AmBank Group

AmBank Economics

#WhatWeThink

Investment upcycle narrows external surplus, but twin deficit risks contained

30 September 2025

Snapshot Summary…

- Malaysia has consistently maintained at least one surplus since 1993, with the current account remaining surplus post-1998, driven by exports.
- Pro-growth policies and countercyclical support have resulted in fiscal deficits, which are acceptable given the government's credible track record in fiscal management.
- The sharp narrowing of Malaysia's current account surplus to just 0.1% of GDP in 2Q2025 has raised some concerns, but it primarily reflects an investment upcycle driving capital goods imports.
- We opine that the risk of a twin deficit remains limited. While the current account surplus may stay relatively narrow and positive in the near term, supported by Malaysia's diversified and resilient export base.

Macroeconomic Variables

	2023	2024	2025F*
Real GDP (y/y%)	3.6	5.1	3.8
Nominal GDP (y/y%)	1.6	5.9	3.2
Fiscal balance (% GDP)	(5.0)	(4.1)	(3.8)
Current account balance (% GDP)	1.1	1.4	1.1

**Forecast by AmBank Economics*
Sources: Department of Statistics Malaysia (DOSM), AmBank Economics

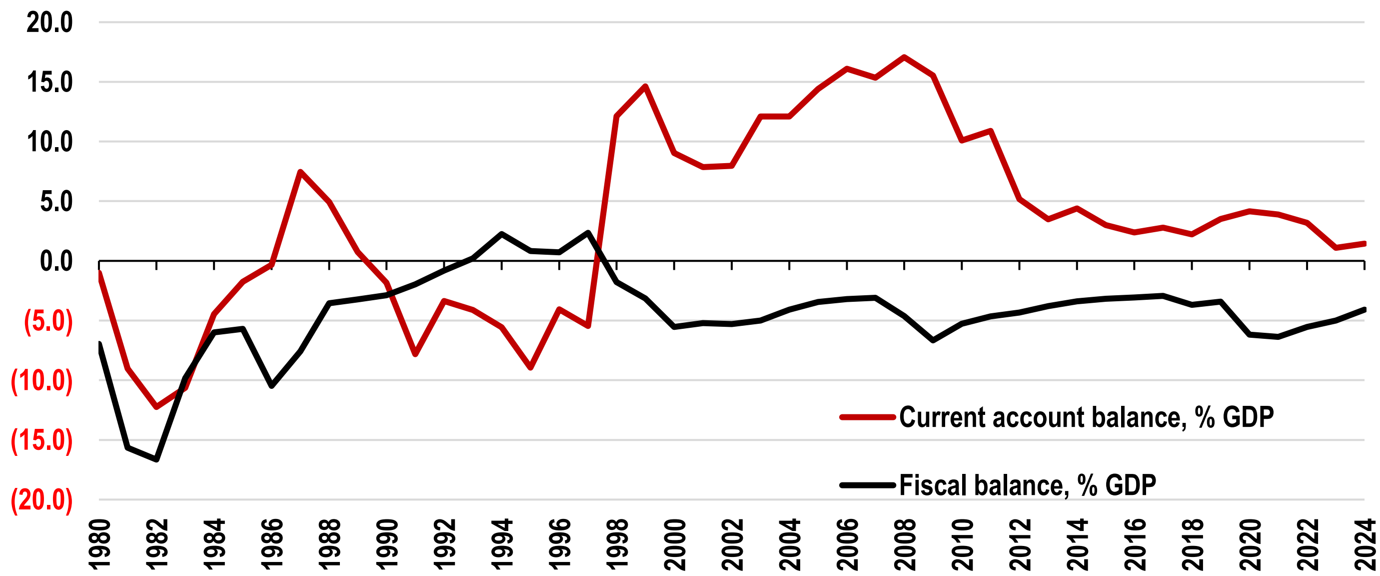
Consistent current account surplus since 1998

Malaysia has largely avoided twin deficits – where both the fiscal and current accounts (CA) are in deficits – except the 1980s and early 1990s, when the two balances tended to move closely together. Since 1993, however, the country has consistently maintained at least one surplus, and post-1998, a noticeable divergence in its trajectories has emerged. The gap between the fiscal and CA balances steadily widened over time. This is partly because developments in the current account are closely tied to trade balances, which have remained in surplus since the country began promoting industrialisation and export-led growth.

