

SCÉNARIO ÉCO

Société Générale Economic & Sector Studies

Policy Fragility

- **Uncertainty and tariffs continue to weigh on the global economy.** While fiscal stimulus and deregulation may offer some lift to the US economy, we believe that this will not suffice to offset the headwinds from immigration, tariffs and broader uncertainty. Downside risks, not least from financial accelerators, remain.
- **US dollar to retain its reserve status** but it is beginning to show signs of strain. An unsustainable debt trajectory will **drive Treasuries term premia higher**. This is likely to keep financial market volatility structurally higher. The post-“Liberation Day” dollar depreciation and pressures on long-term rates are the first signs of a reassessment of the dollar allocation in global portfolios.
- **Euro area competitiveness set to see only slow progress.** Question marks on European industry, technological gaps and structurally higher energy costs will weigh on regional growth over the forecast horizon. The ECB is set to cut rates to the low end of neutral but pursue QT into 2026 (and possibly beyond).
- **China to at least partly offset external drag with temporary stimulus.** The real-estate overhang is easing, but industrial over-capacity remains. We see growth falling short of the 5% target. A major challenge for Chinese authorities remains the rebalancing of growth towards more consumption in a context where household confidence remains low despite some consumption-targeting stimulus measures.
- **Geo-economic fragmentation drives** gradual re-organisation of GVCs. We assume no further geographical expansion of ongoing conflicts.

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EDITORIAL

WORLD ECONOMY REMAINS FRAGILE

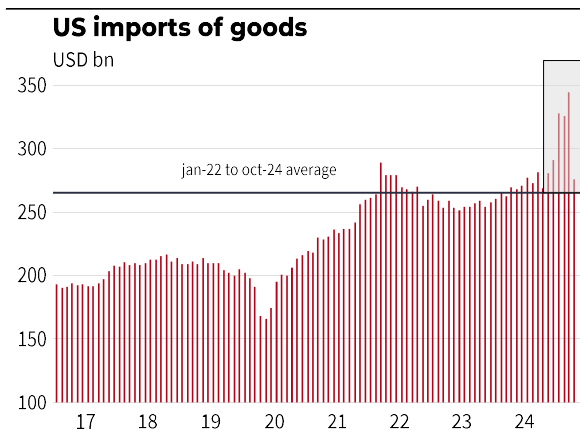
The US administration measures are, in aggregate, set to durably weigh on US growth. Downside risks, not least from financial accelerators, remain.

In the rest of the world, the US tariffs are being met mostly with restraint in terms of retaliation, but policy uncertainty is weighing on the world economy. Tariff uncertainty has now shifted to the courts after the US International Trade Court ruled the reciprocal tariffs unlawful on 28 May, a decision now under appeal. Legal challenges, however, did not stop President Trump from lifting the tariffs on steel and aluminium to 50% as of 4 June.

After the frontloading of the first quarter, international trade dynamics have returned to more normal territory as witnessed by the fall of US imports in April. The spectacular increase in US imports seen in early 2025, in anticipation of the tariffs, is of historic dimensions (see left-hand chart below). During **the period from November 2024 to April 2025 the imports “surplus” compared to average monthly imports represented 0.2% of world GDP**. This temporary boost to global growth should now be behind us.

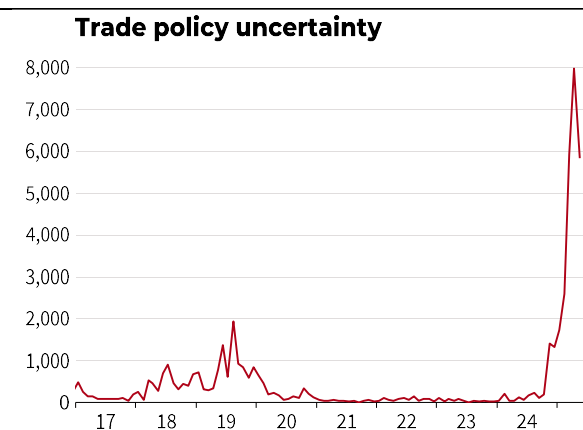
The combination of uncertainty, limited room for fiscal support and timid monetary easing continue to weigh on our short to medium term forecasts. These dynamics are in line with our scenario of weak growth at least over the next two years. We maintain our call of a significant slowdown in the US until 2027, below 1% growth in the euro area and below 4% in China.

Front loading dynamics seem behind



Source: SG Economic and Sector Studies, LSEG

But uncertainties on international trade remain



Source: SG Economic and Sector Studies, EPU

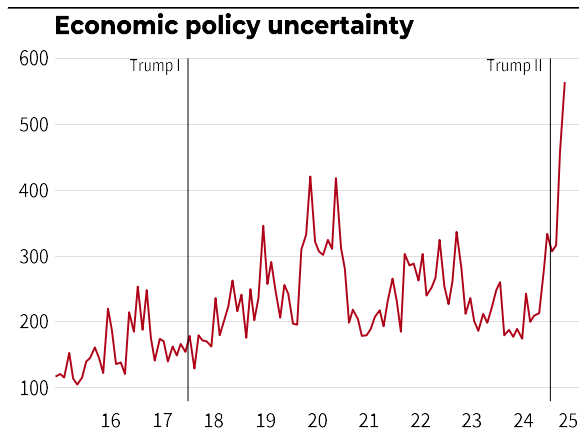
The US administration's measures have created significant uncertainty, reflected in the deterioration of confidence indicators but not yet in hard data as the labour market remains firm, albeit with signs of softening. Consumption was strong in 1Q, but consumer confidence fell to its lowest level since 2022 in April-May. The

“Liberation Day” episode created a durable uncertainty shock which is exacerbated by the ongoing US budget discussions and not least the increasing question marks on the role of the dollar as the reserve currency.

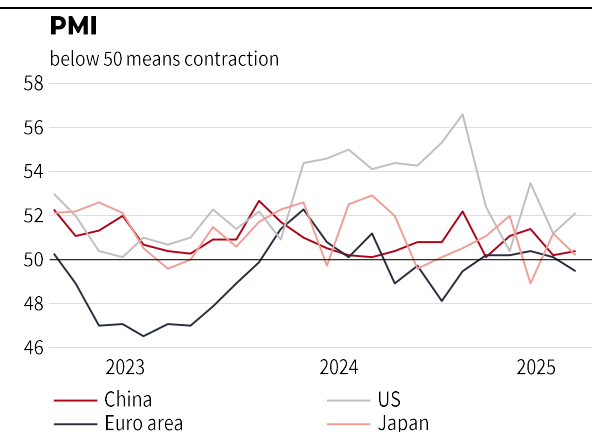
Higher tariffs are expected to depress consumption and corporate profitability. Rising inflation expectations should constrain monetary policy and keep funding costs high. In this context, the coming quarters are likely to suffer from a less dynamic international trade, dented household demand and financial markets volatility.

After the shock of 2 April’s “Liberation Day” which sent market volatility to crisis levels, market nervousness has moderated. Equity markets have strongly recovered but new episodes of volatility cannot be ruled out as uncertainty regarding US policies and geopolitical tensions remains high. As we head to press, further doubt has been cast on tariffs negotiations after the US promised to send letters to trade deficit countries with a “take it or leave it” offer, rattling markets. On the geopolitical front, stalling US-Iran nuclear talks and simmering Middle East tensions have provoked a spike in oil prices.

Policy uncertainty ...



...is hurting firms' confidence



Source: SG Economic and Sector Studies, LSEG, EPU

Source: SG Economic and Sector Studies, LSEG

THE STATUS OF THE DOLLAR: FROM TRADE WAR TO CAPITAL WAR

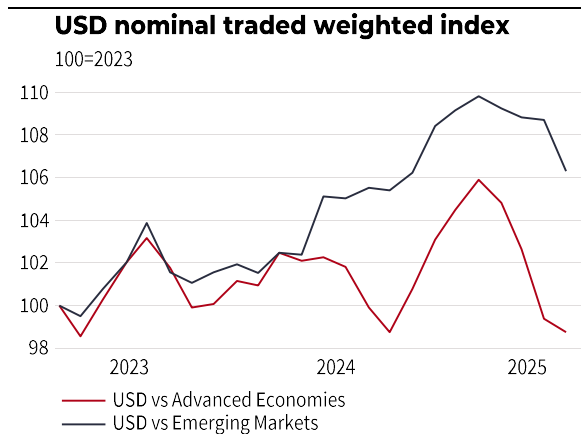
The debate on the dollar’s status is gaining traction due to two main pillars: the freedom of international capital flows to the US and the long-term quality of US sovereign debt.

- The first pillar could be damaged by the potential treatment of foreign investors holding US assets. The “One Big Beautiful Bill” Act’s proposed Section 899 would introduce a US surtax that could impact investors from countries imposing taxes seen as unfair by the US administration.

- The second pillar is under threat from the US fiscal trajectory, with rising concern about the increasing level of public debt, potential sovereign rating downgrades and upward pressures on long-term interest rates. After the downgrade by Moody's in May, the US government lost its last AAA rating, raising doubts about US Treasuries' status as the highest quality financial asset.

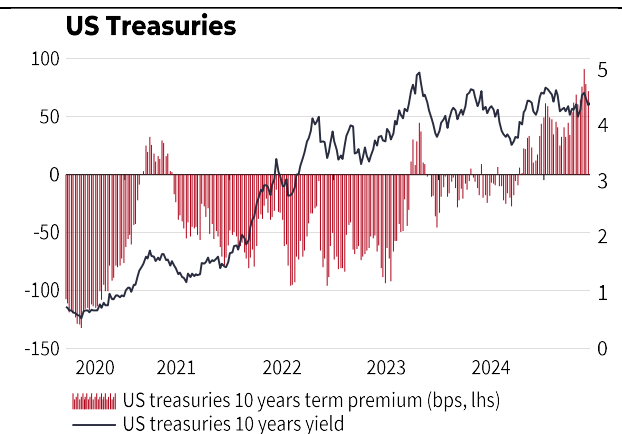
Even though the dollar depreciation episode of April was partly due to a “dash for cash”, it was also a first sign of growing question marks about the currency's reserve status. The concern is that foreign institutional investors may be reassessing their allocations to US assets in their portfolios.

Dollar depreciation...



Source: SG Economic and Sector Studies, LSEG

...accompanied by higher long-term rates



Source: SG Economic and Sector Studies, Federal Reserve of New York

The damaging to the dollar's safe-haven status exposes the troubling lack of credible alternatives. US financial markets are by far the largest and most liquid globally, meaning a shift of capital towards financial assets in other smaller and more fragmented markets is likely to usher in a period with structurally higher volatility and potential financial instability.

ECONOMIC FORECASTS

GDP, % YoY	2024	2025f	2026f	2027f
Developed Markets	1.7	1.5	1.2	1.2
United States	2.8	1.7	1.4	1.0
Japan	0.2	0.8	0.7	0.7
United Kingdom	1.1	0.9	1.0	1.2
Euro area	0.8	0.7	0.8	1.0
Germany	-0.2	0.3	1.1	1.3
France	1.1	0.6	0.6	0.9
Italy	0.5	0.6	0.5	0.5
Spain	3.2	2.3	1.8	1.6
Emerging Markets	4.2	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	6.4	6.4
Central and Eastern Europe	3.2	1.8	1.5	1.5
Latin America	2.2	2.2	2.2	2.2
Brazil	2.9	1.9	1.3	2.0
Middle East and Central Asia	2.4	3.5	3.5	3.1
Africa	3.2	3.5	3.8	3.8
World (PPP weighted)	3.3	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	3.2	2.9	2.6
Japan	2.8	2.7	1.8	1.5
United Kingdom	2.5	2.8	2.3	2.1
Euro area	2.4	2.1	2.0	1.7
Germany	2.5	2.0	2.0	1.9
France	2.3	1.5	1.8	1.7
Italy	1.1	1.8	1.8	1.7
Spain	2.9	2.5	2.2	1.8
Emerging Markets	7.7	5.5	4.9	4.4
China	0.2	0.5	1.0	1.2
India	4.5	4.3	4.5	4.5
Brazil	4.4	5.1	3.9	3.3

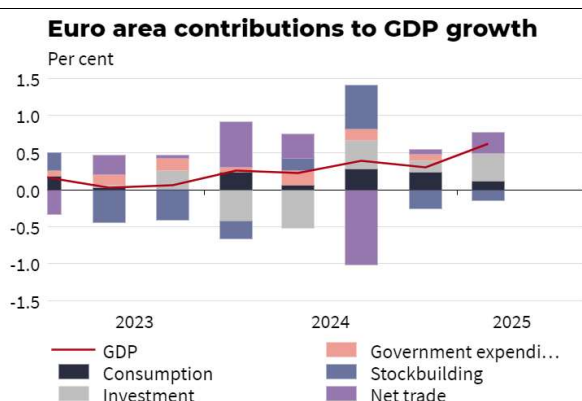
%, EoP (unless otherwise indicated)	Latest 11/06	2025f	2026f	2027f
Fed Funds target (high)	4.50	4.25	3.75	3.50
Gov 10Y, US	4.36	4.00	4.25	4.50
ECB Deposit facility rate	2.00	1.75	1.75	1.75
Gov 10Y, Germany	2.52	2.50	2.50	2.75
Gov 10Y, France	3.20	3.30	3.30	3.45
Gov 10Y, Italy	3.50	3.60	3.60	3.85
Gov 10Y, Spain	3.11	3.25	3.25	3.45
BoE, Bank rate	4.25	4.00	3.75	3.50
Gov 10Y, United Kingdom	4.60	4.25	4.00	4.00
BoJ, Bank rate	0.50	0.75	1.00	1.00
Gov 10Y, Japan	1.51	1.40	1.50	1.50
EUR / USD	1.14	1.15	1.15	1.15
EUR / GBP	0.84	0.85	0.85	0.85
USD / JPY	143	140	130	135
USD / CNY	7.2	7.4	7.4	7.3
Oil Brent (USD/b)	65	60	65	70
European Natural Gas (TTF, EUR/MgW/h)	35	60	50	45
EU ETS carbon (EUR/Metric ton)	72	80	100	110

EURO AREA

- **Growth momentum should remain weak as external competitiveness is hurt and unemployment is set to rise**
- **Growth trajectories are diverging as France is struggling with fiscal consolidation, Spain is performing better than expected, Italy suffers from low growth potential and Germany's growth benefits from the fiscal package**
- **The ECB is expected to stop its rate cut cycle after one last cut until end 2025. QT is expected to continue through 2026 limiting the rate cut transmission to long term interest rates**

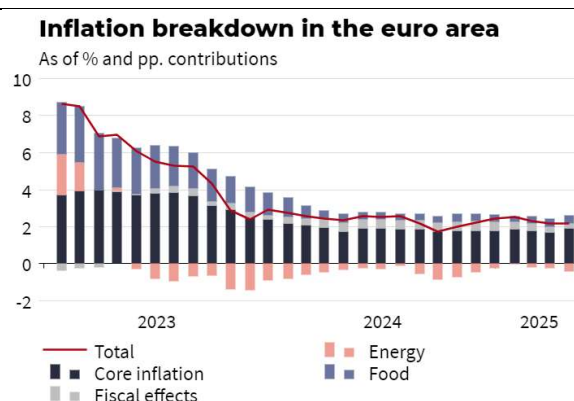
Growth momentum remains weak, held back by political and geopolitical uncertainties. The euro area economy grew by 0.6% QoQ in the first quarter of 2025, but the headline figure was distorted by export loading from Ireland, and the underlying figure for the rest of the euro area is weaker, close to 0.4%. Growth was supported by slightly stronger domestic demand, with easing inflation and renewed optimism following Germany's decision to ease fiscal constraints. Expectations of increased defence spending in the coming years helped counterbalance ongoing concerns over volatile US tariff policies. Among the major economies, Germany expanded by 0.4%, while Spain and Italy performed with growth rates of 0.6% and 0.3%, respectively. In contrast, France and the Netherlands posted more modest gains, each growing by just 0.1%. Momentum may soften in the months ahead, as US tariffs weigh on exports, while elevated uncertainty curbs business investment and household consumption.

