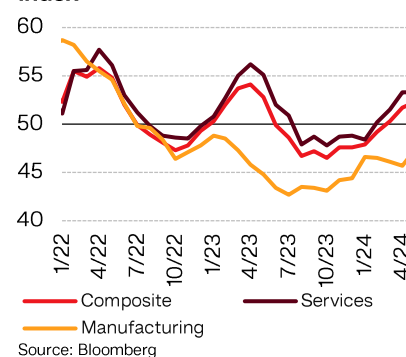


Market Monitor – Europe
Recovery progressively gathered pace


- Business surveys revealed that both the eurozone and the UK economy are on track for further recovery.
- Inflation readings for the eurozone and the UK rose faster than expected.
- The BoE delivered dovish forward guidance while the ECB made a "hawkish" rate cut.

The European economy saw a sustained recovery

The eurozone's business sentiment improved further. The eurozone's composite PMI rose from 51.7 in April to 52.2 in May, staying in expansionary territory for three consecutive months and marking the highest reading since June 2023. The composite PMI index has already been steadily increasing for five months in a row, indicating a gradual pickup in growth momentum. The services sector remained a key growth driver, with its PMI edging slightly lower from 53.3 in April to 53.2 in May, the fourth consecutive month of expansion. Besides, the manufacturing PMI saw a slower contraction, increasing from 45.7 in April to 47.3 in May, the highest reading since April 2023. Meanwhile, the economic divergence among the eurozone member states has narrowed somewhat. Germany, Italy and Spain saw output expansion, with their composite PMIs at 52.4, 52.3 and 56.6 in May, respectively. However, business sentiment in France weakened, with its composite PMI falling to contractionary territory at 48.9 in May. On balance, the eurozone's economic momentum has exhibited further improvements, while the recovery paces have remained varied across different sectors and countries.

Eurozone Purchasing Managers' Index


Economic Research

The UK economy grew further recently. The UK's GDP expanded by 0.4% month-on-month (MoM) in March, following an upward-revised growth of 0.2% in February. Among the major sectors, services output played a key role in driving growth in March, growing by 0.5% MoM after a 0.3% increase in February. The services sector has seen MoM growth in each of the past three months. However, construction output contracted by 0.4% MoM in March after a 2.0% MoM drop in February. The construction sector underwent seven MoM declines in the last nine months. In Q1 2024 as a whole, the UK's GDP grew by 0.6% over the previous quarter. In addition, business surveys indicated that the UK economy continued to expand in early Q2 2024, albeit at a moderating pace. The composite PMI for the UK retreated from 54.1 in April to 53.0 in May, having stayed in expansionary territory since November 2023. The services PMI slowed from 55.0 in April to 52.9 in May, while the manufacturing PMI surged from 49.1 in April to 51.2 in May, returning to expansionary territory.

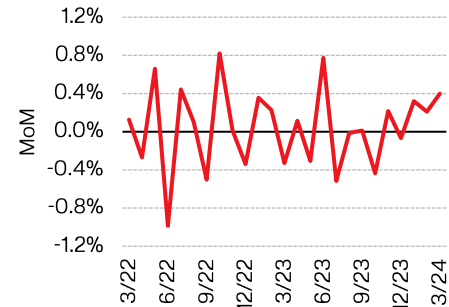
Inflation in the eurozone and the UK rose more than expected

The eurozone's inflation ticked up amid a faster rise in services prices. In May, the eurozone's headline and core CPI grew by 2.6% year-on-year (YoY) and 2.9%, up from 2.4% and 2.7% in April, respectively. On a MoM basis, the eurozone's headline and core CPI inflation eased to 0.2% and 0.4% in May, down from 0.6% and 0.7% in April, respectively. Both readings were higher than expected. One of the major price drivers was services inflation, which accelerated to 4.1% YoY in May from 3.7% in April, marking the fastest growth in the past seven months. Yet, certain one-off factors, including the reversal of Easter's effects and fading discounts for public transport in Germany, were attributed to the rise in services inflation in May. Amid a tight monetary environment, the eurozone's inflation is expected to ease gradually ahead.

