AmBank Group

AmBank Economics

#WhatWeThink

Interest rate differentials make the difference — Revising our USD/MYR projections

30 May 2025

We recently revised our USD (i.e., DXY Index) quarterly forecasts up to 3Q2026. The USD revision considers fresh drivers and macro outlook, especially accounting for developments concerning global tariff disputes/discussions. Regarding USD/MYR revisions, we take in fresh developments not only on the global front but also on the domestic side. Our forecasts expect USD/MYR to end the year at 4.370 and towards a firmer 4.300 by end-2026.

Our USD/MYR forecast considers the following factors:

1) A relook at Malaysia's macroeconomic prospects. Inflation numbers so far this year have been benign despite a solid labour market, while GDP growth has been trending lower than most economists' expectations. Our view on inflation, unemployment, and GDP supports our OPR outlook, which is that we expect a BNM rate cut in 2H2025 before holding at 2.75% OPR for the rest of our forecast horizon. Meanwhile, Malaysia's Current Account (CA) surplus is a modest positive factor for the MYR.
2) Policy rate movements and interest rate differential expectations, specifically the OPR vs. the FFR. Interest rate differentials are expected to be increasingly positive for MYR, as the Fed is expected to be more active in rate cuts vis-à-vis BNM.
3) Fiscal performance outlook and debt-to-GDP. In other words, we take Malaysia's credit outlook into account. Fiscal consolidation supports demand for Malaysia's bonds and MYR.

Key event drivers that may drive USDMYR swings in the near-term include: 1) Further developments on the US tariffs front (legal challenges, terms of trade negotiations and a possible reimposition of 'reciprocal' tariffs), 2) Incoming US data (inflation and labour markets), 3) Potential Asian FX volatility such as the CNH and TWD, and 4) Market reaction to details on RON95 subsidy rationalisation.

AmBank's updated forecasts

	3Q2025	4Q2025	1Q2026	2Q2026	3Q2026	4Q2026
USD/MYR	4.400	4.370	4.340	4.320	4.310	4.300
Previous AmBank forecast	4.480	4.450	NA	NA	NA	NA
Bloomberg median consensus	4.250	4.260	4.250	NA	NA	4.200

Revising our MYR projections

We are revising our USD/MYR forecasts to account for developments both globally and domestically.

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Our USD/MYR forecast considers the following factors:

Interest rate differentials are expected to be increasingly positive for MYR.

We lean toward an Overnight Policy Rate (OPR) cut by Bank Negara Malaysia (BNM) in 2H2025.

We expect FFR to reach 4.00% (upper bound) (now 4.50%) by end-2025, may quickly reach 3. 50% by 2026, and end 2027 at 3.00%.

1) **Policy rate movements** and **interest rate differentials** expectations, specifically MYR vs. Fed rates. Interest rate differentials are expected to be increasingly positive for MYR.
   - We lean toward an Overnight Policy Rate (**OPR**) cut by Bank Negara Malaysia (BNM) in 2H2025, in view of the anticipated slowdown in economic growth momentum. A rate cut could materialise as early as the next Monetary Policy Committee (MPC) meeting, which coincides with the end of the 90-day US reciprocal tariffs pause on Malaysia.
   - Meanwhile, our expectation of the Fed Funds Rate (**FFR**) is maintained, where we assume a larger quantum of interest rate cuts by the Fed vs BNM. In our base case, our assumption is for the FFR to reach 4.00% (upper bound) (now 4.50%) by end-2025 and may reach 3.50% by end-2026 and end-2027 at 3.00%.
   - We revised our DXY forecasts to be lower after the recent ease in market volatility. We now expect the DXY Index to end 2025 at 100.00 vs. our previous forecast of 106.0. Our USD projection is based on the following factors:
     - Interest rate differentials of USD will progressively be negative for the USD vs. major currencies, as we assume continued gradual Fed rate cuts.
     - Risks to US growth remain on the downside. We did not fully account for the tariff impact and Moody's US sovereign rating downgrade in our previous USD forecast.
     - We maintain our outlook for US inflation to progressively decline towards the Fed's 2.0% target by end-2027.
     - Lowering the factor of the USD as a safe-haven currency. Previously, our expectations assumed trade war risks would elevate the USD as a safe-haven. This notion has more recently been placed with some doubts based on the past month's reported trend of funds fleeing from USD and USD assets. Meanwhile, the US sovereign credit remains a function in our forecast model, whereby higher debt-to-GDP contributes to a higher USD value as investors pick up US government debt. On the other hand, higher debt-to-GDP lifts US Treasury yields, as seen in this month's episode when yields rose on the back of Moody's US sovereign rating downgrade from AAA.

