August 28 2023
Vol 29 Issue 32

Emerging Markets Monitor

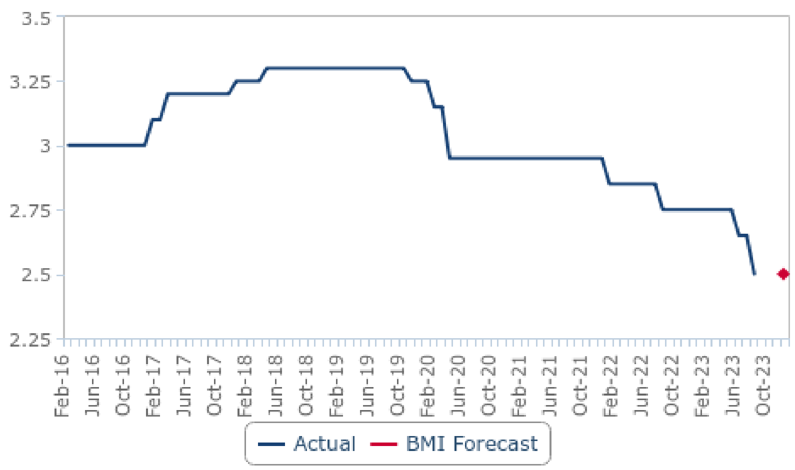
Mainland China: Further Cuts To The MLF Rate Unlikely

Key View

- The People's Bank of China unexpectedly lowered two of its key policy rates on August 15, but the financial stability risks associated with extensive loosening are likely to probably prompt the central bank to stand pat for the rest of 2023.
- Policymakers have a variety of tools at their disposal with which to ease policy without having to cut the MLF further.

MLF Rate To Be Kept Unchanged In 2023

China (Mainland) – One-Year MLF, %



Source: Macrobond, BMI

continued on page 2

Sri Lanka: Economy Will Return To Growth

We expect the pace at which Sri Lanka's economy is contracting to slow to 1.0% in 2023, and output will rise by 3.0% in 2024. While inflation eased in early 2023, real incomes remain weak and industrial production faces a slow recovery.

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Ukraine: Reforming And Rebuilding

Despite our view that Ukraine will be more successful at meeting reconstruction objectives than many other post-war countries, we do not expect the economy to return to its pre-war size until 2031.

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Morocco: One More Rate Hike In H223

We now expect that the central bank will hike its policy rate by 50bps to 3.50% in September and hold it in December as inflation continues to decelerate and domestic demand remains relatively sluggish.

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ISSN: 1359-0006

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Copy Deadline: August 24 2023

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- Risks to our current interest rate forecast are skewed to the downside and are heavily dependent on the health of the economy.

In a surprise move, the People's Bank of China (PBoC) loosened monetary conditions further on August 15 2023, marking the second round of cuts in three months. Policymakers injected CNY204.0bn through a seven-day reverse repurchase operation, concurrently reducing the policy rate by 10 basis points (bps) to 1.8%.

Additionally, the PBoC lowered the one-year medium-term lending facility Rate (MLF) by 15bps to 2.50%, while at the same time injecting CNY401.0bn worth of MLF loans into the banking system.

On August 21 2023, the PBoC cut its one-year loan prime rate (LPR) by 10bps to a record low of 3.45%, as we had expected. The surprising development was that the five-year LPR, which is used to determine mortgage rates, was left unchanged at 4.20%.

The PBoC's latest monetary policy decision was driven by concerns about the health of the economy as it slides into deflationary territory.

This comes on the back of the 3.7% y-o-y growth print for industrial production in July 2023, which missed consensus expectations of 4.4%. Similarly, the slowdown in retail sales growth to 2.5% y-o-y in July was weaker than consensus expectations of 4.5%.

In addition, Mainland China's economic challenges are being further compounded by renewed stress in the property sector as major China-based developer **Country Garden** is facing a cash crunch and is now looking to extend a maturing bond as a result.

This could weigh further on investor sentiment, potentially exacerbating a cumulative 8.5% y-o-y (January-July) contraction in real estate investment. **Despite these mounting economic challenges, we think that cuts to the MLF rate have concluded due to three reasons.**

First, maintaining currency stability will be a major constraint to any further aggressive easing. As a consequence of continued policy divergence in monetary policy between the US and Mainland China, the spread between US and Chinese government bonds has widened to a figure of around 160bps, the largest since 2007. This has exerted significant downward pressure on the Chinese yuan. The currency has already depreciated by about 5% against the greenback in 2023 and is currently trading near its one-year low of CNY7.33/USD.

We think that the Chinese policymakers are likely to exercise caution to avoid excessive loosening as it could result in

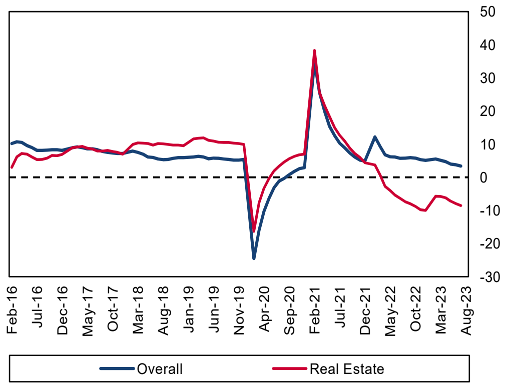
Challenges In Country Garden...

China (Mainland) – Country Garden Share Price, HKD

Source: Bloomberg, Macrobond, BMI

...Will Weigh On Real Estate Investment

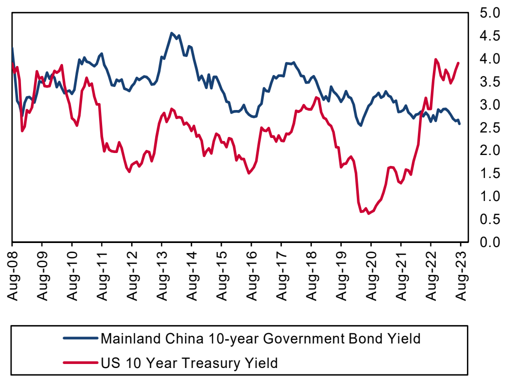
China (Mainland) – Year-To-Date Fixed Asset Investment, % y-o-y



Source: Bloomberg, Macrobond, BMI

Widening Bond Spread Between Mainland China And US...

Selected Markets – 10-Year Government Bond Yields, %



Source: Macrobond, Bloomberg, BMI

2023 MONETARY POLICY OUTLOOK

	Forecast	Notes
Policy rate, eop	2.50%	We think that the PBoC will stand pat for the remainder of 2023.
Inflation, avg	0.6%	We expect inflation to remain below the PBoC target of 3.0% for the rest of 2023.
Real GDP growth	5.2%	Real GDP growth will rebound from 3.0% in 2022 as the economy recovers from Covid-19 pandemic lockdown-induced weakness. However, recent activity data pose downside risks to our forecast.
Exchange rate, eop	CNY7.10/USD	Continued monetary policy divergence will lead to depreciatory pressures on the currency.

Source: BMI

unwanted weakness for the currency. The Chinese authorities have stepped up their support for the yuan by setting its strongest reference rate since October 2022 before the recent monetary policy announcement.

This could be taken as a sign that they are reluctant to see the yuan weaken significantly again.

Second, we believe that the PBoC frontloaded its interest rate cuts, taking into consideration that this might take some time to feed through to the economy. Moreover, the Chinese authorities have taken a cautious approach to easing measures.

We expect that this will continue given the authorities' focus on maintaining financial stability. Even though the recent 15bps reduction in the MLF rate is the most substantial since 2020, we believe that the government's appetite for extensive stimulus is limited.

This restraint stems from concerns that substantial stimulus could exacerbate financial imbalances, which policymakers have been actively working to address for several years.

Third, policymakers could turn to other monetary instruments if additional modest easing is needed. For instance, they could consider lowering the reserve requirement ratio (RRR), which would in turn have a more direct impact on liquidity and lending.

The range of instruments available means that policymakers do not have to necessarily reduce the one-year MLF rate for marginal adjustment.

Such moves can often be interpreted as a signal for more upcoming monetary stimulus, making its impact on the market more significant. Cuts to the MLF rate are often accompanied by subsequent cuts in the LPRs

Considering our outlook beyond 2023, we see the possibility of interest rate hikes.

Chinese policymakers will seek to bolster the Chinese yuan by narrowing the interest rate differentials, which have shifted in favour of the US since the Federal Reserve started hiking interest rates back in 2022. However, if a tightening cycle were initiated prematurely, it could in turn potentially exacerbate economic weakness.

We note that there are many uncertainties surrounding Mainland China's economic trajectory.

As a result, we think that any interest rate increases will only be introduced in the latter half of 2024 once economic conditions have stabilised.

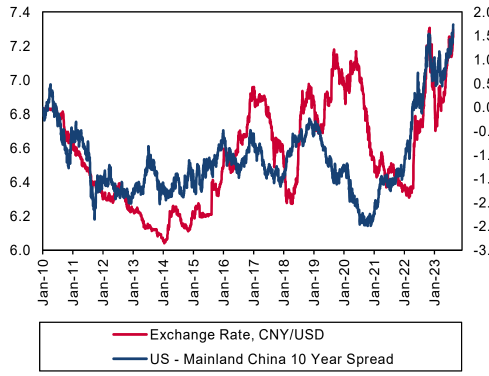
Risks To Outlook

The risks to our interest rate forecasts largely hinge on the trajectory of the economic recovery.

A poor showing in Q3 2023 (the government has a full-year target of 5.0%) would prompt policymakers to enact another round of monetary easing in Q4 2023 in order to try shore up the economy.

...Weighing On The CNY

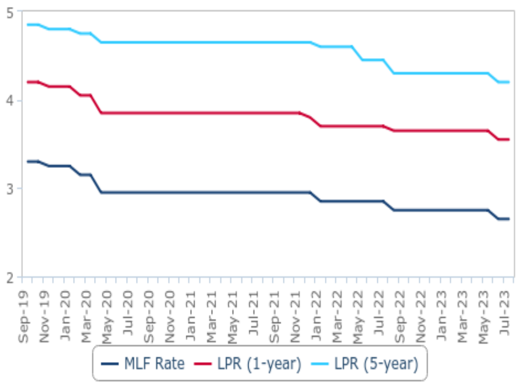
Selected Markets – Spread Of US Bond Yields & Exchange Rate (RHS)



Source: Macrobond, Bloomberg, BMI

LPR Cuts Follow Shortly After

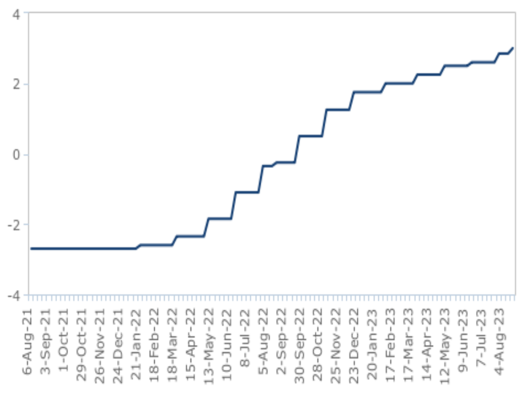
Mainland (China) – Policy Rates, %



Source: Macrobond, BMI

Interest Rate Differentials Have Widened

China (Mainland) & US – Interest Rate Differentials, %



Source: Macrobond, BMI

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Print Deadline: August 25 2023

BMI SUGAR PRICE FORECAST (USC/LB, AVE)	Current	2022	2023 ytd	2023	2024	2025	2026	2027
BMI	24.0	18.6	22.6	22.7	19.0	17.5	16.0	16.0
Bloomberg consensus	na	na	na	22.7	19.5	19.4	20.7	20.7

Note: Second-month ICE sugar prices. BMI contributes to Bloomberg consensus. na = not applicable. Source: Bloomberg, BMI. Last updated: August 14 2023

Sugar: Prices Ease Only Minimally Due To El Niño Concerns

Key View

- We maintain our 2023 average sugar price forecast at USc22.7/lb, requiring prices to average between USc22.0-23.0/lb for the remainder of 2023.
- Global sugar prices will be sensitive to El Niño developments. On June 8 2023, the US National Oceanic and Atmospheric Administration's Climate Prediction Center declared the emergence of El Niño, with their projections indicating a strengthening El Niño over the coming months and a 95.0% probability of El Niño continuing to December 2023 and through to February 2024.
- Weather concerns are driving sugar prices at the moment, and the diversion of sugarcane to ethanol production is adding to worries over supply.

Short-Term Outlook

We maintain our 2023 average sugar price forecast at USc22.7/lb, requiring prices to average USc22.0-23.0/lb for the remainder of 2023. As of August 16 2023, second-month #11 global sugar prices are trading at around USc24.0/lb, averaging USc22.6/lb in the year to date. While prices have eased, they remain elevated. Q323 prices averaged USc24.1/lb compared with a previous average price of USc25.0/lb.

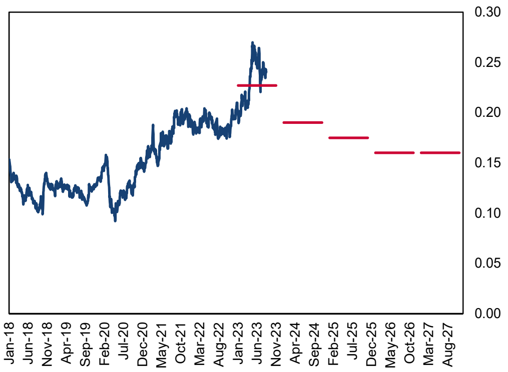
On the one hand, adverse weather conditions throughout significant sugar producers, most notably India, have triggered a series of downward revisions to global production forecasts. The US Climate Prediction Center declared an El Niño climate on June 8 2023, and concerns around this continue to provide support for prices. On the other hand, the strength of the Brazilian sugarcane harvest, which began in May and is ongoing, has benefited from largely favourable weather conditions and has partially eased concerns over global supplies, weighing on prices and capping further upward momentum.

