2H2026 Outlook: *Resilient Growth, Rising Fractures*

AmBank Economics

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AmBank Group

50 YEARS MALAYSIA KITA

Executive Summary

GLOBAL: The global economy entered 1H2026 amid a series of geopolitical tensions, prompting MDBs to announce consecutive growth cuts for 2026. As the world enters 2H2026, the global economy appears to be in a more resilient position than anticipated, although growth has moderated across most major economies. The question now is not whether the global economy faces recession risk, but whether inflation will persist, with a surprisingly resilient near-term outlook.

KEY RISKS: Without a doubt, the key risk to the global economy in 2H2026 is a renewed supply-side shock amid a prolonged war in West Asia rather than demand destruction. Oil prices have retreated sharply in 2Q2026, yet they remain highly vulnerable to depleted strategic reserves and to disruptions in shipping routes. A re-escalation to the war would reignite energy-led inflation. The greatest risk now is how quickly re-escalation could occur, unwillingly tipping the balance of the global economy towards a more pessimistic scenario.

MAJOR ECONOMIES: The war in West Asia has exposed the divergence among major economies in 2026. The US prevails with exceptional resilience, supported by steady labour market conditions, while persistent inflation may nudge the Fed toward greater hawkishness. The Euro Area faces a distinct challenge amid weak growth and subdued investment despite a relatively stable labour market, prompting a more accommodative ECB bias. Meanwhile, China's growth conundrum lies in its heavy reliance on investment and external demand, because domestic demand is insufficiently strong.

MALAYSIA IN 2H2026: Growth is expected to moderate as the impact of elevated commodity prices ripples through the global economy. External risks persist amid ongoing rivalry and contestation over the Strait of Hormuz. Nevertheless, economic resilience should remain intact, with growth underpinned by supportive fiscal measures that sustain household consumption and infrastructure development, as well as by the ongoing AI-driven global investment upcycle, which bolsters electrical and electronics exports and tech-related investments.

OPR: With growth holding up well, labour market conditions remaining healthy, and inflation expected to remain manageable. We expect the Overnight Policy Rate to remain unchanged throughout 2026.

RINGGIT: Following the Fed's policy meeting in mid-June, markets are now fully pricing in a 25bps Fed rate hike by around 4Q2026, with a potential second hike in March 2027. Given our projections for only one Fed hike by end-2026, we think the MYR should see a slight rebound in the coming weeks, and target a USD/MYR fair value trading range around 4.05-4.10 in 2H2026.

FIXED INCOME: We expect support for long-end UST at oversold levels, with downside risks to inflation and oil prices. We expect the UST curve to flatten as a result, but the short end will also be supported by market liquidity, demand, and hints of lower interest rates. Overall, our outlook for the MGS market remains constructive, with elevated yields. Our outlook considers recent conditions in global markets, the impact of the war, fallout from crude supply disruptions, the latest global inflation data showing elevated levels relative to pre-war conditions, and remarks from global central banks. In addition, we consider domestic Malaysian macroeconomic and market conditions, particularly BNM policy signalling, as neutral.

AGENDA

AmBank Group's latest forecasts

	2025	AmBank Forecast 2026F
Real GDP, y/y%	5.2	4.8
Inflation, %	1.4	2.0
Unemployment rate, %	2.9*	3.1*
OPR, %	2.75*	2.75*
USD/MYR	4.06*	4.09*
10Y MGS, %	3.61*	3.66*

GDP by sector, y/y%	2025	2026F
Services	5.4	5.3
Manufacturing	4.5	5.0
Mining	0.6	0.4
Agriculture	2.2	(1.0)
Construction	12.2	9.0

*Note: *Year-end figure*
Source: AmBank Economics

Sources: DOSM, BNM, AmBank Economics

Global forecasts: More downgrades, rebound in 2027

A surprisingly resilient near-term outlook with persistent inflation

The global economy entered 1H2026 amid a series of geopolitical tensions, prompting MDBs to announce consecutive growth cuts for 2026. As the world enters 2H2026, the global economy appears to be in a more resilient position than anticipated, although growth has moderated across most major economies.

Forecasts	IMF				World Bank				OECD			
			Difference				Difference				Difference	
	Jul-26		Apr-26		Jun-26		Jan-26		Jun-26		Mar-26	
	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027
World	3.0	3.4	(0.1)	0.2	2.5	2.8	(0.1)	0.1	2.8	3.1	(0.1)	0.1
Advanced economies/G20	1.7	1.8	(0.1)	0.1	1.5	1.8	(0.1)	0.2	3.0	3.0	0.0	0.0
US	2.3	2.2	0.0	0.1	2.2	2.1	0.0	0.2	2.0	1.8	0.0	0.1
Euro Area	0.9	1.2	(0.2)	0.0	0.8	1.3	(0.1)	0.1	0.8	1.2	0.0	0.0
EMDEs	3.8	4.5	(0.1)	0.3	3.6	4.2	(0.4)	0.1	-	-	-	-
China	4.6	4.1	0.2	0.1	4.2	4.3	(0.2)	0.1	4.5	4.3	0.1	0.0
India	6.4	6.7	(0.1)	0.2	6.6	7.2	0.1	0.6	6.3	6.4	0.2	0.0

Forecasts	IMF*				World Bank				ADB			
			Difference				Difference				Difference	
	Jul-26		Apr-26		Jun-26		Jan-26		Jul-26		Apr-26	
	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027
ASEAN	4.1	4.3	0.0	(0.1)	-	-	-	-	4.5	4.6	(0.1)	0.0
Malaysia	4.7	4.3	0.0	0.0	4.4	4.4	0.3	0.4	4.6	4.5	0.0	0.0
Indonesia	5.0	5.1	0.0	0.0	5.0	5.2	0.0	0.0	5.2	5.2	0.0	0.0
Philippines	3.9	5.5	(0.2)	(0.3)	3.7	5.6	(1.6)	0.2	3.8	5.3	(0.6)	(0.2)
Singapore	-	-	-	-	-	-	-	-	3.2	2.4	0.2	0.1
Thailand	1.9	2.2	0.4	0.1	1.7	2.1	(0.1)	(0.4)	1.8	2.0	0.0	0.0
Vietnam	-	-	-	-	6.8	7.1	0.5	0.4	7.2	7.0	0.0	0.0

*ASEAN-5

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

Global economic overview

The global growth in 2026 is unlikely to follow the pattern of 2025 amid ever-increasing geopolitical risks. Due to the war in West Asia, MDBs issued more pessimistic forecast updates weeks after the war broke out, with forecast downgrades prevalent across all relevant publications. MDB's latest forecasts suggest that global growth is likely to be weaker than expected in 2026, with a rebound in 2027. Despite the strong negative sentiment following the war, none of the MDBs expects the global economy to suffer stagflation, only a slowdown, let alone a full-blown recession.

Global growth projections: focus on the composition, not the downgrades

MDBs expect 2026 to be even weaker than earlier estimates, coming in at 2.5% - 3.0% (January 2026: 2.6% - 3.3%).

The more interesting narrative here is not the forecast downgrades but rather their composition. On the one hand, the United States of America (US), as a major actor in the war, is projected to grow at a steady rate of 2.0% - 2.3% in 2026, with a rebound of up to 0.2 percentage points in 2027. On the other hand, emerging markets and developing economies (EMDEs) will likely suffer unintended negative consequences of the war in West Asia, with the World Bank sharply downgrading the bloc's 2026 growth forecast by 0.4 percentage points, while the Euro Area will experience prolonged weakness until 2027.

Furthermore, MDBs expect China to record subdued growth in the near term, contradicting India's prospects, which are for the largest rebound in 2027 among large economies.

ASEAN: Unlikely to suffer greatly as feared, but growth will trend below potential

MDBs expect the ASEAN economy to moderate marginally to around 4.1% - 4.5% in 2026 (January: 4.2% - 4.4%), with a rebound to 4.3% - 4.6% in 2027. At a glance, the cyclical nature of the region's near-term growth appears small, but upon closer inspection, there is a significant shift in ASEAN's growth composition in 2026 and in 2027. One notable variation here is the Philippines, which has been one of ASEAN's top growth centres in recent years but is now among the worst-affected economies by the war in West Asia. The World Bank's massive 1.6 percentage-point growth downgrade is worth noting, yet the MDB is not expecting the Philippines to rebound as strongly as Vietnam will in 2027. Moreover, neither the IMF nor the ADB expects any material effect on growth in Malaysia and Indonesia, while Singapore is expected to perform better than anticipated.

More importantly, the ASEAN economy is now entering an interesting growth phase with Vietnam and the Philippines joining the World Bank's upper-middle-income nation category.

Malaysia has often viewed Vietnam as a potential competitor in attracting FDI, given Vietnam's continuous policy improvements over the past two decades. The Philippines, too, can be seen as Malaysia's regional competitor for FDI, but to a much lesser degree. Now, the competition for FDI has been taken up a notch, with five ASEAN economies, including Malaysia, ranked in the same income status by the World Bank.

Overall, growth within ASEAN is likely to be highly uneven, although MDBs view growth in 2026 as more of a cyclical downturn than a prolonged global slowdown, at least for now.

Key risks: Disinflation speed bump, trade tailwind

Exhibit 1: World: Consumer inflation, y/y%

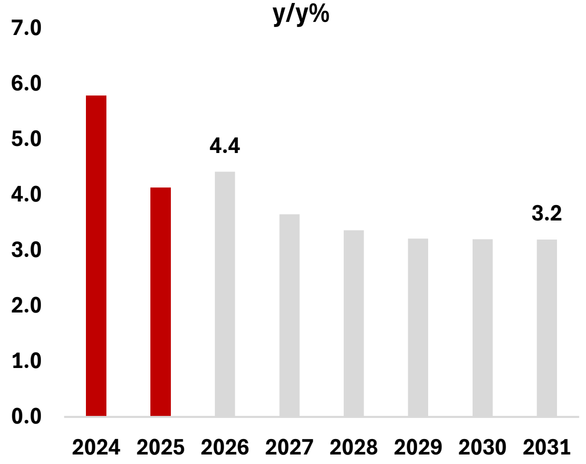


Exhibit 2: Policy rate: Major economies, %

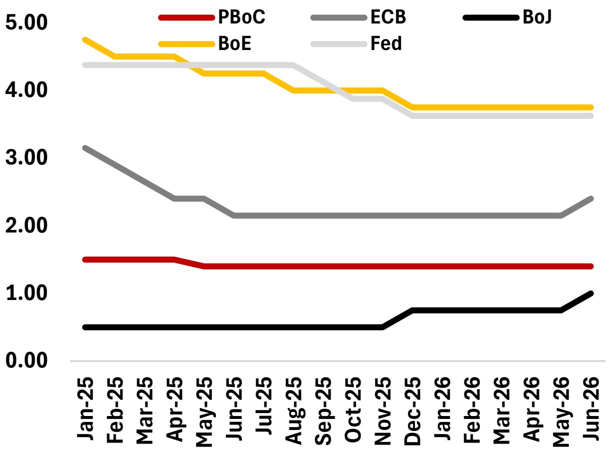


Exhibit 3: World: Trade, y/y%

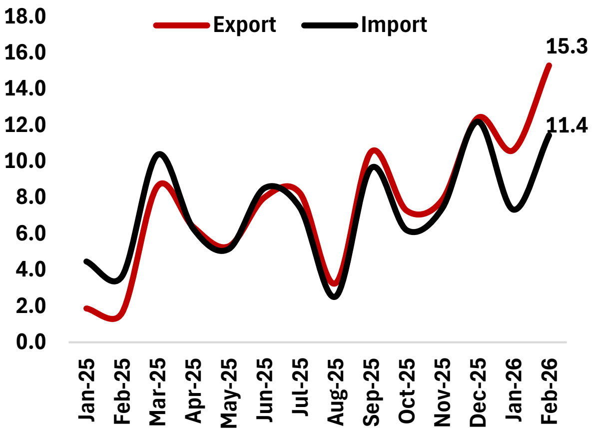
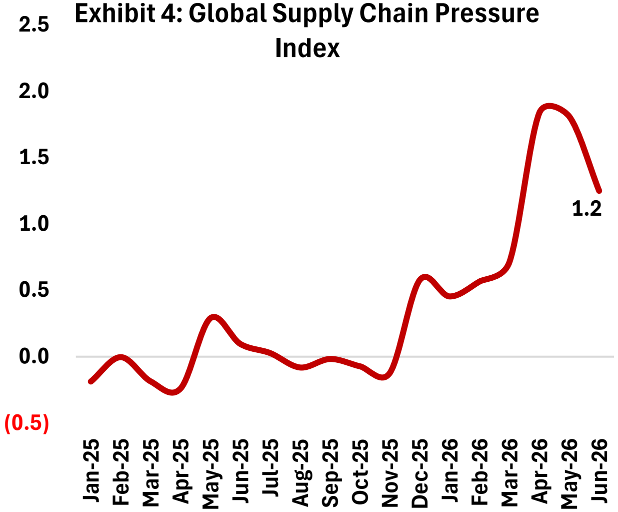


Exhibit 4: Global Supply Chain Pressure Index



Sources: IMF, Federal Reserve Bank of New York, various central banks, AmBank Economics

Stalled disinflation path

The steady global disinflationary trend in recent years is facing another critical speed bump as oil prices have jumped amid the war in West Asia. The IMF expects global inflation to reaccelerate from 4.1% in 2025 to 4.4% in 2026, then gradually decline over the coming years before settling at 3.2% in 2031. This has, in turn, revealed a two-phase global inflation path: one in which disinflation was deemed successful, leading to global easing, and another marked by reacceleration when global oil prices spiked following the war in West Asia and its knock-on effects. The projected moderation from 2027 onwards implicitly assumes no impactful escalation while commodity prices gradually stabilise.

At the time of writing, we believe that global inflation is proving more persistent than expected and that a declining path toward disinflation is an optimistic best-case scenario. Both the US and Iran have reportedly resumed military confrontations, abandoning the ceasefire pact.

Higher for longer: a new normal

The global easing cycle is losing momentum rather than accelerating amid a prolonged war and stable labour market conditions. It is no longer a matter of whether central banks are prepared to fight inflation, but rather of whether doing so will result in accelerated demand destruction.

In 2H2026, we posit that major policy rates will likely remain restrictive and remain historically high. There is no urgent need to act on rates just yet, as global oil prices have peaked in April, barring a major geopolitical escalation.

For now, trade saves the global economy from falling off the cliff

In times of crisis, the global economy is usually categorised by lower inflation and shrinking trade volume. We are not witnessing any of those scenarios in 1H2026. Yet the opposite is now true, with exports accelerating steadily, while global commercial activity remains healthy despite the war in West Asia.

To be clear, global trade was already on an upward trajectory as major economies race for technological dominance. The month prior to the war in West Asia saw both global imports and exports trend at double-digit levels since December 2025, and we suspect they will remain resilient despite the war in 2H2026. A key driver has been the continued strength in technology-related trade, particularly global semiconductors, where investment in AI infrastructures has supported cross-border demand. Most recently, the World Semiconductor Trade Statistics (WSTS) projects a massive 90% y/y growth, valued at USD1.51 trillion, which we believe will bolster global trade in 2026.

However, the resurgence of supply chain pressure is noteworthy. The global supply chain index, tracked by the Federal Reserve Bank of New York, accelerated and peaked in April 2026 before declining as both the US and Iran sought a landing zone. While current conditions remain far below those of the 2022 Russia-Ukraine war, the sharp increase we observed suggests that global logistics are now an inflationary force. In 2H2026, we suspect that it will remain elevated until a meaningful US-Iran ceasefire is in place, which will further ease the global supply chain pressure.

