AmBank Group

AmBank Economics

#WhatWeThink

2025 Macroeconomic Outlook: Policy Trade-Offs for Resilient Growth

24 January 2025

Executive Summary

Global growth: In 2025, the global economy will face a significant test of resilience amid evolving challenges and opportunities. Multilateral development banks (MDBs) expect global growth to come in between 2.7% and 3.3%, with the U.S. leading advanced economies despite signs of ongoing labour market weakness. China, however, is expected to miss its 5.0% target due to trade tensions and domestic constraints.

Inflation: Inflationary pressures will ease globally but remain above pre-pandemic levels. Key drivers include rising food prices, while we expect global oil prices to stabilise at USD 75 per barrel. Trump tariffs 2.0 will introduce new complexities, affecting both allies and adversaries. Malaysia is likely to experience indirect effects from these tariffs but may also benefit from trade and investment diversions.

Major economies: The U.S. economy has shown remarkable resilience despite a notable weakness in its labour market. While inflation is no longer a threat, it is still trending higher than the 2.0% level. We see similarities with the inflation dynamics in the Euro Area, where services inflation is still trending high, thwarting the disinflation process. China is unlikely to grow at 5.0% or higher, while inflation is expected to remain very low in 2025.

Southeast Asia: The Philippines and Vietnam are poised to lead regional growth, exceeding 6.0%. As ASEAN chair in 2025, we believe Malaysia will play a pivotal role in pushing forward the region's long-standing issues, but not to the point of resolving them.

Malaysia in 2025: Real GDP growth is projected to moderate to 4.6% from 5.0% in 2024. Infrastructure projects, private investment realisations, and robust private consumption will underpin Malaysia's economic performance. However, we believe the government faces a delicate trade-off between fiscal consolidation and growth prospects amid a volatile external environment.

Exhibit 1: Selected AmBank Macroeconomic Forecasts (%)

	Actual Data	AmBank Forecast	
	2023	2024F	2025F
GDP, y/y%	3.6	5.0	4.6
Inflation Rate, %	2.5	1.8	2.5 – 3.0
Unemployment rate	3.3	3.2*	3.2*
OPR, %	3.00	3.00	3.00
USDMYR	4.59*	4.47*	4.45*
10y MGS	3.73**	3.81**	3.70*

Sources: DOSM, BNM, AmBank Economics
*Notes: *Year-end forecast, ** Year-end actual*

Exhibit 2: GDP Supply Side Forecast (y/y%)

	Actual Data	AmBank Forecast	
	2023	2024F	2025F
Services	5.1	5.3	5.2
Manufacturing	0.7	4.1	4.1
Mining	0.5	0.9	1.1
Agriculture	0.7	3.0	0.9
Construction	6.1	17.1	8.5
GDP (y-o-y%)	3.6	5.0	4.6

Sources: DOSM, Ambank Economics

Fixed income: Malaysia's bond market will benefit from stable monetary policy, attractive yields, and healthy investor demand. MGS/GII are expected to gain, driven by favourable domestic interest rate trends and a supportive supply environment. Corporate bond issuance could surpass MYR 130 billion, reflecting positive credit conditions and investor appetite for longer tenors with wider spreads. Market participants will closely watch yield spreads for investment opportunities.

FX: We expect the USD to maintain strength amid the new U.S. administration's inflationary policies. The yen may strengthen to the 150-155 range, though political and monetary considerations pose risks. The ringgit's outlook appears favourable amid a narrowing interest rate gap, supported by Malaysia's healthy domestic fundamentals. On the contrary, potential trade tensions could cloud the policy landscape.

Global Economic Overview

The global economy will face a critical test of resilience in 2025

In 2024, the global economy has managed to navigate the potential negative impacts of prolonged higher interest rates. This time is different. The global economy in 2025 will face a critical test of resilience as elections in major countries held last year, particularly the United States (U.S.), will dictate the economic landscape in the year, leading to policy shifts and increased market volatility. We expect many economies to face significant trade-offs – i.e. balancing fiscal discipline or the need for fiscal/monetary stimulus – as they prioritise policy stability and predictability. Given the ongoing uncertainty surrounding the possible policy shifts of major economies, policymakers are likely to draw lessons from the past decade to address the economic challenges of 2025. This will surely spark debates as such a strategy may not be fully effective in an ever-changing global economic landscape.

Projections for Global and Regional GDP Growth

The global economy will grow by approximately 3.2-3.3% this year. The U.S. will lead growth among advanced economies, while China may miss its 5.0% growth target

Multilateral development banks (MDBs) project the global economy to grow by approximately 3.2-3.3% this year, with significant variations across different economies. For advanced economies, growth is expected to stabilise at about 1.8-1.9% in 2025 and 2026, as outlined by the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). The United States (U.S.) is likely to lead the pack of advanced economies, while growth in the Euro Area may be somewhat lower this year compared to 2026. Although projections suggest that China's growth may continue to trend below 5.0%, India stands out with robust expectations of at least 6.5% growth for 2025 and 2026.

Key Risks

Global inflation will ease further, but the trend will still be higher than the pre-pandemic levels. Expect speed bumps due to Trump tariffs 2.0

The IMF anticipates that global average inflation will ease to about 4.3% this year and further down to 3.6% in 2026. While this is certainly a positive trend, we should remain realistic that inflation may not return to pre-pandemic levels immediately, especially if trade tariffs increase starting in 2025. Meanwhile, global trade is on an upward trajectory, possibly amid frontloading before Trump tariffs 2.0, after a dip of -9.6% in 2023. In any case, we should expect some speed bumps ahead, given today's volatile economic environment.

Rising food inflation due to oils and dairy

Global food inflation, tracked by the Food and Agriculture Organization of the United Nations, has been steadily climbing since 3Q2023. The December 2024 food inflation print came in at 6.7% y/y, driven by higher oil and daily food inflation. In 2025, we take it that it may trend at the current level for some time as oil inflation is still at double digits.

The global supply chain is stabilising

Notably, the Global Supply Chain Pressure Index (GSCPI) appears to be stabilising rather convincingly amid geopolitical tensions in the Middle East and Eastern Europe. Furthermore, the Baltic Exchange Index (BDI) shows strong signs of slowing down, indicating a possible easing of supply chain pressures.

We expect global oil prices to trend at USD 75 per barrel in 2025

Global monetary easing will be well-measured, unlike what we saw in 2024

On the energy front, the U.S. Energy Information Administration (EIA) expects Brent crude prices to remain stable at around USD 74 per barrel throughout the year. We did not see global oil prices misbehaving despite geopolitical tensions in 2024; perhaps a similar situation will repeat in 2025. However, we expect Brent crude to

be at USD 75 per barrel, factoring in issues such as the continued lower energy demand in China and increased supply to support our forecast.

We expect the U.S. to adopt a blanket tariff approach against specific countries

Global monetary policy has seen significant easing over the past year as inflation rates decline and growth headwinds persist. While we remain optimistic about this trend continuing, we also caution against expecting a rapid pace of monetary easing like we experienced in 2024. Instead, we anticipate that global central banks will adopt a more measured approach, navigating the delicate balance of growth headwinds and sticky inflation as the labour market stabilises.

We posit that Trump tariffs 2.0 will also impact the U.S.'s closest allies. Meanwhile, we believe that Malaysia's impact will be largely indirect

U.S. President Donald Trump is expected to carry out his campaign promises when he takes office in January 2025. His “new” policies are believed to be highly inflationary, but the biggest risk to global growth is likely to come from tariffs, known as Trump Tariffs 2.0. These tariffs may affect not just China but also Canada, Mexico, and possibly other countries.

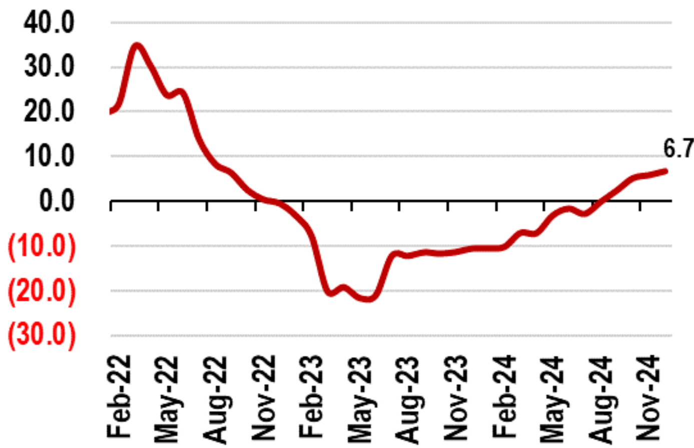
Tariffs can disrupt international trade and supply chains, potentially leading to slower economic growth above baseline. In his previous term in office, higher tariffs on Chinese goods caused investment diversion where Chinese companies set up operations abroad to gain indirect access to the U.S. market and eventually bypass tariffs. If the new U.S. administration imposes broad import tariffs to prevent Chinese goods from entering its market, these companies will likely seek greater market access where they are currently domiciled. As a result, they could become more fiercely competitive with other local and major producers, including the U.S.'s closest allies. On that note, we do not expect Malaysia to be significantly impacted by Trump tariffs 2.0. The impact on Malaysia’s trade will be indirect but will eventually creep in through other markets.

SUMMARY OF GLOBAL GROWTH PROJECTIONS

Forecasts	IMF (Jan 2025)		World Bank (Jan 2025)		OECD (Dec 2024)		ADB (Dec 2024)	
	2025	2026	2025	2026	2025	2026	2025	2026
World	3.3	3.3	2.7	2.7	3.3	3.3	-	-
Advanced Economies/OECD	1.9	1.8	1.7	1.8	1.9	1.9	-	-
U.S.	2.7	2.1	1.8	1.8	2.4	2.1	-	-
Euro Area	1.0	1.4	1.4	1.3	1.3	1.5	-	-
EMDEs	4.2	4.3	4.0	3.9	-	-	-	-
China	4.6	4.5	4.1	4.0	4.7	4.4	4.5	-
India	6.5	6.5	6.7	6.8	6.9	6.8	7.0	-

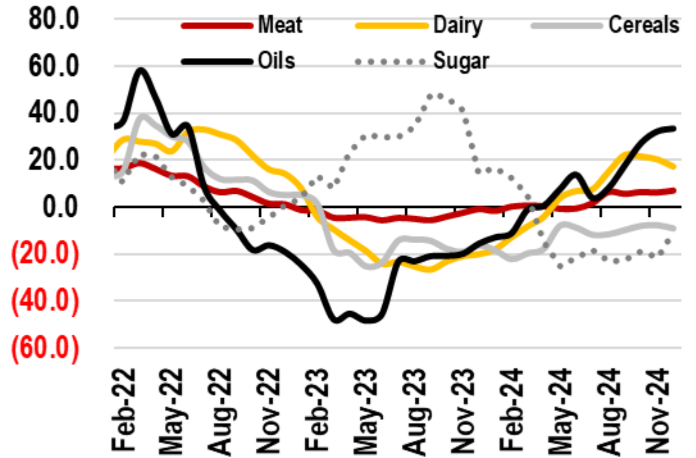
Sources: International Monetary Fund (IMF), World Bank, Organisation for Economic Co-operation and Development (OECD), Asian Development Bank (ADB), AmBank Economics

Exhibit 3: World FAO Food Price Index, y/y%



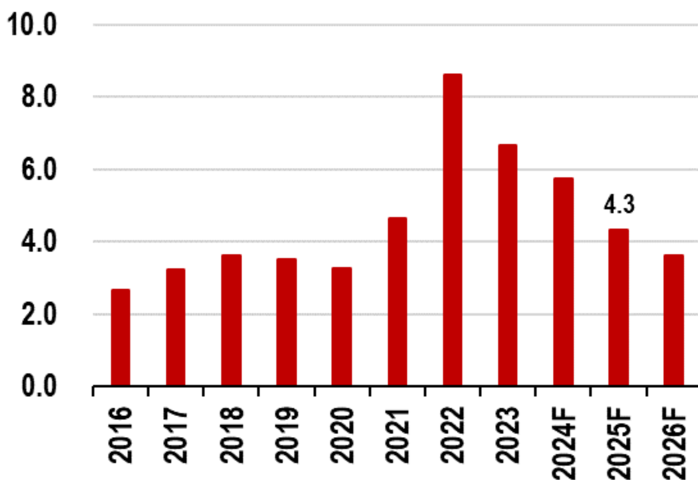
Sources: UN FAO, AmBank Economic

Exhibit 4: World FAO Food Price Index by type, y/y%



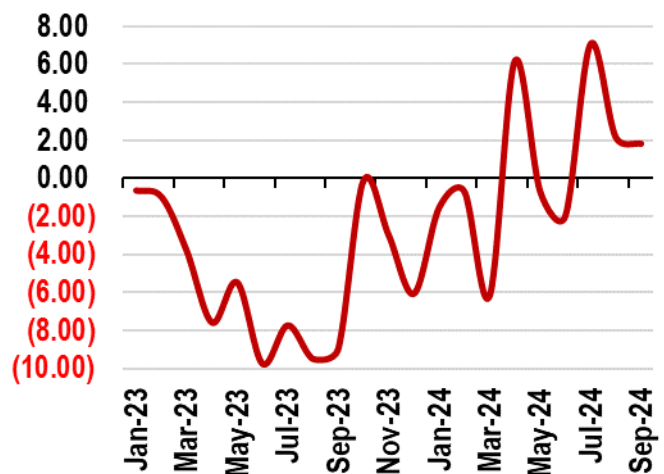
Sources: UN FAO, AmBank Economics

Exhibit 5: World Inflation: average consumer prices, y/y%



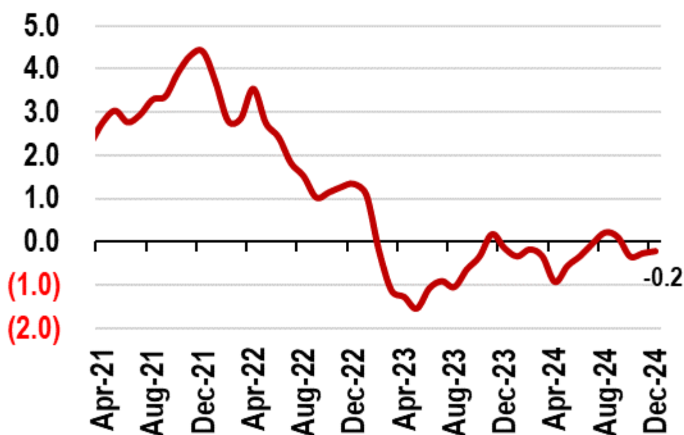
Sources: IMF, AmBank Economics

Exhibit 6: Total global trade, y/y%%



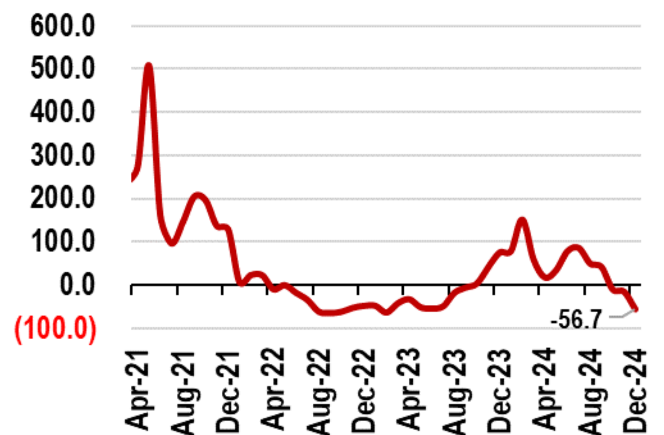
Sources: UN FAO, AmBank Economics

Exhibit 7: Global Supply Chain Pressure Index



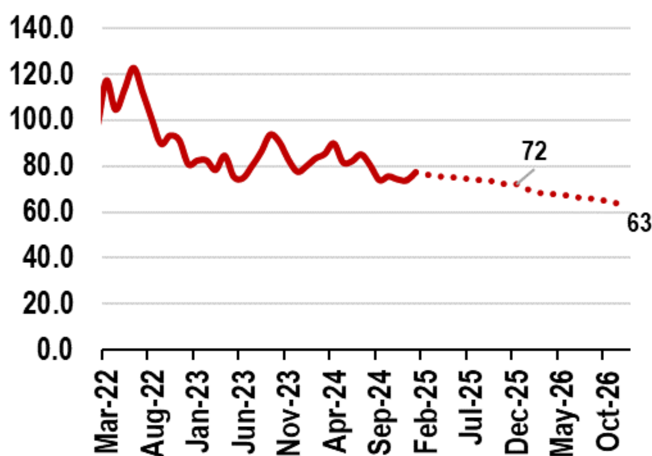
Sources: UN FAO, AmBank Economics

Exhibit 8: Baltic Exchange Index, monthly avg., y/y%



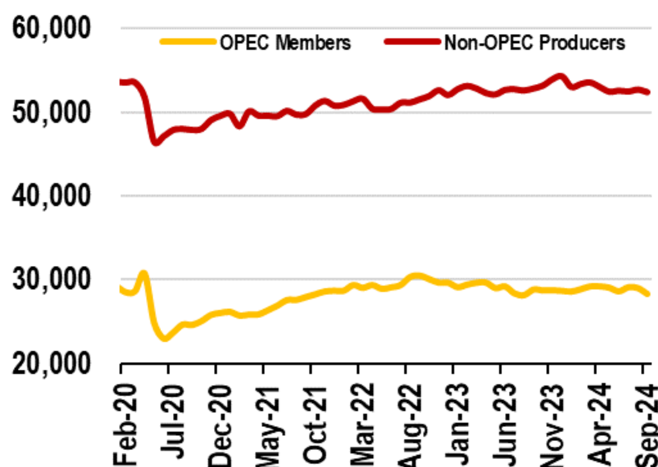
Sources: Baltic Exchange Information Services Limited, AmBank Economics

Exhibit 9: Brent spot average forecast, USD barrel



Sources: EIA, AmBank Economics

Exhibit 10: Crude oil production, '000 Barrel/Day



Sources: EIA, AmBank Economics

MAJOR ECONOMIES

United States (U.S.)

The world's largest economy has been growing steadily since 1Q2024 despite a notable weakness in its labour market

The U.S. economy showed significant growth in 9M2024, with quarter-over-quarter growth rising from 1.6% in 1Q2024 to 3.1% in 3Q2024. The outlook for the world's largest economy remains positive in 4Q2024 and the near term due to the continued strength of the labour market. The U.S. unemployment rate ended 2024 at 4.1%, an increase from 3.8% in 2023, indicating a gradually weakening labour conditions despite hovering around 4.1% to 4.2% since 2H2024. Analysts will closely monitor U.S. labour and inflation for indications of the direction of monetary policy in 2025.

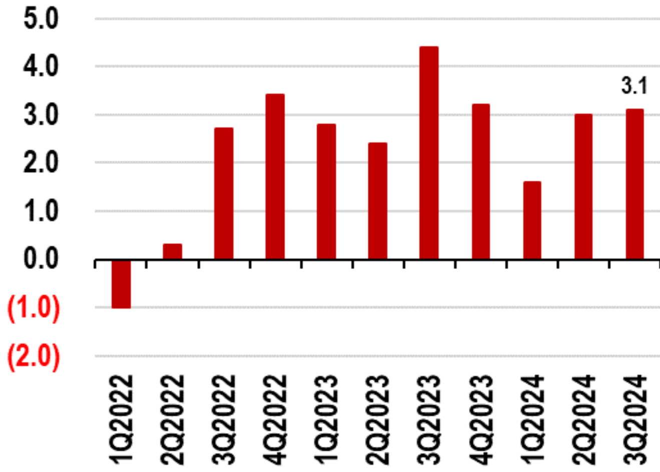
Inflation is no longer a threat as it was in the past two years, yet it is still trending higher than the 2.0% level. It may remain high amid Trump's inflationary policies. The greenback will likely hold its strength in the new year

Disinflation efforts have faced challenges where the U.S. Consumer Price Index (CPI) began to trend upward since September 2024. The recently released CPI data for December 2024 showed an increase of 2.9% y/y%, indicating that disinflation will likely experience speed bumps. We anticipate that U.S. President Donald Trump's policies will contribute to the ongoing inflationary pressures, resulting in a prolonged period of tight U.S. monetary policy. The Dollar Index (DXY) currently stands at 109 points, and we expect the U.S. dollar to remain strong as long as there are no significant threats to the labour market's strength.

