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A LEADERSHIP TRANSITION, A HAWKISH DISSENT AND HEIGHTENED GEOPOLITICAL UNCERTAINTIES LOOM OVER THE FEDERAL RESERVE

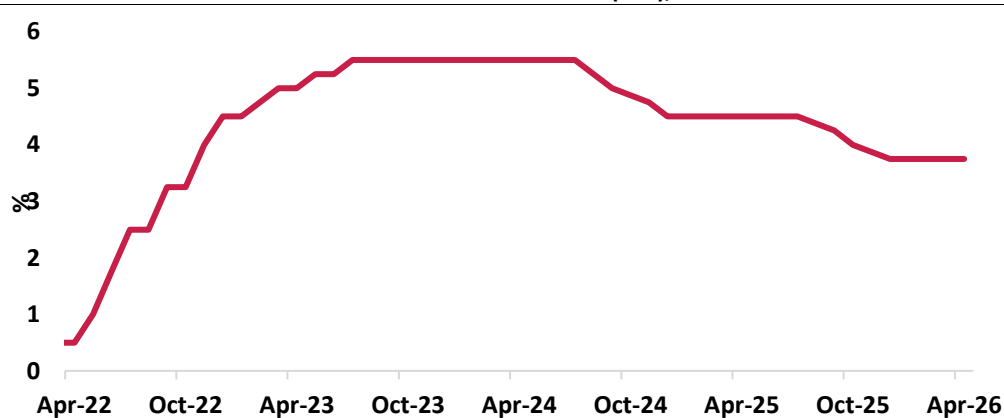
- **Impending Fed leadership transition will be central to investor focus**
 - **The latest policy pause underscores a deepening split within the Committee**
 - **Geopolitical uncertainties, oil supply shocks and rising energy prices reinforce a wait-and-see policy approach**
 - **Kevin Warsh: Likely a Pragmatic Hawk**
 - **Investors price in the likelihood of a “higher-for-longer” Fed**
 - **Concerns of Fed independence continues to linger, albeit somewhat reassured**
- The Federal Reserve is entering a period of heightened uncertainty, marked by an upcoming leadership transition, a deeply divided Federal Open Market Committee (FOMC), and escalating geopolitical risks stemming from the U.S.–Iran conflict. The latest FOMC meeting reinforced a wait-and-see policy stance as internal dissents, growing upside inflationary risks and a protracted geopolitical conflict complicate the policy outlook. Against this backdrop, the anticipated transition to Kevin Warsh as Fed Chair will be a key focal point for markets. His guidance will be closely monitored, particularly as Fed Chair Jerome Powell indicated that he would remain on the Board of Governors. While sending a strong message on the central bank’s independence, Powell’s stay raises the risk of greater internal policy divergence should the new Chair and the former leader adopt differing policy views, potentially complicating the Fed’s messaging.

Current Landscape: April’s Policy Pause Reinforced Caution

- At its April meeting, the U.S. Federal Reserve (Fed) maintained the federal funds rate (FFR) within the 3.50–3.75% range, in line with market expectations. The decision underscored a more cautious policy stance against a backdrop of evolving risks to the economy, with heightened geopolitical uncertainties clouding over the initial inflation and growth outlooks. The escalation of U.S.-Iran geopolitical tensions since February has reignited risks of inflation resurgence, reflecting higher energy prices, while supply chains are increasingly distorted amid shipping disruptions in the Strait of Hormuz.
- The statement highlighted that economic activity continues to expand at a solid pace while labour market conditions are broadly stable and unemployment is little changed, although job gains remain subdued. Inflation remains elevated, partly reflecting higher global energy prices, while developments in the Middle East cast significant uncertainties over the outlook. Altogether, the statement emphasized vigilance, with future adjustments dependent on incoming data and evolving risks.

- Nonetheless, the decision exposed growing internal tensions within the Committee. The policy vote was split 8-4, marking the deepest divide since 1992. Three Fed officials dissented against the inclusion of an easing bias in the statement, arguing that it may prematurely reinforce Fed's broader easing cycle, of which appears increasingly uncertain. Meanwhile, Governor Stephen Miran dissented in favour of an immediate 25-bp cut. The divergent views underscored the Fed's increasingly challenging task of calibrating policy against a backdrop of entrenched inflation, geopolitical shocks and fragile job market momentum.

