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ECONOMIC RESEARCH

BNP PARIBAS

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THE SPECTRE OF A STRUCTURAL DECOUPLING OF THE US AND CHINA

The scenario of a slowdown in the emerging economies in 2023 is based on two hypotheses: 1/a slowdown in global trade and 2/the recessionary impact of inflation and monetary tightening. The first hypothesis is now a certainty: exports have clearly contracted in recent months, in both the advanced countries and emerging economies. The causes are partially circumstantial, and hopefully the cooling of world trade will only be cyclical. It is possible, however, that the trade and technological decoupling of the US and China are also a contributing factor.

For the vast majority of both the advanced and emerging countries, the scenario of an economic slowdown in 2023 is based on two hypotheses: a slowdown in world trade, and the recessionary impact of inflation and monetary tightening. The second hypothesis has yet to manifest itself for two reasons: 1/savings accumulated during the pandemic and measures to boost household income have enabled consumption to withstand the eroding effect of inflation, and 2/higher interest rates have yet to have a very visible impact on lending.

Exports, in contrast, have clearly begun to contract. According to estimates by the Netherlands Bureau for Economic Policy Analysis (CPB), if we compare the average for November 2022-January 2023 with that of the three preceding months, exports contracted at an annualised rate of 10.5% in volume (-7.4% for the advanced countries and -16% for the emerging economies), whereas in mid-2022, exports were still increasing by 3% a year (by 2% and 5.2%, respectively). Markit business surveys conducted during the first months of the year confirm this decline. On average, the PMIs for export order books were significantly below 50, the threshold separating contraction from expansion. Concerning the emerging countries, non-commodity exporters have reported sharper declines in these indices than the other countries since mid-2022.

There has been a particularly sharp decline in exports for the Asian countries excluding China (-19%). This can be explained a priori by the erratic fluctuations in Chinese growth since Q4 2022, and by the downturn in the global electronics cycle. Yet structural factors could also be at work, reflecting the impact of the trade and technological decoupling of the US and China .

Since the outbreak of the trade war between the US and China in 2017, there has been a real break-off in external trade according to the Petersen Institute for International Economics[1]. The PIIE study covers exports of US goods and services to China. At first glance, total exports in 2022 seem to be at the same level as in 2016. Yet this can be attributed to circumstantial factors: 1/the Covid pandemic triggered a strong surge in exports of electronic components and medical equipment, and 2/higher commodity prices in 2020 and 2021 drove up the value of US coal and hydrocarbon exports. Moreover, the truce concluded between the two countries in 2020 resulted in a big increase in exports of agricultural products, even though China did not completely uphold its purchasing commitments. For other manufactured products, notably land and air transport equipment, the decoupling effect was very strong. Aircraft and engine exports were down threefold between 2017 and 2022, while exports of cars, trucks and spare parts were down 2.5x. In 2022, the decline in exports of electronic components and medical equipment was twice as severe as for all Chinese imports. Lastly, exports of services were down by about 30% between 2017 and 2022.

The structural decoupling of the United States and China has numerous consequences on emerging countries, with potentially opposing effects on foreign trade of merchandise and services[2].

More precisely, the partial break-up of trade between the two superpowers – whether due to higher trade barriers or bans/restrictions on trade – obviously has a negative impact on the foreign trade of third countries via the multiplier effect of world trade. This severance also impacts third countries that are a part of supply chains. According to the IMF, however, the consequences differ widely depending on the country's status. The big winners are countries that can substitute in for the United States or China as a supplier in new supply chains. In contrast, countries that are simple links in existing supply chains, without the capacity to strengthen their position among suppliers, will be hit at least by the repercussions of higher trade tariffs, or at worst, they will be evicted from new supply chains.

One might assume that the more industrialised countries with a diversified productive apparatus and that are geographically close to China or the US would rank among the winners. Yet the IMF study shows that between 2018 and 2022, Japan and South Korea both reported a decline in their share of Chinese imports, whereas India, Malaysia and Vietnam reported increases. Among Asian countries, Taiwan is the only country that validates the assumption. As to the US, Mexico is *a priori* a potential beneficiary. Yet between 2018 and 2022, exports of Mexican manufactured goods increased only moderately as a share of total American imports excluding oil (from 14.8% to 15.6%).

We can take comfort in the fact that the widespread contraction of exports in recent months is mainly due to cyclical factors. Although the subject still requires more in-depth research, so far the impact of the structural decoupling of the US and China is unlikely to facilitate matters.

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1 Chad P. Bown & Yilin Wang: "Five years into the trade war, China continues its slow decoupling from US exports" Realtime Economics. PIIE. March 2023
2 IMF East Asia and the Pacific Economic Update - section 5.1. April 2023

CHINA

MOVING OFF UPHILL

Chinese economic growth has re-accelerated since the end of January, mainly driven by services and household consumption. The recovery in manufacturing activity is more moderate. In the real estate sector, the crisis is lessening. These improvements will continue in the short term. However, constraints on economic growth remain significant; they principally stem from the weakening global demand and geopolitical tensions as well as from financial difficulties for property developers, local governments and their financing vehicles. Beyond this, the question arises of a lasting loss of confidence in the Chinese private sector.

POST-COVID RESTART OF THE ECONOMY

Following the abandonment of the zero-Covid policy in early December, the lifting of all restrictions on mobility and the end of the disruptions caused by the surge in the number of infections in December-January, Chinese economic growth has rebounded since the end of January. The recovery has been primarily driven by services, while the improvement in industry turned out to be more modest (Chart 1).

Activity in the services sector and household consumption have recovered more quickly than expected. After several months of contraction, retail sales volumes increased by around +2% YoY in January-February, despite the decline in car sales due to the end of tax incentives. Consumer price inflation remained low (+1.6% YoY in January-February after reaching +1.8% in Q4 2022).

The crisis in the construction and real estate sectors has eased: new construction, housing sales and real estate investment all continued to contract in January-February YoY, but at much slower rates than in previous months. In addition, the average house price in the 70 main cities rose slightly in February (+0.1% MoM) after falling for 18 months in a row (however, the total house price drop has been limited to -5.2% since July 2021).

In the manufacturing sector, the recovery in activity has been more hesitant, and PMIs fell slightly in March after just two months of improvement. Total automobile production has fallen sharply (but new energy vehicle production has continued to rise strongly) and export-oriented sectors have been affected by the decline in global demand for several months. Exports of goods measured in dollars fell by -6% YoY in January-February 2023, after -6.6% in Q4 2022.

Against this difficult but more reassuring backdrop, the National People's Congress held its annual meeting in Beijing at the beginning of March. The government notably announced its main macroeconomic objectives for 2023. The growth target was set at "around 5%", indicative of the cautious realism of the authorities. This target of 5% should in fact be easily reached thanks to the momentum provided by post-Covid catch-up effects, which will continue in the coming months, particularly in the services sectors.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	2.2	8.4	3.0	5.6	5.3
Inflation, CPI, year average, %	2.5	0.9	2.0	2.7	2.5
Official budget balance / GDP, %	-3.7	-3.1	-2.8	-3.0	-3.2
Official general government debt / GDP, %	45.9	46.9	50.4	51.6	53.0
Current account balance / GDP, %	1.7	1.8	2.3	1.7	1.2
External debt / GDP, %	16.3	15.4	14.4	14.3	14.0
Forex reserves, USD bn	3 217	3 250	3 128	3 050	3 030
Forex reserves, in months of imports	16.2	12.6	11.9	11.0	10.0

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: POST-COVID RECOVERY

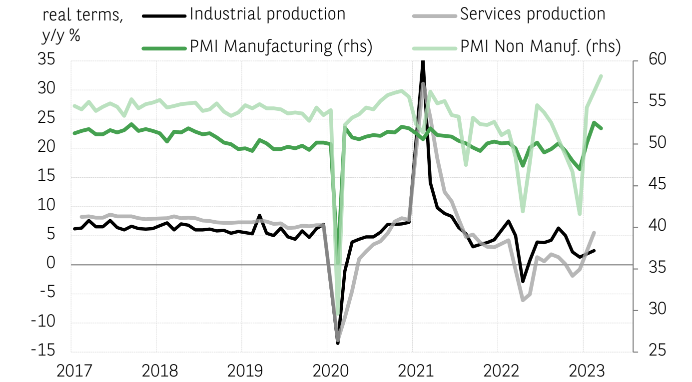

CHART 1

SOURCE: NBS, BNP PARIBAS

OTHER CONSTRAINTS ON GROWTH PERSIST

At the same time, by setting a low growth target for 2023, the authorities are first counting on moderate support from fiscal and monetary policies, and second, recognising the existence of high downside risks.

On the external front, the global economic slowdown will continue to weigh on the performance of the export sector. Furthermore, the geopolitical context, tensions with the United States and the very strict controls imposed by Washington on the sale of electronic components to Chinese companies[1] are clouding the prospects for the expansion of high-tech industries in China – at least in the short and medium term, pending progress in China's search for technological self-sufficiency.

While the international environment becomes more complex, the confidence and demand of private companies could also be durably affected by the increased regulatory risks weighing on the domestic market (lack of visibility, increased control of the State and Communist Party).

1The export controls were drastically strengthened by Washington in October 2022: US semiconductor companies, as well as any foreign company using their components and equipment, must apply for a special licence (with a high risk of refusal) to be able to sell the most advanced chips and equipment to Chinese companies. Under pressure from the US, the Netherlands and Japan recently announced restrictions on exports of semiconductor production equipment.

FRAGILE LOCAL GOVERNMENT FINANCE

The crisis in the property sector remains a threat to short-term growth. Government support measures and the lifting of mobility restrictions should help stop the collapse of activity. Nevertheless, housing sales and new construction projects should remain hindered by the still poor confidence of potential buyers, the persistent financial difficulties of a large number of property developers and the slow pace of their debt restructuring.

The weakness of local government finance is also fuelling growth risks, since it should impose fiscal consolidation efforts, constrain local governments' capacity to resort to debt and therefore weigh on public spending and investment.

Since 2020, public accounts have deteriorated, with local governments being the most affected. They have taken on a large part of the new expenditure linked to the health crisis, and suffered from the weakening of their current revenue (-2% in 2022) resulting from the slowdown in activity and tax support measures. Since mid-2021, they have also suffered from the sharp drop in their land sales proceeds (-23% in 2022). These revenues, resulting from the sale of land to developers, finance "government funds", managed by local governments outside the official general budget and largely dedicated to infrastructure projects[2].

Between the end of 2019 and the end of 2022, the explicitly budgeted debt of local governments increased from 21.6% of GDP to 29%, and that of the central government went from 17% to 21.4% (Chart 2). Taken as a whole, local government debt is not excessively high and benefits from the same favourable conditions as that of the central State. These conditions ensure medium-term debt sustainability (favourable debt profile, moderate interest charge, positive differential between GDP growth rate and interest rate).

However, financial conditions vary widely from region to region and some local governments face excessive debt servicing. In addition, in order to be able to cover all their needs (and in particular to finance infrastructure investments), many local governments have continued to use financing vehicles (LGFV, or local government financing vehicles). The debt of these entities is contracted within a regulatory framework that is sometimes still unclear, outside the official budget, and constitutes an additional indirect debt for the local governments. It is high, mainly made up of bank loans, as well as bonds (around a quarter of the total, mainly issued in domestic markets) and other non-bank financing sources.

According to IMF estimates (Article IV, February 2023), total LGFV debt reached 47% of GDP at the end of 2022, compared to 40% at the end of 2019. The risk of default on this debt is high, especially because the returns on the investments financed are often too late or not sufficient to cover repayments. It is a growing source of vulnerability for local governments, while their capacity for support has deteriorated. The amount of LGFV bond debt falling due will peak in 2023 and remain high in 2024. Liquidity risks are considered very high in some of the least developed provinces. These credit risks should notably weaken certain regional banks, which would be required to cover the liquidity needs of LGFVs through new financing and debt restructuring.

CHINA: DEBT OF CENTRAL AND LOCAL GOVERNMENTS

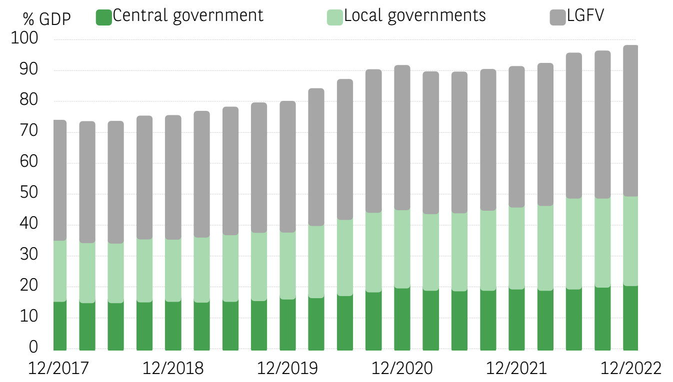

CHART 2 SOURCE: MOF, NBS, IMF, BNP PARIBAS

CAUTIOUS CONSUMERS

Uncertainties remain about Chinese household behaviour during the post-Covid period. Households may remain very cautious, having suffered from lower income growth since 2020 (disposable income per capita increased by +4.4% per year on average in real terms, compared to +6.5% in 2017-2019) and a loss of wealth due to the crisis of the property market (which concentrates around two-thirds of household assets). The consumer confidence index has remained at historically low levels since spring 2022. It has started to improve since December, but its recovery could be slow. As a result, the additional savings accumulated during the pandemic, which were rather moderate, may be only partially spent in the short term[3].

The evolution of household sentiment and demand will largely depend on the recovery of the labour market. However, this could be limited, particularly if the upturn in activity in industry remains moderate and if private business confidence remains fragile. The urban unemployment rate rose slightly in February 2023, reaching 5.6% on average across the country, and 18.1% for the 16-24 age group (compared to 5.2% and 11.9% respectively in 2019).

Structural factors of the economic growth slowdown add to these short-term downside factors, in particular, China's demographic dynamic and the slowdown in productivity growth.

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2 The fiscal slippage is hardly visible in the «official» deficit figures (-2.8% of GDP in 2022), which corresponds to the general government deficit, consolidated and adjusted for transfers between public accounts. More so (but also not covering all government), the consolidated general government deficit, to which is added the «government funds» deficit, is estimated at 7.4% of GDP in 2022, compared to 5.6% in 2019. Analysis of Chinese government accounts remains complicated by the lack of data and numerous transfers and accounting adjustments.
3 The household savings rate is estimated to be 39% of disposable income in 2022, compared to 35% in 2019. The sharp increase in bank deposits in 2022 can be explained in part by the transfer of other financial assets and real estate investments to deposits, which are less risky.

INDIA

BANKS AND COMPANIES STRONGER THAN IN 2019

In 2022, economic growth slowed but was still buoyant. The outlook for 2023/2024 is favourable even though real GDP growth should slow by around 1 percentage point. In the short term, the main risks are linked to rising prices, which could force the Central Bank to tighten its monetary policy further. The occurrence of the El Niño phenomenon is also a potentially negative factor. Despite the slowdown in growth and the rise in interest rates (48% of loans are at a variable rate), banks and companies remain much stronger than at the end of 2019. In its latest stress tests, the Central Bank reaffirmed that, despite the deteriorating economic and financial environment, public banks would not need any capital injection to meet capital requirements.

INCREASING RISKS TO GROWTH

In 2022, economic growth slowed to 6.7% compared to 8.9% in 2021. Domestic demand remained strong, although it decelerated. The contribution of net exports was negative. Over the January-March 2023 period, real GDP should increase by around 5% year-on-year (YoY) and by 7% in the fiscal year (FY) 2022/2023 ending on 31 March 2023.

