ECOPERSPECTIVES

1st quarter 2025
January 2025

EMERGING MARKETS

> SINCE TAKING OFFICE, PRESIDENT TRUMP HAS CONFIRMED HIS THREATS TO RAISE TARIFFS, EITHER TO PROTECT US PRODUCERS OR AS A MEANS OF EXERTING PRESSURE THROUGH HIS MIGRATION AND ANTI-NARCOTICS POLICIES. BUT HE DID NOT REFER TO ANY OTHER EMERGING COUNTRIES EXCEPT CHINA ON THE BASIS OF TRADE POLICY.

ECONOMIC RESEARCH

BNP PARIBAS

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WORLD TRADE: WAITING FOR THE AUDIT

Since taking office, President Trump has confirmed his threats to raise tariffs, but fears of universal and widespread application have abated somewhat. He will decide whether to carry out his threats once an audit of the United States' trade relations with all its trading partners has been completed, which should be by the beginning of April. Between now and then, and even over 2025 as a whole, the divergence in the trajectory of world trade between advanced countries and emerging and developing countries (EMDs) is set to increase. Trade between EMDs is expected to grow significantly faster in 2025 (5%) than during the 2012-2018 pre-COVID period (+3.9% per annum on average), whereas it will be the opposite for advanced countries. The uncertainty surrounding US trade policy could accelerate the redirection of exports from emerging Asian countries, so that the indirect effects of an increase in tariff barriers may partly compensate the negative direct effects.

Since taking office, President Trump has confirmed his threats to raise tariffs, either to protect US producers or as a means of exerting pressure through his migration and anti-narcotics policies (vis-à-vis Mexico and Colombia).

USE OF THREATS

However, fears of universal and widespread application have abated somewhat. On the one side, the US President has threatened to increase tariffs on Canada & Mexico imports to 25% on all goods, except energy products which would carry a 10% tariff. These threats have been delayed by 30 days following concessions on border security by the two countries. Indeed, D. Trump has put the blame on his USMCA partners, Canada and Mexico mainly on the basis of a national emergency over fentanyl and illegal immigration. On the other side, D. Trump has been more moderate vis-a-vis China than during the electoral campaign as tariff on Chinese imports has been increased so far by only 10%. But he did not refer to any other emerging countries except China on the basis of trade policy.

The US President will only decide whether to carry out his threats once an audit of the United States' trade relations with all its trading partners has been completed, which should be by the beginning of April.

WORLD TRADE AT DOUBLE SPEED

The threat to world trade from an increase in customs tariffs will therefore not be felt until the second quarter. In the meantime, the recovery in trade is set to continue. According to the IMF's January forecasts, world trade is set to grow by 3.2%, following 3.4% in 2024. The Fund's economists have revised their forecast slightly downwards compared with October, precisely to take account of the uncertainty surrounding trade policy. But this uncertainty is assumed to be transitory, as the IMF's central scenario does not currently envisage a widespread increase in US tariffs, let alone a drift towards a trade war.

The divergence in the trajectory of world trade between advanced countries (ACs) and emerging and developing countries (EMDs) is set to increase. Trade for EMDs is expected to grow significantly faster in 2025 (5%) than during the 2012-2018 pre-COVID period (+3.9% per annum on average), whereas the opposite is true for ACs (2.1% compared with 3.4% per annum on average over 2012-2018). There are two reasons for this.

Firstly, regardless of the uncertainty surrounding US trade policy, trade growth will remain sluggish for the Eurozone and the UK (less than 2%).

Secondly, the uncertainty factor could backfire on the United States because of the dollar's overvaluation, which will largely neutralise the supposedly positive effect of tariff hikes to protect the «Made in America» project. Conversely, the uncertainty surrounding trade policy could accelerate the redirection of emerging economies' exports. In this respect, emerging Asian countries excluding China would be the main beneficiaries.

EMERGING ASIA TRUMPS ALL OTHER... AGAIN

Already, in 2024, the region's exports were buoyant (+6%), benefiting from the strong ripple effect exerted by Chinese exports, which grew by more than 10%.

According to the Purchasing Managers' Index (PMI), the majority of manufacturers' opinion indexes on their export orders are above the threshold of 50, and significantly higher than over the 2012-2018 period. In India, the index even hit an all-time high in January.

China is the exception, with an index below 50 and down sharply in January. No doubt that the 10% increase in US tariffs on Chinese products, if implemented, would act as a brake on intra-regional trade.

However, ASEAN countries have been able to take advantage of the trade tensions between China and the United States since 2018. In their October regional report on the Asia-Pacific region, IMF economists showed that, for several ASEAN countries, exports of products targeted by an increase in tariff barriers (from the US on Chinese products, from China on US products, and from China or the US on products from other parts of the world) grew faster than exports of non-targeted products (i.e. relative gains in market share), notably because exports of targeted products were redirected to third markets other than China and the US. It should be remembered that these positive redirection effects have gone hand in hand with the intensification of Chinese foreign direct investment in the region as a whole in recent years. All in all, unless Donald Trump decides to raise tariffs on all the countries in the region, the indirect effects of an increase in tariff barriers could partly compensate the negative direct effects for Asian countries.

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ADJUSTMENT OF ECONOMIC GROWTH DRIVERS

After a good start to the year, Chinese economic growth will slow down in 2025 due to still weak domestic demand and the effects of the upcoming protectionist shock on exports. China has tools at its disposal to respond to President Trump's new tariff plans, even though its room for manoeuvre to offset the effects of rising tariff barriers with a depreciation of the yuan and a drop in export prices has narrowed compared to 2018. The authorities will continue to ease their monetary and fiscal policies in the short term to stimulate activity and boost private consumption, and try to support a rebalancing of China's economic growth model.

ECONOMIC GROWTH: TEMPORARY STRENGTHENING

Economic growth continued to accelerate in Q4 2024. It reached +1.6% q/q, after +1.3% in Q3 and +0.9% in Q2, and stood at +5% over the year as a whole, exactly in line with the target set by the authorities in March 2024. Growth is expected to remain sustained in Q1 2025, driven, as in the previous quarter, by the good performance of exports and the strengthening of private consumption.

In fact, exports posted strong growth in Q4 2024, both in value (+10% y/y in USD, after +6% in Q3) and in volume (estimated at +12% y/y, after +10% in Q3). This is due to the still aggressive strategy of Chinese companies to gain market share and the fact that US importers have anticipated the hike in tariffs by inflating their orders pre-emptively. This phenomenon is expected to continue in early 2025.

In addition, household demand growth has finally recovered slightly thanks to the stimulus measures implemented since the end of September. Firstly, retail sales growth accelerated (to a modest rate of +3.6% y/y in volume in Q4 2024, compared to +2.2% in Q3), particularly encouraged by the consumer goods trade-in program subsidised by the government. In the short term, this program is expected to remain an essential policy instrument to support consumption; the total amount of subsidies granted amounted to 0.1% of GDP in 2024 and is expected to increase in 2025, and the list of subsidised goods (household appliances, home decoration products, cars, etc.) is expected to be extended to include electronic goods. Secondly, housing sales have increased very slightly y/y since November, after more than three years of contraction (-17% over the first nine months of 2024). This recovery is the result of the continued easing of policies to support housing demand in recent months. However, it does not signal the end of the property crisis. Construction activity continued to fall in Q4, and the average house price continued to decrease (-8.1% y/y at the end of 2024).

Even with a good start to the year, economic growth is expected to resume its downward trajectory in 2025. In our central scenario, it will reach 4.5% this year as a whole. The manufacturing export sector is expected to suffer from the effects of new tariff barriers. In the domestic market, activity will be supported by the accommodative economic policy mix, but it will also continue to face strong constraints (continued property market correction, deflationary pressures, weak confidence in the private sector). As a result, the contribution of net exports to real GDP growth is expected to decline significantly in 2025, while the contribution of total consumption is expected to increase moderately and that of investment is expected to stabilise (*chart 1*). In terms of sectors, the trends observed last year are expected to reverse in 2025, with a slowdown in industrial growth (+5.8% in 2024) and an improvement in services growth (+5.2% in 2024).

Deflationary pressures will continue, fuelled in particular by excess industrial production capacities and the continued fall in housing prices. However, consumer price inflation is expected to pick up somewhat in 2025 (to +0.8% on average, after +0.2% in 2024), thanks to the recovery in household demand and the rebound in food prices.

FORECASTS

	2022	2023	2024f	2025f	2026f
Real GDP growth, %	3.0	5.2	5.0	4.5	4.3
Inflation, CPI, year average, %	2.0	0.2	0.2	0.8	1.0
Official budget balance / GDP, %	-2.8	-3.9	-3.9	-4.0	-3.8
Official general government debt / GDP, %	50.6	54.7	61.0	66.4	70.0
Current account balance / GDP, %	2.5	1.4	1.9	1.6	1.3
External debt / GDP, %	13.7	13.8	14.0	14.2	14.0
Forex reserves, USD bn	3 307	3 450	3 456	3 450	3 450
Forex reserves, in months of imports	12.6	13.2	12.8	12.2	11.8

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: CONTRIBUTIONS TO ECONOMIC GROWTH

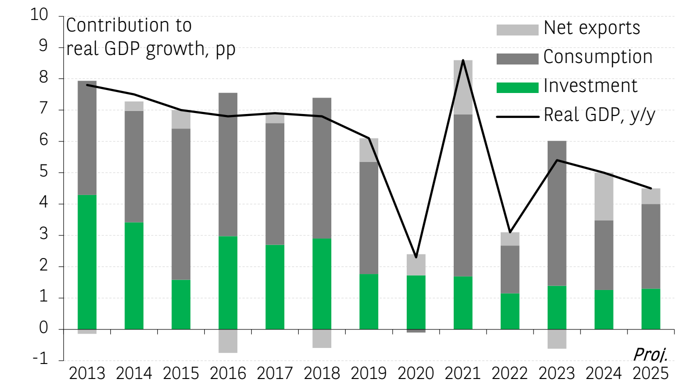

CHART 1 SOURCE: NBS, CEIC, BNP PARIBAS

FISCAL POLICY: PRIORITY GIVEN TO PRIVATE CONSUMPTION?

Since late September, fiscal policy has taken a firmly expansionary turn, which the authorities will maintain in the short term. The main objectives will be to offset the effects of the deterioration in global conditions on economic activity and to strengthen domestic consumption. Policy easing is expected to remain moderate, at least initially, and could be adjusted during the year in response to external shocks.

The budget for 2025 will not be announced until March next year. On the one hand, the authorities have kept some room for manoeuvre to increase deficits thanks to financing at low rates on the local bond markets. The official fiscal deficit in the strict sense is expected to be 4% of GDP (compared to the 3% announced in the 2024 budget), and the general government deficit in the broad sense, as measured by the IMF, is expected to be close to 8% of GDP (compared to 6.9% in 2023). On the other hand, local government (LG) finances are fragile (notably due to the drop in land sales proceeds for three years and the excessively high level of debt of their financing vehicles). This restricts their room for manoeuvre and will force the central government (CG) to increase its direct role in stimulus measures, as it did in 2024. The official general government debt is expected to rise to 61% of GDP at the end of 2024 (CG debt: 26% of GDP + direct debt of LGs: 35%) and to 66% at the end of 2025. To this direct debt we should add the indirect debt contracted by LG financing vehicles, estimated at nearly 50% of GDP by the IMF (a small proportion of which is being gradually refinanced by LG bond issues).

Regarding fiscal policy tools, the government will continue to place the usual emphasis on public investment, particularly in strategic manufacturing sectors and infrastructure projects. But the authorities also indicated at the Central Economic Work Conference last December that strengthening private consumption would be a priority for 2025. The measures introduced so far have been mainly aimed at stimulating household spending temporarily. Meanwhile, a revaluation of pensions and medical coverage has been announced but has yet to be specified; this will need to be significant so as not to dash expectations. Substantial strengthening of the social safety system would in fact be necessary to improve household confidence, reduce savings rates (estimated at 37% of disposable income in 2024) and durably increase their consumption (which has remained close to 38% of GDP since 2020). This would help change China's economic growth model, which the authorities want to make more balanced and of "better quality", less dependent on property and debt, and contributing to "Common Prosperity".

MONETARY POLICY: EASING UNDER CONSTRAINTS

Since 2020, the central bank has conducted an accommodative monetary policy, officially described as a "prudent" policy. Interest rates have been lowered very gradually (the 7-day reverse repo rate fell to 1.5% at the end of 2024, compared to 1.8% at the end of 2023 and 2.5% at the end of 2019), as have the reserve requirement ratios (to 9.5% for large banks at the end of 2024, vs. 10.5% at the end of 2023 and 13% at the end of 2019). However, growth in total social financing has gradually slowed for two years (to reach 7.9% y/y in Q4 2024, an all-time low), a consequence of the cautiousness of banks and the weak credit demand.

In December, the authorities announced further loosening in monetary policy, which should be "appropriately loose" in 2025. The wording is changing, but the pace of easing is expected to remain gradual, as the central bank's room for manoeuvre is constrained by several factors. The first is the effect of lower interest rates on bank profitability. It has deteriorated over the past five years, due to the slowdown in lending activity, the deterioration in asset quality and the narrowing of net interest margins (which fell to a low of 1.5% on average in mid-2024, compared to 2.2% in 2019). Monetary policy is also constrained by the decline in long-term bond rates and currency depreciation. Treasury bond yields reached historically low levels (1.65% on average in January 2025 for 10-year securities, compared to 2.17% in October and 2.51% in January 2024), reflecting investors' concerns about China's economic prospects and the effects of US tariff hikes.

The RMB depreciated 3.5% against the USD between mid-October and mid-January (spot rate), as a result of the general strengthening of the dollar, the widening of the spread between US and Chinese rates and capital outflows. After intensifying at the beginning of the year, pressures on the yuan have eased since 20 January, and the spot exchange rate against the dollar (7.24 on 24 January) has moved away from the upper limit of the permitted trading band. The central bank has stepped up its measures to defend the yuan since the autumn, in order to reduce financial market instability and leave some leeway to respond to future US tariff hikes through further yuan depreciation.

CHINA: EXTERNAL TRADE PERFORMANCE

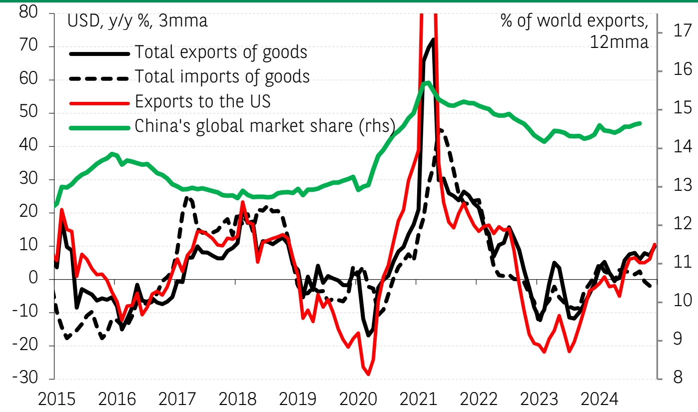

CHART 2 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, CEIC, BNP PARIBAS

TRUMP 2.0: A NEW SHOCK FOR EXPORTS

How China-US trade relations will evolve in 2025 is very uncertain. Will the new US President implement his programme of sharp tariff hikes in the short term, or will he first seek to establish a new balance of power and then move forward in trade negotiations? Our central scenario to date includes a preliminary hike in tariffs of 10% in Q1 2025, followed by further increases from Q3 onwards (+15% over a year).

The overall performance of Chinese exports has not been weakened by the first round of the trade war that began in 2018-2019 and by the resulting trade decoupling between the US and China. Over the past few years, the effects of tariff barriers on Chinese companies have been offset by the decline in export prices (strongly supported by yuan depreciation and public subsidies) and by the re-routing of trade flows. China's goods exports (in USD) have grown by an average of 7% per year since 2018 and their global market share has increased, from 12.8% to 14.7% over the first nine months of 2024 (chart 2). China posted a record trade surplus of USD 992 billion in 2024 (5% of GDP) and a current account surplus estimated at 1.9% of GDP – which was offset however, by net capital outflows in the balance of payments.

The onset of a new round of the trade war could have more painful effects on Chinese exports and economic growth. Admittedly, China's direct exposure to the US market decreased from 19% of its total exports in 2017 to 14.6% in 2024 (i.e. 2.6% of GDP). In addition, China will continue to reorganise its supply chains and trade flows to circumvent tariffs and continue to offset losses of US market share. However, on the one hand, the protectionist threat has spread, and new tariff barriers will not only come from the US. On the other hand, the central bank's room for manoeuvre to depreciate the yuan has narrowed compared to 2018-2019 (depreciation of 3% to 4% is expected by the end of 2025 in our central scenario) and corporate profits have deteriorated, reducing their ability to lower their export prices to offset tariff hikes. China could see its global market share get smaller in 2025.

