2026 Macroeconomic Outlook:

From Acceleration to Calibration

AmBank Economics

Thursday, 22 January 2026

AmBank Group

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Introduction

In recent years, economists and analysts alike have tended to exhibit a downward bias in their expectations at the beginning of the year. This is understandable, as global macroeconomic conditions are becoming more fragile and increasingly exposed to shocks of varying magnitudes. While some turn out to be deleterious enough to cause markets to swing violently, others do not, as risks are mitigated early.

Global trade prospects were the most contentious issue of 2025. Nevertheless, trade did not suffer as initially feared but instead fared much better than baseline as traders rushed to meet tariff deadlines.

2026 is no different, sentiment-wise. The global economy started the year amid the geopolitical crisis in Latin America, which many analysts feared could spill over into other parts of the world and, by extension, into market volatility. Growth will calibrate, but not to a point that necessitates drastic policy intervention. Advanced economies appear no longer to be at odds with inflation as they were during the post-pandemic period, at least not as much, but rather with fiscal sustainability and the health of the labour market.

The Malaysian economy seems more predictable in 2026 than in recent years. Much of the policy heavy lifting has passed and will likely be in full swing in 2026 and beyond. That said, we believe the government will pursue targeted, household-centric policies to support positive macroeconomic indicators.

We also provide a short sectoral outlook for the aviation and tourism sectors in light of Visit Malaysia Year 2026. Malaysia's tourist arrivals in 2025 shot up drastically, surpassing pre-pandemic levels amid the ASEAN chairmanship and increased arrivals from neighbouring countries and China. Our constructive view of the aviation sector's prospects in 2026 is premised on reduced cost pressures (MYR strengthening and lower global oil prices, among others) and expanded regional connectivity.

The FX and FI markets performed well in 2025, with the record-strong MYR appreciation and the return of foreign investors to the government bond market. We do not expect a similar trajectory in 2026, despite our outlook of a narrowing of rate differentials and bond yields.

In sum, although we are more sanguine about the Malaysian economy in 2026 than at the beginning of previous years, we cannot rule out tail-risk events that could overturn our projections for the year.

Executive Summary

GLOBAL: Multilateral banks (MDBs), other than the International Monetary Fund (IMF), anticipate the global economy to moderate in 2026. Growth among advanced economies is expected to remain stable at 1.6-1.8%, while merging markets and developing economies (EMDEs) are expected to fare well, with growth rates of 4.0-4.2%. Southeast Asia's growth is expected to remain solid at 4.2%-4.4% in 2026.

KEY RISKS: As global energy prices moderate, global inflation is expected to remain under control throughout 2026. The IMF expects global inflation to continue its downward trend, reaching 3.8% in 2026 from 4.2% in 2025, though the disinflation rate is likely to decelerate in the coming years.

MAJOR ECONOMIES: Major economies have shown great resilience to growth headwinds in 2025, but growth will likely moderate in 2026. The precarious nature of the US labour market to growth is apparent, with non-farm payroll and average hourly earnings trending more than half of what they were at the beginning of last year. We expect two Fed rate cuts in 202 reflecting market consensus and evolving economic risks. Our view is anchored in the clear signs of labour market softening, which we believe the Fed may aim to pre-empt to mitigate downside risks. Meanwhile, MDBs expect the Euro Area's growth to continue at a sub-1.5% level in 2026, but marginally lower. Once again, MDBs project China's growth to trend below the 5.0% mark, even as headline inflation in China returns to positive territory.

MALAYSIA IN 2026: Malaysia's economy in 2025 has emerged stronger than anticipated. While the recently signed ART agreements provided greater clarity, the AI-driven semiconductor upcycle has underpinned a surge in exports and investment. We have revised our full-year 2025 growth forecast modestly higher to 4.9%, though this still represents a moderation from 5.1% in 2024. Looking ahead to 2026, we expect Malaysia's economy to remain resilient, with growth reaching **4.5%**. Upside risks include a prolonged semiconductor upcycle, a stronger global growth, a fiscal spending boost, and firmer tourism receipts amid the Visit Malaysia Year (VMY) 2026 campaign. Downside risks stem from persistent geopolitical and trade tensions, a more pronounced slowdown in major trading partners such as China, and the risk of a correction following the recent AI-driven investment boom. In the near term, Malaysia's exports will continue to be supported by the AI-driven semiconductor upcycle and favourable market access to the US.

OPR: Following the pre-emptive 25bps cut in 2025, we expect the Overnight Policy Rate (OPR) to remain unchanged at 2.75% throughout 2026, barring a significant shift in economic conditions.

RINGGIT: With gains of 10.1% against the USD in 2025, the MYR also strengthened against all Asian currencies and most major currencies (excluding the EUR and CHF). We believe that USD/MYR is likely to breach 4.00 in the coming weeks/months, though a consolidation below 4.00 is likely to occur only later in. Our call is also premised on continued risk-on sentiment in financial markets – including little geopolitical tensions between the US and China and unimpeded growth in the current AI supercycle – which has supported the ringgit via a stronger trade balance and portfolio inflows.

FIXED INCOME: We expect modest strengthening in Malaysian government bonds in 1H2026, followed by market consolidation in 2H2026. We place a year-end 3Y MGS forecast at 3.00%, pending more solid signals from BNM. Assuming a stable OPR at 2.75%, 10Y MGS should end the year at 3.50%, translating into a 50bps 10Y/3Y spread. Additionally, we believe that 2026 should see larger MGS+GII gross issuance.

AGENDA

Forecasts

	2024	AmBank Forecast	
		2025F	2026F
GDP, y/y%	5.1	4.9	4.5
Inflation Rate, %	1.8	1.4	1.8
Unemployment rate	3.1**	2.9*	3.0*
OPR, %	3.00**	2.75**	2.75*
USD/MYR	4.47**	4.06**	3.94*
10Y MGS (%)	3.82**	3.51**	3.50*
GDP by sector, y/y%			
Services	5.3	5.0	5.0
Manufacturing	4.2	4.4	2.8
Mining	0.9	1.3	1.1
Agriculture	3.1	2.4	2.4
Construction	17.5	12.3	11.8

*Notes: *Year-end forecast, ** Year-end actual*
Source: AmBank Economics

Sources: DOSM, BNM, AmBank Economics

Global growth forecasts: The A to C of growth

From Acceleration to Calibration: 2026 Macroeconomic Outlook

Following the unexpected growth acceleration in 2025, the world economy enters 2026 shaken but unstirred, transitioning into a more measured expansion. Our outlook rests on the view that policymakers and firms have adapted to persistent volatility, enabling growth to stabilise as the new year unfolds.

Forecasts	IMF				World Bank				OECD			
			Difference				Difference				Difference	
	Jan-26		Oct-25		Jan-26		Jun-25		Dec-25		Jun-25	
	2025	2026	2025	2026	2025	2026	2025	2026	2025	2026	2025	2026
World	3.3	3.3	0.1	0.2	2.7	2.6	0.4	0.2	3.2	2.9	0.3	0.0
Advanced economies/OECD	1.7	1.8	0.1	0.2	1.7	1.6	0.5	0.2	1.7	1.7	0.3	0.2
US	2.1	2.4	0.1	0.3	2.1	2.2	0.7	0.6	2.0	1.7	0.4	0.2
Euro Area	1.4	1.3	0.2	0.2	1.4	0.9	0.7	0.1	1.3	1.2	0.3	0.0
EMDEs	4.4	4.2	0.2	0.2	4.2	4.0	0.3	0.2	-	-	-	-
China	5.0	4.5	0.2	0.3	4.9	4.4	0.4	0.4	5.0	4.4	0.3	0.1
India	7.3	6.4	0.7	0.2	7.2	6.5	0.9	0.0	6.7	6.2	0.4	(0.2)

Forecasts	IMF				World Bank				ADB			
			Difference				Difference				Difference	
	Oct-25		Jul-25		Jan-26		Jun-25		Dec-25		Sep-25	
	2025	2026	2025	2026	2025	2026	2025	2026	2025	2026	2025	2026
ASEAN*	4.2	4.2	0.0	0.1	-	-	-	-	4.5	4.4	0.2	0.1
Malaysia	4.6	4.3	0.1	0.3	4.1	4.1	0.2	(0.2)	4.5	4.3	0.2	0.1
Indonesia	5.0	5.1	0.1	0.2	5.0	5.0	0.3	0.2	5.0	5.1	0.1	0.1
Philippines	5.1	5.6	(0.3)	(0.1)	5.1	5.3	(0.2)	(0.1)	5.0	5.3	(0.6)	(0.4)
Singapore	-	-	-	-	-	-	-	-	4.1	2.1	1.6	0.7
Thailand	2.1	1.6	0.1	0.0	2.0	1.8	0.2	0.1	2.0	1.6	-	-
Vietnam	-	-	-	-	7.2	6.3	1.4	0.2	7.4	6.4	0.7	0.4
Timor-Leste	-	-	-	-	4.0	3.4	0.5	0.0	-	-	-	-

Sources: IMF, World Bank, OECD, ADB, AmBank Economics

Global economic overview

The global economy endured much of 2025, arguably the most intense and volatile economic landscape the world has ever seen. Drastic policy changes by the US prompted multilateral banks (MDBs) to recalibrate their global outlook after entering the year with a positive baseline. Nevertheless, 2025 ended as initially intended, heavily bruised, but without growth falling off the cliff as feared.

2026 may witness similar rollercoaster rides, with geopolitics taking centre stage soon after the New Year celebrations. We believe that the dynamics of the US economy and politics will, once again, shape the global economy's landscape in 2026. Discussions about fiscal sustainability and the health of global economies are expected to continue throughout the year, particularly in light of the recent debate over the AI capex supercycle, which could exacerbate the already fragile global economy.

Projections for global and Regional GDP growth

Based on readily available global growth forecasts, MDBs anticipate the global economy will grow slightly slower in 2026 than in 2025, at around 2.6-3.3%. Growth among advanced economies is expected to remain stable at 1.6-1.8%, with the US economy growing at a more robust pace than its high-income peers. In 2026, emerging markets and developing economies (EMDEs) are expected to fare well, with growth rates of 4.0-4.2%. The Indian economy has made significant strides in its catch-up phase, surpassing Japan in 2025 and, potentially, Germany in 2026.

ASEAN: Growth to moderate in 2026, except the Philippines

As one of the world's fastest-growing regions, Southeast Asia offers tremendous potential for MNCs, serving as a springboard to the global market due to its growing domestic demand, robust export sector, youthful demographic profile, and well-connected supply chains. The region's growth is expected to remain solid, with MDBs projecting 4.2%-4.4% growth in 2026, marginally slower than in 2025. The ADB cuts the Philippines' growth in 2026 due to weak infrastructure spending, which will hamper its short-term growth prospects.

We also noticed a significant jump in Singapore's growth prospects amid better-than-expected outputs from manufacturing and wholesale trade. The region appears resilient to the US's Reciprocal Tariffs (RT) not only because of the more favourable outcomes of bilateral negotiations with the US but also, perhaps more importantly, because of higher investments stemming from the reconfiguration of global supply chains, which favour a more "neutral" ground.

In 2026, the World Bank forecasts Malaysia's growth to come in at 4.1%, while the ADB forecasts 4.3%. These projections are noticeably lower than AmBank Economics' 4.5% projection.

The region's inflation has been trending lower in 2025 (2.4%) than in 2024 (3.0%). In 2026, inflation is likely to record an uptick due to base effects and higher-trending inflation in Vietnam, the Philippines, and Indonesia. ADB believes Malaysia's inflation could rise to 2.2%, above our in-house projection of 1.8%.

Key risks: Threats are heavier on growth, no longer inflation

Exhibit 1: World Inflation: average consumer prices, y/y%

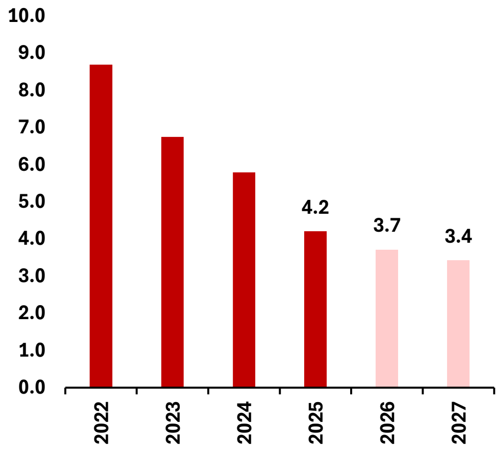


Exhibit 2: World FAO Food Price Index, by type, y/y%

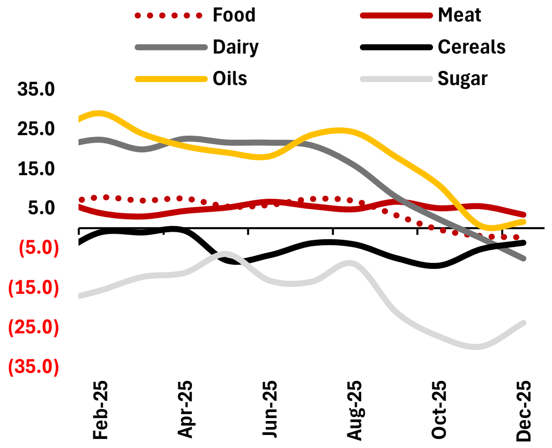


Exhibit 3: Global trade, y/y%

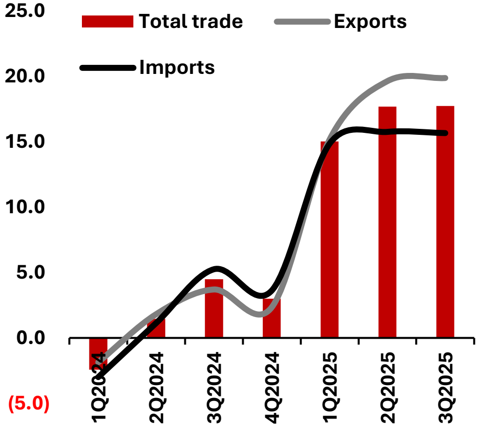
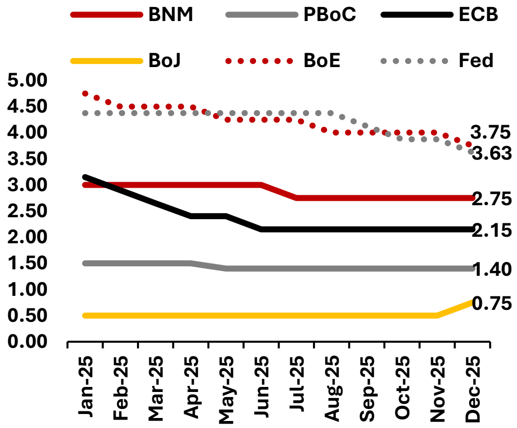


Exhibit 4: Selected Central Banks' Policy Rates, %



Sources: IMF, UN's FAO, various central banks, AmBank Economics

Key risks

Although global trade appears to have responded negatively to the abrupt US trade policy change in April 2025, with the latest reading by the World Trade Organisation (WTO)'s Goods Trade Barometer dropping to 101.8 points in 3Q2025 from 103.5 points in 1Q2025, it is still pointing to above 100 points, which indicates above-trend growth. This correlates well with the latest IMF figures, which show that global trade grew 17.7% in 3Q2025, maintaining a consistent increase at double-digit rates over the past three quarters.

