

04 March 2025

# US-Israel Strike on Iran

## Shifts markets from geopolitical tension to oil shock transmission

### OVERVIEW

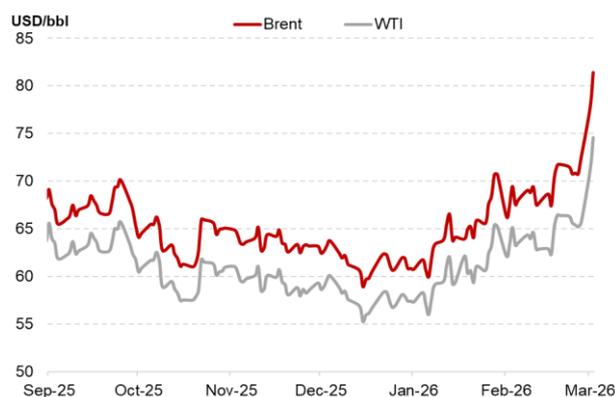
- The escalation from rhetoric to credible supply disruption risk in the Strait of Hormuz shifts oil from a cyclical story to a chokepoint shock. Roughly one-fifth of global oil flows is exposed. The macro outcome hinges on duration.
- This is a cost-push supply shock rather than a demand boom. Higher oil lifts headline inflation, delays easing cycles and reinforces USD strength. Global financial conditions tighten, particularly for energy-importing economies. Duration, not the initial spike, determines the macro impact.
- Malaysia may see higher fiscal revenue from stronger crude prices, but structural leakages limit the benefit. The ringgit no longer behaves like an oil proxy. Our regression evidence shows a positive Brent–USDMYR elasticity, meaning oil strength now coincides with currency weakness as USD dominance and subsidy exposure offset commodity gains.
- Two paths dominate. A short disruption triggers oil retracement, with limited macro fallout and a stabilising ringgit. A prolonged supply shock pushes oil above USD100.0/barrel (bbl), revive global inflation, delay easing cycles and strengthen the USD structurally. In that scenario, Malaysia may face slower growth despite higher petroleum revenue.
- The decisive variable is duration of physical disruption. We maintain our 2026 forecasts (GDP 4.5%, inflation 1.9%, USDMYR 3.95) for now, although risk dispersion has widened. In short, Malaysia's oil cushion has weakened structurally.

### CONTEXT

#### Escalating war in the Middle East

- The escalation following US–Israel strikes on Iran, including reported declarations that the Strait of Hormuz is “closed,” marks a shift from geopolitical tension to credible supply disruption risk.
- The Strait handles roughly 20.0% of global oil flows and a significant share of liquid natural gas (LNG) shipments. This is not a demand-driven oil rally. It is a cost-push shock with direct financial tightening implications.
- Two scenarios matter. A short disruption lasting days or a couple of weeks, would see the oil spike fade and risk premia unwind. A prolonged disruption lasting weeks or months raises the risk of oil above USD100.0/bbl, revives inflation pressures, delays global easing cycles and structurally strengthens the USD.
- Bloomberg Economics estimates that roughly USD19.0/bbl of the current ~USD81.0/bbl Brent price reflects war-related risk premia as of 3 March. Around USD6.0/bbl had already been embedded prior to active hostilities, as markets priced rising geopolitical probability from mid-January. The premium accelerated following the 28 February US–Israel strikes on Iran. Should tensions de-escalate swiftly and flows normalise, Brent could retrace toward sub-USD70.0/bbl levels as risk premia unwind.

Graph 1: Crude Oil Prices



Source: Bloomberg, Kenanga Research

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- At this stage, we are not revising our growth, inflation or USDMYR forecasts because the macro outcome depends largely on how long flows remain disrupted. However, the risk distribution has widened materially. Most importantly for Malaysia, higher oil prices no longer translate into currency support. The oil cushion has weakened structurally.

## GLOBAL TRANSMISSION

### • The nature of the shock

- This episode differs fundamentally from cyclical oil rallies. It does not reflect a demand boom or a synchronised global upswing. It reflects a chokepoint supply shock layered onto fragile global trade conditions. If enforcement of restrictions in the Strait of Hormuz persists, shipping rerouting will raise freight costs, sharply raising insurance premia, and will draw down inventory buffers. LNG markets will tighten alongside crude markets. Even partial disruption will tighten global financial conditions.
- The transmission mechanism is straightforward. Higher oil lifts headline CPI, which raises inflation expectations. Elevated expectations slow central bank easing which should support the USD. A stronger USD tightens financial conditions across emerging markets. This oil shock therefore acts as a monetary tightening amplifier rather than a growth accelerator.

