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Société Générale Economic & Sector Studies

Central banks at Crossroads

- Economic growth at a standstill and declining inflation supports our scenario of a first rate cut from the ECB in the spring. With fiscal tightening underway, doing too little too late on monetary policy would likely tip the economy into recession.
- The US economy has shown surprising strength, but signs of softer momentum are visible, and concerns remain on commercial real estate. With inflation making steady decline, we look for a first rate cut this spring. The key question for the US is the future fiscal stance, with the upcoming presidential election in November adding to this uncertainty.
- The pace and the form of monetary policy normalization on both sides of the Atlantic will continue to shape the market debate in 2024, with focus shifting increasingly to the management of central banks large balance sheets. Both the Fed and the ECB are entering unchartered waters and volatility spikes cannot be ruled out.
- China continues a difficult balancing act of ensuring orderly deleveraging of the economy and management of the resulting real estate crisis. In this context, the role of fiscal policy will remain key. At this stage, announcements point to some policy support, but further measures are required for growth to reach the official 5% target for 2024.
- More broadly, emerging market economies will benefit from already easing monetary policies and Fed rate cuts in the US. However, growth trajectories are very different from a region to another. Most dynamic ones being in Asia and Middle East oil exporters.
- Climate transition investments are likely to support global growth. This will be more difficult in riskier or less developed countries with more limited access to international capital and where fiscal space is small and local financial sector less developed.
- Geopolitical fragmentation and the return of (protectionist) industrial policies adds risks of divergence and frictions. Political risks to remain elevated in 2024.

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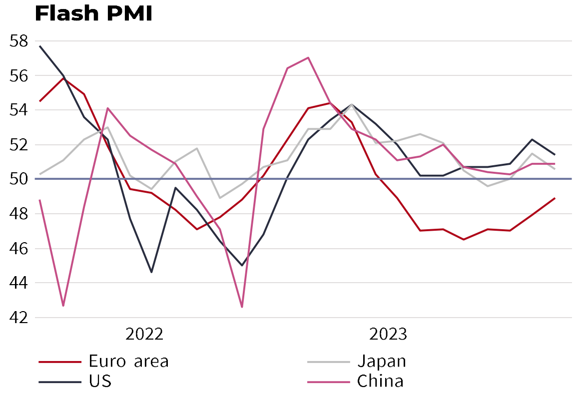
EDITORIAL

GETTING CLOSER TO THE DECISION POINT

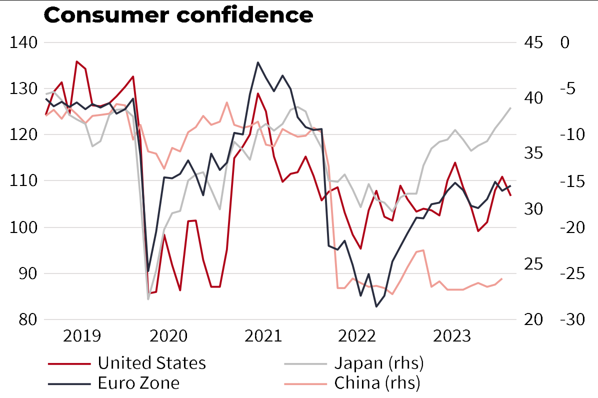
Since the end of 2023, global economic momentum seems to have bottomed out but there is no take off. Overall, activity remains weak, still affected by tight monetary policies with a number of geographies also seeing tight fiscal policies. In this context, the slight improvement in confidence indicators does not seem to point to a durable recovery. Risks remain still tilted to the downside.

Enterprises still hesitant…



Source: SG Economic and Sector Studies

…as well as consumers



Source: SG Economic and Sector Studies

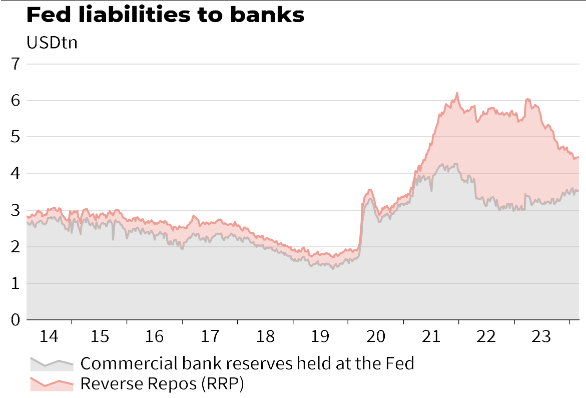
At this stage the global environment remains characterized by the weakness of growth prospects. The consensus prospects for the next five years point to one of the weakest periods of GDP growth in the last thirty years.

This takes its roots on the tighter policy mix in developed markets at least for the next two years and the weaker rebound capacity for emerging markets economies.

Regarding developed markets (DM), the pace of disinflation and signs of lesser tensions in the labour markets should set the path for first rate cuts in the first half of 2024. However, the level of interest rates will remain above what we could consider as expansionary. Moreover, quantitative tightening is expected to continue on both sides of the Atlantic in 2024.

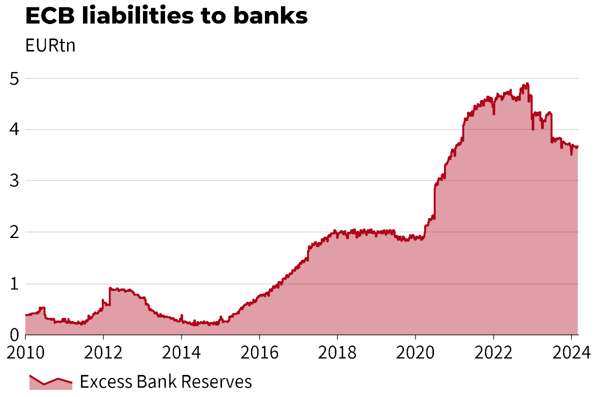
On the fiscal side, we factor in some tightening in the US, but uncertainty is significant with the upcoming Presidential elections. The reactivation of the fiscal rules in the euro area will see ongoing tightening of fiscal policy. Japan is expected get out of its negative rate policy in the second half of the year in a context of still high inflation but contracting household incomes. The fiscal stance will be on the tightening side as a lot of measures related to address soaring energy prices will be removed.

Looking for the right level of banks reserves...



Source: SG Economic and Sector Studies

... will be key for future liquidity conditions



Source: SG Economic and Sector Studies

No unified narrative for Emerging Market Economies but a more fragmented landscape.

Emerging market economies (EMEs) have different stories but face a common headwind from weak DM demand and a more fragmented geopolitical landscape. Fiscal room will remain limited and unlikely to be a major growth driver. On the positive side, EMEs should globally benefit from already easing monetary policies in some regions and from the prospects of the first rate cut in the US. Some countries, such as India, moreover, still benefit from positive internal growth dynamics. The infrastructure and climate transition related investments are likely to remain growth drivers depending on the ability of different countries to channel the funds.

Growth should be the most dynamic in India and the GCC. These countries are benefiting from large public investment programs related to infrastructures (India) and national transformation plans (energy transition, diversification) in the Gulf.

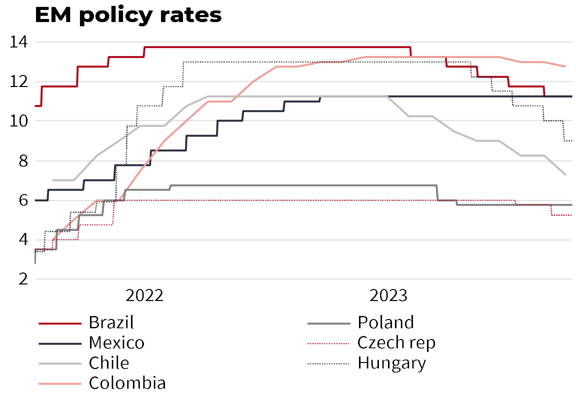
In emerging Asia, Korea, Malaysia and Taiwan should benefit from the recovery in the semiconductor cycle while Indonesia and Philippines are confirming strong growth potential thanks to demographic and investment dynamics. This is contrasting with China which faces a structural headwind from high indebtedness and the related real estate crisis. This being said, the National Popular Congress recently stated target of 5% GDP growth for 2024 (above our forecast of 4.3%) implies a more significant fiscal effort not yet observed.

In Latin America, even though the region suffers from structurally low investment and weak productivity gains, GDP could surprise on the upside given monetary easing has already started and prospects of mining sector investment in critical materials could support medium term growth.

As for Central and Eastern Europe, growth should broadly remain affected by the euro area weakness as well as uncertainties related to the war in Ukraine.

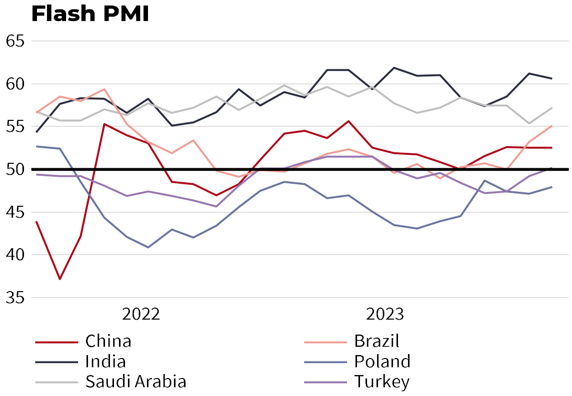
In Africa, growth prospects are not enough to ensure a proper income per capita improvement in years to come. The region remains fragilized by high levels of debt and political instability.

Monetary easing started



Source: SG Economic and Sector Studies

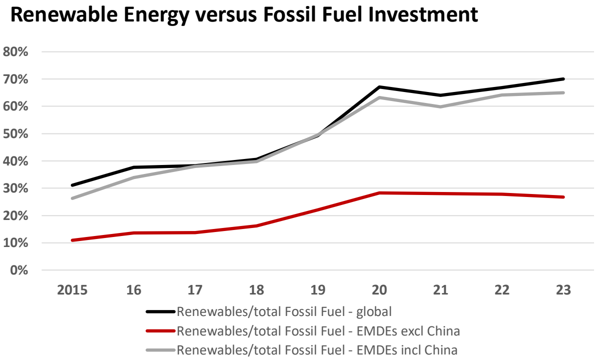
Different activity dynamics



Source: SG Economic and Sector Studies

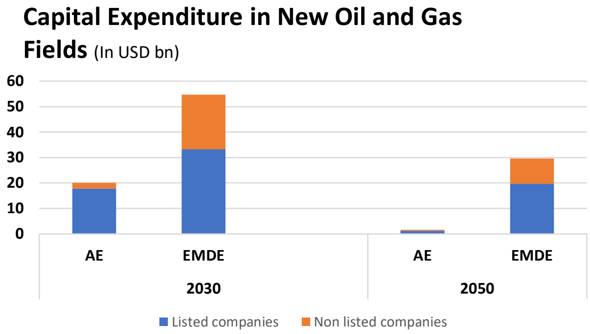
Climate transition investment is likely to remain a growth driver in the EMEs in the medium term even though financial needs are significant. Regarding climate transition related investment needs, the International Energy Agency estimates that EMEs will need about USD 2tn of investment per year (about 4.6% of EMEs 2023 GDP every year, about 40% of global investment needs) by 2030 to achieve net zero emissions in 2050. This is five times more than USD 400bn currently planned over the same period. Given the limited fiscal space to channel public investment it is estimated that between 80 to 90% financing need will have to be covered by private sector funds. This raises the question of the development of local financial systems and access to international finance from DMs. While these might be more achievable by large middle income EMEs, it will be much more complicated for lower income economies almost totally reliant on international finance.

Investments remain low in renewables…



Source: SG Economic and Sector Studies, IMF

…and high in hydrocarbons



Source: SG Economic and Sector Studies, IMF

Regarding climate physical risks, the potential effects of El Nino in 2024 have to be closely monitored as estimates point to a high risk that it will lead to one of the hottest years ever. This is likely to have significant impacts notably on agriculture and risks of wild fires.

Geopolitical fragmentation will remain a threat to growth and financial stability.

In the last fifteen years the idea of several forms of fragmentation has emerged. It started with the Global Financial Crisis opening the gate to the possibility of global financial fragmentation. Rising protectionist measures since then, which intensified in 2017-2018 have raised the idea of trade and supply chains fragmentation. The question of the climate transition and new competition in green technologies is also weighing in. Concerns on supply chains latter has been exacerbated by the Covid crisis, the war in Ukraine, Red Sea attacks and worries around the Taiwan strait.

Sanctions and industrial protectionist policies exacerbates financial fragmentation. While different forms of protectionism restrain technologic diffusion.

As observed over the period the share of financial and trade flows tended to stagnate as a share of world GDP while the number of trade restriction imposed has increased. Hence the benefits of past globalization effects risk are likely to fade in the years to come weighing on growth and financial stability.

ECONOMIC FORECASTS

GDP % ch yoy	2024f	2025f	2026f
Developed Markets	**0.9**	**1.4**	**1.4**
United States	1.7	1.5	1.8
Japan	0.6	0.5	0.6
United Kingdom	0.2	0.9	0.9
Euro area	0.5	0.8	1.1
Germany	0.1	0.6	1.0
France	0.5	0.7	1.1
Italy	0.5	0.6	0.8
Spain	1.4	1.1	1.4
Emerging Markets	**3.7**	**3.7**	**3.6**
Asia	4.4	4.4	4.3
China	4.3	4.0	3.8
India	6.1	6.2	6.2
Central and Eastern Europe	1.9	1.9	1.9
Czech Republic	1.6	2.0	2.1
Romania	2.8	2.8	2.8
Latin America	2.3	2.4	2.4
Brazil	1.6	1.9	2.0
Middle East & Central Asia	3.3	3.4	3.1
Africa	3.5	3.8	3.8
World (PPP weighted)	**2.6**	**2.9**	**2.8**

%, EoP (unless otherwise indicated)	14 March	2024f	2025f	2026f
Fed Funds target (high)	**5.50**	4.25	3.00	3.00
Gov 10Y, US	**4.19**	3.75	3.25	3.50
ECB Refinancing rate	**4.50**	3.25	2.25	2.25
ECB Deposit facility rate	**4.00**	2.75	1.75	1.75
Gov 10Y, Germany	**2.36**	2.25	1.75	2.00
Gov 10Y, France	**2.79**	2.75	2.25	2.50
Gov 10Y, Italy	**3.59**	4.05	3.55	3.80
Gov 10Y, Spain	**3.15**	3.25	2.75	3.00
BoE, Bank rate	**5.25**	4.75	3.50	3.25
Gov 10Y, United Kingdom	**4.02**	4.00	3.50	3.50
BoJ, bank rate	**-0.10**	0.00	0.00	0.00
Gov 10Y, Japan	**0.76**	0.75	0.80	0.85
EUR / USD	**1.09**	1.05	1.10	1.15
EUR / GBP	**0.86**	0.90	0.90	0.90
USD / JPY	**148**	140	125	125
USD / CNY	**7.2**	7.2	7.0	7.1
EUR / CZK	**25.2**	24.0	24.0	24.0
EUR / RON	**5.0**	5.0	5.0	5.0
Oil Brent (USD/b)	**84**	75	70	70
European Natural Gas (TTF, EUR/MgW/h)	**25**	50	50	45
EU ETS carbon (EUR/Metric ton)	**54**	80	90	100

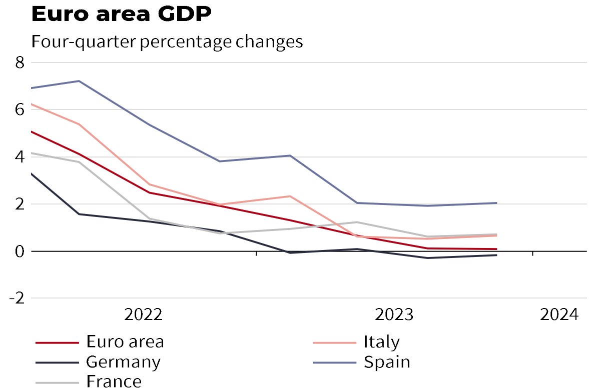
EURO AREA

- **Activity remains weak. Growth will continue to slow down in 2024, and remain modest in 2025 amid a tighter policy mix**
- **The labour market tensions are easing in France and Germany and not yet in Italy and Spain but we expect unemployment to rise in the coming quarters.**
- **The ECB will lower rates from spring 2024. Monetary conditions will nontheless remain tight amid the ongoing Quantitative Tightening and weak bank credit.**

The monetary union registered two consecutive quarters of contraction in the second half of 2023 as the region displays weak consumption and suffers from the weakness in international trade. So far public consumption contributed positively as the fiscal policy remained supportive. This should not be the case in 2024-2025. At this stage, Germany appears as the weakest link in the European economy on the back of contracting investment and sluggish private consumption.

