N° 58 | December 24

SCÉNARIOÉCO

Société Générale Economic & Sector Studies

Uncertainty comes at a cost

- In the US, expansionary policies will lift the outlook for growth and inflation in 2025, leaving the Fed less room to cut. The Trump administration is expected to implement tax cuts and a deregulation agenda that will support growth. Trade and migration policies will fuel higher inflation and weigh on growth, not least in the medium-to-longer term. The implementation of the full electoral campaign agenda remains uncertain. If fully implemented, this would fuel significant inflation and weigh heavily on economic growth.
- China's growth challenge remains. We expect further stimulus will give a temporary lift to 2025, but with growth likely to fall short of 5%. The real estate sector remains in structural decline. The momentum in green products exports offers only partial compensation. We expect support measures to be ramped up in 2025 with a focus on consumption.
- The EU faces significant structural competitive headwinds, beyond trade issues with the US and China. Fiscal policy is, moreover, set to become more restrictive at the aggregate level, with the need to secure sustainable public finances in several key member states and to respect the euro area fiscal rules. Political uncertainties have been exacerbated in both France and Germany, causing government instability.
- Geopolitical tensions are set to remain elevated. We assume no further geographical expansion of ongoing conflicts, but also assume that these do not resolve rapidly. Trade tensions are set to further increase and will weigh on growth prospects.

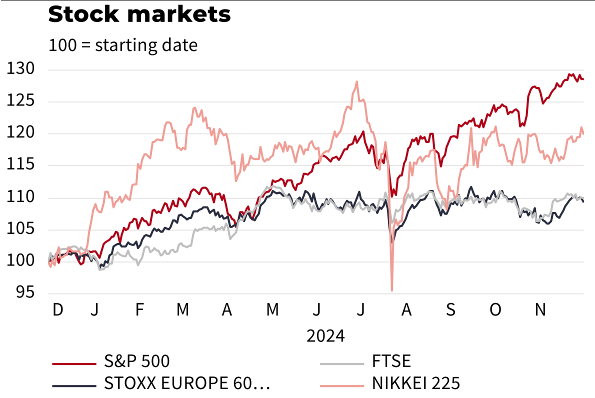
Table of contents

EDITORIAL

HIGH UNCERTAINTY, BUT RISK APPETITE BACK IN THE MARKETS

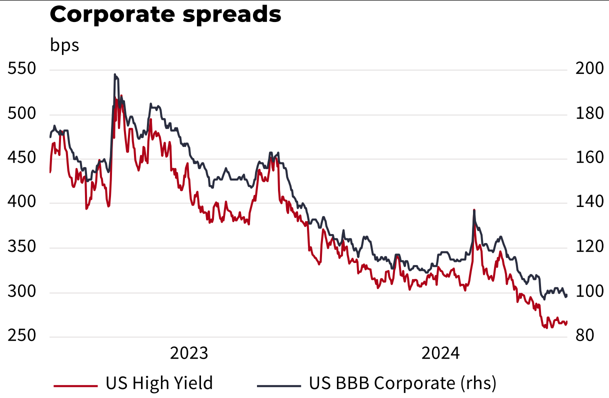
The end of the year is characterised by a renewed appetite for risk in the financial markets since the US elections, particularly in US equities where volatility has returned to pre-summer levels and the S&P 500 has reached record levels, but also in credit markets where corporate spreads have reached historically lows.

US markets are buying growth...



Source: SG Economic and Sector Studies

...and solvency



Source: SG Economic and Sector Studies

Markets expectations are fuelled by surveys reflecting the resilience of the US economy and by the prospect of policies that favour demand (reduction in corporate tax rates, the extension of the TCJA, market deregulation, etc.) and deregulation.

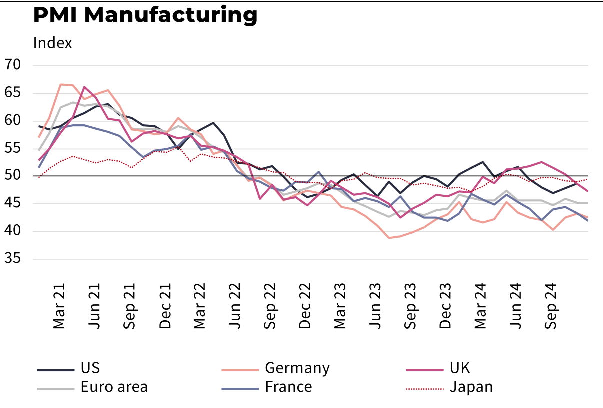
With expansionary policies expected from the new administration, growth forecasts in the United States are being revised upwards for 2025. The introduction of new tariffs on imports is not expected to significantly derail growth momentum in the US next year and could be partly offset by the strength of the dollar (already visible). However, many uncertainties remain about this dynamic. For example, the form that the new administration's migration policy will take is one of them.

The latest figures in the US confirm that the economy is holding up at the start of the fourth quarter, with consumer spending growing slightly more than expected, but the trend towards disinflation appears to have stopped. With expansionary fiscal policy looming, the Fed is expected to be more cautious in its approach to cutting rates. Since September, Fed funds market expectations for December 2025 contracts have been adjusted upwards by 100bp (within a range of 3.75-4%).

In the euro area growth is expected to suffer from higher uncertainties and a more prudent ECB in a general context of fiscal tightening. The possibility of retaliatory measures on potential US tariffs and the weakening of the euro should slow the trend towards disinflation. It should also slow the ECB's rate-cutting path, but not as much as in the US.

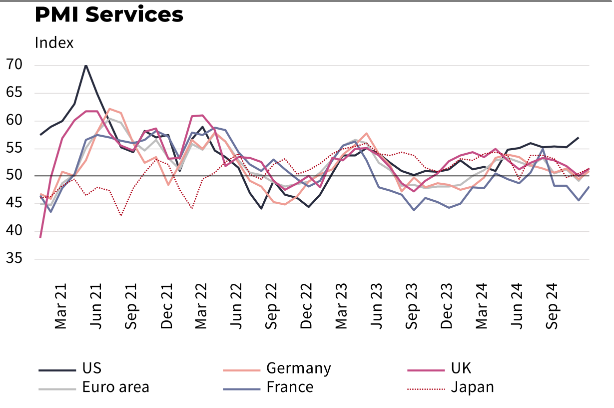
The latest PMI surveys show that activity continues to deteriorate in the euro area. This is particularly true in France where the benefit of the Olympic Games in Q3 has faded. France's PMI index deteriorated the most in the monetary union, probably due to the political and budgetary uncertainties. Surveys are also pessimistic in Germany in the manufacturing industry, but also in the services sector, may be due to political uncertainties ahead of the early elections on 23 February.

Manufacturing activity still suffering...



Source: LSEG, SG Economic and Sector Studies

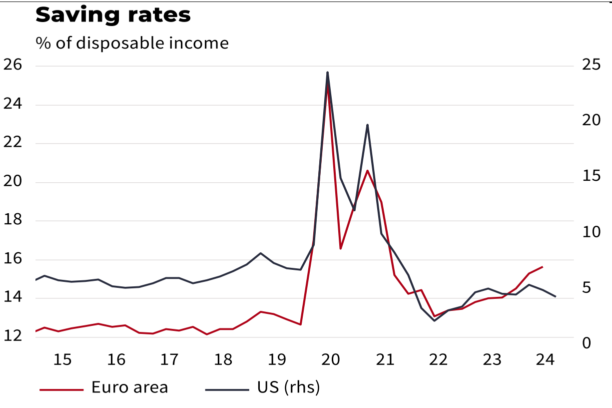
...but diverging trends on services



Source: LSEG, SG Economic and Sector Studies

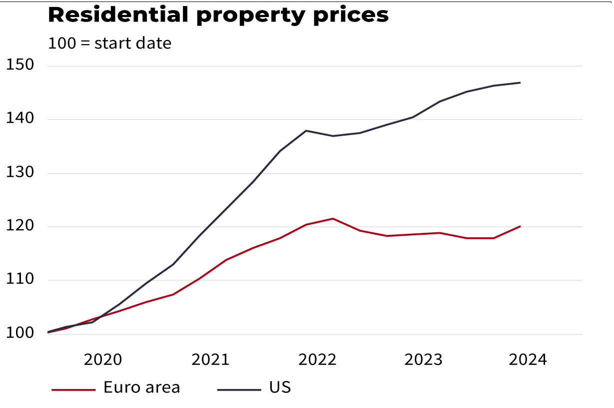
Uncertainty in Europe is being reflected in confidence deterioration leading to households' higher propensity to save. This comes in contrast with consumers behaviour in the US where saving rates have tended to decrease. Saving rates in the euro area remain on average at almost 2pp above their pre-Covid average while in the US they are more than 2pp below their pre-Covid level. This seems partly caused e by strong wealth effects in the US linked to the stock market's performance (which represent 40% of households' financial savings compared to 20% in the euro area). Still increasing real estate prices in the US while stagnating in the euro area might be another explanatory factor.

Diverging propensity to save...



Source: LSEG, SG Economic and Sector Studies

...with diverging wealth effects



Source: LSEG, SG Economic and Sector Studies

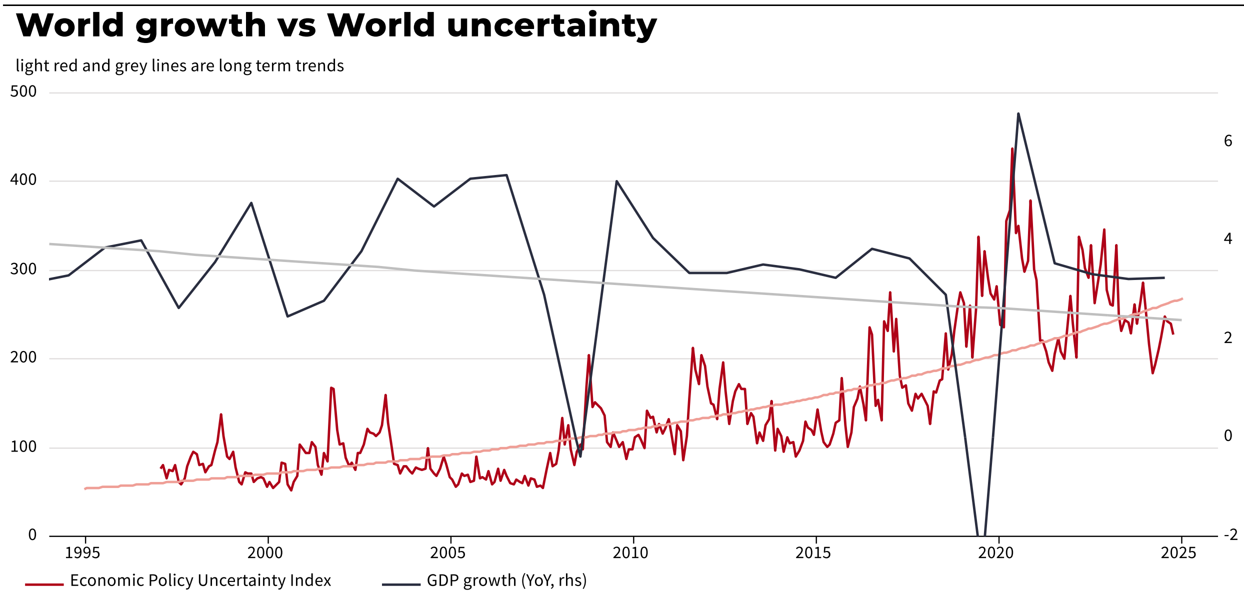
Open Questions on China Policy

In China, talks appear to be still ongoing on what form a comprehensive public support programme should take to achieve a 5% growth target in 2025. The measures announced and implemented so far seem to be aimed only at stabilising growth rather than boosting it. There has been some monetary easing, bank recapitalizations, local government debt restructurings, but this is still insufficient to ensure a rebound in growth next year, especially if the new US administration implements the tariff hikes as announced during the presidential campaign. It should be noted that on 9 December, the Politburo reported mentioned that monetary policy should be further eased in the course of 2025, indicating that the PBoC's stance would be "appropriately relaxed" and no longer "prudent". This change in the definition of monetary policy is the first of its kind since 2008. It remains to be seen what form it will take. This led us to review upwards our 2025 growth forecast from 4 to 4.5%.

Uncertainty comes at a cost

Over the last years the topic of the economic and financial effects of the uncertainty has gained ground. This has been particularly true since the multiplication of “unexpected” structural events by the markets took place starting the Brexit in 2016, followed by the US elections and the start of the trade war between the US and the rest of the world, the technological war with China in 2018, the Covid 2020, war in Ukraine 2022, Middle East tensions since the start of Israel-Hamas war in 2023. This has been accompanied by more fragmented political landscapes especially in Europe (but not only) leading to an increase in economic policies uncertainty. Climate related events also add to this list. This is likely to weigh on investment decisions and hence on potential growth in the medium term. The factor is increasingly considered_by international institutions like in last November, ECB’s Financial stability review and European Commission’s Economic Outlook report.

Increasing Uncertainty likely to weight on global growth



Source: Economic Policy Uncertainty, SG Economic and Sector Studies

FORECASTS

GDP, % ch YoY	2024f	2025f	2026f	2027f
Developed Markets	**1.5**	**1.6**	**1.2**	**1.2**
United States	2.6	1.9	1.4	1.0
Japan	-0.2	0.8	0.4	0.5
United Kingdom	0.9	1.1	0.7	1.0
Euro area	0.9	0.7	0.7	0.9
Germany	-0.1	0.4	0.7	0.9
France	1.1	0.6	0.6	0.9
Italy	0.5	0.4	0.5	0.5
Spain	3.1	1.9	1.6	1.4
Emerging Markets	**3.9**	**3.9**	**3.6**	**3.6**
Asia	4.9	4.7	4.3	4.3
China	4.6	4.5	3.8	3.8
India	6.7	6.2	6.2	6.2
Central and Eastern Europe	2.3	2.0	1.7	1.7
Latin America	2.0	2.2	2.2	2.2
Brazil	2.9	1.9	1.6	2.0
Middle East and Central Asia	2.3	3.5	3.5	3.1
Africa	3.0	3.5	3.8	3.8
World (PPP weighted)	**3.0**	**3.0**	**2.7**	**2.7**

CPI, % ch YoY, avg	2024f	2025f	2026f	2027f
Developed Markets	**2.6**	**2.8**	**2.4**	**2.2**
United States	2.8	3.5	2.9	2.6
Japan	2.5	2.0	1.8	1.5
United Kingdom	2.7	2.4	2.0	2.1
Euro area	2.3	2.2	1.8	1.7
Germany	2.4	2.3	1.8	1.7
France	2.3	1.8	1.8	1.7
Italy	1.3	2.0	1.8	1.7
Spain	2.9	2.5	2.2	1.8
Emerging Markets	**8.3**	**6.2**	**4.9**	**4.4**
China	0.7	1.2	2.0	2.0
India	4.7	4.7	4.7	4.7
Brazil	4.4	4.2	3.7	3.3

%, EoP (unless otherwise indicated)	Latest 19/12	2025f	2026f	2027f
Fed Funds target (high)	4.50	4.25	3.75	3.75
Gov 10Y, US	4.50	4.00	4.00	4.50
ECB Deposit facility rate	3.00	2.25	2.25	2.25
Gov 10Y, Germany	2.24	2.25	2.25	2.50
Gov 10Y, France	3.05	3.05	3.05	3.20
Gov 10Y, Italy	3.40	3.65	3.65	3.90
Gov 10Y, Spain	2.94	3.00	3.00	3.20
BoE, Bank rate	4.75	4.00	3.75	3.50
Gov 10Y, United Kingdom	4.56	3.80	3.60	4.00
BoJ, bank rate	0.25	0.60	0.60	0.60
Gov 10Y, Japan	1.06	1.10	1.15	1.20
EUR / USD	1.05	1.05	1.10	1.10
EUR / GBP	0.83	0.85	0.85	0.85
USD / JPY	154	140	130	130
USD / CNY	7.3	7.0	7.1	7.1
Oil Brent (USD/b)	74	70	70	70
European Natural Gas (TTF, EUR/MgW/h)	41	40	40	35
EU ETS carbon (EUR/Metric ton)	63	80	100	110

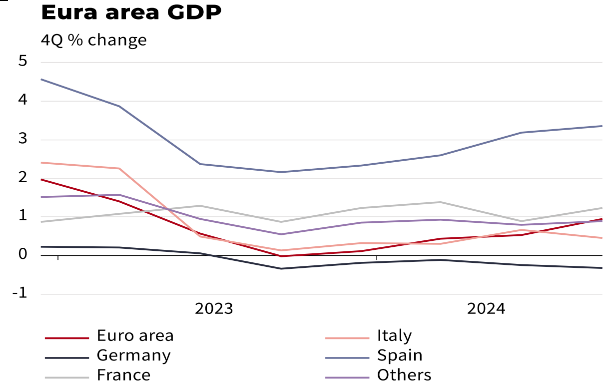
EURO AREA

- **Despite disinflation, growth is set to be held back by (geo)political uncertainty, fiscal tightening, and weak competitiveness.**
- **Fiscal policy is set to become more restrictive at the aggregate level, with the need to secure sustainable public finances in several key member states and to respect the euro area fiscal rules.**
- **Further rate cuts by the ECB are expected in 2025, returning policy to a neutral stance.**

After a resilient 2024, growth momentum is set to falter in 2025 and be held back by weak competitiveness medium-term. Household savings climbed higher in 2024 dampening consumption, and this despite ongoing disinflation. Government spending, external trade and summer events, including the Olympics, thus became the main drivers of growth. Uncertainty related to both domestic politics, and not least in France, and internationally development marked a further headwind that is set to continue heading into 2025. Structurally, the region continues to suffer from a lack of competitiveness as highlighted by the Draghi, Letta and Noyer reports. Tariffs threatening by the incoming Trump administration could mark a further headwind in 2025.