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INDIA

SIGNIFICANTLY SLOWER GROWTH AND RISING RISKS

Economic growth forecasts for the fiscal year 2024/2025, which ends on 31st March, have been revised significantly downwards. The outlook for the next three years could also be downgraded unless the government and the private sector significantly increase their investment. However, the international economic climate is not conducive to either domestic or foreign investment, even if the direct impact of a potential increase in US tariffs on Indian economic growth would be limited. The recent downward pressure on emerging currencies has not spared the Indian rupee, and the depreciation trend is likely to continue, especially as the new Governor of the Central Bank seems to be focusing on supporting economic growth rather than currency stability.

SIGNIFICANTLY SLOWER GROWTH

Following in the footsteps of the Reserve Bank of India (RBI), the Central Statistical Office (CSO) has revised downwards its growth forecasts for the fiscal year (FY) 2024/2025, which will end on 31st March. These revisions (6.6% and 6.4%, respectively, compared with 8.2% for 2023/2024) reflect the economic growth slowdown recorded between July and September 2024. Growth was up just 5.4% year-on-year (y/y), the lowest rate recorded in the last seven quarters. As a result, in the first half of the fiscal year, growth was just 6% compared with 8.2% at the same time last year. This slowdown is due to a marked deceleration in activity in manufacturing and construction. Activity in the services sector remained solid, although decelerating slightly. Only agriculture rebounded. On the demand side, apart from government spending, all components slowed.

In the second half of the fiscal year (October-March), economic activity should accelerate, but is not expected to exceed 6.7%, according to the RBI. Base effects should be unfavourable and the rebound modest. Since November 2024, all the indicators have picked up, on both the supply and demand sides. Industrial output has accelerated from its low point in August, particularly in the manufacturing sector, and the rebound in steel and cement production suggests that construction activity has picked up. Rural household consumption should continue to be underpinned by good summer harvests, higher-than-average water reservoir levels and better winter sowing than in 2024. On the other hand, although expected to rise, the rebound in urban household consumption could be more muted. Sales of two-wheel vehicles accelerated significantly in the fourth quarter, while growth in car sales, despite returning to positive territory in October after three months of decline, remains sluggish (+4.4% y/y in November).

On the investment front, although the government is likely to accelerate the pace of new infrastructure projects, private entrepreneurs may be more cautious, waiting for a clearer picture of the domestic and international environment. Capacity utilisation rates have reached a plateau and average interest rates on new loans remain more than 40 basis points (bps) higher than last year (in real terms), while the financial situation of companies is less comfortable than at the start of the year (with rising interest charges and a slowdown in profits). Over the next three years, growth is expected to average 6.5%, but downside risks are high and the slowdown in investment is something to keep an eye on. In the absence of a significant rebound, the short- and medium-term growth outlook could be revised downwards.

INFLATION SLOWS THANKS TO FOOD PRICES

In November, inflation slowed to 5.5% y/y, mainly due to the noticeable deceleration in food prices and a favourable base effect.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, % (1)	7.0	8.2	6.3	6.6	6.5
Inflation, CPI, year average, % (1)	6.7	5.4	4.8	4.4	4.3
General gov. balance / GDP, % (1)	-9.6	-8.5	-7.9	-7.4	-7.0
General gov. debt / GDP, % (1)	84.8	82.5	82.3	82.9	82.3
Current account balance / GDP, % (1)	-2.0	-0.7	-1.3	-1.5	-1.5
External debt / GDP, % (1)	18.4	18.7	18.6	18.4	18.0
Forex reserves (excl. gold), USD bn	498	551	552	580	594
Forex reserves, in months of imports	6.7	7.5	7.2	7.4	7.5

(1) Fiscal year from April 1st of year N to March 31st of year N+1

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

INDIA: SLIGHT RISE IN INDUTRIAL OUTPUT

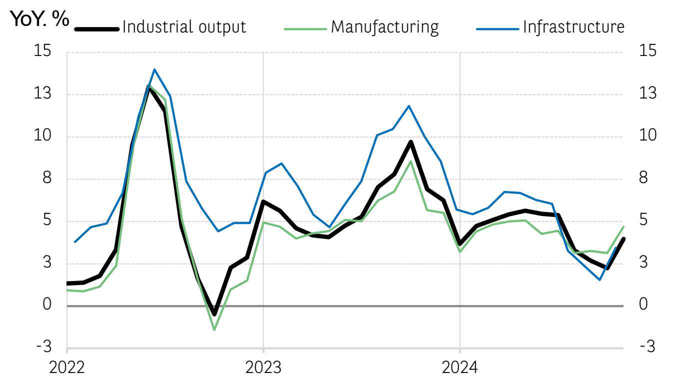

CHART 1 SOURCE: CEIC, BNP PARIBAS

Excluding food and energy, core inflation remained relatively stable at 3.6%. Over the next few months, inflationary pressures should continue to fall, enabling the RBI to ease monetary policy at its next three monetary policy committees, lowering the key rate to 5.75%, despite the downward pressure on the rupee. Indeed, the new Governor of the Reserve Bank of India (RBI) seems to be giving priority to supporting growth rather than the stability of its currency. Such a policy is risky, however, as it would fuel inflationary pressures and penalise consumption by the most disadvantaged households, unless it is accompanied by a reduction in import taxes or an expansionary social policy. This would reduce its budgetary margins for increased investment spending.

EXTERNAL ACCOUNTS: RISING TENSIONS

India's external accounts are structurally robust. Its foreign exchange reserves are plentiful (in mid-January, they covered 1.8 times the country's short-term external financing needs), its current account deficit is moderate (0.8% of GDP on average over the last five years), and its external debt is low (19.3% of GDP). In addition, although India is vulnerable to commodity price shocks, particularly oil as a net importer, it has managed to reduce its exposure by importing oil from Russia at below-market prices. The main areas of concern are the very low level of FDI (which has been falling for two years) and the country's greater vulnerability to external shocks with the inclusion of sovereign bonds in the emerging indices.

The current account deficit, which rose slightly in Q2-Q3 2024 (to 1.2% of GDP), is no longer covered by net FDI flows (which fell to just 0.2% of GDP). Despite this, pressures on the balance of payments were limited thanks to foreign portfolio investment. However, since October, as a result of significant capital outflows caused by the prospect of a status quo in US monetary policy, downward pressure on the rupee has increased significantly and foreign exchange reserves have fallen by more than 11.5% (USD -70 bn). In mid-January, the rupee was trading close to INR87 to USD1, an all-time low. This trend is set to continue with the expected rise in the current account deficit and the fall in domestic interest rates. Furthermore, the new Governor of the RBI appears to be adopting a different strategy from that of his predecessor, who had made the stability of the rupee his main objective. Allowing the rupee to depreciate would increase the competitiveness of Indian exports, but it could also attract the attention of the new Trump administration.

TRUMP 2.0: WHAT ARE THE CONSEQUENCES?

The potential increase in US tariffs will have a moderate impact on the Indian economy.

In 2018, the Trump administration imposed tariffs on some Indian products, in particular steel (25%) and aluminium (10%), which then accounted for around 6% of Indian exports to the US. In 2019, it also abolished the preferential tariff policy (0% customs duty) in force on automotive components, chemical products and nuclear reactors, which then accounted for around 12% of exports. The introduction of these tariffs led to a fall in exports over the following two years (particularly for automotive components), but exports then rebounded strongly. The US has remained India's leading export partner, accounting for 17.6% of its total exports. In 2024, the US trade deficit with India, despite being larger than the US trade deficit with Indonesia and Malaysia, remained modest (USD 45bn) compared with that with China and Vietnam (USD 293 bn and USD 122 bn, respectively). However, as in other Asian countries (apart from Malaysia), this deficit has increased significantly since 2020 (+62%). However, the sharp rise in Indian exports to the US does not reflect a shift of Chinese production to India, but rather a shift of US companies to 'friendly' countries. Although precious stones are still the leading export to the US (13.4% of exports to the US), the share of machinery and electrical equipment has risen sharply since 2020, reaching 13% of goods exported to the US in 2023 (vs. 3.2% in 2018). Exports of smartphones and semiconductors increased by a factor of 3.2 between 2022 and 2023. This very sharp increase is the result of the influx of FDI into these sectors from 2020 onwards.

INDIA: EXPORTS TO THE US

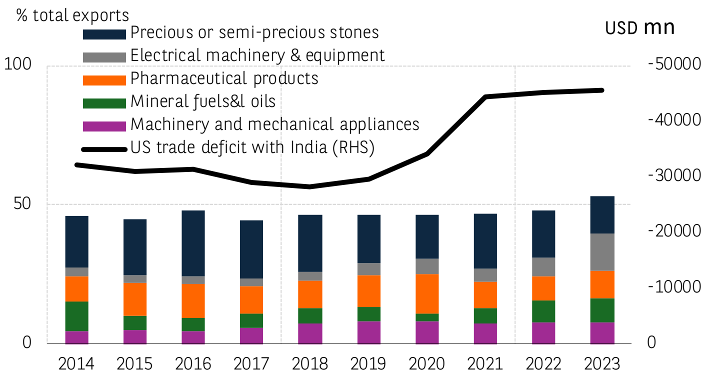

CHART 2 SOURCE: CEIC, BNP PARIBAS

Despite a modest trade surplus with the US, and despite the fact that it has not been accused of manipulating its currency, India, as the ninth largest import partner of the US, could nonetheless face a further increase in US tariffs unless it lowers its customs duties on imported US products. The tariffs applied by India on its imports of US goods averaged 14% in 2023 and 9.6% when taking into account the structure of Indian imports, largely above the weighted average of tarrifs set by the United-States for goods imported from India (2.6%).

However, if the new Trump administration were to decide to increase its tariffs on products imported from India, the impact on the Indian economy would be modest. Exports to the US accounted for 2% of its GDP in 2023. The adoption of a 10% tariff on Indian goods exported to the US could generate a 0.2 pp drop in its GDP (assuming that the elasticity of exports to customs duties is 1.3, as indicated in the 2024 study by Haberkorn, Hoang, Lewis, Mix and Moore).

If the Trump administration were to spare India, the country could benefit from a redirection of trade flows with the US as a final destination, as the cost of its abundant labour remains much lower than in other Asian countries and its performance in logistics is equivalent to that of Vietnam. However, the government still needs to remove the constraints that weigh on the development of its manufacturing sector and penalise FDIs, which remain strong despite the Modi government's efforts.

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SOUTH KOREA

NEW CHALLENGES

South Korea's economic growth slowed throughout 2024, with limited prospects for a rebound. The political crisis and unprecedented government instability in the country are likely to result in a marked slowdown in domestic demand. The outlook for the export sector (mainly semiconductors) will depend in part on the trade policy adopted by the new US administration. South Korea is not directly targeted by tariff measures for the time being, but the resulting upheaval in value chains will adversely affect exports. Economic policy will remain accommodative: the Central Bank and the interim government have already proposed support measures, but the stimulus will not be enough to significantly boost growth, which is likely to continue to slow in 2025.

UNPRECEDENTED POLITICAL CRISIS

The political climate deteriorated sharply at the beginning of December, after President Yoon Suk Yeol briefly imposed martial law. Impeachment proceedings are under way and the President has been suspended pending the outcome of these proceedings. After several weeks of twists and turns, the President was finally arrested on 15 January and charged with insurrection on 25 January (one of the charges for which the President has no immunity). He will face a number of other charges, including treason, corruption and abuse of power. To date, there have been two interim presidents, and tensions are still high, with the opposition between the two "camps" (pro- and anti-president) leading to a number of confrontations.

This political sequence is not surprising, but its scale is unprecedented in South Korea. The polarisation of political life has accelerated in recent years, and a political crisis had in fact been brewing since the last legislative elections in April 2024. The (conservative) presidential coalition, led by the "People Power Party", won just 108 seats, while the opposition coalition, led by the "Democratic Party", took 170 seats. The combination of the President's very low popularity and the opposition majority in Parliament had already led to many government proposals being blocked.

However, the strength of Korean institutions remains undiminished. At the start of the crisis, the Central Bank announced that it was prepared to intervene if necessary to ensure the stability of the financial markets. At the same time, in the absence of a vote, Parliament has renewed the budget for 2024, and any additional expenditure will be examined on a case-by-case basis (the 2025 budget was under discussion in Parliament when martial law was attempted).

For the time being, the financial consequences remain limited. The initial pressure on the Won has partially subsided (at the end of January, the Won was still 2.5% weaker against the US dollar than at the beginning of December). In any case, South Korea's external vulnerability is limited, as foreign exchange reserves amount to around 7 months of imports and the country's net external position is in credit (and has been growing steadily for almost 15 years), which reduces its vulnerability to financial shocks and capital flight.

SLOWDOWN IN GROWTH

On the other hand, the impact on growth is likely to be more significant. Following average annual growth of 2.2% in 2024, growth is expected to fall to 1.6% in 2025. Growth has already slowed throughout 2024, standing at 1.2% y/y in the final quarter, with limited capacity for a rebound.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	2.6	1.4	2.2	1.6	1.9
Inflation, CPI, year average (%)	5.1	3.7	2.3	1.9	2.0
Gen. gov. balance / GDP (%)	-2.8	-1.5	-1.8	-1.7	-1.5
Gen. gov. debt / GDP (%)	49.8	53.6	54.1	54.9	55.3
Current account balance / GDP (%)	1.4	1.9	4.2	2.5	2.4
External debt / GDP (%)	40.0	34.9	31.8	31.0	29.5
Forex reserves (USD bn)	423	420	419	421	428
Forex reserves, in months of imports	6.2	6.6	6.8	6.6	6.4

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

SOUTH KOREA: LOWER INFLATION

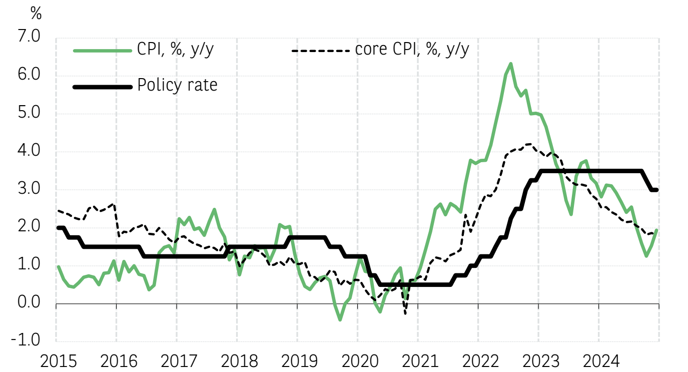

CHART 1 SOURCE: CENTRAL BANK, BNP PARIBAS

The political situation should lead to a slowdown in private consumption and investment. Indices measuring consumer and investor confidence fell in December. In the construction sector, investment has already slowed over the last three quarters. Meanwhile, the outlook for the export sector (mainly semiconductors) will depend in part on the trade policy of the new US administration. The policy mix is likely to remain accommodative, as measures to support growth will almost certainly be passed over the next few months (this is almost always the case in Korea during economic slowdowns), but the stimulus is unlikely to be enough to significantly boost growth.

SUPPORT FROM THE CENTRAL BANK

The Central Bank has indicated that it will look to support growth over the coming quarters. Given the political crisis and its potential financial repercussions, the key rate remained unchanged (at 3%) at the meeting on 16 January, but access to credit has been made easier for small and medium-sized businesses. The Central Bank's announcement suggests that several rate cuts are likely over the coming months. Despite the depreciation of the currency and fluctuations in commodity prices, inflation should remain contained (it came out at 1.9% y/y in December, after 1.5% in November). In addition, growth forecasts have just been revised downwards, as the Central Bank now expects real GDP growth of just 1.6-1.7% in 2025 (compared to 1.9% in the last forecasting exercise in November).

That said, Korean monetary policy is still constrained by the financial risks associated with high household debt (around 90% of GDP). The many macroprudential measures put in place have so far helped to contain these risks. Despite the desire of some committee members to "translate the drop in interest rates into household credit", the Financial Services Commission has indicated that it wants to contain the rise in debt to less than +3.8% (in real terms) in 2025.

NEW UPHEAVAL IN VALUE CHAINS?

South Korea is unlikely to be spared by the change in US economic policy. The situation is very different from the one during Trump's first term in office, since the structure of Korean foreign trade and integration into value chains has shifted in favour of the United States and away from China.

