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EUROPE
EUROZONE & UK EDITION

MONTHLY REPORT | **DECEMBER 2025**

Long end draws support from rate cuts, less issuance

Statistical fog may not prevent another Fed easing in December, and the weaker UK labour market and modest fiscal tightening improve prospects for a BoE easing. Pressure on the ECB to ease rates further is limited, with inflation ticking up, and rates already at 2%. Long govt bonds drew support from reduced supply in Q4, as curves stabilise, and rate cuts, but credit remains a star performer YTD, plus the Eurozone periphery, on convergence trades.

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Macro and policy backdrop – Weak labour markets leave scope for Dec. rate cuts

Statistical fog for Fed, but case for easing. Case for BoE easing strengthened by higher unemployment and modest fiscal tightening. ECB under less pressure to move (pages 2-3).

Europe and UK IG & HY credit – Little evidence of a credit bubble

Tightening in Eurozone spreads partly driven by higher Bund yields. UK IG and HY has cheapened versus other markets, but higher govt yields an important driver (pages 4-5).

Performance – Longs recover in Q4, but underperform YTD. USD weakness dominates

EM inflation linked and Eurozone periphery strongest performers YTD. Credit still the strongest performer in 2025. Euro strength squeezes overseas returns. JGBs show weakest returns, as yen weakens further (page 6-8).

Appendix (from page 11) Global bond market returns, historical bond yields, bond market durations and market values and foreign exchange returns.

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Chart 1: Longer UK gilt yields have fallen most in the last 3 months, helped by reduced issuance, and BoE easing. Long Bunds and French yields increased however, as Italian fiscal tightening attracted investors.

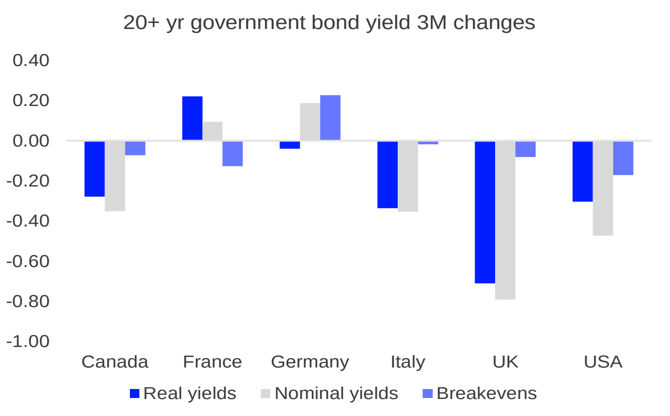
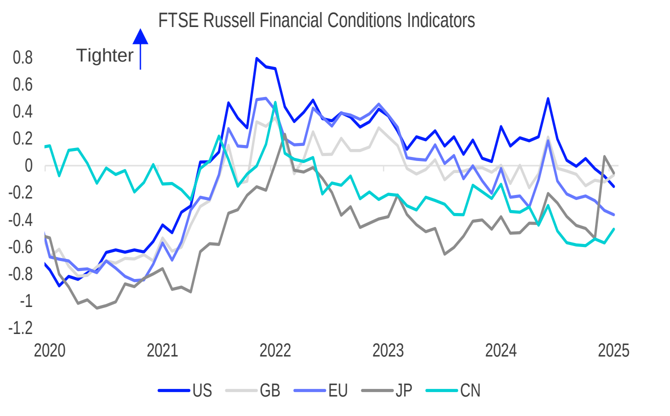


Chart 2: Financial conditions eased more in the Eurozone and China, reflecting lower rates, bond yields and credit spreads. Higher for longer rates kept financial conditions nearer the long term mean in the US & UK.



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Economic policy and financial conditions – Europe

Growth forecasts for 2026 show little recession risk, after Q3 rebounds, as easier economic policy cushions trade tariffs. The AI boom and wealth effects sustained US capex and consumer demand, even if lower incomes were squeezed by 3% + inflation since 2021. The ECB is under less pressure to adjust policy, than the Fed, and may have completed its easing, with fiscal policy stimulative. The Baltic Dry shows a spike in shipping rates but is well below Covid and 2022 levels.

IMF growth forecast revisions have been more modest for 2026, since April, on the view tariff effects would largely be in 2025, and not 2026, and that lower rates would cushion the blow of tariff changes (Chart 1). Both the US and China enjoyed modest IMF upgrades for 2026. US growth tracked close to 4% in Q3, boosted by the AI boom, and positive wealth effects are helping sustain consumer expenditure. Canada's rebound to 2.6% Q3 GDP growth reduces pressure on the BoC for a further rate cut.

The switch to a more expansionary fiscal policy in Germany, and the ongoing difficulties in reducing the French budget deficit to below the 5-6% levels in 2024-25, continue to drive a re-structuring of sovereign spreads in the Eurozone. Italian and Spanish spreads now trade through French spreads vs Bunds for the first time since the Eurozone was formed in 1999.

The Fed goes into December's FOMC meeting with less data than normal but Chairman Powell's reference to " driving more slowly in fog " does not preclude a rate cut, with Fed funds at 3.75-4%, and well above neutral estimates (Chart 3), and unemployment trending higher. The ECB is under less pressure to adjust policy, with unemployment subdued, German fiscal policy stimulus underway, and inflation ticked up to 2.2% y/y in November (it is also forecasting inflation below target in 2026, at 1.7% y/y).

The Baltic Dry index – showing the cost of dry cargo shipping on 23 different global shipping routes – increased to a 2-year high at end-November, reflecting increased demand for commodities like iron ore. Because the supply of large carriers has very low short-term elasticity, index movements are volatile, and often signal economic activity changes in advance. But we note the index level is still well below either the Covid-driven, or levels reached after the Russian invasion of Ukraine in 2023 (Chart 4).

Chart 1: Recent IMF forecasts for GDP growth in 2026 remain close to the forecasts released in April, but higher for the US and China, reflecting the impact of policy easing, and lower US tariff rates than originally mooted.

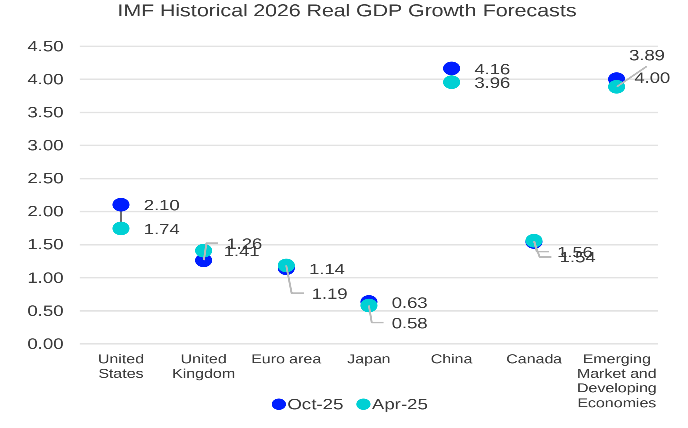


Chart 2: The great convergence trade continues in the Eurozone, in Spain and Italy, while French yield spreads continue to widen. Part of the convergence is due to modestly higher Bund and OAT yields.

