



Can Europe meet the moment?

Frédérique Carrier – London

The euro area defied expectations in 2025, delivering growth amid a challenging environment. Yet beneath this resilience Europe has started to redraw its economic and strategic maps—reducing reliance on the U.S. while capitalising on fresh fiscal momentum from Berlin and a focus on defence.

2025 ends on a good note

The euro area delivered an encouraging surprise in Q4 2025, with 0.3 percent quarterly GDP growth outpacing consensus expectations and driving full-year growth to a solid 1.4 percent despite persistent trade tensions and heightened global uncertainty. Germany, Italy, and Spain accelerated, suggesting underlying resilience across the bloc's largest economies.

Lower rates, stronger banks, easier financial conditions

The European Central Bank's (ECB) substantial 200 basis points (bps) of rate cuts since June 2024 have been instrumental in supporting growth. With inflation hovering around the ECB's two percent target, we believe the deposit rate is likely to remain steady at two percent throughout 2026, though a persistently strong euro could pose a downside risk to price pressures.

Lower interest rates have spurred a recovery in bank lending, and banks are in a markedly stronger position to meet loan demand following a decade of heightened regulation and private sector deleveraging after the 2012 sovereign debt crisis. The continent's top 18 banks are

better capitalised, with a Tier 1 capital ratio averaging 13.7 percent, according to RBC Capital Markets.

Economic resilience was further supported by a narrowing of most sovereign bond spreads—the yield premium over German Bunds—which eased financial conditions. The widest major eurozone sovereign bond spread has compressed from over 150 bps two years ago to closer to 60 bps today, despite heavy sovereign issuance and the ECB's balance sheet reductions. This spread compression reflects fiscal improvements in previously vulnerable economies, as well as increased investor confidence in the ECB's role as a backstop and its institutional framework, which seems to be less susceptible to political interference than its U.S. counterpart.

Looking ahead, we think the momentum could well be maintained. The European Commission's economic sentiment indicator reached its highest level in three years in January 2026. While most euro area economies will undertake fiscal consolidation in 2026, Germany's €500 billion infrastructure programme announced in April 2025 is likely to support regional sentiment. The German government is projecting the federal budget deficit to widen from 1.1 percent of GDP in 2024 to a still enviably low 3.7 percent from 2026 onwards.

For perspectives on the week from our regional analysts, please see [pages 3–4](#).

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Priced (in USD) as of 2/11/26 market close (unless otherwise stated). Produced: 2/12/26, 14:12 ET; Disseminated: 2/12/26, 14:20 ET

Overall, we expect a modest cyclical upturn in 2026, with RBC Global Asset Management recently increasing its 2026 GDP growth forecast for the eurozone to 1.8 percent, above the consensus level of 1.2 percent.

Europe in the new world order

U.S. President Donald Trump's recent threats to annex Greenland, a Danish territory, and to impose punitive tariffs on European countries opposing the plan rattled Europe. As RBC Global Asset Management Inc. Chief Economist Eric Lascelles wrote, the Greenland saga "emphasizes that, in addition to being an unreliable trade partner, the U.S. is now an unreliable military partner ... There is even the previously unfathomable risk that, as with Venezuela and Greenland, the U.S. could be the next adversary."

Although the threats were withdrawn, they inflicted lasting damage on EU-U.S. relations. In response, European Commission President Ursula von der Leyen underscored the need for European strategic autonomy by deepening the single market, expanding the network of free trade agreements (FTAs), and bolstering security capabilities.

Strengthening the single market

Europe's predicament may reinvigorate momentum behind the measures proposed by former ECB President Mario Draghi in 2024 urging EU leaders to address the bloc's persistent productivity shortfall by deepening the single market, boosting innovation, and diversifying supply chains. While implementation has been slow, there has been some progress, with 15 percent of Draghi's 383 reform proposals now fully implemented, up from 11 percent last September.

