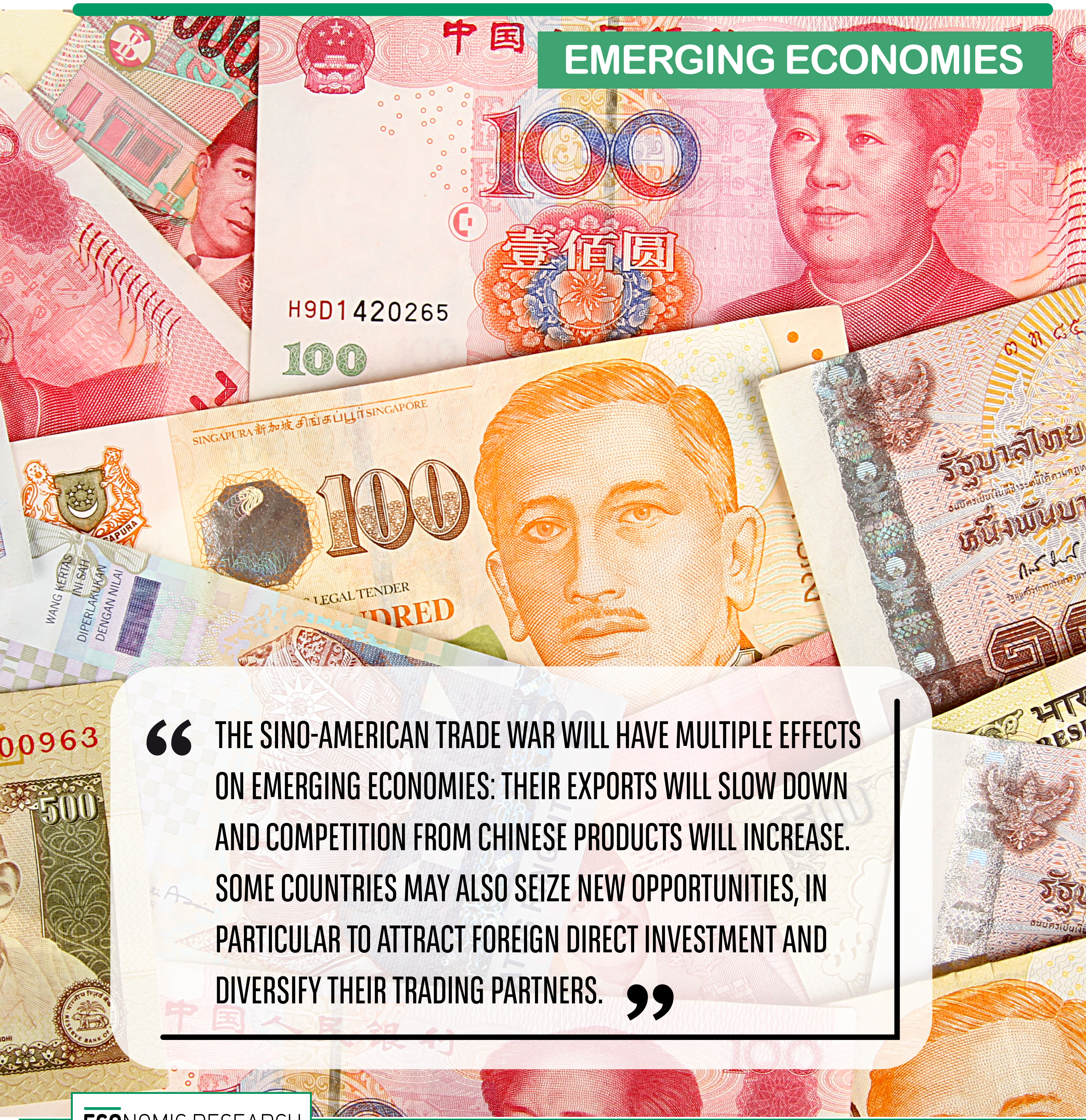
ECOPERSPECTIVES

2nd Quarter 2025
June 2025

EMERGING ECONOMIES



> “THE SINO-AMERICAN TRADE WAR WILL HAVE MULTIPLE EFFECTS ON EMERGING ECONOMIES: THEIR EXPORTS WILL SLOW DOWN AND COMPETITION FROM CHINESE PRODUCTS WILL INCREASE. SOME COUNTRIES MAY ALSO SEIZE NEW OPPORTUNITIES, IN PARTICULAR TO ATTRACT FOREIGN DIRECT INVESTMENT AND DIVERSIFY THEIR TRADING PARTNERS.”

ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

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TARIFF SHOCK : WHAT EFFECTS ON GLOBAL TRADE AND WHAT CONSEQUENCES FOR EMERGING COUNTRIES?

Under the impact of the Trump administration's tariff policy and the acceleration of US-China decoupling, global economic growth is expected to slow, international trade to reconfigure and the reorganization of value chains to continue. These changes will have multiple effects on emerging countries. Their export growth will slow and competition from Chinese products will increase. Some countries could nevertheless take advantage of new opportunities to attract FDI and develop their manufacturing base.

HIGHER US TARIFFS...

The increase in tariffs imposed by the United States and uncertainty over its trade policy are affecting all emerging countries. For China, the additional tariffs introduced by the Trump administration since January 20 amount to 30%. Taking into account sector-specific factors (higher tariffs and exemptions), the effective tariff rate on US imports of Chinese products rose from 11% at the beginning of 2025 to nearly 35%. The current truce between Washington and Beijing remains fragile, but we assume that the additional tariffs will remain at their current level in 2025. Sectoral adjustments are possible.

For other emerging countries, additional tariffs currently stand at 10%. In our central scenario, they will also be maintained at this level in 2025 (the "reciprocal" measures mentioned by Trump on April 2 will not be applied). They will be accompanied by sectoral tariffs, which are likely to be high, but some countries may be able to negotiate a decrease. Tariffs are already at 25% on cars and have just been doubled to 50% on steel and aluminum. Taxes of up to 25% could hit the pharmaceutical, electronics, semiconductor, and copper sectors, which are currently exempt. The hydrocarbon sector will remain protected.

Current effective tariff rates vary from country to country, depending on the structure of their exports to the US. They will evolve in the coming weeks in line with US sectoral policies and bilateral negotiations. For the time being, the highest average effective tariffs are affecting emerging Asia (*Chart 1*). Central Europe is also penalized due to the weight of the automotive industry in its exports. Conversely, the lowest tariffs apply to: countries exporting manufactured goods that are still exempt (such as Singapore), Latin American countries that mainly export raw materials, and hydrocarbon producers.

EFFECTIVE TARIFF RATES, 20 JUNE

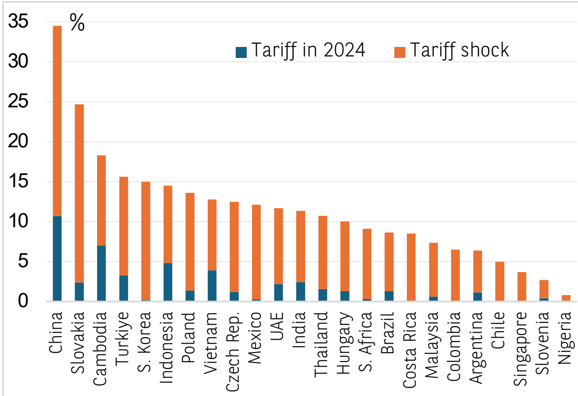

CHART 1 SOURCE: FITCH, BNP PARIBAS

The main Latin American economies (excluding Mexico) are neither highly open, nor substantially dependent on US demand, and are subject to relatively moderate tariff rates. The direct effects on their growth should therefore be limited. Some countries could even benefit from higher prices for their raw material exports (agricultural products, critical metals).

... AND A SLOWDOWN IN GLOBAL TRADE: A NEGATIVE SHOCK FOR EVERYONE

The tariff shock will hamper the growth of emerging economies, initially through a slowdown in US and global demand. Growth in global trade volumes in goods is expected to slow from 2.9% in 2024 to just 1.1% in 2025, according to the World Economic Outlook (WEO) published in early April by the IMF – well below the average for the last ten years (2.5% per year). In mid-April, the WTO even anticipated a slight decline in global trade in goods in 2025 (-0.2%), driven by a more than 10% drop in trade in North America.

The Mexican and Asian economies are the most vulnerable to this slowdown, given their high degrees of trade openness and dependence on the United States (*Chart 2*). Central European economies are very open, but their direct exposure to US demand is low. Even tariffs on automobiles are expected to have limited direct impact on growth, except in Slovakia (see *page 21*). However, indirect effects via the slowdown in exports to Germany will be significant for several Central European countries, but could subsequently be offset by the expected recovery in German growth.

INTENSIFIED CHINESE COMPETITION

Chinese companies will redirect their exports to other markets to partially offset the drop in sales to the US (a 20% decrease in 2025 would represent around USD 100 billion in Chinese goods, or 0.4% of total global exports). This trend was already visible in the spring. The aim is to route goods through third countries in order to circumvent US tariffs and find new outlets.

The momentum observed in recent years is therefore likely to continue. China has continued to increase its global market share (14.7% in 2024 compared with 12.8% in 2017) thanks to low prices and competitive products in many sectors. This strategy will continue, but it is expected to be more difficult to implement. On the one hand, Chinese exporters will find it tougher to lower their prices (see *page 5*). On the other hand, countries facing Chinese competition on their domestic markets will continue to take measures to protect struggling sectors. Beijing must avoid protectionist reactions at a time when it is attempting to strengthen its ties outside the US. Against this backdrop, the European Commission introduced a mechanism to monitor Chinese imports in early April, in agreement with China.

For emerging countries, China's redeployment adds an indirect negative effect to the direct impact of the tariff shock by strengthening competition from Chinese goods both on their domestic markets and on their export markets. In recent years, Chinese products have competed with local products on their export markets in Central Europe, particularly in the automotive and other medium- to high-end sectors. In Asia, Chinese competition has weakened local production in sectors such as textiles and automobiles, particularly in Indonesia and Thailand (see *p. 9*). That said, China has also increased its exports of intermediate goods to certain countries, thereby fueling an industrial upgrade.

THE CONTINUED RECONFIGURATION OF GLOBAL VALUE CHAINS COULD BENEFIT SOME EMERGING COUNTRIES

In fact, China's strategy in response to US protectionism may also have a positive effect on some emerging countries. Between 2018 and 2024, Mexico and Asian countries benefited from US-China trade tensions and increased their market share in the United States. Mexico and Vietnam, in particular, have developed a "connector" activity: a growing share of goods from China transited through these countries to be exported to the US after value was added. This dynamic was accompanied by an increase in FDI and the development of their manufacturing base.

These dynamics are likely to be interrupted in 2025 under a tighter US trade policy. In addition, on the one hand, the Trump administration supports the relocation of factories to the United States and is likely to slow down the FDI projects of US companies. On the other hand, the US administration is stepping up its monitoring of the origins of imported goods. For example, 10% tariffs may only be maintained subject to measures limiting the rerouting of Chinese goods. US pressure should therefore mitigate, at least in the short term, FDI projects in connector countries – particularly in Mexico (see *p. 13*).

However, in the medium term, Chinese companies and other multinationals will continue to reorganize and diversify their production chains. Assuming that the US maintains uniform reciprocal tariffs between emerging markets (which remains uncertain), FDI will flow to countries offering the best conditions for investors in terms of labor (wages, skills, productivity), taxation, trade openness, manufacturing sector development and integration into value chains, and the quality of infrastructure and logistics services. Geographic and geopolitical proximity apply as additional criteria.

In Asia, Vietnam remains well positioned with respect to many criteria (relatively low wages, proactive strategy to attract FDI, integration into value chains, geographical location, multi-alignment foreign policy). However, it needs to invest heavily in infrastructure, and the country is one of the most exposed to further US tariff increases. Thailand, Malaysia, and India (see *p. 7*) can also boast strengths (education levels, infrastructure, and integration into global trade for the first two, low wages and tax incentives for investment in manufacturing for India). These three countries seem best positioned to benefit from new Chinese FDI and boost their market shares, particularly in the US.

Central Europe can attract FDI from companies wishing to move closer to the European market. Since 2018, Hungary has been the leading recipient of Chinese FDI (see *p.19*). The Czech Republic and Poland are also well positioned. These countries are part of the European Union, and they also have a solid manufacturing base, relatively attractive tax systems, a skilled workforce and wages that are still competitive despite rising rapidly in recent years.

RELIANCE ON GOODS EXPORTS AND US MARKET

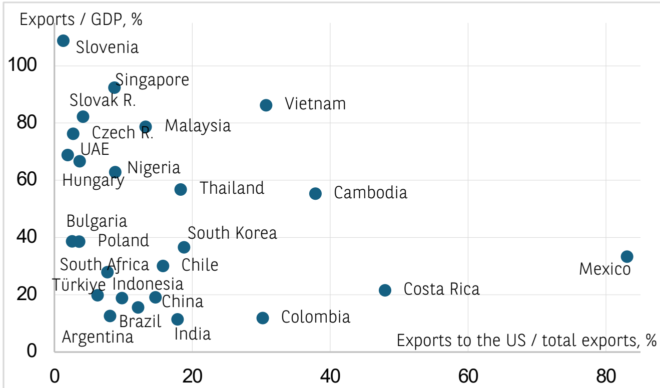

CHART 2

SOURCE: IMF, BNP PARIBAS

WHAT ACCESS TO THE CHINESE MARKET?

Finally, Latin America has a huge asset to attract Chinese FDI: its natural resources (see *p.15*). Furthermore, Latin America could increase its market share in China by replacing the United States in the agri-food sector. Brazil, whose main exports to China are similar to those of the United States (e.g., soybeans, meat, cotton, and oil), has increased its exports to China in recent years and is expected to continue doing so (see *p. 11*). Latin American countries (excluding Mexico), which are less directly exposed to the tariff shock, could therefore also benefit from the US-China trade war by boosting their market shares in China in the mining and agricultural sectors.

Conversely, it will be more difficult for Asian and European countries exporting manufactured goods to improve their market shares in China: even if China manages to boost private consumption, its imports are likely to be limited by Beijing's strategy of strengthening the country's self-sufficiency in industrial sectors. These countries will attempt to diversify their trading partners. For instance, Malaysia and Thailand have recently begun negotiations with the European Union with a view to rapidly establishing free trade agreements.

Article completed on 20 June 2025

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CHINA

FIRST EFFECTS OF THE TRADE WAR

The sharp increase in US tariffs on Chinese imports is a major blow to Chinese exports and economic growth. However, Beijing has prepared for this, and the impact will be partially offset by its response strategy. In the short term, this strategy consists of redirecting exports to other markets, continuing monetary and fiscal policy easing, and boosting private consumption. The redeployment of exports has begun, but it could quickly run into new protectionist barriers. Domestically, the challenge will be to restore household confidence while the labour market may suffer as a result of the slowdown in the manufacturing sector.

ECONOMIC GROWTH SLOWDOWN

Chinese economic growth stood at +5.4% year-on-year (y/y) in Q1 2025, unchanged from the previous quarter. After a stronger-than-expected start to the year, growth is expected to slow over the next three quarters. In our central scenario, it would reach 4.8% for 2025 as a whole: we are expecting a moderate growth slowdown despite the protectionist shock. The impact of this shock on exports and the manufacturing sector will be significant, but it will be partially offset by the positive effects of China's response. It should be noted that the authorities have set an economic growth target of 5% for 2025. The risks to our forecast are clearly on the downside.

Washington's declaration of a trade war on China since President Trump took office on 20 January 2025 has interrupted the momentum of growth recovery observed since last autumn. On the one hand, growth in goods exports slowed – less than expected – over the last two months. Measured in current dollars, exports rose by +8% y/y in April and +4.8% in May (after +5.1% in Q1 2025 and +10% in Q4 2024). They were first supported by intense activity among US importers in anticipation of tariff increases, and then by the beginning of a shift in Chinese goods flows toward third markets (*see below*). Exports are expected to continue slowing in the short term.

On the other hand, private-sector domestic demand lost the momentum that it had gained since the end of September 2024. The strengthening of retail sales in Q4 2024 and Q1 2025, mainly due to the government-subsidised consumer goods replacement programme, is fragile; it stalled in April before picking up again in May. Meanwhile, housing sales have not picked up despite the authorities' stimulus measures; they have continued to contract, albeit at a more moderate pace (-3.2% y/y in the first five months of 2025, after -14.1% in 2024). Indeed, households remain very cautious, against a backdrop of deflation, prospects of a slowdown in the manufacturing sector and, consequently, a deterioration in the labour market. In the first five months of 2025, the unemployment rate improved slightly (5.0% in May), but the weekly average number of hours worked fell slightly, while wage growth had already slowed sharply in 2024 (the average urban wage rose by +2.8% in 2024, after +5.8% in 2023).

