

SCÉNARIOÉCO

Société Générale Economic & Sector Studies

Crowding out headwinds

- The global economy continues to draw support from a new investment super-cycle in technology (AI), defence, energy and climate adaptation. This provides a source of resilience, although growth increasingly faces constraints linked to the availability and cost of capital, energy resources and critical inputs across supply chains.
- Financial conditions are expected to remain restrictive. While lower energy prices could provide some relief by 2027, strong investment demand is likely to keep interest rates structurally higher, while elevated policy uncertainty sustains upward pressure on long-term risk premia.
- Energy market pressures should gradually ease through 2027 under our working assumption of a gradual and uneven reopening of the Strait of Hormuz. Nevertheless, energy markets will remain vulnerable to renewed supply disruptions and price volatility.
- Inflation is expected to gradually ease in its core components. However, recurring extreme weather events and geopolitical tensions are likely to maintain upward pressure on food and energy costs, complicating the inflation outlook and increasing the risk of monetary policy miscalibration.
- Household demand appears increasingly vulnerable as consumers struggle with persistent energy-driven inflation, softer labour market conditions and high borrowing costs. These factors are likely to weigh on spending decisions and reinforce a more cautious consumer environment.
- ▣ Europe offers one of the greatest untapped investment opportunities. Delivering the reforms needed to deepen capital markets, complete the Single Market and accelerate strategic investment could unlock strong productivity and investment upswings.
- Uncertainties remain elevated in relation to elections, not least US midterms, German state elections and the French presidential election.

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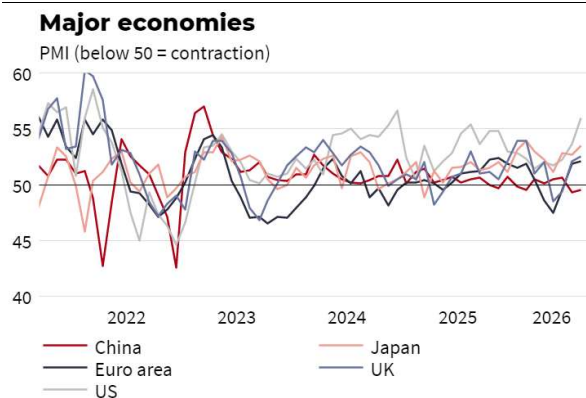
EDITORIAL

CROWDING-OUT RISKS IN A TRANSFORMING ECONOMY...

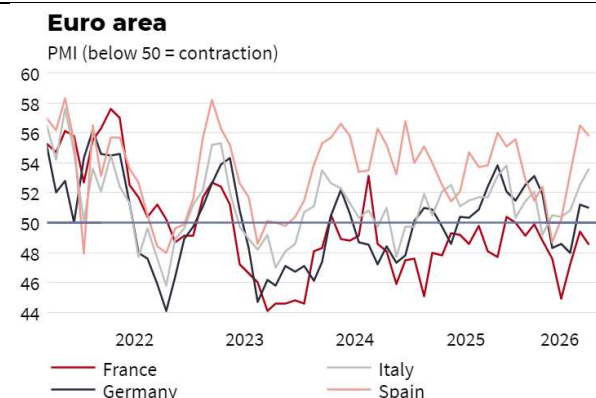
Global activity remains resilient despite renewed tensions in the Middle East, with August PMI surveys signalling broad-based expansion across major economies. This resilience has been underpinned by sustained investment in strategic sectors, notably technology (AI), defence, energy and climate adaptation, which continue to support domestic demand in the major economies. China remains the notable exception, as persistent industrial overcapacity and structural weaknesses continue to weigh on domestic demand, with exports as the main bright spot. In France, economic momentum is being constrained by elevated political uncertainty and the erosion of household purchasing power.

Looking ahead, investment should remain a key pillar of global growth. However, increasingly restrictive financing conditions alongside high input costs are likely to temper the pace of expansion. The combination of elevated public-sector borrowing requirements and the intensifying global race to finance AI-related investment is contributing to a sustained rise in funding costs. Against this backdrop, crowding-out effects are set to weigh in, as growing demand for capital increasingly competes with private-sector financing needs, slowing the pace of growth over the medium term.

Major economies showed strength except ...only France is lagging in the euro area China...



Source: SG Economic and Sector Studies, IMF



Source: SG Economic and Sector Studies, LSEG

More structurally, the global economy is entering a new phase marked by a profound reconfiguration of the forces that have shaped growth, inflation and financial stability over the past decades. These forces were shaped by successive phases which shaped each decade:

- In the 1990s, growth was driven by the dot-com boom, globalisation, EMU convergence and ongoing disinflation, allowing central banks to step in when shocks occurred.

- Between 2001 and 2007, cheap credit, housing market expansion, and the rise of China as a manufacturing powerhouse helped sustain strong global growth and low inflation.
- After the Global Financial Crisis, economies relied on ultra-loose monetary policy and China's investment boom, but growth remained weaker as households and firms deleveraged and financial regulation tightened.
- The Covid and post-Covid period was marked by unprecedented fiscal and monetary support, which fuelled a strong reopening but also triggered the sharpest inflation surge in decades alongside unprecedented disruption to supply chains.
- The current cycle is being driven by a new CAPEX Supercycle in technology (AI), defence, energy and climate adaptation. Higher government debt levels, the conflict in the Middle East and ongoing geopolitical fragmentation, however, leave this expansion more vulnerable to supply side constraints that further limit central banks' policy room.

In this context, the world economy is witnessing major trends shaping demand side as well as supply side dynamics

DEMAND SIDE DRIVEN BY A CAPEX SUPER-CYCLE

The global economy is entering a new investment cycle, underpinned by the unprecedented capital requirements associated with technology (AI), energy (including the climate transition), defence and climate adaptation. This emerging CAPEX super-cycle is being driven by the need to strengthen strategic autonomy, enhance energy security, and maintain technological competitiveness in an increasingly fragmented geopolitical environment.

Beyond these strategic priorities, structural demographic trends are creating additional investment needs. Ageing populations and shrinking workforces are expected to further spur capital spending in technology, be it healthcare, or automation and robotics as economies seek to offset labour shortages and sustain productivity growth. Increased acute and chronic climatic events further increase the need for investment in climate adaptation.

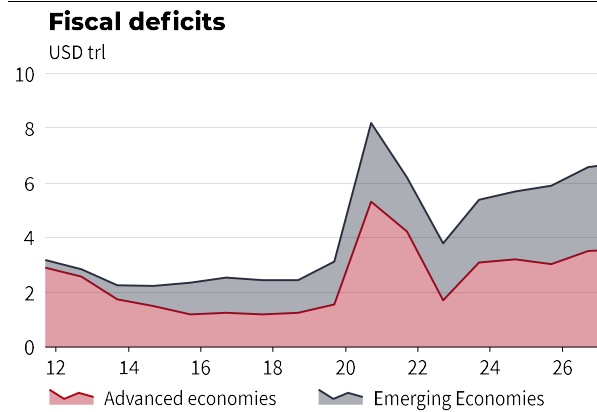
Strategic autonomy is becoming a powerful catalyst for public and private investment alike. Concerns over national security, economic resilience, supply-chain vulnerabilities, climate objectives and technological leadership are prompting governments to adopt more interventionist industrial policies while encouraging substantial private-sector investment. As a result, public support measures, regulatory frameworks and targeted incentives are increasingly shaping decisions across key strategic sectors, reinforcing the foundations of a multi-year investment cycle.

- **Public investment** drivers include rising defence expenditures in Europe, large-scale infrastructure modernisation programmes in the United States and Asia, grid expansion to support electrification, and public funding for strategic sectors such as semiconductors, energy security and transportation networks.
- **Private investment** drivers remain supported by structural demand linked to artificial intelligence, digitalisation, data centres, cloud infrastructure, energy, electrification of transport, and corporate efforts to enhance productivity, resilience and long-term competitiveness.

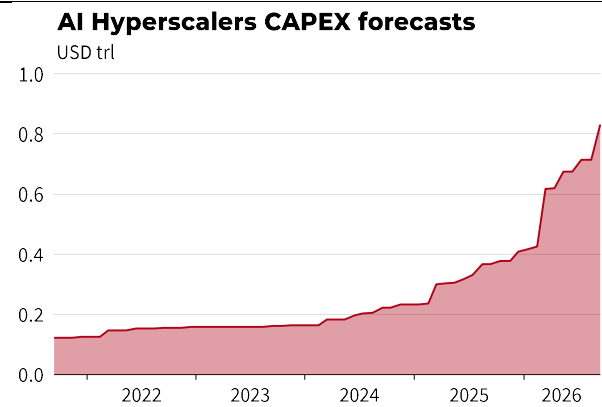
SUPPLY DRIVEN BY FRAGMENTATION BUT ALSO PRODUCTIVITY GAIN HOPES

Four broad developments are expected to define the supply dynamics of the global economy:

- **Persistent geopolitical tensions**, tariffs, conflicts and strategic competition are reshaping trade routes and supply chains. Businesses are increasingly prioritising resilience and security over efficiency, leading to higher operating costs. The risk of financial fragmentation is also rising as geopolitical rivalries spill over into investment and capital flows. As a result, structural constraints on trade and production are likely to remain a feature of the global economy.
- **Policy drivers** through industrial strategies, subsidy schemes, local-content requirements, regulatory mandates supporting the green transition, and initiatives aimed at strengthening supply-chain resilience and technological sovereignty. This can be favourable at the national level but more challenging at the global level as it implies a less cooperative world.
- **Ageing populations** are reducing labour availability, potentially increasing labour costs, even though robotics developments could moderate or even reverse the labour constraint. Increased female participation rates, higher pension ages and immigration also offer policy options.
- **Transformative technologies** can be a game-changer. Over the coming years, AI has the potential to become a significant driver of productivity growth. If these gains materialise, this could represent a significant positive supply shock. However, this raises several questions on the pace and level of productivity gains, valuation levels, cyber risks, labour disruption among other things.

States increasing financing needs...

Source: SG Economic and Sector Studies, IMF

...starting to compete with AI investment

Source: SG Economic and Sector Studies, LSEG

These interactions between supply and demand have different effects on growth and inflation. In the initial phase of a CAPEX-driven cycle, strong demand pressures often run ahead of available supply, leading to some initial pressure on input prices and lifting the cost of financing. During the more mature phase, when productivity gains start to materialise, this leads to new supply placing downward pressure on other prices.

With the notable exception of China, the major economies are today in the initial phase of a CAPEX expansion, but with the traditional risks related to this phase exacerbated by geopolitics, already high public debt levels and tight labour supply.

Top of this list are the pressures we observe on energy and other critical inputs. A further concern is that a fragmented race to become the global leader of AI and the entrance of more efficient technologies may ultimately lead to severe excess supply, in turn giving rise to deflationary pressures (China is an example hereof). Such risks would be further exacerbated by disappointing productivity outcomes.

Our central scenario is to see the pace of investment moderate, not least due to higher financing costs, while productivity gains start to materialise. Alongside our working assumptions of easing tensions in the Middle East and lower energy price pressures, this supports our scenario of inflation returning towards target in 2027.

This being said, if commodity prices remain persistently elevated, the risk of excessive monetary tightening cannot be ruled out.

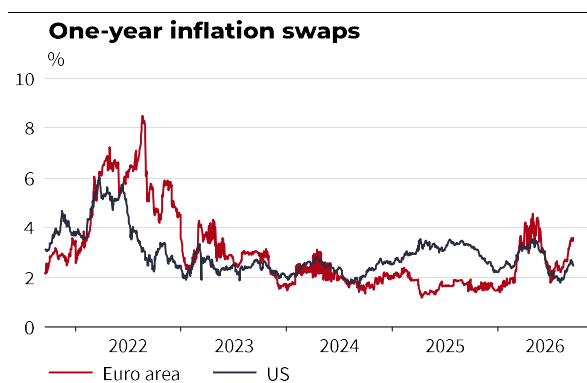
THE FUNDING RACE IS LEADING TO HIGHER FINANCING COSTS...

Structural demand- and supply-side trends imply rising public- and private-sector financing needs. Strategic-autonomy priorities, demographic pressures and the green transition are increasingly competing with substantial private-sector investment requirements, particularly in AI and related infrastructure. This raises the risk of crowding-out effects through higher real interest rates and tighter financing conditions.

The aforementioned underlying trends are pushing real interest rates higher. This has been exacerbated in a context of:

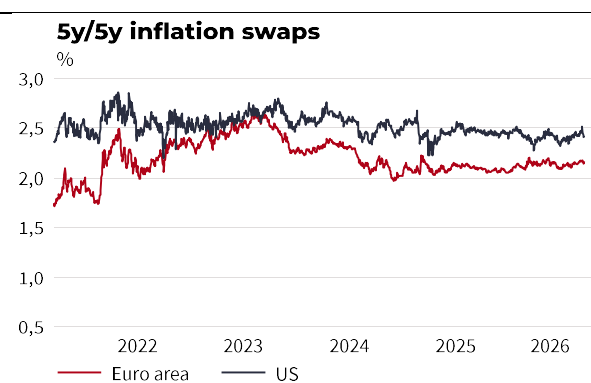
- **Renewed tensions on energy prices**, driven by the US-Iran conflict. The concern is that higher energy costs will trigger second-round effects on inflation. At this stage, market-based inflation expectations have risen but remain below levels observed back in April, immediately after the start of the Middle East conflict. Long-term expectations remain well anchored.
- **Bond markets increasingly concerned by high government debt levels** in several major economies. Moreover, the quantitative tightening ongoing in the euro area is an underlying factor contributing to the gradual tightening of liquidity conditions and to higher term premia.
- **Corporate bond issuance climbing to record highs**. In the US, bond issuance increased by about 30% in the first half of the year to USD 1.5tn against USD 1.2tn for the same period in 2025. This increases credit demand and reinforces expectations that central banks may keep policy tighter for longer as investment demand continues to support resilience.

Short term Inflation expectations rising...



Source: SG Economic and Sector Studies, LSEG

...but long-term expectations remain well anchored



Source: SG Economic and Sector Studies, LSEG

The impact of private-sector investment on global financing conditions is becoming increasingly significant. AI hyperscalers alone are expected to invest close to USD 1 trillion over the coming year, and consensus is to see this number increase to just over USD 4 trillion on a cumulated basis over 2026-2030. Financing will come

from various sources, but debt financing (loans, private credit and corporate bond issuance) has become increasingly important. The OECD's Global Debt Report 2026 found that in a conservative base case, where 29% is funded through bond issuance, the nine hyperscalers alone would issue the equivalent of 9% of historical global gross issuance by non-financial companies from 2026-2030.

The sustainability of this cycle is increasingly being questioned, drawing comparisons with the dot-com era. While both periods are characterised by transformative technological narratives that attracted massive capital inflows and supported elevated valuations, important differences remain.

In both cases, investment spending surged as firms raced to build capacity ahead of anticipated demand. However, unlike many dot-com companies, today's leading companies are well established profitable firms with still strong balance sheets and dominant market positions. The key risk is that expectations for future AI-driven productivity gains and revenue growth may prove overly optimistic, leading to excess investment and valuation adjustments. Nevertheless, just as the internet ultimately transformed the global economy despite the dot-com crash, the current AI boom could deliver lasting economic benefits even if financial markets experience a period of correction and consolidation. The subsequent economic drag would be more substantial if it turns out that there has been significant build-out of overcapacity. The risks hereof are heightened in a fragmented global economy.

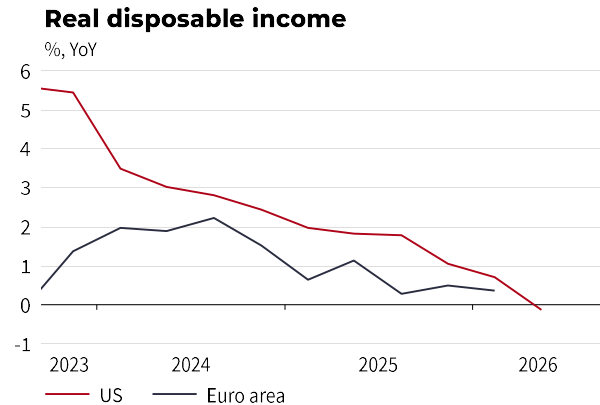
...COULD WEIGH ON CONSUMER DEMAND, CREATE EXCESS CAPACITY AND ULTIMATELY LEAD TO A MARKET CORRECTION AND/OR DEFLATIONARY PRESSURES

The resilience of the real economy in the face of higher energy prices and bond yields will partly depend on the emergence of productivity gains at some point in time. At this stage, our view is that productivity gains will only start to truly materialise at the macroeconomic level towards the end of this decade. In the interim, our concern remains that consumers appear increasingly fragile. Each new round of energy price spikes takes away purchasing power while higher interest rates raise the cost of financing for both consumer goods and housing. Many firms, moreover, are becoming cautious on new hires. This will continue to weigh on households' real incomes and confidence along with political uncertainties in major economies with upcoming elections, notably in the US and France.

An important medium-term vulnerability lies in the widening gap between demand and capacity creation. Capital expenditure dynamics contrast with consumer demand which remains comparatively subdued. If sustained, this imbalance could lead to pockets of excess capacity. The risk appears particularly relevant for AI infrastructure, semiconductors and clean-energy manufacturing in the US, as well as for electric vehicles, batteries and renewable-energy supply chains in Europe. Such

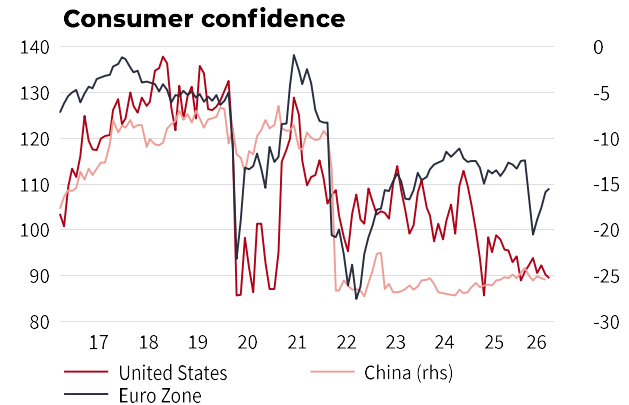
developments would not necessarily call into question the longer-term growth potential of these sectors. Rather, they would reflect a familiar feature of major technological transitions, whereby expectations of future demand encourage a faster expansion of supply than markets can immediately absorb.

