

# SCÉNARIOÉCO

Société Générale Economic & Sector Studies

## Resilient, yet slowdown looms

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- The global economy remains resilient, underpinned by asset price gains, low energy prices, AI-related investment, several pockets of fiscal accommodation (including increased defence spending) and regulatory easing and/or simplification.
- Tariffs have yet to fully feed through and labour markets are softening across several major economies. The US faces a demographic headwind from the sharp slowdown in immigration.
- Uncertainty is gradually shifting to fragmentation posing a slow-moving structural headwind for the global economy. China rebalancing is set to come with slower growth.
- Sudden shifts in financial markets valuations pose the risks of a faster moving headwind, be it equity, housing or sovereign risk premia (with elevated sovereign debt levels).
- After a shared disinflation path, divergence is now visible across several major economies. Consumers remain wary of inflation trends in several major economies.
- We see further Fed rate cuts, but with a hesitant path as the Fed weighs contrasting concerns on its dual mandate. Next Fed Chair will have to prove independence and absence of fiscal dominance.
- The next move from the ECB is still more likely to be a rate cut and end to QT. French politics to remain a headwind at least until the French presidential election due in spring 2027. Albeit fragmented, a majority remains to respect the EU fiscal rules, keeping TPI open for France.

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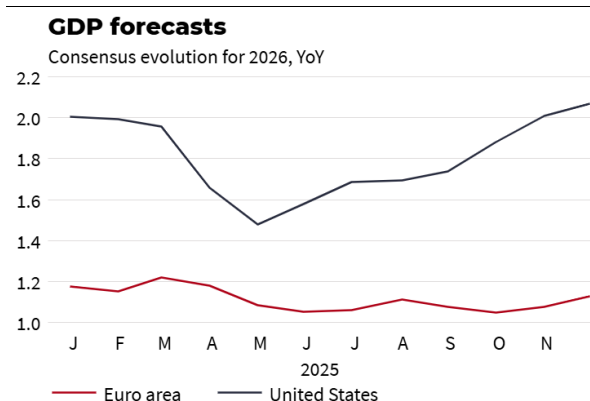
## EDITORIAL

### GROWTH TO SLOW

The resilience of the global economy in 2025 was driven by several factors. Top of the list is AI and digital infrastructure, with 2025 seeing a surge in capacity build-out. Further drivers on the investment front include defence and security, be it military capacity, protection of critical infrastructure or resilience of corporate supply chains. Beyond investment, energy has also been supportive to growth in 2025 with further declines in oil prices. Regulatory easing and simplification have also been supportive as has pockets of fiscal stimulus.

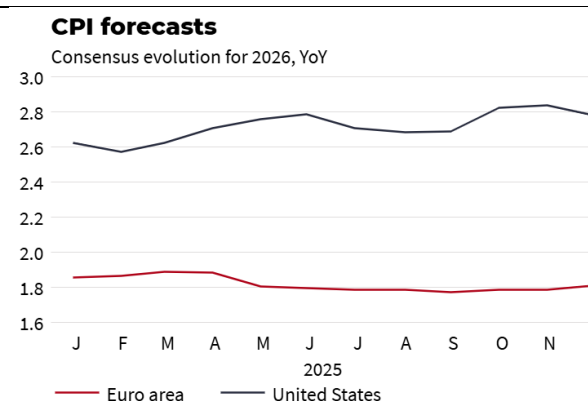
Several of these dynamics are now moderating, while prolonged uncertainty, protectionism, and labour supply shocks will progressively weigh on growth. Sticky service prices, moreover, entail that monetary policy has yet to move into accommodative territory either side of the Atlantic and we expect further rate cuts to remain cautious. Turning the page to 2026, we thus expect growth to decelerate across the major economies.

#### Consensus upbeat for 2026...



Source: SG Economic and Sector Studies, LSEG, Consensus Forecasts

#### ...and still high inflation expected for the US



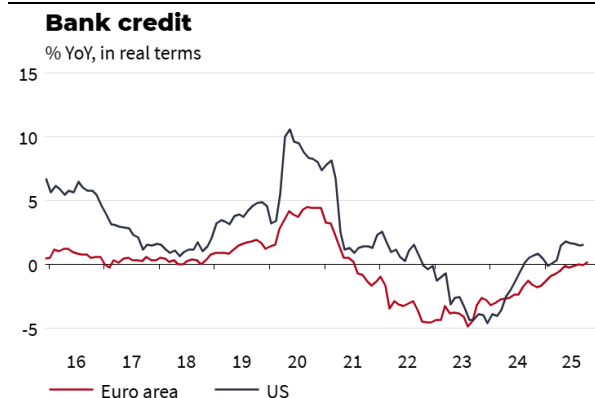
Source: SG Economic and Sector Studies, LSEG, Consensus Forecasts

US activity remains strong, driven by household consumption, positive disposable income growth and favourable financial wealth effects. But growth is concentrated on a limited number of engines such as the AI investment boom. Meanwhile, uncertainty is impacting the labour market resulting in a low-hire, low-fire environment and pushing unemployment up gradually, more acutely amongst the young. We thus forecast a notable slowdown in 2026 and 2027.

In the EU, conditions for modest but steady growth remain, despite a challenging external environment. Growth is supported by a resilient labour market, lower inflation and slightly more favourable financing conditions. Core euro area countries show, however, depressed confidence, but others, such as Spain or Poland, have enjoyed better performance supported by EU funds and/or buoyant tourism sectors. Looking ahead we expect the fiscal stance, albeit uneven across member states, to

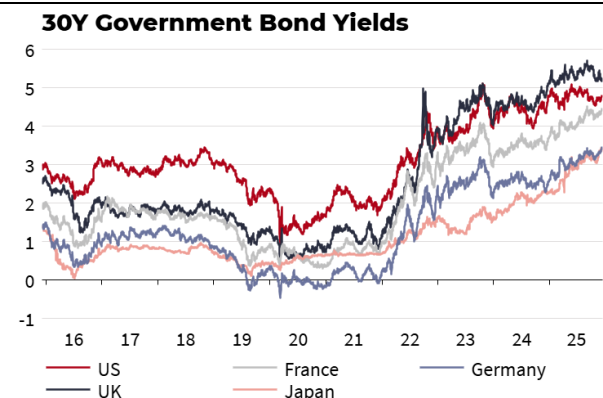
tighten somewhat and see further headwinds from the external environment as tariffs feed fully through and competitive pressure from China remains. Higher term premia and ageing populations represent structural headwinds, and while advances on the EU's competitiveness compass hold potential to deliver a powerful tailwind our concern remains that the pace of progress remains too slow.

### Bank credit is not dynamic...



Source: SG Economic and Sector Studies, LSEG

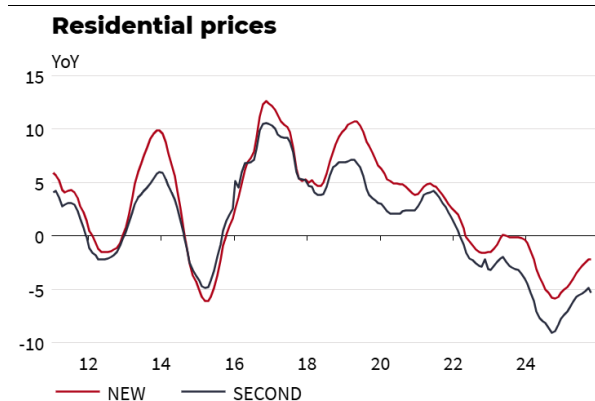
### ...and funding costs are high



Source: SG Economic and Sector Studies, LSEG

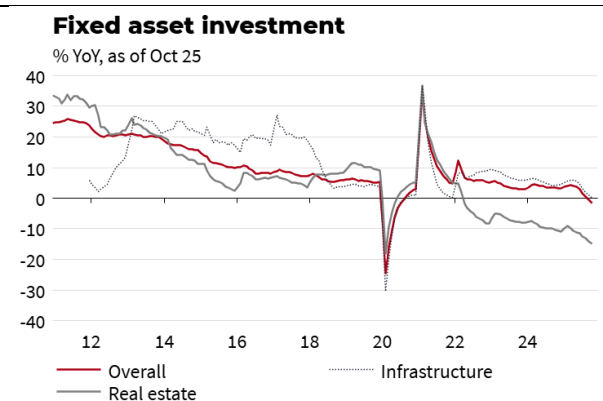
China's growth momentum is expected to soften toward the end of 2025 as the temporary boost from frontloaded exports dissipates, and uncertainty over US tariffs persists, despite the easing of tensions following the October US-China trade truce. Four years after the property bubble burst, real estate investment continues to shrink. The "anti-involution" campaign focuses on closing some overcapacities, but it remains unclear to which extent the authorities are willing to take steps to structurally lower China's elevated precautionary household savings.

### Overcapacities...



Source: SG Economic and Sector Studies, LSEG

### ...will weigh on investment



Source: SG Economic and Sector Studies, LSEG

## REASONS OF RESILIENCE

The global economy displays resilience but will not escape a slowdown. Several factors have been supporting global activity despite the difficult context of rising geopolitical risks and political uncertainties.

In the major economies, the financial situation of households and firms remained solid as they benefit from revenues and profitability resilience.

### Households benefited from:

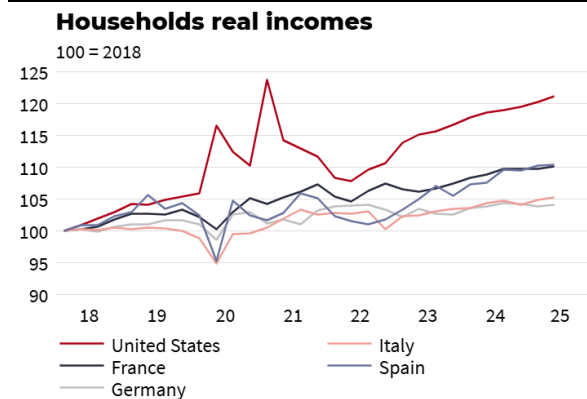
- **Firm labour markets, with unemployment rates remaining low.** This stability can be attributed to several factors, including the reopening of economies after the pandemic, companies choosing to retain staff, mismatches between available skills and job requirements, and demographic trends that have been less supportive of labour supply.
- **Wages income gains,** underpinned by tight labour markets. Wage gains supported households with greater financial security during a period of (geo)political uncertainty.
- During the pandemic and the subsequent rise in energy prices, **households received substantial public support.** Importantly, governments did not implement major fiscal austerity measures afterwards, which helped to cushion the impact of economic shocks.
- **Disinflation, which contributed to recovery in real incomes,** enabling households to regain purchasing power that had been eroded by earlier price increases.

As a result, despite all the shocks of recent years (energy prices, inflation, monetary tightening) real household incomes have recovered above their pre-pandemic levels or even pre-Ukraine war levels, albeit at varying speed as illustrated below. This development contrasts with the still low levels of household confidence. Saving rates remain higher than before the pandemic in the euro area, the UK and Japan. This is also true in China with the real estate crisis underway since 2021. Hence, it seems that households' propensity to save has increased in a context of higher uncertainties (precautionary savings). Further explanations reside with the composition of household incomes (with a higher share on non-wage income that accrues more to higher income households with a higher propensity to save) and efforts to rebuild liquidity buffers eroded by inflation.

The US has been an exception to the general saving behaviour thanks not least to asset price gains. This has also contributed to sustain global growth by the effects of US demand. US consumption represents about 18% of world GDP and has increased by almost 30% in volume terms over the last 10 years (against less than 10% in other

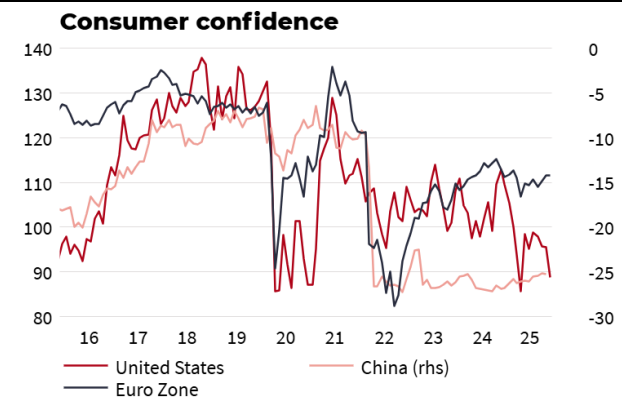
developed economies. As the US economy is expected to significantly slow in the next two years, this will impact the global growth dynamics.

### Household incomes supported consumption



Source: SG Economic and Sector Studies, LSEG

### Even though confidence levels remain low

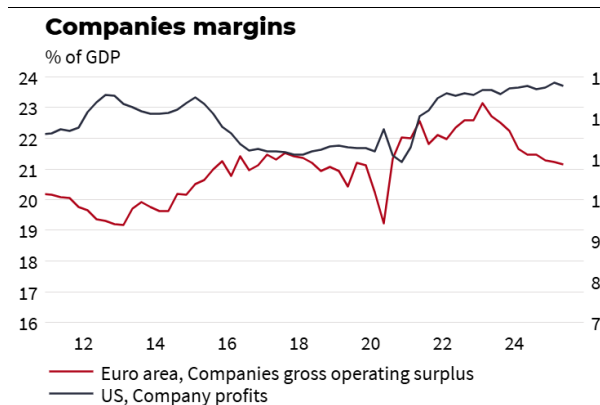


Source: SG Economic and Sector Studies, LSEG, Conference Board

### On the corporate side, profitability remained supported by:

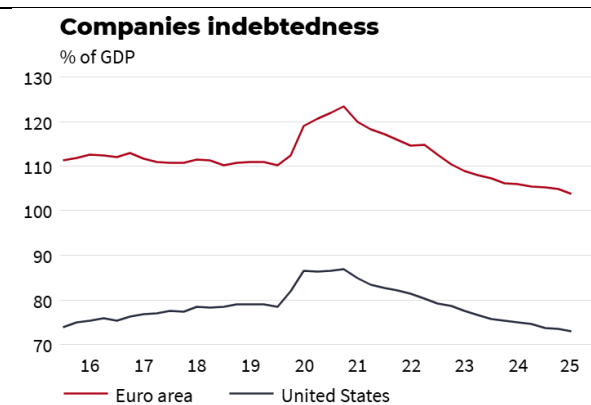
- **Government support measures during the pandemic**, which provided a cushion against economic disruption.
- **Robust consumer demand and pent-up savings** allowed companies to pass on price increases to consumers, and in some instances even to build profit margin.
- **Businesses entered the higher interest rate environment since 2023 with relatively low levels of debt.** This financial position has enabled them to weather the impact of higher borrowing costs more comfortably.

### Sustained margins...



Source: SG Economic and Sector Studies, LSEG

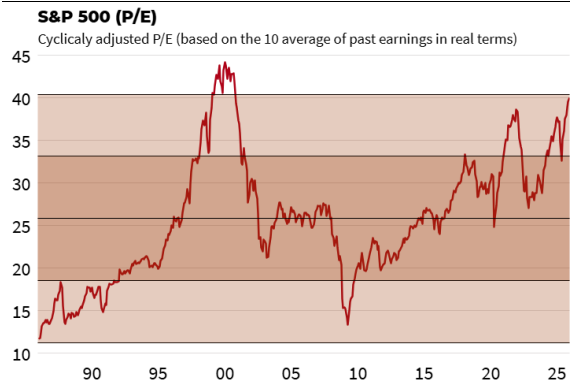
### ...and lower indebtedness



Source: SG Economic and Sector Studies, LSEG

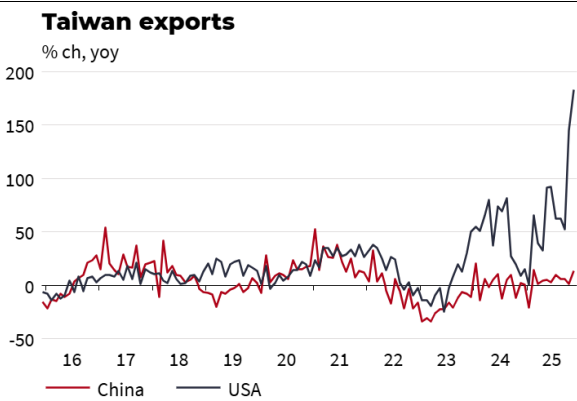
Overall growth is expected to slow in the over the 2026 and 2027 horizon, with most risks tilted to the downside related to the elevated level of uncertainty, geoeconomic fragmentation and elevated asset prices.

Record valuations in the US...