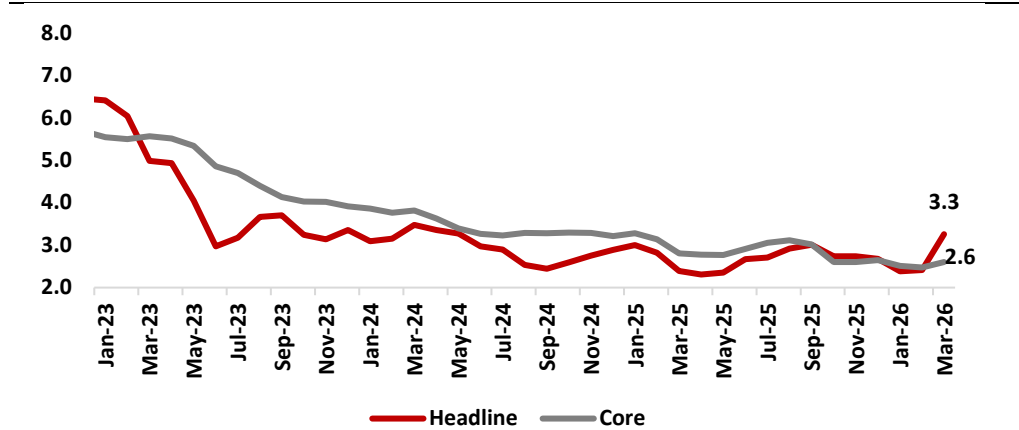
Chart 1: Federal Funds Rate (FFR), %



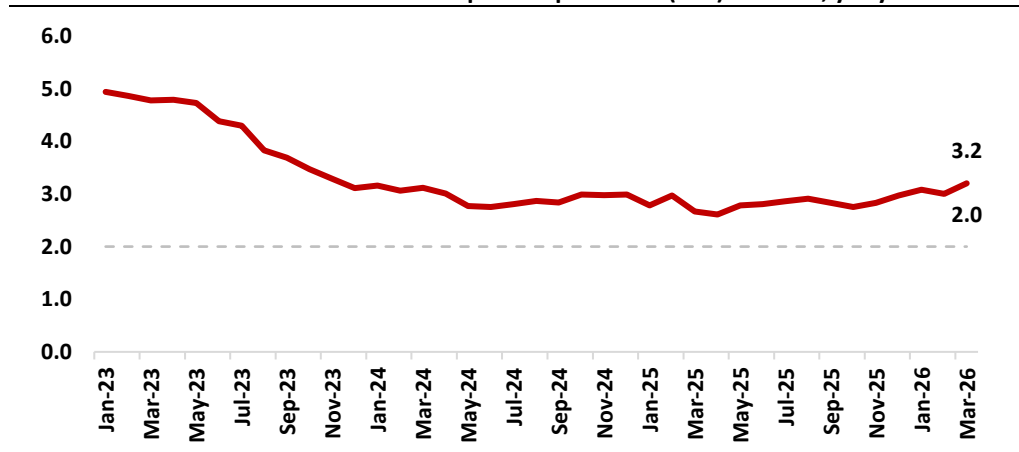
Sources: Federal Reserve (Fed), CEIC Data, Bank Islam

U.S.-Iran Geopolitical Tensions Supports a Wait-And-See Stance

- Price dynamics increasingly reflect the surge in global energy costs. Headline Consumer Price Index (CPI) inflation jumped sharply to a 22-month high of 3.3% y-o-y in March (Feb: 2.4%), driven primarily by steep increases in gasoline prices (+18.9%) and fuel oil (+44.2%). The energy-driven upswing underscores the renewed inflationary impulse stemming from higher global oil prices. Even after stripping out volatile energy components, underlying inflation remains stubborn. Core inflation pressures continue to reflect the lingering effects of import tariffs introduced in 2025, which are still filtering through consumer prices. Evidently, Core Personal Consumption Expenditure (PCE) inflation - the Fed's preferred gauge of underlying price pressures - edged up to 3.2% in March (Feb: 3.1%), marking its highest reading since January 2024. The persistently elevated figure reinforces concerns that inflation remains entrenched above Fed's target, necessitating a sufficiently restrictive policy stance to decisively curb inflation.
- Amid persistent uncertainty over global energy supply, benchmark oil prices are expected to remain elevated for an extended period. Upside risks to energy prices continue to stem from stalled U.S.-Iran peace negotiations, the open-ended potential for military escalation, and continuous maritime blockades across the Gulf region.

Chart 2: Consumer Price Index (CPI), y-o-y%


Sources: CEIC Data, Bank Islam

Chart 3: Core Personal Consumption Expenditure (PCE) Inflation, y-o-y%


Sources: CEIC Data, Bank Islam

- Furthermore, the fallout from the Middle East war on economic activity and productivity growth has yet to materialize, further calling for caution. Currently, labour market momentum remains uneven, with job growth displaying significant volatility in the first three months of the year. Against this backdrop, heightened geopolitical uncertainties, rising input costs and supply chain disruptions may further weigh on business confidence, hiring and productivity. As such, aggressive policy adjustments would likely exacerbate downside risks to growth.
- The International Energy Agency (IEA) has warned that the war will likely result in severe global energy disruption, signaling that this episode of oil supply shock will have lasting implications on the global economy. Major Gulf oil producers also cautioned that restoration efforts will take months, with production capacity and supply chains likewise taking an extended period to normalize. With little clarity on the duration of the war, the Fed appears inclined to maintain a pause, prioritizing incoming data as it assesses the balance between risks to its dual mandate.

