

Brent Nears USD100 as Middle East Risk Broadens: Temporary War Premium or a New Oil Regime?

Brent Nears USD100 as the Risk Map Widens

- Brent crude has once again approached the psychologically important USD100/barrel threshold, but the latest move deserves greater attention than previous geopolitical spikes. The difference this time is that the conflict is increasingly affecting both the transportation network and physical energy infrastructure.
- The immediate catalyst was the coordinated Houthi attack on several locations in southern Saudi Arabia, including energy facilities in Abha, Najran and Jizan. Saudi authorities reported 73 injuries and confirmed that fires broke out at energy facilities, with some operations temporarily suspended. The attacks represent a significant escalation in the Houthi-Saudi front and, importantly for oil markets, introduce a direct threat to Saudi energy infrastructure.
- This is important because the market had previously been able to frame the Middle East risk largely around Iran, the U.S. and the Strait of Hormuz. That framework is becoming increasingly inadequate.
- The risk map now encompasses three separate but interconnected channels:
 1. **Hormuz:** disruption to one of the world's most important oil transit routes;
 2. **Saudi Arabia:** potential damage to production, refining and storage infrastructure; and
 3. **Red Sea/Bab el-Mandeb:** disruption to an alternative route for moving energy from the Gulf towards global markets.
- The attacks therefore add a new dimension to the oil supply equation. Even if Saudi crude production itself remains largely unaffected, damage to refining, storage, pipelines or alternative export routes could tighten regional product and crude balances.
- This explains why Brent has been able to approach USD100 despite the absence, so far, of evidence of a major permanent reduction in global crude production.

The Critical Question: Is This Another War Spike or a New Oil Regime?

- The market has experienced several sharp oil rallies since the conflict began, many of which subsequently faded as the immediate geopolitical risk premium declined.
- The key question now is whether the latest move represents another risk-premium spike or the beginning of a more persistent repricing of physical supply risk.
- There are reasons to take the latter possibility more seriously.
 - ✓ First, the conflict is becoming geographically broader. The Houthi attacks demonstrate that

- the risks associated with the Iran confrontation can spill over into Saudi Arabia, rather than remaining confined to the Gulf.
- ✓ Second, the Strait of Hormuz remains constrained. Market reports indicate that tanker flows through the waterway remain well below normal, meaning that the latest Saudi attacks are occurring against an already impaired supply chain.
 - ✓ Third, Iranian oil exports are themselves under significant pressure, while the US has intensified military action against Iranian oil tankers. This means the market is dealing simultaneously with lower Iranian exports, constrained Gulf shipping and increased risks to Saudi infrastructure.
 - That combination makes the current oil rally fundamentally different from a purely headline-driven move. However, it is still too early to conclude that the market has entered a structurally higher oil-price regime.
 - The decisive variable is actual physical supply disruption.
 - ✓ If the Saudi attacks remain episodic and Saudi Arabia is able to restore affected facilities quickly, while Hormuz traffic gradually normalises, Brent could once again surrender a substantial part of its geopolitical premium.
 - ✓ Conversely, if attacks on Saudi energy infrastructure become recurrent, Hormuz remains effectively impaired and Iranian exports continue to fall, the market would have to price a much more persistent supply deficit.
 - That is the scenario in which USD100 becomes a floor rather than a ceiling.

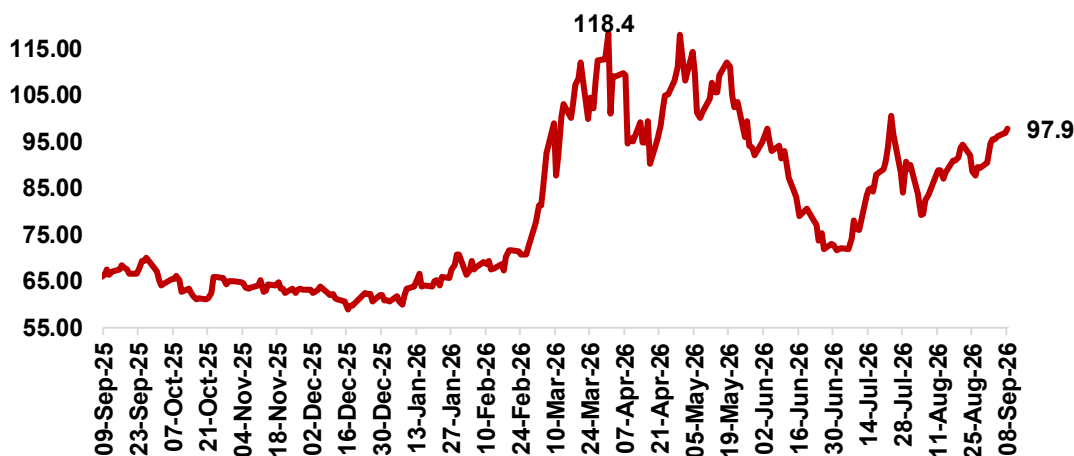
Iran's Exclusion-Zone Threat Adds Another Layer of Risk

