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Strong US Labor Market Reinforces Fed's Higher-for-Longer Bias as Brent Approaches a Critical Inflection Point

Executive Summary

- Financial markets started the week with a modest improvement in risk sentiment following easing geopolitical tensions involving Iran. However, underlying market conditions remain dominated by two key themes: a surprisingly resilient US labour market and expectations that the Federal Reserve may need to maintain restrictive policy settings for longer. Meanwhile, Brent crude oil has continued to decline and is now approaching a key technical and psychological support zone near US$93/bbl, which could have important implications for global inflation, monetary policy expectations and energy-exporting economies, including Malaysia.
- As of the Asian session today, the Dollar Index (DXY) stood at 101.724, US 10-year Treasury yields were at 4.876%, Brent crude traded at US$92.57/bbl, gold at US$4,125.8/oz, while USD/MYR was marginally firmer at 4.0555.

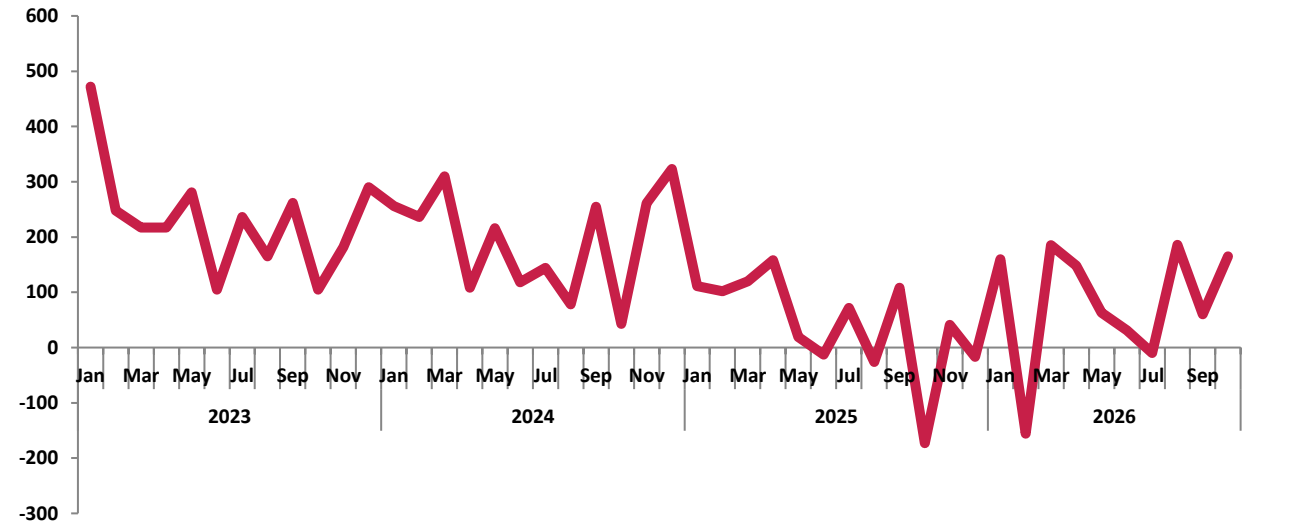
US Labor Market: Strong Headline, Stronger Internals

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- The October US employment report delivered one of the strongest upside surprises in recent months, suggesting that labor-market conditions remain considerably healthier than expected despite restrictive monetary policy.
- Nonfarm payrolls increased by 165,000, substantially above consensus expectations of 56,000. More importantly, revisions added a combined 84,000 jobs to August and September payroll data. August job growth was revised up from 133,000 to 186,000, while September payrolls were revised higher from 29,000 to 60,000. Combined with October's gain, payrolls have increased by 411,000 over the past three months, representing an average monthly increase of 137,000 jobs, almost three times stronger than the average pace recorded over the preceding twelve months.
- The revisions are significant because they suggest that labor-market momentum had already been improving prior to October rather than the latest result being a temporary rebound. This strengthens confidence that economic activity remains fundamentally resilient despite elevated interest rates.
- The household survey also provided encouraging signals. The unemployment rate declined to 4.1% from 4.2%, while labor force participation increased to 61.9% from 61.8%. Simultaneously, the employment-population ratio improved to 59.3% from 59.2%. Normally, an increase in labor force participation can place upward pressure on unemployment if job creation fails to absorb new entrants. The fact that both participation and employment increased while unemployment declined suggests labor demand remains sufficiently robust to accommodate a larger workforce. This is an important indicator that the labor market remains fundamentally healthy rather than merely benefiting from a shrinking labor force.

