

*Market Monitor – Europe***Growth risks persisted amid trade tensions**

- The EU-US trade tensions underwent a bumpy ride, while the UK pushed for a faster implementation of tariff reductions.
- The European Central Bank cut interest rates by 25 basis points. Eurozone inflation eased in May, while UK inflation surprised to the upside in April.
- European stock markets recorded solid performances in May on easing trade tensions, while their currencies appreciated against the US dollar.

Tariff uncertainties weighed on the European growth outlook

EU-US trade relations hit a bumpy patch, while the UK pushed for faster tariff cuts. In late May, US President Trump threatened punitive 50% tariffs on EU imports starting 1st June, later delaying it to 9th July for talks. The EU offered concessions like reduced regulations, eliminating industrial tariffs, and increasing US product purchases. However, major disagreements persisted over issues like value-added taxes, digital services, and food standards. Consequently, the negotiation outcome remains highly uncertain. The EU signalled readiness to retaliate against US tariff hikes. On 4th June, the US unilaterally doubled steel and aluminium tariffs on all countries, including the EU but excluding the UK. The EU stated this decision gravely undermined ongoing efforts and affirmed it would impose countermeasures if needed.

Separately, the UK is seeking to accelerate US tariff cuts on UK cars, a cornerstone of the US-UK trade deal. Furthermore, on 19th May, the UK reached a pivotal agreement with the EU. This deal encompassed a security and defence pact, significantly reduced food and agriculture trade restrictions, a youth mobility scheme, and a new fishing agreement. This agreement not only

Economic Research

June 2025

broadens the UK's access to the EU market but also solidifies the foundation for deeper economic cooperation between the UK and the EU in the future.

European countries introduced new fiscal measures. On 2nd June, the UK government published its Strategic Defence Review, detailing investment plans to modernise its military capabilities. The spending plan comprises building up to 12 attack submarines and allocating GBP 15 billion for the development of new nuclear warheads. On 4th June, the German cabinet approved a EUR 46 billion package of corporate tax relief from 2025 to 2029. The plan included tax incentives for new equipment and new electric vehicles to spur investment. These fiscal initiatives could improve sentiment and pull in private investment, providing a meaningful offset to the negative effects of higher tariffs and increased uncertainty on growth.

The Eurozone's growth momentum moderated in May. The eurozone composite PMI retreated slightly from 50.4 in April to 50.2 in May, a 3-month low. The slowdown was mainly driven by a decline in services PMI from 50.1 to 49.7 as tariff uncertainties weighed on domestic demand, while manufacturing PMI showed a slight uptick from 49.0 to 49.4, possibly due to the frontloading of shipments. France's composite PMI improved but stayed in contraction, while Germany's PMI also slipped into contraction due to weaker services. Italy's PMI hit its highest since April 2024, driven by services, and Spain's PMI declined as services moderated. Furthermore, the eurozone economic sentiment indicator continued to drop from 95.0 in April to 94.6 in May due to weaker services confidence. On 19th May, the European Commission lowered its eurozone GDP forecast for 2025 from 1.3% to 0.9%. Growth is set to moderate as tariff drags emerge.

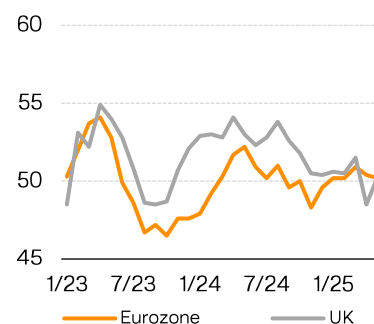
UK economic growth surprised to the upside in Q1 2025. The UK's GDP grew by 0.7% on a quarter-on-quarter basis in Q1 2025, beating market expectations of 0.6%. The growth was driven by strong services and production output. In March, the UK's GDP expanded by 0.2% month-on-month (MoM), compared to 0.5% in February. Besides, the UK composite PMI increased from 48.5 in April to 50.3 in May, driven by a rise in services activity. That said, the growth outlook remains clouded by trade policy uncertainties.

Eurozone and UK inflation showed diverging trends

Eurozone inflation eased on slowing service price gains. The eurozone headline CPI inflation slowed from 2.2% YoY in April to 1.9% in May, below the 2% inflation target for the first time since September 2024. The deceleration was caused by a fall of 3.6% in energy prices and a slowdown in services inflation from 4.0% to 3.2% amid moderating wage growth. Core inflation also declined from 2.7% to 2.3%. Moving forward, the disinflationary trend is expected to continue.

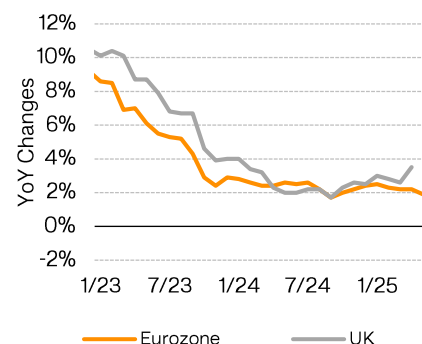
The European Central Bank (ECB) delivered its eighth cut in the current cycle.