UK inflation slowed, but its underlying pressure remained elevated. The UK's headline and core CPI inflation slowed from 3.2% YoY and 4.2% in March to 2.3% and 3.9% in April, respectively. Both were higher than the market consensus. The easing of headline CPI inflation in April was mainly due to falling gas and electricity prices, as the Office of Gas and Electricity Markets (Ofgem) lowered its energy price cap in April. In the meantime, services inflation remained sticky at 5.9% YoY and 1.5% MoM in April, whereas goods inflation dropped by 0.8% YoY and 0.8% MoM. Wage growth continued to bring elevated inflationary pressure to the UK, with regular earnings excluding bonuses rising by 6.0% YoY in January to March. A sustained deceleration in wage growth is essential for the further cooling of the UK's inflation towards its policy target.

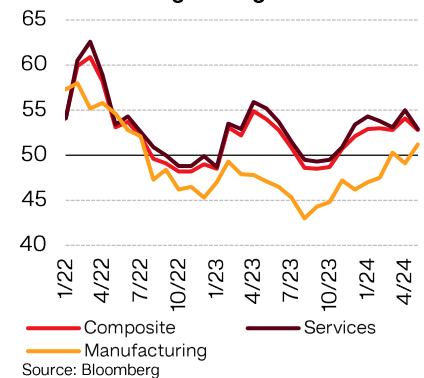
June 2024

Monthly UK Gross Domestic Product



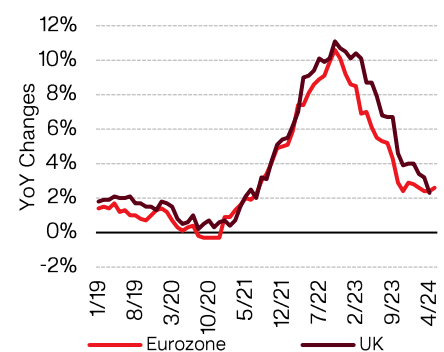
Source: CEIC

UK Purchasing Managers' Index



Source: Bloomberg

Inflation Rate



Source: CEIC

Economic Research

June 2024

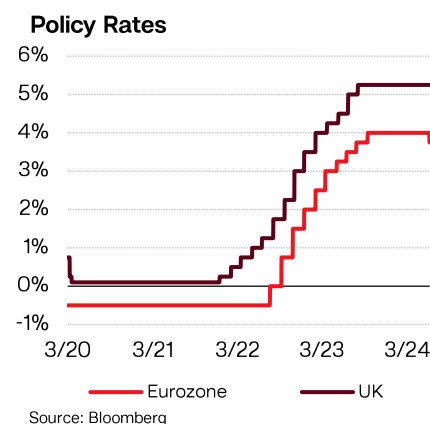
The European Central Bank (ECB) delivered a "hawkish" rate cut. As expected, the ECB cut its deposit facility rate by 25 basis points to 3.75% in the June monetary policy meeting. Meanwhile, it updated the economic projections and revised up the HICP inflation by 0.2 percentage points to 2.5% and 2.2% for 2024 and 2025, respectively. In the post-meeting press conference, ECB's president Christine Lagarde stated that a restrictive monetary environment with high rates and the previous progress of disinflation allowed the ECB to cut rates in June, but she revealed that future monetary decisions will follow a data-dependent and meeting-by-meeting approach, given a still uncertain inflation outlook. Overall, the ECB's message suggests that back-to-back rate cuts in its July meeting are unlikely, while September's cut remains on the table, particularly if further disinflation can be seen in the coming months.

The Bank of England's (BoE) is likely to cut rates somewhat later than the ECB.

In the May monetary policy meeting, the BoE voted by a majority of 7-2 to keep its policy rate unchanged at 5.25%. The two members against the decision preferred a rate cut of 25 basis points. In the post-meeting press conference, Andrew Bailey, the Governor of the BoE, said that "it's likely that we will need to cut bank rates over the coming quarters", suggesting their intention to start cutting rates. However, services inflation in the UK remained elevated, requiring wider evidence to confirm further easing on inflationary pressures. On balance, the BoE is expected to maintain its current policy rate in its upcoming June meeting, while the market will look for hints about when it will start cutting rates later this year.

European equity markets and currencies edged higher

Risk appetite increased with US treasury yields and the US dollar index declining. In May, US treasury yields were slightly lower amid reduced worries about resurging inflation in the US, boosting risk appetite to fuel a rally in major stock indices. Particularly, the UK FTSE 100 index, the German DAX index, and the French CAC index closed higher by 1.6% MoM, 3.2%, and 0.1%, respectively, in May. Besides, as the US dollar index dropped slightly, the Euro and British pound saw a MoM appreciation of 1.7% and 2.0%, closing at US\$ 1.0848 and US\$ 1.2742, respectively, by the end of May.



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