Monetary policy easing is unlikely to be as aggressive as in 2024. Market participants believe the Fed will resume easing in 2H2025, if not later

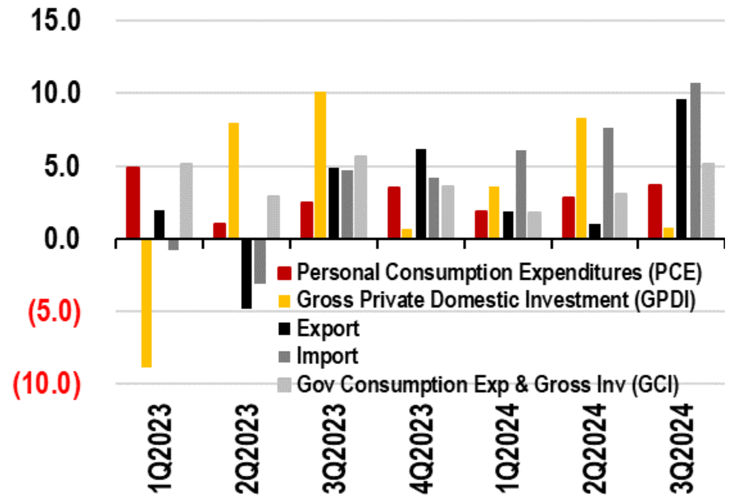
The decision to implement 50 basis points (bps) cut in September surprised us, as the U.S. Federal Reserve (the Fed) typically does not initiate monetary easing with such a substantial easing. Fed Chair Jerome Powell indicated that the notable weakness in the economy's labour market influenced the Federal Open Market Committee (FOMC) decision. However, we believe the Fed hit the iron while it was hot, as the window for future cuts may be limited. By the end of 2024, the Fed delivered a total cut of 100 bps, lowering the Federal Funds Rate (FFR) to 4.25% to 4.50%. According to the December dot-plot, a maximum cut of 50 bps is anticipated in 2025, halving the committee's estimates made in September 2024. However, at the time of writing, traders are only factoring in potential cuts in 2H2025 or later, given the stable conditions in the labour market and uncertainties surrounding the new administration's policy shift.

Exhibit 11: U.S. GDP, saar, q/q%



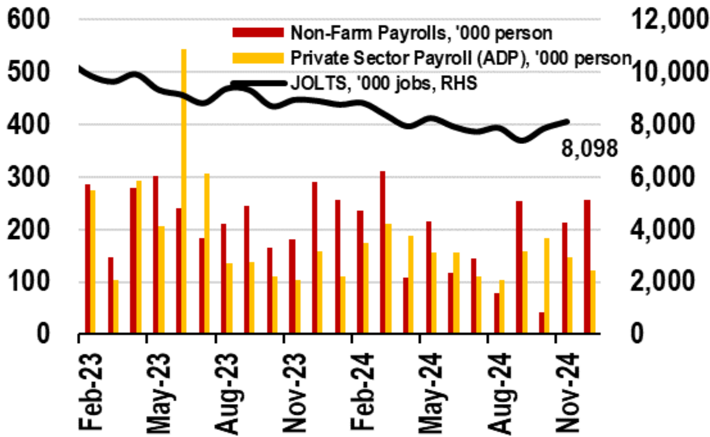
Sources: U.S. Bureau of Economic Analysis (BEA), AmBank Economics

Exhibit 12: U.S. GDP by expenditure, saar, q/q%



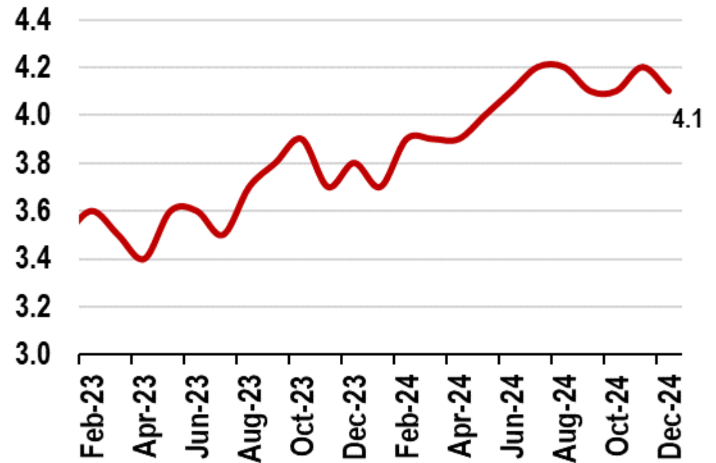
Sources: BEA, AmBank Economics

Exhibit 13: Key labour market indicators



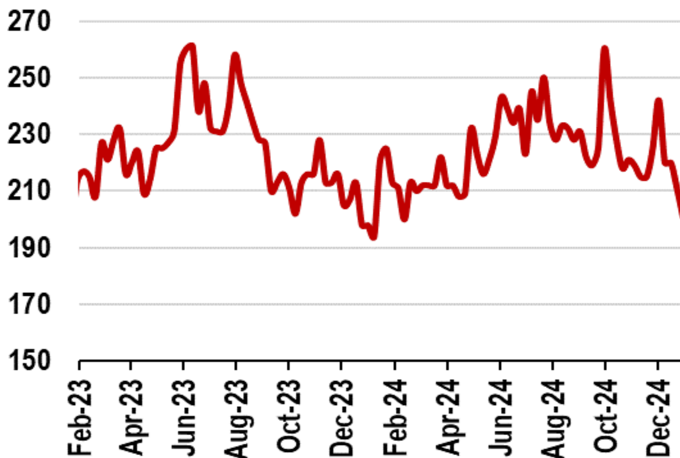
Sources: U.S. Bureau of Labor Statistics, Automatic Data Processing, Inc., AmBank Economics

Exhibit 14: Unemployment rate, %



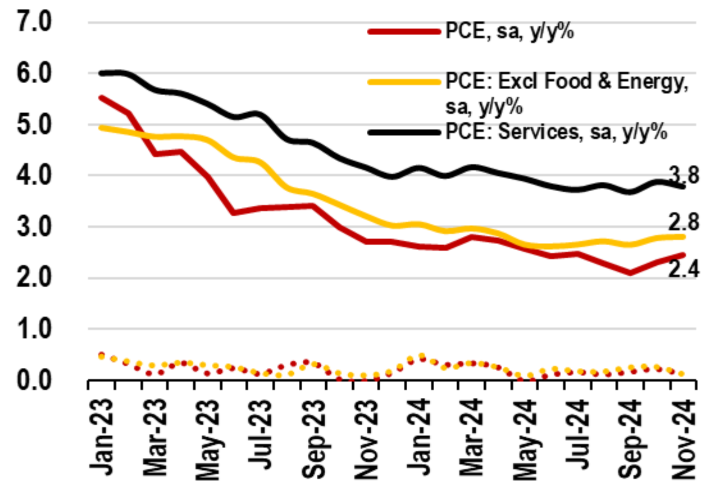
Sources: BLS, AmBank Economics

Exhibit 15: Initial Jobless Claims, sa, '000 person



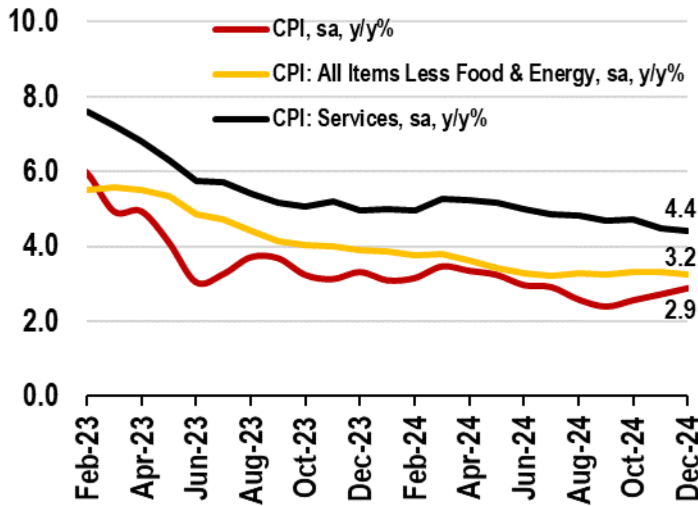
Sources: U.S. Department of Labor, AmBank Economics

Exhibit 16: U.S. PCE inflation



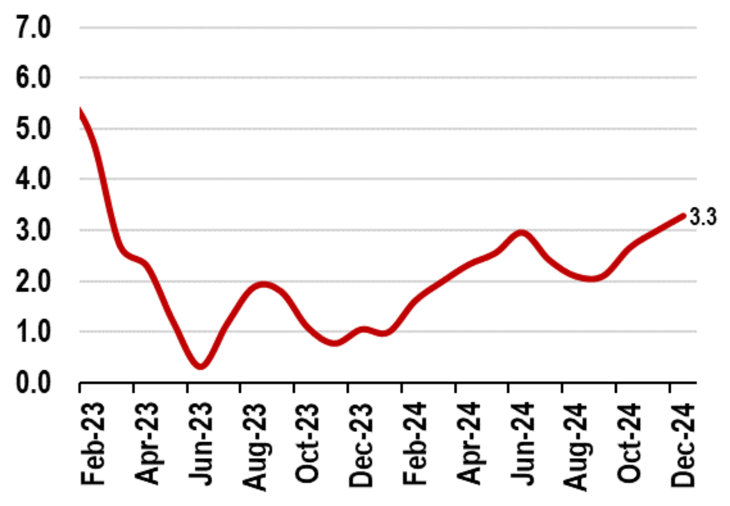
Sources: BLS, AmBank Economics

Exhibit 17: Initial Jobless Claims, sa, '000 person



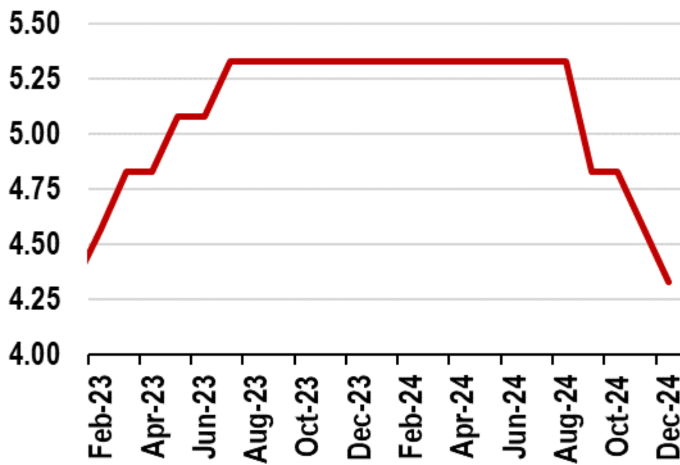
Sources: U.S. Department of Labor, AmBank Economics

Exhibit 18: Producer Price Index, sa, y/y%



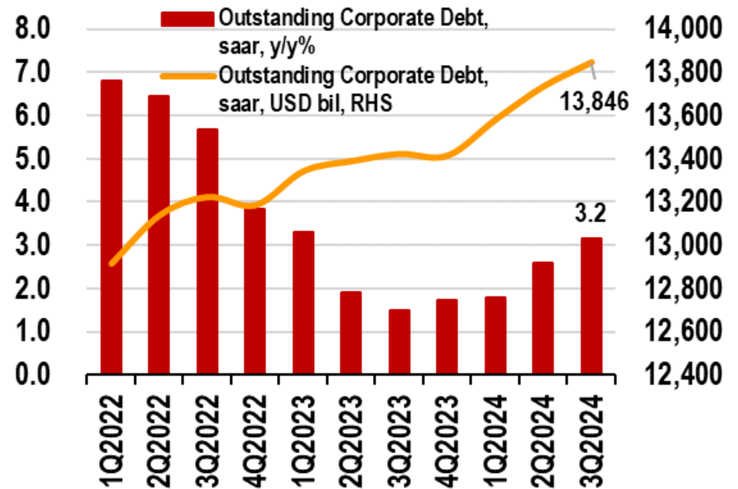
Sources: BLS, AmBank Economics

Exhibit 19: Effective Federal Funds Rate, month-end, %



Sources: Federal Reserve Board, AmBank Economics

Exhibit 20: Effective Federal Funds Rate, month-end, %



Sources: Federal Reserve Board, AmBank Economics

Euro Area

The Euro Area's growth, on a seasonally and working days adjusted basis, has been increasing since 1Q2024. Despite growth headwinds, there are no threats of a recession

The year 2024 saw the Euro Area's growth trend higher, thanks to stable labour market conditions and steady monetary easing. The economy circumvented a technical recession in late 2023 when inflation and interest rates were still trending high. We noticed a steady increase in government consumption with stabilising private consumption, allowing 3Q2024's final consumption expenditure to rise at 1.38% y/y% versus 1.17% y/y% in 2Q2024. Both exports and import growth also came in higher in 3Q2024 but were hampered by investments that trended negatively in the past 3 quarters.

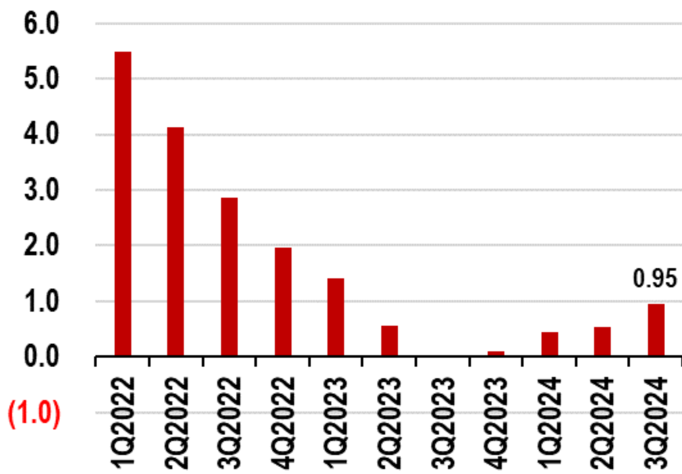
Inflation is no longer a threat but services inflation thwarts the disinflation process

Unlike in the past two years, inflation in the Euro Area is no longer a major concern. The harmonised index of consumer prices (HICP)'s December 2024 print came in at 2.4%, lower than the same month in the prior year at 2.9% but higher than in November 2024 at 2.2%. We think services drive inflation in the Euro Area amid a healthy labour market, while inflation pressure from energy has subsided. As such, the monetary policy direction of the Euro Area in 2025 is likely to be less aggressive than in 2024 as it is no longer about inflation but the economy's growth prospects.

The ECB delivered a total of 100bps cuts in 2024, and further monetary easing is ahead, but in a more measured manner

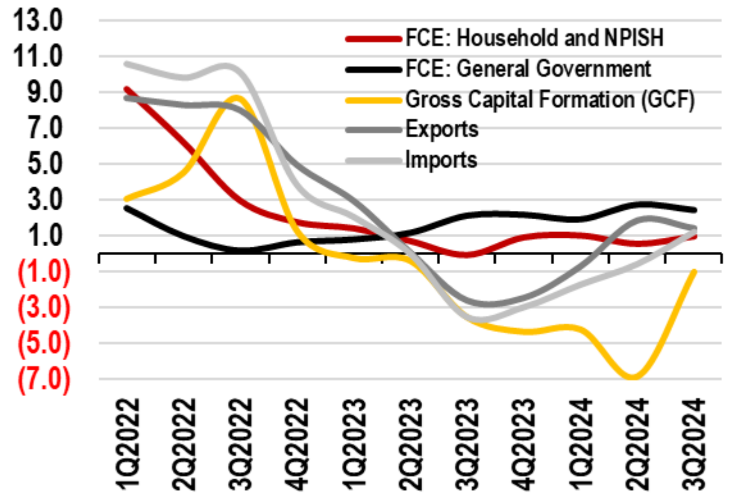
The European Central Bank (ECB) delivered 4 rate cuts in 2024, bringing the Main Refinancing Operations, Deposit Facility, and Marginal Lending Facility rates to 3.15%, 3.00%, and 3.40%, respectively. We believe that the ECB will likely consider prolonged high services inflation in the coming monetary policy settings and growth headwinds from trade. As the economy's unemployment rate continues to be "low" by historical standards, at 6.3% in December 2024, we opine that services inflation will remain sticky in 2025 sans a major growth headwind, making the monetary policy path of the region likely to be well-measured.

Exhibit 21: EA: Real GDP, swda, y/y%



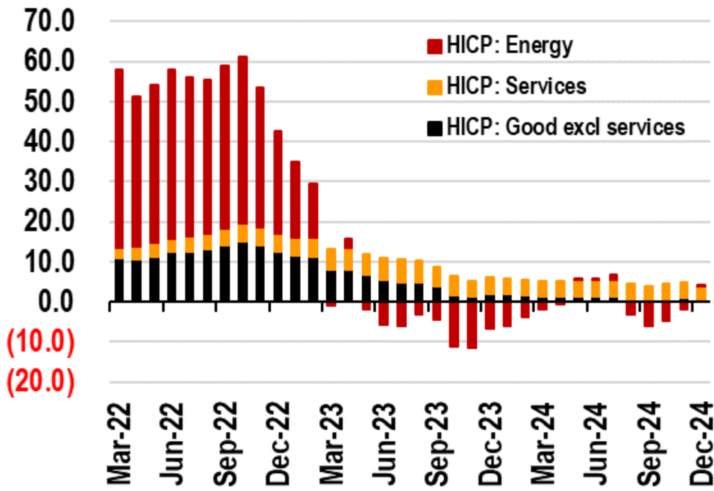
Sources: Eurostat, AmBank Economics

Exhibit 22: EA: Real GDP by expenditure, swda, y/y%



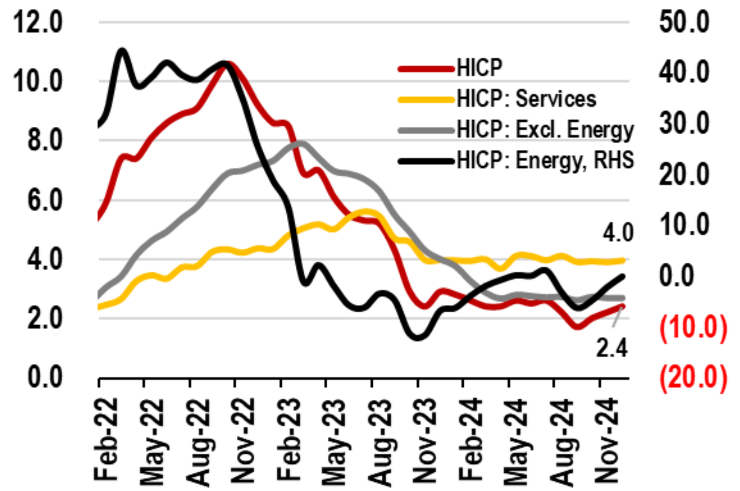
Sources: Eurostat, AmBank Economics

Exhibit 23: EA: Consumer inflation, y/y%



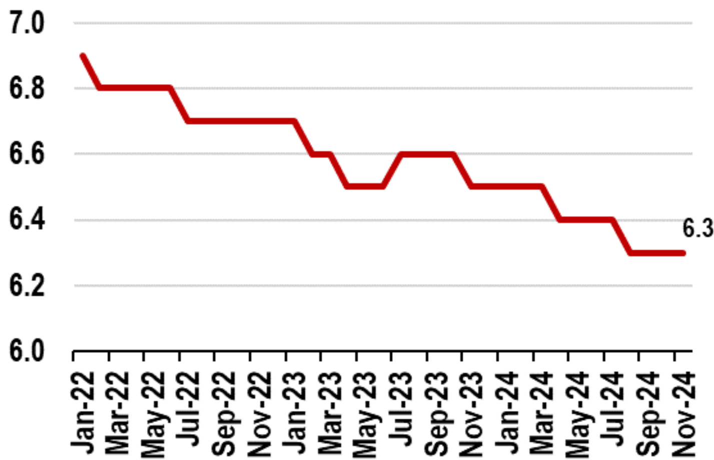
Sources: Eurostat, AmBank Economics

Exhibit 24: EA: Inflation



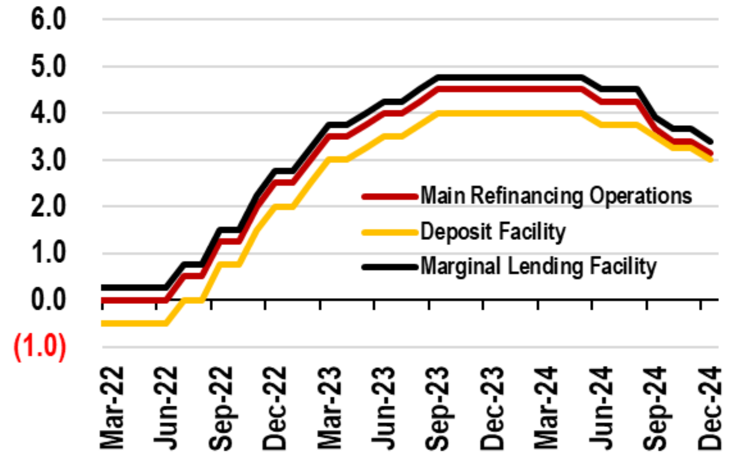
Sources: Eurostat, AmBank Economics

Exhibit 25: EA: Unemployment rate, sa, y/y%



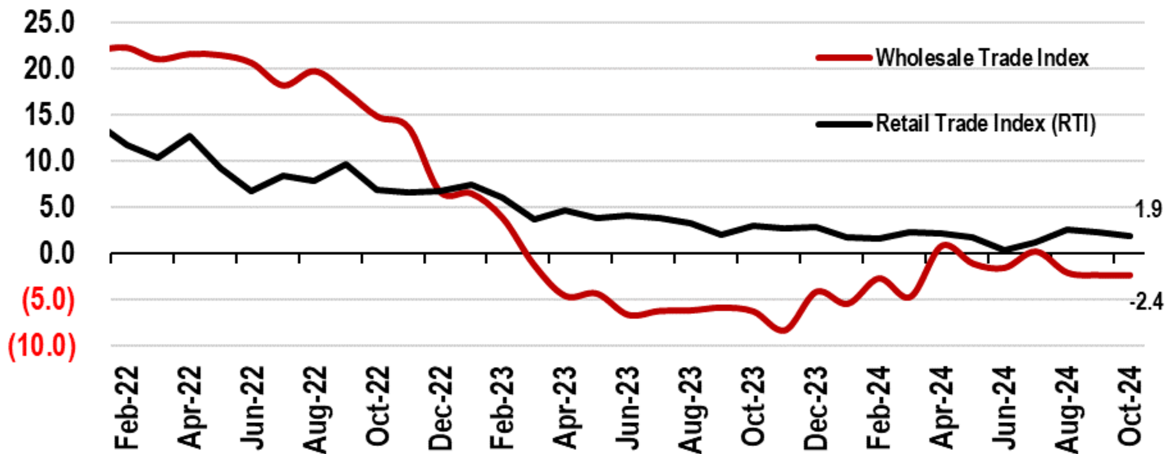
Sources: Eurostat, AmBank Economic

Exhibit 26: EA: Interest rates, %



Sources: ECB, AmBank Economics

Exhibit 27: EA: Wholesale and Retail Trade Index, swda, y/y%



Sources: Eurostat, AmBank Economics

China

MDBs forecast that China's growth will be below 5.0%. External demand is doing most of the heavy lifting, but this scenario could change due to Trump tariffs 2.0

Once again, none of the MDBs expects China to grow at or above the 5.0% mark in 2025 and 2026 amid subdued domestic demand. We notice that China's growth has stabilised at around the high 4.0% mark since 3Q2023, but momentum has softened since 1Q2024. Consumption is easing while the external sector is doing most of the heavy lifting in maintaining the economy's growth in recent quarters. We expect the trend to continue in the coming quarters amid the prolonged strength of the U.S. economy and the resilience of the labour market in the Euro Area. Still, Trump tariffs 2.0 could derail this to a considerable degree.

