

Executive Summary

Economic, Monetary and Financial Developments in 2025

Despite facing considerable external uncertainties, global economic activity was stronger than expected in 2025: Global growth remained steady at 3.4% (2024: 3.3%) even as rising trade barriers and heightened policy uncertainty posed risks to the outlook. Growth in the US was supported by steady domestic demand, while the euro area continued its growth recovery amid moderating inflation and accommodative monetary conditions. In China, frontloading of exports due to tariff concerns and targeted policy support helped to sustain growth, ensuring that authorities' 2025 growth targets were met, despite ongoing weakness in the property sector and subdued consumer sentiment. Notably, global trade outperformed expectations as successful negotiations, product-specific exemptions and frontloading of shipments helped ease the impact of initial tariff developments. Strong technology-related demand, particularly the boom in artificial intelligence (AI)-related investments, lifted trade activity even as the earlier support from frontloading waned.

Global headline inflation eased in 2025: Global headline inflation moderated in 2025, supported by improving commodity supply conditions, the absence of excessive demand pressures and lower imported inflation as many currencies strengthened against the US dollar. Disinflation became more pronounced towards the second half of 2025 across most economies, reinforcing the downward global inflation trend. In the US, however, earlier disinflation proved short-lived, as tariff pass-through effects became gradually more evident as the year progressed, particularly for durable goods.

Global financial conditions loosened further amid continued global monetary policy easing in the face of tariff-induced volatility: Global financial conditions eased in 2025, supported by more accommodative monetary policy across major central banks, despite

episodic volatility arising from uncertainty over US trade measures and shifting expectations about the global monetary policy rate path. Financial market sentiments weakened early in the year following sweeping US tariff announcements. This triggered a broad sell-off in risk assets, a weaker US dollar, and portfolio rebalancing towards alternative safe-haven assets. The subsequent tariff pause and progress in trade negotiations helped stabilise markets, prompting a rebound in risk-taking activity. Towards the later part of the year, synchronous monetary policy easing by major central banks reinforced the global shift towards more accommodative financial conditions. Against this backdrop, emerging markets experienced portfolio inflows alongside currency appreciation.

The shift in global market sentiment and broad-based US dollar weakening, together with positive domestic growth prospects, contributed to a stronger ringgit and net non-resident inflows into the Government and corporate bond markets: Malaysia's financial market developments were largely influenced by shifts in global capital flows, as investors diversified away from US assets amid trade-related uncertainties and monetary policy easing in most advanced economies. Amidst these external developments and further supported by sound domestic macroeconomic fundamentals and favourable growth prospects, Malaysia continued to attract foreign inflows into the bond market. The domestic bond market benefitted from global portfolio rebalancing, with net non-resident inflows rising to RM36.5 billion (2024: RM0.5 billion), partly contributing to broad declines in domestic bond yields. Meanwhile, the equity market rebounded from the second quarter onwards amid improved global risk sentiment and strong domestic corporate earnings. In the foreign exchange market, the ringgit recorded the strongest appreciation against the US dollar in the region. Initially, this was driven by increased investor interest in emerging market assets and later reinforced by policy rate cuts by major central banks and positive sentiment surrounding Malaysia's economic outlook.

The Malaysian economy expanded by 5.2% in 2025, anchored by resilient domestic demand:

The Malaysian economy grew by 5.2% (2024: 5.1%), supported by resilient domestic demand that helped cushion the effects of a highly challenging global environment. Household spending remained firm, supported by positive labour market conditions and more targeted policy measures. Investment activity increased solidly, driven by continued progress in multi-year projects and strong investment approvals, particularly in high-technology services and advanced manufacturing.