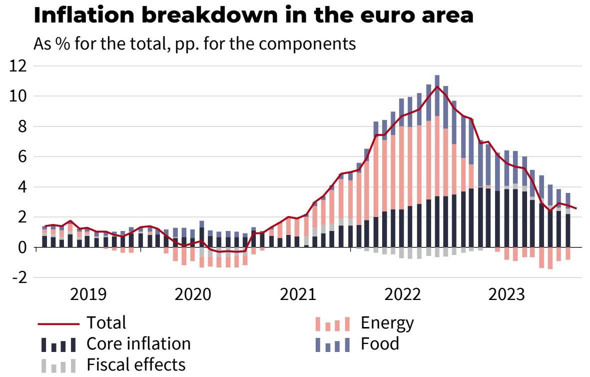
In 2024, activity will continue to slow, before picking up again very modestly in 2025. After the dynamism of the post-pandemic period, the labor market will be less buoyant, with the unemployment rate starting to rise again from 2024. Household demand will be affected by these headwinds. By 2025, financial conditions will remain tight and fiscal consolidation will continue, preventing any significant acceleration in activity. Risks to this scenario remain predominantly bearish, notably due to the delayed effects of synchronized fiscal and monetary policy tightening. Uncertainty surrounding the evolution of energy prices has diminished, but the global geopolitical situation could lead to a return of volatility.

Ongoing slowdown.



Source: Eurostat, SG Economic and Sector Studies

Ongoing disinflation but still sticky



Source: Eurostat, SG Economic and Sector Studies

Growth in investment spending will also fall sharply in 2024, after a rather resilient year, and the rebound will be moderate in 2025. On the corporate side, weakening demand, rising external financing costs, and continuing high uncertainty will weigh on business momentum, despite resilient operating profitability. On the household side, residential investment will continue to slow. Demand is being held back by elevated mortgage rates and the continuing high cost of building work. Here too, only a modest rebound is expected in 2025.

Growth in household consumption will be weak over the forecast horizon. Purchasing power recovered in 2023, thanks to lower inflation, higher wages, and public transfers. But its momentum will be modest in 2024-25. With inflation falling, companies will seek to preserve their profitability by moderating growth in unit labour costs. As a result, wage growth will be more modest, as will employment growth, leading to a rise in the unemployment rate. Lower savings rates, which have not yet normalised in all economies, will be the main source of support for consumption. The savings reserves built up since the pandemic, soon to be exhausted, will offer only a limited source of growth.

From 2024 onwards, the reactivation of European budgetary rules and the ensuing fiscal consolidation will act as a brake on activity. At the height of the energy crisis, governments expanded their arsenal of measures to support the purchasing power of households and businesses, but these measures are now being reversed. In 2024-25, member states' budget plans point to a general tightening of fiscal policy against a backdrop of rising interest rates. On the investment front, some member states will nevertheless continue to benefit from support under Next Generation EU. Overall, fiscal policy, which has been an important support for activity over the past three years, is likely to be a major brake on further acceleration of activity in the medium term.

Inflation will continue to fall in 2024 and 2025, modulated by energy price trends. It should converge slightly below the ECB target in 2026-2027 in a context of slow demand and still high debt. Underlying inflation remains high but has also begun to fall with the slowdown in demand orchestrated by the tighter policy mix from 2024 onwards. The ECB has lingering concerns on wages even though end Q4-2023 figures showed some slowdown in euro area compensation of employees and on negotiated salaries.

In this context of slowing demand and landing inflation, the ECB should start its first cuts in spring 2024. However, the monetary policy should remain on a tight stance in the coming two years as the central bank will continue to reduce the size of its balance sheet. The slowdown in activity and falling inflation will lead the ECB to gradually reduce its rates to just below 2% in 2025. At the same time, as inflation remains on target, the balance sheet will continue to shrink, as the Asset Purchase Programme (APP) and the Pandemic Emergency Purchase Programme (PEPP) wind down from 2025 onwards. Overall, monetary policy will remain neutral or even slightly restrictive over the forecast horizon.

The announcement of the new operational framework on 13th of March indicates that the ECB aims at reviving the interbank market in a context of ample bank reserves.

This framework should start to take full effect in 2 or 3 years depending on the minimum level of excess liquidity effectively binding for the banking sector. Excess reserves are currently at 3.5trn and several estimates point to such minimum level being close to 1.5trn.

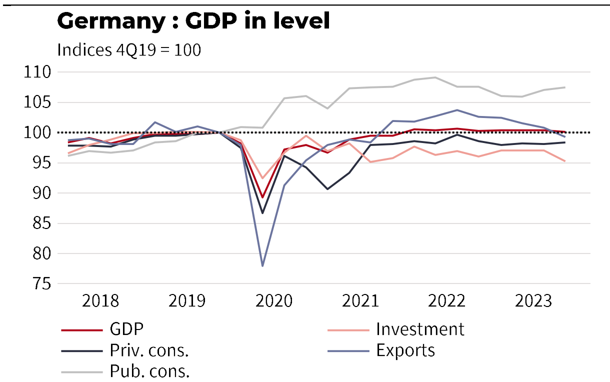
Euro area	2023	2024f	2025f	2026f
Real GDP, % ch yoy	0.5	0.5	0.8	1.1
Household consumption	0.5	0.6	0.7	0.9
Public consumption	0.3	1.1	0.7	0.8
Investment	0.8	0.5	0.8	1.4
Exports of goods & services	-0.8	1.2	2.9	2.9
Imports of goods & services	-1.2	1.5	2.8	2.9
Inflation, % annual average	5.4	2.5	2.3	2.0
Core inflation, % annual average	5.0	2.6	2.2	2.0
Real gross disposable income (GDI), % change	1.2	0.0	0.1	0.6
Households saving rate, % of GDI	14.2	13.7	13.2	13.0
Unemployment, % of labour force	6.5	7.0	7.4	7.5
Fiscal balance, % of GDP	-3.2	-3.3	-3.2	-3.1
Public debt, % of GDP	90	92	94	95
Current account balance, % of GDP	1.8	2.0	2.1	1.8

GERMANY

- **The German economy will remain stagnant in the wake of a sluggish internal demand after a 2023 in recession.**
- **Upward pressures on unemployment, particularly in industry, will continue in the short term.**
- **The impact of lower inflation and interest rates on consumption and investment will be dampened by uncertainty and caution.**

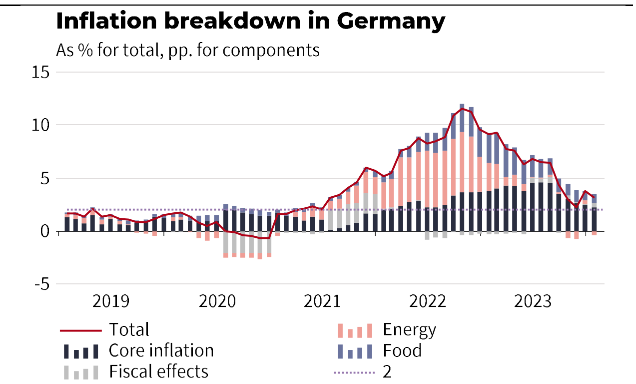
Following a difficult year marked by a moderate recession, the German economy will only recover modestly in 2024-25. The expected rebound in exports after a particularly challenging 2023 will be limited by the projected slowdown of global demand and ongoing frictions in trade. The annulment of the budgetary trajectory by the Constitutional Court, which included significant electricity price subsidies for industry, is a new headwind for the sector. The main driver of growth will come from the decline in inflation and interest rates, but activity will evolve below its trend potential rate and unemployment will continue to rise, following the trajectory that began in 2023. The balance of risks remains deteriorated. The industry and households remain exposed to high energy prices, while government action is at an impasse. Longer term, the competitiveness of the German economy, its export capacity, and its growth potential risk being undermined by the structural challenges posed to its industry by the energy transition and geopolitical tensions.

GDP stagnates and only public consumption surpasses the 4Q-19 level



Source: Destatis, SG Economics and Sector Studies

Energy prices are kept in check as deflation persists



Source: Eurostat, SG Economics and Sector Studies

The recovery of foreign trade and particularly the strength of exports will remain modest over the forecast horizon, with growth rates significantly lower than those observed before the pandemic. German exports will face slow foreign demand, notably from China, one of its key trading partners, and the European block and exports are set to stagnate in 2024. Unit labour costs, which have been increasing for a decade, combined with increasing competition from China in sectors where the German industry has strong comparative advantages, will be a brake on growth in the medium term. This is particularly true in the automobile sector, which, despite being significantly more resilient than the rest of manufacturing in 2023, will face significant challenges to maintain its position in the market in a context of sector transformations to accommodate the production of low-emission vehicles. More broadly, the need to ensure the energy transition poses a structural challenge for key, highly polluting sectors in the country such as chemistry, steel, and automotive. Their transformation is at the heart of the transition but makes them vulnerable to significant losses in competitiveness.

Investment will contract in 2024 and remain on modest trajectories compared to its pre-pandemic behaviour in the medium run. Over the forecast horizon, the total investment rate will be a fraction of the historical annual average growth rate of 2.2% observed between 2005 and 2019. A dampened expected total demand and high equipment costs will act as brakes on productive investment, despite the improving profitability of NFCs since 2023.

Turning to residential investment, this is facing a significant slowdown due to high interest rates and high material prices. Despite a significant correction in real estate prices in 2023 (between 9% and 20% according to the Kiel Institute), the delayed transmission of the ECB's still restrictive monetary policy should persist in 2024. Also, the implementation of climate policies that requires significant investments constitute a persistent upward pressure on input prices. Half of the buildings in the Germany need renovations to meet medium-term emissions targets which includes the installation of expensive low-carbon heating systems. These renovations are also being slowed down by high costs. Finally, public investment will stay subject to the uncertainty of Germany's fiscal policy.

Household consumption will begin to recover as early as 2024, but at a lacklustre pace. The slowdown in inflation, both for its headline and core, will lead to an improvement in disposable income and consumption for households. The evolution in the household's real disposable income will reach from below the its 2010-2019 mean of 1.6% yearly growth. However, the deterioration of the labour market and the moderation of wage increases will limit the recovery of consumption. As for savings, the use of excess savings acted as a relay and driver for growth since the health crisis, but precautionary behaviour of consumers is now kicking in. The gross savings rate is still significantly above its pre-pandemic average and has increased by nearly 1pp, surpassing the 20% threshold in 2023 after two years of stark declines.

Uncertainty over fiscal policy extends into the forecast period with a fragmented coalition government lacking agreements to accommodate the Constitutional Court decision. The country continues to reduce its public debt in the wake of a budget consolidation process that has accelerated to conform with the debt brake which limits the deficit to 0.35% of GDP. This limit has become more stringent with the Karlsruhe decision, which invalidated the multi-annual budget trajectory and triggered the elimination of special funds outside the budget. This includes the climate fund KTF (EUR 60bn by 2027), the economic stabilization fund WSF (EUR 200bn), which financed aid to agents during the pandemic and energy crisis, and the reconstruction fund created following the 2021 floods. Overall, the financing gap is estimated to be around EUR 20bn, and programs such as electric car purchase subsidies and industry subsidies to address rising energy prices have already been phased out. In the short term, this budget constraint prevents counter-cyclical measures for the productive sector that seem necessary. The coalition is in political gridlock and has yet to find a solution to engage in effective fiscal policy while respecting budget rules. The possibility of a debt brake flexibilization has been suggested, notably by the Council of Economic Experts, but there seems to be no political space to carry such a reform. Without measures to accommodate to this context, the prospect of a more stringent budget consolidation worsens the risk balance and questions Germany's ability to meet its climate goals and address structural issues in its economy.

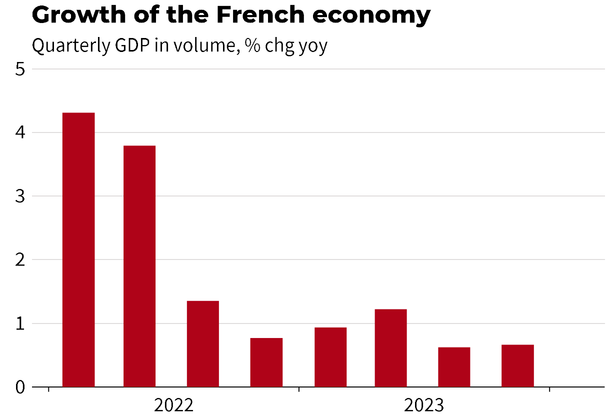
Germany	**2023**	**2024f**	**2025f**	**2026f**
Real GDP, % ch YoY	-0.1	0.1	0.6	1.0
Household consumption	-0.6	0.3	0.6	0.9
Public consumption	-1.5	0.8	0.7	0.9
Investment	-0.2	-1.0	0.1	1.4
Exports of goods & services	-1.7	0.0	2.8	2.9
Imports of goods & services	-3.0	-0.5	3.0	3.0
Inflation, % annual average	6.0	2.7	2.2	2.0
Core inflation, % annual average	5.1	2.8	2.2	2.0
Real gross disposable income (GDI), % change	-0.1	0.1	0.3	0.8
Households saving rate, % of GDI	20.5	20.6	20.3	20.2
Unemployment, % of labour force	5.7	6.0	6.1	6.3
Fiscal balance, % of GDP	-2.2	-2.7	-2.5	-2.2
Public debt, % of GDP	65	65	66	67
Current account balance, % of GDP	6.8	5.7	5.7	5.5

FRANCE

- **After better-than-expected performance in 2023, activity is expected to slow in 2024 and remain lacklustre in 2025, before starting a gradual recovery from 2026 onwards.**
- **Inflation is expected to return to the 2% target.**
- **The current account deficit, which narrowed in 2023, is not expected to deteriorate further over the forecast horizon.**

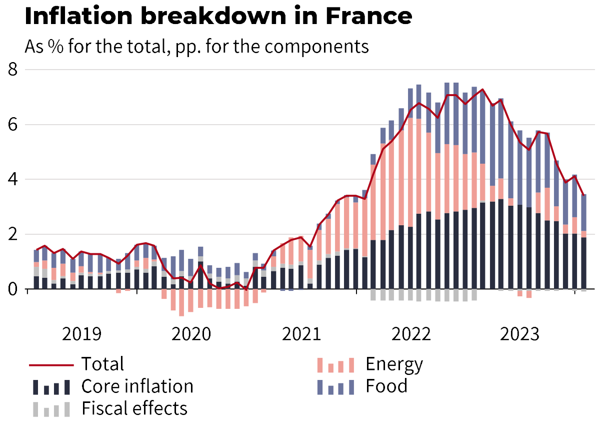
Lacklustre growth outlook for 2024. In 2023, the main drag on growth came from weak household consumption and investment. Business investment and foreign trade, including strong export performance and a sharp contraction in imports associated with lower energy imports, supported economic activity. With less room to raise prices, as in 2021 and 2023, firms will seek to moderate growth in unit labour costs and the projected decline in inflation over the forecast horizon should therefore be accompanied by higher unemployment and ultimately relatively sluggish growth in purchasing power, and hence in household consumption and investment. Credit and the government deficit will provide no stimulus to activity, owing to lags in the transmission of monetary policy and fiscal consolidation. Nor will the international environment be particularly supportive; global demand is projected to remain soft.

A marked slowdown in 2023



Source: INSEE, SG Economic and Sector Studies

Disinflation continues



Source: INSEE, SG Economic and Sector Studies

Export growth will remain subdued over the forecast horizon due to weak external demand. However, the current account deficit is expected to narrow as the energy bill falls. External demand has weakened markedly, notably among France's European trading partners. The volume of exports remains behind its 2019 level, notably due to the very gradual recovery of exports of transport equipment goods, particularly in aeronautics. The current account deficit, which reached almost 2% of GDP in 2022, partly due to this weak export momentum, narrowed in 2023, as the energy bill deflated. Indeed, France is once again a net exporter of electricity thanks to the normalization of nuclear production, imported energy prices have fallen sharply, the need to replenish gas stocks is lower than at the end of the winter 2021-22. However, the path of the current account balance will remain exposed to fluctuations in the price of imported energy.

Business investment, which has shown resilience so far, is expected to slow in 2024 as profits decline and financing costs remain high. Slower demand will reduce firms' pricing power and thus induce a normalization of their operational profitability. Moreover, credit conditions will remain tight in response to rising business failures, which should reduce the appetite for new investment. Productive investment is therefore expected to slow this year.

Household demand is expected to remain modest. Residential investment will contract for the third consecutive year in 2024, before recovering modestly from 2025. Persistently high interest rates, credit scarcity, and high construction costs are expected to continue to constrain household investment. Consumption is also expected to remain subdued, with rising unemployment and slowing wages growth, and fiscal consolidation weighing on purchasing power.