Eurozone and UK Composite PMI



Source: Bloomberg

Inflation Rate



Source: CEIC

Economic Research

June 2025

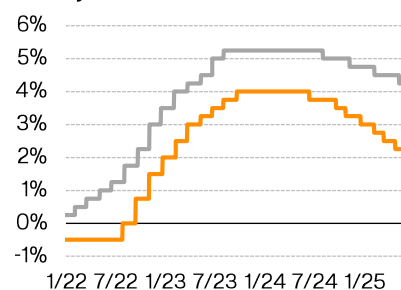
The ECB executed its eighth interest rate cut in June, lowering the deposit facility rate by 25 basis points to 2.00%. This move reflects the ECB's expectation for inflation to sustainably return to its 2% target, driven by moderating wage growth and improving productivity. However, the Governing Council acknowledged that persistent global trade uncertainties and geopolitical tensions continue to impede business investment and exports, posing ongoing downside risks to eurozone growth. ECB President Christine Lagarde confirmed the central bank is nearing the end of this easing phase, emphasising the eurozone's preparedness to navigate uncertain conditions, while the market anticipates a data-dependent approach for any potential future adjustments.

UK inflation re-accelerated in April. The UK's headline CPI inflation rose sharply from 2.6% YoY in March to 3.5% in April, marking its highest level since January 2024 and exceeding the consensus of 3.3%. Core CPI inflation, which excludes energy and food, also climbed to 3.8% from 3.4%. Multiple drivers were linked to faster price growth in April, including an increase in the energy cap, a near 7% rise in minimum wage as well as higher national insurance contributions. While the spike in April's inflation would reduce the likelihood of a near-term interest rate cut, we anticipate that the Bank of England is likely to continue with rate reductions in Q3 as concerns about slowing growth look set to intensify again.

Stock markets rallied on a temporary easing of trade tensions

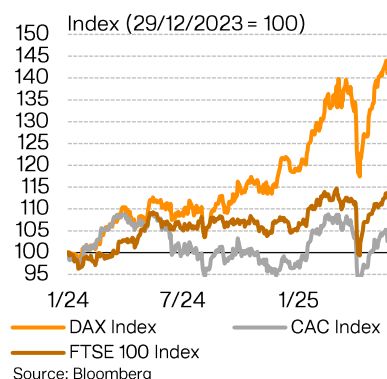
European stock markets recorded solid performance in May. The UK's FTSE 100, France's CAC 40 and Germany's DAX rallied in May, rising by 6.6%, 2.1%, and 6.7% MoM, respectively, as investor sentiment improved following a 90-day tariff truce between the US and China and the US decision to delay imposing 50% tariffs on European imports from 1st June to 9th July. Meanwhile, the euro and pound appreciated against the US dollar, rising by 0.2% and 1.0% MoM, respectively.

Policy Rate



Source: CEIC

Stock Market Indices



Source: Bloomberg

Disclaimer

This material is prepared by The Bank of East Asia, Limited ("BEA") for customers' reference only. The content is based on information available to the public and reasonably believed to be reliable, but has not been independently verified. Any projections and opinions contained herein are expressed solely as general market commentary, and do not constitute an offer of securities or investment, nor a solicitation, suggestion, investment advice, or guaranteed return in respect of such an offer. The information, forecasts, and opinions contained herein are as of the date hereof and are subject to change without prior notification, and should not be regarded as any investment product or market recommendations. This material has not been reviewed by the Securities and Futures Commission of Hong Kong, Hong Kong Monetary Authority, or any regulatory authority in Hong Kong.

BEA will update the published research as needed. In addition to certain reports published on a periodic basis, other reports may be published at irregular intervals as appropriate without prior notice.

No representation or warranty, express or implied, is given by or on behalf of BEA, as to the accuracy or completeness of the information and stated returns contained in this material, and no liability is accepted for any loss arising, directly or indirectly, from any use of such information (whether due to infringements or contracts or other aspects). Investment involves risks. The price of investment products may go up or down, and may become valueless. Past performance is not indicative of future performance. The investments mentioned in this material may not be suitable for all investors, and the specific investment objectives or experience, financial situation, or other needs of each recipient are not considered. Therefore, you should not make any investment decisions based solely on this material. You should make investment decisions based on your own investment objectives, investment experience, financial situation, and specific needs; if necessary, you should seek independent professional advice before making any investment.

This material is the property of BEA and is protected by relevant intellectual property laws. Without the prior written consent of BEA, the information herein is not allowed to be copied, transferred, sold, distributed, published, broadcast, circulated, modified, or developed commercially, in either electronic or printed forms, nor through any media platforms that exist now or are developed later.

For more information, please visit our webpage at <https://www.hkbea.com/html/en/bea-about-bea-economic-research.html>. For any enquiries, please contact the Economic Research Department of BEA (email: lerd@hkbea.com/telephone number: (852) 3609-1504/postal address: GPO Box 31, Hong Kong).