- The second development that deserves attention is Iran's increasingly specific threat to establish a maritime exclusion zone around the Gulf.
- The significance is less about the wording of the threat itself and more about the potential transition from rhetoric to implementation.
- There is an important distinction between:
Threat => announcement => implementation => actual disruption of shipping
- The market is currently somewhere between the first and second stages. Until vessels are actually denied passage, sanctioned or forced to alter their routes, the economic impact remains largely a risk premium.
- Nevertheless, the threat matters because the Strait of Hormuz normally handles roughly one-fifth of global oil and LNG flows. Any credible deterioration in shipping conditions therefore has an outsized impact on marginal oil prices.
- The market should consequently watch tanker movements more closely than military rhetoric. A measurable decline in vessel traffic would be a much stronger bullish signal for oil than another round of political threats.

Brent Technical Outlook: USD102 First, USD104.23 the Real Test

- From a technical perspective, Brent's move above USD\$100 into immediate focus. The first resistance is around USD102, followed by the more important USD104.23, corresponding to the 61.8% projection of the USD70.14–USD102.00 advance.
- The reaction around USD104.23 should be particularly important. A rejection around this level, particularly if momentum indicators remain overbought, would support the interpretation that the latest move is another war-driven spike-and-fade episode. In that case, Brent could retreat towards the USD94–USD96 area, with USD93.91 becoming an important support level.
- However, a decisive break and sustained close above USD104.23 would materially change the technical picture. It would suggest that the recovery is developing into a more impulsive uptrend, potentially opening the way towards USD110–USD116. A move towards USD120 would then no longer look implausible, particularly if accompanied by evidence of genuine physical supply disruption.
- Our near-term assessment is therefore asymmetric: geopolitical risks favour further upside, but the sustainability of the move depends increasingly on physical market evidence rather than headlines.

Chart 1: Brent Oil Price



Source: Bloomberg, Bank Islam

Financial Markets: Oil Shock Complicates the Fed and Treasury Outlook

- The more important implication for financial markets is that an oil shock of this nature is increasingly becoming a monetary-policy problem.
- At current levels, Brent is around USD99.31, while the US 10-year Treasury yield is already elevated at around 4.79%, with the 2-year yield at approximately 4.40%. This gives a positive 2s10s spread of roughly 39bps.
- The transmission mechanism is straightforward:

Higher oil => higher headline inflation => greater inflation persistence risk => less scope for Fed easing/greater probability of tightening => higher front-end yields => upward pressure on longer-dated Treasury yields

- This creates a particularly challenging environment for bonds. Normally, a geopolitical shock would generate a flight-to-quality bid for Treasuries and push yields lower. However, that relationship becomes less reliable when the geopolitical shock simultaneously generates a large and persistent commodity-price shock. This is precisely the risk currently emerging.
- The latest market reaction is already showing signs of this tension: the 10-year Treasury yield briefly moved above 4.8% as oil prices rose and inflation concerns intensified.

