

MARKETS ENTER HIGH-RISK PHASE AS GEOPOLITICAL AND TRADE TENSIONS COLLIDE

- **Middle east escalation becomes dominant market driver**
 - **Geopolitical premium lifts the dollar, but structural downtrend persists**
 - **Gold benefited from safe haven flows as geopolitical tensions ratcheted higher**
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- Global financial markets have entered a volatile and high-risk phase, rattled by a combination of escalating geopolitical tensions, rising energy prices, and an increasingly fractious global trade landscape. In recent months, investors have had to contend with U.S. fiscal uncertainty, mounting fears of economic recession, and the looming expiration of a 90-day reciprocal tariff truce. Last week's sharp escalation in the Middle East, marked by direct military strikes between Israel and Iran, has added a new layer of uncertainty, potentially redefining the global risk environment.

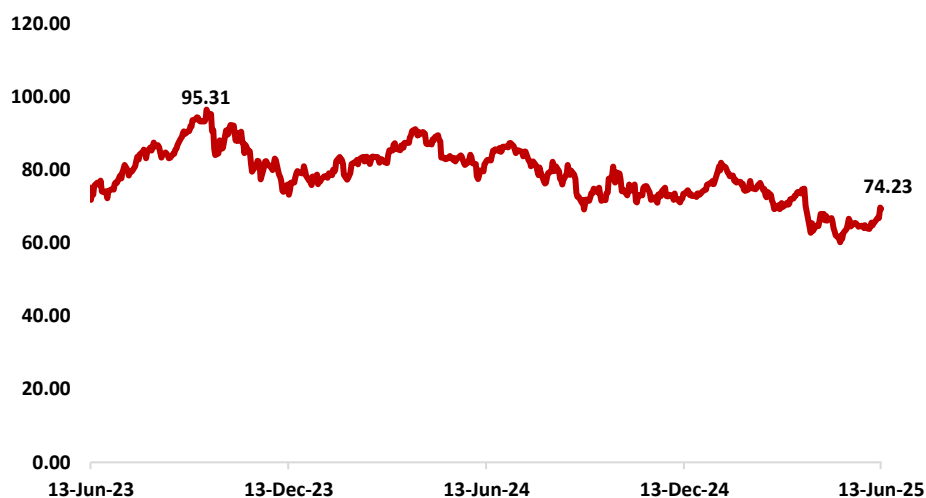
Middle East Escalation Becomes Dominant Market Driver

- The conflict between Israel and Iran has rapidly overtaken other major market concerns to become the dominant force shaping global investor sentiment. Israel's large-scale airstrike on Iran's ballistic missile sites and senior military figures, followed by retaliatory Iranian missile attacks on Israeli cities, signals a dramatic intensification of hostilities. What many initially hoped would be a short-lived exchange now threatens to evolve into a protracted and destabilizing regional conflict.
- **Elevated risk premium and escalation scenarios.** Oil markets have responded swiftly to the renewed geopolitical tensions triggered by the Israel-Iran conflict. Following Israeli airstrikes on Iranian military facilities, oil prices surged as markets reassessed the risk of supply disruptions. Both Brent and WTI crude recorded their largest intraday gains since Russia's invasion of Ukraine in 2022, driven by fears that escalating violence could threaten regional energy infrastructure. WTI rose and settled at USD72.98 per barrel, while Brent climbed 7% to close at USD74.23. At the time of writing, Brent hovered around USD75 and WTI around USD73.75 per barrel.
- Traders are increasingly pricing in the possibility that the conflict could spill over into neighbouring countries, potentially endangering key energy transit routes such as the Strait of Hormuz, a vital chokepoint through which roughly 20% of global oil supply passes. Iran, which

produces about 3.3 million barrels per day and exports over 1.3 million bpd of crude and refined products, plays a pivotal role in global energy markets. Any meaningful disruption to its exports could significantly tighten global supply, pushing prices higher, especially given limited spare production capacity among other OPEC+ members. If hostilities intensify, oil prices could test the USD80 level in the near term.

