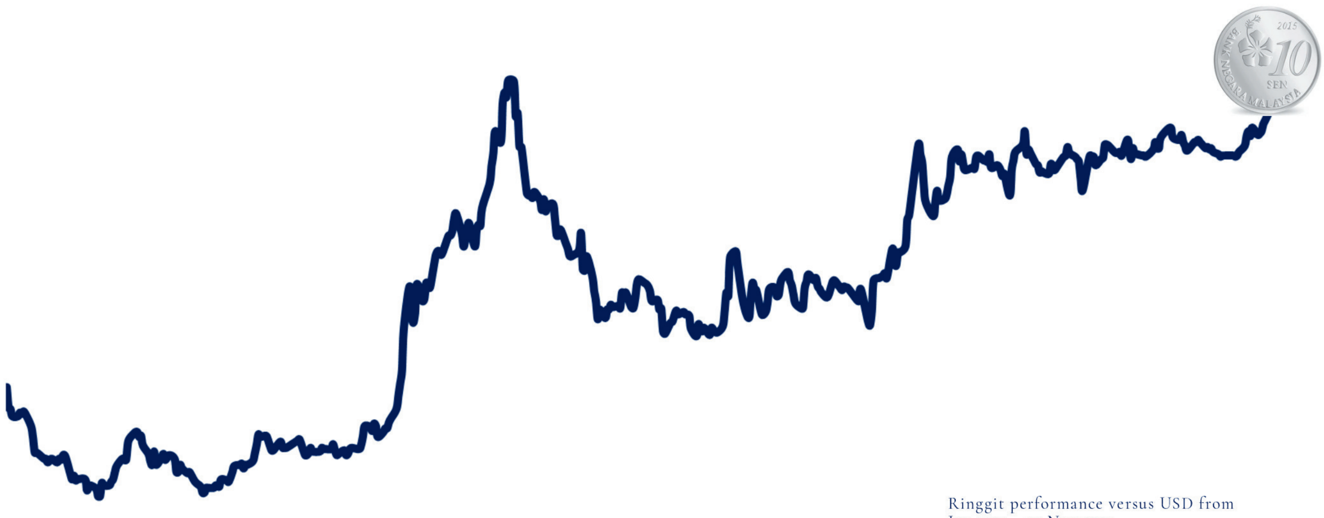
2026

ECONOMIC PULSE

from uncertainty to renewal

resilience in motion *and confidence returns*



Ringgit performance versus USD from
Jan 2024 - 10 Nov 2025
source: Bank Negara (5pm middle rate)

the ringgit leads the region.

Malaysia's currency has outperformed the US dollar and most Asian peers, reflecting solid macro fundamentals and resilient domestic demand. As volatility lingers, this quiet strength sets the stage for a more confident 2026.

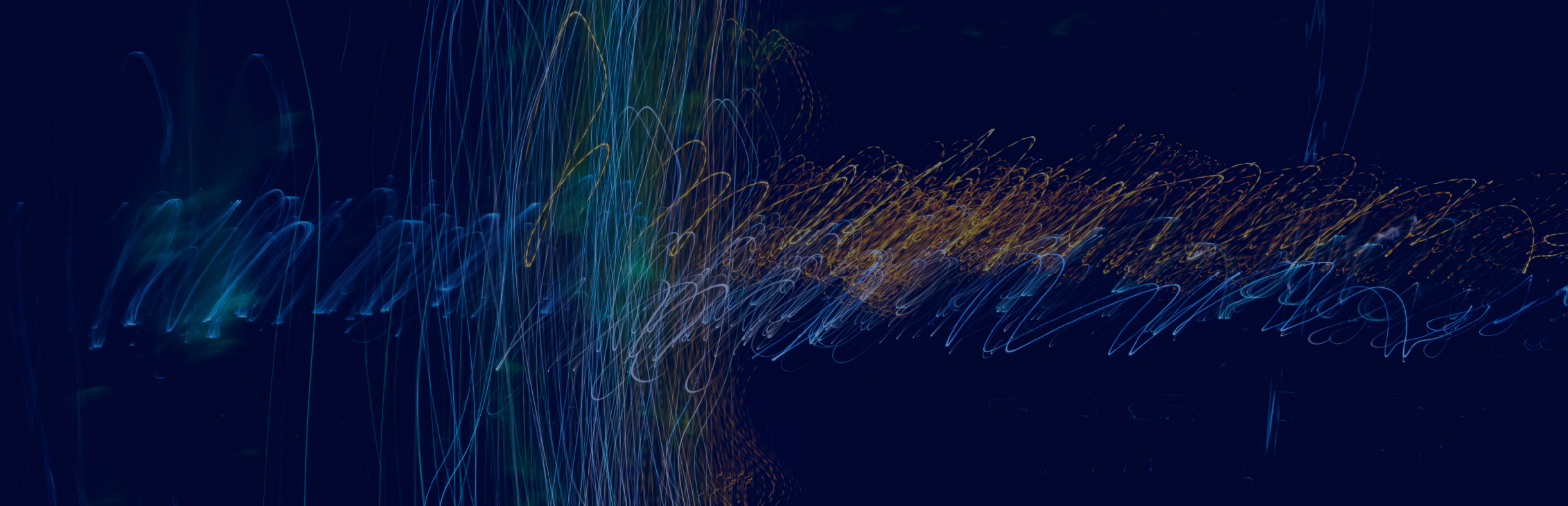
Executive Summary

Malaysia enters 2026 from a position of strengthening resilience, supported by firmer domestic demand, clearer policy signalling and a stabilising regional backdrop. We forecast GDP growth of 4.3–4.5 per cent, underpinned by stable wage gains, rising labour-force participation, targeted fiscal refinement and expanding investment in digital infrastructure, E&E capacity and advanced manufacturing that lift medium-term productivity. Visit Malaysia 2026 is expected to reinforce services momentum, expanding tourism-linked income flows and strengthening consumption impulses at a time when global demand conditions remain mixed.

Externally, Asia continues to anchor macro stability, with China's measured stabilisation and India's sustained momentum supporting regional demand through 2026. Supply-chain diversification and greater tariff certainty under the Malaysia–United States Reciprocal Trade Agreement improve trade visibility and underpin investment flows, while value-chain reconfiguration within ASEAN deepens Malaysia's integration into regional production networks. Broader trade reallocation toward non-traditional markets continues to mitigate concentration risks, supporting gradual export recovery and reinforcing Malaysia's positioning in an increasingly fragmented global landscape.

Beneath the constructive aggregate narrative, however, vulnerabilities remain concentrated among MSMEs. Tight labour conditions, rising wage floors, capability gaps in documentation, certification and logistics, and heightened compliance obligations associated with tariff realignment raise execution risk and compress margins. Firms face operational pressure from longer working-capital cycles and increasing demands for process traceability as supply-chain security frameworks tighten. The pivot toward capability upgrading, stronger cost governance and deliberate diversification will be decisive in determining whether MSMEs can participate meaningfully in Malaysia's evolving trade architecture.

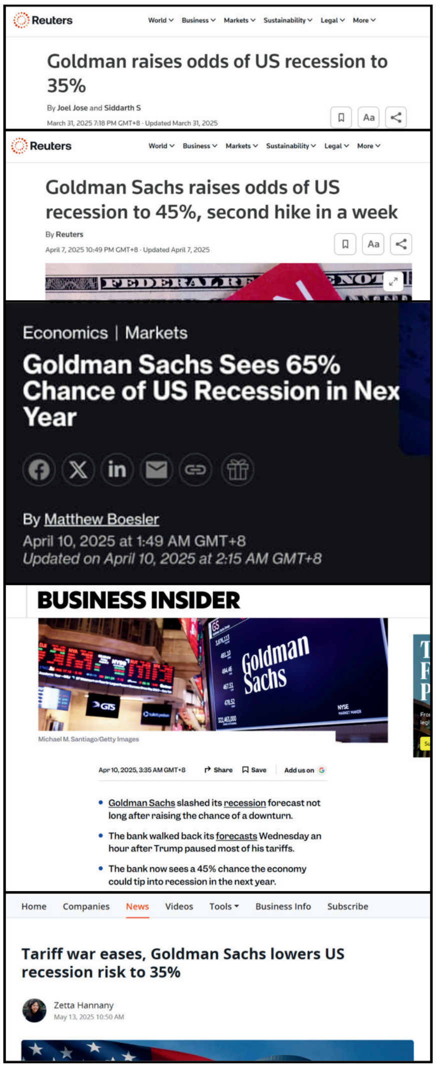
Our 2026 outlook differs from conventional commentaries by prioritising structural feasibility, policy transmission and firm-level readiness over headline-driven reactions. We remain disciplined in separating sentiment noise from genuine macro signals by grounding analysis in data, institutional constraints and real-economy channels. IPPFA is committed to delivering independent, objective insight based on empirical evidence and system-level assessment, equipping policymakers, investors and businesses to navigate an increasingly protectionist and policy-dependent global environment.



Data Over Drama: When Analysis Becomes the Noise

In an age of headline-driven volatility, the real advantage lies in recognising when markets are reacting to sentiment rather than substance.

The reaction to Donald Trump's 2025 reciprocal tariff announcement illustrates how sentiment can easily eclipse substance when analysis loses its economic grounding. Several institutions including Goldman Sachs, shifted their U.S. recession probabilities multiple times, raising estimates from 35 per cent to 65 per cent before cutting them back to 30 per cent, despite no meaningful change in underlying macro conditions.



The tariff proposal itself lacked legal clarity, operational parameters, and political feasibility; it provided neither tariff rates nor implementation timelines, and any unilateral adjustment would still have to navigate lengthy congressional processes. Meanwhile, economic fundamentals remained steady: employment conditions held firm, corporate earnings were broadly resilient, and consumption patterns showed no material stress. This episode demonstrates that headline reactions, when not supported by policy or data validation, amount to market noise rather than structural signals. Political statements only matter when they translate into enforceable policy with measurable and persistent economic outcomes.

The episode also highlighted a broader structural weakness in conventional investment commentary: many analysts reacted to the headline without situating it within the wider architecture of public policy, institutional constraints, or economic transmission. Effective policy analysis requires an understanding of legislative pathways, geopolitical incentives, behavioural responses, and the hierarchy of economic variables, not the assumption that every announcement is immediately actionable. When commentary lacks this foundation, it becomes shallow and reactive, inadvertently fuelling unnecessary volatility. While most analysts aim to provide timely insight, insufficient competency in public economics, fiscal–monetary interactions, or trade mechanics can lead to misinterpretation rather than clarity.

Our framework evaluates the relative weight of each economic variable; growth, inflation, liquidity, and policy stance, while integrating the interplay of monetary, fiscal, and trade dynamics. Technical indicators may reveal price direction, but economic variables explain the story behind the movement and determine whether the signal is genuine or merely noise.

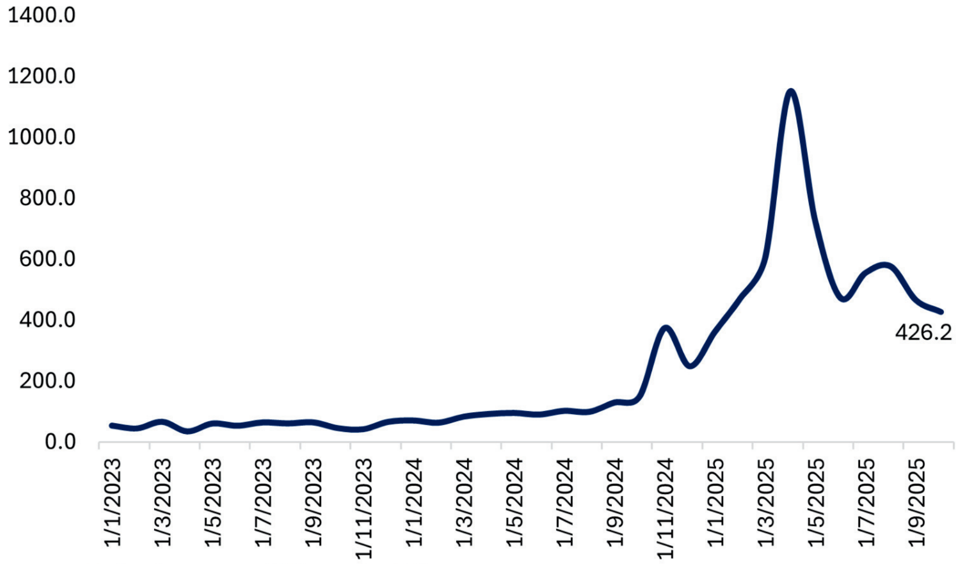
As 2026 approaches, distinguishing political drama from authentic economic signals becomes even more essential. The global landscape will remain saturated with headlines from elections to trade negotiations to shifting supply chains — yet only a small proportion will translate into durable economic outcomes. The real signals will continue to emerge from sustained data trends: stronger trade performance, credible policy direction, stable inflation, healthier investment flows, and steady productivity gains. For Malaysia, this discipline matters greatly, as sentiment-driven narratives often overshadow underlying strengths such as domestic resilience and an improving currency environment. A robust analytical framework must therefore anchor itself in evidence; integrating economic fundamentals, policy structure, and strategic context, rather than relying on surface-level market movements. Markets function best when commentary clarifies instead of distorts, and 2026 should be a year where data-driven reasoning replaces reactionary noise as the compass for investment decisions.

2025 Review: From Volatility to Recalibration

The Global Cycle Finds Its Rhythm — and Malaysia Positions for Stability Amid Shifting Tides

The global economy began 2025 in a renewed phase of geopolitical rigidity, shaped by the return of MAGA 2.0 and a more structured form of U.S. economic nationalism that expanded from tariffs on Canada and Mexico into wider reciprocal measures, driving the Trade Policy Uncertainty Index sharply higher. Yet this time, Washington paired its protectionism with a recalibrated Asia strategy, underscored by President Trump's regional tour and his first-ever visit to Malaysia — a signal of the Indo-Pacific's enduring strategic weight. For Malaysia, these developments highlighted its growing credibility and resilience: the Malaysia–U.S. Agreement of Reciprocal Trade (ART), a firmer Ringgit and renewed diplomatic engagement strengthened its external positioning as many emerging markets faced turbulence. As global trade shifted towards selective partnerships, Malaysia demonstrated capacity not only to adapt but to act as a stabilising force within the Global South. This evolving landscape set the stage for Malaysia's most important response — the construction of a deliberate geoeconomic hedge to widen its strategic room for manoeuvre amid rising fragmentation.

FIGURE 1
TRADE POLICY UNCERTAINTY INDEX



note: Monthly data from January 2023 - October 2025
source: Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo, "The Economic Effects of Trade Policy Uncertainty," manuscript presented at the 91st meeting of the Carnegie-Rochester-NYU Conference on Public Policy, April 2019.

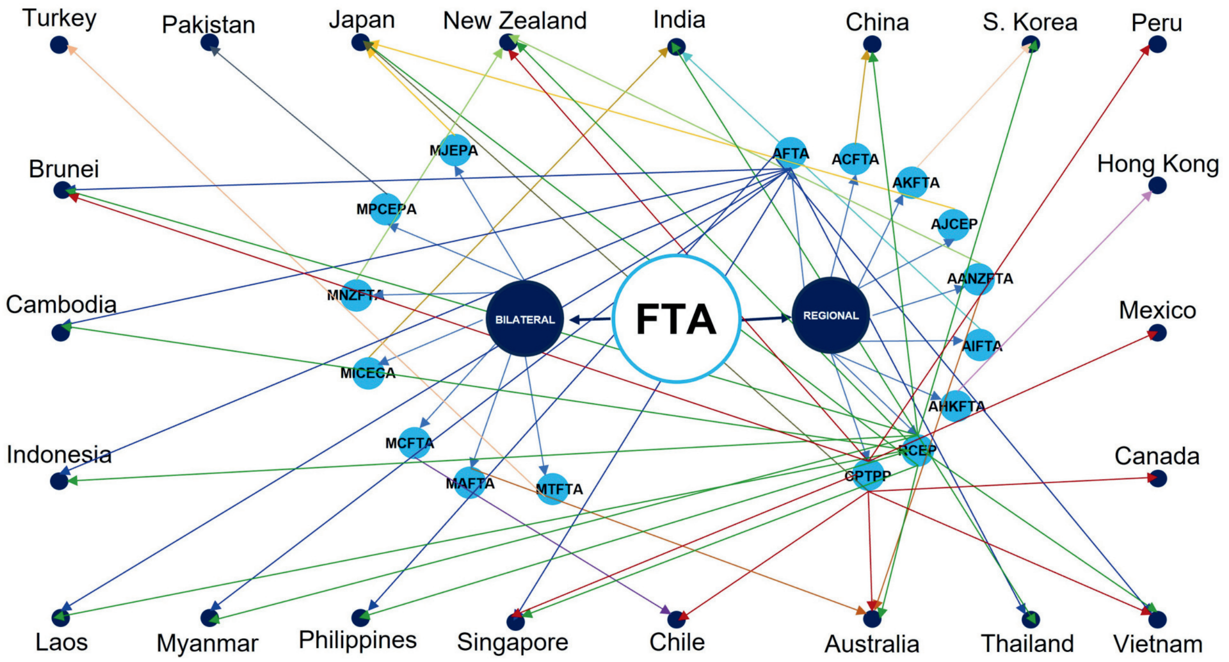
Malaysia's Geoeconomic Hedge: Building Strategic Resilience

Malaysia's adoption of a geoeconomic hedge strategy became a defining pillar of its response to the renewed protectionist cycle. A geoeconomic hedge entails broadening trade, investment and supply-chain linkages across multiple partners to mitigate concentration risks. For a small, highly open economy whose trade exposure exceeds national output, this approach is not optional but essential. The rise of tariff diplomacy and competing regional blocs demanded a policy blueprint that strengthened Malaysia's strategic flexibility rather than tethering it to any single geopolitical sphere.

By embedding itself in a dense network of mega-regional and bilateral agreements — from CPTPP and RCEP to the Malaysia–U.S. ART — Malaysia constructed a multi-layered architecture that cushions external shocks while expanding its supply-chain optionality. This approach aligns with the global narrative of 2025: as major economies recalibrated, Malaysia positioned itself as an active balancer, leveraging institutions, credibility and diversified economic relationships to secure stability.

FIGURE 2

MALAYSIA'S FTA: BILATERAL AND REGIONAL CONNECTIONS

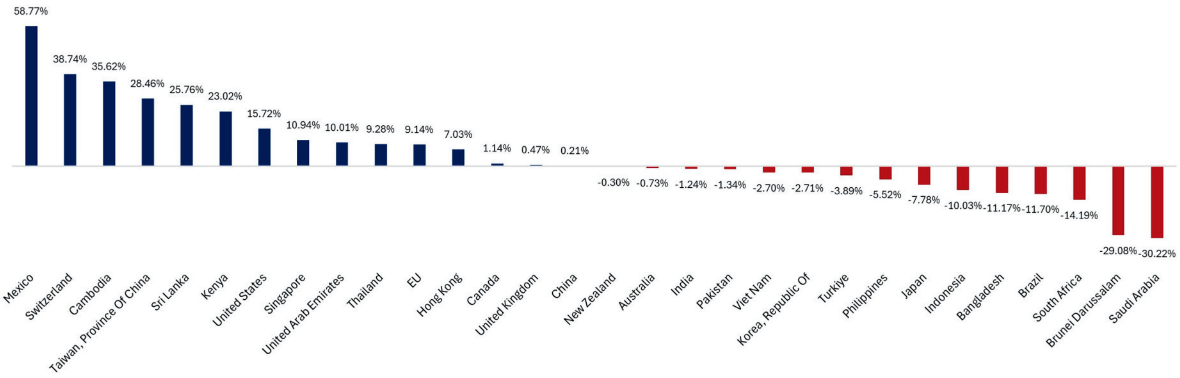


note: As of November 2025
source: Ministry of International Trade and Industry

Trade data as of October 2025 highlights how this hedge is yielding tangible results. Total trade rose 13.6 per cent year-on-year, while the trade surplus surged 58.9 per cent to RM19.0 billion. Although exports to major partners remained strong, the most significant gains came from non-traditional and fast-growing markets. Shipments to Mexico jumped 142 per cent, tapping into supply-chain realignments and nearshoring dynamics. Exports to Kenya rose 83.5 per cent, reflecting deeper penetration into Africa's emerging consumer markets. Cambodia recorded an 86.3 per cent increase, underscoring Malaysia's growing role within secondary ASEAN production networks. These smaller yet rapidly expanding corridors demonstrate the essence of the geoeconomic hedge: cultivating diversified pathways to reduce vulnerability to global cyclicality.

