Trump's Tariff on Malaysia

Deploying leverage for a win-win outcome, minimising the impact on the economy

OVERVIEW

- **Tariff tantrum.** The global market remains in turmoil, with little distinction between noise and signal whenever President Trump reacts to retaliations in response to his sweeping and country-specific tariffs. While Washington claims over 70 countries are willing to cut a deal, tensions with China continue to escalate.
- **Global institutions have sounded alarms** over rising trade tensions. The WTO warns of an 80.0% drop in US-China trade and lasting damage to global trade systems. The World Bank flags rising costs and investment risks, while the IMF cautioned last year that global growth in 2025 could be reduced by 0.8 ppts.
- **Malaysia's bargaining chips.** To escape legacy Trump-era tariffs (25.0% steel, 10.0% aluminium, 15.0% solar) and the new 24% reciprocal levy, Malaysia must leverage its strengths: a key role in US tech and semiconductor supply chains, critical rare earth processing capabilities, and healthcare exports.
- **Flipping the narrative from trade friction to strategic alignment.** The playbook: align with US economic and security interests, and emphasise that tariff relief strengthens alliances—not just lowers import costs.
- **Strategic leverage:** US tariffs on Malaysia reflect strategic and economic motives. Malaysia can counter by highlighting its role in critical supply chains, offering a stable "China+1+1" alternative, pursuing reciprocal trade concessions, and leveraging its 2025 ASEAN Chairmanship to promote open, rules-based trade—positioning itself as a key US ally deserving tariff relief.
- **Banking on domestic demand.** Malaysia's domestic-oriented sectors—services and construction—can help buffer growth against rising external headwinds. Strong consumer spending, a rebound in tourism, and sustained public investment in infrastructure will support GDP growth, keeping our 2025 growth forecast at 4.8% (2024: 5.1%), despite mounting global risk.
- **Harnessing exports headwinds.** While Trump's renewed tariffs and US-China trade tensions pose risks to Malaysia's export outlook, it remains well-positioned to benefit from trade diversion in select sectors. We maintain our 2025 export growth forecast at 5.0% (2024: 5.7%), supported by frontloading activity in 1H25 and ongoing intra-ASEAN trade. However, export headwinds may intensify post-2025 as global trade slows, and policy impacts take hold.
- **Malaysia's inflation to remain anchored despite global tariff shifts.** Headline CPI is forecast at 2.7% in 2025, with subsidy reform as the main upside risk. BNM is likely to hold rates unless growth falls toward 3.0% in 2H25, which would increase the case for a rate cut.
- **The ringgit's stability hinges on tariff dynamics, Fed easing and capital inflows.** A weaker USD—driven by trade shocks and rate cuts—could support emerging markets (EM) FX. However, geopolitical currency realignments, such as a potential "Mar-a-Lago Accord," may trigger volatility. In a shifting capital order, Malaysia's best defence is strategic agility—not alignment.
- **Bond bulls are sniffing around.** Trump's tariff threats have shaken global markets, and ironically, it made Malaysia Government Securities (MGS) look less risky by comparison. With US Treasuries in turmoil and the USD wobbling, MGS offers yield and stability, especially with BNM keeping a steady hand. As investors shift away from US assets, demand for MGS is expected to remain firm, with yields likely to trend lower amid rising growth risk.

CONTEXT

- **Unleashing chaos**. On 2 April 2025, President Donald Trump reignited global trade tensions with a sweeping trade proposal in his "Liberation Day" speech. He announced a 10.0% universal tariff on all US imports while targeting a list of countries and higher, country-specific tariffs targeting both strategic rivals and long-standing allies. China was hit hardest, with an additional 34.0% tariff, bringing the total tariff rate to 54.0%.
- **Trampoline of unpredictability** Just days later, on 9 April, Trump switched its approach by suspending the country-specific tariffs and instead implementing a 10.0% universal tariff for most countries for a 90-day consultation period. However, it escalated tariffs on Chinese goods to 125.0% following Beijing's swift retaliation. Then it clarified that the actual tariff on Chinese goods is 145.0%. Barely 48 hours later, China raised additional tariffs on US goods to 125.0% from 84.0%, stating this would be its final increase.
- **Playing Trump's game.** Although being a small, open emerging economy, **Malaysia may still have a few bargaining chips to secure a win-win deal with US negotiators in Washington DC**. It will be tough, but first, it must overcome the initial hurdle: securing a meeting with President Donald Trump and his inner circle, as over 70 nations are also vying for a spot. Since Malaysia has already signalled its openness to negotiation and ruled out retaliation, it may now have a better chance to put its bargaining chip on the table.

