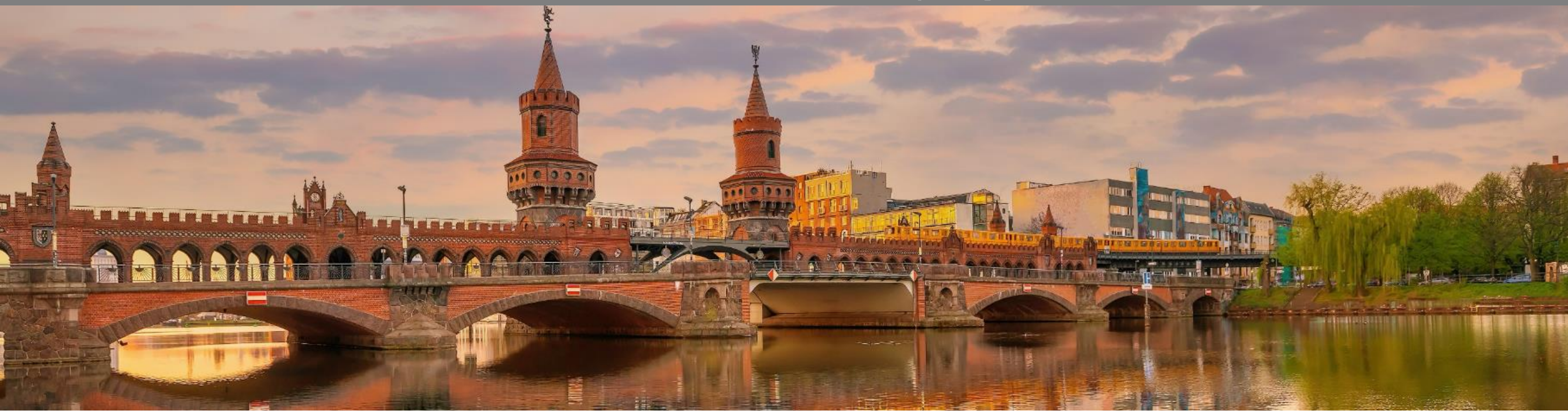
Economic Research

October 2024

Market Monitor – Europe

Renewed weak outlook after the Olympic Games

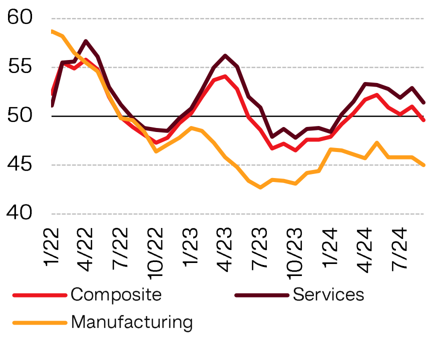


- Notable slowdown in eurozone business activity in September, as the boost from the Olympic Games faded in France, and a renewed weakness in Germany.
- Eurozone headline inflation slowed further due to a significant drop in energy prices, whereas UK services inflation edged higher, driven by a sharp jump in airfares.
- The ECB cut interest rates twice in three months and lowered its growth forecast, while the BoE kept rates unchanged in September amid elevated services inflation.

Growth decelerated amidst a slowdown in the services sector

Eurozone PMI showed renewed weakness in several major member states. The eurozone composite PMI decreased by 1.4 percentage points (ppts) to 49.6 in September, falling back into contractionary territory for the first time in seven months. The decline was largely attributed to slowing business activity in the services sector. Specifically, the services PMI decreased by 1.5 ppts to 51.4, also the lowest reading in seven months, while the manufacturing PMI dropped 0.8 ppts to 45.0. Among key eurozone member states, France experienced a significant slowdown, with its composite and services PMI declining markedly by 4.5 ppts and 5.4 ppts to 48.6 and 49.6 in September, respectively, suggesting that the boost from the Olympic Games was likely to be temporary. Germany and Italy's composite PMI readings also reached contractionary territory and dropped to seven and nine month lows in September, respectively. On the contrary, Spain continued to see a strong expansion with its September's composite PMI surging by 2.8 ppts to 56.3, the highest in four months. The varying growth trajectories among key member states signalled that the recovery path of the eurozone remained subdued. Eurozone composite PMIs averaged at 50.3 in Q3, down from an average of 51.6 in Q2. Though the PMI figures still pointed to a modest expansion in Q3, its growth momentum has slowed notably, calling for more action from the European Central Bank.