FIGURE 3

MALAYSIA EXPORT GROWTH (%, Jan - Oct, 2024 vs 2025)



note: As of October 2025
source: Department of Statistic Malaysia.

Malaysia's sectoral performance reinforces this resilience. E&E exports increased 26.5 per cent year-on-year, confirming Malaysia's strengthening position within Asia's semiconductor and advanced manufacturing ecosystem. Exports to ASEAN grew 20.1 per cent, with Singapore accounting for over half of regional shipments as intra-ASEAN value chains deepened. With trade linkages spanning North America, the Middle East, Africa and the Asia-Pacific, Malaysia is steadily transforming external uncertainty into strategic leverage. While Malaysia strengthened its external resilience through diversified trade architecture, its internal economic engines were simultaneously gaining traction — creating a dual foundation of stability that defined the country's economic performance through 2025.

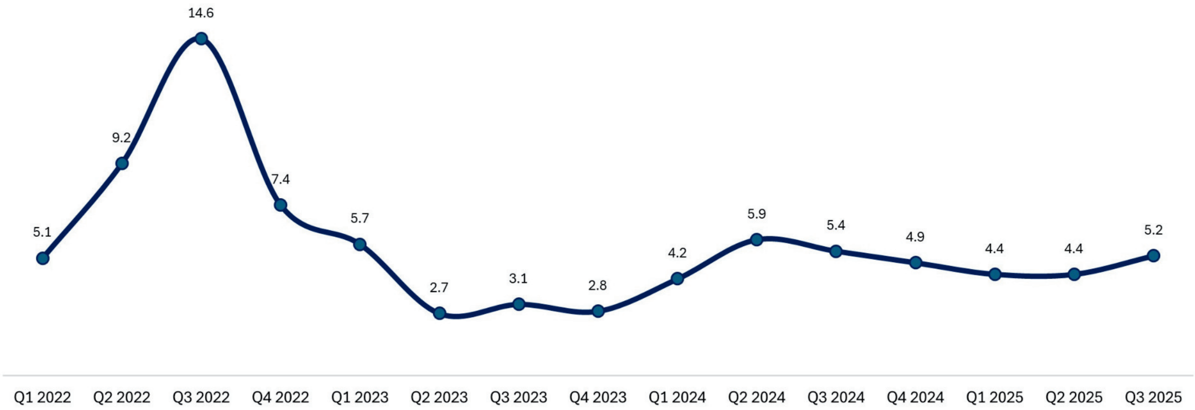
Taken together, the evidence is clear: Malaysia's geoeconomic hedge is no longer an abstract policy idea but a material driver of resilience and opportunity. By widening export destinations, deepening multi-regional connectivity and leveraging overlapping FTAs, Malaysia has reduced its exposure to tariff cycles and great-power competition while unlocking new trade frontiers. In a world where globalisation is shifting from uniform integration to fragmented spheres of influence, Malaysia's strategy positions it as a credible, neutral and adaptive trading hub — transforming uncertainty into strategic leverage and providing stability as the global economy progresses from volatility to recalibration.

Malaysia Consolidates Domestic Strength as the Cycle Recalibrates

The domestic economy emerged as Malaysia's second anchor of stability in 2025, marking a decisive shift towards an internally driven growth model. Despite uneven global demand and tariff shocks, GDP grew 5.2 per cent in the third quarter, including a strong 2.4 per cent quarter-on-quarter lift — clear evidence that momentum was strengthening rather than fading. Malaysia's economic engines began moving in unison: private consumption rose 5 per cent, buoyed by stable employment, rising wages and targeted support that protected households from price pressures. Private investment expanded 7.3 per cent, driven by digital infrastructure, E&E upgrades, data-centre expansion and construction activity. These trends reflected not only cyclical recovery but structural improvements in economic capacity and business confidence.

FIGURE 4

MALAYSIA GDP GROWTH (%,yoy)



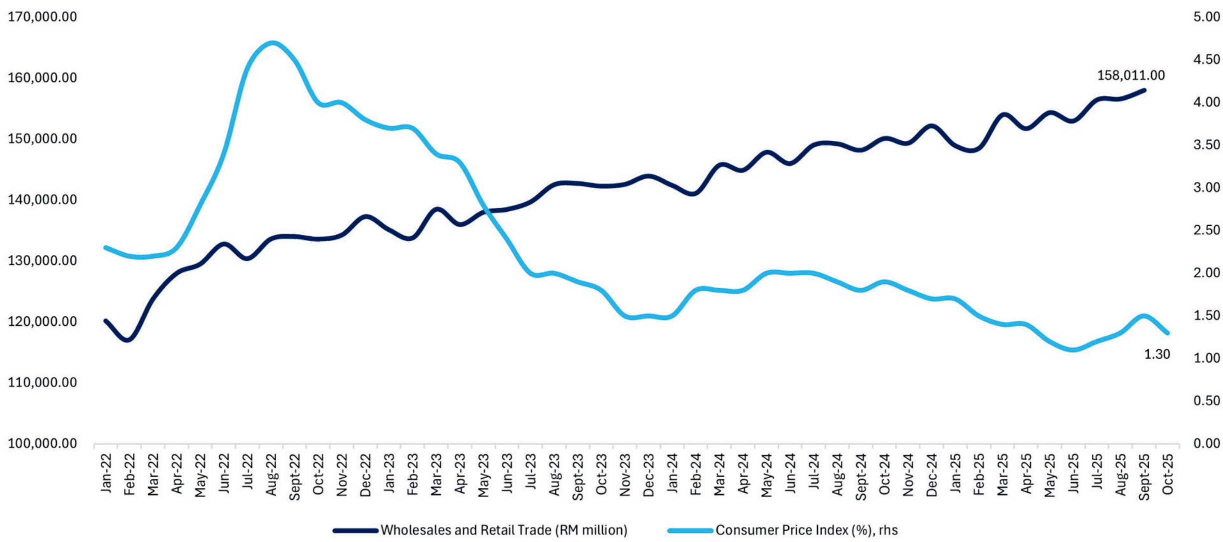
note: As of October 2025
source: Department of Statistic Malaysia.

Labour-market strength played a central role in sustaining domestic momentum. Employment grew 3.1 per cent, unemployment remained low at 3 per cent, and nominal wages increased 3.8 per cent, while real wages continued to rise across consecutive quarters. Labour-force participation held at 70.9 per cent, and productivity per hour worked climbed to RM45.10 in Q3. This combination strengthened household confidence and fuelled broad-based consumption across essential and discretionary segments, including travel, recreation, digital services and retail.

Inflation stability provided a further anchor. Headline inflation remained low at 1.3 per cent, supported by stable fuel prices under BUDI MADANI, while core inflation at 2.2 per cent reflected moderate demand without overheating. These conditions created a predictable environment for households and businesses, enhancing real purchasing power and reinforcing economic continuity.

FIGURE 5

MALAYSIA WHOLESALE & RETAIL TRADE AND INFLATION



note: Monthly data from January 2022 - October 2025 (Retail trade data until Sep 2025)
source: Department of Statistic Malaysia.

Targeted programmes such as STR and SARA strengthened the system's inclusivity and efficiency by directing cash flows to households with the highest spending velocity. This not only supported cost-of-living pressures but enhanced the multiplier effect across local supply chains. Meanwhile, structural reforms under Ekonomi MADANI — especially the dual approach of "raising the ceiling and raising the floor" — became increasingly visible in macroeconomic data. High-value sectors such as digital services, data centres and E&E lifted productive capacity, while targeted support strengthened the resilience of lower-income households. Together, these reforms reduced vulnerability at both ends of the economic spectrum and contributed to a more balanced growth foundation.

Malaysia's 2025 economic story is therefore one of synchronised resilience. The external hedge broadened the country's strategic footprint, while domestic engines provided continuity and strength.

As the global cycle settled into a new equilibrium, Malaysia entered 2026 with deeper buffers, clearer policy direction and growing relevance as a stable, neutral and adaptive economic hub.

Asia Anchors Stability in the 2026 Outlook

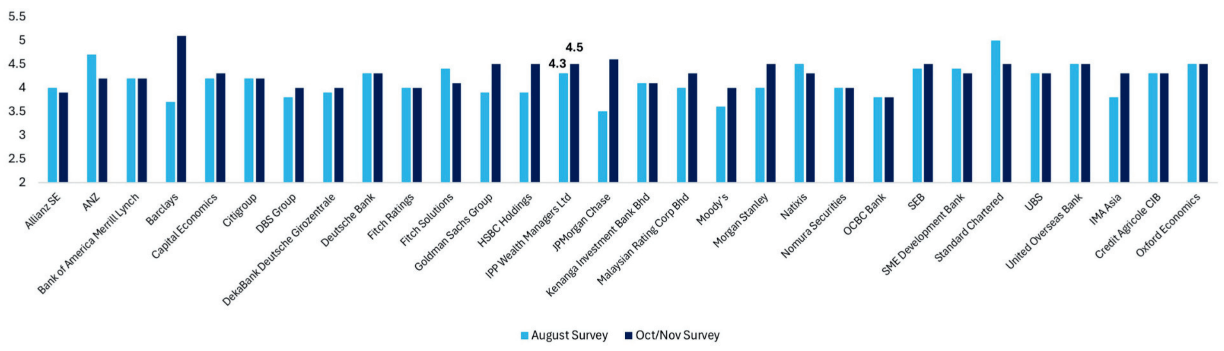
As the world enters 2026, confidence is gradually returning to the global economy, supported by a more predictable policy landscape and a steadier macro environment. Asia stands at the centre of this transition, emerging as the world's primary anchor of stability and providing a reliable counterweight to lingering global uncertainty. With China stabilising, India sustaining strong momentum and regional supply chains regaining rhythm, Asia continues to underpin global growth while strengthening the outlook for its neighbours. Malaysia steps into this environment from a position of renewed domestic resilience, supported by firm demand, rising investment flows and the cumulative benefits of structural reforms. Meanwhile, the United States maintains a constructive trajectory despite political noise, and the broader global cycle shows signs of settling into a new equilibrium. Together, these dynamics frame 2026 as a year in which stability broadens, volatility eases and Asia's influence deepens across the global economy.

Malaysia: Momentum Strengthens as Domestic Engines Drive the Cycle

Malaysia enters 2026 with a clearer and more confident economic footing, supported by a combination of firmer domestic fundamentals, improving investment sentiment and well-sequenced policy execution. We expect the GDP to expand between 4.3 and 4.5 per cent, broadly aligned with Malaysia's medium-term potential of around 4 per cent. Much of this momentum stems from two structural catalysts that will shape the trajectory of the coming year. RMK13 provides medium-term direction by prioritising digital infrastructure, industrial upgrading and the green transition, while Visit Malaysia 2026 delivers an immediate uplift to services, tourism and consumption.

FIGURE 6

ECONOMISTS' FORECAST FOR MALAYSIA'S GDP IN 2026



note: As of 30 Nov 2025
source: Bloomberg

FIGURE 7

MALAYSIA: KEY MACRO INDICATORS AND FORECASTS (2022–2026)

End-Period	Consumer Price Index (%)	Unemployment Rate (%)	Minimum Wage (RM)	Bank Negara OPR (%)	USD/MYR	Budget Deficit (%)
2022	3.80	3.60	1,500.00	2.75	4.40	5.50
2023	1.50	3.30	1,500.00	3.00	4.59	5.00
2024	1.70	3.20	1,500.00	3.00	4.47	4.10
2025 Forecast	1.60	3.00	1,700.00	2.75	4.15	3.80
2026 Forecast	2.20	3.10	1,900.00	2.75	4.05	3.50

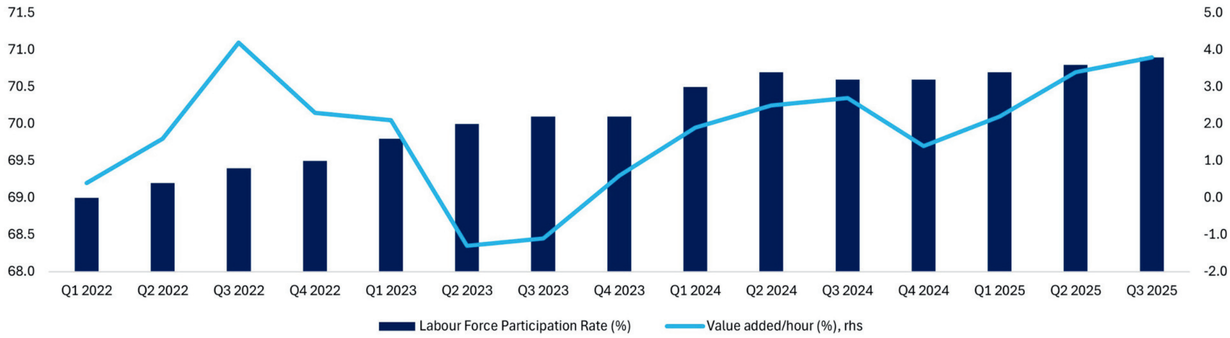
note: As of November 2025
source: IPPFA Malaysia.

Alongside these, the refinement of targeted subsidies strengthens the fiscal anchor by reducing leakages without constraining household demand. These elements collectively place Malaysia on a more balanced growth path, entering 2026 with stronger policy clarity and greater macroeconomic stability.

What differentiates Malaysia's outlook this year is the way its economic engines are now operating in concert, creating a more coherent and durable expansion. Household consumption remains resilient, underpinned by stable employment, rising wages and improving labour-force participation. These conditions are lifting confidence across a wide set of service industries — from retail and hospitality to travel, entertainment and logistics — all benefiting from improved purchasing power and a more assured income outlook.

FIGURE 8

FIRMING LABOUR PARTICIPATION AND PRODUCTIVITY REBOUND



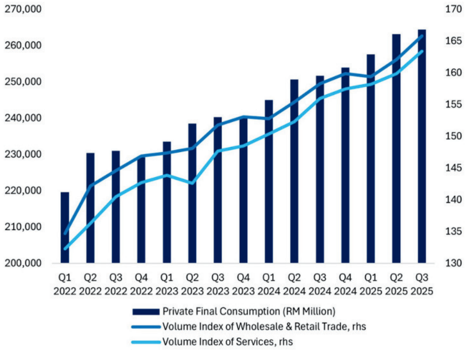
source: Department of Statistic Malaysia.

Visit Malaysia 2026 strengthens this momentum further, with simulation results indicating that the campaign could add between RM13 billion and RM21 billion to private consumption in 2026. This translates into roughly a 1.0 to 1.7 per cent uplift in the level of consumption, equivalent to an additional 1.1 to 1.8 percentage points of nominal private consumption growth for the year. The scale of this impact highlights how tourism-driven income gains, particularly among service-sector households and SMEs, are reinforcing the breadth and depth of domestic demand. Importantly, consumption is no longer driven by a narrow set of categories; it is broadening, signalling a healthier and more inclusive domestic demand base. This synchronised domestic expansion reduces reliance on external volatility and creates a more stable baseline for 2026.

FIGURE 9

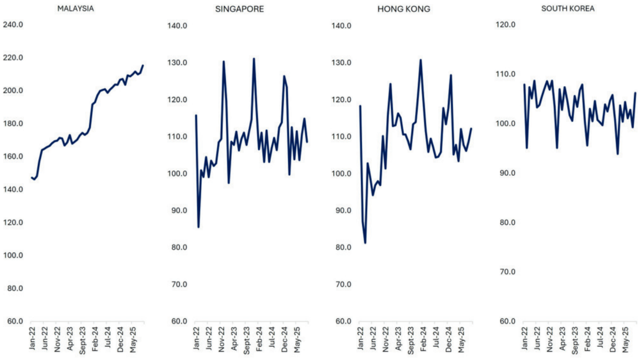
DOMESTIC DEMAND ANCHORS MALAYSIA'S OUTPERFORMANCE

CONSUMER DEMAND



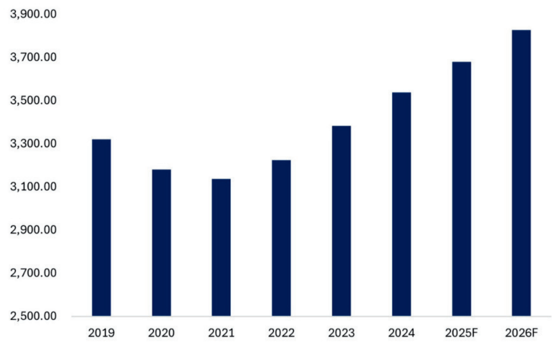
note: Retail and Services Volume Indices are rebased to 2015 = 100.
source: Department of Statistic Malaysia.

RETAIL TRADE INDEX FOR SELECTED COUNTRIES



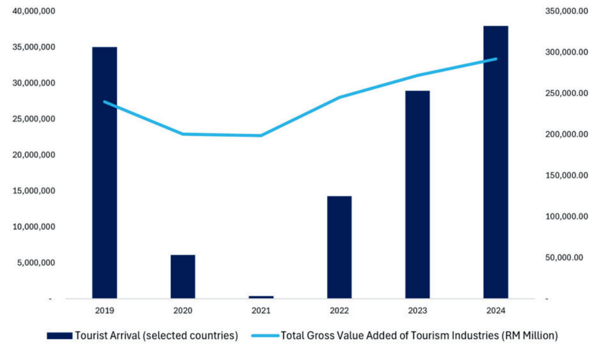
source: Department of Statistic Malaysia.

EMPLOYMENT IN TOURISM INDUSTRIES ('000)



note: 2025 & 2026 = forecast.
source: Department of Statistic Malaysia.

TOURIST ARRIVAL & VALUE ADDED



source: Department of Statistic Malaysia.

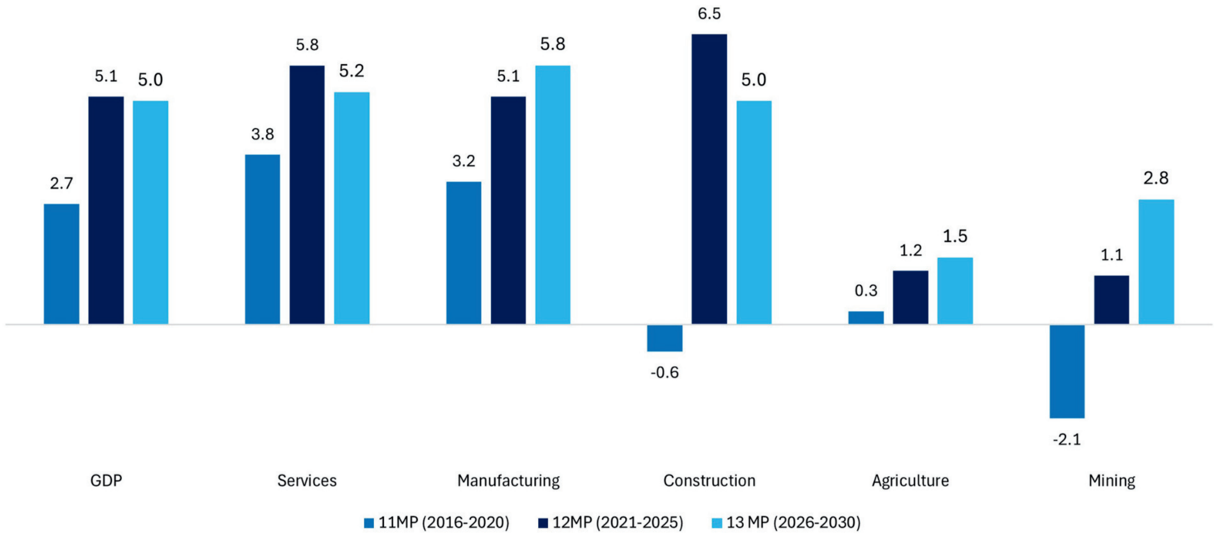
Layered onto this is the growing impact of digital investment, which is reshaping Malaysia's economic structure and reinforcing the services rebound. The rapid expansion of data centres, cloud capacity and E&E-related upgrading is deepening Malaysia's integration within Asia's technology ecosystem. These investments are generating productivity gains, stronger service linkages and new employment opportunities across mid- and high-skilled segments. As traditional services merge with digital capabilities — from e-commerce logistics to fintech and professional services — Malaysia's services sector gains scale and resilience. This transformation strengthens business confidence, supports technology adoption and attracts long-term private investment. The services-technology nexus is now one of Malaysia's key growth multipliers, bolstering domestic demand while enhancing competitiveness in the region.

