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SEMESTRIAL PANORAMA 2023 #2

International economy: new landscape against the backdrop of déjà vu

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Semestrial Panoramas are special issues of the **MacroDev** series written by analysts from the Agence Française de Développement (AFD) (French Development Agency). They present a synthesis of macroeconomic and socioeconomic analyses of emerging and developing countries (EDCs).

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Editorial:

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Since the last edition of our publication MacroDev Semestrial in February 2023, international economic developments have remained eventful and intense, against the backdrop of the continued global geopolitical reconfiguration. They are not without consequences for emerging and developing countries (EDCs), which are increasingly becoming actors and stakeholders in a multipolar world. The succession of shocks since 2020 has severely tested the macroeconomic stability of a number of countries, first and foremost the poorest, in a way that challenges even more acutely their development trajectory and its financing.

It is in this context that the Summit for a New Global Financial Pact was held in Paris on 22 and 23 June. On the heels of COP27, climate vulnerabilities and the Sustainable Development Goals (SDGs) have been put in perspective with debt vulnerabilities. While the USD100 billion of climate finance per year were undoubtedly achieved in 2022, the foundations have been laid for an acceleration in the trends already underway in terms of infrastructure financing, private sector mobilization, the growing importance of Public Development Banks, and sovereign debt service suspension measures in the occurrence of adverse climatic events. In addition, the Summit was an opportunity to formalize the restructuring of Zambia's debt under the Common Framework for Debt Treatment. Finally, the leaders present pledged to monitor over time the implementation of the solutions outlined at the Summit. They also committed to having these solutions discussed at major international events in 2023 and 2024, such as the G20 New Delhi Summit, the United Nations SDG Summit, the Annual Meetings of the International Monetary Fund and World Bank in Marrakech, and COP28 in Dubai.

There has been an editorial change to this edition of MacroDev semestrial panorama, with the first section devoted to global economic developments, still focusing on EDCs, instead of the previous thematic section. It is followed by the Country Focuses in the second section. We hope that this new proposal for a semestrial panorama of current economic developments in emerging and developing countries will meet your expectations.

For this edition, our attention has been drawn to China, Cambodia, Serbia, Burkina Faso, Uganda, Rwanda, Tunisia, Brazil and Mexico. We hope that these analyses will fuel your interest and thinking in terms of the challenges and socioeconomic prospects of these countries!

International economy

A tunnel and slide

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The succession of shocks since 2020 is akin to a tunnel leading to a slide with a worsening global economic outlook. In the short term, the scenarios of "stagflation", recession-disinflation, or even deflation, are all plausible. In the medium term, global economic growth is expected to remain lower than its long-term trend. There is also growing concern over debt sustainability in a number of emerging and developing countries (EDCs) and their development trajectory. The Covid-19 pandemic and war in Ukraine have highlighted the disunited (or even disempowered) state of the world faced with events with global consequences, which reaffirm the interdependence of economic and political systems. The workings of the world extend beyond the duopoly, or even the rivalry, between the USA, the leader of the "old world" and developed countries, and China, the champion of the "new world" and EDCs. National interest, pragmatism and non-alignment are the key words of a new world in which the major emerging countries (India, Brazil, Turkey, South Africa), an unclassifiable Russia, Gulf countries and developing countries want to have a say in the geopolitical and geoeconomic organization. The hegemony of the dollar and extraterritoriality of American law are on the radar of a multipolar, changing and fragmented world. However, temptations towards protectionism and relocations (reindustrialization policies of advanced countries), along with the slowdown in world trade, do not cement an economic deglobalization in the short-medium term: cooperation between China, the USA and Europe remains the cornerstone of the world economy, and EDCs are structurally dependent on commodity exports and imports of intermediate goods and consumer goods. Similarly, multilateralism remains essential in addressing the debt and development crisis of EDCs, as well as the major challenges posed by climate change, energy transition and biodiversity conservation.

Cyclical and structural slowdown in global economic growth…

Following the global recessionary shock in 2020 (-2.8%), the rebound in activity in 2021 (+6.2%) and the "relative return to normal" in 2022 (+3.4%, in line with the long-term average), the slowdown in global economic growth is continuing in 2023, with a forecast of an annual average of +3% (IMF),[1] with little prospect of an acceleration in 2024.

While the forecasts have been revised slightly upwards for advanced economies in recent months, they remain uncertain for the second half of 2023 and early 2024. There are marked disparities between advanced economies and EDCs, within each of the two groups of countries, as well as between China and the rest of the world.

In the USA, the slowdown in activity was more marked than in the euro area in 2022 (2.1%, against 3.5%), but it has proved more resilient in the first half of 2023, bolstered by consumption (full employment and dissaving). The effect of inflation, increasing interest rates and slowdown in credit could result in real GDP growth of around 1.8% in the USA and only 0.9% in the euro area in 2023. In the second half of the year, the USA faces a greater risk of recession than Europe, linked to the regional banking crisis, the increase in business failures and possible labor market adjustment (rising unemployment, falling wages). Without saying so officially, the U.S. Federal Reserve (Fed) may opt for a recession scenario coupled with rapid disinflation. It is worth noting that the current inversion of the yield curve (short-term rates higher than long-term rates) often heralds economic recession in the USA. In this case, the economic growth of developed countries would barely exceed 1% in 2024.

The dynamism of China's economic growth will remain crucial for the world economy and especially for EDCs. The Chinese economy now accounts for 18% of nominal world GDP (25% for the USA) and has superseded the USA economy in purchasing power parity since 2017 (IMF, WEO). Penalized by the zero-Covid policy until the end of 2022, Chinese real GDP growth is expected to rise from 3% in 2022 to over 5% in 2023. However, the intensity and sustainability of the Chinese rebound are undermined by cyclical factors (real estate

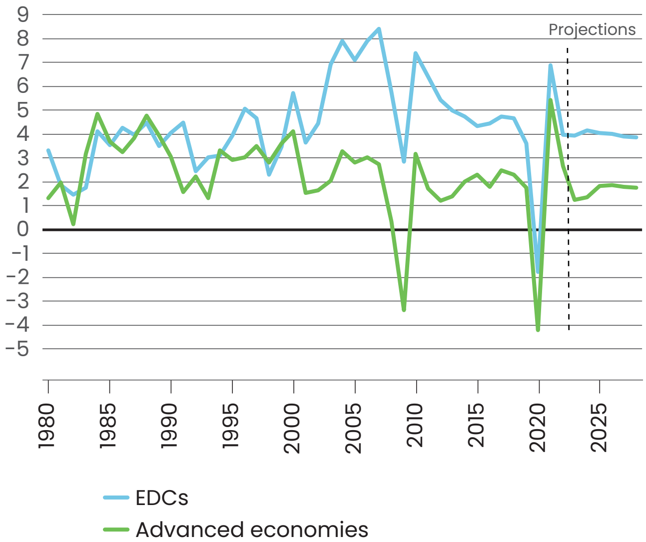
1 *World Economic Outlook,* April 2023 and July 2023.

bubble, domestic demand) and structural factors (declining and aging population, weakness of social safety nets, high savings rate, local government debt, loss of competitiveness).

Consequently, the economic growth of EDCs could remain stable in 2022-2024 at around 4% (against 5.3% on average between 2003 and 2022). While Asia is already generally benefiting from the Chinese rebound, with an acceleration of its economic activity expected in 2023, the situation is more mixed in Africa, the Middle East, "emerging" Europe, Central Asia and Latin America. A growth slowdown is likely in these regions, in particular in Latin America, structurally the least dynamic region among EDCs. The idiosyncratic trajectories of EDCs are affected by social and security tensions (Burkina Faso, Mali, Niger, Peru, Democratic Republic of Congo, Sudan, Tunisia), climate shocks and natural disasters (Argentina, Mozambique, Turkey) and, more often, increased budget and financing constraints (South Africa, Egypt, Kenya, Nigeria, Bolivia), not to mention the countries in default with public debt restructuring, or at high risk of debt distress (Lebanon, Sri Lanka, Ghana, Zambia, Ethiopia), as is the case with half the 28 low-income countries.[2]

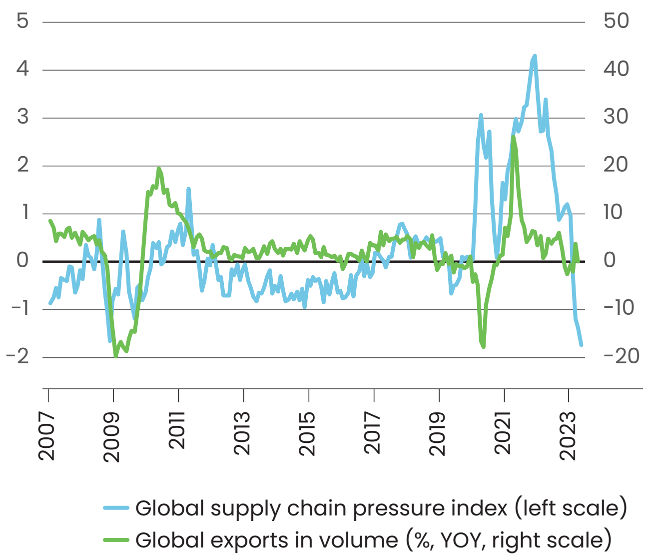
In the medium term, growth prospects would appear to be persistently weaker. Five-year forecasts of potential global GDP growth have steadily decreased from just over 4.5% in 2011 to about 3% today. This decline partly reflects the slowdown in the major emerging economies (China, and India to a lesser extent), a foreseeable trend as countries converge. However, certain more recent factors in the slowdown should be noted: the impact (especially in terms of debt) of the recovery from the pandemic, a slowdown in the pace of structural reforms, and the growing threat of geopolitical fragmentation, leading to further trade tensions, less direct investment and a slowdown in the pace of innovation and its dissemination.

Graph 1 – Economic growth (%)



Source: IMF (WEO)

Graph 2 – World trade



Source: New York Fed, Baltic Exchange

2 *World Bank, Global Economic Prospects,* June 2023.

…held back by the inflationary shock and global monetary tightening to counter it

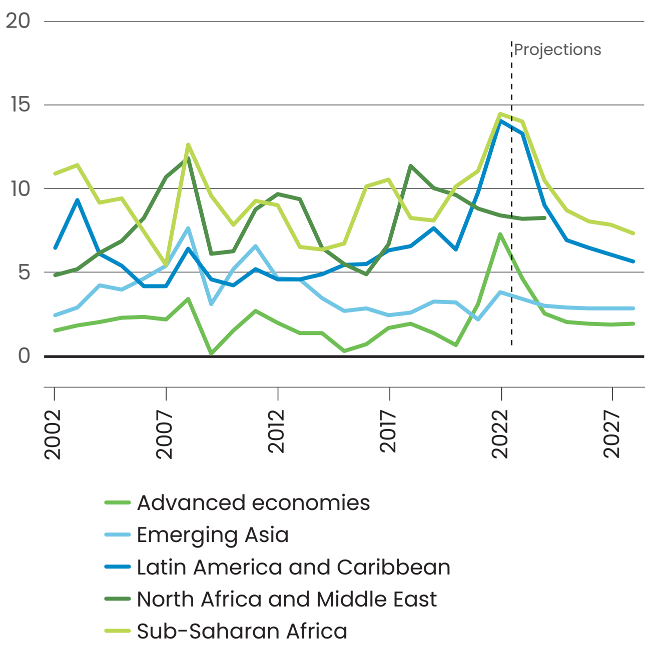
The global inflationary shock and monetary policy tightening (rise in key interest rates and reduction in the balance sheet of the main Central Banks) are the main direct factors weighing on the confidence of economic agents and economic growth. After 8% in the USA and Europe and 10% in EDCs in 2022, the average annual inflation rate is expected to slow down in 2023 to around 5% in developed countries and still above 8% in EDCs. Significant disparities are likely to persist between Asia, which is relatively safeguarded with inflation structurally at around 3%, and the other emerging regions facing inflation remaining in double digits in 2023-2024.

The post-Covid recovery in demand, disruptions in value and supply chains, the synchronous commodity price shock exacerbated by the war in Ukraine and the stronger dollar (imported inflation) have put an end to two decades of a model of global industrial disinflation supported by China[3] and other emerging countries that export manufactured goods.

Base effects, the easing of commodity prices and pressures on supply chains, and relative stabilization of the currencies of EDCs in relation to the dollar in recent months have brought down global inflation which appears to have peaked in early 2023. Nevertheless, the persistence of underlying inflation (excluding energy and food) continues to be a concern for the Fed and ECB over the risk of a de-anchoring of inflation expectations of around 2% : i) wage-price spiral as in the 1970s-1980s (in particular in the USA and more in services than in industry); ii) cascading effect of soaring energy and food prices (Europe, EDCs); iii) reduction of oil production quotas by the expanded Organization of Petroleum Exporting Countries (OPEC+); iv) new energy crisis this fall despite the diversification of supply sources (Europe); v) end of the Black Sea Grain Initiative; vi) renewed pressure on EDCs currencies. The windfall effect which companies would have benefited from to increase their margins appears to be limited to certain sectors (energy, transport), while most have borne the full brunt of rising production costs, as shown by the increase in business failures (USA, Europe).

In this context, the main Central Banks (excluding China) maintain very firm communication on the objective of reducing inflation, suggesting a continuation of increases in key interest rates, while markets anticipate a short-term end to the monetary tightening cycle.

