ECOEMERGING

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ECONOMIC RESEARCH

BNP PARIBAS

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SOMMAIRE

EDITORIAL

DISPARITIES AND RESHUFFLING

Growth in emerging countries held up quite well in H1 2023, thanks to countries in Asia, Brazil and Mexico. In Asia, inflation returned to very moderate levels in August or September (with the exception of India) and, compared to other areas, monetary tightening between mid-2021 and mid-2023 was on a much smaller scale. This helped offset the drop in exports. However, Central European countries did not benefit from this offset effect. Business and household surveys indicate that disparities between areas became more pronounced over the summer. These surveys also show that the heavyweights in Latin America (Brazil, Mexico) are better positioned within the major EM regions.

Up until spring 2023, growth in emerging economies held up well overall, but disparities were significant. Measured year-on-year, real GDP growth in our sample of 26 countries accelerated sharply, reaching 5% in Q2 2023 after 3.3% in Q1 2023 and 2.6% in Q4 2022. Excluding China and Hong Kong, the acceleration is less marked (from 2.6% to 3.9%). Ona sequential basis (i.e. quarter-on-quarter and annualised), economic growth, excluding China and Hong Kong, was stable at 4%. In Q2 2023, GDP fell for around a quarter of emerging economies (either y/y or q/q).

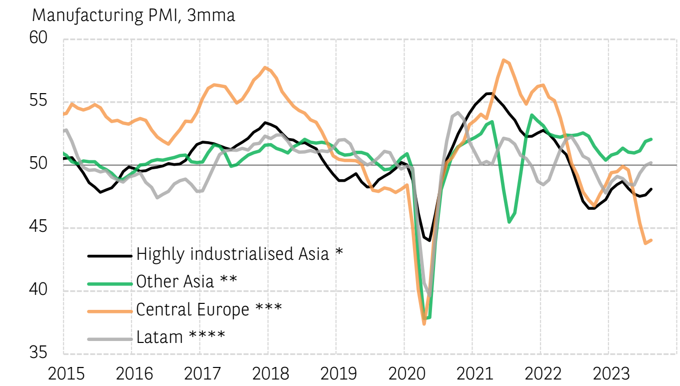
Outside China, economic growth in Asia surprised on the upside in H1 2023. Growth was maintained at around 2% on a sequential basis in industrialised countries (Korea, Singapore, Taiwan) and was firmly sustained at between 5% and 7% in India, Indonesia and Malaysia. Conversely, the main Central European economies experienced a recession or a stagnation, Hungary being the most affected with a drop in GDP over 4 consecutive quarters (-2.3% cumulative). Turkey is proving the exception in Europe, with growth boosted by accommodating monetary policy at the time. The situation varies most widely in Latin America with, on the one hand, Brazil, where growth has surprised on the upside, and Mexico, where growth has held, and, on the other hand, economies that are in recession (Argentina and, to a lesser extent, Chile and Peru) or experiencing a very significant slowdown (Colombia).

The disparities between areas can be explained by past levels of inflation and monetary tightening. In Asia, with the exception of India and the Philippines, inflation returned, in September or October, to moderate levels of between 1% and 4%, while the range is 7% to 12% for Central European countries and 4.5% to 11% for Latin American countries. Disinflation has supported household consumption in Asia more significantly than in other areas. Similarly, monetary tightening between mid-2021 and mid-2023 was, on average, much more moderate in Asia excluding India (+250 bps on average) than in other areas (700 bps in Central Europe and 900 bps in Latin America), which limited its negative impact on private investment spending.

Secondly, the disparities can be explained by a different exposure to the external environment and by specific situations: Mexico has benefited from the momentum of the American economy, Brazil from the strong upturn in agricultural production, still relatively high agricultural commodity prices and measures to support household income, Indonesia from the upturn in tourism and infrastructure investment, and India from increased public investment. Conversely, exports from industrialised countries in Asia have suffered from the reduced momentum of Chinese demand, while Central European economies have suffered from the slowdown in demand in the euro zone, particularly Germany.

Disparities by major areas can be found in business surveys in the manufacturing sector available until September (see chart).

BUSINESS CLIMATE IN MANUFACTURING SECTOR



* SINGAPORE, S.KOREA, TAIWAN / ** INDIA, INDONESIA, MALAYSIA, VIETNAM / *** POLAND, HUNGARY, CZECH REP / **** BRAZIL, MEXICO

CHART 1 SOURCE: S&P GLOBAL, BNP PARIBAS

These disparities are especially pronounced between Central Europe and other areas. At the same time, the recovery in household confidence has been more marked in Brazil, Mexico and Indonesia than in other countries.

Furthermore, surveys confirm what growth estimates had suggested: Latin American heavyweights (Brazil and Mexico) are, just this once, better placed within major EM regions. This new pattern could continue if recent tensions over oil prices were to spread to all commodity prices against a backdrop of fragmented markets and growing geopolitical instability. Mexico is also already benefiting from the development of nearshoring.

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CHINA

ADAPTATION

After some hesitation, the Chinese authorities finally stepped up their stimulus measures over the summer. The recent slight upturn in economic growth is set to continue in Q4 2023. However, action by the central bank and the government remains constrained, cautious and measured, while internal and external obstacles to economic activity are still powerful. In the real estate sector, even if activity stabilises in the short term thanks to support measures, it is likely to remain hampered by the financial fragility of developers and weak buyer sentiment. In the export sector, enterprises are affected by the slowdown in global demand and US-China tensions, while multinationals are starting to rethink their production strategies.

MAJOR CONSTRAINTS ON ECONOMIC GROWTH

The downward trend in China's economic growth, which has been ongoing for around fifteen years, intensified in 2022 and 2023. Real GDP growth stood at 3% in 2022 and should barely exceed 5% in 2023, despite favourable base effects linked to the end of the health restrictions (economic growth averaged 6.7% per year during the 2012-2021 period).

Economic activity has been weakened for two years by an accumulation of powerful internal and external obstacles: unprecedented crisis in the real estate sector, wave of regulatory tightening in services, strict zero-Covid policy applied until December 2022, significant drop in household and investor confidence, lack of room for manoeuvre for monetary and fiscal policy makers, weakening global demand and tensions with the United States. These obstacles have added to the long-term structural factors of the Chinese economic slowdown: decline in the working-age population, moderation of productivity gains and exhaustion of the growth model driven by investment and debt.

Thus, the post-Covid rebound in Chinese growth, observed in Q1 2023, ran out of steam in the spring, and the authorities only provided a very cautious and gradual policy response (Chart 1). However, they have stepped up their stimulus measures since July, and there have been some signs of improvement. Already in August, activity in the services sector strengthened slightly (+6.8% y/y compared with +5.7% in July), supported by retail sales. Growth in industry also recovered slightly (+4.5% in August compared with +3.7% in July). The latest leading activity indicators and PMIs point to a further slight improvement in September.

The real estate sector is still in deep crisis. Property activity has contracted at unprecedented rates in the past two years : in January-August 2023, sales and housing starts represented 65% et 46% respectively of their levels in January-August 2021 (meanwhile, completed property projects recovered and represented 94% of their 2021 level). The average house price for China's main 70 cities declined by only 6% between August 2021 and August 2023, but there are large discrepancies between provinces.

ADDITIONAL MEASURES TO KICKSTART THE ECONOMY

In recent months, the central bank slightly lowered policy rates (between the end of May and the end of September, the 1-year MLF rate was cut from 2.75% to 2.5%; the 1-year and 5-year loan prime rates fell from 3.65% to 3.45% and from 4.3% to 4.2% respectively) as were the reserve requirement ratios (the average ratio fell from 7.6% to 7.4% in September). This monetary policy easing goes with support measures aimed at containing the real estate crisis and with the acceleration in bond issuance by local governments in H2 2023 in order to finance new public spending. The central government has also extended a number of tax incentives for SMEs and households.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	2.2	8.4	3.0	5.1	4.5
Inflation, CPI, year average, %	2.5	0.9	2.0	0.5	2.0
Official budget balance / GDP, %	-3.7	-3.1	-2.8	-3.0	-3.2
Official general government debt / GDP, %	45.9	46.8	50.4	53.0	54.9
Current account balance / GDP, %	1.7	2.0	2.2	1.8	1.4
External debt / GDP, %	16.3	15.4	13.7	13.0	12.5
Forex reserves, USD bn	3 217	3 250	3 128	3 080	3 030
Forex reserves, in months of imports	16.2	12.6	12.0	11.8	10.9

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: UNEVEN RECOVERY IN SERVICES ACTIVITY

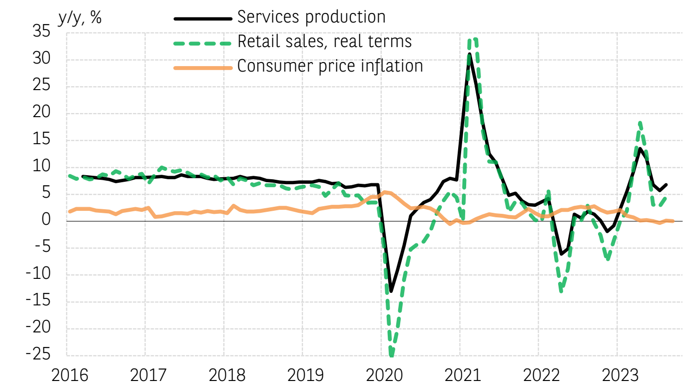

CHART 1

SOURCE: CEIC, BNP PARIBAS

In the property sector, the continued contraction in activity (and its spillover effects on the rest of the economy and household confidence), the increasing number of payment defaults by developers and the spread of risks in the financial sector have led the authorities to adjust their policy in recent months, while maintaining their objectives of making the market healthier (through the deleveraging of developers and the moderation of the cost of housing). Initially, the measures taken were mainly aimed at financing the completion of projects already underway. Since August, the authorities have stepped up their efforts to restore demand for housing. They have announced an easing of prudential rules relating to the purchase of housing and the granting of mortgage loans (including a reduction in down-payment ratios), as well as a reduction in interest rates on mortgage loans (for both new loans and existing loans). These changes are implemented differently by the government of each city depending on the local property market situation.

Thanks to these measures, real estate activity could bottom out and stabilise, or even recover slightly, by the end of the year. This should help the economic improvement seen since mid-summer to continue in Q4 2023.

However, the recovery in activity remains fragile, households are still wary, property developers remain faced with severe financial difficulties, and the authorities' room for manoeuvre to increase support for economic growth is narrow. While consumer price inflation remains very low (+0.3% y/y in August and 0% in September), the central bank's room for manoeuvre is limited by downward pressure on the yuan. The yuan has depreciated by 13% against the US dollar since April 2022 (of which 5% between end-March and end-September) due to the growing differential between US and Chinese interest rates and the large portfolio investment outflows .

Furthermore, economic policy remains heavily constrained by the excessive debt of the private sector and local governments. Total domestic debt reached 284% of GDP in mid-2023 compared with 247% at the end of 2019. This debt limits the central bank's ability to encourage new loans and discourages both bank lending supply and demand from households and enterprises. The fall in confidence is also weighing on credit growth. In fact, growth in total social financing did not strengthen in Q3 2023 (it stood at 9.3% y/y in September, as in June).

On the fiscal front, policy is constrained by the fragility of local governments resulting from their own debt (30% of GDP in mid-2023) and that of their financing vehicles (estimated at around 50% of GDP).

Finally, the authorities' action is dictated by long-term objectives. Beijing seeks to build a more balanced economic growth model, strengthen financial discipline, promote "Common prosperity" and stimulate innovation and the high-tech sectors. The priority is not to support growth in the short term, but to strengthen "national security" with measures aimed at reducing risks: both internal (in particular financial instability) and external (the tensions with the US explain China's efforts to achieve self-sufficiency in advanced technologies).

CHALLENGES IN THE MANUFACTURING SECTOR

After the strong rebound during the pandemic, growth in goods exports rapidly deteriorated in 2022 and 2023. Measured in current dollars, they contracted by 2% y/y in H1 2023, then by 10.8% in Q3 2023 (Chart 2). The very short term outlook remains poor.

The export industry is facing a slowdown in global demand (the IMF expects a slowdown in world trade volume in goods and services to +0.9% in 2023 compared to +5.1% in 2022 and +10.1% in 2021). It is also affected by trade tensions and the technology race with the US. Sales of Chinese goods on the US market fell by 16% y/y over the first nine months of 2023 (the US purchased 16% of total Chinese exports in 2022).

China's trade 'decoupling' with the US has become a reality, as evidenced by the drop in the Chinese share of total US imports from 22% in 2018 to 17% in 2022. By contrast, China has maintained its total global market share much better, notably because exporters have redirected certain products destined for the US to other countries with lower tariffs. China's share of total world exports fell to 14.4% in H1 2023 compared to 15.2% in 2021, but it is still well above its pre-Covid level (13.3% in 2019).

CHINA: DIFFICULTIES IN THE EXPORT SECTOR

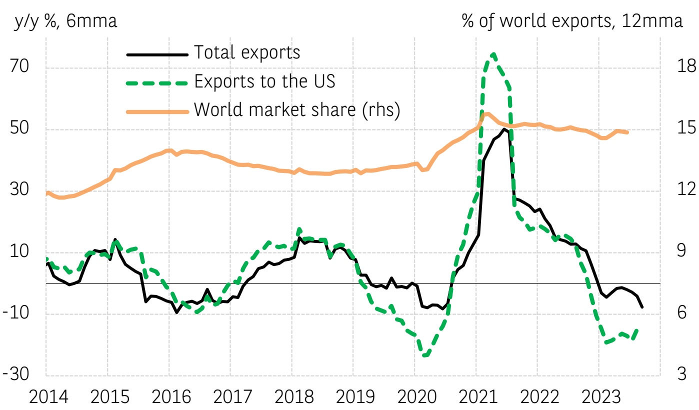

CHART 2 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, BNP PARIBAS

In the coming years, the Chinese manufacturing industry will remain affected by its lower cost competitiveness and the reorganisation of global value chains. Disruptions in value chains and the supply of essential goods caused by the Covid pandemic and then the war in Ukraine, the rise in geopolitical tensions and the increase in regulatory uncertainty in China, have led multinationals to rethink their production strategies. Some companies are moving towards a 'China for China' production strategy and/or towards a 'China+1' strategy, i.e. by relocating part of their production to Southeast Asia or India or to countries closer geographically to their country of origin, such as Mexico or Central Europe (nearshoring). Western governments are also encouraging the reshoring of certain strategic productions. In 2021, China had only received 5% of the total greenfield foreign direct investment (FDI) compared to 11% in 2018. In H1 2023, inflows of FDI recorded in the balance of payments fell significantly.

However, while changes in the organisation of global production and value chains have become evident and are expected to continue, they are unlikely to lead to a significant decline in China's role in world trade in the short and medium term. Firstly, because Chinese goods are mainly driven by Chinese firms. Secondly, because the Chinese manufacturing sector, supported by the government, keeps a solid capacity to adapt, continue its move up the value chain, and develop high-tech and green-tech products.

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HONG KONG

DIFFICULT NORMALISATION OF ECONOMIC GROWTH

The Hong Kong economy is struggling to recover from the series of shocks experienced between 2019 and 2022. Following political and institutional upheavals in 2019 and 2020, the territory was severely affected by the health crisis up until last year. In 2023, activity is recovering, but Hong Kong is now facing the weakening in external demand and, above all, significant tightening of monetary conditions. The rise in interest rates since March 2022 has impacted domestic demand, particularly through its effects on the property market. Fiscal policy, meanwhile, remains resolutely expansionary.

ECONOMIC REBOUND AFTER FOUR YEARS OF SUCCESSIVE SHOCKS

Hong Kong's economic growth averaged -1.3% per year in 2019-2022 (vs. +2.7% per year in 2012-2018). This poor performance has stemmed from an accumulation of shocks: local protests and institutional change in 2019-2020, the pandemic shock and the strict Covid policy applied until mid-2022, the loss of investor confidence, rising US-China tensions and external trade disruptions, and the rapid tightening in monetary conditions since Q2 2022.