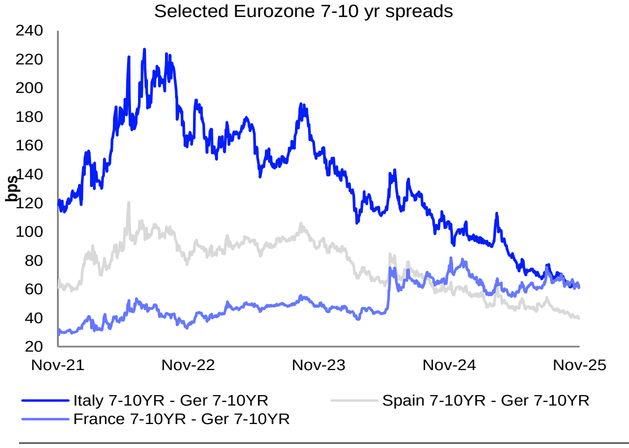


Chart 3: Unchanged policy is likely from the ECB in December, but the BoJ, Fed & BoE may all make December moves, judged by market expectations. With a deposit rate at 2%, the ECB could have finished its easing cycle.

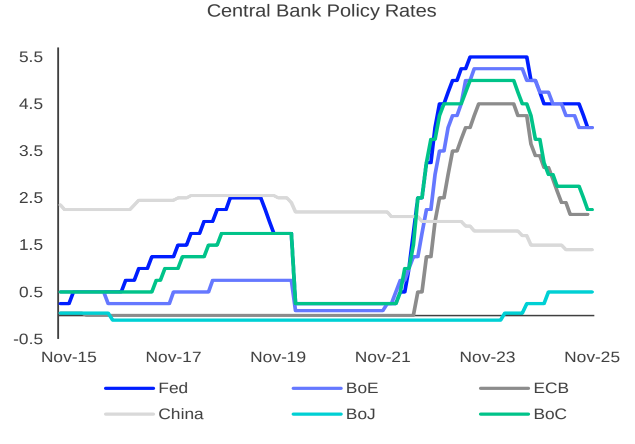
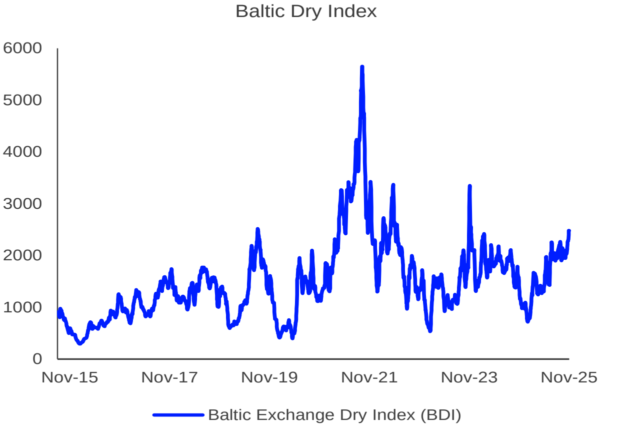


Chart 4: The Baltic Dry index shows dry cargo shipping rates grew to a 2-year high, due to increased demand for dry bulk commodities, across vehicle segments. But rates are below 2020 & 2023 levels.



Economic policy and financial conditions – UK

Further reductions in long end gilt issuance and a modest tightening in UK fiscal policy (though mainly back-loaded to 2028-29) helped long gilts continue the Q4 rally in late-November. UK inflation expectations fell sharply since Q2, and combined with slightly tighter fiscal policy, and the weaker UK labour market, may clear the way for lower UK rates.

Long gilts have moved from being a low yield asset within the G7 to the highest yielding govt bond market (Chart 1). Reflecting these yield attractions, reduced long end issuance (confirmed in the November budget), the steepness of the yield curve, and LDI flows, overseas gilt holdings now exceed those of domestic institutions and the BoE, and yields fell in Q4 (also see Chart 4 below).

UK inflation breakevens show little impact from a month ago, which captures the November budget, but fell about 70 bp in 1-3 yrs compared to 6 months ago, during the height of the tariff turbulence (Chart 2). Breakevens do decline beyond 2030, when UK inflation-linked accruals switch to a CPI-base, rather than RPI. But the decline in breakevens is less than the typical 0.8%-1% lower rate of CPI inflation vs RPI, and the shape of the yield curve is not fully consistent with the BoE's 2% CPI target.

Evidence of weaker employment growth and a slowdown in wage inflation strengthened the case for further easing in UK monetary policy, after fiscal tightening in the budget. However, wage inflation of 4.6% y/y in September remains well above the inflation target, with weak productivity growth compounding the difficulty of achieving the target. Budget measures should reduce UK CPI inflation by 0.4% in 2026 on OBR forecasts, though the OBR is still forecasting inflation to average 2.5% y/y in 2026, above the 2% target.

The UK Debt Management office (DMO) announced a further reduction in long gilt and index linked issuance after the November budget, taking total issuance in these buckets to less than 20% of the total £303.7 bn planned for 2025-26 (Chart 4). UK inflation accruals of 4.3% y/y on the RPI, and long gilt yields above 5%, may explain this switch. This shift in issuance will slowly reduce the duration of the gilt market, though it is notably longer than other markets, exc.Japan (see page 9).

Chart 1: Long gilts have become the G7's highest yielding market. But the recent rally suggests some re-appraisal of relative value, based on lower issuance, the steep curve and the attractiveness of LDI flows.

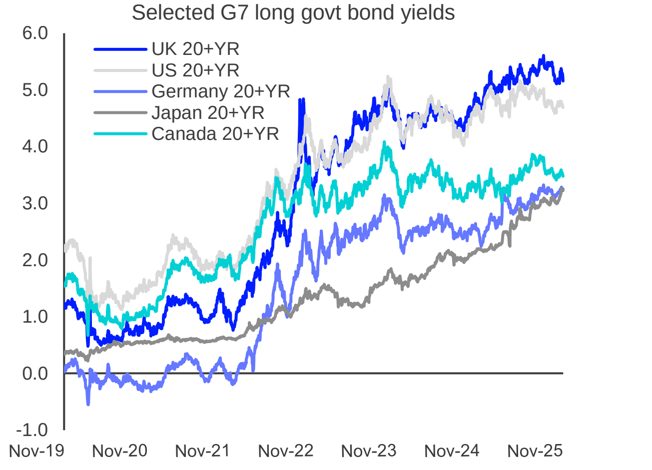


Chart 2: Inflation breakevens fell sharply since the tariff related spike in Q2, though the shape of the breakeven curve is not fully consistent with the mooted switch to CPI-based inflation accruals in 2030.

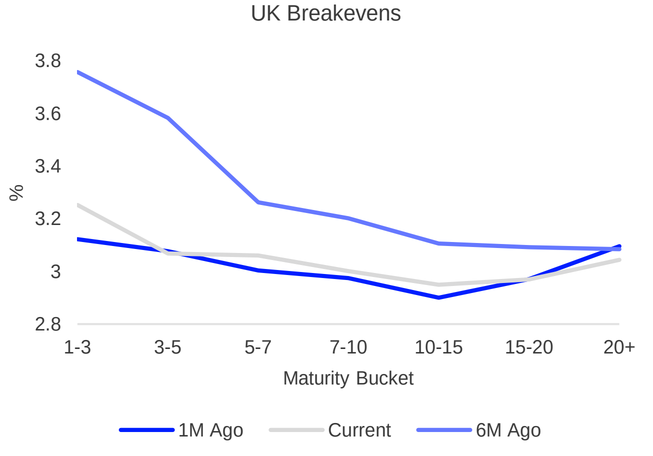


Chart 3: With UK unemployment reaching 5%, and wage inflation slowing further, prospects for a Bank of England December rate cut improved further. Wage inflation slowed to levels last seen in April 2022.