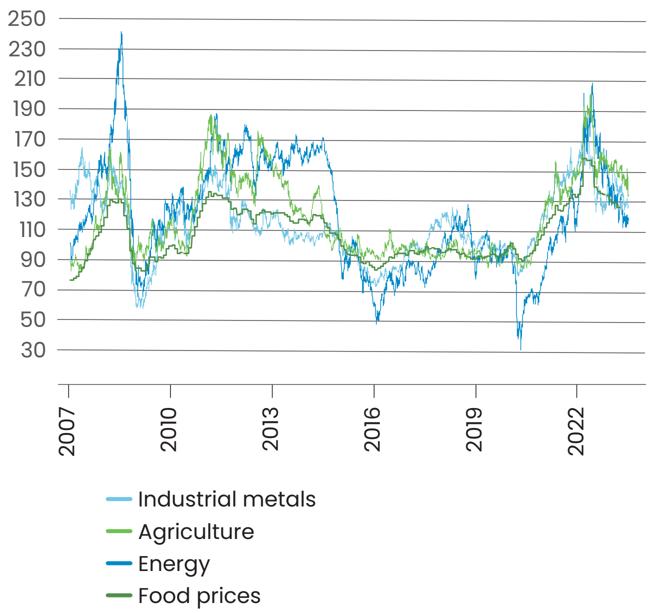
Graph 3 – Inflation
(%, annual average)



Source: IMF (WEO)

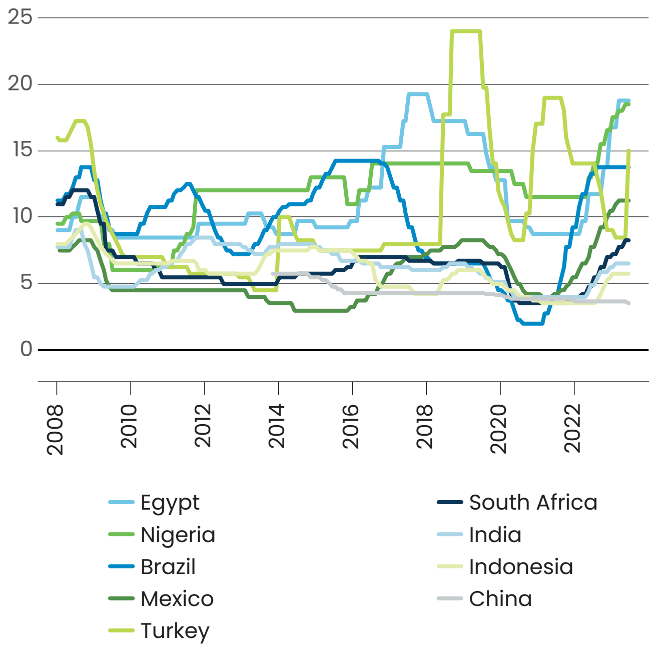
3 Large-scale integration into world trade (WTO, 2001; end of Multifiber Arrangement, 2005), low labor costs, social dumping, regional and international integration and climbing the value chains.

Graph 4 – Commodity prices and food prices (index 31/12/2019=100)



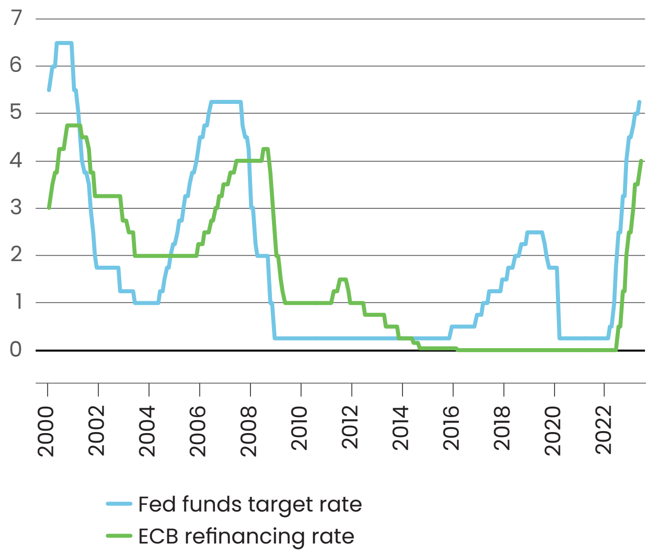
Source: FAO, S&P GSCI, AFD calculations.

Graph 6 – Key interest rates in emerging countries *(%, per annum)*



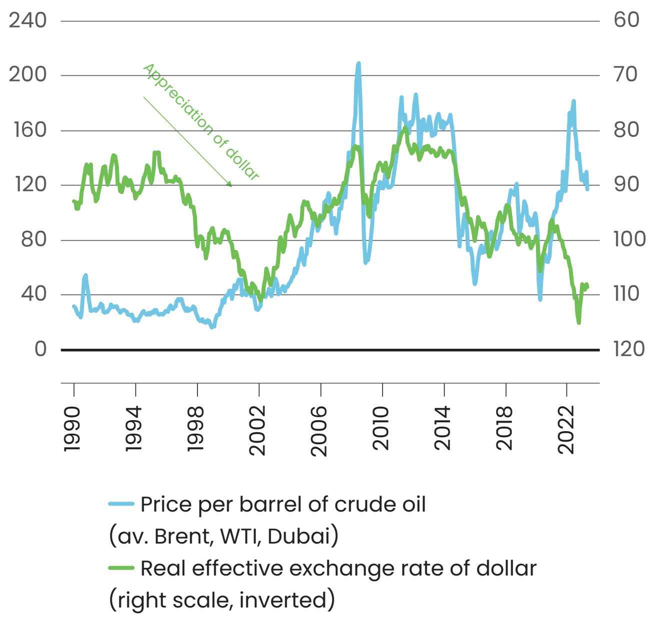
Source: Macrobond

Graph 5 – Key interest rates in the USA and euro area *(%, per annum)*



Source: Macrobond

Graph 7 – Movements in the dollar and oil prices (index Dec.-2019=100)



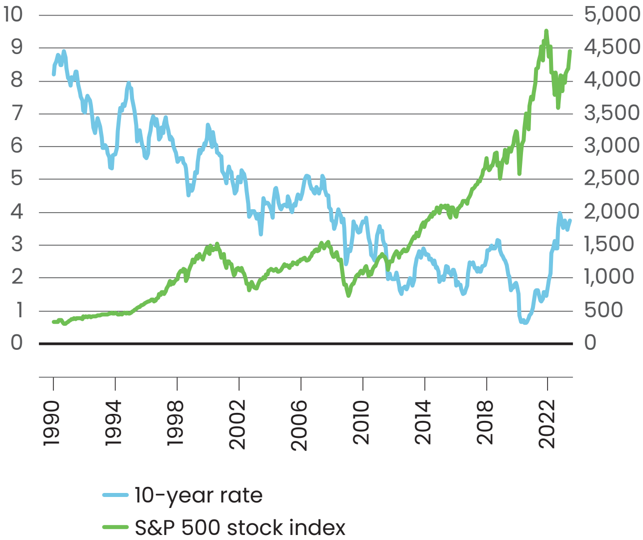
Source: Macrobond, AFD calculations.

US financial system under surveillance

At this stage, spillover risks from the American banking sector's troubles to the rest of the world seem limited. Bank failures in the USA since March 2023 have remained limited to a few non-systemic regional banks.[4] The deployment of measures by the Fed and the Federal Deposit Insurance Corporation (FDIC) to ensure liquidity and bank deposits (44% unsecured before the shock) has limited contagion and maintained the stability of the financial system.[5] Systemic banks, which are generally well regulated, have attracted deposits during this period of bank stress and have successfully passed the stress test conducted by the Fed in June. A concentration/restructuring movement may be on the horizon for the US banking sector which comprises more than 4,000 institutions.

At the same time, the impact of rising interest rates on unregulated financial ecosystems (in particular non-bank financial institutions – NBFI)[6] is uncertain and could be significant if it is combined with a rapid decline in the value of commercial real estate assets and technology stocks. Yet for the last decade, NBFIs have also largely contributed to financing EDCs through international capital markets (Eurobonds) and local markets (local currency bonds and stocks). They have also shown greater volatility in terms of net flows during periods of financial stress. Emerging markets are therefore likely to be vulnerable in the event of a downturn in the NBFI market. In its Global Financial Stability Report of April 2023, the IMF more generally considers that "The impact of tighter monetary and financial conditions could be amplified because of financial leverage, mismatches in asset and liability liquidity, and high levels of interconnectedness within the NBFI sector and with traditional banking institutions."

Graph 8 – Bond yields and equity market in the USA



Source: Macrobond, FMI (IFS)

A shortage of funding with socioeconomic consequences for EDCs

The persistently low level of capital flows towards EDCs and prohibitive financing conditions for many of them are major sources of concern.[7] Behind the increase in liquidity, refinancing, or even public debt sustainability risk for a growing number of countries, there is the specter of an undermining of the "socioeconomic achievements" of the pre-Covid decade and a weakening of the development trajectory of a number of EDCs. This is especially true in Sub-Saharan Africa, which is faced with increased financing needs due to the inflationary shock, an acute food crisis, the effects of climate change, and increased security spending.

4 The problem identified is due to a poor interest rate risk management by institutions that are less regulated than the major banks. In a context of excess liquidity and an accumulation of bank deposits after years of quantitative easing (QE), banks have bought government securities massively. The mark-to-market value of these portfolios has collapsed with rising interest rates, causing a liquidity and solvency crisis for these institutions (SVB in particular) at a time when they faced a run on deposits by their clients.

5 Federal Reserve, Financial Stability Report, May 2023.

6 Investment funds, pension funds, insurance companies, money market funds, structured investment vehicles, hedge funds.

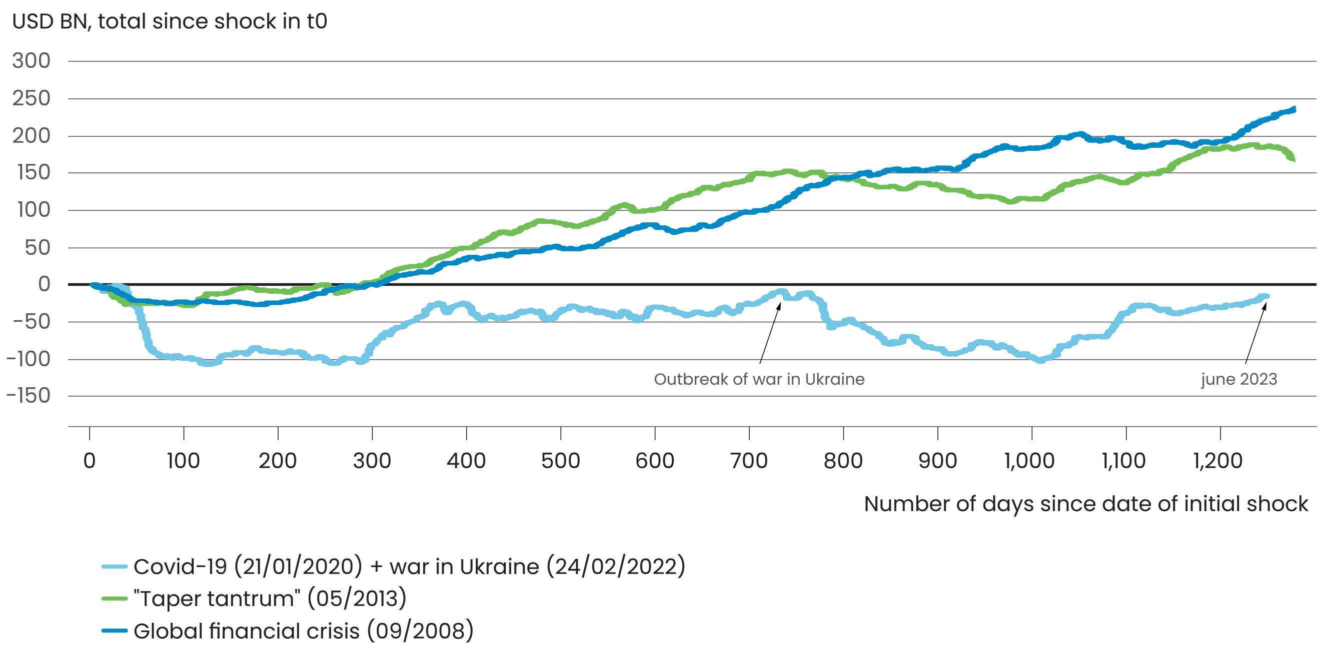
7 For further details, see Agence Française de Développement (2023, February), MacroDev Semestrial Panorama 2023 #1.

The loss of appetite of international investors for the sovereign debt of EDCs, seen since the monetary tightening in developed countries (fall in bond yield differentials) and the outbreak of war in Ukraine, has continued in 2023. Foreign portfolio investment flows in EDCs domestic bond markets have remained cumulatively negative since the health crisis in early 2020 and close to zero since February 2022.

Sovereign spreads of EDCs, which gauge market risk perceptions, have eased off slightly since May 2023, following a new episode of volatility and concern related to the bank stress in the USA. Nevertheless, in early July, sovereign spreads remained above 700 basis points in 19 countries out of 74, concentrated in Africa and Latin America. Coupled with the increase in "risk-free" rates (US Treasury bonds), risk premiums de facto make international markets inaccessible for many countries, with a particular discrimination against Africa, where a dozen or so countries have issued Eurobonds in recent years. In addition to the inability to refinance themselves on international markets, bilateral funds have dried up, in particular from China, the main creditor of a number of countries in Africa and Latin America, not to mention the tightening of financing conditions in domestic markets.