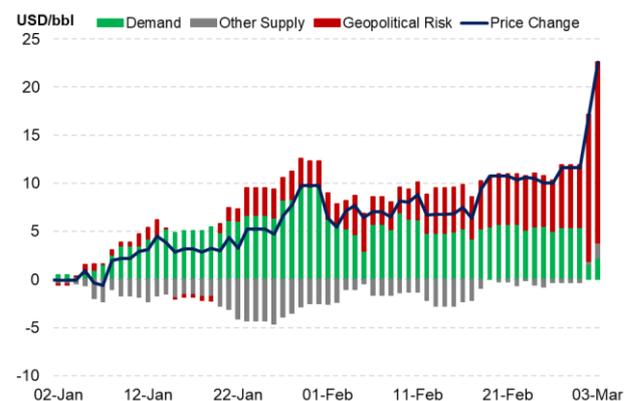
### • The US: Inflation Vs Growth

- For the US, the shock creates policy asymmetry. On the inflation side, gasoline feeds directly into CPI. Headline inflation will rise quickly if oil stabilises at higher levels. Inflation expectations may drift upward if energy prices remain elevated.
- On the growth side, higher fuel costs squeeze household real incomes. Consumer confidence softens. Financial conditions tighten as the USD strengthens and volatility rises. Although the US produces significant energy domestically, higher oil prices remain a net negative for households and consumption.
- For the Fed, materially higher oil prices raise the hurdle for rate cuts. The higher-for-longer bias strengthens. Rate hikes remain unlikely unless second-round inflation effects emerge, but the bar for easing rises meaningfully. Markets now price in two cuts for 2026, one in July and another in December.
- Our base case remains a delay in easing rather than renewed tightening. We continue to expect two rate cuts in 2H26. However, that view depends on the duration and severity of the conflict. If oil remains elevated for an extended period, the Fed's guidance will turn more cautious and USD support will strengthen further. Brent crude has risen by 12.3% to USD81.4/bbl as of March 3 from around USD72.5/bbl before the attack on Iran.

### • Europe and Asia: Greater energy vulnerability

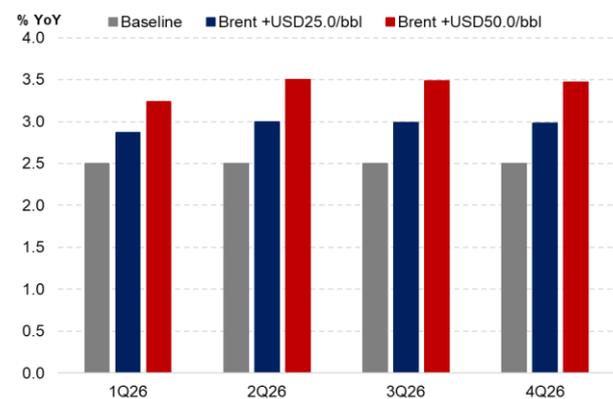
- The eurozone remains structurally exposed to energy shocks. It depends heavily on imported crude oil and LNG while growth momentum remains fragile. An oil spike would lift inflation and weaken business activity, producing a classic stagflationary impulse.

Graph 2: Bloomberg Economics Drivers Model for Brent



Source: Bloomberg Model, Kenanga Research

Graph 3: Impact on US Inflation



Source: Bloomberg SHOK Model, Kenanga Research

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- Asia faces similar exposure. Many economies carry higher energy weights in their CPI baskets, and most remain net energy importers. A sustained oil rally would deteriorate trade balances and raise inflation risks across the region.
- Historically, energy shocks reinforce USD strength. During the 2022 surge, energy-importing currencies underperformed sharply. The key difference today is that global inventories are healthier than in early 2022.
- However, the share of global flows exposed through Hormuz is substantial. If disruption persists, duration will dominate inventory comfort. Duration remains the decisive macro variable.