In 2024, 18.7% of total exports were to the United States (12% in 2017) and 19.5% to China (25% in 2017). Between 2017 and 2024, the trade surplus with the United States almost tripled, while the trade balance with China gradually moved from surplus to deficit (*see chart*). Last November, the US Treasury put Korea back on the list of "economies to watch", which could attract the attention of the Trump administration, even though no increase in tariffs has yet been announced. However, the bilateral US trade deficit with Korea (USD 55 billion in 2024) is still much lower than the one with China (around USD 300 billion). For the time being, Trump has not come out in favour of a potential renegotiation of the United States-Korea Free Trade Agreement (KORUS), as was the case during his first term in office.

A number of factors could work in Korea's favour: in 2023, the United States captured almost 45% of total Korean FDI (or USD 28 billion), well ahead of China (less than 3%, or USD 1.9 billion). The semiconductor sector is one of the main beneficiaries. In 2017, the United States received 33% of total Korean FDI in this sector, and China 7%. In addition, the value added of Korean exports is very high, and Korea is not on the list of "connector" countries used by China to circumvent US tariffs (countries whose exports contain relatively low local value added and high value added produced in China).

SOUTH KOREA: RISING COMMERCIAL SURPLUS WITH THE US

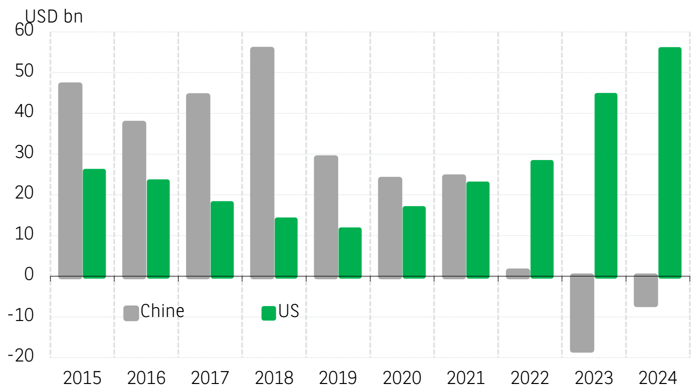

CHART 2 SOURCE: KOREA CUSTOM SERVICE, BNP PARIBAS

That said, even if there is no specific increase in tariffs, the Korean economy will be affected by US tariff increases on Chinese products. The Korean export sector would be indirectly affected. Potential Chinese retaliation could also have consequences, including competitive devaluation, which could destabilise Asian currencies, and tighter controls on Chinese exports, which could disrupt the region's value chains, in which Korea is highly integrated. In the short term, the support measures proposed by the government and the Central Bank would probably not be enough to offset the effects of the yuan's depreciation on Korean exports and growth, if the Chinese central bank were to pursue a strategy of competitive devaluation.

The implementation of long-planned structural reforms to boost industrial competitiveness is also threatened by the current political crisis. However, these reforms are crucial for the country's export sector, particularly against growing competition from China, the European Union and Japan, especially in the semiconductor sector.

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INDONESIA

OUTLOOK IS STRONG BUT VULNERABLE TO EXTERNAL SHOCKS

GDP growth remained robust in 2024 and the outlook for 2025 is favourable. Consumer spending is expected to remain strong, but investment is expected to slow. Monetary easing by the central bank is expected to be constrained by pressures on the rupiah, while real interest rates - already high - have risen further. In fiscal terms, the government is expected to favour its social policy over capital expenditure. This will impact economic growth in the short and medium term. Exports are expected to suffer from the Chinese economic slowdown. In addition, although modest, the direct impact of a potential increase in US tariffs could also have a negative impact on the Indonesian economy.

GROWTH REMAINS STABLE

In 2024, real GDP growth remained stable at 5%. The contribution of net exports was negative despite sustained growth in exports. Domestic demand remained the primary growth driver. Consumer spending and investment reached 52.7% and 31% of GDP, respectively. Despite rising interest rates in real terms, investment has continued to grow (+4%), albeit at a slower pace, thanks in particular to the momentum of public investment in infrastructure. Investment in machinery and capital goods increased primarily in H2, but remained modest (4% of GDP).

Activity was very dynamic in the services sector and, in particular, in high value-added services (+6.2%). Activity was more modest in the manufacturing sector (+4.4%), which is however, presenting significant disparities between sectors. These discrepancies reflect the structural transformations that have been underway for several years. First, metals processing activities continued to post very dynamic growth (+13.3%), driven by the Widodo government strategy to ban exports of crude nickel, to strengthen domestic processing of commodities. Second, growth in labour-intensive industries (textiles, furniture) was much more contained (+4.2%). This should be put into perspective with the sharp increase in imports from China. In three years, the share of labour-intensive manufacturing sectors in GDP fell by 0.3 points to 1.8% of GDP at the end of 2024, as did the share of total employment (-1 pp), which stood at 13.8% in 2023. The indicators available for 2024 suggest that the decline has intensified, and explain the government's decision to extend safeguard duties on textile products in June 2024.

Economic prospects for the next three years are strong. Real GDP growth is expected to reach 5.1% on average, driven by the momentum of consumer spending and an increase in public investment. The main risks for 2025 concern changes in exports due to fragmentation of global trade, the economic slowdown in China (Indonesia's main trading partner) and a potential increase in US tariffs. Moreover, the anticipated rise in inflationary pressures and the strengthening of the US dollar against emerging currencies (in particular the rupiah) could constrain monetary easing and, as a result, impact private investment.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	5.3	5.0	5.0	5.0	5.1
Inflation (CPI, year average, %)	4.2	3.7	2.3	2.5	2.6
Gen. Gov. balance / GDP (%)	-2.4	-1.7	-2.3	-2.5	-2.7
Gen. Gov. debt / GDP (%)	39.7	39.2	38.8	38.7	38.6
Current account balance / GDP (%)	1.1	-0.2	-0.9	-1.4	-1.6
External debt / GDP (%)	30.1	29.8	31.3	31.5	31.3
Forex reserves (USD bn)	124	133	140	138	139
Forex reserves, in months of imports	5.5	6.0	6.1	6.1	6.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDONESIA: ROBUST ECONOMIC GROWTH

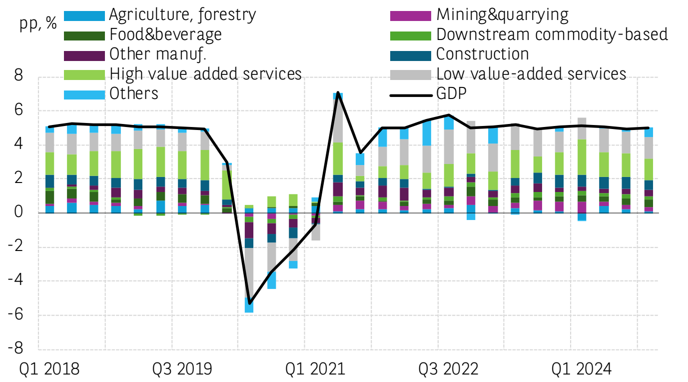

CHART 1 SOURCE: CEIC, BPS, BNP PARIBAS

INFLATION IS EXPECTED TO REBOUND IN 2025

In 2024, price increases slowed to 2.3% (vs. 3.7% in 2023). For 2025, a slight acceleration is expected due to the 1 percentage point (pp) increase in the VAT rate to 12% as of 1st January 2025. However, certain essential products are exempt. Consumer price inflation is expected to reach 2.8% by the end of 2025. It should remain within the target range set by the central bank (2.5% +/- 1 pp) over the entire year.

Despite moderate inflationary pressures, the central bank's scope for easing monetary policy is constrained by changes in the exchange rate. Its recent decision to lower its key rates by 25 basis points (bps) in January, to boost economic growth at a time when downward pressure on the rupiah is already strong, could weaken external accounts.

INVESTMENTS ARE STILL NOT HIGH ENOUGH

Prabowo Subianto's new government aims to increase the real GDP growth rate from 5% on average over the 2014-2024 period (excluding Covid) to 8% within 2-3 years. To do this, the government will boost consumption in the most disadvantaged households through an expansionary social policy. But this growth target of 8% seems unrealistic if not accompanied by a significant increase in investments. Despite the increase posted over the last two years, the country's investment rate remains below its pre-pandemic level. This would have to reach between 39% and 45% of GDP (vs. 30.7% of GDP today) for economic growth to stand at 7%, taking into account the incremental capital output ratio, slightly above 6 in Indonesia. However in 2025, the government plans to reduce its investment expenditure by 0.7 pp to 0.8% of GDP. Priority is being given to social spending, while the country's infrastructure needs remain very significant. The quality of infrastructure has not improved over the past five years, according to the country's latest logistics performance index published by the World Bank. In 2023, Indonesia was ranked 59th out of 139 countries, lagging behind China, Thailand and Vietnam. Deficiencies in infrastructure are weighing on its attractiveness and its industrial development. Private investment is also unlikely to rebound significantly. Production capacity utilisation rates remain below their long-term average and interest rates on investment loans have risen by 120 bps in real terms over the past twelve months.

WHAT IS THE COUNTRY'S VULNERABILITY TO TRUMP 2.0?

Since the election of Donald Trump, US bond yields have risen, followed by Indonesian long-term interest rates, which rose 32 bps between December 2024 and mid-January. These developments need to be monitored. In fact, interest payments on debt continued to rise in 2024, to reach a high of 2.3% of GDP (equivalent to 17.6% of budget revenue), reducing budgetary leeway accordingly.

In addition, although its external accounts are relatively robust, Indonesia has already been weakened by significant capital outflows since Trump took power.

The current account deficit is structurally modest, Indonesia's external debt is moderate and its foreign exchange reserves are sufficient to cover all its short-term external financing needs. The main source of fragility is low net foreign direct investment (FDI), which have stood at just 1.3% of GDP on average over the past five years. This makes the country reliant on volatile portfolio investments to fund its current account deficit. Over the first three quarters of 2024, the current account deficit increased by 0.7 pp to 0.8% of GDP, mainly due to falling commodity prices. Over the whole year, this is not expected to have exceeded 1% of GDP and should therefore be fully covered by net FDI. By contrast, in 2025, the current account deficit is expected to be 1.4% of GDP and might no longer be covered by net FDI. This could then increase Indonesia's vulnerability to volatile capital outflows.

However, since the outcome of the US election, like other emerging Asian countries, Indonesia has posted significant capital outflows, the financial markets fearing that the US Federal Reserve will leave its interest rates unchanged. The rupiah has depreciated against the US dollar by almost 4% since November 2024.

INDONESIA: EXPORTS PER COUNTRY

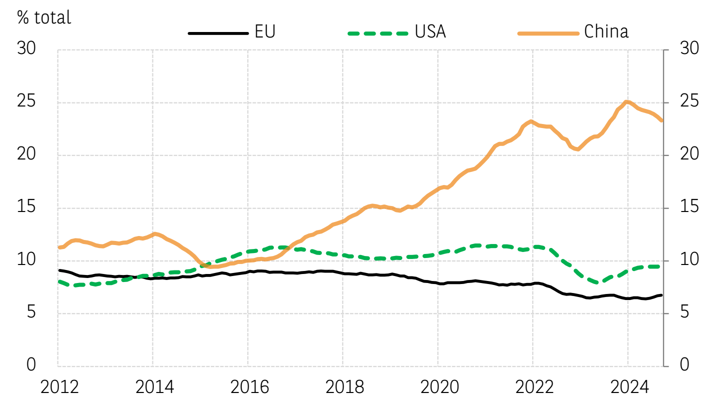

CHART 2 SOURCE: CEIC, BI, BNP PARIBAS

By comparison, the Indian rupee, the Malaysian ringgit and the Thai baht lost 2.1%, 3.3% and 2.5%, respectively. However, the risks generated by this depreciation remain contained. The country's total external debt was only 31.1% of GDP in Q3 2024 and corporate debt with no natural currency hedging was only 5.3% of GDP. In addition, the Central Bank (Bank Indonesia, BI) holds sufficient foreign exchange reserves to contain the rupiah's volatility (USD 140.1 billion, i.e., the equivalent of 6.1 months of imports of goods and services). In addition, it may choose to issue more SRBIs (Bank Indonesia Rupiah Securities), instruments denominated in rupiahs backed by government bonds owned by BI, offering attractive yields to attract foreign investors. In order to contain the pressure on its currency and protect its reserves, it has also required companies exporting commodities to deposit all of their foreign currency revenue with commercial banks for a minimum term of one year from 1st March.

In trade terms, the Trump administration might increase tariffs on products coming from Indonesia. Although the US trade deficit with Indonesia is modest ("only" USD 18.2 billion in 2024) and incommensurate with its trade deficits with China and Vietnam (USD 293 billion and USD 122 billion, respectively), it has increased significantly over the past five years (+32.9%). In addition, Indonesia enjoys a preferential tariff trade policy, in particular for electronics, chemicals, furniture and rubber products. But these products only account for 1.4% of its exports to the United States. More generally, all goods combined (intermediate goods and final goods), the value added of its goods exported to the United States was estimated at 2.3% of GDP in 2020 (according to the OECD TiVA indicators), equivalent to 2.5% of GDP today if the same trade structure was applied. Based on studies[1], which estimate that the elasticity of exports with respect to an increase in tariffs is 1.3, it can be inferred that the adoption of a 10% tariff on all Indonesian goods exported to the United States (directly or not) could generate a drop of 0.3 pp in its GDP.

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1 Global Trade Patterns in the wake of the 2018-2019 US-China Tariff Hikes, Haberkorn, Hoang, Lewis, Mix, Moore (2024).

ECONOMIC SUCCESS THREATENED BY TRUMP 2.0?

The Vietnamese economy posted strong growth of 7.1% in 2024. The conditions for this success could continue on into 2025: the export sector is benefiting from buoyant global demand for electronic goods and is continuing to increase its production capacities thanks to FDI; the property sector is recovering from the 2022-2023 crisis; private consumption is likely to increase further; and the government has some room for manoeuvre for increasing its spending and investment. However, Vietnam's economic outlook is also exposed to high downside risks. Firstly, a strong dollar and unchanged interest rates in the US pose a risk of capital outflows, and pressures on the dong and external liquidity would then constrain monetary policy. Secondly, Vietnam is vulnerable to the risk of protectionism, due to its strong dependence on exports. Most significantly, its role as a "connector" country between Chinese producers and US importers and its large trade surplus with the US could lead the Trump administration to increase tariffs on Vietnamese products.

STRONG ECONOMIC GROWTH, DRIVEN BY THE EXPORT SECTOR

Real GDP growth stood at +7.1% in 2024, which was an impressive recovery following the 2020-2023 slowdown. In 2025, economic growth is expected to slow to 6.2%, which is still strong, supported notably by private consumption growth and by still accommodative economic policies. The prospects for exports and investment in the manufacturing sector are more uncertain.

Goods exports have rebounded rapidly from autumn 2023. They increased by +14% y/y in value terms in 2024 (vs. -4.6% in 2023), with this rebound coming hand in hand with a solid recovery in industrial production (+7.8% in 2024, after +1.7% in 2023) and investment (+7.2% in 2024, after +4.1% in 2023). The export manufacturing sector has benefited greatly from the increased global demand for tech goods, the continued expansion of its production capacities and global market share gains in a wide range of sectors, ranging from agricultural products to electronic goods and computers. Vietnam's share of total global exports increased to 1.7% in 2024, after stagnating at 1.5% in 2021-2023. In 2025, the country is still well positioned to continue benefiting from buoyant global demand for electronic goods, increase its production capacities thanks to foreign direct investment (FDI) inflows and gain market shares. At the same time, the threat of tariff barriers which could be imposed by the United States is a major downside risk to the export outlook.

The tourism sector has been recovering well since 2022, faster than in other South-East Asian countries. In 2024, the number of visitors almost returned to its pre-COVID level (17.6 million) while total tourism revenue exceeded it, standing at 7% of GDP. Total exports of services increased by +18% y/y in value terms over the first three quarters of 2024. Tourism activity will remain solid in 2025. The authorities aim to increase revenue from the sector by nearly 20%, notably driven by returning Chinese tourists (in 2024, total Chinese visitors were still 40% below their 2019 level).

