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> THE TWO MOST RECENT SHOCKS TO EMERGING COUNTRIES (THE 2022-2023 TIGHTENING OF US MONETARY POLICY, AND THE ELECTION OF TRUMP AT THE END OF 2024) HAVE NOT AFFECTED THEIR FINANCING CONDITIONS. BUT IN THE COMING MONTHS, THEY COULD TIGHTEN AS A RESULT OF RISING GEOPOLITICAL RISK IN PARTICULAR. HOWEVER, THE ADVERSE IMPACT ON EMERGING ECONOMIES SHOULD NOT BE OVERSTATED.

ECONOMIC RESEARCH

BNP PARIBAS

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EMERGING COUNTRIES: FINANCIAL VULNERABILITY IS LOWER THAN IT ONCE WAS.

The two most recent shocks to emerging countries (the 2022-2023 tightening of US monetary policy, and the election of Donald Trump at the end of 2024) have not affected their financing conditions[1]. However, supporting factors have weakened since the second half of last year. In the coming months, financing conditions could tighten as a result of rising geopolitical risk in particular. However, the adverse impact on emerging economies should be viewed in perspective, given the low transmission of the two recent external shocks to interest rates. Although exchange rates have continued to depreciate against the dollar, the vulnerability of debt to foreign exchange risk is moderate or low for households and non-financial companies. And, contrary to a popular belief, the vulnerability of companies has not increased over the past decade, and has actually decreased slightly.

Since 4 November, emerging countries' financial conditions have eased overall, despite fears of a negative Trump effect.

• The currencies of the 30 main emerging countries have depreciated against the US dollar by 1% on simple average (-1.8% for the median). However, the depreciation rate has not worsened (-0.3% as a monthly equivalent, compared to -0.5% between the end of 2023 and 4 November 2024 as a simple average as well as a median).

• CDS premiums on dollar sovereign bonds have remained generally stable (-8 basis points on simple average, -6 bps for the median), with the Romanian premium as the sole exception, with a modest increase of 27 bps. The total cost of borrowing in dollars for sovereign borrowers from emerging countries has fallen accordingly, with the yield on US government bonds remaining stable at 4.3% for a 10-year security (after temporary spike at 4.8% in mid-December).

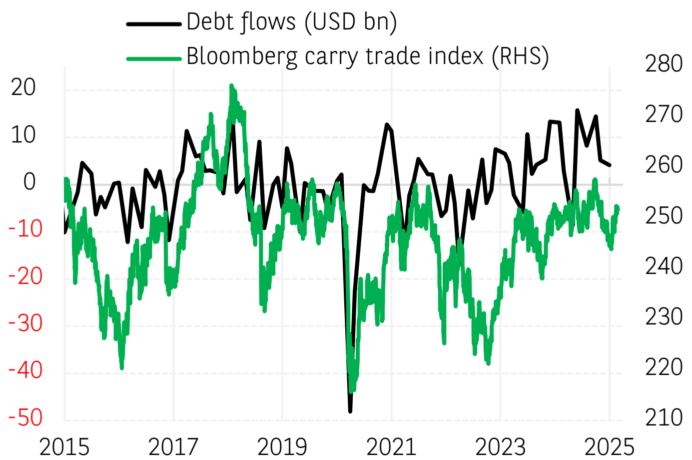
• Government borrowing costs in local currency have also decreased for 70% of the main emerging countries, albeit with some notable exceptions, in descending order: Brazil, Chile, South Africa, Romania and Vietnam. Most importantly of all, the currency depreciation has not deterred half of the central banks from cutting their key interest rates.

• Since the start of the year, EM international bond issues have reached EUR bn 81 in just 2 months, compared with EUR 181 bn for the entire year 2024, which was already a very good vintage.

The main reason for the lack of pressure on financing conditions in emerging countries is that investment flows in bond markets remained strong until January, according to the Institute for International Finance's (IIF) monthly trackers for non-resident portfolio investment inflows (bonds and equities) for the 25 main emerging countries. Bond inflows remained at USD 31 billion per month on average between July and January (USD 36.1 billion excluding China). They largely offset the withdrawals on the equity markets recorded since October (USD -4 billion on average, including USD -2.5 billion excluding China).

