Disentangling Malaysia's Value Chains in the Age of Turbulence

Introduction

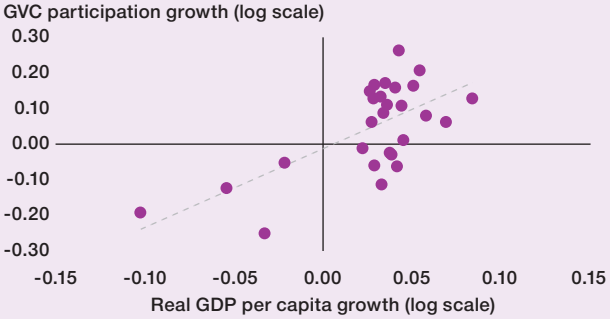
Malaysia is deeply integrated into global value chains (GVCs), with GVC-related activities accounting for more than half of the country's exports.[1] The high level of participation in GVCs has supported export growth and strengthened Malaysia's role as a key supplier within both regional and global production networks (ASEAN–Japan Centre, 2021). However, in recent years, major economies are turning inward and reconfiguring their own supply chains to enhance self-sufficiency amidst heightened geopolitical tensions. The greater use of industrial and protectionist measures reflects a shifting paradigm in GVCs, one in which resilience increasingly outweighs efficiency. For a small and open economy like Malaysia, this shift presents both challenges and opportunities.

Against this backdrop, the article examines how Malaysia's GVC participation has evolved, including changes in linkages and sectoral value-added structure. This sets the foundation for assessing GVC-related risks and vulnerabilities, while also identifying sources of resilience amid global trade volatility. The article concludes by outlining policy considerations aimed at strengthening Malaysia's position in GVCs.

Malaysia retains a strong foothold in global value chains

Strong participation in GVCs and high trade openness[2] have been a cornerstone of Malaysia's development strategy. Consistent with many prevailing literatures, Malaysia's GVC participation supported productivity gains and income growth through specialisation in specific areas (Chart 1). This was achieved via exposing domestic firms to global competition, economies of scale, technology transfer, and knowledge spillovers. Like many countries, Malaysia's GVC-intensive model is shaped by strong inward foreign direct investment (FDI) (Chart 2). Malaysia's ability in attracting capital has not only helped in positioning the country as a key node in global manufacturing networks but has also uplifted its level of GVC participation.

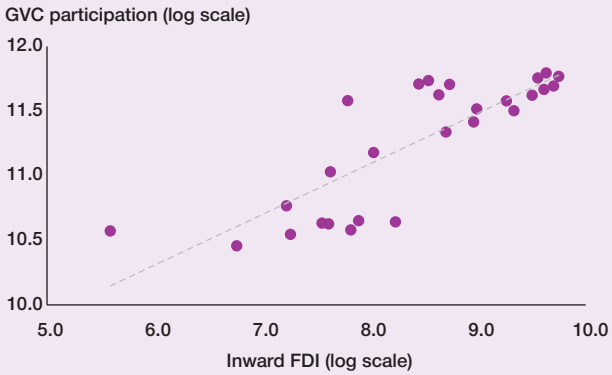
Chart 1: Positive Relationship between GVC Participation and Income Growth Rates in Malaysia, 1996 to 2022



Note: GVC participation is the sum of foreign value added in Malaysia's gross exports and Malaysia's value added in foreign gross exports (in USD millions). GVC participation growth is measured using yearly log-differences of the value, while GDP per capita growth is measured using yearly log-differences of its value in USD.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition and International Monetary Fund database

Chart 2: Positive Relationship between GVC Participation and Inward FDI in Malaysia, 1995 to 2022



Note: GVC participation is measured by the log of the sum of foreign value added in Malaysia's gross exports and Malaysia's value added in foreign gross exports (in USD millions), while for inward FDI stock, its log in USD millions is used.

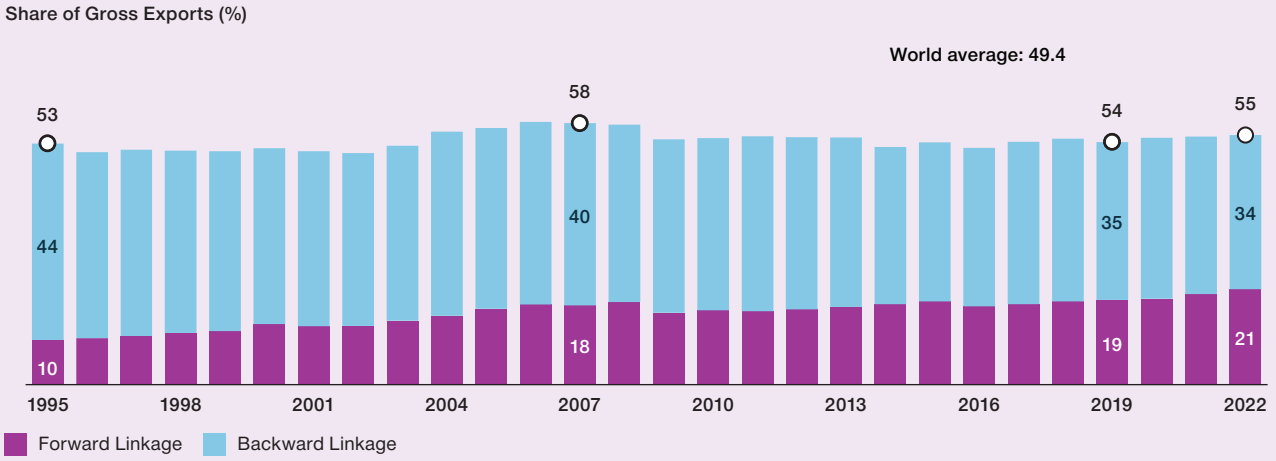
Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition and UNCTAD database

[1] Estimated based on OECD Trade in Value-Added (TiVA) 2025. Refer to Chart 3.
[2] Malaysia's total trade accounting for 136.4% of nominal GDP in 2025.

A country participates in GVCs through backward and forward linkages. Backward linkages are gauged by the share of foreign value added (FVA) in its exports, while forward linkages capture the share of domestic value added embodied in other countries' exports. In other words, in the context of GVCs, backward linkages reflect '*how much of our exports are built using imported inputs*', while forward linkages indicate '*how much of our domestic inputs help other countries produce their exports*'. Backward linkages account for around 34% of Malaysia's gross exports, making it the dominant component of the country's GVC participation (Chart 3). This reflects the substantial use of imported inputs in Malaysia's export production, which are then further processed domestically before being re-exported, either to undergo subsequent stages of production abroad or for final consumption. At the same time, forward linkages have increased steadily over the years, indicating a growing role for Malaysian value added in supporting production and exports in partner economies.

Together, these features place Malaysia among the more globally integrated economies. Malaysia's level of GVC participation is above global average and broadly aligned with other key manufacturing powerhouses in Asia (Chart 4). In contrast, larger economies such as the United States (US) and China exhibit lower participation rates, reflecting a greater concentration of value creation within domestic production systems (US BEA, 2025; Taguchi, 2018).