In 2024, the contribution of net exports of goods and services fell slightly into negative territory (*chart 1*), with the rebound in the volume of imports stronger than the rebound in the volume of exports (which have a high import content). Nevertheless, the strong growth in the export and tourism sectors had positive effects on the rest of the economy. In addition, the accommodative fiscal policy and the easing of credit conditions from spring 2023 have also boosted domestic demand. Real estate and construction activity (9.5% of GDP) has gradually recovered and private consumption growth has accelerated (from +3.4% in 2023 to +6.7% in 2024). Yet households have remained rather prudent, particularly due to inflationary pressures and the property crisis. Their consumption could increase more strongly in 2025.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	8.5	5.1	7.1	6.2	6.3
Inflation (CPI, year average, %)	3.2	3.3	3.6	3.3	3.4
Budget balance / GDP (%)	0.7	-2.5	-2.6	-2.6	-2.4
General government debt / GDP (%)	34.7	34.4	33.8	33.6	33.3
Current account balance / GDP (%)	-0.3	6.5	5.0	4.3	3.8
External debt / GDP (%)	35.9	32.7	30.5	28.7	27.3
Forex reserves (USD bn)	86.5	92.2	86.7	87.8	97.3
Forex reserves, in months of imports	2.8	3.3	2.6	2.5	2.6

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

VIETNAM: CONTRIBUTIONS TO ECONOMIC GROWTH

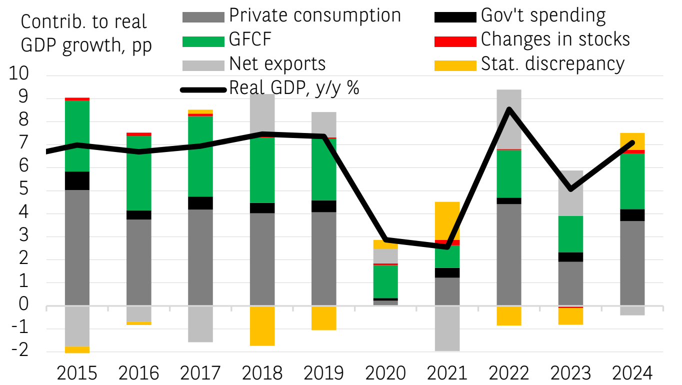

CHART 1 SOURCE: GENERAL STATISTICS OFFICE, CEIC, BNP PARIBAS

Consumer price index inflation accelerated from +2.4% y/y in Q2 2023 to +4.4% in Q2 2024, mainly driven by rising food prices (+4% on average in 2024). CPI inflation has eased since then, falling below 3% in Q4 2024. Core inflation remained close to +2.7% y/y over 2024, a moderately high level. In 2025, CPI inflation is expected to remain below the central bank's target range of 4% to 4.5%.

A GRADUAL IMPROVEMENT IN PUBLIC FINANCE MANAGEMENT

The Vietnamese government has room for manoeuvre for maintaining an expansionary fiscal policy. Fiscal deficits are below 3% of GDP and government debt is moderate, estimated at 34% of GDP in 2024 (based on IMF data).

In 2025, the fiscal deficit is expected to remain stable at 2.6% of GDP. Government spending is expected to continue to rise moderately, driven by current spending and investment. The share of investment in total fiscal expenditure is expected to increase, which is a sign of both improving public finance management and the need to upgrade infrastructure (especially water and energy networks). In addition, from 2022 to 2024, the delivery of public investment projects was significantly slowed down by an extensive anti-corruption campaign spearheaded by the leaders of the Vietnamese Communist Party, and the effects of this campaign are expected to fade this year.

On the revenue side, on the one hand, the tax base should continue to expand gradually, thanks to continued administrative reforms, buoyant economic activity and the introduction of the minimum tax rate of 15% on multinational companies (introduced in 2024, to comply with the OECD agreement reached in 2021). On the other hand, the government is expected to maintain fiscal measures to support domestic demand.

COMPLEXITY OF THE MONETARY AND FOREIGN EXCHANGE POLICY

Since Q2 2023, the central bank (State Bank of Vietnam, SBV) has maintained a monetary and credit policy aiming to support the recovery in the property sector and economic activity. However, its room for manoeuvre has been limited by inflation accelerating until mid-2024 and by downward pressures on the dong (VND). As a result, the SBV has left its policy rates unchanged since June 2023 (at 4.5% for the refinancing rate, after cutting it by 150 basis points in Q2 2023), while it has encouraged bank lending through the adjustment of macroprudential regulations. Growth in outstanding loans to the private sector has rebounded strongly, standing at +16% y/y at the end of 2024 compared to +9% in mid-2023. It is expected to accelerate slightly further in 2025, in line with the target set by the authorities.

On the one hand, the dong is supported by current account surpluses (estimated at 5% of GDP in 2024) and net FDI inflows (4.2% in 2024). On the other hand, Vietnam is still vulnerable to capital outflows: despite the country's macroeconomic stabilisation process of the past few years, residents' confidence in their currency and in their banks is still fragile. Therefore, since 2022, Vietnam has faced large net capital outflows, initially due to US monetary tightening against a backdrop of a confidence crisis in the Vietnamese property and financial sectors, and recently due to changing expectations on US Fed policy and the USD. In order to counteract the downward pressures on the dong, the SBV has stepped up its interventions on the foreign exchange market, consuming its reserves (Vietnam has a managed-float exchange rate regime, with the VND/USD spot rate allowed to trade within a band of ±5% around the reference rate set by the SBV).

In total, the VND/USD spot rate depreciated by 4.5% over 2024, and has depreciated by 10% since the end of 2021. VND depreciation has remained under control, but this has gone with a reduction in the foreign exchange reserves. They fell from USD 92 billion at the end of 2023 to USD 84 billion at the end of September; they now cover less than 3 months of goods and services imports, providing little protection against new external shocks. Of course, Vietnam is not very dependent on external financing and does not face a solvency risk; the country does not need to take on additional debt because it has a positive basic balance (current account surplus + net FDI). In addition, external debt is very moderate and has declined gradually (to around 30% of GDP in 2024 from 37% in 2019). However, in the short term, Vietnam is still exposed to the risk of capital outflows and exchange rate pressures, against a backdrop of a strong dollar and unchanged interest rates in the US.

VIETNAM: US BILATERAL TRADE DEFICITS WITH ASIAN COUNTRIES

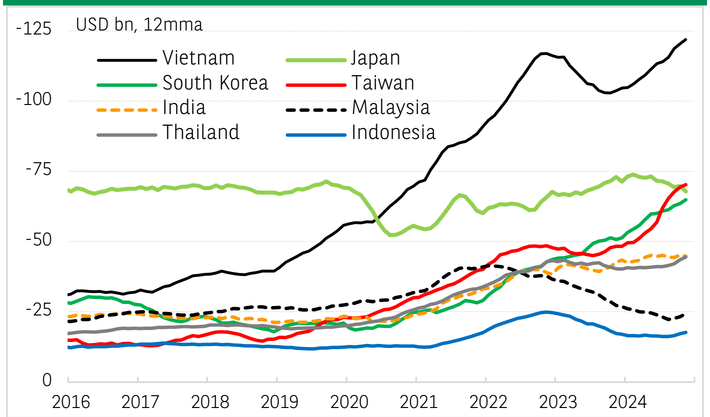

CHART 2 SOURCE: U.S. CENSUS BUREAU, CEIC, BNP PARIBAS

Very strong or prolonged pressures on the dong and on external liquidity could force the authorities to increase the VND/USD trading band and/or tighten capital controls.

TRUMP 2.0: DANGER?

Vietnam is also exposed to the risk of new protectionist barriers. Primarily, because its economy is highly dependent on exports of goods (84% of GDP in 2024) and is therefore vulnerable to a slowdown in global demand that is likely to result from rising protectionism. Moreover, a very large share of Vietnamese exports is also destined for the US market (29% in 2024, compared to 19% in 2017). Then, because Vietnam ticks a number of boxes for attracting the attention of the Trump administration. Firstly, the US trade deficit with Vietnam has increased very quickly and is now the largest, behind China, out of Asian economies. It stood at USD 120 billion in 2024, compared to USD 38 billion just before Trump's first term of office began in 2017 (*chart 2*). Secondly, Vietnam is on the US Treasury's Foreign Exchange Monitoring List. Thirdly, the share of Chinese value added integrated into Vietnam's exports to the United States is now high (estimated at 19% in 2024).

Since 2018, Chinese companies have reorganised their production chains, relocating some of their production factories to other countries to lower production costs and circumvent US tariffs. South-East Asian countries, particularly Vietnam, have benefited greatly. Their trade integration with China has increased, and they have strengthened their role as a production and export hub while also rising the value chain. As a result, they have gained much of the US market share that China has lost over the last six years. As a result, the US could increase tariffs on imports from Vietnam and other "connector" countries where Chinese companies finalise their products.

However, Vietnam still enjoys major comparative advantages (its comparatively high education levels and moderate labour costs, its geographical advantage, proactive policies to attract FDI and its neutral position in geopolitical tensions). As a result, if the United States does not impose tariffs on Vietnamese goods, the country should continue to benefit from changes to global production chains, attract FDI and expand its export base. Conversely, should the United States introduce tariffs, this would adversely affect both its exports and FDI.

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TOWARDS A RECOVERY IN INVESTMENT

Poland stands out from neighbouring countries with an outperformance of its economy. It has also experienced an uninterrupted positive GDP growth since 1992, with the exception of 2020. Growth prospects are strong in 2025 and 2026, due to the expected rebound in public investment and despite the uncertainties related to the presidential elections in May 2025. Inflation is accelerating once again this year and is not expected to converge towards its target before 2026. Monetary authorities are likely to maintain their *status quo* for the time being, and then move towards policy easing later in the year. Regarding the impact of "Trump 2.0", Poland has limited direct trade exposure to the US, but remains vulnerable to the rise of protectionism.

GROWTH CLOSE TO POTENTIAL

Economic activity remains favourable for 2024 as a whole, even though GDP growth slowed in Q3 and scope for a significant rebound in Q4 is unlikely. The carry-over was already 2.2% in Q3, which means that Poland could see higher GDP growth than its neighbours over the past year.

With the pick-up expected in 2025 and 2026, primarily attributed to the recovery in public investment, economic growth should even exceed the medium-term potential estimated at 3% by the IMF. Improving investment prospects rely on the support from EU funds for Poland under the Recovery and Resilience Plan, which are expected to be disbursed by the end of 2026. The amounts allocated to Poland represent EUR 25.3 billion in subsidies and EUR 34.5 billion for loans at preferential rate, i.e. the equivalent of 8% of 2023 GDP. The country also benefits from EUR 76 billion in funds under the European budget, spread over the period 2021-2027.

The momentum of public investment is likely to be strong enough to offset barriers limiting growth. Consumption is expected to lose some momentum due to households turning more cautious, which is already evident in the surveys on purchase intentions for durable goods. Similarly, the long-awaited impetus of external demand is struggling to materialise as Germany, Poland's principal partner, is unlikely to see a significant rebound in its growth in the short term.

HIGHER INFLATION ON AVERAGE IN 2025

The slight drop in inflation in November and December (4.2% y/y in October, to 3.9% y/y in November and December) is probably temporary. Inflationary pressures have generally been on the rise since July 2024 and are expected to continue at least until Q1 2025. This rise in inflation comes from the increase in the cap on electricity prices since July last year, which will remain in place until September 2025. The "food" item is also pushing the consumer price index upwards. Meanwhile, softerinflation expected in the last three quarters of this year could come from a less pronounced wage growth compared to previous years. On average, inflation in 2025 could be higher than last year and a return to the inflation target will not be seen before 2026.

In terms of monetary policy, the Polish Central Bank was the first in the region to start the easing cycle in September 2023, with two consecutive policy rate cuts (the first, by 75 basis points [bps] and 25 bps the following month), followed by a pausethereafter. This recalibration is due to the expectation of slightly higher inflation from mid-2024 to Q1 2025.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	5.5	0.1	2.8	3.5	3.5
Inflation, CPI, year average, %	14.4	11.4	3.7	4.2	2.8
Gen. Gov. balance / GDP, %	-3.4	-5.3	-6.7	-5.7	-5.2
Gen. Gov. debt / GDP, %	48.8	49.7	53.2	55.0	56.9
Current account balance / GDP, %	-2.3	1.8	0.2	-0.7	-1.1
External debt / GDP, %	53.7	49.5	49.2	46.7	44.3
Forex reserves, EUR bn	156.5	175.4	214.2	220.0	225.0
Forex reserves, in months of imports	5.2	6.1	7.3	7.3	7.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

POLAND: EUROPEAN FUNDS FOR RECOVERY AND RESILIENCE

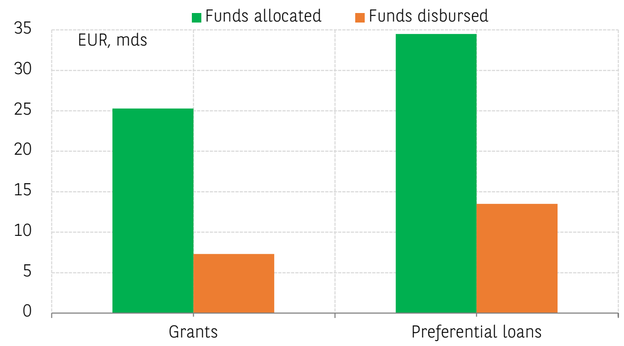

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

In addition, election uncertainties and the expected volatility on the currency market in the face of rising protectionism are likely to prompt greater caution, which reinforces the scenario of a monetary pause, at least in the first half of the year. Resumption of the monetary easing cycle, expected for the second half of the year, should continue next year. According to our scenario, the key rate will probably be reduced to 4.00% at the end of 2025 and to 3.50% in 2026.

GOVERNMENT DEBT ABOVE 60% OF GDP BY 2026

The widening fiscal deficit since 2020 is the result of generous government measures to support the economy. The deficit may reach 6.0% of GDP in 2024 according to estimates and should remain above 5% in 2025.

This year, the budgetary consolidation margin is limited, taking into account the electoral challenges (presidential election scheduled for May 2025) and the magnitude of military expenditure (4.7% of GDP in 2025). The budget also contains an important social component, including, among other things, a 16% increase in healthcare expenditure, a revaluation of wages in certain public sectors and a renewal of the family assistance programme (Family 800+).

The deterioration of the fiscal trajectory is not jeopardising the government's solvency. Government debt is mainly contracted at fixed-rate and the Treasury's ability to refinance itself is strong. Similarly, the government's interest payment remains contained at 9.2% of revenue (1.5% of GDP). However, the proportion of debt to GDP could exceed the threshold of 60% of GDP by 2026, a threshold set out in the Polish constitution, in addition to EU budgetary rules. In the meantime, the prospect of a limited adjustment to public accounts in the short term is reflected in the bond market by rates that remain well above the pre-COVID situation (5.7% in mid-January for the 5-year government bond compared to 1.8% at the end of December 2019).

TRUMP 2.0: POLAND IS EXPOSED TO TARIFF MEASURES

Poland will not escape tariff measures of the Trump administration, even if the country has for years had a marginal bilateral trade balance (of goods) and barely a deficit towards the United States (USD -2.2 billion in 2023; USD -208.7 billion for the EU). The tariff measures planned by the Trump administration will probably be applied to all EU countries indiscriminately. The surplus of the EU's bilateral trade balance with the US, which has also increased since Donald Trump's first mandate, suggests substantial tariffs.

The Polish economy is exposed to the Trump administration's policy through commercial, financial and exchange rate channels. On the first aspect related to trade, Poland's direct exposure is marginal and suggests an initially limited impact since the share of goods exports to the United States was only 2.9% of total exports on average over the last 5 years (1.4% of GDP). By contrast, the indirect impact through Germany, which is more exposed to the US, could be significant. In total, the direct and indirect exposure of Polish exports to tariff measures represents around 15% of GDP. The main export items from Poland to Germany relate to automotive (9.8% of the total in 2022) and machinery and equipment (26.4%). In addition, being a relatively open economy (exports/GDP: 46.8% in 2023), Poland is vulnerable to external shocks given the negative impact of tariff measures on global trade.

On the financial side, the likely slowdown in foreign direct investment (FDI) flows, most of which come from Germany, could put a serious brake on Poland's ambitions to move up the value chain in the short term. Rising economic and geopolitical uncertainties will inevitably lead to a postponement of foreign investment projects. In addition, a reallocation of capital flows in favour of the US is likely in the short term.

