

Overview

Global financial market volatility moderated between October 2025 and January 2026 as expectations over US monetary and trade policies became relatively more anchored. These developments, together with continued domestic structural reforms and a softer US dollar environment, contributed to a stronger ringgit. Against this backdrop, domestic market stress eased, with the Financial Market Stress Index (FMSI) registering an overall decline during the period. The temporary late-January uptick in the FMSI mainly reflected the ringgit's stronger performance and gains in the equity market. Looking ahead, the recent conflict in the Middle East and persistent trade frictions could disrupt supply chains, exert upward pressure on prices and weigh on global growth, thereby complicating the monetary policy outlook in major economies. Amid these global uncertainties, shifts in expectations surrounding the US monetary policy path may also drive episodic volatility and heighten risk aversion, posing downside risks to domestic financial markets. Notwithstanding these risks, domestic market sentiment is expected to be supported by Malaysia's strong economic fundamentals, policy credibility and continued structural reforms. In addition, the well-capitalised banking sector, deep financial markets, and diverse investor base will continue to underpin orderly market functioning and resilience.

In the second half of 2025, business activities remained supported by resilient domestic demand amid a challenging external environment. While cost pressures persisted during the period, these were partly offset by lower imported input costs and a firmer ringgit, alongside firms' cost containment efforts. The impact of these cost pressures, however, remained uneven. Larger firms generally recorded improving operating margins given their relatively sizeable operational scale and greater bargaining capacity, whereas smaller firms faced tighter margins. Nonetheless, overall business profitability and debt-servicing capacity remained intact, with median operating margins increasing marginally to 7.5% and the interest coverage ratio remaining stable at 6.4 times. Correspondingly, the overall credit quality of business borrowings also improved, as reflected

in lower shares of impaired loans and loans with increased credit risk (Stage 2 loans). Among small and medium enterprises (SMEs), repayment stress remained confined to a small segment of borrowers with longstanding structural challenges, while the majority continued to adapt to prevailing business conditions and service their debt obligations. Resilient domestic consumption, sustained investments, steady tourism activity and sustained external demand for electrical and electronics (E&E) goods are expected to continue supporting businesses as they navigate the challenging operating environment moving forward.

Household resilience remained supported by positive labour market conditions. Household debt growth moderated slightly in the second half of 2025 and continued to be primarily driven by housing and car loans. The household debt-to-GDP ratio was stable during the period. Micro-level indicators of households' debt-servicing capacity remained sound. The median debt service ratio stood steady at 33%, while the median debt-to-income ratio, a measure of borrower leverage, remained broadly stable at 1.3 times. In the buy now pay later (BNPL) segment, outstanding exposures continued to be small at 0.3% of total household debt, although its rapid expansion warrants close monitoring. In this regard, the Consumer Credit Commission's establishment is timely and important in safeguarding consumers through the regulation and supervision of previously unregulated non-bank credit and credit service providers, including BNPL providers. Overall household credit quality remained sound, supported by prudent underwriting and affordability assessments by banks and healthy repayment behaviour among borrowers. In the near term, household credit risk is expected to remain manageable. Banks and the Credit Counselling and Debt Management Agency (AKPK) will continue to provide support to borrowers experiencing financial challenges where needed.

Conditions in Malaysia's residential property sector were broadly stable amid robust market activity and moderate house price growth. Housing transactions continued to be driven mainly by the mass-market segment (houses

priced RM500,000 and below), which accounted for around three-quarters of total transactions. Notwithstanding this, the number of unsold housing units increased throughout 2025, although these constituted a relatively small share of overall housing stock. This development reflects ongoing supply-demand mismatches, largely arising from an oversupply of units that are unaffordable for many buyers or less attractive due to factors such as location. In the non-residential property sector, oversupply in the office space and shopping complex segments persisted. Vacancy rates in these segments, while still elevated, have generally improved relative to their pandemic-induced peak in 2022. Risks to financial stability from the overall property sector remain manageable, supported by sound quality of banks' loan exposures and prudent median loan-to-value ratios.

Banks remained well-positioned to support financial intermediation, underpinned by healthy liquidity and funding positions. The aggregate Liquidity Coverage Ratio and Net Stable Funding Ratio were well above regulatory requirements at 154.8% and 115.7% respectively. Asset quality remained sound, as reflected in a low and stable gross impaired loans ratio of 1.4% and a decline in the share of Stage 2 loans to 6.1% of total banking system loans (June 2025: 6.6%). Banks maintained prudent provisioning practices, with a high loan loss coverage ratio. Banks' profitability continued to be healthy, supported by sustained interest income. The banking system also remained well-capitalised, with the total capital ratio at 18.1% and excess capital buffers amounting to RM139.3 billion.

The insurance and takaful sector similarly remained resilient. In the life insurance and family takaful segment, overall profitability softened slightly as higher net underwriting losses amid lower premium income and higher medical payouts outweighed stronger investment performance. Notably, ongoing structural reforms to address medical inflation are progressing well. The advancement in the design of the Base Medical and Health Insurance/Takaful (MHIT) Plan, a standardised and voluntary medical protection plan for the public, is a crucial first step to promote long-term sustainability of

MHIT coverage in Malaysia. In the general insurance and takaful segment, operating profits remained stable and were supported by steady underwriting performance. Overall, the insurance and takaful sector remained well-capitalised, with an aggregate capital adequacy ratio of 225% and excess capital buffers amounting to RM43.8 billion.

The latest macro solvency stress tests conducted by Bank Negara Malaysia (BNM), which incorporated additional downside risks, further affirm the resilience of financial institutions against unexpected losses from severe macroeconomic and financial shocks. The stress tests revealed that the worst post-shock aggregate capital ratios over the stress horizon for banks (15.7%), life insurers (138%) and general insurers (151%) remain above regulatory minima of 8% for banks and 130% for life and general insurers.

BNM and financial institutions continued to prioritise efforts to maintain the industry's operational resilience. To further strengthen fraud mitigation amid increasingly sophisticated malware threats targeting customer devices, the industry advanced mobile shielding capabilities and initiated a structured migration of online banking services to supported browsers and operating systems to reduce security vulnerabilities while balancing the risk of financial exclusion. Financial institutions have also been implementing updated requirements to bolster service resilience and cybersecurity following the issuance of the revised Risk Management in Technology policy document in November 2025. In parallel, BNM's targeted reviews of financial institutions' business continuity plans found that the workaround solutions adopted by financial institutions to ensure the continued availability of critical customer-facing services during operational disruptions remained generally adequate. To reinforce the resilience and efficiency of the payment and settlement systems, BNM enhanced the Real-time Electronic Transfer of Funds and Securities System (RENTAS) through the launch of RENTAS+ in late September 2025. This enables the settlement of retail payment transactions on a near real-time basis, thus greatly reducing interbank credit and settlement risks within the system.