Source: SG Economic and Sector Studies, LSEG

...and record IT related expenditures in the US



Source: SG Economic and Sector Studies, LSEG

## ECONOMIC FORECASTS

GDP, % YoY	2025f	2026f	2027f	2028f
<b>Developed Markets</b>	<b>1.8</b>	<b>1.3</b>	<b>1.2</b>	<b>1.5</b>
United States	1.7	1.4	1.0	1.8
Japan	1.4	1.0	0.7	0.6
United Kingdom	1.3	1.0	1.2	1.2
Euro area	1.4	0.8	1.0	1.3
Germany	0.3	1.1	1.3	1.6
France	0.8	0.6	0.9	1.3
Italy	0.6	0.5	0.5	0.8
Spain	2.9	2.0	1.6	1.6
<b>Emerging Markets</b>	<b>4.0</b>	<b>3.6</b>	<b>3.6</b>	<b>3.6</b>
Asia	5.0	4.3	4.3	4.3
China	4.9	4.2	4.0	3.8
India	6.5	6.1	6.4	6.5
Central and Eastern Europe	1.8	1.5	1.5	1.5
Latin America	2.3	2.0	2.1	2.2
Brazil	2.3	1.1	1.7	2.3
Middle East and Central Asia	3.5	3.5	3.1	3.1
Africa	3.5	3.8	3.8	3.8
<b>World (PPP weighted)</b>	<b>3.2</b>	<b>2.8</b>	<b>2.7</b>	<b>2.8</b>

CPI, % YoY, avg	2025f	2026f	2027f	2028f
<b>Developed Markets</b>	<b>2.9</b>	<b>2.4</b>	<b>2.2</b>	<b>2.0</b>
United States	2.8	2.9	2.6	2.6
Japan	3.3	1.8	1.5	1.5
United Kingdom	3.5	2.6	2.1	2.1
Euro area	2.1	2.0	1.7	1.9
Germany	2.2	2.0	1.9	1.9
France	1.0	1.4	1.7	1.9
Italy	2.0	1.8	1.7	2.1
Spain	2.5	2.2	2.0	2.2
<b>Emerging Markets</b>	<b>5.5</b>	<b>4.9</b>	<b>4.4</b>	<b>4.3</b>
China	0.3	1.0	1.2	1.5
India	4.3	4.5	4.5	4.5
Brazil	5.1	3.9	3.3	3.5



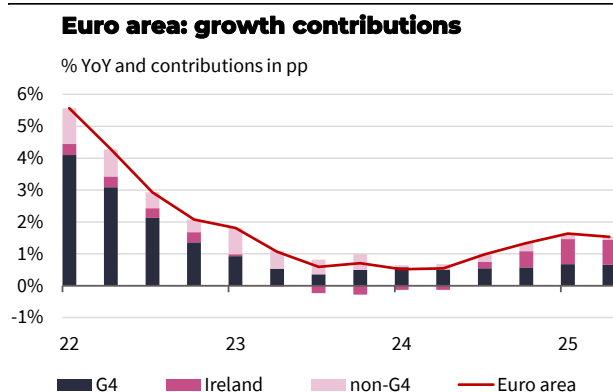
<b>%, EoP (unless otherwise indicated)</b>	<b>Latest 16/12</b>	<b>2026f</b>	<b>2027f</b>	<b>2028f</b>	<b>2029f</b>
Fed Funds target (high)	3.75	3.25	2.75	3.00	3.50
Gov 10y, US	4.18	4.00	4.25	4.25	4.50
ECB Deposit facility rate	2.00	1.75	1.75	2.25	2.75
Gov 10y, Germany	2.85	2.50	2.75	2.75	3.00
Gov 10y, France	3.56	3.30	3.45	3.35	3.60
Gov 10y, Italy	3.53	3.30	3.55	3.55	3.80
Gov 10y, Spain	3.30	3.05	3.30	3.25	3.50
BoE, Bank rate	4.00	3.75	3.50	3.75	4.00
Gov 10y, United Kingdom	4.50	4.50	4.50	4.50	4.75
BoJ, Bank rate	0.50	1.00	1.00	0.80	0.60
Gov 10y, Japan	1.96	1.50	1.50	1.45	1.40
EUR / USD	1.18	1.20	1.20	1.15	1.15
EUR / GBP	0.88	0.88	0.89	0.90	0.90
USD / JPY	155	150	140	145	150
USD / CNY	7.1	7.4	7.3	7.1	7.1
Oil Brent (USD/b)	61	65	70	70	70
European Natural Gas (TTF, EUR/MgW/h)	27	35	40	40	40
EU ETS carbon (EUR/Metric ton)	85	100	110	120	130

## EURO AREA

- Euro area growth will slow as temporary effects ease, before consumption and investment gain momentum, as fiscal support in Germany kicks-in and uncertainty in France eases
- Inflation is easing but remains sticky, narrowing the window for further ECB rate cuts
- Risks lean to the downside, driven by political uncertainty and trade tensions, while productivity gains and easier credit could provide upside surprises

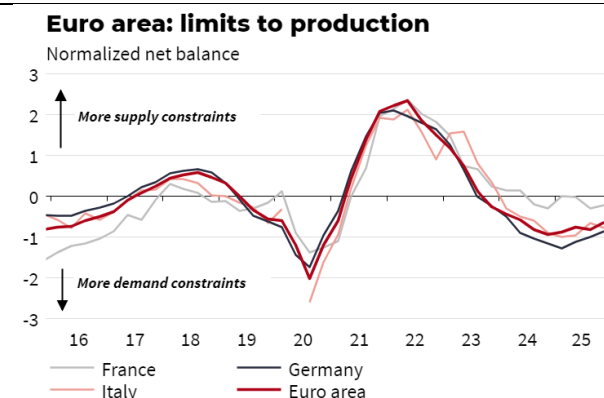
**Growth in the euro area is projected to slow in 2026 before gradually gaining momentum over the medium term.** The upside surprise in 2025 was largely driven by Ireland and Spain – with Ireland benefiting from export frontloading and related investment, and Spain from resilient private consumption and investment through EU funds. As Ireland's contribution is temporary, underlying economic dynamics in the euro area will progressively become more apparent. In the year ahead, consumption is expected to slow as the momentum in Spain and Italy eases, wage growth softens, and sentiment in Germany and France remain hesitant. Medium-term we expect growth pick up to 1.0% in 2027 and 1.3% in 2028, supported by Germany's fiscal expansion taking effect and France returning to its growth trajectory.

### Euro area growth has been largely driven by Ireland and Spain in 2025



Source: Eurostat, SG Economic and Sector Studies

### Most major euro area countries continue to suffer from stronger demand constraints



Source: DG ECFIN, SG Economic and Sector Studies

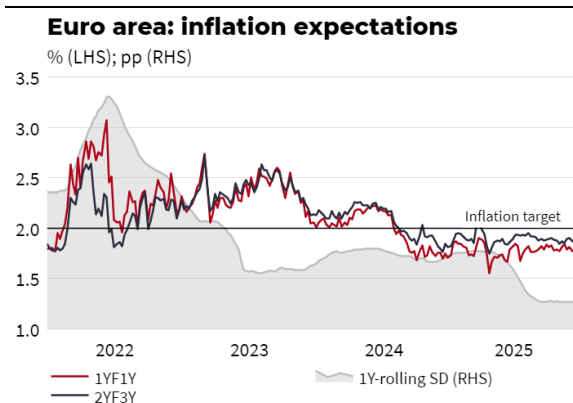
Note: Supply constraints include the availability of labour as well as access to materials and equipment.

**Inflation is easing more slowly than anticipated, as core inflation remains sticky.** In 2026, headline inflation is projected to decline only marginally to 2.0%, while core inflation is expected to ease to a similar level as wage growth and service prices gradually moderate. Among major economies, persistent inflation in Germany continues to offset lower inflation in France. Market pricing indicates short- and

medium-term average inflation persistently just below target, with volatility recently subsiding. This reinforces the view of well-anchored expectations. Downside risks to inflation include cheaper imports from China, productivity gains from AI adoption, and a sharper-than-expected slowdown in wage growth, while an upside growth performance would exert upward pressure on prices. In 2028, moreover, the delayed introduction of ETS2 is likely to exert upward pressure on prices through higher carbon costs for sectors covered under the expanded emissions trading system.

**As the growth outlook remains slow and inflation is expected to be firmly at target, we see room for just one final ECB rate cut.** While conditions appear relatively favourable in the second half of 2025, the ECB's "good place" is likely to become slightly weakened. With growth momentum expected to fade in 2026 and no significant risk of inflation de-anchoring, we expect the ECB to conclude its rate-cutting cycle, after a small pause, with one last cut in the first half of 2026. Meanwhile, quantitative normalization is expected to proceed at its current pace until at least the second half of 2026, weighing on core term premia. In the absence of major shocks, spreads are expected to remain broadly stable in the near term, as markets have already priced in political turmoil in France, while the tightening phase for Spanish and Italian spreads has ended following their strong macro-fiscal performance.

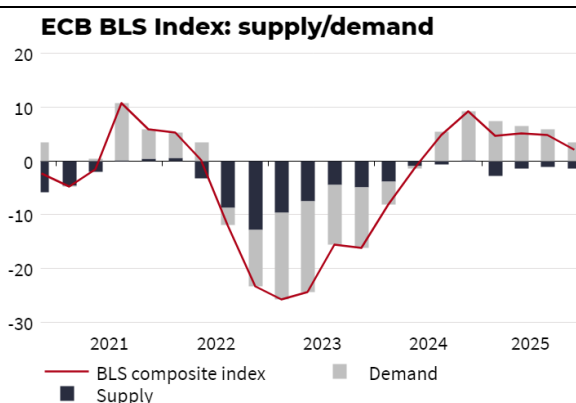
#### **Inflation expectations have remained persistently below target as volatility declined**



Source: LSEG, SG Economic and Sector Studies

Note: ILS forwards include risk and liquidity premia and are therefore not a pure read of inflation expectations. The 1 year rolling standard deviation (SD) is computed from the time series of ILS forwards with lower SD suggesting more stable expectations, while higher SD signals greater uncertainty.

#### **Continuously tight credit conditions weigh on dynamic demand**



Source: ECB, SG Economic and Sector Studies

**Credit conditions are expected to ease only slowly, which will support investment in the medium term.** The recent tightening of credit conditions has been driven by heightened risk perceptions linked to geopolitical uncertainty and sector-specific vulnerabilities. On the demand side, firms' appetite for loans grows but remains subdued, supported mainly by refinancing needs rather than investment. Demand from households continues to rise for housing loans and is stable for consumer credit. Overall, restrictive credit supply is weighing on recently

dynamic bank lending, even as demand contributes positively, albeit at a slow pace. Looking ahead, investment growth is expected to remain resilient, as uncertainty eases and the outlook improves, ticking up to 1.7% in 2026 before accelerating to 2.0% in 2027.

**The unemployment rate is projected to edge higher as growth slows.** The euro area labour market divergence, with strong employment growth and lower unemployment in the South and limited employment growth and stable to rising unemployment in the Core, is expected to persist in the near term before moderating over the medium term. Overall employment growth across the bloc continues to decelerate in line with recent trends, as reflected in negative and subpar employment expectations. Upward pressure on unemployment, particularly in France, is likely to intensify in the year ahead. Medium term, easing growth in Southern countries and stronger growth in France and Germany are projected to narrow intra-bloc divergence.

**The risk profile of our central scenario is tilted to the downside.** Core downside risks to growth stem from a slower recovery in key economies, notably France and Germany. Persistent uncertainty in France, driven by prolonged political gridlock and delays, or worse, misallocation of the fiscal package in Germany, would further weigh on activity. In addition, renewed trade frictions could dampen external demand. A flare-up in tensions with the United States or sustained export restrictions on rare earths from China would also constrain growth. On the upside, improved sentiment, if uncertainty eases further than expected, both domestically and internationally, could support consumption. Moreover, productivity gains from the adoption of AI could provide a boost across implementing economies but only in the medium term.

Euro area	2025f	2026f	2027f	2028f
Real GDP, % YoY	1.4	0.8	1.0	1.3
Household consumption	1.3	0.6	0.7	1.2
Public consumption	1.6	0.6	0.8	1.0
Investment	1.3	1.7	2.0	2.2
Exports of goods & services	0.5	1.5	2.2	2.3
Imports of goods & services	2.0	2.1	2.4	2.6
Inflation, % annual average	2.1	2.0	1.7	1.9
Core inflation, % annual average	2.4	2.0	1.7	1.9
Real gross disposable income (GDI), % YoY	1.1	0.6	0.7	1.0
Households saving rate, % of GDI	15.0	15.0	15.0	14.9
Unemployment, % of labour force	6.4	6.6	6.6	6.5
Fiscal balance, % of GDP	-3.3	-3.5	-3.2	-3.0
Public debt, % of GDP	91	93	95	97
Current account balance, % of GDP	1.7	1.4	1.4	1.2

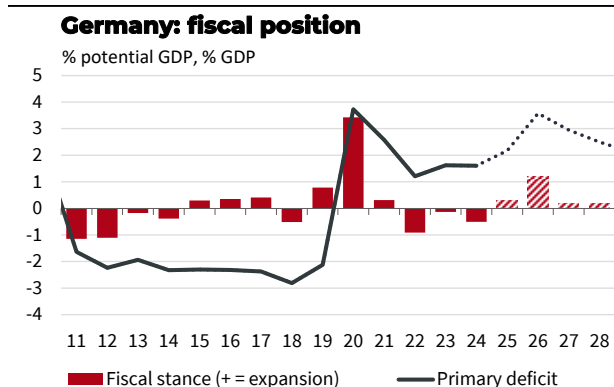
## GERMANY

- **Fiscal package rollout accelerates, but allocation issues, supply-side constraints and bureaucratic hurdles limit its long-term impact**
- **Growth will pick up on domestic consumption while manufacturing and net exports remain a drag**
- **Persistent competitiveness losses, demographic pressures, and the absence of bold reforms amplify downside risks and dampen sentiment**

**Growth is expected to gradually accelerate (1.1% in 2026 and 1.3% in 2027), supported by a stronger fiscal impulse and improving household finances.**

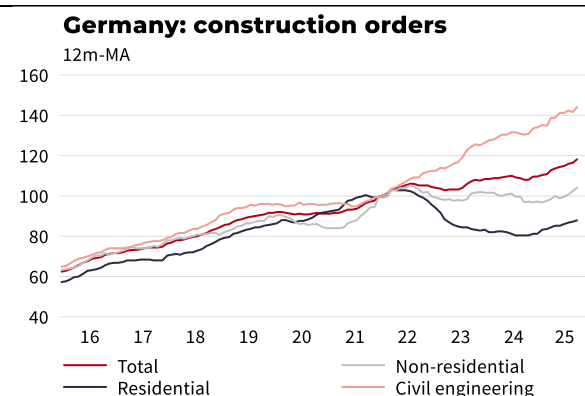
Consumers will continue to benefit from robust wage growth and net social transfers and are likely to increase spending as prices stabilize and unemployment does not pick up. The gradual decline in the household saving rate will support growth over the forecast horizon and facilitate a rebalancing of the economy toward domestic demand. The investment outlook remains mixed: civil engineering will be boosted by the ramp-up in disbursements from the SVIK special funds<sup>1</sup>, while construction will stay subdued as the real estate sector struggles to recover. Commercial real estate players are the biggest laggards, facing persistent financial pressures: the NPL ratio in the sector has nearly tripled since 2022, according to the Bundesbank. Sluggish residential construction will continue to weigh on housing affordability, particularly in large cities and for younger households.

**The announced fiscal impulse provides a lift to growth with lagged effects**



Source: AMECO, SG Economic and Sector Studies

**Investment is polarized between fiscally led civil construction and sluggish real estate**



Source: Destatis, SG Economic and Sector Studies

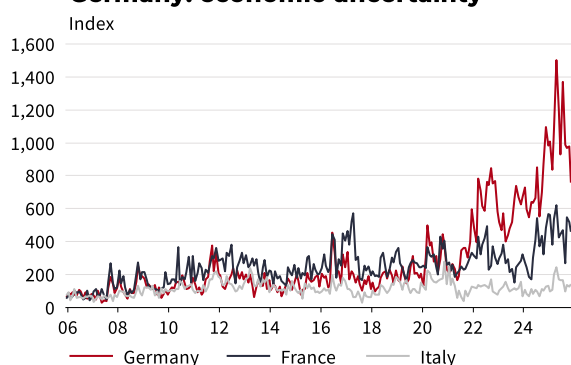
**The gradual ramp-up in the implementation of the fiscal package will weigh on public accounts, while its impact on activity remains uncertain.** National budget

<sup>1</sup> A special fund of EUR 500bn for infrastructure and climate neutrality will be dedicated to national infrastructure, while EUR 100bn will fund state-level projects and the Climate Transformation Fund (KTF).

plans foresee an increase in net borrowing to 4.8% of GDP in 2026 and 4.3% in 2027 to finance the disbursements linked to the package. This will push public debt above the 70% of GDP threshold by 2027, in a context where Bund yields remain relatively elevated as the ECB continues its quantitative normalization program in 2026. The fiscal impulse is expected to have lagged effects on growth, as implementation faces persistent supply-side constraints and bureaucratic hurdles. Downside risks are significant, given unresolved doubts about the allocation of funds. The possibility of reclassifying previously planned expenditures under the package and pork-barrel spending could dilute its aggregate impact on activity and positive spillovers on long-term variables, most notably productivity. The deployment of funds continues to encounter administrative bottlenecks and uncertainty, especially in the defence component of the package. Additional challenges stem from high political and economic uncertainty that has not eased in spite of the change of Government earlier in the year.