Euro area growth remains weak



Source: Eurostat, SG Economic and Sector Studies

Disinflation has momentarily paused

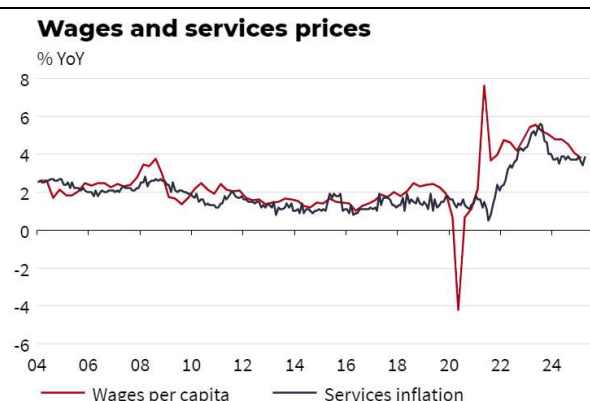


Source: Eurostat, SG Economic and Sector Studies

The disinflationary trend is resuming. CPI inflation reached 1.9% in May according to the first estimate, down from 2.2% in April and 2.5% in January. The annual core inflation rate in the Euro Area, which excludes prices for energy, food, alcohol and tobacco, also fell in May, to 2.3%. If confirmed it would add room for the European

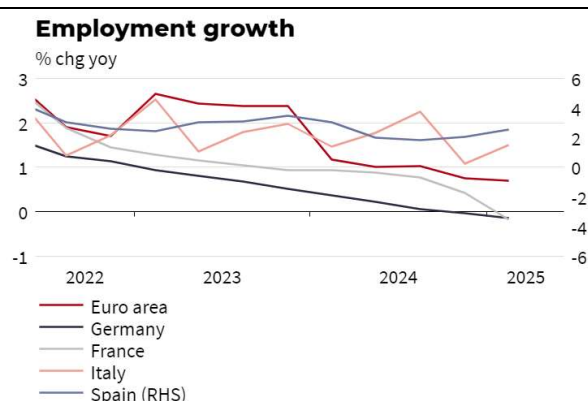
Central Bank to loosen monetary policy and attend to growth concerns. The latest ECB staff projections indicate headline inflation at 2.0% in 2025, 1.6% in 2026, and 2.0% in 2027, marking a downward revision of 0.3 p.p. from previous estimates. Core inflation is expected to average 2.4% in 2025 and 1.9% in 2026 and 2027, remaining broadly unchanged from earlier forecasts. In 2025, we also expect lower average oil prices. With the decline in employee compensation, service price inflation, which stood at 4.0% YoY in April, is expected to ease looking ahead. We expect that these disinflation trends will more than compensate in 2025 the impact of potentially additional trade tariffs that could be imposed as a retaliation to US tariffs.

Wage growth is softening



Source: Eurostat, SG Economic and Sector Studies

Employment has decelerated



Source: Eurostat, SG Economic and Sector Studies

One more ECB rate cut expected. After four reductions of 25bp since January to 2%, we anticipate one more cut by the end of 2025. The weakness of the activity could justify additional cuts. In our central scenario we contemplate only one, with the risk that more are needed. The monetary conditions would remain restrictive, with the ECB's quantitative tightening implying still tight liquidity conditions. Our view is that ECB will pursue its QT well into 2026, and possibly beyond. Thus, credit growth should remain modest, despite the ECB's rate cut, with credit conditions still tight.

Tariff measures announced by President Trump are an additional headwind.

The threatened 50% 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 already struggling. The EU may, moreover, respond with its anti-coercion instrument, a legal framework consistent with the WTO, which enables it to adopt strong response measures (tariffs, quotas, etc.) in retaliation against for coercive actions from a third country. The risk of trade tariffs on European exports is also not yet stabilised towards China, after the increase in customs 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 elevated levels of uncertainty will weigh on business momentum.

Fiscal policy is set to become more restrictive, but significant room for defence spending is likely to be found. Fiscal policy is becoming more restrictive in several countries of the euro area, France in particular, where adjustment is needed. However, some factors will remain supportive. The current disbursement of NGEU funds should still be favourable in several member states until 2026. The Bundestag has voted to reform the 'debt brake,' paving the way for additional spending on defence and infrastructure. At EU level, the Commission announced several measures to increase defence spending, including a derogation from the Stability and Growth Pact that will allow Member States to spend more on defence without being subject to an excessive deficit procedure.

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, which we do not anticipate in our central scenario, could pose an inflationary risk.

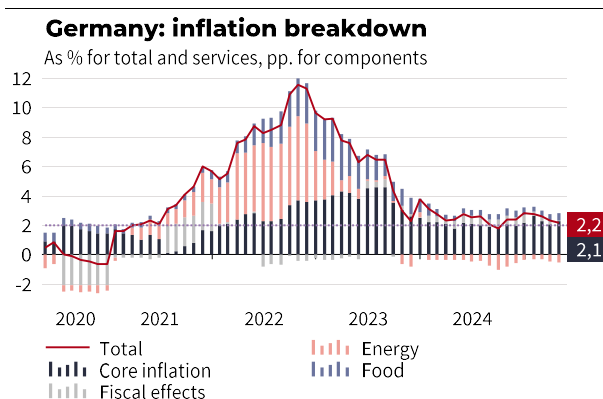
Euro area	2024	2025f	2026f	2027f
Real GDP, % YoY	0.8	0.7	0.8	1.0
Household consumption	1.0	0.6	0.6	0.7
Public consumption	2.7	0.8	0.6	0.8
Investment	-1.9	0.8	1.7	1.7
Exports of goods & services	1.0	0.0	1.5	2.2
Imports of goods & services	0.3	1.1	2.1	2.4
Inflation, % annual average	2.4	2.1	2.0	1.7
Core inflation, % annual average	2.8	2.0	1.8	1.7
Real gross disposable income (GDI), % YoY	2.2	0.6	0.6	0.7
Households saving rate, % of GDI	15.3	15.2	15.2	15.2
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	91	91	92
Current account balance, % of GDP	2.7	1.7	1.5	1.5

GERMANY

- **A strained international context and domestic uncertainties will constrain growth to 0.3% in 2025**
- **A strong rebound is expected from 2026 as the policy mix softens, including an accelerated implementation of the fiscal package**
- **Downward pressures on short-term inflation are to materialise as the euro strengthens and energy prices ease**

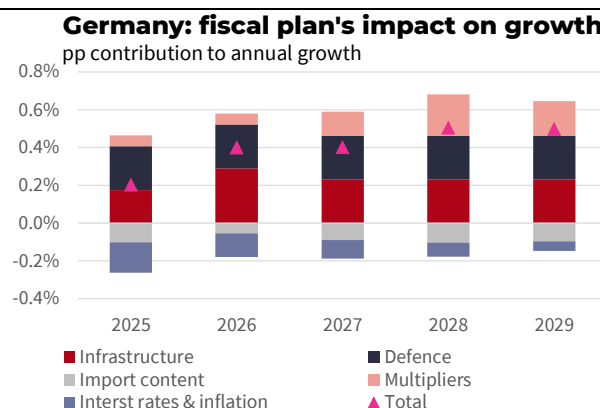
External demand will act as a drag on growth in 2025, as exporters face structural headwinds, a challenging global environment not least from US tariffs, and a strong euro. The 1Q25 strength in frontloaded exports—notably to the US in the automobile and pharmaceutical sectors—will be short-lived. Under our current trade policy (10% bilateral tariff with the US) and exchange rate assumptions, German exporters' competitiveness remains under pressure. Beyond price competitiveness, structural challenges persist, particularly in flagship industries. For example, the automobile sector—which accounts for 17% of German exports—faces difficulties in China (because their local competitors have better products) and in the US (because of the new tariffs). The transition to EVs and software-defined vehicles, coupled with shifting consumer preferences (e.g., reduced emphasis on speed and a preference for smaller vehicles), is eroding German carmakers' competitive edge, even within the luxury segment, which has traditionally been a cornerstone of their competitive strength.

Inflation is oriented to the downside given the strength of the euro and easing energy prices



Source: Destatis, SG Economic and Sector Studies

Merz's fiscal plan will provide a significant lift to growth over the medium term



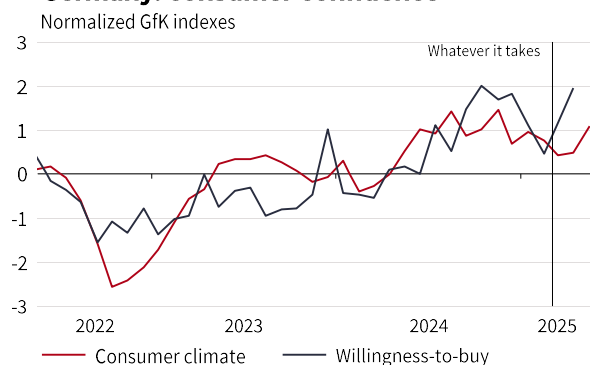
Source: SG Economic and Sector Studies

The euro appreciation and declining energy prices are expected to bring inflation back to target in 2025, despite active tariff policy. Price measures, including sticky core and service inflation, will continue to decline as the labour market softens and wage dynamics ease. Imported deflationary pressures are significant as relative prices in euros fall, and the risk of dumping of Asian

commercial surpluses in Europe rises. The strength of the currency will also offset most of the inflationary effects of eventual retaliatory tariffs.

Households will resume consumption leveraging their regained purchasing power

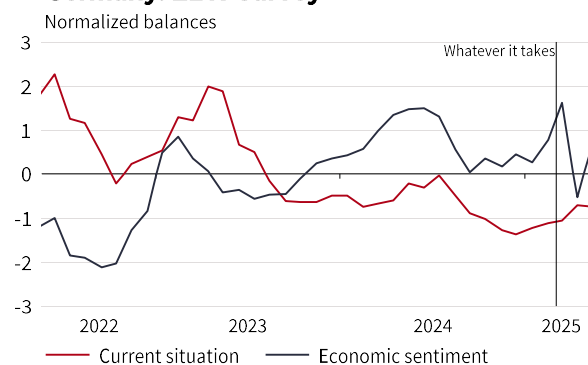
Germany: consumer confidence



Source: GfK, SG Economic and Sector Studies

Investment decisions will be slowed in 1H on the back of global uncertainty

Germany: ZEW survey



Source: ZEW, SG Economic and Sector Studies

Activity is set to strongly rebound in 2026 and 2027 (1.1% and 1.3% respectively) as domestic demand picks up and Merz's fiscal package gradually ramps up.

Fiscal investment and consumption will accelerate as the new Government implements its programme (including tax cuts) and the disbursements for new infrastructure and defence projects begin. The allocation of EUR 100bn from the infrastructure fund for climate projects will reinvigorate the transition efforts in the country. On the private side, sentiment has shown signs of improvement following the elections and Merz's *Whatever-it-takes* announcement, even if it was muted as trade uncertainty increased. Households will continue to expand consumption on the back of recovering purchasing power, even if wages are set to slow more than previously anticipated. Consumers are expected reduce some of the caution that characterized their behaviour since the energy crisis. This, along with lower inflation eroding effects on wealth, should enable the saving rate to decline over the forecast horizon albeit remaining significantly above its pre-pandemic level.

Business investment is set to enjoy a policy induced lift, and residential investment should also continue to accelerate given the recovery of the housing market (+4% in prices from December 2023 to April 2025). As global trade policy stabilises and foresight among economic agents recovers, productive investment will recover, enhancing the implementation of the fiscal package. The prospects of corporate tax cuts are expected to boost private investment improving the investment outlook.

Risks are mixed, especially regarding the implementation of the fiscal package.

A swift and quick kick-start in the implementation of the package would brighten the short-term outlook. It will require *a minima* an efficient identification of projects, the elimination of bureaucratic hurdles, and efficient cooperation between public and private actors along the value chains. The scope and extent of the multiplier effects of the package are conditional on an appropriate allocation of funds and the

availability of factors of production. The risks of “pork-barrel” spending initiatives, frictions along the supply chains, and the scarcity of qualified labour are to bear in mind. Assertive action on the capital market union project will also unlock funds to boost private investment. On the downside, increasing frictions in the decision making and processes in recruiting and sourcing, coupled with excessive red tape, will dampen its positive effects on activity. Tensions with European fiscal rules are also to be kept in mind and could delay the implementation.

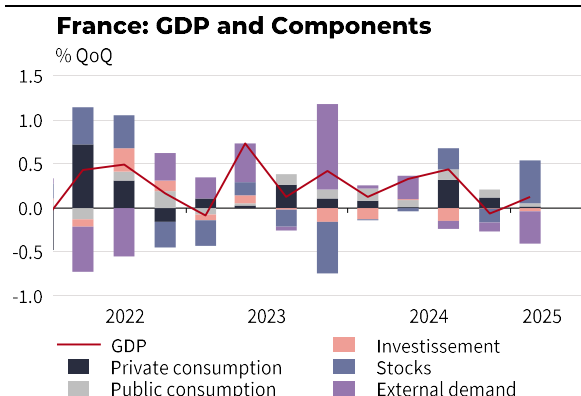
Germany	2024	2025f	2026f	2027f
Real GDP, % YoY	-0.2	0.3	1.1	1.3
Household consumption	0.2	0.7	0.9	1.0
Public consumption	3.2	1.5	1.4	1.2
Investment	-2.5	0.5	3.4	3.4
Exports of goods & services	-1.7	-0.7	1.6	1.9
Imports of goods & services	-0.6	1.5	2.7	2.5
Inflation, % annual average	2.5	2.0	2.0	1.9
Core inflation, % annual average	3.2	2.0	2.0	1.9
Real gross disposable income (GDI), % YoY	1.3	0.6	0.8	1.1
Households saving rate, % of GDI	20.1	20.0	19.9	19.9
Unemployment, % of labour force	6.0	6.4	6.4	6.3
Fiscal balance, % of GDP	-3.4	-3.0	-3.0	-3.2
Public debt, % of GDP	62	65	67	68
Current account balance, % of GDP	5.7	5.2	4.8	4.6

FRANCE

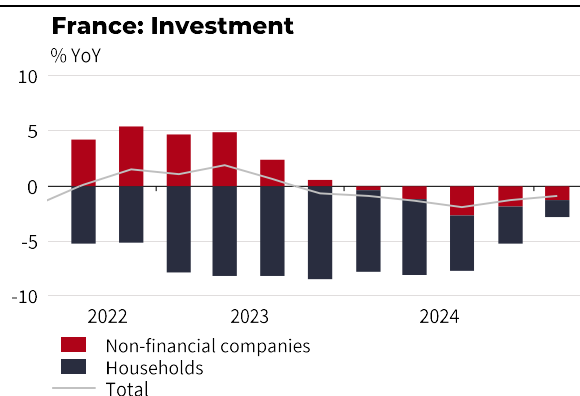
- The French economy has entered a phase of moderate growth, constrained by fragile domestic demand and a decline in investment
- Employment will be under pressure, with unemployment rising to around 8% in 2025-26, driven by the end of apprenticeship subsidies and corporate productivity adjustments
- The public deficit will remain high, despite a gradual adjustment. Debt servicing costs are increasing and upcoming budgetary trade-offs could heighten political and social tensions

The French economy is entering a phase of moderate growth, constrained by fragile domestic demand and declining investment. Political uncertainty and trade tensions continue to impact businesses, delaying expansion projects, while residential investment remains subdued among households. Economic activity is expected to slow in 2025-26, before experiencing a gradual recovery from 2027. This economic stagnation is likely to weigh on the labour market, with unemployment nearing 8%. Despite inflation falling below 2%, household purchasing power will remain limited. Fiscal pressure will remain high, and the public deficit is projected to exceed 5% of GDP in 2025 and 2026.

Uncertainty continues to hinder activity



Investment remains constrained



Source: INSEE, SG Economic and Sector Studies

Domestic demand remains stable. However, this momentum is fragile and could be challenged if economic uncertainty persists. The investment recovery is sluggish, affected by restrictive financing conditions, and increased taxation. Despite some signs of rebound in Q1, household residential investment remains in yearly contraction. Businesses continue to postpone their expansion projects. Weak corporate investment is also due to the decline in the manufacturing sector. This trend is also exacerbated by the French socio-political uncertainties following the dissolution of parliament in June 2024. The decline in interest rates will have only a limited effect.

Foreign trade, which had supported growth in 2024, is expected to slow down.

Exports, which previously benefited from strong global demand, are now facing obstacles due to international trade tensions, particularly with the United States. The introduction of new tariff barriers is affecting several key sectors, including aerospace and wines & spirits. As a result, we anticipate a marked slowdown in exports for 2025, followed by modest growth over the forecast horizon.

A short-term element of uncertainty arises from the recent accumulation of inventories. According to INSEE, inventory changes positively contributed to GDP growth in Q1 2025 (+0.5pp), as businesses, facing weaker domestic and external demand, stocked up on products. The risk now lies in a production slowdown over the coming quarters, as firms may adjust supply downwards to clear excess inventory, potentially worsening the economic deceleration.

The labour market is expected to deteriorate, with unemployment rising to around 8% in 2025-26. Job creation is slowing, particularly due to the end of apprenticeship subsidies, which had supported youth employment in recent years. Additionally, businesses facing uncertain demand are focusing on productivity optimisation, further limiting employment growth. Concerns about unemployment remain high, driving greater household caution and sustaining a high savings rate.