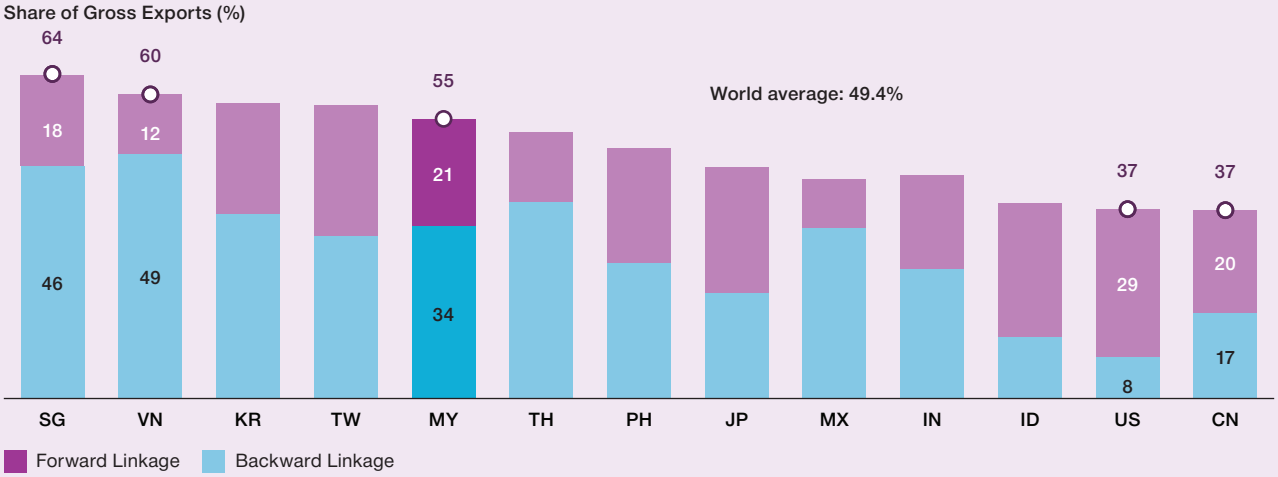
Chart 3: Malaysia's Participation in Global Value Chain (GVC)



Note: 1. Forward linkages refer to domestic value added embodied in foreign exports; backward linkages refer to foreign value added embodied in Malaysia's exports.
2. Estimates are based on OECD Trade in Value Added (TiVA) principal indicator shares.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

Chart 4: Forward and Backward Linkages in the GVC by Market



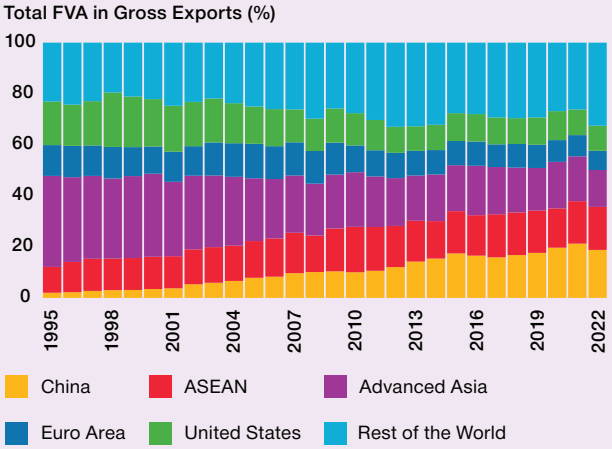
Note: CN = China, ID = Indonesia, IN = India, JP = Japan, KR = Korea, MX = Mexico, MY = Malaysia, PH = Philippines, SG = Singapore, TH = Thailand, TW = Chinese Taipei, US = United States, VN = Vietnam

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

Following the inputs: Foreign value added in Malaysia's exports

Malaysia's sourcing of foreign inputs has become increasingly regional. In 2022, more than half of its FVA was drawn from within the Asian region (Chart 5). While this reflects Malaysia's deepening integration in regional production networks, it also points to a rising dependence on China as a major source of intermediate inputs. This underscores the pivotal role of regional manufacturing hubs in sustaining Malaysia's export production. Malaysia's backward linkages are heavily concentrated in manufacturing, particularly in the electrical and electronics (E&E) industries (Chart 6). E&E industries account for the largest share of FVA in Malaysia's exports. This reflects the fragmentation of production processes where components, sub-assemblies and capital goods cross borders multiple times before reaching final demand. In other words, Malaysia's role in GVC participation is best understood as part of an interconnected regional production network, rather than as a set of bilateral export relationships.

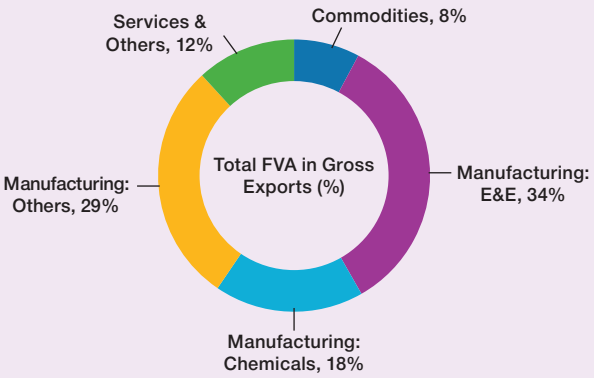
Chart 5: FVA in Malaysia's Gross Exports by Market (2022)



Note: ASEAN refers to Indonesia, Philippines, Singapore, Thailand and Vietnam. Advanced Asia refers to Chinese Taipei, Hong Kong, Japan and Korea.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

Chart 6: FVA in Malaysia's Gross Exports by Sector (2022)



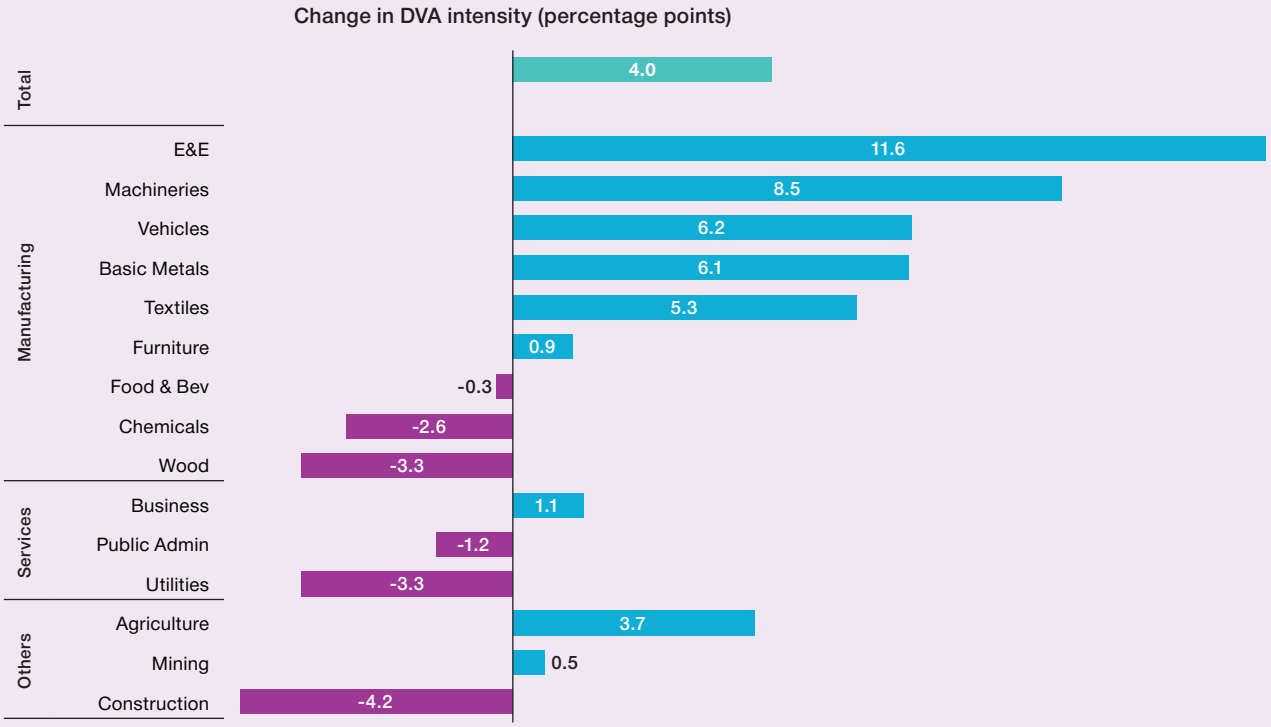
Note: Commodities refer to mining and agriculture.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