RETALIATORY MEASURES AND RESPOND

- **China's** response has been swift, aiming to match if not catch up to impose tariffs on American imports. Chinese authorities also threatened to expand export controls on critical minerals used in smartphones and electric vehicles, disrupting the US and global supply chain. Additionally, China also tightens regulations on more than a dozen US companies operating in China.
- The **European Union (EU)** announced retaliatory tariffs on EUR21.0b (USD23.0b) worth of US goods on April 9, 2025, responding to US steel and aluminium tariffs, just hours before Trump announced a 90-day consultation period. The measures target items that can be sourced from other markets like motorcycles, poultry, fruit, wood, and clothing while minimizing EU economic disruption and applying political pressure on Trump's support base. Despite this, the EU emphasized its preference for a negotiated solution and remains open to restoring stable trade ties with the US.
- In contrast, **ASEAN** took a non-retaliatory approach. In a joint statement on 10 April, ASEAN economic ministers emphasised the importance of open, constructive dialogue and committed to maintaining a balanced and sustainable economic relationship with the US. They reaffirmed ASEAN's intention to work with the US under the ASEAN-US Trade and Investment Framework to enhance two-way trade, investment flows, and supply chain resilience, particularly through digital innovation, while framing the US as a longstanding and valued economic partner.

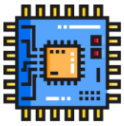
INSTITUTIONAL WARNINGS

- The **World Trade Organization (WTO)** warned that these developments could reduce US-China bilateral trade by up to 80.0% and significantly weaken global trade flows. The WTO also cautioned of long-term consequences such as reduced multilateralism, permanent trade fragmentation, and declining global productivity. However, we expect it would revise its October 2024 outlook, which projected earlier a 2.0% increase in world merchandise trade volume for 2025, up from 2.7% forecast for 2024. WTO is expected to release the global trade outlook this month.
- The **World Bank**, in its Global Economic Prospects in January, flagged "serious and sustained headwinds" for the global economy. It warned that higher tariffs would raise costs for businesses and consumers, reduce cross-border investment, and increase the risk of supply chain disruptions. Despite these risks, the World Bank projected global growth at 2.7% in 2025-2026, maintaining a stable growth trajectory that has remained unchanged since 2023. Given the latest developments, we may not be surprised if the World Bank revised this forecast in its scheduled June forecast updates.
- **The International Monetary Fund (IMF)** in its October World Economic Outlook Update warned last year that higher tariffs could reduce global output by 0.8 ppts. It projects global growth at 3.3% for 2025 in January World Economic Outlook Update (previously 3.2%), but we expect it to revise the forecast downward in its April World Economic Outlook Update.

MALAYSIA'S BARGAINING CHIPS IN US TRADE NEGOTIATIONS

- Malaysia can leverage strategic partnerships and key economic sectors to encourage the US to ease punitive tariffs. Facing legacy Trump-era tariffs on steel (25.0%), aluminium (10.0%), solar panels (15.0%), and a new 24.0% "reciprocal" tariff (announced April 2, 2025), Malaysia's best strategy is to capitalise on areas valued by the US, such as reliable supply chains and geopolitical cooperation. Key bargaining chips or leverage areas include:

KEY LEVERAGE AREAS

				
ELECTRONICS HUB	**SEMICONDUCTOR SUPPLY**	**RARE EARTH ELEMENTS**	**RUBBER GLOVES**	**SECURITY & GEOPOLITICS**
• Major exporter to US tech industries • Stable alternative to China • Partnership opportunities via “friend-shoring”	• Supplies 20.0% of US chip imports • Vital to US automotive and tech sectors • Strategic role in supply chain diversification	• Home to the largest REE plant outside China • Provides secure supply for US defence • Key to addressing US critical mineral dependency	• World’s top producer, essential to global healthcare • Supports preferential US market access • Critical input for US healthcare supply chains	• Partner in Indo-Pacific security cooperation • Aligns with tightened tech-export controls • Supports US strategic interests in the region

– **Electronics Manufacturing Hub**. Major electronics exports (39.9% of total exports in 2024) and a central role in US tech supply chains offer supply chain security and alternatives to Chinese sourcing.

