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FX Focus: USD may benefit from Middle East turmoil

Geopolitical risks in the Middle East spiked over the past weekend. The U.S./Israel-Iran conflict and its disruptions could restrict global energy supplies and place upward pressure on prices. While a sustained shutdown or significant infrastructure damage is not our base case, history shows that even temporary disruptions can create meaningful supply delays and price volatility, underscoring the asymmetric nature of this risk. We therefore see upside risks to U.S. Dollar (USD) and other energy exporters such as Canadian Dollar (CAD) and Norwegian Kroner (NOK), and downside risks to energy importers like the euro, Yen and to a somewhat lesser extent, the Pound Sterling (GBP).

- The events this past weekend resulted in the USD gaining broadly with DXY quickly rising above 99.00. FX volatility also jumped higher but remain below crisis levels for now. Sustained volatility typically requires prolonged conflict, sanctions, or broad economic disruption - none of which can be reliably forecast at this stage.
- Energy markets remain the key transmission channel for geopolitical risk. Nearly 25% of global seaborne oil and ~20% of global LNG (Liquefied Natural Gas) transit the Strait of Hormuz, making it one of the most critical chokepoints in the global system. The straits are largely controlled by Oman and Iran. Citi Commodities Research¹ expects Brent oil to be in the USD80-90 per barrel range over the coming week with heightened risks to regional energy infrastructure. Asian importers are particularly exposed because of their reliance on Middle Eastern producers.
- If tensions de-escalate, volatility should quickly fall back towards pre-attack levels. But if the conflict is prolonged and global energy supplies remain disrupted, we see the US Dollar index (DXY) likely testing and going above 100. This is because of its current short positioning, energy exporter status, and safe-haven inflows.
- The Dollar is likely to outperform energy importers such as JPY and EUR, and to a less extent, GBP, via stronger terms of trade. Notably, 90% of Japanese imports flow through the Strait of Hormuz. This combined with fiscal credibility over Japan's new administration and dovish risks from the Bank of Japan (BoJ) will continue to weigh on yen sentiment, with USDJPY to potentially break above 158.00 and even test 160.00 in the absence of yen interventions.
- The European Union experienced a significant shock to its terms of trade at the onset of the Russia-Ukraine war in 2022, and EURUSD even briefly fell below parity as energy costs skyrocketed in the second half of 2022. While the euro area has been working on mitigating energy risks through energy diversification, a reduction in energy demand and the long-term strategic shift away from fossil fuels, energy supply disruptions remain as a key headwind. EURUSD upside is likely capped at 1.18-1.20 levels, and risks are skewed towards more EUR weakness (1.12-1.15) if energy prices spike.
- Prolonged energy supply disruptions may raise inflationary risks across global markets with the euro area and Japan particularly exposed. If longer-term inflation expectations start to de-anchor, there are risks of earlier-than-expected rate hikes from the ECB and faster monetary policy tightening from the Bank of Japan though policymakers will have to assess if the impact is transitory. The ECB and BoJ choosing a more restrictive policy stance via higher rates may help narrow rate differentials against USD and partially offset the energy price headwind. This could potentially lead to faster recovery in EUR and JPY once geopolitical risks fade.
- In addition to energy importers, Emerging Market (EM) and high beta currencies such as Chinese Renminbi (CNY), Singapore Dollar (SGD), New Zealand Dollar (NZD), Mexican Peso (MXN) and Brazilian Real (BRL) are also vulnerable to risk aversion spillovers. Other energy exporters like Canada and Norway may benefit from higher energy prices while the Swiss Franc (CHF) could outperform on non-USD crosses due to safe-haven inflows.

¹ "Geopolitics on Edge — What Middle East Risks Mean for Oil and Markets", Citi Research March 3, 2026

