ECOPERSPECTIVES

3rd Quarter 2026
July 2026

EMERGING MARKETS

"DESPITE THE WAR IN IRAN, THE CLOSURE OF THE STRAIT OF HORMUZ AND THE TEMPORARY SURGE IN ENERGY PRICES, EMERGING ECONOMIES HAVE SO FAR AVOIDED A CRISIS SCENARIO."

ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

TABLE OF CONTENTS

EDITORIAL
3 Emerging economies: why is the energy shock not derailing growth driven by the AI boom?

ENERGY SHOCK
6 Consequences of the energy shock

MAIN INDICATORS
7 Main indicators of emerging countries

REGIONAL OVERVIEWS
8 Regional overviews

CHINA
10 Strengths and imbalances

SOUTH KOREA
12 Between the energy shock and the AI boom, growth is finding a new balance

INDIA
14 An economy better equipped than in 2022 to face the energy shock

INDONESIA
16 Robust growth but deteriorating governance

POLAND
18 Robust growth with no major imbalances aside from the public deficit

ROMANIA
20 Weakened by political instability

TÜRKIYE
22 The economy will cope with renewed headwinds once again

BRAZIL
24 The high cost of resilience

COLOMBIA
26 A programme of radical change

MEXICO
28 USMCA review: Mexico's industrial headache

SAUDI ARABIA
30 The conflict in the Middle East: more than just a temporary shock

EGYPT
32 Encouraging signs of macroeconomic recovery

EDITORIAL

EMERGING ECONOMIES: WHY IS THE ENERGY SHOCK NOT DERAILING GROWTH DRIVEN BY THE AI BOOM?

Despite the war in Iran, the closure of the Strait of Hormuz and the temporary surge in energy prices, emerging economies have so far avoided a crisis scenario. Their growth is slowing marginally, inflation remains contained in most countries and financial markets have not collapsed. The most powerful growth engine is coming from Asia: global demand for chips, data centers and electronic goods linked to artificial intelligence is offsetting part of the oil shock and reshaping the external balances of several emerging countries.

Emerging economies have so far withstood the energy shock caused by the conflict in the Middle East better than expected. The surge in oil, gas and energy-related input prices was rapid, but less inflationary than in 2022. If monetary easing cycles have been interrupted in many countries, most central banks have been able to keep their rates unchanged over the past four months. Emerging financial markets did not experience a generalized loss of confidence, while macroeconomic buffers stronger than in summer 2022 helped absorb the rise in energy costs. In Asia, the region most dependent on Middle Eastern hydrocarbons, authorities have limited the risks of shortages by diversifying supply sources, mobilizing reserves and adjusting demand. Most importantly, countries exporting technological goods have been benefiting strongly from the boom in artificial intelligence. Investments in AI physical infrastructure and global demand for chips and other electronic goods have been supporting growth and external accounts of several emerging economies, sometimes more than the energy shock penalizes them. In the short term, the average growth of emerging markets should therefore slow down only moderately. Risks remain high, however, including more persistent inflation, possible increases in US Fed rates, geopolitical tensions, volatility in commodity prices and the risk of a tech cycle correction.

GROWTH IN EMERGING ECONOMIES: THE ENERGY SHOCK SLOWS ACTIVITY AND ACCELERATES INFLATION, WITHOUT CAUSING A CRISIS

Emerging market economies have overall withstood the energy shock caused by the war in Iran. Their average growth, solid in the first quarter of 2026 (estimated at +1.0% q/q), is expected to slow only very moderately in the second quarter. Neither business surveys nor activity indicators experienced significant deterioration during the spring. The aggregate manufacturing PMI for emerging countries fell in March before rebounding in April and remaining almost stable thereafter; in June, it was in expansion territory (at 51.4) and slightly above its January-February average level. By the end of June, only four of the eighteen major emerging economies (Chile, Indonesia, Türkiye, Egypt) had a manufacturing PMI below 50 and lower than in February. In industrialized Asian countries that are also net hydrocarbon importers, PMIs remained well-oriented despite the energy shock. In Vietnam, real GDP growth accelerated to +8.4% y/y in Q2, up from +7.9% in Q1, driven by strong industrial production and export performance. In China, economic growth slowed in Q2 (+4.3% y/y after +5% in Q1), notably curbed by rising energy prices, lower public spending and weak demand of the domestic private sector (see the note on China, page 10).

On the inflation front, the shock proved less severe than expected: inflationary pressures have emerged quickly but remained moderate. The closure of the Strait of Hormuz had an immediate and significant impact on global energy prices (Brent price: +57% between late February and late April – see table A & chart B, page 6), as well as on fertilizer and petrochemical product prices. The shock quickly affected fuel prices and transport costs around the world.

Exposure to the energy shock

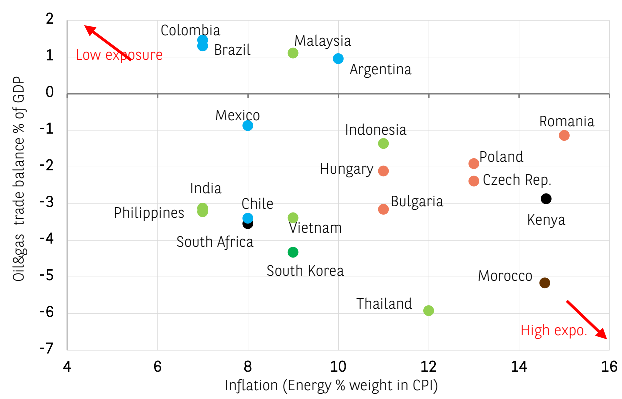

CHART 1 SOURCE: ITC, NATIONAL STATISTICS, BNP PARIBAS

However, on the one hand, the increases have so far spread little to agricultural and food prices. This has significantly limited the impact of the energy shock on CPI inflation (energy typically accounts for less than 15% of the CPI basket in emerging countries, while the average weight of food is 30%), particularly when compared to the 2022 shock resulting from the war in Ukraine. On the other hand, oil prices fell from late April (Brent price: -19% in May and -21% in June), helped by the faster reduction in OECD countries' stocks and lower Chinese oil imports, and then by prospects of the reopening of the Strait of Hormuz[1].

The median CPI inflation rate in emerging markets has risen moderately, from 3.2% y/y in February to 4.3% in June. Inflation thus remains contained in a majority of countries (see chart C, page 6). In the countries most severely affected (notably the Philippines and Thailand, followed by Kenya, South Africa and Bulgaria), the inflationary shock is explained by a greater direct exposure to the energy price shock (Chart 1, above) and, in some cases, by the depreciation of their currency. Conversely, inflationary pressures have been the lowest in countries using subsidies or fuel price controls (for example India, Indonesia, Malaysia or the Gulf countries). In China, rising energy prices have helped reduce deflationary pressures (though not addressing the underlying structural causes): producer prices have been increasing since March after more than three years of decline, and CPI inflation has accelerated slightly to +1.1% y/y in Q2 2026 vs. 0.8% in Q1.

Monetary easing cycles, which were underway in many countries at the beginning of the year, have generally been interrupted. But interest rate hikes have been few and limited in scope (see chart D, page 6). Since the beginning of the war in Iran, only a few central banks have significantly raised their policy rates, but not necessarily in response to the energy shock. It is, in particular, the case of Indonesia and Colombia:

1 BNP Paribas, 16 June 2026: Reopening of the Strait of Hormuz: the oil market between short-term relief and persisting uncertainties

while their direct exposure to the energy price shock is limited (Chart 1, page 3), monetary authorities reacted, in the first case, to the nervousness of foreign investors and the depreciation of the rupee and, in the second, to the expansionary drift of fiscal policy and its effects on inflation (*cf.* Indonesia & Colombia, pages 16 and 26). Monetary policy was also tightened in the Philippines and, to a lesser extent, in South Africa and the Czech Republic, as central banks acted quickly when inflation moved away from target (3%±1 for the Philippines and South Africa, 2%±1 for the Czech Republic). Korea's central bank is the latest to have raised its policy rate on 16 July (+25bp) due to inflationary pressures in a context of solid economic growth (*cf.* South Korea, page 12).

A large number of central banks have kept their key interest rates unchanged, including in Asia. The monetary status quo could be maintained in Thailand (which is emerging from a year of deflation), Vietnam (whose central bank has objectives to stabilize prices but also to support demand) and China (which is seeking to stimulate credit and combat deflationary pressures). Brazil and Hungary are two exceptions as they have, as planned before the war, started their monetary easing cycle (since February, policy rates have been cut by 75bp in Brazil and 50bp in Hungary).

WHY ARE EMERGING COUNTRIES COPING BETTER THAN IN 2022 WITH THE ENERGY SHOCK?

Macroeconomic resilience. Emerging countries' macroeconomic fundamentals and their cyclical position have helped cushion the impact of the external shock. At the beginning of the year, emerging economies as a whole, experienced dynamics of strong growth, disinflation, and lowering public and external account imbalances. In India, for example, the authorities have more leeway to support the economy thanks to a smaller budget imbalance, lower current account deficit and more moderate inflation than in 2022 (*cf.* India, page 14). In Egypt, the adjustment of economic policies over the last few quarters (fiscal reforms, increased exchange rate flexibility) and support from international creditors have been helping to limit the destabilizing effect of rising energy prices (*cf.* Egypt, page 32). In Poland and more generally in Central Europe, inflation is much more moderate than in 2022, and inflation expectations are better anchored (*cf.* Poland, page 18).

Energy resilience. The supply shock was less severe than feared at the time of the first military attacks in late February. Hydrocarbon shortages and their direct effects on activity have been more limited. Asian countries – despite being the most exposed to supply disruption risks due to their reliance on hydrocarbon imports from the Middle East – have demonstrated strong adaptive capacity. They rapidly implemented solutions to reduce the risk of shortages, with measures to contain demand, search of alternative supply sources (for instance from Russia, floating stocks, etc.). Central European[2] and Latin American countries[3] are less or little dependent on hydrocarbons from the Middle East.

The absence of a financial shock. Emerging financial markets have not experienced widespread stress since the beginning of the war in Iran. Investment flows have been highly volatile in an international context marked by rising geopolitical risks and upheavals linked to the AI boom. However, overall, emerging markets have not experienced any major loss of foreign investor confidence. Financial conditions have tightened only slightly for emerging sovereign and private borrowers. CDS spreads and domestic bond yields tensions have remained contained and lower than in 2022, and currencies have generally held up well (Chart E, page 6). Between 27 February and 18 June 2026 (memorandum of understanding between the United States and Iran), the most significant depreciations affected either the countries most directly exposed to the energy shock, such as Thailand (-5.3% vs. USD), South Korea (-6.2%) or the Philippines (-4.5%), or those with specific macroeconomic vulnerabilities, such as Indonesia (-5.7% vs. USD), Romania (-5.4%) and Türkiye (-5.4%). Emerging currencies appreciated between the signing of the MOU and the resumption of military attacks in mid-July.

Another factor contributing to the broad resilience of the emerging economies is the boom in AI and global demand for AI-related goods.

THE EXPANSION OF AI INFRASTRUCTURE SUPPORTS ACTIVITY IN ASIA

For emerging countries as a whole, the rise of AI represents a positive growth shock that offsets the negative impact of the energy shock. So far, the impact of AI expansion on emerging economies has been mainly through the spillover effects of investments in the physical infrastructure of AI[4], via supply chains and global trade[5]. The countries that produce the goods necessary for the construction of data centers and other AI infrastructures (critical metals and, above all, chips and other electronic goods) have indeed a strategic advantage in their international relations, a solid export base and a growth driver. **In some of these countries, the surge in global demand for AI-related goods is also reshaping external account dynamics.**

Countries that produce critical minerals hold a particularly strategic position, but economic growth gains directly linked to the AI boom are modest in the short term. They export these minerals largely in their raw state, without great added value, and the quantities used are limited. While all AI-related goods account for about 15% of the total value of global exports (Oxford Economics data), raw materials represent less than 3%. However, the rise in critical metal prices has supported the terms of trade for exporting countries (for example, the price of copper has increased by 42% over the past year and by 8% since the beginning of 2026). This has enabled, particularly in certain Latin American countries, to offset the impact of rising prices of imported hydrocarbons since the beginning of the conflict in the Middle East.

Countries that produce chips and other electronic goods have, on the contrary, benefited from strong support for activity and exports over the last few quarters. It essentially concerns Asian countries, which provide 65% of global exports of AI-related goods and 85% of semiconductor exports (2025 data). Taiwan, as well as South Korea, China, Vietnam, Malaysia and Thailand are the main beneficiaries of the rise in global demand for AI-related goods in terms of impact on activity[6]. **On the other hand, the impact on current account balances varies widely and depends on the producing country's position in the value chains.**

Upstream in the chain, Taiwan and South Korea produce the most sophisticated and indispensable chips for AI, and the rise of AI supports activity and current account surpluses. Their merchandise exports have shown very high growth rates (+47% y/y in value in both Korea and Taiwan in H1 2026), driven by a strong increase in both volume (estimated at over 20% y/y in H1) and prices (see chart F, page 6). Export prices are supported by the rapid increase in demand and the rise in the value chain (in South Korea, the average price of exported

2 BNP Paribas, 27 April 2026: Energy shock: The four keys to Central Europe's resilience
3 BNP Paribas, 15 April 2026: Latin America: more exposed to inflationary pressures than to disruptions in hydrocarbon supplies
4 BNP Paribas, 6 March 2026: The rise of artificial intelligence: strategic opportunities for emerging countries
5 Growth in the volume of world merchandise exports accelerated from 2.8% in 2024 (1.8% in value) to 4.4% in 2025 (6.8% in value) and 6.7% y/y in the first four months of 2026 (CPB data), largely driven by demand for AI-related goods.
6 According to Oxford Economics estimates, Taiwan benefits from the most significant positive impact on its GDP and net exports from a USD100 increase in US imports of AI-related goods. Vietnam, Malaysia, South Korea, Thailand and China follow. *Cf.* Oxford Economics, 21 May 2026: *How AI is shaping regional supply chains – and fuelling a new savings glut*.

semiconductors has more than doubled in a year). The growth in volumes has recently slowed down, with the manufacturing sector activity being constrained, on the one hand, by rising energy and commodity costs and, on the other hand, by high production capacity utilisation rates.

Boosted by production and exports of AI-related goods, Taiwan's economic growth reached 14.5% y/y in Q1 2026 (with a contribution from net exports of 10.3pp) and South Korean growth accelerated to 3.8% (with a contribution from net exports of 1.5pp). On the external account side, strong growth in chip exports and the improvement of terms of trade have had a direct and significant positive impact on the trade and current account balances (*cf.* chart 2). External surpluses are reaching record highs despite the rise in the energy bill. In Q1 2026, Taiwan's current account surplus is estimated at nearly 25% of GDP (vs. an average of 15% over the past five years), and South Korea's at nearly 15% of GDP, compared to 4% over the past five years (South Korea).

China exports a wider range of AI-related goods, but their production requires importing microprocessors and other high-value-added components, notably from South Korea and Taiwan. The boom in AI-related global demand is boosting export activity, and China's AI sector is becoming an essential driver of growth in both the industrial and services sectors. However, the balance of trade in AI-related goods is close to equilibrium, as imports are increasing in line with exports. Therefore, the boom in trade of AI-related goods does not increase China's trade surplus (*cf.* China, page 10).

Other exporters of tech goods are more specialized in the assembly, testing and packaging of chips to form electronic components at various stages of the value chain. They are all benefiting from solid support for economic growth and export revenues. However, not all have a position that allows them to increase their trade surpluses thanks to the rise in global demand for AI-related goods (*cf.* chart 2). Malaysia currently benefits from its status as a net exporter of hydrocarbons and semiconductors.

At the other end of the spectrum, Thailand, Vietnam and, to a much lesser extent, Mexico produce lower value-added goods. They are currently facing both the rise in energy costs and the rise in the price of electronic inputs that they have to import to run their factories (*cf.* Mexico, page 28). In Thailand and Vietnam, the trade balance moved from a surplus in H1 2025 to a deficit in the same period in 2026. The boom in AI therefore tends to exacerbate their external vulnerability. While Thailand has sufficient foreign exchange reserves to absorb shocks to its balance of payments, Vietnam has low forex reserves and could face some pressure on its currency in the coming months.

FORECASTS FOR 2026: ECONOMIC GROWTH CLOSE TO 4%, BUT THREE MAJOR SOURCES OF RISK FOR TURBULENCE

Average growth in emerging economies is therefore expected to slow only moderately in the short term. In our central scenario, we expect average growth slightly below 4% for the whole of 2026, after 4.5% in 2025. The slowdown is, unsurprisingly, most pronounced in the Gulf[7] and the Middle East. It is widespread but relatively moderate in Asian countries, with the effects of the AI boom helping to offset the consequences of the energy shock in the most industrialized economies. Asia's average economic growth will remain the strongest among emerging regions. The slowdown is much less pronounced in Latin America, particularly thanks to the expected rebound in Mexico and the strong performance of Brazilian growth (*cf.* Mexico and Brazil, see pages 28 and 24), and in Central Europe, where activity is notably supported by public investment (see Regional Overviews, page 8).

External accounts: countries have varied positions in face of the energy shock and the AI boom

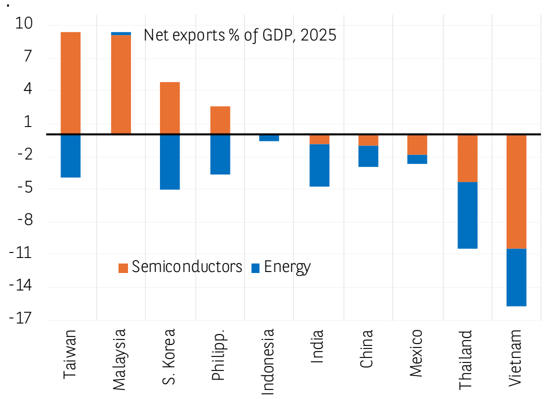

CHART 2

SOURCE: ITC, IMF, BNP PARIBAS

The first downside risk to this central scenario is the inflationary risk. Inflationary pressures are expected to persist, driven by durably higher commodity prices. They could lead to a broader tightening of monetary policies. After the signing, in late June, of the MOU between the United States and Iran, global oil prices had returned to their pre-war levels, but they have been increasing again since the resumption of military attacks. They should remain volatile and high in the short term. Global prices of critical minerals are expected to remain high, particularly due to the wave of AI investments and electrification. Agricultural commodity prices could also rise faster than expected due to a combination of higher fertilizer prices and weather phenomena (El Niño, heatwaves, unfavorable monsoon in India, etc.). The IMF expects an 18.6% increase in the average price of non-fuel commodities in 2026, after +10% in 2025.

The second risk to our forecasts is the risk of tighter global financing conditions for emerging borrowers, which will partly result from the expected increase in US Fed rates and could further intensify if foreign investor sentiment deteriorates. Large depreciations of emerging currencies would then also increase inflationary pressures. In a global context marked by geopolitical tensions and upheavals driven by the AI boom, the risks of financial turbulence are significant.

The third risk is the potential correction of the technology cycle. A sudden slowdown in investments in data centers and digital infrastructures would directly weigh on economies most exposed to semiconductor value chains. Given the current narrow base of global growth and its concentration around tech, such a correction would not be limited to financial markets: it would also affect the real economy, particularly in the industrialized countries of Asia and countries dependent on US demand.

