BEA 東亞銀行

Economic Research Department

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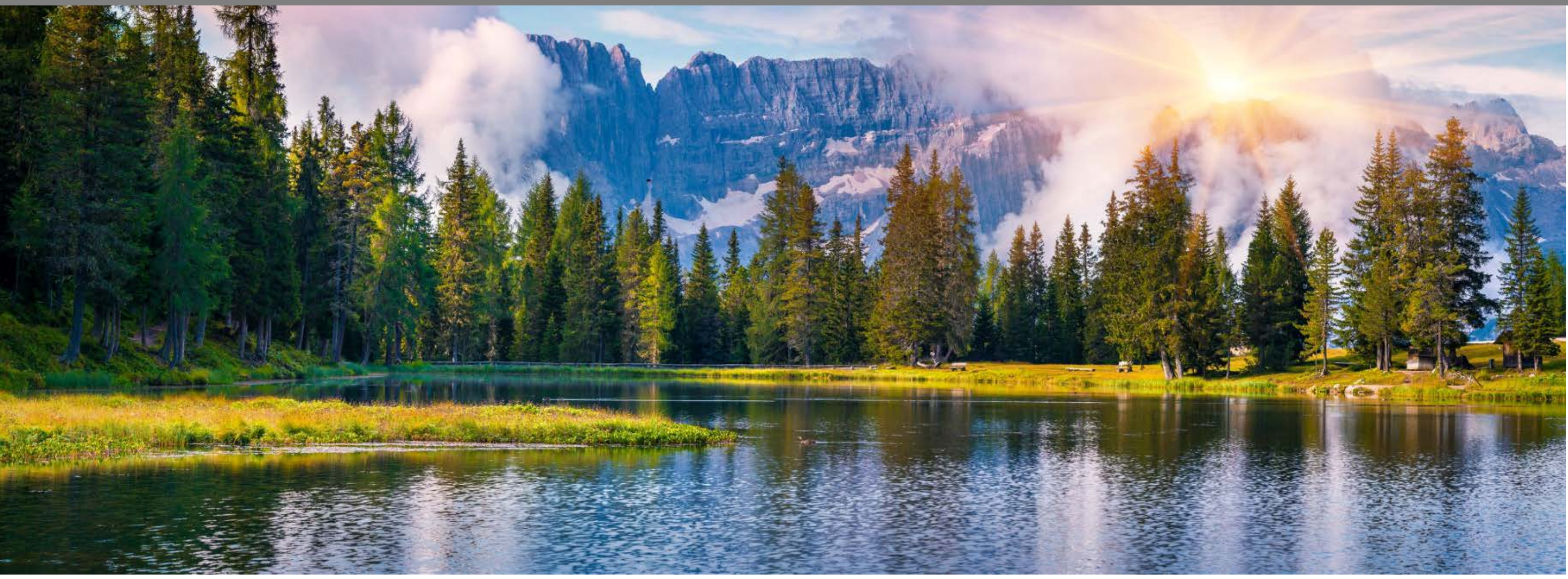
Market Monitor – Europe

ECB Stands Pat while BOE Pivots Dovish



- Eurozone GDP grew by 1.3% YoY in Q4 2025, confirming a resilient 1.5% growth for the full year.
- UK PMIs signalled positive momentum, while inflation continued to stay above target.
- The ECB and BOE kept their interest rates unchanged, with the latter striking a dovish tone for rate cuts in 2026.

Overview Eurozone and UK Economies

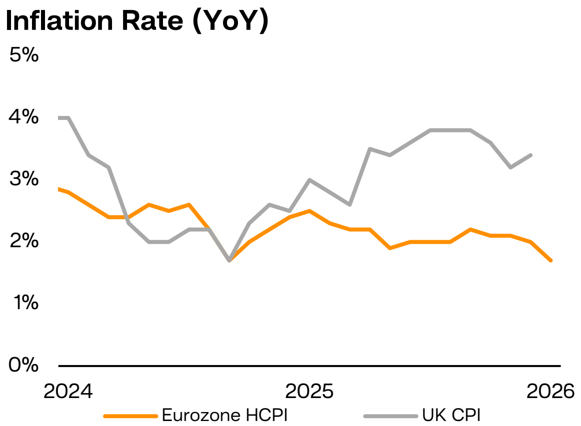
The Eurozone economy finished 2025 on a firmer footing. The Eurostat's preliminary estimate showed that the Eurozone economy expanded by 0.3% quarter-on-quarter (QoQ) in Q4 2025, the same pace as in the preceding quarter and better than the market consensus of 0.2%. On a year-on-year (YoY) basis, Eurozone GDP rose by 1.3% in Q4 2025, following a 1.4% growth in Q3. Based on our estimates, the Eurozone economy recorded an overall growth rate of 1.5% for 2025, a significant recovery from the 0.9% growth rate seen in 2024.