At the same time, the manufacturing sector is regaining traction, benefitting from normalised supply chains, stronger production visibility and an improving export outlook. The recovery is most evident in E&E, where global semiconductor demand is stabilising, but momentum is also visible in machinery, petrochemicals and construction-related manufacturing. This rebound is not occurring in isolation; it is linked to the broader revival in services, logistics and digital infrastructure, creating a reinforcing loop that strengthens overall economic activity. With inflation contained and cost pressures manageable, businesses have greater flexibility to scale output and expand operations. The combined performance of manufacturing and services — moving in alignment rather than divergence — marks a notable shift from previous years and provides Malaysia with a stronger growth foundation.

FIGURE 10

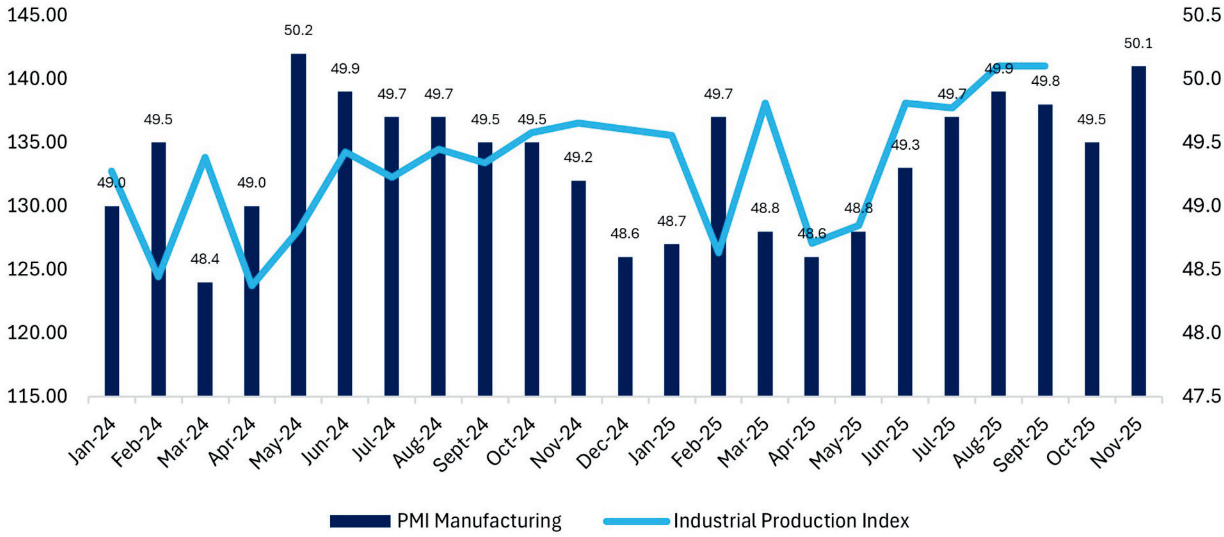
13[TH] MP: DRIVE HIGH-TECH GROWTH VIA SEMICONDUCTOR REFORMS

GDP BY SECTOR 11MP (ACTUAL), 12MP (ACTUAL) AND 13MP (TARGET)



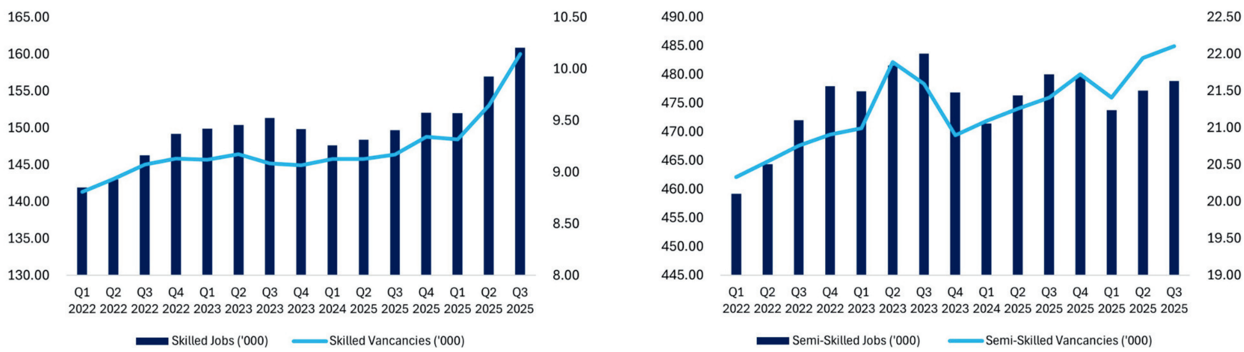
source: Ministry of Economy, Malaysia

MALAYSIA S&P PMI MANUFACTURING & IPI INDEX



source: S&P Global, Department of Statistic Malaysia

EMPLOYMENT STATISTIC IN MANUFACTURING SECTOR – ELECTRICAL, ELECTRONIC & OPTICAL PRODUCTS



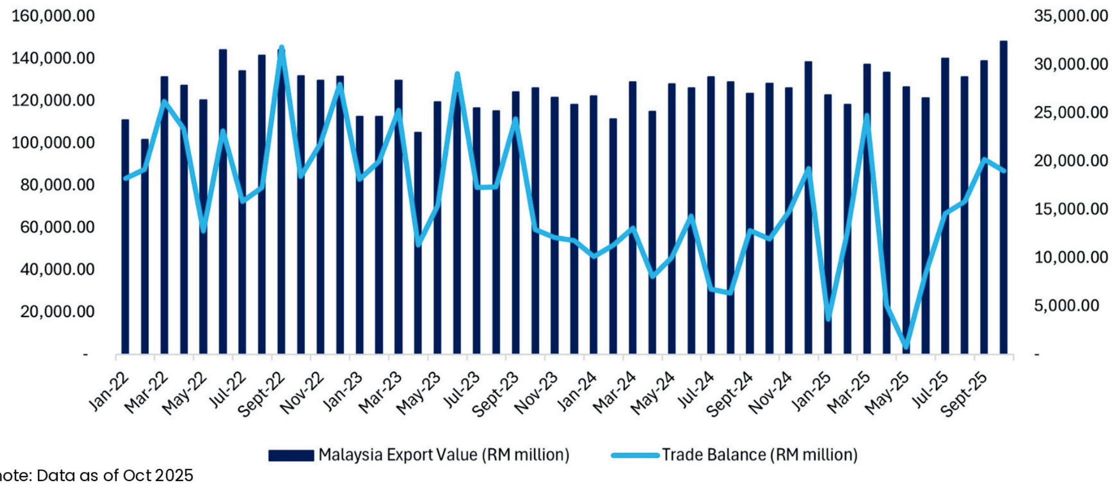
source: Department of Statistic Malaysia

Malaysia's external position continues to be anchored in Asia, with nearly 70 per cent of total trade linked to regional partners and China remaining Malaysia's largest trading counterpart. Export momentum in E&E, machinery and intermediate goods is increasingly supported by intra-Asian production flows, while India has emerged as a fast-growing destination for palm oil, refined petroleum products and selected services. This regional orientation provides Malaysia with a more stable demand base and ensures Malaysia benefits directly from Asia's broader stabilisation as the global cycle recalibrates entering 2026.

FIGURE 11

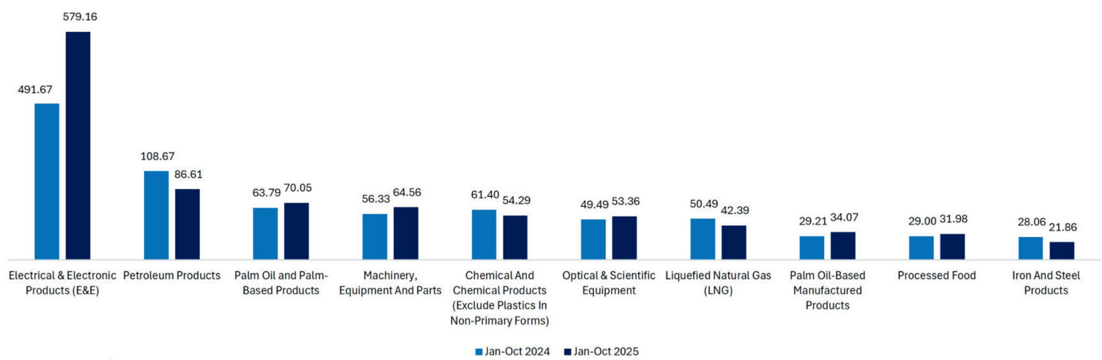
MALAYSIA EXTERNAL TRADE

EXPORT VALUE & TRADE BALANCE



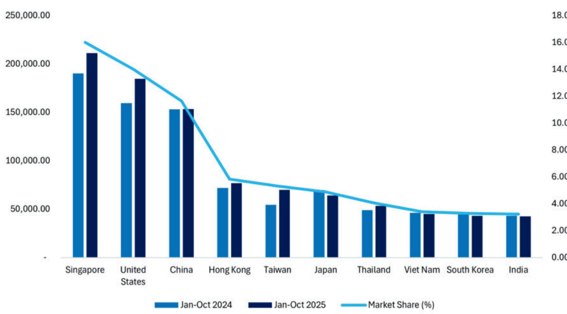
note: Data as of Oct 2025
source: Department of Statistic Malaysia

TOP 10 EXPORTS BY SUB-SECTOR



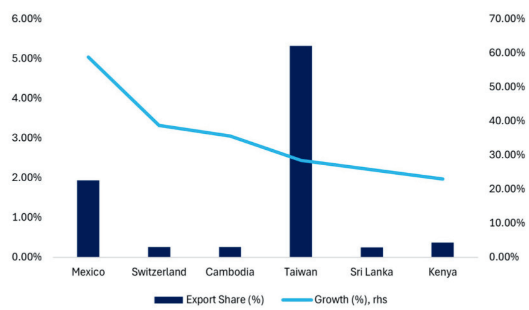
note: Data as of Oct 2025
source: Department of Statistic Malaysia

TOP 10 MALAYSIA EXPORT DESTINATION



note: Data as of Oct 2025
source: Department of Statistic Malaysia

EXPORT GROWTH SURGES ABOVE 20%, 2024



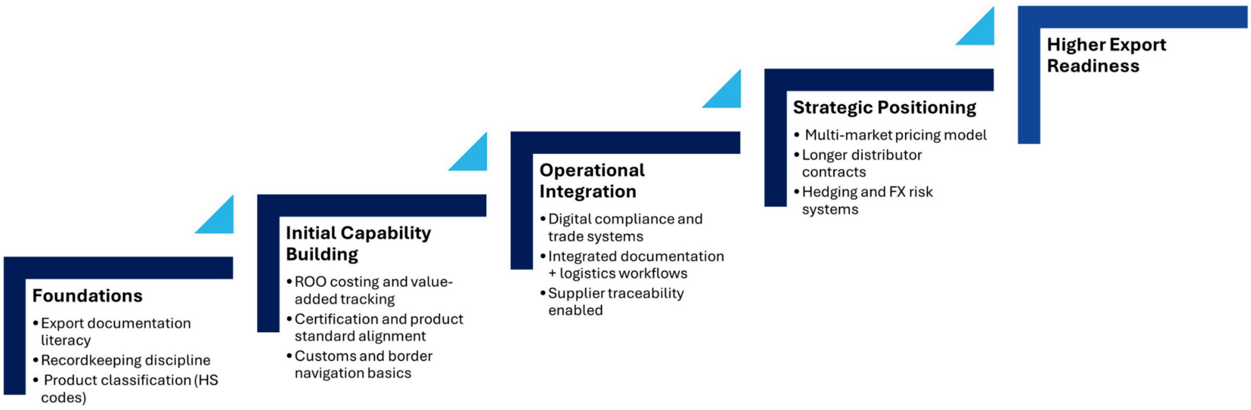
source: United Nations COMTRADE

As Malaysia's external trade architecture expands, the challenge shifts from securing preferential access to ensuring that firms, particularly MSMEs, possess the institutional readiness to utilise these channels effectively. The macro tailwinds now visible on the trade front create a window for broadening export participation if capability constraints can be addressed.

Malaysia's trade architecture remains one of the most extensive in Asia, spanning ASEAN frameworks, RCEP, CPTPP and multiple bilateral agreements, including the Malaysia–United States ART. While this embeddedness provides preferential market access and regulatory cooperation across diverse corridors, MSMEs remain peripheral beneficiaries. Export activity continues to be concentrated among larger firms, while MSMEs participate largely as indirect suppliers within regional value chains. With external demand expected to stabilise through 2026 and tariff certainty improving within regional blocs, the opportunity now lies in enabling MSMEs to translate policy access into scalable commercial pathways.

FIGURE 12

MSME EXPORT CAPABILITY STAIRCASE

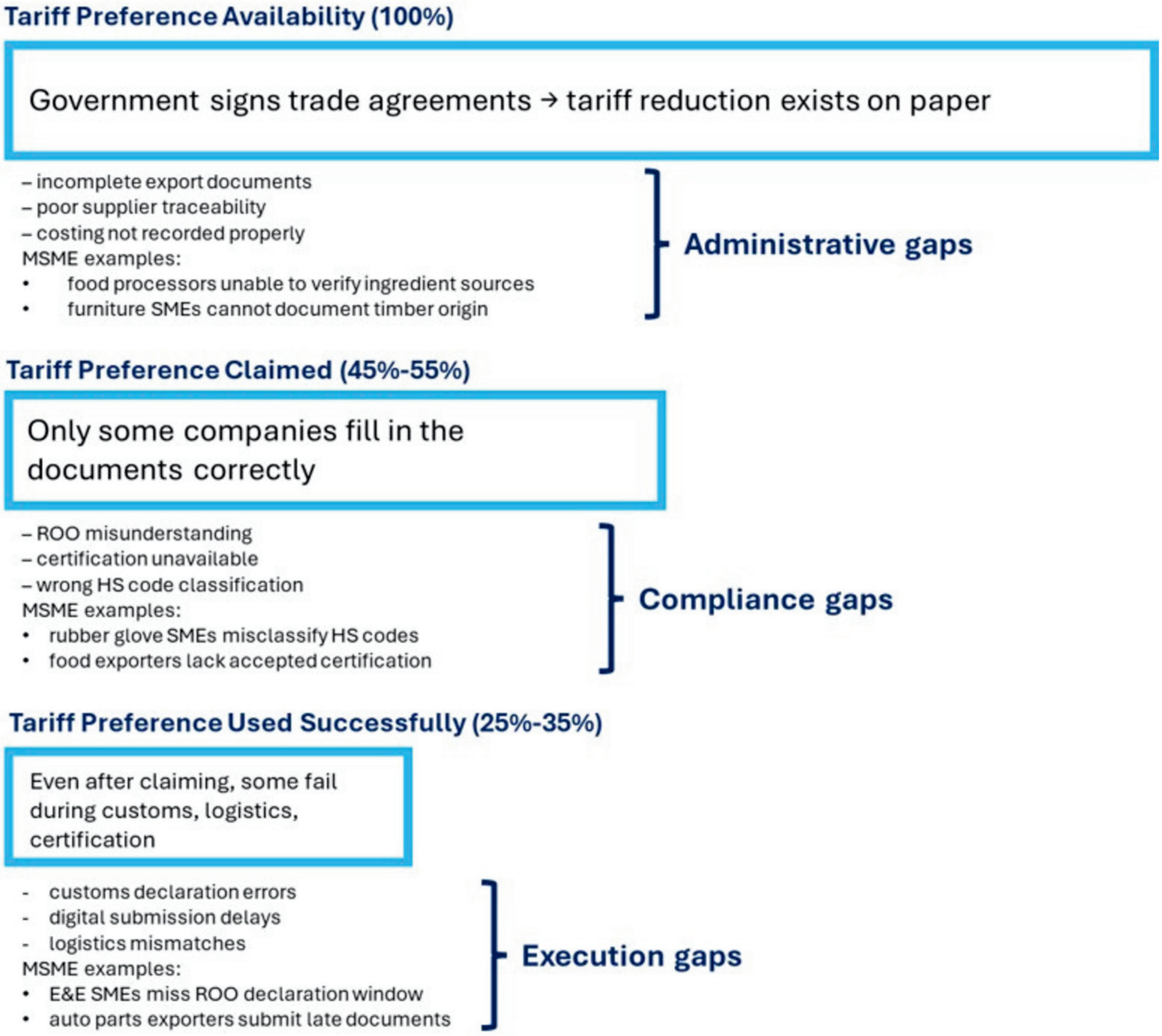


source: IPPFA, 2025

The experience of 2025 illustrates this potential. SMEs benefitted indirectly from Malaysia's geoeconomic hedge when non-traditional markets including Mexico, Kenya and Cambodia recorded strong export growth. These emerging corridors, enabled by diversified trade linkages and increased flexibility in rules of origin, demonstrate that trade agreements increasingly provide new entry points into reconfigured supply chains rather than functioning solely as tariff-reduction instruments. Preferential tariffs provide margin headroom at a time when labour and compliance costs are rising, but the more transformative benefits lie in non-tariff provisions such as mutual recognition of certification, digital trade facilitation and simplified customs processes. These reduce the fixed market-entry costs that have historically served as hard barriers for smaller exporters with limited administrative capacity.

FIGURE 13

TARIFF PREFERENCE UTILISATION GAP AMONG MALAYSIAN MSMES



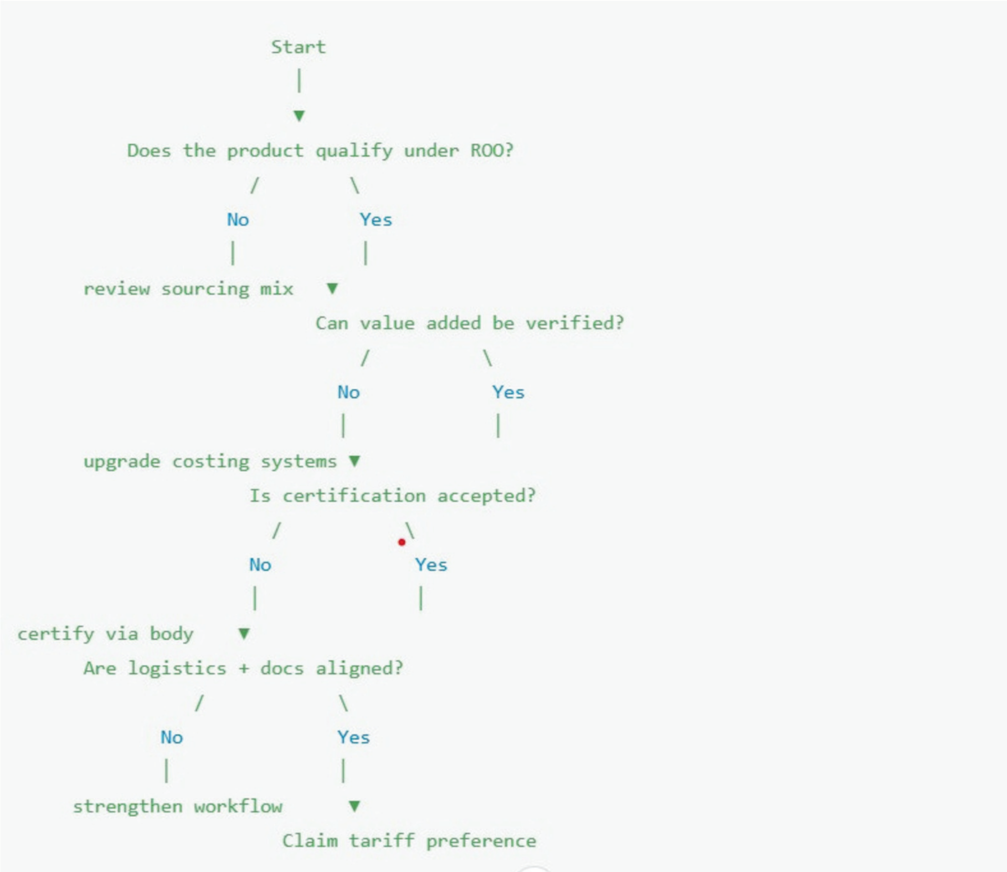
source: IPPFA, 2025

Under this evolving trade landscape, the binding constraint for MSME export scaling is not market demand, but organisational and administrative readiness.

Three practical capabilities determine whether firms can utilise trade agreements effectively. First, internal costing and documentation systems must reliably track value-added and meet rules-of-origin thresholds to support tariff preference claims. Second, product quality and certification processes must align with destination market standards to avoid non-tariff barriers and costly shipment rejections. Third, dependable cross-border logistics and distribution networks are required, increasingly accessed through digital platforms and regional intermediaries across ASEAN and RCEP markets. Without these capabilities, tariff preferences remain legally available but commercially unrealised.