In FY 2023/2024, economic growth should slow to 6%. All components of demand are expected to decelerate due to the rise in interest rates, the residual effects of inflation on household purchasing power and the global slowdown. In the short term, the main risks are linked to a sharper than expected rise in prices (induced in particular by higher crude oil prices). In addition, weather forecasts point to the increased risk of *El Niño* during the monsoon, with the consequent negative impact on agricultural production and inflationary pressures.

Prices rose by 6.7% in 2022, compared to 5.1% in 2021. Excluding energy and food, price rises reached 6.1%. Although it slowed at the end of the year, inflation rebounded in the first few months of 2023, reaching 6.4% YoY in February. Against this backdrop of inflation and tensions over the rupee, the Indian Central Bank (Reserve Bank of India, RBI) raised its key rates by 250 basis points (bps) between April 2022 and April 2023. The transmission of monetary policy has so far been partial. The weighted average lending rate for new loans only increased by 100 bps.

THE BANKING SECTOR WILL SUPPORT ECONOMIC ACTIVITY

The banking sector is now much stronger than it was before the COVID-19 epidemic, but also compared to the situation that prevailed five years ago. Although credit risks may increase in the next few quarters due to the lifting in March 2023 of the latest guarantees provided to micro-, small and medium-sized enterprises (in the framework of "restructuring schemes"), the slowdown in economic activity and the increase in interest rates (48% of loans are at a variable rate). In addition, despite monetary tightening, banks and non-bank financial companies did not reduce their credit supply, which increased by 12.6% over 2022 (compared to 6.6% in 2021). According to rating agencies, SMEs would be the most vulnerable to the monetary tightening. However, an increase in the non-performing loan ratio is not RBI's preferred scenario, and should this occur, it would remain modest and Indian banks would be able to cope, without any new injection of capital by the government.

The latest report on financial stability confirmed the continuation of banking sector consolidation between March and September 2022. The quality of assets improved, profitability increased and liquidity and solvency ratios remained above regulatory standards, although they decreased in conjunction with the sharp rise in credit. However, relative to GDP, the amount of outstanding bank credit (excluding credit to financial companies and the government) has decreased by 0.3 pp over the last twelve months, standing at 50.2% of GDP at the end of 2022.

In September 2022, the non-performing loan (NPL) ratio stood at 5%, down 1.9 pp compared to the same period a year earlier. Furthermore, even though public banks remained more fragile than private banks, their NPL ratios also improved significantly. At the end of September,

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, % (1)	-6.6	8.7	7.0	6.0	6.3
Inflation, CPI, year average, % (1)	6.1	5.5	6.7	5.5	4.4
General Gov. Balance / GDP, % (1)	-13.9	-10.2	-10.0	-9.0	-8.1
General Gov. Debt / GDP, % (1)	89.4	84.1	83.5	83.7	83.5
Current account balance / GDP, % (1)	0.9	-1.2	-3.5	-2.8	-2.8
External debt / GDP, % (1)	21.5	19.5	19.6	19.8	19.9
Forex reserves, USD bn	579	618	562	550	570
Forex reserves, in months of imports	9.0	7.9	6.7	6.2	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

INDIA: CPI AND INTEREST RATES

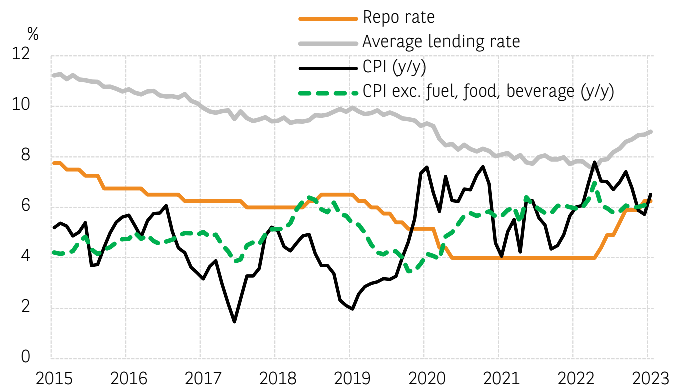

CHART 1

SOURCE: RBI, BNP PARIBAS

NPLs reached only 6.5% of their total loans (compared to 8.8% in September 2021). The drop was particularly marked in industry and in particular in the metals sector, where the ratio was only 6.5% in September 2022 (compared to 44.5% five years earlier). The construction sector remains the most fragile sector. Its NPL ratio was still as high as 18.3% in September 2022. Nevertheless, the risks for the banking sector remain under control, since loans to the construction sector only accounted for 3.4% of total credits.

Micro-, small and medium-sized enterprises (MSME) remain the most fragile actors. Although falling over the last twelve months, the NPL ratio was still 7.7% in September 2022. At that time, 5.2% of lending was still being restructured as part of the programme put in place during the COVID-19 outbreak.

Furthermore, although provisions are still insufficient across the banking sector as a whole, they covered 71.5% of risky assets in September 2022 compared with 68.1% a year earlier.

In conjunction with the rise in bank lending, liquidity in the banking sector has declined over the past twelve months, but remains comfortable. The liquidity coverage ratio stood at 135.6% in September 2022 (141.2% for public banks).

Solvency ratios are down 0.7 pp compared to March 2022, but remain sufficiently comfortable at 16% across the banking sector. The downturn, which can be explained by the very sharp acceleration in bank lending, can be seen for all public, private and foreign banks. However, it has been much more pronounced for foreign banks. Nevertheless, the capital adequacy ratio of public banks (14.5%) remained slightly higher than the level recorded in September 2021 and well above regulatory requirements.

Finally, bank profits consolidated thanks to the slight increase in their net interest margin (+20 bps between September 2021 and September 2022). Their Return on Assets and Return on Equity stood at 1% and 11.2% respectively in September 2022.

In the short term, apart from a worsening in the macroeconomic environment (inflation, growth) proving more significant than expected, two risks are weighing on the banking sector: i) a deterioration in the financial situation of MSMEs due to the rise in interest rates; and ii) a drop in the valuation of banks' asset portfolio due to the monetary tightening, even though government bond yields have remained relatively stable since the beginning of 2023 after having increased by more than 80 bps in 2022. At the end of September 2022, government securities accounted for 51% of banks' total assets.

NON-BANK FINANCIAL COMPANIES ARE STILL FRAGILE

Non-bank financial companies as a whole (including housing finance companies) remain an important source of financing for the Indian economy. In the FY2021/2022, they accounted for 12.4% of total credit. However, they remain structurally more fragile than banks because first, they are financed entirely by borrowing (unlike banks with a deposit base) and second, they finance the actors most vulnerable to a slowdown in economic activity. Apart from lending to small companies in the industrial sector (37.5% of total lending), households are the ones benefiting the most from lending granted by non-bank financial companies (29.5% of total lending). Although their situation has consolidated, particularly since IL&FS went bankrupt in 2019, some non-bank financial companies are still fragile, as evidenced by the latest RBI stress test results.

INDIA: NON-PERFORMING LOANS IN THE BANKING SECTOR

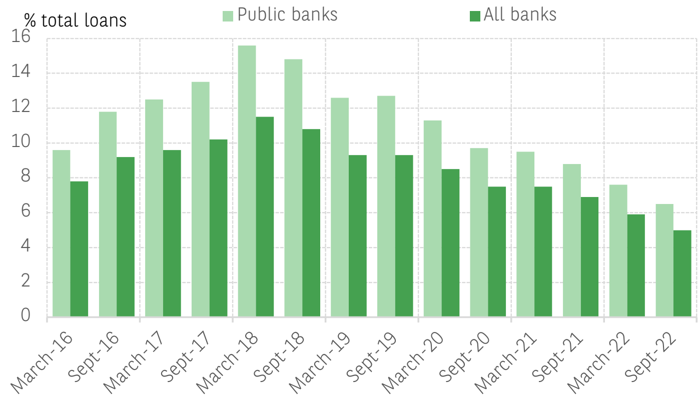

CHART 2 SOURCE: RBI, BNP PARIBAS

Over the past twelve months, the quality of their assets has generally improved. The NPL ratio fell by 1.4 pp, reaching 5.1% in September 2022. At the same time, although falling, their capital adequacy ratio reached an average of 27.4% while their return per asset was 2.5%. However, according to the latest RBI stress tests, nine out of one hundred and fifty-two companies analysed (these nine representing 4.7% of lending granted) would see their solvency ratio drop below the regulatory threshold of 15% during 2023, and thirteen would be affected in the event of a severe shock (recession, inflation above 10%). This would lead to a rise in NPL ratios from 1.8 pp to 6.9% and reduce the average capital adequacy ratio of non-bank financial companies as a whole to 22.6%.

THE FINANCIAL SITUATION OF HOUSEHOLDS AND BUSINESSES IS STILL STRONGER THAN BEFORE THE PANDEMIC CRISIS

Private sector debt (excluding financial companies) reached 87.7% of GDP in Q3 2022. Although still above its pre-crisis level, household debt has declined significantly over the past twelve months. It reached 35.5% of GDP in September 2022 compared to a high of 40.7% of GDP in March 2021, according to the Bank for International Settlements (BIS). Household debt is mostly made up of bank loans (79.6% of the total) and, to a lesser extent, loans taken out with non-bank financial companies and loans from housing finance companies (which make up 9.4% and 9.7% of their total debt, respectively).

Non-financial corporate debt remains modest. According to the RBI, it reached 52.2% of GDP in Q3 2022, which is 2.3 points lower than the level prevailing at the end of 2019. In terms of financial situation, companies are much more comfortable than just before the COVID-19 outbreak. However, this financial situation has deteriorated since Q3 2022 with the slowdown in sales and the increase in interest charges on debt (+18.5% YoY in Q4 2022), which has led to a drop in profits (-15.3% YoY in Q4 2022). As of Q4 2022, pre-tax profits covered 4.6 times their interest costs.

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PAKISTAN

DEFAULT RISK REMAINS VERY HIGH

Over the past twelve months, the economic situation in Pakistan has deteriorated dramatically. The government has been facing a balance-of-payments crisis and, as a result, has had to take extensive measures to try to contain the drop in its foreign exchange reserves and fulfil the IMF's requirements in order to receive the funds needed to avoid defaulting on its external debt. Restrictions on imports, the sharp rise in policy rates, the depreciation of the rupee and the dramatic cut in budget spending have significantly hindered economic growth and triggered a very sharp rise in inflationary pressures. Since February 2023, the external position has improved very slightly. However, it is still very fragile and the default risk remains very high.

A VERY HIGH EXTERNAL REFINANCING RISK

Pakistan's external accounts, which are structurally very weak, have deteriorated significantly over the past 18 months, leaving the country on the brink of a balance-of-payments crisis. By late March 2023, its external liquidity had stabilised, but the country's refinancing risks were still very high.

Pakistan is vulnerable to the external environment. It relies on loans provided by bilateral and multilateral creditors to cover its significant external financing needs. Its current account deficit is structurally far too high (3.1% of GDP over the 2017-2021 period) compared to its foreign direct investment (FDI), which nowhere near cover it, with FDI only standing at 0.7% of GDP on average over the last five years. Furthermore, the short-term external-debt repayments are structurally much higher than the foreign exchange reserves.

Structurally weak, external accounts have weakened further due to the unfavourable external environment. As early as mid-2021, the country's external accounts started to deteriorate as a result of i) the sharp increase in imports caused by the economic recovery and, in particular, the upturn in demand for capital goods and ii) its rising oil bill (prices and volumes have increased).

The balance of payments deteriorated further as a result of all commodity prices rising due to the conflict in Ukraine. In the fiscal year (FY) 2021/2022 (ending in late June 2022), the current account deficit increased by 3.8 pp to 4.6% of GDP. Foreign exchange reserves fell by 45%.

Since summer 2022, the current account deficit has dropped sharply thanks notably to measures introduced by the government to contain the drop in its foreign exchange reserves. Restrictions on imported goods (between May and July 2022, only so-called "essential goods" could be imported) and the ban on banks opening letters of credit to companies in sectors that were deemed non-strategic between May and December 2022 (i.e. all sectors, except for energy and food), cut imports by 29.7% between Q2 and Q4 2022. Therefore, despite the decline in exports (due to constraints on industrial production and the drop in cereal and cotton sales as a result of the floods in October 2022), the current account deficit stood at just USD 1.1 billion in Q4 2022, compared to USD 4.3 billion in Q2 2022. Furthermore, even though all import restrictions were officially lifted in January 2023, in reality, the low level of foreign exchange reserves continued to restrict company imports.

Despite the very sharp drop in the current account deficit (forecasted to fall to 1.5% of GDP in FY2022/2023) and despite loans received from the IMF and international organisations in autumn 2022 (USD 2.7 billion), the country's foreign exchange reserves did not stop falling and stood at an equivalent of less than three weeks of imports by early February 2023. This downturn was fuelled by shrinking FDI (down 40% in the first eight months of FY2022/2023), external debt repayments and central bank interventions.

The situation has very slightly improved since mid-February. The government finally bowed to the IMF's demand to implement a free-floating rupee system and received further loans from China, its main bilateral creditor. On 31 March, FX reserves reached USD 4.2 billion, up USD 1.1 billion from its low level recorded in February 2023. However,

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%) (1)	-0.9	5.7	6.0	1.0	4.0
Inflation (CPI, year average, %) (1)	10.7	8.9	12.2	30.0	20.0
Gen. Gov. balance / GDP (%) (1)	-7.1	-6.1	-7.9	-7.1	-6.3
Gen. Gov. debt / GDP (%) (1)	76.6	71.5	73.5	75.6	71.0
Current account balance / GDP (%) (1)	-1.5	-0.8	-4.6	-1.5	-3.2
External debt / GDP (%) (1)	37.6	35.1	34.6	45.0	41.6
Forex reserves (USD bn) (1)	12.1	17.3	9.8	12.0	14.0
Forex reserves, in months of imports (1)	2.9	3.3	1.3	2.0	2.0

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

PAKISTAN: FX RESERVES AND CURRENT ACCOUNT BALANCE

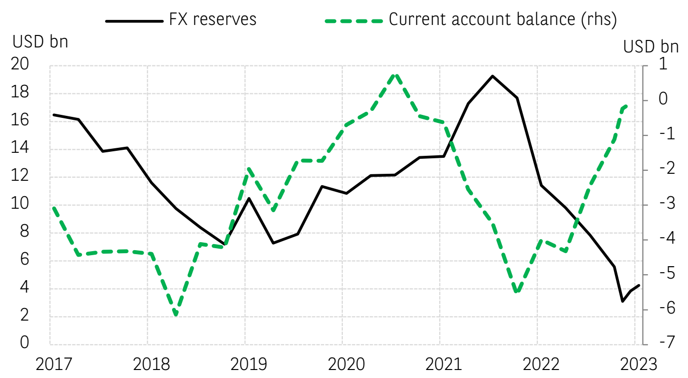

CHART 1

SOURCE: SBP

they are still far below their August 2021 levels (USD 20.1 billion) and nowhere near cover the country's external financing needs, which, according to the IMF, are estimated to stand at USD 7 billion for the April-June 2023 period alone (USD 5 billion according to estimates from Pakistan's Ministry of Finance with maturing loans with China and Gulf States having already been renewed).

