

SCÉNARIO ÉCO

Société Générale Economic & Sector Studies

Temporary clearing

- **Global activity is showing resilience in the face of higher interest rates.** We expect a mild deceleration in the US where activity remains supported by strong household consumption and manufacturing investment. In Europe the picture is less dynamic but is avoiding a downturn. Conditions remain challenging but interest rate reductions are expected soon. Modest stimulus in China is helping the economy to avoid a deeper property-related downturn but is unlikely to provide a structural shift.
- **Monetary policy is expected to ease both sides of the Atlantic,** with ECB now likely to precede the Fed for the first cut. Sticky inflation in the US due to specific factors such as insurance and shelter could delay monetary easing and fuel US dollar strength. US labour markets post volatile signals, but early indicators display some weakness. We expect a 100bps rate cut in the euro area by the end of the year, and similar cuts by the Fed are also possible.
- **European fiscal rules come back into effect and several countries may find it difficult to comply.** Euro area spreads could be under pressure as ECB quantitative tightening will keep monetary conditions restrictive. Environmental issues may add volatility to the outlook and weigh on already stretched public finances.
- **Geopolitical risks remain elevated** with ongoing international conflicts and key elections in 2024, including US elections in November. The return of industrial policy, including sanctions and the provision of incentives, could stoke trade tensions in several sectors. This would drag on the global growth potential.

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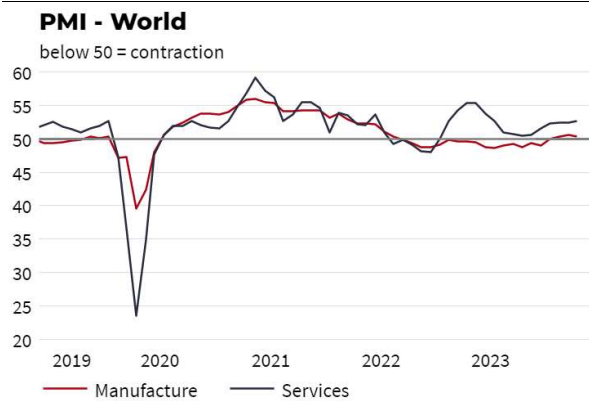
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EDITORIAL

GLOBAL ACTIVITY IS SHOWING SOME RESILIENCE

In the near term the global economy is showing resilience in the face the higher interest rates and of geopolitical and military conflicts. This is reflected mainly in the relative strenght of the US economy and a moderate recovery of international trade.

Global resiliency



Source: SG Economic and Sector Studies

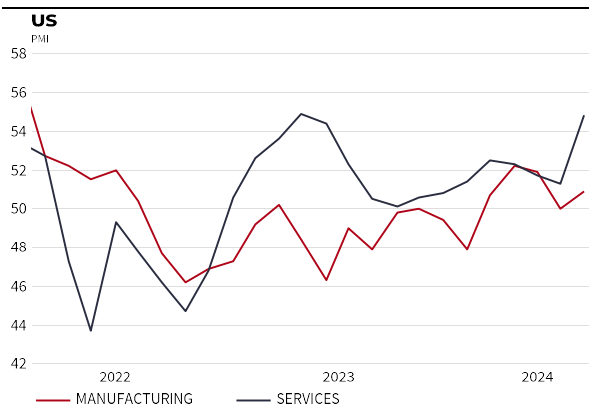
Global trade back in positive territory



Source: SG Economic and Sector Studies

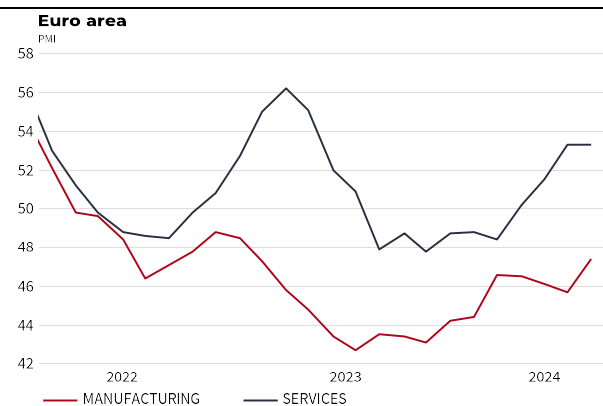
In the US activity has remained supported by relatively strong household consumption and a rising trend in manufacturing investment, but Q1 figures are reflecting some deceleration in consumer spending. In Europe the picture is less dynamic but is avoiding further downturn. Disruption to energy supply has now fully eased and interest rate reductions are expected soon. In China, government stimulus is helping the economy to navigate through the property-related slump.

Rising trend of US manufacturing



Source: SG Economic and Sector Studies

Not in the euro area

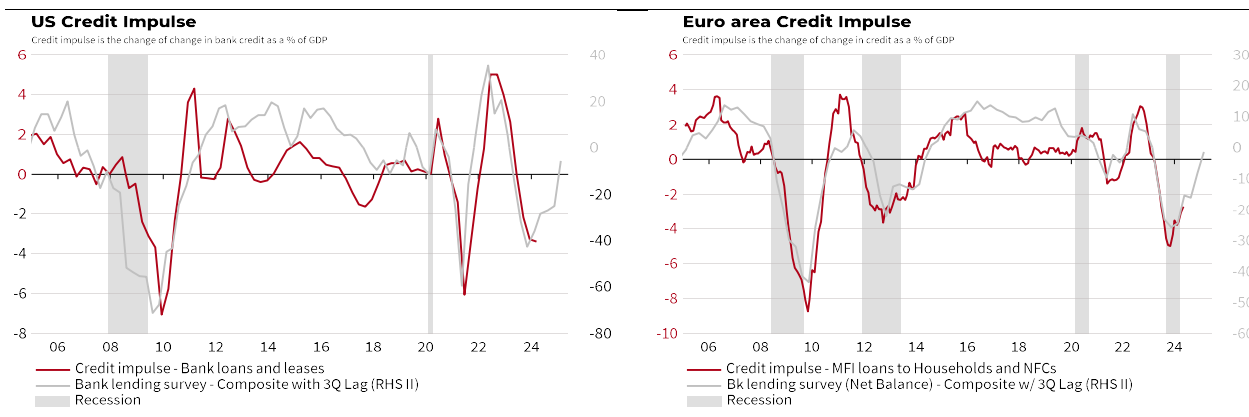


Source: SG Economic and Sector Studies

There are signs of further deceleration in the US. Job creation and wage pressures keep moderating. The credit impulse has also turned far less accommodative, and we expect to see a dampening impact over the coming quarters. The lagged effect of monetary policy tightening will impact the US economy, even if some traditional transmission channels may have been weakened. Among them, a wealth effect may

have strengthened household finances who have also been less immediately sensitive to changes in interest rates as mortgage rates are now mostly fixed or semi-fixed rates.

Monetary policy transmission is making its way ...and credit conditions are still tightening



Source: SG Economic and Sector Studies

Source: SG Economic and Sector Studies

On the fiscal side, we expect some tightening in the US, but uncertainty is significant with the upcoming Presidential elections. In the euro area, the reactivation of the fiscal rules will see ongoing tightening of fiscal policy. We expect the lagged effects of this tighter policy mix in Europe to continue to mark headwinds to economic activity in 2025-2026. In countries like France or Germany, the commercial real estate crisis shows only few signs of healing and will not recover quickly.

FIRST RATE CUTS EXPECTED IN H2

The pace of disinflation and signs of lesser tensions in the labour markets should set the path for first rate cuts in the months to come. The ECB already started cutting rates by 25bps in June and we expect three more cuts until end 2024. The Fed would start to cut rates in September, with three 25bps cuts in 2024. However, the level of interest rates will remain above what can be considered as expansionary or neutral. Quantitative tightening is expected to continue both sides of the Atlantic near term, but with a likely end in the US in late 2024 and continuation in the euro area beyond.

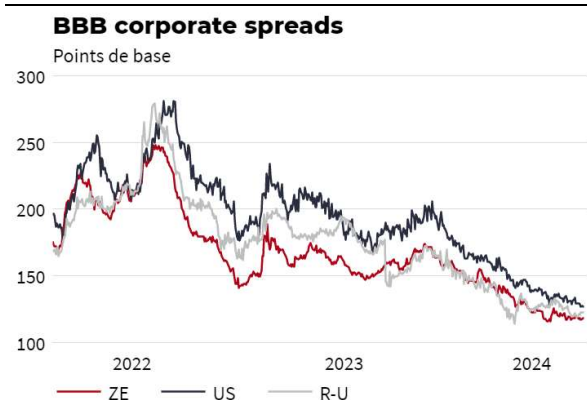
RISK APPETITE, PRESENTLY ELEVATED, IS LIKELY TO CORRECT

US growth resilience has fuelled markets perceptions that the end of the monetary tightening cycle will be followed by a soft landing. Corporate and Sovereign spreads have rallied and are now at levels observed before the start of the US monetary tightening cycle. Sovereign spreads in the euro area have reached their lowest levels since 2021.

Sovereign spreads in the euro area have narrowed despite uncertainties related to the optimistic assumptions in Italian and French fiscal plans for 2024 as noted by the European Commission. Markets also did barely move when France and Italy significantly signalled their deviation from their targets at the end of 2023. Risk

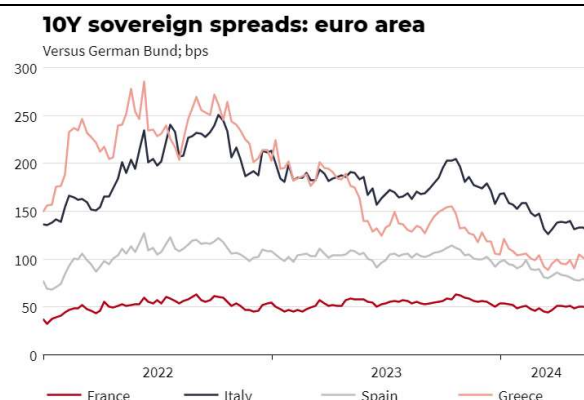
appetite has also broadened to non-investment grade borrowers, with the first sub-Saharan sovereign bond issuances since 2022.

Risk appetite is back on rate cuts expectations



Source: SG Economic and Sector Studies

...and stable euro area sovereign spreads



Source: SG Economic and Sector Studies

Risks of increased volatility in the months to come cannot be ruled out given relatively weak growth, high debt and higher funding costs.

GEOPOLITICAL AND CLIMATE ISSUES TO SHAPE THE OUTLOOK

The electoral agenda (European parliamentary elections in June, US elections in November) and the ongoing conflicts and geopolitical tensions are likely to shape the outlook. The return of industrial policies, including sanctions and the provision of new incentives, will stoke trade tensions in strategic sectors and could push firms to adopt less efficient supply chains.

Trade tensions are also shaped by concerns on green competition. The anti-subsidy investigation launched by the EU Commission on 4 October 2023 on battery electrical vehicles (BEVs) should see a preliminary report published early July, at which time provisional duties may be imposed. The outcome could shape both car prices and activity in the euro area, with the risk of retaliatory measures.

The EU's Carbon Border Adjustment Mechanism (CBAM) will see companies submit their first reporting in 2024. The permanent system is due to come in 2026. The outcome could also push corporates to reshape their supply chains.

The ongoing El Niño phenomenon entails a risk to food crops and related prices, albeit with greatly varying effects across regions and crop types. An upward pressure on food prices would be a concern for many emerging and developing countries where food makes up a high share of consumer baskets. Concern is that climate change may have exacerbating effects, underestimated by past records.

FORECATS

GDP, % ch YoY	2024f	2025f	2026f
Developed Markets	1.1	1.5	1.4
United States	1.9	1.5	1.8
Japan	0.6	0.8	0.6
United Kingdom	0.5	0.9	0.9
Euro area	0.7	0.8	1.1
Germany	0.1	0.6	1.0
France	0.7	0.7	1.1
Italy	0.7	0.6	0.8
Spain	1.8	1.1	1.4
Emerging Markets	3.8	3.8	3.6
Asia	4.5	4.4	4.3
China	4.3	4.0	3.8
India	6.5	6.2	6.2
Central and Eastern Europe	2.5	2.3	1.9
Czech Republic	1.2	2.0	2.1
Romania	2.8	2.8	2.8
Latin America	2.3	2.4	2.4
Brazil	1.6	1.9	2.0
Middle East & Central Asia	2.6	3.8	3.1
Africa	3.5	3.8	3.8
World (PPP weighted)	2.8	3.0	2.8

FORECASTS

%, EoP (unless otherwise indicated)	6/13	2024f	2025f	2026f
Fed Funds target (high)	5.50	4.75	3.50	3.25
Gov 10Y, US	4.33	4.00	3.50	3.75
ECB Deposit facility rate	3.75	3.00	1.75	2.00
Gov 10Y, Germany	2.54	2.25	1.75	2.00
Gov 10Y, France	3.16	2.75	2.25	2.50
Gov 10Y, Italy	3.92	3.75	3.25	3.50
Gov 10Y, Spain	3.37	3.05	2.55	2.80
BoE, Bank rate	5.25	4.75	3.50	3.25
Gov 10Y, United Kingdom	4.13	4.00	3.50	3.50
BoJ, bank rate	0.10	0.20	0.40	0.50
Gov 10Y, Japan	0.99	1.00	1.10	1.15
EUR / USD	1.08	1.05	1.10	1.15
EUR / GBP	0.84	0.90	0.90	0.90
USD / JPY	156	150	140	130
USD / CNY	7.3	7.2	7.0	7.1
EUR / CZK	24.7	24.0	24.0	24.0
EUR / RON	5.0	5.0	5.0	5.0
Oil Brent (USD/b)	82	75	70	70
European Natural Gas (TTF, EUR/MgW/h)	35	40	40	40
EU ETS carbon (EUR/Metric ton)	69	70	83	95

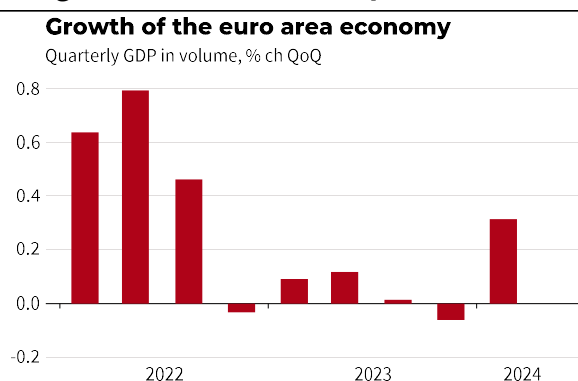
EURO AREA

- **Activity is expected to be sluggish in 2024 and 2025, before gradually picking up from 2026.**
- **Inflation is expected to return to 2%.**
- **The fiscal position is expected to begin to improve from 2024 with the measures announced by governments.**

After the mild recession of the second half of 2023, 2024 enjoyed a better start thanks to a disinflation bounce and a moderate recovery in global trade. The outlook for both 2024 and 2025 remains sluggish. Although inflation is now running below wage growth, past loss of purchasing power has yet to be fully recovered and with corporates under pressure from past monetary policy tightening and higher unit labour costs, we expect to see unemployment rise.

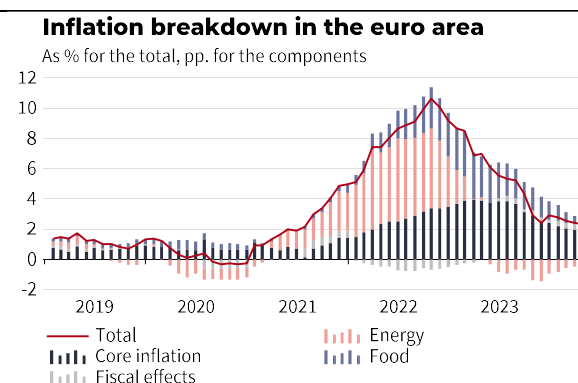
Risks to the scenario remain largely on the downside, owing in part to the lagged effects of tighter monetary policy now joined by much tighter fiscal policy. Uncertainty about energy prices has receded, but the global geopolitical situation could trigger a return to volatility.

A slight rebound in the first quarter



Source: INSEE, SG Economic and Sector Studies

Disinflation continues



Source: Eurostat, SG Economic and Sector Studies

Household demand is expected to recover moderately over the forecast horizon. Purchasing power is expected to continue to recover in 2024 and 2025 as inflation declines. However, as firms will seek to preserve profitability by moderating the growth of unit labour costs, we expect unemployment to rise. With household savings rate still high, this offers a buffer, but softer wealth effects and rising unemployment will likely keep consumers cautious. Residential investment will continue to slow with demand being severely dampened by higher mortgage rates and the maintenance of high construction prices. Gradual ECB rate cuts will help ease the financing side of this equation.

After the sharp decline in 2023, export growth should enjoy some recovery but will remain below the long-term average and with risk of renewed trade

tensions. Moreover, the full impact of replacing Russian gas with alternative, more expensive energy sources will, at least initially, weigh on the export competitiveness of Europe's most energy-intensive companies. Overall, the euro area's current account surpluses will be lower in the future.