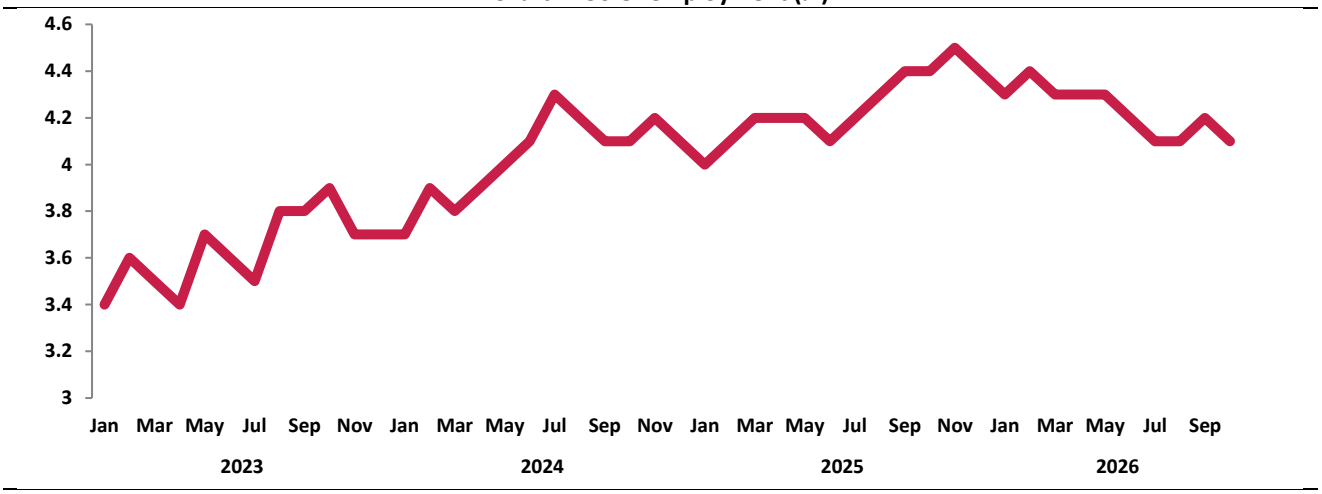
- In absolute terms, household employment surged by 463,000, providing additional evidence of solid labor demand. However, not all indicators were uniformly positive. The number of workers employed part-time for economic reasons rose by 339,000 to 4.84 million. This suggests that some firms may still be moderating labor costs through reduced working hours rather than outright layoffs. While not sufficient to alter the overall positive assessment, it indicates labor-market strength remains somewhat uneven beneath the headline figures.
- Hiring became noticeably broader. Professional and business services led job creation with 70,000 new jobs, including strong gains in professional, scientific and technical services, as well as administrative support activities. Temporary help services rebounded sharply, often considered a leading indicator of future hiring demand. Healthcare added 42,000 jobs, transportation and warehousing increased by 25,000, while manufacturing employment advanced by 19,000. The manufacturing gains are especially noteworthy given ongoing support from semiconductor investments, AI-related infrastructure projects, reshoring activity and industrial policy initiatives.
- Looking ahead, the labor market is expected to moderate gradually as restrictive financing conditions continue to affect business investment and hiring decisions. Nevertheless, current employment trends remain inconsistent with recession conditions. The combination of improving labor-force participation, low unemployment and still-positive wage growth suggests household consumption is likely to remain a key pillar supporting US economic growth over the coming quarters.

Chart 1: US Non-Farm Payrolls ('000)