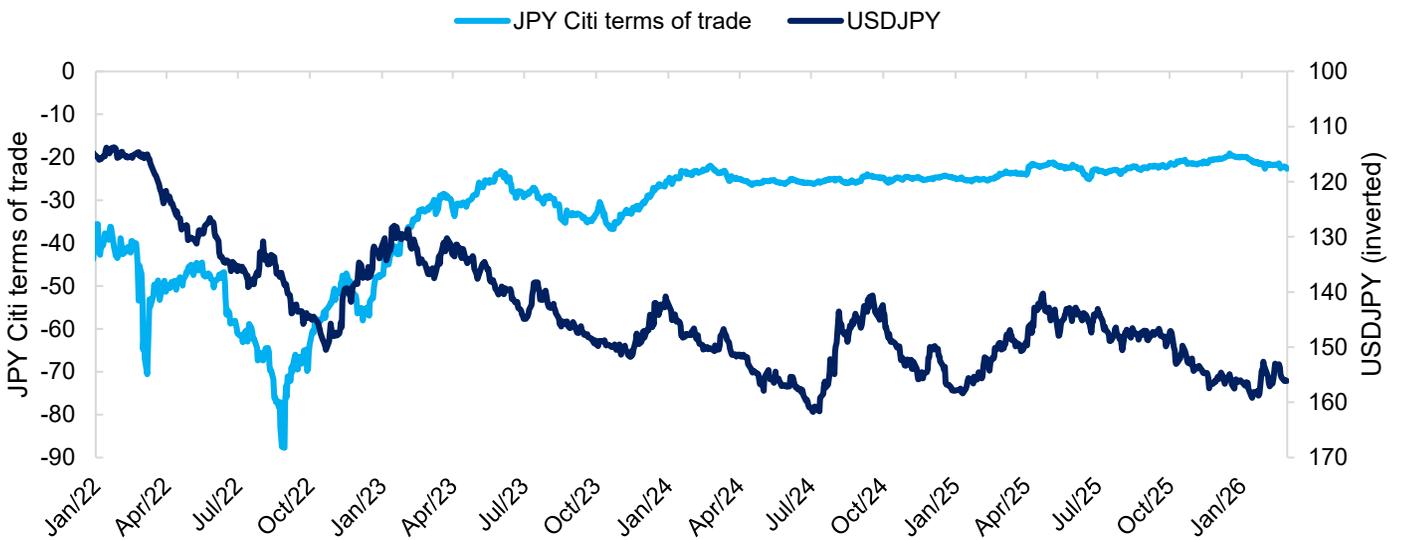
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FIGURE 1: Combined G10 FX volatility jumped but remains well below crisis levels



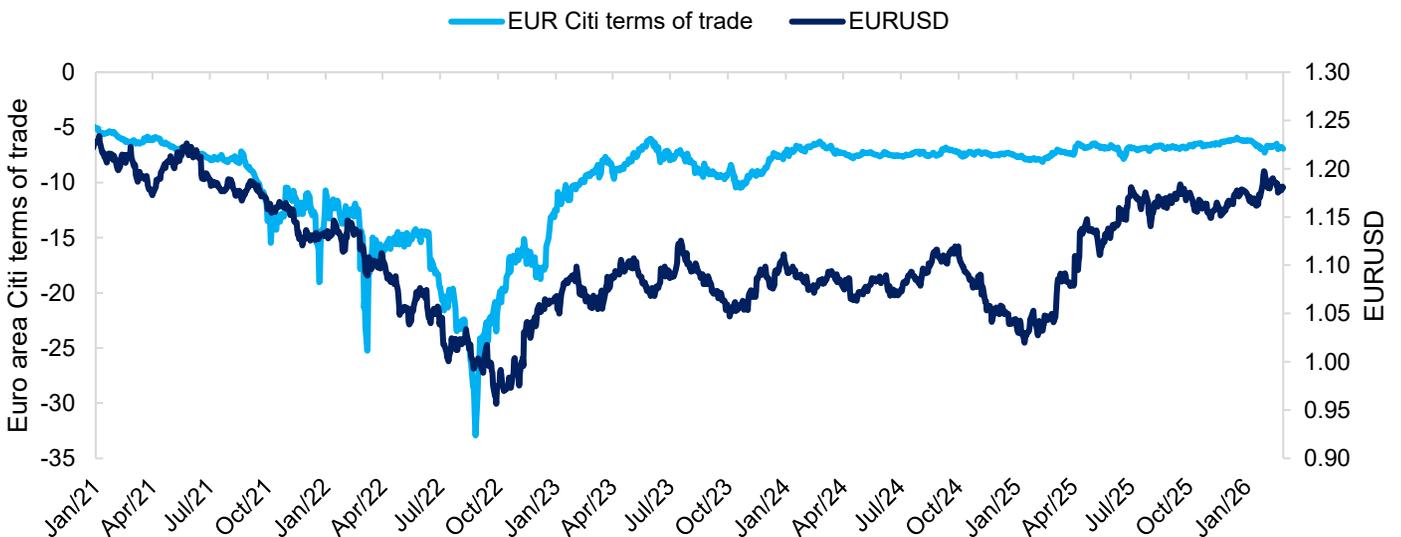
Source: Bloomberg, March 3, 2026. Past performance is no guarantee of future results. Real results may vary.

FIGURE 2: Middle East geopolitical risk a key headwind for Japan terms of trade given its energy dependence



Source: Bloomberg, March 3, 2026. Past performance is no guarantee of future results. Real results may vary.

FIGURE 3: Euro area also vulnerable to a potential terms of trade shock on energy supply disruptions



Source: Bloomberg, February 19, 2026. Past performance is no guarantee of future results. Real results may vary.

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