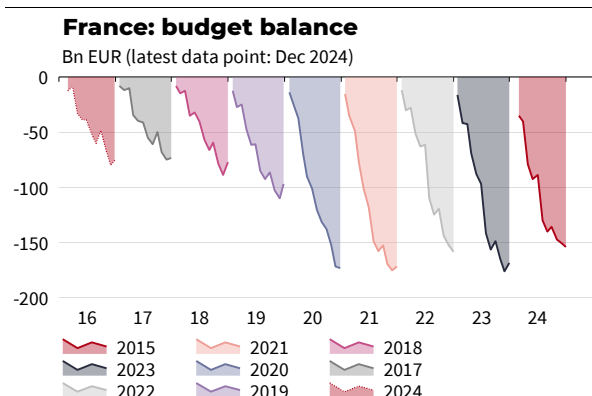
Inflation could fall below the 2% threshold, due to the moderation of energy prices and consumer goods. However, core inflation remains above pre-COVID levels, particularly in services, where disinflation is progressing more gradually. As a result, household purchasing power is improving slightly, but caution remains high, reflecting continued uncertainty in spending behaviour.

We anticipate a moderate recovery starting in 2027, driven by a decline in political tensions after the presidential elections and the need to finance strategic projects. The green transition will play a key role, which should stimulate industrial investment. Additionally, geopolitical conditions will encourage governments to increase defence budgets, further strengthening investment prospects in this sector. This momentum should support a gradual restart of investment.

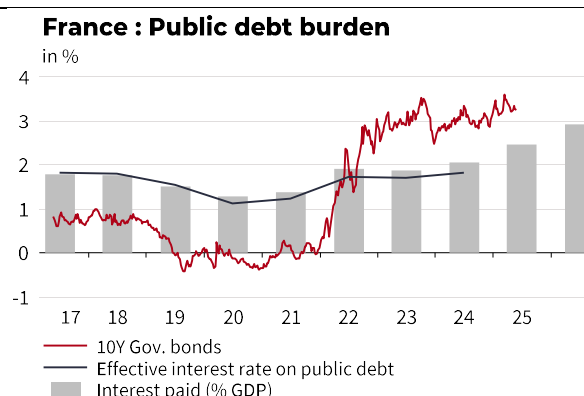
Public finances will remain under pressure. With ongoing efforts towards fiscal consolidation, the public deficit should reach 5.5% of GDP in 2025, showing slight improvement compared to 6.2% in 2024, but public debt continues to rise due to higher interest costs and mandatory expenditures. Beyond 2025, the budgetary trajectory is uncertain. The government will need to balance spending cuts with economic support, which could intensify political and social tensions. In the short term, pension reform remains a key concern, as discussions with social partners have resumed under the condition that financial equilibrium is achieved by 2030. Additionally, the government's commitment to increase defence spending to 3.5% of GDP by 2030 (excluding pensions) adds another budgetary constraint. This strategy unfolds in a context where the executive refuses to invoke the EU's exception clause on military spending, potentially limiting fiscal flexibility. Given

these conditions, we foresee a structural adjustment lower than that communicated in the medium-term programme approved by the European Commission in October 2024. Thus, we expect the public deficit to remain above the authorities' targeted 3%, while public debt continues rising, reaching 120% of GDP by 2029.

Public finances have significantly deteriorated



An increased debt burden



Source: Refinitiv, DGECEFIN, Economic and Sector Studies

The risks to this scenario are tilted to the downside, including a potential deterioration in the national socio-political environment, particularly during the 2026 budget process, which could increase uncertainty and prolong the wait-and-see behaviour among economic agents. A worsening of trade tensions – especially due to protectionist measures from President Trump – could further weaken foreign demand, reducing growth prospects for French exports.

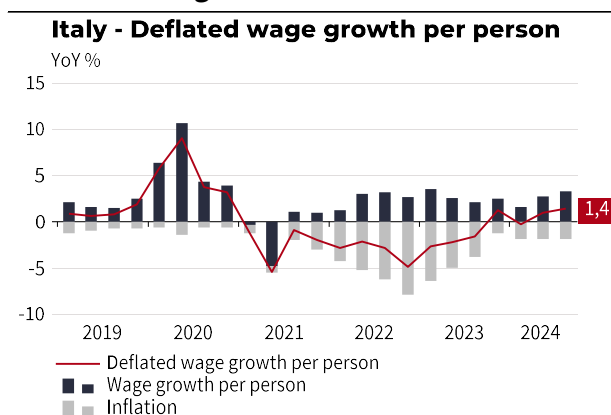
France	2024	2025f	2026f	2027f
Real GDP, % YoY	1.1	0.6	0.6	0.9
Household consumption	1.0	0.7	0.7	0.9
Public consumption	1.4	0.7	0.1	0.6
Investment	-1.3	0.1	1.0	1.4
Exports of goods & services	2.4	1.0	2.3	2.6
Imports of goods & services	-1.3	1.3	2.5	2.7
Inflation, % annual average	2.3	1.5	1.8	1.7
Core inflation, % annual average	2.3	1.8	1.8	1.8
Real gross disposable income (GDI), % YoY	2.5	0.4	0.2	0.4
Households saving rate, % of GDI	18.2	17.9	17.4	16.9
Unemployment, % of labour force	7.2	7.8	8.1	8.0
Fiscal balance, % of GDP	-5.8	-5.5	-5.0	-4.6
Public debt, % of GDP	113	116	118	120
Current account balance, % of GDP	0.4	-0.1	-0.2	-0.2

ITALY

- GDP growth will remain sluggish in 2025 and 2026, with a normalisation of household investment
- Households purchasing power is expected to continue to slightly increase
- Italy has managed to plan a primary surplus for 2025, but not large enough to stabilize the public debt to GDP ratio

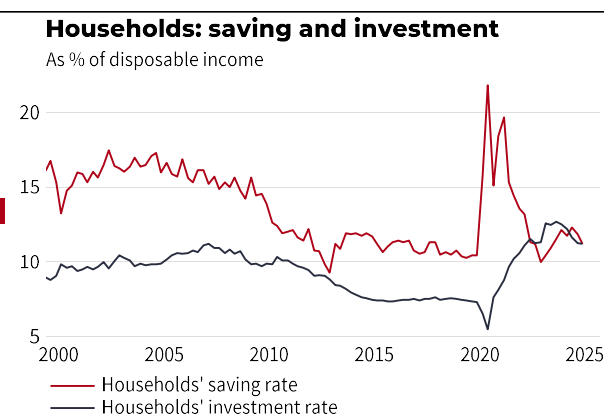
After clocking in weaker-than-expected in 2024, growth is set to remain sluggish in 2025 and 2026. The withdrawal of housing renovation support programmes (*super-bonus*) will generate a prolonged contraction in household investment, while global demand will be weakened by the trade tensions induced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

Rise in real wages...



Source: Istat, SG Economic and Sector Studies

... and fall in households investment rate



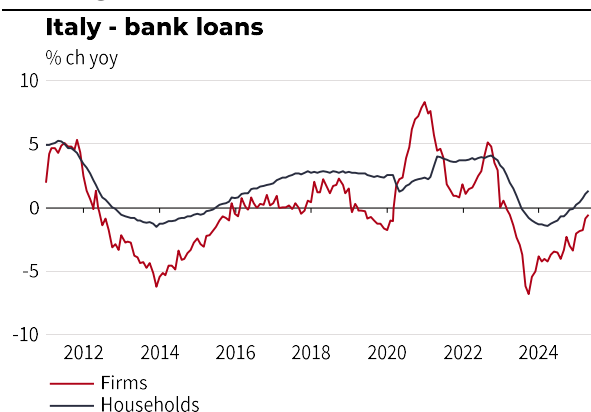
Source: Istat, SG Economic and Sector Studies

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 higher import prices, especially on gas.

Employment is expected to slow significantly from 2026 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. The main explanatory factors are limited migration and poor demographic dynamics.

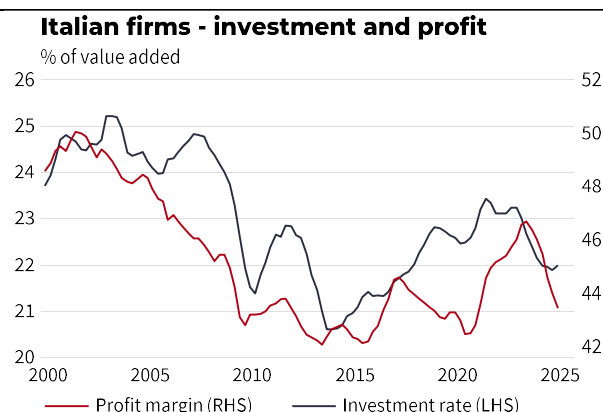
Household purchasing power is expected to increase slightly over the 2025-27 period after dynamic growth in 2024. Nominal wages, which in 2024 benefited from contract renewals reflecting past price increases, are expected to slow gradually. From 2026 onwards, household consumption is expected to be supported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

Banking credit normalises



Source: Istat, SG Economic and Sector Studies

Corporate profits have fallen



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 reduced: the tax credit rate has been reduced from 110% to 70% in 2024 and to 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 allocation of EUR 194bn, and therefore a strong incentive to maintain a cooperative attitude with the European Union and to implement key structural reforms, in particular 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 time profile 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 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.

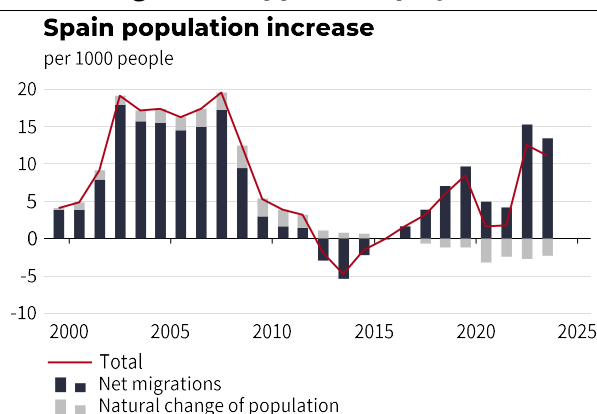
Italy	2024	2025f	2026f	2027f
Real GDP, % YoY	0.5	0.6	0.5	0.5
Household consumption	0.4	1.1	0.5	0.5
Public consumption	1.1	0.2	0.4	0.4
Investment	0.0	1.8	0.9	0.7
Exports of goods & services	-0.3	1.6	1.3	2.3
Imports of goods & services	-1.5	2.7	1.4	2.5
Inflation, % annual average	1.1	1.8	1.8	1.7
Core inflation, % annual average	2.2	1.6	1.8	1.7
Real gross disposable income (GDI), % YoY	1.0	1.8	0.6	0.4
Households saving rate, % of GDI	11.8	12.4	12.4	12.4
Unemployment, % of labour force	6.6	6.0	6.1	6.4
Fiscal balance, % of GDP	-3.5	-3.4	-3.1	-3.1
Public debt, % of GDP	136	138	139	140
Current account balance, % of GDP	1.1	0.6	0.7	0.5

SPAIN

- **Growth will continue to outperform, supported by the influx of foreign labour**
- **Spain has little direct exposure to the United States and would suffer less than its neighbours from an increase in US tariffs**

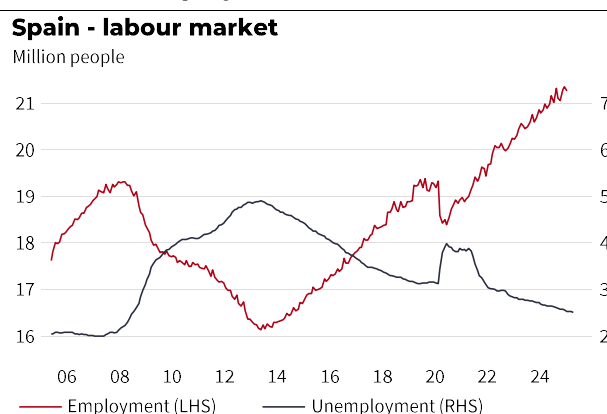
Growth will remain dynamic in 2025 and should come closer to its potential in 2027. It will remain higher than that of its European partners, supported by the European Recovery Plan, a very dynamic tourism sector and a job market benefiting from an influx of foreign labour. The unemployment rate, now below its structural level, is expected to stabilise at around 11% of the working population. Global demand will nevertheless be weakened by trade tensions induced by the protectionist measures promised by President Trump. Spain is relatively less exposed than its European neighbours, as its exports of goods to the United States do not exceed 5% of total exports and 1.1% of GDP. The most affected sectors will be machinery, electrical appliances, chemicals, pharmaceuticals, and the food industry.

Inward migration supports employment...



Source: INE, SG Economic and Sectoral Studies

... and unemployment continues to decline



Source: INE, SG Economic and Sectoral Studies

Household consumption is expected to continue supporting growth through 2027, benefiting from a strong labour market and moderating inflation. Purchasing power gains are expected to slow in 2025 after two years of robust growth but are expected to continue to rise thanks to the resilience of wages and employment, as well as pension increases. Job creation is expected to continue in 2025-26 at a more moderate pace, allowing companies to record productivity gains and rebuild their margins. The savings rate – which reached a level above its historical average in 2024 – is expected to adjust slightly, allowing households to cope with the slowdown in their purchasing power.

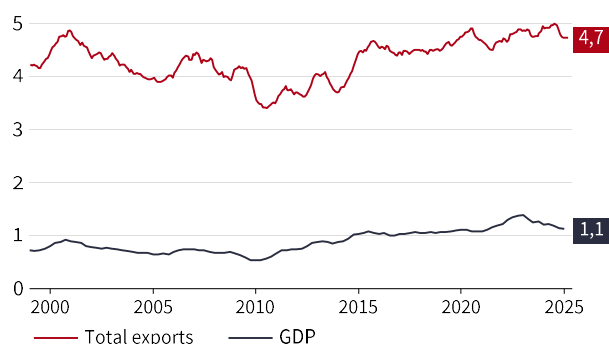
Inflation, still close to 3% in 2024, is expected to slow to around 2.4% in 2025 and fall below the 2% ECB's target in 2027. Energy and food prices are temporarily rising this year due to exceptional factors, but core inflation continues to decline. It

is nevertheless expected to be supported this year by higher prices for imported goods, impacted by the trade retaliatory measures envisaged.

Low dependence on the United States

Spain, exports to the US

As a share of... %

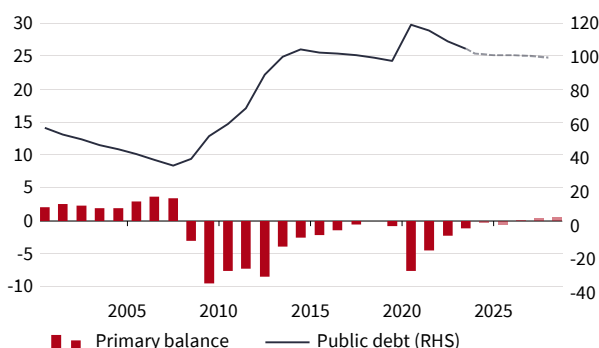


Source: INE, SG Economic and Sectoral Studies

Public debt will stabilize at a high level

Spain - public debt and primary balance

GDP %



Source: INE, SG Economic and Sectoral Studies

Business investment is expected to remain buoyant until 2026, benefiting from the last year of the European Recovery Plan. From the beginning of the Plan through the end of 2024, public contracts and grants worth EUR 46bn are expected to have been awarded, the equivalent of 2.9% of GDP and 58% of the allocated funds. SMEs and microenterprises represent 46% of all beneficiaries and have received 35% of the total allocated funding. Funds are being distributed across the entire territory, with a relative focus on regions with lower per capita income. Autonomous regions of Spain with lower per capita income, such as Extremadura or Galicia, have received a higher volume of funds in relative terms. But recent data show a slowdown in the execution pace of both public tenders and grants. While 89% of the tenders have already been awarded, only 15% of the grant funding has been spent and more than 40% of the projects have not issued a grant. While the Plan is progressing, the current pace is not sufficient to complete all planned investments. Reaching 100% of the committed funding would require a 29% acceleration in the execution rate, up to EUR 1.5bn per month.

This gap between the allocation and actual execution of spending is significant: in its early days, it reduced the countercyclical effectiveness of the Plan, and today it limits the immediate impact on employment and private investment and erodes institutional credibility. The execution of the funds coincided with a significant recovery, but without investment support. The redirection of funds that the government has proposed in recent weeks could help speed up implementation. EUR 5bn will be used to mitigate the impact of the increase in tariffs by the United States on Spanish exporting companies. Similarly, it is expected that just over EUR 1.3bn from the Plan will be used to meet commitments to increase defence spending.