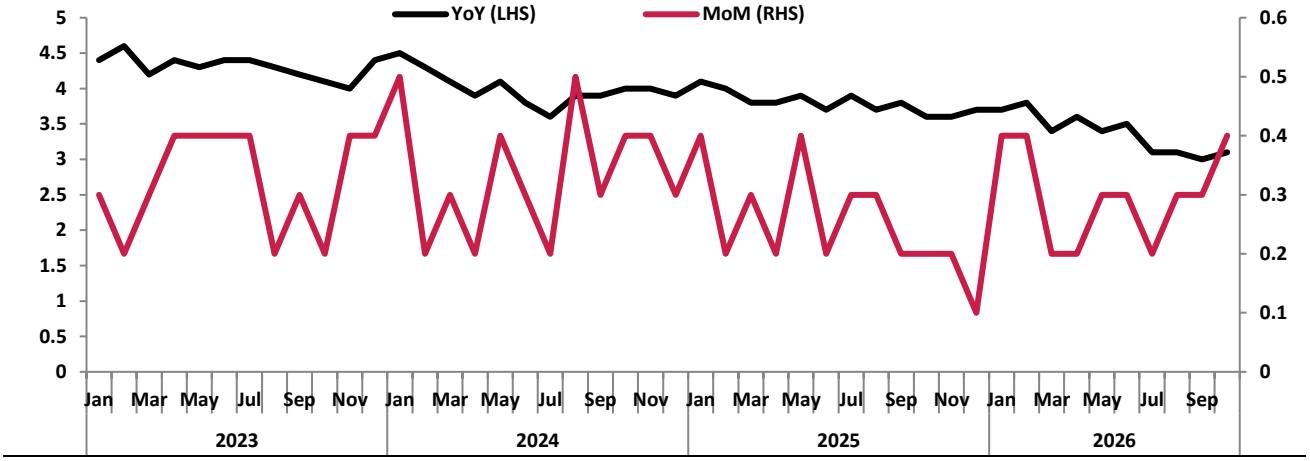
Sources: Bloomberg, Bank Islam

Chart 2: US Unemployment (%)



Sources: Bloomberg, Bank Islam

Chart 3: US Average Hourly Earnings (%)



Sources: Bloomberg, Bank Islam

Implications for Federal Reserve Policy

- For the Federal Reserve, the employment report reinforces the view that the economy remains sufficiently resilient to withstand restrictive monetary policy. The data reduce the urgency for policymakers to consider policy easing, particularly as wage growth remains consistent with healthy labor demand and inflation has yet to return fully to target.
- Market pricing now indicates that a December rate hike remains a realistic possibility. According to the latest CME FedWatch Tools estimates, the probability of a December hike has risen to around 84%, compared with around 76% immediately following the payroll report.
- The October labor market report does not materially increase the likelihood of an aggressive Fed tightening cycle. Instead, it reinforces the view that the Fed can afford to remain patient and data dependent. Consequently, the principal market risk is increasingly not additional rate hikes, but a delay in the timing of future rate cuts should inflation and labor market conditions remain firmer than anticipated.

Fed Policy Scenarios

Scenario 1: Base Case (65%) - One Final 25bp Hike in December

- Under our base case, the Fed delivers a final 25bp rate hike in December, taking the Federal Funds Rate to 4.00%-4.25%, before maintaining policy at restrictive levels through much of 2027. While inflation is expected to trend lower and labor-market conditions gradually cool, policymakers are likely to remain cautious given the resilience of economic activity and employment. As such, we expect the Fed to adopt a data-dependent approach, with the timing and extent of any future policy adjustment hinging on incoming inflation, employment and demand-side indicators. Consequently, the key risk is not necessarily additional tightening, but that rates remain elevated for longer should disinflation progress stall or labor-market conditions remain firmer than expected.

- Market implications:
  - ✓ US 10-year Treasury yields remain around 4.7%-5.0%.
  - ✓ DXY stays primarily within the 100-103 range.
  - ✓ Gold remains supported by expectations of eventual easing.
  - ✓ Equities remain range-bound with elevated volatility.

Scenario 2: Hawkish Higher-for-Longer (20%)

- Inflation proves more persistent than anticipated, particularly across labor-intensive service sectors, while labor market conditions remain resilient. Payroll growth continues to exceed trend levels, unemployment remains close to current lows, and wage growth stabilises above levels consistent with the Fed's inflation target. In such an environment, policymakers may deliver a December rate hike and maintain a distinctly hawkish policy stance throughout 2027. While additional rate hikes cannot be ruled out, the more likely outcome would be an extended period of restrictive policy settings before any consideration of easing.