The government is still awaiting the findings of the ninth review of the Extended Fund Facility with the IMF, which has been suspended since November 2022, as the government was failing to comply with the fund's budgetary consolidation requirements. The findings of the review could release an equivalent of USD 1.2 billion out of the USD 2.6 billion which the country is still entitled to receive by the end of the current programme (which was initially scheduled for June 2023). The disbursement of credit lines could also enable Pakistan to obtain additional loans worth USD 3.5 billion from bilateral lenders (Saudi Arabia and the United Arab Emirates, in particular) and USD 3.5 billion from multilateral lenders.

Even though the risk of defaulting on external sovereign debt has abated slightly (at least temporarily), there is still a high chance of a default occurring. Rating agencies and the IMF estimate that Pakistan's external financing needs will be around USD 30 billion per year over the next three budget years (including a single payment of USD 20-25 billion to service its external debt), whereas its foreign exchange reserves may only stand at USD 12 billion at the end of June. Whether it can cover its short and medium-term foreign currency financing needs will be strongly determined by whether it can obtain further foreign loans. The unstable political climate and the very high yields on government bonds are stopping the government from issuing bonds on the international financial markets at this present time (ten-year yields stood at 15.8% in late March 2023).

SHARP SLOWDOWN IN ECONOMIC GROWTH

Economic growth in the FY2022/2023 is expected to slow to just 1%, compared to 6% in the previous fiscal year. Domestic demand has been hit hard by rising interest rates (the central bank hiked its repo rate by 1025 bp between April 2022 and March 2023), the sharp rise in domestic prices (+26.2% between July 2022 and February 2023) and supply constraints linked to the import restrictions. Furthermore, in order to fulfil the IMF's requirements and consolidate its public finances, the government was forced to abolish all of its subsidies, on energy prices in particular, severely harming the industrial sector, whose production costs have skyrocketed. In addition, the sizeable depreciation of the rupee against the dollar (-34.2% in February yoy) has also increased the cost of imported raw materials and has further weakened the financial position of households and companies. Finally, agricultural production (22.7% of GDP) and cotton production in particular, which are vital for the textile industry (exports of textile and cotton products accounted for 46% and 11.8% of the country's total exports in 2021) plummeted as a result of the October 2022 floods.

ONGOING FISCAL CONSOLIDATION

Public finances are structurally weak due to i) high fiscal deficit and debt levels (over the past five years, the fiscal deficit reached an average of 7.7% of GDP and debt stood at 71.4% of GDP in June 2022), ii) a narrow fiscal base, iii) a very high burden of interest on debt (39.6% of revenues), which is also vulnerable to interest rate fluctuations (19% of domestic debt is variable rate). In addition, over the past five years,

PAKISTAN: INFLATION, POLICY RATE AND EXCHANGE RATE

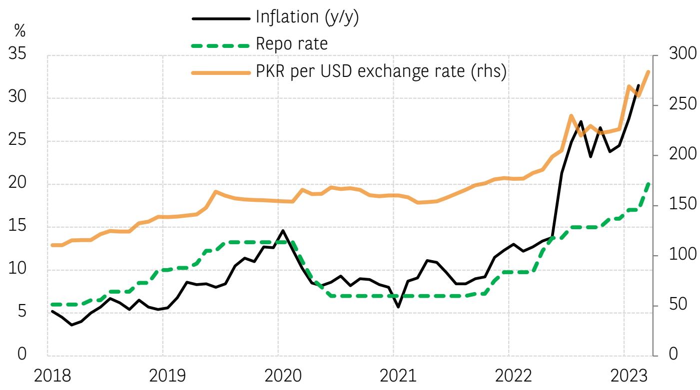

CHART 2

SOURCE: SBP

the government's debt exposure to exchange rate shocks has increased as the share of external debt rose by 7.3 pp to 37.7% of total debt in January 2023.

During the FY2021/2022, public finances deteriorated further (the deficit increased by 1.8 pp to 7.9% of GDP) as the Ministry of Finance heavily subsidised energy and food prices while increasing civil servants' salaries and introducing numerous tax exemptions.

Since summer 2022, the government has adopted a restrictive fiscal policy in order to consolidate its finances and therefore fulfil the IMF's requirements. Electricity and gas subsidies have been abolished, fuel prices have been increased and tax exemptions have been scrapped completely. During the first half of the current fiscal year, fiscal receipts increased by 18.8% compared to the same period in the previous year, despite the economic slowdown. Albeit declining, the fiscal deficit is expected to remain close to 7% of GDP in FY2022/2023, due to, in particular, a sharp rise in the debt-servicing burden (+1 pp to 5.8% of GDP), which will increase to 46.9% of revenue, a very high level.

However, the economic climate is forcing the government to temper its restrictive fiscal stance with the announcement of petrol subsidies for the poorest households in mid-March. If this measure is confirmed, it could once again delay the release of the funds by the IMF. However, there is no guarantee that this will keep the government in office following the general election scheduled for October 2023. Should a new party end up forming a government after this election, it could jeopardize a further IMF support programme, which yet would play a vital role in avoiding the risk of a sovereign default on its external debt.

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SOUTH KOREA

LIMITED POTENTIAL CREDIT RISKS

Korean economic growth lagged behind in Q4 2022, and the slowdown is expected to continue in 2023. Exports will suffer from slowing global demand, while domestic demand will be penalised by rising interest rates and persistent inflation. The risks of financial instability remain limited, but have increased in recent months. Household debt is high at almost 110% of GDP, and households are very exposed to rising interest rates. In fact, 76% of loans to households are being taken out at a variable rate. Potential credit risks though remain limited to the most vulnerable households.

SLOWING EXPORTS

Real GDP growth slowed in 2022 (to 2.6%, from 4.1% in 2021). After holding up relatively well over the first three quarters despite tighter financial conditions, high interest rates and slowing global demand, exports and consumption (public and private) lagged behind in Q4. Real GDP grew 1.4% YoY, after reaching 3% on average over the previous three quarters.

A more marked slowdown is expected in the coming months. Weak demand from Europe and the US is significantly impacting the performance of the export sector, and exports to China will not be enough to offset this slowdown. Exports fell by 12.5% YoY in Q1 2023.

Furthermore, the rapid downturn in the semiconductor cycle is also likely to penalise private investment, at least over the next two quarters. While the total industrial production index rose 2% YoY in February, the semiconductor production index fell by almost 40% YoY

High inflation and high interest rates will impact consumer spending and investment. According to data from the Central Bank, rising interest rates could particularly penalise small companies, which have fewer resources to absorb the rise in debt servicing costs, companies in the construction sector and households with debt.

Lastly, fiscal policy support should be much less significant than in the last three years. President Yoon (elected in May 2022) seems less inclined to support the economy than the previous government, in order to achieve the objective to which he has committed of consolidating public finances (reducing public spending). Last February, the Minister of Finance opposed the demand for support measures made by many MPs, aimed at supporting the most vulnerable households and businesses in the face of persistent inflation. Yet, the government announced in its 2023 budget that it would continue to support the economy, giving priority to strategic sectors for Korean industry, such as the semiconductor sector and new energies (with the objective of significantly reducing Korean dependence on fossil fuels).

We expect a recovery in investment and exports at the end of 2023, partly thanks to the upturn in the new technology sector. Overall, real GDP is expected to grow by 1.4% in 2023. In the medium term, Korea's industry could benefit from the global trend of a transition to electric vehicles and therefore from an increasing need for high-end batteries.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%)	-0.9	4.1	2.6	1.4	2.0
Inflation, CPI, year average (%)	0.4	2.5	5.1	3.7	2.3
Gen. gov. balance / GDP (%)	-6.1	-4.4	-5.1	-3.5	-3.1
Gen. gov. debt / GDP (%)	44.0	47.4	49.8	51.2	52.1
Current account balance / GDP (%)	4.6	4.7	2.1	2.8	2.8
External debt / GDP (%)	33.5	34.9	40.0	34.9	32.7
Forex reserves (USD bn)	430	438	399	418	435
Forex reserves, in months of imports	7.5	7.3	6.9	6.8	6.5

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SOUTH KOREA: INDUSTRIAL PRODUCTION INDEX

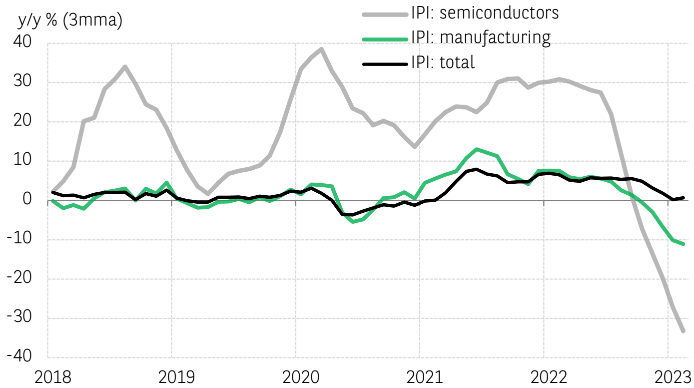

CHART 1 SOURCE: STATISTICS KOREA, BNP PARIBAS

MONETARY POLICY ON HOLD

Throughout 2022, the Central Bank of Korea continued the monetary tightening cycle initiated in August 2021. The main policy rate was raised seven times in 2022 and once in January 2023, bringing it to 3.5% (whereas it had been 0.5% since May 2020, a record low). The policy rate remained unchanged after the February meeting and is expected to remain at this level in the coming months. After reaching over 5% on average in 2022, the rate of inflation should in fact gradually slow over the coming months, thanks to the drop in the oil price and the slowdown in domestic demand. Convergence towards the Central Bank's target (2%) should, however, be gradual: the drop in agricultural commodity prices is being passed on relatively slowly, and inflation expectations remain high.

Furthermore, the Central Bank is reluctant to raise interest rates too aggressively. Given the close link between household debt and the real estate sector, rising interest rates and fluctuating asset prices pose risks to the most vulnerable households.

As the main structural weakness of the Korean economy, household debt has risen sharply in recent years, reaching 107% of GDP at the end of 2022. 76% of loans to households are still being taken out at a variable rate (and about 50% of new loans in January 2023), which leaves them very exposed to a hike in interest rates. According to the Central Bank's estimates, households' debt servicing could reach around 9% of their disposable income in 2023 (compared to almost 5.5% on average in 2010-2019).

The Central Bank intends to limit the impact on private consumption as well as an excessive correction in the real estate market. In fact, the rise in interest rates and a drop in consumer confidence have resulted in a downturn in the real estate market after several consecutive years of increase. Housing sales fell by more than 50% in 2022, after a decline of 21% in 2021, and the house price index already fell by nearly 6% between the peak of June 2022 and January 2023. However, the house price index remains higher than its level reached before the pandemic, while stocks of unsold housing continued to rise during H2 2022. In the short term, the price correction could continue.

CREDIT RISKS REMAIN LIMITED

Credit risks remain limited. Risks for the most vulnerable households have increased but overall, the amount of household financial assets is still twice as high as their debt. Last October, in response to the fall in property prices, the government announced a slight easing in regulations concerning the loan-to-value ratios for property loans (LTV). In some regions, the LTV ratio has reached 50% (usually between 20% and 50%, depending on the region). Authorisation was also given to first-time buyers (or owners of a single property that will be sold during the transaction), to borrow with an LTV ratio of over 50% (compared to 0% up until now), if the price of the property is more than KRW 1.5 bn (USD 1.2 mn).

That said, this measure only affects a very small number of households, and regulation remains generally very strict, notably maintaining the LTV ratio at 0% for owners with multiple properties (in order to limit speculation). In addition, the rigorous macro-prudential policies implemented by successive governments in recent years have improved household debt structure and increased the proportion of borrowers with a high credit score . In Q4 2022, borrowers with high credit scores accounted for almost 78% of all borrowers.

In addition, the regulation on borrowers' capacity to repay their debt (Debt Service Ratio, DSR), implemented in 2018, was strengthened in July 2022, to include borrowings from all financial institutions (i.e., including loans from non-bank institutions). The authorised DSR has been capped at 50% (compared to 40%), and is applied to each borrower. In addition, a large proportion of mortgages and loans linked to the 'jeonse' (a particular type of lease common in the Korean market in which the tenant pays the landlord a very large sum of money whose investment remunerates the landlord) are backed by government institutions.

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SOUTH KOREA: HOUSEHOLD DEBT

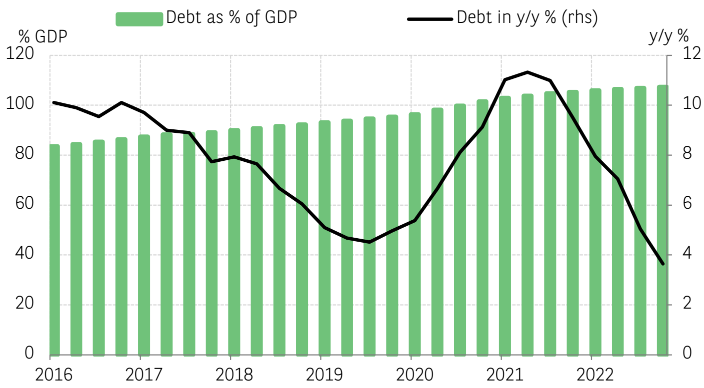

CHART 2 SOURCE: CENTRAL BANK

POLAND

RESILIENCE

Despite the war in Ukraine, Poland's economic growth was relatively solid in 2022. However, it was erratic with a sharp GDP contraction in Q2 and Q4. For 2023, despite a negative carry-over effect, recession will probably be avoided due to continuous fiscal support. Inflationary pressures remain high in the short term due to wage pressures and the return of the VAT rate on energy to its initial rate. The temporary blocking of European funds since 2022 might, at first glance, raise concerns against a backdrop in which public and external accounts have worsened. However, the inflow of foreign direct investment is a notable shock absorber. In 2022, these flows more than offset the current account deficit.

WEAK CONSUMPTION IN 2023

Among Central European countries, Poland posted the best economic performance in 2022, despite several successive shocks. The economy grew 5.2% year-on-year, after reaching 6.7% in 2021. Hungary and Romania follow close behind, with respectively a GDP growth of 4.8% and 4.4%, on average.

However, the good performance of the Polish economy should be put into perspective, given the marked downturn in economic activity in Q4. GDP fell 2.4% q/q compared to +1.0% and -2.3% in previous quarters. Growth was dragged lower mainly by destocking and household consumption. On the other hand, investment and net exports made a positive contribution.

Several factors suggest that household consumption, the main driver of growth, will remain sluggish in the coming months. In fact, the labour market has recently shown some signs of weakness with a slight rise in the unemployment rate to 5.5% in February 2023, compared to 5.2% last September. Household purchasing power has been affected by rising inflation throughout 2022 and is unlikely to improve in the short term. Although the increase in the minimum wage was significant (+15.9% on 1st January 2023, then +3.2% again in July to reach 3,600 zlotys per month), the increase in wages in companies (+13.6% year-on-year in February) is lagging behind inflation. The increase in real wages in the private sector has been in negative territory since August and will probably remain so in the coming months. In addition, the scope for offsetting the loss of purchasing power by savings remains limited. Despite savings accumulated during the Covid-19 crisis and used in part to compensate the loss in purchasing power, it is unlikely that households will reduce their savings rate, which is already very low (4.5% in September 2022 compared to 11% on average in 2020). And household confidence is still tepid.

Investment will likely weaken this year due to uncertainties related to the legislative elections scheduled for next autumn and the increase in credit costs. Exports should suffer from the expected slowdown among the main trading partners, although confidence in industry (European Commission indices and PMI index) has tended to improve in the last few months, in line with the improvement observed in the eurozone.

