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What are the biggest market dislocations? September 2026

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In the latest of our monthly "dislocations" series, we looked at what appears strange in markets, and what might be ripe for a correction.

Last month we wrote about a "goldilocks" setup, where markets were pricing resilient growth, falling inflation and limited monetary tightening. We argued this was unlikely to hold, and since then, a fresh bond selloff has pushed yields to multi-year highs around the world.

However, the current equilibrium remains unsustainable. That's because rates markets still don't reflect the extent of the inflationary pressures ahead, with only limited tightening cycles priced in. **So either inflation needs to fall, or the pressure on rates will continue. And if the pressure on rates is maintained, that in turn will force an adjustment in risk assets.** Something needs to give here, with several asset classes vulnerable to the impact of a more aggressive tightening cycle from central banks.

Several dislocations follow from this:

- First, market pricing for the Fed still implies an unusually shallow hiking cycle given the starting conditions.
- Second, ECB pricing has also seen strikingly little movement in recent weeks, even as swaps have simultaneously priced faster inflation and growth has surprised on the upside.
- Third, the oil futures curve is still assuming that the physical disruption in the Strait of Hormuz will fade, even as it remains blocked month-after-month.
- And fourth, risk assets like equities and credit are still strikingly complacent against the stagflationary shock that's increasingly being priced into rates markets. And even if growth remains resilient, that doesn't solve the inflation problem.

In essence, we are still pricing in a very benign world of persistent growth, limited inflation, modest rate hikes, fading supply shocks and contained fiscal risks. That offers a very narrow landing zone that's very difficult to realise.

The building inflation problem

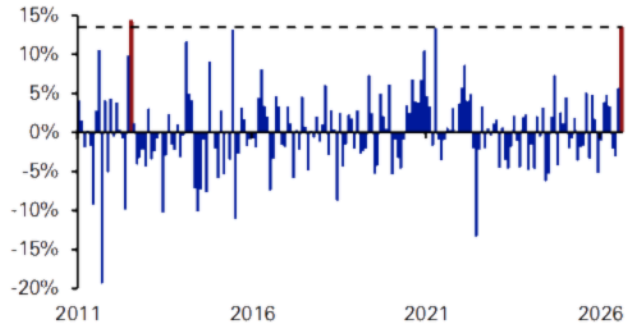
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IMPORTANT RESEARCH DISCLOSURES AND ANALYST CERTIFICATIONS LOCATED IN APPENDIX 1. UNTIL 19th MARCH 2021 INCOMPLETE DISCLOSURE INFORMATION MAY HAVE BEEN DISPLAYED, PLEASE SEE APPENDIX 1 FOR FURTHER DETAILS.

The biggest issue over the last month has been the extent to which more inflationary pressures are still in the pipeline:

- Most obviously, the Strait of Hormuz is still yet to properly reopen, and renewed strikes between the US and Iran mean that Brent crude now stands at $96/bbl this morning, up from $82.49/bbl a month ago.
- That pressure has also translated into European natural gas, where the front-end future is currently around its highest since early 2023.
- Food prices in August just saw one of their biggest monthly jumps in years, with major increases for the likes of sugar (+21.5%), wheat (+18.3%) and corn (+16.8%). Moreover, climate forecasters suggest the worst of this year's El Nino is likely ahead in Q4.
- Metals prices, and precious metals in particular, saw a big jump in August too, particularly after the US Treasury Department's announcement that they'd be increasing their buybacks of longer-dated Treasuries.

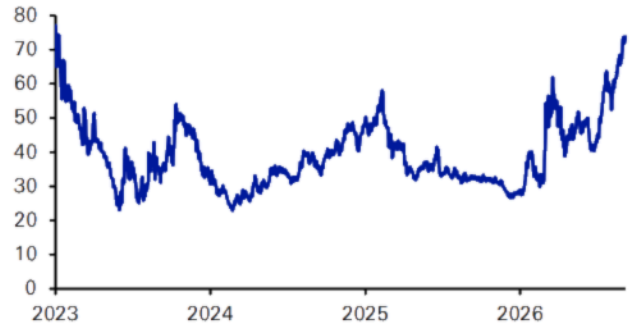
From a market standpoint, the problem is that investors expect much of this inflation to subside. For instance, the futures curve for Brent crude oil and European natural gas is pricing in declines over the year ahead. That's helped to support risk assets, but we've repeatedly seen hopes for a reopening of the Strait of Hormuz not materialise over the last 6 months. And with declines in energy prices already priced in, even flat energy prices would require a repricing across other asset classes.