Fed Leadership Transition to Kevin Warsh on Track

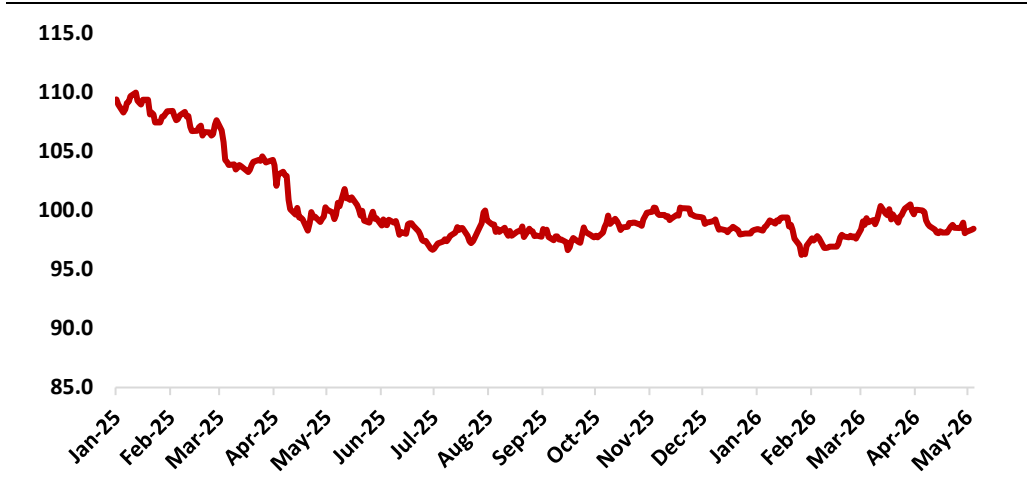
- Kevin Warsh, Trump's nominee as the Fed Chair Jerome Powell's successor, has cleared his Senate Banking Committee hearing, securing approval in a 13–11 party-line vote. Currently, Warsh is awaiting a final confirmation vote by the full Senate before he is sworn in.
- Once confirmed, Warsh is expected to succeed Jerome Powell, inheriting the aforementioned complex policy environment, characterized by geopolitical risks and internal divisions within the FOMC. Warsh will have his plate full of what he described as a "regime change" during his hearing, including potential adjustments to the Fed's economic frameworks, communication strategy, and balance-sheet management.
- Warsh will succeed in the role during a period of pronounced policy divergence. Despite the FFR being kept steady between the 3.50-3.75% range, the underlying picture proved more complicated. The decision marked the most divided policy vote in decades with Governor Stephen Miran favoring a 25-bp cut, highlighting his preference for earlier easing. In contrast, the majority of policymakers appeared broadly comfortable with the overall policy stance. This is starkly different than the three other officials who objected to the easing signals, marking a departure from the Committee.
- The phrasing used, "extent and timing of additional adjustments" to the target range, suggests that the 25-bp cut implemented in December 2025 is viewed as the most recent policy adjustment, with any "additional" moves implying further easing. This nuance in forward guidance sheds clarity into why the policy statement itself became a focal point of dissent. As such, a key challenge for Warsh will be to bridge differing policy views while maintaining credibility and coherence in Fed messaging.

Warsh's Policy Stance: Likely a Pragmatic Hawk

- Initially, investor concerns arose from Warsh's potentially dovish leaning, taking cues from his past arguments for interest rate cuts. Warsh also had historically aligned with the doves' argument that booming productivity and rising artificial intelligence (AI) adoption will allow for neutral or accommodative rates. However, his recent statements led to a shift in market perception.
- During his Senate Banking Committee testimony, Warsh signaled his aim to reinstate a strict 2% inflation target and emphasized the role of interest rates as the main policy tool to combat inflation. His latest views appear more consistent with the Fed's wait-and-see policy approach than a dovish bias initially expected.
- Despite his views on productivity-driven disinflation, Warsh is perceived by investors to be a pragmatist rather than an idealist, meaning that he will likely be data-dependent rather than chasing a predetermined path. With the incoming data pointing to growing upside risks to inflation, investors are increasingly confident that Warsh will adopt a similar stance to the current Fed officials. Investors also focused on his remarks that the central bank has limited window to curb inflation back to target, a statement that tilted more hawkish as it alluded to potential tightening to achieve. As such, markets now expect policy continuity rather than an abrupt pivot

under his leadership.