Business investment is expected to slow in 2024, with a moderate rebound in 2025. Weak domestic demand, relatively high financing costs and continued high uncertainty will weigh on the investment appetite of firms.

Inflation is expected to continue its return to 2% with less pressure as supply side pressures have eased and demand remaining soft. The ECB remains concerned about wage dynamics, although leading indicators point to softer dynamics ahead.

From 2024 onwards, the reactivation of European fiscal rules and the ensuing fiscal consolidation will act as a drag on activity. In 2024-25, the fiscal plans announced by Member States point to a general tightening of fiscal policy. As regards investments, some Member States, notably Spain and Italy, will nevertheless continue to receive support under Next Generation EU. Fiscal policy, which has been an important support to activity over the past three years, will certainly act as an important brake on a further reacceleration of activity over the medium term.

The ECB delivers a first rate cut in June and we expect a further 75bps of rate cuts by year-end. Monetary policy is set to remain in restrictive territory over much of the forecast horizon with the neutral rate seen to be around 2-2.5%. Moreover, ongoing reduction of the balance sheet will mark a further tightening of liquidity conditions.

Risks to this scenario remain on the downside, due to uncertainty about energy availability and prices over the forecast horizon, in an increasingly tense global geopolitical context.

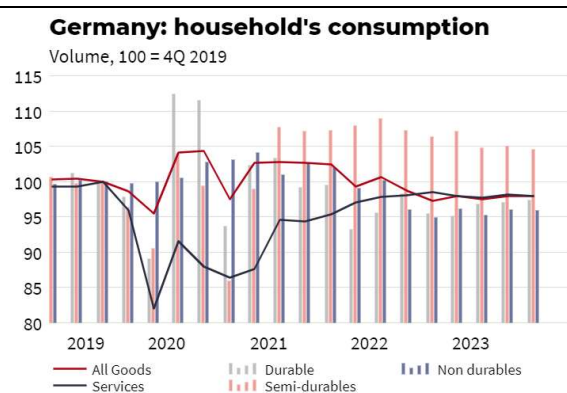
Euro area	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.5	0.7	0.8	1.1
Household consumption	0.6	0.7	0.7	0.9
Public consumption	0.8	1.1	0.7	0.8
Investment	1.4	0.8	0.8	1.4
Exports of goods & services	-1.0	0.8	2.6	2.9
Imports of goods & services	-1.4	0.7	2.3	2.9
Inflation, % annual average	5.4	2.2	2.0	1.9
Core inflation, % annual average	5.0	2.1	2.1	1.9
Real gross disposable income (GDI), % ch YoY	1.3	0.5	0.3	0.8
Households saving rate, % of GDI	14.4	14.3	13.9	13.8
Unemployment, % of labour force	6.6	6.8	7.2	7.3
Fiscal balance, % of GDP	-3.6	-3.6	-3.3	-3.2
Public debt, % of GDP	90	90	91	92
Current account balance, % of GDP	1.6	2.0	2.1	2.0

GERMANY

- **The upswing in Q1 does not indicate a reversal of situation. GDP is expected to stagnate this year, with a slow recovery medium term.**
- **Inflation is approaching target, but strong wages continue to impact the price of services.**
- **Private consumption and foreign trade keep underperforming but will drive growth in the wake of extensive fiscal consolidation.**

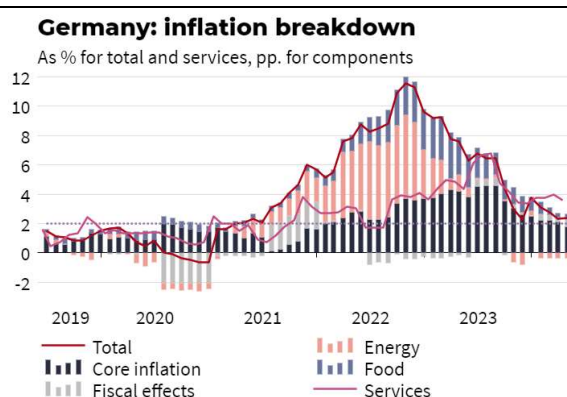
German growth is set to stagnate this year (+0.1% YoY) due to tepid private consumption and lack of investment. After an end of 2023 in recession, growth improved in the first quarter with +0.2% QoQ. Growth was driven by an initial recovery in energy-intensive industries - particularly exports - and a cyclical upturn in construction due to better weather conditions. The normalization of prices and the sustained pace of wage growth point to some recovery in household consumption (+0.5%), which remains almost two points below its pre-pandemic level. This improvement remains very limited compared to the 2010s progression average of 1.4% YoY.

Private consumption rises slowly but is still below its 2019 level



Source: Eurostat, SG Economics & Sector Studies

Disinflation is driven by energy prices, but service inflation is well above the target



Source: Eurostat, SG Economics & Sector Studies

The disinflationary process is consolidating, but inflation will remain above 2% in 2024-25. The rapid contraction in energy prices is the main driving force behind the general fall in prices, with a Q1 change of -2.5% QoQ (-3% YoY) and will enable total inflation to reach to 2.2% by the end of 2024. This evolution, while vulnerable to new shocks, will dampen the effects of the public subsidies phase-out to agents, and give a new breath to energy-intensive industries. Core inflation is also slowing but will remain high in 2024 (2.6%) and 2025 (2.2%). The price of services remains buoyant, at 3.5% YoY in April, with industries such as hotels and catering where price variation reached +6.4% YoY. Inflation should reach its 2% target by 2026, and the end of the forecast horizon will be marked by inflation rates slightly below 2%, as elsewhere in the euro area.

Even as unemployment rises wages continue to show vigorous dynamics, due to past inflation feeding into wage agreements. Unemployment is expected to average 6.2% this year, rising to 6.5% by 2026. This is accompanied by a progression in the working population due to net migration, which remains positive and benefits from new laws aimed to attract skilled workers. Wages, meanwhile, remain buoyant, partly due to the delayed effects of the inflationary cycle. In the first quarter, nominal earnings climbed by 6.4% YoY (3.8% YoY in volume), following three quarters of moderate growth. The rise in wages, combined with the slowdown in prices, is boosting real disposable income and giving a limited boost to household consumption. Precautionary behaviour continues to act as a headwind on recovery, with the household savings rate almost 3pp above the 2010-2019 average of 17.5% of disposable income.

The coalition government acts on a blunt and pro-cyclical budget consolidation for 2024-2025. The 2024 budget is the first since the pandemic not to be subject to the exception clause on the debt brake, which normally limits the Federation's structural net borrowing to 0.35% of GDP. Following the Karlsruhe ruling last autumn, which circumscribed the interpretation of this article of the Basic Law, public finances are further constrained, with the deficit set to be considerably reduced from 2.5% of GDP in 2023 to 1.6% and 1.4% in 2024 and 2025 respectively. Consolidation will involve the phase-out of subsidies given to agents in the context of the energy crisis, the suspension of other planned expenditure and investments, and increase in related tax revenues resulting from higher wages. Public debt is expected to contract to 63% of GDP in 2024. Note that the recent introduction of a funded component in the pension system through a new sovereign wealth fund (EUR 12.5 bn by 2024) will have a lasting effect on the debt level, at +0.3pp *per annum*. This is due to the fact that contributions to the fund (+3% per annum) are considered as financial transactions but are not taken into account in the deficit.

In spite of the prospect for lower interest rates and a cyclical upturn at the start of the year, investment will continue to deteriorate this year (-0.4% YoY). The better-than-expected investment performance in 1Q2024 was driven by a marked improvement in real estate investment, made possible by milder weather conditions. Real estate investment nonetheless remains below the previous year (-2.1% YoY). The suspension of public investment, previously earmarked to advance the green and digital transition, is also weighing on the aggregate. Public underinvestment can be seen in the deterioration of infrastructure, namely digital infrastructure, another weight on growth.

The recovery in foreign trade remains vulnerable to new shocks. In the first quarter, exports rose by 1.1% compared with the end of 2023, driven by goods (+2.1%), while services continued to stall (-2.9%). Exports are expected to grow by 0.5% YoY this year, well below the historical average of 4.9% YoY for the period 2010-2019. This recovery will be partly due to the recovery of energy-intensive sectors, which are benefiting from disinflation. Vehicle exports (around 17% of total exports) remain weak but are beginning to recover (+0.3% YoY in Q1). These trends remain exposed to new price shocks, not least due to geopolitics, and to trade tensions. Imports, on the other hand, will decline less than initially forecast, due to improved domestic demand.

Germany	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.0	0.1	0.6	1.0
Household consumption	-0.6	0.5	0.6	0.9
Public consumption	-1.0	0.4	0.3	0.9
Investment	-0.3	-0.4	0.1	1.4
Exports of goods & services	-0.2	0.5	2.8	2.9
Imports of goods & services	-2.1	-0.3	3.0	3.0
Inflation, % annual average	6.0	2.2	2.2	2.0
Core inflation, % annual average	5.1	2.6	2.2	2.0
Real gross disposable income (GDI), % ch YoY	0.0	0.4	0.1	0.8
Households saving rate, % of GDI	20.3	20.6	20.1	20.0
Unemployment, % of labour force	5.7	6.2	6.4	6.6
Fiscal balance, % of GDP	-2.5	-1.6	-1.4	-1.6
Public debt, % of GDP	64	63	63	63
Current account balance, % of GDP	5.9	6.7	6.6	6.4

FRANCE

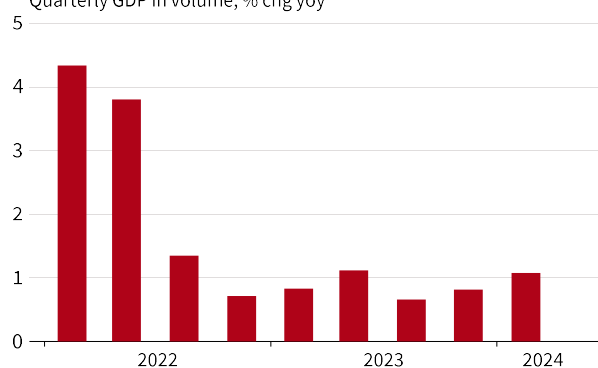
- **Activity is expected to be sluggish in both 2024 and 2025, before gradually picking up from 2026.**
- **Disinflation is set to continue towards the 2% target.**
- **The fiscal position is expected to begin to improve from 2024 but mind the impact of upcoming snap elections.**

Growth prospects for 2024 remain sluggish. Moderate inflation and ECB rate cuts should offer some support to household consumption, but fiscal policy tightening and still overall restrictive monetary conditions mark headwinds. On the external front, there should be some recovery of exports, and notably from transportation equipment. The contribution of external demand will, however, be modest. Fiscal policy is set to turn more restrictive in 2024, but the upcoming elections cast some uncertainty over the outlook.

A lacklustre outlook for 2024

Growth of the French economy

Quarterly GDP in volume, % chg yoy

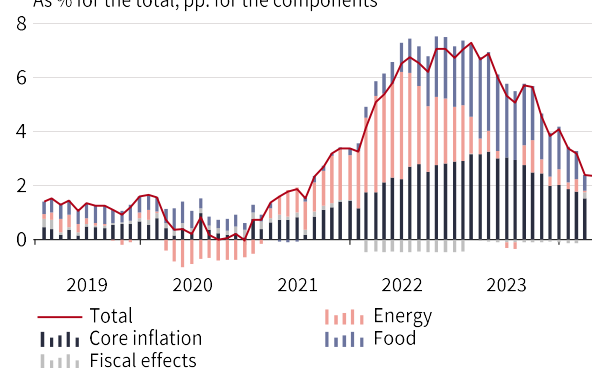


Source: INSEE, SG Economic and Sector Studies

Disinflation continues

Inflation breakdown in France

As % for the total, pp. for the components



Source: Eurostat, SG Economic and Sector Studies

Household demand is expected to recover moderately. Consumption is expected to recover slightly in 2024-25, given rising real wages although this will be partly offset by softer employment developments. The labour market remained dynamic in 2023, with an employment rate that reached a record high (68%). Employment growth is set to slow in 2024-25 as the effect of apprenticeship contracts diminishes and corporates seek to rebuild labour productivity. As a result, the unemployment rate is expected to rise driven in part also by the 2023 pension reform that will force more older workers to remain in the labour market.

Turning to investment, residential investment is expected to contract further in 2024, before recovering modestly from 2025. Persistently high interest rates, credit scarcity, and high construction costs remain headwinds.

The contribution of net exports is not expected to recover over the forecast horizon. A slight rebound in exports is expected, mainly due to the very gradual recovery of exports of transport equipment goods, particularly in aeronautics, but

this should be offset by an increase in imports linked to household consumption. The current account deficit, which reached almost 2% of GDP in 2022, partly due to weak export momentum, narrowed in 2023, as the energy bill deflated. France is once again a net exporter of electricity thanks to the normalization of nuclear production and imported energy prices have fallen sharply. Moreover, the need to replenish gas stocks is lower than at the end of the winter 2021-22. The current account, nonetheless, remains exposed to fluctuations in the price of imported energy.

Business investment, which has shown resilience so far, is expected to slow in 2024 as profits decline and financing costs remain high. Slower demand will reduce firms' pricing power and thus induce a normalization of their operational profitability. Moreover, financial conditions are set to ease only gradually. Rising business failures will further reduce the appetite for new investment and business investment is expected to slow this year.

Public finances should begin to recover. Measures announced by the government and the withdrawal of most energy-related measures are expected to generate about 0.5pp of savings on spending in 2024. While from 2025 onwards, efforts remain to be clarified. Upcoming snap elections add uncertainty to the fiscal policy outlook.

Risks are tilted to the downside. The risks associated with the energy crisis have dissipated, but they will remain with the persistence of conflict in Ukraine, and the worsening of the global geo-political landscape. Upcoming snap elections add further uncertainty.

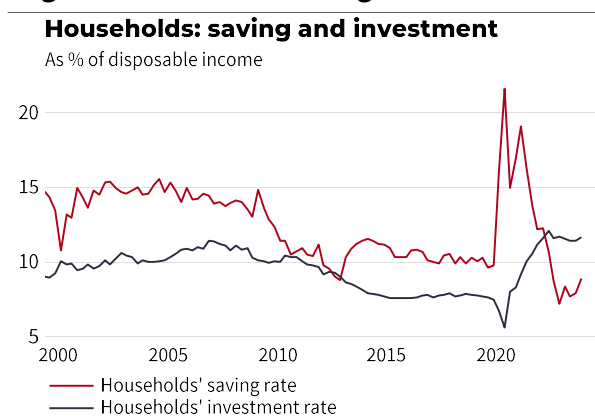
France	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.9	0.7	0.7	1.1
Household consumption	0.7	1.1	1.1	1.2
Public consumption	0.5	0.9	0.0	0.5
Investment	0.6	0.0	1.2	2.0
Exports of goods & services	1.8	1.4	2.0	3.0
Imports of goods & services	-0.2	-0.8	2.5	3.2
Inflation, % annual average	5.7	2.5	2.0	2.0
Core inflation, % annual average	4.0	2.0	2.0	2.0
Real gross disposable income (GDI), % ch YoY	0.8	0.6	0.3	0.6
Households saving rate, % of GDI	17.6	17.0	16.3	15.7
Unemployment, % of labour force	7.1	7.6	8.1	8.1
Fiscal balance, % of GDP	-5.5	-5.5	-5.2	-4.5
Public debt, % of GDP	111	111	113	114
Current account balance, % of GDP	-0.8	-0.3	-0.4	-0.3

ITALY

- **Italian growth outperformed the euro area in 2023 thanks to buoyant investment but should slow as fiscal measures unwind.**
- **Purchasing power is set to increase in 2024 after two years of contraction, allowing households to start rebuilding savings.**
- **Public debt is set to return to an upward trajectory as of next year.**

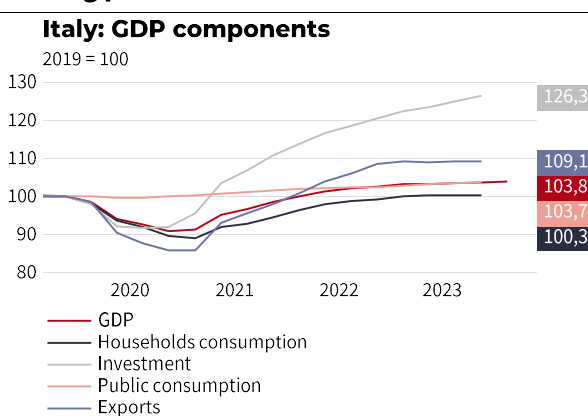
Italian GDP surprised to the upside in 1Q24 and is set to remain close to potential in 2024 and 2025. Growth had held up well to the slowdown in the euro area in 2023, driven by strong investment growth, supported by Next Generation EU funds and national housing renovation support programmes. Total investment is thus 25% higher than its pre-Covid level, and 77% higher for the dwelling component alone. GDP is now 3.8% higher than in 4Q19, but household consumption is barely back to its pre-pandemic level.