Malaysia's fiscal balance has been in deficit since the 1970s, before the country witnessed robust economic growth, which contributed to reducing the fiscal deficit. For the record, the country achieved a fiscal surplus for five years in a row, from 1993 to 1997, thanks to the government's effort to reduce the fiscal deficit seriously and progressively.

However, Malaysia reverted to its budget deficit in 1998 amid the Asian Financial Crisis (AFC) due to implementing stimulus packages to mitigate the crisis, similar measures being undertaken during the Global Financial Crisis (GFC) in 2007-2008. In fact, it rose significantly during COVID-19, reaching around RM98.8 billion and RM99.5 billion, which translated into 6.4% and 5.5% of GDP in 2021 and 2022, respectively.

Exhibit 1: Fiscal vs. current account balance, % of GDP



Sources: DOSM, AmBank Economics

Fiscal deficits can be tolerated when managed well.

Fiscal deficit can be a necessary and constructive tool.

When managed responsibly, running a fiscal deficit is not inherently a cause for concern. It can be a necessary and constructive tool to finance pro-growth policies and countercyclical support during a downturn. As long as deficits remain manageable—supported by a stable external position and efforts to broaden the revenue base—they are generally considered acceptable.

The government's commitment to fiscal consolidation is evident.

The government's commitment to fiscal consolidation is evident in the steady reduction of its deficit, from a pandemic-peak of 6.4% of GDP in 2021 to 4.1% in 2024. Fiscal performance in 1H2025 suggests further progress, with the deficit on track to meet the government's target of 3.8% for the year, reinforcing the credibility of its fiscal management.

Continued prudent spending.

Expenditure discipline has improved. Only 44.8% of the full-year budget was spent in 1H2025, down from 48.5% in 1H2024, with the amount spent declining 1.3% year over year. Prime Minister Anwar's recent special announcement to incur an additional RM2.8 billion in spending represents less than 1% of the total Budget 2025 allocation, indicating continued prudence.

Continued labour market tightness is poised to facilitate a greater inflow of revenues.

On the revenue side, collections rose by 6.1% in 1H2025. Continued labour market tightness is poised to facilitate a greater inflow of revenues, particularly from the expansion of the Sales and Service Tax (SST) beginning in July 2025. This should help offset weaker oil-related receipts amid softer crude oil prices.

We believe the government retains the flexibility to adjust the pace of fiscal consolidation should economic headwinds intensify

Moving forward, we believe the government retains the flexibility to adjust the pace of fiscal consolidation should economic headwinds intensify. For instance, it could consider bringing forward the planned emolument review from January 2026 to 2H2025 to support private consumption. Given Malaysia's past good track record of fiscal management, international credit rating agencies are likely to accommodate such strategic adjustments.

Narrowing the current account surplus reflects robust investment activity.

CA surplus narrowed from 3.4% of GDP in 1Q2025 to a merely just 0.1% of GDP in 2Q2025

The biggest concern was when the latest data, specifically on the CA, registered a sharp decline in 2Q2025 – narrowing significantly to RM0.3 billion from RM16.7 billion in the previous quarter, highlighting a weakening external position following softer trade performance amid global uncertainties. Malaysia's CA deficits in the last decade reflected the movements of foreign direct investment (FDI), which moderated to RM1.6 billion in 2Q2025 against RM15.6 billion in the previous quarter. The surplus may be fragile because CA narrowed from 3.4% of GDP in 1Q2025 to just 0.1% of GDP in 2Q2025.

The narrowing CA balance is attributable to the narrowing trade surplus.

We notice that the narrowing CA surplus is attributable to the narrowing trade surplus, as the relationship between these two data in terms of percentage to GDP is quite strong, over 98%. To investigate further, the impulse response function (IRF) is used to examine the interactions between the variables – the responses of the CA balance to the trade balance. Based on the outcome, while the effect may not be statistically significant, a shock in trade balance does lead to a mild, delayed response in CA balance (*See Exhibit 4, top right chart*)

Investment upcycle spurs imports of capital goods.

The narrowing of the trade surplus reflects external challenges and an investment upcycle driving higher imports. This is evident in gross fixed capital formation (GFCF), which has recorded double-digit growth since 2Q2024, spurred in part by a surge in the construction of data centres and infrastructure developments.

Notably, imports of capital goods surged by an average of 37.5% in the first eight months of 2025, while imports of consumer goods increased by just 1.4% over the same period. This composition suggests that the external position is adjusting constructively, with higher investment-related imports supporting future growth potential rather than signalling excessive domestic consumption. At the same time, the financial account deficit has narrowed, indicating higher investment inflows that are helping finance the rise in capital goods imports.

