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SCÉNARIOÉCO

Société Générale Economic & Sector Studies

Uncertainty shifting to fragmentation

- **The US Administration's economic policy is driving inflation higher and weighing on growth**. Uncertainties on tariffs and questions on the value of the dollar are lifting consumers' and firms' inflation expectations. Combined with still tight monetary policy, no major fiscal impulse and gradual weakening of the labour market, this is weighing on domestic demand.
- **End of Europe's peace-dividend:** Europe is set to increase defence spending. Near-term this will add some upside to growth being initially debt financed. Recent announcements by Friedrich Merz, which also include infra-structure spending, will if voted, add further upside.
- **Geo-economic fragmentation becoming visible.** We assume no further geographical expansion of ongoing conflicts. However, the persistence of high geopolitical uncertainty will weigh on both investment and consumption decisions.
- **Global funding costs hindering demand.** Despite gradual monetary easing, long term bond yields remain fairly elevated raising questions on the transmission of the monetary policy. Moreover, real interest rates have increased and turned positive over the last two years in a context of still high levels of global indebtedness and weak growth.
- **Dollar as a safe haven.** The ongoing debate on the place of the dollar in the global financial system could, at some point, feed market volatility. Fears of a weaker dollar in a context of higher risk aversion would raise threats to financial stability.
- **China's growth challenge** remains. Further stimulus will give a temporary lift to 2025, but with growth remains at risk of falling short of the 5% target, not least given external headwinds.

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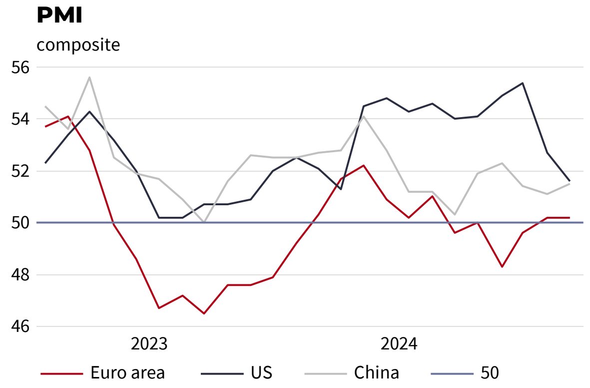
EDITORIAL

UNCERTAINTY AND FRAGMENTATION

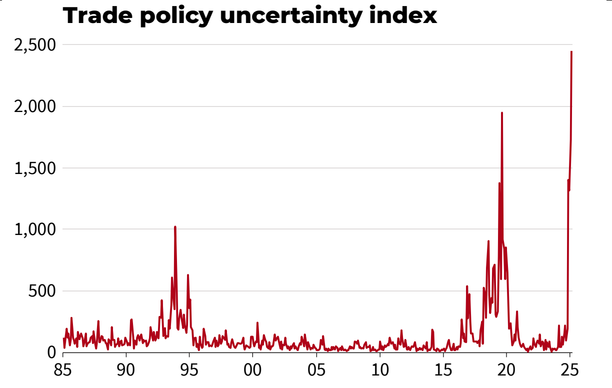
Global economic activity is characterized by persistent weakness. Political and geopolitical uncertainties are high, particularly regarding the policies of the US Administration, while overall financing conditions remain tight. Real interest rates are rising in Europe, in particular, and bank credit surveys are deteriorating. PMI surveys for January and February point to a deterioration in the services sector, particularly in the United States, where retail sales also surprised to the downside in January, reflecting the deterioration in consumer confidence. These recent deteriorations are worth watching because, over the past two years, global activity has been driven by the resilience of services, while manufacturing and global trade have remained in contraction/stagnation territory.

Activity on a soft patch…



Source: SG Economic and Sector Studies, LSEG

…in a context of rising uncertainties



Source: SG Economic and Sector Studies, EPU

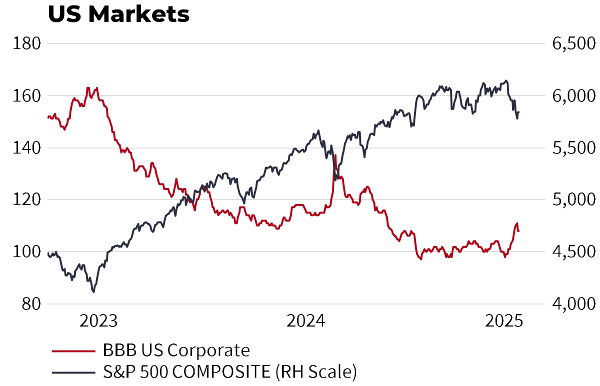
The US administration is blowing hot and cold on tariffs leading to heightened uncertainty for both businesses and financial markets. February trade policy registered levels well above those seen at the height of the pandemic driven disruptions. This marks a significant headwind for the global economy.

The moderate increase in market volatility, which began in early February, does not seem to reflect the high level of US policy and geopolitical uncertainty. The shifting fundamentals of the US and European economies, with the US heading for a substantial slowdown, while Europe is set to see a lift from defence spending, is mirrored in relative performance.

The proposals by the President of the European Commission, Ursula von der Leyen, to ease fiscal rules to boost defence spending and to offer EUR 150bn of loans offer a first positive. In addition, Friedrich Merz, Germany’s expected next Chancellor, announced a massive plan to support infrastructure and defence. This plan has yet to be voted as we head to press, but has already had a very significant market impact, notably lifting German Bund yields and other euro area yields significantly higher.

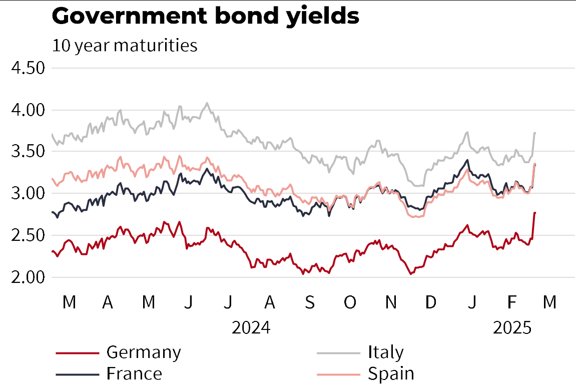
The announcement triggered the most spectacular one day move since the German reunification on German bond yields.

Uncertainty weighing on US market



Source: SG Economic and Sector Studies, LSEG

Defence boost lifts euro area yields



Source: SG Economic and Sector Studies, EPU

ONE MILLION DOLLAR QUESTION

Dollar volatility has substantially increased since the start of the year. First, it strengthened given differing perceptions on the stance of monetary policy and concerns on economic growth outside the US. As relative perceptions on the US economy and monetary policy have shifted, the dollar has weakened. What is more unusual, however, is that as global uncertainty has increased, the dollar has not seen the usual lift from safe haven flows.

This latter observation seems to relate to idea that the US administration wants to achieve a more competitive level of the dollar exchange rate in order to rebuild the domestic manufacturing sector. The topic was brought up by President Trump already during his first term, accusing trade partners, and not least China, of currency manipulation. This idea has returned in full force, now also with market chatter on a new Mar-A-Lago Accord, which in its multilateral co-operative form would seek to replicate a kind of Plaza Accord. The Plaza Accord reached in 1985, between the US, Japan, Germany, the UK, and France sought to adjust exchange rates with the aim of devaluing the dollar. The Plaza Accord is often seen as one of the root causes of the subsequent Japanese debt deflation crisis.

In its unilateral and/or more coercive version, tariff threats could be applied to force policies on dollar deprecation. There are also proposals circulating to “tax” foreign official holding of US Treasuries.

Fears of a weaker dollar in a context of higher risk aversion, thus de facto removing its safe haven status, would raise potential threats to financial stability.

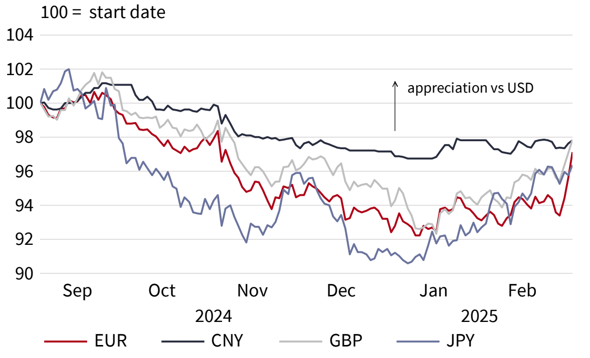
Long term real appreciation…

Dollar real effective exchange rate

Source: SG Economic and Sector Studies

… "short term" doubts?

AE currencies to USD



Source: SG Economic and Sector Studies

ECONOMIC FORECASTS

GDP, % YoY	2024	2025f	2026f	2027f
Developed Markets	**1.6**	**1.6**	**1.2**	**1.2**
United States	2.8	1.9	1.4	1.0
Japan	0.1	1.0	0.7	0.7
United Kingdom	0.9	1.1	1.0	1.0
Euro area	0.8	0.7	0.8	1.0
Germany	-0.2	0.6	1.1	1.3
France	1.1	0.6	0.6	0.9
Italy	0.5	0.4	0.5	0.5
Spain	3.2	1.9	1.6	1.4
Emerging Markets	**4.1**	**3.9**	**3.6**	**3.6**
Asia	5.1	4.7	4.3	4.3
China	5.0	4.5	3.8	3.8
India	6.5	6.2	6.2	6.2
Central and Eastern Europe	3.2	2.0	1.7	1.7
Latin America	2.2	2.2	2.2	2.2
Brazil	3.4	1.9	1.3	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)	**3.2**	**3.0**	**2.7**	**2.7**

CPI, % YoY, avg	2024	2025f	2026f	2027f
Developed Markets	**2.6**	**2.8**	**2.4**	**2.2**
United States	3.0	3.5	2.9	2.6
Japan	2.8	2.3	1.8	1.5
United Kingdom	2.5	2.6	2.3	2.1
Euro area	2.4	2.4	2.0	1.7
Germany	2.5	2.5	2.0	1.9
France	2.3	1.8	1.8	1.7
Italy	1.1	2.0	1.8	1.7
Spain	2.9	2.5	2.2	1.8
Emerging Markets	**7.8**	**6.2**	**4.9**	**4.4**
China	0.2	0.9	1.5	1.8
India	4.7	4.7	4.7	4.7
Brazil	4.4	4.9	3.9	3.3

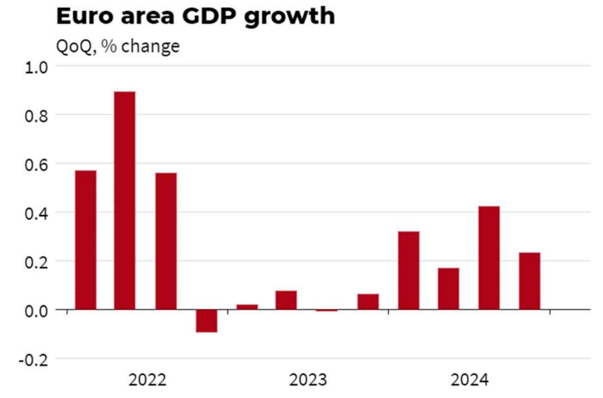
%, EoP (unless otherwise indicated)	Latest 12/03	2025f	2026f	2027f
Fed Funds target (high)	4.50	4.25	3.75	3.75
Gov 10Y, US	4.28	4.00	4.00	4.50
ECB Deposit facility rate	2.50	2.25	2.25	2.25
Gov 10Y, Germany	2.87	2.50	2.50	2.75
Gov 10Y, France	3.59	3.30	3.30	3.45
Gov 10Y, Italy	3.96	3.70	3.70	3.95
Gov 10Y, Spain	3.53	3.25	3.25	3.45
BoE, Bank rate	4.50	4.00	3.75	3.50
Gov 10Y, United Kingdom	4.68	4.25	4.00	4.00
BoJ, Bank rate	0.50	0.75	1.00	1.00
Gov 10Y, Japan	1.50	1.40	1.50	1.50
EUR / USD	1.09	1.08	1.10	1.10
EUR / GBP	0.84	0.85	0.85	0.85
USD / JPY	147	140	130	135
USD / CNY	7.2	7.4	7.4	7.3
Oil Brent (USD/b)	70	70	70	70
European Natural Gas (TTF, EUR/MgW/h)	43	60	50	45
EU ETS carbon (EUR/Metric ton)	67	80	100	110

EURO AREA

- **Growth momentum is weak, and likely to be held back by political and geopolitical uncertainties.**
- **Fiscal policy is set to become more restrictive, but some room for defence spendings is likely to be found.**
- **One more rate cut by the ECB is expected in 2025, but financial conditions will remain restrictive opening for a pause in QT.**

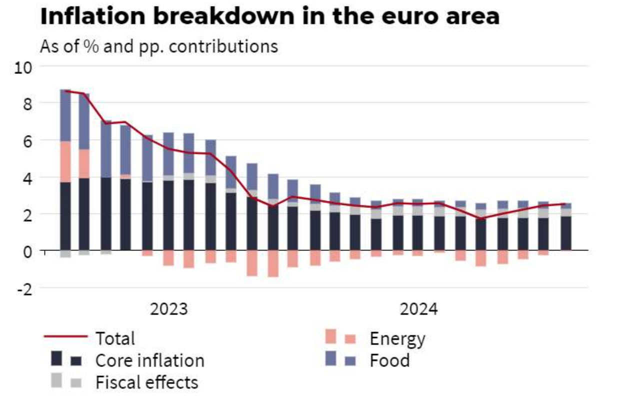
Growth momentum is weak, and likely to be held back by political and geopolitical uncertainties. The eurozone economy stalled in 4Q24, as Germany (-0.2%) and France (-0.1%), the two largest economies, posted worse-than-expected contractions, reinforcing concerns over economic weakness in the region. This is a sharp slowdown from the 0.4% growth in Q3. Meanwhile, Italy's economy remained flat for a second consecutive quarter, while some peripheral economies outperformed: Portugal (+1.5%), followed by Lithuania (+0.9%) and Spain (+0.8%). France and Germany remain a drag, as both face structural headwinds alongside domestic political uncertainty.

Euro area growth stalled in Q4



Source: Eurostat, SG Economic and Sector Studies

Disinflation has momentarily paused



Source: Eurostat, SG Economic and Sector Studies

The disinflationary trend is set to resume. CPI inflation reached 2.5% in January 2025, a high mark since July 2024, driven by a rise in energy costs. Meanwhile, inflation for non-energy industrial goods remained steady, while price increases continued to slow for services and food. Core inflation rate remained unchanged at 2.7% for the fifth consecutive month. In 2025, electricity prices are expected to fall in various countries. With the decline in employee compensation, service price inflation is also expected to ease gradually as well. We expect that these disinflation trends will more than compensate in 2025 the impact of higher gas prices and of potentially additional trade tariffs that could imposed as a retaliation to US tariffs.

ECB rate cuts remain expected. The weak activity momentum strengthens expectations that the ECB will further cut interest rates in 2025. After a 25bp cut in

March, we expect one more cut in 2025 as hawks weigh in on inflation concerns. The ECB's quantitative tightening (QT) weighs on the term premia and implies a tightening of liquidity conditions. We see a strong case for the ECB to end QT in 2025. Overall, we expect the credit impulse to remain modest.