Consumers remain the weak link...



Source: SG Economic and Sector Studies, LSEG

...as revenues and confidence suffer

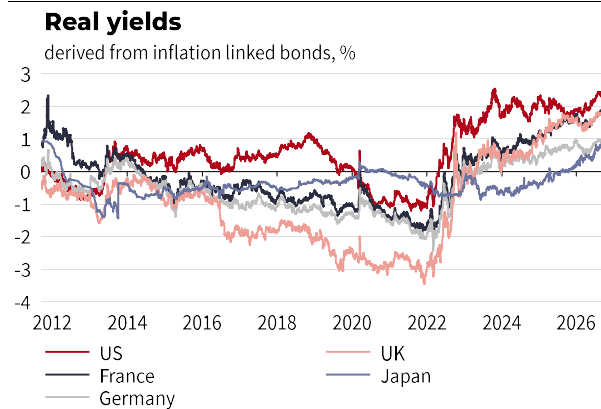


Source: SG Economic and Sector Studies, LSEG

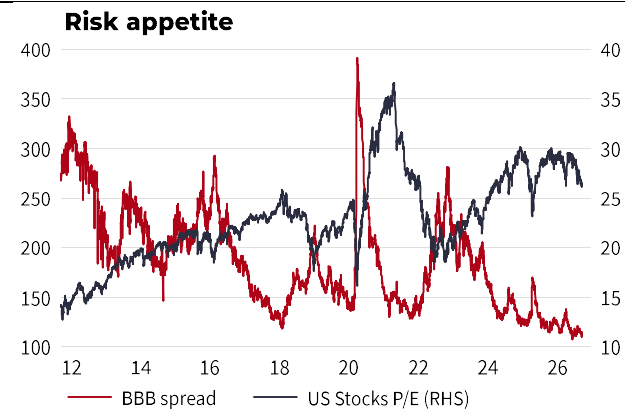
A MARKET CORRECTION CANNOT BE RULED OUT

A key question for equity markets is whether the returns from the current wave of investment, particularly in AI, will be sufficient to justify a higher cost of capital.

Financial markets appear increasingly exposed to elevated valuations coexisting with still-high real interest rates and lingering monetary policy uncertainty. While expectations of technological innovation, have continued to support risky assets, financing conditions remain considerably tighter than in the past. Uncertainty surrounding the neutral rate and the persistence of headline inflationary pressures could lead to policy errors. This environment raises the risk that asset prices may be discounting a more benign macroeconomic scenario than will ultimately materialise. If growth weakens or productivity gains fail to meet expectations, valuation corrections could emerge across a range of sectors. The resulting tightening in financial conditions could, in turn, amplify cyclical headwinds, particularly in parts of the economy where current valuations are predicated on strong long-term growth assumptions.

Real interest rates are at their highest ...

Source: SG Economic and Sector Studies, IMF

... against a backdrop of strong risk appetite

Source: SG Economic and Sector Studies, LSEG

Finally, a busy electoral agenda, not least with US midterms in November, French presidential elections next spring and ongoing German state elections, add political uncertainty to the headwinds.

WHAT COULD DRIVE A NEW IMPETUS FOR THE GLOBAL ECONOMY?

Lower energy prices would offer welcome respite to consumers and corporates alike and would also help ease upward pressure on bond yields.

The near-term energy outlook is highly dependent on geopolitical events, but it is worth recalling that investment in renewables and nuclear is one of the key pillars of the European Competitiveness Compass. The less dependent Europe becomes on fossil fuels, the more resilient its economy will become.

Europe's strategic investment agenda, including digital and defence, requires annual investments in excess of EUR 1tn. Unlocking this potential requires reforms.

Looking around the world today, Europe arguably offers one of the greatest untapped investment opportunities among advanced economies. Europe's challenge is not a lack of opportunities but a gap between potential and execution. While the region possesses deep pools of savings, strong industrial capabilities and leading research institutions, fragmented markets, regulatory complexity and insufficient risk capital continue to constrain innovation and business scaling. Delivering the reforms needed to deepen capital markets, complete the Single Market and accelerate strategic investment could unlock one of the strongest productivity and investment upswings among advanced economies.

ECONOMIC FORECASTS

GDP, % YoY	2026f	2027f	2028f	2029f
Developed Markets	1.5	1.2	1.5	1.6
United States	1.9	1.7	1.8	2.0
Japan	0.6	0.5	0.6	0.6
United Kingdom	1.1	1.0	1.2	1.3
Euro area	1.0	0.8	1.1	1.4
Germany	0.9	0.8	1.4	1.7
France	0.3	0.7	1.1	1.4
Italy	0.7	0.5	0.6	0.8
Spain	2.5	1.6	1.8	1.8
Emerging Markets	3.3	3.6	3.6	3.6
Asia	4.2	4.3	4.3	4.3
China	4.2	4.0	3.8	3.6
India	6.6	6.3	6.5	6.5
Central and Eastern Europe	1.3	1.5	1.5	1.7
Latin America	2.3	2.0	2.1	2.4
Brazil	1.5	1.5	2.0	2.3
Middle East and Central Asia	1.0	4.0	3.3	3.1
Africa	4.0	3.8	3.8	3.8
World (PPP weighted)	2.7	2.8	2.8	2.9

CPI, % YoY, avg	2026f	2027f	2028f	2029f
Developed Markets	2.9	2.3	2.0	2.2
United States	3.3	2.2	2.6	2.7
Japan	1.6	1.5	1.8	1.8
United Kingdom	3.2	2.6	2.1	2.3
Euro area	2.8	1.8	2.1	1.9
Germany	2.7	2.1	1.9	1.9
France	2.1	1.7	1.7	1.9
Italy	2.6	1.8	1.9	1.9
Spain	3.3	2.0	2.2	2.0
Emerging Markets	5.3	4.4	4.3	4.2
China	1.2	1.4	1.7	2.0
India	5.0	4.5	4.5	4.5
Brazil	4.4	3.5	3.5	3.5

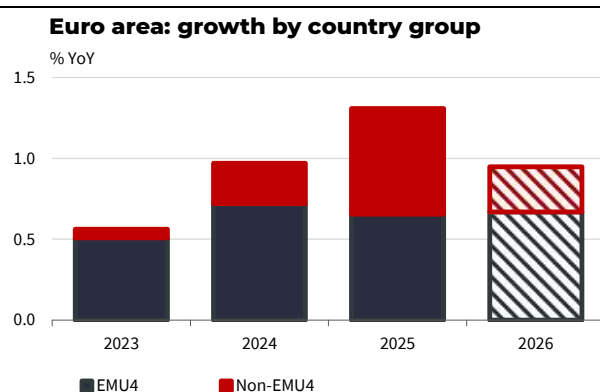
%, EoP (unless otherwise indicated)	Latest 19/09	2026f	2027f	2028f
Fed Funds target (high)	4.00	4.00	4.00	4.00
Gov 10y, US	5.01	4.75	4.75	5.00
ECB Deposit facility rate	2.50	2.50	2.50	2.50
Gov 10y, Germany	3.52	3.30	3.30	3.50
Gov 10y, France	4.57	4.20	4.30	4.30
Gov 10y, Italy	4.44	4.15	4.10	4.30
Gov 10y, Spain	3.99	3.80	3.85	4.00
BoE, Bank rate	3.75	3.75	3.25	3.75
Gov 10y, United Kingdom	5.30	5.25	4.75	4.75
BoJ, Bank rate	1.25	1.25	1.50	1.75
Gov 10y, Japan	2.98	2.90	2.75	2.70
EUR / USD	1.15	1.15	1.15	1.15
EUR / GBP	0.86	0.88	0.89	0.90
USD / JPY	157	155	150	145
USD / CNY	6.7	6.7	6.7	6.6
Oil Brent (USD/b)	105	85	70	70
European Natural Gas (TTF, EUR/MgW/h)	79	65	40	30
EU ETS carbon (EUR/Metric ton)	86	80	90	100

EURO AREA

- The current resilience seems fragile, as the euro area struggles to secure durable sources of near-term growth.
- While the dual-speed economy is no more, divergences in labour markets and investment dynamics persist.
- The ECB's tightening bias is unlikely to shift in the coming months.

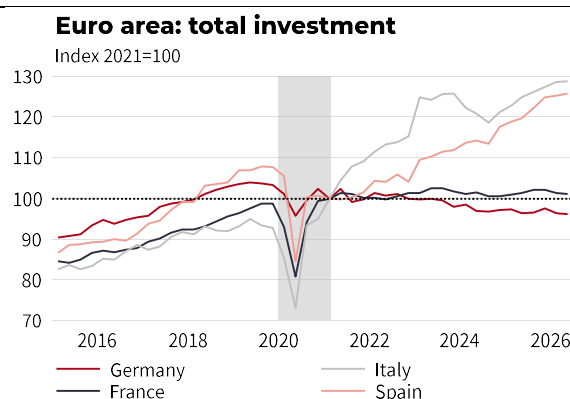
2026 resilience seems fragile, as Europe struggles for durable sources of near-term growth. The factors underpinning this year's upside performance will be difficult to sustain, while the expected drivers struggle to gain traction. In Germany, rising public investment has yet to crowd in private capital, while France faces subdued investment and a triple squeeze on households: rising unemployment, falling purchasing power and weak household confidence. Italy's investment-led boost is fading, exposing structurally weak productivity and depressed household purchasing power, while Spain's migration-driven expansion has yet to translate into stronger productivity or productive capital formation. We expect growth momentum to soften in 2027, although a cyclical recovery in France and the gradual transmission of Germany's fiscal package should provide a lift in the medium term.

Euro area shows resilience in the face of a significant shock



Source: Eurostat, SG Economic and Sector Studies

Dynamic investment in Spain and Italy offsets weakness in Germany and France

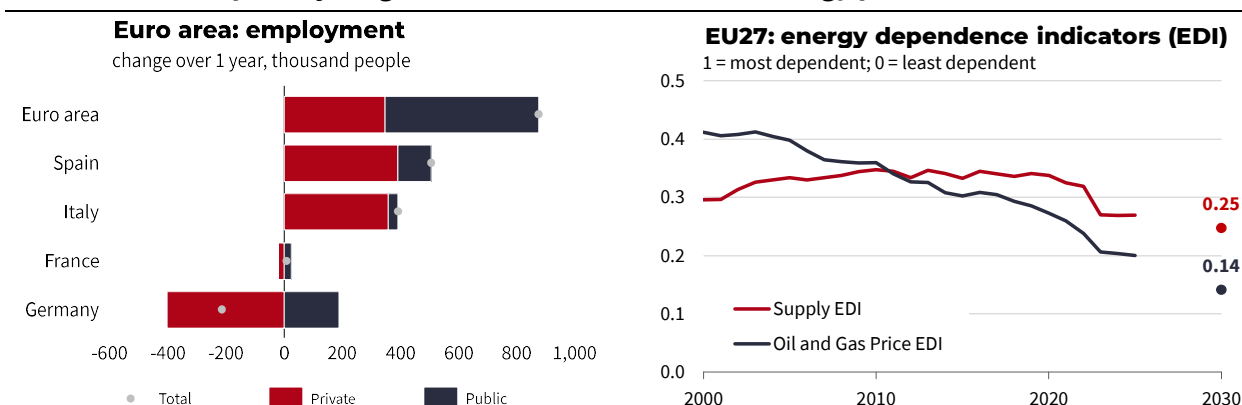


Source: INSEE, Istat, Destatis, Eurostat, SG Economic and Sector Studies

The divergence in euro area investment highlights a particularly large investment backlog in France and Germany. Weak investment in France (-0.2% YoY in 2026) and Germany (-0.3%) is weighing on the bloc's overall investment dynamic, contrasting with the strong post-pandemic rebound in Spain and Italy, supported by NGEU funds and, in Italy, the Superbonus. A significant part of this divergence reflects real estate investment, which has remained particularly depressed in France and Germany. Looking ahead, we expect investment dynamics to gradually converge as momentum in Italy and Spain cools, notably with the NGEU impulse fading in 2027, while Germany's large fiscal package increasingly crowds in private investment and France begins to address its sizeable investment needs.

Euro area labour markets are losing momentum, with cyclical weakness increasingly interacting with deeper structural headwinds. Labour market tightness is continuing to ease across the euro area, pointing to further moderation in employment growth ahead. Notably, 2Q26 marked the first quarter since the pandemic in which public-sector employment contributed more to annual job creation than the private sector, signalling a changing composition of labour demand. Against this backdrop, we expect unemployment to edge higher in 2H26, peaking at 6.6% in 2027. While the duality between the dynamic labour markets of Spain and Italy and the less resilient ones in Germany and France remains intact, even the former are showing signs of softening. This duality reflects both weaker growth momentum, which is weighing on private-sector hiring, and structural factors in Germany, notably ongoing deindustrialisation and demographic trends.

The duality of the EMU4 labour market persists, while reliance on public jobs grows **Progress on energy dependence has helped to curb the energy price shock¹**



Source: OECD, SG Economic and Sector Studies

Source: Eurostat, JRC, SG Economic and Sector Studies; Note: 2030 refers to projections according to EU climate ambitions.

While 2026 inflation remains more contained than anticipated, we expect energy-related base effects to drag inflation below the target in 2H27. Elevated gas prices, lower storage levels ahead of winter and continued supply tightness should temporarily lift inflation above 3% in 2H26. Thereafter, the unwind of energy price pressures is likely to weigh materially on headline inflation, more than offsetting upward pressure from food prices linked to higher input costs and climate-related shocks. We therefore expect inflation to dip modestly below 2% in 2H27. The resilience of inflation to the recent energy shock reflects not only stock depletion and demand destruction, but also a structurally lower energy dependence of the euro area. Lower supplier concentration, reduced oil and gas intensity, and smaller net energy imports have limited the impact of energy shocks on consumer prices, as captured by our Energy Dependence Indicator (EDI).

¹ Note: (1) The Supply EDI is the power mean of energy imports as a share of total energy available and import concentration measured by the Herfindahl-Hirschman Index. (2) The Oil and Gas Price EDI then takes the power mean of (1) and the normalised oil and gas intensity of the economy to account for exposure to price volatility. The values for 2030 correspond to projected progress in line with the EU's climate targets. Find more details [here](#).

The near-term outlook for the ECB has become less difficult, though we do not expect this to last for long. Elevated energy prices are likely to keep headline inflation higher in the coming months, reinforcing the ECB's insurance-hike bias despite the continued absence of meaningful second-round effects. A reversal of this stance would require a combination of lower energy prices, downside growth surprises and continued wage moderation. In our view, the 2027 energy-related base effects, a softer growth backdrop and limited corporate pricing power should move the euro area in that direction. However, the balance of risks to inflation remains significantly skewed to the upside, given geopolitical volatility and risks of climate-related shocks, inducing the ECB to retain a prudent policy stance.

The risk balance tilts to the downside on growth but to the upside on inflation.

On the downside, a further escalation in the Middle East and/or in global trade tensions, including broader US tariff measures, could weigh more heavily on external demand and investment in the short term. The 2027 electoral cycle presents an additional downside risk to growth, particularly if it leads to heightened policy uncertainty or political fragmentation. Headline inflation risks, in particular, remain skewed to the upside. Energy markets remain exposed to geopolitical disruptions and fierce competition to secure supply. Climate-related shocks could also renew pressure on food and energy prices. An even more dynamic economy could induce wage pressures and hence second-round effects, which have so far been absent.

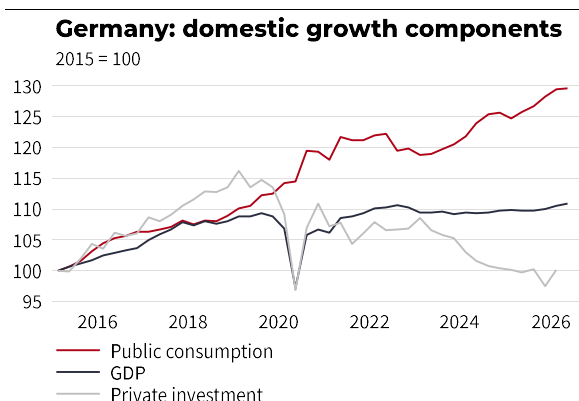
Euro area	2026f	2027f	2028f	2029f
Real GDP, % YoY	1.0	0.8	1.1	1.4
Household consumption	0.9	0.7	1.0	1.2
Public consumption	2.1	1.2	1.0	1.2
Investment	1.0	1.5	2.0	2.4
Exports of goods & services	1.5	1.8	2.3	2.4
Imports of goods & services	1.6	2.0	2.6	2.6
Inflation, % annual average	2.8	1.8	2.1	1.9
Core inflation, % annual average	2.4	2.0	1.9	1.9
Real gross disposable income (GDI), % YoY	0.2	1.0	0.8	1.1
Households saving rate, % of GDI	14.4	14.6	14.4	14.3
Unemployment, % of labour force	6.4	6.6	6.5	6.3
Fiscal balance, % of GDP	-3.2	-3.1	-3.0	-2.8
Public debt, % of GDP	91	92	93	92
Current account balance, % of GDP	1.8	1.6	1.4	1.4

GERMANY

- **Germany's 2026 upswing masks limited progress in replacing the expiring export model with domestic sources of growth.**
- **Fiscal expansion supports near-term activity, but its lasting impact hinges on faster, broader and more effective deployment of special investment funds.**
- **The industrial downturn will persist, led by the automotive sector, as weakening extra-euro-area demand compounds structural competitiveness pressures.**

2026 growth is stronger than expected, but the momentum will be difficult to sustain in the near term. While the global economy is shifting, Germany's growth model is adjusting only slowly. Public consumption remains the main anchor, unexpectedly supported by stronger external demand, the country's former growth engine, after two years of negative contributions. Private demand remains subdued, as weak real wage growth and pessimism about the outlook weigh on households. In fact, while business confidence is improving, household expectations remain well below historical averages. The fiscal package is lifting public investment, currently only 3% of GDP, but has yet to crowd in private investment, which remains constrained by the construction crisis. Weak household demand, subdued private investment and potentially short-lived export support will therefore weigh on growth until the effects of the fiscal impulse become more broad-based.