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- Market implications:
  - ✓ US Treasury yields move higher and could revisit recent highs above 5.0%
  - ✓ DXY strengthens as markets push back expectations for Fed easing
  - ✓ Technology and growth stocks face renewed valuation pressures from higher discount rates
  - ✓ Emerging market currencies, including the ringgit, experience intermittent depreciation pressures
  - ✓ Gold may face headwinds from higher real yields despite safe-haven demand

Scenario 3: Soft-Landing Disinflation (10%)

- Inflation continues to moderate at a faster pace than expected while labor market conditions gradually normalise rather than weaken sharply. Payroll growth slows toward a more sustainable trend; wage pressures ease and inflation moves closer to target without a material rise in unemployment. Under this scenario, the Fed may judge that current policy settings are sufficiently restrictive and either pause in December or adopt a more balanced policy tone following a final rate increase. Policymakers would remain cautious, but financial markets would increasingly price the possibility of policy easing later in 2027.

- Market implications:

- ✓ US Treasury yields trend lower toward 4.5%-4.7%
- ✓ DXY weakens moderately
- ✓ Equities, particularly growth and technology stocks, outperform
- ✓ Gold benefits from lower real yields
- ✓ Emerging market assets and currencies outperform amid improving global liquidity conditions

Scenario 4: Recession Scenario (5%)

- While currently a low-probability outcome given the continued resilience of the labor market, a sharper-than-expected deterioration in employment conditions, consumer spending or business investment could eventually prompt a more accommodative Fed response. Under this scenario, payroll growth turns negative, unemployment rises materially and inflation declines more rapidly due to weakening demand. The Fed would likely end its tightening cycle and begin preparing markets for policy easing.
- Market implications:
  - ✓ Treasury yields fall sharply
  - ✓ Safe-haven demand supports gold
  - ✓ Commodity prices weaken
  - ✓ Initial equity weakness followed by recovery

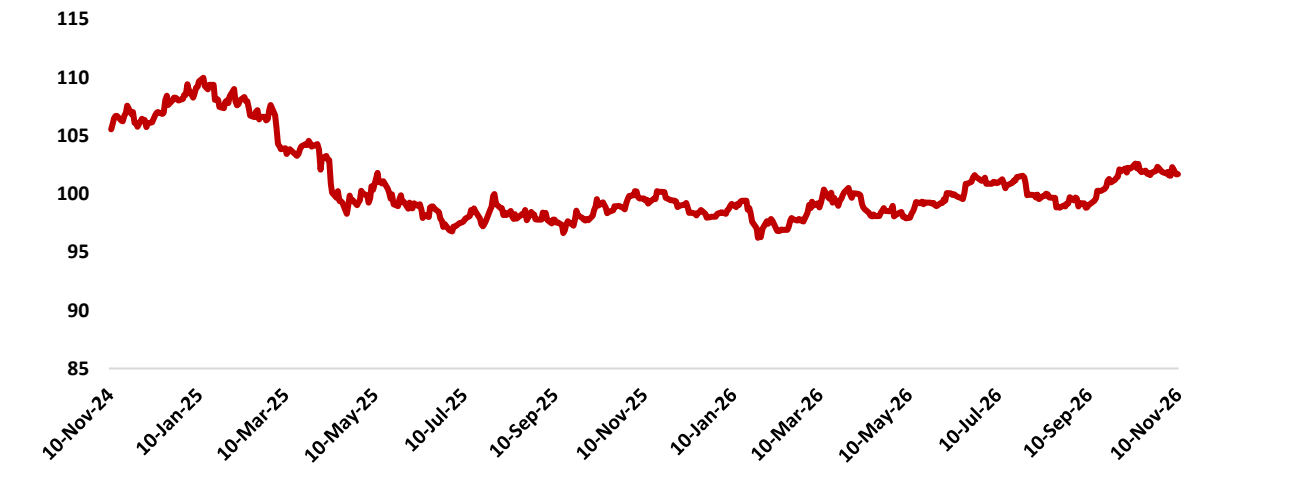
Financial Markets Review and Outlook

US Dollar (DXY)

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- The dollar initially rallied following Friday's payrolls report but subsequently retraced much of those gains as risk sentiment improved. DXY fell to 101.88 on Monday and opened Asian trading today around 101.72. The decline largely reflected easing geopolitical concerns rather than any meaningful change in Fed expectations. Indeed, Treasury yields remained elevated and December hike probabilities stayed above 80%.
- **Outlook:** The near-term direction for DXY will be determined largely by US CPI data. Softer inflation could push DXY below 101, whereas stronger inflation may see a recovery towards 103.00.

