A Fragile Détente

The U.S.-Iran Memorandum, diverging central banks, and markets back in rally mode

→ The Memorandum between the United States and Iran has significantly reduced fears of a prolonged disruption in the Strait of Hormuz, easing pressures on global energy markets and improving investor sentiment.

→ The ECB raised interest rates by 25 basis points in June, citing renewed inflationary risks from energy markets, while the Federal Reserve kept rates unchanged at its first meeting under Chair Kevin Warsh.

United States: Warsh's debut and a Fed focused on inflation vigilance

The first Fed meeting under Kevin Warsh signaled continuity rather than a major policy shift

The Federal Reserve maintained the federal funds target range at 3.50%-3.75% at its June 16th–17th meeting, the first Federal Open Market Committee meeting chaired by Kevin Warsh. The decision reflected a growing consensus that, despite moderation in underlying inflation, the energy shock triggered by the Iran conflict has not yet fully dissipated.

The Fed's June decision signaled continuity rather than rupture despite the change in leadership. Markets had closely followed the meeting for clues about how Warsh would differentiate his approach from that of Jerome Powell. While the new Chair emphasized the importance of preserving the Fed's inflation-fighting credibility, he also reiterated that policy would remain data-dependent and responsive to changes in economic conditions.

The U.S. economy continues to show resilience. Labour market conditions remain relatively solid, household spending has moderated only gradually, and corporate earnings have exceeded expectations in most sectors. However, policymakers remain concerned that the recent energy shock could slow the disinflation process and delay any further monetary easing.

Financial markets interpreted the Fed's decision as moderately hawkish. Treasury yields moved initially somewhat higher following the meeting, while expectations for additional rate cuts in 2026 were pushed further into the future. Nonetheless, financial conditions remain supportive and credit markets continue to function smoothly.

Euro Area: ECB tightens as energy inflation re-emerges

The ECB and the Fed are responding differently to the same energy shock

The European Central Bank did not surprise many in the market at its June meeting by raising its deposit facility rate by 25 basis points to 2.25%. The Governing Council argued that the energy shock generated by the Iran conflict and the earlier uncertainty surrounding the Strait of Hormuz had created renewed upside risks to inflation. Although the Memorandum between Washington and Tehran has significantly reduced immediate geopolitical tensions, policymakers judged that the increase in energy costs had already begun feeding through to prices across several sectors.

The ECB's rate increase highlights the different challenges faced by Europe and the United States. Unlike the U.S., the euro area remains more exposed to imported energy costs. While inflation had moved close to target earlier in the year, the combination of higher oil prices, increased transportation costs, and lingering wage pressures led the ECB to prioritize inflation containment over short-term growth support.

Economic growth in the euro area remains modest but positive. Services activity continues to outperform manufacturing, while lending conditions remain restrictive. The euro depreciated against the dollar after the ECB and Fed decisions as markets are reassessing the path of European and U.S. interest rates.

Global markets: Energy relief and renewed risk appetite

The U.S.-Iran Memorandum has shifted markets from energy anxiety back to risk-taking

The most notable market development over the last two months has been the sharp improvement in investor sentiment following the signing of the U.S.-Iran Memorandum. In the weeks immediately following the agreement, fears of a closure of the Strait of Hormuz receded significantly. Oil prices, which had surged during the peak of the conflict, retreated from their highs as traders reassessed supply risks. Natural gas markets also stabilized, particularly in Europe, where concerns about LNG supply disruptions eased considerably.

The decline in geopolitical risk premiums has provided powerful support for global equities. Equity markets have responded enthusiastically. U.S. indices have reached new record highs, driven by strong earnings, continued investment in artificial intelligence, and growing confidence that the global economy can absorb the recent energy shock without entering recession. European and Asian markets have also participated in the rally, although to a lesser extent.

Credit spreads remain compressed and volatility indicators have returned to levels seen before the Iran conflict. Precious metals have surrendered part of their safe-haven gains, while the U.S. dollar has traded in a relatively stable range despite the divergence between ECB and Fed policies.

Nevertheless, energy markets remain highly sensitive to geopolitical developments. Although the Memorandum has reduced immediate tensions, investors continue to monitor compliance by both parties and remain alert to any renewed threat to maritime traffic through the Gulf region. Periodic military actions by both parties, followed by resumptions of talks, have continued to provoke short-term fluctuations in energy and equity markets.

A new phase of divergence

The geopolitical shock has faded, but monetary policy divergence remains

The July 2026 environment differs significantly from that of only a few months ago. The immediate threat of a major energy supply disruption has diminished, financial markets have recovered strongly, and fears of a global stagflationary scenario have eased. Yet the policy response has revealed increasing divergence among major central banks. While the Fed believes patience remains appropriate, the ECB has judged that inflation risks require additional tightening. This divergence reflects differences in economic structure, energy dependence, and inflation dynamics rather than fundamentally different policy objectives.

For investors, the key question is whether the recent improvement in sentiment can be sustained. The soft-landing narrative has survived another major geopolitical test, but the balance remains delicate. Energy markets, inflation expectations, and the credibility of the new Fed leadership under Kevin Warsh will remain central drivers of financial conditions during the second half of 2026.

As the year progresses, markets appear increasingly confident that the worst-case scenarios have been avoided. Whether that confidence proves justified will depend not only on central banks, but also on the durability of the geopolitical détente that has emerged in recent weeks.