Slight rebound of the saving rate



Source: Istat, SG Economic and Sector Studies

Strong performance of investment



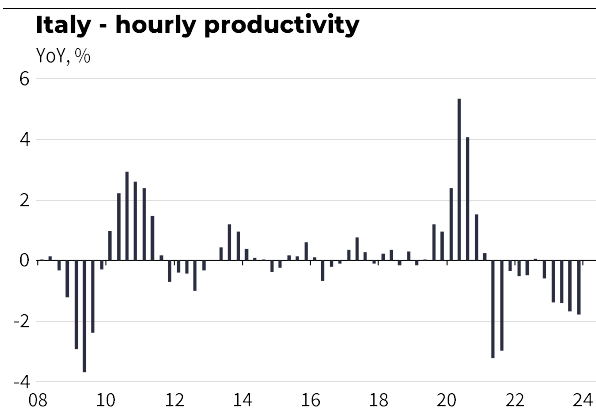
Source: ECB, SG Economic and Sector Studies

Household income is expected to increase slightly in 2024 after two years of contraction in purchasing power. Negotiations have led to hourly wage increases, particularly in industry, which will support purchasing power in a context of slowing inflation. However, subsidies to households will be less generous than in 2023, with the withdrawal of the "energy vouchers" that have enabled households to cope with the energy crisis. The savings rate, at an all-time low, is expected to start to rise, and household consumption is forecast to remain sluggish over much of the forecast horizon.

Inflation is expected to slow sharply in 2024 thanks to lower energy prices and return to the ECB's 2% target in 2025. Core inflation is expected to be slightly above 2% this year, while food prices are decelerating rapidly. Despite a slight upside in negotiated wages, the risks of a wage-price spiral are limited in Italy due to a labour market based on collective bargaining, with a very slow process of renewal of sector agreements, low indexation of wages to prices and very low productivity.

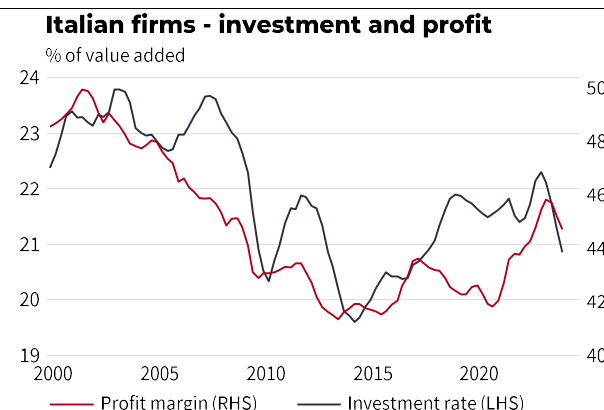
Employment is expected to slow in 2024 after two years of strong job creation. The unemployment rate is expected to continue to fall this year, before rising slightly in 2025. It is expected to remain at a level structurally lower than the average of the last ten years due to persistent tensions linked to demographic changes with a decline in the working-age population and a sharp slowdown in migration flows. Recruitment difficulties remain high and are quoted as the main factor limiting production in Italy.

The decline in hourly productivity ...



Source: Istat, SG Economic and Sector Studies

... is weighing on firms' margins



Source: Istat, SG Economic and Sector Studies

Business investment is expected to slow in 2024 and 2025, after three years of record growth. Investment in capital goods is slowing down, but still positive, fuelled by European subsidies. However, housing investment is expected to stall in 2024, due to the changes made to the housing renovation state aid: the tax credit rate will drop from 110% to 70% in 2024 and 65% in 2025, and the portability of tax credits has been completely abolished, as has the possibility of bringing forward the deadlines to benefit from credits on work undertaken in 2023. Credit momentum remains weak: outstanding corporate loans are contracting at -4% YoY. Credit contraction and moderate investment growth are expected next year.

European funds support the economy. The modified plan, including the REPowerEU chapter, has further strengthened the focus on the green transition, devoting 39% of the available funds to measures that support climate objectives. Key investments for the green transition are: i) energy efficiency in residential and public buildings (EUR 16.9bn), ii) sustainable mobility (EUR 34.5bn), iii) development of renewable energies and the circular economy and improvement in waste and water management (EUR 24.7bn). There will still be €89 billion of funds available to the Italian government by 2026 (4.1% of GDP), and therefore a strong incentive to maintain a cooperative attitude with the European Union and implement key structural reforms, in particular the overhaul of the judicial system.

The primary balance is expected to improve significantly in 2024, from -3.6% to -0.8% of GDP, but will be far from returning to the 2% surplus, necessary to secure a declining trend in general government debt. Support measures in response to the energy crisis will be completely abolished in 2024, reducing spending by almost 1pp of GDP (EUR 22bn). But above all, the cost of housing renovation measures would be drastically reduced (-2.5pp of GDP, or EUR 54bn). On the revenue side, capital transfers will be reduced by 0.5pp of GDP (EUR 13bn), which will weigh on the public balance. Finally, interest costs are expected to be higher, due to the increase in the average cost of debt with the maturities of bonds with lower rates (EUR 5bn). The public balance is expected to remain high (between 4.5% and 5% of GDP) over our forecast horizon.

Public debt is forecast to resume an upward trajectory. Past interest rate hikes and weak growth will weigh on public debt dynamics over the medium term. In 2023, public debt was lower than expected. It is nevertheless 3 points above its pre-Covid level and is expected to resume an upward trajectory to reach nearly 142% of GDP by 2026.

The public debt situation generally remains vulnerable to the risk of increased sovereign tensions following a deterioration in debt sustainability and/or speculative attacks on financial markets. The backstop established by the ECB through flexibility in the reinvestment strategy of maturing PEPP assets (although this will decline as of 2H24 and end at year-end) and the Transmission Protection Instrument (TPI) should limit the risks of excessive movements in financial markets. The TPI, however, has yet to be tested and is only operational for member states respecting the EU fiscal framework.

Italy	2023	2024f	2025f	2026f
Real GDP, % YoY	1.0	0.7	0.6	0.8
Household consumption	1.2	0.4	0.3	0.5
Public consumption	1.2	0.4	0.4	0.4
Investment	4.9	2.1	1.2	1.7
Exports of goods & services	0.5	2.2	2.0	2.3
Imports of goods & services	-0.2	0.7	2.1	2.2
Inflation, % change	5.9	1.4	2.0	2.0
Core inflation	4.5	2.2	2.2	2.0
Real gross disposable income (GDI), % change	-0.5	0.7	0.4	0.6
Households saving rate, % of GDI	8.2	8.5	8.6	8.8
Unemployment, % of labour force	7.7	7.4	7.5	7.3
Fiscal balance, % of GDP	-7.4	-4.8	-4.8	-4.7
Public debt, % of GDP	137	139	141	142
Current account balance, % of GDP	0.5	1.2	1.2	1.1

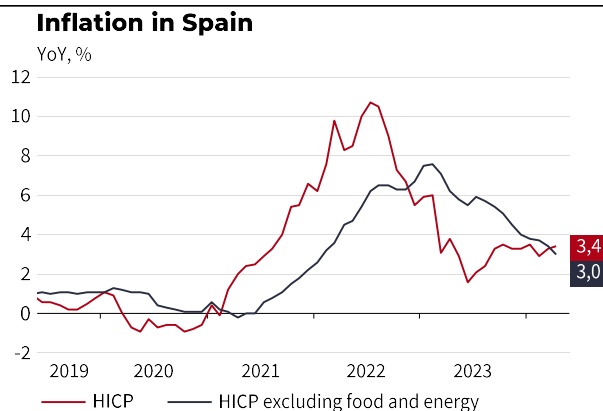
SPAIN

- **Growth is expected to outperform that of the euro area in 2024 but fall below potential in 2025.**
- **Household purchasing power will slow sharply in 2024 after a record year and unemployment is set to rise from 2025 onwards.**
- **The country will only partially reduce its budget deficit and the public debt is set to stabilise close to 106% of GDP.**

Growth will slow somewhat in 2024 and is set to come in below potential in 2025. However, it will remain higher than that of its major European partners, supported by the sharp increase in household disposable income (11% in 2023 and 6% in 2024). The unemployment rate, now below its structural level, is expected to start to rise in 2025. Tight financial conditions will continue to impact companies in financing their investments, while household income is holding up rather well to the rise in interest costs, which took away 0.5pp of purchasing power last year.

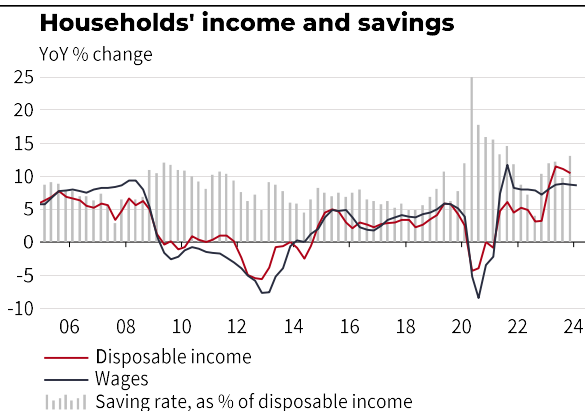
Growth surprised again to the upside in 1Q-24, recording the best performance in the euro area. Investment was very dynamic and external demand also made a strong contribution to growth.

A slow deceleration in prices ...



Source : INE, SG Economic and Sector Studies

... and a strong increase in disposable income



Source : INE, SG Economic and Sector Studies

Business investment is expected to grow modestly in 2024 due to tighter financial conditions and weaker domestic demand. It will, however, be supported by loans and grants from the new version of the European recovery plan, which has revised upwards the total subsidies to €80bn (5.5% of GDP), of which EUR 38 bn (2.5% of GDP) will still be available. Spain's amended recovery plan includes a *REPowerEU* chapter and EUR 83bn of loans (5.7% of GDP) in addition to the grants already allocated. 40% of the plan will support the climate objectives. Main investments are : i) over EUR 12bn in the energy efficiency of public and private buildings including new social housing, ii) EUR 13.2bn in sustainable mobility in urban and long-distance, iii) EUR 6.9 bn for the decarbonisation of the energy sector by under the

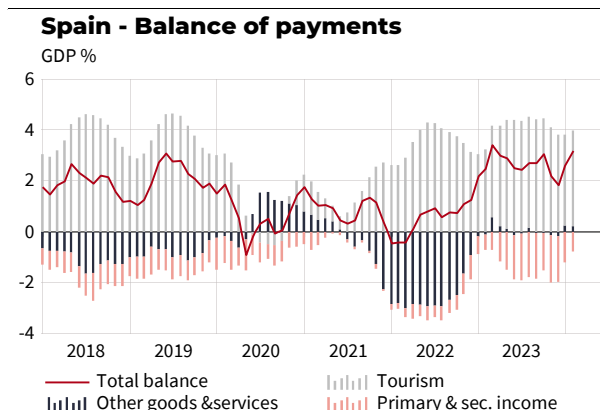
REPowerEU chapter and EUR 22bn under the financial instrument ICO Green Line, in clean technologies and infrastructure (including storage and electricity grids) and accelerating the development and use of renewables, including renewable hydrogen.

Household consumption is expected to grow at a moderate pace in 2024 and slow in 2025. Gains in purchasing power are expected to continue after a record year in 2023 thanks to wage and employment dynamics. Employment is expected to continue to grow in 2024 and contract slightly in 2025, allowing companies to register productivity gains and rebuild their margins. However, slowing inflation, negotiated wage increases and pension increases will support household incomes over the horizon of our forecast. The savings rate – back to higher than historical average level in 2023 – is expected to adjust slightly, allowing households to cope with the expected deterioration in the labour market.

Consumption is set to grow at a moderate pace in 2024 but continue to support growth through further gains in purchasing power after a record year in 2023. Indeed, despite the anticipated slowdown in the labour market and the rise in unemployment, purchasing power is expected to increase further in 2024 and 2025. Slowing inflation, negotiated wage increases, and pension increases will support household income over the horizon of our forecast. The savings rate – which has returned to a level above its historical average in 2023 – is expected to remain high, allowing households to cope with the expected deterioration in the labour market.

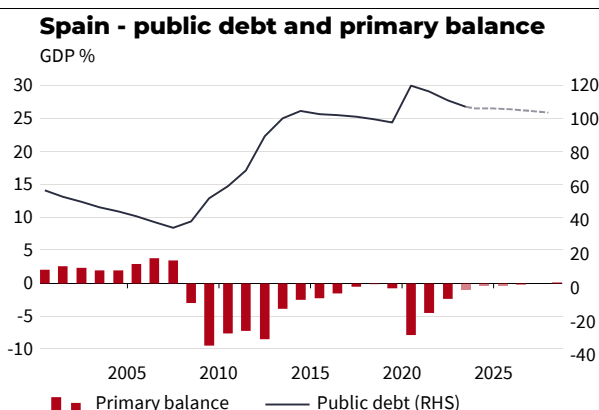
Harmonised inflation is set to remain above 3% in 2024 but ease to 2% in 2025. The disinflation process is uneven, with a marked slowdown in the prices of food and household equipment, and a more persistent price dynamics in the accommodation, food and leisure services. Core inflation is expected to slow gradually, from 4% in 2023 to nearly 2% in 2025.

Economy back in external surplus



Source : INE, SG Economic and Sector Studies

Public debt would stabilize at a high level



Source : Eurostat, SG Economic and Sector Studies

Spain's current account balance recovered in 2023 and is expected to remain in a surplus position over the forecast horizon. While the positive current account balance had suffered from the halt in tourism during the pandemic and the rise in the price of energy imports following the war in Ukraine, it recovered significantly and reached 2.5% of GDP in 2023. The current account balance is set to remain at this level in the medium term, thanks to the strength of tourism revenues in a context of slowing domestic demand.

Fiscal policy is turning restrictive in 2024, due to the lower cost of support measures to offset rising energy prices. The gradual dismantling of energy measures will save around 0.5% of GDP in 2024 and 0.3% in 2025. In addition, the financing of investments via subsidies from the European recovery plan rather than public borrowing makes it possible to reduce their cost by 0.5% of GDP in 2024.

The slowdown in growth will weigh on public finances in 2025, postponing the fall below the 3% of GDP threshold to 2026. The indexation of pensions to inflation weighs on the sustainability of public finances, as it prohibits spending freezes, which are a very effective way to limit the public deficit in times of rising prices. After two years of decline, public debt is still 9pp higher than the pre-Covid level and is expected to decrease slightly over the forecast horizon.

Beyond 2024, the government's fiscal stance is set to return to accommodative. There is a risk of political deadlock and a non-zero probability that Sánchez's government, elected in November 2023 with the support of the left-wing Sumar coalition and Catalan separatists, will not come to an end. The holding of early elections in Catalonia on 12 May forced Sanchez to abandon the idea of having a budget approved in 2024. He had to renew the 2023 budget framework for one year, while waiting to find support for the preparation of the 2025 finance law. Economic policy will continue to focus on addressing income inequality, redistribution, and social and environmental policies.

Spain	2023	2024f	2025f	2026f
Real GDP, % YoY	2.5	1.8	1.1	1.4
Household consumption	1.8	1.6	1.1	1.5
Public consumption	3.8	1.2	0.8	0.8
Investment	0.8	1.6	0.9	2.0
Exports of goods & services	2.3	2.7	2.5	2.9
Imports of goods & services	0.3	2.2	2.6	3.0
Inflation, % change	3.4	3.2	2.1	2.1
Core inflation	4.1	3.2	2.1	2.1
Real gross disposable income (GDI), % change	6.8	1.6	0.8	1.3
Households saving rate, % of GDI	11.7	11.1	10.9	10.8
Unemployment, % of labour force	12.2	12.1	12.5	12.5
Fiscal balance, % of GDP	-3.6	-3.2	-3.1	-2.9
Public debt, % of GDP	108	107	107	106
Current account balance, % of GDP	2.6	2.5	2.5	2.5

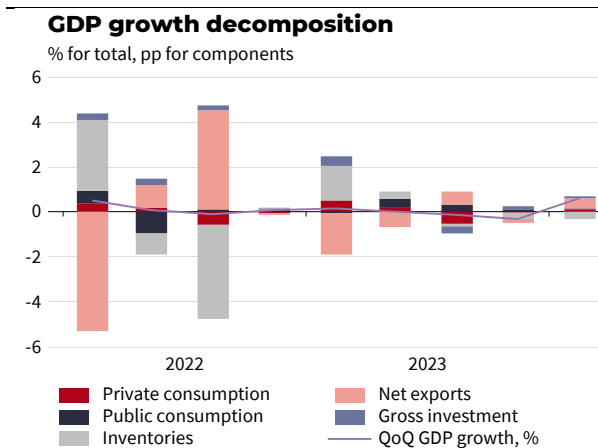
UNITED KINGDOM

- The UK exited the shallow recession with a strong rebound in Q1, but the outlook for the remainder of the year remains weak.
- Tough tax policy decisions await the next government, probably led by the Labour party if opinion polls are correct.
- The BoE should wait as late as Q3 for the first policy rate cut as inflation continues to decelerate at a slow pace.