On the supply side, we forecast Brazil's production at 38.1mn tonnes for 2022/23, representing a 7.6% y-o-y increase, which we expect to weigh on global prices as the harvest progresses in the world's largest producer. So far, Brazil's harvest has progressed with weather conditions supporting a robust level of output. That said, El Niño is expected to strengthen over the coming months, which could slow down harvest progress and threaten the crop that is still to be harvested. Looking at Brazil's sugar output during the last El Niño, 2015/16 output was down by around 8% compared to the non-El Niño affected year of 2013/14, with a significant number of sugarcane fields reported to have gone unharvested due to the heavy rains of El Niño.

The potential for this to be repeated adds downside risks to our forecast for Brazil's sugar production. Given that our global production balance currently indicates a surplus of 6.9mn tonnes, a El Niño as strong as or worse than the one in 2015/16 could trigger downward revisions that would see our forecasts of a

Sugar Prices Pull Back From 11-Year Peak But Remain Elevated

Global – Sugar Second-Month Futures, USD/lb



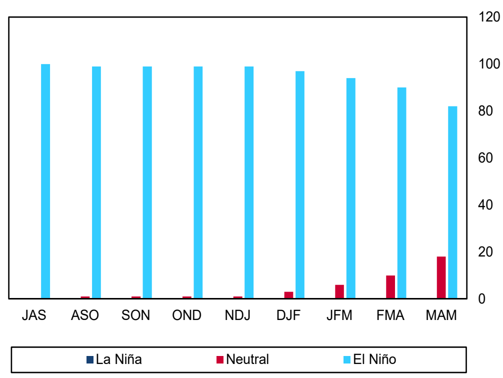
Note: Red horizontal lines show BMI forecasts. Source: Macrobond, BMI

relatively healthy surplus become a forecast of a global production deficit.

For India, generally a climatic shift to El Niño brings about below average precipitation levels during the monsoon season. In 2015/16, India's domestic sugar production declined sharply, falling by around 10% y-o-y. India's 2022/23 harvest faced repeated challenges, even prior to the emergence of El Niño. If El Niño significantly reduces monsoon rainfall, we expect that India's crop schedule will be affected, which will pose a significant risk to the country's output in 2023/24.

El Niño Set To Persist Into 2024, Posing A Downside Risk To Global Production

Global – Official NOAA CPC El Niño Southern Oscillation Probabilities, %



Source: Climate Prediction Center, BMI

Similarly, El Niño increases the risk of inadequate precipitation in other important Asian markets, including Thailand, where output was also curbed by around 10% in 2015/16. While the effects of El Niño on sugar production over the coming months remain unknown, fears of a potential supply crunch are ensuring that demand remains robust.

Although weather concerns are primarily driving sugar prices at the moment, the diversion of sugarcane to ethanol production is adding to supply concerns. In India, elevated domestic ethanol prices have encouraged the diversion of sugar cane towards ethanol production rather than sweetener, with the Indian government planning to increase the biofuel blend from 10% to 20% by 2025. The Indian Sugar Mills Association said that it expects India's sugar mills to divert 4.5-5.0MMT of sugar to ethanol production in 2022/23. In Brazil, higher gasoline taxes incentivise the allocation of sugarcane for ethanol production instead of sugar crushing, decreasing supply from the world's top producer. As a result, we expect to see both markets increasingly divert sugar cane to biofuel production, away from sweetener production, placing a floor under global sugar prices.

Regarding consumption, we expect global human consumption to reach 180.7mn tonnes in 2023/24, representing an increase of 2.4% y-o-y. This will be driven by increases in South and South East Asia and North Africa. Consumption is expected to remain flat year-on-year across the major consumers, such as India, Mainland China and the US.

Long-Term Outlook

We expect prices to ease in 2024, assuming a return of normal weather conditions. We are forecasting an average annual price of USc19.0/lb in 2024, which will gradually ease out to 2027, when we expect prices to reach USc16.0/lb.

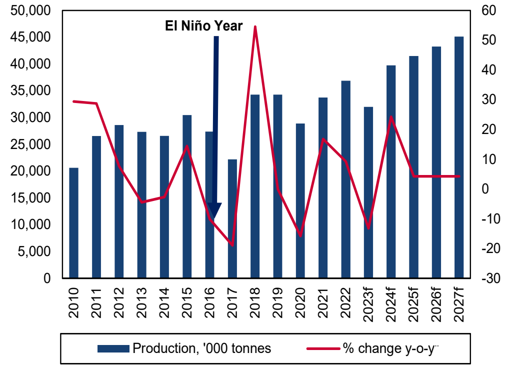
As a primary feedstock in ethanol, we note that changing government blending mandates will impact sugar prices. For example, India's commitment to reach a blending target of 20% ethanol by 2025, emphasised by a requirement for all newly manufactured cars to be E20 compatible, will continue to support prices. We are doubtful of India's chances of achieving a national average blended rate of 20.0% by 2025 due to the limited availability of surplus primary feedstocks such as sugarcane and corn, as well as the current level of distillation capacity. Despite the rapid expansion of distillation capacity, it remains short of where it needs to be. That said, blending rates and ethanol usage are expected to trend upwards, requiring increased feedstock.

In Brazil the ethanol blending mandate remains at 27.0%. While the blending mandate is unlikely to change, we believe that Brazil will make significant efforts to boost supply. Through its RenovaBio programme, which has been in place since 2019, Brazil is expected to increase ethanol supply by 45%, reaching 50bn litres by 2030, which will require the diversion of rising volumes of sugarcane.

Our view of easing prices also assumes an increase in India's export quota from 2024. India has built up a robust domestic stock level, and we expect it to grow further due to the implementation of protectionist measures and India's aim to increase its export quota for the 2023/24 cycle. However, the country's commitment to meeting ambitious blending targets will likely require it to continue to implement sugar export quotas in order to ensure adequate sugar availability for ethanol production; regardless, we expect an increase from the current level of 6mn tonnes. This will ensure an increase in the global supply of sugar and contribute to easing prices.

El Niño Poses Downside Risk To India's Production, Following Sharp Downturn In 2022/23

India – Sugar Production (LHS) & Production Growth (RHS)



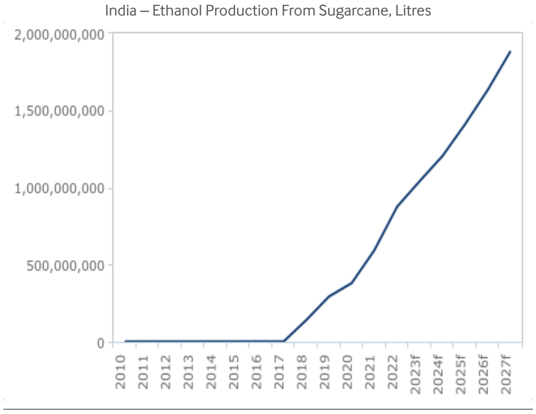
f = BMI forecast. Source: USDA, BMI

Risks To Outlook

On the upside, announcements of further expansions to blending mandates will ensure that an increasing amount of sugarcane is diverted away from sweetener production, keeping global supplies tight and providing upside support for prices. Moreover, the threat of adverse weather conditions continues to provide an upside risk to sugar prices. Our outlook for a robust Brazilian harvest is contingent on the continuation of largely favourable weather conditions as the current harvest progresses. However, a transition to El Niño poses a downside risk to our production outlook. That said, the impact on Brazilian production will depend on its strength. Lastly, further reductions to India's export quota pose an additional upside risk.

Sugarcane Ethanol Production On The Rise As Government Targets E20

India – Ethanol Production From Sugarcane, Litres



f = OECD-FAO forecast. Source: OECD-FAO, Macrobond

On the downside, we note India's efforts to use alternative feedstocks, such as corn, towards the ethanol mandate will reduce Indian ethanol producers' reliance on sugar, ensuring that Indian mills can direct sugarcane towards sweetener production. However, we expect sugar to remain the primary feedstock throughout the forecasting period due to the current level of infrastructure as well as comparatively low corn crop yields, despite this mandate. Lastly, the removal of gasoline taxes in Brazil, which have supported demand for biofuel alternatives, poses a downside risk to our price forecast.

BMI THAILAND CURRENCY FORECAST	2022	Spot	2023	2024
THB per USD, ave	35.06	34.64	33.00	32.50
THB per EUR, ave	36.87	37.88	41.96	40.63
One-day repo rate (%)	1.25	2.00	2.25	1.50

Source BMI. Last updated: August 3 2023

THB: Unit Will Appreciate As Political Uncertainty Subsides

Key View

- We expect that the baht will appreciate in H223, strengthening from THB34.50 per US dollar on August 2 2023 to THB33.30 per US dollar by the end of 2023.
- The currency will benefit from Thailand's current account returning to surplus in 2023, an improving political outlook and the end of the US tightening cycle.
- Looking further ahead, lower structural inflation relative to the US alongside persistent current account surplus will keep the currency on an appreciatory trend.

Short-Term Outlook (three-to-six months)

Since our last update, the baht has been weighed down by heightened policy uncertainty in the market and it has stayed flat against the US dollar over H123. That said, we still think that the currency will strengthen by a further 3.0-4.0% over the remainder of 2023 and we retain our forecast for the currency to reach THB33.30 per US dollar by the end of 2023. **There are two key reasons for our bullish view.**

First, the end of the US tightening cycle will provide a major pillar of support for the currency. The aggressive tightening cycle undertaken by the US Federal Reserve (Fed) was one of the main factors for the baht's steep depreciation in 2023. Interest rate hikes by the Fed weighed significantly on global risk appetite, triggering sharp outflows from risky assets, including the Thai baht. But we think that US policymakers are now done hiking, suggesting that most of the US dollar strength is now behind us. This will provide more room for the baht to appreciate.

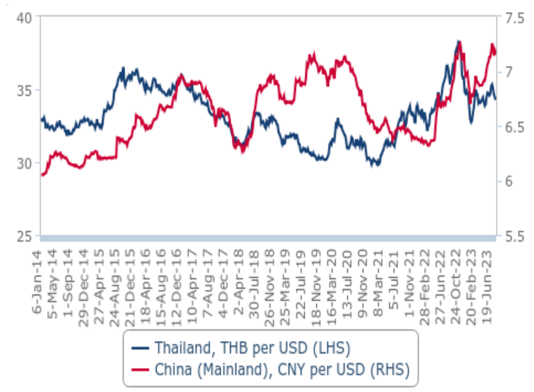
Second, an improvement in Thailand's political landscape will benefit the baht. The general elections held on May 14 2023 cumulated in a landslide victory for the pro-democracy camp. Despite the convincing win, challenges in the formation of the new government have delayed the formation of the next government. Heightened uncertainty surrounding Thailand's political situation has weighed on investor sentiment, leading to much volatility in the currency between May and July 2023. But we think that this will likely subside over the coming weeks when the new prime minister is chosen. Our core view is that the pro-democracy Pheu Thai Party will succeed in appointing its candidate as premier. If we are right, this will help bolster investor confidence, providing support for the baht.

The weak Chinese yuan will, however, keep a lid on the baht's appreciation. This limitation is due to Thailand's strong reliance on the Mainland Chinese economy, causing both currencies to move together. Mainland China is a major trading partner for Thailand, accounting for nearly 14% of its total merchandise exports and about one-fifth of its total tourists before the pandemic.

Despite the anticipation of a boost from China's reopening, the actual impact has been lacklustre so far. In the January-June 2023 period, exports to China declined by 4.0% y-o-y. Similarly, Chinese tourist arrivals have also been disappointing, reaching about 35% of 2019's levels in June 2023. We also forecast that the Chinese yuan will remain weak in 2023 which will do little to help the baht.

Strong Correlation Between Thai Baht And Chinese Yuan

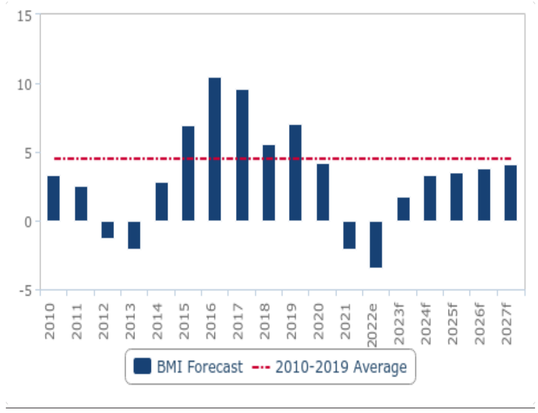
Exchange Rate, THB per USD & CNY per USD



Source: Macrobond, BMI

Current Account Will Recover Back To A Surplus

Thailand – Current Account Balance, % of GDP (2010-2027)



e/f = estimate/forecast. Source: BMI

Long-Term Outlook (six-to-24 months)

Beyond the near term, we think that the baht will appreciate gradually due to strong fundamentals. We forecast the currency to strengthen by 2.4% and reach THB32.50/USD by the end of 2024. This would bring the 2024 average to THB32.50/USD.

Large current account surpluses will lead to appreciatory pressures on the baht. Admittedly, Thailand's external sector came under pressure during the Covid-19 pandemic following the collapse of the tourism industry. Things have started to improve significantly following the easing of border restrictions in 2022. International travellers into Thailand jumped nearly three-fold from 0.7mn in June 2022 to 2.2mn in June 2023.

This is still a bit below the 3.0mn per month figure recorded in 2019, but we think that arrivals will exceed the pre-Covid level in 2024. Consequently, we forecast the current account to flip back to a surplus of 1.8% in 2023 and continue widening over our forecast period.

Lower domestic inflation relative to the US also bodes well for currency stability. Unlike its emerging market peers where price pressures rise more briskly, Thailand's inflation has historically been relatively low. We think that this trend will continue and forecast inflation to average just 1.3% in the next five years (2024-2028) as compared to the US average of 2.6%. Comparatively lower inflation will help boost Thailand's export competitiveness.

Risks To Outlook

Risks to our currency forecast are skewed towards a stronger currency. First, we are currently expecting the tourism sector to only stage a full recovery in 2024. But a faster-than-expected pick-up could bolster the currency. Second, a stronger-than-expected economic rebound (exceeding our expectations) in China could also in turn lead to appreciatory pressures on the baht.