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Key risks: Worst-case global energy crisis averted, for now

Exhibit 5: Brent: Spot vs Futures, USD bbl

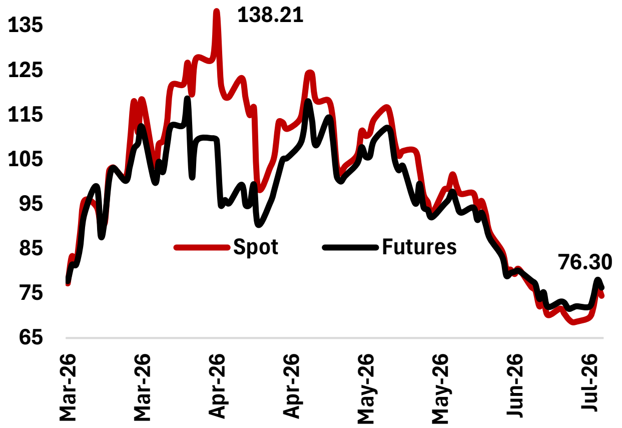


Exhibit 6: Strait of Hormuz: Oil and gas tankers departures, 7-day moving average, units

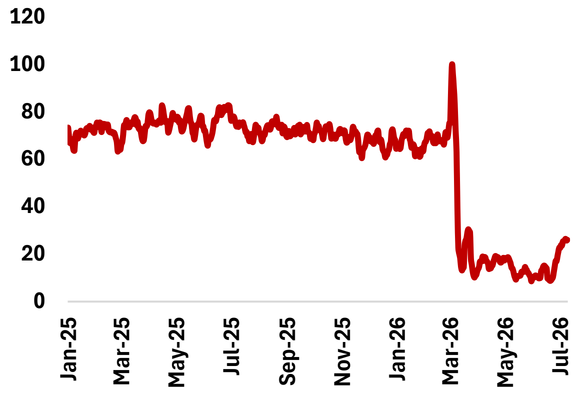


Exhibit 7: Brent spot average forecast, USD barrel

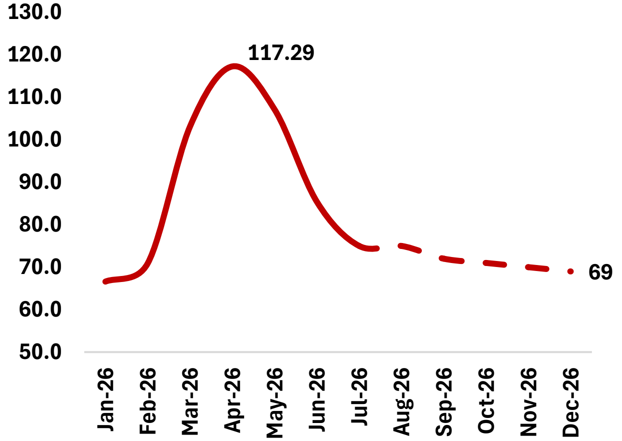
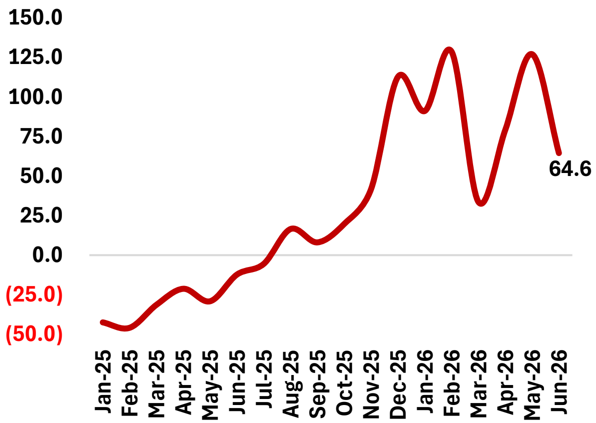


Exhibit 8: Baltic Exchange Index (BDI): monthly average, y/y%



Sources: US Energy Information Administration, Lloyd's List Intelligence, Baltic Exchange Information Services Limited, AmBank Economics

Initial global oil shock

The war in West Asia sent shockwaves through the global economy, with Brent oil futures shooting up from around USD72 per barrel at end-February to USD77 the next trading day, and peaking at below USD120 per barrel end-March. However, Brent Spot rose at a much speedier rate amid supply shortages, peaking at USD138.21 per barrel on 7 April 2026. Having said that, Brent did not spike as initially feared amid panic repricing; instead, it was a somewhat controlled rise, although backwardation widened sharply during the period.

Yet, the real economy was telling us a different story amid an unprecedented drop in traffic through the Strait of Hormuz following its effective closure. While the widened backwardation reflected immediate supply concerns, futures prices remained below spot prices, suggesting markets did not view the disruption as a permanent loss of global supply. At least for now.

Financial markets have normalised much faster than physical markets

Essentially, it was a short-lived "risk-off" period that turned into inflation risk with no systemic crisis pricing. This, we believe, was because markets did not price the war as a demand-destructive or systemic crisis.

The swift intervention by governments around the world signalled to the market that the physical oil shock does not mean a permanent loss of supply. Coordinated release of strategic oil reserves and a marked drop in China's energy imports are the two main reasons for this.

Freight markets remain under pressure

The Baltic Exchange Index (BDI) complements the NY Fed's Global Supply Chain Pressure Index presented earlier. The BDI surged above 120% y/y twice in February and in May, and remains elevated at 64.6% in June.

These readings are distinct in that freight rates usually decline rapidly following a temporary shock. Instead, shipping costs rose sharply and trended sideways, suggesting sustained supply-side frictions. In other words, the war in West Asia may no longer be driving global oil markets, but it is still influencing transportation markets, particularly sea routes.

What does this mean to the global economy in 2H2026?

There are reasons to celebrate with lower global oil prices. Energy-led inflationary pressure has eased, offering some breathing room for central banks to act on rates. Should the present circumstances persist, the US Energy Information Administration (EIA) forecasts Brent spot prices to fall steadily towards USD69 by end-2026.

Our base case for 2H2026 is easing energy prices with persistent supply-side frictions. The global economy appears to have averted a worst-case energy crisis, yet the scarring effects of disrupted trade routes and thinning global oil inventories suggest that the path towards lower inflation is likely to remain uneven and highly vulnerable to renewed geopolitical escalation.

US: Exceptionalism fuels Fed's hawkishness

Exhibit 9: US GDP, saar, q/q%

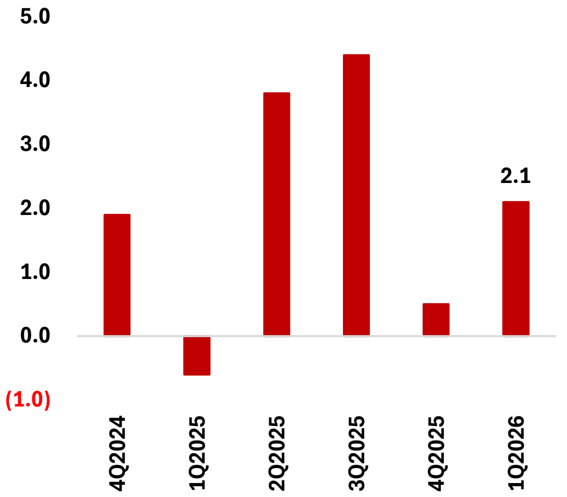


Exhibit 10: US: Selected labour market indicators, sa

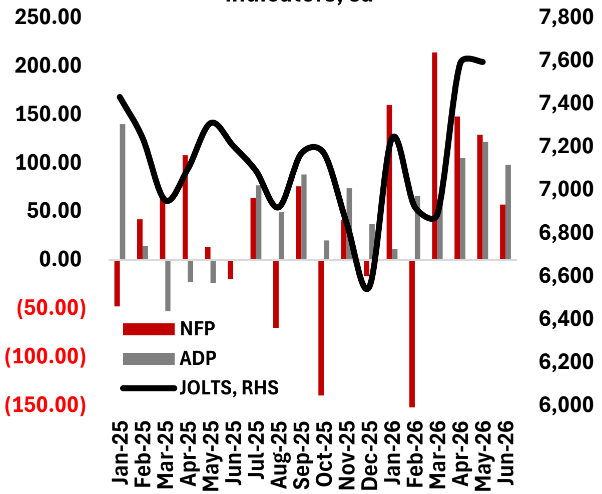


Exhibit 11: US: PCE inflation

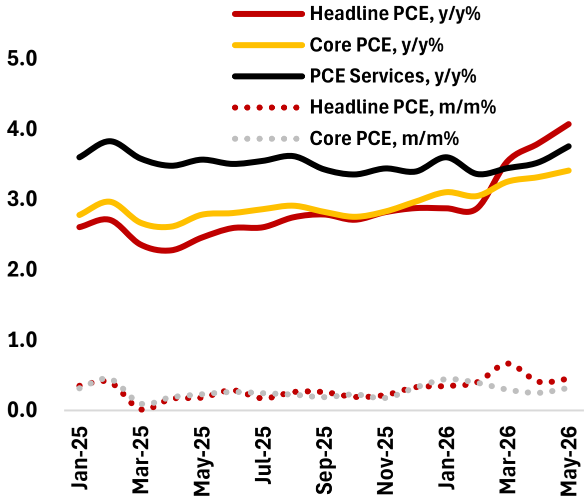
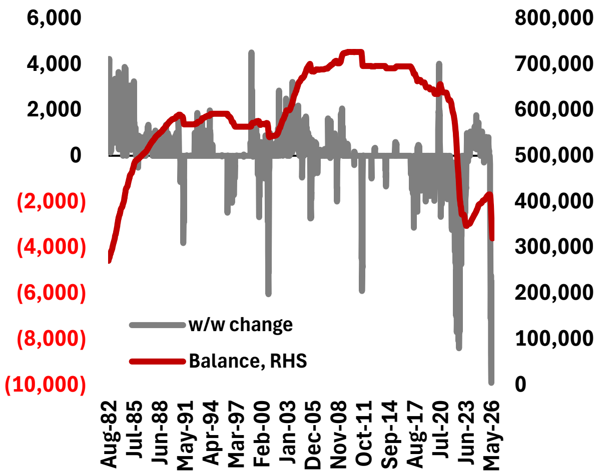


Exhibit 12: US Petroleum Stocks: Strategic Petroleum Reserve, '000 barrels



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

Despite the economy performing under decades-high policy rates, the US economy has successfully demonstrated its exceptional traits, with growth not suffering and likely to outperform many other advanced economies globally. That said, US exceptionalism is also increasingly becoming the source of US inflation persistence.

The US real GDP in 1Q2026 came in at 2.1%, rebounded sharply from a contraction of -0.6% in 1Q2025. In 2H2026, we believe the US economy will perform similarly or better, as the war in West Asia prompts global reliance on American crude as an alternative to Strait of Hormuz supply.

The cost of US exceptionalism

Commendable growth does not come free of charge, as the economy is not showing sufficient signs to generate a pronounced disinflationary impulse. In fact, the war in West Asia is a double-edged sword that comes with higher exports of American crude while fuelling energy-led inflation along the way. Disinflation in the last mile is becoming increasingly sticky amid accelerating PCE inflation, which is expected to trend above 4.0%, while core PCE and services inflation data are expected to rise in tandem. The persistence of services inflation suggests that domestic demand remains sufficiently strong to prevent a rapid return to the Fed's 2% target.

Meanwhile, analysts continue to track the pulse of the US labour market to gauge the balance of risks that will prompt the Fed to act on rates amid rising inflation. Despite occasional weak payroll prints, there is insufficient evidence to suggest a sustained deterioration in the US labour market. Firms are still willing to hire, leading us to believe that the US labour market therefore remains the single biggest reason why US monetary policy is likely to stay restrictive in 2H2026.

The continuous and heavy release of US strategic petroleum reserves (SPR) acts as a hidden buffer for both the US and, by extension, the global economy against a downward growth spiral. This is essentially an important stabilising factor which has helped cushion energy-market disruptions and reduce the risk of a more severe supply shock.

Will US exceptionalism sail in 2H2026?

The US SPR cannot be drawn down indefinitely, especially since the US has not fully replenished its depleted inventories following the Russia-Ukraine war. Furthermore, the recent re-escalation of the Russia-Ukraine war may signal that the global economy needs more, not fewer, SPR drawdowns to keep the wheel turning.

As reserve levels decline in 2H2026, the global oil markets will become increasingly sensitive to future supply disruptions, creating a vulnerability vacuum that financial markets may be underpricing.

Where will the new Fed Chair, Kevin Warsh, steer its monetary policy?

The Fed faces a dilemma as it enters 2H2026. The US economy remains strong, with a resilient labour market, while inflation is facing an upward trajectory. All of these suggest that the present policy rate may be insufficiently restrictive to return to the 2.0% mandate.

We won't fully rule out an easing, although the balance of risks has shifted closer to one hike in 2H2026 amid labour market resilience and rising core inflation. A bias towards a more hawkish stance is well justified, with the possibility of an additional rate hike should inflation and US labour market conditions continue to surprise on the upside.

Euro Area: Rising inflation with a dovish bias

Exhibit 13: EA: Real GDP by expenditure, q/q%, swda

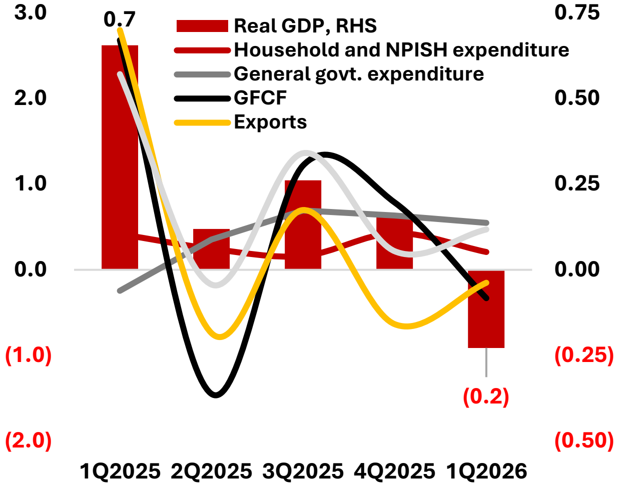


Exhibit 14: EA: Consumer inflation, y/y%

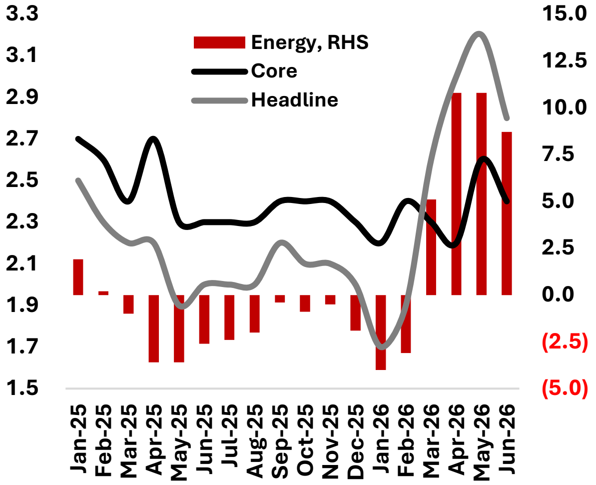


Exhibit 15: EA-21: Unemployment Rate, sa, %

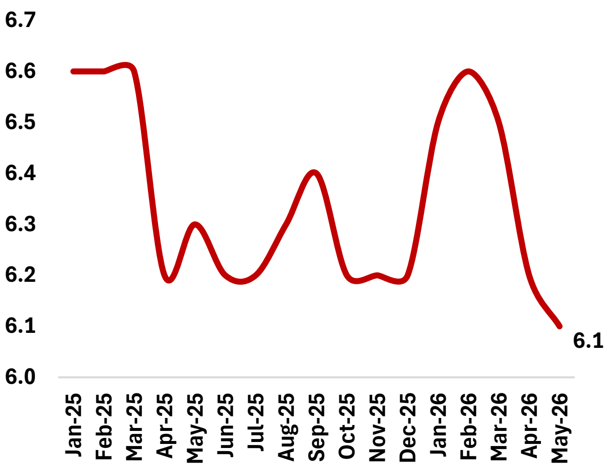
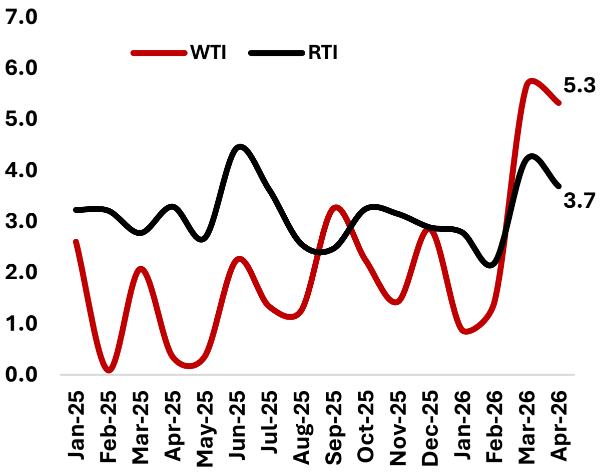


Exhibit 16: EA: Wholesale and retail trade index, y/y%



Sources: Eurostat, AmBank Economics

The biggest problem is growth, with or without rising inflation

The Euro Area (EA) enters 2H2026 with a distinctly different set of challenges from the US: inflation pressures *and* sluggish growth, not with `economic resilience. From a growth perspective, the economy's growth momentum appears to have been dwindling since 1H2025, entering a contraction zone of -0.2% in 1Q2026 following a revision to the flash estimate from +0.1%. Weak investment and exports are the bloc's laggards in 1Q2026, especially as EA's merchandise exports to extra-EA contracted by 6.3%. Household and government spending remained healthy over the past four quarters, albeit still low.

Contrary to recent developments in the US economy, the EA's weak growth is evident despite relatively stable labour markets and improving consumer activity. The economy's unemployment rate continues to show notable improvement, coming in at 6.1% in May 2026, down from 6.6% four months earlier.