US BILATERAL TRADE BALANCES

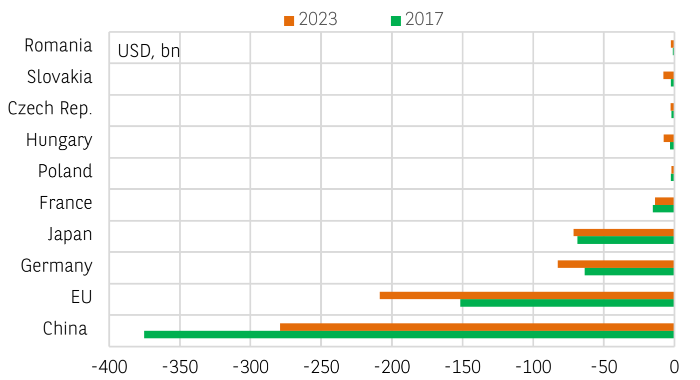

CHART 2 SOURCE: US CENSUS BUREAU, BNP PARIBAS

However, this situation remains manageable and does not present a major risk to external accounts. The current account deficit expected for this year remains moderate and Poland has very comfortable liquidity (foreign exchange reserves of EUR 214.2 billion in December 2024) to meet its needs if necessary.

On the exchange rate side, currency volatility and the upward trajectory of the dollar further weaken countries with a large proportion of their debt denominated in foreign currencies. In Poland, the share of government debt in foreign currencies is moderate, amounting to 24.4% of total debt in 2023 (12.1% of GDP). However, currency risk exposure has nevertheless increased since 2024 as the Polish government is very active on the eurobond market (EUR 7.7 billion raised in 2024) to partially meet its financing needs. This year, Poland has already raised EUR 3 billion in January out of the EUR 10.2 billion planned by the government for 2025. Government exposure to currency risk remains manageable due to supervisory rules in place. The authorised proportion of debt in foreign currencies is set at 25% in Poland.

The expected trend in 2025 is a slight depreciation of the Polish zloty against the euro and the dollar. Caution in monetary policy and the prospect of strong growth in the region should ease downward pressures on the zloty. Last year, the Polish currency reported a modest appreciation of 2.2% against the euro and a limited depreciation of 3.3% against the dollar.

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TWO SIDES TO EVERY COIN

The economy ended 2024 in a state of overheating (reacceleration of inflation, tensions in the labour market) – a situation fueled, in large part, by the prolonged extension of public support measures. Throughout the year, the fiscal trajectory has steadily undermined market confidence – eventually culminating in significant capital outflows in December. The resulting pressures on equities, interest rates and the exchange rate, prompted the Central Bank to take defensive measures to stabilize the BRL. In 2025, a gradual slowdown in economic activity appears inevitable, as domestic demand will be constrained by fiscal adjustment measures, tighter credit conditions, persistent inflation and a deteriorating business climate. Trade and geopolitical tensions add further risks to the outlook despite Brazil's relative resilience to increased American protectionism.

2024: A CROSS-SECTIONAL VIEW

Brazil ended 2024 with macroeconomic and financial indicators moving in a direction diametrically opposed to what most observers anticipated at the start of the year: economic activity and employment strengthened, inflation picked up again while monetary policy tightened. Moreover, the BRL hit a historic low after falling by 22% over the year, while the stock market fell by 30% in dollar terms (compared to -11% in local currency and gains of 7.5% for the MSCI Emerging Markets Index). 10-year government bond yields rose from 10.3% at the start of 2024 to 15.1% at the end of the year while the cost of insurance against a 5-year sovereign default (CDS) rose by nearly 75 basis points over the year. Despite an overall positive record in terms of growth and employment, President Luiz Inacio da Silva "Lula" has seen his popularity decline just over halfway through his term.

The erosion in market confidence throughout the year was largely driven by i/ the expansionary stance of fiscal policy, and ii/ resistance in Congress to supporting reforms raising tax revenues. The fiscal impulse[1] (although less pronounced than in 2023) contributed to the reacceleration of inflation[2] in the second half of 2024 – both directly, by keeping actual output above its potential level (resulting in a positive output gap), and indirectly, through currency depreciation. The downward revision of fiscal targets in April 2024, insufficient cost-cutting plans[3] and a headline budget deficit nearing 9% of GDP (including 7.2% of GDP in interest expenses for the central government) caused significant tensions across local financial markets. In December, these pressures culminated into a full-fledged confidence crisis in the BRL and other asset classes, which were further exacerbated by rising political risks (President Lula's surgeries to address intracranial hemorrhage; debate over his succession within the Workers' Party ahead of the next general election). Net capital outflows reached nearly USD 29 bn in December, marking a peak since 1982. For the entire year, net outflows totalled USD 18 bn – the third largest episode since September 2008. To stabilize the BRL, monetary authorities injected a little more than USD 30 bn by intervening in the FX market – however with ultimately very limited impact overall.

Will Brazil beat expectations again in 2025? Will the tug-of-war with the markets continue? What will be the implications of Trump's return to the US presidency for Brazil?

INFLATION AND MONETARY POLICY: GOING AGAINST THE GRAIN

In contrast to several emerging and advanced economies, financial conditions in Brazil are expected to tighten further in 2025.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	3.1	3.2	3.6	2.1	1.0
Inflation, CPI, year average, %	9.3	4.6	4.4	5.3	4.8
Fiscal balance / GDP, %	-4.6	-8.9	-8.4	-8.7	-8.9
Gross public debt / GDP, %	72	74	79	82	84
Current account balance / GDP, %	-2.9	-1.3	-2.5	-2.0	-1.6
External debt / GDP, %	36	34	36	37	34
Forex reserves, USD bn	324	355	329	334	352
Forex reserves, in months of imports	11	12	11	12	12

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

BRAZIL: BCB FX INTERVENTIONS

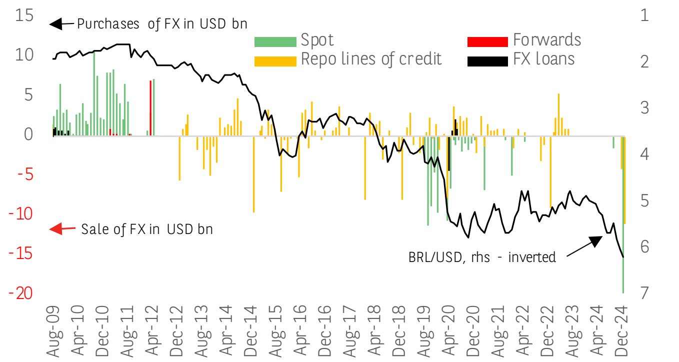

CHART 1 SOURCE: BCB, BNP PARIBAS

Inflationary pressures are likely to persist at levels above the target set by the Central Bank (BCB) under the combined effect of : i/ downward price rigidity in services ii/ a still tight labour market and iii/ continued weakness of the BRL[4] (assuming a slow convergence of inflation expectations towards the target and a strengthening dollar, as U.S. trade and fiscal policies will likely support longer-term yields, attract capital and cause the dollar to rise).

1 Year-on-year change in the primary structural balance (excluding cyclical effects and interest expenses).
2 Inflation ended 2024 at 4.8% year-on-year – above the ceiling of the 3% target +/- 1.5 percentage points. This is the 8th time since the introduction of inflation targeting in 1999 that the monetary authorities have failed to achieve the target. According to the BCB, the inflation surplus in 2024 is due to i/ imported inflation (+0.7pp), ii/ the effect of past inflation on current prices (inertia in contracts, +0.5pp), iii/ the persistence of a positive output gap (+0.5 pp) and inflation expectations (+0.3 pp).
3 The latest one, presented in November, revealed a reduction in spending amounting to about USD 12 bn over the next two years, by limiting, among other things, the increase in the minimum wage and certain social benefits, as well as the repeal of certain privileges for the military. The joint presentation of an income tax reform (aimed at reducing taxes for the middle class) was much less well received, in particular because of its pro-cyclical nature.
4 A study published by the BCB in the Q2 2024 inflation report estimates that, all other things being equal, a permanent 10% rise in the exchange rate adds almost one percentage point to headline inflation.

Since September, authorities have raised the key interest rate (SELIC) by 275 basis points, bringing it to 13.25% by the end of January. The SELIC could peak at 14.75% by May 2025, its highest level since 2006.[5] The real interest rate could hover around 10%, a 20-year high and nearly double the neutral rate, signalling a very restrictive monetary policy. Such a high real interest-rate environment is expected to encourage carry trade strategies but will weigh on household consumption and investment.

FISCAL POLICY: IN A BIND

Since Lula took office, fiscal policy has helped boost growth and reduce poverty. But it has come at the expense of increased public debt vulnerabilities (78% of GDP for the general government at the end of 2024). The authorities now have limited leeway : i/ the rise in interest rates will amplify fiscal imbalances (increase in the debt burden, slowdown in activity and therefore in tax revenues); ii/ the very rigid spending structure (several outlays are protected by the Constitution) and a fragmented Congress make adjustments difficult; in addition, iii/ the fiscal control mechanism voted in 2023 has lost credibility; and iv / the authorities' ability to react to demand or supply shocks (e.g climate events) without raising market concerns has been curtailed.

To restore market confidence and meet primary deficit targets (i.e. excluding interests), a new spending reduction plan is a necessary step. However, to improve the medium-term fiscal outlook, a deep reform of the rules governing mandatory spending is required (new pension reform, unlinking social and pensions from the minimum wage, eliminating spending floors for health and education). Most of these measures conflict with President Lula's economic agenda. Despite the potential political costs, the most likely outcome, nonetheless, seems to be a credible recalibration of spending. Breaking free from the markets could potentially prove more expensive by doubling the macroeconomic effects (acceleration of inflation) with increased instability in the prices of financial assets (stress on the BRL, surge in the cost of debt).

ACTIVITY: MODERATION IN SIGHT

Given the highly restrictive interest rate environment, fiscal policy constraints, and uncertainties surrounding external demand, our central scenario projects real GDP growth of 2.1% in 2025. The statistical carryover from 2024, combined with favourable prospects in the agricultural sector should help keep growth slightly above 2%. Growth is expected to return to its potential, which should help gradually ease pressures on wages and employment.[6]

This scenario assumes a more marked slowdown in activity in the second half of 2025, although some indicators already show early signs of deceleration (slower job creation, credit deceleration, and declining confidence). This forecast includes several upside risks, particularly if authorities resort to extra-budgetary measures to stimulate activity, as seen in the past (e.g., interference in state-owned enterprises' investment policies or boosting public banks' lending activity).

BRAZIL : ECONOMIC ACTIVITY HAS HELD UP MUCH BETTER THAN EXPECTED

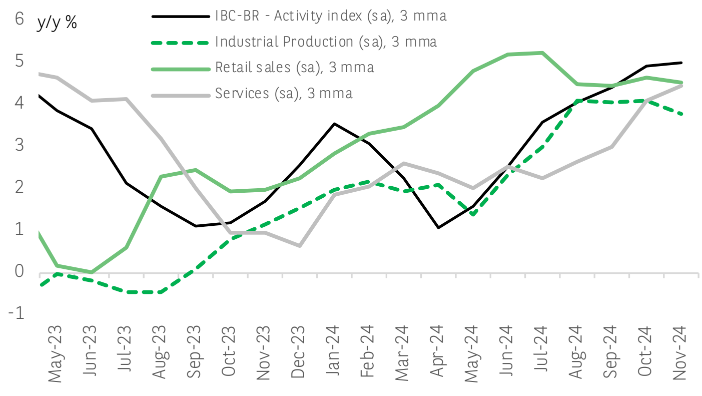

CHART 2 SOURCE: IBGE, BCB, BNP PARIBAS

Additionally, the weak BRL and softer commodity prices could provide stronger-than-expected support to export volumes. Conversely, climate-related shocks affecting agricultural production and energy costs pose downside risks to the central projection.

BRAZIL AND US PROTECTIONISM

Brazil seems less vulnerable to the protectionist threats posed by the new U.S. president than other emerging economies (e.g., Mexico). Firstly, Brazil is not heavily integrated into global value chains and is one of the most closed economies in the world.[7] Secondly, the U.S. does not have a trade deficit with Brazil. Finally, Brazil exports three times more to China than to the U.S. However, the U.S. remains a major economic partner: it accounts for 10% of Brazil's exports (USD 75 bn in 2023) and is the primary destination for Brazilian manufactured goods. The U.S. is also Brazil's third-largest supplier of goods and the leading source of foreign direct investment (FDI).

Simulations using the WTO's GTM model suggest that certain Brazilian sectors would be particularly vulnerable to the imposition of 20% tariffs by the U.S. (oil, metals, and transportation equipment). Beyond the trade channel, the impact of U.S. policy on the dollar and global interest rates could affect Brazil's growth and monetary policy. Finally, the closer ties between President Lula's government and China (with both countries signing 37 new strategic cooperation agreements following the G20 summit in late November), historical tensions between the Brazilian judiciary and Elon Musk, and Lula's desire to move away from the dollar could increasingly put Brazil in Washington's crosshairs.

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5 At its December meeting, the BCB reintroduced its forward guidance policy announcing 100 bps hikes at its January and March meetings.
6 As a reminder, the level of unemployment is estimated to be between 2 and 3 points below the level considered non-inflationary (NAIRU: ~8.5% and 9.5%). In Q4 2024, wages were growing by close to 5% in real terms.
7 Imports + exports accounted for only 34% of GDP in 2023 compared to 95% on average worldwide. The sensitivity of GDP to exports is therefore lower.

MEXICO

A CONSTRAINED ECONOMY

The Mexican economy is slowing down and the short-term outlook is not favourable. The constitutional reforms enacted in recent months (including the reform of the judicial system) are damaging the institutional framework and deterring investment. In addition, consumption could be hit hard by the fiscal consolidation plan announced by the government. Above all, Mexico is one of the most vulnerable countries to the US economic policy change. The new migration measures could significantly reduce money transfers from foreign workers, which significantly support the country's growth. The expected customs tariffs applied would also have severe consequences for the Mexican economy in terms of growth and inflation.

SLOWDOWN IN GROWTH

Activity has slowed in recent months (the PMI index was below 50 throughout the second half of 2024) and the outlook is still poor in the short term.

Political uncertainty, in the US and Mexico, will weigh on investment spending and private consumption. If the strengthened anti-immigration measures promised by the new US administration were implemented, resulting in a massive return to Mexico of citizens working on US soil, the transfers of foreign workers, an important support for private consumption, would be permanently affected. They have increased steadily over the past five years and are estimated to have accounted for nearly 3% of GDP in 2024. A 30% drop in these transfers would reduce GDP growth by nearly 0.75 percentage points. The fiscal consolidation promised by the government is also expected to reduce public spending.

Finally, exports will be affected by the political decisions made by the new US administration. All in all, GDP growth is expected to remain close to 0.5% in 2025, and remain well below its potential level in 2026 (estimated at 1.8% by the IMF).

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	3.9	3.2	1.5	0.5	1.2
Inflation, CPI, year average, %	7.9	5.6	4.7	3.8	3.8
Budget balance / GDP, %	-4.3	-3.3	-5.1	-4.4	-4.2
Public debt / GDP, %	46.9	46.5	49.1	51.5	53.2
Current account balance / GDP, %	-1.2	-0.3	-0.1	-0.1	-0.3
External debt / GDP, %	41.9	33.3	31.0	32.0	33.0
Forex reserves, USD bn	194.0	207.0	214.0	219.0	226.0
Forex reserves, in months of imports	4.8	4.1	4.3	4.5	4.2

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MEXICO: PERSISTANT INFLATION PRESSURES

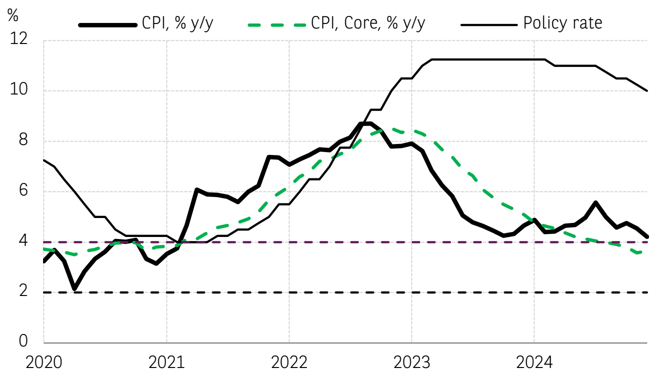

CHART 1

CENTRAL BANK, BNP PARIBAS

PERSISTENT INFLATIONARY PRESSURES

Inflation fell steadily in the second half of 2024, dropping to 4.2% in December. However, inflationary pressures can still be felt, with wages rising by nearly 10% in 2024, following successive minimum wage increases (+135% in real terms since AMLO became President of Mexico in 2018), and production prices continuing to rise by a rate of more than 5%.