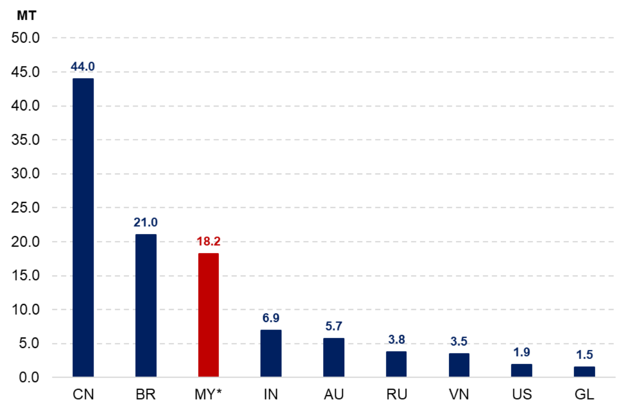
- **Supply Chain Dependence**: Many US firms depend on Malaysian electronics components. Continued tariffs risk harming US companies and consumers, which strengthens Malaysia’s negotiating position.
- **Friend-Shoring Opportunities**: Offering to host increased US electronics production supports US supply-chain resilience, encouraging tariff removal.
- **Cost and Quality Advantages**: Tariffs reducing competitiveness of Malaysian products might push US buyers toward China, contradicting US strategic goals.
- **Proactive Measures**: Adopting voluntary export limits or rigorous origin checks, similar to South Korea’s steel approach, builds credibility for tariff relief.

– **Semiconductor Supply Chain Role**: Producing 20.0% of US semiconductor imports, Malaysia can secure tariff exemptions through "friend-shoring" and semiconductor cooperation, similar to South Korea’s approach with steel.

– **Rare Earth Elements (REEs)**: Malaysia holds a unique position in this realm. It is home to the **Lynas Advanced Materials Plant in Kuantan – the largest rare earth processing facility outside of China.** It gives Malaysia a **rare bargaining chip**: something the US genuinely needs for its EVs, defence, and high-tech. This presents not just an industrial opportunity, but a geopolitical bargaining chip especially if China tightens export controls further (China has supplied ~78.0% of US rare earth imports in recent years). By leveraging that need – through guarantees of supply, partnership offers, and strategic alignment – Malaysia can push for reductions in tariffs, framing it as a win-win: strengthen US critical supply chains while normalizing trade.

- **Supply Chain Security**. Offering the US a reliable non-Chinese rare-earth source directly addresses US strategic supply chain vulnerabilities.
- **Friendshoring Advantage:** Amid renewed geopolitical fault lines, Malaysia aligns with Washington’s “friendshoring” strategy. Strengthening rare-earth ties would reinforce Malaysia’s image as a trusted partner, reducing the appetite for trade penalties.
- **Joint Development**: Inviting US companies into joint ventures to tap Malaysia’s reserves reinforces mutual economic interests, discouraging punitive tariffs. Encouraging US firms to participate in upstream and midstream ventures—such as exploration, refining, and

Graph 1: Countries with Highest Rare Earths Reserves



Source: US Geological Survey, MITI, Kenanga Research

**Note: Malaysia’s figure is sourced from the New Industrial Master Plan 2030* advanced material processing—ensures shared economic interests and deepens bilateral interdependence.

- **Security Angle**: Ensuring reliable rare-earth supplies for US defence contractors provides strong leverage against tariff actions. Rare earths are critical to US defence applications, including missiles, radars, and fighter jets. A stable Malaysian supply chain supports Pentagon objectives, making tariff escalation strategically counterproductive.

– **Rubber Gloves**: Recent US tariffs targeting Chinese medical imports, including gloves, could shift demand towards Malaysian suppliers. This scenario positions Malaysia advantageously to negotiate trade terms, potentially leveraging glove exports for tariff relief. Furthermore, as the world's largest producer, with global market share of around 45.0% in 2024, Malaysia holds strong leverage and can offer preferential glove supply to negotiate tariff reductions. The US is the world's largest importer of rubber gloves in 2023 (About USD6.0b).

– **Geopolitical and Security Alignment**: Strengthening security ties (e.g., Indo-Pacific cooperation) and export controls aligns Malaysia with US strategic priorities, incentivising tariff relief. Nevertheless, it still needs to uphold a neutral, non-aligned foreign policy while remaining an active contributor to regional peace and economic resilience. Constructive engagement with all partners, including the US and China, reinforces Malaysia's credibility as a trusted intermediary in an increasingly multipolar landscape. Such positioning could support efforts to ease trade frictions and secure mutually beneficial outcomes, including tariff relief.