We believe China will try to suppress inflation to mitigate any deleterious impact on its exports

U.S. President Trump may impose broader tariffs to curb Chinese imports

As such, we believe it is in China's interest to keep its inflation very low to dilute the impact of tariffs. We saw the same scenario during the height of the U.S.-China trade war, although it did impact Chinese exports to the U.S. anyway. The difference now is that investment diversion has happened since then, and many large Chinese corporations are domiciled abroad, with many having free trade access to the U.S. market. While we await more details on Trump tariffs 2.0, we expect the worst when the new U.S. administration imposes a wide tariff coverage, which may or may not include

imports from China, particularly in countries with sizeable Chinese investments/presence.

Consumer inflation is weak and will remain low amid the declining food inflation

China's producer inflation has been trending negative for almost two years. We believe keeping producer inflation low is in the country's interest

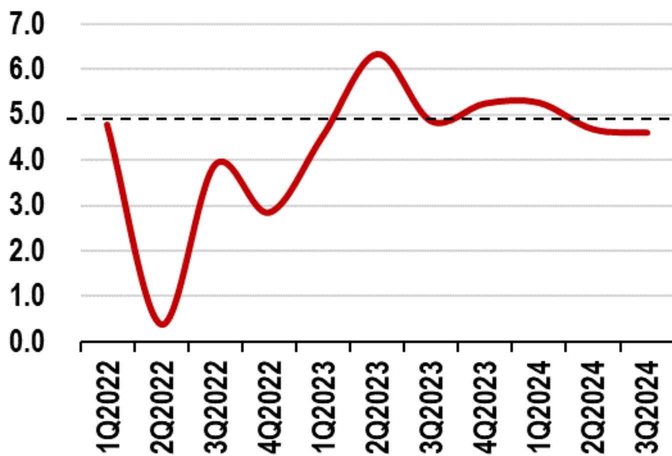
Consumer inflation in China appears to have exited the negative territory since early 2024 and has stayed very low. We think the country's CPI will unlikely increase in 2025 due to food inflation. However, it is very volatile and highly correlated with the CPI, re-entered the deflation territory in December 2024 after staying in positive territory for 5 straight months. Core inflation has also remained very low and stable. Meanwhile, China's producer price index (PPI), from both producer and consumer goods production, has been trending in deflation mode since at least May 2023. Trade may suffer should the economy's PPI rise, especially if Chinese exports are subject to higher tariffs under the new U.S. administration. Thus, we think it is in the country's interest to keep production costs low to dilute the impact of higher tariffs while aiding a bigger market access for Chinese exports.

Retail sales have stabilised when consumer confidence is also low and stable

China's real estate woes persist

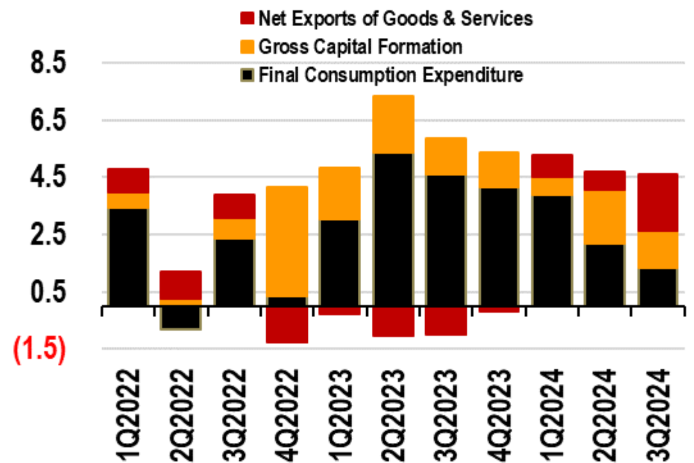
We also notice that retail sales of consumer goods have stabilised amid a low inflation environment. This trend correlates with the stable consumer confidence, which has been low but flat since mid-2022. Having said that, residential building sales remain low, declining each year, signalling the prolonged stress in the real estate market in China.

Exhibit 28: China: Real GDP, y/y%



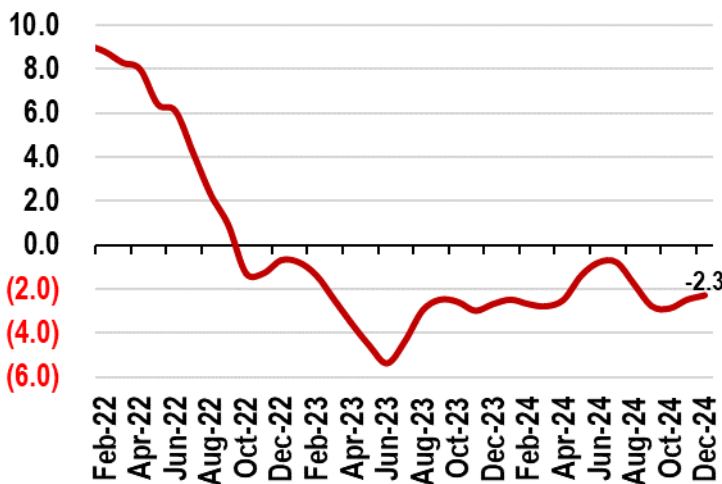
Sources: China's National Bureau of Statistics (NBS), AmBank Economics

Exhibit 29: China: GDP by expenditure, y/y%



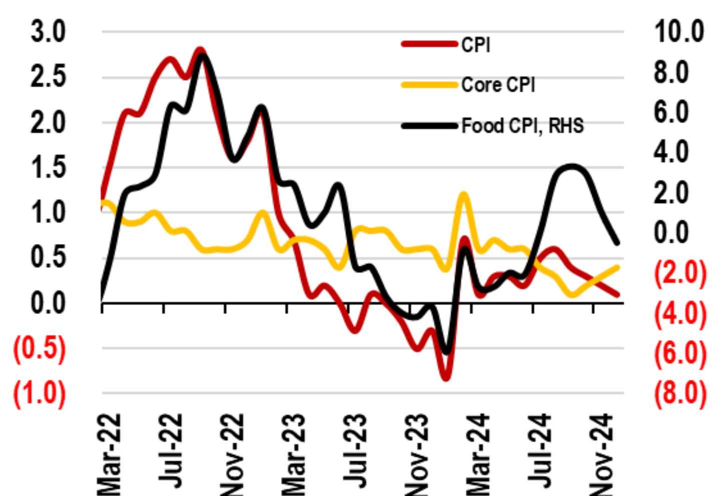
Sources: NBS, AmBank Economics

Exhibit 30: China: Produce inflation, y/y%



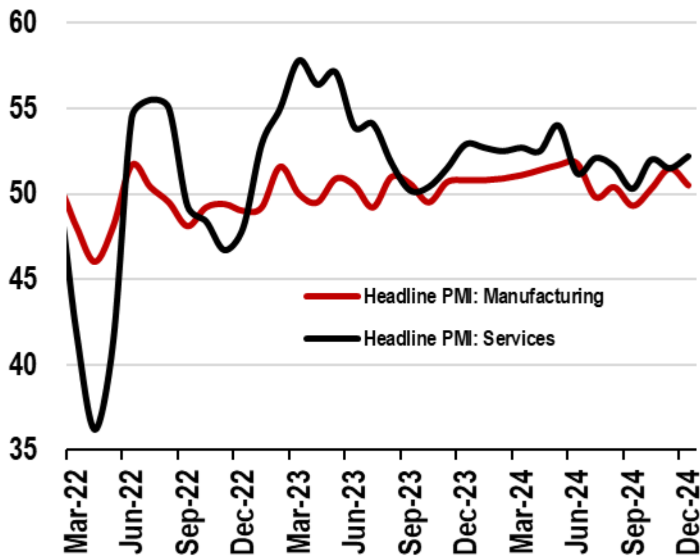
Sources: NBS, AmBank Economics

Exhibit 31: China: GDP by expenditure, y/y%



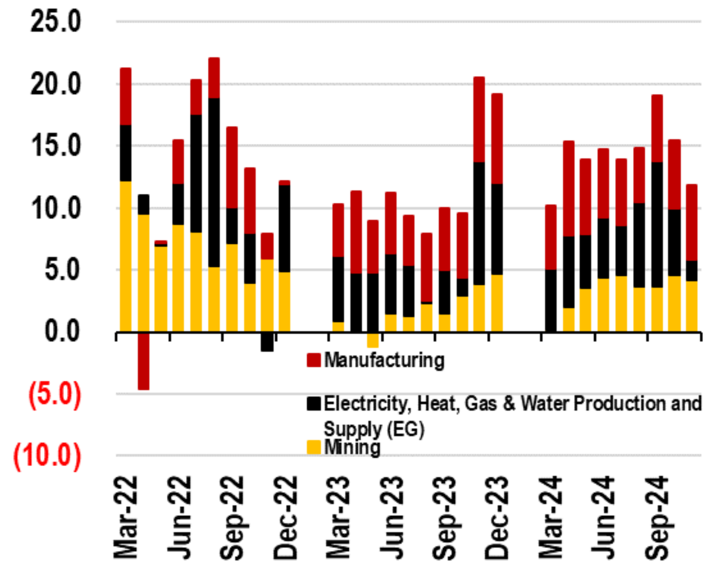
Sources: NBS, AmBank Economics

Exhibit 32: China PMI Index



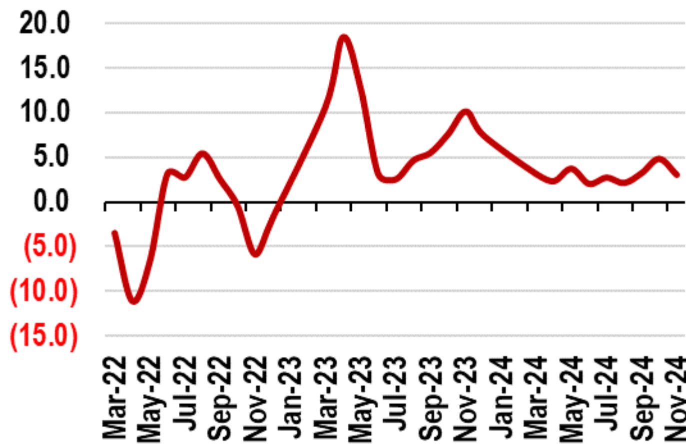
Sources: NBS, AmBank Economics

Exhibit 33: China: Value added by industry, y/y%



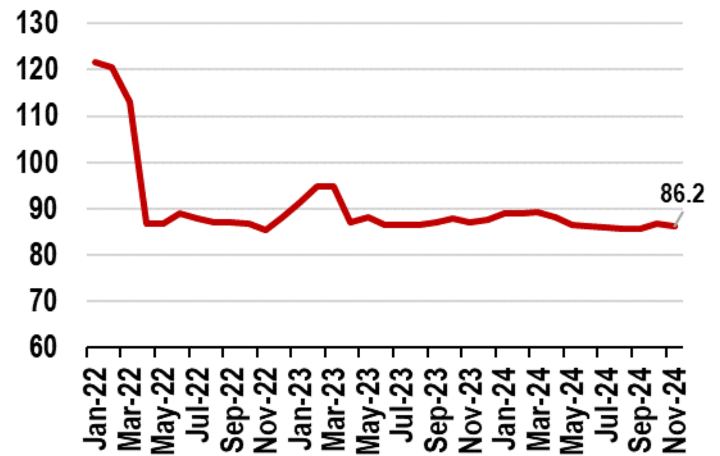
Sources: NBS, AmBank Economics

Exhibit 34: China: Retail Sales of Consumer Goods, y/y%



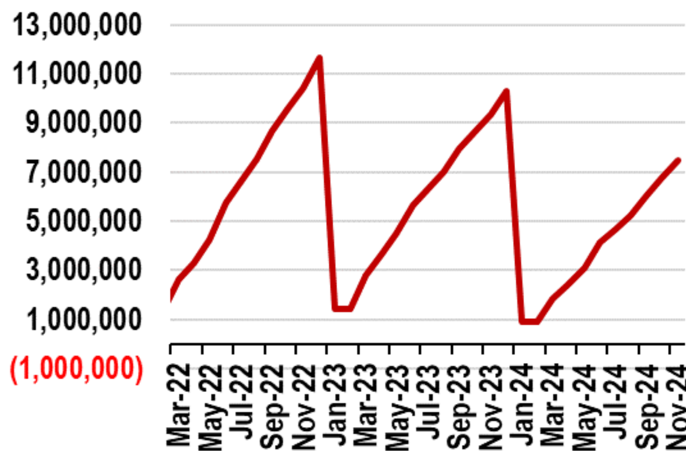
Sources: NBS, AmBank Economics

Exhibit 35: China: Consumer Confidence Index, points



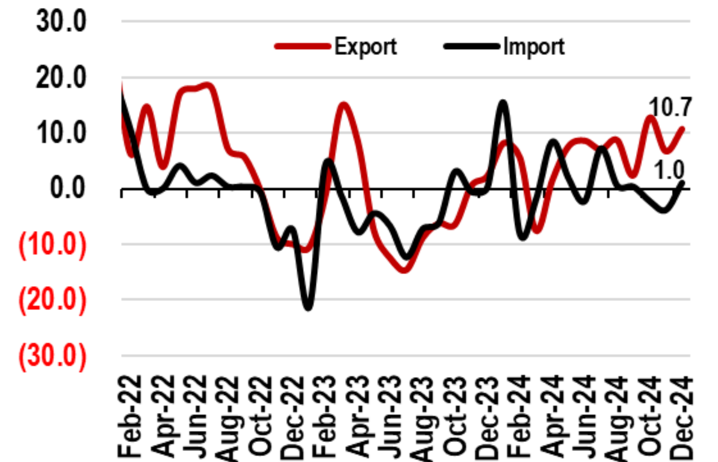
Sources: NBS, AmBank Economics

Exhibit 36: China: Residential Buildings Sold, YTD



Sources: NBS, AmBank Economics

Exhibit 37: China: GDP by expenditure, y/y%



Sources: NBS, AmBank Economics

Southeast Asia

Expect solid growth in 2025, with the Philippines and Vietnam leading growth above 6.0%

MDBs expect Southeast Asia's growth to remain solid. The IMF expects the region to grow at 4.5% in 2025, while the ADB's forecast is higher at 4.7% in 2025. The Philippines and Vietnam will grow at a commendable pace of above 6.0% this year, whereas Indonesia's growth will likely remain constant at 5.1% in 2025 and 2026.

Inflation in the region is expected to be under control

The region is no longer grappling with high inflation as seen in the post-pandemic years and has since stabilised. According to the IMF's October 2024 estimates, despite being a developing regional economy, the Philippines' inflation will likely remain benign at around 2.3% in 2025. In 11M2024, the average inflation in the Philippines was notably higher among ASEAN-5 economies at 3.2%, while Thailand recorded the lowest at merely 0.3%. The 11M2024 average inflation in Vietnam was high at 3.7%, but we noticed that monthly inflation stabilised in the later part of the year at 2.8%, although growth was on an uptrend throughout 2024.

Malaysia will host ASEAN meetings this year under the slogan "inclusivity and sustainability." We believe Malaysia will continue to address ASEAN's longstanding issues, but they may not be fully resolved

As chairman of ASEAN, Malaysia will chart the post-2025 narrative not only in the economic but also in the political and socio-cultural aspects of the region. Malaysia is going with the "inclusivity and sustainability" slogan, and all eyes will be on key regional issues, such as the South China Sea and dialogue partners. In contrast, internal ones concerning Myanmar and the entry of Timor Leste will also be closely watched by observers.

SUMMARY OF GROWTH PROJECTIONS IN SOUTHEAST ASIA

Forecasts	IMF (Jan 2025)		World Bank (Jan 2025)		ADB (Dec 2024)	
	2025	2026	2025	2026	2025	2026
ASEAN	4.5*	4.5*	-	-	4.7	-
Malaysia	4.7	4.4	4.4	4.3	4.6	-
Indonesia	5.1	5.1	5.1	5.1	5.0	-
Philippines	6.1	6.3	5.9	5.9	6.2	-
Singapore	2.5**	2.5**	-	-	2.6	-
Thailand	2.9	2.6	2.8	2.9	2.7	-
Vietnam	6.1**	6.0**	6.0	6.5	6.6	-

*ASEAN-5
**October 2024 projections

Sources: IMF, World Bank, ADB, AmBank Economics

MALAYSIA IN 2025

We anticipate Malaysia's GDP growth to pick up to 4.9% in 2024 from a below-trend 3.6% in 2023

Malaysia's economy is poised for another year of solid growth in 2025, albeit moderating to 4.6%

Exhibit 38: GDP Expenditure Side Forecast (y/y%)

	Actual Data	AmBank Forecast	
	2023	2024F	2025F
Domestic Demand	4.7	6.5	4.9
Private Consumption	4.7	5.0	4.8
Public Consumption	3.3	4.8	3.1
Private Investment	4.6	12.7	8.4
Public Investment	10.1	10.2	-0.4
Real Exports	-8.1	9.7	4.4
Real Imports	-7.4	10.8	5.1
Net Exports	-16.1	-6.4	-8.1
GDP (y-o-y%)	3.6	5.0	4.6

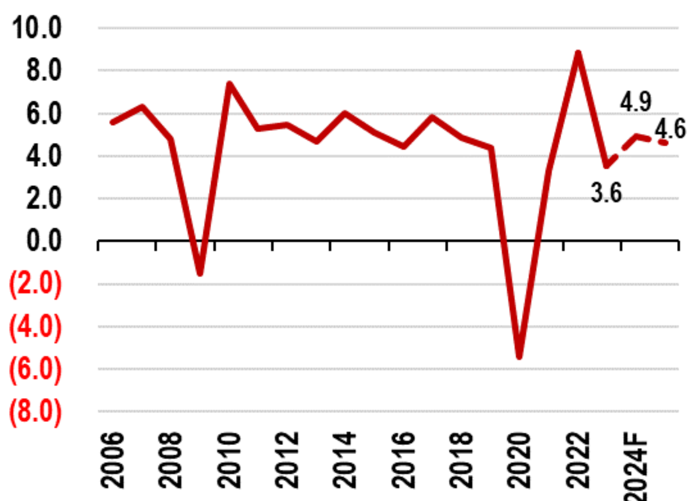
Sources: DOSM, Ambank Economics

Solid growth, but clouds of uncertainty looms

The economic landscape in 2024 marked by resilience and steady progress. GDP growth has surpassed expectations, while the unemployment rate has returned to the pre-pandemic low without fuelling high inflation. We anticipate Malaysia's full-year GDP growth to pick up from a below-trend 3.6% in 2023 to 5.0%, which is comfortably within the government's upwardly revised range of 4.8% to 5.3%. This performance is underpinned by robust private consumption, an investment upcycle, and improved trade dynamics aided partly by the global semiconductor recovery.

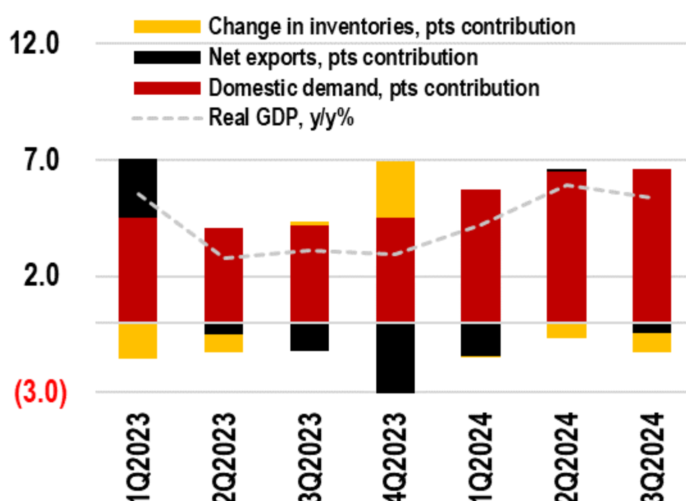
In 2025, we expect Malaysia's economy to be poised for another year of solid growth, albeit moderating to 4.6%, aligning with the lower bound of the official projection range of 4.5% to 5.5%. Risks to growth are weighted somewhat to the downside due to external risks, including potential trade disruptions from protectionist policies and escalating geopolitical risks given the ongoing Middle East and the Russia-Ukraine conflicts. Against this backdrop, growth is expected to be more domestically driven, supported by the government's proactive measures.

