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FX Focus: Dollar Sentiment Turns Bullish

Prior to the Middle East conflict, several headwinds seemed to be weighing on U.S. Dollar (USD) sentiment including expectations the U.S. Federal Reserve (Fed) will likely lag other central banks in lifting rates and concerns about U.S. fiscal spending and trade policy uncertainty. However, the conflict changed that with the spike in oil prices leading to capital flows returning to USD. Recently, the above consensus non-farm payrolls report for May has added to its bullish sentiment as U.S. short rates move to discount rate hikes from the Fed to play catch up with the pricing of other major central banks.

- From March, the conflict in the Middle East has been instrumental in turning around the dollar's fortunes. Prior to the conflict, a number of headwinds seemed to be weighing on dollar sentiment including expectations that the Fed may need to cut rates should the U.S. labor market soften. This while other central banks were signaling an end to their easing cycle. Longer term concerns about fiscal spending impacting the U.S. budget also weighed on USD sentiment as did uncertainty surrounding U.S. trade policy following the announcement of tariffs by the U.S. administration in April 2025.
- However, the Middle East conflict changed all that as the spike in oil prices saw capital flows returning to USD while traditional safe havens such as the Japanese Yen (JPY), Swiss Franc (CHF) and Gold were sidelined. The status of U.S. as a net oil exporter saw USD benefit from higher oil prices as the economy appeared to be more insulated to a terms of trade shock and stagflation compared to the euro area, UK and Japan. As a result, the dollar was able to regain its safe haven status.
- Furthermore, the release of the consensus-beating non-farm payrolls report for May showed the three-month average payrolls change rising to 188k compared to 79k in April, well above most estimates of the breakeven payrolls growth rate needed to keep the unemployment rate constant. The data opposed the view that the labor market is softening, and the narrative fitted with the theme of continued expansion with a stable U.S. labor market, allowing the Fed to focus more attention on upside inflation risks.
- Payrolls added another layer of hawkish sentiment with U.S. short rates rising more aggressively to discount a full 25 basis point Fed rate hike before year-end 2026 and a further 25 bps hike in 1H27. With U.S. rates markets moving to price Fed rate hikes than a flat trajectory, forward rate differentials started to shift in favor of USD and no longer pose a headwind to USD as they had pre-conflict.
- The combination of inflows and U.S. short rates playing catch up to the pricing in other major central banks has lifted DXY to a higher range which could potentially lead to a test of levels as high as 102/103 especially if oil prices remain higher for longer and the U.S. labor market remains stable. Currencies expected to feel the most pressure against USD will likely be EUR, GBP and JPY, which are most vulnerable to a terms of trade deterioration and stagflation risks.
- That said, longer term headwinds remain for USD. Fiscal and trade uncertainty concerns likely to undermine sentiment once the Middle East conflict fades and oil prices return to pre-conflict levels. Of course, the extent of any reversal depends on how markets balance those aforementioned concerns from the U.S. and the euro area, UK and Japan. This remains unknown for now.

FIGURE 1: The DXY received a boost from higher oil prices from early March and again following the release of nonfarm payrolls for May in early June

Source: Bloomberg, June 11, 2026. Past performance is no guarantee of future results. Real results may vary.

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