Vietnam: Geopolitical Risks Salient, Anti-Corruption Drive Losing Steam

Key View

- We continue to expect US-Vietnam ties to strengthen further in 2023, especially following US Treasury Secretary Janet Yellen's visit in July.
- Vietnam's policymakers have been attempting to manage the geopolitical risks with Mainland China. We think that their efforts will prove successful.
- The government's anti-graft campaign appears to have lost some steam, suggesting that policymakers are wary of the negative impact that this has been having on the economy.

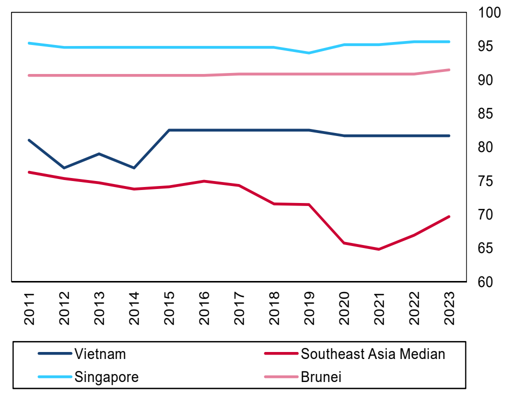
We expect that Vietnam will strengthen relations with the US without alienating Mainland China, though elevated tensions between Washington and Beijing are adding to the risks to this view. If these political risks are managed successfully, then Vietnam's reputation as a stable destination for foreign investment will become further entrenched. This would in turn allow the economy to rebound from what is shaping up to be a very weak 2023 (we forecast growth to slow sharply to 5.0%). We continue to assign Vietnam a score of 81.7 out of 100 in our Short-Term Political Risk Index (STPRI), leaving it well above the South East Asia median of 69.6 and behind only Singapore and Brunei.

We continue to think that US-Vietnam ties will strengthen in 2023. In May, we argued that the US would remain inclined to cultivate a deeper partnership with Vietnam due to the latter's strategic importance in South East Asia. More recent developments reinforce our view. On July 20 2023, US Treasury Secretary Janet Yellen visited Vietnam and told Prime Minister Pham Minh Chinh that 'the United States considers Vietnam a key partner in advancing a free and open Indo-Pacific'. This followed US President Joe Biden's diplomatic phone call in March and US Secretary of State Antony Blinken's visit to Hanoi in April.

All of this is taking place against the backdrop of simmering US-China tensions, but we still believe that Vietnam will keep its relationship with China stable. On May 18, vessels from Vietnam and China confronted each other in the South China Sea, in the region which Vietnam claims as its own exclusive economic zone. However, tensions quickly cooled off in late June due to a visit to China by Vietnam's Prime Minister Pham Minh Chinh. A joint statement was issued which reaffirmed Vietnam's and China's commitment to reaching 'a substantive and effective code of conduct in the South China Sea that is consistent with international law'.

Less Volatile Than South East Asian Peers

South East Asia – Short-Term Political Risk Index (2011-2023)



Note: Scores out of 100; higher score = lower risk. Source: BMI

We think that this is illustrative of the Vietnamese government's diplomatic abilities.

The outlook for the government's anti-graft campaign is uncertain. One key thrust of policymaking under the ruling Communist Party of Vietnam is a low tolerance for corruption. The anti-corruption drive picked up pace in late 2022, but it has also led to negative consequences for policymaking and investor sentiment. For example, anecdotal evidence reported by international media suggests that government officials have become increasingly cautious when implementing policy, as they are wary of the heavy consequences if their actions are perceived as corrupt. This is especially so following former president Nguyen Xuan Phuc's resignation earlier in 2023, which had its roots in the corruption crackdown. Another example is the arrest of a major real estate tycoon in October 2022 for alleged corrupt behaviour. This contributed to risk aversion among property investors and exacerbated the credit squeeze in the real estate sector.

It appears that policymakers have become more cognisant of these downsides. There is also the risk of the anti-corruption drive coming to a complete standstill, which would hinder or even reverse the years of progress that Vietnam has made.

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Vietnam's ranking on Transparency International's Corruption Perception Index has improved over the last decade, coming in at 77th out of 180 markets (first being the least corrupt) in 2022. The score rose from 31 out of 100 in 2016, to 42 in 2022, overtaking Indonesia, Thailand and the Philippines.

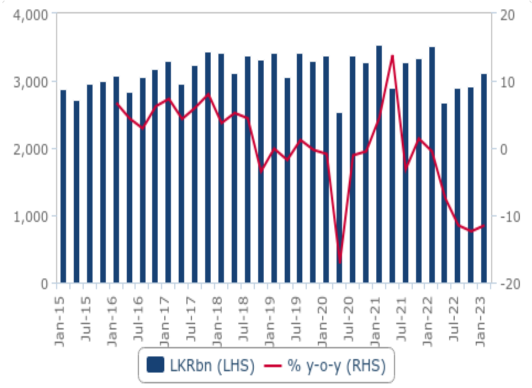
Sri Lanka: Economy Will Return To Growth In 2024

Key View

- We expect that the pace at which Sri Lanka's economy is contracting will slow to just 1.0% in 2023, and that output will rise by 3.0% in 2024.
- While inflation eased in early 2023, real incomes remain weak and industrial production faces a slow recovery. The tourism sector is picking up, but we do not expect a rapid return to pre-pandemic arrival numbers.
- Risks are weighted to the downside. A breakdown of relations with the country's creditors would cause another bout of currency weakness that would push up inflation and hit consumer confidence.

Early Signs Of Contraction Easing

Sri Lanka – Real GDP



Source: Department of Census & Statistics, BMI

We expect that the pace of economic contraction in Sri Lanka will ease to just 1.0% in 2023, and that the economy will grow by 3.0% in 2024. This is a slightly more optimistic forecast than the -1.8% consensus forecast collected by Focus Economics. We think that growth will continue to accelerate over the remainder of our 2023-2027 forecast period.

Figures from Q123 were still very poor. While real GDP picked up compared to Q422, output was still 11.5% lower than it had been a year earlier.

The year-on-year contraction was driven by industrial activities (down 23.4% y-o-y) and the service sector (down 5.0% y-o-y). This easily counterbalanced a slight pick-up in agricultural activity (up 0.8% y-o-y). Industrial sectors of the economy have faltered in recent years as a result of high input prices, low domestic demand, and a shortage of necessary components. More timely figures suggest that industrial production picked up a touch in May 2023. Even so, output remained 3.1% lower than a year earlier. This suggests that, while the drag from the industrial sector eased in Q223, it did not fully dissipate.

However, we expect that the ongoing deceleration of inflation will cause economic conditions to improve in H223. Inflation in Sri Lanka peaked at 51.7% y-o-y in January 2023 as a result of the sharp depreciation of the currency. Improved currency stability and lower energy prices, however, cut price growth to just 12.0% in June 2023. We expect that inflation will ease to 4.0% by the end of 2023 as further currency stability provides positive base effects.

Slower inflation will help domestic firms to regain competitiveness and – crucially – allow local incomes to stabilise. Figures from the Central Bank of Sri Lanka suggest that the rapid inflation of 2022 and early 2023 cut the real value of wages in the informal private sector by 21% and the value of total wages in the public sector (where nominal wages rose more slowly) by 36%. This is the key reason why consumer spending fell by 9.0% in 2022. More gradual inflation will also allow the Central Bank of Sri Lanka to continue loosening policy, which will provide another boost to consumption. Policymakers at the central bank cut their key rate from 14.00% to 12.00% in July, and we think that the key rate will drop to 10.50% by the end of 2023.

We think that private consumption will essentially stabilise in 2023, falling by just 0.7%. Public spending will fall even faster; we expect a 3.2% decline in government consumption as the authorities tighten fiscal policy.

We expect that net exports will actually cut 0.1 percentage points from headline growth. Sri Lanka's tourism sector is beginning to recover. We expect that this will continue over the coming months, though arrival numbers will remain low by historical standards. Sri Lanka has, traditionally, received a large number of Russian visitors, who may now be less able to travel. We also expect that international news coverage of the country's recent crisis is likely to deter some potential visitors.

Whereas falling consumer demand caused imports to fall 19.9% in 2022, we expect that the stabilisation of domestic conditions will cause imports to rise by 7.5% in 2023. This will essentially counterbalance the growth impact of increased tourism inflows.

We expect that conditions will continue to improve into 2024, with the economy expanding by 3.0%. Provided that the government succeeds in reaching an agreement with its creditors, we think that investor confidence will recover, which will help to boost fixed capital formation. We expect that investment will fall by another 0.5% in 2023, but rise by 4.0% in 2024. Policy will also continue to loosen, which will boost consumer spending.

While we expect that the economy will return to growth, the recovery will be slow. We think that headline GDP will remain below its 2018 peak until 2026.

Risks to this forecast are weighted to the downside. If talks between the Sri Lankan government and its external creditors break down, this would probably result in another period of currency weakness and a further bout of rapid inflation that would hit consumers hard and derail the recovery.

Given Sri Lanka's dependence on imported food and fuel, further shocks to global commodity prices also pose a serious downside risk.

Argentina: Devaluation Prompts Spike In Interest Rates, Inflation

Key View

- After a poor showing in the PASO vote, the Argentine government devalued the peso and raised its monetary policy rate from 97.0% to 118.0% to support peso-denominated assets. We expect rates will have to be raised further in 2023, to 140.0%, due to another likely devaluation and accelerating inflation.
- We forecast inflation will spike higher, ending the year at 145.0% y-o-y. Another likely devaluation in Q124 will cause a spike in the first half of 2024 but a rightward shift in economic policy should temper price growth and currency exchange rate volatility, leading inflation to 45.0% by end-2024.
- We see both upside and downside risks to our forecast. However, on balance, the risks skew to an earlier devaluation – two in 2023 rather than one in each – as a new administration may opt to devalue in December if the government's financial position deteriorates more than we currently expect.

On August 20, the Banco Central de la República de Argentina (BCRA) hiked its monetary policy rate by 2,100 basis points (bps) to 118.0%. This comes after the BCRA held the rate at 97.0% for two months, as the real effective annual interest rate of 154.2% remained above annualised month-over-month inflation. The move also keeps Argentina in compliance with its Extended Fund Facility deal with the IMF. Unlike other Latin American markets, the BCRA's motivation to hike rates is to maintain the attractiveness of peso-denominated deposits and assets. Indeed, as the BCRA itself points out, Argentina's credit channel is quite small and raising interest rates would not meaningfully slow credit or price growth.

However, this latest rate hike is unique in that it was prompted by the announcement on Monday, August 14 – the day after the incumbent's poor performance in the PASO vote – of a devaluation of the official currency exchange rate from ARS286.7/USD, where it stood on Friday, August 11, to ARS350.0/USD. The rate hike was meant to counterbalance against the weakening of the peso, by raising the rate of return for peso-denominated assets. The government has stated that the new official rate will be maintained until the elections on October 22.

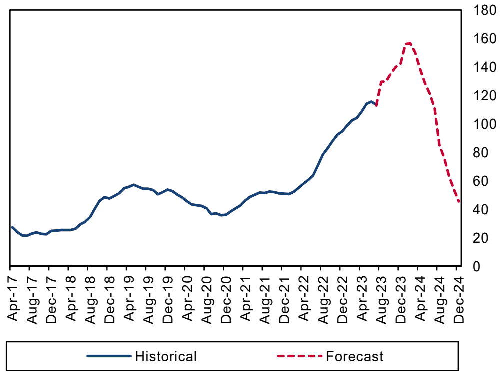
Long-Term Interest Rate Outlook

We forecast that interest rates will rise to 140.0% in 2023, as another likely devaluation after the October elections will prompt the BCRA to once again buttress against the weakening value of the peso. Exchange rate volatility and shifting political incentives have exacerbated uncertainty regarding the time and scope of another rate hike. The peso depreciated heavily on the parallel market from ARS605/USD on August 11 to a peak of ARS780/USD by end-August 16, but it had pared back some of those losses to ARS720/USD as of end-August 18. Given that the spread between the parallel and official exchange rate remains above 100%, we believe another devaluation is likely to occur in November.

Political considerations are also a factor here; we expect that the incumbent Union por la Patria bloc will lose power in the October elections, which will remove the incentive to delay painful policy measures and makes a devaluation more palatable to the outgoing government. Lastly, we highlight that an IMF disbursal of USD7.5bn in Special Drawing Rights by the end of August will bolster the BCRA's ability to intervene in the FX market and defend the peg if necessary.

Devaluation To Cause Spike In Rates, Inflation In 2023...

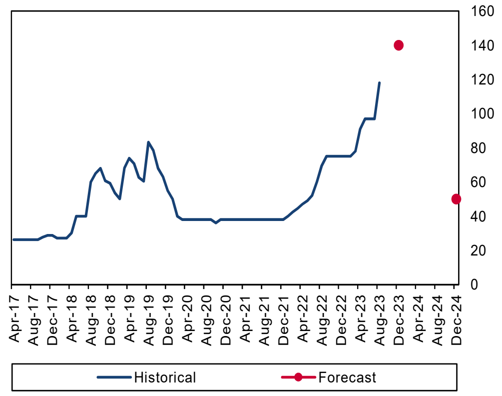
Argentina – Consumer Price Inflation (Historical & Forecast), % y-o-y



Source: Macrobond, BCRA, BMI

...But To Fall Substantially In 2024

Argentina – Monetary Policy Rate (Historical & Forecast), %

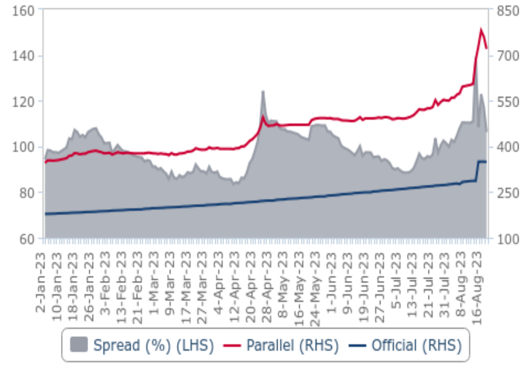


Source: Macrobond, BCRA, BMI

This will effectively buy it some time to wait until November to devalue.