The UK defied expectations by exiting a short-lived recession with a strong rebound in 1Q24, but the outlook for the remainder of the year remains weak. GDP expanded by 0.6% QoQ, marking the fastest growth since 2021. The rebound was driven by both services, across most sub-sectors, and manufacturing, notably car producers, partly offset by a decline in construction.

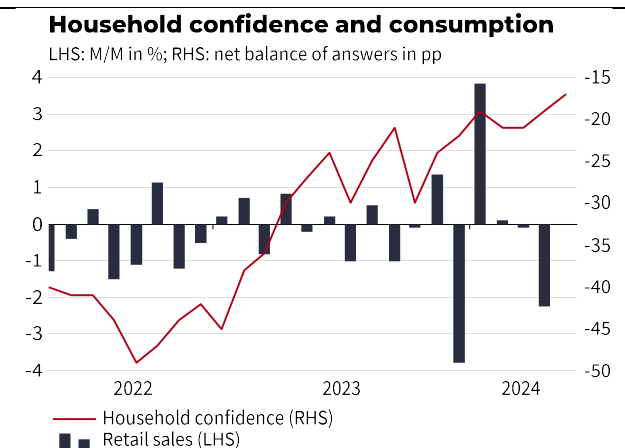
Compared to the same quarter a year ago, however, total output grew by a mere 0.2%. While investment and public consumption should grow in 2024 more strongly than previously expected due the 1Q carry over, weak private consumption should keep constraining growth for the rest of the year. It should then reaccelerate at modest speed in 2025 and beyond as structural headwinds limit potential supply and compel the future government to tough fiscal policy decisions.

GDP rebounded in the first quarter, driven by external demand



Source: ONS, Refinitiv, SG Economic and Sector Studies

Consumers become more confident but sentiment remains negative

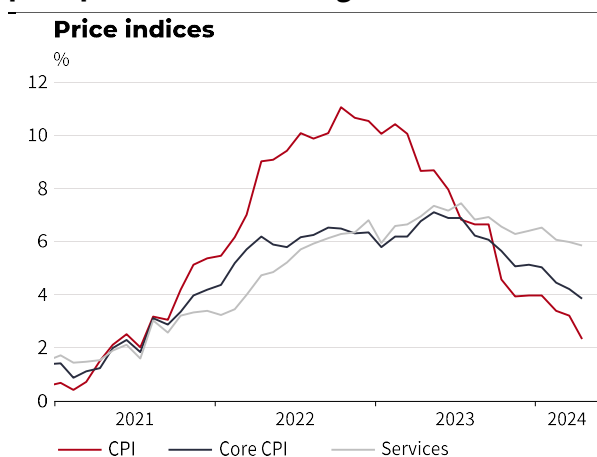


Source: ONS, Refinitiv, SG Economic and Sector Studies

Prudent consumption behaviour by households should keep weighing on domestic demand. Robust government support and strong nominal wage growth pushed up real personal disposable income in 2023 amid slowly-decelerating inflation. Wages should continue to grow faster than inflation this year, helping rebuild households’ purchasing power on aggregate, only partly offset by lower employment levels due to businesses laying off staff to protect margins. On the other hand, higher mortgage interest payments and rental prices have been weighing on consumers’ standards of living, especially among lower income deciles. In a context of weaker job prospects and ongoing uncertainties, households will seek precautionary savings, delaying the recovery of internal demand.

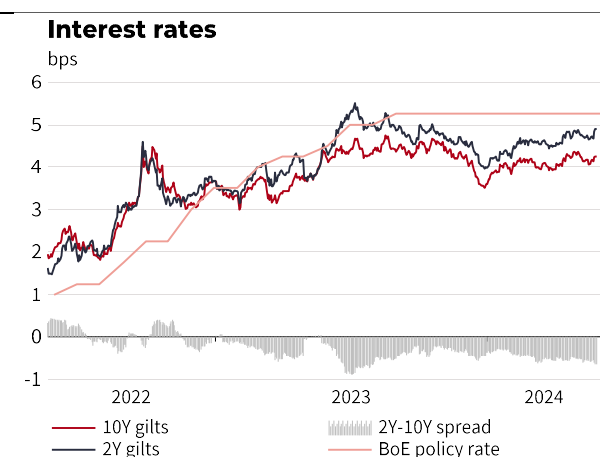
As the country heads towards general elections, the next government will face difficult decisions regarding public finances. The current PM Rishi Sunak unexpectedly called a general election for 4th July. All major polls have been consistently pointed to a defeat of the Tories to the Labour party led by Keir Starmer, with a lead larger than 20 points. The next government will inherit fiscal plans that needs to be updated, the more so as the beneficial effect of the fiscal drag are fading off with the ongoing disinflation. Given the fiscal rules, tough tax policy decisions await the current opposition party as the need to top up defence spending, refinance the health and social care and increase public investments exerts spending pressures which are hard to avoid. In a context of weak medium-term economic perspectives, the public debt ratio should thus continue to grow.

Inflation continues to decelerate but domestic price pressures are still significant



Source: S&P Global, Refinitiv, SG Economic and Sector Studies

The long plateau of policy rates is coming to an end



Source: GfK Group, CBI, Refinitiv, SG Economic and Sector Studies

Inflation should continue to decelerate in the UK, although at a slower pace than in peer countries in Europe, pushing the BoE to wait as late as Q3 for a first cut.

CPI inflation dropped to 2.3% in April from 3.4% in February as energy prices have been falling significantly with the resetting of the Ofgem retail price cap. Underlying inflation also decelerated, but less than was expected, signalling that domestic price pressures remain significant, as also suggested by the services inflation. However, the continuing fall in energy prices, the deceleration of food inflation and the base effects should drive CPI inflation back to target on average in Q2. It will then return above target throughout the rest of the year because of perduring supply-side constraints. The BoE should then operate its first policy rate cut in Q3, terminating with another one before the end of the year.

Stronger wages pressures could result in a boost to consumption and fuel inflation. The latter could also originate from new price shocks in connection with the potential escalation of current geopolitical tensions. In either case, the rate trajectory would be higher than currently forecast.

United-Kingdom	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.1	0.5	0.9	0.9
Household consumption	0.3	0.2	0.6	0.6
Public consumption	0.5	1.7	1.1	1.2
Investment	2.2	0.0	1.1	1.0
Exports of goods & services	-0.5	0.4	2.0	2.0
Imports of goods & services	-1.5	-0.2	1.6	1.6
Inflation, % annual average	7.3	2.5	2.2	2.0
Core inflation, % annual average	6.2	2.8	2.1	2.0
Real gross disposable income (GDI), % ch YoY	2.1	0.7	0.9	0.8
Households saving rate, % of GDI	9.7	9.4	9.5	9.7
Unemployment, % of labour force	4.0	4.5	4.7	4.9
Fiscal balance, % of GDP	-5.8	-5.6	-5.2	-4.7
Public debt, % of GDP	99	101	102	104
Current account balance, % of GDP	-3.3	-3.3	-3.2	-3.2

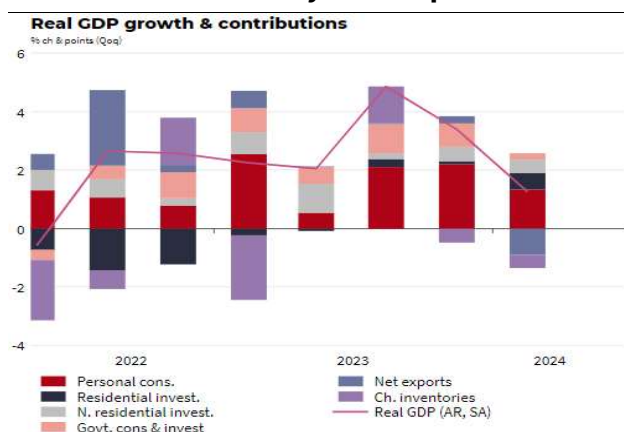
UNITED STATES

- **We expect growth to slow over the coming quarters.**
- **Consumption expenditures should indeed decelerate as households need to rebalance their saving behaviour.**
- **After some setbacks in the first part of the year, disinflation should proceed more decisively in the 2nd, opening the way for Fed cuts.**

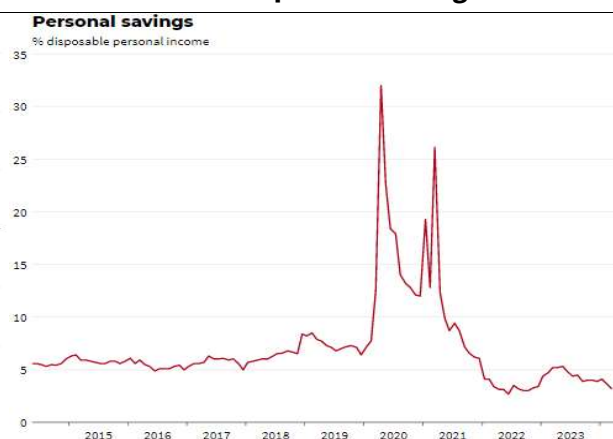
Real GDP growth should slow over the coming quarters. Q1 data showed easing growth (1.3% QoQ annualized), with negative surprises compared to consensus estimates, while still moderately exceeding our more subdued projection. Labour market tensions have also eased with a reduction in job openings (vacancies/unemployed ratio is nearly back to 2019 levels) and a modest tick up in unemployment at 4.0% in May.

With job creation and wages set to keep moderating, real gross disposable income growth will be positive but significantly slower than last year (just over 2%). Moreover, as households' have depleted their pandemic-era excess savings, the current saving rate at 3.2%, well below pre-2020 averages, suggests need for further moderation in consumption over the coming quarters. Finally, even as the Fed eases, interest rates are set to remain elevated for some time, which is a further headwind for the economy along with some fiscal consolidation.

Growth is still fuelled by consumption...



...as households keep under-saving



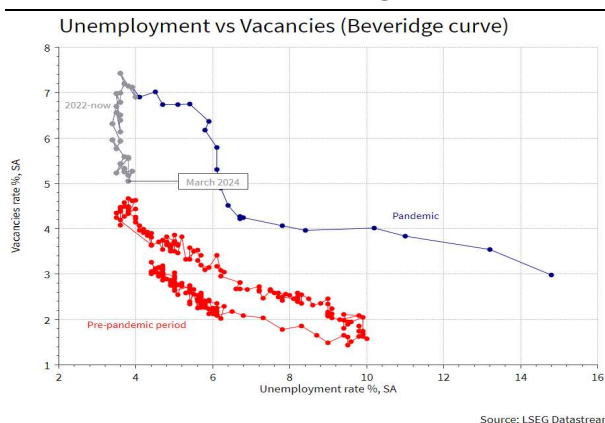
Source: Bureau of Economic Analysis, US Department of Commerce, Refinitiv, SG Economics and Sector Studies

Inflation surprises have delayed but not compromised disinflation. After few consecutive upside surprises that spooked markets, leading to high volatility in futures markets, April CPI brought some relief, with both headline (3.4% YoY) and core (3.6%) tracking lower.

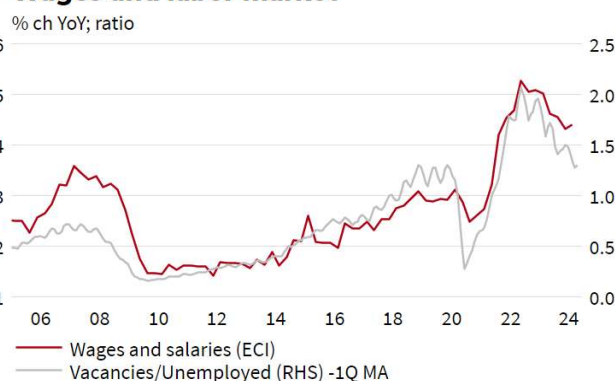
A closer look at components suggests that much of the high recent prints are due to shelter easing less than expected, strong increases in car insurance premiums due to higher car repair costs, higher claim severity and an increase in disaster-related claims, and in medical care services. Looking ahead, while increases in some of these components may still run above historical averages in connection with structural factors, such as climate change and ageing, significant easing is to be expected in the second half of the year, notably on the shelter component, reflecting eased pressures on market rents. Easing wage pressures (average hourly earnings down to 3.9% YoY in April) will support this process.

Labor market eases via falling vacancies...

... supporting benign disinflation



Wages and labor market



Source: Bureau of Labour Statistics, US Department of Labor, Refinitiv, SG Economics and Sector Studies

The Fed will thus have room to cut rates this year. Indeed, unless another shock arises, easing shelter and wage pressures are likely to persuade the Fed that inflation is on a steady decline. Meanwhile, as explained, the growth rate is predicted to decelerate from its robust 2023 levels, due to policy headwinds, along with mounting stress on household finances.

The Fed's communication has been markedly data-dependent over the last months, contributing to market volatility, and recent policy makers' statements suggest decreased confidence in the 75bp rate reduction by year-end envisaged in the March 2024 Summary of Economic Projections. However, we still expect such a path to be likely, given our growth and inflation outlook.

Turning to QT, the FOMC decided to slow down the pace of balance sheet runoff, reducing the cap on Treasury reinvestments from \$60bn to \$25bn per month, starting from June, while leaving the \$35bn threshold for agency debt and agency MBS unchanged. This follows a QT strategy that anticipated the intention to go on with MBS further than with Treasuries, while underlying that the decision to slow the pace of runoff does not mean that eventual reduction in the Fed's balance sheet will be more limited than otherwise. We expect that QT will continue even after the first cut, likely through the first half of 2025.

Upsides risks to the outlook remain in connection with more solid disposable income growth in case the labour market cooled less than expected (or households saved less), leading to stronger jobs creation and higher wages increases. This could

also result into a more restrictive stance by the Fed. On the other hand, geopolitical conflict remains a top-of-mind downside risk in case spikes in oil prices further depress incomes.

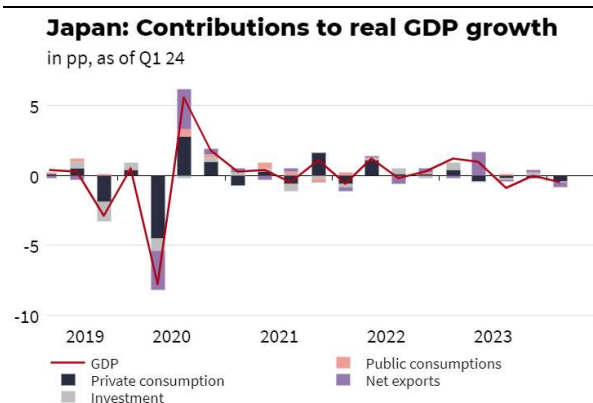
US	2023	2024f	2025f	2026f
Real GDP, % ch YoY	2.5	1.9	1.5	1.8
Household consumption	2.2	2.0	1.8	2.1
Public consumption	2.7	1.3	1.1	1.0
Investment	2.0	3.2	1.9	2.7
Exports of goods & services	2.6	1.0	2.0	2.0
Imports of goods & services	-1.7	2.8	2.9	3.3
Inflation, % annual average	4.1	2.9	2.5	2.5
Core inflation, % annual average	4.8	3.4	2.5	2.5
Real gross disposable income (GDI), % ch YoY	4.2	2.3	2.2	2.4
Households saving rate, % of GDI	4.6	4.3	5.3	5.6
Unemployment, % of labour force	3.6	4.0	4.3	4.0
Fiscal balance, % of GDP	-6.3	-5.3	-5.8	-5.6
Public debt, % of GDP	98	99	101	102
Current account balance, % of GDP	-3.0	-3.1	-3.0	-3.1

JAPAN

- **GDP contracted again in 1Q24. Growth is expected to rebound but remain lacklustre over the forecast horizon.**
- **Inflation will continue to slow in 2024, as commodity-related inflationary pressures ease.**
- **Household consumption is expected to gradually recover with better wage growth and a slowing pace of inflation.**

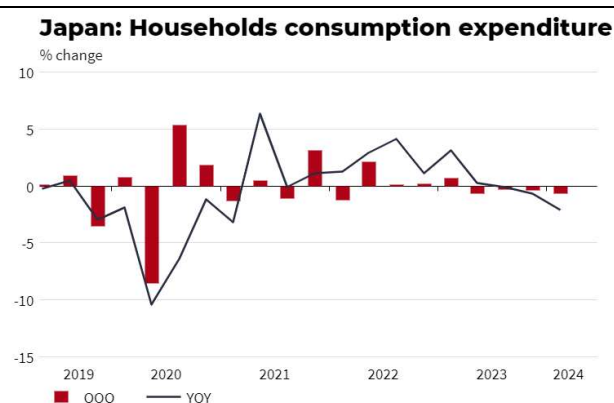
GDP growth contracted in 1Q24, growth momentum is expected to remain weak over the forecast horizon. With inflation persisting, the contraction in real wages continues to constrain household spending. The wage negotiations last spring, which are at historical high levels at 5.2%, should nevertheless gradually mitigate the inflationary effects on household consumption, should inflation dynamics stabilize.