Against this backdrop, the EU has stepped up work on several targeted initiatives to strengthen the single market in practice. Issues to be discussed at a Feb. 12 summit include the proposed Industrial Accelerator Act, which would streamline regulations and boost investment across key industrial sectors, and modifying the regional emissions trading system to reduce the cost of doing business.

On the financial side, German Chancellor Friedrich Merz recently reiterated the need for progress on a capital markets union. In October 2025, Germany indicated its willingness to cede certain supervisory powers to the European Securities and Markets Authority—a significant departure from its longstanding opposition to EU-level regulatory centralisation.

A broad network of FTAs

Von der Leyen sees expanded FTAs as critical to strengthening Europe's economic power. The EU recently concluded two landmark agreements after decades

of negotiations, securing access to critical products, resources, and markets.

The pact with the Mercosur nations (Brazil, Argentina, Uruguay, and Paraguay) enhances access to critical minerals, diversifying Europe's supply base. The FTA with India reduces tariffs on European cars from around 110 percent to just 10 percent for up to 250,000 vehicles annually. This could turn India, which imported just 10,000 cars from the EU in 2024, into a major auto export market.

Lascelles notes that both agreements represent meaningful steps towards trade diversification, though bilateral trade with Mercosur and India combined remains just one-quarter of EU-U.S. trade.

Security

Lascelles believes the Greenland episode has accelerated the military spending theme, with a pronounced pivot from within Europe that we anticipate will positively impact the EU economy. As Lascelles does not expect higher defence expenditures to be offset by cuts elsewhere, he anticipates a significant fiscal expansion ahead that could exceed consensus estimates. We note that eurozone public debt has returned to near pre-pandemic levels of some 85 percent of GDP.

Investing in Europe

Last year's optimism following the announcement of the German stimulus has faded—perhaps overly so, in our view. We believe the impact of the German investment programme is now underestimated, as investors focus on structural challenges.

The MSCI Eurozone Index is trading at 16.3x 2026 consensus earnings estimates, a premium to its median valuation since 2003, though we view this as justified given the region's improved economic momentum and earnings growth prospects.

Political risk remains in France but is likely contained until the 2027 presidential election. A strong euro poses a headwind to European exporters' earnings, but this is likely to be offset by more buoyant economic activity.

Europe merits a Market Weight allocation within global portfolios, in our view. Beyond geographic diversification, we believe the continent presents compelling investment opportunities. We expect companies exposed to the German spending plan—particularly select Industrials, defence, and Materials—to do well. Banks are also attractive, in our view, supported by a steepening yield curve and improving loan demand, while trading at a valuation discount to their U.S. peers.

UNITED STATES

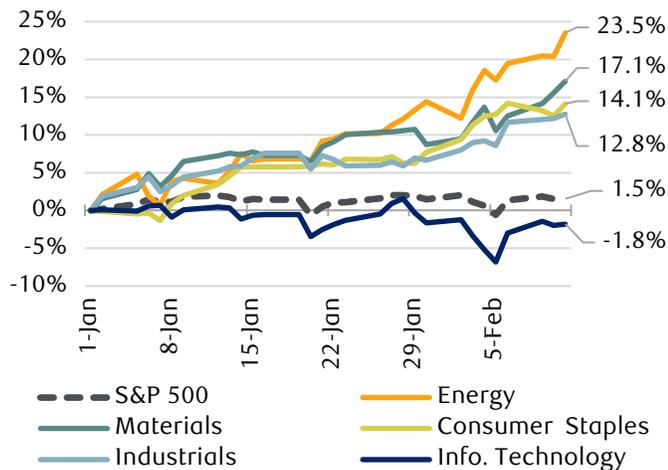
Phil d’Entremont, CFA – Minneapolis

■ **Energy leads the sector charge.** The S&P 500 has started the year up a modest 1.5% through Wednesday, but the headline number masks the strength in various sectors beneath the surface. The S&P 500 sector leaders year to date are Energy up over 20%, Materials up over 15%, and Consumer Staples and Industrials up over 10% each. What we are seeing looks like a rotation in U.S. stock markets reflecting a shift in investor sentiment. Consumer Staples, Energy, and Materials were among the laggards in 2025, with all three underperforming the broader S&P 500. Industrials is the lone sector that outperformed in 2025 and has been able to maintain its strength on growing demand for industrial equipment in the United States.