The UN's Food and Agriculture Organisation (FAO) Food Price Index recorded a decrease of -2.3% in December 2025, reversing the trend seen throughout 2024. We have observed that global food inflation has remained relatively stable over the past three years, following the global economy's adjustment to the supply shock caused by the Russia-Ukraine military conflict in 2022. Prospects of heightened geopolitical tensions and climate change could alter the current trajectory, although we are more concerned about the former rather than the latter.

Global oil prices have been moderating steadily since 2022, with a decline of over 20% in the past year, and analysts expect this trend to continue throughout 2026. The US Energy Information Administration (EIA) forecasts that Brent crude will average USD 55 per barrel, though volatility may persist amid ongoing geopolitical tensions in Latin America and the Middle East.

As global energy prices continue to decline, global inflation is expected to remain under control throughout 2026. The IMF expects global inflation to continue its downward trend, reaching 3.8% in 2026 from 4.1% in 2025, though the disinflation rate is likely to decelerate in the coming years.

As a result, we may also see inflation-targeting central banks become less willing to cut rates unless they foresee strong growth headwinds amid the lack of compelling growth drivers in 2026.

The end of synchronised global easing

2025 was a peculiar year in which central banks held a similar view that the US's abrupt policy shift could create headwinds for their respective economies and, by extension, global growth. It is no surprise that MDBs cut growth projections for 2025 at the end of 1H2025, anticipating that the harmful effects of sudden global trade reconfiguration could disrupt consumer and investment confidence.

While inflation is a major factor in rate setting in many central banks, so is growth, particularly among advanced economies. We observed inflation moderating steadily across economies, including in Malaysia, which prompted inflation-targeting central banks to ease gradually in line with incoming data. As inflation remains elevated in the US and UK, rate cuts in these economies throughout 2026 will likely be even more gradual than in 2025, notwithstanding the divergence in rate-setting views among respective monetary policy members.

The ECB could afford to take a back seat when setting rates, while the BoJ would continue to act on rates as inflation bites. The PBoC and BNM would be more cautious in their approach, with a view to maintaining an ample buffer should the economy take a sharp turn.

US: Shocks, shutdowns, yet still standing

Exhibit 5: US: Real GDP, saar, q/q%

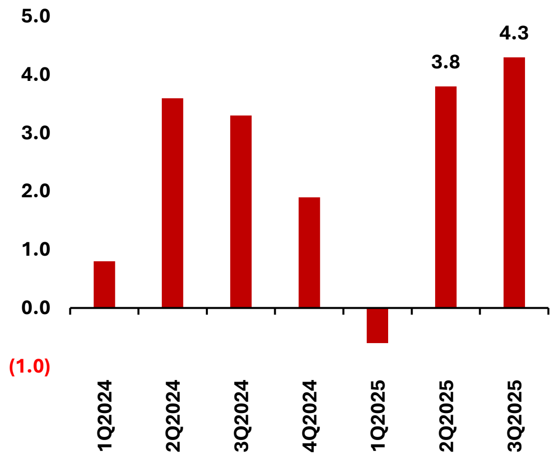


Exhibit 6: US: Selected labour market indicators, sa

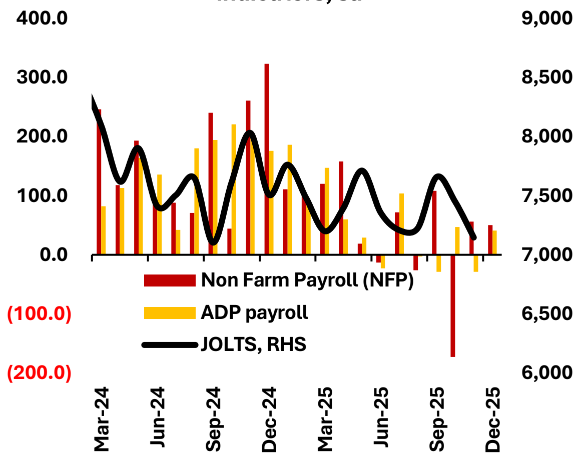


Exhibit 7: US: Real GDP by expenditure, saar, q/q%

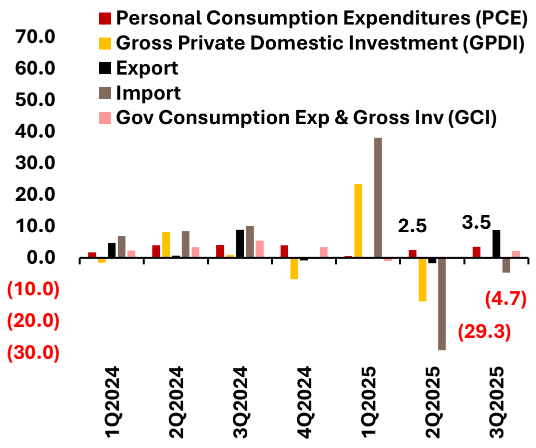
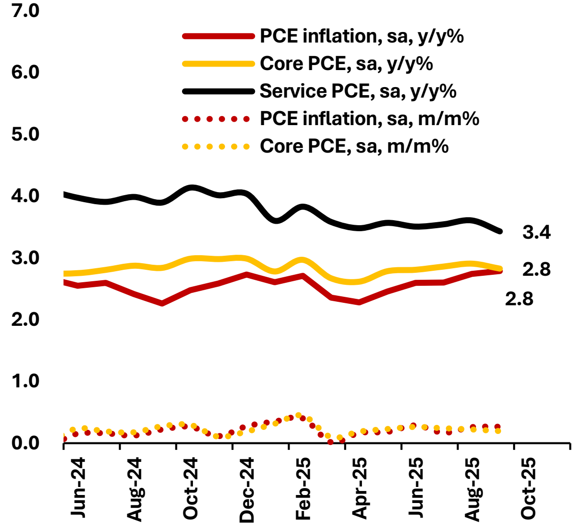


Exhibit 8: US: PCE inflation



Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Automatic Data Processing, Inc., AmBank Economics

Performed well in the short-term, medium-term hangs in a balance amid the US policy shift and mid-term elections

While most economists anticipated a renewed push for ‘America First’ policies under President Trump’s second term, few foresaw the scale and intensity of measures that would reshape its trade, fiscal priorities, and global economic relations. Throughout 2025, escalating trade tensions with China and neighbouring economies, direct critiques of the Federal Reserve, rising geopolitical tensions, and the implementation of the US Reciprocal Tariff (RT) dominated headlines.

The historic government shutdowns did not help, as many publications of crucial economic indicators were either delayed or skipped entirely. These developments forced economists to revise growth projections as markets jitter. Yet, paradoxically, US GDP growth outperformed expectations, buoyed by resilient domestic demand even as imports contracted.

Things could get worse before they get better. The precarious nature of the US labour market to growth is apparent, with non-farm (Jan25: 111k, Dec25: 50k) and ADP (Jan25: 186k, Dec25: 41k) payrolls, as well as average hourly earnings (Jan25: 0.42%, Nov25: 0.14%) are trending more than half of what they were at the beginning of last year.

In contrast, we do not see a jump in jobless claims or the unemployment rate. In fact, although the unemployment rate rose higher in December 2025 (4.5%) versus in January 2025 (4.0%), we have noticed a decrease from November 2025 (4.6%), providing a mixed picture of the US labour market conditions.

US disinflation was well underway but only to be disrupted by constant and abrupt policy changes throughout 2025. Both headline and core inflation remain elevated but stabilising, suggesting that US inflation is now broad-based, although services inflation continues to trend way above the 2.0% target.

We believe that US inflation will remain sticky down as the Trump administration continues its tariff agenda. That said, we also believe the US would not be overly aggressive with tariffs, as it was in 2025 amid US mid-term election fever. If labour conditions continue to suffer, so will growth and inflation, which will influence the Fed’s rate path if central bank independence is not severely compromised.

We expect **two Fed rate cuts in 2026**, one more cut from the Fed’s December SEP baseline, reflecting market consensus and evolving economic risks. Recent Fed signallings suggest a shift toward supporting employment as inflation moderates, albeit gradually.

To be clear, our view is anchored in the clear signs of labour market softening, which we believe the Fed may seek to pre-empt to mitigate recession risk arising from elevated debt levels and AI capex supercycle.

Euro Area: Sluggish growth, firm wages

Exhibit 9: Euro Area 20: Real GDP, %q/q, swda

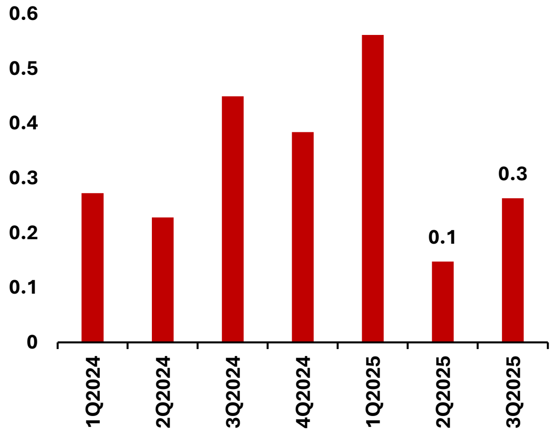


Exhibit 10: EA: Unemployment rate, sa, %

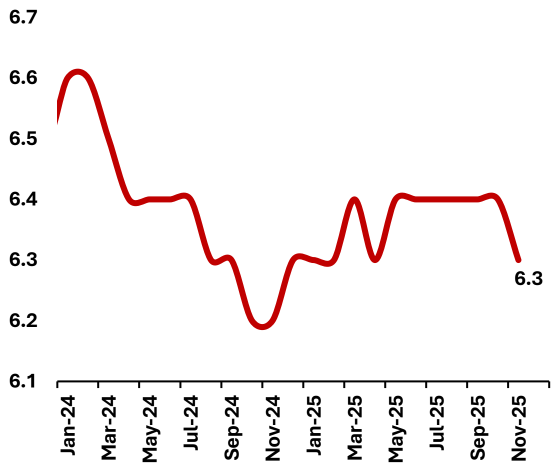


Exhibit 11: EA: Consumer inflation, y/y%

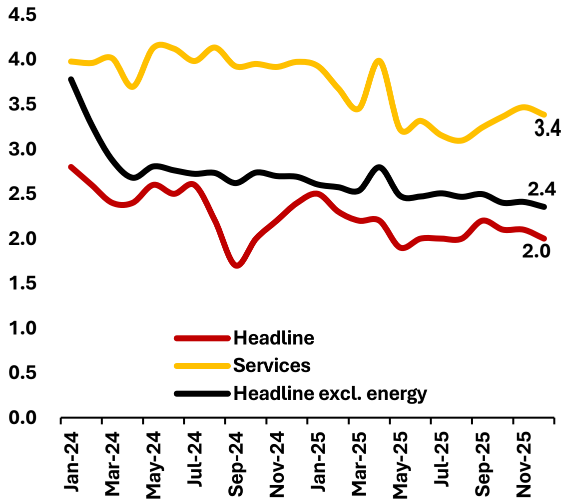
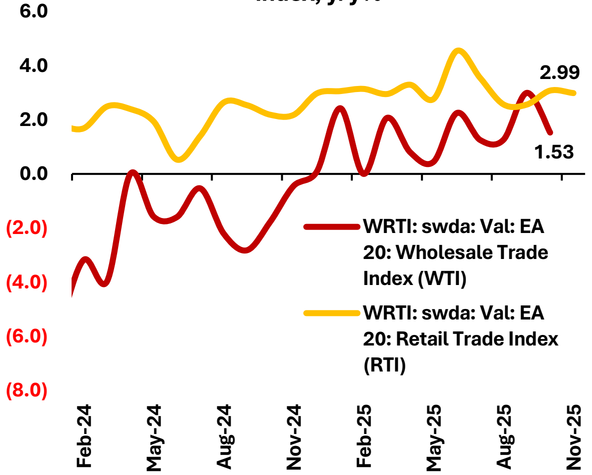


Exhibit 12: EA: Wholesale and retail trade index, y/y%



Sources: Eurostat, AmBank Economics

Continued weakness albeit higher wage-to-GDP ratio

In 2026, both the IMF and the OECD expect the Euro Area's growth to come in at 1.3% and 1.2%, respectively. Growth continues to moderate from the year's peak in 1Q2025 at 1.6% to 1.4% in 3Q2025 and to 1.2% in 4Q2025 based on ECB staff projections. We take it that the region's growth will remain weak, although it will likely remain slightly positive in 2026.

Its subdued labour market beleaguered the economy, as the unemployment rate for the younger (15-24 age group) workers remained high at 14-15% throughout 2025, while the older cohort (25-74 age group) remained flat at 5.5%.

We have noticed a rising wage-to-GDP ratio and relatively stable unemployment rates, yet EA's growth remains sluggish due to weak productivity gains and muted domestic demand. Higher labour costs, tariff-induced and elevated price levels may have squeezed corporate margins, discouraging investment and slowing output.

Noticeably, external headwinds are not helping as trade tensions and soft global demand, particularly from China, further weigh on the region's growth performance.

Inflation is at the target rate, expect no rate change

Inflation in the EA is no longer a critical issue, as it was during the post-pandemic period, and is now trending closer to the ECB's target range of 2.0% (November 2025: 2.1%).

We noticed that its service inflation, while remaining elevated, has started to rise since 4Q2025, perhaps a response to strong wage growth, sticky prices, even as goods and energy inflation have stabilised. This creates a challenge for the ECB, as services inflation is a key driver of core inflation, despite the ECB staff projecting inflation to remain flattish at 1.9% in 2026.

The ECB did not cut rates in 2H2025, following three cuts in 1H2025. The "dovish hold" phase is based on the inflation outlook, where disinflation is well on course to settle around the target rate of 2.0%.

We take the view that the region's current policy is appropriate unless inflation dynamics were to change amid geopolitical tensions and/or climate-related shocks.