Fiscal policy is easing in 2025 to address the cost of the unprecedented floods in the Valencia region. The government has allocated a budget of EUR 14bn to help households and businesses cope with the consequences of this disaster. Fiscal policy

is expected to resume a restrictive stance in 2026, allowing the budget deficit to fall below 3% of GDP. After five years of decline, public debt is still 4pp of GDP higher than its pre-COVID level, and it is expected to fall slightly over the horizon of our forecast.

The main risks to this forecast are a sharp increase in tariffs from the United States, which would curb Spanish exports and affect the growth of its European neighbours. From 2027, the end of European subsidies could give rise to a marked slowdown in investment and halt the country's growth dynamics.

Spain's left-wing minority government, led by Pedro Sánchez of the centre-left PSOE, who was re-elected in November 2023, remains intrinsically unstable owing to the high number of regional parties on which it depends. Last year, the Socialist government had to contend with difficult negotiations with Catalan separatists over an amnesty law and allegations of corruption against Mr Sánchez's wife that made him consider resigning. There is a risk of policy paralysis and of the government collapsing before the end of its term in 2027.

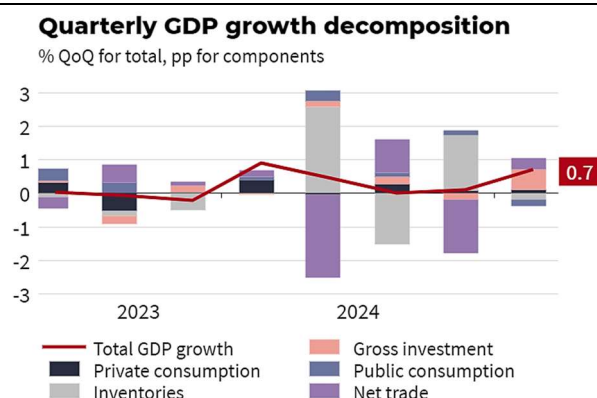
Spain	2024f	2025f	2026f	2027f
Real GDP, % YoY	3.2	2.3	1.8	1.6
Household consumption	2.9	2.6	2.1	1.8
Public consumption	4.1	1.9	1.3	0.8
Investment	3.0	4.3	2.7	1.9
Exports of goods & services	3.1	2.2	2.2	2.5
Imports of goods & services	2.4	3.3	2.8	2.5
Inflation, % annual average	2.9	2.5	2.2	1.8
Core inflation, % annual average	2.8	2.2	2.1	1.8
Real gross disposable income (GDI), % ch YoY	4.2	2.2	1.7	1.5
Households saving rate, % of GDI	13.6	13.2	12.8	12.6
Unemployment, % of labour force	11.3	10.9	10.9	11.1
Fiscal balance, % of GDP	-2.8	-3.2	-2.6	-2.5
Public debt, % of GDP	102	101	101	101
Current account balance, % of GDP	3.0	2.0	2.0	2.1

UNITED KINGDOM

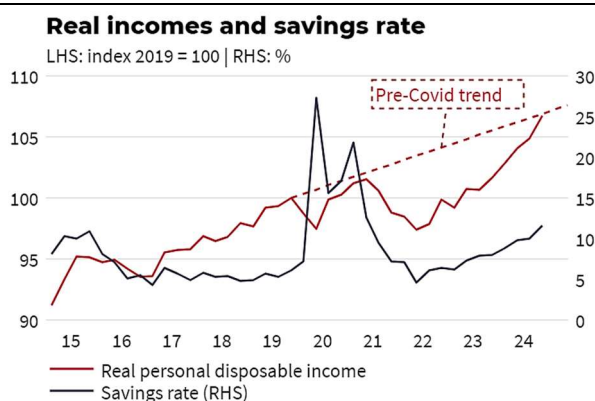
- Despite a front-loaded 1Q25 activity, underlying economic fragilities will emerge in a context of persistently weak activity
- Household consumption and investment will remain subdued in 2025, while fiscal policy will provide countercyclical support to growth
- Inflation is set to remain sticky in 2025-26, with the BoE following a cautious pace of rate cuts, reaching 4% by year-end

Activity was front-loaded in 1Q25, and underlying economic fragilities will emerge in a context of persistently weak activity. The 1Q25 uptick in activity (+0.7% QoQ) temporarily boosted growth figures, driven by businesses accelerating investment and exports to the US in anticipation of forthcoming increases in US tariffs. However, this front-loaded performance masks underlying economic vulnerabilities that will become increasingly apparent as the business cycle continues to weaken. GDP has already contracted by 0.3% in April. Countercyclical measures – fiscal stimulus and monetary policy easing – are expected to partially offset subdued private demand. We project real GDP to grow by 0.9% in 2025, with risks tilted to the downside due to elevated gilt market financing costs and heightened global geopolitical uncertainty.

A front-loaded 1Q25 growth



High real incomes and savings rate



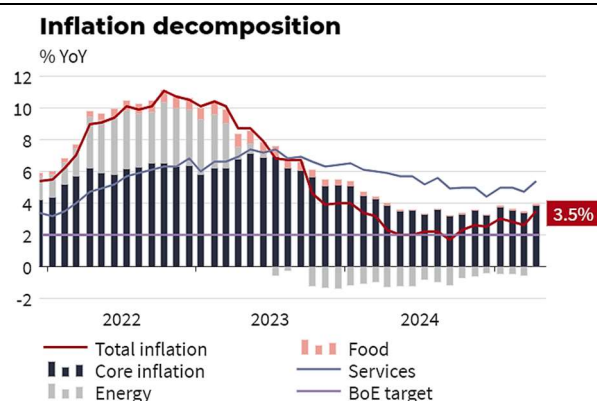
Sources: ONS, Refinitiv, SG Economic and Sector Studies

Household consumption will remain subdued in 2025 before rising gradually over the forecast period. Ongoing global uncertainty, a deteriorating labour market, and elevated gilt yields slowing mortgage rate declines have driven consumer confidence to its lowest level since December 2023. This is fostering higher precautionary savings and perpetuating the post-pandemic trend of suppressed consumption despite real income growth. Looking ahead, we anticipate a gradual rise in private consumption through 2027, supported by monetary policy easing and rising real incomes as uncertainty subsides. The household savings rate will decline but remain above its long-term average due to scarring from successive economic shocks, including Brexit, Ukraine War, the energy price crisis, and trade tensions.

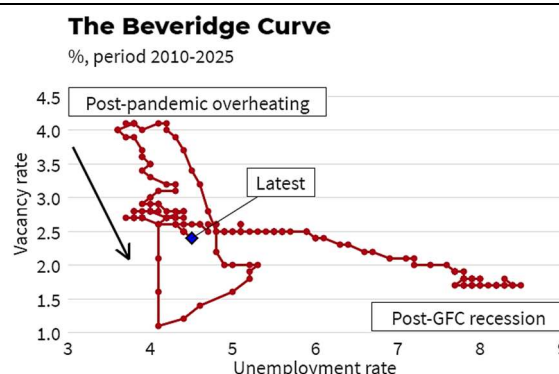
Business investment growth will weaken in the coming quarters as uncertainty and rising cost pressures take hold. Despite the 1Q25 investment uptick, momentum is unlikely to be sustained. The April increases in employer National Insurance Contributions, National Living Wage, and US tariffs will erode the already-squeezed profit margins and weigh on investment for the remainder of the year. Business confidence has remained in negative territory for three consecutive quarters, with BoE agents' surveys indicating that investment intentions are at their lowest level since the pandemic. Looking ahead to 2026-27, we expect a recovery in investment as firms restore margins by reducing hiring and wages. At the same time, government planning regulation reforms are expected to facilitate construction and housebuilding, while increased public investment in defence and the climate transition should crowd in private investment.

Public spending is set to support growth in 2025-26. The countercyclical fiscal stimulus announced last Autumn is projected to increase public spending by GBP 72bn (2.5% of 2024 GDP) per year over the next five years. The March 2025 Spring Statement did not change the overall direction of fiscal policy while implementing targeted adjustments to ensure compliance with the country's fiscal rules. The government introduced modest cuts to welfare and day-to-day spending – totalling GBP 4.8bn and GBP 3.6bn per year respectively (0.17% and 0.14% of 2024 GDP). At the same time, defence and public investment received a boost of GBP 16.4bn over the five-year period, equivalent to 0.6% of 2024 GDP, reflecting strategic priorities in national security and capital spending.

Inflationary pressures remain persistent



The labour market is easing



Sources: ONS, Refinitiv, SG Economic and Sector Studies

Inflation is set to remain elevated through 2025-26, before converging to the BoE's 2% target in 2027. Headline inflation reached 3.5% YoY in April, its highest level in 15 months. The rise was driven by increased household energy costs following the Ofgem price cap adjustment, alongside rises in regulated water tariffs and the Vehicle Excise Duty. Core domestic price pressures remain persistent, with services inflation accelerating to 5.5% amid sustained wage growth. We forecast that the fiscal expansion and persistent wage pressures will sustain inflation at an average of 2.8% YoY in 2025, although declining oil prices are expected to provide some offsetting

downward pressure. However, the labour market is cooling, as businesses adjust employment levels and wages to manage rising labour costs and restore their margins. Recruitment difficulties reported by firms have fallen to their lowest level since 2021, and the vacancy-to-unemployment ratio has returned to the pre-pandemic average. We expect this trend to produce disinflationary momentum in the medium term, with inflation returning to the BoE's 2% target in 2027.

The BoE should follow a cautious pace of rate cuts, reaching 4% this year. The BoE faces a complex policy balancing act, with persistent price pressures and inflation expectations requiring prudence, while the current business cycle downturn necessitates countercyclical accommodative measures. Following the 8 May decision to reduce rates by 25bp to 4.25%, we expect a cautious easing cycle with an additional 25bp reduction in 4Q25, continuing in 2026 as inflationary pressures subside.

Risks to the outlook are tilted to the downside. Gilt yields spiked in 1Q25, highlighting the UK's vulnerability to bond market volatility. Unexpected yield increases could force public spending cuts to comply with fiscal rules. Additional risks are linked to international geopolitical tensions. Heightened uncertainty and an expansion in US tariffs – even if not directly targeting the UK – could weigh on the outlook by dampening confidence and reducing external demand.

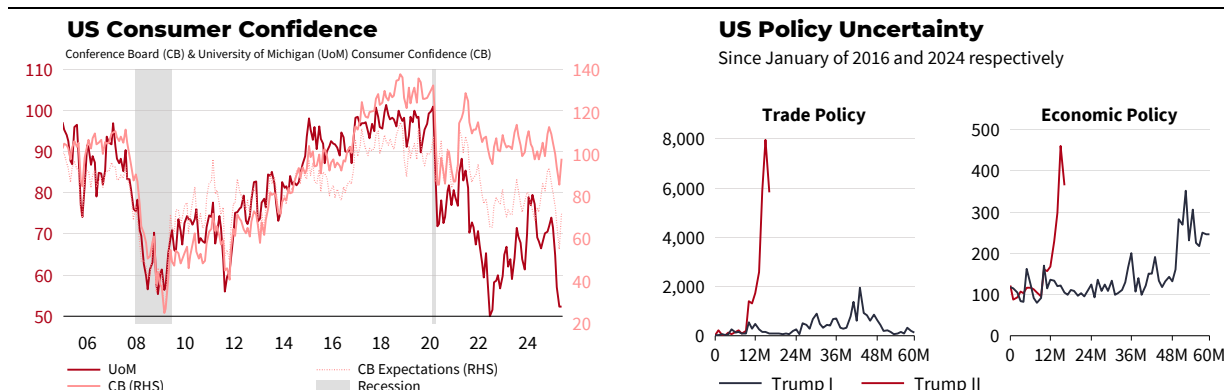
UK	2024	2025f	2026f	2027f
Real GDP, % YoY	1.1	0.9	1.0	1.2
Household consumption	0.6	0.8	0.8	1.0
Public consumption	3.0	4.3	2.1	1.5
Investment	1.5	1.1	1.5	2.3
Exports of goods & services	-1.2	0.9	1.0	1.4
Imports of goods & services	2.7	2.3	2.3	2.5
Inflation, % annual average	2.5	2.8	2.3	2.1
Core inflation, % annual average	3.7	2.8	2.3	2.0
Real gross disposable income (GDI), % YoY	4.0	0.7	0.9	0.7
Households saving rate, % of GDI	10.1	10.0	9.9	9.5
Unemployment, % of labour force	4.3	4.7	4.8	4.9
Fiscal balance, % of GDP	-5.9	-5.7	-5.5	-5.3
Public debt, % of GDP	97	100	102	103
Current account balance, % of GDP	-2.7	-3.4	-3.5	-3.6

UNITED STATES

- Despite de-escalation of tensions with China, volatile tariffs have seen trade uncertainty soar, weighing on domestic demand.
- The 'One Big, Beautiful Bill' is poised to pass, with a limited lift to growth and weighing on federal debt.
- The Fed is stuck between its dual mandate, will continue to wait-and-see.

The administration's "Liberation Day" announcements on 2 April took markets and trade partners by surprise. While Trump's team has stepped back from the brink of decoupling with China, the average effective tariff rate has risen to 12.3% from 2.8% prior to Trump's tenure, with significant upside risks. Should negotiations on 'reciprocal' tariffs falter, or if issues such as semiconductor tariffs and secondary tariffs on buyers of Venezuelan and Iranian oil resurface, the average effective tariff could potentially exceed 30%. On the other hand, the use of the International Emergency Economic Powers Act to impose "reciprocal" and fentanyl tariffs remains contentious. A ruling by the Court of International Trade has struck down these measures, however a temporary reprieve is currently allowing revenue collection to continue pending an appeal. A final legal ruling could yet overturn these tariffs, adding further uncertainty to the trade outlook. Racing to beat impending tariffs, businesses accelerated imports in the first quarter, but signs are already emerging of this behaviour slowing. Goods imports fell by 19.9% MoM in April following a record high in March, which brought imports roughly back in line with levels last seen in November 2024. We anticipate this import volatility will continue over the next 12 months, with frontloaded demand this year followed by diminished import growth next year, prompting us to revise our import growth forecast from 2.7% YoY to 2.1% in 2026.

Tariff uncertainty is hurting consumer confidence



Sources: University of Michigan, The Conference Board, Baker, Bloom & Davis, Refinitiv, SG Economic and Sector Studies

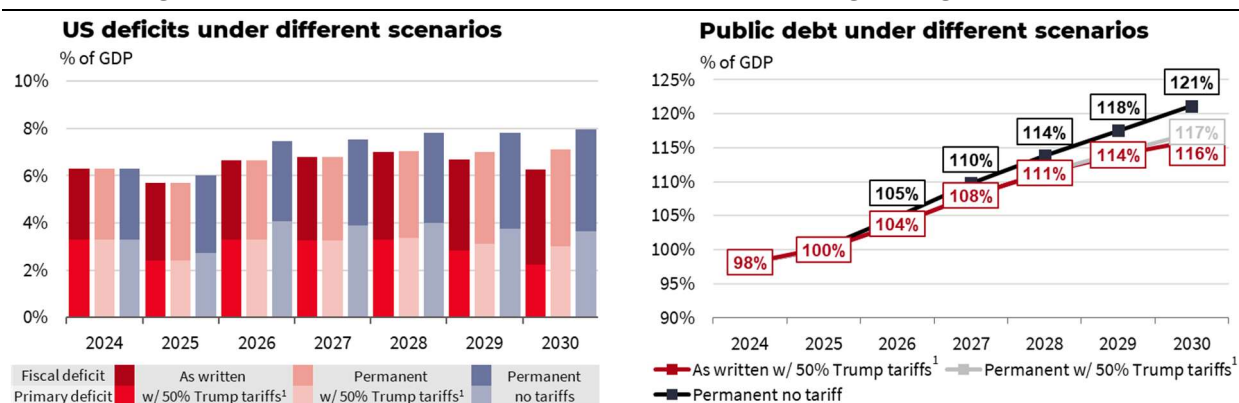
Consumer sentiment is notably pessimistic, as reflected by the sharp declines in confidence reported by the University of Michigan and the Conference Board,

alongside rising inflation expectations. Although consumer prices have yet to reflect the impact of tariffs, major American companies, including Walmart and Procter & Gamble, have indicated that price hikes are imminent. Consequently, we expect consumer demand to be weaker than previously anticipated, leading to a downward revision of household consumption from 1.9% YoY to 1.7%.

Increased tariff revenues and spending cuts should slightly improve government finances this year. However, the administration’s “One Big, Beautiful Bill” is projected to widen deficits over the next decade. The bill, which is currently making its way through the Senate, is expected to increase primary deficits by approximately USD 3.3tr over the next decade. Under our central scenario the budget bill will be signed into law this summer, albeit with some potential changes in the Senate. Looking ahead, we make the working assumption that tax provisions set to expire in 2028 and 2029 will do so. We further assume that a 15% tariff rate¹ persists until at least 2030, due to the political challenges of replacing this revenue.