Tarif measures announced by President Trump are an additional headwind. The threatened 25% blanket tariffs on US imports from the EU, would be a significant additional constraint on the euro area, at a time when the productivity of its industrial sector is struggling. The EU may, moreover, respond with it anti-coercion instrument, a legal framework consistent with WTO, that enables it to adopt strong response measures (tariffs, quotas, etc.) in retaliation to coercive actions from a third country. The risk of trade tariffs on European exports is also rising in China, as a response to the increase in custom duties on imports of Chinese electric vehicles. Global export growth will remain modest, due also to sluggish global demand.

Domestic demand is likely to remain weak. Household purchasing power is likely to grow only modestly. In a very uncertain environment companies will seek to preserve profitability by moderating unit labour cost growth, resulting in modest growth in real wages and employment. High household savings could offer room for manoeuvre, but moderate wealth effects and high uncertainties will keep consumers cautious. On the corporate side, sluggish demand, still-tight lending conditions and the high levels of uncertainty will weigh on business momentum.

Fiscal policy is set to become more restrictive, but significant room for defence spendings is likely to be found. Fiscal policy is becoming more restrictive in several countries of the euro area, France, and Italy in particular, where adjustments are needed. However, some factors will remain supportive. The current disbursement of NGEU funds should still be favourable in several member states until 2026.Germany is expected to find a way relax is constitutional the debt brake to support defence spending and the proposal of an infrastructure fund also adds upside. At EU level, on March 4, the Commission announced several measures to increase defence spending. A derogation from the Stability and Growth Pact will allow Member States to spend more on defence without being subject to an excessive deficit procedure. This would provide additional fiscal space up to EUR €650 billion over a four-year period if member states increase defence spending by 1.5% of GDP on average. In addition, a new instrument will allow member states to have access to a loan facility, guaranteed by the European budget of up to €150 billion for military spending. Members will be able to use European cohesion funds for defence-related investments. The mandate of the European Investment Bank will be broadened to allow for public and private financing of defence companies. As a reference, in 2024, according to Stockholm international Peace Research Institute military expenditures amounted 2,1% of GDP in France, 1.5% in Germany and 3.8%in Poland (up from 1.9% in 2022).

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 risk would be a sharper-than-expected adjustment in the labour market, weighing on consumption. A sharp depreciation of the euro against the dollar, that we do not anticipate in our central scenario, could pose an inflationary risk.

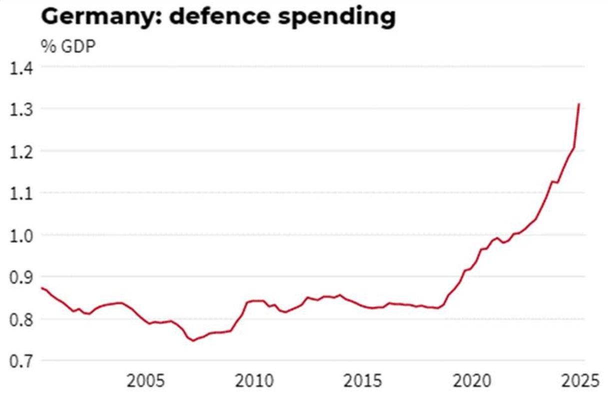
Euro area	**2024**	**2025f**	**2026f**	**2027f**
Real GDP, % YoY	0.8	0.7	0.8	1.0
Household consumption	1.0	0.6	0.6	0.7
Public consumption	2.8	0.6	0.6	0.8
Investment	-2.0	0.6	1.5	1.7
Exports of goods & services	1.0	1.4	2.0	2.2
Imports of goods & services	0.2	1.3	2.3	2.4
Inflation, % annual average	2.4	2.4	2.0	1.7
Core inflation, % annual average	2.8	2.3	1.8	1.7
Real gross disposable income (GDI), % YoY	2.2	0.3	0.6	0.7
Households saving rate, % of GDI	15.3	15.0	15.0	15.0
Unemployment, % of labour force	6.3	6.9	6.9	6.8
Fiscal balance, % of GDP	-3.6	-3.5	-3.3	-3.2
Public debt, % of GDP	89	90	91	92
Current account balance, % of GDP	2.8	2.1	2.0	2.0

GERMANY

- **If successfully adopted by the Bundestag, the announced fiscal package will lift growth by 2pp over the next five years**
- **Ramp-up in infrastructures and defence spending will meet frictions along the supply chains and on the labour market**
- **Headwinds from a hostile international environment will continue to weigh on the outlook**

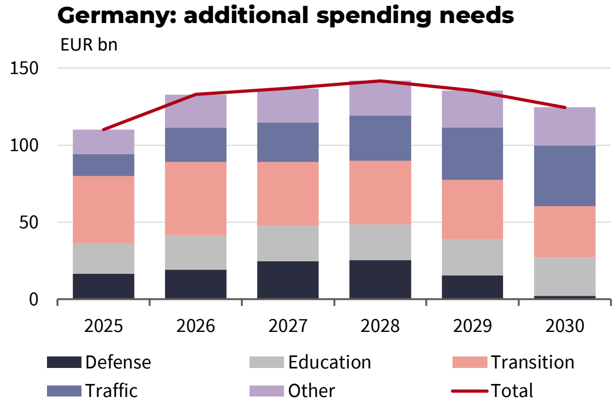
Growth is expected to rebound (0.6% in 2025, 1.1% in 2026), driven by domestic factors and under the working assumption that the bulk of the proposed fiscal package is adopted the Bundestag. The agreement between the CDU/CSU and the SPD -most likely coalition partners in the forthcoming government- includes (i) a EUR 500bn off-budget infrastructure fund to be spent over 10 years and (ii) a reform to the debt brake to exclude all defence spending above 1% of GDP (freeing about 0.3% of GDP in fiscal space) and to allow *Länder* to run deficits up to 0.35% of GDP. The package still needs to be adopted by parliament and we here make the working assumption that the bulk of the measures will be adopted. This would then lead to a robust acceleration of both public and private investment averaging 3% YoY on average until the end of the decade. Private consumption is also set to bounce back (0.7% in 2025) as households leverage their gains real disposable income following the energy shock driven by dynamic-albeit slowing- wages.

Defence spending will accelerate supported by a partial waiver on debt brake rules



Source: Destatis, SG Economic and Sector Studies

Infrastructure fund is a first step in tackling the massive spending needs of the country

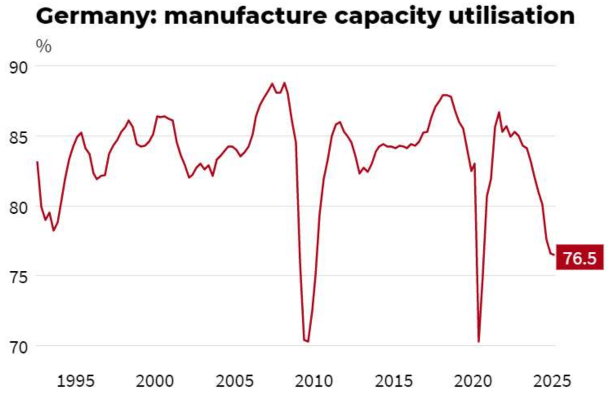


Source: Dezernat Zukunft, SG Economic and Sector Studies

The assumed military and infrastructure spending is expected to yield positive spillovers and boost potential growth, albeit gradually and with some frictions. The defence sector is poised to gain from increased spending in Germany, unbounded by the debt brake, and regionally through the proposed mobilisation of EUR 800bn for the *ReArm Europe* program. This offers an opportunity to reallocate some resources from challenged industries like automotive manufacturing toward defence equipment production, partially correcting manufacturing capacity utilization which has fallen to 76.5%, its lowest level outside a crisis since 1992. Defence spending has a relatively low import content (less than 20%) and is prone to R&D activities that could lead to innovations trickling down to the civil economy, lifting productivity and growth in the medium-term.

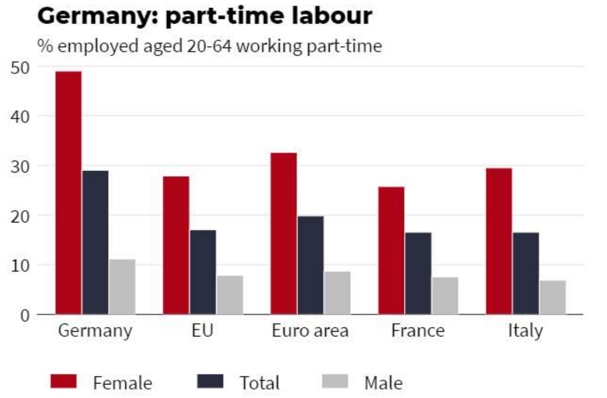
The infrastructure fund is expected to tackle the massive spending needs of the country in terms of transportation, and education (incl. childcare facilities), estimated by Dezernat Zukunft at about EUR 300bn over the next five years. The fund's use will therefore be aimed mainly to avoid further deterioration of existing infrastructure, where multiplier effects may be limited. A gradual ramp-up of spending in these areas is anticipated as projects need to be identified and approved, with slowing risks coming from bureaucratic hurdles and red tape. In both cases, frictions in increased spending are expected, including challenges in material sourcing amid increasingly fragmented global value chains, and the inherent challenges of sectoral reallocation (e.g. reskilling, delays in factory repurposing, low productivity as new activities and products are launched).

The economy is prone to a sectoral reallocation of resources



Source: Ifo, SG Economic and Sector Studies

Tensions in the labour market could be addressed on the extensive margin



Source: Eurostat, SG Economic and Sector Studies

The recent uptick in unemployment will continue this year (6.4%), but shortages of labour persist, further limiting multiplier effects. The participation rate reached historical high levels, exceeding the 80% mark, and over 16% of industrial firms cited labour shortages as a factor limiting production in 1Q25. The country's workforce will continue to face the shrinking pressures as population ages. Labor force robustness depends on migration flows—which most of the political spectrum seeks to limit—and potentially on the extensive margin, i.e. by increasing the working hours of employed individuals. This would be primary involve seniors (even though 74% of adults aged 55-64 currently work in Germany, about 10pp more than the EU average), and women, who have a high propensity to work part-time. Increasing the labour supply of women will be supported by the investment in childcare infrastructure.

The proposed stimulus package is projected to increase Germany's debt to 70% of GDP by 2029, but concerns about debt sustainability remain at bay. Fiscal deficits are expected to rise to 3% of GDP by 2027. The announcement led to a 30bp increase in long-term rates. The 10Y Bund is anticipated to remain about 25bp higher than previously expected, reaching 2.75% by the end of 2027. Although higher rates will increase interest charges and primary deficits are higher, Germany's debt sustainability is not expected to be questioned in the medium term, as increased public spending will enhance nominal growth. Furthermore, the country is likely to maintain its benchmark issuer status and its commitment to fiscal conservatism.

Higher domestic demand will rebalance Germany's economic model, prone to current account surpluses, in a global environment less inclined to absorb them. Diminished competitiveness on the world stage affected export volumes, including in capital goods and in luxury segments (e.g. for cars). Further escalation of trade tensions is set to weigh on the outlook, as foreign demand contracts due to higher prices for international customers and lacklustre growth in key trading partners (US, China). Higher domestic demand, higher fiscal deficits, the use of domestic savings to fund investment and the reconfiguration of trade flows will contribute to the decline of the current account balance below 5% by 2027.

Risks are balanced. Positively, efficient implementation of the proposed fiscal package, particularly by reducing bureaucratic hurdles, could boost growth. A bipartisan government may also reduce economic uncertainty, boost sentiment and encourage private spending. Conversely, failure to adopt the proposed package, supply tensions, volatile gas prices, and implementation of US threatened tariffs with EU retaliation could drive inflation higher, prompting a hawkish ECB response and delaying private spending. Additionally, higher than expected import content in infrastructure and defence spending or slow fund deployment could negate growth effects.

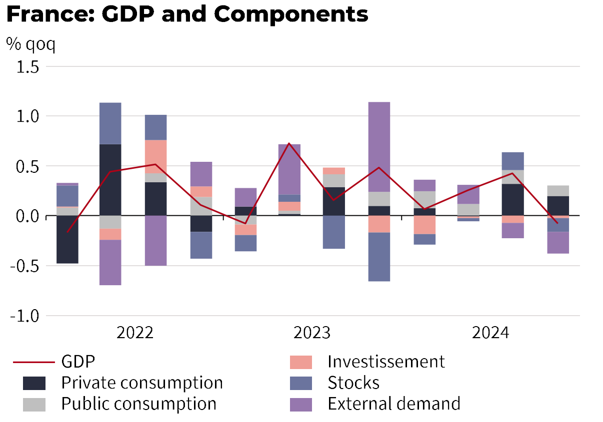
Germany	**2024**	**2025f**	**2026f**	**2027f**
Real GDP, % YoY	-0.2	0.6	1.1	1.3
Household consumption	0.3	0.7	0.9	1.0
Public consumption	3.5	1.5	1.4	1.2
Investment	-2.6	0.5	3.4	3.4
Exports of goods & services	-1.0	0.0	1.6	1.9
Imports of goods & services	0.3	1.5	2.7	2.5
Inflation, % annual average	2.5	2.5	2.0	1.9
Core inflation, % annual average	3.2	2.2	2.0	1.9
Real gross disposable income (GDI), % YoY	1.3	0.6	0.8	1.1
Households saving rate, % of GDI	20.2	20.0	19.9	19.9
Unemployment, % of labour force	6.0	6.4	6.4	6.3
Fiscal balance, % of GDP	-2.8	-2.7	-2.8	-3.0
Public debt, % of GDP	63	65	66	67
Current account balance, % of GDP	5.8	5.4	5.0	4.8

FRANCE

- **After a resilient 2024, aided by the Olympics, economic activity is expected to be sluggish in 2025 and 2026, owing to uncertainties at both the domestic and international levels**
- **Sluggish activity will be accompanied by upward pressure on unemployment**
- **The fiscal deficit is expected to decline in 2025 but the overall fiscal path remains uncertain**

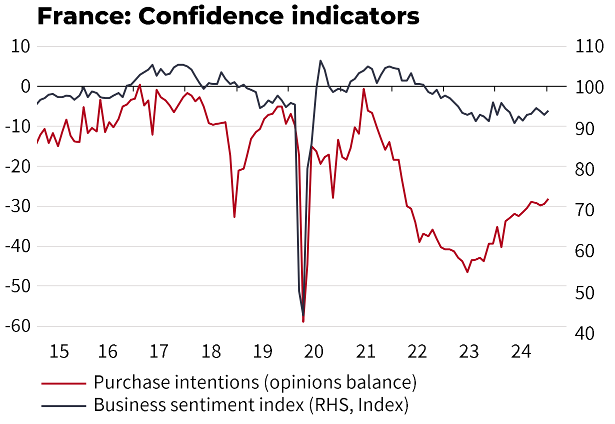
Growth prospects for 2025 appear weak. Political uncertainty, which already penalized activity in the second half of 2024, persists and is expected to continue to weigh on economic activity. The adoption of the 2025 budget has reduced the risks of impending instability, but confidence remains fragile. Adding to the domestic uncertainty is international uncertainty, linked to the US Administration protectionist agenda. We anticipate that the positive contribution of international trade, which was very beneficial for France in 2024, will mark the pause in 2025 and 2026.