Article completed on 16 July 2026

Christine Peltier
christine.peltier@bnpparibas.com

7 BNP Paribas, 15 July 2026: The conflict in the Middle East: a massive blow to growth in the Gulf

CONSEQUENCES OF THE ENERGY SHOCK

Oil and gas prices (annual averages)

	2025	2026p	2027p
Brent (USD/b)	68.1	81-96	79-110
TTF (€/MWh)	36.3	40-51	35-86

Forecasts: **lower bound** = temporary hike in tensions but negotiations continue;
upper bound = reescalation with indefinite Hormuz outage

TABLE A — SOURCE: BNP PARIBAS

Prices of oil, gas and fertilisers

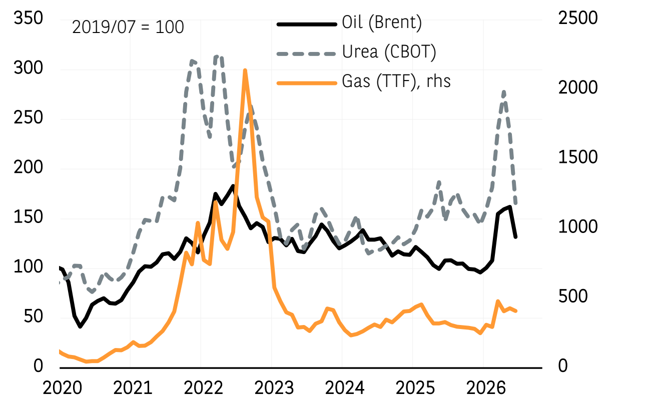

CHART B — SOURCE: BLOOMBERG

Moderate increase in inflation pressures

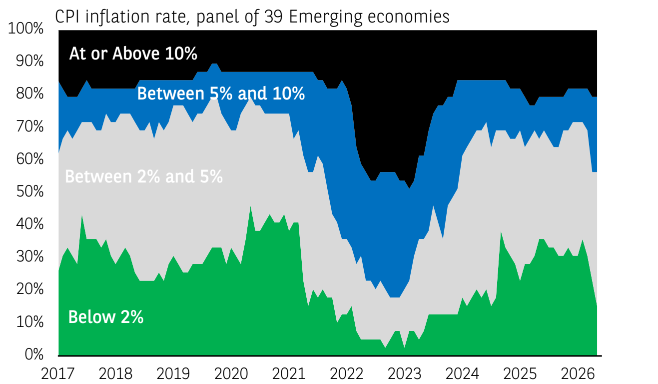

CHART C — SOURCE: CENTRAL BANKS, MACROBOND, BNP PARIBAS

Monetary tightening is not widespread so far

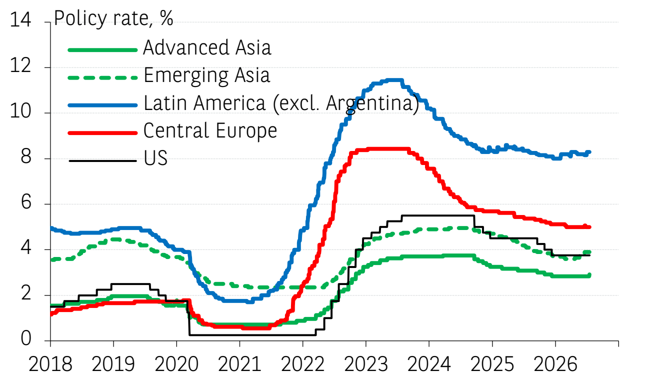

CHART D — SOURCE: CENTRAL BANKS, MACROBOND, BNP PARIBAS

Moderate currency depreciations

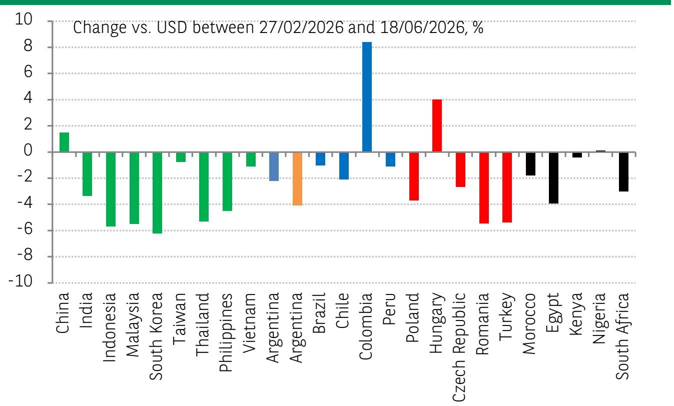

CHART E — SOURCE: MACROBOND, BNP PARIBAS

Chip producers enjoy the strongest export growth

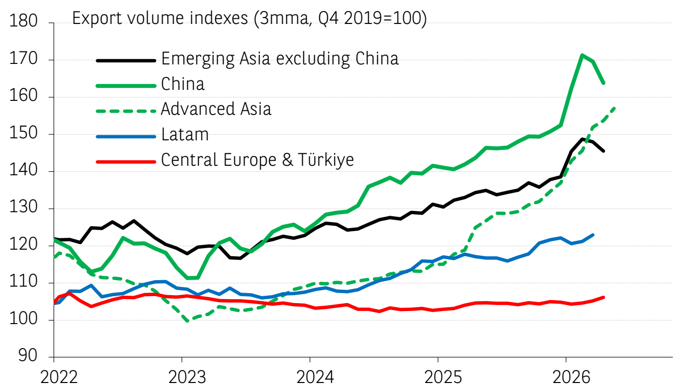

CHART F — SOURCE: CPB, MACROBOND, BNP PARIBAS

KEY INDICATORS

Real GDP

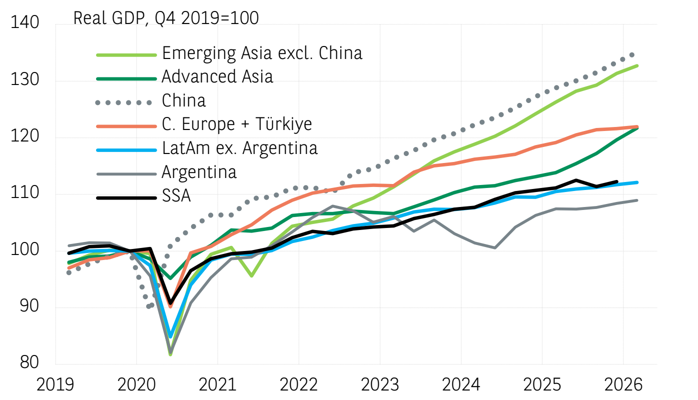

CHART 1 SOURCE: MACROBOND, BNP PARIBAS

Inflation

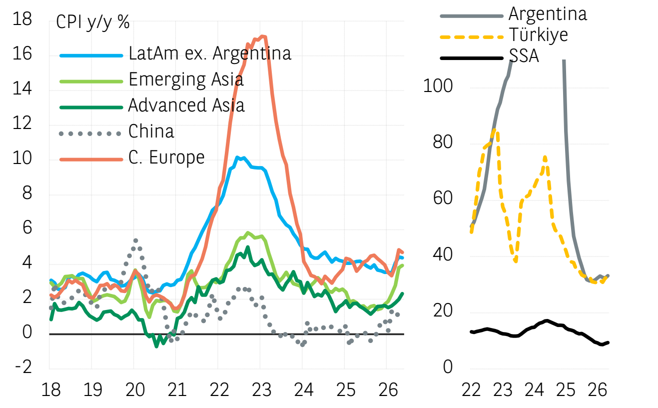

CHART 2 SOURCE: MACROBOND, BNP PARIBAS

Domestic bank credit

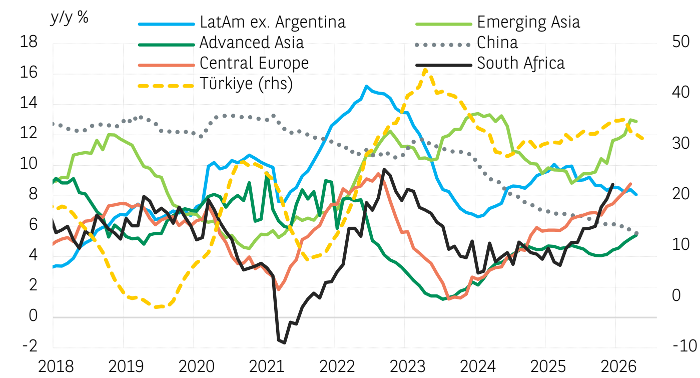

CHART 3 SOURCE: CENTRAL BANKS, BNP PARIBAS

Current account balance

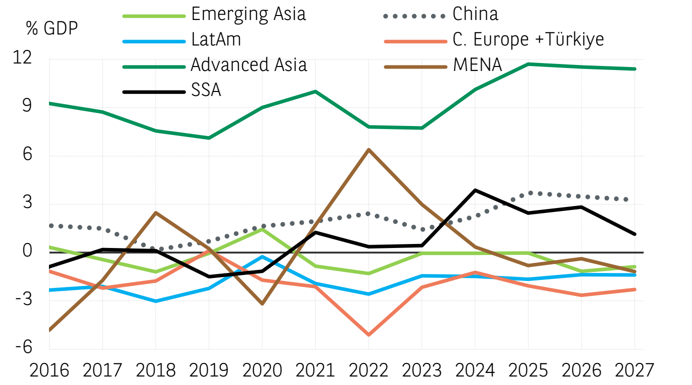

CHART 4 SOURCE: IMF (WEO), BNP PARIBAS

General government net balance

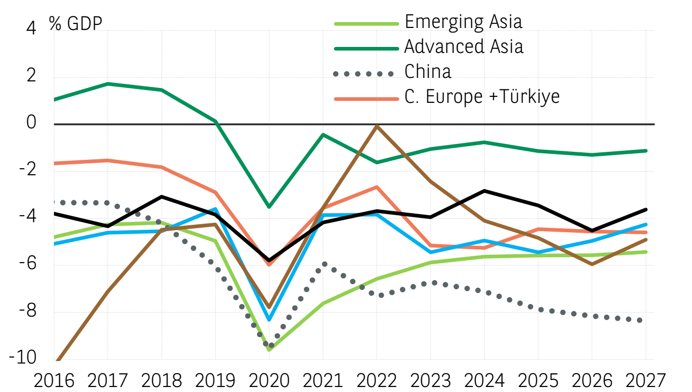

CHART 5 SOURCE: IMF (WEO), BNP PARIBAS

General government gross debt

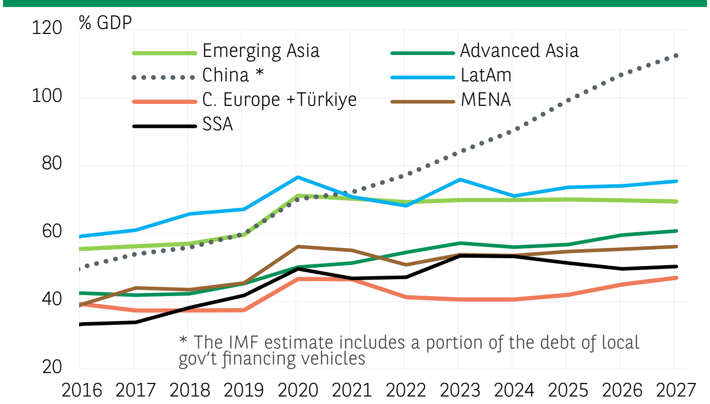

CHART 6 SOURCE: IMF (WEO), BNP PARIBAS

Emerging Asia: India, Indonesia, Malaysia, Philippines, Thailand, Vietnam **Advanced Asia:** Hong Kong, Singapore, South Korea, Taiwan **Central Europe:** Bulgaria, Czech Rep., Hungary, Poland, Romania, Slovakia **Latin America:** Argentina, Brazil, Chile, Colombia, Mexico, Peru **MENA:** Middle East-North Africa **SSA :** Sub-Saharan Africa: Angola, Kenya, Nigeria, South Africa.

REGIONAL OVERVIEWS

Article completed on 13 July 2026

NORTH AFRICA / MIDDLE EAST: A SEVERE SHOCK WITH DISPARATE EFFECTS

The consequences of the conflict in the region are significant. Average economic growth is expected to fall to 0.5% this year, compared to 4% in 2025. The Gulf Cooperation Council (GCC) countries are bearing the brunt of the correction, as, for the first time since 2020, a GDP contraction (of approximately 1%) is expected in 2026, due to the sharp decline in oil and gas production during the conflict. Non-hydrocarbon activity is also decelerating, although it is not contracting in Saudi Arabia or the United Arab Emirates. For Kuwait and Qatar – the least diversified GCC economies and with no alternative to the Strait of Hormuz – the growth shock is much more severe. For these two countries, real GDP contraction is expected to reach 7% to 8% in 2026.

Provided the situation stabilises, GCC growth is expected to rebound to 4.6% in 2027, driven by the recovery of oil and gas production and a rebound in the non-hydrocarbon sector. Uncertainties remain very high. Nevertheless, several factors are contributing to the resilience of these countries: relatively high global energy prices, vast financial resources and moderate debt levels. Financial market reactions have remained contained so far, including for Bahrain, despite its deteriorated macroeconomic fundamentals. Subsidies and the reorganisation of logistical flows around Saudi Arabia have helped to contain the inflationary risk induced by the closure of the Strait of Hormuz. Although rising, average inflation in the Gulf countries is not expected to exceed 2.5% this year.

The development models of the Gulf countries, while not entirely called into question, will need to be adjusted. Substantial investments will be required over the medium term, within an oil environment that could become unfavourable again. Saudi Arabia will have to continue managing a delicate balance between fiscal stability and the pursuit of the « Vision 2030 » programme.

In North Africa, the energy shock should remain manageable, particularly in Morocco, thanks to robust macroeconomic fundamentals. Greater exchange rate flexibility has enabled Egypt to absorb the impact on foreign currency liquidity resulting from higher energy bills and portfolio investment outflows. The upturn in activity and the disinflationary trajectory remain intact. In Algeria, the surge in energy prices will aid an economy which has seen its fiscal and external deficits deteriorate dangerously in recent years. However, without a clearly established fiscal consolidation strategy, this respite will be short-lived.

stephane.alby@bnpparibas.com

SUB-SAHARAN AFRICA: EXACERBATED FRAGILITIES

In 2026, regional economic growth is expected to slow to 4.1% (-0.4 pp compared to 2025), hindered by rising energy and fertiliser prices. Countries in Southern and Eastern Africa, which have nearly 50% of their oil and gas imports originating from the Middle East, have been impacted by temporary fuel shortages. To some extent, however, these countries have been able to diversify their oil supply sources through Nigeria, which is better positioned than in 2022 to benefit from higher oil prices (rebounding production and additional refining capacity).

Most countries have seen a rebound in inflation since March-April, with the exception of those that chose to subsidise fuel (WAEMU zone and Angola), but few central banks have tightened their monetary policy. In South Africa, the central bank raised its policy rate by 25bps in May, whereas cuts had been expected prior to the energy shock.

The shock is weakening the external accounts and public finances of many countries. With the exception of Angola and Nigeria, most countries in the region are net energy importers, and their energy trade deficits are considerable (up to 8% of GDP in Zambia). The external accounts of countries with raw material exports supported by favourable prices (gold, copper and other low-carbon transition metals) should remain resilient. For others, concerns persist. In Kenya, the risk of a sudden devaluation of the shilling has increased with the widening of twin deficits. Since the start of the conflict in Iran, the government has halved the VAT rate on fuels, while the fiscal deficit had already reached 5.8% of GDP over the first six months of the fiscal year. In Senegal, energy subsidies are expected to cause a fiscal slippage of approximately 2 pp of GDP for 2026. In Mozambique, the energy shock could be the trigger for restructuring Eurobond debt in the coming months.

lucas.ple@bnpparibas.com

LATIN AMERICA: LESS EXPOSED TO THE ENERGY SHOCK

Average growth in the main Latin American economies is expected to slow moderately in 2026 and remain close to 2% for the full year (compared to 2.3% in 2025).

During the Q4 2025–Q1 2026 period, growth performances were very uneven. Argentina and Brazil posted a significant acceleration in activity. Conversely, growth slowed in Peru and slumped in Q1 2026 in Chile and Mexico. With the exception of Argentina and Peru, the region's economies entered the turbulence created by the oil shock from a less comfortable position than the economies of Asia and Central Europe (the output gap remained negative in Q1 in Brazil, Colombia and Mexico).

South American economies should, in theory, be less affected by the oil shock than other emerging zones. Firstly, the risk of supply disruption is low. Secondly, these economies are, to varying degrees, net exporters of raw materials. Prices for hydrocarbons, as well as other raw materials, will be higher in 2026 than in 2025, particularly for certain raw or processed metals (copper and aluminium). To a lesser extent, agricultural commodity prices have recovered since the end of 2025 (wheat).

The status of net commodity exporter is not protecting countries against accelerating inflation. In May, compared to February, the year-on-year change in consumer prices was higher by +1.6 percentage points (pp) in Chile and Peru, +0.9 pp in Brazil, +0.5 pp in Colombia, only 0.1 pp in Argentina and even -0.1 pp in Mexico. **Nevertheless, overall, the inflationary impact remained moderate through May.**

Current account deficits should narrow due to improved terms of trade, especially in Brazil and Colombia. In contrast, rising energy prices will increase pressure on public finances via higher subsidies in Brazil, Mexico and Colombia. However, this risk is expected to be mitigated by the expected increase in fiscal revenues from oil. For Argentina, Chile and Peru, the inflationary impact could lead to monetary tightening, which would increase the interest burden on public debt. However, the moderate fiscal deficits of these countries should enable them to absorb this additional cost. Furthermore, governments in the region should overcome any potential tightening of international financial conditions without any undue difficulty.

helene.drouot@bnpparibas.com
francois.faure@bnpparibas.com
lucas.ple@bnpparibas.com

REGIONAL OVERVIEWS

Article completed on 13 July 2026

ASIA: THE REGION IS WELL-EQUIPPED TO FACE THE ENERGY CRISIS

In emerging Asia, a region highly exposed to the energy shock, economic growth is expected to average 5.0% in 2026, compared to 5.4% in 2025. The slowdown is expected to be fairly widespread, but moderate overall. Growth is expected to reach 4.6% in China (compared to 5% in 2025), 6.7% in India (for the 2026/2027 fiscal year, compared to 7.7% in 2025/2026) and 4.5% in the ASEAN-5 (compared to 5% in 2025).

Most countries have sufficiently solid fundamentals to cope with the consequences of the energy shock, although some currencies (notably in Indonesia and India) are under strong downward pressure. Furthermore, authorities have skilfully managed supply challenges, particularly in China. Most of all, activity in the most industrialised countries is largely supported by the booming global demand for AI-related goods, which is inflating the region's export revenues. Risks to our forecasts are skewed to the upside, despite accelerating inflation, rising interest rates and geopolitical uncertainty.

Except for Malaysia, Asian countries are large net importers of oil and gas. In 2025, their energy trade deficits reached between 1.4% of GDP in Indonesia and 5.9% of GDP in Thailand. However, governments have more headroom than in 2022 during the crisis linked to the war in Ukraine, as inflation is generally lower and fiscal deficits are better controlled. Furthermore, external accounts remain solid and current account deficits are modest. Even Vietnam, whose reserves represent less than three months of imports, has held up well against the shock.

The primary short-term risk is not the widening of the current account deficit, but the acceleration of capital outflows (already pronounced in India and Indonesia), especially if the Fed raises interest rates. Between the start of the war in Iran in late February and the end of June, Asian currencies overall experienced the most significant depreciations among emerging currencies, notably the Indonesian rupiah (-6.4% against the US dollar) and the Thai baht (-6.1%). These depreciations could accelerate in countries facing risks of fiscal slippage, particularly in India and Indonesia, where subsidies weigh on public finances. Conversely, the Chinese yuan continued to appreciate slightly (+1% against USD).

Energy price control policies have helped to limit inflation in India, Indonesia and, to a lesser extent, Malaysia, while prices rose more sharply in the Philippines and Vietnam. China has emerged from deflation thanks to higher prices at the pump and producer prices, but domestic demand is still sluggish, meaning that the resurgence of inflation could therefore prove temporary. In other Asian countries, inflationary risks will persist due to rising production costs and consistently high oil prices. While only the central banks of Indonesia and the Philippines have raised their rates so far, broader monetary tightening is possible by the end of 2026.

johanna.melka@bnpparibas.com
christine.peltier@bnpparibas.com

CENTRAL EUROPE: THE REGION SHOWS RESILIENCE

Central European economies are expected to cope with the energy shock well once again. As they are less dependent on the Middle East for hydrocarbon imports, the region's countries – with the exception of Poland– are minimally exposed to supply disruption risks. Admittedly, rising fuel prices are affecting economic activity. However, at the same time, growth will be supported by European recovery and resilience funds, of which EUR 43.1 bn (2.1% of the 2025 regional GDP) remain to be paid. These funds notably finance public investment.

In 2026, regional GDP growth could reach 2.4% (after 2.5% in 2025), but it will remain uneven. Poland, Hungary and the Czech Republic should be among the top-performing economies in the region, while Slovakia and Romania are expected to lag behind. These two countries are engaged in a fiscal consolidation process. Additionally, Romania is currently facing a political crisis, which is weighing on economic activity.

Downward pressure on currencies and the rise in inflation have remained moderate and far less pronounced than in 2022. Furthermore, the recent slowdown in food prices, followed by a slowdown in pump prices, has contributed to falling inflation in almost all countries, except Romania. Inflation should remain close to central banks' target zones in 2026 (except in Romania and Slovakia). However, prolonged uncertainties related to the situation in the Strait of Hormuz could alter this scenario.

Monetary authorities have reacted differently (a policy rate cut of 25bps in Hungary, a policy rate hike of 25bps in the Czech Republic and the status quo in Poland and Romania). In the short term, central banks are expected to remain cautious and keep their rates unchanged.

The energy shock has had a limited impact on public finances. With less fiscal headroom than in 2022, support measures have been limited to capping prices at the pump and reducing excise duties and VAT on fuel. Furthermore, exceptional taxes temporarily imposed on oil companies (Romania and Poland) are mitigating the effect on public finances.

External accounts are solid and should absorb the shock without any major difficulties. Since the start of the war in Iran, Central European countries have accumulated foreign exchange reserves, which cover more than 7 months of imports on average. Moreover, the outlook for portfolio investments remains well-oriented with a positive yield differential relative to Germany, while FDI remains dynamic (EUR 41.7 bn in the first three months of the year, or +109% y/y).

With a current account surplus, Hungary and the Czech Republic are the least exposed to a balance-of-payments deterioration. Conversely, Romania appears most exposed, given the scale of its current account deficit. However, the situation remains manageable because its energy trade deficit is relatively low (lower than other countries in the region) and the shock's impact on the current account remains limited. Romania produces the bulk of its gas consumption, which reduces its energy dependency.

cynthia.kalasopatanantoine@bnpparibas.com

CHINA

STRENGTHS AND IMBALANCES

China's economic growth continues to be characterised by a significant disparity between the robust performance of the export sector and the fragility of sectors that rely on domestic demand. This gap has even widened this year, fuelling concerns about China's growth model and its imbalances with its trade partners. In recent months, China has once again demonstrated its resilience to external shocks. The impact of the energy crisis caused by the war in Iran on economic activity and inflation has been limited. Furthermore, exports have benefited from the surge in global demand for goods linked to AI and green technologies. This momentum is expected to continue in the short term.

CHINA IS MANAGING THE ENERGY SHOCK WITH RELATIVE EASE

The energy shock triggered by the war in Iran has produced various effects on the Chinese economy, yet its overall impact has been moderate. Firstly, the country, which is a major importer of hydrocarbons (accounting for 72% of its crude oil requirements), has not experienced any supply difficulties. It has strengthened its energy security in recent years by diversifying supply sources and increasing reserves, developed renewable energy (which constitutes around 20% of the energy mix), all the while maintaining a predominant reliance on coal (55% of the mix). China has also acted swiftly to cushion the blow: turning to suppliers outside the Gulf region, compensating for shortfalls with coal, domestic gas and green energy, drawing on commercial reserves, temporarily suspending exports of refined products and fertilisers, and, finally, reducing crude oil imports and the production of refined products to lessen the impact of rising prices.

