 2023 excludes the extraordinary large inflows in the January that included rebates from the state and compensation for payments that were paused during the pandemic.

by increasing their contribution rate. It is possible that this money would have gone into savings in any case, but regular monthly payments help to maintain savings discipline and reduce the likelihood of the money being used for current spending.

The increase in contributions to the second pillar has also boosted saving this year. The payment rate can be raised or lowered each year, and a further 33,000 applications to increase payments had been submitted by the start of 2026. Growth of around 6% in the payroll in the first half of the year would imply an increase of 23 million euros in second pillar contributions from January to August, but the actual additional amount saved was 12 million euros more than that. Regular monthly payments to second pillar funds and pension investment accounts have averaged 53 million euros a month this year.

The income tax rate rose at the start of 2025, limiting the growth in disposable income for consumption, and so also the amount that people were able to save. However, some pension savers in the second pillar raised their contribution rate at the same time and put around 60 million euros more into their savings, helping raise the saving rate.

EXTERNAL BALANCE AND COMPETITIVENESS

Demand from Estonia's main trading partners improved in the second quarter and sales of goods and services in foreign markets increased. The volume of exports from Estonia was 2.8% up over the year in the second quarter as exports of goods increased by 4.2% and exports of services by 0.8%. Increased imports of goods expanded the volume of imports, which was 6.9% larger than a year earlier, while imports of services were down by 1%.

The growth in exports of goods was backed by increased sales from manufacturing in foreign markets. Growth in exports of machinery and equipment, including electrical equipment,

made the largest contribution to the increased turnover of exports in the second quarter. Sales of metal products also increased in May and June. An increase in the turnover of exports of mineral fuels also made a large contribution to the growth in exports, though it came partly from the rise in prices (see Figure 20). The countries to which the turnover of goods exported increased most were Latvia, where exports of electricity had an impact, and the Netherlands, where sales of oil-shale oil increased. Exports to Latvia and Poland have however recorded the fastest growth over the past 12 months on average. The increased turnover of exports of machinery and equipment, especially electrical equipment, may receive support from the growing demand that is driven by the construction of data centres and the other infrastructure needed for artificial intelligence. Growth in exports

Figure 20. Exports of goods and contributions of groups of goods

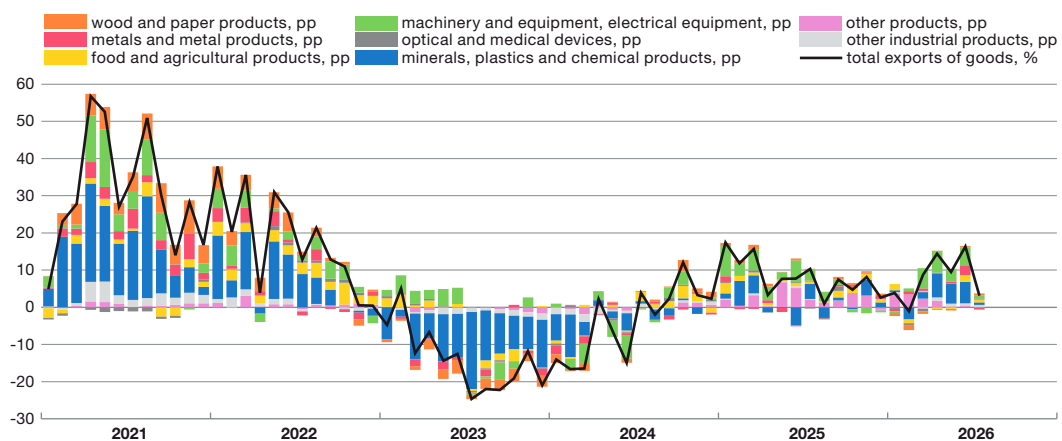
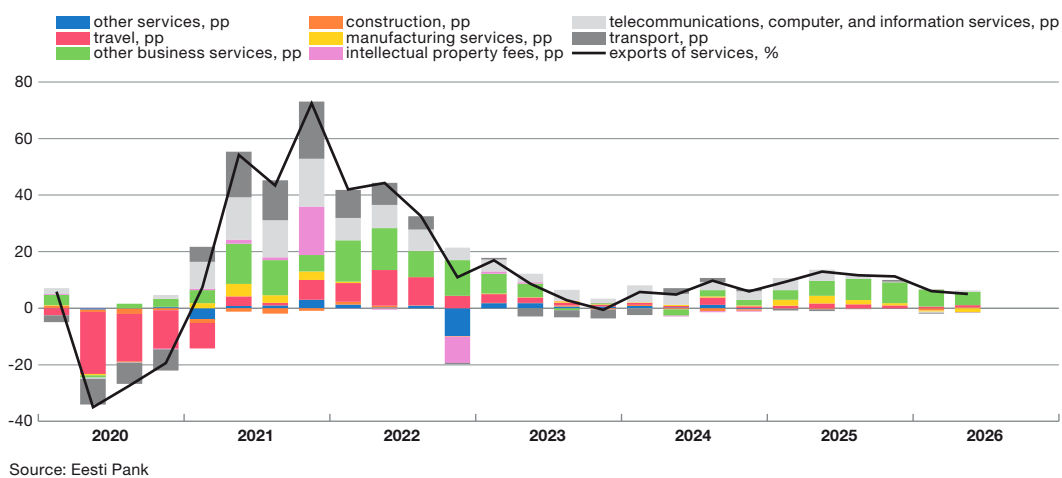


Figure 21. Exports of services and contributions of groups of services

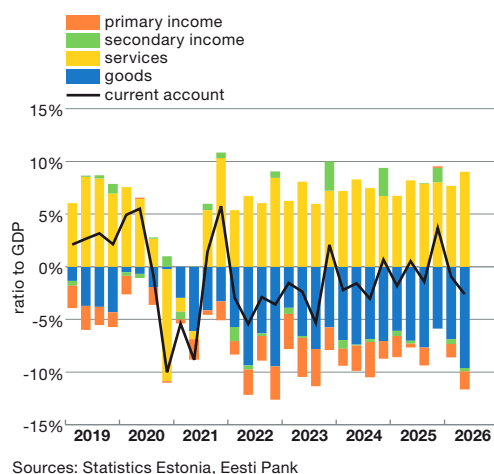


to Finland was also positive, and this has long been awaited. Data from the balance of payments indicate growth of 7% in the turnover of exports of goods in the second quarter.

Imports of goods have been affected this year by the purchases related to the investment in national defence. The revival in private consumption also boosted imports in the second quarter. The turnover of imports of goods was 8% more than a year earlier, and the biggest contributors to the growth were imports of machinery and equipment, and of electronics. The turnover of services imports was up by a little over 1% over the year. The largest part of imports of services was business services, at a little over a third of them, while transport services and ICT services were each around a fifth.

The growth in services exports has long been driven by the growth in business services, and exports of ICT services have also been strong. The turnover of services exports was up by 5% in the second quarter as exports of business services again took the lead with growth of 17%. The growth in exports of travel services was also strong at 7%, while growth in the turnover of exports of telecommunications and computer services has been more modest this year than previously, and was 2% in the second quarter. Computer services are the largest part of that sector, and sales of them in foreign markets increased by 4% (see Figure 21). The turnover of exports of transport services was down by 1% in the second quarter, but it is positive to note that exports of freight transport by road grew by 10%

Figure 22. Current account

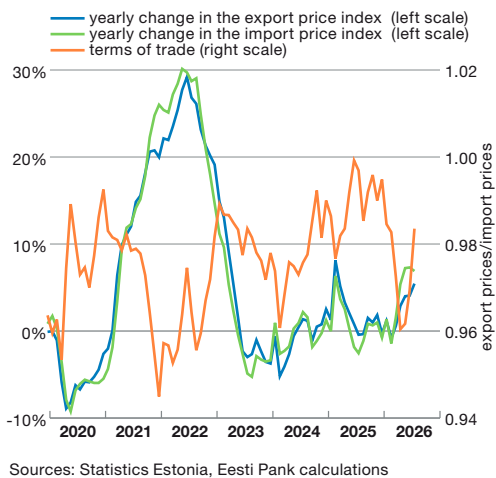


in the second quarter having long been in decline. The turnover of exports of maritime transport also continued to grow, gaining 9%. Maritime transport accounts for about a quarter of exports of transport services, and road transport for a third.