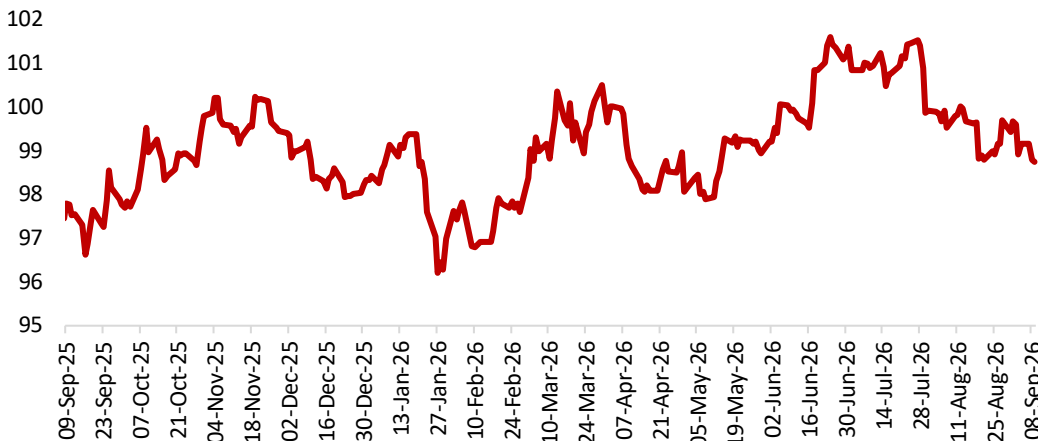
Our near-term Treasury view

- We therefore see two competing forces:
Safe-haven effect => lower yields versus **Oil/inflation/Fed effect => higher yields**
- For a short-lived escalation, the safe-haven channel could dominate and push the 10-year yield temporarily lower. But if Brent remains above USD100 for several weeks, we expect the inflation/Fed channel to increasingly dominate, limiting the downside in Treasury yields and potentially pushing the 10-year yield towards the 4.85–5.00% area.
- The 2-year Treasury is arguably more vulnerable because it is directly linked to expectations for the Fed funds rate. With the 2-year already around 4.40%, persistent oil inflation would make the market increasingly reluctant to price aggressive Fed easing.
- This reinforces our broader view that the probability of the Fed holding rates in 2026 is higher than the probability of further cuts, with the risk increasingly skewed towards a hike should inflation expectations become unanchored.

USD: Safe-Haven Demand Should Keep DXY Supported

- The US dollar should retain a near-term safe-haven advantage from the renewed escalation. DXY is currently around 98.77, and the combination of geopolitical uncertainty, higher oil prices and reduced expectations for Fed easing provides a supportive backdrop.
- There is, however, an important nuance. A stronger USD is not necessarily driven by broad-based confidence in the US economy. Rather, the current mechanism is more defensive:
geopolitical risk => risk aversion => demand for USD liquidity + higher US yields => DXY support
- If oil remains elevated and Treasury yields continue rising, the USD should retain an advantage over higher-beta currencies.
- We therefore expect DXY to remain biased towards the upside in the near term, although a sustained move materially above the 100 level would likely require either a further escalation in the conflict or a significant repricing of Fed expectations.

Chart 2: US Dollar Index (DXY)



Source: Bloomberg, Bank Islam

Gold: Safe-Haven Demand Versus Higher Real Yields

- Gold presents a more complicated picture. XAU/USD is currently around USD4,375/oz, already reflecting a substantial geopolitical risk premium.
- The immediate impulse remains positive: worsening geopolitical tensions, uncertainty around the global economy and concerns about financial-market stability all support demand for gold as a safe-haven asset.
- However, gold faces an important countervailing force from higher Treasury yields. If the oil shock causes markets to price fewer Fed cuts or even a greater probability of future tightening, real yields could rise, increasing the opportunity cost of holding non-yielding gold.
- Hence, our near-term view is: **Gold remains structurally supported by geopolitical risk, but the upside could become more volatile if higher oil prices drive Treasury yields materially higher.**
- In other words, the next leg higher in gold will be easier to sustain if geopolitical risk rises without a corresponding sharp increase in real yields.

Ringgit: Near-Term Weakness Despite Malaysia's Oil Exposure

- The USD/MYR is currently around 4.0665. At first glance, higher oil prices should be positive for Malaysia given its status as a net exporter of energy-related commodities. Higher crude and LNG prices improve export receipts and the external trade balance, providing a natural buffer to the currency.
- However, in the immediate market reaction, global risk sentiment and USD strength are likely to dominate. The transmission is:
Middle East escalation => USD safe-haven demand + higher UST yields => pressure on EM currencies => MYR weakness
- Therefore, we would expect the ringgit to remain under some near-term pressure even as higher

commodity prices provide a fundamental offset.