Activity is penalized by uncertainty



Source: INSEE, SG Economic and Sector studies

Confidence remains weak



Source: INSEE, Banque de France, SG Economic and Sector studies

Political instability continues to weigh on the French economy. The renewal of the 2025 budget affected activity in the first quarter, due to contained public spending and the wait-and-see attitude of economic agents. Although France now has a budget for 2025, uncertainty about the political situation remains. The budget was adopted through decree (Article 49.3), as the government failed to find a supporting majority in parliament. Risks of renewed political tensions remain high. The degree of uncertainty measured in the Banque de France's monthly business survey rose sharply in February, reaching its June 2024 level. In this context, we do not expect a significant improvement in activity for the rest of the year. Growth is thus expected to lag behind 2023 and 2024, when it stood at 1.1%.

Business investment will remain weak in 2025 due to sluggish demand, in a context of overall weak activity, rising taxes and reduced business support. Lending conditions that remain tight still penalize investment. It should pick up moderately from 2026, driven by the need to invest in the green transition (the expected introduction of "gigafactories" of electric batteries, among others) and military spending, as governments respond to geopolitical tensions by boosting their defence budgets.

The labour market is expected to slow somewhat. The effect of apprenticeship contracts on employment growth is expected to diminish as government support is reduced. The slowdown in activity and efforts to restore productivity are expected to weigh on employment growth.

Household demand will remain weak. Despite the decline in inflation, which is expected to continue in 2025, household purchasing power is projected to increase only modestly. The contraction in employment, the slowdown in wages and the slower growth in wealth and capital income, will have a negative impact on purchasing power. In addition, ongoing fiscal and broader (geo)political uncertainties are expected to continue to weigh on household confidence, which remains low according to INSEE surveys. Purchasing intentions remain contained, 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 envisaged by President Trump. French export growth is expected to be modest over the forecast horizon.

Debt is expected to remain at high levels due to persistently high deficits. The budget adopted for 2025 closely aligns with the measures proposed by the Barnier government, but it features more realistic growth and inflation assumptions, along with a lower deficit target. Based on these adjustments, we anticipate that the budget balance will be in line with the authorities' expectations. Beyond 2025, the fiscal trajectory remains fraught with challenges. It will depend critically on the effective 2025 budget execution and the government's capacity to implement reforms. The current composition of parliament leaves little room for manoeuvre. The next hurdle is pension reform. Discussions with the social partners have been re-launched by the government, on condition that financial balance is achieved in 2030. This could fuel political tensions. Additionally, the government's pledge to increase military spending (to 3.5% of GDP by 2030 excluding pensions, corresponding to about EUR 20bn increase per year) in response to rising geopolitical tensions in Europe will further strain public finances. This commitment to bolster defence capabilities may necessitate reallocating resources, potentially impacting other budgetary priorities, and exacerbating the challenges in achieving fiscal targets. In this context, we expect a lower structural adjustment than envisaged in the medium-term program approved by the European Commission in October 2024. The 3%

target for 2029 appears difficult to achieve. Against this background, the public debt ratio will continue to increase.

Risks to this scenario are tiled to the downside. They include a deterioration of the national socio-political environment, particularly during the 2026 budget process, which could increase uncertainty and prolong staff wait-and-see behaviour. A sharper-than-expected deterioration in trade tensions, owing to President Trump's plans for protectionist measures, would also be unfavourable, owing to the drop in foreign demand.

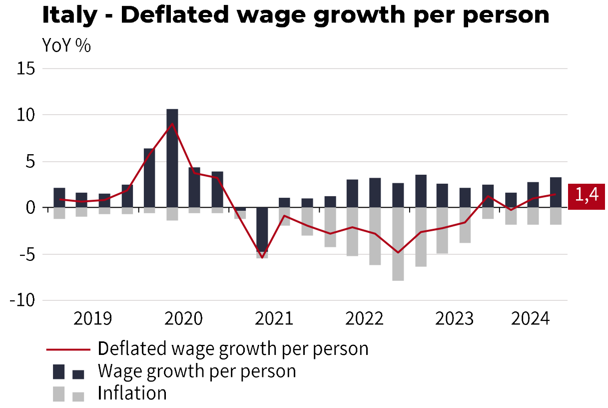
France	**2024**	**2025f**	**2026f**	**2027f**
Real GDP, % YoY	1.1	0.6	0.6	0.9
Household consumption	1.0	0.7	0.7	0.9
Public consumption	2.1	0.3	0.1	0.6
Investment	-1.5	0.4	1.0	1.4
Exports of goods & services	1.6	1.6	2.3	2.6
Imports of goods & services	-1.1	1.7	2.5	2.7
Inflation, % annual average	2.3	1.8	1.8	1.7
Core inflation, % annual average	2.3	2.0	1.8	1.8
Real gross disposable income (GDI), % YoY	2.3	0.2	0.2	0.4
Households saving rate, % of GDI	18.0	17.5	17.0	16.6
Unemployment, % of labour force	7.2	7.8	8.1	8.0
Fiscal balance, % of GDP	-6.1	-5.5	-5.0	-4.6
Public debt, % of GDP	113	116	118	120
Current account balance, % of GDP	-0.3	-0.1	-0.2	-0.2

ITALY

- **GDP growth slowed significantly in 2024 and will remain below potential in 2025 and 2026 as household investment normalises**
- **Households are set to reap small gains in purchasing power and stabilize their saving rate**
- **Despite the return to a low primary surplus in 2025, public debt is expected to remain on an upward trajectory**

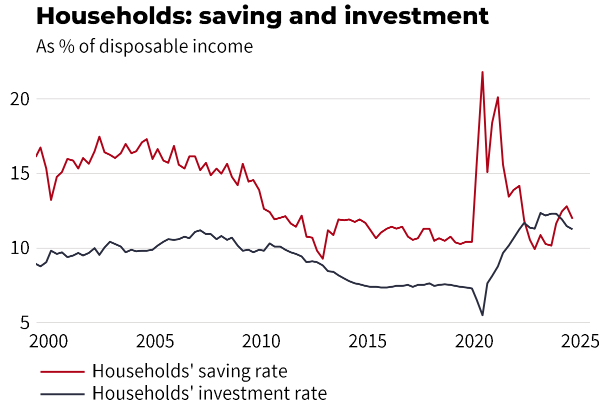
After clocking in weaker-than-expected in 2024, growth is set to remain sluggish in 2025 and 2026. The withdrawal of housing renovation support programmes (*superbonus*) will generate a prolonged contraction in household investment, while global demand will be weakened by the trade tensions induced by the protectionist measures envisaged by the US Administration. However, household consumption, lower 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



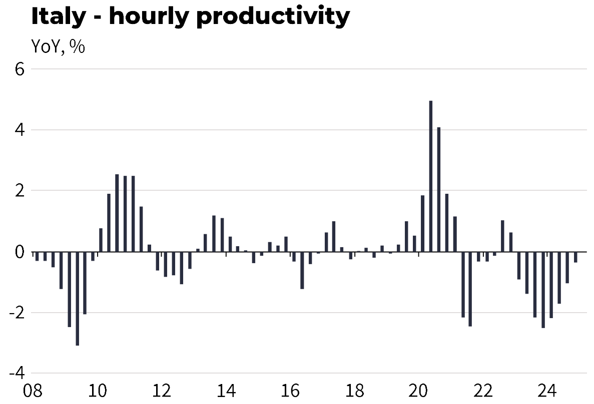
Source: Istat, SG Economic and Sector Studies

Inflation slowed sharply in 2024 with the decline in energy prices. It is expected to return to the ECB's target in 2025, stabilising at around 2%. Core inflation, which has fallen below 2%, could accelerate again in 2025 in the wake of imported product prices, especially on gas.

Employment is expected to slow significantly as of 2026 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 . Main explaining factors are limited migration and poor demographic dynamics.

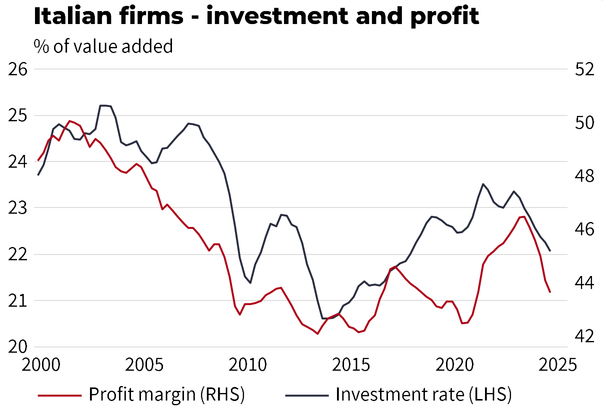
Household purchasing power is expected to increase slightly over the 2025-27 period after a dynamic growth in 2024. Nominal wages, which in 2024 benefited from contract renewals reflecting past price increases, are expected to slow gradually. From 2026 onwards, household consumption is expected to be 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. The credit dynamic is negative: outstanding loans to companies contracted by 2.4% over one year and credit to households stagnated.

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 (-0.1%) and is expected to turn into a surplus in 2025. However, it is far from returning to the 2% surplus, a necessary condition for the downward trend in public debt. The budget deficit is expected to decrease very gradually from 4% in 2024 to 3.5% 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 addition, the public debt ratio is impacted in 2025 and 2026 by exceptional items related to the spread over time of the use of tax credits for housing renovation. Public debt is already three points above its pre-Covid level and is expected to resume an upward trajectory to reach close to 142% of GDP in 2027.

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. 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.

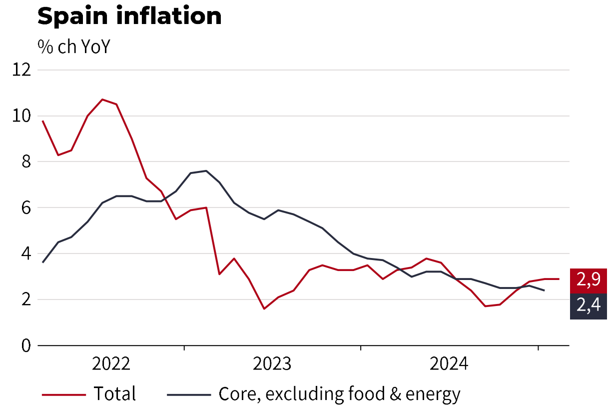
Italy	**2024**	**2025f**	**2026f**	**2027f**
Real GDP, % YoY	0.5	0.4	0.5	0.5
Household consumption	0.5	1.1	0.5	0.5
Public consumption	0.5	0.5	0.4	0.4
Investment	0.2	-0.8	0.9	0.7
Exports of goods & services	-0.1	0.6	1.8	2.3
Imports of goods & services	-2.1	1.1	2.1	2.5
Inflation, % annual average	1.1	2.0	1.8	1.7
Core inflation, % annual average	2.2	2.0	1.8	1.7
Real gross disposable income (GDI), % YoY	2.8	1.0	0.6	0.4
Households saving rate, % of GDI	12.7	12.6	12.7	12.6
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	1.2	0.8	0.7	0.5

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 in 2024, is expected to fall below 3%**

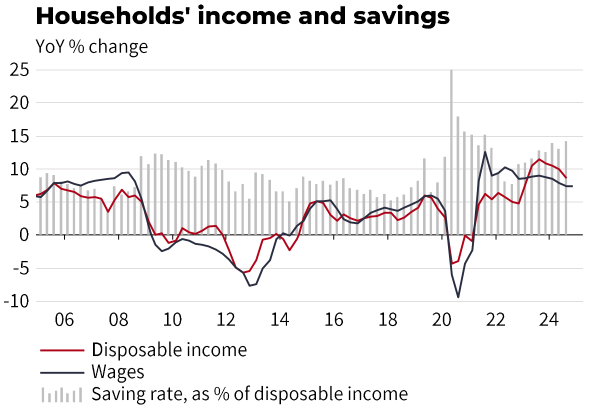
Growth is still very dynamic in 2024 but will slow down in 2025 and return to its potential in 2027. It will remain higher than that of its European partners, still supported by the European recovery plan, a very dynamic tourism sector and a job market benefiting from an influx of foreign labour. However, the unprecedented floods are set to reduce growth by around 0.2pp of GDP in 4Q24. In 2025-26, global demand would be weakened by trade tensions induced by the US Administration'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

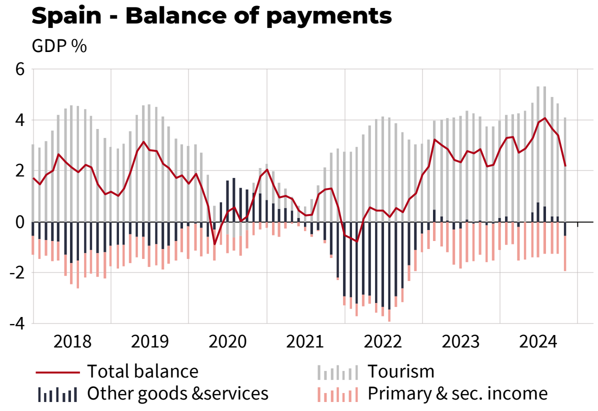
Inflation, still close to 3% in 2024, is expected to slow to around 2.4% in 2025 and return to the 2% ECB's target in 2027. Lower fuel and food prices are the main drivers of disinflation, while service prices remain buoyant, supported by wage increases. Core inflation is expected to remain above 2% 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.

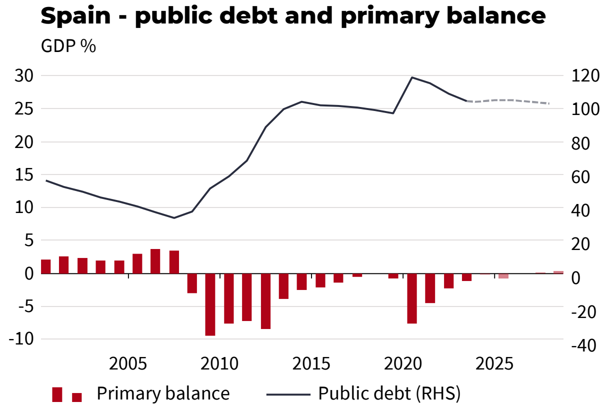
Business investment is expected to remain buoyant until 2026, despite weak credit. It is still supported by loans and grants from the European recovery plan, of which there are still EUR 32 bn in grants available (2% of GDP) out of a total of EUR 80 bn (5.5% of GDP). 40% of the plan will support the 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



Source: INE, SG Economic and Sector Studies

Public debt will stabilize at a high level



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 0.5pp of GDP in 2025, due to the cost to public finances 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 is set to return to accommodative
Sánchez's minority government, elected in November 2023, failed to pass the 2025 budget. 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 7.2bn 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 750mn 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	3.2	1.9	1.6	1.4
Household consumption	2.9	2.0	1.9	1.6
Public consumption	4.9	1.9	1.3	0.8
Investment	2.3	1.8	1.7	1.2
Exports of goods & services	2.9	1.8	1.9	2.5
Imports of goods & services	2.0	2.5	2.3	2.5
Inflation, % annual average	2.9	2.5	2.2	1.8
Core inflation, % annual average	2.8	2.6	2.3	1.8
Real gross disposable income (GDI), % ch YoY	4.3	1.6	1.4	1.3
Households saving rate, % of GDI	13.5	13.2	12.8	12.5
Unemployment, % of labour force	11.3	10.9	10.9	11.1
Fiscal balance, % of GDP	-3.0	-3.4	-2.8	-2.7
Public debt, % of GDP	102	102	103	103
Current account balance, % of GDP	3.0	2.2	2.1	2.1

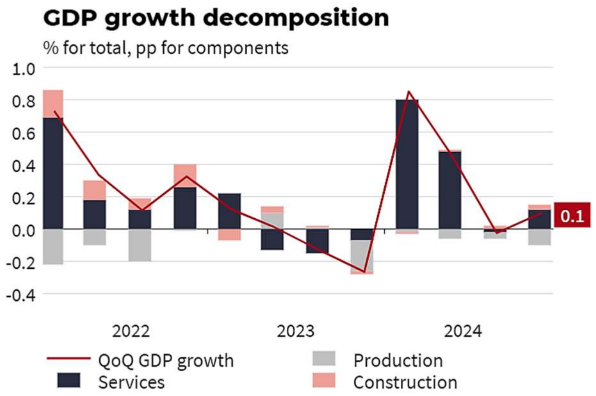
UNITED KINGDOM

- **Public consumption and public investment are set to drive growth in 2025, but they risk crowding out some business activity**
- **Headline inflation is set to remain sticky in 2025-26, but domestic pressures will subside as the labour market eases**
- **Risks are tilted to the downside due to high financing costs and geopolitical tensions**

Growth is slowly regaining momentum. In 4Q24, GDP expanded by 0.1% QoQ and by 1.3% YoY, marking a modest acceleration compared to the flat growth in 3Q24. The annual growth for 2024 was 0.9% YoY, up from 0.4% in the previous year. On the supply side, the quarterly growth was mainly supported by the service sector, which was the main driver of output growth in 2024. On the demand side, the expansion in inventories and public consumption was partially offset by the negative contributions from net exports and gross investment.