■ **Conflict with Iran drives energy stocks higher.** An extra factor contributing to the rally in energy stocks is the escalating conflict between Iran and the United States. The U.S. and Iran are engaged in negotiations in Oman, with the U.S. looking for Iran to cease nuclear enrichment activities and ballistic missile development. Some media outlets are saying President Donald Trump may send a second aircraft carrier to the Gulf region to strike Iran in the event talks fail. RBC Capital Markets’ Head of Global Commodity Strategy and Middle East and North Africa (MENA) Research Helima Croft notes that “if US/Israel does commence another round of strikes against Iran, we continue to contend that the risk to regional energy supplies would be heightened if either party directly targets the Supreme Leader as a part of a regime change effort.”

S&P 500 starting 2026 with a rotation

Sector returns, 1/1/26–2/11/26



Source - RBC Wealth Management, FactSet, Standard & Poor’s

■ **Walmart joins trillion dollar club.** After a rally in Consumer Staples, Walmart joined the trillion dollar market cap club last week. Current valuations place Walmart as the 10th-largest U.S. company. While much is required to join the exclusive club, continued membership is not guaranteed. One only needs to look at Eli Lilly, whose market cap reached 13 digits in November 2025 but has dropped back below that threshold as of the time of this writing.

CANADA

David Iacono, CFA & Shizhe Zhong – Toronto

■ **Bank of Canada Governor Tiff Macklem stated that interest rate cuts alone won’t solve Canada’s economic challenges,** which stem from U.S. trade tensions, AI disruption, and slower population growth. He emphasized the economy is undergoing structural shifts requiring action from policymakers, businesses, and households—not just monetary policy. With modest 1.5% growth expected over two years, Macklem warned against misdiagnosing economic weakness as cyclical when it’s structural, cautioning that rate cuts risk fuelling future inflation. The central bank maintained rates at 2.25% and will likely hold steady pending a CUSMA trade agreement review, in our opinion. Canada’s growth is now largely dependent on adapting to technological change, diversifying trade, and boosting productivity.

■ **Statistics Canada’s Labour Force Survey showed employment declining by 25,000 in January,** reversing cumulative gains of 189,000 over the previous four months. Despite the job losses, the unemployment rate fell unexpectedly to 6.5% (0.3 percentage points lower than December and well below the 6.8% consensus forecast). This decline was driven by fewer Canadians actively seeking work, as the labour force participation rate dropped 0.4 percentage points to 65%, the lowest level since 2021. Ontario accounted for most of the national employment decline, losing 67,000 jobs, with manufacturing hardest hit, down 51,000 jobs, due to U.S. tariffs on the automotive sector. The data suggests the labour market is cooling without deteriorating sharply. Macklem has noted that unemployment remains “elevated but not going up,” and the central bank believes monetary policy has largely run its course. With payroll growth subdued but offset by weak immigration and population growth, we believe further rate cuts are unlikely unless economic conditions weaken significantly.