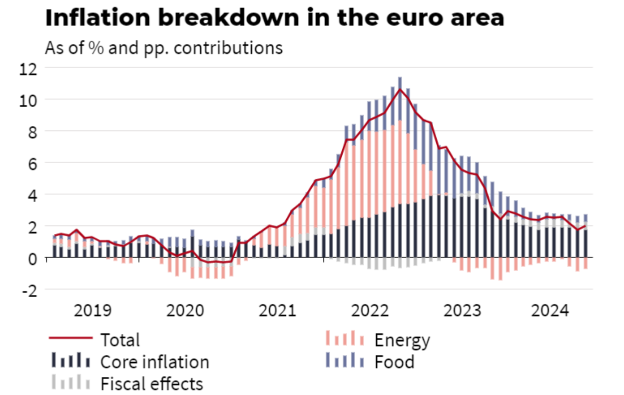
Potential offsets come in the form of monetary policy easing and a still fairly robust labour market, albeit likely that with profit margins under pressure from weak demand unemployment will tick higher in 2025. Looking at the credit impulse, moreover, we note that this remains both weak demand conditions and still overall tight supply conditions. The monetary policy stance remains restrictive, and this despite ECB rate cuts. Further rate cuts in 2025 should nonetheless see a neutral stance returned.

A growth dynamic driven by the periphery



Source: Eurostat, SG Economic and Sector Studies

Disinflation continues



Source: Eurostat, SG Economic and Sector Studies

Domestic demand is likely to remain weak in 2025, constrained by headwinds. In a generally uncertain environment companies will seek to preserve their profitability by moderating unit labour cost growth, resulting in modest growth in real wages and employment. As a result, unemployment is likely to rise. Comfortable household savings offer room for manoeuvre, but more moderate wealth effects and rising unemployment will keep consumers cautious. Uncertainty over (geo)politics will mark an additional headwind.

While consumer confidence for the euro area improved in 2024, aided by ongoing disinflation, the latest reading saw a pullback and overall levels remain well below those that prevailed pre-pandemic.

Growth in investment spending will be modest. On the corporate side, sluggish demand, still-tight lending conditions and continuing high levels of uncertainty will weigh on business momentum. The Next Generation EU will nonetheless continue to support some investment, and not least for the green and digital transitions. On the household side, residential investment is likely to remain lacklustre.

Public spending, which supported activity in 2024, will be less favourable. Policy is becoming more restrictive in several euro area member states, France, and Italy in particular, where significant adjustments are expected. However, the current disbursement of NGEU funds could still be favourable in several member states. To date, €257bn (€435bn in the form of grants and €288bn in the form of loans) of the €807bn allocated (4.7% of EU GDP, of which 1.7% for Euro Zone) has been disbursed, with the situation varying widely from country to country. The plan is due to end in 2027.

The risk of renewed trade tensions likely to on exports. Export growth will be modest, due to sluggish global demand, and the potential increase in tariffs, be it by the US or in connection to the ongoing tensions with China.

The fall in consumer prices is set to continue. The recent fall in energy prices has led to further disinflation. This will intensify in 2025, with electricity prices which likely to fall by 3 to 4% according to ECB estimates. With the decline in employee compensation, we expect service price inflation to begin to ease gradually as well.

The ECB is likely to continue the rate cut it began in 2024, and we expect it to fall by 75 bps in 2025. Monetary policy should nevertheless remain restrictive over the forecast horizon. The ECB's announcements of quantitative tightening imply a further tightening of liquidity conditions, but we expect the ECB to end QT earlier than currently signalled, in late 2025.

The risks to this scenario remain tilted to the downside, due to political and geopolitical risks, as well as the risk of international trade tensions. Another major risk would be a sharper-than-expected adjustment in on labour market, leading to a rise in the unemployment rate and weighing on consumption. In addition, euro depreciation in excess of what we forecast could further add to headline inflation and limit ECB room for rate cuts.

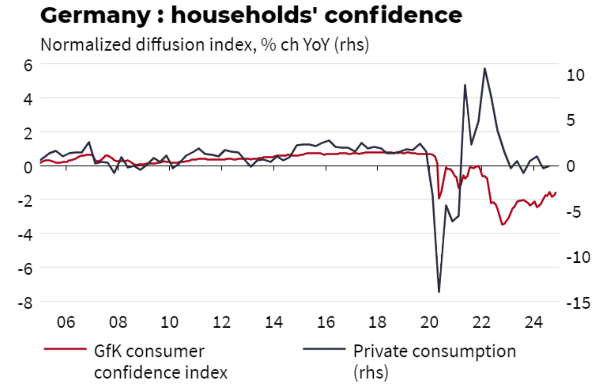
Euro area	**2024f**	**2025f**	**2026f**	**2027f**
Real GDP, % ch YoY	0.9	0.7	0.7	0.9
Household consumption	0.9	0.6	0.6	0.7
Public consumption	1.9	0.6	0.6	0.8
Investment	-2.4	0.6	0.9	1.3
Exports of goods & services	1.9	1.9	2.0	2.2
Imports of goods & services	-0.5	2.0	2.3	2.2
Inflation, % annual average	2.3	2.2	1.8	1.7
Core inflation, % annual average	2.8	2.3	1.8	1.7
Real gross disposable income (GDI), % ch YoY	1.9	0.5	0.6	0.7
Households saving rate, % of GDI	15.1	15.0	15.0	15.0
Unemployment, % of labour force	6.4	6.9	6.9	6.9
Fiscal balance, % of GDP	-3.9	-3.5	-3.4	-3.1
Public debt, % of GDP	90	91	92	92
Current account balance, % of GDP	2.8	2.3	2.1	2.2

GERMANY

- **The country is heading for a second year of contraction. Structural fragilities could be accentuated by renewed trade tensions.**
- **Household caution, driven by past erosion of purchasing power and a deteriorating job market, is weighing on domestic demand.**
- **2025 will be marked by political and budgetary uncertainty, as the country faces the trade-offs between fiscal discipline, major financing needs and maintaining social spending.**

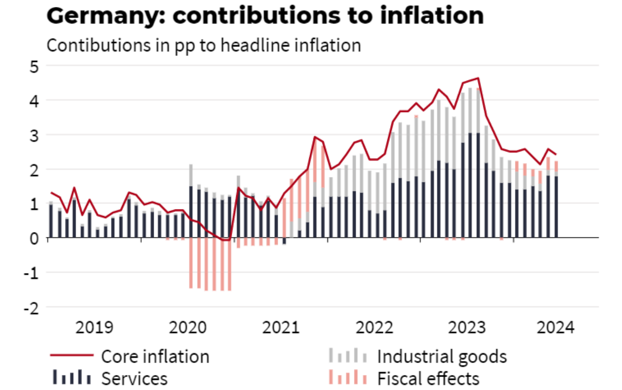
Even avoiding a technical recession, the German economy is set to contract in 2024 (-0.1% YoY) for the second year in a row. The level of GDP has stagnated at its 2019 level for three years, due to the underperformance of private consumption and investment. Recovery will be postponed until at least 2026, due to lacklustre demand on key export markets, past loss of purchasing power, uncertainty holding back investment and hiring decisions, and a structural loss of competitiveness.

Households remain prudent and constrain their consumption expenses



Source: GfK, Destatis, SG Economics & Sector Studies

Disinflation continues but service's prices are sticky and keep rising



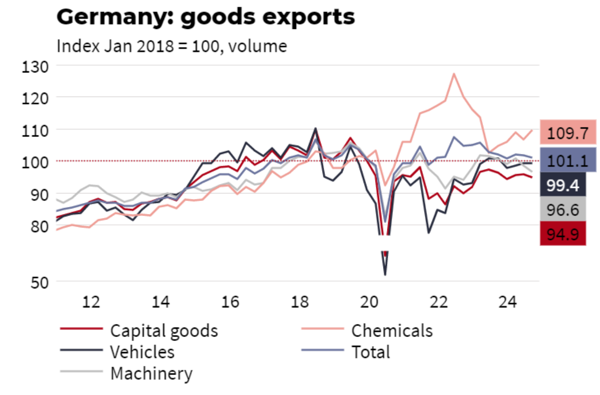
Source: Eurostat, SG Economics & Sector Studies

Although the overall situation of households is improving, they remain cautious and limit spending. Precautionary savings continue to increase (with a savings rate of 19.8% in 2024, i.e. almost 3pp higher than the 2000-2019 average), restricting private consumption. Consumption should increase slightly (0.4% YoY in 2024 and 2025), as suggested by the improvement in household confidence, which remain nevertheless at low levels. Cautious consumer behaviour lags while the disinflationary process is well underway - with a major contribution from the normalization of energy prices - and tensions on the job market persist.

Some lift to household spending should come as inflation returns to target during 2025, monetary easing restarts credit, and subjective perceptions of income adjust to the real wage gains observed since early 2024 (+3.5%YoY on average between

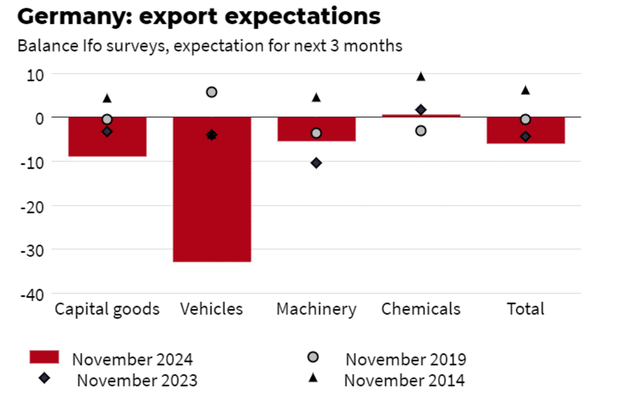
January and September). The speed of this adjustment will be modulated by the evolution of the labour market, which is likely to deteriorate in 2025.

The industry is struggling to return to its pre-crisis export levels...



Source: Bundesbank SG Economics & Sector Studies

... and will have to cope with further volatility in the international outlook



Source: Ifo, SG Economics & Sector Studies

The prospect of new geopolitical and trade tensions poses a major challenge that could exacerbate pre-existing weaknesses. German producers are facing years of stagnation in their productivity per employee - which remains at its 2016 level - and rising unit costs (+34% since 2016) that are undermining their competitiveness. Moreover, in traditional flagship industrial sectors of excellence (capital goods, automotive), German producers struggle to innovate and are facing increased competition from their Asian peers. Against a backdrop of commercial and geopolitical tensions exacerbated by the US elections, exporters will face new challenges: (i) higher tariffs on products exported to the US market, which accounts for 10% of exports, (ii) a contraction in foreign demand due to the resulting international volatility, and (iii) the possibility of increased fragmentation of their value chains - particularly in Asia. This would affect the export model of German industry, making it more difficult for them to remain competitive. All in all, exports are expected to make a smaller net contribution to growth in the medium term.

The public debate in the run-up to the February 23rd general election illustrates the growing tension between fiscal discipline and the need for new spending. Given the electoral timetable, the provisional management of public spending is likely to last until late spring, when a new government in power will be able to put its budget to the vote. During this time, spending will be limited to current affairs, any new programmes or investments will be adjourned until 2H25. The possibility of amending the debt brake, which limits the federation's structural net borrowing to 0.35% of GDP, will be central to the electoral debate. According to the think tank Dezernat Zunkunft, the country faces growing public investment needs to meet its medium-term objectives (defence, energy, and digital transition in particular), amounting to at least EUR 782bn (18% of GDP) cumulated by 2030. Defence spending is set to increase beyond this forecast, not least with pressure from the new Trump Administration of US diplomacy (~EUR 300bn between 2025 and 2030 to reach 3% of

GDP per year) in a volatile geopolitical context. A possible reform of the debt brake would give the next government more leeway to respond to these strategic needs as well as to new cyclical shocks, but it remains an uncertain task since it requires 2/3 of the votes in the Bundestag and Bundesrat to be changed.

The balance of risks remains tilted on the downside over the forecast horizon. For an export-led economy with structural current account surpluses on shrinking foreign markets, there is a need for far-reaching changes to the productive fabric, and to contain any scarring on potential growth. Moreover, the country's demographic decline is being met by much tougher political rhetoric on immigration than in the past, which could lead to extended imbalances in the labour market. On the other hand, a federal election result that would allow the necessary reforms to be made to give fiscal policy greater room for manoeuvre in the event of shocks, to increase the efficiency of capital markets, and to promote innovation and investment, could lighten the balance of risks.

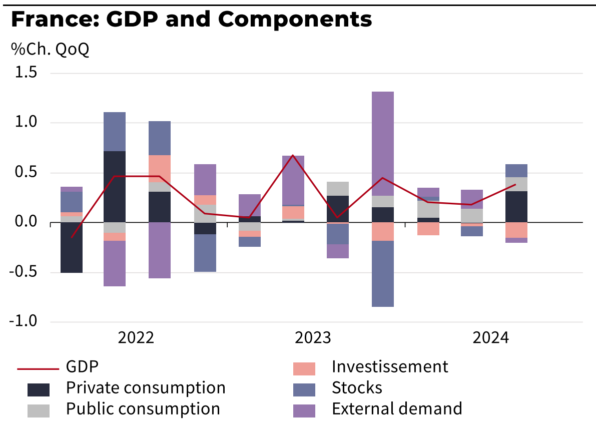
Germany	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	-0.1	0.4	0.7	0.9
Household consumption	0.1	0.3	0.6	0.8
Public consumption	2.1	0.6	0.9	1.0
Investment	-2.7	-0.3	1.2	1.4
Exports of goods & services	-0.3	0.8	1.9	1.9
Imports of goods & services	-0.1	1.1	2.2	2.1
Inflation, % annual average	2.4	2.3	1.8	1.7
Core inflation, % annual average	3.2	2.2	1.8	1.7
Real gross disposable income (GDI), % ch YoY	1.2	-0.1	0.8	1.1
Households saving rate, % of GDI	19.8	19.4	19.5	19.8
Unemployment, % of labour force	6.0	6.4	6.6	6.5
Fiscal balance, % of GDP	-2.5	-1.9	-1.9	-1.6
Public debt, % of GDP	63	64	64	64
Current account balance, % of GDP	5.7	5.4	5.2	5.2

FRANCE

- **The economic context in France is marked by fiscal slippage and political uncertainty, weighing on business confidence and leaving France at risk of rating downgrades and renewed spread widening.**
- **Public finance should start to be consolidated, but at a slow pace.**
- **Political uncertainties are unlikely to lift anytime soon.**

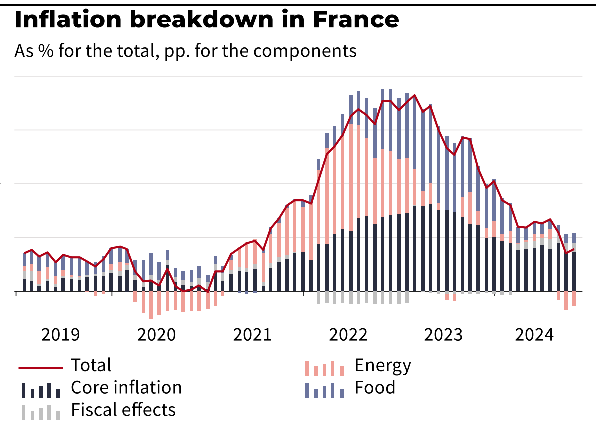
Activity is set to be subdued in 2025 and 2026. Government spending and net exports supported growth in 2024. These factors are now expected to reverse and constrain the expansion of activity. The increase of France sovereign spread resulting from the political uncertainties is, moreover, dampening the supportive impact that was expected to come from the further decline in ECB policy rates in 2025 in a context of contained inflation. The international environment will also not be supportive. Global demand is expected to remain lacklustre in 2025, with potential trade tensions arising from Trump's threat of tariffs.

Growth drivers peter out



Source: INSEE, SG Economic and Sector studies

Disinflation continues



Source: Euro Area, SG Economic and Sector studies

The economic context in France is marked by fiscal slippage and political uncertainty. The public deficit is expected to reach 6.1% of GDP in 2024, compared to 5.5% projected three months ago by the authorities. A new 2025 Budget is still not in place keeping uncertainty elevated and weighing on growth. This was clearly reflected in the Banque de France's monthly business survey, which suffered yet a decline in November.

Uncertainty over the budget process has increased with the rejection of the draft finance law for 2025 and the censure of the Barnier government. The immediate focus of the newly appointed Prime Minister, Francois Bayrou, is to form a government and secure a viable Budget for 2025. The path to a sustainable compromise is very narrow and risks remain significant.

Business investment will remain lacklustre. While productive investment held up in 2022-23, it contracted in 2024, as corporate sought to protect margins and in the face of lacklustre domestic demand. Looking ahead to 2025, political uncertainty coupled with still tight credit conditions will continue to weigh on investment. We nonetheless expect to see ongoing investments linked to the green transition.

The labour market is expected to slow somewhat. The employment rate remains at a high level, but it is expected to decline. The effect of apprenticeship contracts on employment growth is expected to diminish along with less supportive government support (albeit that this is a point of uncertainty pending a new Budget 2025). In addition, we expect to see reduced labour hoarding as companies focus on rebuilding profit margins.

Household demand will remain sluggish. Despite inflation below 2%, household purchasing power is set to increase only modestly. The contraction in employment, the expected slower growth in social benefits, the slowdown in wages and weaker growth in wealth and capital income, in a context of lower rates, and will negatively affect purchasing power. In addition, continuing uncertainties over economic and fiscal policies are expected to continue to weigh on household confidence, which remains low according to INSEE surveys. Purchasing intentions remain subdued, which should translate into low consumption and residential investment.

The momentum of external trade is expected to be less favourable, owing to weak external demand due to a difficult global environment and the tariff measures threatened by the incoming Trump Administration. French export growth is expected to be modest over the forecast horizon.

Debt is expected to rise again due to persistently high deficits. The path of public finances remains uncertain. Our central scenario assumes a new 2025 Budget coming into effect in early 2025, with measures of size similar to those included in the initial budget proposal. Nonetheless, we remain concerned that measures will prove less effective, not least in terms of efficiency gains, and se weaker growth prospects. As such, we forecast a budget deficit at 5.5% of GDP in 2025, but note considerable uncertainty given the political situation.