The fiscal trajectory is not expected to recover quickly. The fiscal consolidation that the government is pursuing will have an impact on real growth over the medium term. Sustained high interest rates are expected to weigh on debt servicing. Price increases, which are expected to be much less vigorous from 2024 onwards, will finally be less supportive of nominal growth. Overall, after relative stability in 2023, the public debt ratio is projected to increase from 2024 onwards, reaching 114 % in 2025.

The decline in consumer prices, which began in mid-2023, is expected to continue, falling below 3% in 2024. In 2023, stable inflation was driven by strong increases in food prices that offset energy disinflation, as well as second-round effects on prices of goods and services. In 2024, moderating inflation will be enabled by slower demand. However, given the risks to the outlook for energy prices, this outlook remains subject to upside risks.

The balance of risks remains balanced but worsened. The risks associated with the energy crisis have dissipated, but they will remain if the conflict in Ukraine persists. The risk of a stronger structural consolidation of public finances than currently projected should be monitored. It is important to note that budgetary support for greening is still ongoing. France's "green budget" has more resources, with an increase of EUR 7bn in spending on ecological planning (reallocating part of the money freed up by the planned increase in taxes on gas and electricity).

France	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.9	0.5	0.7	1.1
Household consumption	0.7	0.9	0.9	1.3
Public consumption	0.5	0.9	0.9	0.8
Investment	1.2	0.0	1.2	2.0

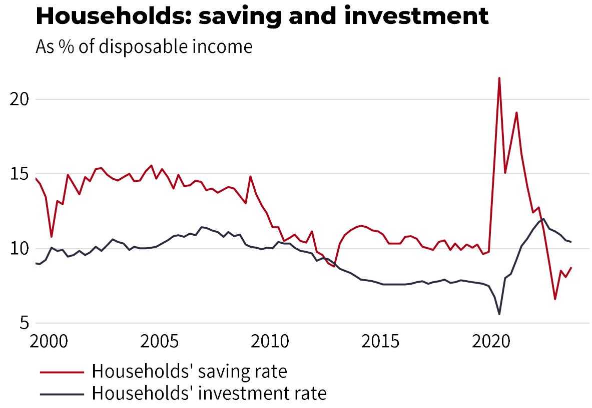
Exports of goods & services	1.5	0.9	2.0	2.4
Imports of goods & services	-0.3	-1.1	2.8	3.1
Inflation, % annual average	5.7	2.5	2.0	2.0
Core inflation, % annual average	4.0	2.3	2.0	2.0
Real gross disposable income (GDI), % change	0.7	0.4	0.2	0.2
Households saving rate, % of GDI	17.7	17.0	16.4	15.4
Unemployment, % of labour force	7.1	8.0	8.3	8.6
Fiscal balance, % of GDP	-4.8	-5.2	-5.1	-5.0
Public debt, % of GDP	110	111	114	116
Current account balance, % of GDP	-1.2	-0.6	-0.5	-0.6

ITALY

- **Italian growth outperformed the euro area in 2023, but will slow significantly in 2024 and 2025, below potential growth.**
- **Purchasing power is set to contract slightly in 2024 after a very small increase last year, and the savings rate would remain at a historically low level.**
- **Public debt is set to return to an upward trajectory as of next year.**

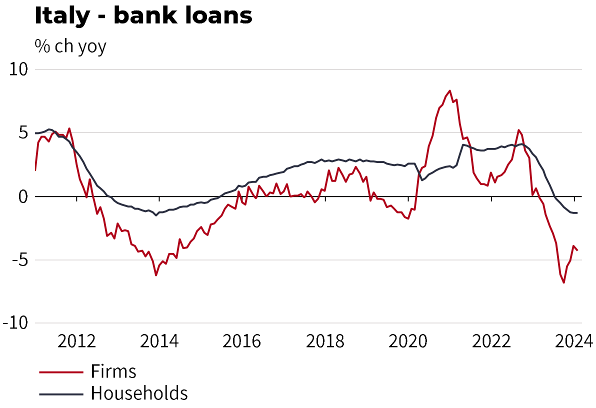
Italian GDP is forecast to grow modestly in 2024 and 2025, remaining below its trend potential growth. Growth held up well to the slowdown in the euro area in 2023, ending the year at 1%. GDP has been driven by strong investment growth, supported by Next Generation EU funds and now 30% above its pre-covid level. There has been a boom in housing investment (+80% since 4Q19), with government subsidies for renovation. DP is now 4.2% higher than in 4Q19. While households and businesses have so far weathered the inflationary spiral and tighter financial conditions, the economic situation is deteriorating for all economic agents.

Slight rebound of the saving rate



Source: Istat, SG Economic and Sector Studies

Strong contraction of credit to firms



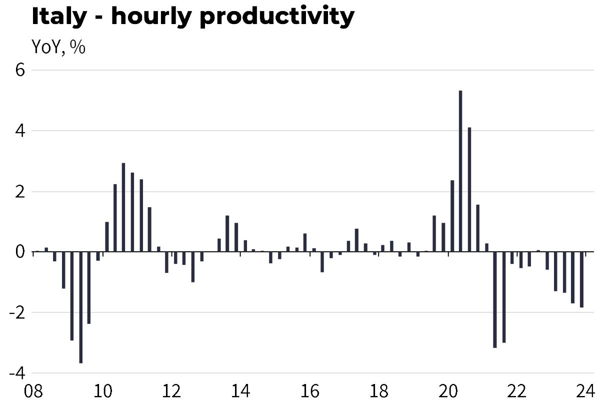
Source: ECB, SG Economic and Sector Studies

After two years of losses in purchasing power, household income is expected to stabilize in real terms in 2024. Negotiations have led to hourly wage increases, particularly in industry, which will support purchasing power in a context of slowing inflation. However, subsidies to households will be less generous than in 2023, with notably the withdrawal of "energy vouchers" that have enabled households to cope with the energy crisis. The savings rate, already at an all-time low, is expected to decline in 2024 before stabilising below 9%. Household consumption is expected to remain sluggish over the next two years.

Inflation is expected to slow sharply in 2024 and 2025 thanks to lower energy prices. Core inflation is expected to remain above the ECB's target, and food prices are expected to rise by more than 5% in 2024. However, the risks of a wage-price loop are limited in Italy due to a labour market based on collective bargaining, with a very slow process of renewal of sectoral agreements, low indexation of wages to prices and the absence of productivity gains for 20 years.

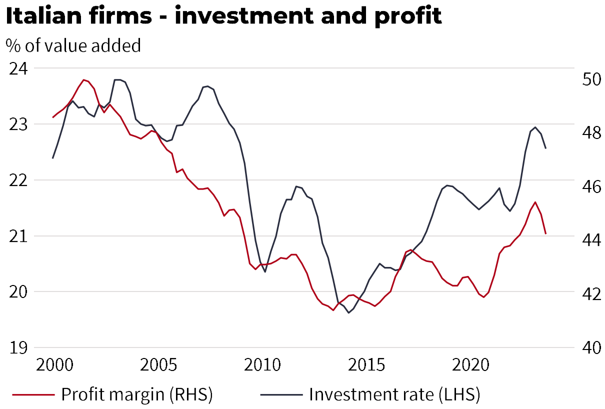
Employment is expected to contract from 1Q24 after two years of strong job creation. The effect of monetary policy tightening is beginning to be felt on business confidence and margins, which will limit hiring. In addition, the decline in hourly productivity observed over the past two years will prompt companies to try to restore their margins, not least in a context of weak demand prospects. The unemployment rate is forecast to rise to 8.3% of the labour force by 2025. The low participation of women in the labour market and the high inactivity rates of younger people remain a structural challenge for the Italian economy.

The decline in hourly productivity ...



Source: Istat, SG Economic and Sector Studies

... is weighing on firms' margins



Source: Istat, SG Economic and Sector Studies

Business investment is expected to slow in 2024, after three years of record growth. Investment in capital goods is slowing down, but still on the rise, fuelled by European subsidies. However, investment in construction is expected to contract in 2024, due to the end of very advantageous state aid for housing renovation. Credit conditions are tightening and outstanding corporate loans are contracting by 5% YoY. Credit contraction and weak investment growth are expected next year.

European funds support the economy. The modified plan, including the REPowerEU chapter, has further strengthened the focus on the green transition, devoting 39% of the available funds to measures that support climate objectives. Key investments for the green transition are : i) energy efficiency in residential and public buildings (EUR 16.9bn), ii) sustainable mobility (EUR 34.5bn), iii) development of renewable energies and the circular economy and improvement in waste and water management (EUR 24.7bn). There will be about EUR 105bn of funds available to the Italian government by 2026 (5.2% of GDP), and therefore a strong incentive to maintain a cooperative attitude with the European Union and implement key structural reforms, in particular the overhaul of the judicial system.

The primary balance is expected to fall from -1.6% to -1.0% of GDP in 2024. This is far from returning to a primary surplus of 2%, a necessary condition to secure a declining trend in the Italian general government debt. The cost of extraordinary measures to support households and businesses will fall this year, due to lower energy prices, saving around 1 percentage point of GDP. However, the Italian government has adopted or extended fiscal measures in favour of households, the total cost of which is around 0.7% of GDP. These include, on the revenue side, the prolongation to 2024 of cuts to social security contributions for those on low- and medium-incomes; a tax deduction for enterprises hiring employees on a permanent basis; and a first step of the general tax reform which (i) merges the first and second income tax brackets, (ii) increases the no-tax area and (iii) revises tax deductions on high incomes.

Public debt is forecast to resume an upward trajectory. Past interest rate hikes and weak growth will weigh on public debt dynamics over the medium term. In 2023, public debt is still 5 points above its pre-Covid level and is expected to resume an upward trajectory to reach nearly 146% of GDP by 2026.

The public debt situation generally remains vulnerable to the risk of increased sovereign tensions following a deterioration in debt sustainability and/or speculative attacks on financial markets. The backstop established by the ECB through flexibility in the reinvestment strategy of maturing PEPP assets and the new Transmission Protection Instrument (TPI) should limit the risks of excessive movements in financial markets. The TPI, however, has yet to be tested and is only operational for member states respecting the EU fiscal rules.

Italy	**2023**	**2024f**	**2025f**	**2026f**
Real GDP, % YoY	1.0	0.5	0.6	0.8
Household consumption	1.2	0.2	0.3	0.5
Public consumption	1.2	0.4	0.4	0.4
Investment	4.9	2.4	1.4	1.6
Exports of goods & services	0.5	2.2	2.1	2.3
Imports of goods & services	-0.2	0.9	2.0	2.2
Inflation, % change	5.9	2.2	2.0	2.0
Core inflation	4.5	2.6	2.4	2.2
Real gross disposable income (GDI), % change	0.3	-0.2	0.4	0.6
Households saving rate, % of GDI	8.9	8.6	8.7	8.9
Unemployment, % of labour force	7.7	8.0	8.3	8.2
Fiscal balance, % of GDP	-5.3	-5.1	-5.0	-4.9
Public debt, % of GDP	140	142	144	146
Current account balance, % of GDP	0.2	1.2	1.2	1.1

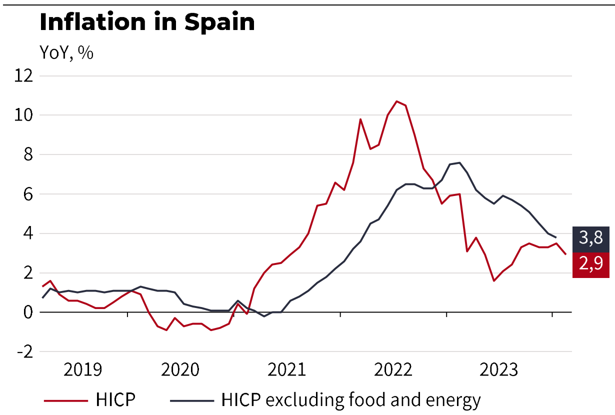
SPAIN

- **Growth is expected to slow significantly in 2024 and remain below potential in 2025.**
- **Households purchasing power will decline in 2024 and unemployment is set to rise.**
- **The country will only partially reduce its budget deficit and public debt is set to stabilize close to 111% of GDP.**

Activity is set to slow significantly in 2024, and growth will remain below potential in 2025. However, it will remain higher than that of its European partners, supported by the strong increase in household disposable income (10% in 2023 and 4% in 2024). The tight labour market is expected to turn around in 2024, and unemployment is set to rise. The tightening of financial conditions will continue to impact companies in financing their investments, while household income held up rather well to the rise in interest costs, which took 0.5pp of purchasing power last year.

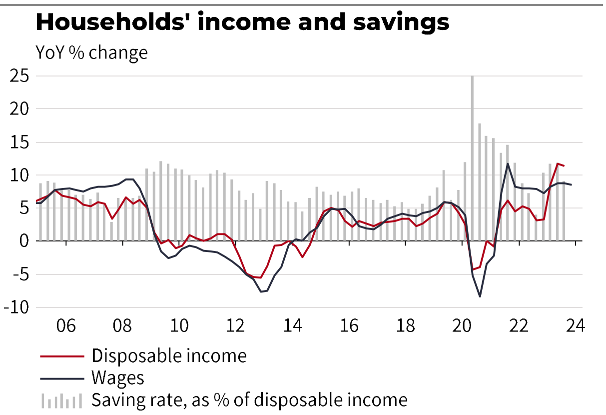
Growth held up well in 4Q23, thanks to favourable external demand and restocking, despite a sharp decline in business investment. Investment contracted in all its components (construction, equipment, and intellectual property), putting an end to two years of growth.

A slow deceleration in prices ...



Source : INE, SG Economic and Sector Studies

... and a strong increase in disposable income



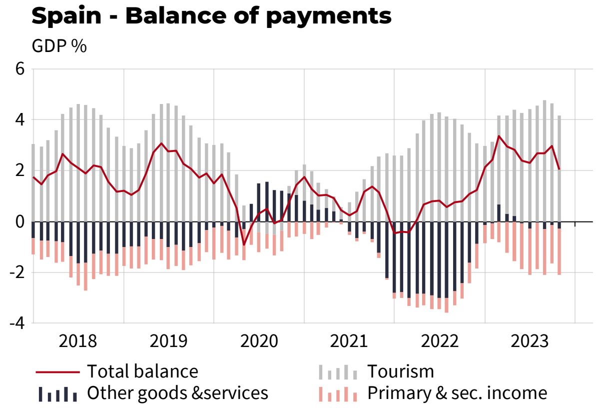
Source : INE, SG Economic and Sector Studies

Business investment is expected to grow modestly in 2024 due to tighter financial conditions and weak domestic demand. It would, however, be supported by loans and grants from the new version of the European recovery plan, which has revised upwards the total subsidies to 80 billion (5.5% of GDP). In autumn 2023, the European Commission approved Spain's amended recovery plan, which includes an *REPowerEU* chapter and EUR 83bn of loans (5.7% of GDP) in addition to the grants already allocated. 40% of the plan will support the climate objectives. Main investments are : i) over EUR 12bn in the energy efficiency of public and private buildings including new social housing, ii) EUR 13.2bn in sustainable mobility in urban and long-distance, iii) EUR 6.9 bn for the decarbonisation of the energy sector by under the REPowerEU chapter and EUR 22 bn under the financial instrument ICO Green Line, in clean technologies and infrastructure (including storage and electricity grids) and accelerating the development and use of renewables, including renewable hydrogen.

Consumption is set to grow at a moderate pace in 2024 but continue to support growth through further gains in purchasing power after a record year in 2023. Indeed, despite the anticipated slowdown in the labour market and the rise in unemployment, purchasing power is expected to increase further in 2024 and 2025. Slowing inflation, negotiated wage increases, and pension increases will support household income over the horizon of our forecast. The savings rate – which has returned to a level above its historical average in 2023 – is expected to remain high, allowing households to cope with the expected deterioration in the labour market.

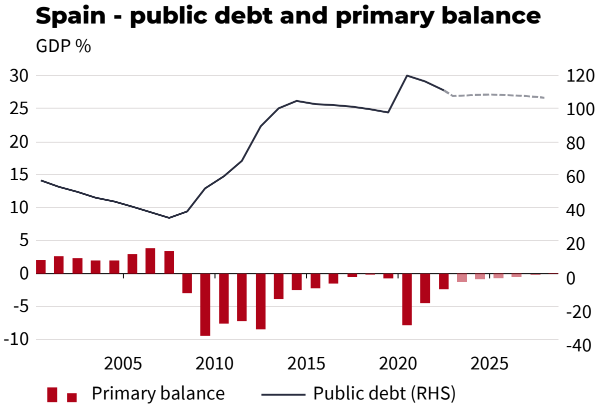
Harmonised inflation slowed sharply in 2023 and is expected to be below 3% in 2024. However, core inflation is also expected to slow, but remain 1pp above the ECB's target this year, making the decision to cut key interest rates tricky. Nevertheless, the second-round effects on wages were limited last year, despite the 8% increase in the minimum wage in February 2023.