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China: Proving the critics wrong

Exhibit 13: China: Contribution to GDP Growth, y/y%

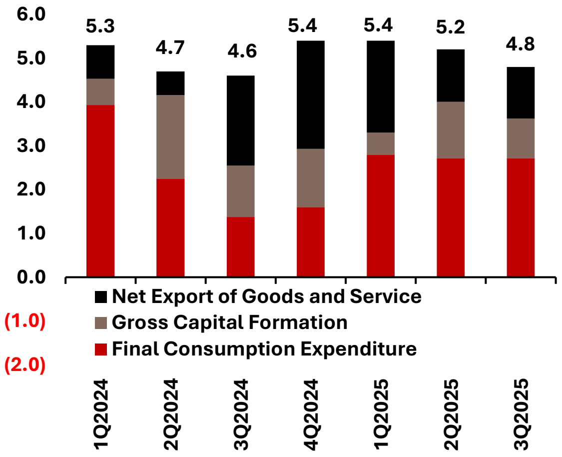


Exhibit 14: China: Consumer inflation, y/y%

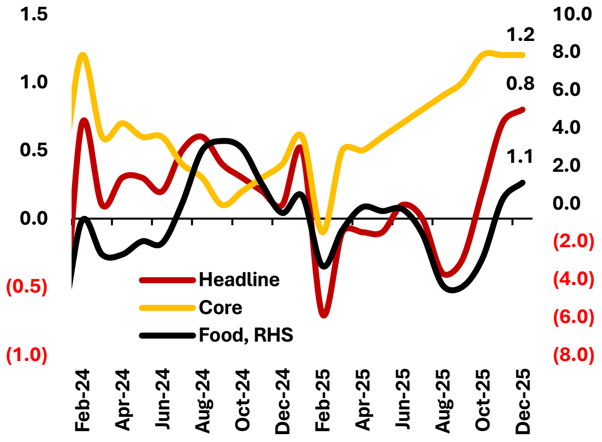


Exhibit 15: China: Share of GDP by expenditure, %

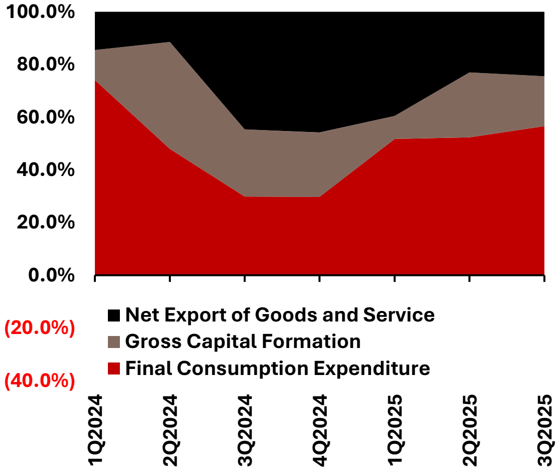
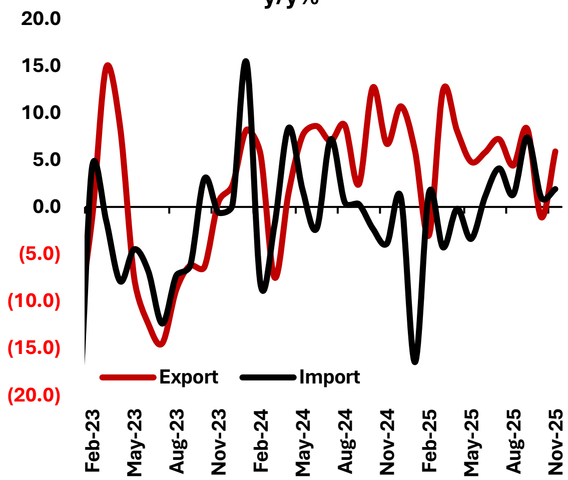


Exhibit 16: China: Trade performance, y/y%



Sources: National Bureau of Statistics, General Administration of Customs, AmBank Economics

China met its 5.0% growth target, off from MDB's forecasts

In his New Year's speech, President Xi Jinping noted China's ability to muddle through a "very unusual" year and expected the Chinese economy to achieve "around 5%" in 2025. This comes as none of the MDBs expected China to achieve the 5% growth, or at least come close to the target. Yet, they did.

Once again, no MDBs expect China to hit the 5.0% growth mark in 2026. In fact, the World Bank expects the country's growth to moderate steadily, reaching 4.9% in 2025, 4.4% in 2026, and 4.2% in 2027. The IMF takes a similar view at 4.5% in 2026. Despite the pessimistic outlook, we remain positive that China will defy analysts' expectations, as it has in recent years.

Besides, the country's push for its 15th five-year plan (2026-2030) aims to elevate its "dual circulation" strategy in achieving "socialist modernisation", which should provide the necessary impetus to growth in 2026 and in the coming years.

In any case, China's gravity-defying growth came not only through technological upgrading but also through diversifying its trade away from North America and toward the rest of the world.

China's total trade increased 3.8% in 2025, with trade with North America slumping 16.9%, contrasting with Asia (+7.3%) and Africa (+17.8 %).

The end of ultra-low inflation in 2026?

Inflation in China has been very low since the pandemic, but signs are emerging that headline inflation is indeed moving out of deflation territory and into low-positive territory. China's policymakers set their inflation target at 2.0%, yet we suspect inflation will likely remain well below the target in 2026. The producer price index (PPI) has been trending in negative territory since October 2022, yet there are no near-term catalysts to reverse this trend.

Steady labour market

China's unemployment rate has remained relatively stable, with slight improvements, fluctuating between 5.0% and 5.4% throughout 2025. This indicates that the country's labour market has demonstrated great resilience to external headwinds and has fallen below the official target of 5.5%. It would be interesting to see how policymakers juggle the need for technological upgrading while sustaining the health of its labour market in 2026 and beyond as China pushes ahead with its 5-year plan.

Liquidity management

The 7-day Reverse Repurchase Rate was cut only once, in May 2025, to 1.4%. Recently, the People's Bank of China (PBoC) announced that loose monetary policy will continue in 2026, with a view to cutting the reserve requirement ratio (RRR) and interest rates to maintain ample liquidity. We infer that the PBoC's view is to support short-term liquidity amid global uncertainties, while avoiding aggressive rate cuts that could weaken the RMB.

Malaysia: Slightly below-trend growth, but holding up well

Exhibit 17: Real GDP growth under Trump tariff cycles, y/y%

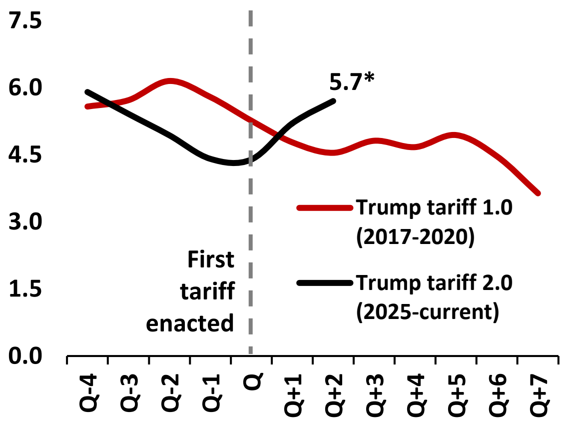


Exhibit 18: Annual real GDP growth and contributions

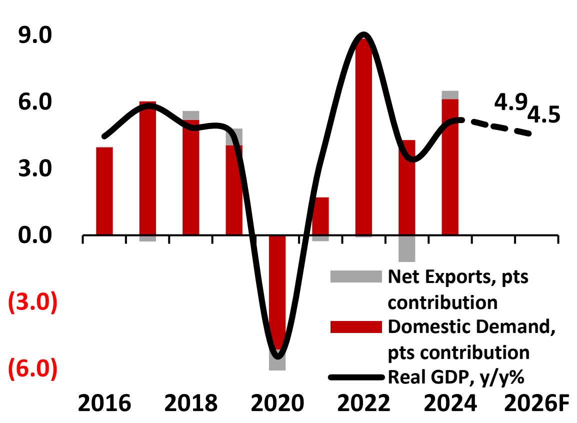


Exhibit 19: GDP Expenditure Side Forecast (y/y%)

	Actual Data	AmBank Forecast	
	2024	2025F	2026F
Domestic Demand	6.5	6.3	5.2
Private Consumption	5.1	5.2	4.9
Public Consumption	4.7	6.0	5.6
Private Investment	12.3	9.1	5.9
Public Investment	11.0	10.7	4.8
Real Exports	8.3	2.7	2.2
Real Imports	8.2	3.6	2.7
Net Exports	9.1	(9.9)	(8.0)
GDP	**5.1**	**4.9**	**4.5**

Sources: Bank Negara Malaysia (BNM), Ministry of Finance (MOF), AmBank Economics

Economic resilience persists with both upside and downside risks

In early 2025, we forecasted that the Malaysian economy would grow steadily at 4.6% amid a positive outlook of robust private investment and private consumption. Tariff-related headwinds prompted us to shave off our earlier projections. As incoming data started to trickle in, we upgraded our FY25 forecasts to reflect the ground reality, returning to our earlier baseline.

Things end up where they all started, but only better. The Malaysian economy in 2025 emerged stronger despite those concerns. Recent trade agreements offered greater clarity and are likely to support growth in 2026. At the same time, the AI capex supercycle has underpinned a surge in exports and investment. With growth in 2H2025 set to outperform the 4.4% recorded in 1H2025, we have revised our full-year growth forecast modestly higher to 4.9%, although this still represents a slight moderation from the 5.1% growth in 2024.

Looking ahead to 2026, we expect the Malaysian economy to remain resilient, with **growth reaching 4.5%, at the upper bound of the official forecast range of 4.0%-4.5%**. That said, the outlook remains subject to symmetric risks amid fluid global developments, especially when the tariff impact is likely to become more apparent. Upside risks include a prolonged semiconductor upcycle, a stronger global growth, a fiscal spending boost, and firmer tourism receipts amid the Visit Malaysia Year (VMY) 2026 campaign. Conversely, downside risks stem primarily from the external sector amid persistent geopolitical and trade tensions. To be precise, a more pronounced slowdown in major trading partners such as China, and the risk of a correction following the recent AI capex supercycle.

A more nuanced picture of tariff-related impact on the Malaysian macroeconomic performance

During Trump tariff 1.0 (2017-2020), Malaysia's growth rate was already on a downtrend, but the decline became more pronounced six quarters after the announcement. Trump tariff 2.0 (2025 – present), growth was also on a similar downward trajectory. The differences in cycles matter, as the shock transmission in Trump tariff 1.0 manifested primarily through China (Malaysia's largest trading partner)'s supply chain contraction, which dampened Malaysia's trade prospects. Trump tariff 2.0, however, directly impacts Malaysia. The outcomes of these trade wars are completely opposite.

At a glance, our analysis is counterintuitive. However, there are fundamental differences here: Trump tariff 1.0 also coincided with the late-cycle US expansion and low inflation, whereas Trump tariff 2.0 began when the US economy recorded commendable growth, as did Malaysia and other global economies in 2024.

High/elevated US inflation in recent years also plays a role. The US's robust domestic demand, the ongoing AI-led growth and semiconductor upcycle also provided the necessary tailwinds for Malaysia to neutralise any deleterious impact while keeping tech sector tariffs untouched. The sticky-down US inflation also helped as a shock absorber, as we believe US President Trump is merely using tariffs as a bargaining instrument rather than bringing manufacturing jobs back to the US.

Having said that, we cannot tell whether there will be a second-round effect to the tariff, but the scenario of it happening is low. It is in the US's interest to keep inflation manageable/low while the recently signed US Agreement on Reciprocal Tariff (ART) helps to cushion the impact on trade in 2026.

Malaysia: Robust spending key to sustaining growth momentum

Exhibit 20: Private Consumption vs retail sales, y/y%

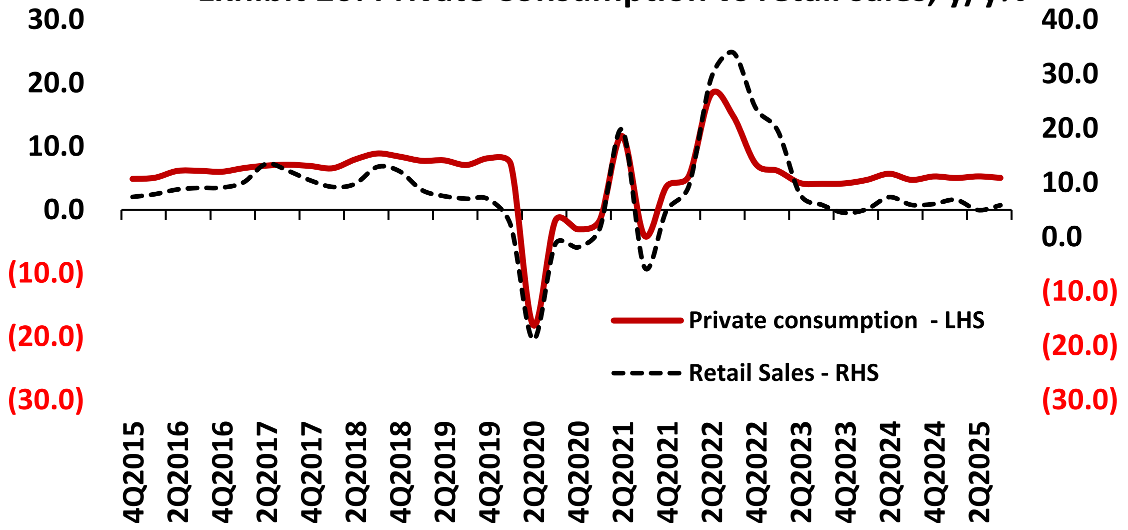
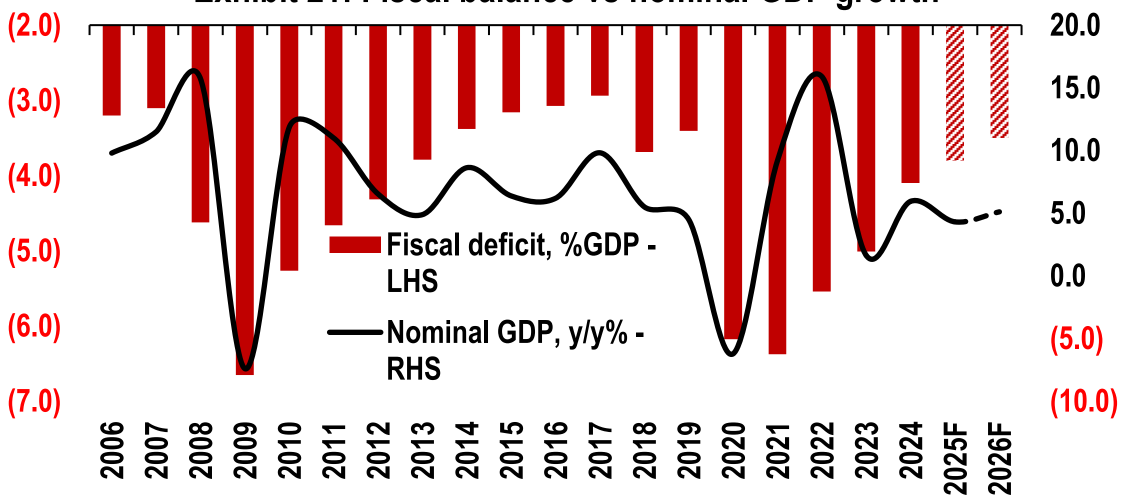


Exhibit 21: Fiscal balance vs nominal GDP growth



Sources: DOSM, AmBank Economics

Services sector to benefit from robust household spending and vibrant tourism

In 2026, private consumption will remain a crucial growth driver given the tight labour market. Government measures, including the second tranche of the civil service salary revision, a one-off MYR100 SARA cash handout to all Malaysians aged 18 and above, and continued targeted cash assistance, should also help alleviate the higher cost of living. This should act as a necessary buffer against the erosion of households' purchasing power, as evidenced by the recent pick-up in credit card non-performing loans (NPLs).

Nevertheless, the supporting factors are likely tempered by a more prudent spending environment, as indicated by slowing household credit growth. **We therefore project private consumption growth to ease slightly to just below 5% in 2026**, from above 5% in the previous two years, but it would still represent a healthy pace by historical standards.

The services sector is also poised to benefit from more vibrant tourism activity under the VMY2026 campaign. Achieving the ambitious target of 43 million international tourist arrivals – about 10% higher than the estimated figure of nearly 40 million in 2025 – would firmly position tourism as a key pillar of growth, driving spillovers across transportation, retail, and hospitality. Tourism already contributed 15.1% of GDP in 2024, up from 12.8% during the pandemic, and is on track to reclaim, or even surpass, its pre-pandemic share of 15.9%.

Fiscal policy to remain focused on supporting growth

We expect Malaysia's fiscal policy to remain expansionary in 2026 as it marks the start of the 13th Malaysia Plan (RMK-13). The plan proposes allocating MYR430 billion in development expenditure over the five years from 2026 to 2030, up from MYR400 billion under the previous plan, with 2026 laying the foundation for high-impact projects. Budget 2026 also signals a stronger rakyat-centric policy focus, evident in the slew of support measures, ranging from family tax reliefs to higher cash handouts.