Steady labour market conditions supportive of growth

This phenomenon differs from conventional thinking, where a slowing economy often leads to rising joblessness. Various studies show labour-hoarding behaviours in the economy (retain workers despite weaker economic activity), given the assumption that the current weakness could be temporary.

This could explain why household consumption remains healthy, as evidenced by the steady rise in both wholesale and retail trade. In April, wholesale trade grew by 5.3%, while retail trade grew by 3.7%. These are healthy numbers, considering that regional consumer inflation was already rising due to rising global energy prices and supply chain pressures.

What will 2H2026 bring to the EA economy?

We opine that weak trade and investment prospects will be the economy's biggest drag on growth. The weakness in EA's exports suggests that external demand is no longer providing the necessary growth support that it once did. This comes at a time when European firms face increasing competitive pressures from global manufacturers who are rapidly climbing the technological ladder with a price advantage.

The ECB's rate path is more complicated than the Fed's

On the one hand, there are arguments for the ECB to continue easing, such as weak GDP growth, subdued investment activity and prospects, and businesses becoming increasingly vulnerable to global energy shocks. But on the other hand, arguments for further tightening are valid amid rising energy-led headline inflation and steady labour market conditions.

Having said that, an energy-driven inflation suggests that the inflation problem is primarily imported rather than demand-driven. A more restrictive rate environment could tilt the economy further towards a recession when the risk of such an event is low amid labour-hoarding and resilient consumption. In sluggish investment conditions, the likelihood of energy-led inflation feeding into a wage-price spiral is low, unlike in the US.

We believe that the balance of risks is weighted toward an accommodative stance, as the ECB faces an uncomfortable trade-off between supporting a stagnating economy and responding to price pressures. As such, we expect a dovish tone from the ECB, as to act otherwise could be harmful.

China: Banking on external demand for growth

Exhibit 17: China: Contribution to GDP Growth, y/y%

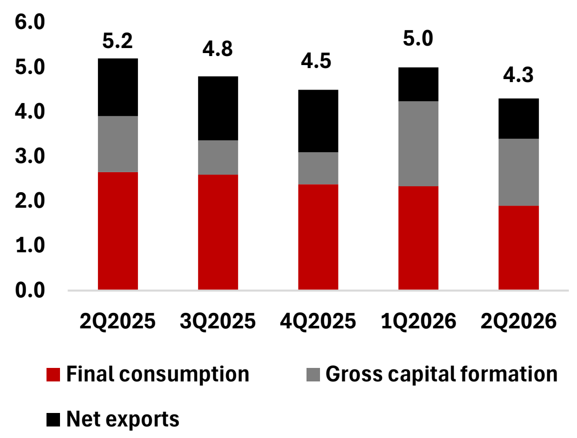


Exhibit 18: China: Consumer inflation, y/y%

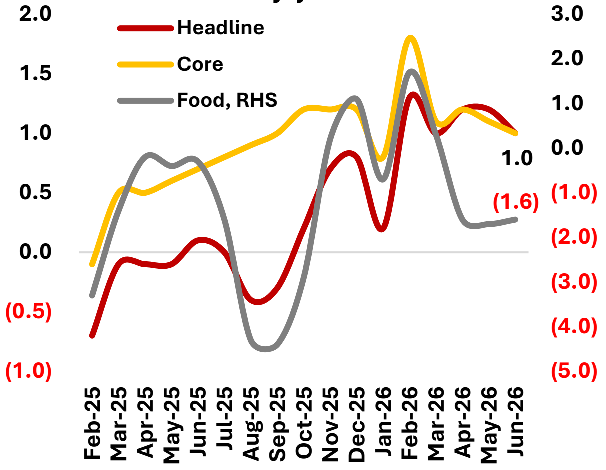


Exhibit 19: China: Trade performance, y/y%

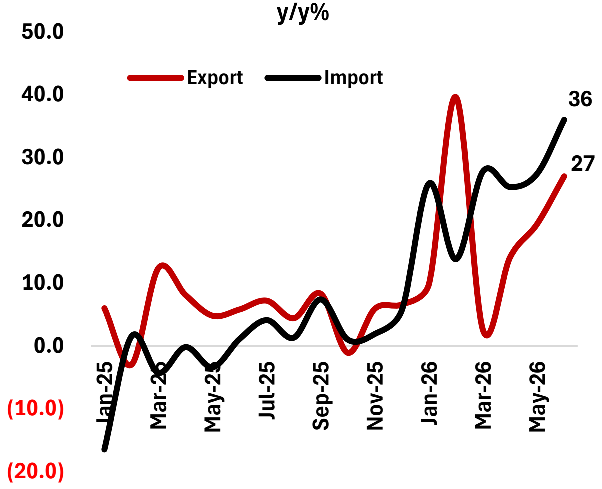
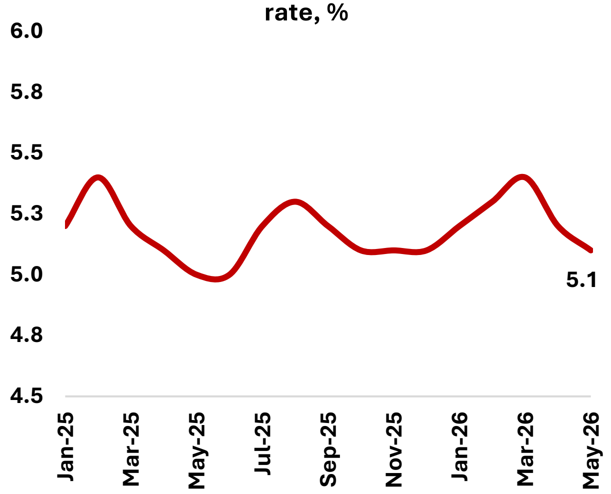


Exhibit 20: China: Unemployment rate, %



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

Underwhelming 2Q2026 growth performance

Despite a meaningful rise in growth in 1Q2026, China appears unable to keep its growth momentum. Consumption, evidently, has been the growth anchor, but it has also caused China's underwhelming growth over the past quarters. Net exports picked up in 2Q2026, but not strong enough to sustain the growth momentum. Simply put, the growth conundrum of the world's second-largest economy lies in its heavy reliance on investment and external demand, with domestic demand insufficiently strong.

China's short-term growth prospects primarily hinge on the external demand's ability to absorb its expanding industrial output. Policymakers appear to be banking on investments and external demand to spur growth, with rapid technological upgrades as a catalyst. As exports have been on an upward trend of late, China's current growth strategy hinges on fragile external demand amid prolonged geopolitical tensions.

Inflation does not mirror other advanced economies

China is the only major economy not battling inflation. Despite solid growth in 2025, inflation was negative for months amid lukewarm household spending. While inflation has recovered, food inflation has not (17.2% of the CPI basket). Core inflation has tumbled, signalling a weak domestic demand. As the world's largest crude oil importer, the rising/elevated global oil prices is punitive to China's near-term growth performance.

Overall, China's inflation dynamics are more influenced by supply-side factors, unlike in other advanced economies. If geopolitical fragility persists in 2H2026 and beyond, China will likely seek deeper market access to drive growth, as global demand for Chinese products remains resilient despite supply chain pressures.

In contrast, China's labour market remains stable, just like in advanced economies

Despite recent fluctuations in China's unemployment rate, we believe the economy's labour market is chugging along well. The latest reading came in at 5.1% in May 2026, which neither led to a deterioration in consumer confidence nor triggered a wage-led inflation.

China in 2H2026

It is extraordinary for a large economy to consistently record growth at near the 5.0% level without inflation misbehaving. Therefore, policy discussions in Beijing may differ significantly from those in Washington, DC, or Brussels. While China's growth continues to be strong, the economy does not experience sticky inflation (US) and weak growth (EA). Growth may be adequate, although domestic demand appears to be weakening. As such, China's policy rate can afford to remain neutral in 2H2026, with a slight tinge of dovishness.

All in all, we opine that China's key risk lies in the economy's ability to sustain an investment-heavy, external-oriented growth model. While China is unlikely to experience a setback from such a strategy, we believe China will eventually lay the groundwork for its next phase of development. This is particularly urgent for Chinese policymakers, not only due to the ongoing war in West Asia (which is affecting China's oil imports in the near term) but, more importantly, because of the prolonged nature of geopolitical tensions. As a result, we take it that China's challenge is no longer achieving growth but, eventually, improving the quality and sustainability of its growth in 2H2026 and beyond.

Malaysia: Resilient economy, albeit with moderation ahead

Exhibit 21: Real GDP, y/y%

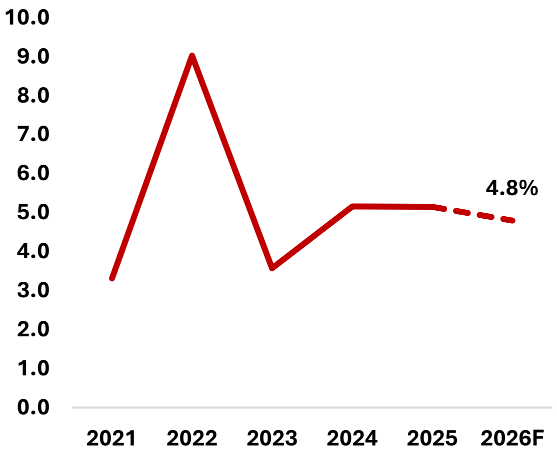


Exhibit 22: GDP growth and contributions

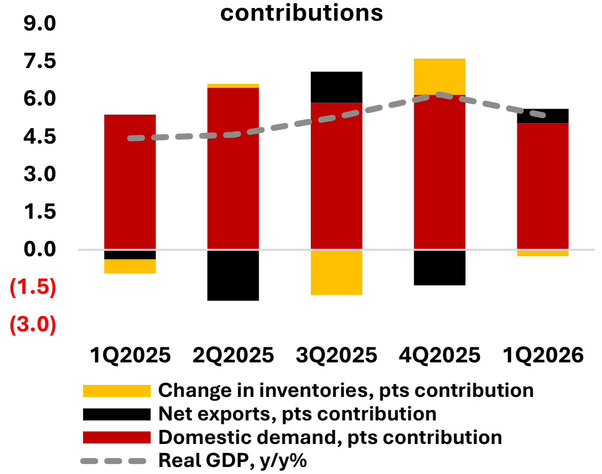


Exhibit 23: Household credit growth, y/y%

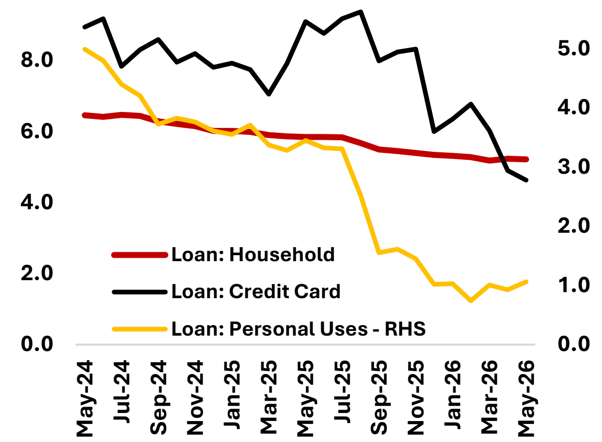
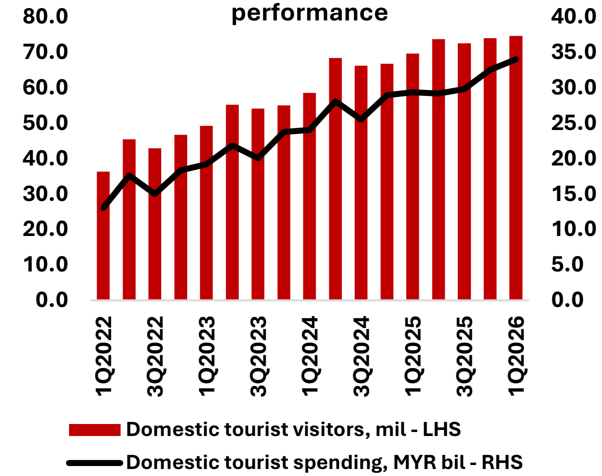


Exhibit 24: Domestic tourism performance



Sources: Bank Negara Malaysia (BNM), Department of Statistics Malaysia (DOSM), AmBank Economics

Economic resilience remains intact despite heightened external risks, 2026 growth forecast revised upward to 4.8%

Despite the conflict in West Asia since late February, which has triggered an oil price shock and shipping disruptions, recent economic indicators indicate that growth in 1H2026 has outperformed the assumptions underpinning our earlier forecast. In addition, the reduction in the US tariff rate (10% vs. 19% previously), together with the recent signing of the Memorandum of Understanding (MoU) between the US and Iran, which helped to avert a full closure of the Strait of Hormuz, has provided near-term relief.

Consequently, we revise our 2026 GDP growth forecast upward to 4.8% from 4.5% previously, at the upper bound of BNM’s growth projection range of 4.0%-5.0%. Growth should continue to be underpinned by supportive fiscal measures that sustain household consumption and infrastructure development, as well as the ongoing AI-driven global investment upcycle, which bolsters E&E exports and IT-related investments.

Even with the upward revision, growth is still expected to ease from 5.2% in 2025. Our forecast incorporates a moderation in 2H2026 as the impact of elevated commodity prices gradually ripples through the global economy. External risks remain tilted to the downside, with uncertainties persisting despite the signing of the US-Iran peace agreement. Growth is likely to remain uneven across sectors, with AI-driven technology upcycle benefiting technology-related industries, while sectors exposed to higher input costs and supply chain disruptions from the West Asia conflict continue to grapple with margin pressures.

Consumer spending remains solid, although cautious sentiment suggests a more measured pace ahead

Private consumption moderated in 1Q2026 (4.7% vs 4Q2025: 5.6%) despite several supportive factors, including the civil servant salary hike in January, a one-off MYR100 cash handout to all Malaysian adults in February, and festive spending during Chinese New Year and Hari Raya Aidilfitri. This is consistent with the slowdown in household credit growth, suggesting more cautious household spending behaviour.

Moving forward, consumption growth is expected to remain measured amid heightened uncertainty that undermines sentiment, rising prices that are eroding purchasing power and a slight uptick in the unemployment rate. In this context, government measures will be crucial in alleviating cost of living pressures and supporting household consumption, particularly through continued subsidies, cash assistance and family tax reliefs, with the potential for additional support if needed.

Tourism remains robust

Tourist arrivals hit 10.6 million in 5M2026, but sustaining this pace may prove challenging as flight cancellations, higher airfares and lingering geopolitical uncertainties weigh on foreign travel demand. Domestic tourism, by contrast, is expected to remain resilient, having already reached record levels of 74.7 million visitors and MYR34.0 billion in spending in 1Q2026, supported by fuel subsidies that cap RON95 and diesel retail prices, as well as the MYR1,000 income tax relief for local travel spending.