Given that geopolitical uncertainties have intensified in recent months, bond investments remaining high is even more noteworthy.

NON-RESIDENT PORTFOLIO DEBT FLOWS TO EM* AND BOND YIELDS DIFFERENTIAL



*BRAZIL, MEXICO, INDIA, INDONESIA, HUNGARY, POLAND, TÜRKIYE AND SOUTH AFRICA

SOURCE: BLOOMBERG, IIF, BNP PARIBAS

CHART 1

An explanation often given for this is the continuation of carry trade transactions. In a sample of 8 main financial markets in emerging countries (Brazil, Mexico, India, Indonesia, Hungary, Poland, Türkiye and South Africa), there is indeed a fairly close correlation between non-resident bond investments for these 8 countries and the Bloomberg carry trade index (i.e. the bond yield spread between the investment currency and the reference financing currency, divided by the volatility of the investment currency).[2] However, there was a joint downturn in the two sets of figures during the second half of 2024.

Sustained bond investment activity has been supported through other channels than the traditional determinants (US monetary policy, yield spreads and growth performance). The other most likely sources are international bond issues (which were steady throughout 2024) and institutional investors which are not just looking to make carry trade transactions when investing (sovereign funds).

1 This is only the case, with very few exceptions, for emerging countries. This is not the case for developing countries, many of which have seen their risk premiums on dollar-denominated financing rise. As a result, their vulnerability has increased all the more, as they will be hit with the cuts to development aid announced by the US administration.

2 The sensitivity of bond investment flows (in % of GDP) to the carry trade index is 0.4 according to our estimates on a panel of 15 main emerging countries (excluding China), which means that a permanent 100 basis increase in bond yield spread (scaled by volatility) generates USD 25 bn in bond inflows over a year.

In 2025, developments in the traditional determinants will have a neutral impact (with the increasingly likely prospect of monetary *status quo* in the United States), or will adversely affect (downgraded growth forecasts) bond investments. In addition, the geopolitical risk is rising due to the Trump administration's trade and foreign policy. . This could lead to higher currency volatility, which would then reduce the appeal of carry trade transactions. In addition, geopolitical uncertainty could prompt institutional investors with a long-term investment strategy to shift their diversification policy more towards dollar-based support. The uncertainty could even lead central banks in emerging countries that have initiated monetary easing to be more cautious.

As a result, financing conditions for emerging countries could tighten this year. However, the adverse impact on emerging economies should be viewed in perspective, given the low transmission of the two recent external shocks (the tightening of US monetary policy in 2022 and the election of Donald Trump at the end of 2024) to interest rates. The main source of risk comes from the depreciation of exchange rates. However, once again, the impact should not be overestimated at least for non-financial private borrowers.[3] Contrary to common belief, companies and households do not have a great deal of foreign currency debt, and they no longer have as much debt as they did at the end of 2019 or even at the end of 2015.

Households generally have a minimal amount of foreign currency debt (1% of GDP on average, 0.2% for the median and a maximum of 2.9% on a sample of about forty countries), as regulations in many countries prohibit it. For companies, a distinction must be made between external debt and domestic debt in foreign currencies, as the latter is the main source exposure to fx risk in particular. This is because the external debt of non-financial companies, which are often very large companies (or multinationals, is frequently covered by income in foreign currencies from exports of goods and services. Therefore, at an aggregate level, external debt is a source of foreign exchange exposure if the ratio is high and if it drifts upwards. However, when using both the data from the IIF and the Bank of International Settlements, this ratio of external debt-to-G&S exports was 13.1% on average in September 2024, and 11% for the median (with very high variability, however, the maximum ratio is 85%). The average and median for this ratio are currently lower than they were at the end of 2019 and at the end of 2015. Finally, non-financial companies' domestic debt in foreign currencies is moderate (5.9% of GDP on average, 10.6% on the median) and the ratio has also fallen over the past decade.

François Faure

Data visualisation and cartography: Tarik Rharrab

3 For sovereign borrowers, the assessment is more mixed. Foreign currency indebtedness has increased over the last decade and is high for a number of Latin American countries. It is also high for Egypt and Türkiye (but for Türkiye, domestic financing can easily replace external financing). On the contrary, foreign currency indebtedness is low for Asian countries and Central European countries. See Emerging markets: which sovereign debts are most vulnerable to rising global financial volatility? by Lucas Plé.