Economic growth is rebounding from last year's weak base. It is currently projected to reach 3.8% in 2023 and then gradually slow to 2.4% by 2026. Activity has been normalising in recent months, as border controls and mobility restrictions were lifted both in Hong Kong from about mid-2022 and in China from late 2022. Private consumption had the biggest contribution to real GDP growth in H1 2023 (Chart 1). It has been boosted notably by the reopening of borders with the Mainland and the return of tourists, improving labour market conditions and fiscal support measures. Retail sales volumes rebounded by 18.2% year-on-year (y/y) in H1 (after a contraction of 3.4% in 2022).

After almost three years with very few visitors, Hong Kong's inbound travellers have returned gradually since H2 2022. In August 2023, Hong Kong hosted 4.1 million tourists (84% of which were Chinese), which is still well below the pre-protest, pre-Covid level (Hong Kong had 5.4 visitors a month on average in 2018). Activity in the tourism sector is expected to continue to recover in the coming months, even if Chinese households remain cautious. This will continue to support the economic growth recovery: before the Covid crisis, spending by tourists accounted for about a third of Hong Kong's total retail sales, and tourism represented an estimated 4.5% of GDP.

The labour market is recovering gradually. The unemployment rate has returned to its pre-pandemic level: it stood at 2.9% in August 2023, down from 4.3% in August 2022. Meanwhile, real wages rose again by +1.5% y/y in H1 2023 after they remained on a slight downward trend in the previous two years.

Spending of households and enterprises has also been supported by the government's still accommodative policy stance, with the introduction or the extension of fiscal and credit-relief measures (consumption vouchers, tax reductions, extension of loan repayment deferrals and low-interest financing schemes, etc.).

However, the economic rebound remains difficult, as highlighted by the new contraction of real GDP in quarter-on-quarter terms registered in Q2 2023. Activity is constrained by the tightening in monetary conditions as well as the downturn in global trade and China's sluggish momentum of the post-Covid growth rebound. Both exports and imports of goods declined meaningfully in the first eight months of 2023 (by -12% and -10% y/y respectively in USD value). As of Q2 2023, real GDP had not yet recovered its level of four years ago; this may not occur before 2024.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-6.5	6.4	-3.5	3.8	2.7
Inflation, CPI, year average, %	0.3	1.6	1.9	2.0	2.4
Budget balance / GDP, % (1)	-9.2	0.0	-6.6	-3.5	-2.5
Government debt / GDP, %	4.4	5.9	7.8	9.2	10.5
Current account balance / GDP, %	7.0	11.8	10.5	9.8	9.5
Forex reserves, USD bn	492	497	424	420	415
Forex reserves, in months of retained imports	46.6	47.7	42.6	41.0	40.0
Forex reserves, in months of imports	16.2	12.6	11.9	11.1	10.1

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

HONG KONG: CONTRIBUTION TO REAL GDP GROWTH

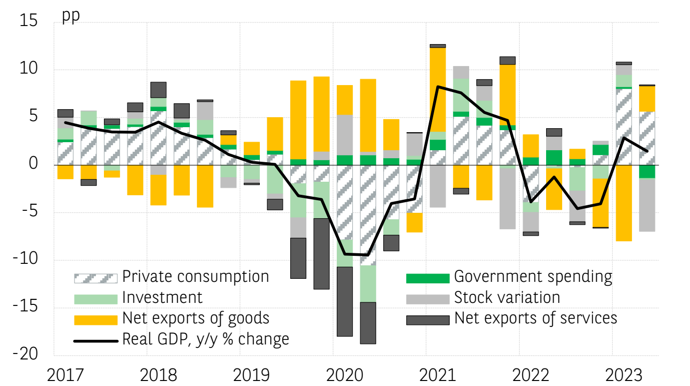

CHART 1 SOURCE: CENSUS AND STATISTICS DEPARTMENT, BNP PARIBAS:

SHARP TIGHTENING IN MONETARY CONDITIONS

Hong Kong's monetary policy follows that of the US given its Currency Board regime. As a consequence, its base rate soared from 0.5% to 5.75% between March 2022 and August 2023 (Chart 2). It is presently projected to be stable until Q1 2024 and then start to decline slowly. Unlike in the US, Hong Kong's inflation remains low given the persisting slack in the economy. Consumer price inflation averaged 1.9% y/y in the first eight months of 2023, and it has declined slightly since May. This means an even sharper tightening in monetary conditions than in the US.

Tighter financial conditions have weighed heavily on domestic demand due to the contraction in bank loans (-4.5% y/y in August 2023), higher debt servicing costs, and the downturn in the property market. Domestic investment grew by only 3.2% y/y in H1 2023 in spite of post-Covid rebound effects.

Since the end of 2021, the real estate market has undergone a significant correction: average property prices have fallen by 14% and total sales volumes by almost 40%. The correction is likely to continue in the short term as monetary and credit conditions remain tight. Moreover, the crisis in China's real estate sector also probably affects Hong Kong's own market through confidence effects and Hong Kong developers' lower investment appetite.

FISCAL POLICY DECISIVELY ACCOMMODATIVE

The government has kept an accommodative fiscal policy stance since 2019, with the implementation of large, one-off stimulus measures such as health spending, temporary employment schemes and direct support to enterprises and households.

As a result, general government spending and fiscal deficits have reached record high levels since 2020. After more than a decade of fiscal surpluses (3.0% of GDP on average in 2009-2018) and moderate spending (18% of GDP on average), the government posted a small deficit of -0.6% of GDP in the fiscal year FY2019/20 (extending from April 2019 to March 2020). Then the deficit soared to 9.2% of GDP in FY 2020/21, with spending reaching 30% of GDP. The deficit returned to 0.0% in FY2021/22, helped by the economic rebound, but it rose again to 6.6% in FY2022/23 (with spending amounting to 28.4% of GDP) and is projected at 3.5% in FY2023/24.

Notwithstanding larger fiscal deficits, the government's solvency and liquidity position remains very strong. The government has used its fiscal reserves to fund the recent deficits. These reserves have fallen by 30% since end-2018, but this significant reduction follows years of policy discipline and accumulation of fiscal savings. Therefore, fiscal reserves remain a comfortable buffer: they amounted to HKD 763 bn as of June 2023, still equivalent to 26% of GDP and 13 months of government spending (vs. 38% of GDP and 26 months in 2018). In addition, the government's debt is moderate and largely covered by its assets, and only a very small portion of it has been issued for direct budget funding.

The government thus keeps a good capacity to deal with fiscal challenges in the medium term. Its budget may remain in small or moderate deficit in the coming years. In particular, structural spending measures will be needed to improve housing affordability (notably through enhanced public housing for lower-income households) and social protection, address climate change and energy transition issues as well as strengthen Hong Kong's economic growth prospects.

HONG KONG: MONETARY TIGHTENING

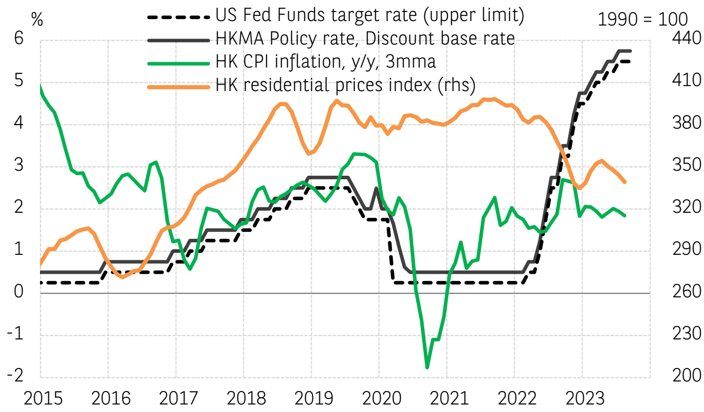

CHART 2 SOURCE: HKMA, CSD, FEDERAL RESERVE BOARD US, BNP PARIBAS

On the positive side, economic prospects continue to be well supported by Hong Kong's sound macroeconomic fundamentals (with solid public and external accounts), disciplined fiscal and monetary policies, and very high-quality and well-regulated services sector. Economic growth is also closely and increasingly dependent on China's economic performance and financial market dynamics. The development of the Guangdong-Hong Kong-Macau Greater Bay Area through increasing infrastructure and commercial links further enhances Hong Kong's territorial and economic integration with the Mainland.

On the negative side, Hong Kong's investment ratio has fallen in recent years (to 16.5% of GDP in H1 2023 from 21.8% in H1 2018) and demographic trends have been worrisome (talent shortage, decline in the labour force, ageing population), which points to a lower economic growth potential. In order to intend to address these issues, the Hong Kong authorities plan to multiply measures to attract investments and talents. They have recently launched a plan and a new investment fund to promote local innovation, digitalisation and technology development.

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INDIA

DETERIORATION DESPITE SUSTAINED GROWTH

In Q2 2023, Indian economic growth remained solid. But since the summer, the situation has deteriorated slightly. In addition to the contraction in exports, rural demand is slowing. Inflation has rebounded and downward pressures on the rupee have increased slightly due to the sharp slowdown in capital inflows. External accounts are expected to remain under pressure until the end of the year. The sharp rise in oil prices and a below-normal monsoon are weighing on the trade deficit and fuelling inflationary pressures. In addition, the narrowing yield spread between Indian and US government bonds is limiting portfolio investment. So far, the banking sector has weathered the rise in interest rates well. Credit risks have receded, even though the private sector is highly exposed to an interest rate shock. Finally, the financial position of public banks has strengthened.

GROWTH STILL ROBUST IN Q2 2023

In the second quarter of the calendar year (first quarter of the fiscal year 2023/2024), Indian economic growth remained robust (+7.8% y/y). It was supported by the dynamism of domestic demand as exports contracted in conjunction with the global economic slowdown.

Although slightly slowing, the pace of growth in investments remained solid (+8% y/y). After deteriorating slightly in 2022, due to higher interest charges and production costs, the financial position of listed companies improved in the first half of 2023. The increase in their net profits offset the increase in their interest burden. At the end of June 2023, their EBIT (earning before interest and tax) covered 5.2 times the interest payments on their debt (compared with 4.9 times a year earlier). Under these conditions, the increase in production capacity utilisation rates in Q1 2023 (to 76.3% compared with a long-term average of 74.3%) argues in favour of an increase in private investment over the remainder of 2023, albeit at a slower pace than in previous quarters given the downside risks to global growth and monetary tightening. Weighted average interest rates on new loans have risen by 126bps over the past twelve months (+210bps in real terms). However, at the end of July, the pace of growth in business loans remained robust (+13.7% y/y compared with an average of 9.7% over 2022).

Government investment, too, remained buoyant in the first four months of the 2023/2024 fiscal year (up 51.9% on the same period last year). Over the year as a whole, the government is forecasting an increase in capital expenditintures from 0.6pp to 3.3% of GDP.

Although business confidence remains particularly positive, consumer confidence seems to have started to turn around after an uninterrupted rise since Q3 2021. According to the Reserve Bank of India (RBI), urban and rural wages have fallen in recent months. In addition, rural households fear that winter crops will be smaller than in previous years. At the end of September, the last month of the monsoon, the rainfall deficit compared with normal was still estimated at 5.6%.

STRONG REBOUND IN INFLATIONARY PRESSURES

After several months of slowdown, inflation has rebounded over the last two months. Consumer prices rose by an average of 7.1% year-on-year (y/y) in July and August 2023, after slowing to 4.3% in May 2023. This rise reflects the pressure on food prices, and more specifically on vegetable prices (+26.1% y/y). To contain this increase (45.9% of household consumer goods), the government decided at the end of July to ban exports of non-basmati rice (as it had done in September 2022 on broken rice) and imposed additional taxes on parboiled rice exports.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, % (1)	-5.8	9.1	7.2	6.1	6.0
Inflation, CPI, year average, % (1)	6.1	5.5	6.7	5.9	5.0
General Gov. Balance / GDP, % (1)	-13.9	-9.6	-9.2	-9.0	-8.1
General Gov. Debt / GDP, % (1)	89.3	84.8	83.6	83.9	83.5
Current account balance / GDP, % (1)	0.9	-1.2	-2.0	-1.7	-1.8
External debt / GDP, % (1)	21.4	19.7	18.4	18.7	19.0
Forex reserves, USD bn	579	618	562	515	537
Forex reserves, in months of imports	9.0	7.9	6.7	7.2	8.2

(1) FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1
e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: CPI AND INTEREST RATES

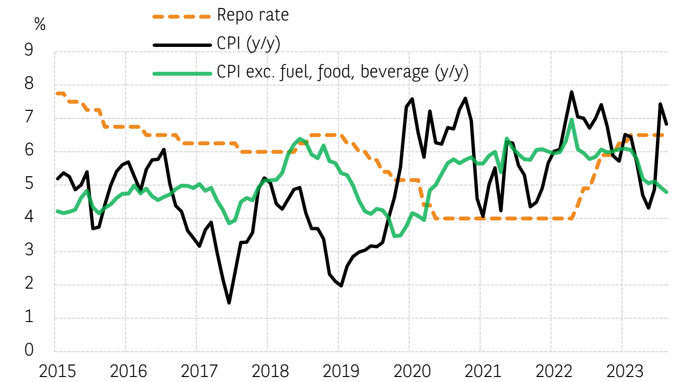

CHART 1 SOURCE: CEIC, RBI

To date, this rise in food inflation has not spread to core inflation (prices excluding food and energy), which has continued to decelerate, although it remains high (+4.8% y/y in August).

However, due to the rebound in inflationary pressures, the RBI is in an uncomfortable position. Indeed, the rise in prices excedeed the target of 4% +/- 2pp, even though economic activity is showing signs of slowing and downward pressure on the rupee remains strong. Furthermore, given the pressure on food prices and the rise in international oil prices, inflationary risks remain on the upside.

SLIGHT DETERIORATION IN EXTERNAL ACCOUNTS

In the first half of 2023, the current account deficit fell by 0.8pp of GDP compared with the previous six months, to just 0.6% of GDP, compared with 2.3% for the whole of 2022.

However, this consolidation, reflecting the fall in the trade deficit brought about by the contraction in the price of imported raw materials, is unlikely to last. According to data from the Indian Ministry of Trade, the trade deficit increased significantly in July and August compared with the previous quarter. Exports lagged, while imports accelerated again. The economic slowdown in the United States, India's largest trading partner (17.7% of its exports in 2022), partly explains this deterioration. Exports to the US fell 9.7% in the first half of 2023 compared with the same period last year.

In addition, the recent rise in oil prices is likely to further widen the trade deficit, even though in H1 2023 34.2% of oil came from Russia and was imported at a price a third lower than Brent.

At the same time, net capital inflows, which were already modest over 2022 as a whole, have slowed significantly since July, according to data published by the Institute of International Finance (IIF). This movement can be explained by the scissor effect between the fall in yields on 10-year Indian government bonds and the rise in 10--year US government bond yields. Downward pressure on the rupee has increased slightly over the past three months. Interventions by the RBI to contain the depreciation of its currency have been limited and foreign exchange reserves, although down since mid-July (USD -16.7 bn), remain very comfortable. They stood at USD 523 bn at the end of September, equivalent to 1.7 times the country's short-term external financing needs. The country's net external debt accounts for only 10.8% of GDP.

The main risks to external accounts and growth are persistently high oil prices and an increase in capital outflows. These two phenomena weigh on the rupee and exacerbate inflationary pressures.

A MORE ROBUST BANKING SECTOR

Over the past five years, the Indian banking sector has strengthened significantly. Private sector debt has been fairly stable at 90% of GDP since the end of 2021 (household and non-financial corporate debt was estimated in Q4 2022 at 36.4% and 53.6% of GDP respectively by the Bank for International Settlements).

Asset quality has improved and solvency ratios have strengthened. Public banks, while still more fragile than private banks, are now strong enough to cope with a macroeconomic shock without any additional capital injection. In particular, strengthening their position has enabled them to increase their credit offer. Although still modest, the outstanding credit granted by commercial banks increased by 2.6pp in a year to 53.3% of GDP in July 2023.