Growth momentum remains fragile



Source: SG Economic and Sector Studies, Refinitiv

... held back by low household consumption



Source: SG Economic and Sector Studies, Refinitiv

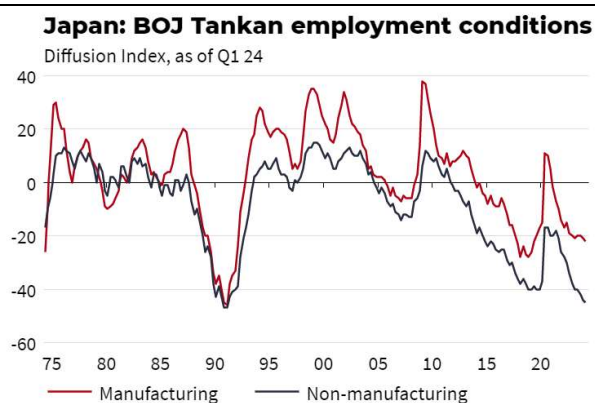
Exports should benefit from the recovery in the semiconductor sector, but risks remain tilted to the downside given geopolitical tensions. Exports are accelerating with the recovery in external demand, and more specifically from China. The increase in Japan's exports to China was mostly driven by growth in semiconductor manufacturing equipment. A resilient industrial production in China and demand for less advanced equipment after Japan's export restrictions on advanced semiconductor equipment in 2023 explain the increased Chinese demand for semiconductor equipment. The recovery in the global semiconductor industry is also expected to support Japanese exports, but these could be held back by geopolitical tensions in this segment, as they align with the US stance on export controls directed at China. Tourism revenues, which accounted for nearly 5% of Japan's exports before the crisis, have surpassed pre-pandemic levels since March 2024.

Business investment is expected to remain robust. Corporate earnings, which have been above pre-pandemic levels and are boosted by the depreciation of the yen, are supporting investment. Going forward, investment is expected to continue to increase, albeit at a slower pace, supported by government subsidies, particularly for green and digital investments.

The higher-than-expected spring wage increase, and a stabilising pace of inflation, should support real wages and household consumption. Last April, the workers' union (Rengo) managed to conclude a wage increase of 5.3%, higher than their initial target. Indeed, companies continue to show their concerns about the labour shortage that has intensified since the end of the health crisis, as reflected by the BoJ's Tankan survey.

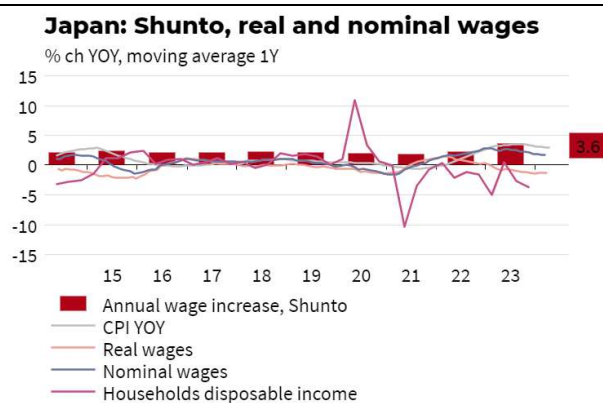
Consumption is expected to recover gradually in the second half of 2024, as the effect of the spring wage negotiations is expected to emerge from July onwards and the pace of inflation stabilises at around 2%. The labour shortage, which could give greater bargaining power to employees than in previous years, and the improvement in consumer confidence since 2022 could also support household consumption. That said, there is a risk of higher inflation due to a persistent depreciation of the yen, an increase in import prices, which could weigh on real wages, and therefore on disposable income.

The labour market remains tight



Source: SG Economic and Sector Studies, Refinitiv

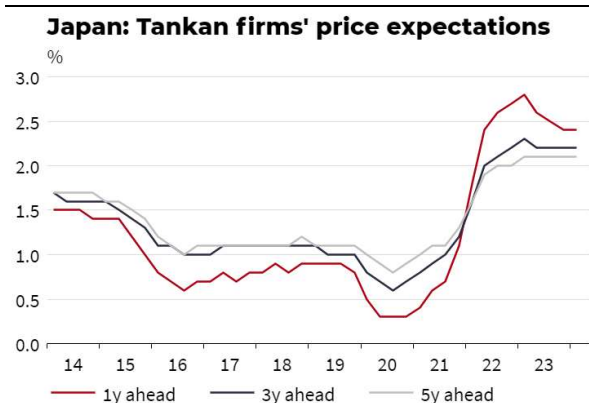
Inflation has so far accelerated faster than nominal wages



Source: SG Economic and Sector Studies, Refinitiv

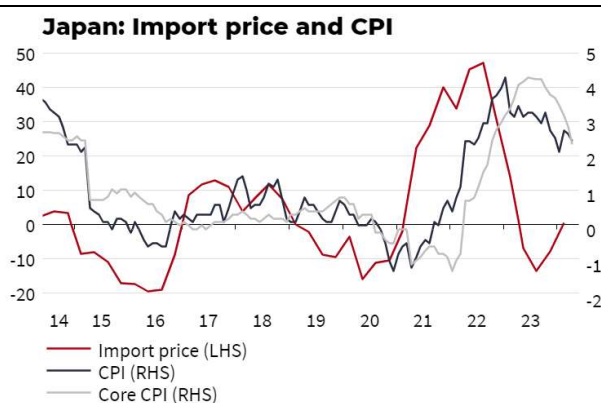
Inflation will gradually decline as food and energy prices recede, but remain elevated, close to the BoJ's target. Government measures to reduce the burden on household energy costs have lowered CPI, but they are being phased out in May (electricity and gas costs), which could put some upward pressure on inflation in the short term. Medium term, labour shortages due to ageing and less of an impulse from higher women's participation rate put pressure both wages and prices. Corporate inflation expectations remain unchanged at 2% over the medium to long term, reflecting their confidence in the BOJ's inflation target, while the virtuous circle between wages and prices is forming.

Corporate inflation expectations remain around the BOJ target



Source: SG Economic and Sector Studies, Refinitiv

The risk of an acceleration in import prices may weigh on real wages



Source: SG Economic and Sector Studies, Refinitiv

Despite persistent inflation, fragile growth is expected to slow the BoJ's tightening cycle this year. With stronger wage negotiations, the BoJ accelerated its decision on exiting negative rates last March in view of stronger wage increases with the following key decisions: (1) The end of negative rates: The BoJ has set the key rate in a range between 0.0% and 0.1%. (2) YCC: The BoJ removed the top 1.0% benchmark on Japanese 10-year government bond (JGB) yields, ending YCC. However, the BoJ continues to buy JGBs as before. (3) Asset purchases: Regarding risk assets, the BoJ indicated that it would stop buying ETFs and J-REIT (a real estate investment trust established in Japan). The BoJ will gradually reduce the amount of corporate bond purchases and will stop these purchases in about a year.

If considering that long-term expected inflation is around 1.5%, and the neutral real interest rate is around -0,5%, the nominal neutral rate should converge towards 1%. Until now, a fragile growth has slowed down the BoJ's tightening cycle. That being said, the effects of the Spring wage negotiations should improve real wages and household consumption in the second half of 2024 and allow the monetary policy to be more expansionary. With the end of electricity subsidies in May and increasing import prices, risks on inflation are rather tilted to the upside, which could support the BoJ's hikes.

Risks are broadly tilted to the downside. Downside risks to growth include a slowdown in the global economy, increased geopolitical fragmentation and a more volatile food and energy prices. On the domestic front, a weaker consumption related to negative real wage growth, more intense labour shortages could drag activity and bring back deflationary pressures.

Japan	2023	2024f	2025f	2026f
Real GDP, % ch YoY	1,9	0,6	0,8	0,6
Household consumption	0,6	0,7	1,0	0,7
Public consumption	0,9	0,5	0,4	0,4
Investment	4,3	1,0	0,8	0,8
Exports of goods & services	3,2	1,7	1,0	1,6
Imports of goods & services	-1,4	1,5	1,9	2,0
Inflation, % annual average	3,2	2,0	1,8	1,3
Core inflation, % annual average	3,1	1,7	1,6	1,0
Real gross disposable income (GDI), % ch YoY	-1,6	0,7	0,9	0,4
Households saving rate, % of GDI	0,6	1,3	1,2	1,0
Unemployment, % of labour force	2,6	2,4	2,4	2,5
Fiscal balance, % of GDP	-4,5	-4,0	-3,0	-3,0
Public debt, % of GDP	258	258	259	259
Current account balance, % of GDP	2,0	3,0	2,3	2,2

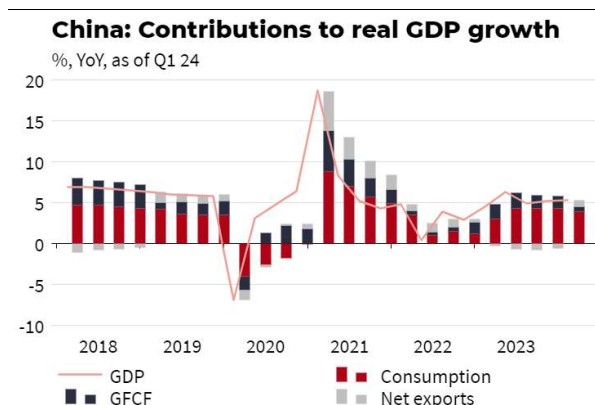
CHINA

- **GDP growth is expected to slow over the forecast horizon, with the real estate sector correction as the main drag.**
- **Inflation will remain low in 2024 given fragile domestic demand.**
- **Policymakers have accelerated support measures to reverse the slowdown in the housing market but are not expected to provide a structural solution.**

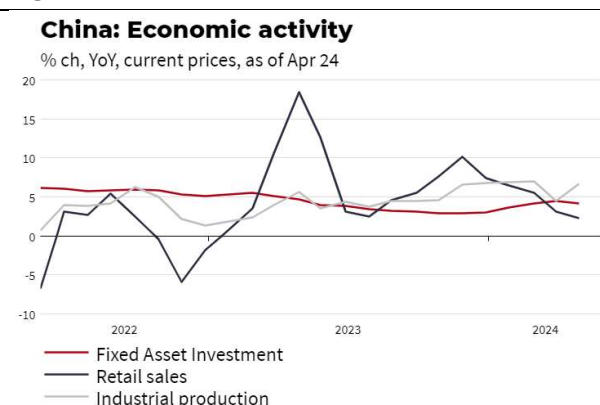
GDP growth is expected to experience a structural deceleration over the forecast horizon. The ongoing correction in the property sector will continue to weigh on investment amid persistent financial stress among property developers and local governments, slowing demand for housing, and a housing surplus. On the export front, rising tensions with the United States and its allies will continue to weigh on China's trade and technological advances. Medium term, the growth outlook is set to be structurally weaker also due to lasting effects of the slowdown in the housing market and still high precautionary savings by households.

Rebalancing efforts toward consumption-led growth could increase China's growth potential. Policy, however, still favours the manufacturing industry to compensate for the weakness of the real estate market, while signs of production overcapacity have emerged and could fuel trade tensions. Despite the economic slowdown, support measures and a capital account that is still relatively closed should help the deleveraging process.

Growth surprised in Q1, driven by consumption Economic activity continues to show mixed signals



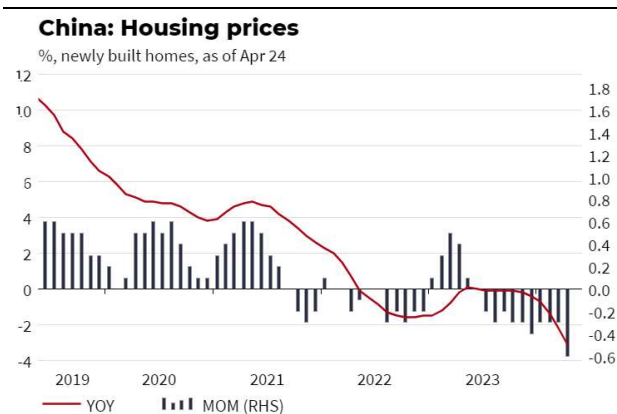
Source: SG Economic and Sector Studies, Refinitiv



Source: SG Economic and Sector Studies, Refinitiv

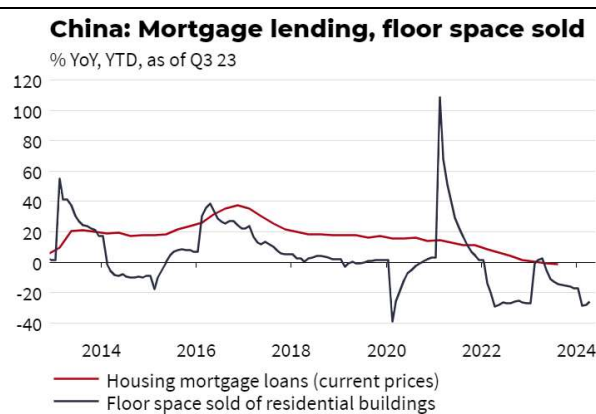
The slowdown in real estate will continue to be a major drag on growth, both on the supply and demand side. The acceleration of the contraction in property prices and sales in April 2024 prompted the authorities to accelerate support measures, including absorbing the housing surplus with the introduction of a CNY 300 billion facility from the PBoC to state-owned enterprises, mandated to purchase unsold housing and convert it into social housing. The facility can encourage bank lending to the tune of CNY 500 billion, according to the authorities. Given the size of the unsold housing stock (391 million square meters at the end of April 2024), only a part can be absorbed by this measure (~10%). This trend is expected to continue over the forecast horizon. The shrinking population and slowing urban population growth will structurally reduce the demand for housing in the coming years and make it difficult to absorb excess stocks.

House prices continued to fall



Source: SG Economic and Sector Studies, Refinitiv

Demand for housing is still struggling to recover



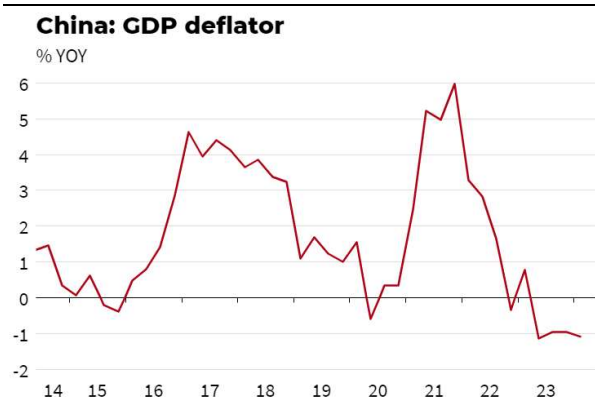
Source: SG Economic and Sector Studies, Refinitiv

Export growth is expected to pick up slightly in 2024, driven by the semiconductor sector, but this will be moderated by trade tensions. Global cyclical upturn in the electronics sector support demand for China's manufactured goods, in line with robust exports from neighbouring South Korea or Japan. China's dominance in the global renewable energy supply chain is offsetting a decline in demand in other sectors. China has secured a position as a low-cost producer in strategic sectors such as automotive, solar, wind and rare earth metals to produce them. If we take the example of electric vehicles, China has gone from being a net importer in 2019 to a net exporter in 2023. While ongoing tensions with the United States and its allies may hamper China's technological progress (particularly in the semiconductor space), these sectors are expected to continue to support export growth over the forecast horizon.

Inflation will remain low in 2024, despite a decline in disinflationary pressures. Although lower global commodity prices and low food prices have contributed to disinflationary pressures, inflation remains close to zero (0.3% YoY in April) and the contraction of the GDP deflator for five consecutive quarters reflects fragile domestic

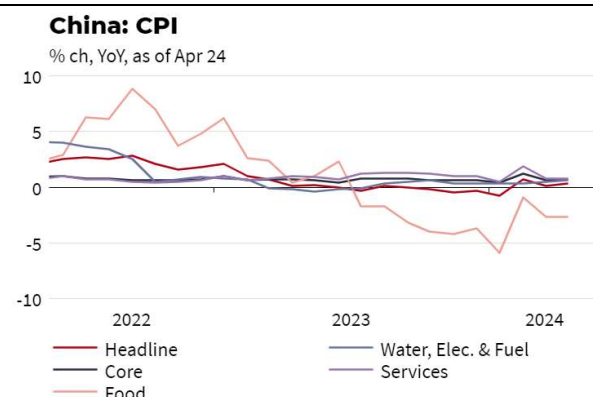
demand. The stabilisation of food prices, driven by pork prices, should nevertheless stabilise inflation this year.

The deflator has been contracting since the beginning of 2023



Source: SG Economic and Sector Studies, Refinitiv

Inflation remains close to zero, far from the authorities' 3% target for 2024



Source: SG Economic and Sector Studies, Refinitiv

The policy mix will remain accommodative in 2024 to support growth and mitigate the real estate crisis but is not expected to provide a structural solution. The stimulus measures are expected to increase infrastructure spending to help offset weak real estate investment. In a context of contraction in property prices, transfers from the central government to local governments are expected to support refinancing needs, although they will not solve the problem structurally.