Figure 1: Monthly change in Bloomberg's Agriculture Spot Index - August saw the biggest rise since 2012



Source: Bloomberg Finance LP, Deutsche Bank

Figure 2: Meanwhile, European natural gas futures (EUR/MWh) have risen to their highest levels since early 2023



Source: Bloomberg Finance LP, Deutsche Bank

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

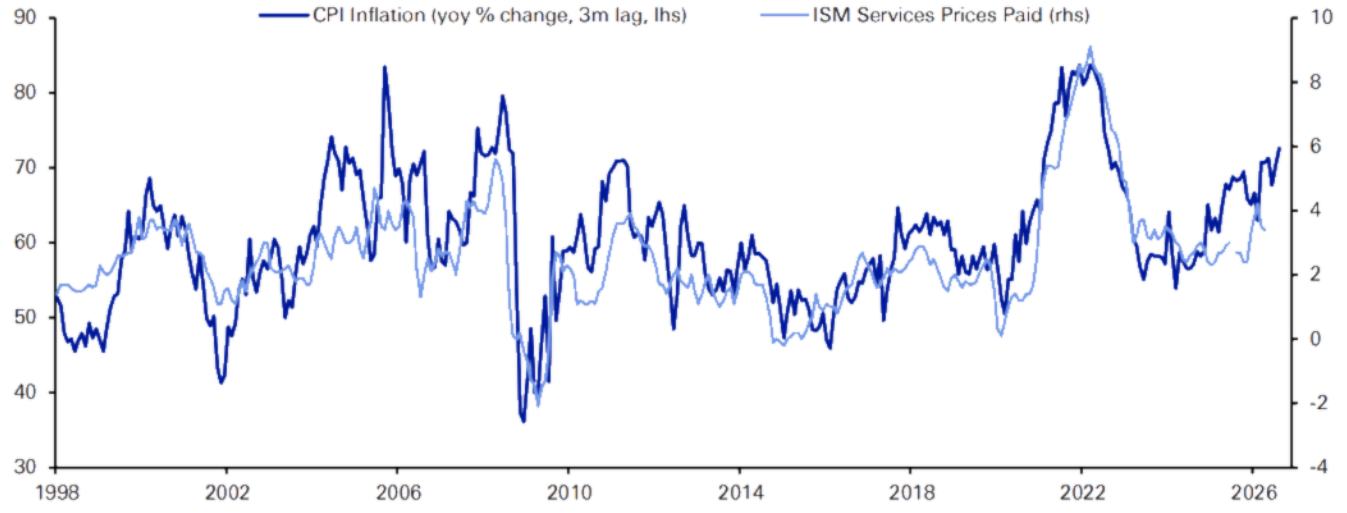
1. Markets continue to price in a shallow Fed hiking cycle that's inconsistent with how they've behaved in past hiking cycles. As it stands, this is already the 4th year in the last 5 where markets have under-estimated how hawkish the Fed will be.

- When it comes to building inflationary pressures, the prices paid component of the ISM services index hit a 4-year high in August. Based on how it behaved in the last inflation wave, that's consistent with a CPI rate above 5%, and we know this indicator tends to operate with a lag of a few months.
- Meanwhile, Fed Chair Warsh was openly striking a more hawkish tone at Jackson Hole. He described the 2% target as a "firm, fixed target", and said

that the summer's inflation readings "do not tell me that underlying trends have meaningfully improved." And with Friday's jobs report surprising on the upside, that gives them more space to focus on the inflation side of their mandate.