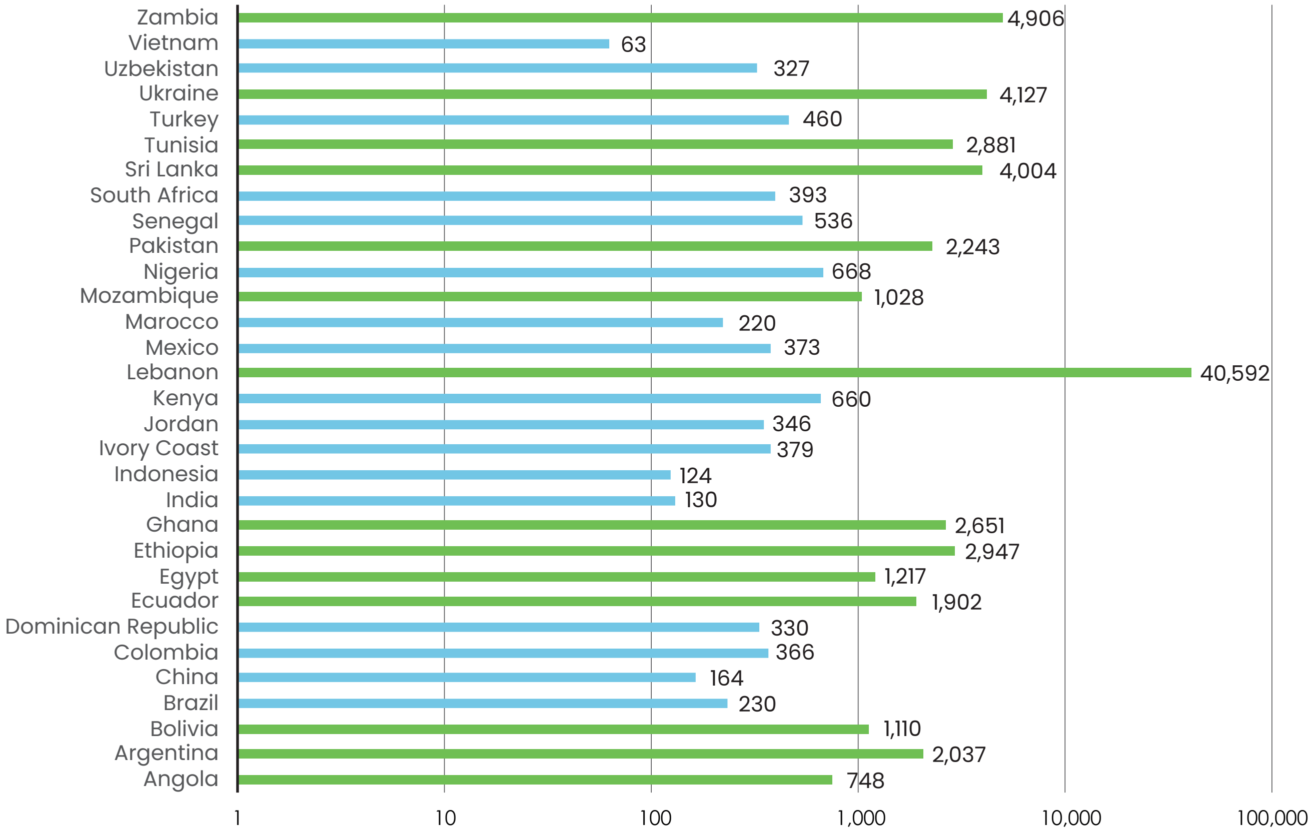
The increase in the government debt ceiling in the USA on 1 June 2023 (79th in six decades) may have potential consequences for EDCs. The volume of US Treasury bill issuances affects trends in bond yields, asset allocations and financing conditions for EDCs, through the potential crowding out effect of US government debt and the flight to quality during periods of risk aversion.

Graph 9 – Portfolio investment flows in the main emerging countries



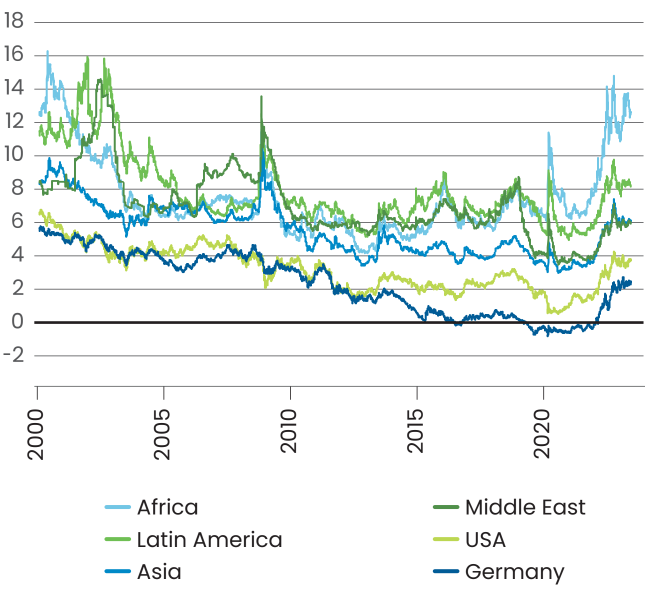
Source: IIF, AFD calculations

Graph 10 – Sovereign spreads (basis points*)



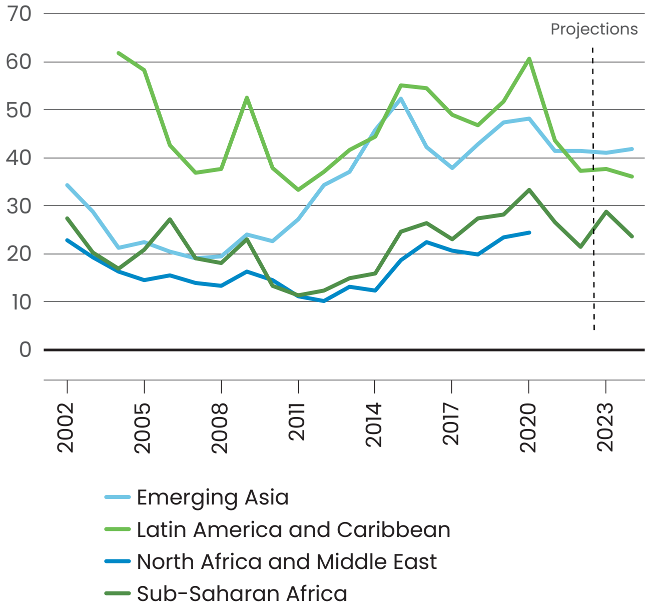
Source: JP Morgan EMBIG.
*Spreads as at 3 July 2023, logarithmic scale; in green spreads above 700 bp

Graph 11 – 10-year rate in the USA and Germany, yield-to-maturity in USD in EDCs



Source: JP Morgan

Graph 12 – Total external debt service (% of exports of goods and services)



Source: IMF (WEO)

The Paris Summit for a “New Global Financial Pact”, held in Paris on 22 and 23 June 2023, generated cautious optimism. In a context of multiple crises (pandemic, war in Ukraine, public overindebtedness, climate change), the Summit aimed to launch an overhaul of the international financial architecture of the international financial system to better finance the low-carbon transition, while supporting EDCs to achieve the SDGs.

While it is too early to turn the Paris Summit into a new Bretton Woods Agreement, three main points can be noted: i) new tools will be launched to address climate change, such as debt suspension clauses in the event of a natural disaster, or debt-for-climate swaps and debt-for-nature swaps to free up fiscal resources; ii) multilateral financing for EDCs will be increased, with USD200 billion announced for multilateral development banks, in addition to the USD100 billion of Special Drawing Rights (SDR) and USD40 billion of funds from the IMF’s new Resilience and Sustainability Trust; iii) major efforts will be made to mobilize the private sector, in particular through the Private Sector Investment Lab launched by the World Bank. Finally, the announcement of a debt restructuring agreement between Zambia and all its public creditors is an important and positive milestone, but also once again shows the slowness of the Common Framework process.

In a context of growing international fragmentation, the Summit also sought to set an agenda for an ongoing review to monitor the deployment and impacts of the measures that have been or will be taken...

Country focus

China
Cambodia
Serbia
Burkina Faso
Uganda
Rwanda
Tunisia
Brazil
Mexico

China: A three-dimensional transition

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Both an economic and demographic powerhouse, China experienced another marked slowdown in its economic growth in 2022, following the one in 2020, as well as a decline in its population. More generally, the Chinese growth model, which has been seriously affected by the"zero-Covid" policy , appears to be reaching its limits and needs to be reinvented. At the same time, the country is faced with the premature aging of its population and major energy transition challenges due to its position as the world's largest emitter of greenhouse gases (GHGs).

The Chinese economic model, based on public investment and exports, has turned the country into the world's second largest economy. However, this model is currently losing momentum and is causing substantial macroeconomic imbalances. It appears to be reaching its limits and perhaps moving towards a persistently slower growth model, while aiming at a rebalancing towards domestic consumption. Consequently, in this article, the economic transition refers both to a change in pace and in growth drivers. The aging and decline of the Chinese population have an impact on this economic transition, which must also be combined with a green transition.

An inevitable economic transition

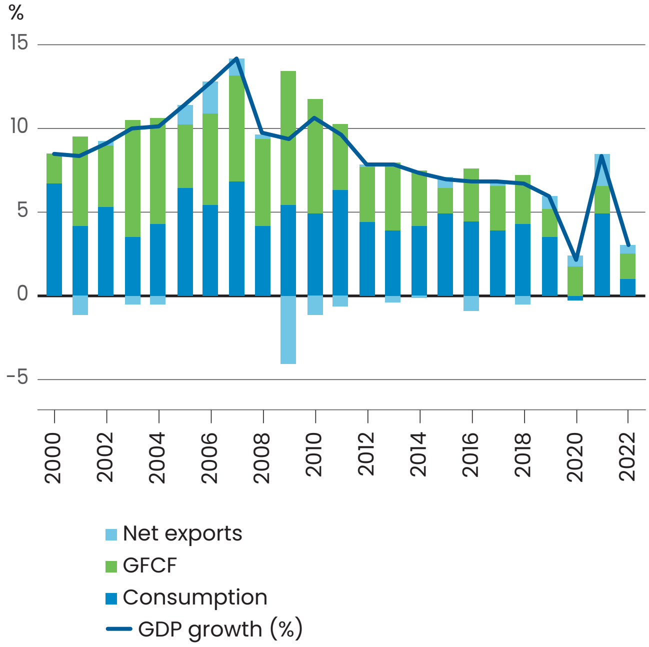
While the annual average growth rate stood at 10.5% during the 2000s and 2010s, real GDP only increased by 3% in 2022, a result significantly lower than the objective of 5.5% previously set by the authorities. This slowdown is due to: i) the continuation of the "zero-Covid" policy, which led to lockdowns in many big cities (such as Shanghai, Chengdu and Shenzhen) following the resurgence of the pandemic, but also ii) the severe drought in the summer of 2022, and iii) the major difficulties experienced by the real estate sector since the tightening of financing conditions adopted to address indebted developers.

While the economic slowdown of 2022 is, along with the one in 2020, the biggest in China's modern history, the country's growth has been structurally slowing down since the early 2010s, from 10.6% in 2010 to 5.9% in 2019. The Chinese economy therefore appears to be transitioning towards slower economic growth, in particular as a result of less and less productive investments and the aging population. Peschel and Liu (2022),[8] estimate China's growth potential at 5.3% for 2020-2025, against 10% between 2001 and 2010. It is expected to gradually fall to only 2% between 2036 and 2040. According to these authors, long-term growth will be driven by capital and total factor productivity, whose contributions will, however, decrease, while the decline in the working population will dampen economic activity.

Besides the growth rate, the economic model, which was based on investment, appears to be less and less sustainable in view of the macroeconomic imbalances it causes, in particular an increase in public debt, which reached 110% of GDP in 2022. In this economy characterized by an extremely high savings rate (46% of GDP in 2022), the Chinese authorities are trying to move their growth model more towards domestic consumption, while reducing dependence on external demand. But while the relative contribution of consumption had tended to increase during the pre-Covid decade, the pandemic put an end to this trend. Indeed, lockdowns and health restrictions have adversely affected consumption, while the authorities have supported economic activity through public investment. The lifting of the "zero-Covid" policy in late 2022 and the base effect led to an acceleration of growth in the first months of 2023 and a rebound

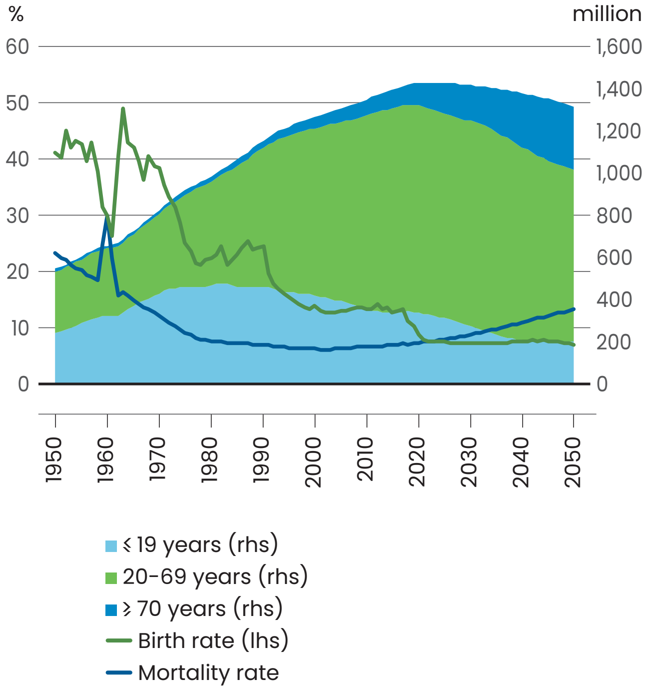
8 Peschel, D. and W. Liu (2022), "The Long-Term Growth Prospects of the People's Republic of China", *ADB East Asia Working Paper Series nº 54.*

Graph 13 - An economic slowdown and a rebalancing needed



Source: China National Bureau of Statistics

Graph 14 – China's population is declining and aging



Source: United Nations Population Division, (intermediate scenario)

in consumption. However, the recovery fell short of expectations, with consumption suffering from the lack of household confidence and from the real estate crisis which affects the value of their assets.