Fiscal position: Support crucial to sustaining growth

Exhibit 25: Nominal GDP vs. fiscal balance

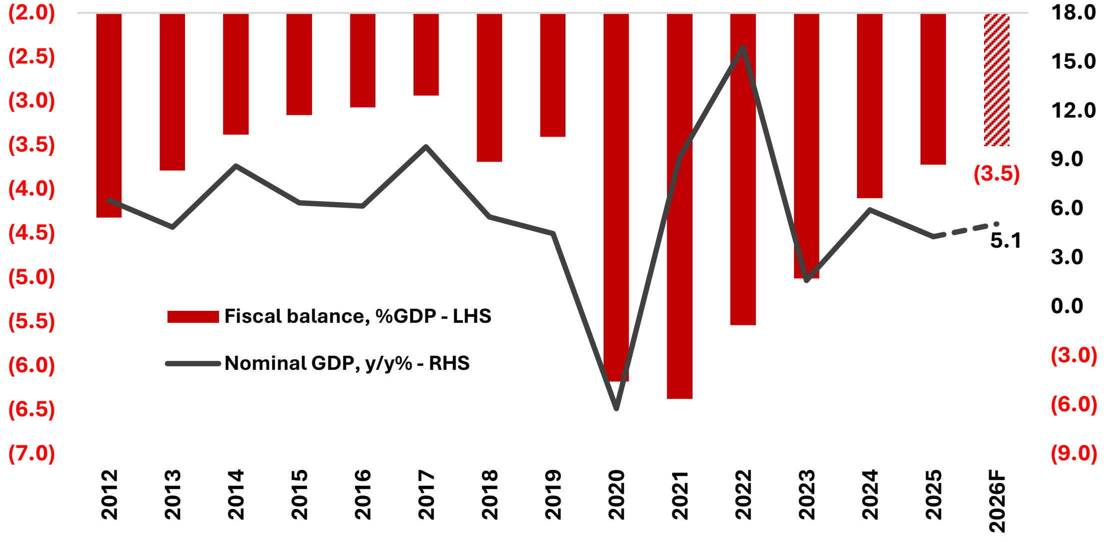
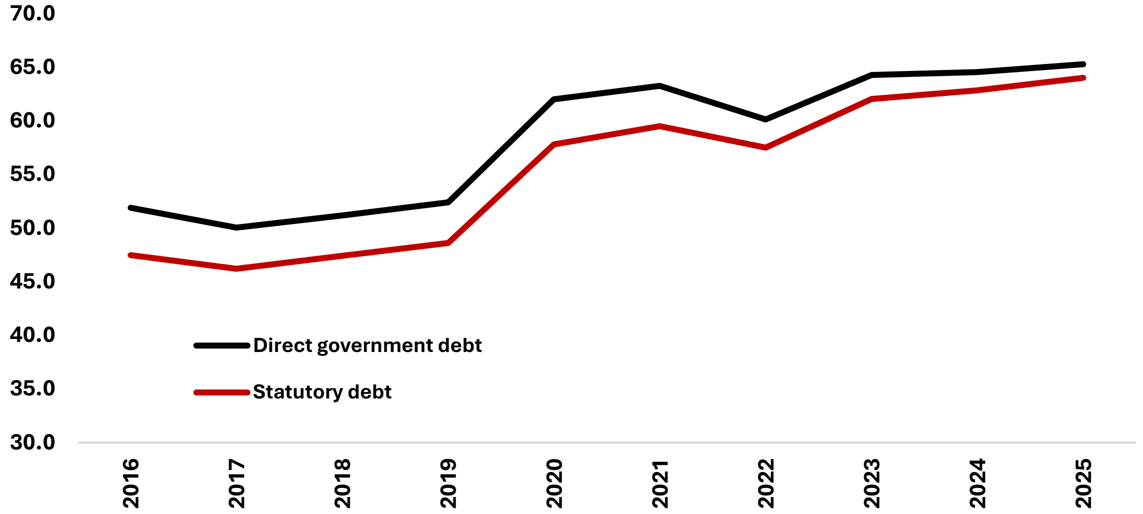


Exhibit 26: Federal government debt, % GDP



Sources: Ministry of Finance Malaysia (MoF), DOSM, AmBank Economics

Fiscal space allows targeted support

Against a backdrop of heightened external uncertainties, fiscal policy serves as a crucial growth stabiliser, mitigating downside risks and preventing further deterioration in growth drivers. This is particularly important given that monetary policy space remains relatively constrained amid persistent inflationary pressures.

In response to recent energy price shocks, the government has implemented a range of support measures, including cushioning households from rising cost of living pressures through fuel subsidies, as well as preserving employment and business continuity via a labour market resilience package and financing guarantees for small and medium enterprises (SMEs). In our view, there remains some policy room for additional support if needed, underpinned by the fiscal space rebuilt through sustained fiscal consolidation efforts in the last few years.

At the same time, policymakers will need to ensure that any increase in support measures does not come at the expense of development expenditure. Infrastructure projects, including the East Coast Rail Link (ECRL), Pan-Borneo Highway, MRT 3, Penang LRT and Perak-Penang Water Supply scheme, are important pillars of economic growth. Continued spending on infrastructure projects will help crowd in private investment and enhance the economy's productive capacity.

A temporary and modest deviation from the deficit reduction target could be justified

Higher government spending entails a trade-off as efforts to support the economy may come at the cost of wider fiscal deficits and rising debt levels. Notably, maintaining fuel subsidies amid persistently elevated oil prices could raise fuel subsidy spending to around MYR40.0 billion in 2026, more than twice the MYR15.0 billion initially allocated under Budget 2026, according to Prime Minister Anwar Ibrahim.

A temporary and modest deviation from the deficit-reduction target is justified, provided there is a clear commitment to return to the fiscal consolidation path once growth conditions improve. The Second Finance Minister recently indicated that the fiscal deficit may slightly miss the 3.5% of GDP target for 2026, although the medium-term consolidation path towards a 3.0% deficit by 2028 remains intact.

Fiscal deficit-to-GDP ratio still expected to be lower than in 2025

Nonetheless, we expect the fiscal deficit in 2026 to come in below the 2025 level of 3.7% of GDP, given the government's credible track record of prudent fiscal management, and our expectation that nominal GDP growth will pick up in 2026 due to the low base effect.

Statutory debt, estimated at 61.9% of GDP as of the end of March 2026, is expected to remain within the debt ceiling of 65.0%. While the upward trend in the debt service ratio warrants monitoring, risks are contained by the low share of external debt and a largely domestic debt profile.

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Fiscal position: Deficit target cannot depend on reducing expenditures alone

2026			
Description	Budget (MYR mil)	Actual 5M2026 (MYR mil)	% Actual 5M2026
Revenue	343,124	138,432	40.3%
Expenditure	417,702	173,894	41.6%
Fiscal balance	**(74,578)**	**(35,462)**	**47.5%**

2025			
Description	Budget (MYR mil)	Actual 5M2025 (MYR mil)	% Actual 5M2025
Revenue	339,706	124,770	36.7%
Expenditure	419,679	158,548	37.8%
Fiscal balance	**(79,973)**	**(33,779)**	**42.2%**

2024			
Description	Budget (MYR mil)	Actual 5M2024 (MYR mil)	% Actual 5M2024
Revenue	307,600	118,468	38.5%
Expenditure	393,000	164,475	41.9%
Fiscal balance	**(85,400)**	**(46,007)**	**53.9%**

Sources: MoF, BNM, AmBank Economics

5M2026 fiscal position: higher revenues with higher spending

We examine the federal government's updated fiscal position and find that total revenues increased by 11% in 5M2026, from MYR124.8 billion to MYR138.4 billion. Budget 2026 projects total revenues of MYR343.1 billion, with actual collections reaching 40.3% of this target in 5M2026. This is notably higher than the 36.7% recorded during the same period in 2025 and in 2024.

On the expenditure side, we notice a similar pattern. The total expenditure in 5M2026 increased by 9.7% (from MYR158.6 billion to MYR173.9 billion), representing 41.6% of the 2026 budget. This is higher than in the same period in 2025, of 37.8% in both percentage and value terms.

The government expects the fiscal balance to shrink from MYR79.9 billion in 2025 to MYR74.6 billion in 2026, assuming higher revenues and spending. However, as the increase in revenues is now matched by an increase in expenditures, the actual 5M2026 fiscal balance relative to Budget 2026 stands at 47.5%, up from 42.2% in 5M2025.

Is higher spending justified?

Despite global uncertainties, we commend the government for materially improving its revenue collection without putting a significant drag on growth prospects in 2026. We are comforted by the fact that stronger revenue creates the necessary fiscal buffer to cushion unforeseen growth headwinds. This is why we opine that the government is fiscally capable of expanding fuel subsidies when global oil prices spike amid the war in West Asia.

The increase of MYR15.3 billion in 5M2026 versus the same period in 2025 is justified. The faster pace of fiscal execution is intended not only to ensure that most key fiscal metrics remain well within expectations despite external challenges, but, more importantly, to ensure that vulnerable groups are well insulated from the rapid rise in energy prices.

What to expect in 2H2026?

The government expects the fiscal deficit in 2026 to come in at 3.5%, lower than in 2025, of 3.7%. As achieving this target can be challenging amid higher fuel subsidies, we are of the view that the target is still achievable if any of the combinations of the four conditions are met: 1) stronger revenue collection in 2H2026 (than budgeted), 2) higher nominal GDP growth, 3) a more stringent fiscal enforcement, and 4) higher non-tax revenues.

Having said that, the deficit target could be ambitious if the four scenarios were to happen: 1) growth moderates faster than amid external drag, 2) commodity-related revenues are neutralised by a higher war premium, 3) external shock affects revenue collection in 2H2026, and 4) external demand deteriorates, affecting Malaysia's export performance.

Overall, we believe that Malaysia's fiscal position remains fundamentally stable despite higher expenditures in 5M2026. While the federal government's fiscal consolidation is primarily dependent on increasing revenue collection and ensuring expenditure growth remains consistent with the fiscal deficit target. As external headwinds intensify, this strategy should gravitate towards maintaining the economy's growth momentum.

Investment: Growing confidence in Malaysia's economic and digital future

Exhibit 27: Total approved investment, MYR bil

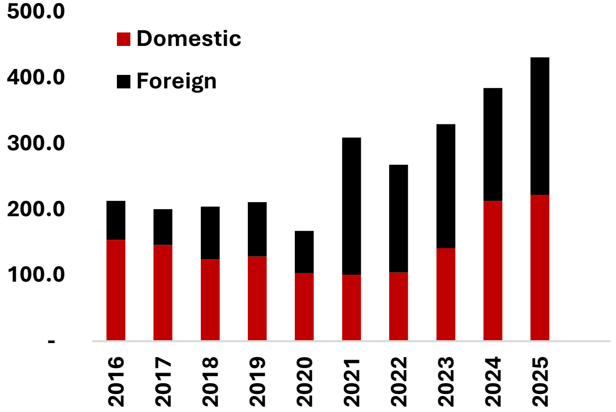


Exhibit 28: Top 5 approved investment by state as of 1Q2026, MYR bil

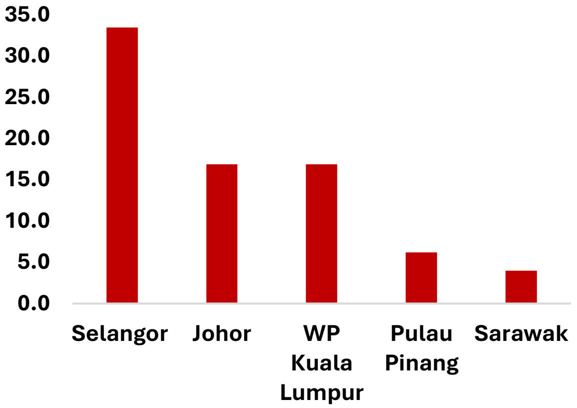


Exhibit 29: Top 5 approved investment by country as of 1Q2026, MYR bil

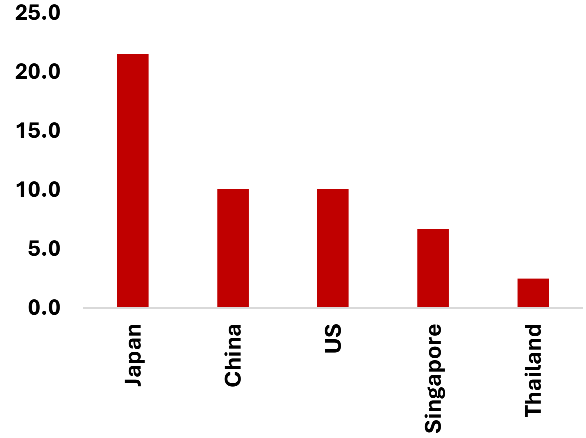
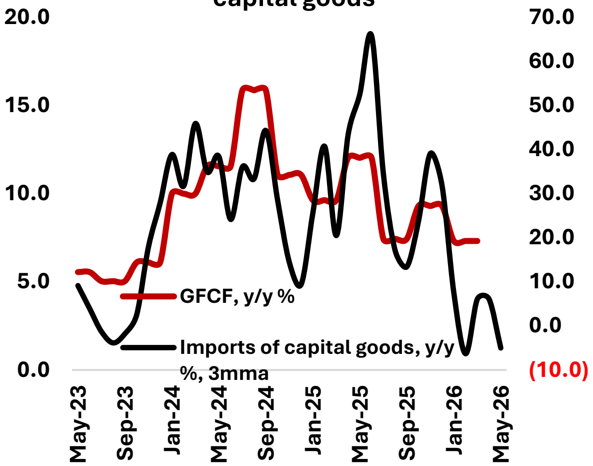


Exhibit 30: Investment vs. Imports of capital goods



Sources: MIDA, DOSM, AmBank Economics

Foreign and domestic investments remain strong, underpinned by infrastructure development

According to the Malaysian Investment Development Authority (MIDA), Malaysia recorded RM92.8 billion in approved investments during 1Q2026, with foreign investment dominating the investment landscape, contributing RM56.2 billion, or 60.5% of the total, indicating strong external investor confidence. As for domestic investment, it accounted for RM36.7 billion, or 39.5% of overall investment, and grew 13% y/y during the quarter (4Q2025: 4.4%), reflecting increasing domestic participation.

Japan emerged as the largest foreign investor, underscoring the deepening of our economic ties with the country following the establishment of the Malaysia-Japan Comprehensive Strategic Partnership in December 2023. Significantly, over 90% of Japanese-approved investments in 1Q2026 were concentrated in digital transformation activities, highlighting Malaysia's growing role in high-tech supply chains.

At the same time, Malaysia's infrastructure pipeline is closely aligned with MIDA-approved investments, with major projects enhancing connectivity and attracting new economic activities. Initiatives such as the ECRL and the Johor–Singapore Special Economic Zone are driving investments in manufacturing, logistics, and high-value services.

Meanwhile, urban transit developments like MRT3 and the Penang LRT improve productivity, supporting continued inflows into services and high-tech sectors. On the other hand, digital infrastructure expansion, such as Johor's large-scale data centre developments that are attracting global tech firms like Microsoft, has significantly boosted investment in the digital economy.

The investment cycle remains intact but is normalising from exceptionally strong levels

While the investment upcycle should remain intact amid the ongoing realisation of approved projects and continued expansion in high-value sectors, growth is expected to normalise from the strong pace recorded previously (1Q2026: 7.3% vs. 4Q2025: 9.3%) as major investment projects mature. This is reflected in the slower growth of capital goods imports, alongside the completion of infrastructure developments such as LRT3 and several data centre projects.

Trade: AI-driven tech upcycle lifts export prospects

Exhibit 31: Global semiconductor sales vs. Malaysia's exports, y/y%, 3mma

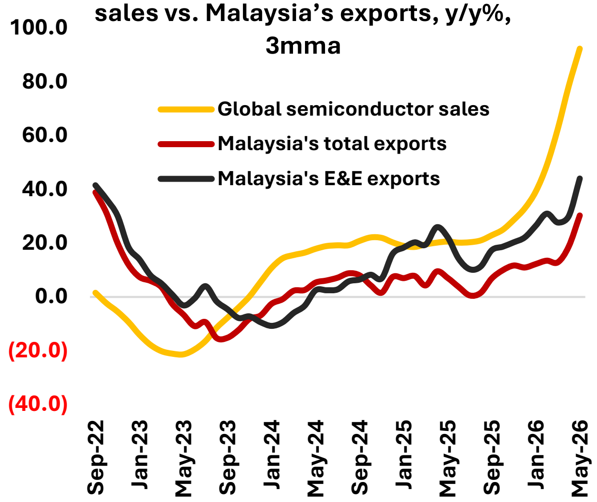


Exhibit 32: Current account trade balance, % GDP

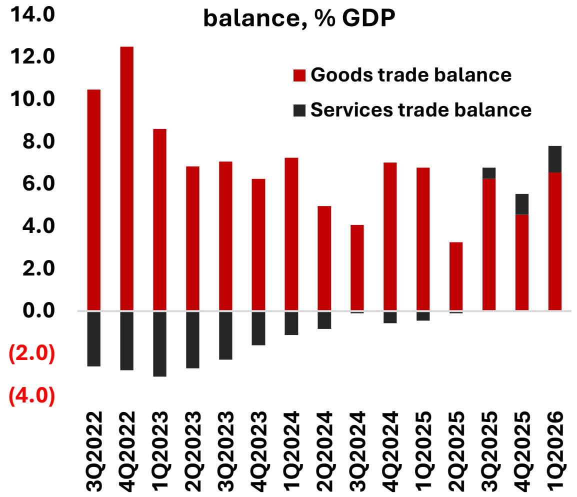


Exhibit 33: Imports, y/y%, 3mma

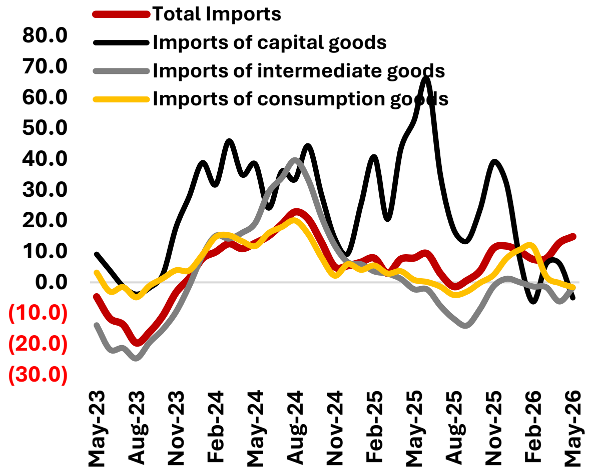
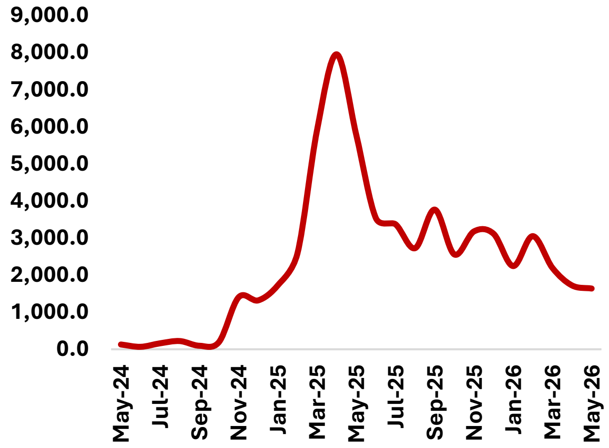


Exhibit 34: Trade policy uncertainty index



Sources: Federal Reserve Bank of St Louis, Semiconductor Industry Association (SIA), DOSM, AmBank Economics

E&E strength offsets weakness, keeping net exports positive

Goods exports recorded a strong performance in 5M2026 (24.3% vs. 5M2025: 5.5%), driven by robust demand for E&E products, higher commodity prices and precautionary inventory building amid disruptions to energy supplies and logistics.