Total investment growth began to slow slightly in April (reaching +3.7% y/y in value terms in the first five months of 2025), due to the slowdown in manufacturing investment (+8.5%) and the continued decline in real estate investment (-10.7%). On the other hand, infrastructure investment has strengthened since the beginning of the year (+5.6%).

Therefore, while the direct effects of the US tariff increases on exports are beginning to emerge, their spillover effects on other components of growth are already noticeable.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	3.1	5.4	5.0	4.8	4.5
Inflation, CPI, year average, %	2.0	0.2	0.2	0.0	1.0
Official budget balance / GDP, %	-2.7	-3.8	-3.0	-4.0	-3.8
Official general government debt / GDP, %	49.4	54.7	61.0	66.7	71.4
Current account balance / GDP, %	2.4	1.4	2.3	1.8	1.5
External debt / GDP, %	13.4	13.4	12.9	12.5	12.0
Forex reserves, USD bn	3 307	3 450	3 456	3 451	3 442
Forex reserves, in months of imports	12.6	13.3	12.7	12.7	12.0

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

DEFLATION

Deflationary pressures persist. They have been fuelled by excess production capacity, weak demand, falling house prices, slower wage growth and lower commodity prices. Consumer price inflation (CPI) remained slightly negative in the first five months of 2025 (-0.1% y/y). Core inflation has remained close to +0.5% since March, but food prices have been falling since December (-0.4% y/y in May) and fuel prices have been dropping since last summer (-12.9% in May). Producer prices have been falling continuously since Q4 2022 (-3.3% in May).

In the short term, the expected recovery in private consumption is likely to be moderate, the real estate market is expected to stabilise at best and the slowdown in goods exports will exacerbate production overcapacity. Therefore, we forecast zero CPI growth in 2025, compared with +0.2% in 2024. Deflationary pressures are weighing on nominal GDP growth (which remained below real growth in 2023-2024). They are damaging the financial health of enterprises, complicating monetary policy management and weighing on domestic demand.

CONTINUED MONETARY AND FISCAL POLICY EASING

The authorities have accelerated the easing of their fiscal and monetary policies in recent months and they have prepared to ease them further in the course of the year.

On the monetary front, the latest decisions date from May[1]. In addition, the large state-owned banks have received capital injections to strengthen their capacity to increase lending. However, for the time being, the monetary policy easing and loosening of the prudential rules for mortgage lending and house purchases has had very limited effects.

1 Lower reserve requirement ratios (-50 bp to 9% for large banks); 10 bp cut in policy rates; increase in bank refinancing facilities to encourage lending to targeted sectors (agricultural enterprises, SMEs, innovation, elderly care and other services); and strengthening of support measures for equity markets.

This is due to weak private-sector credit demand, banks' caution and the solvency or liquidity problems that real estate developers are still facing. In 2025, bank loan growth has continued to slow (+7% y/y in nominal terms in May) and housing loans have continued to contract slightly. Meanwhile, total financing to the economy has grown slightly faster (up 8.7% in May), driven by Treasury and local government bond issuance.

Therefore, the authorities will need to lower interest rates more significantly and/or strengthen fiscal stimulus measures. In fact, fiscal policy has taken a decidedly accommodative turn. The official budget deficit target has been set at 4% of GDP for 2025, the highest level in 30 years. In addition, measures have been implemented over the past few months to strengthen local government finances. These remain fragile but have nevertheless gained some leeway. Furthermore, the central government is expected to increase its role in support plans. Finally, the acceleration of government bond issuance since the beginning of the year reflects the increased stimulus efforts.

Increased public investment (particularly in strategic sectors and infrastructure projects), support for exporters weakened by US tariffs and a boost to private consumption are key objectives of the fiscal strategy for 2025. Strengthening private consumption in a durable manner requires the authorities to accelerate structural reforms aimed at improving the social protection system and reducing household savings[2]. In the short term, they will need to step up support measures to offset the effects of the slowdown in the manufacturing sector and revive the real estate market. Announcements are expected during the summer. Measures directly targeting incomes would be particularly welcome in order to reassure households.

RAPID REORIENTATION OF CHINESE EXPORTS

Following the announcements on "Liberation Day" on 2 April, escalating tensions between Washington and Beijing led to reciprocal tariffs reaching unprecedented levels within a few days (US tariffs on Chinese goods at 145%, Chinese tariffs on US goods at 125%). The start of negotiations then reduced the new tariffs to 10% on both sides as of 12 May. In addition to the US tariff of 10%, there is the 20% already applied to China by the Trump administration (the recent cancellation of which by the US International Trade Court is currently suspended).

As a result, the effective tariff rate (weighted average) applied by the US on Chinese imports rose from 10.7% at the end of 2024 (a 20% tariff was applied on nearly 60% of imports from China) to 34.2% in mid-June (+23.5 pp). This figure takes into account all exemptions and sector-specific measures (50% on steel and exemptions for pharmaceuticals, electronics and semiconductors).

Negotiations between Washington and Beijing have resumed but remain difficult to predict. The effective US tariff could rise again in the event of a disagreement or new sectoral tariffs. It would exceed 40% if 25% tariffs were introduced on semiconductors and electronic products (which account for around 20% of Chinese exports to the US). Our central scenario assumes that the effective tariff will remain at its current level in 2025.

Chinese exports to the US accounted for 14.6% of total exports in 2024, or only 2.6% of GDP. Assuming export price elasticity of -1, the loss of activity due to higher tariffs is estimated at 0.6 percentage points of GDP.

CHINA: GROWTH IN EXPORTS BY DESTINATION

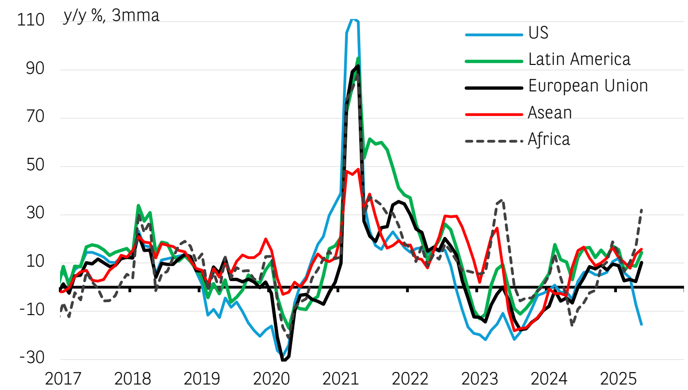

CHART 1 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, BNP PARIBAS

This direct impact excludes the indirect negative effects linked to the global economic slowdown and the positive effects of monetary and fiscal easing and China's strategies to offset the decline in its exports to the United States.

China will continue to reorganise its production chains in the coming years. In the short term, the reorientation of trade flows towards third countries will help to offset losses on the US market. Since April, the decline in exports to the US (-27.8% y/y on average in April-May) has been offset by a sharp increase in sales to the rest of the world (European Union: +10.2% y/y on average in April-May; ASEAN: +17.8%; Africa: +29.3%; Canada: +17.7%; and Latin America: +9.8%). This shows how quickly Chinese companies can redirect their exports (*see chart*).

This reorientation will continue, but it could become increasingly complex. First, it could be constrained by Beijing's efforts to develop its trade relations with its Asian and European partners. At the same time, countries facing increased competitive pressure from China could raise protectionist barriers. Then, Chinese exporters could find it increasingly difficult to lower their prices in order to gain market share. The evolution of the yuan will be decisive. After the depreciation episode in early April, the yuan appreciated against the US dollar and has remained fairly stable in recent days (the CNY/USD spot rate gained just over 1% between 1 April and 18 June). Its short-term evolution will depend in part on the outcome of negotiations with Washington. In real effective terms, the yuan depreciated by nearly 5% in March-April, which greatly helped Chinese exports to markets outside the US.

Article completed on 18 June 2025

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2 See BNP Paribas EcoWeek (24 March 2025): China in 2025: temporary adjustment or structural rebalancing of economic growth drivers?

INDIA

ECONOMIC SLOWDOWN AND LIMITED ROOM FOR MANOEUVRE

India's economic growth is slowing down. Household consumption is sluggish, hampered by slower real wage growth and rising debt burdens, and private investment is weak. Given its low degree of openness, India will be little affected by US tariff increases, but it is unlikely to be spared altogether. Its room for negotiation with the Trump administration is limited. However, its domestic market is vast and allows for diversification of production in Asia. In order to take advantage of the Sino-US trade war, India will need to address the structural constraints weighing on the development of its industry quickly. However, the government's room for manoeuvre to push through reforms in the short term is very limited.

ECONOMIC PROSPECTS REVISED DOWNWARDS

According to the IMF's April 2025 forecasts, India is expected to post the highest real GDP growth rate in Emerging Asia over the next three years (6.3% on average). India will be one of the Asian countries least affected by US tariff increases given its low integration into global trade. However, despite enviable forecasts, India's growth has slowed compared to the 2015-2019 period (7.4% on average) and is not enough to increase GDP per capita significantly and create sufficient jobs to reduce the youth unemployment rate (15.5% in 2023, according to the World Bank).

India is facing a slowdown in domestic demand (the main driver of its economic growth). While rural household consumption has supported real GDP growth over the past 12 months, urban household consumption has slowed in line with the deceleration in real wages and the increase in debt servicing (which averaged 7.3% of disposable income for the 2024/2025 fiscal year). However, household debt, estimated at 42.1% of GDP, according to the Bank for International Settlements, remains modest. Although consumer confidence indices recovered slightly at the beginning of the year and the slowdown in inflationary pressures and monetary easing point to a rebound in domestic demand, downside risks remain significant. According to data from the Centre for Monitoring Indian Economy (CMIE), wage growth in listed companies continued to slow in Q1 2025 (+4.8%), falling to just 1% in real terms. On the other hand, rural household consumption is expected to remain robust. Monsoon rains are expected to be slightly higher thannormal (according to initial forecasts by the India Meteorological Department).

Public investment, which had supported economic growth in fiscal years (FY) 2021/2022 and 2022/2023, slowed in FY2023/2024 and FY2024/2025 (fiscal year ending March 2025). Private investment, which was already weak (11.3% of GDP for FY2023/2024), did not pick up. No significant rebound is expected for FY2025/2026, as the high level of uncertainty surrounding US trade policy and its impact on Chinese production overcapacity will prompt Indian companies to exercise greater caution.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, % (1)	7.7	9.2	6.5	6.3	6.7
Inflation, CPI, year average, % (1)	6.7	5.4	4.6	4.1	4.4
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	82.1	81.0
Current account balance / GDP, % (1)	-2.0	-0.7	-0.8	-1.0	-1.3
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
e: ESTIMATES & FORECASTS

TABLE 1

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: ECONOMIC GROWTH

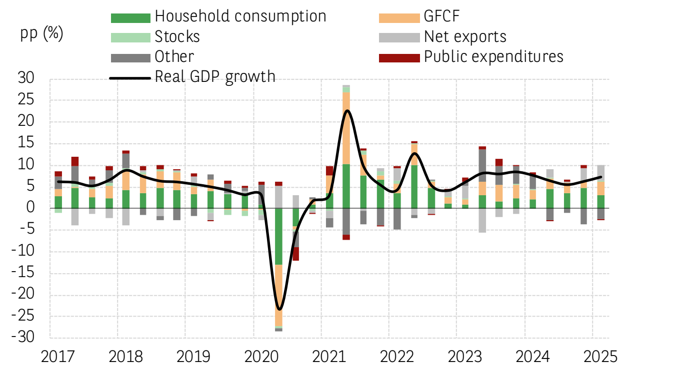

CHART 1

SOURCE: CEIC, BNP PARIBAS

MONETARY EASING CYCLE STARTED IN FEBRUARY 2025

In a disinflationary context (consumer prices rose by only +2.8% year-on-year in May, below the target of 4% +/- 1 pp for the fourth consecutive month), the Reserve Bank of India (RBI) began its cycle of monetary easing in February. Despite the volatility of the rupee (limited by significant intervention by the RBI in the foreign exchange markets), two further rate cuts were implemented in April and June (-25 bp and -50 bp, respectively) and the repo rate was reduced to 5.5%. However, this monetary easing has not yet translated into lower rates on fresh loans, which have, on the contrary, risen sharply in real terms (+200 bp since December 2024). Furthermore, although lower rates should support domestic demand, they will do little to ease the debt burden of the most vulnerable households, whose debt has risen mainly as a result of an increase in unsecured fixed-rate loans.

Despite the slight increase in credit risks (highlighted by the rise in the delinquency ratio, particularly for unsecured household loans), the banking sector should remain solid. Non-performing loan ratios continued to decline in 2024 (to 2.5% in December 2024), capital adequacy ratios are comfortable (16.4%) and provisions covered 77% of non-performing loans in Q3 2024. Non-bank financial companies are the credit institutions most exposed to the economic slowdown and the risk of default by low-income households with unsecured loans.

Although they generally have sufficient capital to cope with an increase in credit risk (the CAR stood at 27.2% in Q3 2024), not all of them would be able to meet regulatory solvency ratios in the event of even a moderate shock to the economy, unlike banks, according to the latest RBI stress tests.

WHAT ROOM FOR NEGOTIATION IS THERE WITH DONALD TRUMP?

The United States is India's largest export trading partner (18.3% of goods exports in 2024). Before the Trump administration announced the increase in US tariffs on 2 April, the effective rate on Indian products was only 2.4%. If no agreement was signed between the two countries by 9 July, the effective rate could be raised to 18.8% (including new tariffs on automobiles, steel and aluminium). The increase in customs duties could cost the Indian economy up to 0.3 pp of GDP (all other things being equal), given the share of value added included in Indian exports to the US (85% of the value of exported products) and assuming that the elasticity of exports to custom duties is 1.

The Modi government's room for manoeuvre in negotiations with the Trump administration is limited, but not zero. India is not a strategic trading partner for the US, unlike China: imports from India accounted for only 2.7% of US imports of goods and 4.7% of its imports of services in 2024. Although India is a major supplier of textiles, vegetable fibres (particularly for paper) and jewellery, these products are easily substitutable. Its room for negotiation on other exported products is even more limited. Even though exports of pharmaceuticals and telephones account for 13.9% and 9.9% of its total exports to the US, India supplies only 6% and 7.8% of the pharmaceuticals and telephones imported by the US, respectively. However, India could offer the US government privileged access to its domestic market. In 2023, the effective tariff rate on US imports of goods stood at 9.6%. Tariffs were particularly high for food products (39.3%) and motor vehicles (21.3%). Furthermore, according to UNCTAD, 74% of Indian imports were subject to non-tariff barriers in 2024. The US government could also put pressure on India to replace Russian oil with US oil, although this would not be optimal for India for cost reasons (crude oil prices and transport costs) and due to the nature of the imported oil. The Indian government had already floated the idea of increasing its purchases of US gas last March.

Finally, the question arises as to what extent India could benefit from the reorganisation of value chains in Asia. It has many advantages over other Asian countries due to its strong growth, large population, large skilled workforce (119 million Indians had higher education level in 2024, according to the International Labour Organization) and very competitive wages.

It could become even more attractive if its customs duties in the United States were (effectively) lower than those of other Asian countries. However, on the one hand, the Trump administration has threatened US companies seeking to set up operations in India, and on the other hand, the country also has many disadvantages. To date, its manufacturing capacity is too underdeveloped to make the country the new factory of the world. Value added in manufacturing accounts for only 12.5% of GDP. Structural constraints, which weigh on foreign investment and hamper the development of its industry, remain strong. This is reflected in the low level of FDI, which has been falling steadily (in nominal terms and as a percentage of GDP) since 2021. FDI inflows to India reached their lowest level in 15 years in 2024 (0.7% of GDP), despite multiple tax incentives for foreign companies. By way of comparison, FDI received by Vietnam amounted to 4.2% of GDP in 2024.