Indeed, the surge in oil and gas prices has increased production costs, contributing to a slowdown in industrial production (+4.3% y/y in April–May, down from +6.1% in Q1). Moreover, the rise in petrol prices at the pump has undoubtedly impacted household consumption. However, the direct impact of the inflationary shock is expected to be limited, thanks to China's fuel price control mechanism.

Finally, the conflict in Iran has not held back exports. In fact, it could even improve their prospects in the green technology sector.

ECONOMIC GROWTH: THE IMBALANCE CONTINUES

Exports have been rising rapidly since the start of the year (+18.7% y/y in value terms in H1 2026 vs. +5.4% in 2025). This growth has been driven by higher volumes (+16% y/y in January-April vs. +8.7% in 2025) and, for the first time since 2022, by a positive price effect (Chart 1).

Exports have benefited from: i) the reduction in US tariffs since 24 February and the rebound in sales of Chinese goods to the United States (+23% y/y by value in April-May, following twelve months of decline), ii) the surge in global demand for AI-related goods (exports in this sector rose by +44% y/y in January-May, accounting for 22% of total Chinese exports), and iii) strong demand for green technologies, which may continue in the short term as various countries seek to bolster their energy security in response to the shock caused by the war in Iran. Total exports of goods linked to the low-carbon transition (notably batteries, electric vehicles and solar panels) have risen rapidly (+40% y/y by value in January–May, according to Ember data), particularly to Asia and Europe. These goods account for 7% of China's total exports. The short-term outlook for exports remains very positive, despite the potential for a correction in the tech sector.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	3.1	5.4	5.0	5.0	4.6	4.5
Inflation, CPI, year average, %	2.0	0.2	0.2	0.0	1.3	1.6
Official budget balance / GDP, %	-2.7	-3.8	-3.0	-4.0	-4.0	-4.0
Official general gov. debt / GDP, %	49.4	54.7	60.9	68.5	74.6	77.5
Current account balance / GDP, %	2.2	1.4	2.5	3.8	3.5	3.4
External debt / GDP, %	13.4	13.4	12.5	11.9	11.7	11.4
Forex reserves, USD bn	3 307	3 450	3 456	3 744	3 844	3 924
Forex reserves, in months of imports	12.5	13.0	12.5	13.6	13.4	13.2

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

China's external trade: energy shock and IA boom

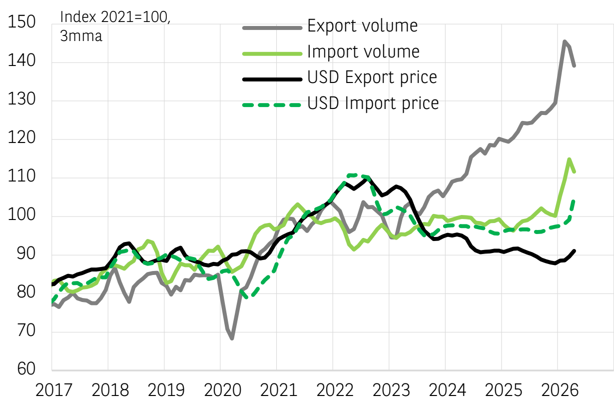

CHART 1 SOURCE: CPB, BNP PARIBAS

Domestic demand, meanwhile, has remained sluggish. It rebounded in January and February, but it has since significantly declined. In H1 2026, retail sales rose by only 1.3% y/y in value terms, vs. +3.7% in 2025. Investment saw a decline of 5.7% y/y in value terms in H1 2026, driven by a contraction in the property sector, manufacturing and infrastructure. The crisis in the property sector continues and household confidence remains low. Output in the services sector slowed to +4.5% y/y in Q2 2026, down from +5.1% in Q1 2026.

INFLATION: THE ACCELERATION IS NOT ENTRENCHED

Consumer price inflation accelerated slightly due to the energy shock, rising from +0.8% y/y in January–February to +1.2% in April–May. It then fell to +1% in June (having not exceeded +1% since early 2023). In Q2, vehicle fuel prices rose by an average of 17.9% y/y after six consecutive quarters of decline, while food prices fell by 1.6% y/y. Producer prices rose by 3.6% y/y, following more than three years of decline (Chart 2).

This rebound in prices would be welcome if it facilitated a sustainable exit from deflation for China. However, the problem lies in the fact that it is not accompanied by a strengthening of domestic demand – quite the contrary. It is primarily driven by rising commodity prices (with two other contributing factors being anti-involution measures and rising prices for electronic goods). Core inflation slowed slightly in H1 (+1.1% y/y in June). Consequently, inflationary pressures are unlikely to intensify in the short term unless oil prices start to rise again.

ECONOMIC POLICY: ADDITIONAL FISCAL SUPPORT EXPECTED IN H2

A short-term recovery in domestic demand seems possible only if the authorities step up their support measures. While the implementation of the new five-year plan (2026–2030) is expected to encourage investment, particularly in innovation, technology and AI[1], the easing of monetary and fiscal policies aimed at stimulating private consumption will remain cautious.

On the monetary policy front, the moderately accommodative stance of recent months will be maintained in the short term. Further cuts to policy rates are no longer expected in 2026 (the last cut to the 7-day reverse repo rate, from 1.5% to 1.4%, took place in May 2025), but real interest rates on loans have been falling slightly. Furthermore, the authorities are urging banks to increase their loan supply. However, reversing the slowdown in credit growth, observed since 2023, will be difficult without a recovery in the property market. Growth in total social financing reached a low of +7.7% y/y in May (down from +9.8% at the end of 2023), largely held back by the decrease in property loans (-3.4% in March).

On the fiscal policy front, the stance became restrictive in Q2 2026, particularly as local governments cut their spending[2], constrained by a decline in their land sales proceeds and tighter fiscal management rules. However, in line with the budget announced last March for the entire year, public spending is expected to rise in H2 2026. The budget forecasts a 4.4% increase in total general government expenditure in 2026; therefore, following a 1% y/y decrease over the January–May period, spending is expected to rise by 6% y/y over the June-December period. Households may therefore benefit from slightly more fiscal support in the coming months.

TRADE SURPLUS DOWN SLIGHTLY, EXPORTS UP SHARPLY

China's trade surplus has narrowed slightly since the start of the year. Imports have rebounded even more strongly (+26.2% y/y in H1 2026, following a period of near stagnation in 2025) compared to exports. This trend may continue, leading to a modest reduction in the current account surplus this year (projected at 3.5% of GDP).

On the capital account side, China is expected to remain a major net external creditor. Foreign exchange reserves remained largely unchanged in the first half of 2026, amounting to USD 3,786 bn in June, and the current account surplus continued to be channelled primarily through residents' investments abroad. Total resident capital outflows fell in Q1 to USD 144 bn, consistent with the decline in the current account surplus and ongoing geopolitical uncertainties.

China: slightly higher inflation

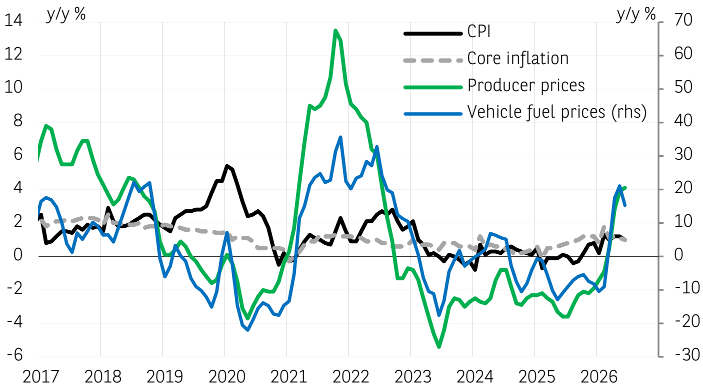

CHART 2 SOURCE: NBS, CEIC, BNP PARIBAS

At the same time, China has seen its export base strengthen, leading to increasing imbalances with some of its trade partners. Exports have been buoyed by strong global demand and the sustained competitiveness of Chinese goods. Although the yuan appreciated in H1 2026 (by 3% against the USD and 2% in real effective terms), it remains nearly 10% lower than its end-2022 level in real effective terms. This situation is expected to continue to support exports for the rest of the year.

The trade surplus stood at USD 577 bn in H1 2026, compared with USD 583 bn in H1 2025. Firstly, the energy trade balance (oil and gas) is in deficit (-1.8% of GDP in 2025), and the shock caused by the war in Iran has had a negative impact, although this has been mitigated by the reduction in oil imports.

Secondly, the boom in trade in AI-related goods has not led to an increase in China's trade surplus. In fact, the trade balance in this sector is close to equilibrium: while China exports a wide range of goods, their production requires the import of microprocessors and other high value-added components (particularly from South Korea and Taiwan). Imports have therefore risen in tandem with exports, both in terms of volume and value. Over the first five months of 2026, imports and exports of AI-related goods were estimated at around USD 380 bn.

By contrast, in sectors linked to the low-carbon transition, China often controls the entire value chain. As a result, the robust growth in exports has a significant positive impact on its trade balance. An acceleration of the low-carbon transition in certain European and Asian countries could potentially exacerbate their trade imbalances with China. Over the January-April period, China's trade surplus with the Eurozone grew by nearly 10% y/y, driven in particular by its exports of green technologies.

Article completed on 15 July 2026

Christine Peltier
christine.peltier@bnpparibas.com

1 BNP Paribas, 6 March 2026: China: Innovation and AI driving economic development
2 Local governments account for over 80% of expenditure in the general government budget. See BNP Paribas, September 2021: China's public finances, a tangled web

SOUTH KOREA

BETWEEN THE ENERGY SHOCK AND THE AI BOOM, GROWTH IS FINDING A NEW BALANCE

South Korea is one of the countries most exposed to the global energy shock, yet it also reaps substantial benefits from soaring demand for artificial intelligence-related products. Despite the country's dependence on hydrocarbon imports, with the vast majority transiting through the Strait of Hormuz, short-term growth forecasts remain highly optimistic, bolstered by a robust export sector. Factors such as inflationary pressures, the depreciation of the won, and rising household debt, justify monetary tightening. In the longer term, the government is banking on an integrated AI ecosystem, encompassing data centres, robotics and advanced materials to strengthen its key position in global value chains.

HIGHLY VULNERABLE TO THE ENERGY SHOCK, THE COUNTRY ACTED SWIFTLY

Since the beginning of the year, the Korean economy has had to deal with both the energy shock caused by the war in Iran and a global surge in demand for semiconductors.

South Korea imports almost all of its energy. Over 70% of its crude oil imports and over 20% of its liquefied natural gas imports pass through the Strait of Hormuz. However, from the beginning of the conflict, the authorities announced that substantial crude oil supplies had been secured from various partners, including Saudi Arabia, for the remainder of 2026, using alternative routes to the Strait of Hormuz.

THE ENTIRE ECONOMY IS BENEFITING FROM THE AI CYCLE

Against a backdrop of rising energy prices, Korea's structural growth imbalances (the polarisation of growth between exports and the domestic market, as well as between technology and non-technology sectors) call for caution in short- and medium-term forecasts.

The figures for the first quarter have far exceeded expectations. Real GDP growth reached 3.8% y/y (up from 1.6% in Q4 2025), driven by unexpectedly strong exports (11.6% y/y in volume), while household consumption and private investment saw a notable resurgence, challenging the hypothesis of a « K-shaped » growth.

Data from the second quarter confirmed this impression: total export value continued to rise, reaching a year-on-year growth of 70% in June (up from 53% in May), primarily driven by semiconductors. Semiconductor exports more than tripled year-on-year, bolstered by rising chip prices for artificial intelligence (AI) infrastructure. This performance supported industrial activity: the sector's production index grew at a rate comparable to that of export volumes.

The first signs of the technology sector's gains beginning to permeate the rest of the economy are starting to emerge. Despite inflationary pressures, domestic demand continues to recover, aided by measures announced by the government at the beginning of the conflict (amounting to nearly 1.5% of GDP), which include price caps, tax relief, budgetary support, and the acceleration of the energy transition. Retail sales (up nearly 4% y/y in May, following a sluggish 2025) are gradually recovering, while household and investor confidence indicators remain positive.

TOWARDS A NEW INDUSTRIAL STRATEGY

In the short term, any stabilisation of tensions in the Middle East is likely to underpin economic activity, despite the ongoing uncertainty, the scale of the government's expansionary policy and the continuing AI cycle.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	2.6	1.4	2.0	1.0	3.1	2.2
Inflation, CPI, year average, %	5.1	3.6	2.3	2.0	2.6	2.3
Central gov. balance / GDP, %	-5.0	-3.6	-4.1	-4.5	-4.8	-4.5
Gen. Gov. debt / GDP, % (EU standards)	46.2	48.8	50.6	52.5	54.2	56.1
Current account balance / GDP, %	1.4	1.8	5.3	6.6	8.2	7.4
External debt / GDP, %	38.6	39.5	37.5	40.5	37.4	34.0
Forex reserves, USD bn	418.3	415.3	410.8	423.0	412.7	418.0
Forex reserves, in months of imports	7.8	6.2	6.6	6.5	6.7	6.2

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

The rise in tech exports has offset the rise in energy imports

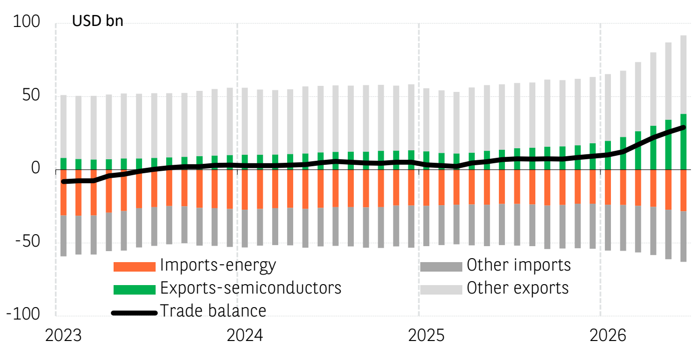

CHART 1

SOURCE: KOREA CUSTOMS SERVICE

Despite the rise in energy imports, the current account surplus was exceptionally high in Q1 (nearly 15% of GDP on an annualised basis, up from 8% in Q4 2025), representing the largest quarterly surplus ever recorded. For 2026, goods exports (including semiconductors) are expected to significantly offset the rise in imports (associated with higher energy prices and equipment investments. Similarly, the increase in tourism revenue is expected to facilitate a rapid reduction in the services trade deficit. A current account surplus of more than 8% of GDP is expected in 2026.

In the longer term, the large-scale public and private investment plan announced by the government at the end of June could mark a turning point in Korea's industrial policy. While the previous economic strategy primarily concentrated on consolidating sectors where the country already had a comparative advantage, the government now intends to establish a comprehensive artificial intelligence ecosystem. This ecosystem will encompass semiconductor production, physical infrastructure through the construction of dedicated data centres, as well as advanced packaging, materials, infrastructure and robotics. The goal is not to develop national AI models, but to make South Korea a key supplier of the essential components needed for their operation.

While the specifics of the implementation are yet to be defined, this strategy reflects a desire to strengthen South Korea's position in the most strategic segments of the global AI value chain. Investment, which is expected to reach a level close to 20% of GDP and span several decades, should also be accompanied by an increase in production capacity and a geographical redistribution of industrial activities (which are currently largely concentrated in the Seoul metropolitan area), to achieve a more equitable distribution of economic activity. This initiative also seeks to alleviate pressures in the Seoul property market.

FIRST INCREASE IN THE POLICY RATE

In June, inflation reached 3.2% y/y, its highest level in eighteen months, primarily driven by the surge in transport prices (+11% y/y) and the depreciation of the won by over 8% against the US dollar between March and late June. This inflationary pressure has now extended beyond energy prices, as evidenced by the rise in service prices (+3.4% y/y), which has exceeded the 3% threshold for the fifth consecutive month.

Although Brent prices have stabilised since May, remaining significantly below the Bank of Korea's projection (USD95/barrel) for the second half of 2026, uncertainties persist, particularly due to potential wage pressures. In addition, the price diffusion index calculated by the central bank, a key indicator of domestic demand, has reached its highest level since 2010 (excluding the pandemic period). In this context characterised by sustained economic growth, ongoing inflationary pressures and exchange rate challenges, the central bank began to tighten its monetary policy at its meeting on 16 July. An initial rate hike of 25bps has brought the rate to 2.75%. According to the statement released by the central bank, the economy is deemed sufficiently robust to withstand monetary tightening, despite the energy shock.

The won is expected to face continued pressure in the short term due to capital outflows, geopolitical risks and sustained demand for dollars linked to foreign investors' hedging operations.

Finally, the high level of household debt (87% of GDP in Q1) requires enhanced scrutiny. The central bank has identified two particularly troubling trends: i) the rapid increase in property prices in Greater Seoul (up more than 14% y/y in June, driven by a shift in demand from *Jeonse*[1] to home purchases), while the national house price index is rising more moderately (+3.5%), which could lead to a new wave of mortgage loans despite the tightening of credit conditions and the macroprudential measures recently announced by the authorities, and ii) the increase in « other loans », particularly those related to stock market investments, which is fuelling a rise in credit risks in a context of volatile financial markets.

The real estate market remains tight in Seoul

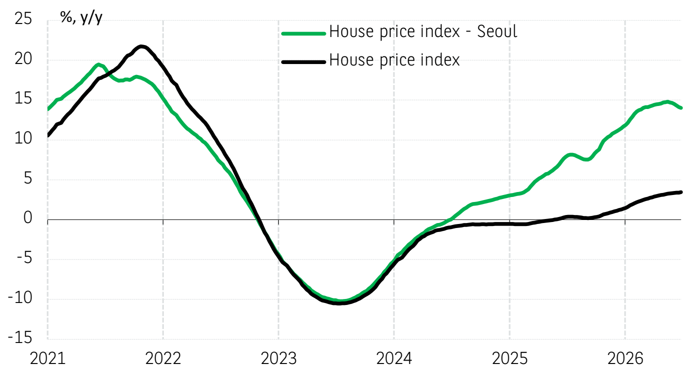

CHART 2 SOURCE: BOK

AN EXPANSIONARY AND PROCYCLICAL FISCAL POLICY, BUT PUBLIC FINANCES REMAIN SOUND

Public finances remain remarkably strong. Given the scale of the measures announced by the government, which amount to nearly 1.5% of GDP) fiscal policy will take a more expansionary stance in 2026, despite an economy already buoyed by the export sector. This strategy is primarily aimed at cushioning the effects of the energy shock on households and businesses, while accelerating investment in sectors deemed strategic. As a result, the public deficit is expected to rise slightly in 2026, to 4.8% of GDP from 4.5% in 2025. The overshoot in the deficit is expected to be mitigated by increased revenues from the semiconductor sector and the implementation of a comprehensive fiscal reform aimed at broadening the revenue base. This reform includes, among other initiatives, an increase in the corporation tax rate to 25% from the current 24%, and the planned introduction of a 20% tax on gains from digital assets in 2027. Nevertheless, the deficit is set to rise for the third consecutive year.

Consequently, public debt is also expected to continue its upward trajectory, reaching 54% of GDP by the end of 2026. The debt profile remains very favourable, characterised by long-term maturities exceeding 10 years and a diversified investor base, both nationally and internationally. Finally, while ownership of Korean sovereign bonds has been on the rise in recent years, it still constitutes less than 25% of the total outstanding.

Article completed on 10 July 2026

Hélène Drouot
helene.drouot@bnpparibas.com

1 *Jeonse* is a rental system in which the tenant pays the landlord a very high deposit (usually between 50% and 80% of the property's value) instead of a monthly rent. The deposit is returned in full at the end of the tenancy.

INDIA

AN ECONOMY BETTER EQUIPPED THAN IN 2022 TO FACE THE ENERGY SHOCK

India is currently in a stronger position than it was in 2022 to cope with the new energy shock. The fiscal capacity to support the economy has increased, and inflation is more contained. Although a slowdown is anticipated (from 7.7% for FY 2025/2026 to 6.7% for the current year), economic growth is expected to remain robust. However, the government's subsidy policy is likely to delay the consolidation of public finances. Despite the expected reduction in energy subsidies — supported by lower oil prices — food subsidies could rise due to a poor monsoon.

GROWTH REVISED DOWNWARDS FOR FY2026/2027

Indian economic growth reached 7.7% in FY 2025/2026 (up from 7.1% the previous year), marking one of Asia's most dynamic rates. For the current year, and despite stronger than expected growth in the last quarter of FY 2025/2026 (+7.8% y/y), the central bank has revised its growth forecast downwards by 0.3pp to 6.6% due to the sharp rise in energy prices and the risks associated with an unfavourable monsoon, which will weigh on rural household incomes. Household consumption still accounts for 55.7% of Indian growth (with investment at 34.3%, and government spending at 7.1%).

