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14th August 2026

Geopolitical stalemate, cooling jobs and inflation

Markets weigh a Middle East deadlock against softer US data and sticky inflation risks. The geopolitical situation in the Middle East appears to have reached a stalemate, allowing oil prices to stabilise. Both sides appear to have hardened their position, with Iran insisting on management of the strait of Hormuz, while Trump posted on social media that the US has “total control” over the strait as he talked up the US naval blockade. Pakistan’s foreign ministry has suggested that the larger peace process seems to have stalled.

The Fed should have room to remain on hold through 2026, though other central banks may restart hiking. July US CPI continued to moderate in line with expectations, with y/y headline CPI falling to 3.4% while core dropped to 2.5%, the lowest level since 2021. In addition, US non-farm payroll unexpectedly contracted in July with a reduction in net job creation of -23,000 while both June and May numbers were also revised lower, suggesting that the momentum in Spring has dissipated. These data prints on the margin give the Fed more breathing room to remain patient and on hold through the end of the year.

The ECB, being an inflation-targeting central bank, remains under pressure to hike rates again as European natural gas prices remain near their highs during the initial outbreak of the US Iran conflict. Meanwhile, the BoJ remains behind the curve with negative real yields. The still significant yield gap between Japan and the US is once again putting pressure on the yen, despite the earlier US-Japan coordinated intervention. Both ECB and the BoJ expected to hike one more time before the year end.

With the earlier discussed cooling economic data softening bond yields, coupled with still strong reported earnings, equities continue to deliver positive returns. The equity rally appears to be broadening out, including themes like Global Power & Electrification as well as US financials which continue to benefit from heightened capital market activity.

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