NET FDI INFLOWS STILL LOW IN INDIA

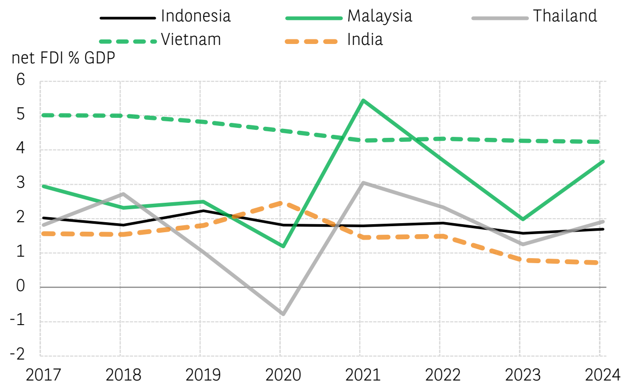

CHART 2

SOURCE: CEIC, BNP PARIBAS

Although FDI flows are low and mainly concentrated in services (particularly IT), they have enabled India to increase its export market share, particularly in mobile phones.

India remains insufficiently integrated into world trade, particularly in Asia. China is its main supplier (15.5% of its imports), but it exports relatively little to Asian countries as a whole (9.5% to ASEAN-6 and 3.4% to China). Similarly, the share of Asian investment in India (excluding investment from Singapore, which does not allow the origin of the funds to be identified) is low and no significant change has been recorded since Donald Trump's first term in office. However, despite failing to develop its trade and financial ties with Asian countries, India has increased its trade with the United States. The amounts invested remain modest, but their share of FDI flows received by the country has increased significantly over the last five years, reaching an average of 14.9% of the flows received (compared to 6.9% over the 2015-2019 period).

In order to take advantage of the upcoming adjustments in global trade, the Modi government must lift protectionist barriers. Recent free trade agreements and economic partnership agreements are a step in this direction, notably the agreement signed with the United Kingdom in May, which could come into force in a year's time, and the agreement currently being negotiated with the EU, which could be concluded in December if the talks scheduled for September are successful. However, they will not be enough if reforms to liberalise the country do not accelerate. The labour market reform adopted in 2020 is not expected to be implemented before 2026 (at best), and the land acquisition reform has still not been passed by Parliament. Modi's obligation to negotiate with the smaller parties in his coalition will further reduce his room for manoeuvre in liberalising the economy.

Article completed on 13 June 2025

Johanna Melka

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THAILAND

ECONOMIC GROWTH THREATENED BY CHINESE COMPETITION

Thailand's real GDP growth remained solid in Q1 2025, but downside risks are high. Thailand is one of the Asian countries that has benefitted most from the trade tensions between the US and China, but the effects of the further tightening of US trade policy could be more painful. Its products might be taxed more heavily than those of its competitors in the US market, while the influx of Chinese goods could increase significantly. However, it could also benefit from new investment from foreign companies seeking to diversify their production chains. It has many advantages over some of its neighbours.

MODEST REAL GDP GROWTH WEAKENED BY EXCESS PRODUCTION CAPACITY IN CHINA

Four years after the recession caused by the COVID-19 pandemic, Thailand's real GDP finally exceeded its 2019 level in 2024. However, the pace of growth remains below the 3.4% recorded between 2015 and 2019, and the outlook for the next three years remains modest. Even assuming that US tariffs remain significantly lower than the levels announced on 2 April 2024, difficulties are likely to persist in the manufacturing industry. In addition, Thailand faces increased competition from Chinese products in its domestic market.

In 2024, real GDP growth accelerated from 2% to 2.5%, driven by higher government spending, while private consumption and investment slowed. In May, the National Economic and Social Development Council (NESDC) revised its economic forecast for 2025 downwards (-1 pp, with estimated growth between 1.3% and 2.3%) due to the increase in US tariffs. Thailand, which has a high degree of trade openness (its exports of goods accounted for 56.4% of its GDP in 2024), will be affected not only by weaker trade with the US and China (due to the expected economic slowdown), but also by competition from China, which will seek to offload its excess production capacity.

In Q1 2025, economic activity remained solid but downside risks increased significantly. Seasonally adjusted real GDP grew by 0.7% compared to the previous quarter (+3.1% year-on-year). Services and agriculture recorded robust GDP growth, while manufacturing GDP growth remained weak (+0.6% y/y). Economic growth is expected to slow in the coming quarters. In April, consumer confidence indices fell for the fourth consecutive month, credit growth to households and companies declined further and tourist numbers fell, mainly due to a drop in Chinese tourists (-29.9%). Activity in the tourism sector is likely to remain depressed in the second half of the year given the recent earthquake, global economic uncertainty and persistently weak demand from Chinese households. Even though industrial output accelerated in April (+2.2% y/y), this rebound is likely to be temporay. The risk of an influx of Chinese products onto the domestic market is weighing on investment decisions.

Given the risks to growth, the government decided in May to reallocate the remaining funds earmarked for the household consumption support programme (the "digital wallet programme") to infrastructure projects and loans to small and medium-sized companies amounting to 0.8% of GDP. The relatively high level of government debt (63.9% of GDP), close to the legal ceiling of 70% of GDP, limits its room for manoeuvre, but raising the ceiling is not impossible. The depth and liquidity of the domestic financial markets would allow it to easily finance new spending.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth (%)	2.6	2.0	2.5	2.0	2.4
Inflation (CPI, year average, %)	6.1	1.3	0.4	0.8	1.6
General gov. balance / GDP (%) (1)	-4.5	-2.0	-2.4	-4.3	-3.8
General gov. debt / GDP (%) (1)	60.5	62.4	63.3	65.7	67.6
Current account balance / GDP (%)	-3.2	1.9	2.4	2.0	1.9
External debt / GDP (%)	42.1	39.1	35.1	34.9	34.7
Forex reserves (USD bn)	196	202	211	201	198
Forex reserves, in months of imports	7.2	7.4	7.5	7.2	7.2

TABLE 1

(1) Fiscal year from October 1st of year N-1 to September 30 of year N
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

THAILAND: DECOUPLING BETWEEN MANUFACTURING OUTPUT AND CONSUMPTION

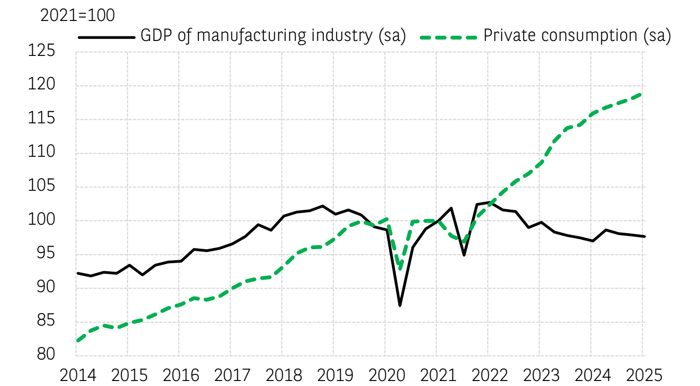

CHART 1

SOURCE: BOT, BNP PARIBAS

DISINFLATION AND MONETARY POLICY

In this context of slowing growth and falling prices (-0.6% year-on-year in May), the central bank (Bank of Thailand, BOT) cut its key rates by 25 bp at its last two monetary policy committees (February and April).

It lowered the repo rate to 1.75% and further rate cuts are expected by the end of the year in order to support economic growth and reduce household debt and the debt burden. The slowdown in economic growth could exacerbate the difficulties of the most vulnerable borrowers, households and small and medium-sized enterprises, which have already seen an increase in non-performing loans over the past year. The increase in credit risk does not currently pose a risk to the banking sector, which has comfortable capital buffers (the capital adequacy ratio stood at 20.7% in Q1 2025) and provisions (177.1% of non-performing loans). In terms of exchange rate policy, the BOT is expected to continue its managed float policy in order to mitigate any excessive volatility of the baht, with risks tilted to the downside.

RISE IN US TARIFFS: RISKS AND OPPORTUNITIES

Thailand is one of the Asian countries most vulnerable to the Trump administration's trade protectionism. The country could face not only a decline in exports to the US (if tariffs are raised), but also an influx of Chinese products into its already fragile domestic market.

Within ASEAN, Thailand is the country that has benefitted most from trade tensions between the US and China since 2018, after Vietnam. Its market share of goods imported by the US increased by 0.7 pp between 2017 and 2024 to 1.9% of US imports (compared to +2.2 pp for Vietnamese goods). The US has become its largest trading partner (18.3% of total exports, or 10.4% of GDP in 2024), ahead of China (11.7% of exports).

All other things being equal, an increase in US tariffs to 25.1% (the effective tariff rate that would come into effect on 9 July if no agreement was reached with the US, taking into account the rise in tariffs on automobiles, steel and aluminium, compared with an effective tariff of only 0.68% on 1 April) could cost the economy 1.8 percentage points of GDP – assuming that exports are fully elastic to tariffs and that the Thai value added in direct exports to the US is estimated at 69% of total exports (7.2% of GDP). Although it seems unlikely that the tariffs applied from July will be those announced on 2 April, Thailand could be severely penalised if it fails to negotiate tariffs that are lower than or equal to those of its competitors. It exports electrical machinery and equipment (31.9% of its exports) to the United States, particularly telephones, semiconductors and electrical transformers. For these products, it competes with other ASEAN countries (particularly Vietnam and, to a lesser extent, Malaysia), as well as with India and Taiwan. For its exports of machinery and mechanical equipment (particularly computer equipment), it competes with Taiwan and with China for all exported products.

The second risk weighing on the Thai economy is the flood of Chinese products observed since 2017, which is expected to accelerate significantly. Thailand's imports from China have risen sharply since 2017 (+81.6%) to account for 26.2% of its total imports (compared to 19.9% in 2017). Although Thailand mainly imports intermediate goods, Chinese competition in final goods (20.3% of its imports in 2024) weighs heavily on its industry. All products are affected (copper, aluminum, textiles and furniture), but the sector most affected is likely to be the automotive industry. Imports of motor vehicles from China increased 106-fold between 2017 and 2024. At the same time, in both Thailand and Indonesia, domestic production of textiles and motor vehicles declined significantly. Since 2022, trends in private consumption and manufacturing output have decoupled. The BOT has shown that the decline in the production of electrical equipment, automobiles, metals and textiles correlates with the increase in the penetration rate of Chinese products.

THAILAND: GROSS FOREIGN INVESTMENTS

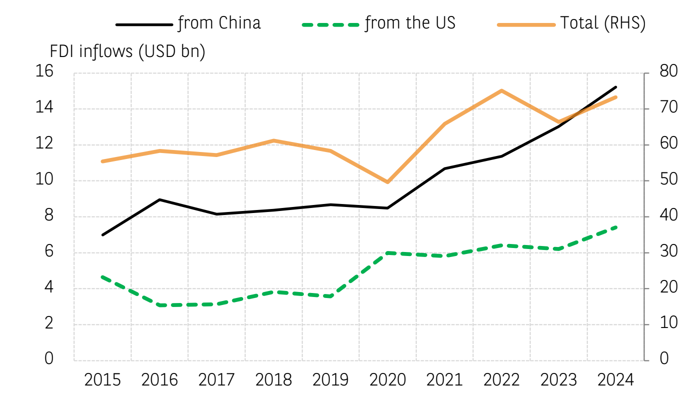

CHART 2 SOURCE: BOT, BNP PARIBAS

Finally, the last risk relates to foreign direct investment (FDI) flows. Thailand has managed to increase its market share in the United States in recent years because it has benefitted from an increase in FDI (like Vietnam, but to a lesser extent). Chinese and US gross investment increased 1.9- and 2.4-fold, respectively, between 2017 and 2024, accounting for 20.8% and 10.1% of gross foreign direct investment.

Can this momentum continue? Which Asian countries offer favorable conditions for foreign companies to set up operations? Does Thailand have sufficient conditions to continue benefitting from the reorganisation of value chains and offset the effects on its exports and growth of a possible increase in US tariffs on its products?

In order to answer these questions, several aspects need to be analysed: 1) wage and skill levels, 2) taxation, 3) manufacturing sector development, and 4) logistics performance. Although Vietnam competes with Thailand on average wages (1.5 times lower), its production capacity and infrastructure are now saturated. Compared with India and Indonesia (where wages are on average 2.6 and 1.9 times lower than in Thailand), Thailand has significant advantages: its overall level of education is higher than that of India and Indonesia, its infrastructure is more efficient overall (although there is an urgent need to modernise port infrastructure), its industry is much more developed and its production capacity utilisation rates are relatively low. It also offers a more advantageous tax system than Indonesia, but a less favorable one than India. In fact, India has introduced tax incentive programmes since 2020 to develop its industry, particularly in certain sectors (i.e., electronics) that could compete with Thai exports.

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TARIFFS HEADWINDS, STRATEGIC TAILWINDS?

The tightening of US trade policy presents Brazil with numerous challenges and pressure points through its effect on economic growth, commodity prices, the need to defend its export market shares and heightened competitive pressure within its borders stemming from the rerouting of inexpensive goods. However, this new environment also presents Brazil with opportunities to reposition itself in the global trade landscape enabling it to take advantage of the reconfiguration of trade flows and global value chains. This shifting geography could also act as a catalyst to accelerate its trade integration (Mercosur, EU, Canada, Mexico). In the short term, however, the most pressing challenges will be domestic. Despite a highly restrictive monetary policy, signs of moderation in the economy have been slow to materialize. In addition, authorities are still grappling with closing the credibility gap of the new fiscal framework.

RESILIENT GROWTH, PERSISTENT INFLATION

The Brazilian macroeconomic picture presents a complex challenge for monetary authorities. Despite operating under significant constraints, economic activity has held up well; meanwhile inflation has been slow to converge to the target (+3%). Although inflation experienced a slight decline in May for the first time in four months – driven in part by easing food prices – its dynamics remain fuelled by robust demand. The labour market remains tight, credit growth has been slow to decelerate – notably due to the expansion of earmarked credit lines – and the economy continues to feel the effects of strong real wage growth (+4.8% y-o-y in 2024). These factors have helped support consumer spending – the main driver of activity in Q1 on the demand side – contributing to half the growth in real GDP over the quarter (1.4% q/q).

In the short term, although some factors should help dampen inflation (moderation of industrial activity constrained by the high-rate environment, global economic slowdown, easing of imported inflation amidst the strengthening of the *reais*), inflationary pressures could persist under the combined effect of demand and supply-side drivers. Some measures announced by the government are likely to support household disposable income: payment of *precatorios* (settlement of court-ordered payments owed by the government to individuals and companies), relaxation of withdrawal rules from the FGTS (a mandatory severance indemnity fund), expansion of the *Minha Casa Minha Vida* social housing programme, the new gas voucher programme (*Gas para Todos*) phased in January aiming to elevate coverage to 20 mn families (up from ~5.6 mn) and continued roll out of the new workers' credit programme (*Credito do Trabalhador*) launched in March. On the supply side, below-average rainfall levels and escalating tensions in the Middle East could drive up electricity and oil prices.

MONETARY AND FISCAL AUTHORITIES ON A TIGHTROPE

The strength of economic activity – and even more so the resilience of investment (+3.1% q/q in Q1) – are surprising in view of the broad base deterioration in confidence (see Chart 1) and the highly restrictive monetary policy pursued by the Central Bank of Brazil (BCB). The SELIC policy rate – now at 15% – has been raised by 450 basis points since August 2024, reaching levels both in nominal and real terms not seen in nearly 20 years. The BCB remains concerned about the persistent de-anchoring of inflation expectations, largely attributed to the credibility gap of the new fiscal framework (2023). This gap has proven difficult to mend (i) due to the absence of reforms targeting mandatory spending[1] and (ii) given the series of constraints currently facing the government (high real interest rates, prospects of slowing economic activity, political obstacles to increasing revenues[2]). The fiscal adjustment effort carried out by the central government (bringing the primary deficit – excluding interests – from 2.4% of GDP in January 2024 to 0.1% at the beginning of May 2025) has indeed been partly neutralised by a one percentage point of GDP increase in interest payments over the same period (to 6.9% of GDP over 12-months in May). To meet its target of achieving a zero primary deficit in 2025 (in alignment with the fiscal rule) the government may be forced – in the absence of new revenue-generating

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	3.1	3.2	3.6	2.4	1.3
Inflation, CPI, year average, %	9.3	4.6	4.4	5.5	4.8
Public sector fiscal balance / GDP, %	-4.6	-8.8	-8.5	-8.3	-7.5
Gross public debt / GDP, %	72	74	77	80	84
Current account balance / GDP, %	-2.9	-1.3	-2.5	-2.6	-2.4
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: CONFIDENCE INDICES

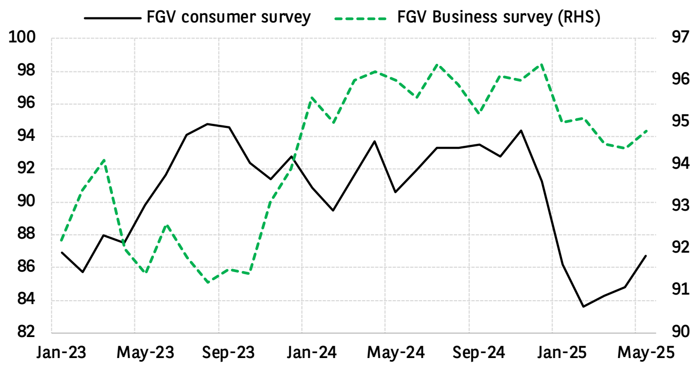

CHART 1 SOURCE: FGV

1 Including civil service salaries, pensions, social programs and constitutionally mandated minimums for health and education.
2 Illustrated by the Congressional opposition in June to the IOF decree destined to increase the tax on financial operations.

measures – to proceed to yet another budgetary freeze (after July and November 2024 and May 2025). To stabilize the public debt ratio, the authorities would need to generate a primary surplus of at least 2.4% of GDP, assuming real GDP growth of 2% and an implicit real interest rate close to 6.5%. In 2025, public debt is projected to exceed the 80% of GDP threshold.