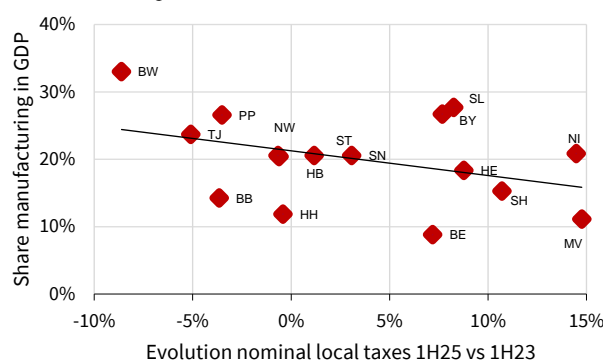
### Political pressure on the coalition has not eased, rising economic uncertainty above peers      Manufacturing losses have trickle down consequences on local tax revenues

**Germany: economic uncertainty**



Source: EPU, SG Economic and Sector Studies

**Germany: local taxes**



Source: Destatis, SG Economic and Sector Studies

**Risks remain skewed to the downside, as structural challenges continue to weigh on Germany's growth outlook.** The economy faces a secular manufacturing recession, driven by eroding competitiveness amid persistent frictions in global value chains, rising unit labour costs, and heightened competition from Asian producers, even in flagship sectors such as capital goods and automobiles, where the premium edge of German manufacturers is fading. A strong euro further compounds these pressures. The government's plan to subsidize industrial energy costs until 2028 may temporarily ease production burdens but is unlikely to halt the ongoing process of deindustrialization, particularly as China's export-led growth model intensifies global competition. Against this backdrop, Germany's growth model will need to pivot successfully toward domestic demand, as exports will no longer provide the same contribution to activity. This structural shift carries significant microeconomic implications, in some segments of the labour market, and manufacturing-intensive regions are likely to experience economic decline. Early signs of this adjustment are visible in mounting pressure on local tax revenues in manufacturing-oriented Länder.

The absence of structural reforms further challenges Germany's ability to sustain robust growth. Firms continue to face significant administrative burdens and barriers to competition that hinder dynamism and discourage new entrants. Meanwhile, the country's demographic profile is deteriorating, exacerbating shortages of skilled labour and increasing pressure on social security finances. Implementing bold reforms to reduce red tape, foster competition, and advance European initiatives such as Savings and Investment Union and the completion of the Banking Union would improve the medium-term outlook.

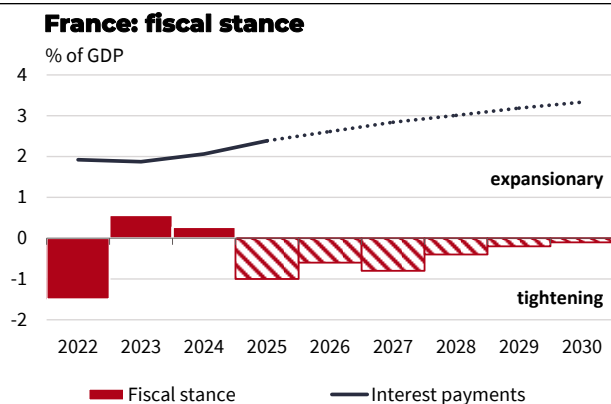
Germany	2025f	2026f	2027f	2028f
Real GDP, % YoY	0.3	1.1	1.3	1.6
Household consumption	1.1	1.2	1.2	1.4
Public consumption	2.2	2.5	2.3	2.3
Investment	-0.5	2.1	2.8	3.2
Exports of goods & services	-0.5	0.9	1.1	1.7
Imports of goods & services	2.8	2.0	2.0	2.3
Inflation, % annual average	2.2	2.0	1.9	1.9
Core inflation, % annual average	2.7	2.2	1.9	1.9
Real gross disposable income (GDI), % YoY	0.6	1.0	1.1	1.2
Households saving rate, % of GDI	19.6	19.4	19.3	19.0
Unemployment, % of labour force	6.3	6.3	6.3	6.1
Fiscal balance, % of GDP	-3.3	-4.8	-4.3	-4.0
Public debt, % of GDP	65	69	73	77
Current account balance, % of GDP	4.7	4.1	4.1	3.9

## FRANCE

- **Uncertainty continues to shape France's economic outlook as political gridlock weighs on confidence**
- **Weak confidence and high household savings delay recovery in consumption and investment**
- **Downside risks dominate with the possibility of adverse political scenarios**

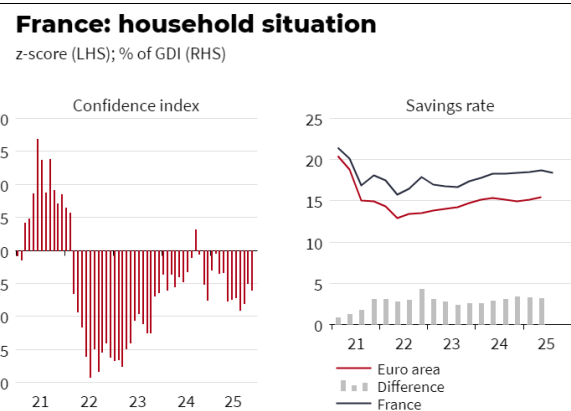
**Uncertainty continues to shape the economic outlook** as political gridlock weighs on confidence among consumers, businesses, and financial markets. Parliamentary fragmentation, fragile governing coalitions, and acute time pressure create a complex backdrop for economic policy. Work continues to secure the 2026 Budget as we head to press, but even if compromise is found the cost has been high with pension reform delayed and prospects for more costly budget consolidation for economic growth. A still fragmented National Assembly, moreover, entails that vital structural reforms are being delayed and political risks continue to linger in the background weighing on sentiment.

### The fiscal stance is likely to remain restrictive going forward



Source: DG ECFIN, SG Economic and Sector Studies

### High uncertainty drives the French savings rate notably above the euro area's



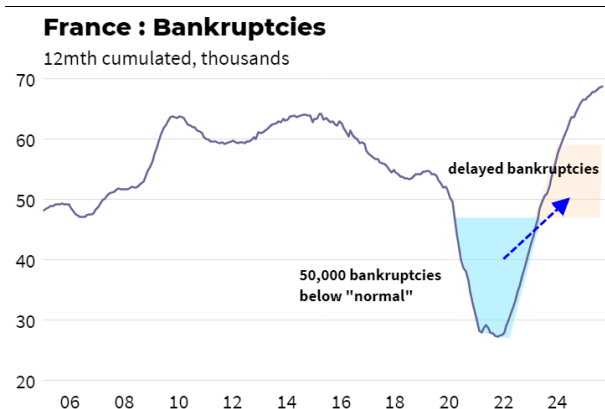
Source: INSEE, Eurostat, SG Economic and Sector Studies

**The budget debate remains the main source of political friction.** After a projected deficit of 5.4% in 2025, down from 5.8% in 2024, fiscal policy is set to remain restrictive in 2026, with a deficit reduction to around 5.2% under our central, compromise scenario. Adjusting social spending remains highly sensitive, while interest payments are rising. Additional revenues are expected to come from higher taxes on large corporations and financial transactions. To secure backing from the left, Prime Minister Lecornu offered to freeze the 2023 pension reform until early 2028 and pledged not to invoke Article 49.3, the government's constitutional tool to impose a budget law, during the debate. The pension freeze alone adds up to EUR 3.5bn to government spending until 2027.



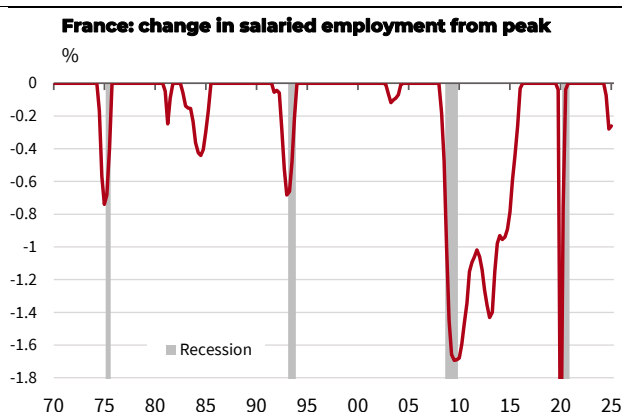
**Economic sentiment is expected to remain weak with only slow improvement medium-term, translating to a slow recovery of consumption, investment, headline growth.** Private consumption is expected to stay subdued in the near term, as households continue to prefer to save rather than spend despite rising disposable income. The elevated saving rate will therefore persist but slowly decline in the medium term, as the recent key drivers of political uncertainty and higher interest rates ease. The absence of fiscal stimulus in 2026 will also leave consumption without immediate support. Household investment will slowly rebound, supported by easing financial conditions and fiscal incentives for residential real estate, while business investment is unlikely to strengthen before 2027, when sentiment improves, and simplification reforms gradually take hold. External conditions are not expected to offer relief in the year ahead, with trade frictions and structural challenges continuing to constrain export growth. Greater political clarity and stronger external demand are expected to pave the way for a more pronounced recovery, but not before 2027.

#### Surging bankruptcies are partially driven by a rebound effect post-Covid



Source: Banque de France, SG Economic and Sector Studies

#### Salaried employment has been declining since 3Q24, typically coinciding with recessions



Source: INSEE, SGCIB, SG Economic and Sector Studies

**A combination of cyclical factors and a catch-up effect post-Covid has driven higher bankruptcies.** Amid weak growth and persistently tight financial conditions, business bankruptcies have surged to a record 69,600 over the 12 months to September 2025. This sharp increase, however, reflects not only cyclical pressures but also a catch-up effect following the pandemic. During 2020–2022, extensive public support measures prevented an estimated 50,000 insolvencies, creating an unusually low baseline. Current figures are therefore inflated by these delayed failures with the withdrawal of policy support. The most affected firms are small enterprises (TPEs), mature (>6 years old), concentrated in construction, retail, and hospitality. This trend signals a normalization toward long-term averages and is likely to persist in the near-term weak growth environment. Given the profile of these companies, the impact on banks' cost of risk should remain contained.

**Employment pressures are expected to rise in the short term as uncertainty, weak growth, and elevated bankruptcies weigh on labour demand.** Since

salaried employment peaked in 3Q24, the economy has recorded three consecutive quarters of net job losses, leaving employment 0.3% below its peak by 2Q25. Historically, such a trend has frequently coincided with recession, which has not materialized so far but underscores the fragility of the already weak growth dynamic. Deteriorating employment sentiment, coupled with weak growth and investment, puts downward pressure on employment and household confidence. As a result, unemployment is projected to edge up to 7.9% in 2026 before stabilizing and slowly retreating over the medium term.

**Our central scenario remains subject to predominantly downside risks to growth as the political situation remains volatile.** This environment may reinforce caution among households and firms, weighing on consumption and investment. On the financial side, concerns over the fiscal and debt trajectory, paired with large issuances of Germany could again widen the French sovereign spread. On the upside, growth could surprise if household saving rates decline more rapidly if uncertainty resolves. Stronger business investment and export performance, supported by rising demand for defence, digital, and green technologies both at home and across Europe, could provide a boost.

France	2025f	2026f	2027f	2028f
Real GDP, % YoY	0.8	0.6	0.9	1.3
Household consumption	0.4	0.7	0.9	1.2
Public consumption	1.4	0.3	0.6	1.0
Investment	-0.1	0.9	1.4	2.0
Exports of goods & services	0.7	1.6	2.6	2.7
Imports of goods & services	1.9	2.5	2.7	2.9
Inflation, % annual average	1.0	1.4	1.7	1.9
Core inflation, % annual average	1.6	1.6	1.8	2.0
Real gross disposable income (GDI), % YoY	0.7	0.7	0.6	0.6
Households saving rate, % of GDI	18.5	18.4	18.1	17.5
Unemployment, % of labour force	7.6	7.9	7.8	7.8
Fiscal balance, % of GDP	-5.4	-5.2	-4.8	-4.3
Public debt, % of GDP	116	118	120	121
Current account balance, % of GDP	-0.4	-0.5	-0.4	-0.4

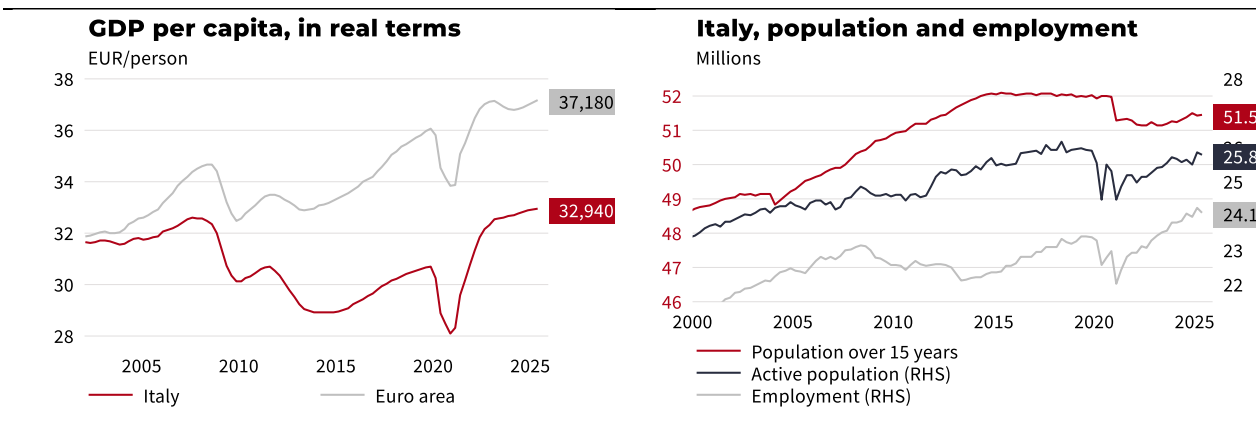
# ITALY

- **Growth is expected to remain weak, weighed down by sluggish exports and muted household consumption**
- **Italy is likely to exit the excessive deficit procedure in 2026, posting the first below 3% public deficit since 2019**
- **Public debt will continue to rise until 2027 reaching 138% of GDP, and is set to decline gradually thereafter**

**GDP in the third quarter of 2025 was 0.4% higher than a year earlier.** Output stagnated in the second and third quarters as weaker exports and heightened uncertainty weighed on activity and spending. Rising capital investment, buoyed by accelerating spending on the NGEU projects, has driven output growth. Industrial production stabilised mid-year after an extended period of broadly-based decline, with output rising for most goods with the notable exception of transport equipment. Construction activity continued to grow, despite the withdrawal of various tax incentives. Household consumption volumes stalled in the middle of the year and households increased their savings rates. This was despite solid labour market conditions and rising real incomes, with employment rising by 0.7% in the first 9 months of 2025, the labour force by 1.1% and the average wage rate by 3.3%.

**The economy has proved relatively resilient since the end of the Covid pandemic,** benefitting from its large and diversified industrial base and export sector. GDP per capita is now back to its 2007 peak level, and 7% above pre-Covid crisis (versus 3% for the euro area).

## Growth has stalled after a rapid post-Covid recovery, but employment is still buoyant



Source: Eurostat, LSEG, SG Economic and Sector Studies

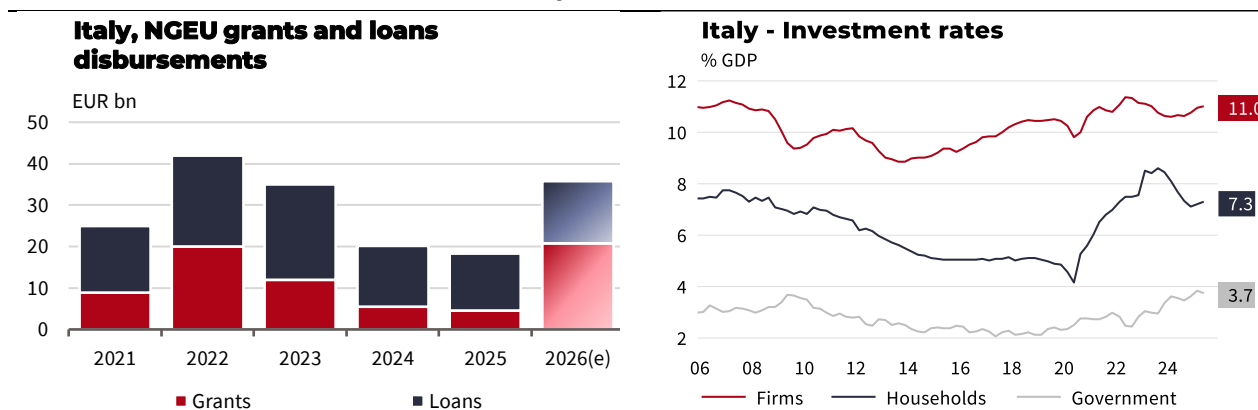
Source: Istat, LSEG, SG Economic and Sector Studies

**GDP growth is set to continue at a slow pace of 0.5% over the next two to three years.** Weak export growth and the effects of global policy uncertainty are expected to drag down activity into the first half of 2026, before exports and activity pick up as conditions stabilise. Rising public investment is projected to support growth through 2026, buoyed by accelerating disbursement of the NGEU funds ahead of its deadline,

before slowing in 2027. Greater certainty, improved borrowing conditions, and ongoing implementation of the NGEU projects are expected to nurture greater business investment and consumer demand in 2027, offsetting the winding back in public investment spending. Inflation is expected to remain modest, as wage pressures abate with slower employment growth than in recent years.

**Lower-than-expected annual spending of allocated funds has reduced the potential stimulus for the economy.** In 2021 the government projected a cumulative impact of 2.4pp of additional real GDP growth for 2021-2024, which was revised to 1pp in 2024. Most of the economic stimulus is now expected in 2025-26, with an estimated cumulative impact of 2.7pp of additional real GDP growth. However, this implies exceptionally high expenditure of EUR 37bn in 2025 and EUR 49bn in 2026, which is unlikely. Moreover, by the end of 2026, most of the EUR 194bn will be allocated to projects that are then implemented in subsequent years. The recovery plan's capacity to stimulate Italian GDP growth will be spread over a longer period than initially projected.

