

Market Monitor – Europe

Stabilising at A Varied Recovery Pace



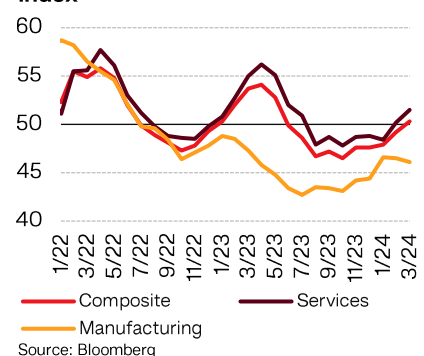
- Survey indicators pointed to further stabilisation in the eurozone economy, led by the services sector, while the UK resumed mild growth in early 2024.
- Recent softening of Eurozone year-on-year inflation paves way for rate cut in mid-2024 though the high month-on-month jump is still worrying.
- The ECB and the BoE will continue to monitor the persistence of inflation when deciding their paths of policy adjustments.

The European economy stabilised in early 2024

The eurozone economy continued its stabilising trend in March. The eurozone's composite purchasing managers' index (PMI) improved further from 49.2 in February to 50.3 in March, returning to expansion the first time since May 2023 and marking the highest reading in the past 10 months. The services sector remained the major driving force, with the services PMI rising from 50.2 in February to 51.5 in March, marking a second consecutive month of expansion. Meanwhile, the manufacturing PMI remained subdued, dropping from 46.5 in February to 46.1 in March. Among the eurozone's member states, Germany and France still recorded output contraction with their composite PMIs at 47.7 and 48.3 in March, respectively, while Italy and Spain provided strong boosts in the region. Overall, the eurozone's economic momentum is stabilising, but at an uneven pace across sectors and countries.

The UK economy resumed mild growth in early 2024. The UK's gross domestic product (GDP) expanded by 0.2% month-on-month (MoM) in January 2024, after a MoM drop of 0.1% in December 2023. Among the major sectors, the services sector ranked as the top growth contributor, rising by 0.2% MoM. The construction sector rebounded by 1.1% MoM after declining for three successive months. The production sector contracted by 0.2% MoM. On a three-month basis,

Eurozone Purchasing Managers' Index



Economic Research

April 2024

the economy contracted slightly by 0.1% from November 2023 to January 2024, a smaller decline than a 0.3% quarter-on-quarter drop in Q4 2023. Business surveys were further improving, pointing to a moderate expansion in Q1 2024, as an average UK composite PMI in Q1 2024 surpassed that of Q4 2023. In March, the services PMI took the lead at 53.1, while the manufacturing PMI improved to 50.3 in March from 47.5 in the preceding month, showing signs of stabilisation.

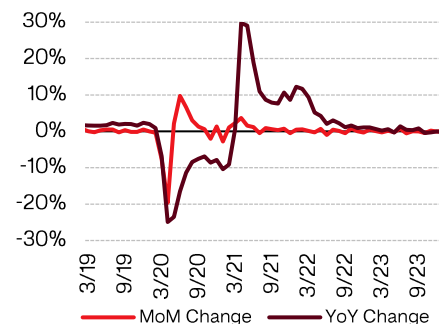
Central banks continued to monitor the persistence of inflation

Eurozone's inflation eased but inflationary pressure remained sticky. Headline and core consumer price inflation were recorded at 2.4% and 2.9% year-on-year (YoY) in March, moving down from 2.6% and 3.1% in February. On a MoM basis, both headline and core CPI inflation rose by 0.8% and 1.1% in March, accelerating from 0.6% and 0.7% in February, respectively, signalling sticky inflationary pressure. Besides, the low base effects of energy prices started to fade, with energy inflation showing a narrower decline from -3.7% YoY in February to -1.8% in March. In addition, services inflation remained relatively high at 4.0% YoY and 0.7% MoM in March.