- What's also notable is that in 4 of the last 5 years since 2022, investors have underestimated how hawkish the Fed will be. That includes this year, where we began with two cuts being fully priced in by the time of the September meeting next week. In reality, there haven't been any cuts, and the conversation is entirely based around whether they'll hike, with futures pricing in a 60% probability of that.
- Based on the past correlation of the ISM services prices paid component, if inflation got to 4-5%, that would be consistent with over 200bps of hikes in the first year, if you purely looked at what happened in past hiking cycles when the Fed began hiking relative to the starting CPI level (Figure 8). Meanwhile, we also know from experience that simple "one and done" hiking cycles are incredibly rare, given that a single 25bp move in either direction has a pretty modest effect on financial conditions relative to all the other factors that influence them. As in recent years, the risk is that the market is caught off-guard once again in a hawkish direction.

Figure 3: The prices paid component of the ISM services index is at levels consistent with 5% US CPI inflation in the 2021-23 inflation wave



Source: Bloomberg Finance LP, Haver Analytics, Deutsche Bank

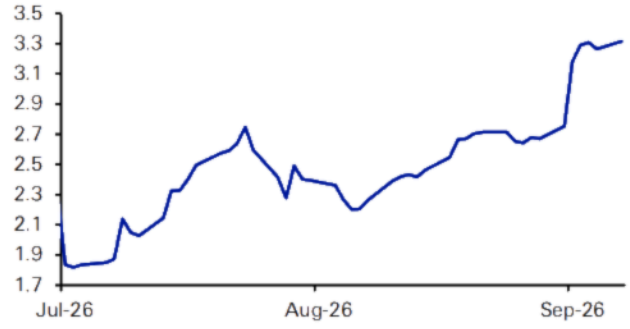
2. Meanwhile at the ECB, if we look at market pricing for the June 2027 meeting, it's barely changed from where it got to at the recent July peak. That's despite gas prices rising significantly, economic data surprising on the upside, and even market-based inflation swaps being notably higher. In other words, investors are pricing more inflation for the next year, but not any more hikes, even as growth has surprised on the upside.

- These hawkish risks don't just apply to the Fed, and historically the ECB has actually had a more hawkish reaction function than the Fed. That reflects how they only have a single mandate for inflation, rather than a dual mandate that also include employment.
- If we look at market pricing for the June 2027 meeting, it's seen little

movement from its peak on July 23, the same day that Brent closed above $100/bbl again. Back then, it was pricing 74bps of further hikes by the June 2027 meeting, and at time of writing, it's pricing in 72bps of further hikes.

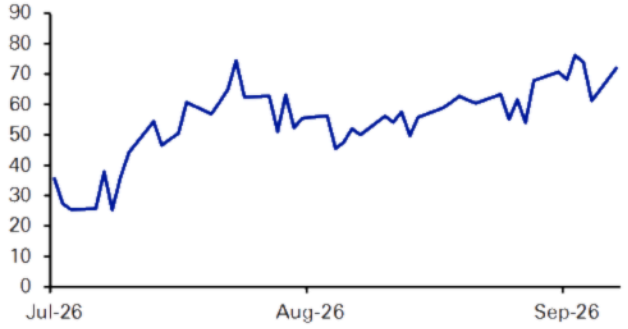
- Yet in that time, natural gas futures have risen significantly, up more than +18%. Brent is almost level again at $96/bbl, the growth data has continuously surprised on the upside, and even investor expectations of inflation have risen significantly. So in other words, the newsflow and market pricing for inflation has shifted hawkishly, yet ECB pricing hasn't.
- Looking forward, we know that further inflationary pressures remain in the pipeline, and central banks also tend to overcorrect for perceived mistakes in the last cycle. In the ECB's case, they came under criticism for reacting too late to the 2021-22 inflation shock, as they didn't even begin to lift the deposit rate out of negative territory until inflation was above 8%. This year, however, we saw how they already delivered a rate hike in June, even though headline CPI was "only" at +2.8% that month.