- In a worst-case scenario, such as Iran retaliating by targeting Gulf oil producers, U.S. military assets in the region, or attempting to block the Strait of Hormuz, global energy markets could face severe dislocation. This could trigger a sharp spike in oil prices, stoke inflationary pressures worldwide, and undermine investor sentiment. Brent could surge past USD100 under such circumstances. While the U.S. has clarified that it is not directly involved in Israel's military actions, any retaliatory strikes on American interests could drag Washington into the conflict, raising the risk of a broader regional war with global economic and security implications.

Chart 1: Brent Crude (USD/pb)

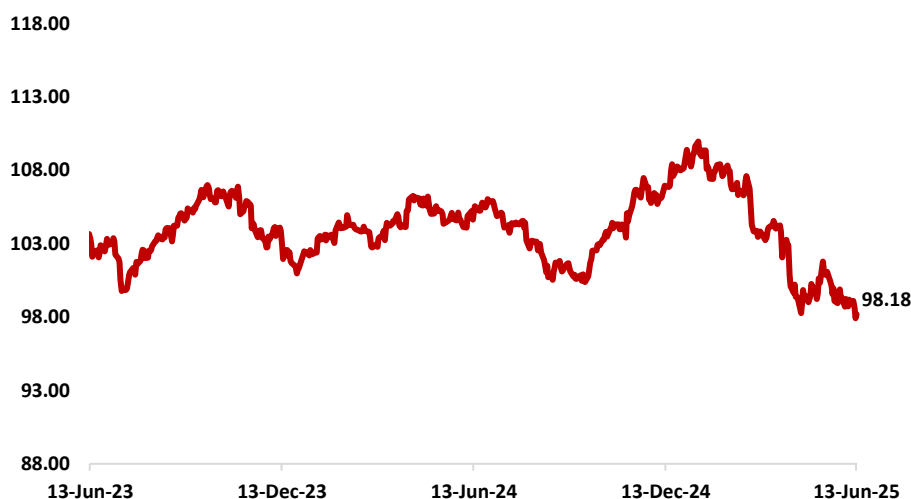


Sources: Bloomberg, Energy Information Administration (EIA), Bank Islam

Geopolitical Premium Lifts the Dollar, But Structural Downtrend Persists

- Currency markets reflected the heightened geopolitical risks, with traditional safe-haven assets outperforming. The Swiss franc (CHF) and Japanese yen (JPY) rallied, alongside gold, as investors sought shelter from market turbulence. The euro (EUR) gained as well, buoyed by diminishing expectations for further European Central Bank (ECB) easing. Meanwhile, the U.S. dollar (USD) staged a modest late-week recovery, helped by a partial return of its geopolitical hedge appeal. However, it remained among the weaker performers on the week, underscoring the market's broader bearish tilt toward the greenback amid soft inflation data and rising expectations for Federal Reserve rate cuts.

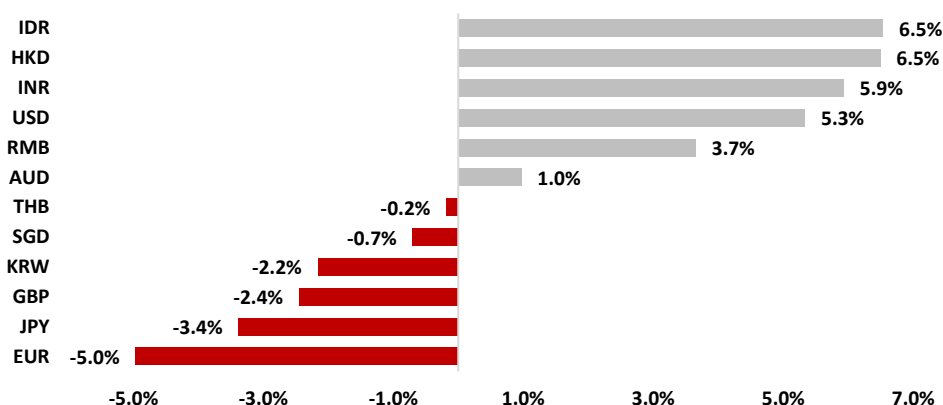
Chart 2: Dollar Index (DXY)