Limited post-pandemic growth has been held up by public consumption



Source: Destatis, SG Economic and Sector Studies

While businesses seem optimistic about the upswing, consumers still need convincing



Source: S&P Global, LSEG/IPSOS, SG Economic and Sector Studies

Inflation is set to peak in 2H26 before easing below the 2% target in 2H27.

Inflation has re-accelerated and is expected to average 2.7% YoY in 2026. This follows a temporary moderation in 2Q26, supported by fuel-price measures and easing tensions in the Middle East. Persistently high energy prices, together with supply-chain bottlenecks linked to low water levels on the Rhine and low gas-storage fill levels, are key drivers of inflation. The latter is expected to weigh particularly on

households, as gas inventories will need to be replenished at elevated prices ahead of winter, likely increasing pressure on retail energy tariffs and household utility bills. However, we expect energy-related base effects to act as a drag on headline inflation in 2H27, bringing annual inflation down to 2.1% YoY in 2027.

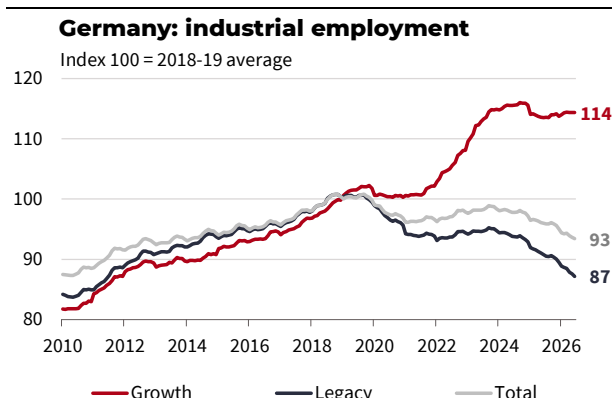
Despite its slow roll-out, SVIK² fund further lifts an already expanding federal budget. Looking ahead, rising social transfers, the defence build-up and accelerating SVIK disbursements should sustain strong public consumption and gradually lift fixed investment. Public expenditure is already expanding, driven primarily by social-security transfers and military procurement, while much of the recent investment growth reflects financial support to public institutions rather than fixed asset investment. The latter is partially compensated for by the investments of the SVIK fund. This is despite their slow roll-out, as at the current pace only 74% of 2025–26 funds will be disbursed by year-end. Stronger-than-expected growth should boost revenues and contain the 2026 fiscal deficit at 4.0% of GDP. The medium-term multiplier of the SVIK will depend critically on accelerating project execution while preserving sufficient room for regular investment in the annual budgets.

The labour market appears close to bottoming out, but any recovery is likely to remain tentative given the structural nature of the industrial downturn. Employment is expected to decline for a seventh consecutive quarter, albeit at a slower pace, as firms' employment expectations rebound and labour-market softness appears to have passed its trough. Persistent industrial weakness will nevertheless constrain the recovery, with unemployment unlikely to decline before 2H27. The three largest industrial sectors by employment, automobiles, metals and machinery (see chart for “Legacy” sectors), accounted for 43% of industrial employment in 2018 and have shed 13% of their workforce since the pandemic. This has contributed to a 7% decline in overall industrial employment, while the higher-value-added specialised manufacturing sectors (“Growth” sectors) that had previously supported job creation have stagnated in recent months.

The car industry remains in decline amid gradually weakening extra-euro-area sales. The pressure on the industry is not easing, as the renewed energy price shock, US tariffs, and competition from China, notably on electric vehicles, are in full effect. The recent stagnation of total sales in the industry is therefore unlikely to hold up, as the decline in extra-euro-area sales continues, at an average of around -6% YoY. This is because the trade balance in vehicles with China turned negative in 1Q26 for the first time in history, and US exports (13% of total vehicle exports in 2024) dropped due to the 2025 tariffs. That German sites bear a disproportionately large share of Volkswagen's recently announced job cuts exemplifies the deterioration in Germany's relative location attractiveness and cost competitiveness in the sector.

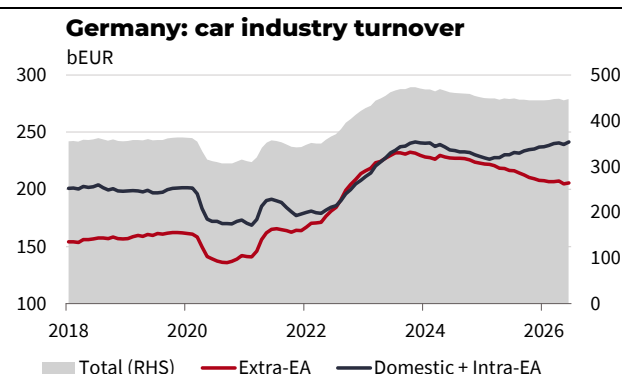
² Special Fund for Infrastructure and Climate Neutrality (Sondervermögen für Infrastruktur und Klimaneutralität)

The industrial core's downturn drags industrial employment, despite pockets of growth



Source: Destatis, SG Economic and Sector Studies; Note: Legacy sectors refer to the three biggest sectors by employment (auto, metals, machines), while growth sectors comprise five of the fastest growing sectors (batteries, space/aeronautics, optical equipment, pharma, and weapons/ammunition).

Rising domestic turnover is only cushioning declining extra-euro-area sales



Source: Destatis, SG Economic and Sector Studies; Note: EA refers to euro area

The risk landscape remains skewed to the downside, as the current growth recovery relies heavily on policy support while exposure to external shocks remains elevated. On the downside, pressure on the government following state elections could further complicate the political climate and weigh on reform and investment efforts. In addition, the growth impact of fiscal support could prove weaker than anticipated if spending is delayed, scaled back, or allocated inefficiently. Supply-side disruptions also remain a risk, stemming from both heightened geopolitical tensions and domestic climate-related challenges, notably renewed low water levels on the Rhine. On the upside, a further easing of geopolitical tensions and energy prices could support both growth and disinflation. Moreover, if mounting pressure from weak economic performance or political opposition strengthens the government's reform impetus, Germany's medium-term outlook may improve. Faster-than-expected transmission of fiscal spending into private investment and business confidence could provide an additional upside risk to activity.

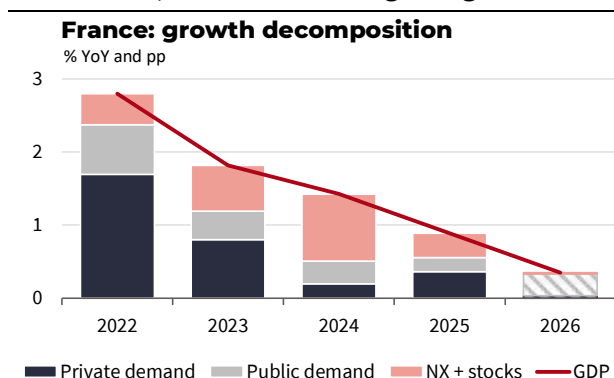
Germany	2026f	2027f	2028f	2029f
Real GDP, % YoY	0.9	0.8	1.4	1.7
Household consumption	0.4	0.7	1.2	1.5
Public consumption	3.4	2.3	2.3	2.0
Investment	-0.3	2.1	2.8	3.1
Exports of goods & services	2.3	0.9	1.4	1.9
Imports of goods & services	2.0	2.0	2.1	2.3
Inflation, % annual average	2.7	2.1	1.9	1.9
Core inflation, % annual average	2.5	2.2	2.2	2.1
Real gross disposable income (GDI), % YoY	0.4	0.9	0.9	1.3
Households saving rate, % of GDI	18.8	18.8	18.5	18.1
Unemployment, % of labour force	6.3	6.3	6.1	5.7
Fiscal balance, % of GDP	-4.0	-4.2	-3.9	-3.5
Public debt, % of GDP	65	67	69	70
Current account balance, % of GDP	4.2	3.5	3.0	2.9

FRANCE

- **Private domestic demand stagnates, as public consumption and external demand keep 2026 growth just positive.**
- **The 2027 elections dominate the outlook. We make the working assumption that the next French government will seek a path to sustainable public finances, albeit gradual, and avoid any lasting confrontation with the European Union.**
- **Fragility will persist as the recovery of households and overall investment dynamics will only arrive in the medium term.**

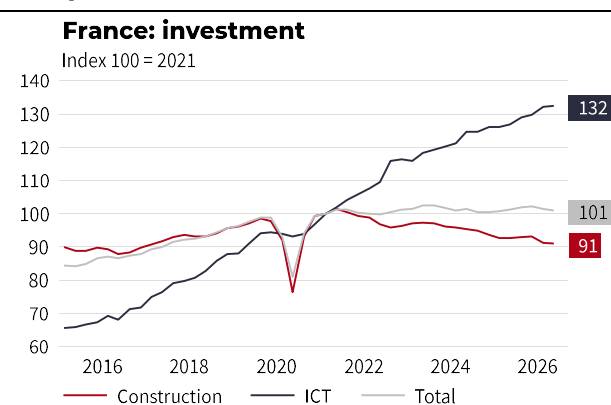
Growth will remain barely positive in 2026 before picking up only moderately in 2027. Despite persistent budgetary pressures, continued fiscal expansion will keep growth marginally above zero, with some additional support from external demand. However, the latter factor is likely to remain volatile, as its resilience is concentrated in sectors dependent on large-scale order delivery. At the same time, the triple squeeze on households remains a key obstacle, as unemployment continues to rise, real income growth remains negative, and confidence remains low. This dynamic will persist in the short term, leaving the macroeconomic backdrop to the 2027 elections fragile. Over the medium term, a recovery in household demand, alongside faster capital deployment to address substantial investment needs, should gradually rebalance the growth model and underpin France's economic trajectory. The main downside risk stems from the 2027 presidential election, with uncertainty likely to remain elevated as candidacies take shape and policy platforms emerge.

Constrained private demand, consumption and investment, continues to weigh on growth



Source: INSEE, SG Economic and Sector Studies

Dynamic AI-related investment is too small to compensate for the construction malaise



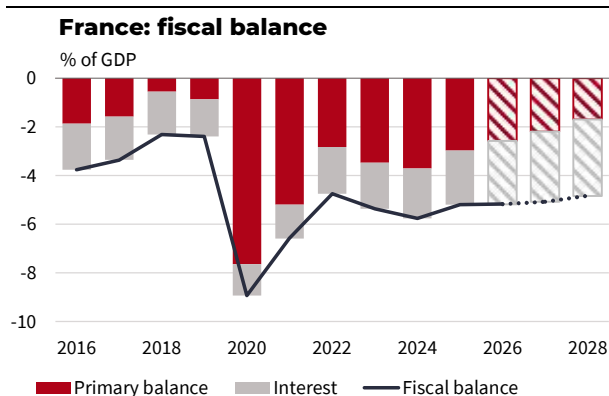
Source: INSEE, SG Economic and Sector Studies; Note: ICT refers to Information Communication Technology

Construction is likely to remain a drag on investment, as it recovers only gradually. In the short term, improving orders for industrial equipment and capacity expansion in the aerospace and defence sectors should provide some support, while investment in ICT remains robustly dynamic. Construction, however, is likely to

remain a drag: office starts are still close to decade lows, while the recovery in commercial and social housing construction remains limited. Still-elevated borrowing costs and political uncertainty should also constrain the tentative recovery. Over the medium term, gradually improving demand and financing conditions, relatively stable corporate margins, and investment needs related to the green and digital transitions, AI and defence should strengthen the recovery.

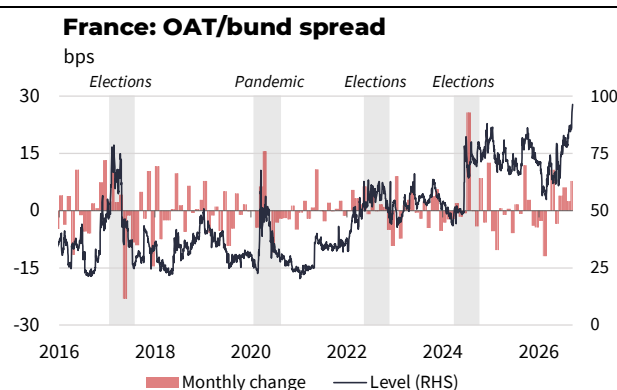
Inflationary pressures are expected to slowly ease, while the labour market should remain soft until the second half of 2027. Headline inflation is likely to average slightly above 2% in 2026 before returning to its lower-growth trajectory in 2027 as the energy shock fades. A large part of the spring increase in input costs has already been passed on to selling prices, while weak demand is likely to constrain firms' scope for further price increases. Despite remaining above their 2012–20 average, profit margins have recently been normalising and should improve gradually over the medium term, supported by renewed productivity gains. The labour market will remain the weaker part of the outlook. Private-sector employment has declined for six consecutive quarters, while unemployment has risen amid labour market softness comparable to pre-pandemic levels. Employment should stabilise only towards the second half of 2027 as activity recovers, allowing unemployment to begin edging lower thereafter.

Fiscal consolidation proceeds in slow-motion as the interest bill is becoming heavier



Source: INSEE, SG Economic and Sector Studies

The 2027 election is likely to keep the pressure on the OAT/bund spread



Source: LSEG, SG Economic and Sector Studies

Fiscal consolidation is set to proceed in slow-motion, while the rising interest bill further narrows fiscal space. We expect the deficit to reach 5.2% of GDP in 2026, reflecting weak revenues and persistently high current expenditure. The persistent structural deficit requires substantial adjustments going forward to meet EU spending limits, with little room for fiscal slippage. Meanwhile, debt-servicing costs will continue to rise as higher rates feed gradually into the debt stock. The 10-year OAT yield now stands above 4%. The general government interest bill is projected to almost double from 1.5 % of GDP in 2019 to 2.9 % of GDP in 2027.

The 2027 elections are set to dominate the markets over the coming months, with heightened uncertainty likely to keep spreads under pressure. Our central

scenario for the presidential elections on 18 April and 2 May (first and second round) and likely subsequent elections to the National Assembly makes the working assumption that the next French government will seek a path, albeit gradual, to sustainable public finances and avoid any lasting confrontation with the EU. Even under this relatively benign scenario, household and business hesitancy could persist through the election period, alongside periods of market volatility. A more pronounced confrontation with the EU remains a material risk under alternative electoral outcomes.

The balance of risks remains tilted to the downside. A messy budget process and election campaign, and a new government failing to deliver a credible fiscal policy pathway and/or seeing lasting confrontation with the EU would weigh on both financial markets and the real economy. Climate-related disruptions also pose downside risks. Droughts, heatwaves, wildfires and floods could impair agricultural output, infrastructure and productivity while generating renewed price pressures. More fundamentally, growth could disappoint if firms fail to deliver the investment required for the green and digital transitions and to reverse the stagnation in productivity. On the upside, a faster recovery in corporate investment, combined with greater political stability, would support productivity, employment and domestic demand.

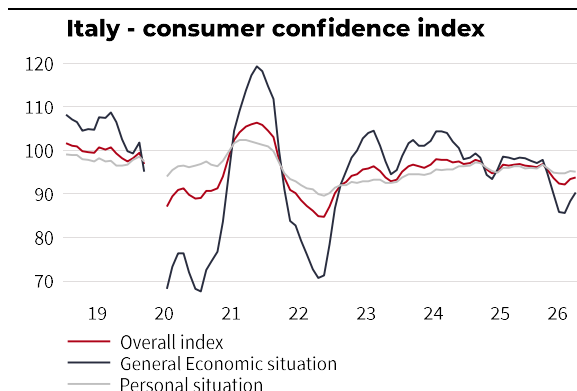
France	2026f	2027f	2028f	2029f
Real GDP, % YoY	0.3	0.7	1.1	1.4
Household consumption	0.1	0.7	1.0	1.0
Public consumption	1.2	0.8	1.0	1.0
Investment	-0.2	0.8	1.7	2.4
Exports of goods & services	1.5	2.4	2.7	3.0
Imports of goods & services	1.1	2.3	2.9	3.0
Inflation, HICP, % annual average	2.1	1.7	1.7	1.9
Core inflation, HICP, % annual average	1.4	1.6	1.8	2.0
Real gross disposable income (GDI), % YoY	-0.6	0.2	0.6	0.6
Households saving rate, % of GDI	17.2	16.7	16.3	16.0
Unemployment, % of labour force	8.1	8.0	7.8	7.7
Fiscal balance, % of GDP	-5.2	-5.1	-4.8	-4.8
Public debt, % of GDP	119	121	123	124
Current account balance, % of GDP	-0.4	-0.2	-0.4	-0.4

ITALY

- **Resilience of growth is set to fade in 2027 as investment linked to the National Recovery and Resilience Plan comes to an end.**
- **Italy is particularly sensitive to an increase in oil and gas prices due to its high fossil fuel dependence.**
- **Beyond 2027, the end of the NGEU programme is expected to add a significant headwind.**

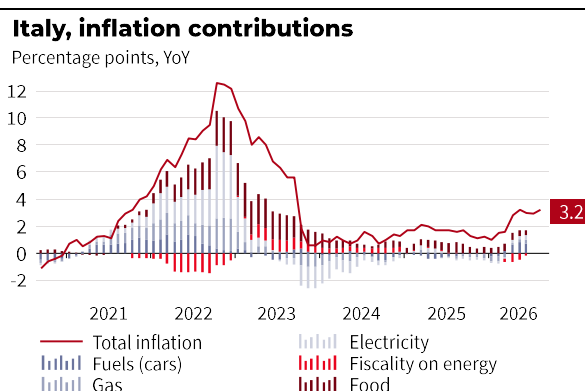
The conflict in the Middle East will erode growth by around 0.3pp of GDP in 2026 and is expected to affect all components of demand. Private consumption is set to decelerate, owing to a reduction in real disposable income, and despite a slight drop in the saving rate. Investment growth is projected to slow compared to 2025, as housing construction falls slightly. The NGEU continues to support investment in infrastructure and equipment, although the latter is set to be dampened by geopolitical tensions and rising interest rates. The impact of US tariffs and disruptions in some export markets due to the conflict in the Middle East is anticipated to further weigh on the goods export outlook while reducing imports. Net exports are thus expected to subtract from GDP growth, albeit less than in 2025.

