Global

Cross-Discipline

Thematic Research

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What are the biggest market dislocations? May 2026

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In another of our "dislocations" series, we got thinking about what looks strange in markets, and what might therefore be ripe for a correction.

With the Iran conflict still ongoing, there's been a clear repricing in recent months. However, that's often been inconsistent across different asset classes and regions, particularly in the face of a fresh inflation shock and more hawkish central bank pricing.

So what are some of the biggest market dislocations right now?

1. Since the Iran conflict began, US Treasury yields have closely tracked oil prices, but equities have diverged after the initial correlation. It looks like equities are pricing in a temporary shock, but rates are simultaneously pricing in a more protracted conflict.

- In the first month of the Iran conflict, there was a tight correlation between different asset classes, with oil, bonds and equities all seeing consistent moves. But since mid-April, equities have strongly diverged from oil and rates.
- Clearly many factors affect equities, and some have made the argument that US tech earnings have shifted the picture. But that's only part of the story, given that European equities have also diverged, despite being more exposed to the energy shock.
- The inconsistency is that rates are clearly pricing in the oil shock and the inflation consequences, hence they're still moving in line with oil. But equities are looking through it, with the S&P 500 already back to record highs. Even in Europe, the STOXX 600 is only -1.7% beneath its record high, so this is a very different playbook to 2022, when the major indices slumped into bear market territory.

Figure 1: The 10yr Treasury yield has traded in a tight correlation with oil prices since the Iran conflict began...

Source : Bloomberg Finance LP, Deutsche Bank

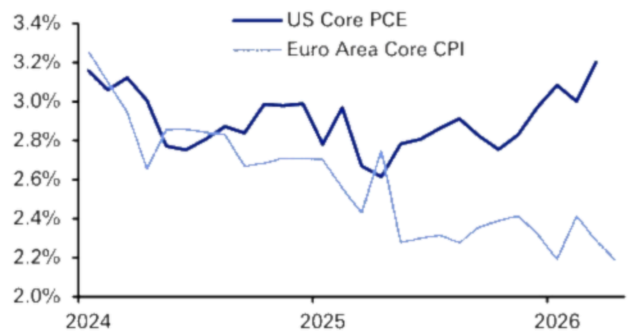
Figure 2: ...But the S&P 500 has completely diverged after the initial correlation

Source : Bloomberg Finance LP, Deutsche Bank

2. Central bank pricing looks inconsistent on a relative basis. Markets are pricing the Fed to stay on hold over the next 12 months, but also think the ECB might even hike 3 times by March. That's despite the US having stronger growth and higher core inflation.

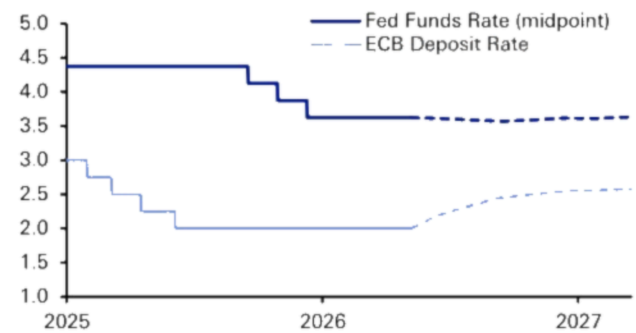
- Since the Iran conflict began, there's been a hawkish repricing for central banks. At the Fed, futures are pricing in just 2bps of hikes by March 2027, basically staying on hold. By contrast, clear hikes are priced in at the ECB, with 59bps priced by March 2027. In other words, two 25bp hikes are fully priced, along with a roughly one-in-three chance of a third hike.
- The dislocation is that it's difficult to imagine a world where the ECB hike 3 times by March, but the Fed are staying on hold. Admittedly, the Fed have a dual mandate for the labour market, but recent US labour market data has been robust, with unemployment broadly steady, and we've just had the strongest payrolls in 15 months. US growth more broadly has also been strong, and is clearly faster than the Eurozone right now.
- Meanwhile on the inflation side, US core PCE was at 3.2% in March, whereas Eurozone core CPI was 2.3% that month, before falling to 2.2% in April on the flash print. So given the divergence in growth and core inflation, particularly with global energy prices as a key driver of that, it's striking that markets are simultaneously pricing in multiple ECB hikes over the next 12 months, and the Fed remaining on an extended pause.

Figure 3: Core inflation (year-on-year % change) is running notably higher in the US...



