

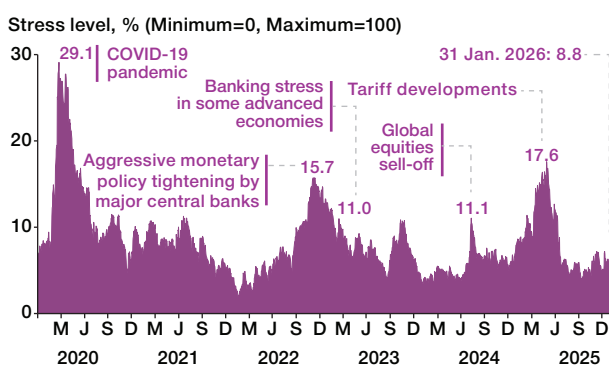
Key Developments in the Second Half of 2025

MARKET RISK

Domestic financial markets remained orderly amid lower volatility in global markets

Since the release of the Financial Stability Review in October 2025, volatility in global financial markets has moderated between October 2025 and January 2026, driven mainly by more stable expectations around the expected path of US monetary policy and some initial clarity surrounding US trade policy. Nevertheless, market sentiment remains weighed down by persistent geopolitical tensions, renewed uncertainty over US trade policies, concerns over stretched valuations in artificial intelligence (AI)-related investments and slowing growth in several major economies. Domestic market stress conditions also eased over the period. The average Financial Market Stress Index (FMSI) level declined to 5.6% between October 2025 and January 2026 (March–September 2025: 9.9%) (Chart 1.1). The FMSI registered a temporary uptick in late January 2026; however, unlike past episodes of elevated stress, this increase mainly reflected volatility associated with the strengthening ringgit and gains in the domestic equity market. These developments lifted the FMSI even as broader market conditions remained orderly.

Chart 1.1: Financial Market – Financial Market Stress Index (FMSI)

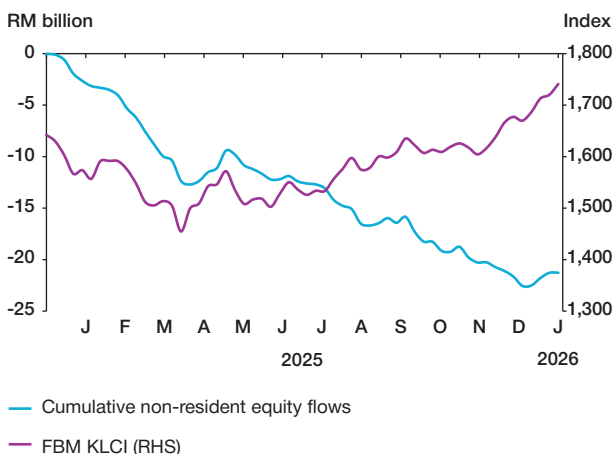


Source: Bloomberg, Reuters and Bank Negara Malaysia estimates

The domestic equity market recorded steady gains, with the benchmark FBM KLCI rising by 8% between October 2025 and January 2026 (Chart 1.2), supported by improved investor sentiment following the conclusion of Malaysia’s trade negotiations and non-tariff measures with the US in October 2025. Despite this, non-residents registered net outflows from the domestic equity market amounting to RM5.9 billion between October and December 2025, as investors shifted their investments to markets with larger exposures to technology-related stocks. In January 2026, however, non-resident flows turned positive, with net inflows of RM1 billion (March–September 2025: -RM11.1 billion), supported by growing interest in emerging markets and increased optimism over Malaysia’s economic prospects. This optimism was underpinned by resilient domestic demand, a healthy labour market and continued progress in structural reforms, including fiscal consolidation efforts, alongside the ongoing realisation of the large pipeline of approved investment projects in 2025. Domestic institutional investors¹ remained as net buyers of domestic equities, accumulating RM8.6 billion in holdings between October 2025 and January 2026 (March–September 2025: RM11.3 billion). Trading activity in the domestic equity market also remained resilient, with the average daily value traded standing at RM3.9 billion between October 2025 and January 2026 (March–September 2025: RM3.3 billion). Meanwhile, retail participation increased to 17.7% of total value traded in the domestic equity market between October 2025 and January 2026 (March–September 2025: 17%).

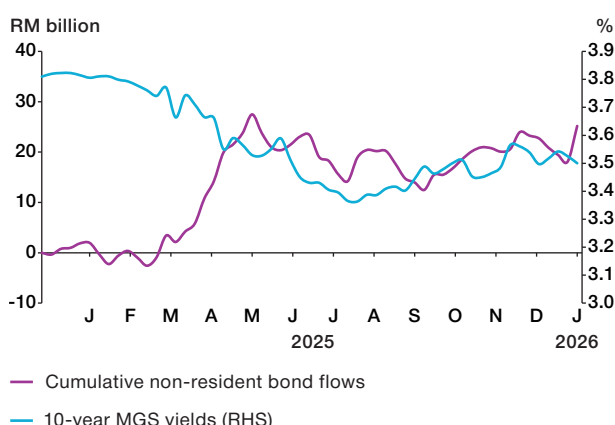
¹ Domestic institutional investors include banks, non-bank financial institutions (NBFIs) and insurers and takaful operators (ITOs).

Chart 1.2: Financial Market – Cumulative Non-resident Equity Flows and Performance of the Domestic Equity Market



Source: Bloomberg

Chart 1.3: Financial Market – Cumulative Non-resident Government Bond Flows and Performance of the Domestic Government Bond Market



Source: Bank Negara Malaysia and Bloomberg

The government bond market recorded non-resident inflows amid positive investor sentiment.