Figure 4: Even as the 1yr Euro inflation swap (%) has risen notably since late-July…



Source : Bloomberg Finance LP, Deutsche Bank

Figure 5: … Market pricing for additional hikes by the ECB's June 2027 meeting has not moved much, even as growth has also been resilient



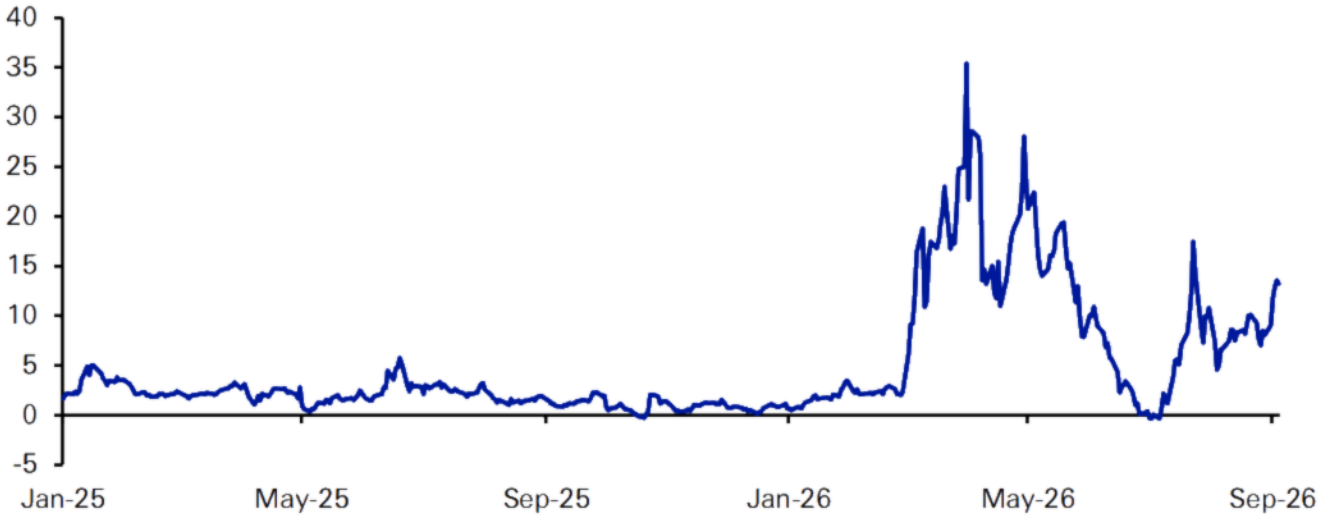
Source : Bloomberg Finance LP, Deutsche Bank

3. There's an ongoing physical dislocation between the blockage in the Strait of Hormuz and the reality of oil prices still well beneath their highs. Hopes for a reopening mean that the oil futures curve remains sharply downward-sloping, but with hopes for lower oil prices consistently dashed, this is not a sustainable equilibrium.

- At time of writing, the latest exchange of strikes between the US and Iran has pushed Brent crude oil up to $96.2/bbl. However, the 6-month Brent future is notably lower, at $83.2/bbl, reflecting investor expectations that the Strait of Hormuz may well reopen in the coming months and bring down the price of oil.
- That's a perfectly rational expectation, but the issue is that the futures curve has been heavily downward-sloping for around 6 months now. The only exception was the period around the Memorandum of Understanding being signed when traffic did pick up again through the Strait of Hormuz.
- Looking forward, the problem is that if expectations for lower oil prices are consistently dashed, at some point investors will have to adjust their expectations. That doesn't just matter for oil prices either, as expectations of a decline have been a critical factor supporting risk assets like equities and credit in recent months as well.

- This is in keeping with the experience of recent history as well. After Russia's invasion of Ukraine in 2022, the oil futures curve also became backwardated on expectations that the conflict might end swiftly. However, as time passed, that backwardation was unable to be sustained, and the curve normalized again.

Figure 6: Spread between Brent crude front end future ($/bbl) and 6-month Brent future ($/bbl) - investors have consistently been pricing in lower oil prices over the months ahead



Source : Bloomberg Finance LP, Deutsche Bank

4. Risk assets haven't really reacted to the real rates story, and have been consistently resilient. This is viable if inflation falls back and the tightening cycles aren't required, but that seems questionable given the pressures described above. Moreover, the traditional cushions of rate cuts or fiscal stimulus aren't as easily available, given inflation is still above target and bond yields are around multi-year highs.