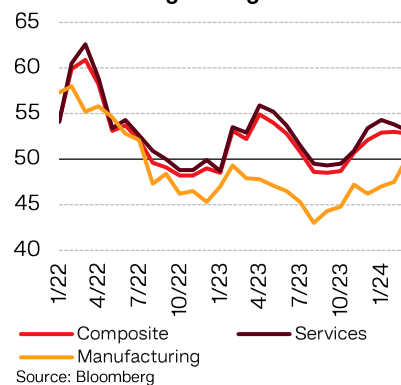
The UK's inflation eased at a faster pace than expected. The UK's headline consumer price inflation decelerated to 3.4% YoY in February, after staying flat at 4.0% YoY for two consecutive months. Core inflation (excluding energy & food) slowed from 5.1% YoY to 4.5%. Goods inflation remained moderate at 1.1% YoY in February, lower than the around 2% level seen in the past three months. Services inflation trended lower again, from 6.5% YoY to 6.1% in February, after a slight pick-up in the preceding two months. Wage growth sent further encouraging signals, with the growth of weekly labour earnings (excluding bonuses) slowing from 7.8% in Q3 2023 to 6.1% in the 3-month period to January 2024. This should help ease the underlying inflation pressures ahead.

The European Central Bank (ECB) held rates unchanged but awaited further evidence on disinflation to kick-start policy adjustment. In March, the ECB kept its major interest rates unchanged, but revised its annual inflation projection for 2024 to 2.3%, down from 2.7% in December 2023. In early March, ECB President Lagarde highlighted that more wage and inflation data will come in the next few months, which could raise the confidence level for the ECB to dial back its restrictive policy stance. This suggests that a rate cut can come as early as June. In addition, the ECB also announced changes to the operational framework for implementing monetary policy. Under the proposed framework, the ECB will continue to steer its monetary policy stance by adjusting the deposit facility rate (DFR), with the main refinancing operations (MROs) likely to play a central role in meeting banks' liquidity needs. The interest rate spread between DRF and MROs will be narrowed from 50 basis points (bps) to 15 bps, starting from 18 September 2024. Liquidity will be provided through short-term credit operations, three-month longer-term refinancing operations, and, at a later stage, structural longer-term credit operations and a structural portfolio of securities.

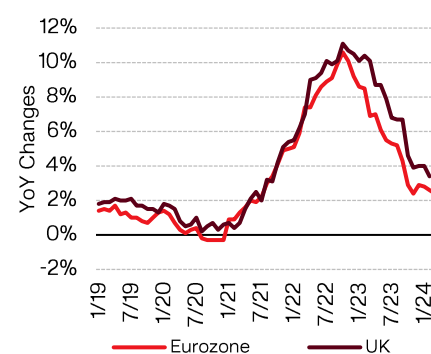
Monthly UK Gross Domestic Product



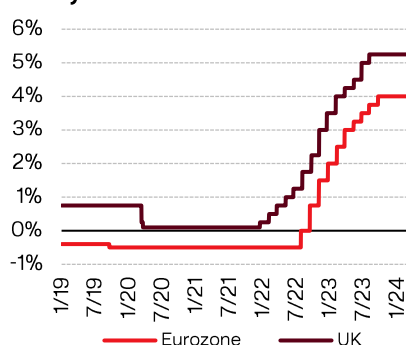
UK Purchasing Managers' Index



Inflation Rate



Policy Rate



The Bank of England (BoE) turned more dovish. The BoE announced it would hold its policy rate at 5.25% under a majority vote of 8-1 in March 2024. One member preferred to cut the policy rate by 25 bps, while the two previously hawkish members now followed the majority's preference to hold. The BoE projected that consumer price inflation will fall to slightly below 2% in Q2 2024, driven by the reduction of household energy price cap, but inflation sets to increase again in Q3 and Q4 2024. Having said that, the BoE is likely to maintain a restrictive monetary policy and look for more progress in disinflation. This is particularly due to key indicators of inflation persistence, such as wage growth and services price inflation, remaining elevated in the UK.

European equity markets posted a solid gain

Optimistic market sentiment fuelled further advance in equity markets. Market expectations for the US Fed to begin its first rate cut around mid-2024 increased investors' risk appetite. In addition, the upbeat corporate earnings in certain sectors (e.g. the retail sector) reinforced the upward momentum of equity markets. At the end of March, the UK FTSE 100 index, the German DAX index and the French CAC index increased by 4.2% MoM, 4.6% and 3.5%, respectively. The performance of the euro and British pound were largely stable, closing at US\$ 1.079 and US\$ 1.2623 by the end of March, respectively, representing a slight depreciation of 0.1% and 0.02% respectively, over the previous month.

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