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Four Failed Breakouts: Why US Dollar, Treasury Yields and Dow Still Cannot Commit

Markets Reacted to Everything, but Committed to Nothing

- Financial markets entered September with several catalysts capable of triggering a decisive repricing. The US labor market delivered a stronger-than-expected August payrolls report, while upward revisions to previous months removed much of the concern over a sharp deterioration in employment. At the same time, Federal Reserve officials continued to emphasize the importance of incoming inflation data, leaving the door open to either holding or tightening policy. Meanwhile, renewed pressure from the Trump administration for lower interest rates introduced a political dimension that runs counter to the Fed's conventional reaction function. Geopolitical tensions also kept the risk of another energy-driven inflation shock alive.

- Yet, despite these competing forces, markets ended the week without a clear directional commitment.

- The US Dollar Index (DXY) recovered but was rejected near key resistance. The 2-year Treasury yield briefly moved above 4.40% but failed to sustain the breakout, while the 10-year yield similarly tested 4.81% without establishing a decisive move higher. Equities remained resilient, but the Dow Jones Industrial Average (DJIA) was unable to resume its record-setting advance. In other words, markets have repriced the news but have not confirmed the underlying narrative.

- This is important because the failure to break higher is not necessarily a sign of complacency. Rather, it reflects an unresolved contest between opposing forces. Stronger employment argues against an aggressive easing cycle, while continued disinflation provides the Fed with room to remain patient. Political pressure favors lower rates, while geopolitical risks retain the potential to lift inflation through higher energy prices. The result is a market caught between a hawkish growth signal and a still-dovish inflation signal.

- The August CPI report on 11 September therefore assumes outsized importance. It could determine whether the stronger labor-market data represents the beginning of a broader hawkish repricing or merely removes one obstacle to the Fed maintaining its current stance.

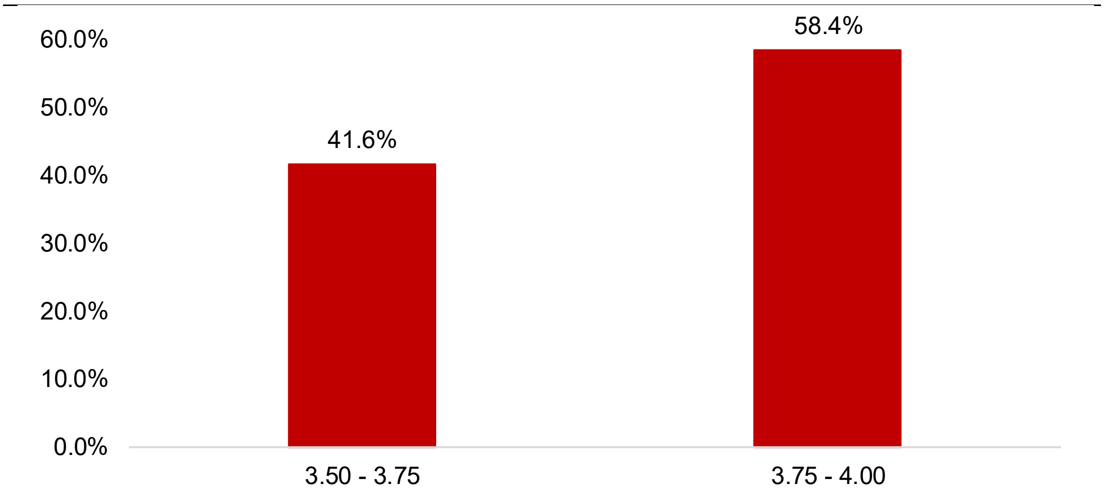
Stronger NFP Repairs the Labor-Market Narrative, but Does Not Settle the Fed Debate

- The August employment report provided the clearest hawkish signal during the week. Nonfarm payrolls increased by 162K, substantially above the 58K consensus, while June and July payrolls were revised a combined 55K higher. More importantly, the revision to July transformed what was initially reported as a 23K contraction into a 21K increase.

- This materially changes the interpretation of the labour market. Prior to the report, the combination of weak payrolls and softer labour indicators had raised the possibility that employment growth was moving beyond a slowdown towards an outright deterioration. The August report largely removed that concern.

