

*Market Monitor – Europe***Downside risks persist despite EU-US trade deal**

- The EU reached a trade deal framework with the US, and the UK signed a free trade deal with India.
- Eurozone inflation held steady in July, while UK inflation picked up in June.
- European stock markets advanced on easing trade tensions, as the EUR and GBP depreciated notably against the US dollar in July.

Trade policy developments continue to present headwinds

The EU reached a trade deal framework with the US, while the UK signed a free trade deal with India. On 27th July, the EU and the US agreed to a trade deal framework that imposes a 15% tariff on most EU exports to the US, reducing the rate from the previously threatened 30% tariff. However, exports of steel and aluminium remain subject to a 50% tariff, while pharmaceuticals, the EU's largest export category to the US, could face additional sectoral levies in the future. The agreement also outlines EU commitments to purchase US energy products valued at USD 750 billion over three years, invest an additional USD 600 billion in the US, and procure significant amounts of US military equipment. While this trade framework delivers greater predictability for businesses, higher effective tariff rates would add costs to bilateral trades. As a result, export-dependent economies in the EU would continue to face a challenging external environment.

Separately, the UK signed a free trade deal with India in July. The deal includes phased tariff reductions on 90% of UK exports to India over ten-year period, with particular benefits for the cosmetics, apparel, and food & beverage industries. The UK government projects a 60% long-term increase in exports to India from this agreement, with a boost of GBP 4.8 billion to GDP per year.

The European Commission unveiled its long-term budget proposal. On 16th July, the European Commission presented its draft Multiannual Financial Framework (MFF) for 2028-2034, outlining a seven-year budget totalling nearly EUR 2 trillion (equivalent to an average of 1.26% of the EU's gross national income). The proposal allocates substantial funds for strategic investments, including EUR 409 billion for a new European Competitiveness Fund, EUR 175 billion for Horizon Europe aimed at fostering innovation, EUR 200 billion for Global Europe to enhance international cooperation, and EUR 100 billion earmarked for Ukraine. While the proposal marks a considerable increase from the current EUR 1.2 trillion expenditure ceiling for 2021–2027, there are plans for generating new revenues to repay the loans under NextGenerationEU, meaning a milder increase in net fiscal expenditure. Moving forward, prior experiences suggest that member states are likely to begin complex and prolonged talks over the budget draft before any final agreement is reached.

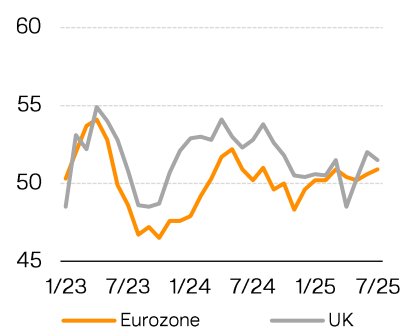
Growth in the eurozone decelerated sharply in Q2. The eurozone's GDP growth slowed to 0.1% quarter-over-quarter (QoQ) in Q2 2025, from 0.6% QoQ in Q1, the slowest expansion since Q4 2023. Within the bloc, Spain and France reported stronger growth at 0.7% QoQ and 0.3%, respectively, while the Netherlands recorded a marginal growth of 0.1% QoQ. In contrast, Germany and Italy both fell into contraction, each posting a 0.1% QoQ decline. These results underscore the vulnerability of export-oriented economies to ongoing trade headwinds. Survey data indicated some signs of stabilisation. The eurozone composite PMI edged up from 50.6 in June to 50.9 in July, driven by solid services PMI (up from 50.5 to 51.0) and a slight improvement in manufacturing PMI (up from 49.5 to 49.8).

The UK economy contracted again in May. The UK's GDP shrank by 0.1% month-on-month (MoM) in May, following a decline of 0.3% in April. Output weakness remained concentrated in production and construction, which fell by 0.9% MoM and 0.6%, respectively. The UK composite PMI also dipped, falling to 51.5 in July from 52.0 in June, with services expansion slowing and manufacturing remaining in contraction, albeit at a reduced pace. Looking ahead, rising domestic labour costs associated with higher national insurance costs and minimum wage rates and elevated trade uncertainties will continue to weigh on UK economic growth.