- The distinction is important: **this is not necessarily a deterioration in Malaysia's external fundamentals. Rather, it is primarily a relative pricing effect arising from a stronger USD and higher global risk premium.** If Brent remains elevated but the global shock remains contained, Malaysia's commodity exposure should eventually become more supportive for MYR.

Malaysian Bonds: MGS Vulnerable to Higher UST Yields and Oil Inflation

- For Malaysian fixed income, the immediate bias is less favorable. The 10-year MGS yield is currently around 4.02%, compared with the US 10-year Treasury at around 4.79%. The key transmission channel remains the global bond market. If the oil shock pushes UST yields higher, Malaysian government bonds are likely to face upward pressure, particularly at the long end.
- The concern is not simply the direct inflation impact. It is the combination of:
 - higher UST yields;
 - wider global term premia;
 - stronger USD;
 - higher commodity-price inflation; and
 - reduced expectations for global monetary easing.
- This argues for MGS yields remaining elevated in the near term, even if domestic inflation remains relatively contained. Importantly, the Malaysian market should not be expected to fully decouple from the global bond sell-off simply because domestic fundamentals remain relatively resilient.

What Does This Mean for BNM and the OPR?

- For Bank Negara Malaysia, the oil shock creates a familiar but difficult policy trade-off. Higher oil prices would raise headline inflation through fuel and transportation costs and could eventually feed into broader services and wage pressures. At the same time, a prolonged geopolitical shock could weaken external demand and business confidence.
- Therefore: **Short-term oil shock => higher inflation** while **Prolonged conflict => weaker growth**
- The appropriate BNM response would depend heavily on the persistence and pass-through of the shock.
- For now, we would not interpret the latest escalation as sufficient to trigger a change in the OPR. With the OPR at 2.75%, subdued underlying inflation and a still-resilient domestic economy, the more likely response is for BNM to remain on hold while assessing whether the oil shock is temporary or becoming embedded in domestic inflation.
- However, a prolonged Brent price above USD100 would materially reduce the probability of any future easing and could bring forward the point at which the market begins discussing policy normalisation rather than additional accommodation.

Bottom Line: The Oil Market Is Approaching a Critical Confirmation Point

- The latest move in Brent is more credible than many of the earlier war-related spikes because the risk has moved beyond rhetoric and shipping disruption towards actual attacks on energy infrastructure in Saudi Arabia. The conflict is effectively broadening from a Hormuz-centred disruption into a wider regional energy-security problem.
- Nevertheless, USD100 is a psychological threshold, not yet a new equilibrium price. Our key test is whether the market can sustain Brent above USD100-USD104. A rejection would suggest that geopolitical risk is once again being priced too aggressively relative to actual physical supply losses. Conversely, a decisive break above USD104.23, particularly if accompanied by declining tanker flows, further attacks on Saudi infrastructure or actual implementation of restrictions around Hormuz, would signal that the market is moving into a more persistent supply-risk regime.
- For financial markets, the key concern is no longer simply "war means risk-off". The more consequential transmission is:
Middle East escalation => higher oil => higher inflation expectations => fewer Fed cuts/greater hike risk => higher UST yields => stronger USD => pressure on EM currencies and bonds
- This creates a potentially stagflationary market environment. Gold should remain supported by safe-haven demand, although higher real yields could limit its upside. The USD should remain firm, while Treasury yields may stay elevated despite intermittent flight-to-quality buying.
- For Malaysia, higher oil prices provide an external-sector cushion but do not fully offset the near-term negative impact of stronger USD and higher global yields. We therefore see continued pressure on MGS yields and some near-term MYR weakness, while the higher oil-price environment reduces the room for further monetary easing by BNM.
- Our central message: **Brent's move towards USD100 is no longer just a geopolitical headline. The critical issue is whether the conflict begins producing persistent physical supply losses. If it does, USD100 could become the new floor; if not, the latest move risks becoming another war premium that eventually fades.**