

Market Monitor – Europe

Energy Shocks Deepen Europe's growth-inflation dilemma

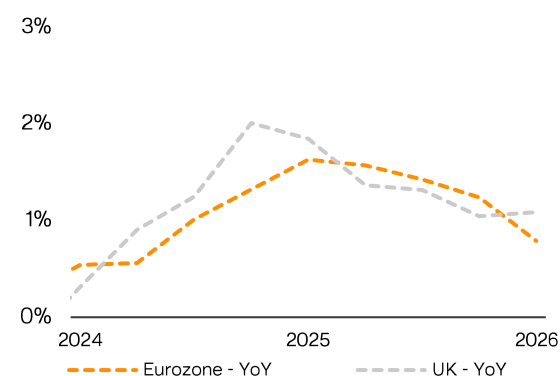


- Eurozone economic momentum softened in Q1, while UK economy posted strong growth.
- ECB are shifting toward a tightening bias, with a likely rate hike in June.
- The BoE exhibited widening internal divisions regarding its response to the inflation shock.

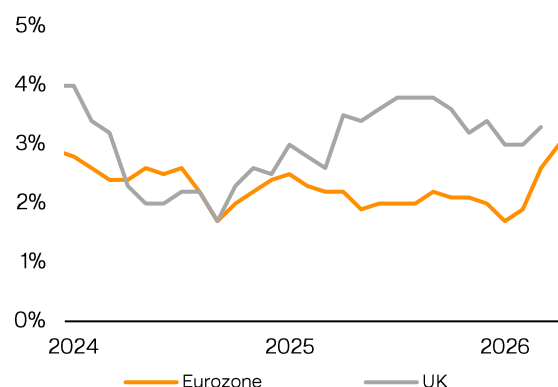
EU and UK Economic Overview

Eurozone momentum softened in Q1 with uneven performance across member states. The Eurozone's GDP expanded by 0.1% quarter-on-quarter (QoQ) in Q1 2026, below market consensus of 0.2% and down from 0.2% in Q4 2025. On an annual basis, GDP growth slowed to 0.8% from 1.3% in the previous quarter, the softest pace since Q2 2022. Among major member states, France, Spain and Italy recorded slower QoQ GDP growth in Q1 2026, while Germany gained slightly faster with a 0.3% GDP growth. Despite a moderating momentum, the labour market showed resilience. The Eurozone unemployment held steady at 6.2% in March, hovering near the cycle low of 6.1%. Leading indicators reflected a broad-based deterioration in Eurozone sentiment. The Eurozone composite PMI slipped back into contractionary territory, falling from 50.7 in March to 48.8 in April, a 17-month low. This decline was heavily driven by the services sector, where the PMI dropped to 47.6. The manufacturing PMI posted an unexpected rise to 52.2. However, these improvements appeared to be driven largely by temporary inventory accumulation and front-loading behaviour, as firms accelerated purchases ahead of anticipated supply bottlenecks, following the Middle East tensions. Overall, Eurozone growth outlook remains clouded.

The UK economy posted solid growth in Q1, yet this momentum is unlikely to sustain. In Q1 2026, UK GDP expanded by 0.6% QoQ, driven by a robust 0.8% increase in services output. Monthly data revealed that GDP grew by 0.4% in February and 0.3% in March. The March readings were accompanied by a 0.2% contraction in production output, offering the first tangible signal that the Middle East energy shock is beginning to bite. Overall, the Q1 strength is unlikely to prevent broader stagnation in the coming months, as the drag of protracted Middle East tensions and high energy prices is set to gradually emerge.

Eurozone and UK Economic Growth (YoY)


Source: CEIC

Inflation Rate (YoY)


Source: CEIC

Eurozone inflation ticked up in April. Eurozone CPI inflation rose to 3.0% YoY in April (from 2.6% in March). Specifically, energy inflation surged to 10.9% (from 5.1%), reflecting the impacts of protracted Middle East tensions. Conversely, core CPI inflation eased to 2.2% (from 2.3% in March), thanks to slower services inflation at 3.0% (from 3.2%). On the supply front, Eurozone PPI surged rapidly to 2.1% YoY in April (from -3.0% in February). These dynamics indicate a potential lag that the rise of input prices is not yet fully transmitted to consumer goods. It is also worth noting that Eurozone market-based long-term inflation expectations, like the 5y5y forward inflation swap rate, has trended up sharply since March. Overall, Eurozone inflation risks remain tilt to the upside.