Support measures announced since the beginning of the year

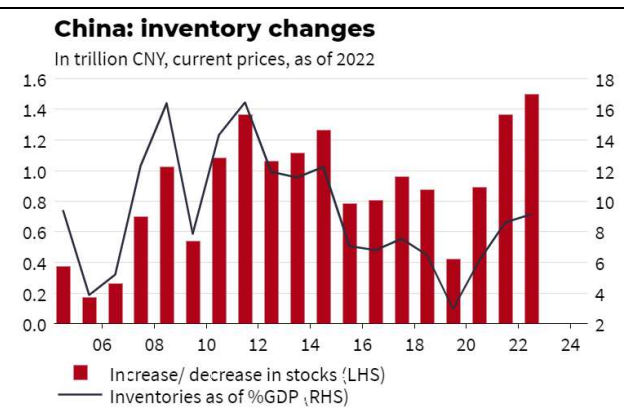
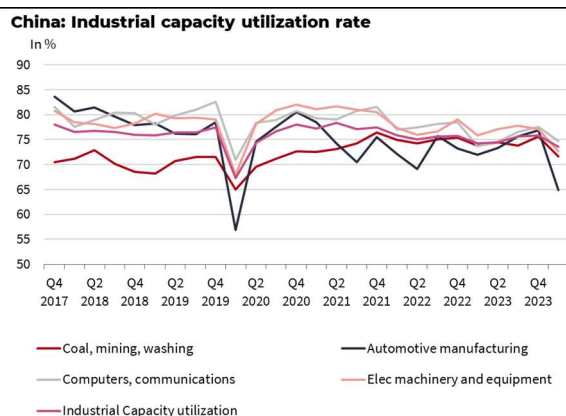
Property market	<p>01/2024: The approval of the "whitelist" mechanism in which the government recommends to banks residential projects that can benefit from financial support and coordinates with financial institutions to meet the needs of the projects.</p> <p>05/2024: (1) reduction of the requirements for the provision of funds from 5 pp to 15% for first-time buyers and to 25% for second-time buyers (2) Abolishing the national minimum on mortgage rates (3) introduction of a CNY 300 billion facility to support CNY 500 billion bank loans to state-owned enterprises mandated to purchase unsold properties and convert them into self-financed social housing</p>
Monetary policy	02/2024: PBoC lowered the 5-year prime lending rate (LPR) by 25 bps to 3.95%
Fiscal policy	05/2024: CNY 1 trillion of special central government bonds with long maturities ranging from 20 to 50 years (not accounted in the official budget deficit)

Downside risks to the growth outlook are related to overcapacity and disinflationary risks, partly caused by persistently weak demand. Industrial utilization capacity has been on a downward trend since the pandemic, especially in the automotive sector, while inventory growth has also been faster than pre-pandemic rates. As production is unable to find sufficient domestic demand, stocks are accumulating and encouraging industries to export the surplus at more competitive prices, the authorities have shown their willingness to support the "new

productive forces" as a growth driver. This could accentuate the existing imbalances in Chinese growth between manufacturing and consumption.

Industrial utilization capacity has been declining since the pandemic

Inventories are growing at faster rates than pre-pandemic



Source: SG Economic and Sector Studies, Refinitiv

Source: SG Economic and Sector Studies, Refinitiv

Geopolitical tensions will remain present and may intensify. Geopolitically, the trade and national security relationship with the United States will continue to weigh and shape global value chains and China's role in them.

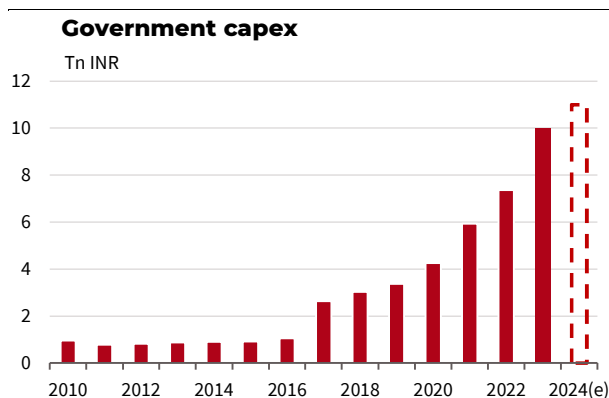
China	2023	2024f	2025f	2026f
Real GDP, % ch YoY	5.2	4.3	4.0	3.8
Household consumption	7.9	5.6	4.9	3.8
Public consumption	4.5	4.3	4.3	4.1
Investment	4.2	3.9	3.9	3.8
Exports of goods & services	1.1	3.2	2.0	2.6
Imports of goods & services	1.9	4.6	3.5	2.3
Inflation, % annual average	0.3	0.7	1.2	2.0
Fiscal balance, % of GDP	-6.8	-6.9	-6.8	-6.7
Public debt, % of GDP	83	90	96	101
External debt, % of GDP	16	17	17	18
Current account balance, % of GDP	2.1	1.7	1.3	1.0

INDIA

- **Investment is set to slow over the medium term, following a strong momentum driven by public investment.**
- **Growth should therefore land back to its potential (6-6.5%) in the medium term.**

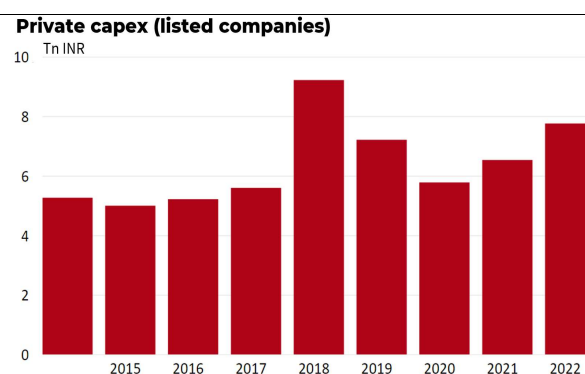
Investment will slow in the medium term. Public investment should start to slow, in line with the planned fiscal consolidation, which we expect to stay in PM Modi's agenda after the election. Growth in investment by private companies is too weak for the time being to hope to extend the current momentum in total investment. Private consumption should not take over either, especially as it has been growing below the historical average in the last year, as inflation still prevents the easing of monetary conditions. This would contribute to a slowdown in Indian growth, which is currently above potential.

Public investment should grow at a slower pace in 2024



Source: CSO, SG Economics and Sector Studies

Private capex contributes less to growth



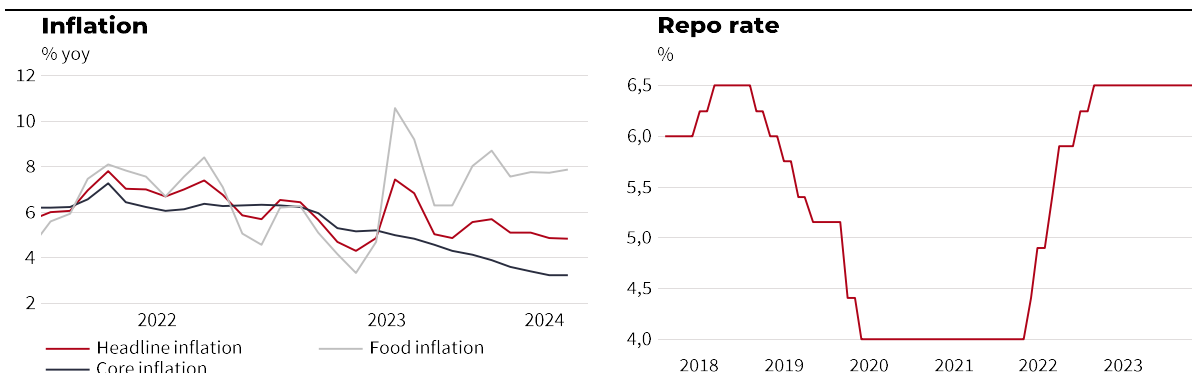
Source: Eikon, SG Economics and Sector Studies

Inflation is on a downward trajectory in 2024, due the deceleration in core inflation since 2023, which offsets the impact of high food prices. The lagged effects in 2024 of the restrictive monetary policy, which for the time being does not seem to be having an impact on credit (15% growth YoY), should contribute to a further deceleration in inflation. Inflation is thus moving closer to the RBI target (4%).

The inclusion of government bonds in the JP Morgan emerging index will contribute to the attractiveness of local-currency bonds, amid easing pressures on the rupee in the last quarters. Although of a small magnitude (USD20-30Bn inflows are expected due to passive investors), the dollar inflows expected in 2024 should be beneficial for the rupee. Note however that this gradual expansion of the foreign investor base raises volatility risks in times of crises. The FX rate policy from the RBI will be key to ensure macroeconomic stability in such times.

The increase in inflation is (again) accounted for by food prices

The RBI is at the top of its tightening cycle



Source: RBI, Refinitiv and SG Economics and Sector Studies

Source: RBI, Refinitiv and SG Economics and Sector Studies

Fiscal consolidation has begun and the fiscal balance will improve on the medium-term. The interim 2024-2025 budget expects a reduction in the central government fiscal deficit, landing at 5.1% of GDP (vs. 5.6% for 2023). Public investment should grow (albeit slower than in the last two fiscal years) slightly faster than nominal GDP, while public expenditures should not expand much in 2024. The re-election of PM Modi provides political continuity for further consolidation over the medium-term.

India's officially neutral position towards Russia remains a source of geopolitical uncertainty. Trade flows are growing, as monthly imports from Russia were multiplied more than tenfold compared to the historical mean. However, this situation raises questions on the nature of India's international relations in the medium term, and the risk of exposition to potential sanctions.

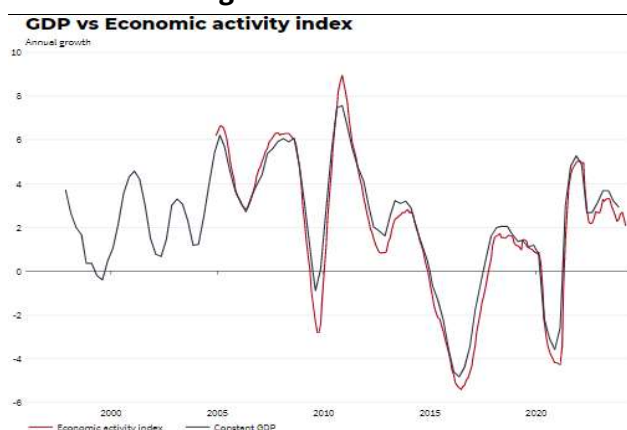
India	2023	2024f	2025f	2026f	2027f	2028f
Real GDP, % ch yoy	8.2	6.5	6.2	6.2	6.2	6.2
Household consumption	4.0	6.5	6.0	6.0	6.0	6.0
Public consumption	2.5	6.0	5.6	5.6	5.6	5.6
Investment	9.0	7.5	6.5	6.2	6.2	6.2
Exports of goods & services	2.6	7.5	6.0	6.0	6.0	6.0
Imports of goods & services	10.9	8.0	6.0	6.0	6.0	6.0
Inflation, % annual average	5.4	4.7	4.5	4.5	4.7	4.7
Fiscal balance, % of GDP	-9.2	-8.5	-8.0	-7.7	-7.5	-7.5
Public debt, % of GDP	84	84	84	83	83	83
External debt, % of GDP	17	16	15	14	14	14
Current account balance, % of GDP	-1.7	-1.2	-1.5	-1.5	-1.5	-1.5

BRAZIL

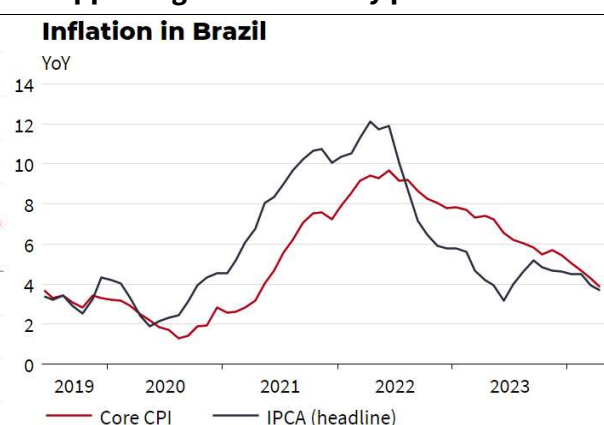
- **Growth expected to slow in 2024, after a solid 2023.**
- **Inflation kept easing and is now within the target band.**
- **The BCB opted for a cautious approach amid uncertainty of Fed easing and of domestic fiscal policy.**

Growth came flat in 4Q23 in line with our expectations. The slowdown in the second half of 2023 follows surprisingly strong growth in the first half and had been anticipated, given signals from high frequency indicators, such as the Central Bank's economic activity index (IBC-Br). Although the index has been volatile in the last year, it has a good track record in anticipating official GDP releases, as it well summarizes indicators related with agriculture, manufacturing, and services sector. Going forward, we expect growth to remain weak in 2024 reflecting moderation in real wage gains (real effective earnings were up just over 4% in March compared to 7% the year before).

Growth is cooling...



... supporting disinflationary process



Source: Banco Central do Brasil, IBGE - Instituto Brasileiro de Geografia e Estatística, Refinitiv, SG Economics and Sector Studies

Inflation keeps cooling, driven by easing core pressures, with IPCA easing to 3.7% YoY in April, also thanks to declining transport prices contribution. Thanks to significant easing over the last years, this is now within the 4.5% upper limit of inflation targeting set for this year (with 3% as the central target within the range).

Nonetheless, the central bank's rate setting body opted for caution in its May meeting, reducing rate by just 25bp to 10.5%, less than the 50bp that it had projected in March. The decision was motivated by a more adverse global environment – not least related with increased uncertainty surrounding the beginning of the easing cycle in the US – and potential for domestic upside surprise, in connection with a more expansionary fiscal policy.

Indeed, in the 2025 budget proposal the government weakened fiscal targets. A primary balance target substituted the anticipated 0.5% GDP surplus in 2025, while targets were also revised down by around 0.5pp GDP for the following years, and now the 1% surplus previously projected for 2026 is set to be reached just in 2028. Such revisions come in the direction of our fiscal forecasts which were already more conservative than the government ones, motivating only minor corrections of our medium-term forecasts and no changes for the short term. Indeed, we had already remarked how the objective looked challenging, as it was largely reliant on record increase of net revenues. Earlier last year, President Lula himself casted doubts on the need to erase the deficit already this year, pushing the need to support other programs, notably social spending. Moreover, our deficit forecast integrates the expectation that interest expenses will remain elevated.

Upside risks to the outlook persists in connection with households' consumption, which could grow more than anticipated, stimulated by solid real effective earnings growth, and with investments, which could be further sustained by rate cuts.

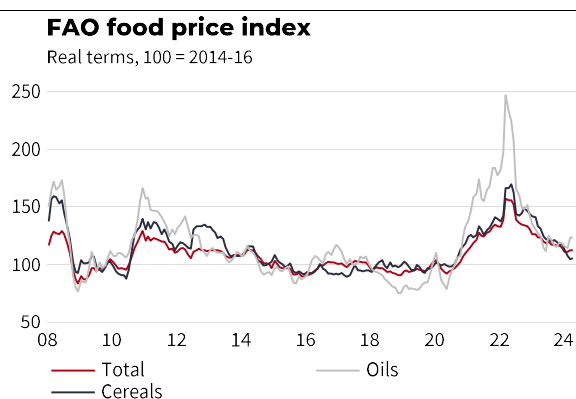
Brazil	2023	2024f	2025f	2026f
Real GDP, % ch YoY	3.0	1.6	1.9	2.0
Household consumption	3.4	1.9	2.0	2.0
Public consumption	1.5	1.5	1.5	1.3
Investment	-3.0	1.2	1.4	1.7
Exports of goods & services	9.0	3.0	3.0	3.0
Imports of goods & services	0.0	1.5	2.5	2.5
Inflation, % annual average	4.6	4.0	3.5	3.5
Fiscal balance, % of GDP	-8.0	-7.5	-6.0	-5.5
Public debt, % of GDP	87	90	91	92
External debt, % of GDP	34	33	33	33
Current account balance, % of GDP	-1.7	-1.7	-1.7	-1.9

AFRICA

- **The regional economic environment is gradually improving, with a reduction in inflation and a rebound in international private capital flows.**
- **Regional growth forecasts remain unchanged, however, as growth is expected to disappoint in some major economies (South Africa, Egypt, Angola).**
- **These prospects remain fragile, whether due to weak growth or still vulnerable public finances.**

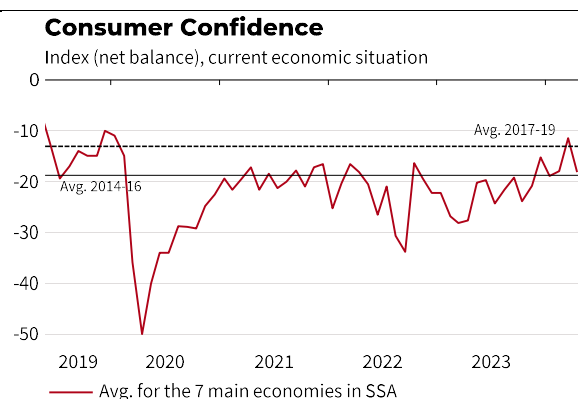
The regional economic situation is slowly improving. Firstly, inflation continues to decelerate in most countries, and only those that have recently experienced a sharp depreciation of their currencies (Nigeria, Angola, DRC, Zambia) continue to record rising and/or 2-digit inflation rates. This has been made possible mainly by the steady decline, since March 2022, in world food prices (and in particular cereal prices, at their lowest since September 2020). This reduction in inflationary pressures has contributed to the – still fragile – improvement in main confidence indices, both for households (now back to their pre-Covid levels) and for corporates. Secondly, international private financial flows confirmed their return. While no new countries in the region issued Eurobonds in 2Q24, sovereign spreads continued the (slow) decline that began in 3Q23. FDI remains resilient for the time being (stable in 2023, compared with a 9% decline in YoY terms on average in emerging economies, according to the UNCTAD), while portfolio investments seem to be growing again in some of the region's "frontier" markets (Nigeria, Kenya, Ghana to a lesser extent, etc.).