Parallel Rate Spikes, Then Recedes Partially After Surprise Devaluation, PASO Result

Exchange Rates, ARS Per USD



Source: Macrobond, CoinMonitor, BMI

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We forecast that inflation will end the year at 145.0% y-o-y, as devaluation will drive pass-through inflation. It does not appear the government's voluntarily price control regime will lead all businesses to limit their price increases. The Argentine government has extended this regime – Precios Justos – for 90 days through end-November, capping price increases at 5.0% per month.

However, negotiations with businesses have gone on longer than expected, and reporting suggests that many business leaders are unwilling to the sign on again, especially given that many distributors are already impacted by the new PAIS tax of 7.5% for access to USD to finance imports, that was implemented earlier in August 2023. Indeed, automobile manufacturer FIAT has warned that they are likely to raise autos prices by an average of 20.0% this month.

Given our core view that there will be another larger devaluation in early 2024, we expect interest rates will be raised as well. However, steep fiscal austerity and exchange rate unification will help put the country on a disinflationary path, which will allow for policy loosening as well. Our core view is that Patricia Bullrich of the Juntos por el Cambio bloc will win the presidency in the second-round runoff on November 19, with risks of a victory by the outsider libertarian candidate Javier Milei rising.

Regardless, both candidates have campaigned on fiscal conservatism and the unification of the exchange rate – despite the pain that this may cause households in the short-term – which we believe will help anchor inflation expectations and cause demand-side pressures to ease. This commitment to fiscal discipline, despite the risks to social stability, underpins our expectations that the next administration will not hesitate to devalue to the currency significantly to restore exchange rate stability.

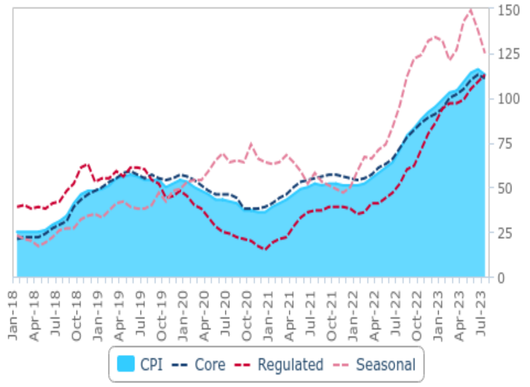
We forecast that inflation will average 107.2% y-o-y for the entire year but that it will end the year at 45.0%. With inflation falling and the peso stablising, the BCRA will be able to start cutting interest rates rather quickly, especially in H224, bringing the policy rate down to 50.0% by the end of 2024 (real rate of 5.0%).

Risks To Outlook

While there are risks both to the upside and downside for our interest rate forecasts, on balance, they are skewed more to the upside. If the financial market volatility worsens

Headline, Core Inflation Remain In Triple Digits

Argentina – Consumer Price Inflation Breakdown, % y-o-y

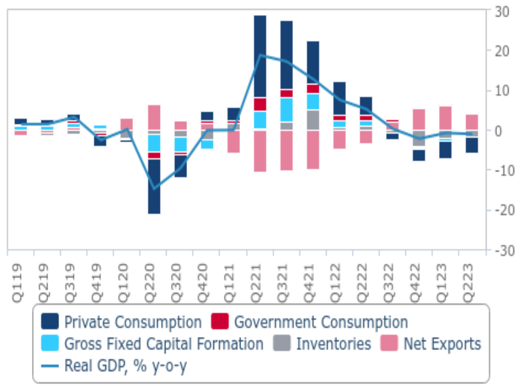


Source: Macrobond, INDEC, BMI

and the parallel-official exchange rate spread widens significantly, there would likely have to be a more drastic devaluation by the Peronist government in November than we currently expect.

Private Consumption Remains The Main Drag

Chile – Percentage Point Contribution To Real GDP Growth, % y-o-y



Source: Macrobond, BMI

Alternatively, if the current government refuses to do so or devalues insufficiently, that may put the pressure on the likely new right-leaning government to devalue in December rather than early 2024, as international reserves will likely decline further and may not be sufficient to defend the peg.

MONETARY POLICY OUTLOOK FOR 2023

	Forecast	Notes
Policy rate, eop	140.00%	We anticipate further rate hikes in 2023 as the BCRA prioritises keeping real effective annual rate positive.
BCRA Median Survey Inflation Expectations (July)	154.9%	Inflation expectations continue to climb as macro fundamentals continue to point to rampant wage growth through 2023.
Inflation, eop	145.0%	Hot consumer price inflation will be caused by continued currency weakness and nominal wage growth.
Real GDP growth	-2.1%	Drought conditions, negative wage inflation and triple digit inflation will push the economy into a deep contractions.
Exchange rate, eop	ARS420/USD	Dwindling international reserve levels, coupled with uncertainty regarding the IMF deal renegotiations, will continue to cause the currency to soften in 2023

Source: BCRA, BMI

Chile: Q223 GDP Print Confirms Economy's H123 Weak Performance

Key View

- We have held our Chilean growth forecast for 2023 at -0.1%, after Q223 data confirmed the economy's poor performance in the quarter.
- That said, we remain optimistic on the outlook for H223, largely due to the aggressive start to an interest rate easing cycle and falling inflation. This should boost private consumption and investment in the quarters ahead.
- Mining output will likely remain fairly weak in the coming months, though net exports will contribute positively to growth as a whole due to a sharp fall in imports.

We have maintained our 2023 real GDP growth forecast for Chile at -0.1% following the release of Q223 data that showed a steep slowdown in the quarter. Growth in Q2 came in at -1.1% y-o-y, or -0.3% q-o-q in seasonally adjusted terms. A slowdown was widely expected, though the decline was a bit less severe than the 1.4% we estimated based on the monthly data. Bloomberg consensus landed on the same 1.4% figure. For H123 as a whole, the Chilean economy contracted 1.0%, after the Q123 figure was lowered from -0.6% y-o-y to -0.8%. In our last full GDP revision, we had expected a 0.6% contraction in the first half.

The growth slowdown was largely underpinned by very weak private consumption, which cut 4.1 percentage points (pp) off of the annual growth figure. This was somewhat balanced by a positive 3.9pp contribution from net exports, as Chile has run a relatively wide trade surplus in 2023, though we note that this primarily reflects very weak import demand (real imports fell 15.1% in H123) rather than robust exports (up 0.7% in the same period).

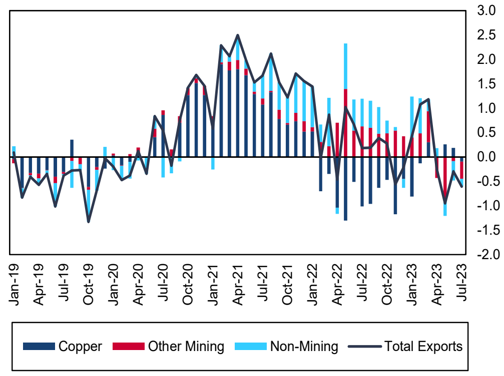
While H123 was weaker than we previously forecasted, we have become more upbeat on H2, leading us to hold our forecast for 2023. We see the economy expanding 0.7% in H223, then 2.1% growth in 2024. In particular, the backdrop for private consumption has improved more than we expected. The Banco Central de Chile (BCC) has begun an easing cycle sooner and more aggressively than we assumed for our last forecast. We now see the benchmark rate falling from 11.25% in H123 to 7.50% by the end of the year and 4.50% by end-2024. As elevated borrowing costs have weighed heavily on lending growth, the BCC's rate cuts should allow for a rebound in lending to consumers as well as businesses.

Additionally, inflation has cooled substantially (we see it at 4.2% y-o-y at end-2023 and 3.0% at end-2024, from 12.3% at the beginning of the year) and the unemployment rate has fallen a bit after spiking earlier in the year, sitting at 8.5% as of June. This should benefit household purchasing power in the quarters ahead. We forecast that private consumption will contribute -3.0pp and 1.9pp to real GDP growth in 2023 and 2024 respectively.

We also maintain our view that falling borrowing costs and repeated defeats for Chile's progressive movement bode well for investment moving forward. Leftist President Gabriel Boric's flagship tax reform was rejected in March, and in May right-of-centre parties won a supermajority on the council to rewrite Chile's constitution. While Boric has revised his tax reform plan, he will have to negotiate with a sceptical Congress, suggesting it will either fail again or be heavily moderated. This suggests Chile's business-friendly policy will largely remain in place, attracting more investment. Gross fixed capital formation declined 0.4% in H123. We see it contributing -0.2pp and 0.6pp to GDP in 2023 and 2024.

Export Performance Has Been Fairly Weak, Meaning Surplus Is Driven By Low Imports

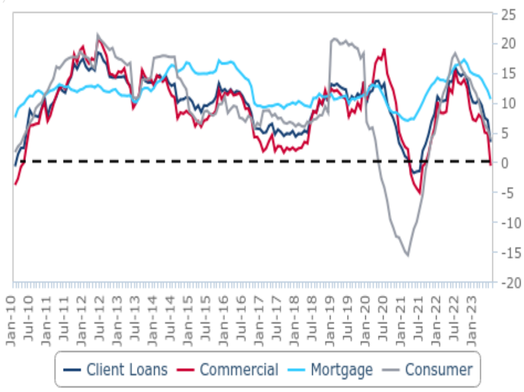
Chile – Goods Exports, USDbn, y-o-y



Source: Macrobond, BMI

Elevated Rates Weighing Heavily On New Borrowing

Chile – Client Loans, % y-o-y

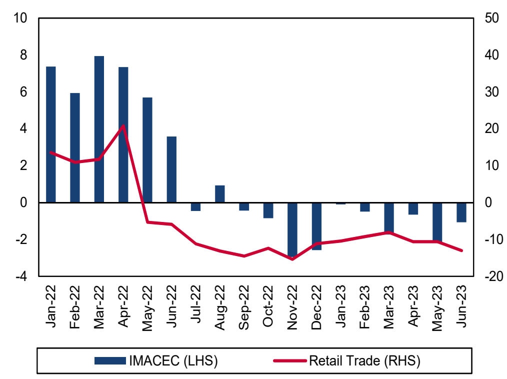


Source: BCC, BMI

Lastly, net exports will contribute positively to growth in 2023 (3.0pp), though given lingering weakness in the mining sector and soft demand from Mainland China, this will continue to largely reflect low

Chilean Consumers Have Struggled Massively, But Background Conditions Improving

Chile – Retail Trade & IMACEC Economic Activity Index, % y-o-y



Source: BCC, Macrobond, University of Chile, BMI

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import demand. The mining sector has performed poorly since the pandemic, reflecting operational challenges such as water shortages and low ore grades for copper mining which will continue to limit output growth in the year ahead. Imports will recover in 2024, flipping net exports to a negative contribution (-0.8pp).

Risks To Outlook

Risks to our forecast are generally to the downside. Most significantly, private consumption could recover by less than we anticipate in the quarters ahead, particularly if higher global oil prices push up inflation or if the lagged impact of the BCC's aggressive hikes weigh more heavily than we assume.

We also note that economic data coming out of Mainland China has consistently disappointed. While our growth forecast of 5.2% has been below consensus, if efforts by Chinese policymakers to boost demand prove ineffective our forecast for Chile's exports could prove too optimistic.

Bolivia: Fiscal Deficit To Narrow, But Still Wide Compared To Region

Key View

- We have held our forecast for Bolivia's 2023 fiscal deficit at 7.1% as contracting revenues will force the government to reduce expenditures as well.
- The fiscal deficit will likely narrow somewhat to 6.9% of GDP in 2024, with rising debt servicing costs and weak revenue growth preventing a more pronounced improvement.
- We forecast that Bolivia's debt-to-GDP ratio will rise from 59.1% in 2022 to 64.4% in 2023 and 69.4% in 2024, given the wide primary deficits in both years.

We have maintained our 2023 forecast for Bolivia's fiscal deficit at 7.1% of GD as weaker-than-expected revenues will be counterbalanced by the government's surprise cuts to spending.

On the one hand, in the year through to April, contracting tax intakes (4.7% y-o-y), falling hydrocarbon sales (9.0%) and declining profits from public sector companies (33.7%) underpinned an 8.8% contraction in overall revenues.

On the other hand, the government has responded with a 5.1% cut in total expenditures, comprising cuts to compensation spending (5.9%), goods and services (9.7%) and capital expenditures (13.2%).

This has led to a budget surplus of BOb1.1bn – compared with BOB2.7bn in the year through to April 2022. We note that Bolivia tends to run surpluses earlier in the year and then flips to a deficit as expenditures outpace revenues in the second half of the year.

That weaker revenues have stemmed from softer economic activity was confirmed by the recent release of Q123 GDP data, which showed headline slowed to 2.3% compared to 4.1% in Q122. Expenditures cuts, while higher than expected, were likely given that Bolivia can no longer rely on international reserves to finance their deficit, given their dwindling stocks of liquid hard currency.

While the projected 2023 fiscal deficit is lower than the pre-pandemic average of 7.4% of GDP, persisting wide budgets have and will continue to cause the national debt load to expand, raising the interest payment burden and threatening to crowd out other spending priorities in the medium term. Indeed, Bolivia has the second highest deficit compared to our major markets, excluding Brazil.

In H223, we expect revenues to continue falling and for expenditure cuts to moderate. Revenue growth, specifically for taxes, will suffer from continued tepid economic activity. Indeed, we forecast below-average growth of 2.5% in 2023 as households suffer from elevated consumer prices for food and energy, even with government subsidies. Additionally, our Oil & Gas team projects that natural gas production will fall into contraction in 2023, which will also hurt revenues from hydrocarbon sales.

We expect that the government will continue to make cuts where they can, likely in the health and education sectors, in order to prevent cuts to politically-sensitive subsidies for fuel and food.

Even if there are further cuts to staffing in H223, we expect government expenditures to spike due to end-of-year salary bonuses for public sector employees, which will also add to the deficit.

We note that interest rate expenditures have also risen by 40.5% y-o-y in the year-to-date (6.7% of total expenditures), a trend that seems unlikely to reverse in the medium term.

