

FX Focus

Limits to USD Downside

- Risk assets rebounded on de-escalation hopes, denting USD safe-haven demand despite elevated oil.
- A less dovish Fed and US equity leadership limit USD downside.
- Higher-for-longer oil favours exporters, complicating a bearish USD view against energy importer currencies.

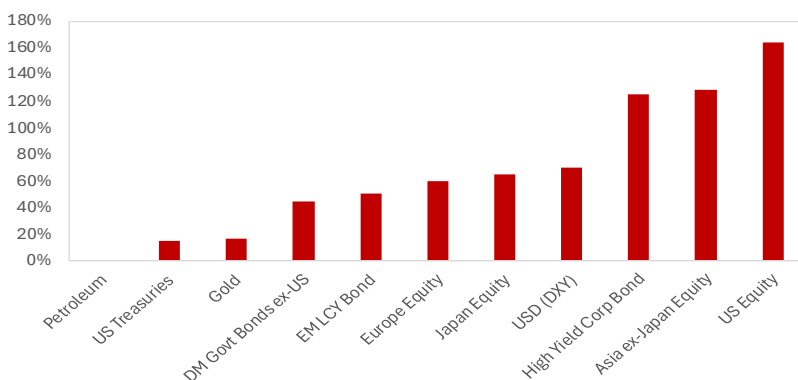
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Uncertainty remains around when the Strait of Hormuz will reopen and how long the energy shock will persist. With the strait still closed, oil prices would likely be higher if not for continued drawdowns in strategic and commercial inventories. That buffer is finite. If the closure drags on for months, markets will need to price materially higher oil to force demand destruction.

Risk sentiment has improved on hopes of Middle East de-escalation. This has lifted risk assets and high-beta FX, even as oil briefly pushed to fresh highs in April. Strong global equities have also eroded the USD’s safe-haven appeal, with the US Dollar Index (DXY) retracing around 70% of its March rally. The USD would likely soften further if US-Iran tensions ease, and we still forecast mild USD depreciation in 2H26. However, our conviction has weakened. A less dovish Fed, relative US equity outperformance and the risk of a slow oil price unwind are all USD-supportive.

Strong global equities weakened the USD’s safe-haven appeal, leaving FX retracements mid-pack

Percentage retracement from extreme since the onset of US - Iran war at the end of February



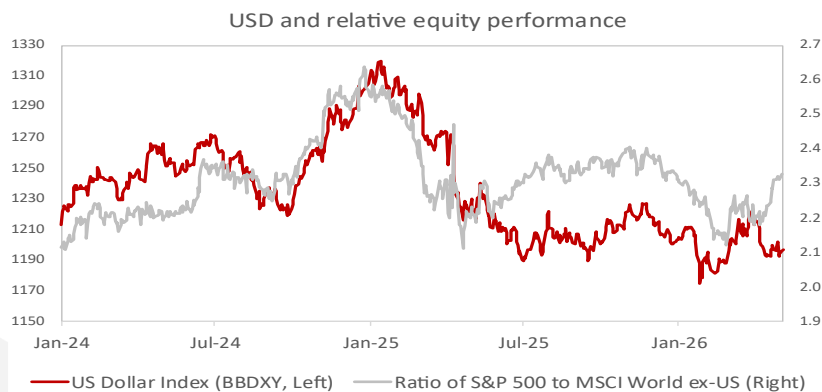
Source: Bloomberg, OCBC Group Research

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The April FOMC marked a clear hawkish shift as US data surprised more positively than elsewhere. This divergence is likely to extend into 2Q26, when energy-related disruptions become more evident outside the US. Chair Powell highlighted a move toward a more neutral stance, underscored by dissents from regional bank presidents Hammack, Kashkari and Logan against maintaining dovish guidance. A less dovish Fed limits scope for USD weakness. While renewed hikes would be USD-positive, they remain unlikely for now under the incoming Fed leadership, with Kevin Warsh widely expected to take the chair ahead of the June FOMC.

Meanwhile, the rotation out of US equities has stalled. Tech-led earnings strength has outweighed geopolitical concerns, reinforcing US equity outperformance. Continued investment in technology should cushion the drag on the US economy from higher energy costs. While improved global risk appetite reversed the USD's March rally, sustained US equity resilience through earnings season should limit USD downside.

US equity outperformance, driven by the AI theme, raises questions about how far the USD can weaken in a de-escalation scenario



Source: Bloomberg, OCBC Group Research

Oil prices are also likely to stay elevated. Infrastructure damage, precautionary stockpiling amid shifting energy security priorities should support prices even if the strait reopens. We now expect Brent to end the year near USD80 per barrel, up from USD70 previously. Higher-for-longer energy prices favour exporters like the US over importers such as the euro area, widening performance gaps and further weakening the case for a bearish USD in 2H26.

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