Consumer confidence shows resilience...



Source: Istat, LSEG, SG Economic and Sector Studies

...despite the rise in inflation



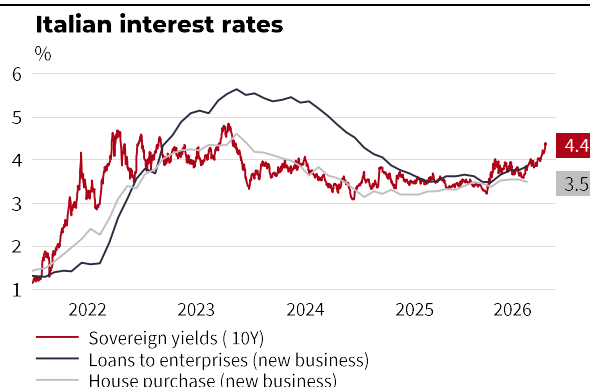
Source: Eurostat, LSEG, SG Economic and Sector Studies

Italy is particularly sensitive to an increase in oil and gas prices due to its high fossil fuel dependency, amounting to 76% of its total energy supply (versus 46% in France). The share of gas in total energy consumption is among the largest in Europe (38% versus 21% on average in the EU) and particularly strong in households' energy consumption (58%). However, the country has reduced its global energy dependency by increasing the share of renewable energy sources to 44% in power generation, from 16% 20 years ago.

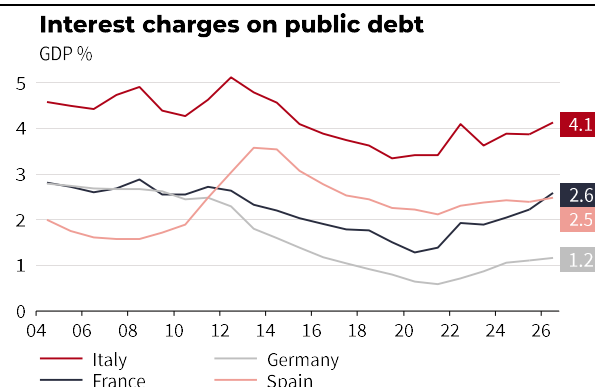
The government has announced limited support worth 0.2% of GDP. The measures include temporary fuel-duty cuts alongside anti-speculation measures and targeted support for vulnerable households. The measures also pursue

structural measures aimed at reducing electricity charges and limiting the pass-through of carbon costs into power bills.

Market tensions are pushing up sovereign yields, putting public debt dynamics at risk



Source: LSEG, SG Economic and Sector Studies

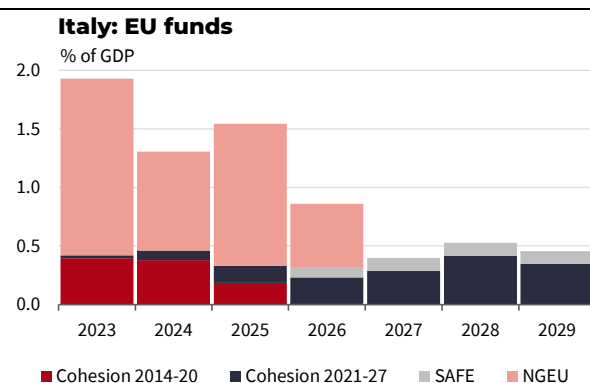


Source: DG-ECFIN AMECO, LSEG, SG Economic and Sector Studies

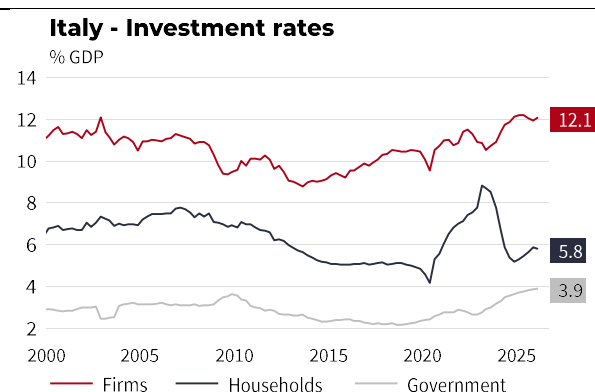
Recent tensions on sovereign yields reflect a new rise in oil prices and uncertainties regarding the duration of the conflict. Ten-year sovereign yields reached 4.4% in September, a level not seen since November 2023. Interest expenditures now amount to 4.1% of GDP—almost double that of France and Spain, and four times that of Germany—and total debt exceeds EUR 3,095bn.

A prolonged energy shock would affect growth through three channels: lower household purchasing power as utility bills rise; reduced corporate margins and investment; weaker exports and industrial production due to higher production costs. Italy remains one of the euro area's most energy-sensitive economies because manufacturing is energy intensive, the country remains a large importer of energy, and higher gas prices rapidly feed into electricity prices and industrial costs.

Investment slowdown in sight, but from a very high level for firms and government



Source: EU website, SG Economic and Sector Studies



Source: Eurostat, LSEG, SG Economic and Sector Studies

The approaching end of the NGEU programme as of 2027 is expected to become a significant headwind for the Italian economy, as a large share of recent investment growth has been supported by EU-funded infrastructure, digitalisation and energy-transition projects. Investment has been one of the main pillars of Italian growth in recent years, helping to offset weak productivity and a challenging external environment. As these funds are phased out, public investment is likely to

slow, construction activity could weaken, and private capital spending may lose an important source of support. It remains to be seen whether the funds will succeed in improving transport infrastructure, energy efficiency, digital adoption and public-sector productivity, thereby boosting potential growth and competitiveness.

The fiscal deficit is projected to edge up to 3.2% of GDP in 2026, placing Italy's exit from the EU excessive deficit procedure in 2026 at risk. The government will need a fiscal effort of 0.4% of GDP in 2027 and 2028 (circa EUR 10bn) to contain the public debt rise and stabilise the ratio at 140% of GDP.

Risks are primarily to the downside. A reversal of recent gains in fiscal sustainability—particularly if accompanied by a renewed widening of sovereign spreads—or a prolonged slowdown in key trading partners would weaken the outlook. Conversely, stronger-than-expected improvements in investment conditions could support growth. Additional risks stem from several sources, including a potential weakening of EU support, raising refinancing pressures on Italy's high public debt and a deterioration in fiscal dynamics leading to slower consolidation or a rising debt-to-GDP ratio. Persistent geopolitical tensions and elevated energy prices represent further downside risks.

Italy	2026f	2027f	2028f	2029f
Real GDP, % YoY	0.7	0.5	0.6	0.8
Household consumption	1.1	0.5	0.7	0.7
Public consumption	0.4	0.4	0.4	0.4
Investment	2.8	0.7	0.7	1.7
Exports of goods & services	3.0	2.0	2.4	2.7
Imports of goods & services	3.5	1.7	2.3	3.0
Inflation, % annual average	2.6	1.8	1.9	1.9
Core inflation, % annual average	1.8	2.0	2.0	2.0
Real gross disposable income (GDI), % YoY	-0.2	0.4	0.5	0.7
Households saving rate, % of GDI	10.3	10.4	10.3	10.3
Unemployment, % of labour force	5.6	5.7	5.7	5.6
Fiscal balance, % of GDP	-3.2	-3.1	-3.1	-3.0
Public debt, % of GDP	139	140	140	139
Current account balance, % of GDP	0.5	0.3	0.4	0.3

SPAIN

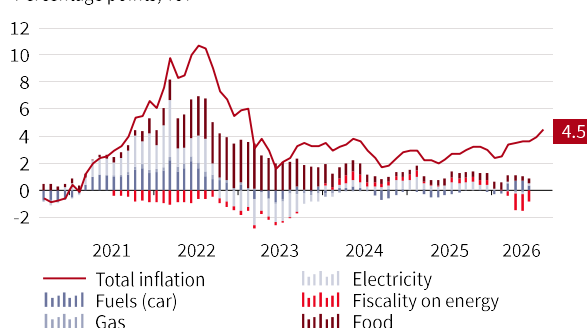
- **The Middle East conflict is expected to weaken the economy, despite the early adoption of a Royal Decree-Law to limit fuel price hikes.**
- **Inflation is projected to climb to 3.3% in 2026, eroding households' purchasing power and increasing production costs.**
- **The end of the NGEU programme as of 2027 will exert downward pressure on investment.**

The Middle East conflict is expected to weaken Spain's economic outlook, mainly through higher energy prices and increased uncertainty. As oil and gas costs rise due to disruptions in global supply routes, inflation is projected to climb to 3.3% in 2026, eroding households' purchasing power and increasing production costs. This reduces consumption and investment, leading to slower GDP growth, namely 2.5% in 2026 and 1.6% in 2027, a deceleration also driven by the end of the NGEU funding programme. Weaker external demand from slower-growing European partners and tighter financial conditions—due to delayed interest-rate cuts or possible hikes—will further weigh on activity. However, Spain remains a resilient economy, supported by strong domestic demand, employment growth, and tourism.

The energy shock is adding pressure to inflation, already fuelled by a dynamic credit cycle

Spain, inflation contributions

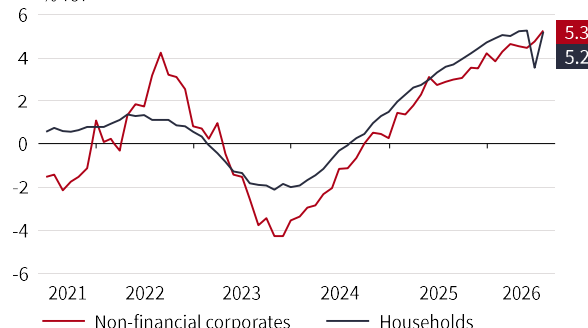
Percentage points, YoY



Source: Eurostat, LSEG, SG Economic and Sector Studies

Spain, banking credit

% YoY



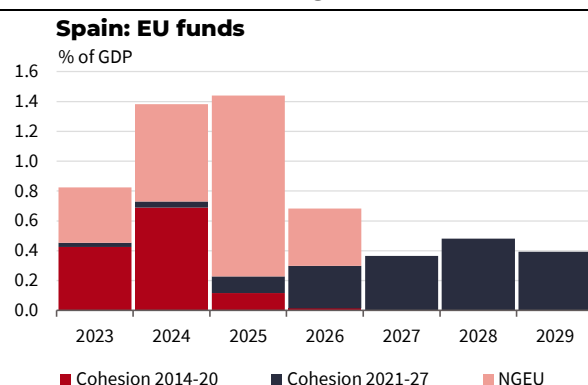
Source: ECB, LSEG, SG Economic and Sector Studies

Spain's resilience to an energy shock is stronger today than a decade ago, reflecting structural changes in its energy system and supply structure. First, the electricity mix has been largely decarbonised, with renewables accounting for 57% of power generation in 2025, compared with 35% in 2015 and 15% looking back a further decade, which reduces the pass-through of fossil-fuel price shocks to electricity prices. It also increases energy self-sufficiency and reduces marginal reliance on imported fuels. Second, although Spain remains highly import-dependent (around 70% of primary energy), its gas sourcing is more diversified and geopolitically proximate, with Algeria supplying about 35–40% of imports via pipeline and the remainder as flexible LNG from the US and others, supported by Europe's largest regasification capacity. Regarding crude and refined

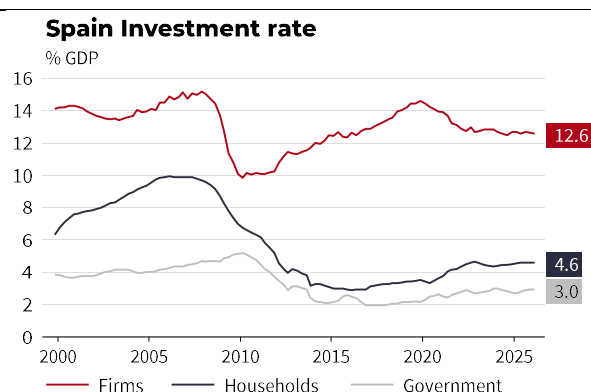
petroleum, only 12% of Spain's imports were transiting via the Strait of Hormuz (mainly Saudi Arabia and Iraq), limiting the country's exposure to oil shortages. Finally, the gradual decline in energy intensity of GDP reduces the macroeconomic impact of a given energy price shock.

In response to the energy shock, the Spanish government adopted a fiscal package on 20 March (Royal Decree-Law 7/2026) combining short-term price relief with structural energy measures. According to the Bruegel fiscal response tracker, Spain accounts for almost half of the energy-related fiscal support announced across Europe so far in 2026, making it one of the most aggressive responders relative to GDP. The initial package was estimated at EUR 5.8bn (0.3% of GDP), but the government has explicitly stated that measures can be extended or scaled up if the crisis worsens.

The end of the NGEU Programme will exert downward pressure on investment



Source: INE, LSEG, SG Economic and Sector Studies



Source: INE, LSEG, SG Economic and Sector Studies

Spain's labour market remains robust and dynamic in 2026, supported by strong job creation and a decisive contribution from immigration. Foreign workers now account for nearly 16% of total employment (over 3.1 million workers) and have played a strong role in labour market expansion, contributing nearly two-thirds of net job creation since the pandemic. This reflects both demographic pressures and persistent labour shortages. In terms of sectoral composition, employment growth remains heavily concentrated in services, consistent with Spain's economic structure. Tourism-related activities—particularly hospitality, retail and accommodation services—account for a large share of employment, and foreign workers are strongly represented in these segments (with nearly 29% employed in hospitality). At the same time, job creation has broadened to include higher value-added sectors such as information and communications, energy and professional services, which have shown some of the fastest growth rates. Overall, the labour market expansion combines continued strength in low-productivity service sectors with gradual diversification into more knowledge-intensive activities, although productivity differentials between domestic and foreign workers persist.

The outlook is subject to a combination of short-term cyclical risks and medium-term structural constraints. In the near term, the main downside risks stem from geopolitical tensions and energy price volatility, which are pushing inflation up and weighing on household purchasing power, investment and tourism demand. At the same time, persistently high inflation could keep interest rates elevated, tightening financial conditions and slowing growth. Fiscal vulnerabilities remain significant, with public debt close to 100% of GDP and increasing pressure from age-related spending, limiting room for stimulus in case of shocks. Domestically, risks are building in the housing market, with rising prices and affordability concerns potentially creating financial imbalances. Over the medium term, rapid population ageing and structurally low productivity weigh on potential growth, while heavy reliance on tourism and low-productivity services increases exposure to external shocks. Overall, the balance of risks is tilted towards lower growth and higher inflation, with structural reforms needed to sustain long-term resilience.

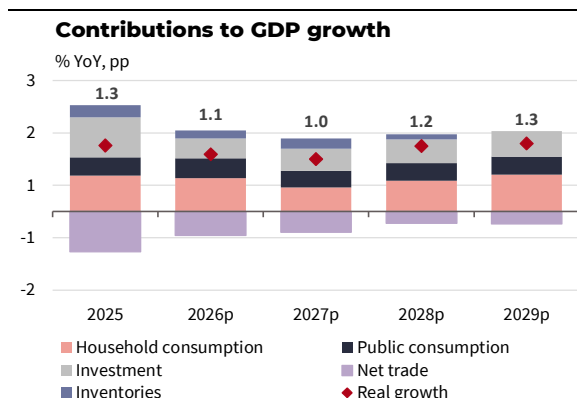
Spain	2026f	2027f	2028f	2029f
Real GDP, % YoY	2.5	1.6	1.8	1.8
Household consumption	2.8	1.8	2.0	1.8
Public consumption	2.0	1.4	1.4	1.4
Investment	3.8	0.9	1.2	2.0
Exports of goods & services	1.6	2.6	2.7	2.9
Imports of goods & services	2.4	2.4	2.4	3.0
Inflation, % annual average	3.3	2.0	2.2	2.0
Core inflation, % annual average	3.2	2.2	2.2	2.0
Real gross disposable income (GDI), % YoY	2.6	1.9	1.4	1.7
Households saving rate, % of GDI	12.0	12.0	11.5	11.4
Unemployment, % of labour force	10.3	10.6	10.5	10.4
Fiscal balance, % of GDP	-2.4	-2.3	-2.3	-2.3
Public debt, % of GDP	99	100	99	98
Current account balance, % of GDP	1.9	2.3	2.3	2.3

UNITED KINGDOM

- The economy proved resilient in 1H26, but high energy costs, elevated borrowing costs, and policy uncertainty will slow growth in 2H26, bringing annual growth to 1.1%.
- We expect headline inflation to average 3.2% in 2026 as energy and food pressures build, but a weak labour market should contain second-round effects and allow CPI to ease to 2.6% in 2027.
- Muted underlying inflation will keep the BoE on hold through 2026, while elevated gilt yields will constrain the Autumn Budget and help keep fiscal consolidation on track.

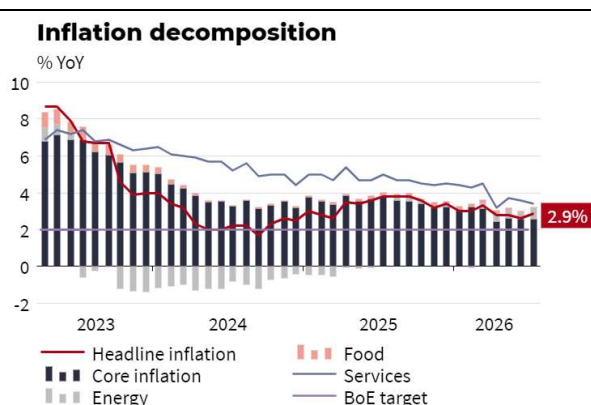
The UK economy proved resilient in 1H26, but momentum is set to fade in the second half of the year. GDP grew by 0.4% in 2Q26 despite the Middle East conflict. Growth was driven by investment, including a 7.4% QoQ rise in ICT equipment, potentially an early sign of a wave of AI-related capital spending. The UK is well placed to benefit from the AI boom given its strong universities, human capital, established technology and professional services sectors. However, persistently high energy costs, elevated borrowing costs and uncertainty surrounding international tensions and the Autumn Budget will weigh on activity in 2H26. We expect quarterly GDP growth to slow to 0.2% in 3Q26 and 0.1% in 4Q26, bringing annual growth to 1.1% in 2026.