A better measure of value creation: Malaysia's domestic value added

Malaysia's reliance on foreign inputs reflects one dimension of GVC integration. Domestic value added (DVA)[3] captures the portion of exports created in the country (i.e. the part of exports that contributes to GDP). DVA, or sometimes more informally known as 'local content', is a stronger channel through which exports translate into domestic incomes and jobs. This is of particular importance as export-oriented manufacturing sector employs about 1.3 million workers[4] and generates a large share of labour income, contributing around 58% of total manufacturing wages. Malaysia's ability to create DVA within its exports has improved over time. DVA intensity[5] has risen modestly across most sectors (Chart 7). The improvement in DVA intensity across manufacturing sectors between 2010 and 2022 is particularly important. It indicates meaningful upgrading within the manufacturing as firms progress into more complex activities or more advanced stages of production, enabling a larger share of value to be generated domestically.

Chart 7: Difference in DVA Intensity between 2010 and 2022



Note: DVA intensity refers to the share of domestic value added embodied in a country's gross exports.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

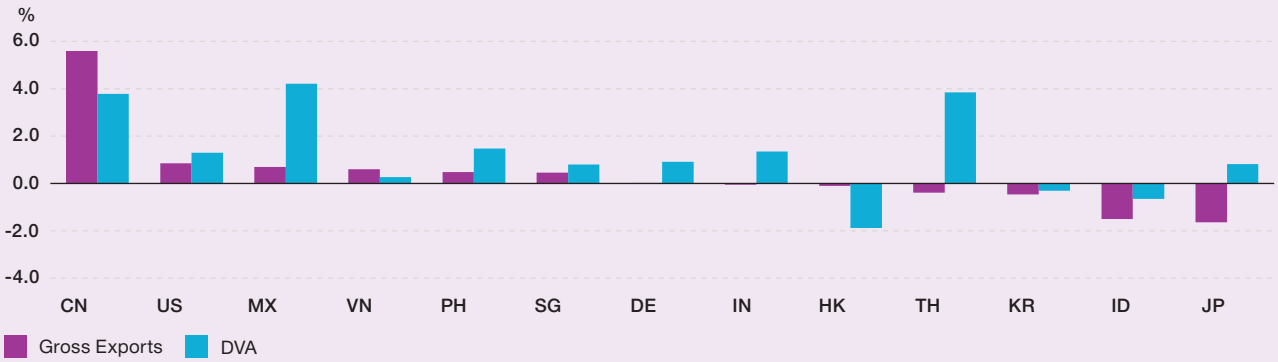
Of significance, increases in Malaysia's DVA have not always moved in tandem with changes in gross export shares across partner markets. In several destinations, DVA intensity has risen more rapidly than export shares, indicating improvements in value capture within existing trade relationships rather than expansion in export scale (Chart 8). Mexico exemplifies this pattern; despite only seeing modest growth in Malaysia's gross export share, higher DVA intensity points to upgrading within production activities and greater domestic retention of value.

[3] Domestic value added (DVA) refers to all value created within Malaysia as defined by the OECD TiVA database. Only the share of DVA that is embedded in other countries' exports, known as domestic value added in foreign exports (DVX), is classified as forward linkage. If foreign value added (FVA) accounts for 34% of Malaysia's gross exports, the remaining 66% represents DVA. Of this, approximately 21 percentage points reflect forward linkage DVX, which captures Malaysian value added absorbed into foreign countries' exports (Chart 3). The remaining DVA is absorbed abroad in trade partners' final demand.

[4] Computed using Department of Statistics, Malaysia's Monthly Manufacturing Statistics: paid employee data from Table 1.2a and wages & salaries from Table 1.3a (Jan–Dec 2025). Export-oriented sectors include: textiles, wearing apparel; wood, furniture; petroleum, chemicals, rubber & plastics; and electrical & electronics.

[5] DVA intensity refers to the share of domestic value added embodied in a country's gross exports.

Chart 8: Reallocation of Malaysia's Gross Exports and DVA Intensity by Market, 2015 to 2022



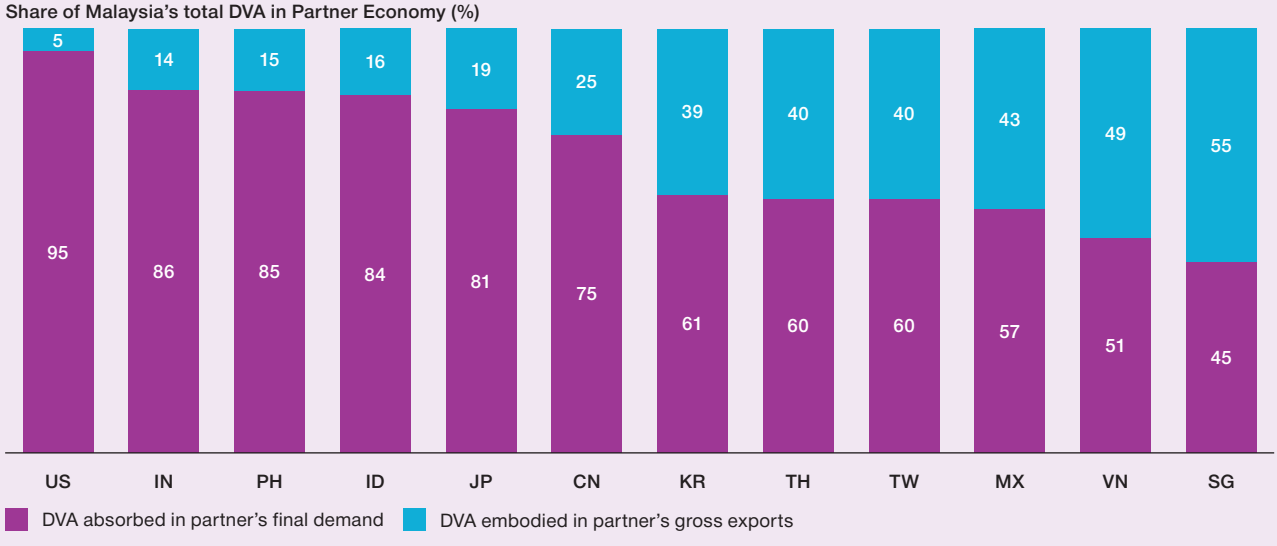
Note: 1. Change in gross export shares and DVA intensity by market.
2. CN = China, DE = Germany, HK = Hong Kong, ID = Indonesia, IN = India, JP = Japan, KR = Korea, MX = Mexico, PH = Philippines, SG = Singapore, TH = Thailand, TW = Chinese Taipei, US = United States, VN = Vietnam

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

By contrast, markets such as Vietnam and China recorded strong growth in Malaysia's export share, while the increase in DVA intensity was comparatively more gradual. This reflects the nature of Malaysia's participation in regional production networks, where a portion of value added is embedded in intermediate goods rather than final-demand products.