#### EUR 35bn worth of funds to be disbursed by end 2026



Source: European Commission, RRF scoreboard, SG Economic and Sector Studies

Source: Istat, LSEG, SG Economic and Sector Studies

**The fiscal deficit is set to decline to 3.0% of GDP in 2025**, following the return of the primary budget balance to surplus in 2024, mostly thanks to rising personal income tax revenues and social security receipts due to the labour market's strength and less-than-planned spending, notably on construction incentives. The deficit is projected to decline to 2.6% of GDP in 2028 through slower growth in public investment and public payrolls, paving the way for exiting the EU procedure in 2026, one year ahead of schedule. The primary budget surplus is projected to rise to 1.6% of GDP in 2028, exceeding the level required to stabilize the public debt ratio.

**The draft 2026 budget aims to reduce the deficit** but lightens some taxes on employment and extends some incentives, financed through one-off and ongoing revenue sources. The budget cuts personal income tax rates for middle income earners, workers with unusual hours and with small bonus payments, expands some social benefits, and encourages renewal of low-wage contracts. It extends certain tax incentives for businesses, and tax credits for housing renovations. These measures

are funded in part through extra taxes on banks and insurance companies (worth 0.2% of GDP), and by raising the lump-sum 'flat tax' on new residents' foreign income by 50%.

**Public debt is forecast at 138% of GDP in 2026 as the Super Bonus housing renovation tax credits are recorded in the stock of debt.** Past interest rate hikes and weak growth also weighs on public debt dynamics. However, the public debt ratio is expected to decline as of 2028, when the primary surplus reaches 1.6% of GDP, just enough to put the ratio on a downward trend.

**Finally, Italy's growth potential over the medium term** should be supported by the implementation of structural reforms planned by 2026 related to the judicial system, competition law, public administration and procurement reforms, among others. These reforms and their impact on Italy's growth potential are critical to sustain Italy's high public debt burden.

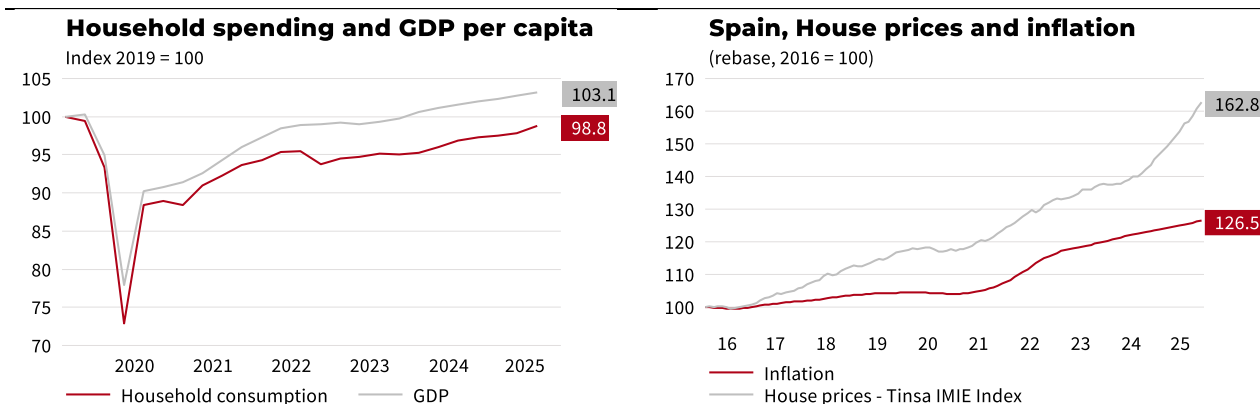
Italy	2025f	2026f	2027f	2028f
Real GDP, % YoY	0.6	0.5	0.5	0.8
Household consumption	0.6	0.3	0.5	0.7
Public consumption	0.4	0.4	0.4	0.4
Investment	2.5	1.2	0.7	1.4
Exports of goods & services	0.0	0.9	2.3	2.8
Imports of goods & services	2.2	1.7	2.5	2.9
Inflation, % annual average	2.0	1.8	1.7	2.1
Core inflation, % annual average	2.0	1.8	1.7	2.2
Real gross disposable income (GDI), % YoY	1.4	0.6	0.4	0.5
Households saving rate, % of GDI	12.5	12.8	12.7	12.5
Unemployment, % of labour force	6.1	6.1	6.3	6.3
Fiscal balance, % of GDP	-3.0	-2.8	-2.8	-2.6
Public debt, % of GDP	136	138	138	137
Current account balance, % of GDP	1.1	0.5	0.5	0.4

## SPAIN

- **Growth will continue to outperform, supported by the influx of foreign labour, but the economy is changing gears**
- **The economy is set to decelerate as engines of recent growth lose steam**
- **Climate change may end up taking a toll on tourist arrivals**

**Growth continues to surprise on the upside**, and Spain keeps overperforming the euro area despite inner political tensions, an unprecedented heatwave and global uncertainties. Real GDP grew by 2.8% year-on-year in the third quarter of 2025, driven by robust gross capital formation and private consumption. Social security affiliations grew at a year-on-year rate of 2.4% in October, while the unemployment rate declined to 10.5% in September. Strong job creation and nominal wage growth supported steady gains in gross disposable incomes. Business expectations continued to improve in the third quarter of 2025. Headline inflation rose to 3.2% in October, largely driven by higher electricity prices while the partial extension of transport subsidies helped offset some of the increase. Core inflation reached 2.9% in October, with persistent services price inflation.

### Household's spending remains muted while tourism is inflating house prices



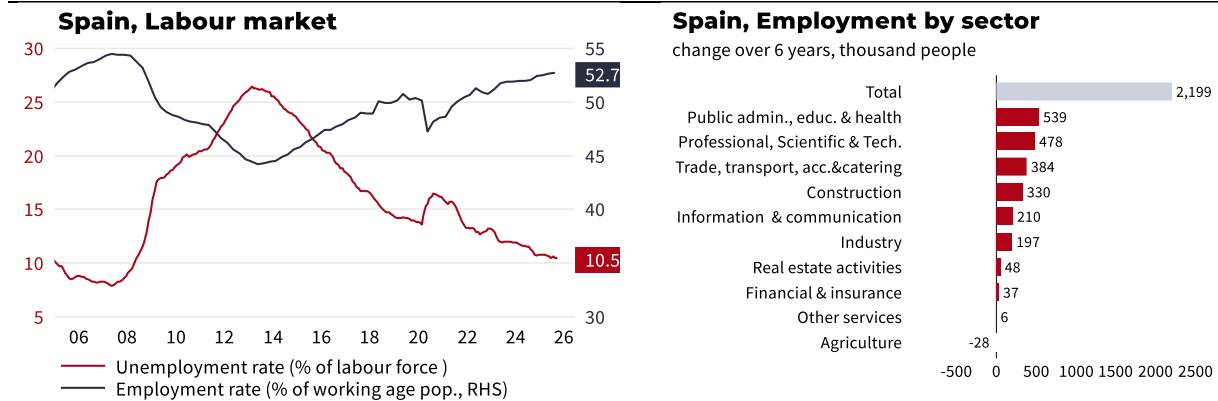
Source: European Commission, RRF scoreboard, SG Economic and Sector Studies

Source: INE, LSEG, SG Economic and Sector Studies

**Credit to non-financial private businesses has expanded**, following monetary easing. Housing credit to households and credit to firms increased by 2.9% and 2.3% respectively year-on-year in September 2025.

**Spain's trade deficit widened in the first half of the year**, with imports growing faster than exports due to strong domestic demand and elevated trade uncertainty. Tourism exports continue to grow, though at a slower pace. Direct exposure of Spain to US tariffs remains limited, with exports of goods to the United States accounting for only 1.1% of GDP. However, Spain is exposed to any weakening of demand from its main European trading partners.

## Labour market shows no sign of softening and job creation is broad-based



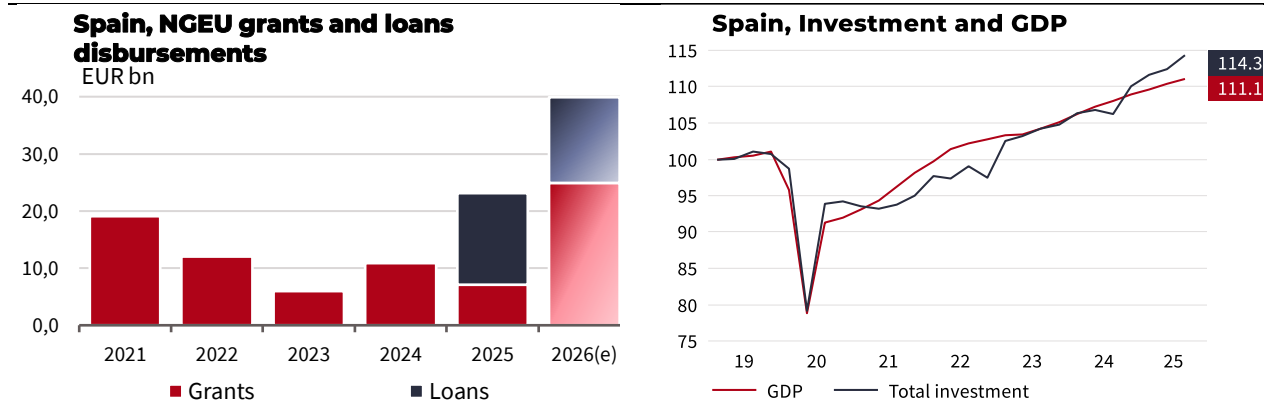
Source: INE, LSEG, SG Economic and Sector Studies

Source: Eurostat, LSEG, SG Economic and Sector Studies

### The Spanish economy is entering a new and more moderate phase of expansion

in which the engines of recent growth are losing steam. Public consumption and foreign tourism drove the recovery, exceeding pre-pandemic levels by 18% and 43%, respectively. Growth is now supported more by household consumption and investment, which are both welcome. The trend is likely to continue given sound household balance sheets, lower inflation, employment and wage gains, as well as the expected fall in interest rates as of 2026. Investment is driven by residential construction (benefiting from lower interest rates) and public investment by the resources allocated to help the victims of the floods in Valencia and the NGEU funds.

## Up to EUR 40bn worth of funds to be disbursed by end 2026



Source: European Commission, RRF scoreboard, SG Economic and Sector Studies

Source: INE, LSEG, SG Economic and Sector Studies

**In August, the European Commission disbursed EUR 23.1bn to Spain**, which will support measures to boost renewable energy, cut red tape, and improve justice efficiency. The funds will also be invested in short-distance rail travel and strengthen cybersecurity resilience. This is twice the amount received in 2024 (EUR 11bn), and there is still up to EUR 40bn worth of NGEU funds to be disbursed by end 2026, out of a total envelope of EUR 163bn (13% of GDP).

**Spain has not passed a budget since 2023, and the 2026 budget was rejected by Parliament end-November.** The most likely scenario is that Spain will run a third consecutive year with the 2023 budget. As a consequence, the fiscal stance is set to

be broadly neutral. The fiscal deficit was narrowed to 2.5% of GDP in 2025 due to higher economic growth and stronger-than-expected revenues. The deficit is projected to narrow further in 2026 and 2027 towards 2.1% of GDP, largely reflecting the withdrawal of support following the floods in the Valencia region, higher revenue from strong job creation and solid economic growth. As a result, public debt will gradually decline to 96% of GDP in 2028.

**The country is required to conduct a gradual increase in defence spending in 2025 and 2026 to reach 2% of GDP.** The government would have to nearly double its defence budget, to EUR 33.7bn from EUR 17.5bn last year, to reach the 2% of GDP target. This will be challenging given the ongoing lack of parliamentary support.

**Despite the current political deadlock, PM Sanchez is unlikely to resign before 2027.** The intense wildfire this summer and corruption cases linked to the PM inner circle have led to a political crisis in Spain. The government was accused of an “inefficient and slow” response to the fires. Despite mounting pressure, Sánchez reiterated that neither resignation nor early elections are under consideration, as he seeks to keep his fragile coalition afloat until the 2027 elections.

Spain	2025f	2026f	2027f	2028f
Real GDP, % YoY	2.9	2.0	1.6	1.6
Household consumption	3.4	2.4	1.8	1.8
Public consumption	1.5	1.7	1.0	0.8
Investment	5.5	3.1	1.9	1.7
Exports of goods & services	3.7	2.2	2.6	2.7
Imports of goods & services	5.7	3.2	2.7	2.7
Inflation, % annual average	2.5	2.2	2.0	2.2
Core inflation, % annual average	2.6	2.3	2.0	2.2
Real gross disposable income (GDI), % YoY	2.7	1.9	1.6	1.4
Households saving rate, % of GDI	12.1	11.7	11.5	11.1
Unemployment, % of labour force	10.6	10.6	10.8	10.9
Fiscal balance, % of GDP	-2.5	-2.1	-2.1	-2.1
Public debt, % of GDP	100	98	97	96
Current account balance, % of GDP	2.7	2.1	2.1	2.0

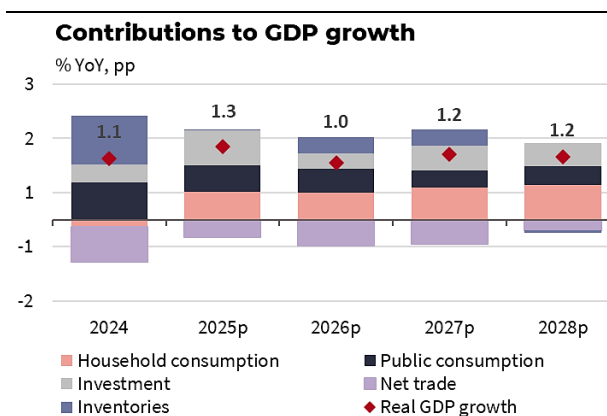


## UNITED KINGDOM

- GDP growth will slow in 2026, exposing underlying economic fragilities
- The Autumn Budget signals a modest tightening of the fiscal stance, though fiscal consolidation will be insufficient to stabilise the debt
- Inflation will converge to the BoE's 2% target in 4Q26, as labour market slack builds

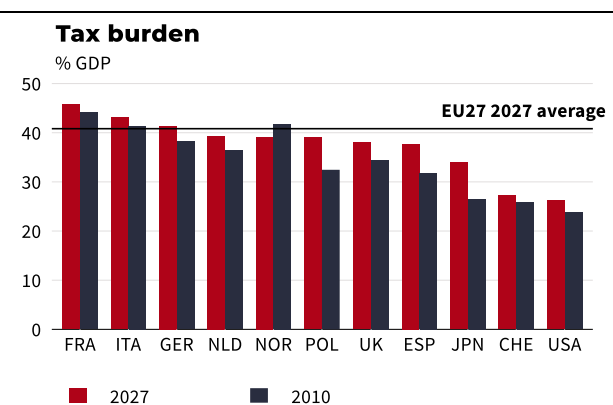
**Momentum has eased in 2H25, but the yearly overall performance remains resilient.** Activity has been supported by strong government consumption and investment, particularly in housing and public infrastructure. In contrast, elevated uncertainty continues to weigh on exports, business investment, and household spending. We forecast real GDP growth of 1.3% YoY in 2025, ahead of European peers, but expect it to slow to 1% in 2026 as fiscal support fades and weak private demand exposes underlying economic fragilities.

### GDP forecast: resilient growth



Source: ONS, SG Economic and Sector Studies

### Tax burden is rising but still below EU average



Source: EU Commission, OBR, SG Economic and Sector Studies

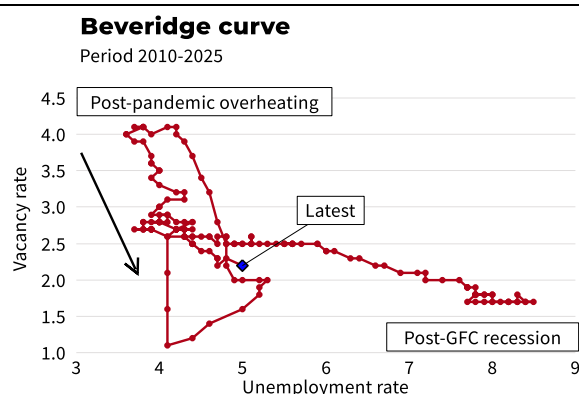
**The Autumn Budget signals a modest tightening of the fiscal stance, moving the UK closer to a European-style model of high taxation and high public spending.**

Tax increases from 2028 are expected to raise around GBP 26bn annually by FY 2029–30 (0.9% of 2025 GDP), largely driven by the freeze on income tax thresholds that will push a quarter of employees into higher tax brackets. This additional revenue has more than doubled the government's fiscal headroom to GBP 22bn (0.8% of 2025 GDP), the highest since March 2022, giving public finances greater capacity to absorb future shocks. As a result, the tax burden is projected to reach 38.2% of GDP by 2030, the highest since World War II but still below the EU average of 40.7%. Public spending is forecast to rise to 44.3% of GDP, about 5pp above pre-Covid levels, marking a structural shift toward a larger state and ending the UK's previous, fiscally unsustainable mix of European-style spending and US-style low taxation.

**The fiscal consolidation will be insufficient to stabilise the debt.** Current plans imply halving real-terms growth in public service spending from FY2028-29, with cuts of 3.3% per year for “unprotected” departments such as policing, courts, and local government. We view these plans as difficult to deliver: implementing both higher taxes and lower spending in an election year (2029) will be politically challenging. Instead, we expect tax increases to proceed —given the UK’s relatively low starting point compared with EU peers— but the 2027 Spending Review will moderate the spending cuts. As a result, the fiscal deficit is set to narrow gradually, leaving the primary balance insufficient to stabilise the debt-to-GDP ratio. We expect gilt yields to remain elevated, with markets pricing in a persistent “UK risk premium” that keeps the 10Y yield averaging around 4.5% over the medium term.