India has been particularly exposed to the energy shock and the closure of the Strait of Hormuz. It imports nearly 88% of its oil (approximately 50% from the Middle East), 62% of its liquefied petroleum gas (LPG; 90% from the Middle East), and 50% of its liquefied natural gas (LNG; 55% from the Middle East). LPG is used by households at a rate of 87%, while LNG is primarily used by industry (particularly for electricity generation) and fertiliser production. India is highly dependent on fertilisers, as 41.5% of the population works in agriculture.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, % (1)	7.6	7.2	7.1	7.7	6.7	6.8
Inflation, CPI, year average, % (1)	6.7	5.4	4.6	2.1	5.1	4.3
General gov. balance / GDP, % (1)	-9.1	-8.3	-8.1	-7.4	-7.6	-7.5
General gov. debt / GDP, % (1)	85.3	85.4	84.3	84.4	83.3	82.6
Current account balance / GDP, % (1)	-2.0	-0.7	-0.6	-0.7	-1.9	-1.6
External debt / GDP, % (1)	18.6	16.8	19.8	20.1	20.0	19.8
Forex reserves (excl. gold), USD bn	498	552	552	560	536	545
Forex reserves, in months of imports	6.7	7.5	6.8	6.7	6.2	6.3

TABLE 1

(1) Fiscal year from April 1st of year N to March 31st of year N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

RISING INFLATIONARY RISKS

In June 2026, consumer price growth was contained at +4.4% y/y, remaining below the 4% ± 2pp target set by monetary authorities (Chart 1). However, inflationary risks have increased due to higher domestic energy prices, with petrol prices rising by 7.9% in May, and producer prices climbing by 9.9% y/y in June, exacerbated by the rupee's depreciation against the dollar. Additionally, while the increase in food prices is still moderate at +5.3% y/y, risks are skewed upwards as the Indian Meteorological Department (IMD) forecasts a below-normal monsoon.

The central bank, the Reserve Bank of India (RBI), has revised its inflation forecast for the current fiscal year to 5.1%, compared to 2.1% for 2025/2026. Since late February, it has kept its policy rates unchanged at 5.25%. The recent drop in energy prices and reduced downwards pressure on the rupee have reduced the likelihood of a rate hike at the upcoming Monetary Policy Committee meeting in August.

Inflationary pressures below 2022 level

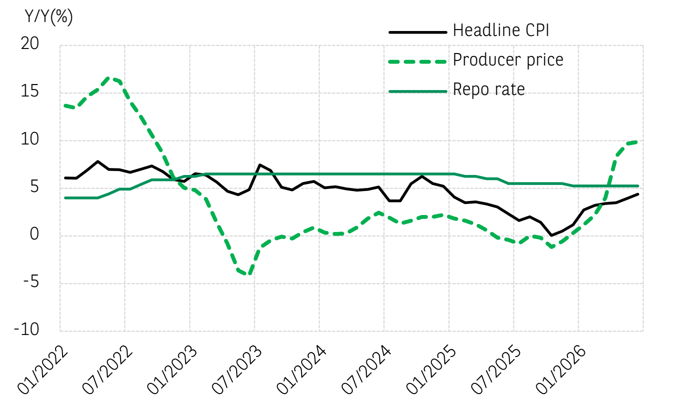

CHART 1

SOURCE: RBI, BNP PARIBAS

EXTERNAL ACCOUNTS UNDER PRESSURE

India's external accounts have been affected by the Middle East conflict through two channels: i) higher commodity prices (oil, gas) and ii) capital outflows.

India's energy trade deficit, encompassing oil and gas, is relatively high at 2.8% of GDP in 2025.

Assuming oil prices stabilise around USD 80 per barrel for the rest of the year, the current account deficit could reach 1.9% of GDP for FY 2026/2027, compared to 0.7% of GDP for FY 2025/2026.

Although still modest and slightly lower than during the previous energy shock, the current account deficit will not be covered by foreign direct investment (FDI), thereby increasing the need to attract portfolio investments. Over the past five years, net FDI inflows have averaged just 0.5% of GDP annually, while the current account deficit stood at 1.2% of GDP. The country's reliance on portfolio investments to meet its external financing needs has gradually increased. However, in a climate of uncertainty, the appeal of emerging markets is fundamentally diminished. Since the start of the Middle East conflict, portfolio investment outflows from India have reached levels not seen since the pandemic, amounting to 2.4% of GDP on an annualised basis between March and May 2026, thereby intensifying downwards pressure on the rupee. The central bank's efforts to mitigate currency depreciation resulted in a USD 32 billion reduction in foreign exchange reserves between March and June 2026, marking a 5.6% drop, the most significant among Asian emerging markets.

Moreover, this did not prevent the rupee from recording one of the worst performances in Asia. In mid-May, it neared INR 97 per USD 1 (compared to below INR 90 at the start of the year) before rebounding due to measures taken by Indian authorities and a reduction in oil prices. However, risks of renewed pressure on the rupee remain high as illustrated by tensions recorded mid-July and are closely linked to fluctuations in energy prices and US monetary policy.

To address the widening current account deficit and promote foreign investment inflows, the central bank and government have implemented several measures: i) increased taxes on gold and silver imports, ii) shortened the legal timeframe for repatriating foreign exchange earnings by Indian exporters, iii) eliminated or reduced specific taxes for foreign investors holding sovereign bonds, and iv) created a more favourable environment to attract foreign currency deposits from non-resident Indians by mitigating exchange rate risk.

The risk associated with foreign currency refinancing remains manageable. Although declining, foreign exchange reserves still cover 1.5 times the country's short-term external financing needs and 6.3 months of goods and services imports (Chart 2). At the end of 2025, external debt stood at just 20.2% of GDP, with debt servicing accounting for only 5.8% of goods and services export revenue. Furthermore, although government debt is high (84.4% of GDP), it is largely insulated from exchange rate risk, as only 4.4% is denominated in foreign currency. Additionally, since nearly 97% is held by residents, it is only slightly susceptible to fluctuations in foreign investor sentiment.

RISK OF FISCAL DEFICIT SLIPPAGE

Public finances are structurally fragile due to one of the lowest tax bases in Asia and one of the highest interest burdens (second only to Pakistan). Consequently, the government has limited fiscal leeway to mitigate the impact of the energy shock on the economy. Nevertheless, the government is in a more comfortable position than during the 2022 energy shock. In particular, budget deficits have been reduced. For FY2025/2026 (ended March 2026), the central government deficit was cut by 0.5pp to 4.4% of GDP (down from 6.7% in FY2021/2022), while the general government deficit is estimated at 7.4% of GDP (down from 9.5% in FY2021/2022).

To mitigate the shock's impact on households, the government initially kept petrol prices unchanged. Refining companies absorbed the financial loss, which was partially offset by lower excise duties on petroleum products. It was only in mid-May, after regional elections, that the government passed on a small percentage of the rise in international prices to prices at the pump. Additionally, to lessen the impact of higher fertiliser prices on farmers, the government raised subsidies.

Budget revenue losses attributed to i) lower excise duties, ii) reduced dividends from public enterprises, and iii) the economic slowdown could reach 0.5% of GDP. Meanwhile, fertiliser subsidy costs could rise from 0.4% to 0.8% of GDP.

FX reserves still comfortable

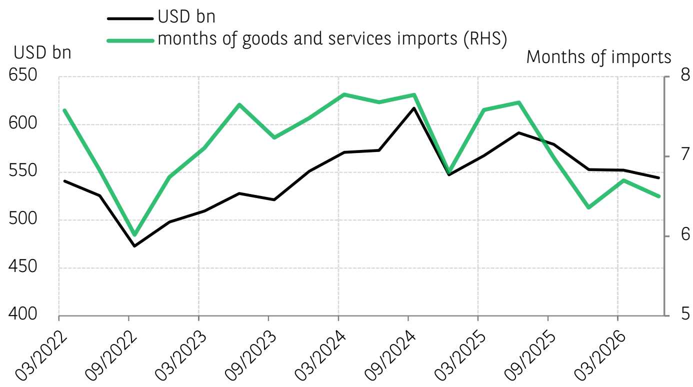

CHART 2 SOURCE: RBI, BNP PARIBAS

In an effort to mitigate the risk of fiscal slippage, the government has raised taxes on fuel exports and limited household diesel purchases. It is also expected to suspend some expenditures. However, these measures are unlikely to be adequate to achieve its 0.1pp deficit reduction target. The overall deficit is projected to rise by 0.2pp to 7.6% of GDP. The main concern regarding fiscal slippage is the potential increase in bond yields. Although still manageable (10-year yields rose by 45bps between January and mid-July), yields could climb further if inflationary pressures or downward pressures on the rupee force the central bank to hike rates. This would further increase debt interest payments (projected to reach 3.6% of GDP in FY2025/26, equivalent to 36.7% of budget revenue) and reduce the government's capacity to boost investment spending.

BETWEEN ENERGY DIVERSIFICATION AND RELIANCE ON THE GULF

The energy shock is expected to expedite India's ongoing shift towards i) speeding up solar and nuclear energy development to lessen oil dependency and ii) increase energy stockpiles, particularly by expanding domestic storage capacity in collaboration with the United Arab Emirates (UAE). However, despite India's efforts to diversify its oil sources, the Middle East will likely remain its primary supplier. Imports from Russia, Africa and Venezuela cannot fully replace Middle Eastern oil due to factors such as geographic proximity, lower transport costs, refineries designed to process Gulf crude, and strategic ties with the UAE.

Article completed on 10 July 2026

Johanna Melka
johanna.melka@bnpparibas.com

INDONESIA

ROBUST GROWTH BUT DETERIORATING GOVERNANCE

Indonesia is facing two external shocks: rising energy prices and capital outflows. The decline in governance quality has indeed impacted foreign investor confidence. Assuming that the conflict in the Middle East subsides, pressures on external accounts and energy subsidy costs are expected to ease. However, oil prices are expected to remain consistently above their early-2026 levels, perpetuating the risk of fiscal slippage. Investors remain cautious, and rupiah volatility is high.

STRONG GROWTH

In Q1 2026, real GDP growth accelerated sharply to 5.6% y/y, a rate not seen since 2012 (excluding the post-pandemic rebound). The main driver was household consumption, bolstered by wage increases and distribution of free meals. Activity was also bolstered by increased government spending and accelerated investment, supported by an accommodative monetary policy.

The growth outlook for 2026 remains positive. Real GDP growth is expected to remain robust at 5%, although it is expected to fall short of the government's 5.4% target, partly due to rising real interest rates impacting investment decisions.

CONSUMER PRICE INFLATION STILL UNDER CONTROL

To mitigate the impact of the energy shock caused by the conflict in the Middle East on households, the government has kept petrol prices unchanged for all fuels except Pertaminax, which saw its price double but accounts for only 7% of petrol consumption. Consumer price inflation has so far remained manageable (+3.3% y/y in June). However, producer price increases (+6.5% y/y in June) will gradually feed through to consumer prices (Chart 1).

Despite inflation remaining within the target range (+2.5% ±1pp), the central bank has raised its policy rate twice since the conflict began, primarily to counter downward pressure on the rupiah (+75bps to 5.75%).

INCREASING RISK OF FISCAL SLIPPAGE

For two decades, Indonesia has managed to maintain its fiscal deficit at 3% of GDP (excluding the pandemic period) while keeping public debt at a reasonable level, despite modest revenue. However, since taking office in October 2024, the Prabowo government has implemented several budget adjustments that deviate from the conservative fiscal approach of the Widodo administration. This shift raises concerns about fiscal slippage, especially as public finances were already strained by the pandemic.

In 2025, the fiscal deficit increased by 0.6pp to 2.9% of GDP—an unprecedented level outside the pandemic period. In addition to the widening deficit, the sharp decline in revenue (-1.3pp) is concerning, as it fell to just 11.6% of GDP, the lowest among the ASEAN-6 countries. This situation highlights inefficiencies in the implementation of a centralised tax system and the allocation of state-owned enterprise dividends to the sovereign wealth fund Danantara (-0.4% of GDP). Furthermore, the postponement of the VAT hike (from 11% to 12%), which was initially proposed by the Widodo government for all consumer goods but was ultimately applied only to luxury items, has deprived the government of an estimated revenue boost of 0.3% of GDP. For 2026, the likelihood of the deficit exceeding the 3% of GDP threshold set by Parliament has increased due to rising energy subsidy costs, further exacerbated by the depreciation of the rupiah.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth (%)	5.3	5.0	5.0	5.1	5.0	5.2
Inflation (CPI, year average, %)	4.1	3.7	2.3	1.9	3.5	3.2
Gen. Gov. balance / GDP (%)	-2.4	-1.7	-2.3	-2.9	-3.0	-3.0
Gen. Gov. debt / GDP (%)	39.7	39.2	39.4	40.5	40.6	40.9
Current account balance / GDP (%)	1.1	-0.2	-0.6	-0.1	-1.2	-0.7
External debt / GDP (%)	30.1	29.8	29.6	29.9	30.0	30.1
Forex reserves (USD bn)	124	133	140	135	123	130
Forex reserves, in months of imports	5.5	6.0	6.1	5.6	5.0	5.3

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Inflationary pressures remain limited so far

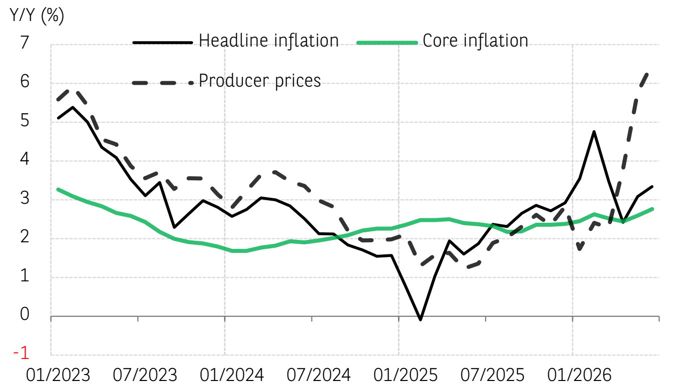

CHART 1 SOURCE: BI, BNP PARIBAS

Over the first five months of the year, the fiscal deficit widened by 0.6% of GDP compared to the same period last year. Energy subsidies increased in tandem with oil prices, reaching 0.8% of GDP — the level initially projected for the entire year. The worsening fiscal deficit is also attributed to higher civil servant wages. To mitigate the deficit expansion, the government has cut other expenditures, particularly the budget allocated to the free meal distribution programme, which could see a reduction equivalent to 0.3% of GDP, bringing it down to 1% of GDP. But this may not be sufficient. Oil prices in H2 2026 are expected to remain consistently above early-2026 levels. Assuming an average price of USD 81.6 in H2 2026 (vs. USD 91.8 in H1 2026), annual energy subsidies could reach 1.6% of GDP.

Additionally, interest payments on government debt are set to rise further in 2026. They have steadily increased since 2023, reaching 2.2% of GDP in 2025 (or 19% of revenue, compared to 16.1% in Malaysia and 6% in Thailand). So far, the moderate increase in interest rates and a favourable debt structure (with long maturities and approximately 97% fixed-rate) have limited the growth in interest burden. However, bond yields — which have risen by 114bps between January and mid-July 2026 — could continue to climb, further reducing the government's fiscal room for manoeuvre.

As a result, the fiscal deficit could increase from an average of 2.3% of GDP over the past five years (excluding the pandemic) to 3% of GDP over the next five years. Government debt, which remains relatively low (40.5% of GDP at end-2025), could exceed 42% by 2028. While this level is still moderate, the risks are skewed to the upside. The debt-to-GDP ratio could rise further if the rupiah depreciates (as 29.5% of the debt is denominated in foreign currency). Above all, the main risk lies in the potential increase in debt refinancing costs, as Indonesia faces significant foreign investor distrust that currently hold 37.1% of the total government debt.

EXTERNAL ACCOUNTS UNDER PRESSURE

Indonesia ranks among the Southeast Asian countries least affected by the energy shock, alongside Malaysia, with a modest oil and gas trade deficit standing at 1.4% of GDP in 2025, compared with 3.6% in the Philippines and Vietnam, and 5.9% in Thailand. Nevertheless, between January and mid-July, the rupiah recorded one of its worst performances against the dollar (-7.3%), breaching the IDR 18,000/USD threshold in early June, a historically low level.

This downward trend, which began in mid-2025 and was exacerbated by the Middle East conflict, can be attributed to: i) a decline in the trade surplus, which fell by 73.8% y/y in the first five months of 2026, resulting in a current account deficit that widened to 1.1% of GDP in Q1 2026, compared to just 0.1% in 2025, and ii) heightened foreign investor distrust.

Foreign direct investment (FDI), which had already declined significantly in 2025 to just 1% of GDP, down from 1.8% over the previous five years, further decreased to only 0.3% of GDP (annualised) in Q1 2026. FDI is no longer sufficient to cover the current account deficit, making the country reliant on portfolio investment.

However, portfolio investment outflows have accelerated sharply. In the first five months of the year, foreign holdings of all market securities plummeted by 32.9%, now accounting for just 35.6% of total issued securities, marking the lowest level on record. The Jakarta stock index fell by over 32% between January and early June, representing the worst performance in Southeast Asia.

Two factors explain this loss of confidence in Indonesia, despite its robust growth and strong macroeconomic fundamentals: i) the government's shift towards a less conservative fiscal policy, and ii) deteriorating governance quality.

Currently, foreign currency refinancing risk remains manageable. Although foreign exchange reserves have been declining since early 2026 (USD -12.3bn), they still cover 1.5 times the country's external financing needs. However, the depreciation of the rupiah has led to an increase in the external debt-to-GDP ratio, which stands at a modest 29.5%, and exposes unhedged sectors, such as services and construction, to currency risk.

External accounts have deteriorated

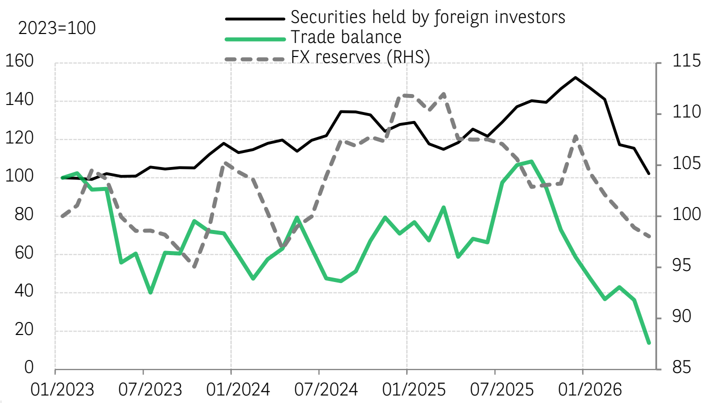

CHART 2

SOURCE: BI, BNP PARIBAS

Since mid-June, the rupiah has experienced a temporary reprieve due to higher domestic interest rates and lower oil prices. However, the potential for further depreciation remains high, and the volatility of the rupiah is heightened. Additionally, while MSCI upheld Indonesia's designation as an «emerging market» in June 2026, there is still a risk of being downgraded to a «frontier market» in the upcoming November review. Such a downgrade could trigger accelerated capital outflows and a lasting deterioration of the country's external position.

Deteriorating governance quality

Since Prabowo Subianto took office, governance quality has declined. The mechanisms for oversight, transparency and conflict-of-interest prevention within the sovereign wealth fund Danantara are deemed insufficient by international standards. Furthermore, the government has increased interventions in the economy, notably by centralising exports of strategic commodities through Danantara — a move that is both protectionist and unpredictable, raising investor concerns about legal certainty and policy consistency. Furthermore, the independence of the central bank has been called into question following the appointment of the president's nephew as its governor, amid increasing centralisation of economic decision-making by the executive.

TOWARDS A SHIFT IN ENERGY STRATEGY?

The Middle East crisis could prompt the Indonesian government to prioritise rapid energy self-sufficiency over ecological transition. While the economy is less oil-dependent than its regional counterparts (with oil accounting for less than 30% of its energy mix, compared to 47% in Thailand), it remains vital for the population, posing social and political risks. Consequently, the priority may shift towards reducing oil imports by expanding biodiesel (derived from palm oil) and, more crucially, increasing the use of domestic coal for electricity generation (particularly for electric vehicles). Indeed, Indonesia has abundant coal reserves.

Article completed on 10 July 2026

Johanna Melka

johanna.melka@bnpparibas.com

POLAND

ROBUST GROWTH WITH NO MAJOR IMBALANCES ASIDE FROM THE PUBLIC DEFICIT

Despite the energy shock, Poland's economic growth is expected to remain robust and could even accelerate slightly in 2026. This growth is being driven by a recovery in investment, while consumption, although slowing, will continue to be one of its main pillars. Inflation remains moderate despite rising fuel prices and is expected to stay within the Central Bank's target range. The external accounts, meanwhile, are very solid and can accommodate for the rise in energy costs. However, the trajectory of public debt is a cause for concern, particularly given that the government's lack of a qualified majority is hampering fiscal consolidation.

GROWTH DRIVEN BY DOMESTIC DEMAND

The repercussions of the conflict in the Middle East have, so far, had little impact on the Polish economy. With a GDP growth rate of 3.5% y/y in Q1 (+0.6% q/q), Poland has once again confirmed its status as the region's most dynamic economy. This performance is driven by both household and government consumption, inventory build-up and, to a lesser extent, investment. The contribution from external demand has been negligible, with the growth in exports nearly matching that of imports. The latest economic indicators remain broadly reassuring, suggesting a moderate slowdown in economic activity. Household confidence, as well as that of business leaders in industry and services, shows only a slight decline, which is significantly less severe than in 2022. Retail sales and industrial production have held up well despite rising energy costs (Chart 1). Industrial activity has even improved over the last three months (+4.0% y/y on average from March to May; +2.1% y/y from December to February).

Investment is expected to pick up in the coming quarters, primarily due to the disbursement of EU funds. Indeed, a substantial portion remains to be disbursed by the end of 2026. Of the EUR 54.7 billion allocated to Poland under the Recovery and Resilience Facility, EUR 20,6 billion (2.2% of GDP) has yet to be disbursed this year. Private consumption, bolstered by wage growth (but at a slower pace than last year) and a resilient labour market will be a key driver, albeit a less dynamic one. In addition, the projected recovery of the German economy in 2026 and 2027 is also expected to underpin Polish growth. Our forecasts point to a robust growth rate of 3.7% in 2026. In 2027, economic growth is expected to slow slightly (to 3.2% according to our forecasts) as the impact of EU funding diminishes.