That said, the expansionary stance is not expected to derail the fiscal consolidation path as the government continues to demonstrate strong deficit controls and sustained efforts to broaden its revenue base. **We view the government's target of reducing fiscal deficit from 4.1% of GDP in 2024 to 3.8% in 2025, and further to 3.5% in 2026 as achievable**, assuming there are no unforeseen shocks that necessitate additional fiscal support.

Given continued fiscal discipline and our expectation that nominal GDP growth will pick up in 2026 due to the low base effect, **we anticipate the statutory debt – 63.5% of GDP as of June 2025 – will remain within the 65% debt ceiling**. While the upward trend in the debt service ratio warrants monitoring, risks are contained by the low share of external debt and the largely domestic debt profile.

Risks: Mixed external risks shape investment and trade

Exhibit 22: GFCF growth, y/y%

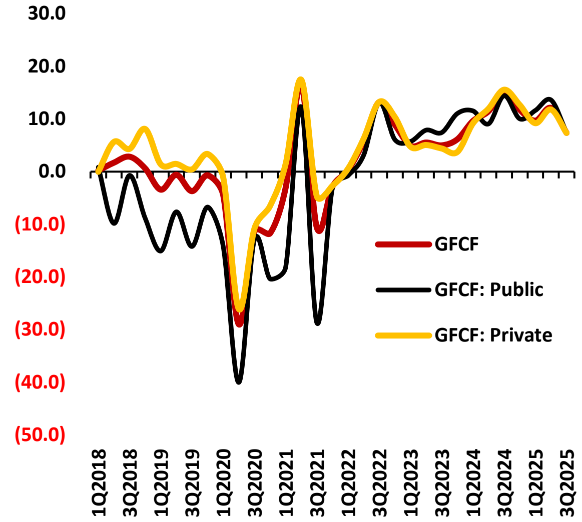


Exhibit 23: Approved private sector investments, MYR bil

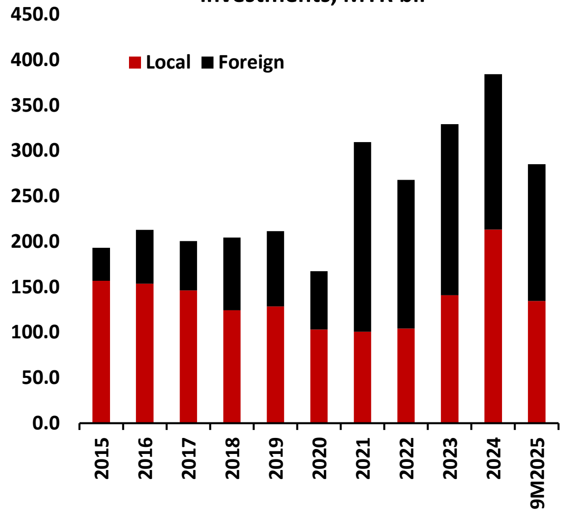


Exhibit 24: Exports vs Imports, 3MMA,y/y%

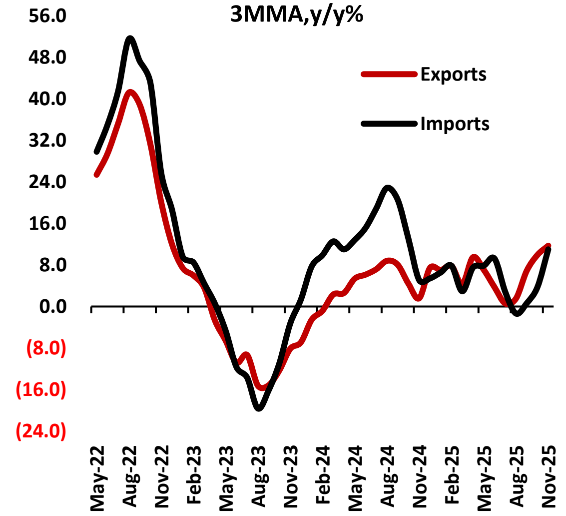
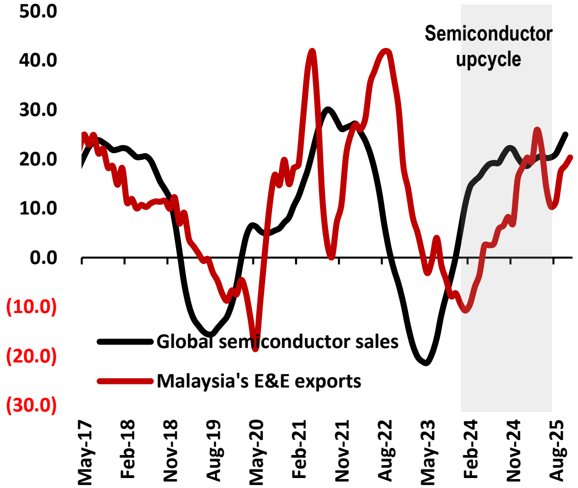


Exhibit 25: Global semiconductor sales vs. Malaysia's E&E exports, 3mma, y/y%



Sources: DOSM, Bloomberg, AmBank Economics

Investment upcycle remains intact

While the latest data suggest that gross fixed capital formation (GFCF) growth in the current investment upcycle – driven by the data centre boom – may have peaked (3Q2025: 7.4%; 2Q2025: 12.1%), we expect investment activity to sustain solid momentum. This is supported by a robust pipeline of infrastructure projects, including the Penang Light Rail Transit (LRT) Mutiara Line, the Trans-Borneo Highway, and water infrastructure developments in the northern states of Peninsular Malaysia, as well as the continued realisation of approved private-sector investments totalling nearly MYR1.0 trillion between 2023 and 9M2025. Notably, Malaysia recorded MYR285.2 billion in approved private investments in 9M2025 alone, up from MYR252.0 billion in 9M2024. Further affirming that the upcycle remains intact, imports of capital goods and construction work done continue to register double-digit growth.

We opine that the government's efforts to retain and attract investors, including the current initiatives under the New Industrial Master Plan (NIMP) 2030 and the National Energy Transition Roadmap (NETR), along with an enhanced investment incentive framework expected in 2026, will underpin the resilience of investment accumulation. In addition to the development of economic zones such as the Johor-Singapore Special Economic Zone (JSSEZ), investment growth will also be supported by Chinese automakers' plans to establish manufacturing plants along the Perak-Selangor border.

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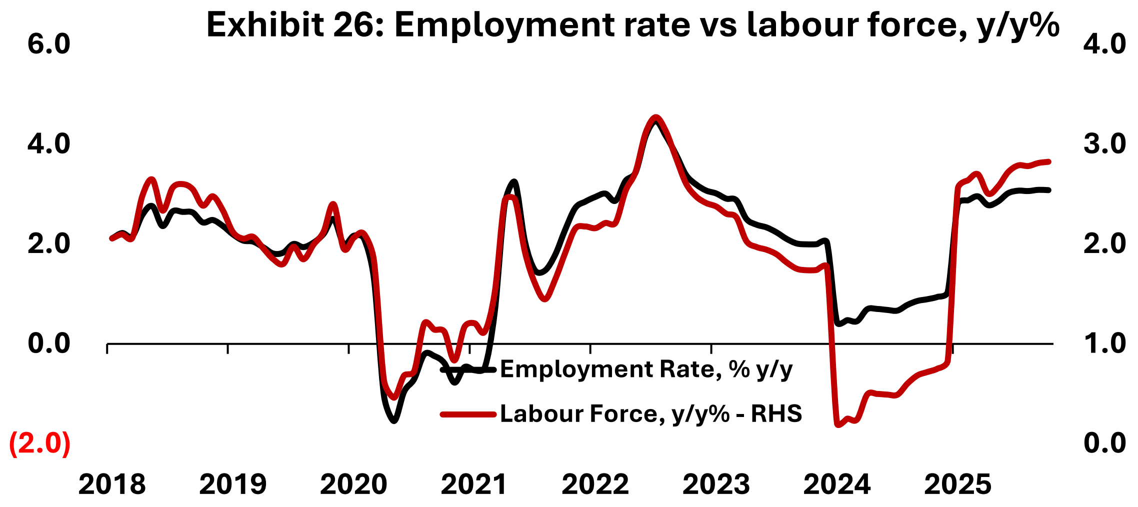
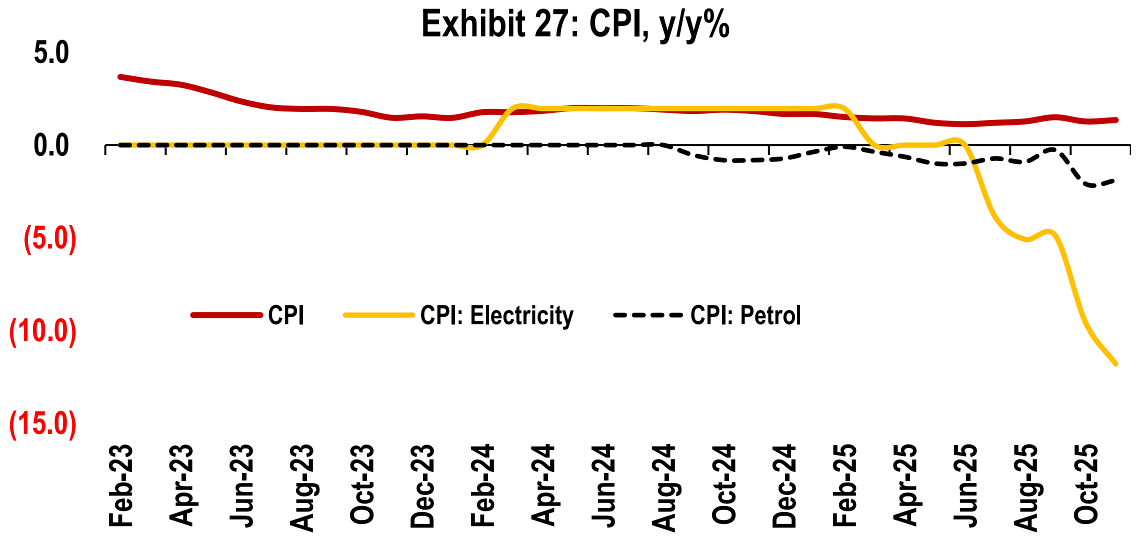
Trade growth to moderate, but a significant decline in net exports is not anticipated

In the near term, Malaysia's exports will continue to be supported by the AI-driven semiconductor upcycle and by enhanced market access to the US under the ART agreement. **Our estimates indicate that 90.7% of Malaysia's total tariff lines – representing 74.5% of its export value to the US – are exempt from reciprocal tariffs under the ART, with exemptions concentrated in semiconductor/electrical & electronics (E&E) products**. However, export momentum is expected to ease as earlier frontloading wanes alongside lacklustre external demand, with the impact potentially more pronounced if major trading partners such as China experience a sharper slowdown.

Given the strong export-import link, import growth is also expected to moderate, though strong capital goods imports tied to the investment upcycle should partially mitigate the slowdown. As both exports and imports are projected to slow rather than diverge, the likelihood of a significant contraction in net exports remains limited

OPR: to remain steady with a tight labour market and subdued inflation





Sources: DOSM, AmBank Economics

Tourism to spur employment

In the latest development, the unemployment rate declined even further to 2.9% in November 2025, the lowest level since November 2014, signaling the labour market continued to strengthen, supported by stable economic conditions. We foresee the labour market to remain healthy in 2026, with hiring activity steady and **the unemployment rate staying around 3.0%** despite potential spillovers from a more challenging external trade environment. Additionally, we note that employment growth has outpaced labour expansion since August 2021, indicating a strong job market and robust economic growth, which explains the latest unemployment rate outlook, as more people are being hired.

We also note that around half a million Malaysians in the job market are currently unemployed. This is cause for alarm, as the labour force participation rate is at an all-time high, while the majority of the unemployed are actively seeking jobs.

Job creation is likely to remain broad-based, particularly in services and manufacturing, with support from electronics or technology-driven industries. Additionally, wage growth for both services (3Q2025: 4.7% vs. 2Q2025: 4.2%) and manufacturing (3Q2025: 2.0% vs. 2Q2025: 1.8%) continued its upward momentum, signalling a favourable dynamic in the labour market that can sustain job creation in these sectors. At the same time, government initiatives under VMY2026 will further support employment opportunities in tourism-related sectors.

Upside inflation pressures to remain contained

Malaysia's headline inflation is expected to remain subdued at 1.8% in 2026, picking up from an estimated 1.4% in 2025. The uptick primarily reflects a low base effect and the anticipated lagged cost pass-through from water tariff adjustments and the expansion of Sales and Services Tax (SST). However, upward pressure will be partially offset by softer global commodity prices – particularly oil and coal – which should translate into lower fuel and electricity prices, together accounting for about 8.2% of the CPI basket. Moreover, a stronger ringgit should reduce import costs, further containing inflationary pressures.

Tourism to spur employment

Following the pre-emptive 25 bps cut in 2025, **we expect the Overnight Policy Rate (OPR) to remain unchanged at 2.75% throughout 2026, barring any significant shift in economic conditions** – an outcome we view as unlikely in the near-term. With the labour market expected to remain tight and inflation well-anchored, we see little impetus for BNM to adjust its current policy stance.

Tourism: Gearing up for VMY2026

Exhibit 28: Tourist arrival, person

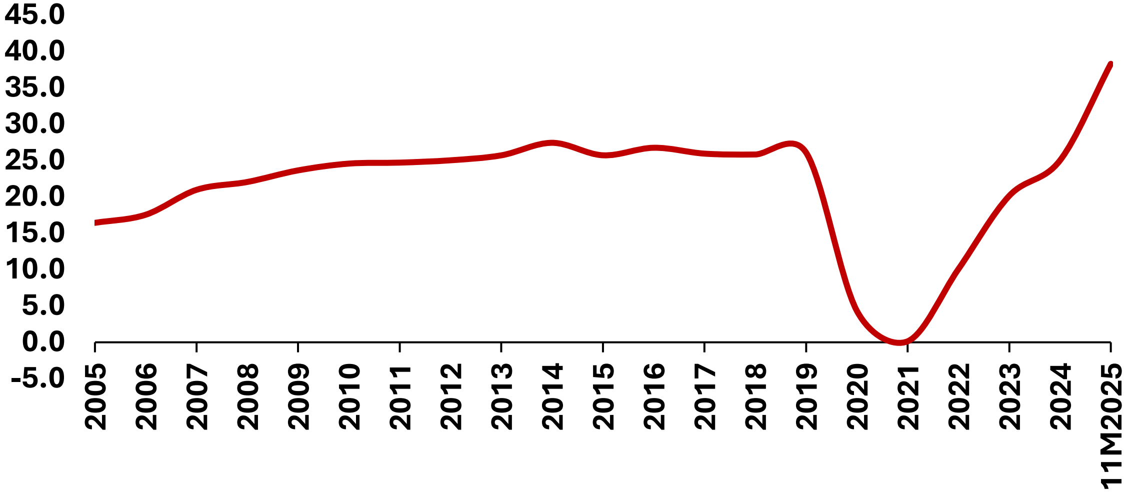
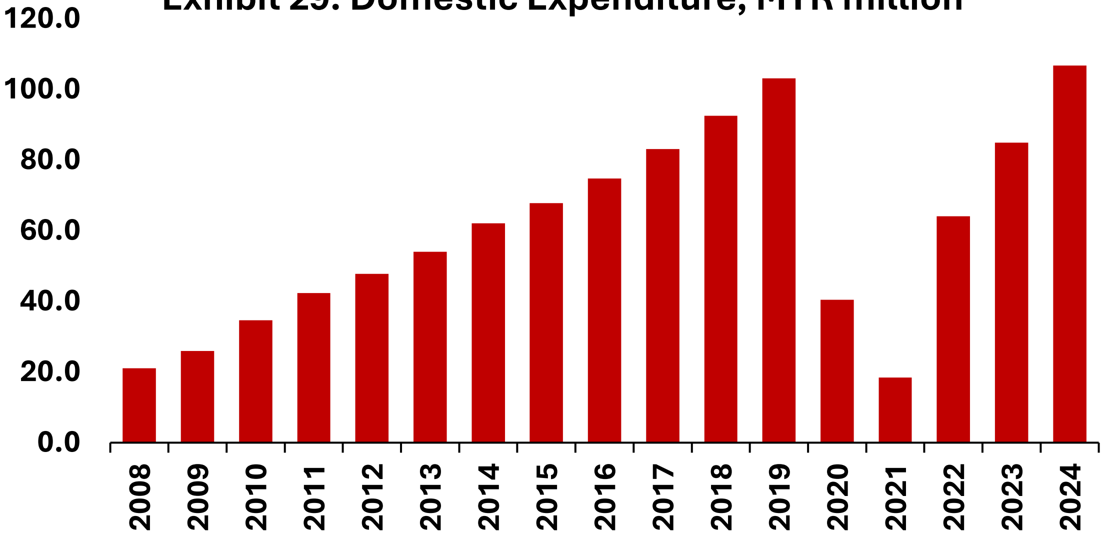


Exhibit 29: Domestic Expenditure, MYR million



Sources: Ministry of Tourism, Arts and Culture, DOSM, AmBank Economics

VMY2026) anchors tourism growth as a key economic driver

Malaysia's tourism sector is set for a strong upswing in 2026, buoyed by the VMY2026 campaign and backed by more than RM700 million allocated under Budget 2026. With the campaign, the country is aiming to attract about 43 million international tourist arrivals this year, based on strong 2025 momentum of 38.3 million international visitors for the first 11M2025, with notable increases from neighbouring countries, including Singapore, Thailand, Indonesia, and China.