Furthermore, the way this value added is absorbed abroad differs markedly across markets. In destinations such as India and the Philippines, Malaysia's DVA is largely absorbed through final demand, linking Malaysia's domestic value creation more directly to consumption and investment conditions in the partner economies (Chart 9). In these cases, demand shocks are expected to reach Malaysia more directly and often reflect specific developments in the individual market. In contrast, for markets such as Singapore, Vietnam and Mexico, a substantial share of Malaysia's DVA enters as intermediate goods that are processed and are later exported as foreign country's goods. This is the key condition for DVA to be classified as forward linkage. Here, the transmission of shocks is channelled through global supply chains. This means domestic outcomes are more sensitive to disruptions in intermediate trade flows and global manufacturing cycles (ECB, 2022).

Chart 9: Channels of Absorption for Malaysia's DVA in Partner Economies



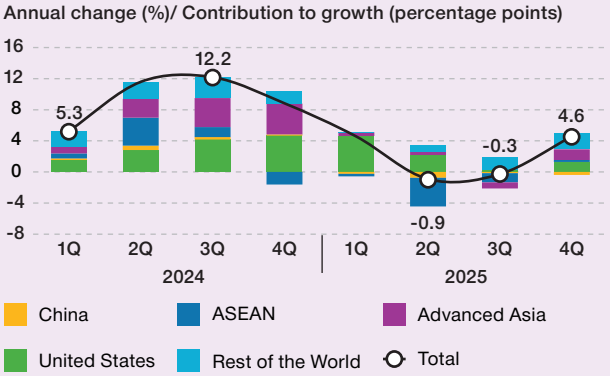
Note: 1. CN = China, ID = Indonesia, IN = India, JP = Japan, KR = Korea, MX = Mexico, PH = Philippines, SG = Singapore, TH = Thailand, TW = Chinese Taipei, US = United States, VN = Vietnam
2. For each partner economy, Malaysia's DVA reaching that market is computed as the sum of:
(i) Malaysia's DVA absorbed in partner's final demand, and
(ii) Malaysia's DVA embodied in partner's gross exports.
Each component is shown as a share of the total DVA absorbed in that economy.
3. This measure captures Malaysian value added that reaches partner economies both directly (via final consumption and investment abroad) and indirectly (via re-exports through multi-country production networks). Estimates are derived from TiVA's origin of value added in final demand (FDVA) and origin of value added in gross exports (EXGRVA) indicators from the OECD.

Source: Bank Negara Malaysia estimates using data from OECD Trade in Value Added (TiVA) 2025 edition

Cyclical tariff headwinds: Malaysia's GVC resilience holds firm

Malaysia's exposure to rising trade tensions reflects both its position within GVCs and its reliance on final demand from key markets, particularly the US and China. At this point, although higher tariffs have raised trade costs, final demand conditions in the US remain supported by robust demand for technology products, keeping Malaysian exports resilient across multi-stage production networks. The diversification of demand and input sourcing inherent in GVCs allows firms to absorb trade shocks, including tariffs, while maintaining production continuity (Mancini et al., 2022). Malaysia's domestic exports[6] to the US continued to register positive growth in 2025 despite higher tariffs (Chart 10).

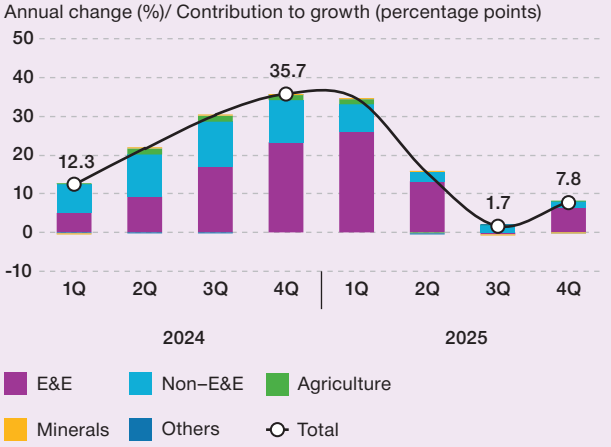
Chart 10: Domestic Exports by Country



Note: ASEAN refers to Indonesia, Philippines, Singapore, Thailand and Vietnam. Advanced Asia refers to Chinese Taipei, Hong Kong, Japan and Korea.

Source: Bank Negara Malaysia estimates using data from Department of Statistics, Malaysia

Chart 11: Domestic Exports to US by Product



Source: Bank Negara Malaysia estimates using data from Department of Statistics, Malaysia

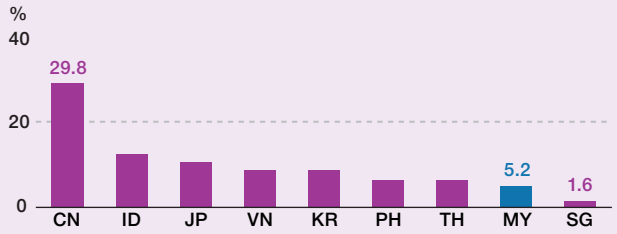
This growth was driven mainly by E&E products (Chart 11), which accounted for more than half of the increase in export receipts. In addition to being exempted from tariffs, the strong shipments of semiconductor devices and integrated circuits reflect Malaysia's integrated role in the global technology value chain, underpinned by its position as the world's ninth-largest E&E exporter[7] and its durable supply chain relationships.

Additionally, Malaysia's resilience has also been supported in part by the composition of its export mix and the nature of the US tariffs introduced during this period. Although trade frictions between the US and China have intensified, spillovers to Malaysia remained modest. A key factor is that the effective tariff burden on Malaysia's exports to the US, which is calculated based on import duties collected on Malaysian products relative to the value of Malaysian exports to the US, was lower than that faced by several regional peers in 2025 (Chart 12). This is important because firms adjust to actual cost pressures rather than headline tariff rates. Based on the data by S&P Global, following the increase in US tariffs on China's goods, there was a marked decline in US imports from China alongside a corresponding rise in imports from regional countries (Chart 13).

[6] Domestic exports are goods produced or significantly processed in the country and then sold abroad. They do not include re-exports, which are goods imported from another country and later exported again with little or no change.

[7] For further details, please refer to the box article 'Malaysia's Position in Global E&E Value Chain and Prospects' in Bank Negara Malaysia's Economic and Monetary Review 2024.

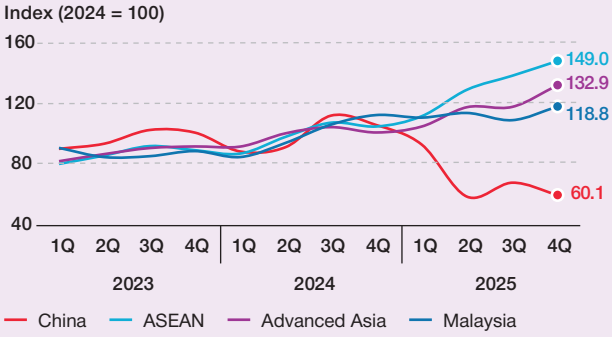
Chart 12: Effective Tariff Rate on US Imports in 2025 by Country



Note: 1. CN = China, ID = Indonesia, JP = Japan, VN = Vietnam, KR = Korea, PH = Philippines, TH = Thailand, MY = Malaysia, SG = Singapore
2. The effective tariff rate is derived by taking the share of total import duties collected over the total value of US merchandise imports.