In 2024, we expect the government will prioritise fiscal consolidation, but a worsening hydrocarbon sales outlook will limit its scope, yielding a 6.9% deficit in GDP terms. Currently, we forecast another year of lacklustre growth of 2.4% in 2024, which will weigh on the tax intake.

While energy prices are likely to rise broadly in 2024, weaker domestic production should result in a worsening of the energy trade balance, reducing the boost from energy exports as the cost of subsidising costlier energy imports rises. These factors will contribute to a decline in revenues to 34.6% of GDP in 2024, from 36.0% in 2023.

We believe that the Bolivian government will continue to make cuts to capital expenditures and public services as it prioritises reducing its deficit.

That said, the barriers to fiscal consolidation will persist. We do not expect that the Bolivian government will be wiling to pay the political penalty for lowering subsidy spending as many households rely on this for essential goods.

We expect that the US Federal Reserve will likely start cutting rates in 2024. While this will in turn allow for global borrowing costs to decline, they will still remain historically elevated.

In addition, the growing debt burden will also translate to larger interest payments. Ultimately, we project that total expenditures will only fall from 43.1% of GDP in 2023 to 41.5% in 2024.

Ukraine: Reforming And Rebuilding – The Reconstruction Path

Key View

- Despite our view that Ukraine will be more successful at meeting reconstruction objectives than many other post-war countries, we do not expect the economy to return to its pre-war size until 2031.
- We remain sceptical of Ukraine's ability to attract the volume of funds needed for the political and economic future envisioned by the National Recovery Plan.
- International aid and robust support from Western allies will help the country maintain a steady course of reconstruction provided that this is matched with adequate political reforms.

Ukraine's reconstruction will steadily gain momentum while the country is still at war and accelerate rapidly thereafter. In our core view for the progression of the war over the next decade, we outline three distinct phases of conflict.

As the intensity of the conflict will be the principal determinant of the pace of recovery, we believe that there will be three distinct phases of reconstruction: damage control, stabilisation and laying foundations.

We retain our view that the economy will not return to its pre-war size until 2031. Ukraine's National Recovery Plan (NRP) assumes that Ukraine will achieve growth of 7% or higher over the next decade, implying that the economy will return to its pre-war size by 2028.

We believe that the NRP does not adequately consider future security risks, instead relying on an optimistic assumption that the war will end in 2023. Based on our outlook for the progression of the war, our own projec-

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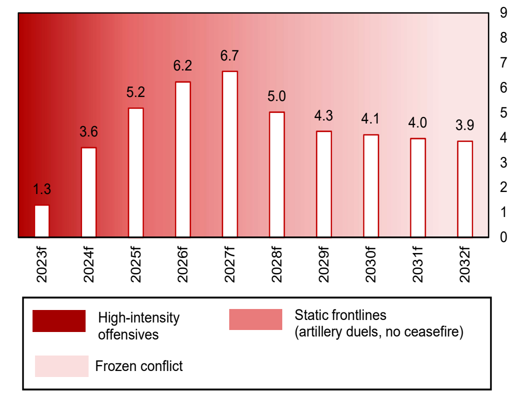
Ukraine Set For Slow Gradual Path Of Recovery

Ukraine – War Intensity Projection & Real GDP Growth, % chg y-o-y (2023-2032)



Source: BMI

UKRAINE'S RECOVERY TIMELINE

War Timeline	Reconstruction Phase
Current Phase (high-intensity warfare) This phase of the war is characterised by high-intensity mechanised warfare. Fighting is concentrated in Eastern Ukraine but missile strikes threaten security countrywide.	**Damage Control** • The Ukrainian government prioritises the needs of the military over major reconstruction. • Reconstruction campaigns focus on energy and transportation infrastructure. • Close to the frontline, state support is limited to meeting vital needs (food, fuel, medicine). • International partners focus on preserving macroeconomic stability rather than imposing reforms. • The capacity of the state to align with EU legislation is hampered by the fragile state of the economy.
Transitional Phase (low-intensity warfare) The frontlines will become increasingly static. The conflict could remain locked in this state for several years, as was the case in the Donbas in 2015-2021.	**Stabilisation** • The availability of insurance against war-related risks rises. • Infrastructure repairs gain momentum across the country. • Despite receding security threats, the capacity of refugees to return is likely to be limited by a lack of housing similar to the post-WWII period. • Debt restructuring including a substantial debt haircut will likely be explored. • The NBU returns to an inflation-targeting regime and takes new steps to liberalise the hryvnia. • The IMF is likely to advise Ukraine to pursue tax reform.
Final Outcome (frozen conflict) We see the most likely eventual outcome as a 'frozen' conflict comparable to that between North and South Korea at the end of the Korean War (1950-1953).	**Laying Foundations** • International partners condition financial support on decentralisation, modernisation and liberalisation. • Housing stock now represents a priority for reconstruction. • Refugees return in larger numbers but the overall demographic outlook remains bleak. • Heavy manufacturing industry is unlikely to be fully restored as Ukraine moves towards a new export base. • There is a major risk of a 'false start' during this period as the turbulent backdrop could fuel strongman politics.

Source: BMI

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tion of 4.4% average growth over the next decade is considerably more conservative.

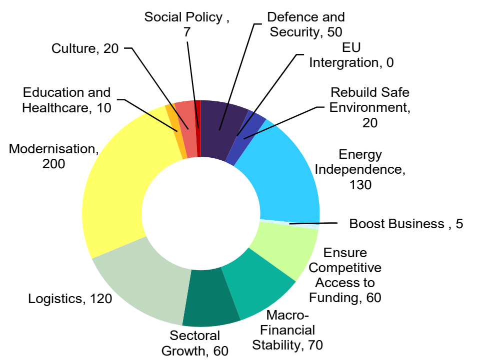
According to the March 2023 estimate by the World Bank, European Commission and the UN, Ukraine's reconstruction will cost USD411bn (279% of GDP). Ukraine's July 2022 NRP puts the cost higher at USD750bn.

For the reasons we outline in this article, we are sceptical about the assumptions built into the NRP, particularly that Ukraine will be able to secure USD750bn (511% of GDP) in grants and investment.

Our expectation for Ukraine's economy to remain below its pre-war size over most of our forecast period is indicative of the country's unfavourable demographics, pre-existing economic weaknesses and continued exposure to security threats.

Ukraine Is Unlikely To Receive The USD750bn It Plans For

Ukraine – Estimated Reconstruction Needs & Funding, USDbn



Source: Ukraine's NRP, BMI

The Plan: Implementation Challenges Are Extensive

Ukraine's reconstruction plan is likely to embrace a strategy resembling the 'Marshall Plan'. We believe that the country's pre-war development status will enable more successful attainment of reconstruction objectives than seen in Iraq or Afghanistan.

The post-World War II (WWII) Marshall Plan is widely regarded as one of history's most successful recovery projects. In part, this can be attributed to the scale of the Marshall Plan, USD165bn in today's prices (estimates vary between USD100bn and USD1.0trn).

However, as the cases of Afghanistan and Iraq demonstrate, money does not guarantee success. Iraq's reconstruction was modelled on the Marshall Plan but it did not yield the same results. We identify several factors which contributed to the Marshall Plan's success. We find that while Ukraine does benefit

THE MARSHALL PLAN'S SUCCESS AND UKRAINE'S PROSPECTS

Factor	Ukraine
The Marshall Plan did not face sustained security threats.	• Ukraine will experience security threats from Russia for several years to come. However, unlike Afghanistan and Iraq, we do not expect Ukraine to face an insurgency. • In our final stage of reconstruction, we believe a demilitarised zone (DMZ) will be established. The South Korean reconstruction experience suggests a DMZ can still provide a safe space for reconstruction, allowing the government to refocus on rebuilding infrastructure and housing stock. 24.0
The Marshall Plan enjoyed broad international support.	• Whether Ukraine's international partners will remain unified in the long term is uncertain. While Russia's invasion has in many ways strengthened the concept of a 'collective West', there are outliers. • In Europe, Hungary, Slovakia and Bulgaria have stood out as particularly ambivalent. In the US, several high-profile Republicans are Ukraine sceptics. • Disputes over resource allocation varying and perceptions of security concerns could impede the coordination of aid, echoing the experience of the coalition-led reconstruction of Iraq.
Geopolitical dynamics in Europe were relatively stable post-WWII.	• Competing regional influences often lead to inefficient resource utilisation. The involvement of Iran and Saudi Arabia in Iraq's reconstruction fuelled ethnic tensions that intersected with the reconstruction process. • We do not expect neighbouring countries to compete for influence in Ukraine. Russia has lost meaningful influence over Ukrainian politics and Russian-speaking Ukrainians. According to a survey by the Kyiv Institute of Sociology conducted in May 2022, 80% of citizens who held a positive view of Russia before the invasion now hold a negative view.
Instances of corruption were relatively minor.	• Corruption afflicts nearly all post-war reconstruction projects. However, unlike Bosnia-Herzegovina, Iraq, Afghanistan and Kosovo, Ukraine's anti-corruption reforms predate the 2022 invasion. • There is little evidence to suggest assistance funds to Ukraine were misappropriated at a large scale in the aftermath of the 2014 crisis. In February 2023, the Pentagon's inspector general announced in that his office had not found any evidence that aid has been diverted in the early stages of investigation. • Our core view implies that Ukrainian institutional structures will not be displaced due to the war. Institutional vacuums are a common feature of post-war economies and facilitated corruption by criminal syndicates in Kosovo and Bosnia-Herzegovina.

Source: BMI

from a stronger base than Afghanistan and Iraq in that reforms pre-date Russia's latest invasion, Kyiv will likely face security threats that the Marshall Plan did not.

Funding: Private Investors Will Delay Return To Market

Ultimately, funding the reconstruction through the war timeline will prove to be the most severe challenge. Mobilising enough funding to rebuild Ukraine will require multiple funding vehicles.

We believe that Ukraine's dependence on allied governments and international organisations will peak during the 'damage control' phase of reconstruction.

We also expect that abating security risks thereafter to open the door for a public-private partnership.

In terms of aid pledged thus far, there is a major distinction between US aid and European aid. Aid from the US has primarily been delivered in the form of grants, while aid from Europe has largely been channelled through the EU's Macro-Financial Assistance (MFA+) package (a long-term concessional loan).

Though Ukraine will not have to make repayments on the MFA+ until 2033, we believe that the rapid accumulation of EU debt during wartime raises questions about the sustainability of Ukraine's debt burden in the later stages of reconstruction. The projected devaluation of the *hryvnia* over the next decade will only exacerbate this problem.

During the 'stabilisation' phase of reconstruction, we believe it is likely that Ukraine will seek debt restructuring. In the aftermath of Russia's initial invasion, bondholders were forced to agree to a 20% haircut and four-year payment extension in the 2015 restructuring of Ukraine's USD15.0bn debt load.

While the Ukrainian economy was experiencing significant turbulence at this time, the economy had not been devastated by full-scale war. The experiences of post-war Germany (50% haircut), Italy (50-60%) and Bosnia-Herzegovina (67%) likely provide better case studies.

We are also sceptical about the NRP's assumption that Ukraine will receive USD250bn (170% of GDP) in foreign direct investment by 2032. The war has aggravated Ukraine's pre-existing chronic underinvestment issues.

Over the last decade, Ukraine has consistently failed to receive sufficient capital injections to achieve consistent economic development.

To rebuild, Ukraine will need to lure in uncertain private investors with policy reforms and guarantees. Presently, war-risk insurance coverage is very limited.

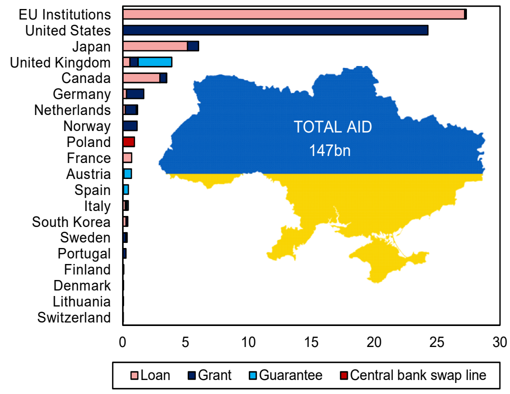
We believe that there are very few risk mitigation tools available through traditional multilateral development banks and private insurance is either very expensive or non-existent. This reality is not lost on Ukraine's international partners, the UK announced a war risk insurance framework worth USD25.5mn in June 2023.

However, a pledge of this size is relatively insubstantial in the context of Ukraine's actual needs. Sergiy Tsivkach, director of UkraineInvest, a Ukrainian government agency tasked with attracting foreign direct investments, estimates that Ukraine needs around USD5.0bn in war insurance provision.

Over the long term, we believe that the use of frozen Russian assets in support of Ukraine's reconstruction could become more acceptable. Repurposing frozen Russian assets for Ukraine's reconstruction is currently both legally contentious and politically divisive, making a substantial handover unlikely.

Ukraine Rapidly Accumulates Debt During Wartime

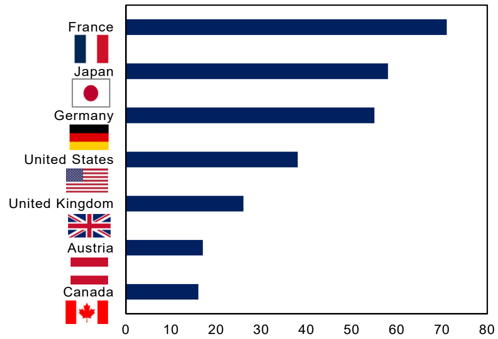
Ukraine – Aid By Source



Source: Kiel Institute for the World Economy (up to May 2023), BMI

Transferring Frozen Russian Assets Is Legally Contentious And Politically Divisive

Selected Countries – Value Of Assets Of The Bank Of Russia Frozen, USDbn



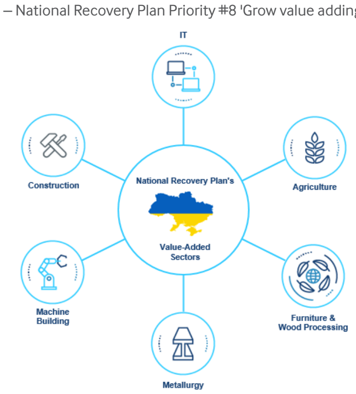
Note: Does not represent all frozen Russian assets, only those seized from the Bank of Russia. Source: BMI

While Ukraine's NRP does not allude to seized Russian assets as a potential source of funding, President Zelenskyy has repeatedly called for these funds to be repurposed for Ukraine's reconstruction.