A NEW TARIFF REGIME...

Brazil has not been in the crosshairs of the Trump administration's protectionist agenda despite (a) the structural imbalance in the effective tariff rates applied by the two countries on their respective goods (5.8% on US products versus 1.3% on Brazilian products[3]) and (b) the proportion of imports subject to non-tariff barriers in Brazil (86%) vs. the United States (77%). It is the United States' trade surplus (around USD 7 bn in 2024 according to Comtrade[4]) since 2009 that justified Brazil's inclusion on the list of countries subject to a minimum "reciprocal" tariff rate of 10% as of April 2nd. In addition to this baseline rate, specific duties on steel and aluminium – now taxed at 50% since early June – have been imposed. As a result, the average (weighted) effective tariff rate applied by the United States on Brazilian goods is now close to 9%, up from around 1.3% previously.

At this stage, no retaliatory measures have been announced by Brasilia in response to the US trade policy. The United States remains Brazil's 2nd largest foreign supplier (~15% of imports) and 3rd largest export market (capturing 12% of Brazilian exports in 2024) after China and the European Union. However, in early April, Brazil's Congress passed a reciprocity law, allowing the country to respond to trade barriers imposed by other countries, if needed.

... SOURCE OF RISKS...

This new tariff environment presents several risks for Brazil. First, its trade with the United States is likely to weaken. In addition to the short-term impact of a US economic slowdown, the tariff hike is projected to penalise the steel industry the most due to the high concentration of steel and aluminium exports to the US market (60% and 15% respectively of total Brazilian steel and aluminium exports in 2024). Brazil is the 2nd largest steel supplier to the United States after Canada.

However, three factors should help mitigate the slowdown in trade: (i) the exemption of crude oil from the new tariffs (oil was the largest US import from Brazil accounting for 14.3% of total exports to the United States in 2024), (ii) the lower price elasticity of high value-added products exported by Brazil (notably machinery and equipment as well as aerospace products) and (iii) a lower tariff rates applied to Brazil relative to China and possibly other Asian exporters (which could translate into relative competitiveness gains if the "reciprocal" tariffs announced on April 2nd, were introduced in July).

Brazil is also vulnerable to facing a growing influx of low-cost imports originating from China and other major Asian exporters. While this may have a salutary disinflationary effect it also risks intensifying competitive pressures in some sensitive industrial sectors, especially textiles and apparel, home appliances and steel.[5]

BRAZIL: ONE OF THE WINNERS OF THE FIRST SINO-AMERICAN TRADE WAR (2018-2020)

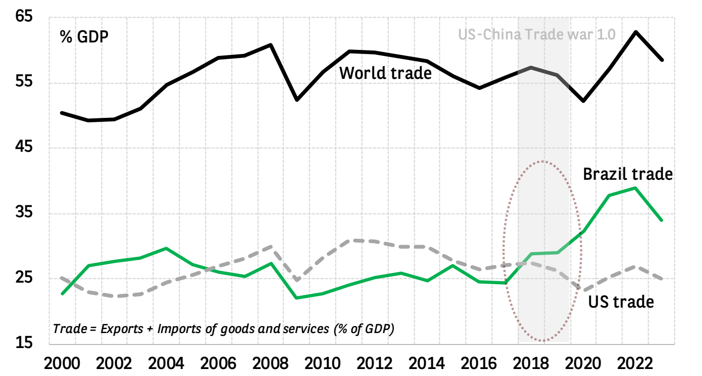

CHART 2

SOURCE: WORLD BANK

Due to various offsetting effects, the significant undervaluation of the Brazilian *reais* in real terms and the relatively limited weight of Brazilian exports to the United States (~2% of GDP compared to more than 25% of GDP in the case of Mexico), the direct impact of the US tariff shock on Brazilian economic activity is likely to be moderate. That said, indirect effects *via* the global slowdown, falling commodity prices and increased market uncertainty could exacerbate pressure on the *reais* and heighten volatility of capital flows. Finally, Brazil's strategic alignment with China could spur future tensions and become a source of geopolitical friction with Washington.

... AND OPPORTUNITIES

This new global trade order also presents opportunities for Brazil. Since April, shifting trade flows have benefited the country. China has already redirected part of its purchases of soybeans, meat, oil and, to a lesser extent, corn from the United States to Brazil. The latter now supplies over 70% of China's soybean imports, meeting strong demand from pig and poultry farmers; China also purchases more than 45% of Brazil's oil exports.

The US tariff shock is also expected to encourage Brazil and its regional partners to deepen integration into Mercosur and to accelerate the conclusion of the free trade agreement with the European Union. President Lula is also trying to advance negotiations with Mexico and Canada.

In the medium term, Brazil could benefit from the reconfiguration of global value chains, attracting firms seeking to relocate operations to access the US market at lower cost. Brazil boasts some key comparative advantages including direct access to strategic raw materials and a low-carbon energy mix. If this materializes, it could pave the way for technology transfers and support a gradual move up the value chain for Brazil's industrial base.

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3 According to the WITS database, end of 2022.
4 The trade surplus is much lower in the order of USD 250 mn according to Brazilian national data (MDIC).
5 As a reminder, in 2023, China, in the wake of its real estate crisis, directed record volumes of low-priced steel towards the rest of the world. In Brazil, this resulted in a drop in local production, job losses and factory closures – forcing the Brazilian government to introduce protectionist measures in April 2024, with similar actions taken by its neighbours Chile, Colombia and Argentina.

MEXICO

IN THE EYE OF THE STORM

The outlook continues to deteriorate in Mexico, one of the countries most exposed to US economic policy. The Mexican economy is set to contract in the coming quarters, with weak domestic demand unable to offset the marked slowdown in exports. Mexico's Minister of the Economy has begun talks with Washington on a faster-than-expected renegotiation of the USMCA free-trade agreement. The aim is to reduce the short-term uncertainty surrounding bilateral relations between the two countries.

SLIGHT RECESSION IN SIGHT

Economic activity has held up better than expected in Q1 2025. GDP grew by 0.8% year-over-year in Q1 (after 0.4% in Q4). Details of GDP components are not yet available, but economic data suggest that growth was largely underpinned by buoyant exports (+3.6% y-o-y). This was achieved due to anticipation of the additional tariffs announced by the Trump administration. In contrast, other indicators (private consumption, industrial production, employment) point to a marked slowdown in activity. The monthly investment index also fell sharply (-7% y/y) in Q1.

The outlook is clearly bleak, with GDP expected to fall by 0.3% in 2025, making it one of the few emerging countries to record a recession in 2025... Exports are likely to suffer under the combined effect of the slowdown in the US economy (our central scenario forecasts a growth of 1.7% in 2025) and the increase in US tariffs.

We do not expect domestic demand to rebound in the short term. Household consumption will remain sluggish at best. Our forecasts could be revised downwards if a new tax targeting the remittances of foreign workers (a major source of support for private consumption, accounting for almost 3% of GDP in 2024) is adopted by the US Congress. Initially proposed at 5%, the tax is now expected to represent 3.5% of total remittances, following strong protests from the Mexican government. The tax would affect nearly 70% of Mexican workers on American soil (it does not apply to naturalized workers). Furthermore, the final adoption of this tax would further complicate diplomatic relations between the United States and Mexico.

In addition, the new measures presented by President Sheinbaum to encourage private investment under the "Mexico Plan" are likely to have limited impact. A few measures presented at the beginning of April are worthy of note, notably in the energy sector. The role of the public sector will remain predominant (as previously announced), but new opportunities for partnerships with the private sector have been presented. The effect on investment is likely to remain marginal, at least in the short term. The business climate has deteriorated significantly. In addition, the negative effects of judicial reform (which includes the dismantling of several autonomous regulatory bodies) and the uncertain evolution of relations with the United States have resulted in a wait-and-see attitude on the part of investors (domestic and foreign) that will take time to dissipate.

The authorities' leeway to support the economy is limited: on the one hand, the government is committed to consolidating public finances, and it is unlikely that any support measures will be announced; on the other hand, support from monetary easing is weak, real rates remain high and the use of credit is relatively limited.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	3.9	3.2	1.5	-0.3	0.2
Inflation, CPI, year average, %	7.9	5.6	4.2	3.8	3.8
Budget balance / GDP, %	-4.3	-3.3	-5.1	-4.0	-4.0
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: INVESTOR CONFIDENCE WEAKENS

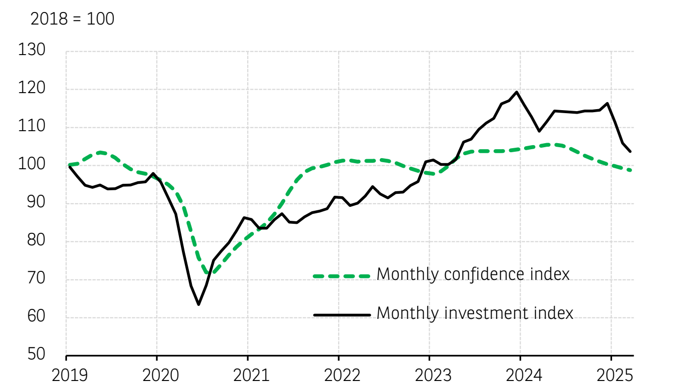

CHART 1

SOURCE: CENTRAL BANK, BNP PARIBAS

PERSISTENT INFLATIONARY PRESSURES

In April, headline and core inflation indices came out at 3.9% y/y (after 3.8% and 3.6% respectively in March). For the third time in succession, the Central Bank cut its main key rate by 50 basis points (to 8.5%) at its May 15 meeting. It also indicated that further rate cuts are envisaged in the short term.

However, short-term inflation forecasts have been revised slightly upwards, to 3.6% and 3.1% for 2025 and 2026 respectively (compared with 3.4% and 3.0% previously), mainly due to a stronger-than-expected rise in inflation for consumer goods.

The risks remain high, especially if the Trump administration adopts a more aggressive stance towards Mexico, and particularly if it imposes higher tariffs.

DEGRADATION OF PUBLIC FINANCES

In early April, alongside the preliminary presentation of the 2026 budget, the government revised its fiscal consolidation targets. Given the slowdown in activity, the expected reduction in the deficit has been downgraded from 5.1% of GDP in 2024 to around 4% in 2025 (previously 3.5%). Although the government's growth forecast seems overly optimistic (the government expects GDP growth of between 1.5% and 2.3% for 2025), this target looks achievable: tax revenues rose by 20% in Q1 relative to Q4 2024, thanks to recent measures to improve collection (on e-commerce in particular) and, to date, the reduction in public spending announced by President Sheinbaum is continuing.

In the medium term, however, fiscal consolidation is likely to become increasingly complicated. On the one hand, because interest payments will remain high (we estimate that they will reach 17% of government revenues in 2025, up from less than 12% in 2022), reflecting the prolonged rise in interest rates at which the government funds its needs. On the other hand, social spending and budgetary rigidities, a structural problem in the Mexican economy, will make it difficult to apply new austerity measures. The need to support the oil company, Pemex, and the government's determination not to implement any major tax reforms also represent major obstacles to fiscal consolidation.

RENEGOTIATION OF THE USMCA TRADE AGREEMENT, THE FOCUS OF ATTENTION IN THE MONTHS AHEAD

The outlook for risks in terms of growth and public finances is bleak, mainly due to uncertainty over US trade policy and bilateral relations between Mexico and the United States. As far as Mexico is concerned, tariff measures currently in force include an exemption for goods meeting the criteria defined in the trade agreement between the United States, Mexico and Canada (USMCA), while customs duties of 25% apply to all other products. In addition, specific customs duties, raised to 50% at the beginning of June, apply to steel-aluminum products and certain automotive products (light vehicles).

Around 80% of total Mexican exports, or 27% of GDP, are destined for the USA, and over 50% of total exports to the USA do not meet USMCA criteria and are therefore subject to customs duties. The effective rate of customs duties applied by the United States on imports of Mexican goods is therefore currently 12.1% (compared with virtually zero before the start of the second term).

This rate could fall if a greater percentage of exported goods was USMCA-compliant (by meeting rule-of-origin criteria, for example, or by clearing red tape). The margin seems significant for Canadian goods, but narrower for Mexico: according to US Census Bureau data, 48% and 47% of total goods imported by the USA were USMCA compliant in March and April 2025 respectively, after 45% in February (the average over the last five years is close to 50%). In Canada, on the other hand, the proportion of compliant goods jumped to 50% in March 2025, then 57% in April, after 33% in February (see graph), and the five-year average is close to 36%.

MEXICO: US IMPORTS WITH USMCA CRITERIONS

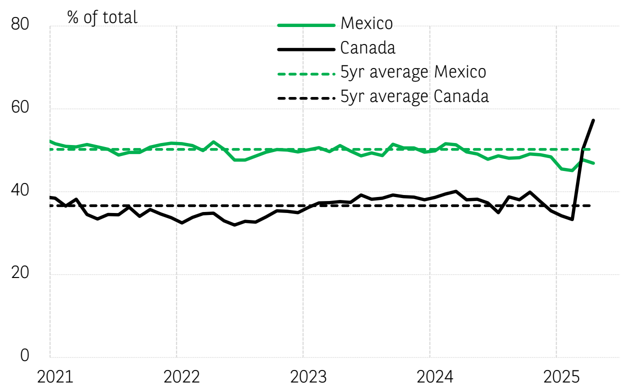

CHART 2

SOURCE: CENSUS BUREAU, BNP PARIBAS

Sectoral distribution is highly heterogeneous in both countries, with the exception of the automotive sector, where 84% and 90% of goods exported in 2024 were USMCA-compliant in Mexico and Canada respectively. Mexico's market share of US imports could ultimately decline.

In order to reduce the uncertainty surrounding the renewal of the USMCA trade agreement, Minister of the Economy, Marcello Ebrard, requested the opening of negotiations in May, even though they were scheduled to start in mid-2026.

In 2020, when the USMCA replaced the NAFTA, negotiations had been successful and strengthened the nearshoring process. The outlook is much less positive this time around for Mexico, given President Trump's stated preference for relocating production to the USA. In addition, Mexico's structural difficulties and deteriorating business climate will continue to severely limit investment in the country.

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CHILE

THE ECONOMY REMAINS DEPENDENT ON THE MINING SECTOR

GDP growth is holding up rather well in Chile, buoyed by the mining sector and a solid domestic demand. The outlook is relatively favourable: inflation is contained, fiscal consolidation should continue and political risk remains moderate in the run-up to the presidential election at the end of the year. Lastly, apart from the announcements regarding the copper sector, the direct impact of the increase in tariffs imposed by the Trump administration on the Chilean economy is relatively low. Indirect effects, volatile commodity prices and uncertainties over the pace of progress in the global low-carbon transition, on the other hand, represent a very significant risk for the Chilean economy.

GROWTH HOLDS UP

Buoyed by the mining sector, economic activity held up rather well in Chile over the first four months of the year. GDP grew by 2.3% year-on-year in Q1, and the monthly activity index showed a further acceleration to 3.3% in April. The outlook remains rather favourable for the months ahead: we expect GDP growth to be close to 2.2% in 2025, after 2.4% in 2024.

Domestic demand should remain solid, supported by the recent increase in the minimum wage and a healthy job market. Following growth of 1.1% in 2024, household consumption rose by 1.5% y/-y in Q1. Nevertheless, the expected slowdown in global demand will translate into a slowdown in exports.