Source: Bank Negara Malaysia estimates using data from S&P Global

Chart 13: US Imports by Market



Note: ASEAN refers to Indonesia, Philippines, Singapore, Thailand and Vietnam. Advanced Asia comprises Hong Kong, Chinese Taipei, Japan and Korea.

Source: Bank Negara Malaysia estimates using data from S&P Global

From Uncertainty to Adjustment: Perspectives from Firms in Malaysia in Response to US Tariffs

2025 was a year marked by increased uncertainties following the imposition of tariffs by the US. Given the volatile external environment, BNM conducted periodic industrial engagements with export-oriented firms in Malaysia to monitor the impact of US tariffs on Malaysia's exports amid several tariff policy changes throughout 2025.

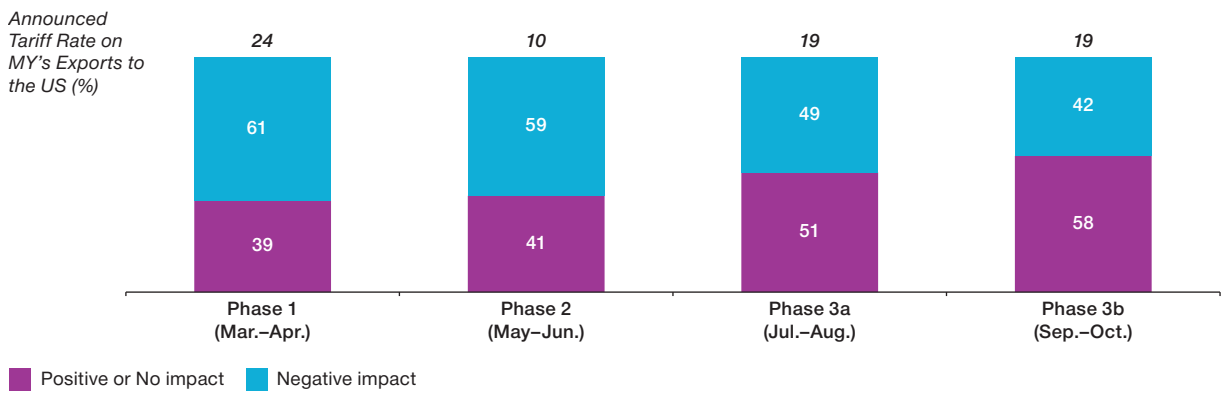
Firms reported less disruption as the year progressed due to greater policy clarity, but negative impact continued to weigh on the growth outlook

Despite the reduction in the tariff rate from 24% to 10% on 9 April 2025 for a 90-day consultation period (Phase 2), the share of firms expecting adverse impacts from US tariffs was largely unchanged (Chart A). This reflected the general uncertainty surrounding the outcome of trade negotiations between the US and Malaysia. Once the tariff rate for Malaysia's goods exports to the US was finalised at 19%, fewer firms anticipated negative impacts (Phase 3a) amid greater policy clarity. Firms also expressed relief that the tariff rate was broadly similar to regional developing economies, providing a relatively level-playing field with competitors in Southeast Asia. As firms continued to adjust to the new tariff environment and completed the negotiation of new orders (Phase 3b), more US customers, who were initially hesitant, resumed orders. Moreover, some local exporters, especially in the E&E subsector, were positively impacted through transfer of orders or relocation of production lines into Malaysia. A notable share of firms remained unaffected by US tariffs as their products, such as semiconductors and generic pharmaceuticals, were exempted, or due to limited direct exposure to the US market.

However, the negative impact from US tariffs persisted. Firms in the primary-related industries were concerned about higher competition in non-US markets, exacerbated by the availability of cost-competitive goods due to excess industrial production capacity in China. Moreover, revenue for consumer-oriented exporters, such as those in the processed food, furniture and consumer electronics segments, was adversely affected by softer final demand from the US amid higher tariff-induced end-consumer prices. Consumer demand from the US was expected to gradually adapt to new price levels, which could take up to a year. The revenue growth outlook was also weighed by the inability to share tariff costs with customers in the US, particularly for players already operating at thin profit margins. This could potentially lead to a decline in orders if clients were unable to absorb the cost of tariffs.

Chart A: How will your revenue or orders be impacted in 2H 2025 by US tariffs?

Share of respondents (%)



Note: 1. Phase 1 refers to the initial shock when the US announced tariffs on selected imported goods (e.g. steel, aluminium, automobile and automobile parts) in March 2025, followed by a 24% reciprocal tariff on goods imported from Malaysia on 2 April 2025.
2. Phase 2 refers to the suspension of country–specific reciprocal tariffs and implementation of 10% universal tariffs for a 90-day consultation period, announced on 9 April 2025.
3. Phase 3 refers to the announcement of the revised tariff rate on goods imported from Malaysia to 19%, announced on 31 July 2025, effective 1 August 2025.
4. Responses were based on field interviews and industrial engagements with export–related firms conducted between March and October 2025 (n = 37, 37, 47, and 37, respectively).

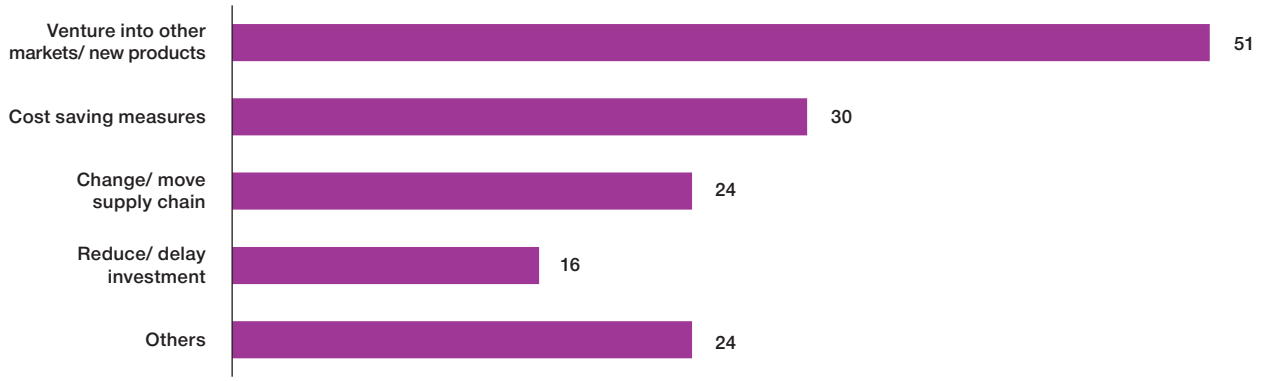
Source: Bank Negara Malaysia

Firms affected by the new tariff environment planned to venture into alternative markets and diversify supply chains

To cope with the adverse impact of US tariffs, half of the firms considered venturing into a new market or pivoting to new product lines in niche segments with higher profit margins (Chart B). Nonetheless, these firms acknowledged the potential challenges to pivot in the immediate term, including difficulty in securing new, long-term non-US clients.