Economy back in external surplus



Source : INE, SG Economic and Sector Studies

Public debt would stabilize at a high level



Source : Eurostat, SG Economic and Sector Studies

Spain's current account balance recovered in 2023 and is expected to remain in a surplus position over the forecast horizon. While the current account balance had suffered from the halt in tourism during the pandemic and the rise in the price of energy imports following the war in Ukraine, it recovered sharply and reached 2.5% of GDP in 2023. The current account balance would fall back to a surplus of 2% of GDP over the medium term, with the rebalancing of the economy.

Fiscal policy is expected to become restrictive in 2024, due to the lower cost of support measures to offset rising energy prices. The gradual dismantling of these measures would save around 1% of GDP in 2024. In addition, the financing of investments via subsidies from the European recovery plan rather than public borrowing makes it possible to reduce their budgetary cost by 0.5% of GDP in 2024.

The slowdown in growth will weigh on public finances and the public deficit will remain above the 3% threshold over our forecast horizon. The indexation of pensions to inflation weighs on the sustainability of public finances, as it prohibits spending freezes, which are a very effective way to limit the public deficit in times of rising prices. After two years of decline, public debt is still 10 percentage points higher than pre-Covid level and expected to stabilise at around 109% of GDP by the time of our forecast.

Beyond 2024, the government's fiscal stance will become accommodative. There are risks of political deadlock and a non-zero probability that Sánchez's government, elected in November 2023 with the support of Sumar and Catalan separatists, will not come to an end. Economic policy will continue to focus on addressing income inequality, redistribution, and social and environmental policies.

The challenge for Mr Sánchez's government could worsen as regionalists and separatists gain support across Spain. The recent elections in Galicia saw the left-wing regional nationalist party BNG gain a lead over the Socialists. Regional elections are also planned in the Basque Country. These could see Bildu, a Basque separatist party, move closer to or overtake the more moderate PNV.

Concessions made by the PSOE to secure the backing of regional parties include debt relief for Catalonia and Galicia of EUR 15bn and 12.3bn respectively. Similar debt relief could be made available for other autonomous communities. Mr Sánchez has also agreed to several local infrastructure projects in Galicia, such as improved roads and train services, and has signed an agreement with the PNV pledging to hand greater autonomy to the Basque region.

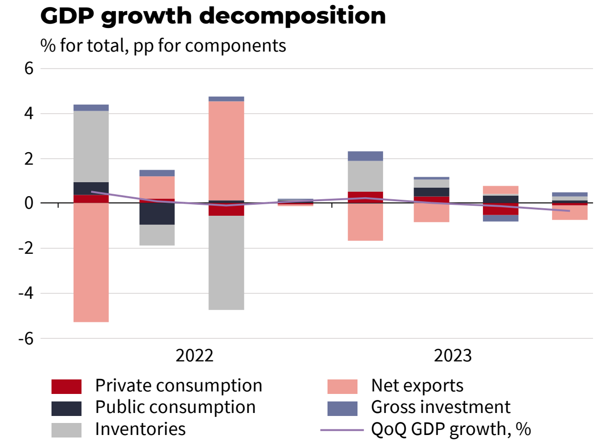
Spain	**2023**	**2024f**	**2025f**	**2026f**
Real GDP, % YoY	2.5	1.4	1.1	1.4
Household consumption	1.8	1.3	1.1	1.5
Public consumption	3.8	0.8	0.8	0.8
Investment	0.6	0.5	0.9	2.0
Exports of goods & services	2.4	1.8	2.8	2.9
Imports of goods & services	0.3	1.7	2.5	3.0
Inflation, % change	3.4	2.8	2.1	2.1
Core inflation	4.1	3.0	2.1	2.1
Real gross disposable income (GDI), % change	5.6	1.0	0.8	1.3
Households saving rate, % of GDI	10.5	10.2	9.9	9.8
Unemployment, % of labour force	12.1	12.3	12.7	12.7
Fiscal balance, % of GDP	-4.0	-3.6	-3.5	-3.3
Public debt, % of GDP	108	108	109	109
Current account balance, % of GDP	2.4	2.2	2.2	2.2

UNITED KINGDOM

- **The UK should barely escape stagnation in 2024, followed by moderate growth in 2025.**
- **Domestic demand should remain weak as households stay prudent despite the recovery in real incomes.**
- **The concomitant fall in inflation and signs of perduring economic weakness should convince the BoE to cut its rate during springtime.**

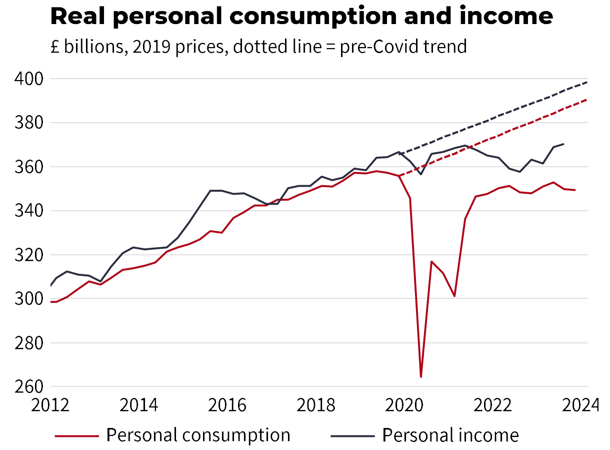
After entering a technical recession at the end of last year, the UK should barely escape stagnation in 2024 despite falling inflation and recovery of real incomes. The economy has expanded by a mere 0.1% in 2023, as GDP contracted for two consecutive quarters at the end of the year. In a context of still high inflation, tight labour markets and low productivity growth, the two driving sectors of the country, construction and services, have performed quite poorly. Although the UK should return to growth already in Q1, the overall picture of flatlining output, which we have seen now for about two years, will probably continue throughout the current year, followed by modest rebound in 2025. Moreover, risks to the outlook remain skewed to the downside due to perduring domestic and global uncertainties.

The country fell in a technical recession at the end of 2023



Source: ONS, Refinitiv, SG Economic and Sector Studies

Incomes recouped some lost purchasing power, but consumption kept stagnating



Source: ONS, Refinitiv, SG Economic and Sector Studies

Anaemic private consumption should weaken domestic demand this year, as households prefer to stay prudent. Household consumption volumes are still about 2% below pre-pandemic levels. If the galloping inflation in 2022 and in early 2023 had eaten into real income and deprived the after-Covid consumption rebound of momentum, British households remained cautious thereafter despite decelerating inflation and robust nominal wage growth. A persistently uncertain economic environment and the renegotiation of fixed-rate mortgage loans for many households should prompt consumers to stay prudent in 2024, tempering consumption dynamics amidst further real take-home pay gains. Moreover, businesses may prefer cutting back on staff more than raising prices to defend margins, thus affecting employment levels.

The lagged impact of higher interest rates should negatively impact private investment in 2024, but it will return to growth in 2025. After a long period of decline started after the Brexit referendum, business investment experienced a robust rebound over the last two years, not the least due to significant policy support. Housing investment, on the other hand, started reversing part of its pandemic boom at the end of 2022. Over the current year, the delayed effects of the tightening cycle should affect private investment across the board. It should return to growth next year as the monetary policy turns more neutral. Reviving investments is a key instrument in the wider objectives of levelling up regional inequalities and reaching the net zero. The current and the next government should thus maintain a benign policy stance regarding private investments.

Inflation should (temporarily) fall to the central bank's target in Q2, providing the BoE with a tell-tale sign in favour of a first rate cut after the long pause. While overall inflation remained around 4% between November and January, driven by a stubbornly high core and services inflation, the trend is certainly downward. During springtime, the fall in energy prices and the high inflation in early 2023 "dropping out" of the annual comparison will probably push inflation back to target. As supply-side constraints should ease only partially, core inflation will not fall quickly enough to maintain inflation at such target for the rest of the year. Nevertheless, the concomitant fall in headline inflation and clear signs of perduring economic weakness should convince the BoE to cut its policy rate sometime in Q2, with a rate landing at 4.75% at the end of this year.

UK	2023	2024f	2025f	2026f
Real GDP, % ch YoY	0.1	0.2	0.9	0.9
Household consumption	0.4	0.2	0.6	0.6
Public consumption	0.6	1.2	1.1	1.2
Investment	2.9	-1.0	1.1	1.0
Exports of goods & services	-1.4	0.4	2.0	2.0
Imports of goods & services	-1.6	-0.2	1.6	1.6
Inflation, % annual average	7.3	2.8	2.2	2.0
Core inflation, % annual average	6.2	3.2	2.1	2.0
Real gross disposable income (GDI), % change	2.0	0.5	0.7	0.8
Households saving rate, % of GDI	9.7	9.6	9.6	9.7
Unemployment, % of labour force	4.1	4.6	4.8	4.9
Fiscal balance, % of GDP	-6.0	-5.8	-5.4	-4.9
Public debt, % of GDP	98	100	102	104
Current account balance, % of GDP	-3.1	-3.1	-3.0	-3.0

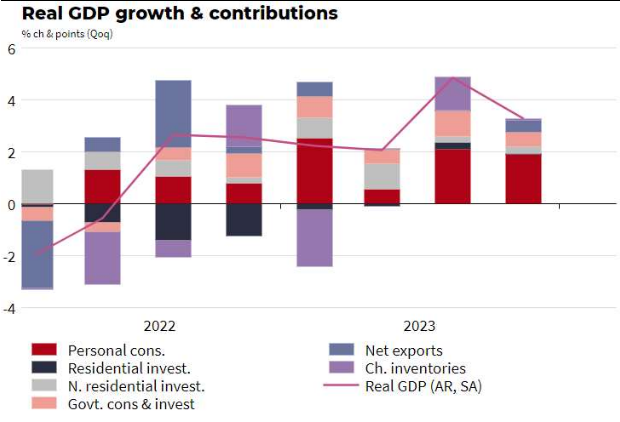
UNITED STATES

- **We are revising our GDP growth forecasts for 2024, on the back of strong labour market and solid real disposable income growth.**
- **Economic activity is still set slowdown, faced with headwinds from fiscal and financial conditions.**
- **While upside risks persist, disinflation should persist, opening the way for a first Fed cut in May.**

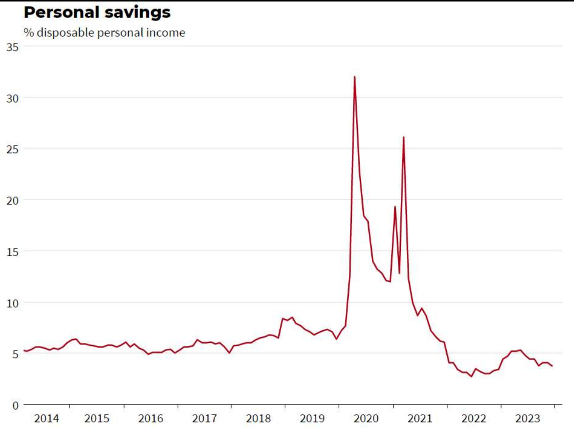
We revised up our growth forecasts for 2024. Real GDP beat expectations with a solid 3.3% QoQ annualized in Q4 2023 (driven by consumption, which contributed 1.9pp). Moreover, so far, the labour market has remained more resilient than previously expected, with an average of over 250k nonfarm payroll monthly job gains in 2023, and unemployment still below 4%, at 3.9%. At the same time, however, significant easing has happened via a decline in job openings, which have diminished by 3 million from their peak in March 2022, reducing the imbalance between demand and supply of labour and supporting disinflation. We now expect easing to proceed mainly through decline in vacancies. We have therefore revised down our unemployment forecasts.

All in all, real disposable personal income should expand, given easing inflation and positive contributions by interest income. In addition, we also expect a significant increase in personal interest income, supporting consumption, despite limited increase in saving rate. This should, however, grow more significantly in 2025, as real disposable personal income will still grow at around 2%, consumption will remain moderated and personal interest payments will contract.

Growth is still fuelled by consumption…



…as households keep under-saving



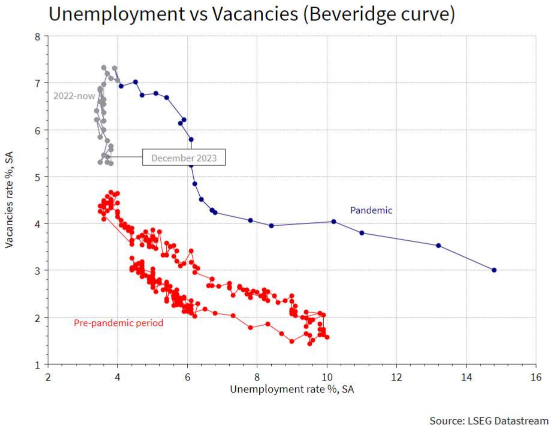
Source: Bureau of Economic Analysis, US Department of Commerce, Refinitiv, SG Economics and Sector Studies

We still expect aggregate economic activity to slowdown in 2024, however, in connection with fiscal and financial headwinds. Private non-financial corporates will face a refinancing wall (which will mostly concern investment grade companies, however), which presents risks for profits and investments.

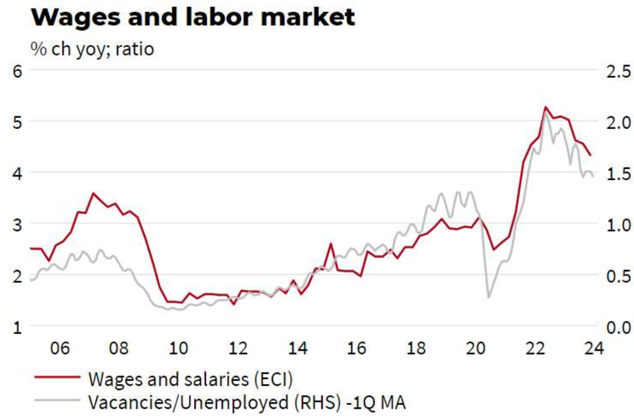
We maintain our above-consensus forecast on inflation, but we still expect significant easing over the year. Inflation came in slightly stronger than expected in January, at 3.1% YoY. Shelter inflation jumped 0.6% m/m in January (vs 0.3% average over the previous quarter), but we anticipate this acceleration to be short lived and that shelter contribution to CPI will decline significantly, reflecting the time gap of this measure (which reflects also continuing rents, which are taking time to adjust) vis-à-vis new tenant rent inflation (which has already eased significantly). Energy contribution over the year should come slightly negative, but upsides risks persist, were oil prices to increase more significantly than expected in connection with the conflict in Middle East.

Looking forward, while wages increase remain above pre-pandemic levels so far (according to the employment cost index, they eased to 4.2% YoY in Q4 vs a peak at 5.3%, while they were expanding at less than 3% in 2019), they are expected to keep easing, reflecting the significant jobs-workers gap reduction over the last year and further easing in the pipeline. However, while we expect wage growth to moderate in the coming year, labour costs should contribute more to inflation over the next decade, compared to the previous. This reflects demographic factors (ageing) which are expected to represent a headwind for labour force expansions, thus fuelling labour shortages and keeping upwards pressures on salaries. This motivates, together with other themes such as the climate transition and more fragmented supply chains, our medium-term inflation forecasts at 2.5%, slightly above the Fed's target.

Labor market eases via falling vacancies…



… supporting further disinflation



Source: Bureau of Labour Statistics, US Department of Labor, Refinitiv, SG Economics and Sector Studies

We do not see cuts before May, but we the fed funds target rate to be reduced to 4-4.25% by year-end, as the Fed takes advantage of easing inflation to insure growth. Absent another shock, easing rent and declining wages growth should convince the Fed that inflation is coming down sustainably. At the same time, growth is expected to slow from its solid pace of 2024, reflecting fiscal and financial headwinds, as well as increasing pressure on households' balance sheets. This sustains expectations of slowdown by Fed's policy makers, as suggested by recent Fedspeak. Combined with easing inflation, this should make a strong case for the most dovish policy makers to support cuts.