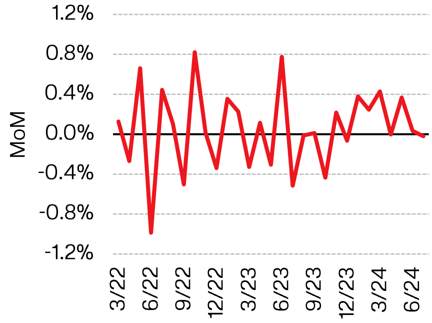
Eurozone Purchasing Managers' Index



Source: Bloomberg

The UK economy has stalled for two straight months. The UK GDP unexpectedly registered no growth in July, missing market forecasts of 0.2% month-on-month (MoM) growth. It marked the third month of no growth from April to July, raising concerns that the rapid recovery observed in Q1 2024 has been losing momentum. The services sector saw an output growth of 0.1% MoM in July, whereas production and construction output dropped by 0.8% and 0.4%, respectively. On a year-on-year (YoY) basis, the UK economy grew by 1.2% in July, up from 0.7% in June, but was still below the market consensus of 1.4%. Besides, the UK composite, manufacturing and services PMIs all retreated in September, down by 0.9, 1.0, and 0.9 ppts to 52.9, 51.5 and 52.8, respectively. These declines mark the first in the past three months, though the overall message remained that the UK economy was expanding modestly in Q3 2024.

Monthly UK Gross Domestic Product

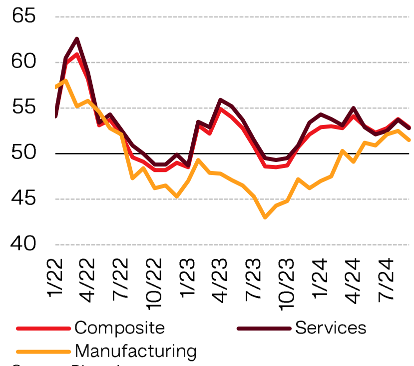


Source: CEIC

Eurozone inflation fell below the central bank's target

The eurozone headline inflation eased further. In September, the eurozone headline and core CPI inflation decelerated further by 0.4 and 0.1 ppts to 1.8% YoY and 2.7%, respectively. Both readings were slightly lower than market forecasts. The headline rate was the lowest since May 2021. The drop in headline inflation was attributed to the decline in energy costs, which dropped by 6.0% YoY in September, marking the biggest decline since February. The prices for food, alcohol and tobacco remained stable, growing by 2.4% YoY in September. Meanwhile, services inflation ticked down slightly by 0.1 ppt to 4.0% YoY in September, hovering at 4.0-4.1% over the past five months. This suggested that underlying inflationary pressure remained sticky. Services inflation and labour market developments will continue to play a crucial role in the eurozone disinflation progress.