Diverging paces across major members remained notable. Spain continued to outperform within the Eurozone, with GDP growth accelerating from 0.6% in Q3 to 0.8% QoQ in Q4. This was driven by solid performance in household consumption, private investment and services exports. Meanwhile, Germany, France and Italy reported GDP growth of 0.3%, 0.2% and 0.3% QoQ in Q4, respectively. However, the gap is poised to narrow. Growth momentum in Germany, the region's largest economy, is set to pick up, driven by a marked increase in fiscal spending ahead. At the start of 2026, the Eurozone composite PMI held up at 51.5 in January and 51.3 in February, pointing to a steady expansion in Q1 2026.

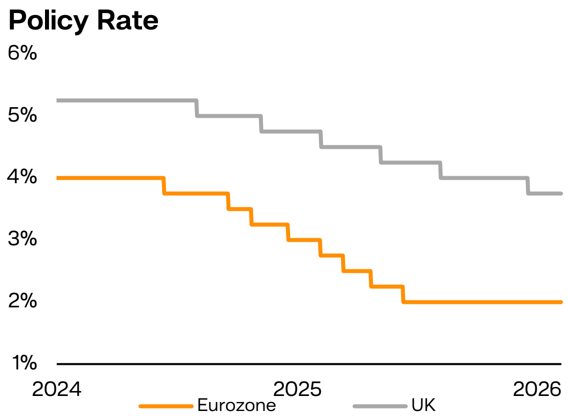
Eurozone inflation edged lower, though price pressures from the services sector were yet to dissipate. Eurozone CPI inflation slowed to 1.7% YoY in January 2026, down from 2.0% in December 2025. The slowdown was largely due to a deeper contraction in energy prices (-4.1%). Core inflation, excluding food and energy, slipped by 0.1 percentage points to 2.2% YoY in January 2026, marking the lowest level since October 2021. Services inflation, a key gauge of domestic price pressures, also moderated to 3.2% from 3.4%, though it has remained visibly above the ECB's 2% target for more than 3 years. Price growth for non-energy industrial goods stayed subdued at 0.4% YoY.

UK inflation ticked up. UK inflation rose to 3.4% YoY in December 2025, up from 3.2% in November and above market expectations. The rise was driven by higher tobacco prices and airfares. Core inflation held steady at 3.2% YoY. Services prices posted a growth of 4.5% YoY. Against this backdrop, the Bank of England's February 2026 Monetary Policy Report projects headline CPI to fall to 2.1% in Q2 2026, largely due to measures announced in Budget 2025 and favourable energy base effects. The BOE suggested that, reflecting the impact of monetary policy, recent wage growth and services price inflation had generally continued to ease, albeit remaining above target-consistent levels.

UK PMIs strengthened at the start of 2026, pointing to a turnaround in activity. Survey data highlighted significant improvements in UK growth momentum. The UK services PMI rose to 54.0 in January 2026 from 51.4 in December 2025, while the manufacturing PMI also increased to 51.8 from 50.6, its strongest reading since August 2024. Taken together, the UK composite PMI climbed to 53.7 in January 2026 from 51.4 in the month before, suggesting a solid expansion across sectors.



Source: CEIC



Source: CEIC

ECB Navigates Near the Neutral Rate

The European Central Bank (ECB) stayed on hold in February 2026. The decision was in line with expectations, reflecting a wait-and-see approach. The ECB's key interest rates remained unchanged, with the deposit facility rate at 2.0%, the main refinancing rate at 2.15%, and the marginal lending facility at 2.4%. While the latest inflation readings undershot 2%, ECB President Lagarde attributed it to certain temporary factors. In addition, the ECB expects the economy to remain resilient, underpinned by low unemployment, solid private-sector balance sheets, and the gradual ramp-up of public spending on defence and infrastructure, alongside the supportive effects of previous rate cuts.

BOE Executes a Dovish Hold

The Bank of England (BoE) struck a more dovish tone at its February meeting, while holding its Bank Rate at 3.75%. The shift reflected reduced concern about inflation persistence, particularly from wage growth. The vote was a close 5-4 to hold, with Alan Taylor, Swati Dhingra, Dave Ramsden and Sarah Breeden favouring a 25-basis-point cut. The Monetary Policy Committee (MPC) also adjusted its collective guidance. The previous line "Bank Rate is likely to continue on a gradual downward path" was replaced with "Bank Rate is likely to be reduced further", a more explicit call for future cuts. Market participants interpreted the change as more dovish than expected and repriced toward additional easing through 2026.

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