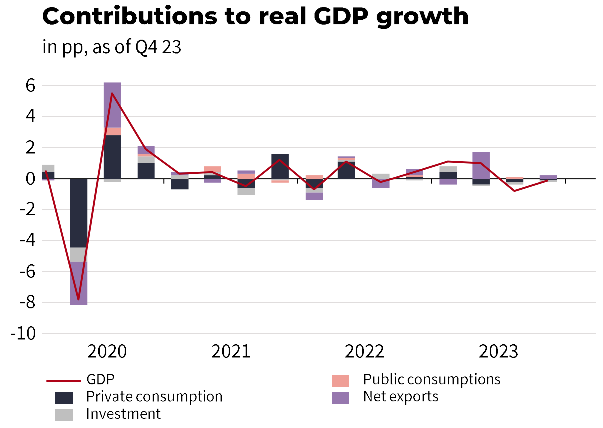
US	2023	2024f	2025f	2026f
Real GDP, % ch YoY	2.5	1.7	1.5	1.8
Household consumption	2.2	1.4	1.8	2.1
Public consumption	2.8	1.3	1.1	1.0
Investment	1.9	2.5	1.9	2.7
Exports of goods & services	2.7	1.0	2.0	2.0
Imports of goods & services	-1.7	2.0	3.3	3.3
Inflation, % annual average	4.1	2.7	2.5	2.5
Core inflation, % annual average	4.8	3.0	2.5	2.5
Real gross disposable income (GDI), % change	4.2	2.1	2.2	2.4
Households saving rate, % of GDI	4.5	4.7	5.7	5.9
Unemployment, % of labour force	3.6	4.2	4.3	4.0
Fiscal balance, % of GDP	-5.9	-5.3	-5.8	-5.6
Public debt, % of GDP	98	99	101	102
Current account balance, % of GDP	-3.1	-2.9	-3.0	-3.1

JAPAN

- **Growth has contracted over the past two quarters. It will remain relatively low over the forecast horizon.**
- **Consumption, which has been weak so far, is expected to be supported by rising wages, but external demand is uncertain.**
- **Inflation is expected to slow in 2024 as commodity pressures ease but will be supported by a catch-up in salary increase.**

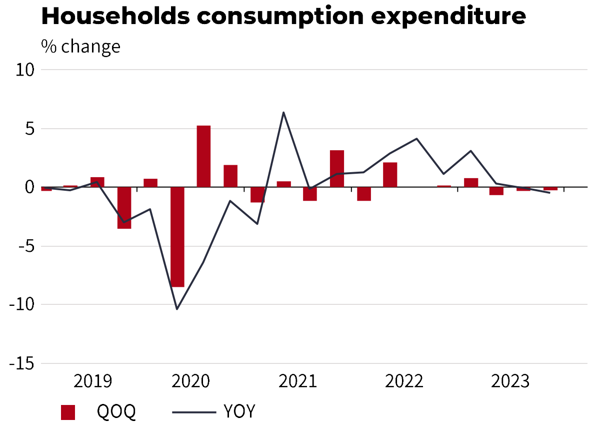
GDP growth has contracted since Q3, and growth momentum is expected to remain weak over the forecast horizon. Persistently high inflation continues to weigh on consumption. The contraction in real wages is constraining household spending.

Growth momentum is weakening...



Source: SG Economic & Sector Studies, Refinitiv

Household consumption remains fragile



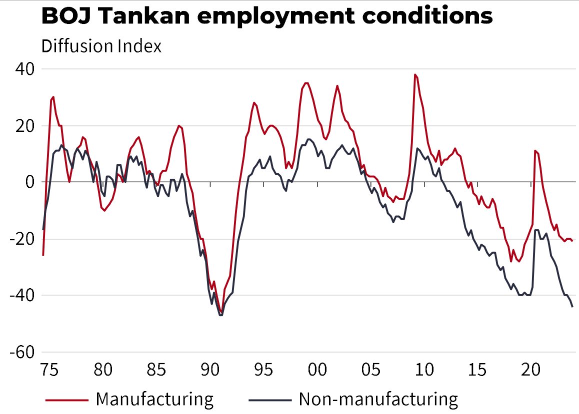
Source: SG Economic & Sector Studies, Refinitiv

Exports are benefiting from the recovery in the semiconductor sector, but risks are skewed to the downside given weak external demand and geopolitical tensions. Exports began to slow due to a decline in chip and steel exports to China, given weakening external demand. While the recovery of the global semiconductor industry is expected to support Japanese exports, these may be dampened by geopolitical tensions in this segment as Japan aligns with the US stance on China-directed export controls. Tourism revenues, which accounted for nearly 5% of Japan's exports before the crisis, have returned to pre-pandemic levels since October.

Business investment is expected to remain relatively modest. Corporate profits have been above pre-pandemic levels and are benefiting from the yen's depreciation, which is supporting investment. Going forward, investments are expected to continue to increase, albeit at a slower pace, supported by government subsidies, most notably for green and digital investments.

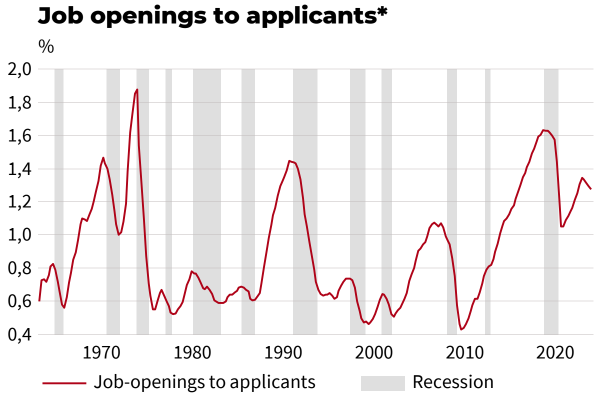
The improvement in business confidence and profits, combined with the labour shortage, should in principle be favourable to employees in the spring wage negotiations of 2024. The workers' union (Rengo) has set a target of an increase of at least 5%, including an increase of 3% or more in the basic salary (compared to 2.8% in 2023). A tight labour market with a low unemployment rate (2.4%, the lowest rate since the 1990s) and more job openings than applicants should prompt companies to raise wages to attract employees. Companies' concerns about a labour shortage have intensified since the end of the health crisis, as reflected in the BOJ's Tankan survey. The intensification of social pressure in a context of still negative real wages is likely to weigh in favour of employees.

Labour market remains tight



Source: SG Economic & Sector Studies, Refinitiv

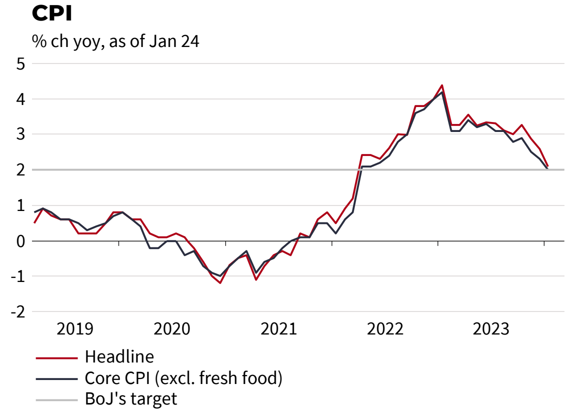
There are more job openings than applicants



Source: SG Economic & Sector Studies, Refinitiv

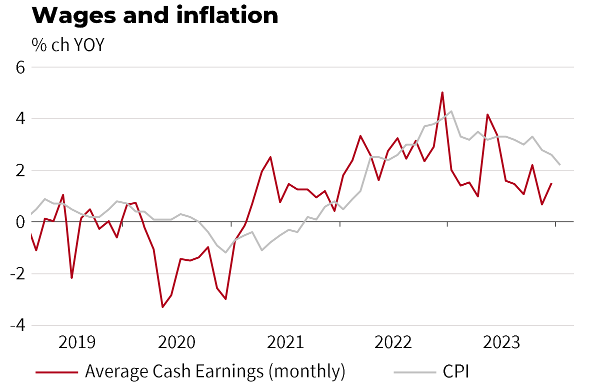
Household consumption will modestly support growth. Private consumption has not returned to its pre-pandemic level, constrained by a persistent contraction in real disposable income. The government's new stimulus package is expected to mitigate inflationary effects on consumption, but it is rather limited. These support measures, including subsidies to reduce household electricity bills, amount to 2% of GDP, less than the previous stimulus package in 2022, and will not be implemented until June 2024. Higher wages could also partly offset these headwinds on disposable income and household purchasing power.

Inflation slows but remains above target



Source: SG Economic & Sector Studies, Refinitiv

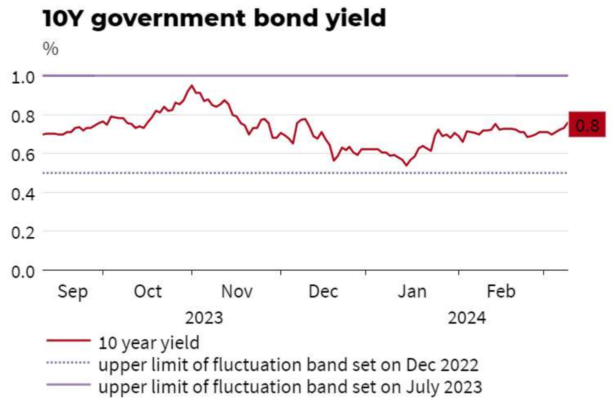
Inflation is accelerating faster than wages



Source: SG Economic & Sector Studies, Refinitiv

Inflation will gradually decline as food and energy prices fall but will be supported by catch-up wage increases. The peak in headline and core inflation has already passed but remains above the BoJ's target. That said, inflation expectations remain above the BoJ target in the short to medium term support the prospect of a sustained increase in the wage bill. In 2024, a gradual catch-up in wage growth should support inflation and should give the BoJ confidence that its 2% inflation target is stably achievable.

The 10Y government bond yield has relatively stabilised



Source: SG Economic & Sector Studies, Refinitiv

The JPY has started to appreciate against the USD since the beginning of March

Source: SG Economic & Sector Studies, Refinitiv

With a narrowing output gap that could be positive next year, the BoJ may exit its negative interest rates this year after policy review talks are expected to conclude in May 2024. Policymakers will closely monitor the future development of the outcome of the spring wage negotiations and significant improvements in wage data in order to form a virtuous circle between wages and prices. The YCC can be scrapped in the first half of 2024, as the original reasons to avoid an excessive decline in long-term rates are no longer relevant and the BoJ has since diluted the importance of the YCC over the course of 2023, offering more flexibility. Yield Curve Control (YCC) was made more flexible in Q3 by changing the 1% cap to a benchmark rate in October 2023. The change did not put any noticeable pressure on the 10-year Japanese government bond yield, which has stabilized around 0.7% since then.

A gradual catch-up of wage growth towards higher inflation should give the BoJ more confidence that the 2% inflation target is achievable and to exit negative rates in the first half of the year. However, we do not expect rapid adjustments to the policy rate that could affect the Japanese financial system, worsen debt servicing in a high debt environment.

With more resilient private demand and a gradually narrowing output gap, fiscal policy support measures, partly related to pandemic aid, are being gradually phased out. The fiscal deficit will narrow in the short term thanks to a decrease in pandemic relief support measures. Indeed, the budget for 2024, approved in March, marks the largest drop in a decade (dropped by 2% compared to FY2023). Nonetheless, the budget reflects authorities' commitment to boost spending in defense (+16%) and social security (2%). The tax cuts voted in December, which aim at hedging households from price hikes will also be more than offset by the reduction in inflation measures presented in the budget (-75% compared to FY2024). In the medium term, ageing-related spending, particularly in the health sector, will continue to put pressure on the public deficit and debt.

Japan	**2023**	**2024f**	**2025f**	**2026f**
Real GDP, % ch YoY	1.9	0.6	0.5	0.6
Household consumption	0.7	0.7	0.7	0.7
Public consumption	0.9	0.5	0.4	0.4
Investment	3.7	1.0	0.8	0.8
Exports of goods & services	3.0	1.7	0.8	1.6
Imports of goods & services	-1.4	1.5	1.3	2.0
Inflation, % annual average	3.2	2.0	1.5	1.3
Core inflation, % annual average	3.1	1.7	1.3	1.0
Real gross disposable income (GDI), % change	-1.6	0.7	0.6	0.4
Households saving rate, % of GDI	0.6	1.3	1.2	1.0
Unemployment, % of labour force	2.6	2.4	2.4	2.5
Fiscal balance, % of GDP	-4.5	-4.0	-3.0	-3.0
Public debt, % of GDP	258	258	259	259
Current account balance, % of GDP	2.0	3.0	2.7	2.2

CHINA

- **GDP growth is expected to decelerate, with the ongoing correction in the property sector being the main drag.**
- **Inflation is set to remain low in 2024 despite expected waning disinflationary pressure from pork prices.**
- **More support measures should mitigate liquidity stress for housing and local government debt issues but won't provide a structural resolution.**

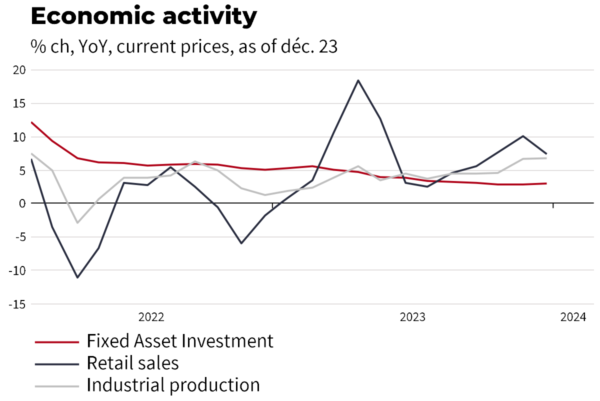
GDP growth is expected to go through a structural deceleration on the forecast horizon. The ongoing correction in the property sector will continue to weigh on investments amid persistent financial strains among property developers and local governments, slowing demand for housing and an inventory overhang. On the export front, tensions with the US and Europe will weigh on China's trade and technological advances. We believe that the 5% growth target announced during the NPC in March seems difficult to achieve, with no base effect and with similar support measures as in 2023. No measures to support consumption were announced during the Congress as the authorities have sought for years to rebalance growth towards consumption, as the new main driver of growth. The report shows that the authorities are focusing on 'what works', i.e. the 'new productive forces' (the development of green tech), while the risk of overcapacity has already emerged.

In the medium term, growth prospects are deteriorating given a prolonged confidence crisis and the lasting effects of the housing market downturn. Rebalancing efforts towards consumption-led growth could lift China's growth potential. However, until now, the pandemic and the housing crisis have curbed rebalancing progress. In a context of ageing population, strengthening social safety net could reduce the need for precautionary savings. The Common Prosperity policy and Hukou reforms could increase household disposable income by improving access to public services, provided that financial pressures from local governments ease. Despite the economic slowdown, government support and a still relatively closed capital account should help keep the deleveraging process orderly.

GDP growth has met the 2023 annual target

Source: SG Economic & Sector Studies, Refinitiv

Economic activity gives mixed signals

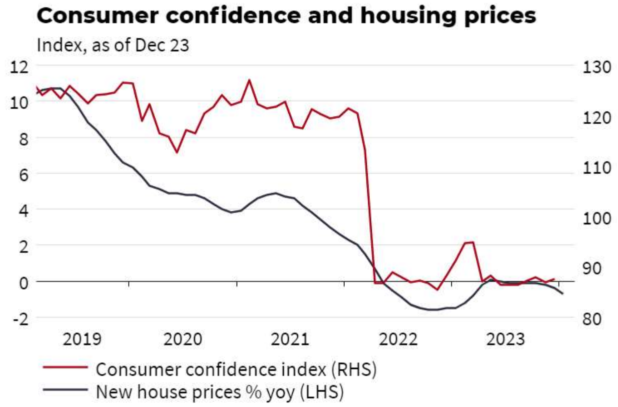


Source: SG Economic & Sector Studies, Refinitiv

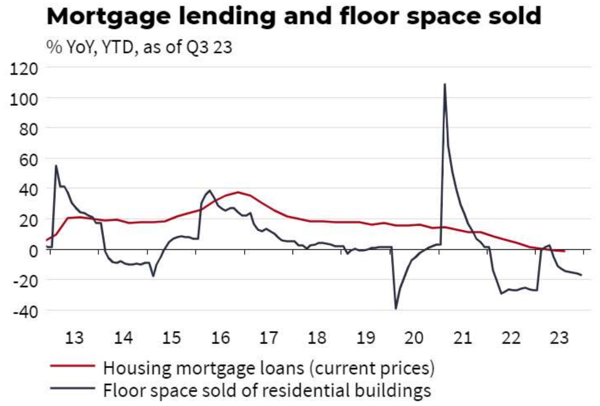
The real estate downturn will remain a major drag on growth, on both the supply and demand sides. The consolidation of the real estate market since the Three Red Lines has severely constrained developers' finances and the completion of real estate projects. The fact that most of new houses are pre-sold and that real estate accounts for nearly 60% of household assets, the inability of developers to carry out projects has greatly deteriorated household confidence. Authorities have intervened on both supply side by making funds available to distressed property developers and demand side by relaxing conditions on downpayments, reducing mortgage rates, but little improvement has been observed. Mortgage demand and housing prices have continued to contract. The real estate downturn is likely to persist in the forecast horizon. A shrinking population and a slowing urban population growth will reduce structurally demand for housing in the coming years and make it difficult to absorb excess inventory.

