



FX update: Past indicators, present conditions, future outlook

26 March 2026

Executive Summary

Markets appear to be underpricing inflation risks from the Middle East war, driven by a focus on headline Brent/WTI price changes rather than refinery products, as well as continued optimism of an impending end to the war with minimal lasting supply chain disruptions. While the near-uniform hawkish turn by central banks has supported their respective currencies, the outlook ahead will also be shaped by countries' exposure to energy shocks. We expect USD outperformance to continue ahead, while remaining more bearish on the JPY and EUR outlook.

Rise in headline oil prices downplays inflation risks ahead

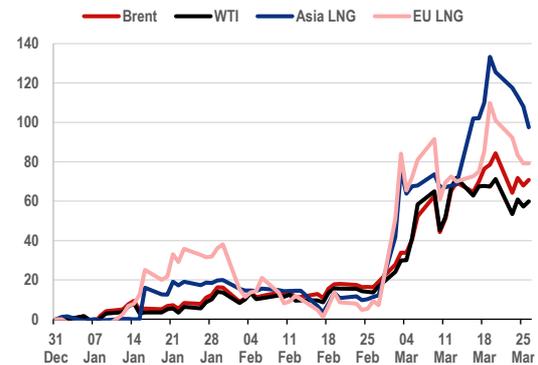
The US/Israel-Iran war has paralysed vessel traffic and energy production across the Strait of Hormuz and the Persian Gulf – home to 20-30% of global oil and LNG production - driving up benchmark upstream energy prices (Exhibit 1). The rise in refined petroleum products' prices has been even more acute (Exhibit 2), reflecting: 1) Historically greater impact on product markets from geopolitical events, 2) Demand growth for products that were expected to exceed refinery capacity expansion for 2026, 3) Refinery outages and reduced refinery capacity in locations closer to demand, and 4) Tighter product inventories (especially gasoline and diesel) compared to crude oil, leading to greater volatility/sensitivity to news developments.

This contrasts with markets' earlier bearish view for Brent/WTI prices due to a projected oversupply environment for 2026 (prior to the war), while measures such as an easing of sanctions on Russian oil and the release of a record amount of emergency oil stocks from IEA member countries have also helped keep a lid on benchmark oil prices. Given markets' proclivity on relying on the latter (Brent/WTI) when tracking energy price changes, we think concerns towards upside inflation risks and/or government fiscal deficit increases (for countries maintaining energy subsidies such as petrol) remain understated for now, of which we may see a manifestation only when March inflation data is out (to be released around April-May), and/or during the countries' next fiscal update.

Central banks determined to exorcise spectre of inflation

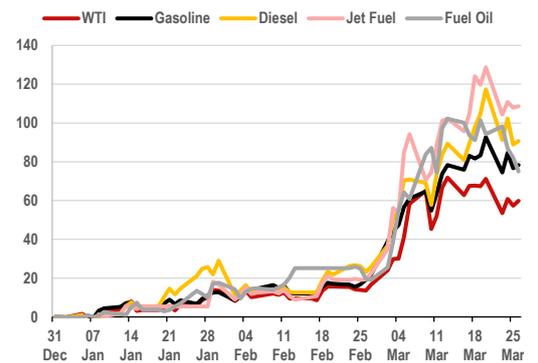
Aside from the RBA, global central banks generally tuned more hawkish during their recent monetary policy meetings (between 17 – 19 March) despite not raising interest rates. Fed chair Powell guided that policymakers won't lower rates further until inflation resumes cooling, while revised Fed projections see upward revisions to headline and core PCE inflation at 2.7% y/y each (prior: 2.4% and 2.5% respectively), an unchanged unemployment rate (4.4%), and median dot plot interest rate projections (for one cut each in 2026 and 2027). The ECB also raised its inflation rate projections to 2.6% y/y for 2026 (prior: 1.9%) under its 'benign' baseline scenario, with ECB President Lagarde guiding

Exhibit 1: The sharp rise in benchmark energy prices...