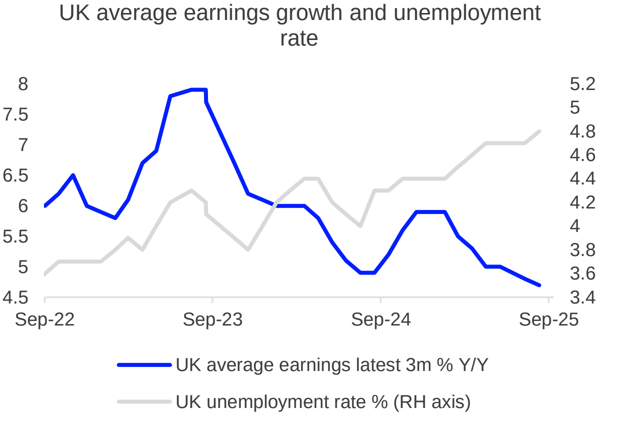


Chart 4: The UK's DMO announced a further reduction in long gilt issuance after the 2025 budget, taking long-dated issuance to less than 10% of total issuance in 2025-26, versus short-dated issuance of 44%.

Gilt sales in 2025-26 (£mn)	April 2025	Issuance split prior to 2025 budget	Budget 2025	Budget 2025 vs April 2025	Budget 2025 vs issuance prior to budget
Short	117.9	133.5	133.5	15.6	0.0
Medium (inc.green)	89.7	93.2	102.1	12.4	+8.9
Long (inc.green)	29.8	30.9	28.7	-1.1	-2.2
Index linked	30.9	34.8	31.1	0.2	-3.7
Unallocated	30.8	6.7	8.3	-22.5	1.6
Total	299.1	299.1	303.7	+4.6	+4.6

Source: FTSE Russell, LSEG, DMO and ONS. All data as of November 30, 2025. Past performance is no guarantee of future results. This report should not be considered 'research' for the purposes of MIFID II. Please see the end of the report for important legal disclosures. Bond market data is derived from FTSE Fixed Income Indices. See Appendix for list of indices used for each market.

Chart 1: Eurozone credit spreads remain near multi-year lows, though the modest increase in Bund yields in Q4 has been a factor. Credit quality improvements and shorter duration help justify spread levels.

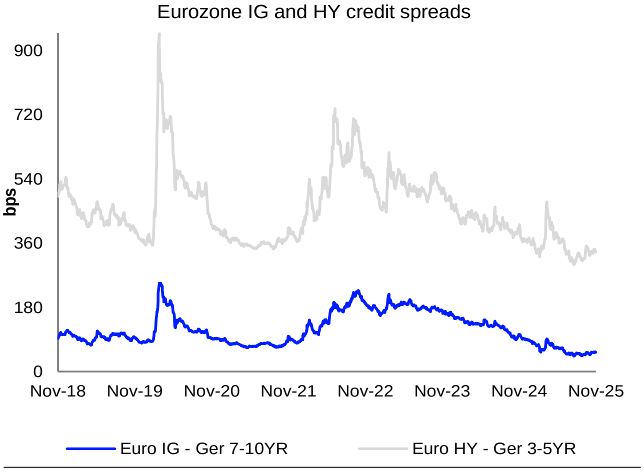


Chart 2: The narrative of improved and outperforming financials hasn't changed throughout 2025. A benign credit cycle and better bank capitalisation remain key drivers. Note banks have a 30% market weight.

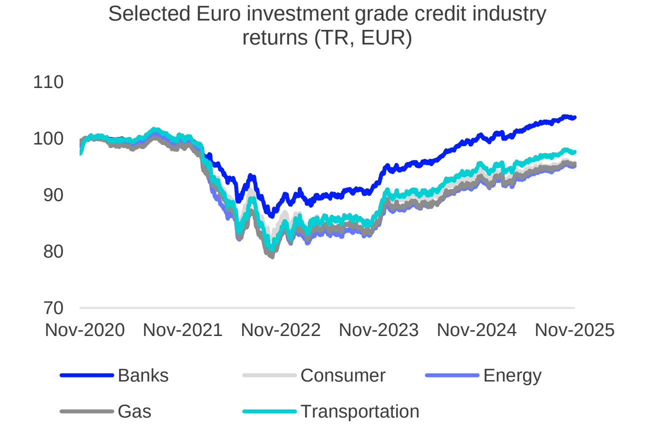


Chart 3: Yield levels, as well as credit spreads against govt bonds, are important in valuing IG credits. The Chart shows the increase in 7-10 yr Bund yields is an important driver of spread compression in 2025.

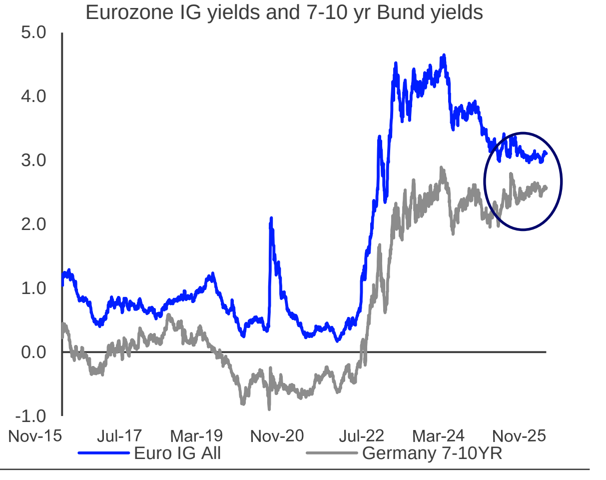


Chart 4: IG market duration has also fallen since 2020, in all major markets, including Eurozone credit. So investors are exposed to less duration risk, but receive more yield reward for holding IG credits.

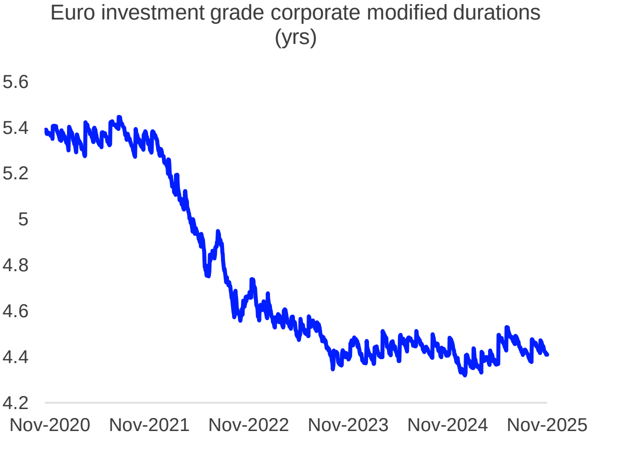


Chart 5: Lower quality Euro HY credits (i.e. CCCs) have outperformed better quality issues, in outright terms, but risk-adjusted returns are stronger in B (27% of the Euro HY index).