In the medium term, potential growth — which the IMF estimates at 2.7% for 2026-2031 — is lower than in the periods 2010-2019 and 2021-2025, but remains robust. The dynamism of several sectors, including defence, electric mobility and AI, could enable a faster catch-up. According to a recent World Bank study[1], GDP could rise by up to 12.1% by 2035 in a scenario where the adoption of AI accelerates, compared with another scenario where the adoption rate remains stable. Furthermore, Poland's per capita GDP, at USD 55,793 (in purchasing power parity), is now comparable to that of Spain and Japan.

INFLATION UNDER CONTROL

The inflationary impact of the conflict in the Middle East has so far proved modest. Headline inflation has significantly decreased for the second month running, reaching 2.5% y/y in June (down from 3.1% in May and 3.2% in April). The inflation rate for food has also slowed. Similarly, prices for « transport fuels » and « electricity, gas and other » components, which account for a relatively small share of the household basket (5.3% and 11.4% respectively), have also risen more slowly. In Poland, the price of petrol surged by 24.9%, peaking at 7.2 zlotys per litre at the end of March, up from 5.7 zlotys. Since mid-June, it has fallen significantly, bringing prices close to their pre-conflict levels. Several key factors have contributed to this trend, including the preliminary peace agreement between the United States and Iran, a reduction in VAT from 23% to 8%, a decrease in excise duties on fuels to the minimum level permitted by the EU, and the introduction of a daily price cap on petrol and diesel.

1 Navigating the Age of AI: Implications for Poland's Economy – World Bank 2026.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	5.6	0.2	3.1	3.6	3.7	3.2
Inflation, CPI, year average, %	14.4	11.4	3.8	3.8	3.0	2.7
Gen. Gov. balance / GDP, %	-3.4	-5.2	-6.4	-7.3	-6.6	-5.8
Gen. Gov. debt / GDP, %	48.8	49.5	54.8	59.7	61.6	63.9
Current account balance / GDP, %	-2.3	1.5	0.3	-0.9	-1.6	-1.5
External debt / GDP, %	53.3	49.8	51.6	50.2	47.1	44.2
Forex reserves, EUR bn	156.5	175.4	214.2	231.0	262.0	275.0
Forex reserves, in months of imports	5.2	6.1	7.3	7.4	8.1	8.1

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Poland: Resilience

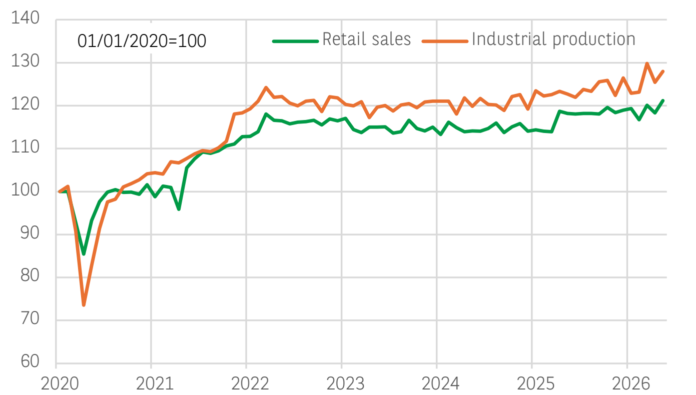

CHART 1 SOURCE : EUROSTAT, BNP PARIBAS

However, delayed knock-on effects on the prices of other consumer goods cannot be ruled out. Furthermore, at the end of June, the government lifted the temporary measures, in particular the cap on fuel prices, which may result in a short-term and moderate increase in prices at the pump (PLN 6.77 currently). In any case, inflation is expected to remain, on average, within the Central Bank's target range of 2.5% ±1 percentage point this year and next.

A PRUDENT MONETARY POLICY

The Polish central bank kept its key interest rate unchanged at 3.75% in July for the fourth consecutive month, following a 25-basis-point cut in March. In the short term, the monetary authorities have greater leeway thanks to the slight fall in oil prices and inflation. The Central Bank is expected to remain cautious as the Polish zloty is facing a renewed episode of volatility. Our scenario therefore anticipates that monetary policy will remain unchanged this year. However, if inflation continues to be contained in the coming months, monetary easing cannot be ruled out.

THE EXTERNAL ACCOUNTS ARE ABSORBING THE SHOCK

Poland relies heavily on hydrocarbon imports. Consequently, it is not surprising that the trade balance deteriorated significantly in April. Imports rose by 5.6% y/y in March and by 6.1% in April, averaging a 1.7% y/y rise over the previous three months. This surge was primarily driven by a sharp rise in the energy bill (+121.9% y/y in March, according to the latest available figures). The growth in imports is expected to slow from June onwards following the signing of the memorandum of understanding between the United States and Iran, along with a relative easing of pressure on commodity prices.

Over the year as a whole, the impact of the shock on the energy trade balance is expected to be moderate, estimated at around -0.4% of GDP, assuming an average oil price increase of 25% in 2026 and a 13.5% rise for gas.

This situation remains manageable despite the trade balance and current account being structurally in deficit. In fact, the country benefits from a robust external financing capacity. With inflows of foreign direct investment and portfolio investment totalling EUR 19.2 bn over the first four months, these inflows more than compensate for the current account deficit of EUR 1.7 bn over the same period. Furthermore, external liquidity indicators are strong, bolstered by very healthy foreign exchange reserves that have been rising steadily for several years.

LIMITED FISCAL ROOM TO MANOEUVRE

As there was very little flexibility related to the budget, the government's support measures were limited to a temporary cap on fuel prices, along with a reduction in the VAT rate and excise duties on fuel. These measures were ultimately lifted at the end of June. As a result, the cost of the government's measures remains modest, estimated at PLN 1.6 bn per month, or approximately 6.4 bn (0.2% of GDP) over the four months during which the measures were in place. Furthermore, a one-off tax on the profits of energy companies is expected to raise PLN 3.8 bn for the state, partially offsetting the rise in expenditure.

Poland: Inflation is contained

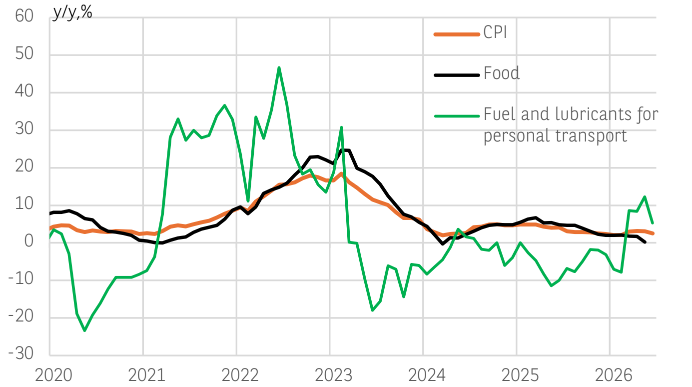

CHART 2 SOURCE: STATISTICS POLAND, BNP PARIBAS

However, the budget deficit is not expected to fall significantly this year. It is forecast to be 6.6% in 2026, following a rate of 7.3% of GDP in 2025. Consequently, the public debt-to-GDP ratio is expected to increase in the short term, likely surpassing the 60% threshold in 2026. To stabilise the debt-to-GDP ratio, the budget deficit would theoretically need to be reduced to below 3.7% of GDP — a target that is difficult to achieve in the short term. Since 2024, Poland has been subject to the excessive deficit procedure and is struggling to consolidate its public finances.

The political deadlock, caused by the lack of a constitutional majority in Parliament, limits the government's ability to consolidate its public finances and obstructs structural reforms. The upcoming general election in 2027 further diminishes the likelihood of ambitious fiscal consolidation.

For the time being, financing the budget deficit does not pose a major problem. The country has managed to raise funds on international markets since the start of the year (in euros, yen and dollars), including a USD 6 billion USD-denominated issue last April, against a backdrop of high volatility. By the end of May, the Polish government had already covered 56% of its funding requirements for the year.

The rise in the cost of borrowing since late February (+0.5 percentage points for yields on 5-year government bonds) has been relatively modest and less pronounced than in 2022 (+4.4 percentage points between mid-February and mid-June 2022). Furthermore, sovereign risk in foreign currency remains limited; in fact, debt denominated in foreign currency accounts for only 20.3% of the government's total debt stock, and the depreciation of the Polish zloty has been limited since the beginning of the year.

Uncertainties surrounding the reopening of the Strait of Hormuz are raising fears of energy supply difficulties. This is a significant concern for Poland, which imports around 50% of its crude oil from Saudi Arabia and 10% of its gas from Qatar. However, the situation has remained manageable so far.

Article completed on 10 July 2026

Cynthia Kalasopatan Antoine
cynthia.kalasopatanantoine@bnpparibas.com

ROMANIA

WEAKENED BY POLITICAL INSTABILITY

Recent political tensions are once again drawing attention to Romania. The next government's priority will be to further consolidate public finances; otherwise, the public debt-to-GDP ratio will continue to deteriorate. In addition, Romania appears to be the Central European country most adversely affected by the energy shock, although the situation is still manageable. Economic growth has been sluggish since 2024 and is not expected to improve in 2026. Inflation has now exceeded 10%, but it is expected to ease from September as the effects of the VAT rate hike subside. Monetary authorities are expected to adopt a cautious approach in the short term. By 2027, the Neptun Deep gas project in the Black Sea is set to be a major asset that should help reduce public and external account deficits.

STAGNANT GROWTH

Since 2024, Romanian growth has been below 1%, constrained by political uncertainties and, since last summer, by budgetary austerity measures. In Q1 2026, Romania's GDP contracted by 1.1% y/y (0% q/q) following a contraction of -1.4% in Q4 2025 (-1.9% q/q). Consumption, which is one of the key pillars of the economy, has contracted for the first time since 2021. The rebound in investment has not been sufficient to offset this decline. In terms of foreign trade, both exports and imports have increased at similar rate, but their growth has slowed. Economic indicators do not point to any improvement in Q2. Retail sales and consumer confidence continue to deteriorate. Likewise, confidence in the industrial and services sectors remains low.

For the remainder of 2026, the outlook is bleaker due to the combined effect of political tensions in the country and the conflict in the Middle East. A rebound in consumption is unlikely, as inflation is rising faster than wages, which is eroding households' purchasing power.

One positive aspect is that investment opportunities are becoming more promising due to the availability of European Union funds. In particular, the recovery and resilience funds, a significant portion of which remains unallocated (EUR 8.4 bn, or 2.2% of GDP), will be used to finance various public investment projects. However, it is anticipated that the economy should regain momentum by 2027, as consumer spending picks up and global demand improves.

DOUBLE-DIGIT INFLATION

Romania currently has the highest inflation rate in Central Europe. This situation can largely be attributed to the VAT rate increase of 2 pp (to 21%) implemented in August last year as part of the Romanian government's austerity measures. Furthermore, the surge in fuel prices in Q2, driven by the ongoing conflict in the Middle East, is further intensifying inflationary pressures. The price of diesel has even slightly exceeded the 2022 level, reaching EUR 1.84 per litre in June (compared to the peak of EUR 1.72 per litre in 2022). According to the Consumer Price Index (CPI), inflation has already crossed into double digits, recorded at 10.4% y/y in June. This increase is primarily fuelled by rising costs in the « energy » segment and services. However, the inflation rate remains lower than in 2022 (see Chart 1).

In the short term, the potential for a peace agreement between the United States and Iran offers some respite for oil prices and, therefore, for inflation, even though, according to our scenario, oil prices may hover around USD 80/85 per barrel in the short term before gradually decreasing. However, a rebound in inflation cannot be ruled out in the short term, as the rise in transport costs and the prices of certain raw materials could have a knock-on effect on the prices of all goods.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	4.2	2.3	0.9	0.7	0.1	2.6
Inflation, CPI, year average, %	13.7	10.5	5.6	7.3	7.9	4.6
General gov. balance / GDP (%)	-6.5	-6.6	-9.3	-7.9	-6.5	-5.7
General gov. debt / GDP (%)	48.1	49.3	54.8	59.3	61.5	63.0
Current account balance / GDP, %	-9.6	-6.7	-8.2	-7.9	-8.0	-7.5
External debt / GDP, %	54.7	56.9	57.5	60.2	62.1	64.9
Forex reserves, EUR bn	52.3	66.0	70.5	77.0	85.0	92.0
Forex reserves, in months of imports	5.3	6.9	7.1	7.5	8.0	8.2

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Inflation driven by energy and services

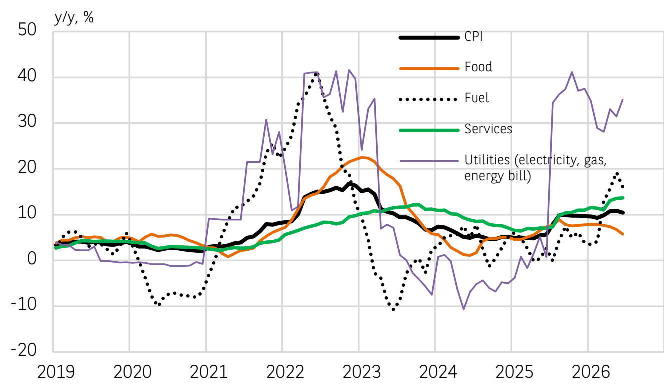

CHART 1 SOURCE : NATIONAL INSTITUTE OF STATISTICS, BNP PARIBAS

Moreover, the impact of the VAT rate increase is expected to diminish starting in September. Our projections indicate that inflation will average 4.6% next year. The central bank's target of 2.5% ± 1 pp is not expected to be achieved before 2029.

Monetary policy remains cautious. The central bank has maintained its key rate at 6.5% since August 2024, following two rate cuts earlier that year. In the short term, it is likely that the current stance will persist. While inflationary risks and downward pressure on the Romanian currency suggest a need for tightening, the slowdown in economic activity calls for a cautious approach.

LIMITED CORRECTION OF FINANCIAL MARKETS DESPITE THE POLITICAL CRISIS

The political context deteriorated in May with the collapse of the government that had been in place for less than a year. Tensions within the governing coalition ultimately resulted in one of the four parties exiting, leading to a vote of no confidence on 5th May. Prior to that, the government managed to survive several votes of confidence since it came to power. The immediate challenge is to quickly form and approve a new government, otherwise the country would be heading towards snap elections.

At the onset of the conflict in the Middle East, the Romanian currency (leu), which operates within a managed float framework against the euro, exhibited minimal fluctuations compared to other currencies in the region, due to several interventions by the central bank. However, downward pressures increased at the end of April amid the political crisis, intensifying further in early May with the collapse of the government. The leu peaked at 5.27 against the euro in early May, then stabilised slightly below that level (5.25 leu to 1 euro, compared to 5.1 before the political crisis). Between 29 April and 10 July, the currency depreciated by 2.8% against the euro and by 5.3% against the dollar. The political crisis has so far had minimal impact on the 5-year bond yield, which has only risen by 0.7 point since late April. Similarly, the impact of geopolitical tensions has been minimal. The stock market has maintained its upward trajectory (+15.6% since the beginning of the conflict).

The repercussions on the financial markets have so far been limited. However, political uncertainties are impacting both household confidence and that of business leaders. The longer the resolution of the crisis is delayed, the longer it will take for economic activity to resume.

PUBLIC FINANCES TO KEEP AN EYE ON

In 2025, the austerity measures introduced by the government helped contain the budget deficit at 7.9% of GDP, thereby preventing a downgrade of the sovereign rating by external agencies and a freeze on European funds. However, further adjustment measures are essential in the short term. Otherwise, government debt as a percentage of GDP will continue to rise. According to our forecasts, this ratio is expected to exceed the 60% of GDP threshold in 2026. The target set last year aims to bring the deficit down to 6% of GDP in 2026, but achieving this goal will be challenging due to the ongoing political crisis and sluggish growth. Short-term uncertainties persist regarding the policies that will be implemented by the incoming government. While the budget consolidation process should remain intact, there might be a slight easing of austerity measures.

In response to the energy shock, the government has prioritised several targeted measures enacted by decree, designed to prevent an increase in public spending. These measures include a cap on the commercial margins of fuel distribution chains, a reduction in excise duties on diesel for three months, and a so-called « solidarity » tax on the exceptional profits of companies in the oil sector. The authorities have recently announced the end of the reduction in excise duties on diesel.

The government's financing needs are high (13.5% of GDP in 2026), but they are being met without major difficulties. Several unsuccessful auctions of last March can be largely attributed to the uncertainty stemming from the conflict in the Middle East. By early June, 43% of the financing needs for 2026 had already been secured. The increase in financing costs on the bond markets remains moderate.

Romania: A moderate energy trade deficit

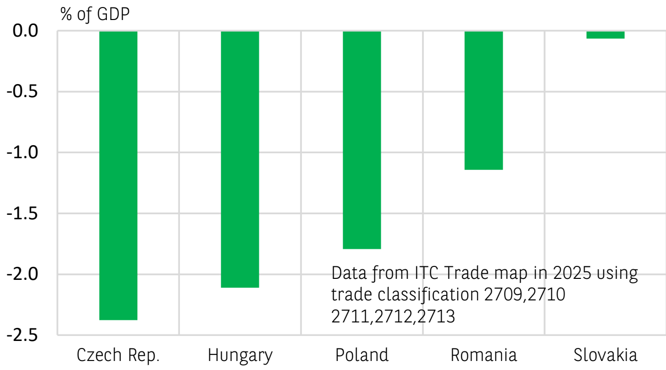

CHART 2 SOURCE: ITC, BNP PARIBAS

However, debt servicing has increased since 2020 due to increased borrowing and given that the bond rate is the highest in the region, standing at 6.75% at the end of June for the 5-year bond rate. The interest burden now stands at 2.8% of GDP (8.3% of budget revenues).

NEPTUN DEEP, A SIGNIFICANT ASSET

Romania appears to be the country most exposed in the region to the energy shock due to its significant macroeconomic imbalances. Last year, both the budget deficit and the current account deficit reached 7.9% of GDP, indicating limited fiscal flexibility for the government. Moreover, the increase in the energy bill is expected to weigh on the current account deficit. However, the country can withstand this shock, as its energy dependence is considerably lower than that of other countries in the region (see Chart 2). Indeed, most of Romania's gas needs are met through domestic production. Our estimates suggest that the impact of the energy shock on the trade balance would be -0.3% of GDP, assuming an average 25% increase in oil prices and a 13.5% increase in gas prices in 2026. The current account deficit is expected to be largely offset by capital inflows. Moreover, foreign exchange reserves are comfortable at EUR 77 bn as of May 2026, equivalent to 8 months of imports, and provide a safety net. However, these reserves have decreased by EUR 2.9 bn since January.

By 2027, the Neptun Deep offshore gas exploitation project, located in the Black Sea, is anticipated to provide a significant financial benefit for Romania. Once operating at full capacity, Romania is expected to generate around 8 bn cubic meters (bcm) of gas per year. The country already produces gas that covers around 90% of its consumption needs (approximately 10 bcm). Romania is on track to become a net exporter of gas, which will strengthen its position as a key partner in supplying Europe and improve its external accounts. Moreover, the royalties and various taxes derived from gas exploitation will help strengthen its public finances.

Article completed on 10 July 2026

Cynthia Kalasopatan Antoine
cynthia.kalasopatanantoine@bnpparibas.com

THE ECONOMY WILL COPE WITH RENEWED HEADWINDS ONCE AGAIN

Turkish growth has slowed significantly since Q4 2025, and the oil shock since March has led to a significant erosion of foreign exchange reserves, a more pronounced depreciation in the lira than in other emerging-market currencies, and pressure on domestic bond yields. The risk of disruptions to hydrocarbon and fertilizer supplies is limited. However, the revision of official inflation forecasts, the subsequent tightening of monetary policy, and warnings of the finance minister about potential budget slippage have dampened investor sentiment, which is further unsettled by the AKP's strategy of systematically sidelining potential rivals in the presidential elections. There are often recurring financial tensions in Türkiye. However, the risk of economic destabilization is low given the government's moderate debt levels and the strength of the banking system. The slowdown is even beneficial, as it will help to limit the current account deficit and should help the central bank in curbing expectations of inflation and rebuilding its foreign exchange reserves.

ECONOMIC GROWTH: A WELCOME SLOWDOWN

The slowdown in growth is becoming increasingly evident (Chart 1). GDP decelerated sharply in Q4 2025 before virtually stagnating in Q1 2026 (+0.1% q/q), notably because consumer credit momentum has eased. The indicators available for April and May (industrial production, exports, business and consumer confidence indices) point to a slight recovery (particularly in exports), although this is yet to be confirmed.

A slowdown in domestic demand is needed because the underlying trade balance (i.e. excluding oil and net imports of gold) has returned to a deficit since the end of 2025, and inflation remains too high to be sustainable in the long term (risk of an overvalued exchange rate, increased interest burden on index-linked debt). In H2 2025, growth in domestic demand was still above potential growth and domestic credit growth remained very robust.

The presidential and general elections, due to be held by spring 2028 at the latest, are drawing nearer; fiscal policy, whilst not necessarily expansionary, will not act as a moderating factor. As a result, the burden of moderation falls on monetary policy, which has performed this role thus far (*see below*).

FINANCIAL TENSIONS, REFLECTING VULNERABILITY TO THE OIL SHOCK AND POLITICAL RISK

Foreign investors' jitters since March have led to a sharp decline in international reserves (forex reserves + gold holdings), from USD 218 bn in early February to USD 157 bn on June 21st. However, there is no immediate danger. They still more than cover the hot money[1]. Moreover, the deterioration in the current account balance since late 2025 — which may reflect an overvalued exchange rate — is not severe enough to escalate into a balance-of-payments crisis requiring tighter exchange controls[2].

