

SCÉNARIO ÉCO

Société Générale Economic & Sector Studies

Fading resilience factors

- 2025 saw unexpected resilience, supported by stockpiling of traded goods, low energy prices, a surge in AI-related investment, pockets of fiscal accommodation, asset price gains and narrowing spreads. Already now factors of resilience are fading and we expect to see further fade over 2026, fat tails remain.
- The conflict in the Middle East carries very high level of uncertainty. Our central scenario makes the working assumption of a fairly short-lived conflict, but there are substantial downside risks to this assumption for the global economic outlook.
- Broader policy uncertainty is set to remain elevated ... the US Supreme Court ruling striking down IEEPA tariffs (20 February) protected institutions but injected renewed tariff uncertainty. Elections add to uncertainty, including US mid-terms (Nov-26) and French presidential elections (Spring-27).
- 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).
- Europe must resolve energy, defence and broader competitiveness. The need for action is understood, but progress remains hampered by national political concerns.
- China to see slower growth and remain a source of disinflation: Human capital and household spending are policy objectives, but core focus is technology, security and resilience.
- We see room for further monetary policy easing on both sides of the Atlantic, and this despite higher energy prices.

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EDITORIAL

After the outbreak of the conflict in the Middle East, downside risk to the global economic outlook has risen sharply. If our working assumption of a relatively short-lived conflict holds and the Strait of Hormuz reopens, the impact on global growth and inflation should be moderate albeit still discernible.

The global economy demonstrated resilience in 2025, and this despite high levels of uncertainty stemming from geopolitical tensions, US domestic policy, and US tariffs.

This resilience was rooted in several supportive factors;

- A significant tail-wind from AI investment adding around 1pp to US GDP growth in 2025, both through the direct investment channel and through the wealth effect channel of asset price gains.
- Declining energy prices, driven by rising oil supply mainly from the United States but also from Canada, Brazil and Guyana. LNG supply also increased, with production coming from the US, Canada and Qatar.
- A relatively accommodative policy mix supporting demand, with several pockets of fiscal easing and tailwinds from central banks rate cuts.
- Strong risk appetite, reflected in compressed credit spreads across all issuer categories (euro-area sovereigns, emerging markets, corporates) and higher equity market valuations—led by the tech sector—which have supported wealth effects, especially in the US.
- Solid financial positions for households and firms. Labour markets have remained strong, corporate profitability has held up, and debt ratios for both households and businesses have declined in recent years.

Question is whether this resilience will replay in 2026. The announcement of Liberation Day tariffs last spring delivered a very substantial negative confidence shock and caused a substantial selloff on global risky assets. Recovery was fast, however, as final tariff announcements proved lower than threatened and resilience factors prevailed.

There are numerous differences to the present situation, however. Threatening tariffs generates an uncertainty shock but does not entail any direct upfront costs, apart from building inventory ahead of threatened tariff implementation. The present conflict not only comes with very real human suffering but also comes with immediate and significant upfront costs to the real economy, be it higher energy costs, the risk of energy supply shortages, risks to fertilisers needed for food production, damage to critical infrastructure or lost business activity. Even once a ceasefire is reached, recovery will take time.

Moreover, even prior to the Middle East conflict these factors of resilience were fading, and the conflict further undermines them:

1. AI-LINKED INVESTMENT STILL HOLDS POTENTIAL, BUT DYNAMICS TO SLOW

AI linked investment delivered significant upside surprise in 2025 and proved a key support for the global economy, and not least in the United States. While we still see potential for further build out, we do expect to see a lower contribution in 2026. AI investment may also face some constraints, with tighter funding conditions, linked both the concerns on rapid build out and the tremors in private credit, and in terms of risks to energy. Medium-term, we see opportunity for productivity gains from AI, but see these materialising at the macro level more towards the end of this decade.

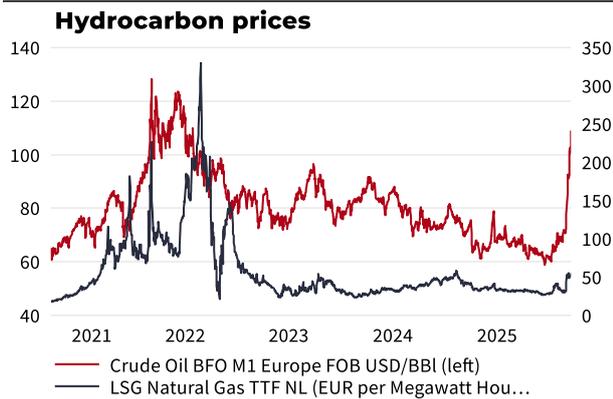
2. THE SURGE IN ENERGY PRICES LINKED TO THE EFFECTIVE BLOCKADE OF THE STRAIT OF HORMUZ

The Strait is critical for the global economy (~30% of global seaborne oil trade, ~20% of LNG trade, ~35% of urea fertilizer trade) and for regional producers (~90% of oil exports from Bahrain, Iraq, Iran, Kuwait, Qatar, Saudi Arabia and the UAE). In the short-term, alternatives are quite limited. For example, 80–90% of Saudi oil exports pass through the Strait, with only 10–20% using the Red Sea route, where instability cannot be ruled out. Insurers have sharply increased premiums on Gulf transits, contributing to a near halt of insured maritime traffic.

The ability of the US to restore safe navigation through naval intervention— and/or to lower insurance and coverage costs through large-scale public reinsurance— would require a strong and lasting commitment. This capacity has yet to be tested once the conflict ends and the area is deemed safe.

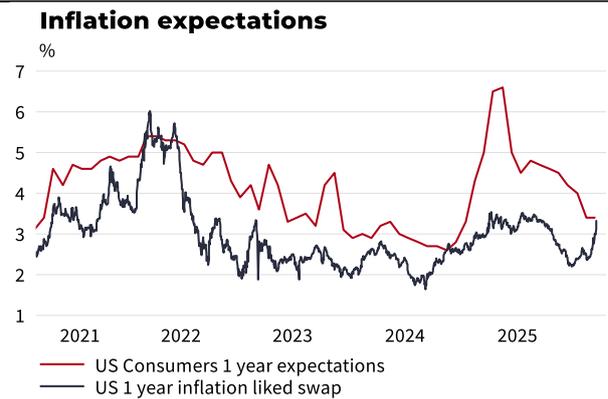
All else equal, a sustained USD 10/bbl increase in oil prices adds around 0.2 pp to headline inflation and reduces GDP growth by roughly 0.1 pp in advanced economies in the first year after the shock. Part of the energy shock is also likely to spill over into food prices, notably through higher fertilizer costs. As of the time of writing, oil prices are around USD 100/bbl compared with approximately USD 70/bbl before the conflict.

Significant oil price shock...



Source: SG Economic and Sector Studies

...could hurt inflation expectations



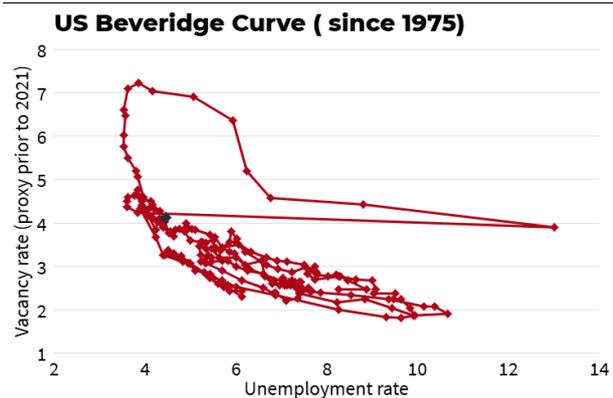
Source: SG Economic and Sector Studies

3. THE ABILITY OF POLICYMAKERS TO SUPPORT THE GLOBAL ECONOMY

Following the major supply-side shocks from Covid-19 and the war in Ukraine, central banks may be more reluctant to “look through” this new supply shock. Central banks will closely monitor market-based and household/business inflation expectations when assessing the appropriate monetary policy stance.

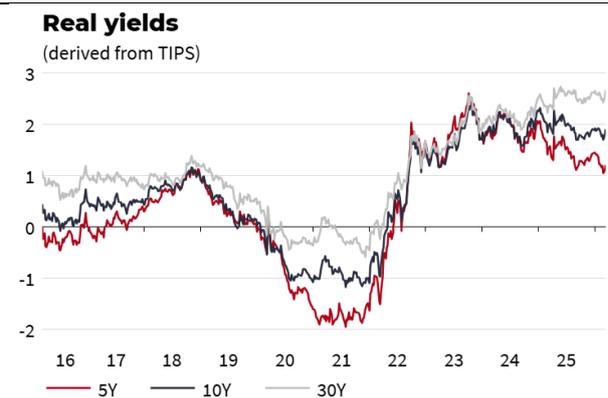
Beyond inflation expectations, the current situation differs from 2022, when central banks began raising rates. There is now much less fiscal space to reproduce the substantial fiscal impulse of 2021–2022. Households, moreover, no longer enjoy pent-up savings, like those that resulted from the pandemic lock downs. Monetary conditions are far tighter than in the post-Covid period, with positive and historically high real interest rates (the highest in 15–20 years). Labour markets also appear less tight than during the immediate post-pandemic reopening.

Less tight labour markets...



Source: SG Economic and Sector Studies

...and tighter financial conditions



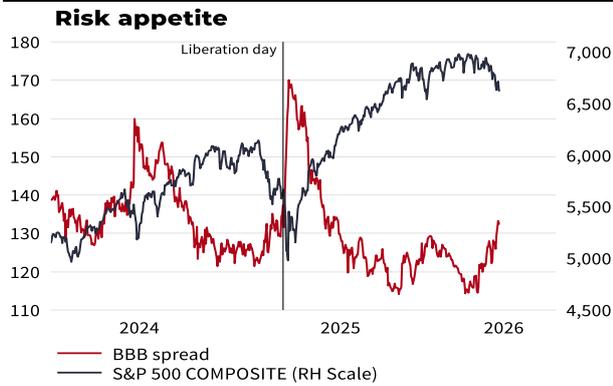
Source: SG Economic and Sector Studies

4. THE RESILIENCE OF MARKET RISK APPETITE

So far, market reactions have been relatively moderate compared with last spring’s “Liberation Day tariffs” episode. However, some factors of resilience are more fragile. The equity rally that characterised markets over the past year has already

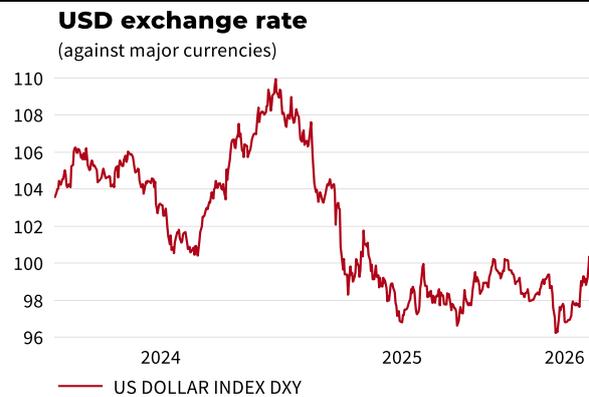
faded since last October amid growing doubts over AI-related valuations. In addition—and unlike last year's persistent dollar weakness—the US dollar has strengthened against all currencies, reflecting a risk-off environment and flight to quality. It is also reflecting the positive terms-of-trade shock benefiting the US as a hydrocarbon producer at a time of rising international prices.

Markets moderately affected so far...



Source: SG Economic and Sector Studies

...but the dollar is strengthening

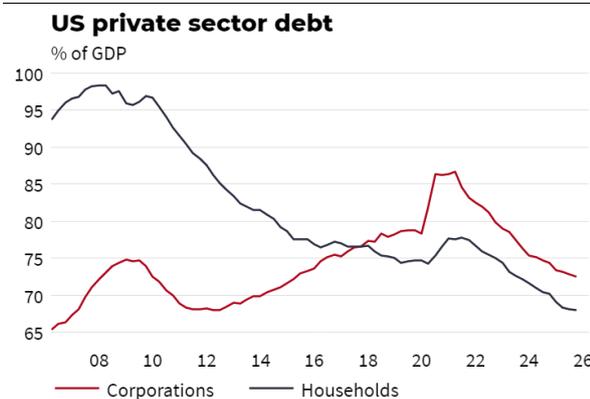


Source: SG Economic and Sector Studies

5. THE RESILIENCE OF HOUSEHOLDS AND FIRMS

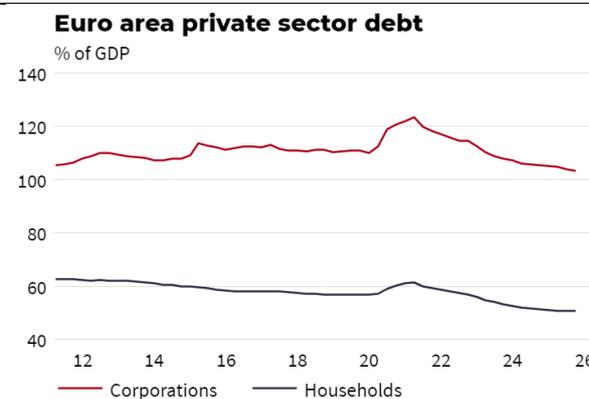
Households and firms have reduced their debt ratios and remain in better shape than in previous crises. This explains, in part, their resilience to recent shocks. However, this pillar could weaken if labour markets deteriorate more rapidly than expected or if corporate profitability declines.

Private sector still solid...



Source: SG Economic and Sector Studies

...with declining debt ratios



Source: SG Economic and Sector Studies

At this stage, markets still appear to anticipate a relatively short and quickly resolved conflict. This is also our baseline scenario. However, uncertainty is extremely high, and signs of fragility are accumulating. The risk of a deeper global crisis cannot be excluded—particularly as concerns grow around the tech sector and its spillovers to private credit markets.

ECONOMIC FORECASTS

GDP, % YoY	2025	2026f	2027f	2028f
Developed Markets	1.7	1.6	1.3	1.5
United States	2.1	2.1	1.6	1.8
Japan	1.1	1.0	0.7	0.6
United Kingdom	1.3	1.0	1.2	1.2
Euro area	1.5	1.1	1.0	1.3
Germany	0.4	1.1	1.3	1.6
France	0.9	0.8	0.9	1.3
Italy	0.7	0.7	0.5	0.6
Spain	2.8	2.2	1.6	1.6
Emerging Markets	4.1	3.5	3.6	3.6
Asia	5.0	4.3	4.3	4.3
China	5.0	4.4	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	2.4	2.1	2.1	2.2
Brazil	2.5	1.3	1.7	2.3
Middle East and Central Asia	3.3	2.5	3.3	3.1
Africa	4.3	4.0	3.8	3.8
World (PPP weighted)	3.2	2.8	2.8	2.8

CPI, % YoY, avg	2025	2026f	2027f	2028f
Developed Markets	2.5	2.6	2.2	2.0
United States	2.7	3.1	2.4	2.6
Japan	3.2	2.0	1.5	1.5
United Kingdom	3.4	2.8	2.1	2.1
Euro area	2.1	2.0	1.7	1.9
Germany	2.3	2.2	1.9	1.9
France	0.9	1.6	1.7	1.9
Italy	1.7	1.6	1.7	1.9
Spain	2.7	2.4	2.0	2.2
Emerging Markets	5.2	5.1	4.4	4.3
China	0.3	1.2	1.2	1.5
India	2.2	4.7	4.5	4.5
Brazil	5.0	4.1	3.3	3.5

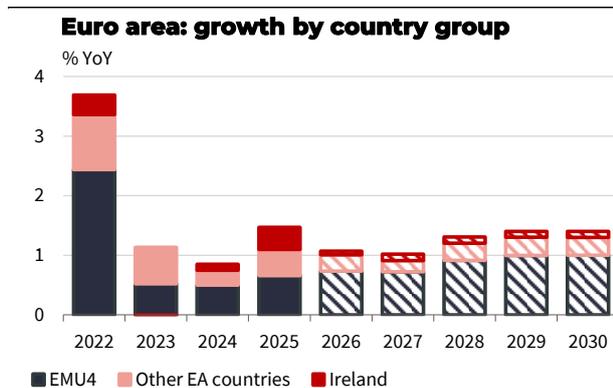
%, EoP (unless otherwise indicated)	Latest 19/03	2026f	2027f	2028f
Fed Funds target (high)	3.75	3.25	2.75	3.00
Gov 10y, US	4.27	4.00	4.25	4.25
ECB Deposit facility rate	2.00	1.75	1.75	2.25
Gov 10y, Germany	2.94	2.50	2.75	2.75
Gov 10y, France	3.60	3.30	3.45	3.35
Gov 10y, Italy	3.74	3.30	3.55	3.55
Gov 10y, Spain	3.44	3.00	3.30	3.25
BoE, Bank rate	3.75	3.25	3.25	3.75
Gov 10y, United Kingdom	4.74	4.50	4.50	4.50
BoJ, Bank rate	0.75	1.25	1.50	1.25
Gov 10y, Japan	2.21	2.25	2.30	2.20
EUR / USD	1.15	1.20	1.20	1.15
EUR / GBP	0.86	0.88	0.89	0.90
USD / JPY	159	155	150	145
USD / CNY	6.9	6.9	6.9	6.8
Oil Brent (USD/b)	109	65	70	70
European Natural Gas (TTF, EUR/MgW/h)	56	35	30	30
EU ETS carbon (EUR/Metric ton)	65	100	110	120