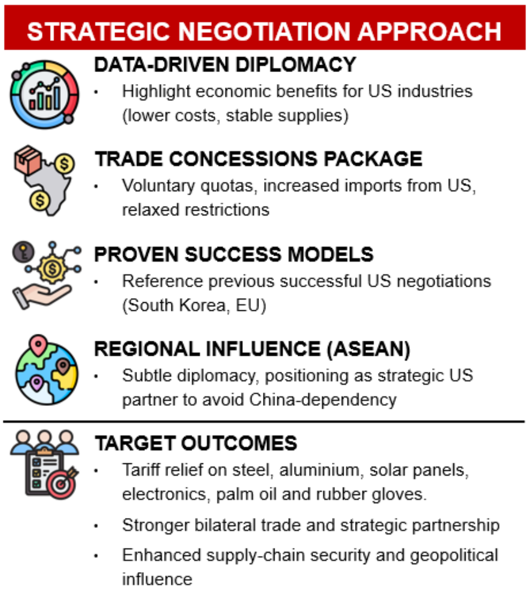
- Using these leverage points through quiet diplomacy, targeted concessions, and supply chain partnerships, Malaysia can effectively negotiate tariff rollback. There is a high possibility that the US will reciprocate if it perceives tangible benefits such as reshoring support, reduced reliance on China, and security cooperation.

- **Strategic Leverage and Context**. US tariffs on Malaysia reflect both economic and strategic motives. Malaysia's response should emphasise its strategic value through:

– **Critical Supply Chain Partnership**: Malaysia's integration into global supply chains significantly impacts US industries. Highlighting how tariffs disrupt these chains, inflating US consumer and business costs, could persuade Washington to reconsider tariffs.

– **Offering "China+1+1" Supply Chain Diversification Model**: With the US keen to diversify away from China and Vietnam (the original +1), Malaysia can offer a stable "friend-shoring" destination for critical products presents a valuable alternative to reliance on strategic competitors. It can offer better access to Western markets, FTAs of trade treatment than the original +1s especially in electronics, semiconductors and medical supplies.

– **Trade Concessions and Market Access**: Malaysia can address US trade imbalance concerns through reciprocal actions, including selective tariff reductions, increased US imports, or quotas, mirroring South Korea's steel quota arrangement.



– **Security and Diplomatic Cooperation**: Enhanced security and diplomatic alignment, including cooperation on sensitive tech exports and defence activities, positions Malaysia as an essential ally, deserving tariff relief.

– **Multilateral Platform Leverage**: As ASEAN Chair in 2025, Malaysia is well-positioned to promote rules-based, inclusive trade diplomacy. Leveraging its regional influence, Malaysia can underscore the value of economic stability and open market access for all major partners — including both the US and China. While not aimed at any one country, a coordinated ASEAN approach could enhance the bloc's collective bargaining power in global trade settings. With a combined GDP of USD3.6t and a population exceeding 650.0m, ASEAN represents a strategic trade partner in its own right.

- Combining these approaches provides a coherent framework for a "grand bargain": Malaysia supports US strategic objectives in exchange for fairer market access.

- **Deploying Leverage Effectively.** Malaysia should integrate these bargaining chips into a unified negotiating strategy:

– **Bilateral Diplomacy with Data**: Present a detailed case showing how US industries (from auto manufacturing to defence to consumer goods) would benefit from tariff removal.

– **Concession Packages**: Offer a bundle of concessions, such as a steel export cap or increasing imports of US goods.

– **Highlighting Precedents:** Point to cases where Washington recalibrated tariffs following constructive diplomacy—such as South Korea's steel quota arrangement or the US-EU accord on steel and aluminium.

– **ASEAN and Multilateral Context:** Subtly remind the US that continued tariff pressure could push Malaysia and neighbours closer to China's orbit.

- Malaysia's objective is shifting US perceptions from confrontation to collaboration, creating a mutually beneficial trade relationship through effectively deployed leverage.
- Malaysia can't afford to wait and hope the tariffs go away. If Trump 2.0 is back, **it needs to be first in line, not last on the list.** That means bold, strategic, and business-savvy diplomacy — with the right mix of pressure, partners, and pragmatic deal-making.

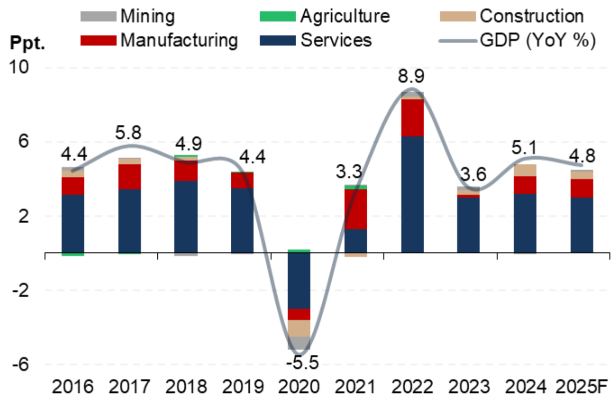
GROWTH OUTLOOK

- **GDP Growth: Domestic sectors expected to act as a stabiliser amid rising external headwinds**

– Malaysia's domestic economy has shown resilience, supported by solid consumer activity, a rebound in tourism, and steady expansion in the services sub-sector as a result of the quality investment and structural shift in the domestic economy post-COVID-19 pandemic.

