



Europe: Filtering out the noise

Frédérique Carrier – London

The European economy has proven surprisingly resilient so far, though the ECB remains alert to the risk of rising natural gas prices. The region faces a crowded political agenda with plenty to watch over the next six to 12 months. We explore where political noise could create opportunities.

Economic resilience, policy shift

European corporate earnings were strong in Q2, with STOXX Europe 600 earnings per share excluding Energy rising a respectable 13 percent y/y, a notable performance given that energy shocks have historically dented European earnings.

In our view, strong earnings largely reflect a combination of domestic reflation and rising investment. The global AI infrastructure buildout, especially in the U.S. but also in Europe, has improved prospects of many global semiconductor and capital goods firms. Financials have benefitted from steeper yield curves and private sector releveraging, while Germany's €500 billion infrastructure fund is beginning to filter through to construction and engineering order books. This all sits alongside a broader shift in European Union (EU) policy.

Squeezed between an unreliable U.S. trading partner and heavily subsidized Chinese industries, the EU has started protecting key industries, emphasizing strategic self-reliance over export-led growth. Steel import quotas, for instance, have already lifted European steelmakers' Q2 earnings. In our view, this response to a distorted playing field could support economic resilience, though policymakers must guard against protection extending beyond what is strictly needed.

Overall, consensus expects GDP growth of 1.2 percent and 1.5 percent this year and next, respectively, while corporate earnings growth expectations have been upgraded to 15 percent y/y in 2026, and nine percent y/y in 2027.

Keeping watch on natural gas prices

Against the backdrop of economic resilience, the European Central Bank (ECB) has raised interest rates in September, following inflation that had reached 3.3 percent y/y in August.

Going forward, we expect the central bank to focus on how higher natural gas prices feed into broader inflation. Europe relies heavily on natural gas which also sets electricity prices. This gives the fuel a far wider inflation pass-through than oil, according to RBC Capital Markets.

Recently, natural gas prices have risen above €80/MWh, or more than double the pre-Iran-war level before retreating somewhat. Middle East uncertainty continues to impair liquefied natural gas shipping, with storage levels also low ahead of winter.

Markets are pricing in four more hikes by July 2027. In our view, the ECB will aim to keep this inflation spike short-lived. If successful, it could reverse course on interest rates later next year.

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

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Priced (in USD) as of 9/23/26 market close (unless otherwise stated). Produced: 9/24/26, 14:08 ET; Disseminated: 9/24/26, 14:20 ET

Noise ahead

The region is entering a period of political and fiscal uncertainty. France's budget bill is due before Parliament by Oct. 6. So far, negotiations are highlighting the country's reluctance to rein in social spending, even as subdued economic growth makes debt of close to 120 percent of GDP harder to sustain. The government now expects the fiscal deficit to reach 5.4 percent in 2026, up from 5.1 percent in 2025 and well above the EU's three percent reference level.

Profligacy is a problem for France, whose borrowing costs now exceed Italy's. It is now also an EU issue, given France is its second-largest economy. The French lack of fiscal discipline is complicating the case for EU joint borrowing, a route the bloc last took during the COVID-19 pandemic when it issued €750 billion in common debt. Germany and the Nordic states are reluctant to further joint borrowing, wary that it could leave fiscally stronger members effectively underwriting the debts of less disciplined ones, such as France. Joint borrowing matters to the bloc because it could fund large-scale shared priorities, such as defence, more efficiently than fragmented national efforts.

French presidential elections, to be held as a two-round vote next April and May, are likely to add to investor unease, in our opinion. Polls currently put Marine Le Pen, of the populist National Rally party, far ahead in the first round. Even though she has tempered her anti-euro rhetoric over the past few years, Le Pen would be unlikely to support further EU integration should she win.