The balance of payments showed the current account was 290 million euros in deficit in the second quarter of 2026, or 2.6% of GDP. This deficit was larger than that in the same quarter of last year though, as imports of goods grew faster. The deficit on the goods account widened to 1.1 billion euros, but the surplus on the services account bolstered the current account in the second quarter (see Figure 22).

Terms of trade deteriorated in the first half of 2026 as prices of imports rose faster than prices of exports (see Figure 23). The situation

Figure 23. Export and import price indexes



improved a little in the second quarter, but import prices continued to rise fast. This was affected most by the rise in energy prices in response to the war between the USA and Iran.

THE LABOUR MARKET

Labour force participation was lower than previously in the fourth quarter of 2025 and the first half of 2026. The labour force participation rate shows the share of people of working age who are either working or actively looking for a job and ready to start work within a short time. There were around 10,000 fewer people unemployed in the second quarter than a year earlier, but the number of people in employment fell at the same time. This may be a temporary phenomenon caused by difficulties in the labour market in recent years, where the shortage of vacancies and the large number of applicants has made it hard to find a job. It may also be a consequence of changes in the unemployment benefit system. People who had not recently been in employment, such as those who had been studying full-time, at home with children, or caring for relatives, earlier had the right to receive unemployment benefits, but the basic level of unemployment insurance that has replaced those benefits requires them to have been in work previously. This may make it harder to start the search for a job.

Demand for labour from the private sector has not overall increased. The labour force survey showed that there were as many people employed at Estonian companies and institutions in the second quarter as there were a year earlier, but the number of people receiving a

Figure 24. Employment at Estonian companies and institutions, seasonally adjusted

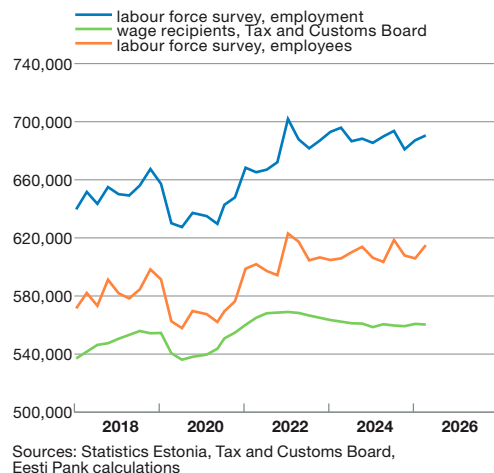
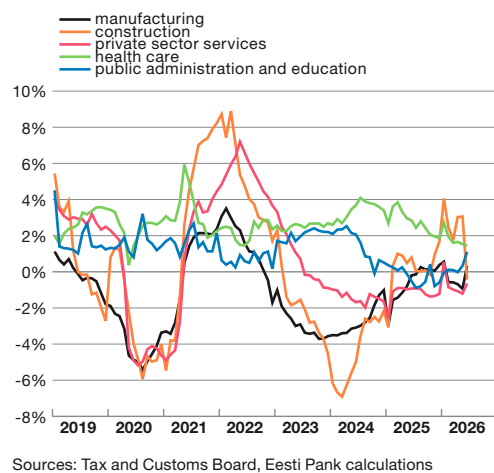


Figure 25. Yearly change in the number of declared wage recipients



wage rose by 2% (see Figure 24). Data from the Tax and Customs Board, which cover everybody declared as receiving a wage, show the situation to be weaker as the number of people receiving a wage was the same as a year earlier. The number receiving a wage from companies in the business register fell by 0.3%, while the number in the rest of the economy rose by 0.9%. The number of people receiving a wage in construction in the private sector rose by around 2% in the second quarter (see Figure 25), which may have been driven by the work on Rail Baltica. The number earning a wage in manufacturing fell by 0.4% meanwhile. The data for June and July showed employment falling in construction and rising in manufacturing, though it is possible that some companies operate at the meeting point of the two sectors. Employment in services fell even as expectations for it improved. The number of people working in the government

sector rose again in healthcare, while it also started to increase again in public administration and education taken together.

The number of jobs intermediated by Töötukassa has not yet shown signs of a lasting upwards trend. The number of vacancies started to rise at the end of 2025 and increased in the first quarter of 2026, but it remained unchanged over the year in the second quarter. The figures for June, July and August were better, as there were on average 17.5% more jobs available in those months than a year previously. The sectors that contributed most to the rise in the number of vacancies were construction and retail. The total number of vacancies in manufacturing in the second quarter was down over the year, but it started to rise again in the summer.

Unemployment fell to 6.6% in second quarter, though this was because labour force participation was lower, not because employment was higher. The average unemployment rate in May, June and July, which is an indicator that foreshadows the third quarter of 2026, rose to 6.9% as the number of people unemployed rose from 49,000 to 51,000 (see Figure 26). Unfortunately this again indicates a decline in participation in the labour force, though the participation rate remains one of the highest in the European Union despite falling. The number of people registered as unemployed was down by 12% over the year in the second quarter of 2026, but the faster fall in the summer months in the number of young people registering as unemployed shows that the change in the system of unemployment benefits had an impact.

Data from Statistics Estonia show the average gross monthly wage rose in the second quarter by 5.5%. Wage growth slowed in the private sector, while collective agreements meant it was faster in the public sector in education, healthcare and public administration than a year earlier (see Figure 27). The rise of 6.8% in the minimum wage from the start of April boosted the growth in wages that are below the average, while the growth in higher wages slowed. The recovery in the economy is reflected in wages rising faster than the average in manufacturing and construction. The average wage in those sectors fell relative to the average in the economy during the recession, but it is now climbing back. Low inflation meant that the growth in real wages