INFLATIONARY PRESSURES PERSIST

Inflation slowed in May for the second month in a row (to 4.4% y/y, after 4.5% in April), but remains above the 3% target set by the Central Bank, as it has been since July 2024. Underlying inflation remained stable at 3.7%. Inflationary pressures remain high, reflecting rising prices for certain utilities (electricity). The inflation rate should remain above target over the coming months. In June, the Central Bank again left its key rate at 5%, unchanged since December 2024.

FISCAL CONSOLIDATION CONTINUES

The budget deficit widened in 2024 (to 2.9% of GDP, exceeding the government's 2% target), as lower-than-expected revenues (particularly in the non-mining sector) were not fully offset by the spending cuts implemented at the end of the year.

At the end of April, the government raised its public deficit target for 2025 to 1.4% (from 1.1% previously) and announced additional spending reduction measures, over and above those set out in the initial budget. We expect the deficit to fall in 2025, but it is likely to be higher than the government's target: the approach of the presidential elections (in November 2025) makes it unlikely that strict spending reduction measures will be implemented.

In addition, a reform of the pension system (under discussion for over 15 years) was adopted at the end of January 2025. The main objectives were to improve coverage (many Chileans are totally or partially excluded from the current system), the lack of transparency in the management of private pension funds and, above all, the replacement rate (i.e., the percentage of working income received by an employee when he or she claims his or her pension rights). Currently, the replacement rate is around 38% for a man and 35% for a woman. This is well below the OECD average of 63%.

After significant concessions on the part of the government, the reform includes a further (gradual) 7 percentage point increase in the total contribution rate paid by employers (which, added to the current 10% rate financed by employees, would gradually bring Chile closer to the OECD average contribution rate of 18%), and an increase in the Guaranteed Universal Pension (PGU), while maintaining the principles of the Chilean individual capitalisation model. Another long-term objective is to rebuild retirement savings. These have fallen sharply following the multiple withdrawals authorised by the government at the time of the Covid-19 crisis to support business activity. Whereas they accounted for 80% of GDP in 2019, retirement savings assets accounted for 60% of GDP by the end of 2024.

According to government estimates, the total fiscal cost of the planned reforms could reach around 1% of GDP by 2032, and remain at this level thereafter. However, we expect the net cost to be slightly lower.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, %	2.4	0.2	2.4	2.2	1.8
Inflation, CPI, year average, %	11.6	7.6	3.9	4.5	3.0
Central Gov. balance / GDP, %	1.1	-2.5	-2.9	-1.8	-1.9
Public debt / GDP, %	38.0	39.4	41.7	42.4	42.6
Current account balance / GDP, %	-8.7	-3.5	-2.5	-2.6	-2.7
External debt / GDP, %	76.4	71.1	77.5	76.5	76.6
Forex reserves, USD bn	39.1	46.3	47.8	46.3	47.1
Forex reserves, in months of imports	4.9	7.0	7.3	7.5	7.6

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

CHILE : TOTAL AND COPPER EXPORTS

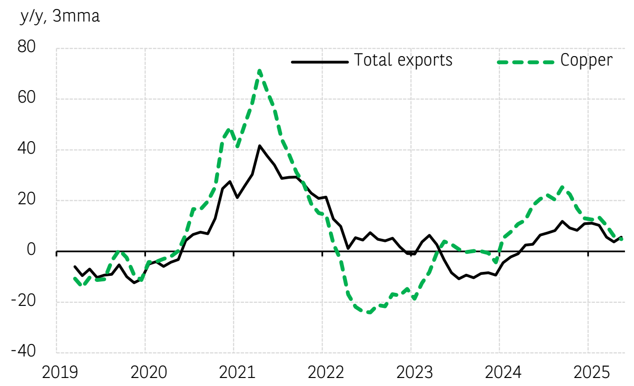

CHART 1 SOURCE: CENTRAL BANK, BNP PARIBAS

In fact, the increase in the PGU should be partly offset by the gains linked to the anti-tax evasion bill.

All in all, the government's objective of achieving structural balance by 2029 seems difficult to attain: financial support for Codelco (the national copper mining company) could be substantial in the years ahead (its debt has increased over the past five years, between the need for massive investment to maintain infrastructure and the decline in production for technical reasons). In addition, social spending will remain high, whatever government is elected at the end of the year, while the revenues generated by tax reform remain uncertain.

Central government debt increased but remained moderate, standing at 41.7% of GDP in 2024 (versus 28% of GDP in 2019). This dynamic is set to continue, with debt reaching 42.6% of GDP in 2026.

THE COPPER SECTOR AWAITS TRUMP'S DECISIONS

As with most countries in the region (excluding Mexico), the Trump administration has imposed 10% «reciprocal» tariffs on goods from Chile.

To date, the direct impact on the Chilean economy has been limited: on the one hand, exports to the United States account for only 17% of total Chilean exports, or around 5% of GDP (compared with almost 40% of total exports to China, the country's leading trading partner). Secondly, as the copper sector is not currently subject to taxes, the effective rate for Chile is only 5%.

However, Chile is highly exposed to fluctuations in raw material prices: the country is the world's leading producer and exporter of copper and the second largest producer of lithium (behind Argentina). The mining sector in its broadest sense (to which copper makes a very large contribution) accounts for over 18% of GDP and just over 55% of total exports.

Copper prices and Chilean exports rose sharply in the first few months of the year (in anticipation of potential tariff hikes announced by the US government), encouraging new investment in the Chilean mining sector.

According to forecasts by the International Energy Agency, demand for copper should remain robust in 2025 and 2026. Even in the event of a sharper-than-expected slowdown in Chinese demand (50% of global demand), the emergence of new markets (India and Vietnam, in particular) should keep global demand buoyant. On the supply side, several technical problems and maintenance requirements will limit production in Peru, the Democratic Republic of Congo and Panama. Although the National Copper Commission has announced an increase in Chilean copper production of 3% per year in 2025 and 2026 (after several years of stagnation, also due to maintenance operations), this will not be enough to offset the global shortage.

At the beginning of June, the Trump administration's announcements regarding the steel and aluminum sector rekindled fears of higher copper tariffs. In our central scenario, these threats will have no effect: around 12% of Chilean copper exports are destined for the USA, while Chilean copper accounts for around 60% of US copper imports. Therefore, if additional tariffs were imposed specifically on copper, the US would mainly harm its own importers and users, while remaining heavily dependent on Chile.

CHILE : INFLATION AND POLICY RATE

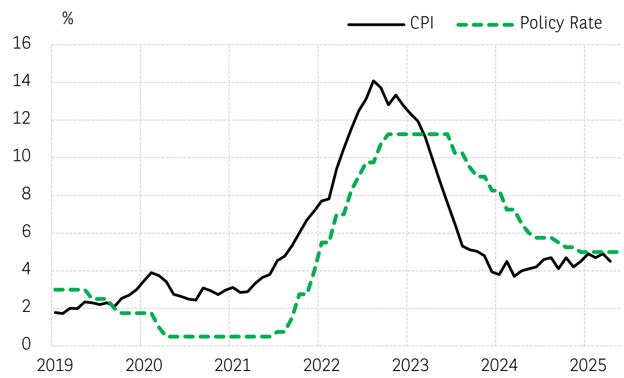

CHART 2 SOURCE: CENTRAL BANK, BNP PARIBAS

What's more, with over half of the world's refining capacity located in China (or, as is the case in Chile, owned by Chinese companies), raising tariffs on a critical material would likely result in a substantial rise in geopolitical tensions. The Chilean government could come under strong pressure from the Trump administration to reduce its economic ties with China, its biggest trading partner, and, above all, the main player in the entire value chain of critical materials, and mainly copper and lithium.

In the medium term, the possible slowdown in the pace of progress in the global ecological transition (linked in particular to the Trump administration's economic policy), synonymous with lower demand for copper, represents a significant risk for the Chilean economy. In particular, copper and lithium prices have a direct impact on tax revenues and may have repercussions on business activity, including in non-mining sectors.

Article completed on 20 June 2025

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TÜRKIYE

THE REED

After picking up again in fall 2024 and winter 2025, the Turkish economy is expected to bend. This is due to financial tensions since mid-March, the impact of US tariff increases on exports, and a more restrictive fiscal policy. But it will not break. Our scenario remains one of continued gradual disinflation, which would allow the monetary easing cycle to resume. The government's solvency should continue to strengthen, but external vulnerability, due to volatile portfolio investment, is likely to increase. However, with moderate twin deficits, historically low public debt and a solid banking sector, financial stability is not at risk.

DIFFICULT REBALANCING OF GROWTH

After a slowdown in Q2 2024 and Q3 2024, growth picked up again in Q4. Real GDP grew by 2.7% cumulatively in Q4 2024 and Q1 2025. Growth was driven by domestic demand, with foreign trade making a negative contribution on average over the last two quarters. The rebalancing between these two components in the spring and summer of last year was short-lived. Private consumption remained the main driver, while exports were broadly stable. The gap between retail sales on the one hand and exports and industrial production on the other continues to widen. As regards investment, only construction investment is growing, with activity in this sector rebounding strongly (+9% cumulatively in Q4 2024 and Q1 2025).

The only indicators available for Q2 2025 are business and household surveys (up to May). Household confidence remains steady despite perceived inflation of 60% and high underemployment (nearly 30%), which puts the decline in the unemployment rate to a historically low level (8.6% in April)[1] in perspective. On the other hand, business confidence has deteriorated compared to Q1 in industry and services, with the trade sector spared for the time being.

TOWARDS GRADUAL DISINFLATION

At the same time, disinflation slowed. Admittedly, measured over one year, consumer price inflation fell sharply from +75.6% in June 2024 to +35.4% in May 2025. But this trend is misleading. The peak in mid-2024 reflects two episodes of monthly acceleration above 5% (in summer 2023 and then in January and February 2024). These were due to two episodes of financial stress that led to a sharp depreciation of the exchange rate. In fact, monthly core inflation remains high (+2.4% on average over the last three months available). Beyond the impact of the exchange rate on the price index (the pass through is 0.3 on average), inflation is being driven by both demand and costs: by demand, as consumption remains buoyant, even though households have been using credit cards less since the start of the year; by costs, because until Q4 2024, nominal wages grew much faster than inflation (70% year-on-year compared with 50%).

As productivity virtually stagnated in 2024, unit labor costs across the economy rose at the same pace as wage costs. Inflation expectations (published for May but collected in April) over a 12-month horizon among financial market professionals are, unsurprisingly, almost identical to the Central Bank's forecast for the end of the year (25%), but well below the expectations of non-financial business leaders (41%). Our forecast (30% at the end of 2025) lies between the Central Bank's forecast and the expectations of business leaders.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	5.5	5.1	3.2	2.5	3.5
Inflation, CPI, year average, %	72.3	53.9	58.5	34.8	24.8
Central gov. balance / GDP, %	-1.0	-5.2	-4.9	-3.3	-2.4
Gen. Gov. debt / GDP, % (EU standards)	30.8	29.3	25.6	24.3	24.0
Current account balance / GDP, %	-5.1	-3.6	-0.8	-0.9	-1.1
External debt / GDP, %	50.2	44.7	38.7	34.8	33.5
Forex reserves, USD bn	82.9	92.8	90.7	80.0	90.0
Forex reserves, in months of imports	2.6	2.9	3.0	2.6	2.7

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TÜRKIYE: UNBALANCED GROWTH

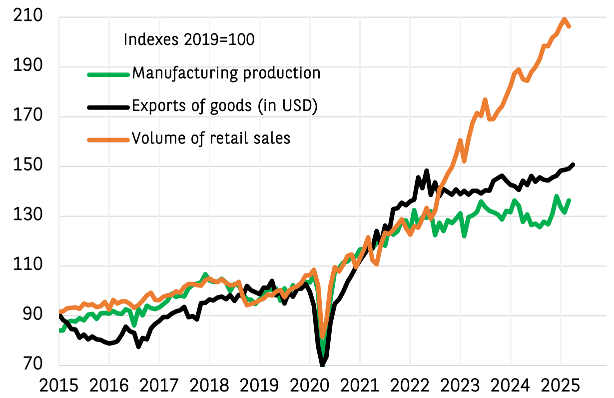

CHART 1 SOURCE: TUIK

TEMPORARY MONETARY TIGHTENING AND MORE RESTRICTIVE FISCAL POLICY

The Central Bank made another U-turn in April, raising its key policy rate from 42.5% to 46%. It cited the impact of financial tensions and tariff increases on inflation. Its statement also highlighted stronger-than-expected demand.

1 According to the Turkish Statistical Institute (TUIK) series, we have to go back to 2006-2007 to find a comparable unemployment rate (i.e., between 8.5% and 9%).

The key rate hike was accompanied by an increase in the reserve requirement ratio on short-term financing in Turkish lira obtained by banks on the offshore market. The monetary authorities' main objective is to avoid fueling carry trade operations. As compensation, and on the instructions of President Erdogan, Economy Minister Mehmet Simsek announced a new credit facility for SMEs at the end of May. This facility is currently very limited (TRY 30 billion, or around USD 800 million) but could be increased tenfold, as was the case in 2017. Overall, monetary tightening is likely to be limited and temporary. We expect disinflation to continue at a slow pace, which would nevertheless allow the central bank to resume its easing cycle in the second half of the year.

Fiscal policy is likely to be more significantly and sustainably restrictive. The central government budget deficit is expected to fall from 4.9% of GDP in 2024 to 3.3% this year thanks to a 1.5-point improvement in the primary balance (i.e. excluding interest payments). The budget would be virtually balanced (-0.2% of GDP), with the interest burden remaining broadly stable (3.1% of GDP compared with 2.9% in 2024). The decline in the primary balance would be the result of lower one-off expenditures related to the February 2023 earthquake (expenditures that are expected to be spread out until 2026) and an increase in the tax burden.

In this context i/ of a more restrictive fiscal policy than in 2024, ii/ bond yields rising since mid-March (from 26% to 33% in early June), and therefore tougher borrowing conditions for businesses and households, iii/ higher customs duties (see below), activity is expected to stagnate in the spring and pick up very gradually in H2 2025. Despite growth of 2.2% in Q1 2025, growth is expected to slow to 2.5% in 2025, compared with 3.2% in 2024. The assumption of a rebound in 2026 is based on a recovery in the Eurozone, a more conciliatory trade policy from the US, and a continued slowdown in inflation, allowing the Central Bank to ease its monetary policy again.

CURRENT ACCOUNT DEFICIT CONTAINED BUT GREATER EXTERNAL VULNERABILITY

Political tensions in March led to a decline in the Central Bank's international reserves, but not to a bleeding . Although they fell by USD 18 billion between mid-March and the end of May 2025, they remain high in absolute terms (USD 153 billion, including USD 69 billion in foreign exchange reserves) and satisfactory in terms of imports. They have even recovered since mid-May.

In Q1 2025, the current account deficit nevertheless widened (USD 4.5 billion per month on average, compared with 3.2 in Q1 2024), mainly due to net energy imports. Excluding energy and gold[2], the trade balance and current account balance remained in surplus. Cumulatively over 12 months, the current account deficit is only USD 12.6 billion, thanks in particular to a travel surplus, which remains above USD 50 billion. Before March 2025, the current account deficit was covered by portfolio investment and a large rollover debt ratio for companies and banks. Non-resident portfolio investment in sovereign debt and equities reached USD 70 billion in mid-March, double the level at the beginning of 2024. It began to withdraw from March 19, explaining both the decline in foreign exchange reserves and the depreciation of the pound. This hot money still amounted to USD 50 billion on May 25. The exchange rate is also vulnerable to changes in the position of offshore investors' currency swaps with domestic banks (USD 30 billion), even if they do not result in an inflow of hard currency[3].

The increase in US customs duties on Turkey is substantial, with the effective rate rising from 3.3% to 15.7% (weighted average by exports). However, exports to the US account for only 8% of total exports, or 1.3% of GDP. Even assuming that the price elasticity of exports to the US is higher than that of total exports (-1 versus between -0.5 and -0.8[4]), the impact would only be -0.15 percentage points of GDP. Admittedly, Turkey is a major exporter of crude steel and steel products, on which tariffs have been raised from 25% to 50%. However, the US market accounts for only 7.5% of exports of these products. The threat is mainly indirect, as Turkish products compete with Chinese products, particularly on the European market, which accounts for 41% of the country's total merchandise exports. On this market, Turkish exporters have not lost any market share so far (with the exception of textiles). However, the sharp appreciation of the real exchange rate (+20% from early 2024 to April 2025), a major instrument of disinflation, risks causing them to lose market share this year.