On May 10 2023, the US attorney general approved the first-ever transfer of Russian assets to Ukraine.

NRP's Value-Added Sector Priorities Misaligned With Economic Realities

Ukraine – National Recovery Plan Priority #8 'Grow value adding sectors'



Source: Ukraine's NRP, BMI

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The funds (USD5.4mn) were originally seized from Russian oligarch Konstantin Malofeev. While the repurposing of Malofeev's assets sets an important precedent, it makes a very small dent in the stockpile of frozen assets accumulated by Ukraine's partners in the West.

In June 2023, the British government proposed legislation that locks away Russian assets until the Kremlin has agreed to compensate Ukraine.

In addition to USD58bn of frozen assets that G7 countries have seized from Russian oligarchs, the G7 and its allies have frozen USD300bn of Russia's foreign reserves. A transfer of this value would have a transformative impact on Ukraine's ability to finance reconstruction – potentially similar to the success of the Marshall Plan.

While moving confiscating assets into an escrow account is not unprecedented, transfers of Iranian funds in 1981 and Iraqi assets in 1992 were delivered on a far smaller scale. It is also worth mentioning that the European Central Bank has vocalised concerns that tapping the interest proceeds of frozen assets risks disincentivising other central banks from holding euros. **Therefore, we believe that any Russian repurposed assets would be distributed in small tranches and Ukraine is highly unlikely to receive the entire USD358bn.**

Winners And Losers: A New Ukraine

During the reconstruction process, we believe that certain sectors are unlikely to be restored to their pre-war size as Ukraine seeks to transform its economic base. The NRP outlines the development of value-adding sectors of Ukraine's economy as a priority objective. However, the industries classified as 'valued-adding' sectors and thus deemed eligible for reconstruction privileges are not always aligned with Ukraine's economic reality.

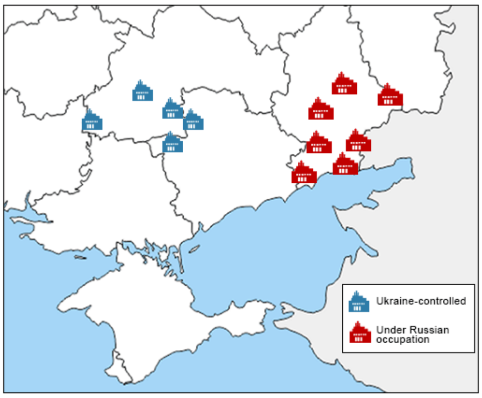
High-intensity fighting is concentrated in Eastern Ukraine and Ukraine's traditional industrial belt has suffered the most extensive destruction. As Ukrainian heavy manufacturing firms are unlikely to be globally competitive post war, we believe Ukraine will ultimately need to transform its export base, emulating the path of former East Germany in the 1990s and the UK in the 1960s. This transformation may take decades, as was the case in many US cities after the collapse of domestic manufacturing.

Ukraine's post-war agricultural sector must overcome shortcomings of the past. Agricultural products are Ukraine's leading exports, accounting for 41% of outbound shipments in 2021 and providing employment for 14% of the population. The extent to which land is damaged will likely only become evident well into the frozen conflict stage of the war. If we assume that there is a fixed pool of recovery funds, the required investment in agriculture could provide relatively low returns if damages are high, particularly where land must be cleared of mines.

The strategy for rebuilding the sector must seek to address pre-existing weaknesses such as inadequate investment in modern agricultural technologies and fragmented land ownership, which have sapped productivity. Prior to Russia's 2022 invasion, Ukraine was already moving in the right direction in terms of liberalisation and adopted a land reform law in 2021. If Ukraine can successfully push through further liberalising legislation and address regulatory challenges, we believe there is potential to eventually attract private investors. Around 50% of Ukraine's arable land is composed of Chernozem, a rich

Metallurgy Heavily Concentrated In Eastern Ukraine

Ukraine – Map Of Steelmaking Plants

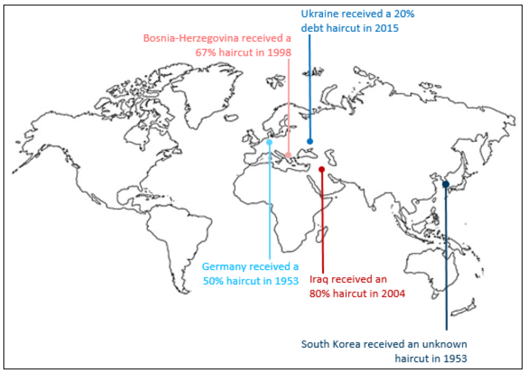


Source: Berlin Economics, National Bank of Ukraine, BMI

black soil which is highly fertile. As a potential driver of growth, Ukraine's agricultural industry has the potential to move up the value chain within agriculture by expanding its processing capacity (processing grain into flour etc). Russia's blockade of Ukraine's Black Sea ports does represent a major limitation on future exports. However, we tentatively take the view that Ukraine will regain access to its Black Sea ports towards the end of our forecast period.

Debt Haircuts Are A Common Feature Of Post-War Recovery Programmes

Post-War Economies – % Of Debt Forgiven



Source: BMI

The tech industry is a sensible priority for the NPR and has been the standout of Ukraine's wartime economy. Structural changes in the services industry over the last few years have been transformative and despite the destructive impact of war, the IT sector remains a bright spot for the Ukrainian economy. IT exports amounted to 39% of total services exports in 2021, up from just 1% in 2000. In 2022, when the economy contracted by almost a third, Ukraine's IT exports grew by nearly 7%.

However, with the work-from-anywhere flexibility of IT careers, Ukraine will need to provide incentives to draw back the 10% of IT businesses which have relocated abroad (Advanter Survey, July 2022). Alignment with EU standard intellectual property rights protection may be prioritised in this regard, as IT infringements have been frequent and rarely prosecuted.

US-Iran: Prisoner Swap Bodes Well For Lower Geopolitical Tensions

Key View

- The prisoner swap between the US and Iran supports our long-held view that geopolitical tensions in the Middle East and North Africa region will continue to ease over the course of 2023.
- Iran's decision to reduce its stockpile of 60% enriched uranium and slow down the pace of accumulation reinforces our view that tensions over the Iranian nuclear programme will remain contained through transactional agreements.
- The resumption of talks between Iran and the US would also help defuse maritime tensions in the Gulf waterways, while providing Iran with some 'economic breathing room' and financial benefits, which would reduce its incentive to intensify tensions.

The prisoner swap between the US and Iran supports our long-held view that geopolitical tensions in the Middle East and North Africa region will continue to ease over the course of 2023. On August 10, Iran has moved four US prisoners into house arrests, joining a fifth person who was already under house arrest. This move paves the way for the five US citizens to return to the US in the coming weeks.

In return, once the US prisoners leave Iran, the US will allow the transfer of the equivalent of USD6.0bn of Iranian oil proceeds that were held at South Korean banks to Qatari banks to be used to fund unsanctioned goods, such as food and medicine. According to media reports, the US will also release five Iranian prisoners.

Tensions over the Iranian nuclear programme will remain contained through transactional agreements. According to the Wall Street Journal (August 11), 'Iran has diluted a small amount of 60% enriched uranium in recent weeks and slowed the rate at which it is accumulating new material'. US officials denied a link to the deal, though the timing of the two announcements points to at least an implicit re-engagement.

We also think that the Iranian authorities will cooperate with the International Atomic Energy Agency and allow its officers to regain access to nuclear sites, which has long been a key US demand in indirect talks with Iran.

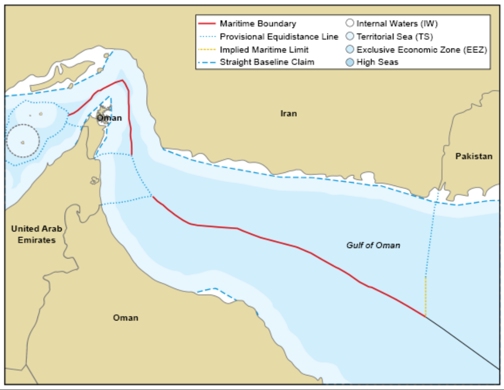
We believe that Iran would want to build on the recent breakthrough and regain access to larger shares of about USD90.0bn worth of frozen assets under US sanctions. This, along with the recent rapprochement between Iran and its neighboring Arab markets, would reduce the incentive for an aggressive nuclear posture from Tehran.

At the same time, we continue to believe that US and Iran will not return to a comprehensive nuclear agreement. For Iran, concerns over the outcome of the upcoming US presidential election in November 2024 will prevent it from signing a deal with the current administration. For the Biden administration, any nuclear agreement would be difficult to receive Congressional and public support given negative public sentiment towards Iran due to Tehran's sustained support for Russia in the war in Ukraine, and frequent reports of widespread human rights violations in Iran.

The resumption of talks between Iran and the US would also help defuse maritime tensions. The US is a key player in the Persian Gulf Sea (Arabia Gulf Sea) and the Gulf of Oman. Attacks on oil tankers in the two water areas since May 2023 culminated with the US sending more than 3000 troops to the Red Sea aboard two warships in August 2023. We cannot rule out more Iranian attacks on oil tankers.

Lower Security Risk In The Gulf Of Oman And Arabian Gulf

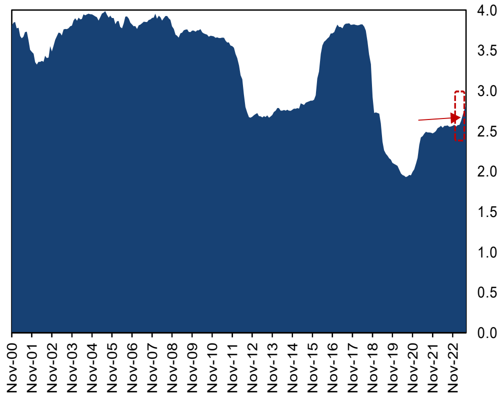
Map of UAE, Oman & Iran Maritime Borders



Source: Sovereign Limits, BMI

Pickup In Iranian Oil Exports Since April 2023

Iran – Oil Exports, mn bbl/day



Source: OPEC, Macrobond, BMI

However, we think that stronger US presence in the Gulf waterways, the recent prisoner swap and the prospect of other agreements (which will give access to more frozen funds) would deter Iran from intensifying its attacks,

Only A Temporary Strengthening Of The Iranian Rial

Exchange Rate, IRR per USD (daily black market rate)

Source: Macrobond, BMI

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keeping the broader de-escalation on track. This would make the Gulf waterways another proxy battleground where tensions have eased in recent months, following improvements in Iraq, Yemen and to a lesser extent Syria, driven by Iran's improving relations with the governments of these markets.

We also believe that providing Iran with some 'economic breathing room' as well as financial benefits would reduce its incentive to intensify tensions. Iranian oil exports have shown a pick-up in recent months, which supports our view that the US has likely exercised less scrutiny over sanctioned Iranian oil exports amid the ongoing negotiations regarding the prisoner swap. We expect Washington's less hawkish stance to continue as a goodwill gesture over Iran's cooperation with the IAEA and slower rate of uranium enrichment.

While Iran still has to compete with Russia in the market of sanctioned oil, which will further reduce the price of discounted Iranian oil, we think that oil proceeds will increase as oil prices will continue to rise in the coming months and over the remainder of 2023.

Granted, the Iranian rial on the parallel market has had a mixed reaction to the prisoner swap deal, losing the gains registered at the time of the announcement. We are therefore of the opinion that this is because the prisoner swap does not entail direct access to foreign currency that would be necessary to increase FX supply in the market and lead to a more sustained strengthening of the rial.

The prisoner swap deal will likely reduce the pressure on the currency over the coming months of 2023 as the authorities would be able to spare FX to other usage than food and medicine. This therefore reinforces our view that the Iranian rial would continue to weaken in the coming months but at a slower pace than in the first half of 2023. After losing nearly 20% of its value in H123, we expect the rial to lose about 12% in H223. We believe that this then reinforces our view that inflation has peaked at 55.5% y-o-y in April 2023, slowing to 39.4% in July 2023. In full-year 2023, we therefore expect that average inflation will ease from 41.9% in 2022 to 40.8%.

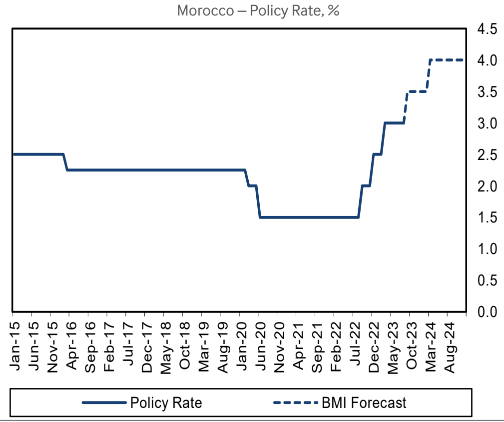
Morocco: One More Rate Hike In H223 Despite Slowing Inflation

Key View

- We now expect that the central bank will hike its policy rate by 50bps to 3.50% in September and hold it in December as inflation continues to decelerate and domestic demand remains relatively sluggish.
- We expect sticky inflation and a negative interest rate differential with the European Central Bank will provide impetus for the BAM to hike by 50bps in H124, and hold the rate through to the end of 2024.
- Stickier-than-expected inflation could push BAM to raise interest rates by more than we currently expect, while concerns about economic growth could prompt the bank to adopt a more cautious approach and tolerate above-target inflation.