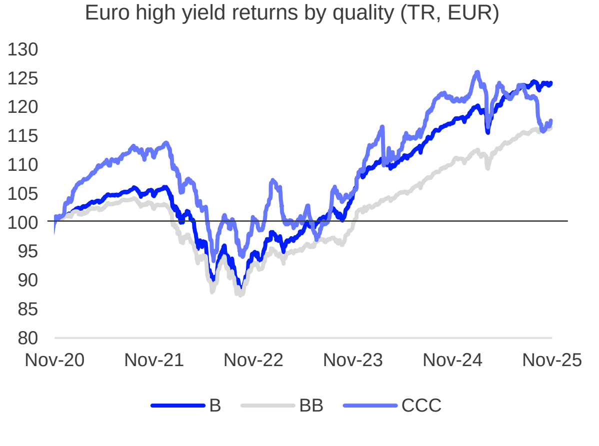
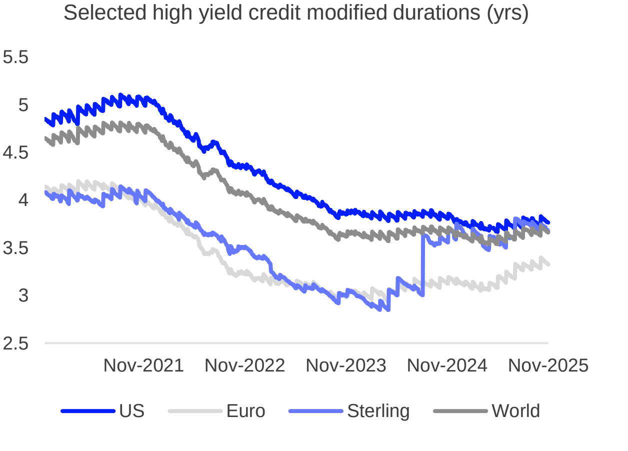


Chart 6: HY credits have less duration than IG credit, partly because issuers struggle to access long term capital. This made HY credit less sensitive to rates in 2022-23. Eurozone HY has shortest duration.



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UK Credit Analysis

Chart 1: Reflecting the level of gilt yields, UK IG yields are the highest in the peer group, and have now ticked above US IG yields. Canadian IG yields trade well through UK yields, due to the decline in BoC rates.

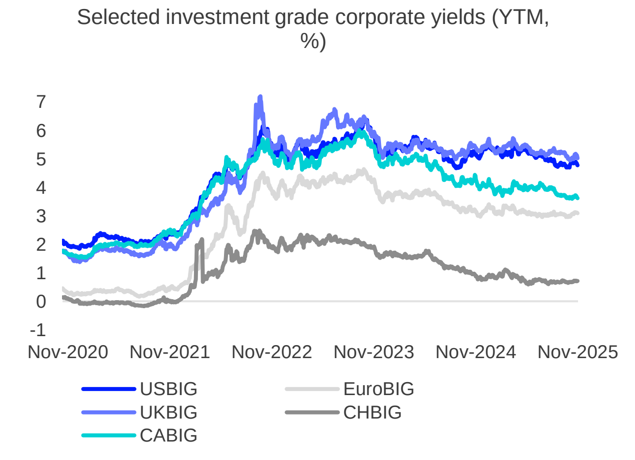


Chart 2: Longer duration of the US and UK IG credit markets left them vulnerable to higher govt bond yields and rates in 2022-2023. Investors now receive about the same yields as 2022, but with less duration risk.

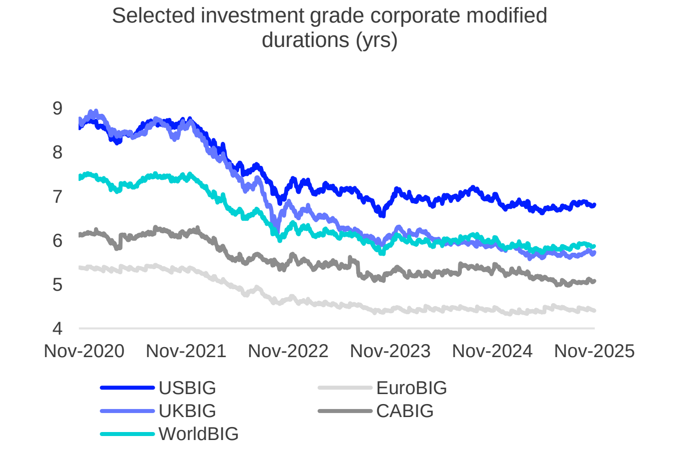


Chart 3: Banks and insurers continue to lead UK IG credit returns, helped by steeper curves and stronger net interest income. Financials have far outperformed other sectors since yields rose in 2022-23.

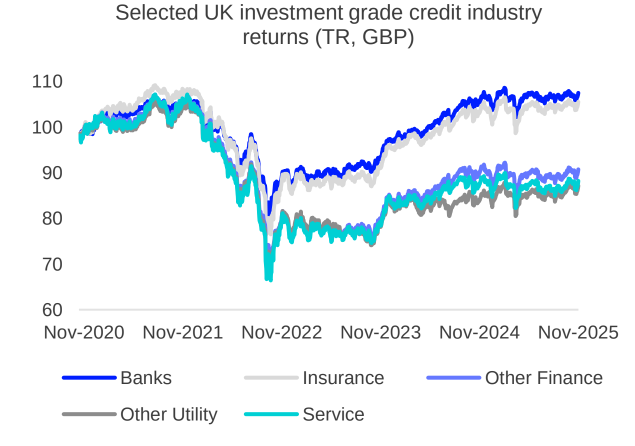


Chart 4: As in other credit markets, the share of BBB has declined in UK IG credit, but the share of single A has risen steadily since Covid. This has eased fears of a substantial migration from IG credits to high yield.

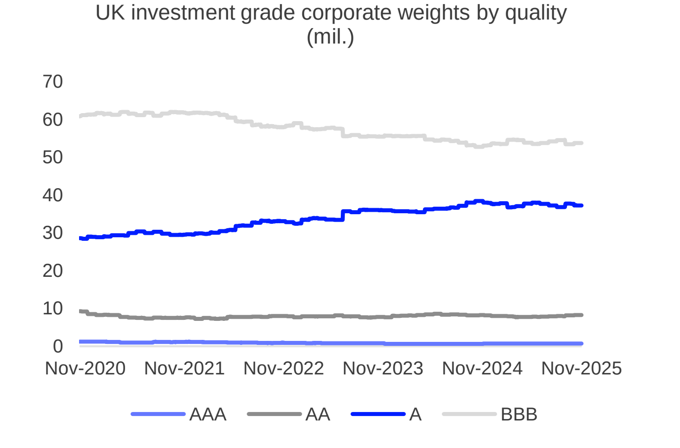


Chart 5: UK high yield has the highest yielding assets in the asset class, partly due to the rise in UK rates and gilt yields relative to other markets since 2021. US yields dominate world index yields due to size.