FIGURE 14

RULES-OF-ORIGIN COMPLIANCE PATHWAY FOR MSMES



source: IPPFA, 2025

Policy experience in successful export-oriented MSME economies suggests that capability upgrading delivers disproportionate returns when paired with preferential market access. In 2026, Malaysian MSMEs can leverage levy-funded training schemes and subsidised export development programmes to build internal compliance and certification capacity at lower cost. Strengthening administrative skills in documentation, rules-of-origin compliance and cost accounting enables systematic tariff utilisation. Adoption of digital trade tools and certification pathways raises eligibility for participation in global value chains. Expanding distributor partnerships or utilising platform-based intermediaries accelerates market entry without the fixed overheads of establishing physical presence abroad. Effective utilisation of trade agreements therefore functions as both a margin-preservation and revenue-expansion strategy precisely at a time when Malaysia's external architecture provides renewed export tailwinds in 2026.

These external opportunities, however, coexist with tightening domestic operating conditions. For MSMEs to sustain export participation and capitalise on preferential access, internal capability development and workforce readiness become increasingly important, particularly as wage floors rise, labour markets tighten and operational slack narrows through 2026. The ability to utilise trade agreements effectively will therefore hinge not only on compliance and documentation capacity but also on the broader macro-financial environment. Monetary and currency dynamics now play a reinforcing role: exchange rate stability and predictable funding conditions strengthen planning horizons and reduce volatility for firms that are preparing to scale regional exports.

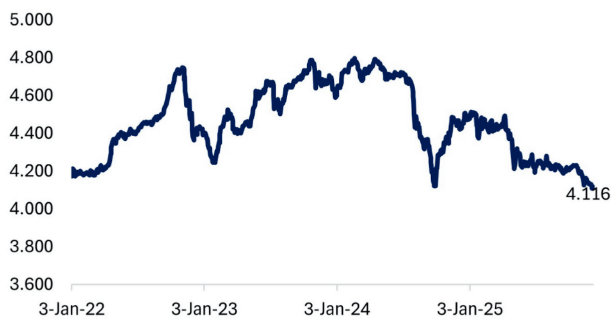
Monetary and currency dynamics are adding stability to Malaysia's 2026 outlook. We expect the Ringgit to trade around RM4.05 per USD, supported by a stronger external balance, clearer fiscal signalling and renewed investor interest. A firmer currency will moderate imported inflation, lift real household incomes and enhance Malaysia's competitiveness within emerging Asia. Bank Negara Malaysia is likely to maintain the OPR at 2.75 per cent even as the Federal Reserve eases rates. As the rate differential narrows, the USD yield premium shrinks, creating a more favourable backdrop for the Ringgit. Together, a steady currency and a predictable monetary stance provide continuity for businesses and reinforce Malaysia's growth trajectory heading into 2026.

These monetary underpinnings are increasingly reflected in Malaysia's fixed-income market. Foreign participation in Malaysian Government Securities and Government Sukuk has been gradually rebuilding, signalling growing confidence in Malaysia's macro direction and the stability of its sovereign curve. Improving fiscal clarity, a predictable rate outlook and the deepening sukuk market are encouraging foreign investors to extend duration and re-enter Malaysian bonds. This alignment of currency stability, steady funding costs and rising foreign interest provides a firmer foundation for bond-market resilience, reinforcing the broader narrative of strengthening macro-financial stability in 2026.

FIGURE 15

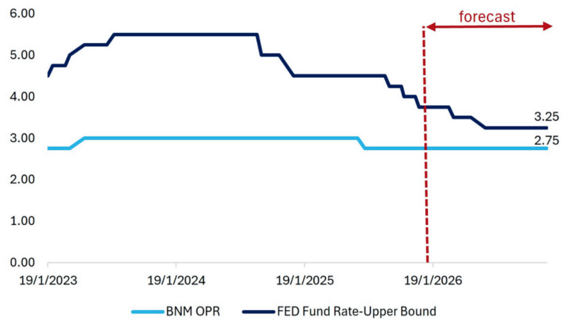
RINGGIT STRENGTHENS AMID A STABLE AND PREDICTABLE OPR OUTLOOK

USD/MYR EXCHANGE



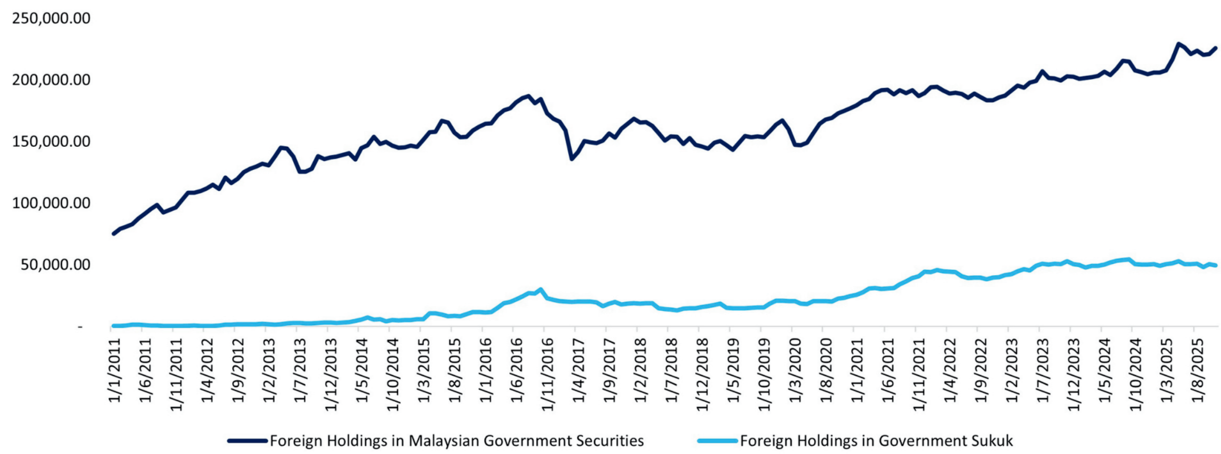
note: as of 8 Dec 2025, 5.00pm mid rate
source: Bank Negara Malaysia

CENTRAL BANK POLICY RATE (%)



note: as of 11 Dec 2025
source: Bank Negara Malaysia, Federal Reserve

FOREIGN HOLDINGS OF MALAYSIAN GOVERNMENT BONDS & SUKUK (RM million)



note: as of Nov 2025
source: Bank Negara Malaysia

This more stable backdrop, combined with clearer fiscal reforms, has strengthened expectations that Malaysia may be approaching the threshold for a sovereign credit upgrade. A move by Fitch Ratings from BBB+ to A– would reflect concrete policy progress, including the Fiscal Responsibility Act, the Medium-Term Fiscal Framework, subsidy rationalisation and efforts to broaden the tax base through digitalisation and enhanced enforcement. These measures underpin Malaysia's debt-stabilisation trajectory and reinforce the credibility of its long-term fiscal anchors. An upgrade would narrow sovereign risk premiums, lower borrowing costs and raise Malaysia's prominence in global bond indices, attracting higher-quality, long-duration capital. Should it materialise, such a re-rating would validate Malaysia's reform momentum and position the country among ASEAN's most stable and investable sovereign markets in 2026.

Although the baseline outlook is constructive, the balance of risks remains two-sided. Domestic risks stem from inflationary pressures associated with subsidy rationalisation and tight labour-market conditions, which may lift operating costs in selected industries. External risks relate to shifting global tariff regimes and widening geopolitical fragmentation, both of which could affect export momentum and supply-chain planning. While Malaysia's export destinations have become more varied, the export structure still relies heavily on E&E, underscoring the need to deepen diversification across machinery, chemicals, medical devices and higher-value agricultural products. Progress in these areas would better align Malaysia with its geoeconomic-hedge strategy by reducing concentration risk at the sub-sector level, not only across trading partners. Yet meaningful upside potential also exists: a stronger Ringgit, firmer demand from Asia and Malaysia's expanding role in intra-Asian production networks could accelerate a broader-based manufacturing recovery and attract stronger capital inflows. With domestic engines synchronising, reform momentum intact and regional demand strengthening, Malaysia enters 2026 with clearer visibility, stronger buffers and a more durable platform for growth.

As Malaysia moves into 2026 with firmer buffers and clearer momentum, the regional landscape becomes the next defining pillar of the outlook — and Asia is emerging as the global economy's most reliable anchor.

China and India: Stabilisation Meets Momentum

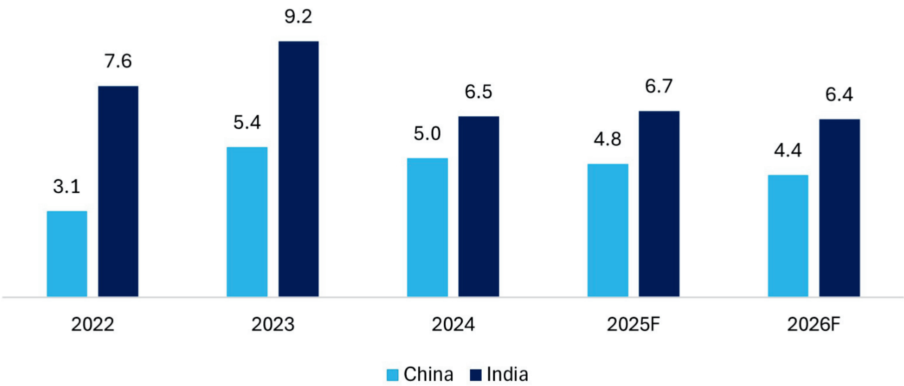
China and India enter 2026 from distinct yet complementary positions that strengthen Asia's role as the global economy's anchor. China's growth is stabilising as policy continuity, selective stimulus and industrial upgrading restore confidence across manufacturing and services, while India continues to expand on the back of strong investment, consumption and reform momentum. For Malaysia, these dynamics provide a firmer external base: China remains the country's largest trading partner, and India is an increasingly important market for commodities, services and intermediate goods. Together, the stabilisation of China and the momentum in India reinforce regional demand and create a more predictable environment for Malaysia's trade, investment and supply-chain integration.

China's growth profile moving into 2026 reflects a shift toward controlled stabilisation rather than renewed acceleration, with consensus projections clustering between 4.0 and 4.4 per cent. Forecasts by the World Bank, IMF and ADB point to a moderation from 2025 levels, while the OECD maintains a slightly firmer view at 4.4 per cent. This range suggests that policymakers are intent on defending a mid-4 per cent growth floor through targeted fiscal support, prudent monetary flexibility and continued emphasis on high-value manufacturing. India's outlook is notably stronger, with most major institutions projecting GDP growth between 6.2 and 6.5 per cent in 2026, underpinned by a robust investment cycle, expanding services sector and resilient domestic consumption. The accompanying chart illustrates this divergence clearly: China consolidating around a mid-4 per cent trajectory while India sustains a structurally higher mid-6 per cent growth path.

FIGURE 16

CHINA & INDIA: FIVE-YEAR ECONOMIC GROWTH

CHINA AND INDIA GDP GROWTH 2022 - 2026, YOY (%)



note: as of Dec 2025. 2025 & 2026: Forecast
source: IPPFA

INSTITUTIONS FORECAST: CHINA AND INDIA GDP 2025- 2026, YOY (%)

Year	GDP Growth (%)							
	China				India			
	World Bank	IMF	ADB	OECD	World Bank	IMF	ADB	OECD
2025F	4.5	4.8	4.8	5.0	6.3	6.0	7.2	6.7
2026F	4.0	4.2	4.3	4.4	6.5	6.2	6.5	6.2

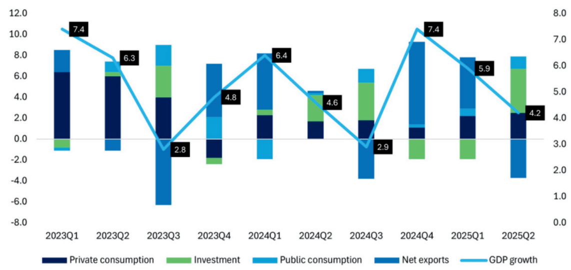
note: as of Dec 2025.
source: World Bank June 2025, IMF Oct 2025, ADB ADO Dec 2025, OECD Dec 2025

Beyond headline growth, China's economic structure continues to shift toward higher-value industries, as reflected in the technology, manufacturing and resource-sector indicators in the accompanying charts. Investment is increasingly directed into advanced sectors such as electric vehicles, batteries, semiconductors, robotics and renewable-energy equipment, where China has already established substantial global scale. The country's dominance in rare earths — essential for EV motors, magnets, aerospace, defence and clean-tech supply chains — further reinforces its strategic position and cushions the broader industrial transition. These strengths help counterbalance lingering softness in traditional manufacturing and the drag from a still-weak property sector. External demand is also recovering at the margin, particularly in electronics and high-end components, consistent with the global rebound in semiconductor and cloud-infrastructure cycles. However, confidence indicators for households and private firms remain subdued and local-government finances remain constrained. Against this backdrop, policymakers are likely to maintain a measured, risk-containment stance — preventing downside spillovers while avoiding large-scale stimulus — consistent with a stabilisation path rather than a reacceleration phase.

FIGURE 17

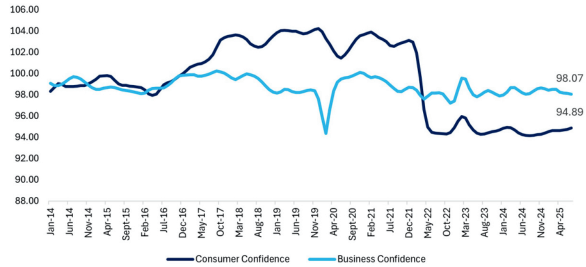
CHINA'S STRUCTURAL TRANSITION: SIGNALS FROM THE REAL ECONOMY

CONTRIBUTIONS TO QUARTERLY GDP GROWTH



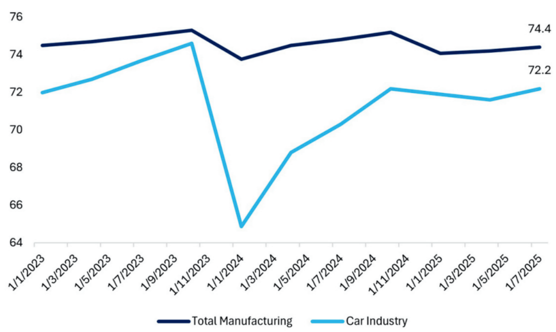
source: IMF

CONSUMER & BUSINESS CONFIDENCE



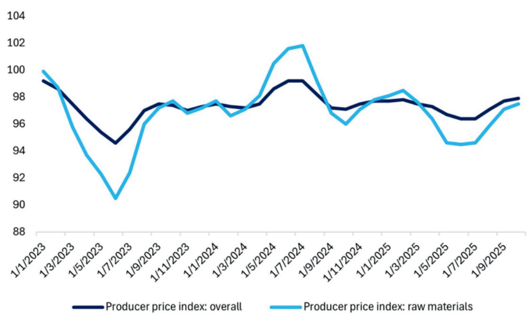
source: IMF, OECD

CAPACITY UTALISATION IS RELATIVELY LOW



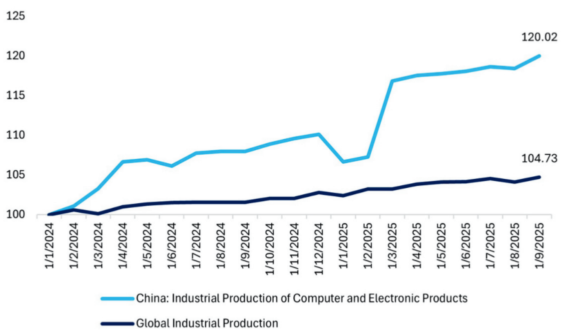
source: OECD, CEIC

PRODUCER PRICES ARE STARTING TO RECOVER



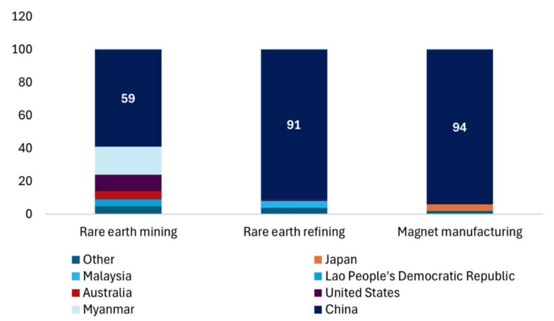
source: OECD, CEIC

TECH SECTORS OFFSET MANUFACTURING SOFTNESS



source: OECD, NBS

RARE EARTHS & PERMANENT MAGNET PRODUCTION



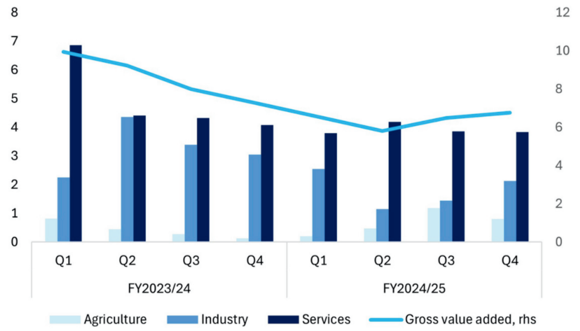
note: Data as of
source: OECD, NBS

Against this backdrop of China's measured stabilisation, India enters 2026 with a markedly stronger and more broad-based momentum that continues to distinguish it within emerging Asia. The latest data point to an economy driven by a well-synchronised combination of domestic demand, investment and sectoral depth, with the Gross Value Added (GVA) breakdown showing balanced contributions across agriculture, industry and services. Industrial activity has firmed alongside the manufacturing and construction recovery, while the services sector — underpinned by digital adoption, rising urban incomes and expanding technology-enabled services — remains India's most powerful growth engine. With inflation settling within the 4–5 per cent range and financial conditions remaining supportive, domestic consumption remains robust. Public infrastructure spending, healthier corporate balance sheets and rising foreign direct investment continue to reinforce the investment cycle. Together, these dynamics ensure India maintains its position as one of the fastest-growing major economies heading into 2026, providing a complementary source of regional strength alongside China's stabilising trajectory.

FIGURE 18

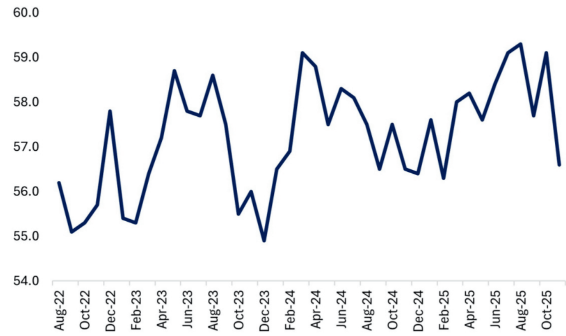
INDIA REMAINS THE FASTEST-GROWING EMERGING ECONOMY

INDIA'S SECTORAL ENGINES CONTINUE TO BROADEN



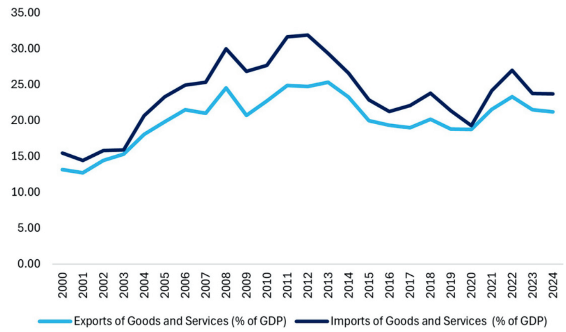
note: Percent change in non-seasonally adjusted real output (gross value added) from a year earlier and contributions of respective components.
source: Haver Analytics; World Bank.

MANUFACTURING PMI HOLDS ABOVE 50



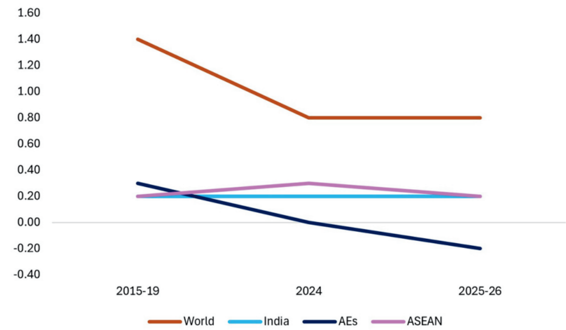
source: S&P Global

TRADE OPENNESS REMAINS HIGH



source: IMF

OIL DEMAND SIGNALS FIRM DOMESTIC CYCLE



note: Data based on IEA's Oil Market Report, May 2025 edition. 2025 and 2026 are projections.
source: International Energy Agency; World Bank.