Article completed on 13 June 2025

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2 Net gold imports are structurally high in Turkey.
3 Currency swaps between the offshore sector and banks allow the latter to balance their net foreign currency positions between the structural net foreign currency liabilities on their balance sheets and their cash position in swaps. In doing so, they obtain Turkish lira financing to fund domestic lending, mainly in local currency. More specifically, banks exchange their dollars for Turkish lira with the offshore sector which obtains the lira on the spot market. The offshore sector is therefore engaged in a carry trade (borrowing a low-interest currency and investing it in a high-interest currency).
4 Gül and Kazdal "Time-varying relationship between exports and real exchange rate in Turkey: a recent analysis at sectoral level" - CBRT Working Paper 21/38 - December 2021.

HUNGARY

TARIFF HEADWINDS ARE MANAGEABLE

The unexpected decline in Hungarian GDP in Q1 2025 will probably be followed by modest growth over the next few quarters, with consumption as the main pillar. However, Hungary will not escape the negative consequences of the US tariff shock, as it is a very open economy. More intense competition from China is expected, particularly on medium and high-tech products. Nonetheless, China remains a major investor in Hungary, mainly in the automotive sector.

RESILIENCE OF THE ECONOMY DESPITE HEADWINDS

The Hungarian economy experienced a technical recession in Q2 and Q3 2024 but recorded a moderate GDP growth of 0.5% over the year as a whole. In Q1 2025, growth unexpectedly fell by 0.2% q/q (0.0% y/y).

Our growth forecast for this year has been revised downwards compared with last January (-0.9 point in 2025), mainly because of the tariff shock, which should result in a fall in exports and a postponement of investment projects in the short term. Despite this, growth is expected to improve modestly in 2025 compared with 2024. The resilience of the economy is expected to be underpinned primarily by household consumption, thanks to strong wages alongside with the gradual decline in inflation. Fiscal measures are likely to be generous in the run-up to the general election scheduled for 2026 and will provide support for consumption. For example, the Budget for 2025 provides for the continuation of the 13th month for pensioners, higher salaries for teachers and healthcare staff, an income tax exemption for mothers and generous family allowances. The budget for 2026 aims to support families even though the government's ability to significantly increase spending is limited. The country is already subject to an excessive deficit procedure and must therefore adjust its public accounts (Hungary has a four-year timeline) as part of its commitments towards the EU.

Hungarian economic growth is set to accelerate from 2026, but is likely to remain below its long-term trend (2010-2019: 2.9%) and its medium-term potential (estimated at 2.8% by the IMF). As far as exports are concerned, Hungary should benefit from a brighter outlook for demand from Germany over this period. The effects of the German recovery plan for defence and infrastructure (EUR 1,000 billion over 12 years) should be positive for Central European countries and should contribute to moving up the value chain. Certain sectors, such as armaments, machinery and electrical equipment, will undoubtedly see their activity grow over the next few years (they represented 29% of the added value of the Hungarian manufacturing sector in 2022), as will the construction sector. However, the implementation of the recovery plan will take time, and its effects will probably only be visible from 2027 onwards. The outlook for public investment remains conditional on the lifting of the suspension of European funds. At present, the blocked funds represent around EUR 19 bn (9% of GDP).

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	4.3	-0.7	0.5	0.9	2.2
Inflation, CPI, year average, %	14.5	17.6	3.7	4.3	3.2
General gov. balance / GDP (%)	-6.2	-6.7	-4.9	-4.5	-4.5
General gov. debt / GDP (%)	73.9	73.0	73.5	74.3	75.0
Current account balance / GDP, %	-8.5	0.3	2.2	1.4	1.2
External debt / GDP, %	92.0	85.8	84.8	82.5	77.6
Forex reserves, EUR bn	38.7	41.4	44.6	47.5	49.8
Forex reserves, in months of imports	3.0	3.4	3.9	4.1	4.2

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

HUNGARY: INFLATION

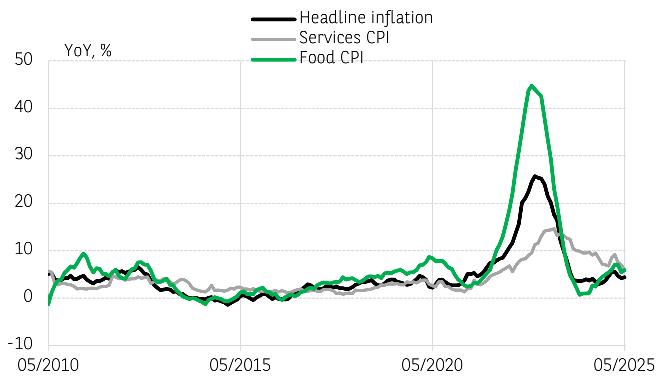

CHART 1

SOURCE: CENTRAL STATISTICAL OFFICE, BNP PARIBAS

GRADUAL EASING OF INFLATION

Inflation remains contained (4.4% y/y in May), following a temporary rise between October 2024 and February 2025 (5.6% y/y). The relief is due, in particular, to the temporary introduction of a cap on margins for companies in the agri-food sector between March and May 2025. In 2025, average inflation should be slightly higher than in 2024 due to high figures at the start of the year. A return to the 3% inflation target is expected in 2027.

Expectations of a fall in inflation, albeit gradual, may pave the way for monetary easing later this year. The Central Bank is likely to remain cautious in the short term. The risk of volatility in the Hungarian forint, in particular, is likely to weigh on the monetary authorities' decision, even though the Hungarian currency has appreciated against the dollar and its depreciation against the euro has been contained since the announcements on US tariffs. The key rate could therefore be cut to 5.75% at the end of 2025 and 4.50% at the end of 2026.

TRUMP 2.0: IMPACT ON TRADE FLOWS

The economies of Central Europe have not escaped the rise in US tariffs, even though their trade deficit with the United States is marginal.

In Hungary, the average effective rate of US customs duties rose from 1.4% at the end of March 2025 to 18.8% today. Exports of vehicles and spare parts to the United States are subject to a 25% tariff; the tariff on steel and aluminium rose to 50% on 4 June. The rest of the goods exported are subject to a rate of 10%. The effective rate could rise further to 25.8% if the reciprocal rate is increased to 20%. The pharmaceutical and electronics sectors may also be targeted by Donald Trump's administration. They account for 16% of Hungarian exports to the United States.

In Central Europe, Hungary is one of the countries most exposed to a trade shock, as it is a very open economy. Between 2022 and 2024, combined exports and imports of goods represented an average of 154.8% of GDP (77.1% for exports alone). Admittedly, the share of exports going to the United States is low (4.1% of total exports and 2.9% of GDP in 2024), but given the importance of its trade link with Germany (25.1% of exports in 2024 and 17.5% of GDP), Hungary will be affected indirectly and more markedly than other countries in the region.

The cumulative loss of activity linked to the negative effects on exports could represent between -1.4% and -2.3% of GDP. According to our calculations, which include tariff rates differentiated by sector, the direct impact would be -0.9% of total exports and -0.5% of GDP (with an elasticity of 1). On the other hand, assuming a 5-10% drop[1] in exports to Germany, Hungary would suffer a loss of around -0.9% and-1.8% of GDP respectively.

CHINA: BOTH COMPETITOR AND PARTNER

Against a backdrop of slowing global demand, and with all our trading partners affected by US customs measures, the ability to find new outlets for export products will be limited.

It cannot be ruled out that products from Asia, particularly China, will compete with locally manufactured goods intended for export, particularly in the medium and high-tech segments. Hungary specialises in the production of machinery and transport equipment, which accounted for an average of 55.5% of the country's total exports in 2024. Hungary's gains in market share in Germany in this segment since the 2000s (2000: 3.8% of German imports from Hungary, 2024: 4.9%) could be eroded somewhat in favour of China, which also has a revealed comparative advantage in these goods according to the UNCTAD indicator.

Meanwhile, China has also become one of Hungary's key partners in terms of foreign direct investment (FDI). Hungary has received the largest share of Chinese FDI in Central Europe, mainly in the automotive sector (USD 6.1 billion of Chinese FDI in stock in Q12025, 32.6% of Chinese investment). This is part of its strategy to become a key player in the production of electric batteries and electric vehicles. Hungary's strategy is to encourage foreign direct investment in the medium term.

HUNGARY'S EXPORTS TO THE UNITED STATES

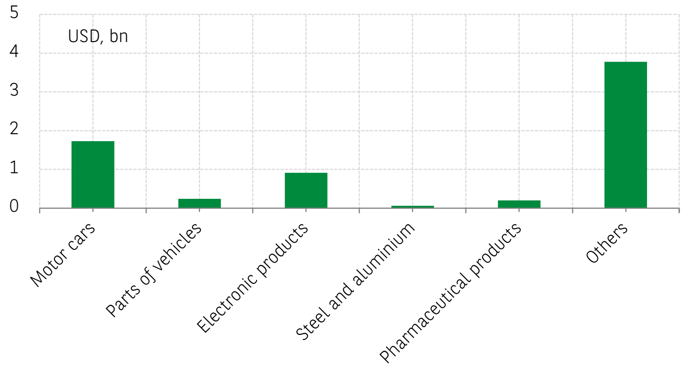

CHART 2

SOURCE: UNCTAD, BNP PARIBAS

Hungary remains an attractive destination for FDI and should continue to benefit from nearshoring in the short and medium term. FDI inflows rebounded strongly in 2021 and 2022 (5.6% and 8.4% of GDP respectively). These flows edged down in 2023 and 2024 (2.2% of GDP in 2023 and 2% in 2024) but remain well-oriented in the region.

SUPPORT FACTORS

In the short term, the negative impact of tariff measures should prevail. The scope for monetary and fiscal policy to offset these effects is relatively limited.

As part of the EU's defence plan, Hungary should benefit from a degree of budget flexibility in the medium term, should the need arise. The country, like other Member States, has activated the escape clause for defence, which allows defence spending to be excluded from the budget rules by up to 1.5% of GDP per year for 4 years. Moreover, a line entitled "defence reserve" has been included in the budget for 2026. For the time being, the Hungarian authorities plan to maintain defence spending at 2% of GDP in 2026, after 2.1% in 2024.

Article completed on 13 June 2025

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1 We expect Hungarian exports to Germany to fall by around 5-10% in 2025. By way of comparison, exports fell by an average of 1.3% in 2019/2020, 11.3% in 2015 and 26.8% in 2009. Last year, exports to Germany fell by 7.3%.

SLOVAKIA

THE FLIPSIDE OF SPECIALISATION

Our growth forecasts have been revised downwards due to the tariff shock initiated by the United States, and the country's industrial specialisation. Slovakia is the most exposed Central European country to the Trump administration's tariff measures. The economy is heavily dependent on foreign trade and the automotive sector. The Slovak economy should avoid a recession thanks to public investment and consumption. The rise in inflation at the start of the year, following the increase in the VAT rate, is temporary and limited, and should not weigh heavily on consumption. In the medium term, the German stimulus plan and FDI inflows will be supportive factors for the economy.

RESILIENCE IN GROWTH

In Q1 2025, GDP growth was only 0.2% q/q and the year-on-year increase was only 1%, but it is resilient. For the rest of the year, we expect stagnation or, at best, weak growth due to the negative effects of US tariff measures and restrictive fiscal policy (EUR 2.7 bn in savings, or 2% of GDP, are forecast in the budget for 2025). However, the economy should avoid a recession.

Slovakia is the most exposed amongst Central European countries to a shock on exports, which account for 81.6% of GDP. The uncertainties generated by the back-and-forth announcements related to tariffs should also affect private investment decisions in the short term.

Our growth forecasts have been revised downwards since January (-0.3 point in 2025 and 2026 respectively), but they remain above the Eurozone average. European funds will continue to support public investment. Similarly, consumption will continue to be a major driver of growth, due to buoyant wages and falling inflation, although households are likely to adopt a cautious stance amidst an uncertain international environment.

In 2026, economic growth is expected to remain well-oriented thanks to falling inflation and improved growth prospects in Germany, Slovakia's main trading partner. However, the expected positive effects of the German investment plan will not necessarily be visible until 2027. In the meantime, growth is likely to remain below 3.1% (its average for 2010 and 2019), or even below its potential, estimated at 2.1% by the IMF.

SLOW RETURN TO INFLATION TARGET

The increase in the VAT rate from 20% to 23% since 1st January 2025 has put upward pressure on consumer prices, especially in the first quarter. Inflation accelerated to 4.2% in Q1 2025 after 3.5% in Q4 2024. The sharp slowdown in growth and the recessionary effect of tariff measures, expected later in the year, will help to bring inflation back to the rate seen at the end of 2024. Similarly, an appreciation of the euro against the dollar in the short term would help to contain imported inflation. However, the deceleration will be gradual. Wage pressures remain high, even though wage growth has eased somewhat compared with last year (+5% y/y on average between November and January 2025; +6.6% in 2024). A return to the 2% inflation target is expected by 2027.

The ECB is likely to continue with monetary easing in the short term, given the outlook for inflation in the Eurozone (2.1% in 2025 and 1.9% in 2026 after 2.4% in 2024). According to our forecasts, the deposit facility rate could reach 1.75% by the end of 2025 (it is currently at 2.25%).

LARGE AUTOMOTIVE SECTOR AND HIGH EFFECTIVE TARIFF RATE

Slovakia is rightly seen as the most exposed Central European country to US tariffs. The automotive sector, which plays a key role in the economy (16.6% of employment and 23.4% of value added in the manufacturing sector in 2022), is hit by a rate of 25%. Exports are also concentrated, unsurprisingly, in this sector. In 2024, cars and parts accounted for 33.7% of exports and 26.6% of GDP. Car exports are mainly destined for the European market, with a share of 53.9%, followed by the United States (10.6%), the United Kingdom (9.5%) and China (6.9%). Significantly, the automotive sector accounts for almost all Slovakian exports to the United States (77.4% in 2024).

Steel and aluminium products, which account for only a small proportion of Slovakia's exports, were subject to a prohibitive customs duty rate of 50%. All EU countries have been charged an additional 10% customs tax on European goods exported to the United States.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	0.4	2.2	2.1	1.5	1.8
Inflation, HICP, year average, %	12.1	11.0	3.1	3.9	3.1
Gen. Gov. balance / GDP, %	-1.7	-5.2	-5.3	-4.9	-4.5
Gen. Gov. debt / GDP, %	57.7	55.6	59.3	61.1	62.7
Current account balance / GDP, %	-7.3	-0.9	-2.8	-1.9	-0.8
External debt / GDP, %	105.5	95.3	98.5	95.6	93.1

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

SLOVAKIA'S MAIN EXPORT PARTNERS

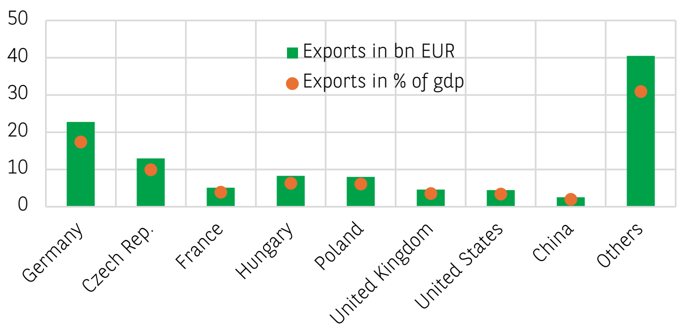

CHART 1 SOURCE: STATISTICAL OFFICE OF SLOVAKIA, BNP PARIBAS

Slovakia's effective tariff rate has risen from 2.4% before "Liberation Day" to 24.5% currently, mainly due to the concentration of its exports in the automotive sector. This is the highest rate in Central Europe. Should negotiations on reciprocal tariffs fail, pushing them up to 20%, the effective rate would rise to 26.7%. The pharmaceutical and electronics sectors could also be affected by tariff increases, but these two sectors account for a tiny share of Slovakian exports to the United States.

EFFECTS OF US TARIFFS ON TRADE FLOWS

We have estimated the direct impact of US tariffs on exports to the United States, taking into account differentiated tariff rates. All other things being equal, exports could fall by 0.9%, or an impact on GDP of -0.7 percentage point. There is also the indirect effect of a fall in German demand. The main products exported to Germany are cars and car parts (52.7% of exports) and capital goods (37.6%). We anticipate a 5-10% drop[1] in Slovakian exports to Germany, equivalent to -0.9% of GDP to -1.8% of GDP. In total, the direct and indirect impact could represent between -1.6% and -2.5% of GDP if exporters are unable to compensate for the fall in exports to the United States and Germany.