EURO AREA

- **2025 resilience is fading, with normalisation of growth in Ireland, less supportive financial conditions and lower fiscal support.**
- **The euro area outlook faces downside risks, with significant uncertainty on the energy price outlook and future US tariffs.**
- **ECB faces a difficult balancing act between renewed upside risk to inflation expectations and downside risks to economic growth.**

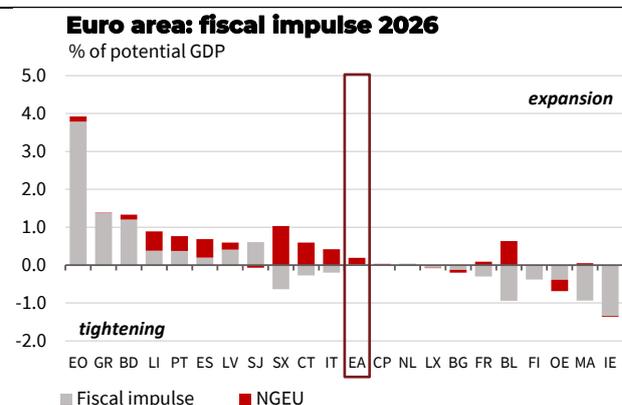
Growth in 2026 is expected to moderate after firm momentum in 2025, despite a degree of strengthening in the bloc's largest economy. Germany's return to more significant growth (from 0.4% in 2025 to 1.1% in 2026), supported by its fiscal push, will offer some support to the region and help offset the forecast moderation in Spain (from 2.8% to 2.2%) and the virtually stable growth profiles of France (0.9% to 0.8%) and Italy (0.7% in both years). Moreover, Germany's rebound narrows the dual-speed dynamic that has characterised the bloc for years and partially compensates for the reduced contribution from smaller member states. In 2026, the bloc will benefit from increased defence investment, Germany's fiscal expansion, and the final year of NGEU disbursements. However, a softening labour market, tighter credit conditions, and external headwinds will weigh on the euro area's resilience.

After an exceptional year, the contribution of Ireland should return to the historical average



Source: AMECO, IMF, SG Economic and Sector Studies

Fiscal impulse is neutral, despite the German weight, but final NGEU funds act as support



Note: Fiscal impulse as the change in structural primary balance;
Source: AMECO, EU, SG Economic and Sector Studies

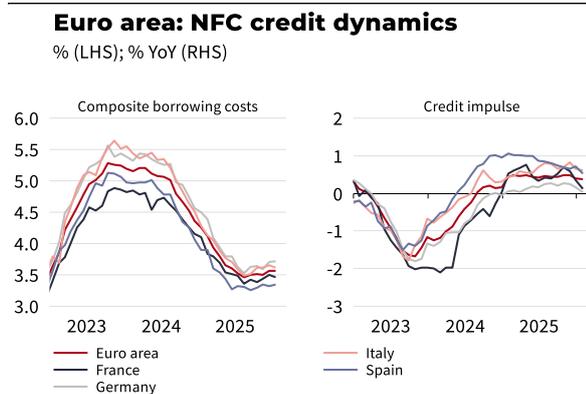
A restrictive fiscal impulse in large parts of the euro area is just counterbalanced by the large German fiscal package. Germany's substantial budget expansion, with a stimulus of 1.2% of potential GDP, will counterbalance the slight contraction expected in France, Italy, and most smaller economies. The final year of NGEU fund disbursements will deliver an additional boost, especially to Eastern and Southern European countries. Spain and Italy are expected to receive impulses of 0.5% and 0.4% of GDP respectively, helping sustain their growth momentum. The effective

rollout of public investment plans is key in determining the aggregate fiscal support the bloc receives.

Business investment is expected to moderate with heightening uncertainty and tightening financial conditions. Business sentiment and the economic outlook remain clouded by uncertainty. Moreover, across 2025 banks have tightened credit supply conditions, in response to regulatory and supervisory actions and, to a lesser extent, concerns on credit quality, according to the ECB’s Bank Lending Survey. Already now, the euro area credit impulse is showing signs of moderating, and we expect to see some moderation of private investment demand in 2026. Public investment should nonetheless see some continued support, and not least from key areas such as defence spending and build out of critical infrastructure.

The easing of inflation slows to target due to higher energy prices. The gradual decline in headline inflation is set to slow in 2026, reaching 2.0% after 2.1% in 2025. The main driver is energy prices, which continue to add uncertainty to the inflation trajectory. The otherwise favourable base effect in 1Q26 is offset by the oil and gas price shock following the conflict in the Middle East. Inflation expectations have eased substantially since the pandemic, but there is clearly concern at the ECB that second round effects could materialise more rapidly. Our view remains that room to pass on higher energy costs to consumer is today much more limited than during the pandemic, absent major pent-up savings and government fiscal support, and with little corporate appetite to further hoard labour.

The credit impulse is fading as reaction to tightening credit conditions



Source: ECB, SG Economic and Sector Studies

Inflation expectations are ticking up again after easing substantially since the pandemic



Source: LSEG, SG Economic and Sector Studies

The ECB’s “good place” called into question. Fading resilience drivers, notably a softening labour market, lower excess savings, and tight credit conditions, will weigh on domestic demand. While fiscal constraints likely restrict government support to deal with high energy prices, we assume limited and targeted fiscal support measures focusing on the most vulnerable households and businesses. The risk remains that governments will deliver more aggressive fiscal support, which in turn would drive inflation and further ECB tightening. Given our working assumption of a short-lived conflict in the Middle East, lower headline inflation and weakening

growth momentum should keep the door open to an ECB rate cut in 2026. As excess liquidity converges toward pre-pandemic levels, we expect the ECB to halt its quantitative normalisation toward year-end.

Near-term euro area growth risks are to the downside. Renewed trade frictions and prolonged geopolitical tensions continue to dominate the risk landscape, as they may constrain exports, push up prices, and weigh on confidence. The persistence of the renewed energy price shock remains a key vulnerability for households and businesses alike. A stronger EUR/USD poses a two-pronged downside risk: euro appreciation would weaken net exports and risk pushing inflation below the ECB's target. Upside risks stem from, a faster and better-targeted German fiscal rollout and potential efforts at the European level to fast track the Competitiveness Compass.

Euro area	2025	2026f	2027f	2028f
Real GDP, % YoY	1.5	1.1	1.0	1.3
Household consumption	1.3	1.0	0.7	1.2
Public consumption	1.8	0.8	0.8	1.0
Investment	2.6	1.9	2.0	2.2
Exports of goods & services	2.0	1.5	2.2	2.3
Imports of goods & services	3.4	1.9	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	0.8	0.7	1.0
Households saving rate, % of GDI	15.2	15.0	15.0	14.9
Unemployment, % of labour force	6.3	6.4	6.6	6.5
Fiscal balance, % of GDP	-3.0	-3.3	-3.0	-2.8
Public debt, % of GDP	89	91	93	94
Current account balance, % of GDP	1.9	1.6	1.4	1.2

GERMANY

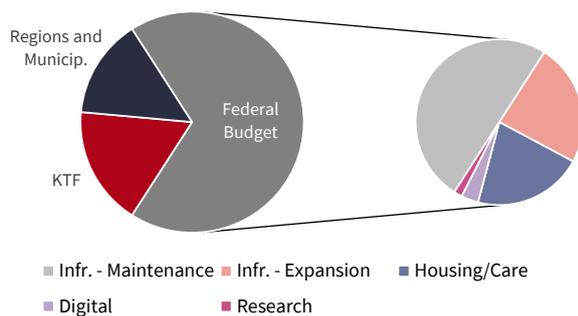
- **Growth prospects (1.1% in 2026, 1.3% in 2027) hinge on a successful rebalancing of the engines of growth towards domestic factors.**
- **Fiscal impulse is to accelerate in tandem with SVIK (Special Fund for Infrastructure and Climate Neutrality) roll-out but will continue to face implementation risks.**
- **External drag is set to persist with a challenged manufacturing sector.**

After broadly stagnating since Covid, the German economy is gaining momentum by leveraging its domestic drivers. Growth is expected to accelerate to 1.1% in 2026 and to 1.6% by the end of the forecast period supported by consumer spending and the deployment of the fiscal package.

Fiscal impulse to accelerate in tandem with SVIK disbursements

Germany: 2026 SVIK allocations

% of total (EUR 57.5bn)

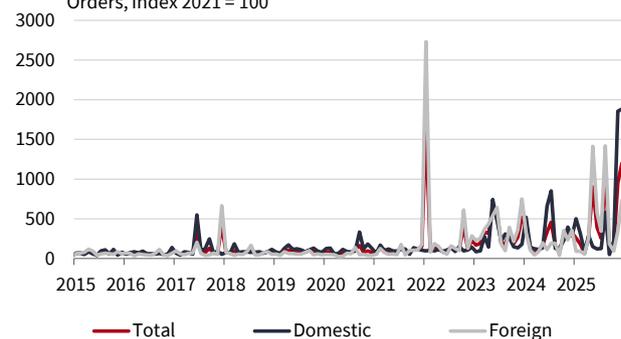


Source: BMF, SG Economic and Sector Studies

The defence sector is gaining traction but continues to face supply-side hurdles

Germany: weapons and ammunition

Orders, index 2021 = 100



Source: Destatis, SG Economic and Sector Studies

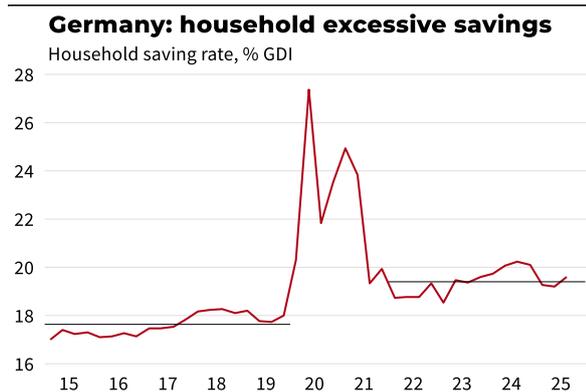
Fiscal impulse is expected at 1.2% of potential GDP in 2026 as SVIK¹ begins to roll out, with over 10% of the planned expenditure allocated to it. SVIK -the 12-year, EUR 500bn infrastructure package- disbursements will start this year with over EUR 57bn earmarked under its umbrella in the 2026 budget and paper issuance for it began in October. Note that 20% of the total package is dedicated to the Climate Fund (KTF) and sub-sovereign budgets split in equal parts, and the rest is attributed to the Federal Budget. Implementation risks remain significant, potentially diluting the short-term lift to growth. Some already planned expenditure appears to be redirected to SVIK (reducing net additional spending), and bureaucratic hurdles in project identification and approval may delay the funds' absorption. Moreover, funds allocated within the Federal Government are mainly focused on maintenance

¹ Special Fund for Infrastructure and Climate Neutrality (*Sondervermögens für Infrastruktur und Klimaneutralität*)

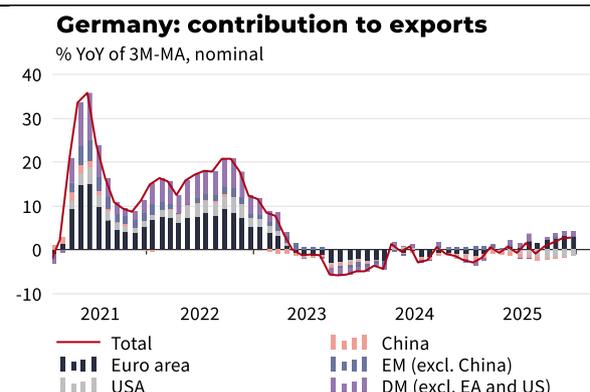
of existing infrastructure, which has limited positive effects on long-term growth potential.

The defence sector will continue to benefit from tailwinds from European strategic positioning. Political momentum -both domestically and within Europe- is set to persist in favour of rearming following the Russian invasion of Ukraine, and in favour of enhancing strategic autonomy given the evolution of US national security strategy in 2025. German manufacturers will continue to benefit from it -as seen by surging orders, notably domestic- but impact on the real economy will be dampened and delayed by persistent supply side constraints. Value chains remain highly fragmented in this sector. Various European manufacturers produce equivalent products, while their supply chains are very long and require specialised labour, which slows down production. The defence sector will remain a leader and a relative source of resilience for a German manufacturing sector facing secular headwinds and expected to continue eroding albeit at a slower pace.

Some reduction in household savings to provide continued leeway to consumption **External demand to remain a drag, highlighting the need for rebalancing**



Source: Eurostat, SG Economic and Sector Studies



Source: Bundesbank, SG Economic and Sector Studies

Households continue to benefit from a rather tight labour market (unemployment expected to plateau over the next two years) and disinflation.

Income remains dynamic, driven by resilient wage growth, and inflation is set to largely remain within target over the forecast horizon, assuming that the current conflict in the Middle East proves short-lived and thus only has a transitory effect on energy prices. We still expect households to adjust their behaviour in favour of reducing precautionary savings and in favour of consumer spending (albeit with significant import content). This should lead to a continued and gradual decline of the saving rates.

External headwinds will constitute a persistent drag on the outlook.

Manufacturing production remains about 15% below its 2018 level in volume terms and capacity utilisation remains at very low levels (77.5%, +1pp since its trough in 4Q24). Its muted recovery will be driven by high value added, sometimes niche production notably in optical products, pharmaceuticals and the defence sector mentioned above but the manufacturing sector will remain at an overall lower level.

Manufacturers continue to face heightened competition in their core export segments (capital goods, automobile, chemicals) notably from Asian counterparts, and their competitiveness is further pressured by a strong EUR and high unit costs, limiting demand and boosting imports. Free trade agreements with EM (MERCOSUR, India) should only have a limited upside for exporters, as those markets remain small compared to China and the US where market shares have eroded the most, and competitors are also aggressive in those markets.

Risks remain tilted to the downside, skewed by unaddressed structural challenges and geopolitical fragmentation. Geopolitical events could add upside pressure to energy prices and revive supply chain frictions if persistent, reversing the attenuation of precautionary savings (weighing once again on consumption) and pressuring producers' competitiveness. The impact of the fiscal expansion will be constrained by the need to accelerate efforts to improving bureaucratic efficiency, to tackle supply side constraints (e.g. easing care infrastructure constraints to promote higher female employment) and to ensure the appropriate allocation of funds to limit their use for already planned projects. The country will also need to tackle constraints on the labour factor as it faces unfavourable demographic dynamics due to a rapidly ageing population and political backlash against immigration. This adds pressure to a tight labour market – already facing labour shortages and a historically high participation rate – and social security spending.