Looking ahead, the E&E segment (5M2026: 40.0% vs. 5M2025: 20.0%) is expected to remain the key driver of export growth. The outlook for the E&E industry remains underpinned by global AI drive and technological advancements, with the World Semiconductor Trade Statistics (WSTS) Organisation projecting a sharp 90% y/y expansion in the global semiconductor market in 2026, led by memory and logic segments – areas where Malaysia's E&E industry is well positioned.

Meanwhile, non-E&E exports are likely to soften amid the lagged transmission of energy price shocks through the global economy, resulting in weaker external demand, especially if key trading partners such as China and Europe experience a slowdown.

Beyond goods exports, the AI-driven technology upcycle is also catalysing data centre expansion in Malaysia, which in turn is expected to boost services exports as more of these facilities become operational. This is evidenced in the improvement in the services balance, which has turned into a surplus since 3Q2025 in the current account.

Imports remain supported due to the strong export-import linkage

Imports are expected to continue expanding, supported by strong export-import linkages, albeit at a slower pace than exports. This is primarily due to a decline in capital goods imports (5M2026: -4.2% vs 5M2025: 47.7%) as the investment upcycle peaks, while investment growth remains robust. Consequently, net exports are expected to be a positive contributor to growth in 2026.

External risks persist despite near-term relief

Risks remain, particularly from trade policy uncertainty. While lower effective US tariff rates (from 19% to 10%) and a broader list of tariff-exempt goods have provided some near-term relief, the risk of renewed tariff tantrums persists, as seen in recent US allegations of forced labour and the subsequent imposition of tariffs on selected Malaysian exports.

Meanwhile, geopolitical risks in West Asia remain elevated despite the signing of the US-Iran peace agreement. Recent reports of rivalry and contestation over the Strait of Hormuz indicate that vulnerabilities surrounding this key global energy chokepoint remain. Any renewed disruption to traffic through the Strait could trigger fresh volatility in commodity markets and disrupt global supply chains, weighing on global trade and economic activity.

Labour market: Broadly stable despite West Asia-related headwinds

Exhibit 35: Loss of employment (LOE), person

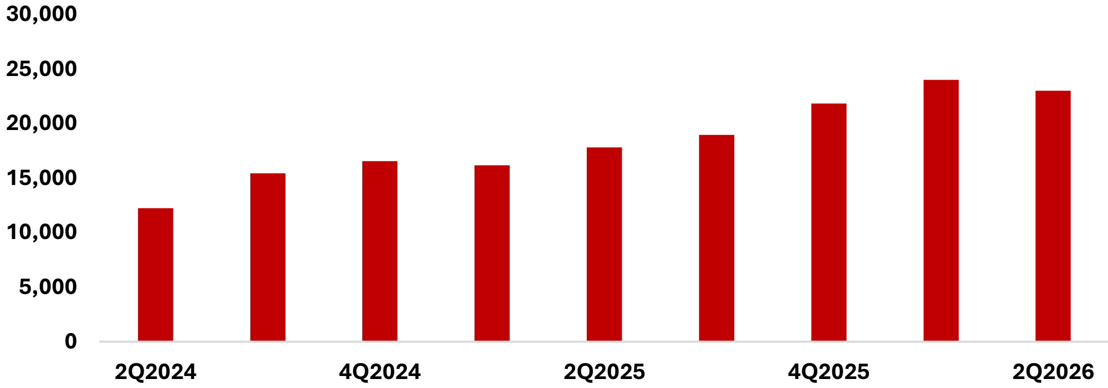
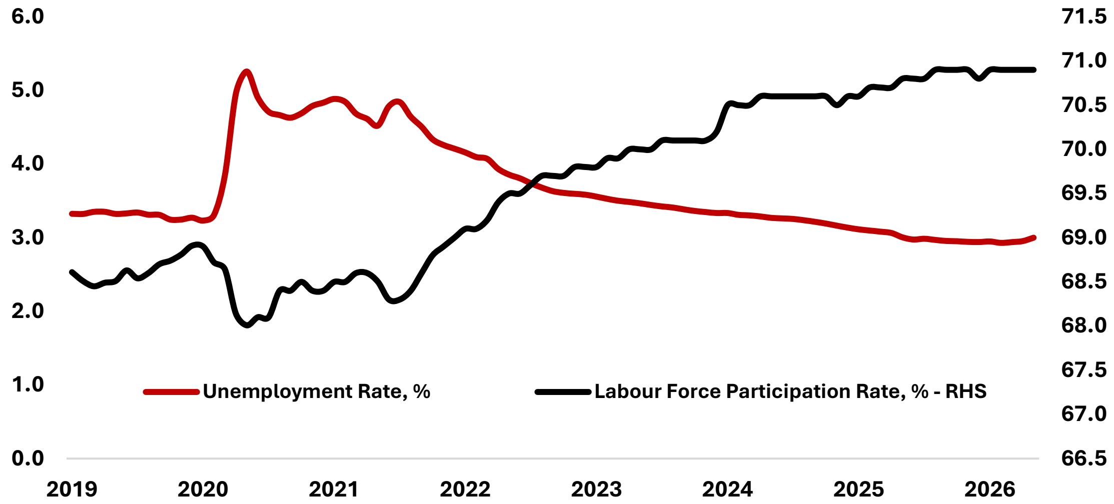


Exhibit 36: Unemployment rate vs. Labour force participation rate, %



Sources: SOCSO, DOSM, AmBank Economics

Labour market holds steady, but downside risks are increasing

In the latest development, Malaysia's labour market conditions remained broadly stable in May 2026, staying at its highest level since October last year. Nevertheless, the level of unemployment recorded a marginal increase to 513.4 thousand in May 2026 from 511.8 thousand in March, although it remained below the 522.4 thousand observed in the corresponding period last year. This suggests that labour market slack has remained contained thus far, notwithstanding heightened external uncertainties associated with the West Asia conflict.

However, data from Social Security Organisation (PERKESO)'s Employment Insurance System (EIS) showed that over 47,000 people lost their job in 1H2026. In January alone, PERKESO recorded more than 10,000 retrenchment cases, the highest level on record, raising concerns that, under a worst-case scenario and in the absence of timely policy intervention, job losses could potentially revert to magnitudes observed during the pandemic period six years ago.

Growing external uncertainties could push unemployment slightly higher in 2026

Additionally, we think the West Asia crisis could have a moderate impact on Malaysia's Visit Malaysia 2026 campaign, mainly through indirect channels rather than a major drop in total tourist numbers. While tourist arrivals from West Asia are projected to decline by around 11-27%, according to Deputy Prime Minister Ahmad Zahid Hamidi, the market accounts for less than 0.5% of Malaysia's overall visitors. The bigger effect comes from disruptions to flight routes, higher fuel costs, and reduced connectivity, which can affect long-haul travel demand. Given that the Visit Malaysia Year 2026 (VMY 2026) tourism campaign has been extended to 2027 to counter the impact of the West Asia conflict on travel demand, flight routes, and costs, we think the unemployment rate could tick slightly higher, possibly ending the year at 3.1%.

OPR: Remain steady with a still-tight labour market and modest rise in inflation

Exhibit 37: Consumer price index (CPI) vs. producer price index (PPI), y/y%

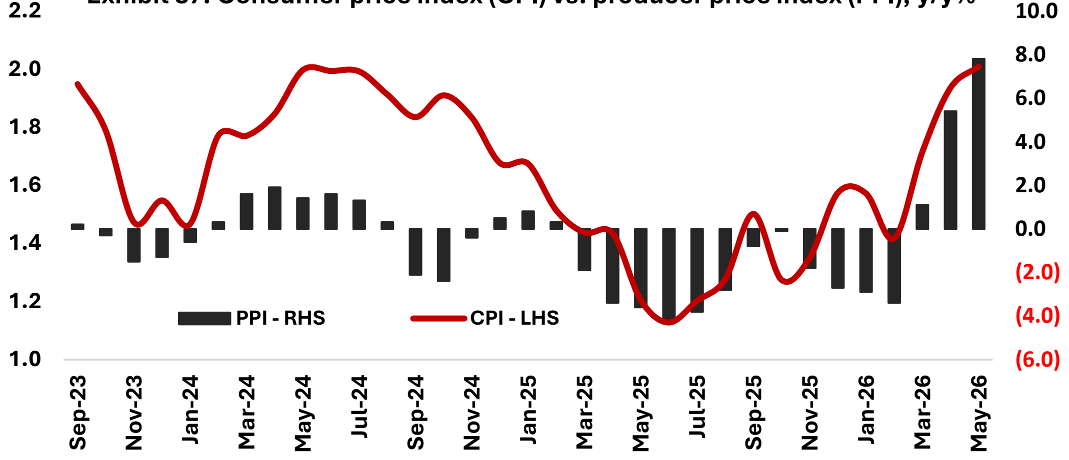
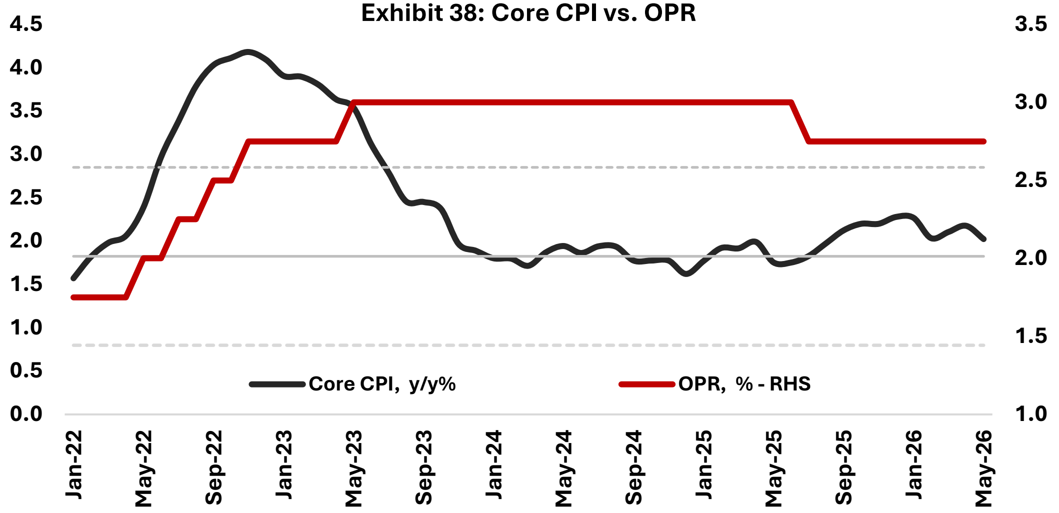


Exhibit 38: Core CPI vs. OPR



Sources: DOSM, BNM, AmBank Economics

Cost pressures persist, but with limited upside

Malaysia's headline inflation averaged 1.7% in 5M2026, reflecting a gradual uptrend, with the latest print rising to 2.0% as higher oil prices begin to feed through. We maintain our inflation forecast at 2.0% for 2026, the midpoint of the official forecast range of 1.5%-2.5%.

Looking ahead, inflation is expected to continue to trend higher due in part to the lagged pass-through of elevated raw material prices and transportation costs. Evidence of mounting cost pressures is becoming increasingly apparent, with producer prices inflation accelerating to 7.8% in May, marking a third consecutive month of increase and the fastest pace since June 2022. Based on our estimates, changes in producer prices typically take around three months to be transmitted through supply chains and reflected in retail prices. In addition, potential weather disruption associated with El Niño could exert upward pressure on food prices.

However, the upside to inflation is likely to remain contained due to the continued presence of government subsidies and the absence of excessive demand pressures. Core inflation also remains stable, with the latest reading easing to 2.0% from 2.3% at the start of the year, suggesting stable demand conditions.

BNM continues to keep OPR unchanged

With economic growth holding up well, labour market conditions remaining healthy, and inflation expected to remain manageable, we opine that BNM is under no pressure to adjust interest rates in the near term. As such, we expect the OPR to remain unchanged throughout 2026, barring any significant shift in the macroeconomic conditions.

In its latest policy statement, BNM noted that at the current OPR level, the monetary policy stance remains "appropriate and consistent with the outlook of continued price stability and sustainable economic growth". At the same time, BNM expressed confidence in Malaysia's growth prospects, noting that growth is "firmly within the forecast range of 4.0%-5.0%". Meanwhile, BNM assessed that inflation seems more market-assuring as higher global price pressures have resulted in "initial pass-through", with no consumer shock as "domestic policy measures" mitigate these effects. Taken together, these assessments suggest that BNM remains comfortable with the current policy settings.

Manufacturing: Momentum strengthens amid global semiconductor upcycle

Exhibit 39: Malaysia: Exports, y/y%

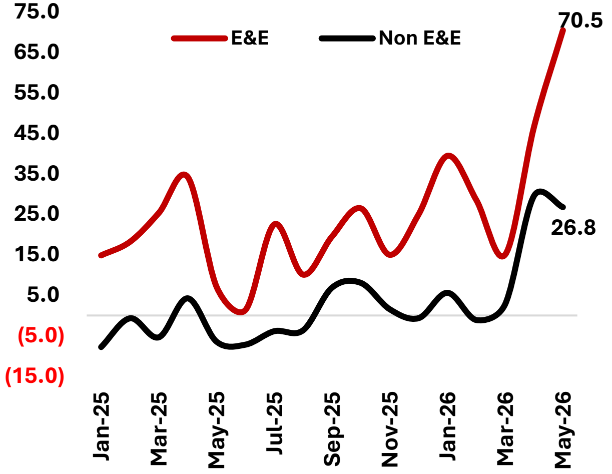


Exhibit 40: GSS vs. Malaysia's E&E export, y/y%

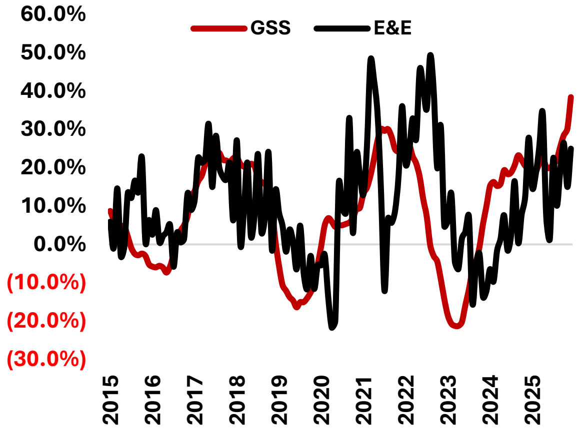


Exhibit 41: Malaysia Manufacturing IPI: by industry, y/y%

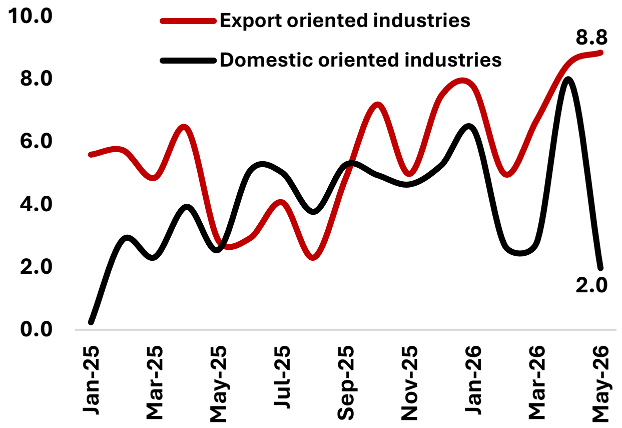
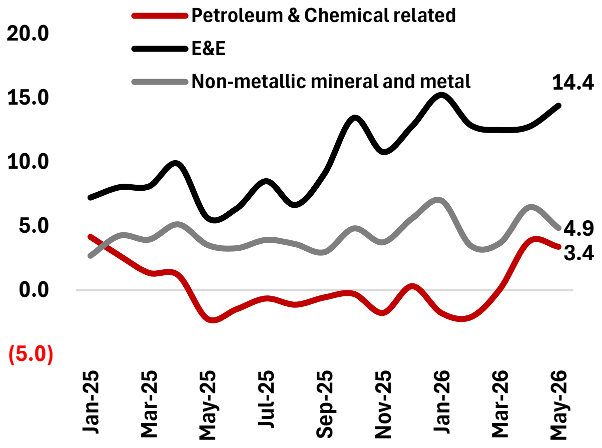


Exhibit 42: Malaysia: Top 3 manufacturing IPI, y/y%



Sources: SIA, DOSM, AmBank Economics

Strong investment and export performance cement Malaysia's position in the global electronics supply chain

On the export front, the manufacturing sector saw its sales rise to 51.7% y/y in May (April: 40.5%), lifted by electrical and electronic products (E&E), which rose to 70.5% y/y (April: 46.6%). We think that Malaysia's strong E&E export performance reflects the ongoing upturn in the global semiconductor cycle. As global semiconductor sales continued to rise to April 2026, driven by AI, electronics recovery and automotive demand, this has boosted demand for back-end semiconductor activities, where the country plays a key role.