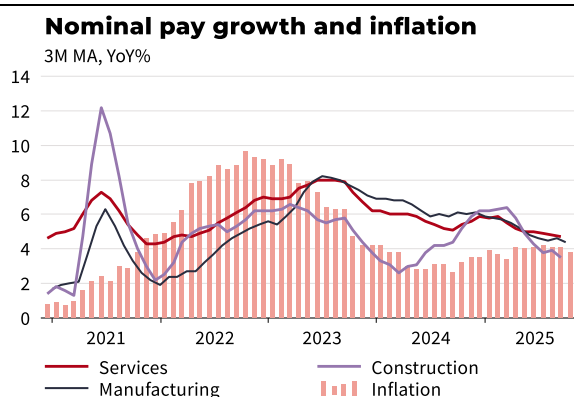
**Household consumption is expected to remain weak, with only a gradual recovery from 2027–28.** Recent government measures reinforce two opposing forces shaping post-Covid private spending: the 4% rise in the minimum wage (8.5% for 18–20-year-olds) will support income growth in the short term. However, medium-term tax increases, with fiscal drag from frozen thresholds, will weigh on incomes, limiting real disposable income growth to 0.8% per year on average over 2028–2030. Elevated uncertainty, a cooling labour market, and sticky mortgage rates will encourage households to maintain precautionary savings, keeping the saving ratio above its long-term average. As a result, private consumption is likely to remain sluggish for longer than previously expected.

### Labour market cooling



Source: ONS, LSEG, SG Economic and Sector Studies

### Declining wage growth, both nominal and real



Source: ONS, LSEG, SG Economic and Sector Studies

**Inflation will remain above the BoE’s 2% target until 4Q26, as labour market slack builds.** Headline inflation eased to 3.6%YoY in October from 3.8% in September — the first decline in five months — but remains the highest in the G7. The Autumn Budget is unlikely to alter this trajectory: upward pressure from the 2026 minimum wage increase will be offset by extended fuel duty freezes and lower energy bills. Meanwhile, the labour market continues to soften, with unemployment at 5% (a five-year high), vacancies falling since mid-2022, and hiring intentions at their weakest in four years. Wage growth is slowing, down to 4.6%YoY in September from a 5.9% peak in February and is expected to converge to 3.2% by end-2026 as slack widens. We

forecast the disinflationary momentum to accelerate in April 2026 as the impact of regulated price hikes and higher labour costs drops out of annual comparisons, allowing inflation to return to the BoE's 2% target in 4Q26.

**Risks to the outlook remain skewed to the downside.** A persistently high saving ratio could decline more slowly than expected as rising taxes and uncertainty encourage caution, delaying the recovery in household consumption. Inflation and interest rate paths also face risks: the current persistently high inflation expectations could weaken the traditional link between wage moderation and labour market slack, slowing disinflation and forcing the BoE to keep rates higher for longer.

United Kingdom	2025f	2026f	2027f	2028f
Real GDP, % YoY	1.3	1.0	1.2	1.2
Household consumption	0.8	0.8	1.0	1.0
Public consumption	2.3	2.1	1.5	1.6
Investment	3.4	1.5	2.3	2.2
Exports of goods & services	3.2	1.0	1.4	2.0
Imports of goods & services	4.0	2.3	2.5	2.4
Inflation, % annual average	3.5	2.6	2.1	2.1
Core inflation, % annual average	3.6	2.7	2.0	2.0
Real gross disposable income (GDI), % YoY	0.7	0.9	0.9	0.5
Households saving rate, % of GDI	10.0	10.0	9.8	9.2
Unemployment, % of labour force	4.9	5.0	4.9	4.7
Fiscal balance, % of GDP	-4.5	-4.0	-3.5	-3.0
Public debt, % of GDP	97	98	99	100
Current account balance, % of GDP	-3.2	-3.5	-3.6	-3.6

## UNITED STATES

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- **Government spending delayed by the October – November shutdown will be recovered, but the risk of another shutdown in early 2026 looms large**
  - **The AI-driven investment surge will reshape labour markets, but is unlikely to significantly boost short-term productivity gains**
  - **Corporate margin compression has largely absorbed the tariff hikes so far, thus supporting consumption, but lower income households are increasingly strained**
- 

**The Trump administration’s immigration and trade policies continue to weigh on domestic demand, supporting our slow-bleed scenario through 2027 and risking lasting damage to potential growth.** The CBO estimates the six-week shutdown trimmed just under 0.1% from 2025 GDP growth due to delayed discretionary spending. An almost commensurate rebound is expected in 2026, such that the permanent loss should be negligible. The government faces a new potential funding cutoff in January 2026. Delayed data releases obscure a panorama where uncertainty remains high amid ongoing shifts in AI, tariffs, and immigration. Weak retail sales growth and persistently low consumer sentiment reinforce our expectation of below-trend growth in 2026 to 2027.

**Investment should remain a bright spot over the next two years led by the AI boom.** The expected productivity gains from the new general-purpose technology may follow a “J-curve” pattern: limited impact at first, then more pronounced toward the end of the cycle. Automation is likely to accelerate the depreciation of human capital in certain exposed sectors while increasing demand for new skills elsewhere. Labour reallocation may initially be slow due to skill frictions, leading to a temporary increase in unemployment before long-term gains materialise. The AI boom’s contribution to GDP growth has been mainly through investment which could reach USD 3 - 4tn by 2030 globally.

In 2025, OpenAI has signed deals for 36 gigawatts of computing capacity, requiring data centre capex of USD 1.5 – 1.8tn, plus energy requirements equivalent to 3% of current installed US generating capacity. The import content of the physical infrastructure investment for data centres is high, meaning the direct effects are partly negated during the construction phase. Productivity gain estimates vary widely from 0.7 – 15% cumulated over a decade, depending on assumptions regarding the speed of integrating AI services into business processes<sup>2</sup>. The current adoption rate among US firms is below 10% but is expected to follow an “S-curve”

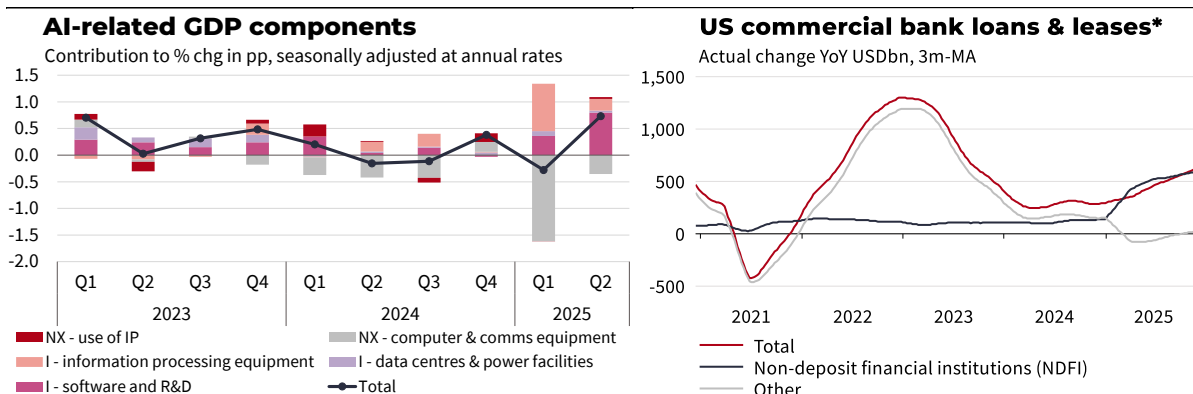
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<sup>2</sup> Filippucci, F. et al. (2025), “Macroeconomic productivity gains from Artificial Intelligence in G7 economies”, OECD Artificial Intelligence Papers, No. 41, OECD Publishing, Paris, <https://doi.org/10.1787/a5319ab5-en>

similar to previous general-purpose technologies such as the Internet or personal computers. The largest gains are expected after a 2 – 4-year integration phase. AI will reshape labour demand and could gradually become a driver of job market turnover.

According to outplacement firms, job cut announcements this year through October have significantly risen, up 65% YoY. Layoffs can be put into three main categories: DOGE federal job cuts; private sector cost cutting due to margin compression; and AI-related productivity and automation initiatives. However, AI has been cited as a driver in less than 5% of layoffs this year, indicating that its effect remains peripheral compared to other drivers at this stage.

### AI-related investment is booming but relies heavily on imports      Credit growth is accelerating, and is increasingly channelled via NBFIs

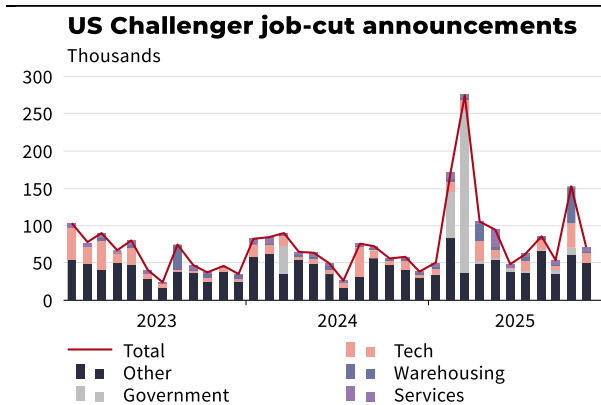


Source: US Department of Commerce, SG Economic and Sector Studies

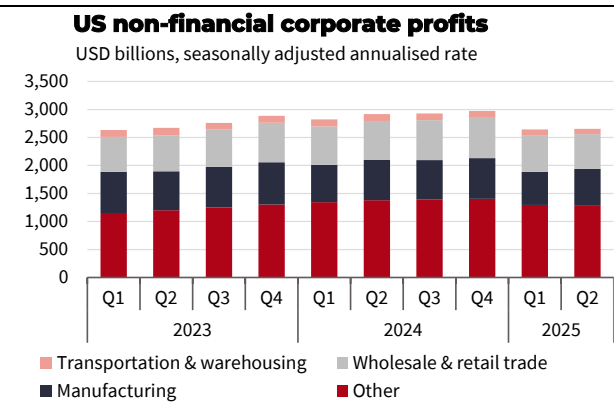
Source: Federal Reserve, SG Economic and Sector Studies

\*In 2025, assets of some domestically chartered commercial banks were reclassified to provide greater granularity on lending to NDFIs.

**Non-financial corporate profits have fallen by around 10% so far in 2025, as rising input costs from tariffs and weak consumer sentiment compelled businesses to compress margins rather than fully pass through costs.** Manufacturing, transport & warehousing, and wholesale & retail trade are among the most impacted. This partly explains the lower-than-expected increase in inflation in 2025, as well as the increase in layoffs, with cost-cutting frequently cited as an important motivation in surveys. Ongoing weakness in consumer sentiment should slow the reestablishment of profit margins through price rises, driving continued sluggishness in the labour market.

**Job cuts have increased significantly in 2025**

Source: Challenger, Gray &amp; Christmas, SG Economic and Sector Studies

**Non-financial corporations are facing margin compression**

Source: US Department of Commerce, SG Economic and Sector Studies

**Household savings are low, providing little buffer to support consumption.**

Personal tax cuts contained within the OBBBA worth over USD 130bn in 2026 alone will benefit middle- and upper-income households, while the funding cuts to health insurance programs set to take effect gradually from 2026 onwards will constrain lower income households' consumption. The administration has also proposed that households earning below USD 100,000 per year receive a USD 2,000 "tariff dividend" cheque. If approved by Congress, this measure would lift real disposable income, particularly for liquidity-constrained lower income households. We estimate the measure could cost USD 200–340bn, depending on eligibility criteria. For comparison, around 45% of Trump's first-term COVID stimulus cheques, which were not means-tested, were consumed almost immediately. With no COVID-era restrictions on consumption this time and targeting of lower-income households, the marginal propensity to consume may increase, however the measure would likely push the fiscal deficit above 7% of GDP.

**Risks to the forecast are skewed to the downside.** Medium-term growth will be driven by a relatively narrow section of the economy connected to the AI boom. The extent to which AI applications will be labour-augmenting versus labour-replacing remains uncertain. A jobless expansion could dampen consumer demand further than expected. Alternatively, if organisational integration of AI proceeds slower than anticipated, revenue projections for model developers may become unrealistic. This could weigh significantly on equity market sentiment, leading to a sharp price adjustment and subsequent negative wealth effects.

US	2025f	2026f	2027f	2028f
Real GDP, % YoY	1.7	1.4	1.0	1.8
Household consumption	1.7	1.5	1.2	1.8
Public consumption	1.0	1.4	1.1	1.4
Investment	1.9	2.2	2.1	2.4
Exports of goods & services	1.9	1.4	1.0	2.4
Imports of goods & services	2.4	2.1	2.5	3.4
Inflation, % annual average	2.8	2.9	2.6	2.6
Core inflation, % annual average	3.0	2.8	2.6	2.7
Real gross disposable income (GDI), % YoY	1.8	1.9	1.2	1.7
Households saving rate, % of GDI	5.5	6.0	6.0	6.1
Unemployment, % of labour force	4.4	4.9	5.2	5.1
Fiscal balance, % of GDP	-5.7	-6.7	-6.8	-7.0
Public debt, % of GDP	100	104	108	111
Current account balance, % of GDP	-3.6	-3.8	-3.8	-3.9

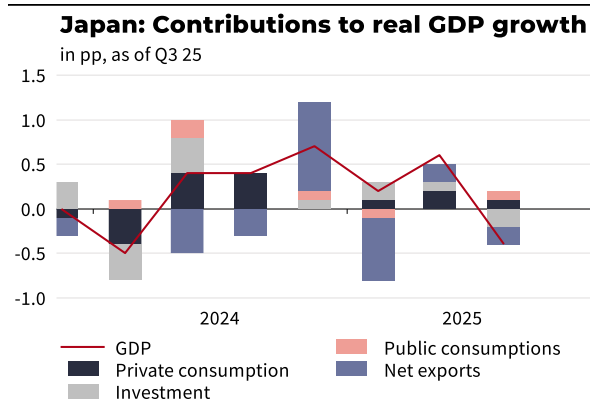
## JAPAN

- **The new Prime Minister Sanae Takaichi has unveiled a massive stimulus package designed to spur economic growth and shield households from the rising cost of living**
- **Real GDP is revised up to 1% in 2026 after 1.4% in 2025, as the stimulus package will spur household consumption and investment**
- **The normalisation of monetary policy is expected to continue very gradually, but JPY weakness adds pressure for more rate hikes**

After growing robustly at 1.4% in 2025, real GDP growth is projected to slow to 1.0% in 2026 and 0.7% in 2027. Domestic demand will be the main driver of growth, with external demand exerting a drag on activity, reflecting the US tariffs. Private consumption will be supported by wage gains pushing up real disposable incomes. Robust corporate profits and government subsidies will support business investment. Headline consumer price inflation will slow down gradually to 1.5% in 2027, following the easing of food inflation. The new fiscal stimulus package will support public consumption and investment, including tax cuts, energy subventions and rice coupons. Meanwhile, elevated political and policy uncertainty and the trade uncertainties will weigh on business sentiment.

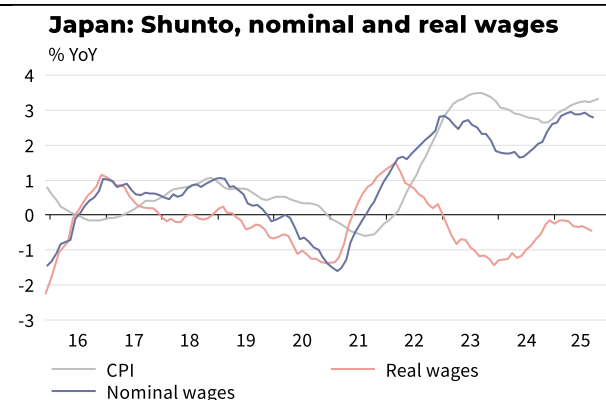
**Export momentum is weakened by global trade frictions.** Japan's trade agreement with the US includes relatively moderate levels of US reciprocal tariffs and levies on Japanese cars, both at 15%. For a leading exporter of vehicles, machinery and robotics this remains negative for growth. The US is Japan's main export destination at 20% of total goods exports in 2024.

### Growth will be weakened by tariffs



Sources: SG Economic and Sector Studies, LSEG

### Inflation suspends real wage growth



Sources: SG Economic and Sector Studies, LSEG

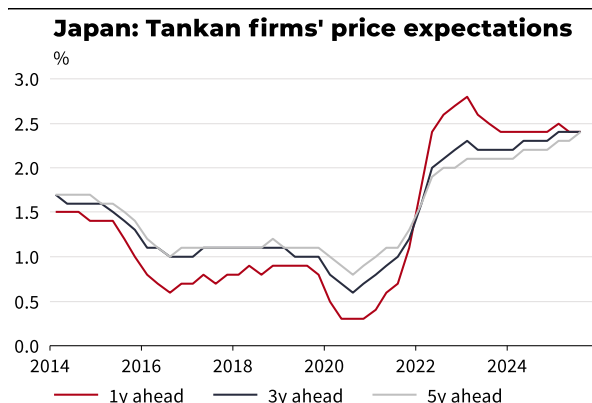
**Corporate investment should continue to sustain growth.** Corporate profits are firm, especially in sectors such as services, which have benefited from strong domestic sales thanks to tourism and higher prices. The increase in profits supports their investments. They are expected to continue to rise, albeit at a slower pace,



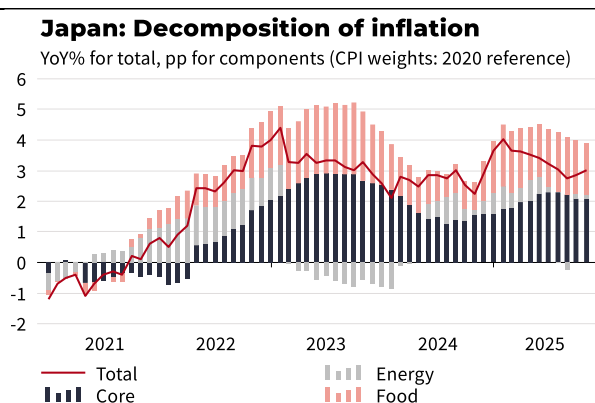
supported by government subsidies, especially for green and digital investments. The structural need to increase productivity in the face of labour constraints should also boost corporate investment in the medium term.