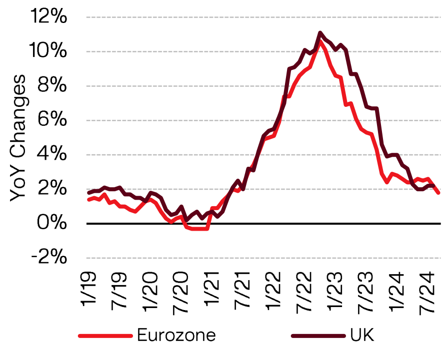
UK Purchasing Managers' Index



Source: Bloomberg

A sharp jump in airfares sent UK services inflation higher. In August, UK headline CPI inflation remained flat at 2.2% YoY, while core CPI inflation edged higher by 0.3 ppts to 3.6%, the highest level since May. On a MoM basis, headline and core CPI inflation advanced by 0.5 and 0.3 ppts to 0.3% and 0.4%, respectively. Specifically, services inflation accelerated by 0.4 ppts to 5.6% YoY, partly due to a 22.2% increase in air fares in August, the second-largest increase since 2001. Regarding wage growth, regular pay (excluding bonuses) rose by 5.1% YoY in the three months to July, down from the 5.4% rise in the preceding three-month period. This marked the slowest increase since June 2022. The continuous slowdown in wage growth is viewed as important for promoting further disinflation progress in services inflation. However, the labour market remained relatively tight, with the unemployment rate in the three months to July down by 0.1 ppt to 4.1%, the lowest level since the three months ending January 2024.

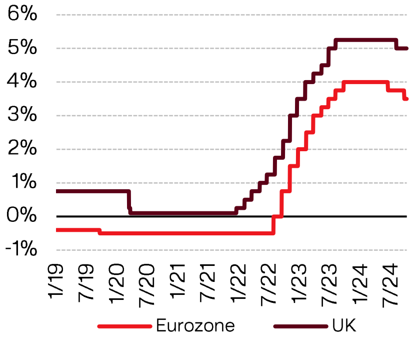
Inflation Rate



Source: CEIC

The ECB cut policy rates twice in three months and lowered its growth forecast. The European Central Bank (ECB) reduced its deposit facility rate by 25 basis points (bp) to 3.5% at the September monetary policy meeting, marking the second rate cut in three months. The decision was made despite the upward revision to inflation forecasts, reflecting a greater focus on growth. The ECB indicated that inflation would accelerate in late 2024 as the low base effect of energy costs fades, and forecasted that inflation would revert to ease towards the policy target in 2H 2025. Specifically, the ECB projected core inflation to average at 2.9%, 2.3% and 2.0% in 2024, 2025 and 2026, respectively, up from previous forecasts of 2.8%, 2.2% and 2.0% in June. These upward revisions reflected the increases in service prices. As to economic growth, the ECB projected the eurozone GDP to grow by 0.8%, 1.3% and 1.5% in 2024, 2025 and 2026, respectively, with each forecast lowered by 0.1% ppt compared to June's projections, largely due to a weaker outlook for domestic demand. In a European Union parliamentary hearing in late September, ECB President Christine Largarde said the latest developments strengthen their confidence that inflation will return to target in a timely manner, and they will take that into account in the next monetary policy meeting in October. This possibly indicated that they are open to another rate cut as soon as October.

Policy Rate



Source: CEIC

The BoE kept its policy rate unchanged but hinted at further rate cuts on the horizon. The Bank of England's (BoE) Monetary Policy Committee voted by a majority of 8-1 to keep the Bank Rate unchanged at 5.0% in September. The Committee also voted unanimously to reduce the BoE's government bond holdings by another GBP 100 billion over the coming year. In a recent media interview in early October, BoE Governor Andrew Bailey revealed that the BoE could become a "bit more aggressive" in cutting the policy rate, provided that disinflation continued to see good progress. Meanwhile, the BoE mildly lowered its GDP growth forecast for Q3 2024 by 0.1 ppt to 0.3%, while expecting inflation to rise from 2.2% YoY in August to around 2.5% towards the end of 2024 as the low base effect of energy prices fades.

Mixed performance in stock markets despite the Fed's jumbo cut

A jumbo rate cut by the Fed boosted European currencies but had limited impact on its stock markets. In September, the Fed lowered the federal funds rate by 50 bps, marking the first rate cut in four years. However, this sizable rate cut did not substantially boost European stock markets. In particular, the UK FTSE 100 index dropped 1.7% MoM in September, whereas the German DAX index and the French CAC index gained modestly by 2.2% and 0.1% MoM in September, respectively. Meanwhile, the Euro and British pound appreciated by 0.8% and 1.9% MoM, ending September at US$ 1.1135 and US$ 1.3375, respectively.

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