More Tightening Ahead

Morocco – Policy Rate, %



Source: BAM, BMI

We expect Bank Al Maghrib (BAM) to raise its policy rate from 3.00% currently to 3.50% by the end of 2023 and to 4.00% by end-2024. This marks a downward revision from our previous forecasts of 4.00% for the end of 2023 and 4.50% for the end of 2024 as we now foresee a faster deceleration in inflation in H223 due to the government's measures to contain the increases in domestic prices. After the July inflation print surprised us to the downside coming in at 4.9% y-o-y against our expectations of 5.1%, we now expect that inflation will average 4.7% in H223, down from 5.1% previously. Nonetheless, while BAM hold the rate in its most recent meeting on June 20 after increasing it every quarter by 50bps since September 2022 (total of 150bps), the June statement outlined the need to consider the lagged effects of monetary tightening, thus still laying forward a relatively hawkish tone. We think that a relatively hawkish rhetoric along with still elevated inflation and negative interest rate differentials with the European Central Bank (ECB) will ultimately push BAM to continue raising its policy rate into 2024.

Outlook For Next Meeting

We anticipate that BAM will hike by 50bps to 3.50% in its next meeting in September 2023 as inflation remains elevated. Despite contracting on a month-on-month basis in May and June 2023 following government measures to combat price increases, we think that inflation will remain relatively sticky in the second half of the year 2023 and is unlikely to dip below 4.0% by the end of 2023. This is particularly because we expect a rebound in global commodity prices, especially agricultural and energy-related commodities, which will keep inflation relatively elevated in the coming months despite decelerating. We believe that inflation will therefore remain higher than BAM's implicit target of 2.0% and is likely to prompt the bank to raise its policy rate.

Long-Term Interest Rate Trajectory

In the December meeting, we forecast that BAM will hold the policy rate. We think that decelerating inflation will give reason for BAM to pause in December in order to take into account the lagged affects of monetary tightening. BAM will also remain cautious not to put significant pressure on growth as domestic demand remains relatively subdued.

Moving forward, we expect that BAM will raise its policy rate by 50bps in H1 2024 to 4.00%, and to hold thereafter. This is for two main reasons. First, we think that BAM will want to reduce its negative interest rate differential with the ECB in order to preserve its fixed exchange rate. The Moroccan dirham is indexed to a basket of currencies composed of 40% USD and 60% EUR, with a 5.0% margin of fluctuation. While the introduction of a margin of fluctuation in 2018 and its widening in 2020 allow BAM for more freedom in the conduct of its monetary policy, we believe that a negative interest rate differential with the ECB would still pose risks to the kingdom's exchange rate policy. Given that the current interest rate differential between BAM's policy rate and the ECB's deposit facility is at -75bps, the first time this differential has been negative since the creation of the ECB, we expect that BAM will ultimately move to further tighten its monetary policy.

Second, we anticipate that inflation will remain elevated in the medium term, mainly due to the phasing out of government subsidies on butane gas and sugar starting in 2024 as outlined in the government's medium-term fiscal plan.

This, along with a small increase in global commodity prices and stronger domestic demand in 2024, will see inflation average 4.1% in 2024.

With inflation above target and historical trend, and economic growth picking up, we are of the opinion that BAM will ultimately move to increase its policy rate in 2024.

Risks To Outlook

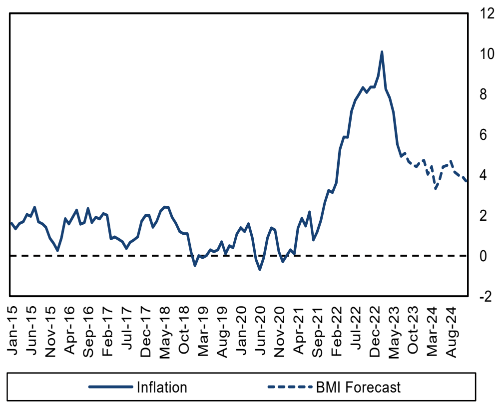
Stickier-than-expected inflation poses an upside risk to our interest rate forecast. While not our core view, in the event that inflation proves to be stickier than our current forecast, BAM could raise the terminal rate beyond our current forecast of 4.00%. Stickier inflation could be due to a more significant increase in global commodity prices, or a contraction in agricultural production, which have become more frequent in the kingdom recently due to adverse weather conditions.

Conversely, concerns about economic activity in Morocco or the reversal of the government's decision to phase out subsidies could prompt BAM to hold its policy rate for the rest of 2023.

While growth has accelerated in Q123 due to strong export growth, private consumption and investment were weak, with the former growing by only 0.1% y-o-y, and the latter contracting by 2.6% y-o-y.

Sticky Inflation Will Push BAM To Raise Interest Rates

Morocco – Inflation, % y-o-y

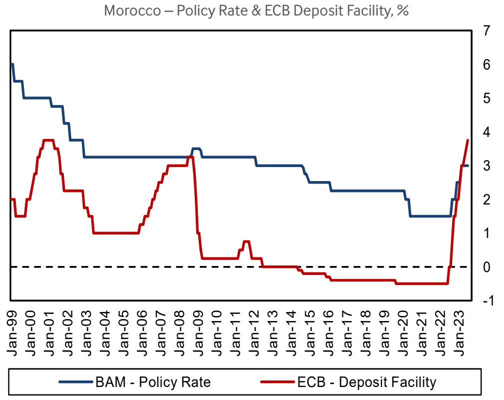


Source: HCP, BMI

If these subdued performances persist in H223, this could push the BAM to be more cautious in its tightening cycle, and possibly to tolerate slightly higher inflation in the medium term in order to support economic activity, therefore refraining from further raising interest rates.

Negative Interest Rate Differential With The ECB Will Prompt BAM To Raise Interest Rates

Morocco – Policy Rate & ECB Deposit Facility, %



Source: BAM, ECB, BMI

Similarly, inflation could come in lower than our current expectations in the event the government chooses not to move forward with the phasing out of subsidies on butane gas and sugar. We believe that this would prompt BAM to refrain from further raising interest rates.

MONETARY POLICY OUTLOOK FOR 2023

Forecast	Notes	
Policy rate, eop	3.50%	Elevated and sticky inflation will prompt BAM to hike interest rates by 100bps in 2023.
Inflation, aop	6.3%	Inflation will remain elevated at 6.3% in 2023 as low agricultural output and BAM's cautious rate hiking cycle will support upward momentum in prices.
Real GDP	2.3%	A sluggish recovery in agricultural production and a deceleration in growth in the eurozone will limit Morocco's economic rebound in 2023.
Exchange rate, eop	MAD9.69/ USD	The Moroccan dirham has continued to rally to below MAD10.00/USD due to downside pressure on the dollar, but pared back some of its gains as the dollar regained some strength. We expect the dirham will trade sideways to higher in the coming quarters

Source: BAM, HCP, BMI

UGANDA CURRENCY FORECAST

	2022	Spot	2023	2024
UGX per USD, ave	3,690	3,733	3,740	3,783
UGX per EUR, ave	3,883	4,058	4,077	4,161
Policy rate, %	10.00	9.50	9.50	8.50

Source: Bloomberg, Macrobond, BMI

UGX: Unit Will Weaken Further In 2024

Key View

- We forecast that the Ugandan shilling will weaken further over the coming months, ending the year at UGX3,775/USD, down 1.1% compared with the current spot rate of UGX3,733/USD.
- This comes after the World Bank announced a halt to funding, a move which prompted a sharp sell-off of the currency, in response to the passage of the Anti-Homosexuality Act.
- In 2024, we expect the pace of depreciation to slow as investor appetite for riskier emerging market assets picks up as developed market central banks begin cutting interest rates.

Short-Term Outlook (three-to-six months)

We forecast that the Ugandan shilling will weaken further over the coming months, ending the year at UGX3,775/USD, down 1.1% compared to the current spot rate of UGX3,733/USD. Since our last update (June 27 2023), the shilling has depreciated by 1.6%, prompted by the World Bank's decision on August 8 to suspend new funding to Uganda in response to the passage of the Anti-Homosexuality Act.

According to the latest available data (December 2022), 22.5% of Uganda's USD4.8bn of undisbursed external loans are held by the World Bank, with a further 12.5% held by the IMF. Given that Uganda relies on external financing to plug its fiscal deficit – which stood at an estimated 5.5% of GDP in FY22/23 (fiscal year runs from July-June) – the potential for further funding withdrawals will prevent a return to levels that pertained over H123.

At its August 15 meeting, the Bank of Uganda's monetary policy committee (MPC) cut its policy rate by 50 basis points (bps) to 9.50%. Citing low inflation – price growth fell to 3.9% y-o-y in July, from 4.9% in June – and fears of a growth slowdown, the MPC opted to cut rates for the first time in two years in order to stimulate growth.

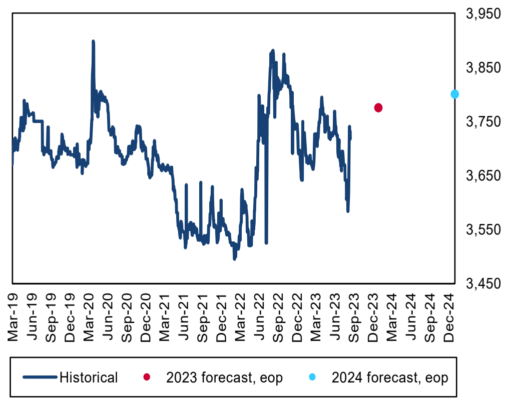
While our current view is that the Bank of Uganda will refrain from further cuts in 2023, a tighter interest rate differential with the US over the coming months will compound growing investor concerns, in turn exerting further downward pressure on the shilling.

A persistent trade deficit will squeeze dollar availability in the near term. In H123, the trade deficit stood at USD1.5bn, a meagre improvement from USD1.8bn in H122. This comes despite a very strong performance by coffee exports, with earnings up 8.1% y-o-y in June. In the coming quarters, we highlight the risk that wetter conditions caused by a potentially strong El Niño event could impact coffee yields, adding further strain to Uganda's trade balance. This is especially true given that September to November is a major harvest period for Ugandan coffee producers.

Additionally, the USD10bn development of the Lake Albert Oil Project – jointly funded by **TotalEnergies** and the **China National Offshore Oil Corporation** – will keep demand for

Shilling Will Trade Weaker In H223

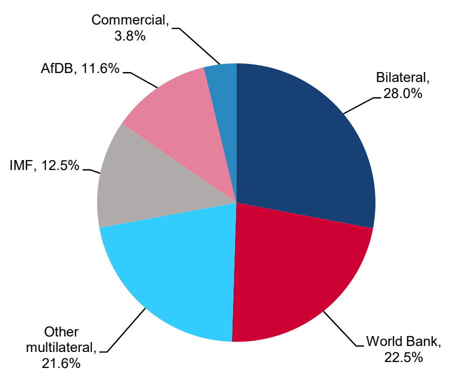
Exchange Rate, UGX per USD



Note: BMI forecast. Source: Macrobond, BMI

Risk Of Further Funding Cuts Will Weigh On The Shilling

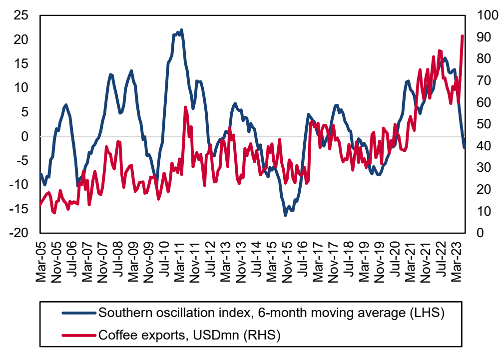
Uganda – Undisbursed External Loans



Note: Percentage share of USD loans. Source: Macrobond, Ministry of Finance, Planning, & Economic Development, BMI

Strong Coffee Exports Have Supported The Shilling In Recent Years

Global – Southern Oscillation Index & Uganda – Coffee Exports



Note: For southern oscillation index, negative figures indicate El Niño. Source: Macrobond, Australian Bureau of Meteorology, Bank of Uganda, BMI imported capital inputs high, thereby generating significant demand for dollars.

Long-Term Outlook (six-to-24 months)

We see the pace of depreciation slowing in 2024, with the shilling ending the year at USD3,800/USD, down 0.7% compared to end-2023. However, a weak external sector outlook – we project that the current account deficit will remain wide at 9.8% of GDP in 2024 – will continue to weigh on the currency. Despite strong capital inflows due to the development of Uganda's oil sector, the persistent current account deficit will keep Uganda's reserves position weak by historical standards. Therefore, we forecast that the import cover will fall from 3.4 months in 2023 to 3.2 months in 2024, the lowest level since 1994.

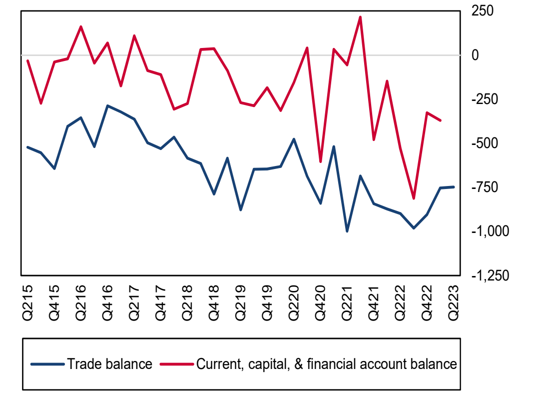
In order to preserve external buffers, we do not expect the Bank of Uganda to intervene in the foreign exchange market to support the currency, especially given Uganda's USD1.0bn IMF Extended Credit Facility (ECF) arrangement. Indeed, in the fourth review under Uganda's ECF, published on June 26 2023, the IMF stated that 'more active FX purchases need to be deployed to replenish reserves when market conditions allow', implying that a managed depreciation may be necessary in order to bring the import cover closer to 4.0 months, the target threshold under the current ECF. While our core view remains that the Bank of Uganda will not engage in depreciatory foreign exchange purchases, this does mean that intervention to support the currency is highly unlikely.