An irremediable demographic transition

China's population fell in 2022. According to national data, this had not happened since the great famine of 1959-61. As the world's most populous country until April 2023,[9] China has used this comparative advantage to develop its economy. However, the challenges posed by this huge population prompted the authorities to opt for a drastic control of the births number. The one-child policy adopted in 1979 contributed to the rapid decline in the fertility rate: from 7.5 children per woman on average in 1963 to less than 1.6 between 1995 and 2002. This policy was eased in 2013, then totally repealed in 2015, allowing Chinese households to first have two children, then three children since 2021. Despite this turnaround, the birth rate has remained low due to urbanization, the rising cost of living, the cost of housing and changes in behavior. This has contributed to the slowdown in the natural growth rate,[10] which became negative in 2022, reflecting a decline in the population. This trend is expected to continue and, according to the United Nations' base case scenario, China's population should fall below 1.4 billion by 2035, then to 1.31 billion by 2050.

9 India's population has officially surpassed that of China since April 2023.

10 Difference between the crude birth rate and the crude death rate.

This situation has also led to a premature aging of the population and, consequently, an increase in the old-age dependency ratio. Neither the lack of household confidence, exacerbated by the years of pandemic, nor the fall in the value of assets due to the real estate crisis are likely to support the fertility rate in the coming months. The aging of the population poses a major challenge for China's public finances and economic vitality. But it could also be an obstacle to the shift towards domestic consumption. While Modigliani's Life-Cycle Hypothesis supposes a movement of dissaving among old age people to maintain or increase consumption, in China, the aging may actually have a negative effect on consumption (Jiang and Chang, 2018;[11] Xu and Zoir hao, 2021).[12] Conversely, China's urbanization, another demographic change that could rapidly gather pace if the *hukou system* (urban residence permit) is abolished, could support consumption and more than offset the aging effect (Wang and Yu, 2020).[13]

A necessary energy transition

China is the world's largest greenhouse gas emitter (30% of global emissions in 2021), way ahead of the USA (12%) which is in second place. In the latest version of its Nationally Determined Contribution (NDC) submitted in October 2021, a few days ahead of the opening of COP26, China pledged to: i) reach a peak in its CO_2 emissions before 2030, ii) achieve carbon neutrality before 2060, and iii) increase the share of renewable energies in its total energy consumption by 25% before 2030.

China's carbon emissions started to increase very rapidly in the 2000s, as a result of the development of industry and the country's economic growth. However, they have stabilized over the last decade, with the beginning of the implementation of the energy transition, reducing the carbon intensity of the Chinese economy. Indeed, China has already achieved significant progress in developing renewable energies. Their share in electricity production rose from 18% in 2010 to 30% in 2022, making China one of the countries using renewable energies the most for its electricity production (22% in the USA and 21% in Japan, for example). China ranks 8th in the world for CO_2 per unit of GDP and its per capita emissions are lower than a number of developed countries (7 tons of CO_2 per capita against, for example, 14.7 in Australia, 13.8 in Canada, 13.2 in the USA). However, it should be noted that while China no longer finances coal-fired power plants abroad, new ones continue to be built on its territory. She decided to reopen certain power plants in the face of the energy crisis at the end of 2021 and the construction projects of new coal plants have not slowed down[14]. Furthermore, even if China managed to achieve its targets, the Climate Action Tracker considers that they would be "highly insufficient" with regard to the commitments made under the Paris Agreement.

The decline in China's population could automatically reduce GHG emissions, but given the slowness of the decline in the Chinese population, the effects on reducing emissions are likely to be limited. Assuming a constant emission rate per capita (an unrealistic assumption given the country's climate targets) and according to the United Nations' population projections, total emissions would still reach 9.98 billion tons of CO_2 equivalent in 2050, meaning a reduction of only 7% compared to 2019. In addition, beyond the volume effect related to changes in the size of the

11 Jiang, Y. and F. Chang, (2018), "Influence of Aging Trend on Consumption Rate of Rural Residents – Empirical Analysis Based on Provincial Panel Data", *Asian Agricultural Research,* Vol.10, N° 4.

12 Xu, G. and X. Zhao (2021), "The Influence of Aging Population on Consumption Quantity in China", *Journal of Advanced Computational Intelligence and Intelligence Informatics,* Vol. 25 N° 5.

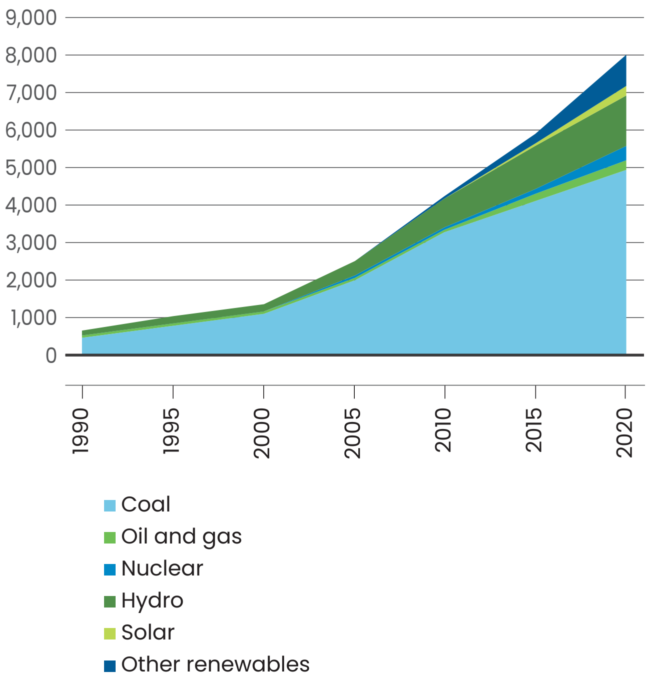
13 Wang, M. and X. Yu (2020), "Will China's Population Aging Be a Threat to its Future Consumption?", *China Economic Journal,* Vol. 13, N° 1.

14 CREA (2023), «China permits two new coal power plants per week in 2022», Briefing.

population, it is necessary to take into account changes in the structure of the population. Indeed, while certain scientific articles highlight a lower carbon footprint among elderly people (Zhang et *al.,* 2023),[15] urbanization is likely to encourage emissions, as China's urban lifestyle generates higher emissions (Feng and Hubacek, 2016).[16]

The slowdown in the pace of economic growth could automatically slow the increase in emissions. Conversely, according to the World Bank,[17] the transition to a low-carbon economy is likely to affect China's economic growth, but with ambiguous cumulative effects in the long term (improved energy efficiency, but rise in energy costs penalizing supply). Finally, a rebalancing towards consumption, allowing China's economy to develop services and reduce its dependence on carbon-intensive industries, could reduce CO_2 emissions by 15% by 2050.[18]

Graph 15 – A significant rise in the share of renewable energies in China's energy mix (in thousands of GWh)



Source: International Energy Agency

15 Zhang, Z., Y. Cui and Z. Zhang (2023), Unequal Age-based Household Carbon Footprint in China, *Climate Policy,* Vol. 23, N° 5, 577-592

16 Feng, K. and K. Hubacek (2016), Carbon Implications of China's Urbanization, *Energy. Ecology and Environment,* Vol. 1, 39–44.

17 World Bank Group (2022), *China Country Climate and Development Report,* CCDR Series, World Bank Group, Washington D.C.

18 IMF (2022), "People's Republic of China: 2021 Article IV Consultation", *IMF Country Report* N° 22/21.

Cambodia: significant progress towards sustainable economic growth

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For two decades, Cambodia has been experiencing a gradual transformation enabling it to achieve significant economic and social progress and become a lower-middle-income country (LMIC). However, the various exogenous shocks since 2020 have underscored the fragile nature of the progress achieved and highlighted the challenges the country still needs to address to improve its socioeconomic environment, accelerate its economic growth and make it more inclusive, so that it can definitively leave the category of least developed countries.

Mostly agricultural at the turn of the 1990s, Cambodia has gradually liberalized its economy, allowing it to attract foreign investors and initiate a structural transformation. It has thereby benefited from a dynamic economic growth rate of over 7% on average, with its GDP per capita multiplied by 3.5 between 1993 and 2018. With GDP per capita estimated at USD 1,354 in 2021 (World Bank), the country is in the process of being reclassified as a lower-middle-income country (LMIC). The Cambodian authorities aim for it to become an upper-middle-income country (UMIC) by 2030, or even join the group of advanced countries by 2050, requiring an ambitious level of average annual economic growth of 6 to 7%.

Economic performance seriously affected by recent external shocks

Real GDP contracted by 3.1% in 2020, affected by the health crisis, in particular due to the reduction in external demand and the halt of tourism. There was only a moderate upturn in activity in 2021 (+3%), in particular supported by public investment expenditure. There was a stronger recovery in economic growth in 2022 (+5%), supported by the resumption of tourism and exports, despite the slowdown in the textile and construction sectors.

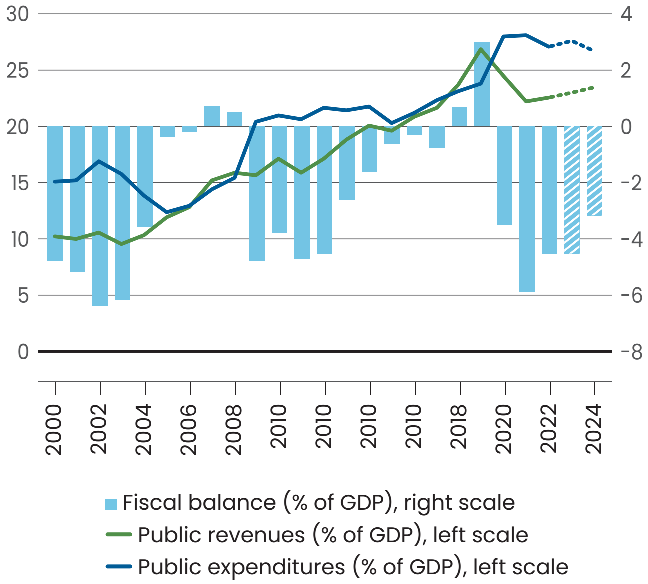
The tense international situation (war in Ukraine, tightening of international monetary conditions, reduction in global demand) negatively affects growth prospects. However, real GDP is expected to continue to recover in 2023 and reach +5.4%, supported by tourism and domestic demand, despite moderate growth in the external sector. Growth should gradually converge towards its potential, estimated at around 6.5% by the IMF. This potential has been revised down slightly (~7% pre-Covid-19 crisis), but remains comparable to the potential growth rates of neighboring countries (Vietnam, Thailand).

Strong fiscal fundamentals central to the strategy to become a LMIC

The revenue mobilization strategy for 2014-2018 has significantly increased public revenues (26.8% of GDP in 2019). The country also recorded fiscal surpluses in 2018-19, allowing the Government to build up substantial deposits placed with the Central Bank (23.7% of GDP in 2020). These public savings partly financed the countercyclical fiscal policy in response to the Covid-19 crisis, in order to limit the public deficit and recourse to borrowing. The belated implementation of anti-Covid-19 measures contained the budget deficit to 3.4% of GDP in 2020, prior to its increase to 7.1% in 2021. Reduced to 4.1% of GDP in 2022, it is expected to increase slightly in 2023, in relation to policies to help cope with rising prices implemented from mid-2022, before resuming a downward trend in 2024.

Fiscal consolidation remains a priority for the authorities. They are currently developing a new revenue mobilization strategy for 2024-2028. One of its aims is to introduce a tax on capital gains (2024) and household income (2025), while reducing the Government's operating expenditure. At the same time, a new law allows savings of between 2 and 4% on public revenue from the previous year, if the revenue collected is higher than anticipated in the budget. This law could make it possible to rebuild public savings, which were reduced to 15.1% of GDP in 2022.

Graph 16 – Fiscal consolidation remains a Government priority



Source: IMF (WEO)

Furthermore, while public debt increased following the Covid-19 crisis, it remains contained. At the end of 2022, the debt ratio stood at 36.1% of GDP, representing an increase of +7.9 pp since 2019. The structure of public debt appears to be at low risk: it is exclusively external and concessional (average maturity of 26 years, average interest rate of 1.3%). It is mainly held by bilateral creditors (68% of the total), with China being the country's main creditor, while the remaining 32% are held by multilateral creditors. The external debt is mainly denominated in US dollars, limiting the foreign exchange risk as the riel is pegged to the US dollar, which is considered credible. The risk of debt distress, which has been low since 2012, has been confirmed by the IMF's latest debt sustainability analysis in December 2022.