As a result, Malaysia's hotel industry has grown in recent years with almost 15,000 accommodation establishments in 2022, a sharp increase from 4,377 in 2015, according to DOSM's Economic Census 2023 – reflecting recovery in the tourist arrivals, supportive policies and improving occupancy and average room rates. In fact, the latest report from Oxford Economics revealed that Airbnb contributing RM9.2 billion to Malaysian economy in 2024 – approximately 5% of tourism sector's contribution to GDP which support thousands of job opportunities.

Such a performance is consistent with statistics from Domestic Tourism Survey 2024 released by DOSM showed that Malaysia's domestic tourism sector recorded substantial growth during that year with total expenditure by domestic visitors reaching MYR106.7 billion from MYR84.9 billion in 2023, translating an expansion of over 25% y/y, driven by increased spending from both tourists and excursionists at 20.6% and 33.8%, respectively.

We believe the local tourism sector will be strengthened even more in the coming years in view of special income tax relief amounting to MYR1,000 to be enjoyed by Malaysians as announced in Budget 2026 as part of the VMY2026 to encourage them to travel within the country. Apart from that, infrastructure development could play a vital role in Malaysia's tourism sector, with the Rapid Transit System (RTS) linking Johor Bahru and Singapore, set to be operational by December this year, making cross-border travel more convenient for tourists, especially from Singapore itself.

Aviation: Constructive outlook

Exhibit 30: World GDP, y/y% vs global RPK, y/y%

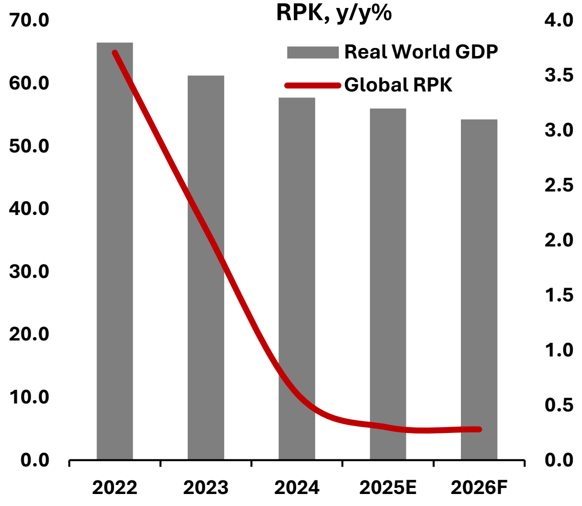


Exhibit 31: Malaysia's passenger traffic

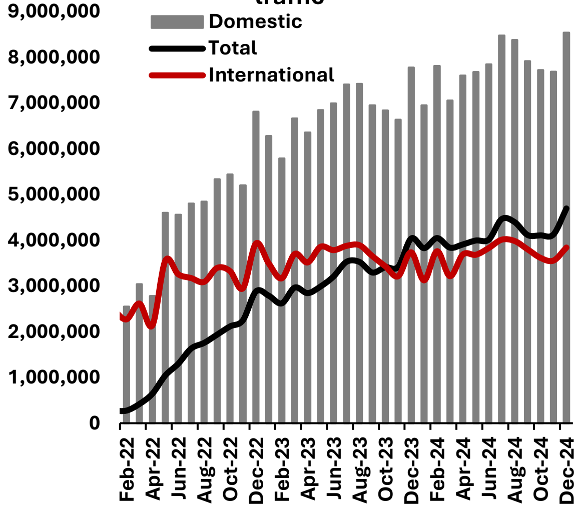


Exhibit 32: Imports & Exports value by air

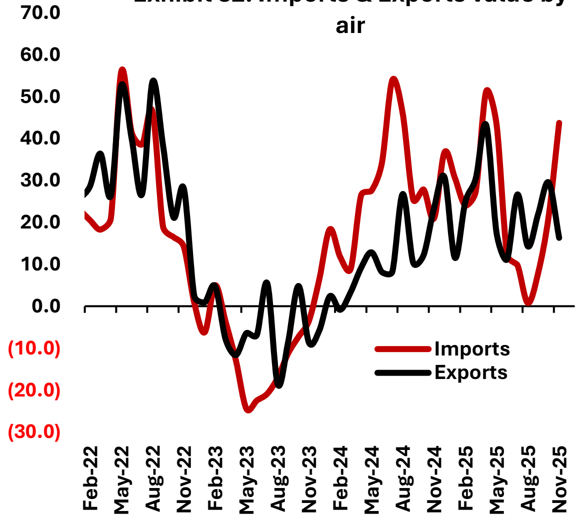


Exhibit 33: IATA'S passenger traffic growth forecast

Region	2025 y/y Growth Estimation (%)
Global	5.8
Asia Pacific	9.0
North America	0.4
Middle East	6.4
Europe	6.0
Latin America & Caribbean	5.8
Africa	8.0

Sources: International Air Transport Association, Malaysia Airports Holding Berhad, DOSM, AmBank Economics

Aligned for expansion amid market constraints

Global air passenger traffic is projected to climb to 4.99 billion in 2025, marking a 5.8% y/y increase, according to the International Air Transport Association (IATA). Demand for air travel, measured in revenue passenger kilometres (RPK), is likewise expected to expand by 5.8% in 2025, though this is a moderation from the earlier projection of 8.0%. The Asia Pacific region is set to drive the bulk of this growth, with passenger demand rising 9.0% y/y and contributing more than half of the global increase, underpinned by strong economic performance and robust international travel activity.

Following the pandemic downturn, passenger traffic rebounded strongly in 2024 for Malaysia (Chart 50) and is expected to trend higher in 2025-2026 (1H2025: 11.4% y/y, 51.9 million passengers), supported by robust tourism demand and steady household incomes. This growth is driven by strong demand for both domestic and international travel, with average load factors expected to reach a record 84.0%, indicating high aircraft occupancy. The Civil Aviation Authority of Malaysia (CAAM) projects that air cargo traffic growth in 2025 will likely trend toward the lower bound of its forecast range, between 4.5% and 8.5% y/y, underpinned by front-loading activity, resilient e-commerce demand, and ongoing trade diversions, which continue to support cargo volumes despite broader global uncertainties.

A key structural priority is workforce development. Malaysia has articulated its ambition to become ASEAN's aviation training hub, addressing the rising demand for pilots, engineers, cabin crew, and safety specialists. Investment in training institutions and international partnerships is central to this strategy, ensuring talent supply aligns with industry expansion. Parallel to this, sustainability has emerged as a defining challenge.

The Malaysian Aviation Decarbonisation Blueprint (MADB) sets a pathway to net zero emissions by 2050, with sustainable aviation fuel (SAF) adoption as a cornerstone. The adoption depends on a combination of policy mechanisms designed to encourage production, reduce costs, and ensure widespread use in aviation. Key policy instruments designed to accelerate sustainable aviation fuel (SAF) adoption include a mix of financial incentives and regulatory measures.

Looking ahead, Malaysia's aviation industry maintains a constructive outlook, though several risks remain on the horizon. Tourist arrivals are projected to increase even as tourism receipts contracted sharply by 73% q/q in the 1Q2025. The underlying momentum in travel demand is expected to persist throughout the year, providing a solid base for growth. At the same time, airlines are benefiting from easing cost pressures, with the Ringgit strengthening by 10.1% against the USD and closing at 4.06 by year-end 2025, helping to lower foreign-denominated expenses. Brent crude prices declined to USD60.85/bbl by the end of 2025, down from USD75.93/bbl at the start of the year, which in turn pulled jet fuel prices lower. This reduction in one of the industry's largest expense categories has improved margins and supported financial stability. Better regional connectivity is also another positive factor worth considering.

Nevertheless, global supply chain disruptions, geopolitical tensions, and intensifying competition from neighbouring aviation hubs pose significant downside risks. The sector's long-term success will depend on Malaysia's ability to balance expansion with sustainability, strengthen its talent pipeline, and uphold service excellence.

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FX: USD Outlook

Exhibit 34: Both ADP and NFP indicators point to a downward trend in hirings in 2025

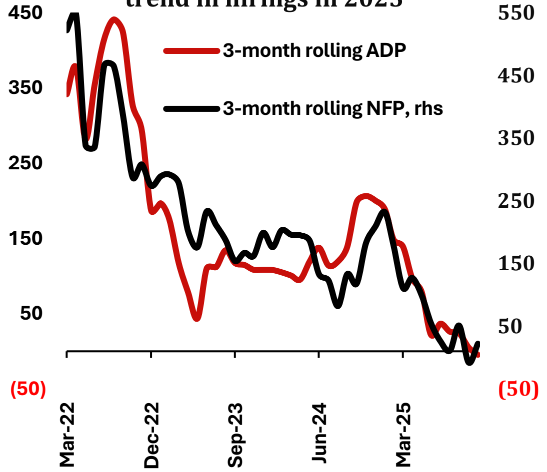


Exhibit 35: Stagnant core inflation at the 3% y/y level expected to make progress in 2026

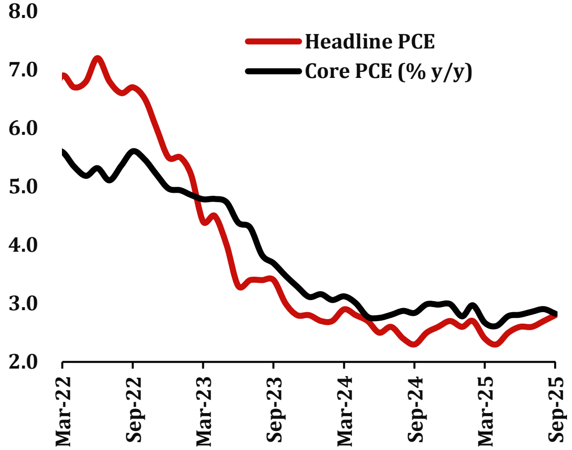


Exhibit 36: Bearish dollar wagers have declined in recent weeks post-fading of USD strength

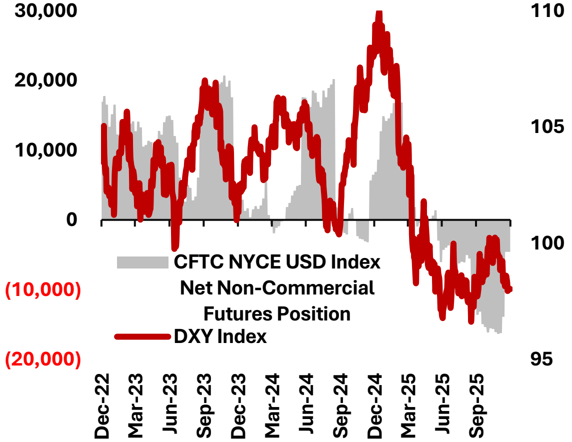
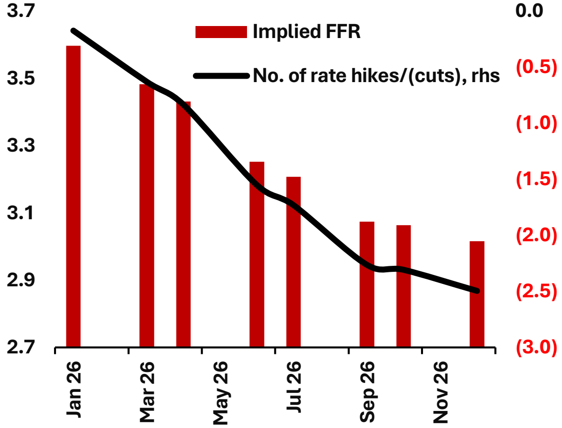


Exhibit 37: Markets currently expect the next two 25bps Fed rate cuts to be in 2Q2026 and 3Q2026



Sources: Bloomberg, AmBank Economics

USD – Back to the slide

A tale of two halves was evident in DXY trading in 2025, with 1H2025 marked by steady depreciation from a high of 109.6 to a low of 96.9. Actions by US President Trump dominated news headlines during this period - most notably on the tariffs front, which raised significant concerns about US and global growth and inflation. Calmer trading conditions ensued thereafter in 2H2025, with shock announcements fading and countries mired in trade negotiations with the US. The DXY mostly traded within a steady 97-100 range during this latter period, with an uncertain outlook on US inflation and employment keeping aggressive bearish (and bullish) bets in check.

Recent indicators suggest the US economy is in a conundrum. The Fed's Beige Book reports an increasingly K-shaped economy (resilient upper-income consumers supporting overall US growth, but worsening conditions for low- and middle-income households), even as the University of Michigan's consumer sentiment also remained near-historical lows.

While new headline job layoffs appear to be stalling, the high number of continued jobless claims and declining fresh new job additions (Exhibit 34) suggest a 'frozen' labour market, with both businesses and jobseekers adopting a cautious approach. Meanwhile, while disinflation progress in the US has stalled since 2Q2024 (Exhibit 35), we note the recent deceleration in services inflation (a stickier segment). In contrast, tariff-driven goods inflation is expected to result in one-off price increases, suggesting sustained disinflation.

It is against this backdrop that the Fed began its recent round of monetary easing in September (after pausing rate cuts since December 2024). Besides cooling inflation and growing concerns that recent job growth data have been overstated, upcoming changes to the Fed FOMC committee (change of Fed chairman as decided by US President Trump, rotation of voting regional Fed presidents towards a more dovish lineup in 2026, etc.) also posit a more dovish pathway ahead for the Fed.