In the banking sector as a whole, the non-performing loan (NPL) ratio has fallen by two percentage points (pp) over the past twelve months to just 3.9%. In public banks alone, NPLs accounted for 5.2% of total loans compared with 15.6% five years earlier. It is in the agricultural sector that loans remain the most fragile. According to the RBI, risky assets accounted for 8% of loans in March 2023. This ratio was 6.8% in industry, 5.1% in services and 2.9% for loans to households. In industry, the most fragile sectors are construction and jewellery. Even though provisions remain modest, they now cover 74% of NPLs (compared with 48.1% five years earlier).

INDIA: RISING TRADE DEFICIT

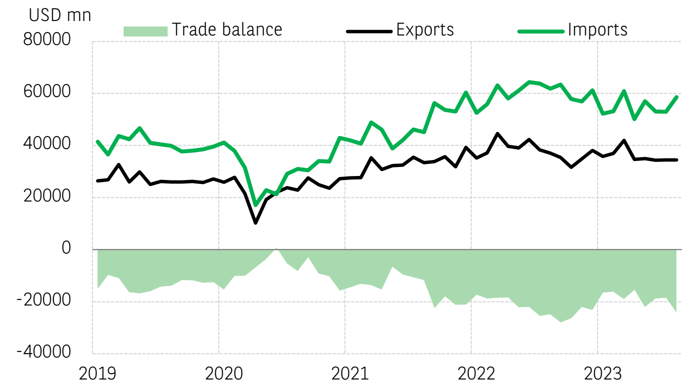

CHART 2 SOURCE: CEIC, RBI

At the same time, solvency ratios have improved. At the end of March 2023, the Capital Adequacy Ratio (CAR) was 17.1% in the banking sector as a whole and 15.5% in public banks.

The main risk is the high level of loans at flexible rate. According to the RBI, 72% of loans granted by the 14 largest commercial banks (which hold 81% of total banking assets) are at flexible rates. This type of loan constitutes 79.4% of loans in agriculture, 82.3% in industry, 76.3% in services and 60.2% for loans to individuals (excluding consumer goods). Mortgages (51.3% of loans to households, or 16.4% of bank loans) are the most vulnerable to an increase in interest rates, as 94.8% of them are granted at flexible rates.

In addition, the transmission of monetary policy to the real economy increased significantly over the last period of monetary tightening compared with previous periods. Over the period from April 2022 to July 2023, the rise in key rates (+250 bp) resulted in an increase in weighted average rates on new loans of 193 bp.

The property market is also showing signs of a slowdown in some states, as evidenced by lower sales prices in the major cities of Gujarat, West Bengal and Rajasthan. However, credit risks in the real estate sector are partially limited by regulatory constraints. Thus, the amount of the mortgage loan (for any purchase of a property worth more than INR 3 million) must not exceed 80% of the value of the property purchased (90% for loans of less than INR 30 million).

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INDONESIA

INDONESIA'S ECONOMY IS HOLDING UP WELL

Despite the global economic slowdown, Indonesia's economic growth has remained robust. Inflationary pressures remain contained despite rising rice prices. Public finances have strengthened and the fiscal deficit has fallen below the regulatory threshold of 3% of GDP a year earlier than expected. Although government debt is higher than before the crisis, it remains modest and its refinancing is less reliant on portfolio investments. The increase in the payment of interests on debt should be monitored as it reduces the government's fiscal leeway to support the economy. Despite increased pressures on external accounts, due to the downward reversal in prices of exported raw materials and capital outflows, foreign exchange reserves remain sufficient to cover the country's short-term external financing needs. Looking ahead to the next two years, the current account deficit is expected to remain modest and covered by FDI.

GROWTH DRIVEN BY DOMESTIC DEMAND

In Q2 2023, economic growth remained robust: it reached 5.2% y/y and 5.1% over the first half-year as a whole. Economic activity was supported by domestic demand (+5.9% y/y) while exports contracted by 2.7% y/y. Household consumption returned to its long-term growth rate (5-5.2%), supported by the upturn in tourism and the decline in unemployment. Although still slightly higher than before the Covid-19 crisis, the unemployment rate stood at 5.5% in February 2023. Investments remained strong, especially public investment in infrastructure. Activity was particularly buoyant in the construction, transport, trade and services sectors.

Growth prospects for the second half of the year are favourable, although downside risks remain high, particularly due to the global economic environment. The contribution of net exports to growth is expected to fall into negative territory in Q3. A significant rebound in exports is very unlikely due to the economic slowdown in China, Indonesia's largest trading partner (22.6% of exports in 2022), and the United States (9.7% of its exports).

Household consumption is expected to remain dynamic, although slightly slowing. Retail sales already started to slow down in July and August. Although consumer confidence indices remain positive, they seem to have slightly lagged behind. Similarly, the pace of expansion in credit growth to households has stabilised. For their part, companies seem to remain confident, according to the latest survey results. On the other hand, growth in imports of capital goods slowed significantly in August, pointing to a slowdown in private sector investment.

In addition, the sharp rise in international oil prices since July 2023 should weigh on corporate profits and household purchasing power. In August, consumer price index remained moderate (+3.3% y/y) and below the target of 3% +/- 1 pp set by the monetary authorities for 2023 (2.5% +/- 1 pp for 2024). However, it has rebounded slightly from the low reached in July, mainly due to the rise in food prices caused by the increase in rice prices. Inflation is set to pick up again in the second half of the year, but should be contained by domestic price controls; excluding food and energy prices, the rise in prices recorded in August was just 2.2% y/y. The Indonesian central bank (Bank Indonesia, BI) remains confident that inflation will be well under control. It thus kept its key rate unchanged at 5.75% in September.

CONSOLIDATION OF PUBLIC FINANCES

Public finances have strengthened over the past two years. The fiscal deficit, although still slightly above the 2019 level, has fallen significantly. Furthermore, government debt remains modest, although it is above its pre-crisis level (37.8% of GDP at the end of August 2023 vs. 29.7% of GDP at the end of 2019).

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%)	-2.1	3.7	5.3	5.0	5.0
Inflation (CPI, year average, %)	2.0	1.6	4.2	3.4	2.7
Gen. Gov. balance / GDP (%)	-6.1	-4.6	-2.4	-2.7	-2.5
Gen. Gov. debt / GDP (%)	39.4	40.7	39.7	39.3	38.9
Current account balance / GDP (%)	-0.4	0.3	1.1	-0.1	-0.5
External debt / GDP (%)	34.1	34.9	30.1	29.3	29.0
Forex reserves (USD bn)	129	131	124	120	123
Forex reserves, in months of imports	7.3	7.4	5.6	5.5	6.1

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

INDONESIA: INFLATIONARY PRESSURES REMAIN MODERATE

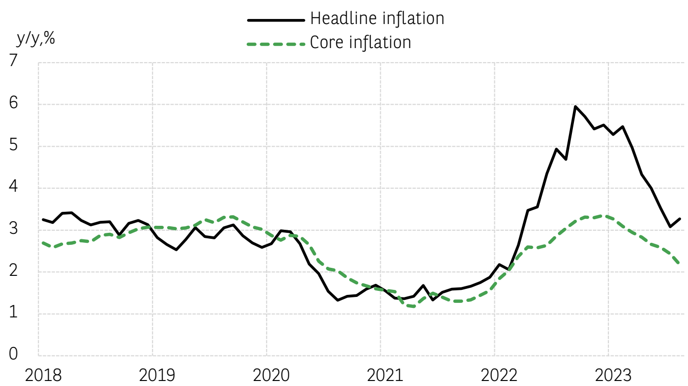

CHART 1

SOURCE: CEIC, BI, BNP PARIBAS

Its structure remains fragile but is less vulnerable to an external shock than in 2019. The share of debt denominated in foreign currencies (exposed to an exchange rate shock) is high (37.3% of total debt in Q2 2023), but the proportion of debt held by foreign investors, although slightly up since the end of the central bank's asset purchasing programme at the end of 2022, remains much lower than the 2019 level.

It was only 27.9% of total debt in August 2023 compared to 58.2% at the end of 2019. Domestic banks currently hold 30.6% of government debt, compared to just 23.9% in 2019.

In 2022, the government managed to reduce its fiscal deficit to 2.4% of GDP (compared to 4.6% of GDP in 2021), which is below the 3% of GDP threshold that it had committed to achieving by the end of 2023. This good performance can be explained by the increase in fiscal revenues (+2.7pp to 13.5% of GDP) against a backdrop of rising export commodity prices.

For 2023, the government forecasts an increase in the fiscal deficit to 2.8% of GDP. It anticipates a decline in revenues linked to the fall in exported commodity prices, including crude oil price (on an annual average basis). However, over the first eight months of 2023, public finances were stronger than the government expected. Revenues accelerated slightly compared with the same period last year, reaching 74% of the annual target. In addition, government expenditures were more modest than initially anticipated (53% of the annual target compared with 60% over the 2015-2019 period), despite the increase in investment and transfers to the provinces. Although the recent rise in food and oil prices could weigh on the cost of subsidies, the fiscal deficit should be below the target set by the government. In addition, the government has proven its ability to control its spending on subsidies. In 2022, despite the rise in commodity prices, subsidies remained contained at 1.3% of GDP (the level recorded in 2019) and, compared to GDP, they should continue to fall in 2023 and 2024 (-8% over the first eight months of 2023).

The biggest increase in expenditures is the payment of interest on debt (+17.1% over the first eight months of the year), which reached 15.1% of revenue (compared to 14.3% in 2022) and could reach over 17% according to government forecasts. This increase reduces the government's budgetary leeway to support the economy.

In the short and medium term, the risks of public finances slipping out of control are contained, even if the structurally low fiscal base remains a major source of weakness. The government should continue to consolidate its public finances. It plans to reduce the deficit to 2.3% of GDP in 2024. The next government to emerge from the general elections (presidential, legislative and regional) in February 2024 should continue along this path. The main risk, although contained, relates to sources of financing due to the end of the central bank's asset purchasing programme on the primary market.

SLIGHT DETERIORATION IN EXTERNAL ACCOUNTS IN Q2 2023

In 2022, for the second year running, the current account recorded a surplus equivalent to 1% of GDP, boosted by a trade surplus of 5.1% of GDP, a level not seen since 2010. In contrast, net foreign direct investment (FDI) have slowed. Incoming investments, already structurally modest, only reached 1.8% of GDP over the whole of 2022, compared to 2% of GDP the previous year (which also corresponds to the average recorded over the 2017-2021 period). Nevertheless, even though the FDI-to-GDP ratio fell, the share of flows received by Indonesia worldwide increased in 2022 to 1.7% (compared to an average of 1.3% over the last decade). Investment from China has accelerated significantly since 2021 (+16.2% in 2022, compared with an average of 8.1% over the 2015-2019 period). In particular, China has increased its investment in manufacturing by a factor of 7.5 compared with the average recorded between 2015 and 2019.

INDONESIA: CURRENT ACCOUNT STILL IN SURPLUS IN H1 2023

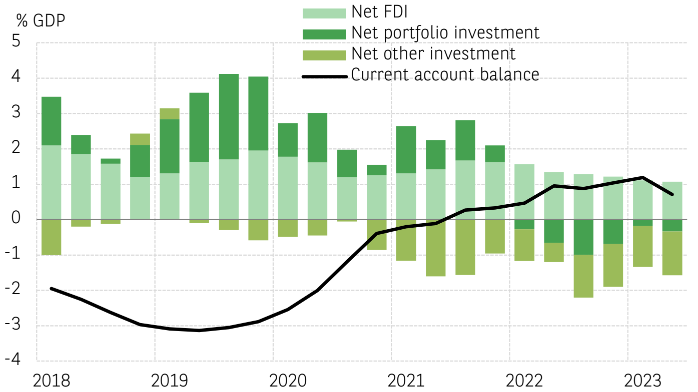

CHART 2 SOURCE: CEIC, BI, BNP PARIBAS

Indonesia is seeking to attract FDI to become a major electric battery manufacturing centre and expand its metal processing activities.

Since the beginning of 2023, the balance of payments has deteriorated due to the negative impact of the fall in commodity prices on the current account and the indirect impact of the tightening of US monetary policy on the financial account.

In Q2 2023, the current account balance returned to negative territory (-0.5% of GDP) after seven quarters of surplus. The decline in the trade surplus (as of Q1 2023) was significantly accentuated in Q2 due to the global economic slowdown and the fall in the prices of the main commodities exported by the country (-57.9% on the price of coal, -32.2% on the price of palm oil over the first eight months of 2023). This was not offset by the increase in the surplus of the balance of services brought about by the upturn in tourism.

At the same time, the financial account recorded a deficit of 1.4% of GDP, whereas it was in surplus in Q4 2022 and Q1 2023. Net capital inflows slowed significantly due to the sharp narrowing of yield spreads between domestic government bonds and those in advanced countries (particularly US government bonds). Thus, the balance of payments (excluding changes in foreign exchange reserves) recorded a significant deficit in Q2 2023 (2.1% of GDP). According to data from the Institute of International Finance (IIF), capital outflows increased in August, as in many other Asian countries.

Downward pressures on external accounts and the rupiah are expected to remain strong until the end of the year, as well as in 2024, due to risks on Chinese growth and food and energy prices. However, despite the expected increase in external financing needs, refinancing risks are limited. Foreign exchange reserves, although slightly down in Q2 (-5.7% since March 2023), remain comfortable. Estimated at USD 124 bn in July 2023, they still covered 2.3 times the country's short-term financing needs.

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TURKIYE

A CLEAR STRATEGY

The normalisation of economic policy (tightening of monetary policy and a dose of fiscal restraint) has restored confidence among investors and rating agencies. Official foreign exchange reserves consolidated over the summer, the lira is much more stable and risk premiums have eased. Economic growth remains resilient despite the slowdown in domestic credit, and the budget deficit is much lower than expected given pre-election promises. However, inflation has accelerated once again and the current account deficit has just about stabilised. The rebalancing of growth and de-dollarization have not yet been achieved, but it is more likely now that these will be seen in 2024.

Over the summer, confidence grew among foreign investors in the willingness and ability of the new team leading the Ministry of Finance and Treasury and the Central Bank (CbT) to convince President Erdogan to make a radical change in economic policy. The monetary turnaround started after their appointment and continued, with two further increases in the CbT base rate (750 bps and 500 bps), taking the policy rate to 30%. In August and September, non-residents' investments in domestic government securities returned, although flows remained limited (USD 400 million on average per month). The lira is more stable against the dollar and risk premiums on 5-year CDS are shrinking (Chart 1).

CLEAR ECONOMIC POLICY STRATEGY

Only yields on government bonds tightened following the rise in the policy rate, which enabled normalisation of the yield curve. Normalisation is the key word in economic policy. According to Cevdet Akçay, the aim is to break the dependence of economic agents (State, households, companies) on negative real interest rates, inverted yield curve despite very high inflation, and nominal depreciation of the exchange rate above inflation (in order to maintain an artificially undervalued real exchange rate). The dependence of companies, but above all households, on real interest rates, has fuelled a credit bubble, and the real depreciation of foreign exchange has led companies to maintain their market share without any effort in terms of productivity and innovation.

But this normalisation will take time and, to quote Mehmet Simsek, requires "patience" from investors. Fitch and S&P also confined themselves to revising the outlook for the Government rating from negative to stable. Normalisation will take time for at least two reasons. Firstly, the return to real interest rates presupposes i/ a slowdown in inflation that has still to come, ii/ further re-appreciation of the real exchange rate in order to firmly anchor inflation expectations and stimulate companies' non-price competitiveness. Secondly, normalisation involves the dismantling of the tangle of regulations facing banks, which had been created by the previous government with the aim of supporting growth through credit, while trying to limit pressures on external liquidity. And lastly, tightening of monetary policy may be accompanied by a slowdown in growth (which will have an effect on the population), and by an increase in credit risks, although these should remain limited.

GROWTH REMAINS UNBALANCED

So far, the Turkish economy has been more than resilient, despite the acceleration in inflation (+7.8% on average per month in Q3, 61.5% y/y in September), a consequence of the depreciation of the lira in Q2. In Q2, growth rebounded by 3.5% q/q after stagnation in Q1. Over the year, GDP growth was still at 3.8%. Growth remained unbalanced, with a negative contribution from net external trade of -1.6% q/q (-6.3% y/y).