The GCC States, which are all oil- and gas-producing countries, also have dollar debt but their income provides a natural hedge against the risk of dollar appreciation. Besides, Bahrain would not theoretically be supported by Saudi Arabia.

Find our scenario and forecasts

INTERNATIONAL TRADE

Another round of threats. Donald Trump has confirmed that additional tariffs will be imposed on imports from Canada and Mexico from 4 March. However, a reduced rate could be applied if both these countries were to adopt tariffs similar to those imposed by the United States on China. A further 10pp will have to be added to this on Chinese products, which have already been subject to an additional tariff of the same order since 4 February.

ADVANCED ECONOMIES

United States

The warning signs are mounting. The consumer confidence index, measured by the Conference Board, fell by 7 points in February to 98.3 (the lowest since June 2024), due to deteriorating expectations, which fell below the 80 threshold, which is viewed as a sign of a recession. In January, while core inflation measured by the PCE slowed to +2.6% y/y (-0.2 pp), household consumption fell -0.5% m/m in real terms, the biggest monthly drop for 5 years. In the same month, orders for durable goods rose for the first time since October (+3.1% m/m). The Atlanta Fed's GDPnow is now forecasting a contraction in Q1 GDP (-0.4% q/q), due to a surge in imports. The House of Representatives passed a budget resolution including USD 4,500 billion in tax cuts over 10 years, partially offset by USD 2,000 billion in budget cuts. It is now up to the Senate to vote on a budget.

European Union / Eurozone

The European Commission has unveiled its 'Clean Industrial Deal" and its first Omnibus laws to simplify regulations. These include measures to reduce energy costs (acceleration of permits for green infrastructure, long-term energy contracts, and revamp of state aid rules), a EUR 100 billion decarbonisation fund, and a platform for joint purchases of critical materials. In particular, the Omnibus laws extend the exemption from the CSRD reporting (by two years for non-exempt companies). On the macroeconomic front, negotiated wage growth in the Eurozone slowed to 4.1% in Q4 2024, from 5.4% in Q3, and median household inflation expectations in the Eurozone for the year ahead fell to 2.6% in January (2.8% in December). New car registrations dropped by 2.5% y/y in January 2025. However, the economic sentiment index reached its highest level in five months in February, buoyed by an increase in Germany and France.

France **Inflation has improved, but not employment.** Inflation fell to 0.9% y/y in February (harmonised index) from 1.8% in January, due to the 15% cut in the regulated electricity tariff. The French economy shed 90,000 net jobs in Q4 (68,000 in the private sector and 22,000 in the public sector). Household confidence rebounded from 92 in January to 93 in February (89 at the low point in December, 95 in September 2024, 100 on long-term average). However, households are more concerned about unemployment (+55 in February compared with +48 in January and +29 in September). The opportunity to buy a property is declining (8% of households in February, compared to 9.5% in December). Property prices for existing homes rose by 0.1% q/q in Q4 (-0.1% q/q in Q3 and -0.5% in Q2), and the number of transactions in existing homes over a 12-month period rebounded (792,000 at the end of 2024, compared to 780,000 at the end of September 2024).

Germany **No rebound in economic indicators.** Germany's GfK consumer confidence index fell to -24.7 points in March (compared to -22.6 in February). The Ifo business climate indicator stood at 85.2 points in February 2025, which is stable compared to January. Germany's seasonally adjusted unemployment rate held steady at 6.2% in February 2025, remaining at its highest level since October 2020. Inflation is unchanged from January, at 2.8% y/y in February 2025. The likely future Chancellor, Friedrich Merz, wants an additional budgetary effort of EUR 200 billion for defence. One option would be to put it to a vote before 24 March in the outgoing assembly (where the parties opposed to this plan do not have a blocking minority), but this will be difficult.

Spain **Rising electricity prices should continue to fuel inflation.** Inflation remained stable at 2.9% y/y in February. Production prices rose by 2.6% y/y in January (+0.3 pp over one month) due to increasing energy prices (+8.6% y/y). The core index is close to the ECB's target (2.1%; -0.3 pp over one month). **The Economic Sentiment Indicator (ESI) slowed** (102.3; -2 pts over one month) due to deteriorating confidence in industry (-6.2; -1.8 pt).