Source : Haver Analytics, Deutsche Bank

Figure 4: ...Yet if we look at market pricing for central bank rates, the ECB is priced for faster hikes

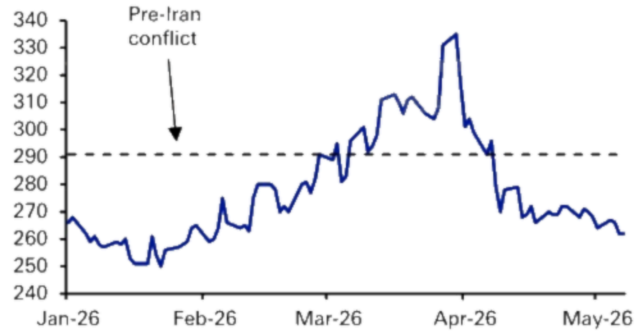


Source : Bloomberg Finance LP, Deutsche Bank

3. In the US and Europe, both HY and IG credit spreads are tighter now than before the Iran conflict began, despite an energy shock, lower growth expectations, and a hawkish shift in central bank pricing.

- Even before yesterday's positive headlines on the Iran conflict, credit spreads were already tighter than their pre-conflict levels.
- That's striking when you consider that we've seen a clear energy shock, with oil prices still far above their initial levels, alongside downgrades to consensus growth forecasts, as well as a hawkish central bank repricing.
- Moreover, it's not just the US where it's happened, even European HY spreads are tighter, despite the clear energy exposure and negative growth hit from higher energy prices.
- If you just knew beforehand that there would be an energy shock, lower growth expectations, and a hawkish shift in central bank pricing, then the expectation would have been for higher spreads like 2022, not tighter ones.

Figure 5: US HY spreads (bps) are now tighter than they were prior to the Iran conflict...



Source : Bloomberg Finance LP, Deutsche Bank

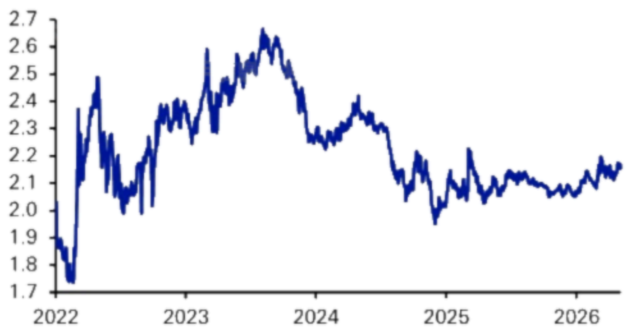
Figure 6: Even European HY spreads are slightly tighter, despite being a region more exposed to the energy shock

Source : Bloomberg Finance LP, Deutsche Bank

4. Bigger picture, markets have retained a remarkable faith in longer-term inflation staying anchored around target. That's despite another energy shock, several years of above-target inflation by now, and a persistent upward bias historically as well.

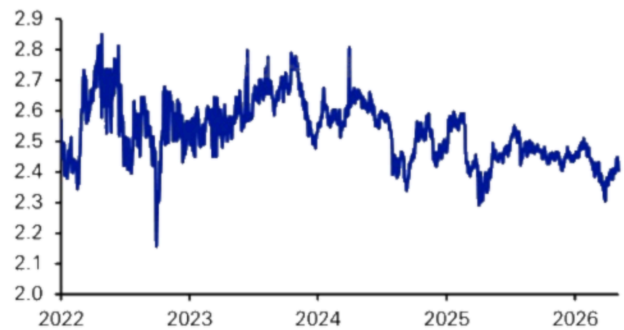
- Despite recent events, longer-term inflation expectations have remained around target levels. Looking at the 5y5y forward inflation swap (expectations over the 5-year horizon starting in 5 years' time), they're at 2.16% in the Euro Area, and 2.41% in the US. In both cases, that's within 10bps of their levels before the Iran conflict started.
- But this confidence that inflation will return to target is striking. After all, US PCE inflation has been above the Fed's target for 5 years now. Similarly, Euro Area core CPI has been above 2% for 4.5 years. Moreover, inflation is rising once again thanks to the latest energy shock, so that points to an even longer period of above-target inflation.
- Clearly shocks happen, but what's also striking about this belief is that for many decades, inflation has been upwardly biased relative to target. Indeed, there isn't a single country in the world that's kept average inflation beneath 2% since the end of the Bretton Woods system in 1971.

Figure 7: The Euro 5y5y forward inflation swap has remained remarkably subdued since the Iran conflict began, unlike what happened in 2022-23



Source : Bloomberg Finance LP, Deutsche Bank

Figure 8: Similarly in the US, the 5y5y forward inflation swap hasn't seen a major uptick at all



Source : Bloomberg Finance LP, Deutsche Bank