Our view of Malaysia's inflation and GDP outlook supports our view for a BNM rate cut in 2H2025.

2) A relook at Malaysia's economic **growth** and **inflation** prospects.

- **Inflation** numbers so far this year have been benign and on the lower side of most economists' expectations, though core inflation, which excludes administered prices such as fresh foods and fuel, held steady at near its long-term average of 1.9% for the second straight month in March before rising to 2.0% in April. Our view aligns with BNM's that price pressures will remain contained without demand-pull factors. Any inflationary risk is expected to be supply-side induced, such as the planned Sales & Services Tax (SST) expansion, RON95 subsidy rationalisation and electricity tariff hike. Benign inflation and a strong labour market suggest the economy remains resilient, though growth may moderate in the coming quarters as post-pandemic momentum fades or policy effects take hold. Should the government proceeds with the said inflationary measures, we believe inflation will still be largely contained but the impact may manifest through muted consumer spending and confidence instead.
- Malaysia's **GDP** has been coming in lower against expectations. We note Malaysia's 1Q2025 GDP final reading came in at 4.4% y/y, which equals the advance estimate but was below the consensus of +4.5% y/y. The 1Q2025 growth rate was lower vs. 4.9% y/y in 4Q2024 (downward revised from 5.0% y/y). Domestic demand fell in 1Q2025 at a 6.0% y/y pace from 6.4% y/y in 4Q2024, with fixed capital formation down to 9.7% y/y from 11.8% in 4Q2024. Consumption expenditure growth was less resilient at 4.9% in 1Q 2025 versus 5.0% y/y in 4Q2024.
  - Given the softer-than-expected 1Q2025 GDP outcome – relative to our initial assumptions when the full-year forecast was set – and the growing downside risks to growth stemming from recent external developments, we **are revising down our 2025 full-year GDP growth forecast to 3.8%, from 4.6% previously**. While growth is expected to hold up relatively well in 2Q2025 as frontloading activity continues, momentum will likely slow further in the 2H2025.

. We find Malaysia's Current Account (CA) surplus to be a modest positive factor for the MYR

- Trade/exports, and **Current Account** expectations. Malaysia's Current Account (CA) surplus is a modest positive factor for the MYR. Theoretically, a surplus in the CA means the country is spending less on foreign exchange than it demands. Our expectation for Malaysia's CA is for a positive monthly number (1-2% of GDP) in 2025-2026, inputting into our MYR forecast model. Meanwhile, a positive trade balance (exports>imports) would mean a country would have less demand for foreign exchange, which is positive for its currency. However, Malaysia's positive trade balance is found to be a very small negative factor for MYR (coefficient of <0.000001), probably because export earnings are in USD and need to be exchanged into MYR to boost our currency. We note foreign exchange deposits vs. total deposits in Malaysia have increased from 7-8% in 2015 to 10-11% by end-2024 (and which exacerbated the MYR weakness in 2023-2024 when USD/MYR rose above 4.500). We do not input foreign exchange deposits ratio into our MYR forecast model but expect the ratio to sustain near preexisting levels in 2025-2026.

Fiscal consolidation supports demand for Malaysia's bonds and MYR.