Growth slows before a modest recovery



Source: ONS, SG Economic and Sector Studies

Higher headline, weaker underlying inflation



Source: ONS, SG Economic and Sector Studies

Headline inflation is set to rise further as energy and food pressures build... CPI inflation rose to 3.1% in August from 2.9% in July, driven by higher fuel prices. Yet core and services inflation remained unchanged, at 2.6% and 3.4% respectively, suggesting that the energy shock has not spread to underlying prices. Food inflation should follow with a lag as fertilizer shortages caused by disruption in the Strait of Hormuz and summer heatwaves feed through to prices. The UK's fossil-fuel-heavy

energy mix, with oil and gas accounting for 75% of supply, and its high net energy import dependence leave the economy exposed to global energy price shocks.

...but a weak labour market should contain second-round effects. Firms so far have absorbed much of the inflationary shock. PMI surveys confirm the squeeze, with input prices rising faster than prices charged. Firms are therefore likely to limit labour costs by deferring recruitment and pay rises. Unemployment remains at 4.9% but falling payrolls and vacancies at their lowest level since 2014 excluding the pandemic already point to a stagnant low-hire, low-fire economy. Private-sector regular wage growth slowed to 2.8%, leaving real wages flat. As growth weakens in 2H26, labour demand and workers' bargaining power should deteriorate further, preventing higher energy and food costs from becoming embedded in wages. We expect headline inflation to average 3.2% in 2026 before easing to 2.6% in 2027 as external price pressures fade.

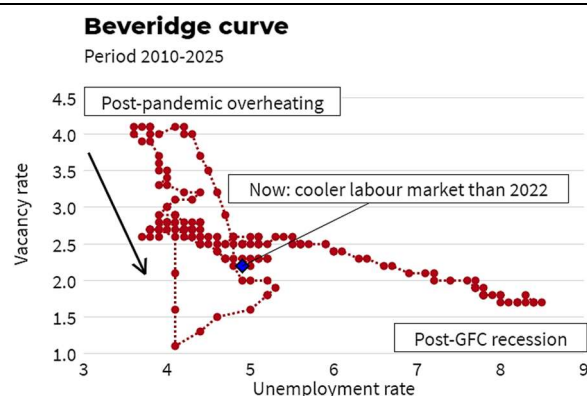
Households have weathered the shock so far, but resilience should progressively fade. The low-hire, low-fire labour market has protected those already in work, while savings drawdowns have helped sustain consumption. The World Cup and warm weather provided additional support, with consumer confidence returning to its pre-conflict level in August. However, households will come under growing pressure as employment weakens, Ofgem's energy price cap and food bills continue to rise through 2027, eroding purchasing power, while mortgages are refinanced at higher rates. Real incomes will come under renewed pressure just as they recover from the 2022 cost-of-living crisis, keeping consumption subdued through 2H26 and 2027. In this context, retailers' sales expectations remain well below pre-conflict levels.

We expect the Bank Rate to remain on hold through 2026 as domestic pressures remain subdued. Stable core inflation, easing services inflation and slower wage growth suggest limited second-round effects, while weaker activity should open a wider output gap through 2027. This path is consistent with our forward-looking Taylor rule, which looks through temporary headline inflation spikes and has closely tracked Bank Rate since the pandemic. Monetary policy can restrain domestic demand, but it cannot reverse a global energy-driven supply shock. Tighter policy would therefore be warranted only if the shock fed into wages and underlying inflation, which we do not expect. As headline inflation falls back in 2027, we expect two 25bp cuts, bringing Bank Rate to 3.25% by year-end, in line with a neutral stance.

Gilt-market pressure will keep fiscal consolidation on track. The 10Y gilt yield has reached its highest level since the global financial crisis and remains the highest in the G7. Higher US yields and a steeper Treasury curve explain part of the rise, but domestic factors have amplified it. The Middle East conflict pushed up the short end of the SONIA OIS curve as markets repriced the BoE path. At longer maturities, large borrowing needs, active gilt sales under BoE QT and weaker demand from defined-benefit pension funds have increased the volume of debt that price-sensitive

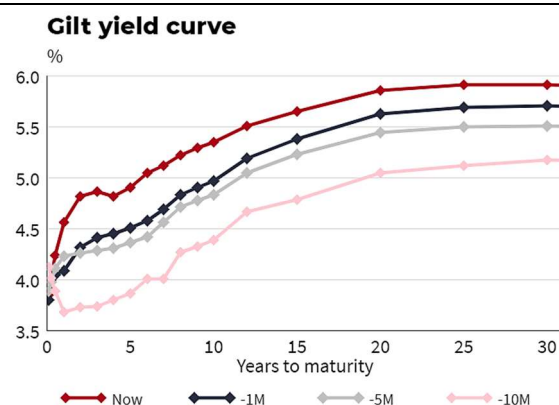
investors must absorb. These pressures compound the UK's structural vulnerabilities, including the absence of the dollar's reserve-currency privilege or an ECB-style backstop, and the credibility scar left by the 2022 mini-budget crisis. With yields on new debt above nominal GDP growth, refinancing at current rates would eventually require primary surpluses of around 1.5% of GDP to stabilise the debt-to-GDP ratio. The gilt market will therefore remain the main constraint on fiscal policy, leaving the government little scope to loosen its fiscal rules or increase borrowing at the Autumn Budget.

The labour market is weaker than post-Covid



Source: ONS, SG Economic and Sector Studies

Gilt yields have risen across the curve



Source: LSEG, SG Economic and Sector Studies

Risks remain skewed to the downside. A prolonged Middle East conflict would keep energy prices elevated and intensify stagflationary pressures, complicating the BoE's policy trade-off. The longer the conflict persists, the greater the risk that higher costs become embedded in inflation expectations and trigger second-round effects, forcing the BoE to keep rates higher for longer.

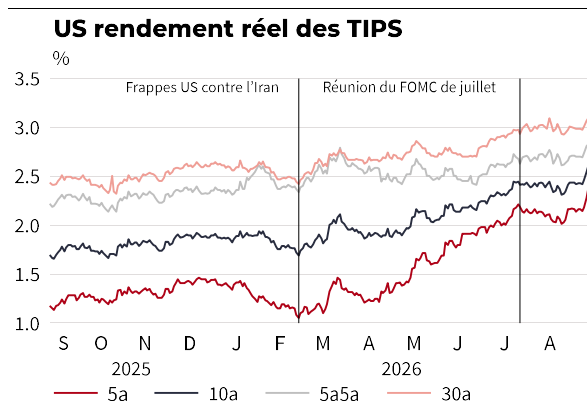
United Kingdom	2026f	2027f	2028f	2029f
Real GDP, % YoY	1.1	1.0	1.2	1.3
Household consumption	1.0	0.8	1.0	1.2
Public consumption	1.8	1.5	1.6	1.6
Investment	1.9	2.1	2.2	2.4
Exports of goods & services	1.3	1.2	2.0	2.7
Imports of goods & services	2.5	2.2	2.4	3.1
Inflation, % annual average	3.2	2.6	2.1	2.3
Core inflation, % annual average	2.7	2.3	2.0	2.3
Real gross disposable income (GDI), % YoY	0.8	0.7	0.5	0.9
Households saving rate, % of GDI	9.6	9.4	8.9	8.6
Unemployment, % of labour force	5.0	5.1	4.7	4.7
Fiscal balance, % of GDP	-4.5	-4.2	-3.5	-3.0
Public debt, % of GDP	95	96	97	97
Current account balance, % of GDP	-3.9	-3.3	-3.6	-3.6

UNITED STATES

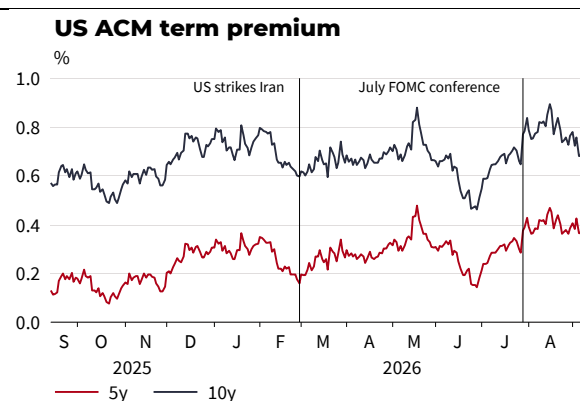
- **Growth to remain resilient at 1.9% in 2026, supported by strong earnings, AI-related investment and boosted by temporary fiscal support, before slowing to 1.7% in 2027 as these effects fade.**
- **We make a working assumption that the November midterms produce a divided Congress, offering little prospect of fiscal consolidation and increasing government-shutdown risks.**
- **Labour supply is contracting as structural ageing is compounded by falling participation among younger workers, keeping unemployment low despite weak payroll growth.**
- **Higher real yields are tightening financial conditions, and alongside proposed defence spending increases will compound a deteriorating fiscal trajectory.**

Growth is expected to remain resilient at 1.9% in 2026, supported by strong corporate earnings, AI-related investment and temporary fiscal support from tax cuts and tariff refunds. Indeed, final sales to private domestic purchasers (a proxy for underlying private-sector momentum) have accelerated in 2026 with core inflation persistently above target, indicating growth may still be running above potential. As the effects of the temporary stimulus fade and supply constraints persist, growth is expected to slow to 1.7% in 2027.

Yields have risen across the curve reflecting higher rate expectations and higher term premia, tightening financial conditions



Source: LSEG, SG Economic and Sector Studies



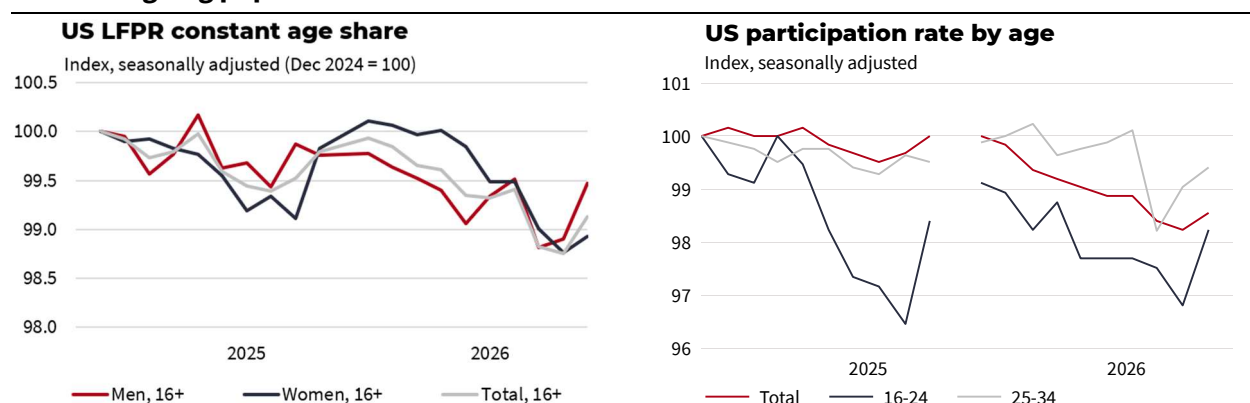
Source: LSEG, SG Economic and Sector Studies

The recent rise in Treasury yields has mainly reflected a higher expected path for real short-term rates. Strong private capital investment in IT equipment, fiscal deficits above 6% of GDP, and the prospect of higher defence spending could push rates higher still. As such, we expect the term premium, which has remained largely

stable over the last 12 months, to rise over the coming year as investors demand greater compensation for absorbing rising Treasury supply and fiscal risk.

The November midterms are unlikely to produce meaningful fiscal consolidation. We make the working assumption of a divided Congress, which would increase the risk of government shutdowns from 2027, while restricting the passage of new legislation to measures with bipartisan support. However, agreements to fund the administration's priorities on defence and border security could require concessions to Democratic priorities, notably reversing healthcare and welfare cuts, leaving fiscal risks tilted towards further deficit expansion. A Democratic sweep would similarly increase pressure to restore social spending, while the outside risk of a Republican sweep would provide the clearest route to additional defence and security expenditure. Complete legislative deadlock would be fiscally closest to the status quo but would leave deficits above 6% of GDP and provide no solution to the structural deterioration in the public finances expected over the medium term. Executive discretion over tariffs would remain largely intact under any plausible outcome, although a Democratic-controlled House could intensify scrutiny through congressional committees.

The participation rate has fallen since 2024, mostly explained by workers <34-year-olds rather than the ageing population



Source: U.S. Bureau of Labor Statistics, SG Economic and Sector Studies

Source: U.S. Bureau of Labor Statistics, LSEG, SG Economic and Sector Studies

Soft payroll growth has not produced the expected rise in the unemployment rate due to the contraction in labour supply. The foreign-born workforce is estimated to have decreased by close to 1mn people in 2026. The participation rate has fallen by 1.1pp since end-2024, of which population ageing explains around 0.3pp. The remaining decline is concentrated among workers under 34, potentially signalling growing discouragement or more persistent detachment among young workers. Weaker participation may be lowering potential growth, meaning even modest demand growth can sustain inflationary pressure going forward.

With demand resilient and inflation above target, monetary policy appears less restrictive than previously assumed. We therefore revise our policy-rate forecasts for 2026 and 2027 upwards. Warsh's Jackson Hole address laid out a more informative and hawkish assessment of the economy than his first two FOMC press conferences, arguing that sluggish wage growth is not a reliable predictor of future inflation. This stance was confirmed at the September FOMC meeting. Despite the bond sell-off over the summer, financial conditions were assessed by the Fed to not have sufficiently tightened to rein in inflation.

Warsh's five task forces are due to report their findings before the end of 2026. The task force on balance-sheet reform is of immediate relevance to the outlook. If the Fed begins actively selling longer-dated Treasuries and reinvesting the proceeds in bills, it could leave the total size of the balance sheet unchanged while increasing the duration that private investors must absorb. This could put the Fed on a collision course with the Treasury. The Treasury's decision to expand liquidity-support buybacks should improve trading conditions in off-the-run securities but is unlikely to offset upward pressure from persistent issuance.

Risks to the scenario are tilted to the downside. A disappointment in expected AI revenues could raise doubts about providers' ability to honour long-term data-centre and computing commitments, triggering a sharp retrenchment in capital expenditure. The lack of fiscal consolidation risks putting upward pressure on the term premium, where a return to the average of around 150bps in the decade prior to the GFC could see further upside for 10y yields and interest costs. Furthermore, if the fall in labour participation is sustained it could lower potential growth and intensify inflationary pressure.

United States	2026f	2027f	2028f	2029f
Real GDP, % YoY	1.9	1.7	1.8	2.0
Household consumption	1.7	1.6	1.8	2.0
Public consumption	1.3	2.0	1.4	1.4
Investment	3.6	3.2	2.6	2.4
Exports of goods & services	3.4	1.4	2.4	2.5
Imports of goods & services	1.9	2.5	3.4	3.6
Inflation, % annual average	3.3	2.2	2.6	2.7
Core inflation, % annual average	2.6	2.6	2.7	2.8
Real gross disposable income (GDI), % YoY	0.5	1.8	1.7	2.0
Households saving rate, % of GDI	3.4	3.6	3.5	3.5
Unemployment, % of labour force	4.4	4.7	4.8	4.8
Fiscal balance, % of GDP	-6.4	-6.5	-6.8	-6.7
Public debt, % of GDP	102	105	108	110
Current account balance, % of GDP	-3.3	-3.4	-3.5	-3.6

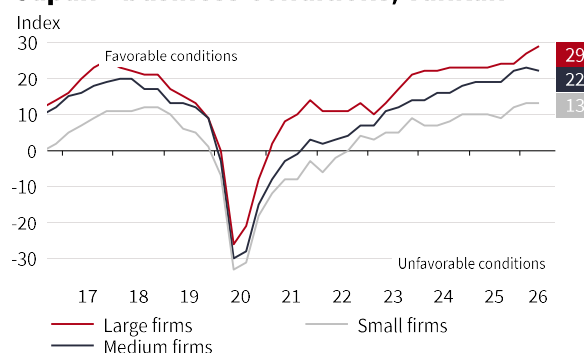
JAPAN

- Japan may finally be emerging from its long era of very low inflation into a more normal nominal-growth environment.
- Energy subsidies and real wage gains are set to mitigate the oil price surge for households and fiscal stimulus is set to support investment.
- The BoJ is set to pursue further rate hikes as medium-term inflation expectations rise towards the 2% target.

The Japanese economy is expected to continue expanding at a moderate pace despite the continuing Middle East conflict. The extensive fiscal stimulus package will support consumption and investment through cost-of-living support measures for households and SMEs. The stimulus includes a supplementary budget of 0.5% of GDP that will finance energy subsidies, replenish depleted reserve funds and create a new buffer in case the conflict persists. Japan is highly sensitive to the Middle East conflict. Should the conflict ease within the coming months, the economy is expected to continue to register resilient growth at a moderate pace due to fiscal support and a recovery in private consumption. A more prolonged conflict would affect both household consumption and business profitability, as Japan is a large importer of fossil fuels with a strong reliance on Gulf providers.

Improved business conditions...