– The services sector will remain a key growth driver, bolstered by rising tourism inflows, with Malaysia aiming for 31.4m tourist arrivals (2024: 25.0m). Ongoing promotion efforts, strong household spending on improved income, and recovery in retail, hospitality, and transport will sustain growth. The return of international tourists, mainly from China, India and ASEAN has already begun to lift accommodation, F&B, and entertainment sectors, offsetting weakness in export-driven manufacturing.

Graph 2: GDP by Industry (Kenanga Forecast)

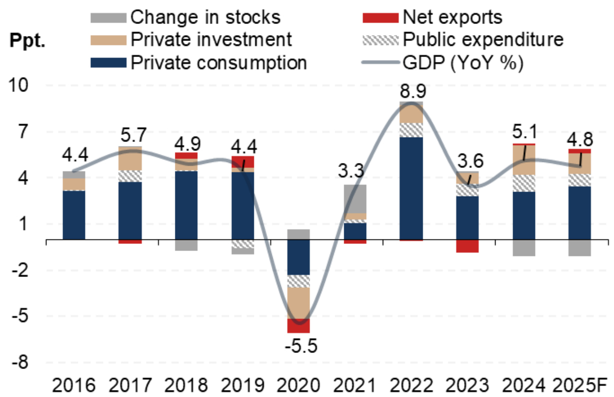


Source: Macrobond, BNM, Dept. of Statistics, Kenanga Research

– **The services sector's contribution to GDP could surprise positively, potentially returning** to **pre-pandemic levels** (2019: 3.5 ppts; 2018: 3.9 ppts). However, we maintain a conservative forecast of 3.0 ppts for 2025 (2024: 3.2 ppts). Malaysia's domestic economy is poised to move toward higher value-added activities, with increased adoption of digital and AI technologies expected to boost productivity.

– On the expenditure side, **private consumption and public investments** remain key growth drivers. The government's focus on infrastructure and the digital economy, supported by various national policy frameworks such as NIMP2030, NETR, and the upcoming 13th Malaysia Plan (13MP), should sustain investment momentum and act as a buffer against external shocks. More importantly, a stable domestic political environment and clear government policy direction would ensure support in implementing and executing the plans. **The government has room to embark on fiscal measures** should the economy head south, including targeted support for affected sectors, reducing the overall risk of a potential downturn while committed to its fiscal consolidation path.

Graph 3: GDP by Expenditure (Kenanga Forecast)



Source: Macrobond, BNM, Dept. of Statistics, Kenanga Research

– However, there are growing risks of a downgrade to our growth forecast, particularly in 2H25, especially if exports decline and dampen the export-driven manufacturing sector. Risks include uncertainty surrounding Trump's tariffs, escalating US-China trade tensions, and the potential for a global slowdown due to higher tariffs. This could weaken external demand and affect Malaysia's export-oriented sectors. The impact may be mitigated by a recovery in domestic manufacturing, which appears insulated from external development.

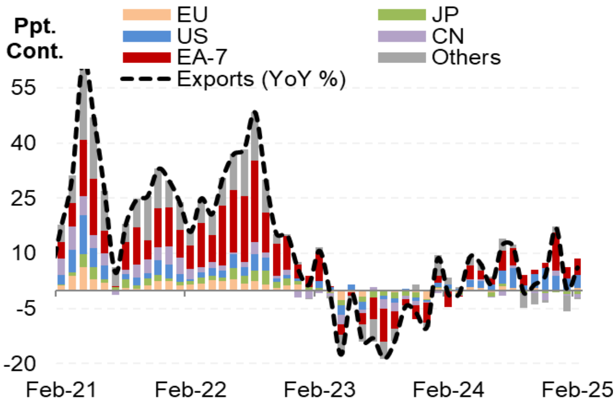
– Malaysia's diversified growth base and ongoing reform under the Madani government will continue to support the economy. Domestic demand and services-led activity are expected to provide a buffer to the economy against external headwinds, allowing us to **maintain our 2025 GDP growth forecast at 4.8% (2024: 5.1%) for now.**

- **External Trade: Export outlook under pressure, but opportunities remain**

– Malaysia's high exposure to international trade makes it vulnerable to the impact of Trump's tariffs. With both the US and China among Malaysia's top three trading partners, the country is susceptible to both direct and indirect spillover effects from a prolonged trade conflict between the two giants.