- The unemployment rate remained at 4.1%, while average hourly earnings increased 0.3% m-o-m. Private payrolls also rose 127K. Although the composition of hiring was not uniformly broad, the overall report was sufficiently strong to challenge the argument that the US economy is rapidly approaching a labour-market downturn.
- Nevertheless, a stronger payrolls report does not automatically translate into a rate hike. Rather, it changes the balance of risks facing the Fed. With the labor market looking less vulnerable, the Fed has less reason to ease pre-emptively. However, the inflation side of the mandate remains critical.
- This distinction is reflected in market pricing. The probability of a September hike increased from 49.4% before NFP to 58.4% afterwards. While this is a meaningful adjustment, it is not a decisive repricing. Indeed, the probability had previously been around 57% before comments from Fed Governor Christopher Waller pushed expectations closer to an even split.
- Thus, the NFP report effectively **restored a hawkish bias rather than creating a new hawkish consensus**.

Chart 1: CME FedWatch Tool Target Rate Probabilities for 16 September 2026 FOMC Meeting



Source: Bloomberg, Bank Islam

Waller's Reaction Function Places CPI at the Centre of the September Decision

- The comments from Waller provide an important framework for interpreting the market's relatively restrained response to NFP.
- Waller characterised the labor market as being in satisfactory shape and highlighted low layoffs and jobless claims. More importantly, he placed considerable emphasis on the improvement in underlying inflation. Three-month core inflation had declined from 4.76% in February to 3.05% through July, suggesting meaningful progress on disinflation.

- His policy message was therefore conditional. If disinflation continues, he would be inclined to allow current policy to work for longer. If inflation instead accelerates, he will consider tighter policy.
- The stronger August payrolls report weakens the argument for patience because the labor market appears healthier than previously feared. However, it does not eliminate the inflation test. Waller had already indicated that August inflation would carry greater weight than payrolls in determining his September vote.
- This explains why markets have not fully embraced the stronger NFP signal. **Employment has raised the hurdle for holding rates, but inflation still needs to clear the hurdle for hiking.**
- The distinction is crucial for financial markets. If CPI remains contained, the Fed can plausibly argue that a healthy labor market provides room to wait. Conversely, if inflation accelerates again, the combination of strong employment, firm wages and renewed price pressures would make the case for tighter policy considerably stronger.

Political Pressure Adds a Second Policy Axis

- The market is also having to price a second, increasingly visible policy axis: pressure from the White House for lower interest rates.
- President Donald Trump renewed calls for rate cuts following the strong employment report and linked his argument for lower borrowing costs to US economic strength and trade relationships. This creates a framework that is fundamentally different from the Fed's conventional reaction function.

- The Fed is primarily assessing whether inflation is sufficiently contained and whether employment conditions require a change in policy. The administration, by contrast, is increasingly emphasising the economic benefits of lower borrowing costs.
- This divergence creates additional uncertainty around the expected policy path. Importantly, there is no evidence that political pressure has overridden the Fed's reaction function. However, it raises the uncertainty premium around the policy outlook and makes investors less willing to fully commit to a one-directional repricing.
- For markets, this means stronger economic data does not necessarily produce a proportionate rise in yields or the Dollar if investors believe policy expectations could still be influenced by political developments.

Oil Also Failed to Provide the Inflationary Confirmation

- Geopolitical tensions provided another potential catalyst for a hawkish repricing, but energy prices also failed to deliver a decisive signal.
- Brent and WTI tested, but did not decisively clear, key resistance levels around USD97 and USD93.50 per barrel respectively. The escalation in the US-Iran conflict therefore remains an inflationary tail risk, but it has not yet generated a sufficiently large and sustained energy shock to materially alter the near-term inflation narrative.

- This is significant because a sustained oil-price breakout would reinforce the argument that recent disinflation could prove temporary. Instead, the failure of crude to establish a fresh high has allowed markets to continue focusing on the underlying inflation trend.
- Consequently, the main catalysts remain divided: **NFP points towards tighter policy, disinflation towards patience, political pressure towards lower rates, and oil remains a potential but unconfirmed inflationary risk.**
- That is precisely the environment in which markets can react sharply without establishing a new trend.

