BEA 東亞銀行

Economic Research **September 2024**

Market Monitor – Europe

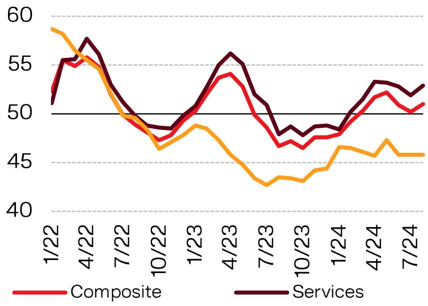
Growth momentum picked up with the Olympic boost

- Growth momentum in the eurozone improved with a boost from the Olympic Games, while the UK economy expanded solidly in Q2.
- Inflation in the eurozone and the UK cooled further, despite elevated underlying inflationary pressure.
- The ECB remained open to cutting rates in September's monetary policy meeting, while the BoE Governor was "cautiously optimistic" about the inflation outlook.

Growth momentum gained pace, led by the services sector

Growth momentum accelerated, although the boost may be temporary. The eurozone composite PMI rose from 50.2 in July to 51.0 in August, marking the best reading in the past three months and the sixth consecutive month of expansion. The rise was mainly fuelled by the services PMI, which climbed notably by 1.0 percentage point (pp) to 52.9 in August, whereas the manufacturing PMI was flat at 45.8. Among the Eurozone key member states, France reported a notable expansion in business activity, with its service PMI jumping markedly by 4.9 points to 55.0 in August, the fastest expansion since June 2022. This reflected a boost from the Olympic effect, which would be one-off and fade after the Games. While Spain and Italy also saw stronger expansion, Germany's business activity remained in contraction, with its composite PMI dropping to 48.4 in August, the lowest level in five months. These regional variations raised doubts over the sustainability of the eurozone recovery. Besides, underlying survey data highlighted economic fragility, as new orders, employment and business confidence worsened in August. On balance, the eurozone area is likely to see

Eurozone Purchasing Managers' Index

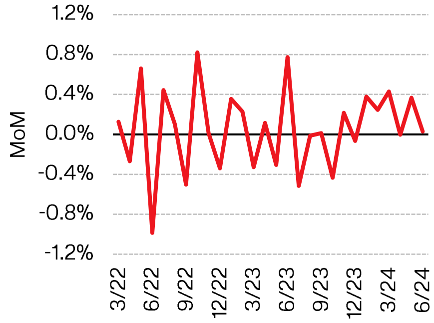


Source: Bloomberg

modest expansion in 3Q 2024, but growth could slow as the boost from the Olympic Games fades.

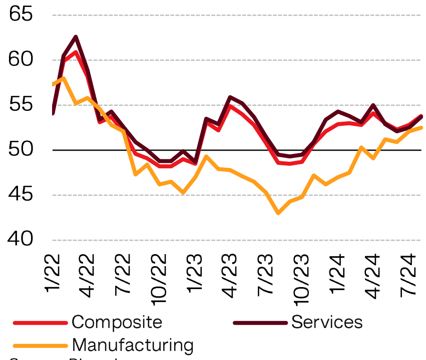
The UK economy recorded robust growth in 2Q. UK GDP expanded strongly, with a robust 0.6% quarter-on-quarter (QoQ) growth in Q2, following a strong 0.7% expansion in Q1. On a year-on-year (YoY) basis, the UK economy grew by 0.9% in Q2, accelerating from 0.3% in Q1. These readings were in line with market expectations. Among key economic sectors, the services sector remained a key growth driver, with its output rising by 0.8% QoQ in Q2, while both production and construction output saw a mild decline of 0.1%. Besides, UK business activity continued to expand in 3Q, with the composite, manufacturing and services PMIs rising by 1.0, 0.4, and 1.2 pps to 53.8, 52.5 and 53.7 in August, respectively. These PMI readings have improved for two consecutive months. Notably, UK manufacturing PMI reached its highest level in 2 years, supported by a sharp increase in new orders. In terms of the monthly GDP readings, the UK economy was flat in June, with robust 0.4% month-on-month (MoM) growth in May.