India's sectoral indicators further underscore the breadth of this expansion. The Manufacturing PMI has remained comfortably above the 50-point threshold throughout 2024 and 2025, signalling sustained improvement in factory activity and forward production expectations.

This trend aligns with deepening capacity in electronics assembly, automotive components, pharmaceuticals and renewable-energy manufacturing — all supported by supply-chain diversification and targeted industrial incentives. Digital and IT-enabled services continue to anchor India's export base, supporting foreign-exchange inflows and enhancing competitiveness in high-value services. Reforms in taxation, labour markets and industrial policy are easing structural bottlenecks, lifting productivity and strengthening India's ability to integrate into regional and global value chains.

India's external position remains constructive. As the trade-openness chart shows, exports and imports of goods and services remain elevated as a share of GDP, reflecting India's deepening integration into global and regional supply chains. This openness enhances the country's attractiveness as a long-term investment destination. The oil-demand chart highlights another important structural trend: unlike many economies experiencing energy-demand softness, India's oil consumption is expected to hold firm through 2026, supported by industrial expansion, urbanisation and resilient mobility. This stability reinforces India's position as a major driver of Asia's energy and consumption cycles.

United States: Moderation, Policy Crosswinds and a Slower but Resilient Expansion

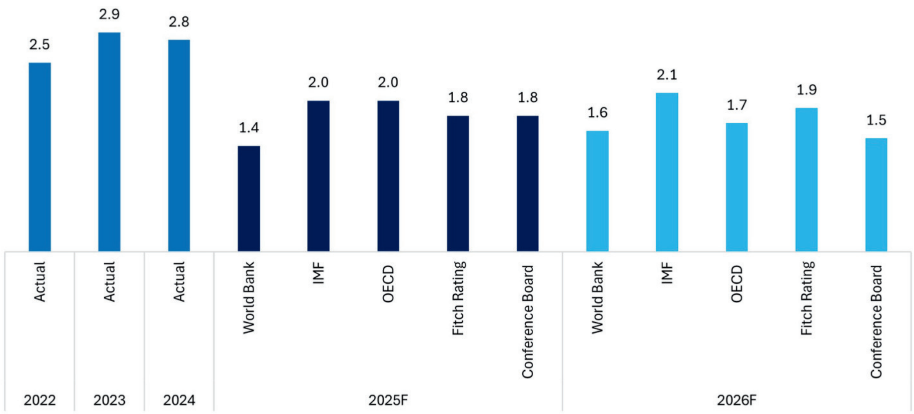
With Asia providing the principal anchor of global stability in 2026, attention now shifts to the United States and how it manages its transition from an overheated expansion to a more balanced, policy-dependent phase. The quality of this adjustment—rather than headline growth itself—will determine the direction of global financial conditions, shaping interest-rate differentials, capital flows and market volatility across both advanced and emerging economies.

U.S. economic momentum is cooling as the cycle transitions from a stimulus-lifted phase to one shaped more by underlying fundamentals. Most institutional forecasts point to real GDP expanding at a slower but positive pace, consistent with a late-cycle expansion characterised by uneven productivity gains and cooling demand. The effects of 2025's fiscal boost are fading, household spending is normalising and firms are recalibrating hiring plans in response to tighter labour conditions. Even so, the adjustment remains controlled. Household and corporate balance sheets are broadly stable, productivity gains in technology-intensive sectors continue to outperform and investment in digital infrastructure remains firm. The result is a slower but steady expansion profile—one that neither signals imminent recession nor suggests a return to the elevated growth rates of recent years, but instead provides a more predictable and stabilising contribution to the global outlook.

FIGURE 19

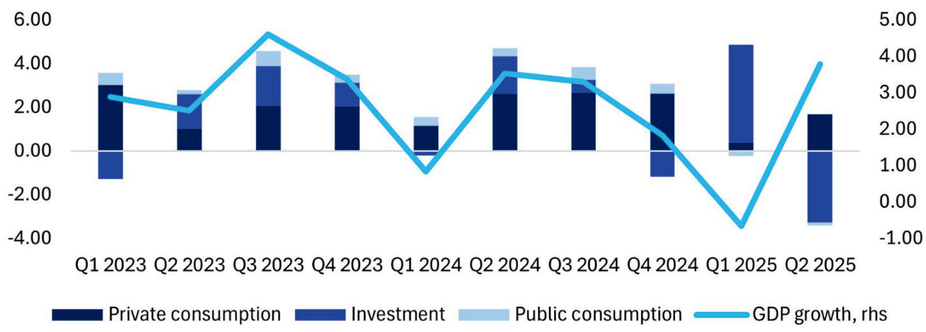
US FIVE-YEAR ECONOMIC GROWTH

GDP GROWTH WITH INSTITUTIONAL FORECAST 2022 - 2026, YOY (%)



note: as of Dec 2025. 2025 & 2026: Forecast
source: IPPFA, World Bank, IMF, OECD, Fitch Rating, Conference Board

CONTRIBUTIONS TO QUARTERLY GDP GROWTH



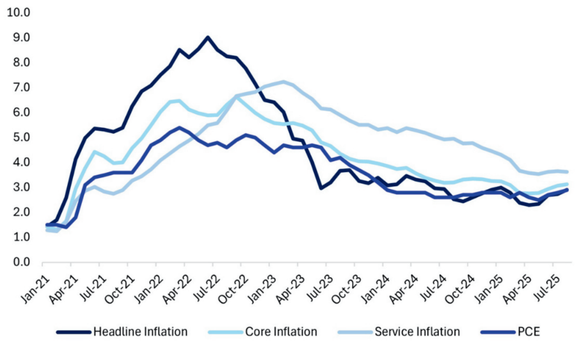
source: IMF

Inflation dynamics in the United States continue to complicate the policy outlook. While headline and core measures have eased from their 2022 peaks, the decline has slowed, and services inflation remains sticky — a trend mirrored in the still-firm labour market, where unemployment has hovered near 4 per cent with signs of gradual softening rather than a sharp adjustment. This combination keeps the Federal Reserve cautious. We expects a maximum of two 25-basis-point cuts in 2026, most likely in March and June, as policymakers balance cooling demand against the risk of a renewed inflation pulse driven by wages and services. Crucially, a more aggressive easing cycle would introduce additional risks: premature cuts could weaken policy credibility, loosen financial conditions too quickly and potentially reignite inflationary pressures, undermining the late-cycle stabilisation the Fed is attempting to engineer. As such, monetary policy is likely to remain firmly data-dependent, with the Fed tolerating only a gradual improvement in labour-market slack and inflation before considering further easing.

FIGURE 20

INFLATION AND LABOUR-MARKET DYNAMICS KEEP THE FED CAUTIOUS

PERSISTENT SERVICES INFLATION KEEPS FED CAUTIOUS



source: Federal Reserve

U.S. UNEMPLOYMENT EDGES HIGHER BUT STAYS FIRM

source: Federal Reserve

With inflation proving uneven across sectors and the Federal Reserve signalling a cautiously calibrated easing cycle, the behaviour of sentiment indicators has become a critical lens through which to understand how the U.S. real economy is absorbing late-cycle dynamics. The gradual cooling in labour-market conditions and the slower pace of disinflation have not produced a uniform response across households and firms; instead, a clear divergence has emerged. The University of Michigan Consumer Sentiment Index has risen steadily from the historical lows of 2022–2023, supported by easing inflation, firmer wage gains and improved real purchasing power among higher-income households. Yet sentiment remains well below pre-pandemic norms, underscoring persistent cost-of-living pressures — particularly in housing, healthcare and essential services — that continue to weigh on middle-income consumers and temper the breadth of the recovery.

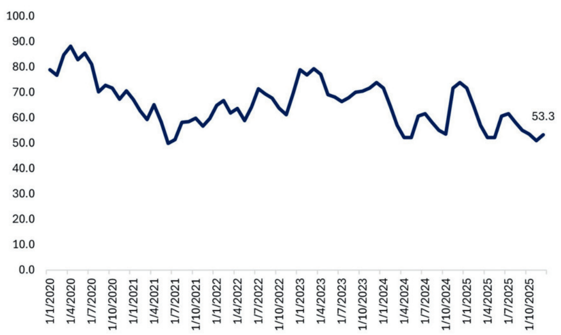
On the business side, the ISM Manufacturing PMI has spent much of 2024–2025 oscillating around the 50-point threshold, signalling muted activity, weaker new orders and cautious inventory strategies. Goods-producing industries remain more sensitive to tight financing conditions, margin compression and ongoing supply-chain reconfiguration, leaving manufacturing confidence slower to rebound than household sentiment.

The combination of a cautiously improving consumer outlook and persistently soft manufacturing sentiment captures the defining feature of this phase of the U.S. cycle: growth is still intact, but its drivers are increasingly narrow and uneven. Services and large corporates continue to provide stability, while smaller firms and middle-income households navigate more constrained conditions. Together, these sentiment dynamics reinforce the picture of a late-cycle expansion that is stabilising, but not yet broadening.

FIGURE 21

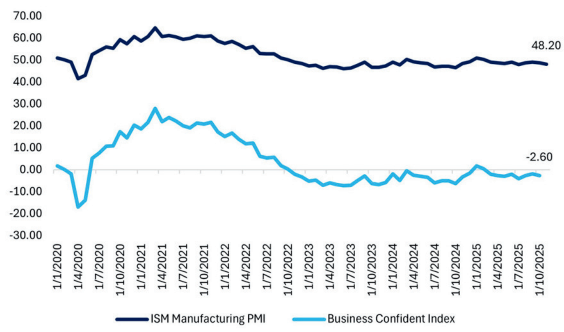
SENTIMENT DIVERGENCE: CONSUMERS RECOVERING, FIRMS CAUTIOUS

CONSUMER SENTIMENT REMAIN LOW



source: Federal Reserve

BUSINESS CONFIDENT AND PMI BELOW AVERAGE



source: Federal Reserve, OECD

As these uneven sentiment dynamics take hold, the next phase of the U.S. cycle depends increasingly on policy rather than organic demand, setting the stage for the One Big Beautiful Bill (OBBA) to play a more central role in shaping economic outcomes in 2026. Enacted in July 2025, OBBA represents the most substantial restructuring of investment and household incentives in nearly a decade, aimed at countering softening business confidence, reinforcing real incomes and strengthening the supply side of the economy. Its core provisions — full expensing for equipment and R&D, expanded family deductions and targeted regulatory streamlining — are designed to accelerate capital deepening, support technology adoption and ease cost-of-living pressures. In effect, OBBA operates both as a cyclical buffer and a structural catalyst, intended to maintain resilience in an economy that is transitioning from broad-based growth to a more policy-dependent, late-cycle configuration.

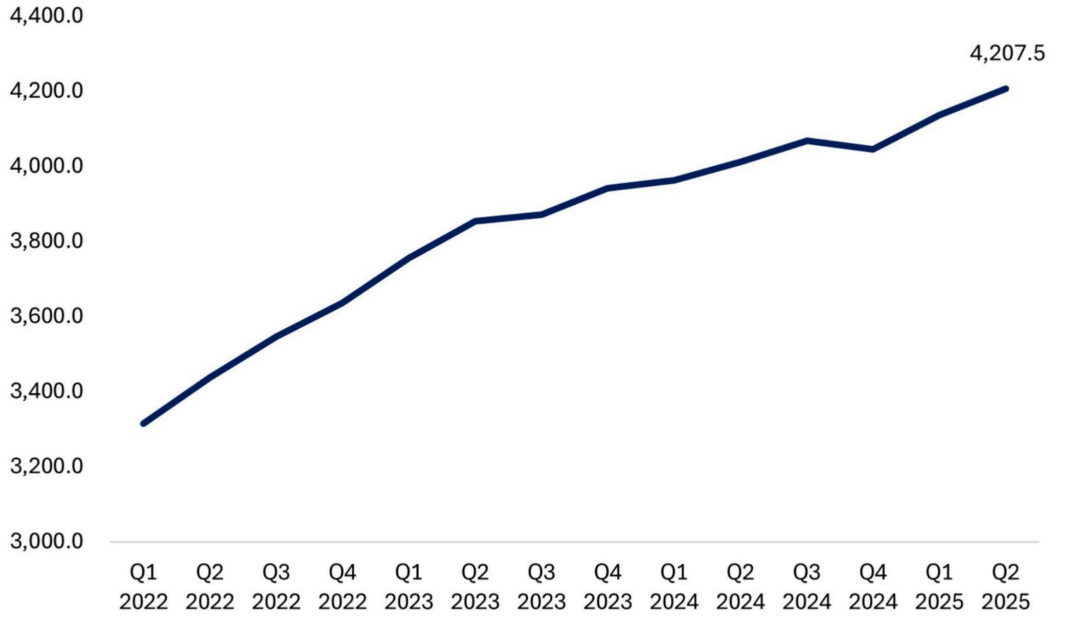
Against this backdrop, OBBA's fiscal and regulatory measures introduce a distinctive policy impulse that operates through both corporate investment and household income channels, a dynamic made evident in the recent behaviour of fixed investment and transfer receipts. On the corporate side, enhanced full expensing lowers the effective cost of capital and is expected to encourage firms to pull forward planned capex. While OBBA's impact will only begin to appear in the data from Q3 2025 onward, the steady rise in private non-residential fixed investment (PNFI) up to Q2 2025 highlights that underlying momentum in automation, AI infrastructure and energy upgrading was already in place before the legislation. OBBA therefore amplifies an existing investment cycle rather than creating a new one. On the household side, OBBA's tax relief will not immediately appear in paycheques due to delayed withholding adjustments; instead, it will surface as unusually large refunds in early 2026, reinforcing consumption at a point when demand is expected to soften. This aligns with the seasonal spikes visible in personal current transfer receipts (PCTR), which are poised for an amplified increase next year.

Together, these channels generate an asymmetric fiscal boost — steady, investment-led momentum complemented by a concentrated household income surge — adding complexity to the Federal Reserve's task of engineering controlled disinflation without reigniting price pressures. As these fiscal measures filter through corporate and household channels, the tone of 2026 will increasingly be shaped by how quickly financial conditions ease and whether markets internalise the shift toward a gentler policy environment.

FIGURE 22

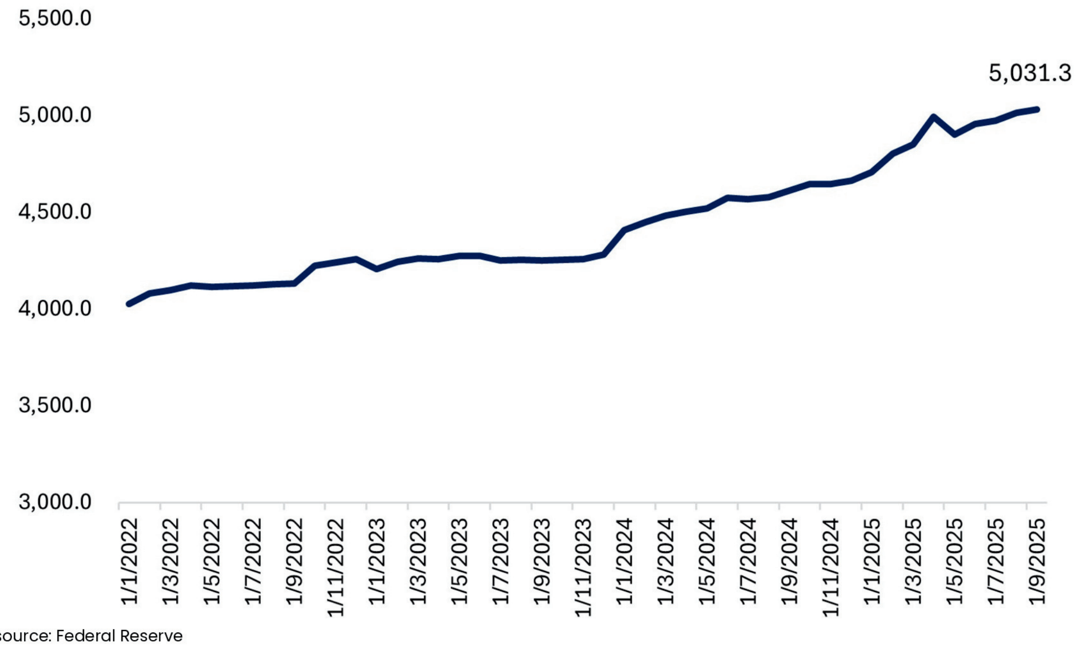
OBBA: A DUAL-DEMAND AND INVESTMENT IMPULSE

OBBA TRANSMISSION — CORPORATE INVESTMENT RESPONSE



source: Federal Reserve

OBBA TRANSMISSION — HOUSEHOLD REFUND BOOST



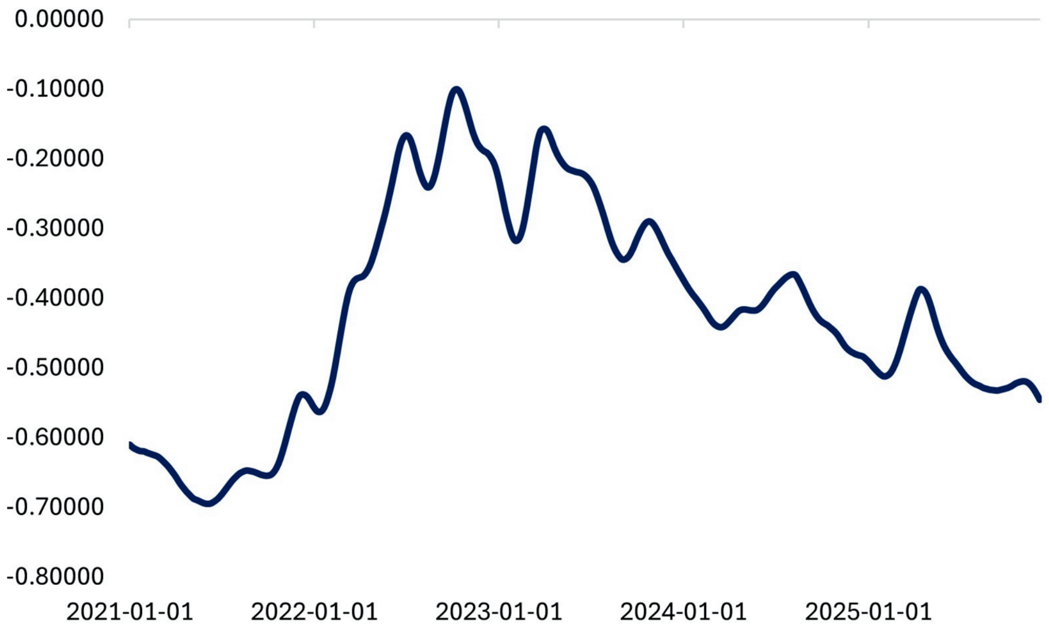
source: Federal Reserve

This evolving fiscal impulse feeds directly into broader financial conditions, which have been easing steadily even before any formal policy rate cuts materialise. The National Financial Conditions Index (NFCI) continues to drift downward from the tightness seen during the 2022–2023 hiking cycle, with conditions now approaching the loosest levels since early 2021. Credit spreads have narrowed, liquidity indicators are improving and market risk appetite has firmed, all signalling that financial markets are pre-emptively pricing a gentler macro landscape for 2026. This easing offers meaningful support to activity at a time when consumption is cooling and business sentiment remains uneven. Yet it also amplifies the Federal Reserve's central dilemma: too much easing too soon risks rekindling demand and slowing progress on disinflation, particularly in labour-intensive services. The NFCI trend therefore captures the essence of the U.S. outlook — an economy moving toward a soft landing, but one where the balance between stability and overheating remains delicate, and where policy calibration will determine whether easing financial conditions reinforce resilience or inadvertently prolong inflation persistence.

FIGURE 23

U.S. FINANCIAL CONDITIONS INDEX POINTS TO GRADUAL EASING INTO 2026

NORMALISATION OF U.S. FINANCIAL CONDITIONS SIGNALS



source: Federal Reserve

Mapping the Crosswinds: Key Risks Shaping 2026

Although Malaysia enters 2026 with strengthening domestic momentum and Asia providing a stable — though normalising — external backdrop, the apparent macro resilience masks a more complex risk landscape. MSMEs, in particular, face rising vulnerabilities despite favourable headline indicators, as cost pressures intensify alongside a persistently tight labour market, elevated wage expectations, growing skill mismatches and accelerating technological demands. These challenges coincide with the structural ambitions of RMK13 and the policy signals in Budget 2026, both of which require MSMEs to upgrade capabilities precisely when operational buffers are thinnest. At the global level, the primary risks stem not from weak growth but from shifting policy regimes — including evolving tariff rules, industrial-policy recalibrations and tightening supply-chain security frameworks across major economies — all of which introduce new uncertainties for Malaysia's highly open economy.