EUROPE

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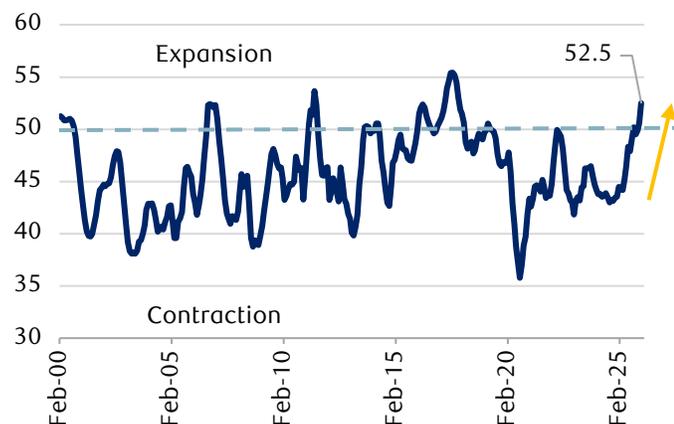
■ **European equity markets have pushed higher year to date**, with the STOXX Europe 600 up around 5.5% (in euro terms). However, there have been sharp factor rotations under the surface of the market, with value sharply outperforming growth, while companies considered at risk from AI disruption in areas such as software and information services have sold off aggressively. While we believe some of the moves within the market have been too indiscriminate, sentiment towards companies perceived to be in the crosshairs of potential AI disruption is likely to remain negative near term, with any signs of slowing growth or margin pressure punished by the market, a standout feature of this earnings season. For example, industrial software company Dassault Systèmes saw its shares fall more than 20% on Feb. 11, its worst-ever one-day decline, after issuing weaker-than-expected sales growth guidance for 2026.

■ **Several European companies continued to report strong demand and orders for data-center-related equipment**, including Siemens, Siemens Energy, and Legrand. Elsewhere, AstraZeneca provided guidance for mid to high single-digit sales and low double-digit earnings-per-share growth in 2026. EssilorLuxottica reported Q4 sales growth over 18%, ahead of consensus expectations for 11.5%, boosted by a sharp acceleration of its AI-glasses business developed in partnership with Meta.

■ **Finally, early evidence of Germany deploying its €500 billion infrastructure programme appeared in rising civil engineering activity**, as measured by the sector's economic activity index.

German infrastructure construction is picking up

HCOB Germany Construction Purchasing Managers' Index (PMI) – Civil Engineering Activity



Note: Seasonally adjusted six-month moving average.

Source - RBC Wealth Management, RBC Capital Markets, Macrobond; data through January 2026

■ **In the UK, Prime Minister Keir Starmer seemed to have survived**, for now, the scandal surrounding his appointment of Peter Mandelson as ambassador to the United States. The revelations—centring on Mandelson's links to Jeffrey Epstein and leaks of sensitive government information—rattled sterling and Gilt yields on concerns a new Labour prime minister might increase fiscal spending. Though markets have largely retraced these moves, political risk remains elevated, and the prime minister's position precarious. A leadership contest could still materialise following local elections in May, potentially reigniting volatility.

ASIA-PACIFIC

Nicholas Gwee, CFA – Singapore

■ **Japanese voters handed Prime Minister Sanae Takaichi a powerful mandate**, delivering her Liberal Democratic Party (LDP) and its coalition partner, the Japan Innovation Party (Ishin), a strong victory in the lower house election. The two parties secured 75% of available seats. LDP alone secured a two-thirds supermajority that allows the new administration to override the upper house and initiate constitutional amendments. Markets reacted positively to the election results with the TOPIX gaining 2.3% and the Nikkei 225 3.9% on Monday.

■ **The two key pillars of Takaichinomics are** 1) new measures against rising prices and 2) strategic investment in select sectors.

■ **Our bull-case equity scenario is building.** Areas we expect to benefit under the strong LDP mandate include defense, AI semiconductors, and nuclear energy. We think consumer stocks should also benefit as private consumption potentially improves as the government weighs in on inflation.

■ **Given the strong market run-up ahead of and after the election results, we think there are risks of profit-taking in the near term.** We view any pullback as an opportunity to increase exposure.

■ **In the currency market, the immediate reaction to the election results was a weakening of the yen** to 157 against the U.S. dollar as markets priced heavier fiscal spending and a possible pause in the Bank of Japan's rate hike normalization. Japan's chief currency official, however, said that he was watching the market with a high sense of urgency, and the yen has since edged back up. In the medium term, we think stronger nominal growth, wage gains, corporate cash repatriation, and eventual policy normalization should support the yen. **Risks from the unwinding of the carry trade remain, but the structural reform story provides a credible floor, in our opinion.**