However, the Polish economy is likely to escape a recession thanks to continuous fiscal support, and should improve from 2024 onwards as inflation falls and the global economy recovers.

TOWARDS A DROP IN INFLATION

Similarly to several countries in Central Europe, Poland is still experiencing high inflation. It reached 18.4% year-on-year in February after an average of 14.4% over 2022. This rise in prices is primarily the consequence of the VAT rate on energy going back up to 23% on 1st January 2023. It was temporarily lowered to 8% in February 2022 until the end of December. By way of compensation, the authorities announced a tariff freeze on gas prices at 2022 levels for all households and public services, as is being done for electricity. In March, inflation fell slightly (+16.2%), according to preliminary estimates. As for core inflation, this is self-reinforcing due to high wage pressures.

The relative easing of agricultural and energy prices on global markets is an argument for a further drop in inflation. However, global droughts could create renewed tensions on agricultural commodity prices in the short term. All in all, inflation should remain in double digits this year

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-2.0	6.7	5.2	0.5	3.0
Inflation, CPI, year average, %	3.4	5.2	14.4	13.0	7.5
Gen. Gov. balance / GDP, %	-6.9	-1.8	-3.0	-4.9	-3.9
Gen. Gov. debt / GDP, %	57.1	53.8	48.5	47.6	46.9
Current account balance / GDP, %	2.4	-1.4	-3.1	-1.8	-1.9
External debt / GDP, %	60.7	56.6	51.0	46.2	45.0
Forex reserves, EUR bn	125.6	146.6	156.5	158.5	162.5
Forex reserves, in months of imports	5.9	5.6	4.7	5.2	5.5

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

POLAND: WAGES AND CPI GROWTH

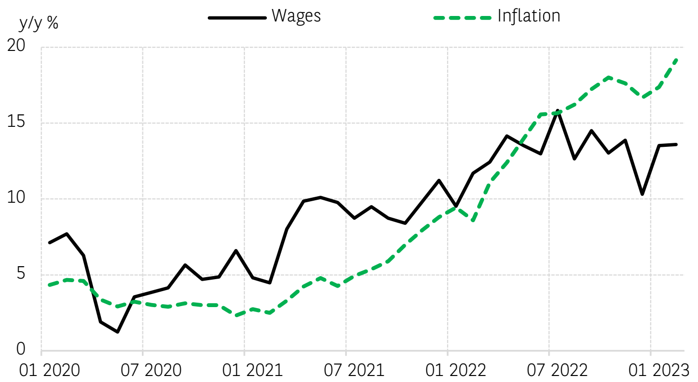

CHART 1 SOURCE: STATISTICS POLAND, BNP PARIBAS

and then gradually fall in 2024. It is unlikely to return to the Central Bank's target range of 1.5-3.5% by 2025.

Despite inflationary pressures, monetary policy has become less restrictive. After raising the key rate by 450 basis points over the first 9 months of 2022, the Central Bank of Poland has since maintained a monetary status quo. The latest release does not provide signals about the future approach to monetary policy, but concerns about growth seem to indicate the end of the monetary tightening cycle. Bearing in mind inflation levels, a less restrictive monetary policy alongside with uncertainties about the outcome of the general election, the zloty should a priori depreciate again this year after a limited drop of 2.6% against the euro in 2022. However, the central bank's likely intervention in the foreign exchange market will help to limit downward pressures. Since 1st January 2023, the zloty has remained more or less stable against the euro.

THE TEMPORARY BLOCKING OF EUROPEAN FUNDS IS MANAGEABLE

European funds, which constitute a significant source of funding, are still blocked by the EU as progress on judicial reforms is still deemed insufficient. These funds are estimated at EUR 35 billion under the recovery and resilience plan and EUR 76.5 billion under the 2021-2027 Budget.

However, the temporary absence of European funds does not present major concerns despite the deterioration of external and public accounts. The Polish economy should continue to show resilience given solid macroeconomic fundamentals and structural assets.

The country is an attractive destination for foreign direct investment (FDI), which constitutes a stable source of funding. In terms of volume, FDI stock received by Poland, at EUR 291.3 billion in Q3 2022, exceeds other Central European countries, although the situation is more mixed when compared to GDP. In 2022, net FDI flows in Poland even continued to rise to EUR 26 billion (4% of GDP) after reaching EUR 23.4 billion in 2021. Over the recent period, the influx of FDI can be explained by the relocation of production activity within Central European countries in the face of supply shocks linked to the Covid-19 crisis and protectionist measures implemented by the United States against China since 2018. FDI flows largely contributed in convering the current account deficit, representing EUR 19.5 billion over the same period.

The current account, which structurally has a negative balance, reached -3.1% of GDP in 2022, mainly due to the deterioration of the trade balance and primary incomes. Without the balance of services' surplus, the current account deficit would have been more pronounced. Nevertheless, external liquidity and solvency ratios are solid. Foreign exchange reserves were comfortable, at EUR 158.2 billion in February 2023, and the country even built up these reserves in 2022 (+EUR 9.9 billion). These reserves cover about 5 months of imports. Over the next two years, an improvement in the current account is to be expected due to a reduction in the energy and food bill. Similarly, the rebound in the global economy over this period should also contribute to the improvement in the current account.

In terms of public finances, fiscal consolidation was temporarily halted to mitigate the shocks faced by the economy since 2020. In 2022, the budget deficit, estimated at 3% of GDP, is less pronounced than expected, thanks in part to the good performance of tax revenues.

POLAND: CURRENT ACCOUNT BALANCE & FDI FLOWS

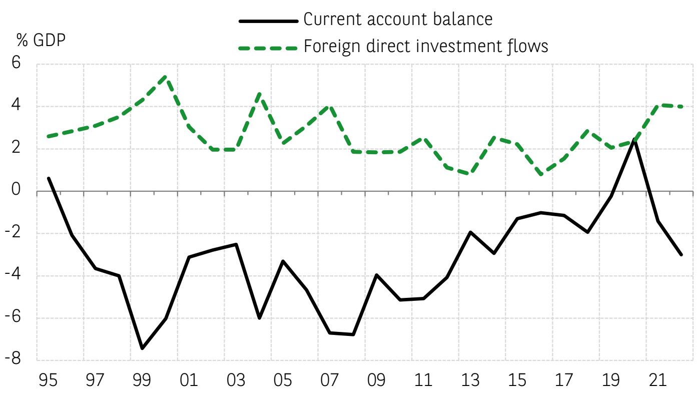

CHART 2

SOURCE: IMF, BNP PARIBAS

In 2023, the budget deficit is expected to be higher. The authorities are anticipating a deficit of around 4.5% of GDP in the 2023 Budget due to the extension of support measures for households, including amongst other things, energy subsidies and price freezes on certain foods. A strong increase in military spending is also expected. It is estimated to be in the region of 4% of GDP in 2023, compared to 2.4% in 2022. The electoral context, generally accompanied by generous measures, should also have a significant impact on public accounts.

The rise in the rate of government bonds does not raise any concerns in terms of the sustainability of public debt. Interest expense in relation to tax revenue remains very low at 6.9%. The majority of the debt already issued by the Polish authorities is at a fixed-rate (71.5% at the end of 2022) so that the apparent interest rate would only be progressively affected by the rise in bond yields. Only inflation-linked bonds and floating-rate bonds will be affected, but they only represent 28.5% of Government debt. It is to be reminded that the Government debt-to-GDP ratio estimated at 48.6% of GDP, is among the lowest in the European Union, and must not exceed 60% according to the Constitution.

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QUARRELS AT THE TOP

The Executive's calls for monetary authorities to lower rates are fuelling debates on the appropriate inflation target, the permanence of the Central Bank's independence and the right calibration for the policy mix. The opposition between both parties is weighing on inflation expectations due to uncertainty over the path of economic policy. To help create favourable conditions for monetary easing, the government has accelerated the presentation of its new fiscal framework. Following the downturn in activity in Q4 2022, the economy should temporarily return to growth in Q1 2023, driven by the strong performance of the agricultural sector. The deceleration - which began in the second half of 2022 - is however expected to resume its course for the remainder of the year. Local financial markets and the banking sector have been facing increased pressure on the back of rising investors' risk aversion and increasing credit risks exemplified by the bankruptcy of one of Brazil's largest retail players.

THE INFLATION TARGET DEBATE AND THE NEW FISCAL FRAMEWORK

Since Lula's inauguration last January, relations between the Executive and monetary authorities have crystallized the attention of both market participants and public opinion. The government has made multiple calls to ease monetary policy highlighting i/ the decline in real GDP at the end of 2022 (-0.2% q/q in Q4), ii/ waning confidence levels in services and industry, iii/ the high cost of disinflation (at 8%, real rates are about 4 times higher than potential growth) as well as the iv/ noticeable slowdown in credit since last June. The government is particularly concerned about the effects of tighter credit conditions on investment (-1.1% q/q in Q4). Maintaining Lula's social commitments depend indeed largely on the government's capacity to bolster growth in particular by reviving investment in infrastructure. To authorize rate cuts, the President and his allies defend the idea of raising inflation targets. The National Monetary Council (composed of the Finance Minister, the Minister of Planning, Budget and Management as well as the Central Bank's Governor) is due to meet in June to discuss the target for 2026. The President will also be able to appoint two members to the monetary policy committee (COPOM) next year.

For its part, the Central Bank (BCB), whose benchmark rate (SELIC) has remained unchanged since August 2022 (at 13.75%), has indicated that it will not consider rate cuts as long as observed inflation does not durably slow down and as long as medium-term inflation expectations are not anchored around the target. For the time being, inflation remains widespread, even if food inflation has been slowing down. In addition, headline inflation is expected to rise in the short term with the partial reinstatement of federal taxes on fuel (which could cause an increase of nearly half a percentage point of the CPI rate according to local bank estimates). The rise in energy prices, following OPEC's recent decision to cut production could also delay any near-term easing. The BCB is meanwhile not buying the argument of a credit crunch (it expects nominal credit to rise by 8.2% in 2023 compared to 14% in 2022; in real terms, the growth of credit is expected to be in line with the monetary cycle and the growth of the economy). In parallel, it has been monitoring the impact on inflation expectations and the yield curve of official statements and other measures announced by the executive. In recent months, both have been strongly affected by challenges to the Central Bank's independence, personal attacks against its Governor, calls to revise the inflation target, and the perceived lack of credibility of fiscal consolidation measures presented in early January.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-3,3	5,0	2,9	1,5	0,5
Inflation, CPI, year average, %	3,2	8,3	9,3	5,5	5,5
Fiscal balance / GDP, %	-13,3	-4,3	-5,3	-8,8	-9,5
Gross public debt / GDP, %	87	78	73	76	80
Current account balance / GDP, %	-1,9	-2,8	-2,9	-2,3	-2,0
External debt / GDP, %	44	42	39	41	43
Forex reserves, USD bn	356	362	324	335	340
Forex reserves, in months of imports	19	15	13	14	13

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

BRAZIL: GROWTH RATE OF CREDIT OPERATIONS (INFLATION-ADJUSTED)

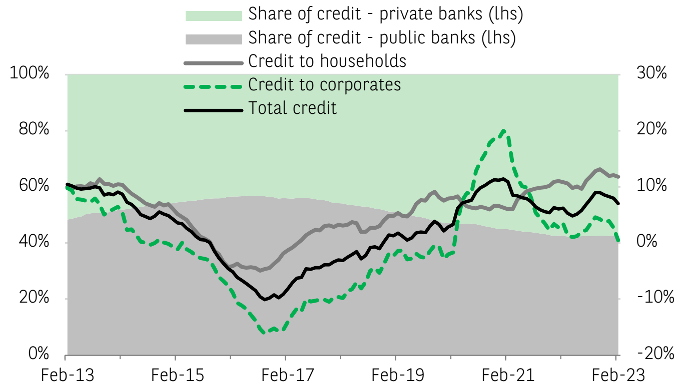

CHART 1 SOURCE: CENTRAL BANK OF BRAZIL, BNP PARIBAS

In an effort to create more favourable conditions for a prospective relaxation of monetary policy, the government accelerated the presentation of its proposal for a new fiscal framework (intended to replace the spending cap – the main fiscal rule introduced in 2016). The proposal provides i/ target ranges for the primary balance whereby the primary result would be reduced to zero in 2024 and have a surplus of 0.5% and 1% of GDP, respectively in 2025 and 2026, each time with a tolerance of +/- 0.25% of GDP and with the underlying objective of stabilizing the federal government's debt ratio at some 77% of GDP by 2026. The proposal also imposes ii/ constraints on expenditure growth (the extent of which will vary depending on compliance with the primary balance objective from the previous year but will, in any case, be less than revenue to enable a prospective consolidation of public accounts), iii/ to set up a minimum for public investment and iv/ to allow recourse to counter-cyclical measures in the event of a downturn.

This announcement was overall well received by market participants and rating agencies – however with the caveat that they will wait and see what measures will accompany these objectives to fully assess their credibility (the government is due to present a complementary plan in H2 to increase fiscal revenues). The role of quasi-fiscal actors as a central piece of the government's agenda remains, however, a point of concern. Public companies such as Petrobras and the development bank BNDES operate outside the fiscal rule but their actions can influence estimates of the neutral interest rate, an important tool for calibrating monetary policy.

AN EXPECTED DECELERATION OF ECONOMIC ACTIVITY

In the first quarter of 2023, the available indicators point to a temporary upturn in activity. The very strong agricultural production and the good performance of external trade should compensate for the declines observed in other sectors (slowdown in private consumption, decline in industrial production).

Despite favourable prospects in the agricultural sector[1] and household income holding up well[2], the deceleration that took hold in the second half of 2022 is expected to resume its course for the remainder of the year. Private consumption will be held back by i/ the partial elimination of tax exemptions on fuel and ethanol[3], ii/ the decline in job creations in the informal sector (especially in services), as well as by iii/ the slowdown of credit to households.

In January, arrears on revolving lines of credit cards reached 44% while non-performing loans on household credit reached 6.1% of total non-earmarked credit – its highest level since June 2016. The most fragile households have been experiencing payment difficulties for several months now because of the rise in interest rates and food inflation. To remedy this situation, the government has put in place tax exemptions and debt restructuring schemes for households living on less than two minimum wages per month.

On the supply side, highly credit-sensitive sectors such as retail or manufacturing are meanwhile expected to continue to slow down. The reopening of the Chinese economy, the revival of Lula's social housing programmes (which entails the construction of 2 million new homes by 2026) and the consumption of public services (an important growth driver in previous Workers' Party government) should help limit the slow down in growth.

BRAZIL: GOVERNMENT BONDS YIELDS VS INFLATION

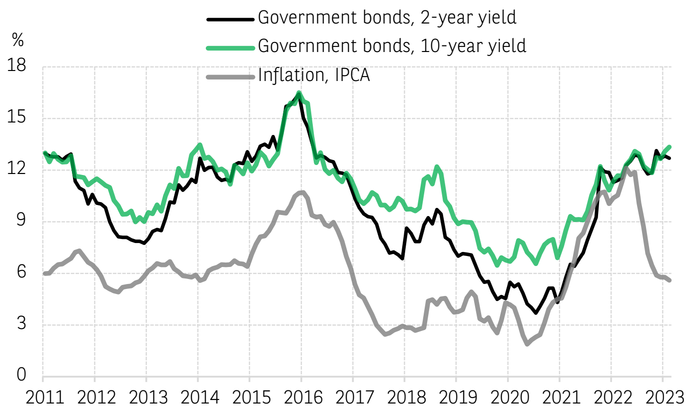

CHART 2 SOURCE: MACROBOND, IBGE, BNP PARIBAS

RISING INVESTORS' RISK AVERSION

In January, the filing for bankruptcy protection of one of Brazil's retail giants - Americanas[4] - sent major shockwaves to the corporate debt market and the banking sector. The episode temporarily halted the sale of local bonds, but also led to widening corporate spreads and fuelled an increase in bank provisions.