In Q3, CbT confidence indicators of companies and households fell, on average, over the quarter as a whole, but recovered in September (except in the services sector). The rise in interest rates on both consumer credit (48%) and commercial credit (43%) led to a slowdown in domestic credit. Over the year, growth in bank lending in TRL remained very strong (+67% y/y in mid-September) but the momentum, measured over 3 months at an annualised rate, fell sharply (+33% compared to above 100% Q2). However, households continued to make extensive use of credit cards to fund their purchases.

Unemployment also continued to fall, reaching 9.4%, i.e. below its average since 2015 (10.5%), and real wage losses incurred from the end of 2021 to mid-2022 were largely wiped out. In total, household consumption is still expected to have contributed significantly to

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	1.9	11.4	5.5	4.0	3.5
Inflation, CPI, year average, %	12.3	19.6	72.3	54.2	49.5
Gen. Gov. balance / GDP, %	-3.5	-2.8	-0.9	-4.2	-5.4
Gen. Gov. debt / GDP, %	35.9	37.9	26.9	28.5	30.2
Current account balance / GDP, %	-4.4	-0.9	-5.4	-5.0	-3.4
External debt / GDP, %	59.5	53.3	50.6	50.4	48.2
Forex reserves, USD bn	50.0	72.5	83.0	84.0	89.0
Forex reserves, in months of imports	2.6	3.1	2.6	2.6	2.6

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TURKEY: FINANCIAL INDICATORS

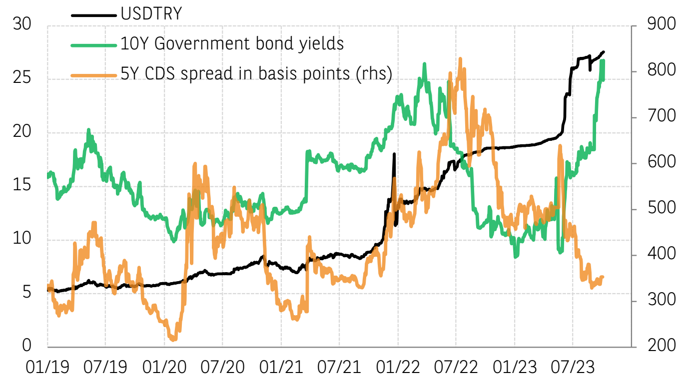

CHART 1 SOURCE: MACROBOND, REFINITIV, BNP PARIBAS

growth in Q3 2023. At the same time, imports of capital goods remained very strong. Private domestic demand is therefore expected to have supported growth in Q3. However, the contribution of external trade will remain firmly negative; in July and August, total non-oil imports (measured in dollars) increased by 5.9% compared to Q2, against 4.9% for exports. Despite the slowdown in domestic credit, the necessary rebalancing of growth has not been achieved. This is expected to be the case in 2024 if the new policy strategy is successful.

LIMITED DETERIORATION IN BUDGET DEFICIT

Prior to the election, the expected deterioration of the twin deficits against a background of tensions on foreign exchange reserves, was a real cause for concern. Developments over the summer are slightly more reassuring.

In August and over a period of 12 consecutive months, the primary deficit of the central government came out at just -0.1% of GDP, compared to a surplus of 1.1% in 2022. A downturn was broadly expected due to i/ expenditure associated with the earthquakes last February, with an estimated cost to the budget of 3% of GDP in 2023 and 2024, and ii/ pre-election promises. In the medium-term economic programme presented at the beginning of September, the primary deficit is expected to reach reach 3.9%, which means a very sharp increase in expenditure over the last part of the year. The low deficit so far can be explained by the reduced use of the earthquake envelope or delays in disbursements, and by a sharp increase in tax revenues linked to growth in revenues and the measures decided on by Mehmet Simsek in early July. The interest burden is contained at 2.5% of GDP, thanks to an effective interest rate on domestic debt in 2023 which is still limited to 18%, and a debt reduced to 30.3% of GDP in June.

For 2024, the MTEP forecasts a primary deficit of 3.4% and an interest burden up slightly to 3% of GDP, as a result of the rise in bond yields in H2 2023. The central government's external debt service for 2024 stands at nearly USD 17 billion (10.5 in principal and 6.5 in interest). If investors' appetite is confirmed, the Treasury should be able to issue as many international bonds as in 2023 (USD 7.5 billion so far) and at a lower cost (US benchmark bond yields have in theory reached their maximum and the spread of the last issue on 13/04/2023 was almost 600 basis points, which is significantly higher than currently). In addition, the liquidity buffer of the public sector (mainly the central government) with the CbT stood at USD 18 billion at the beginning of September.

DIFFICULT REDUCTION IN CURRENT ACCOUNT DEFICIT AND CHALLENGE OF DE-DOLLARIZATION

Regarding external accounts, the current account deficit (USD 58.5 billion over a period of 12 months ending in in July) has just about stabilised over the last three known months, despite significant tourism revenues (USD 45.2 billion). The oil bill was reduced by around USD 14 billion, thanks to the drop in oil prices between mid-2022 and mid-2023. However, net imports of gold, an asset that traditionally serves as a safe haven against inflation, reached USD 30 billion, whereas this item was balanced at the end of 2022. Excluding oil and gold, the trade balance, still at an equilibrium at the end of 2022, posted a deficit of USD 25 billion in August (over a period of 12 months).

The structure of the funding of the current account deficit improved slightly compared to 2022, but it remains fragile. Net direct investments did not accelerate (USD 6.2 billion), but portfolio investments are starting to return and residents' deposits remained sustained (USD37.2bn). Above all, the "errors and omissions" item is contributing much less to the balance of payments than was the case in 2022.

TURKEY: CENTRAL BANK INTERNATIONAL RESERVES

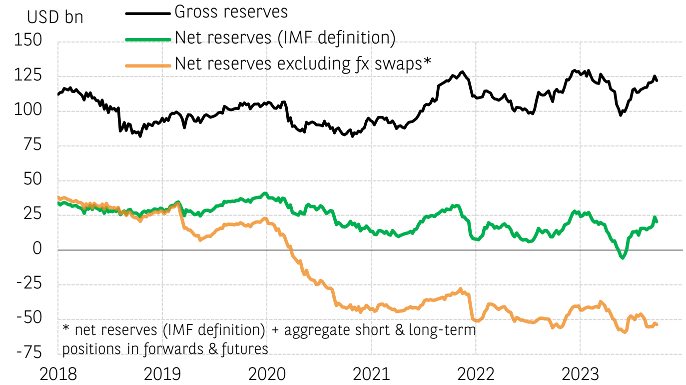

CHART 2 SOURCE: CENTRAL BANK, BNP PARIBAS

Overall, international reserves consolidated, reaching USD 122.2 billion at the end of September (including USD 74 billion in foreign exchange reserves), compared to USD 97 billion at the end of May.

Net international reserves, in IMF definition, are only USD 20 billion. If we consider the CbT's off-balance sheet foreign exchange positions (primarily foreign exchange swaps with commercial banks), net reserves are negative, to the tune of USD 54 billion. The media focus on these net reserves more than on gross reserves, which is very questionable. Firstly, because the CbT swap lines with the other central banks (i.e., the equivalent of USD 23.1 billion) are, a priori, stable resources (such as the deposits of Gulf States with the CbT). Secondly, the counterparties of the CbT's debtor foreign exchange position are local commercial banks (USD 126 billion when banks' foreign currency deposits and foreign exchange swaps are added together). In the past, the banking sector balanced its foreign exchange on-balance sheet position – by nature, a debtor position – with foreign investors. The vulnerability of the banking system (CbT + commercial banks) to the currency shock was therefore greater at the time.

De-dollarization is required for financial stability. Up until now, the State had been prompting households and companies to transfer their foreign currency and lira deposits to accounts in lira, which would guarantee them protection against depreciation of the exchange rate (the fx-protection deposit scheme known under the Turkish acronym KKM). KKM deposits currently represent the equivalent of USD 123 billion, which results in an "official" rate of dollarization of deposits of 41% (but 65% when these KKM deposits are included). This system represents a potentially significant cost for the State, valued at 3 points of GDP at the current exchange rate. The objective for the authorities is to encourage KKM account holders to close them, in order to transfer them to traditional accounts in lira. Rising interest rates on deposits should support this transfer. Even if the State has a financial interest, in theory, in making transfers quickly, the risk is redollarization of deposits and therefore, pressures on foreign exchange reserves if inflation remains high and the exchange rate continues to depreciate. Here again, success relies on the disinflation strategy with support from banks.

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SOME CHALLENGES FOR THE FUTURE GOVERNMENT

The current government is running for a third term in the general elections on 15th October. Whatever the outcome, the future government will face three major economic challenges: a marked slowdown in growth, a deterioration in budget deficit and an increase in credit risk. However, this increase in risk is not a real cause for concern. There are safeguards against rising public debt. The country also has comfortable external liquidity and the banking sector is strong. The decline in inflation has facilitated the shift in gear in monetary policy, but this seems premature given strong pressure on wages.

A DOWNTURN IN ECONOMIC ACTIVITY IN 2023

Growth in Poland was very erratic from mid-2022 to mid-2023. The trend, however, was a sharp slowdown, followed by a recession at the beginning of 2023. Year-on-year, GDP slowed down from 6% in Q2 2022 to -1.5% in Q2 2023.

This year, economic activity is suffering from the downturn in domestic and external demand, with a negative carry over of -1.3% in Q2. Exports have been less dynamic in recent months and the situation will unlikely improve, given the slowdown in the German economy. Private investment will be affected by weak external demand and a likely postponement of investment projects amidst election uncertainties. Moreover tighter credit conditions alongside with higher credit costs are penalising both investment and household consumption.

However, consumer confidence has recently improved. This bodes well for a rebound in consumption in H2 2023, despite inflation remaining high. From 2024 onwards, we anticipate higher growth prospects as shocks dissipate. The expected recovery of the eurozone economy, the fall in inflation, the return of real wages to positive territory, the expected increase in the minimum wage in 2024 (+19% in 1 year) and the revaluation of child benefits (+60% in 2024) are amongst all the factors contributing to revitalising the economy. In addition, monetary easing should provide support to the credit market. And lastly, public investment will undoubtedly benefit from a possible release of European funds towards 2024/2025.

PREMATURE CHANGE OF DIRECTION IN MONETARY POLICY

Poland embarked on a cycle of monetary easing in September with a cut in the key rate by 75 basis points to 6.00%. Further rate cuts are to be expected in the coming months.

The central bank's action surprised the markets. It is being interpreted as a strong signal regarding the new direction of monetary policy. Meanwhile, the action taken by the monetary authorities is probably taking account of the real interest rate, which is close to shifting into positive territory. Nevertheless, the scale of the policy rate cut, at this stage, seems premature as inflation remains high (8.2% y/y in September), although it has fallen in recent months. On the one hand, the 12% reduction in electricity prices, effective since 19 September, backdated to 1st January 2023, should push disinflation further. On the other hand, the potential impact of *El Niño* and the significant rise in oil prices since June (close to USD 100 per barrel) will have the opposite effect. Furthermore, core inflation is not expected to fall rapidly due to strong pressure on wages. Wages in industry are still showing double-digit growth, although the increase is slightly lower (+10.4% y/y in July, +11.9% in June, +12.2% in May). The central bank does not expect inflation to return to the target range of 1.5%-3.5% before 2025.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-2.0	6.9	5.5	0.0	3.0
Inflation, CPI, year average, %	3.4	5.2	14.4	11.8	6.3
Gen. Gov. balance / GDP, %	-6.9	-1.8	-3.7	-5.2	-4.7
Gen. Gov. debt / GDP, %	57.1	53.8	48.3	48.4	48.9
Current account balance / GDP, %	2.4	-1.3	-2.4	-0.1	-0.6
External debt / GDP, %	60.7	56.4	53.0	48.8	45.6
Forex reserves, EUR bn	125.6	146.6	156.5	169.0	174.0
Forex reserves, in months of imports	6.6	6.1	5.2	5.9	5.8

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

POLAND: POLICY RATE, REAL INTEREST RATE AND INFLATION

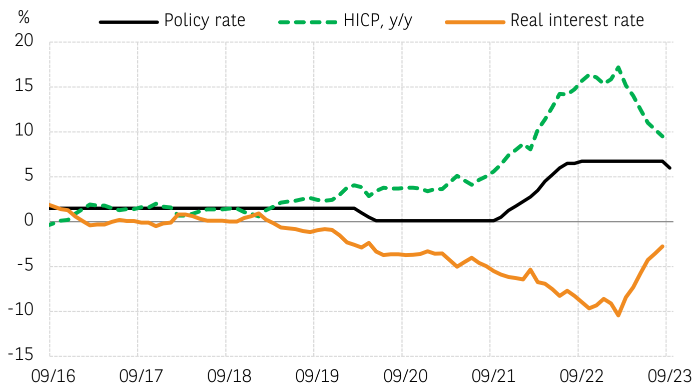

CHART 1 SOURCE: EUROSTAT, CENTRAL BANK OF POLAND, BNP PARIBAS

CREDIT RISK HAS INCREASED BUT REMAINS MANAGEABLE

Household accounts have deteriorated significantly since 2022 due to the impact of higher interest charges on their budgets. In Poland, loans are essentially contracted at a variable rate. Mortgage rates for a 5 year maturity or more rose from an average of 2.4% in 2021 to 5.2% in 2022, then to 6.8% in H1 2023.

Government measures to support households should provide some relief. In July 2022, the Polish government introduced a moratorium on mortgage loans in zlotys. Households were therefore able to suspend their repayments free of charge four times in 2022 and four times in 2023.

One of the election promises is to extend this measure in 2024. Also, first-time buyers under the age of 45 have benefited from a new programme since July. According to this scheme, a family can contract a loan at a fixed rate of 2% for 10 years for an amount of PLN 600,000 (i.e. approximately EUR 130,000). Monetary policy has also helped. The cycle of easing should be reflected in mortgage rates and reduce the burden of loan repayments.

Another area of caution relates to the case of mortgages denominated in Swiss Francs (CHF) which remain open, despite a lengthy debt reduction process. These mortgage loans accounted for 7.2% of the total in July 2023, compared to 51.2% in 2011. The latest development is the decision of the European Court of Justice in June 2023 on bank charges linked to this type of loan in CHF, which incurs an additional cost for banks (estimated at PLN 100 billion, i.e. EUR 21.6 billion, by the authorities).

The Polish banking system remains well capitalised with an equity ratio of 17.3% on average in Q1 2023. The Covid-19 crisis has had little impact on non performing loans, which has remained at 2.4% since 2021. The moratorium could potentially lead to an increase in this ratio once loans start maturing. However, credit risk remains moderate for now, given the many measures aimed at supporting households. Similarly, the increase in the cost of risk has probably already been provisioned by banks, which are well capitalised.

THE BUDGET DEFICIT IS WORSENING BUT DEBT IS SUSTAINABLE

The government is anticipating a budget deficit of almost 5% of GDP in 2023 and of 4.5% in 2024, well above the 3% target set by the Maastricht criteria. In fact, several factors will affect government accounts in the short term. Firstly, military spending will increase sharply in the next few years, due to the military's modernisation plan. This item of expenditure should probably reach 4% of GDP in 2023 and 2024, a record among EU countries, and should stand at around 2-3% in the following years. Secondly, the interest burden has increased with the rise in the rate of Government bonds since 2022. Interest payments compared to government's revenue amounted to 4.1% in H1 2023, after reaching 3.6% in 2022 and 2.8% in 2021. And lastly, measures linked to the energy shock, the increase in social welfare expenditure (+60% in 2024 for child benefit, revaluation of civil servants' wages, free healthcare expenditure for the elderly), as well as an expected drop in revenues caused by the slowdown in growth, will significantly affect the budget. Funding requirements will also increase in the next two years: more than 90% of the PLN 290 billion estimated in 2023 has already been funded. In 2024, these requirements are likely to reach PLN 400 billion, including around PLN 200 billion in maturing debt repayments. This means that the government is increasingly using external funding.

As a result, the ratio of public debt to GDP will inevitably increase in the medium term, although it will probably remain below 60%.