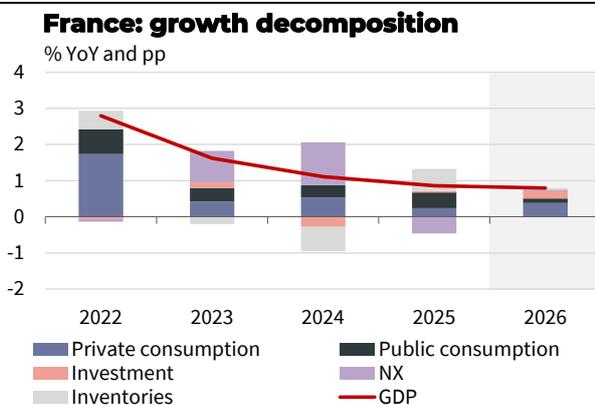
Germany	2025	2026f	2027f	2028f
Real GDP, % YoY	0.4	1.1	1.3	1.6
Household consumption	1.7	1.4	1.4	1.4
Public consumption	1.3	1.9	2.3	2.3
Investment	0.0	2.1	2.8	3.2
Exports of goods & services	-0.3	0.9	0.9	1.7
Imports of goods & services	3.7	2.5	2.0	2.3
Inflation, % annual average	2.3	2.2	1.9	1.9
Core inflation, % annual average	2.8	2.2	1.9	1.9
Real gross disposable income (GDI), % YoY	0.3	0.8	1.1	1.2
Households saving rate, % of GDI	19.4	18.9	18.6	18.3
Unemployment, % of labour force	6.3	6.3	6.3	6.1
Fiscal balance, % of GDP	-2.7	-4.6	-4.0	-3.7
Public debt, % of GDP	63	67	71	75
Current account balance, % of GDP	4.4	3.3	3.2	3.0

FRANCE

- **With little support from government policy, external demand, and wage dynamics, growth remains modest.**
- **Despite consolidation needs, the fiscal impulse is only slightly restrictive, due to political concessions.**
- **External demand will no longer be a drag on growth, but numerous challenges hinder the full realisation of strong sectoral demand.**

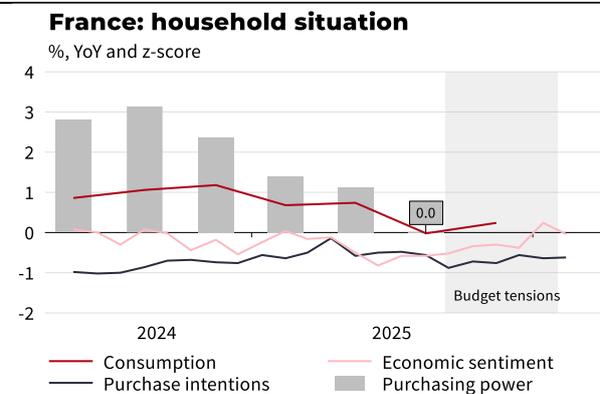
Growth remains modest due to fiscal tightening, external demand, and softer wage dynamics. A high household savings rate does offer some buffer support to consumer spending. The combination of persistent structural challenges and the potentially temporary nature of the current political calm pose a risk to the durability of the recovery. Fiscally speaking, the slightly tightening in the 2026 budget (-0.3% of potential GDP) marks a moderate headwind, but the need for further fiscal consolidation remains. External demand will not help significantly, with ongoing competitiveness challenges and elevated import demand will. At the same time, the softening labour market will weigh on wage growth. Finally, the run-up to the 2027 presidential election, and ongoing geopolitical tensions may again weigh on sentiment.

External demand is no longer a drag on growth, while internal demand gains share



Source: INSEE, SG Economic and Sector Studies

Weak incomes limit consumption growth, but households are slowly adapting to uncertainty



Source: INSEE, SG Economic and Sector Studies

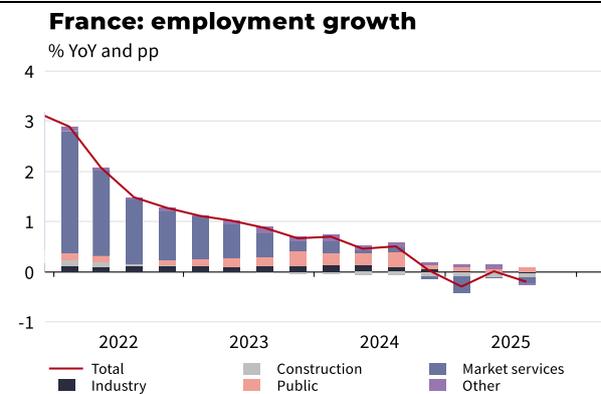
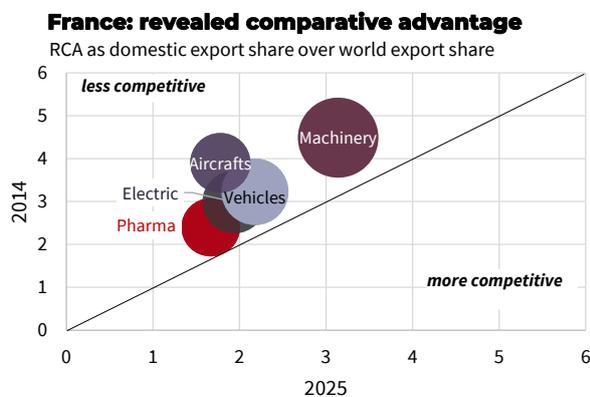
The fiscal impulse is mildly restrictive, reflecting political concessions. While the 2026 budget hurdle has been cleared, the 2027 budget process is unlikely to prove any easier, not least ahead of the 2027 presidential election. This increases the risk that fiscal policy will lack the clarity needed to underpin sentiment and that much needed structural reforms will lag. Equally, the medium-term outlook hinges heavily on the outcome of the 2027 presidential election. Our baseline assumes protracted budget negotiations and only modest consolidation. Social-spending pressures are set to rise, with the pension-reform debate set to reopen in 2027.

Household consumption is growing only cautiously. External and domestic uncertainties continue to weigh on private consumption. Although real income growth slowed significantly, consumption and sentiment held up during the year-end budget tensions, suggesting households are becoming more tolerant of uncertainty. We expect this to persist in 2026, but higher energy costs, even if temporary with our working assumption of a relatively short-lived conflict in the Middle East, will mark a headwind. The household savings rate stands at a high 18% compared to the 14.7% average over the pre-pandemic decade, offering some buffer. Against this backdrop, lingering uncertainty and only marginal gains in real income point to modest consumption growth.

The labour market continues to soften, with unemployment expected to rise further to 7.9%. Past wage growth has compressed corporate margins, contributing to the recent uptick in unemployment. Moreover, growth remains below potential, and the employment-driving service sector continues to be sluggish. The labour-market outlook therefore reflects a gradual adjustment by firms as they adapt to weaker demand, tighter financial conditions, and ongoing uncertainty. As this environment weighs on entry-level positions, youth unemployment is affected disproportionately, having already surpassed the levels of Greece, Italy, and Portugal, and currently stands at 21.2%.

Internal challenges, a strong euro and declining competitiveness will limit export growth

Sources of employment growth remain weak, as unemployment is expected to tick up



Source: LSEG, SG Economic and Sector Studies

Source: INSEE, SG Economic and Sector Studies

External demand will not be a key growth driver in 2026, despite heightened demand in specific sectors. In aeronautics, an uptick driven by large order backlogs and robust global demand is expected; however, supply and operational constraints will temper the pace of acceleration. Moreover, a stronger euro and declining competitiveness across several key sectors will compound external headwinds. Imports will remain elevated, driven in particular by more expensive energy imports and persistently high freight prices. Taken together, net exports will no longer be a drag on growth, as it was in 2025, but will not act as a meaningful accelerator either.

Risks are tilted to the downside, as the political situation remains fragile and challenges within the export sector persist both domestically and abroad. Energy

prices mark a further downside risk with the present conflict in the Middle East. A more resilient labour market, potentially supported by upside surprises in demand, especially in the recently weakened services sector, could bolster household consumption. Likewise, lower-than-expected uncertainty in the run-up to the 2027 presidential election could also lift consumption. However, a deterioration in the political environment or renewed legislative gridlock in 4Q26 would have the opposite effect. In the external sector, exports could surprise to the upside if internal bottlenecks in aeronautics are resolved, but ongoing uncertainty and tariff-related debates could weigh on the sector just as easily.

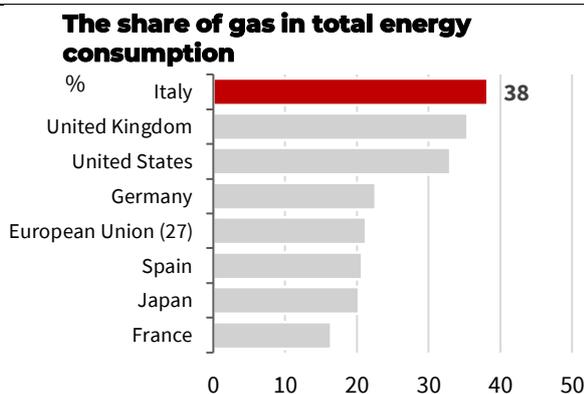
France	2025	2026f	2027f	2028f
Real GDP, % YoY	0.9	0.8	0.9	1.3
Household consumption	0.5	0.7	0.9	1.2
Public consumption	1.7	0.5	0.8	1.0
Investment	0.8	0.9	1.4	2.0
Exports of goods & services	1.4	2.3	2.6	2.7
Imports of goods & services	3.0	2.2	2.7	2.9
Inflation, HICP, % annual average	0.9	1.6	1.7	1.9
Core inflation, HICP, % annual average	1.6	1.6	1.8	2.0
Inflation, CPI, % annual average	0.9	1.4	1.6	1.8
Real gross disposable income (GDI), % YoY	0.7	0.4	0.6	0.6
Households saving rate, % of GDI	18.4	17.8	17.5	16.9
Unemployment, % of labour force	7.5	7.9	7.8	7.8
Fiscal balance, % of GDP	-5.2	-5.2	-4.8	-4.3
Public debt, % of GDP	116	117	120	121
Current account balance, % of GDP	-0.4	-0.3	-0.4	-0.4

ITALY

- **Growth is expected to remain weak as energy costs drag on household consumption and uncertainty is clouding the outlook.**
- **Italy is set to be more impacted than its neighbours by the conflict in the Middle East as its share of gas in energy consumption is the largest in the EU.**
- **Public debt will continue to rise until 2027 reaching 138% of GDP, and is set to decline gradually thereafter.**

GDP grew by 0.7% in 2025, which is half the euro area growth and close to Italy's potential. Activity was mainly driven by internal demand, and more specifically investment and construction fed by abundant NGEU funding. Despite a steep rise in household purchasing power, consumption growth remained muted, and savings increased sharply. Imports grew much faster than exports and external demand exerted a drag on growth. The labour market is still very tense due to demographic pressures and new employment needs. The working age population started to decline ten years ago, and Italy has seen a one million person decline in people aged 15 to 64 since 2018, marking a shrinkage of 2.6% to the working age population. During that period, employment increased by 760 000 persons, thanks to a sharp decline in both unemployment (-920 000 persons) and inactivity (-820 000 persons). Today, the unemployment rate stands at a record low of 5.1%.

Italy is particularly vulnerable to gas prices



Source: IEA, SG Economic and Sector Studies

A buoyant labour market despite muted growth



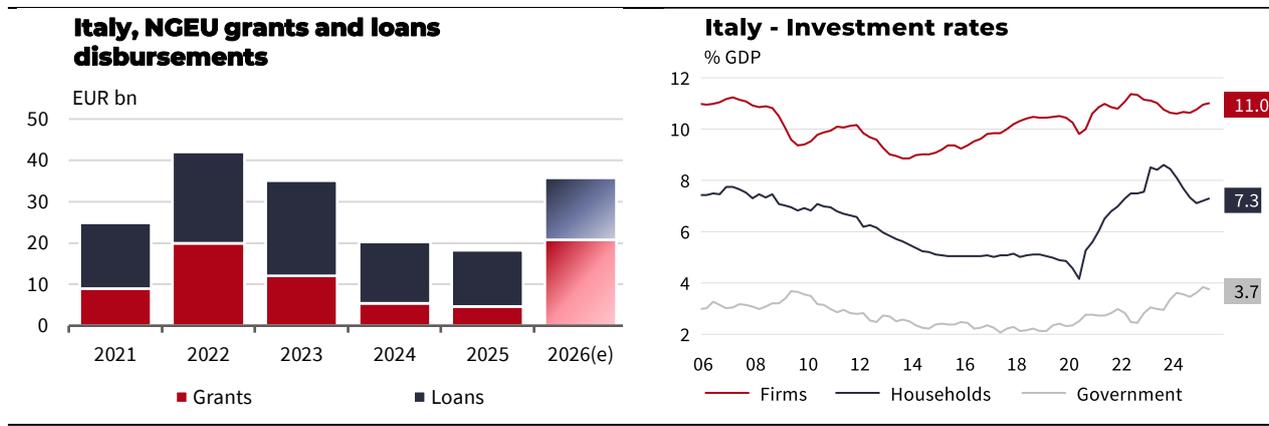
Source: Istat, LSEG, SG Economic and Sector Studies

GDP is set to record 0.7% growth in 2026 as investment continues to be supported by NGEU funding, and then slow to a pace of around 0.5% over the rest of the forecast horizon. This is under the assumption that the conflict in the Middle East is short-lived, and the Strait of Hormuz reopens rapidly. Italy is particularly sensitive to an increase in oil and gas prices due to its high fossil fuel dependency. The share of gas in total energy consumption is the largest in Europe (38% versus 21% on average in the EU) and one third of LNG is imported from Qatar.

The cost of strong increases in oil and gas prices would be borne by households and firms, as the government has a very limited room for new energy subsidies.

Global trade restrictions are weighing on exports and activity. 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.

EUR 35bn of EU funds to be disbursed by end 2026, feeding public investment



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 2.8% of GDP in 2026 after 3% in 2025, paving the way for exiting the EU excessive deficit procedure in 2026, one year ahead of schedule. The decline would be supported by 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. As of 2027, slower growth in public investment and public payrolls will consolidate the improvement of public finances. The primary budget surplus is projected to rise to 1.4% of GDP in 2028 (from 0.5% in 2024), exceeding the level required to stabilise the public debt ratio.

The 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%. The government is likely to continue implementing modest tax relief measures, but this is unlikely to derail fiscal targets.

Public debt is forecast to rise to 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 weigh on public debt dynamics. However, the public debt ratio is expected to decline as of 2028, when the primary surplus reaches 1.4% of GDP, just enough to put the ratio on a downward trend.

Risks are tilted to the downside. If recent improvements in fiscal sustainability prove short-lived and interest rate spreads widen again, or weakness in key trading partners is prolonged, the outlook would deteriorate. Conversely, stronger than expected structural improvements in investment conditions could boost growth. Other risks include a weaker support from European institutions, increasing refinancing risk on Italy's high public debt stock; a deterioration in the fiscal outlook, resulting in a significantly slower fiscal consolidation, or a material rise in debt-to-GDP ratio; and/or a weaker medium-term growth outlook due to delays or setbacks in public investment and/or reforms under the country's NGEU programme. Geopolitical tensions and high energy prices add further downside risk.

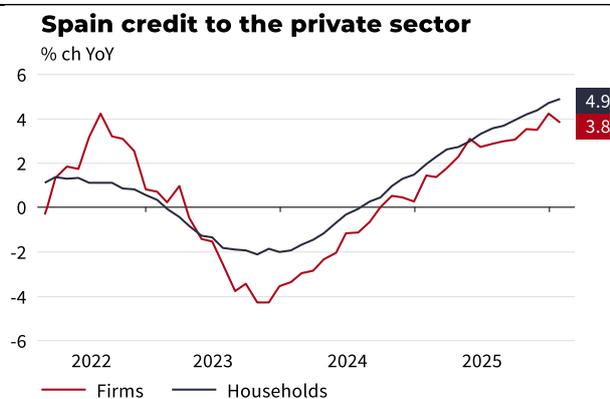
Italy	2025	2026f	2027f	2028f
Real GDP, % YoY	0.7	0.7	0.5	0.6
Household consumption	0.8	0.6	0.5	0.7
Public consumption	0.4	0.4	0.4	0.4
Investment	3.3	2.8	0.1	0.2
Exports of goods & services	1.4	1.6	2.0	2.4
Imports of goods & services	3.1	2.4	1.7	2.1
Inflation, % annual average	1.7	1.6	1.7	1.9
Core inflation, % annual average	1.9	1.8	1.7	2.0
Real gross disposable income (GDI), % YoY	2.5	1.8	0.4	0.5
Households saving rate, % of GDI	13.3	14.4	14.2	14.1
Unemployment, % of labour force	6.1	5.6	5.7	5.7
Fiscal balance, % of GDP	-3.0	-2.8	-2.8	-2.8
Public debt, % of GDP	137	138	138	137
Current account balance, % of GDP	1.1	0.8	0.9	1.0

SPAIN

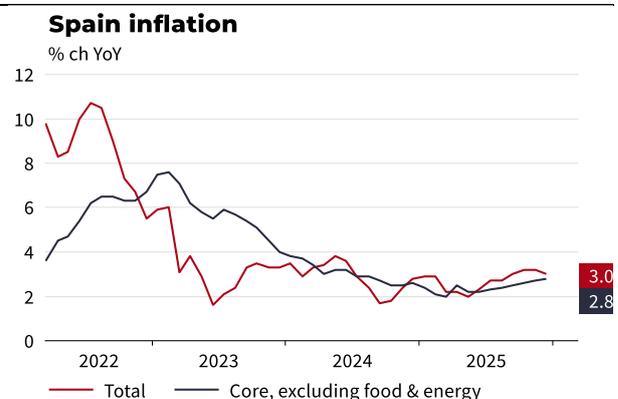
- **Growth will continue to outperform, supported by the influx of foreign labour, but the economy is changing gears.**
- **Momentum is set to decelerate as engines of recent growth lose steam.**
- **Climate change may end up taking a toll on tourism revenues.**

Growth continues to surprise on the upside, and Spain keeps overperforming the euro area despite inner political tensions and global uncertainties. Real GDP grew by 2.8% in 2025, driven by robust gross capital formation and private consumption. External demand had a strong negative contribution on growth as imports surged to feed investment. Strong job creation and nominal wage growth supported steady gains in gross disposable incomes. Growth has been more extensive than intensive, with productivity remaining stagnant while employment increased by 2.6% (567 200 jobs were created). The unemployment rate reached a record low of 9.8%, fuelling core inflation with persistent services price inflation. The main challenge now is for future growth to result from simultaneously increasing the employment rate and productivity, by boosting investment and improving its efficiency, in order to ensure sustained gains in real wages and overall well-being.