As a result, companies have had to cope with higher debt financing costs on the back of more expensive bond and bank debt. Given more difficult market conditions, the largest companies have, since February, increasingly turned to international capital markets for financing. This marked a reversal of the trend observed in 2022. With only USD 10bn in new offerings, 2022 was indeed the second least active year (after 2008) for Brazilian corporate debt issuances in the international market, according to Dealogic. The local market had, in contrast, a record year with bond issuances totaling BRL 271bn (USD 55bn) in 2022, according to Anbima.

In light of a more turbulent local environment (rising household and corporate credit risks, uncertain trajectory of economic policy, projected economic slowdown, etc.), foreign portfolio investors have reduced their allocations to Brazil. Non-residents have been net sellers in the stock market since the start of the year, reversing the trend observed since June 2022 (during which foreigners allocated about BRL 120bn, or USD 25bn, to the local stock market). These movements have been largely accentuated by the Fed's interest rate hike and the episodes of banking instability in the United States and Europe. The stress tests conducted by the BCB's Financial Stability Committee indicate nonetheless a high level of resilience of the Brazilian banking system to these shocks. Liquidity, provisioning and capital adequacy ratios remain well above minimum requirements.

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1 The National Agency for Agriculture (CONAB) forecasts record harvests of cereals and oilseeds this year, boosted by the increase in cultivated land and favourable weather conditions earlier in the year. Meanwhile, poor harvests in Argentina, Ukraine and the United States should also benefit exporters. Brazil is expected to become the world's lead exporter of corn and account for nearly 55% of soybean exports, according to the latest forecasts from the USDA.
2 Aided by the government's social transfers, the rise in the minimum wage, strong job creations in 2022 (about 3 mn) and due to wages still growing faster than inflation.
3 The exemptions for cooking gas and diesel were maintained until the end of the year, in particular to avoid a truckers' strike.
4 The Group filed for bankruptcy after disclosing a BRL 20bn hole (approx. USD 3.6 bn) on its balance sheet due to accounting inconsistencies. The company has been trying to renegotiate its debts for approximately USD 8.5 bn.

MEXICO

SEIZING THE RIGHT OPPORTUNITY

Economic growth should slow significantly in 2023. The relative resilience of private consumption will not be enough to offset the slowdown in external demand, particularly from the US. In addition, the investment outlook remains limited. In the medium term, the Mexican economy could benefit from the relocation of American companies, a trend recently accelerated by the disruption of value chains linked to the pandemic and trade tensions between China and the United States. To take full advantage of this, Mexico will need to restore investor confidence and meet its energy policy commitments.

SIGNIFICANT SLOWDOWN IN GROWTH

Real GDP grew by 3.1% in 2022 (after reaching 4.9% in 2021), which was higher than expected. Exports of manufactured goods remained dynamic despite an unfavourable external environment, and private consumption continued to rebound, buoyed by the improvement in the labour market and transfers of expatriate workers. Lastly, in Q4 2022, total investment was slightly higher than the pre-pandemic levels reached in Q4 2019. The significant increase in public investment is due to the government's desire to complete several of its flagship projects before the end of its mandate (end of 2024), such as the Dos Bocas refinery and the Tren Maya railway. That said, expressed as a percentage of GDP, total investment remains at just over 19%.

Although the data available (monthly activity index, exports, PMI index) for January and February remains positive, we expect a marked slowdown in growth to 1.0% in 2023. The slowdown in the US economy should cause a significant hit to the Mexican exporting sector and lead to a drop in remittances and tourism revenues. Net exports are expected to contribute negatively to growth in the first half of the year, contributing to a widening of the current account deficit. At the same time, persistent inflation and ongoing restrictive monetary policy should slow the recovery in private consumption and hit investment.

Persistence of inflation

Inflation rose continuously between mid-2021 and mid-2022, reaching 8.7% year-on-year in August and September last year. Total inflation and core inflation have fallen in recent months (to 7.6% and 8.3% year-on-year respectively in February), but both remain high. The drop in inflation is expected to continue in the coming months. However, inflation should remain above the Central Bank's inflation target (between 2% and 4%) throughout 2023. In addition, a survey conducted by the Central Bank showed that expectations regarding inflation remain high.

At its monetary policy meeting on 30 March, the Central Bank raised its main key rate for the fifteenth time since the tightening cycle began in June 2021, taking the rate to 11.25% (or a total of 725 basis points). According to the press release, inflation forecasts were only changed marginally for 2023 (the annual average should be slightly below 6% in 2023, whereas it was barely above 6% last September). However, the forecasts for 2024 and the medium term have not changed, and the press release emphasises that the conditions are now being met for the inflation rate to converge towards the target (3%) by the end of 2024. Unlike at previous meetings, future rate hikes are no longer being mentioned, suggesting that the tightening cycle is being paused, at least for the time being.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-8.1	4.9	3.1	1.0	0.3
Inflation, CPI, year average, %	3.4	5.7	7.9	6.2	5.0
Budget balance / GDP, %	-4.1	-3.8	-3.8	-4.1	-3.8
Public debt / GDP, %	50.8	47.8	48.5	49.5	51.0
Current account balance / GDP, %	2.4	-0.4	-1.2	-1.0	-0.9
External debt / GDP, %	43.1	35.7	31.7	30.4	30.1
Forex reserves, USD bn	195.0	202.4	201.0	209.0	210.0
Forex reserves, in months of imports	5.3	5.1	4.8	4.1	4.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MEXICO: INFLATION AND POLICY RATE

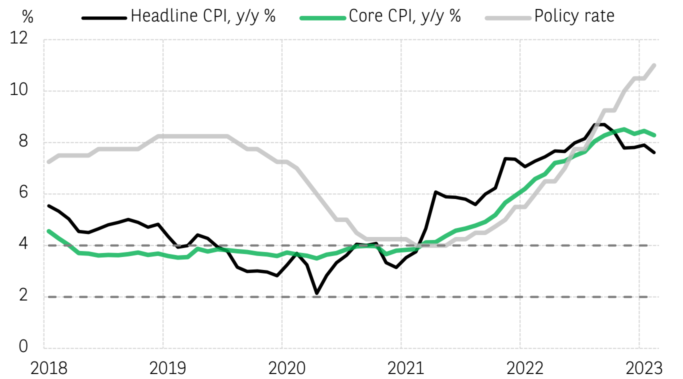

CHART 1 SOURCE: CENTRAL BANK

A DRAMATIC YEAR IN ON THE POLITICAL FRONT

The political climate could remain tense until the next elections in July 2024. Last February, Congress passed an electoral reform of the National Electoral Institute (INE), the body responsible for organising elections. Sought by President Andres Manuel Lopes Obrador (AMLO) who considered the INE to be 'partisan', this reform includes a drastic reduction in its budget, involving a reduction in staff and the closure of many polling stations.

The passing of this reform has led to several large-scale popular protests, with opponents saying there is a risk of elections being manipulated by the government. The reform was suspended by the Supreme Court on 18 March, but the government announced that it would be filing an appeal.

Although President AMLO is still very popular, five years after coming into power, the strength of opposition to this reform has shaken his popularity. However, the President's party, Morena, remains for the time being the favourite for the next general and presidential elections in 2024 (constitutionally, President AMLO is not authorised to run for a second consecutive term). In the coming months, the focus will be on the candidate chosen by the Morena Party, and the relative strength of opposition parties.

The two main candidates to represent the Morena Party are currently Claudia Sheinbaum (Head of Government of Mexico City and President AMLO's favourite, with a political agenda even more radical than the current government's), and the Minister of Foreign Affairs, Marcelo Ebrard, whose ambition is to pursue a more centrist policy, drawing on the country's middle class. The party candidate should be nominated through opinion polls, which could create tension within the party.

Against this backdrop, the local elections for the governors of the States of Mexico City and Coahuila, scheduled for June, are highly anticipated. Although the results are unlikely to have a significant impact on domestic policy, they will give an indication of which way the wind is blowing in political terms for the coming year, and will in particular help weigh up the strength of the opposition parties against the President's party.

SEIZING THE RIGHT OPPORTUNITY

In the medium term, the growth outlook remains mixed. Although the economy has returned to its pre-pandemic level, the gap with the 2015-2019 trajectory is wider for Mexico than for its peers. The government's decision to implement an austerity policy as soon as it came into power in 2018 (including in 2020-2021) has, admittedly, helped it curb the public deficit during its term of office and limit the increase in public debt. However, the drop in productivity caused by the fall in public investment (particularly in infrastructure), the lack of support for the economy in 2020-2021 and the deterioration in the business climate and investor confidence since AMLO was elected have all contributed to reducing potential growth (estimated at 2%, whereas it was close to 2.5% before the crisis).

As a result, the Mexican economy may not be able to take full advantage of the opportunities created by the disruptions and shortages that have spurred many countries to reorganise their value chains. This phenomenon was emphasised in the US by trade tensions with China, and Mexico is a natural candidate for the relocation of American companies, i.e., the transfer of supply chains closer to the target country (nearshoring).

Beyond the geographical situation, several factors look very favourable in Mexico. Both countries are members of the USMCA, the free trade agreement between Mexico, the United States and Canada, in force since 1 July 2020, both economies are highly integrated, and Mexican wages are competitive.

MEXICO: US CONTRIBUTION TO TOTAL EXPORT GROWTH (3MMA, Y/Y %)

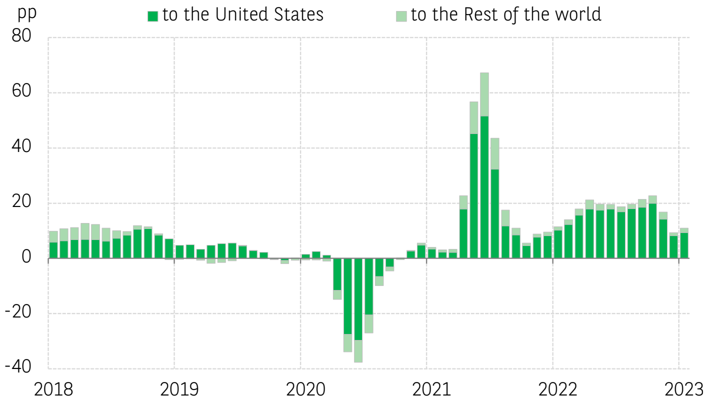

CHART 2

SOURCE: CENTRAL BANK

For the time being, however, not much nearshoring towards Mexico can be seen in the data. It could be curbed or even hampered by Mexican energy policy, which continues to promote and generously fund the national oil company PEMEX. At the same time, the United States and Canada have committed to ambitious energy transition policies to reduce their greenhouse gas emissions by 2030, and achieve carbon neutrality by 2050.

However, there are some positive signs: during the North American Leaders' Summit last January, Mexico undertook, with its two partners, to reduce methane emissions and develop a clean hydrogen market in North America, in particular. The three countries also reaffirmed their desire to strengthen value chains (particularly in the automotive industry, including the production of 'clean' vehicles). PEMEX also announced in mid-March that it intends to improve its ESG policy from H2 2023 onwards. Against this backdrop, the energy policy of the next government and the decisions taken regarding the ongoing reform of the sector (the current government wants to restrict participation of private, domestic and foreign investors in the energy sector as much as possible) will be key.

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ARGENTINA

HERE WE GO AGAIN

Argentina's economy is in turmoil. Since Q4 2022, it has been mired in a recession that is bound to extend at least through H1 2023. The farm sector has been plagued by misfortune: for the third consecutive year it has been hit by drought – whose intensity has been compounded by climate change – and an outbreak of avian influenza. Inflation has soared, forcing the central bank to tighten monetary policy. Despite fiscal efforts, the balance of payments and foreign reserves are coming under increasingly fierce pressures, even with IMF support. The government has rolled out a series of measures to avoid wasting foreign reserves and defaulting on its external debt with official creditors. It has also had to offer a proposal to reschedule domestic debt in the local currency.

Argentina's already precarious economic situation has deteriorated significantly in recent months. Economic activity contracted and inflation has soared, forcing the BCRA, Argentina's central bank, to raise its key rates significantly. At the same time, the trade surplus shrank even though soybean prices were still holding at high levels, and the central bank had to proceed with net currency sales to the private sector, reducing the already low level of foreign reserves. The IMF continued to provide financial support in accordance with the Extended Facility Fund (EFF) concluded in March 2022. Yet, Economy Minister Sergio Massa still had to resort to two sovereign debt buyback operations to reduce this year's debt repayments. With the approach of primary elections in August and then the presidential election in October, the situation seems alarmingly similar to the one in 2019, when the Macri government, following the outcome of the primary elections, was forced to suspend the payment of Treasury notes and to ask for the restructuring of domestic and external sovereign bonds.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-9.9	8.0	5.5	-3.0	-2.5
Inflation (official), annual average, %	42.0	48.4	77.6	100.5	113.0
Fiscal balance/ GDP, %	-8.9	-5.0	-4.0	-4.1	-3.7
Public debt / GDP, %	104.3	80.9	83.2	77.0	75.0
Current account balance / GDP, %	0.9	1.4	-0.3	1.5	1.0
External debt / GDP, %	69.9	59.2	58.4	50.7	50.3
Forex reserves, USD bn	39.4	39.6	44.6	46.2	52.9
Forex reserves, in months of imports	9.1	7.2	7.6	7.5	8.0

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TOWARDS A HARD LANDING

Argentina's economy held up fairly well in the first 9 months of 2022, with total GDP up 6.5% compared to the same period in 2021, despite a 2.5% decline in farm sector value added, which accounts for 7% of GDP. Growth was driven by domestic demand (including investment), which fuelled activity in construction and services. Given the simultaneous increase in imports, net external demand made a sharply negative contribution (-2.7%), even though exports were robust. At the same time, inflation accelerated rapidly, rising from a monthly average of 3.7% in 2021 to nearly 7% in Q3 2022. But employees benefited from a wage catching-up effect, and employment was on the rise.

In Q4 2022, the economy unfortunately ran out of steam. GDP was down 1.5% compared to the previous quarter. Industrial production stagnated after contracting in Q3, and the construction sector also slumped. After holding to a monthly rate of 5.8% between October 2022 and February 2023, inflation peaked at 102.5% in February, eroding private consumption (-1.5% in Q4) and household confidence. After surging over the summer months, household confidence fell back to levels that were barely above pre-Covid figures. Exports were the only factor that rebounded, but that was after bottoming out in Q3. Actually, exports were also losing momentum.

Argentina's economy will not escape recession this year. The drought and water stress during the last months of the austral summer season will trigger a dramatic drop-off in farm production (down 21% for soybeans, 45% for wheat and 11% for maize). *La Nina* undoubtedly had its effect on rainfall, but climate change is also to blame, the only factor that explains the persistence of the drought (the third consecutive year) and this year's exceptional intensity. The farm sector is also

ARGENTINA: ACTIVITY INDICATORS

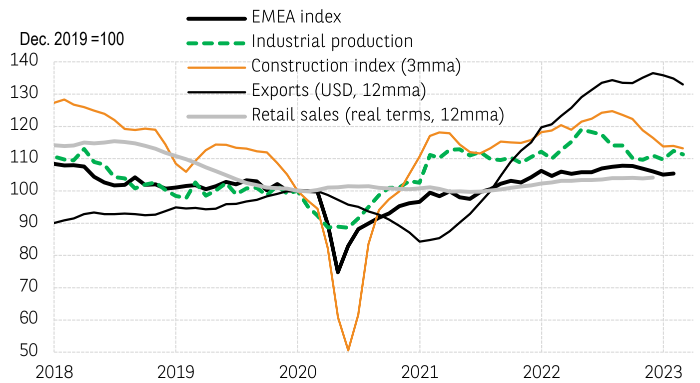

CHART 1

SOURCE: INDEC, BNP PARIBAS

having to face up to an outbreak of avian influenza since mid-February 2023.