Chart 4: US Dollar Index (DXY)



Sources: Bloomberg, Bank Islam

US Treasury Market

- Despite the decline in oil prices and modest improvement in risk sentiment, US Treasury yields remain elevated. The 10-year Treasury yield currently stands at 4.876%, reflecting continued expectations that the Fed will maintain a restrictive stance. The resilience of yields despite falling oil prices and a weaker dollar indicates that markets remain focused on inflation and policy expectations rather than geopolitical developments.
- **Outlook:** Treasury yields are likely to remain near current levels unless CPI produces a significant surprise.

Chart 5: UST 10Y Yield (%)



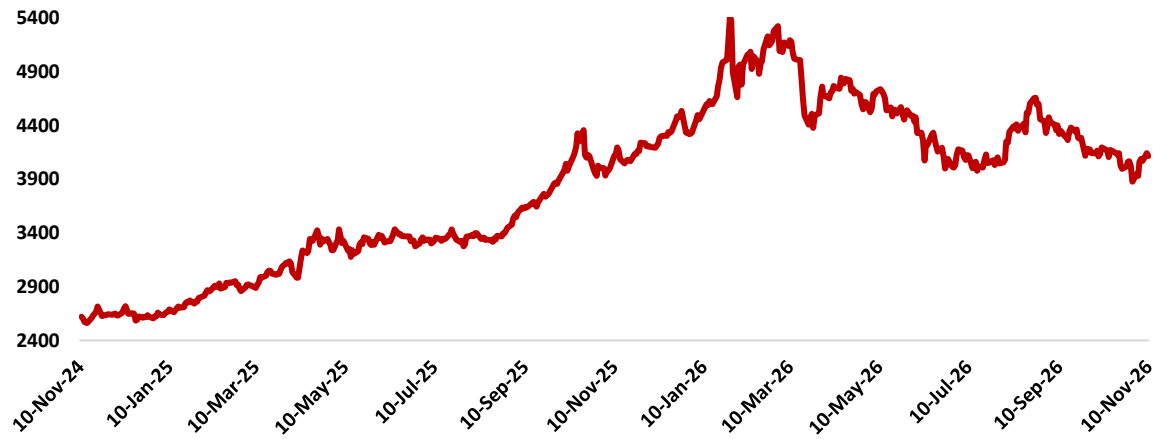
Sources: Bloomberg, Bank Islam

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Gold

- Gold retreated modestly to US$4,125.8/oz during Asian trading after reaching higher levels earlier in the week. The correction largely reflects stabilising risk sentiment and resilient Treasury yields.
- **Outlook:** Gold remains supported by expectations of eventual policy easing but could face short-term pressure should US inflation surprise to the upside.

Chart 6: Gold XAU/USD (USD per ounce)