The drop in global food prices has led to a decline in inflation



Source: Refinitiv, SG Economic and Sector Studies

Households' confidence levels are now close to their pre-Covid levels

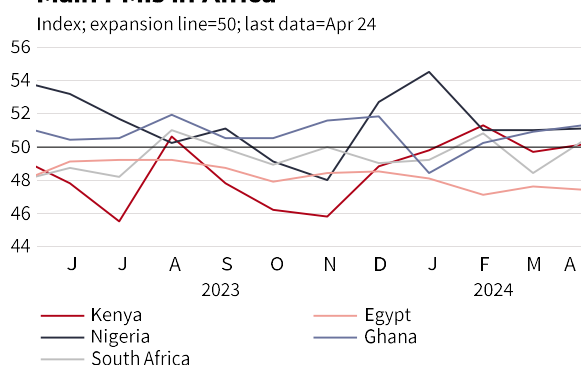


Source: Refinitiv, SG Economic and Sector Studies

Despite these improvements, we are keeping our regional growth forecast unchanged, at 3.5% in 2024 (vs. 3.2% in 2023), then 3.8% in 2025. Indeed, weaker-than-expected growth prospects in some large economies in the region should offset the (slight) improvement in forecasts in the majority of smaller economies. Growth in South Africa, Egypt and Angola remains respectively hampered by i) persistent structural constraints on activity (electricity, transport, etc.), ii) sluggish oil production (ageing fields, lack of investment, etc.), and iii) strong financial instability (devaluation of the USD/EGP by 37% and increase in the key rate of 600bps in March 2024) and the repercussions of the attacks in the Red Sea on traffic in the Suez Canal. More generally and for other countries in the region, the recovery in activity expected for 2024 and 2025 should mainly be driven by private demand, which will continue to benefit from the fall in inflation. The possible easing of monetary policies that are now mostly restrictive (in real terms) could (marginally) help. Public demand is expected to be less dynamic, with the majority of African countries having initiated budgetary consolidation efforts. Finally, external demand will remain dependent on changes in commodities prices (especially oil), which are currently particularly volatile.

Corporates are also more confident (except in Egypt)

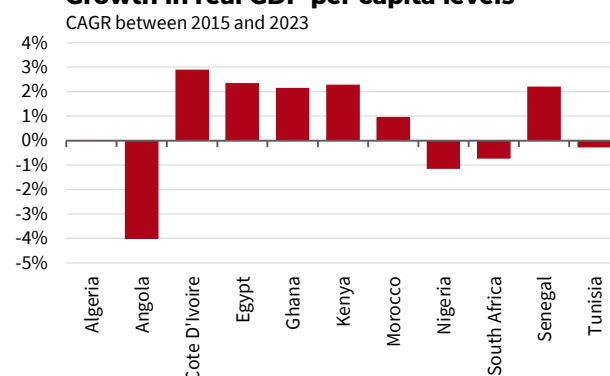
Main PMIs in Africa



Source: Refinitiv, SG Economic and Sector Studies

Several countries have registered a decrease in their GDP per capita levels since 2015

Growth in real GDP per capita levels



Source: Refinitiv, SG Economic and Sector Studies

Several risks continue to weigh on this (limited) acceleration. First of all, expected growth rates remain insufficient (to ensure a sustainable increase in per capita income given still strong African demographic growth, of the order of 2.5% per year) and fragile, because they are often dependent on climatic conditions (the primary sector often remains the leading “employer” in Africa). This vulnerability of growth appears all the more problematic as the region's political structures remain fragile. Secondly, the public balances of the region are still fragile: tensions on domestic financing conditions of sovereigns remain present, and the problem of the low sustainability of public debts remains unresolved (with, in particular, significant risks weighing on the refinancing of FX public debts).

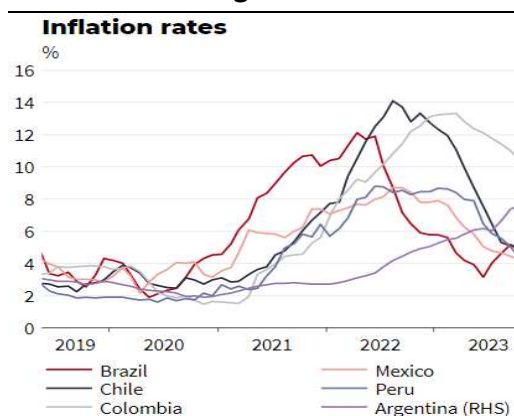
LATIN AMERICA

- **Easing cycle is well underway, with timid hopes for Argentina.**
- **This is supported by falling import prices and subdued growth.**
- **Real rates remain rather elevated.**
- **Risk sentiment has improved amid positive macro surprises.**

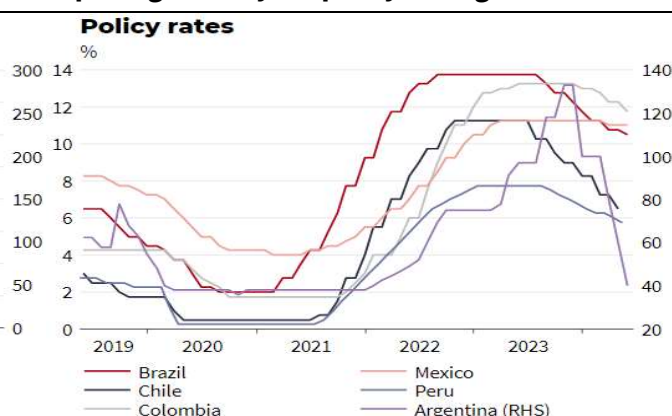
The region leads in the easing cycle, as disinflation is well underway. Inflationary pressures kept easing in the largest economies of the region, supported by contracting import prices and subdued growth. Also in Argentina, pressures have eased over the last quarter, following the stark measures put in place by the new President Milei, such as deep budget cuts and despite the strong devaluation of the currency. This is fuelling hopes of regaining control of price pressures, although these still have to be tested in the coming months, with optimism motivating the significant rate cuts by the central bank.

This follows the ongoing easing cycle already started by the other large central banks of the region. However, despite such cuts, real rates remain elevated in the region, thanks to easing price pressures, at around 7% in Brazil and 6% in Mexico, while significantly lower at below 3% in Chile, as the country's economy stagnated in 2023.

Inflation is cooling in most countries ...



...paving the way for policy easing

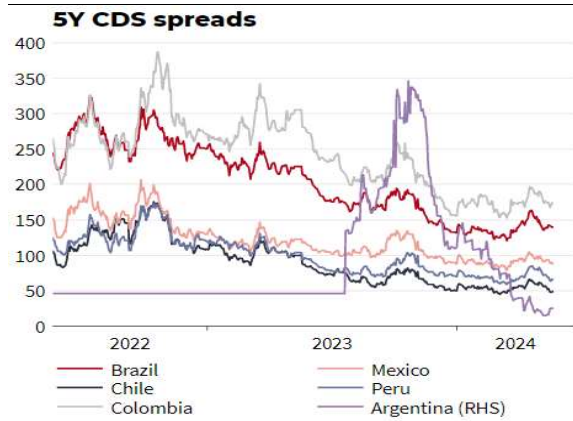


Source: National central banks and Statistics Institutes, Refinitiv, SG Economics and Sector Studies

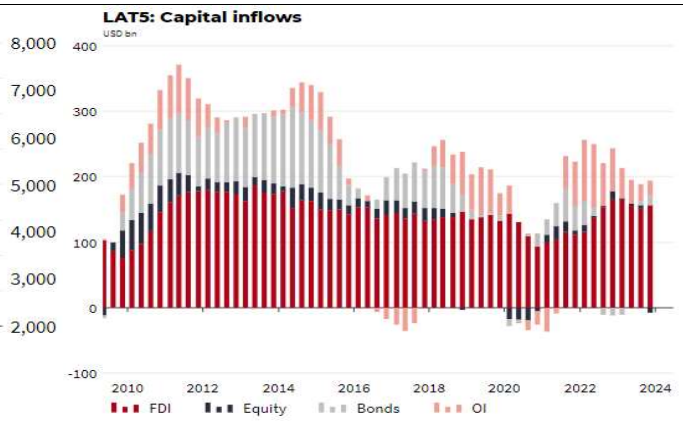
Growth is overall expected to significantly cool in 2024 and is set to be just around half of the solid expansion recorded in 2022 (~4%) on the back of lagged effects of tighter policy, weak external demand and lower commodity prices throughout the region.

Risk sentiment keeps improving, in connection with growth surprises. Rather positive surprises on economic data releases (expectations for inflation have been muted, while those for growth have broadly improved – with some exceptions), have improved investor sentiment. 5Y CDS premia have moderately declined since March, after a short-lived rise in October in parallel with rising yields of US long term bonds. Capital inflows to Lat5 countries have remained resilient in Q4 2023, consisting mainly of FDIs.

Risk sentiment has improved.



Capital inflows remained resilient in Q4 2023



Source: Refinitiv, IMF, SG Economics and Sector Studies

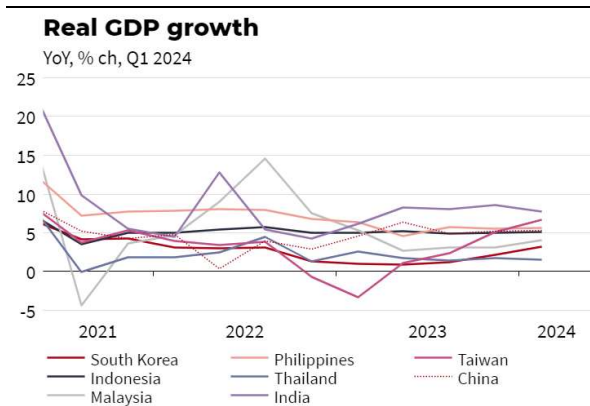
EMERGING ASIA

- **Emerging Asia, with the exception of China, will remain dynamic thanks to resilient domestic demand and the recovery of the semiconductor industry.**
- **Inflationary pressures are gradually dissipating. However, climate risks such as El Niño may exacerbate pressures on food prices.**
- **Downside risks related to economic and geopolitical uncertainties may weigh on regional investment and trade.**

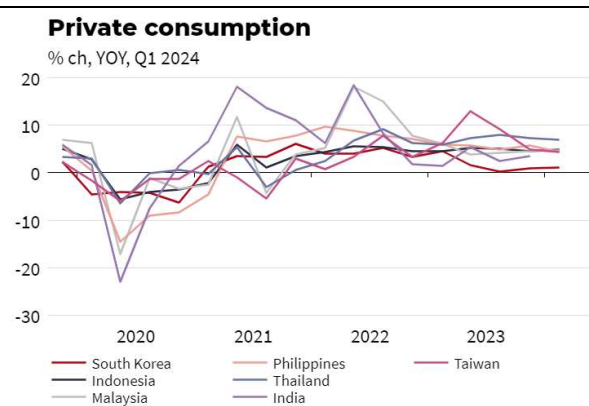
Regional growth is expected to remain buoyant this year as inflationary pressures dissipate. Domestic consumption, which accounts for more than half of GDP for most countries in the region, will continue to support regional growth. The labour market is improving, with unemployment in most economies already back to pre-pandemic levels. Tourism has continued to recover, supporting consumption and service activity. Regional trade is gradually improving, driven by the recovery of the semiconductor sector.

Growth in the region remains dynamic

... supported by private consumption



Source: SG Economic and Sector Studies, Refinitiv

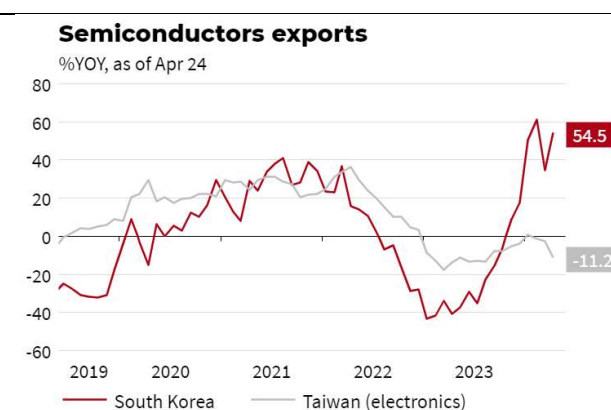
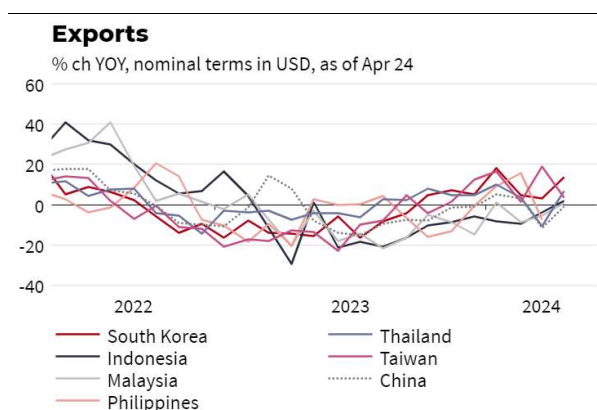


Source: SG Economic and Sector Studies, Refinitiv

External demand is gradually picking up and the recovery in the semiconductor cycle is improving the region's trade prospects. Exports are gradually recovering, especially for technology exporters (Taiwan and South Korea). The semiconductor industry is seeing signs of improvement. Semiconductor exports and production have accelerated in South Korea since August 2023, starting a cyclical recovery from the industry's contraction that lasted more than a year. In 2024, this improvement driven by the recovery in semiconductors will continue. That said, fragmentation and geopolitical tensions pose a downside risk to exports, especially the semiconductor industry.

External demand is gradually picking up

Driven by the recovery of the semiconductor industry, particularly for South Korea



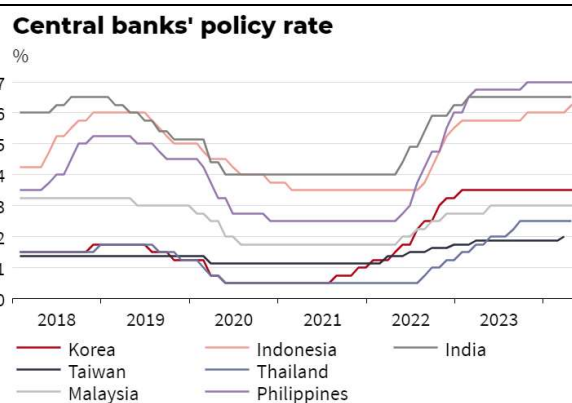
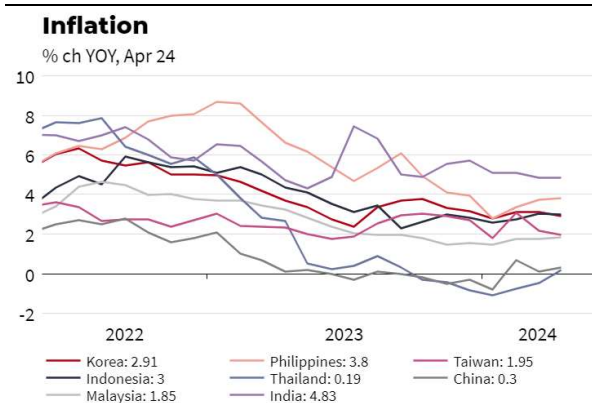
Source: SG Economic and Sector Studies, Refinitiv

Source: SG Economic and Sector Studies, Refinitiv

Inflationary pressures will continue to ease, but upside risks from climate change (El Niño) may exacerbate food prices. Despite robust domestic demand, most economies have returned to pre-pandemic inflation averages and close to the central bank target (India, Philippines, Vietnam, Indonesia), as pressures on energy and food prices eased. That said, climate change combined with the arrival of El Niño can affect agriculture and crops in the region and exacerbate food prices.