Sources: Bloomberg, Bank Islam

- The US dollar rebounded modestly on news of Israeli strikes but failed to reclaim losses from earlier in the week. While traditionally a safe haven, the greenback's status has eroded due to domestic fiscal concerns and softer macro data. Still, in the event of wider Middle East escalation, the USD could attract renewed flows, especially given its recent oversold conditions.
- For Malaysia, the ringgit (MYR) continues to trade defensively, with limited upside despite a weaker USD backdrop. Ongoing global uncertainties, including U.S.-China trade tensions, rising oil prices, and escalating geopolitical risks, have weighed on sentiment. In the coming days, all eyes will be on further developments in the Israel-Iran conflict and the outcome of Malaysia's next round of tariff negotiations with the U.S.. If the new U.S. tariff regime remains under the 10% threshold as targeted, downside pressure on Malaysian exports and the ringgit could be partially mitigated.

Chart 3: MYR Against Regional Currencies, YTD% (As of 13 June 2025)

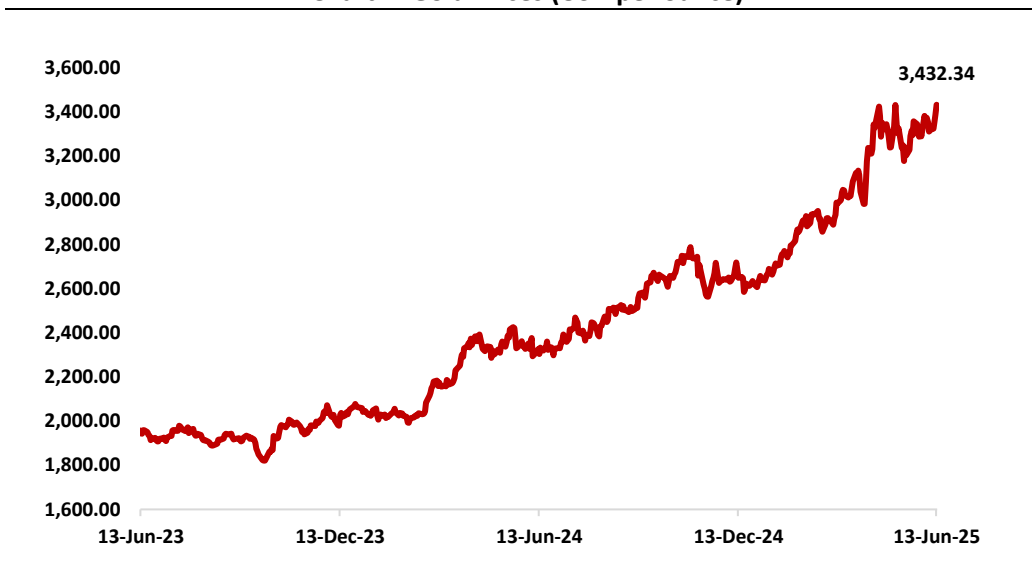


Sources: Bloomberg, Bank Islam

Gold Benefited from Safe Haven Flows as Geopolitical Tensions Ratcheted Higher

- Gold extended its rally for a third consecutive session on Friday, gaining 1.4% to close at USD3,432 per ounce, driven by heightened safe-haven demand amid escalating tensions between Israel and Iran. The uptrend continued into Monday, marking a fourth straight day of gains, with prices briefly touching a fresh two-month high above USD3,450 before paring some of the advance. The renewed geopolitical risk has reinforced investor appetite for gold, traditionally viewed as a hedge in times of crisis. The recent breakout above the key USD3,400 level signals continued bullish momentum, with near-term resistance seen around USD3,500. A sustained push above this threshold could open the door to new all-time highs. Market participants remain focused on developments in the Middle East, particularly the risk of a broader regional conflict, as well as any major trade-related headlines that could further shape sentiment and drive demand for safe-haven assets.