Financial conditions remain tight for local governments and local government financing vehicles (LGFV) as a result of the real estate downturn. Local governments generate their income mainly through land sales (leasing of land rights to developers in residential, commercial development) and account for more than a third of their revenues. Lower demand in the property market and fewer projects have led to a drop in land sales which have been halved since the implementation of the Three Red Lines. In addition to the direct impact on local government revenues, a drop in land sales also undermines financial stability of local governments financing vehicles, which are owned and used by local governments to raise funds by issuing debt to finance infra-structure projects. It is estimated that at least 60% of their income comes from activities related to land development. Their debt has exploded (+20pp of GDP since 2016, estimated at 40% of GDP in 2023) accordingly.

Confidence remains at low levels



Housing demand still struggle to restart



Source: Refinitiv and SG Economics and Sector Studies

Export growth should see a modest recovery in 2024, as global electronics market is bottoming out but expected to be subdued over the forecast period given trade tensions. China's dominance in the global renewable energy supply chain offsetting a decline in demand in other sectors. China has secured a position as a low-cost producer in strategic sectors such as automotive, solar and wind energy and rare earth metals to produce them. If we take the example of electric vehicles, China went from a net importer in 2019 to a net exporter in 2023. While ongoing tensions with the U.S. and its allies may hinder China's technological progress (especially in semiconductors), these sectors are expected to provide additional export growth in the coming years.

Inflation will remain low in 2024, despite lower disinflationary pressure. Until now, global commodity price declines and low food prices contributed the most to disinflationary pressure, which could be proved temporary. Pork prices, a major driver of CPI, have been on a downward cycle since the end of 2022 and have contracted since May. However, live pig stock has stabilized in recent months. Pork prices could stabilize and the drag to inflation could gradually wane as a result.

Policy mix will remain accommodative in 2024 in attempt to support growth and address liquidity stress but should not provide a structural resolution. The PBoC governor signalled that there was scope for further monetary policy easing when he announced a RRR cut in January. There should be a window of opportunity to cut LPR and RRR after the Fed starts to ease Fed funds rate in spring, causing less pressure on the CNY. Fiscal policy should remain accommodative and "proactive" as highlighted during the CEWC (Central Economic Work Conference). Stimulus should secure more infrastructure spending to help offset weakness in real estate investment. In a context of housing price contraction, more transfers from the central government to local governments are expected to support refinancing needs, although they will not address the issue structurally.

Real estate	**Jan 24**: Nearly 30 cities have further eased measures home-buying restricting: Suzhou, Shanghai and Guangzhou now accept buyers regardless of their residential status. **Jan 24**: Regulators drafted a whitelist of 50 property developers in Nov. A state-backed property project has received the first development loan. **Aug 23**: tax incentives first implemented in 2022, are extended until 2025 – allowing taxpayers who buy a new home within one year of selling their old home to benefit from a personal income tax refund.
Monetary policy	**Jan 24:** 50bp cut in RRR which would inject the equivalent of USD140bn liquidity into the market **Dec 23**: resumption of Pledged Supplemental Lending (PSL) – injection of USD 50bn of low-cost funds into policy-oriented banks **Sept 23**: lower interest rates on existing mortgages for first-home loans
Fiscal policy	**Oct 23:** Authorities announced plans to issue CNY 1tn in CGB, which increased the 2023 budget deficit target to 3.8% of GDP from initially planned 3% **Oct 23:** local government debt swap program and roll-over on existing local government debt with longer-term loans at lower interest rates

Geopolitics and policy error remain a risk to the growth outlook. Geopolitically, trade and national security relationship with the U.S. will continue to weigh and shape global value chains and China's role in them, with U.S. supply chain de-risking efforts. Major trading partners have imposed export controls on advanced semiconductors and related products to China. In response, China imposed export restrictions on rare-earth metals in August and rare-earth processing technology in December 2023, which are used in the production of high-performance chips, needed in EVs battery manufacturing. Given that these minerals are produced and refined primarily in China, such restrictions could potentially have spillovers on global production of chips and EVs. Geopolitical and security issues in Taiwan also remain a source of risk. Following DPP's Lai victory in the presidential election in January, authorities' rhetoric during party's annual Taiwan work conference held in February has toughened towards Taiwan, increasing pressure on the island as president-elect Lai prepares to take office in May.

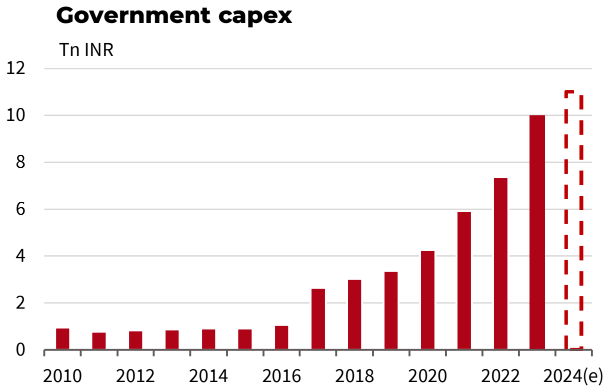
China	2023	2024f	2025f	2026f
Real GDP, % ch YoY	5.2	4.3	4.0	3.8
Household consumption	7.9	5.6	4.9	3.8
Public consumption	4.5	4.3	4.3	4.1
Investment	4.2	3.9	3.9	3.8
Exports of goods & services	1.1	3.2	2.0	2.6
Imports of goods & services	1.9	4.6	3.5	2.3
Inflation, % annual average	0.3	1.2	1.6	2.0
Fiscal balance, % of GDP	-6.8	-6.4	-6.3	-6.2
Public debt, % of GDP	83	90	95	99
External debt, % of GDP	16	17	17	18
Current account balance, % of GDP	2.1	1.7	1.3	1.1

INDIA

- **After an exceptional growth in the fiscal year ended, public capex should slow as fiscal consolidation bites…**
- **… coupled with a restrictive monetary policy. Growth should therefore land back to its potential (6-6.5%) in the medium term.**

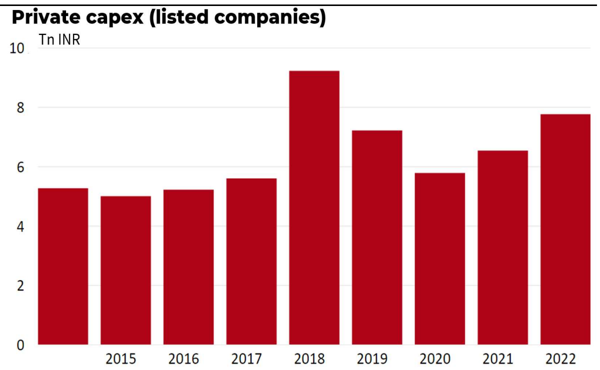
After a technical rebound in 2022 linked to the second wave of covid-19, Indian growth should normalise around its potential (6-6.5% YoY) in the medium term. After being a major contributor to growth in the last two fiscal years, public capex should start to slow according to the February interim budget (interim because its implementation depends on the elections results). Private capex growth dynamic is currently too weak to sustain the strong total investment inertia of the last years.

Public investment should grow at a slower pace in 2024



Source: CSO, SG Economics and Sector Studies

Private capex contributes less to growth

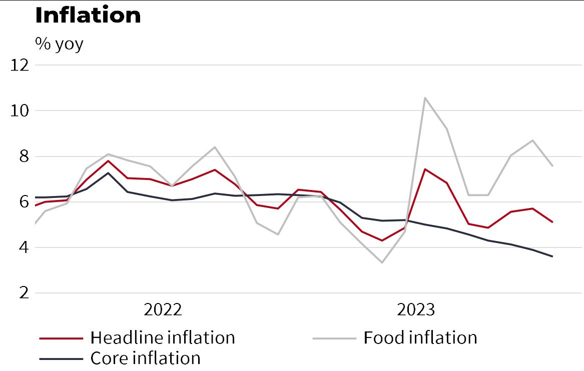


Source: Eikon, SG Economics and Sector Studies

Core inflation deceleration path supports the case for a further decrease in headline inflation in 2024. The increase in inflation in the first months of 2024 is accounted for by food prices, subject to high volatility. The downward trend remains on prices however, especially as core inflation has been decreasing since 2023. Lag effects of the monetary policy tightening, which for the time being does not impact credit growth (+20% YoY), should contribute to the taming of inflation.

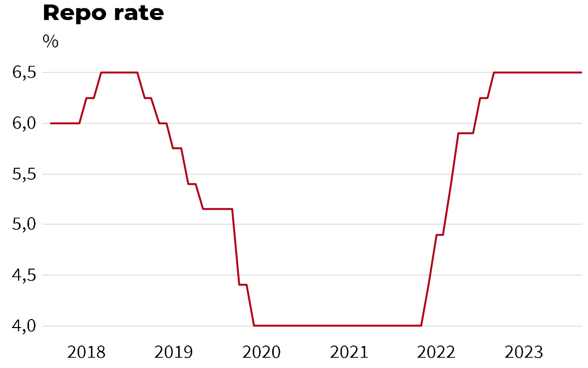
The inclusion of government bonds in the JP Morgan emerging index will contribute to the attractivity of local-currency bonds, amid easing pressures on the rupee in the last quarters. Although of a small magnitude (USD20-30Bn inflows are expected due to passive investors), the dollar inflows expected in 2024 should be beneficial for the rupee. Note however that this gradual expansion of the foreign investor base raises volatility risks, as waves of outflows are to be expected in times of global risk aversion. The FX rate policy from the RBI will be key to ensure macroeconomic stability in such times.

High inflation (again) due to food prices



Source: RBI, Refinitiv and SG Economics and Sector Studies

The RBI is at the top of its tightening cycle



Source: RBI, Refinitiv and SG Economics and Sector Studies

Fiscal consolidation began, the fiscal balance will improve on the medium-term. Since the pandemic, annual public borrowings have nearly doubled, with a major impact on interest expenses (more than 30% of revenues). The interim 2024-2025 budget expects a reduction in the central government fiscal deficit, landing at 5.1% of GDP (vs. 5.8% anticipated for 2023-2024). Public investment should grow (albeit slower than in the previous fiscal year) slightly faster than nominal GDP, while public expenditures should not expand much in 2024. This rather restrictive budget announced by Modi reveals his confidence in his re-election in April-May.

India's officially neutral position towards Russia remains a source of geopolitical uncertainty. Trade flows are growing, as monthly imports from Russia were multiplied more than tenfold compared to the historical mean. However, this situation raises questions on the nature of India's international relations in the medium term, and the risk of exposition to potential sanctions.

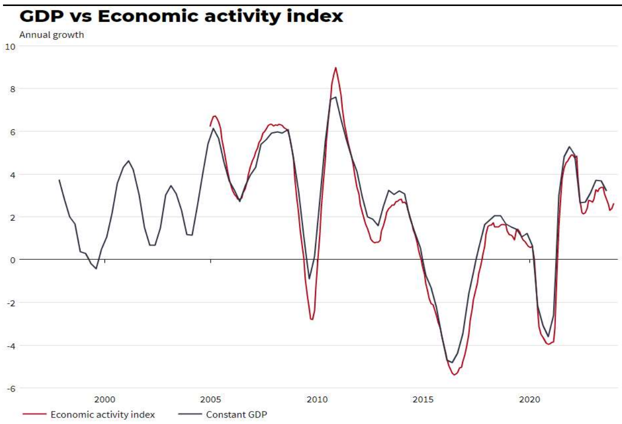
India	2023	2024f	2025f	2026f	2027f	2028f
Real GDP, % ch YoY	6.8	6.1	6.2	6.2	6.2	6.2
Household consumption	5.0	6.0	6.0	6.0	6.0	6.0
Public consumption	7.0	6.0	5.6	5.6	5.6	5.6
Investment	9.0	7.0	6.5	6.2	6.2	6.2
Exports of goods & services	4.0	7.5	6.0	6.0	6.0	6.0
Imports of goods & services	11.0	7.0	6.0	6.0	6.0	6.0
Inflation, % annual average	5.5	4.7	4.5	4.5	4.7	4.7
Fiscal balance, % of GDP	-9.2	-8.5	-8.0	-7.7	-7.5	-7.5
Public debt, % of GDP	84	84	84	83	83	83
External debt, % of GDP	17	16	15	14	14	14
Current account balance, % of GDP	-1.5	-1.0	-1.5	-1.5	-1.5	-1.5

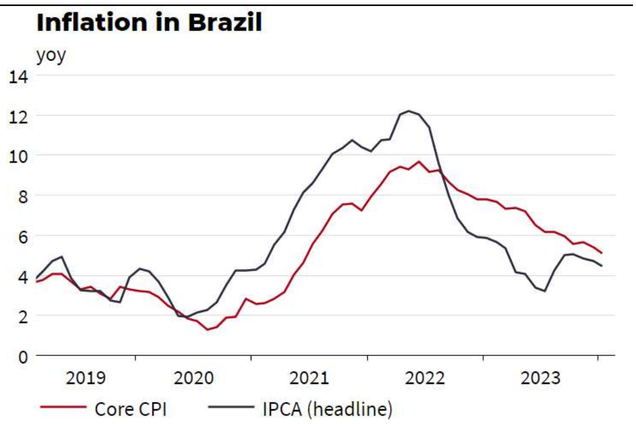
BRAZIL

- **Growth expected to slow in 2024, after a solid 2023.**
- **The BCB is expected to further ease rates, thanks to benign inflation outlook.**
- **A tax simplification reform has been approved and the 2024 budget bill has set a challenging primary balance target.**

Growth slowed in Q3, broadly in line with our expectations. Q3 growth came in at 0.14% QoQ, as consumption expanded (+0.7pp) and investments contracted (-0.5pp). This slowdown follows surprisingly strong growth in the first half of this year and was expected, given signals from high frequency indicators, such as the Central Bank's economic activity index (IBC-Br), which fell to a quarterly average of 1% YoY in October (then rebounding closer to pre-pandemic rates), compared to 3.5% in June. Although the index has been volatile in the last year, it has a good track record in anticipating official GDP releases, as it well summarizes indicators related with agriculture, manufacturing, and services sector.

Growth is set to cool after strong performances...... supporting disinflationary process





Source: Banco Central do Brasil, IBGE - Instituto Brasileiro de Geografia e Estatistica, Refinitiv, SG Economics and Sector Studies

Despite a temporary pick up in headline inflation, the BCB is set to continue easing policy as underlying inflationary pressures and economic activity cool. Inflation rebounded during the summer with a second peak at 5% in September (well below the heights of over 12% reached in 2022) from 3.2% in June, in connection with base effect and transport contribution (which includes energy) turning again positive, also reflecting discontinuation of some fuel tax cuts.

As anticipated, however, this pick up was short lived, and the indicator fall to 4.5% in January. This was explained by the decline in core inflation, which was down to 5.1% in January (from 5.6% in October), and well below the peak of nearly 10% reached in 2022. The cooling of underlying inflationary pressures, together with anticipations for a slowdown in economic activity, depict a rather benign inflation scenario. This has given confidence to the Banco Central do Brasil to ease policy, with another 50bps cut in January, which brought rates to 11.25%. Consensus expectations are for rates to fall further, at 10.75% by April and by 9.25% by January 2025. While the policy rate has so far been reduced by 250bps, real rates remain high, close to 7% (compared to around 3% in 2019), thanks to declining inflation.

A long-awaited tax reform has finally been approved and should introduce simplifications. After passing in the Senate, the reform has finally been approved. This aims at simplifying the notoriously complex consumption tax system by scrapping multiple production and distribution taxes, substituting them with a dual value added taxes – one at a federal and the other at a regional level - simplifying the system and increasing clarity for businesses. The increase in tax burden should be limited via a limit set as a % of GDP. The initiative is part of a broader set of economic and financial reforms culminating with the approval of the new fiscal framework loosening limits on public expenditures, scrapping the rule limiting expenditures' growth to the inflation rate. Under the new rule, real expenditures growth is limited at up to 70% of real revenues growth, allowing the budget to grow more than the inflation rate.

In addition, according to the budget bill approved at the end of last year, the government is aiming for eliminating its primary budget deficit. This objective remains challenging, tough, as it is reliant on record increase of net revenues. Earlier last year, President Lula himself casted doubts on the need to erase the deficit already this year, pushing the need to support other programs, notably social spending. In addition, interest expenses will remain very elevated, having reached around 6pp GDP at the end of last year.