**Inflation should ease but Japan will 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 coming years. In the medium term, labour shortages and an ageing population could keep pressure on wages and prices. However, past performance calls for caution. Even if medium-term expectations are now much more anchored, the inflation trajectory could still disappoint if real wages adjust to lower than anticipated GDP growth.

### Medium term price expectations on the rise



### Food inflation shows no sign of easing so far



Sources: SG Economic and Sector Studies, LSEG

Sources: SG Economic and Sector Studies, LSEG

**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. We expect the BoJ to continue its quantitative tightening. The central bank has scaled back its purchase of ten-year government bonds and exchange-traded funds, which is reducing the size of its balance sheet. The BoJ would slow this tapering only if the bond's market volatility is considered too high. Due to its history of deflation, we expect the BoJ to err on the side of caution.

**The fiscal stance is temporarily expansionary in 2026, reflecting the large fiscal stimulus package announced in November**, and is set to be broadly neutral in 2027. Public deficit will nevertheless continue to increase as interest charges become more pronounced, with the rise of interest rates after years of negative policy rates. The fiscal package includes measures to support medium-term investment in several areas (JPY 7.2tr, 1.1% of GDP), such as artificial intelligence and semiconductors and to strengthen defence capabilities and diplomatic effectiveness (JPY 1.7tr, 0.3% of GDP). To moderate the impact of high prices, the

package also has cash handouts to households with children and support for households through local governments (JPY 2.4tr, 0.4% of GDP) and subsidies for electricity, city gas and gasoline (JPY 1.5tr, 0.3% of GDP). The latter will be switched to a permanent tax cut in January. The higher income deduction in the personal income tax from FY2025 will reduce tax revenues (JPY 1.2tr, 0.2% of GDP).

**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 a new benchmark of 2% of GDP. Debt servicing costs are also going to rise. We expect the fiscal deficit to average close to 3% of GDP over the forecast horizon. The gross public debt-to-GDP ratio is projected to increase slightly, reflecting the rise in debt servicing costs.

**Japan has entered a period of political uncertainty after the ruling coalition between the Liberal Democratic Party (LDP) and Komeito lost its majority** in both chambers of parliament, leading the prime minister, Ishiba Shigeru, to resign. The LDP subsequently elected Takaichi Sanae from its conservative faction to succeed him. The new LDP-led coalition government remains weak. Unless the LDP expands the ruling coalition, it will have to seek support from opposition parties to pass bills and state budgets through parliament.

**Risks are tilted to the downside.** Uncertainties over global trade could continue to exert pressure on Japanese exports (20% of GDP) and growth and delay the pace of monetary policy normalisation. A large appreciation of the yen could reduce corporate profits and weigh on wage increases. Interest rates on long-dated Japanese government bonds are rising and a loss of confidence in Japan's fiscal sustainability could increase the sovereign risk premium. The large fiscal stimulus increases the risk of fiscal slippage if measures are maintained over several years.

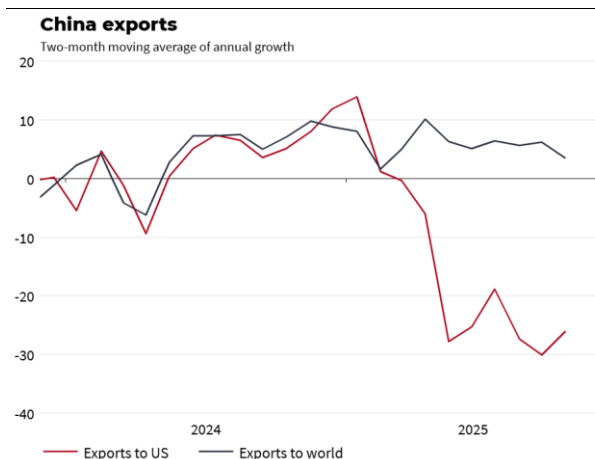
Japan	2025f	2026f	2027f	2028f
Real GDP, % YoY	1.4	1.0	0.7	0.6
Household consumption	1.3	1.1	0.8	0.6
Public consumption	0.3	0.8	0.4	0.4
Investment	1.7	1.0	0.7	0.6
Exports of goods & services	3.5	1.5	1.7	2.0
Imports of goods & services	4.1	2.3	2.0	1.8
Inflation, % annual average	3.3	1.8	1.5	1.5
Core inflation, % annual average	3.0	1.8	1.2	1.2
Real gross disposable income (GDI), % YoY	0.8	1.7	0.7	0.6
Households saving rate, % of GDI	3.8	4.3	4.2	4.1
Unemployment, % of labour force	2.5	1.9	1.8	2.0
Fiscal balance, % of GDP	-1.3	-2.2	-2.7	-3.1
Public debt, % of GDP	235	236	236	238
Current account balance, % of GDP	4.8	4.2	4.2	4.2

## CHINA

- **GDP growth in 2025 is close to the official target of “around 5%”**
- **In contrast, consumption and private investment are weak**
- **The 15th Five-Year Plan contains few surprises. It is mostly a continuation of previous policies**

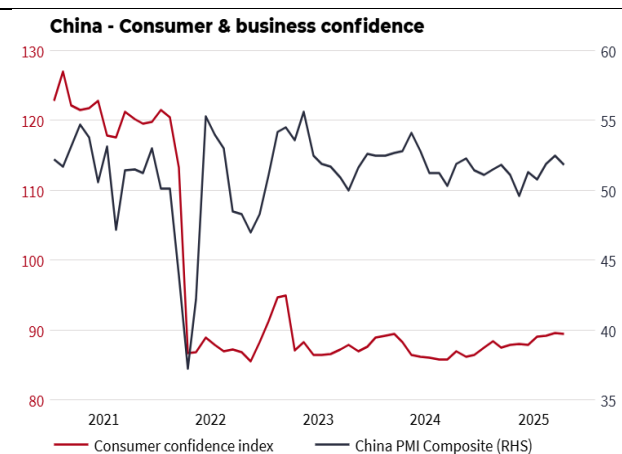
**GDP growth during the first three quarters of 2025 is close to the official annual target of "around 5%."** It is mainly driven by industrial production and exports. The latter have remained surprisingly strong despite the volatility of US tariff increases, which jumped to over 100% in April before dropping to around 30% since May, with difficult decisions ultimately postponed by one year at the end of October, while transshipments continue to face a 40% tariff. Export growth reached 8% over the first three quarters, benefiting from frontloading but also demonstrating the competitiveness of Chinese products across a wide range of industries. Overall, exports should now soften after the front-loading, while the rise of protectionism worldwide should further weigh on momentum.

### Export growth is resilient



Source: SG Economic and Sector Studies, LSEG

### Household confidence struggles to improve

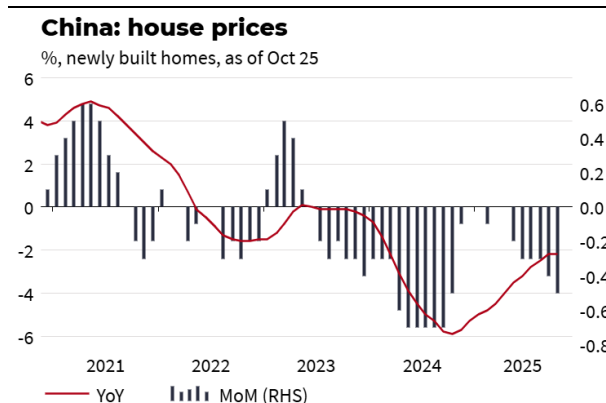


Source: SG Economic and Sector Studies, LSEG

**In sharp contrast, domestic consumption and private investment are weak.** Recent indicators point to further deterioration of fixed asset investment, due to concerns on industrial overcapacities. Overcapacity in manufacturing and weak demand have led to falling prices, squeezing corporate margins and tax revenues. The real estate sector remains subdued, with home prices continuing to fall. The property downturn will enter its fifth year in 2026, after peaking in 2021. New housing starts are 75% below the peak, and property investment is 50% lower, but recovery is unlikely in 2026, with some large developers facing liquidity crunch and possible defaults. Retail sales also eased, reflecting continued weakness in housing, depressed consumer confidence and a soft labour market. Structural issues like aging demographics and youth unemployment exacerbate this trend.

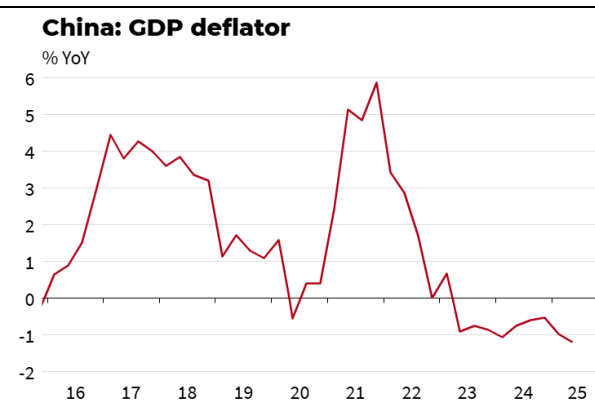
Unemployment hovers around 5%, but youth unemployment is high by historical standards. Inflation is near 0%, reflecting subdued demand and deflationary pressures.

### House prices do not stabilize



Source: SG Economic and Sector Studies, LSEG

### The GDP deflator remains in contraction



Source: SG Economic and Sector Studies, LSEG

**The authorities have released plans for several industries for 2025-26, shedding light on "anti-involution" policies** and the supply adjustment required to avoid excessive overcapacity. The reduction has begun for basic industries. They are characterized by a majority presence of state-owned enterprises, limited potential for demand growth, and they are not considered strategic by the authorities, which allows for accelerated restructuring. For example, steel mills in Hebei have been ordered to cut their production by about 30%, while coal mines must once again adhere to annual capacity quotas.

In more complex manufacturing industries, the authorities are opting for market-based methods to promote consolidation, indicating a less imposed and much more gradual process. Production growth targets for 2025–2026 that are only slightly lower than for 2024. This is the case for the automotive sector (6% in 2025-26 compared to 9.1% in 2024) and for computing and electronics (7% compared to 11.8% in 2024). For these more complex sectors, market-driven restructuring efforts are a novelty in China. It is difficult to predict rapid success. The lack of effective bankruptcy laws remains an obstacle. Regional issues, particularly concerning tax contributions, remain very significant and will slow down the process.

**The 15th Five-Year Plan contains few surprises.** It is mostly a continuation of previous policies with an emphasis on quality growth. Tech sufficiency and innovation remain the top policy priorities. The long-term goal for GDP per capita to reach middle-income country status by 2035 is reiterated. China needs 4.2% annual growth in 2026-35 to reach this target. Tech and innovation remain the top policy priorities, despite the background of rising external tensions. China's 15th Five-Year Plan for the first time highlights the goal of boosting consumption rate (consumption as a percentage of GDP). Support for consumer goods purchases is likely to continue in some form over the coming years, but the wording regarding promoting social

welfare suggests policy efforts may remain underwhelming. Despite the ongoing decline in house prices, aggressive stimulus measures for the sector are absent from the Five-Year Plan. High levels of local government debt and corporate leverage constrain the implementation of an ambitious recovery plan, limiting the effectiveness of support measures.

**Financial stability risks will remain contained** by the country's closed capital account and net external creditor position. We do not anticipate a significant depreciation of the renminbi to boost export competitiveness, as the authorities remain committed to exchange-rate stability.

**Geopolitical tensions will remain present and could intensify with the risks of overcapacity.** China-US relations will remain fraught over the coming years amid tensions over trade, technology, and security. Disputes over tariffs and export controls with the US have temporarily de-escalated, but this is only a truce. The disagreements are too wide to be bridged, and any accord will not prevent periodic reignitions of bilateral tensions. China's dominance in critical minerals adds strategic leverage but also risk of retaliation. This will remain a source of uncertainty for exporters and supply chains.

China	2025f	2026f	2027f	2028f
Real GDP, % YoY	4.9	4.2	4.0	3.8
Household consumption	5.5	4.5	4.2	3.8
Public consumption	6.1	4.9	4.8	4.5
Investment	4.0	4.0	3.9	3.5
Exports of goods & services	4.0	2.7	2.1	2.5
Imports of goods & services	3.8	3.8	2.2	2.0
Inflation, % annual average	0.3	1.0	1.2	1.5
Fiscal balance, % of GDP	-8.0	-7.8	-7.6	-7.6
Public debt, % of GDP	94	97	99	101
Current account balance, % of GDP	3.0	2.0	1.0	1.0

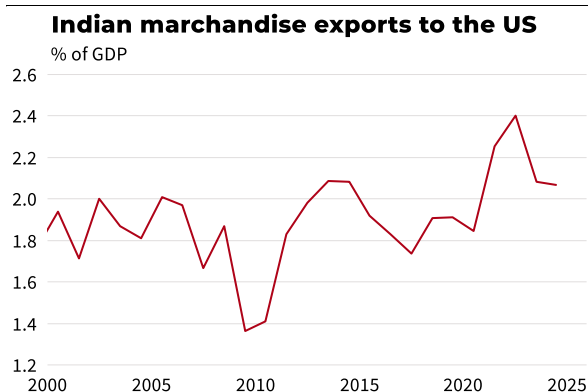
# INDIA

- **GDP Growth will remain elevated, even if the trade frictions with the US will slow momentum**
- **External imbalances will re-emerge with the reduction in imports of low-priced Russian oil**
- **Strong foreign exchange reserves and dynamic services exports will be supportive**

**Growth will remain buoyant despite ongoing fiscal consolidation.** After the wave of public investment, total investment will be supported by the gradual increase in private investment, accompanied by a more solid financial system in recent years.

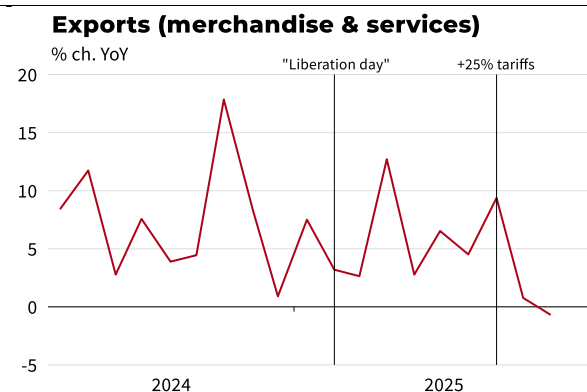
**US tariffs, if they were to continue, will have only a limited impact on growth.** India is poorly integrated into global value chains, and merchandise exports to the United States represent a small portion of India's GDP (2%). About half of these exports are subject to tariffs, so the economic impact of tariffs will be mitigated. The goods affected by the tariffs come mainly from labour-intensive sectors such as textiles, precious stones and jewellery, leather and shrimp. It is likely that, as exports of these products decline, the disposable income of the associated labour force will dry up, which will weigh on private consumption. The deceleration in exports has begun to materialize over the past two months, following President Trump's second announcement of tariffs.

## Exports to the US are a small share of GDP



Source: IMF, SG Economic and Sector Studies

## Exports start to feel the impact of US tariffs

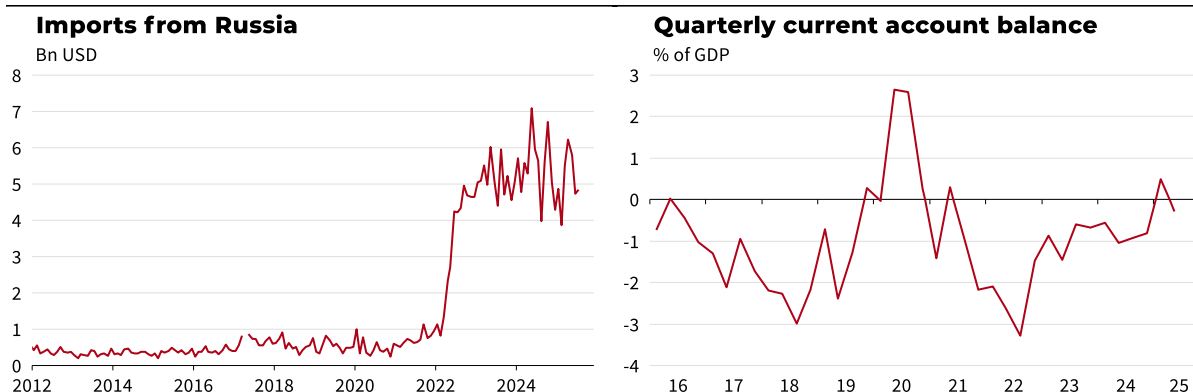


Source: Ministry of Commerce and Industry, SG Economic and Sector Studies

**The American and European sanctions against Russian oil importers will worsen India's external balances.** The Europeans and Americans will sanction all companies that do business with Rosneft or Lukoil starting from the end of 2025. As a result, several major Indian oil companies have already announced reductions in Russian oil imports. Since the war in Ukraine, India has benefited heavily from cheap Russian oil imports, which has allowed it to improve its current account balance. The

country should therefore return to a situation of greater external imbalance, albeit with a more solid position than in the past: replenished foreign exchange reserves (USD 700bn) and very dynamic exports of services.