Redirecting exports to other markets will prove complex, given Slovakia's sectoral specialisation. The automotive sector is, and will be, more severely affected than most other industries. The global economic climate is particularly gloomy in this sector. Slovakian car exports have fallen by 3.8% in 2024, after rebounding strongly in 2022 and 2023. What's more, the Chinese market, which is important for manufacturers present in Slovakia, especially German ones, is highly competitive, with a strong presence of local manufacturers. The capacity to gain market share is therefore limited. Finally, the domestic market is also subdued. Vehicle registrations fell by 7.9% over the first four months of the year compared with the same period in 2024, and the survey of intentions to purchase automotive goods over the next 12 months remains downbeat.

Overall, car production fell by 8.1% last year, partly as a result of the reorganisation of production lines for new models. It could fall further this year.

WHAT ARE THE SUPPPORTIVE FACTORS?

In the medium term, the German investment plan of EUR 500 billion over 12 years, together with the rearmament plan, would indirectly benefit all the countries of Central Europe by stimulating certain sectors (construction, machinery, electrical equipment). Slovakia has also submitted a request to the European Union to activate the defence clause, which will enable it to exclude the increase in defence-related investment from the public accounts over the next four years (if the request is approved). But the scale of the impact is likely to be small, as the country has no immediate plans to increase military spending (EUR 2.8 bn; 2% of GDP expected in 2025).

CENTRAL EUROPE: EXPORTS OF CARS AND CAR PARTS

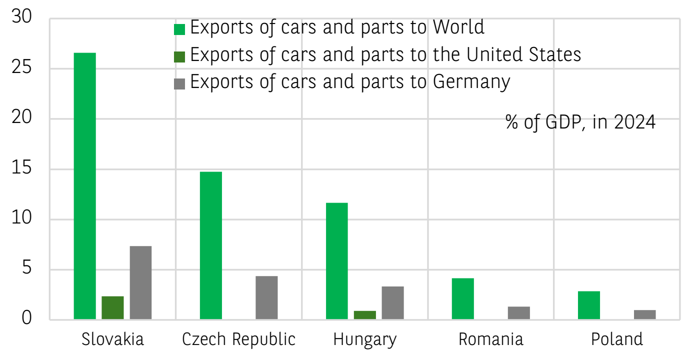

CHART 2

SOURCE: UNCTAD, BNP PARIBAS

European funds provide significant support for the economy. Between 2004 and 2024, Slovakia received net payments of around EUR 29 billion. Moreover, the country remains a net beneficiary of the European budget in several areas. It offers Slovakia an opportunity to further improve its labour productivity and to move up the value chain. The country's priority will be to improve its capacity to absorb these funds, which remains low compared to other European countries.

Net foreign direct investment has declined on average over the last three years compared with the pre-Covid period (2022-2024: 1.1% of GDP; 2017-2019: 2.1%). Nevertheless, Slovakia remains an attractive destination for foreign investment, with a skilled workforce that is competitive in terms of wages. Driven by Chinese investment in the automotive sector, Slovakia will have production capacity for electric vehicles by 2027. The country has also entered into a partnership with the Chinese company Gotion to build an electric battery factory. The automotive sector remains highly focused on internal combustion engines, and the transition to the electric segment remains marginal (0.3% of the vehicle fleet, EU: 1.8% by 2023 according to ACEA).

Article completed on 13 June 2025

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1 Exports to Germany are expected to fall by around 5-10% by 2025. By way of comparison, exports fell by an average of 2.6% in 2019/2020, 10.8% in 2015 and 21% in 2009. Last year, exports to Germany rose by 0.1%.

SLOVENIA

MORE VULNERABLE TO THE GERMAN ENGINE THAN THE AMERICAN BRAKE

The Slovenian economy is very open, making it highly sensitive to the economic situations of its main partners and to trends in world trade. The slump at the start of the year is due to the disruption in world trade. Household consumption and public investment should continue to underpin activity. Inflation is edging up on the back of wage pressures and a possible rise in energy prices. The resumption of government spending should lead to an increase in the budget deficit, but without causing any slippage and while keeping debt trends under control. The effects of US trade policy should remain moderate. However, the German economy remains the key factor in Slovenia's external performance.

ACTIVITY SLOWDOWN

Economic activity took a breather in Q1 2025 (-0.8% y/y), while the rest of the Eurozone remained resilient (+1.5% y/y). The negative contribution of foreign trade was the main factor, as exports fell (-0.2%) despite a slowdown in imports, reflecting the moderation in household consumption. According to the Central Bank, this underperformance is linked to the expected tightening of international trade. The rebound in economic activity in Q1 (+0.4% q/q and 0% y/y) in Germany, Slovenia's main trading partner, has had no tangible effects on the Slovenian economy so far. Furthermore, investment momentum remains negative (-5.1% y/y) for the fourth consecutive quarter, in line with the sharp drop in construction activity (-6.0%). Household consumption, although up modestly (+0.4%), remains sluggish. Despite real wage growth and stable employment, the consumer confidence indicator remains depressed. As in 2024, public spending remains the main driver of activity (+2.6% y/y), thanks, in particular, to reconstruction spending following the floods of mid-2023.

Unemployment remains close to record lows (4.9% in February). The labour market remains tight, and use of foreign labour is growing. As a matter of fact, the aging of the population means that employment growth is essentially due to non-nationals, mainly in labour-intensive sectors.

In the short term, uncertainties surrounding the evolution of international trade are the main drag on economic activity. However, the continued rise in real wages, a dynamic labour market and falling interest rates in the Eurozone should boost household consumption. Over 2025, as a whole, Slovenian growth should match the Eurozone average (1.2%).

In the medium term, government consumption should benefit from the European rearmament effort under the ReArm Europe/Readiness 2030 programme, which includes an increase in member countries' military spending and dedicated funding to support the sector. Slovenia's defence spending is estimated at 1.35% of GDP in 2024, and the government has pledged to reach 2% by 2030. The defence effort should help to boost activity in the sector. According to the Central Bank, although the defence sector employs only 1% of the Slovenian workforce and contributes only 1% of the country's value added, around 70% of its companies are export-oriented.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth (%)	2.7	2.1	1.6	1.2	2.4
Inflation (CPI, year average, %)	9.3	7.3	2.0	2.8	2.0
Cent. Gov. balance / GDP (%)	-3.0	-2.6	-1.0	-1.5	-2.0
Cent. Gov. debt / GDP (%)	73.0	68.0	67.0	66.0	65.0
Current account balance / GDP (%)	-1.1	4.5	2.7	2.3	2.2
External debt / GDP (%)	91.0	92.0	87.0	84.0	80.0

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SLOVENIA: CONTRIBUTIONS TO REAL GDP GROWTH

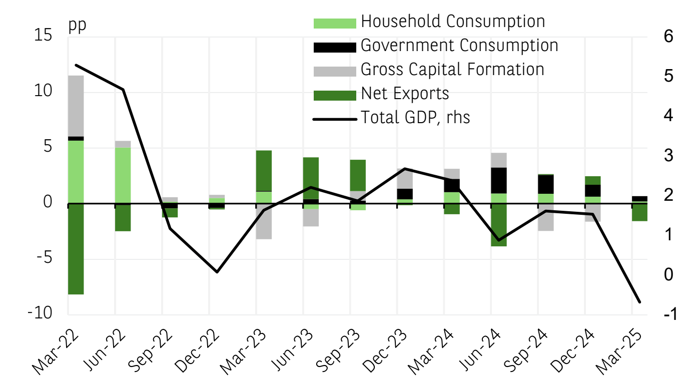

CHART 1 SOURCE: IMAD, BNP PARIBAS

PERSISTENT INFLATION

Consumer price inflation has been rising since the end of 2024. It is expected to average 2.8% over 2025 as a whole. Since the beginning of the year, price rises have been driven in particular by food prices (+3.6% y/y on average). Over the course of 2025, rising oil prices (due to geopolitical tensions) and rising wage costs will continue to fuel inflation.

What's more, the ECB's ongoing monetary easing is not conducive to moderating credit demand. In April, household credit grew by 6.5% y/y, and consumer credit by 12.3%. Conversely, the euro's appreciation on international markets should limit imported inflation.

Escalating geopolitical tensions in the Middle East could seriously disrupt hydrocarbon markets and accelerate the pace of inflation. Indeed, it is estimated that, at Eurozone level, a 10% rise in oil and gas prices would add around 17.5 bps to inflation. Slovenia is sensitive to variations in oil prices (35% of its energy mix), but less so to those of natural gas (11%). Furthermore, by 2026, the gradual reduction in wage pressure on production costs should help to reduce inflationary pressures (+2% on average).

Against a backdrop of falling inflation by 2025 in the Eurozone, the reduction in the ECB's main interest rates, initiated in June 2024, is set to continue until next September. For the time being, rising geopolitical tensions do not call this outlook into question. Nevertheless, a blockage in the transport of hydrocarbons in the Middle East, which would push oil prices to very high levels, could call into question Europe's deflationary trajectory and the continuation of the rate cut.

BUDGET DEFICIT UP BUT UNDER CONTROL

The public accounts should deteriorate moderately in 2025 and 2026, after a remarkable fiscal consolidation effort. This resulted in a deficit of less than 1% of GDP in 2024, compared with the government's forecast of 2.9%. The deficit is expected to reach 1.5% of GDP in 2025 and 2% in 2026. The expected slowdown in growth in 2025 should, however, weigh on tax revenues. At the same time, capital expenditure, which fell sharply in 2024, should pick up again, and the reconstruction effort following the floods of 2023 should continue. In addition, long-term rates on public debt are set to rise in the quarters ahead. Indeed, we anticipate a rise of around 80 bps in the German 10-year benchmark rate. Nevertheless, the rise in the interest burden is expected to remain moderate, reaching 1.35% of GDP in 2026 (1.24% in 2023). The government debt ratio should continue to fall. It should be equivalent to 63% of GDP in 2028 (67% in 2024).

FOREIGN TRADE: MODERATE IMPACT OF TRADE WAR WITH THE UNITED STATES

The openness of the Slovenian economy is very high (the ratio of imports + exports as a percentage of GDP exceeds 170%), but its direct exposure to the US market is limited (around 2.5% of total goods exports). Generally speaking, Slovenia has a trade surplus with the United States, but the amount is very small (EUR 0.5 billion in 2023). Under the reciprocal tariff, Slovenian exports to the USA are currently taxed at 10%. According to national data for 2024, around 18% of exports are subject to a specific regime (steel, aluminum and automobiles), while 2% are exempt from the reciprocal tariff (pharmaceuticals). According to our estimates, the resulting decline in exports would adversely affect GDP by less than 0.2%, all other things being equal. In addition to this direct effect, there are indirect sectoral effects. According to OECD data for 2020, taking indirect exposure into account could double this impact. More generally, the economy's high degree of openness makes it vulnerable to the effects of a slowdown in world trade (+1.7% expected in 2025, versus +3.8% in 2024, according to the IMF).

SLOVENIA: FISCAL BALANCE

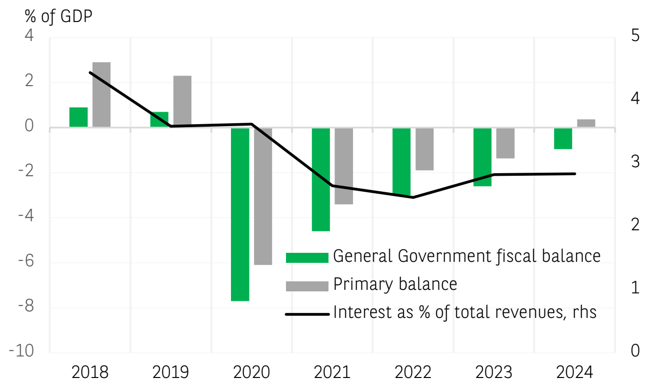

CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

All in all, despite their relatively low exposure to the US market, Slovenian exports of goods are likely to remain constrained in 2025. Indeed, the economic activity outlook for Germany, the main market for Slovenian exports (around 17% of the total), is mixed. In 2024, the recession in Germany was the main reason for the sluggishness of Slovenian exports. In 2025, German growth is forecast to reach 0.4%, before picking up again to 1.0% in 2026. The deep crisis in the German automotive sector is having a particular impact on Slovenian exports (the automotive sector accounts for 1/5th of exports). Nevertheless, in the medium term, German investment targets should benefit Slovenian equipment exports to that country (around 30% of exports).

Article completed on 16 June 2025

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SOUTH AFRICA

ON A BUMPY ROAD

In South Africa, the coalition government formed in June 2024 is overcoming its strong internal divisions one way or another. After three months of stormy negotiations, the final version of the 2025/2026 Budget, presented to Parliament at the end of May, was recently approved by all coalition parties. This is a necessary condition for regaining investor confidence, but it is not enough. The government will also have to ease diplomatic tensions with the United States. Without a significant rebound in investment, economic growth is likely to remain weak over the next three years, contributing to the fragility of public finances.

ECONOMIC GROWTH: MORE OBSTACLES THAN ADVANCES?

In Q1 2025, economic growth measured over four quarters stagnated at 0.6%. Despite the daily power cuts that had disrupted the whole country ending in March 2024, activity has not rebounded, mainly because of the persistence of logistical bottlenecks. On the demand side, real GDP growth was dragged down by a further contraction in gross fixed capital formation (-3.9%), after two years of timid rebounds. Uncertainty, caused by the election period and then by the formation of a coalition government, prompted investors to adopt a wait-and-see approach. At just 14% of GDP on average over the last five years, the rate of investment is structurally low. It will take many years for it to rebound to a sufficient level to address the infrastructure deficit and restore medium-term economic growth potential.

Economic growth is therefore unlikely to exceed 2% per annum between 2025 and 2027. The outlook is particularly gloomy for 2025, with growth expected to be just 1%. It will be driven mainly by growth in household consumption (1% in 2024). Inflationary pressures have eased: in April 2025, the year-on-year rise in the consumer price index was 2.8%, below the lower limit of the inflation target of the central bank (South African Reserve Bank, SARB). After opting for a pause in its monetary easing cycle in March 2025, the SARB cut its key rate again on 29 May, to 7.25%. On the other hand, net exports will make a negative contribution to growth. Exports are likely to suffer due to US trade tariffs and, in particular, the end of the AGOA, which gave many South African goods preferential access to the US market. Total investment should rebound slightly, supported by local political momentum but dragged down by the highly uncertain international environment.

The cyclical obstacles should not, however, mask the positive results of the structural reforms carried out by the government since October 2020 under the name 'Operation Vulindlela' (OV). In addition to the end of daily power cuts, the increased involvement of the private sector in the management of port and rail infrastructure has halted the operational decline of these sectors. In May 2025, the government launched the second phase of the OV, which will run until 2029. It aims to remedy the chronic underinvestment by municipalities in essential public services. The growing involvement of the private sector in these areas will be key to kick-starting the long-awaited investment momentum.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	1.9	0.7	0.6	1.0	1.8
Inflation, CPI, year average, %	6.9	5.9	4.4	3.2	3.7
Fiscal balance / GDP, % (1)	-4.6	-4.6	-4.5	-4.9	-4.5
Public debt / GDP, % (1)	70.5	74.1	77.0	79.2	79.6
Current account balance / GDP, %	-0.4	-1.6	-0.6	-1.4	-2.4
External debt / GDP, %	41.4	41.1	41.0	40.9	40.7
Forex reserves, USD bn	59.7	61.7	64.8	66.3	68.2
Forex reserves, in months of imports	5.6	6.0	6.5	6.4	6.4

TABLE 1

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

SOUTH AFRICA: FINANCIAL ACCOUNT

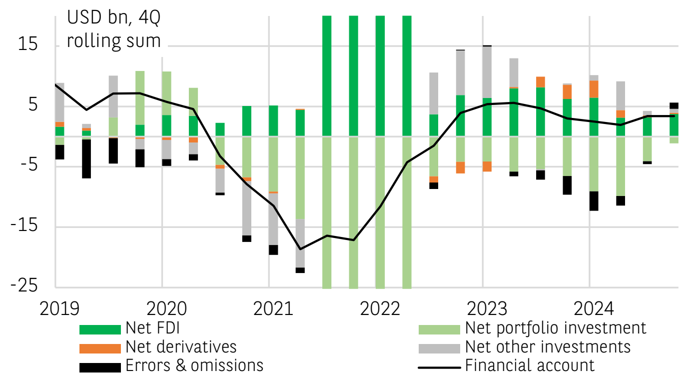

CHART 1

SOURCE: IMF

PUBLIC FINANCES: THE GNU WITHSTANDS THE BUDGETARY TEST

The public finance situation is mixed. For the fiscal year (FY) ending 31 March 2025, the government generated a primary fiscal surplus for the second year running (0.7% of GDP, i.e. +0.3pp compared with the previous FY). However, despite the reduction in the SARB's policy rate over the period, interest payments on public debt continued to rise, reaching 5.2% of GDP, or 21% of government revenue. The risk premium on Treasury bonds suffered in particular due to the high level of political uncertainty. Since June 2024, the ANC, which has lost its absolute majority in Parliament, has had to share power by forming a coalition government made up of ten heterogeneous parties. Ideological differences between the ANC and the other parties on issues such as education, the expropriation law and black empowerment have repeatedly threatened the stability of the coalition.