Figure 26. Unemployment

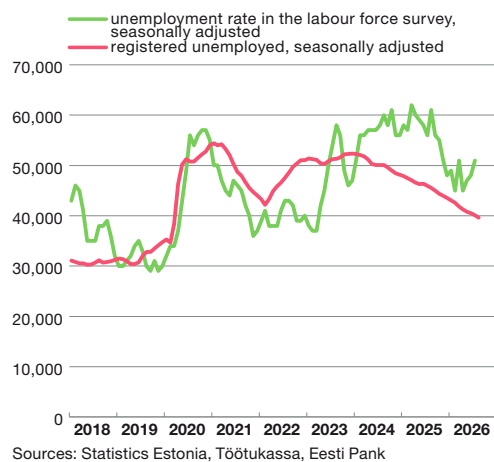


Figure 27. Yearly change in average wages

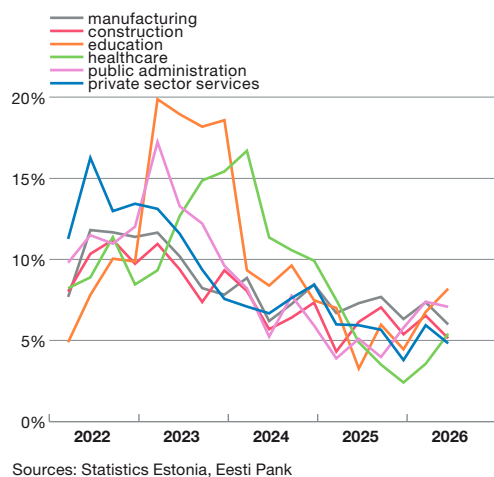
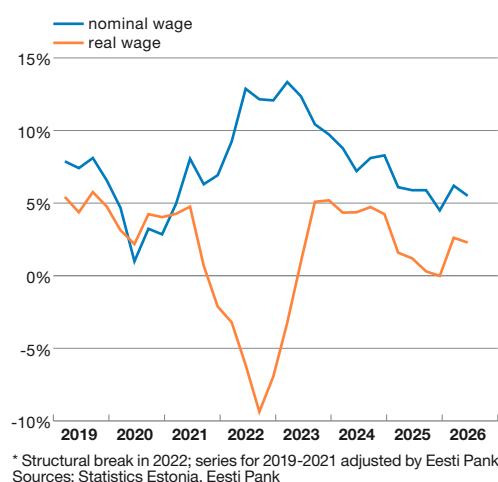
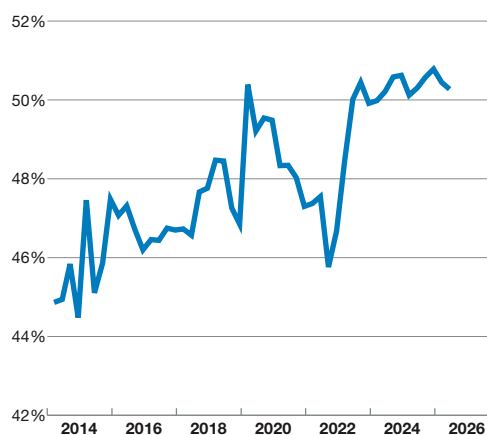


Figure 28. Yearly change in average wages*



picked up to 2.5% in the first quarter of 2026 (see Figure 28). The purchasing power of the average net wage rose even faster, gaining an estimated 7.4%, as the elimination of the tax hump lowered the average income tax rate. The payroll as a share of the total economy remained the same in the first half of 2026 as it was a year earlier. This means that the labour costs of production are not rising any more, but nor have they started to come down yet from the high level they reached during the recession (see Figure 29).

Figure 29. Labour share in GDP, seasonally adjusted



Sources: Statistics Estonia, Eesti Pank calculations

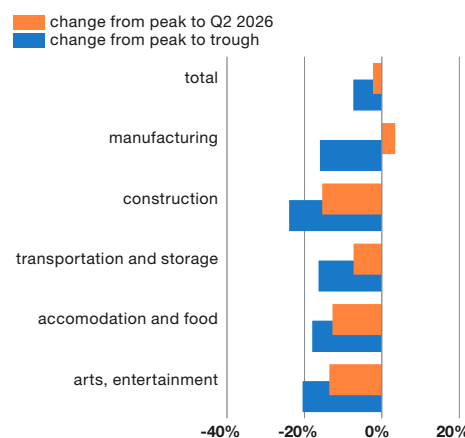
Box 3: How much can the Estonian economy grow without employment increasing?

The output of the Estonian economy dropped by substantially more than employment did during the recession of 2022–2023 and there was a fall in labour productivity, or the real value added per employee. Companies often hoard labour and avoid reducing their headcount of staff during a recession to the same degree that demand declines, as firing and hiring is expensive, especially when there are long-term labour shortages. The drop in productivity that this causes is temporary, as the companies are able to use their existing employees to increase output and regain productivity when economic activity rebounds. This box assesses how much space there was by the second quarter of 2026 for value added to grow as a consequence of productivity recovering.

This analysis calculates labour productivity as the ratio of seasonally adjusted real value added to the number of wage earners across ten sector groups. The indicator chosen for employment is wage recipients in the register data, as the estimates in the labour force survey are quarterly and are not precise enough across sectors. The peak of productivity before the recession is found for each sector group, and then the lowest point of productivity and the level of it in the second quarter of 2026. These values are used to calculate how much value added in each sector would need to increase by for productivity to recover to its peak from before the recession, and what level of growth that would indicate for the whole economy.

The fall in productivity for the whole economy from its peak in the first quarter of 2022 to the second quarter of 2023 was around 7.4%. Some 69% of this fall had been recovered by the second quarter of 2026, and productivity was around 2.3% below its earlier peak. This aggregate figure hides some large differences between sectors however. One of the largest productivity gaps is in construction (see Figure B3.1). Productivity in construction peaked in the

Figure B3.1. Change in productivity during the most recent recession and recovery



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

third quarter of 2021 and then fell by almost 24% to the end of 2025. It has recovered in recent quarters, but in the second quarter of 2026 it still remained around 15% below its earlier peak. It would need to rise by around 18% from its current level to return to that peak. Construction did not adjust to the recession entirely by holding on to labour, as there was a notable fall in employment in the sector as well as in productivity. There are also reserves of productivity in accommodation and food service, transport, and arts, entertainment and leisure, as productivity in accommodation and food services is 18% lower than it was in the first quarter of 2024, when the number of tourists arriving from Russia had already fallen and the temporary impact from the arrival of refugees from the war in Ukraine had faded. The transport sector was particularly hit by the disappearance of the transit trade with Russia, which has proved a permanent change. To avoid counting this in the potential for recovery, it is only the fall since the start of 2024 that is considered here. Labour productivity in arts, entertainment and leisure was around a fifth lower than it was before the recession.

The unwinding of labour hoarding in manufacturing has already ended. The total value added is still recovering and remains 2% lower than it was before the recession, but employment has fallen more than output and so productivity exceeds its earlier peak. There are several other sectors besides manufacturing where value added should not be expected to grow in response to the recovery in productivity as there was no decline in productivity in them during the recession. These sectors are mainly services with high productivity such as information and communications, real estate, research and development, and administrative and support activities, and also some parts of the public sector.

Two sectors stand out as notable exceptions. The first is energy, where productivity was temporarily very high during the energy crisis, and it should probably not be expected that it will return to that level again. The other is finance, where real value added is hard to measure and the rapid growth in employment in recent years is an indicator of structural changes.

If employment measured as the number of employees receiving a wage were to remain at the level of the second quarter of 2026 in all sectors and productivity in those sectors where it is clearly cyclical were to return to its level of before the recession, real value added in the economy would increase by around 2-2.5%. This was also shown by the estimate found from the aggregate indicators for the economy. Construction would contribute around 1.2 percentage points of this, accommodation and food service 0.6 percentage point, and other sectors a total of 0.7 percentage point. Further growth in value added in those sectors where employment fell by as much as value added during the recession or where the readjustment after the recession has been completed will depend on technological development, an increase in capital per employee, or a larger contribution from labour in the form of either more employees, or more hours worked per employee.

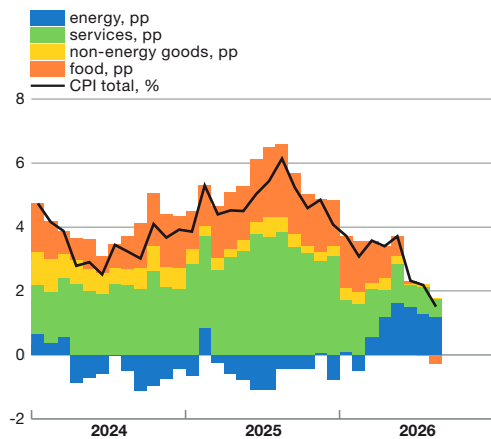
PRICES

Inflation slowed sharply in the summer months. Inflation in Estonia was the lowest in the euro area in July at 2.0% and in August at 1.3%. This is partly because the rise in VAT a year earlier passed out from the inflation figures. Falling food prices and prices for manufactured goods and services rising more slowly combined to restrain inflation (see Figure 30). Box 4 discusses in more detail why inflation in Estonia was lower.