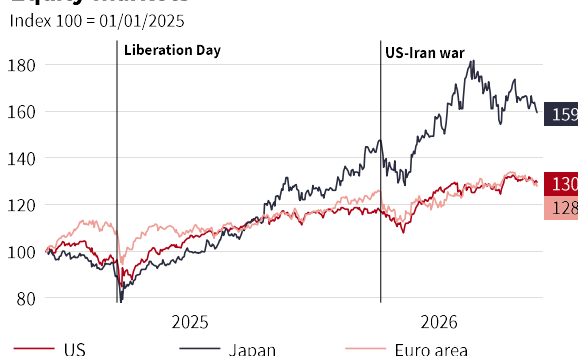
Japan - business conditions, Tankan



Sources: Bank of Japan, LSEG, SG Economic and Sector Studies

... and resilience of the equity market

Equity markets

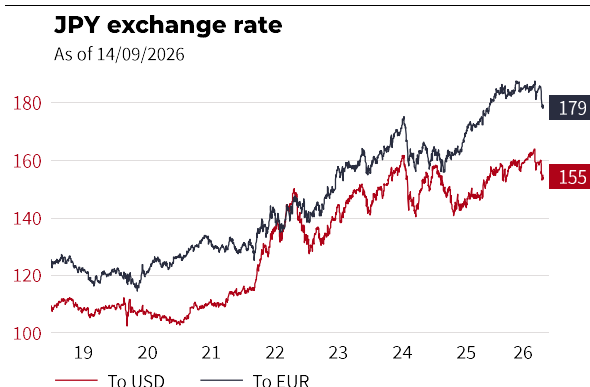


Sources: NIKKEI, STOXX, S&P, LSEG, SG Economic and Sector Studies

Business conditions have held up very well, reflecting a combination of supportive domestic and financial factors. The economy continues to grow moderately, with solid corporate profits, resilient domestic demand, and ongoing wage gains limiting downside risks. Fiscal policy has played a key cushioning role, with energy subsidies and supplementary spending mitigating the shock to households and firms. At the same time, a weak yen is boosting exporters' earnings, while rising yields are supporting financial sector profitability. Global investors are also reallocating towards Japan, attracted by structural changes such as policy normalisation and

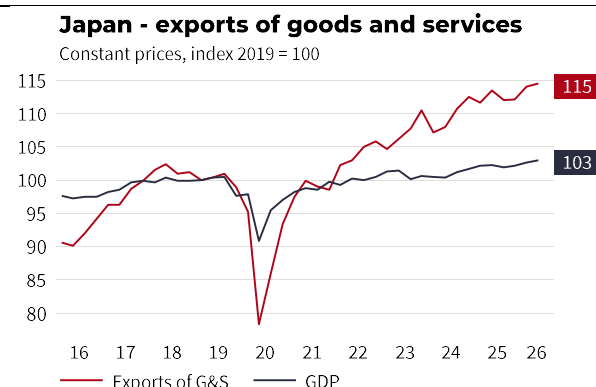
improved corporate governance. The structural need to increase productivity in the face of labour constraints should also boost corporate investment in the medium term. Overall, markets are expecting a mild temporary slowdown, with medium-term fundamentals remaining intact.

The weakness of the JPY ...



Sources: Tokyo Financial Exch., LSEG, SG Economic and Sector Studies

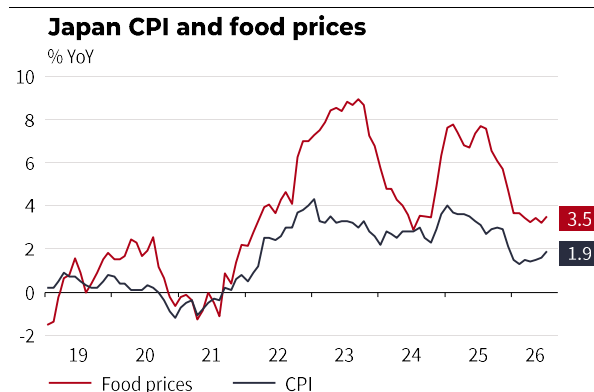
... is boosting Japan's export performance



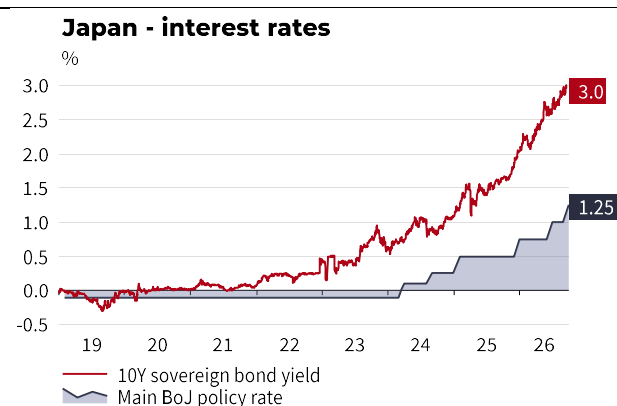
Sources: Cabinet Office Japan, LSEG, SG Economic and Sector Studies

Consumer price inflation slowed to below 2% in 1H26 due in part to measures aimed at reducing energy-related burdens, and to the easing of food prices. However, rising import prices associated with surging crude oil prices are expected to spread to a broad range of items, including food products and daily necessities, pushing inflation towards 2.5% by the end of 2026.

Inflation is contained so far, as food prices decelerate and gasoline prices are subsidised



Sources: Ministry of Internal Affairs & Comm. Japan, LSEG, SG Economic and Sector Studies



Sources: Bank of Japan, LSEG, SG Economic and Sector Studies

The Bank of Japan is expected to continue normalising the monetary policy over the next two years and raise its policy rate to 1.75% by the end of 2028. The central bank will remain cautious throughout this period to ensure that policy normalisation does not cause an economic slowdown or jeopardise 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 or suspend this tapering if the bond market's volatility is considered too high. Due to its history of deflation, we expect the BoJ to err on the side of caution.

The fiscal stance will be expansionary in 2026 and 2027, with a stimulus package injecting more than 1.5% of GDP into the economy, including the May supplementary budget worth 0.5% of GDP. Public deficit will continue to increase as interest charges become more pronounced, with 10Y JGB rates now close to 3%. However, the average debt maturity is over 9 years which provides some breathing room. 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 slowly 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.

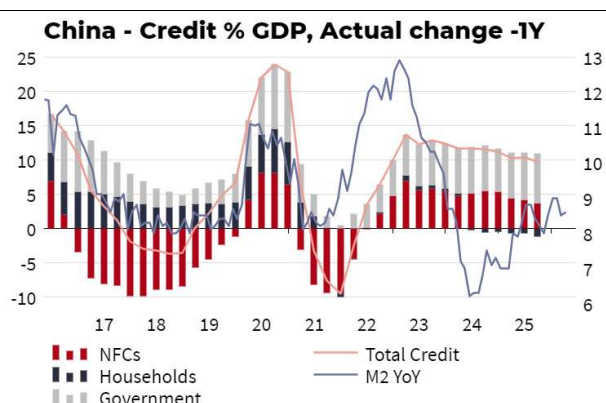
Japan	2026f	2027f	2028f	2029f
Real GDP, % YoY	0.6	0.5	0.6	0.6
Household consumption	0.8	0.5	0.6	0.6
Public consumption	1.6	0.2	0.4	0.3
Investment	0.2	0.5	0.6	0.7
Exports of goods & services	1.9	1.7	2.0	2.0
Imports of goods & services	0.0	1.7	1.8	2.1
Inflation, % annual average	1.6	1.5	1.8	1.8
Core inflation, % annual average	1.7	1.3	1.7	1.8
Real gross disposable income (GDI), % YoY	2.2	0.7	0.6	0.5
Households saving rate, % of GDI	1.0	1.1	1.1	0.8
Unemployment, % of labour force	2.7	2.7	2.6	2.4
Fiscal balance, % of GDP	-2.4	-2.9	-3.3	-3.6
Public debt, % of GDP	202	200	199	198
Current account balance, % of GDP	5.0	4.9	4.8	4.9

CHINA

- **The Chinese economy continues to slow while domestic demand remains too weak to support balanced growth.**
- **We expect limited policy changes with the authorities maintaining a stance of moderate support.**
- **Resilience will be tested by industrial overcapacity, weak confidence and trade frictions.**

Economic growth continued to slow in Q2. GDP expanded by 4.3% year-on-year in Q2, down from 5.0% in Q1, marking the weakest pace of growth since late 2022. On a quarter-on-quarter basis, GDP rose 0.9% in Q2, compared to 1.3% in Q1. China does not publish a quarterly expenditure breakdown of GDP into its main components such as consumption, investment, and net exports. Instead, related indicators are released monthly or as cumulative figures from the beginning of the year. A brief review suggests that the economy is still far from reaching the bottom of the cycle and we are comfortable maintaining our 2026 growth forecast (+4.2%), which is below the official target (4.5%-5%).

Credit is decelerating



Investment pick up in Q1 was short lived



Source: SG Economic and Sector Studies, LSEG

Source: SG Economic and Sector Studies, LSEG

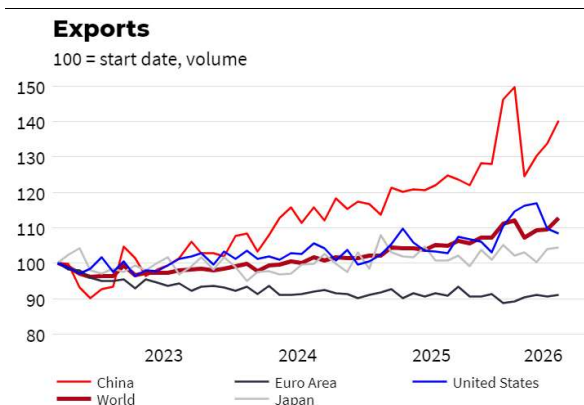
The property cycle has not yet bottomed out. Fixed asset investment declined by -5.7% in H1, including -18% for real estate, an impressive drop suggesting that the property sector hasn't bottomed out yet. There is limited progress on inventory reduction, the speed of destocking is slow, and property price decline may have further to go, suggesting that the bottom of the cycle is unlikely to be reached before 2027-2028. This is certainly clouding household confidence and is a factor explaining why retail sales grew by only 1.3% in 1H26, far below the 4% average since the post-Covid recovery and 8-10% before that. Credit growth remains slightly above nominal GDP growth and slows in parallel. As of end-May, bank lending was up 5.5% year-on-year, while Total Social Financing (TSF), a broader measure of financing conditions,

increased by 7.7%. As credit is decelerating, the credit impulse has now turned slightly negative.

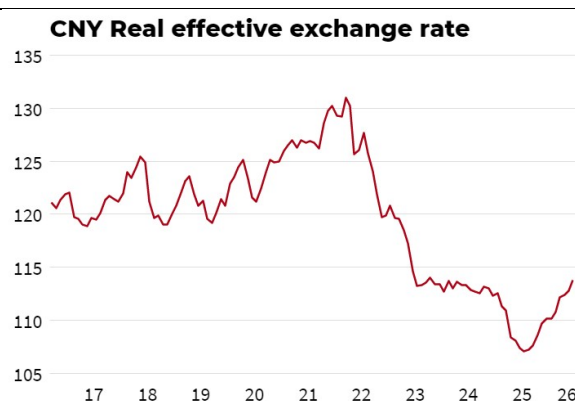
Overall, the same weaknesses remain. Weak household consumption, a persistent real estate crisis weighing on confidence, and disappointing investment despite public support. The export-oriented manufacturing sector remains the bright spot, but domestic demand is too low to generate balanced growth.

The growth pattern is increasingly export-led. ASEAN, EU and emerging markets have more than compensated for the contraction with the US and China has seen a rapidly rising trade surplus (USD 1.2trn in 2025, +19%). The trade surplus is unlikely to decline in 2026, as exports continue to rise strongly, still driven by the same sectors (electric vehicles, equipment related to AI and the energy transition). Imports are also increasing, linked to export inputs and industrial raw materials, but not due to the energy bill, for which the drop in volumes (around 20% in 1H26) seems to have offset the price increase.

The significant rise in exports



is coincident with a depreciation of the CNY



The gains in export share are increasingly criticized by partners beyond the US.

The concern, and not least in Europe, is that this is the result of a deliberate mercantilist policy, or even industrial dumping. They are coincident in the past three years with significant depreciation of the CNY in real terms. The OECD estimates that Chinese industrial companies have received significantly more state support than their international competitors: 3 to 8 times more (depending on sectors) relative to their turnover over the past two decades, explaining around 60% of their global market share gains during the period. China provides wide-ranging support to its self-defined priority sectors. The fiscal costs of these measures were estimated by the IMF to reach about 4% of GDP in the China Article IV report earlier this year. EU state aid to its industries amounts in comparison to 1.5% of its GDP. These recent reports are bound to give rise to international pressures from trade partners. Since the beginning of 2026, exports have continued to expand, increasing by around 20% in nominal terms, supported by the same key sectors: electric vehicles and equipment linked to AI and the energy transition. Imports have also risen, but largely due to higher purchases of export-related inputs and industrial raw materials. By

contrast, the energy import bill has remained contained, as the decline in volumes (around 20%) appears to have offset higher prices.

Despite the weak internal demand, we expect only moderate policy support.

There is a little room to ease monetary policy, due to reduced bank profitability. The authorities have announced additional capital injections for public banks and insurers in September, after a first wave in 2025, in a bid to support credit growth, and despite weak profitability. Further measures to support consumption could also be in the pipeline if domestic activity data remain too soft. The reduction of overcapacities has begun for basic industries. In more complex industries, the authorities have opted for market-based methods to promote consolidation, pointing to a much more gradual process. 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 the process.

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 stability, allowing even a small trend of appreciation in real terms since the beginning of 2026 that we expect to continue.

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 a risk of retaliation. This will remain a source of uncertainty for exporters and supply chains.

China	2026f	2027f	2028f	2029f
Real GDP, % YoY	4.2	4.0	3.8	3.6
Household consumption	4.5	4.2	3.8	3.9
Public consumption	4.9	4.8	4.5	4.0
Investment	3.5	3.0	3.5	3.5
Exports of goods & services	5.0	2.1	2.5	2.3
Imports of goods & services	5.8	2.0	2.2	2.0
Inflation, % annual average	1.2	1.4	1.7	2.0
Fiscal balance, % of GDP	-7.8	-7.6	-7.6	-7.6
Public debt, % of GDP	97	99	101	103
Current account balance, % of GDP	3.0	3.0	3.1	3.2

AFRICA

- **Regional growth continues to show resilience and is still expected to remain at around 4% over 2026-28.**
- **However, even without any further escalation, the crisis in the Middle East is exacerbating the region's pre-existing vulnerabilities.**
- **Finally, given the importance of its agricultural sectors, Africa remains particularly vulnerable to a potential climate shock and/or significant tensions in global agricultural input markets.**

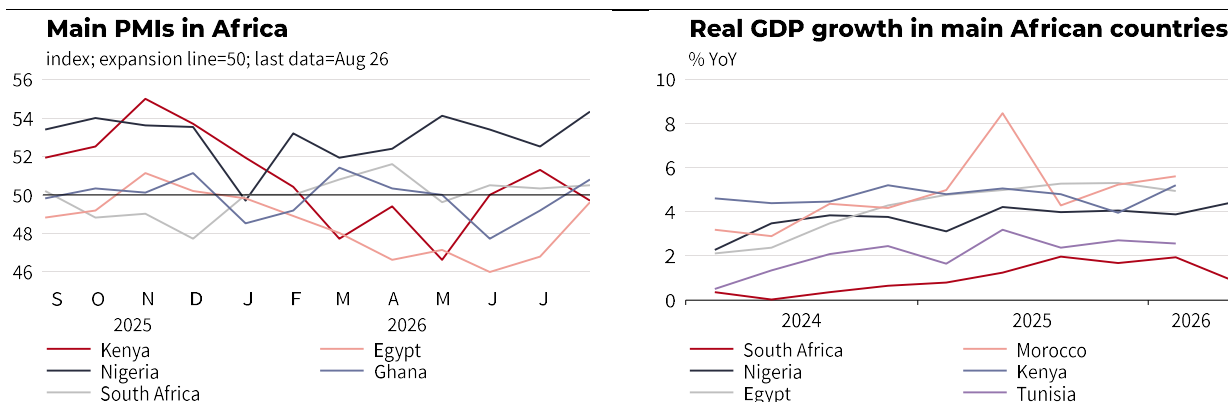
Despite a slight slowdown (4% this year, vs. 4.5% in 2025), regional growth has so far confirmed its resilience against a challenging international backdrop.

Private consumption should remain the main driver of activity (accounting for more than 70% of growth). Its momentum is likely to be only partly dampened by the rebound in inflation observed since April, as illustrated by confidence indicators, including PMIs, which have so far remained relatively well oriented. Private investment should also remain robust, notably thanks to solid Foreign Direct Investment (FDI). According to the latest UNCTAD figures, FDI flows to Africa reached almost USD 70bn in 2025, accounting for more than 4% of global flows (vs. an average of 3% between 2010 and 2020). Finally, external demand should remain relatively supportive this year. As a reminder, more than two-thirds of the continent's exports consist of unprocessed commodities, whose international prices and regional production levels are, overall, following favourable trends. Trade data, which are often among the first indicators available in the region, therefore point to buoyant exports, which are currently growing faster than imports. This latter trend is likely being "facilitated" by the resilience of most African currencies. This forms part of a broader trend of resilience among emerging-market currencies, supported by a long-term improvement in external positions and continued strong risk appetite among international investors, despite the current crisis in the Middle East. Such exchange-rate stability is relatively new to the region, except for the countries in the CFA zones, which already benefited from their pegs to the EUR. Despite recent announcements regarding the possible introduction by 2027 of a common currency, the ECO, for the countries of the Economic Community of West African States (ECOWAS), we do not expect the existing monetary arrangements in the two CFA zones to be called into question over the short or medium term.

Overall, where available, growth figures for 1Q26, and in some cases 2Q26, have tended to surprise on the upside. They have also confirmed an improvement in growth momentum in several of the continent's largest economies, notably Egypt, Nigeria and South Africa (to a lesser extent), which respectively account for around 20%, 20% and 10% of regional GDP measured at PPP. We expect these trends to

continue in 2027 and 2028, barring an escalation of the crisis in the Middle East, with annual growth expected to remain slightly below 4%.