<u>We pencil in two additional Fed rate cuts in 2026</u>. An end to the Fed's quantitative tightening, continued concerns over the US fiscal outlook, a backdrop of softer US economic exceptionalism, and continued leakages in the USD safe-asset premium further anchor a downward trajectory for the USD. We pencil in a steady decline for the DXY index ahead, which we expect to bottom around 95-96 by end-2026.

FX: EUR and GBP Outlook

Exhibit 38: Manufacturing sentiment (PMI) has consistently lagged peers, as EU manufacturing hollows out

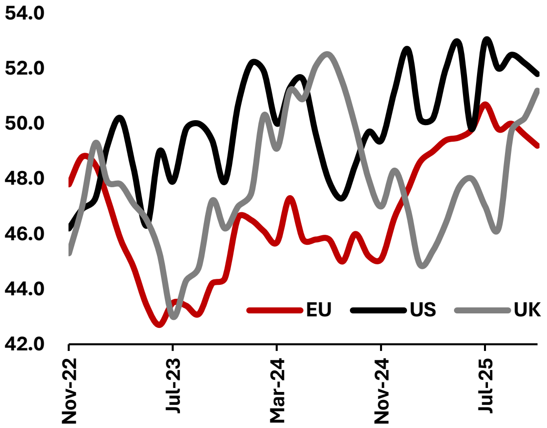


Exhibit 39: EUR has been the main beneficiary of USD weaknesses recently

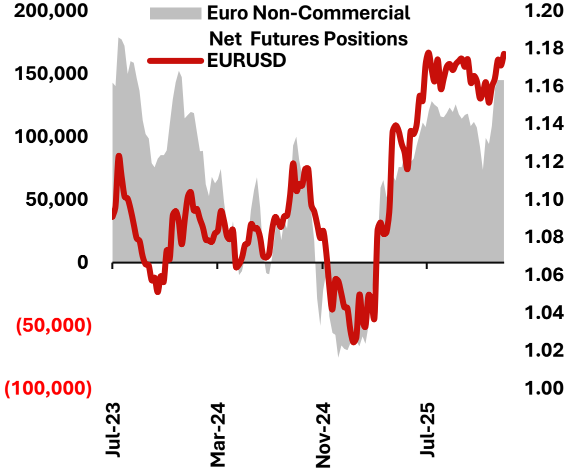


Exhibit 40: The GBP is not expected to see much support from Fed rate cuts, given expected BOE cuts in near lockstep

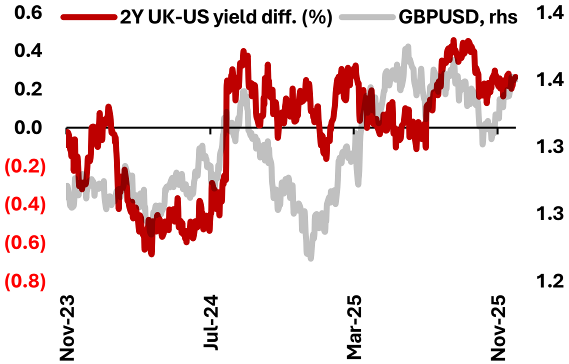
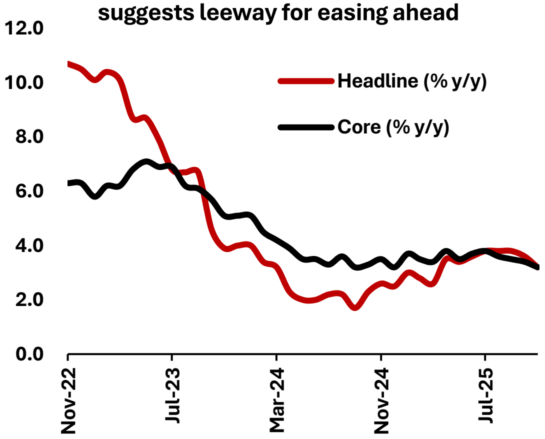


Exhibit 41: Tentative signs of progress on UK inflation in recent months suggests leeway for easing ahead



EUR – The facade of strength

Similarly, for the year past, EUR/USD will likely remain dictated by US dollar pulses in 2026. Policy rate differentials remain tilted in favour of the EUR, with recent Fed cuts (and more ahead) juxtaposed against the ECB's hawkish rate holds.

Meanwhile, other soft-dollar dynamics, receding geopolitical and fiscal risks among EU members, projected declines in energy prices, improving sentiment among consumers and businesses, and better growth expected in Germany and Spain, all combine to provide a supportive floor for the EUR in the year ahead.

However, long-term structural challenges for the euro area economy remain unaddressed by policymakers, including unregulated competitive Chinese imports and their impact on domestic manufacturing, continued demographic challenges on growth and pensions, weak productivity growth vis-à-vis the US and China, overregulation, secularly higher energy costs, and continued geopolitical risks on its eastern front. **We remain bearish on EUR over the long term.**

GBP – Choppier winds to wash ashore

The GBP fared relatively weaker in 2025 than its EUR peer, hampered by stronger prior-year gains, steady BOE rate cuts, and the Eurozone's relative economic resilience compared to the UK. Additionally, concerns over Chancellor Rachel Reeves' budget weighed on sentiment in 2H2025, amid pre-existing market anxiety stemming from the controversial 'mini budget' by former PM Liz Truss in 2022. However, anxiety about the 2025 Autumn budget was soothed on 26 November, given the better-than-expected fiscal space and clarity delivered, which has since supported GBP outperformance.

Nevertheless, the GBP is expected to benefit from a lighter tailwind from USD weakness in 2026. Though BOE policymakers appear more hawkish than their Fed counterparts, given their recent 5-4 vote splits, the UK's stagnant domestic growth, widening trade deficits, rising unemployment, and cooling inflation continue to suggest a gradual downward path for policy rates in 2026.

Elevated political temperature over UK PM Starmer's stance on growth and immigration also suggests volatility ahead for the GBP, with speculation that a challenge may emerge over his leadership in May 2026 if the Labour Party underperforms in local elections.

Sources: Bloomberg, AmBank Economics

FX: AUD and JPY Outlook

Exhibit 42: Improvements in AU-US yield differentials has helped drive AUD strength...

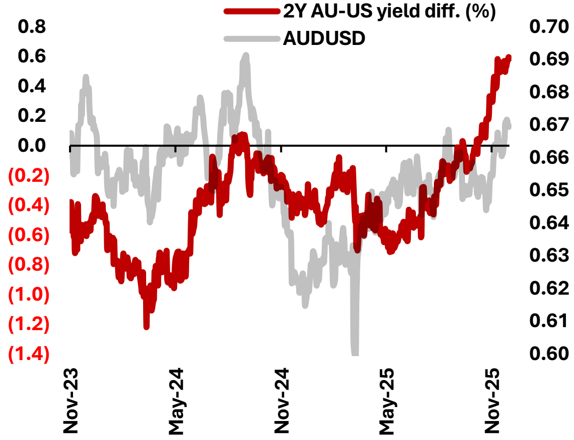


Exhibit 43: ... though recently higher commodity prices have not translated into a firmer trade account

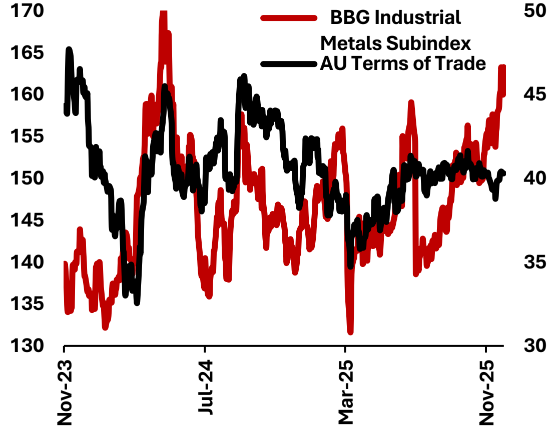


Exhibit 44: High inflation in Japan has kept short-term real yields deeply negative, placing pressure on the JPY Title

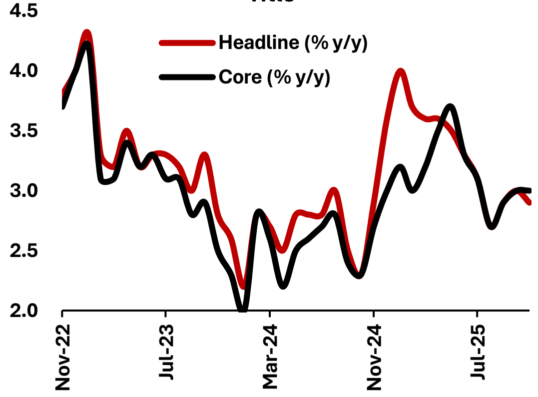
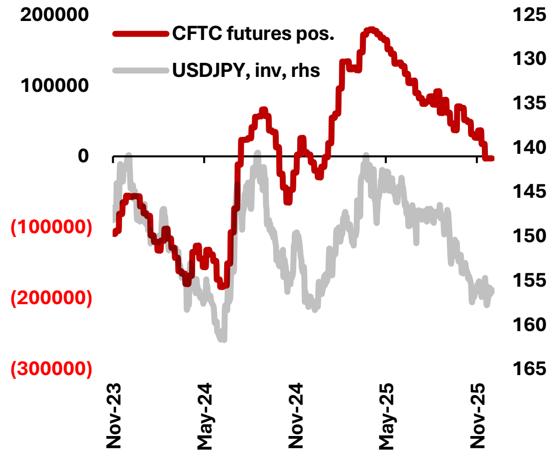


Exhibit 45: ... however, speculative fever on the JPY remains relatively low compared to prior years



AUD – Smooth surfs, sunny outlook

AUD/USD has settled into a 0.64-0.67 trading range in 2H2025, after earlier USD-driven gains in 1H2025, excluding the brief selloff triggered by US reciprocal tariff announcements in April. Shifting headline global news and market sentiment drove elevated volatility for the high-beta currency due to expected pass-through effects from shifts in commodity prices, in contrast to the stabler narrative of the Australian economy – an economy growing close to potential, expansionary territory for both manufacturing and services PMI, resilient labour markets, and still-hot inflationary territory.

Given these dynamics, recent RBA meeting minutes revealed discussions about whether a rate rise might be needed in 2026. This is despite a rate cut as recent as August 2025, since when rates have remained relatively elevated at 3.60%.

Historically, AUD/USD has been highly sensitive to short-term rate differentials. Seeing that the Fed is leaning towards more rate cuts ahead, vs. a hawkish hold (or even rate hikes) by the RBA, the AUD is likely to be a beneficiary of carry-trade capital flows in 1H2026, driven by Australia's higher bond yield differential. The AUD is also a beneficiary of the current risk-on market sentiment, though China's economic growth backdrop remains a key factor for the AUD.

Markets are on the lookout for more investment-related policy support measures by China's top officials later in March 2026, with greater upsides expected for the commodity-exporting currency should it materialise.

JPY – Fiscal cues lend dominance to FX directionality

Unlike its other G10 peers, the JPY has remained weak since June 2025. In past cycles, the JPY has typically drawn support from broad-based USD weakness, showing elevated sensitivity to shifts in short-term interest rate differentials. Nevertheless, despite the recent policy divergence between the Fed and BOJ (and ahead), the JPY has failed to draw support from USD weakness. This is driven by a backdrop of rising fiscal policy concerns overriding those of monetary policy signals, as newly minted PM Sanae Takaichi's administration veers towards policies of relying on high public spending amid low borrowing costs to boost economic growth, of which the administration has already approved a JPY18.3 trillion supplementary budget – primarily funded via net additional JGB issuances. While market concerns have partially dissipated, reduced purchases by the BOJ, rising debt payments due to higher interest rates, and the potential for further loose monetary policy ahead continue to worry investors, as do other issues, including uncertainty over the BOJ's monetary policy rate pathway and weak economic growth.

Tentatively, further upside for USD/JPY remains constrained by rising intervention risks, with verbal warnings from the MOF becoming more frequent since USD/JPY reached levels above 155, just short of historical intervention levels around 160. While we think actual intervention actions remain unlikely (and in any case, unlikely to reverse broader trends), we believe upside risks to USD/JPY remain limited for now – given tacit awareness by the MOF on risks to fiscal excesses, historically limited bearish yen bets, and futures rate differentials remaining in favour of the JPY. We pencil in only a mild appreciation pathway for the JPY in 2026, with upside JPY strength constrained by the concoction of fiscal and monetary policy brews.

Sources: Bloomberg, AmBank Economics

FX: MYR Outlook

Exhibit 46: Strong REER appreciation in Nov/Dec indicates domestic factors driving MYR strength

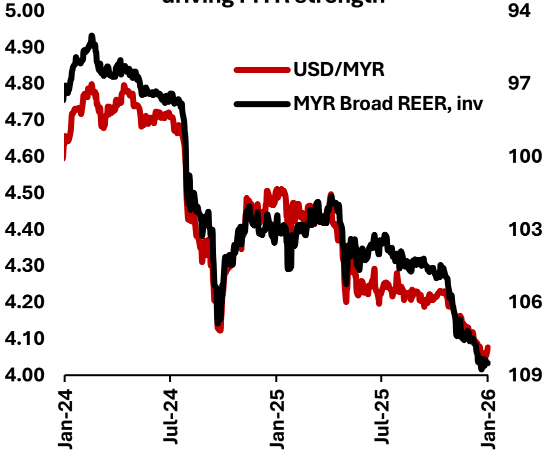


Exhibit 47: Recent MYR strength has driven greater FCY conversions, giving momentum to MYR's strength

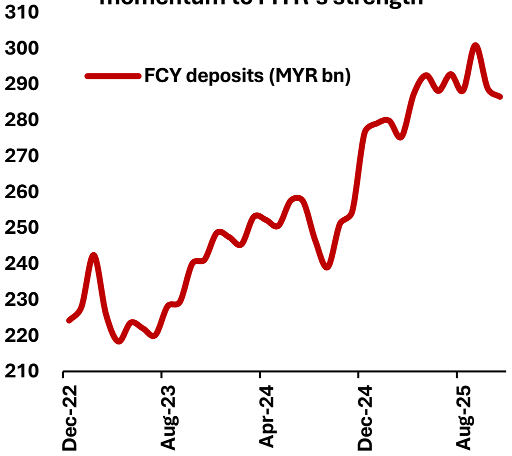


Exhibit 48: Though significant, foreign purchases of MGS in 2025 were mostly offset by their selloff in equities

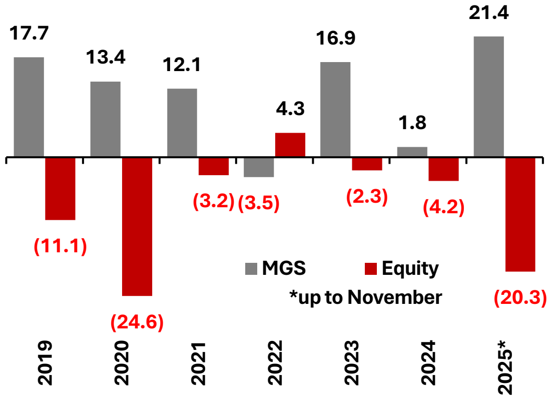
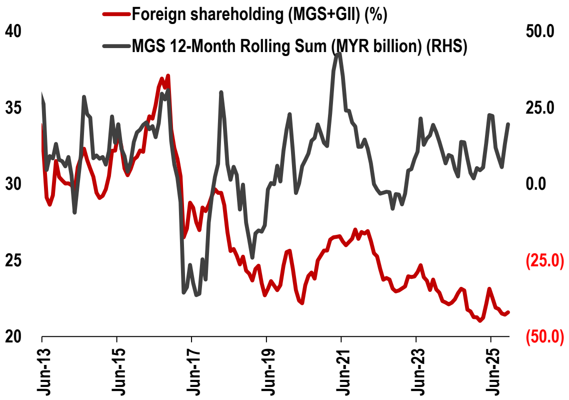


Exhibit 49: Room for further increases, with foreign shareholder ownership near historical lows



Sources: Bloomberg, AmBank Economics

MYR – On a final stretch home to 4.00

With gains of 10.1% against the USD in 2025, the MYR also strengthened against all Asian currencies and most major currencies (excluding the EUR and CHF). Strengthening tendencies were uneven and crystallised only in two periods throughout the year – in April (post-Trump tariffs, when the dollar broadly weakened against all currencies globally) and in November-December, which was more domestically centric (i.e., MYR strengthening against all peers) and came alongside strong non-resident portfolio inflows into domestic bonds.