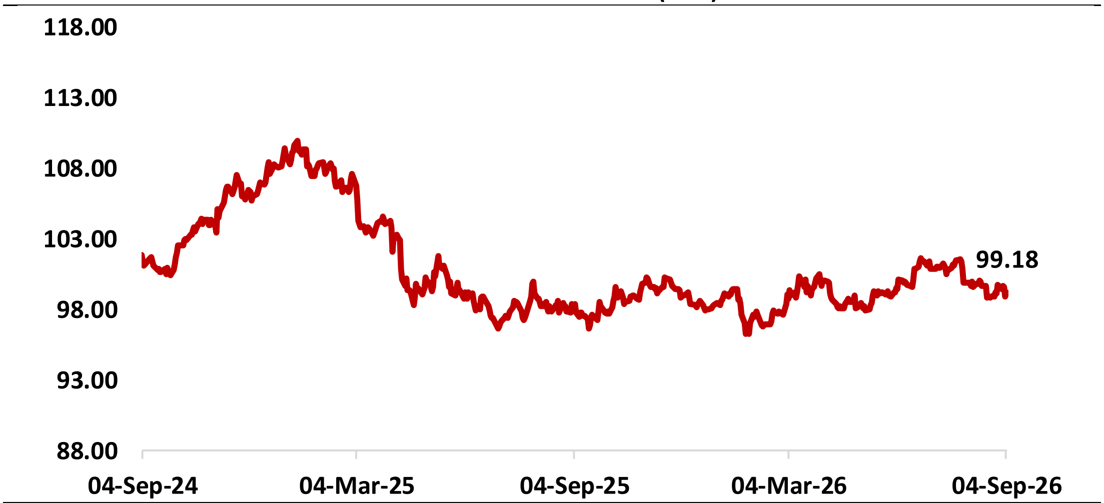
Four Failed Breakouts Reflect the Same Unresolved Macro Narrative

- The technical behaviour across the Dollar, Treasury yields and equities is unusually consistent.

US Dollar: Recovery Fails at Resistance

- The DXY recovered during the week but was rejected around 99.86. This leaves the broader bearish structure intact, although the Dollar has yet to decisively break below the 98.55 support level.
- A sustained break below 98.55 would reinforce the view that the recent recovery was merely corrective and expose 97.62, followed by the previous low around 95.55. Conversely, a decisive move above 99.86 would suggest that the earlier decline has run its course.
- Fundamentally, the Dollar is facing the same uncertainty as the rates market. A stronger labour market supports the Dollar through higher US rate expectations, but the lack of a clear Fed repricing limits the upside.

Chart 2: US Dollar Index (DXY)



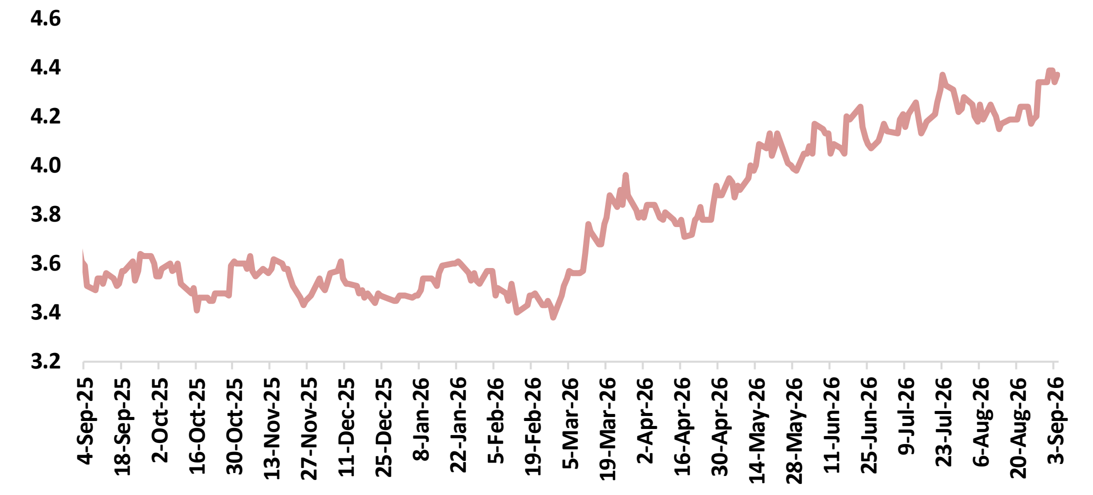
Source: Bloomberg, Bank Islam

2-Year Treasury: Hawkish Lean Without Confirmation

- The 2-year Treasury yield provides perhaps the clearest expression of the Fed debate. It rose to 4.423%, effectively testing the 4.40% psychological threshold and the 2025 high around 4.424%, before retreating towards 4.37%.