Dynamic credit allocation to firms and households is fuelling inflation



Source: ECB, LSEG, SG Economic and Sector Studies

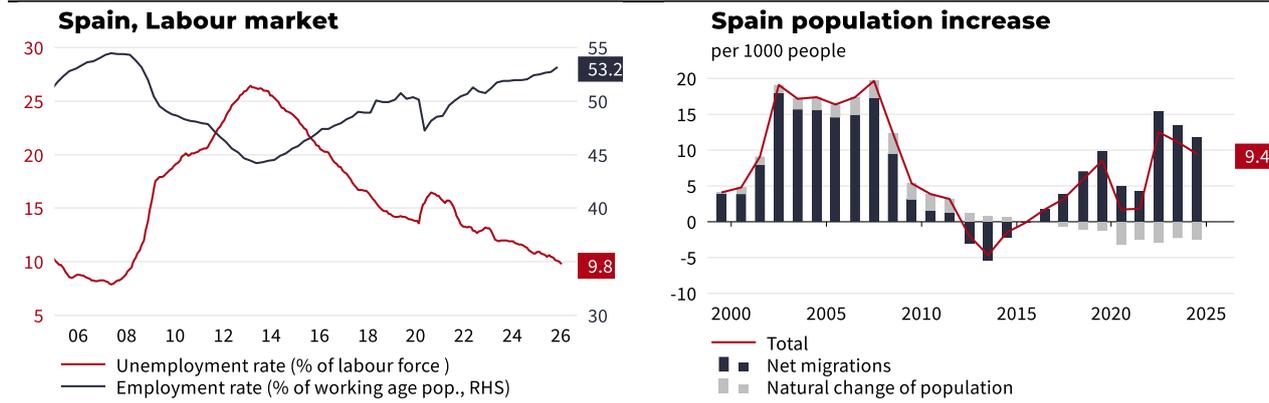


Source: INE, LSEG, SG Economic and Sector Studies

Credit to non-financial private businesses has expanded following monetary easing. Housing credit to households and credit to firms increased by 4.9% and 3.8% respectively year-on-year in Feb-26 and is set to remain on a firm upward trend.

Spain's trade deficit widened in 2025, with imports growing faster than exports due to strong domestic demand and a decline in exports to the US. 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 permitted by an influx of migrants

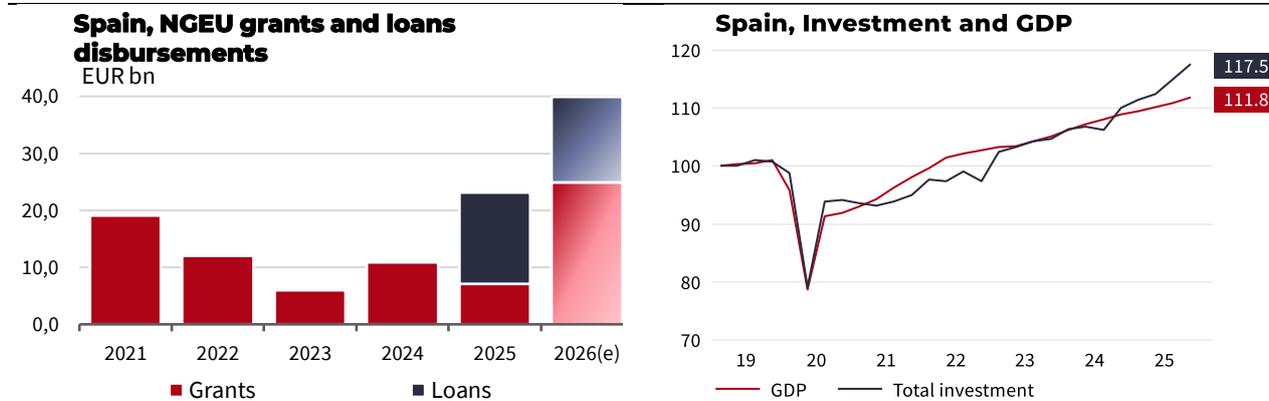


Source: INE, LSEG, SG Economic and Sector Studies

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 will support investment



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

Source: INE, LSEG, SG Economic and Sector Studies

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.

Spain is reducing its deficit and risk premium thanks to economic growth, even in the absence of an approved budget. Part of what has changed—and what markets value—is the momentum of economic activity and the impact it is having on the

government's ability to reduce its imbalances. The certainty of having explicit fiscal consolidation measures, agreed upon in Parliament, has been replaced by confidence in an economy that continues to grow faster than its main peers and that is turning favourable cyclical conditions into improvements on public accounts. That said, the evolution of public finances conceals less favourable elements. Of particular concern is the increase in net primary spending, which grew at 4.5% year-on-year in 2025, above the 3% average outlined in the Fiscal and Structural Plan.

Spain has explicitly refused to commit to NATO's defence-spending target of 5% of GDP by 2035, setting itself apart from the other 31 members of the Alliance. While NATO allies agreed in 2025 to significantly increase military expenditure—allocating 3.5% of GDP to core defence needs and an additional 1.5% to areas like cyber and infrastructure—Spain secured a special exemption and chose instead to cap its contribution at approximately 2.1% of GDP. The Spanish government argues that this level fully meets NATO's capability requirements without compromising the country's social model or fiscal priorities.

Despite the current political deadlock, PM Sanchez is unlikely to resign before 2027. The withdrawal of external support from Junts per Catalunya, a Catalan nationalist party, has left the administration in a legislative deadlock, highlighted by its failure to pass a budget for the third consecutive year. Despite holding a working majority on paper (until Junts' withdrawal), Sanchez's coalition had struggled to pass legislation since the last general election, which was held in 2023. 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	2025	2026f	2027f	2028f
Real GDP, % YoY	2.8	2.2	1.6	1.6
Household consumption	3.4	2.6	2.0	1.8
Public consumption	1.8	1.7	0.8	0.8
Investment	6.3	4.4	0.3	0.6
Exports of goods & services	3.4	2.4	2.6	2.7
Imports of goods & services	6.3	4.0	2.1	2.0
Inflation, % annual average	2.7	2.4	2.0	2.2
Core inflation, % annual average	2.6	2.3	2.0	2.2
Real gross disposable income (GDI), % YoY	2.7	3.1	1.6	1.4
Households saving rate, % of GDI	12.2	12.6	12.2	11.8
Unemployment, % of labour force	10.5	10.4	10.5	10.6
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	2.8	2.1	2.3	2.3

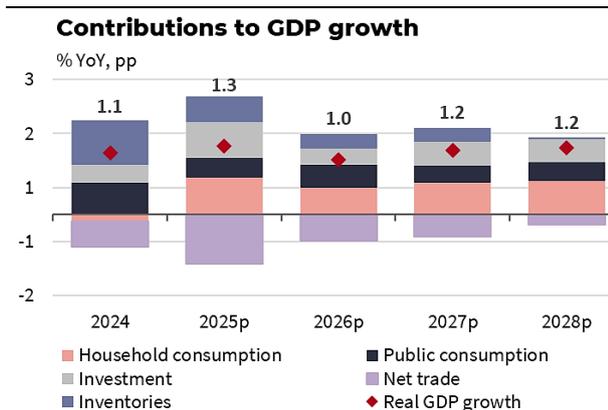
UNITED KINGDOM

- We see real growth easing to 1.0% in 2026 as household consumption and business investment remain muted, before moderately rebounding in 2027.
- Fiscal policy is set to remain contractionary over the medium term, implying a gradual handover from public- to private-led growth.
- Inflation is set to converge to the BoE's 2% target in 2026, allowing for two 25bp Bank Rate cuts this year but energy prices add risk.

The UK grew by 1.3% in 2025, faster than European peers, but it leaned heavily on components that are unlikely to repeat at the same pace. About half of the growth came from government consumption and business investment. Public consumption is still doing some of the lifting, but fiscal policy remains contractionary. At the same time, investment and inventories were a bigger-than-usual growth driver due to firms bringing activity forward in anticipation of Liberation Day tariffs, leaving little room for a repeat. Exports and household spending remained held back by uncertainty.

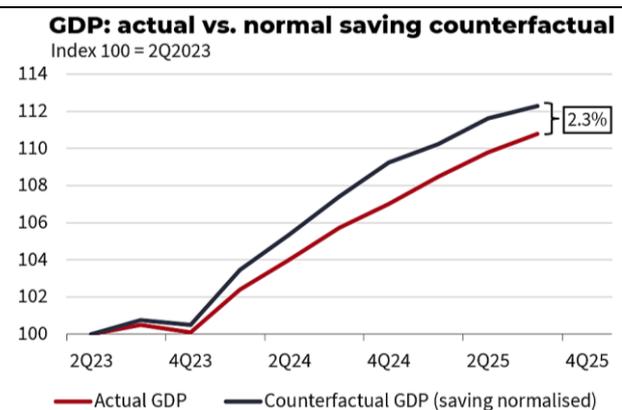
We see real growth easing to 1.0% in 2026, before moderately rebounding in 2027. The drag comes from the private side: investment normalises, households stay cautious, and exports struggle to build momentum amid elevated uncertainty. With fiscal tightening continuing and the 2025 outturn leaving an adverse base effect for 2026, the near-term arithmetic is simply less favourable. In 2027, we expect a modest re-acceleration to 1.2% as disinflation and BoE rate cuts support investment and household consumption.

GDP forecast: resilient growth



Source: ONS, SG Economic and Sector Studies

Excess saving has cost 2.3% of GDP since 2023



Source: ONS, SG Economic and Sector Studies

In the short term, the scars from repeated shocks will continue to weigh on household consumption... Prolonged uncertainty—Brexit, wars, the cost-of-living squeeze, and global trade tensions—has damaged confidence: surveys remain structurally below their pre-Brexit levels. Additional headwinds persist as the labour

market cools and BoE rate rises are still feeding through as lower-rate pre-2022 fixed mortgages roll off. Households have responded by building higher precautionary savings: the saving rate jumped after the pandemic and has not normalised, holding back spending. With household consumption around 60% of GDP, this has restrained growth. By our estimate, had the saving ratio normalised after the pandemic, the level of nominal GDP today would be about 2.3% higher (see figure above).

...and constraining business investment. Prolonged Brexit uncertainty forced years of supply-chain overhauls, regulatory realignment and contract renegotiation, diverting capital from productive investment. Further headwinds have come from energy costs, while a tight labour market has driven faster wage growth over the past two years. Employer costs rose further in 2024 with higher employer National Insurance Contributions and increases in the minimum wage, which are still feeding through and squeezing margins. Although the BoE is easing policy, the Bank Rate remains at 3.75%, well above pre-pandemic levels and one of the highest in the G7 in real terms. These headwinds rest on a longer-running constraint: private-sector deleveraging since the 2008 GFC, which has left growth more reliant on public support, limiting the scope for a near-term investment rebound until cost pressures, rates and uncertainty show stronger signs of easing.

In the medium term, there is room for a gradual recovery in private demand. Several aspects point at a medium-term growth in household consumption and business investment. Households have rebuilt purchasing power as nominal pay has outpaced inflation in the last 30 months: real salaries are now about 3% above their pre-2022 level, and consumer confidence has shown the first signs of recovery. The 2025 Autumn Budget doubled fiscal headroom to 2030, reducing the risk of frequent tax rises to meet the fiscal rules and improving policy certainty. As the BoE continues to cut rates, easier financial conditions will support credit to households and firms. Planning reform should support housebuilding and residential investment, while a softer labour market and slower pay growth give firms scope to rebuild margins. Households now carry lower debt and higher savings than before the pandemic, and corporate balance sheets are healthier.

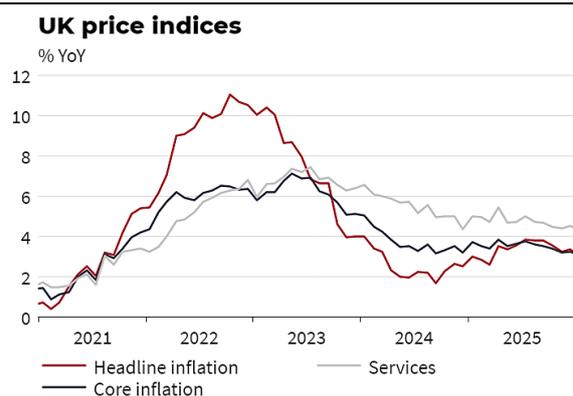
Fiscal policy is set to remain contractionary through 2031, implying a gradual handover from public- to private-led growth. Tax measures in the 2025 Autumn Budget are set to raise about GBP 26bn a year by FY2029/30 (around 0.9% of 2025 GDP), largely via frozen income-tax thresholds. In parallel, the plans imply sharp real-terms spending cuts from FY2028/29, with “unprotected” departments—policing, courts and local government—falling by about 3.3% a year. We doubt the government can deliver both higher taxes and spending cuts heading into a 2029 election year. Our base case is that the tax rises proceed, but the 2027 Spending Review softens the cuts. The public deficit therefore narrows but gradually, leaving the primary balance short of what is required to put debt-to-GDP on a clear downward path.

Softening wage growth



Source: ONS, LSEG, SG Economic and Sector Studies

Declining inflation



Source: ONS, LSEG, SG Economic and Sector Studies

Inflation is set to converge to the BoE's 2% target in 2026, allowing for two 25bp Bank Rate cuts this year, but risks are present from energy prices. Headline inflation fell to 3.0% in January from 3.4% in December, led by decline in as food and fuel inflation-categories consumers feel more directly. The labour market continues to soften: unemployment reached 5.2% in January 2026, the highest in since 2015 (excluding the pandemic), dragging private wage growth down to 3.5% versus 5.9% at the start of 2025. We expect inflation to decline more sharply in April 2026, as last year's regulated price hikes drop out of the annual comparison and government energy price reduction measures take effect. This should bring inflation to the BoE's 2% target in 2026. With inflation, wages and GDP growth all moderating, we forecast two 25bp Bank Rate cuts, bringing the terminal rate to 3.25%. No further cuts are expected in in 2027, as the rate reaches its neutral level.

Risks to the outlook remain tilted to the downside. A prolonged Middle East conflict could hold energy prices high, slowing disinflation and keeping the BoE on a higher-for-longer path.