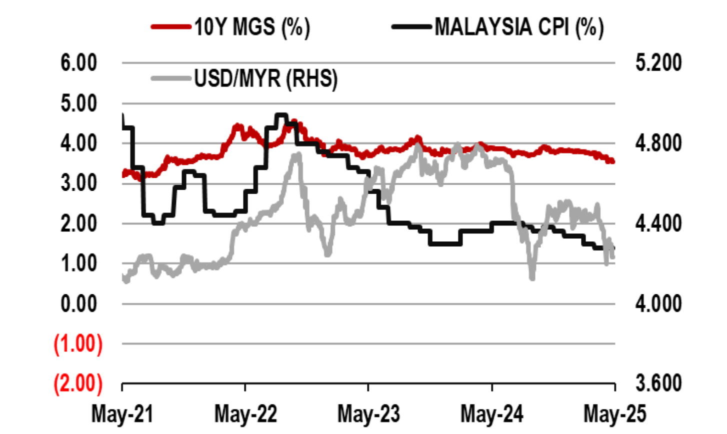
3) Fiscal performance outlook and **debt-to-GDP**. In other words, we consider Malaysia's credit outlook. Official numbers placed the federal government debt-to-GDP at 63.1% in 2024, commensurate with the federal budget deficit of 4.3% of GDP. If 2025 federal budget deficit falls to 3.8% of GDP (as per Budget 2025), and Malaysia's aim for fiscal consolidation progresses as planned in the longer term then there is hope for the debt-to-GDP ratio to decline and aim for the 60% level (60% of GDP within 3-5 years is the target under Malaysia's Public Finance and Fiscal Responsibility Act of 2023). For the purpose of our MYR model, and to ensure a conservative projection for MYR in 2025-2026, we use the central government debt-to-GDP data and assume the monthly level to hover at 62-64% in our forecast horizon. Our model finds that a higher ratio is a very modest negative for MYR. A lower ratio would mean the government's debt is falling vis-à-vis GDP (and its creditworthiness gets a boost), increasing the attractiveness of Malaysia's bonds and sukuk for investors. It will boost MYR if foreign investors are likewise inclined to invest in Malaysia's debt market. We note that foreign holdings in Malaysian Government Securities (MGS) have continued to rise, from MYR201 billion at the start of 2024 to MYR208 billion in March 2024.

As we delved into the link between MYR and Brent, we noticed that their correlation has significantly declined.

4) Global commodity market, specifically Brent, though it is a factor in determining MYR, has fallen in recent years. As we delved into the link between MYR and Brent, we noticed that their correlation has significantly declined during post-COVID compared to pre-COVID. The latter shows a 76% correlation in our model compared to the former, 35%. Before Covid-19, the ringgit maintained a strong correlation with oil prices, strengthening when oil prices rose due to increased export revenues and improved investor confidence.

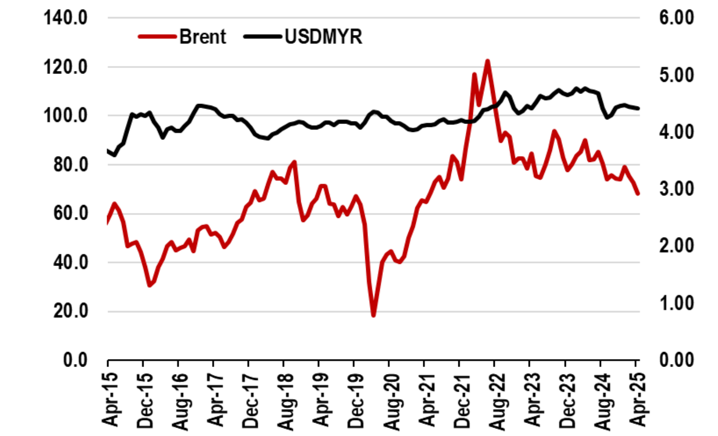
We find that more recent years have seen MYR impacted more by interest rate differential movements, interest rate policy, and movements vs. the USD being a safe-haven currency (i.e., ringgit depreciations vs. USD amid global economic headwinds such as geopolitics and COVID-19). Meanwhile, post-pandemic, Malaysia shifted further away from oil dependence by diversifying its economy, prioritising foreign direct investment, tourism, the digital economy, and manufacturing. FDI soared to MYR174 billion (USD40 billion) in 2024, supporting industrial and technological expansion, while tourism rebounded to 96% of pre-pandemic levels, bolstered by visa-free policies for Chinese and Indian visitors. Domestic demand also played a crucial role, driven by wage growth, higher government cash transfers, and civil servant salary adjustments. Malaysia further reinforced economic resilience by accelerating the adoption of digital infrastructure, e-commerce, and remote work. Streamlined trade and investment policies also positioned the country as a regional manufacturing hub, stabilising its economy and reducing reliance on oil revenues. Relatively, oil price is now a smaller factor in our latest MYR modelling. Our projection for Brent is at USD70 pb average in 2025-2026.