- The inability to sustain the move is notable because the 2-year yield is particularly sensitive to expectations for the Fed funds rate. Had the August payrolls report fundamentally altered the expected policy path, the front end should have provided the clearest confirmation.
- Instead, the market is signalling a higher probability of tightening, but not a settled tightening cycle.
- A break above 4.424% would strengthen the hawkish interpretation and open the way towards 4.527%. Conversely, a move below 4.316% would indicate that the latest upside attempt has failed more materially, potentially bringing 4.19% back into focus.

Chart 3: US 2Y Treasury Yield (%)

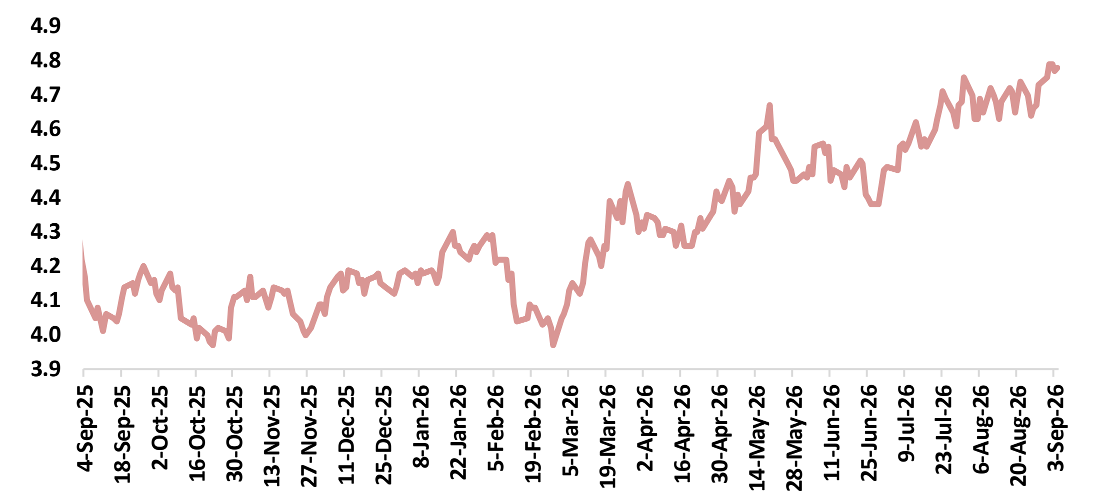


Source: Bloomberg, Bank Islam

10-Year Treasury: Growth Is Not Enough to Trigger a Long-End Breakout

- The 10-year Treasury yield similarly tested 4.81% before retreating to around 4.79%.
- The long end reflects a broader combination of factors, including monetary policy expectations, inflation, fiscal risk and the term premium. The failure to clear 4.81% therefore suggests that investors are not yet convinced that the stronger employment data represents a sufficiently large change in the medium-term inflation and policy outlook.
- A decisive break above 4.81% would open the way towards 5.09%, bringing the 5.00% psychological threshold and the 2023 peak back into focus. A break below 4.73%, however, would signal weakening upside momentum and expose the market to a move towards 4.63%.
- The key message is that both ends of the Treasury curve are asking the same question: Is the stronger labour market sufficient to generate a broader and more durable repricing of the Fed and inflation outlook? So far, the answer is no.