Several factors suggest the ringgit's recent bull run has some steam left in 2026, including:

1. Incoming Fed rate cuts, and other US-centric issues that are expected to weaken the dollar;
2. The gradual appreciation pathway for the yuan, creating room for other trade-dependent Asian FX to also likewise strengthen;
3. Malaysia's constructive economic outlook, including on the E&E exports-driven trade front, a fiscally-prudent local backdrop, and relative political/policy stability compared to regional peers; and
4. Continued global risk-on sentiment is boosting all EM assets (including the ringgit).

Regarding the latter, **we think positive foreign sentiment towards Malaysian bonds can continue**, given benign inflation, rising bond yields, and Malaysia's stable monetary policy outlook (in contrast to expected Fed rate cuts). With ongoing fiscal concerns in the US and Japan, valuations are already rich for the EUR and CHF (and their local bonds), as well as for precious metals such as gold and silver. As such, **Malaysian bonds are expected to benefit from the continued search for safe-haven alternatives, with the ringgit likely to see ancillary support**.

Hence, **USD/MYR is likely to breach 4.00 in the coming weeks/months, though a consolidation below 4.00 is likely to occur only later in 2H2026** – when more visibility emerges on Fed rate cuts. Our call is also premised on continued risk-on sentiment in financial markets – including little geopolitical tensions between the US and China and unimpeded growth in the current AI capex supercycle – which has supported the ringgit through stronger trade balances and portfolio inflows.

A manifestation of said external risks should see USD/MYR close higher in the 4.20-4.30 range, although we do not currently pencil these in as our base case — a broad-based Asian FX rally against the USD.

Fixed Income: US Treasuries

Exhibit 50: US core PCE, FFR and UST yield (%)

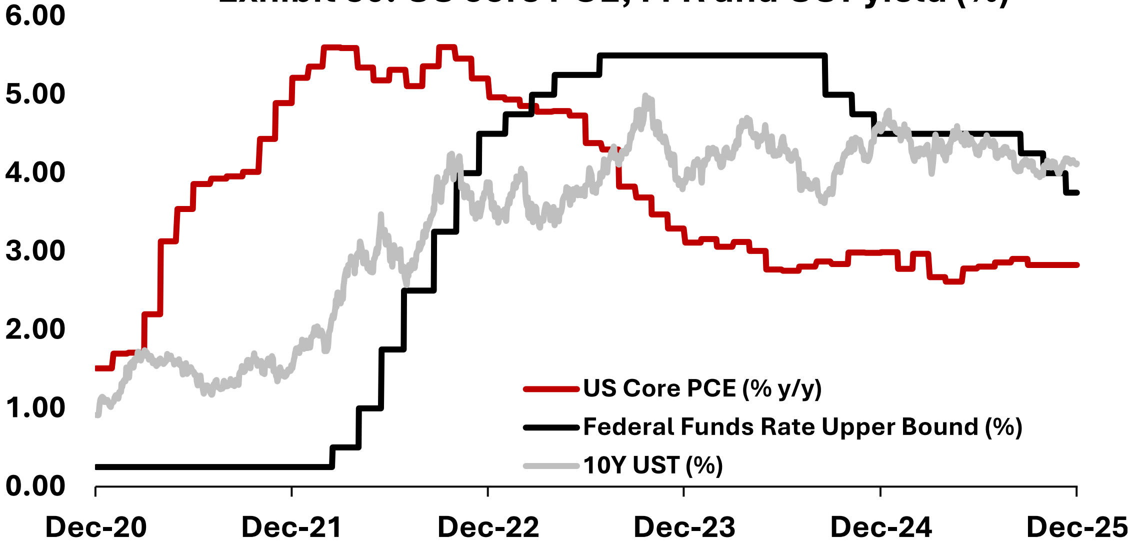
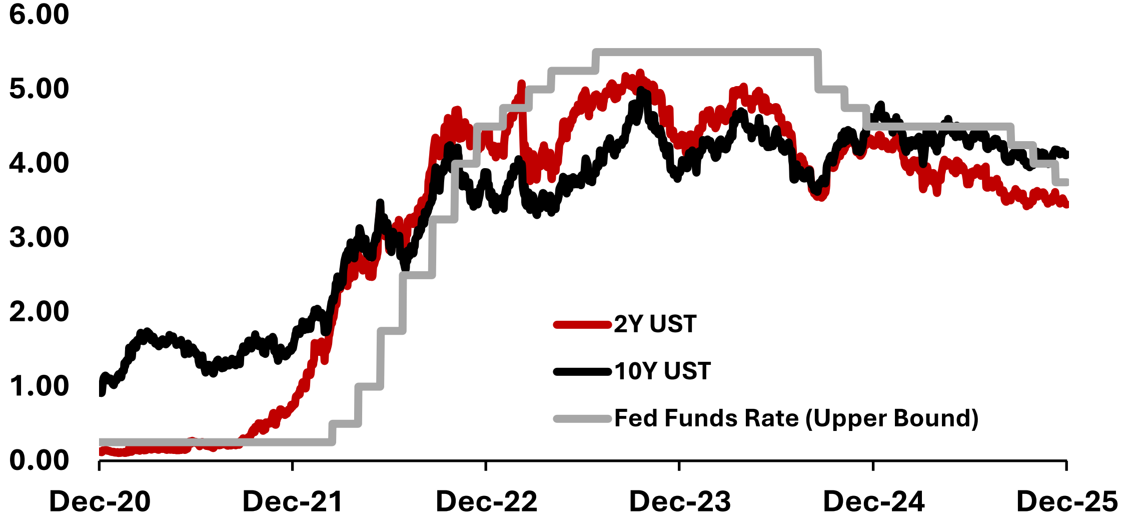


Exhibit 51: Steeper 10Y/2Y UST in 2025 (%)



Sources: Bloomberg, AmBank Economics

Recap 2025

US Treasuries rallied, with the 2Y UST falling about 80 bps and the 10Y around 40bps. The bulk of the rally occurred in 4Q2025, on the back of the Fed's 75bps rate cut (25bps in September, 25 bps in November, and 25bps in December). Lack of select data releases coinciding with the US government shutdown sent safe-haven demand into bonds as well, but mixed-to-weaker economic data released, including a rise in the unemployment rate, added to the last quarter rally.

There was a lull in the market, absent strong net buying, in 2Q-3Q2025, coinciding with a period when the Fed was reluctant to signal a timeframe for continued interest rate easing. The 2Q-3Q2025 period also coincided with USD weakness, as global investors shunned dollar assets amid drastic US political and policy risks, including US international trade policy.

Outlook for 2026

Overall, we expect strong gains for UST relative to current yields. Our forecast (where we see 2Y UST ending 2026 at 3.20% and 10Y at 3.80%) assumes the market is pricing in an ongoing Fed rate-cut outlook for 2026-2027.

FFR is currently 3.75%, and our UST numbers assume the 10Y UST could go sub-3.50% in 2027, with the FFR cut by 75bps in 2026-2027.

Exhibit 52: Bond yield quarterly forecasts 1Q2026-1Q2027 (y/y%)

	1Q2026	2Q2026	3Q2026	4Q2026	1Q2027
2Y UST	3.60	3.40	3.30	3.20	3.10
10Y UST	4.20	4.10	3.90	3.80	3.70
3Y MGS	3.00	2.95	3.00	3.00	3.00
10Y MGS	3.50	3.45	3.45	3.50	3.50

Fixed Income: US Treasuries

Exhibit 53: US Treasuries issuances vs US budget balance

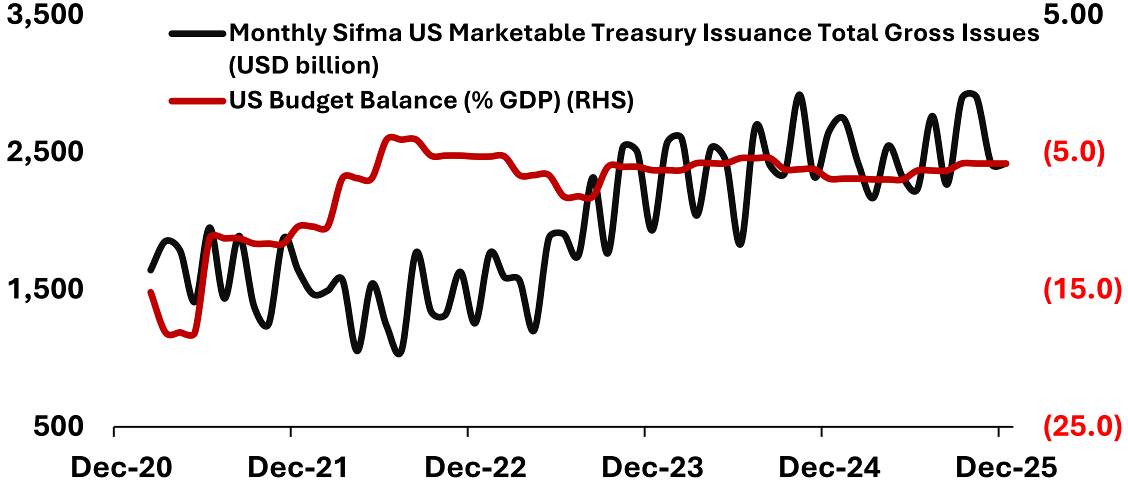
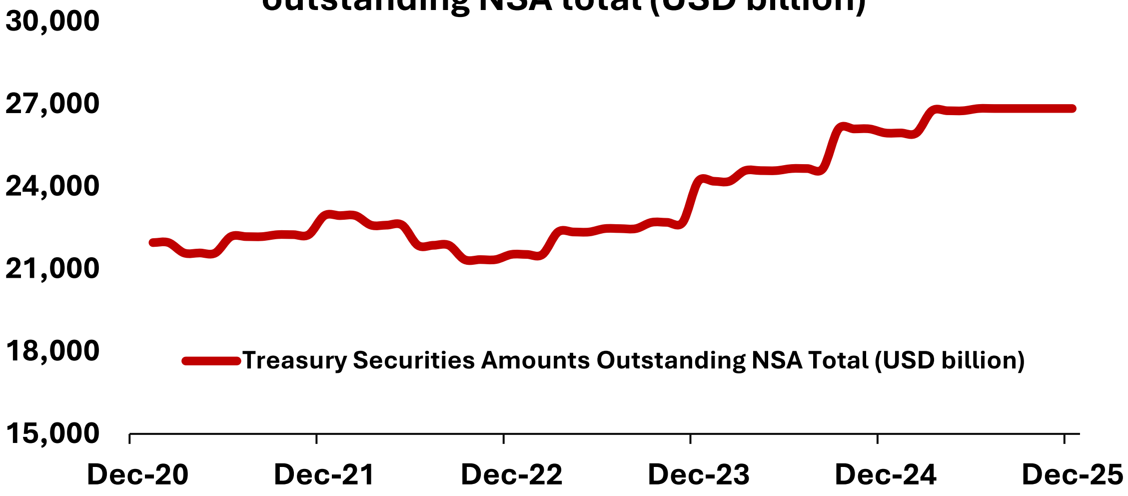


Exhibit 54: Treasury securities amounts outstanding NSA total (USD billion)



Sources: Bloomberg, AmBank Economics

Relatively steep UST curve to hold. We noted a 2H2025 steepening of the curve, with the 10Y/2Y UST moving from mostly <40 bps in 1H2025 to end last year around 70-75 bps, and we foresee a steep curve prevailing. However, we expect the market will rein in some of the steepness as the inflationary outlook could show less sticky anchoring and a potential downward trend, even though the PCE 2% Fed long-term target may be too far away. We place the 10Y/2Y spread at 60-70 bps on average in 2026, ending at 60 bps by end-2026.

Fiscal pressures. In addition to inflation concerns sustaining the steep UST curve, we price in fiscal pressures into our forecast for 2026. The US fiscal outlook remains a concern for the UST, with the US fiscal deficit likely to approach USD2.0 trillion in 2026 again. The “One Big Beautiful Bill”, which is actually a 2025 reconciliation package, includes incentives to boost the economy but may also increase the US deficits by USD3.0-USD4.5 trillion over 2025-34. In 2025, CBO estimates federal outlays at USD7.0 trillion and revenue USD5.2 trillion, translating into a deficit of USD1.9 trillion [cbo.gov], [crfb.org]. The deficit is expected to increase in 2026 due to expiring tax cuts, rising entitlements, and elevated interest costs.

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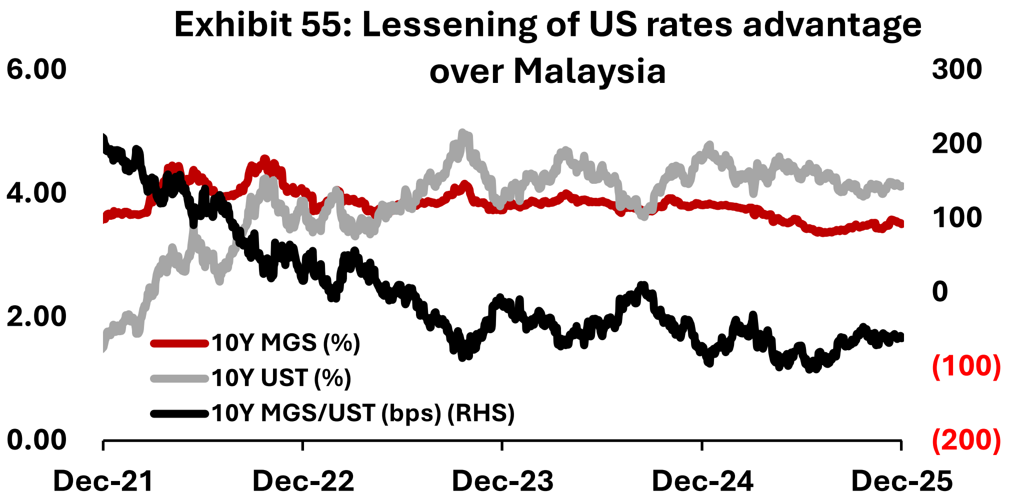
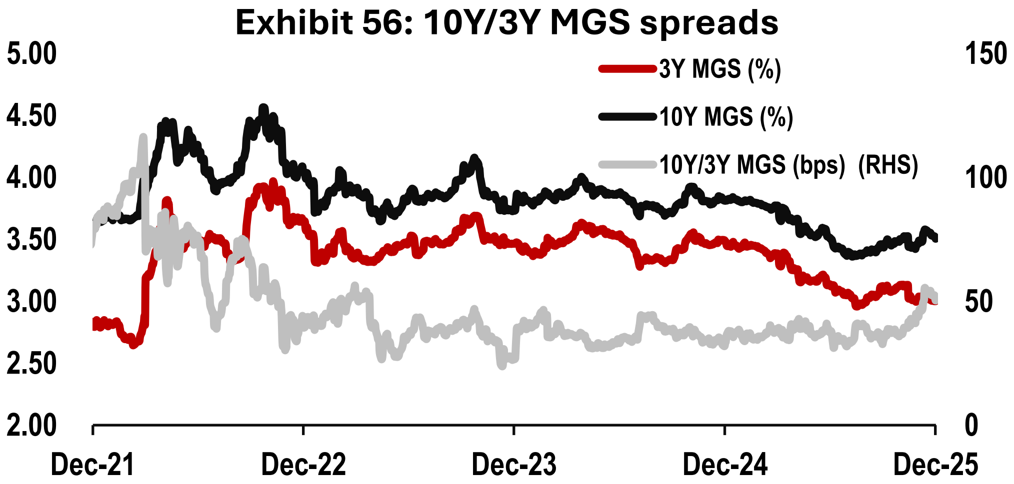
Malaysia's government bonds: Modest strengthening in 1H2026





Sources: Bloomberg, AmBank Economics

Recap 2025

Government bonds in Malaysia completed a rally in 2025 (yields down 35-50bps y/y on the shorter end and down 20-35bps on longer tenors). A vast strengthening of onshore bonds occurred during May-September 2025, as markets priced in Fed and BNM rate cuts. MGS yields were also in line with the strengthening path of the ringgit last year, as the Fed executed a 75bps cut whilst BNM reduced by a smaller 25bps, reinforcing the relative attractiveness of MYR and MYR assets.

