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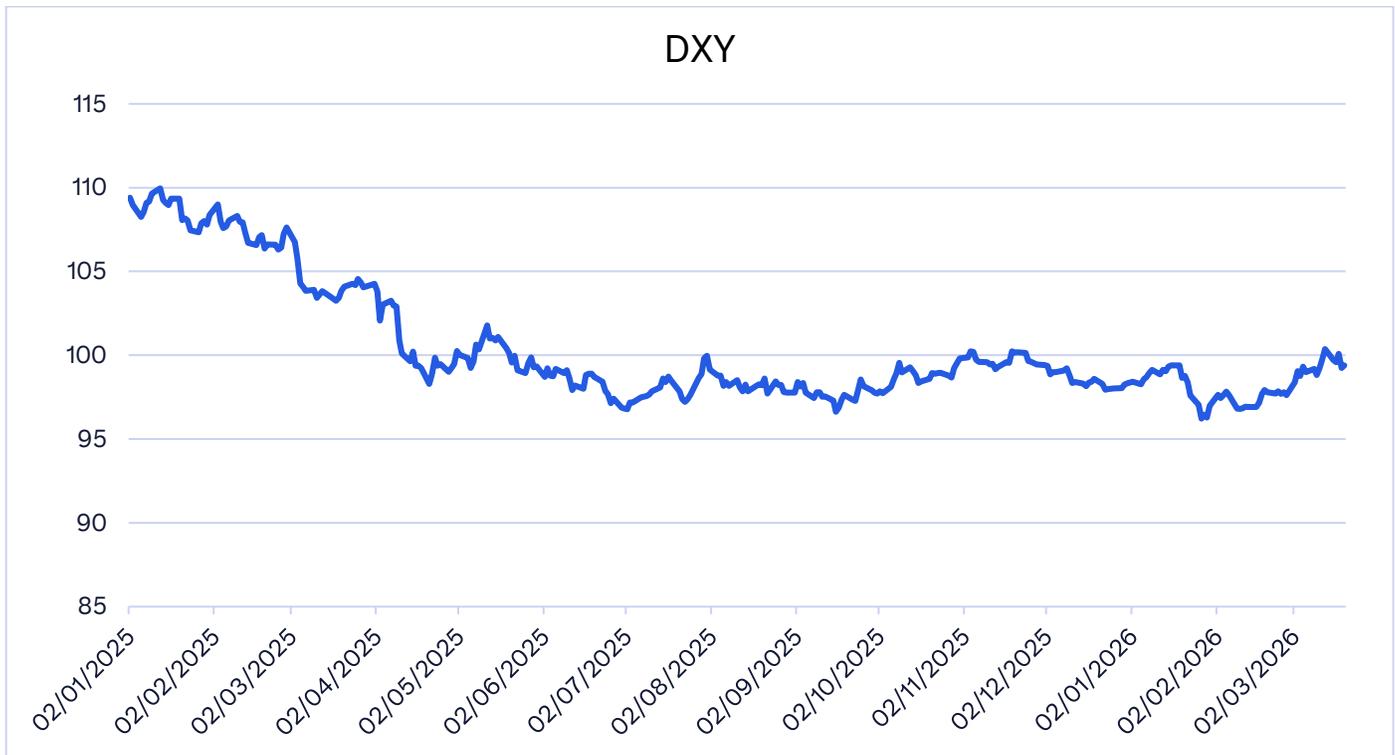
FX Focus: Middle East Tensions Skew Near-Term USD Risks

The U.S. Dollar has had strong inflows since the conflict in the Middle East began. This is a change from the sentiment that followed the Trump tariff announcement last April. But the bid has re-asserted itself amid the oil price spike due to U.S.'s status as a net energy exporter. The extent to which USD can strengthen further will be determined by how long oil prices remain elevated which in turn will largely depend on the duration of the conflict. The Dollar's medium-term headwinds however, remain and could show itself once these tensions subside.

- The DXY Index has strengthened meaningfully since the start of the Middle East conflict, breaking above the 100 level to track sharply rising oil prices up at levels last seen in 2008.
- Markets have become increasingly more sophisticated in choosing an appropriate safe haven, discarding the other usual safe havens such as the Japanese Yen (JPY), Swiss Franc (CHF) and Gold in favor of the USD. The oil price spike makes the rest of the world more vulnerable to stagflation risk relative to the U.S. economy that is likely shielded by its status as a net energy exporter.
- The US's relative resilience to stagflation risks appears to be supported by the U.S. Federal Reserve. In its March Federal Open Market Committee (FOMC) meeting and subsequent statement, the Fed's decision-makers said it would wait to see how tariffs and oil prices play out and impacts inflation. Markets had been expecting a more hawkish Fed due to the inflationary consequences of higher fuel prices.
- It seems there is little immediate urgency from the Fed which eventually expects a return to disinflation once the Middle East crisis fades and appears more worried about derailing the steadiness of the U.S. labor market, which has been relatively stable the past few quarters.
- The extent to which U.S. Dollar can strengthen further will depend on how long oil prices remain elevated, which in turn will largely depend on how long the Iran-U.S./Israel conflict drags on for. Of course, oil prices could change tack via a coordinated stockpile release or insurance backstop but the tit-for-tat strikes by Israel on Iran's energy infrastructure and Iran's threat to retaliate by hitting Gulf oil refineries is a relatively new development that risks even higher oil prices in the interim.
- For now, market focus remains squarely on the direction of oil prices but the Dollar's pre-oil and Middle East headwinds include:
 - Rate differentials still working against USD. Markets are discounting Fed cuts, albeit with significantly reduced odds, against rate hikes for other G10 central banks
 - Renewed steepening in the U.S. Treasuries curve against the backdrop of still sticky US inflation and budget spending pressures

BOTTOM LINE: A potentially higher range in the DXY Index implied by the Middle East risk premium is skewing near term risks to the upside - towards the 101-102 level - with solid support seen at 97.0. This may break through the topside if oil prices rise well above current levels but a reversal could be just as rapid back to 95-96 when tensions ease and non-conflict headwinds return.

FIGURE 1: The DXY Index has strengthened sharply since the Middle East conflict began at the start of March



Source: Bloomberg, March 18, 2026. **Past performance is no guarantee of future results.** Real results may vary. Indices shown are unmanaged and do not reflect the deduction of any fees or expenses. An investor cannot invest in an index.

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