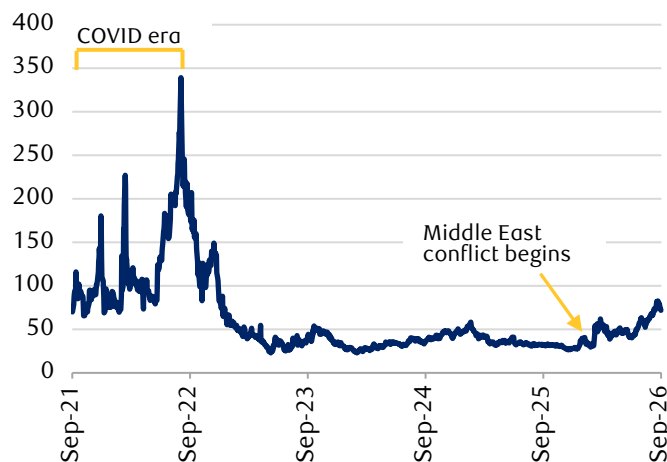
In our view, investors will also follow with interest the impact of the recent landslide win of the AfD, a hard-right party, in two East German states. AfD supports normalizing economic relations with Russia, and is anti-immigration. The wins are unlikely to alter federal decision-making day to day, in our view, but the risks are that Germany Chancellor Friedrich Merz's political position becomes even less secure, and it weakens the federal government's reform programme somewhat.

National votes are also due in several other European countries. Italy, the bloc's third-largest economy, must hold elections by December 2027. Prime Minister Georgia Meloni has moved towards the centre once in office, favouring fiscal discipline and softening her Eurosceptic rhetoric. She is also feeling pressure from the National Future party, a Eurosceptic party positioned to her right, that has drawn defectors.

The rise of populist forces in Europe's largest economies is a trend worth monitoring, even as its near-term policy impact looks limited.

European wholesale natural gas prices have doubled since the Middle East conflict started

Euros per megawatt-hour



Note: The chart uses the TTF, or Title Transfer Facility, a virtual trading point for natural gas in the Netherlands, as a proxy for European wholesale natural gas prices.

Source - RBC Wealth Management, Bloomberg; data range 9/24/21–9/23/26

Volatility brings opportunity

Political risks will surely make headlines over the coming months, in our view, but the European corporate sector has accumulated a lot of experience at navigating uncertainty over the past 100 years. Moreover, companies on the STOXX Europe ex UK derive more than 50 percent of sales from non-European sources. Finally, inflation, fiscal, and political risks are well known and at least partially discounted by markets, in our assessment.

European yields reached multi-year highs in September. Moreover, the spread (difference) between French bond 10-year yields and German Bund 10-year yields reached 105 basis points, a decade high. While much of the French fiscal and political risk seems to be discounted, we expect the worsening deficit to keep this premium elevated. We prefer Spanish, Portuguese, and EU bonds. We believe 10-year Bund yields beyond 3.4 percent is an attractive entry point.

As for equities, we continue to rate European equities Market Weight. At 14.8x the 2027 consensus earnings forecast, we believe European equities offer broad appeal, particularly to investors who worry about a potential fading of the AI story in the United States. The asset class remains under-owned globally by institutional and individual investors, and we would use periods of volatility to build positions. We continue to like Industrials supported by various structural tailwinds.

UNITED STATES

Miles D'Alessandro – Minneapolis

■ **Diesel prices continue to rise, with a looming export ban a potential catalyst for more inflationary pressure.** The Iran war has driven various inflationary effects domestically, with a notable rise in diesel prices a more recent development. The average price of diesel in the U.S. reached nearly \$6.30 per gallon this week, up 68% from a year ago, according to FactSet, and climbed even higher by other measures. As a result, diesel reached a new record all-time high across benchmarks. This consistent rise in prices has been fueled by supply disruptions abroad, most notably from shipping constraints in the Strait of Hormuz and from attacks on Russian production facilities. According to RBC Capital Markets, U.S. refiners are running near maximum rates of diesel output, while global diesel exports have moved well below five-year averages. A potential diesel export ban could come with consequences including higher diesel prices abroad, as international diesel supply would become even more limited. The impact of higher diesel prices is felt across the economy, from trucking to farming and construction. Shares of trucking company J.B. Hunt dropped 13% on an update from the company earlier this month where the CFO called out expectations for earnings to decline 5%–10% in the upcoming quarter due to elevated diesel prices. High diesel prices are impacting more than trucking, as according to our national research correspondent, the number of earnings calls that have cited “diesel” in the past two quarters totaled 89, the highest level since Q3 2008. We continue to monitor diesel prices amidst other inflationary pressures and would view a diesel export ban as an attempt to curtail inflationary effects of military conflicts abroad. We question whether an export ban on diesel would be effective, as domestic storage and output remain at peak levels, forcing the

U.S. diesel prices surge to record highs

U.S. ultra-low-sulfur diesel prices (\$/gallon)



Source - RBC Wealth Management, FactSet; data range 1/2/15–9/23/26

hand of refiners to cut production, impacting global supply, and potentially exacerbating prices further.