Chart B: If negatively affected by US tariffs, how do you plan to cope?

Share of respondents (%)



Note: 1. Percentage shares do not sum to 100% as respondents could mitigate challenges using more than one strategy.
2. Responses were based on field interviews and industrial engagements with 37 export-related firms conducted between March and August 2025.
3. Others include reducing headcount and shutting down production lines.

Source: Bank Negara Malaysia

Beyond tariff cycles: Malaysia faces broader economic risks amid seismic geoeconomic shifts

a) Between Two Giants: Malaysia's Demand Exposure

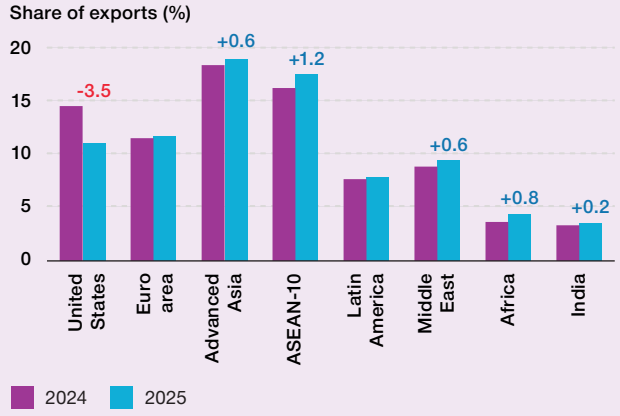
Deep GVC integration has helped cushion the Malaysian economy against recent tariff shocks. However, rising protectionism and global industrial policies, that operate along value-chain lines, are reshaping production networks rather than merely altering bilateral trade flows (IMF, 2023). At the same time, Malaysia's exposure to external demand has increased: the share of DVA embodied in foreign final demand has risen from 20% in 1995 to 37% in 2022. This reflects the growing reliance on final demand from China and the US. Although this integration creates opportunities during periods of strong global growth, it also amplifies Malaysia's sensitivity when geopolitical tensions escalate and external demand slows down, pointing to a structural vulnerability.

b) Shifting Tides in Global Supply

A further source of pressure arises from changes in global supply conditions. While China's exports to the US have declined in 2025, its exports to other markets have increased significantly (Chart 14). For ASEAN, imports from China comprises both intermediate inputs that reinforce regional production networks and final goods that intensify competition with domestic producers.

For Malaysia, the effect is rather mixed at this juncture. Intermediate goods sourced from China remain vital for supporting domestic E&E and machinery production by strengthening backward linkages. However, the rising presence of competitively priced final goods heightens competitive pressures, particularly in sectors where global supply has expanded faster than demand and where China is capturing a growing share of world exports (Chart 15). Malaysia has maintained modest gains in global market share in recent years, but sustaining these gains will require continued upgrading to avoid being crowded out.

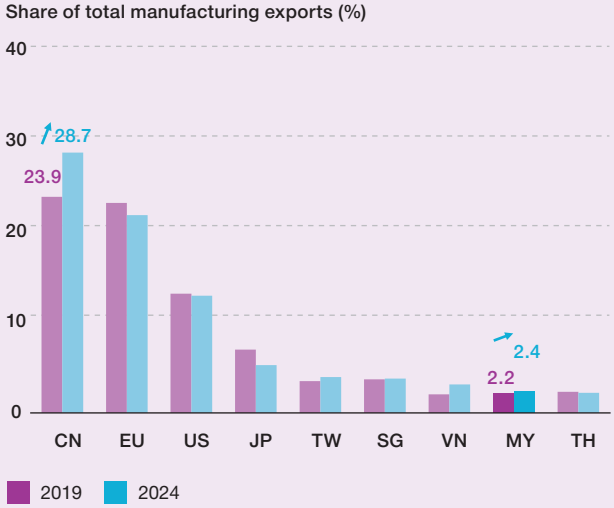
Chart 14: China's Export Share by Market



Note: 1. Figures above each bar denote the percentage point change in China's export share to the respective countries.
2. Advanced Asia refers to Chinese Taipei, Hong Kong, Japan and Korea. Latin America, Middle East, and Africa follow IMF aggregate classifications. ASEAN-10 comprises Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

Source : Bank Negara Malaysia estimates using data from S&P Global

Chart 15: Share of Global Manufacturing Exports



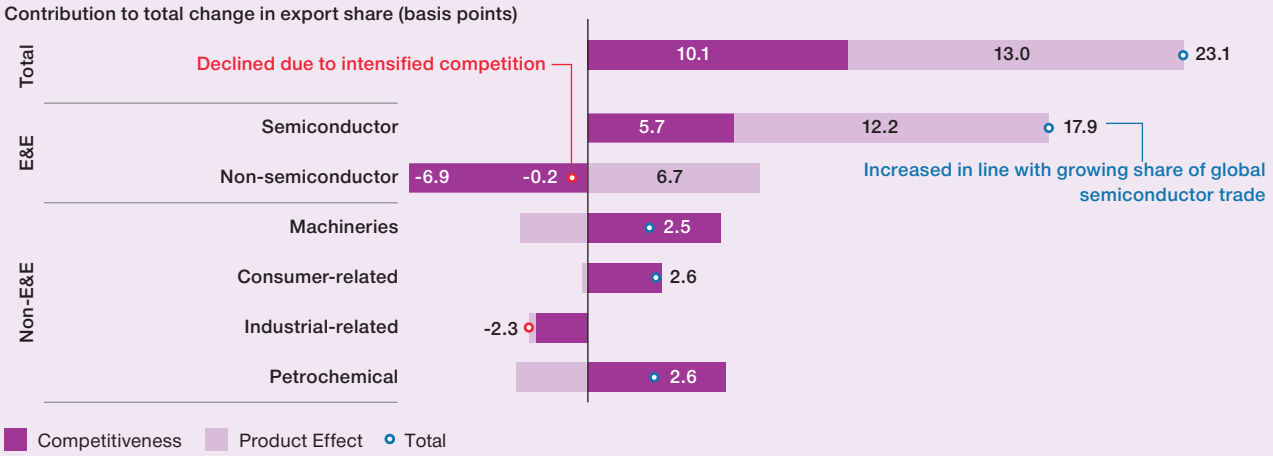
Note: CN = China, EU = European Union, US = United States of America, JP = Japan, TW = Chinese Taipei, SG = Singapore, VN = Vietnam, MY = Malaysia, TH = Thailand

Source: Bank Negara Malaysia estimates using data from S&P Global

c) Risks from Riding Cyclical Tailwinds

These external pressures intersect with Malaysia's own structural realities. The strength in the recent export performance has been concentrated in sectors benefiting from strong global demand, particularly E&E. Analysis of export market-share changes reveals that the 0.23% gain by Malaysia between 2019 and 2024 reflects favourable product composition, particularly in semiconductors (Chart 16). Improvements in underlying competitiveness has been a factor, though by a lesser extent than demand factors. While specialisation in fast-growing technology segments has supported recent performance, reliance on these cyclical drivers exposes the export base to greater volatility when the tech cycle turns or when global competitors advance into the same product space.