With a total approved investment of RM426.7 billion in 2025, the manufacturing sector attracted RM131.3billion, led by the E&E segment at RM28.5 billion in the said period. This underscores the country's role as a manufacturing powerhouse. Additionally, the E&E industry contributes significantly to Malaysia's exports, accounting for over 40% as of 2025, and is vital in shaping industrial development.

Malaysia's E&E export remained strong in 2025, and we believe that the sector will continue to grow steadily as long as the US economy remains resilient. Meanwhile, the global semiconductor sales (GSS) data from SIA continued to grow substantially in April, maintaining its double-digit growth of 93.9% y/y (March: 79.0%) since December 2023. Subsequently, the WSTS organisation highlighted a robust growth projection for 2026, with a remarkable 90% y/y rise, driven by sustained strong demand for AI infrastructure, high-bandwidth memory (HBM), and accelerated computing platforms.

Sustained sector performance in 2H2026?

In 2H2026, we expect Malaysia's manufacturing performance, and by extension, export momentum, to be more durable than in previous episodes of E&E-led growth. Our expectations are premised on two main considerations. Firstly, as the world accelerates investments in digital infrastructure, Malaysia is a key beneficiary in the global tech supply chain, deepening the economy's strength in semiconductor manufacturing and export. In other words, Malaysia is no longer a participant in the global semiconductor cycles but is increasingly integrating into the industry as part of its technological advancement.

And secondly, while E&E continues to support Malaysia's manufacturing and export growth story, we are also seeing non-E&E production recovering from its sluggish performance in recent months. Owing to the steady rise in global energy prices, Malaysia's petroleum and chemical-related production is staging a comeback. This suggests a bright manufacturing sector prospect, with more diversified performance across the wider industrial base. This reduces Malaysia's concentration risk on a single manufacturing and export sector. For these reasons, Malaysia is likely to be viewed as a more stable and strategic investment destination by multinational corporations.

The key risk is not domestic weakness but a potential moderation in the global technology cycle. Should this materialise, Malaysia's manufacturing sector will likely be impacted as global demand for E&E cools, affecting E&E export momentum. Barring a sharp decline in AI-related capital expenditures, we believe that Malaysia's manufacturing sector will likely be one of the primary drivers of growth in 2H2026.

Construction: Private sector is doing the heavy lifting amid rising cost pressures

Exhibit 43: GDP: 2015p: Construction, y/y%

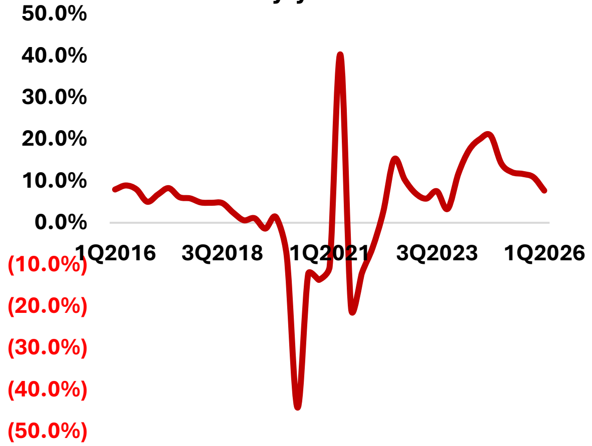


Exhibit 44: Construction Work Done, Share %

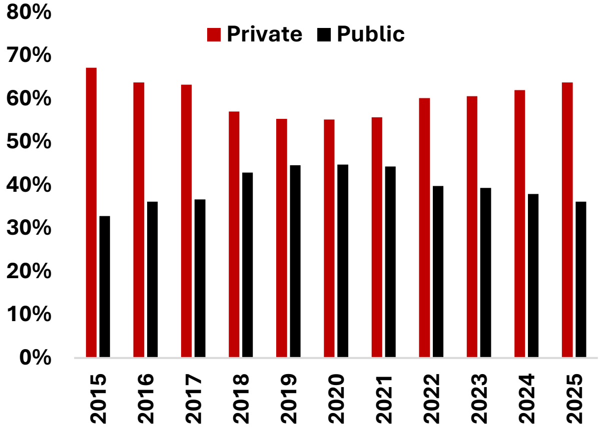


Exhibit 45: Malaysia: Construction loans vs PPI for construction, y/y%

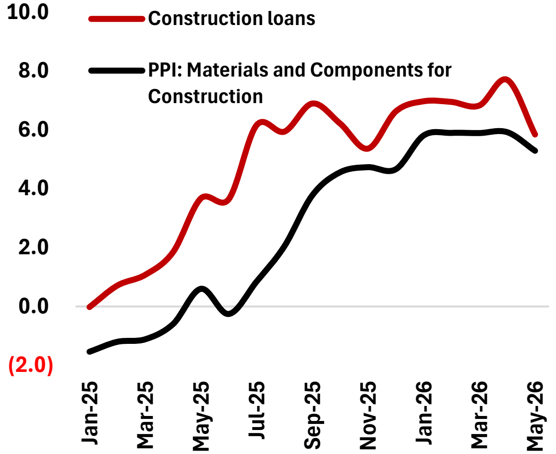
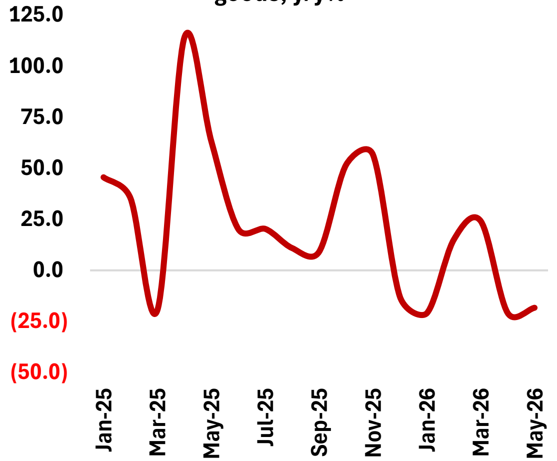


Exhibit 46: Malaysia: Imports of capital goods, y/y%



Sources: DOSM, AmBank Economics

The construction sector remains resilient despite moderating growth

Data from the Department of Statistics Malaysia (DOSM) showed that the construction sector remained on a positive trajectory, albeit growing at a slower pace during the 1Q2026, registering 7.7% y/y after an expansion of 10.9% in the previous quarter.

As of last year, construction works were largely carried out by private entities, accounting for nearly 65%, the highest share since 2016, driven by high-value investments in hyperscale data centres, alongside rising residential demand. Based on the analysts' view, the full-year contract flows for 2026 are still expected to remain broadly steady as it marked the first year of the 13th Malaysia Plan (13MP) in comparison to 2024 to 2025's run-rate, supported by data centre (DC) rollouts, water infrastructure projects and rail-related packages.

Additionally, data from the Construction Industry Development Board (CIDB) showed that contracts awarded in 2025 totalled RM202.5 billion, down from RM231.6 billion in the previous year, partly reflecting a high base effect. While 1H2026 saw strong contract awards, supported by 13MP and active tendering, especially for data centres and early infrastructure packages, 2H2026 would see a moderation in new awards, as many projects have already been awarded and fiscal spending becomes more selective.

In any case, the moderation in construction growth to 7.7% in 1Q2026 should not be misconstrued as a loss of momentum. Rather, it reflects normalisation phase following exceptionally strong activity in preceding quarters.

Prospects in 2H2026

As the chart suggests, Malaysia's construction sector is increasingly supported by a private sector-led investment cycle rather than an infrastructure-led one. As there are no public megaprojects and existing ones are either completed or at the tail end of the construction phase, we should expect the share of public construction to be lower in the near to short term.

We noticed that construction loan growth outpaces construction cost pressures. While this may imply that project pipelines remain healthy and financing conditions continue to support construction activity, the dip in recent months indicates that the sector's growth may have peaked, although investment demand for construction remains positive. The decline in growth in capital goods imports suggests that investment momentum is moderating from exceptionally strong levels rather than a structural weakening.

On balance, we believe that Malaysia's construction sector will be well supported amid stable domestic demand and financing conditions. Rising cost pressures are indeed a concern amid the recent surge in commodity prices, which, in turn, feed into logistics, transport, and materials production costs.

The risks of the global technology cycle and higher-for-longer rates will continue to linger, but we are comforted by the fact that manufacturing and construction are reinforcing each other. At a time when the global semiconductor cycle is expected to rise in the coming months, we expect the Malaysian construction industry to trend positive in 2H2026, albeit slower.

Logistics: Despite global energy crunch, Malaysia's logistics sector remains resilient

Exhibit 47 : Aviation activity remains supported by sustained tourism demand

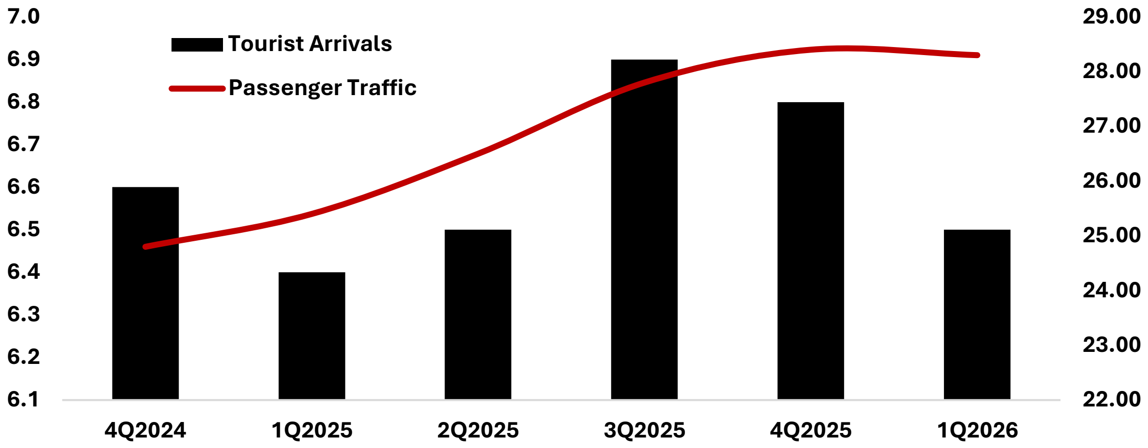
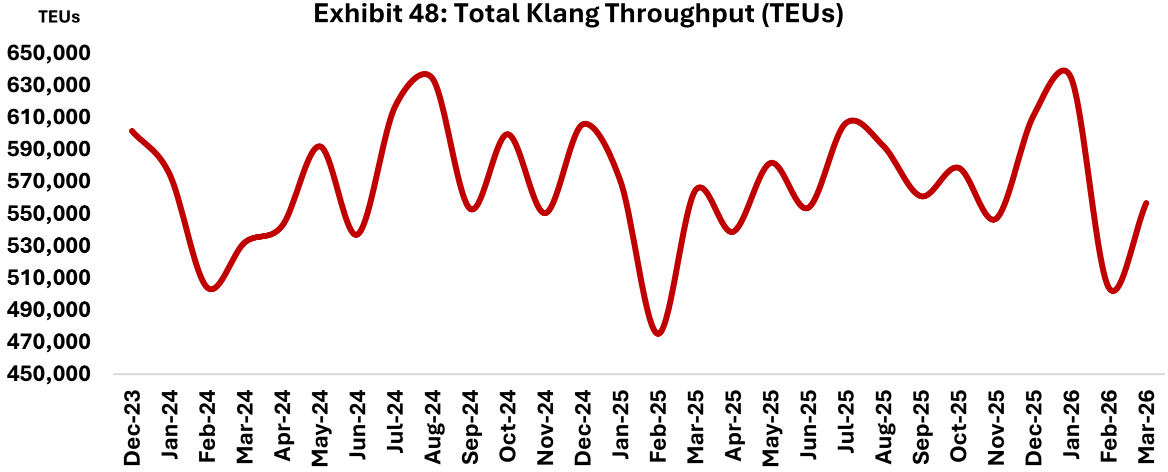


Exhibit 48: Total Klang Throughput (TEUs)



Sources: DOSM, Tourism Malaysia, Civil Aviation Authority of Malaysia (CAAM), AmBank Economics

Shipments diversion and travel recovery support the logistic sector's expansion

Road transport remains the largest source of transportation-related emissions in Malaysia, driven by high private vehicle ownership and continued reliance on fossil fuels. In response, the government has stepped up decarbonisation efforts under the National Energy Transition Roadmap (NETR) and its net-zero emissions target by 2050, with a growing emphasis on electrification, sustainable mobility and energy security. The transition has become increasingly urgent amid global energy market disruptions, geopolitical tensions and volatile oil prices, which continue to pressure fuel subsidy spending, transportation costs and inflation. To strengthen long-term energy resilience and reduce reliance on petroleum-based fuels, Malaysia is accelerating EV adoption through supportive policies and infrastructure development. As of May 2026, 6,416 public EV charging points had been installed nationwide, with a target of 30,000 chargers by 2030. These initiatives are expected to support both the country's decarbonisation agenda and broader energy security objectives.

Malaysia's aviation sector remains resilient despite a more challenging operating environment. Air passenger traffic expanded by 11.5% y/y to 28.3 million passengers in 1Q2026, underpinned by strong international travel demand (+13.5% y/y) and steady domestic growth (+9.4% y/y). Although the Civil Aviation Authority of Malaysia (CAAM) revised its 2026 passenger traffic forecast to 103.8–109.7 million passengers amid geopolitical tensions in West Asia, higher fuel prices and rising travel costs, demand remains broadly above pre-pandemic levels.

At the same time, airlines and airport operators are intensifying efforts to improve fuel efficiency and adopt Sustainable Aviation Fuel (SAF) as part of the sector's long-term decarbonisation strategy. While jet fuel prices rose 33.6% q/q to USD122/bbl in 1Q2026, contributing to a 13.4% increase in international airfares, Malaysia's aviation industry continues to benefit from favourable travel fundamentals and its position as a regional aviation hub.

Port operators may simultaneously benefit from trade rerouting and stronger transhipment activity, despite elevated logistics costs

In the maritime segment, Malaysia is strengthening its position as a regional green bunkering hub by adopting alternative marine fuels such as LNG and methanol. The government's Green Bunkering Regulatory Roadmap targets low-carbon fuels accounting for 40% of maritime fuel consumption by 2050, while the Port of Tanjung Pelepas (PTP) has already undertaken LNG and methanol bunkering operations. Meanwhile, Malaysia's port sector has benefited from trade rerouting arising from geopolitical tensions in West Asia, reinforcing the country's role as a safe and efficient transhipment hub along the Straits of Malacca. Port Klang and PTP recorded record container throughputs of 15.14 million TEUs and 14.03 million TEUs, respectively, in 2025, while cargo volumes increased by 5% and 8% y/y, respectively, in the first five months of 2026.

Looking ahead, continued supply chain diversification and transhipment growth are expected to support port activities, although sustaining competitiveness will require ongoing investment in capacity expansion and strategic infrastructure projects.