United Kingdom	2025	2026f	2027f	2028f
Real GDP, % YoY	1.3	1.0	1.2	1.2
Household consumption	1.1	0.8	1.0	1.0
Public consumption	1.7	2.1	1.5	1.6
Investment	3.4	1.5	2.3	2.2
Exports of goods & services	1.6	1.0	1.4	2.0
Imports of goods & services	4.2	2.3	2.5	2.4
Inflation, % annual average	3.4	2.8	2.1	2.1
Core inflation, % annual average	3.5	2.7	2.0	2.0
Real gross disposable income (GDI), % YoY	0.7	0.7	0.9	0.5
Households saving rate, % of GDI	9.9	9.8	9.6	9.0
Unemployment, % of labour force	4.9	5.0	4.9	4.7
Fiscal balance, % of GDP	-5.4	-4.5	-4.0	-3.5
Public debt, % of GDP	96	98	100	101
Current account balance, % of GDP	-3.5	-3.5	-3.6	-3.6

UNITED STATES

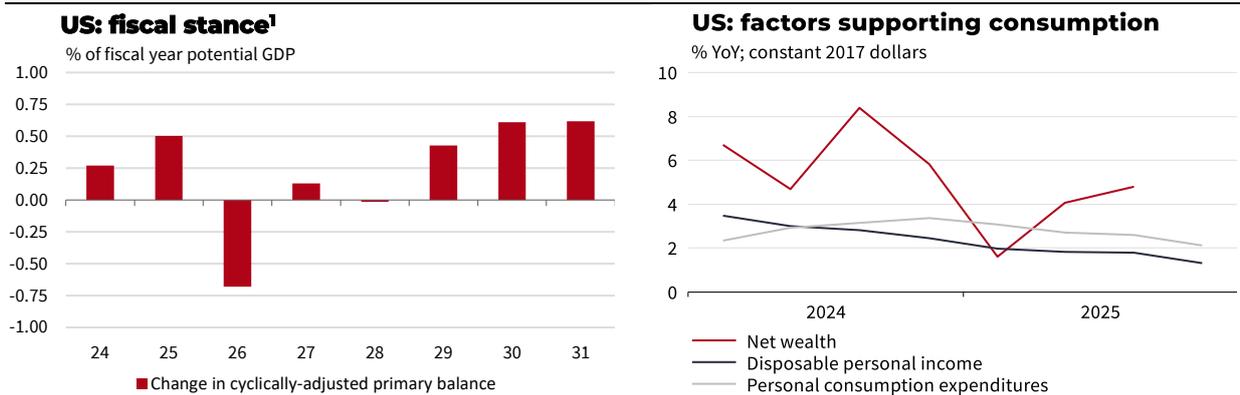
- **Consumption resilience is set to fade further over 2026 as fiscal stimulus dissipates and further positive wealth effects look unlikely.**
 - **Tariffs are set for heightened volatility this year as investigations, congressional validation and litigation evolve; potentially large IEEPA refunds add to an already deteriorating fiscal trajectory.**
 - **Kevin Warsh will likely push for lower rates and a smaller balance sheet, but we see slow moves only given the FOMC composition and operational constraints on the balance sheet.**
-

US household consumption should get a temporary lift in early 2026 as roughly USD 80bn in extra tax refunds (about 0.3% of disposable personal income) is paid after the 2025 filing season. Overall, 2026 tax bills will fall by about USD 134bn, raising disposable income mainly for middle- and upper-income households. The resulting consumption boost in 2026 is likely to be modest (0.1–0.2pp), as much of the gain accrues to higher-income households with lower marginal propensities to consume. Moreover, some of the effect has likely already occurred: consumption has stayed resilient despite slowing income growth, and the savings rate fell to just 3.6% in December, suggesting households anticipated the cuts. Higher energy prices, linked to the conflict in the Middle East, are also weighing on household budget.

From 2027, fiscal policy turns into a drag as spending cuts, notably to Medicaid and SNAP, bite, reducing federal outlays by roughly USD 600bn over 2026–2031. Because the cuts fall largely on the bottom income quintile (under 10% of total consumption), the direct hit to aggregate consumption growth should be limited, though they imply a material social cost with around 2.1 million fewer people insured by 2034.

Wealth-driven support to consumption should weaken from 2026. Over the past two years, rising asset prices have offset slower real income growth, with wealth changes now more correlated with consumption than income in a reversal of the pre-2000 pattern. But gains have been highly concentrated: about 80% of post-2023 wealth gains accrued to the top quintile, which accounts for around 40% of consumption. That helped sustain 2025 resilience, yet it raises downside risk as stretched equity valuations, and a cooling housing market leave limited room for further asset-price gains. High-income households are most exposed to any equity adjustment, while middle-income households face housing demand constrained by high long rates. With fiscal tailwinds fading and wealth effects losing momentum, consumption growth should slow in 2027.

Fiscal stimulus flips to contraction from 2027... ..and future positive wealth effects appear unlikely



Sources: CBO, SG Economic and Sector Studies

Sources: Federal Reserve, BEA, SG Economic and Sector Studies

Note: 1) A negative value implies a fiscal impulse and a larger structural primary deficit

Non-residential private fixed investment should drive growth through at least 2028, led by AI-related infrastructure spending. Hyperscaler guidance implies 2026 capex will exceed the exceptional 2025 increase (around USD 180bn), contributing roughly 0.8pp to GDP growth on a gross basis. However, high import content (potentially ~40%) means domestic value added is materially less than the headline suggests. Real estate investment should remain a drag as elevated long-term rates and weaker net migration reduces demand.

The Supreme Court decision striking down IEEPA country-of-origin tariffs removes ~62% of tariffs collected at the time and entails potential refunds of roughly USD 170bn (~0.5% of GDP). Potential refunds are likely to be protracted and legally contested, so cash outflows may be spread over years. The administration's shift to Section 122 tariffs (10%, with intent to raise to 15%) pushes the average applied rate back towards ~12–14%, only slightly below the previous regime. Volatility should remain high, incentivising some import front-loading from countries where applied rates have fallen, such as Brazil and China. Section 122 requires congressional validation within 150 days and may face legal challenges as it is reserved for balance of payments crises, and the administration is already looking to expand Sections 301 and 232. These statutes offer less flexibility and require investigations into discriminatory practices by trading partners against US exports, or into the critical importance of a good for national security, respectively. These frameworks are, in principle, more robust, but remain contestable and require longer investigative timelines, which limits their usefulness as rapid-action instruments for the Presidency. As a result, they are less likely to be used for "Liberation Day"-type threats. Nevertheless, the trade environment is set to remain erratic, and the fiscal dynamics harder to stabilise, which could put pressure on long Treasury yields.

Import growth is set to decline in 2026 due to base effects from last year's stockpiling/destocking cycle, temporarily lifting net exports. That support

should fade as the year progresses and imports re-accelerate with resilient domestic demand. Over the medium term, the external sector is unlikely to provide a lasting boost to offset slowing domestic demand from 2027.

The nomination of Kevin Warsh as Fed Chair signals a desire to cut rates on an AI-driven, productivity-led disinflation hypothesis, and to shrink the Fed balance sheet. Both objectives are likely to meet resistance on the FOMC, but the second appears particularly challenging. Accelerating the run-off of the Fed’s long duration Treasury portfolio would likely push up long yields in a period of massive issuance. Operationally, late-2025 money market volatility signalled that reserves are already near “ample”, prompting Reserve Management Purchases. Reducing reserves further risks renewed liquidity stress and loss of rate control absent active intervention. Reducing reserve demand would likely require an overhaul towards a Bank of England-style “reserves on demand” framework. The discount window’s stigma makes it unattractive as a provision tool, so the Standing Repo Facility could fulfil this role, provided its size cap is removed. If banking regulations are eased this may reduce the need for reserves, however meaningful balance sheet shrinking would nonetheless plausibly take years rather than months.

Risks to the scenario are skewed to the downside. Equity markets are elevated despite recent rotation, credit spreads are still fairly tight, and business credit growth was still accelerating as of January. A meaningful tightening — via an equity correction, higher term premia, or shifts in monetary policy expectations — could expose the narrowness of current growth drivers. Recent tremors in private credit mark a further risk. The conflict in the Middle East presents a substantial downside risk and comes with a notable fiscal cost.

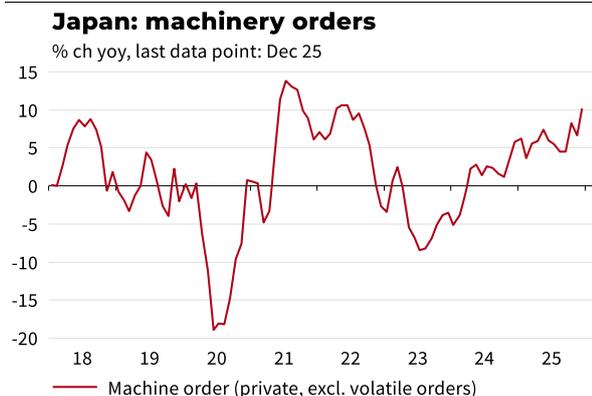
United States	2025	2026f	2027f	2028f
Real GDP, % YoY	2.1	2.1	1.6	1.8
Household consumption	2.6	1.8	1.6	1.8
Public consumption	0.6	2.1	1.4	1.4
Investment	2.7	2.5	2.6	2.6
Exports of goods & services	1.6	1.4	1.4	2.4
Imports of goods & services	2.7	-0.1	2.5	3.4
Inflation, % annual average	2.7	3.1	2.4	2.6
Core inflation, % annual average	2.9	2.8	2.6	2.7
Real gross disposable income (GDI), % YoY	1.6	1.7	1.6	1.7
Households saving rate, % of GDI	4.5	4.2	4.2	4.0
Unemployment, % of labour force	4.3	4.7	5.0	5.1
Fiscal balance, % of GDP	-5.8	-6.3	-6.4	-6.4
Public debt, % of GDP	100	102	106	108
Current account balance, % of GDP	-3.8	-3.8	-3.8	-3.9

JAPAN

- **The ruling coalition's two-thirds majority has strengthened Sanae Takaichi capacity to implement fiscal policy expansion.**
- **Domestic demand is set to drive growth in 2026, consumption being supported by real wage gains in a context of slowing inflation.**
- **Though the normalisation of monetary policy is set to continue as inflation expectations anchor, it might be derailed by new risks on growth and from higher oil prices.**

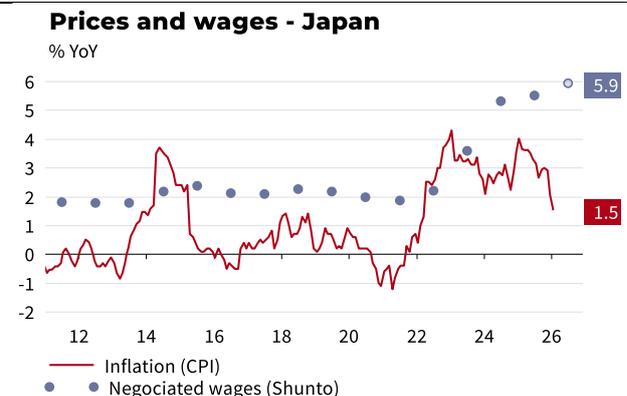
GDP growth is projected to stay above potential at 1.0% in 2026 and slow to 0.7% in 2027. Domestic demand will be the main driver of growth, with external demand exerting a drag on activity, reflecting the US tariffs headwinds. Private consumption will be supported by wage gains pushing up real disposable incomes, with Shunto negotiations set to give rise to a third year of above 5% wage growth. Robust corporate profits and government subsidies will support business investment. Headline consumer price inflation will be affected by soaring energy prices in 1H26 and slow down gradually to 1.5% in 2027, provided that the geopolitical situation normalises. The fiscal stimulus package will support public consumption and investment, including tax cuts, energy subventions and rice coupons. Meanwhile, heightened policy and trade uncertainties will weigh on business sentiment.

Pick-up expected in investment



Sources: SG Economic and Sector Studies, LSEG

Third year of record Shunto wage negotiations



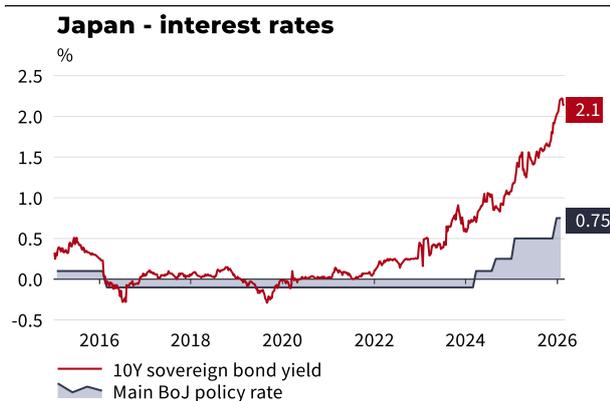
Sources: SG Economic and Sector Studies, LSEG

The ongoing conflict in the Middle East presents considerable uncertainty. Should the situation be resolved within our working assumption timeframe, however, growth conditions are expected to remain robust in 2026 due to fiscal support and a recovery in private consumption. A longer duration of the conflict would affect both household consumption and business profitability, Japan being a large importer of fossil fuels with a strong reliance on the Strait of Hormuz passage.

Corporate investment will 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, being also 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.

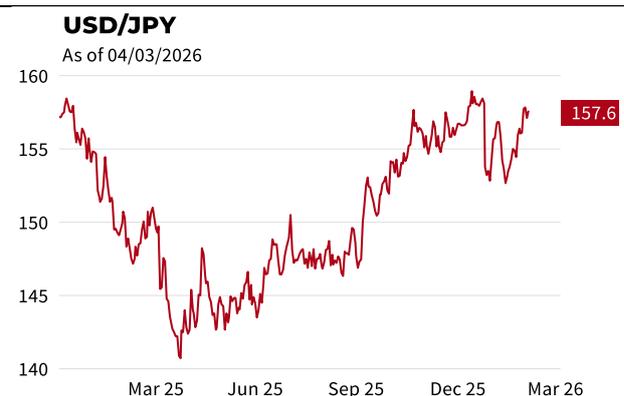
The Bank of Japan is expected to gradually normalize monetary policy over the next two years and raise its policy rate to 1.5% by the end of 2027. The central bank will remain cautious throughout this period to ensure that policy normalization does not cause an economic slowdown or jeopardize its success in the recovery. The pace of further rate hikes will depend on inflation data and real wage growth. A persistent JPY depreciation might add pressure for more rate hikes. 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.

Policy rate expected to reach 1.5% by 2027



Sources: SG Economic and Sector Studies, LSEG

JPY set to be supported by higher interest rates



Sources: SG Economic and Sector Studies, LSEG

A prolonged supply shock could shift the BoJ's approach. Rising costs and uncertainty from an oil shock may curb private spending and investment, leading to slower growth and higher inflation that will complicate decisions for the BoJ. If the rise in inflation is mostly driven by supply shock (which eventually curbs the recovery of real wages and consumption), the BoJ may have to slow the pace of rate hikes.

Japan's political stability has significantly improved after the election on 8 February 2026. The two-thirds majority in the lower house will enhance the stability and strength of the coalition government of the Liberal Democratic Party (LDP) and Nippon Ishin no Kai (Ishin), facilitating government-initiated legislation and parliamentary approval of the state budget. The LDP's conservative wing, of which Ms Takaichi is an important member, will exert a strong influence over the policy direction of the government. Her policy agenda will follow that of her late mentor,

Shinzo Abe, seeking a more assertive role for Japan on the global stage and featuring a more proactive fiscal stance to stimulate growth.

The fiscal stance will thus be expansionary in 2026 and 2027, with a stimulus package injecting more than 1% of GDP in the economy. Public deficit will continue to increase as interest charges become more pronounced, with 10Y JGB now exceeding 2%. However, the average debt maturity of over 9 years creates some breathing room. 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).

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. While we expect the fiscal deficit to average close to 3% of GDP in 2027, the gross public debt-to-GDP ratio is projected to remain on a declining path, as nominal GDP still exceeds the average interest rate on debt service.

Risks are tilted to the downside. Trade frictions and geopolitical uncertainties could weigh on 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.

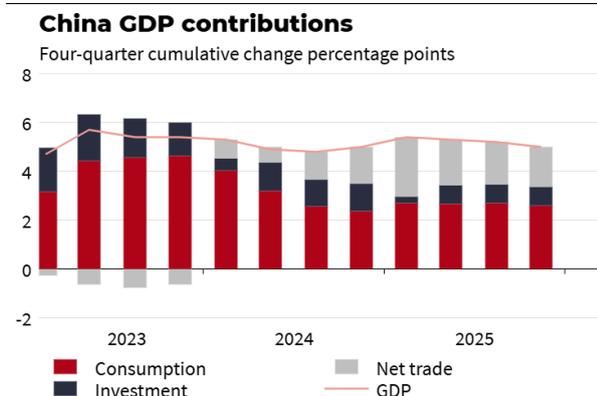
Japan	2025	2026f	2027f	2028f
Real GDP, % YoY	1.1	1.0	0.7	0.6
Household consumption	1.4	1.1	0.8	0.6
Public consumption	0.7	0.8	0.4	0.4
Investment	0.5	0.7	0.7	0.6
Exports of goods & services	2.9	1.5	1.7	2.0
Imports of goods & services	4.0	2.3	2.0	1.8
Inflation, % annual average	3.2	2.0	1.5	1.5
Core inflation, % annual average	3.1	1.8	1.5	1.5
Real gross disposable income (GDI), % YoY	-0.2	1.5	0.7	0.6
Households saving rate, % of GDI	-0.5	-0.1	-0.3	-0.4
Unemployment, % of labour force	2.5	1.9	1.8	2.0
Fiscal balance, % of GDP	-1.3	-2.2	-2.9	-3.2
Public debt, % of GDP	218	213	211	209
Current account balance, % of GDP	4.7	4.2	4.2	4.2

CHINA

- **GDP growth is set to slow to 4.4% in 2026, from 5% in 2025.**
- **China is emerging from deflation, but negative price pressures are likely to persist, due to overcapacities.**
- **The 15th Five-Year Plan is mostly a continuation of previous policies.**

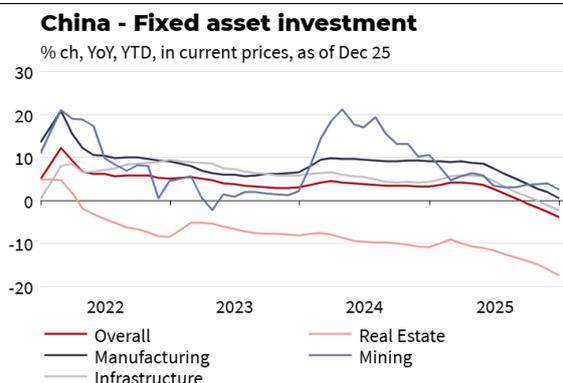
GDP Growth has already started to slow. GDP rose by 4.5% in 4Q25, compared to 4.8% in Q3. For the year 2025, it reached the official target of 5%, but this figure masks weakening of domestic demand. Retail sales grew by only 0.9% in December, still hindered by low confidence and precautionary saving behaviour. Investment in fixed assets declined by 3.8% in 2025, weighed down by real estate investment, which fell by 17.2% after a 10.6% drop in 2024. Foreign trade remains dynamic and contributed about one-third to growth in 2025. China's exports will remain resilient, supported by competitive pricing amid supply-chain reorganisation and improving product quality. However, exports growth is likely to soften amid a global trade "payback" following front-loading in 2025. Rising protectionism worldwide will also continue to weigh on momentum.