The external sector demonstrated resilience despite shifting global trade dynamics and significant uncertainties. The current account of the balance of payments registered a higher surplus of RM31.8 billion, or 1.6% of GDP (2024: RM27.7 billion, or 1.4% of GDP). This was contributed by a continued surplus in the goods account and a turnaround in the services account into a surplus. The surplus in the goods account was underpinned by sustained electrical and electronics (E&E) exports. Malaysia's diversified export structure also provided continued resilience. While growth in intermediate imports moderated, capital imports, especially for data centre and information technology (IT) equipment, remained robust due to ongoing investment activity. The turnaround in the services account was supported by the increase in information and communications technology-related services exports and higher travel receipts. Meanwhile, the financial account recorded a higher net acquisition of foreign assets of RM21.4 billion (2024: net acquisition of RM4.9 billion) amid net portfolio outflows. This was partly offset by strong net foreign direct investment (FDI) inflows.

Headline inflation moderated further in 2025, while core inflation increased marginally:

In 2025, headline inflation moderated to 1.4% (2024: 1.8%), reflecting continued improvements in global supply conditions and the disinflationary effects of selected domestic policy measures. Softer global commodity and energy prices reduced production costs while the stronger ringgit helped contain import costs. The impact of domestic policy adjustments was also milder than expected, owing to the design of measures such as electricity tariff restructuring and the phased BUDI95 rollout, which helped cushion household cost burdens. Core inflation edged up to 2% (2024: 1.8%), driven mainly by higher-weighted services components, in line with firm domestic

demand. Nonetheless, price pressures remained contained, with inflation pervasiveness trending below historical averages.

Monetary policy remained supportive of the economy amid price stability:

The Overnight Policy Rate (OPR) was reduced by 25 basis points to 2.75% in July 2025 as a pre-emptive measure to safeguard Malaysia's growth momentum while maintaining price stability. While domestic economic conditions remained resilient, the Monetary Policy Committee (MPC) assessed that heightened uncertainties from tariff measures and geopolitical developments posed additional downside risks to the growth outlook. The benign inflation environment provided the policy space to act early. Overall, the monetary policy stance was deemed appropriate and supportive of the economy. Following the OPR reduction, banks' overall cost of funds declined in line with lower interbank and deposit rates. This, together with effective transmission to reference rates, led to lower lending rates on new and existing loans, supporting credit flows to households and businesses. Liquidity conditions in the domestic banking system also remained supportive of financial intermediation, aided by the reduction in the Statutory Reserve Requirement (SRR) ratio from 2% to 1% in May 2025.

Continued expansion of credit to the private non-financial sector:

Credit to the private non-financial sector expanded by 5.4% in 2025 (2024: 5.2%), supported by resilient domestic economic conditions and lower borrowing costs following the OPR reduction. Outstanding loans grew by 5% (2024: 5.7%). Households remained the major contributor to loan growth, supported by favourable labour market conditions, income-related policy measures and lower lending rates. For businesses, loan growth moderated following slower growth in working capital loans among non-SMEs. Nonetheless, loan growth for investment-related purposes remained above pre-pandemic levels, indicating continued strong investment momentum. Outstanding corporate bonds expanded by 6.9% (2024: 3.4%), reflecting several large issuances for capital expenditure amid lower bond yields and flexible financing structures. Overall, credit conditions remained supportive of financing needs, underpinned by banks' healthy capital and liquidity buffers. Repayment assistance continued to be available for borrowers facing debt-servicing challenges while financing facilities and credit guarantees continued to offer targeted support for SME financing.

Outlook and Policy in 2026

Global growth is expected to expand at a more moderate pace in 2026: Growth will be supported by resilient domestic demand and robust investment in technology, particularly AI. However, global trade growth is projected to slow as the temporary boost from frontloaded shipments fades and the impact of tariffs materialises. Even so, demand for E&E, machinery and equipment, AI-related exports and steady tourism activity will provide support to trade growth. Nevertheless, global growth and trade will continue to face headwinds from the uncertainties surrounding the ongoing conflict in the Middle East and higher tariffs. The prevailing disinflationary trend in global inflation now faces greater uncertainty as the Middle East conflict disrupts energy markets and supply chains, raising risks of higher inflation in 2026. Global financial conditions are projected to remain broadly accommodative, underpinned by generally supportive monetary policy. Nonetheless, central banks are expected to maintain a cautious stance amid the prospect for higher inflation arising from the Middle East conflict. Financial market sentiments will remain subject to shifts in monetary policy expectations, evolving trade and geopolitical dynamics and potential market corrections. Overall, risks to the global growth outlook are tilted to the downside. Higher tariffs could weigh on global trade flows while prolonged and more destructive conflict in the Middle East and continued supply disruptions could further push commodity prices higher, affecting financial markets, global inflation and growth. Conversely, stronger-than-expected technology spending, a milder tariff impact on growth and greater policy support in major economies present upside risks to growth.