One of the main reasons that inflation slowed was that food prices fell. The consumer food

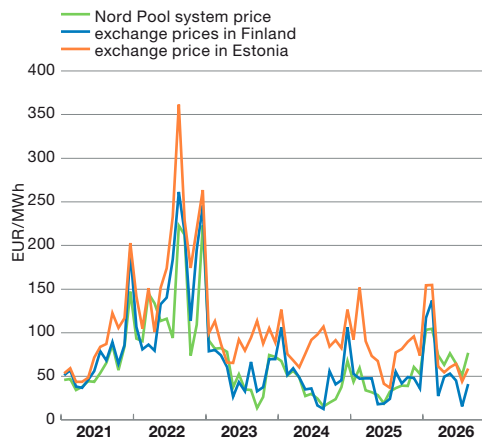
basket cost 2.6% less in August than it did a year earlier. Production volumes have increased in response to the earlier high price level, and this has brought producer and import prices for food products down. Prices for butter and other dairy products have continued on the downward track they started to follow last year. Seasonal food goods have also notably dropped in price this year, which might be explained by the weather in the Baltic states and Poland being more favourable than it was last year. Fruit was 15% cheaper in August than it was a year earlier, and vegetables were 2% cheaper.

Figure 30. CPI growth



Source: Statistics Estonia, Eesti Pank

Figure 31. Electricity exchange prices



Source: Nord Pool

Around three quarters of the yearly inflation in August came from fuels, as motor fuels started to rise in price again. The crude oil price is not as high as it was in spring after the war started between the USA and Iran, but the refining margins on fuels have increased sharply. Europe relies on external suppliers for its diesel, and imports of diesel have been interrupted since the spring. Increased demand in the second half of summer also led the refining margin for petrol to increase. The market price of electricity was a quarter lower in August than a year earlier, but the final price for consumers rose a little (see Figure 31). Prices mainly rose because fixed-rate packages became more expensive, and also to some extent because fees were introduced in January for the frequency reserve and security of supply.

The rate of inflation in Estonia for services and manufactured goods was one of the lowest in the euro area in the summer. Inflation for manufactured goods has for some time now been held down by falling prices for clothing. This has mainly happened because import prices have been low, while the margins of retailers have remained large. Inflation for services has been held down this year by prices for accommodation services and package holidays falling over the year. Tight competition in the insurance market has pushed insurers to look for ways of cutting their prices. New price pressures have appeared at the same time from price rises for waste transport services and water services, and the seasonal rise in rental prices.

Box 4. The background to falling inflation in Estonia

Inflation has fallen sharply in Estonia in recent months to the lowest levels in the euro area. This has only happened once before, at the start of the pandemic in 2020. This box looks at the reasons why inflation has been lower in Estonia.

The harmonised index of consumer prices was 2.0% higher in July in Estonia than a year earlier, while the average in the euro area was almost one percentage point higher than that (see Figure B4.1). Services was the main reason inflation in Estonia was lower than the average in the euro area, as the contribution of services to inflation was 0.75 percentage point smaller in Estonia. The difference was increased by motor fuels contributing 0.42 percentage point less, and inflation falling for unprocessed food and industrial goods. The energy costs of housing had the opposite impact, as inflation for electricity, gas and heating was notably higher in Estonia than in the euro area on average.

Indirect taxes account for a large part of the differences in inflation between countries. Tax changes meant that inflation in Estonia in July was around 0.35 percentage point higher than

Figure B4.1. Yearly HICP growth, July 2026

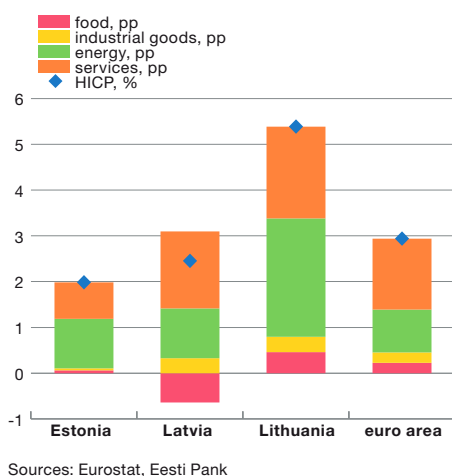
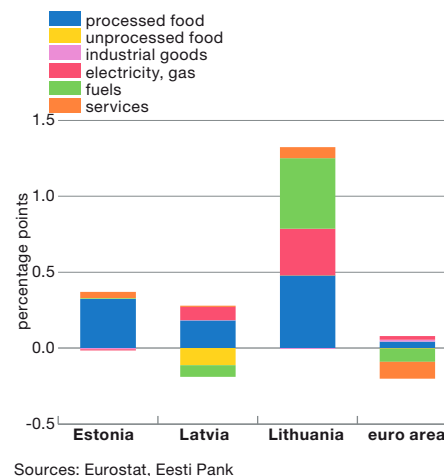


Figure B4.2. Contribution of indirect taxes to inflation, July 2026



the HICP calculated with constant tax rates (see Figure B4.2). Taxes contributed more than one percentage point in Lithuania, while they added very little in Latvia and had a small negative impact in the euro area as a whole. Indirect taxes consequently increased the difference between the inflation rates in Estonia and Lithuania, and brought Estonian inflation closer to that in the euro area. Food prices fell in Latvia, as the VAT rate on bread, milk, chicken and eggs was cut from 21% to 12% in July. The lower rate already applied to fresh fruit and vegetables. The rise in energy excise in Estonia that was planned for May 2026 was cancelled and the next rise, which will be larger than originally intended by the amount that was cancelled, was postponed to 2027. This decision lowered the consumer price index for 2026 by about 0.1% from what it would have been with the tax policy originally planned.

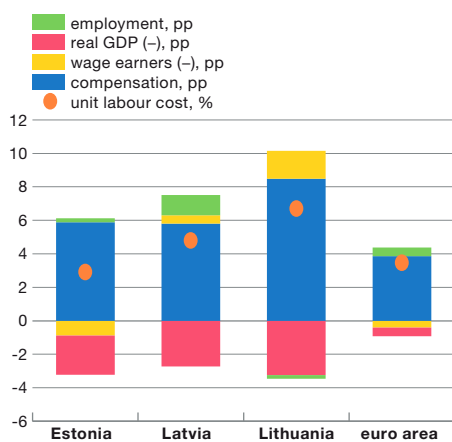
Motor fuels were responsible for part of the difference between inflation rates in Estonia and Lithuania and the euro area. Fuel rose in price by 8.3% over the year in Estonia, while inflation for fuels in Lithuania and the euro area as a whole was much faster. A price war that started in autumn 2025 in the Estonian fuel market squeezed the retail margins on fuel. Competition became tighter after one chain of filling stations stopped offering special prices for loyalty card holders, and the other chains followed suit.

The situation in the electricity market was the opposite. Hot weather and the increased use of gas-fired power plants pushed electricity prices higher in Central Europe, and so several euro area countries were forced to reduce their network charges for electricity. Consumer prices for electricity consequently rose more slowly in the euro area.

Low inflation this year reflects both the high reference base and the general softening of price pressures. Inflation trimmed by 10% to exclude the largest price changes fell in July from 4.24% to 2.3%. This shows that inflation did not come down because of exceptional one-off price falls, but did so across a large part of the consumer basket. The disappearance of the impact from the extreme price rises last year explains about a third of the drop in inflation in July. The remainder came from price pressures weakening across a broad base as prices rose more slowly in the central part of the distribution of price changes.