However, public finances are not a cause for concern. The debt profile is strong as most debt was contracted at a fixed rate and is mainly composed of an average maturity of 5 years. Similarly, fiscal discipline is reflected in the country's constitution, whereby public debt should not exceed 60% of GDP. In addition, Poland has to comply with the Stability and Growth Pact as part of its commitments towards the EU.

POLAND: GOVERNMENT INTEREST PAYMENT TO REVENUE

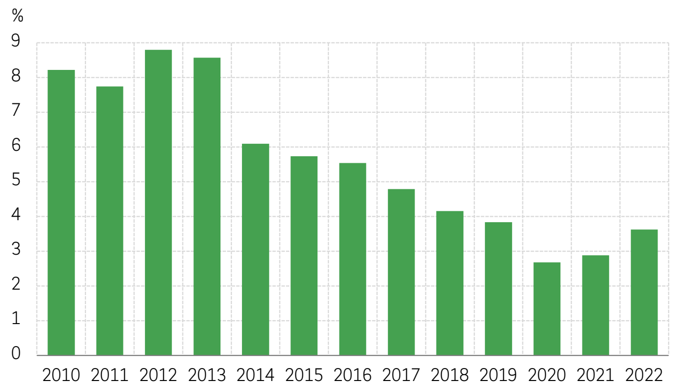

CHART 2 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

The escape clause from the budgetary framework, activated by the EU during the pandemic, will no longer be in force from 2024. Consolidation measures therefore need to be implemented quickly.

Government debt remains sustainable, according to IMF scenarios (central and stress). Measures to increase revenue or to contain certain expenditures will be necessary in the medium/long term, in order for government accounts to have necessary buffers in the event of a future shock.

THE CURRENT ACCOUNT BALANCE IS IMPROVING

The current account reverted to a large surplus, at EUR 6.9 billion cumulatively over the first seven months of the year, after a deficit of EUR 15.7 billion in 2022 (2.4% of GDP). Poland's current account balance is expected to improve significantly this year due to lower energy bills and an expected drop in domestic demand. But this will probably be temporary. The expected increase in military spending and major investment plans in the next few years will increase imports in the short term, and no doubt push the external accounts back into the red in 2024 and 2025.

As for the exchange rate, the trend was more towards appreciation over the first eight months of the year, owing to an improvement in the current account balance and a strong momentum of capital inflows. The change in monetary policy has led to a recent depreciation of the zloty (respectively, 5.6% and 3.4% against the dollar and the euro since early September). In the short term, the zloty is likely to come under downward pressure due to further monetary easing.

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EGYPT

DARK PROSPECTS

Egypt's management of external accounts, which consists of buying time thanks to external support between two drastic exchange rate readjustments, is reaching its limits. The persistence of a significant external financing need, notably due to the amortisation of external debt, and international creditors (Gulf States and the IMF) who condition their support on painful and politically costly reforms, have led the Egyptian economy to a dead end. The banks' net external position is deteriorating at an alarming rate. Restrictions on foreign currency transactions are increasing, with negative consequences on activity in a country highly dependent on imports. The central bank is still able to cope with external debt amortisation in the very short term, but any further postponement of an agreement with the IMF reduces this capacity beyond that.

ACCUMULATION OF BAD NEWS

Affected by a balance of payments crisis for several months, the Egyptian economy is experiencing a series of bad news: the postponement to an indefinite date of the first review of the IMF's financial support programme (essential for the release of funds), the downgrading of the sovereign rating by Moody's, the prospects of an exit of Egyptian financial assets from certain international indices and, finally, the sudden resumption of political tensions in the region.

The agreement with the IMF was concluded in December 2022 to deal with the consequences of the war in Ukraine on Egyptian external accounts: capital outflow (around USD 20 billion in H1 2022) and an increase in the cost of commodity imports. Conditional on a series of macroeconomic reforms (mainly the continuation of fiscal consolidation, the privatisation of public assets and the flexibility of the exchange regime), the IMF's USD 3 billion loan must trigger other financing from multilateral creditors and the return of foreign investors to the government's local currency debt market, as well as that of foreign direct investment. After a postponement of the IMF's first review, from March to June and then during Q3 2023, the continuation of the support programme will now have to wait at best for the first half of 2024.

DIFFICULT ADJUSTMENTS IN THE FACE OF A CURRENCY SHORTAGE

The Egyptian pound exchange rate is not flexible and the central bank is trying to maintain a level of foreign exchange reserves in line with the IMF's prudential standards (reserves in foreign currency of more than 3 months of goods and services imports). Egypt is highly dependent on imports (especially food) and its external debt has doubled since 2016.

Against this backdrop, the currency shortage is reflected in multiple rationing, the development of a parallel exchange market, a deterioration in the net external position of the banking system and, as a last resort, a sharp depreciation in the exchange rate. The Egyptian pound has depreciated by more than 50% since the beginning of 2022, while the exchange rate on the one-year offshore market has now reached more than EGP 50 for one USD, representing a gap of more than 50% compared to the official exchange rate.

Currently, the official foreign exchange reserves of the central bank are relatively stable (USD 33 billion or 4.6 months of goods and services imports in August 2023). Tier 2 reserves (a priori intended to cope with volatile capital outflows) amounting to USD 9.9 billion can be added to this. However, the maintenance of an acceptable level of reserves for the central bank is at the price of a regular deterioration in the external situation of commercial banks.

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth, %	3.3	6.6	4.2	3.6	5.0
Inflation, CPI, year average, %	4.5	8.5	24.0	32.2	20.0
Central. Gov. balance / GDP (%)	-7.0	-5.8	-4.6	-10.7	-11.1
Central. Gov. debt / GDP (%)	91	89	93	88	84
Current account balance / GDP (%)	-4.4	-3.5	-1.2	-2.4	-2.6
External debt / GDP (%)	35	33	40	38	36
Forex reserves (USD bn)	41	33	35	39	40
Forex reserves, in months of imports	6.0	3.9	4.3	5.9	5.6

FISCAL YEAR FROM JULY 1ST OF YEAR N TO JUNE 30 OF YEAR N+1
e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: NET FOREIGN ASSETS

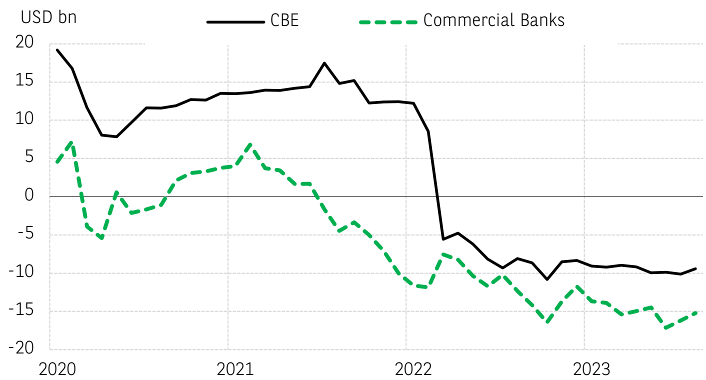

CHART 1 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

Foreign currencies that they cannot obtain from the central bank are provided to them by international creditors in the form of foreign currency bond issues and bank loans. Net external debt in the banking system reached around USD 15.2 billion in August (4.1% of GDP), down slightly compared to June (USD 17.2 billion), but remains at a historically high level. Furthermore, according to local estimates, the backlog linked to imports of goods amounted to around USD 6-9 billion.

These constraints, which affect all imports to varying degrees according to their priority, are hindering Egyptian economic activity. Finally, another indicator of the severity of the current situation, the central bank is extending a ban to the entire banking system on foreign currency payments to holders of a payment card linked to an Egyptian pound account.

SHORT-TERM INCREASE IN CURRENCY TENSIONS

The external financing requirement (current account deficit and amortisation of external debt) is estimated at USD 22-30 billion per year for the fiscal years (FY) 2024 and 2025. According to estimates by the central bank, the amortisation of external debt due to multilateral creditors and that of eurobonds amounted to around USD 7.6 billion in H1 2024, while more than USD 8 billion of short-term external debt should be amortised in Q1 2024. In this context, we can refer to a debt wall for the beginning of 2024, and any postponement of external financial support increases tensions on foreign currency liquidity accordingly. The central bank's foreign exchange reserves are sufficient to cope with short-term debt maturities. Nevertheless, further deterioration in the external situation of the banking system and a widening of the gap between official and offshore exchange rates can be expected in the coming months. The planning of the presidential elections in December 2023 makes an exchange rate adjustment before the end of 2023 unlikely.

Furthermore, access to private external financing deteriorated, particularly following the downgrading of the sovereign rating by Moody's, which mechanically led to that of the country's main commercial banks being downgraded, given the link between the banking sector and the government. Public banks hold approximately half of the total banking assets, and government debt accounts for approximately 50% of the total assets of all public and private commercial banks. Government access to the international capital market has been closed for several months given the level of risk premiums (greater than 1,500 basis points), except for issues of a reduced amount (a few hundred million USD) and denominated in Asian currencies.

A MISLEADING IMPROVEMENT IN THE CURRENT ACCOUNT

With regard to current account revenue, the positive developments observed in recent months are not enough to loosen the constraints weighing on foreign currency liquidity. Indeed, the improvement is largely due to restrictions affecting foreign currency transactions. A current account surplus was recorded in the last quarter of the FY 2023 (USD 0.6 billion compared to USD -3 billion a year previously). It is the sharp drop in imports (-24% y/y), constrained by the lack of available foreign currency, which explains much of this improvement. Tourism revenues and those of the Suez Canal are up sharply (+30% and +33% y/y respectively in Q4 of the FY 2023), but expatriate transfers (around 30% of total current income) fell sharply (-38% in H1 2023 y/y) because they use non-official channels for part of the transfers. There were no LNG exports during the three summer months due to a peak in seasonal consumption and a drop in domestic gas production, despite a sharp increase in Israeli gas exports compared to 2022 (+50% y/y over the first 7 months of the year). The sudden reduction in Israeli exports (estimated at 20%) for security reasons will further reduce Egypt's LNG export prospects for an indefinite period. Furthermore, assuming a return of the exportable surplus of LNG in the coming months, prices on

EGYPT: EGP/USD OFFICIAL EXCHANGE RATE & MARKETS' EXPECTATIONS

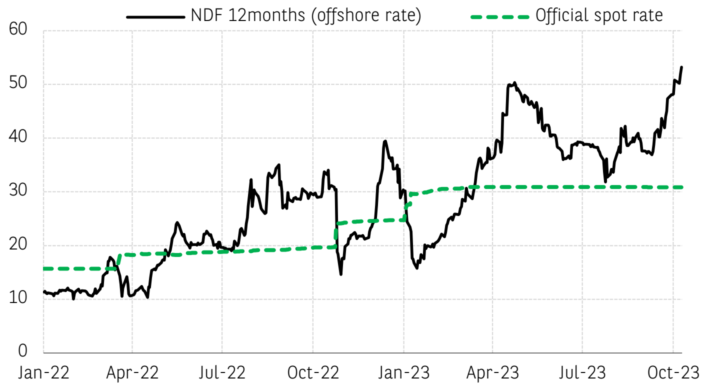

CHART 2 SOURCE: CENTRAL BANK OF EGYPT, BLOOMBERG, BNP PARIBAS

the European market will probably not be as high this winter as in 2022 due to the level of European stocks and high imports from the US.

A NARROW PATH OUT OF CRISIS

The IMF is making its support conditional mainly on the progress made in the privatisation of public assets and in the flexibility of the exchange rate system. The privatisations already carried out and in progress seem relatively in line with the IMF requirements. Approximately USD 2 billion in asset sales was made for the FY 2023, while around USD 6 billion is underway or scheduled for this fiscal year. The question of exchange rate flexibility is much more difficult, particularly due to its consequences for inflation, an endemic problem in the Egyptian economy. The rise in consumer goods prices reached a record level last September (+38% y/y), while core inflation reached 40%.

The structural weakness of Egyptian external accounts and the need to regularly call on external support are not new, but the current situation differs from the crisis in 2016 by the attitude of international creditors which have become more conditional. The IMF's conditionality in terms of macroeconomic reforms is certainly stronger, particularly regarding the functioning of the foreign exchange market. For their part, the Gulf countries have changed the nature of their support. While they continued to make government deposits with the central bank of Egypt in 2022, sovereign wealth funds are looking to optimise their investment. Support in the form of equity investments in listed companies and in privatisations can therefore be seen, but at a price that suits them, in particular by taking into account currency risk.

If an agreement with the IMF were to take place at the beginning of 2024, we believe that Egypt will be able to avoid the short-term balance of payments crisis. However, in the medium term, the vulnerability of the balance of payments will persist. On the one hand, Egypt will once again see its external debt increase, although at concessional conditions. On the other hand, the problem of the country's economic competitiveness remains unresolved. Exports of non-hydrocarbon-related goods remain concentrated in low value-added sectors, and foreign direct investment outside the hydrocarbon sector is low.

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BRAZIL

DEFYING EXPECTATIONS

Brazil's cyclical performance continues to boast positive surprises. Growth and employment have held up well, core inflation is retreating, trade surpluses are beating all-time records and the real is holding its ground despite a rising dollar. Against this backdrop, the Central Bank eased its monetary policy in August for the first time in a year. These developments coupled with the revival of social policies, have helped spur a rise in Lula's approval ratings. In search of new growth drivers to reduce inequality and accelerate the energy transition, the President unveiled the third act of his Growth Acceleration Pact (Novo PAC). Financing the investment programme, however, poses questions in the face of the recently enacted fiscal framework. To enhance its room to maneuver in Congress and help pass reforms (in particular the long-awaited tax reform), the ruling coalition has expanded further to the right.

BUSINESS CYCLE : SOME GOOD SURPRISES

In H1 2023, growth and employment held up much better than initially expected considering the Central Bank's aggressive fight against inflation – a cycle it initiated back in March 2021 (12 consecutive hikes of the SELIC policy rate which it held up at 13.75% for a year since August 2022).

After exceptional harvests in Q1 (driven by favourable climate factors, increases in arable land and productivity), economic activity once again surprised to the upside in Q2 (+0.9% q/q, 3.4% y/y). Meanwhile, the unemployment rate continued to retreat (down one point between March and August to 7.8%, the lowest since 2015). In contrast to Q1, however, domestic demand turned out to be the main driver of growth in Q2 supported by measures destined to protect households' disposable income. Growth was also supported by public spending and the recovery in tourism[1].

On the supply side, performance has been more heterogeneous. Challenges were more pronounced in the manufacturing sector while services surprised by their resilience. In livestock and commodity extraction, many sub-sectors are expected to register record production volumes this year (oil[2] and gas, soybeans, corn, wheat, meat). The dynamism of these sectors contributed to unprecedented trade surpluses in the first eight months of the year (USD 73 bn) spurring a reduction in the current account deficit[3]. The latter remains well covered by net FDI despite the decline in foreign capital flows this year[4]. Meanwhile, the unwinding by the BCB of a foreign-currency credit line granted in 2022 and the absence of intervention in the FX market have led to a strengthening of official foreign exchange reserves (+USD 20 bn since the end of 2022 to reach USD 340 bn at the end of September).