– Nevertheless, Malaysia's neutral stance, strategic location, pro-trade and investment policies, and capacity to substitute production for key global items could present opportunities. Key sectors benefiting from this include:

Graph 4: Malaysia Exports Trend by Destination



Source: Macrobond, BNM, Dept. of Statistics, Kenanga Research

- **E&E sector:** 39.9% of total exports in 2024 (2023: 40.3%), central to global supply chains. Malaysia leads in integrated circuits (ICs) and microchips, sensors and transistors, and automated machinery components.

- **Rubber gloves**: Malaysia is the largest global exporter of rubber gloves whereby several local companies dominating the global glove market.

- **Palm oil**: The Second largest global producer and exporter of palm oil after Indonesia, with key exports product of crude palm oil, oleochemicals, and processed food-grade oils.

- **Petroleum and petrochemicals**: Major exporter of refined petroleum, LNG, and downstream petrochemical products such as plastics and resins.

- **Medical devices**: Includes catheters, surgical instruments and diagnostic tools.

– A slowdown in global demand, especially from the US may reduce Malaysia's export volumes, potentially dragging down industrial production and impact job creation in key export-driven regions such as Penang, Johor, and Selangor. However, the impact is expected to be contained, as Malaysia could benefit from trade diversion in sectors where it holds a comparative advantage such as semiconductors, medical devices and palm oil.

– There is still room for Malaysia's exports to expand in 2025, building on the moderate rebound recorded last year. Additionally, ongoing efforts to enhance intra-ASEAN trade and diversify its exports beyond traditional markets could further strengthen its external sector.

– Nevertheless, we acknowledge the worst-case scenario where exports contract. Historically, over the past four decades, Malaysia's export growth has experienced contractions, typically during major global demand and supply shocks, rather than tariff-driven disruptions. These highlight Malaysia's historical vulnerability to external shocks, but also its capacity to recover and adapt, supported by targeted trade policies, strong regional linkages, and competitive export-driven sectors. Historical contractionary periods include:

- **1985-1986:** Export growth declined by 1.4% and 7.2%, respectively, following a collapse in global commodity prices.

- **2001:** Exports contracted by 10.4% amid the global tech bubble burst and mild recession in the US.

- **2009:** Exports plunged by 16.7%, the sharpest drop in history, due to the Global Financial Crisis (GFC).

- **2019-2020:** Export growth declined by 0.8% and 1.1%, respectively, due to the COVID-19 pandemic.

- **2023:** Exports fell by 8.0%, reflecting a high base effect following pent-up demand in the post-pandemic reopening phase.

– Despite these risks, **we maintain our export growth forecast at 5.0% for 2025 (2024: 5.7%)**, expecting moderate expansion. While this points to a modest expansion, we do not anticipate a sharp downturn in the near term, as global supply chains may recalibrate rather than collapse.

– Frontloading activity in 2Q25 is expected as businesses accelerate shipments ahead of potential tariff implementation, taking advantage of the 90-day consultation window. While this surge may not be sustained in 2H25, stronger 1H25 performance should be able to partly support our full-year forecast.

– The real concern lies beyond 2025, when the full effects of heightened trade tensions, retaliatory measures, and further tariff escalation could take a toll on trade. As such, global trade could face a more pronounced slowdown in 2026, raising downside risks for Malaysia's medium-term export outlook, but the tariff impact may normalise as American consumers adapt to the new tariffs.

INFLATION, RATES, CURRENCY AND BOND MARKET OUTLOOK

- **Inflation forecast anchored; reform still viable**

  – Tariffs, by design, distort price signals. As outlined in our earlier note on Trump's trade policy pivot, the imposition of import duties often leads to higher production costs for import-dependent sectors which can stoke inflation when passed on to consumers. However, the inflationary impact of tariffs depends critically on the pass-through capacity of firms, demand elasticity, and the availability of alternative supply chains.

  – In the US, inflationary pressures are expected to rise modestly, particularly if the tariff differentials between China and other exporters continue to disrupt input costs. Compounding this is the relative softening of the USD, which may contribute to higher import prices at the margin. In contrast, Malaysia should remain largely insulated from these direct inflationary pressures, at least in the near term. The ringgit has held relatively stable, mitigating any pass-through effects from higher import prices.