These assumptions are uncertain, and we illustrate alternative scenarios on the charts below. In 2025, the combination of higher tariffs and an accounting convention that allows USD 200bn in cuts to student loans subsidies to be recorded upfront will bring the fiscal deficit down to 5.7% of GDP. From 2026, the extension and expansion to the 2017 Tax Cuts and Jobs Act and brand-new cuts on overtime, tips and raising the state and local tax deductions cap will take effect, reducing revenues by around USD 600bn compared to the CBO baseline. As wider deficits and rising inflation expectations, coupled with concerns about the Fed’s independence, drive up the term premium, interest payments on public debt will increase. In this scenario, public debt is projected to soar from 99% of GDP in 2025 to 128% in 2035, while the fiscal deficit is expected to exceed 7% of GDP in 2028, before declining to 6.3% in 2030 as certain tax cuts expire.

The “One Big, Beautiful Bill” would lead to increased deficits and growing public debt



¹ A weighted average effective tariff rate of 15% corresponds to a “50% Trump” scenario, which entails implementing half of Trump’s election campaign proposal to impose additional tariffs of 60% on China and 20% on the Rest of the World.

One of the bill's more contentious provisions, Section 899, would allow the Treasury to increase taxes - up to 20pp - on foreign entities' (including governments, individuals, corporations and trusts) US income if their home countries implement "unfair taxes", likely to include digital service taxes. While the Joint Committee on Taxation estimates this measure could raise USD 116bn over the next decade, it is likely, if adopted, to deter foreign investment and weaken demand for US assets, weighing on growth and increasing borrowing costs.

The bill and the persistence of trade barriers would hinder the recovery after 2027, leading us to revise our growth forecast for 2029 down to 2.0% YoY from 2.5%. Despite its messaging, the Republican budget bill is regressive in nature. Adjustments to tax bands favour top earners, who pay the highest federal rates and tend to save more. The bill also weakens the social safety net by cutting Medicaid and food stamps, increasing precarity for those at the bottom of the income distribution. Consequently, any boost to domestic demand is expected to be limited in the short to medium run, with most of the windfall leading to increased private sector savings. Deficits could rise even higher than in our scenario, given the tendency for temporary tax cuts to become permanent, and any reduction in tariff levels would hurt federal revenues.

The Fed is caught between its dual mandate goals of maximum employment and price stability. The sharper-than-expected drop in oil prices led us to revise down our CPI forecast from 3.5% YoY to 3.2% for 2025, however inflation risks are skewed to the upside as reflected by consumers and markets expecting inflation over 3% in a year's time. The labour market is currently balanced but cooling gradually, with unemployment rising to 4.2% in April from 4% in January. Consequently, the Fed is unlikely to expedite its interest rate cutting cycle, opting instead to await the impact of tariffs on consumer prices and unemployment data before making its next move.

Given unemployment is expected to increase only moderately by 0.2pp by year end, we maintain our expectation of one 25bp cut this year coming in the fourth quarter, followed by quarter-point cuts in the first and second quarters of 2026 as domestic demand deteriorates, and unemployment rises further.

Risks to the outlook are tilted to the downside. The oscillating tariff policy could further depress business investment as well as the American consumer, especially if equity markets fall from current valuations which remain close to all-time-high price-to-earnings ratios despite the deteriorating economic outlook. Tax cuts and deregulation have already been priced in, creating downside risk should tariffs drive up inflation, forcing the Fed to keep rates higher for longer.

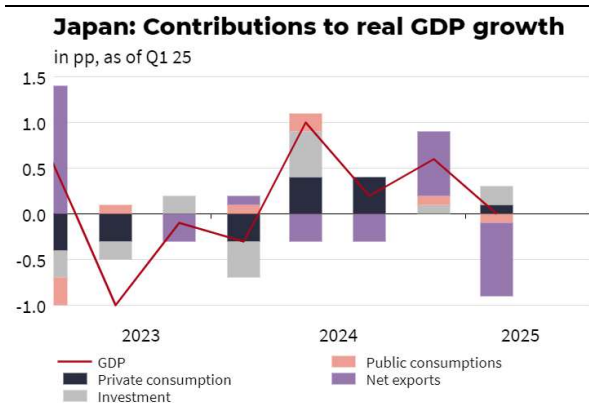
US	2024	2025f	2026f	2027f
Real GDP, % YoY	2.8	1.7	1.4	1.0
Household consumption	2.8	1.7	1.5	1.2
Public consumption	2.5	1.5	1.4	1.1
Investment	4.3	1.9	2.2	2.1
Exports of goods & services	3.3	2.6	1.4	1.0
Imports of goods & services	5.3	3.4	2.1	2.5
Inflation, % annual average	3.0	3.2	2.9	2.6
Core inflation, % annual average	3.4	3.4	2.8	2.6
Real gross disposable income (GDI), % YoY	2.7	1.5	1.9	1.2
Households saving rate, % of GDI	4.5	4.3	4.7	4.7
Unemployment, % of labour force	4.0	4.4	4.9	5.2
Fiscal balance, % of GDP	-6.4	-5.7	-6.7	-6.8
Public debt, % of GDP	99	100	104	108
Current account balance, % of GDP	-3.7	-3.6	-3.8	-3.8

JAPAN

- **Consumption should gradually recover, supported by real wage growth**
- **US tariffs are nevertheless slowing down the recovery of the economy**
- **The normalisation of monetary policy is expected to continue very gradually...**
- **...while fiscal policy will continue to support activity over the forecast horizon**

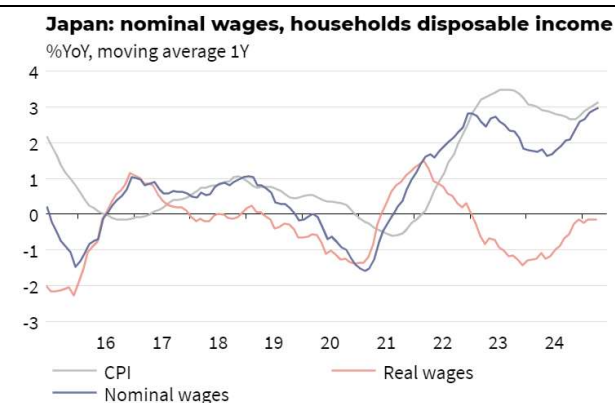
The results of the *shunto* (spring wage negotiations) resulted in an average wage increase of 5.5%, slightly higher than last year (5.3%). The results should be tempered because this increase only concerns large companies and unionized employees (16% of all employees), and according to seniority. The wage increase among SMEs, employing almost 70% of the working population, has so far been lower (4% on average). Structurally, the labour shortage should encourage an increase in wages and household disposable income.

Growth is weakened by tariffs



Sources: SG Economic and Sector Studies, Refinitiv

Accelerating inflation in Q1 suspends real wage growth



Sources: SG Economic and Sector Studies, Refinitiv

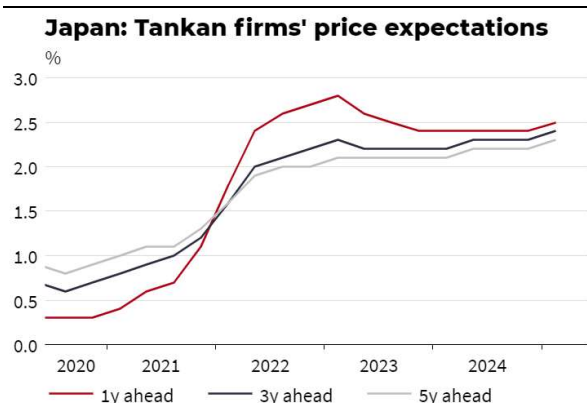
Corporate investment is expected to continue to increase. Corporate profits are firm, especially in sectors such as services, which have benefited from strong domestic sales thanks to tourism and higher prices. This increase in profits supports their investments, especially their capital expenditures. 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 corporate investment in the medium term.

Export momentum will be weakened this year by US tariffs, despite the truce on reciprocal tariffs. To date, Japan is affected by these tariffs: 25% on the automotive

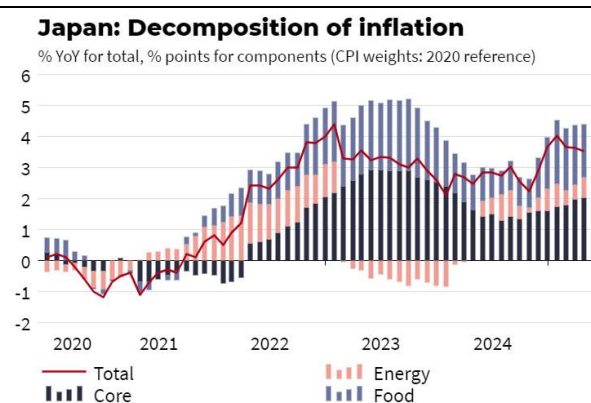
sector, 25% on the steel and aluminium sector, and 10% on all products. Assuming a price elasticity of exports of 0.5 and assuming a diversification of trade to other markets (Europe, emerging Asia, etc.), the impact of tariffs would be around 0.3% of GDP in 2026.

Inflation to ease but stay clear of deflation. Heightened geopolitical tensions and adverse weather conditions have kept energy and food prices high. These factors are now expected to dissipate. Real wage growth should take over and support inflation. In the medium term, labour shortages and an ageing population could keep pressure on wages and prices. However, past performance calls for caution. The inflation trajectory could disappoint, even if expectations seem more anchored.

Price expectations are slightly rising



Inflation persists due to food and energy prices



Sources: SG Economic and Sector Studies, Refinitiv

Sources: SG Economic and Sector Studies, Refinitiv

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 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 further rate hikes will depend on inflation data and real wage growth. Due to its history of deflation, we expect the BoJ to err on the side of caution. Uncertainties around US tariffs are constraining the pace of normalization this year.

The fiscal deficit is expected to narrow slightly over the forecast horizon, but fiscal policy will remain supportive of activity. 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). It is possible that support measures will be announced later this year to counter the impact of tariffs through supplementary budgets, which could widen the budget deficit. 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 percent of GDP over the forecast horizon.

Risks are tilted to the downside. Uncertainties over US tariffs, if negotiations are not concluded in July, could continue to exert pressure on Japanese exports (20% of GDP) and growth, and delay the pace of monetary policy normalisation. Persistent inflation from energy and food prices, including rice in Japan, could hamper real wage growth and the recovery in consumption.

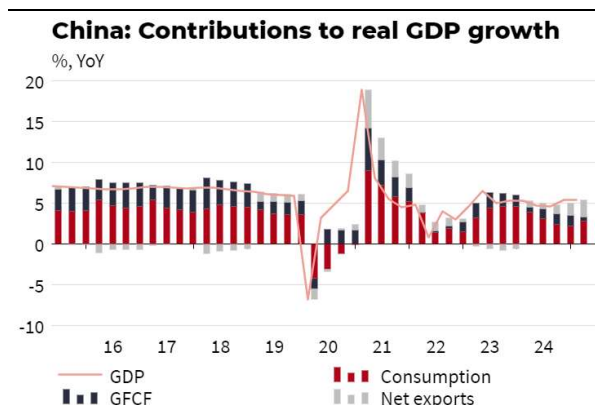
Japan	2024	2025f	2026f	2027f
Real GDP, % YoY	0.2	0.8	0.7	0.7
Household consumption	-0.1	0.7	0.8	0.8
Public consumption	0.9	0.8	0.8	0.4
Investment	0.3	1.7	0.6	0.7
Exports of goods & services	1.1	1.2	1.3	1.7
Imports of goods & services	1.0	2.7	2.2	2.0
Inflation, % annual average	2.8	2.7	1.8	1.5
Core inflation, % annual average	2.5	2.3	1.6	1.2
Real gross disposable income (GDI), % YoY	3.5	0.8	0.7	0.7
Households saving rate, % of GDI	4.1	4.2	4.1	3.9
Unemployment, % of labour force	2.5	2.3	2.2	2.1
Fiscal balance, % of GDP	-3.0	-3.3	-3.2	-3.1
Public debt, % of GDP	255	256	258	258
Current account balance, % of GDP	4.8	4.0	4.0	4.2

CHINA

- **Domestic demand remains weak, due to the structurally lower contribution of real estate and low consumer confidence**
- **Incremental measures are designed to support consumption but should only partially offset the external headwinds**

On the export front, rising tensions with the United States and its allies are expected to weigh on China's trade performance. Over the medium term, the growth outlook is deteriorating due to the persistent low confidence and the lasting effects of the slowdown in 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 in social protection, etc.), household confidence will remain weak and will dampen consumption.

Growth in 1Q was driven by exports in Households' confidence struggles to improve anticipation of US tariffs



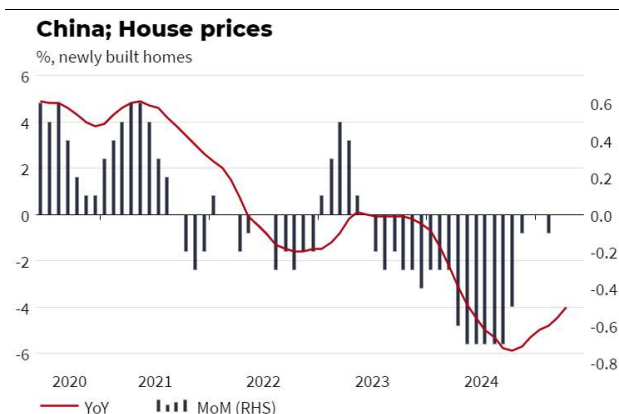
Source: SG Economic and Sector Studies, Refinitiv



Source: SG Economic and Sector Studies, Refinitiv

The real estate sector shows signs of stabilisation, thanks to support measures, but structural problems, such as fragile buyers' confidence and overcapacity, persist. The month-on-month improvement since the beginning of the year reflects some signs of stabilisation in the short term, supported by support measures. That said, the year-on-year contraction suggests that the market remains weakened by buyers' confidence, which remains fragile. The measures announced in May are expected to continue to strengthen the sector in the short term, with the reduction of the prime borrowing rate (LPR) by 10bp, to 3% and 3.5% for the 1-year and 5-year LPR, respectively. The reduction in pre-selling homes (74% of total new home sales) is under discussion at the central government level and could slow down new housing supply, reduce overcapacity in the sector and thus, accelerate the recovery in prices.

The contraction in housing prices has slowed



Source: SG Economic and Sector Studies, Refinitiv

Price expectations are slightly recovering

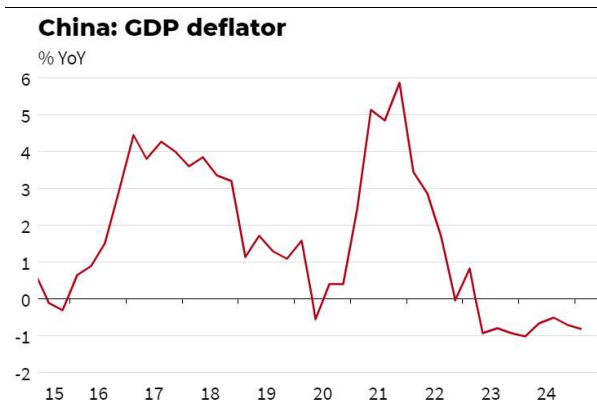


Source: SG Economic and Sector Studies, Refinitiv

Exports are expected to remain resilient in the first part of 2025, given the reversal of US tariffs on Chinese imports to 30%. Exports surprised in March and April despite the announcement of the tariffs which seem to have accelerated Chinese trade diversification. In April, the contraction in exports to the United States (-21% YoY) was offset by exports to ASEAN (20% YoY). Exporters should continue to accelerate sales in anticipation of tariff hikes. Xi's visit to Southeast Asia in April, in response to the tariffs, is also expected to shore up regional trade diversification and cooperation. Given the persistent domestic deflation and weak demand, exporters will continue to offer competitive export prices.

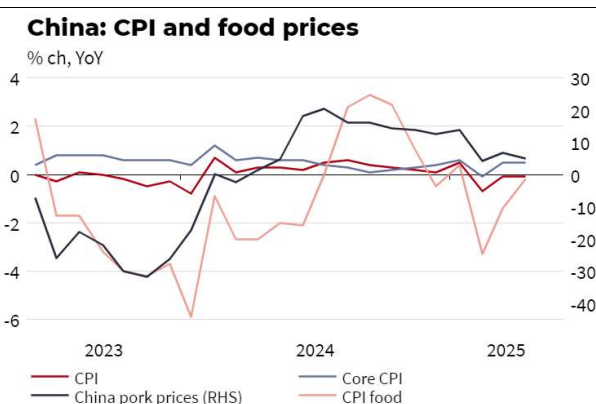
Inflation will remain close to zero in 2025, despite a decline in disinflationary pressures. Lower global commodity prices and negative food prices have contributed to disinflationary pressures. Inflation is close to zero and the contraction of the GDP deflator over the past year reflects the weakness 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.