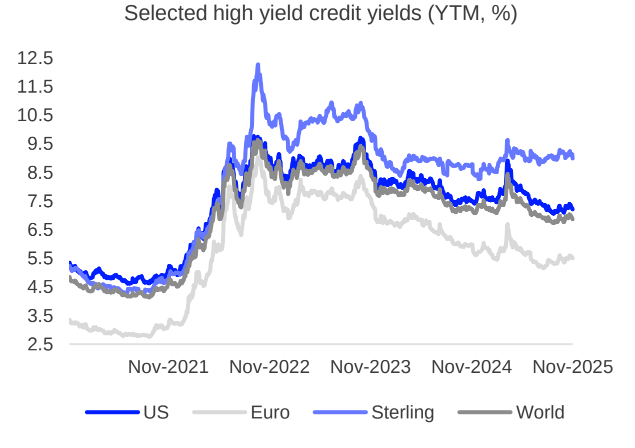
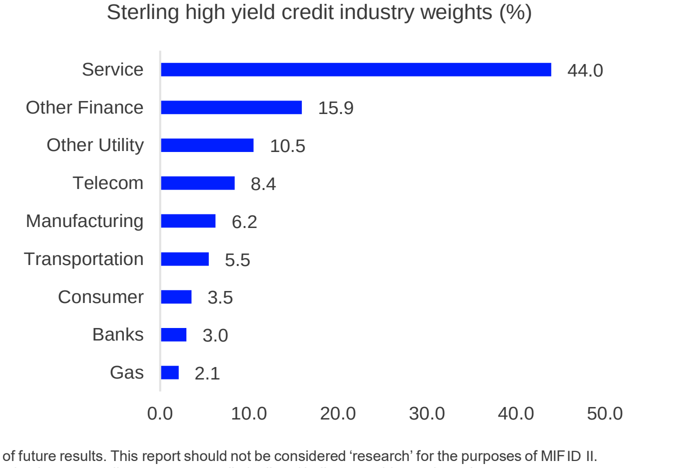


Chart 6: The collapse in Other Utility returns after the defaults in the water sector has stabilised in 2024-25, but the relatively high weight in the index should be noted. Note that banks have a very low weight in the HY sector.



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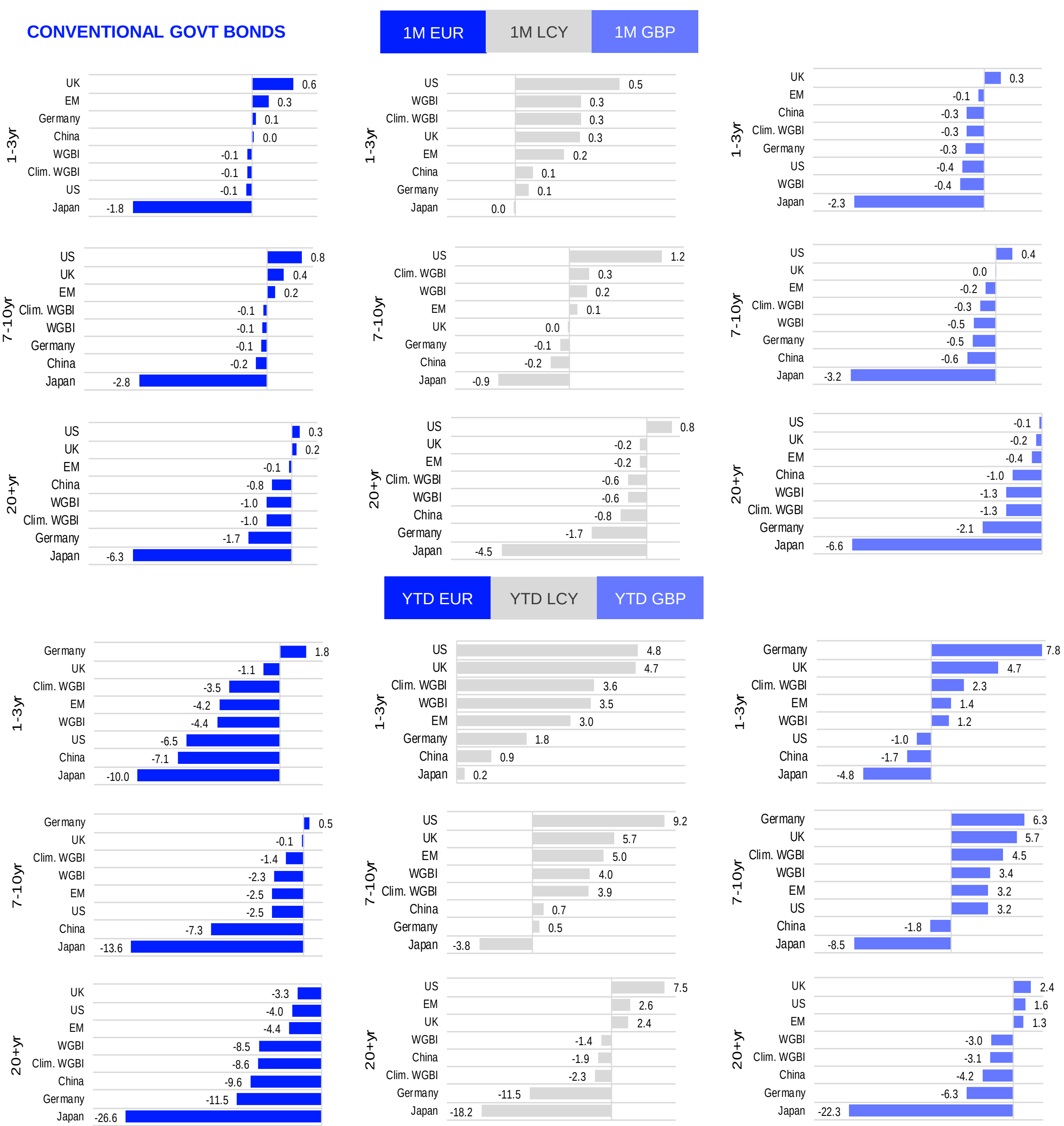
Conventional Government Bond Returns − 1M & YTD % (EUR, GBP, LC, TR)

November returns show modest moves for both EUR and GBP-based investors, apart from JGBs with losses of 6-7% in longs, partly due to further yen weakness. YTD returns still reflect currency strength in the EUR, with losses in all overseas bonds, extending to 10-27% in long JGBs. For GBP investors, the picture is more mixed with positive returns of 5-8% in short gilts and Bunds, but mostly losses in longs of 3-22%, led by JGBs.

Neither credit nor govt bonds moved much in November, after central bank decisions in October, though JGBs fell again.

Euro strength drove YTD losses in overseas markets. Only short and medium Bunds showed positive returns in Euros of 1-2%.

Lower central bank policy rates helped shorts and mediums more than longs YTD, though JGBs were the exception, as rates rose. China underperformed on relative currency weakness and a lacklustre performance of govt bonds as the PBOC proved cautious about cutting rates further.