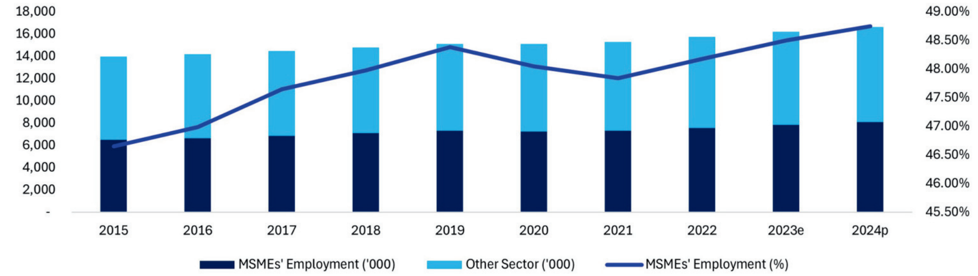
Malaysia's MSME: Cost Pressures, Labour Tightness and Capability Gaps in 2026

Malaysia enters 2026 with a firm macroeconomic footing, yet this strength is unevenly distributed across the business landscape. The employment data underline why MSMEs sit at the centre of this divergence. Over the past decade, MSMEs have consistently accounted for nearly half of total national employment, with their share rising from around 46.5 per cent in 2015 to close to 49 per cent by 2024. In absolute terms, MSME employment has expanded steadily, even through periods of economic disruption, reinforcing their role as the economy's primary employment anchor. This structural dominance means that MSME performance is no longer a peripheral issue but a core determinant of labour-market stability, household income and domestic consumption.

FIGURE 24

MSMES ANCHOR NEARLY HALF OF MALAYSIA'S EMPLOYMENT

SHARE OF TOTAL EMPLOYMENT (%) AND EMPLOYMENT LEVEL ('000)

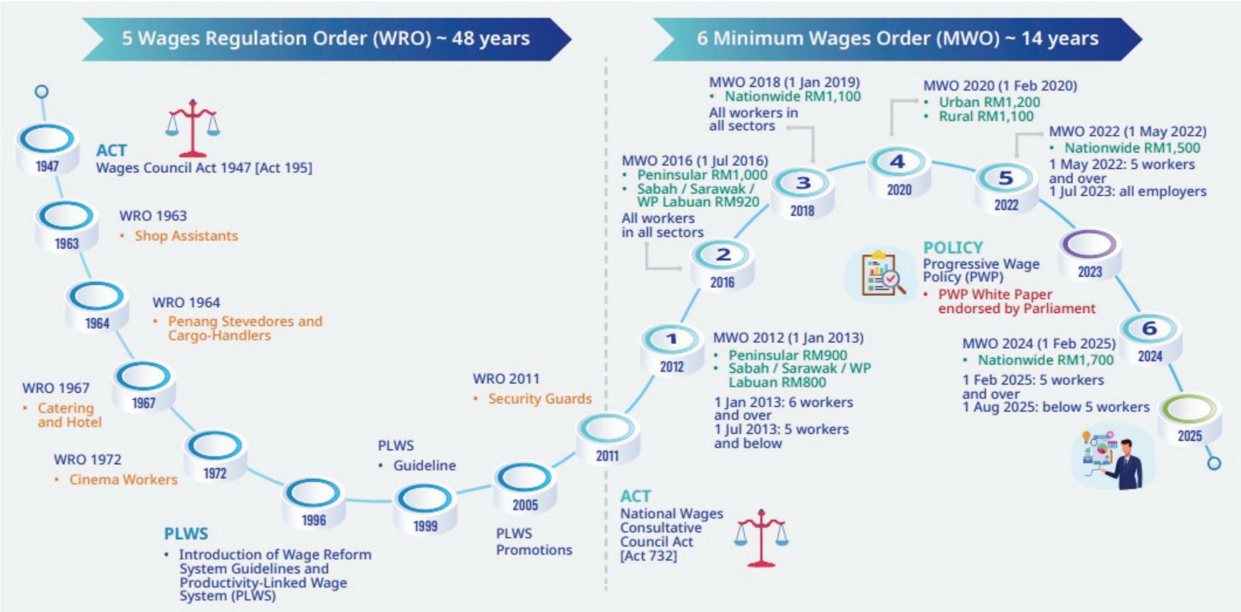


note: Data as of July 2025. 2023 estimates, 2024 preliminary
source: Department of Statistic Malaysia

Given the central role MSMEs play in national employment, labour policy becomes the most direct channel through which macroeconomic adjustments are transmitted into firm-level risk. In this context, Malaysia's minimum wage framework represents both an economic necessity and a near-term pressure point for MSMEs heading into 2026. From a macroeconomic perspective, minimum wage adjustments are defensible: standard labour-market theory suggests that higher wage floors can support aggregate demand, reduce in-work poverty and encourage productivity upgrading, particularly in economies transitioning toward higher value-added activities. Over time, better wage alignment can improve labour retention and reduce costly turnover, outcomes that are consistent with Malaysia's medium-term productivity ambitions under the 13th Malaysia Plan.

FIGURE 25

EVOLUTION OF WAGES POLICY AND INSTITUTIONS

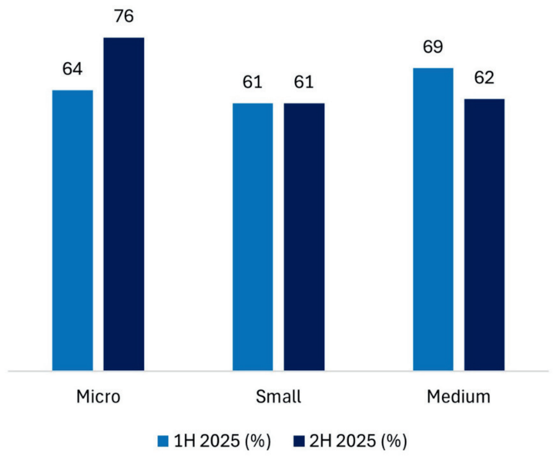


source: Ministry of Finance Malaysia, National Wages Consultative Council

However, the short-run transmission is uneven. For MSMEs operating with thin margins, limited pricing power and labour-intensive business models, wage increases translate almost immediately into higher operating costs. Industry feedback and recent MSME surveys conducted by SME Bank consistently identify labour expenses as one of the fastest-rising cost components, particularly across services, retail, logistics and traditional manufacturing segments. The macro trade-off is therefore clear: while higher wages support household income and consumption at the aggregate level, they simultaneously compress MSME margins, raising execution risk if productivity gains do not materialise quickly enough. Mitigating this imbalance requires firms to move beyond viewing minimum wage adjustments as a pure cost shock and instead treat them as a catalyst for operational recalibration — through workforce redesign, selective automation, tighter performance-linked remuneration and more effective use of government incentives tied to training, digitalisation and productivity upgrading. In this sense, the minimum wage challenge in 2026 is less about wage levels per se, and more about MSMEs' capacity to adapt business models quickly enough to absorb structurally higher labour costs without eroding competitiveness or employment stability.

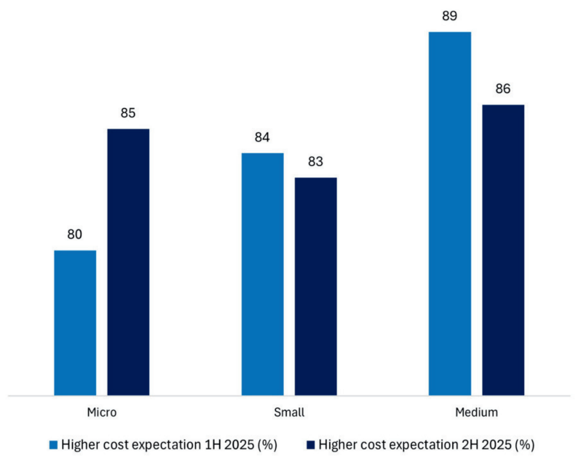
FIGURE 26
LABOUR COSTS ARE A KEY PRESSURE FOR MSMES

FUTURE SALES EXPECTATION (% RESPONDENT)



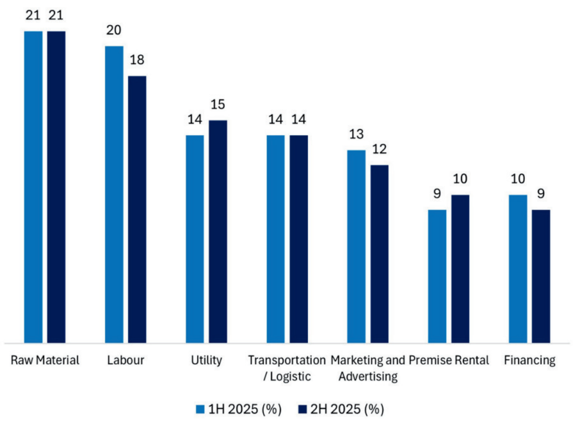
source: SME Sentiment Index 2H 2025, SME Bank

HIGHER COST EXPECTATION (% RESPONDENT)



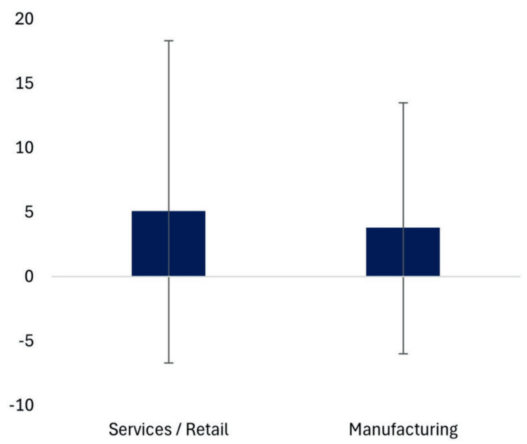
source: SME Sentiment Index 2H 2025, SME Bank

FACTORS CONTRIBUTING TO HIGHER COST EXPECTATION (% RESPONDENT)



source: SME Sentiment Index 2H 2025, SME Bank

ESTIMATED IMPACT OF MINIMUM WAGE INCREASE ON MSME OPERATING COSTS (95% CI)



source: IPPFA, 2025

ESTIMATED IMPACT OF MINIMUM WAGE INCREASE ON OPERATING COSTS

MSME Segment	Labour Cost Share (%)	Wage Increase (RM)	Estimated Increase in Total Operating Costs
Services & Retail	32–35%	RM1,500 → RM1,700	**+5.1%** (median)
Manufacturing	22–25%	RM1,500 → RM1,700	**+3.8%** (median)
High Labour Intensity (P95)	>40%	RM1,500 → RM1,700	**Up to +14–18%**

source: IPPFA, 2025

This divergence is best understood when translated into quantified outcomes rather than qualitative intuition. Econometric simulations indicate that a hypothetical increase in the minimum wage from RM1,500 to RM1,700 would raise total operating costs for a representative MSME by approximately 5.1 per cent in services and retail and 3.8 per cent in manufacturing, reflecting differences in sectoral labour intensity. More importantly, the distribution of outcomes is highly asymmetric. At the 95 per cent confidence level, total operating costs for services-oriented MSMEs could range from marginal declines to increases exceeding 18 per cent, while manufacturing firms face a narrower but still material upper-bound impact of around 14 per cent. This dispersion suggests that minimum wage adjustments do not act as a uniform cost increment across the MSME base. Instead, they function as a screening mechanism, exposing firms with weaker productivity buffers, tighter cash-flow positions and limited pricing flexibility. In 2026, the policy impact is therefore less about the average cost increase and more about which firms are structurally positioned to absorb the adjustment, reinforcing the risk of widening performance gaps within the MSME segment.

The stress-test effect of minimum-wage adjustments raises a natural follow-up question: what differentiates MSMEs that absorb this cost shock from those that do not? The evidence points decisively to structure rather than scale. Firms that manage higher labour costs without destabilising operations tend to exercise tighter control over total compensation, not wages alone. In practice, this means maintaining clear visibility over all labour-related outlays — including fixed benefits, insurance premiums and statutory contributions — and actively managing them as a unified cost framework rather than treating non-wage components as immovable overheads.

One area where inefficiencies are most persistent, yet frequently overlooked, is employee medical insurance coverage. For many MSMEs, medical benefits are either under-designed or over-engineered, resulting in cost leakage that compounds wage pressure. Over-insurance typically arises when firms apply uniform inpatient limits across a heterogeneous workforce, regardless of age, marital status or seniority. Under-coverage, by contrast, shifts medical cost risk back onto employees, often translating into higher absenteeism, morale erosion or unplanned employer top-ups. In both cases, costs rise without a commensurate improvement in productivity or workforce stability.

FIGURE 27

EMPLOYEE MEDICAL INSURANCE COVERAGE

EXAMPLE OF ANNUAL PREMIUM FOR CASHLESS PLAN

Hospitalisation	Plan 1	Plan 2	Plan 3	Plan 4
Employee Only	1,381.00	932.00	702.00	416.00
Employee and Spouse	3,454.00	2,332.00	1,759.00	1,042.00
Employee and Children	3,454.00	2,332.00	1,759.00	1,042.00
Employee and Family	5,527.00	3,730.00	2,813.00	1,668.00

source: IPPFA, 2025

Optimising employee benefits is one of the most underappreciated levers through which MSMEs can absorb higher labour costs without suppressing wages. In many firms, employee medical insurance has evolved incrementally rather than strategically, resulting in either over-coverage that delivers limited marginal value or under-coverage that exposes both employers and employees to volatile out-of-pocket costs. A comparison of standard cashless medical plans commonly adopted by MSMEs shows that annual premiums can vary meaningfully for broadly similar core protection, driven less by risk profile than by benefit design, panel structure and rider selection. For a representative MSME workforce, differences in plan configuration alone can generate premium dispersion of 15–25 per cent, even before utilisation effects are considered. In a labour environment where costs are rising structurally, such design inefficiencies represent a silent but material drain on operating margins.

FIGURE 28

MEDICAL BENEFIT DESIGN AS A HIDDEN DRIVER OF MSME LABOUR COSTS

CAN SAVINGS BE REDEPLOYED WITHOUT RAISING TOTAL COST?

Item	Before Optimisation (RM)	After Optimisation (RM)	Net Effect
Average annual medical premium per employee	2,000	1,650	–350
Total annual medical premium (20 employees)	40,000	33,000	–7,000
Total employee allowances funded from savings	–	7,000	+7,000
Total labour-related cash outlay	40,000	40,000	Neutral
Share of fixed vs flexible costs	Mostly fixed	More flexible	↓ Rigidity
Perceived employee benefit value	Moderate	Higher	↑

Cost Driver	Lean Design	Typical Design	Over-Engineered Design	Impact on Premium
Inpatient annual limit (RM)	80,000	100,000	150,000	↑ non-linear
Room & board (RM/day)	150	200	300	↑ moderate
Panel size & network	Narrow	Standard	Broad / premium	↑ material
Outpatient visit cap	Limited	Standard	Unlimited	↑ utilisation-driven
Riders (maternity, specialist, dental)	Minimal	Selective	Comprehensive	↑ structural
Indicative annual premium per employee (RM)	**1,600**	**1,900**	**2,300**	—
Premium dispersion vs median	–16%	Baseline	21%	**15–25% range**

source: IPPFA, 2025

The economic trade-off becomes clearer when viewed through a total-compensation lens rather than a wage-only framework. Malaysian tax guidelines allow employers to treat medical benefits as allowable business expenses, but they do not require firms to maximise insurance coverage indiscriminately. Simulated scenarios suggest that rationalising medical coverage—by aligning sum assured, outpatient limits and rider benefits more closely with actual workforce demographics—can free up meaningful cost headroom. For example, reducing redundant inpatient riders or excess outpatient limits could lower annual premium outlays by several hundred ringgit per employee.

Under-insurance, however, carries its own execution risks and must be avoided. Insufficient coverage shifts medical costs back onto employees, increasing financial stress, absenteeism and turnover—outcomes that ultimately feed back into higher replacement and training costs for employers. The optimal strategy, therefore, is not cost minimisation but benefit calibration. Evidence from overseas MSME-heavy economies shows that firms which segment benefits by employee profile—differentiating between operational staff, senior management, single versus family dependants—and formally review insurance structures every two to three years achieve more stable labour costs and higher employee satisfaction. In practice, this approach converts employee benefits from a static overhead into an adjustable risk-management tool.

FIGURE 29

EMPLOYEE MEDICAL COVERAGE NEEDS BY AGE, MARITAL STATUS AND SENIORITY (ILLUSTRATIVE FRAMEWORK)

COVERAGE CALIBRATION MATRIX

Employee Profile	Typical Risk Characteristics	Efficient Coverage Focus	Cost Efficiency Implication
Young, Single (<35)	Low inpatient usage, short stays	Moderate inpatient cap, optional outpatient	Avoids over-insurance
Mid-career, Married (35–50)	Rising utilisation, dependents	Higher inpatient cap, maternity / specialist riders	Balances cost & welfare
Senior staff (50+)	Higher chronic risk, replacement cost	Enhanced inpatient limits, chronic care	Reduces productivity loss
Clerical / Operational	Labour-intensive, lower income buffer	Core inpatient protection	Prevents financial stress
Management / Key personnel	High replacement risk	Higher caps, broader panel	Protects business continuity

source: IPPFA, 2025

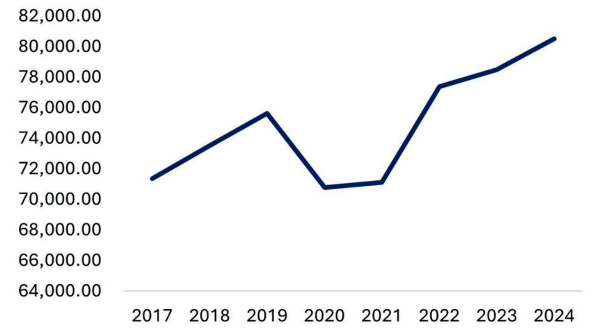
Within the broader context of 2026, where wage floors continue to rise and structural operating costs remain elevated, cost optimisation alone is insufficient to determine MSME resilience. While benefit calibration can partially buffer immediate wage pressures, it does not address the binding constraint emerging within Malaysia's tightening labour market, which is the availability, stability and productivity of workers relative to rising unit labour costs. Recent labour productivity patterns reflect this tension. After the pandemic trough, MSME labour productivity has resumed an upward trend, yet the recovery remains gradual compared with the acceleration in wage levels. As unit labour costs rise faster than output per worker, the widening productivity to wage gap presents a growing execution risk for MSMEs, particularly those constrained by small workforce pools and limited redundancy in operational roles.

This divergence is visible at the firm level. Hiring difficulties for semi-skilled roles persist, turnover remains elevated and many MSMEs continue to rely heavily on overtime, extended shifts or informal staffing adjustments to maintain operations. Such workarounds increase effective labour costs beyond headline wages and heighten operational fragility. These pressures compound long-standing utilisation inefficiencies that include legacy job structures, uneven skills across staff and excessive dependence on a small cohort of experienced workers.

FIGURE 30

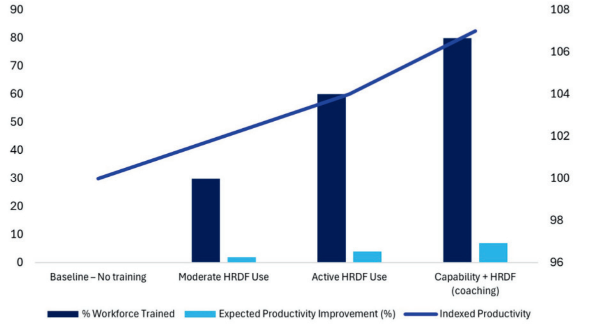
HRDF UTILISATION & MSME WORKFORCE PRODUCTIVITY PATHWAYS IN 2026

LABOUR PRODUCTIVITY TRAJECTORY FOR MALAYSIAN MSMES



source: Department of Statistics Malaysia, MSME Labour Productivity Statistics, 2017–2024. IPPFA, 2025

ESTIMATED PRODUCTIVITY GAINS UNDER HRDF TRAINING UTILISATION SCENARIOS



source: IPPFA, 2025

Under tightening labour conditions, incremental wage increases provide diminishing returns if they are not complemented by capability strengthening. Firms facing identical wage levels may experience sharply different outcomes depending on their ability to deploy and utilise labour efficiently.