The deflator remains in contraction



Source: SG Economic and Sector Studies, Refinitiv

Food prices weakened CPI



Source: SG Economic and Sector Studies, Refinitiv

The policy mix will remain accommodative and incremental but is not expected to provide a structural solution. The National Party Congress in March put

consumption as a top priority to support growth this year. As a result, the budget of the *Trade-in* programme in place since July has been doubled, from CNY 150bn to CNY 300bn financed by the issuance of special Treasury bonds. As a reminder, this program, which consists of replacing more energy-efficient appliances (especially household appliances), contributed to the acceleration of consumption by one percentage point in 2024. It has now been extended to cars and electronic devices (smartphones, tablets, etc.). While the scope has been extended, the impact is expected to be less significant in 2025 and only temporary. The budget deficit target has also been raised from 1pp to 4% in 2025, the highest in history but is expected to partially compensate for export losses.

Geopolitical tensions will remain present and could intensify with the risks of overcapacity. Geopolitically, relations with the United States and national security rationale will continue to weigh on and shape China's role in global value chains. The Taiwan issues 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.

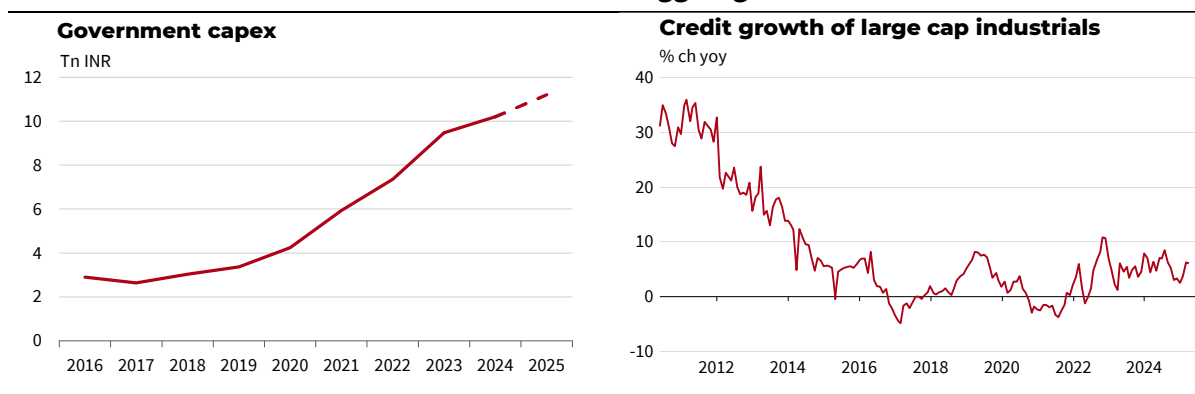
China	2024	2025f	2026f	2027f
Real GDP, % YoY	5.0	4.5	3.8	3.8
Household consumption	5.8	5.2	4.3	3.8
Public consumption	6.9	5.0	4.9	4.8
Investment	2.8	3.8	3.6	3.6
Exports of goods & services	4.8	3.0	1.8	2.1
Imports of goods & services	2.9	3.7	2.5	2.0
Inflation, % annual average	0.2	0.5	1.0	1.2
Fiscal balance, % of GDP	-7.1	-8.0	-7.8	-7.6
Public debt, % of GDP	91	94	97	99
Current account balance, % of GDP	2.2	1.5	1.0	1.0

INDIA

- GDP growth remain close to 6.5% YoY over the forecast horizon
- The financial system has become more resilient allowing to accompany investment dynamics
- As a result, after a period of public sector driven investment, the conditions for the private sector to take over investment dynamics seem to have gathered

Investment should accelerate, with the private sector taking over from public investment. The country benefited from years of public investment helped also by the recovery of the banking sector which suffered from past crises (infrastructure investment crisis, NBFIs crisis). Public investment has been a major contributor to growth over the last two years, however, it has already started to decelerate, in line with the ongoing fiscal consolidation. We expect a gradual pickup in private investment as soon as this fiscal year, supported by rate cuts and infrastructure improvements following the massive public investment campaign. This should enable growth to accelerate towards 6.5% YoY in the medium term.

Public investment's strong momentum should start to fall **Private capex should pick up, after years of sluggish growth**

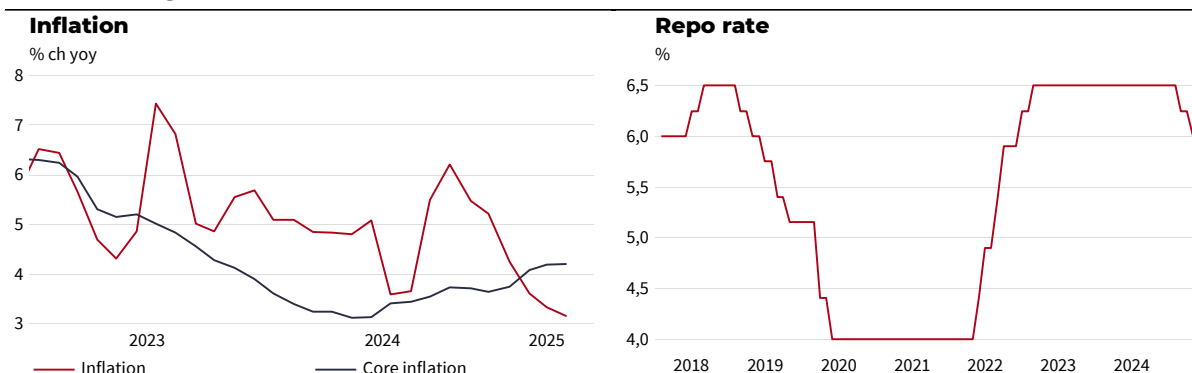


Source: CSO, SG Economics and Sector Studies

Source: RBI, SG Economics and Sector Studies

Inflation is expected to decline towards 4.5%, enabling further rate cuts that should support private consumption. Inflation has already decelerated to 3% YoY due to easing vegetables prices, while core inflation stabilised at 4% after an acceleration due to high gold prices. The RBI has therefore already started cutting the policy rate from 6.5% to 6% since the start of 2025. This cycle should continue and support private consumption. However, we expect that the RBI will struggle to reach its 4% target. The economy is still characterized by durable supply constraints linked to still insufficient infrastructure and production capacity. Domestic demand is expected to remain vigorous linked to demographics and urbanisation. As a result, inflationary pressures are likely to persist.

Inflation is stabilising at levels in line with the RBI's 4% target... which has started its cutting cycle



Source: RBI, Refinitiv and SG Economics and Sector Studies

Source: RBI, Refinitiv and SG Economics and Sector Studies

Fiscal consolidation has begun and the budget balance will improve over the medium term. The downside of India's growth since 2020 has been rising public debt, which now stands at 80% of GDP (a high ratio compared with other emerging countries). Consolidation is therefore a major goal for the Modi administration. Already, for the fiscal year 2024-2025, the central government has posted a deficit of 4.9% of GDP, compared with 5.8% in 2023. This dynamic will continue over the medium term, with public debt falling as a percentage of GDP and public consumption slowing.

India's financial services sector has recovered well in recent years from a domestic bad-loans crisis the late 2010's and from the global turmoil caused by COVID-19. The banking sector has recorded several years of higher profits as the tightening of monetary policy has improved interest margins for lenders. Since 2017, partly thanks to recapitalizations of public sector banks, the capital adequacy ratio of the banking system has gained nearly 300bp to reach over 17% and nonperforming loans declined from over 9% of total loans to below 4%. In its February 2025 financial stability assessment, the IMF has recognized this improvement, flagging only some concerns about the Non-Banking Financial Companies, due to their concentrated exposures, especially to the power and infrastructure sectors

The Trump 2.0 administration is not a major threat at this stage. Indian growth is not very dependent on export performance as it depends more on domestic demand. Moreover, Prime Minister Modi's visit to Washington in February resulted in the promise of bilateral agreements by October, which would be less punishing for India than the 25% tariffs threatened against Venezuelan oil importers, of which India is one.

Risks to this scenario are balanced. On one hand, domestic demand dynamics could positively surprise in a context of easing monetary policy and inflation stabilisation which could boost investment and consumption. On the other hand, downside risks come from the country's exposure to climate uncertainties given the

size of the agricultural sector and its impact on food prices. Geopolitical risks remain somewhat elevated following tensions with Pakistan.

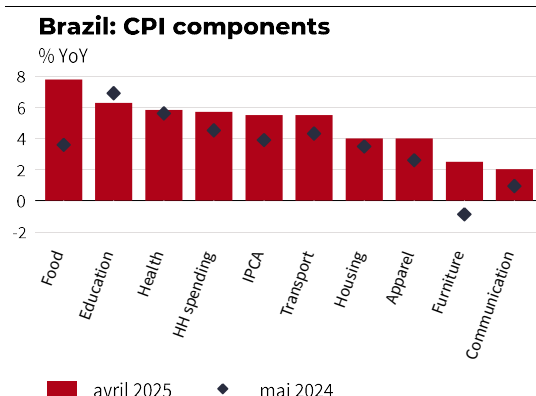
India (fiscal years from April to March)	2024	2025f	2026f	2027f
Real GDP, % YoY	6.5	6.2	6.4	6.4
Household consumption	6.5	6.5	6.5	6.4
Public consumption	6.0	5.6	5.2	5.0
Investment	5.2	5.7	6.3	6.5
Exports of goods & services	7.0	5.5	5.0	5.5
Imports of goods & services	2.0	5.5	6.0	6.0
Inflation, % annual average	4.5	4.3	4.7	4.7
Fiscal balance, % of GDP	-7.4	-7.3	-7.3	-7.1
Public debt, % of GDP	83	82	80	78
Current account balance, % of GDP	-0.8	-1.5	-1.7	-1.7

BRAZIL

- The trough of the cycle is seen within the next 12 months, as domestic factors ease, and the policy mix remains restrictive
- Brazil remains at the margins of trade tensions and could benefit from the reorganisation of global value chains
- Inflation will remain elevated this year on the back of a faster-than-expected rise in food prices, though easing is expected in 2H

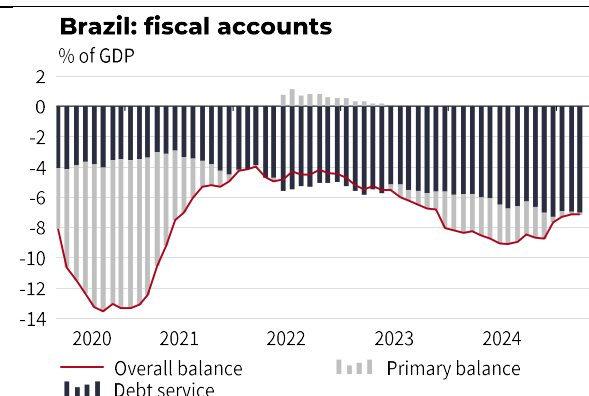
Overheated domestic factors will significantly slow down this year (1.9%) as unemployment rises and the policy mix tightens. The labour market is set to continue to soften over the next two years, although unemployment rates will remain lower than in the pre-pandemic period. Wage dynamics are set to ease reducing the risk of an inflation-wage spiral on the outlook, while consumption will slow as the country reaches the trough of its cycle.

Inflation acceleration will ease in 2H, but food prices are still volatile



Source: IBGE, SG Economic and Sector Studies

Fiscal space is narrowing as interest rates remain high



Source: BCB, SG Economic and Sector Studies

Inflation is forecast above target in 2025 (5.1%) and the BCB is set to sustain a restrictive stance, even if the end of the tightening cycle is within sight. Service prices, characterised by being particularly sticky, remain high delaying the return to target. Food prices (coffee, eggs, meat) continue to exhibit vigour dampening households' budgets, notably for the more modest. The volatility of the BRL, heightened by global uncertainty and fluctuating risk appetite, casts doubt on the evolution of the imported components of the IPCA.

The BCB remains reactive and has continued to actively raise the Selic to 14.75%, the highest level since 2006. While its stance will remain restrictive at least over the next 12 months, some easing is expected in 2H25 as worries on the activity and the fiscal front. The effects of the monetary tightening on credit are being realised with a lag. Credit to the private sector has slowed but remains dynamic (9.7% YoY in March). Importantly, the monetary policy has effectively acted as an anchor, as inflation

expectations that had been drifting since November began to plateau. For 2026, inflation expectations are set at 4.5%, the upper bound of the BCB tolerance band.

While the country remains broadly on the margins of trade tensions, idiosyncratic events and second round effects are to be kept in mind. Brazil has not been targeted by the US, and it has been leveraging good diplomatic relations with both China and the US to soften the blow of heightened global commercial policy. However, in the short run, the main risks to the outlook come from the slowdown in external demand, as tariff volatility persists. Moreover, risks to export prices -notably commodities like oil and soy- weigh on the outlook. Other idiosyncratic elements to consider include the discovery of a bird flu cluster in Rio Grande do Sul which prompted a suspension of exports to 63 countries, affecting almost half of poultry exports. The country's exporters might see some upside from the reorganisation of global value chains as hinted by the announced Chinese shift from US soy imports to Brazilian, a USD 12bn market.

Fiscal policy will remain restrictive, but interest charges continue to balloon the deficit and the debt. The approval of the 2025 budget allows the Government to adjust discretionary spending to ensure compliance with its medium-term objectives. Primary surpluses are within reach in the next two years even if risks continue to emerge from local government spending. High interest rates continue to weigh on over 7% of GDP, pushing the debt to 90% of GDP

Risks are mixed. A rapid slowdown of inflation and rate cuts will boost activity as the economy faces a more favourable policy mix. Maintaining favourable diplomatic ties with commercial partners would also bring new opportunities to leverage external demand for growth as GVC reorganize. On the downside, the country could see a faster-than-expected deterioration in the labour market, which would weigh on consumption. It could also see the dumping of cheap Asian products, risking its already challenged industrial base. Finally, the return of corruption cases in the government could further dampen the business and investment environment.

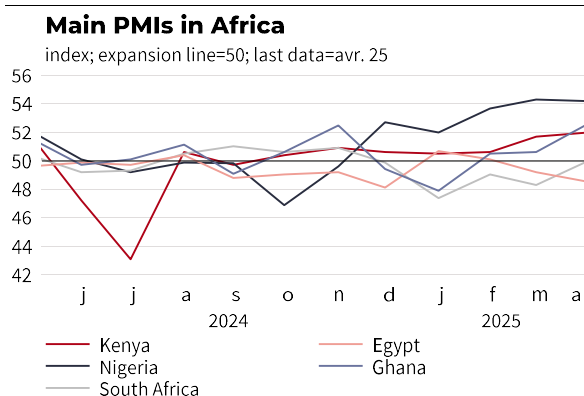
Brazil	2024	2025f	2026f	2027f
Real GDP, % YoY	2.9	1.9	1.3	2.0
Household consumption	4.8	2.0	1.8	2.3
Public consumption	1.9	1.5	1.0	1.0
Investment	7.2	2.0	1.4	2.2
Exports of goods & services	2.1	2.5	2.5	2.5
Imports of goods & services	13.2	2.0	1.8	2.5
Inflation, % annual average	4.4	5.1	3.9	3.3
Fiscal balance, % of GDP	-6.6	-7.3	-7.0	-6.5
Public debt, % of GDP	87	90	92	93
Current account balance, % of GDP	-2.8	-1.7	-1.5	-1.9

AFRICA

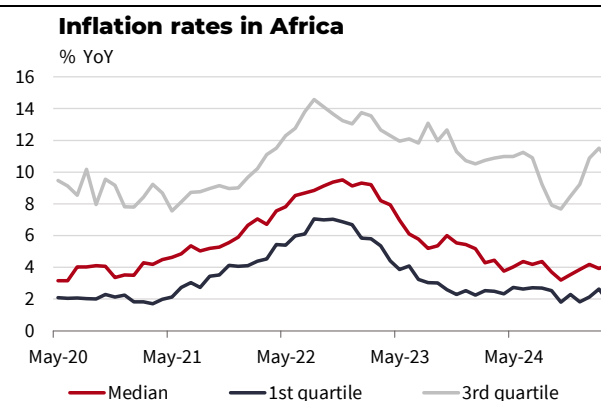
- **Regional growth is expected to accelerate slightly in 2025 (3.5% vs. 3.2% in 2024), driven by stronger private demand**
- **Compared to other emerging regions, Africa is less directly exposed to higher U.S. tariffs (and, more broadly, a global tariff war)**
- **However, the potential indirect consequences (economic uncertainty, global slowdown, and rising financing costs) pose significant risks to the region**

Regional growth (likely) stood at 3.2% in 2024. This performance represents a very slight deceleration compared to 2023 and **remains one of the worst recorded since the early 2000s** (along with 2016, 2019, and 2020). In addition to the postponement of certain hydrocarbon or mining projects (Libya, Botswana, Mozambique) and/or the rapid deterioration of political and security environments (Libya, Sudan, and South Sudan), growth slowed in three of the region's four main economies (South Africa, Egypt, and Algeria) – still hindered by persistent structural issues, including, respectively: deficient electricity production; exchange rate and inflation vulnerabilities weighing on private consumption; and a lack of dynamism in *oil and gas* production and economic diversification.