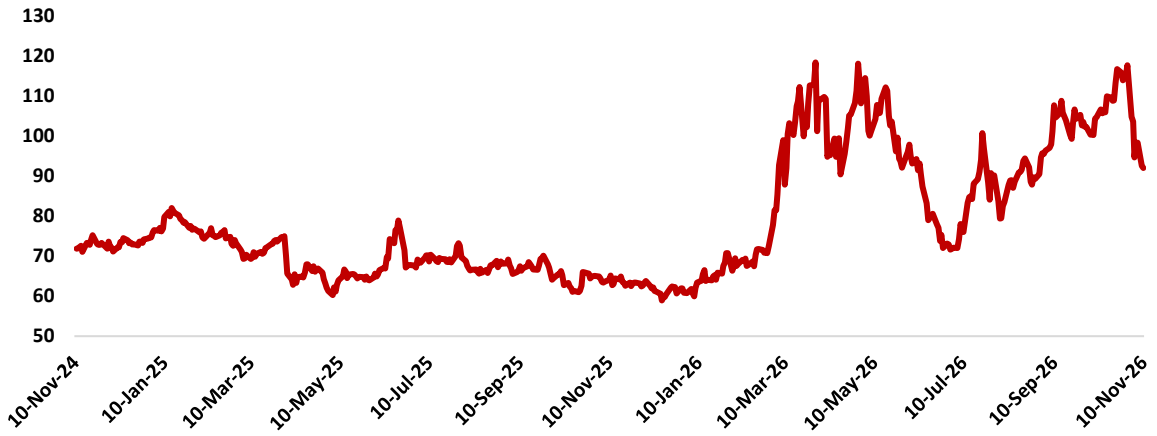


Sources: Bloomberg, Bank Islam

Brent Crude Oil: Key Market Focus

- Brent crude has emerged as the most important market variable heading into the week. The Brent price has now fallen to US$92.57/bbl, breaking below the critical 93.22-93.80 support zone highlighted previously.
- The decline reflects both geopolitical and fundamental factors.
- On the geopolitical front, comments from Donald Trump suggesting that further military action against Iran is unlikely if diplomatic negotiations continue have encouraged investors to unwind a significant portion of the geopolitical premium embedded in oil prices. At the same time, Qatar's mediation efforts have helped keep discussions active, reducing immediate concerns over disruptions in the Strait of Hormuz.
- Fundamentally, oil-market balances are also becoming less supportive. Estimates indicate global oil supply exceeded consumption by approximately 1.1 million barrels per day in September and 1.4 million barrels per day in October, suggesting the market is moving into surplus conditions.

Chart 7: Brent Crude Oil (USD per barrel)



Sources: Bloomberg, Bank Islam

Table 1: Brent Outlook

Scenario	Outlook
Bullish Scenario (30%)	Negotiations stall Strait of Hormuz tensions re-emerge Brent rebounds to above USD95 and retests USD100
Base Case (50%)	Diplomatic progress continues. Supply surplus persists. Brent trades within USD88-USD95.
Bearish Scenario (20%)	Sustained break below USD93. Market increasingly focuses on oversupply. Brent declines toward USD88.21.

- At present, risks appear tilted modestly toward further downside, especially if geopolitical concerns continue to ease.

Implications for Malaysia

- The recent decline in oil prices has important implications for Malaysia.
- From an inflation perspective, lower Brent prices are clearly positive. The moderation in global energy costs should reduce imported inflation pressures, lower transportation and logistics costs and support household purchasing power. It also reduces the risk of a resurgence in fuel-driven inflation, allowing headline inflation to remain relatively contained.
- For fiscal management, lower oil prices somewhat reduce petroleum-related government revenues. However, current Brent levels remain well above long-term fiscal assumptions and therefore do not pose immediate budgetary risks.
- For monetary policy, softer energy prices strengthen the case for Bank Negara Malaysia to maintain policy stability. Combined with contained domestic inflation and steady growth, there remains little justification for near-term adjustments to the OPR.
- From a financial market perspective, the stronger US labor market and elevated Treasury yields could continue generating intermittent pressure on the ringgit. However, lower oil prices may partially offset this through reduced inflation risks and improved macro stability.
- Importantly, Malaysia's economy is now considerably less dependent on crude oil than during previous commodity cycles. Domestic demand, services activity, tourism recovery, data-centre investments, semiconductor exports and AI-related infrastructure spending are increasingly important growth drivers. Consequently, a decline in Brent towards USD88-90 should not materially derail Malaysia's growth outlook, particularly if lower energy prices simultaneously support global disinflation and ease financial conditions.
- For the domestic bond market, MGS yields remain relatively stable, with the 10-year MGS currently around 3.836%. The spread against UST yields remains attractive, and lower global inflation expectations could ultimately provide support to the local fixed-income market.

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Week Ahead Outlook

- Markets will remain heavily focused on three developments:
  1) **US CPI Inflation -** The most important event of the week. Inflation will determine whether markets continue pricing a December Fed hike and whether Treasury yields remain elevated.
  2) **Brent's Break Below USD93 -** Markets will assess whether the decline reflects a genuine easing in geopolitical risks or a broader deterioration in oil-market fundamentals.
  3) **Global Risk Sentiment -** Particular attention will remain on technology stocks and whether weakness extends beyond Nvidia into broader semiconductor and AI-related sectors.

Conclusion

- The latest employment report confirms that the US economy remains resilient and that recession risks remain low in the near term. Consequently, the Fed is likely to maintain a cautious and restrictive policy stance. Meanwhile, Brent crude's break below the USD93 support zone introduces a potentially important disinflationary force into the global macroeconomic outlook. If sustained, lower oil prices could help moderate inflation expectations, reduce pressure on central banks and improve the outlook for importing economies, including Malaysia.
- For Malaysia, the balance of developments remains broadly constructive. While higher US yields may continue to generate external volatility, lower oil prices, manageable inflation, resilient domestic demand and ongoing investment activity should continue supporting economic growth and financial market stability over the coming quarters.

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