As is usually the case, the exchange rate and domestic bond yields came under far greater pressure than in most other emerging markets. The lira depreciated by 5.5%, compared with a median of 3.2% for other EM currencies. The yield on 5-year domestic government bonds rose by 390 basis points, compared with a median of 45 basis points in other EMs, and accelerating inflation accounts for only a tiny fraction of this difference[3]. However, at the same time, the 5-year CDS spread has narrowed by 10 basis points since 22 July (to 220 basis points); investors have not reassessed the risk of default on government debt.

The risk of a disruption to hydrocarbon supplies is very limited, as Russia is the main supplier (46 per cent for oil and 43 per cent for gas).

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	5.4	5.0	3.3	3.6	3.1	3.5
Inflation, CPI, year average, %	72.3	53.9	58.5	34.9	30.7	23.8
Central gov. balance / GDP, %	-0.9	-5.1	-4.7	-2.9	-3.8	-3.5
Gen. Gov. debt / GDP, % (EU standards)	26.3	24.9	20.8	21.7	22.4	23.3
Current account balance / GDP, %	-5.0	-3.7	-1.0	-1.9	-2.2	-2.2
External debt / GDP, %	41.9	37.9	33.9	35.7	35.2	35.6
Forex reserves, USD bn	82.9	92.7	90.9	77.0	89.8	98.3
Forex reserves, in months of imports	2.6	2.9	3.0	2.3	2.5	2.6

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Activity indicators

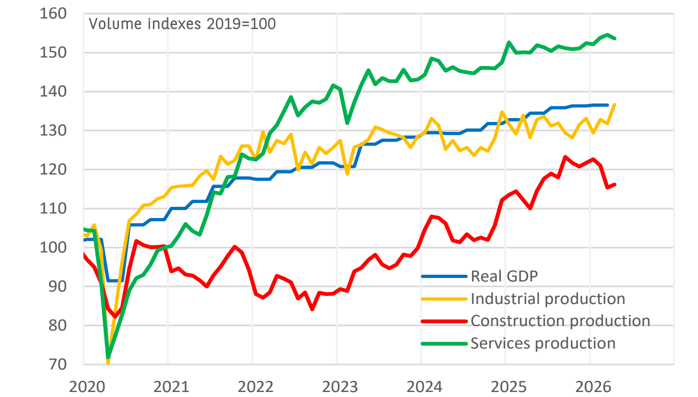

CHART 1

SOURCE: TURKSTAT

1 Hot money consists of sovereign debt securities denominated in local currency and stocks held by non-residents. It amounts to approximately USD 60 bn. The coverage ratio based on international reserves is therefore 2.5.
2 According to the IMF, the cyclically adjusted current account deficit was just 1% of GDP in 2025. Assuming an elasticity of the current account balance with respect to the real exchange rate (RER) of 0.25 (according to the IMF), the RER adjustment needed to clear the cyclically adjusted deficit is therefore only 4%.
3 The increase of the year-on-year rise in consumer prices, stood at 110bps between February and May for Türkiye, compared with a median of 80 basis points for the major emerging economies.

As regards to fertilizers, Oman is a major supplier to Türkiye (20% of the domestic market) but, unlike its Gulf neighbors, Oman has not been affected by the blockade of the Strait of Hormuz.

However, the consequences of the oil crisis are driving the pressure on the lira and domestic interest rates. According to joint estimates by the central bank and the Treasury, a rise in the price of Brent crude of USD 15 per barrel from a level of USD 65 (*i.e.* a set of assumptions similar to our own for the period 2025–2026) has a very significant impact on the key macroeconomic variables[4].

The central bank's revision of its inflation forecasts (to take account of the impact of the oil shock, see Chart 2), the subsequent tightening of monetary policy, and the Finance Minister's warning about a potential budgetary slippage have dampened investor sentiment. Financial volatility is also being fueled by the AKP's strategy of sidelining all serious rivals in the presidential elections.

MONETARY TIGHTENING TO CONTAIN INFLATION

Headline inflation accelerated in April but fell back in May, meaning that the average monthly increase for March–May was lower than that for February (2.6% compared with 3%). The main reason for this is that a sliding-scale system was introduced to limit the impact of rising Brent prices on retail oil prices[5]. This helped to offset the very sharp rise in the price of fresh produce. Year-on-year, the rate of disinflation levelled off rather than accelerated (32.6% in May compared with 31.5% in February).

Pressures are more evident in core inflation but are much less pronounced than in 2023 following the invasion of Ukraine (Chart 2). The more moderate depreciation of the exchange rate has played a significant part in this. The slowdown in private consumption may also have been a factor.

In its latest inflation report, published in May, the central bank (CBRT) has revised its inflation forecasts for 2026 and 2027 quite significantly[6].

As a result, monetary policy has become more restrictive; the CBRT, which cut its key interest rate by 250bp between December and February, has left it unchanged at 37% since then. Its interventions in the foreign exchange market to support the lira have reduced lira liquidity in the money market. Finally, bank refinancing has been at the overnight lending rate (40%).

FISCAL SLIPPAGE: NOTHING SERIOUS

In the wake of the oil crisis, the budget deficit is set to widen; however, as with the external accounts, the deterioration is likely to be limited and, in any event, will not exceed the warning threshold (commonly 5% of GDP) — far from it.

On a 12-month cumulative, the central government deficit – which had reached a low of 2.2% of GDP in February — widened to 3.1% in May. However, excluding interest payments, the balance — which had turned into a surplus in January — remains slightly positive.

Energy retail prices, exchange rate and core inflation

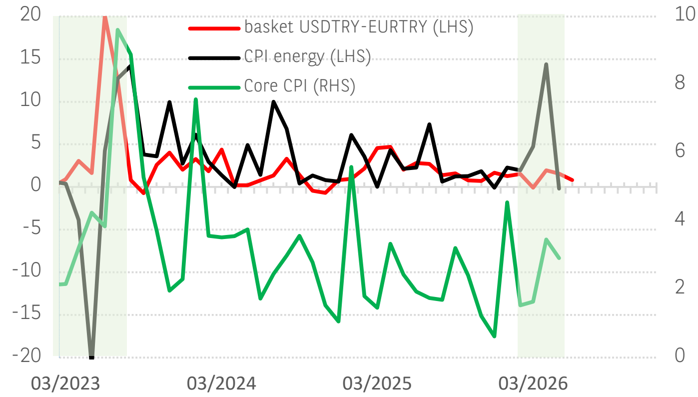

CHART 2

SOURCE: TURKSTAT-TCMB

It has narrowed since March due to a fall in revenue (as a percentage of GDP) rather than a rise in primary expenditure. Interest payments (3.5% of GDP) increased by 0.4 ppof GDP in 2025, whilst, at the same time, the debt-to-GDP ratio continued to fall to 22% of GDP. The reason for this is the appreciation of the real exchange rate (by around 15% on average per year since 2022), which, on its own, has been driving down the debt-to-GDP ratio for several years[7].

Even assuming a budget overspend of 3.8% of GDP this year (the Ministry of Finance's latest estimate is 3.5%), the debt would rise only marginally.

Finally, the oil crisis poses no threat whatsoever to the central government's ability to service its external debt, even without support from the Gulf states. The Treasury has already issued nearly 10.25 bn in international bonds and lease certificates denominated in USD or EUR since the start of the year. The government's hard-currency deposits at the CBRT stand at USD 15.4 bn end May which cover the USD 10 bn in interest and principal that the Treasury must repay between June and December. In the menatime, the economic slowdown should enable the central bank to replenish its foreign exchange reserves.

Article completed on 10 July 2026

François Faure

francois.faure@bnpparibas.com

4 Between -0.5 and -1.2 percentage points (pp) in growth, between 2.8 pp and 3.5 pp of additional inflation, an increase in the current account deficit of between 0.7 and 1.1 pp of GDP, and a widening of the budget deficit by 0.4 pp of GDP.
5 Conversely, regulated electricity and natural gas tariffs have risen significantly, not only for businesses but also for the 12–13% of households whose consumption exceeds a predetermined threshold by 75%, thereby disqualifying them from subsidies.
6 In February, the CBRT forecasted an inflation rate of 16% by the end of 2026, 9% by the end of 2027 and 8% by the end of 2028. In May, these figures have been revised up to 26%, 15% and 9%.
7 The increase in the interest burden (as a percentage of GDP) stems from an average real interest rate on domestic debt denominated in TRY, which returned to positive territory in 2025.

BRAZIL

THE HIGH COST OF RESILIENCE

The Brazilian economy continues to withstand an ultra-restrictive monetary policy stance. In an election year, fiscal policy has become increasingly active to help cushion the impact of high interest rates and mitigate the effects of the oil shock on households' purchasing power. The resilience of economic activity comes at the cost of slower disinflation and a shift in the fiscal burden towards public banks. The policy mix — protective fiscal policy versus restrictive monetary policy — complicates the adjustments of prices, public finances, and inflation expectations amid more frequent supply shocks. The oil price shock has helped strengthen both external accounts and the reais. Over the medium term, it could strengthen Brazil's attractiveness as an energy supplier while accelerating the country's drive towards greater productive sovereignty.

ECONOMIC GROWTH: FISCAL SUPPORT MASKS POLITICAL DRAG

During the first half of 2026, Brazil's economy proved more resilient than expected, benefiting from the oil price shock and a rebound in private consumption. The latter was underpinned by a strong labour market, high real wages and targeted fiscal measures designed to shield households' purchasing power. In Q1 2026, GDP expanded by 1.1% compared to Q4 2025 and by 1.8% y/y. Activity remained resilient in Q2, albeit with signs of moderation. After reaching its highest level in more than a year in April, the Composite PMI slipped below the 50-point threshold in May before returning to expansion territory in June (50.7), confirming the resilience of the private sector while pointing to a gradual loss of momentum, with services remaining robust but manufacturing still subdued.

Looking ahead, exports and the oil sector should continue to underpin growth while a pre-election push to expand credit to industry, households and agriculture may provide an additional lift. Overall growth will remain constrained by inflationary pressures linked to the oil shock and the persistence of high real interest rates.

The ambivalence of the policy mix should continue to weigh on investment, compounded by a deteriorating business environment resulting from tensions between the executive and legislative branches and a series of political scandals (fallout from *Banco Master; Pleno*). In the race for the presidential nomination, President Lula retains a lead over Flavio Bolsonaro — although his advantage remains fragile. According to *Genial/Quaest* polls, public concerns over security, corruption and relations with the United States — notably Brazil's growing exposure to the Sino-American technological rivalry — are the main issues that could reshape the electoral campaign.

MONETARY POLICY: A CONSTRAINED EASING CYCLE

Since March, the Central Bank of Brazil (BCB) has embarked on a highly cautious easing cycle, lowering the Selic policy rate from 15% to 14.25% by mid-June. The BCB must contend with renewed inflationary pressures stemming from the oil price shock. After easing to 3.81% y/y in February, consumer price inflation (IPCA) reaccelerated to 4.72% in May, moving back above the upper bound of the central bank's inflation target (3% ± 1.5 pp). Food, fuel, housing and electricity prices have been the main drivers of the renewed inflationary pressures.

The partial easing in fuel price pressures following the reopening of the Strait of Hormuz in June is unlikely to prevent broader inflationary pressures from becoming more entrenched, as price increases are no longer confined to the energy sector. The underlying inflation indicators closely monitored by the BCB continue to rise at an annualised pace of around 5.5% for core measures and 5.6% for services inflation. Against this backdrop, the key risk is no longer a temporary overshooting of the inflation target, but rather inflation remaining above target for an extended period, thereby limiting the scope for a more pronounced monetary easing cycle. Moreover, the El Niño weather phenomenon — by reducing harvests through droughts in the north and excessive rainfall in the south — is likely to exacerbate agricultural and food price inflation over 2026–27. At the same time, labour market conditions remain too tight to provide the BCB with reassurance. The unemployment rate fell to 5.8% in April, well below the 7–8% range generally regarded as non-inflationary.

The BCB therefore faces an increasingly difficult policy trade-off: preventing inflation expectations from further de-anchoring by maintaining very high real interest rates, at the risk of exacerbating financial pressures on already fragile private-sector entities. Rising household delin-

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	3.1	3.2	3.6	2.3	2.3	1.4
Inflation, CPI, year average, %	9.3	4.6	4.4	5.0	4.7	5.1
Public sector fiscal balance / GDP, %	-4.6	-8.8	-8.5	-8.3	-8.8	-8.6
Gross public debt / GDP, %	72	74	77	79	82	86
Current account balance / GDP, %	-2.9	-1.2	-3.0	-2.9	-2.3	-2.5
External debt / GDP, %	35	33	33	35	36	33
Forex reserves, USD bn	324	355	329	358	365	362
Forex reserves, in months of imports	11	13	10	11	11	12

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Lula widens lead over Flavio Bolsonaro

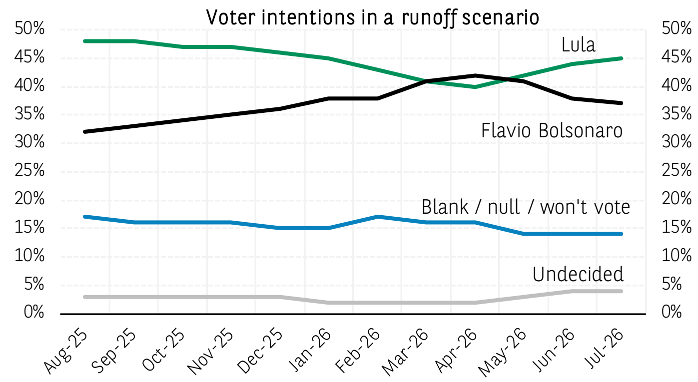

CHART 1 SOURCE: GENIAL/QUAEST SURVEY (JULY 2026), BLOOMBERG

quencies and an increasing number of corporate restructurings illustrate the growing strain imposed by tight monetary conditions. In 2025, Brazil recorded 5,680 corporate judicial recovery filings, up 24.3% y/y.

EXTERNAL ACCOUNTS: THE OIL PRICE SHOCK BOLSTERS THE TRADE SURPLUS

During the first half of the year, the surge in oil prices, combined with record domestic hydrocarbon production and another strong agricultural harvest, provided a significant boost to exports. As a result, the trade surplus reached USD 32.7 bn by the end of May, up 34% y/y, and is projected to reach around USD 90 bn in 2026 (4% of GDP). This performance has been driven primarily by rising crude oil exports to Asia, particularly China and India, while food exports to the Gulf countries weakened owing to conflict-related logistical disruptions. Robust export performance is expected to narrow the current account deficit to 2.3% of GDP in 2026, from 2.9% in 2025. The deficit continues to be comfortably financed by strong foreign direct investment inflows (the country attracts around 5% of global flows – ranking 3rd in the world in 2025, behind the United States and China).

Stronger growth, resilient external accounts and elevated real interest rates continue to support carry trade inflows and underpin the *reais* (+6% against the USD dollar since the start of the year). However, fiscal slippage, a more accommodative stance towards inflation and rising political uncertainty ahead of the elections could undermine capital inflows and weaken the currency.

FISCAL POLICY: SUPPORT TODAY, FISCAL RISKS TOMORROW?

Overall, the energy shock has had a broadly neutral impact on the fiscal balance. Windfall revenues generated by higher oil prices (through higher dividends from Petrobras and temporary taxes on oil exports) have largely been offset by higher public spending and tax relief measures. To cushion the pass-through to domestic prices and protect household purchasing power, the authorities have temporarily subsidised diesel and LPG, while reducing or deferring selected fuel taxes. The government has also expanded targeted support for lower-income households.

The primary balance target of 0.25% of GDP (called for by the fiscal rule) remains technically achievable according to the Independent Fiscal Institute (IFI). But formal compliance relies on the exclusion of certain expenditure from the calculation of the primary balance. In addition, policy support is increasingly being channelled through off-budget instruments, subsidised lending and implicit guarantees. In order to ease the monetary squeeze on the private sector, the government is relying more heavily (i) on the development bank (BNDES) to support industry (*Nova Industria programme*, launched in 2024 experienced a recent injection of BRL 140 bn), (ii) on Banco do Brasil and Caixa to support distressed households, but also on otherwise creditworthy borrowers whose repayment capacity has been eroded by persistently high interest rates, particularly informal workers (*Novo Desenrola programme* and its recent extension *Desenrola Adimplentes*); (iii) The government has also expanded directed lending and other forms of subsidised credit to support agriculture (*Plano Safra 2026/27*). Since mid-2025, these quasi-fiscal measures have amounted to around BRL 275 bn (2.1% of GDP). While politically attractive, this approach risks shifting fiscal risks onto the balance sheets of public financial institutions.

With gross public debt standing at around 81% of GDP and projected to rise further in 2027, the required fiscal adjustment cannot rely indefinitely on windfall revenues. Persistently high real interest rates that remain above real GDP growth make debt stabilisation difficult without a structural improvement in the primary balance, even with extensive

Public debt ratio: an upward trend difficult to curb

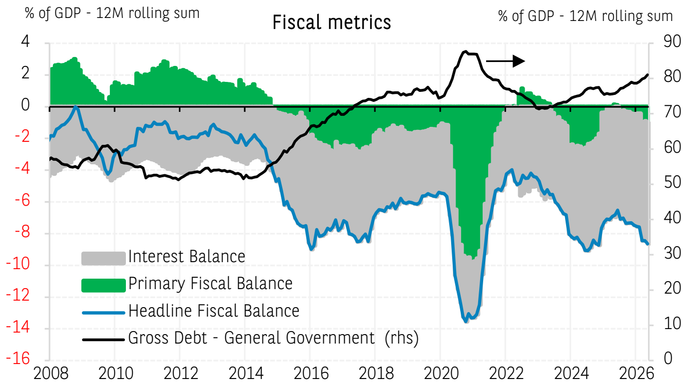

CHART 2 SOURCE: NATIONAL TREASURY, BNP PARIBAS

recourse to off-budget support measures. These developments point to a deterioration in sovereign risk which warrant close monitoring, given the already elevated interest burden (~7.6% of GDP) and the forthcoming electoral cycle — which could further delay monetary easing and push sovereign risk premia higher. In a context where global financial conditions could tighten, the government may face durably higher debt refinancing costs.

THE ENERGY SHOCK REINFORCES BRAZIL'S DRIVE TOWARDS PRODUCTIVE SOVEREIGNTY

As a net exporter of hydrocarbons with a largely decarbonised energy mix, Brazil has turned the disruption in the Strait of Hormuz into an opportunity rather than a constraint. Beyond the immediate cyclical gains for exports, public finances and the reais, the energy crisis has strengthened Brazil's strategic positioning as a reliable energy supplier — given its lesser exposure to geopolitical risks compared to Russia and Gulf producers. The key structural challenge now lies in transforming oil windfall revenues into productive investment. This transformation is essential to boost the country's growth potential, which remains hampered by low total factor productivity, limited trade openness and prohibitively high financing costs for local businesses.

The shock has nevertheless highlighted several structural vulnerabilities. Insufficient domestic refining capacity forces Brazil to import around 25% of its diesel requirements. Given diesel's critical role in agriculture as well as transport and logistics (about 60% of freight is carried by road) — this dependence leaves the economy vulnerable to price volatility[1] and transport disruptions (eg. truckers strike). The energy shock thereby underscored the need for additional investment in domestic refining capacity.

These energy-related vulnerabilities are compounded by Brazil's heavy reliance on imported fertilisers, which account for around 85% of domestic consumption, with the Middle East remaining a major supplier. Against this backdrop, the authorities have recently designated fertiliser production as a strategic priority under the *Nova Industria Brasil* (NIB) programme, illustrating how the energy shock has reinforced Brazil's drive towards greater productive sovereignty.

Article completed on 15 July 2026

Salim Hammad salim.hammad@bnpparibas.com

1 By contrast, gasoline prices are regulated in Brazil and adjusted on an ad hoc basis by Petrobras, which controls around 70% of domestic oil production.

COLOMBIA

A PROGRAMME OF RADICAL CHANGE

The presidential election on 21 June 2026 was won by Abelardo de la Espriella, an outsider who distances himself from the traditional figures of the Colombian right. His programme, which represents a total departure from that of the outgoing government, draws clear inspiration from the economic liberalisation advocated by Argentine President Javier Milei and the security measures of Salvadoran President Nayib Bukele. His accession to power in August therefore heralds major shifts in economic and fiscal policy, as well as in the fight against drug trafficking. Although economic growth has remained largely unaffected by the closure of the Strait of Hormuz, it is expected to slow in 2026, primarily due to more restrictive monetary and fiscal policies. However, the risks associated with implementing the incoming government's socio-economic programme are considerable, particularly given the high level of fragmentation in Parliament, where the outgoing government's party retains a large number of seats.

GROWTH REMAINS RESILIENT BUT IS EXPECTED TO SLOW

In Q1, year-on-year real GDP growth remained relatively strong at 2.2%. Household consumption picked up, partly due to the sharp increase in the minimum wage (+23.7%), which came into force on 1st January. In the short term, growth is likely to remain resilient as it is largely unaffected by the closure of the Strait of Hormuz. On the one hand, Colombia does not source hydrocarbons from the Gulf states and has therefore avoided fuel shortages. On the other hand, domestic gasoline and diesel prices, which are regulated by the government, have seen minimal increases since 1st March (+5.2% for gasoline and +2.7% for diesel). Instead, the main source of vulnerability stems from rising fertiliser prices, as agriculture accounts for a moderate share of the economy (10% of GDP).

Despite this limited exposure, growth is expected to slow. The unprecedented scale of the minimum wage increase has weakened the labour market. In April, the seasonally adjusted unemployment rate reached 8.7%, up from 8.4% in December 2025). Furthermore, job creation since January has been concentrated in the public administration, defence, education and health sectors, with an increase of (+419,000 jobs since last December). Conversely, other sectors recorded a net loss of 366,000 jobs during the same timeframe, the vast majority of which were in manufacturing and retail.