A (fragile) rebound of PMIs...



Inflation rates back to pre-2021 levels

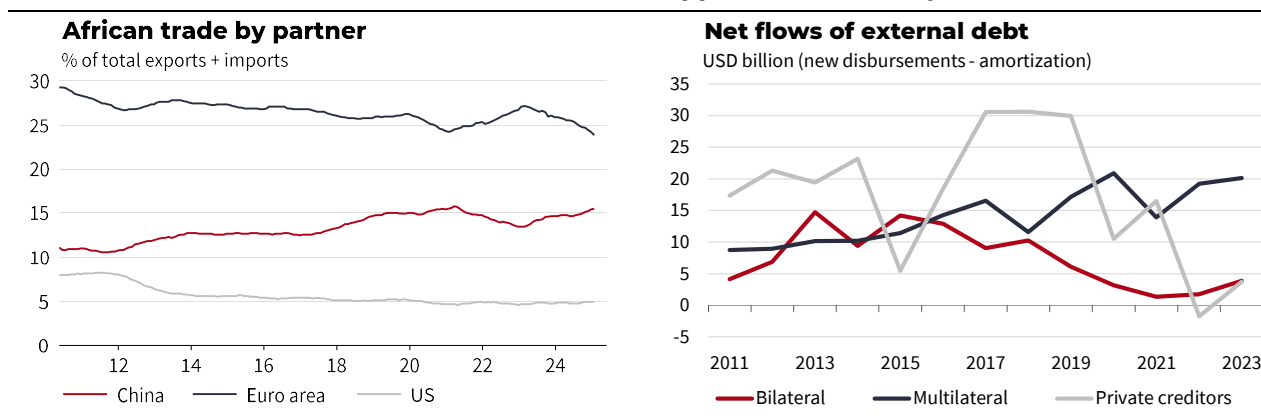


Source: Refinitiv, SG Economic and Sector Studies

We still expect a (modest) acceleration in regional growth to 3.5% in 2025, followed by 3.8% per year from 2026 onwards. On the demand side, this acceleration is expected to be driven by greater dynamism in private demand, enabled by inflation rates that have now returned to their pre-2021 levels (in most countries, despite persistent heterogeneity). Confidence indices (PMIs) reflect this gradual return of confidence. The two other potential drivers of growth (public demand and external demand) are expected to be more subdued. The first will be constrained by ongoing budgetary consolidation efforts (which remain insufficient to significantly improve the sustainability of public finances). The second will be hampered – unsurprisingly – by a significantly more challenging international

environment compared to the previous quarter, marked by i) falling commodity prices (as commodities still account for 80% of the continent's exports), and ii) a global rise in protectionism risks. Regarding the latter, Africa is less exposed (compared to other emerging regions) to changes in US tariffs, given its limited trade with the United States (which also reflects, more broadly, the continent's low integration into global value chains and its low level of industrialisation). However, it should be noted that several countries are more at risk (South Africa, Madagascar, Lesotho, Mauritius), due to larger manufacturing bases that are more exposed to the United States. Moreover, this lower direct exposure should not overshadow the fact that the continent remains more vulnerable (compared to other emerging regions) to heightened economic uncertainty, a global growth slowdown, and/or tighter international financial conditions.

Africa shows limited (direct) exposure to the United States... but a reduction in multilateral financial support would be very detrimental



Source: Refinitiv, SG Economic and Sector Studies

Downside risks to this trajectory have increased significantly since last quarter.

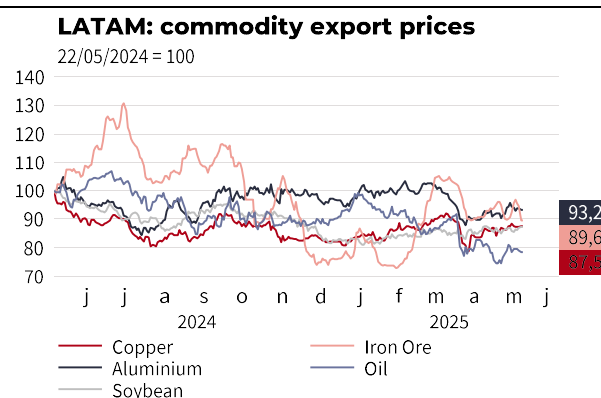
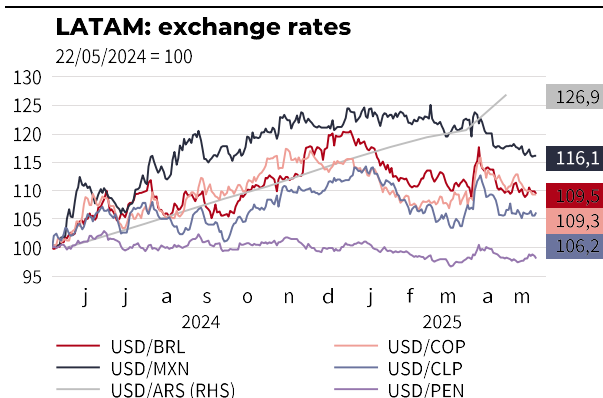
On the one hand, the growth rates currently projected (below 4%) – which would be revised downwards if global growth were to fall below expectations – remain insufficient to ensure the durable and sustainable development of the region. This risk is even more concerning as the continent continues to be characterised by (i) persistently fragile political structures and security environments, and (ii) intensifying climate shocks (particularly affecting agricultural sectors that remain essential to the region). Tighter global financial conditions are once again exacerbating the already very high risks of foreign currency refinancing. Finally, a tougher stance by the United States towards major multilateral financial institutions (IMF, World Bank, etc.) could undermine their financing capacities, even though these institutions have been the primary source of foreign currency financing for the region since the COVID crisis.

LATIN AMERICA

- The region remains on the margins of trade tensions, but the short-term outlook remains muted as domestic factors slow
- Second-round effects from the slowdown in global activity weigh on the outlook for several countries, particularly commodity exporters
- With the frontloading of monetary policy easing and strained fiscal budgets, the region has limited capacity to withstand further shocks

The region continues to face moderate growth prospects (2.2% per year until 2027), with significant heterogeneity across countries. Business cycles remain unsynchronised in the region. Brazil, Chile, and Peru will see a moderation of growth, while Colombia and Ecuador will experience a larger uptick. Among the notable changes in growth profiles, Argentina will see a strong rebound this year (5.5% per the IMF), as the country continues to tame inflation. On the downside, Mexico's activity will be constrained by heightened trade uncertainty with the US and a weakened labour market (-0.3% per the IMF). Moreover, changes in the sanctions targeting Venezuelan oil production and distribution, coupled with a weaker VES and lower oil prices (see infra) are set to plunge the country once again into crisis as the IMF expects inflation to surpass 180% this year while GDP will contract by 4%. The prospects of new immigration waves should be kept in mind.

FX evolution is preserving the external ... but a global slowdown in activity weigh on competitiveness of the region... exports anyways



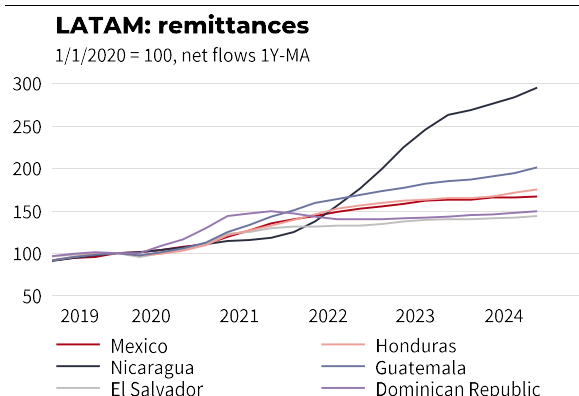
Source: Refinitiv, SG Economic and Sector Studies

Source: Refinitiv, SG Economic and Sector Studies

The region remains mostly on the margins of current trade tensions but second-round effects from a global slowdown should be kept in mind. The region is not being targeted by US tariffs and has overall kept good diplomatic relations with both the US and China. In the case of Mexico, renegotiation of the USMCA is still pending in 2026 and will determine the long-term relationship with North America. The depreciation of most of the major currencies of the region against the USD counteracts losses in competitiveness within the US market. The penalty of trade tensions and uncertainty on global activity will weigh on the region's notably as it

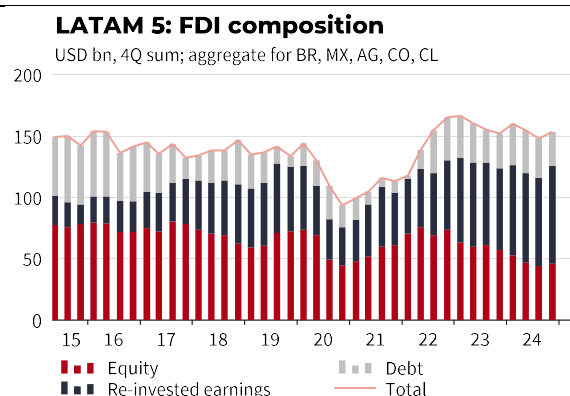
pressures export commodity prices (oil, metals). Lower commodity prices affect notably South American economies dependent to their exports including for government income (Colombia, Ecuador, Brazil). In the Caribbean, some risks of slowdown and uncertainty in the US and Europe will appear in the form of reduced tourism inflows. Finally, a harsh implementation of US immigration policy would slow remittance flows that have sustained household consumption and the improvement of external balances in Central America since the pandemic.

A slowdown in remittances flow will slow activity and weigh on external balances



Source: IMF BOPS, SG Economic and Sector Studies

FDI flows are still robust in the region highlighting its attractiveness



Source: IMF BOPS, SG Economic and Sector Studies

The region could see some upside from the reorganisation of GVC in the medium term, but it will need to tackle its structural challenges. FDI flows remain robust in a region that could benefit from near-and-friend-shoring efforts from the US even though uncertainty about them persist. These would notably benefit Mexico, which is already heavily intertwined with American supply chains. The region could also gain from good and expanding diplomatic relations with China as seen in the rhetoric and bilateral agreements (Brazil, Chile, Colombia) than accompanied April's China-CELAC summit. In all cases, to secure a prosperous exchange with the rest of the world the region will need to tackle its structural challenges, namely the lack of a highly qualified labour (formal) force, the need of hiking investments to improve public infrastructure and the necessity of improving security and governance indicators.

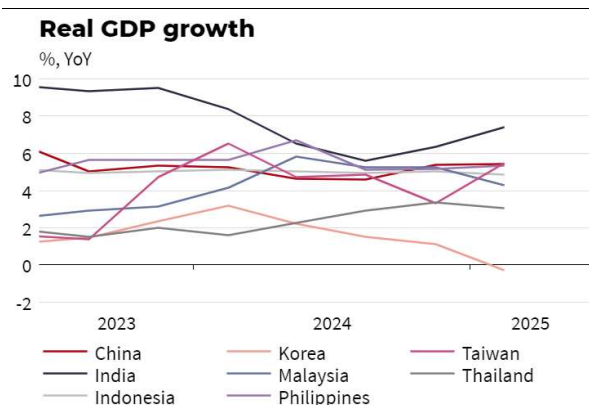
The balance of risks is tilted to the downside as policy space is limited to absorb further shocks. Monetary policy easing has been front-loaded in most countries (but Brazil as mentioned in a previous note), limiting the place of further monetary easing in case of new shocks. This is particularly striking as inflation rates seem to have normalised above their pre-pandemic levels and remain volatile. On the fiscal side, most countries (e.g. Brazil; Mexico, Colombia, Peru, Ecuador) are facing an urgent need to consolidate fiscal accounts following spending hikes at the beginning of the decade that hasn't fully reabsorbed, and higher interest rates.

EMERGING ASIA

- The region is exposed to a shock from U.S. tariffs
- With monetary policy easing and less inflationary pressures, domestic demand could partially offset the impact of tariffs
- Downside risks are increasing and may weigh on regional investment and trade

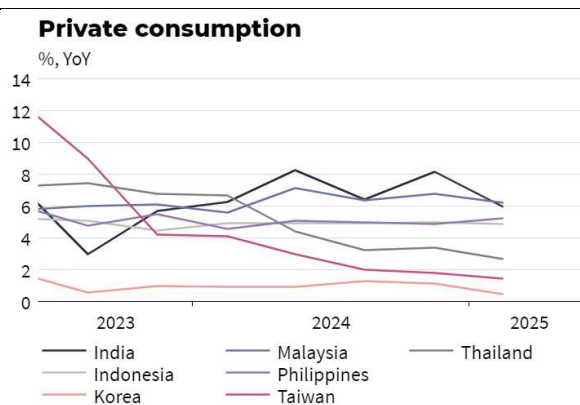
Regional growth in emerging Asia outside China will face a larger shock from U.S. tariffs than other regions, with domestic demand expected to partially offset the impact. Slowing external demand and a slower technology cycle will weigh on the economic outlook. Domestic demand, which accounts for half of their GDP, is expected to partially offset the impact, supported by their monetary policy easing and expansionary fiscal stance.

The pace of growth is stabilizing



Source: SG Economic and Sector Studies, Refinitiv

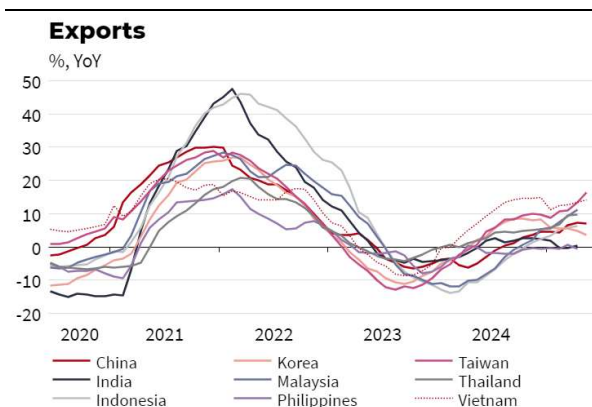
Private consumption remains buoyant



Source: SG Economic and Sector Studies, Refinitiv

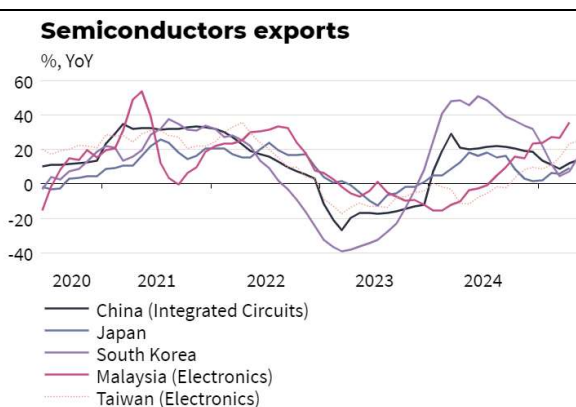
Exports could slow this year given trade tensions and a deceleration in demand from China and the United States. Only tech exporting countries can benefit from the development of generative artificial intelligence. Semiconductors are also exempted from tariffs for the time being. That said, geopolitical tensions and existing export controls on China on semiconductors pose a risk to the fluidity of supply chains, which are fragile in nature due to the degree of specialization and strong interdependence between players. As we head to press, news headlines suggest a potential trade agreement between the US and China, which could help ease tensions also for the broader region.

Export momentum slows...



Source: SG Economic and Sector Studies, Refinitiv

Some tech exporting countries can still benefit from the development of AI



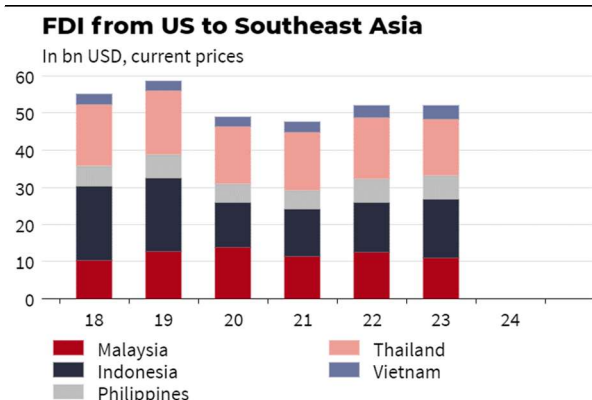
Source: SG Economic and Sector Studies, Refinitiv

Inflation is expected to remain subdued, but upside risks are emerging. Inflation in most countries has returned to 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, especially flooding.