Growth remains sustained by exports



Source: SG Economic and Sector Studies, LSEG

Investment signals a slowdown



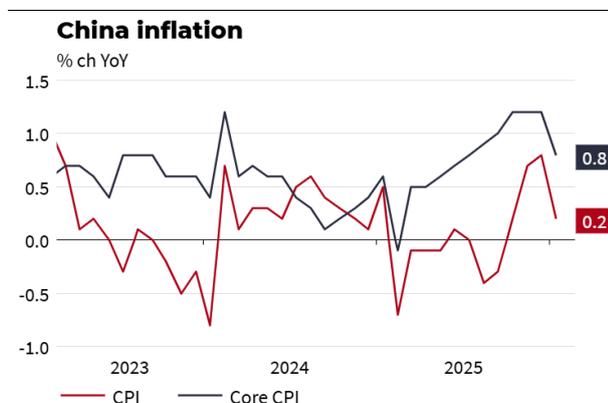
Source: SG Economic and Sector Studies, LSEG

China has emerged from deflation since October, thanks to the rebound in food prices and service prices. However, deflationary pressures persist on the business side. Producer prices are contracting (-1.9%YoY in December), as are export prices. The restructuring of sectors with overcapacity is underway, but the process will take time and is expected to continue beyond 2026. The gradual approach favoured by the government, along with the continued decline in property prices, should limit the rebound in inflation. China is thus expected to maintain relatively low inflation in 2026 and contracting export prices.

The capacity reduction has begun for basic industries, but support to priority sectors will continue. Basic industries 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. 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. 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.

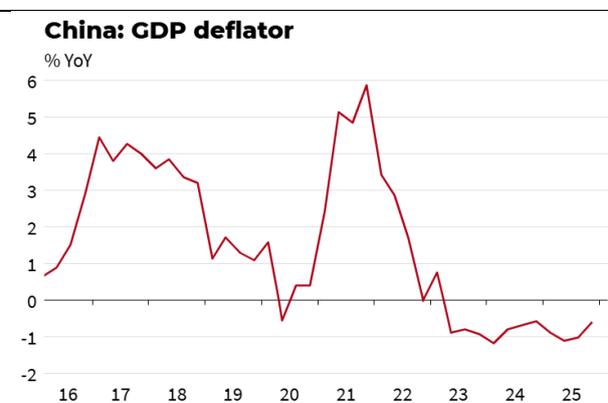
China will also continue to provide wide-ranging support to its self-defined priority sectors. While there is little official information on the magnitude of the Chinese Industrial policy, the fiscal costs of these measures are estimated by the IMF to reach about 4% of GDP in the February 2026 article 4 report. According to the IMF, EU state aid to its industries amounts in comparison to around 1.5% of its GDP. This is bound to give rise to international spillovers and pressures from trade partners. The strong growth of industrial production combined with weak domestic demand is rendering China more reliant on exports as a source of growth and is pushing down export prices. This is likely to fuel further commercial tensions with trade partners such as the EU.

China has emerged from deflation...



Source: SG Economic and Sector Studies, LSEG

...but negative price pressures persist



Source: SG Economic and Sector Studies, LSEG

The 15th Five-Year Plan is a continuation of previous policies with an emphasis on quality growth. Tech sufficiency and innovation remain the top policy priorities. 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, but support to welfare and consumption may remain underwhelming. In March, the growth target for 2026 has been revised downwards to the bracket of 4.5-5% YoY.

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.

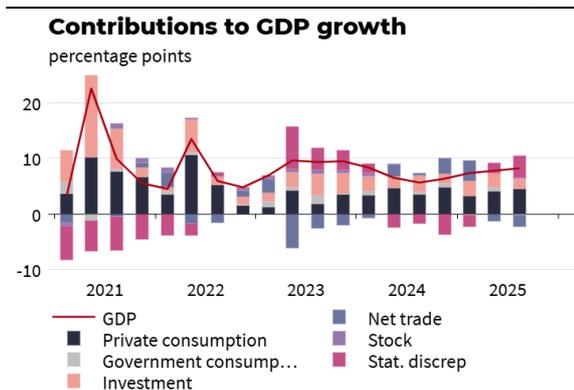
China	2025f	2026f	2027f	2028f
Real GDP, % YoY	4.9	4.2	4.0	3.8
Household consumption	5.5	4.5	4.2	3.8
Public consumption	6.1	4.9	4.8	4.5
Investment	4.0	4.0	3.9	3.5
Exports of goods & services	4.0	2.7	2.1	2.5
Imports of goods & services	3.8	3.8	2.2	2.0
Inflation, % annual average	0.3	1.0	1.2	1.5
Fiscal 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

- **Growth momentum will remain strong over 2026/27.**
- **India recently concluded several trade agreements with major partners, signalling a will to overcome its protectionist legacy.**
- **Lower than expected inflation provides some policy room for monetary policy but this could be challenged by higher energy and fertilizer prices.**

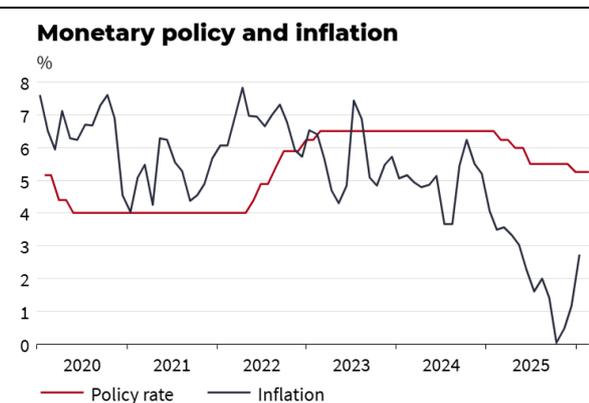
Growth will remain buoyant despite ongoing fiscal consolidation. Growth is driven by the insular nature of the Indian economy, pre-emptive monetary easing by the Reserve Bank of India, reforms for direct and indirect taxes, strong public investment, resilient services exports, strong rural demand and trade deals that will open new markets.

Growth is well balanced, not overheating



Source: IMF, SG Economic and Sector Studies

This leaves some monetary policy room



Source: SG Economic and Sector Studies, LSEG

India has recently concluded trade agreements with major partners. In January 2026 India and the EU finalised a FTA covering nearly all tariffs on goods and services. This will need ratification from the European Parliament and is unlikely to be implemented before early 2027. In 2025 India had already concluded FTAs with Oman, New Zealand, and the UK. In February 2026 India and the US announced an interim bilateral trade agreement—the details of which are not yet available—under which the US reduced tariffs on most Indian goods from 50% to 18%, in exchange for enhanced market access. These agreements with the most important trade partners signal India's push to overcome its protectionist legacy, prioritising tariff reliefs for industrial sectors such as automotives, electronics, pharmaceuticals and textiles, while still shielding agriculture and dairy.

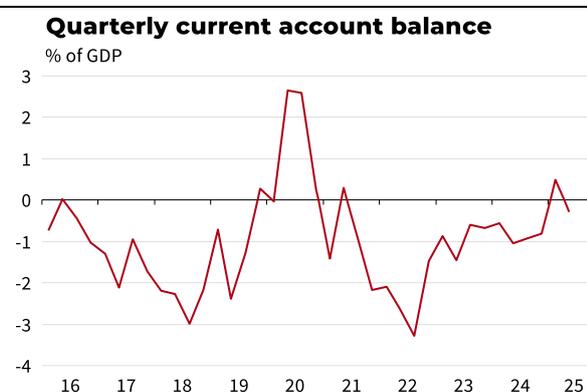
Inflation is significantly below target. Growth is resilient, not overheating. Policy stance is neutral, keeping flexibility. Markets anticipate the possibility of one more modest cut.

India has significantly benefited from cheap Russian oil imports since 2022, as a result of EU and US sanctions. At the end of 2025, additional sanctions targeted Indian importers. As a result, Indian refineries started in Q1 to redirect purchases. After the first week of conflict in the Middle-East, these additional sanctions were suspended by the US, but the era of cheap oil for India is now over.

Indian has benefited from low-priced oil



...improving its 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 tilted to the downside, as India remains very sensitive to oil prices through its impact on food prices. On the other hand, if the Middle-East conflict proved short, domestic demand dynamics could positively surprise in a context of easing monetary policy and inflation stabilisation which would boost investment and consumption.

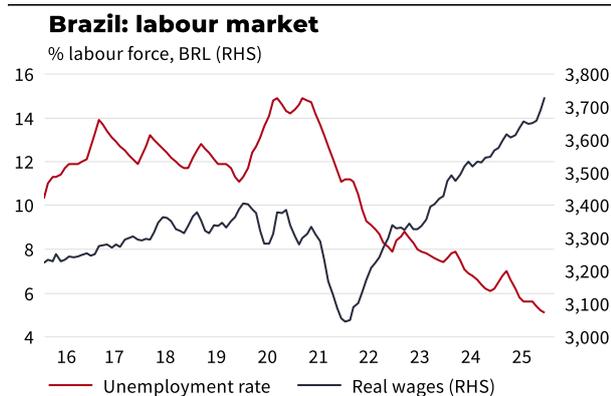
India (fiscal year from April to March)	2025f	2026f	2027f	2028f
Real GDP, % YoY	6.5	6.1	6.4	6.5
Household consumption	6.7	6.3	6.4	6.6
Public consumption	5.6	5.2	5.0	4.8
Investment	6.0	6.3	6.5	6.7
Exports of goods & services	5.5	4.0	5.5	6.0
Imports of goods & services	5.8	5.0	6.0	6.5
Inflation, % annual 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

- **2026 will mark the trough of the country's cyclical correction with growth expected at 1.3%.**
- **BCB signals the beginning of a cautious easing cycle from March as IPCA returns back to its confidence bands.**
- **Agents' balance sheets have deteriorated following the high real interest rates, amplifying the slowdown.**

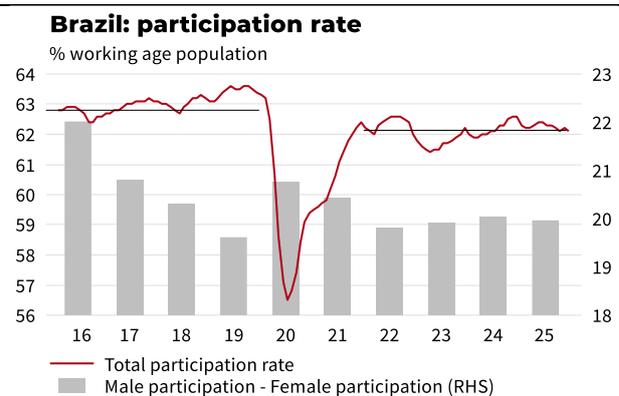
The overheating cycle comes to an end, with a deceleration in 2026 (1.3% vs 2.5% last year) driven by private consumption. Households continue to benefit from a tight labour market, which remains a key resilience factor, with historically low unemployment rates and dynamic wages. However, the labour market continues to be characterized by a lower participation rate than before the pandemic. Female participation continues to be challenged, with gender gaps around 20pp, and structural constraints persist not least regarding public infrastructure. On the upside, the agricultural sector is set to support activity as soy harvest is expected to outperform, a source of export resilience.

A still tight labour market...



Source: IBGE, SG Economic and Sector Studies

... running on lower participation



Source: IBGE, ILO, SG Economic and Sector Studies

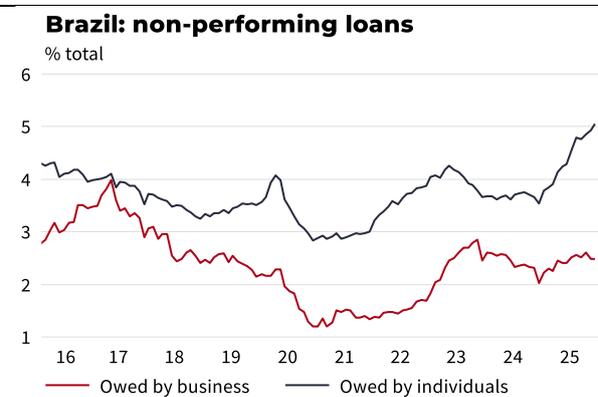
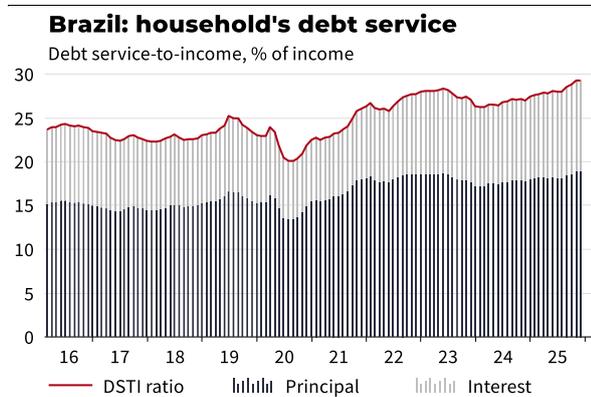
The disinflation cycle is well underway, with the BCB expected to engage in a slow easing cycle while transmission effects materialize in the real economy.

The latest prints in headline IPCA show a return to the BCB tolerance bands with a sticky core that allows the Central Bank to signal cuts from March onwards. The speed and amplitude of the easing cycle will remain data-dependent but terminal rates are expected to remain above neutral. In the meantime, the effects of the lagged transmission of monetary tightening (credit impulse only turning negative in 2H25) are straining agents' balance sheet. High interest rates, reaching 60% in December 2025 for new non-earmarked operations for households, have pushed them to pay over 10% of their income in interest, bringing debt-service (including principal) to 30%, its highest level in over 20 years. Households' NPLs have risen to 5%, its highest level since 2013, notably from credit cards. On the NFC side,

investment is set to continue the deceleration of the investment cycle in line with restrictive monetary conditions and the expected slowdown in activity.

On top of rising NPL ratios, the banking sector is being further pressured in the aftermath of the fallout of Banco Master in December. The banking sector remains well provisioned (provisions amounted to 178% of NPLs in 3Q25) and adequately capitalized limiting the risks of systemic financial turmoil. The liquidation of Banco Master by the BCB on fraud-related counts led to the liquidation of other mid-sized institutions, resulting in the use of about BRL 52bn of the deposit-insurance fund (~40%) to compensate depositors. It constitutes the largest compensation made by the fund, which will require subsequent re-capitalisation expected end of March. The prospect of renewed corruption scandals heightens political risks ahead of the Presidential and Legislative elections in October.

High interest rates deteriorated household's ... resulting in rising NPL ratios now at its balance sheet... highest level since 2013



Source: BCB, SG Economic and Sector Studies

Source: BCB, SG Economic and Sector Studies

Some fiscal leeway is expected ahead of the October elections, but fiscal slippage remains a concern. Fiscal space remains highly limited as debt as a share of GDP has continuously risen since 2023 and is expected to move north of 95% this year. Modest primary deficits (and impulse) are expected throughout the year, not least to ensure governability as the elections approach. However, they will not allow debt dynamics to stabilise, posing fiscal risks, including on the capacity to sustain social programs. Domestic interest burden has mechanically risen with the aggressive stance of the BCB -the 5y rate has risen about 2.5pp from two years ago- while abroad it is benefitting from the global appetite for EM -EMBI spreads narrowing about 35bp since January 2025. Interest payments represented over 8% of GDP in 2025 (+2.5pp with respect to 2019) as implicit rate on the debt stock have risen to its highest level in over a decade.