However, the public sector's ability to boost job creation is unlikely to last. A. de la Espriella has stated his intention to cut 700,000 public sector jobs, representing nearly 3% of total employment. The rise in the unemployment rate could therefore accelerate rapidly from the second half of 2026 onwards. Combined with the drastic budget cuts promised by the incoming president, which could take effect as early as Q3, consumption — the main driver of growth in 2025 — is expected to slow significantly (Chart 1).

On the other hand, the economic liberalisation programme promised by A. de la Espriella could lead to a rebound in private investment. We would then see a gradual rebalancing of growth drivers. However, this rebalancing is likely to be hindered by the Central Bank's monetary policy tightening.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	7.3	0.8	1.5	2.6	2.0	2.7
Inflation, CPI, year average, %	10.2	11.8	6.6	5.1	6.2	5.5
Central gov. balance / GDP (%)	-5.3	-4.2	-6.7	-6.4	-6.5	-5.4
Central government debt / GDP (%)	59.3	54.5	59.7	64.4	66.8	68.4
Current account balance / GDP (%)	-6.0	-2.3	-1.7	-2.4	-2.1	-2.3
External debt / GDP (%)	59.2	59.6	52.6	53.1	54.3	55.6
Forex reserves, USD bn	57,3	59,6	62,5	64,4	66,8	67,2
Forex reserves, in months of imports	7.7	9.3	9.5	9.2	9.3	9.3

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Economic growth is driven by consumption

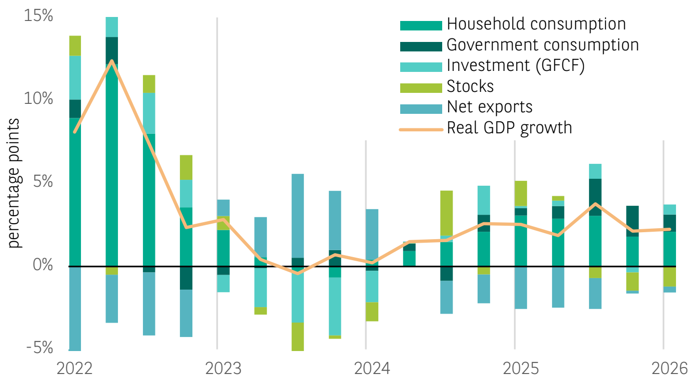

CHART 1 SOURCE: DANE, BNP PARIBAS

MONETARY POLICY: INDEPENDENCE REAFFIRMED, MORE TIGHTENING EXPECTED

Since the start of 2026, inflation has started to rise again. It is largely driven by the sharp rise in the minimum wage, which is fuelling inflation in the services sector. It is also driven by inflationary pressures resulting from the closure of the Strait of Hormuz, albeit to a lesser extent[1]. In June, inflation continued to accelerate, reaching 6.1% y/y, compared with 5.1% in December 2025.

In response, the Central Bank raised its key interest rate by 100 basis points on two occasions in Q1. This action was met with considerable discontent from the government, which threatened to raise the minimum wage again if the Central Bank raised rates in April.

1 Since the start of the year, year-on-year inflation in the services sector has exceeded 7% (healthcare and education) or even 9% (catering and hospitality industry, which is characterised by the lowest wages according to the DANE). By comparison, food price inflation peaked at 6.8% in June and inflation in the transport sector averaged 5.2% from March to June.

Despite a hawkish majority, the monetary policy committee opted to leave the key interest rate unchanged until May.

Threats to the Central Bank's independence have since receded. Firstly, at the end of May, the Council of State suspended the requirement for the Minister of Finance to attend monetary policy committees to ratify its decisions. Furthermore, the defeat in the presidential elections of I. Cepeda, the incumbent government's candidate, has reduced the risk of a prolonged standoff between the executive and the Central Bank. The Central Bank therefore resumed its cycle of monetary tightening on 30 June with a 75bp increase, raising the key interest rate to 12%. In the coming months, the second-round effects of the minimum wage increase are likely to continue, and more rate hikes are expected.

EXTERNAL ACCOUNTS: SEVERAL SUPPORTIVE FACTORS ON THE HORIZON

Colombia's energy trade surplus is one of the largest in Latin America[2]. It exceeded 2% of GDP in 2025. External accounts are therefore well-positioned to benefit from rising energy prices. According to our calculations, an increase in the price of a barrel of oil to an average of USD 85 in 2026 (+25% compared with 2025) could lead to a gain of USD 1.9 bn (0.4% of GDP) for the trade balance. The current account deficit — which stood at just 1.2% of GDP in Q1 — is therefore expected to shrink this year.

The capital account could also strengthen. The election of A. de la Espriella as president has been positively received by foreign investors. Since 31 May, when he came out on top in the first round of voting, the COP has appreciated by 11.3% against the US dollar (Chart 2). The incoming president's ideological affinity with his US counterpart, from whom he has received support, is likely to help improve bilateral relations after two difficult years. The renewed confidence among foreign investors could, in the short term, result in a marked increase in net portfolio investment inflows (which already accounted for 1.2% of GDP in Q1 2026), while the economic liberalisation programme could boost net foreign direct investment inflows, which fell to 1.5% of GDP in 2025, marking a record low not seen since the Covid-19 pandemic. However, a sustained rebound in capital inflows is not guaranteed. Foreign investor confidence could erode if the government fails to lay the foundations for fiscal consolidation swiftly. A deterioration in the already fragile security situation, coupled with a resurgence of social unrest in response to the new government's highly controversial socio-economic programme, could also lead to capital outflows.

In the medium term, the measures championed by A. de la Espriella — which represent a complete departure from the previous government — should, in principle, improve the country's external accounts. In particular, the incoming president plans to lift the ban on granting new licences for hydrocarbon exploration and hydraulic fracturing (fracking). Crude oil production, which has fallen by 1.5% since 2022, could therefore rebound. This would bolster exports of goods, which have experienced sluggish growth in recent years (+0.2% per year in real terms from 2023 to 2025). However, this would be at the expense of the energy transition.

The peso appreciates and sovereign yields decline

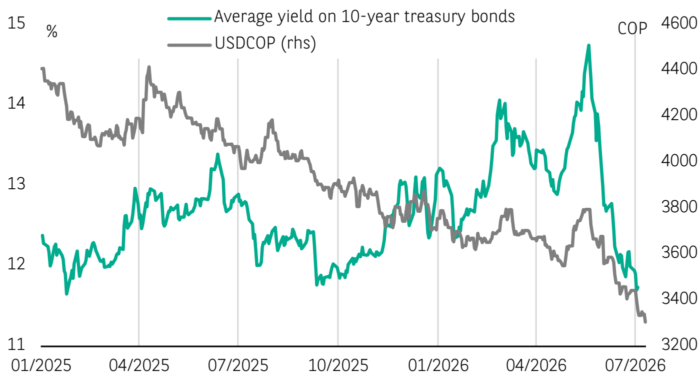

CHART 2 SOURCE: BANREP, BNP PARIBAS

PUBLIC FINANCES: AUSTERITY PROGRAMME

The rise in international energy prices since March poses a risk of fiscal slippage, given the subsidies paid by the state to offset fuel price controls[3]. On average, from 2022 to 2024, transfers from the central government to the fuel price stabilisation fund amounted to 1.4% of GDP per year. However, the risk of fiscal slippage is somewhat mitigated by government revenue from oil, which also increase in line with energy prices: on average, from 2022 to 2024, it reached 2.1% of GDP.

So far, this risk of fiscal slippage has not materialised. From January to April 2026, the central government deficit stood at 2.2% of full-year GDP. This is down by 0.6pp compared with the deficit recorded from January to April 2025, but it remains high. A. de la Espriella has promised a stringent fiscal austerity programme. His election has therefore reassured investors: since the first round of the presidential elections on 31 May, yields on sovereign bonds have been falling (Chart 2).

Budget cuts are expected from 2026 onwards. However, the continuation of fiscal consolidation in 2027 faces several obstacles. In particular, President Espriella's government will have to contend with a highly fragmented Parliament, which could complicate the passing of budget laws and tax reforms[4]. These difficulties could fuel strong financial volatility in the coming months.

Article completed on 10 July 2026

Lucas Plé

lucas.ple@bnpparibas.com

2 See: Latin America: more exposed to inflationary pressures than to disruptions in hydrocarbon supplies
3 See: In Latin America, the energy crisis is expected to have a moderate impact on public finances
4 See: Presidential Election in Colombia: A 180 Degree Turn

MEXICO

USMCA REVIEW: MEXICO'S INDUSTRIAL HEADACHE

Mexico's economic outlook remains modest. It is characterised by a slowdown in private consumption and investment still held back by uncertainty and a lack of new infrastructure projects. Exports, the main drivers of economic activity, have benefited from the US regionalisation strategy, but the USMCA renegotiation is introducing new constraints. The US is tightening the conditions for accessing its market, threatening the competitiveness of the manufacturing sector, which remains dependent on Asian inputs. At the same time, rising public debt, continued support for Pemex and falling oil revenues are drastically reducing fiscal margins, exacerbating the country's economic challenges.

GROWTH REMAINS SLUGGISH

The outlook for the Mexican economy is not showing any significant improvement. Growth will remain close to 1%, which is well below its potential (2%). Following a disappointing first quarter (+0.2% q/q in Q1, after +1.7% in Q4 2025), monthly economic data suggest sluggish growth in the second quarter, with a marked slowdown in domestic demand and generally disappointing industrial performance.

In real terms, private investment fell by 5% year-on-year in Q1, marking its seventh consecutive quarterly drop since 2023. This contraction reflects persistent structural constraints (unreliable energy and water supplies, and security instability) and a climate of uncertainty exacerbated by recent institutional reforms, including to the judicial system. The latter is currently being implemented, but several unclear provisions are raising doubts about the independence of the judiciary. On top of this institutional instability is the uncertainty surrounding the renewal of the USMCA and global geopolitical tensions. All of this may be driving investors' wait-and-see approach. Furthermore, the difficult transition from the major infrastructure projects launched by the previous government (the Tren Maya and the Dos Bocas refinery, now completed) and the lack of new projects (as part of the government's fiscal-consolidation policy) are adversely affecting public-investment spending.

Furthermore, private consumption is showing signs of losing momentum, against a backdrop of a less buoyant labour market. The unemployment rate remains low (2.8% in May) and the employment rate continues to rise, but job creation is concentrated almost exclusively in the informal sector. The decline in remittances from workers abroad is also contributing to the slowdown in private consumption. Remittances fell both in volume terms — following the implementation of the US government's restrictive immigration policies — and in value terms, due to the appreciation of the peso throughout the second half of 2025 and the first few months of 2026. Remittances in dollars have picked up slightly in recent months. However, they continue to fall in real peso terms, leading to a significant decline in the purchasing power of households for which they are intended.

STRONG EXPORTS: FALSE COMFORT

The export sector remains the mainstay of the economy. Total exports have risen every month since the start of the year, posting year-on-year growth of 30% in value terms in May. It should be noted that nearly 85% of Mexico's total exports are destined for the United States.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	3.9	3.2	1.5	0.5	1.1	2.0
Inflation, CPI, year average, %	7.9	5.6	4.2	3.8	4.0	3.7
Budget balance / GDP, %	-4.3	-3.3	-5.1	-3.9	-3.8	-3.8
Public debt / GDP, %	46.9	46.5	49.1	51.5	53.1	54.0
Current account balance / GDP, %	-1.2	-0.3	-0.9	-0.4	-0.6	-0.5
External debt / GDP, %	41.9	33.3	31.0	32.0	33.0	33.1
Forex reserves, USD bn	194.0	207.0	221.0	239.0	245.0	258.0
Forex reserves, in months of imports	4.8	4.1	4.3	4.5	4.2	4.1

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Informal employment weighs on consumption

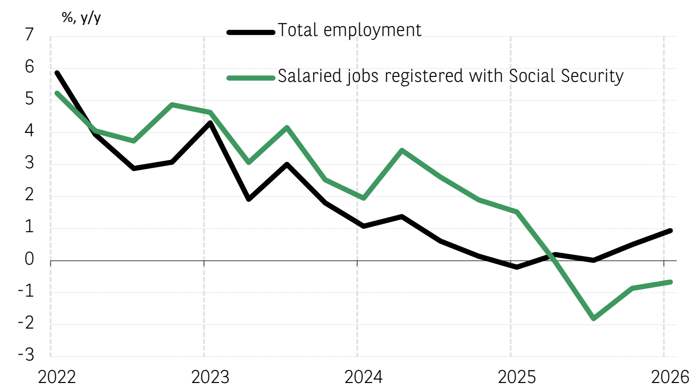

CHART 1

SOURCE: INEGI, ENOE

The performance of the automotive sector (25% of total manufacturing exports) has been mixed. Although vehicles complying with the USMCA's rules of origin continue to enjoy preferential access to the US market, they are now subject to a 25% tariff on their non-US content. This measure has weighed on automotive exports since the end of 2025 and throughout the first quarter of 2026. Data for April and May show a slight rebound, which may not prove to be sustainable.

Conversely, non-automotive manufacturing exports have grown at a steady pace, reaching 43% y/y in May. In particular, exports of machinery and electrical and electronic equipment (HS headings 84 and 85), driven by strong US demand for these products, have been rising every month since the start of 2026 (33% y/y in May).

This trend cannot be interpreted as a sign of a genuine upmarket move by the Mexican manufacturing industry. Alongside exports, there has been a parallel rise in imports of these same product categories from Asia. Imports directly from China are moving towards stabilising, but imports from other Asian countries (South Korea, Malaysia, Taiwan and Vietnam, in the case of electrical and electronic machinery and equipment) have been growing rapidly since the start of 2025. This trend suggests that Mexico is still primarily positioned in the assembly segments of value chains, while the production of the most sophisticated components remains largely concentrated in Asia. It also points to a diversification of Asian suppliers.

REVIEW OF THE USMCA: THE ISSUES GO BEYOND THE SCOPE OF A TRADE AGREEMENT

1st July marked the official start of the USMCA's "joint review". The United States refused to confirm the automatic extension of the agreement, triggering a period of annual reviews and negotiations that could continue until 2036. The agreement will remain in full force during this period.

During the first official USMCA renegotiation meetings in late May, followed by a second round of talks in mid-June, discussions focused mainly on strengthening rules of origin, particularly in the automotive sector. The United States is proposing to add a requirement for a minimum proportion of content produced on its territory to the current 75% produced within the region. The negotiations also include stricter wage requirements, tariffs imposed on components sourced from outside the region and specific rules introduced for the steel and aluminium sectors. A third round of talks is scheduled for 20 July.

At the same time, critical minerals could be one of the key issues in this review. The aim would be to adapt an agreement designed to promote trade to an environment primarily grappling with the issues of economic security and the energy transition. Discussions are focusing on better coordination of trade policies, stronger rules of origin for products containing critical minerals (batteries and semiconductors), and common mechanisms to secure supplies. With this in mind, the agreement between the United States and Mexico, signed in February 2026, aiming to integrate critical minerals further into North American supply chains, appears to be an important step. If these provisions were incorporated into the USMCA, it would then go beyond the scope of a mere trade agreement to become closer to a genuine common industrial policy. Failing that, the proliferation of bilateral agreements could lead to a more fragmented and less effective framework for reducing North America's dependence on China.

THE EASING CYCLE IS NOW COMPLETE

In May, headline inflation slowed for the third consecutive month, to 3.9% y/y. For the first time since the start of 2026, the inflation rate has fallen below the 4% ceiling set by the Bank of Mexico. Price pressures continued to ease for food, drinks and tobacco.

Regionalisation of trade, but not of supplies

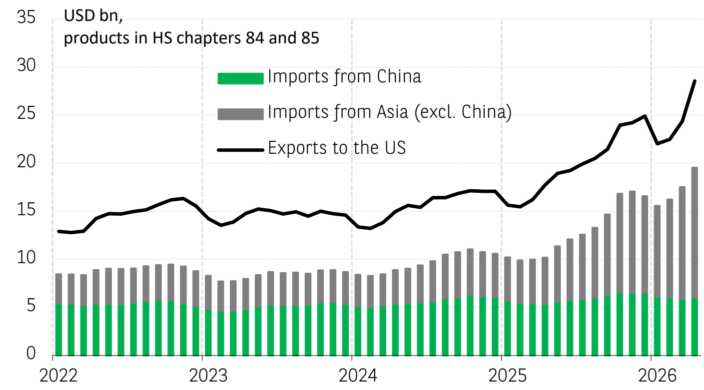

CHART 2 SOURCE: COMTRADE

Core inflation also decelerated in May, to 4.2% y/y. Base effects and upward pressures linked to the FIFA World Cup are preventing a faster slowdown in inflation.

Faced with the risks of second-round effects linked to energy prices and the possibility of a rate rise by the US Federal Reserve, the Bank of Mexico kept its benchmark rate at 6.5% on 25 June, indicating that it would be appropriate to maintain this level in the future.

PUBLIC FINANCES: DIFFICULT FISCAL CONSOLIDATION

Fiscal consolidation, a priority for President Sheinbaum since she took office in 2024, is making progress (3.9% of GDP in 2025, down from 5% in 2024), but the public deficit remains high. The government's overly optimistic growth assumptions, high interest payments (16% of GDP), inflexibility in current expenditure and continued support for Pemex (despite a slight improvement in its results, the company remains dependent on state support due to its high debt, low profitability and significant investment needs) are limiting the improvement in the fiscal situation. Furthermore, the president remains reluctant to implement a wide-ranging tax reform. According to the government, the rise in global energy prices is expected to have a broadly neutral impact on the budget, with higher oil revenues offsetting tax cuts aimed at stabilising prices for end consumers, the fall in production and budgetary transfers to Pemex. We expect the deficit in 2026 to be close to the level seen in 2025, at 3.8% of GDP. As a result, debt is continuing to rise, limiting the government's room for manoeuvre in the face of any new economic shocks.

Article completed on 10 July 2026

Hélène Drouot
helene.drouot@bnpparibas.com

SAUDI ARABIA

THE CONFLICT IN THE MIDDLE EAST: MORE THAN JUST A TEMPORARY SHOCK

Saudi Arabia may not be the Gulf economy most vulnerable to the conflict in Iran, but it is by no means unaffected. This year's growth forecasts have been significantly downgraded due to the decline in oil production. Nevertheless, excluding hydrocarbons, economic activity remains resilient. Crucially, the country has been able to capture some of the trade flows blocked in the Strait of Hormuz thanks to its infrastructure on the Red Sea. In the short term, the rise in oil exports will improve its external accounts. On the other hand, the recovery in public finances will be less pronounced due to soaring budgetary expenditures. However, there is still ample fiscal headroom. Public debt levels are moderate and the conflict has not undermined creditors' confidence. Beyond the short-term effects, this conflict is likely to have lasting repercussions across the entire region. Saudi Arabia could stand to benefit from this.

GROWTH: A SIGNIFICANT SLOWDOWN BUT NO RECESSION

Despite the signing of a memorandum of understanding between the U.S. and Iran, the situation remains fragile, with numerous sensitive issues at stake, chief among them the full restoration of traffic in the Strait of Hormuz.

Saudi Arabia is not the Gulf country most vulnerable to the consequences of the war in Iran. The expanded capacity of the port of Yanbu on the Red Sea and the use of the East-West pipeline have helped to cushion the blow to hydrocarbon exports and external accounts (see below). With this reorganisation of logistics flows, the country also has an advantage in rapidly ramping up its oil production. However, in the short term, it will be unable to fully offset the losses. From over 10 million barrels per day (b/d) in February, crude oil production fell to 6.9 million b/d in May, a drop of 31.6%.

Excluding hydrocarbons, the economy has demonstrated a remarkable ability to adapt. Unlike many other countries in the region, Saudi Arabia has been able to rely on its port infrastructure outside the Strait of Hormuz to contain the inflationary risk associated with rising prices for imported goods. In particular, the YoY rise in food prices has remained under 1% since the start of the conflict. While inflationary pressures may emerge in the coming months, they should be manageable overall, thanks to subsidies that help stabilise energy prices. With inflation expected to average 2.2% this year, household consumption is expected to remain robust. Furthermore, most economic indicators (PMI indices, confidence surveys) stabilised in April after falling in March; however, they remain at relatively low levels.

In addition to the reorganisation of logistics flows, several factors have contributed to the economy's resilience to date: the depth of the domestic market, the strength of the banking sector, and the vigour of the labour market. Saudi Arabia has also been less affected by Iranian military attacks. Air traffic from Saudi Arabia's main airports has fallen by only 20% on average since the start of the conflict, compared with 60% for other Gulf countries. It has now almost returned to normal. Against this backdrop, the slowdown in non-hydrocarbon activity is expected to be moderate, with growth estimated at 3% this year compared with 4.1% in 2025. Despite a 6% decline in value added in the hydrocarbon sector (20% of GDP), Saudi Arabia's economy may be one of the few in the Gulf not to contract this year. Nevertheless, the impact on growth will be significant. Initial forecasts had predicted growth of 4.6% in 2026, but it is now expected to reach only 0.8%.