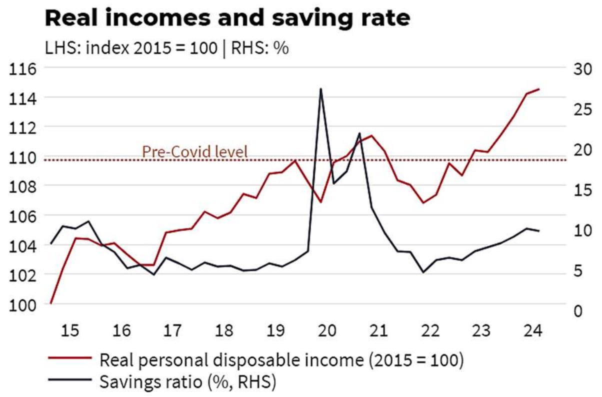
Looking ahead, growth is expected to continue picking up, especially in the second half of the year, with a 1.1% YoY increase forecasted for 2025. Public consumption and public investment are set to drive growth in the coming quarters, in line with the public spending increase planned in the Autumn Budget. Forward-looking leading indicators, such as the PMI composite and the OECD Composite Leading Indicator, still present a more positive outlook for the UK compared to its European peers. However, the policies announced in the Budget are weighing on business and consumer confidence. Risks are tilted to the downside due to high the financing costs and the possibility of US tariffs.

Growth slowly returns to momentum



Source: ONS, Refinitiv, SG Economic and Sector Studies

High real incomes and savings rate



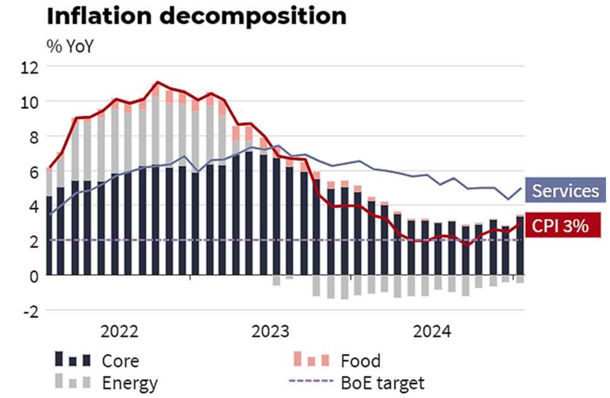
Source: ONS, Refinitiv, SG Economic and Sector Studies

Public consumption and public investment are set to drive growth throughout 2025, but they risk crowding out some business activity. Public spending is projected to increase by GBP 72bn (2.5% of 2024 GDP) per annum over the next five years, with one-third allocated to public investment and two-thirds to public consumption. However, as we forecasted, there are already signs that increased public spending is already being partially offset by some crowding out of private consumption and investment, as the economy is running close to full capacity. The cost of employment has risen after the Autumn Budget, and indicators of business activity have deteriorated. Business confidence has plummeted, business investment ticked down in 4Q24, and PMIs show signs of weakness, especially in the manufacturing sector.

In response, **the government now focuses on fostering business investment and attracting FDIs**. To achieve this, it aims at relaxing regulations, announcing infrastructure projects, and offering businesses a stable political and regulatory environment. For instance, the government has authorized the Oxford-Cambridge Growth Corridor to support the establishment of a joint R&D centre and has greenlit plans to build a third runway at Heathrow Airport, despite environmental concerns. It is also reforming the existing planning rules to make building easier. We expect this approach to support private investment and housing activity in the medium term. In the long term, the increased public capital spending should crowd in private investment, boosting aggregate supply.

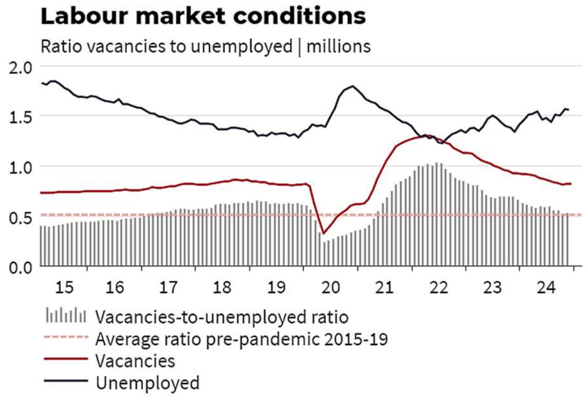
Household consumption is expected to gradually expand in the coming quarters. Robust government support and strong nominal wage growth led to an increase in real personal disposable income during 2024 amid decelerating inflation. Nominal wages are set to continue growing faster than inflation this year, helping to rebuild households' purchasing power. This will be only partly offset by lower employment levels, as businesses reduce hiring to maintain profit margins, in the context of higher employment costs following the Autumn Budget. Private demand is thus expected to pick up and contribute to growth in 2025, as monetary policy continues its prudent easing cycle and real disposable income continues to rise. However, consumers will remain cautious, with the saving rate remaining above its historical levels.

Inflationary pressures remain persistent



Sources: ONS, Refinitiv, SG Economic and Sector Studies

The labour market is easing



Sources: ONS, Refinitiv, SG Economic and Sector Studies

Headline inflation is set to remain sticky in 2025-26, but domestic pressures will subside as the labour market eases. CPI inflation rose to 3% YoY in January from 2.5% in December, its highest level in 10 months. However, this surge will be transitory, as it is mostly the result of base effects. The downward trend in services inflation momentarily halted in January due to one-off increases in bus fares and VAT on private schools. This kept core inflation elevated at 3.7%. The labour market is still tight, albeit with signs of easing. The share of firms reporting labour shortages remains high, but the vacancies-to-unemployed ratio has converged to its pre-pandemic level. We expect headline inflation to remain sticky in 2025-26 due to base effects, firms passing on the rise in employment costs to consumers, and the increase in the price of gas, the main energy source in the UK energy mix. We expect CPI inflation to average 2.6% YoY this year, higher than previously forecasted, and to return to the BoE’s 2% target only in 2027. Core inflation will follow a disinflationary trend in a context of easing labour market pressures and the fading out of fiscal expansion in 2026.

The BoE should follow a prudent pace of rate cuts, reaching a rate of 4% this year. At its February 5th meeting, the BoE opted for a 25bp cut to 4.5%, in line with our forecasts. We expect two additional 25bp cuts in 2025, one per quarter until 3Q25, in line with a prudent pace of rate cuts in a context of sticky headline inflation but declining core inflation.

Risks to the outlook are tilted to the downside. The main source of risk is linked to the gilt market. The rise in 2- and 10-year gilt yields in January showed that the country is vulnerable, as unanticipated gilt yield growth can force spending cuts if the government intends to respect the fiscal rules. Additional risks are linked to international geopolitical tensions. A rise in US tariffs could weigh on the country’s inflation and growth prospects. However, the probability of higher tariffs is moderated by the fact that the UK runs a goods trade deficit vis-à-vis the US.

UK	2024	2025f	2026f	2027f
Real GDP, % YoY	0.9	1.1	1.0	1.0
Household consumption	0.7	1.1	0.8	0.8
Public consumption	2.0	4.3	2.1	1.7
Investment	1.3	1.4	1.5	2.1
Exports of goods & services	-2.2	1.1	1.2	1.4
Imports of goods & services	1.6	2.5	2.5	2.5
Inflation, % annual average	2.5	2.6	2.3	2.1
Core inflation, % annual average	3.7	2.3	2.1	2.0
Real gross disposable income (GDI), % YoY	3.3	0.9	1.1	0.9
Households saving rate, % of GDI	9.4	9.2	9.3	9.4
Unemployment, % of labour force	4.3	4.5	4.6	4.6
Fiscal balance, % of GDP	-5.8	-5.7	-5.5	-5.3
Public debt, % of GDP	97	99	101	102
Current account balance, % of GDP	-2.9	-3.6	-3.4	-3.5

UNITED STATES

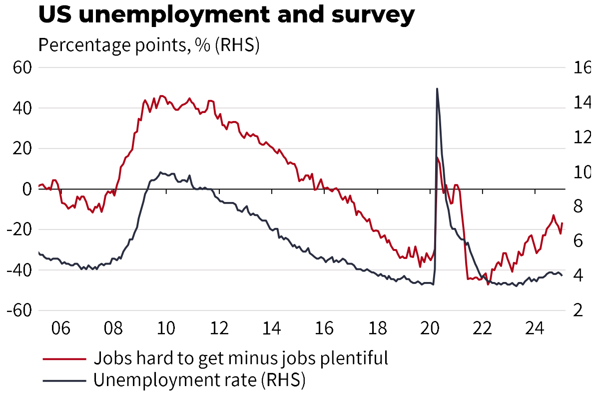
- **President Trump has rapidly set about implementing his vision for trade, immigration, and fiscal policy**
- **The announcement of tariffs has increased uncertainty, which will weigh on investment and increase costs for American consumers**
- **The effects of lower net migration and higher tariffs will weigh on growth leading to higher unemployment**
- **The budget deficit is set to remain above 6%, as cuts to federal spending and anticipated tariff revenues will be more than offset by the cost of extending key provisions of the Tax Cuts and Jobs Act**
- **The Fed will to operate a cautious approach to monetary policy due to the heightened inflation risks**

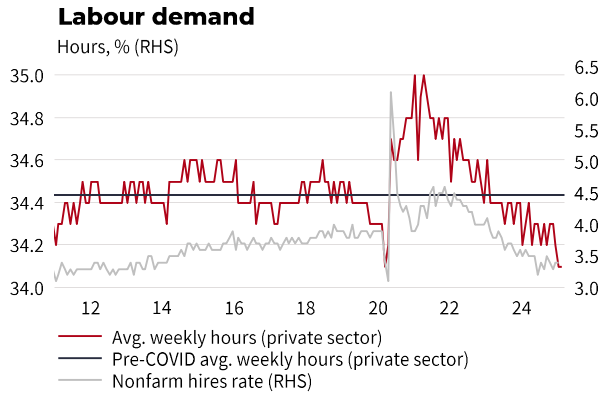
The economy shows signs of slowing and will not be helped by piling on policy uncertainty. In 4Q24, GDP expanded by 2.3% YoY, decelerating after strong growth of 3.1% YoY in 3Q24. During his first term, Trump sought to stimulate markets with tax cuts before launching his pugnacious trade policy. This time around however, the extension of his 2017 tax cuts requires groundwork from Congress, meanwhile Trump wasted little time before pointing his favourite weapon squarely at America's main trading partners under the International Emergency Economic Powers Act (IEEPA). Incremental 10% tariffs have already been placed on China, which made up USD 439bn of US imports last year, while 25% tariffs on Mexico, Canada, and the EU have been announced, making up USD 506bn, USD 413bn, and USD 607bn of imports respectively.

A suite of Sector tariffs on steel, aluminium, automobiles, semiconductors, and medications seem set to follow, along with the delivery of a "Fair and Reciprocal Plan" in April. How many of these measures will eventually be implemented is unsure, however their breadth raises uncertainty. This is especially damaging to the highly integrated supply chains between the USMCA signatories, where unfinished goods cross borders multiple times during manufacture. We revise downwards our forecast for import growth for 2025. Tariffs will feed through to prices, acting as a tax hike on domestic consumers, whose confidence has fallen in surveys since December. We also revise downwards our forecast for household consumption growth for 2025.

The labour market could deteriorate from 2026. The unemployment rate stood at 4.0% in January, cooling slightly versus 3.7% at the same point last year. Hiring has slowed, survey respondents are reporting that it is harder to find a job, and private sector workers' average weekly hours continued fall, reaching their lowest level since March 2020. Labour demand is forecast to soften as the economy cools. Lower net migration will be a headwind for output growth by reducing labour supply, which will affect sectors with higher concentrations of regular and irregular migrant labour such as construction and agriculture, according to the Census Bureau and the Pew Research Centre. Moreover, evidence from Clemens and Lewis (2022) suggests that migrant workers have a positive or neutral effect on the employment of U.S. workers due to poor substitutability, therefore tighter controls on the issuance of work visas are unlikely to boost domestic employment. Furthermore, it is highly unlikely that the 300,000 federal employees (13% of the executive-branch workforce) at risk of job cuts are unlikely to fill vacancies created by immigration tightening measures, due to obvious skills mismatches. We revise upwards our expectation for unemployment over the entire forecast period.

The labour market remains relatively tight demand shows signs of weakening

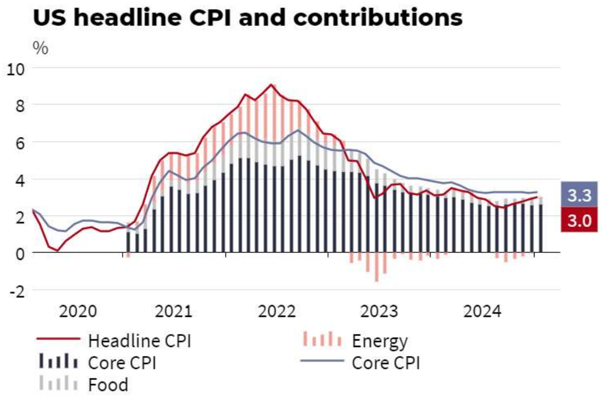


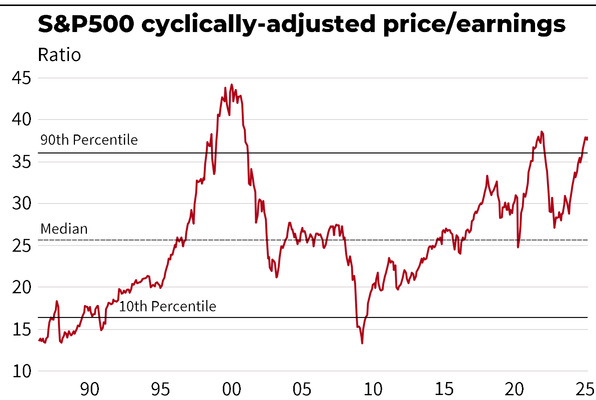


Sources: BLS, The Conference Board, Refinitiv, SG Economic and Sector Studies

The budget deficit will remain above 6% over 2025-2027. The administration will raise revenues through tariffs and will seek cuts the Inflation Reduction Act's green energy tax credits. House Republicans are targeting a reduction of USD 2tn in mandatory spending over the next decade. A major legacy of Trump's first term, the Tax Cuts and Jobs Act is set to expire at the end of this year. Its extension would be equivalent to around USD 4.2tn in tax cuts over the next decade.