  – Moreover, Trump's move to temporarily reduce tariffs to 10.0% for most countries, while maintaining high duties on Chinese goods, creates a bifurcated trading environment. The diversion of Chinese exports to non-US markets, including ASEAN, could bring disinflationary effects for Malaysia. This may depress input prices through dumping but could also increase competition for domestic producers, particularly in manufacturing subsectors such as steel, textiles, and intermediate electronics.

  – Baring an unprecedented supply shock, we maintain our 2025 headline inflation forecast at 2.7% (2024: 1.8%), reflecting modest domestic price pressures. The primary upside risk stems from an anticipated RON95 subsidy rationalisation in 2H25. While politically sensitive, the current low Brent price (currently around USD65/barrel) environment provides a strategic opportunity for reform. Implementing it amid a period of global trade flux could be framed not as austerity, but as prudent fiscal housekeeping—supporting expenditure reprioritisation and improving the fiscal deficit trajectory. A commitment to reform amid external uncertainty could enhance sovereign credibility and re-anchor medium-term inflation expectations.

- **BNM to keep rates steady amid tariff turbulence**

  – BNM is expected to maintain its data-dependent stance. If real GDP growth holds above the 3.5% threshold, we believe the OPR will likely remain unchanged. However, if spillovers from the tariff dispute begin to weigh significantly on domestic demand, bringing growth towards the 3.0% range in 2H25, a rate cut would become more probable. However, the probability in the near term remains low, as policymakers are likely to favour a targeted approach and preserve the OPR for future shock, while balancing price stability and growth sustainability.

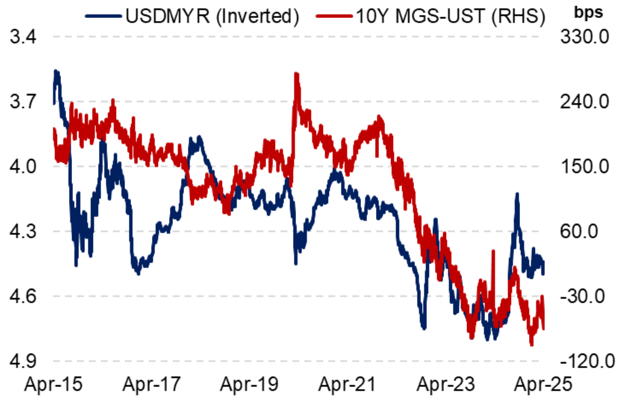
- **The ringgit's delicate balance amid tariffs, Fed shifts and US policy maneuvering**

  – We maintain our year-end USDMYR forecast at 4.45, premised on a confluence of global and domestic dynamics. Much hinges on the post-90-day tariff pause and how the US-China trade impasse evolves. The market expects the Fed to deliver 4–5 rate cuts by end-2025 in response to softening demand indicators. However, Fed Chair Powell has emphasised the asymmetric risks of both elevated unemployment and persistent inflation, suggesting the Fed will proceed cautiously.

- As the USD structural advantages erode. Trump's tariff agenda may push the US closer to demand-side stagnation, weakening the USD. This would benefit EM currencies, including the ringgit, particularly if Malaysia's export mix remains resilient. A diversified trade structure and continued inflows into local currency debt market should support the currency despite external challenges.

- The shift in global capital allocation also works in Malaysia's favour. As fixed-income investors increasingly looking to reallocate from the US to other markets in search of real yields, Malaysia's bond market—backed by improving fiscal discipline and reform signals—should attract stable inflows. A credible path toward subsidy rationalisation would further support local debt, lower term premiums, and reinforce confidence in Malaysia's medium-term fiscal consolidation strategy.

Graph 5: USDMYR and 10Y MGS-UST Yield Differential



Source: Bloomberg, Kenanga Research

- Beyond tariffs and interest rates, a deeper strategic game may be at play. Over the past decade, central banks have accelerated their diversification away from USD-denominated reserves into gold. This reflects both geopolitical hedging and a reassessment of the USD's long-term purchasing power.

- Trump may seek to counter the de-dollarisation trend, using tariffs as leverage to restore USD holdings to above 60.0% of global reserves. One plausible scenario is the emergence of a so-called Mar-a-Lago Accord—a play on the 1985 Plaza Accord—where the US uses informal diplomacy to pressure trading partners to rebalance currency valuations in its favour, weakening the USD in real terms without sacrificing its global dominance. This would boost US net exports and address the twin deficits through terms-of-trade manipulation rather than fiscal restraint.