Eurozone inflation held steady, while UK inflation accelerated

Inflation dynamics in the eurozone have stabilised. Eurozone headline inflation was unchanged at 2.0% YoY in July, with a moderation in services inflation (from 3.3% YoY in June to 3.1% in July) offsetting higher prices in food, alcohol, and tobacco and non-energy industrial goods. Core inflation also remained steady at 2.3% YoY in July. Overall, domestic cost pressures are expected to ease gradually amid moderating wage growth, improved productivity, a stronger currency, cooling demand in the wake of higher US tariffs.

Eurozone and UK Composite PMI



Source: Bloomberg

The ECB left policy rates unchanged at its July meeting. On 24th July, the European Central Bank (ECB) concluded its monetary policy meeting and voted unanimously to maintain the interest rates on the deposit facility, the main refinancing operations, and the marginal lending facility unchanged at 2.00%, 2.15% and 2.40% respectively. The ECB signalled a wait-and-see approach due to elevated economic uncertainties. The ECB also acknowledged ongoing process in disinflation from softer wage growth, while expecting heightened downside risks to growth. In our view, there is still scope for the ECB to conduct further monetary easing, particularly in the event of an unexpected deterioration in growth outlook.

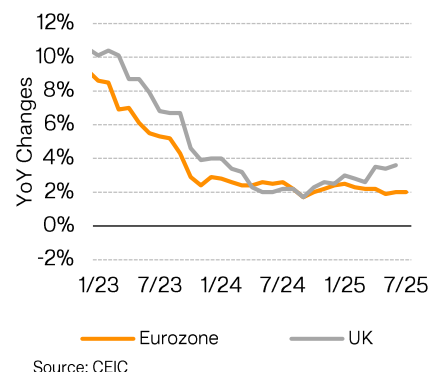
UK inflation accelerated in June. The UK headline inflation rose to 3.6% YoY in June, from 3.4% in May, exceeding market expectations and marking the highest level since January 2024. The main contributors were higher motor fuel prices and transportation costs. In the near term, inflation is expected to remain elevated, as firms pass through increased employer costs from higher national insurance contributions and minimum wage rates to consumers.

The BoE cut interest rates in a tight vote. On 7th August, the Bank of England (BoE)'s Monetary Policy Committee (MPC) cut the Bank Rate by 0.25 basis points to 4%. This decision was closely contested with a 5-4 vote under an unprecedented second vote, as the Committee failed to reach a majority verdict initially. The BoE reiterated that monetary policy easing would be "gradual and careful", with new forecasts expecting annual inflation to peak at 4% in September. Given such deep divisions within the MPC, the outlook of further BoE's easing is poised to become more uncertain.

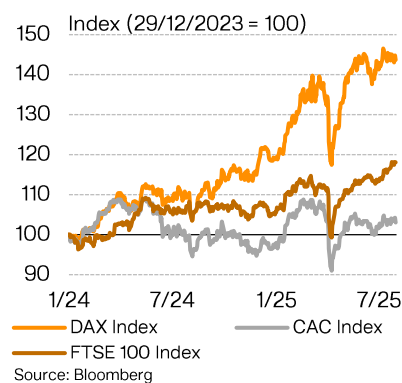
Stock markets advanced on easing trade tensions

European stock markets rose on improved sentiment toward trade tensions. In July, the UK's FTSE 100, France's CAC 40, and Germany's DAX rose by 4.2%, 1.4%, and 0.7%, respectively, driven by easing trade tensions and optimism surrounding progress in EU-US trade negotiations. Nevertheless, the euro and pound depreciated notably against the US dollar by 3.2% and 3.8%, respectively,

Inflation Rate



Stock Market Indices



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).