

Research @ Citi Markets Edition Podcast: European Outlook for 2026 — When Cyclical Pickup Meets Fiscal Tailwinds

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Transcript:

Podcast Opener (0:00)

Research @ Citi, Markets Edition.

Elise Badoy (0:04)

Welcome to Research at Citi, Markets Edition, where we break down global macro in under 10 minutes. I'm your host, Elise Badoy, Head of Equity Research for Europe, UK, the Middle East and Africa at Citi. And today we're inverting the roles: I will be interviewing the usual host of this podcast, Beata Manthey, who is Citi's Head of European Equity Strategy.

When Cyclical Pickup Meets Fiscal Tailwinds: We have just released our outlook for 2026. And each year, Citi equity analysts come together at this time of the year with our macroeconomists and strategists to marry top-down and bottom-up expertise and produce our views for the year ahead.

So stay tuned as we record from London and dive into fiscal revival, AI broadening and, of course, geopolitics.

Beata Manthey (0:53)

Great to be here, Elise, in these swapped roles and to discuss the very crucial topics for the next year.

Elise Badoy (1:01)

Let's get right into it. Your team at Citi, together with the analysts and the economists, have published essentially what is a constructive outlook on European equities for 2026. So, give us, to begin with, the high-level view, starting with the economic outlook.

Beata Manthey (1:16)

Absolutely, Elise. So, the macro environment is indeed becoming more favorable. On the fiscal front, we project a more supportive stance across most major euro area countries for next year, maybe with the notable exception of France. A significant factor here is the acceleration of NGEU, the next-generation EU spending. In periphery

countries like Italy and Spain, this could generate a fiscal impulse close to half a percentage point of GDP. And of course, fiscal easing in Germany is even bigger and expected to see a GDP boost of almost one percentage point. That's a pretty good backdrop for equities.

Next year, we are going to see effects of fiscal easing together with the lagged effect of monetary easing. And all this means that our economies have lifted their euro-zone GDP forecast for next year. And now they expect growth of 1.2%, which is in line with potential growth and actually above the consensus right now.

Elise Badoy (2:23)

So obviously, Beata, this is only the domestic macro story. What about the broader international backdrop? Obviously, we're recording this week. We've just heard from the Fed. What do you make out of this week's decision and how does this impact your views?

Beata Manthey (2:41)

So we've been arguing for quite some time that Fed cutting into soft or actually perhaps even no landing underpins this super-favorable backdrop for equities. This is the type of environment where all regional equity indices go up, with some skew for more cyclical ones to do even better than the rest.

So, what we've heard from the Fed this week is they will cut again, growth is resilient, maybe even better than what they forecast beforehand. And actually, inflation is mostly under control. What's not to like, Elise?

Elise Badoy (3:19)

OK, that's a very clear picture of the micro tailwinds. But with this supportive backdrop, your team at Citi is also quite constructive, again, specifically for European equities. Can you give us the high-level view and perhaps hint at where you see the Stoxx 600 heading by then?

Beata Manthey (3:36)

Indeed. With that backdrop, our view on European equities is constructive and frankly is becoming more structural in nature, which is very important. We've introduced our end-2026 Stoxx 600 target of 640. That implies a solid 10% upside from the current levels, assuming multiples remain relatively stable around today's 12 months forward P/E of 15x.

We also see good potential for FTSE 100: We target 10,700 for roughly similar upside. And this positive stance is built on the combination of factors, including the cyclical improvements we've just discussed, combined with the structural and fiscal shifts that we see ongoing.

Elise Badoy (4:24)

Obviously, we now finally have what sounds like a generally very positive environment. But let's talk briefly about the themes that should shape and drive equities going forward. You've written about a few, but which one is the most important?

Beata Manthey (4:39)

Elise, by far the most important for us is EPS recovery and what comes with it, EPS broadening. Broadening is the key word for next year. So let me explain this. This year, European equities have faced large earnings downgrades, larger actually than major peers around the world. And the downgrades were driven by internationally exposed stocks, primarily due to factors like tariffs and currency strength, so euro/dollar strength.

However, these headwinds are now easing considerably, setting the stage for significant earnings inflection into the next year. After what we expect to be a relatively flat 2025, bottom-up analysts are projecting a robust 11% EPS growth for European equities next year with a wide set of sectors contributing. That's the broadening.