### Indian imports from Russia, which include low-...contributing to the last improvement in the priced oil, soared since 2022... current account balance



Source: IMF, Ministry of Commerce and Industry, SG Economic and Sector Studies  
Source: CSO, SG Economic and Sector Studies

**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 elevated following tensions with Pakistan.

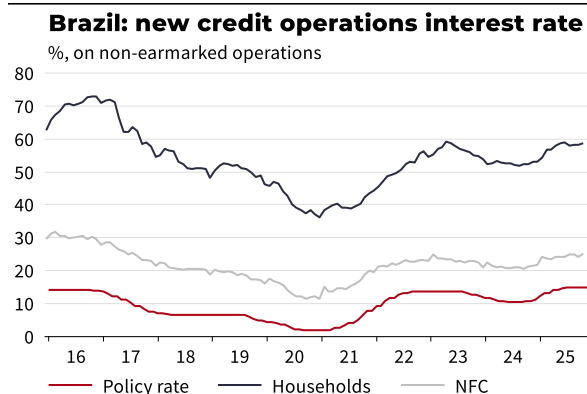
India (fiscal year from April to March)	2025f	2026f	2027f	2028f
Real GDP, % YoY	6.5	6.1	6.4	6.5
Household consumption	6.7	6.3	6.4	6.6
Public consumption	5.6	5.2	5.0	4.8
Investment	6.0	6.3	6.5	6.7
Exports of goods & services	5.5	4.0	5.5	6.0
Imports of goods & services	5.8	5.0	6.0	6.5
Inflation, % annual average	4.3	4.5	4.5	4.5
Fiscal balance, % of GDP	-7.3	-7.3	-7.1	-6.9
Public debt, % of GDP	82	80	78	76
Current account balance, % of GDP	-1.7	-1.4	-1.7	-1.8

## BRAZIL

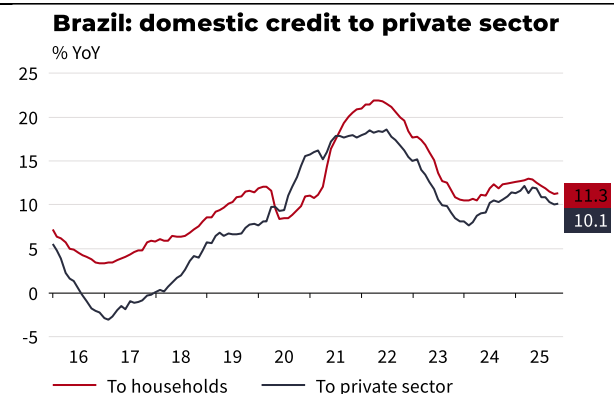
- **The country will face a cyclical slowdown, with growth expected at 2.3% in 2025 and 1.1% in 2026**
- **A tight labour market sustains activity as the BCB stance is expected to remain restrictive in 2026**
- **Trade tensions with the US have scaled down thanks to large exemptions on commodity exports**

The economy is entering a cyclical downturn, as i) the lift from strong agricultural production fades and ii) the effects of tight monetary policy trickle down. We forecast growth to settle at 2.3% in 2025, slowing to 1.1% in 2026, before rebounding towards potential afterwards. The downturn will be limited by a still resilient household consumption (thanks to a historically tight labour market and disinflation) and resilient oil production. The robust investment cycle seen over the last year (largely driven by machinery and equipment) is set to ease, setting the investment rate at around 18% of GDP – similar to its early 2000s level.

**Despite an effective transmission of high Selic into commercial interest rates...**



**... credit remains robust both for households and firms**



Source: BCB, SG Economic and Sector Studies

**The BCB is expected to maintain a hawkish tone as the start of the easing cycle approaches.** Its decision to keep the Selic rate at 15% for most of 2025 has succeeded in bringing down inflation and re-anchoring expectations. We anticipate the IPCA to return to the 3%  $\pm$  1.5pp target band by early 2026, supported by the strength of the real, and we expect a gradual easing cycle to begin in 1Q26. Monetary policy transmission has been effective, notably through higher household lending rates, yet credit growth has remained buoyant. This reflects robust economic activity, underpinned by a historically low unemployment rate (5.4% in October) sustaining household income. Structural changes – such as increased competition among financial intermediaries driven by new entrants and a greater reliance on bond financing by corporates – have also softened the impact on credit volumes. Looking ahead, we expect investment and consumption to moderate as the lagged



effects of tight policy take hold. The monetary stance will remain restrictive, with Selic cuts proceeding slowly over the next year.

**Brazil will continue to face domestic and external (geo)political uncertainty, even if the most acute risks have recently receded.** The US threat of imposing 50% tariffs following the Bolsonaro trial has been diluted through exemptions (notably on commodity exports), reducing the tariff base to around 22% of exports (concentrated in industrial goods). Nevertheless, tensions with the US are likely to persist over issues such as Brazil's partnership with China and the rollout of the popular PIX payment system by the BCB. Bilateral negotiations between China and the US could also undermine Brazilian interests, as illustrated by China's pledge to resume imports of American soybeans by end-2025, which limits Brazilian exporters' ability to capture additional demand. A potential conclusion of the EU-Mercosur trade agreement would provide exporters with a modest hedge against these risks, though its impact is expected to be limited (+2.65% in exports and +0.3% in GDP by 2044 per the Government).

**Risks are mixed.** Limited fiscal space and the need to comply with the fiscal rule heighten vulnerability, though election-related spending should soften the drag next year. A strong labour market offers resilience, but a sharp rise in unemployment remains a risk. Oil output will support activity, yet price volatility could curb CAPEX, as already mentioned by Petrobras. Successful exploration of the Foz do Amazonas basin could nonetheless lift Petrobras production capacity by 50%, boosting investment and fiscal revenues.

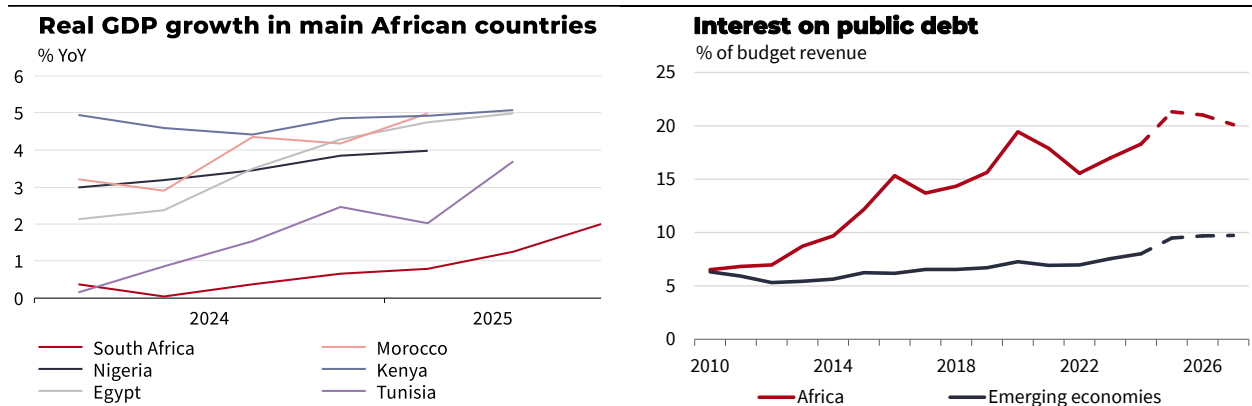
Brazil	2025f	2026f	2027f	2028f
Real GDP, % YoY	2.3	1.1	1.7	2.3
Household consumption	2.2	1.4	2.1	2.5
Public consumption	0.7	0.8	0.8	0.8
Investment	3.0	0.7	2.0	2.5
Exports of goods & services	2.7	1.3	2.1	2.3
Imports of goods & services	5.9	1.5	2.2	2.3
Inflation, % annual average	5.1	3.9	3.3	3.5
Fiscal balance, % of GDP	-8.5	-8.3	-7.0	-6.2
Public debt, % of GDP	91	95	97	98
Current account balance, % of GDP	-2.5	-2.3	-2.3	-2.3

## AFRICA

- **Growth figures available for 2025 confirm the expected acceleration in regional growth (to 3.5%, vs. 3.2% in 2024)**
- **The rebound in private demand should continue and offset the expected sluggishness in public demand**
- **The region is currently showing resilience in a difficult international context, but the factors of fragility remain intact**

**The growth figures available for countries in the region (1Q, or 2Q at best) are generally better than expected and seem to confirm the anticipated acceleration in average regional growth.** This acceleration (to 3.5%, vs. 3.2% in 2024) is mainly due to the rebound in private demand, which is benefiting from the normalization of inflation rates (despite persistent divergence between countries and the fact that these rates often remain slightly above their pre-Covid levels). Public demand is still expected to be more subdued, as most countries in the region continue their fiscal consolidation efforts made necessary by i) persistent tensions on local currency financing conditions, and ii) the reduction in international aid that is already underway (see below). Finally, activity in several of the region's major countries has also been supported by domestic factors: *inter alia*, improved electricity supply in South Africa, normalization of macro-financial conditions in Egypt and Nigeria (combined with growth in hydrocarbon production in the latter), infrastructure spending – particularly in anticipation of major sporting events (CAN 2025/26, 2030 World Cup) – and better agricultural harvests in Morocco.

### An acceleration in growth rates in some of the key countries in the region      Public debt service burden remains too heavy

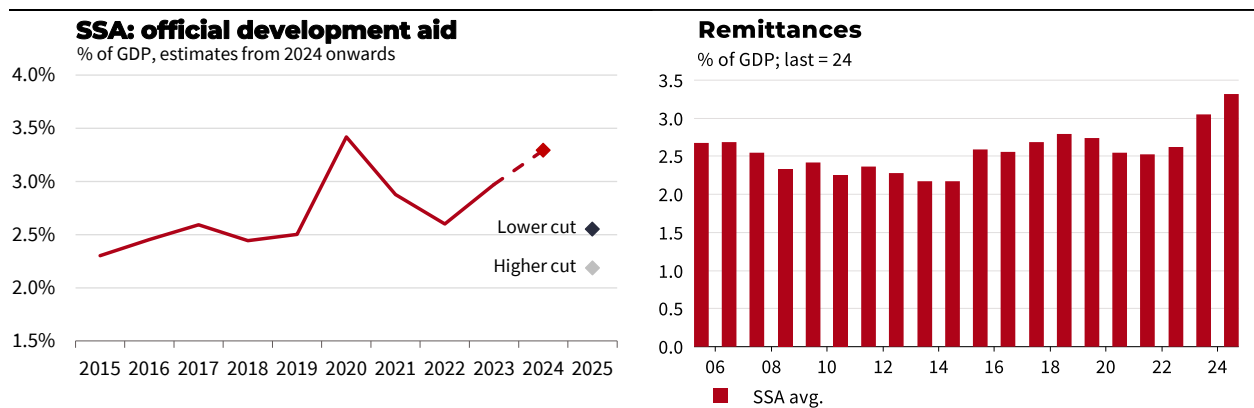


Source: LSEG, SG Economic and Sector Studies

**These trends are expected to continue in 2026 and 2027, leading to further growth of around 3.8%.** Private demand will remain buoyant, also supported (in part) by continued strong foreign direct investment (FDIs). External demand could also prove to be a positive surprise: oil prices (which account for a significant share of imports for most African countries) are expected to remain moderate over the next

few years, while several other commodities traditionally exported by the region (agricultural products, precious and industrial metals) have recently experienced favourable dynamics that are expected to continue. There is obviously considerable uncertainty surrounding this external demand, although Africa's limited integration into global trade flows and the fact that two-thirds of exports are commodities (which are usually excluded from protectionist measures) should help. Overall, however, the expected growth rates remain insufficient to ensure sustainable development in the region.

### A decline in ODA that is expected to continue... ... but that could be partially offset by dynamic remittances



Source: LSEG, OECD, SG Economic and Sector Studies

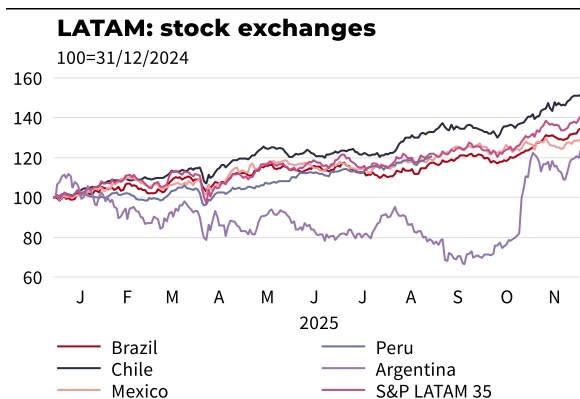
**Although the region has so far proved more resilient than expected, its structural weaknesses remain intact and several risks continue to weigh on our forecasts.** In addition to its persistent vulnerability to increasingly frequent climate events, the region continues to show precarious fiscal and external balances. The burden of public debt servicing (interest paid as a percentage of revenue) remains nearly twice that of the average for emerging countries, and the region continues to run a significant current account deficit (estimated at around USD 50-60bn in 2026 and 2027). **These balances are also likely to suffer from a downward trend in Official Development Aid (ODA)**, due to the growing “financial autarchy” of the United States (illustrated by the end of the USAID agency) and, more generally, persistent budgetary problems in developed countries. The OECD estimates, for example, that in 2025, ODA received by sub-Saharan Africa will have fallen by more than 20% compared to 2024, with very limited prospects for recovery. While on average aid represents “only” 3% of Sub-Saharan Africa's GDP, its importance in the most fragile countries is much greater. This decline could be (partially) offset by continued strong remittances (which are greater than ODA) and the reopening of international capital markets for most countries in the region.

## LATIN AMERICA

- **Growth is expected to slightly decelerate in 2026 to 2% before rebounding towards potential**
- **Tailwinds from tight labour markets, strong remittance flows and risk appetite for EM will soften the slowdown**
- **Renewed interest from US foreign policy will continue to be a source of uncertainty despite seemingly easing trade tensions**

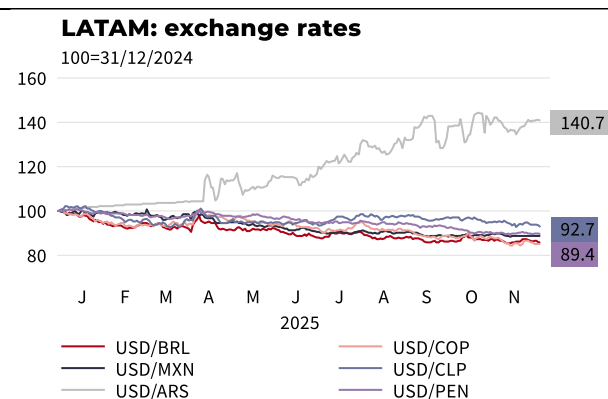
**Growth is set to settle at 2.3% in 2025 broadly supported by private consumption and exports.** Labour markets are tight across the region, while remittances remain high and credit growth robust, supporting households' income. The largest economies continue a slow disinflation process (except for Colombia, where inflation edged up in 2H25), facilitated by a weak USD and despite somewhat higher levels of core inflation reflecting dynamic wages and the positive orientation of major economies. In spite of high trade uncertainty, exports remained overall robust as i) anticipation effects to the deployment of US tariffs led to higher demand, in particular for Mexican goods at the beginning of the year, ii) robust production of agricultural goods (Brazil, Colombia, Argentina) and mining (Chile) sustained export volumes, and iii) tourism receipts remained elevated, notably around the Caribbean. The region has benefited over the year from higher risk appetite for emerging markets, with bullish major equity markets and overall capital inflows that should support the private sector moving forward.

**Regional equities are benefiting from global risk appetite for emerging markets**



Source: LSEG, SG Economic and Sector Studies

**A weak USD has lifted major regional currencies facilitating disinflation**



Source: LSEG, SG Economic and Sector Studies

**Regional growth will slightly decelerate to 2.0% in 2026 and 2.1% in 2027 before gradually returning towards potential.** Household consumption is expected to moderate as the vigour of the labour market wanes, remittance flows soften given the expected slowdown in major developed economies (notably the US), and tailwinds from easing monetary policy in major economies stall. Upside risks to inflation mainly stem from depreciating currencies and volatile components (food

and energy), highly sensitive to climatic shocks. Private investment should rebound, notably in Mexico (as trade uncertainty fades), Argentina (with progress on macro stabilisation), and Colombia and Chile following elections. Guyana's oil production will continue to surge, expected to almost double by 2035 (to 1.2 mbd), allowing for double-digit growth numbers in the medium term, while Suriname's production is expected to start in 2028. The need to credibly pursue fiscal consolidation efforts remains present across the region in a context where the deterioration of public accounts following the pandemic did not reverse, and interest costs remain high.