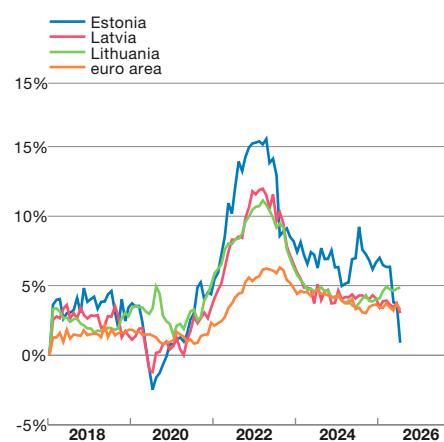
More moderate growth in labour costs helps to explain why inflation for services was lower in Estonia than elsewhere in the Baltic states. The nominal unit labour cost rose in first half of 2026 by around 3% in Estonia, 5% in Latvia, and 7% in Lithuania. Compensation per employee increased by around 5% in Estonia, but the growth in the labour costs per unit of production was

Figure B4.3 Nominal unit labour cost, Q1-2 2026



Sources: Eurostat, Eesti Pank

Figure B4.4. Wage-sensitive underlying inflation



Sources: Eurostat, Eesti Pank

restrained by an increase of around 2% in productivity. Compensation per employee in Lithuania meanwhile increased by 10%.

The indicators for core inflation confirm the differences in price pressures. Core inflation, which strips out food, alcohol, tobacco and energy, was 1.5% in Estonia in July, while it was 3% in Latvia and Lithuania, and 2.4% in the euro area. Cyclically sensitive supercore inflation based on the output gap¹⁹ was higher in Estonia than in the euro area, but was still lower in recent months than it was in Latvia or Lithuania. This shows that the cyclical price pressures coming from slightly faster wage growth and more buoyant consumption are stronger in the other two Baltic states. Domestic demand in Lithuania has been supported by fast growth in wages and the pension reform in early 2026 that allowed people to withdraw their savings from the second pension pillar.

Wage-sensitive underlying inflation²⁰ has been highly volatile in Estonia in recent years. It stood at 7.6% as recently as July 2025, but had fallen sharply by July 2026 (see Figure B4.4). It fell because the earlier leaps in price had passed out from the yearly calculation, and price pressures in labour-intensive services had weakened. Components that have a larger weight in the wage-sensitive HICPX basket for Estonia are food service, other personal services, outpatient healthcare, culture and leisure services, accommodation, and education.

In summary it was a combination of factors that meant inflation was lower in Estonia than in the euro area. The biggest factors were that price pressures were smaller in services, and food prices fell. Lower inflation for the components of core inflation indicates that the pass-through of wage costs into consumer prices has weakened, while improved productivity has also restrained inflation.

¹⁹ Supercore inflation is found by estimating the cyclical sensitivity of components of core inflation with a Phillips regression, where quarterly inflation is explained with a lag by the output gap and the rise in import prices. The basket contains components for which the output gap coefficient is positive and statistically significant, and inflation for them was aggregated using HICP weights.

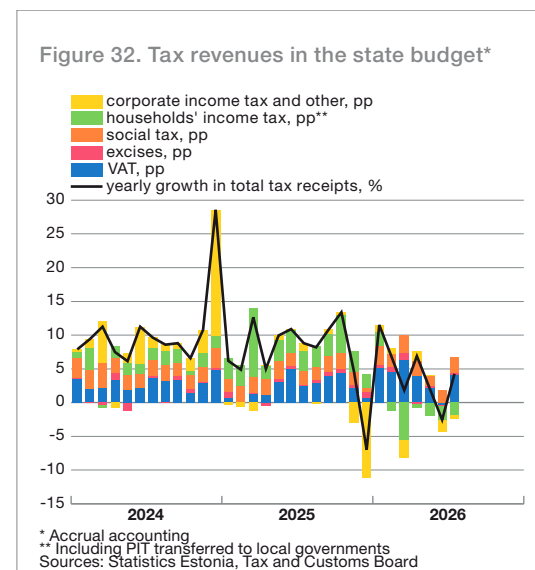
²⁰ Wage-sensitive underlying inflation is found by calculating the wage costs in each sector as a share of input costs using the input output tables and transferring these to the HICP components of core inflation using the correlation tables. Components within a country are considered wage sensitive if their wage intensity exceeds the average for it in the core inflation basket.

GENERAL GOVERNMENT FINANCING

The growth in tax revenues slowed noticeably in the second quarter (see Figure 32). This was affected above all by personal income tax, as receipts were reduced by the introduction of the uniform tax-free income rate. Receipts of personal income tax each month from May to August were on average 9.5% smaller than a year previously. The growth in VAT receipts was also modest. VAT receipts were up by 6.4% over the year in the second quarter, though the growth in them was not large given the rise in the standard rate of VAT in July 2025 from 22% to 24%. Once the rise in the VAT rate no longer affected the calculation in July, receipts of VAT were 14.9% higher over the year. The monthly growth rates for VAT receipts are quite variable and it is not possible to estimate from one single month whether the increase in the rate of growth in receipts will be a permanent one. Favourable developments in the labour market and wage growth were reflected in receipts of social tax, which were 5.2% higher in the second quarter than a year earlier, and 6.1% higher in July.

The growth in general government investment picked up in the second quarter, as investment was up by 23.6%, or about 162 million euros, over the year. This large increase came from investment in construction of buildings and structures, as some 240 million euros more was spent on that than a year earlier. It was driven mainly by construction work for rail and road transport, especially the work to build Rail Baltica. The amount invested in machinery meanwhile was around 100 million euros less than it was a year earlier. The data for the first half of the year on investment in machinery and equipment do not yet show the large increase in investment in national defence planned for this year.

The largest part of general government consumption expenditure comes from the payroll, and the rate of growth in that rose



even further in the second quarter. Data from Statistics Estonia show that the payroll was 8.4% or about 108 million euros larger than a year previously. The increase was led by large pay rises at the start of the year in national defence, education and internal security. The growth in the payroll was boosted further in the second quarter by healthcare, as a collective agreement came into force in April that raised the minimum rates of pay by 5%. The notably smaller increase in April last year in the minimum rates of pay was still affecting wage rises in healthcare in the first quarter. Total general government spending on consumption in the second quarter was 165.1 million euros more than a year previously.

Preliminary data show that rates of increase over the year in the main components of general government expenditures such as the payroll, social benefits paid in cash, investment, and intermediate consumption were higher in the second quarter than a year earlier. This indicates in combination with the slower growth in tax revenues that the general government fiscal deficit increased in the second quarter and was probably larger than it was a year before.

THE EESTI PANK ECONOMIC FORECAST FOR 2026-2028

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 correspondence 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

The global economy will continue to grow at a moderate rate with support coming mostly from the strong growth in investment in technology. The International Monetary Fund (IMF) forecasts that the global economy will grow by 3.0% in 2026, 3.4% in 2027, and 3.2% in 2028²¹. The IMF and the OECD estimate that growth in the global economy will be supported by investment in artificial intelligence and by trade²². The Bank for International Settlements (BIS) considers that global investment in artificial intelligence in 2026 will be around 500 billion US dollars and market participants consider it may increase to 3-4 trillion dollars a year by 2030²³. More than half of the investment in data centres and other infrastructure for artificial intelligence will be made outside the US. It may have an impact far beyond the technology sector, as building technology infrastructure needs electricity, electrical networks, production equipment and raw materials²⁴. The war in the Middle East, high energy prices, high yields on sovereign bonds, and tighter financing conditions will hold growth in the global economy back though, and make the global economy more vulnerable to new shocks. Aside from larger shocks, those problems could also amplify one another, intensifying the impact of them.

