BEA東亞銀行

Economic Research **July 2025**

Market Monitor – Europe

Economic outlook stays clouded amid trade uncertainties

- The EU intensified efforts to secure tariff relief for key industries, while the UK's new trade deal with the US came into force.
- Eurozone inflation edged up in June, while UK inflation eased slightly in May.
- Heightened geopolitical tensions induced volatility in European stock markets, while the EUR and GBP appreciated notably against the dollar.

Trade tensions dimmed growth outlook

The EU intensified efforts to secure tariff relief for key industries, while the UK's new trade deal with the US came into force. In the EU-US trade talks, the EU is reportedly seeking tariff reductions for sectors, including cars, pharmaceuticals, aerospace parts, alcohol, and semiconductors, and has signalled a willingness to increase purchases of US goods, such as natural gas and agricultural products. However, significant differences remain, particularly over digital regulation, with the EU preparing potential countermeasures like retaliatory tariffs and a digital tax on US technology companies, should talks fail to reach an agreement.

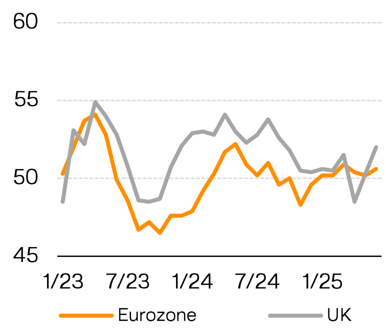
Separately, the UK's trade deal with the US took effect on 30th June. The agreement lowers tariffs on US beef and ethanol imports in exchange for reduced tariffs on UK car and aerospace exports. However, UK steel and aluminium exports remain subject to a 25% tariff, while most other exports face a 10% baseline tariff, which would weigh on UK manufacturers.

European countries took further action to increase public spending. On 24th June, the German government unveiled its 2025 budget draft, projecting a 6% year-on-year (YoY) increase in public spending to EUR 503 billion (11.7% of GDP).

The budget includes a notable rise in defence spending, targeting 2.4% of GDP in 2025 and rising to 3.5% of GDP by 2029. Besides, EUR 115 billion (2.7% of GDP) is allocated for investments in mobility, digitalisation, innovation, education, research, and climate protection. On 25th June, NATO leaders agreed to raise the alliance's defence spending target to 5% of GDP by 2035, with at least 3.5% of GDP allocated to core defence and 1.5% of GDP to broader defence-related expenditures, like infrastructure and industry. These fiscal measures are expected to offset some of the drag from US tariffs and support medium-term growth prospects in the EU.

The eurozone's growth momentum remained subdued in June. The eurozone composite PMI edged up from 50.2 in May to 50.6 in June, indicating only marginal expansion. Services activity grew slightly, with its PMI rising from 49.7 in May to 50.5 in June. Manufacturing activity continued to contract, though at a slightly slower pace, with its PMI edging up from 49.4 to 49.5. Among the major member states, Germany's composite PMI returned to expansion territory, buoyed by a stronger manufacturing sector; France's PMI remained in contraction due to weak demand across both manufacturing and services; Italy's PMI continued to rise, bolstered by robust services activity; and Spain's PMI dipped as services growth slowed sharply. In addition, the eurozone's economic sentiment indicator fell from 94.6 in May to 94.0 in June, reflecting broad-based declines in confidence across industry, retail, and consumers. Looking ahead, ongoing trade uncertainty and geopolitical tensions are expected to weigh on business investment and dampen the export outlook ahead.

Eurozone and UK Composite PMI



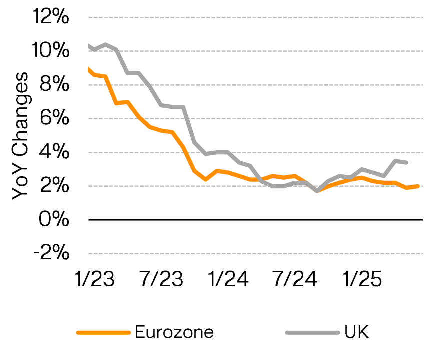
Source: Bloomberg

The UK economy fell into a contraction in April. The UK's GDP contracted by 0.3% month-on-month (MoM) in April, the steepest decline since October 2023, primarily due to weak services output. However, the UK composite PMI rose to 52.0 in June 2025 from 50.3 in May, indicating a modest improvement in business activity. The uptick was driven by a faster expansion in services and a slower decline in manufacturing. Nonetheless, higher tariffs continued to pose downside risks, with manufacturers reporting another export-led decline in orders.

Inflation stayed largely stable

Eurozone inflation edged up in June. Eurozone headline inflation edged up from 1.9% YoY in May to 2.0% in June, driven by higher services prices and a smaller decline in energy prices. Core inflation remained steady at 2.3% in June. Looking forward, inflationary pressures are expected to moderate as wage growth eases, productivity recovers, and lower energy costs filter through. The European Central Bank (ECB) is expected to hold interest rates steady at its next meeting in July, following a rate cut of 25 basis points (bps) in June, but it retains room for further easing if growth deteriorates. In late June, the ECB published its assessment on its monetary policy strategy, highlighting the need for agility in the face of growing geopolitical fragmentation and technology change ahead.

Inflation Rate

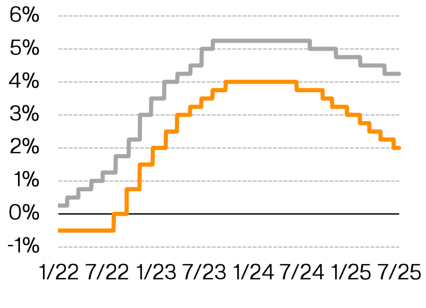


Source: CEIC

The UK inflation eased slightly in May. UK headline inflation edged down to 3.4% YoY in May from 3.5% in April, though still well above the Bank of England's (BoE) 2% target. The main contributors to the decline were lower transport prices amid falling airfares, declining motor fuel prices, and a technical correction in the Vehicle Excise Duty series. Inflationary pressures are expected to remain elevated in the near term, given the recent increases in labour-related costs.

The BoE kept interest rates unchanged in June. The BoE's Monetary Policy Committee (MPC) voted 6–3 to keep the Bank Rate at 4.25% in June, with three members favouring a 25 bps cut. The BoE reiterated its gradual and cautious approach to further monetary policy easing, citing persistent global uncertainties and weak underlying GDP growth. Going forward, we anticipate that a rate cut by the BoE remains likely in Q3, particularly if growth concerns intensify.

Policy Rate

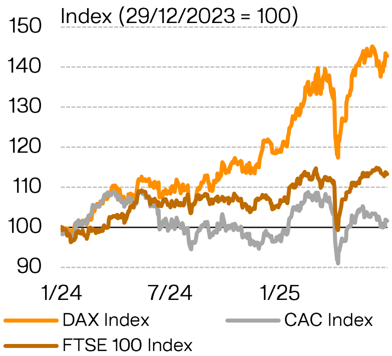


Source: CEIC

Geopolitical tensions induced financial market volatility

Heightened geopolitical tensions induced volatility in European stock markets, while the EUR and GBP appreciated notably against the dollar. In June, major equity indices fell after the Israel-Iran conflict escalated but rebounded after a ceasefire agreement was reached. During the month, the UK's FTSE 100, France's CAC 40, and Germany's DAX fell 1.3%, 0.4%, and 1.1%, respectively. However, the euro and pound appreciated against the US dollar by 3.9% MoM and 2.0%, respectively.

Stock Market Indices



Source: Bloomberg

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