In the medium term, Cambodia should have less access to concessional loans following the country's reclassification as a LMIC as of 2027. To address this, the authorities have started to develop a domestic market of Treasury bills. While the first issuances in late 2022 did not meet with the expected success (low interest rates, instruments proposed too rigid), the domestic market should expand in the coming years and could allow the Treasury to diversify its sources of financing.

Continue reforms to remove structural barriers

The country is seeking to diversify its economy, which has until now been based on four main sectors: agricultural production (about 20% of GDP, in particular rice), textiles (18% of GDP), construction (10% of GDP) and tourism (5% of GDP, experiencing growth since the 2000s). Yet Cambodia still suffers from a number of structural barriers which prevent the country's needs for diversification from being met. The socioeconomic challenges persist and have been exacerbated with the Covid-19 crisis. There are also a number of remaining challenges in terms of education, the skills level of the workforce, and the integration of newcomers into the labor market. The transparency and business environment indicators are structurally weak, while there are still widespread problems of corruption, compounded by the deterioration of the political environment since 2017. In the financial sector, the boom in bank credit and microfinance since 2011 is in danger of overheating, while the external sector lacks transparency (measurement of the financial account and private external debt is problematic) and remains dependent on a few key sectors.

Several reforms are in the process of being adopted to address these challenges, such as: i/ a new law on private investment and a regulatory framework on public-private partnerships; ii/ a roadmap for the promotion of investments in higher value-added sectors (automotive, electronics, machines, new textile strategy published); and iii/ a general reform of the social protection system under development. It seems that the Cambodian Government, supported by the new political generation, want to continue to introduce socioeconomic reforms to reduce inequalities and promote the socioeconomic development of the country. However, this transition based on moving beyond the traditional growth engines still has far to go. It is in particular jeopardized by the war in Ukraine and the resulting global economic slowdown, while external demand remains the main driver of Cambodia's economic growth.

Serbia: The European Union, so far and yet so near…

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Almost a quarter of a century after the collapse of the planned socialist economy, Serbia shows good economic performance, the cornerstone of its wish to join the European Union. This is despite the international economic situation, which is unfavorable for such an outward-looking country, and despite inflation which is high and firmly established. With its status as an upper-middle-income country, the country's per capita income is much higher than its Bulgarian and Romanian neighbors at the time of their accession. But the economy is not everything: the authoritarian excesses of those in power, the threats to the rule of law, the recognition of Kosovo still a burning issue, and an ambiguous foreign policy towards Russia are all barriers to integration.

Since 2015, Serbia has been experiencing strong and robust economic growth, driven by investment, exports and household consumption. This growth is based on the reforms to consolidate the economy, established with assistance from the IMF after years of sluggishness following the 2008 global financial crisis. Since then, Serbia has subscribed to IMF programs, on its own initiative and without interruption, in order to implement a series of adjustments, strengthen its foreign exchange reserves and kick-start its economy. This strategy has been extremely successful: the return to macroeconomic stability has allowed Serbia to comfortably address the Covid-19 health crisis and get through 2020 limiting the contraction of its real GDP to 0.9%, before a sharp rebound in 2021 (+7.6%). Between 2018 and 2022, Serbia's average annual economic growth reached 3.5%, one of the best performances in Europe.

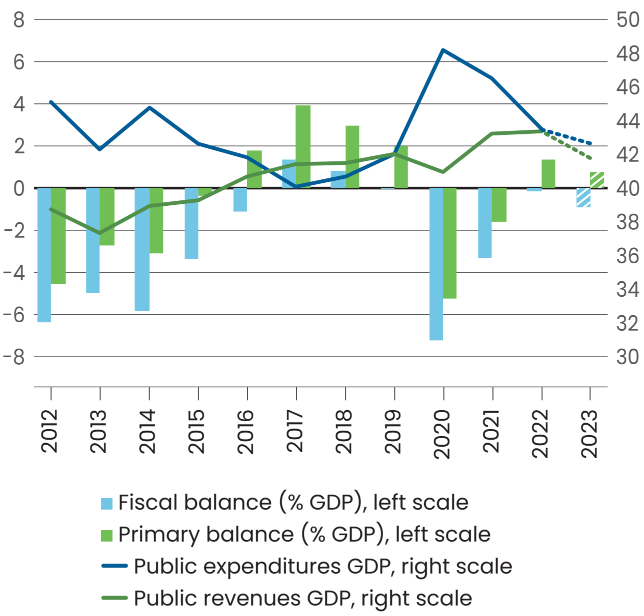
However, there was a slowdown in growth in 2022 (2.3%) and it is expected to fall further in 2023 (2%). This is due to the weak international economic climate and the fall in demand among Serbia's main European partners. In addition, low labor productivity, large-scale emigration (the population has fallen by 12% since 1994) and the overrepresentation of public enterprises and their poor governance adversely affect the country's long-term growth potential. Nevertheless, it is still close to 4% according to the IMF.

Resilient public accounts

Thanks to the fiscal consolidation efforts conducted with the IMF between 2015 and 2018, Serbia's public finances have recorded a primary budget surplus for three years in a row. The massive response plan to the Covid-19 crisis in 2020 (+15% for public expenditure) increased the deficit to 7.2% of GDP. But the quality of the management of the accounts has allowed the fiscal balance to return to -0.1% of GDP (excluding energy) in just two years. Consequently, the financing need has fallen and outstanding public debt has been on a downward trend since 2015, with the exception of 2020, and is expected to reach 50% of GDP in 2023.

The introduction of fiscal rules to limit the public deficit, the adoption of a strategy for the development of financial markets, and the preparation of an action plan for the management of public enterprises should further strengthen the consolidation in the coming years. In December 2022, a new two-year IMF Stand-by Arrangement amounting to EUR 2.4 billion was approved to address the anticipated financing needs, given the global economic situation, and support the efforts for structural reforms, with a focus on the crisis-stricken energy sector. Indeed, the good results for public accounts conceal a slippage in budgetary expenditure related to the energy sector (2.9% of GDP in 2022), increasing the budget deficit to 3.2% of GDP in 2022. With the support of the IMF program, the Government intends to put a permanent stop to these transfers to the energy sector in two years.

Graph 17 – Successful and sustainable fiscal consolidation (excl. energy)



Sources : IMF (WEO)

An open and integrated economy that bears the brunt of imported inflation

Serbia is a very outward-looking economy, with a level of trade openness of 62% of GDP. The European Union (EU) accounts for almost two-thirds of trade, which is mainly made up of intermediate goods. China and Germany are its main supplier countries. In 2022, due to high import costs, mainly for internal reasons (crisis with electricity production facilities) and external reasons (increase in import prices due to the war in Ukraine), the increase in the trade deficit led to a rise in the current account deficit which reached 6.9% of GDP. However, the slippage was limited by a sharp increase in exports of goods and services at the end of the year, as well as in diaspora remittances.

However, net inflows of foreign direct investment (FDI), which have increased sharply (7% of GDP on average since 2017), alone cover the current account deficit. Serbia has for many years been a hospitable country for foreign investors, as the Government has put in place very advantageous policies. These FDI flows are diversified geographically (divided equally between EU countries and China) and sectorally (construction and real estate, industry and transport).

In 2022, gloomy prospects for the current account deficit in the middle of the year prompted the request for the IMF program, in order to anticipate potential problems in covering the external financing need. With the easing of energy prices in the second half of the year and the very high level of FDI inflows from China (record amount), Serbia was ultimately able to avoid drawing on its foreign exchange reserves.

The de facto pegging of the dinar to the euro is the cornerstone of the monetary policy promoted by the Central Bank to maintain the confidence of international investors and control inflation. The confidence is still very much there, but prices have soared: inflation peaked at 16.2% in March 2023 year-on-year, before decelerating in April, which was much later than in the other economies of the Western Balkans region. Indeed, to maintain economic growth, the Central Bank waited a long time before increasing its key interest rate thirteen times. Inflation is expected to return to the target band of 3% +/- 1.5 pp by the end of 2024.

Growing political unrest

The SNS (*Srpska Napredna Stranka,* Serbian Progressive Party), both a nationalist and pro-European center-right party, has dominated political life for ten years. Its hegemony has been accompanied by a constant deterioration of the rule of law. All the indicators of international political observatories have been declining since 2017. In its last report of October 2022, the European Commission expresses its alarm over the slowdown in the pace of reforms. The progress expected concerns the independence of the judiciary, the fight against corruption, the freedom of the press, air pollution, and relations with Kosovo. Indeed, the normalization of relations between Pristina and Belgrade is hampered by recurrent and sometimes violent tensions, which was the case in December 2022 and June 2023.

Finally, the ambiguity of Serbia's position towards its traditional Russian ally since beginning of the invasion of Ukraine (official condemnation at the UN but refusal to vote sanctions) has caused tensions in diplomatic relations with the EU, which is calling on the country to align with its foreign policy.

Burkina Faso: From a political and security crisis to an economic and fiscal crisis

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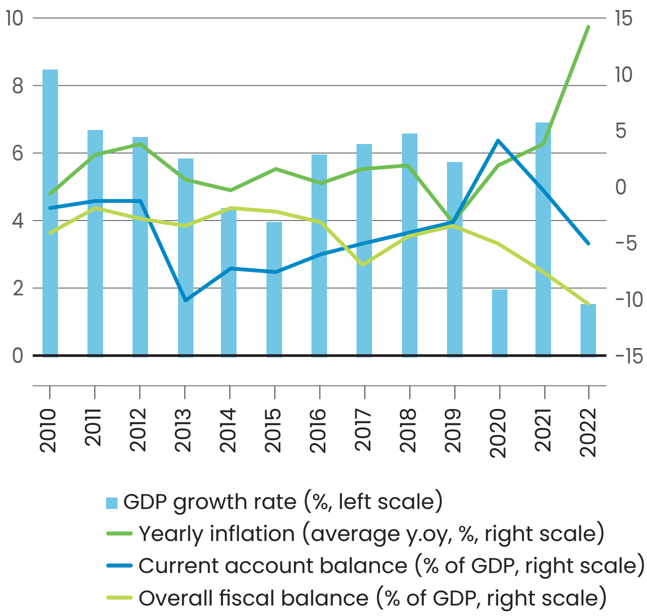
The deteriorating trend in the political and security environment reached a new milestone in 2022, with an escalation of terrorist attacks and two successive military coups. This instability weighs on the economy, which recorded one of its worst-ever performances in terms of economic growth, inflation and fiscal and current account deficits in 2022. This situation has been compounded by disruptions in the international environment. The reduction of donor support and tensions on the regional debt market makes it harder to cover growing public financing needs, while public deficits are likely to remain high due to the security situation. At this stage, the prospects for both a recovery in activity and fiscal consolidation are at best uncertain.

2022 marked a further step in the deterioration of the political and security situation

Since 2016, the authorities of Ouagadougou have been faced with growing insecurity caused by the activity of armed terrorist groups. They have lost control of more than 40% of the national territory. At the beginning of 2023, there were more than two million internally displaced persons, meaning more than one in ten people in Burkina Faso. President Kaboré's failure to combat terrorism effectively led to his removal by a military coup in January 2022. However, the setbacks encountered by the new authorities and the army led to a another mutiny then a putsch, which brought Captain Ibrahim Traoré to power in September 2022. Since then, the authorities have continued to face the same challenges as their predecessors because the terrorist threat is continuing to spread. The combination of major shocks generates substantial macroeconomic imbalances In addition to the political and security shock in 2022, Burkina Faso has been hard hit by the disruptions in the international environment, such as rising commodity prices and the tightening of international liquidity. This combination of shocks has had a significant impact on an already fragile macroeconomic environment.

These shocks have first weighed heavily on economic growth performance: following the post-pandemic recovery in 2021 (6.9%), the real GDP growth rate slowed significantly in 2022. At the beginning of 2023, the IMF estimated it at 2.5%, while the latest estimates of the National Institute of Statistics puts it at only 1.5.%. It is the lowest level of economic growth since 1994, when the CFA franc was devalued. This poor performance

Graph 18 – A sharp deterioration in the macroeconomic environment in 2022



Source: IMF (WEO), National Institute of Statistics and Demography (Burkina Faso) is also due to inflationary pressures on demand and supply factors. For example, gold production fell by almost 13% in 2022 (whereas it had risen by 8% per annum since 2013) due to the closure of a number of mining sites as a result of the growing insecurity. Inflation reached an average of 14% in 2022 (here again, its highest level since 1994), double the average of the West African Economic and Monetary Union (WAEMU). It has been driven by rising import prices, supply chain disruptions due to the security situation, and a poor agricultural harvest in 2021-2022.

There has also been a sharp deterioration in public and external accounts. The public deficit rose from 7.4% of GDP in 2021 to 10.4% of GDP in 2022, the highest level ever in the country and far short of WAEMU convergence criteria. This rise in the public deficit is mainly due to increased public spending, in particular to offset rising prices (fuel and fertilizer subsidies, reduction of customs duties on food products). There has also been a sharp rise in security-related expenditures, as the fight against terrorism is the priority of the military regime. Finally, there was a marked deterioration of external accounts in 2022: the increase in imports in value terms (+22%) and the reduction in gold exports led to the first trade deficit since 2015 and a rise in the current account deficit from 0.4% of GDP in 2021 to 5.2% of GDP in 2022.