The balance of risks remains tilted to the downside. Fiscal risks and financial stability concerns warrant monitoring as their spillover effects on the real economy would significantly downgrade the outlook. The elections are taking place in a polarized environment which could also raise socio-political risks. On the external front the latest uncertainty on US trade policy seems to be benefitting Brazilian

exporters reducing the expected tariff even if volatility on that front is still expected. However, risks arising from a potential “geopolitical squeeze”, namely heightened pressure to decouple from China (c.f. Latin America section) dampen the outlook as China is the country’s largest export market (~28% of exports). Conversely, a scenario of persistent tensions over oil prices stemming from the geopolitical context would improve growth prospects, foreign exchange rates and public finances, while posing upside risks to inflation. Finally, abrupt changes in the risk appetite for EM which for now are enabling soaring financial inflows, a stronger BRL and limited sovereign spreads in FX would also dampen the outlook.

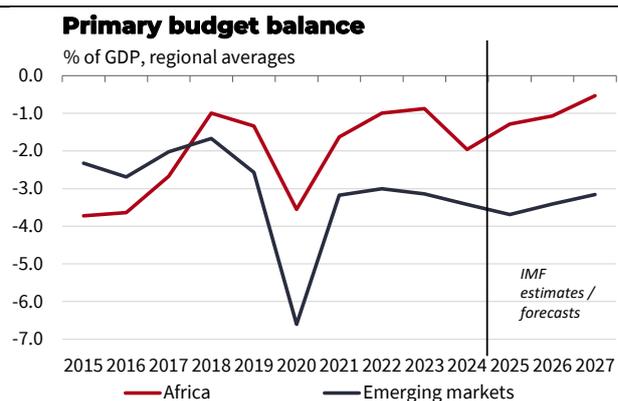
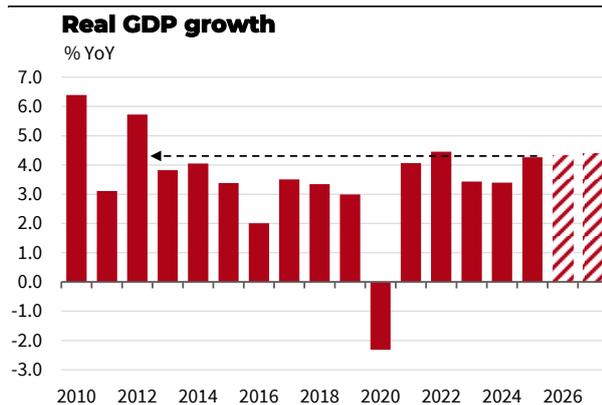
Brazil	2025	2026f	2027f	2028f
Real GDP, % YoY	2.5	1.3	1.7	2.3
Household consumption	1.6	1.4	2.1	2.5
Public consumption	1.7	1.2	0.8	0.8
Investment	3.8	1.0	2.0	2.5
Exports of goods & services	4.6	2.0	2.1	2.3
Imports of goods & services	6.2	2.2	2.2	2.3
Inflation, % annual average	5.0	4.1	3.3	3.5
Fiscal balance, % of GDP	-8.6	-8.4	-6.9	-6.2
Public debt, % of GDP	91	95	97	98
Current account balance, % of GDP	-3.5	-3.0	-3.0	-3.0

AFRICA

- **Growth surprised on the upside in 2025, at 4.3%, the second-best performance since 2013 (included).**
- **It is nonetheless expected to gradually return to its “structural” level, which we still estimate to be below 4%.**
- **Several risks continue to weigh on these forecasts: vulnerabilities in public debt, persistent conflicts and violence, etc.**

Regional growth accelerated in 2025, now estimated at around 4.3% (vs. 3.4% in 2024), the second-best performance since 2013 (included). Private demand was dynamic: the gradual normalization of inflation rates (which broadly returned to their 2021 levels) likely supported consumption, while investment benefited from resilient FDI inflows. External demand, for its part, enjoyed favourable terms-of-trade developments: on average in 2025, energy prices (which represent a significant share of imports) remained generally low, while several key export products for the region (precious and industrial metals, agricultural commodities such as cocoa and coffee) registered high price levels (by historical standards). Public demand, however, likely remained sluggish. Governments initiated consolidation efforts in 2025 (still insufficient at this stage – see below), as illustrated by a significant reduction in the regional average primary fiscal balance (-1.3% of GDP in 2025, vs. -2% in 2024).

Growth in 2025 was among the highest performance in 15 years **Consolidation efforts weigh on public demand**



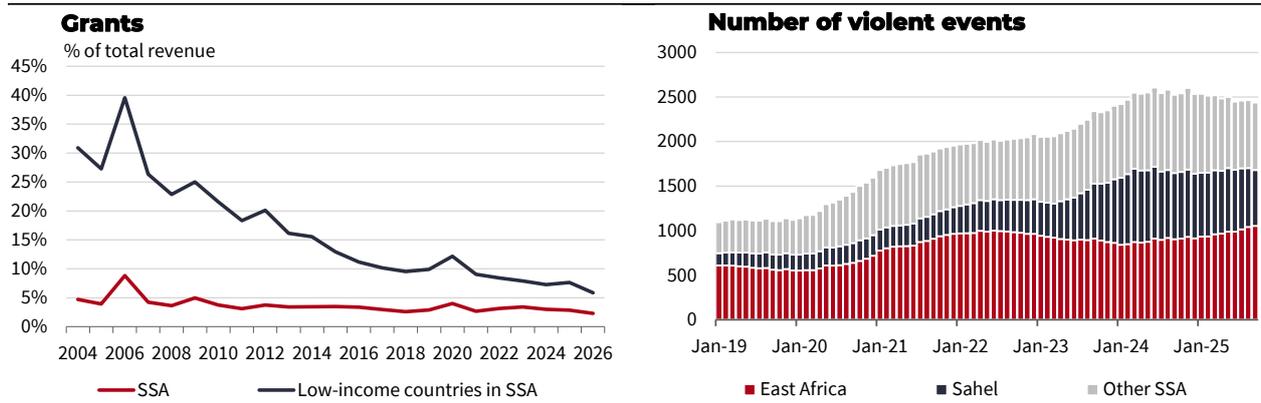
Source: LSEG, IMF, SG Economic and Sector Studies

These dynamics should broadly hold in 2026, despite a slight expected slowdown in regional growth (to 4%). Thanks to declining inflation rates, most regional monetary policies have now become very restrictive in real terms (compared with historical levels). This should enable central banks to lower policy rates, thereby supporting the expected momentum of private demand. Public demand, on the other hand, is expected to remain a drag on growth, as the fiscal impulse will remain negative on average in 2026 and 2027. Governments in the

region continue to face tight financing conditions, particularly in local currency (mainly due to structurally limited investor bases, while on average nearly 20% of the region’s banking sector balance sheets are already composed of government claims). Finally, external demand may be slightly affected by a less favourable global environment and is expected to be less dynamic than in 2025. On the one hand, price risks for crude oil have clearly turned more to the upside due to the conflict between Iran and the United States / Israel. On the other hand, the prices of the region’s main exports remain volatile and dependent on external factors subject to significant uncertainty for 2026 and 2027: the trajectory of US monetary policy for precious metals, the robustness of Chinese growth for industrial metals, climatic conditions for agricultural commodities, etc.

More broadly, we are maintaining our long-term growth forecasts, unchanged at around 3.8% – a level insufficient to ensure sustainable and broad-based development (beyond the main urban areas) in Africa. The structural barriers limiting this “potential” growth remain (inter alia): low agricultural productivity, limited industrialization, inadequate infrastructure, and governance levels still below those of other emerging regions.

The dependency on grants has decreased over the past 20 years **“Violence levels” remain high, despite a (seemingly) recent stabilisation**



Source: LSEG, IMF, World Bank, SG Economic and Sector Studies

Several risks continue to weigh on these forecasts. First, public finances in the region remain vulnerable (with debt-service burdens nearly twice as high as the emerging-market average), alongside additional pressure stemming from the long-term decline in development aid (even though the region’s dependence on grants has clearly decreased over the past 20 years). Furthermore, the region (particularly some of its most fragile countries) continues to be affected by persistent conflicts, with significant economic and social repercussions.

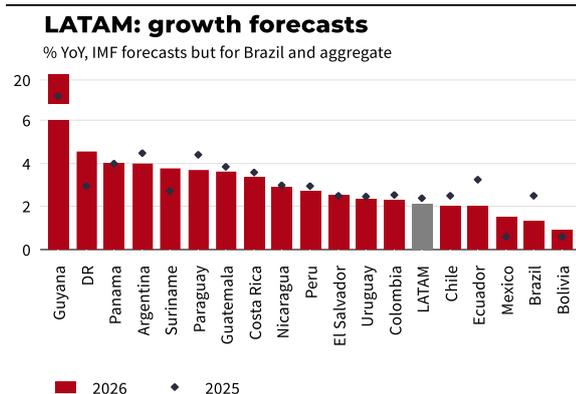
LATIN AMERICA

- **Softer momentum across the region pressures growth to the downside in 2026 (2.1% vs 2.4% in 2025).**
- **Renewed interest from US foreign policy will lead to renewed considerations on the geoeconomic positioning of the region.**
- **Structural challenges remain unaddressed, deteriorating the balance of risks.**

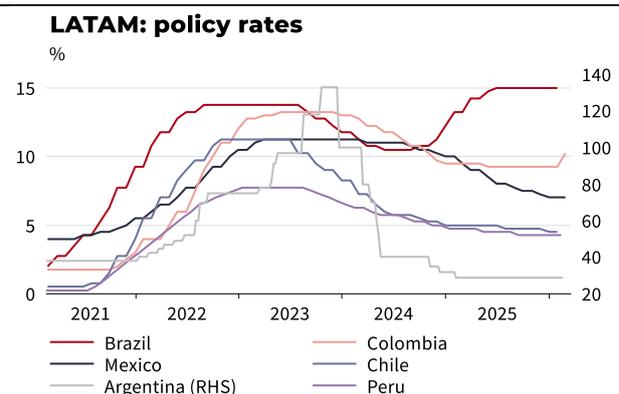
Easing dynamics across the region lead to lower growth for 2026 (2.1%), before growth then reconverges towards potential. Most larger economies (Brazil, Argentina, Colombia, Chile) will see cyclical slowdowns as domestic demand resilience eases. Labour markets continue to show signs of tightness, with low unemployment rates and dynamic wages. Favourable commodity prices, notably of metals, should ease, and heightened uncertainty on US domestic policy can weigh on remittances that have boosted domestic consumption. Mexico will recover from the 2025 trade-tension shock with the US, and smaller economies will continue to outperform within the bloc.

The region should see overall lower inflation in 2026, as price pressures ease in Brazil, Argentina, Chile, and Bolivia. On the contrary, reflation pressures have been exacerbated in Colombia, following the Government's decision to hike the minimum wage by 23% -currently under judiciary review- and prompting a 100bp pre-emptive rate hike by BanRep in February. To a lesser extent, reflation fears also apply to Mexico where Banxico seems to be pausing its easing cycle.

Easing momentum in activity across the ... with some divergence in inflation and MP board...



Source: IMF, SG Economic and Sector Studies



Source: LSEG, SG Economic and Sector Studies

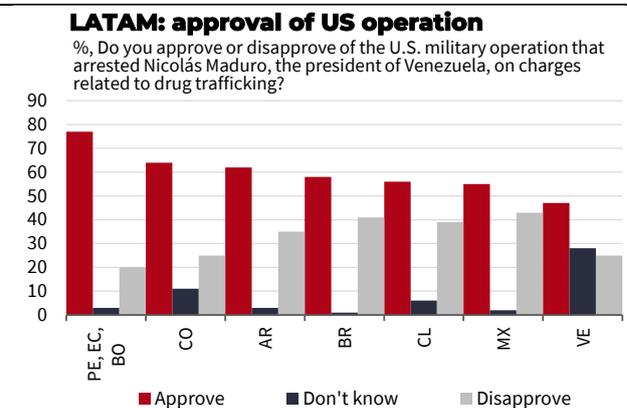
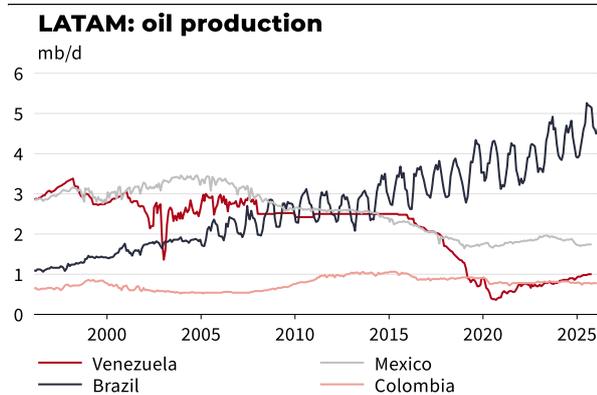
US renewed focus on the Western Hemisphere puts the region at a crossroads in determining its strategic positioning as geoeconomic fragmentation takes hold.

The region is increasingly central to strategic American interests and rhetoric. The biggest illustration of this is the 3 January US intervention in Venezuela to remove N.

Maduro from power and capture him on drug-related charges. In the aftermath of the intervention, the country formally continues to be ruled by the Chavista regime under the direction of Maduro’s vice-president, Delcy Rodriguez with cooperation with the Trump administration. Sanctions have been gradually lifted to encourage increased investment -notably in the O&G sectors- from Western companies. The prospect of selling oil outside of the black market and thus at less of a discount, notably to the US and India, brightens the short-term outlook even if the recovery will be long. The rehabilitation of crude production capacity is expected to remain gradual as the longstanding deterioration of infrastructure requires massive long-term investment in a country where institutional capacity has been depleted, no transition is in sight and human capital loss will be persistent as over 8 million people have left the country. Moreover, Venezuela continues to face over USD 170bn (>180% of 2025 GDP) in debt that must be restructured, a process that has not yet started.

VEN’s oil industry to be constrained by CAPEX, weak institutional capacity and human capital loss

Maduro’s removal from power is seen positively across the region



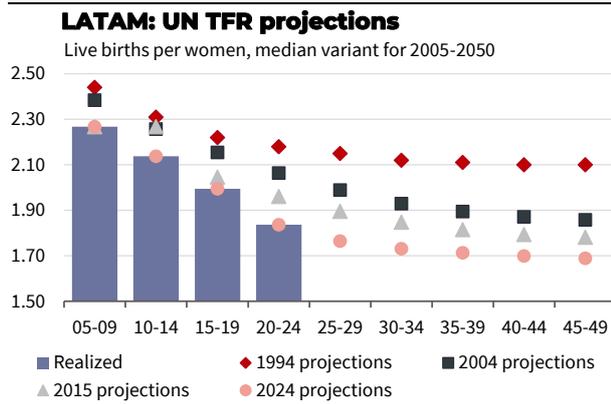
Source: IEA, SG Economic and Sector Studies

Source: AtlasIntel Jan 2026, SG Economic and Sector Studies

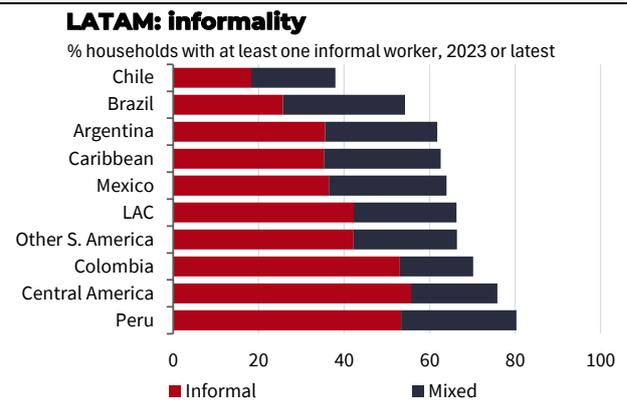
For the region, the most direct consequence of the operation will lie in potential renewed migration flows (from or out of Venezuela), and the further destabilisation of Cuba, which is currently facing energy shortages as oil imports from Venezuela and Mexico have stopped. Broader direct intervention from the US remains unlikely as diplomatic and cooperation channels stay opened, and domestic policy seems responsive to American interests to exclude Chinese interests (e.g. the decision to deem unconstitutional the concession of two of the Panama Canal Ports to Hong Kong based operators) and to address security concerns (see Mexico’s closer cooperation with US authorities, and Colombia’s decision to re-launch glyphosate aerial spraying).