Exhibit 39: Real GDP, y/y%



Sources: DOSM, AmBank Economics

Exhibit 40: Contributions to real GDP growth



Sources: DOSM, AmBank Economics

Robust domestic demand provides a buffer against external risks

Our base case assumes a partial implementation of Trump's tariff proposal

At the time of writing, it remains unclear how much further U.S. President Donald Trump will go with his protectionist policies. Yet, our base case assumes a partial implementation of Trump's tariff proposal. Recent remarks by Trump and his officials suggest higher tariffs could serve as a strategic bargaining chip in trade negotiations. In our view, any additional tariffs imposed are likely to be more targeted, focusing on products that directly compete with U.S. manufacturers – some of which have already been subject to high tariffs. For example, solar cell imports from Malaysia have faced a general duty of 9.1% since October 2024. Even if Trump moves ahead with his proposed blanket tariffs, obtaining Congressional approval is not a straight line, even with the Republicans having control of the U.S. Congress.

Malaysia could still benefit from trade and investment diversions stemming from U.S.-China trade tensions

Uncertainty surrounding trade policies and geopolitics will undoubtedly weigh on business sentiment and investment decisions. Nonetheless, Malaysia could still benefit from trade and investment diversions from U.S.-China trade tensions. Renewed concerns over the U.S. increasing tariffs on China and possible Chinese retaliation could lead businesses to diversify operations away from China, thus creating opportunities for Malaysia. Indeed, Malaysia's foreign direct investment (FDI) inflows have been mainly positive and robust since the onset of U.S.-China trade tensions initiated during Trump's first presidency *(see Exhibit 41).*

The government's investment incentives will remain instrumental in attracting and retaining investments

We opine that the government's investment incentives will remain instrumental in attracting and retaining investments. In Budget 2025, the government announced a new investment incentive framework to mitigate the impact of the impending Global Minimum Tax (GMT) on incentivised multinational companies, scheduled for rollout in 3Q2025. The framework includes enhancements to existing tax incentives, extensions to incentive periods, forming economic clusters, matching grants for capital expenditure, and research and development in high value-added activities.

The continued implementation of infrastructure projects and the realisation of sizeable approved private investment will help sustain investment momentum

The investment upcycle is already underway, with gross fixed capital formation (GFCF) posting double-digit growth for two consecutive quarters through 3Q2024, significantly contributing to the GDP growth acceleration in 2024. We expect continued relatively strong investment growth in 2025, driven by technological advancements, infrastructure projects and initiatives such as the New Industrial Master Plan (NIMP) 2030 and National Energy Transition Roadmap (NETR), albeit at a somewhat slower rate than in 2024. Although no new mega projects were announced in Budget 2025, the ongoing implementation of infrastructure projects and the realisation of significant approved private investments (MYR1.2 trillion from 2021 to September 2024) will help sustain investment momentum. These projects include the East Coast Rail Link (ECRL), the Pan-Borneo Highway, the Nenggiri Hydroelectric Plant, the Johor-Singapore Special Economic Zone (JSSEZ) and new data centres.

Exports will continue to benefit from a temporary boost in the near term due to frontloading activities ahead of the anticipated tariff implementation

In the near term, Malaysia's exports will continue to benefit from a temporary boost due to frontloading activities ahead of the anticipated tariff implementation, helping to propel growth into early 2025 alongside robust domestic demand. In fact, exports to the U.S. have been on an uptrend since late 2023, helping to mitigate the drag from slower or even contracting exports to other countries. However, the positive contribution of exports to net exports will be partially offset by the continued growth of imports of capital goods amid an ongoing investment upcycle.

We do not foresee a significant drag from net exports on overall growth if the U.S. economy's strength persists. American importers and consumers will actively trade despite the presence of higher tariffs

The potential implementation of higher U.S. tariffs could negatively impact Malaysia's export performance. The direct impact could be notable, given that the U.S. accounts for 13.1% of Malaysia's total exports, though it may be less significant than many fear. We believe the impact on exports could be limited if the U.S. economy remains strong as U.S. importers and consumers actively trade despite higher tariffs, ensuring robust market activity. However, trade headwinds may arise from subdued demand from Malaysia's other key export markets, such as China (12.4%) and the E.U. (7.8%), both of which are already grappling with weak economic conditions and could face further strain from heightened trade barriers. With import growth also expected to moderate, we do not foresee a significant drag from net exports on overall growth.

Trade headwinds may manifest from other key trading nations such as China and the E.U

Private consumption is expected to remain the primary engine of growth, underpinned by healthy labour market conditions and government supportive measures

Private consumption accounts for more than 60% of GDP and is expected to remain the primary growth engine. While broader economic uncertainties, including the RON95 targeted subsidy rationalisation, may weigh on consumer sentiment, household spending will likely stay resilient. This resilience is underpinned by healthy labour market conditions and government supportive measures, including salary hikes for civil servants, continued government cash handouts under various schemes, namely Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA), a higher statutory minimum wage from MYR1,500 to MYR1,700 and the progressive minimum wage, all of which should aid alleviate the impact of higher living costs.

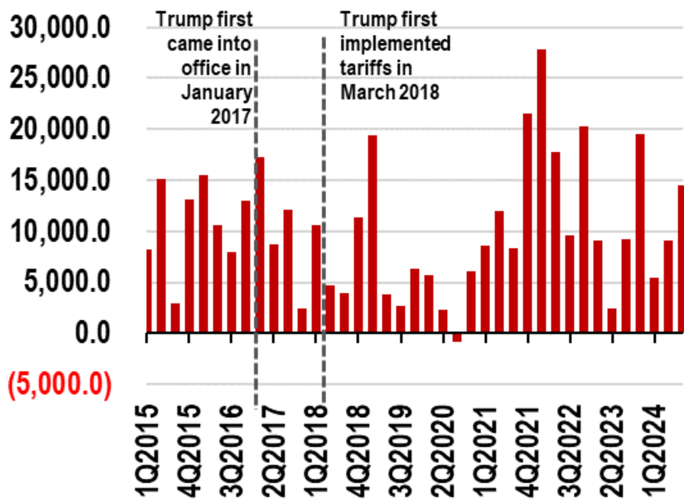
The government's fiscal position has shown improvement

Public spending has also played a vital role in supporting growth, while the government's fiscal position has improved amid expenditure cuts. Fiscal metrics in the first nine months of 2024 indicate that this year's fiscal deficit target of 4.3% of GDP – a reduction from 5.2% in 2023 – is within reach.

Yet the government's commitment to strike a balance between promoting growth and pursuing fiscal consolidation is becoming a challenging trade-off

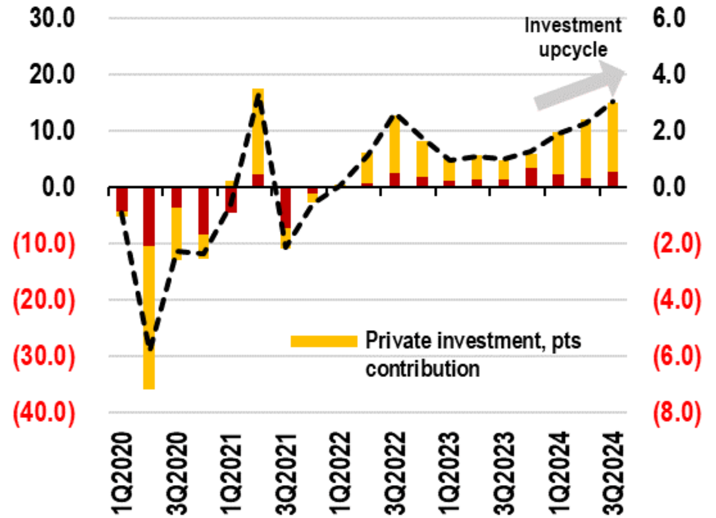
Budget 2025 reaffirmed the government's commitment to balancing promoting growth and pursuing fiscal consolidation, a challenging trade-off in the mid-political cycle and as uncertainties grow over the global economic outlook, with more protectionist policies likely to be implemented. This creates a now-or-never scenario that limits the government's ability to implement reform measures. Fiscal conditions remain tight despite ongoing efforts to address these constraints, such as introducing new taxes and closing tax loopholes. The fiscal revenue-to-GDP ratio is expected to decline slightly further to 16.3% in 2025 (2024E: 16.5%) amid the reduced reliance on petroleum-related income. In any case, we opine that the government will achieve the 2025 fiscal deficit target of 3.8% of GDP unless unforeseen headwinds necessitate additional fiscal measures to buttress growth. Given this, the government debt is expected to rise slower in 2025 compared with 2024. As of GDP, overall government debt is projected to be around 65.0% by end-2025, with statutory debt – comprising Malaysian Government Securities (MGS), Government Investment Issues (GII) and Malaysian Islamic Treasury Bills (MITB) – at 63.0%.

Exhibit 41: FDI inflows, MYR million



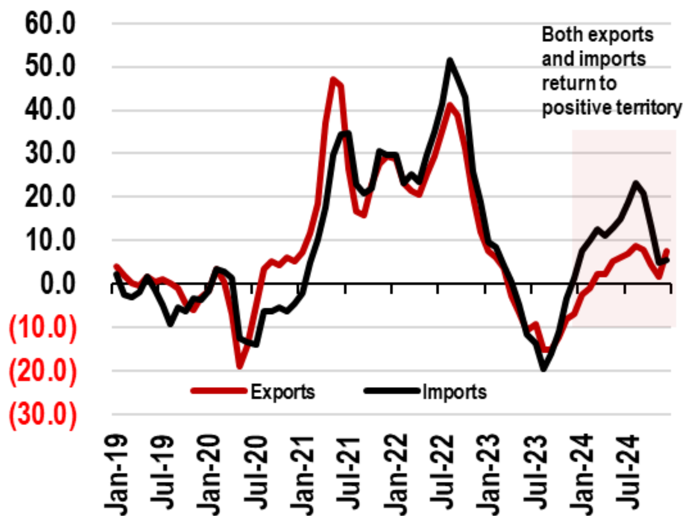
Sources: Bank Negara Malaysia (BNM), AmBank Economics

Exhibit 42: GFCF and its contributions to real GDP



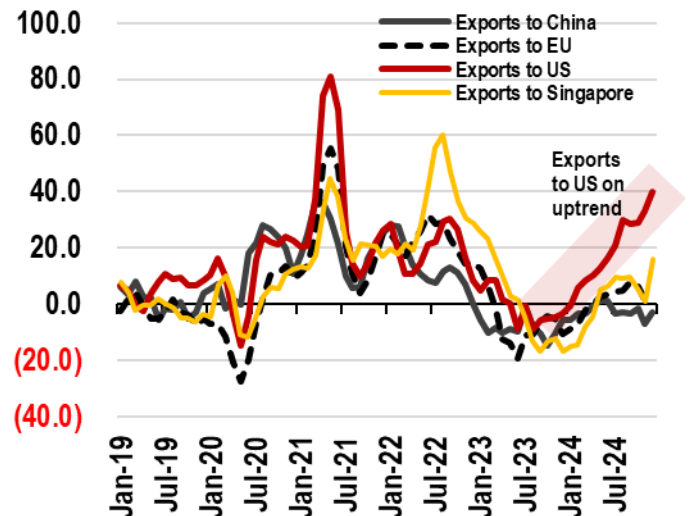
Sources: DOSM, AmBank Economics

Exhibit 43: Exports vs. Imports, 3-month moving average (3mma), y/y%



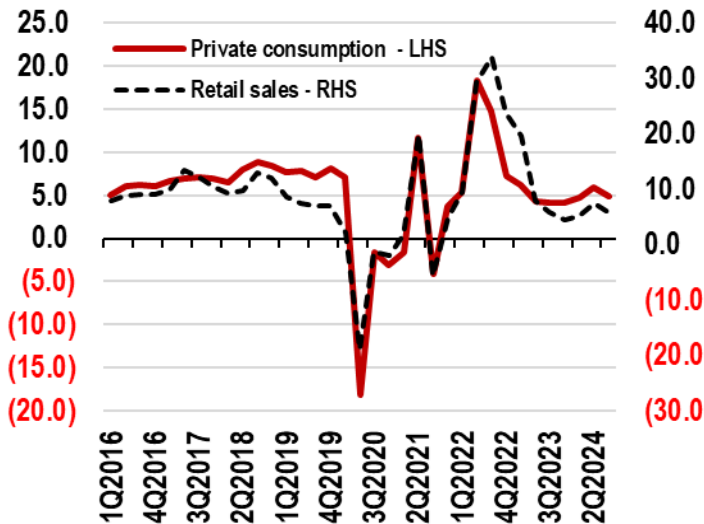
Sources: DOSM, AmBank Economics

Exhibit 44: Exports by destination country, 3mma, y/y%



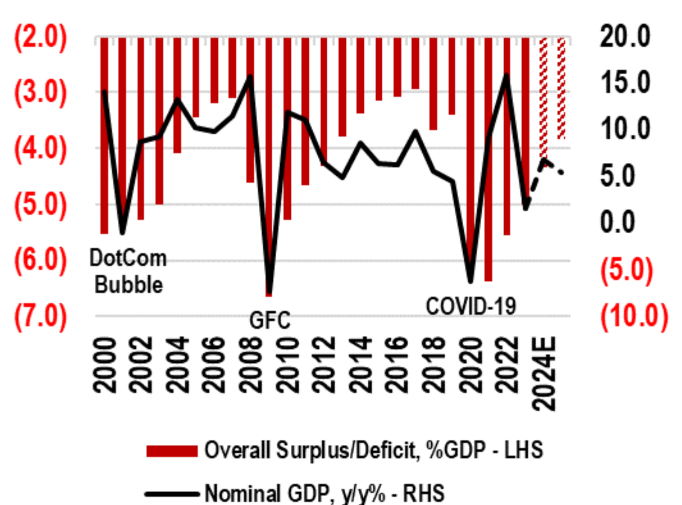
Sources: DOSM, AmBank Economics

Exhibit 45: Private consumption vs. retail sales, y/y%



Sources: DOSM, AmBank Economics

Exhibit 46: Fiscal balance and nominal GDP



Sources: BNM, MoF, AmBank Economics

Healthy labour market supported by continued job creation

Labour market conditions have been steadily improving

Labour market conditions have been steadily improving with the economic recovery from the pandemic, with the unemployment rate returning to the pre-pandemic low of 3.2% and the employment growth outpacing labour force expansion since August 2021. These came despite a record-high labour force participation rate of 70.5%, reflecting strong labour demand driven by establishing and expanding businesses amid higher investment and trade activities.

Our expectation of solid economic growth underpins our view that the labour market will remain healthy

According to the Malaysian Investment Development Authority (MIDA), if fully realised, the sizeable approved private sector investments since 2021 are expected to generate over 532K new jobs. Our expectation of solid economic growth underpins our view that the labour market will remain healthy. We project the unemployment rate to average 3.2% in 2025, slightly lower than 3.3% in 2024. However, looming uncertainties arising from increased trade protectionism and geopolitical tensions could weigh on business confidence and, thus, hiring decisions, posing downside risk to the labour market.

Inflation risks skewed upward but remain manageable

Both headline and core inflation have been subdued

Inflation has been subdued after retreating from their peaks in 2H2022. Inflation came in at 1.8% in 2024, lower than the 2.5% and 3.0% recorded in 2023 for headline and core measures, respectively. The moderation in inflationary pressures reflects a combination of the high base effect and global disinflationary trends amid the easing of supply chains. The impact of the weaker ringgit and recent policy adjustments – including water tariff revisions in February, a 2.0% increase in the Sales and Services Tax rate (SST) in March, and targeted diesel subsidy rationalisation beginning in June – has been modest.

Inflationary pressures are likely to pick up gradually through 2025 as the high base effect dissipates and cost-push factors intensify

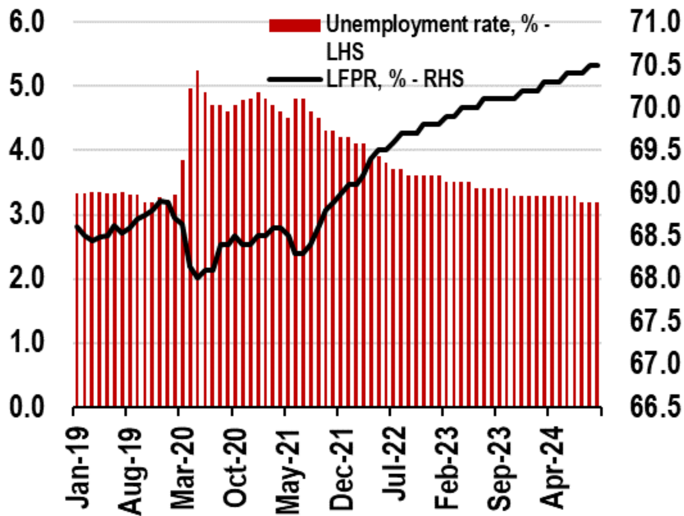
Inflation is expected to remain well contained in the near term amid the easing of production costs, as reflected by three consecutive months of producer deflation since September 2024. However, inflationary pressures will likely increase gradually through 2025 as the high base effect dissipates and cost-push factors intensify. Key upside risks include the anticipated implementation of RON95 subsidy rationalisation in mid-2025 and a potential hike in electricity tariff starting in July 2025, with RON95 and electricity accounting for 5.5% and 2.7% of the CPI weightage, respectively. Nevertheless, the impact is expected to be manageable as the government has assured that subsidy rationalisation will only impact the top 15% income group. We project inflation to average between 2.5%-3.0% in 2025, in line with the official projection range of 2.0%-3.5%. Additional inflationary risks may stem from the potential U.S. tariffs, which could increase import costs and further amplify price pressures.

Neutral stance to persist, but room to manoeuvre if there are downside growth risks

We anticipate BNM will maintain its accommodative stance and keep the OPR steady through at least 1H2025

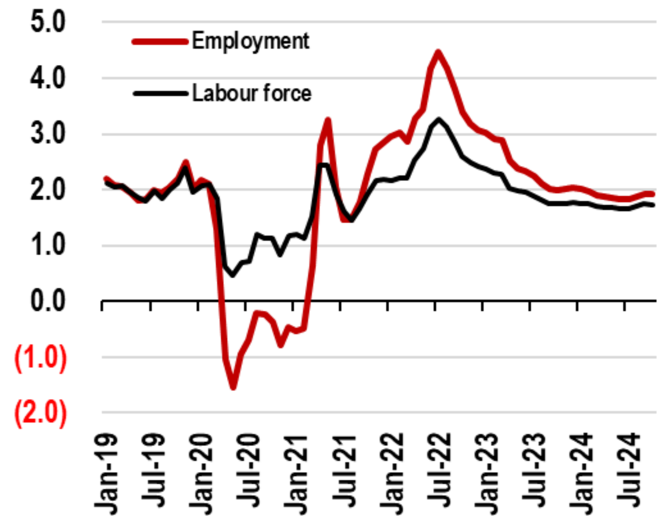
BNM has been on a rate pause since raising its benchmark Overnight Policy Rate (OPR) to 3.00% in May 2023. We view the current OPR level as neutral, aligning with the BNM's assessment that the prevailing monetary policy stance supports economic growth. With growth expected to remain robust and inflation relatively stable, we anticipate BNM will maintain its accommodative stance and keep the OPR steady through at least 1H2025. However, as global central banks proceed with monetary easing, we believe BNM will retain ample policy space to manoeuvre if downside risks to growth intensify. Given this backdrop, the next rate move will likely be a cut rather than a hike, though this is unlikely to materialise before 3Q2025.