Inflationary pressures remain persistent, but equity markets keep the blues at bay for the moment





Sources: BLS, Refinitiv, SG Economic and Sector Studies

Sources: Robert J. Shiller, Refinitiv, SG Economic and Sector Studies

Inflation should rise over 2025-26 due to higher tariffs. CPI inflation rose to 3% YoY in January up from 2.9% YoY in December. We maintain our forecast for CPI inflation to average 3.5% YoY this year and to remain above the Fed's 2% target through 2027.

After rising from 3.2% YoY in December to 3.3% in January, core CPI should reach 3.6% on average in 2025. At their 28-29 January meeting, the Fed kept the fed funds target range at 4.25%-4.5%, advocating a wait-and-see approach concerning the effects of policy on inflation. We expect one 25bp cut to come in the final quarter of 2025, and a further 50bps in cuts over the first half of 2026, as the Fed will shift to a more accommodative stance to respond to rising unemployment.

Risks to the outlook are tilted to the downside. The US Administration's stagflationary policy cocktail could quickly leave the American consumer with a headache. The personal savings rate fell to 3.8% in December, leaving little extra room to support consumption. Consumer sentiment has already weakened since December. It could fall in earnest should equity markets fall from their current lofty valuations which are at close to all-time-high price-to-earnings ratios. Markets have largely priced in tax cuts and deregulation expectations since the election, creating downside risk if tariffs drive up inflation and the Fed keeps rates higher for longer.

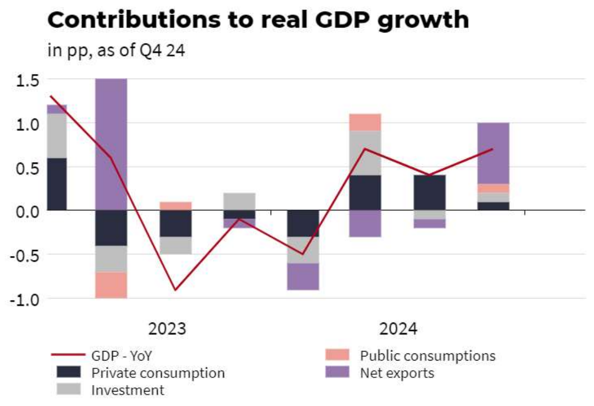
United States	2024	2025f	2026f	2027f
Real GDP, % YoY	2.8	1.9	1.4	1.0
Household consumption	2.8	1.9	1.5	1.2
Public consumption	2.4	1.9	1.4	1.1
Investment	4.3	1.9	2.2	2.1
Exports of goods & services	3.2	2.6	1.4	1.0
Imports of goods & services	5.4	3.4	2.7	2.5
Inflation, % annual average	3.0	3.5	2.9	2.6
Core inflation, % annual average	3.4	3.6	2.8	2.6
Real gross disposable income (GDI), % YoY	2.9	1.5	1.7	1.6
Households saving rate, % of GDI	4.7	4.3	4.5	4.9
Unemployment, % of labour force	4.0	4.4	4.9	5.2
Fiscal balance, % of GDP	-6.4	-6.3	-6.3	-6.4
Public debt, % of GDP	99	100	101	104
Current account balance, % of GDP	-3.6	-3.6	-3.6	-3.6

JAPAN

- **With the first signs of improvement in real wages, the obstacles to the recovery of 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 tilted to the downside, with the possibility of external trade tensions.**

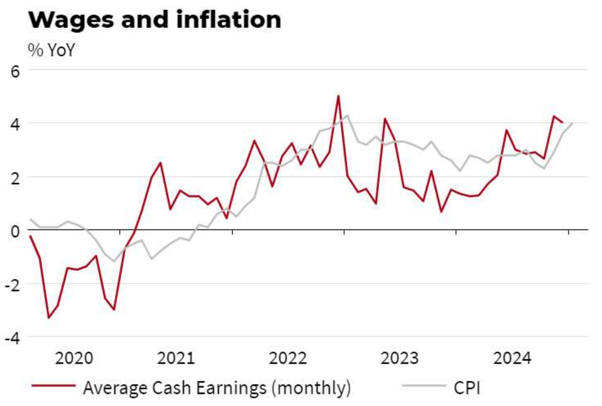
With the first signs of real wage growth, the obstacles to a recovery in consumption should ease. Consumer confidence remains fragile but is expected to recover gradually. Wage negotiations in the spring seem to be on a good track, on par with last year, and the pace of inflation is expected to slow. Large companies have expressed an increase of 4.74% (5% on average in previous years) in the latest survey by the Japan Centre for Economic Research, which should support real income growth. Structurally, labour shortages are expected to encourage higher wages and household disposable income. Government policy should also support wage increases.

Growth has not secured a strong footing yet



Source: Refinitiv, SG Economic and Sector Studies

… But real wages are rising



Source: Refinitiv, SG Economic and Sector Studies

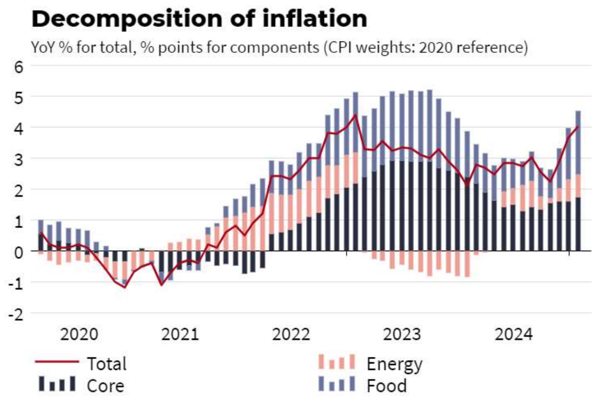
Business investment is expected to continue to rise. Corporate earnings have been above pre-pandemic levels and are being boosted by the depreciation of the yen, which is supporting investment. They are expected to continue to rise, albeit at a slower pace, supported by government subsidies, especially for green and digital investments. The structural need to increase productivity in the face of labour constraints should also boost business investment in the medium term.

Inflation is set to move closer to the BoJ's target over the forecast horizon. Intensifying geopolitical tensions, a weak yen and unfavourable weather conditions have kept energy and food prices high. 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 expectations seem more anchored.

Price expectations stabilize around BoJ target

Source: Refinitiv, SG Economic and Sector Studies

Inflation is accelerating with the rise in food prices.



Source: Refinitiv, SG Economic and Sector Studies

Monetary policy is expected to continue to normalise. The Bank of Japan is expected to gradually normalize monetary policy over the next two years and raise its policy rate to around 1% 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 slowdown 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 remain caution. An increase in trade tensions could complicate its task. Normalization should be very gradual. It is expected to be supportive of the yen and should also raise the floor on borrowing costs in international markets.

The fiscal deficit is expected to narrow slightly over the forecast horizon, but fiscal policy will remain supportive. The deficit is expected to widen slightly in 2025 given the latest stimulus plan at the end of 2024, with the resumption of subsidies to ease inflationary pressures on households (4% of GDP). The fiscal consolidation is delayed by a year, as the government aims at delivering a primary budget surplus from FY 2026. In the medium term, ageing-related spending, particularly in the health sector, will continue to put pressure on the fiscal 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 raise import prices and translate through to higher inflation, hampering real wage growth and the recovery in consumption.

Japan	**2024**	**2025f**	**2026f**	**2027f**
Real GDP, % YoY	0.1	1.0	0.7	0.7
Household consumption	-0.1	0.9	0.8	0.8
Public consumption	0.9	0.8	0.8	0.4
Investment	0.4	0.6	0.6	0.7
Exports of goods & services	1.0	2.1	1.3	1.7
Imports of goods & services	1.3	1.9	2.2	2.0
Inflation, % annual average	2.8	2.3	1.8	1.5
Core inflation, % annual average	2.5	2.1	1.6	1.2
Real gross disposable income (GDI), % YoY	2.7	0.8	0.7	0.7
Households saving rate, % of GDI	3.6	3.5	3.4	3.4
Unemployment, % of labour force	2.5	2.3	2.2	2.1
Fiscal balance, % of GDP	-3.0	-3.2	-3.0	-2.8
Public debt, % of GDP	255	256	258	258
Current account balance, % of GDP	4.7	4.2	4.0	4.2

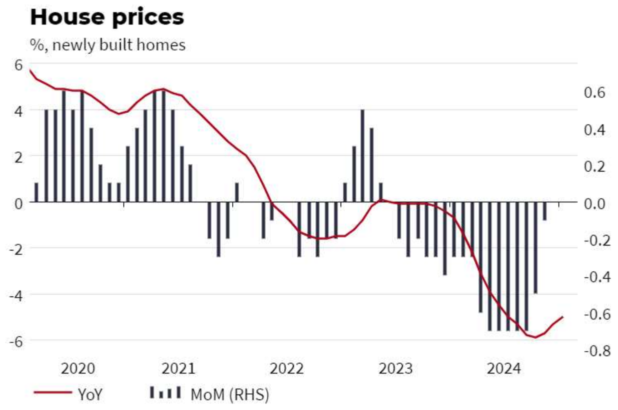
CHINA

- **The economy is suffering from weak domestic demand with subdued consumer confidence.**
- **The real estate sector is still undergoing adjustments and exports will be constrained by the United States' protectionist measures.**
- **Incremental measures targeting consumption are accelerating but should only partially offset the impact of the increase in US tariffs and absorb partly excess supply.**

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 are expected to weigh on China's trade performance. Over the medium term, the growth outlook is deteriorating due to the protracted crisis of confidence and the lasting effects of the slowdown in the housing market. Rebalancing growth towards consumption could increase China's growth potential. Consumption-related measures remain incremental for the time being. Without a recovery in the real estate sector and structural measures (improvement of social protection, etc.), household confidence will remain weak and will dampen consumption. The National People’s Congress in March placed stimulating domestic demand (consumption and investment) as top priority in 2025, but the details of the measures show it may not be sufficient to compensate the US tariffs impact on GDP growth. Apart from the trade-in program already in place, the government pledged to reduce the burden on low-to-middle-income groups but provided no concrete measures. As such, the economy will struggle to reach the 5% growth target in 2025 unless additional support measures could come later in the year (through more special bonds issuances).

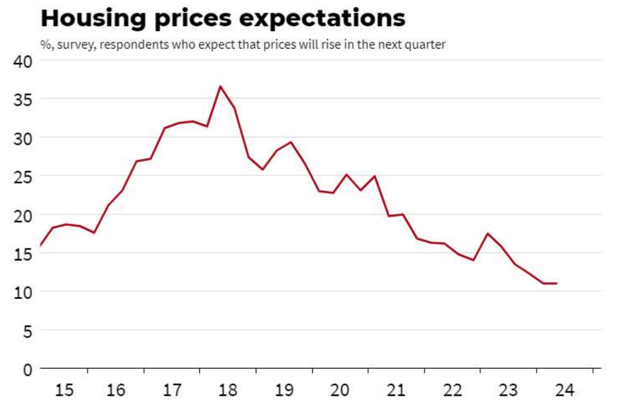
The slowdown in real estate will continue to be a drag on growth. Despite the measures announced in October, property prices remain in contraction year-on-year. Structurally, the shrinking population and slowing urban population growth will reduce the demand for housing in the coming years and make it difficult to absorb excess inventory (unsold real estate projects are estimated at CNY 93 tr if they are fully completed, or 60% of GDP).

The contraction in house prices has begun to slow down



Source: Refinitiv, SG Economic and Sector Studies

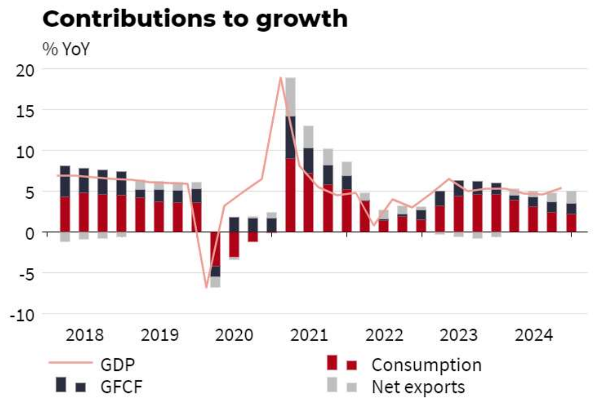
Housing prices expectations remain low



Source: Refinitiv, SG Economic and Sector Studies

Exports may remain resilient in the first part of 2025, although higher tariffs could constrain its dynamic. Given the continued domestic deflation and weak demand, exporters will continue to offer competitive export prices.

Growth momentum slows



Household confidence fails to recover

Source: Refinitiv, SG Economic and Sector Studies

The policy mix will remain accommodative and incremental but is not expected to provide a structural solution. While other measures targeting consumption are under discussion, they should support consumption, but will remain limited by the weakness of the real estate sector, dampening household confidence. Civil servants received a monthly salary increase of CNY 300 to CNY 500. Assuming that civil servants consume a higher share of their income (75%) due to higher levels of social security benefits and that the budget multiplier is 1.7, the salary increase is expected to boost growth between 0.17pp and 0.28pp, which could partly offset the impact of the 10% increase in US tariffs. The *Trade-in* programme announced in July 2024, which consists of replacing more energy-efficient appliances (including household appliances), contributed to the acceleration of consumption by one percentage point in 2024. While the scope was extended to mobile phones in January, the impact is expected to be less significant in 2025.

Inflation remains close to zero in 2025, 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 increase in the price of pork is expected to slow down given stable domestic consumption and a supply that continues to increase this year.

Downside risks to the growth outlook are related to overcapacity, disinflationary risks, and persistently weak demand. 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.

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. China's rhetoric has hardened towards the island, leading to an increase in coercive military activities. As a result, the risks of errors related to Chinese military exercises cannot be excluded.