CA surplus is likely to remain relatively narrow.

BNM views the narrowing of the current account surplus as "temporary," expecting a rebound once key private sector projects reach completion in 2H2025. While we do not see the current account falling below its 2Q2025 level, it could remain relatively narrow. Exports will likely be weighed down by dissipating frontloading effects and broad-based softness in external demand.

Twin deficits remain an unlikely risk.

We opine that the risk of a twin deficit remains limited. While the current account surplus may stay relatively narrow in the near term, it is expected to remain in positive territory, supported by Malaysia's diversified and resilient export base. We project the CA surplus to ease to 1.1% of GDP in 2025 from 1.4% in 2024, below BNM's projection range of 1.5%- 2.5%. Nonetheless, Malaysia's still-robust external position, alongside the government's credible fiscal management, will continue to provide a buffer against external shocks.

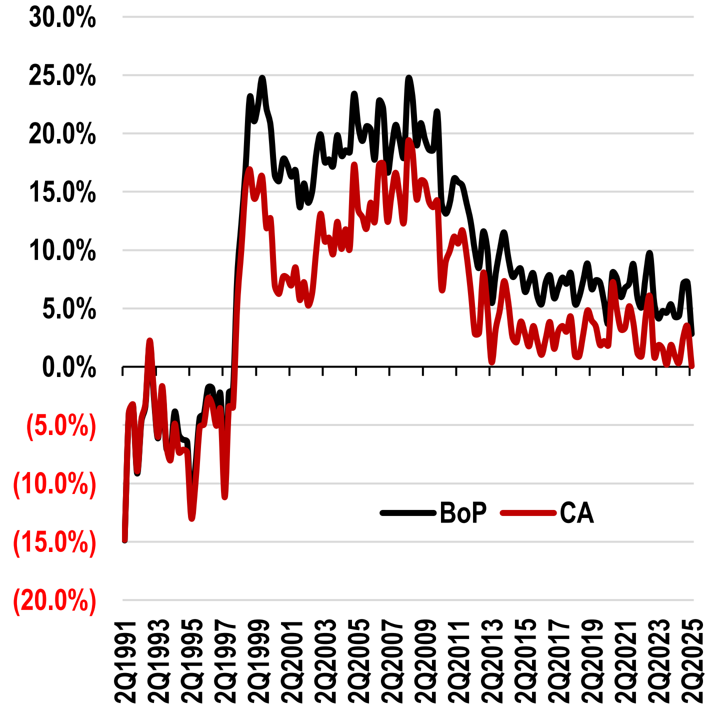
Downside risks

The unlikely risk of twin deficits is not automatic. The government should take proactive steps to ensure such a probability remains low for longer. That said, our take on the issue entails an assessment that CA will continue to remain narrow even after the investment upcycle peaks.

There are 3 reasons to support our assessment. Firstly, we believe there will be a moderate increase in services exports following the completion of the data centre's construction. Secondly, Malaysia's wage growth will likely continue, albeit at a smaller pace, which could fuel higher goods and services imports should the ringgit hold its value better than other regional currencies. And thirdly, reversing the CA narrowing trend involves supply-side reforms, particularly import substitution policies, which are slow and may also be politically sensitive. Furthermore, a higher wage level could limit the investments needed for import substitution, primarily in key inflation-related sectors such as food and beverages, accommodation/real estate and transportation.