The outlook for growth in the global economy in different countries depends increasingly

on how each country is connected to the technology value chains and on how independent its energy supply is. Increased investment in artificial intelligence will particularly benefit countries that are part of the value chains for semiconductors, data centres and other technological infrastructure such as Taiwan, South Korea and Malaysia. It is not clear though how quickly the investment will result in productivity growth, and whether the current pricing and financing of it will prove sustainable. The IMF estimates that the US economy will grow by 2.3% in 2026 and 2.2% in 2027. It will be supported by large investments in technology, a looser fiscal policy, relatively favourable financing conditions, and growth in private consumption, but demand will be limited by higher long-term interest rates and expectations of monetary policy tightening. Growth in the United Kingdom economy will slow because of the energy shock to 1.0% this year, but will pick up to 1.3% in 2027 as the impact of that shock fades. Growth in the Chinese economy will slow to 4.6% this year and 4.1% in 2027, as domestic demand remains weak and the problems in the real estate sector are acting as a brake on growth. The Indian economy will again be one of the fastest growing large economies, with growth of 6.4% in 2026 and 6.7% in 2027.

Higher energy prices have again strengthened global price pressures, but they should ease gradually as those prices fall, though the war in the Middle East has increased uncertainty about the outlook. The IMF forecasts that average global inflation will rise from 4.1% in 2025 to 4.7% this year, but will then fall to 3.9% in 2027 and 3.4% in

21 IMF, *World Economic Outlook Update: Global Economy in Crosscurrents of War and Technology*, July 2026.

22 OECD, *Economic Outlook, Volume 2026 Issue 1*, June 2026.

23 BIS, *Artificial intelligence, growth and financial stability: challenges for central banks*, September 2026.

24 IEA, *World Energy Investment 2026*, June 2026.

2028. Inflation will rise this year primarily because of higher prices for energy and food, which rose after the war started in spring between the US and Iran. The outlook for inflation moving forward depends largely on how long supply disruptions last, and on the extent to which higher energy costs pass through into the prices of goods and services and into wages. The impact of the energy shock on inflation more widely was limited in its extent in the summer, but oil prices rose again in September and the reduction in stocks means the risk has increased of the price pressures coming from energy prices enduring for longer than was earlier assumed.

Investment in technology will drive growth in international trade. The volume of goods and services traded around the globe will grow by an estimated 3.5% in 2026 and 4.3% in 2027²⁵. Trade will increasingly be affected by investment in artificial intelligence, which has high import intensity and will increase demand for semiconductors, servers, electrical equipment and other technology goods. Production of those goods is concentrated in international value chains, and so components often move through several countries before the final product is completed, meaning investment in technology will have a particularly strong impact on global trade. High tariffs, energy costs and geopolitical fracturing will restrict the growth in trade at the same time though, encouraging the reorganisation of supply chains and trade flows. The conflict in the Middle East becoming worse could again increase transport and energy costs and cause new disruptions to supply, and encourage stocking up and advance purchases of goods.

The risks to the outlook for the global economy are mainly on the downside, and the most immediate of those risks is an escalation of the conflict in the Middle East and a new energy shock resulting from it. That could raise prices for energy and commodities, make supply difficulties worse and increase inflation pressures. Global oil stocks have been reduced since the spring and there is tension in the market for refined products, meaning the buffers against new supply disruptions are smaller. With winter approaching and the need for energy increasing, this makes the global economy vulnerable to a new energy shock.

Lasting price pressures could in turn push central banks to maintain a restrictive monetary policy for longer, and to tighten financing conditions.

The other major risk is that a further rapid rise in the yields on government bonds could make financing conditions tighter. Higher long-term interest rates are increasing the cost of financing and making capital-intensive investments in artificial intelligence particularly vulnerable. The BIS estimates that the high valuations and opaque financial connections in the artificial intelligence sector will make it more exposed, and there could be a sharp revaluation on stock markets if the return on the investment is smaller than expected²⁶.

The euro area

The economy in the euro area continues to grow. Economic activity in the euro area is increasing despite the ongoing uncertainty around how the war in the Middle East will be resolved and the consequent volatility in energy prices. Sentiment continues to strengthen in the private sector and domestic demand will provide the basis for economic growth this year. Domestic demand is forecast to remain the main source of growth in the euro area economy for the time being. A good sign is that companies in the euro area are being bold in their investments, especially in solutions using artificial intelligence, and surveys show that this trend will continue in future. Public sector investment in national defence and infrastructure will continue to grow, and this will all help make the euro area more competitive. Extreme weather conditions such as the heat and drought in the summer, will however cause other problems for companies in the euro area. This has not yet had an evident impact on the economy in the euro area, but may restrain the rate of economic growth in future. The European Central Bank forecasts that GDP growth in the euro area will be 0.9% this year, and will then accelerate to 1.4% in 2027 and 1.5% in 2028. The outlook for the euro area economy will remain uncertain though because of the ongoing conflict in the Middle East, the closure of the Strait of Hormuz, and the continuing volatility in energy prices. The baseline forecast of the European Central Bank is consequently accompanied by three updated alternative scenarios²⁷.

25 IMF, *World Economic Outlook Update: Global Economy in Crosscurrents of War and Technology*, July 2026.

26 BIS, *Annual Economic Report 2026*, June 2026.

27 https://www.ecb.europa.eu/press/projections/html/ecb.projections202609_ecbstaff~8e340fc69d.en.html#toc8

Inflation will rise. Inflation is again picking up its pace in the euro area and will remain above the target of the European Central Bank for the time being. This is again because of the rise in energy prices caused by the war in the Middle East. Inflation for services has also increased recently, indicating that the impact of higher energy prices is gradually reaching other sectors. Inflation for food will remain relatively modest however. Russia's full-scale war on Ukraine has hindered grain transport in the Black Sea in recent months, and could cause prices for cereals to rise in future. The heat and drought that ravaged Europe in the summer also put pressure on local food producers. Energy prices in Europe are largely steered by the price of natural gas, and so inflation in the euro area will depend very much on that. Gas reserves in Europe are not yet at the recommended level, and so the outlook for inflation in the euro area depends largely on how quickly the conflict in the Middle East is resolved. The European Central Bank forecasts that inflation in the euro area will be 3.0% this year. It will fall to 2.5% in 2027 if the earlier rise in energy prices passes out from the yearly comparison, and it will be approaching its target in 2028 at 2.1%.

TECHNICAL ASSUMPTIONS USED IN THE FORECAST

Assumptions for the external economy

The assumptions for the external environment used in this forecast are based on those in the September forecast of the European System of Central Banks, which showed the most probable directions of development at the point they were fixed on 19 August.

Global trade has revived, which has helped increase demand in Estonia's trading

partners. The weighted imports of Estonia's trading partners will increase by 3.9% this year (see Table 2), and the growth will remain above 3% a year in the following years. Expectations for growth in demand in foreign markets this year and next are higher than they were in the June forecast. This is partly because the rise in commodities prices caused by the war between Iran and the USA has not had the negative impact on the global economy that was originally feared. The effect has also been alleviated by the global growth in investment related to artificial intelligence, which is providing impetus to growth in international trade.

The recovery in foreign demand is overshadowed though by rapid price movements in commodities markets.

The rise in the prices of key commodities does not however reflect all of the price pressures stemming from the war in Iran. Motor fuels and natural gas have risen more in price than might be concluded only from the rise in the oil price. Fuel prices have risen because refining margins have increased, and they are expected to remain higher than usual for a longer time and will come down gradually over the forecast horizon to approach where they were before energy prices started rising. Expectations for food commodities have moved in a different way to those for fuel, as they are notably lower than they were in June.