Inflationary pressures will be sustained by wage increases during the coming months, as the new President of Mexico, Claudia Sheinbaum, has taken up the "fourth transformation" measures and is planning a number of minimum wage increases during her term of office. As a result of these efforts, she wants the minimum wage to be equal to 2.5 times the basket of essential goods by 2030 (compared to 1.8 currently). With this in mind, the minimum wage was raised again, by 12% on 1st January 2025 in the free zones on the northern border.

According to the latest estimates by the Bank of Mexico, the inflation target (3%) will only be hit in Q3 2026.

The Bank of Mexico cut its key interest rate five times in 2024, taking it down to 10% by December. In its statement, it indicated that this rate could continue to come down in the coming months if disinflation continued. However, a number of members noted the risk posed by the new US economic policy, which could constrain Mexican monetary policy. The effects on inflation are still difficult to quantify: on the one hand, tariffs would weaken the peso, which would increase import prices, producer prices, and finally inflation (reinforced by the likely rise in US inflation, which would be reflected in value chains). But, on the other hand, the recessive effect on growth could accelerate the process of disinflation.

DETERIORATING PUBLIC FINANCES

The public deficit has increased substantially over the past five years, rising from -2.7% of GDP in 2020 to 5.1% of GDP in 2024. As she promised in her election campaign, President Sheinbaum announced a fiscal consolidation policy, with the budget adopted by the Chamber of Deputies aiming to bring down the public deficit to 3.5% of GDP in 2025. This process is expected to take longer, however. This is because of, on the one hand, the seemingly overly optimistic growth assumptions used in the budget (around 2.5% of GDP), and on the other hand (and above all), the rigid public spending and the financial support required by PEMEX, the national oil company. By adding access to social transfers to the constitution, a measure adopted by the Senate at the end of last October, this rigidity is now even greater. Even though the details of this reform are not yet known, including how it is going to be implemented, the government's ability to make spending adjustments will be reduced even further in the coming years. In addition, the President's plans around adopting a large-scale tax reform (which would streamline expenses and improve collection) are still vague.

Interest payments have increased in recent years and are expected to account for 15% of the country's revenue in 2025 (compared to 12% in 2018), reflecting the sustained rise in the rates used by the government for financing itself. The refinancing and market risk is low in the short term for the government (maturities are long and foreign currency exposure is still limited), but the latter is still vulnerable to a shift in investor sentiment (30% of the peso-denominated public debt is held by foreign investors).

MEXICO : ACCELERATING PUBLIC FINANCE DETERIORATION

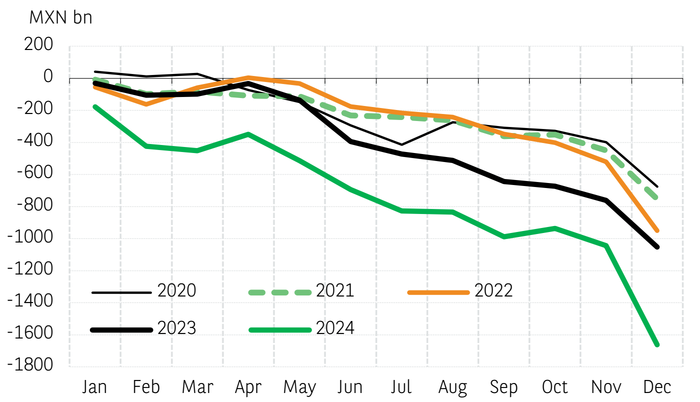

CHART 2 SOURCE: SECRETARY OF FINANCE AND PUBLIC CREDIT, BNP PARIBAS

POLITICAL RISK HITS FORECASTS HARD

Mexico, the United States' main trading partner (15% of imports) ahead of China (13%), is one of the most vulnerable countries to the US economic policy change.

As promised during his election campaign, Donald Trump announced several measures relating to Mexico as soon as he took office on 20 January. Rather than the scale of the trade deficit (estimated at nearly USD 170 billion for 2024), Trump expressed strong concern about the flow of illegal immigrants and drug trafficking from Mexico to the United States. A national emergency has been declared at the border, drug cartels will now be classified as terrorist organisations and asylum seekers will have to stay in Mexico (and no longer in the United States) while waiting for their claim to be processed.

In particular, a 25% increase in customs tariffs could affect all imports from Mexico from 1st March. An increase is also expected to be applied to Canadian (25% as well) and Chinese (10%) products.

This announcement can be interpreted as a desire to open negotiations on revising the USMCA trade agreement between the three countries (USA, Canada and Mexico) now, as opposed to the scheduled start date in Q4 2025. In addition, rather than revising it, Trump will likely want to renegotiate the agreement, just as he did during his first term of office (the road to signing the USMCA in 2020 began with revising the NAFTA in 2017).

In Mexico, the government's intentions are clear. Since the UMSCA was signed in 2020, Mexico has also gradually imposed tariffs on some products from Asia. At the same time, a number of measures have been put in place to regulate the flow of illegal workers to the United States and drug trafficking, but the effects are harder to measure. Finally, a few days before 20 January, President Sheinbaum presented the so-called "Plan Mexico" intended to reassure the US administration, by announcing measures aiming to reduce Chinese involvement at all stages of production, particularly in the automotive sector. The details are not yet known, but, in her speech, the President mentioned "import substitution", the need to "increase foreign direct investment in order to create value added" and "ramping up".

The aim is to significantly increase the share of Mexican value added in exports, which is still low. The plan also seeks to secure nearshoring opportunities that are currently not particularly prominent. Alignment on customs tariffs on China was also suggested.

Despite these announcements, Mexico's bargaining power is low and there is still a lot of work to be done. None of the structural difficulties of the Mexican economy were mentioned in the plan (low productivity, a lack of infrastructure and low public spending on R&D, in particular). In addition, all of the economic policies initiated during AMLO's term of office (and adopted by the current administration), such as reforming the energy sector (increased State involvement, lack of transparency and restrictions on private investors, particularly foreign investors), seemingly run counter to the commitments requested by Trump. The constitutional reforms undertaken last year (particularly the reform of the judicial system, which is weakening the institutional framework) have made the country even less attractive to investors. Most importantly, these reforms are out of line with the criteria for acceding to the USMCA.

That said, even though the negotiations promise to be tough, our central scenario is still that an agreement will be reached and the USMCA will be renewed. Mexico appears to be the most vulnerable country, but the imposition of tariffs would in fact have potentially far-reaching macroeconomic consequences for all countries involved.

The integration of the US and Mexican economies has increased considerably in recent years, particularly since Trump's first term of office. Mexican exports to the United States now account for nearly 85% of the country's total exports (i.e. nearly 30% of GDP). They have diversified and make up a growing share of the value chains connected to the United States. In the automotive industry, for example, intermediate goods cross the US-Mexico border several times before the final assembly of a vehicle, meaning imposing high customs tariffs at each stage of manufacturing would be extremely costly for both countries.

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ARGENTINA

IMPRESSIVE STABILISATION

Argentina's economy is back on track. Since mid-2024, growth has returned and inflation has slowed significantly. There has been a high social cost to the severe cuts in public spending, but the government budget is in surplus for the first time since 2010. With the recessionary impact of fiscal austerity, the current account balance has turned into a surplus as well. But exports have also been rebounded , despite low prices of agricultural commodities. For the time being, the central bank's foreign exchange reserves are still insufficient for exchange controls to be lifted before the mid-term elections in October. The renewal of an agreement with the IMF is already a prerequisite. The economic recovery should be confirmed in 2025, especially as the change of government in the United States could have positive effects.

GROWTH: THE END OF RECESSION

Real GDP rebounded strongly in Q3 2024 (+3.9% q/q) after three quarters of consecutive declines. All of the components of private demand made a positive contribution to the upturn in activity, including net foreign trade thanks to stronger growth in exports than in imports. By sector, the rebound has been particularly noteworthy in construction (+11%) and industrial production (+3.4%), but it only very partially corrects the fall in late 2023-early 2024 (see chart). Measured over a year, GDP growth is still negative (-2%) and remains almost 5% below its previous high in Q4 2018.

Over the last months of the year, trends in industrial production and in agricultural and industrial manufacturing exports in dollars (75% of total exports) confirmed the return to growth. Only construction activity contracted again, but this does not reflect a trend, as data are highly volatile, even when seasonally adjusted. Household confidence, which had fallen sharply in the first half of the year, returned to its late 2024 level, reinvigorated by the progress of disinflation (see below). Between January and October 2024, wages actually recovered. However, over the year as a whole, wage trends remained negative, especially in the public sector (-18% compared with -2.5% for registered private-sector employees). As job losses increased at the same time, and social benefits were cut in real terms, the rebound in household consumption was based largely on a falling saving rate.

For 2025, the return to full-year growth is based on i/ continuing disinflation, which would enable household disposable income to recover and provide a more solid basis for consumption ii/ rebounding investment as a result of deregulation and the tax incentive programme (RINGI programme). On the other hand, the positive contribution of foreign trade could be reduced or even reversed due to the very strong appreciation of the real exchange rate. In addition, the prices of the main exported agricultural commodities (soybean, corn and wheat) are not buoyant.[1]

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	5.3	-1.6	-2.6	3.9	2.8
Inflation, CPI, year average, %	72.4	133.5	219.9	42.0	29.0
General gov. balance / GDP, %	-3.8	-4.4	-0.0	0.2	0.9
General gov. debt / GDP, %	85.6	156.5	87.4	74.8	69.4
Current account balance / GDP, %	-0.6	-3.2	1.5	0.7	-0.0
External debt / GDP, %	43.8	44.4	51.4	40.4	33.1
Forex reserves, USD bn	41.2	19.0	22.0	34.8	46.7
Forex reserves, in months of imports	5.1	2.5	3.4	5.0	6.3

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ARGENTINA: ACTIVITY INDICATORS

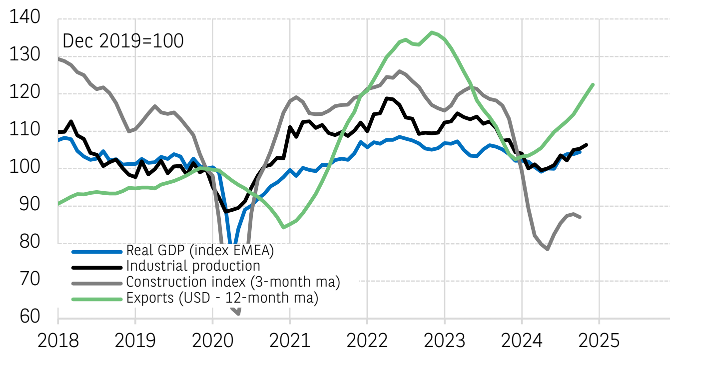

CHART 1 SOURCE: INDEC, ISAC, BNP PARIBAS

INFLATION: FIRST SUCCESS FOR THE ANCHORING STRATEGY

Inflation has slowed significantly in recent months, from an average of 4.2% per month between May and August to 2.8% between September and December. This disinflation is mainly due to i/ an appreciation of the real exchange rate, as a result of the setting of a nominal depreciation rate for the official exchange rate against the dollar of only 2% per month and the reduction in the gap between the main parallel exchange rate used for market instruments (the Blue Chip swap rate) and the official exchange rate, which was reduced to 30% on average in 2024 (17% in mid-January 2025) compared with more than 200% before devaluation ii/ the slowdown in money supply growth since July 2024. This strategy of anchoring expectations to the real exchange rate and controlling the monetary base has been facilitated by falling real wages and the extreme fiscal discipline imposed by Javier Milei's government.

1 Only corn prices have recovered since mid-2024, and are currently 11% above the 2024 average. Conversely, soybean prices are stagnating and wheat prices are depressed, down 2% and 9% on 2024, respectively.

PUBLIC FINANCES: AUSTERITY

Fiscal adjustment was spectacular in 2024. The central government budget recorded a surplus of 0.3% of GDP for the first time since 2010. The primary balance surplus hit 1.9% of GDP, compared with a deficit of 2.7% in 2023. The bulk of this spectacular improvement has come from a drastic cut in spending of 4.5 points of GDP. Social benefits and current transfers alone shrank by 2.6 points of GDP. The social cost is high, with the official poverty rate hitting a record 52.9% in June 2024. Thanks to disinflation, it is estimated to have fallen below 40% during the second half of the year[2]. However, according to calculations by the UCA Catholic University's social debt observatory, the poverty rate has actually risen over the past year and is still above 40% due to rising prices for services (electricity, water, gas and transport) and cuts in basic social benefits.

Revenue as a % of GDP remained more or less stable between the end of 2023 and the end of 2024, thanks in particular to the increase in real terms in taxes on foreign trade. Finally, the net interest burden also remained stable at 1.6% of GDP.

For 2025, the government aims to maintain a balanced budget and therefore to maintain a primary surplus of at least 1.5% of GDP. However, the abolition of the *Impuesto Pais* on imports and tourist spending by Argentines is likely to result in a loss of 1% of GDP in revenue. Further spending cuts will therefore be necessary.

The public debt ratio as a % of GDP is still very high at 94%. The change between the end of 2022 and the end of 2024 (see forecast table) almost exclusively reflects the impact of changes in the real exchange rate (+190% against the dollar in 2024 after -40% in 2023). With foreign currency debt still accounting for the majority of total debt (56% at the end of 2024), the ratio should continue to fall sharply over the next two years if the monetary authorities maintain a target rate of nominal exchange-rate depreciation significantly lower than the inflation rate, and if convergence between the parallel rate and the effective rate continues, or at least does not reverse. These last two conditions presuppose the maintenance of fiscal credibility and the strengthening of external liquidity and solvency, and, therefore, a lasting improvement in the current account.

EXTERNAL ACCOUNTS: FOREIGN EXCHANGE RESERVES REMAIN INSUFFICIENT DESPITE THE RECESSION SURPLUS

The current account balance returned to surplus last year (+USD 5 billion in Q1-Q3 2024). This is mainly a recession surplus following the extreme tightening of fiscal policy; imports excluding petroleum products contracted by 14% and the energy balance recorded a significant surplus of USD 4 billion. However, the surplus is also due to very dynamic exports, given the sluggish growth in global trade (3.4%). Exports of manufactured agricultural and industrial products rose by 16%, largely offsetting the fall in exports of raw agricultural products. In October and November, the trade balance (customs source) was still clearly in surplus (USD 1.6 billion cumulatively).

Over Q1-Q3 2024, net inflows of direct investment (USD 8.9 billion) largely offset net outflows of portfolio investment (USD -5.1 billion). Net capital flows from Argentinians (not included in FDI and PI) were negligible after massive net outflows in 2023 (USD 15.3 billion).

However, foreign exchange reserves only increased by USD 6 billion between the end of 2023 and the end of 2024, mainly due to the repayment of foreign public debt (USD 5.7 billion). The tax amnesty on dollars kept under the mattress or as deposits abroad enabled up to USD 15 billion to be repatriated, but these remained in the form of deposits in local banks. At the end of January, official foreign exchange reserves stood at just 30 billion.

In 2025, the amortisation of public foreign debt will almost double (USD 11.1 billion) despite the absence of repayments to the IMF. The budget surplus in 2024 enabled the Treasury to rebuild its foreign currency reserves, purchased from the central bank, enabling it to cover the international bond maturities in January and July 2025 (USD 5.8 billion amortisation, USD 3.1 billion interest).

Monetary and exchange rate policy: Argentina moves towards lifting exchange controls after the mid-term elections

The central bank has made only two moderate cuts to its key rate since the end of April 2024, bringing it down to 32% since the beginning of December. The BCRA had been forced to raise it very sharply during the devaluation at the end of 2023, and then to cut it markedly once the stressful period in late 2023-early 2024 had passed. The level of the key rate is in line with inflation expectations (26% according to the BCRA's December survey).

The exchange rate policy closely drives the nominal exchange rate in order to consolidate the convergence of the various rates before lifting exchange controls. The BCRA has lowered the rate of depreciation of the official exchange rate to 1% per month for 2025. However, exchange controls will not likely be lifted before the mid-term elections in October; the government team estimates that between USD 11 billion and USD 20 billion are needed for the lifting of exchange controls to be successful. Tthe renewal of the IMF agreement (which has been secured, but with very little additional funding) is a prerequisite in order to attract sustainable private investment.

TRUMP 2.0: A BONANZA?

The change of government in the United States could have positive implications for Argentina. The threat of a 10% or 20% increase in customs tariffs would only affect 8% of the country's exports. In addition, Argentina's trade balance with the United States is usually in deficit (the surplus in 2024 – USD 229 million - was an exception) and the Argentine monetary authorities cannot be suspected of manipulating the exchange rate to boost their competitiveness, quite the contrary. Javier Milei and Donald Trump have a very cordial relationship, and Javier Milei may even seek to negotiate a bilateral free trade agreement, even if it means leaving Mercosur, which he has described in the past as a "protectionist prison". The United States is the largest direct investor in Argentina, and the very liberal economic policy of the Milei government should attract US investors.