Italy **Consumer confidence returned to its highest level in three years** (-13.6 in February; +1.2 pts over one month). The Economic Sentiment Indicator continued to stagnate, falling back below 100 this month (99.8; -0.4 pt). Confidence in industry remains negative (-8.2; +0.0 pt), with production and employment expectations for the coming months deteriorating for another month.

United Kingdom **The CBI's distributive trade survey is gloomy.** The index of expected order volumes for the coming month fell to its lowest level in four years. According to Nationwide, house prices hit a new record high in February (+0.4% m/m and +3.9% y/y). **The UK government has announced an increase in defence spending**, with the aim of raising it from the current 2.3% of GDP to 2.5% in 2027 and 3.0% after 2029. The initial increase will be financed by a reduction in development aid spending.

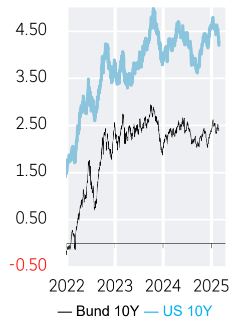
Japan **Opposing trends for hard data.** Industrial production deteriorated in January, to -1.1% m/m (-0.9 pp), marking the third month of contraction in a row. Conversely, retail sales rose (+0.5% m/m, +1.3 pp). Finally, core inflation (excluding unprocessed food) in the Tokyo metropolitan area, a leading indicator of national earnings, slowed in February (+2.2% y/y, -0.3 pp).

MARKETS OVERVIEW

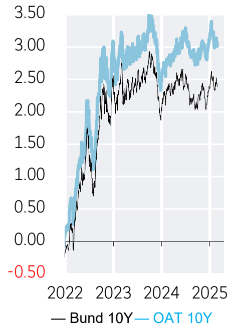
Bond Markets

	in %	in bps			
	28/02/2025	1-Week	1-Month	Year to date	1-Year
Bund 2Y	2.06	-6.0	-22.4	-0.4	-97.2
Bund 5Y	2.14	-7.5	-18.1	+2.2	-37.0
Bund 10Y	2.39	-5.1	-14.7	+2.3	-5.4
OAT 10Y	3.01	-7.7	-19.1	-11.1	+15.2
BTP 10Y	3.37	-7.6	-17.7	-5.4	-52.7
BONO 10Y	3.00	-5.3	-12.8	-1.7	-24.9
Treasuries 2Y	4.01	-19.8	-19.3	-23.9	-66.9
Treasuries 5Y	4.01	-25.8	-32.1	-36.8	-26.7
Treasuries 10Y	4.20	-22.9	-33.7	-37.4	-8.2
Gilt 2Y	4.19	-4.9	+6.6	+4.4	-45.2
Treasuries 5Y	4.16	-15.8	-15.9	-18.9	+10.9
Gilt 10Y	4.52	-5.9	-10.2	-5.6	+33.2

Bund 10Y vs US Treas. 10Y



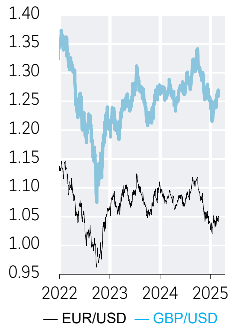
Bund 10Y vs OAT 10Y



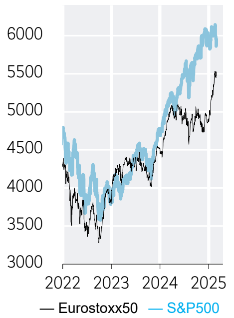
Currencies & Commodities

	Level	Change, %			
	28/02/2025	1-Week	1-Month	Year to date	1-Year
EUR/USD	1.04	-0.5	-0.2	+0.4	-4.0
GBP/USD	1.26	-0.4	+1.3	+0.5	-0.5
USD/JPY	150.70	+0.8	-3.2	-4.1	-0.1
DXY	111.99	+7.9	+11.5	+10.5	+6.1
EUR/GBP	0.83	-0.1	-1.5	-0.1	-3.5
EUR/CHF	0.94	-0.2	-0.6	-0.0	-1.6
EUR/JPY	156.72	+0.2	-3.5	-3.7	-4.1
Oil, Brent ($/bbl)	73.56	-1.2	-5.2	-1.6	-11.7
Gold ($/ounce)	2851	-2.7	+3.4	+8.6	+40.3

