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Energy disruptions, persistent inflation, and AI resilience shape market dynamics

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Global markets in May were dominated by the continued fallout from the Iran conflict, elevated energy-market risks, and growing concerns that inflationary pressures could remain entrenched for longer than previously anticipated. Despite intermittent diplomatic efforts, negotiations between Washington and Tehran made limited progress, while disruptions around the Strait of Hormuz continued to threaten global energy supplies. The geopolitical backdrop remained a major source of market volatility, compounded by rising strategic competition between the United States and China in areas such as artificial intelligence and semiconductors. Developments within the energy sector added further uncertainty, including the UAE's decision to exit OPEC+, changes in regional supply dynamics, and continued concerns over shipping disruptions across the Gulf.

The energy shock increasingly fed into global inflation dynamics throughout the month. Inflation accelerated across major economies as higher fuel and transportation costs filtered through supply chains. In the United States, both consumer and producer prices rose sharply, while import prices recorded their strongest increase since 2022. Similar pressures emerged in Europe, where energy-driven inflation accelerated, particularly in Germany, while wholesale prices recorded their fastest pace of growth in over a year. Inflationary pressures also broadened across Asia, affecting both China and India, reinforcing concerns that the disinflation trend observed in recent quarters may be losing momentum.

Central banks maintained a cautious stance as policymakers sought to balance slowing growth with renewed inflation risks. The Federal Reserve left rates unchanged at 3.50%–3.75%, although policy divisions widened amid concerns over the inflationary consequences of higher energy prices and the transition to a new Fed leadership team. Other major central banks, including the European Central Bank, Bank of England, Bank of Canada, and Bank of Japan, also refrained from policy adjustments while emphasizing uncertainty surrounding the inflation outlook. In contrast, the Reserve Bank of Australia continued tightening policy, delivering another rate increase as policymakers responded to rising inflation risks linked to energy markets.

Economic activity remained mixed but broadly resilient. In the United States, growth indicators generally surprised to the upside, with first-quarter GDP accelerating, durable goods orders strengthening, and business investment remaining firm. Manufacturing activity improved globally, supported in part by continued investment linked to artificial intelligence and digital infrastructure. However, softer labor-market participation, rising layoffs in certain sectors, and weakening consumer sentiment highlighted growing concerns about the impact of higher prices and prolonged policy uncertainty on household demand.

Regional growth trends diverged. Europe continued to face a challenging environment characterized by weaker sentiment, rising energy costs, and uneven economic momentum. China delivered mixed signals, with exports benefiting from AI-related demand and precautionary stockpiling, while domestic demand indicators softened amid higher energy costs and fragile confidence. Japan experienced firmer inflation and stronger expectations of policy normalization, while India faced increasing inflationary pressures linked to energy costs. Taiwan remained one of the strongest-performing economies globally, supported by robust AI-driven demand and continued strength in technology exports.

Despite geopolitical uncertainty and inflation concerns, corporate fundamentals remained a key source of support for financial markets. Earnings results across major technology companies continued to exceed expectations, underpinned by strong demand for AI infrastructure, cloud services, and semiconductor-related investments. More than four-fifths of reporting S&P 500 companies beat earnings estimates, reinforcing confidence that corporate profitability remains resilient even as the macroeconomic backdrop becomes increasingly complex.

Overall, May was characterized by a delicate balance between resilient economic activity and mounting inflationary pressures. While growth remained positive across many regions, the combination of elevated energy prices, geopolitical uncertainty, and cautious central-bank positioning reinforced expectations for a prolonged higher-for-longer interest-rate environment and a more challenging outlook for global markets.

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