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2 38.9% in Q3 according to the Consejo Nacional de Coordinación de Políticas Sociales (CNCPS), 34.8% in Q4 2024 according to a study by an economist at the Università Torcuato di Tella.

SAUDI ARABIA

THE HIGH COST OF DIVERSIFICATION

Economic growth is being restrained by OPEC+ restricting oil production. Excluding hydrocarbons, activity is holding up well however, driven by consumption and the government's intensive investment policy under the Vision 2030 economic diversification programme. This solidity comes with large budget deficits, and now also current account deficits, which are requiring record-high debt issuance. Fortunately, the country still has comfortable financial leeway. However, Donald Trump's return to the White House could have a deep impact on a number of areas.

SOLID YET LIMITED GROWTH

After a 0.8% contraction in GDP in 2023, the Saudi economy has started growing again. However, it is still struggling to really build momentum due to the oil production cuts under OPEC+ policy. Saudi Arabia produced 9 million barrels/day (mbd) in 2024, compared to 9.6 mbd in 2023 and 10.5 mbd in 2022. While real oil GDP is no longer in recession since Q3 (chart 1), it fell by around 4% over 2024 as a whole, pulling economic growth downwards to just 1.3%. Therefore, compared to the initial expectations (4.4%) when drawing up the budget, the landing is pretty hard. Catch-up hopes for 2025 are likely to come up against similar difficulties, but less so.

Our growth forecasts for this year have already been lowered to 3.4% (4.6% for the government) in order to factor in the announcements made in December by OPEC+, namely: 1/ the three-month extension of voluntary restrictions on oil production; and 2/ the very gradual lifting of restrictions, a process which will continue until the end of September 2026, i.e. one year later than expected. For Saudi Arabia, which is supporting the bulk of effort, this will mean a shortfall of 0.4 mbd in 2025. At 9.2 mbd, Saudi oil production would therefore only be increasing by 2% compared to the 6% figure initially forecast, and there is a risk that OPEC+ will make further adjustments during the year as long as the global oil market remains fragile. However, a contraction in oil production seems unlikely at this stage. As a result, athough there is major uncertainty around oil production, it is not expected to have a similar recessive effect as during the last two years.

Against this backdrop, most of the growth will come from the non-oil sector once again. It continues to enjoy strong growth (+3.9% on average over the first nine months of 2024), buoyed by investment (+4.1%) and household consumption (+2.9%). Its prospects are looking favourable too. The continued infrastructure megaprojects as part of the Vision 2030 economic diversification programme and the strong labour market (with a record low unemployment rate of 3.7% and a constantly rising labour force participation rate, particularly among women) should therefore help the non-hydrocarbon sector to continue growing at a rate of at least 4%.

INFLATION REMAINS CONTAINED

Despite the robust domestic demand and rents rising by more than 10% (21% of the consumer price index, by far its main component), fuelled by sustained urbanisation and the growing working population, the inflationary risk is under control. The increase in CPI stood at 1.7% on average in 2024, compared to 2.3% in 2023, and is not expected to go over 2% this year. A number of factors moderating inflation are at play, in particular the strength of the US dollar on which the Saudi riyal is pegged

However, Saudi Arabia's monetary policy is closely linked to the US Federal Reserve's monetary policy. Even though the country was relatively spared from the global inflationary shock, the key rate was hiked from a low of 1% in early 2022 to 6% in mid-2023, before being gradually cut starting from September 2024. It currently stands at 5% and is expected to hold if monetary easing in the United States stops. For the time being, the "imported" monetary policy has not adversely affected the pace of lending. Growth in bank lending to the private sector remained above 10% in 2024, buoyed by strong corporate demand. Given the solid outlook for non-hydrocarbon growth, there is little evidence to suggest that this will change in 2025.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	7.5	-0.8	1.3	3.4	4.3
Inflation, CPI, year average, %	2.5	2.3	1.7	2.0	2.0
Gen. Gov. balance / GDP (%)	2.5	-2.0	-2.9	-3.7	-3.5
Gen. Gov. debt / GDP (%)	24	26	30	33	34
Current account balance / GDP (%)	13.7	3.2	0.2	-1.6	-1.6
External debt / GDP (%)	24	28	30	32	35
Forex reserves (USD bn)	460	437	437	423	414
Forex reserves, in months of imports	21.4	18.0	17.1	15.3	13.8

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

SAUDI ARABIA: NON-OIL SECTOR IS THE MAIN GROWTH DRIVER

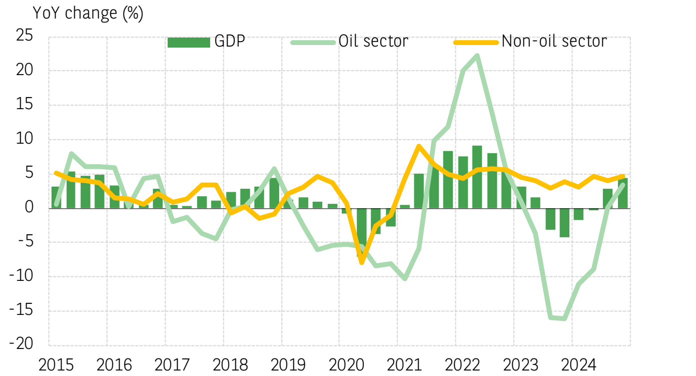

CHART 1 SOURCE: GASTAT, BNP PARIBAS

THE RETURN OF TWIN DEFICITS IN 2025

The country's strong non-oil growth has come at a cost. The acceleration of the Vision 2030 diversification programme has resulted in a 30% total increase in budget spending over the past three years. At the same time, oil revenues (more than 60% of fiscal revenue) have suffered from combined adverse price and volume effects, with the impact partially offset by the exceptionnal payment of a "performance-linked dividend" from the national oil company Aramco. Amounting to 1.8% of GDP in 2023 and 4% of GDP in 2024, this operation helped to keep the budget deficit down at between 2% and 3% of GDP. However, the payment is expected to be discontinued this year, as the expected fall in global oil prices will continue to strain government resources. In response, the authorities have presented a conservative budget. Spending is expected to be cut by 4.5%, which would be the largest fiscal consolidation effort in 20 years (with the exception of 2015 and 2016). Nevertheless, fiscal slippages are common. As a result, budget spending should, in the best case, stabilise at a high level, and the budget deficit should widen to 3.7% of GDP.

The current account slipping into the red in Q3 2024 (deficit of USD 9 billion) is another indicator of the macroeconomic pressures caused by by soaring public spending (*chart 2*). The Saudi economy, which is usually in surplus, now needs a Brent price of around USD 80/barrel in order to balance its current account, compared to less than USD 55 in 2022. The country is therefore expected to record fiscal and current account deficits in 2025, a situation which has not occurred since the pandemic.

DEBT RISING TOWARDS NEW RECORD LEVELS

Saudi Arabia will continue to issue large volumes of debt after already being one of the most active emerging countries on the international financial markets in 2024. Excluding syndicated loans, the government raised USD 17 billion in eurobond debt last year, with USD 9 billion added for the PIF sovereign wealth fund (the main vehicle for the Vision 2030 programme), as well as USD 9 billion for Aramco.

These record issuance amounts could be exceeded in 2025. Indeed, the government must cover USD 6.6 billion in amortisation of eurobond debt this year (compared to USD 1 billion in 2024). For the time being, the Saudi government is still able to take on a lot of debt, as net external assets reached more than 70% of GDP at the end of 2023 and central government debt is moderate (30% of GDP) with a favourable structure (average maturity of 9.2 years, 61% of the stock is domestic) and low costs (interest expenses absorb 3.6% of budgetary resources).

TRUMP 2.0: A BALANCING ACT FOR THE KINGDOM

The massive use of debt is profoundly changing the country's role on the global stage. Once a net supplier of capital, Saudi Arabia is now a net importer in order to cover its development needs. Over the first nine months of 2024, the financial balance posted a USD 34 billion net surplus, compared to a deficit of a similar amount during the previous year. Excluding special operations in the hydrocarbon sector, foreign direct investment only accounts for 1% to 1.5% of GDP. The entry into force of new investment legislation this year is expected to improve the Kingdom's attractiveness.

SAUDI ARABIA: STRONG MACROECONOMIC PRESSURES

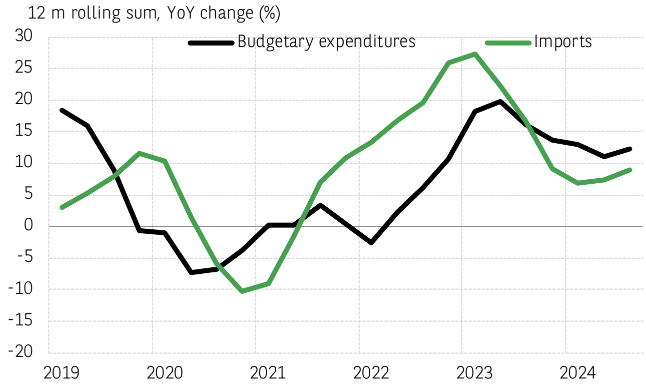

CHART 2 SOURCE: CENTRAL BANK, MINISTRY OF FINANCE, BNP PARIBAS

Until these hopes materialise, the authorities will therefore have to continue to support a large part of the economic transformation through public investment. Therefore, despite the Vision 2030 programme being recalibrated, this transition period leads to increased economic vulnerability to oil fluctuations.

Against this backdrop, the stability of the external environment more generally, and of the oil market in particular, is paramount for Saudi Arabia. However, Donald Trump's return to the White House could have deep impact on many areas, particularly due to his energy policy, which aims to increase US oil production in the medium term, while also seeking to keep global prices quite low. Therefore, Saudi Arabia could be involved in this drive at the start, by increasing its production, but there are uncertainties around the timing. On the external trade side, the country is unlikely to be targeted by increased customs tariffs. However, escalating tensions between the United States and China should make the balancing act between its two strategic partners even more challenging. While China is now Saudi Arabia's principal trade partner (18% of total trade in 2023, compared to 6.5% for the United States), the United States is still ahead of the game when it comes to investment. There will also be opportunities for the country to grasp. In fact, the Saudi authorities and the Trump administration share a common transactional approach to international relations. Saudi Arabia, in particular, could harness this to strengthen its influence in a changing Middle East. This will be decisive in preventing tensions around Iran from degenerating into a new regional conflict, even if Saudi Arabia could also indirectly benefit from harder sanctions on Iranian oil (back-up capacity and upward pressures on oil prices).

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THE EGYPTIAN ECONOMY REMAINS VULNERABLE DESPITE POSITIVE MOMENTUM

The massive support of international donors has restored a degree of optimism to the Egyptian economic outlook. The depreciation of the exchange rate is under control and inflation is clearly on a downward trajectory, which should make it possible to ease monetary policy. Nevertheless, structural problems remain and will only be resolved very gradually, both in terms of public finances and external accounts. The policies of the new US administration should have a limited impact on Egypt's external accounts.

UNCERTAIN ECONOMIC RECOVERY

After a downturn in activity in fiscal year 2024 (FY2024) due to a deep balance of payments crisis, the Egyptian economy is in a phase of gradual recovery, with growth expected to average 4% in FY2025. The stabilisation of the foreign exchange market and the easing of tensions over foreign currency liquidity over the next two years will be key factors in the recovery, particularly given the country's heavy dependence on imports and expatriate remittances. This recovery should initially be based on household consumption, the traditional driver of Egyptian growth (around 80% of GDP), which showed signs of recovery in the first half of FY2025. Nevertheless, some uncertainties remain in the short term, and we expect a more balanced recovery from the start of 2026. Household disposable income continues to be affected by persistently high inflation. Public sector investment is not expected to be a significant support factor due to the fiscal consolidation effort under the IMF programme. In turn, productive investment by the private sector should only really pick up again from 2026 onwards. For the time being, capacity utilisation remains below 70% on average, which is not enough to trigger an investment drive (above 90%). Moreover, in nominal terms, interest rates remain very high, and monetary easing is likely to be gradual because of the risks to the pace of decline in inflation. Against this backdrop, we expect a moderate acceleration in growth in FY2026 to 4.7%.

DEPRECIATION OF THE EGYPTIAN POUND UNDER CONTROL

The balance of payments crisis triggered by the geopolitical shock of 2022 led to a massive depreciation of the pound and access to the dollar rationed on multiple segments of the economy. Financial support from the UAE and then from international donors enabled the foreign exchange market to return to normal. The main imbalances have been corrected (in particular, the net foreign asset position of commercial banks), the central bank's foreign exchange reserves hit USD 46.4 billion in December (excluding gold and including Tier II reserves), equivalent to 6.5 months of imports of goods and services (USD 33.2 billion and 4.8 months in December 2023), and the pound has become more flexible. The pound depreciated by only 5.5% in the second half of 2024, mainly due to the appreciation of the US dollar against all other currencies. The low volatility of the exchange rate during this period signalled the central bank's desire to keep some influence over this market. In the short term, the pound should continue to depreciate as a result of the dollar's strength on international markets and the increase in the current account deficit, albeit at a moderate pace.

MONETARY POLICY EXPECTED TO EASE

Consumer price inflation hit 24.1% in December, confirming the downward trend which began last September, thanks in particular to the sharp fall in food prices and the stabilisation of the exchange rate.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	6.6	3.8	2.6	4.0	4.7
Inflation, CPI, year average, %	8.5	24.0	33.6	19.8	10.3
Central gov. balance / GDP (%)	-5.8	-5.7	-3.3	-6.8	-5.3
Central gov. debt / GDP (%)	89	96	94	83	76
Current account balance / GDP (%)	-3.5	-1.2	-5.4	-4.4	-4.2
External debt / GDP (%)	33	42	40	46	44
Forex reserves, excl. Gold, incl. Tier II (USD bn)	27	31	46	52	57
Forex reserves, in months of imports	3.1	4.5	6.3	6.9	7.0

Fiscal year from July 1st of year n to June 30 of year n+1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: RESTORATION OF FOREIGN CURRENCY LIQUIDITY

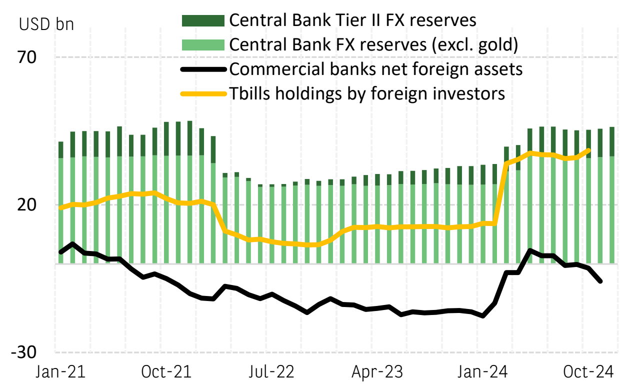

CHART 1 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

Nevertheless, overall inflation is still far above the central bank's target (7% +/-2%). Core inflation is following a similar trend. Due in part to base effects, inflation should fall significantly from February 2025, averaging at 19.8% for FY2025 as a whole and around 10% for FY2026. While the downward trend seems assured for the next 18 months, specific factors could slow the pace, particularly fiscal consolidation, especially if it takes the form of VAT hikes and subsidy cuts. In addition, the expected depreciation of the pound, even if kept under control, could fuel inflationary pressures.

The expected acceleration in the fall in inflation in Q1 2025 should enable the central bank to begin a cycle of monetary easing, following 1,900 basis points of increases since February 2022. The pace of this rate cut presents the central bank with a difficult choice, as, on the one hand, the sharp rise in real interest rates from February onwards will act as a brake on the recovery in investment. With an unchanged nominal rate, the central bank's lending rate should rise from 4% in December 2024 to over 16% in February 2025 in real terms. On the other hand, uncertainties over the inflation outlook are likely to make the central bank cautious. We can therefore expect rates to fall gradually in 2025.