Chart 4: US 10Y Treasury Yield (%)

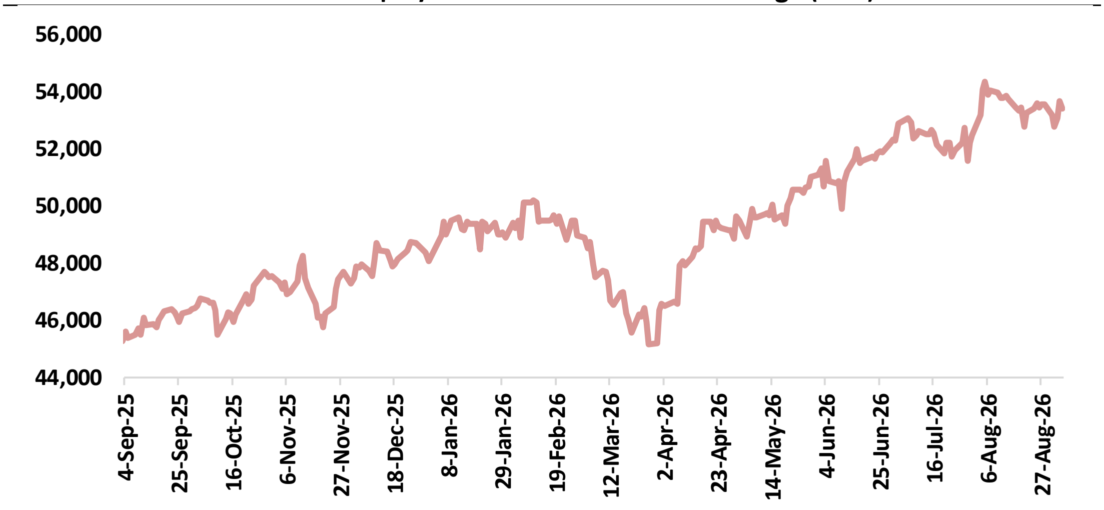


Source: Bloomberg, Bank Islam

Dow Jones: Equities Remain Resilient but Lack a Fresh Catalyst

- The Dow has also remained in consolidation below its record high of 54,749.47. While the broader uptrend remains intact above 52,696.27, investors have yet to push the index into a fresh record.
- This behaviour is consistent with the broader cross-asset picture. Equities are not pricing a major hawkish shock, but neither are they displaying the type of risk-on momentum that would normally accompany a decisive easing in financial conditions.
- A break above the record high would restore the broader uptrend and target 55,475. Conversely, a break below 52,696.27 would raise the risk that consolidation is turning into a deeper correction, with 51,049.37 as the next major downside level.

Chart 5: US Equity – Dow Jones Industrial Average (DJIA)



Source: Bloomberg, Bank Islam

September CPI: The Missing Catalyst

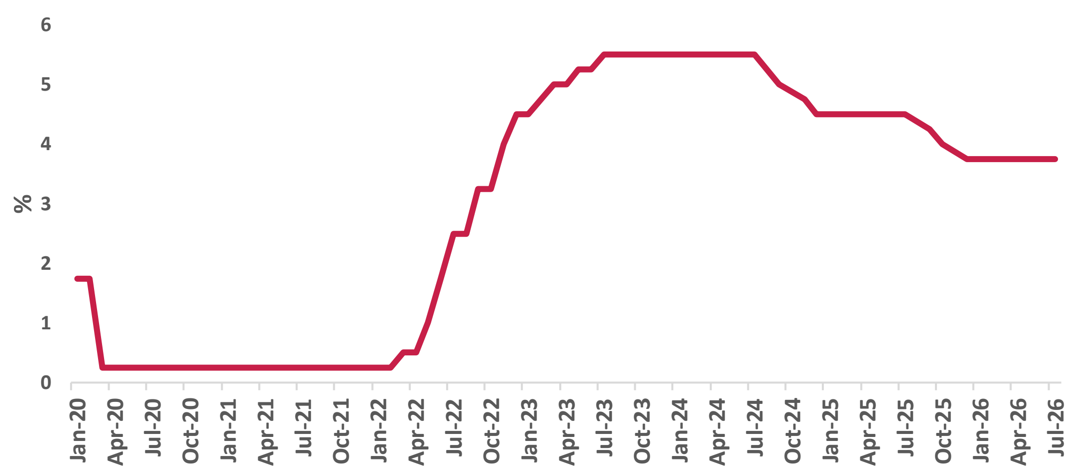
- The August CPI report on 11 September is therefore likely to be more consequential than the NFP report in determining the next direction of markets.
- The employment report has largely answered the question of whether the labour market is deteriorating rapidly. The answer is increasingly no. The remaining question is whether inflation has improved sufficiently for the Fed to tolerate a stronger labour market without tightening, or whether price pressures are beginning to reaccelerate.
- A broadly stable CPI print may not be sufficient to trigger a rate hike. If underlying inflation continues to trend lower, the Fed retains the option of waiting despite stronger employment. In this scenario, September hike expectations could retreat towards an even split or lower, pulling the 2-year yield back from 4.42% and reducing upward pressure on the Dollar and long-end yields.
- Conversely, a hotter-than-expected CPI would materially strengthen the hawkish case. Strong employment, upward payroll revisions, firm wages and renewed inflation would provide the combination needed for markets to price a more decisive tightening bias.
- Under this scenario, the 2-year yield could establish itself above 4.42%, while the 10-year yield could finally clear 4.81%. The Dollar would also have a stronger fundamental basis to challenge 99.86.
- In short, **NFP has removed the labor-market argument for patience; CPI now needs to determine whether there is a positive inflation argument for tightening.**