Taking solely into account the three biggest crops, the farm sector's negative contribution can be roughly estimated at 1.5 percentage points of GDP at the least. At the same time, non-farm GDP will be hit by the slowdown in world growth, the erosion of household purchasing power in Argentina and the rise in domestic interest rates. The BCRA raised its key central bank rate from 38% in early 2022 to 78% on 27 March 2023. All in all, total GDP could contract by 3%, while inflation barely levels off at an average annual rate of 100%, or a monthly inflation rate of between 5% and 6%. Price inflation will remain very high despite the recession because of expectations of currency depreciation, which is likely to hold at the current pace (-5.3% a month against the USD since the beginning of the year, compared to -4.4% in 2022) as long as the balance of payments remains under fierce pressure.

FOREIGN RESERVES UNDER PRESSURE

Despite currency controls, the central bank's reserves are eroding, from USD 44.6bn at year-end 2022 to USD37.6 bn at 31 March 2023. The cumulative 12-month current account balance swung into a deficit in Q3 2022 as the trade surplus narrowed sharply (from USD 14bn at year-end 2022 to USD 5.4bn in February 2023, according to customs data). In addition, non-resident capital outflows picked up again recently, after the BCRA sold a little more than USD2 bn to the private sector since the beginning of the year. The surplus demand for dollars is showing no signs of abating, with the spread between the blue chip swap rate and the official exchange rate holding at 90%.

The favourable conclusion of the fourth review of the EFF arrangement will pave the way for the disbursement of the equivalent of USD 5.3bn. Yet over half of this amount will be used to repay international financial institutions, primarily the IMF. The rebuilding of foreign reserves will be temporary at best, even if imports were to contract. Prices for the main grains are trending downwards, while export volumes will decline due to smaller harvests. The economists at JP Morgan estimate the decline in exports of the three main crops at USD 15bn in value terms, or 2.4% of GDP.

To try to reduce the surplus demand for dollars reflected in the persistently high spread between the parallel and official exchange rates, in mid-March the government announced that it would require public institutions to: 1/sell certain domestic-law foreign-currency bonds to the Treasury, and to use 70% of the proceeds to purchase long-term bonds denominated in pesos (for an estimated total of USD 15bn) and 2/to exchange their international bonds into domestic bonds in pesos, whose pay-out would be indexed either to inflation or forex trends at maturity.

These measures are a way for the government to make advanced payments on the Treasury's upcoming debt servicing needs in foreign currency without dipping into the foreign reserve. In January, Sergio Massa already announced that the BCRA would purchase USD 1bn in sovereign debt securities denominated in foreign currency on the Treasury's behalf. Although following each review of the EFF arrangement, the IMF refinances the amounts that the Argentina must reimburse quarterly, the economy minister is seeking to avoid wasting foreign reserves and to respect the IMF targets set for the end of each quarter. So far, however, we can see that the Argentine authorities have had to painfully claw back all of the ground that was quasi-systematically lost after each review. Note that Argentina's foreign currency sovereign debt repayments (international bonds and loans + domestic debt in foreign currencies) amount to USD 35bn in 2023.

FISCAL EFFORTS ARE NOT ENOUGH

In addition to the squeeze on external liquidity, Argentina is also having trouble rolling over domestic debt in pesos. The cumulative 12-month primary deficit was still small at 2.2% of GDP through February 2023

ARGENTINA: EXCHANGE RATE AND OFFICIAL FX RESERVES

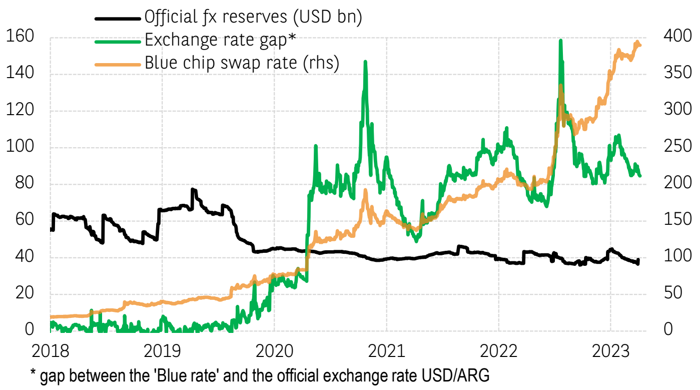

CHART 2 SOURCE: BCRA, BNP PARIBAS

(4.3% for the total deficit), thanks to fiscal efforts. Primary spending was cut from 29% of GDP at year-end 2021 to 27% at year-end 2022. In January-February, however, the primary deficit swelled to 0.3% of GDP, which is already above the IMF's Q1 2023 target.

On 9 March, Sergio Massa offered public and private creditors the possibility of exchanging peso-denominated debt securities maturing through Q2 2023 for new notes due in 2024 and 2025. Second-quarter maturities indeed amounted to 5% of GDP, a little less than half of the full-year total. The participation rate was very disappointing at only 57.3%. Although the operation helps ease the domestic debt servicing charge by the equivalent of 2.6% of GDP, the participation rate of private creditors was very low. Moreover, domestic debt securities indexed either to the exchange rate or inflation now account for 93% of total domestic debt. Private creditors clearly felt that indexation guarantees were insufficient for them to accept the risk of further debt restructuring. At the same time, sterilisation costs for the central bank soared from 3% of GDP at year-end 2021 to nearly 8% at year-end 2022, despite the halting of direct central bank advances to the Treasury (i.e. direct monetary financing of the budget deficit) since August 2022, and the absence of net financing flows from the rest of the world. In case of domestic debt restructuring, the banking sector will be the first to be hit since public securities (excluding Leliq and Noliq, the BCRA's sterilisation instruments) account for 23% of the sector's total assets.

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SAUDI ARABIA

INVESTMENT IS DRIVING GROWTH

Oil production feeds growth volatility in Saudi Arabia, as evidenced by the slowdown expected this year. Nevertheless, the non-oil economy is benefiting from the momentum of investment and household consumption against a backdrop of gradual transformation of the economy and the labour market. State intervention and a favourable exchange rate effect are keeping inflation at moderate levels. Against this favourable economic backdrop, bank lending to the private sector is very dynamic, creating some strain on bank liquidity. The budget surplus posted in 2022 is not likely to be repeated this year due to the expected downturn in oil production and prices. However, public finances are on a positive trajectory thanks to the increase in non-oil revenues.

NON-OIL GROWTH BUOYED BY INVESTMENT

Economic growth was strong in 2022 (8.7%), buoyed primarily by the increase in oil production. Oil GDP rose by 15% in real terms, linked to the increase in OPEC+ production quotas (OPEC and Russia) in the first part of the year. On their part, non-oil sectors benefited from sustained household consumption, and above all from very strong growth in investment (+24% YoY, i.e., the strongest increase in 22 years). Investment is benefiting from the programme for massive investment in infrastructure and new cities, initiated by the government's economic reform programme (Vision 2030). While the central government's contribution to investment has decreased, the public sector contribution remains predominant via the Public Investment Fund (PIF) and the National Development Fund (NDF). This public impetus is necessitated by the weakness of foreign direct investment (FDI). Over the last five years (excluding 2021 due to an exceptional operation), inward FDI was equivalent to 0.5% of GDP on average, which is not enough to make a meaningful contribution to the Kingdom's economic transition.

From a sector-based point of view, manufacturing activity (12% of total GDP) is sustained (+7.9% YoY), but partly depends on oil refining. Trends in services are showing sharp contrasts and making less progress than in 2021. The Saudi economy is currently in a transitional situation that is limiting non-oil GDP growth. As a result, the impact of public spending on business is relatively lower than before, due to a more prudent budgetary policy less linked to variations in oil revenues. Furthermore, the massive investment programme aimed at diversifying the economy (in services, the manufacturing sector and also decarbonised energies) is currently underway, and is not yet having a significant impact on the sector-based composition of GDP.

SHARP ECONOMIC SLOWDOWN IN 2023

Economic growth is expected to slow in 2023 due to the oil market outlook. OPEC+ member countries are currently adopting a cautious production policy due to uncertainties over short-term oil demand. While there is consensus to forecast an increase in global oil demand in 2023, particularly due to the economic recovery in China, uncertainties regarding European and American demand make the timing of this recovery difficult to predict. Against this backdrop, OPEC+ members have decided to reduce their oil production over 2023. Given its leading role in OPEC+ policy, Saudi Arabia is contributing the most to this revision of quotas, with a production cut of 0.5 mb/d to reach the new quota of 9.98 mb/d. Saudi oil GDP can therefore be expected to fall this year. Against this backdrop, non-oil sectors will be the drivers of growth, buoyed by investment and sustained household consumption in a context of moderate inflation, but constrained by the tightening of monetary conditions. Overall, GDP growth is expected to reach 1% this year.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-4.3	3.9	8.7	1.0	2.9
Inflation, CPI, year average, %	3.4	3.1	2.5	2.0	1.9
Central. Gov. balance / GDP (%)	-10.7	-2.3	2.5	-1.8	-2.4
Central. Gov. debt / GDP (%)	31	29	24	27	28
Current account balance / GDP (%)	-3.1	5.1	14.4	7.3	5.5
External debt / GDP (%)	30	37	30	31	31
Forex reserves (USD bn)	454	456	460	480	490
Forex reserves, in months of imports	30	27	26	22	21

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SAUDI ARABIA: CONTRIBUTIONS TO GDP GROWTH

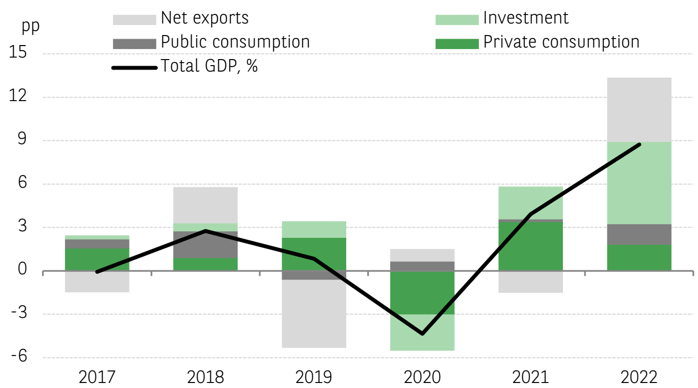

CHART 1

SOURCE: GENERAL AUTHORITY FOR STATISTICS, BNP PARIBAS

In the medium term, Saudi growth should be sustained and relatively less volatile thanks to a gradual disconnection from the oil economy. This can be seen in recent labour market developments which show a steady increase in employment among Saudi nationals, irrespective of developments in the oil market. The Saudi labour force participation rate has risen by 10 points over the last five years to 52% at the end of 2022. The labour force participation rate for women more than doubled during this period, reaching 36%.

STABILISATION OF INFLATION AT MODERATE LEVELS

Consumer price inflation slowed in 2022 (2.5% on average compared to 3.1% in 2021), well below the average seen in all emerging countries (9.2% on average). Since mid-2022, the housing component of the inflation basket (21% of the total) has been the main driver of price increases. Controlling the prices of certain food items and energy, along with appreciation of the dollar (to which the rial is pegged) for some of 2022 were factors in moderating inflationary pressures. In 2023, the housing component should continue to rise, while food prices seem to have been falling since the end of 2022. We expect inflation to stabilise at 2.4% on average.

SLOWDOWN IN BANK LENDING

The rial peg to the US dollar means that the Saudi central bank must follow the Fed's monetary policy decisions. The central bank therefore increased its main rate by 350 bps in 2022 to 4.5%. This monetary tightening should continue during the first half of 2023, contributing to the slowdown in credit growth.

Growth in credit to the private sector has been strong since mid-2020, but has started to slow since Q4 2022 (to 11% in February 2023). This period of sustained growth may have created some tensions on domestic liquidity during 2022 due in particular to the drop in government deposits. This resulted in a widening of the spread between the interbank rate and the central bank's interest rate corridor. Government deposits have recovered since the end of 2022 and are currently 29% of total deposits (after a low of 23% in Q1 2022). Contrary to previous periods, the sharp rise in oil revenues in 2022 resulted in the continued high level of bank lending to the public sector (around 22% of total bank lending over the year) and periods of falling government deposits at banks.

In this environment characterised by the strong growth in credit to the private sector and moderate growth in total deposits, bank liquidity is becoming more strained and the loan-to-deposit ratio of the entire banking system reached 104% last February (compared to 86% at the end of 2019). Nevertheless, prudential liquidity metrics remained relatively stable. The percentage of liquid assets in proportion to total assets was 23% at the end of 2022, compared to 25% in 2021. In the short term, investment policy should remain an important driver of credit growth. Nevertheless, rising interest rates and a slowdown in household mortgage loans should contribute to a slowdown in credit growth.

BUDGET DEFICITS CONTAINED IN THE SHORT TERM

The high level of oil income in 2022 has helped the government post its first budget surplus (2.5% of GDP) since 2013. Oil revenues account for the majority of fiscal revenues (62% of total on average since 2018), but VAT revenues accounted for a significant proportion of the budget. They were equivalent to 20% of total revenues in 2022, compared to less than 5% in 2016. This diversification of revenues reduces the fiscal vulnerability to oil prices. With regard to spending, the government continues to adopt a fairly cautious policy, as the favourable oil market has not resulted in a sharp increase in spending. Spending was equivalent to 27% of GDP, compared to 32% the previous year. Capital expenditure increased by 22% but remained at a historically low level: 7.4% of non-oil GDP on average since 2018, compared to 13% on average over the previous five years.

SAUDI ARABIA: COMMERCIAL BANKS BALANCE SHEET, MAIN ITEMS

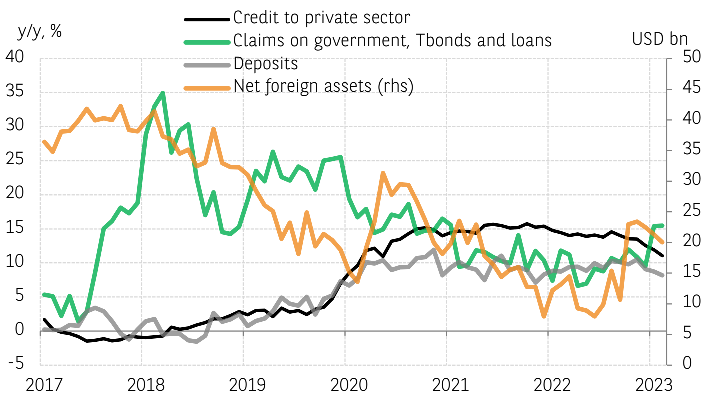

CHART 2 SOURCE: SAUDI CENTRAL BANK, BNP PARIBAS

For several years, a significant proportion of public investment has been implemented by the PIF and the NDF, which have their own resources.