Exhibit 1: Malaysia CPI vs 10Y MGS vs USD/MYR



Sources: Bloomberg, AmBank Economics

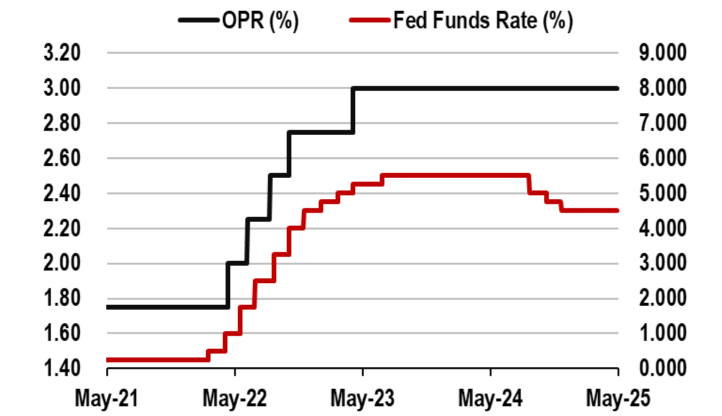
Exhibit 2: Brent vs USD/MYR



Sources: Bloomberg, AmBank Economics

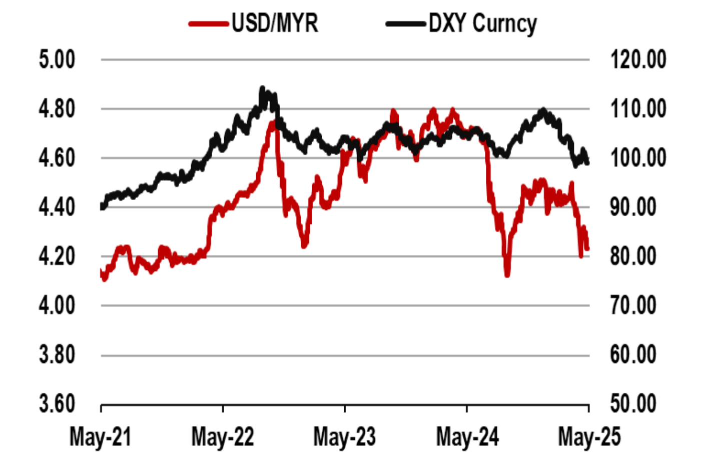
Exhibit 3: OPR vs FFR

US interest rate policy lags majors. Our base case assumes FFR to hit 3.00% end-2027.



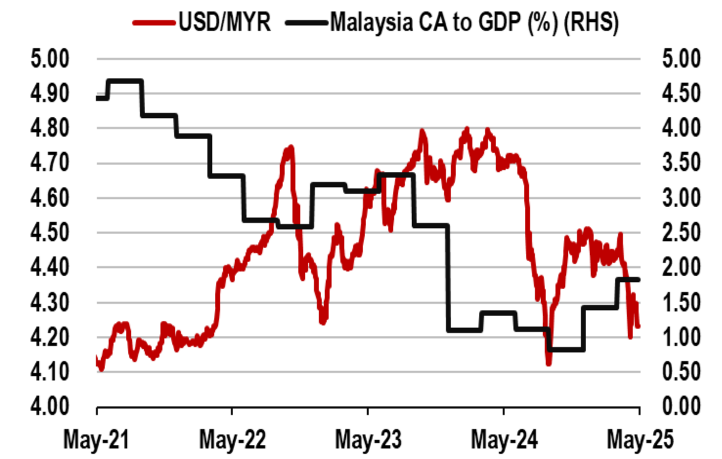
Sources: Bloomberg, AmBank Economics

Exhibit 4: DXY vs USD/MYR



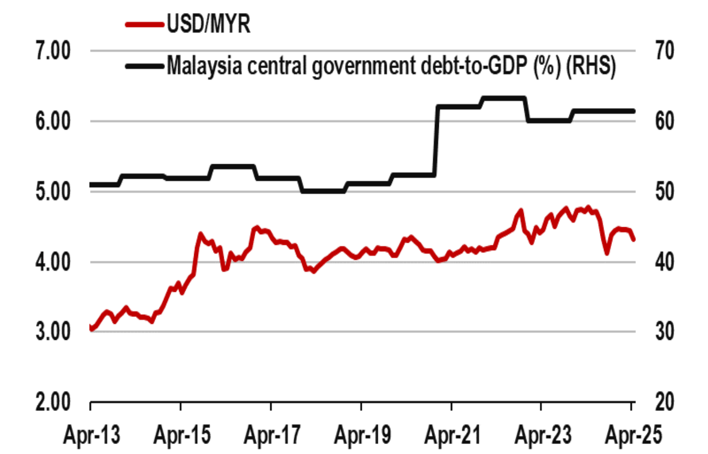
Sources: Bloomberg, AmBank Economics

Exhibit 5: Malaysia's CA vs USD/MYR



Sources: Bloomberg, AmBank Economics

Exhibit 6: Malaysia's Debt-to-GDP vs USD/MYR



Sources: IMF, Bloomberg, AmBank Economics

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