The Malaysian economy is projected to grow between 4%–5% in 2026: Domestic demand is forecast to remain the main driver of growth in 2026 amid steady private sector spending. Household spending will continue to be underpinned by firm labour market conditions and ongoing fiscal support. Investment activity will continue to expand, albeit at a more moderate pace. While intensified competition from China's production surpluses will continue to weigh on non-E&E exports, the E&E sector will benefit from strong semiconductor demand and the ongoing realisation of data centre investments. Tourism activity is also expected to remain steady, aided by promotional efforts in conjunction with Visit Malaysia 2026 and visa exemptions for visitors from China and India. Nevertheless, the conflict in the Middle East may weigh down exports and tourism activities.

Malaysia's growth outlook remains subject to uncertainties: Overall, external downside risks could arise from weaker global trade amid the conflict in the Middle East and tariffs. The global AI momentum also remains sensitive to shifts in global financial markets, which could spill over to production and trade. Domestically, lower-than-expected commodity output may weigh on growth. On the upside, better-than-expected global growth outlook, stronger E&E demand and more robust tourism activity could provide further lift to Malaysia's growth prospects.

Headline and core inflation are expected to average between 1.5%–2.5% and 1.8%–2.3%, respectively in 2026: Inflation is expected to remain moderate and close to its long-term average. While global commodity prices are likely to be volatile amid the conflict in the Middle East, the stronger exchange rate could provide some support in containing imported costs. Domestic policy measures will also help mitigate the pass-through of global cost pressures to domestic prices. Overall, the inflation outlook will be largely influenced by external factors. Upside risks could arise from prolonged supply disruptions, trade policy uncertainty and elevated commodity prices, potentially amplified by the conflict in the Middle East and adverse weather conditions. Conversely, downside risks to inflation mainly stem from weaker global demand and softer commodity prices.

Domestic monetary and financial conditions to remain supportive of financing needs amid continued economic expansion: Credit demand will be driven by positive domestic growth and income prospects. Credit supply is likewise expected to remain forthcoming, aided by conducive funding conditions and banks' healthy liquidity and capital positions. Overall, domestic financial conditions are expected to remain broadly favourable, supported by generally accommodative global financial conditions and Malaysia's strong economic fundamentals. These factors are also expected to sustain positive investor sentiment towards domestic financial markets. External factors such as unexpected shifts in expectations around the path of US monetary policy, adjustments in valuations of AI-linked equities and heightened geopolitical uncertainties could, however, lead to periods of heightened market volatility. Even so, any spillovers to domestic financial conditions will continue to be manageable given Malaysia's strong economic fundamentals, deep domestic institutional investor base and well-capitalised banking system. BNM will continue to ensure adequate banking system liquidity to support financial intermediation and maintain orderly market conditions.

Monetary policy will continue to support sustainable economic growth, while maintaining an environment of price stability:

Monetary policy in 2026 will continue to be guided by the evolving balance of risks to Malaysia's inflation and growth outlook. The Middle East conflict is a significant development, with implications to financial markets, global inflation and growth. The overall impact on Malaysia will depend on the duration and intensity of the conflict, as well as the degree to which it

disrupts global energy production and logistics. It is important to note that Malaysia is facing the conflict from a position of strength, characterised by robust domestic demand, moderate inflation, a sound financial sector and a resilient external position. Malaysia's position as a net energy exporter also provides some buffer against external headwinds. Nevertheless, the MPC remains vigilant to developments in this conflict, to ensure that monetary policy continues to support sustainable economic growth while preserving price stability.