Implications for the Fed Funds Rate

- Our assessment is that the August employment report has shifted the balance of risks towards a less accommodative Fed, but has not yet fundamentally changed the expected policy trajectory.
- The immediate September decision remains highly data dependent. A soft or benign CPI would allow the Fed to maintain an easing bias or at least preserve policy flexibility, particularly if the recent disinflation trend remains intact. In contrast, a renewed acceleration in core inflation would increase the likelihood of a September hike and, more importantly, raise the possibility that the Fed would need to maintain a higher policy rate for longer.
- The distinction between a **one-off hike and a higher-for-longer cycle** is therefore important. Markets are unlikely to price a sustained tightening cycle based on NFP alone. A more persistent repricing would require evidence that inflation is reaccelerating and that the Fed's progress towards its 2% objective has stalled.
- Our base case remains that the Fed will be cautious in adjusting policy, given the still-improving inflation backdrop. However, the stronger labour-market data means the threshold for further easing has become higher. The risk has therefore shifted from an unequivocally dovish policy path towards a more balanced, two-sided reaction function.
- From a market perspective, this implies that US rates are likely to remain volatile around

incoming inflation and labour-market data. The 2-year yield should remain the primary barometer of changes in Fed expectations, while the 10-year yield will continue to reflect the additional influence of inflation, fiscal and term-premium risks.

Chart 6: US Federal Fund Rate (%)



Source: Bloomberg, Bank Islam

Implications for Malaysia Financial Markets

- The implications for Malaysian financial markets will operate mainly through the US rates, USD and global risk-appetite channels rather than through a direct change in Bank Negara Malaysia's reaction function.

MGS: External Rate Pressure Remains the Key Risk

- Malaysian Government Securities (MGS) yields are likely to remain sensitive to movements in US Treasury yields. A decisive rise in the US 10-year yield above 4.81%, particularly if driven by a renewed inflation repricing, would place upward pressure on global bond yields, including MGS.

- The transmission could be amplified if a stronger Dollar is accompanied by a reduction in global risk appetite and foreign demand for emerging-market fixed income.

- Conversely, a softer US CPI report and retreat in Treasury yields would provide a more supportive environment for MGS. Lower UST yields would reduce external yield pressure, while a softer Dollar could improve foreign investor sentiment towards Malaysian fixed income.

- Hence, the near-term direction of MGS yields is likely to be determined more by the resolution of the US rates breakout than by domestic monetary policy expectations alone.

OPR: BNM Can Remain Patient

- For Bank Negara Malaysia, the implications are less direct. A stronger US labour market and potentially higher US yields do not, by themselves, warrant a change in the Overnight Policy Rate (OPR).

- The domestic policy reaction function remains centred on Malaysia's growth, inflation and financial conditions. If domestic growth remains resilient and inflation remains manageable, BNM has room to maintain the OPR at its current level.

- A sustained rise in US yields could nevertheless reduce BNM's room for policy easing by increasing external financial pressure and potentially weakening the Ringgit. Conversely, a decline in US yields and a more supportive global financial environment would provide greater policy flexibility.

