Economic Research

July 2024

Market Monitor – Europe

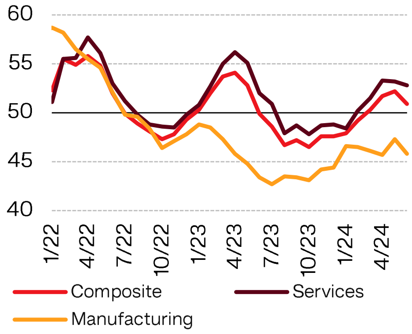
Moderating growth momentum

- Latest indicators showed that the momentum of both the eurozone and the UK economies has moderated somewhat recently.
- Disinflation progress remains uncertain, given the stickiness of service prices and elevated wage growth.
- The UK's Labour Party won a landslide victory, while the French elections resulted in no single bloc securing an outright majority.

Growth momentum has moderated somewhat recently

The eurozone economy points to a modest expansion. After five consecutive months of acceleration, the eurozone composite PMI declined from 52.2 in May to 50.9 amid political uncertainty after the announcement of snap elections in France. Despite reaching a three-month low in June, the composite PMI averaged 51.6 in Q2, higher than the 49.1 averaged in Q1, indicating a continuous improvement and modest expansion of the eurozone economy. Both the manufacturing and services sectors took a hit, declining 1.5 and 0.4 points to 45.8 and 52.8 in June, respectively, with the former staying in contractionary territory for two years while the latter was in an expansion zone for five months. The services sector is expected to remain the driving force behind the modest expansion of the eurozone economy, while the weak manufacturing sector signals that the eurozone has yet to benefit from the manufacturing and export growth seen in other parts of the world. Among the member states, the composite PMI decline was broad-based across countries, though the big four economies except France were still in expansion zones. In France, both the manufacturing and services sectors were in contraction zones, likely because of the political uncertainty, while Germany's manufacturing sector was the worst performer among all member states, likely attributable to its high auto industry

Eurozone Purchasing Managers' Index

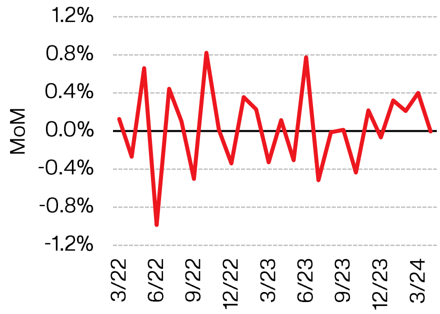


Source: Bloomberg

exposure. Spain and Italy were both benefitting from their solid services sector performances.

Steady recovery of the UK economy. After the UK GDP growth was revised up by one-tenth to 0.7% quarter-on-quarter (QoQ) in Q1 2024, its monthly GDP was flat in April. Services stood out as the best performing sector, with a 0.2% month-on-month (MoM) growth following a 0.5% increase in March. However, construction and manufacturing output both decreased by 1.4% MoM in April. Despite the flat reading in April, the UK GDP is now running above its Q1 average, pointing to a steady expansion of the UK economy in Q2. Nevertheless, the UK PMI indicated moderating momentum in the economy, with the composite, manufacturing and services PMIs declining 0.7, 0.3, and 0.8 points to 52.3, 50.9 and 52.1 in June, respectively. Both the manufacturing and services sectors remained in the expansion zone, with the former still staying at a relatively high level over the past two years, while the latter was somewhat affected by the wait-and-see attitude ahead of the general election.