Exhibit 47: Unemployment rate vs. LFPR



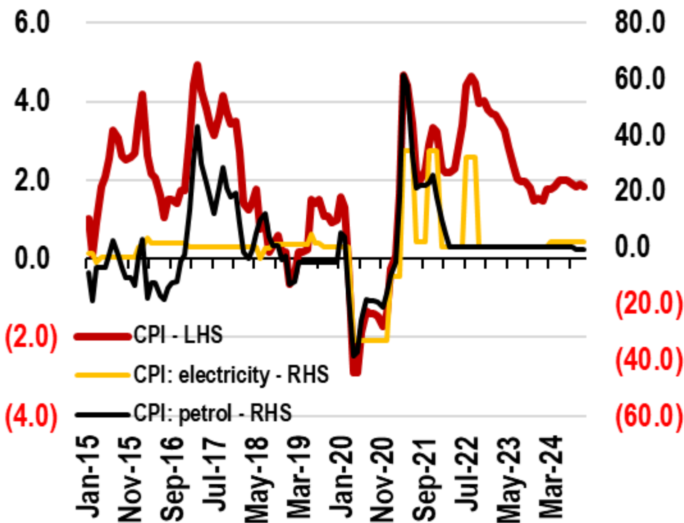
Sources: DOSM, AmBank Economics

Exhibit 48: Employment and labour force, y/y%



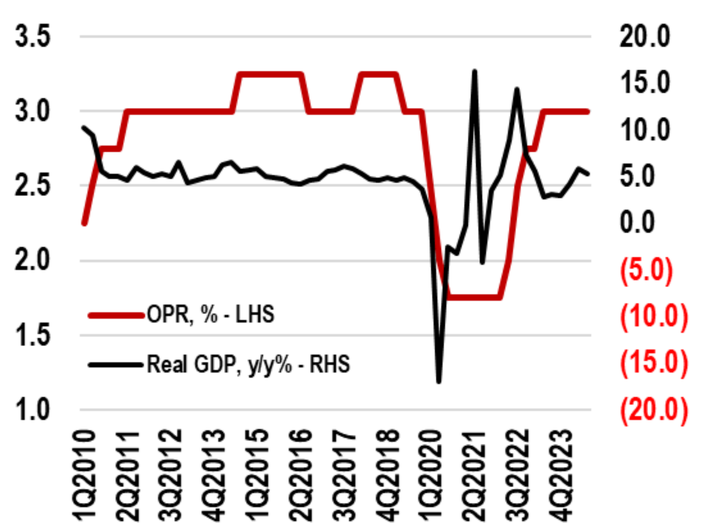
Sources: DOSM, AmBank Economics

Exhibit 49: CPI, y/y%



Sources: DOSM, AmBank Economics

Exhibit 50: OPR vs. real GDP



Sources: BNM, DOSM, AmBank Economics

FX Outlook

Recap of global FX performances in 2024

The global FX market shows a strong demand for USD, which caught us by surprise amid the apparent signs of strain within the U.S. economy

Recent global foreign exchange (FX) market trends have shown a strong inclination toward buying the U.S. dollar (USD). This was an unexpected outcome when we outlined our 2024 FX Outlook. We had anticipated that the U.S. economy would exhibit some weaknesses, ultimately moving toward a soft-landing scenario. To mitigate the recession risks, we believed the Federal Reserve (Fed) would focus on signs of strain within the economy alongside the gradual reduction of inflationary pressures. This was expected to foster a more favourable global risk appetite, encouraging market participants to seek growth opportunities elsewhere, including in emerging markets.

However, as the year progressed, the situation diverged significantly from our expectations. The DXY index, which measures the dollar's value against a basket of major currencies, surged by more than 6.0%. In contrast, many other major currencies fell to multi-year lows: the euro (EUR) decreased by 7.0%, the Australian dollar (AUD) dropped by about 9.0%, and the New Zealand dollar (NZD) plummeted by 11.5% over the year. The Japanese yen (JPY), typically a funding currency, also retreated by more than 11%. Notably, the British pound (GBP) fared somewhat better, declining only by 2.8%. In Southeast Asia, the Malaysian ringgit (MYR) stood out as the only regional currency to gain, increasing by 2.5%.

We anticipated the upside risk for the dollar amid U.S. elections

In our FX Outlook Update report in 2H2024, we pointed out that the potential for an upside risk for the dollar was associated with the U.S. presidential elections and the notion of "U.S. exceptionalism." However, we did not anticipate that the DXY would reach levels between 107 and 108, reminiscent of 2022 when the Fed was raising interest rates with no end in sight. In contrast to that period, the Fed is currently in an easing cycle. Additionally, economic challenges in the Euro Area have pressured the euro down to its multi-year low of around 1.03, raising concerns about the possibility of it breaking parity.

Uncertainties and dollar buying continue

Alas, uncertainties remain high. Market sentiment continues to favour dollar buying as participants remain cautious ahead of Trump's Inauguration Day and, subsequently, his early policy announcements as the new U.S. president. We present several points for consideration that may help navigate the potentially volatile FX market over the next 12 months.

Exhibit 51: AmBank FX Forecast Table

Pair	1Q25 (f)	2Q25 (f)	3Q25 (f)	4Q25 (f)
DXY	109	108	107	106
BBG	108	108	108	107
USDMYR	4.51	4.50	4.48	4.45
BBG	4.53	4.53	4.53	4.50
EURUSD	1.00	1.02	1.03	1.04
BBG	1.03	1.04	1.04	1.05
GBPUSD	1.23	1.24	1.25	1.26
BBG	1.26	1.25	1.26	1.27
USDJPY	155	154	152	150
BBG	153	150	149	146
USDCNY	7.39	7.38	7.35	7.34
BBG	7.35	7.40	7.40	7.40

Sources: AmBank Economics

USD – Still flying high

Considering a volatile 2025 FX market, we expect the dollar to remain strong longer than during Trump 1.0

The USD is poised for volatility in 2025 due to uncertainties related to Trump, monetary policy, and geopolitical issues. We expect the dollar to remain strong but recognise that certain factors could reverse its gains. Currently, the dollar mirrors its performance during the Trump 1.0 era, and it may remain elevated for a longer period this time.

Disruptive U.S. policies are positive for the greenback

The ongoing rate cuts by the Federal Reserve distinguish the current situation, yet concerns around Trump's tariffs 2.0 will increase the likelihood of intensified trade conflicts and consequently strengthen the dollar through safe-haven demand. Another equally important key to the dollar's strength is the prospect of rising U.S. inflation and uncertainties surrounding the Fed's easing path. Recent bond yields, particularly the 30-year U.S. Treasury yield nearing the 5.0% level, signal that the market is pricing in these factors despite the Fed lowering the federal funds rate (FFR).

The market has already started to price in the impact of Trump tariffs 2.0

The dollar's appeal as a safe-haven asset continues, supported by global central banks starting to ease. Market sentiment remains bullish on the dollar, as shown by Bloomberg's risk reversal pointing to ongoing positive momentum. However, institutional investors' long positioning in the dollar has not exceeded 20,000 contracts, indicating potential limits on further gains. In any case, we expect a slower pace of rate cut in 2025, forecasting the FFR at a range of 3.75% - 4,00% range by the end of 2025.

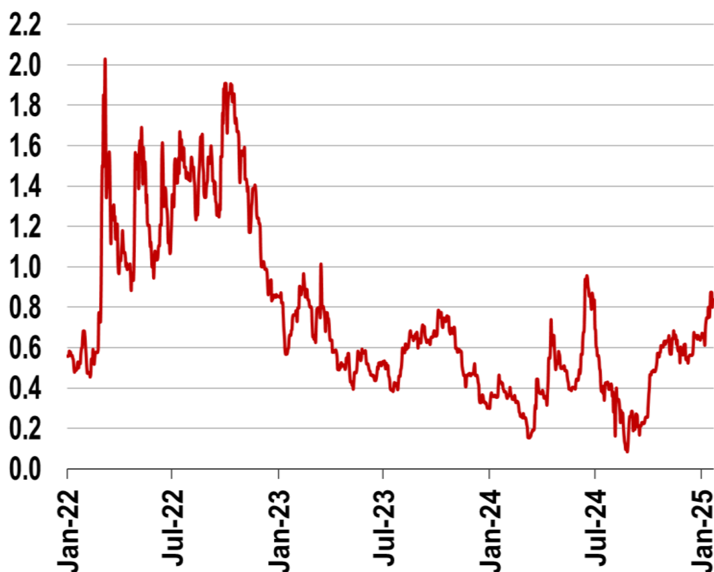
There are downside risks for the dollar, in particular, the strength of its labour market conditions

That said, we do not discount the downside risks for the dollar, including Trump's opposition to a strong dollar and high interest rates. Additionally, the strength of the U.S. economy may show more mixed signals in the coming months, with declining non-farm payroll growth and rising credit card delinquencies among households, among others.

U.S. President Trump may face hurdles even with unified control of the U.S. Congress

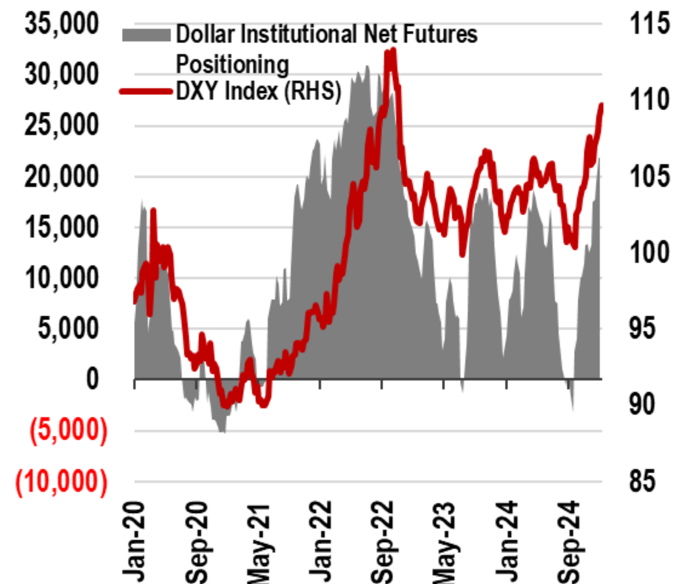
Lastly, market expectations may falter if President Trump faces challenges in implementing his tariffs and pro-growth policies, especially given the slim Republican majority in the U.S. Congress.

Exhibit 52: BBDXY 3-Month Risk Reversal



Sources: BNM, AmBank Economics

Exhibit 53: CFTC DXY Net Futures vs. DXY



Sources: BNM, AmBank Economics

EUR – Darker path ahead?

Apparent structural weakness among the region's major economies, particularly Germany

Amid looming risks from trade barriers, political challenges, a growth slump, and a more accommodating central bank policy, the euro is expected to reach parity in 1H2025. From growth perspective, despite moderating inflation readings, the Eurozone, particularly Germany, faces structural weaknesses due to an ageing population and slower productivity growth. The decline in Germany's output has also impacted the manufacturing sector.

ECB may cut up to 100bps

Current market pricing supports this outlook, and the latest economic figures have not yet shown signs of recovery. The Fed's gradual rate reductions to approximately 3.75%–4.00% reflect ongoing concerns about inflation. In contrast, the European Central Bank (ECB) may cut its policy rate by up to 100 basis points, bringing it closer to 2.00%, in response to slow growth and limited fiscal flexibility. This divergence in monetary policy, combined with persistent U.S.-EU trade tensions and potential further deterioration in these relations, alongside Europe's vulnerability to energy supply shocks, raises worries about the EUR/USD reaching parity. While sustained consecutive cuts in the central bank's rates are unlikely due to inflation pressures, upside risks remain, and geopolitical tensions in Eastern Europe are still unresolved.

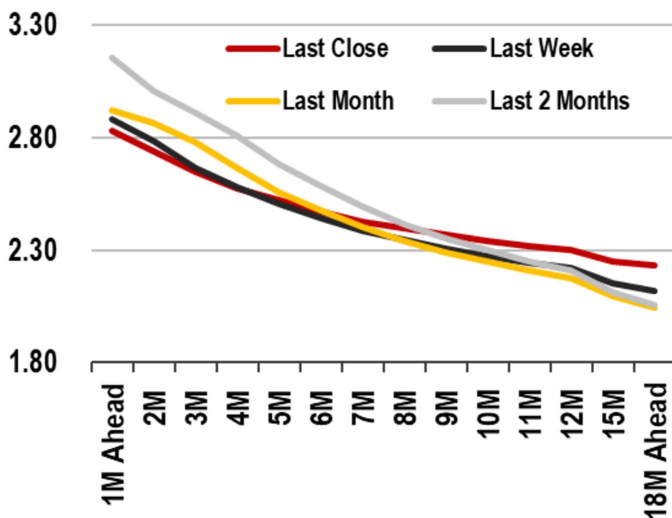
Political uncertainties cloud the region's prospects

Investors are closely monitoring political developments in Germany and France. In Germany, recent polls indicate that the CDU/CSU is leading. If these parties form a coalition following the upcoming election in February, the proposed reduction in income tax and a gradual cut in corporate tax to 25% could stimulate private consumption.

There are upside risks if the region could rebound quickly and its labour market conditions remain robust

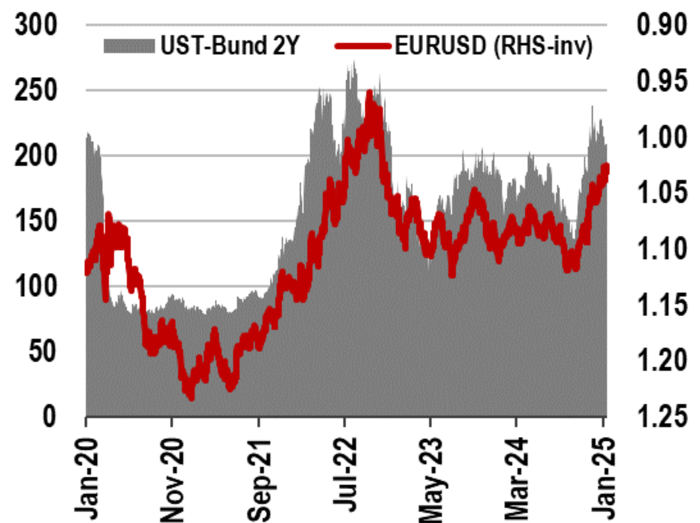
However, there are risks that the EUR/USD may continue to decline and maintain its weakness. The economic slump may prove harder to overcome than previously anticipated. Additionally, escalating geopolitical tensions and weaker global demand could drive investors towards safe-haven assets. Conversely, upside risks could emerge if the regional economy rebounds more quickly and if the labour market remains robust. Furthermore, since the ECB was one of the first central banks to loosen monetary policy, the lagged effects of its actions could come into play, leading the ECB to avoid cutting its key rates as much as initially expected. This is more so when the economy's services inflation continues to be sticky.

Exhibit 54: ECB OIS by Months Ahead (%)



Sources: Bloomberg, AmBank Economics

Exhibit 55: UST-Bund 2Y (bps) vs. EURUSD



Sources: Bloomberg, AmBank Economics

JPY – A shift in the regime

The sharp drop in USD/JPY in July 2024 could be a prelude to what may happen to the Japanese yen in 2025

As a result of the Bank of Japan (BoJ) raising its interest rate for the second time in July 2024, the market was taken by surprise, leading to a sharp strengthening of the yen to approximately 140–145 yen per dollar, as market players quickly unwound their short positions. However, the BoJ's hesitation to execute another round of rate hikes, along with expectations that U.S. rates would decline at a measured pace, contributed to these gains being erased. As of now, the USD/JPY is trading at a significantly weaker level, around 151–156 yen per dollar. If these trends continue over the next 12 months, we may see the pair hovering around the current level, with a worst-case scenario targeting the 160–165 range. Our baseline prediction, however, anticipates that the yen will strengthen to the 150–155 level. That said, any gains for the yen would likely be gradual due to the wide yield differentials between the Federal Reserve and the BoJ. Even with an expected rate hike from the BoJ, it is unlikely that the yen will lose its status as a funding currency.

Our baseline prediction anticipates that the yen will strengthen to the 150–155 level

They (finally) have inflation

Inflation trends have been notable, with both headline and core inflation remaining sustainably above the BoJ's target for the past 32 months. Additionally, wage negotiations for Spring 2024 resulted in an average wage increase of over 5% for the first time in 33 years. The BoJ indicated it would wait for this year's wage negotiations to confirm the virtuous cycle of rising wages and higher inflation conditions. We believe that Rengo, the labour unions, will achieve another round of successful negotiations.

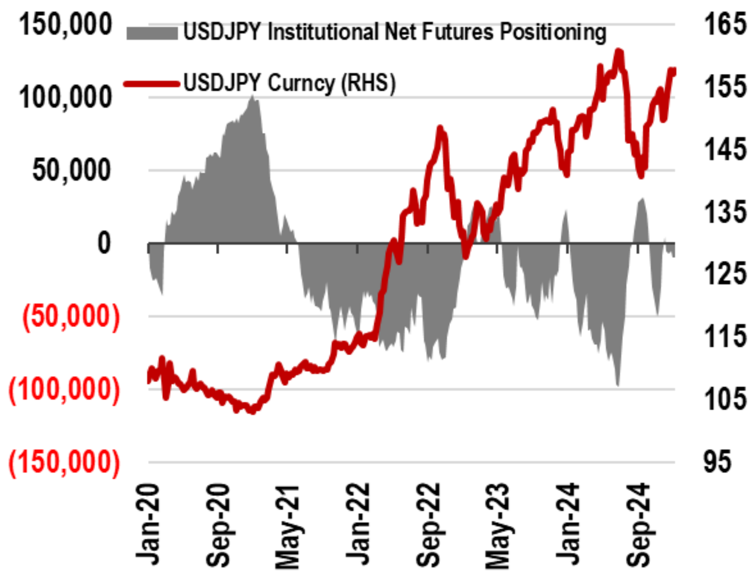
The current elevated political noises have prevented the central bank from acting on rates

The BoJ has not followed through with rate hikes since the last increase in July 2025. Towards the end of 2024, investors began receiving vague signals, and uncertainties regarding timing resurfaced. This was coincident with the loss of a single-party majority by the long-standing Liberal Democratic Party (LDP) in the recent snap election, resulting in an evenly divided House of Representatives between ruling and opposition blocs. Consequently, the LDP must seek support to form a coalition. Given this context, the BoJ has become more cautious in navigating its exit from the ultra-accommodative policy amidst a changing economic backdrop.

The downside risk for the Japanese yen will be the BoJ's inaction in raising its key interest rates.

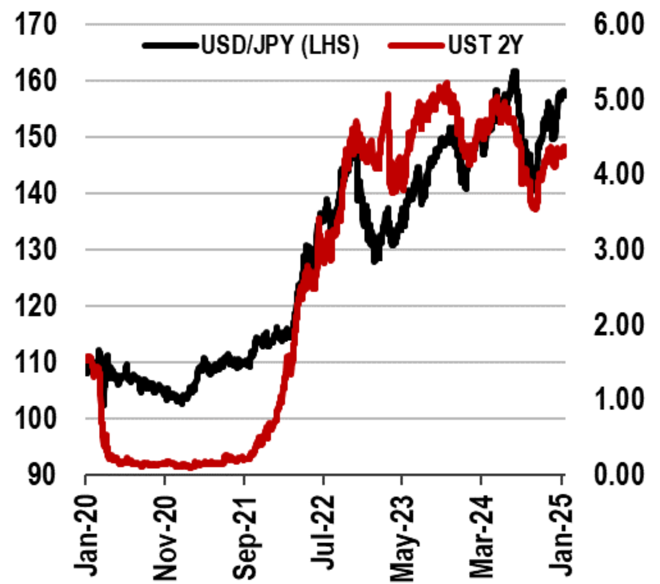
While the new political environment may necessitate a more deliberate approach from the BoJ, current economic conditions will require action. Failure to take further steps could undermine the central bank's credibility. If the yen weakens towards the 160 range, there could be intervention risks similar to those observed in 2024.

Exhibit 56: CFTC USDJPY Insti. Net Futures vs. USDJPY



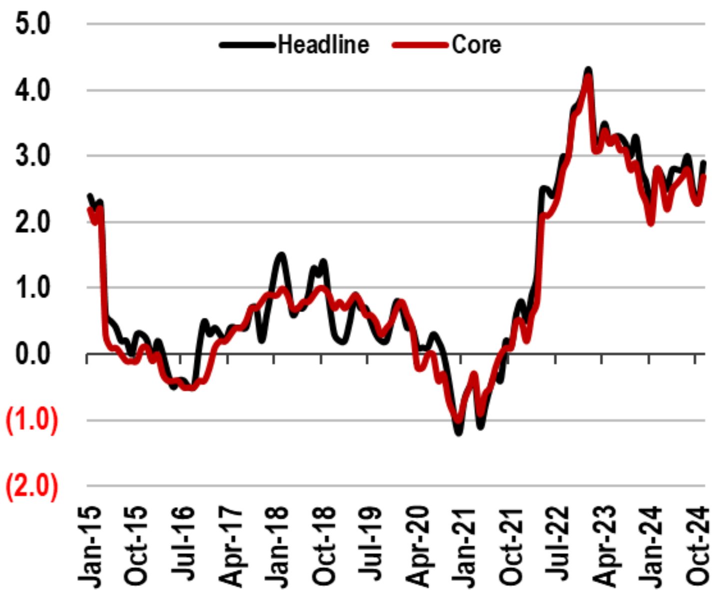
Sources: BNM, AmBank Economics

Exhibit 57: USDJPY vs. UST2Y (%)



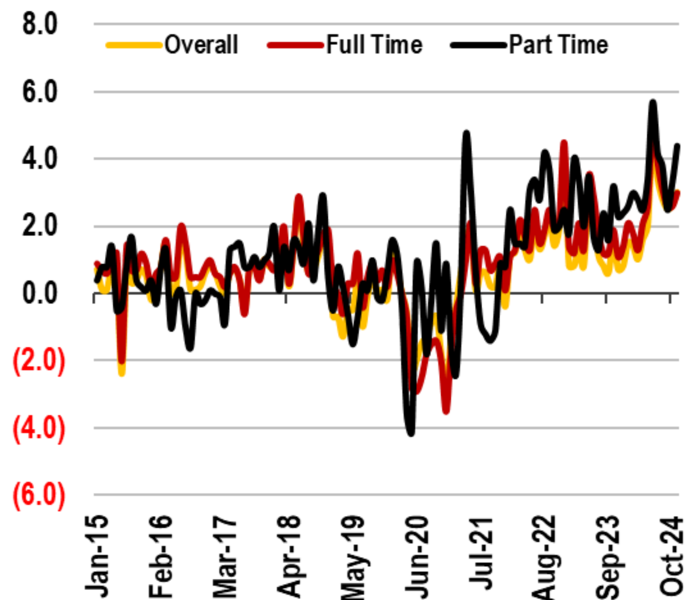
Sources: BNM, AmBank Economics

Exhibit 58: Japan CPI (% y/y)



Sources: BNM, AmBank Economics

Exhibit 59: Avg. Monthly Cash Earnings (% y/y)



Sources: BNM, AmBank Economics

GBP – BoE ready to pivot?