Chart 4: USD Index (DXY)



Sources: Bloomberg, CEIC Data, Bank Islam

A Subtle Hawkish Tilt on the Horizon

- A notable development is that Warsh is set to replace Stephen Miran, a consistent dove on the Board of Governors. Miran had previously voted for rate cuts at every meeting he attended, underscoring his dovish lean. Thus, with Warsh stepping into his place, the Board will gain a pragmatic hawk compared to an optimistic dove, subtly tilting the balance of the Board towards policy restraint and reinforcing expectations of an extended pause under his leadership.
- The reaffirmation of a higher-for-longer Fed stance, coupled with growing energy-driven inflation risks, continues to provide structural support for the dollar. Nonetheless, near-term upside for the USD index appears limited as investors have largely priced in the likelihood of an extended pause throughout December, with geopolitical developments emerging as the dominant influence over the USD trajectory.
- Since the onset of the U.S.-Iran war, the dollar has appreciated on its safe-haven appeal, breaking decisively above the 98.00 resistance level on 3 March and advancing to mark its highest close of 2026 at 100.51 on 30 March. During this period, the USD index appreciated during risk-off episodes and retreated at signs of continued diplomatic engagements. However, persistent uncertainties and mixed signals from both sides have gradually weighed on broader confidence, snapping the dollar's bullish momentum.
- With subdued investor sentiment and expectations of an extended Fed pause, the DXY index traded within a narrow 97.60–99.40 range throughout April. Despite an active geopolitical backdrop, the USD has remained under pressure, weighed down by a prevailing risk-on environment that continues to dominate market dynamics. Weak economic data tend to erode confidence in the greenback and trigger selling pressure, while stronger data fuel risk appetite, diverting capital flows toward higher-yielding assets and away from the dollar. Absent a material shift in geopolitical conditions or a change in Fed signalling, this asymmetric risk profile is likely to keep the USD skewed

to the downside in the near term.

- Looking ahead, the leadership transition to Kevin Warsh is not expected to prompt abrupt changes in dollar dynamics. Broad expectations of policy continuity suggest the dollar will remain firm but range-bound, with upside risks primarily stemming from higher-than-anticipated inflation surprises or a renewed escalation in geopolitical tensions.

Fed Independence under Scrutiny

- The end of Powell term is marked by the central bank adopting a wait-and-see approach. Although Powell will be stepping down as the Chair, he indicated that he would remain on the Board of Governors until his term ends in 2028, a decision largely understood as Powell's effort to continue preserving the Fed's institutional independence against growing political pressure. Powell has been well-documented to be at odds with Trump over the Fed's policy trajectory, with the latter persistently calling for a significantly more aggressive pace of easing.
- In an apparent attempt to exert pressure on the central bank, the Justice Department previously launched an investigation into the renovation of Fed buildings. Although the probe has since concluded, the episode has continued to cast a shadow over Powell's tenure. At his final press conference, Powell stated that he intends to remain in his role until the matter is resolved with "finality and transparency," indicating that any decision to step aside would be made on his own terms. Markets have responded positively to this stance, viewing Powell's continued presence as a stabilising factor that limits President Trump's ability to appoint an alternative candidate to the Federal Reserve Board.
- When Trump nominated Kevin Warsh as his pick for the next Fed Chair, concerns over the central bank's independence came alive once again. Investors perceived Warsh's alignment with Trump as signal that he may undermine the Fed's independence. However, Warsh explicitly reaffirmed his commitment to uphold the Fed's independence during his Senate Banking Committee hearing, reassuring fears of political interference during his term. Speaking on the issue, Powell publicly acknowledged Warsh's commitment and stated that he "takes him at his word", injecting some confidence into investors.

Outlook

- Looking ahead, the leadership transition to Warsh marks a new phase for the Fed, one clouded by mounting geopolitical risks, energy-driven price pressures and emerging downside risks to growth. Against this backdrop, the central bank is inclined to maintain its wait-and-see policy stance, reinforcing expectations for a higher-for-longer FFR. While the baseline remains an extended pause, investors are eyeing scope for potential tightening if the U.S.-Iran war proved more protracted than expected, which may fuel hotter-than-expected inflation. According to the CME FedWatch tool, markets are currently assigning roughly a 50% probability that the FFR will be held steady at 3.50–3.75% through December 2026, underscoring expectations for a prolonged policy pause.

- Policy communication will also be a key challenge as the Fed grapples with calibrating its policy rate to incoming data, without prematurely reinforcing either bias. Early signals also suggest that Warsh's tenure will likely feature policy continuity, pragmatism and a bias towards patience, instead of a dovish overhang that investors initially expected. While it is still too early to determine the implications of Warsh on the Fed's institutional independence, markets seem to be appeased for now. Investor confidence remains backed by his explicit commitment to preserve the Fed's autonomy, the absence of any immediate signs of political alignment and his apparent shift from his previous bias for policy easing.

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