We also note that the shilling remains overvalued in real-effective exchange rate (REER) terms. Historically, periods of overvaluation have led to a corrective depreciation, such as in 2010-2011 and 2014-2015. Uganda's REER has been overvalued compared to its 10-year moving average since November 2021, implying that mean reversion is increasingly likely to take effect over the coming quarters. This supports our view that the shilling will depreciate further in late 2023 and 2024.

We expect the pace of depreciation to slow in 2024. EM assets, which have been under pressure since the US Federal Reserve (Fed) started its monetary tightening cycle in Q222, are likely to find some relief once the Fed begins cutting rates in 2024. Our Global team currently expects the US Fed to hold interest rates at 5.50% until at least end-Q124, after which the bank will cut by 175bps to 3.75% by the end of the year. By contrast, we expect the central bank to cut rates by just 100bps in 2024, opening a wider positive interest rate differential with the US, a move which will support capital inflows.

Unfavourable External Dynamics Will Depress Reserves

Uganda – Balance Of Payments, USDmn



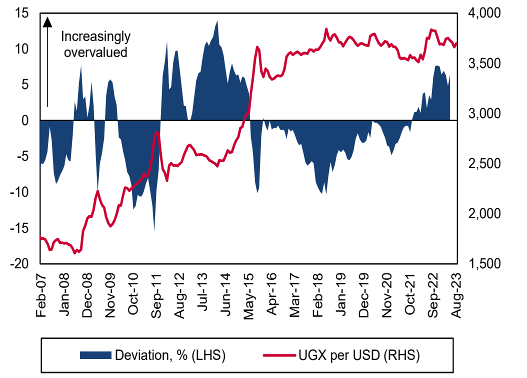
Source: Macrobond, Bank of Uganda, BMI

Risks To Outlook

Risks to our exchange rate forecasts are tilted to a weaker shilling. The Fed has signalled that further interest rate hikes may be needed to preserve the current disinflationary path, which, while not our core view, would sustain downward pressure on EM assets.

Sustained Overvaluation Points To Correction

Uganda – REER Deviation From 10-Year Moving Average & Exchange Rate, UGX per USD



Source: Macrobond, BMI

Moreover, should the international backlash to the Anti-Homosexuality Act prompt further retaliations (such as suspension from the US's Africa Growth & Opportunity Act scheme), this could result in further sharp sell-offs.

Mozambique: Real GDP Growth To Strengthen In 2023, Weaken In 2024

Key View

- We forecast that Mozambique's real GDP growth will accelerate from an estimated 4.1% in 2022 to 6.5% in 2023.
- Investment in the country's energy sector and rapidly rising liquefied natural gas exports will support economic growth in 2023.
- In 2024, we see economic growth decelerating to 4.2% due to a tepid outlook for Mozambique's gas and mining sector.

We forecast that real GDP growth in Mozambique will accelerate from an estimated 4.1% in 2022 to 6.5% in 2023. The latest available data from the Instituto Nacional de Estatísticas show that at the Mozambican economy grew by 4.2% y-o-y in Q123, unchanged from its Q422 rate.

While Mozambique was hit by Cyclone Freddy in March 2023 – which caused widespread infrastructural damage, slowing private sector activity – this was largely offset by strong growth in Mozambique's primary sector (8.2% y-o-y), mainly due to the mining sector which grew by 32.6%. The broad stability of the economy also reflects the strong momentum of the

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nascent liquefied natural gas (LNG) exports. The LNG sector will be the main driver of growth in 2023 as a whole.

We expect that investment in Mozambique's LNG sector will provide tailwinds to real GDP growth in 2023. We forecast that Mozambique's fixed capital formation growth will accelerate from an estimated 5.0% in 2022 to 9.2% in 2023, contributing 3.0 percentage points (pp) to headline growth. In May 2023, Mozambique and Japan agreed to encourage FDI inflow from Japan, into Mozambique's gas sector. We believe that the ongoing Russia-Ukraine war, which has limited Europe's energy supply, will attract more foreign interest in Mozambique's LNG sector over the remaining months of 2023. We have maintained our fixed investment forecast.

The LNG sector will support exports in 2023. We believe that the ongoing Russia-Ukraine war – which weighs on Europe's energy supply – will boost international demand for Mozambique's LNG as an alternative source of energy. Our Oil & Gas team projects that the volume of LNG exports will increase by 238.5% in 2023. In November 2022, energy major **Eni** shipped first gas from the Coral South Floating LNG Project in Mozambique, and that the project will ramp up quickly to 3.5mn tonnes of LNG per year in 2023. Taking this into account, we expect that exports will grow by 74.3% in 2023.

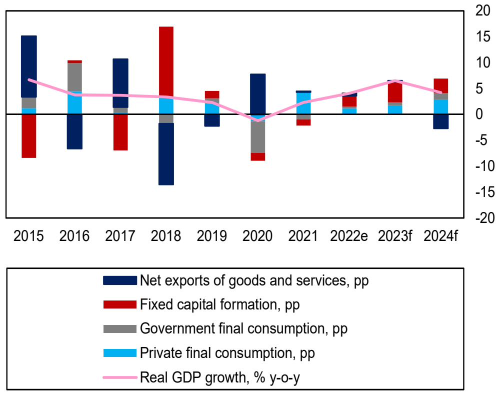
We expect exports to be offset by stronger imports. This is because improving consumer purchasing power as a result of slower inflation (we forecast annual average inflation to slow from 9.9% in 2022 to 7.6% in 2023) will increase consumer and business confidence, resulting in an uptick in consumer and capital goods imports. While we expect that net exports will take away 3.5pp from real GDP growth, it will remain below the 2010-2019 average of -4.9pp.

In 2024, we see economic growth decelerating to 4.2%. We expect tepid gas and mining sector output, with our Oil & Gas team forecasting that the volume of LNG exports will not grow in 2024 and that of dry natural gas exports will decline by 2.8%. Total coal production growth will slow from 2.4% in 2023 to 2.1% in 2024. We forecast net exports to subtract 3.2pp from real GDP growth.

Fixed investment will remain strong in 2024. Our Oil & Gas team now expects that **TotalEnergies** will resume its LNG project in 2024 (after declaring a forced majeure in 2021 following an Islamist attack near its project site in the country's Cabo Delgado province), supporting fixed capital formation. Meanwhile, we believe that the ongoing Russia-Ukraine war will attract more foreign interest in Mozambique's LNG sector – particularly from European firms – over 2024. Taking these dynamics into account, we forecast fixed investment growth to remain strong at 6.5%, offering tailwinds to the Mozambican economy in 2024.

Economic Growth To Pick Up In 2023

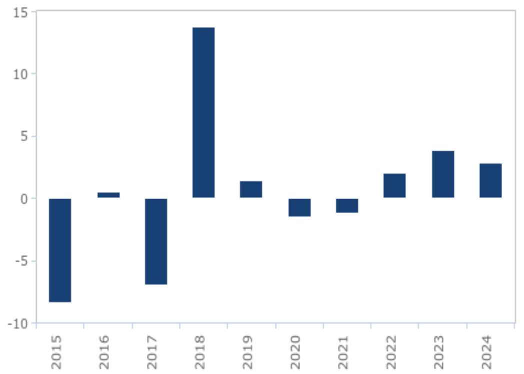
Mozambique – Contribution To Real GDP Growth, pp



Note: 2022 remains an estimate as annual data has not been released yet. e/f = BMI estimate/forecast. Source: Instituto Nacional de Estatísticas, BMI

LNG Sector To Improve Growth Contribution Of Investment

Mozambique – Fixed Capital Formation, pp



Source: Instituto Nacional de Estatísticas, BMI

Risks to our outlook remain tilted to the downside. Ongoing insurgent attacks in the northern Cabo Delgado province, where the LNG sector is being developed, continue to pose risks to the sector. Potential attacks or instability near project sites could delay the development of the LNG sector and could prompt firms to halt or pull operations out of the country. This could further delay TotalEnergies' resumption to its LNG project.

GROWTH OUTLOOK FOR 2023

BMI Forecast	2022	2023	Notes
Real GDP, % chg	4.1	6.5	The economy will strengthen on the back of FDI inflows and more robust exports stemming from the LNG sector.
Household consumption, pp	1.3	1.8	Falling inflation will reduce downward pressure on real incomes and improve consumers' purchasing power, increasing consumer demand and spending.
Gross fixed capital formation, pp	1.6	3.0	An improving security situation and limited oil and gas supply from Russia will encourage more investment interest in Mozambique's LNG sector.
Government consumption, pp	0.3	0.6	An uptick in government revenue as a result of more LNG receipts will give the authorities room to increase spending.
Net exports, pp	-2.1	-3.5	Tailwinds to LNG sector will support exports.

Note: Contributions may not sum due to statistical discrepancies. Source: BMI

BMI EMERGING EUROPE FX FORECASTS, AVE	2021	2022	Current	2024	2025
Czech Republic, CZK per EUR	25.65	24.56	24.08	24.50	24.75
Hungary, HUF per EUR	358.59	391.83	382.79	427.50	442.50
Poland, PLN per EUR	4.57	4.69	4.47	4.68	4.68
Romania, RON per EUR	4.92	4.93	4.94	5.00	5.02
Russia, RUB per USD	73.65	68.48	118.69	96.50	93.50
Turkiye, TRY per USD	8.85	16.55	27.21	30.00	29.00
Ukraine, UAH per USD	27.29	32.34	36.77	42.00	45.50

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI LATIN AMERICA FX FORECASTS, AVE	2021	2022	Current	2024	2025
Argentina, ARS per USD	94.99	130.62	349.97	450.00	840.00
Brazil, BRL per USD	5.39	5.16	4.94	5.08	5.05
Chile, CLP per USD	758.96	873.31	869.13	800.00	778.49
Colombia, COP per USD	3,744.24	4,256.19	4,110.38	4,350.00	4,457.20
Mexico, MXN per USD	20.27	20.13	16.91	18.20	17.20
Peru, PEN per USD	3.88	3.84	3.72	3.65	3.60

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI SUB-SAHARAN AFRICA FX FORECASTS, AVE	2021	2022	Current	2024	2025
Ghana, GHS per USD	5.81	8.27	11.20	10.85	10.94
Kenya, KES per USD	109.64	117.87	144.48	155.06	162.53
Nigeria, NGN per USD	401.15	425.98	762.23	690.00	695.00
South Africa, ZAR per USD	14.78	16.36	18.79	20.20	19.99
Uganda, UGX per USD	3,587.05	3,689.82	3,724.23	3,782.50	3,770.00
Zambia, ZMW per USD	20.02	16.94	19.49	18.95	18.93

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI MIDDLE EAST AND NORTH AFRICA FX FORECASTS, AVE	2021	2022	Current	2024	2025
Egypt, EGP per USD	15.64	19.16	30.85	37.07	36.48
Morocco, MAD per EUR	10.63	10.69	10.85	10.78	10.72

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI EMERGING ASIA FX FORECASTS, AVE	2021	2022	Current	2024	2025
China (Mainland), CNY per USD	6.45	6.74	7.29	6.80	6.65
India, INR per USD	73.92	78.60	82.93	81.00	83.03
Indonesia, IDR per USD	14,308.14	14,849.85	15,315.00	15,700.00	15,918.50
Malaysia, MYR per USD	4.14	4.40	4.65	4.38	4.45
Philippines, PHP per USD	49.25	54.48	56.38	55.75	56.25
Taiwan, China, TWD per USD	28.02	29.81	31.94	28.50	27.10
Thailand, THB per USD	31.98	35.06	34.95	32.90	32.25

Note: May include territories, special administrative regions, provinces and autonomous regions. Source: Bloomberg, BMI. Last updated: August 23 2023

BMI EMERGING EUROPE CENTRAL BANK POLICY RATE FORECASTS, % EOP	2021	2022	Current	2024	2025
Czech Republic	3.75	7.00	7.00	6.00	3.00
Hungary	2.40	13.00	13.00	11.00	5.00
Poland	1.75	6.75	6.75	5.00	2.50
Romania	1.75	6.75	7.00	6.25	4.50
Russia	0.00	7.50	12.00	12.00	10.00
Turkiye	14.00	9.00	17.50	20.00	16.00
Ukraine	9.50	25.00	22.00	20.00	10.00

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI LATIN AMERICA CENTRAL BANK POLICY RATE FORECASTS, % EOP	2021	2022	Current	2024	2025
Argentina	38.00	75.00	40.00	50.00	20.00
Brazil	9.25	13.75	13.25	9.25	8.50
Chile	4.00	11.25	10.25	4.50	4.00
Colombia	3.00	12.00	13.25	7.00	5.25
Mexico	5.50	10.50	11.25	8.00	8.00
Peru	2.50	7.50	7.75	4.50	3.50

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI SUB-SAHARAN AFRICA CENTRAL BANK POLICY RATE FORECASTS, % EOP	2021	2022	Current	2024	2025
Ghana	14.50	27.00	30.00	22.00	17.00
Kenya	7.00	8.75	9.00	9.50	8.50
Nigeria	11.50	16.50	18.75	17.00	17.00
South Africa	3.75	7.00	8.25	7.25	6.75
Uganda	6.50	10.00	9.50	8.50	7.50
Zambia	9.00	9.00	9.50	8.00	8.00

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI MIDDLE EAST AND NORTH AFRICA CENTRAL BANK POLICY RATE FORECASTS, % EOP	2021	2022	Current	2024	2025
Egypt	9.25	17.25	19.25	15.25	8.25
Morocco	1.50	2.50	3.00	4.00	3.00

Source: Bloomberg, BMI. Last updated: August 23 2023

BMI ASIA CENTRAL BANK POLICY RATE FORECASTS, % EOP	2021	2022	Current	2024	2025
China (Mainland)	2.95	2.75	4.35	2.95	3.25
India	4.00	6.50	6.50	5.75	5.75
Indonesia	3.50	5.50	5.75	5.00	5.00
Malaysia	1.75	2.75	3.00	3.00	3.25
Philippines	2.00	5.50	6.25	5.25	3.50
Taiwan, China	1.13	1.75	1.88	1.75	1.75
Thailand	0.50	1.25	2.25	2.00	1.50

Note: May include territories, special administrative regions, provinces and autonomous regions. Source: Bloomberg, BMI. Last updated: August 23 2023