GBP has fared fa well so far

The GBP performed well during 9M2024, but conditions changed swiftly after Donald Trump won the U.S. election. While it posted losses in 2024 overall, the GBP had the smallest losses among the G10, at around 1.7%.

Inflation is still a concern, nudging the MPC to reconsider options in its policy setting

GBP bulls may wonder if the BoE is finally ready to surrender after consistently resisting the global rush to cut rates more aggressively. So far, the BoE Governor and its MPC members have justified their caution by pointing to the UK's inflation risks—headline inflation is ticking up at 2.6% y/y (Nov'24), core at 3.5%, and wage growth at 2.8% y/y. Meanwhile, UK GDP growth held up at 0.9% y/y in 3Q24 (and 0.7% y/y in 2Q24), but the quarter-on-quarter stagnation in 3Q24 is causing jitters. In December 2024, the BoE kept rates on hold at 4.75%, with a 6-3 split indicating some MPC members remain open to immediate cuts, while others insist on maintaining policy tight to head off any inflationary flare-ups.

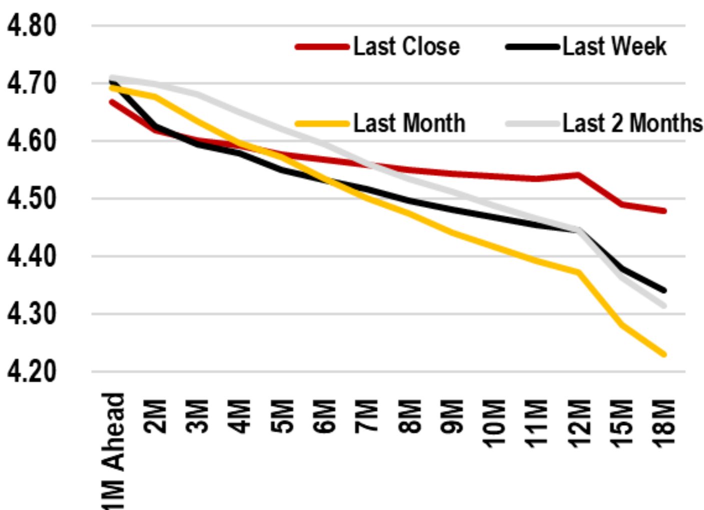
Enter stagflation fears, past jitters surfaced

This policy divergence underscores the unstable balancing act the BoE faces, especially now that inflation jumped to 2.6% in November from 2.3% in October. Pessimists are warning of a throwback to 1970s-style stagflation, fuelled by slowing GDP growth and a re-accelerating inflation picture. Despite the stagflation fears, the BoE has been reluctant to change course abruptly, opting for a steady hand as growth data teeters and price pressures remain elevated.

The U.S. may dodge the Trump tariff 2.0 bullets since its strength is mostly in services and not trade in goods

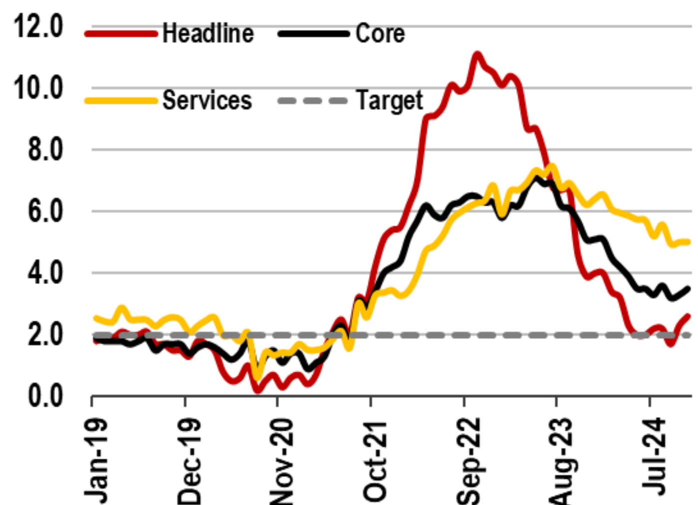
A key bright spot for the pound is the BoE's seemingly more measured approach to easing than the ECB, which could nudge lower EUR/GBP if rate differentials support sterling. On top of that, the UK appears relatively insulated from the Trump administration's tariff. Since roughly two-thirds of British exports to the U.S. are in services, the U.K. is less exposed to punitive tariffs on goods. For now, markets will watch every inflation print and BoE rate decision like hawks, bracing for volatility if the MPC changes its tune—or stands firm longer than the market expects. On the other hand, however, the UK's government fiscal sustainability poses worries among investors following the latest Budget, which showed the government is still committed to borrowing and spending.

Exhibit 60: BoE Cash Rate OIS by Month Ahead (%)



Sources: Bloomberg, AmBank Economics

Exhibit 61: UK Inflation (% y/y)



Sources: Bloomberg, AmBank Economics

CNY – Double Whammy

Markets are bracing for Trump tariffs 2.0 on China, while domestic growth headwinds persist

The CNY is under double whacking as trade tensions escalate and domestic headwinds are prolonged. On one side, markets are bracing for a fresh round of tariffs from Washington, with the yuan already hovering in the 7.30–7.35 range on fears that China remains U.S. President Trump's primary target. Conversely, a drawn-out property slump and persistent structural weaknesses have led to expectations that the PBoC and Beijing will double down on accommodative measures. These factors have combined to keep USD/CNY under upward pressure.

There will be measures to spur the economy in 2025, including debt-led growth

Beijing's latest signals point to further policy support in the coming year, especially following the December Politburo meeting and the annual Central Economic Work Conference (CEWC). Officials pledged to "keep employment and prices generally stable" throughout 2025 while stimulating domestic demand emerged as a top priority. In a more proactive fiscal stance, policymakers hinted at a higher deficit-to-GDP ratio for the first time since COVID-19. Additionally, they plan to roll out dedicated campaigns to spur consumption, alongside expanding existing equipment upgrades and consumer trade-in programs that aim to sustain demand growth among households for durable goods.

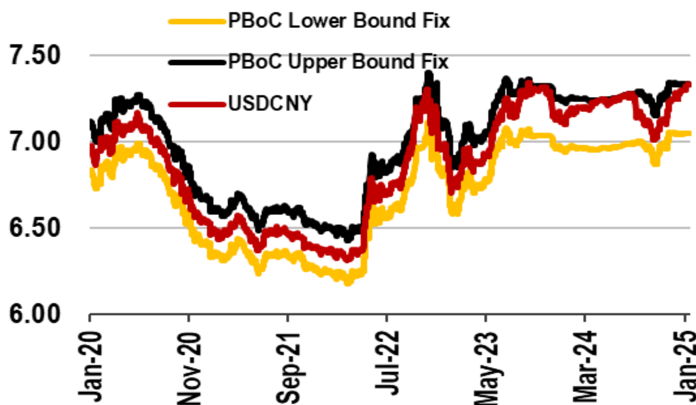
Yields gap is a critical issue

One of the biggest implications of these measures is a persistently negative yield differential between China and the U.S., potentially keeping USD/CNY at elevated levels. The authorities' decision to shift their monetary policy to a "moderately loose" stance reinforces this view. After all, the Politburo and CEWC explicitly vowed to reduce RRR and interest rates "at an appropriate time," a stance that already helped pull 10Y CGB yields lower by 36 bps in December. Meanwhile, the PBoC continues to manage the yuan's daily onshore fix, though recent reports suggest it may tolerate more CNY weakness to offset the threat of fresh tariffs.

Beijing may scale-up pro-consumption stimulus

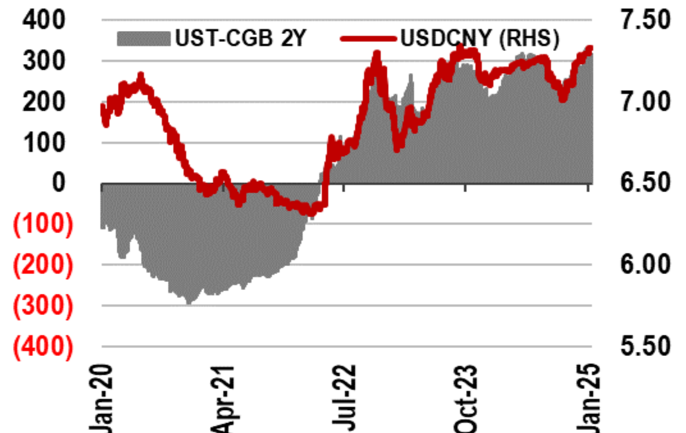
The yuan faces ongoing headwinds from weak domestic demand, low interest rates, and renewed international trade friction—no longer confined to just the U.S. Nevertheless, severe tariff shocks could also push Beijing to ramp up pro-consumption fiscal stimulus to shield its economy. That scenario might offer a reprieve for growth. Still, it would likely keep the currency on the defensive, reinforcing the "double whammy" effect that has already left many traders wary of CNY volatility. However, with most but not all "bad news" priced into the current levels, any signs of faster domestic economic rebound or watered-down implementation of trade barriers would help CNY recover relatively quickly.

Exhibit 62: USDCNY & PBoC Daily Fixing Boundary



Sources: Bloomberg, AmBank Economics

Exhibit 63: UST-CGB 2Y (bps) vs. USDCNY



Sources: Bloomberg, AmBank Economics

MYR – Still solid fundamentals, but risks ahead

MYR could have strengthened further if not because of the U.S. elections

The Malaysian ringgit (MYR) stood out in 2024 as the only regional currency to strengthen against the mighty USD, closing the year with impressive gains of 2.7%. One key driver behind the currency's resilience was the narrowing of rate differentials between the Fed and the BNM. While the Fed's monetary policy tilted toward the easing side—albeit at a more measured pace—BNM's decision to keep rates on hold gave the ringgit a steady advantage. This solid performance also owed much to Malaysia's robust economic backdrop. GDP growth may touch 5.0% y/y in 2024, the current account remained in surplus, and exports increased speed, with the latest print rising to 4.1% y/y from 1.6%.

MYR's outlook appears to be more favourable than its regional peers, thanks to the healthy domestic outlook

Looking into 2025, growth is forecasted to come in around 4.6%, down slightly from the 4.9% estimated in 2024 but still comfortably above any recessionary territory. We believe the Malaysian economy has ample room to expand over the next 12 months, keeping the ringgit in a relatively favourable position against its peers. On top of that, an investment upcycle appears to be already underway, according to our macro team. This could yield healthier growth and higher productivity down the road—standing in contrast to the multiple headwinds confronting other major and regional economies. As a result, we think the ringgit remains well supported by a healthy domestic outlook.

The ringgit remains undervalued on a real effective exchange rate (REER) basis and has yet to recapture its pre-pandemic value

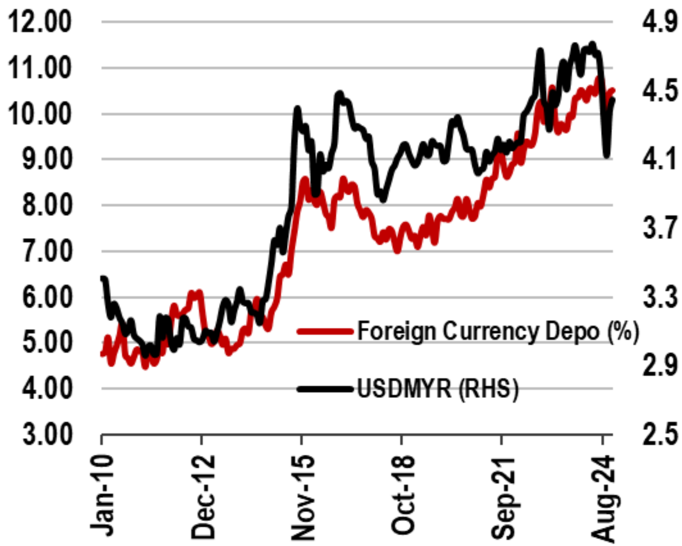
On the monetary front, BNM's commitment to maintain its policy rate at a level it deems still accommodative, combined with the Fed's slower-than-previously-expected easing path, should keep yield differentials relatively tight. This scenario bodes well for potential MYR gains, especially when factoring in valuation metrics. The ringgit remains undervalued on a real effective exchange rate (REER) basis and has yet to recapture its pre-pandemic value. Even if we compare current levels to the historical average of around 3.80 per dollar (from the post-peg era in 2004/2005), there is still room for the ringgit to appreciate. Another wild card that could bolster the currency is the possible conversion of export proceeds. Foreign currency deposits have increased in line with MYR's weakness, and any repatriation of those proceeds would provide additional support.

We believe BNM has no appetite to act on rates but Trump tariff 2.0 may cloud prospects of a steady OPR

A second round of re-shoring could happen, increasing the demand for ringgit

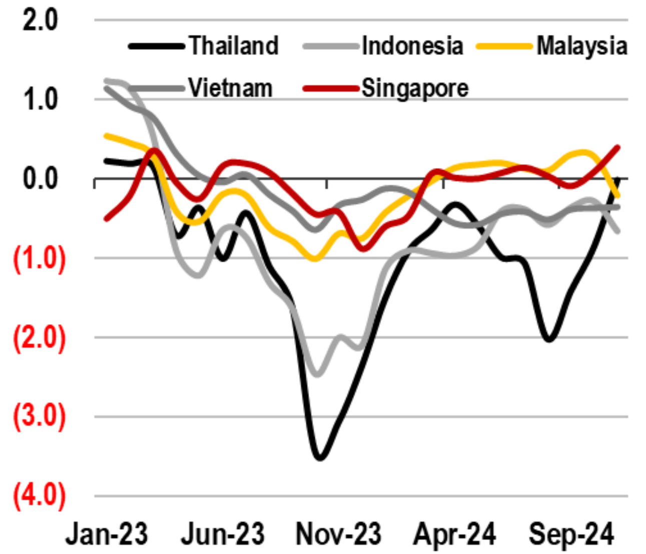
That said, plenty of potential risks over the next 12 months. Our macro team noted that there is a risk for OPR to be cut rather than a hike as downside risks on growth become more pronounced amidst global monetary easing. In this case, we are pencilling in a worst-case scenario of the ringgit possibly touching 4.60 – 4.65 per dollar as yield differentials would widen again in view of more staggered cuts by the Fed. Other than that, renewed Trump-era tariffs, slower-than-anticipated export growth, lingering geopolitical risks, and a general risk-off tilt in global markets could all pressure the ringgit. Elevated trade barriers could also complicate the outlook. However, there is a silver lining: escalating trade tensions might spur a "re-shoring" push to more business-friendly locales like Malaysia, potentially sustaining foreign direct investment flows. Should that happen, the MYR would likely remain in demand, reinforcing the ringgit's capacity to navigate any turbulence in 2025.

Exhibit 64: FCD/Total Depo (%) vs. USDMYR



Sources: BNM, AmBank Economics

Exhibit 65: EPFR Fund Flow (USD"bn)

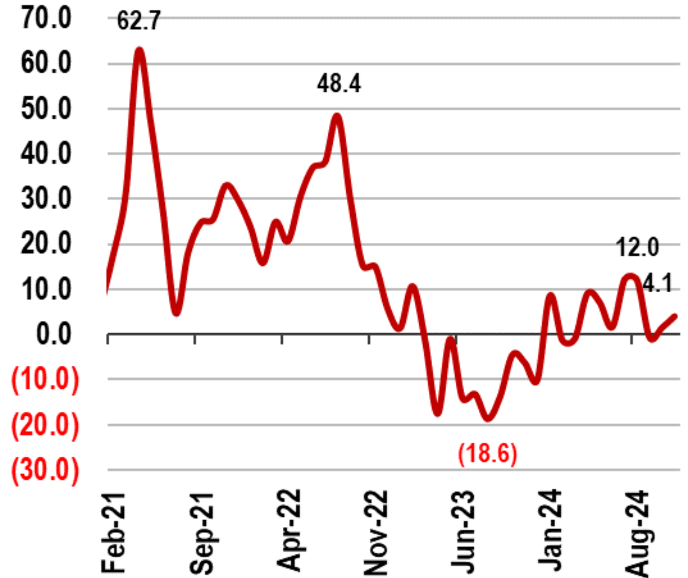


Sources: BNM, AmBank Economics

Exhibit 66: USDMYR REER

Sources: BNM, AmBank Economics

Exhibit 67: Malaysia Exports (y/y %)



Sources: BNM, AmBank Economics

FIXED INCOME OUTLOOK

U.S. Treasuries: Short recap of 2H2024 performance

Monetary, fiscal, and trade policy quandary led to about-turn in UST performance.

As the Fed cuts, the bond market rally was halted by U.S. presidential elections

Interest rates in the time of Trump. During 2H2024, the UST market went from rallying in June to September and then reversing the trend to post large losses. The quantum of the moves was large with the 10Y UST yield coming down from 4.45% area at the start of July 2024 down to just above the 3.60% level by mid-September. The driver was the outlook for the Fed to start cutting interest rates after months of speculation in 1H2024. When the cuts came, the September FOMC meeting resulted in an outsized 50 bps cut, plus two more rate cuts totalling 50 bps in November and December. With the release of the new dot-plots in December 2024, the Fed's signal is for two cuts totalling 50 bps in 2025.

We expect global bond markets to benefit from continued global monetary easing. However, the outlook for the US Treasuries (UST) market is more constrained in view of the upbeat growth and inflation impact of Trump's anticipated fiscal and trade policies. Meanwhile, we foresee ringgit bonds to benefit from declining global rates. Continued fiscal consolidation in Malaysia additionally supports our outlook for ringgit bonds

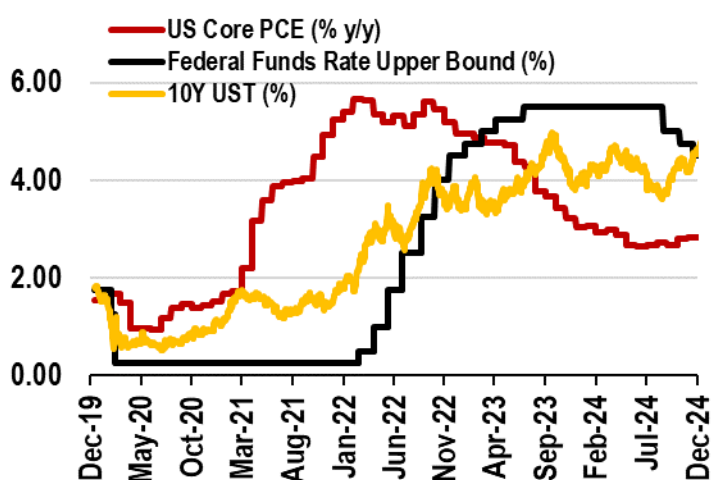
Trump's fiscal and trade policy outlook dampens bonds. The tide turned on Trump's fiscal and trade policy expectations. UST yields had surged by 60 bps ahead of the U.S. election in November when polls suggested a Trump victory. With the Republicans now controlling the White House and Congress, yields then surged by another 40 bps, reaching 4.63% in December. The hint of possible readjustments to monetary policy outlook due to incoming Trump expansionary fiscal but restrictive trade policies contributed to the UST reversal. Fiscal concerns and solid U.S. data came alongside Fed chair Powell suggesting there is no rush to cut rates. UST players continued to price in rate cuts, just not at the prior pace of easing.

Exhibit 68: Bond yield quarterly forecasts 1Q2025-1Q2026 (%)

	1Q2025	2Q2025	3Q2025	4Q2025	1Q2026
2Y UST	4.30	4.15	4.00	3.90	4.00
10Y UST	4.67	4.45	4.40	4.20	4.30
3Y MGS	3.45	3.35	3.35	3.30	3.25
10Y MGS	3.80	3.75	3.70	3.70	3.75

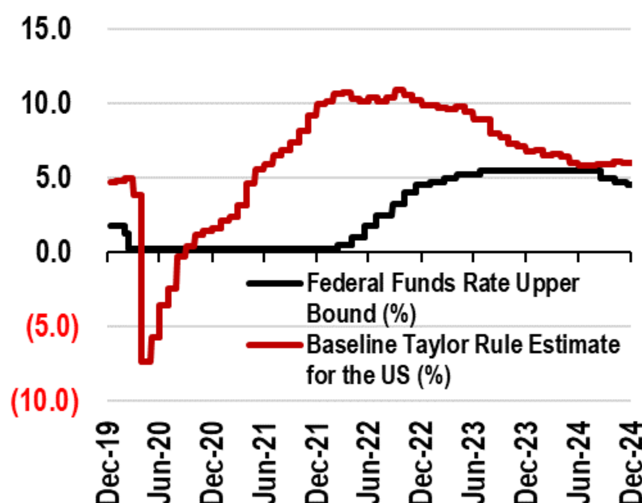
Sources: AmBank Economics

Exhibit 69: U.S. core PCE, FFR and UST yield (%)



Source: Bloomberg, AmBank Economics

Exhibit 70: Taylor Rule rate vs FFR upper bound (%)



Source: Bloomberg, AmBank Economics

Expect a gradual strengthening of the UST market

UST will benefit from the Fed's continued monetary easing, though the upbeat bond market outlook is more constrained

Rate cuts will continue, but lowered cuts will deter bond yield downside

Rate cuts are ongoing, but the outlook for UST is constrained. Our UST yield forecast acknowledges continued interest rate cuts by the Fed. As mentioned earlier, the December FOMC dot-plot suggests a smaller pace of cuts amid a sticky U.S. inflation outlook. For the basis of our UST yield forecasting, to account for the Republican influence on fiscal and trade policies, we place a base case total of 50 bps cuts in 2025 and 50 bps in 2026. Thus, the outlook for slowing rate cuts will deter downside in UST yields. As per our forecast methodology, the change to our UST forecasts considers changes to economic growth, inflation, short-term interest rates, and market volatility. We point to the Taylor Rule rate, which has decreased substantially in 2023-2024 and is a precursor to the current Fed rate cuts. Assuming the continued lowering of inflation, the Taylor Rule level should move closer to the FFR level.