Risks to this scenario remain on the downside. Risks include a worsening of the political environment along with risk of social tensions. The budget process could be further blocked, which would increase uncertainty and prolong the wait-and-see behaviour. The risk in such a situation is to see further spread widening and further rating downgrades, weighing on growth and unemployment, and further raising the need for austerity to tame public finances. Such a negative spiral of political gridlock is clearly very costly. Externally, a sharper-than-expected deterioration in trade tensions with the US and/or China, would add a further headwind.

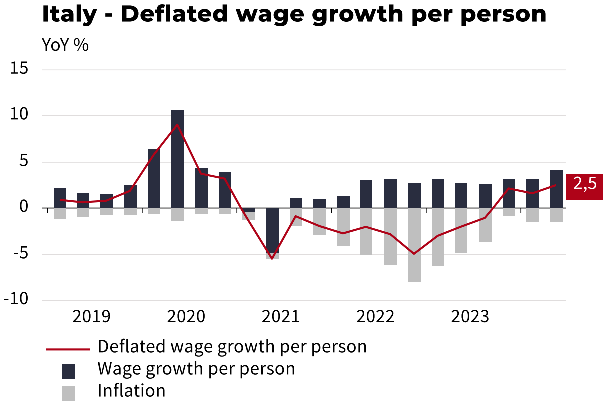
France	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	1.1	0.6	0.6	0.9
Household consumption	0.9	0.7	0.8	0.9
Public consumption	2.0	0.2	0.1	0.6
Investment	-1.6	0.3	1.0	1.4
Exports of goods & services	1.6	1.7	2.3	2.6
Imports of goods & services	-1.4	1.7	2.5	2.7
Inflation, % annual average	2.3	1.8	1.8	1.7
Core inflation, % annual average	2.4	2.2	2.0	1.8
Real gross disposable income (GDI), % ch YoY	1.1	-0.1	0.2	0.3
Households saving rate, % of GDI	17.8	17.0	16.5	15.8
Unemployment, % of labour force	7.4	8.0	8.1	8.0
Fiscal balance, % of GDP	-6.1	-5.5	-5.0	-4.6
Public debt, % of GDP	113	115	118	119
Current account balance, % of GDP	-0.4	-0.3	-0.4	-0.3

ITALY

- **GDP growth slowed significantly in 2024 and will remain below potential in 2025 and 2026 as household investment normalises.**
- **Purchasing power is set to increase further in 2025, allowing households to rebuild their savings.**
- **Despite the return to a low primary surplus in 2025, public debt is expected to remain on an upward trajectory.**

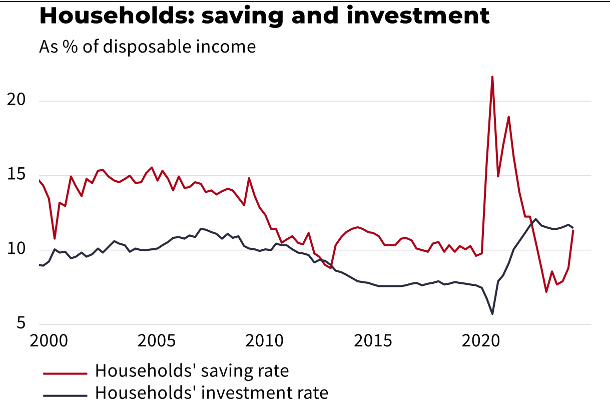
Growth came in weaker-than-expected in 2024 and is set to remain slightly below potential in 2025 and 2026. The withdrawal of housing renovation support programmes (*superbonus*) will generate a prolonged contraction in household investment, while global demand will be weakened by the potential trade tensions induced by the protectionist measures envisaged by the incoming Trump Administration. However, household consumption, further cuts in policy rates and Next Generation EU funds will directly support growth until 2026.

The rise in real wages...



Source: Istat, SG Economic and Sector Studies

... has translated into a rebound in savings



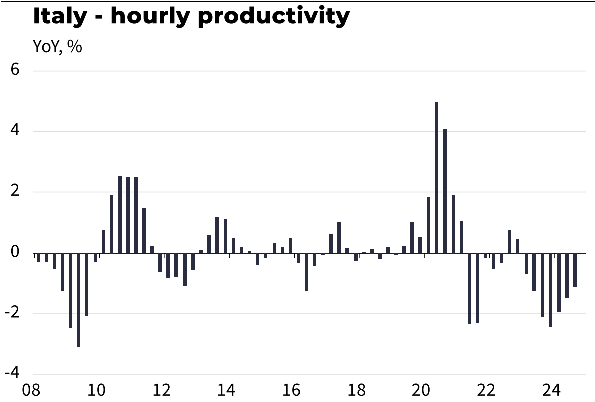
Source: Istat, SG Economic and Sector Studies

Inflation slowed sharply in 2024 thanks to lower energy prices (mainly due to the decrease of electricity tariffs in March) and is set to return to the ECB's 2% target in 2025. Core inflation remained below 2% in November but is expected to accelerate again next year in the wake of imported product prices, which are likely to be impacted by retaliatory trade measures.

Employment is expected to slow significantly as of next year after strong job creation over the 2022-24 period. This should see a stabilisation followed by a slight increase in the unemployment rate. Unemployment is set to remain at a level structurally lower than the average of the last ten years due to persistent tensions linked to demographic changes: a decline in the working-age population and a sharp slowdown in migration flows. However, the increase in labour force participation is forecast to exceed the projected decline in the working-age population, allowing for a slight increase in the labour force. Recruitment difficulties remain high and are quoted as the main factor limiting production in Italy.

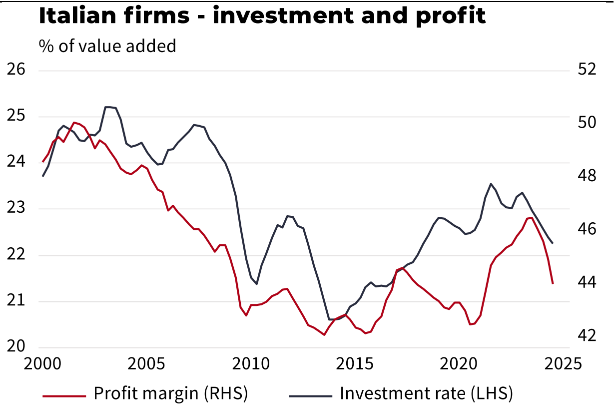
Household purchasing power is expected to increase slightly over the 2025-27 period after a dynamic growth in 2024. Nominal wages, which in 2024 benefited from contract renewals reflecting past price increases, are expected to slow gradually. From 2026 onwards, household consumption is expected to be supported by a slight decline in the savings rate, which rebounded strongly in 2024.

The drop in hourly productivity...



Source: Istat, SG Economic and Sector Studies

... weighs on corporate profits



Source: Istat, SG Economic and Sector Studies

Investment slowed significantly in 2024 and is expected to contract in 2025. The withdrawal of tax credits for home renovations is leading to a sharp contraction in household investment, only partially offset by the growth in infrastructure investment fuelled by European subsidies. The aid scheme for housing renovation has been greatly reduced: the tax credit rate has been reduced from 110% to 70% in 2024 and 65% in 2025 and the portability of tax credits has been abolished, as has the possibility of bringing forward the deadlines to benefit from credits on work undertaken in 2023. Credit momentum remains weak: outstanding credit to companies contracted by 3% YoY in October.

European funds are still supporting the economy. There is still EUR 81bn (3.7% of GDP) of funds available to the Italian government, out of a total allocated of EUR 194bn, and therefore a strong incentive to maintain a cooperative attitude with the European Union and implement key structural reforms, in particular that of the overhaul of the judicial system. The main investments planned for the period 2022-26 for the green transition are: (i) energy efficiency in residential and public buildings (EUR 16.9bn), (ii) sustainable mobility (EUR 34.5bn), (iii) the development of renewable energy and the circular economy and the improvement of waste and water management (EUR 24.7bn).

The primary balance narrowed significantly in 2024 and is expected to turn into a surplus in 2025. However, it would be far from returning to a 2% surplus, a necessary condition for the downward trend in public debt. The sharp decline in 2024 is due to the elimination of energy crisis support measures (1% of GDP) and tax credits for housing renovation (around 3% of GDP). The public deficit is expected to decrease very gradually from 4% in 2024 to 3.7% in 2027 thanks to moderate primary spending and broadly stable interest expenditure. Italy would therefore still be in the excessive deficit procedure by the horizon of our forecast.

Public debt is set to resume an upward trajectory. Past interest rate hikes and weak growth will weigh on public debt dynamics over the medium term. In 2024, public debt is revised downwards due to an upward revision of nominal GDP. It is nevertheless 3 points above its pre-Covid level and is expected to resume an upward trajectory to reach over 140% 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 put in place by the ECB through flexibility in the PEPP asset reinvestment strategy expires at the end of 2024. However, the Transmission Protection Instrument (TPI) should limit the risks of excessive movements on sovereign spreads. The TPI, however, has yet to be tested and is only operational for member states respecting the EU fiscal framework.

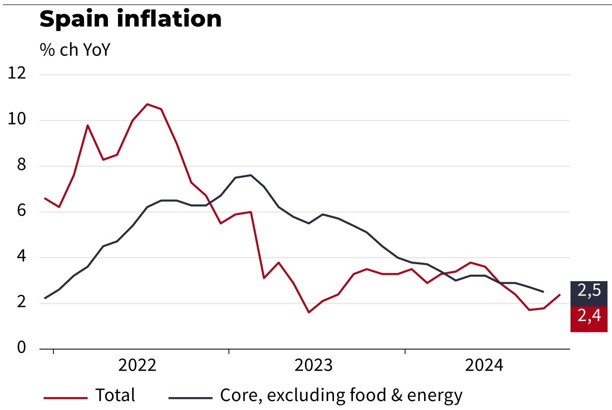
Italy	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	0.5	0.4	0.5	0.5
Household consumption	0.7	1.1	0.5	0.5
Public consumption	0.5	0.5	0.4	0.4
Investment	-0.1	-0.8	0.9	0.7
Exports of goods & services	0.0	0.6	1.8	2.3
Imports of goods & services	-2.2	1.1	2.1	2.5
Inflation, % annual average	1.3	2.0	1.8	1.7
Core inflation, % annual average	2.3	2.0	1.8	1.7
Real gross disposable income (GDI), % ch YoY	2.3	1.0	0.6	0.4
Households saving rate, % of GDI	12.6	12.9	12.9	12.8
Unemployment, % of labour force	6.5	6.2	6.3	6.6
Fiscal balance, % of GDP	-4.0	-3.8	-3.6	-3.6
Public debt, % of GDP	136	139	141	142
Current account balance, % of GDP	1.1	1.0	0.9	0.7

SPAIN

- **Growth will continue to outperform that of the euro area in 2025 but is expected to slow towards its potential by 2027.**
- **Purchasing power is expected to slow in 2025 after two years of strong growth and unemployment is set to stabilize.**
- **The budget deficit, after a temporary increase in 2025 due to the exceptional flooding episode, is expected to fall below 3%.**

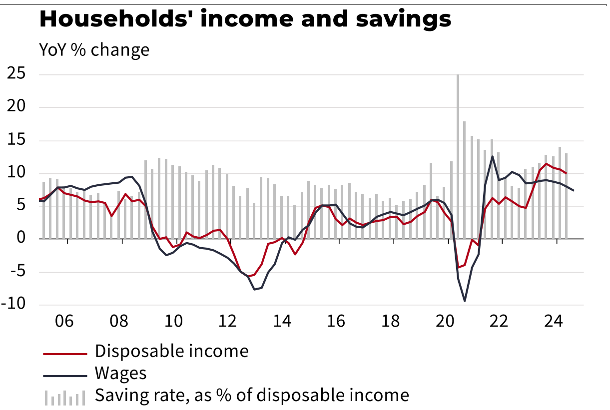
Growth is still very dynamic in 2024, but will slow down in 2025 and return to its potential in 2027. It will remain higher than that of its European partners, still supported by the European recovery plan, a very dynamic tourism sector and a job market benefiting from an influx of foreign labour. However, the unprecedented floods would reduce growth by around 0.2 percentage points of GDP in Q4-24. In 2025-26, global demand would be weakened by trade tensions induced by President Trump's protectionist measures. The unemployment rate, now below its structural level, is expected to stabilise at around 11% of the working population.

A deceleration in prices…



Source : INE, SG Economic and Sector Studies

…and a dynamic growth of disposable income



Source : INE, SG Economic and Sector Studies

Inflation, still close to 3% in 2024, is expected to slow to around 2.4% in 2025 and return to the 2% ECB's target in 2027. Lower fuel and food prices are the main drivers of disinflation, while service prices remain buoyant, supported by wage increases. Core inflation is expected to remain above 2% next year, driven by higher prices for imported goods, impacted by the depreciation of the euro and possible trade retaliatory measures.

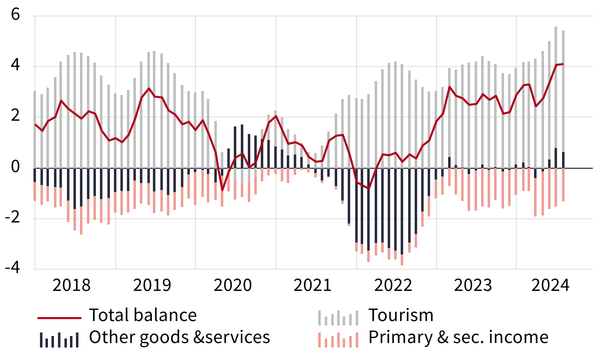
Household consumption is expected to continue to support growth until 2026. Purchasing power gains are expected to slow in 2025 after two years of strong growth supported by wage and employment dynamics. Job creation is expected to continue in 2025, but at a more moderate pace, allowing companies to record productivity gains and rebuild their margins. Slowing inflation, negotiated wage increases and pension increases will support household incomes over the horizon of our forecast.

The savings rate – which has risen sharply over the past two years and has reached a level above its historical average – is expected to adjust slightly, allowing households to cope with the slowdown in their purchasing power.

Business investment is expected to remain buoyant until 2026, despite weak credit. It is still supported by loans and grants from the European recovery plan, of which there are still EUR 32 bn in grants available (2% of GDP) out of a total of EUR 80 bn (5.5% of GDP). 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.

Economy back in external surplus

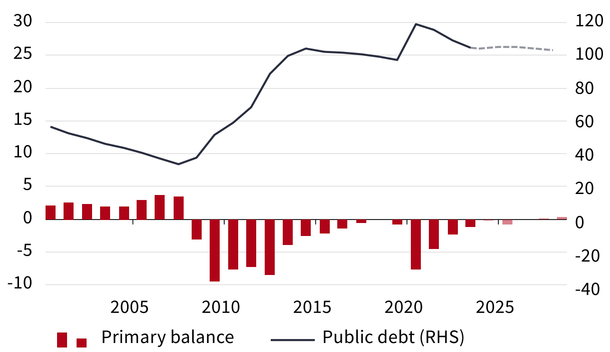
Spain - Balance of payments



Source : INE, SG Economic and Sector Studies

Public debt would stabilize at a high level

Spain - public debt and primary balance



Source : Eurostat, SG Economic and Sector Studies

Fiscal policy took on a restrictive stance in 2024, with the reduction in energy subsidies allowing the deficit to return to 3% of GDP. The public balance is expected to widen by 0.5 percentage points of GDP in 2025, due to the budgetary cost of the unprecedented floods in the region of Valencia, which have caused the death of more than 200 people. The government has announced a EUR 14bn aid plan to help households and businesses cope with the consequences of this disaster. The deficit is expected to fall below 3% of GDP in 2026. After four years of decline, public debt is still 6 percentage points of GDP above its pre-Covid level, and it is expected to decrease slightly over the horizon of our forecast.

Beyond 2024, the government's fiscal stance would return to accommodative. Sánchez's minority government, elected in November 2023, failed to pass the 2025 budget, and there is a non-zero probability that the government will not come to an end. Sánchez nevertheless secured the support of the far-left Podemos party at the end of November 2024 for new fiscal measures that guarantee the disbursement of EUR 7.2 billion in EU subsidies. At the heart of the scheme is a strengthening of corporate tax legislation that ensures that companies with a turnover of more than EUR 750 mn will pay a minimum of 15% tax on profits. In addition, there is a three-year extension of the annual tax on banks' windfall profits. Economic policy will continue to focus on addressing income inequality, redistribution, and social and environmental policies.