Indeed, external inflows into the Malaysian bond market were strong. **Net cumulative foreign fund flow into all MYR fixed income securities was MYR25.6 billion in 2025** (2024: MYR4.8 billion).

Net cumulative flows into MGS were MYR21.2 billion (2024: MYR1.8 billion).

Outlook for 2026

We expect modest strengthening in Malaysian government bonds in 1H2026, followed by market consolidation in 2H2026. Our expectation, similar to consensus, is that BNM will hold the OPR at 2.75% in 2026. Even though this limits downside to yields, the bond market will consider a 25bps rate cut.

That would mean a broad 3Y MGS range of 3.85-4.05% (10-30 bps spread vs. OPR) is a possible trading range for the year. We place an end-year 3Y MGS forecast at 3.00% for now, pending more solid signals of a BNM interest rate cut.

Assuming a stable OPR at 2.75%, 10Y MGS should end the year at 3.50%, translating into a 50bps 10Y/3Y spread. This maintains around current spreads, but it's already the widest since early 2023.

Malaysia's government bonds: Primary market

Exhibit 57: MGS vs equity net annual cumulative flow (MYR billion)

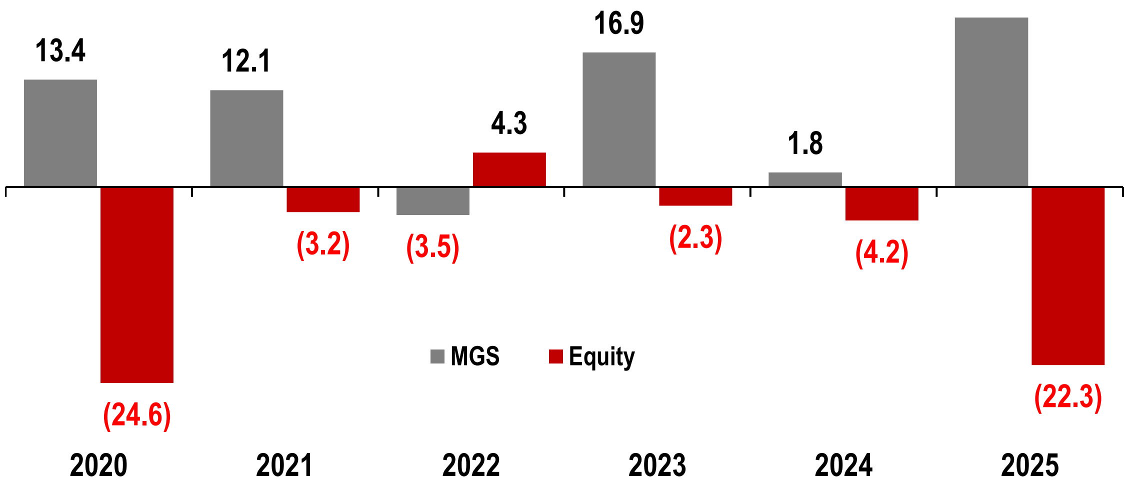


Exhibit 58: Foreign holdings (% of total outstanding securities)

	End Period		
	Dec-24	Nov-25	Dec-25
Malaysian Government Securities	32.3	33.9	33.7
Government Investment Issue	8.9	8.1	8.5
Aggregate Sovereign Bonds	21.3	21.6	21.6
Equities	19.7	13.9	13.6

Sources: BNM, AmBank Economics

Supportive primary market outlook

Supporting longer bonds includes a supportive primary market outlook, and Malaysia's overall inflation outlook should remain benign in 2026.

- **2026 should see larger MGS+GII gross issuance**: For 2026, we forecast a larger MGS and GII gross issuance (2026: MYR185.0 billion; 2025: MYR168.5 billion). The 2026 gross total includes the government's 2026 fiscal deficit, with refinancing of maturing MGS and GII totalling MYR108.7 billion (MYR53.7 billion in MGS and MYR55.0 billion in GII). As per the Budget document 'Fiscal Outlook and Federal Government Revenue Estimates 2026,' the target of fiscal deficit financing is circa MYR74.6 billion for 2026.... But an expected drop in the total size of net MGS+GII offerings (2026: MYR76.0 billion; 2025: MYR85.0 billion). **We are not concerned about the larger MGS+GII gross issue size in the coming year, as the expected rise will be due to the refinancing of a large number of maturing MGS+GII in 2026, totalling MYR108.8 billion**. For 2025, we note redemption of MGS+GII totalled MYR83.5 billion; hence, net issuance was MYR85.0 billion.

- **Aside, there is the 2026 maturity USD1.0 billion Malaysia government global sukuk**. However, we do not expect this refinancing to be placed in the MYR segment. The investor holding profile of global sukuk may differ from that of onshore bonds; thus, **any refinancing should again be in USD**. The Reg-S sukuk was issued in 2016 as a 10Y paper. Nevertheless, if the government decides to refinance in MYR, it would probably cost around MYR4.2 billion, and yet it may instead turn to the bills segment to raise relatively small financing.

Bond index. We have the targeted drop in Malaysia's weight in the JP Morgan Government Bond–Emerging Market (GBI-EM) diversified bond Index, from nearly 10% to 9%. Other countries (China, India, Indonesia, Mexico) will also see similar cuts of 10% to 9%. JP Morgan places AUM following the index at about USD233 billion as of mid-2024. Assuming Malaysia's 10% share, this equates to USD23 billion (MYR95-100 billion) in exposure.

Assuming a 10% reduction (from 10% to 9%) in this total, this could result in MYR10 billion in potential outflows from Malaysia. **We think this is manageable**. Moreover, the reduction is to be implemented over 5 months in 1H2026, further limiting the potential net selling pressure.

Malaysia's government bonds: New monies

AmBank Group MALAYSIA KITA 50 YEARS

Exhibit 59: AmBank's estimate of new monies at local insurance companies and EPF, and expected placement in MGS+GII (MYR billion)

	Life Insurance MYR billion	General Insurance MYR billion	Takaful MYR billion	EPF MYR billion
New Monies				
2020	57.73	14.27	6.38	58.58
2021	52.38	14.29	8.17	(8.89)
2022	49.62	15.46	9.24	32.49
2023	63.20	16.14	8.46	91.67
2024	75.89	17.05	7.12	83.86
2025 (estimate)	51.01	14.00	7.42	87.76
2026 (forecast)	53.50	15.17	8.81	85.81
Asset Allocation - MGS+GII				
2020	11.14%	13.64%	8.09%	21.84%
2021	12.32%	14.56%	7.72%	22.07%
2022	13.89%	15.42%	8.48%	24.70%
2023	15.12%	15.75%	8.91%	25.08%
2024	15.52%	16.15%	10.06%	24.90%
2025 (estimate)	13.60%	15.10%	8.65%	23.72%
2026 (forecast)	14.09%	15.40%	8.76%	24.09%
Investable Amounts – MGS+GII				
2020	6.43	1.95	0.52	12.79
2021	6.45	2.08	0.63	-1.96
2022	6.89	2.39	0.78	8.03
2023	9.55	2.54	0.75	22.99
2024	11.78	2.75	0.72	20.88
2025 (estimate)	6.94	2.12	0.64	20.81
2026 (forecast)	7.54	2.34	0.77	20.67

Sources: BNM Monthly Statistical Bulletin, EPF Annual Reports, AmBank Economics

New Monies: Expectations of continued new monies support MGS+GII primary market

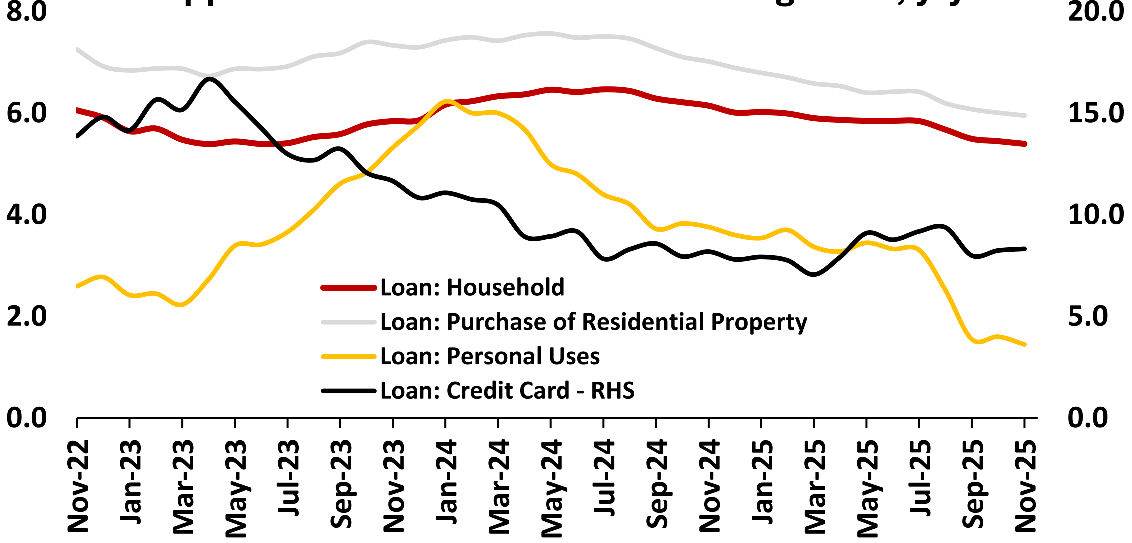
We attempted to estimate the "New Monies" among major investors in fixed-income securities in the country. Typically, these "new" cash, i.e., cash raised by investors (such as insurance premiums and pension contributions, as well as institutions' profits from investments), should be available to pick up the net issuance of MGS+GII in the coming year.

Meanwhile, cash returned to investors because of the redemption of MGS+GII during the year should, we assume, be rolled back into the bond market as well. In any case, based on the available data we gathered from General Insurance and Life Insurance companies and the EPF, we estimate that, as of 2024 (next Exhibit), their total new monies were MYR 183.9 billion (led by EPF at MYR 83.9 billion and Life Insurance companies at MYR 75.9 billion).

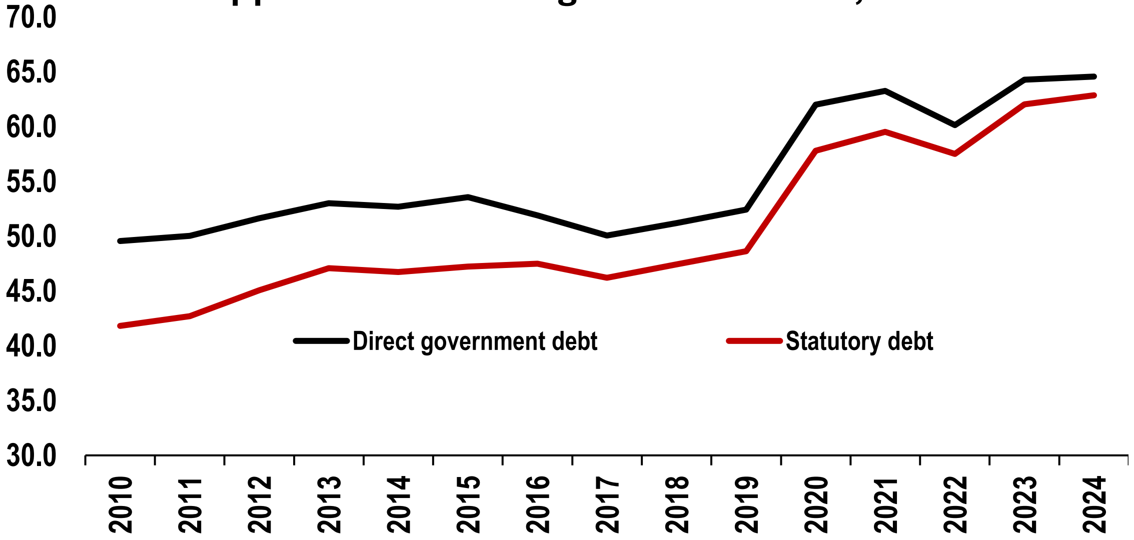
If the same levels of new monies are seen in 2026, and taking 25% of these new monies, estimated at MYR46 billion, are ploughed into MGS+GII, that will already eat up a huge chunk of the MYR76 billion net MGS+GII issuance estimated for the coming year. Based on BNM's monthly data, EPF's holdings of MGS+GII rose by MYR37.5 billion in the period September 2024-September 2025, while that of insurance companies rose by MYR5.0 billion in the same period.

Appendices

Appendix 1: Household sector loan growth, y/y%



Appendix 2: Federal government debt, % GDP



Sources: MOF, DOSM, AmBank Economics

Appendix 3: Imports & exports value by air

Global Airline Industry		Passenger traffic (RPK) y/y%				Passenger capacity (ASK) y/y%				
		2023	2024	2025E	2026F	2022	2023	2024	2025E	2026F
Global	64.9%	36.8%	10.6%	5.2%	4.9%	40.1%	31.1%	8.9%	4.9%	4.7%
Regions										
Africa	84.3%	36.5%	12.7%	7.4%	6.0%	51.4%	35.6%	10.0%	5.3%	5.7%
Asia Pacific	32.3%	95.9%	17.5%	8.0%	7.3%	15.5%	75.0%	13.2%	6.6%	7.1%
Europe	103.9%	20.3%	8.7%	5.0%	3.8%	69.6%	16.0%	8.1%	5.1%	3.8%
Latin America	62.9%	16.8%	7.8%	7.1%	6.6%	54.4%	14.4%	7.2%	7.0%	6.5%
Middle East	144.4%	32.4%	9.7%	6.0%	6.1%	67.2%	24.7%	8.5%	5.9%	5.4%
North America	45.7%	15.1%	4.6%	0.2%	1.5%	28.7%	14.0%	4.7%	1.2%	1.0%

Sources: International Air Transport Association, AmBank Economics

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