Fed balance sheet reduction of UST and MBS adds to market pressure

Fed balance sheet reduction continues. In addition, further limiting the downside to yields is continued Fed balance sheet reduction, though the amount of reduction has fallen. In June 2024, the Fed started to reduce the cap on its Treasury securities sell-down (allowing them to mature and not be replaced) to USD25 billion per month from its previous limit of USD60 billion. This should result in a circa USD35 billion less reduction in the Fed's monthly balance sheet via the sell-down of its UST holdings. In addition, the Fed also left the cap on mortgage-backed securities (MBS), which will allow it to roll off its books at USD35 billion per month and reinvest any excess MBS principal payments into Treasuries. Fed's holding of UST declined to USD4.4 trillion by July 2024 from a high of USD5.8 trillion in May 2022.

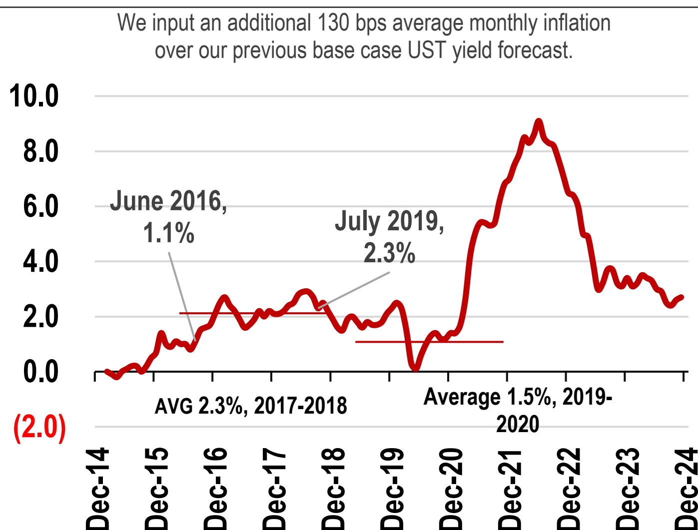
Improving U.S. growth outlook and protectionism boost inflation, which is negative for bonds

The raised outlook for tariffs and inflation is negative for bonds

We input 130 bps inflation over our previous base case assumptions

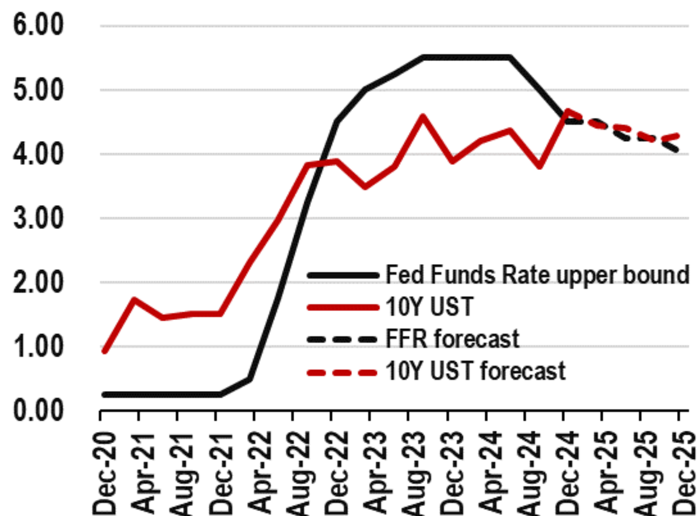
Inflationary pressure limits UST yield downside. Inflation is a key variable in our UST yield forecasting method (note: we use U.S. CPI % y/y). We note that the overall GOP policy outlook is very much expansionary (tax cut extensions, deregulation) and, thus, inflationary. We also note that expanding trade protectionism (i.e., import tariffs) is also on the agenda, which pose upward pressure prices. In any case, we are also mindful that while Trump has pledged to raise tariffs (i.e., a 10% rate on all goods into the U.S. and as much as 60% on goods from China), it may not materialise fully at those rates. Various studies may indicate that import tariffs are inflationary to the importing country; it may just be the extent/quantum of the price increases that differ. Hence, we will use Trump's first-term inflation rates to project bond yields as a guide. This should also inform our model of any subsequent impact of tariffs on GDP and its influence on limiting price upside. Before the first Trump term, U.S. inflation was just 1.0% y/y in June 2016, but rose to 2.9% y/y in July 2019 (before falling below 2% after that and towards zero per cent during Covid). This is a price increase of 190 bps. However, we note that the inflation averaged 2.3% y/y per month in 2017-2018 (before the average fell to 1.5% y/y in 2019-2020). ***This is a 130 bps rise in inflation from the June 2016 level***. Hence, we input the 130 bps inflation rise against our previous base case into our UST yield projections. Overall, we foresee global investors will favour risk assets at the expense of sovereign bonds due to the improving U.S. growth outlook and inflation.

Exhibit 71: U.S. CPI (% y/y)



Sources: Bloomberg, AmBank Economics

Exhibit 72: Quarterly FFR vs 10Y UST yield; Actual and AmBank forecasts (%)



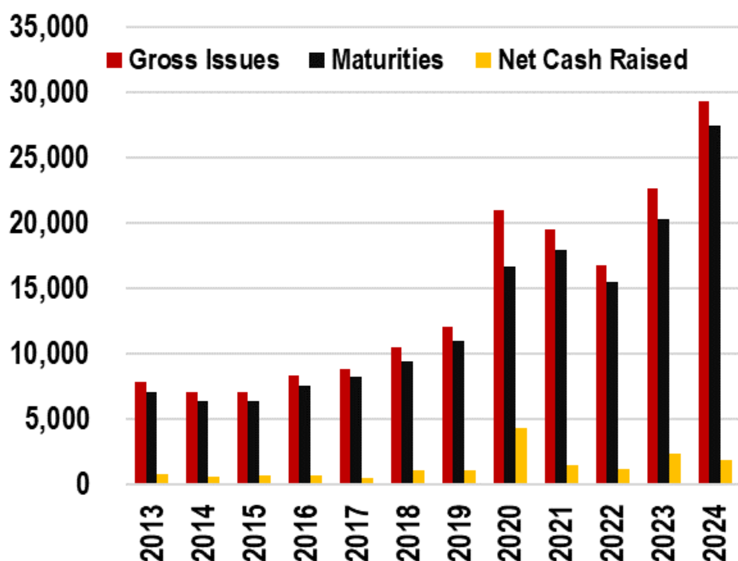
Sources: CEIC, Bloomberg, AmBank Economics

Continued fiscal deficits imply heavy UST issuances will continue

Our short take is that the fiscal deficits will remain prominent in the next 1-2 years, and thus, UST securities issuances will also remain large

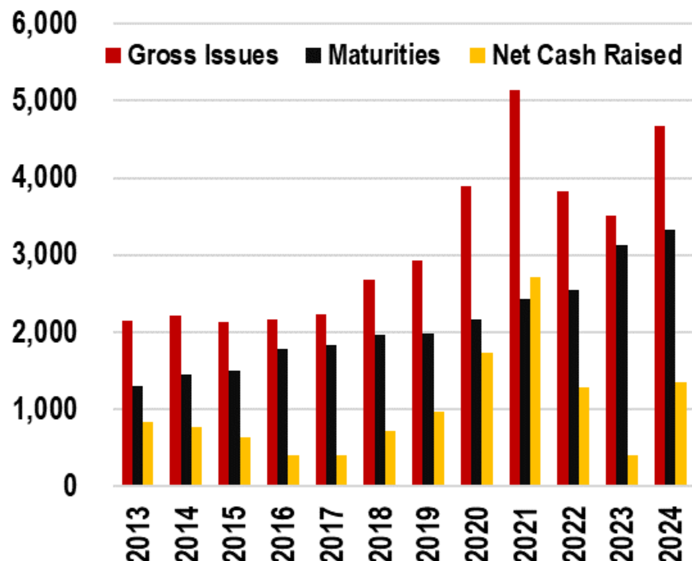
Large Treasury issuances will continue to fund incoming budget deficits. Our short take is that the U.S. fiscal deficits would remain large in the next 1-2 years. We consider sustained tax cuts in 2024-2025 and possible enlarged tax cuts after 2025. As per a Bloomberg survey, the *U.S. budget deficit*, estimated at 6.5% of GDP in fiscal year 2024 (2023: 6.5%), is forecast to be maintained at 6.5% in fiscal year 2025. Fitch Ratings has a 2025 fiscal deficit forecast of 8.1% of GDP, which brings us to our view of a negative impact on the bond market arising from continued enlarged budget financing. As a recap, *gross issuance of UST securities (bills, notes, and bonds) surged from USD16.7 trillion in 2022 to **USD22.7 trillion in 2023** and onward to **USD29.3 trillion in 2024***. Meanwhile, UST notes and bonds (not including bills) gross issuance remained high at USD4.7 trillion in 2024 compared with USD3.5 trillion in 2023. The Congressional Budget Office estimates the U.S. fiscal deficit to be 6.2% of GDP in fiscal year 2023, up to USD1.68 trillion. Meanwhile*, net issuance of UST securities amounted to **USD2.67 trillion** in 2023*. The Congressional Budget Office estimates the fiscal year 2024 deficit to amount to USD1.99 trillion (USD1.68 trillion in 2023). Our reading of the Securities Industry and Financial Markets (SIFMA) data stated that *in 2024, net issuance of UST securities amounts to **USD1.9 trillion***. Going into 2025, the Congressional Budget Office number has placed a 6.5% fiscal deficit to GDP and, in dollar terms, will be USD1.94 trillion. Hence, according to our expectations, the net issuance of UST securities will likely be similarly large in 2025, at least USD2.0 trillion. The office's projections consider the spending, revenues, economic predictions, and debt effect from legislation enacted up to 12 May 2024.

Exhibit 73: UST securities (bills, notes, and bonds) gross and net issuances (USD billion)



Sources: SIFMA, AmBank Economics

Exhibit 74: UST securities (notes and bonds only) gross and net issuances (USD billion)



Sources: SIFMA, AmBank Economics

Malaysia's government bond market is likely to find support post-Trump-driven weakness

During 2H2024, Malaysian government bond market performance was moderately stronger, directed mainly by external drivers

MGS was on a downtrend to follow the trend in global bond markets

However, UST's finding support and Malaysia's monetary and fiscal policy outlook supported bonds

Moderately stronger overall despite the externally driven sell-down. A rally in the 3Q2024, where the 10Y MGS yields fell from around 3.90% towards 3.70%, which was heavily influenced by expectations of Fed rate cuts, was reversed as UST yields surged in October-December as Trump and his Republican party won the U.S. elections. However, the MGS yield upside was tamer – despite a large 70 bps y/y rise in the 10Y UST at end-2024, the 10Y MGS rose about 10 bps y/y. Meanwhile, BNM continued to hold the OPR at 3.00% in 2H2024, yet to signal any potential policy moves in the coming quarter(s) supported onshore bonds. Malaysia's Budget 2025 targeting fiscal consolidation provided additional support as BTC at the local govvies auctions continued to be mainly decent. On the flip side, there were risks emanating from sticky inflation levels (2H2024 monthly Malaysia CPI in the range of 1.8-2.0% y/y) and potential for rising inflation, seeing Budget 2025 hinted plans for RON95 subsidy rationalisation in 2H2025. In any case, we do not see BNM acting on rates should inflation misbehave due to subsidy rationalisation unless its knock-on effects are negative on Malaysia's growth outlook.

Signs of support at year-end. The MGS segment received more support in December 2024. Primarily, UST yields finding a ceiling at 4.60%, USD/MYR supported below 4.500, and small govvies auction amount in December, aided sentiment. We also sensed bargain-hunting interest in the market, seeing yields trekking higher by about 10 bps from October to November.

Stronger Malaysian govvies performance is expected in 2025

We expect MGS gains in 2025, supported by

For 2025, we foresee a modestly stronger MGS performance

… global and domestic interest rates outlook

… attractive yield levels

… current yield levels are already pricing in a possible rate hike in 2025

… favourable supply outlook

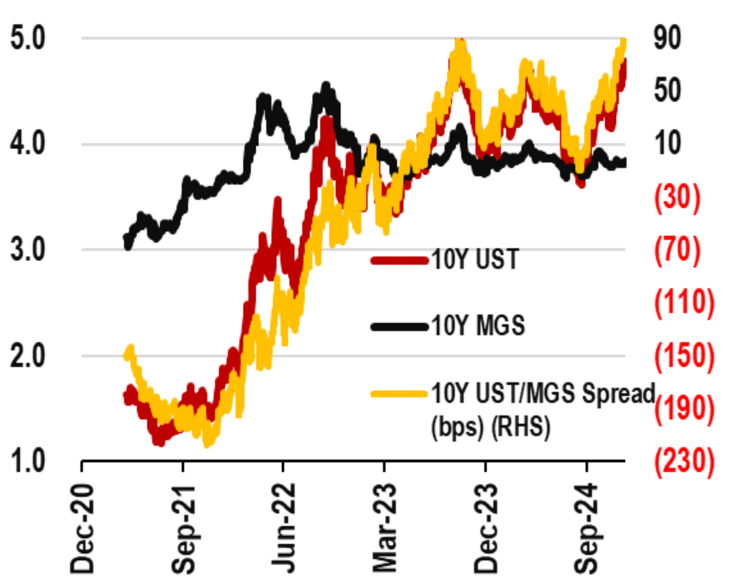
… healthy onshore demand

The basis for our firm MGS/GII outlook is the following factors:

1. declining global rates and ringgit upside;
2. yield levels expected to remain attractive;
3. yields already pricing in higher OPR, and
4. modestly favourable MGS/GII supply outlook whilst onshore demand remains firm.

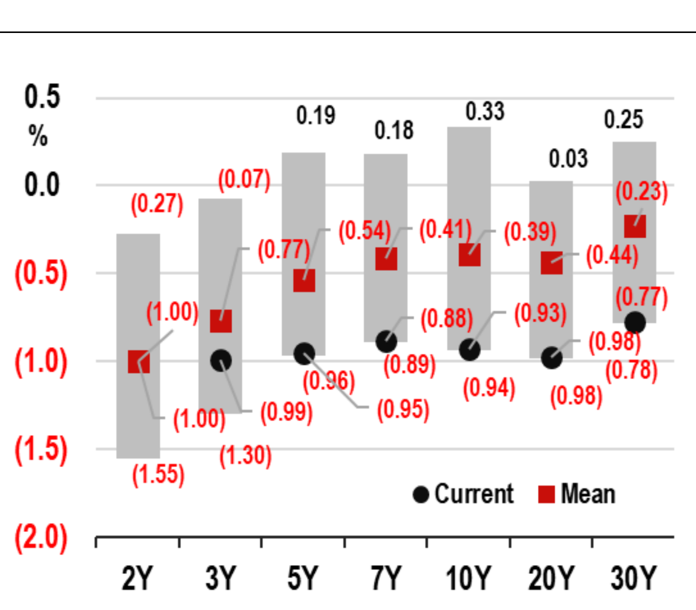
Declining global rates with ringgit upside aid MYR bonds. Reducing interest rates differentials of USD over MYR levels, with the Fed anticipated to cut rates further should boost MGS performance. Further, Fed rate cuts should lead to a depreciation in the USD vis-à-vis the MYR, which additionally aids MGS demand.

Exhibit 75: Anticipated lessening of U.S. rates advantage over Malaysia



Sources: Bloomberg, AmBank Economics

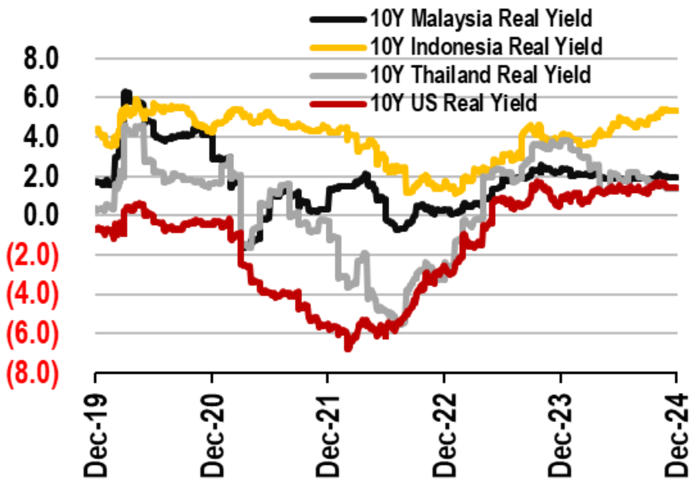
Exhibit 76: MGS over UST spreads, past 1 year (%)



Sources: Bloomberg, AmBank Economics

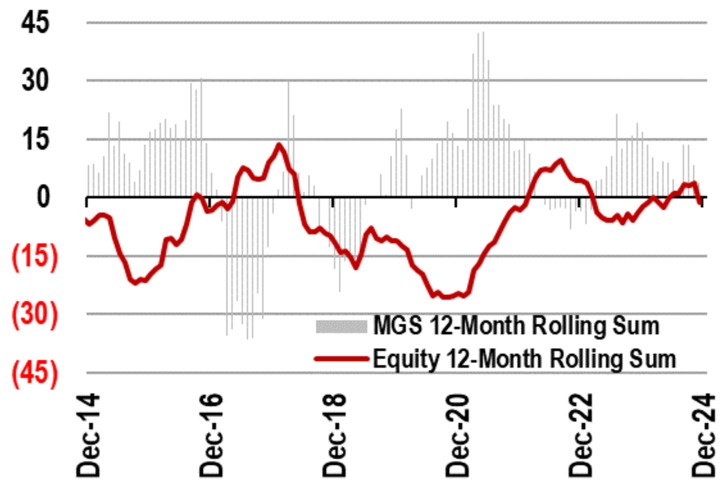
Still attractive yield levels. On top of reducing interest rate differentials, as Fed cuts and UST yields decline, MGS real yields should remain attractive vis-à-vis the U.S. and aid foreign interest for MGS/GII in 2025. We believe elevated MGS yield levels after the previous BNM hiking cycle and safe-haven demand will contribute to foreign interest. Yields in Malaysia and the region remain relatively attractive on a real basis compared to the U.S.. Latest data also show that Malaysian yields on a real basis have surpassed Thai govvies slightly after TH bond yields slipped on the back of falling inflation and the Bank of Thailand interest rate cut in October.

Exhibit 77: MGS real yields vs UST, TH and ID



Sources: Bloomberg, AmBank Economics

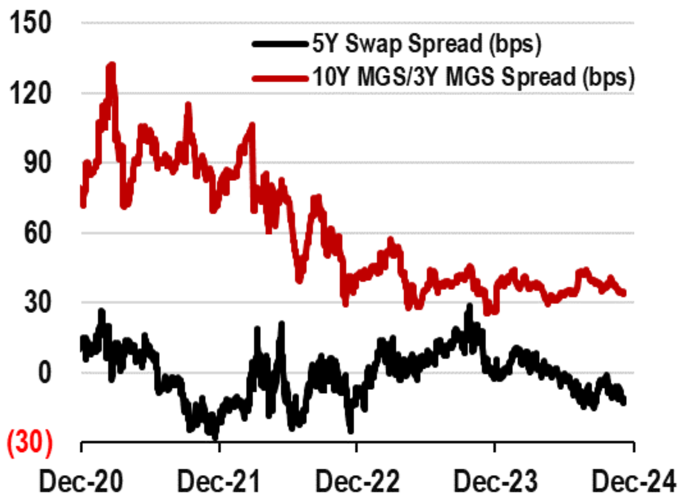
Exhibit 78: Net monthly foreign flow into MGS vs. Malaysian equity market (MYR billion)



Sources: CEIC, BNM, AmBank Economics

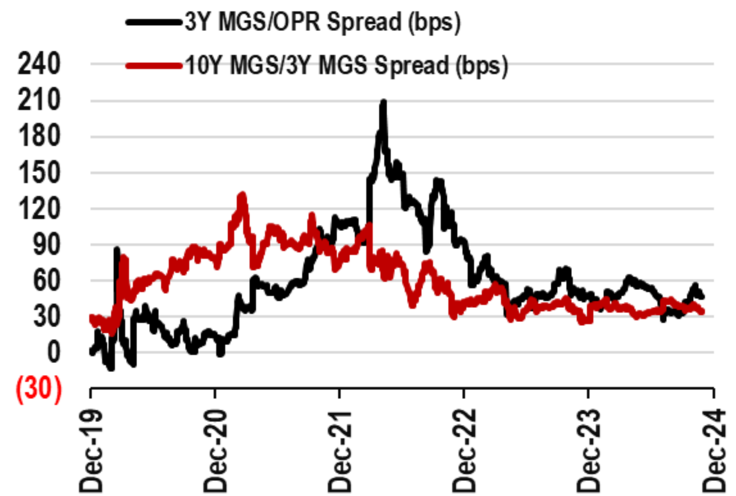
Stable BNM (for now) but yields already pricing higher OPR if need be. We note the 3Y MGS at 3.40%-3.50% is relatively wide vis-à-vis the OPR, at the current spread of 45-50 bps, whereas during periods of stable interest rates (such as now), the spread tends to hover nearer to 25 bps only. We think higher MGS yields partly account for the current pricing as these were brought higher by the rise in UST yields, but also because of concerns that inflation in Malaysia is at risk of rising in 2025 if fuel subsidy cuts (RON95) are indeed implemented in the coming year. We foresee the MGS curve will show modest steepening led by a slightly larger dip in shorter tenor (ST) MGS yields in the next few quarters vis-à-vis longer tenor (LT). Longer tenors will also be supported, but inflationary pressures limit the LT yield dip.

