Economic Research

September 2025

Market Monitor – Europe

Sentiment stabilised but uncertainty persists

- The EU and the US unveiled a framework agreement on bilateral trade.
- Eurozone and UK inflation ticked up.
- European equities were mixed in August, while the EUR and GBP appreciated notably.

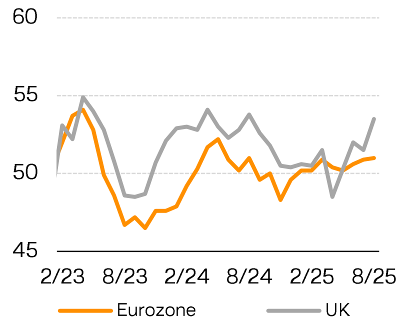
Trade pact details released but uncertainty persists

The EU and the US unveiled a framework agreement on bilateral trade. The EU and US published a "Framework on an Agreement on Reciprocal, Fair, and Balanced Trade" (framework agreement) on 21st August. The agreement caps most US tariffs on EU goods at 15%, while the EU moved to reduce or eliminate EU tariffs on US industrial goods and grant preferential access to selected farm and seafood products. Besides, the EU plans to purchase USD 750 billion of energy and USD 40 billion in AI chips from the US and invest USD 600 billion in the US. There will also be increased EU procurement of military equipment from the US. However, the issues concerning digital services taxes remain unresolved, which could complicate future trade negotiations.

Risks from domestic politics and geopolitical tensions remain high. In France, Prime Minister François Bayrou called for a vote of confidence on 8th September, seeking to break a deadlock over planned budget cuts. However, key opposition parties have signalled their objection to back the government, raising the odds of collapse or snap elections. This has led to surging French yields, as the market is pricing in a weaker growth outlook due to a potential political impasse. Meanwhile, the military operations between Russia and Ukraine endure. The conflict has continued to disrupt European supply chains.

Sentiment stabilised modestly. The eurozone composite PMI edged up from 50.9 in July to 51 in August. The improvement was driven by the manufacturing PMI, which rose from 49.8 to 50.7, while the services PMI slowed from 51.0 to 50.5. Improvements were seen in major member states. Germany's composite PMI increased on better manufacturing; France's readings ticked up, albeit remaining in contraction; Italy and Spain both showed firmer prints on services-led momentum. Looking ahead, while the EU-US framework agreement reduces near-term trade policy uncertainty, higher effective tariff rates, as well as fading impacts from front-loading, could temper export growth and cap private investment.

Eurozone and UK Composite PMI



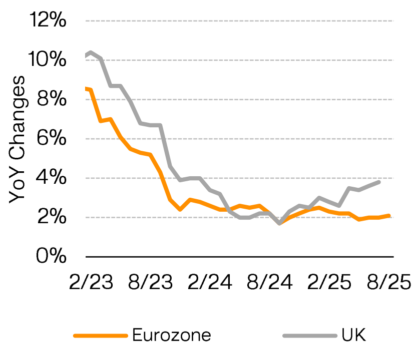
Source: Bloomberg

UK economic growth picked up in June. UK GDP rose by 0.4% month-on-month (MoM) in June, reversing the prior month's 0.1% decline, with services the primary driver. The UK composite PMI also rose to 53.5 in August from 51.5 in July, indicating more upbeat business confidence. The surge was led by services activity while manufacturing activity continued to decline. Nonetheless, ongoing global trade fictions, softening consumer demand and rising labour costs are likely to constrain economic growth in the near-term.

Price pressures increased

Eurozone inflation inched up. The eurozone headline inflation rate rose to 2.1% year-on-year (YoY) in August from 2.0% in July, with core inflation steady at 2.3% YoY in August. During the month, energy deflation eased, while price gains for services categories held up. While inflation dynamics are set to be driven by various contrasting forces including the euro rally, global supply chains, energy prices and labour market conditions, the eurozone inflation outlook is anticipated to remain stable. While the European Central Bank (ECB) recently indicated its intention to take a pause after a series of rate cuts, we consider that a stable inflation backdrop will offer the ECB flexibility to ease monetary policies if downside risks to growth intensify.

Inflation Rate



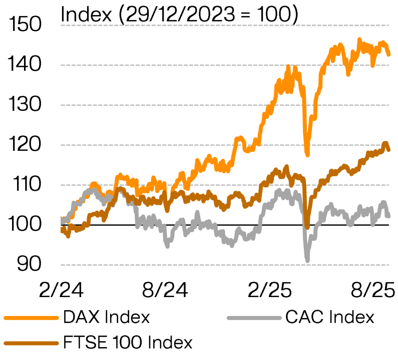
Source: CEIC

UK inflation accelerated in July. The UK headline inflation rate increased to 3.8% YoY in July, up from 3.6% in June, above market expectations and marking the highest pace since January 2024. This was driven by transport costs, particularly airfares, likely due to summer travel demand. July's upside surprise makes near-term easing less likely. The Bank of England is expected to take a cautious approach to interest rate cuts, opting to remain on hold until there is clear evidence that inflation has peaked.

European equities were mixed, while currencies surged

European equities were choppy in August, while the EUR and GBP appreciated against the dollar. In August, France's CAC 40 and Germany's DAX fell by 0.9% and 0.7%, respectively, as investor sentiment weakened due to rising political instability in France and slow progress toward resolving the Russia/Ukraine conflict, while the UK's FTSE 100 was up slightly by 0.6%. That said, the EUR and GBP appreciated notably against the USD, rising by 2.4% and 2.2%, respectively, in August.

Stock Market Indices



Source: Bloomberg

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