Evidence from structured workplace upskilling strengthens this conclusion. Workforce development simulations demonstrate a positive and scalable relationship between training intensity and worker productivity. As a greater proportion of employees receive structured skills upgrading, indexed productivity rises accordingly through improved task efficiency, faster throughput and reduced execution errors. Improvements in task efficiency, workflow stability and workforce retention mean that structured skills development can translate productivity gains into operational continuity. For MSMEs, the value of training therefore lies not only in reducing unit labour cost pressures but in reinforcing output capacity without proportional increases in staffing. These relationships show that labour expenditure can generate measurable performance gains when channelled toward capability enhancement rather than being absorbed as higher wage overheads.

The strategic implication for MSMEs in 2026 is clear. Labour strategy must move beyond headcount adjustments and wage increases toward targeted capability alignment and skills enhancement. Structured training pathways, particularly those funded through levy mechanisms that employers already contribute to, offer a cost efficient means to lift utilisation efficiency, moderate unit labour cost pressures and protect operating margins in an environment where replacing workers is both costly and uncertain. MSMEs that embed structured skills development into workforce planning are better positioned to preserve service quality, sustain operations and formalise internal talent pipelines. In this way, labour tightness can serve not merely as a macroeconomic constraint but as a catalyst for capability upgrading that converts labour investment into productivity and revenue resilience for Malaysian MSMEs.

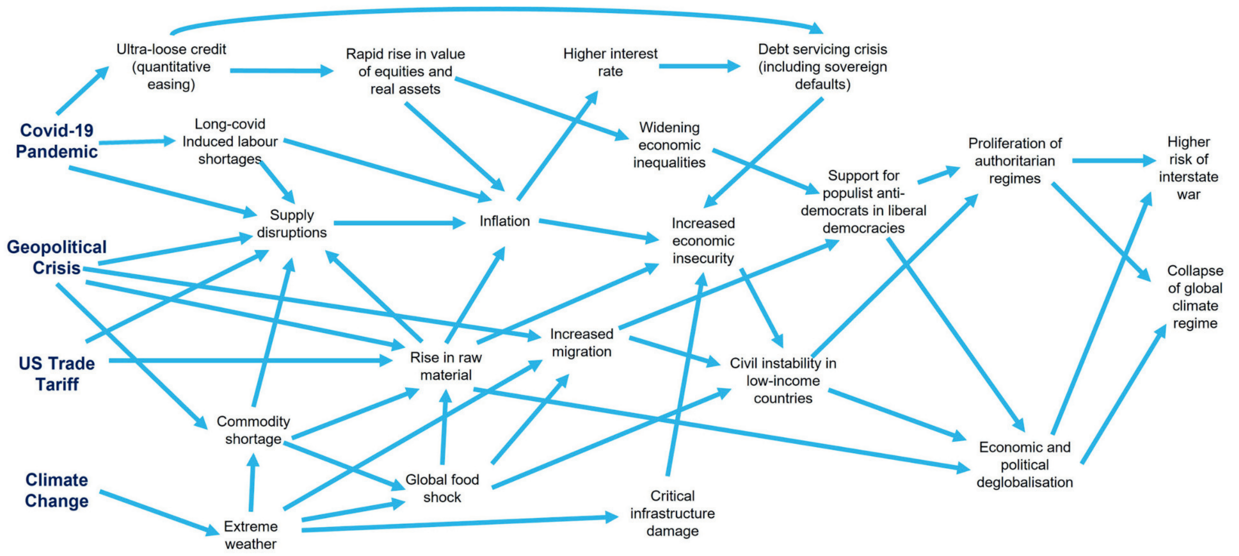
Geoeconomic Fractures: Trade Fragmentation, Technology Controls and Resource Scarcity in 2026

The interconnected nature of contemporary global shocks means that risks in 2026 will not unfold independently. Rather than a sequence of isolated disruptions, Malaysia faces an increasingly dense web of feedback loops linking public health legacies, geopolitical confrontation, supply chain reconfiguration, trade protectionism and climate related stresses. The escalation of these linkages creates an environment where a disruption in one domain accelerates vulnerabilities in others, compressing reaction time for policy makers and firms alike. Such interdependence is defining a shift away from predictable globalisation toward a more contested mercantilist setting, where competing industrial strategies, technology access controls and resource security considerations drive policy choices. Within this emerging landscape, uncertainty is not linear or cyclical but compounding, underscoring the need for more systematic assessment of geoeconomic exposure and strategic resilience as Malaysian businesses navigate 2026.

FIGURE 31

POLYCRISIS ESCALATION IN A MODERN MERCANTALIST WORLD

POLYCRISIS WEB



source: Thomas Homer-Dixon, The Cascade Institute; IPPFA 2025

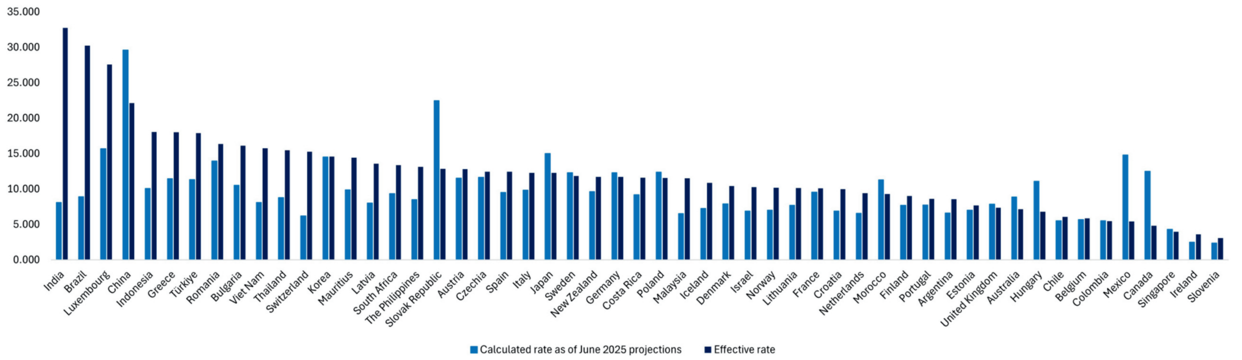
As the geoeconomic environment fragments, the most immediate pressure emanates from the recalibration of U.S. tariff and industrial policy under Trump 2.0. Sweeping proposals for reciprocal tariffs, domestic-content prioritisation and preferential sourcing frameworks indicate a structural realignment of production geography rather than short-term protectionism. Instead of relying solely on headline rates, the transmission mechanism will likely operate through rules-of-origin tightening, local-content verification and conditional access to U.S. markets for firms operating outside designated friendshoring corridors. These shifts compress planning visibility, elevate compliance risk and raise the cost of sustaining access to strategic markets, particularly for semiconductor-linked and industrial machinery exporters integrated into U.S. value chains. Firms dependent on intermediate exports may need to diversify trade-routing strategies, build sourcing redundancies and negotiate more flexible contract terms to absorb policy-induced volatility in 2026.

These firm-level adjustments must be read within a wider strategic context. What appears initially as compliance friction reflects a deeper structural recalibration of U.S. tariff policy under Trump 2.0, in which tariffs are increasingly deployed to reshape global production networks. Whereas earlier tariff episodes tended to function as temporary bargaining tools, the present escalation signals a durable shift anchored in industrial and geostrategic priorities. Proposed tariff schedules extend beyond headline rate increases to incorporate domestic-content verification, preferential sourcing incentives and rules-of-origin tightening designed to accelerate reshoring and friendshoring trajectories. These measures aim to re-anchor manufacturing capacity, strengthen supply-chain security and reinforce U.S. leverage over strategic technologies. OECD estimates of effective tariff rates show a sustained upward drift across product categories, reinforcing expectations that tariff tightening is structural rather than cyclical. As such, tariff realignment increasingly defines the parameters within which export-dependent economies must recalibrate strategy and reposition within global production architectures.

FIGURE 32

US TRADE TARIFF

ESTIMATED US EFFECTIVE TARIFF RATES



note: Estimates based on trade policy announcements as of 14 November 2025 and calculated using weights based on product level data for US imports by country in 2024. These take account of country-specific tariff rates and sector-specific changes due to a 25% tariff rise for listed cars, parts, trucks and buses; a 50% tariff rise on steel, aluminium and copper products; and zero-rated general goods as well as those related to semiconductors. Europe, Japan and Korea face a maximum 15% tariff on cars and parts, and timber, and 0% tariffs are applied to civil aviation products, generic pharmaceuticals and certain natural resources). The United Kingdom faces a 25% tariff rise on steel and aluminium, 7.5% for British cars within the annual quota, 10% on timber products, and duty-free civil aviation products. China, Brazil and India face additional country specific tariffs, with varying application across products. Data classifications are based on product-level lists published by the US administration.
source: United States International Trade Commission; US Census Bureau, and OECD calculations.

The structural nature of tariff realignment also shapes how its effects propagate globally. Impacts extend far beyond border-tax adjustments and permeate the financial and operational foundations of supply-chain organisation. As tariff burdens rise, compliance obligations intensify through more rigorous documentation, origin-verification procedures and certification thresholds, raising administrative costs and elevating legal exposure. Firms respond by reassessing sourcing arrangements, accelerating diversification initiatives and building larger inventory buffers to mitigate potential clearance delays or reclassification risks. These behavioural adjustments contribute to heightened trade-policy uncertainty, which IMF and OECD estimates show dampens trade elasticity, investment intentions and capital-expenditure cycles. Export diversion emerges as a central transmission channel as shipments are redirected toward jurisdictions offering reciprocal access or lower tariff exposure, reinforcing fragmentation within supply networks. For firms embedded in multi-jurisdictional production processes, rules-of-origin tightening raises the likelihood of cascading tariff incidence as components traverse borders multiple times before final assembly. The resulting lengthening of working-capital cycles and contractual renegotiation requirements illustrates how tariff escalation restructures not only cost dynamics but also the strategic economics of supply-chain management.

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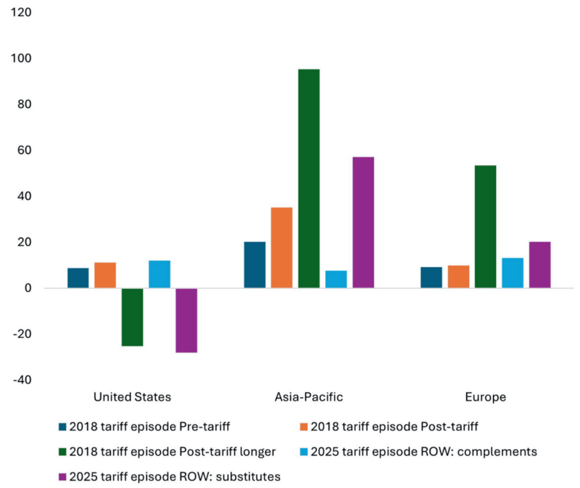
FIGURE 33

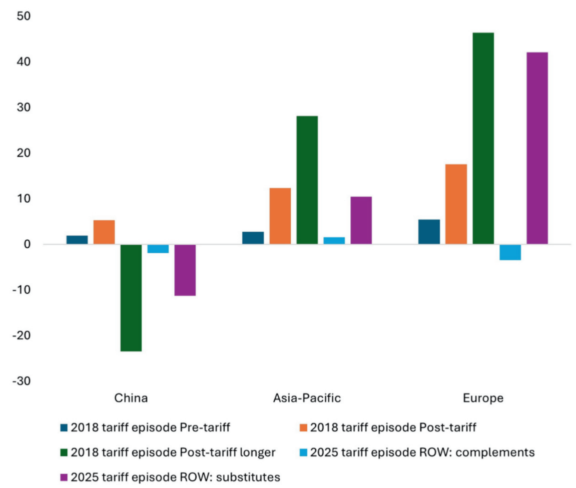
TRADE REALLOCATION IN RESPONSE TO TARIFFS

EXPORT FROM CHINA



source: Trade Data Monitor; and IMF staff calculations.

EXPORT FROM US



source: Trade Data Monitor; and IMF staff calculations.

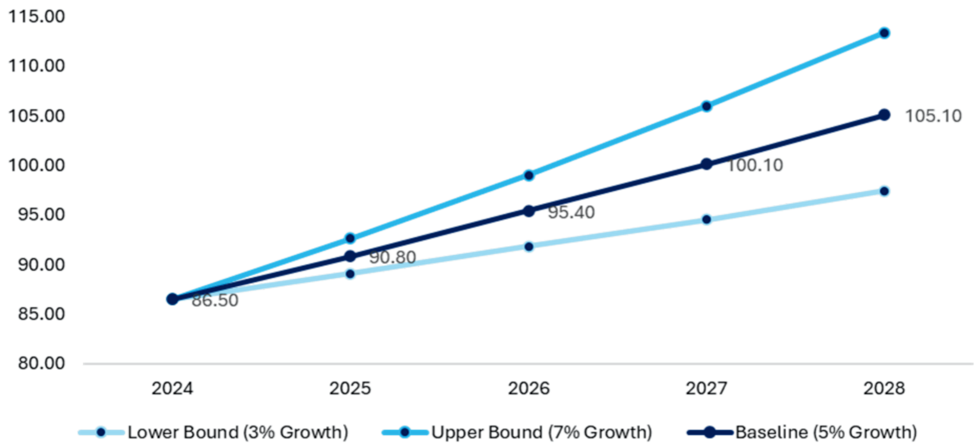
These evolving dynamics hold particularly significant implications for Malaysia. Its deep integration into global semiconductor, electrical and electronics and precision-engineering value chains—systems characterised by high intermediate-goods intensity and frequent cross-border processing—exposes domestic firms to cumulative tariff incidence even where direct tariff lines remain unchanged. Mid-tier contract manufacturers are especially vulnerable due to thin margins, concentrated input dependencies and limited working-capital buffers. Delays in customs clearance, documentation mismatches or changes in component classification can trigger disruptive cost escalation and ripple effects through delivery schedules. Without enhanced traceability systems, diversified routing strategies and strengthened procurement frameworks, smaller firms may struggle to adapt quickly to policy-driven shocks. These pressures risk entrenching heterogeneity within Malaysia's industrial base, widening capability gaps between globally competitive leaders equipped to navigate tariff uncertainty and domestically oriented firms lacking strategic resilience.

These vulnerabilities heighten the need for institutional mechanisms that can cushion Malaysian firms from policy-driven supply-chain shocks. One such stabilising anchor is the U.S.–Malaysia Agreement on Reciprocal Trade (ART). In October 2025, IPPFA published a detailed research note evaluating Malaysia's positioning under the agreement, modelling tariff-risk insulation pathways and medium-term multiplier effects. Projections embedded in the agreement indicate bilateral trade rising from USD86.4 billion in 2024 toward USD110–115 billion by 2030, implying USD20–25 billion in cumulative trade expansion supported by predictable tariff ceilings and reciprocal market access. This trade uplift is expected to reinforce domestic capital formation, lifting Malaysia's investment-to-GDP ratio from roughly 21 per cent in 2024 toward a 24–28 per cent range by 2028, underpinned by USD15–18 billion in anticipated U.S. FDI. Complementary productivity spill-overs arise through standard harmonisation and technology diffusion, with cumulative TFP projected to exceed baseline trajectories through sustained 0.3 percentage-point annual improvements. Efficiency gains also materialise as certification processes and customs procedures are streamlined, reducing clearance durations from approximately 62 hours to below 36 hours by 2030 and generating USD1.1–1.3 billion in operational savings. Taken together, these transmission channels demonstrate how ART can transform tariff-exposure from a structural vulnerability into a platform for resilience-building and value-added upgrading under a fragmented global trade landscape.

FIGURE 33

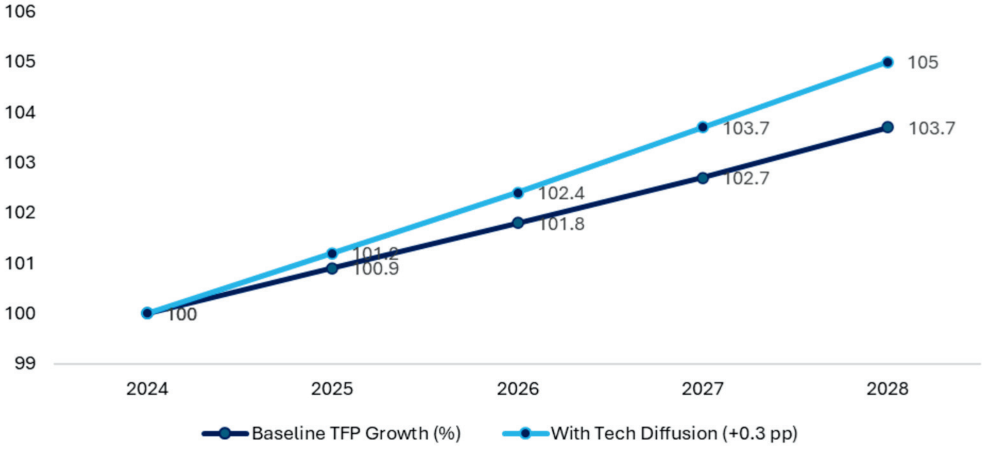
ART AS A RESILIENCE ANCHOR: QUANTIFIED TRADE, FDI AND PRODUCTIVITY EFFECTS FOR MALAYSIA, 2024–2030

PROJECTED US-MALAYSIA BILATERAL TRADE (USD BILLION)



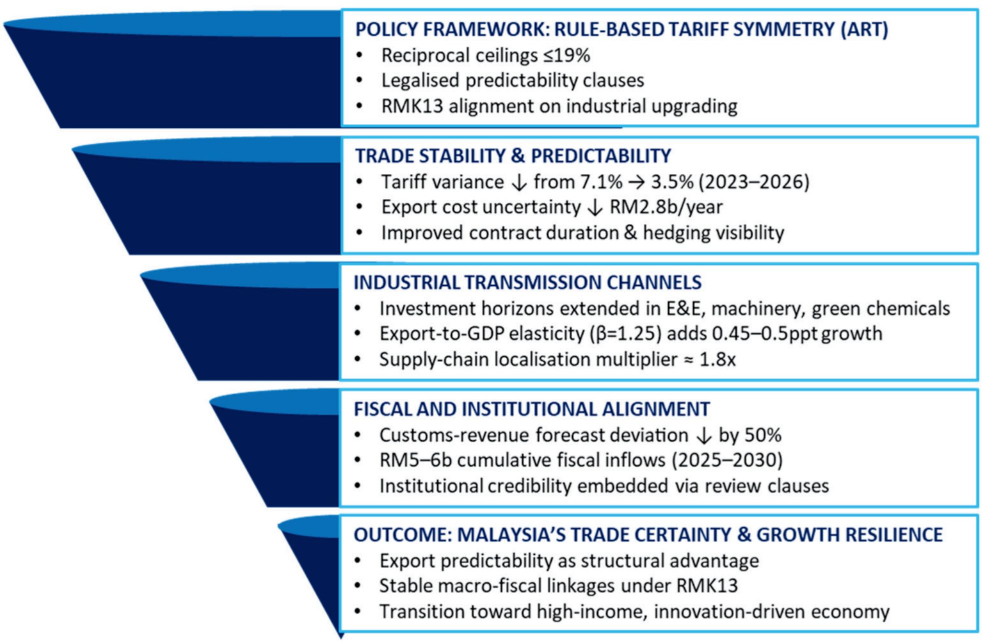
source: US Census Bureau (Foreign Trade Division): Primary data for 2024 full-year ($86.4B total) and 2025 YTD goods trade (through September); OEC World (Observatory of Economic Complexity): Monthly updates, e.g., August 2025 exports to US (down 16.7% YoY); Malaysia External Trade Development Corporation: 2024 annual performance (exports to US: RM198.65B ≈ US$42B at 4.72 MYR/USD average); Statista (Malaysia-US Trade Relations): Contextual shares (US as ~12% of Malaysian exports in 2024); IPPFA interpretation: Projections derived from RMK13 export targets (82.4% goal achievement by 2025) and post-RTA analyses (e.g., 3–7% CAGR bounds reflecting tariff/supply-chain dynamics).

CUMULATIVE TFP INDEX - BASELINE VS ART-ENHANCED TECH DIFFUSION



source: World Bank (Malaysia Economic Monitor, June 2025): Historical TFP growth (0.8–1.0% average 2015–2024); baseline projections ~0.9% annual through 2030; Bank Negara Malaysia (BNM) Economic and Monetary Review 2024/25: 2024 TFP contribution to GDP (1.2% rate); input-driven trends pre-RMK13; OECD (Productivity Database, September 2025): FDI spillover estimates (0.2–0.5 pp annual uplift from tech diffusion in Asia-Pacific economies); Asian Macroeconomic Research Office (AMRO) ASEAN Regional Economic Outlook 2025: TFP decomposition for Malaysia (0.5–1.2% range, with semis/digital sectors adding 0.3 pp potential); RMK13 Executive Summary (July 2025): Productivity targets (1.5–2% annual TFP under tech upgrading; RM611B outlays enabling diffusion); IPPFA interpretation: Cumulative index derived from Cobb-Douglas framework (α=0.35 capital share) and RTA-specific boosts (e.g., US investments yielding sustained +0.3 pp), compounding at constant rates for baseline (0.9%) vs. enhanced (1.2%) scenarios to 2030.