The government's financing strategy is particularly threatened in the short term

This deterioration in the economic situation, combined with exogenous factors, has a significant impact on funding public financing needs. The deteriorating trend of public finances (the average fiscal deficit rose from 3% of GDP in 2012-14 to 8% in 2020-23) has driven up public debt. According to IMF estimates, the public debt ratio increased from 33% of GDP in 2017 to 54% of GDP in 2022. The increasing use of short-term debt in local currency, combined with substantial public deficits, has contributed to the increase in the public financing needs from USD1.6 billion in 2019 (10% of GDP) to USD3.6 billion in 2022 (18% of GDP).

At the same time, the government's sources of financing are under pressure. The commitments of donors (bilateral and multilateral) declined by 30% in 2022 due to the political instability, the security situation and the absence of a multi-year fiscal and economic framework. Indeed, the authorities have so far not presented an economic strategy. This situation could improve under the next IMF program, as the authorities and the IMF's services reached a Staff-level Agreement on 30 June 2023 for a four-year facility amounting to about USD305 million. This seems essential for catalyzing donor financing, which on average covered 70% of the public financing needs until 2015, but just under 25% in 2022. However, the geostrategic positioning of the authorities, which have forged closer ties with Russia, impedes a strong resumption of commitments from Western donors.

The public debt denominated in CFA francs is rapidly increasing due to the rise in financing needs and the decline in support from donors: it rose from 3% of GDP in 2012 to over 30% of GDP in 2022. Yet this debt is significantly more costly (its average interest rate is 7%, against about 1.2% for foreign currency debt contracted with donors). It is mostly issued on the WAEMU regional debt market and also poses a refinancing risk. Indeed, Burkina Faso, which traditionally issued on a monthly basis, did not issue between September 2022 and March 2023 due to a perception of increased political risk by regional banks. While the country has resumed issuing debt on the regional market in March 2023, it comes at the cost of the highest financing conditions in the region and an inverted yield curve (short-term interest rates higher than long-term rates). Most importantly, the appetite of regional players has been lower since mid-2022 due to liquidity pressures, related to the rise in international and regional rates and the increased demand of larger economies (Côte d'Ivoire and Senegal in particular). The coverage of public financing needs is therefore at risk for the coming years, as long as the substantial budget deficits and the decline in donor commitments persist.

Uganda: The oil project as a panacea?

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Uganda, which is betting on the Lake Albert oil project to accelerate its economic development, benefits from an IMF program since June 2021. Although this program is supporting fiscal consolidation, the debt strategy adopted by the authorities in recent years, combined with monetary tightening, is increasing pressure on public finances and weighing on an external sector already suffering from the increase in imports resulting from the oil project. While there is some leeway (sustainable debt, level of foreign exchange reserves relatively satisfactory although declining), developments in the situation in the medium term will need to be monitored.

Uganda has seen two decades of sustained economic growth (6.3% on average in the 1990s and 7.5% in the 2000s). This significantly improved its socioeconomic indicators up until 2010. However, the progress made since is not sufficient and the country no longer stands out from its peers (Tanzania, Rwanda, Kenya). Continental GDP per capita convergence has also reached a standstill. With GDP per capita at USD760 (Atlas method), Uganda is still a low-income country. After falling sharply from 63% in 1993 to 36% in 2012, the extreme poverty rate has levelled off at around 40% in the recent period. In a context of strong demographic pressure (+3% per year), the integration of young people into the labor market is also a major challenge: the country will need to create 600,000 jobs a year until 2030, then one million until 2040.

Uganda's economic growth remains dynamic

Following a mild recession in 2020 (-1.3%), Uganda's economy rebounded in 2021 (+6.0%), boosted by public and private investment. Growth was more moderate in 2022 (+4.9%), due to a slowdown in agricultural activity and consumption. The level was, however, above its potential (4% according to the IMF). It has gathered pace again in 2023 (+5.7%), largely thanks to an upturn in agricultural production and the development of oil infrastructure.

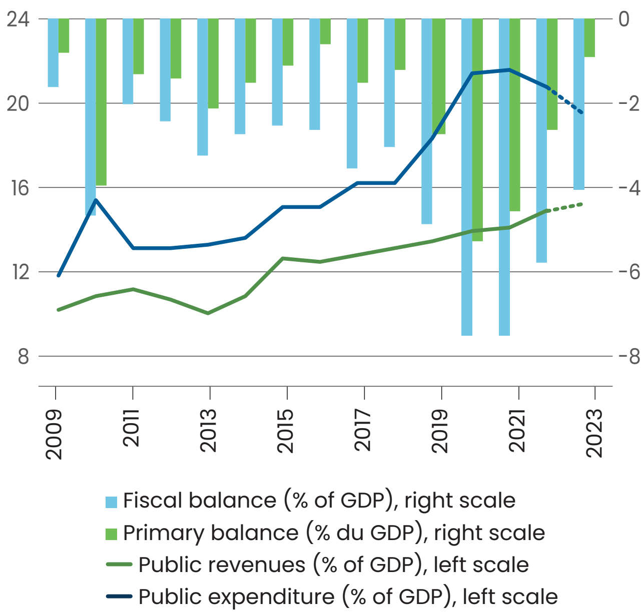
In the medium term, growth is expected to benefit from the Lake Albert oil project, whose commissioning is scheduled for 2025. The project, which is implemented by Total and China National Offshore Oil Corporation (CNOOC), comprises two operating sites and a 1,443 km heated pipeline (East African Crude Oil Pipeline Project), which will transport crude oil to Tanga Port in Tanzania for its export. While the IMF estimates that this should increase the country's growth by 7% on average between 2025 and 2027, this project is widely criticized for its impact on the environment and human rights (population displacements, operating site partly located in Murchison Falls National Park, etc.).

Growing pressure on public finances, despite the IMF program…

The level of public revenue remains low (15% of GDP), even compared to peer countries. This is due to significant crowding-out effects related to informality and a relatively inefficient tax revenue mobilization in the formal sector, although it is improving. The capacity of the authorities to implement public policies and the large-scale infrastructure projects launched as of 2012 is limited by significant absorption constraints, leading to an under-execution of the budget. The increase in current expenditure to address the Covid-19 crisis has widened the budget deficit, which reached 7.5% of GDP in both 2020 and 2021 (against 3.3% of GDP on average for 2015-2019). It declined to 5.8% of GDP in 2022, despite a further increase in the interest burden (at 23% of revenues, against 13% on average for 2012-2020).

The USD 1 billion three-year Extended Credit Facility (ECF) signed with the IMF in June 2021 supports fiscal consolidation, which should gradually allow the deficit to come back to its pre-crisis level. However, delays in the program reviews reflect the difficulties in achieving the targets. Indeed, the second review, scheduled for June 2022, was only approved in January 2023, together with the third review.

Graph 19 – The increase in the debt burden weighs on fiscal consolidation



Source: IMF (WEO)

Public debt increased sharply between 2010 and 2021, before levelling off at 51% of GDP in 2022 (+13 pp in three years). 60% of public debt is held by non-residents (mainly in foreign currency), but it remains largely concessional and long-term. However, in recent years, the Ugandan Government has increasingly resorted to borrowing on the domestic market and from external commercial creditors, under less favorable terms (high interest rates, short maturities), which explains the increase in the interest burden.

Monetary policy tightening creates an additional burden by increasing the cost of domestic debt. Indeed, the Central Bank increased its key interest rate four times between June and October 2022, by a cumulative 350 basis points to 10% (the rate remains unchanged), in order to alleviate inflationary pressures. Inflation accelerated sharply at the beginning of 2022 and peaked at 11% year-on-year in October. It has slowed since the beginning of the year and stood at 6.2% in May 2023. The Central Bank expects it to return to the target (5%) in the course of Q3 2023.

To alleviate pressure on public finances, the Central Bank conducted two debt conversion operations (extension of maturity but with a higher coupon) at the beginning of 2023, targeting private creditors holding government bonds maturing in April 2023. In this context, between November 2022 and March 2023, the main rating agencies revised the outlook associated to Uganda's sovereign rating (B2 according to Moody's, B according to S&P and B+ according to Fitch), from "stable" to "negative".

...with an additional risk for the external position

The current account deficit is structurally high (5.7% of GDP on average between 2010 and 2019) and has widened further as a result of the Covid-19 crisis, to over 8% of GDP in 2021-2022. The IMF estimates that it will increase again in 2023 to over 10% of GDP, in view of the significant increase in imports related to the oil project. This substantial current account deficit contributes to a high external financing requirement (EFR) (11.5% of GDP in 2022). The EFR is expected to remain at a high level in the medium term, in particular due to the continuation of the oil project and a significant external debt servicing. It is only partly covered by FDI and financing from international donors (at about 3 and 2% of GDP, respectively). The EFR lever increases the downward pressure on the Ugandan shilling, which depreciated by 5% against the dollar in 2022 and by almost 2% since the beginning of the year.

There has been a significant increase in the external debt since 2014 (+18 pp), but it is still relatively contained at close to 45% of GDP in 2022. The IMF expects it to remain at this level in the medium term. This debt is mainly held by the public sector (70%) and on concessional terms. Foreign exchange reserves, which have remained relatively stable in recent years through support from international donors, have fallen due to the increase in imports and the external debt service. They stood at USD3.6 billion in April 2023, equivalent to 3.8 months of imports of goods and services (against USD4.3 billion, 4.6 months of imports, at the end of 2021). This is close to the minimum level recommended by the IMF (4 months of imports), but below the convergence criteria of the East African Community (set at 4.5 months of imports).

Rwanda: UMIC by 2035, an ambitious objective

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Over the last two decades, Rwanda has achieved spectacular progress, illustrated by a strong economic growth dynamic, good political governance, and a significant improvement in the standard of living. Driven by a proactive political approach and public investment, the country's development trajectory is now undermined by a series of external shocks suffered since 2020. The objective of becoming an upper-middle-income country (UMIC) by 2035 appears optimistic in view of the more limited fiscal space and financing sources.

A small country at the heart of the Great Lakes region, led by authoritarian governments, Rwanda emerged weakened after the genocide in 1994. It was followed by the reconstruction of the country, conducted through the coming to power of the Rwandan Patriotic Front (FPR) and its co-founder Paul Kagame, which drove the compound annual growth rate (CAGR) to 8.2% between 2000 and 2010. The improvement in governance and living conditions subsequently brought the CAGR to 7.4% until 2019. Rwanda has now become one of the most attractive countries in Africa. However, its development ambitions are hampered by its structural weaknesses and the successive shocks since 2020, as shown by the sharp deterioration in public and external accounts and the recent decline in the standard of living. The country must work towards finding new sources of growth and financing, otherwise it will need to redefine its objectives.

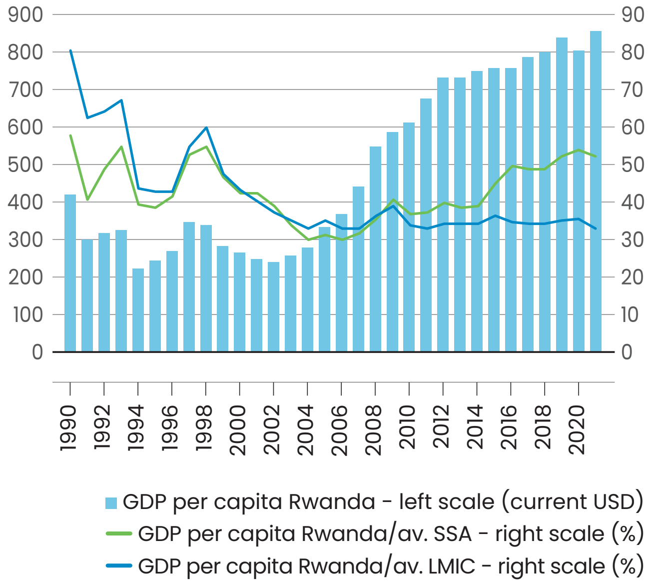
A model example of development in Africa which appears to be losing steam

Rwanda's success is due to the interventionist role of the State through its development plans (Vision 2020, Vision 2050), supported in part by Official Development Assistance (ODA). Its national development strategy is based on the promotion of investment and entrepreneurship, technological innovation, the improvement of living conditions and a green growth strategy. Launched in 2000, the objective of Vision 2020 was for the country to become a middle-income country (MIC). It may not have achieved the status in the end, but the economic and social spheres have experienced radical changes.

With the acceleration of investment (increase in gross fixed capital formation from 12% to 25% of GDP between 2000 and 2019), including FDI, Rwanda has experienced a sectoral transformation. The predominantly rural economy, focused on agriculture, has diversified and shifted towards the service sector with the development of trade and related services (transport, tourism, aviation sector, international conferences and events). The service sector now accounts for 50% of GDP, and almost 30% of employment. But agriculture remains important (24% of GDP, 55% of employment), while industry is developing (20% of GDP, 19% of employment). State interventionism has also improved the HDI, which increased from 0.319 in 1990 to 0.534 in 2021 (165th out of 191 according to the United Nations Development Programme). Life expectancy at birth increased from 48 to 66 years over the same period. Household consumption has also contributed significantly to the growth dynamic. Rwanda is determined and, through Vision 2050, is now seeking to become an UMIC by 2035 (GDP per capita above USD 4,466), and a high-income country (HIC) by 2050 (GDP per capita above USD 13,845).

While its governance indicators exceed those of UMICs, Rwanda's ambitions of becoming a financial, technological and commercial hub come up against structural obstacles: trade barriers, being landlocked, weak human capital and productivity, a large informal sector (90% of jobs), and exports dependent on world prices. Moreover, the convergence process in terms of GDP per capita is slow and held back by strong population growth (2.5% per year) which accelerates population density. The expected doubling of the population by 2050 could give rise to conflicts over land ownership and lead to a persistently low level of agricultural productivity. Climate hazards, such as droughts and floods, pose a threat to the agriculture sector and therefore to livelihoods.