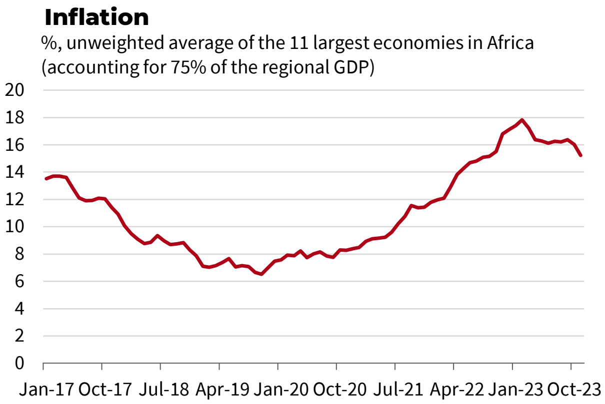
Brazil	2023	2024f	2025f	2026f
Real GDP, % ch YoY	3.0	1.6	1.9	2.0
Household consumption	3.4	1.9	2.1	2.1
Public consumption	1.5	1.5	1.5	1.3
Investment	-3.0	1.2	1.8	2.0
Exports of goods & services	9.0	4.0	3.5	3.5
Imports of goods & services	0.0	3.0	5.0	5.0
Inflation, % annual average	4.6	4.0	3.5	3.5
Fiscal balance, % of GDP	-8.0	-7.5	-6.0	-5.5
Public debt, % of GDP	87	90	91	92
External debt, % of GDP	34	33	33	33
Current account balance, % of GDP	-1.7	-1.9	-2.2	-2.5

AFRICA

- **Regional growth slowed in 2023, to 3.2% (6th worst performance since 2000).**
- **Despite Africa's return to international capital markets and the (slow) decline in inflation, the expected rebound for 2024 will remain moderate.**
- **There are several important risks to this outlook, including a significant increase in political instability.**

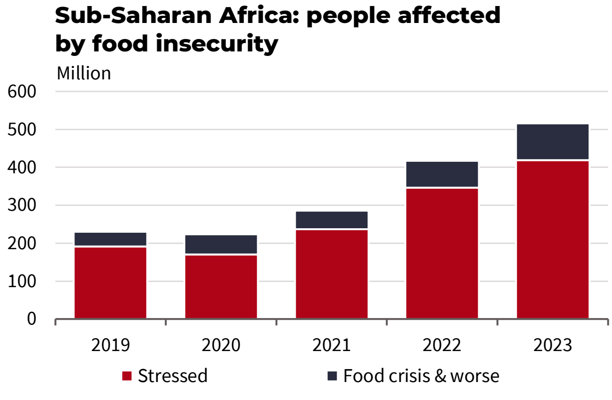
The latest growth figures available for the region (3Q23 for most countries, 4Q23 for some) **confirmed the slowdown in average regional growth in 2023. It is now estimated at 3.2%** (vs. 3.9% in 2022), the 6th worst performance since 2000. There are several reasons for this: i) private demand remains constrained by inflation, slowing but still high by historical standards, ii) public demand suffers from persistent constraints on public finances (particularly in local currency), and iii) external demand – probably the most resilient driver at the beginning of 2023 – seems to have slowed down in 2S23 (as illustrated by a rapidly deteriorating regional trade balance). Moreover, the continent's agricultural performance remains sensitive to still bad weather conditions (Sahel, Sudan, Ethiopia) or fragile (East, Southern and Northern Africa), bearing in mind that the primary sector is often the first "employer" in Africa.

While declining, inflation remains high



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

Rising food insecurity

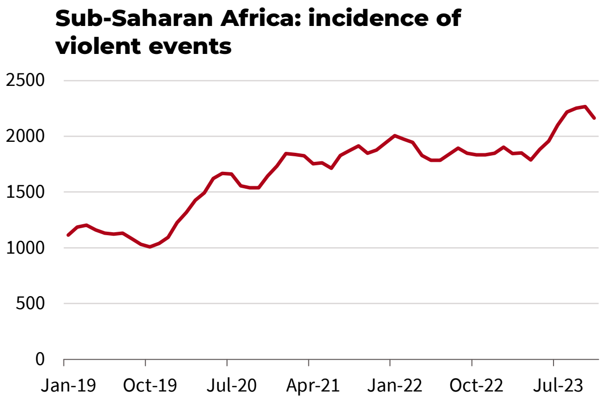


Source: Refinitiv, World Bank, SG Economic and Sector Studies

Growth is expected to increase (too slightly) in 2024, to around 3.5%, with still significant disparities between the majority of "small" diversified economies (with growth rates often close to 5%), and the "large" economies (usually exporters of natural resources) which are struggling more: Nigeria is facing significant tensions on the Naira (FX rate, FX availability); South Africa suffers from its structural bottlenecks (energy, transport); Egypt continues to face a balance of payments crisis that is weighing heavily on activity. More generally, episodes of political instability and social upheavals are multiplying, whether in countries already in difficulty (decision by Mali, Burkina Faso and Niger to withdraw from the Economic Community of West African States – ECOWAS) or countries that are usually more stable (postponement of the presidential election scheduled for January 2024 in Senegal, resulting in massive protests). These troubles will inevitably weigh on the economies concerned, in a more or less limited manner depending on their conclusions.

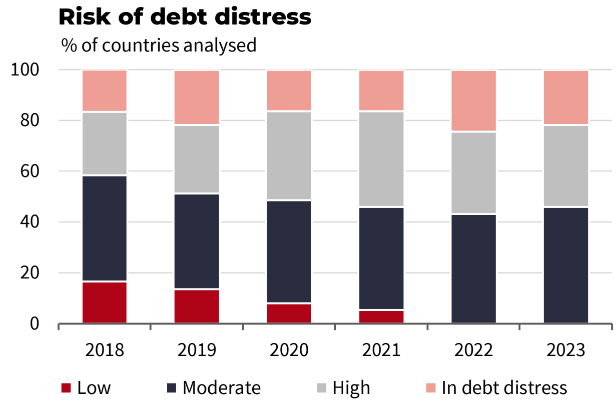
On a more positive note, as expected, international capital markets are gradually reopening for Africa: Côte d'Ivoire, Benin and Kenya have been able to issue Eurobonds, with relatively long maturities (shorter: 7 years for Kenya; longer: 14 years for Benin) and generally satisfactory financial conditions (except for Kenya's issuance which is quite expensive). While the issues of the first two states are not surprising (being among the highest rated by rating agencies in sub-Saharan Africa), the Kenyan issuance reflects the renewed appetite of international investors for riskier paper (the country has recorded several downgrades in recent quarters, and faces a significant repayment maturity of FX public debt due in June 2024).

Rising social and political instability



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

High risk of debt distress



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

Several risks continue to weigh on this (too slight) expected improvement. The improvements currently perceived remain fragile and will need to be confirmed in the coming quarters. The current decline in inflation, mainly due to lower world energy/food prices, could be affected by a reversal of the trend (currently not foreseen in our scenario), for example due to the unrest in the Red Sea. The reopening of international capital markets for Africa is good news, but financing conditions for governments in local currency often remain tight (high rates, or even difficulty in meeting all needs). More generally, the problem of low debt sustainability remains. Finally, a particularly busy electoral calendar in 2024, even though the political and economic structures of the region remain fragile, poses a risk of a persistent "derailment".

LATIN AMERICA

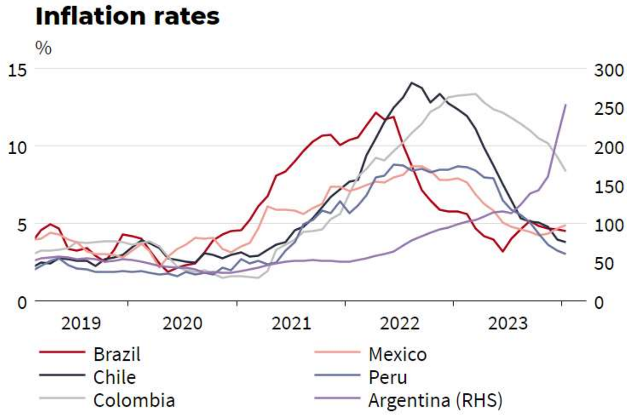
- **Easing cycle is well underway and set to persist.**
- **This is supported by falling import prices and subdued growth.**
- **Risk sentiment has improved amid positive macro surprises, which has also sustained strong stocks performances.**

The region leads in the easing cycle, as disinflation is well underway. Inflationary pressures kept easing in the largest economies of the region. The exceptions were Argentina, struggling with out-of-control inflation, which has increased 250% YoY in January, and Mexico, that has experienced a slight rebound since November. Import prices are contracting in the whole region, further supporting the process.

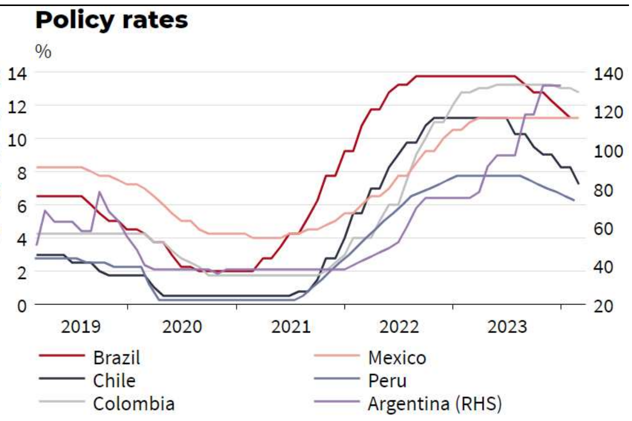
Since their peak, policy rates have already been reduced by 250bps, 400bps and 150ps in Brazil, Chile and Peru. Fast easing in Chile also reflects subdued growth, as the country is set to have closed 2023 either with stagnant growth or even a shallow contraction.

Moreover, it should be noted that, despite policy easing, real rates remain elevated (with the exception of Argentina), or in some cases even increasing (such as in the case of Colombia and Peru), thanks to declining price pressures.

Inflation is cooling in most countries ...



...paving the way for policy easing

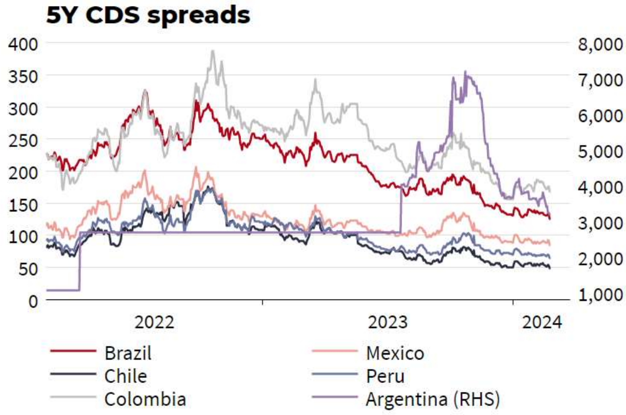


Source: National central banks and Statistics Institutes, Refinitiv, SG Economics and Sector Studies

Growth is overall expected to significantly cool in 2024 and is set to be just around half of the solid expansion recorded in 2022 (~4%) on the back of lagged effects of tighter policy, weak external demand and lower commodity prices.

Risk sentiment improved, thanks to positive macro surprises, and fuelled strong stocks performances in the second half of 2023. Rather positive surprises (expectations for inflation have rather reduced, while those for growth have broadly improved – with some exceptions), have improvement investor sentiment. 5Y CDS premia have declined since October, after a short-lived rise in October in parallel with rising yields of US long term bonds. Such developments have underpinned strong performances by stocks in the second half of 2023.

Risk sentiment has improved …



Source: Refinitiv, SG Economics and Sector Studies

…driving strong stocks performances

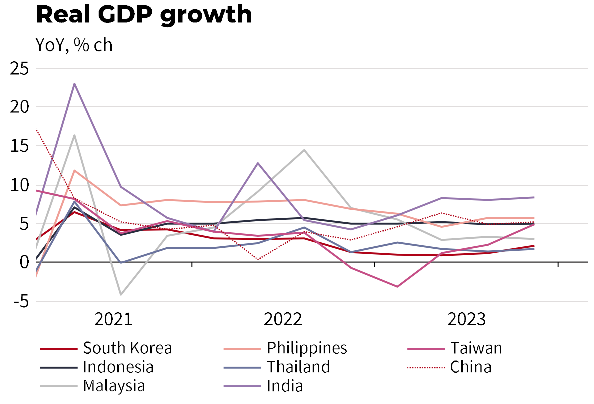
Source: Refinitiv, SG Economics and Sector Studies

EMERGING ASIA

- **Emerging Asia ex-China, will remain buoyant thanks to resilient domestic demand and the recovery of the semiconductor industry.**
- **Inflationary pressures are gradually dissipating. That said, climate risks like El Niño can exacerbate food price pressures.**
- **Downside risks related to economic and geopolitical uncertainties can weigh on investment and regional trade.**

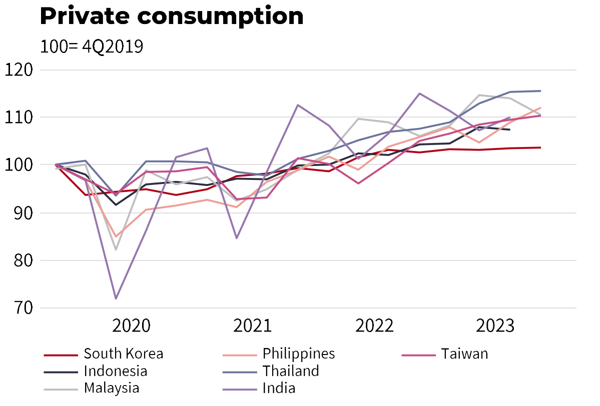
Regional growth is expected to remain buoyant this year. Domestic consumption, which accounts for more than half of GDP for most countries in the region, will continue to support regional growth. The labour market is improving, with unemployment in most economies already back to pre-pandemic levels. Tourism continued to recover, supporting consumption and service activity. Regional trade is gradually improving, driven by the recovery of the semiconductor sector. The start of the monetary policy easing cycle in the United States and Europe could provide a window of opportunity for central banks in the region to cut key rates and increase the attractiveness of emerging markets to investors.

Despite weak international trade, regional momentum remains resilient



Source: SG Economic & Sector Studies, Refinitiv

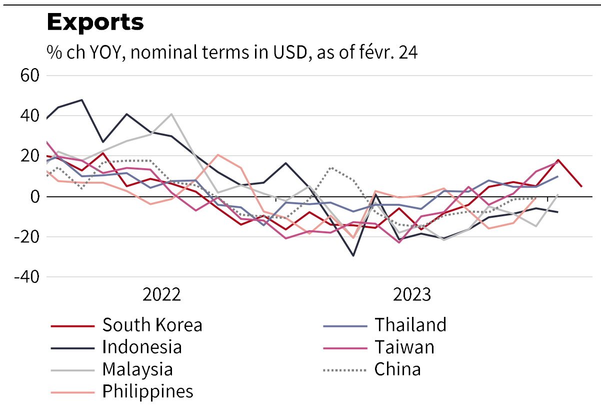
... Supported by private consumption



Source: SG Economic & Sector Studies, Refinitiv

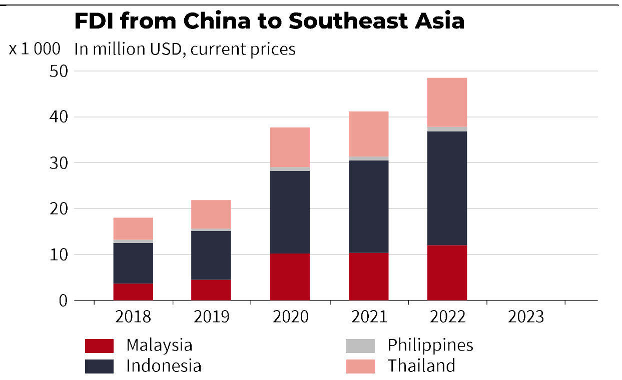
External demand is gradually improving, as the recovery in the semiconductor cycle improves the region's trade prospects. Exports from the region are gradually recovering, especially for technology exporters (Taiwan and South Korea). The semiconductor industry is seeing early signs of improvement... Semiconductor exports and production have accelerated in South Korea since August 2023, initiating a cyclical recovery from the industry's more than year-long contraction. In 2024, this improvement, driven by the recovery in semiconductors, is expected to continue. The West's de-risking policy towards China could also be an opportunity for Southeast Asia to improve its position in value chains, especially for semiconductor producing countries such as Malaysia or Vietnam and base metals producing countries such as Indonesia. The region's relative neutrality towards China and the United States could help attract foreign direct investment, especially from China, to circumvent export controls imposed by the West. China's foreign direct investment in Southeast Asia has more than doubled in the space of 5 years, driven by the EVs and renewable energy sectors.