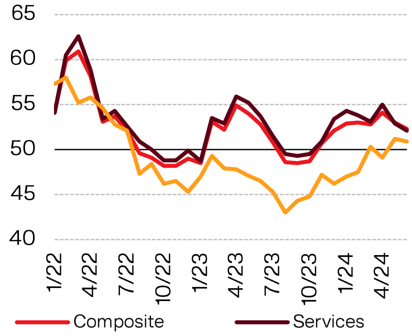
Monthly UK Gross Domestic Product



Source: CEIC

Further decline in headline inflation but services prices stay sticky

UK Purchasing Managers' Index

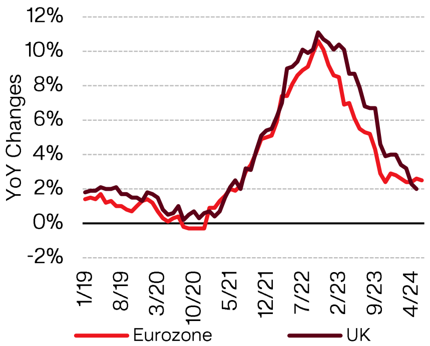


Source: Bloomberg

Limited service price disinflation in the eurozone. In June, the eurozone's headline CPI grew by 2.5% year-on-year (YoY), edging down from 2.6% in May. Core CPI remained unchanged at 2.9%, which was higher than the consensus forecast of 2.8%. On a MoM basis, the eurozone's headline CPI stayed unchanged at 0.2% in June, while core CPI edged down from 0.4% in May to 0.3% in June. Notably, services prices were flat at 4.1% YoY, driven by a 0.6% MoM growth, while core goods prices held steady at 0.7% YoY and -0.1% MoM, respectively. It is worth noting that the momentum of service prices has shown little sign of disinflation since November 2023. The elevated wage growth and resilient labour market are the key drivers for the sticky services prices. Wage growth jumped 5.3% YoY in Q1 2024, accelerating from the 3.2% growth seen in 4Q 2023, though partly reflecting the sky high inflation in the earlier period. Moreover, disinflation of core goods prices might come to a halt soon, and the recent increase in oil prices could also feed through to consumer prices. Both will add to the inflation momentum ahead.

Headline inflation returned to the 2% target in the UK, while services prices stayed elevated. The UK saw a notable slowdown in both headline and core CPI inflation rates, with the YoY readings dropping to 2.0% and 3.5% in May from 2.3% and 3.9% in April, respectively. The decrease in headline CPI inflation was primarily driven by a high comparison base of energy prices and a decline in food prices. However, service prices stayed at a high level, edging down from 5.9% in April to 5.7% in May. Similar to the eurozone, wage growth remains high and sticky in the UK. Regular earnings, excluding bonuses, saw a 6.0% YoY rise from February to April, though this also partly reflected the impact of previous high inflation. Currently, achieving a sustained deceleration in wage growth is crucial to cooling down inflation towards the policy target.

Inflation Rate

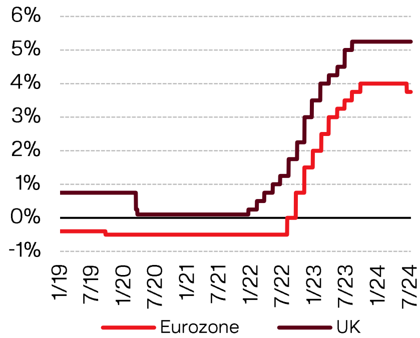


Source: CEIC

The Labour Party ended 14 years of Conservative rule in the UK. Both the UK and France held their general elections in early July. In the UK, the Labour Party won a landslide victory and secured 411 parliamentary seats out of the 650 in the House of Commons. The Labour Party leader, Keir Starmer, becomes the new Prime Minister. According to the Labour Party's manifesto, one of its top priorities is to attain economic stability through clear rules on tax and spending policies. Thus, while tax policies are not likely to see a massive overhaul, certain tax rises are still likely, such as an increase in capital gain tax, the elimination of non-domiciled UK residents, VAT on private school fees, and taxes on energy companies. Besides, housing is another key policy area for Labour, particularly, there is a pledge to deliver 1.5 million new homes over the next five years in a bid to produce more investment and growth and solve the housing shortage problem. On the relationship with the EU, the Labour Party has made it clear that the UK will remain outside the EU, but it will seek an improved relationship with the EU. Regarding the elections in France, preliminary results showed that the French National Assembly is set to see three major blocs: the left-wing alliance Nouveau Front Populaire (around 182 seats), followed by President Emmanuel Macron's Ensemble centrist alliance (around 168 seats), and Marine Le Pen's far-right Rassemblement National (around 143 seats). With no single bloc having an outright majority of 289 seats, negotiations among the various parties will determine whether a coalition government can be formed. Domestic political uncertainties are poised to remain elevated in the months ahead after the French elections.

No further cut in July is expected for the European Central Bank (ECB), while the Bank of England's (BoE) is on track to cut rates in 2H 2024. After the ECB cut its key policy rates for the first time since 2019, it removed the easing bias towards further cuts, and will follow a data-dependent and meeting-by-meeting approach. As it is widely expected that the ECB will not conduct a back-to-back rate cut in July, the upcoming meeting's focus will be on whether it will provide any clear guidelines about a possible cut in September, despite sticky services prices. In the UK, the BoE kept its policy rate unchanged in June with a majority vote of 7-2. However, its meeting statement noted that for some policymakers who voted to keep rates unchanged, the decision is "finely balanced", suggesting the BoE is getting closer to cutting rates. Therefore, even though services prices remain sticky and elevated, on balance, the BoE is still on track to cut its policy rate in 2H 2024.

Policy Rate



Source: CEIC

Equity markets and currencies in Europe declined in June

The French snap election call spooked financial markets. In June, French President Emmanuel Macron called for a snap election after his party lost to far-right Marine Le Pen's National Rally in the European Parliament election. This surprising move sent shockwaves across the equity markets. In particular, the UK FTSE 100 index, the German DAX index, and the French CAC index closed lower by 1.3% MoM, 1.4%, and 6.4%, respectively, in June. Besides, as the US dollar index climbed, the Euro and British pound saw a MoM depreciation of 1.2% and 0.8%, ending June at US$ 1.0713 and US$ 1.2645, respectively.

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