Fixed Income: US Treasuries

Exhibit 49: MGS and UST spread

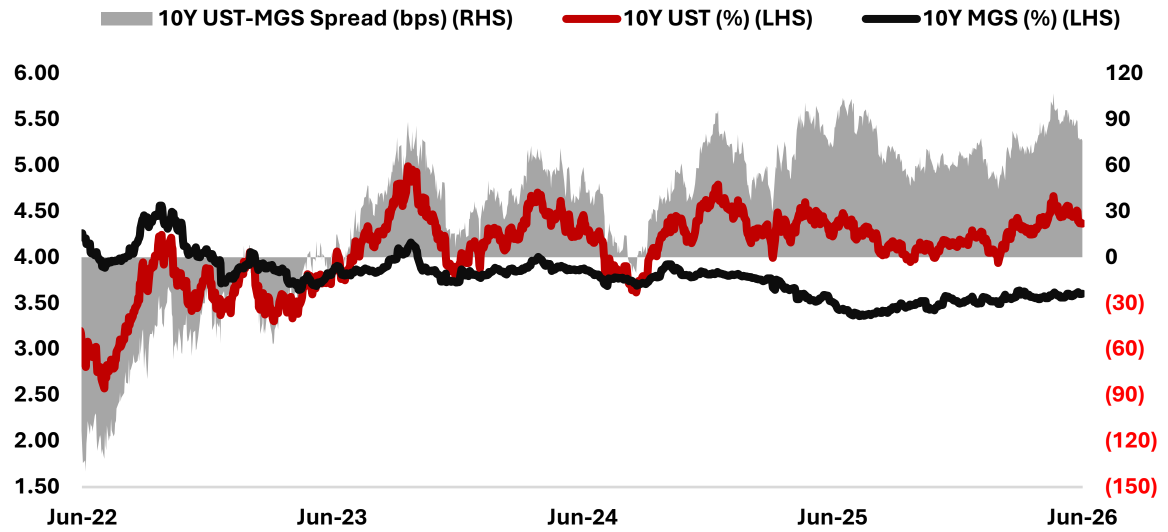


Exhibit 50: AmBank Economics' MGS and UST yield forecast (%)

	2Q2026 (A)	3Q2026	4Q2026	1Q2027	2Q2027
3Y MGS	3.25	3.15	3.15	3.10	3.10
10Y MGS	3.61	3.64	3.66	3.64	3.64
10Y/3Y MGS (bps)	36	49	51	54	54
10Y UST	4.47	4.33	4.28	4.20	4.20

Note: (A) Actual

Sources: Bloomberg , AmBank Economics

Inflation vs growth risks. The US CPI forecast, per Bloomberg, is 3.4% for full-year 2026, and the PCE forecast is 3.5%. The monthly US CPI print was pushed up to 3.8% y/y in April and 4.2% y/y in May, from 2.7% full year 2025, as global oil prices rallied amid the US/Israel-Iran war. Inflation correlation with 10Y UST yield is relatively strong at 0.510, but with GDP is not insignificant at -0.207. US inflation in March saw headline CPI rise more than core CPI, suggesting underlying price pressures are not broadly accelerating. However, no matter; fear of rising inflation remains elevated, as oil prices remain high even if the war ends and global energy supply chains remain at risk.

Markets remain somewhat cagey on inflation risks, especially ahead of central bank signalling. The FOMC came out hawkish in June (even as Warsh took over), and the ECB et al. have been hiking or treating inflation as a risk. Contrarian could be the BOE, which downplayed inflation at the MPC meeting in June.

We take a balanced view of UST yields, based on the interplay between growth and inflation risks. We take no less a factor of GDP to project our UST yields. With inflation risks higher, growth risks will persist or increase. On the flip side, the US-Iran peace deal and reopening of the Straits of Hormuz have deflated global oil prices to pre-war levels, thereby placing inflation risks lower. However, how far oil prices may fall would also depend on the supply network (the Straits of Hormuz being freely open) and on repairs to damaged energy/oil infrastructure in West Asia.

The US fiscal outlook remains a concern for the UST, with the US fiscal deficit likely to approach USD2.0 trillion again in 2026. The US fiscal balance remains negatively affected by rising expenditure and entitlements, including elevated interest costs.

Overall, we expect support for long-end UST on oversold levels and downside risks to inflation and oil prices. We expect the UST curve to flatten as a result, but the short end will also be supported by market liquidity, demand, and hints of lower interest rates. Additionally, safe-haven USD demand is not discounted as an AI investment surge may pose revaluation risks on riskier assets.

Fixed Income: Malaysian Government Bonds

Exhibit 51: 3Y MGS vs. OPR (%)

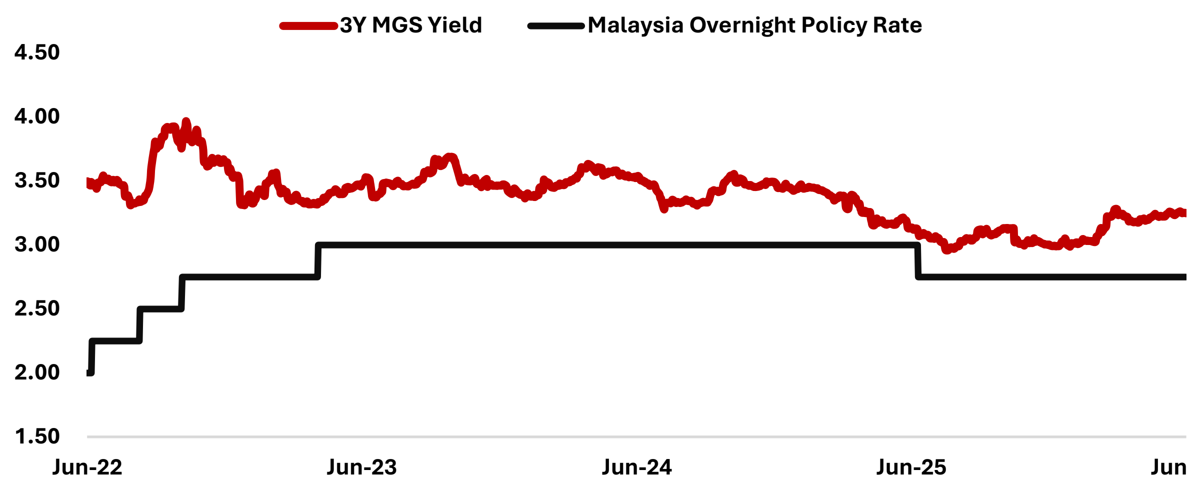
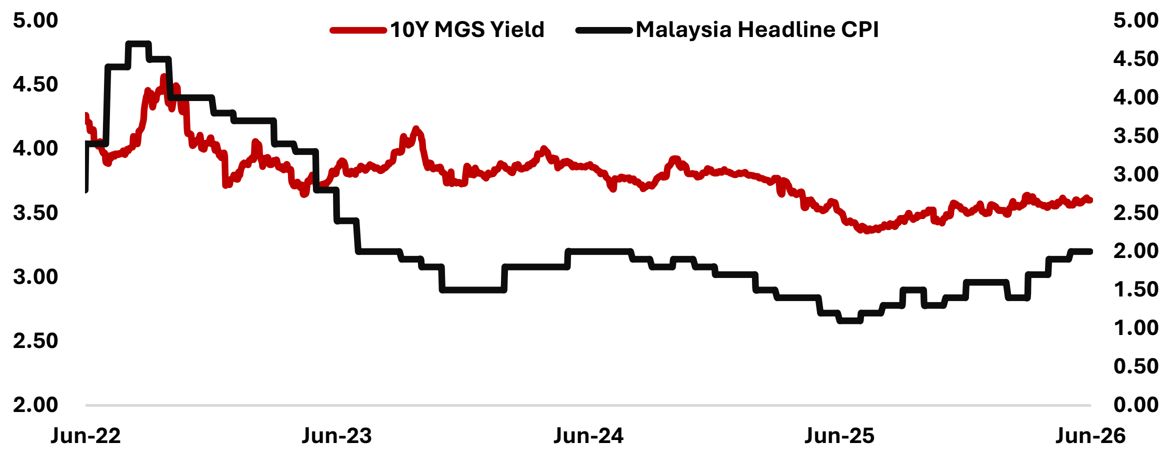


Exhibit 52: 10Y MGS vs. Malaysia CPI (%)



Sources: Bloomberg, AmBank Economics

Overall, our outlook for the MGS market remains constructive. But yields will remain elevated. Our outlook considers recent conditions in global markets, the impact of the war in West Asia, fallout from crude supply disruptions, the latest global inflation data showing elevated levels relative to pre-war levels, and the hawkish remarks from global central banks. In addition, we consider domestic Malaysian macroeconomic and market conditions, particularly BNM policy signalling, which we view as neutral. As a recap, due to the war, MGS yields shot up in 1H2026, with the 10Y MGS closing 1H2026 at 3.60%, up 10 bps YTD, and the 3Y MGS at 3.25%, up 25 bps YTD.

We consider the impact of elevated MGS yields in light of the potential of a Fed hike. Although there has been some decoupling of MGS correlation from UST (correlation of 0.24), interest rate differentials still affect MGS returns relative to UST. The 10Y UST spread above the 10Y MGS has risen to about 85 bps, brought on by the larger jump in UST yields versus MGS since March 2026. The spread was about 50 bps back in February. In March, 2Y and 10Y UST yields were up 42 bps and 38 bps to close at 3.79% and 4.32%. The MGS was tracking the rise in UST yields, though MGS yields are up a smaller 15-25 bps m/m.

A risk to our view is that the Fed may turn dovish, especially if there are not enough reasons to be so, simply because the dove Kevin Warsh will now be in charge at the Fed. No matter, a dovish Fed will otherwise pressure UST yields down, thereby pushing MGS yields lower as well.

We are more upbeat about the front of the yield curve. The 3Y MGS at around 3.20-3.30% (50-60 bps over the OPR) is steep against the OPR. In a neutral interest rate environment, the 3Y MGS/OPR spread is normally around 25 bps. Hence, if BNM's narrative remains neutral in the next 1-2 MPC statements, we foresee short-tenor MGS receiving support.

We expect another half year of firm demand at the auctions. Regarding MGS+GII new supply for 2026, we maintain our forecast of gross issuance of MYR185 billion. In 1H2026, total issuance was MYR95 billion, leaving a slightly smaller MYR90 billion to be issued in 2H2026. The average bid-cover at the 1H2026 auctions was 2.44x, compared with 2.55x in full year 2025. Expected net issuance for 2026 is MYR76 billion based on the expected fiscal deficit of about MYR74.6 billion. There is MYR75 billion in MGS+GII set to mature in 2H2026 vs MYR34 billion in 1H2026. Expected net issuance in 2H2026 is thus a minor MYR15 billion.

FX: USD Outlook

Exhibit 53 : Expectations for the Fed has turned more hawkish over time…

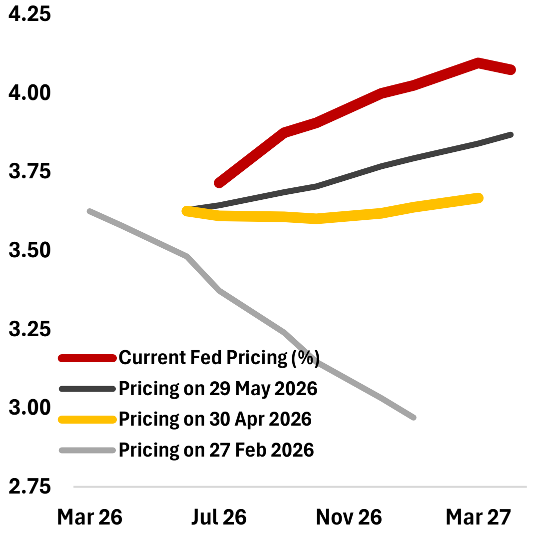


Exhibit 54: supporting the more bullish USD bets in recent months…

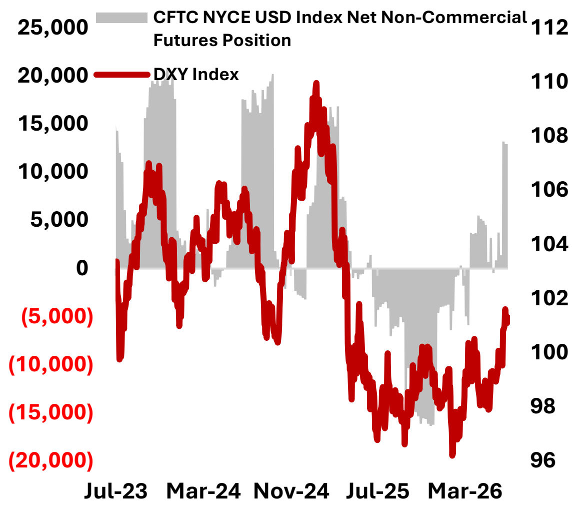


Exhibit 55: *… alongside upward revisions in Fed rates and inflation projections*

Summary of Fed projections	Fed Funds Rate (%)			Core PCE (% y/y)			GDP growth (% y/y)		
	Dec 25	Mar	Jun	Dec 25	Mar	Jun	Dec 25	Mar	Jun
- for 2026	3.4	3.4	**3.8**	2.5	2.7	**3.3**	2.3	2.4	**2.2**
- for 2027	3.1	3.1	**3.6**	2.1	2.2	**2.5**	2.0	2.3	**2.3**
- for 2028	3.1	3.1	**3.4**	2.0	2.0	**2.1**	1.9	2.1	**2.2**

*refers to end-year figures (not full-year average)

Sources: BNM, Bond Pricing Agency Malaysia (BPAM), AmBank Economics

DXY

The DXY rose 2.9% in 1H2026, with the USD seeing broad-based strength vs. most G10 currencies during the period. Supporting greenback strength were tailwinds from higher energy prices (benefiting the US's current account as a net energy producer with significant reserves for exports as well), and a hawkish shift in the Fed's expected trajectory due to the upward revision in expected inflation trajectories (Exhibit 53 and 54). This was reflected in the Fed's recent June FOMC meeting, whereby though policy rates were left unchanged as expected, overall signals turned hawkish – with nine out of eighteen FOMC members now seeing a need for at least one Fed rate hike compared to none in March. This is driven by members' sharp upward revisions to PCE inflation forecasts for 2026 and 2027 (Exhibit 55), while risks to growth are deemed manageable as officials described it as 'solid' – especially coming alongside recent batches of US data indicating labour market resilience.

However, the recent US-Iran deal likely caps further upside in the USD as markets reverse earlier safe-haven US rotations into battered EM assets, while easing energy-driven inflation risks suggest that fewer Fed rate hikes are needed to temper inflation expectations. Given market pricing of two Fed rate hikes by 2Q2027 (vs. 1 only under our base case), we think a firmer DXY has been well priced in, and therefore anticipate the DXY to gradually moderate in the coming quarters (end-2026 DXY forecast: 100.3).

Risks ahead remain two-sided – though new Fed chairman Kevin Warsh has affirmed price stability commitments, the decision to reduce forward guidance while establishing five task forces to overhaul internal operations (including its inflation framework and Fed communications methodology, among others) suggests some level of unpredictability. Policy uncertainties from the US administration may also arise ahead with the US-Iran conflict now largely over, ahead of the US mid-term elections in November.

FX: EUR and GBP Outlook

Exhibit 56: In contrast to the Fed, hawkish ECB expectations has faded recently amid the pullback in oil prices

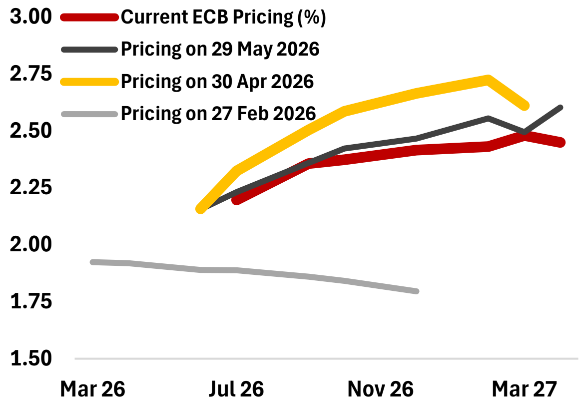


Exhibit 57: Net bullish EUR positioning remain, even if it has fallen significantly since March

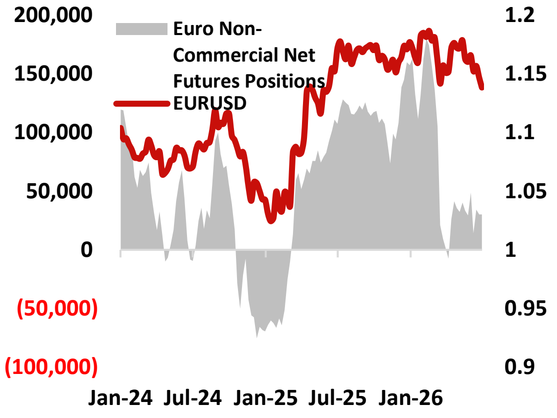


Exhibit 58: Elevated UK borrowing costs and anaemic growth in the UK (vs. G7 peers) keeps debt-to-GDP ratio elevated

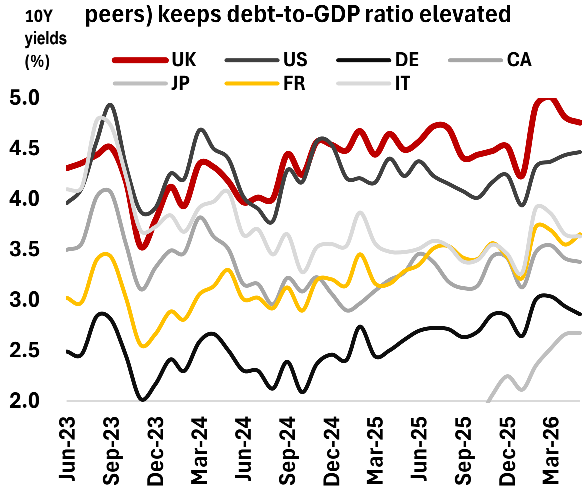
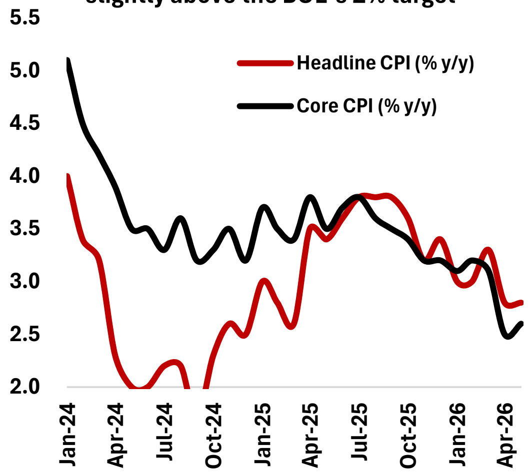


Exhibit 59: While progress on UK inflation is seen, core CPI still remains slightly above the BOE's 2% target



Sources: BNM, Bond Pricing Agency Malaysia (BPAM), AmBank Economics

EUR

EUR/USD fell 2.8% in 1H2026, with moves over the past few months mainly dictated by the rhythm of the USD. An early hawkish shift in the ECB's rhetoric has initially insulated it from relatively greater declines compared to G10 peers, though the EUR subsequently saw pressure due to USD strength and the Eurozone's net energy import dependency, with increased energy dependency from the US in the past few months.