- So far at least, risk assets have continued to perform strongly in general, despite the building inflationary pressures and hawkish risks. There was a brief selloff at the start of the Iran conflict, but that subsided from April when the initial ceasefire was reached. That's despite a continued climb in real rates, with the US 10yr real yield up more than 70bps since its low prior to the Iran conflict.
- To be fair, what's helped so far has been the incredible growth resilience around the world. That has simultaneously supported risk assets, whilst pushing yields higher at the same time. A similar phenomenon happened in the late-1990s as well.
- But looking forward, the inflationary pressures described above are increasingly of the cost-push variety that central banks can't easily combat, and are likely to put growth under pressure. In other words, there's a negative supply shock brewing of the kind that raises inflation and also hits growth.
- We have seen this setup cause problems for risk assets before. Back in 2022, there was a sharp equity correction and a material widening in credit spreads as it became apparent that growth was slowing and central banks

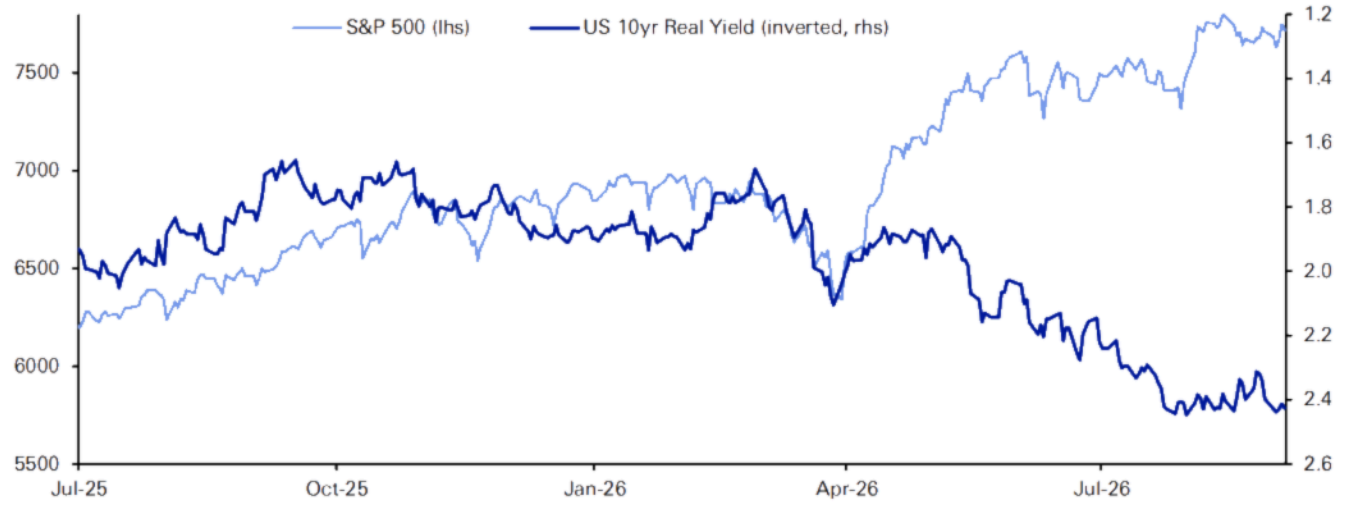
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would be hiking more aggressively than expected. Again, in late-2015 into early-2016, heightened recession fears (just as the Fed began to hike rates again) also drove an equity selloff alongside wider credit spreads.

- In recent years, this has often been staved off by some sort of monetary or fiscal stimulus, which in turn has supported risk assets. But that is much more difficult in the current context:
  - First, because headline and core inflation are already above target in many countries, easing monetary policy is not an easily available option like we saw in the 2010s. So something like the Fed's easing in 2019 (which occurred in the context of below-target inflation) is much more difficult to imagine.
  - Second, fiscal stimulus is also more difficult today, because bond yields are around multi-year highs and the debt-to-GDP ratios have risen significantly. So a meaningful fiscal stimulus is not an easily available option either. In other words, policymakers don't have easily available tools to support risk assets if they do come under pressure.