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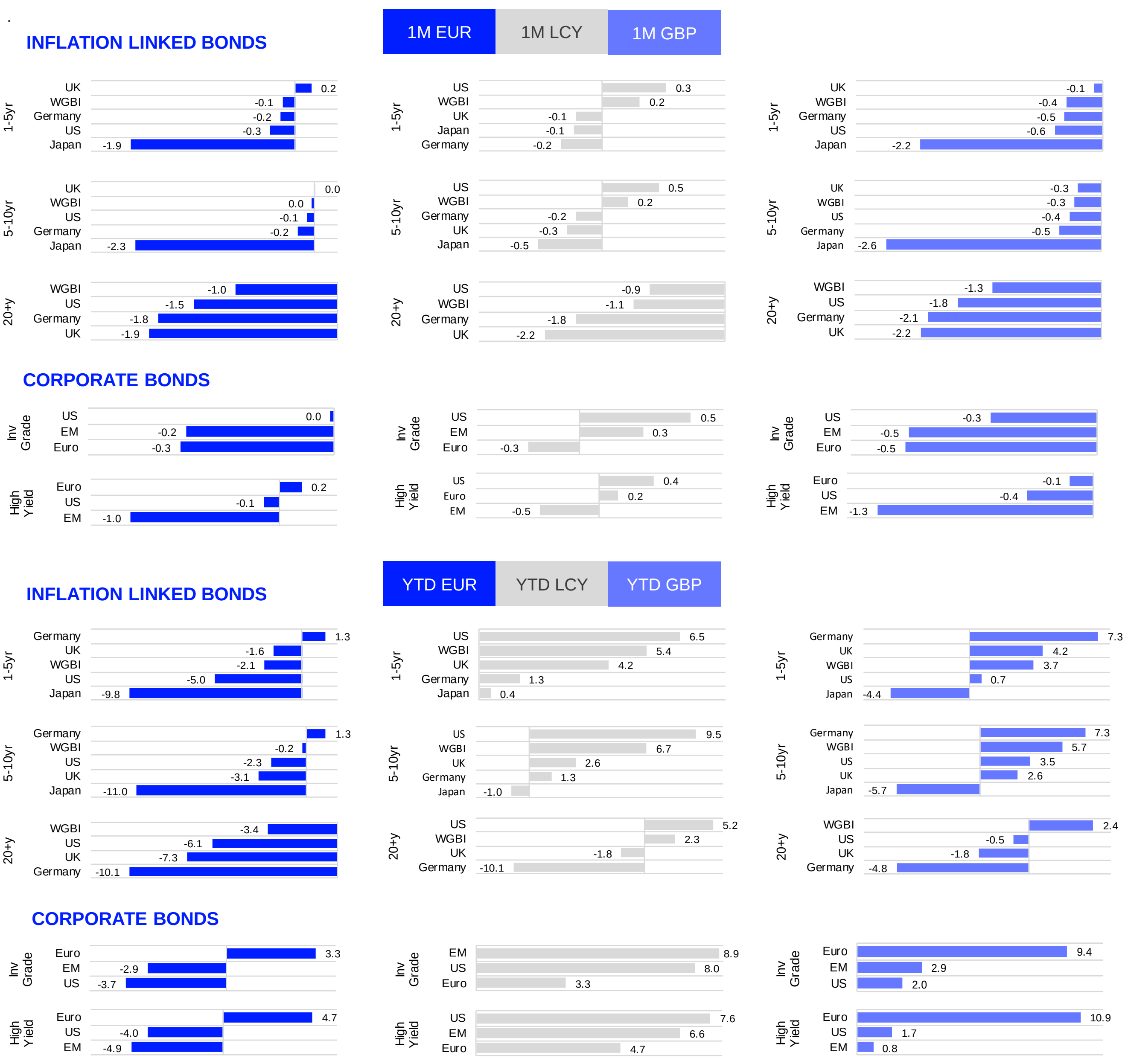
Global Inflation-Linked Bond Returns −1M & YTD % (EUR, GBP, LC, TR)

Like conventionals, inflation linked govts or real return bonds barely moved in November, though longs made small losses of up to 2% in EUR and GBP-based terms. Like conventionals, YTD returns reflect EUR strength with losses in overseas markets of up to 11% in JGB linkers. Only short Bund linkers show (tiny) gains of 1% YTD. The picture is more mixed in GBP, with positive returns of 4-7% in short inflation-linked gilts, WILSI and Bund linkers. Credit outperformed.

Neither credit nor inflation linked moved much in November, after central bank decisions in October, though JGBs fell again, as a possible rate increase in December moved centre stage.

Lower central bank policy rates helped shorts and mediums more than long linkers YTD, though JGBs were the exception, as rates rose.

Credit barely moved in November overall, but showed solid gains in both IG and HY YTD, led by Euro HY, with gains of 9-11% in GBP terms, and 3-5% in EUR terms. Strong correlation of HY credit to the equity market rally was a key narrative again in 2025.



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Top and Bottom Bond Returns − 1M & 12M % (EUR, GBP, TR)

Further Latam currency gains in Q4 (page 13) helped EM inflation-linked dominate 12M returns with gains of 15% to 21%, in EUR and GBP terms. The strong SEK and Euro also boosted Swedish and Euro HY credit bond 12M returns, plus the risk rally. Eurozone convergence trades in Italy and Spain drove gains in those markets, as core markets underperformed, most notably France. Long OATS and JGBs were again weakest performers in EUR and GBP terms on 12M.

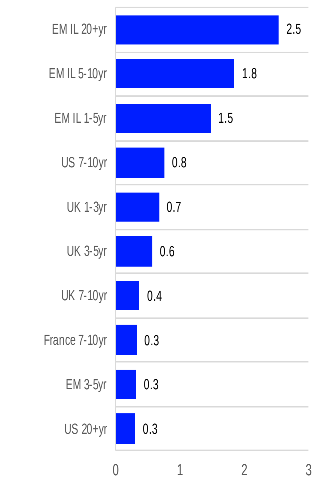
Latam currencies rallied further in Q4, after escaping larger tariff increases. The Mexican economy could also benefit from US re-shoring, and geographical proximity to the US in supply-chains.

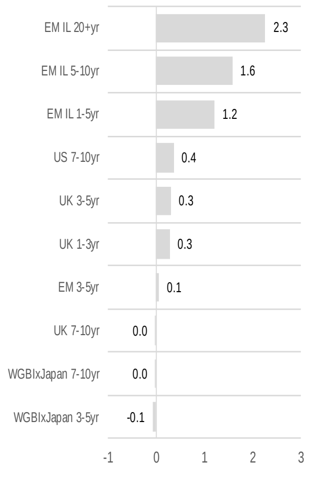
Re-structuring of Eurozone spreads accelerated in 2025, with Italy, Spain, Portugal and Greece all gaining from stronger relative growth and more fiscal deficit control, with returns of 3-12% in EUR and GBP. In contrast, France has suffered from fiscal frailty, and the German govt projects larger fiscal deficits of at least 3% of GDP until 2029.

Bear steepening in the JGB yield curve and the weak yen depressed JGB returns on 12M, with losses of 24-28% in long JGBs in EUR and GBP. Improvement in rate differentials support for the yen has yet to boost the currency, though this may begin to change if the BoJ raises rates at the December 18-19 meeting, and the Fed cuts rates on December 10.