Graph 20 – LMIC status still a long way off



Source: IMF (WEO)

These structural vulnerabilities are exacerbated by economic shocks which affect the prospects for convergence. The pandemic in 2020, followed by the impact of the war in Ukraine in 2022, have caused substantial harm which especially affects the budget of households and the State. High inflation (13.9% on average in 2022, then 19.3% year-on-year in March 2023, projected decline to 8% at the end of 2023) also prompted the Central Bank (BNR) to increase its main policy rate for the first time in ten years. It began in February 2022 and subsequent hikes led the policy rate to increase from 4,5% to 7% mid-2023. Under the de facto crawling peg to the US dollar, the Rwandan franc continued to depreciate by 4% on average in 2022 and 5% in the first half of 2023.

…as reflected by deteriorated public and external finances

Solid economic growth rates (6.8% in 2022, 6.2% projected in 2023, in line with its potential) mask structural twin deficits, as well as a sharp rise in public debt. Despite the relatively high level of public revenue (24% of GDP), close to the level of LMICs, and an increasingly lower level of dependence on grants, tax revenues may have reached a ceiling due to the income level of the population and the size of the informal sector. Public spending is high (29% of GDP), driven by capital expenditure (12% of GDP), which is essential in supporting the pace of growth. As a result, the fiscal balance shows a deficit which has been increasing for the last five years: 6.7% of GDP in 2019-2023, against 1.1% of GDP in 2000-2018. Public debt has risen considerably since 2012, after the HIPC Initiative, from 19% to 69% of GDP projected in 2023. Three-quarters of it is external and it is largely concessional, with 90% of public external debt held by bilateral and multilateral donors. But the domestic share is increasing with less favorable interest rates and maturities. Public financing need (PFN) stands at 15% of GDP, while external public debt service is low at 1%-2.5% of GDP in 2022-25. Public finances have become more sensitive to external and growth shocks. Consequently, the IMF has downgraded the risk of debt distress from low to moderate.

In terms of the balance of payments, tea, coffee and mineral exports (⅔ of total exports) are dependent on world prices and climate hazards, while imports are boosted by major infrastructure projects and construction. The current account balance is structurally in deficit and has stood at 10% of GDP on average since 2010. Rwanda continues to benefit from financial support from the IMF, the World Bank and bilateral donors (China, France). Its second and last Eurobond issuance in 2021 (USD620 million at 10-year maturity and 5.5%) refinanced the first USD400 million Eurobond issued in 2013 which matured in 2023. Furthermore, the level of foreign exchange reserves is considered adequate, covering 4.6 months of imports at the end of 2022.

However, the financing of Vision 2050 is constrained by limited internal resources and the relative decline in ODA. The objective of the authorities is therefore to attract FDI and find alternative sources of financing, in particular through the private sector which is struggling to fill the gap (high interest rates, high costs of logistics due to the country being landlocked, and lack of interest for companies shielded against competition), while continuing to manage climate risks.

Tunisia: A possible bailout by the IMF, enough for a recovery?

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While Tunisia has suffered from major macroeconomic imbalances since the 2010-2011 revolution, the situation of its public and external accounts has deteriorated significantly since the Covid-19 pandemic and the war in Ukraine. To reduce these imbalances and revive economic activity, the Tunisian authorities have been negotiating a loan with the IMF for over two years, but the negotiations are making no headway. However, as shown by the controversial results of the two previous programs, it would appear that another bailout by the IMF will only rebalance the accounts if it is backed by a program of ambitious and effectively implemented reforms. Strong political support will therefore be key.

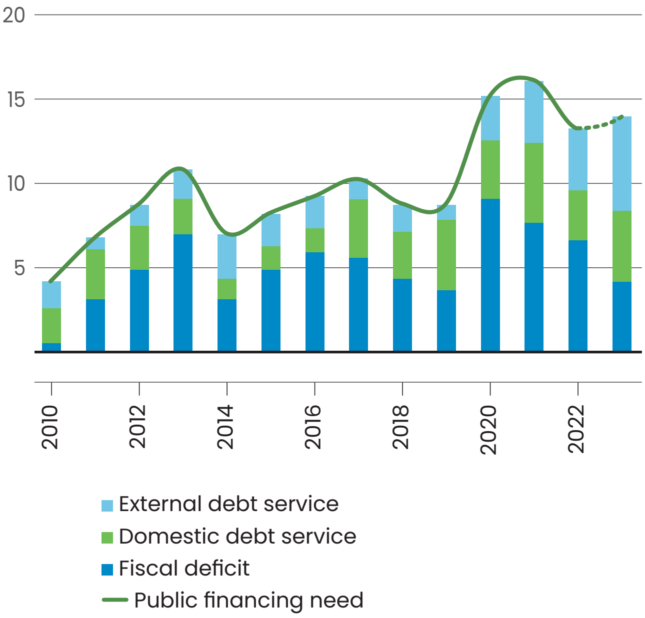
Over the last ten years, Tunisia has been experiencing a marked slowdown in its economic growth. This is due to a deterioration in the political and security situation, a fall in investment, and the decline in growth in Europe, its main commercial and financial partner. As a smal and open economy, highly dependent on fluctuations in the tourism sector (up to nearly 15% of GDP), the country was hard hit by the Covid-19 pandemic in 2020 (recession of 8.8%). The rebound in activity only reached 4.4% in 2021, then 2.5% in 2022. While growth is expected to slow further in 2023 (at only 1.6% according to the IMF), Tunisia might not return to its pre-pandemic real GDP level until 2024. The social situation is also alarming. Over the last ten years, GDP per capita (USD in PPP) has stagnated and unemployment remains at a high level, at close to 15% of the working population, especially among young people. In addition, there has been in recent months an acceleration of inflation not seen since the 1980s (close to 10% year-on-year since the beginning of 2023), along with tensions over the supply of several essential goods and a collapse in domestic cereal production (-66% year-on-year) due to drought.

Alarming imbalances in public and external accounts

Weighed down by the heavy wage bill and food and energy subsidies, and by difficulties in a number of public enterprises, Tunisia's fiscal balance reached a deficit of around 5% of GDP on average between 2011 and 2019. While the implementation of timid consolidation measures led to a slight improvement in 2018-2019, the pandemic and the increase in commodity prices have since caused a further budgetary slippage (-7.8% of GDP on average in 2020-2022). Although the decline in international prices should reduce the deficit in 2023 (to 4.2% of GDP according to the IMF), substantial debt repayments are scheduled this year, meaning the public financing needs, see graph). In addition, the coverage of these financing needsis becoming increasingly complex due to the drying up of the country's external sources of financing: de facto impossibility of issuing bonds on international markets (prohibitive market conditions) and reluctance of official donors. Consequently, the Tunisian Treasury is increasingly going to the domestic financial market, under comparatively less favorable terms, including via a "Tunisian National Bond" and syndicated foreign-currency loans from local banks (in addition to monetary financing from the Central Bank in 2020). This recourse to the local market increases the systemic risk through the sovereign-bank nexus and gives rise to a risk of a crowding out effect on credit to the private sector.

At the same time, Tunisia's external accounts are no exception. Despite a diversified export base, a dynamic tourism sector (traditionally the main source of foreign exchange) and substantial migrant remittances, the current account balance is structurally in deficit (-9.0% of GDP on average for 2011-2019). In recent years, the current account balance has successively been affected by the Covid-19 pandemic (collapse in international tourism flows), and by the surge in import prices for commodities (energy, cereals, sugar, oils, etc.). In addition to this substantial current account deficit (8.5% of GDP in 2022), significant public and private external debt repayments have increased the external financing needs to a record level in recent years, to nearly 15% of GDP in 2022. The pressure on the balance of payments is a source of concern because FDI (below 2% of

Graph 21 – Public financing needs reach record levels



Sources : Ministry of Finance (Tunisia), IMF

GDP, on a downward trend), financial markets (prohibitive conditions) and donor support - as of today - would not be enough to cover foreign-currency financing needs. Consequently, the country's foreign exchange reserves could be drained to bridge the financing gap and thereby continue to fall: following a peak at USD 8.9 billion at the end of 2020 (5.4 months of imports of goods and services), they only stood at USD 7 billion in May 2023, equivalent to 3.1 months of imports.

Need for ambitious reforms

To reduce the country's macroeconomic imbalances and revive activity, the Tunisian authorities have been negotiating a financing program with the IMF since April 2021. The various stakeholders reached a Staff-level Agreement in October 2022 over a 4-year program amounting to almost USD 2 billion. However, its conclusion is dragging on. Despite the authorities' efforts at the end of 2022 (agreement on public sector wages, increases in fuel prices), several obstacles remain, in particular concerning energy subsidies and the management of public enterprises. In addition, relations between the authorities and international donors became tense in early 2023, following the controversial declarations of President Kaïs Saïed in February about migrants from Sub-Saharan Africa, then the referral to certain IMF demands as "foreign diktats"[19] in April.

In the short term, the relative decline in international commodity prices, along with the good results for tourism flows and migrant remittances, give the country's accounts a welcome breathing space. The recent loans and grants from several partners also appear to have mitigated the urgent need for fresh funds. However, the substantial debt repayments expected in the third and fourth quarters of 2023 (almost USD 1.5 billion of repayments) raise fears of increased tensions.

However, the IMF program and the financing it would catalyze should not be seen as the silver bullet solution to all the country's macroeconomic imbalances. A 48-month IMF program amounting to almost USD 2 billion should, in particular, be compared with the levels of Tunisia's public and external financing needs, which are much higher (USD 9.7 billion and USD 7.4 billion for 2023 alone, respectively). At the same time, ambitious reforms need to be undertaken. They still need to be defined, as some of those proposed by the IMF at the end of 2022 have been rejected by the authorities to some extent. In light of the difficulties and delays encountered during the two previous IMF programs (2013-2015, then 2016-2020), such reforms will in any case require strong political support to ensure their effective implementation.

19 *Jeune Afrique*, 7 April 2023.

Brazil: Beware of own goals

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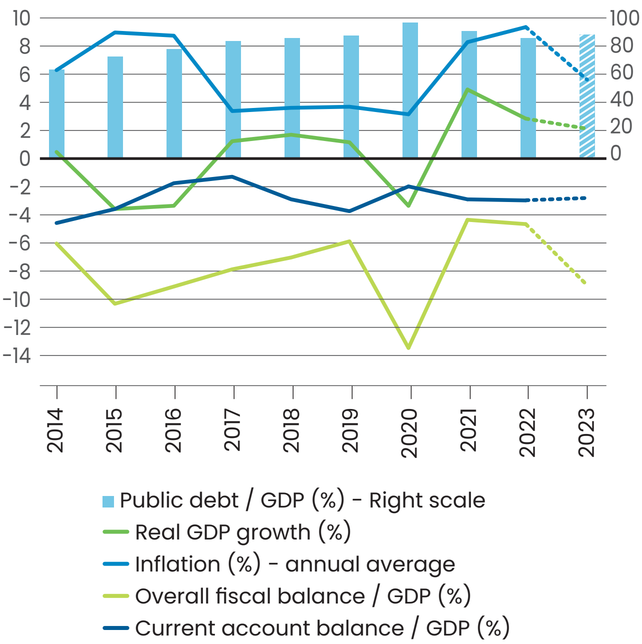
Lula's return to power in early 2023 marks a renewed defense of multilateralism, democratic institutions and the fight against climate change. However, the proactive social policy he intends to carry out will need to be combined with a prudent policy mix. This will include respecting the new fiscal rule. Above all, to avoid any risk of challenging the independence of monetary policy and a de-anchoring of inflation expectations, the Government's repeated attacks against the Central Bank will need to be more restrained. A more peaceful situation would thereby enable the implementation of the reforms required to revitalize a currently flagging economic model.

"Is this country doing well? Is this country growing? Are people's lives improving? No. So, I want to know what independence was good for,"[20] said Brazilian President Luiz Inácio Lula da Silva ("Lula") in February, referring to the law on the autonomy of the Central Bank of Brazil (BCB), voted in 2021 under the administration of his predecessor, Jair Bolsonaro. By openly attacking the BCB and its President, Roberto Campos Neto, Lula and his Government want to push for interest rates cuts and thereby show their determination to revive economic growth which is expected to be moderate in 2023 (IMF projections at 2.1%). But this strategy could turn out to be counterproductive.

Graph 22 – Main economic aggregates



Source: IMF (WEO)

Lula returns to power in a changed Brazil

During his first two terms (2003-2010), the proactive redistribution policy of the Lula Governments, favored by the commodity supercycle, enabled more than 30 million Brazilians to join the middle class. Twelve years later, Lula has returned to power in a significantly changed Brazil. The country has experienced a succession of crises, both political (protests in 2013, impeachment of Dilma Rousseff in 2016 for manipulating government accounts, scandals over the "Lava Jato" anti-corruption operation) and economic (cumulative GDP contraction by 7% over 2015-2016, Covid-19 crisis), seriously undermining the gains of the 2000s. Average growth of 3.4% during the 2000s has thereby given way to potential growth of 1.5-2%. Income per capita in 2022 returned to its 2007 level. And the administration of Bolsonaro, a far-right president as populist as he is unpredictable, has deepened the polarization of an already divided country. For Lula, restoring unity will require improving the standard of living of the population, as he did when he first held the reins of power. His strategy to revive growth through a demand-side policy, and therefore by stimulating consumption and investment, does not sit well with high interest rates.