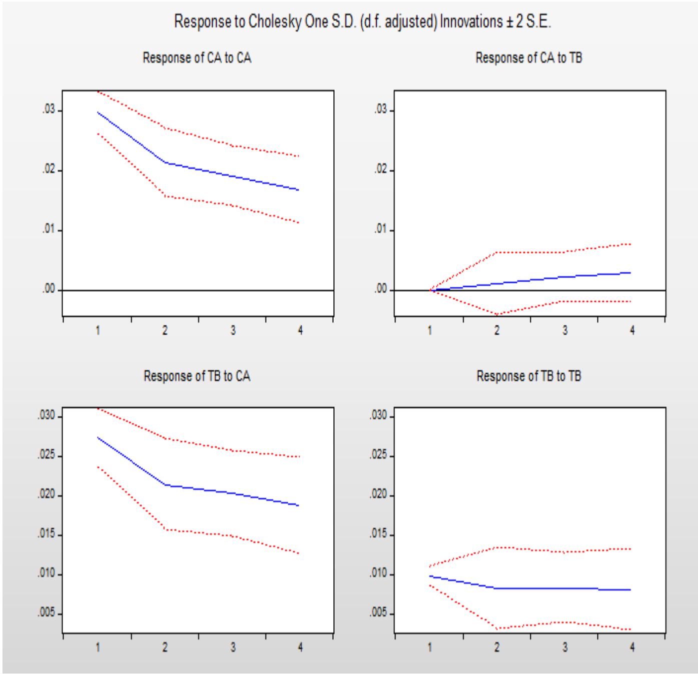
In sum, Malaysia's CA narrowing is not a cyclical anomaly but a structural evolution in the economy's macroeconomic landscape over the past decades. To prevent twin deficits, policymakers should redefine Malaysia's macroeconomic objectives to improve its long-term prospects.

Exhibit 2: Balance of payment vs. Current Account, % of GDP



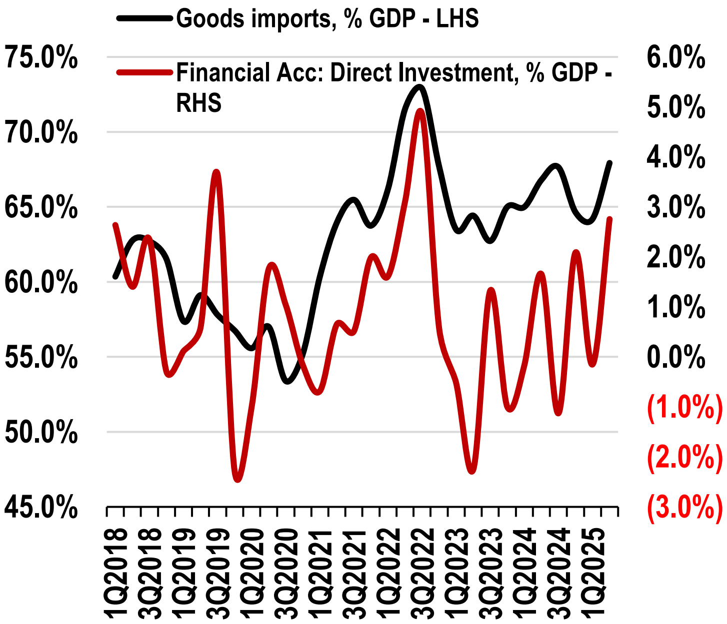
Sources: DOSM, AmBank Economics

Exhibit 3: IRF test between Current Account and Trade Balance



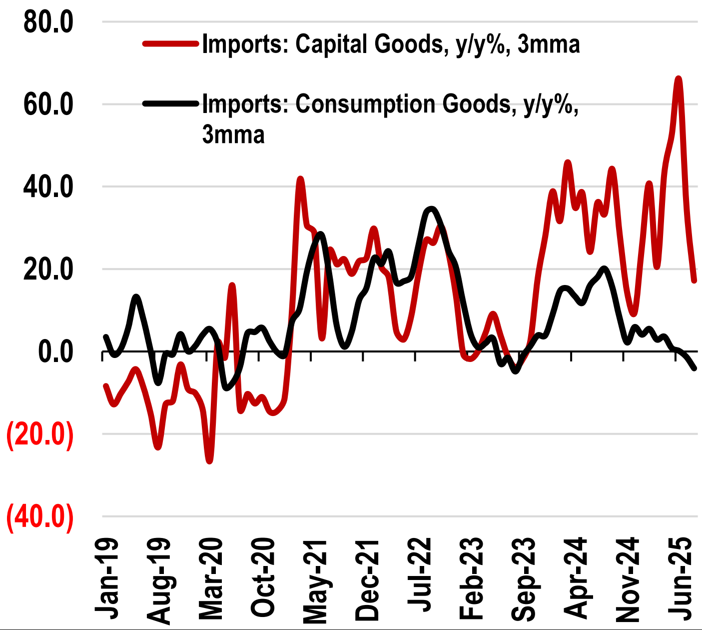
Sources: Eviews, AmBank Economics

Exhibit 4: Direct investment flows vs. goods imports, % of GDP



Sources: DOSM, AmBank Economics

Exhibit 5: Imports of capital goods vs. consumption goods, y/y%, 3-month moving average (3mma)



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