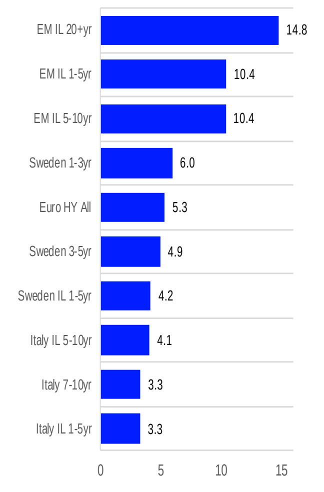
TOP 10

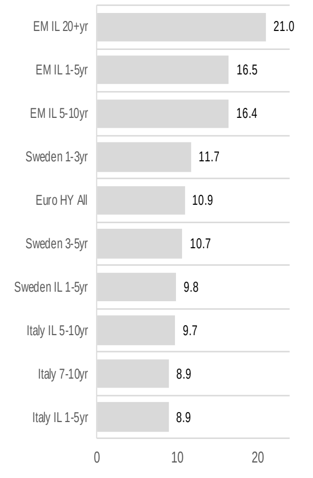
1M EUR | 1M GBP





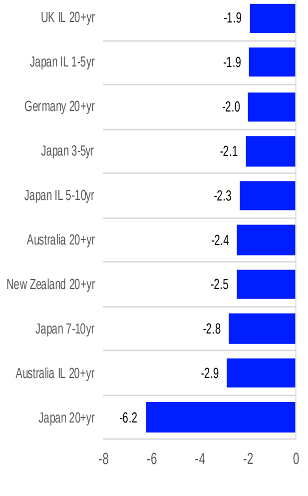
12M EUR | 12M GBP



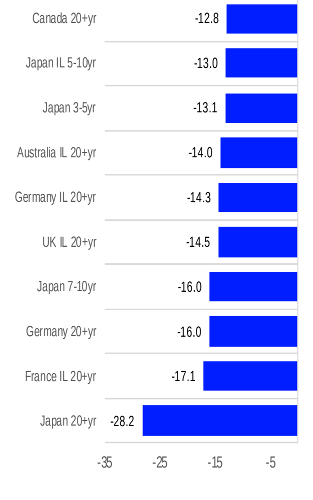


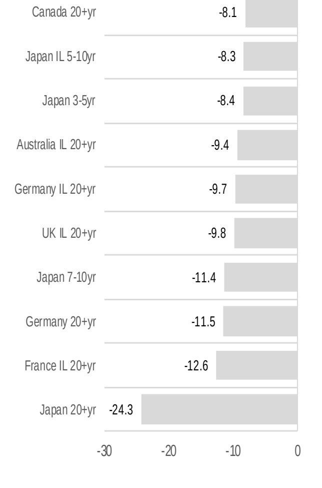
BOTTOM 10

1M EUR | 1M GBP



12M EUR | 12M GBP





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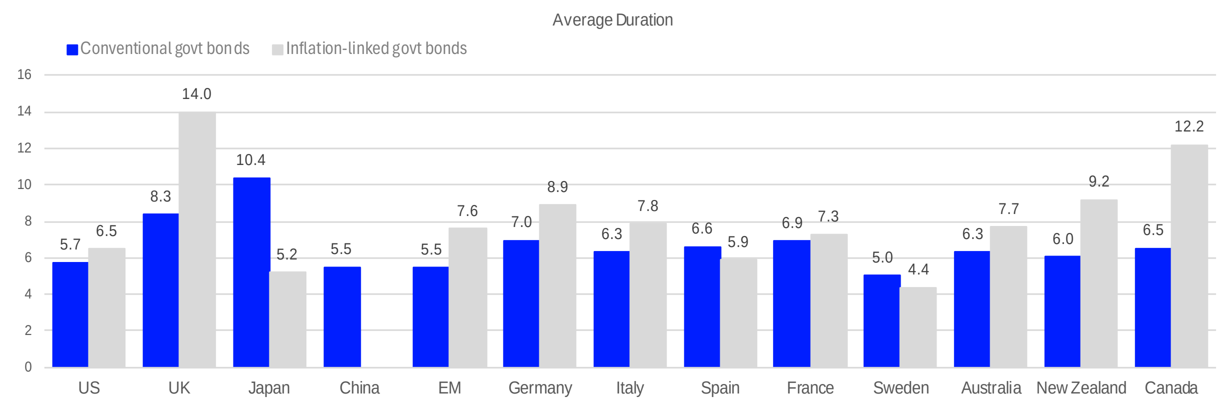
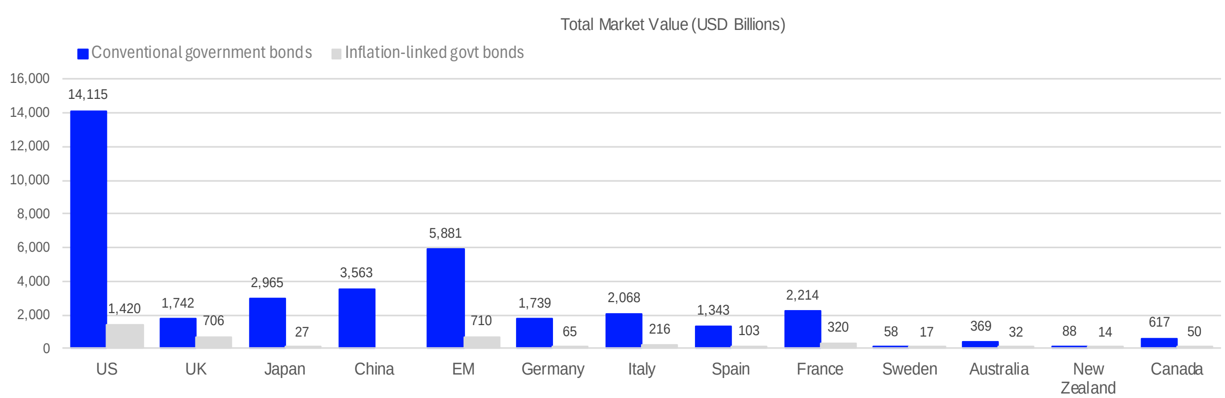
Appendix − Duration and Market Value (USD, Bn) as of November 30, 2025

	Conventional government bonds								Inflation-linked government bonds					
	Duration				Market Value				Duration			Market Value		
	3-5YR	7-10YR	20+YR	Overall	3-5YR	7-10YR	20+YR	Total	5-10YR	20+YR	Overall	5-10YR	20+YR	Total
US	3.6	7.0	16.1	**5.7**	3,086.1	1,387.5	1,592.6	**14,115.5**	6.9	20.8	**6.5**	489.1	116.0	**1,420.3**
UK	3.6	7.2	17.3	**8.3**	217.2	306.4	342.9	**1,742.4**	7.4	25.6	**14.0**	162.2	217.2	**705.8**
Japan	3.9	8.1	21.5	**10.4**	389.6	509.6	514.9	**2,965.1**	7.7		**5.2**	14.4		**27.4**
China	3.7	7.8	17.8	**5.5**	751.7	619.7	356.7	**3,563.1**						
EM	3.6	7.1	15.5	**5.5**	1,249.6	1,077.3	554.8	**5,881.0**	6.0	13.5	**7.6**	160.2	179.1	**710.4**
Germany	3.8	7.4	19.8	**7.0**	346.5	321.5	199.2	**1,738.7**	7.2	19.5	**8.9**	14.6	17.0	**64.9**
Italy	3.7	7.0	16.3	**6.3**	387.7	371.5	174.8	**2,068.2**	7.3	23.0	**7.8**	82.0	9.6	**216.2**
Spain	3.5	7.2	17.9	**6.6**	268.5	239.1	111.7	**1,342.7**	6.2		**5.9**	60.9		**103.2**
France	3.5	7.2	18.2	**6.9**	463.8	398.5	234.9	**2,214.0**	6.3	22.7	**7.3**	74.5	21.4	**320.3**
Sweden	3.8	7.8		**5.0**	9.1	14.2		**58.1**	6.3		**4.4**	3.6		**17.0**
Australia	3.5	7.0	15.6	**6.3**	65.2	106.9	20.7	**369.0**	7.9	20.5	**7.7**	10.7	2.6	**31.7**
New Zealand	3.6	7.0	15.6	**6.0**	18.5	22.5	5.2	**88.2**	8.6	16.9	**9.2**	5.4	1.2	**13.5**
Canada	3.8	7.2	18.5	**6.5**	133.2	131.1	86.9	**617.4**	5.3	21.1	**12.2**	8.3	13.1	**50.0**