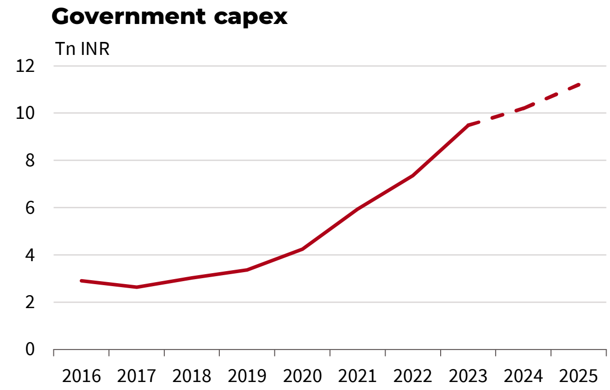
China	2024	2025f	2026f	2027f
Real GDP, % YoY	5.0	4.5	3.8	3.8
Household consumption	5.8	5.2	4.3	3.8
Public consumption	6.9	5.0	4.9	4.8
Investment	2.8	4.8	3.6	3.6
Exports of goods & services	4.8	1.8	1.8	2.1
Imports of goods & services	2.9	3.7	2.5	2.0
Inflation, % annual average	0.2	1.0	1.5	1.8
Fiscal balance, % 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.**

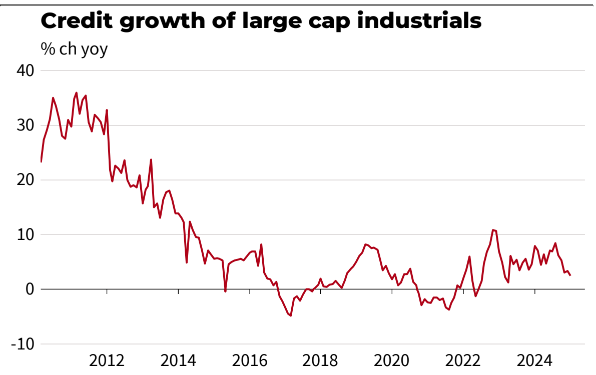
Investment should start to slow. Public investment, a major contributor to growth over the last two years, started to slow, in line with planned fiscal consolidation. Growth in private-sector investment is currently too weak to sustain the current momentum in total investment. This would contribute to a slowdown in Indian growth, which is currently above potential. This slowdown is already beginning to be felt: GDP growth in 3Q24 was only 5.4% YoY, with investment growth slowing to 5.4%. However, there is still part of the public investment budget to be spent during this fiscal year, which should prevent Indian growth from decelerating too sharply in the short term.

Public investment's strong momentum should start to tame



Source: CSO, SG Economics and Sector Studies

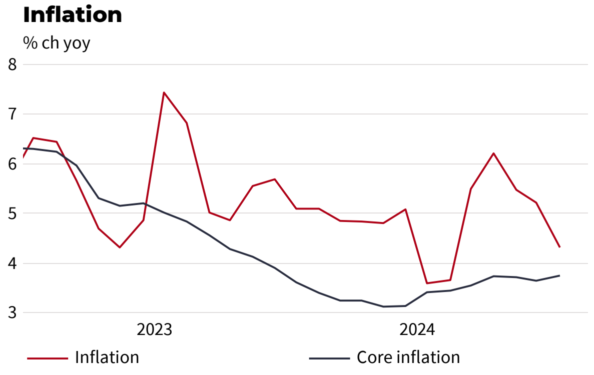
Private capex contributes less to growth



Source: RBI, SG Economics and Sector Studies

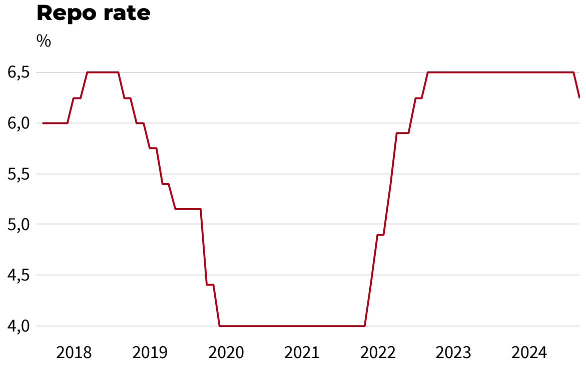
Core inflation is decelerating, slowly, which should sustain private consumption. Core inflation deceleration should continue, despite the last acceleration due to a one-off mobile tariff revision in July. Lower inflation will support private consumption, which is set to rebound from growth well below its historical average in 2023. The real growth in private consumption in 3Q24 of 6% 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 should be delayed. However, it should be noted that food prices are very volatile and can drive inflation, thus the recovery in demand could be delayed depending on agricultural performance.

Inflation is stabilising at levels in line with the target of 4% from the RBI...



Source: RBI, Refinitiv and SG Economics and Sector Studies

...which has started a rate cut cycle



Source: RBI, Refinitiv and SG Economics and Sector Studies

Fiscal consolidation has begun, and the fiscal balance will 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.

The Trump administration 2.0 does not pose a major threat at this stage. Prime Minister Modi's visit to Washington in February resulted in the promise of bilateral agreements, limiting the likelihood of a sudden increase in tariffs on Indian products in the short term. The rupee has slightly depreciated over the past six months, in line with other emerging currencies, implying RBI interventions in the markets.

Risks on India are related to climate uncertainties given the size of the agricultural sector and its impact on food prices (which represent about half of the Indian consumer basket. On the medium term, there is a risk related to investment which has been mainly driven by the public sector. The private sector firm have been reluctant to invest so far as past crises have led them to keep liquid assets available to face possible financial tensions.

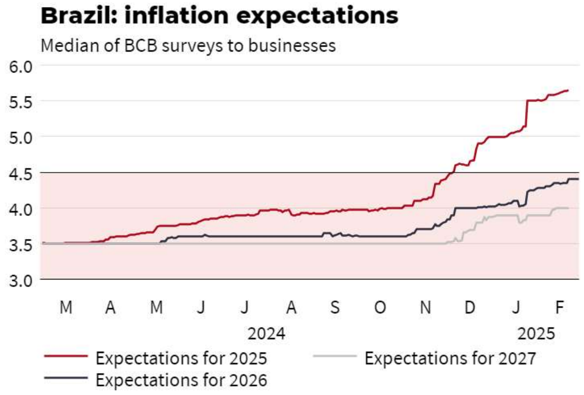
India (fiscal years from April to March)	2024	2025f	2026f	2027f
Real GDP, % YoY	6.5	6.2	6.2	6.2
Household consumption	6.8	6.0	6.0	6.0
Public consumption	6.0	5.6	5.6	5.6
Investment	7.0	6.5	6.5	6.5
Exports of goods & services	7.5	5.5	6.0	6.0
Imports of goods & services	7.9	5.5	6.0	6.0
Inflation, % annual average	4.7	4.7	4.7	4.7
Fiscal balance, % of GDP	-7.7	-7.5	-7.5	-7.5
Public debt, % of GDP	83	82	81	80
Current account balance, % of GDP	-1.2	-1.5	-1.5	-1.5

BRAZIL

- **The impetus of domestic demand will be lacklustre this year in a context of inflation and high real interest rates.**
- **The BCB is showing a hawkish approach in the rise of the Selic and the support of the BRL.**
- **Trade uncertainty will dampen the medium-term outlook**

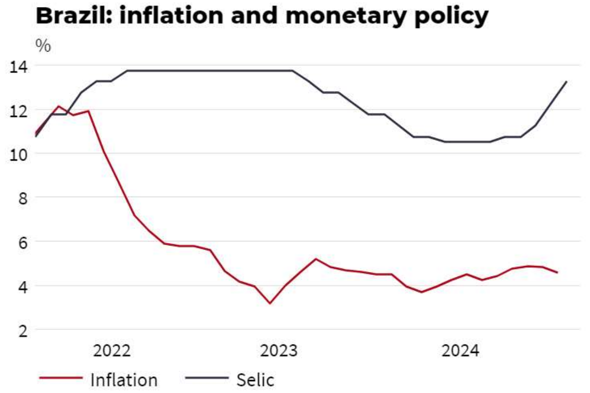
Activity remained highly dynamic in 2024 growing by 3.4%, with a surge in private consumption and an investment rebound. Households benefited from the strongest labour market in over a decade, characterized by low unemployment (6.2% in 4Q24) and a progression of real wages (+4.7% in 2024), and public support for low-income population. Investment rose on average 6.5% YoY during the first nine months of the year, recovering from the contraction of the previous year.

Inflation expectations that are slipping…



Source: BCB, SG Economic and Sector Studies

… leading to a firm response from the BCB



Source: IBGE, BCB, SG Economic and Sector Studies

Growth will soften in 2025 (1.9% YoY) as higher inflation (4.9%) pushes the BCB to tighten policy. Inflation has risen over the last eight months have been largely attributed to climate events that have pressured the prices of food and energy. Core inflation has largely stagnated, and inflation expectations are showing some signs of de-anchoring. We expect inflation to remain above the upper limit of the BCB's tolerance interval set at 4.5%, at least until 2H25 as food prices remain under pressure (notably meat), and industrial goods' prices will adjust to a depreciated BRL (15% since the beginning of 2024). The BCB will sustain its aggressive stance, with markets anticipating the Selic to breach the 15% mark by the end of 2Q25, exceeding the maximum levels seen during the previous tightening cycle. High inflation and tight financial conditions have moderated sentiment measures, and will be central in the slowdown of consumption, as well as delaying investment. Debt servicing capacity for both corporates -notably for micro and small enterprises- and households will therefore be narrower, limiting the credit channel to sustain activity.

Fiscal policy will be constrained by high borrowing costs, and investor pressure to ensure budget responsibility. Transfers are expected to slow down as the Government demonstrate fiscal constraint, but higher approval of BNDES subsidised credit will offset fiscal tightening efforts. Furthermore, the Government's ability to satisfy its fiscal framework depends on optimistic macroeconomic and revenue hypotheses that raise doubts specially as the 2026 presidential elections approach. Investors remain nervous which keeps interest rates high and exerts pressure the BRL. Interest payments will remain burdensome as interest rates stay elevated, above 6% of GDP, contributing to the deficit.

Geopolitical uncertainty raises the risk to the outlook, even if the country seeks to maintain a neutral stance. American announced tariffs do not explicitly target Brazilian exports as of when we go to print, but they can be at the crosshairs of trade tensions, e.g. the announced 25% tariff on steel and aluminium could reduce total exports volume by about 0.4%. As China remains the biggest foreign market of the country representing about 1/3 of total exports-notably for its commodities both for agricultural products like soybean, and for mineral products- and its slowdown will limit exports volume.

We continue to see downside risks to our scenario in an uncertain global environment. The threat of reciprocal tariffs by the US would raise the tariffs on Brazilian exports to the US from 2.2% to 11.3%, harming the competitiveness of the country in its second largest market after China. Moreover, a sudden degradation of the labour market will soften consumption and activity in the context of a restrictive policy mix. A scenario with a stronger dollar and a more restrictive Fed will encourage imported inflation and delay easing by the BCB. Finally, the country remains vulnerable to climate events affecting agricultural output and exports as well as rising fiscal pressure.

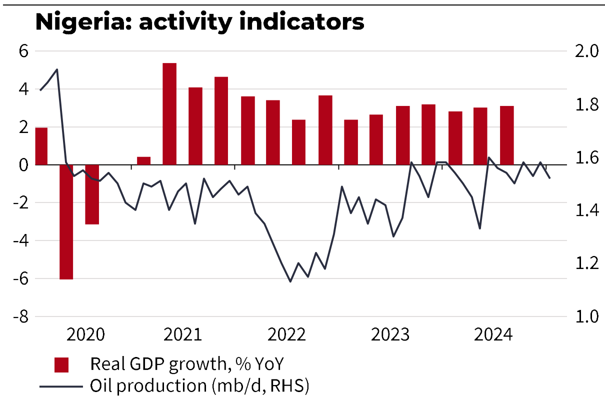
Brazil	2024	2025f	2026f	2027f
Real GDP, % YoY	3.4	1.9	1.3	2.0
Household consumption	5.4	2.0	1.8	2.3
Public consumption	1.9	1.5	1.0	1.0
Investment	7.3	2.0	1.4	2.2
Exports of goods & services	3.0	2.5	2.5	2.5
Imports of goods & services	13.5	2.0	1.8	2.5
Inflation, % annual average	4.4	4.9	3.9	3.3
Fiscal balance, % of GDP	-6.9	-7.3	-7.0	-6.5
Public debt, % of GDP	88	90	92	93
Current account balance, % of GDP	-1.7	-1.7	-1.5	-1.9

AFRICA

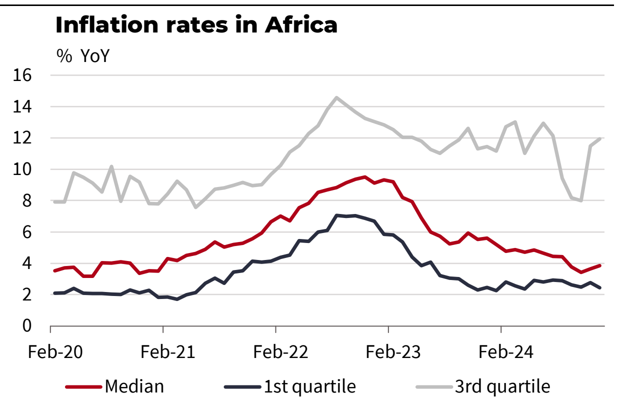
- **After the underperformance of 2024 (3%), regional growth is expected to accelerate in 2025 and 2026, to 3.5% and then 3.8%**
- **These rates remain insufficient to ensure a real and widespread development of wealth levels in the region**
- **The risks to these forecasts have increased, particularly due to the United States (higher than expected interest rates, shutdown of the USAID development agency)**

Average regional growth is likely to have reached 3% in 2024, the 3rd worst performance since the early 2000s (2.2% in 2016, -1.4% in 2020). As explained last quarter, this underperformance is mainly due to local factors. The postponement of some major hydrocarbon or mining projects (Senegal, Libya, Zambia, Botswana) and/or the rapid deterioration of the political and security environments (Libya, Sudan and South Sudan) have led to much lower-than-expected growth in these countries, shaving a few percentage points off the regional average.

Nigeria: a gradual rebound in oil production



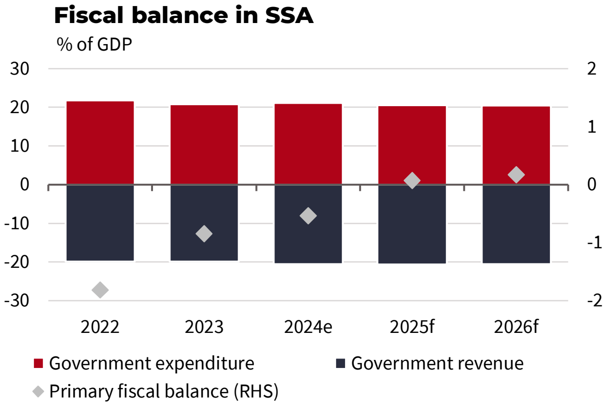
A gradual decline in inflation, despite strong disparities between countries



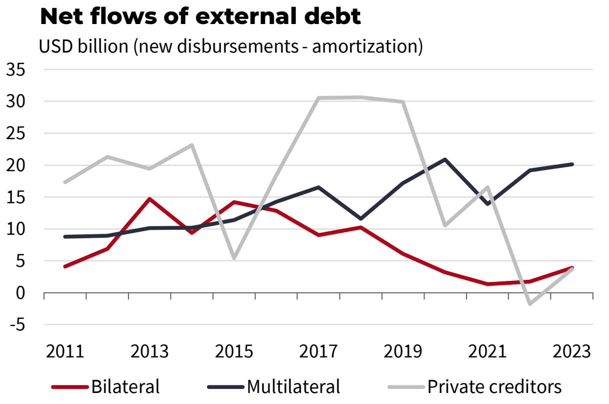
Source: Refinitiv, SG Economic and Sector Studies

We still expect a (modest) acceleration in growth to 3.5% in 2025, then 3.8% in 2026. Firstly, regional growth would benefit from the start of projects postponed to 2024 (a hypothesis that has already been verified in some cases, such as in Senegal with the start-up of the GTA offshore gas project in January 2025). Other positive local factors are also expected: continued improvement in electricity production in South Africa (which remains significantly below its historical high in mid-2011); rebound in oil production in Nigeria (again, still far from its pre-Covid level). A positive surprise cannot be ruled out in Egypt (which accounts for more than 20% of regional GDP, vs. 10% for South Africa and 15% for Nigeria), where a recovery in private demand is likely (despite significant risks) after the “confidence shock” – currency depreciation, interest rate hikes – administered in 1Q24. More generally, and in most countries in the region, this rebound in growth is expected to be mainly based on stronger private demand, made possible by the continued gradual reduction in inflation levels – although the situation remains problematic in several countries (notably those that have experienced recent episodes of sharp currency depreciation: Nigeria, Angola, Zambia to a lesser extent).