Monthly UK Gross Domestic Product



Source: CEIC

UK Purchasing Managers' Index



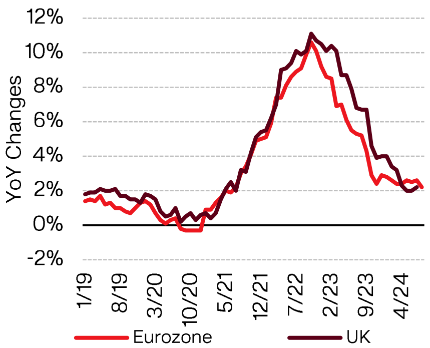
Source: Bloomberg

Underlying inflationary pressure remained notable

The Eurozone's headline inflation cooled while services inflation picked up. Headline and core inflation for the eurozone went down by 0.4 and 0.1 pps to 2.2% and 2.8% in August, respectively. Both readings were in line with market expectations, with headline inflation marking the softest increase since August 2021. The slowdown in headline inflation was driven by a notable reduction in energy prices, which dropped by 3.0% YoY in August, compared to a 1.2% increase in July. However, the eurozone's services inflation accelerated by 0.2 pps to 4.2% YoY in August, the highest readings since November 2023. Meanwhile, food, alcohol and tobacco prices edged 0.1 pps higher to 2.4% YoY in August. Going forward, the eurozone's disinflation progress will largely depend on a further moderation in service prices, which are highly linked to wage growth and labour market conditions.

UK services inflation slowed but remained elevated. UK headline inflation edged up by 0.2 pp to 2.2% YoY in July, whereas its core inflation slowed by 0.2 pps to 3.3%. Both readings were below market consensus. On a MoM basis, UK headline and core CPI softened from 0.1% in June to -0.2% in July and from 0.2% to 0.1%, respectively. In particular, services inflation eased by 0.5 pps to 5.2% YoY in July, the slowest price growth since July 2022. However, the UK labour market remained tight, with the unemployment rate falling to 4.2% in the three months to June, close to historical lows. On wage growth, regular earnings (excluding bonuses) rose by 5.4% YoY in the three months to June, down from a 5.8% increase in the three months to May. Previous pay increases are likely to continue exerting upward pressure on services inflation ahead.

Inflation Rate



Source: CEIC

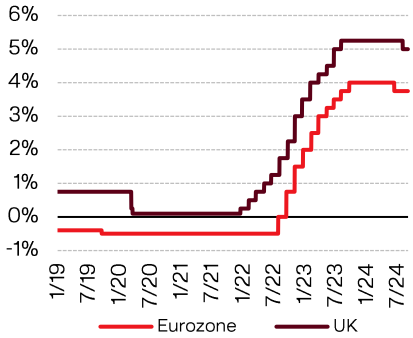
The ECB signalled openness to cut rates in September. According to the minutes of the ECB's July meeting, ECB officials concluded that "the September meeting was widely seen as a good time to re-evaluate the level of monetary policy restriction. That meeting should be approached with an open mind". In addition, several ECB officials attending the Jackson Hole Economic Symposium in late August spoke about the prospects of another rate cut at the upcoming monetary meeting. These messages send a strong signal that the ECB is ready to cut rates in September.

The BoE sounded more positive about the inflation outlook. At the Jackson Hole Economics Symposium, BoE Governor Andrew Bailey stated that he was "cautiously optimistic that inflation expectations are better anchored" and added that "the second-round inflation effects appear to be smaller than we expected", suggesting that the knock-on impact of inflation is manageable. Regarding the pace of rate cutting, Mr. Bailey indicated that "the policy setting will need to remain restrictive for sufficiently long", implying that the upcoming easing cycle is likely to be gradual and measured. Following a rate cut in early August, we expect the BoE to cut its bank rates again in Q4.

Stock markets and currencies gained in August

Financial markets surged given rising hopes of rate cuts in the US. In August, US treasury yields declined, notably on expectations of a rate cut by the US Federal Reserve in September, driving global equities higher. In particular, the UK FTSE 100 index, the German DAX index, and the French CAC index edged 0.1%, 2.2%, and 1.3% higher MoM in August, respectively. Besides, the Euro and British pound strengthened, appreciating by 2.1% MoM, ending August at US$ 1.1048 and US$ 1.3127, respectively.

Policy Rate



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