The disagreements came to a head in April 2025 with the negotiations on the 2025/2026 Budget. Normally, the budget is approved without debate thanks to the ANC's absolute majority in Parliament. This time, it has taken three months and three different versions of the Budget for the ten parties in the GNU to reach agreement. In particular, the ANC had wanted to increase the VAT rate from 15% to 17% in order to finance new spending, but many parties were opposed. In the end, the ANC had to give in. As a result, in the latest version of the Budget presented to Parliament on 21 May, the VAT rate remains unchanged and spending has been revised downwards.

Fiscal consolidation is likely to continue. Passing the budgetary test is an important guarantee of stability for the coalition in power which could help to reduce the risk premium on sovereign bonds in the coming months. The 2025/2026 Budget forecasts a fall in the deficit from 4.6% of GDP for the current year (which began on 1 April) to 3.7% of GDP for the following year and 3.2% for 2027/2028. However, the risk of fiscal slippage persists. The government has made no financial provision in the event that the Social Relief of Distress allowance is extended beyond March 2026. This allowance, which was created during the pandemic, has been renewed every year. With the official unemployment rate still very high (32.9% in Q1 2025), it is difficult for the government to do without this allowance, which costs public finances about 0.4% of GDP each year.

Despite fiscal consolidation efforts, public debt is set to continue rising, approaching 80% of GDP in 2026/2027. In order to stabilise the debt-to-GDP ratio in the medium term, it remains crucial to raise economic growth above 2% per year.

EXTERNAL ACCOUNTS: RISKS TO WATCH

In 2025, the current account deficit should widen moderately to 1.4% of GDP. The volume of imports should accelerate slightly in line with economic activity, while domestic logistical constraints and the rise in US tariffs will weigh on exports. On a positive note, the terms of trade should be favourable: they will be supported by the fall in the import price of oil and by the significant rise in the export price of gold (between 2 January 2025 and 27 May, the price of an ounce of gold in USD rose by 27%). However, there are still risks of deterioration in the financial account. In 2024, net foreign direct investment fell to 0.9% of GDP (compared to 1.6% in 2023). Given the high level of global uncertainty, foreign investors are likely to maintain a wait-and-see attitude again this year. On a positive note, the resolution of the budget impasse at the end of May and the stabilisation of the GNU could lead to renewed confidence in the domestic environment, and net portfolio investment flows could swing back into positive territory for the first time since Q2 2020 (Graph 1). However, they will remain highly vulnerable to strong diplomatic tensions with the United States.

US TARIFFS: HOW TO AVOID THE WORST?

Donald Trump's return to the White House has rekindled long-standing diplomatic tensions between South Africa and the United States. The average tariff on South African imports has risen from just 0.3% in 2024 to 8.8% at present. This rate could rise to 18.4% if the United States finally decides to apply the 30% tariff, as announced on Liberation Day on 2 April (the rate is currently 10% for a period of 90 days from 9 April). In addition to economic sanctions, some members of the government could receive individual diplomatic sanctions for their relations with Russia, Iran and Hamas.

The South African government has taken the threat of US sanctions seriously and has responded proactively. On 21 May, President Ramaphosa met his US counterpart at the White House to reaffirm the importance of the bilateral relationship. The meeting was an opportunity to present a first version of a bilateral trade and investment agreement.

SOUTH AFRICA: EXPORTS TO THE US BY SECTOR, 2023

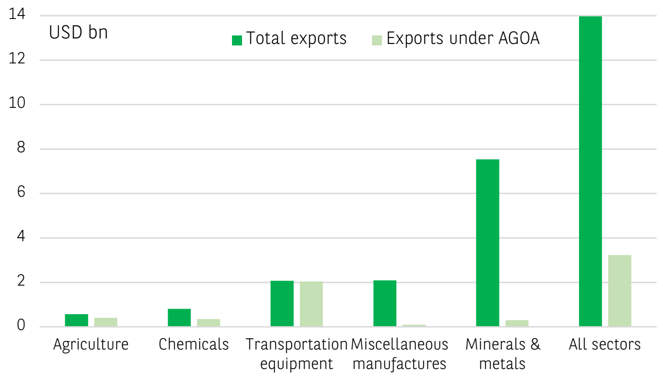

CHART 2

SOURCE: AGOA.INFO

The US administration took a very positive view of several of the proposals, including those to import liquefied natural gas (LNG) and to encourage US companies to invest in mining exploration. South Africa exports to the United States twelve types of minerals described as 'critical' by the US administration and the country is the main supplier of nine of them.

However, a trade agreement will not be enough to put an end to all the tensions, many of which stem from the country's political non-alignment. The main stumbling blocks with the United States are therefore likely to persist (South Africa's complaint against Israel to the International Court of Justice, joint military exercises with Russia and China, rumours of expropriation of Afrikaners). Indeed, even within a coalition government, it is unlikely that the ANC would renounce its historic relations with the countries of the Global South in order to satisfy the United States. Further episodes of tension can therefore be expected in the coming months. For the time being, the impact of the tariffs on South African exports should be limited. Total exports to the United States amounted to 3.6% of GDP in 2024, but minerals (exempt from customs duties) accounted for almost half of this figure. In addition, agricultural exports, which were notable beneficiaries of the AGOA, could be redirected to Southern Africa, which regularly faces droughts and food shortages. On the other hand, the automotive sector (4% of GDP) appears highly vulnerable (Graph 2). It could, however, benefit from the potential opening up of the Chinese market: China announced today that it plans to lift tariffs on all African imports. In addition, in the medium and long term, the sector could benefit from the African Continental Free Trade Area (AfCFTA). Despite its slow roll-out, this could become a vehicle for diversifying the country's trade links: South Africa, as the continent's leading industrial power, would have a comparative advantage to put forward.

Article completed on 13 June 2025

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UNITED ARAB EMIRATES

IN A SOLID POSITION

The outlook remains positive despite international turmoil. The United Arab Emirates (UAE), which is relatively unaffected by the tightening of US trade policy, has room to manoeuvre to cope with lower oil prices and the slowdown in global trade. Its economy is more diversified than that of other Gulf countries. It is also driven by its strong attractiveness to foreign investment and the support of the government. In the longer term, the UAE could also benefit from a potential reconfiguration of trade flows and leverage its assets to maintain its strategic relationship with the United States.

GLOBAL TURMOIL: INDIRECT CHANNELS

Like other Gulf countries, the UAE has been largely spared by Trump's trade policy, with a minimum tariff of 10%. The effective average rate is higher, at 11.7%, if we take into account the latest announcements of a 50% increase in tariffs on aluminium and steel imports. However, the amounts are marginal, accounting for less than 1% of total UAE exports, and the measure affects sectors in which the United Arab Emirates is highly competitive. On the other hand, with exports of goods and services exceeding 110% of GDP, the UAE economy is by far the most sensitive in the region to the slowdown in global trade. Despite being relatively diversified compared to other Gulf countries, it also remains vulnerable to fluctuations in global oil prices. Brent Crude was expected to average USD65 in 2025-2026, compared to USD80 in 2024 before the renewed tensions in the Middle East. The risk is now on the upside. However, the impact on Brent prices has remained moderate so far and the fundamentals of the global oil market remain fragile. The volatility of the dollar and the direction of US monetary policy are other factors that could affect the UAE. Overall, however, the economy is well positioned to weather these headwinds.

GROWTH OUTLOOK REMAINS STRONG

The UAE is the most dynamic economy in the region. Despite OPEC+'s restrictive policy in 2023-2024, growth remained solid at 3.7%, 3 points above the average for other Gulf countries. Over the same period, non-hydrocarbon GDP growth reached 5.5%, a substantial difference not only compared to the rest of the region but also compared to the UAE's pre-pandemic performance (see Chart 1). Yet, there are no signs of a major shift in this trend at this stage.

Most short-term indicators remain positive: the number of tourist arrivals in Dubai is up (+7% year-on-year over the first four months of the year) and the S&P PMI index for the UAE's non-oil private sector remains above 50 (53.3 in May), the value separating the zone of activity expansion from contraction. In fact, there are multiple solid drivers of growth, starting with Dubai's strong attractiveness to foreign investors, particularly in times of global turmoil. The resulting influx of expatriates is a key factor in the development of the residential real estate sector, where construction continues apace., Abu Dhabi, which is committed to a massive economic diversification plan is also driving the UAE's growth upward. This emirate accounts for 60% of the federation's GDP and derives most of its wealth from the exploitation of its subsoil. For the past four years, non-hydrocarbon growth has been extremely strong, averaging close to 8%, supported by the construction, transport and finance sectors. Many of these projects are driven by the public sector and are therefore vulnerable to falling oil revenues. However, the authorities have sufficient room for manoeuvre to cushion the shock without having to adjust their investment policy.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	7.5	3.6	3.7	4.0	4.6
Inflation, CPI, year average, %	4.8	1.6	1.6	1.8	2.0
Gen. Gov. balance / GDP, %	10.0	5.0	4.8	3.0	1.9
Gen. Gov. debt / GDP, %	32	32	32	33	32
Current account balance / GDP, %	13.2	10.6	8.2	6.3	5.7
External debt / GDP, %	82	86	87	87	86
Forex reserves, USD bn	134	185	223	234	240
Forex reserves, in months of imports	4.1	5.0	5.6	5.6	5.4

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

UNITED ARAB EMIRATES: NON-HYDROCARBON GDP GROWTH

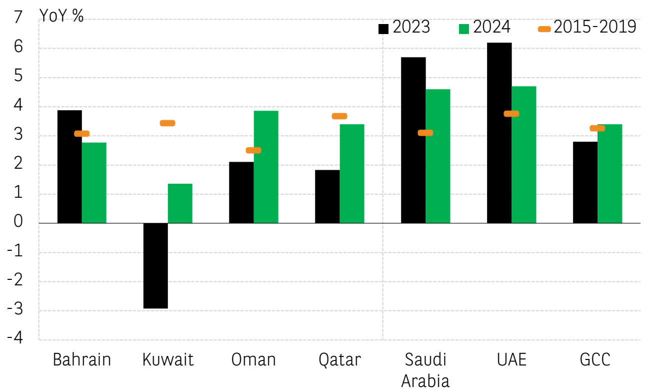

CHART 1 SOURCE: IMF, NATIONAL STATISTICAL OFFICES, BNP PARIBAS

In this context, non-hydrocarbon growth is expected to remain robust, at around 4.5% in 2025-2026. While global turmoil will undoubtedly weigh on key sectors (logistics and transportation), strong domestic demand and the UAE's status as a safe haven will limit the impact. The economy will also benefit from increased oil production, although the extent of this remains uncertain. Several OPEC+ alliance countries (including the UAE), which had initially committed to a gradual policy of reducing voluntary production cuts, have decided to accelerate the movement since April, in particular to regain global market share.

As this strategy is risky, we are still forecasting moderate oil GDP growth in 2025 (+2.5%) before a more pronounced rebound in 2026 (+5%). This would bring overall economic growth in the UAE to 4% this year and 4.6% in 2026. However, the momentum could be stronger.

INFLATION CONTAINED BUT VULNERABLE TO EXTERNAL FACTORS

Maintaining a restrictive monetary environment should not weigh too heavily on economic activity. Despite inflation remaining below 2% in 2024, the Central Bank of the UAE must keep its key interest rate high in line with the decisions of the US Federal Reserve, whose currency serves as an anchor for the Emirati dirham. Although the real interest rate began to fall in September 2024, it is still around 3%. At the same time, bank lending growth has remained strong, particularly for the private sector (+8.3% in February 2025), and is expected to remain so, given the solid outlook for non-hydrocarbon growth. Ultimately, the main economic threat, induced by US economic policy, could be the inflationary impact of a depreciation of the dollar. However, the risk also appears limited. On the one hand, overall inflation in the UAE masks divergent dynamics between emirates, which could be exacerbated in the event of higher import prices. In particular, Dubai is facing latent tensions due to sharp rises in rental prices. On the other hand, as the UAE is the only Gulf country where petrol prices are determined by market conditions, the turnaround in oil prices (even after the recent peak of tensions) is helping to limit price pressures. Furthermore, a significant weakening of the dollar would not only have negative consequences for an economy seeking to diversify, and whose nominal effective exchange rate has appreciated by more than 50% since 2010.

BUDGET AND EXTERNAL SURPLUSES MAINTAINED

The strength of public and external finances is also reassuring. The price of oil would have to fall below USD 50 per barrel (USD/b) for the public finances of the Emirates as a whole to slip into the red. In the current scenario, budget surpluses will therefore remain comfortable (between 2% and 3% of GDP), largely due to the relatively high weight of non-hydrocarbon revenues: 48% in the UAE in 2024, compared to an average of 72% for other Gulf countries. The consolidation of Dubai's public finances also contributes to the overall strength. From 78% of GDP in 2020, the emirate's government debt fell to 34% in 2024 thanks to the acummulation of budget surpluses and the monetisation of its public assets. For the United Arab Emirates as a whole, the debt reduction trend is less pronounced due to its desire to develop the capital market. Consolidated debt remains moderate (32% of GDP) and its dynamics are under control. In addition, the contingent debt of public enterprises no longer represents a systemic risk, even though it remains high (36% of Dubai's GDP and 20% of Abu Dhabi's GDP).

With oil prices at only USD 34 per barrel in order to balance its current account and robust capital flows (mainly foreign direct investment), the UAE's external position is even more comfortable. Despite the reduction in oil exports, foreign exchange reserves should therefore continue to grow.

UNITED ARAB EMIRATES: FISCAL AND EXTERNAL BREAKEVEN OIL PRICES

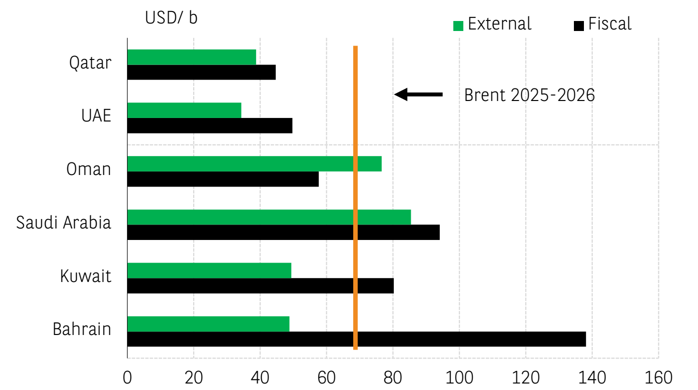

CHART 2

SOURCE: IMF, BNP PARIBAS

Above all, the UAE will be able to maintain its strategy of acquiring assets abroad and, thus, consolidate an already very solid position (sovereign wealth fund assets exceed 200% of GDP, compared with external debt of 87% of GDP).

REORGANISATION OF TRADE FLOWS: AN OPPORTUNITY TO MAXIMISE

Beyond the short-term consequences, the change in economic policy in the United States is likely to cause profound upheaval in international trade. The UAE is well positioned to take advantage of this.

Since 2022, the UAE has been signing a series of economic partnership agreements to strengthen its position as a trading hub and to attract foreign investment in order to accelerate the transition to an economy less dependent on oil. While the results so far have been promising, they need to be confirmed over time. The announcement of the launch of negotiations with the European Union could take the UAE, whose exports remain mainly focussed on Asia, to another level. Discussions are also under way with Japan. These could be concluded by the end of the year, following those already concluded with India (the first signatory country in 2022) and Australia and New Zealand. Finally, Trump's recent visit to the Gulf confirmed that the UAE also maintains a strong relationship with the United States. At first glance, the commitments appear to favour the US economy. However, joint investment projects in the UAE in the AI sector meet strategic needs whose development was hampered by the context of mistrust towards China until recently.

By projecting their financial power abroad and multiplying economic partnerships, the UAE therefore seems to be protecting itself against the risk of geo-economic fragmentation. It could also seize opportunities, particularly if relations between Europe and India are strengthened.

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