Chart 16: Decomposition of Manufacturing Export Share in the Global Market from 2019 to 2024



Interpretation:
Malaysia's total market share increased by 23.1 basis points (bps). Of this, 13.0 bps were attributed to the product effect, with 12.2 bps specifically driven by semiconductors. This was complemented by 10.1 bps of competitiveness gains.

Source: Bank Negara Malaysia estimates based on methodology from Bonanno (2016) Constant Market Share Analysis using data from S&P Global

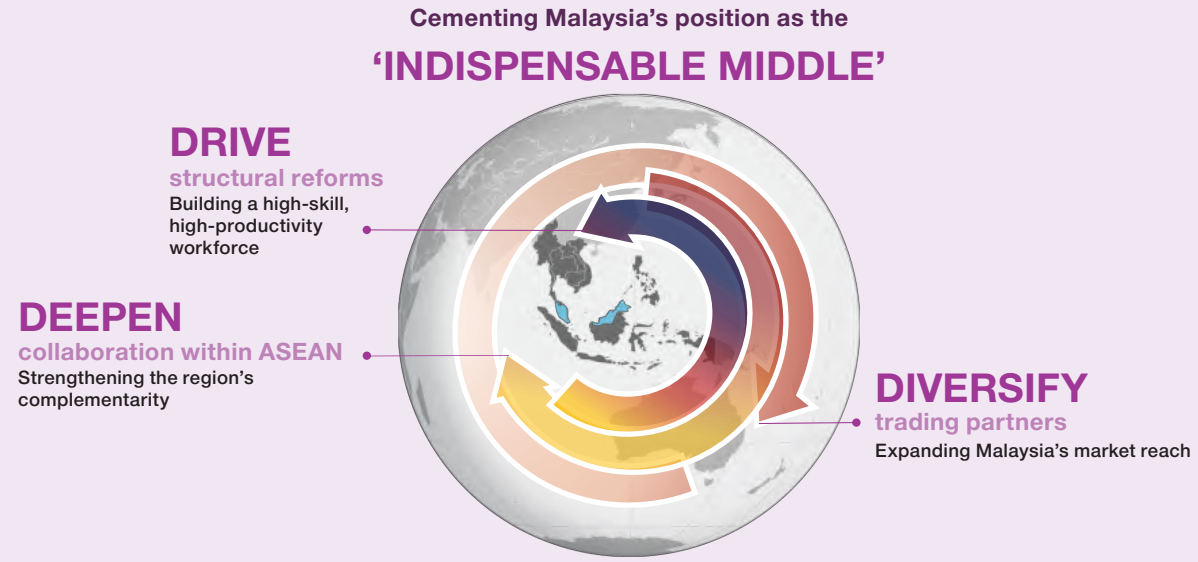
The strong do what they can, the weak adapt as they must:[8] Cementing Malaysia's position as the 'indispensable middle'[9]

In a geoeconomically fragmented environment where production networks are constantly being reconfigured, the policy impetus is not to retreat from GVCs, but to strengthen Malaysia's role within them. The strategic objective is to position Malaysia as an 'indispensable middle', a reliable, high-value node that global firms depend on for continuity, diversification, and risk management across fragmented production networks. To this end, the following three policy focus areas are proposed (Diagram 1).

[8] Paraphrasing a famous line from Thucydides' History of the Peloponnesian War, 'The strong do what they can, the weak suffer what they must'. In the context of geoeconomics, the phrase is used to describe situations where larger or more powerful economies set the rules of engagement, while smaller economies must accommodate because they lack leverage.

[9] The term 'indispensable middle' aligns with academic literature on mid-stream hubs in GVCs: countries that specialise in critical intermediate stages become essential connectors, gaining productivity spillovers and shaping how shocks propagate across economies. Alfaro and Chor (2023), for instance, documented how countries like Vietnam and Mexico have strengthened their roles as pivotal intermediaries as global firms re-route sourcing and production across multiple geographies amidst geopolitical tensions. In recent years, Liew Chin Tong, former Deputy Minister of Investment, Trade and Industry of Malaysia, has used the term to characterise Malaysia's role in the global technology and semiconductor supply chain.

Diagram 1: Policy Considerations



Source: Bank Negara Malaysia

Focus 1: Diversify trading partners: Expanding Malaysia's market reach

The concentration of Malaysia's trade flows with the US and China introduces a material vulnerability to geopolitical and trade policy shocks. A sustained effort to broaden the geographic reach of Malaysia's exports is therefore warranted. This objective is not predicated upon a retreat from existing bilateral relationships, but rather upon the prudent imperative to ensure that no single corridor of trade accounts for a disproportionate share of exports.

This requires both institutional capacity and the pre-existing market relationships to execute such a rebalancing. For Malaysia, sizeable export opportunities remain untapped beyond the US and China (share of global value added in the US: 27%, China: 17.3%). These include the European Union (16% of global value added) as well as Middle East, Latin America, and Sub-Saharan Africa, where aggregate demand for manufactured goods and intermediate inputs is expected to rise in the coming years, driven by expanding industrial capacity and growing consumption (IMF, 2025; UNIDO, 2023; ISS African Futures, 2025). Malaysia is well-positioned to deepen its presence in these under-penetrated markets by leveraging existing agreements, including the EFTA[10]–Malaysia Economic Partnership Agreement, the Malaysia–UAE CEPA[11] and the CPTPP[12] (for Mexico, Chile and Peru). This can be complemented by new exploratory initiatives such as a prospective Malaysia–SACU[13] engagement to anchor longer-term access into Southern Africa.

Beyond market diversification, Malaysia must also broaden the composition and origin of its imports, including critical minerals that underpin its electronics, renewable energy and advanced manufacturing sectors. This provides further opportunities to enhance supplier-manufacturer partnerships with mineral-rich economies across Latin America, Africa and Central Asia which could help Malaysia secure a more stable and diversified access to essential inputs, reinforcing both industrial resilience and competitiveness.

Market and product diversification is best pursued in tandem with measures to lower regulatory barriers. Existing and new trade agreements with trade partners provide a platform for this, which entails streamlining rules of origin, lowering tariffs and harmonising standards. This ensures that Malaysian firms can access new markets with fewer regulatory frictions while maintaining sufficient safeguards to protect their commercial interests.