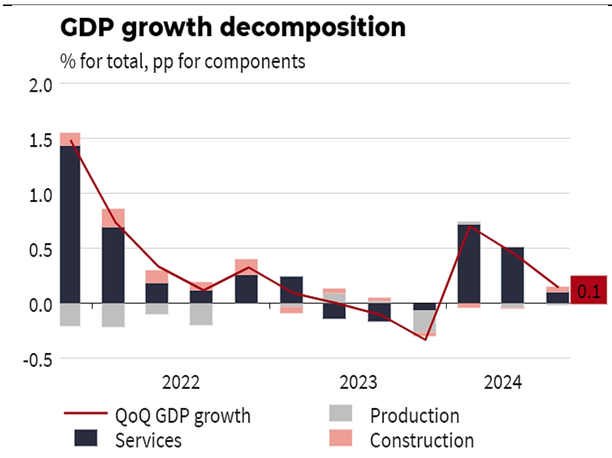
Spain	**2024f**	**2025f**	**2026f**	**2027f**
Real GDP, % ch YoY	3.1	1.9	1.6	1.4
Household consumption	2.7	2.0	1.9	1.6
Public consumption	4.5	1.9	1.3	0.8
Investment	1.9	1.8	1.7	1.2
Exports of goods & services	3.3	1.8	1.9	2.5
Imports of goods & services	2.1	2.5	2.3	2.5
Inflation, % annual average	2.9	2.5	2.2	1.8
Core inflation, % annual average	3.0	2.8	2.3	1.8
Real gross disposable income (GDI), % ch YoY	3.5	1.1	1.2	1.3
Households saving rate, % of GDI	13.2	12.5	11.9	11.6
Unemployment, % of labour force	11.4	11.2	11.2	11.2
Fiscal balance, % of GDP	-2.9	-3.4	-2.8	-2.7
Public debt, % of GDP	105	105	105	105
Current account balance, % of GDP	2.9	2.4	2.3	2.3

UNITED KINGDOM

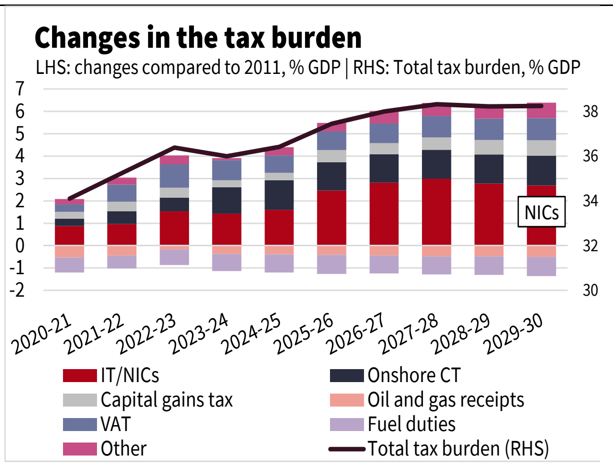
- **The net impact of the Autumn budget will be expansionary, supporting growth in 2025.**
- **We expect inflation to rise throughout the remainder of 2024, followed by a return to a disinflationary trend in 2025, albeit at a slower pace than previously anticipated.**
- **The BoE is set to follow a more gradual stance, keeping interest rates higher for longer.**

Growth loses momentum. In 3Q24, GDP expanded by 0.1% QoQ and by 1% YoY, a slowdown compared to growth in 1H24. On the supply side, this has mainly been due to a downturn in service sector growth, which had been the main driver of output growth in 1H24. On the demand side, the expansion in net exports, private and public consumption was partially offset by the negative contribution from a drawdown of inventories. Looking ahead, growth should remain weak for the remainder of the year (0.9% expected in 2024). It should then pick up subsequently, reaching 1.1% in 2025. Public consumption and public investment are set to drive growth in the next quarters, in line with the public spending increase planned in the Labour government's Autumn Budget. Forward-looking leading indicators, such as the PMI composite and the OECD Composite Leading Indicator of business cycle, paint a more positive picture for the UK compared to its European peers. Risks are however tilted to the downside due to geopolitics and the risk of US tariffs.

Growth loses momentum



Taxes are set to rise



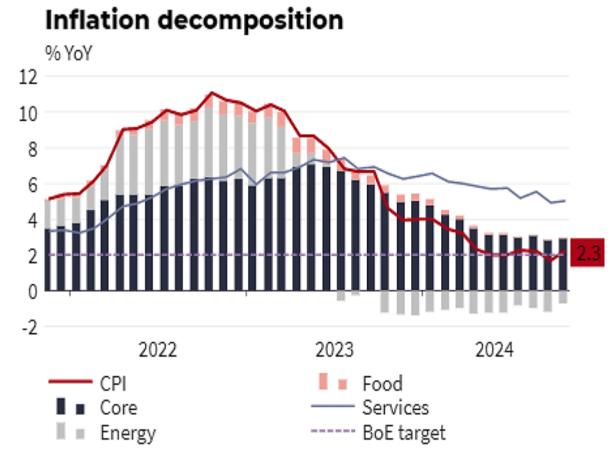
Sources: OBR, ONS, Refinitiv, SG Economic and Sector Studies

The Autumn budget will increase public services, with the UK moving closer to European standards. Public spending is set to increase by GBP 72bn (2.6% 2023 GDP) per annum over the next 5 years, of which one-third is allocated to public investment, and two-thirds to improve the quality of public services, especially the NHS. The additional day-to-day spending will be funded by tax increases, notably the employer National Insurance Contributions (NICs), while capital spending will be financed through increased borrowing, by an average of GBP 30bn (1.1% GDP) per annum. To increase debt issuance, the government has revised the country's fiscal rules and changed the definition of 'debt', which is now Public Sector Net Financial Liabilities. It is worth noting that the additional public spending is considerably front-loaded, with most of the increases planned for FY 2024-25 and 2025-26.

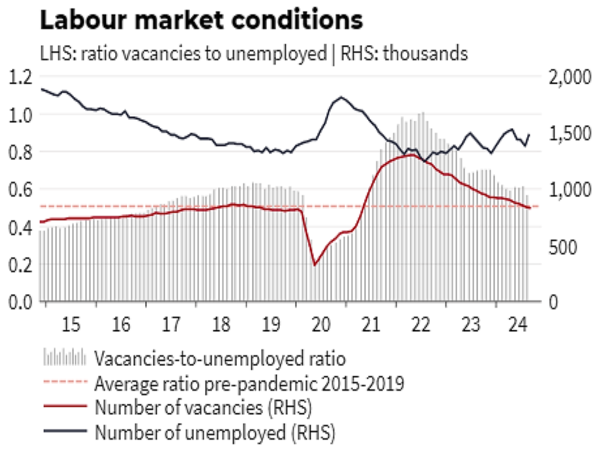
The net impact of the budget will be expansionary, driving growth throughout 2025. In the short term, we expect the budget to boost aggregate demand, supporting growth in the coming quarters. At the same time, the short-run effect of greater public spending will be partially offset by some crowding out of private consumption and investment, as the economy is already running close to full capacity.

Household consumption is expected to gradually expand in the coming quarters as monetary policy continues its easing cycle, disinflation progresses, and real disposable income continues to rise. However, it should remain constrained, with the saving rate staying above its historical levels. The fade out of the fiscal expansion, the negative impact of potential US tariffs, and a slower rate cutting cycle are set to weigh on growth in 2026. In the long term, the greater public capital spending should crowd in private investment, boosting aggregate supply.

Disinflation is underway



The labour market is cooling



Sources: ONS, Refinitiv, SG Economic and Sector Studies

Inflation is set to rise throughout the remainder of 2024, followed by a return to a disinflationary trend in 2025, albeit at a slower pace than previously expected. The BoE should follow a more gradual stance, keeping interest rates higher for longer. CPI inflation rose to 2.3% YoY in October after temporarily falling to 1.7% in September, as a result of base effects as well as the October 10% rise in the Ofgem energy price cap. Core and service inflation remain stickier and at high levels, at 3.3% and 5% YoY in October, respectively. This is due to a still-tight labour market, albeit with signs of easing. The share of firms reporting labour shortages remains high, but the vacancies-to-unemployment ratio is gradually converging to its pre-pandemic level.

We expect headline inflation to keep rising slightly due to base effects, reaching 2.7% YoY by the end of 2024. In 2025, inflationary pressures stemming from the Budget and the expected increase in US tariffs will keep CPI above 2%. It should then return to the BoE's target by 2026, in a context of easing labour market pressures and fading out of the fiscal expansion. In November, the BoE opted for a 25bp cut to 4.75%. We expect three 25bp cuts in 2025, one per quarter until 3Q25, in line with a slower pace of rate cuts than previously anticipated.

Risks to the outlook are tilted to the downside. Risks are linked to the international geopolitical tensions. Significant US tariffs could weigh on the UK inflation and growth prospects, potentially leading to monetary policy adjustments with negative growth implications. Moreover, the rise in the employer National Insurance Contributions and National Living Wage could add to the inflationary pressures in the short term, as employers adapt to the increase in the cost of employment. In the medium term, this could reduce the economy's supply capacity, leading to structurally lower wages and higher unemployment.

UK	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	0.9	1.1	0.7	1.0
Household consumption	0.7	1.1	0.6	0.8
Public consumption	2.0	4.3	2.1	1.7
Investment	1.3	1.4	1.4	2.1
Exports of goods & services	-1.0	1.1	1.2	1.4
Imports of goods & services	1.1	2.5	2.2	2.5
Inflation, % annual average	2.7	2.4	2.0	2.1
Core inflation, % annual average	3.5	2.3	2.1	2.0
Real gross disposable income (GDI), % ch YoY	3.5	1.1	0.8	0.7
Households saving rate, % of GDI	9.5	9.4	9.5	9.2
Unemployment, % of labour force	4.3	4.5	4.9	4.7
Fiscal balance, % of GDP	-5.4	-5.7	-5.5	-5.3
Public debt, % of GDP	100	102	105	106
Current account balance, % of GDP	-4.4	-3.6	-3.2	-3.3

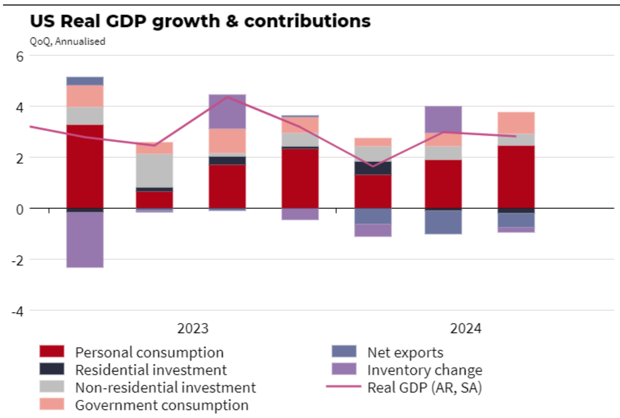
UNITED STATES

- **Donald Trump's decisive victory gives him leeway to pursue his economic agenda, at least for the next two years.**
- **Tax cuts and looser regulation will boost activity near-term, but also inflation, with the risk of seeing a subsequent bust to activity. Substantially slower immigration flows would weigh on both growth and add upside risks to inflation.**
- **The Fed is set to pursue more cautious easing in 2025, waiting to see the impact of the new policies.**
- **In the long term, markets could be increasingly concerned about the sustainability of US public finances, with bonds term premia rising.**

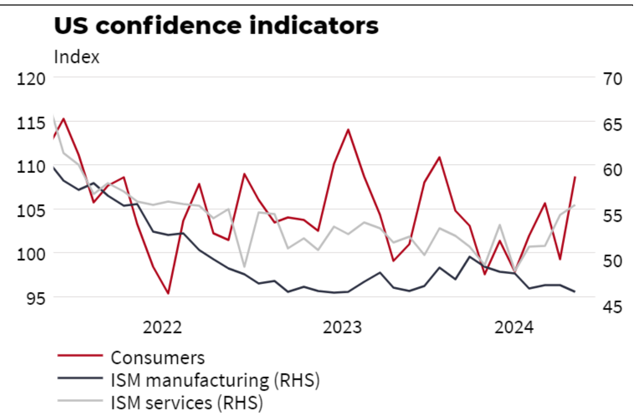
Real GDP remained strong in Q3. The increase in real GDP primarily reflected increases in consumer spending, exports, and federal government spending. Compared to Q2, the slight deceleration in real GDP in the third quarter primarily reflected a downturn in private inventory investment and a larger decrease in residential fixed investment. These movements were partly offset by accelerations in consumer spending. The relative strength of consumer spending could be partly fuelled by the wealth effects resulting from high valuations of stocks and real estate, and possibly also from a positive perception of the evolution of productivity.

We forecast somewhat slower growth of 1.9% in 2025, but higher than our previous forecast (of 1.5%). We expect growth momentum to go be sustained by the prospect of tax cuts, the impact of looser regulations and by the interest-rate cuts feeding through to the real economy including the housing market.

Growth remained solid in Q3…



…reflecting a well oriented demand



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

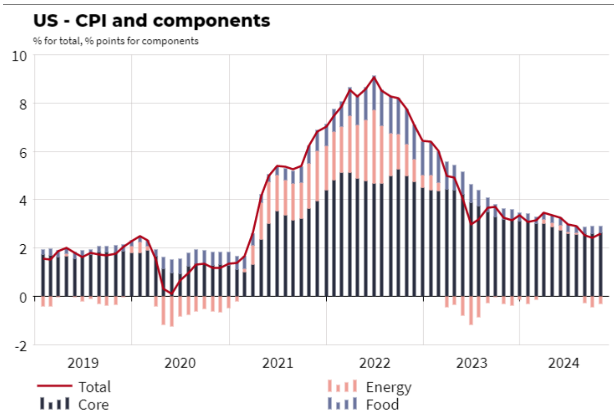
Donald Trump's decisive victory gives him leeway to pursue his fiscal agenda. Trump plans to make the personal income tax cuts enacted in his first term permanent and may make additional cuts such as exemptions of Social Security benefits, workers' overtime pay and tips from income tax. Government income from tariffs will rise, but this, together with expected spending cuts is unlikely to counterbalance the revenue foregone through corporate and individual tax cuts.

We do not expect the budget deficit to contract, it should remain above 6% of GDP over 2025-29. Federal debt as a share of GDP is expected to rise over the forecast period, from 97% to about 103% in 2029. Bond yields should remain elevated, pushing debt servicing cost higher. Republicans in Congress are likely to raise the debt ceiling to bolster the incoming government.

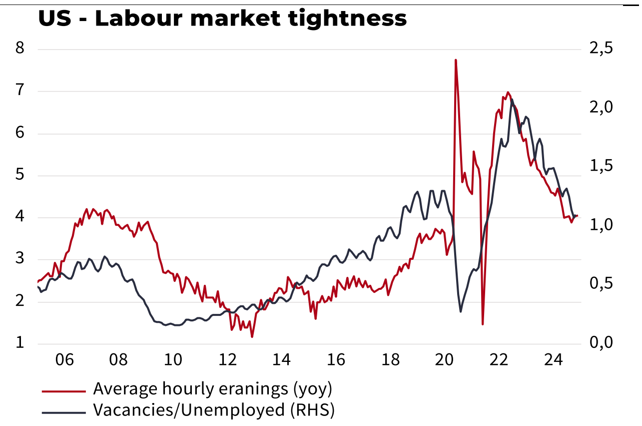
Deregulation will be another priority. The Trump administration is likely to pull back regulations related to anti-trust, banking supervision, cryptocurrencies and environment and pollution controls.

The agenda on migration is unlikely to be fully implemented. The new administration intends to deliver on "*the largest deportation effort in US history*". Tougher border control, visa bans and restriction on legal pathways to enter the US are part of the plan. But a significant "deportation" programme would be very costly for the US economy. The Pew Research Centre estimates the unauthorised immigrant population at around 11m in 2022, with 8.3m hereof accounted in the labour force (4.8% of total). The cost of a deportation would be very elevated. The bulk would come from the impact on growth and inflation (lost labour force and lost consumers). Some sectors would be particularly hard hit; the construction workforce, for example, is estimated to be 14% undocumented. Even without mass deportations, just slowing immigration inflows (which we do see as likely) will significantly dampen US growth.

Inflation largely eased…



… in line with labour market developments



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

Inflation rebounded slightly in October, but further easing in Q4 is expected. Consumer prices rose 0.3% in November and were up 2.7 % from the year before. Housing-related inflation accounted for 40% of the monthly rise, and energy prices were flat after dragging down the overall index for four of the past six months. November's increase was anticipated, due to unfavourable base effects and stubborn housing-related inflation. On going decline of inflation remains likely in services (such as transportation and medical care), and on the shelter component, reflecting eased pressures on market rents. The underlying trend remains favourable for another round of interest rate cuts.

Fed is likely to become more cautious in the future. In September the Fed reduced its policy rate for the first time in this cycle by 50bp, and by another 25bp in November. We expect a further 150bp by end-2026 which is 50bp less than in our previous forecast. Scope for easing beyond that, however, is likely to be constrained by inflation concerns associated with the impact of trade tariffs, and more crucially with the impact of migration constraints on a still tight labour market. The inflationary implications of these policies are likely to push the Fed to be more cautious on further adjustments in the future.

Risks to the outlook are linked the impact of the trade and migration policies of the new administration. They could fuel higher than expected inflation. This could trigger a monetary tightening by the Fed and followed by a sharper deceleration of the US economy.

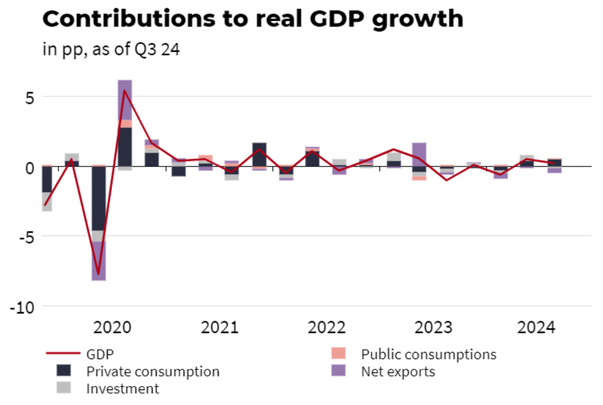
US	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	2.6	1.9	1.4	1.0
Household consumption	2.6	2.7	1.5	1.2
Public consumption	2.4	2.6	1.4	1.1
Investment	4.0	1.9	2.2	2.1
Exports of goods & services	3.2	2.6	1.4	1.0
Imports of goods & services	5.6	5.4	2.7	2.5
Inflation, % annual average	2.8	3.5	2.9	2.6
Core inflation, % annual average	3.3	3.6	2.8	2.6
Real gross disposable income (GDI), % ch YoY	3.1	1.7	1.2	1.8
Households saving rate, % of GDI	5.1	4.7	4.5	4.9
Unemployment, % of labour force	4.1	4.1	4.4	4.7
Fiscal balance, % of GDP	-6.0	-6.3	-6.3	-6.4
Public debt, % of GDP	98	100	101	104
Current account balance, % of GDP	-3.4	-3.6	-3.6	-3.6

JAPAN

- **With the first signs of real wage growth, the headwinds to a recovery in consumption should gradually ease.**
- **The normalisation of monetary policy is expected to continue gradually.**
- **Fiscal policy will continue to support activity over the forecast horizon.**
- **The main risks are to the downside, with the possibility of external trade tensions and/or the relative weakness of the new minority government.**

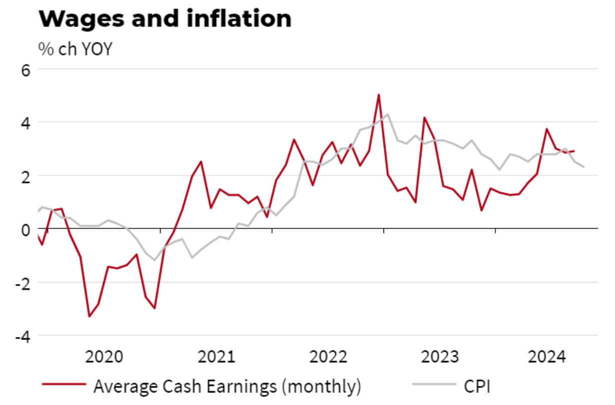
With the first signs of real wage growth, the obstacles to a rebound in consumption should ease Last April, the workers' union (Rengo) managed to conclude a wage increase of 5.3%, above its initial target, although there are disparities in wage increase, depending on the size of the company – small and medium-sized companies offer an average wage increase of 3.6%, against 5.6% for major companies. Consumer confidence remains fragile but is expected to recover gradually as the spring wage negotiations take effect and the pace of inflation slows. Consumption, which has been modest so far, should then gradually improve. From 2025 onwards, persistent labour shortages and an ageing population are expected to contribute to wage increases, which will relatively support household disposable income as labour shortages could be concentrated mostly in a few sectors (scientific research, healthcare, construction). Furthermore, an ageing population will also reduce demand and increasing pension obligations will weigh on public finances.