In Q3, activity showed signs of slowing down despite a good start to the quarter (increase in the Central Bank's IBC-BR indicator – a proxy for GDP – in July, expansion of the composite PMI in August). Business confidence rebounded in August (on the back of the BCB's first rate cuts). However, it remained fragile in industry driven down in part by the end of tax breaks in the automotive sector, the contraction of margins in the manufacturing industry and still high financing costs, in real terms. In the short term, investment is not projected to recover (survey data point to still large inventories of machinery and equipment, while unearmarked business loans have continued to slowdown since May). The slowdown in activity has also been more pronounced since September (contraction of the composite PMI, deceleration in job creation). In H2, the primary sector is projected to contribute negatively to growth as the bulk of crops were harvested in Q1.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-3.3	5.0	2.9	3.1	1.8
Inflation, CPI, year average, %	3.2	8.3	9.3	4.7	4.2
Fiscal balance / GDP, %	-13.3	-4.3	-4.6	-7.6	-6.9
Gross public debt / GDP, %	87	78	73	76	78
Current account balance / GDP, %	-1.9	-2.8	-2.9	-2.0	-1.7
External debt / GDP, %	44	42	39	41	43
Forex reserves, USD bn	356	362	324	341	338
Forex reserves, in months of imports	19	14	10	16	15

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

BRAZIL: TRADE BALANCE BY CATEGORY (JAN.-SEPT., CUMULATIVE SUM)

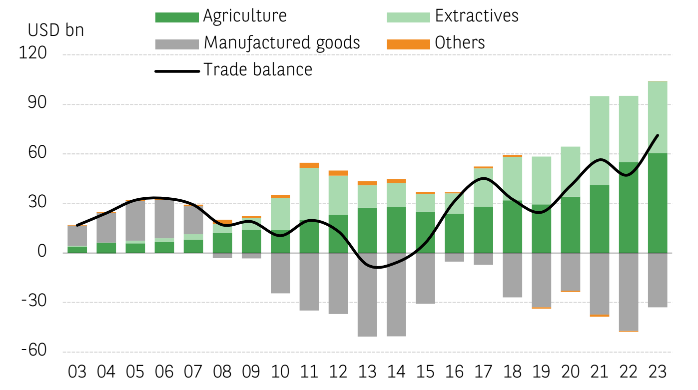

CHART 1

SOURCE: SECEX, BNP PARIBAS:

Due to the reinstatement of federal taxes on fuel, the disinflationary process at work across the economy is currently not visible in the headline inflation rate (+4.6% y/y in August compared to +3.2% in June). However, the monthly change in the IPCA index shows a decline in prices, particularly in transport and household goods.

1 Brazil received almost as many visitors in the first 6 months of the year (3.2 mn) as in all of 2022 (3.6 mn), according to Embratur.
2 The production cuts decided by Russia and Saudi Arabia during the summer were partly offset by rising outputs from producers (outside of OPEC+) such as Brazil, the United States, Norway and Guyana. In July, Brazil produced 3.51 mn barrels/day +18.6% y/y.
3 2.21% of GDP over 12 months in August compared to 2.9% of GDP at the end of 2022
4 From January to August 2023, non-resident inflows amounted to (1) USD 38 bn in net FDI inflows (compared to USD 56 bn over the same period in 2022); (2) USD 7.5 bn in net inflows for portfolio investments (vs. net outflows of USD 7.3 over the same period in 2022); (3) USD 15.2 bn in net inflows for other investments (compared to USD 25.2 bn over the same period in 2022).

The favourable trend in core inflation (excluding food and energy), the expected deceleration of the economy in the coming months coupled with the easing of inflation expectations have led the Central Bank to cut the SELIC rate twice by 50 bps since August (and to announce cuts of the same magnitude in the coming months). However, the BCB is on alert over (a) the internal risks weighing on inflation (the economy is growing at an annualized rate which is twice the growth potential, latent risks of budgetary / extra-budgetary slippage) and (b) external risks (effects of the *El Niño* weather phenomenon on food prices, more persistent rises in oil prices, rise in the dollar and long-term rates, renewed concerns over the Chinese real estate market). All in all, the successive declines in the SELIC have had less of an impact on the real than the rise in the dollar in recent months. The currency has lost 10% of its value against the USD since August, but is still up some 5% since January.

NEW MANDATE, OLD RECIPES

Lula's approval ratings have been on the rise (they have climbed back up to 60% according to a Genial/Quaest poll in mid-August from 52% back in April). The President's popularity has been bolstered both by a stronger economy (two additional points of growth expected this year; a drop in unemployment) but also thanks to social policies destined to support households' purchasing power and enhance living conditions for the poor.

The redeployment of flagship programmes such as *Minha Casa / Minha Vida* (housing), *Brasil sin Fome* (action against hunger, formerly *Fome zero)*, *Luz para Todos* (electricity in rural areas) - combined with the increase in conditional cash transfers (*Bolsa familia*), debt renegotiations for low-income households (*Desenrola Brasil*)[5] as well as increases in the minimum wage, scholarships and salaries for civil servants have collectively helped boost household confidence – which last September, had reached its highest level since February 2014. The historical increase in the volume of subsidized loans (+27% y/y) under the annual financing program for agriculture (*Plano Safra*), and the concurrent launch of a specific program for family farming have also helped attract the sympathy of small and mid-sized farmers, many of whom had tended to fly closer to *Bolsonarismo* in recent years.

In search of new growth drivers to help dampen social inequalities and accelerate the energy transition, Lula launched the third act of the PAC (a growth acceleration plan which both Presidents Lula and Dilma Rousseff had previously relied upon over the period 2007-2016). The government announced in August its intention to invest BRL 371 bn (USD 72 bn) over four years. By the end of Lula's term in office (2026), the program – which also includes spending by public enterprises and private investment – provides for a total of BRL 1400 bn in investments, or about 14% of GDP. The largest volumes will go to public buildings (social housing, schools, hospitals, etc.), energy (especially renewables) and transport. The government plans to generate 2.5 million direct jobs and 1.5 million indirect jobs.

FINANCING THE *NOVO PAC*...NOT A SLAM DUNK

PAC 1 and PAC 2 had mixed results due to a lack of funding and issues pertaining to governance. Will the *Novo PAC* (i.e. PAC 3) suffer the same fate? The share to be financed by the federal government has surprised to the upside given the constraints emanating from the recently enacted new fiscal framework (end of August).

BRAZIL: IPCA INFLATION INDEX BY MAIN COMPONENTS*

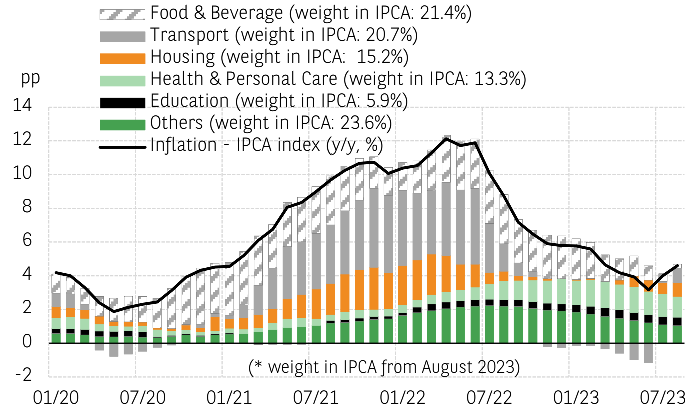

CHART 2 SOURCE: MACROBOND, IBGE, BNP PARIBAS

The latter determines a floor for public investment by the federal government (set at 0.7% of GDP, i.e. BRL 70 bn in 2023). Assuming that the government meets its primary balance target over the next 4 years, the fiscal framework would allow it to commit a minimum of BRL 280 bn in investment expenditure (a floor if we assume no increase in inflation). In this scenario, the federal funding gap for the PAC would be in the order of BRL 90 bn (this gap would fall to BRL 70 bn assuming nominal GDP growth of 5% per year over the period). Granted, the new rule provides for mechanisms to boost public investment above the floor, however, they are premised on the government registering primary budget surpluses over the period (which at this stage, appears to be a challenging task). If we consider 2024 alone, the government will likely require a fiscal adjustment of at least one percentage point of GDP to achieve its current target (a balanced primary budget). And if the target is not met with a tolerance of 0.25 points of GDP, discretionary expenditure (such as public investment) would be blocked until corrective actions are taken. To help meet its objectives, the government will not be able to rely on the tax reform currently being reviewed in the Senate as it is not intended to increase revenues *per se*[6]. The Ministry of Finance has therefore had to announce a new plan to increase revenues (estimated at some BRL 168 bn, or 1.5% of GDP). In addition to creating new taxes, the plan seeks to lift longstanding tax exemptions and deductions (e.g. dividends). The government also intends to rely on an income tax reform. The road ahead appears fraught with challenges and could result in a revision of the primary balance target. However, since the summer, Lula is better positioned to get the required majorities to help him pass reforms in Congress. To achieve that, however, he has had to hand large parliamentary grants, cede the management of the state-owned bank Caixa Economica – a major player in mortgage lending – to allies of the President of the Lower House and form an alliance with conservative parties leading to the first cabinet reshuffle of his mandate. The government now has 38 ministries from 11 political parties – a record.

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5 The coronavirus (Covid-19) pandemic and high inflation have reduced household budgets and led to nearly 72 million Brazilians no longer being able to buy on credit.
6 Even if the bill provides for the creation of a selective tax (IS) for products that harm households' health and the environment, the reform is not intended to increase the country's tax burden (about 33.5% of GDP) but mainly intends to simplify the tax code to reduce significant compliance costs – an obstacle to the competitiveness of Brazilian products and a significant obstacle to investment. The reform, if approved, would only take effect from 2026 on and will provide for a transition period of 8 years.

MEXICO

ELECTION YEAR ON THE HORIZON

Mexico's economic activity is expected to slow in the next few quarters under the combined effect of the slowdown in the US economy and the continuation of high interest rates. Beyond 2024, growth could be supported by a new driver, nearshoring, the effects of which are starting to be seen in export and investment data. The next administration, to be elected in June 2024, will therefore face the challenge of implementing the structural reforms necessary to take full advantage of this new relocation strategy and maintain financial support for Pemex, while limiting the slippage in public finance.

SLOWDOWN IN 2024

Surprisingly, Mexican economic growth rose in the first two quarters of 2023 (real GDP rose by 3.7% y/y in Q1 and Q2), buoyed by the resilience of the US economy. In addition, robust transfers of foreign workers (up by more than 9% y/y since the beginning of 2023) helped bolster consumer spending, despite continued high inflation (down to 4.6% y/y in August after reaching a high of 8.7% y/y in September 2022). Core inflation (6.1% y/y in August) is also slowing, but more moderately, despite a continued restrictive monetary policy. The central bank has kept its key interest rate unchanged at 11.25% since March, and plans to leave it at this level in the coming months due to "persistent inflationary pressures".

GROWTH IN INVESTMENT, THANKS TO NEARSHORING

Another growth driver may have been underestimated in recent quarters and could support growth in the medium/long term: the effects of nearshoring, i.e. the relocation of production and marketing activities to a country geographically close to the company's country of origin. Globally, the phenomenon has accelerated significantly due to disruptions and shortages in value chains following the Covid-19 period, followed by the war in Ukraine. As for US companies, the relocation of value chains to neighbouring countries dates back even further; this began with the US disengagement from the Trans-Pacific Partnership (TPP) in 2017 and the beginning of the trade tensions with China in 2018.

Barely visible to date, the effects of nearshoring are starting to emerge in macroeconomic data.

First, since 2018, the market shares of Mexico and Canada have increased gradually, while China's market share has decreased significantly (Chart 1). Recently, Mexico has even become the USA's biggest trading partner, ahead of Canada. More specifically, Mexico exports manufactured goods to the United States (mainly the automotive and electronics sectors, but also medical devices and supplies) and mainly imports energy (as a reminder, Mexico has been a net importer of energy since 2016).

Second, the very recent momentum in investment reflects the effects of nearshoring: total investment remains relatively low (around 19.5% of GDP), but has risen very rapidly over the past few months (over 20% on average and y/y over the first 7 months of the year according to the series of monthly indices, while the average is -0.3% in 2018-2022). Investment in imported machinery and other capital goods has been particularly dynamic since the beginning of 2023 (up almost 25% on average y/y). In July, investment in imported machinery and other capital goods was 35% higher than its pre-pandemic level, compared to only 5% for total investment

Foreign direct investment (FDI) has also grown at a steady pace over the past few quarters. "New" FDI rose by almost 30% in 2022 to more than USD 18 billion, a level not seen for nearly ten years.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-8.1	4.9	3.0	3.5	1.3
Inflation, CPI, year average, %	3.4	5.7	7.9	5.6	4.5
Budget balance / GDP, %	-4.1	-3.8	-3.8	-3.3	-5.0
Public debt / GDP, %	50.8	47.8	46.9	46.5	49.1
Current account balance / GDP, %	2.4	-0.4	-1.3	-0.4	-0.4
External debt / GDP, %	55.5	47.5	42.9	34.8	35.2
Forex reserves, USD bn	195.0	202.4	194.0	207.0	217.0
Forex reserves, in months of imports	5.3	5.1	4.8	4.1	4.1

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SHARE OF US TRADE

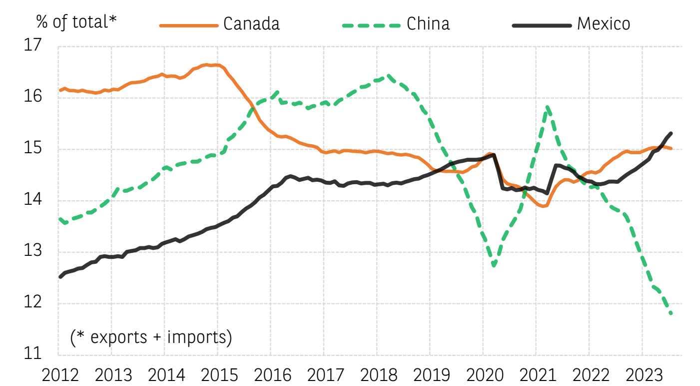

CHART 1

SOURCE: US CENSUS BUREAU, BNP PARIBAS

Unsurprisingly, the strongest growth comes from the US and Canada.

In the very short term, the effects of nearshoring will only partially offset the effects of the expected slowdown in the US economy in 2024. Although manufacturing production has risen sharply since 2021, nearshoring is not the explanation for everything. Exports and industrial production have started to slow down since the beginning of the year. Overall, GDP is not expected to rise above 1.5% in 2024.

In the longer term, the Mexican economy seems to be in a transition period. In the long run, the effects of nearshoring should improve the growth outlook. But the weaknesses of the Mexican economy remain: several years of underinvestment (in infrastructure, education and energy) are having a significant impact on potential growth.Lack of commitment to the energy transition could also prevent the country from taking full advantage of the opportunities represented by nearshoring.

Lastly, relations with the United States and economic and fiscal policy (in particular concerning reform of the energy sector) implemented during the next term of office (the next general election is scheduled for June 2024) will be decisive.

FISCAL AND ELECTION STRATEGY

In mid-September, the current government presented its latest budget. As is often the case in Mexico during election years, this latest budget has turned out to be expansionist, leaving a large share to the increase in public spending. This confirms the ambition of the current president, Andres Manuel Lopez Obrador (AMLO), who will not be standing, to keep his party (Morena) in power during the next presidential mandate.

In concrete terms, the budget proposal predicts a lower deficit for 2023 (at 3.3% of GDP, whereas initial estimates were based on 3.5% of GDP), but a significant increase for 2024, at 4.9% of GDP. The government is expecting a slight decline in revenues to 21.3% of GDP in 2024 (estimate for 2023 is 21.7% of GDP), due to lower income from oil revenues. The increase in the deficit is mainly due to the increase in public expenditure: in addition to the increase in interest costs, the priorities are identical to those of the previous budgets (at least since the beginning of the AMLO Presidency, in 2018): significant increase in "social spending" (nearly +8% compared to the 2023 budget), and in particular, pensions (+30%), in accordance with the Morena party's central campaign issue. And lastly, despite multiple government announcements, infrastructure spending is expected to fall slightly (estimated at 2.6% of GDP in 2024, after reaching 2.8% in 2023). However, the government's key projects (especially the two railway projects, the Maya Train project and the Interoceanic Corridor of the Isthmus of Tehuantepec project) will see their allocation increase.

Our deficit estimate is close to the authorities' estimate: the optimistic assumptions made by the government (GDP growth for 2024 in the range of 2.5%-3.5%, inflation of 3.8%, oil production estimated at around 2 million barrels per day) are offset by the conservative assumption regarding the oil price (at USD 56.7 per barrel for the WTI on average for the year, while futures prices stand at USD 80).

CLEAR SUPPORT FOR PEMEX

For the first time, the budget also details the planned support for the oil production and exploitation company Pemex. Up until now, support has been piecemeal, and the budget changed over the year to take into account the payments made. This time, the budget proposal states that firstly, the royalties paid by the company to the government will only represent 35% of revenues (compared to 40% up until now, and 65% when AMLO became President), i.e. a loss of revenues estimated at USD 2.5 billion, and secondly, direct transfers will amount to nearly USD 8.25 billion. And lastly, the government has already indicated that additional payments could be made if necessary. According to Fitch estimates, commitments for 2024 amount to more than USD 11 billion, so new payments are very likely.