■ **Equity markets maintain highs amidst varying economic developments.** Following a 25-basis point interest rate hike last week from the Federal Reserve, the S&P 500 has shifted upward since then but remains roughly flat this week as a number of economic indicators were provided. The S&P Global U.S. Purchasing Managers' Index reached a five-year high, driven by new orders, which have swelled thanks to demand for data center construction and AI-related investments. Initial jobless claims remain in a multi-year downtrend, and new home sales were up month over month in August but remain down year over year. As for consumer insights, McDonald's (MCD) expects traffic to remain flat if inflation remains elevated, which continues to weigh on the stock despite announced long-term investments into franchisees and innovative menu collaborations.

CANADA

Nguyen Dang, CFA & Claudia Humbert, CFA – Toronto

■ **Bank of Canada (BoC) warns new U.S. tariffs could cut Q4 growth to below 1%.** BoC Governor Tiff Macklem said Canada's economy entered the summer on firmer footing, with Q2 GDP growth rebounding to a 3.3% annualized pace as businesses and households adapted to trade tensions, though renewed U.S. tariff uncertainty now threatens to interrupt that progress. Macklem cautioned that if the latest U.S. tariffs on Canadian exports remain in place, GDP growth could be roughly halved in Q4 to below 1%, as businesses may opt to delay investment and hiring decisions. At the same time, higher energy prices are keeping inflation elevated, complicating the policy outlook. Importantly, Macklem reiterated that monetary policy cannot offset the economic damage from tariffs or influence global energy prices, but the central bank can act if these shocks begin to create broader inflationary pressures. Futures markets are now pricing in five rate hikes by the BoC over the next 12 months, which we believe may be underappreciating the downside risks to growth as policy remains caught between trade-related drag and energy-driven inflation.

■ **The Canadian dollar could face further pressure before conditions become more supportive.** The loonie currently trades close to US\$0.71, below its US\$0.76 10-year average. Markets expect U.S. interest rates to remain higher than Canadian rates in the near term, encouraging yield-seeking investors to favour U.S.-dollar assets and helping to support the greenback. The yield advantage offered by U.S. government bonds has widened recently, with the two-year Government of Canada bond now roughly 1.50% below its U.S. counterpart, the widest gap since March 2025. RBC Capital Markets expects the Federal Reserve to raise rates further this year while viewing the BoC as more likely to remain on hold, a

combination that we believe should keep the loonie under some pressure and could push it toward US\$0.70 by year-end. Looking further ahead, RBC Capital Markets expects the interest rate differential to narrow as the Fed holds rates and the BoC begins tightening, potentially in 2027. This underpins its forecast for the Canadian dollar to gradually recover toward US\$0.74 by the end of next year.

UK & EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- September's euro area activity indexes underscore the region's resilience. **Despite energy shocks, transport disruptions of key industrial commodities from low water levels, and rising interest rates, the composite Purchasing Managers Index climbed to 53.1—its highest level since April 2023 and up from 52.0 in August.** Strong new orders across manufacturing and services signalled robust domestic demand, according to RBC Capital Markets. However, the Middle East conflict poses a risk to sustaining this momentum.
- **The resilient backdrop and potential for energy price inflation have prompted markets to price in four key interest rate increases over the coming 12 months by the European Central Bank.**
- **The dominant theme this week was the global bond selloff, with European government yields reaching nearly two-decade highs.** Germany's 10-year Bund yield hit 3.57%, the highest since 2011. Over the past three months, this yield surge has created a clear divergence within the market: cyclical value segments of the equity market, namely energy, basic resources, and banks, have notably outperformed; meanwhile, defensive and higher-valuation industries, such as consumer products, construction, telecoms, utilities, real estate, food, and beverage, have underperformed.
- This divergence reflects a clear dynamic: **inexpensive sectors with solid earnings momentum have offset rising discount rates, while higher-valued sectors lacking earnings growth have borne the brunt of the yield surge.** We remain constructive on value-oriented European equity exposures, particularly banks and basic resources, given their combination of robust earnings momentum and attractive valuations.