The pace of inflation is stabilizing for most countries around the central banks' target

... allowing most central banks to pause their tightening cycle



Source: SG Economic and Sector Studies, Refinitiv

Source: SG Economic and Sector Studies, Refinitiv

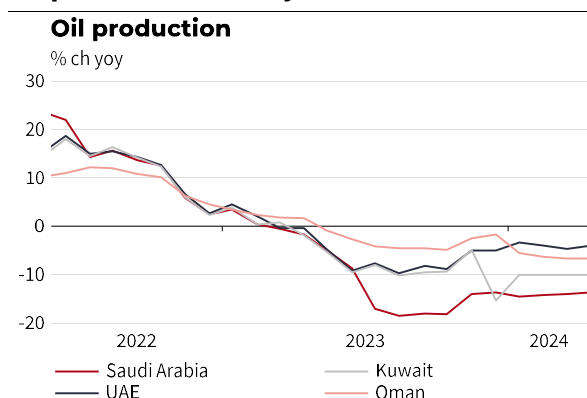
Risks in the region are bearish given the uncertainties related to the external environment that remain high. Higher inflation in developed economies could lead to further tightening of financial conditions and could put pressure on growth and investment in the region. A more pronounced or prolonged correction in China's property market could affect countries in the region whose exports are strongly linked to China's investment and demand for raw materials. A slowdown in productivity and investment in China could also weigh on the region, as the region is highly dependent on Chinese demand, investment, and global value chains. In the medium term, given the deterioration in U.S.-China relations, including on trade policies and Taiwan's status (including with the upcoming U.S. presidential elections), risks of further fragmentation of global trade could weigh on the region, which is vulnerable to declining trade flows and foreign direct investment.

GULF STATES

- **Regional growth in 2024 should be lower than initially expected, now forecast at around 2.5%.**
- **Growth would remain driven by non-hydrocarbon sectors, while oil production should remain stable.**
- **The conflict between Israel and Hamas remains the main risk.**

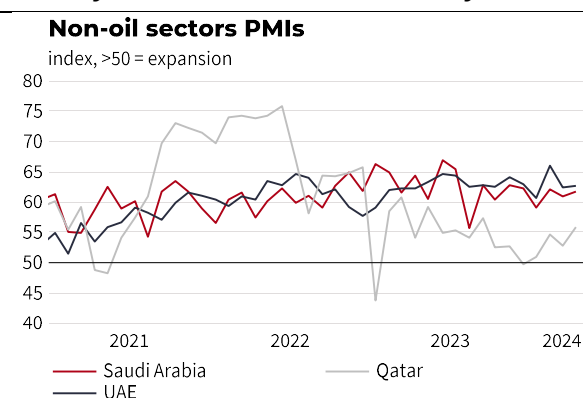
Previously estimated at around 1%, growth in the GCC (Gulf Cooperation Council) countries was finally established at around 0.5% in 2023 (vs. 7% in 2022). This is mainly explained by the contraction in oil production decided by OPEC+ in April 2023 (Saudi Arabia adding a voluntary reduction in its production of one million barrels/day). The countries most dependent on their oil sector (Saudi Arabia, Kuwait) even recorded recessions (-0.7% for the first country, for instance), with Qatar benefiting from a more resilient gas production. In all countries, non-hydrocarbon sectors remained dynamic.

Oil productions have yet to recover



Source: Refinitiv, SG Economic and Sector Studies

Non-hydrocarbon sectors remain dynamic

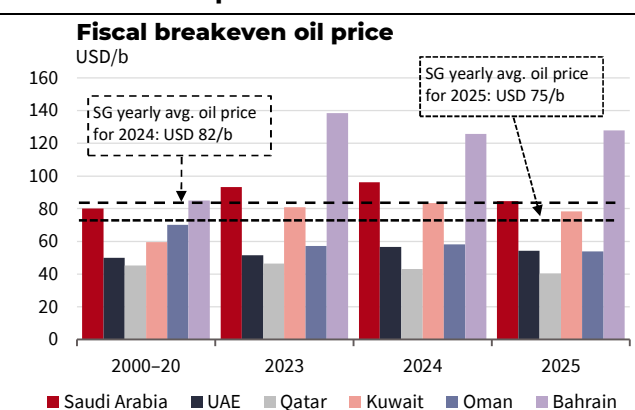
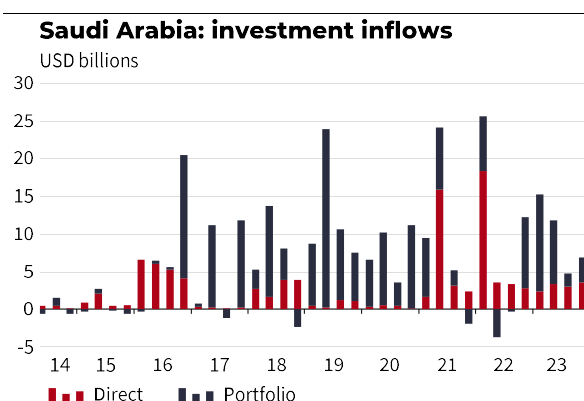


Source: Refinitiv, SG Economic and Sector Studies

The outlook for 2024 and 2025 remains generally solid, even if regional growth for this year should be lower than expected (2.5% forecast at best in 2024, then 4.5% in 2025). At present, OPEC+ appears to want to maintain a cautious posture, and it is now likely that the voluntary reductions announced in 2023 will be maintained until the end of 2024 (while the organization's market share in global oil supply is now at around 40%, its historic low). Oil production could rebound from 2025 onwards (in particular to meet global demand, still driven by China), while gas production in Qatar will then benefit from the end of extension work on its North Field (scheduled for 2026). Growth would therefore remain mainly driven by non-hydrocarbon sectors, which will continue to benefit from the significant increase in “green” (more particularly, mitigation) and economic diversification investments, as the region remains one of the most exposed to climate risks (more particularly, transition risks).

On the demand side, public demand could slow slightly in 2024 and 2025, suffering from the (admittedly limited) budgetary consolidation efforts undertaken in the region. This should, however, be offset by increased dynamism in private demand, which benefits from both i) low inflation (particularly linked to the reduction in world food prices), ii) the good performance of labour markets, and iii) the increase in incoming investment flows (for example in Saudi Arabia, where the “structural” level of FDI has increased slightly compared to the previous decade). Note, however, that the region's monetary policy rates (following that of the United States) could remain higher for longer than initially expected, in line with a FED that is likely less accommodating than expected.

Investment inflows in Saudi Arabia are resilient **Oil prices should remain high enough to maintain solid public finances**



Source: Refinitiv, IMF, SG Economic and Sector Studies

Source: Refinitiv, IMF, SG Economic and Sector Studies

Several risks continue to weigh on these prospects, even if the region's external and budgetary balances remain particularly solid. For example, all countries – except Bahrain – show fiscal “breakeven oil prices” lower (or very slightly higher for Saudi Arabia) than our oil price forecasts for 2024 and 2025 (annual average: USD 82/b then 75/b, respectively). **The biggest risk remains the conflict between Israel and Hamas.** An escalation/generalization of the conflict (for example with the involvement of Iran) would strongly impact the Gulf countries: decline in the general attractiveness of the region due to security issues; loss of investor confidence which would undermine the various projects initiated by governments as part of their diversification plans; drop in tourism revenues, etc. Furthermore, greater unrest in the Red Sea would inevitably affect regional supply chains (hydrocarbon exports, imports of consumer/equipment goods).

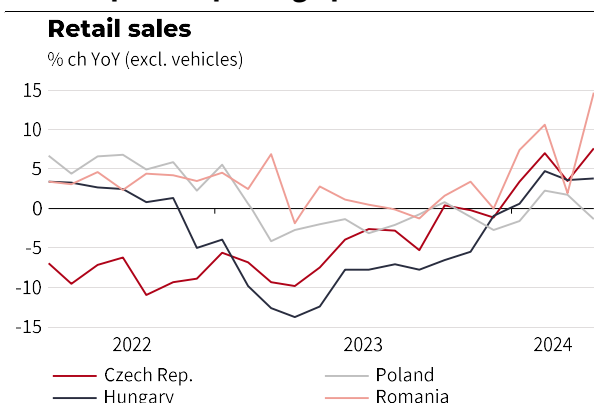
CENTRAL AND EASTERN EUROPE

- **Growth should rebound slightly in 2H24 and 2025 driven by recovery in domestic demand.**
- **Inflation has slowed leading to first rate cuts in Poland Hungary and Czech Republic. This trend is expected to continue and further rate cuts should occur in 2H24.**
- **Downside risks relate mainly to a slower-than-expected EU fund absorption, to the war in Ukraine and the related uncertainties.**

Growth has gradually resumed since the start of 2024, mainly driven by domestic demand. After a marked deceleration in 2023 in the wake of the slowdown in activity in the euro area and tight financial conditions, growth is gradually restarting in the region in a context of disinflation and gradual loosening of monetary policies. Private consumption has shown a gradual recovery thanks to growth in real wages since the end of 2023. The absorption of NextGeneration EU funds is progressing, although slowly: 35% of funds allocated to Czech Republic were disbursed in May 2024, 14% for Poland, 24% for Bulgaria, 48% for Romania compared to more than 60 % for Italy for example.

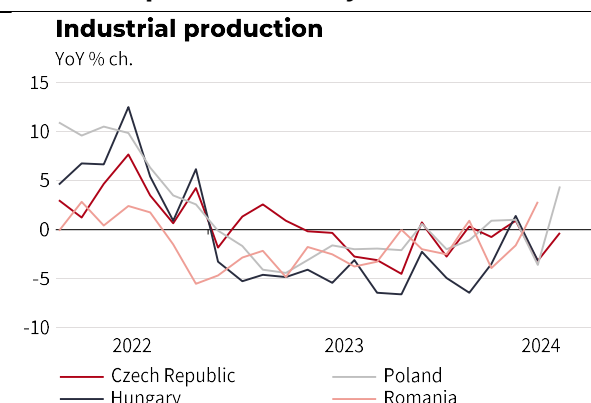
In January 2024, the European Commission relaxed the freezing of cohesion funds and NextGeneration EU funds for Hungary. Poland has also regained access to European funds (first disbursement of NextGeneration EU funds in April 2024 and Cohesion Fund from the 2021-2027 budget). By contrast, industrial production, particularly for the automobile sector, remains sluggish throughout the region. In addition, the significant inventory reduction observed in Czech Republic, Poland and Romania also weighed on growth during the first months of 2024.

Consumption is picking up



Source: SG Economic and Sector Studies, Refinitiv

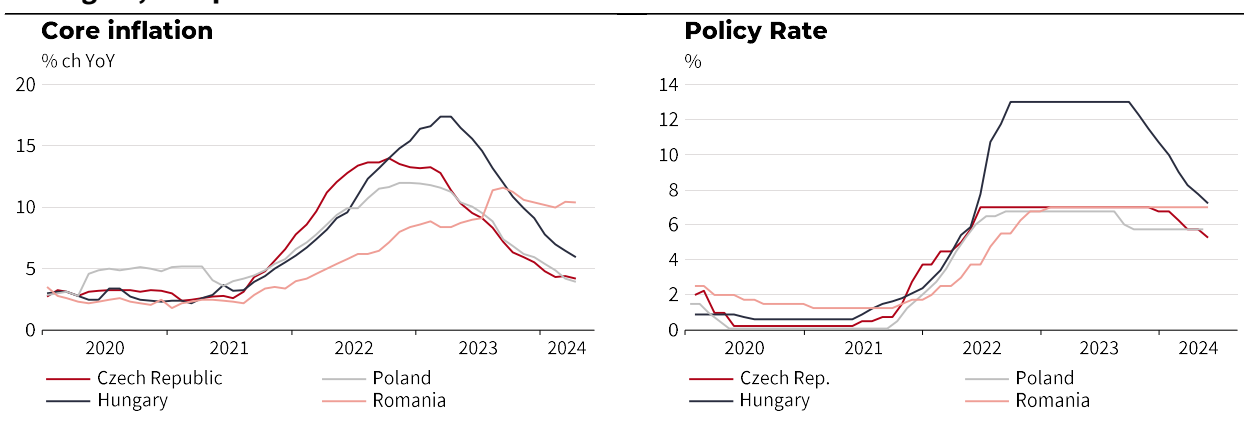
Industrial production not yet



Source: SG Economic and Sector Studies, Refinitiv

Disinflation has continued in the first half of 2024 even if the consumer price index remains slightly above central bank targets. The price of gas on the European market remained moderate and core inflation (excluding food and energy prices) continued to decelerate in Czech Republic, Poland and Hungary. In this context, several central banks in the region (Czech Republic, Poland, Hungary) have started to lower their key rates since 3Q23. Romania is an exception with high core inflation (10.4% in April 2024) in a context of strong wage increases and still expansionary fiscal policy.

Core inflation has continued to decelerate in the region, except in Romania Further rate cuts could take place in 2024



Source: SG Economic and Sector Studies, Refinitiv

Source: SG Economic and Sector Studies, Refinitiv

Growth in the region is expected to continue its gradual recovery in 2H24 and 2025, driven by the recovery in domestic demand. In a context of moderating inflation, purchasing power and household consumption should continue to recover. However, the end of several household support measures (such as in Poland where the Energy Shield and the Solidarity Shield expired in December 2023) will limit the rebound.

Public investment is expected to remain dynamic due to the continued absorption of European funds: Cohesion Fund and NextGeneration EU Fund. On the other hand, private investment and exports are expected to remain weak in a context of still tight financial conditions and a slow recovery in the euro area.

Fiscal policy should become more restrictive due in particular to the reactivation of European budgetary rules and the fiscal consolidation that will follow. Romania, which posts one of the highest fiscal deficits in the region, has not yet undertaken fiscal consolidation given the busy electoral calendar in the country in 2024 (parliamentary, presidential and local elections) as evidenced by the vote last November for a 40% increase in pensions from September 2024. Significant fiscal consolidation will be necessary in 2025, including the implementation of compensatory measures to avoid a significant slippage in public finances.

Disinflation is set to continue in 2H24 and 2025. The slowdown in inflation will be enabled by the moderation of energy and food prices. In this context, central banks in the region could continue to lower their rates in 2H24.

Downside risks to the growth outlook relate mainly to a slower-than-expected EU fund absorption or lower effectiveness of implemented projects to raise growth prospects, and weaker-than-expected external demand. They also relate to the war in Ukraine and the related uncertainties surrounding the availability and price of energy in the region. A total cut-off of Russian gas supplies would have a significant impact on some countries, with a high risk of recession in Hungary, due to its high share of gas in the primary energy consumption, also high in Croatia. Poland and Romania are less exposed.

CONTACTS

Michala MARCUSSEN

Group Chief Economist
+33 1 42 13 00 34
michala.marcussen@socgen.com

Olivier de BOYSSON

Emerging Markets Chief Economist
+33 1 42 14 41 46
olivier.de-boysson@socgen.com

Emmanuel MARTINEZ

Chief Environment Economist
+33 1 57 29 57 88
emmanuel.martinez@socgen.com

Ariel EMIRIAN

Head of macroeconomic analysis
+33 1 42 13 08 49
ariel.emirian@socgen.com

Edgardo TORIJA ZANE

Head of macro-sectoral and macro-finance
analysis
+33 1 42 14 92 87
edgardo.torija-zane@socgen.com

Foly ANANOU

Euro area, France, Germany
+33 1 58 98 93 65
folly.ananou@socgen.com

Benoit ASTIER

South and Central Asia, Turkey, Climate
+33 1 42 14 39 06
benoit.astier@socgen.com

Evelyne BANH

Asia
+33 1 57 29 37 39
evelyne.banh@socgen.com

Paul BERTHIER

Macro-sectoral analysis
+33 1 42 14 38 90
paul.berthier@socgen.com

Constance BOUBLIL-GROH

Climate, Central & Eastern Europe, Russia
+33 1 57 29 08 73
constance.boublil-groh@socgen.com

Jacopo Maria D'ANDRIA

Macro-finance analysis, UK
+33 1 42 14 25 51
jacopo-maria.d'andria@socgen.com

Joe DOUAIHY

Macro-sectoral analysis
+33 1 58 98 64 87
joe.douaihy@socgen.com

Clément GILLET

Africa, Middle East
+33 1 42 14 31 43
clement.gillet@socgen.com

Giovanni PACCHIARDI

Americas
+33 1 58 98 27 11
giovanni.pacchiardi@socgen.com

Francesco PESTRIN

Macro-sectoral analysis
+33 1 57 29 01 59
francesco.pesttrin@socgen.com

Danielle SCHWEISGUTH

Western Europe
+33 1 57 29 63 99
danielle.schweisguth@socgen.com

Stéphanie HUET

Assistant
+33 1 57 29 34 97
stephanie.huet@socgen.com

Yolande NARJOU

Assistant
+33 1 42 14 40 07
yolande.narjou@socgen.com

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