Growth remains fragile and hesitant



Source: SG Economic and Sector Studies, Refinitiv

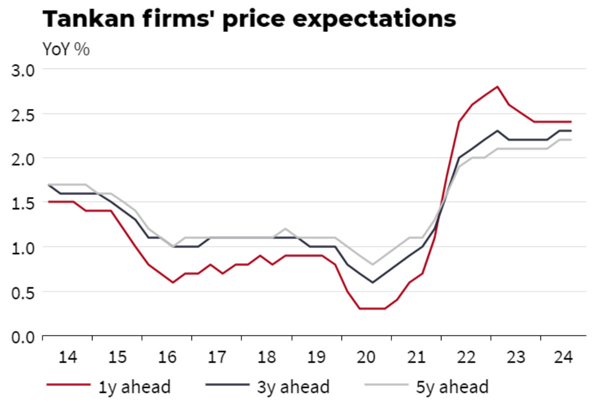
... But real wages are rising



Source: SG Economic and Sector Studies, Refinitiv

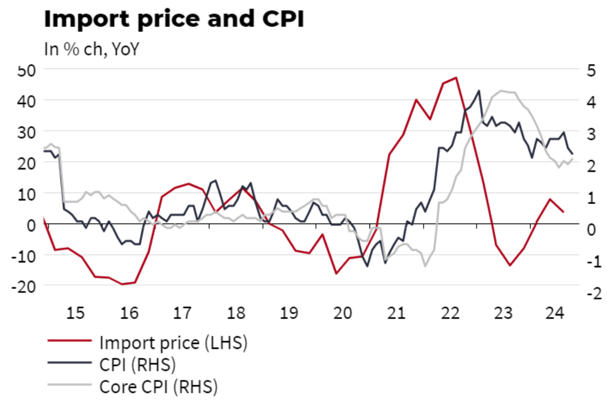
Business investment is expected to remain stable. Corporate earnings have been above pre-pandemic levels and are being boosted by the depreciation of the yen, which is supporting investment. They are expected to continue to rise, albeit at a slower pace, supported by government subsidies, especially for green and digital investments. Structurally, the need to increase productivity in the face of labour constraints should also boost business investment medium term. **Inflation will gradually decline as food and energy prices decline, and then move closer to the BOJ's target.** Intensifying geopolitical tensions, a weak yen and unfavourable weather conditions have kept energy and food prices high. Government measures to reduce the burden on household energy costs have also been phased out. These various factors have supported inflationary pressures. They are now expected to decline, but real wage growth should provide additional strength to the inflation path. In the medium term, labour shortages and an ageing population could keep pressure on wages and prices. However, past performance calls for caution. The path of inflation could disappoint, even if higher expectations seem more anchored.

Price expectations stabilize around BOJ target



Source: SG Economic and Sector Studies, Refinitiv

Inflation remains sensitive to imported prices.



Source: SG Economic and Sector Studies, Refinitiv

Monetary policy is expected to continue to normalise. We expect the Bank of Japan to gradually normalize monetary policy over the next two years and raise its policy rate to around 0.6% by the end of 2026. The pace of further rate hikes will depend on inflation and wage growth data. The central bank will remain cautious throughout this period to ensure that policy normalization does not cause an economic recession or jeopardize its success in the recovery. The pace of interest rate hikes will largely depend on the strength and sustainability of wage growth. Due to its history of deflation, we expect the BOJ to err on the side of caution. Normalization should be very gradual. It should nevertheless be favourable to the yen and also raise the floor on borrowing costs on international markets.

The budget deficit is expected to narrow slightly, but fiscal policy will continue to support activity. As the output gap gradually narrows, fiscal support, partly linked to pandemic support, is being phased out. However, over the medium term, age-related spending, particularly in the health sector, will continue to put pressure on the deficit. The planned increase in defence spending by 2027 is significant, to align with NATO's benchmark of 2% of GDP. Debt servicing costs are only going to rise. We expect the fiscal deficit to average close to 3% of GDP over the forecast horizon.

Further downside risks could weigh on the economic outlook. An increase in tariffs under Trump's second term and a decrease in global demand could put pressure on Japanese exports (20% of GDP). A persistent depreciation of the yen could also increase import prices and feed through to inflation, hampering the recovery in consumption. As a result, the BoJ could review its pace of rate hikes over 2025-2026 to prevent inflation from deviating from its target.

At the domestic level, political instability could last under a minority government: the coalition (LDP-Komeito) lost its majority in the House of Representatives in the early elections at the end of October. The weakening of the central government could stall the policy agenda, and undermine market confidence in the sustainability of Japanese growth and the prospects for fiscal consolidation.

Japan	**2024f**	**2025f**	**2026f**	**2027f**
Real GDP, % ch YoY	-0.2	0.8	0.4	0.5
Household consumption	0.0	0.9	0.5	0.6
Public consumption	0.5	0.6	0.8	0.4
Investment	0.4	0.6	0.4	0.6
Exports of goods & services	0.2	1.8	1.3	1.7
Imports of goods & services	0.7	1.9	2.0	1.8
Inflation, % annual average	2.5	2.0	1.8	1.5
Core inflation, % annual average	2.3	1.9	1.6	1.2
Real gross disposable income (GDI), % ch YoY	1.4	1.0	0.7	0.7
Households saving rate, % of GDI	1.4	1.2	1.3	1.3
Unemployment, % of labour force	2.4	2.3	2.5	2.6
Fiscal balance, % of GDP	-3.8	-3.0	-3.0	-2.8
Public debt, % of GDP	257	258	259	261
Current account balance, % of GDP	3.7	3.9	3.4	4.2

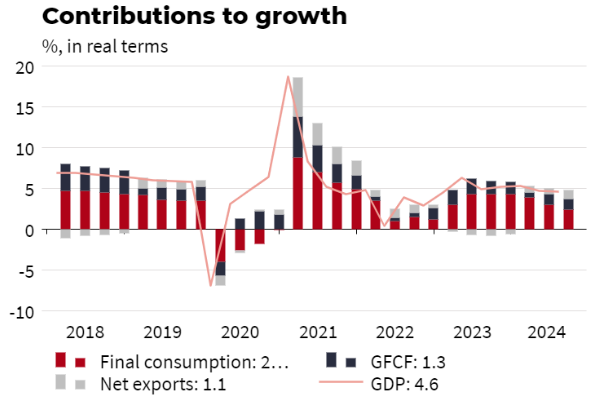
CHINA

- **The economy is suffering from weak domestic demand, weak confidence and slowing private consumption.**
- **The real estate sector is in chronic decline. The momentum in green products exports (4% of total exports), notably electric vehicles (1% of exports) offer only partial compensation.**
- **Support measures continue to focus on supply over demand, albeit that the latest measure hint at a more focus on consumption.**

GDP growth is recording a structural deceleration over the forecast horizon. The ongoing correction in the real estate sector will continue to weigh on investment amid continued 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 are expected to weigh on China's trade and technological advances.

Medium term, the growth outlook is deteriorating due to the protracted crisis of confidence and the lasting effects of the slowdown in real-estate. More support will be needed to counter headwinds, which will ultimately weigh on an already high indebtedness. Rebalancing growth towards consumption could increase China's growth potential. But the authorities appear to continue to favour manufacturing to compensate for the weakness in the housing market, despite signs of overcapacity that could fuel trade tensions. Latest support measures announced following the central economic work conference seem tilted towards consumption, although they should only absorb real estate excess capacity by allowing local governments more autonomy in purchasing housing stocks to stabilize the real estate industry. To achieve the 5% growth in 2025, the fiscal deficit has been raised to 4% of GDP, the largest since 1994, underscoring authorities’ acknowledgment to counter headwinds to the economy but will deteriorate public finances further.

Growth slows down



Source: SG Economic and Sector Studies, Refinitiv

Household confidence does not rise

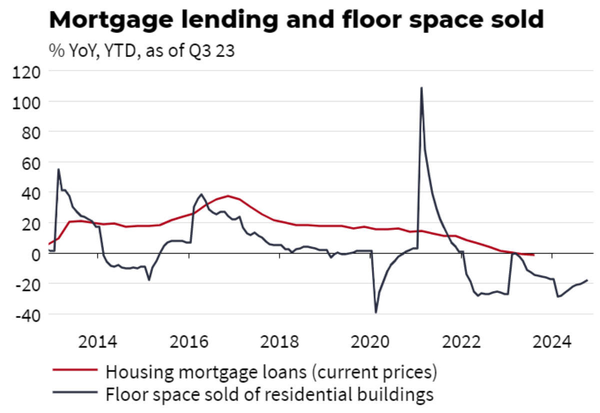
Source: SG Economic and Sector Studies, Refinitiv

The slowdown in real estate will continue to be a drag on growth, although the latest measures announced are expected to slow down the contraction in investment. The continued contraction in property prices and sales prompted the authorities to respond with more support measures at the end of September, both on the supply and demand sides, in particular with the reduction of 0.5pp on average in outstanding mortgages and the minimum personal contribution for second homes. often purchased for investments, increasing from 25% to 15% and expanding the pool of loans from the "whitelist" of financing through state-owned banks for pre-qualified projects and developers from CNY 2 to 4tn by the end of 2024, in order to accelerate the completion of real estate projects. Given the large number of unsold and unfinished homes, the measures should only cover 7% of unfinished homes. Structurally, the decrease in population and the slowdown in urban population growth will reduce the demand for housing in the coming years and make it difficult to absorb excess stocks (unfinished and unsold real estate projects, currently at stand at CNY 60tn, or 47% of GDP).

House prices continued to fall

Source: SG Economic and Sector Studies, Refinitiv

Demand for real estate is still struggling to recover



Source: SG Economic and Sector Studies, Refinitiv

The policy mix will remain accommodative and incremental to mitigate the housing crisis and facilitate the refinancing of local governments but is not

expected to provide a structural solution. In a context of shrinking house prices, the central government's response should facilitate the refinancing of local governments, although it will not solve the problem structurally. Indeed, the authorities announced measures (8% of GDP) targeting the implicit debt of local governments in October, for more transparency and to limit financial risks, including:

Increasing the ceiling on the special debt of local governments (recorded in the official balance sheets) from CNY 6tn (USD 838bn, or 4.8% GDP) to CNY 35tn, over the next three years. This means that from 2024 to 2026, CNY 2bn yuan will be used annually to account for implicit debt in local government accounts.

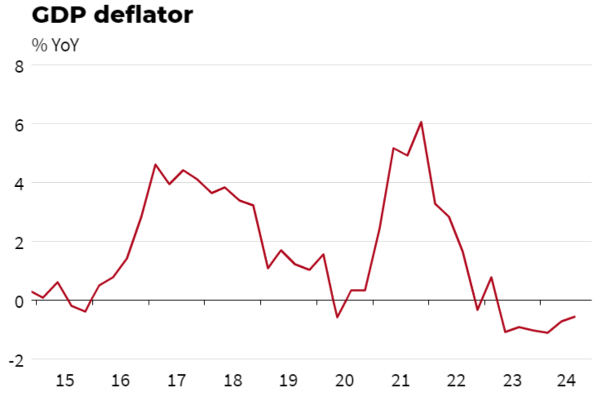
Allowing local governments to issue more special-purpose bonds of [1]up to CNY 800 billion each year for five years, for a total of CNY 4 tn (3.2% GDP).

According to the authorities, the implicit debt, which is recorded off-balance sheet, is then expected to decrease by CNY 12 trn to CNY 2.3 trn by 2028 and reduce interest payments by CNY 600bn. That said, this measure would only free up 0.1% of GDP in interest payments while local governments will face large repayment deadlines (CNY 4tn each year, in 2025-2026). While other measures targeting consumption are under discussion, the impact could be limited, given the impact of the housing crisis on household wealth and the authorities' restraint on deploying social policies (direct cash transfers) historically.

Inflation remains close to zero in 2024, despite a decline in disinflationary pressures. Lower global commodity prices and negative food prices have contributed to disinflationary pressures. Inflation is close to zero and the contraction of the GDP deflator over the past year reflects the weakness of domestic demand. The recent rise in food prices, driven by pork prices, is nevertheless expected to stabilize inflation this year.

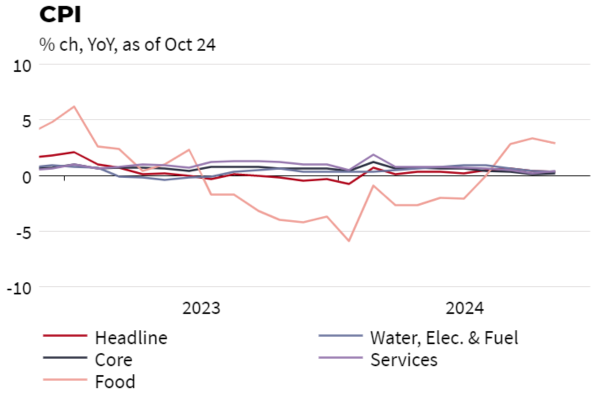
[1] SPBs are a form of 'off-balance' obligation that local governments use to raise resources (especially for infrastructure projects). They tend to be invested in projects that have long investment durations – often more than 10 years. Unlike regular local government bonds, SPB sales require approval from an NPC standing committee and have a lower interest rate because they are perceived as "government backed", so investors accept lower returns, making it easier for local governments to refinance.

The deflator continues to contract



Source: SG Economic and Sector Studies, Refinitiv

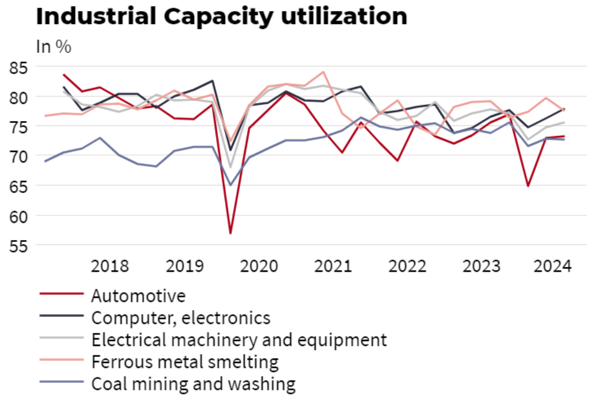
Inflation remains close to zero



Source: SG Economic and Sector Studies, Refinitiv

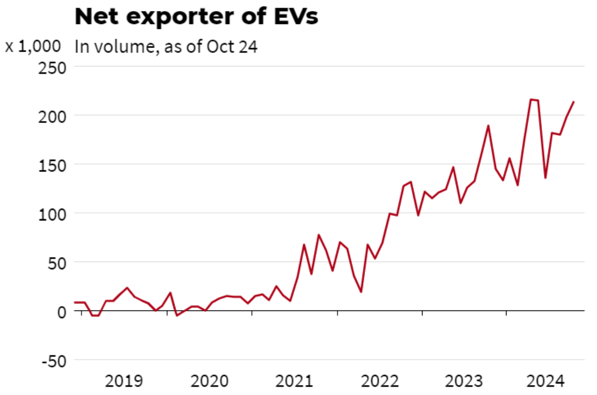
Downside risks to the growth outlook are related to overcapacity and disinflationary risks, partly caused by persistently weak demand. Industrial utilization capacity has been on a downward trend since the pandemic, particularly in the automotive sector, while inventory growth has also been faster than pre-pandemic rates. Some specific sectors, such as electric vehicles, are shining but not yet a counterweight to the scale required and could face obstacles in export markets. The authorities have shown their willingness to continue to support the "new productive forces", without significantly supporting domestic consumption, which remains depressed by the real estate market. This could accentuate the existing imbalances in Chinese growth between manufacturing and consumption.

Utilization capacities are declining



Source: SG Economic and Sector Studies, Refinitiv

Electric vehicle exports slow but remain dynamic



Source: SG Economic and Sector Studies, Refinitiv

Geopolitical tensions will remain present and could intensify with the risks of overcapacity. 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. Geopolitical and security issues in Taiwan also remain a source of risk. As the ruling DPP party secured a third term in January 2024, China's rhetoric has hardened towards the island.