ASIA-PACIFIC

This section will return next week.

MARKET Scorecard

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 0.70 means 1 Canadian dollar will buy 0.70 U.S. dollar. CAD/USD -2.7% return means the Canadian dollar has fallen 2.7% vs. the U.S. dollar year to date. USD/JPY 158.35 means 1 U.S. dollar will buy 158.35 yen. USD/JPY 1.0% return means the U.S. dollar has risen 1.0% vs. the yen year to date.

Source - Bloomberg; data as of 9/23/26

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	7,706.03	0.3%	12.6%	15.8%	34.8%
Dow Industrials (DJIA)	51,511.59	-3.1%	7.2%	11.3%	22.3%
Nasdaq	26,936.04	2.1%	15.9%	19.3%	49.9%
Russell 2000	2,838.66	-4.0%	14.4%	15.5%	27.9%
S&P/TSX Comp	35,751.43	-1.4%	12.7%	19.9%	49.6%
FTSE All-Share	5,770.30	-1.2%	7.8%	15.6%	27.8%
STOXX Europe 600	639.92	-1.7%	8.1%	15.3%	23.9%
EURO STOXX 50	6,299.82	-1.9%	8.8%	15.1%	28.9%
Hang Seng	24,834.12	-2.9%	-3.1%	-5.1%	36.1%
Shanghai Comp	3,936.52	-1.2%	-0.8%	3.0%	43.2%
Nikkei 225	65,018.95	-1.9%	29.2%	42.9%	72.4%
India Sensex	74,828.25	-2.8%	-12.2%	-8.9%	-11.9%
Singapore Straits Times	5,709.91	-0.8%	22.9%	32.7%	56.9%
Brazil Ibovespa	185,814.09	4.7%	15.3%	26.9%	42.3%
Mexican Bolsa IPC	64,216.68	-1.9%	-0.1%	3.0%	22.5%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	5.108%	35.8	94.1	100.2	135.9
Canada 10-Yr	3.951%	21.3	51.8	76.3	100.3
UK 10-Yr	5.347%	28.4	86.8	66.7	142.4
Germany 10-Yr	3.555%	23.1	70.0	80.6	139.9
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	5.28%	-0.9%	-1.2%	-0.2%	2.6%
U.S. Investment-Grade Corp	5.73%	-0.6%	-1.0%	-0.4%	3.2%
U.S. High-Yield Corp	7.69%	-0.8%	1.9%	3.1%	11.1%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	4,284.78	-3.4%	-0.8%	13.8%	63.0%
Silver (spot \$/oz)	64.41	-3.2%	-10.1%	46.3%	109.9%
Copper (\$/metric ton)	14,820.97	2.6%	19.0%	49.7%	57.5%
Oil (WTI spot \$/bbl)	92.79	8.2%	61.6%	46.3%	31.9%
Oil (Brent spot \$/bbl)	103.68	14.6%	70.4%	53.3%	40.3%
Natural Gas (\$/mmBtu)	3.04	3.7%	-17.4%	6.7%	16.5%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	101.1100	1.7%	2.8%	4.0%	0.3%
CAD/USD	0.7090	-1.8%	-2.7%	-1.9%	-4.0%
USD/CAD	1.4103	1.8%	2.8%	1.9%	4.2%
EUR/USD	1.1382	-2.0%	-3.1%	-3.7%	2.4%
GBP/USD	1.3240	-2.3%	-1.7%	-2.1%	-0.8%
AUD/USD	0.7040	-1.8%	5.5%	6.7%	3.0%
USD/JPY	158.3500	-0.9%	1.0%	7.3%	10.3%
EUR/JPY	180.2400	-2.9%	-2.0%	3.3%	13.0%
EUR/GBP	0.8597	0.3%	-1.4%	-1.6%	3.3%
EUR/CHF	0.9391	0.0%	0.9%	0.5%	-0.3%
USD/SGD	1.2802	0.7%	-0.4%	-0.2%	-0.8%
USD/CNY	6.7111	-0.1%	-4.0%	-5.7%	-4.8%
USD/MXN	17.5216	3.1%	-2.7%	-4.5%	-9.8%
USD/BRL	5.1669	-0.4%	-5.6%	-2.2%	-6.7%

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			Count	Percent
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