Available confidence indicators remain generally well oriented **Growth in 1Q26 tended to surprise on the upside, particularly in the largest economies**

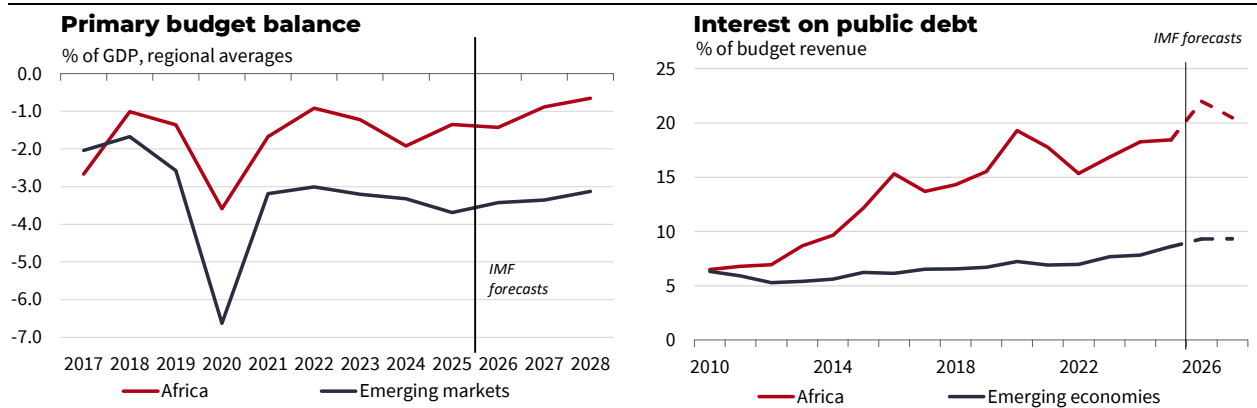


Source: LSEG, SG Economic and Sector Studies

However, this regional resilience should not obscure the fact that annual growth of around 4% remains insufficient to ensure genuine development and sustained economic convergence in Africa, particularly given still-robust population growth in most countries. Moreover, even without any further escalation, the crisis in the Middle East will exacerbate several pre-existing vulnerabilities. Africa continues to be characterised by significant heterogeneity across countries, which the current crisis is likely to increase further. While some hydrocarbon exporters, notably Nigeria and Algeria, as well as Angola and Central Africa to a lesser extent, should at least benefit from higher international prices, many more fragile countries remain highly dependent on oil and gas imports and will probably experience a rapid deterioration in their external balances and lower growth.

More generally, the fiscal positions of most countries in the region remain under pressure despite the consolidation efforts initiated a few years ago. In particular, interest payments on public debt remain excessively high relative to government revenue. Moreover, higher global energy prices, and possibly food prices (see below), could jeopardise the expected continuation of fiscal consolidation, as consumption of these products remains heavily subsidised in many countries across the region, including, and perhaps especially, hydrocarbon producers. These vulnerabilities could be exacerbated by the marked decline in Official Development Assistance (ODA) flows to Africa observed since 2024. Although these flows remain relatively modest as a share of regional GDP or total government revenue, they can account for a significant proportion of the financial resources available to the most fragile countries. Yet these countries are generally also the least able to absorb the economic repercussions of the conflict in the Middle East.

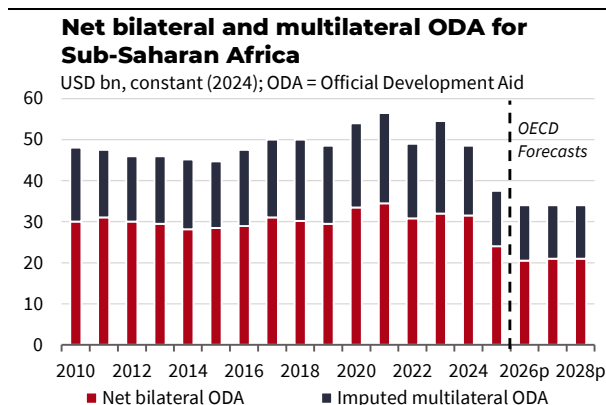
Despite the fiscal consolidation efforts initiated in 2024, African public finances remain fragile, notably due to an excessively burdensome interest bill



Source: LSEG, SG Economic and Sector Studies

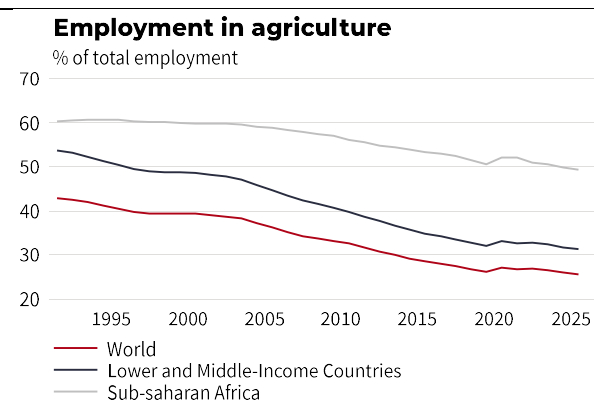
Finally, Africa remains particularly vulnerable to climate shocks, given the importance of the agricultural sectors to regional economies and populations. Agriculture still accounts for almost 50% of employment in sub-Saharan Africa, a higher proportion than in the rest of the world and one that is declining more slowly. This vulnerability is all the more concerning as the El Niño episode expected in late 2026 and early 2027 is likely to be particularly intense, with disruptions, notably to rainfall patterns, concentrated in Southern and East Africa. The economic consequences of a "Super El Niño" event are difficult to anticipate but could range from a "simple" increase in food prices, particularly if global fertiliser prices were also to rise because of the crisis in the Middle East, to more substantial GDP losses, estimated at between USD 10bn and USD 20bn for Africa according to a recent African Development Bank study. Other, more localised climate disruptions could also occur similar to the adverse rainfall conditions that have already affected cocoa production in West Africa and Cameroon.

The decline in development assistance flows could exacerbate existing vulnerabilities



Source: LSEG, SG Economic and Sector Studies

Agriculture remains vital to the region's populations

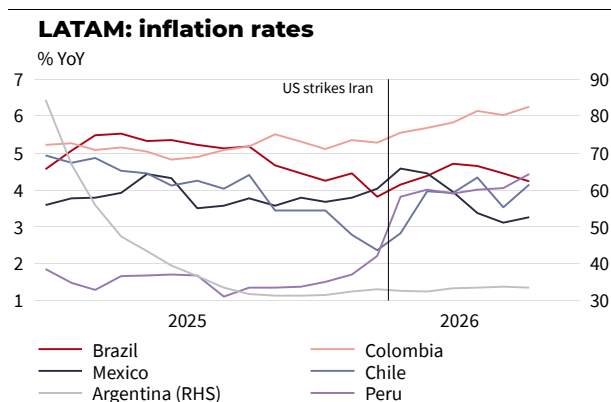


LATIN AMERICA

- The inflationary impact of the Middle East conflict has remained largely contained, but a strengthening El Niño poses risks to food prices and further monetary easing.
- The US decision not to extend the USMCA has clouded Mexico's nearshoring outlook, as potentially prolonged annual reviews are likely to weigh on investment. More broadly, the region is increasingly caught between China and the US.
- The shift to the right in the 2026 elections could support investment in extractive industries, but weak governing mandates and fiscal pressures will constrain policy implementation.

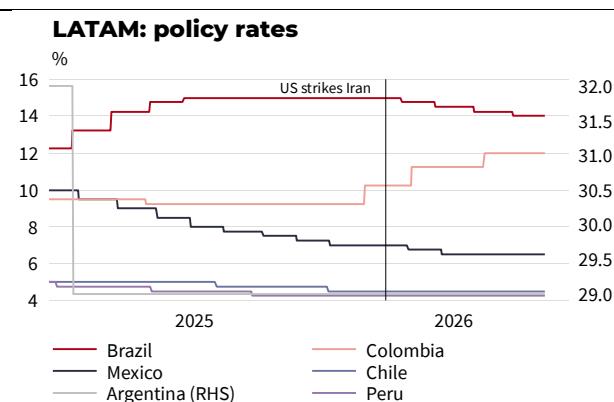
Latin America has so far weathered the inflationary consequences of the Middle East conflict better than feared. Flexible exchange rates, relatively moderate external imbalances and government measures to limit domestic fuel-price increases have weakened the immediate pass-through from higher oil prices. The effects remain highly uneven, however. Net energy exporters such as Argentina, Brazil, Colombia, Venezuela and Ecuador have benefited from improved terms of trade, while import-dependent economies in Chile, Central America and the Caribbean face continued pressure on inflation, fiscal accounts and household purchasing power. Central banks have consequently slowed or halted their rate-cutting cycles, although second-round effects are not yet apparent in most countries. Further disinflation, and therefore additional monetary easing, will depend on developments in the Middle East and the inflationary consequences of a strengthening El Niño.

The inflation breakout from the US-Iran conflict has remained largely contained so far...



Source: LSEG, SG Economic and Sector Studies

...but has slowed or halted central banks' rate-cutting cycles



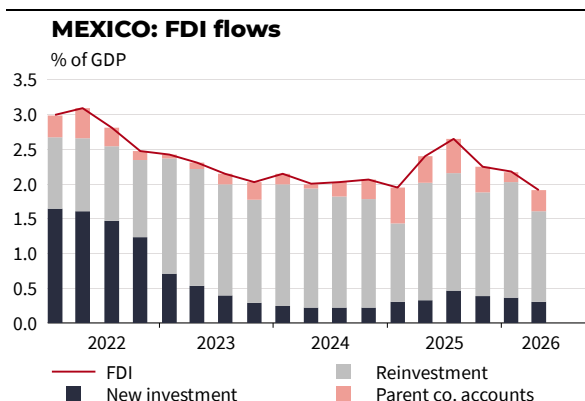
Source: LSEG, SG Economic and Sector Studies

Trade policy is a double-edged sword for the region. Its wealth of critical minerals and rare earths, as well as agricultural and energy resources, creates opportunities

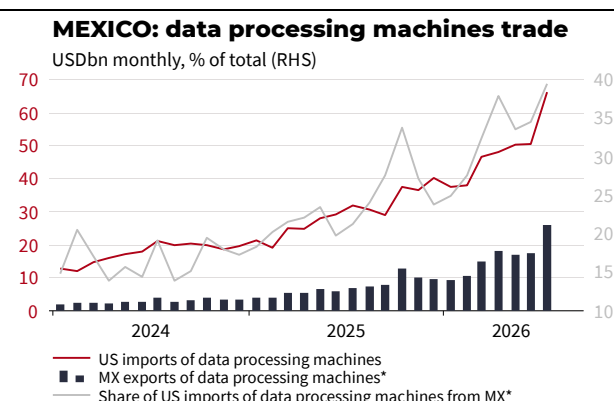
to attract foreign investment and increase exports and fiscal revenues. However, these resources also place the region at the centre of growing geopolitical competition between China, a major export destination and source of investment, and a more interventionist US administration. Greater US involvement in Venezuela's oil industry could stimulate much-needed foreign investment, but the benefits for broader growth would depend on improvements in governance, infrastructure and the domestic investment environment.

New FDI inflows to Mexico are at risk from trade uncertainty...

...and the USMCA review could threaten Mexico's recent boom in data processing equipment exports



Source: LSEG, SG Economic and Sector Studies



Note: *More than 90% of Mexican data processing equipment exports are destined for the US.

Source: LSEG, SG Economic and Sector Studies

Close integration into US supply chains also exposes Mexico, the region's largest nearshoring beneficiary, to downside investment risks. The United States' decision not to extend the USMCA for a new 16-year period leaves the agreement in force until 2036 but subjects it to annual reviews until an extension is agreed. Existing preferential market access remains in place, limiting the immediate threat to Mexican exports. The more important effect is likely to be on new foreign direct investment, which fell by 13% in the first half of 2026, as uncertainty over rules of origin and future tariff treatment complicates investment decisions with long payback periods. The US objective of reducing Chinese participation in North American supply chains could also disrupt Mexico's expansion in advanced electronics, illustrating the vulnerability of the nearshoring trend.

Following President Kast's election in Chile at the end of 2025, the shift to the right across the region gathers momentum after elections in Peru and Colombia. The more market-oriented, extractive-industry-friendly administrations elected in the 2026 election cycle so far could help boost investment and export growth. Closer policy alignment with the US administration could influence bilateral trade and diplomatic relations. Constraints come from limited governing mandates and growth headwinds from the requirement for fiscal consolidation.

President Fujimori's very narrow victory in Peru brings continuity at the central bank and plans to accelerate USD 33bn of mining investment. However, the government lacks a parliamentary majority, while the close result underlines the country's pronounced regional polarisation. Increased rainfall associated with El Niño will also raise the risk of flooding, particularly along the Pacific coast. Disruption to agricultural production and transport could keep food inflation elevated and constrain monetary easing in the near term.

Colombian President de la Espriella also won a very narrow victory and faces a highly fragmented legislature. His administration has pledged to revive investment in mining and hydrocarbons, but legislative fragmentation is likely to restrict the scope for rapid deregulation and increase reliance on executive decrees. The government has also inherited an acute fiscal problem, projecting deficits of 7.2% of GDP in 2026 that could widen to 9.4% of GDP in 2027, up from previous estimates of 5.3% and 4.5%, respectively, unless urgent revenue increases are approved. The situation is aggravated by the reconstruction costs from the 10 August earthquake in the west of the country, where damage is estimated by the government at about USD 9.6bn. External refinancing is being explored to extend maturities and reduce near-term liquidity pressure. Measures to ease restrictions on mining and extraction could improve investment in the medium term, but maintaining fiscal credibility will require prompt revenue increases to arrest the deterioration in public finances, which will likely weigh on growth in the near term.

Argentina is advancing a reform of the central bank charter that would prohibit direct and indirect Treasury financing, narrow the central bank's objectives and strengthen the rules governing the appointment and removal of officials. Its passage through the lower house is an important signal that the Milei administration is trying to embed disinflation beyond the current political cycle by raising the barrier to direct Treasury financing by the central bank which had contributed to high inflation in previous years. The bill requires Senate approval. The progress on institutional reforms is encouraging, but stronger real wage growth will be needed if Milei is to turn around his decline in popularity ahead of the 2027 elections.

A strengthening El Niño highlights the region's economic and climatic disparities. Drier and warmer conditions are expected across parts of Central America, the Caribbean and northern South America into 2027, increasing the risks of drought, weaker crop yields, reduced hydropower generation and higher food inflation. Wetter conditions are expected in parts of the Pacific coast of South America and the Southern Cone, raising the risk of flooding and infrastructure damage, although they could support hydropower generation and some crop yields.

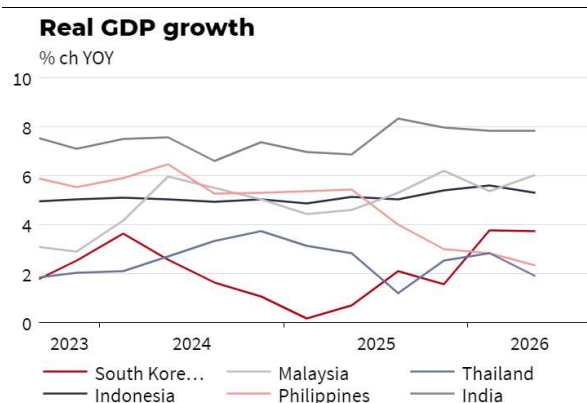
EMERGING ASIA

- **The resilience of growth is being challenged by the war in the Middle East and the ensuing energy shock.**
- **Strong investment in electronics and AI-related industries continues to underpin export performance.**
- **Domestic demand is playing an increasingly important role in driving growth in India and Indonesia.**

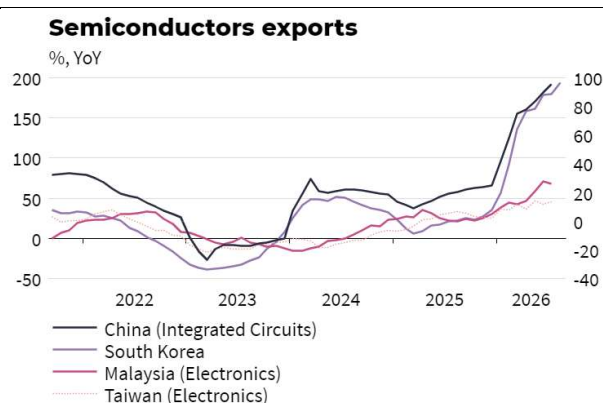
Emerging Asia should remain the world's fastest-growing region, supported by strong external demand despite the trade sanctions, ongoing industrial investment, and structural shifts in global supply chains. However, the environment is becoming more challenging. China's structural slowdown, tighter global financial conditions, geopolitical fragmentation, and rising public borrowing needs are likely to constrain growth relative to the post-pandemic rebound years. The baseline scenario remains one of continued expansion rather than a sharp slowdown.

The war in the Middle East has triggered an energy shock that is testing that strength. Higher oil and gas prices are pushing up inflation, widening trade gaps, and limiting governments' room to respond in fragile economies that depend heavily on imported fuel, like Pakistan and Bangladesh. But on average these pressures are contained, and emerging Asia is still set to display resilient growth.

Resilient growth



Very strong semi-conductor exports



Malaysia continues to benefit from the ongoing boom in semiconductor and data-centre investment, as well as supply-chain shifts due to geopolitics. The economy is expected to grow above 5% in 2026-2028. Strong exports, supported by demand for AI, cloud infrastructure and consumer electronics, will remain the drivers of expansion. It continues to attract FDI, particularly in semiconductors and data centres. Headline inflation has been contained below 2% in 2026 by fuel subsidies. But it remains dependent on energy shipments and further supply disruptions could spur inflationary risks, pushing Bank Negara to start raising interest rates in 2027. Malaysia is currently more politically stable than during the 2018-2022 period of

frequent government changes, but it remains politically fragmented. PM Anwar Ibrahim's national unity government is entering a more challenging phase ahead of the next general election, due before February 2028. China is Malaysia's largest trading partner, but Malaysia relies on the US as a security partner, and it will try to avoid choosing sides between the US and China.

Indonesia's position as a commodity exporter provides some buffer to its economy amid a surge in global energy prices. It is a net importer of oil, but a large net exporter of gas and coal. There are, however, vulnerabilities. The government is exposed to a jump in its subsidy bill, facing a difficult choice between reducing subsidies, cutting spending in other areas, or breaching the 3% deficit cap—a move that could undermine external investor confidence. External confidence in Indonesia is coming under strain, owing to the perception of a recent deterioration in governance and policymaking. President Subianto's large new social spending programmes—including free meal programs and rural cooperative initiatives—could strain the fiscal balance, especially given Indonesia's chronically low tax revenue base. GDP growth should nevertheless remain close to 5% in 2026, as the hit from a spike in oil prices is offset by higher demand for exports of metals, gas, coal and fertiliser.