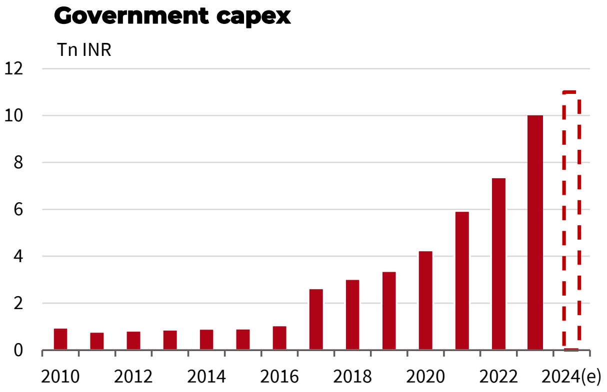
China	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	4.6	4.5	3.8	3.8
Household consumption	5.3	5.2	4.3	3.8
Public consumption	5.4	5.0	4.9	4.8
Investment	3.3	4.8	3.6	3.6
Exports of goods & services	4.8	1.8	1.8	2.1
Imports of goods & services	2.9	3.7	2.5	2.0
Inflation, % annual average	0.7	1.2	2.0	2.0
Fiscal balance, % of GDP	-7.1	-7.8	-7.8	-7.6
Public debt, % of GDP	91	93	96	98
Current account balance, % of GDP	2.2	1.3	1.0	1.0

INDIA

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

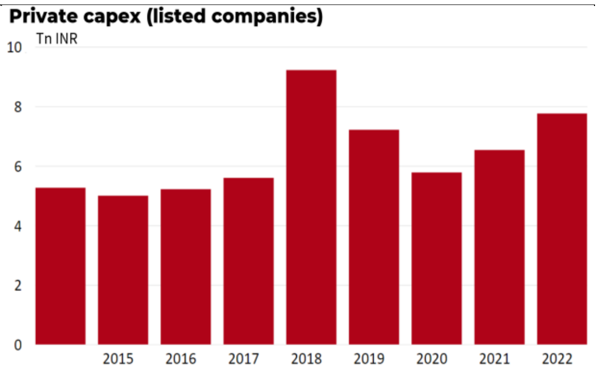
Investment should start to slow. Public investment, a major contributor to growth over the last two years, should start to slow down, in line with planned fiscal consolidation. Growth in private-sector investment is currently too weak to sustain the current momentum in total investment. This would contribute to a slowdown in Indian growth, which is currently above potential.

Public investment's strong momentum should start to tame on the medium term



Source: CSO, SG Economics and Sector Studies

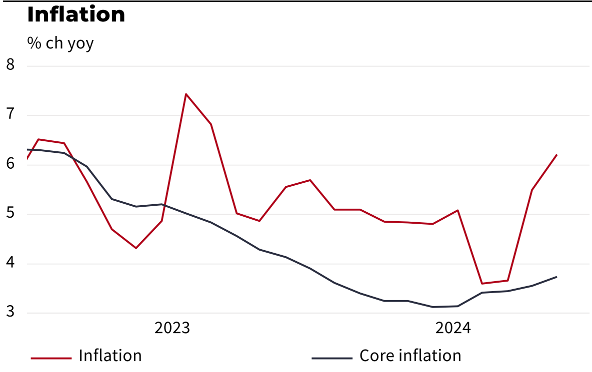
Private capex contributes less to growth



Source: Eikon, SG Economics and Sector Studies

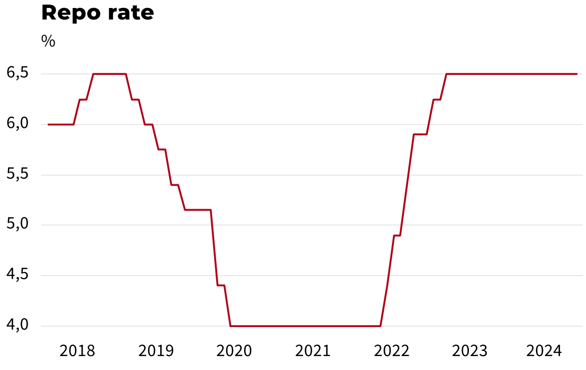
Core inflation is decelerating, slowly, which should sustain private consumption. Core inflation deceleration should continue, despite the last acceleration due to a one-off mobile tariff revision in July. Lower inflation will support private consumption, which is set to rebound from growth well below its historical average in 2023. The real growth in private consumption in 2Q24 of 7.5% YoY, well above that of the last semesters (around 2%), is a first sign of this rebound. It is worth note however that should food prices stay elevated for longer, in line with recent data, the recovery in private demand would be delayed.

Inflation is slowly decelerating in 2024



Source: RBI, Refinitiv and SG Economics and Sector Studies

The RBI is at the top of its tightening cycle



Source: RBI, Refinitiv and SG Economics and Sector Studies

Fiscal consolidation has begun, and the fiscal balance is set to improve over the medium term. The 2024-2025 budget forecasts an improvement in the central government's public deficit to 4.9% of GDP (vs. 5.8% in 2023). Public investment will increase (albeit at a slower pace than in the last two years) slightly faster than nominal GDP.

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.

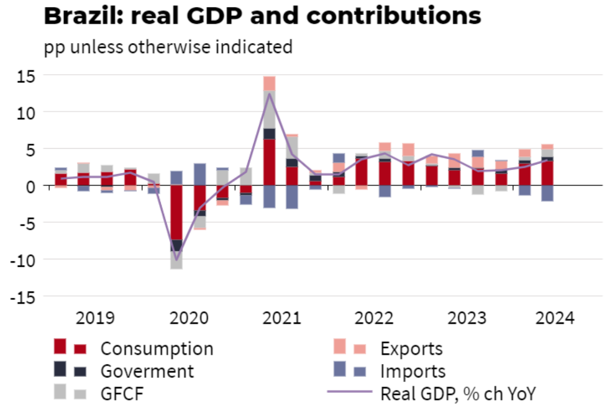
India	2024f	2025f	2026f	2027f
Real GDP, % ch YoY	6.7	6.2	6.2	6.2
Household consumption	6.8	6.0	6.0	6.0
Public consumption	6.0	5.6	5.6	5.6
Investment	7.8	6.5	6.5	6.5
Exports of goods & services	7.5	5.5	6.0	6.0
Imports of goods & services	8.3	5.5	6.0	6.0
Inflation, % annual average	4.7	4.7	4.7	4.7
Fiscal balance, % of GDP	-8.3	-7.5	-7.5	-7.5
Public debt, % of GDP	83	82	81	80
Current account balance, % of GDP	-1.4	-1.5	-1.5	-1.5

BRAZIL

- **The tightening of the policy mix will act as a brake on household consumption from 2025, which has been the main driver of growth for the past 3 years.**
- **Faced with a re-acceleration in inflation, the BCB will have to capitalise on its independence to ensure that expectations are anchored and that markets have confidence.**
- **Exacerbating trade tensions could hamper exports, particularly to the Chinese market.**

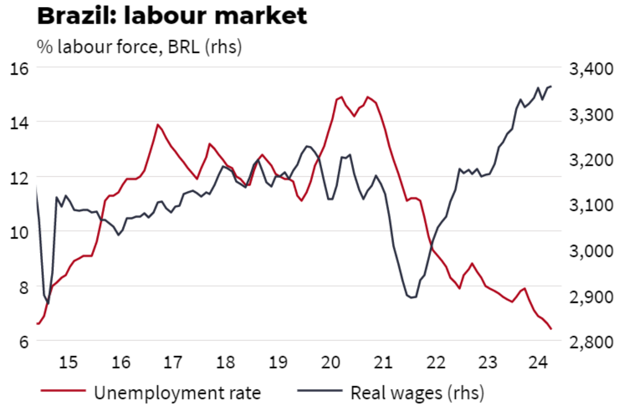
2024 will mark the end of the recovery cycle following the Covid shock, characterised by growth rates above potential. The country has overcome the shocks of the early part of the decade, with real GDP 10% higher than in 2019. This recovery has been largely driven by household consumption, helped by the fiscal stimulus and a favourable labour market. Indeed, the unemployment rate has been falling overall since the end of the health crisis, and now stands at 6.4%, its lowest level in 10 years, while real wages are buoyant (up 17% since the start of 2022).

Private consumption remains the main driver of growth…



Source : IBGE, SG Economics and Sector Studies

…leveraging a tight labour market and fiscal effects

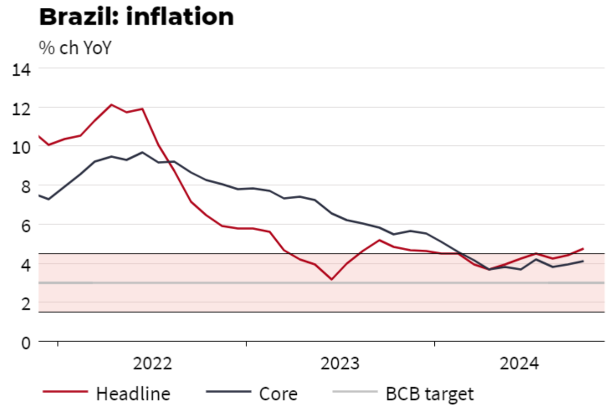


Source : IBGE, SG Economics and Sector Studies

Faced with rising inflation, the BCB is forced to embark on a new tightening cycle at least until the end of 1H2025. Headline inflation has been rising since April (4.8% in October, +1.1pp compared with April), with core inflation also surprised on the rise (+0.4pp). Food prices are rising due to the normalization of agricultural production after record years, and adverse climatic events, notably the floods in Rio Grande do Sul at the beginning of the year. They accounted for 1/3 of the total inflation rate in November, compared with 8% in January. Faced with these pressures on prices, which finally exceeded the BCB's margin of tolerance (3%, +/-1.5pp) in October, the central bank is embarking on a new cycle of tightening monetary conditions. The Selic rate gained 175bp during the Copom meetings since

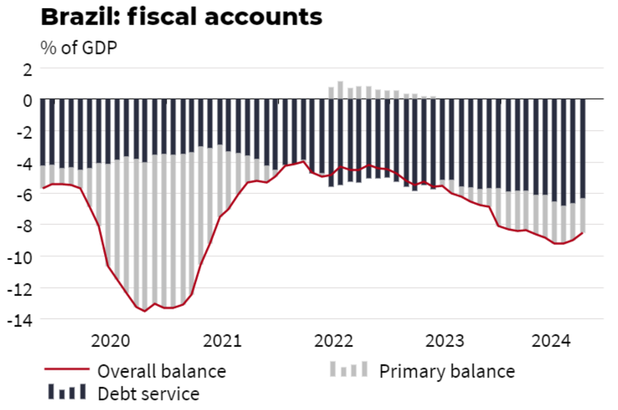
September, and now stands at 12.25%. Further rises are expected in December and January 2025 at the very least. We expect monetary conditions to remain tight in the first half of 2025, weighing on credit, household consumption and investment. The effects of the tightening will be noticeable for households which are heavily indebted. Their debt servicing costs have been rising since 2020, and now account for 27% of their income. Nonetheless, the BCB's determined action remains crucial, given the signs that inflation expectations are easing, gaining 0.6pp for 2025 between April and October in the BCB's producer surveys. Furthermore, with the arrival of G. Galípolo - close to Lula - at the head of the BCB from January, monetary policy will have to assert its independence from the executive in order to reassure market participants.

The BCB must assert its independence to ensure that inflation is contained



Source : BCB, SG Economics and Sector Studies

The government is compelled to consolidate public finances



Source : BCB, SG Economics and Sector Studies

The Lula government is planning fiscal consolidation from 2025, without yet providing complete reassurance to the market. The primary account is expected to be balanced from 2025, due to major increases in revenue (~BRL 170 billion). 1/3 of these are contingent on approval by Congress, where the PS lost influence following the municipal elections in October which marked a shift to the right. The government's ability to honour its announcements will be put to the test, at a time when efforts to contain spending growth are weak. The government also needs to better target its spending and limit its growth by reducing the rigidities in the budget (pensions, social programs to be better targeted) in order to achieve its fiscal objectives. The challenge of public spending will remain central over the entire forecast horizon, given the growing weight of interest charges (6.6% of GDP in 2025, compared with 4.8% in 2019), and the high rates paid on local and foreign currency debt, which encourage snowball effects. Market participants remain cautious about the government's announcements. The latest fiscal package announced in November (income tax reform, BRL 12bn in spending cuts, adjustment of the minimum wage, among others) caused the real to depreciate sharply (by 1.8% following the announcements, exceeding the USD/BRL 5.9 mark) and the stock market to fall by 1.7%.

We see downside risks to our scenario, in a more volatile and fragmented international environment. The prospect of diplomatic tensions between the US and China could put pressure on Sino-Brazilian relations. The Chinese market accounts for around 30% of the country's exports, which would be vulnerable in the event of heightened geopolitical tensions. Furthermore, the prospect of a strong dollar will weigh on the country's ability to manage its external financing needs (~USD 93bn in 2025). Conversely, if the real were to appreciate as a result of the interest rate differential with the Fed, it would harm the country's competitiveness.

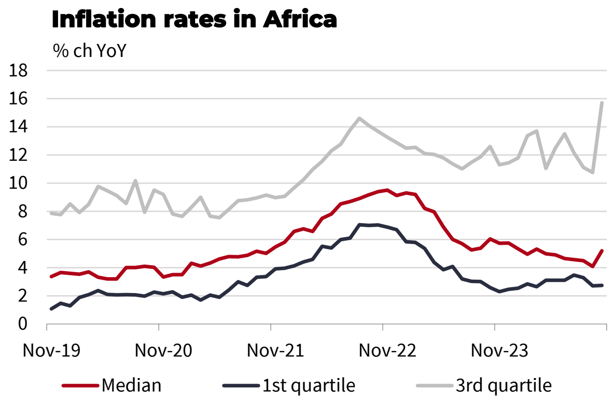
Brazil	**2024f**	**2025f**	**2026f**	**2027f**
Real GDP, % ch YoY	2.9	1.9	1.6	2.0
Household consumption	3.0	2.0	2.0	2.0
Public consumption	1.5	1.5	1.3	1.3
Investment	1.4	1.4	1.4	1.7
Exports of goods & services	3.0	2.5	2.5	2.0
Imports of goods & services	1.7	2.0	2.0	2.0
Inflation, % annual average	4.4	4.2	3.7	3.3
Fiscal balance, % of GDP	-6.9	-7.3	-7.0	-5.9
Public debt, % of GDP	88	90	92	94
Current account balance, % of GDP	-1.7	-1.7	-1.9	-1.9

AFRICA

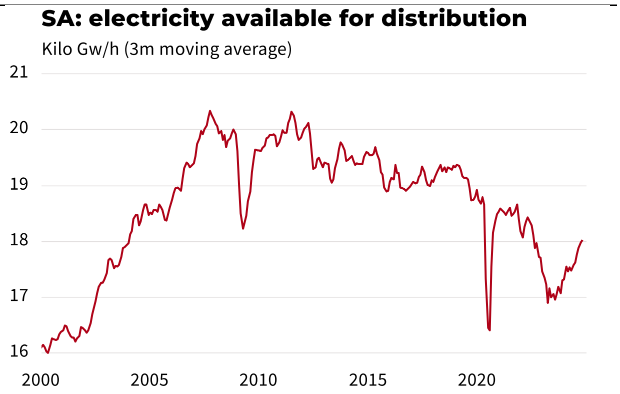
- **Regional growth for 2024 has been revised downwards (to 3%, compared with 3.5% previously), due in particular to delays in several major hydrocarbon and mining projects.**
- **The expected acceleration in growth for 2025 remains insufficient (and too fragile) to ensure a real increase in wealth levels.**
- **The prospect of higher US interest rates (than previously forecasted) increases the risk of refinancing foreign currency debt.**

Regional growth for 2024 is likely to be lower than expected, at around 3% (vs. 3.5% still forecast last quarter). Most African countries posted disappointing growth figures in 1Q24 or 2Q24, due to the (slight) loss of momentum of all the growth drivers: private demand suffering from persistently high inflation at the time; public demand held back by (modest) fiscal consolidation efforts; etc. In addition, the postponement of some major hydrocarbon or mining projects (Senegal, Libya, Zambia, Botswana) and/or the rapid deterioration in the political and security environment (Libya, Sudan and South Sudan) led to significant revisions in growth forecasts in these countries, taking a few percentage points off the regional average.

A gradual decline in inflation



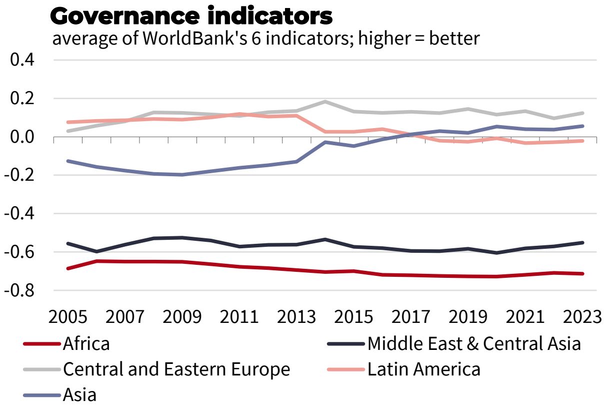
South Africa: electricity production is finally bouncing back



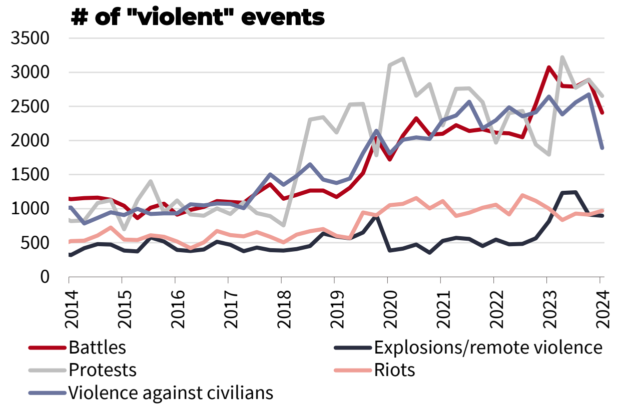
Source: Refinitiv, SG Economic and Sector Studies

For 2025, we are still forecasting an acceleration in regional growth, but again at a lower level than previously expected (3.5% compared with 3.8% in the previous quarter). This rebound should be based mainly on stronger private demand, helped by the continuing gradual reduction in inflation levels – even if the situation remains problematic in several countries (particularly those which have recently seen their currencies depreciate sharply: Nigeria, Angola and, to a lesser extent, Zambia). Public demand, on the other hand, is still expected to be at half-mast, as governments continue their fiscal consolidation efforts. It should be noted that these efforts are often 'forced', as many countries are facing growing financing constraints, particularly in local currency (tensions illustrated by the rise in payment incidents and delays on public debt). Lastly, the outlook for external demand remains uncertain, against a backdrop of major uncertainties about commodity prices (which still account for over 2/3 of the continent's total exports) and geo-economic fragmentation (particularly with the likely increase in US tariffs following the election of President Trump). From a geographical point of view, better growth prospects in Egypt (where the economy is gradually rebounding after the "confidence shock" – depreciation of the exchange rate, rise in interest rates – of 1Q24) and South Africa (where electricity production is finally picking up after more than 10 years of decline) give us some comfort about the rebound in regional growth in 2025 (the 2 countries representing 20% and 10% of regional GDP respectively in PPP terms). **We then expect a further acceleration (still limited) in 2026 and subsequent years, taking regional growth to 3.8%.** As always, these growth rates remain both insufficient (to ensure a sustainable rise in per capita income, given the continuing high demographic growth of around 2.5% per annum) and fragile, at a time when the frequency and intensity of climatic events seems to be increasing.