Even though the government continues to keep budgetary spending under control and even though there is progress in diversification of government revenues, public accounts should post a deficit in 2023 and 2024 (1.8% and 2.3% of GDP respectively) according to our oil price and production forecasts. Against this backdrop, government debt should rise again moderately and reach 28% of GDP in 2024. Nevertheless, the government's solvency remains satisfactory, since the government's assets with the central bank (a priori the most liquid) are equivalent to 18% of GDP and the PIF's assets are over 50% of GDP. Furthermore, risk premiums on the international bond market are low, below 70 bps since the beginning of the year.

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EGYPT

BUYING TIME

The crisis is taking hold in Egypt, as evidenced by the deterioration in all macroeconomic indicators. Activity is slowing down against a backdrop of high inflation, caused in particular by the depreciation of the exchange rate. The balance of payments crisis has been endemic for a year, and the international support plan initiated by the IMF has not allowed any reduction in tensions regarding foreign currency liquidity. Despite the sharp rise in nominal rates on government securities, international investors remain cautious due to the very high level of inflation and expectations of currency depreciation. The external financing requirement will remain high for at least two years, with the privatisation programme only providing partial relief. Furthermore, international support has become increasingly conditional and has left government with little room for manoeuvre. In the very short term, excluding a debt repayment delay, the strategy can only be to maintain a primary surplus and very strict monetary policy despite the slowdown in growth, in order to restore portfolio investors' confidence and avoid a sharp balance of payments crisis.

STRONG INFLATIONARY PRESSURE

The Egyptian economy is currently in the midst of some turbulence, with a very uncertain outlook.. The fiscal year 2023 should be marked by a slowdown in economic activity (with 4% expected at best, compared to 6.6% the previous year) and by accelerating inflationary pressures. The drop in household purchasing power and the slowdown in some major infrastructure programmes are further reducing the prospects for growth in the short term. Inflation has showed little sign of slowing down (+33% year-on-year in March 2023) and should remain very high in the short term. On the contrary, emerging countries should see inflationary pressures ease this year (from 9.2% on average in 2022 to 7.1% in 2023). Indeed, even though the fall in commodity prices since mid-2022 has had a favourable effect in a country highly dependent on food product imports, the sharp depreciation of the pound over the past year (around 50%) will continue to fuel inflation. In 2023 (civil year), it should reach 31.5% on average compared to 13.8% in 2022.

THE BALANCE OF PAYMENTS CRISIS PERSISTS

Despite the expected reduction in the current account deficit, the financial support from international financial institutions, the cautious return of portfolio investments at the beginning of 2023 and financial support from Gulf states (rollovering their deposits at the Central Bank of Egypt when the IMF's new financing was agreed), foreign currency liquidity remains under pressure. The Central Bank's foreign exchange reserves have risen very moderately since the turn of the year (USD 37bn in February 2023, including Tier 2 reserves, i.e. less than four months of goods and services imports), while the net external position of commercial banks has once again deteriorated sharply, with banks' net external debt, of which approximately 40% is short-term, having reached USD 13.9 billion in February. This is close to the highest levels reached in Q4 2022 (USD 16.5bn). The causes of this crisis are known: a significant external financing need (current account deficit and amortisation of external debt) and volatile and more uncertain foreign currency resources.

The current account deficit is expected to decrease to around USD 13.5bn in fiscal year 2023 thanks to support from hydrocarbon exports, the increase in revenue from the Suez Canal, and restrictions on imports.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	3.5	3.3	6.6	4.0	4.0
Inflation, CPI, year average, %	5.7	4.5	8.5	24.4	21.6
Central. Gov. balance / GDP, %	-7.5	-7.0	-6.0	-8.3	-8.7
Central. Gov. debt / GDP, %	86	90	89	92	90
Current account balance / GDP, %	-2.9	-4.4	-3.5	-3.3	-2.7
External debt / GDP, %	32	33	37	40	38
Forex reserves (excl. gold), USD bn	38	41	33	35	38
Forex reserves, in months of imports	6.1	6.0	3.9	3.9	4.0

TABLE 1

(1) FISCAL YEAR FROM JULY 1ST OF YEAR N TO JUNE 30 OF YEAR N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: CPI INFLATION

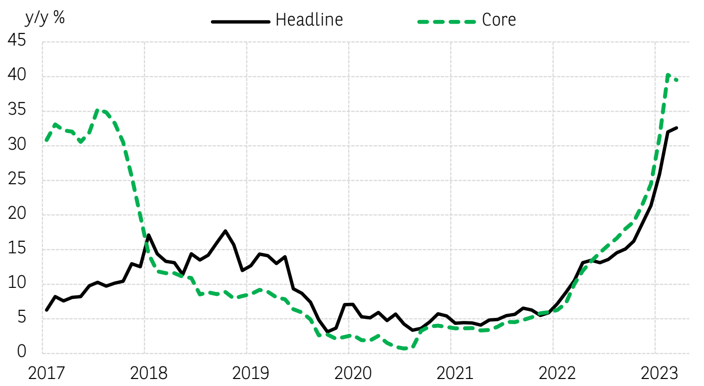

CHART 1

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

In terms of financing sources, the announcement of the IMF's USD 3bn support plan last October did not triggered an inflow of bilateral and private financing, as was the case in 2016-2017. Support from the Gulf states remains significant, but has taken the form of targeted investments (even though deposits at the Central Bank were still made in 2022). In addition, the payment of these investments depends on the timing of the public assets sales, which remains relatively uncertain despite the government's intention to do so. Portfolio investment flows (mainly treasury bills in local currency) have returned (USD 11bn in January compared to a low of USD 6.5bn last October). They remain potentially highly volatile due to negative real rates on all treasury securities maturities and the persistence of a short-term currency depreciation risk. According to data from the Cairo Stock Exchange (including the equity and bond markets), foreign investors were net sellers of securities in February and March. Futures markets continue to expect a fall in the pound in the short term (around 25% at 12-month maturity on the Egyptian pound offshore market). More generally, sovereign risk is considered very high by the markets. The risk premium on international sovereign bonds currently stands at 1,300 bps and has averaged 1,000 bps for the past year.

FOREIGN CURRENCY LIQUIDITY UNDER PRESSURE UNTIL 2025

The need for foreign currency financing will remain significant for at least the next two years. The current account deficit should stabilise at around USD 12bn, but the amortization of foreign currency debt should continue to increase until 2025. In fiscal year 2025, the IMF expects the external financing need to reach around USD 30bn a year. Even if Egypt regains access to the international bond market on acceptable terms, the use of external debt should remain limited in order to contain foreign currency debt servicing. Since 2015, external debt servicing as a percentage of current account income has increased fivefold to 25% in 2022. Portfolio flows could pick up again, but only at the cost of falling inflation and uncertainties weighing on the exchange rate. Given the structural constraints limiting the growth of foreign direct investment in the short term, the authorities are implementing a privatisation plan aimed at attracting foreign capital in particular.

At the beginning of this year, the government announced the opening of the capital of at least thirty public companies, either through investment with strategic investors or by introduction on the local equity market. The government hopes to raise USD 40 bn by 2026, but in the short term, the expected revenue will be limited to around USD 5bn, i.e. less than 1.5% of GDP forecast in 2023. Like portfolio investments, privatisations are subject to economic and political uncertainties.

DETERIORATING PUBLIC FINANCES

Against this deteriorating economic backdrop, the budget deficit should increase this year to around 8% of GDP, which will mark the end of six consecutive years of reducing the deficit. The main driver will be the significant rise in the debt service (interest only). This increased by 36% in the first half of the fiscal year, while the increase in current expenditure remained contained. In total, budgetary expenditure increased by 20% over the period, while the increase in revenue was 15%. Against a backdrop of deteriorating household living conditions, current expenditure should accelerate in the second half of this fiscal year. The government announced a 15% increase in salaries and pensions for employees in the public sector (around 18% of total budget spending) from April onwards, as well as an increase in allowances for the Takaful and Karama social programmes. The primary balance (excluding payment of interest on government debt) should nevertheless remain positive and reach around 1% of GDP in 2023.

EGYPT: NET FOREIGN ASSETS OF THE BANKING SYSTEM AND PORTFOLIO FLOWS

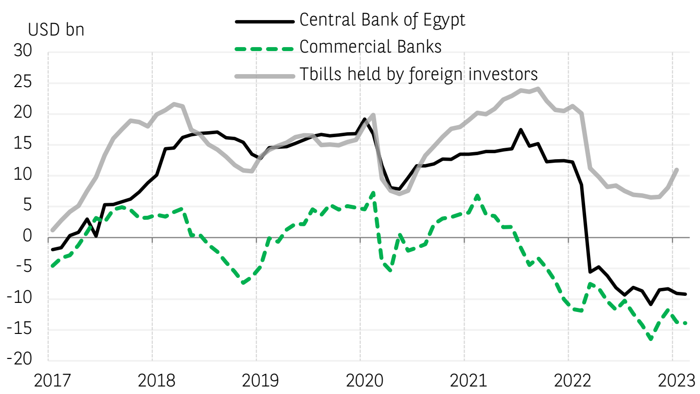

CHART 2 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

The debt service burden should continue to grow markedly with the transmission of part of the central bank's key interest rate hike (1,000 bps since the beginning of 2022) to yields offered on local currency debt issuances. Indeed, since the beginning of 2022, around 80% of the debt issued by the government has been in local currency on maturities of one year or less. During this period, the one-year treasury bill issue rate (the largest issue volume) rose from 13.2% to 21.8%. Furthermore, the very high level of risk premiums on the foreign currency bond issuances market (around 1,000 bps) closed off this market's access to the Egyptian government. Against this backdrop, the debt service as a percentage of income should rise again to reach more than 50%. This level, one of the highest among emerging countries, significantly reduces the government's leeway.

Government debt is expected to reach 92% of GDP at the end of the 2023 fiscal year, before falling back to 90% of GDP in 2024 if the government is able to maintain a primary budget surplus. Indeed, the implementation of the privatisation plan should not significantly reduce the debt ratio.

In the short term, the state's solvency clearly depends on fiscal execution, but also on the Central Bank's ability to preserve its foreign currency reserves and reduce foreign exchange pressure. Monetary easing is therefore not yet an option to ease the public debt burden.

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ALGERIA

WINDFALL EFFECT

The Algerian economy has enjoyed almost unprecedented favourable conditions for a decade. 2022 saw twin surpluses return thanks to soaring global hydrocarbon prices and a lower than expected fiscal support. Despite the fragile international environment, the outlook for 2023 is positive and macroeconomic risks are limited. Nevertheless, the persistently high inflation poses a risk that must be monitored. Above all, soaring public spending planned in the budget could contribute to further medium-term macroeconomic imbalances, without providing a major boost to economic activity, however.

EXTERNAL ACCOUNTS: BACK INTO SURPLUS

The rebalancing of external accounts that began in 2021 accelerated significantly last year. Over the first nine months of 2022, Algeria ran a current account surplus of more than USD 10 billion, compared to the deficit of USD 4.8 billion in 2021. At a time of high energy demand from Europe, hydrocarbon exports rose to USD 43.2 billion from USD 24.1 billion over the same period in 2021. This strong performance has been mainly fuelled by soaring global oil and gas prices. Hydrocarbon export volumes were down 4% year-on-year over the first nine months of 2022. This was due to the fall in gas exports by more than 10% (both pipeline and liquefied natural gas), whereas oil exports grew by 7%. Export growth momentum seemingly increased further during the past quarter: according to the national hydrocarbon company Sonatrach, oil and gas exports totalled USD 60 billion over 2022, a figure that Algeria had not hit since 2013/2014.

The non-hydrocarbon export performance was also solid, with a 43% year-on-year increase over the first nine months of 2022. They stood at USD 4.4 billion over this period, meaning that the USD 7 billion target for the whole year should be achieved. By contrast, they were only USD 2 billion in 2019. Even though this non-hydrocarbon export figure is still low, non-hydrocarbon exports now account for 10% of total exports, more than double the pre-pandemic figure.

More surprisingly, import value growth remained at just 3% over the first nine months of 2022. The 20% rise in food and raw material imports was offset by the fall in industrial capital goods imports. In addition to the measures to reduce imports that have been introduced in recent years, the monetary authorities have sought to limit the impact of the rising global commodity prices on imports through the appreciation of the Algerian dinar (DZD). The nominal effective exchange rate rose by 6.6% in 2022, driven largely by the appreciation of the DZD against the euro (more than half of Algerian imports come from Europe). However, this is not the only reason. In fact, capital good imports fell below the USD 4 billion mark over the first nine months of 2022, vs. USD 6.3 billion in 2019, which is also a clear reflection of the currently sluggish state of the economy and weak dynamism of investment.

In the end, with a current account surplus of close to 8% of GDP during 2022, Algeria was able to accumulate FX reserves, for the first time in nearly a decade (Chart 1). After bottoming out at USD 46.6 billion at the end of 2021, FX reserves now exceed USD 60 billion, which is equivalent to more than 15 months of goods and services imports. Even though reserves are still nowhere near their USD 195 billion peak at the end of 2013, the recovery of external liquidity is making a balance of payments crisis far less likely. Moreover, external debt is negligible and the Algerian economy is expected to continue recording current account surpluses provided that the Brent price remains above 80 dollars per barrel. This is expected to be the case once again in 2023.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%)	-5.1	3.5	3.0	3.3	2.7
Inflation (CPI, year average, %)	2.4	7.2	9.2	8.2	7.0
Gen. Gov. balance / GDP (%)	-11.9	-7.2	2.3	-5.1	-5.9
Central. Gov. debt / GDP (%)	50.3	62.3	59.4	60.0	62.3
Current account balance / GDP (%)	-12.6	-3.2	7.5	2.9	1.2
External debt / GDP (%)	2.4	1.9	1.7	1.6	1.6
Forex reserves (USD bn)	49	47	62	69	74
Forex reserves, in months of imports	13.8	12.4	15.7	16.7	17.0

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ALGERIA: FX RESERVES

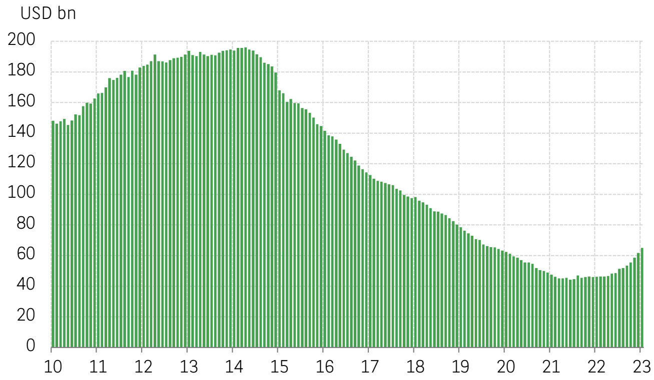

CHART 1

SOURCE: IMF, BNP PARIBAS

PUBLIC FINANCES: A TEMPORARY UPTURN

By contrast, the improvement in public finances may not last. According to the IMF, Algeria ran a budget surplus in 2022, which is estimated at just over 2% of GDP. This came as a surprise. This was the first surplus since 2008 and was a sign of the significant recovery from the deficits accumulated since 2014 (which averaged 10% of GDP and still stood at 7.2% in 2021). Above all, the 56% increase in public spending included in the 2022 Supplementary Financing Law (approved in July) suggested that the budget balance would remain in the red despite the surge in hydrocarbon revenue (around 40% of the government's revenue). However, the increase in spending was kept below 10% in 2022, illustrating the significant under-execution on current expenditures and, in particular, on public investment. Public investment declined further, even though it was supposed to double in 2022. When expressed in GDP points, capital expenditure therefore fell to 7%, compared with 14% in 2019. The figures published by the central bank on the budgetary situation at the end of August are in line with the IMF's estimates.

