BEA 東亞銀行

Economic Research

April 2023

Market Monitor – Europe

Better-than-expected economic performance amid uncertainties

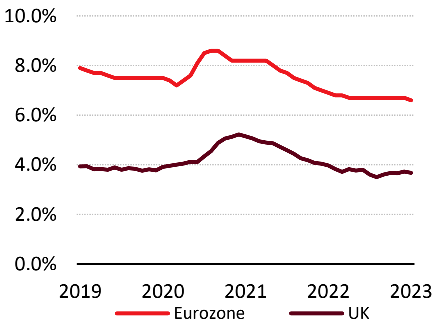
- Stable employment, lower energy costs, and improving confidence, etc. helped the European economy avoid a recession.
- Despite banking and financial market turmoil, the European Central Bank (ECB) and the Bank of England (BoE) hiked rates again to contain inflation.
- Looking ahead, the European economy will continue its modest recovery amid numerous uncertainties.

European economy performed better-than-expected

Following a stagnant Q4 in 2022, the European economy performed better-than-expected in early 2023. In the 2H 2022, the European economy was impacted by geopolitical tensions, an energy crisis and high inflation, etc. However, the steady energy supply and warmer weather, etc. caused lower energy prices and reduced worries of an energy crisis. Both the eurozone and UK economies avoided a deep recession in the winter of last year.

Meanwhile, the solid labour market has continued to support consumer confidence. Eurozone's unemployment rate registered at 6.6% in February 2023, near the lowest level on record. The UK's unemployment rate recorded at 3.7% during November 2022 and January 2023, remaining at a low level since December 1973. The solid labour market has resulted in wage hikes in a number of European economies and will likely stabilise the consumers' income expectation. As such, the consumer confidence index in the eurozone increased from an average of -25.7 in 2H 2022 to -19.6 in Q1 2023; the UK GfK consumer confidence index also rose from -44.5 to -39.7 during the same period. Amid strengthening consumers' confidence, UK retail sales has increased for a second consecutive month, accelerating from a month-on-month growth of 0.9% in January to 1.2% in February 2023. The services sector also continued to improve, with the services purchasing managers' index in the eurozone and the UK staying at expansionary territory for the third and the second consecutive month, registering at 55.6 and 52.8 respectively in March. This indicates that the European economy could be stronger than the previous

Unemployment Rate



Source: CEIC

quarter, though its pace of recovery is still restrained by high inflation, high interest rates, geopolitical tensions and financial market risk, etc.

Uncertainties remain, delaying a full recovery

Eurozone and UK inflation have likely peaked, but it will take some time for inflation to return to policy target. Eurozone and UK inflation has decelerated to 6.9% in March and 10.4% year-on-year (YoY) in February 2023, after hitting a peak of 10.6% and 11.1% YoY in October 2022, respectively. However, food and services prices are still rapidly rising, resulting in sticky and elevated core inflation and a slower-than-expected pace of deceleration. Given that the eurozone and UK economies didn't enter into a deep recession as originally expected, together with its steady employment market, the ECB and BoE is yet to finish their work on controlling inflation.

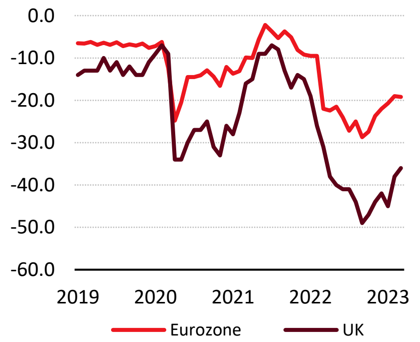
The ECB and BoE hiked rates again, with the future rate path becoming more uncertain. Recently, a few European and US banks suffered from a liquidity and confidence crisis, triggering the regulatory authorities' moves to stabilise the financial system. However, the inflationary pressure in both the eurozone and the UK remains far higher than their 2% policy target; the ECB raised its policy rate again by 50 basis points (bps) to 3% in March 2023, the highest since November 2008, while the BoE has also increased its policy rate by 25 bps to 4.25%. Going forward, the ECB and BoE will closely monitor the impact on financial stability arising from the European and US banking confidence crisis, and are expected to take any necessary actions. If the financial volatility could be put under control in the short term, the ECB and BoE are expected to continue their fight against inflation, with further room of interest rate hikes and a tightened monetary environment for an extended period.

Looking ahead, the European economy is expected to post a modest expansion, but remains restrained by uncertainties. Despite better-than-expected economic performance, high inflation and high interest rate environment, tightened credit conditions, volatile financial markets, geopolitical tensions, as well as a higher UK corporate tax rate and protests in France, etc., are expected to dampen business and consumer confidence ahead. Accordingly, the European economy is expected to register a modest expansion amid numerous uncertainties.

Financial markets turned increasingly risk adverse

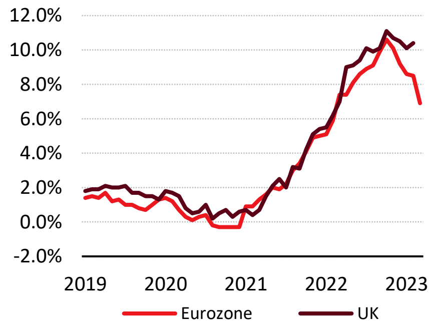
There is a rapidly rising risk adverse sentiment amid worries over financial stability. The liquidity concerns among the US and European banks have resulted in rising risk adverse sentiment over the potential contagion risk with financial sector shares under intense pressure. The UK FTSE 100 index declined by 3.1% in March from the level at the end of February. Nonetheless, the German DAX index and the French CAC index rose by 1.7% and 0.7%, respectively, over the same horizon. Moreover, easing market expectations of future US interest rate hikes or even pricing-in earlier rate cut amid confidence crisis among US regional banks have led to softening US dollar exchange rate. At end-March 2023, the euro and British pound closed at US$1.0839 and US$1.2337, respectively, representing appreciation of 2.5% and 2.6% compared to end-February 2023.

Consumer Confidence Index



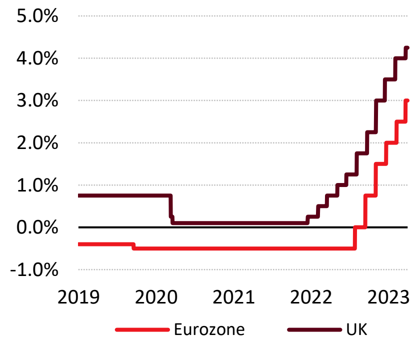
Source: CEIC

Inflation Rate



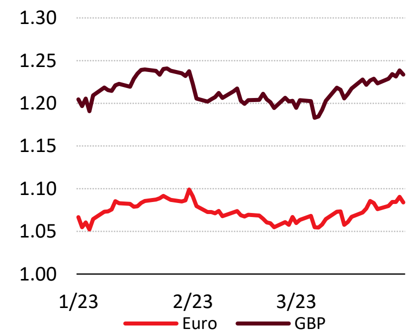
Source: CEIC

Policy Rate



Source: CEIC, data as of 31/3/2023

Euro & British Pound against USD



Source: Bloomberg, data as of 31/3/2023

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