Chart 4: Gold Prices (USD per ounce)



Sources: Bloomberg, Bank Islam

Oil Shock Complicates Fed Policy Outlook as Tariff Clock Ticks

- The sharp rally in oil prices comes at a delicate time for the U.S. Federal Reserve. After soft CPI and PPI prints last week, markets were increasingly confident that the Fed would begin cutting rates as early as September. Fed fund futures had priced close to 60% chance of such a move. But the recent oil shock is reviving concerns over energy-driven inflation, which could force the Fed to pause or even reverse course if headline inflation reaccelerates.

- This challenge is compounded by the July expiry of the 90-day U.S. tariff truce. While Treasury Secretary Scott Bessent has hinted at possible extensions for "good faith" trading partners, President Trump has taken a more hawkish stance, suggesting that countries should prepare for the resumption of unilateral tariff hikes. This policy uncertainty, combined with the inflationary risks stemming from surging oil prices, is likely to trigger renewed market volatility and make it more difficult for the Fed to chart a clear path forward.

Global Economic Outlook Darkens Amid Energy Shock and Trade Fragmentation

- Beyond financial markets, the Israel-Iran conflict threatens to weigh heavily on the global economy. An extended oil price rally would act as a tax on consumers and businesses, weakening purchasing power and profit margins. Transport, aviation, and manufacturing sectors would be particularly vulnerable. Higher energy costs could reignite inflationary pressures just as many central banks, including the Fed and the ECB, are preparing to ease monetary policy.
- Global growth projections, already under pressure from rising protectionism and tighter financial conditions, could see further downward revisions. Supply chain disruptions and renewed energy price volatility could dent industrial production and trade volumes globally. Fragile emerging markets and energy-importing countries, especially in Asia, would bear the brunt of the shock.

Implications for Malaysia: Downside Risks Accumulate

- The Israel-Iran conflict introduces fresh external headwinds to Malaysia's already cautious 2025 outlook. As a small, open, and trade-reliant economy, Malaysia is particularly vulnerable to global energy shocks, heightened financial market volatility, and shifting investor sentiment. A sustained climb in Brent crude prices would inflate the country's import bill and increase the cost of fuel subsidies, amplifying fiscal pressures. While Malaysia is a net exporter of oil and gas, and higher energy prices could boost Petronas revenues and government royalties, providing temporary fiscal and trade gains, these benefits may be outweighed by broader macroeconomic risks.
- Malaysia's deep integration into global value chains leaves it exposed to any significant slowdown in global trade or manufacturing demand. Key export sectors, particularly electronics and commodities, could feel the brunt of weaker external conditions. On the domestic front, sustained energy price pressures may gradually lift inflation, especially through higher transport and fuel costs. However, the immediate pass-through to consumers could be muted by ongoing price controls and subsidies.

- This complex backdrop could complicate Bank Negara Malaysia's monetary policy stance. While BNM is widely expected to maintain the Overnight Policy Rate (OPR) at 3.00% in the near term, a prolonged rise in oil prices, especially if coupled with sticky domestic inflation, may force a more hawkish tone. The central bank would face the delicate task of balancing support for growth with the need to anchor inflation expectations, particularly if the U.S. Federal Reserve remains on hold for longer.
- Elevated geopolitical risk could also trigger risk-off sentiment across emerging markets, weakening capital flows into Malaysia and exerting additional pressure on the ringgit. This could further tighten domestic financial conditions and push bond yields higher, underscoring the sensitivity of Malaysia's economy to global shocks and market volatility.

Conclusion: Markets on Edge as Crisis Deepens

- The confluence of escalating geopolitical tensions, rising oil prices, and fraying global trade ties has set the stage for a period of elevated market stress. Investors are grappling with overlapping risks, each potent in its own right, but collectively capable of triggering widespread volatility. For Malaysia, the near-term outlook is mixed: while higher oil prices may cushion government revenues, downside risks to trade, inflation, and financial stability are growing. Much now hinges on whether diplomacy can rein in the conflict, or whether the world must brace for another prolonged geopolitical and economic shock.