After the ECB raised policy rates by 25bps as expected at its June meeting, President Lagarde warned that inflation risks are widening beyond energy alone. Coupled with the ECB's core inflation forecasts rising by 0.2% and 0.3% respectively for 2026 and 2027 (to 2.5% y/y), this suggests policy rates to shift in favour of the EUR in the coming quarters. Hence, we forecast upsides for the EUR at 1.14 by 4Q2026, with the EUR to also command a premium over the USD and JPY on perceived institution credibility (vs. the Fed and BOJ) – even if yields remain below that of Gilts and UST. However, risks are likely skewed to the downside relative to meeting our expectations, with disinflation progress evident across several (but not all) euro area economies, which may allow the ECB to end its rate-hiking campaign earlier than expected. ECB President Lagarde has also noted that risks to inflation and growth have subsided (with the recent US-Iran deal).

GBP

GBP saw a milder 1.6% decline vs the USD in 1H2026, supported by higher real interest rates in the UK, including the recent reduction in UK core inflation. That said, domestic political and fiscal developments are likely to play a key role for the GBP ahead, with former Manchester Mayor Andy Burnham having successfully challenged PM Keir Starmer for his role amid a strong by-election victory and support within his Labour Party. Though Burnham has earlier stated his 'complete commitment' to UK's fiscal rules and fiscal reduction, Burnham's team is reportedly exploring ways to be 'bolder' on borrowings for investments, raising the spectre of another sharp selloff in UK Gilts (as seen in 2022), as bond markets remain wary of the UK's struggles to cut spending vis-à-vis anaemic growth and already high debt and interest payments (Exhibit 58)

On the monetary policy front, we believe BOE moves will be in near lockstep with the Fed heading into 1H2027, keeping policy rate differentials to a minimum. Hence, we remain slightly constructive on the GBP's outlook despite near-term fiscal policy risks from the UK administration, targeting a GBPUSD valuation of 1.36 by end-2026. Key to monitor ahead is whether Burnham can undertake fiscal policy plans without spooking bond markets, with markets set to be on watch after his likely installation from mid-July

FX: AUD and JPY Outlook

Exhibit 60: Softening energy commodity prices acting as headwinds for the AUD...

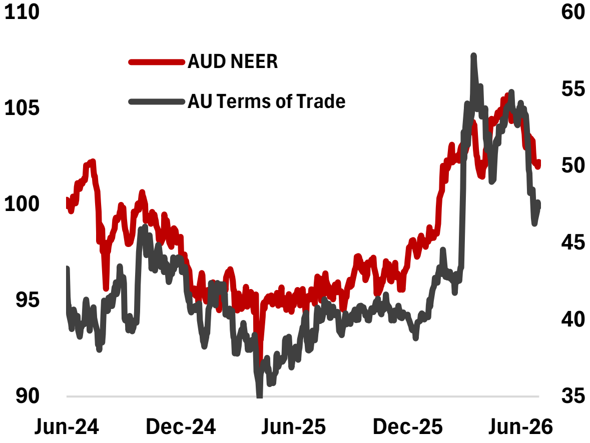


Exhibit 61: ... alongside weakening yield differentials

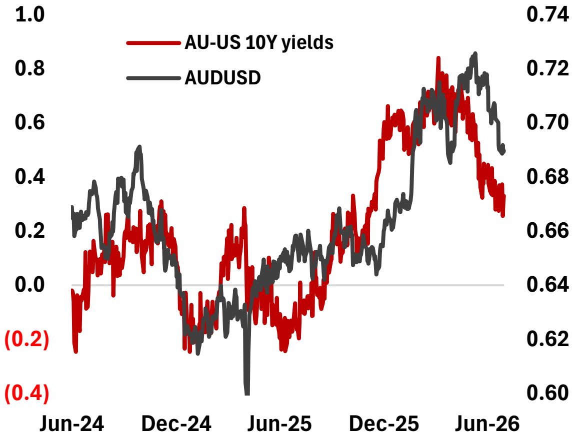


Exhibit 62: JGB term premia on a steady rise, as markets assess the BOJ in addressing persistent inflation

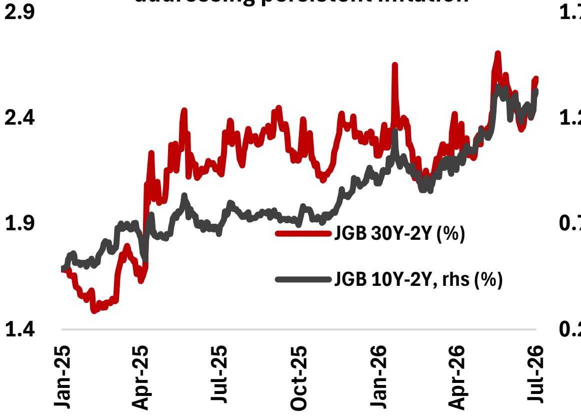
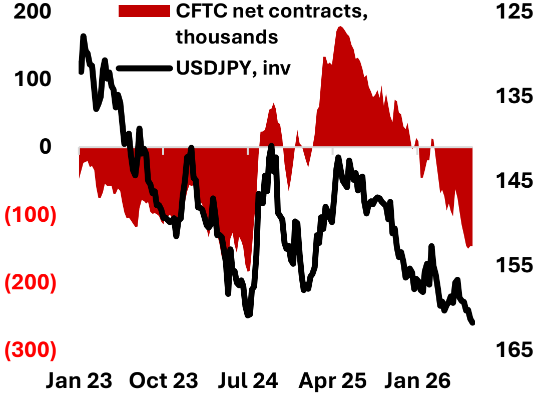


Exhibit 63: Renewed pressure on the JPY as bearish positioning piled on since mid-2025



Sources: BNM, Bond Pricing Agency Malaysia (BPAM), AmBank Economics

AUD

AUD gains during 1H2026 (+3.4%) were frontloaded in January, driven by the RBA's early and aggressive rate hikes to parry inflation risks vis-à-vis tight labour market conditions even before the US-Iran conflict; while subsequently supported by the generally risk-on market sentiment, strength for the Chinese yuan, and elevated prices for LNG exports.

Though Australia's labour market conditions have shown some signs of softening in recent months, trimmed-mean inflation has also accelerated to 3.6% y/y in May – rising well above the RBA's inflation target of 2-3%. As such, while the RBA left policy rates unchanged at its latest policy meeting – citing tightening financial conditions following its recent three consecutive rate hikes - policymakers noted that inflation risks remain elevated. Subsequent comments from RBA Deputy Governor Hauer (on the Phillips Curve) also suggest some deemphasis on the unemployment rate in its pursuit of disinflation.

Hence, while the pathway for the RBA looks to be guided by incoming inflation and employment datapoints (especially for full-quarterly 2Q2026 and 3Q2026 releases), we think pervasive and persistent inflation stickiness (hovering above the middle of the 2-3% inflation target range since 4Q2021) means the AUD looks set to be supported by tight monetary policy for an extended period. Nevertheless, potential headwinds for the AUD ahead include: 1) Soft labour data prints in the coming months, 2) Declining premiums on LNG export prices (with a resumption of Qatar supply) and its impact on Australia's trade balance, and 3) Bearish sentiment from a reversal in AI-driven equity valuations. We pencil in an estimated fair value of AUD/USD at 0.68-0.72 over the next several quarters, in view of these two-sided risks.

JPY

Since 2Q2026, bearish yen bets has kept the USD/JPY floor above 158, driven by a combination of: 1) Elevated energy prices and its negative impact on Japan's terms-of-trade, 2) Rising inflation in Japan eroding real yields on government bonds, 3) Fiscal worries under PM Sanae Takaichi's government, and 4) Yield differentials shifting in favour of the USD (see US/DXY currency section). Furthermore, the risks of FX interventions by Japan's Ministry of Finance (and the US Treasury) when USD/JPY hovers above 160 have slowed JPY depreciation. Indeed, MOF intervention was observed during the holiday-thinned liquidity period, when USD/JPY closed above 160 in late April. Nevertheless, the JPY11.7 trillion (USD73.5 billion) intervention cost only briefly supported JPY, with USD/JPY rebounding to the 160.0 level within a month.

Though the BOJ has raised policy rates by 25bps to 1.00% in June 2026 (with another hike anticipated by end-2026), we think this remains insufficient to arrest persistent bearish pressure on the JPY, as energy prices remain slightly elevated in the near-term, while inflationary pulses in the US keep Fed rates leaning hawkish. In comparison, with negative real rates on front-end JGBs and the BOJ's glacial policy rate normalisation process (BOJ hesitancy driven in part by Japan government's debt sustainability concerns and risks to financial markets), persistent JPY pressures effectively signal markets' verdict that the BOJ is well behind the curve in confronting persistent price pressures. Absent events that spark global bond volatility, we think investors' carry trades will be difficult to dislodge sustainably. As such, we maintain our USD/JPY appreciation (JPY depreciation) trajectory towards 163 by end-2026 – effectively calling for a managed JPY depreciation exercise by the BOJ towards more sustainably defensive levels (i.e. without excessive expenditure of reserves for currency defence at a strict USD/JPY 160 level).

FX: MYR Outlook

Exhibit 64: Ringgit slightly tracking the rising front-end yield differentials

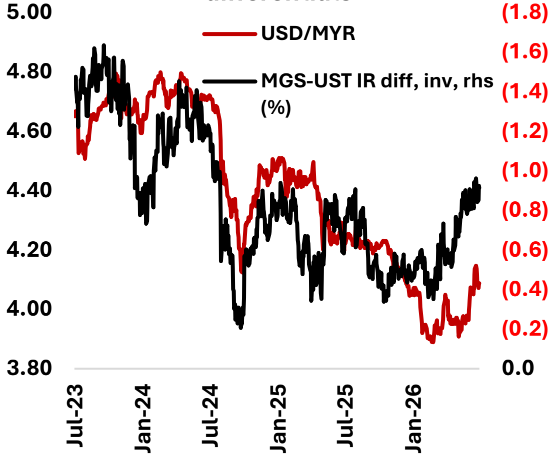


Exhibit 65: Market Expectations on BNM's OPR has generally remain unchanged around 2.75%

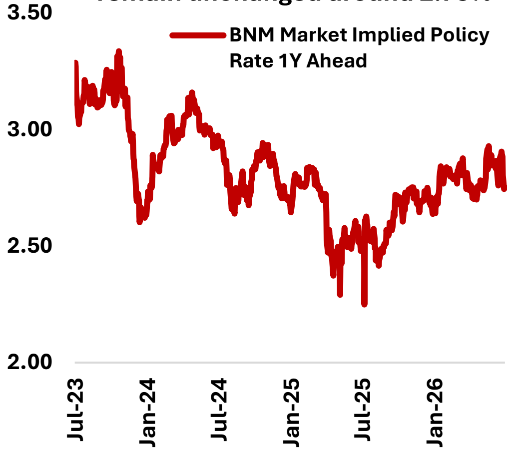
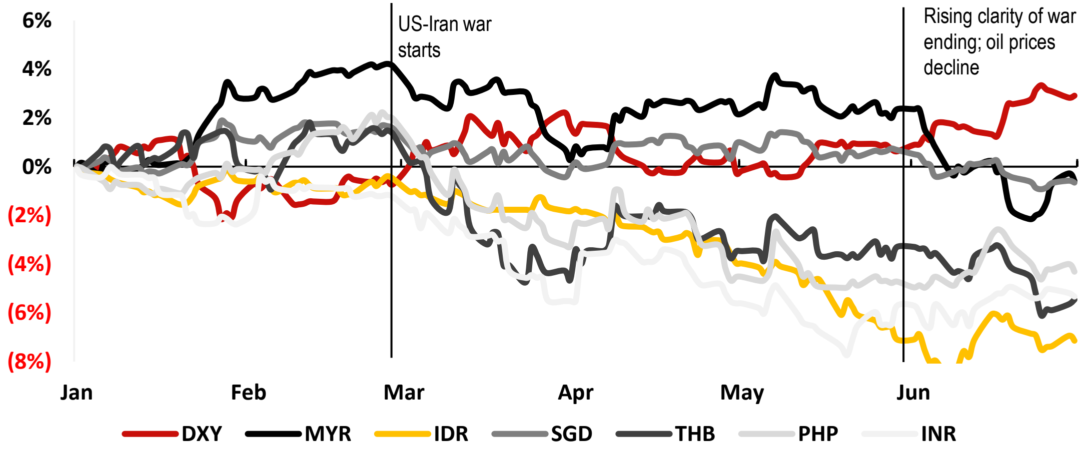


Exhibit 66: Regional FX performance hinges on energy import reliance (IDR, THB, PHP, INR), and relative energy insularity + beneficiaries of the AI cycle (DXY, MYR, SGD)



Sources: BNM, Bond Pricing Agency Malaysia (BPAM), AmBank Economics

MYR

The MYR closed 0.6% lower vs the USD in 1H2026, following several bouts of volatility over the past few months. USD/MYR has been trading within the 3.90-4.05 range for an extended period (since February) and has maintained its outperformance vs Asian peers since November 2025. However, pressure was subsequently seen on the Ringgit, with USD/MYR seen rapidly ticking up by nearly 3% in June alone.

We think this was primarily driven by upward repricing of front-end UST yields (due to hawkish Fed projections). Vis-à-vis stability in MGS yields, supported by local investors and an expected steady OPR path in the medium term, has put pressure on the Ringgit due to widening interest rate differentials (Exhibits 64 and 65). Better performance for Asian peers such as the PHP and IDR in recent sessions also suggests a reversal in earlier regional safe-haven inflows into Malaysian bonds, as easing energy supply risks from the US-Iran war also looks set to erase Malaysia's regional trade advantage as a net energy exporter (Exhibit 66). Meanwhile, medium-term risks from Malaysia's upcoming state elections remain, which may herald earlier general elections and, in turn, policy uncertainties, and might have led to some foreign portfolio repositioning away from local government bonds.

While BNM's Financial Market Committee (FMC) subsequently acknowledged the Ringgit's decline and some of these attributing factors in a statement (including foreign portfolio equity rebalancing amid a revision in the MSCI Malaysia Index), the FMC affirmed that Malaysia's macroeconomic fundamentals remain intact and that onshore FX markets remain healthy, which is expected to provide continued support for the Ringgit. The FMC also said ongoing measures to encourage inflows under its QRI program, as well as repatriation of income for GLCs, GLICs, and corporates, will also be intensified.

Following the Fed's FOMC meeting in mid-June, which was deemed hawkish, markets are now fully pricing in a 25 bps Fed rate hike by end-2026, with a potential second hike by March 2027. Given our projections for only one Fed hike by end-2026, we think the MYR should see a slight rebound in the coming weeks, and target a USD/MYR fair value trading range around 4.05-4.10 in 2H2026. Key events to watch ahead include the outcomes of state elections in Johor and Negeri Sembilan, continued vessel movements in the Strait of Hormuz amid US-Iran negotiations, AI-led E&E export momentum, as well as US/Malaysia data releases, including inflation and labour market data.

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