**The region remains at the crosshairs of geopolitical tensions, driven by renewed interest from the US.** Trade tensions with the US have overall eased and resulted in somewhat limited increases in tariff rates for countries in the region (+9.6pp on average vs +12.7pp for the rest of the world), and exporters benefit from recent exemptions, notably on commodities. Mexico continues to have the lowest tariff shock in the region (+4pp) entering USMCA renegotiations in 2026, where we expect that the privileged relationship across North America will be largely preserved. The advancements in EU trade negotiations with Mexico and MERCOSUR (alongside the interim deal with Chile) reflect the willingness of both regions to enhance their partnership as the risk of fragmentation of GVCs subsists.

**The US shift towards a “Trump corollary of the Monroe doctrine” re-centres the region for American foreign interests.** Continuous strikes on boats allegedly linked to drug trafficking activities in the Caribbean and the Pacific since September show the transformation of the anti-narcotics fight in the region. Fierce rhetoric from the Trump administration towards the Maduro regime in Venezuela represents a source of uncertainty in the region at the turn of the year. Governments ideologically aligned with Washington will continue to benefit from this “alliance”. The most salient illustration is Argentina, which benefited from ample support from the US Treasury (including a USD 20bn currency swap and the direct purchase of ARS) as the ARS and bond market were under distress in October following Buenos Aires province election. Milei's macroeconomic stabilisation programme stands in a more robust place following the intervention and the legislative elections, and we expect it to accelerate in 2026 despite the persistent challenges, notably on the external accounts (FX reserves remain below their end-2022 level, around USD 40bn).

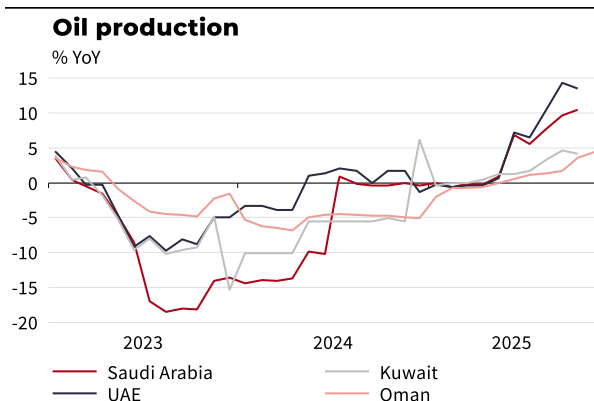
**Risks remain balanced.** The region should continue to benefit from external demand and capital inflows (linked to near-shoring events and infrastructure projects) to leverage growth. Its fiscal accounts remain vulnerable and can be prone to geopolitical risks difficult to forecast (Panama, Venezuela), as well as to domestic political uncertainty (Colombia, Peru, Chile).

## GULF STATES

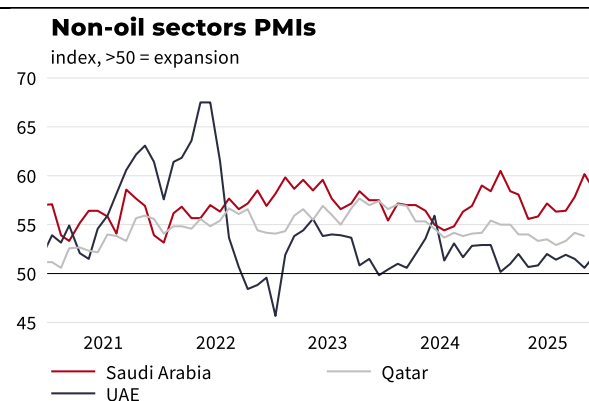
- The outlook remains positive, with rising oil production and dynamic non-oil sectors
- The region remains generally “comfortable” in the face of low oil prices, which would still stay above USD 60/b
- The risks facing the region remain limited, with countries still having substantial fiscal and external “buffers”

**The growth prospects for the Gulf Cooperation Council (GCC) countries remain well oriented.** In accordance with the April 2025 OPEC+ decision, the GCC countries have increased their oil production, notably those with the most readily accessible marginal production capacities (Saudi Arabia, United Arab Emirates). Whilst the hydrocarbon sectors still directly account for between 25% and 35% of the region’s GDP (with even greater indirect multiplier effects), this increase mechanically boosts overall growth. The non-hydrocarbon sectors remain just as dynamic, supported by i) massive public investments aimed at diversifying and “greening” the economies (even though the region continues to be one of the most exposed to climate risks – particularly transitional risks); ii) substantial Foreign Direct Investments (FDIs) that stimulate private demand; and iii) a general improvement in governance environments over the past five years.

### A strong rebound in oil production



### Non-oil sectors remain particularly dynamic

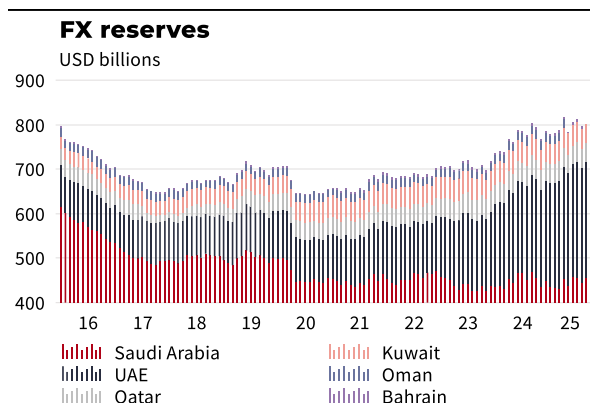


Source: LSEG, SG Economic and Sector Studies

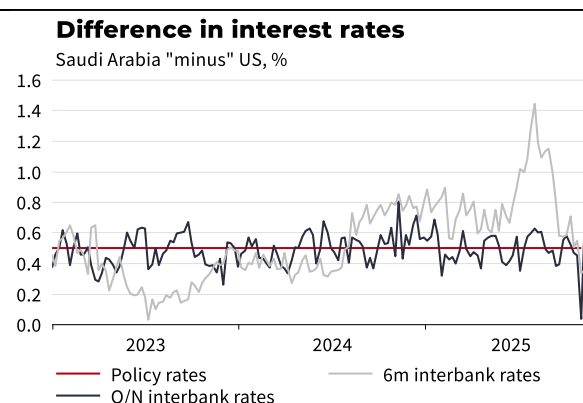
**Overall, average growth is accelerating and expected to settle at just under 4% in 2025 (compared to 2.2% in 2024) and then exceed this threshold in 2026 and 2027.** While Russia (an OPEC+ member) is expected to see its oil production gradually decrease in the coming quarters/years, it is likely that OPEC countries will continue to increase theirs until the end of 2027. Indeed, countries in the region appear to remain “comfortable” even if oil prices were to remain contained over the coming years, due to abundant supply (namely OPEC countries excluding Russia, as well as Brazil, Guyana, and, to a lesser extent, the United States) and relatively sluggish global demand. Although calculations of external or fiscal “breakeven oil

prices” remain approximate (as countries can at least partly constrain their imports or spending if necessary), **it is probable that the “floor oil price” for the GCC countries (notably Saudi Arabia) is around USD 60/b.** Below this threshold, currently expected increases in oil production could be called into question. It should be noted that Qatar's situation is different: gas production (which is not regulated by OPEC+) is significantly more substantial, and the expansions at the North Field will almost certainly be initiated as planned (normally around mid-2026 and mid-2030).

### External and fiscal buffers are still massive



### Maintaining pegs could cause (slight) pressures on domestic interest rates



Source: LSEG, SG Economic and Sector Studies

**The risks weighing on these regional prospects remain limited.** Firstly, despite an ongoing challenging regional geopolitical context, market indicators (stock markets, spreads) remain resilient. Furthermore, the region benefits from massive external reserves (foreign exchange reserves) and fiscal buffers (sovereign funds) and is expected to continue recording twin surpluses (on average) by 2030. Despite this, the GCC countries are likely to continue issuing massively on international capital markets (on very favourable terms), including those that exhibit structural vulnerabilities on their public debt (Bahrain, two issues since early 2025 for a total of USD 1.75bn, or the historically “isolationist” Kuwait, with three issues in October 2025 for a total of USD 11.25bn – the country’s first international issue since 2017). Some economic policy issues remain, whether in the long term/structurally (e.g., can massive public investments be mismanaged, or even become a source of inflation and/or crowding-out effects) or in the short term/cyclically (e.g., the management of regional currency pegs, linking monetary policies to that of the Fed, even though inflationary pressures or conditions in the interbank markets are rarely similar to those in the United States).

## CENTRAL AND EASTERN EUROPE

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- **The region is set to display divergent growth and inflation patterns in 2026-2027 (slowdown in Romania and Slovakia, stronger performance in the Czech Republic, Poland and Hungary)**
  - **Household consumption will remain a key driver and investment is expected to accelerate due to the increased absorption of EU funds ahead of deadlines and to defence sector investments**
  - **Tight labour markets as well as geopolitical and trade uncertainties are the main risks to the outlook**
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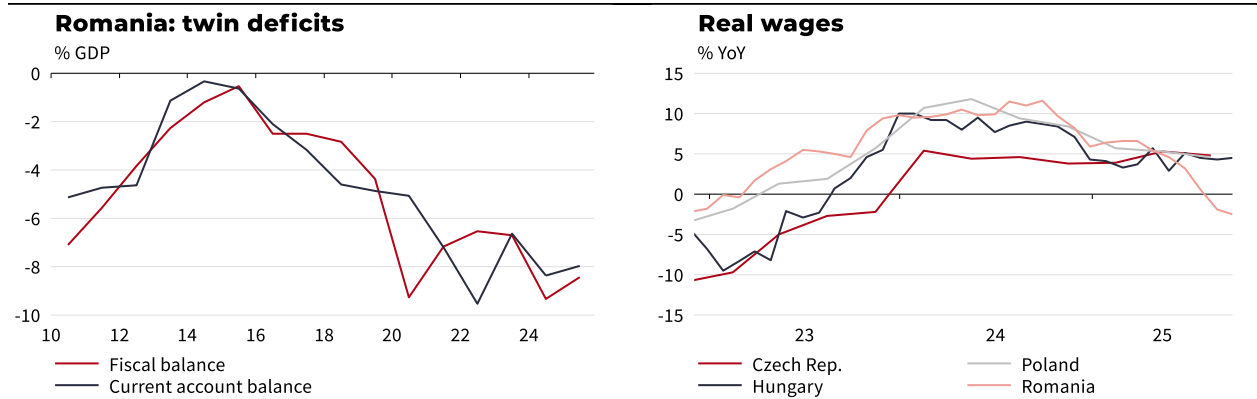
**The region will experience a two-speed economic growth and divergent inflation trends in 2026-2027, notably due to fiscal tightening in some countries.**

**On the one hand, Poland, Czech Republic and Hungary will perform well in 2026-2027 thanks to solid domestic demand.** Polish growth – which has been supported by an expansionary policy mix in 2025 amid contained inflation – will benefit from buoyant private consumption thanks to solid wage growth and higher investment driven by EU funds and defence spending. The Czech economy is expected to benefit from strong growth in the services and construction sectors, while the manufacturing sector has bottomed out in early 2025. In Hungary, growth is expected to rebound in 2026-2027 after the 2025 trough, driven by household consumption supported by expansionary fiscal policy (wage increases in the civil service, housing support measures). However, nearly two-thirds of EU funds remain frozen due to the lack of rule-of-law reforms.

**On the other hand, Romania and Slovakia are expected to underperform due to the large-scale fiscal consolidation weighing on private consumption.** In Romania, growth remained sluggish in 2025 due to political uncertainties and the adoption of three fiscal consolidation packages during the summer, including VAT increases and public wage and pension freezes. These three packages have been key to easing financial tensions, maintaining access to European funds and avoiding a downgrade of Romania's sovereign rating in summer 2025. In 2026, the full impact of consolidation measures should materialize, leading to a sharp slowdown in private consumption. Nevertheless, a hard landing should be avoided thanks to an investment rebound driven by EU funds. In Slovakia, growth is expected to remain weak in 2026 and slightly pick up in 2027, as household consumption is affected by fiscal consolidation. Moreover, the country remains vulnerable to tariff hikes due to the significant share of the automotive industry in its GDP.



## Romania announced a major fiscal consolidation in the summer of 2025... weighing significantly on the country's real wages and private consumption

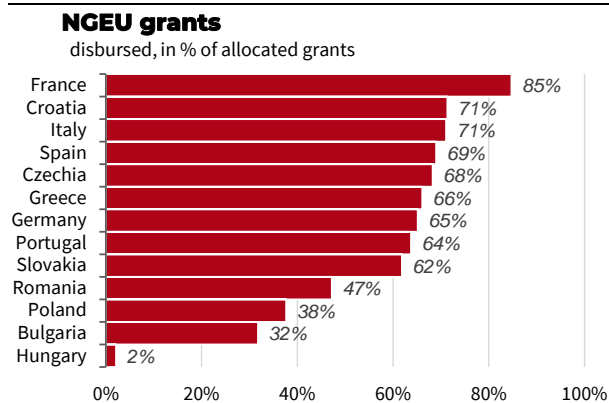


Source: LSEG, SG Economic and Sectoral Studies

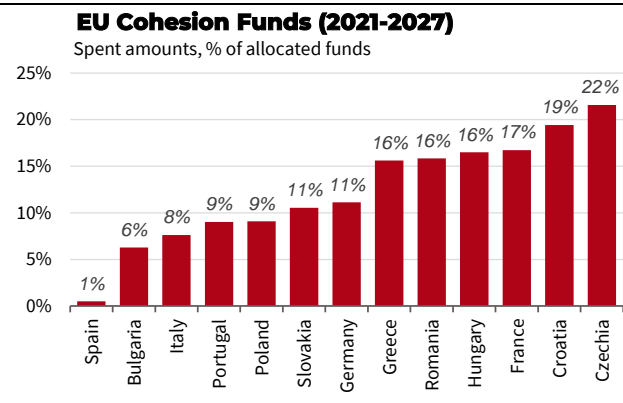
**While household consumption will remain a key growth driver in the region, investment is expected to accelerate in 2026-2027 thanks to increased absorption of EU funds and defence spending.** By the end of 2025, Central and Eastern Europe still lags the EU average in absorbing *NextGeneration EU* (NGEU) funds, with the deadline for European Commission disbursements set for December 31, 2026. Hungary is at the bottom of the pack with only 2% of grants disbursed. Bulgaria is also behind, with an absorption rate at 32%. Czech Republic and Croatia fare better, above the EU average, but still far below France's 85%, the EU leader. Poland negotiated an extension, as its EU funds were frozen for almost two years. For *European Structural and Investment* (ESI) funds available for the period 2021-2027, absorption has been very slow so far, as countries prioritized NGEU funds given their closer deadline. Indeed, payments for ESI Funds can traditionally be made up to two years after the end of the 2021-2027 budget cycle, i.e. until the end of 2029. Their absorption is expected to accelerate from 2027 to take over from NGEU.

**In parallel, the *ReArm Europe* initiative, adopted in March 2025 by the European Commission, is expected to support investment in the defence sector in the region.** This plan aims to mobilize up to EUR 800bn over four years to strengthen European defence capabilities, combining several levers, including easing fiscal rules to allow states to increase spending (up to +1.5% of GDP per year) and creating a EUR 150bn loan instrument, *Security Action for Europe* (SAFE), offering long-term loans of up to 45 years with a 10-year grace period. These loans will finance military equipment, with a maximum of 35% of components sourced outside the EU, EEA-EFTA, or Ukraine. Poland, Romania, and Hungary are expected to be the main beneficiaries. Submission of national plans – due by November 30, 2025 – will enable pre-financing disbursements as early as early 2026. *ReArm Europe*, and particularly SAFE, are expected to support investments in strategic equipment (air defence, drones, cyber) and boost the European defence industrial base over the next years.

## Lower absorption of NGEU grants in CEE compared to the euro area.



## A very slow start to the absorption of ESI funds so far



Source: EC, SG Economic and Sectoral Studies

**Several risks continue to weigh on this outlook.** Despite the recent slowdown in real wage growth in the region, labour shortages remain significant due to low unemployment rates and population ageing, keeping labour markets tight. In this context, inflationary pressures could re-emerge in the region. Furthermore, the ongoing war in Ukraine continues to strain public finances, as Central and Eastern European countries plan substantial increases in defence spending. Several rating agencies have placed negative outlooks on Romanian and Polish sovereign ratings due to fiscal slippages. Finally, uncertainty over upcoming tariff decisions – particularly between the United States, Europe, and China – could affect value chains, especially in the automotive sector, which remains highly dependent on Germany.

## CONTACTS

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**Michala MARCUSSEN**

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

**Olivier de BOYSSON**

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

**Emmanuel MARTINEZ**

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

**Ariel EMIRIAN**

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

**Edgardo TORIJA ZANE**

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

**Benoit ASTIER**

South and Central Asia, Turkey, Climate  
benoit.astier@socgen.com

**Foly ANANOU**

Quantitative Economics, Geoeconomics  
folly.ananou@socgen.com

**Evelyne BAHN**

Asia  
evelyne.bahn@socgen.com

**Constance BOUBLIL-GROH**

Climate, Central & Eastern Europe, Russia  
constance.boublil-groh@socgen.com

**Natalia CARDENAS FRIAS**

Germany, Latin America  
natalia.cardenas-frias@socgen.com

**Clément GILLET**

Africa, Middle East  
clement.gillet@socgen.com

**Dominic LOCK**

North America  
dominic.lock@socgen.com

**Danielle SCHWEISGUTH**

Western Europe  
danielle.schweisguth@socgen.com

**Yannik STRITTMATTER**

France, Euro area  
yannik.strittmatter@socgen.com

**Antonio VISANI**

Climate, United Kingdom  
antonio.visani@socgen.com

**Stéphanie HUET**

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

**Yolande NARJOU**

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

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