Our own top-down forecast also implies very healthy 8% EPS growth, which is still a very robust number.

Elise Badoy (5:45)

All very encouraging, Beata. And obviously, at the beginning of this podcast — and our listeners are staying tuned — I had mentioned fiscal revival and AI broadening. Do you want to tell us about these themes?

Beata Manthey (5:56)

Absolutely. So we've touched already very briefly on this fiscal revival, talking about fiscal policy and macro backdrop. But what is worth mentioning and emphasizing? Investors around the world remain quite skeptical on Europe's ability to deliver on the stepped-up fiscal spend. Now, our view is more sanguine.

We think that the fiscal is happening. It's already started to be evident in the data, in the positive data flow. It should result in better GDP growth, better EPS, and justify higher valuations. We also argue that this potential growth has not yet fully been priced in by the markets, so playing this theme in the new year should be a good investment opportunity.

This is also a very good place to mention another theme, AI broadening. While the AI trade has seen some recent volatility, we think that the underlying thematic will remain one of key drivers for global equities going forward. But we expect this AI trade to broaden further, moving beyond just the initial hardware and software giants to more focus on adaptation and integration, which really makes Europe a very interesting

crossroads, particularly with its potential for domestic infrastructure spending complementing AI advancement. So we argue is that it's really a crossroad between AI and fiscal, and that's where you can play it in Europe.

Elise Badoy (7:35)

So we've covered macro, the Fed, we've covered earnings and fiscal revival, AI broadening, but really we haven't mentioned geopolitics at all. So we really need to look into this.

Cease-fire hopes re-emerge again for the next year. How could that impact the European economic landscape and your outlook, Beata.

Beata Manthey (7:55)

That's an excellent point, Elise. And it could be a significant upside catalyst. A cease-fire, particularly one that leads to lower energy costs, would essentially act as a hidden stimulus for Europe on the top of the evident ones that we already have. Even without the cease-fire, we expect global LNG supplies to start exceeding the demand from next year onwards. And most of this excess supply should be flowing into Europe.

But a cease-fire would accelerate and amplify this trade, providing a substantial relief, both to the European economy, but also the manufacturing base and sectors that are more energy-heavy.

Elise Badoy (8:42)

Beata, that's a very clear picture of the macro and thematic drivers in Europe. How does it feed into the global context of equity investing?

Beata Manthey (8:50)

So, Elise, we are facing the type of environment — we've briefly touched upon it already — where it's going to be really favorable for a broad set of sectors and regions with preference for more cyclical parts of the market. And the way we frame it for the investors from a global equity-allocation perspective is we continue to be overweight AI in the U.S. but argue you should have a diversified portfolio.

This means that the U.S. is neutral, even though we are overweight AI, and we argue for the broadening of the AI theme to be overweight to emerging markets and for this cyclical uptick to be overweight to continental Europe.

Elise Badoy (9:37)

Thanks Beata. We've spoken about the many positive aspects that we have took for the next year, and you are worried that we're always having balancing views. So what are the risks that investors or market participants pointed our listeners today to be aware of?

Beata Manthey (9:52)

We've left the worst for last, Elise, but we cannot record this podcast without speaking about the risks. And we could talk about many, but I would narrow it to this one.

Broader market volatility could remain elevated, even if it is a continued reassessment of the AI thematic that we've been hearing recently, combined with really demanding and high valuations. For us, high valuations could cap upside if EPS doesn't deliver. That's my biggest risk. These are market price for delivery, if not for over-delivery.

Elise Badoy (10:30)

Thank you so much for breaking down Citi's comprehensive outlook for European equities in 2026, Beata. This has been really incredibly insightful. This is the last episode of Citi's Markets Edition podcast for this year. We'd like to take this opportunity to wish you all happy holidays and a prosperous new year.

Thank you for joining us today. This episode was recorded on Dec. 12, 2025. And I'm your host, Elise Badoy. Our next Research @ Citi Markets Edition podcast will be hosted by Dirk Willer, Citi's Global Head of Macro. Thanks for tuning in and goodbye for now.

Disclaimer (11:05)

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