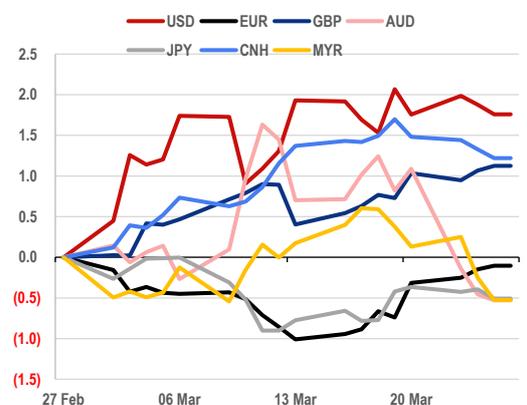
Sources: AmBank Economics, Bloomberg

Exhibit 2: ... were comparatively smaller, compared to increases in product prices



Sources: AmBank Economics, Bloomberg

Exhibit 3: Currencies' real effective exchange rate (REER) % chg since the war started



Source: AmBank Economics, Bloomberg

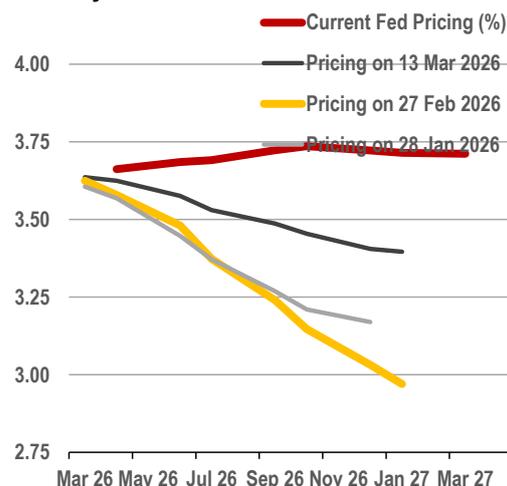
that policy tightening would be warranted even under a ‘not-too-persistent’ energy shock, even as she projects inflation at 4-6% under the ECB’s adverse and severe inflation scenarios. The BOE also turned hawkish with its first unanimous rate hold in 4.5 years, as policymakers noted the risks of second-round inflationary effects on other goods and wages. This marks a reversal from pre-war trends, which showed disinflationary pressures on wages and domestic prices, shifting the narrative from potential cuts to potential rate hikes for 2026. Meanwhile, the RBA lifted the cash rate by 25bps for a second consecutive meeting to 4.10%, as the RBA board noted persistent inflationary pressures (both domestic and externally driven) with risks still skewed to the upside, including through inflationary expectations, warranting the very tight monetary policy and the latest rate hike. On the flip side, the BOJ was relatively more dovish than its peers. The BOJ indicated Japan’s economic recovery is at risk from the Middle East war, while noting that headline inflation is expected to temporarily dip below 2% in the near term. Alongside BOJ Governor Kazuo Ueda’s earlier statement that its 2% inflation target must be accompanied by domestic wage gains, this suggests the BOJ may look past near-term energy-driven inflation, putting significant pressure on the JPY.

Investors lulled by Trump’s lullaby set for rude awakening

Meanwhile, despite Trump’s implied intention to end the war, we think market optimism of a pathway to peace is misplaced, as actions by parties to the conflict continue to indicate very little actual de-escalation, including continued intense US/Israel strikes and Iranian attacks, US military movements of another 5,000 troops to the Middle East (an approximate 10% increment from current levels), and signalling that Saudi Arabia and the UAE are inching closer towards joining the US-led coalition against Iran. These developments suggest the current conflict may evolve into a broader regional war, which will likely prolong the current production and export halt in the Strait of Hormuz region, given Iran’s asymmetrical ability to control the Strait despite relative military weaknesses.

Our revised FX forecasts (Exhibit 5) reflect these recent developments. While the near-uniform hawkish turn by global central banks is expected to support their individual currencies, we think outperformers may still be evident from either energy-exporter nations (such as the USD) or relatively energy-insulated economies (CNH and MYR), while the EUR and JPY are expected to be adversely impacted due to significant energy dependence from the region. Potential events to watch ahead include: 1) The deployment of US troops directly into Iranian territory, which may derail any ceasefire plans, 2) More energy-related crises among energy import-dependent nations, particularly in Asia, and 3) A contagion effect arising from, or a combination of, points 1 and 2.

Exhibit 4: Rapid dial back in Fed rate cut expectations seen after the war began in late-February



Sources: AmBank Economics, Bloomberg

Exhibit 5: AmBank FX forecasts (end-period)

	2Q26	3Q26	4Q26	1Q27	2Q27
DXY	100.2	101.5	102.2	102.8	102.1
EURUSD	1.14	1.12	1.11	1.10	1.11
GBPUSD	1.32	1.30	1.29	1.29	1.31
AUDUSD	0.70	0.69	0.68	0.67	0.66
USDJPY	159	160	162	165	165
USDCNY	6.93	6.95	6.95	6.95	6.94
USDMYR	4.01	4.07	4.10	4.10	4.08

Source: AmBank Economics

AmBank Economics

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