20 Financial Times, "Lula's Attacks on Brazil Central Bank Alarm Investors", 11 February 2023.

Pressure on the Central Bank and risk of de-anchoring inflation expectations

To counter the inflationary pressures which returned at the end of 2020 (rebound in domestic demand, beginning of the rise in commodity prices, bottlenecks, weakness of the real), since March 2021, the BCB has been pursuing a very restrictive monetary policy. A step ahead of most other economies, in particular advanced economies, the tightening by 1,100 bp between March 2021 and August 2022 raised the key interest rate to 13.75%, a level at which it has stabilized. With a fall in inflation from 12% in April 2022 to 3.9% in May 2023, the real interest rate now stands at almost 10%, one of the highest levels in the world. This restrictive policy is expected to hamper growth in 2023, enraging the Brazilian President. "Does Campos Neto want to achieve European inflation standards? We have to reach a Brazilian standard. An inflation rate of 4.5 per cent in Brazil, of 4 per cent, is a good thing if the economy is growing,"[21] said Lula in a further outburst during one of his speeches at the beginning of the year. However, these statements against an institution recognized for its seriousness and credibility could turn against Lula. Firstly, the possible return of State interference in monetary policy has spooked the markets, concerned about a de-anchoring of inflation expectations, which could have a much more lasting impact on economic stability than high rates. Secondly, assuming Lula is heard, excessively premature monetary easing could result in a rapid return to rising inflation, which would make it difficult to control and would again contribute to de-anchoring expectations. Finally, if the BCB remains cautious, it is also because it is keeping a close eye on Lula's new fiscal policy, which is an additional source of concern.

A new fiscal rule ultimately reasonable

Lula is eager to increase public spending. During the election campaign, he said that he wanted to abandon the fiscal rule in force since 2017, which he considered to be too stringent. The rule, which capped the annual increase in public spending at the level of inflation, had allowed Brazil to restore a certain level of credibility in terms public financial management. While Bolsonaro had already undermined this credibility in 2022 by bending the rule to increase welfare benefits, Lula seemed ready to go further to raise public spending. This prompted fears of further fiscal slippages and, consequently, an increase in the cost of an already high public debt (86% of GDP at the end of 2022). In the end, none of this is likely to happen. A new fiscal rule, presented in early April 2023, will allow for a more flexible increase in spending, but will limit its procyclical nature, while aiming to achieve equilibrium in the primary balance (new anchoring). Despite its complexity, the new rule should avert the risk of fiscal slippage. In this context, the BCB should now have more reassurance to start easing monetary policy when inflation is closer to the target (3.25%), probably as of Q4 2023. And Lula may then tone down his rhetoric against the BCB.

Rethinking the Brazilian model

Assuming the monetary and fiscal hobbyhorses have been settled, Lula will have to bear in mind that economic recovery will also and above all require a redefinition of the Brazilian model, an economy which is currently caught in the middle-income trap. The objectives of reviving public investment in infrastructure and mobilizing the Public Development Bank (Banco Nacional de Desenvolvimento Economico e Social, BNDES) to support the industrial policy are interesting leads. But it will especially be necessary to reduce the "Brazil cost",[22] assessed in 2022 at EUR300 billion (equivalent to ~20% of GDP) per year. The complexity of the tax system, the legal and regulatory environment, along with the skills mismatches in the labor market, account for the bulk of the Brazil cost. The reforms to reduce this cost, initiated through the Mais Brasil plan under Bolsonaro, will need to continue, otherwise Lula risks disappointing his voters. The fact that Brazil will continue to benefit from a form of natural rent in the coming years gives grounds for hope: the inflow of FDI, attracted in particular by the size of the Brazilian market, is likely to continue (3.1% of GDP in 2022), with positive benefits in terms of growth and accumulation of foreign exchange reserves (over 10 months of imports of goods and services), the sign of a strong external position.

21 *Ibid.*

22 Additional production cost for Brazilian companies compared to the average cost for OECD countries.

Mexico: Never-ending emergence

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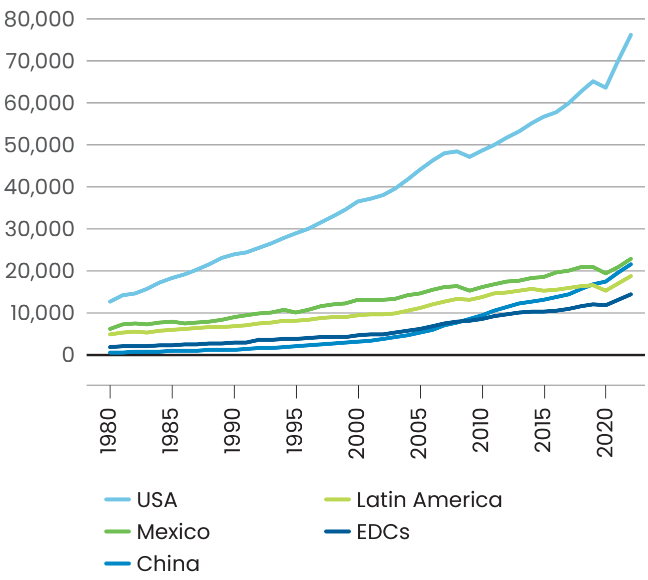
Almost 30 years after joining the North American Free Trade Agreement (NAFTA) and the OECD (1994), Mexico remains caught in a middle-income trap. The economic model based on the triad of policy mix, economic liberalism and ties to the USA, without comprehensive reforms and a welfare state, has failed to achieve the convergence with advanced economies. Faced with the succession of exogenous shocks since 2020, the mantra of macroeconomic stability reduces liquidity and public and external solvency risks. However, the confrontational approach of President Andrés Manuel Lopez Obrador ("AMLO") towards the business community and his concern to protect national sovereignty over natural resources complicate the equation of economic growth – oil – public finances – development – energy transition.

At the forefront of the emerging crises in the 1980s-1990s, Mexico experienced its biggest ever recessionary shock in 2020 (-8%) without any substantial macroeconomic destabilization. This does definitely reflect a flexible and resilient economy, but also the minimal countercyclical measures taken, mainly involving direct transfers to disadvantaged people in the absence of social safety nets. The Mexican economy is faced with a duality in four respects: i/ between exporting and domestic sectors, ii/ between formal and informal labor, iii/ between the North and the South, and iv/ between economic liberalism and protectionism-Statism. While in 2022 the earned income of 38.5% of Mexicans was below the cost of the food basket *(Consejo Nacional de Evaluación de la Política de Desarrollo Social, CONEVAL)* and inequality remains high (Gini index of 45.4 in 2020), social demands are lower than in a number of Latin American countries. This is in particular due to the positive (but overestimated) perception of social mobility, like the North American neighbors. President AMLO remains popular faced with a dispersed opposition, but he will not be able to run for a second six-year term in July 2024.

Prosperity constrained by the economic model and ideological dogmatism

Mexico's real GDP growth did not exceed the level seen in developed countries on average between 2003 and 2022. It stood at 1.8%, against 5.3% for emerging and developing countries (EDCs). The rebound in activity was disappointing in 2021 (+4.8%), adversely affected by supply chain shortages, the restrictive policy mix, and the slow progress in vaccination. In 2022, GDP had still not returned to its pre-pandemic level (+3.1%), despite the strong performance of consumption, investment, job creations, exports, tourism revenues and remittances. The loss of real wages and the restrictive monetary policy point to a slowdown in 2023, against the backdrop of a banking system under stress and the specter of recession in the USA. Real GDP growth could reach 2.6% in 2023 before slowing down in 2024 in the wake of the USA, to be below its potential level estimated at around 2%.

Graph 23 – GDP per capita
(current USD in purchasing power parity)



Source: IMF (WEO)

The Mexican economy is trapped in a model of low-wage workshops and an adjustment variable of the North American market. In 2022, 88% of Mexico's exports was manufactured goods, mainly to the USA (82%), but it has not gained market share there (14% in 2022) since the outbreak of Sino-US trade frictions in 2018. The prospects of nearshoring created by the reconfiguration of global value chains and President Biden's USD369 billion plan for business subsidies represent a windfall for Mexico. Its capacity to attract high-potential sectors with high local added value (e.g.: electric vehicles) will be critical to sustain the current account balance (-1% of GDP in 2022), economic growth and employment in the medium term.

There is still a gap between the two neighbors in terms of productivity, technical progress and human capital. Despite dynamic FDI flows (USD35.3 billion in 2022, or 2.4% of GDP) in the industrial sector, including Chinese firms, the investment ratio (GFCF) did not exceed 21% of GDP on average in 2018-2022, against 23% of GDP in advanced economies and 33% of GDP in EDCs. The investment climate and contract compliance are insecure, as it is the case with the unraveling of the 2014 energy reform, opening the sector to private and foreign investors and the "forced buyback" of the Spanish company Iberdrola's assets in April 2023, akin to a nationalization. Faced with the financial and technical difficulties of Petróleos Mexicanos (PEMEX), a public monopoly since 1938, oil production has dropped by half since the peak of 2004 (stable since 2019 at 1.7 million barrels per day). Mexico has consequently fallen from the 5th to 12th place in the world and become a net oil importer. The new mining code favors the public sector for exploration and reduces the duration of concessions from 50 to 25 years, jeopardizing some USD 9 billion of potential investments *(Cámara Minera de México, CAMIMEX)* in minerals essential for the energy transition (silver, lithium, copper, zinc, etc.).

Budgetary orthodoxy futile in the absence of reforms

The AMLO administration follows the long tradition of budgetary discipline established since the crisis of 1994-1995. The public deficit has remained under control, at 4% of GDP on average in 2020-2022, and the IMF forecasts a return to the fiscal rule of 3% of GDP in 2024, which should be facilitated by the reduction of energy subsidies. The public debt ratio is expected to level off at below 60% of GDP by 2028, 20 pp lower than the average of EDCs. The debt profile is relatively favorable, which limits liquidity and foreign exchange risks (⅓ foreign-currency denominated, including half contracted by PEMEX, with a long maturity). The public debt burden in relation to revenues is relatively heavy (18% in 2022-2023). However, the public financing requirement (11-12% of GDP in 2023-2027) could be absorbed by the local market, offering rate arbitrage opportunities to foreign investors, and through an active and pragmatic management of the external bond debt. Nevertheless, the sustainability of the investment grade status is undermined by PEMEX, requiring a State contribution through tax credits and recapitalizations, as well as the financing of its investments and the repayment of its debt. In this context, and faced with a very low level of consent to taxation (tax revenues limited to 13% of GDP in 2022), a major tax reform, postponed ad *vitam aeternam,* is all the more essential to finance needs in terms of social spending, education, health, pensions and infrastructure.

Monetary policy and banking system attuned

The Central Bank (BANXICO) is independent and took proactive measures back in mid-2021 to stem the inflationary pressure that existed before the Ukrainian crisis owing to supply disruptions, rebound in consumption and rise in commodity prices. Following a peak at 8.7% year-on-year in September 2022, the inflation rate slowed to 5.1% in June 2023. Expectations remain anchored with a return to the target of 3% +/-1 pp forecasted for 2024. This heralds the end of the monetary tightening cycle, following a cumulative increase in the key interest rate of 725 bp to 11.25%. The peso is fully convertible and flexible and has been supported by the substantial rate differential with the USA and the relatively good performance of external accounts. The banking sector, which is concentrated and largely owned by international banks, is conservative in its risk management. The significant intermediation margins support banks' financial and prudential ratios. Outstanding loans to the private sector, limited at 41% of GDP, and the financial support and debt restructuring measures during the pandemic, have preserved the quality of bank assets (NPL rate of 2% at the end of 2022) and mitigate the risk of excessive debt among economic agents.

List of acronyms and abbreviations

AAGR	Average annual growth rate
BANXICO	*Banco de México*
BCB	*Banco Central do Brasil*
BN	Billion
BNDES	*Banco Nacional de Desenvolvimento Economico e Social* (Brazil)
CAMIMEX	*Cámara Minera de México*
CCP	Chinese Communist Party
CNOOC	China National Offshore Oil Corporation
CONEVAL	*Consejo Nacional de Evaluacion de la Politica de Desarrollo Social* (Mexico)
COP	Conference of the Parties
EACOP	East African Crude Oil Pipeline Project
ECF	Extended Credit Facility
EDCs	Emerging and developing countries
EFR	External financing requirement
EMBIG	Emerging Markets Bond Index Global (J.P. Morgan)
EU	European Union
FDI	Foreign direct investment
FDIC	Federal Deposit Insurance Corporation
FPR	Rwandan Patriotic Front
GFCF	Gross fixed capital formation
GHG	Greenhouse gas
HIC	High-income country
IMF	International Monetary Fund
LMIC	Lower-middle-income country
NAFTA	North American Free Trade Agreement
NBFI	Non-bank financial institutions
NDC	Nationally Determined Contribution
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OPEC+	Organization of Petroleum Exporting Countries extended to 10 countries
PEMEX	Petróleos Mexicanos
pp	Percentage point
PPP	Purchasing power parity
SDGs	Sustainable Development Goals
SDR	Special Drawing Rights
SNS	*Srpska Napredna Stranka* (Serbian Progressive Party)
UMIC	Upper-middle-income country
UNDP	United Nations Development Programme
WAEMU	West African Economic and Monetary Union
WEO	*World Economic Outlook* (IMF biannual report on the global economy)
YOY	Year-on-year

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