India will remain one of the fastest-growing economies in the region and in the world, with real GDP growth expected to be around 6.5% in 2026, supported primarily by robust domestic demand, public infrastructure investment, and continued strength in services, particularly digital and business services. While global trade uncertainty and weaker external demand are weighing on exports, India's growth model remains largely domestically driven. Private consumption has benefited from rising incomes and easing financial conditions, while investment activity continues to be supported by government-led infrastructure spending and efforts to attract manufacturing supply chains. Inflation has moderated compared with previous years and is expected to average around 4.5-5.0% in 2026, broadly consistent with the Reserve Bank of India's target range. Lower price pressures and prudent monetary policy have helped contain inflationary risks. However, the impact of below-average rainfall on food prices, fluctuations in energy prices, and geopolitical tensions in the Middle East remain potential sources of volatility. With inflation still under control and economic growth remaining strong, the monetary policy stance continues to be supportive.

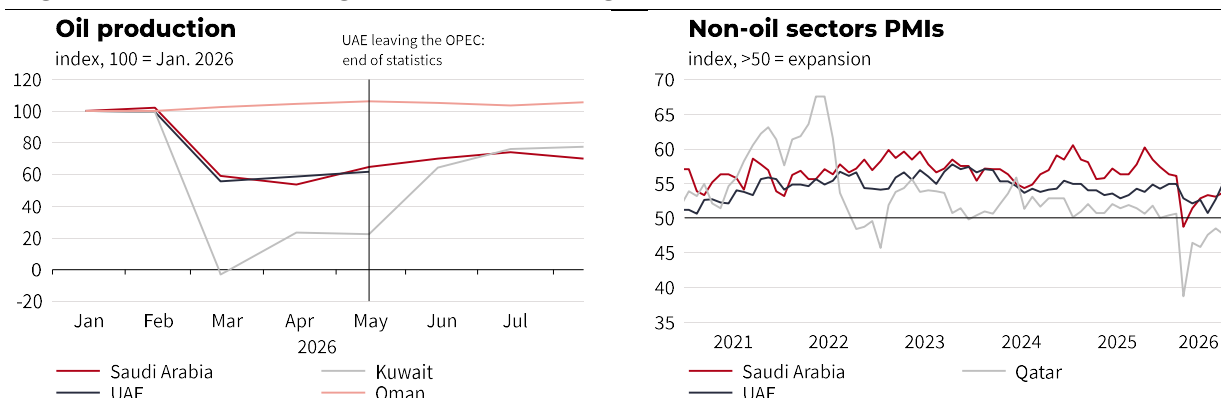
Downside risks to the outlook for the region remain significant: renewed escalation of the Middle East conflict, prolonged energy market uncertainty, tighter global financial conditions, a sharp correction in global equity markets and repricing of AI-related stocks, rising trade policy uncertainty, food price pressures, and a deeper property downturn in the PRC, and rising tensions between the United States and China could significantly impact regional growth.

GULF STATES

- **The ongoing rebound in regional oil production supports our expectation that growth will remain (barely) positive in 2026.**
- **We continue to expect growth to rebound in 2027, notably owing to favourable oil-related base effects.**
- **The current conflict is bringing new structural challenges for the region to the fore, although its vast financial resources should enable it to address them.**

As the regional conflict persists and uncertainty surrounding the region's economic and political outlook remains high, we continue to expect slightly positive regional growth of around 1% for the Gulf countries. First, regional oil production is gradually rebounding after falling sharply in March. Oman is an exception, as it can export its production without passing through the Strait of Hormuz. While the Strait has remained largely closed since the beginning of the conflict, except for a few weeks of relative "calm" between late June and early July, the Gulf Cooperation Council (GCC) countries have i) made use of their alternative export routes (the Fujairah terminal for the United Arab Emirates, UAE, and the Yanbu terminal for Saudi Arabia) and ii) expanded their storage capacities, both onshore and offshore, in order to increase production. It should be noted that UAE oil statistics have no longer been published since the country formally withdrew from OPEC on 1 May 2026. However, the national oil company ADNOC has repeatedly stated its intention to rapidly increase production to almost 4mn b/d (vs. 3.4mn b/d in February 2026).

Regional oil production is gradually rebounding Confidence indicators remain well oriented

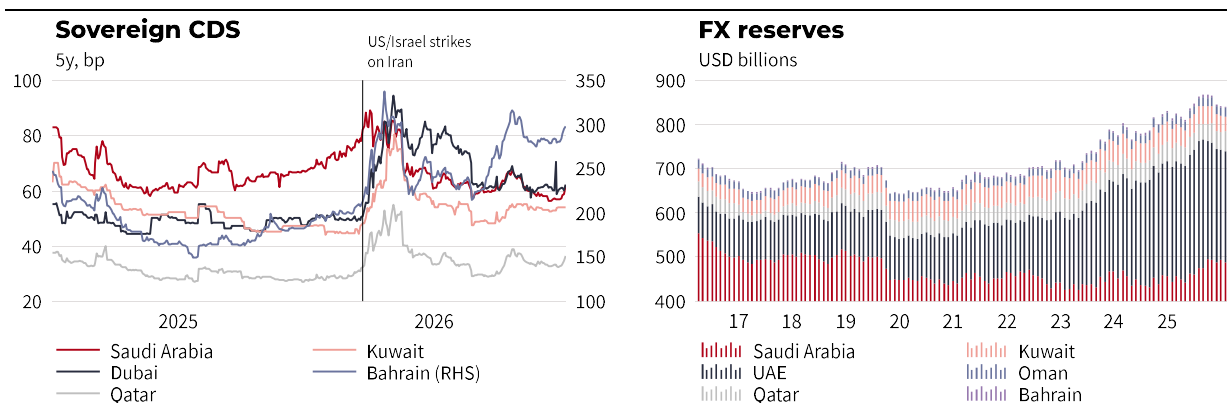


Source: LSEG, SG Economic and Sector Studies

Second, non-hydrocarbon sectors appear to remain dynamic, as illustrated by PMIs that are still well oriented, particularly in Saudi Arabia and the UAE. While tourism, whose share of regional GDP remains limited except in the UAE, and logistics have suffered from the conflict, other non-hydrocarbon sectors have proved more resilient, most likely supported by strong public demand. Finally, the few available

growth figures for 1Q26 confirm the asymmetric impact of the conflict across the region, already highlighted last quarter: growth reached 3% in Saudi Arabia, compared with -4.6% in Kuwait (YoY), as the latter has no alternative export route bypassing the Strait of Hormuz. The Gulf economies have also benefited from continued confidence among international investors. Following a period of tension in the weeks after the outbreak of the conflict, GCC sovereign CDS spreads have returned to levels close to those recorded at the beginning of the year, while generally remaining relatively stable. Bahrain is an exception, as the country already displayed significant financial vulnerabilities before the conflict. Regional stock markets have not collapsed, while investment flows, comprising FDI and portfolio investment, to Saudi Arabia and Qatar, the only two countries in the region that publish quarterly balance-of-payments statistics, were maintained in 1Q26. GCC countries also continue to benefit from privileged access to international capital markets, as illustrated by several international bond issuances since early June 2026, notably by Qatar, Bahrain and Kuwait. More generally, the region's foreign exchange reserves have declined only marginally, suggesting that pressures on the balance of payments of regional countries have so far remained contained.

Sovereign CDS spreads remain contained and The decline in FX reserves has remained limited relatively stable, except in Bahrain

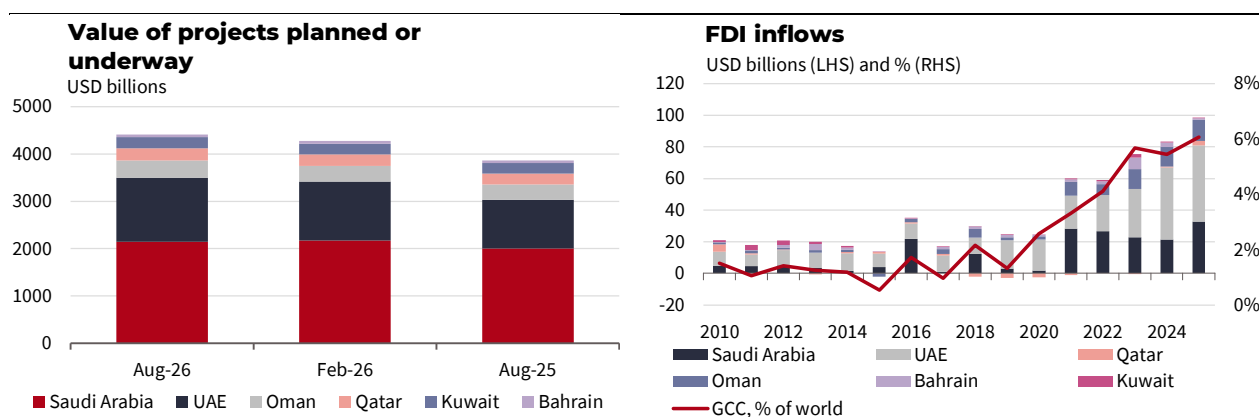


Source: LSEG, SG Economic and Sector Studies

Despite the significant uncertainty surrounding the current conflict, we continue, for now, to expect a marked rebound in regional growth in 2027, most likely to above 5%. This rebound would be driven mainly by the continued recovery in oil production, which would create favourable base effects supporting growth. Non-hydrocarbon sectors would benefit both from post-conflict reconstruction efforts and from significant infrastructure investment aimed at reducing dependence on the Strait of Hormuz, whose accessibility has become more uncertain. The value of projects under preparation or implementation, across all sectors but with construction accounting for a large share, has continued to increase since the beginning of the conflict and points to continued buoyant activity over the short and medium term. More generally, GCC countries should continue to benefit from several structural factors supporting growth, notably a substantial increase in FDI flows to

the region, which accounted for 6% of global flows in 2025, compared with less than 2% before 2021, steady improvements in governance and public demand that remains sufficiently strong to support activity. On the latter point, the combination of rebounding hydrocarbon production and higher energy prices should strengthen regional fiscal balances in the short term, although the impact will vary depending on each country's ability to maintain its exports.

The project pipeline points to buoyant activity ahead FDI flows to the region continue to increase ahead



Source: SG Economic and Sector Studies, UNCTAD, MEED

Although the impact of the current conflict on the region's macroeconomic and financial performance has so far remained relatively limited, it has nevertheless highlighted, and in some cases exacerbated, several structural vulnerabilities that could weaken the GCC countries' long-term outlook. First, the various diversification programmes, particularly in the UAE and Saudi Arabia and, to a lesser extent, in Qatar and Oman, which have been at the heart of growth dynamics in recent years, could be partially called into question, particularly in the tourism and logistics sectors. Second, the region's political and economic "fragmentation" appears to have increased once again, as illustrated by the UAE's withdrawal from OPEC in May, even though greater cooperation seemed necessary to better coordinate the GCC countries' massive, but often competing, investments. Finally, the region remains particularly vulnerable to a further escalation of the current conflict, even if this remains unlikely. GCC countries often remain highly dependent on a small number of strategically important infrastructure assets, for their energy sector (such as the aforementioned alternative routes) or the rest of their "civilian life" (notably water desalination plants and power stations). The recent attacks on the Bab el-Mandeb Strait and the East-West pipeline in Saudi Arabia are a perfect example of these vulnerabilities.

CENTRAL AND EASTERN EUROPE

- **Growth remains resilient but uneven: EU-funded investment and consumption have supported Poland, Czechia and Hungary, while fiscal tightening has weighed on Romania and Slovakia.**
- **Energy-driven inflation remains persistent, eroding purchasing power but without triggering a repeat of the 2022 wage-price spiral.**
- **Risks remain elevated: fiscal expansion is increasing sovereign risks in Poland, while fiscal consolidation and weak EU-fund absorption are weighing on Romania's growth and credit outlook.**

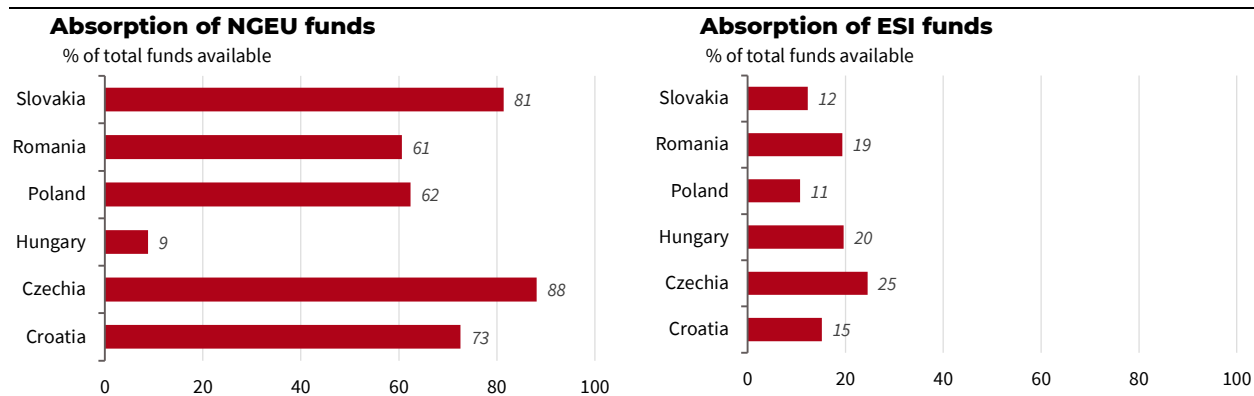
CEE activity is proving relatively resilient, but growth trajectories will remain very uneven in 2027-2028, largely reflecting diverging fiscal policies. Poland and Czechia are expected to remain on a strong growth footing and have recently announced 2027 draft budgets with sizeable fiscal expansions centred on defence, infrastructure, healthcare and public-sector wages. These measures are expected to support investment and household consumption, partly offsetting the persistent weakness of euro-area manufacturing. Conversely, fiscal consolidation will remain a significant drag in Romania and Slovakia. Romania is expected to remain a regional laggard, as fiscal consolidation and political uncertainty following the fall of the government in May 2026 heavily weigh on domestic demand.

NextGeneration EU (NGEU) funds have remained an important buffer, but absorption risks are material in several countries. Czechia is among the strongest performers, with 88% of its NGEU allocation disbursed by end August 2026, while Slovenia and Slovakia have also recorded disbursement rates above 80%. Poland had received around 62% of its allocation, providing substantial support to investment, although its late start has left some projects exposed to the deadline. By contrast, Hungary has not secured a full post-election release of EU funds, as payments remain conditional on the implementation and validation of outstanding rule-of-law and anti-corruption reforms. Romania faces the region's largest implementation shortfall. Its allocation has already been reduced from EUR 28.5bn to around EUR 20.2bn, mainly through a downsizing of the loan component and the removal of projects that could not be completed by the deadline. With less than EUR 13bn received by end-August 2026, a significant share of the remaining envelope is still at risk because of implementation delays and unmet milestones.

European Structural and Investment (ESI) funds and SAFE loans should provide further support in 2027-28, although their absorption will vary across countries. As NGEU funds reach their final implementation stage, ESI funding and SAFE defence loans should increasingly take over. Poland and Czechia are likely to combine these EU resources with a stronger domestic fiscal impulse. Romania and Slovakia will

instead need to preserve productive investment while reducing recurrent expenditure and correcting large fiscal imbalances. Differences in administrative capacity and EU-fund absorption will consequently become an additional source of regional growth divergence.

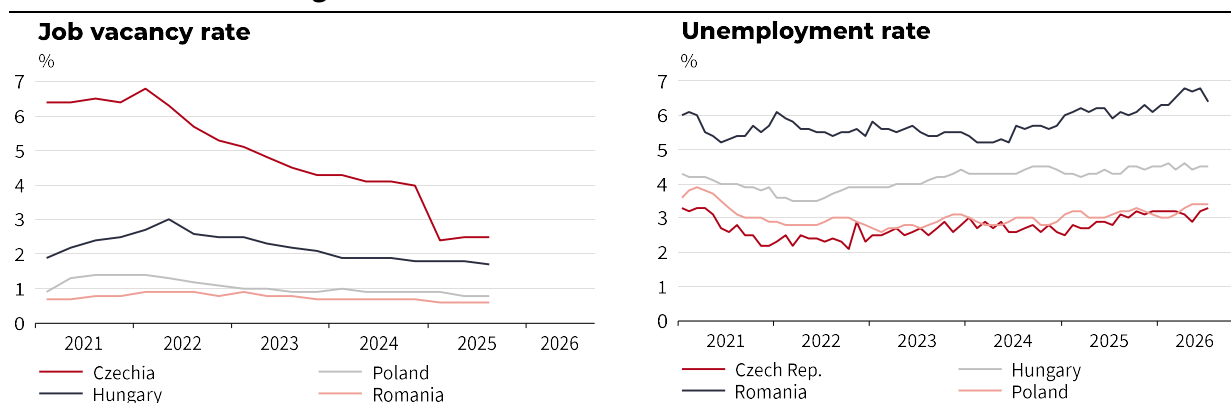
Following the end-2026 NGEU deadline, ESI funds are expected to gradually take over.



Source: European Commission, SG Economic and Sector Studies

Inflation is proving persistent. Elevated oil and gas prices are keeping headline inflation above target and eroding purchasing power across the region. Poland and Czechia also face domestic price pressures from resilient demand, wages and fiscal support, while tax increases are adding to inflation in Romania. In Poland, the central scenario remains an extended pause, but stronger or more persistent inflation could bring rate hikes back into consideration. In Czechia, sticky core inflation and fiscal stimulus have increased the risk of renewed monetary tightening, while Hungary retains greater scope for easing but remains exposed to currency depreciation and energy-price pressures. Nevertheless, the energy shock should be less destabilising than in 2022. More diversified supplies, lower energy intensity and less tight labour markets should contain second-round effects and limit the risk of another wage-price spiral.

Lower labour-market tightness limits second-round effects.



Source: LSEG, SG Economic and Sector Studies

Risks to growth and financial stability remain tilted to the downside. Fiscal risks are shifting upwards. Higher borrowing needs due to expansionary fiscal policy could put upward pressure on bond yields and rating prospects in Poland. Romania remains the most exposed to downgrade risk, given weak growth, political uncertainty and implementation risks around EU funds. Slovakia's deteriorating debt trajectory and Hungary's unresolved access to EU funding also warrant close monitoring. In addition, the war in Ukraine and hybrid threats remain major tail risks. The absence of a credible settlement, together with drone incursions, cyberattacks and interference, will sustain defence costs and investor uncertainty, particularly in Poland and Romania.

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