Faster-than-expected fall in fertility accelerates population ageing

Labour markets continue to face high informality



Source: UN, SG Economic and Sector Studies



Source: OECD KIIbIH and LEO 2025, SG Economic and Sector Studies
Caribbean incl. BS, JM, DO, BB, TT; Other S. America incl. UY, SR, PY, BO;
Central America incl. CR, SV, GT, NI, HN

The balance of risks is broadly balanced but constrained by persistent, structural factors. Global risk appetite for EM should continue benefiting local equity markets, spreads, and exchange rates. The strength of the labour market is to be confronted with still high informality rates and low female and youth participation rates. Domestic demand is also likely to be constrained by strained fiscal accounts across the region, highlighting the need for credible fiscal anchors and reforms. On the external front, the region could benefit from US nearshoring efforts along value chains. However, the prospects of some form of decoupling from China will not be without a cost, notably for exporters in South America (China is the biggest export market for Brazil, Chile, Peru), and would endanger joint infrastructure projects. The region is also facing the prospect of a rapidly ageing population as fertility rates dive and remain below replacement. On top of the mechanical constraints this poses on labour markets, when coupled with the high informality rates mentioned above, pressures social security coverage. Security concerns also warrant monitoring. Organized-crime governance is strengthening where state authority is weak. Drug-related violence is intensifying in Mexico as the Sheinbaum government renews action against cartels with US cooperation, and security conditions in Colombia, Ecuador, and Venezuela remain fragile. In countries historically less exposed to organised crime (e.g., Chile, Uruguay, Costa Rica), deteriorating security indicators are turning crime into a central electoral issue.

GULF STATES

- **Depending on its length and scope, the conflict in the Middle East will materially change the economic outlook for the Gulf States. The rapid reopening of the Strait of Hormuz is key.**
- **Under our working assumption of a fairly short-lived conflict, GCC countries could use their large financial buffers to support growth in 2H26 and 2027.**
- **If the conflict were to intensify / last longer, consequences on the region would be substantial.**

The current conflict in the Middle East will materially change the short-term outlook for the Gulf Cooperation Council (GCC) countries. Before that, growth was expected to accelerate to ~4.5% in 2026 (vs. an estimated 3.3% in 2025), on the back of increasing oil & gas (O&G) productions and still dynamic non-O&G sectors. While it is too early to precisely estimate the economic impact of the crisis, even under our current working assumption (in which hostilities last 2 months at the maximum), we estimate that GCC growth will slow down, and we have already decreased our 2026 forecast for the “Middle East and Central Asia” aggregate (where the GCC countries account for ~40% of GDP, and ~55% if Iran is added) from 3.5% to 2.5%. Growth is impacted through several channels.

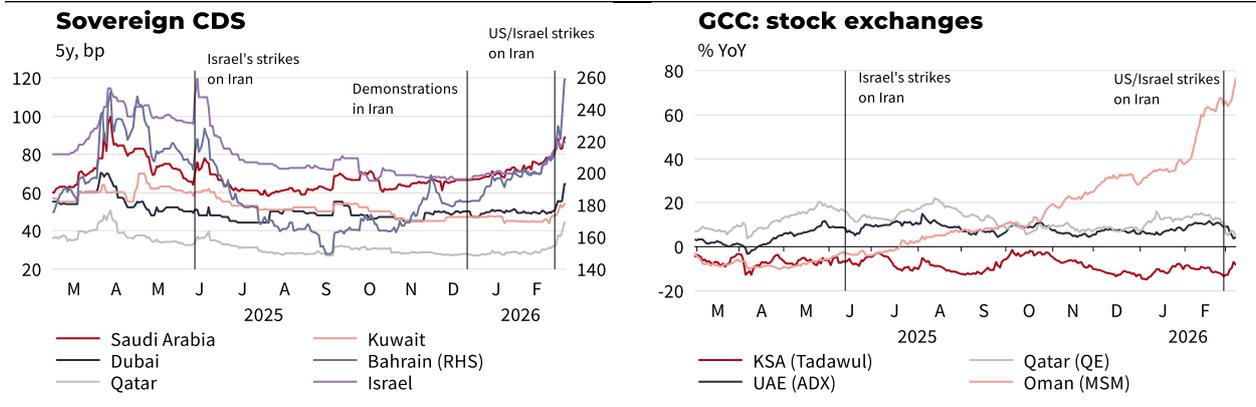
First (and foremost), despite recent diversification efforts, GCC economies remain overwhelmingly dependent on hydrocarbon outputs (with O&G sectors typically accounting for about 25% to 45% of real GDPs, with sizeable additional indirect effects on other sectors), for which the current closure of the Strait of Hormuz is dramatic. In addition to its importance in global trade flows (cf. our editorial), the Strait accounts for i) ~80/90% of Saudi oil exports, with no rapidly available alternative route (10% of oil exports are actually done through the Red Sea, where increase Houthi attacks is a real risk); ii) ~90% of Qatari LNG (given the closure and recent Iranian attacks on some key facilities, the country actually decided to stop LNG production – with snowballing effects on its fertilizer and aluminium production); iii) ~70% of the UAE’s oil exports (the country has alternative route, through the Fujairah pipeline/terminal – on the Indian Ocean, “past” the Strait – which could “theoretically” handle up to ~60% of oil exports). **As long as the Strait remains essentially closed, economic losses for GCC countries will be sizeable.**

Second, non-O&G sectors will also be impacted. Tourism and logistics, at the heart of diversification strategies followed by most GCC countries in recent years (most notably the UAE and Saudi Arabia), will obviously suffer from current hostilities.

Third, while “physical” damage and casualties have remained rather limited so far (as of March 10), GCC economies (and more generally societies) are dependent on key non-O&G infrastructure such as power plants and desalination water plants.

More damage done on these infrastructures would prove particularly detrimental to Gulf countries.

Market reaction for GCC countries has so far remained rather muted, considering the severity of the geopolitical crisis

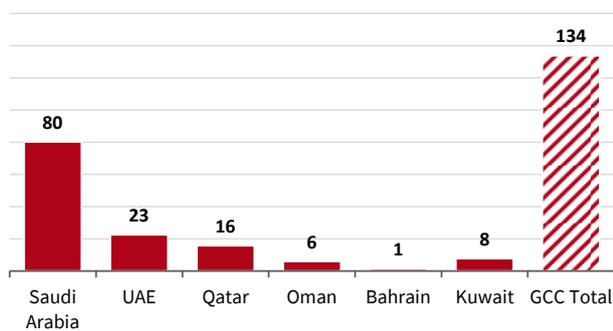


As of now, the market reaction in the GCC has been rather muted (given the severity of the crisis): 5y CDS and sovereign spreads have increased, but so far remained below or close to their April 2025 levels. Regional stock exchanges have not plunged (although this is probably explained by suspensions of trading, and very probably strong “control” from the authorities). **If our working assumption is verified and the conflict is indeed short-lived, several factors could come and support activities in the region from 2H26 onwards.** First, O&G outputs will most probably increase once the “bulk of the crisis” is over. During the first weekend of the conflict (in a meeting that Iran did not attend), OPEC+ countries originally decided to increase oil production by 200,000 b/d in April. This increase will most probably be postponed but could also be revised upwards substantially. Moreover, while we have not changed our end-2026 oil price forecast (at USD 70/b), prices will be higher on average for the year, which will also benefit GCC countries. Second, GCC countries will be able to use their vast financial resources in order to support growth, at the very least through reconstruction efforts. As a reminder, before the crisis, (net) foreign assets held by Gulf States were estimated above USD 4,000bn (although such figures should be taken with a grain a salt, given considerable shortcomings in Balance of Payments statistics). However, we should bear in mind that different types of public expenditures have different impact on growth: for instance, a (very probable) increase in military spending in the region (which already amounted to USD 134bn in 2024, or ~20% of expenditures) should have rather limited “trickledown” effects on growth, as almost all of military material is imported.

Military spending in GCC countries was already high before the current crisis

Military spending

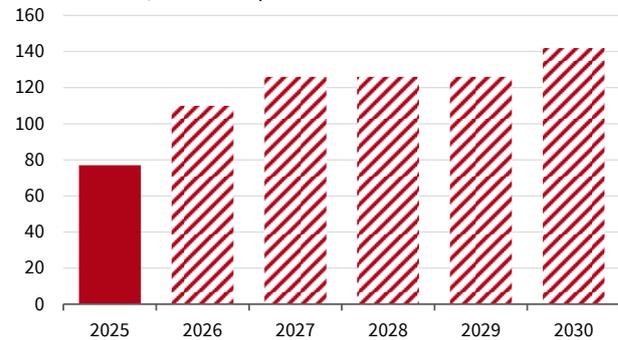
estimates for 2024, USD bn



Qatar: crucial North Field expansion plans could be put in jeopardy

Qatar: LNG production capacities

estimates, million tons per annum



Source: LSEG, IMF, SG Economic and Sector Studies

Significant risks weigh on this outlook, as the geopolitical situation remains extremely fluid and unpredictable. Given the utmost importance of the Strait of Hormuz (as explained above), much will depend on its reopening. Some early estimates seem to indicate that a prolonged closure – which would most probably go alongside with continued retaliations from Iran, hence an extended stop of tourism flows – would probably push GCC growth into negative territory for 2026. In a longer / more structural perspective, the current geopolitical crisis could also durably affect the region’s growth prospects.

Overall, the “business model” developed and promoted by GCC countries over the past 10 years heavily relies on the region’s reputation as a very safe location, to attract both foreign investments, expatriates and tourists (all of which being still critical to Gulf States’ diversification strategies). More particularly, Qatar, which shares the world’s largest gas field with Iran (“North Field” in Qatar, “South Pars” in Iran), may face significant challenges to develop its LNG production as originally expected: as a reminder, after several years of (costly) expansion work, North Field output was supposed to start increasing substantially in late 2026 (from ~80 million tons per annum to a target of 140 mtpa for 2030).

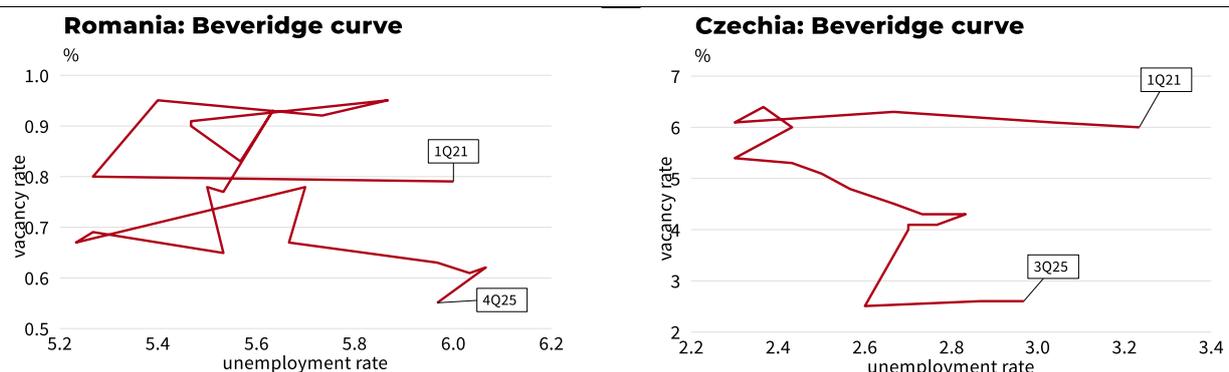
CENTRAL AND EASTERN EUROPE

- **Economic growth in Central and Eastern Europe is expected to remain well-oriented in 2026–2027, except in Romania and Slovakia.**
- **The scheduled end of NextGeneration EU in 2026 is unlikely to generate significant cliff effects, as European Structural and Investment Funds (ESIF) and Security Action for Europe (SAFE) loans will take over.**
- **Risks remain tilted to the downside on growth due to geopolitical uncertainties, institutional frictions and electoral cycles.**

Regional growth should remain well-oriented in 2026–2027, mainly driven by domestic demand. Hungary and the Czechia will post growth rates above 2% in 2026–2027, supported by strong dynamics in services and construction and by a mild recovery in manufacturing. Poland will record the strongest growth in the region (above 3%). By contrast, Romanian and Slovak growth slowed sharply in 2025 and is expected to remain sluggish in 2026 due to the implementation of sizeable fiscal consolidations in both countries.

Household consumption will remain an important growth driver, benefiting from rapid real wage increases in a context of moderate inflation. However, labour markets have become less tight across the region, with slight increases in unemployment rates and declines in job vacancy rates after the 2022 peak. Recent Beveridge curves illustrate this trend, showing a shift toward the lower-right quadrant since 2023.

Labour markets becoming less tight across the region, with slight increases in unemployment rates and declines in job vacancy rates



Source: LSEG, SG Economic and Sector Studies

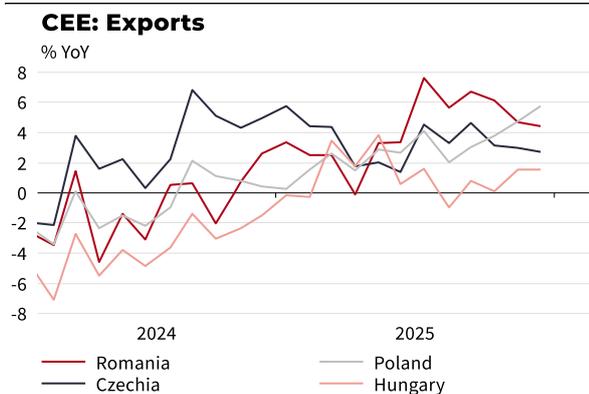
Investment contribution to growth is expected to strengthen in 2026–2027, supported by increased absorption of EU funds as regulatory deadlines approach. As of February 2026, Romania, Poland and Bulgaria have absorbed only about 50% of their available *NextGeneration EU* (NGEU) envelopes, while the Czechia

have reached nearly 70%. Under the European Commission’s regulatory framework, Member States must complete all targets and milestones in their resilience and recovery plans by 31 August 2026, submit their final payment request no later than 30 September 2026, and the Commission must execute all remaining payments before 31 December 2026, which marks the operational closure of the instrument. This tight timeline implies a clear acceleration in disbursements throughout 2026.

Nevertheless, the end of NGEU should not trigger major cliff effects, as European structural and investment funds (ESIF) and Security Action for Europe (SAFE) loans will take over and ensure continuity in investment financing. The absorption of ESIF for the 2021–2027 period has remained relatively slow but could accelerate as soon as 2027, taking over from NGEU. Payments can traditionally be made up to two years after the end of the 2021–2027 budget cycle, i.e., until end-2029. Furthermore, SAFE loans (long-term loans up to 45 years, with 10 years grace), totalling EUR 150bn, should enable an acceleration of investment in strategic equipment (air defence, drones, cybersecurity) and support the development of Europe’s defence industrial base. Poland, Romania and Hungary would be the main beneficiaries.

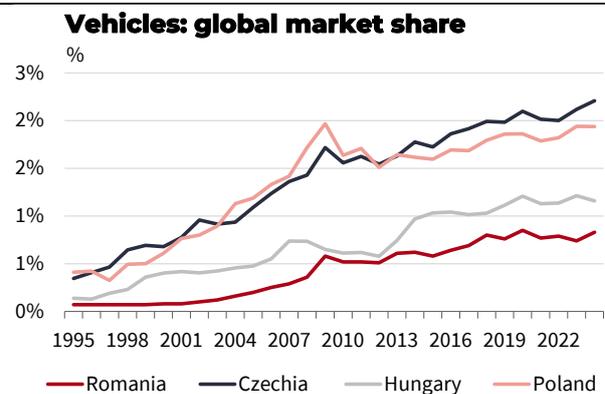
Despite uncertainties related to US tariffs, the region’s exports have remained and should remain resilient, supported in particular by the expected gradual recovery in Germany in certain sectors following the implementation of the stimulus plan focused on infrastructure and defence. Moreover, the region continues to gain market share in several industries.

A recovery in exports



Source: LSEG, SG Economic and Sector Studies

Market share gains in the automotive sector



Source: LSEG, SG Economic and Sector Studies

Risks remain skewed to the downside. The ongoing lack of progress toward ending the war in Ukraine continues to strain public finances, prompting countries in the region to plan additional increases in defence spending. Reform momentum also remains fragile in several economies, hindered by persistent institutional frictions in Poland, marked political polarization in Romania, and growing political fragmentation in Slovakia. In addition, upcoming electoral cycles (Hungary, Slovenia, Bulgaria) and potential shifts in governing coalitions could weigh on fiscal trajectories and slow the implementation of structural reforms. From a sectoral perspective, the high level of industrial concentration – particularly in the automotive sector in Slovakia, Czechia, and Hungary – further increases these economies’ exposure to potential tariff hikes, uncertainties related to the transition to electric vehicles, and supply-chain disruptions.

CONTACTS

Michala MARCUSSEN

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

Olivier de BOYSSON

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

Emmanuel MARTINEZ

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

Ariel EMIRIAN

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

Edgardo TORIJA ZANE

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

Foly ANANOU

Quantitative Economics, Geoeconomics
foly.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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