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	6,941.47	0.0%	1.4%	14.4%	38.1%
Dow Industrials (DJIA)	50,121.40	2.5%	4.3%	12.4%	29.6%
Nasdaq	23,066.47	-1.7%	-0.8%	17.4%	44.2%
Russell 2000	2,669.47	2.1%	7.6%	17.3%	32.8%
S&P/TSX Comp	33,254.19	4.2%	4.9%	29.7%	58.3%
FTSE All-Share	5,634.33	2.2%	5.3%	18.4%	36.2%
STOXX Europe 600	621.58	1.7%	5.0%	13.6%	28.2%
EURO STOXX 50	6,035.64	1.5%	4.2%	12.0%	28.0%
Hang Seng	27,266.38	-0.4%	6.4%	28.0%	73.2%
Shanghai Comp	4,131.99	0.3%	4.1%	24.5%	44.2%
Nikkei 225	57,650.54	8.1%	14.5%	48.6%	56.2%
India Sensex	84,233.64	2.4%	-1.2%	10.4%	17.7%
Singapore Straits Times	4,984.58	1.6%	7.3%	29.1%	58.8%
Brazil Ibovespa	189,699.12	4.6%	17.7%	49.9%	48.2%
Mexican Bolsa IPC	71,582.83	5.9%	11.3%	33.9%	24.9%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	4.170%	-6.5	0.3	-36.5	-0.5
Canada 10-Yr	3.338%	-7.9	-9.5	24.0	-20.5
UK 10-Yr	4.476%	-4.6	-0.3	-3.2	39.0
Germany 10-Yr	2.792%	-5.1	-6.3	36.2	41.0
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	4.28%	0.6%	0.8%	7.3%	11.1%
U.S. Investment-Grade Corp	4.79%	0.6%	0.8%	7.8%	12.5%
U.S. High-Yield Corp	6.53%	0.3%	0.8%	8.0%	18.3%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	5,078.43	3.8%	17.6%	75.2%	150.9%
Silver (spot \$/oz)	84.11	-1.3%	17.4%	164.4%	271.9%
Copper (\$/metric ton)	13,031.90	-0.3%	4.6%	41.1%	61.6%
Oil (WTI spot \$/bbl)	65.02	-0.3%	13.2%	-11.3%	-15.4%
Oil (Brent spot \$/bbl)	69.78	-1.3%	14.7%	-9.4%	-15.1%
Natural Gas (\$/mmBtu)	3.20	-26.4%	-13.1%	-9.0%	73.4%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	96.9210	-0.1%	-1.4%	-10.2%	-6.9%
CAD/USD	0.7363	0.2%	1.1%	5.2%	-0.9%
USD/CAD	1.3581	-0.2%	-1.0%	-4.9%	0.9%
EUR/USD	1.1871	0.2%	1.1%	14.6%	10.1%
GBP/USD	1.3627	-0.4%	1.1%	9.5%	7.9%
AUD/USD	0.7126	2.3%	6.8%	13.2%	9.2%
USD/JPY	153.2400	-1.0%	-2.2%	0.5%	2.6%
EUR/JPY	181.9000	-0.8%	-1.1%	15.1%	13.0%
EUR/GBP	0.8711	0.6%	-0.1%	4.6%	2.0%
EUR/CHF	0.9160	0.0%	-1.6%	-3.2%	-2.9%
USD/SGD	1.2619	-0.7%	-1.8%	-6.7%	-6.2%
USD/CNY	6.9121	-0.6%	-1.1%	-5.4%	-3.9%
USD/MXN	17.1846	-1.6%	-4.6%	-16.4%	0.6%
USD/BRL	5.1843	-1.5%	-5.3%	-10.1%	4.6%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD 1.1% return means the Canadian dollar has risen 1.1% vs. the U.S. dollar year to date. USD/JPY 153.24 means 1 U.S. dollar will buy 153.24 yen. USD/JPY -2.2% return means the U.S. dollar has fallen 2.2% vs. the yen year to date.

Source - Bloomberg; data as of 2/11/26

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			Count	Percent
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