EUR/USD vs GBP/USD



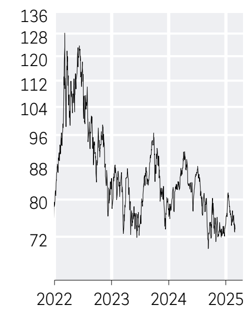
EUROSTOXX 50 vs S&P500



Equity Indicies

	Level	Change, %			
	28/02/2025	1-Week	1-Month	Year to date	1-Year
World					
MSCI World ($)	3805	-1.0	-0.8	+2.6	+14.5
North America					
S&P500	5955	-1.0	-1.9	+1.2	+17.5
Dow Jones	43841	+1.0	-2.3	+3.0	+12.6
Nasdaq composite	18847	-3.5	-4.5	-2.4	+18.2
Europe					
CAC 40	8112	-0.5	+2.7	+9.9	+2.0
DAX 30	22551	+1.2	+5.2	+13.3	+28.1
EuroStoxx50	5464	-0.2	+5.2	+11.6	+11.9
FTSE100	8810	+1.7	+3.2	+7.8	+15.5
Asia					
MSCI, loc.	1400	-1.8	-2.0	-2.2	+2.7
Nikkei	37156	-4.2	-4.8	-6.9	-5.2
Emerging					
MSCI Emerging ($)	1097	-4.4	+0.7	+1.9	+7.7
China	73	-4.3	+11.7	+12.5	+35.4
India	907	-4.6	-5.5	-11.8	-5.9
Brazil	1250	-5.7	-3.0	+6.2	-26.9

Oil, Brent ($/bbl)



Gold ($/ounce)

Performance by sector

Eurostoxx600

Year 2025 to 28-2, €

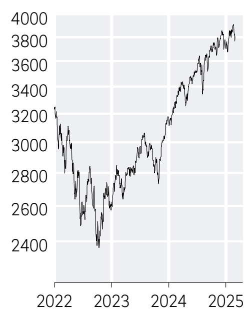
+23.5%	Banks
+12.0%	Telecoms
+10.9%	Insurance
+10.8%	Consumption Goods
+10.7%	Industry
+9.8%	**Eurostoxx600**
+9.6%	Financial services
+9.2%	Health
+9.1%	Construction
+8.3%	Food industry
+8.1%	Chemical
+7.0%	Oil & Gas
+5.0%	Technology
+4.0%	Utilities
+3.9%	Commodities
+3.5%	Real Estate
+1.5%	Travel & leisure
+1.3%	Retail
+0.5%	Media

S&P500

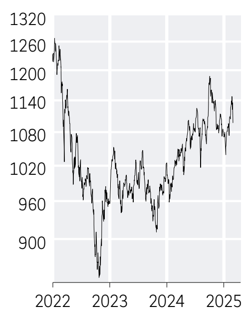
Year 2025 to 28-2, $

+16.0%	Telecoms
+9.4%	Insurance
+9.4%	Retail
+8.7%	Pharmaceuticals
+8.1%	Food, Beverage & Tobacco
+8.0%	Bank
+7.4%	Real Estate
+7.2%	Healthcare
+6.7%	Commercial & Pro. Services
+5.5%	Consumer Services
+5.4%	Materials
+5.3%	Energy
+4.1%	Utilities
+2.2%	Capital Goods
+1.2%	**S&P500**
+0.7%	Media
-1.3%	Consumer Discretionary
-2.7%	Tech. Hardware & Equip.
-6.5%	Semiconductors
-25.3%	Automobiles

MSCI World ($)



MSCI Emerging ($)



SOURCE: LSEG, BLOOMBERG, BNP PARIBAS
DATA VISUALISATION AND CARTOGRAPHY: TARIK RHARRAB

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GROUP ECONOMIC RESEARCH

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

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

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

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