Sub-Saharan Africa: fiscal consolidation constrains public demand



Multilateral financing support is vital for the region



Source: Refinitiv, World Bank, SG Economic and Sector Studies

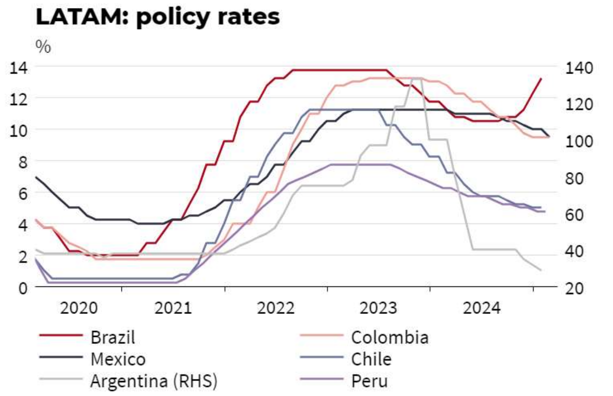
The risks to these forecasts appear to have broadly increased in recent months. On the cyclical front, the combination of higher US interest rates, a strong USD and greater political and economic uncertainties (usually resulting in a lower risk appetite) could further deteriorate foreign currency financing conditions and reinforce already high refinancing risks (as a reminder, the region will have to repay around USD 12bn of Eurobonds per year in 2025 and 2026). This would – at the very least – weaken public demand, which is already burdened by the fiscal consolidation efforts underway in most countries and still tight local currency financing conditions. More structurally, these consolidation efforts remain insufficient to significantly improve the sustainability of public debt in the region, with an interest-to-revenue ratio still around 20% (compared to less than 10% on average for emerging markets). Secondly, the region could suffer from a "financial withdrawal" by the United States, already illustrated by the announcement of the closure of USAID (US' development agency, with about USD 18bn disbursed in Africa at end-2023). Less US cooperation with multilateral financial institutions (IMF, World Bank, etc.), although unlikely as of today, would be even more dangerous for the region. Finally, as explained in previous quarters, the combination of growth rates that are still insufficient (to ensure real development) and more regular climatic events still poses a strong risk to political structures that are still often fragile in the region.

LATIN AMERICA

- **Regional growth will slightly slow down to 2.2% in 2025 (vs 2.4% in 2024) and face downside risks**
- **US policy shifts will raise challenges for the region even if most countries should not be specifically targeted by US trade policies**
- **Fiscal tensions remain high as a new electoral cycle gets underway**

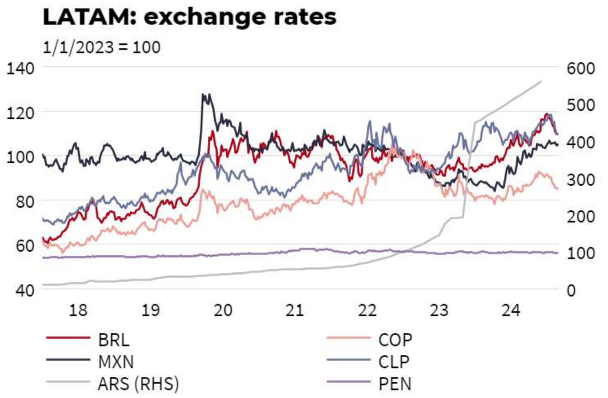
Growth will remain slightly below its long-term average (2.4%) over the forecast horizon, masking country differences. Our forecast for 2025 (2.2%), is driven by good performances of the small economies -e.g. Guyana, Dominican Republic, Guatemala, Paraguay, Nicaragua- and an Argentinean sharp recovery after a two-year recession. Argentina will indeed start to see the upside of the major macroeconomic and fiscal adjustment it went through last year, with positive real growth (5% per the IMF) as disinflation continues, and real wages recover. The two biggest economies of the region, Brazil and Mexico, will face significant headwinds. The case of Brazil has been discussed in a previous section. As for Mexico, its economy will be constrained by muted consumption and investment as uncertainties arise from the US trade policy, the volatility of international financial markets and of geopolitical tensions.

A divergence in the conduct of monetary policies…



Source: LSEG, SG Economic and Sector Studies

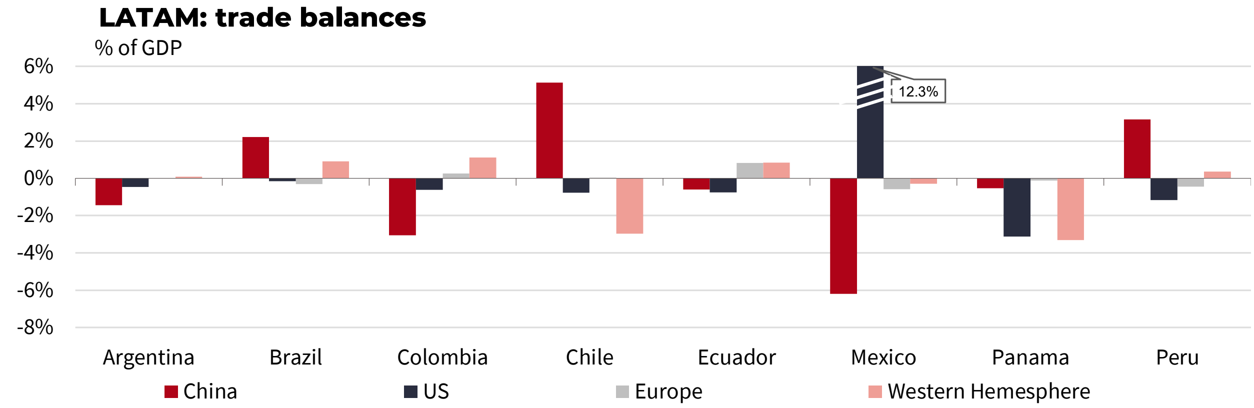
… and exchange rates in an uncertain international environment



Source: LSEG, SG Economic and Sector Studies

On the monetary front, the region continues to see some divergence in the evolution of inflation and of interest rates. In Brazil -and to a lesser extent Uruguay-, inflation hikes and anticipations' de-anchoring have push the central bank to engage in a new tightening cycle of financing conditions. Inflation rates show signs of stubbornness in Chile, Colombia, Guyana and Dominican Republic, where the monetary authorities have paused their easing cycles. On the contrary, in Mexico and Peru, disinflation continues its curse allowing central banks to keep lowering rates early 2025. In the case of Banxico, it has stick to the dovish stance it announced last year in spite of the high uncertainty the country faces, and the possibility of deviating from the Fed stance. Currencies will continue to be under pressure over the forecast horizon given an uncertain global environment. Differences in monetary policy stances might exacerbate it.

Most countries in the region are not expected to be particular targets of new US tariffs



Source: IMF, SG Economic and Sector Studies

The region risks being at the crosshairs of trade tensions albeit -most countries-bearing little announced interests for the US. The Trump has shown overall little interest on the region overall, as it did in the 2017-2021 term, with the exception of Mexico and Panama. The US decisions regarding tariffs to Mexican imports, and the renegotiation -if any- of the USMCA will be central to that country outlook. Panama could be prone to geopolitical actions difficult to predict given the US interest on the use conditions of the Canal, but we expect some political solution between governments. As of the rest of the countries in the region, the US does not run trade deficits with them, ruling out the hypothesis of targeted sanctions. Moreover, governments, even left-wing ones (Brazil, Chile, Colombia, Honduras), have so far been cooperative with the new US administration -notably accepting deportations flights- in order to minimize diplomatic tensions. Geopolitical tensions would however weigh on the region. Slower growth of trade partners, in particular US and China, combined the prospects of higher tariffs -even if non-targeted like the 25% tariff on steel and aluminium- will narrow the possibility of the region to leverage external demand to grow. Furthermore, uncertainty will delay/cancel FDI flows that the region expected for nearshoring efforts.

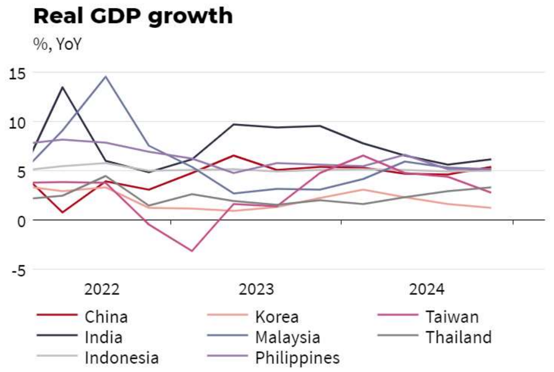
The region continues to face a challenging outlook. Fiscal space is reduced across the region, with governments needing to balance their books, while investment needs need to be addressed. At the same time farther global uncertainty will continue to put pressure on currencies, and sovereign spreads weighting on the external balances and further limiting the capacity of governments to borrow, especially if the Fed were to turn hawkish. Finally, a slower pace on transition efforts will limit external demand for critical commodities (lithium, copper, gas), limiting growth potential in South America.

EMERGING ASIA

- **Regional growth is expected to remain resilient in 2025, despite an expected decline in Chinese demand, thanks to domestic demand**
- **Inflationary pressures are expected to continue to moderate, paving the way for a monetary easing cycle**
- **Downside risks related to economic and geopolitical uncertainties are intensifying and may weigh on regional investment and trade**

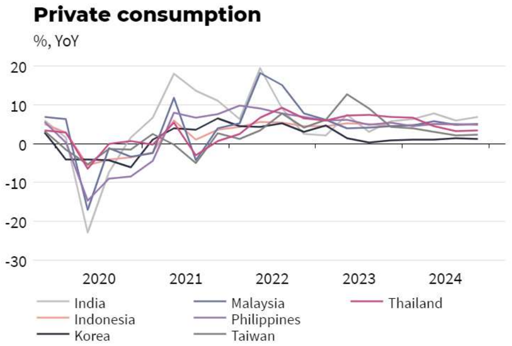
Regional growth in emerging Asia, excluding China is expected to remain buoyant in 2025, despite lower Chinese demand. Domestic consumption, which accounts for more than half of GDP for most countries, continues to support growth. The labour market is improving, with the unemployment rate in most economies returning to pre-pandemic levels. Tourism continues to recover, supporting consumption and service activity. Exports have remained favourable so far, supported by buoyant regional trade, still driven by the semiconductor sector.

Growth in the region remains dynamic



Source: SG Economic and Sector Studies, LSEG

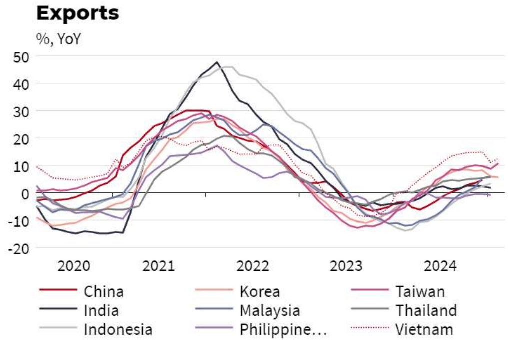
...... supported by private consumption



Source: SG Economic and Sector Studies, LSEG

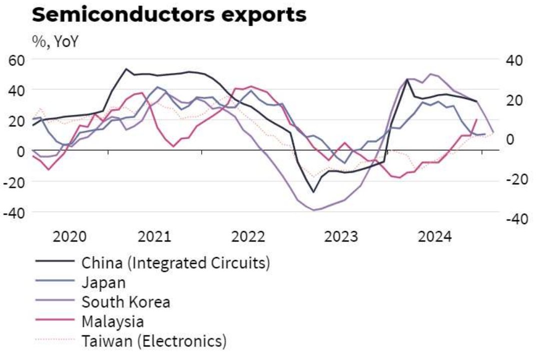
External demand has gradually recovered but may slow down onwards, with a deceleration in demand from China and the United States expected in 2025. The semiconductor cycle is also maturing. Exports and production of semiconductors have accelerated in South Korea since the summer of 2023, but their cyclical recovery is maturing. In addition, geopolitical fragmentation and tensions, especially with Trump's re-election, pose a downside risk to exports.

Export momentum slows down



Source: SG Economic and Sector Studies, LSEG

The peak of the semiconductor cycle seems to be over

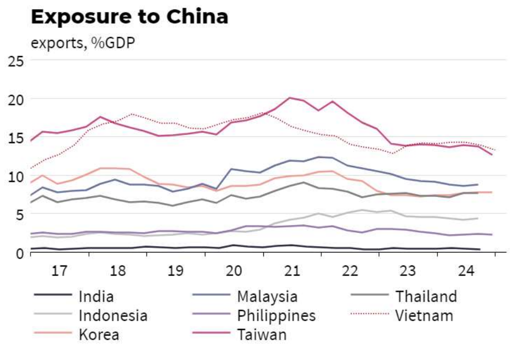


Source: SG Economic and Sector Studies, LSEG

Inflationary pressures are expected to moderate, but upside risks are emerging. 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, upside risks are increasing, with inflationary pressures generated by short-term protectionist measures and climate risk.

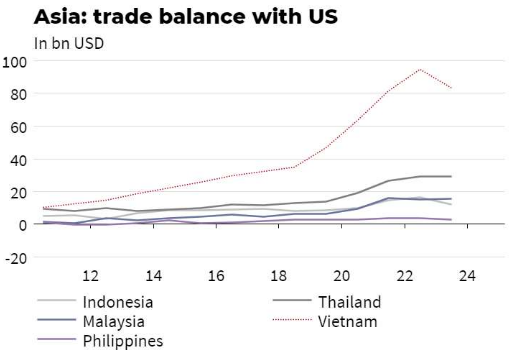
The monetary easing cycle has begun and should support domestic demand. Many countries have seen the effects of rising interest rates since 2022. This brake should now fade as monetary policy is gradually eased. However, the pace of rate cuts is likely to be more measured than initially expected. Central banks should take a cautious approach and strike a balance between supporting growth and managing inflationary pressures resulting from US protectionist policies. 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, LSEG

Southeast Asia has large trade surpluses with the United States



Source: SG Economic and Sector Studies, LSEG

Downside risks are intensifying. 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. In addition, Southeast Asian countries benefit from the *China +1* strategy, and they have large trade surpluses (Vietnam in particular) with the United States. In the event of an escalation of tensions between the US and China, Southeast Asia could come under scrutiny given its close trade ties with China, including their role in re-exporting Chinese manufactured goods. For tech exporters, US export controls on China (the largest trading partner) will slow the momentum of semiconductor exports.

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.