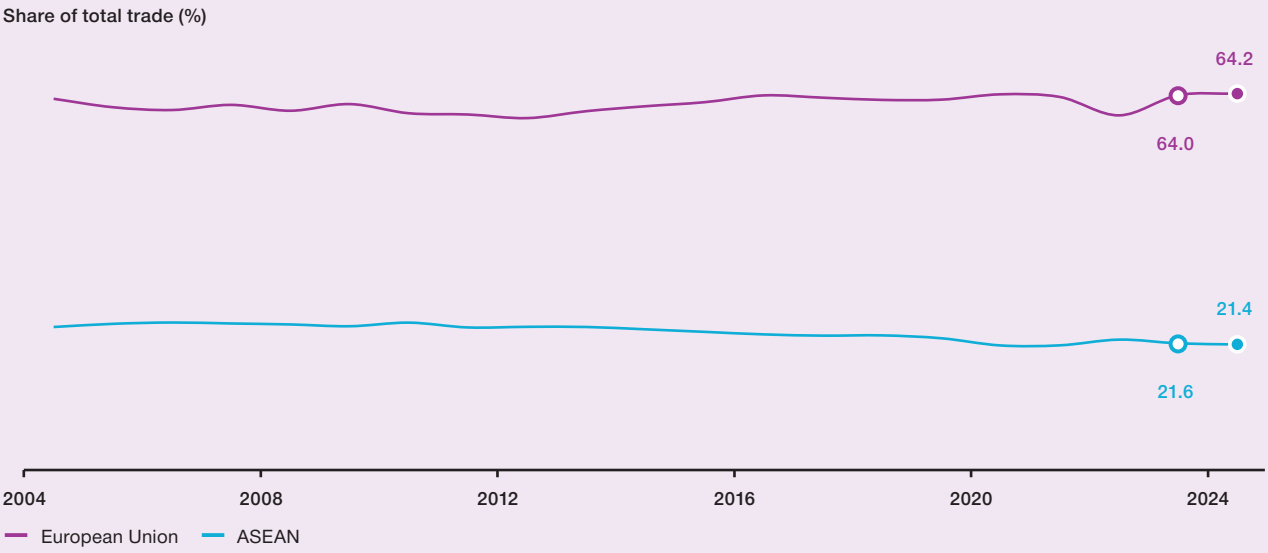
[10] European Free Trade Association comprises Iceland, Liechtenstein, Norway and Switzerland.
[11] Malaysia-United Arab Emirates Comprehensive Economic Partnership Agreement.
[12] Comprehensive and Progressive Agreement for Trans-Pacific Partnership.
[13] South Africa Customs Union comprises Botswana, Eswatini, Lesotho, Namibia and South Africa.

Focus 2: Deepen collaboration within ASEAN: Strengthening the region's complementarity

Malaysia's push to broaden the geographical reach of its trade must be matched by deeper economic integration. While diversification helps reduce market-concentration risks, it is the depth of such integration that determines how these relationships generate value. Collectively, stronger coordination within ASEAN enables member states to attract more FDIs and serves as a buffer against ongoing global supply chain risks.

Malaysia should continue to leverage on intra-ASEAN trade to fulfil growing demand from ASEAN consumers. ASEAN is the world's fifth-largest economy, with GDP set to exceed USD 5 trillion by 2030. It also boasts a young population of 670 million and is expected to add over 130 million new middle-class consumers this decade (World Economic Forum, 2020). This is an underutilised opportunity to capture a growing consumer base, yet intra-ASEAN trade has not risen materially since the early 2000s. As a reference point, the European Union (EU), a major trading bloc, has significantly higher intra-regional trade than the ASEAN region (Chart 17).

Chart 17: Intra-regional Trade Share of European Union and ASEAN



Note: ASEAN refers to Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. European Union comprises Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain and Sweden.

Source: Bank Negara Malaysia estimates using data from Eurostat and ASEANStats

Aside from serving as an additional source of demand, there is a structural impetus for greater regional integration too. A case in point, EU's high trade integration reflects its strong production complementarities and more synergistic export structures whereas ASEAN's lower integration reflects an export structure characterised by countries producing more similar goods (AMRO, 2025). Achieving greater synergistic export structure calls for higher intra-regional complementarity. To this end, intra-regional FDI is crucial to promote more targeted investments into ASEAN countries, allowing for the formation of more regionally-focused and complementary production ecosystems.

As of 2024, intra-regional FDI remains low, at 14% of total FDI stock, well below the levels observed in the EU at 51.6%.[14] These limited investment links weaken the development of durable supplier networks and cross-border backward and forward linkages, preventing ASEAN from fully realising the potential of its collective industrial base. Enhancing these investment links is therefore essential for unlocking a more cohesive, regionally-focused production ecosystem. Notably, the growing footprint of leading semiconductor multinationals across multiple ASEAN economies reflects the region's complementary strengths. This demonstrates the ecosystem's latent potential that deeper intra-ASEAN investment could help unlock and scale.

[14] Source: ASEANstats, Eurostat

ASEAN's growth demonstrated that the whole can be greater than the sum of its parts. Consequently, Malaysia can pursue its investment aspiration and contribute to the growth of ASEAN's production network simultaneously by positioning itself as part of a complementary network, rather than an isolated investment hub. This includes prioritising collaboration with its ASEAN counterparts to develop cohesive investment strategies which would enable Malaysia to harness its own distinctive capability to draw in more investments, and to also enrich the breadth and the depth of ASEAN's value chain. Special Economic Zones that combine targeted incentives aligned to the regional priorities with integrated talent development would help Malaysia to deepen its role in the specific segments of regional value chains where it has a competitive edge and build economic complexity.

Focus 3: Drive structural reforms: Building a high-skill, high-productivity workforce

The sustainability of Malaysia's GVC participation and the aspiration to become an 'indispensable middle' rest upon the capacity of the domestic economy to supply the human capital and productive capabilities required for higher-value integration. Across BNM's industry engagements, firms consistently cite high-skilled labour shortages[15] as one of the binding constraints to production expansion. This challenge is primarily observed in E&E segments, where specialised competencies face stiff competition globally. At the same time, industry stakeholders acknowledge that resolving these shortages will also require more competitive compensation packages to retain talent and to also attract Malaysia's high-skilled diaspora to return.

Addressing this structural challenge necessitates a recalibration of the approach to skills development. This includes elevating technical and vocational education and training (TVET) to genuine parity with degree-based pathways. Recent reforms reflect meaningful progress, such as legislative amendments to strengthen accreditation and recognition, and the expansion of demand-driven training through industry partnerships. However, deeper alignment with employer needs and further institutional strengthening[16] remain an important priority (Wan, C.D., 2025). Positioning TVET as a credible, high-return pathway would help attract more learners into programmes that directly match industry demand.

Beyond improving TVET, Malaysia must collaborate more closely with subject-matter experts to design and co-fund sector-aligned training. Public–private partnerships, where industry shapes curricula and contributes to training costs, will offer the most responsive model for building specialised capabilities. Existing national strategies, including the 13th Malaysia Plan, NIMP 2030 and the National Semiconductor Strategy, provide policy levers to operationalise this approach by linking incentives to expanding dual training,[17] and scaling institutional capacity. Together, these reforms will lay down a well-rooted and strong human capital foundation to pave the way for Malaysia toward becoming an 'indispensable middle'.

Conclusion

The three policy focus areas, export market diversification, deeper trade relationships and domestic human-capital-focused structural reforms create a mutually reinforcing framework rather than standalone initiatives. Market diversification strengthens resilience to external shocks, strategic, complexity-enhancing FDI supports upgrading along the value chain and a skilled domestic workforce ensures that the benefits of GVC participation are broad-based and sustainable over time.

Taken in aggregate, these strategies position Malaysia to consolidate and extend its role within GVCs at a level commensurate with its development aspirations. The aim is not merely to maintain participation in GVCs, but to become an 'indispensable middle' whose role is critical to the functioning of the broader production network. If Malaysia succeeds in securing this position, the path toward high-income status and more durable prosperity will be significantly more secure.

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15 For further details, please refer to the box article 'The Case for Labour Market Reforms in Malaysia: Challenges and Opportunities' in Bank Negara Malaysia's Economic and Monetary Review 2023.

16 Refers to ongoing efforts to strengthen governance and coordination within the TVET ecosystem, including the pending establishment of a dedicated TVET Commission along with broader reforms to align industry standards, funding and data across institutions.

17 Refers to Malaysia's National Dual Training System, an industry-driven apprenticeship model that combines practical training in real workplaces and theory in training centres to build a highly skilled workforce.

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