MEXICO: INVESTMENT INDEX

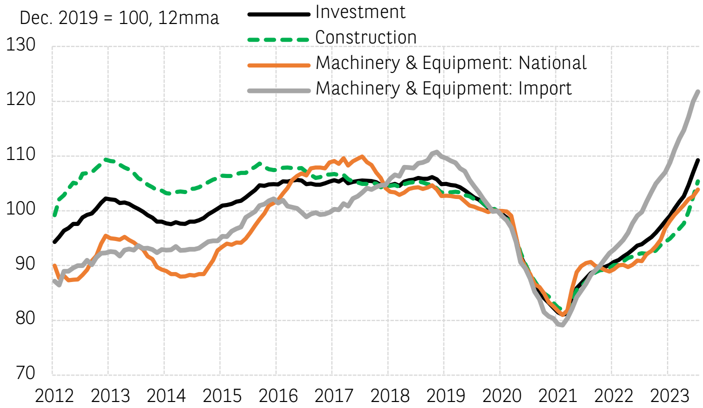

CHART 2 SOURCE: INEGI, BNP PARIBAS

Regular government support over recent years has significantly reduced the contingent public debt associated with Pemex.

This public debt is currently valued at 6% of GDP (whereas it represented almost 10% of GDP in 2020). According to statements made by the various parties, to date, support for Pemex should not be called into question by the next government.

According to official estimates, public debt is expected to rise to 48.8% of GDP in 2024 (after reaching 46.5% in 2023). The first estimate put debt at 49.9% of GDP, but the government has benefited from a "technical" reduction in the debt-to-GDP ratio (as is the case every 5 years, GDP has been rebased to 2023). Although the question of debt sustainability will not arise in the short term for Mexico, the sustained increase in social spending and the various infrastructure projects started, left to the discretion of the next government, will increase sovereign risk in the medium term.

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SAUDI ARABIA

FAVOURABLE ECONOMIC MOMENTUM

The current period is very favourable for the Saudi economy due to high oil revenues and implementation of extensive reform and investment programmes. Nevertheless, despite real progress in diversification, activity remains vulnerable to oil market vagaries and OPEC production policy. A moderate upturn in activity is expected in 2024 after a slight recession this year. Oil revenues remain decisive for maintaining budgetary balance and implementing Vision 2030 investments. However, the scale of funding requirements and the lack of attractiveness of the Kingdom to foreign investors mean massive use of debt as well as the sale of public assets. This highly capital-intensive economic transformation will need to continue, despite persistent vulnerability to oil market, which could increase with the energy transition.

STRONG SLOWDOWN IN ACTIVITY

In 2023, the Saudi economy is expected to be in recession (-0.3%) due to the drop in oil GDP. Accounting for around 40% of total GDP, oil GDP is expected to record its sharpest decline in more than a decade (-7.5%). In the context of the policy of OPEC+ (OPEC member countries and Russia), Saudi Arabia has decided to reduce its production beyond the agreement entered into with the cartel. With a voluntary reduction to around 9 mb/day by the end of the year, annual production is expected to average 9.6 mb/day, i.e. a decrease of 0.9 mb/day compared to the previous year.

Primarily driven by the private sector, activity in non-hydrocarbon sectors has accelerated over the past two years, reaching 6.4% in 2022. In H1 2023, activity slowed slightly but maintained some momentum (5.6% y/y), particularly thanks to the retail and hospitality sectors and, to a lesser extent, the construction sector. In the short term, consumption and investment should continue to support growth, but at a slower pace than in 2022. As a result, investment growth slowed sharply in Q2 (+2.4% y/y compared to +18% in Q1), while consumer spending only fell slightly (+3.3% y/y compared to 3.9% in Q1).

Credit growth to the private sector (corporates) and public-sector enterprises slowed, but remained at sustained levels (+11% and +21% y/y respectively in August 2023). By contrast, consumer credit entered a downward phase (-0.4% y/y in Q2 2023). Nevertheless, the moderate level of inflation (+2% in August 2023) and the continued decline in unemployment (8.3% in Q2 2023 compared to 8.5% in Q1 for the national population) should continue to have a favourable influence on consumer expenditure.

TIMID REBOUND EXPECTED IN 2024

In 2024, GDP growth is expected to pick up again, while remaining constrained by activity in the oil sector. In fact, we are only expecting a modest increase in oil production in 2024. Growth forecasts are down in OECD countries and China. For the time being, only oil supply constraints and declining stocks in OECD countries are keeping prices high. In 2024, Saudi Arabia could keep production at current levels for part of the year so as to support prices. We expect oil GDP to rise by 2.4% over the year as a whole. In terms of non-hydrocarbon GDP, the early signals of slowdown in consumer spending could intensify next year. The rise in interest rates (the SAMA key rate has risen by 500 bps since February 2022) is expected to have an impact on credit growth. Against this backdrop, government spending will be a factor in support of activity, and the 2024 budget proposal is moving in this direction. After a significant increase in spending in 2023 (+8% y/y according to budget forecasts), spending will remain high, despite a less favourable oil market for public finance.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-4.3	3.9	8.7	-0.3	3.3
Inflation, CPI, year average, %	3.4	3.1	2.5	3.0	2.8
Central. Gov. balance / GDP (%)	-10.7	-2.3	2.5	-2.1	2.0
Central. Gov. debt / GDP (%)	31	29	24	28	27
Current account balance / GDP (%)	-3.1	5.1	14.4	5.1	3.1
External debt / GDP (%)	32	32	24	25	26
Forex reserves (USD bn)	454	456	460	450	430
Forex reserves, in months of imports	30	26	22	19	17

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

SAUDI ARABIA: REAL GDP GROWTH

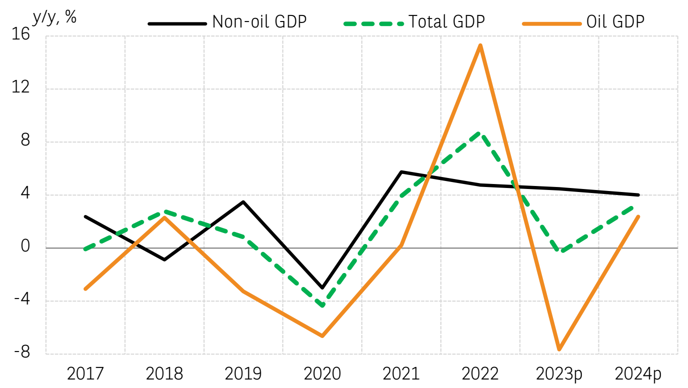

CHART 1 SOURCE: GENERAL AUTHORITY FOR STATISTICS, BNP PARIBAS

DIVERSIFICATION STILL DEPENDENT ON OIL REVENUES

Diversification of the Saudi economy continues, albeit rather slowly. The share of hydrocarbons in GDP is falling (40% in 2022 compared to 45% in 2012) in favour of the non-hydrocarbon private sector (from 38% to 41% over the same period), thanks in particular to growth in manufacturing industries excluding refining and retail and hospitality activities. Nevertheless, it should be noted that fiscal impetus and, therefore, oil revenues, remain decisive in supporting activity, whether through infrastructure programmes (the various projects linked to Vision 2030) or budgetary support. This is partly due to the weak attractiveness of the Saudi economy to foreign direct investments (FDIs). Since 2017, FDIs have been below 1% of GDP (the highest level in 2021, 2.2% of GDP, is linked to an exceptional asset monetization by Aramco). This means the country is relying heavily to debt in order to implement programmes for diversification of the economy.

MODERATE BUDGETARY DEFICIT EXPECTED

In 2023, the decline in oil revenues (because of a decline in price and volume) and the sustained level of spending are expected to lead to a return to a moderate budgetary deficit of around 2.1% of GDP. In 2024, although we are expecting near-stability in oil revenues and a slight increase in spending, the budgetary balance is expected to be around 2% of GDP. This is due to distribution of a "performance dividend" by Aramco (the government directly owns 90% of the capital of Aramco), which will amount to around USD 10 billion (around 1% of GDP) per quarter between Q3 2023 and Q4 2024.

These forecasts attest to the solidity of public finance despite the volatility of the oil market. However, this puts into perspective the progress made in terms of diversification of revenues. While setting VAT at a high level (compared to regional standards) from 2020 onwards significantly contributed to increasing the share of non-oil revenues in the budget, we note that budgetary dependence on hydrocarbons remains significant.

ACCELERATION OF PUBLIC DEBT ISSUANCES

In the context of the economic transformation programme, public sector funding requirements are very high, and go far beyond covering the budgetary deficit (around USD 21.5 billion) and repaying the government debt amortisation (around USD 25 billion according to the IMF) estimated for 2023. Active debt management is reflected in the redemption of outstanding bonds and issues of securities over longer maturities, in order to reduce the refinancing risk over time. In 2022, the equivalent of USD 1.3 billion was issued.

Since the beginning of the year, international government issues (Eurobonds and Sukuk) totalled USD 21 billion, while around USD 11 billion were issued locally, representing more than 3% of GDP in total. In addition, government assets with the central bank fell by USD 51 billion over the first eight months of the year (more than 5% of GDP). And finally, the government intends to borrow USD 11 billion in the form of a syndicated loan. In total, these issues are well in excess of the government's funding requirements.

The level of total government debt is moderate (28% of GDP expected in 2023, with external debt representing 37% of the total) while government assets at the central bank currently represent 11% of GDP.

SAUDI ARABIA: GOVERNMENT DEBT

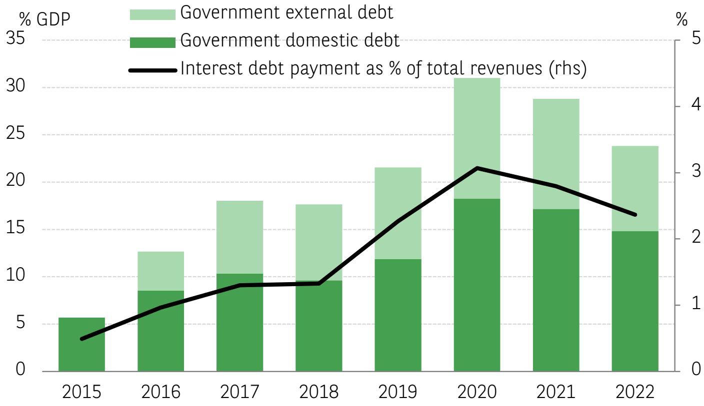

CHART 2 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

Interest on debt only represents approximately 3% of total budget revenue. The debt profile is favourable: average maturity is 9.3 years (7.9 in 2018) and the average rate was 2.95% in 2022 (2.91% in 2018). The risk premium on 5-year sovereign bonds denominated in currencies is low (around 50 bps). The government's capacity to pay its debt is therefore solid and should not deteriorate in the medium term. Nevertheless, it should be pointed out that the growing role of sovereign funds in public policy (in the form of investment in the local economy) entails a rise in debt in the public sector as a whole. According to the IMF, sovereign fund debt was 33% of GDP in 2021, higher than government debt. The assets held by the Public Investment Fund are equivalent to around 53% of GDP, of which 68% are invested in the local economy and are therefore, in theory, less liquid than securities listed on international markets. In addition, the country's external position is very strong thanks to significant current surpluses and a recent increase in portfolio flows. SAMA's foreign exchange reserves, excluding government assets, amount to USD 308 billion (August 2023), equivalent to one year of imports of goods and services.

The situation of public finance therefore remains comfortable. However, public finance presents two factors of fragility: first, its persistent vulnerability to oil market volatility (the budget has only seen a surplus once since 2014), and second, significant funding requirements until at least 2030 - although the government's projections for investment seem overestimated (around USD 300 billion per year until 2030). These funding requirements will have to be covered for the most part by debt, notably with international creditors (in an environment of much higher interest rates since early 2022) and, to a lesser extent, by the monetisation of public assets.

On the other hand, the global energy transition (the International Energy Agency expects global oil demand to start to structurally decline before 2030) could weigh on public finance faster than expected.

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ANGOLA

DECLINE IN OIL PRODUCTION

Since the beginning of 2023, Angola's oil production has fallen short of the target set by the government and is declining compared to 2022, which is severely penalising economic growth. Combined with the fall in Brent prices, this underperformance is weakening the external accounts of the country, which is also dealing with particularly high external debt repayments. Dollar liquidity therefore fell in Q2 2023 and the Kwanza depreciated sharply. The government's solvency also deteriorated. To counteract this, the authorities announced major budget cuts at the beginning of August. In the short term, the rise in Brent prices will stabilise foreign exchange reserves, which still stand at a satisfactory level. However, against the backdrop of a structural decline in oil production, Angola's ability to repay external debt could be threatened in the event of a sharp fall in oil prices.

STRUCTURAL DOWNTURN IN THE OIL SECTOR

In 2023, after two years of modest recovery, economic growth in Angola is expected to slow sharply to 0.9%. Once again, activity is being penalised by the downturn in the oil sector, which accounted for 30% of GDP in 2022. Over the first eight months of 2023, oil production contracted by 5.8% year-on-year (y/y). This was primarily due to maintenance operations that impacted output results in February and March. Rebounding since then, oil production between January and August reached an average of 1.12 million barrels per day (mbpd), a figure that remains significantly below the target set by the government in its budget for 2023 (1.18 mbpd).

Despite this underperformance, the government remains confident in the sector's ability to increase its production in the short term. In September, the National Oil, Gas and Biofuels Agency (ANPG) announced its intention to increase its OPEC-imposed production quota, which already stands at 1.45 mbpd, well above the country's current production capacity. According to the government, recent efforts to attract foreign investors should bear fruit in the coming months. Their appetite was already confirmed in September, when the ANPG granted two new operating licences for blocks that contain considerable oil reserves.

The oil sector will therefore return to growth in 2024. However, this growth is expected to remain limited. The sector is being penalised by both the natural decline in reserves and by ageing infrastructure, which requires new maintenance operations. Since 2015, when the country reached its production peak, the sector has contracted by 35% in real terms. This long-term trend is having a significant impact on Angola's external accounts, as oil accounts for 95% of its exports.

NORMALISATION OF CURRENT SURPLUSES

Global conditions over the past two years have been favourable for Angola's external accounts. Over 2021-22 on average, the current account surplus exceeded 10% of GDP, a level not seen since 2012. The recovery of global demand after the pandemic, followed by the impact of the war in Ukraine on oil prices, has enabled the country to generate significant trade surpluses. This momentum has more than offset the structural deficits of the balance of services and income. Angola has even been able to repay some of its foreign debt in advance.

Nevertheless, in 2023, the current account surplus should contract sharply to 2% of GDP as the trade surplus shrinks. During H1 2023, exports in value contracted by 25% y/y, hampered by falling oil prices and contracting domestic production. Conversely, imports increased by 19% y/y, driven by the increase in imports of transport equipment, capital goods and industrial goods.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-5.7	1.1	3.0	0.9	2.4
Inflation, CPI, year average, %	22.3	25.8	21.4	14.6	22.3
Gen. Gov. balance / GDP (%)	-1.9	3.8	0.7	-1.7	2.3
Public debt / GDP (%)	138.9	77.8	65.2	84.6	81.1
Current account balance / GDP, %	1.5	11.2	9.6	2.0	6.5
External debt / GDP, %	114.0	86.6	47.8	61.9	60.3
Forex reserves, USD bn	14.9	15.5	14.7	12.7	15.2
Forex reserves, in months of imports	11.8	9.9	6.1	6.2	7.4

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ANGOLA: NORMALISATION OF CURRENT ACCOUNT SURPLUSES

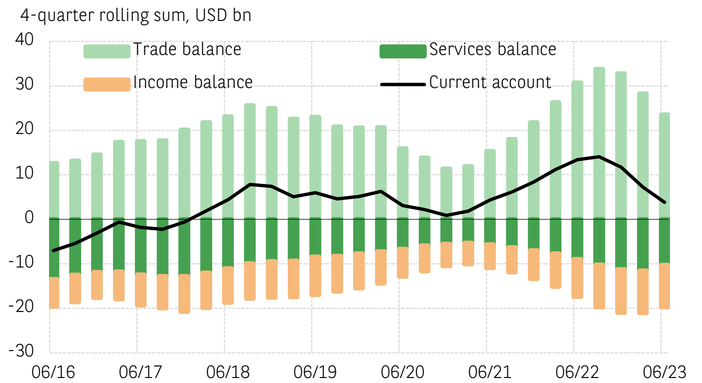

CHART 1

SOURCE: IMF, BNP PARIBAS

The decline in current surplus in H1 2023 impacted dollar liquidity, while Angola faces high repayments of its external debt. In fact, after a three-year moratorium, debt servicing to China has resumed; this accounts, on average over 2023-24, for half of the country's total servicing of external debt. In addition, Angola's financial account remains undermined by net outflows of foreign direct investment (FDI), while portfolio flows remain modest and strongly correlated with developments in the oil sector. All these factors led to strong depreciation of the Kwanza (AOA), which lost 55% of its value against the US dollar between May and July.