The monetary easing cycle has started and should support domestic demand.

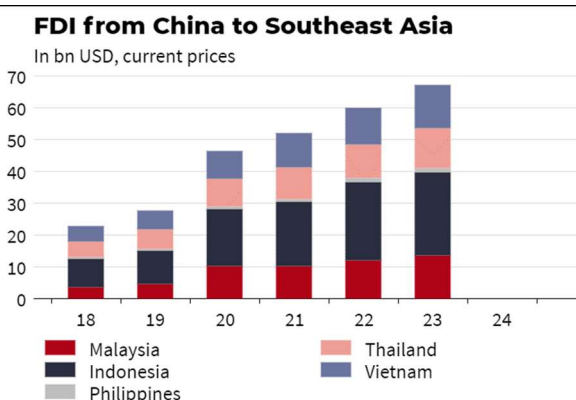
Many countries have seen the effects of rising interest rates since 2022. This should now fade as monetary policy is gradually eased. In countries where inflation is or below the central bank's target, there is room for monetary easing to mitigate external shocks. However, the pace of rate cuts is likely to be more measured than initially expected. Central banks will be cautious and will seek to find a balance between supporting growth and managing inflationary pressures from US protectionist measures. As inflation slows, consumer confidence is expected to recover.

FDI from US to Southeast Asia stabilise ...



Source: Refinitiv, SG Economic and Sector Studies

... while Chinese FDI have doubled in five years



Downside risks are intensifying given the uncertainties in international trade.

The slow recovery of the Chinese property market and an increase in US tariffs against China would affect countries in the region whose exports are strongly linked to China's investment and demand for commodities.

While the region, especially ASEAN, has benefited from the diversification of supply chains away from China since the first trade war, the U.S. tariffs could pose a risk to the ongoing trade diversification in the region. Indeed, China's close trade ties with the region, and manufacturing FDI inflows (China is the largest investor in ASEAN) could be more scrutinized by the United States.

On the geopolitical front, developments in Taiwan and on the Korean Peninsula will remain the main flashpoint, while protectionist measures intensify.

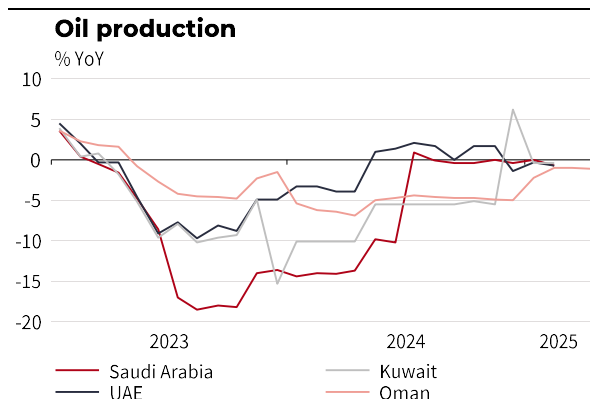
Climate change remains a major challenge for the region. Many countries in emerging Asia remain vulnerable to global warming, which could cause structural damage (food insecurity, supply chain disruptions, infrastructure). Investments in the management of these climate risks will weigh on public finances.

GULF STATES

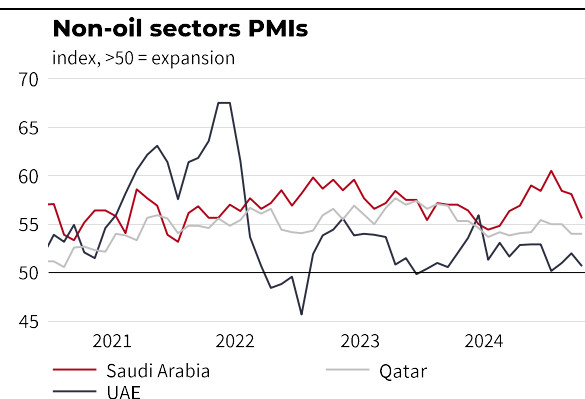
- In line with the recent OPEC+ decision, the recovery in oil production will support the acceleration of growth expected for 2025 (approximately 3.5%-4%, versus 1.7% in 2024)
- Non-oil sectors remain dynamic (and less volatile), still driven by large investment programmes
- Gulf countries appear resilient in the face of persistently high geopolitical risks in the region

After standing at 1.7% in 2024, average growth in the GCC (Gulf Cooperation Council) countries is expected to accelerate to around 4% in 2025. This acceleration will be primarily driven by the recovery in oil production, confirmed by the OPEC+ announcement in April 2025 to gradually reverse the cuts decided in 2023 (as a reminder: 2.2 million barrels per day – mb/d – were withdrawn from the market). The pace of this production recovery remains uncertain to date: some countries (notably Saudi Arabia) are advocating for an 'aggressive response' that would reverse the voluntary cuts of 2023 before the end of 2025. Overall, the *oil & gas* (O&G) sectors, which acted as a drag on growth last year, are expected to grow again in 2025. Meanwhile, the non-O&G sectors will remain dynamic, as evidenced by non-oil PMIs, which continue to be firmly in expansion territory.

Oil production is picking up again



Non-oil sectors PMIs remain firmly in expansion territory

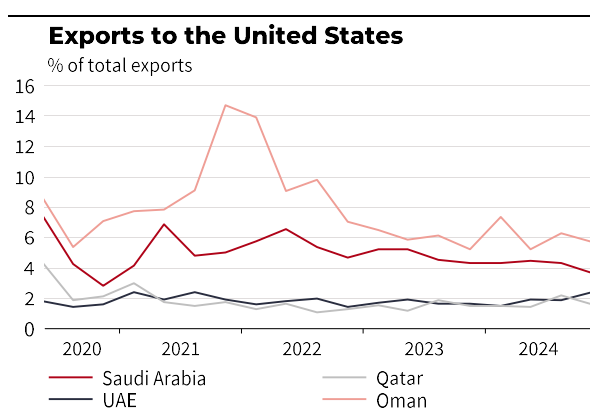


Source: Refinitiv, SG Economic and Sector Studies

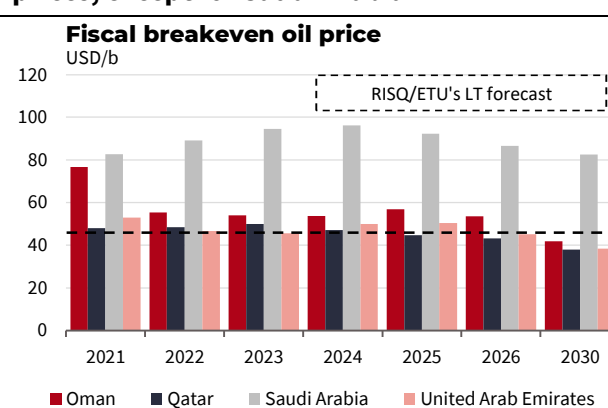
Growth is expected to continue accelerating (albeit more modestly) in 2026 and 2027 (around 4.5%). We remain cautious about the medium- to long-term trajectories of oil production. First, the outlook for global oil demand remains subdued (as illustrated by the IEA's almost monthly downward revisions), with significant downside risks given the current geoeconomic uncertainties. Second, the decline in oil prices observed since early April 2025 (leading to a modest downward revision of our forecasts for 2025 and 2026) could prompt OPEC+ countries to remain cautious about their oil production, in order to avoid reigniting a 'price war,' which

does not appear to be desired at this time. Indeed, while most countries in the region still have 'equilibrium oil prices' (both fiscal and external) below current levels, they are also relying on major investment plans (primarily public) aimed at diversifying and 'greening' their economies (as the region remains one of the most exposed to climate risks – particularly transition risks). These investments remain the key driver of the anticipated dynamism in the non-O&G sectors in the coming years. Furthermore, current oil prices are approaching break-even levels for new oil drilling in the United States, which should stabilise US production in the short to medium term. Overall, an 'additional effort' (in terms of oil production) by OPEC+ countries is unlikely to be desirable or necessary in 2026 and 2027. As highlighted in previous quarters, the outlook for gas production remains more robust, if only because gas is often considered a 'transition energy' (less harmful to the climate than oil).

Limited exposure to the United States



Breakeven oil prices are still below current prices, except for Saudi Arabia



Source: Refinitiv, SG Economic and Sector Studies

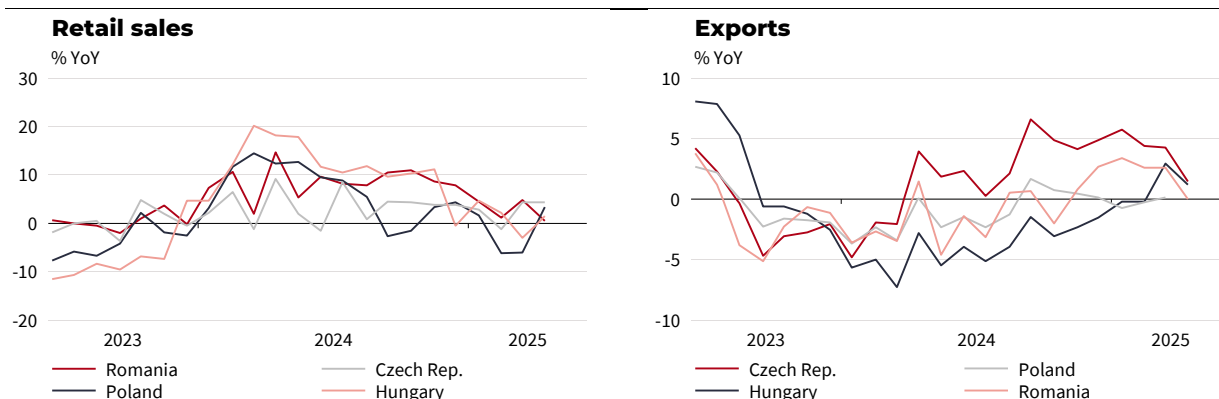
The persistently high geopolitical risks in the region and the rise in global uncertainties since last quarter do not appear to be affecting the region's resilience for the time being. Market indicators (spreads, stock markets, etc.) remain broadly solid (despite a slight reaction in early April). Countries in the region have limited trade exposure to the United States – except for Oman, to a small extent. They remain, however, vulnerable to a more prolonged or sharper decline in oil prices, which would inevitably hamper the investment capacities of public actors (and, to a lesser extent, private ones). Nevertheless, the region can rely on substantial fiscal and external 'reserves' to weather periods of uncertainty.

CENTRAL AND EASTERN EUROPE

- Despite significant uncertainties around US tariffs targeting the EU and the automotive sector, the region is expected to remain resilient thanks to massive EU funds inflows and strong private consumption
- Central banks in the region are expected to resume their easing cycle as inflation is set to remain contained in a context of moderate energy prices
- Uncertainties related to the war in Ukraine and to the future of US-EU defence cooperation put pressure on the region's defence expenditures. Yet, the introduction by the European Commission of a "national escape clause" gives Member States a margin of fiscal manoeuvre regarding their defence spending for four years

Despite the introduction of US tariffs on the automotive sector (a key sector for the region), Central and Eastern Europe has shown resilient growth in 1Q25, driven by domestic demand. Household consumption is benefiting from strong real wage growth and, in some countries, from increased public spending in an electoral context in a few countries (notably in Romania and Poland). Investment is driven by European funds, even if their absorption was uneven. In May 2025, 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 with 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.

Households' consumption has remained strong supported by dynamic wage growth... **...while exports have slowed down in 1Q25 amid poor performance in the euro area**



Source: SG Economic and Sector Studies, LSEG

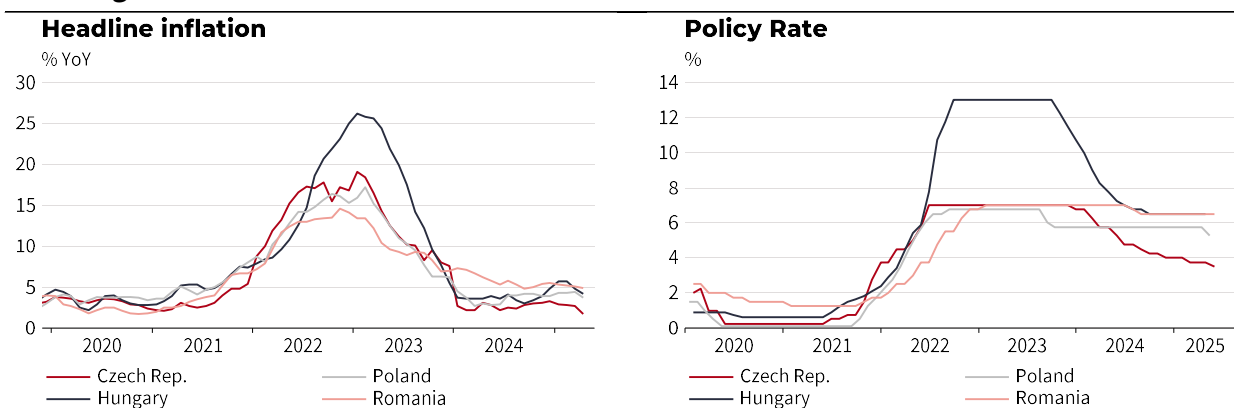
GDP growth will remain resilient and gradually accelerate in 2025-2026 supported by the dynamism of domestic demand, despite the burden of fiscal consolidation and uncertainties around US tariffs. Household consumption is

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 uncertainties around the trade war, 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 has so far delayed its fiscal consolidation due to the presidential elections held in May 2025 (after their cancellation by the Constitutional Court at the end of 2024 following significant irregularities) and the resignation of the Prime Minister in May 2025. A large fiscal consolidation in Romania will be necessary in the second half of 2025 and in 2026, including tax increases, failing which the country's conditions of access to international financing could deteriorate.

Inflation is expected to remain subdued amid moderating oil and gas prices. In this context, several central banks in the region could resume their monetary policy easing cycle in 2025.

Inflation is expected to remain relatively stable Further rate cuts could take place in 2025 in the region in 2025



Source: SG Economic and Sector Studies, LSEG

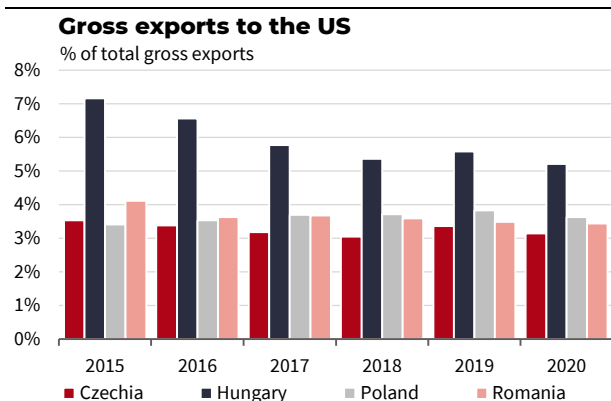
Downside risks to the growth outlook relate to uncertainties surrounding the policies of the new US administration, particularly regarding potential tariffs which could impact the EU along with the future US-EU defence cooperation.

Although the region's direct commercial exposure to the United States is low (5% of Hungarian exports go directly to the United States and just over 3% of Czech, Romanian and Polish exports), the implementation of tariffs on the automotive sector and of a potential 50% blanket tariffs on US imports from the EU could significantly affect the region. The automotive sector is indeed a crucial contributor to the value added and exports of the region's major countries: it accounts for 15%

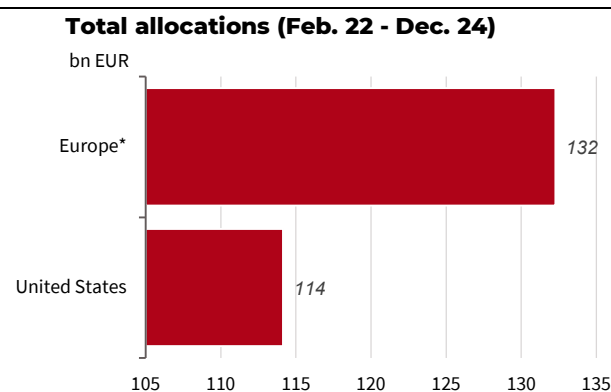
of Czech exports, 27% of Slovak exports, 12% of Hungarian exports, and 8% of Polish exports.

In addition, uncertainties surrounding reduction 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. Nevertheless, the European Commission announced in February 2025 the implementation of a “national escape clause” from EU fiscal rules allowing Member States to raise defence spending by 1.5% of GDP each year for four years without any disciplinary steps that would normally kick in once a deficit is more than 3% of GDP. Fourteen Member States have requested the activation of this clause, including Poland, Hungary, Slovakia, Slovenia, Bulgaria, and the Baltic States.

Limited direct trade exposure to the United States.



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



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

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