EXTERNAL ACCOUNTS: PRICE EFFECT DOMINATES

By rerouting 70% of its oil export capacity via the Red Sea, and thanks to rising oil prices, the Saudi economy has been able to absorb much of the energy shock. In March, oil exports reached USD 25bn, the highest level since late 2022 (Chart 1). April, May, and June are also shaping up strongly as Saudi Arabia has been selling its oil at an unprecedentedpremium of USD 12.50 per barrel on average to Asian countries, which are by far its main customers. Although oil prices have been falling since the signing of the memorandum of understanding between the United States and Iran, they are expected to remain above their pre-crisis levels for the rest of the year. With Brent averaging around USD 85 per barrel in 2026, Saudi Arabia's hydrocarbon exports could reach USD 250bn, compared with USD 214bn in 2025.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth (%)	12.0	0.5	2.6	4.5	0.8	4.4
Inflation, CPI, year average, %	2.5	2.3	1.7	2.0	2.2	2.1
Gen. Gov. balance / GDP (%)	2.2	-1.8	-2.5	-5.8	-5.1	-4.3
Gen. Gov. debt / GDP (%)	21	23,0	25,9	31,8	34,9	38,0
Current account balance / GDP (%)	12.1	2.1	-1.3	-2.6	-0.8	-1.1
External debt / GDP (%)	21	24,6	29,5	37,5	38,1	40,4
Forex reserves (USD bn)	460	437	437	460	487	493
Forex reserves, in months of imports	21.4	17.2	15.5	15.4	15.5	14.9

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Oil exports: volume drop, USD revenue spike

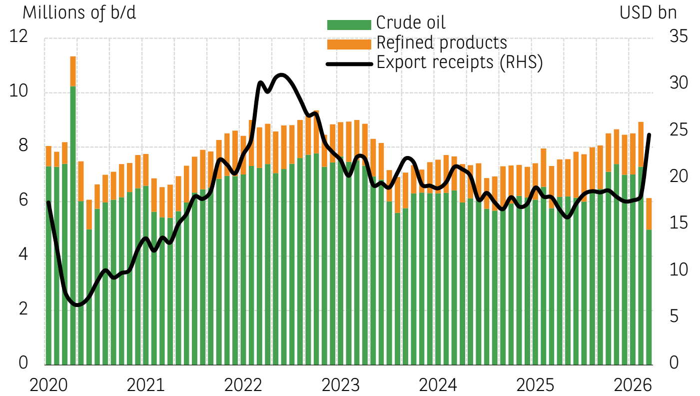

CHART 1

SOURCE: GASTAT, JODI, BNP PARIBAS

The current account balance, which has been deteriorating gradually in recent years, is therefore set to improve. Having previously been in structural surplus, the current account slipped into deficit in Q3 2024. This deficit has continued to expand, driven by the combined effect of a rapid increase in imports and a decline in exports. The anticipated rise in oil exports is expected to help reduce the current account deficit from 2.6% of GDP in 2025 to less than 1% GDP this year.

Furthermore, foreign exchange reserves are currently around USD 490bn, up 6% since the start of the year. While the banking sector's net external position remains heavily in deficit, it has also begun to improve. For the first time in 16 months, it reduced by USD 8.5bn in April.

PUBLIC FINANCES: STILL UNDER PRESSURE

However, pressure on public finances will remain strong. The budget deficit reached a record USD 33.5bn in the first three months of the year (Chart 2), representing three-quarters of the amount forecast in the Budget law. The surge in expenditure was remarkable: up 20% compared with Q1 2025, driven largely by 'goods and services' (+52%) and investment (+56%). Subsidies have also tripled. While it is difficult to estimate the proportion attributable to the cost of the conflict, the target of reducing the budget deficit from 5.8% of GDP in 2025 to 3.3% this year will not be met. However, the gains generated by the increase in oil revenues (which account for over half of total revenue) were not evident in Q1. Despite the prospects for improvement in the coming quarters, the budget deficit is expected to remain significant (above 5% of GDP).

Government debt is currently moderate, but it will continue to rise rapidly. It is expected to reach 35% of GDP this year (up from 31.8% in 2025 and just 2% in 2022). Despite consolidation efforts over the past two years, the government has been unable to stem the rise in debt. However, it still has comfortable room for manoeuvre. The debt profile is favourable, and the conflict has not undermined foreign investors' confidence in the strength of the country's macroeconomic fundamentals. Risk premiums on 5-year foreign-currency debt have even fallen by 23 basis points since late February, providing scope for the authorities, who claim to have already secured full funding requirements for this year. This is particularly true given that the government's strategy has been cautious so far. Following two record-setting years, the volume of Eurobond issuance has fallen: USD 11.5bn between January and June, compared with USD 14.5bn over the same period in 2025 (and USD 13bn in 2024). Favourable financial conditions on the domestic market (Saudi Arabia's monetary policy aligns with that of the Fed due to the SAR's peg to the US dollar) and reserves equivalent to 9% of GDP (held by the Central Bank) provide additional levers on which the government can rely.

THE POST-CONFLICT ERA: CHALLENGES AND OPPORTUNITIES IN A RESHAPED REGION

Provided that the situation in the Middle East stabilises in the long term, the Saudi economy is expected to grow by 4.4% in 2027, primarily driven by rising oil production.

However, the easing of security tensions is likely to coincide with a rapid resurgence of macroeconomic pressures. In addition to the normalisation of regional oil production, the United Arab Emirates is no longer bound by their membership of OPEC+. As a result, the global energy market could once again swing into oversupply, leading to a decline in world oil prices at a time when the Gulf states will need to realign their priorities.

Record Q1 deficit: budget equation turns tougher

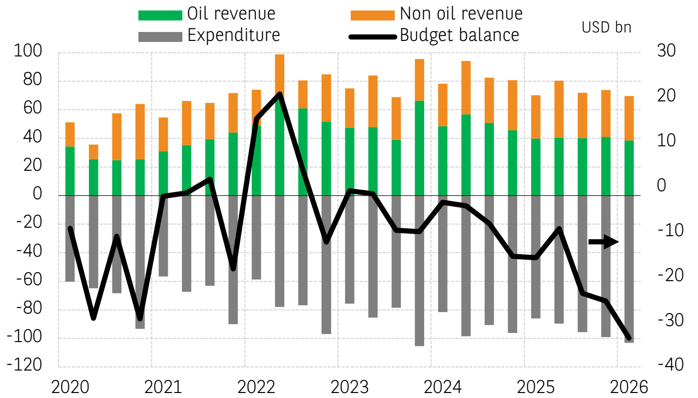

CHART 2

SOURCE: MOF, BNP PARIBAS

Alongside diversification efforts, there are now heightened security requirements and a major overhaul of infrastructure to bypass the Strait of Hormuz.

The strategy drawn up by the Saudi authorities partly addresses these new requirements. Unveiled in mid-April, it aims for a more selective allocation of resources from the PIF, the Saudi sovereign wealth fund, across a narrower range of domestic sectors, with a view to maximising the value of existing assets. Discussions regarding the creation of a logistics powerhouse through the consolidation of several assets from the PIF's portfolio illustrate this drive for economic efficiency. Indeed, the crisis has underscored the strategic significance of Saudi infrastructure in the Red Sea. By strengthening these assets, the country could benefit from the reconfiguration of logistics flows across the entire region.

While the next phase of the '2030' transformation plan is better aligned with macroeconomic constraints, it still relies heavily on the country's ability to attract foreign direct investment (FDI). Despite progress in recent years, FDI inflows to Saudi Arabia remain lower than those in neighbouring countries. In 2025, they stood at 2.6% of GDP, almost 1 percentage point below the average for Gulf countries. However, the conflict's impact on regional attractiveness remains highly uncertain.

Furthermore, by focusing on its domestic market, Saudi Arabia is poised to solidify its new position: transitioning from being a capital exporter to the rest of the world to becoming a net importer since 2024. This trend is expected to continue in the coming years. Although the PIF has a clear mandate to continue acquiring assets abroad, its operations will need to prioritise the diversification objectives set out in the '2030' plan. Given the substantial investment needs and the already significant pressures on public finances, this will probably be achieved through asset reallocation. A slowdown in the pace of acquisitions is also to be expected.

Article completed on 10 July 2026

Stéphane Alby
stephane.alby@bnpparibas.com

EGYPT

ENCOURAGING SIGNS OF MACROECONOMIC RECOVERY

The impact of the war in Iran and the energy crisis on the Egyptian economy are currently limited. The economy has benefited from macroeconomic fundamentals strengthened by international support and the increased credibility of its economic policy. The momentum for economic recovery and disinflation, which began in 2025, remains intact. The main source of vulnerability – foreign exchange liquidity – has only slightly deteriorated, supported by increased exchange rate flexibility. Nevertheless, while the Egyptian economy's vulnerability to external shocks is diminishing, it remains high, particularly due to the growing imbalance in the energy sector and dependence on volatile capital flows. In the medium term, Europe's willingness to diversify its gas imports could benefit the Egyptian gas hub.

THE ECONOMIC RECOVERY REMAINS ON TRACK

The economic recovery was confirmed during the first three quarters of the 2026 fiscal year (FY), with an average year-on-year growth rate of +5.2%. Growth in the final quarter (April–June 2026) is expected to slow (to +3.2% y/y) due to the repercussions of the war in Iran. Nevertheless, these effects are expected to be confined to the impact of energy consumption rationing measures. For the 2026 fiscal year as a whole, real GDP growth is forecast to reach 4.7%, indicating an improvement on 2025.

The improvement in foreign exchange liquidity since the second half of 2025 has enabled the Egyptian economy to weather the energy crisis linked to the war in Iran more effectively than in 2022. Furthermore, as international investors did not panic and did not exit the Egyptian market en masse, the Egyptian pound ultimately depreciated only slightly against the US dollar, which mitigated the inflationary effects of the energy shock. More generally, the credibility of economic policy has strengthened in recent quarters due to fiscal reforms and increased exchange rate flexibility.

Nevertheless, the momentum behind the recovery in growth, observed since the end of 2024, is showing some signs of running out of steam. Industrial production and private sector lending slowed in Q1 2026. Against this backdrop, we forecast that growth will stabilise at 4.7% during FY2027. Furthermore, in the medium term, growth rates below 5% will be insufficient to include new entrants into the labour market and to reduce poverty levels. According to the World Bank, only growth of more than 6% would achieve this.

DISINFLATIONARY MOMENTUM CONTINUES

The war in Iran and the energy crisis have halted the decline in Egyptian inflation. However, the positive momentum, set in motion in 2024 by macroeconomic stabilisation, is expected to resume in the short term. The sharp rises in energy prices imposed by the government at the start of the war, together with the depreciation of the pound (which fell by 12% against the dollar in the first month before stabilising), have fuelled inflationary pressures (+15% y/y in April compared with 11.9% in January), particularly in the food component. Consumer price inflation averaged 13.2% in FY2026 and is expected to decrease slightly to 12.3% in FY2027.

This resurgence in inflationary pressures is expected to be temporary. In the short term, while inflationary risks remain, they are manageable. In our baseline scenario, oil and gas prices are expected to remain fairly high over the coming quarters. The risk associated with agricultural commodity prices, particularly for wheat (of which Egypt is the world's largest importer), are expected to be contained this year due to the plentiful local harvest and the record imports authorised by the government to build up precautionary stocks.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth (%)	6.7	3.8	2.4	4.4	4.7	4.7
Inflation, CPI, year average, %	8.5	24.0	33.6	21.0	13.2	12.3
Gen. Gov. balance / GDP (%)	-5.8	-5.7	-3.3	-6.5	-9.3	-6.1
Gen. Gov. debt / GDP (%)	89	96	91	87	81	72
Current account balance / GDP (%)	-3.5	-1.2	-5.4	-4.2	-3.6	-2.9
External debt / GDP (%)	33	42	40	44	42	40
Forex reserves (USD bn)	31,5	32,8	44,3	45,3	47,3	49,5
Forex reserves, in months of imports	3.7	4.7	6.0	5.1	5.0	5.3

TABLE 1

Fiscal year from July 1st of year n-1 to June 30 of year n
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Egypt: Economic recovery remains on track

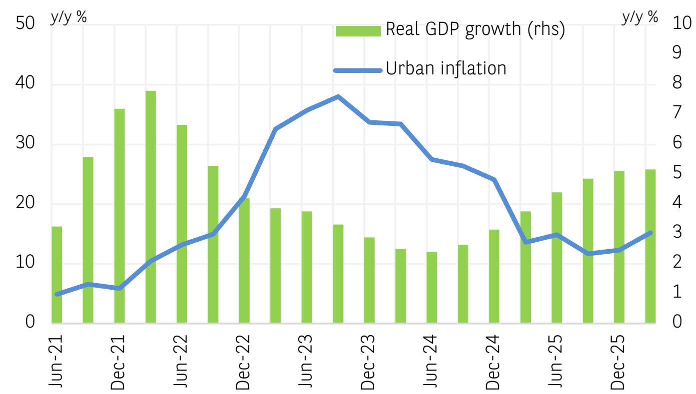

CHART 1

SOURCE: IMF, CEIC, BNP PARIBAS

Inflation is expected to remain significantly above the Central Bank of Egypt's (CBE) target (7.0% ± 2% in Q4 2026). Indeed, we forecast that the annual rate of price inflation will remain above 14.5% by the end of 2026. Against this backdrop, the Central Bank will maintain its cautious monetary easing policy, which began in 2025 as inflation eased. The cycle of rate cuts will not resume until there is a genuine stabilisation of the geopolitical situation in the Gulf. The CBE's lending rate currently stands at 20%, having fallen by 825bp between April 2025 and February 2026.

EXTERNAL ACCOUNTS REMAIN VULNERABLE

Despite an unfavourable external environment, the current account deficit is expected to shrink to 3.6% of GDP in FY2026. Over the year as a whole, hydrocarbon imports are expected to rise by over 30%, driven by rising prices on international markets and the need to import larger quantities of liquefied natural gas (LNG) to satisfy domestic demand. We do not anticipate a significant decline in LNG prices in the short term. In fact, it will take several years for Qatari production to return to full capacity, and European demand for restocking ahead of next winter is bolstering prices. On a more positive note, non-hydrocarbon exports, tourism revenues and remittances from expatriates are expected to rise sharply. By FY2027, largely due to a moderate decrease in hydrocarbon prices, the current account deficit is expected to shrink to 2.9% of GDP.

Support from bilateral and multilateral creditors remains significant, estimated at 1.7% of GDP in FY2026, according to the IMF. However, this support is expected to decrease from next year onwards as the European and IMF programmes come to an end. At the same time, external financing requirements, which encompass the current account deficit and external debt servicing, will remain high at around 6% of GDP until FY2028, according to the IMF.

Against this backdrop, there is a high risk of a significant tightening of Egypt's foreign exchange liquidity in the short to medium term, particularly as part of its external financing is inherently volatile. The IMF indicates that around 10–15% of financing needs will continue to depend on portfolio investments. Furthermore, the net foreign assets of commercial banks – a key component of Egypt's external liquidity – have nearly halved since January 2026. Maintaining exchange rate flexibility will be essential to reducing Egypt's external vulnerability, particularly because, in the event of pressure on foreign exchange liquidity, it would help to preserve the net foreign assets of the banking system, including both the Central Bank and commercial banks, which would erode rapidly under a fixed exchange rate regime.

MIXED OUTLOOK FOR FISCAL IMPROVEMENT

The state of public finances remains mixed. On the one hand, the primary surplus is rising, expected to reach 4.6% of GDP this year, marking an all-time high excluding one-off items, largely due to higher tax revenues and the gradual reduction in subsidies. On the other hand, interest expenditure on government debt remains at record levels, accounting for 70% of total revenue forecast for the 2026 budget. The budget deficit is expected to be high this year at 9.3% of GDP, due to a sharp rise in the interest burden, which is equivalent to 2.5% of GDP. However, it is expected to decline in FY2027 to 6.1% of GDP, aided by the reduction in interest rates that began in 2025.

Government debt is falling but remains high at 87% of GDP in FY2025. The main challenge lies in the cost of refinancing this debt, particularly through the extension of maturities. Local debt accounts for 70% of total government debt, with over a third comprising securities with maturities of less than one year. The government's objective is to raise the average maturity of the debt stock from the current 3.5 years to between 4.5 and 5 years by FY2029. Keeping inflation under control over the long term will be key to achieving this objective.

Egypt: Growing dependence on LNG imports

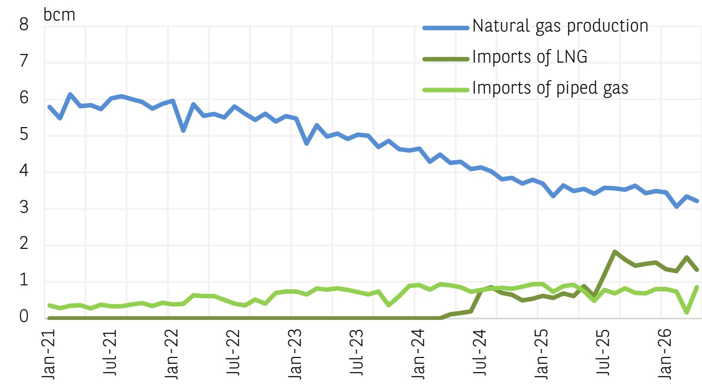

CHART 2

SOURCE: JODI, BNP PARIBAS

THE ENERGY ISSUE REMAINS CENTRAL

The energy issue is a key factor contributing to the vulnerability of the Egyptian economy. While the country benefitted from hydrocarbon export revenues during the 2000s, it became a net importer of hydrocarbons in 2024. In terms of gas, the ongoing increase in consumption (75% of the electricity mix) and the decline in domestic production (down by an average of 12% per year since the production peak in 2021) have led to an increase in imports, which now account for around 38% of gas consumption. Furthermore, Egypt is exposed to market price fluctuations, as a growing proportion of its imports consists of LNG. Moreover, the cost of liquefied gas is twice that of gas supplied from Israel via pipeline. Similarly, the reliance on oil imports has also increased in recent years, coinciding with a steady decline in domestic production.

In the short term, the repercussions of the energy crisis are negative but limited. The 33-day suspension of Israeli exports in March 2026 (which accounted for around 28% of total gas imports prior to the suspension), due to the war, had limited consequences for economic activity (such as reduced shop opening hours). The impact on electricity generation was also limited thanks to the availability of floating storage and regasification units (FSRUs), which allowed for increased reliance on LNG imports.

The impact on inflation was more severe, but is expected to be temporary (see above). In the medium term, the war in Iran is likely to prompt hydrocarbon-importing countries to further prioritise their energy sovereignty, particularly in Europe, which could work in Egypt's favour. Given that Egypt cannot export its own production, it is seeking to position itself as the gas hub of the eastern Mediterranean. The country has two liquefaction terminals that allow producer countries in the region to export their output with minimal investment. Cypriot gas is therefore expected to supply these terminals by the end of this decade. While some of this gas may satisfy domestic demand in Egypt, the remainder is likely to find a natural market in Europe.

Article completed on 10 July 2026

Pascal Devaux
pascal.devaux@bnpparibas.com

GROUP ECONOMIC RESEARCH

Isabelle Mateos y Lago Group Chief Economist	+33 1 87 74 01 97	isabelle.mateosylago@bnpparibas.com
Hélène Baudchon Deputy Chief Economist, Head of Global Macroeconomic Research	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com

Stéphane Alby Maghreb, Middle East	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Lucie Barette Europe, Germany, Italy, Spain	+33 1 87 74 02 08	lucie.barette@bnpparibas.com
Anis Bensaidani United States, Japan	+33 1 87 74 01 51	anis.bensaidani@bnpparibas.com
Céline Choulet Banking Economics	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Stéphane Colliac Head of Advanced Economies – France	+33 1 42 98 26 77	stephane.colliac@bnpparibas.com
Guillaume Derrien Europe, Eurozone – World Trade	+33 1 55 77 71 89	guillaume.a.derrien@bnpparibas.com
Pascal Devaux Middle East, Western Balkans – Energy	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Latin America	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
François Faure Head of Country Risk – Türkiye – Argentina	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Salim Hammad Head of Data & Analytics – Brazil	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Thomas Humblot Banking Economics	+33 1 40 14 30 77	thomas.humblot@bnpparibas.com
Cynthia Kalasopatan Antoine Central Europe, Ukraine	+33 1 53 31 59 32	cynthia.kalasopatanantoine@bnpparibas.com
Johanna Melka Asia	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
Marianne Mueller Europe, United Kingdom, Portugal, Greece	+33 1 40 14 48 11	marianne.mueller@bnpparibas.com
Christine Peltier Head of Emerging economies – Asia	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Lucas Plé Sub-saharan Africa, Colombia, Central America	+33 1 40 14 50 18	lucas.ple@bnpparibas.com
Jean-Luc Proutat Head of Economic Projections	+33 1 58 16 73 32	jean-luc.proutat@bnpparibas.com
Laurent Quignon Head of Banking Economics	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Tarik Rharrab Data scientist	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com

Mickaëlle Fils Marie-Luce Media contact	+33 1 42 98 48 59	mickaelle.filsmarie-luce@bnpparibas.com

BNP PARIBAS

The bank
for a changing
world

GROUP ECONOMIC RESEARCH

ECOINSIGHT
Structural or thematic topics

ECOPERSPECTIVES
Analyses and forecasts with a focus on developed and emerging economies.

ECOFLASH
Data releases, major economic events

ECOWEEK
Recent economic and policy developments, data comments, economic calendar, forecasts

ECOCHARTS
Easy-to-read monthly overview of inflation dynamics

ECOATLAS
The key economic figures for France and major European economies

CHART OF THE WEEK
A weekly chart highlighting points of interest in the world economy

ECOTV
What is the key event of the month?
You will find the answer in our economy broadcast.

MACROWAVES
Our economic podcast

HOW TO RECEIVE OUR PUBLICATIONS

SUBSCRIBE ON OUR WEBSITE
see the Economic Research website

&

FOLLOW US ON LINKEDIN
see the Economic Research linkedin page

OR TWITTER
see the Economic Research Twitter page

Published by BNP PARIBAS Economic Research
Head office: 16 boulevard des Italiens – 75009 Paris France / Phone : +33 (0) 1.42.98.12.34
Internet: www.group.bnpparibas - www.economic-research.bnpparibas.com
Head of publication: Jean Lemierre / Chief editor: Isabelle Mateos y Lago
Copyright image: StreetOnCamara_Comeback

Subscribe to our publications:
ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world