Governance levels remain low



Overall, a high risk of social unrest



Source: Refinitiv, ACLED, SG Economic and Sector Studies

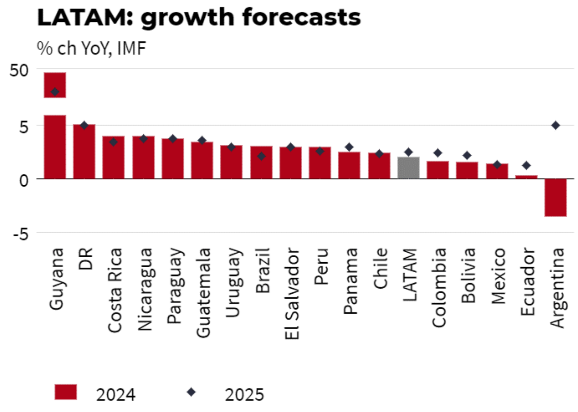
Several risks continue to weigh on this outlook. Firstly, the inadequacy and vulnerability of growth in many countries remain problematic, particularly because the region's political structures remain significantly more fragile (on average) than those of other emerging regions, and because the number of "violent events" is already on the rise. In addition, the prospect of higher US interest rates (again following the election of President Trump) is likely to add to the strong pre-existing fragilities weighing on the region's balance of payments, particularly in terms of the refinancing risks on foreign currency debt: the region will have to repay USD 12bn of Eurobonds in 2025, for example.

LATIN AMERICA

- **Regional growth has been revised to the downside over the entire forecast horizon in the wake of a strained international environment.**
- **Heavily exposed to the volatility resulting from the US elections, the continent's economies will have to show resilience in the face of renewed trade tensions.**
- **Rising risk perceptions and a strong dollar could lead to increased risk for economies with significant financing needs.**

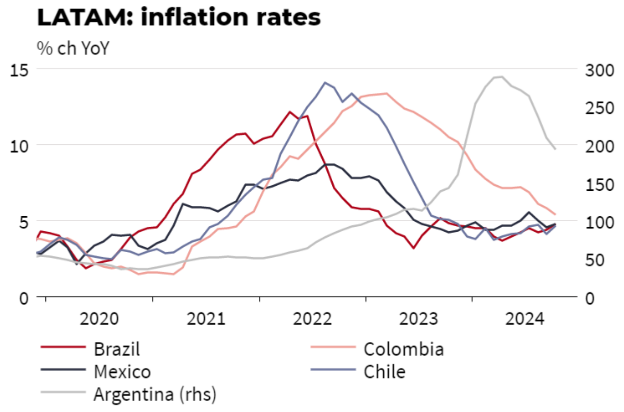
Regional growth in 2024 (2%) is in line with its long-term average, but masks significant heterogeneity in country growth. The smaller economies are doing well overall, along Brazil that is surprising on the upside (2.9% in 2024). Growth in Guyana -which tops the list of economies thanks to its recent oil production- should start to slow from 2025 but will remain in double figures for the rest of the decade. In contrast, most of the other major economies will experience a greater slowdown than initially forecast. Ecuador and Colombia are facing severe droughts as a result of the El Niño phenomenon, which is translating -respectively- into electricity and water service rationing that is weighing on their economies. Argentina faces a sharp contraction in 2024 (-3.5%) in the backdrop of its fiscal and macroeconomic adjustment, driven by a sharp contraction in real incomes.

Regional growth masks strong cross-country heterogeneity



Source : IMF, SG Economic and Sector studies

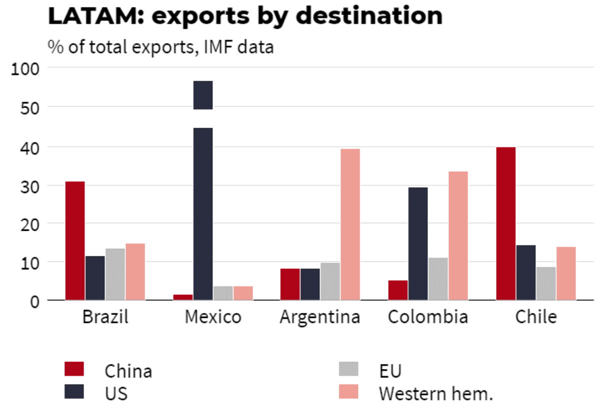
The inflation trajectories also show signs of divergence



Source : Refinitiv, SG Economic and Sector studies

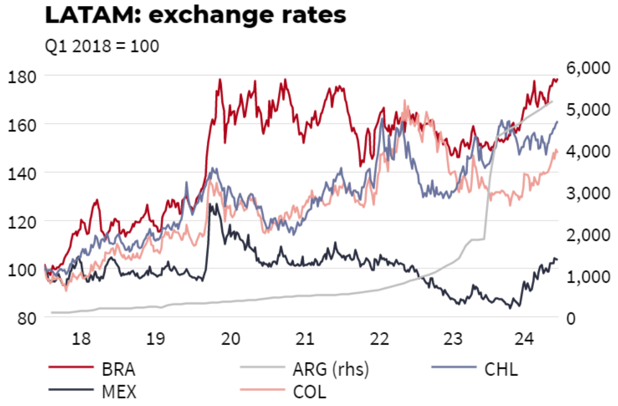
Disinflation processes and central bank reactions are also scattered across the region. Peru, Colombia and Argentina have succeeded in reaffirming the sharp reduction of their inflation rates, which has led to easing cycles by their central banks. Conversely, Mexico, Brazil and Chile have seen their inflation rise since Q2. This has led to a new tightening cycle in Brazil, and very cautious behaviour on the part of Banxico. Overall, we see inflation rates that are well under control, but at higher levels than in the previous decade, and most of the rate cuts seem to have already taken place.

The region is highly exposed to commercial tensions…



Source : IMF, SG Economic and Sector studies

…which adds significant pressures on local currencies



Source : Refinitiv, SG Economic and Sector studies

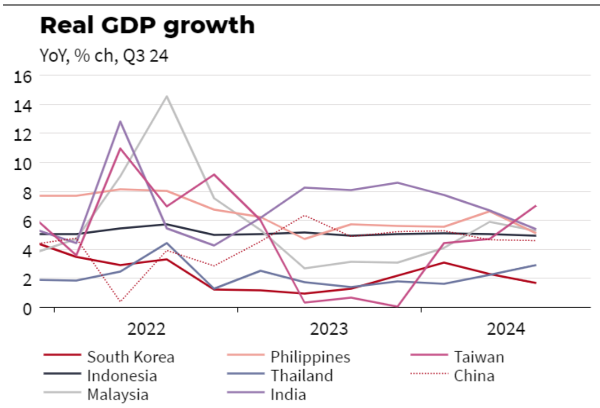
The region is at the forefront of changes in US foreign policy, with increased risks in the medium term. Rising geopolitical and trade tensions are making export sectors vulnerable. Mexico –where 82% of its exports are destined to the US market- is particularly vulnerable to new US tariffs, especially from 2026 onwards when the USMCA will have to be renegotiated. The southern part of the continent is more exposed to risks linked to the Chinese market, such as a slowdown of its economy leading to lower demand for commodities, or the desire of Western countries to isolate China. Furthermore, expected FDI flows linked to nearshoring efforts are subject to greater uncertainty. The prospect of a strong dollar and greater volatility could push up sovereign spreads -which have remained fairly stable until now- adding further pressure to the region's external balances.

EMERGING ASIA

- **Regional growth in emerging Asia (ex China) is expected to remain resilient in 2025, despite an expected decline in Chinese demand, supported by firm domestic demand.**
- **Inflationary pressures are gradually dissipating. However, the impact of El Niño on harvests could push up food prices.**
- **Downside risks related to economic and geopolitical uncertainties are intensifying and may weigh on regional investment and trade.**

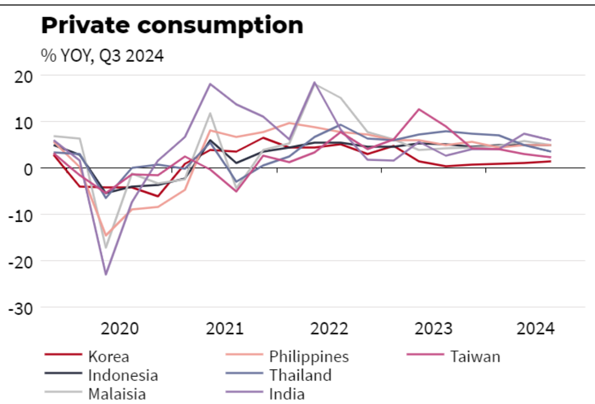
Regional growth in emerging Asia ex China is not expected to slow down much in 2025, despite a real decline in Chinese demand. Domestic consumption, which accounts for more than half of GDP for most countries, continues to support growth. The labour market is improving, with unemployment in most economies already back to pre-pandemic levels. Tourism continues to recover, supporting consumption and service activity. Exports have remained favourable so far in 2024, supported by strong regional trade and driven by the recovery of the semiconductor sector.

Growth in the region remains dynamic…



Source: SG Economic and Sector Studies, Refinitiv

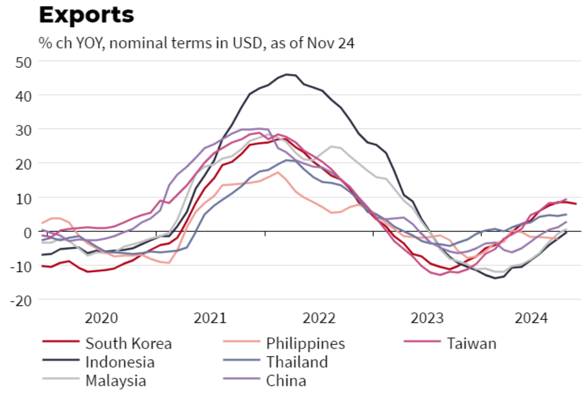
… supported by private consumption



Source: SG Economic and Sector Studies, Refinitiv

External demand has gradually recovered but may start to slow as we expect demand from China and the US to decelerate in 2025. The recovery of the semiconductor cycle is also maturing. Exports and production of semiconductors 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 continued, but the cycle is coming to maturity. In addition, geopolitical fragmentation and tensions, especially with Trump's re-election, pose a downside risk to exports.

The rebound in external demand...



Source: SG Economic and Sector Studies, Refinitiv

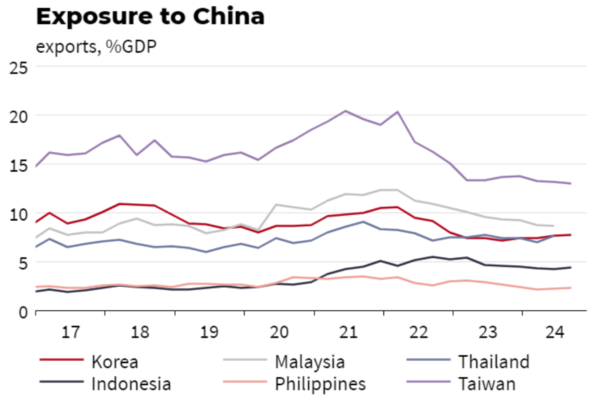
... is driven by the semiconductor industry

Source: SG Economic and Sector Studies, Refinitiv

Inflationary pressures are expected to continue to ease. Most economies have returned to pre-pandemic inflation averages, within the central banks' target range, as pressures on energy and food prices have eased. However, climate risks combined with the impact of El Niño could affect agriculture in the region and exacerbate food prices.

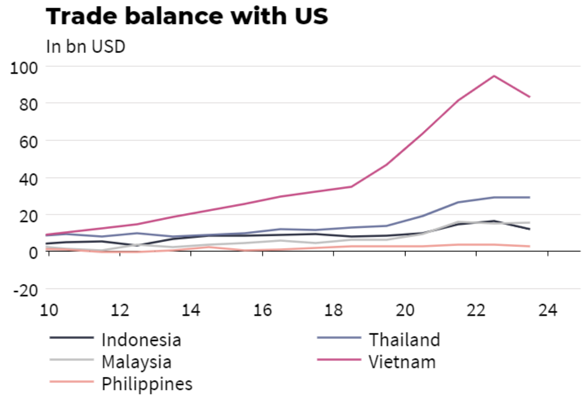
Many countries have seen the effects of rising interest rates since 2022. This brake should now fade as monetary policy is gradually eased. As consumer price inflation slows, consumer confidence in spending is expected to recover. A final headwind will come in the form of gradual fiscal consolidation.

The region is vulnerable to a slowdown in Chinese demand



Source: SG Economic and Sector Studies, Refinitiv

Southeast Asia already has large trade surpluses with the United States



Source: SG Economic and Sector Studies, Refinitiv

Downside risks are intensifying. Economic growth and easing price pressures should be beneficial for political stability, but risks remain, as recent instability in Bangladesh and Thailand shows. The new leaders have not yet consolidated their positions. On the geopolitical front, developments in Taiwan, the South China Sea and the Korean Peninsula will remain the main flashpoint, as trade protectionism intensifies with Trump's re-election.

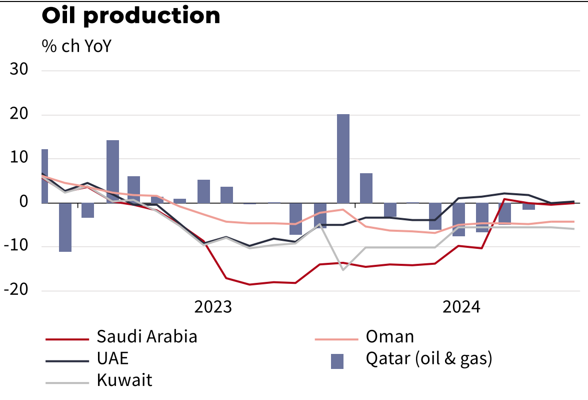
A prolonged correction in the Chinese property market and an increase in tariffs against China following Trump's second term would affect countries in the region whose exports are strongly linked to China's investment and demand for raw materials. Moreover, although Southeast Asian countries benefit from the *China+1* strategy, they already have large trade surpluses (Vietnam in particular) with the United States and may face more pressure from U.S. trade policy due to its close trade relations with China.

GULF STATES

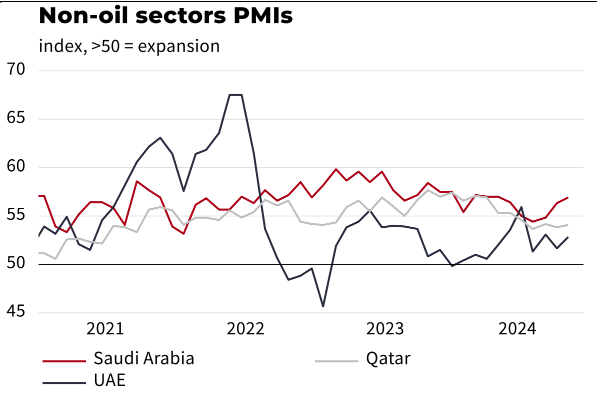
- **Regional growth is expected to hover around 2% in 2024, still limited by sluggish hydrocarbon production.**
- **However, growth should accelerate in 2025/26 (to around 4%), due to the stabilization of volumes produced (at least) and non-oil sectors that are still dynamic.**
- **While the region continues to face increasing geopolitical risks, it remains "solid" thanks to comfortable budgetary and external balances.**

Confirming the trends already reported in previous quarters, growth in the GCC (Gulf Cooperation Council) **countries is expected to settle – at best – around 2% in 2024.** Although slightly improved compared to 2023 (0.4%), this rate would be the 5th lowest since 2010. Thanks to more advanced levels of economic diversification, the United Arab Emirates (UAE) and Bahrain – to a lesser extent – seem to be holding up better and should record growth above 3% this year. Oil production remains stable for the time being at best (Saudi Arabia and UAE) or is even still declining (Oman and Kuwait), in line with the OPEC+ strategy of supporting oil prices and therefore limiting supply. In November, the organization again postponed the withdrawal of the reductions decided in 2023 until early 2025 at best. The non-oil sectors remain dynamic, as evidenced by non-oil PMIs still firmly in the expansion zone.