- Therefore, the more important implication is not that stronger US data necessarily leads to a higher Malaysian policy rate, **but that higher-for-longer US rates could constrain the extent and timing of any future easing by BNM.**

Ringgit: US Rate Differentials Remain Important

- The Ringgit is likely to remain particularly sensitive to the outcome of the US inflation and Fed debate.

- A hotter CPI that pushes US rate expectations higher would likely support the Dollar and place renewed depreciation pressure on the Ringgit, particularly if UST yields break decisively higher. A stronger Dollar could also reduce appetite for emerging-market currencies as global investors reassess relative returns.

- On the other hand, a softer CPI would reduce US rate expectations, weaken the Dollar and improve the relative attractiveness of Asian currencies. This would provide a more supportive backdrop for the Ringgit, particularly if domestic fundamentals remain resilient.

- The failure of DXY to sustain its move above 99.86 therefore remains important. As long as the Dollar cannot establish a sustained upside breakout, the Ringgit should retain some support from the broader adjustment in US rate expectations.

Conclusion: The Market Needs Confirmation, Not Another Catalyst

- The defining feature of the current market environment is not a lack of catalysts. It is the lack of **confirmation**.

- The stronger August payrolls report repaired the labour-market narrative, but did not produce a decisive repricing of the Fed. Waller's emphasis on inflation kept the door open to patience, while renewed political pressure for rate cuts introduced another source of uncertainty. Geopolitical risks remain inflationary, but oil prices have not broken decisively higher.

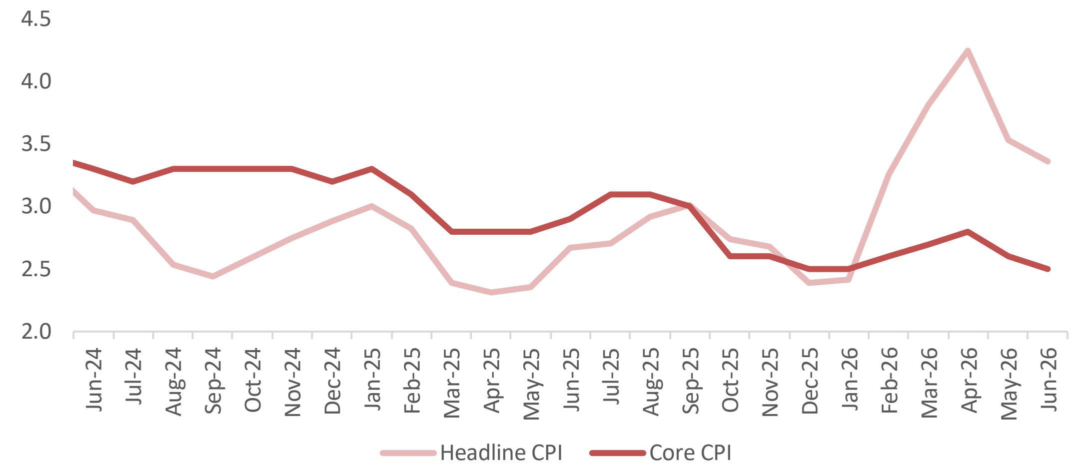
- As a result, the Dollar, 2-year Treasury yield, 10-year Treasury yield and Dow have all reached levels where a broader directional move could have been confirmed, but all four have failed to do so.

- This leaves the market in a state of compressed conviction. The next move is likely to depend less on another strong headline and more on whether the August CPI report provides the missing confirmation.

- A **hot CPI** would bring the pieces together: stronger employment, firm wages and renewed inflation would support a higher-for-longer Fed narrative, pushing the 2-year and 10-year yields through their respective resistance levels and providing renewed support for the Dollar. For Malaysia, this would translate into upward pressure on MGS yields and the Ringgit, while limiting BNM's room for policy easing.

- A **soft CPI**, in contrast, would reinforce the view that disinflation remains intact. This would weaken the case for a September hike, allow Treasury yields to retreat and reduce Dollar support. Malaysian bonds and the Ringgit would benefit from a more favourable global rates environment, while BNM would retain greater flexibility to respond to domestic conditions.
- Until that confirmation arrives, the most appropriate description of the market remains the same: **reactive, volatile, but not yet committed.**

Chart 7: US Headline and Core Inflation



Source: Bloomberg, Bank Islam