The increasing inflation pressure from energy is also reflected in rising expectations for interest rates. Future transactions indicate that the three-month Euribor will be higher than was forecast in June. Higher expectations for interest rates in the money markets show that inflation pressures are expected to increase as commodities prices rise, and monetary policy is expected to react to that.

Table 2. External assumptions in the forecast ¹⁾

	June 2026 projection						
	2025	2026	2027	2028	2026	2027	2028
Foreign demand growth (%) ²⁾	4.2	3.9	3.1	3.2	2.5	2.7	3.3
USD/EUR exchange rate	1.129	1.169	1.168	1.168	1.169	1.168	1.168
Interest rate (three-month EURIBOR, %)	2.2	2.4	3	3	2.4	2.8	2.7
Oil price (USD/barrel)	69.1	89.5	78	73.6	96.9	82.2	77.1
Price growth for food commodities (EUR, %) ³⁾	4.1	-6.6	-1.3	-0.1	-0.4	2.9	-0.2

1) Cut off date of technical assumptions is 19 August 2026, 2) Weighted growth of imports of trading partners, 3) Food commodity price index by European Commission Directorate-General for Agriculture and Rural Development (DG AGRI)
Source: European Central Bank

Table 3. Forecast assumptions for government finances

	2026	2027	2028
Government sector GFCF (EUR billion)	3.5	3.4	3.3
Government sector intermediate consumption (EUR billion)	2.9	2.9	3.4
Government sector non-tax revenues (EUR billion)	3.0	2.9	2.8

Source: Ministry of Finance

Assumptions for general government financing

The assumptions for tax policy take account of all of the tax changes that have been enacted. It is assumed that some wage recipients will not use the uniform tax-free income allowance that was introduced at the start of this year throughout the whole of 2026. This will increase tax revenues this year, but lead to rebates next year for excess income tax paid. The number of wage recipients who do not use the tax-free allowance throughout the year will gradually fall over the coming years.

The forecast for the state finances also takes account of the summer economic forecast 2026 of the Ministry of Finance for investment, intermediate consumption, and non-tax revenues (see Table 3). This means that the forecast takes account of the increase in spending on national defence to 5.3% of GDP that is expected this year, and of that spending remaining at 5.2-5.3% of GDP in the years ahead.

ECONOMIC GROWTH

Economic activity

Growth in the economy will be encouraged by a looser fiscal policy and a stronger external environment, which will support growth in exports. The elimination of the former tax hump will encourage demand directly and so will support growth in sectors that focus on the domestic market. The large budget deficit means though that the fiscal stimulus will come from borrowing by the state. The global boom in artificial intelligence will increase trade volumes and revive markets in Estonia's trading partners, indirectly helping to increase demand for Estonian products.

Demand reviving has helped companies to bring spare production capacity into use and this will help the economy grow by 2.6% this year (see key indicators for the forecast in Table 4

and comparison with forecasts by other institutions in Table 5). Spare capacity has shrunk and the output gap has narrowed however, and growth in future will need new investment and increased productivity. Economic growth in the years ahead will depend first of all on new investment and on the availability of labour with the appropriate skills. GDP is forecast to grow by 2.4% in 2027 and 2028.

The long-term potential for growth in the Estonian economy is smaller than it was over the past decade. Yearly growth of 2–2.5% of GDP may be more modest than before, but that rate of growth is in line with the economy growing in a way that was earlier seen in countries with a similar standard of living to Estonia. The potential for growth in the Estonian economy in the years after the forecast horizon will be around 2%.

Risks from the energy markets could threaten economic growth and could apply the brakes to it. Events in the Middle East have raised the price of energy commodities, though the impact on the Estonian economy has so far remained limited. A cold winter and a rise in gas prices on the global market could drive energy prices up, which could then make Estonian industry less competitive and weaken demand from households.

The labour market

Labour shortages will again become an issue in the years ahead. The decline in the working age population and the recovery in the economy will make it easier for job-seekers to find work, and at the same time make it harder for companies to find good staff. The unemployment rate has already fallen from the peak it reached during the recession and will slowly fall further during the forecast horizon. The fall will be limited though by a rise in labour force participation, as having a better chance of finding a job encourages people to return to the labour market and to stay in it for longer. Longer working lives will be supported in the longer perspective by the retirement age rising and the population being generally more healthy.

Table 4. Economic forecast by key indicators ¹⁾

	2024	2025	2026	2027	2028
Nominal GDP (EUR billion)	39.87	41.86	44.40	46.72	49.19
GDP volume ²⁾	0.2	1.3	2.6	2.4	2.4
Private consumption expenditures	0.5	-0.2	2.7	2.9	2.5
Government consumption expenditures ³⁾	1.6	2.4	2.1	0.2	3.1
Gross fixed capital formation	-5.7	2.1	-1.9	6.4	3.2
Exports	-1.6	4.8	2.8	3.3	3.3
Imports	0.4	4.7	4.5	3.4	3.7
Output gap (% of potential GDP)	-4.0	-3.3	-1.5	-0.3	0.4
CPI	3.5	4.8	3.1	2.3	2.1
HICP	3.7	4.8	2.9	2.3	2.1
GDP deflator	4.3	3.7	3.4	2.7	2.8
Unemployment rate (% of the labour force)	7.6	7.5	6.4	5.8	5.7
Employment ⁴⁾	0.2	-0.5	0.3	0.1	0.1
Average gross wage (EUR)	1981	2092	2207	2309	2419
Average gross wage growth	8.1	5.6	5.5	4.6	4.8
Median gross wage (EUR)	1628	1724	1825	1916	2013
Median gross wage	8.5	5.9	5.9	5.0	5.1
GDP per employee	0.0	1.8	2.3	2.3	2.3
Current account (% of GDP)	-1.6	0.3	-1.9	-1.9	-1.9
Budget balance (% of GDP)	-1.1	-2.0	-4.5	-4.8	-4.5

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, %				
	2024	2025	2026	2027	2028	2024	2025	2026	2027	2028
Eesti Pank	0,2	1,3	2,6	2,4	2,4	3,5 3,7*	4,8 4,8*	3,1 2,9*	2,3 2,3*	2,1 2,1*
Ministry of Finance	0,1	1,3	2,5	2,3	2,4	3,5 3,7*	4,8 4,8*	3,2 3,1*	2,8 2,8*	2,2 2,3*
European Commission	-0,1	0,6	1,6	1,7		3,7*	4,8*	4,4*	2,9*	
IMF	-0,1	0,6	1,4	1,9	2,3	3,7*	4,8*	3,8*	3,0*	2,8*
OECD	-0,1	0,5	1,8	2,7		3,7*	4,8*	4,1*	2,6*	
Consensus Economics	-0,1	0,6	2,1	2,4		3,5	4,8	3,4	2,8	
Luminor	0,2	1,2	2,0	3,0	3,0	3,5	4,8	3,0	3,0	3,0
SEB	0,2	1,3	2,5	2,8	2,7	3,7*	4,8*	3,0*	2,5*	2,4*
Swedbank	0,2	1,3	2,0	2,5	2,4	3,5	4,8	3,4	2,7	2,2

* HICP

Sources: Eesti Pank, September forecast, 22.09.2026; MoF, Summer 2026 forecast, 27.08.2026; European Commission. European Economic Forecast. Spring 2026, 21.05.2026; IMF, WEO, April 2026, 13.04.2026; OECD, Economic Outlook, Volume 2026 Issue 1, 03.06.2026; Consensus Economics, Eastern Europe Consensus Forecasts, August 2026, 19.08.2026; Luminor forecast, 16.09.2026; SEB, Nordic Outlook, August 2026, 25.08.2026; Swedbank Economic Outlook, 25.08.2026

Faster economic growth in the years ahead will need labour productivity to recover, while hiring of additional labour will play a smaller role. As smaller generations enter the labour market than those that are leaving it, companies will come under pressure to invest in

new technologies and automate work processes, and so reduce their need for labour. The success of that investment assumes that employees will develop their skills.