- **Malaysia: Revenue gains Vs Structural exposure**

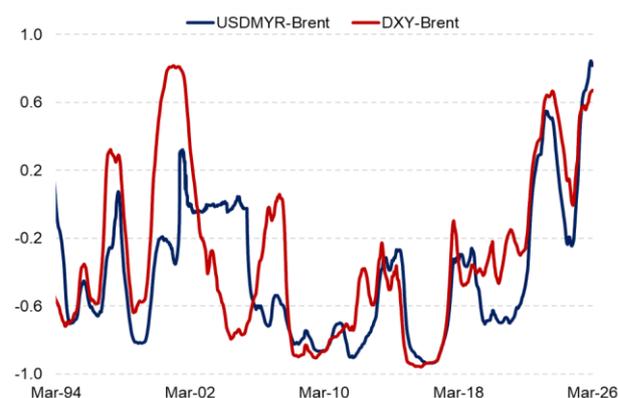
- At first glance, Malaysia appears insulated. The country is still a net energy exporter. Nevertheless, higher crude oil and gas prices support fiscal revenue through petroleum-linked income, particularly via government-controlled Petronas. Government income rises through petroleum taxes and dividends, and the current account benefits from oil and gas exports.
- However, Malaysia is also a net importer of petroleum products. While it produces crude, it imports a meaningful share of refined fuels. This structural feature limits the net external gain from higher global oil prices. Malaysia's contribution to global oil supply remains relatively small. As a price taker in global markets, it cannot materially influence supply dynamics.
- While higher crude prices lift upstream revenues, they simultaneously increase the fiscal cost of maintaining broad fuel subsidies. Under the BUDI95 framework (RON95 fixed at RM1.99/litre), a sustained rise in global oil prices would widen the subsidy gap. For reference, the current unsubsidised RON95 price stands at RM2.59/litre, broadly unchanged from RM2.60/litre at the programme's introduction in September 2025, though this may adjust higher to reflect Brent's elevated levels during the 5-11 March week.
- Over time, sustained oil increases will raise transportation and production costs across the economy. Businesses will gradually pass these increases through supply chains and inflation expectations may shift higher if cost pressures persist. Shipping and insurance costs pose an additional risk and both exporters and importers will face higher costs. These pressures transmit more quickly than petroleum revenue gains.
- In short, a short spike in oil may deliver a mild terms-of-trade benefit. A prolonged disruption would likely prove growth negative with inflation pressure and rising fiscal burdens.

## DE-COMMODITISATION OF THE RINGGIT

- A decade ago, global markets traded the ringgit as a direct beneficiary of energy spikes, where a rise in Brent acted as a fiscal and trade windfall for Malaysia. At that time, the USD typically moved in the opposite direction of oil prices. However, our regression analysis confirms that this historical link is not just broken but has fundamentally inverted. In the current macro environment, the ringgit no longer gains from higher energy prices; instead, it is being penalised by them.

- The tactical implication of this shift is clear. A log-log regression over the past three years yields a statistically significant Brent elasticity of +0.3 for USDMYR, implying that a 1.0% increase in Brent is now associated with approximately 0.3% depreciation in the ringgit. In the event of a major supply disruption in the Strait of Hormuz pushing Brent to or above USD100.0/bbl, the ringgit could face a 6.0-9.0% depreciation pressure from the oil channel alone, independent of broad USD strength. The ringgit now trades with the vulnerability of a net-importer emerging market (EM) currency. Energy rallies now hurt rather than help.

**Graph 4: Rolling Three-Year Correlations**



Source: Bloomberg, Kenanga Research

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- When Brent and the DXY rise together during inflation shocks, USD safe-haven demand overwhelms commodity-linked support. Malaysia may benefit economically from higher oil prices, but the ringgit does not automatically benefit financially. The currency now trades more like a high-beta EM currency than a traditional oil proxy.

## SCENARIO FRAMEWORK

- Scenario 1: Short Conflict
  - If disruption lasts only days, oil prices should retrace. The Fed's policy path would remain broadly intact. USD momentum would moderate, and the ringgit would stabilise. Macro damage would remain limited.
- Scenario 2: Prolonged Disruption
  - If disruption extends for weeks or months, oil above USD100.0/bbl becomes plausible. Freight rerouting would persist. Inflation would re-accelerate globally. Central banks would delay easing cycles. The USD would strengthen structurally. EM currencies would weaken. Malaysia's growth would slow despite higher petroleum revenue. This environment would resemble a stagflationary episode.

**Table 1: Scenario Matrix**

Variable	Short Shock	Prolonged Shock
Brent	USD80.0-90.0/bbl	>USD100.0/bbl
US CPI	Temporary lift	Persistent rise
Fed	Minor delay	Cuts postponed
DXY	Short spike	Sustained strength
MYR	Volatile	Depreciation bias

Source: Kenanga Research

## CONCLUSION & OUTLOOK

- The central issue is not rhetoric but whether physical energy flows remain constrained and for how long. At this stage, we are not revising our key 2026 macroeconomic forecasts (GDP: 4.5%, Headline inflation: 1.9%, end-year USDMYR: 3.95) because the duration of conflict remains uncertain. However, the distribution of risks has widened meaningfully.
- Malaysia's oil cushion has weakened structurally. The country exports crude but imports refined products. Higher prices lift fiscal revenue in the short term but raise subsidy burdens and cost pressures over time. Shipping and insurance risks add another layer of exposure.
- If the disruption persists, USD direction will dominate ringgit performance. In this regime, oil strength does not guarantee currency strength. We continue to monitor developments closely.

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