Yields on 10-year Malaysian Government Securities (MGS) increased marginally by 4 basis points (bps) between October 2025 and January 2026, averaging 3.5% during the period (March–September 2025 average: 3.5%) (Chart 1.3). The modest upward movement largely reflected expectations of a stable Overnight Policy Rate (OPR) environment. It was also broadly consistent with developments in the 10-year US Treasury yield amid firmer expectations that the US Federal Reserve would begin reducing policy rates at a measured pace. Despite the slight uptick in the 10-year MGS yields, the government bond market recorded non-resident net inflows of RM11.4 billion between October 2025 and January 2026 (March–September 2025: RM13.4 billion). These inflows were supported by improved investor confidence arising from Malaysia’s favourable macroeconomic prospects, ongoing structural reforms and fiscal consolidation measures, as well as the conclusion of trade negotiations with the US. Domestic institutional investors, including non-bank financial institutions, also registered net purchases totalling RM29.9 billion over the same period (March–September 2025: RM32.4 billion). Market liquidity remained healthy, supported by sustained demand for government bonds in the primary market, as indicated by the relatively healthy average bid-to-cover ratio of 2.2 times between October 2025 and January 2026 (March–September 2025: 2.7 times).

Conditions in the corporate bond market remained favourable to support fundraising activities. Between October 2025 and January 2026, corporates raised RM60.7 billion in new issuance (March–September 2025: RM107.3 billion). In 2025, gross issuance reached a record high (RM173.3 billion) surpassing the previous peak (2022: RM149.8 billion). Credit spreads between 10-year AAA-rated papers and 10-year MGS remained tight, averaging at 23.7 bps during the period (March–September 2025: 20.5 bps), reflecting sustained demand for high-quality corporate bonds from yield-seeking investors. Issuances continued to be concentrated in government-guaranteed and AAA-rated papers, which collectively accounted for more than half of the outstanding corporate bonds.

Total banking system liquidity declined between October 2025 and January 2026 from RM100.7 billion to RM86.7 billion. Over the same period, it ranged between RM84.5 billion and RM100.7 billion (March–September 2025: RM70.9 billion to RM108 billion). The decline primarily reflected year-end seasonal demand for banknotes as well as the lower reverse repo borrowings by banks from Bank Negara Malaysia (BNM), which partly offset the impact of capital inflows. Notwithstanding the lower banking system liquidity levels, liquidity conditions remained favourable, as reflected in the Malaysia Overnight Rate (MYOR) and the average overnight interbank rate (AOIR), which traded close to the OPR during the review period. Trading activity in the interbank markets remained robust, indicating healthy intermediation and smooth market functioning. The average daily interbank unsecured volume remained resilient at

RM6.3 billion between October 2025 and January 2026 (March–September 2025: RM6.7 billion), while the average daily interbank secured volume stood at RM1.1 billion over the same period (March–September 2025: RM1.1 billion).

Consistent with typical year-end seasonal trends, interbank rates rose slightly in the fourth quarter of 2025, before falling in January 2026 (3-month interbank rate: October–December 2025: +5 bps; December 2025–January 2026: -4 bps). The increase was notably more modest than in the same period in recent years, supported by the Statutory Reserve Requirement (SRR) reduction in May 2025 and capital inflows in the second half of 2025. The 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) spread over the OPR widened gradually from 47 bps to 53 bps between end-September and end-December 2025, before settling at 48 bps at the end of January 2026. The more favourable liquidity environment compared to the same period last year also contributed to less intense deposit competition in 2025, which helped ease upward pressure on interbank rates. Reflecting this improved liquidity condition, banks' demand for BNM's lending facilities declined, with outstanding reverse repos falling to RM24.9 billion at end-January 2026, from RM48.6 billion at the end of September 2025. Longer-term interbank rates have stabilised since January 2026, indicating that funding conditions have normalised heading into the period ahead.

Between October 2025 and January 2026, the ringgit appreciated by 6.6% against the US dollar to 3.9453, its strongest level since May 2018. Investor sentiment was positive, with market participants attributing the ringgit's performance to ongoing domestic reforms, the conclusion of trade negotiations with the US and supportive external conditions. The ringgit also strengthened against other major trading partners, as reflected in a 6.1% appreciation in the Nominal Effective

Exchange Rate (NEER). The ringgit's positive performance was aided by an overall softer US dollar, which saw the DXY declining by 0.8% over the same period. The ringgit's volatility remained manageable, with the average 1-month USDMYR implied volatility at 4.5% between October 2025 and January 2026 (March–September 2025: 5.2%). Activities in the domestic foreign exchange market also continued to remain vibrant, with average daily onshore trading volume at USD19.9 billion between October 2025 and January 2026 (March–September 2025: USD20.4 billion).

Looking ahead, Malaysia's financial markets will continue to operate in a highly uncertain global environment, shaped by ongoing developments and uncertainties surrounding geopolitical tensions and trade tariffs. In particular, the recent conflict in the Middle East could lead to greater volatility in energy markets and commodity prices. These risks, together with developments in US trade policies, could weigh on supply chains and add to global inflationary pressures, while also posing headwinds to global growth. This may complicate the monetary policy outlook in major economies, with any abrupt shifts in market expectations regarding the future path of US monetary policy potentially prompting episodes of heightened risk aversion across financial markets. Reflecting these developments, domestic financial market stress has increased, with the FMSI rising to 11% as of 9 March 2026. Taken together, these dynamics point to a challenging operating environment that could heighten global market volatility and spill over into domestic financial markets. Nonetheless, Malaysia's strong economic fundamentals and ongoing domestic structural reforms are expected to provide support to domestic market sentiment. At the same time, the well-capitalised banking sector, deep and liquid financial markets, as well as diversified investor base are expected to continue supporting orderly market functioning and resilience.