AN AMBITIOUS PRIMARY SURPLUS TARGET

Fiscal performance in FY2024 was remarkable, but exceptional in nature due to the inflow of funds linked to the Ras El-Hekma deal (USD 24 billion, around 7% of GDP, in FDI from the United Arab Emirates). The budget deficit hit 3.3% of GDP, while the primary balance was in surplus by more than 6% of GDP. The government's fiscal target for the current year remains ambitious, with a primary surplus equivalent to 3.5% of GDP. This objective should be achieved through measures to broaden the tax base, reduce some subsidies (mainly energy), cut some public investment expenditure and increase VAT on specific categories of products. In the first five months of the current fiscal year, the Ministry of Finance estimates the primary surplus to stand at 1% of GDP, compared to 0.4% for the same period last year. The total budget deficit will remain high (6.8% of GDP expected this year) due to the interest burden, which amounted to 47% of general government revenues in FY2024 (55% this year), one of the highest levels among emerging countries. Active debt management should make it possible to reduce the cost of debt, notably by extending maturities. The government aims to get to an average maturity of 4.5 years in FY2026 (3.2 in FY2023). The gradual nature of the fall in rates will make this a fairly slow process. It is in the government's interest to continue issuing on short maturities initially in order to benefit from the gradual fall in rates.

WHAT IMPACT WILL TRUMP 2.0 HAVE ON THE EXTERNAL ACCOUNTS?

From a US perspective, Egypt is not a major trading partner, accounting for less than 0.05% of total US imports. This reduces the risk of a unilateral increase in customs duties. The Trump administration's policy will have a more indirect impact on Egypt's external accounts.

On the geopolitical front, US support for a ceasefire agreement between Israel and Hamas, if it lasts, will have positive effects. Tensions in the Red Sea should ease, allowing maritime traffic through the Suez Canal to gradually resume. Revenues from the Suez Canal (9% of the country's foreign currency earnings) fell by 60% in the first nine months of 2024. Tourism revenues should also benefit from the reduced geopolitical tensions. Nevertheless, the current ease in tensions remains precarious, and US objectives in the region and how they might be achieved are still uncertain.

Energy is a key issue in Egypt, and the deterioration in the external balance for hydrocarbons is making external accounts more vulnerable to fluctuations in oil and gas prices. The faster than expected decline in Egyptian gas production and the steady increase in consumption are forcing Egypt to import increasing quantities of liquefied natural gas (LNG) in order to supplement imports from Israel via pipeline. These LNG imports cost around USD 1 billion in FY2024. Despite encouraging

EGYPT: DECLINING INFLATIONARY PRESSURE

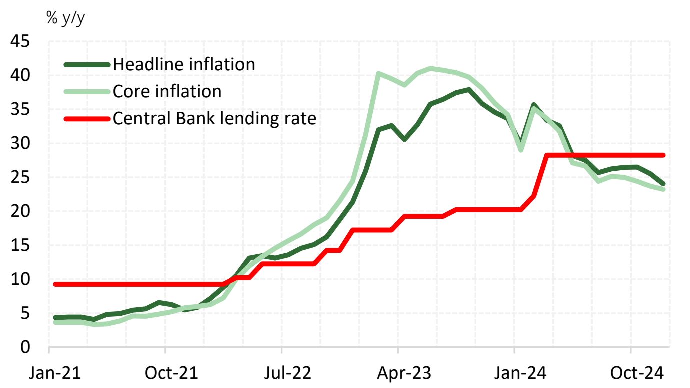

CHART 2 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

exploration results from gas companies, the gradual implementation of new solar power generation capacity and the possible import of electricity from Saudi Arabia, Egypt's gas deficit could persist for at least the next 2-3 years. The increased LNG production and export capacity at the heart of future US energy policy is unlikely to have a positive short-term impact on Egypt's energy bill. The increase in US LNG exports expected in 2025 is linked to decisions taken under the previous administration. The effects of the new export licences will not be felt for a few years, and will then only be one of the drivers behind increased LNG production, with Qatar expected to play a dominant role.

US monetary policy plays an important role in i/ covering Egypt's external financing needs through carry-trade flows and ii/ the cost of servicing external debt.

Although carry-trade transactions are expected to be less significant than before 2022, due to the increased bilateral financing and FDI, they are still an important factor in the balance of payments. We estimate that net investment inflows linked to carry-trade transactions should cover 19% and 12% of the total external financing requirement (current account deficit and amortisation of external debt) in FY2025 and FY2026, respectively. But the Fed could leave rates unchanged this year. However, stable US rates and reduced rates in Egypt would automatically reduce the appeal of Egyptian securities denominated in local currency. Further depreciation of the pound, even if moderate, would add an additional negative factor to the appeal of Egyptian securities in local currency.

Foreign currency debt servicing has increased significantly in recent years and is contributing to the vulnerability of Egypt's external finances. In FY2024, interest payments on foreign currency debt were equivalent to 9% of total foreign currency revenues, compared with an average of 3% between 2018 and 2022. The Egyptian government, which has just issued USD 2 billion in international bonds (in USD), plans to issue around USD 3 billion (not only in USD) in the first half of 2025.

All in all, we feel that the potential consequences of the new US administration's policy on external accounts will be relatively balanced and, in principle, limited in scope. They could be fairly positive on the current account balance and neutral or even negative on the financing side.

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KENYA

A BRIEF RESPITE

In Kenya, further fiscal consolidation is proving increasingly difficult. The efforts required of the population were strongly protested over the summer of 2024, forcing the government to withdraw the finance bill it had drafted with the IMF. Now, for the current fiscal year, the deficit is to be reduced mainly through spending cuts, which are adversely affecting economic growth. While this alternative offers a brief respite, a sustained increase in public revenues remains essential to ensure debt sustainability and safeguard the IMF's financial support in the medium term. This could prove all the more necessary as Donald Trump's return to the White House could pose new risks for Kenya's public and external accounts.

SLOWDOWN IN ECONOMIC GROWTH

Economic growth has been slowing since the start of 2024. From 5.6% in Q4 2023, growth measured over 4 quarters fell to 4.7% year-on-year (y/y) in Q3 2024. Activity is unlikely to rebound sharply in Q4, and real GDP growth for the year as a whole will be lower than the Central Bank's initial forecast of 5.1%.

There are several reasons for this general slowdown in the main sectors of the economy. Firstly, activity between June and August was affected by the protests against the government's finance bill. In addition, the tightening of the monetary policy of the Central Bank of Kenya (CBK), pursued from May 2022 to early 2024, rapidly squeezed the flow of credit to the private sector (25% of GDP). In October 2024, nominal growth in credit to the private sector was null y/y, compared with 14% in December 2023. Despite a first cut in the policy rate in August 2024, commercial banks' lending rates continued to rise, hitting 17.1% in October, the highest level since 2016. Monetary tightening and the deterioration in the business climate since 2022 have severely penalised private investment. Finally, with the fiscal consolidation efforts undertaken by the Ruto administration, which came to power in 2022, public development spending, which includes public investment, contracted by 8.5% in nominal terms during the 2023/2024 fiscal year (FY).

As a result, by 2023, the total investment rate had already fallen to 16% of GDP, compared with 19% in 2022 and 20% on average over 2015-2021. This decline is damaging the country's medium-term economic outlook. The Kenyan Treasury's target of taking economic growth above 7% by 2028 seems ambitious, as does the goal of doubling the share of the manufacturing sector in GDP by then. The manufacturing sector currently accounts for just 7.3% of GDP, and this share has declined slightly since 2019. Nevertheless, this sector is the second largest provider of formal employment after the agricultural sector. Therefore, its development remains crucial to reduce the size of the informal sector (estimated at around 80% of total employment), which would help increase fiscal revenues.

INFLATION UNDER CONTROL AND MONETARY EASING UNDERWAY

In 2022, rising oil prices (26% of imports) and global monetary tightening contributed to a sharp depreciation of the local currency and a significant rise in inflation. The Kenyan shilling depreciated by 27% against the US dollar between the end of 2021 and the end of 2023, while inflation averaged 7.7% over 2022 and 2023. The CBK raised its policy rate by 600 basis points (bps) between May 2022 and February 2024, taking it to 13%. The subsequent improvement in the external accounts, thanks in particular to the government's return to international capital markets in February, enabled the Kenyan shilling to appreciate again (by 23% against the dollar between February and April) and then stabilise. Since May 2024, inflation has fallen back below the Central Bank's 5% target, hitting 3% in December. These two factors enabled the CBK to cut its policy rate by 175 bps between August and December.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth (%)	4.9	5.6	4.6	5.0	4.8
Inflation, CPI, year average, %	7.6	7.7	4.5	5.0	5.0
Cent. Gov. balance / GDP (%) (1)	-5.3	-5.2	-4.8	-4.4	-4.0
Cent. Gov. debt / GDP (%)	67.8	73.1	68.2	70.7	70.5
Current account balance / GDP (%)	-5.0	-4.0	-4.1	-4.3	-4.8
External debt / GDP (%)	34.6	39.4	34.9	37.0	37.4
Forex reserves (USD bn)	7.4	6.6	9.2	8.9	8.6
Forex reserves, in months of imports	4.2	3.5	4.7	4.4	4.2

(1) Fiscal year from July 1st of year N to June 30th of year N+1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

KENYA: CONSUMER PRICES AND MONETARY POLICY

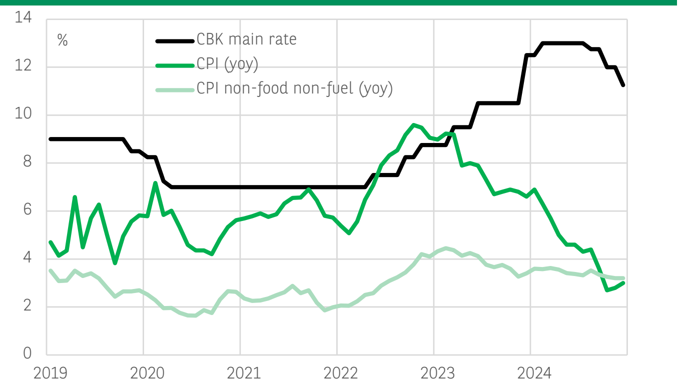

CHART 1 SOURCE: CBK, BNP PARIBAS

The monetary easing cycle is expected to continue at the next committee meeting in February 2025, given the sharp slowdown in growth of credit to the private sector and the margin between the current inflation rate and its target. However, the CBK's room for manoeuvre has narrowed since Donald Trump's return to the White House and the risk of a status quo in US monetary policy in 2025.

FISCAL CONSOLIDATION AT RISK

Since 2022, the government has been undertaking a process of fiscal consolidation. It is aiming to correct years of substantial deficits (7.2% of GDP on average over 2015-2022), which pushed the public debt ratio to 73% of GDP in Q4 2023 (compared with 45% in 2015). The interest burden on public debt, which has systematically absorbed more than 25% of government revenues over the last five years, is a major obstacle to debt sustainability.

In FY 2023/24, unpopular measures, such as doubling VAT on fuel and creating new taxes, enabled government revenues to grow by 14%, compared with nominal GDP growth of 9%. However, at 17% of GDP, revenues remained low, while interest payments on debt amounted to 5.3% of GDP, or 31% of government revenues. Therefore, despite a slightly positive primary fiscal balance, the fiscal deficit remained at 5.2% of GDP.

The Treasury has attempted to redouble its efforts for the current fiscal year (July 2024-June 2025). However, the initial finance bill, which planned to drastically reduce the deficit to 3.3% of GDP by increasing tax revenues, was fiercely protested. The protests, which culminated in the storming of Parliament at the end of June, forced the government to withdraw its finance bill, which had been drawn up in collaboration with the IMF. Instead, the finance bill that was finally adopted stipulates a fiscal deficit of 4.4% of GDP. Fiscal consolidation is no longer being achieved through increasing revenues, but through reducing spending instead. More specifically, development spending has once again been revised downwards (-14% compared with the initial finance bill), while total revenues are expected to stagnate at 17% of GDP, compared with 18.5% in the initial finance bill.

The planned budget cuts do not tackle the government's recurrent expenditure. This includes the public sector wage bill, the size of which is a major challenge. In FY 2022/23, it absorbed 42% of fiscal revenues. The government's plan to reduce this to 35% by 2028 seems ambitious in light of the strong pressures to increase wages. Besides, in order to ensure public debt sustainability, government revenues still need to be increased. This will need to be accompanied by measures to restore taxpayer confidence, such as improving the transparency of public spending, increasing public accountability and fighting corruption. Implementing these measures will be essential if the government wants to renew the IMF's financial support in the medium term, as its programme expires in April 2025.

TEMPORARY IMPROVEMENT IN THE BALANCE OF PAYMENTS

The external accounts are fragile. The current account's structural deficit is large (-5.5% of GDP on average over 2015-2022). Since 2023, due to the fall in public investment and the recovery in agricultural exports after two years of drought, the current account deficit has contracted to 4% of GDP in Q3 2024. However, the same vulnerabilities persist and the trade deficit remains high (8% of GDP). On the one hand, the country's export base is limited to low value-added agricultural production that is vulnerable to climate shocks. On the other hand, a large proportion of imports cannot be reduced, as Kenya is a net importer of energy and food products.

To finance the current account deficit, Kenya relies mainly on issuing public debt in foreign currency, with debt accounting for 86% of gross foreign capital inflows on average over 2015-2023. With the global monetary tightening of 2022-2023, the government lost its access to international capital markets. Despite increased financial support from multilateral donors over the period, Kenya had to draw on its foreign exchange reserves to cover its external financing needs. They fell by USD 1.1 bn between February 2022 and mid-February 2024. Since a Eurobond issuance in February, the confidence of private external creditors has risen and net portfolio flows have returned to slightly positive territory (USD 700 mn cumulatively over 12 months). Foreign exchange reserves have gradually increased by USD 2.1 bn between February and January 2025, hitting USD 9.2 bn. At this level, they cover 4.7 months of imports, a relatively comfortable level. However, without financial support from the IMF, foreign exchange reserves are expected to fall again in 2025 and 2026.

KENYA: DIFFICULT FISCAL CONSOLIDATION

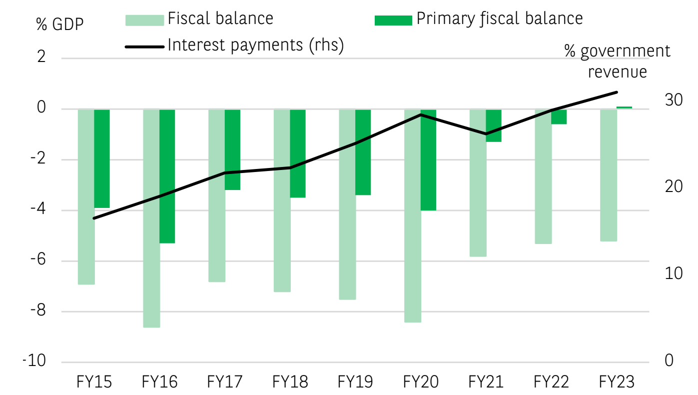

CHART 2 SOURCE: CBK, BNP PARIBAS

TRUMP 2.0 AND THE RISKS TO PUBLIC AND EXTERNAL ACCOUNTS

Given the vulnerability of external accounts, Donald Trump's return to the White House is a risk factor for Kenya. His programme is likely to delay monetary easing by the Fed, which could contribute to a tightening of international financing conditions. This could disrupt the Kenyan government's external financing plans ahead of the many debt repayments that it faces in the medium term. Between 2025 and 2031, the country will have to repay a total of USD 4.2 bn in Eurobonds that are due to mature, including an amortisation of USD 1 bn in 2028. In addition, if the CBK eases its monetary policy less than expected, this could adversely affect the interest burden on domestic public debt (80% of total interest payments) and on fiscal consolidation. For the time being, the USD/KES exchange rate has been stable since the election of D. Trump (-0.3% between the first week of November 2024 and mid-January). However, pressure on the external accounts and the exchange rate could increase from April 2025 with the end of the IMF programme.

Kenya's exports to the United States, and the African continent's exports to the United States as a whole, could also suffer as a result of Trump's protectionism. Kenya and 31 other African countries currently enjoy duty-free access to the US market for many goods thanks to the African Growth and Opportunity Act (AGOA). As a result, in 2023, the average tariff on Kenya's exports to the United States was just 0.3%. However, the AGOA expires in September 2025, and its terms will have to be reviewed by the US Congress. On a positive note, with the United States accounting for just 6% of Kenya's exports (mostly textiles), the impact should be limited. In addition, Kenya could succeed in redirecting its textile exports to the European Union, with which it has signed a free trade agreement in force since July 2024.

Finally, the amount of official development assistance (ODA) paid by the United States could be revised downwards. On average over 2019-2023, ODA flows from the United States totalled USD 0.8 bn per year, i.e. almost a quarter of total ODA flows and 0.8% of GDP. Of this amount, 40% is earmarked for emergency food programmes which, in theory, should not be suspended. However, the HIV programme (29% of the United States' ODA), as well as other health and education programmes, face the risk of budget cuts.

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