Exhibit 79: 10Y/3Y MGS and 5Y IRS/MGS Spreads (bps)



Source: Bloomberg, AmBank Economics

Exhibit 80: 3Y MGS/OPR and 10Y/3Y MGS Spreads (bps)



Source: Bloomberg, BNM, AmBank Economics

Primary market aids outlook

Favourable supply outlook as onshore demand remains firm

Modestly favourable MGS and GII supply outlook in 2025

Less heavy auction schedule. The issuance of MGS and GII will be slightly less heavy in 2025 than in 2024. After the Government of Malaysia's (GOM) announcement of the 2025 Budget in October, with a major focus on fiscal consolidation, we placed a ***gross issuance target of MYR165 billion for fiscal year 2025*** compared with MYR175 billion in 2024. Though we are persisting with the MYR165 billion target, there is the possibility that MGS/GII gross issuance in 2025 could reach MYR170 billion to account for the refinancing of Treasury bills (T-bills) during the coming year.

Fiscal financing. In 2025, ***the net issuance of MGS and GII is estimated to reach MYR80 billion, which*** will finance the target fiscal deficit of MYR79.97 billion.

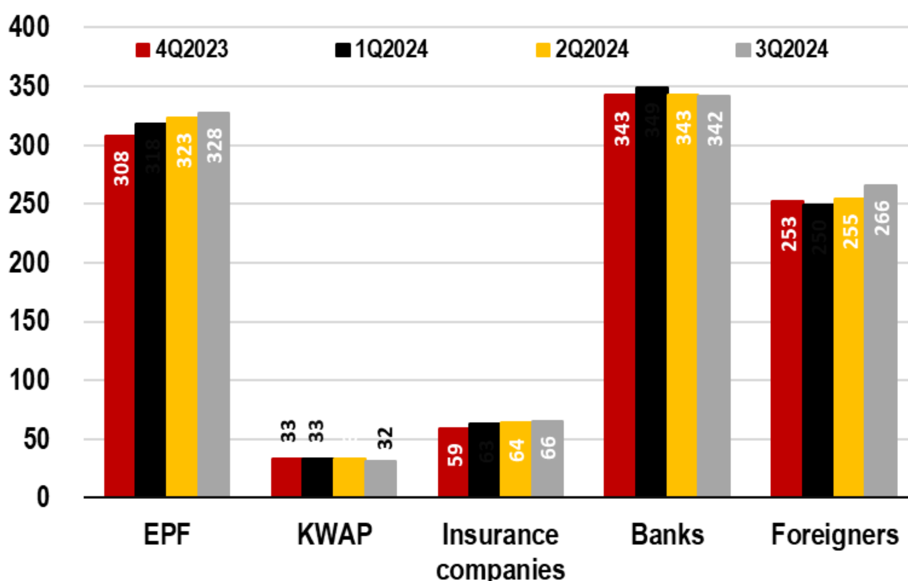
Refinancing MGS and GII maturities. MYR83.5 billion maturing MGS and GII in 2025 (2024: MYR87.5 billion) should be refinanced via MGS/GII issuances in the coming year. Unlike 2024, we will see no plan to refinance SPK bonds via MGS and GII offerings this year. The last maturing SPK tranche, amounting to MYR5.5 billion, occurred in 2024. If we add MYR87.5 billion MGS/GII maturities with MYR5.5 billion SPK, then total govvies maturities in 2024 were MYR93.0 billion, and thus net issuance in 2024 was MYR82.0 billion (MYR175 billion minus MYR93.0 billion).

T-Bills. The total 2024 gross MGS and GII issuances is MYR175 billion, of which MYR93.0 billion was to refinance MGS/GG/SPK. Then, the balance (net issuance of MYR85 billion) was to finance the 2024 fiscal deficit. However, there was also a consideration for the Treasury bills (T-bills). Total issued bills in 2024 have come up to MYR23.0 billion (2023: MYR42.5 billion). Outstanding T-bills at end-2023 were MYR20.0 billion and fell to MYR19.0 billion in 2024. According to our calculations, there was a total maturity of MYR24.0 billion T-bills in 2024. If true, we assume that the issuance of MGS/GII in 2024 to refinance maturing bills during the year was only about MYR1.0 billion. For 2025, we assume that out of the total MGS/GII issuance ultimately to be issued next year, MYR1.0-5.0 billion (low to high estimate) could be used to refinance maturing T-bills. In this case, MGS/GII gross issuance in 2025 is possible to reach MYR170 billion.

Supply vs. demand. The number of auctions in 2025 will be 36, like in 2024. This will translate into an auction average of MYR4.7 billion in 2025 vs. MYR4.9 billion in 2024. Thus, per auction, demand may remain firm. The average BTC in 2024 was 2.41 times (x), which was already an improvement from 2.16x in 2023. The demand outlook assumes a sustained increase in MGS/GII holdings by large investors in the coming year (especially social security institutions, banks, and offshore funds). Data from BNM of the holdings of these three types of investors rose to MYR967.5 billion in 3Q2024, or a 9.3% increase from MYR900.0 billion in the prior year's corresponding period.

Onshore investors continue adding bond holdings with higher and more attractive yields.

Exhibit 81: Major holders of MGS and MGII (4Q2023-3Q2024) (MYR billion)



Sources: BNM, AmBank Economics

Malaysian Corporate Bonds: *Modest* widening of credit spreads anticipated

Bias towards wider spreads, but not too much

More widening of credit spreads is a possibility, but spreads have remained narrow historically. We expect that in 2025, credit spreads will see a modest widening but remain tight from a historical perspective. We note that spreads had already widened since mid-2024, and this corresponded with technical charts suggesting overvalued situations - such as a trend in spreads extending 2 s.d. below their five-year mean (see below chart). Meanwhile, credit yields coming down from post-pandemic highs and very tight spreads (5Y and 10Y AAA and AA1 spread dipping sub-20 bps) suggest duration risk premium is undervalued, especially on lower ratings (AA and A) segment.

Outlook for corporate bonds based on

… credit conditions
… supportive supply outlook
… interest rate outlook

We further base our outlook for ***modest*** widening in coming quarters on the following factors:

1) Improvements in credit health alongside firm GDP growth;
2) Lagging numbers in gross and net PDS issuances; and
3) Global rates are coming down.

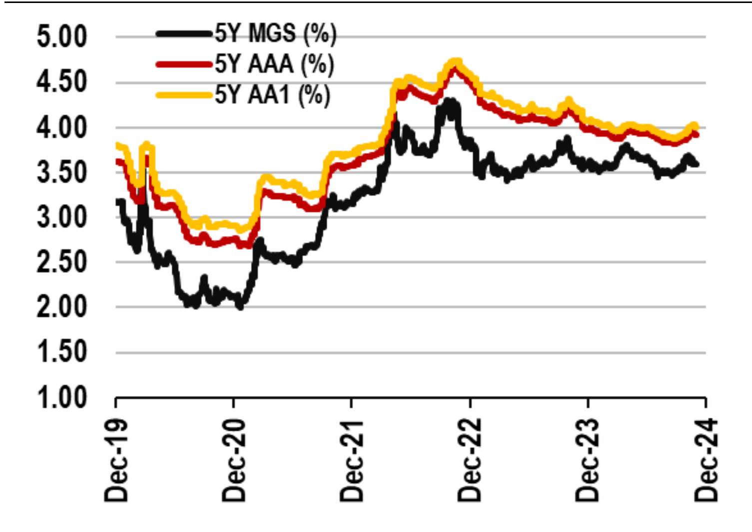
Corporate financial and credit conditions look stable. Steady Malaysian GDP growth and business conditions in 2024 contributed to improving corporate sector returns, cashflows, and debt levels and lessening the impetus for repricing credit risks.

- **Cash flows look healthy**. We use aggregated numbers from Bloomberg of KLSE Emas Index members. Up to the end of 3Q2024, we note that cash flows (CF) from operations have improved since 3Q2023, with corporates showing signs of capacity expansion via increased CF from financing and negative CF from investing.
- **Corporate balance sheet levels are also healthy**. Assets have grown further, though accompanied by a rise in liabilities as corporates expand.

Debt-to-equity levels remained at around 90% and debt versus assets below 20%.

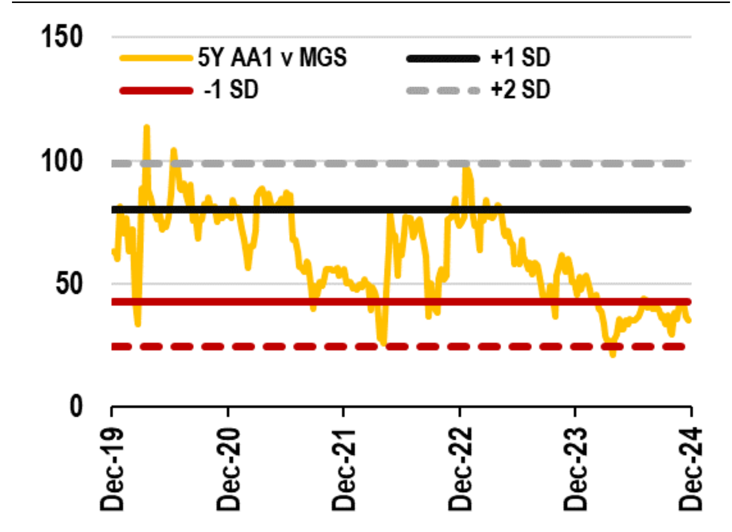
- **Rating downgrades and negative rating outlooks look contained** with signs of improvements, as we have seen a rise in Positive rating outlooks since 2023. RAM and MARC numbers show that debt facilities downgraded was six (6) YTD 2024 (2023: 11), while facilities upgraded also totaled six (6) in YTD 2024 vs. 12 in 2023.

Exhibit 82: 5Y PDS yields vs MGS (%)



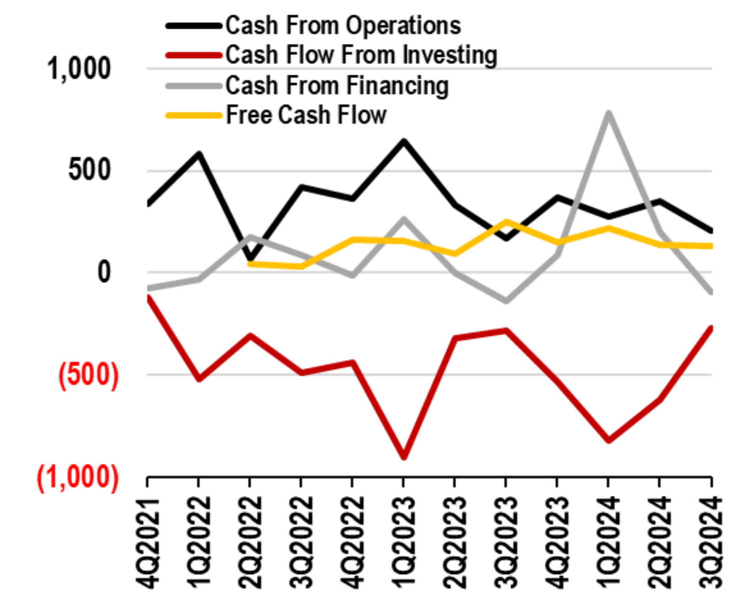
Sources: Bloomberg, AmBank Economics

Exhibit 83: 5Y AA1 credit spreads (bps)



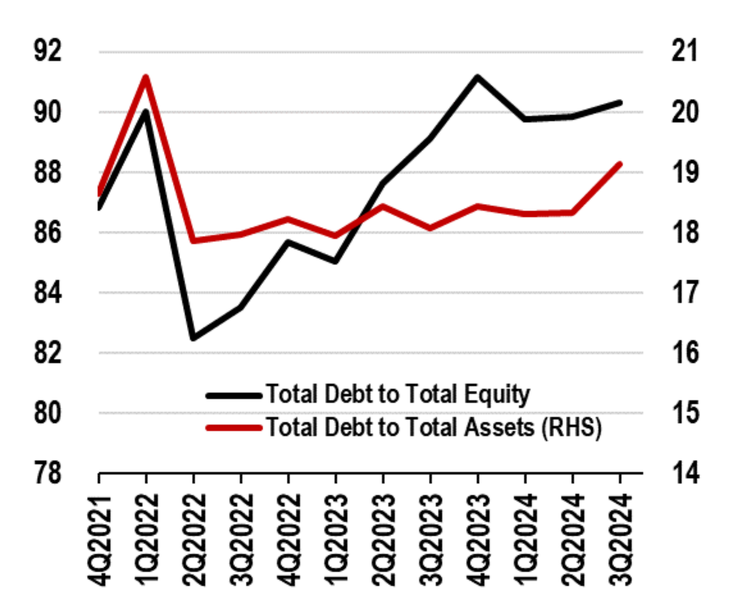
Sources: Bloomberg, AmBank Economics

Exhibit 84: Cash Flows of KLSE Emas Index Members (MYR per share)



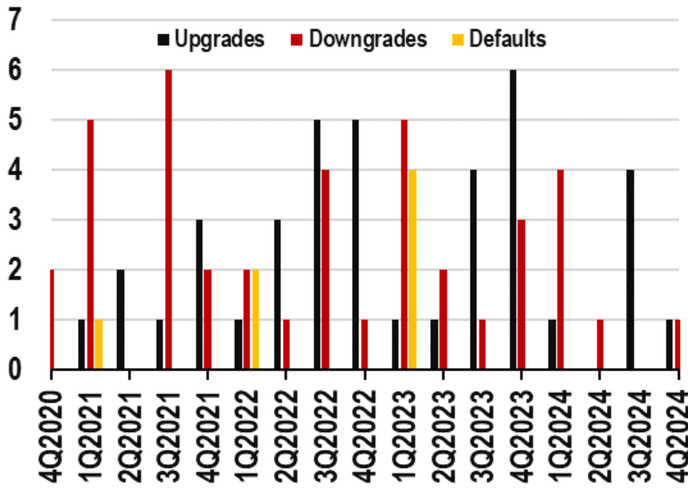
Sources: Bloomberg, AmBank Economics

Exhibit 85: Debt Ratios of KLSE Emas Index Members (%)



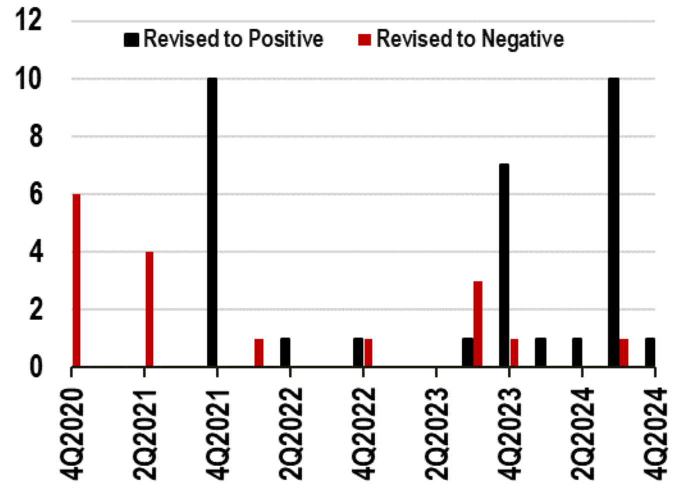
Sources: Bloomberg, AmBank Economics

Exhibit 86: RAM and MARC ratings upgrade vs downgrades (# of facilities)



Sources: RAM, MARC, AmBank Economics

Exhibit 87: RAM and MARC Ratings outlook more Positive than Negative (# of facilities)

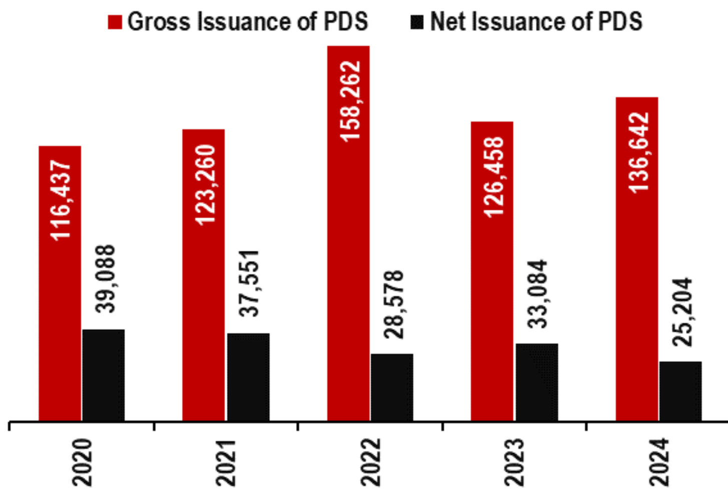


Sources: RAM, MARC, AmBank Economics

We anticipate that gross issuance of PDS in 2025 will exceed MYR130 billion (2023: MYR120-130 billion)

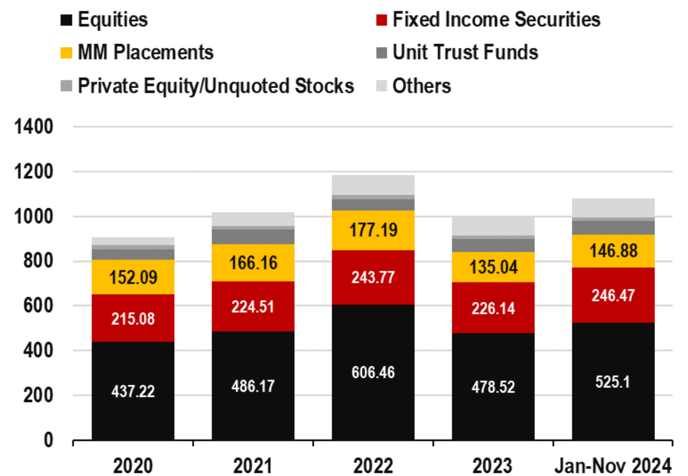
Lagging numbers in gross and net PDS issuances. We note the spread compression in 2023 and 2024, including where quasi-government and AAA spreads tightened to sub-10 bps and 20 bps, respectively, before the recent correction, were in large part due to a lack of new supply of bonds, especially net issuance amount, since the pandemic. The steadier issuances last year then contributed to the wider credit spreads. We expect gross and net PDS issuances to increase slightly in 2025 as GDP grows and investments/capacity expands. We note that 2024 issuance was on pace to exceed 2023 slightly, but the overall pace has lagged the 2022 number. ***We anticipate gross issuance of PDS in 2025 of about MYR130 billion (2023: MYR126 billion).*** This will limit the upside to PDS yields in the coming year, thus limiting the upside to spread levels.

Exhibit 88: PDS gross and net issuances 2020-2024 (MYR million)



Sources: BPAM, AmBank Economics

Exhibit 89: Asset Allocation for Overall Fund Management (MYR billion)



Sources: Securities Commission

Fixed income recommendations

Pick up MGS/GII ahead of auctions as we anticipate competitive WI pricing

- **Pick up MGS/GII ahead of more global interest rate cuts/Competitive WI trading in 2025.** At MGS/GII auctions in 2024, where BTCs were 3.00x and more, most involved longer tenors (15 years and longer). We attribute the solid demand from players eager to pick up and lock in higher yields ahead of the central bank's interest rate cuts. With lessened govvies auctions in 2025, we anticipate BTCs to remain healthy. Given more competition in the auctions in the coming year, we think many MGS/GII players have an eye right now to preempt competitive WI trading and pick up incoming new supply well ahead (days or weeks) of the auctions.

Longer tenors will receive bids as and when spreads widen

Spreads >60 bps on the 10Y/3Y offer the opportunity to buy longer tenors

- **Look out for spreads on longer tenors.** We anticipate the MGS curve to remain flat with very modest potential for spreads to widen, considering the current stable OPR versus modest inflation pressures. Also, slower global rate cuts than previously anticipated may provide a stickier situation for longer-tenor MGS/GII yields. That being said, a steeper curve offers bond-laddering opportunity. Our expected 10Y/3Y spread is targeted at 35 bps in 1H2025 and towards 40-60 bps as we move towards 2026. ***Thus, spreads >60 bps on the 10Y/3Y offers opportunity to buy longer tenors***. The spread of longer-tenor MGS over shorter tenors had narrowed substantially since mid-2021. During post-pandemic, there was a bear flattening of the curve alongside central bank hikes (including by BNM). For 2025, we anticipate MGS yields to decline modestly. And because the main driver for lower yields is the reduction in short-term interest rates, we expect a dip in MGS yields to be led by shorter to medium-tenor papers, leaving longer-duration papers to maintain relative attractiveness over shorter papers.

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