	Investment grade bonds										High Yield	
	Duration					Market Value					Duration	MktVal
	AAA	AA	A	BBB	Overall	AAA	AA	A	BBB	Overall		
US	10.1	8.2	6.9	6.5	6.8	76.0	460.4	3171.1	3708.2	7415.6	3.8	1202.7
Europe	6.3	4.8	4.6	4.2	4.4	38.0	243.2	1457.2	1724.3	3462.7	3.3	415.0
EM		6.2	5.7	5.5	5.7		76.7	166.3	256.7	499.6	3.7	184.6

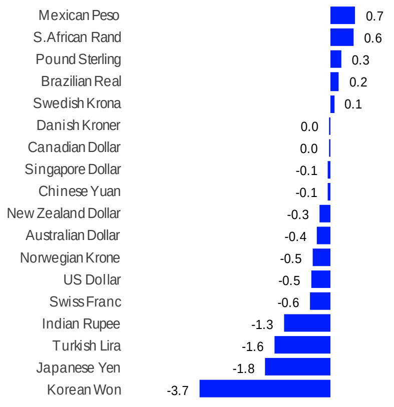




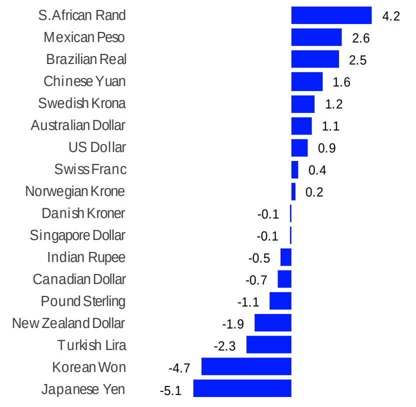
Source: FTSE Russell and LSEG. All data as of November 30, 2025. Past performance is no guarantee of future results. This report should not be considered 'research' for the purposes of MIFID II. Please see the end of the report for important legal disclosures. Bond market data is derived from FTSE Fixed Income Indices. See Appendix for list of indices used for each market.

Appendix − Foreign Exchange Returns % as of November 30, 2025

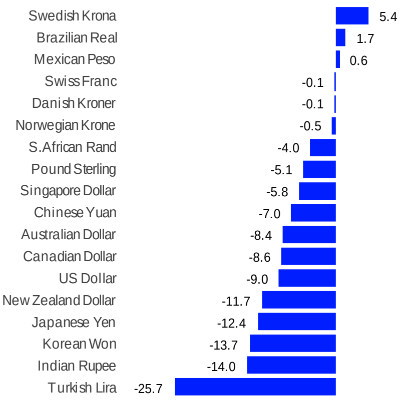
1M vs EUR



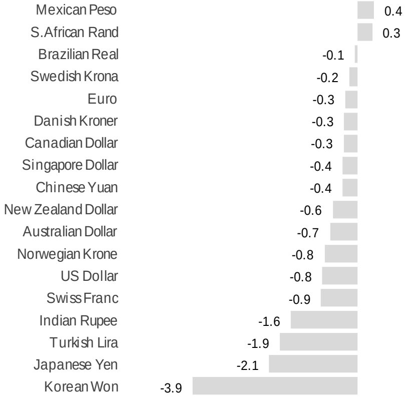
3M vs EUR



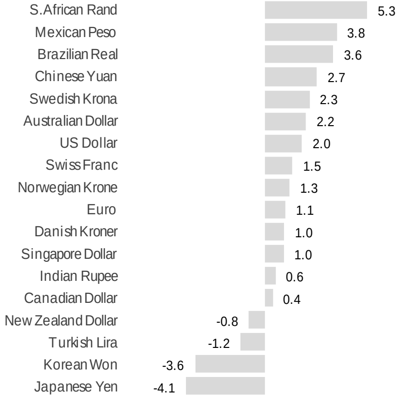
12M vs EUR



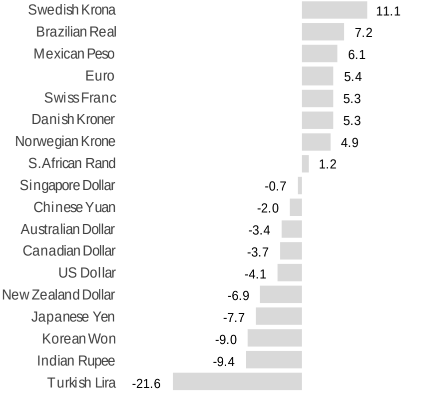
1M vs GBP



3M vs GBP



12M vs GBP



Source: FTSE Russell and LSEG. All data as of November 30, 2025. Past performance is no guarantee of future results. This report should not be considered 'research' for the purposes of MIFID II. Please see the end of the report for important legal disclosures. Bond market data is derived from FTSE Fixed Income Indices. See Appendix for list of indices used for each market.

Appendix − Glossary

Bond markets are based on the following indices:

FTSE World Government Bond Index (WGBI) for all global government bond markets

FTSE World Inflation-Linked Securities Index (WorldILSI) for all global inflation linked bond markets

FTSE US Broad Investment Grade Bond Index (USBIG®) for the US corporate bond market

FTSE US High-Yield Market Index for the US high yield bond market

FTSE Euro Broad Investment Grade Bond Index (EuroBIG ®) for the Euro denominated corporate bond market

FTSE European High Yield Market Index for the European high yield market

FTSE Chinese Government and Policy Bank Bond Index (CNGPBI) for the Chinese government bond market

FTSE Emerging Markets Inflation-Linked Securities Index (EMILSI) for the emerging markets inflation linked bond market

FTSE Emerging Markets Government Bond Index (EMGBI) for the emerging markets government bond market. Please note that over 50% of this index is invested in China

FTSE Emerging Markets Broad Bond Index (EMUSDBBI) for the emerging markets corporate bond market

FTSE ESG World Government Bond Index for the global government bond markets with an ESG tilt

FTSE Climate Risk Adjusted World Government Bond Index (Climate WGBI) and FTSE Advanced Climate Risk Adjusted World Government Bond Index (Advanced Climate WGBI) for each country’s relative exposure to climate risk, with respect to resilience and preparedness to the risks of climate change

List of Abbreviations used in charts:

IL = Inflation-linked bonds
IG = Investment-grade bonds
HY = High-yield bonds
BPS = Basis points
EM = Emerging market
LC = Local currency

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For over 40 years we have been at the forefront of driving change for the investor, always innovating to shape the next generation of benchmarks and investment solutions that open up new opportunities for the global investment community.

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