Figure 7: Since April when the US-Iran ceasefire began, the S&P 500 has diverged from the path of real yields. Clearly that can be explained by unexpectedly resilient growth, but the inflation pressures are now building again, risking a return of the correlation we saw back in March.



Source: Bloomberg Finance LP, Deutsche Bank

Conclusion: The current equilibrium is unsustainable

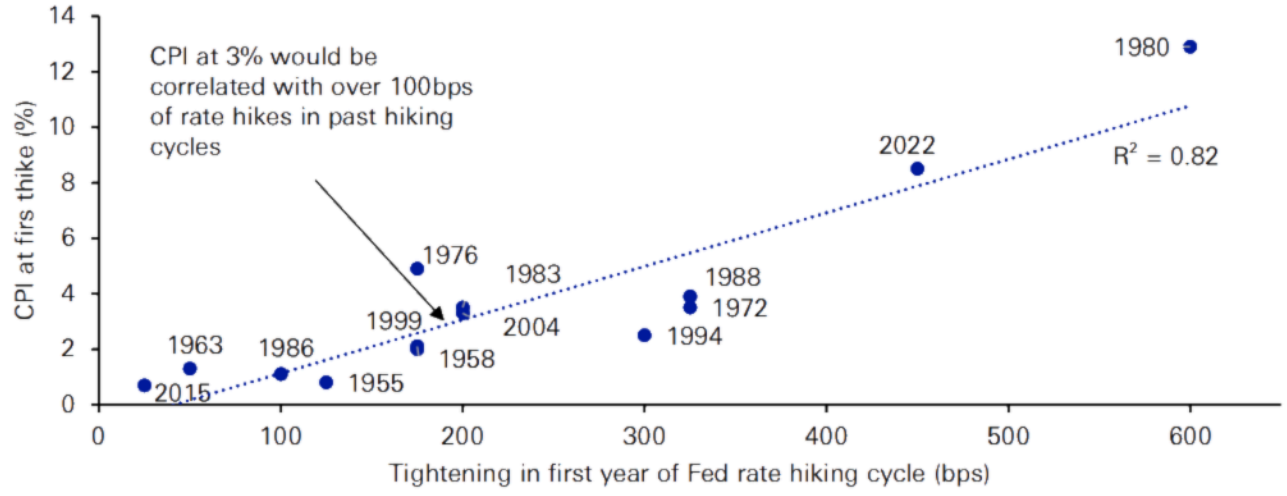
The fundamental dislocation is that rates markets still imply only limited central bank tightening, amidst mounting inflationary pressures. And we have equities and credit assuming that higher yields aren't going to cause material damage to growth.

But the risk is that markets are caught off guard over the coming weeks and months. Even if the inflation is concentrated in categories like energy and food (which sit outside core inflation), it's also the sort of inflation that's difficult for consumers to substitute away from, so second-round effects become a greater risk.

Moreover, even if growth remains resilient (which has supported both real yields and risk assets so far), the inflation story isn't going away. That adds to the risk of more aggressive tightening cycles from central banks, and we know historically that many of the biggest non-recessionary declines for equities have taken place in the context of tightening cycles. We saw that as central banks hiked rates in 2022, and again in 2015-16 as the Fed began to hike again whilst growth was weakening. Indeed, as recently as March this year we also saw those same dynamics, where real yields moved sharply higher alongside equity declines and wider credit spreads.

Ultimately, we are still pricing in a very benign world of persistent growth, limited inflation, modest rate hikes, fading supply shocks and contained fiscal risks. That offers a very narrow landing zone.

Figure 8: The amount of Federal Reserve rate hikes in the first year of a tightening cycle is strongly correlated with the initial starting level of CPI inflation



Source: Bloomberg Finance LP, Haver Analytics, Deutsche Bank