Oil productions are still stable at best



Non-oil PMIs are still firmly in expansion territory

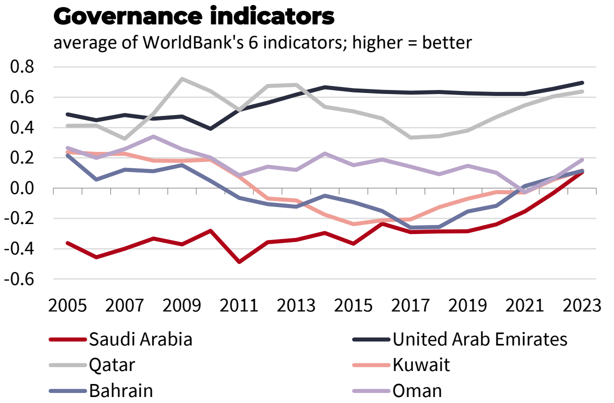


Source: Refinitiv, SG Economic and Sector Studies

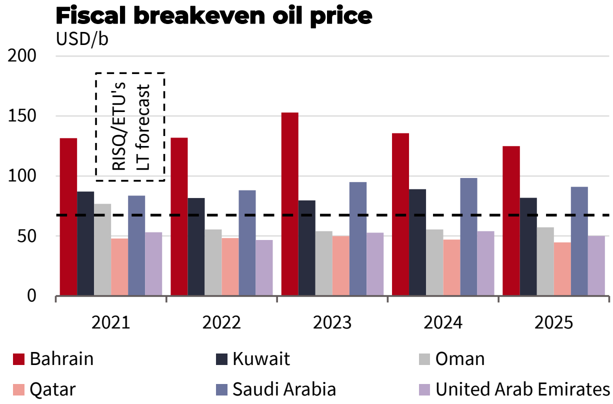
Regional growth is still expected to increase for 2025, at around 3.5%. At a minimum, a stabilization (in % YoY terms) of hydrocarbon productions would mean that the oil sectors would no longer constitute a "drag" on total growth. Possible increases in production – which should in any case remain moderate in our opinion – could add a few percentage points to regional growth. The outlook for gas production remains better oriented, whether in Qatar (with the end of the North

Field expansion work planned for 2026) or in Oman. For their part, the non-oil sectors will remain dynamic, still benefiting from significant "green" investments (particularly mitigation) and economic diversification efforts, while the region remains one of the most exposed to climate risks (particularly transition risks). According to the IMF, the weight of non-oil sectors has increased on average in the region, from around 50% of GDP in 2000 to 66% in 2023, even though oil & gas (O&G) still represent around 60% of exports and 70% of budget revenues in the GCC on average. On the demand side, public demand could slow down slightly in 2025 and 2026, suffering from the (limited) budgetary consolidation efforts undertaken in the region. However, this should be more than offset by increased dynamism in private demand, which benefits from i) low inflation (still around 2%), ii) the good performance of labour markets, iii) the structural increase in inward FDI throughout the region, and iv) more generally, the continued improvement of governance environments. However, due to GCC's pegs linking the region's monetary policies to that of the Fed, these monetary policies should be slightly more restrictive than expected in 2025 and 2026, in line with our forecast of a less accommodative Fed in the face of a more inflationary US economic context.

Governance levels are improving throughout the region



Saudi Arabia: less capacity to generate current account surpluses



Source: Refinitiv, IMF, SG Economic and Sector Studies

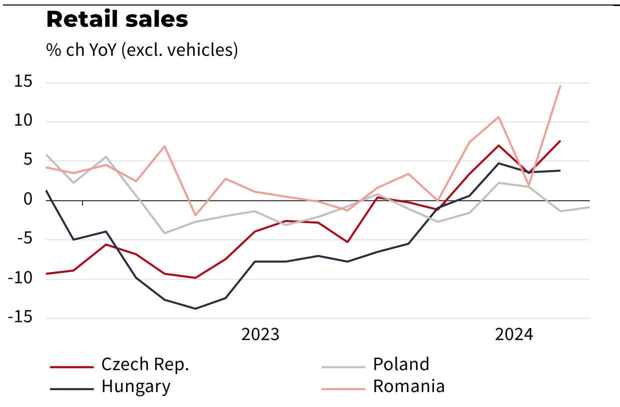
An increasingly uncertain geopolitical context (particularly following the election of President Trump in the United States) remains the main risk weighing on the GCC countries, even if for the moment, the various regional conflicts (Gaza, Lebanon, Yemen, strikes in Iran, etc.) have had little impact on the 6 countries. In addition, while the GCC's budgetary and external accounts remain particularly solid, the “breakeven oil prices” balancing these accounts tend to structurally increase, particularly in Saudi Arabia. At the very least, this should result in a (very gradual) reduction in GCC investments abroad.

CENTRAL AND EASTERN EUROPE

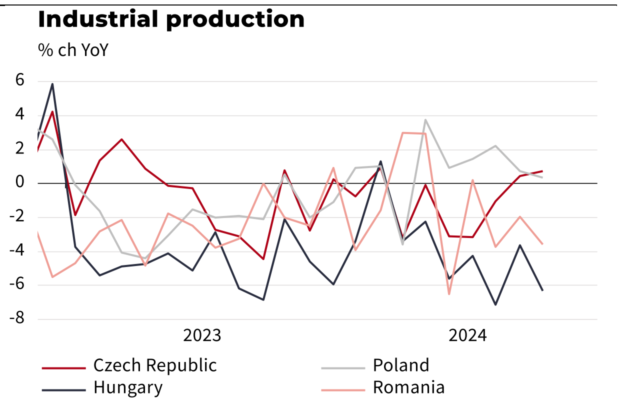
- **Despite the expected fiscal consolidations in the region, growth will continue its gradual recovery in 2025, driven by domestic demand.**
- **After strong disinflation and rate cuts since the end of 2023, inflation should remain relatively stable in 2025 in a context of moderation in energy prices.**
- **Downside risks relate mainly to a slower-than-expected EU fund absorption and to uncertainties linked to Donald Trump election, particularly on trade and value chains as well as on the financing of aid to Ukraine.**

The growth recovery in the region was two-speed in 2024: while private consumption showed strong dynamism supporting retail sales, exports were sluggish due to weak external demand weighing on the manufacturing sector. Households benefited from strong disinflation which allowed real wages to rise and, in some countries, from increased public spending in the run-up to the elections (notably in Romania and Poland). The absorption of European funds has progressed, although slowly: 35% of NextGeneration EU funds allocated to the Czech Republic were disbursed in November 2024, 14% for Poland, 24% for Bulgaria, 48% for Romania, 2 % for Hungary compared to more than 80% in France and more than 60% in Italy and Spain for example. The European Commission released the frozen Cohesion Funds and *NextGeneration EU* Funds for Poland and part of these funds for Hungary at the beginning of 2024. On the other hand, over the whole year, industrial production, particularly for the automobile sector, remained in negative territory, except in Poland. In addition, the significant inventories reduction observed in the Czech Republic, Poland and Romania weighed on growth in 2024.

Household consumption is the main growth driver



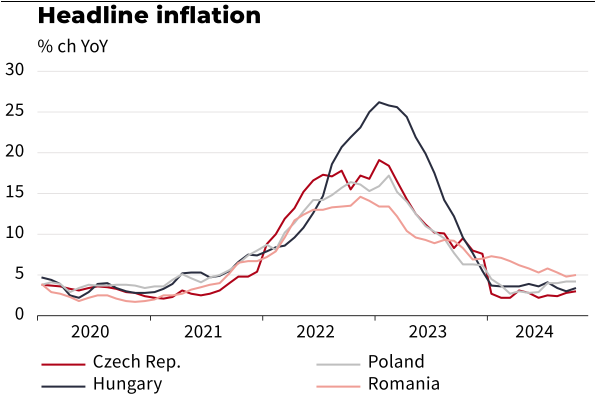
Industrial production remains in negative territory



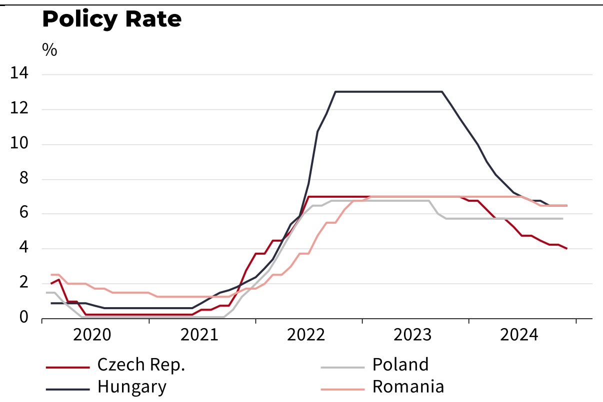
Sources: Refinitiv, SG Economic and Sector Studies

In 2024, inflation remained relatively stable in the region, except in Romania where it continued to decelerate. Indeed, Romanian disinflation started later (from January 2024) than in the rest of the region, notably due to still expansionary fiscal policy and a tight labour market implying strong wage pressures. In this context, the region's central banks have lowered their key rates since 3Q23: by 300bp in the Czech Republic, by 650bp in Hungary and by 100 bp in Poland. The Romanian central bank only started lowering its key rate in July 2024 (by 50bp).

After a sharp disinflation in the region, inflation has stabilized since January



Further rate cuts could take place in 2025



Sources: Refinitiv, SG Economic and Sector Studies

In 2025, growth in the region is expected to continue its gradual recovery driven by domestic demand. In a context of moderating inflation, purchasing power and household consumption should continue to recover. Note that labour markets have remained tight in the region: regional companies shed very few workers during the soft patch that hit manufacturing sector last year and in 1H24, with labour hoarding continuing in most countries.

Investment is expected to accelerate slightly 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 a slow recovery in the euro area.

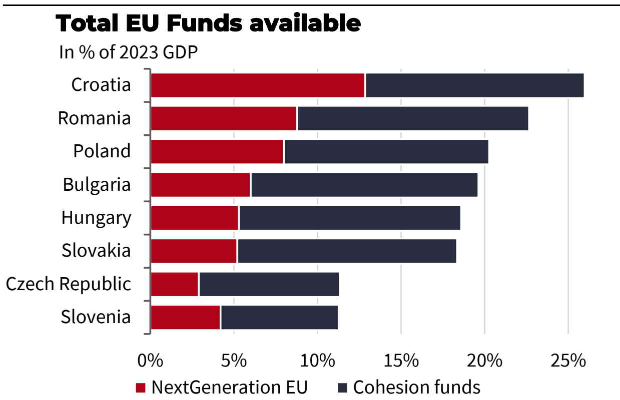
Fiscal policy should become more restrictive due in particular to the reactivation of European fiscal rules and the fiscal consolidation that will follow. The European Commission opened an excessive deficit procedure in June 2024 for Poland, Hungary and Slovakia while it confirmed it for Romania. The latter displays one of the highest fiscal deficits in the region. The country has not undertaken a fiscal consolidation yet given the busy electoral calendar in 2024 (parliamentary, presidential and local elections) as evidenced by the vote for a 40% increase in pensions from September 2024. Significant fiscal consolidation will be necessary in 2025, likely including tax increases.

Inflation should remain broadly stable in 2025 to gradually reach central bank targets. The slowdown in inflation will be enabled by the moderation of energy prices and the tightening of fiscal policies. In this context, central banks in the region could continue to slightly lower their policy rates in 2025.

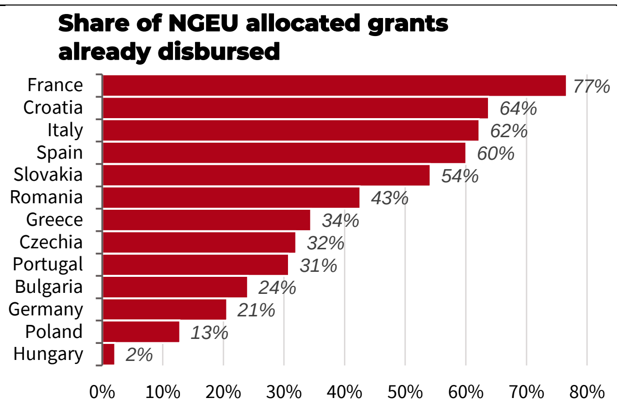
Downside risks to the growth outlook relate mainly to the absorption capacity of EU funds and to the uncertainties linked to the election of Donald Trump, particularly on trade and value chains as well as on the financing of aid to Ukraine.

NextGeneration EU (NGEU) funds available until 2026 and Cohesion funds available over the period 2021-2027 represent substantial amounts for Central and Eastern European countries (between 11 and 26% of GDP). A slower absorption of European funds in the region or a lower efficiency of the projects implemented could significantly weigh on investment in the region and thus on growth prospects.

European funds are key to growth prospects in the region…



However, disbursement of *NextGeneration EU* funds remains slow in CEE.

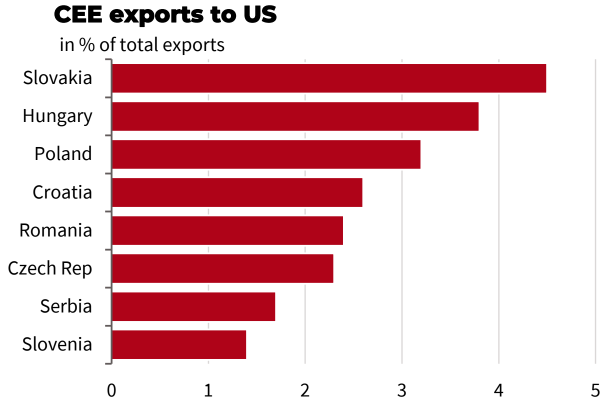


Sources: Refinitiv, European Commission, SG Economic and Sector Studies

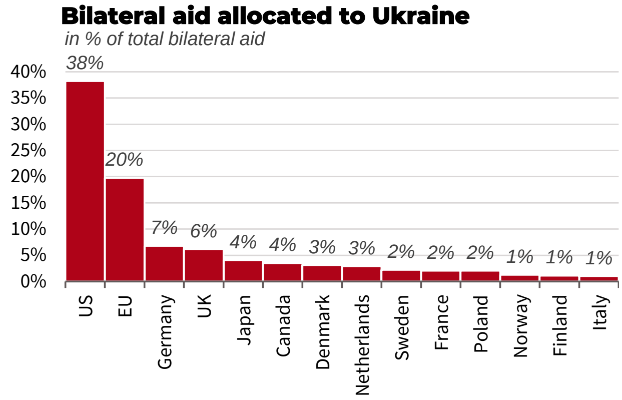
Downside risks also concern growing uncertainties following the election of Donald Trump. If the region's direct trade exposure to the United States remains low, the implementation of high tariffs towards the United States' main trading partners could affect the region indirectly via value chains and the strong dependence of the region on the German economy.

Furthermore, the election of Trump and the potential reduction in American bilateral aid to Ukraine could increase uncertainties about the evolution of the war and the availability of energy for a few countries in the region that are still dependent Russian gas or oil and put pressure on the defence spending of countries in the region.

Limited direct trade exposure to the United States.



Significant consequences in CEE if US bilateral aid to Ukraine is cut.



Sources: Refinitiv, Kiel Institute, SG Economic and Sector Studies

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,
+33 1 58 98 93 65
foly.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

Natalia CARDENAS FRIAS
Euro Area, Germany, Latam
natalia.cardenas-frias@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

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

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

Antonio VISANI
UK, Environment
antonio.visani@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

Société Générale | Société Générale Economic and Sector Studies | 75886 PARIS CEDEX 18

Subscribe to the Economic studies series:

https://www.societegenerale.com/en/news-and-media/economic-studies/our-economic-research

DISCLAIMER

This publication reflects the views of Société Générale S.A.'s Economic and Sector Research department at the date of publication. This publication is subject to change at any time without notice. It is provided for information purposes only, and does not constitute an investment recommendation or an investment advice within the meaning of current regulations. This publication has no contractual value. This publication is not a product of the SG Research Department and should not be regarded as a research report.

Neither the information contained in, nor the analyses expressed therein constitute in any way an offer to sell or a solicitation to offer to subscribe, purchase, sell a product or execute a transaction and shall not engage the liability of Société Générale S. A. or any of its entities, in compliance with current regulations. Then, should a retail or a professional client, or eligible counterparty obtain this publication, they should not base any investment decisions solely on the basis of this publication, and must seek independent financial advice.

The accuracy, completeness or relevance of information derived from external sources is not warranted, even if it comes from sources reasonably believed to be reliable. Subject to the current regulations, Société Générale S. A. does not accept any liability in this respect. The economic information mentioned in this document is based on data valid at a given time, and may therefore change at any time.

Société Générale S. A. is a French credit institution authorized and supervised by the Autorité de Contrôle Prudentiel et de Resolution (the French Prudential Control and Resolution Authority) ("ACPR"), regulated by the Autorité des Marchés Financiers (the French financial markets regulator) ("AMF") and under the prudential supervision of the European Central Bank ("ECB"). Société Générale S.A. is authorised by the Prudential Regulation Authority and with deemed variation of permission. Société Générale is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. The nature and extent of consumer protections may differ from those for firms based in the UK. Société Générale London Branch is authorised by the Prudential Regulation Authority with deemed variation of permission and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Notice to US Investors: this publication is written by SG economic analysts outside of the U.S. and is intended to be distributed in the U.S. solely to "Major U.S. institutional investors" pursuant to SEC Rule 15a-6. This publication is not a product of the SG Research Department and should not be regarded as a research report. IT HAS NOT BEEN PREPARED IN ACCORDANCE WITH THE REGULATORY PROVISIONS DESIGNED TO PROMOTE THE INDEPENDENCE OF INVESTMENT RESEARCH. Any Major U.S. Institutional Investor wishing to discuss this report or effect transactions in any security or financial instrument discussed therein should do so with or through their salesperson at SG Americas Securities, LLC. ("SGAS"). SGAS is a regulated broker-dealer, futures commission merchant (FCM) and is a member of SIPC, NYSE, FINRA and NFA. Please visit https://cib.societegenerale.com/en/who-are/compliance-regulatory-information/ for important disclosures regarding SGAS and transactions you may enter into with SGAS. The SGAS registered address is at 245 Park Avenue, New York, NY, 10167. (212)-278-6000.

Notice to Asian investors: this document is prepared for and intended to be distributed in Asia solely to sophisticated and professional clients. You should therefore be appropriately qualified as a professional, accredited, wholesale, expert or institutional investor (however defined in your local jurisdiction).