External demand is very gradually recovering



Source: SG Economic & Sector Studies, Refinitiv

Southeast Asia could benefit from China-US decoupling policy



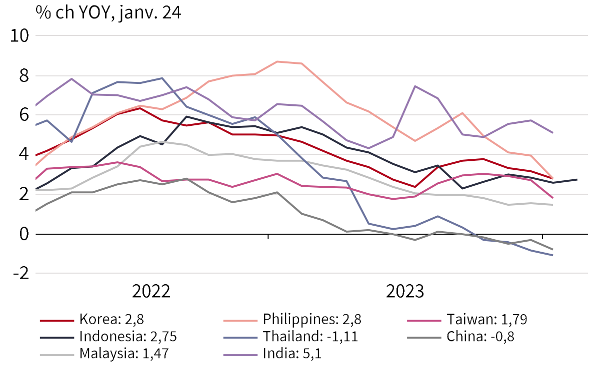
Source: SG Economic & Sector Studies, Refinitiv

Inflationary pressures will continue to ease, but upside risks from El Niño, may exacerbate food prices. Most economies have returned to pre-pandemic inflation averages, as energy and food price pressures ease. That said, El Niño may affect agriculture and harvests in the region and exacerbate food prices while ongoing Israeli-Palestinian conflicts could increase oil prices.

Inflationary pressures have gradually dissipated

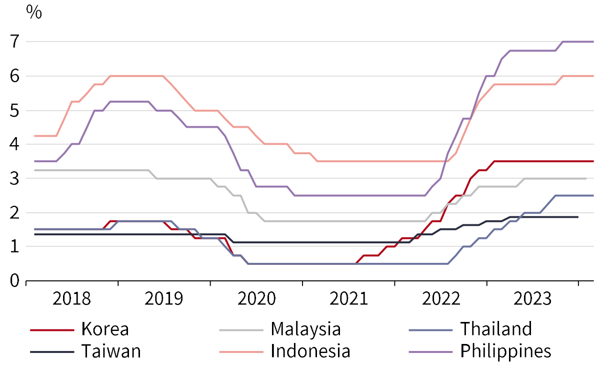
… allowing central banks to halt their tightening cycle

Inflation



Source: SG Economic & Sector Studies, Refinitiv

Central banks' policy rate



Source: SG Economic & Sector Studies, Refinitiv

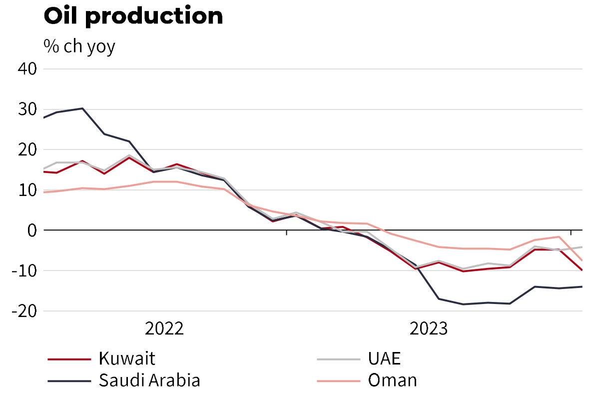
Risks in the region are to the downside given the uncertainties related to the external environment that remain elevated. Stronger inflation in developed economies could lead to a further tightening of financial conditions and could put pressure on growth and investment in the region. A sharper or more prolonged correction in China's property market could affect countries in the region whose exports are strongly linked to China's investment or demand for commodities. A slowdown in productivity and investment in China could also weigh on the region, as the region relies heavily on Chinese demand, investment, and global value chains. In the medium term, given the deterioration of relations between the United States and China, particularly on trade policies and the status of Taiwan (especially with the upcoming US presidential elections), the risks of further fragmentation of global trade could weigh on the region, which is vulnerable to declining trade flows and foreign direct investment.

GULF STATES

- **Regional growth slowed sharply in 2023, due to the contraction in hydrocarbon production.**
- **Non-oil sectors have generally been more resilient, and will support the rebound expected for 2024.**
- **The conflict between Israel and Hamas remains the main risk.**

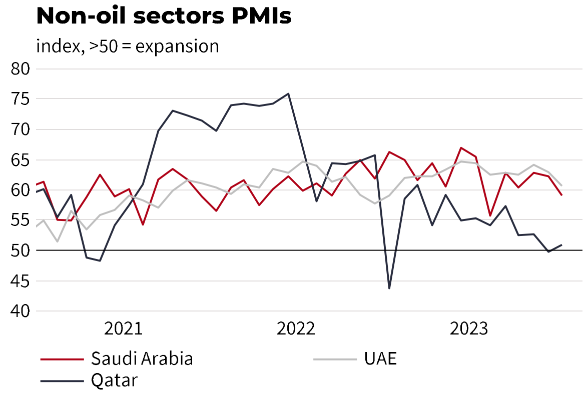
Growth in the GCC (Gulf Cooperation Council) countries slowed significantly in 2023, estimated at slightly above 1% (vs. around 7% in 2022). This is mainly explained by the contraction in oil production decided by OPEC+ in April 2023 (Saudi Arabia adding a voluntary reduction in its production of 1 million barrels/day). In total, the region's hydrocarbon GDP probably contracted by 1% last year. Although slowing, non-hydrocarbon growth has proven to be more resilient, still supported (among others) by major investment projects (infrastructure, tourism, energy, trade) – particularly in Saudi Arabia and the United Arab Emirates. Non-hydrocarbon performances were more moderate in Qatar (base effect after 2022 marked by the FIFA World Cup), as well as in Oman and Bahrain due to fiscal consolidation efforts.

Contraction in oil production



Source: Refinitiv, SG Economic and Sector Studies

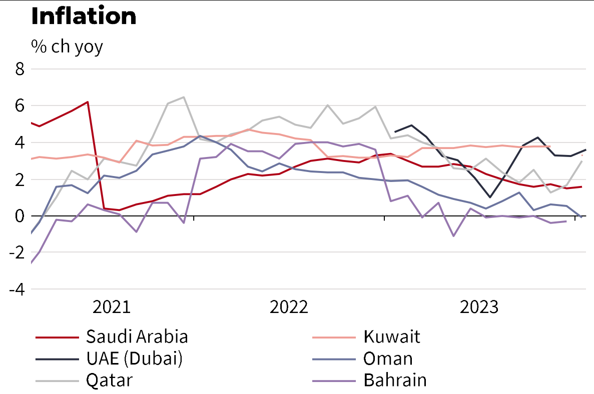
Resilient PMIs



Source: Refinitiv, SG Economic and Sector Studies

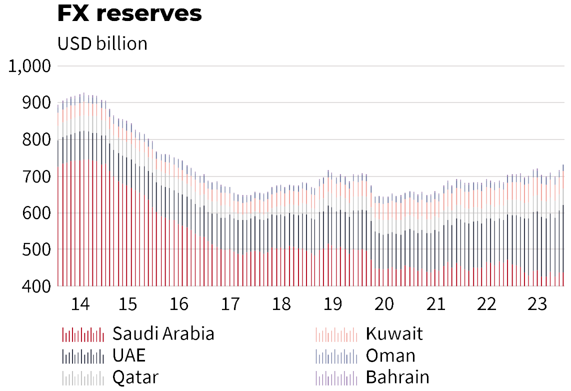
The outlook for 2024 is good, even if uncertainties have increased regarding the recovery of the oil sectors. In total, regional growth should be around 3.5%. The available leading indicators (PMIs in particular) confirm that the good performance of the non-hydrocarbon sectors should continue in 2024 and 2025. Solid labour markets (with for example unemployment rates often returning to their pre-Covid level) and the gradual decline of inflation (particularly linked to the reduction in world food prices) should enable a rebound in private consumption. Public demand should remain robust: although expected to fall (slightly), oil prices should remain, for 2024, higher than the fiscal breakeven oil prices in most countries (or close to them, in the case of Saudi Arabia). Only Bahrain, with a fiscal breakeven oil price of around USD 100/b, will likely have to accelerate its budgetary consolidation efforts. More generally, and while the region remains one of the most exposed to climate risks (more particularly transition risks), non-hydrocarbon sectors will continue to benefit from the significant increase in "green" (more particularly, mitigation) and diversification investments. The outlook for the oil sectors is more uncertain. While most observers expected a gradual acceleration of production in most GCC countries, the January 2024 repeal by the Saudi Ministry of Energy of a directive issued in 2020 to Saudi Aramco (the state oil company), aimed at increasing the "maximum sustainable capacity" of oil production from 12 million b/d to 13 million b/d, suggests that the country could be satisfied with its current production. Given the political weight of Saudi Arabia within OPEC, a more "wait-and-see" regional stance on future production increases cannot be ruled out – in order to support prices in the face of a US oil production at its historical high. However, several oil & gas megaprojects will still emerge in the years to come (expansion of the North Field gas field in Qatar, for example).

Gradual decline in inflation rates



Source: Refinitiv, SG Economic and Sector Studies

Comfortable FX reserves



Source: Refinitiv, SG Economic and Sector Studies

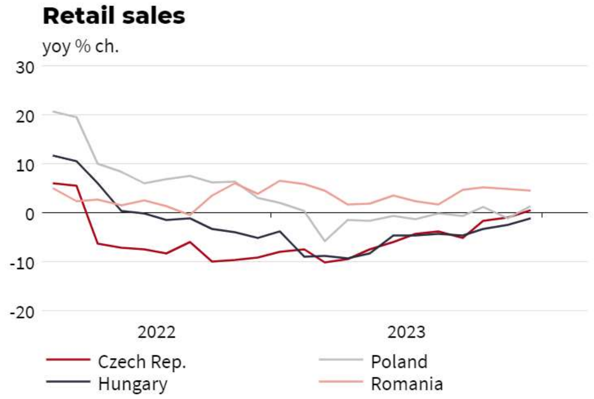
Several risks continue to weigh on these prospects, even if the financial situations of countries in the region remain very comfortable (large budget surpluses, vast foreign exchange reserves, etc.) – except in Bahrain. The most important of these risks remains the conflict between Israel and Hamas. An escalation/generalization of the conflict (for example with the involvement of Iran) would strongly impact the Gulf countries: decline in the general attractiveness of the region due to security issues; loss of investor confidence which would undermine the various projects initiated by States as part of their diversification plan; drop in tourism income, etc. Furthermore, greater unrest in the Red Sea would inevitably affect regional supply chains (for hydrocarbon exports, but also for imports of consumer/equipment goods).

CENTRAL AND EASTERN EUROPE

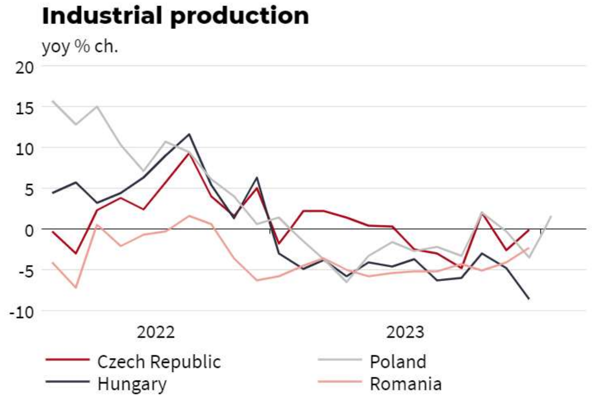
- **Growth should rebound slightly in 2024-2025 driven by the recovery in domestic demand.**
- **Inflation has slowed leading to first rate cuts in Poland, Hungary and Czech Republic. This trend is expected to continue and further rate cuts should occur in 2024.**
- **Downside risks relate mainly to a slower-than-expected EU fund absorption, to the war in Ukraine and the related uncertainties.**

Growth has decelerated in 2023, in a context of slowing activity in the euro area and tight financial conditions. Growth remained sluggish in Q3 and Q4-23 in the region and in negative territory in Czech Republic. The slowdown in the euro zone, the region's main trading partner, weighed on activity. The maintenance of high interest rates has affected corporate investment and household residential investment, particularly in countries with a high share of variable-rate mortgages such as Poland. However, with ongoing disinflation, real wages are progressively returning to positive territory. This should sustain consumption in the coming quarters. Industrial production remains in negative territory, except in Poland.

Consumption is picking up



Industrial production not yet

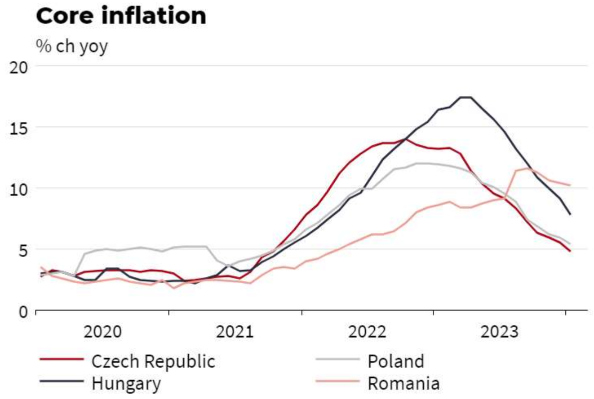


Source: Refinitiv, SG Economic & Sector Studies

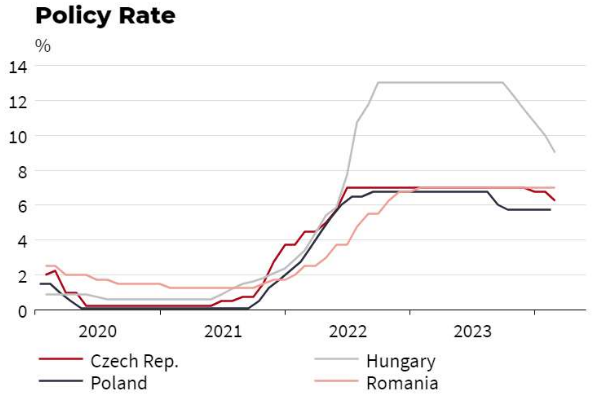
In the wake of the moderation of gas prices, inflation has decelerated but remains above central bank targets. The price of gas on the European market peaked in August 2022 and has fallen significantly since amid falling demand and additional supplies of liquefied natural gas from Norway and Algeria. Core inflation (excluding food and energy prices) has peaked in H12023 in the Czech Republic, Poland and Hungary and has decelerated since, except in Romania. In this context, several central banks have started to lower their key rates since Q3-23: Poland in September, Hungary in October, and Czech Republic in February 2024.

Disinflation will continue in 2024-2025. The slowdown in inflation will be enabled by the moderation of energy and food prices. In this context, central banks in the region could lower rates during 2024.

Core inflation peaked in early 2023 (except in Romania)



Further rate cuts could take place in 2024



Source: Refinitiv, SG Economic & Sector Studies

Growth in the region is expected to rebound slightly in 2024-2025, driven by the recovery in domestic demand. In a context of moderating inflation, purchasing power and household consumption should recover. However, the end of several household support measures (such as in Poland where the Energy Shield and the Solidarity Shield have expired in December 2023) will limit the rebound in private consumption.

Public investment will continue to show positive momentum due to the continued absorption of European funds: Cohesion funds and European Recovery and Resilience Facility (NextGeneration EU). The EU commission has relaxed in January part of the cohesion funds frozen for Hungary. In February, it has confirmed that the EUR 60bn Recovery and Resilience Facility (RRF) for Poland would start to be disbursed in April, as well as the Cohesion Funds in the 2021-27 budget. The first RRF tranche is worth EUR 6.3bn and the first Cohesion Funds EUR 600m.

Private investment is likely to remain weak, despite the lower frictions in supply chains in the automotive sector, due to the continued tightening of financial conditions and the rising unit labour costs in a context of sustained dynamics of nominal wages. The increase in costs will be partly passed on in prices by companies, but certainly not entirely, which will weigh on their margins.

Fiscal policy should become more restrictive due to the reactivation of European fiscal rules and the fiscal consolidation that will follow, particularly in Romania which displays a substantial budget deficit.

Downside risks to the growth outlook relate mainly to a slower-than-expected EU fund absorption or lower effectiveness of implemented projects to raise growth prospects, and weaker-than-expected external demand. They also relate to the war in Ukraine and the related uncertainties surrounding the availability and price of energy in the region. A total cut-off of Russian gas supplies would have a significant impact on some countries, with a high risk of recession in Hungary, due to its high share of gas in the primary energy consumption, also high in Croatia. Poland and Romania are less exposed. Another risk lies in the evolution of inventories in 2024, after their sharp increase since 2021**.** In Poland and Czech Republic, a scenario of normalization of their trajectory could generate a downside.

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