Since then, the Kwanza has stabilised at around AOA 825/USD, but this stabilisation is mainly due to malfunctions in the foreign exchange market linked to the introduction of restrictions by the central bank (BNA). In fact, a new directive in force since August prohibits oil companies from selling currencies only to those commercial banks with which they have a relationship. They are being asked instead to negotiate with all banks. This has in fact paralysed the foreign exchange market and reduced access to the dollar. Since the introduction of this directive, oil exporters have been selling their currencies directly to the BNA, now the sole provider of dollars. These restrictions are expected to be only temporary. But further changes to the rules of the foreign exchange market could expose the Kwanza to sudden adjustments.

The BNA's foreign exchange reserves remain satisfactory. At the end of September, they stood at USD 13.8 bn, i.e. 6.7 months of imports, compared to USD 14.7 billion at the end of 2022. However, they have been declining steadily since 2014, and are currently at an all-time low, despite the good economic conjuncture seen in the past two years. In the short term, the rise in Brent prices (observed since July), combined with higher oil production, should buoy Angola's external accounts. However, the ability to repay external debt will remain fragile. On a positive note, in the event of a negative shock on oil prices or production and a sharp deterioration in external accounts, Angola should be able to obtain a new funding programme from the IMF, given the recently implemented reforms to strengthen its public finances.

RETURN TO FISCAL DEFICIT

With three quarters of its debt denominated in foreign currency, the Angolan government is heavily exposed to exchange rate shocks. The depreciation of the Kwanza in Q2 2023, combined with falling oil revenue, has had a marked impact on public debt sustainability and solvency ratios. Debt rose from 61% of GDP in March 2023 to 91% of GDP in June, while debt service costs increased from 99% of government revenue to 144% over the same period.

As a result, although in February the Ministry of Finance forecast a budget surplus of 0.9% of GDP for 2023, in early August it estimated that the balance could reach a deficit of USD 10 bn (10% of GDP) if no corrective measures were taken. Against this backdrop, the government shortly after announced the suspension of all public investment projects with an implementation rate of less than 80%, and the freezing of non-essential recurring expenditure.

Thanks to these measures of last resort and the recovery in Brent prices since July, the fiscal deficit should ultimately be contained at 1.7% of GDP in 2023. Public finances are expected to improve in 2024, supported by sustained high oil prices. In addition, last June, the government embarked on the first stage of a phasing out of fuel subsidies, a key measure for improving public finance management according to the IMF. In 2022, these subsidies had cost the equivalent of 2.7% of GDP, which had greatly reduced the positive impact of high oil prices on fiscal revenue. The Ministry of Finance intends to phase out fuel subsidies in 2024, until full price liberalisation in 2025.

ANGOLA: RETURN OF INFLATIONARY PRESSURES

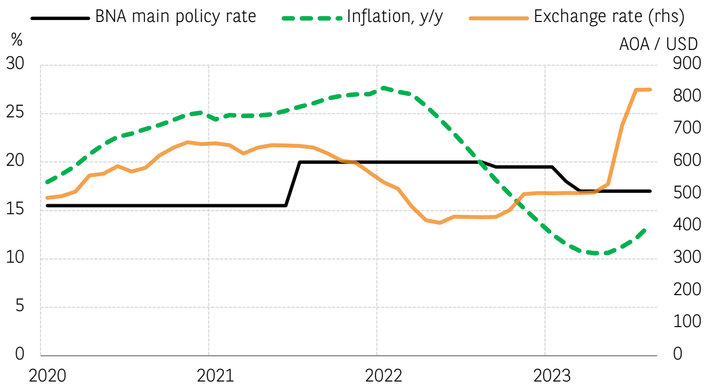

CHART 2 SOURCE: BNA, BNP PARIBAS

To offset the impact of this reform on the poorest households, the authorities plan to reduce VAT on food products from 14% to 7% from January 2024. However, the government's ability to complete this subsidy reform is uncertain, as inflation has picked up again and public unrest broke out in June when the decision was announced.

RESILIENCE OF THE NON-OIL SECTOR

In 2023, growth in the non-oil sector is expected to slow to 3.4%. In H1 2023, the sectors with the highest growth rates were transport (+20.4% y/y), financial intermediation services (+14.8%) and telecommunications (+3.8%). Trade, the second largest sector of the economy (20% of GDP), posted more modest growth of 2.7% y/y. Industry only grew 0.7% over the same period, and remains an underdeveloped sector (8% of GDP).

The resilience of the non-oil economy is being put to the test in H2 2023. In particular, it has had to cope with the return of inflationary pressures since June. After reaching 10.6% in April, its lowest level in seven years, inflation rapidly picked up, driven by the depreciation of the Kwanza and the partial phasing out of fuel subsidies. It reached 13.5% in August and is expected to rise to around 19% at the end of 2023. It is not expected to slow down in 2024. Faced with rising inflation, the central bank has had to interrupt its monetary loosening cycle. For the third time in a row, it maintained its key rate at 17% at its last monetary policy committee meeting in mid-September. However, the BNA's monetary policy should have only limited scope in curbing inflation.

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GHANA

SOME PROGRESS BUT MANY WEAKNESSES

The Ghanaian economy is gradually recovering from the severe macroeconomic crisis of 2022. GDP growth is holding up better than expected and inflation has started to fall even though it remains too high. In terms of public finances, progress is also encouraging. In addition to satisfactory budget implementation during the first six months of the year, the authorities completed their domestic debt restructuration operation. However, the country remains in default on its external debt. Despite the support from the FMI, it also lacks a cushion to protect it from a possible new external shock.

After a nightmarish 2022, which ended with the government defaulting on its external debt, Ghana has embarked on an all-out race to get its economy back on its feet. To achieve this, it will be supported by the IMF. The extended 3-year credit facility, amounting to USD 3 billion, and the associated programme thus aim to strengthen macroeconomic stability and restore debt sustainability. The first review has just been concluded. Results were satisfactory, paving the way for. a second USD 600 million disbursement once the the Ghana's authorities and their bilateral creditors have reached an agreement on external debt restructuring. Optimism is therefore slowly returning. However, caution remains necessary as long as the pitfalls remain significant.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%)	0.5	5.1	3.1	2.5	3.0
Inflation (CPI, year average, %)	9.9	10.0	31.9	42.5	22.2
Gen. Gov. balance / GDP (%)	-11.5	-9.2	-11.8	-4.5	-4.8
Gen. Gov. debt / GDP (%)	78.9	79.6	88.1	91.0	91.6
Current account balance / GDP (%)	-3.0	-3.2	-2.1	-1.0	-1.2
External debt / GDP (%)	45.5	46.2	47.9	53.6	54.1
Forex reserves (USD bn)	7.0	7.9	4.4	4.8	5.1
Forex reserves, in months of imports	3.4	3.7	2.0	2.2	2.2

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

DEBT RESTRUCTURING: SOME PROGRESS BUT STILL NO OVERALL AGREEMENT

The situation of the public finances was unsustainable, with debt reaching 88% of GDP and nearly half of the budgetary resources in 2022 dedicated solely to interest payments. In addition, Ghana was set apart from most of its African peers by overwhelming domestic debt (53% of debt stock but 73% of interest). It was therefore necessary to restructure the entire debt and not only that contracted with external creditors, as has been the norm during previous debt crises in low-income countries.

A first step has just been completed. After an exchange of domestic debt securities in February, the government recently renegotiated debt held by pension funds, dollar-denominated bonds and eligible securities on the Ghana Cocoa Board's cocoa. In total, half of the domestic debt stock will have been exchanged for bonds at lower rates and longer maturities. In addition, the central bank cancelled 50% of the government securities it holds, which represent 25% of domestic debt. This financing had become massive and expensive in recent years.

The primary aim of restructuring domestic debt is to relieve public finances by reducing debt servicing. The effects on the debt stock not held by the central bank are fairly limited. In the absence of an agreement on external debt, public debt should continue to rise slightly, to over 90% of GDP this year, before starting to stabilise from 2024 onwards (Chart 1), provided that the fiscal consolidation policy continues and the exchange rate stabilises (two realistic but fragile assumptions). As far as external debt is concerned, negotiations with official creditors could quickly be concluded. On the other hand, those undertaken with private creditors remain uncertain. Of the USD 20 billion of external debt eligible for restructuring, 73% is held by the latter, the vast majority in the form of euro bonds (USD 13.1 billion compared with USD 5.4 billion for official bilateral debt). In addition, the effort required is significant. The FMI estimates the external financing gap at USD 10 billion over the 2023-2026 period, which the restructuring of debt should implicitly cover. Against this backdrop, the government's goal of completing the whole process by the end of the year seems optimistic.

GHANA: PUBLIC DEBT

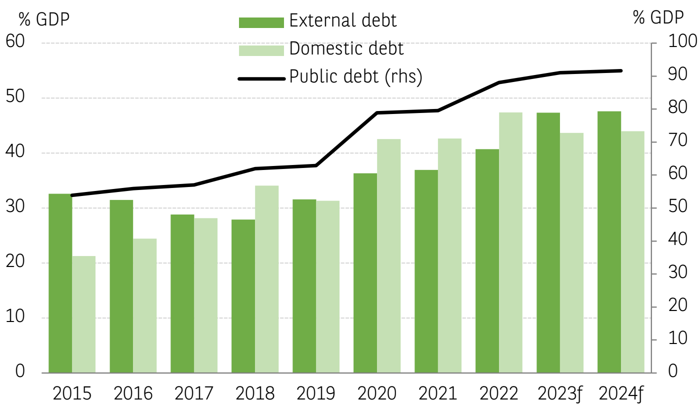

CHART 1 SOURCE: MINEFI, IMF, BNP PARIBAS

FISCAL POSITION: SOME POSITIVE RESULTS TO BE PUT INTO PERSPECTIVE

Debt restructuring will be a prerequisite but not enough to restore its sustainability. To reduce public debt to 55% of GDP by 2028, it will also be necessary to continue the ambitious fiscal consolidation strategy set by the FMI, namely an adjustment of 5.1% of GDP over the 2023-2026 period, thanks to a 3pp increase in budget revenue, and a 2.1pp reduction in non-interest expenditure.

Thus, the primary balance would return to surplus again from 2024, at 0.5% of GDP compared with 3.6% in 2022, before reaching 1.5% of GDP in 2025 and 2026. However, since 2010, Ghana has only managed to generate primary surpluses twice (in 2015 and 2017).

The results of budget execution for the first six months of the year were therefore eagerly awaited. They were satisfactory, but not completely reassuring. On the revenue side, performance is slightly below the new budget targets due to a sharp decline in oil revenue. Up 56% y/y, they nevertheless showed higher growth than nominal GDP, thanks in particular to the increase in VAT from 12.5% to 15%. On the expenditure side, the increase in primary expenditure was moderate (+29%), but this was due to financing constraints that forced the government to dratiscally cut investment (stable y/y but less than half the target), in favour of a sharp increase in the wage bill (+40% y/y). However, this dynamic is not sustainable.

The government is now forecasting a primary deficit of 0.5% of GDP for 2023, compared with a surplus of 0.7% in the initial financing bill and 1.1% for the first six months of the year. Thus, the budget deficit would fall to 6.4% of GDP from 11.8% in 2022. In all likelihood, it could be significantly lower due to the suspension of payment of virtually all interest on external debt. Over a full year, this "gain" could amount to almost 2 points of GDP, which would bring the budget deficit below 5% of GDP in 2023 and 2024 if no agreement is reached with external creditors.

However, the authorities' ability to stay the course is questionable. Even if it increases, tax revenue will remain below 13% of GDP. This gives very little room for manoeuvre. Yet, financing conditions are deteriorating. In fact, the government is forced to issue short-term securities at rates that now fluctuate between 28% and 32% (compared with a range of 19-27% in April). More than 80% of government financing needs will have to be covered locally this year. The interest burden on domestic debt is therefore set to rise in the coming months, absorbing a large part of the benefits from the restructuring. Above all, general elections will be held in 2024, giving rise to fears of possible budgetary slippages, as was the case in the past, even if the tutelage of the IMF should limit this risk.

GROWTH: BETWEEN RESILIENCE AND WEAKNESSES

It is hardly surprising to see economic activity weaken in the context of this debt crisis. However, it has not broken down so far. After 3.1% in 2022 and 5.1% in 2021, growth once again surprised in H1 (+3.2%) thanks to the good performance of the agricultural sector (+6.2%) and services (+6.3%). The government's forecast of 1.5% should therefore be exceeded, even if a deceleration is expected in H2 due to the persistence of strong headwinds (budgetary consolidation, restrictive monetary environment). In total, growth is expected to reach 2.5% this year before gradually recovering from 2024 onwards, subject to financial stabilisation, which is far from assured.

Inflation is falling, but it remains very high at 40.1%, compared to a peak of more than 50% between the end of 2022 and the beginning of 2023 (Chart 2).

GHANA: MONETARY ENVIRONMENT

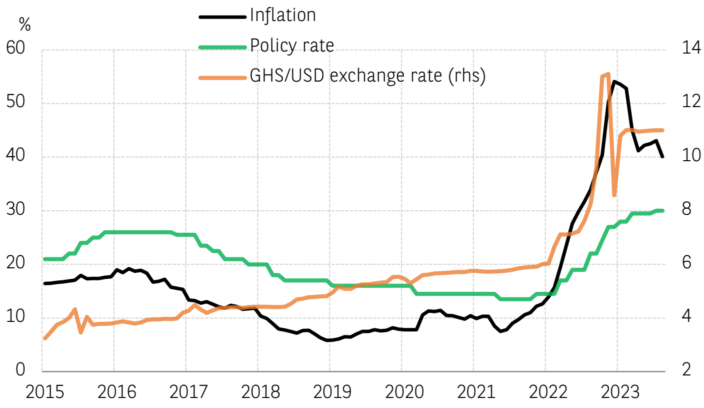

CHART 2 SOURCE: GSS, CENTRAL BANK, IMF

Inflationary pressures will remain strong mainly due to exchange rate volatility. In 2022, the cedi fell sharply, losing up to over 50% of its value against the US dollar at the peak of the crisis, before recovering in December when the IMF agreement was announced. Since then, the situation has stabilised, but Ghana's external accounts remain very fragile.

Despite a trade surplus in H1 and the suspension of payment of external debt servicing (1.2% of GDP just for non-payment of interest on Eurobonds in 2023), forex reserves have fallen further since the beginning of the year to cover only 1.5 months of imports of goods and services. In the very short term, the disbursement of a new tranche of the IMF programme should somewhat ease the pressures on external liquidity. But with a coverage ratio that should just exceed two months of imports at the end of the year, Ghana is still exposed to a further exchange rate shock. If this were the case, the central bank would have no choice but to tighten its monetary policy even further (the key policy rate has increased from 14.5% in 2022 February to 30% currently), which would weaken the private sector (the ratio of non-performing loans reached 20% in August 2023 compared with 14.2% at the beginning of 2022).

After posting substantial losses in Q4 2022, the banking sector returned to profit in Q1 2023. In addition, the monetary authorities gave banks four years to restore their solvency ratio. It remains above prudential standards at 14.2%, but its sharp fall (19.4% in June 2022) nevertheless leaves banks more vulnerable to an increase in credit risk.

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