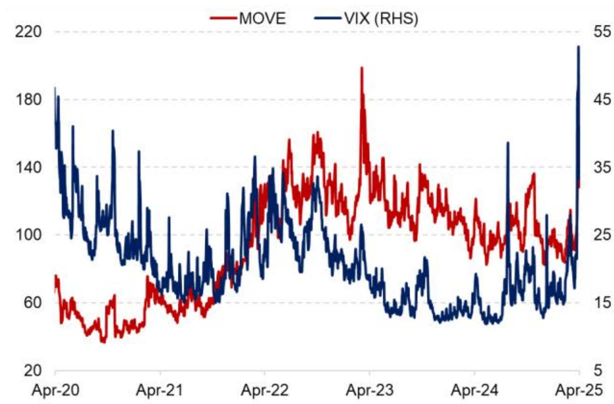
- If such an accord materialises, export-dependent nations like Malaysia would face a complex calculus: the short-term benefit of export competitiveness from a weaker USD versus medium-term risk of currency realignment and capital flow volatility. Policymakers and investors must remain agile, responding to shifts in global policy while staying anchored in fundamentals.

- **Tariffs, Treasuries, and Turbulence: Reading the tea leaves for Malaysia's bond market**

  - Global markets are once again caught in the crosscurrents of policy risk, as the Trump administration's latest tariff salvo has reignited fears of a return to economic nationalism. In tandem, US Treasuries—long considered the ultimate safe haven—have begun behaving more like risk assets, rattled by inflation angst, fiscal uncertainty, and rising geopolitical stakes. For Malaysia, this confluence of shifting capital flows and policy recalibration merits closer scrutiny.

  - The sharp repricing of US Treasuries in early April—where 10-year yields surged from 3.90% to above 4.30% in just days—mirrored a market reassessing both macro resilience and escalating political risk. Fed Chair Jerome Powell's reaffirmation of a data-dependent stance tempered hopes of imminent rate cuts. Treasury auctions, while well received, failed to reverse the broader mood: renewed trade frictions are now feeding a more volatile mix of inflationary concerns and growth anxieties.

Graph 6: The MOVE and CBOE Volatility Index



Source: Macrobond, Kenanga Research

  - Importantly, the traditional flight to Treasuries during global turmoil appears to be losing its gravitational pull. A growing chorus of global investors is recalibrating, turning instead to markets with more predictable policy backdrops—such as Europe and Japan. This shifting tide suggests that a portion of global capital may increasingly rebalance toward home markets or into assets perceived as relatively more insulated from US political volatility.

- Malaysia, while not immune to global risk-off sentiment, has held up comparatively well. The echoes of 2018–2019 are unmistakable: back then, both 10-year MGS and UST yields trended lower following each escalation in US-China tariffs, with Malaysia's yields declining more moderately due to domestic resilience. Today's landscape is more nuanced. Inflation remains elevated globally, and monetary conditions are tighter. Yet, the pattern of investor defensiveness is re-emerging, albeit with greater selectivity.
- Crucially, the 90-day exemption period offered to selected countries, including Malaysia, presents a diplomatic window that could alter the trajectory of escalating trade tensions. If the Ministry of Finance and MITI can effectively leverage this window to broker a favorable arrangement with Washington, the worst-case scenario may still be averted. Market sentiment, though cautious, is beginning to price in such an outcome.
- Against this backdrop, Trump's tariff threats continue to roil global markets and inject fresh volatility into US Treasuries, prompting investors to reassess risk across fixed income assets. Ironically, this has made the MGS appear less risky by comparison. With the dollar wobbling and US yields swinging amid shifting policy expectations, MGS is benefiting from a flight to relative safety.
- Malaysia's macroeconomic fundamentals add further support. BNM's steady policy stance, a stable sovereign rating outlook, clear signals of fiscal consolidation, and ongoing reforms have helped anchor investor confidence. As global investors seek predictable returns and geopolitical diversification, Malaysia offers a compelling mix of yield premium and policy stability. These fundamentals, coupled with the relative predictability of BNM's policy stance, should continue to support local bond demand. Hence, **demand for local bonds is expected to remain firm, and we expect 10-year MGS yields to trend toward 3.83% by year-end, as the market shifts its focus from inflation fears to broader concerns over slowing global growth and strategic capital realignment.**

For further information, please contact:

Wan Suhaimie Wan Mohd Saidie
Head of Economic Research
wansuhaimi@kenanga.com.my

Muhammad Saifuddin Sapuan
Economist
saifuddin.sapuan@kenanga.com.my

Afiq Asyraf Syazwan Abd. Rahim
Economist
afiqasyraf@kenanga.com.my

Nurul Hanees Hairulkama
Economist
nurulhanees@kenanga.com.my

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Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my