UK inflation accelerated in March. Headline CPI rose to 3.3% YoY in March (from 3.0% in February), predominantly driven by the energy component. Services inflation, the BoE's preferred gauge of domestic persistence, also climbed to 4.5% (from 4.3%), underscoring stickiness in wage-sensitive sectors. Nonetheless, the full inflationary impact remains unrealised, pending the delayed pass-through of imported energy costs, the recent minimum wage increase, and the lags due to Ofgem's quarterly energy price cap.

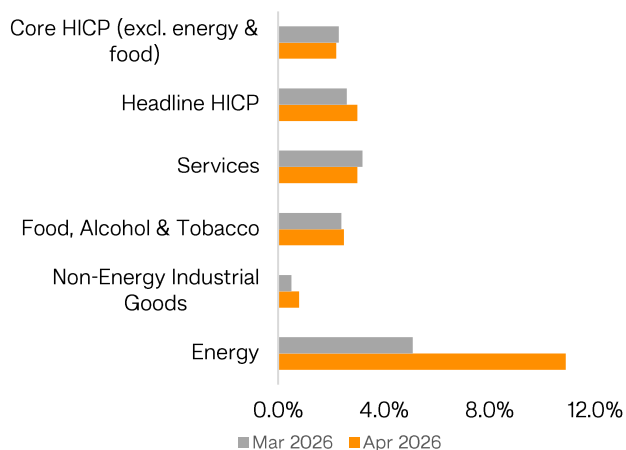
BOE and ECB Decision amid Middle East Tensions

ECB are shifting toward a tightening bias, with a likely rate hike in June. The European Central Bank (ECB) unanimously kept the deposit facility rate unchanged at 2.0% on 30 April but offered hawkish tilt in its forward guidance. President Christine Lagarde indicated that the council "debated, at length and in depth, a decision to possibly hike" during the meeting. It signaled that rate hike was

an imminent option in the April meeting. Given the upside risks to inflation, it is increasingly likely for the ECB to implement a rate hike in its June meeting.

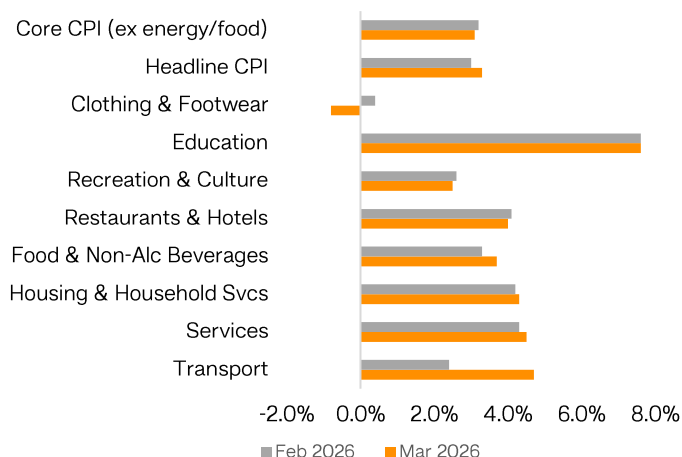
The BOE kept the Bank Rate unchanged at 3.75% in April. The Monetary Policy Committee (MPC) voted 8-1 to hold the Bank Rate at 3.75% on April 30, with Chief Economist Huw Pill dissenting in favor of a 25-basis-point hike to 4.00%. The BOE also revised its inflation forecasts in response to the energy shocks, projecting inflation rising to 3.5% by end-2026 under a benign scenario, while a severe scenario sees a peak of 6.2% in early 2027. Meanwhile, Governor Andrew Bailey highlighted recent labour market weaknesses, citing easing pay pressures, a softer labour market and firms' caution about passing on cost increases. On balance, while pressures to hike have been building, the BoE's recent communications suggested that the central bank is likely to opt for a wait-and-see approach for its June meeting, with potential hikes in 2H 2026.

**Eurozone HICP Components
April vs March 2026 (% YoY)**



Source: Eurostat

**UK CPI Components
March vs February 2026 (%YoY)**



Source: ONS

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).