The situation of public finances is expected to deteriorate in 2023. The deferral of some spending not yet implemented in 2022, the 20% increase in civil servants' salaries (as a result of the salary scale being raised), and rising unemployment benefits and pensions will contribute to increase spending by 7% of GDP. Despite the strong performance of hydrocarbon revenues (although they should fall compared to 2022), Algeria is expected to once again run a budget deficit of around 5% of GDP in 2023. The financial situation will still be manageable. According to the IMF, the budget surplus in 2022 helped to rebuild partially the Algerian Government's fiscal reserve within the Fonds de Régulation des Recettes (Revenue Regulation Fund - FRR). The FRR is estimated to be worth 7.2% of GDP and could theoretically cover all of the Treasury's needs. In addition, even though government debt stands at 60% of GDP, it is financed by captive creditors on the local currency market, as it is held by the central bank (46%) and commercial banks (56%) at negative real interest rates and on long maturities, as a result of direct or indirect monetisation programmes since 2017. Furthermore, there are no guarantees that the authorities will be able to resolve budgetary execution problems. As a result, spending could increase less than expected, like in 2022. At the same time, however, the social aspects of the main measures are reducing the likelihood of this occurring.

Looking beyond the size of fiscal imbalances, the growing burden of current expenditures in public finances is cause for concern. Current spending increased from 64% of total spending in 2014 to 76% in 2022, as adjustment efforts focused on public investment and social benefit mechanisms were maintained (the subsidy system in particular). They could account for 80% of the budget this year. However, with an increasingly rigid spending structure, public finances are becoming increasingly vulnerable to fluctuations in oil and gas revenues.

ECONOMIC GROWTH: A MODEST RECOVERY TAKES HOLD

After a 5.1% recession in 2020, growth rebounded to 3.5% in 2021 and stood at 2.9% year-on-year over the first nine months of 2022. The driving forces of economic activity have changed. While the post-pandemic recovery had been fuelled by gas production bouncing back, non-hydrocarbon GDP now underpins Algeria's growth. It posted an average growth of 3.7% year-on-year in the first three quarters of 2022, compared to just 2.4% in 2021. This momentum is expected to grow further thanks to the country's expansionary fiscal policy. Despite virtually flat hydrocarbon real GDP, economic growth is expected to go above 3% in 2023.

However, the recovery in economic activity is modest in view of the Algerian economy's favourable conditions. Above all, it is still fragile. In particular, measures to support household purchasing power could be counter-productive, as they could be neutralised by the inflationary pressures they could create. Inflation has fallen slightly since its 10.8% year-on-year peak in June 2022, but is still very high at 9.3% (Chart 2).

ALGERIA: INFLATION RATE

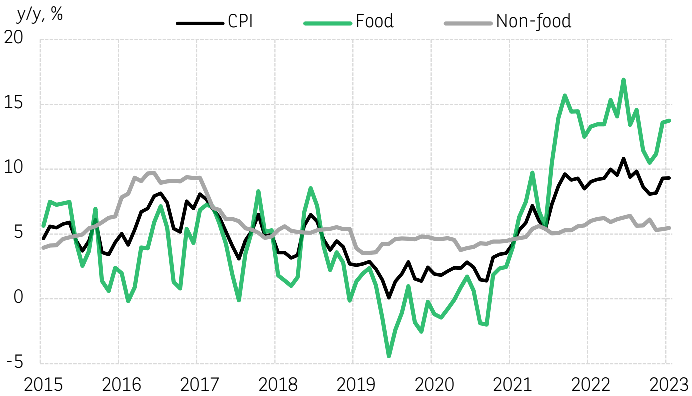

CHART 2

SOURCE: CENTRAL BANK, BNP PARIBAS

In January 2023, food prices were up more than 10% year-on-year for the 19th consecutive month. Non-food inflation stood at 5.5%. In fact, the acceleration in inflation started before the shock caused by the war in Ukraine, highlighting its partially endogenous nature. In view of this situation, the central bank has seemingly decided to maintain its accommodative stance (its policy rate has stayed at 3% since May 2020). This is a risky strategy, in view of the already strong growth in money supply (+14.2% in September 2022) and the forthcoming fiscal stimulus.

The new investment law adopted in June 2022 builds on a set of measures that have been in place since 2019 to boost private-sector development. These measures are positive but with limited results so far. For example, bank lending to the private sector is still growing sluggishly (+3.9% year-on-year in nominal terms in January 2023).

Assuming a lower support from fiscal policy, continued low levels of private investment and a still fragile international environment, economic growth is expected to slow down starting from 2024. Algeria's macroeconomic vulnerabilities could then increase again.

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SOUTH AFRICA

AN ECONOMY PARALYSED BY LOAD SHEDDING

After years of underinvestment in its power grid, South Africa is experiencing daily load shedding, the intensity of which has only increased in recent months. Economic activity is severely impacted. The restoration of electricity production capacities will be slow, which will have a significant impact on growth and the trade balance in 2023. Supply-side constraints will keep inflation high, while the unemployment rate is a concern. Under these conditions, the ruling party, the ANC, will be pushed to revise its budgetary consolidation trajectory downwards. Furthermore, the partial transfer of the debt of electricity company Eskom to the government will contribute to a sharp increase in public debt.

Between 1991 and 2021, while South Africa's electricity needs increased, Eskom built only one power plant. Years of corruption and mismanagement have left the utility company with a considerable debt that has prevented it from investing heavily in building new infrastructure and maintaining the old ones. As a result, production is now insufficient to meet demand. In order to preserve the national electricity grid, Eskom has to resort to voluntary power outages, which have a significant impact on the country's economic growth, public finances and political stability.

SUDDEN SLOWDOWN IN GROWTH

Compared to the anaemic growth experienced by South Africa before the pandemic (1% on average over the 2015–2019 period), the 4.9% growth rebound in 2021 was a promising record. However, it turned out to be short-lived: caught up by long-known infrastructure constraints, growth suddenly slowed to 2% in 2022, bringing South Africa's GDP back to its pre-pandemic level by the end of the year.

Last year, economic activity experienced a sharply fluctuating development marked by an initial contraction in Q2 (-0.8% q/q) attributable to severe weather conditions affecting the KwaZulu-Natal region, as well as the first high-intensity cases of load shedding imposed by the public company for electricity Eskom. The country saw a record 207 days of load shedding in 2022 (compared to 75 in 2021), which increased both in frequency and intensity over the last quarter, which alone amassed 90 days of load shedding. As a result, economic activity in Q4 contracted again (-1.3% q/q), well beyond the forecasts of the South African authorities.

The primary and secondary sectors, which include energy-intensive industries, are threatened by the most intensive stages of load shedding. More specifically, the mining sector contracted by 7% in 2022, also held back by logistical constraints and the strike at the public carrier Transnet last October. The secondary sector contracted by 0.9%, weighed down by the decline in the construction sector since 2017. Thus, only the tertiary sector proved to be a vector for growth in 2022, supported by finance (+3.9%) and trade (+3.5%).

Over the whole calendar year, despite the adverse environment, investment growth accelerated to 4.7%. However, this is mainly a rebound effect after almost zero growth (+0.2%) in 2021, since gross fixed capital formation remained 10% below its 2019 level in 2022. Household consumption was robust (+2.6%), while it had already recorded a solid upturn of 5.6% in 2021. It thus exceeded its 2019 level by 2%. However, inflation remained at a high level. Since May 2022, it has been above the upper bound of the Central Bank's target (6%), propelled by the rise in commodity prices and the persistence of bottlenecks in the country. The Central Bank was therefore forced to raise its main policy rate by 350 basis points over the past twelve months bringing it to 7.75% at the end of March. Despite these interventions, the rise in prices continued to spread to all sectors of the economy: inflation accelerated slightly to 7% year-on-year in February, buoyed by food price inflation (+13.6%) and inflation in the transport sector (+9.9%). It is expected to decrease only very slowly in the coming months, forcing the Central Bank to keep its key rate around its current level until the end of the year.

The short- and medium-term growth outlook is heavily impacted by the electricity shortage. The South African Central Bank estimates that it would cost growth 2 points of GDP in 2023, for an expected 250 days of load shedding. Despite the declaration last February of a national

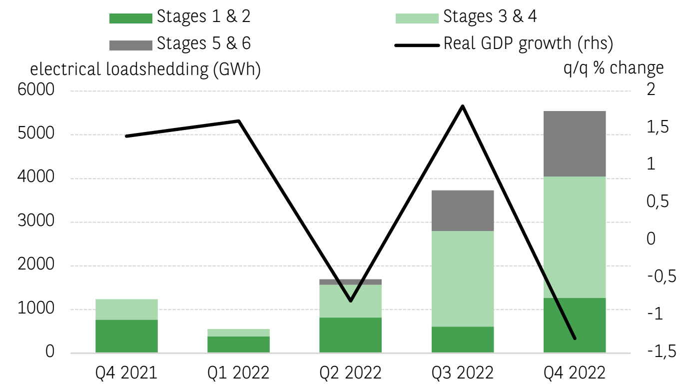
FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-6.3	4.9	2.0	0.2	1.0
Inflation, CPI, year average, %	3.3	4.6	6.9	6.1	5.4
Central Gov. balance / GDP, % (1)	-9.8	-5.1	-4.6	-4.5	-4.6
Central Gov. debt / GDP, % (1)	70.7	68.0	70.1	70.6	71.1
Current account balance / GDP, %	2.0	3.7	-0.5	-1.6	-1.8
External debt / GDP, %	47.3	39.4	40.6	41.2	41.3
Forex reserves, USD bn	54.2	55.5	59.0	60.2	61.4
Forex reserves, in months of imports	8.2	6.4	5.1	5.0	4.8

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

SOUTH AFRICA: LOAD SHEDDING INCREASED IN FREQUENCY AND INTENSITY



Note : to reach a higher stage of loadshedding means Eskom rations the country by a further 1000 MW of power

CHART 1

SOURCE: CSIR, STATS SA, BNP PARIBAS

state of disaster making it possible to accelerate the development of energy-generating projects and to open up the electricity distribution network to the private sector, the restoration of production capacities will be slow and uncertain.

A MISSED OPPORTUNITY FOR COMMODITY EXPORTS

After the sharp contraction of the economy in Q2 2020, exports were the driver of the post-Covid economic recovery. Driven by the surge in commodity prices, they reversed the trade balance trend, which was structurally in deficit, and generated historically high trade surpluses. However, since the start of the war in Ukraine, the 12-month rolling trade balance has gradually eroded, returning to its lowest level since September 2020 at the end of 2022.

The trend can be explained firstly by the sustained increase in import volumes, up 14.2% annually, combined with the deterioration in the terms of trade. In particular, the rise in global prices is weighing heavily on oil imports in value terms, which rose 79% year-on-year in December and accounted for 23% of total imports in Q4 2022. In addition, there is a risk that demand will increase in the coming months. Indeed, Eskom is limiting the intensity of load shedding at the most critical times by using electric generators running on diesel. At the same time, exports have recorded lower growth rates than imports since June 2021, weighed down in particular by the sharp contraction in the mining sector.

Thus, 2022 sounded the death knell for the current account surpluses that had been observed since the start of the pandemic. The current account deficit is expected to widen in 2023, as the increased constraints on the primary sector and its exports will not allow South Africa to fully benefit from the still-high prices of commodities and the reopening of China.

THE BURDEN ON PUBLIC FINANCES

The resolution of the energy crisis in South Africa will have a direct impact on the country's public debt trajectory. After years of poor management, Eskom has accumulated a debt equivalent to 6% of South African GDP, leaving it powerless. For Eskom to continue to operate, last February the government announced it would take on 60% of the stock of this debt. This debt relief will gradually extend over the next three years through zero-interest loans and a direct debt transfer that will take place during fiscal year 2025/26. As a result, public debt will increase significantly in the medium term, while it already reached 70% of GDP at the end of fiscal year 2022/23.

Furthermore, in this deteriorating economic environment, the government's persistent optimism about the trajectory of reducing budget deficits should be viewed with caution. The sudden stop to growth in 2023 will have a significant impact on government revenues, and will contribute to the deterioration of the budget deficit beyond the 3.9% envisaged by the government for the 2023/24 fiscal year.

In addition, there are numerous risks of fiscal slippage which are already materialising. Last February, when the government presented its budget for the coming fiscal year, it was counting on a 4.7% revaluation of public sector salaries. However, negotiations with trade unions have been turbulent. As they are about to be concluded, the government has finally proposed a 7.5% wage increase, which will put a heavy strain on the trajectory of the fiscal balance. In addition, trade unions want to sign an agreement for two years only, compared to a typical term of three, which would increase uncertainty in the medium term. It seems

SOUTH AFRICA: END OF THE EXPORT BOOM

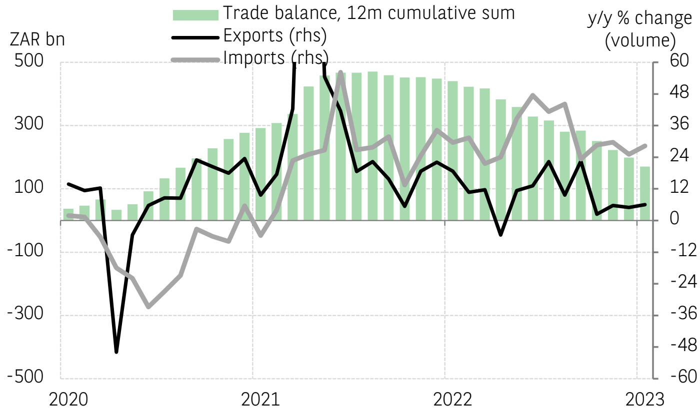


CHART 2 SOURCE: SARS, BNP PARIBAS

unlikely that the government will be able to limit its other expenditure items to compensate for this unforeseen event. The temporary social relief allowance introduced in 2020 in response to the pandemic shock was extended until March 2024. Its continuation is being increasingly envisaged given the stagnation of the labour market, burdened by a worrying unemployment rate (32.7% in Q4 2022). Coupled with high inflation, all of these factors are putting a heavy strain on the popularity of the ANC, which is going through a profound crisis.

A POLITICAL CRISIS

The electricity crisis turned into a major political crisis from the beginning. It has become a symbol of the government's difficulties in bringing about significant reforms, evidenced by the proliferation of Eskom's supervisory bodies, the creation of a new Ministry of Electricity, and the declaration of a severely criticised national state of disaster.

This paralysis is deeply eroding the population's support for the ANC, which had already reached its lowest historical level in the last local elections in 2021. According to the latest polls, voters are turning away from the ANC in droves due to the persistence of load shedding. The ruling party may not be able to form a majority in the upcoming 2024 general elections given its current popularity.

The re-election of President Cyril Ramaphosa as leader of the ANC last December ensures the continued fight against corruption in the short term. However, in the race for the presidency, there will be many challenges for the ANC. Its priority to limit the intensity of load shedding via massive oil imports, in order to preserve its electorate, constitutes an additional risk to the budget and the success of this approach will be decisive with regard to the alliances that the party will have to form to maintain power. A coalition with the political party Economic Freedom Fighters, desired by a more radical fringe of the ANC, could jeopardise the ambitions of reforms and the fight against corruption. It would also send a negative signal to international markets, while the FATF has just put South Africa on its grey list for its lack of transparency in the fight against money laundering and terrorist financing.

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