Wage growth will be around 5.5% this year, but will then fall to 4.5-5%. Growth in wages will slow as the long-term rate of growth in the economy and the rate of harmonisation of the price level also slow. The rate of growth in the economies of countries with similar income levels to Estonia has in the past remained around a couple of per cent. The price level in Estonia has approached the average in the European Union and so there is no longer the same room to raise prices that there was in earlier decades. This means that wage growth of 4–5% will be sustainable for Estonia in the coming years. Wages rising faster than that would make Estonia less competitive internationally. In the long term the average wage will rise together with labour productivity and consumer prices.

Domestic demand

The increased fiscal stimulus in 2026 will affect consumption with a lag. The introduction of the uniform minimum tax-free income allowance increased the disposable incomes of households at the start of 2026, but its impact on growth in private consumption will emerge gradually. The elimination of the tax hump has increased the disposable income of higher-paid employees relatively more, and so its short-term impact on consumption has proven limited, as households with higher incomes have a smaller marginal propensity to consume than the average. The elimination of the tax hump gave a permanent boost to household incomes, and so the additional income should over time be used for consumption. Growth in private consumption is consequently forecast to rise in the second half of 2026 and later.

That not everyone who could benefit from the tax-free allowance has done so yet also indicates that consumption responds with a lag, and some 17% of people have not applied the allowance. This means that around 100 million euros of disposable income will not have been claimed by households this year, but the state will return it to them next year in the form of income tax rebates. Given that people on higher incomes are overrepresented among those who have not used the tax-free allowance, their

marginal propensity to consume is likely to be below average in the short term.

The recovery in domestic and foreign demand will improve corporate confidence and create the climate for increased investment.

Production capacity utilisation in industry will increase gradually, making it necessary to expand production and replace outdated equipment. Constant pressure to raise productivity and alleviate labour shortages will drive investment in automation, digitalisation and artificial intelligence solutions, increasing demand for ICT products and contemporary data infrastructure.

As people's wealth increases, so will the desire to improve or change their living standards.

The positive developments in the Estonian economy will improve sentiment among Estonian households as well. A rise last year in the number of construction permits issued after a long period of stagnation also points to the market reviving, and new housing developments will soon reach the market. The rate of growth in investment in housing will be restrained because buyers remain cautious and price-sensitive. The number of people aged 30-40 will also fall during the forecast horizon, and data from the commercial banks show these to be the main group who take out housing loans.

The good capacity of the banks to lend and tight competition between them will mean that access to finance stays good throughout the forecast horizon.

Demand for loans remaining moderate will mean that competition between the banks that are looking to grow will be the toughest it has been in the past decade for housing loans and corporate loans.

External balance and competitiveness

Exports will be supported by strong foreign demand and diversity of markets.

Efforts by Estonian companies to diversify their target markets have started to bear fruit, as exports are now more evenly distributed across different markets. The role of Germany, Poland and Lithuania as target markets has increased. Poland has benefited from nearshoring, and is becoming an important centre of production in Europe. Demand has also increased in Estonia's traditional export markets in the Nordic countries. The growth in exports of goods will exceed 3% a

year throughout the forecast horizon. Exports of services will grow throughout the forecast horizon largely through business services.

The growth in imports will reflect the increased spending on defence. Imports of goods and services will grow by 4.7% in 2026 under the impact of investment in defence and additional inventory. Imports will grow more slowly in subsequent years, but the volume of imports will remain large as investment in defence will also be large. Additional imports in 2026 will cause the deficit on the current account to widen.

The war between the USA and Iran has pushed up the prices of fuels and commodities, making production in Europe more expensive. As Europe is dependent on imported energy, higher energy prices could make companies operating in European value chains less competitive and so limit the opportunities for growth for companies in Estonia.

PRICES

Inflation will remain at around 3% this year, but will fall in the years ahead. Higher energy prices and inflation for production inputs will increase cost pressures, but demand-side price pressures will remain softer. Indirect taxes will have a smaller impact on inflation in 2027 than in several preceding years. Inflation will be pushed up by 0.5 percentage point in 2028 by the cost of the ETS2 emissions quotas.

Energy prices will be the main driver of inflation this year, but markets expect them to return to normal over the forecast horizon. Energy prices will rise by 9% this year on average, mainly because of the rise in the price of motor fuels. The unusually wide positive price gap between crude oil and refined oil products will narrow only gradually until the end of 2027 and so consumer prices for refined oil products will remain relatively high. Higher prices for gas and electricity will pass through strongly into the housing costs of households in autumn 2026, and that will keep inflation up in the first half of 2027. Global uncertainty about supplies of oil products and gas may provoke prolonged price pressures. Markets expect that energy prices will stabilise during the forecast horizon and then start to fall, reducing inflation over the duration of the forecast.

Other imported goods alongside energy have however not risen in price in the same way. Prices for agricultural commodities will fall in total in 2026 and this will be seen in changes in consumer prices in 2027 as well. More expensive energy will affect the price of food through the price of fertilisers, though this will happen over a very long time. Prices for manufactured goods have risen modestly with a few exceptions, and depend largely on imported goods. This situation is similar to what it was before the pandemic, when prices for manufactured goods also rose slowly.

The impact of tax measures on inflation for services will fade away. Prices of services will rise by close to 4% in 2027 and around 3% in 2028, which is better aligned with growth in wages. Inflation for services will also depend a great deal on administrative decisions about healthcare and social services and the transport sector.

GENERAL GOVERNMENT FINANCING

The general government budget deficit is forecast to be 4.5% of GDP this year. There are two main reasons why the fiscal balance will be sharply worse than it was last year. The first is that it is planned for spending on defence to increase this year by almost 600 million euros from last year, which is equivalent to 1.1% of GDP, and the second is that the personal income tax burden was reduced at the start of this year and the income tax revenues of the state declined as a uniform tax-free income allowance was introduced for everyone of working age. The change to income tax will increase the deficit this year by around 1.3% of GDP from what it would have been if the previous income tax system had remained in place.

The budget deficit will increase further in 2027. The current forecast is that the deficit next year will be 4.8% of GDP, though the current assumption is that the growth in spending will slow substantially to around 3.5%. Revenues will grow even more slowly though. The growth in tax revenues was still supported in the first half of 2026 by the rise in VAT on 1 July 2025, but there are no major measures planned for increasing tax revenues in the coming years. Tax revenues will also grow more slowly next year because some wage recipients have not used their tax-free

income allowance in 2026 and their excess income tax will need to be returned to them in 2027. The use of external funding will peak this year, and it will provide less support from 2027.

The budget deficit will remain large moving forwards. Current assumptions indicate that the budget deficit in 2028 will be approximately the same as in 2026 at 4.5% of GDP.

The sharp increase in the budget deficit will give some support to domestic demand, but the higher costs will have to be covered from

borrowed money, and so the debt burden and interest payments will increase rapidly.

The current forecast is that the general government debt will reach 16.7 billion euros by the end of 2028, or 34% of GDP, and that the interest payments to service it will be around 470 million euros a year. That is 1.0% of GDP or 2.3% of the forecast general government revenues in 2028. Rising interest expenses will leave less fiscal headroom, as a larger part of revenues will be needed for servicing the earlier debt, rather than being available to finance new spending or tax policy choices.