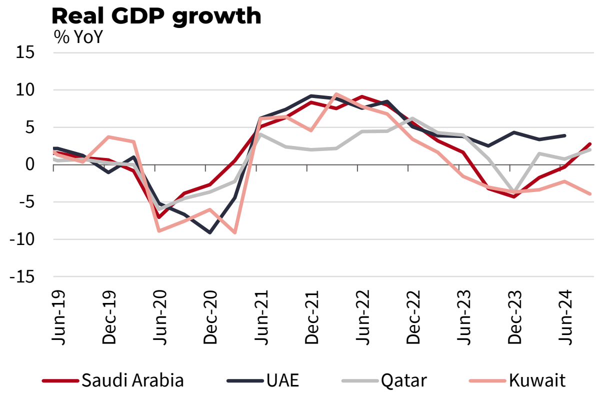
Climate change remains a major challenge for the region. Many countries in emerging Asia are vulnerable to global warming which could cause structural damage (food insecurity, supply chain disruptions, infrastructure). Investments in the prevention of these climate risks will weigh on public finances.

GULF STATES

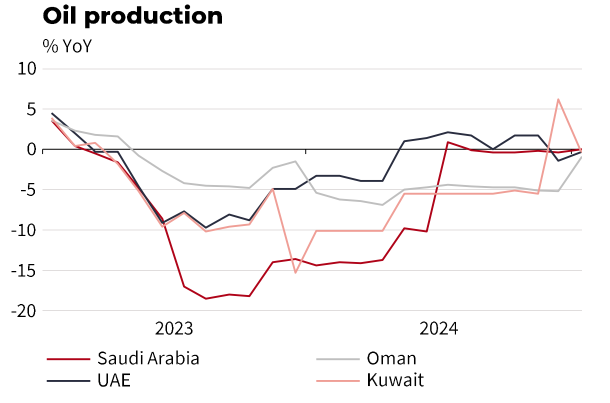
- **Growth was weak in 2024 (below 2%), weighed down by the oil production cuts decided by OPEC+ in 2023**
- **Growth is expected to accelerate from 2025 onwards, depending on possible (limited) increases in oil production, and still driven by the dynamism of the non-oil sectors**
- **Gulf countries appear resilient in the face of rising geopolitical risks in the region**

The average growth of the GCC (Gulf Cooperation Council) **countries was likely to be below 2% in 2024.** Although slightly improved compared to 2023 (0.4%), this rate would be the 5th lowest since 2010. The continuation of the oil production cuts decided by OPEC+ in 2023 meant that on a YoY basis, oil sectors in the region represented a significant drag on growth. Thus, the estimated performance for 2024 illustrates the level of diversification of the GCC economies: growth of more than 3% in the United Arab Emirates (UAE) and Bahrain; "average" performance in Saudi Arabia, Oman and Qatar; contraction of GDP in Kuwait. Reassuringly, the non-oil sectors remain dynamic, as evidenced by non-oil PMIs, which are still solidly in expansion territory.

Growth in 2024 was disappointing, but more resilient in the United Arab Emirates



After 18 months of contraction, production is "only" stabilizing

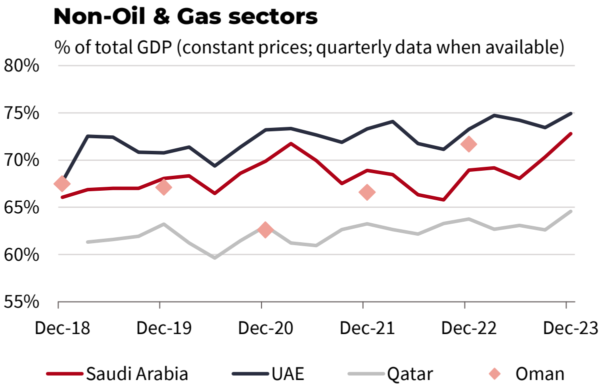


Source: SG Economic and Sector Studies, LSEG

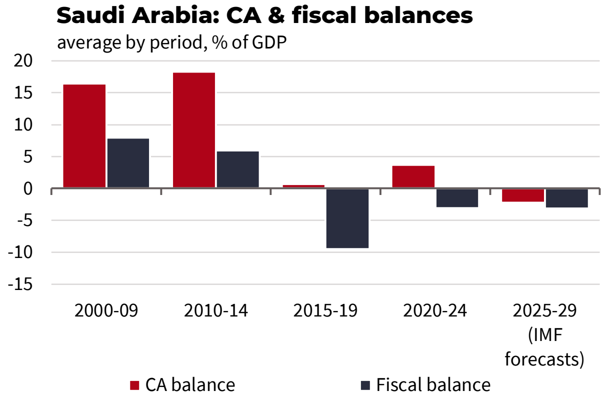
Regional growth is still expected to accelerate, to around 3% in 2025 and then 3.5%/4% in 2026 and 2027. Unsurprisingly, the numbers will largely depend on future OPEC+ decisions. In our view, the prospect of higher oil production in several "non-OPEC+" countries (United States, Brazil, Guyana) and weaker-than-expected global demand (risks to Chinese and European growth) means that oil production restarts in the GCC countries will remain limited and late (at best in 3Q or 4Q24). In any case, and at the very least, a stabilisation (in YoY terms) of these productions would mean that the oil sectors would no longer constitute a "burden" for total growth. As recalled in previous quarters, gas production remains on a better trajectory, if only because gas is often considered a "transition energy" (less negative for the climate than oil) – which makes the outlook for its long-term demand more solid. This should mainly benefit Qatar (with the commissioning of the North Field extensions from 2026 onwards) and Oman (to a lesser extent).

In any case, the non-hydrocarbon sectors are expected to remain dynamic, still benefiting from significant "green" investments (more specifically, mitigation) and economic diversification, while the region remains one of the most exposed to climate risks (particularly transition risks). These efforts will be particularly important in Saudi Arabia, which faces the most urgent diversification needs in the region (due in particular to its large – more than 30 million inhabitants – and young – more than 60% are under 30 years old – local population). The projections of the "Vision 2030" have recently been revised (while keeping the total investment target: USD 3,300bn between 2021 and 2030, or about 3 times the current GDP), postponing certain "flagship" projects (NEOM) in favour of more pressing infrastructure needs. The country is due to host several major international events: the Asian Winter Games in 2029, the World Expo in 2030, and the FIFA World Cup in 2034.

A very gradual diversification of economies



Twin deficits in Saudi Arabia: a new situation, but quite "manageable"



Source:SG Economic and Sector Studies, LSEG

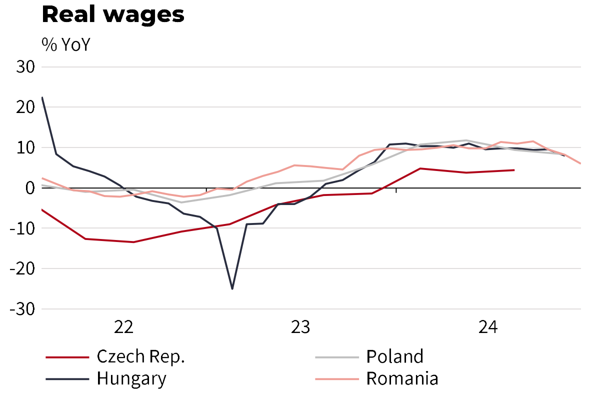
So far, the Gulf countries have shown themselves to be resilient in the face of ever-increasing geopolitical risks in the region (and even more difficult to anticipate since the election of Trump). From a cyclical point of view, the region's private demand could (moderately) suffer from more restrictive monetary policies than expected, since regional pegs mechanically link them to that of the Fed (which we now expect to be less accommodative). In the longer term, the region's main diversification plans (Saudi Arabia, UAE, Oman) remain very ambitious, could "include" a misallocation of funds (with possible inflationary effects in the short term), and should degrade fiscal and current account balances (which are currently very solid).

CENTRAL AND EASTERN EUROPE

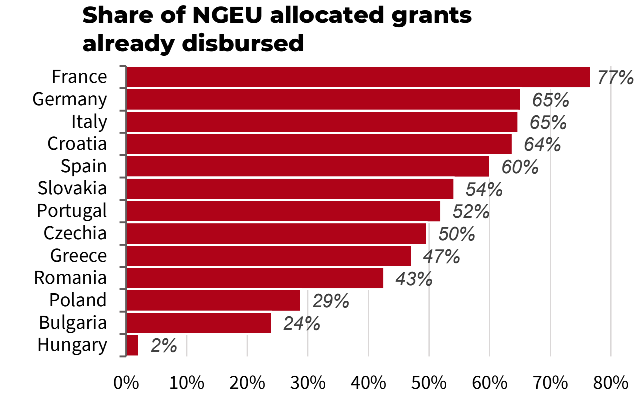
- **Despite the expected fiscal consolidations in the region, growth will continue its gradual recovery in 2025-2026, driven by domestic demand**
- **After a sharp deceleration, inflation is expected to remain moderate in 2025 despite the recent rise in gas prices**
- **Downside risks to activity are linked to tensions with the US, with potential tariffs affecting the automotive sector and uncertainties over the ongoing negotiations related to the war in Ukraine**

The growth recovery in the region in 2024 has been very gradual and mainly driven by internal demand. Household consumption benefited from strong disinflation which allowed real wages to rise and from increased public spending in an electoral context in a few countries (notably in Romania and Poland). Investment was driven by European funds, even if their absorption was uneven. At the end of December 2024, 50% of NextGeneration EU funds allocated to the Czech Republic have been disbursed, 43% for Romania, 29% for Poland, 24% for Bulgaria, 2% for Hungary (two thirds of whose funds remain frozen due to the triggering of the conditionality mechanism) compared to more than 77% in France and 65% in Italy and Germany. On the other hand, external demand remained sluggish due to the weak performance of the euro area, weighing on industrial production, particularly in the car industry.

The main growth driver remains private consumption thanks to strong wages' growth



Investment has been driven by the absorption of European funds



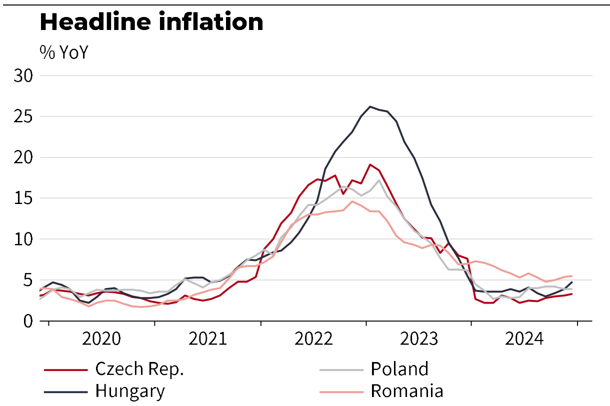
Source: SG Economic and Sector Studies, LSEG

In 2025-2026, activity will continue to gradually accelerate, supported by the dynamism of domestic demand, despite the fiscal consolidations expected in several countries in the region. Household consumption is expected to remain strong in a context of a tight labour market (low unemployment rates and high vacancy rates) and rising real wages. Investment is expected to accelerate due to the continued absorption of European funds – structural funds and NextGeneration EU funds. On the other hand, private investment and exports are expected to remain weak in a context of slow recovery in the euro area and particularly in the automotive sector.

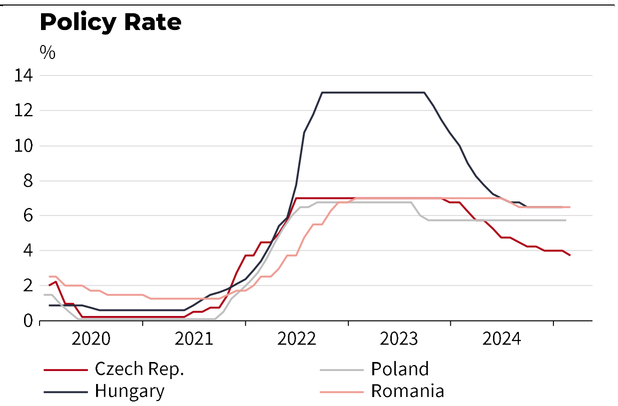
Fiscal policy is expected to become more restrictive. The European Commission opened an excessive deficit procedure in June 2024 for several countries in the region: Poland, Hungary, Slovakia and Romania. The latter displays one of the highest budget deficits in the region but could delay its fiscal consolidation due to the presidential elections scheduled for May 2025 (after their cancellation by the Constitutional Court at the end of 2024 following significant irregularities). A large fiscal consolidation in Romania will be necessary in the second half of 2025 and in 2026, likely including tax increases, failing which the country's conditions of access to international financing could deteriorate.

Inflation is expected to remain moderate despite the recent rise in gas prices linked to strong demand for LNG following the end of Russian gas transit through Ukraine since January 2025, the increase in consumption during the winter period and the need to replenish stocks, which were relatively low at the end of January in comparison with January 2023 and 2024. In this context, the region's central banks could continue to slightly lower their policy rates in 2025.

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



Further rate cuts could take place in 2025



Source: SG Economic and Sector Studies, LSEG

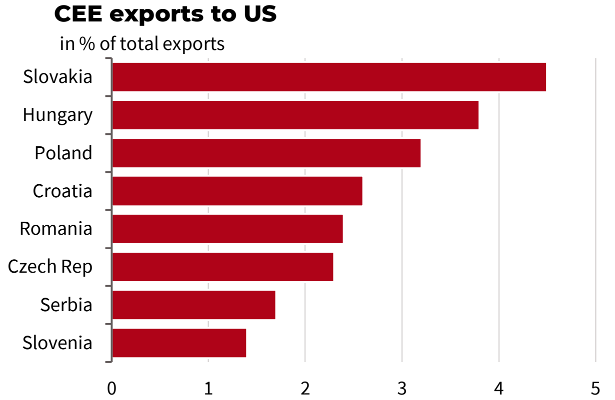
Downside risks to the growth outlook relate mainly to uncertainties surrounding the policies of the new US administration, particularly regarding potential tariffs which could impact Europe along with ongoing negotiations related to the war in Ukraine.

Although the region's direct commercial exposure to the United States is relatively low, the potential imposition of tariffs, especially on the automotive and pharmaceutical sectors, could have a significant impact. The automotive sector is a crucial contributor to the value added and exports of the region's major countries: it accounts for 15% of Czech exports, 27% of Slovak exports, 12% of Hungarian exports, and 8% of Polish exports. Similarly, the pharmaceutical sector constitutes 17% of

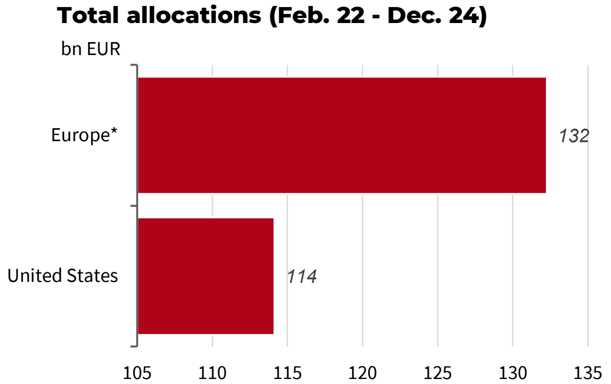
Slovenian exports. Tariffs on these sectors could disrupt the region's highly integrated value chains.

Additionally, uncertainties surrounding potential reductions in US bilateral aid to Ukraine coupled with the ongoing negotiations on a ceasefire could lead to increased pressure on defence spending within the region.

Limited direct trade exposure to the United States.



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



Source: Kiel Institute, SG Economic and Sector Studies, LSEG

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