MALAYSIA'S TARIFF SYMMETRY TRANSMISSION (2025-2030)



source: IPPFA, 2025

AI adoption and technology upgrading are becoming decisive determinants of growth trajectories in 2026, reinforcing the resilience channels supported through ART. As tariff symmetry moderates part of the external uncertainty, productivity gains will increasingly depend on firms' capacity to embed automation, data infrastructure and intelligent systems across production networks. The shift is already material in major economies.

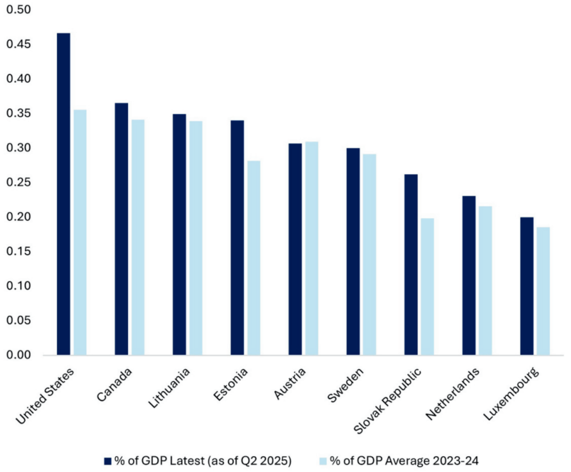
In the United States, private investment in ICT equipment as a share of GDP strengthened through the first half of 2025 and remains many multiples higher than in peer economies. ICT equipment and software investment contributed meaningfully to real GDP over the same period, while rapid increases in ICT imports indicate robust domestic demand for frontier inputs.

Capital deepening extends into digital physical infrastructure: spending on data-centre construction rose at an annualised pace exceeding 20 per cent in early 2025, accounting for over 5 per cent of total non-residential construction. With the United States hosting roughly 43 per cent of global installed data-centre capacity—compared with 25 per cent in China and 16 per cent in Europe—these developments underline the scale and concentration of AI-related capacity. ICT-related industrial production has also accelerated across key Asian manufacturing hubs including Korea, Singapore, Japan and Chinese Taipei, while China recorded value-added growth of 9.3 per cent in computer and electronic manufacturing in the year to October 2025. Correspondingly, "AI-enabling" goods contributed more than half of merchandise trade growth among selected G20 and Asian economies in the second quarter of 2025, up significantly from the 2017–24 average. This acceleration confirms that AI diffusion is now reshaping investment, industrial capacity and trade flows at the system level.

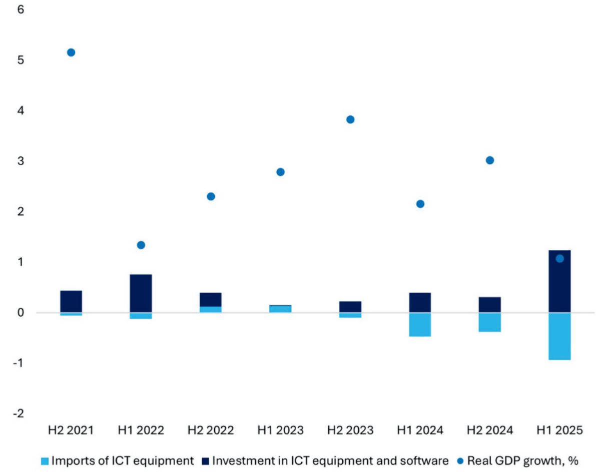
FIGURE 34

STRONG ICT INVESTMENT HAS SUPPORTED ECONOMIC GROWTH

REAL ICT EQUIPMENT INVESTMENT (% OF GDP)

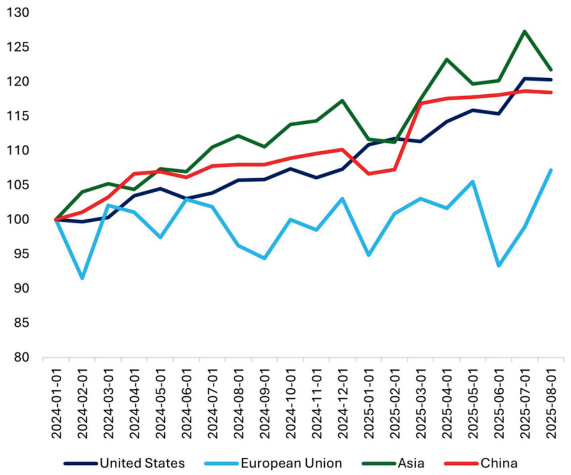


CONTRIBUTION OF ICT TO REAL GDP GROWTH IN THE UNITED STATES (% POINTS)

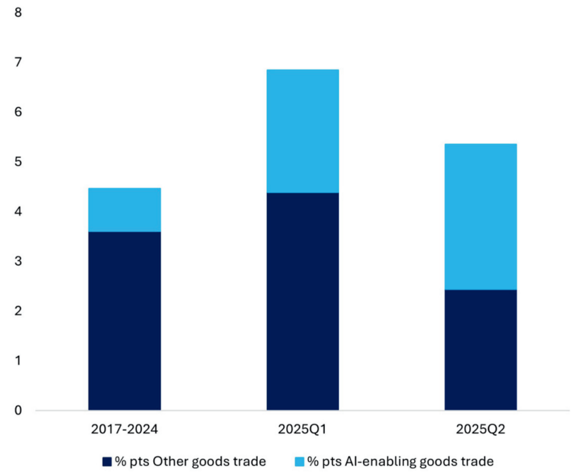


source: OECD Quarterly GFCF by Assets database; Bureau of Economic Analysis and OECD calculations

INDUSTRIAL PRODUCTION OF COMPUTER AND ELECTRONIC PRODUCTS



CONTRIBUTION OF AI-ENABLING TRADE TO TOTAL TRADE FOR SELECTED G20 AND ASIAN ECONOMIES (Y-O-Y CHANGES)



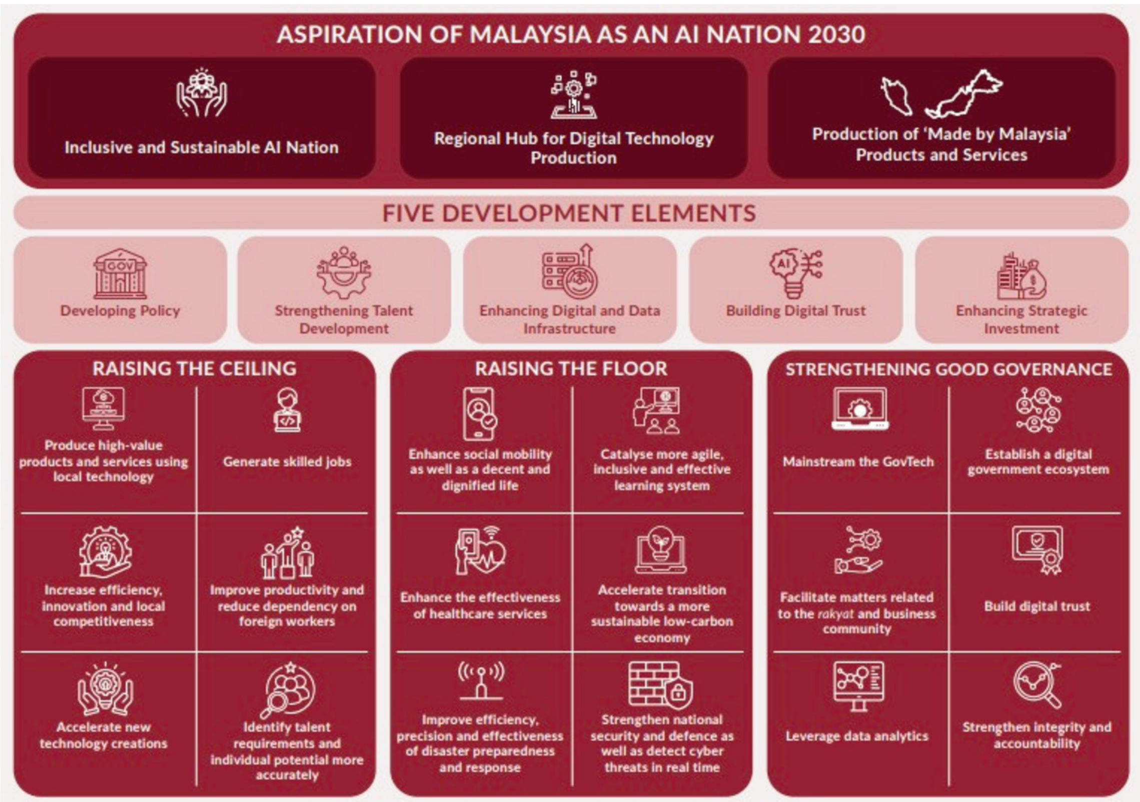
source: OECD Main Economic Indicators database; Eurostat; General Administration of Customs China; Ministry of Economic Affairs Chinese Taipei; National Bureau of Statistics of China; Statistics Korea; Statistics Singapore; Ministry of Economy Trade and Industry of Japan; UN Comtrade; US Federal Reserve; and OECD calculations.

For Malaysia, the implication is that competitiveness upgrades must increasingly derive from diffusion and adaptation of industrial AI systems rather than export expansion alone. Firms that underinvest in automation and data-driven operations risk widening productivity differentials as technologically advanced peers consolidate advantages. These asymmetries influence procurement leverage, value-chain bargaining power and the distribution of supply-chain rents, particularly where high-end inputs face export screening or national-security licensing constraints. Technology readiness therefore becomes a central dimension of resilience, complementing sourcing diversification, balance-sheet strength and tariff-risk insulation.

Malaysia has embedded these imperatives within its medium-term national development agenda. The aspiration to become an inclusive and sustainable AI nation by 2030, anchored in the Thirteenth Malaysia Plan, provides a policy framework for expanding absorptive capacity and mitigating technology-access asymmetries. The strategy rests on five development elements: policy coordination, talent strengthening, digital and data infrastructure enhancement, digital-trust building and strategic investment facilitation. These pillars translate into three priority outcomes: raising the ceiling through technology-driven innovation and productivity uplift; raising the floor through AI-enabled public services, healthcare and climate-transition readiness; and strengthening governance through mainstreaming GovTech, improving cybersecurity assurance and enhancing regulatory integrity. Together, these initiatives place Malaysia on a pathway to integrate into emerging trusted digital-technology networks while reducing exposure to concentrated technological control.

FIGURE 35

AI NATION DEVELOPMENT FRAMEWORK



source: 13th Malaysia Plan; Ministry of Economy and Ministry of Digital

Yet Malaysia's ambitions unfold within a global landscape where AI diffusion is uneven and increasingly strategic. The United States and China continue to lead in scale and speed of deployment, while Europe lags due to slower adoption, fragmented digital infrastructure and demographic constraints. Japan and China also face ageing-workforce pressures that may compress future productivity gains despite accelerated digital investment. Corporate research and development remains heavily concentrated in software, technology and semiconductor sectors headquartered in the United States and East Asia, reinforcing geographic asymmetries in innovation capacity and standard-setting power. These divergences imply that economies slow to operationalise AI diffusion risk structural productivity gaps and weaker spill-over absorption capacity, eroding bargaining power within global value chains.

FIGURE 36

AI AND TECH INNOVATION REMAIN GEOGRAPHICALLY CONCENTRATED

TOP 5 CORPORATE R&D SPENDERS BY SECTOR AND COUNTRY/REGION

United States	Euro Area	United Kingdom	China	Japan	Australia
Software	Automotive	Pharmaceutical	Technology	Automotive	Pharmaceutical
Software	Automotive	Pharmaceutical	Software	Automotive	Technology
Technology	Automotive	Finance	Software	Telecommunications	Finance
Software	Automotive	Finance	Construction	Leisure goods	Finance
Technology	Automotive	Finance	Automotive	Pharmaceutical	Travel

notes: This table is based on the 2024 EU Industrial R&D Investment Scoreboard, which analyzed the world's top 2,000 research and development (R&D) investors, headquartered across 40 countries. The table depicts the top five corporate R&D spenders by sector within six countries/regions, allocated geographically by the location of company headquarters.
source: European Commission, as of December 31, 2024

However, as AI becomes more deeply embedded in strategic industries, technology policy increasingly intersects with trade, diplomacy and security. Major jurisdictions are tightening export controls, investment screening and localisation mandates governing frontier chips, embedded software and cross-border data flows, signalling a shift from market-fairness considerations toward system resilience and technological primacy.

Modelled outcomes of a full U.S.–China semiconductor decoupling scenario highlight the scale of reconfiguration underway: projections show the United States' global semiconductor market share falling significantly relative to the status quo, while China's share rises over the medium term, implying a redistribution of technological capacity rather than containment. These projected shifts reflect how reduced market access erodes R&D intensity, impairs economies of scale and accelerates the emergence of parallel technology ecosystems. As leadership advantages deepen across competing blocs, technology access becomes a lever for negotiation through licensing conditions, platform interoperability, IP transfer requirements and market-entry rules. For Malaysia, the resulting exposure arises not only through supply constraints or higher compliance costs, but more fundamentally through conditional access to leading-edge technologies that underpin competitiveness in semiconductor-linked and automation-intensive sectors. Access pathways may increasingly depend on institutional positioning within trusted industrial networks rather than cost competitiveness or commercial readiness alone, heightening the risk that firms operating outside preferred alignments face delays or denials in acquiring critical inputs.

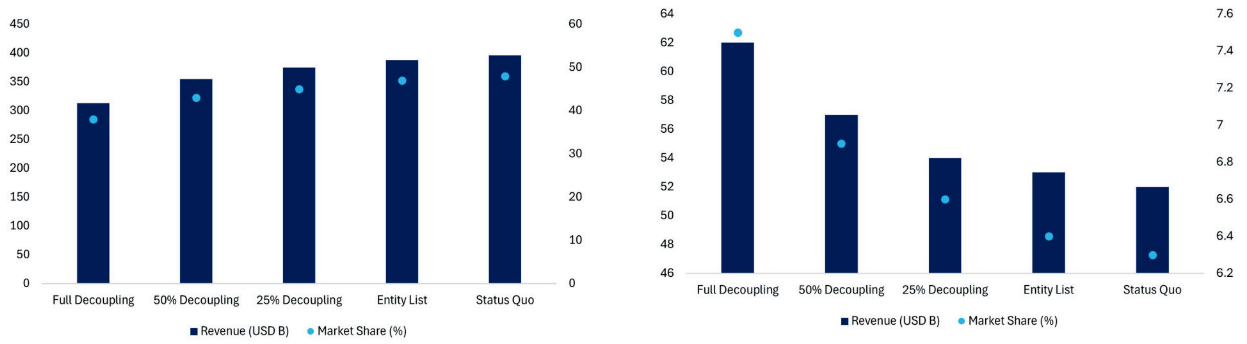
The strategic task for policymakers and firms is consequently twofold: accelerating capability upgrading and digital adoption domestically to avoid structural competitiveness erosion, while managing dependency risks associated with externally controlled standards, licensing frameworks and security-centred technology governance.

FIGURE 37

IMPACT AFTER FULL DECOUPLING VERSUS THE STATUS QUO

U.S. SEMICONDUCTOR FIRMS' GLOBAL MARKET SHARE FIVE YEARS AFTER FULL DECOUPLING VERSUS THE STATUS QUO

CHINA SEMICONDUCTOR FIRMS' GLOBAL MARKET SHARE FIVE YEARS AFTER FULL DECOUPLING VERSUS THE STATUS QUO



source: Information Technology & Innovation Foundation (ITIF), November 2025

The intensification of AI deployment and the expansion of semiconductor and data infrastructure heighten structural pressures on mineral, metal and energy systems. High-performance computing, advanced fabrication and hyperscale data-centre operations require significant quantities of copper, rare earth elements, refined alloys and reliable electricity and water. Yet processing and refining capacity has not kept pace with accelerating global electrification and friend-shoring realignments that encourage parallel manufacturing corridors. Market concentration amplifies fragility: China controls rare earth mining and separation and refining capacity, including critical heavy rare earth elements such as dysprosium and terbium, according to the report The Rare Earth Imperative ADL. The distribution of global reserves and active development projects shown further illustrates this imbalance.

FIGURE 38

MAJOR RARE EARTH OXIDE-PRODUCING COUNTRIES, 2023 AND 2024

Country	Y2023	% production, 2023	Y2024	% production, 2024	Reserves	% of reserves
China	255		270		**44,000**	**48.4%**
US	42	67.8%	45	68.5%	1,900	2.1%
Burma	43	11.1%	31	11.4%	NA	NA
Australia	16	11.4%	13	7.9%	**5,700**	**6.3%**
Nigeria	7	4.3%	13	3.3%	NA	NA
Thailand	4	1.9%	13	3.3%	5	0%
India	3	1.0%	3	3.3%	**6,900**	**7.6%**
Russia	3	0.8%	3	0.7%	**3,800**	**4.2%**
Madagascar	2	0.7%	2	0.6%	NA	NA
Other	1	0.6%	1	0.5%	NA	NA
Vietnam	0.3	0.4%	0.3	0.3%	3,500	3.9%
Malaysia	0.31	0.1%	0.13	0.1%	NA	NA
Brazil	0.14	0.1%	0.02	0.0%	**21,000**	**23.1%**
Canada	-	0.0%	-	0.0%	830	0.9%
Greenland	-	0.0%	-	0.0%	1,500	1.7%
South Africa	-	0.0%	-	0.0%	860	0.9%
Tanzania	-	0.0%	-	0.0%	890	1.0%
TOTAL	**376**	0.0%	**394**	0.0%	**90,885**	**100%**
		100%		**100%**		

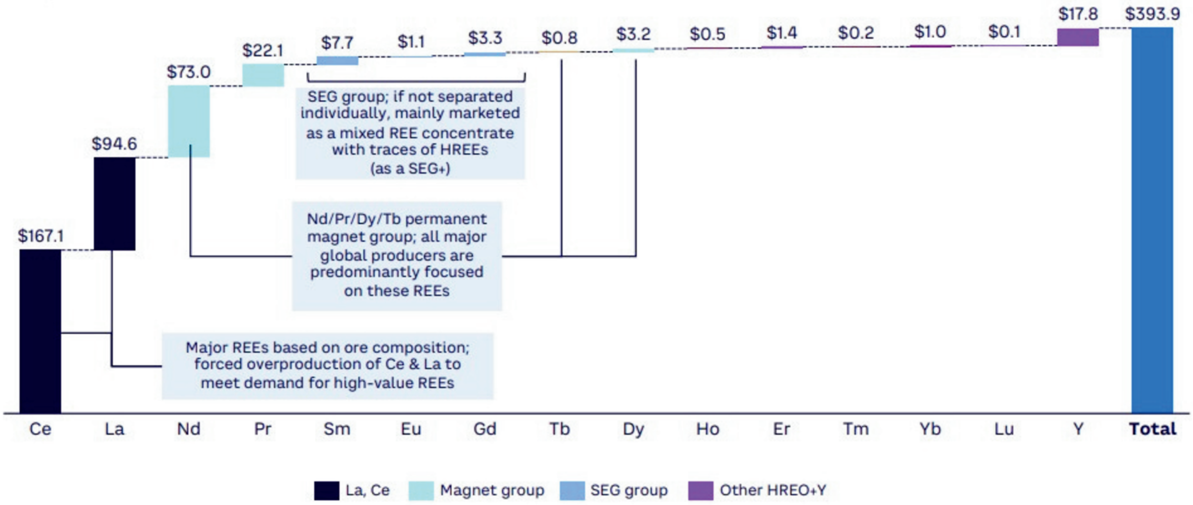
source: Arthur D. Little

For Malaysia, which depends heavily on imported refinery-grade inputs and grid-reliant industrial clusters, volatility in access to critical materials presents a binding constraint on industrial upgrading at the point when capital formation in semiconductor, electrical and electronics and data infrastructure is accelerating.

These pressures are reinforced by tariff realignment and tightening technology controls that drive duplication of industrial capacity within trusted-network corridors. Export screening, investment review regimes and reshoring incentives accelerate demand for additional fabrication and processing capacity across parallel value chains, raising mineral and energy requirements at a faster rate than supply expansion. The Rare Earth Elements (REE) market's structural imbalance compounds the challenge: while cerium and lanthanum represent the majority of mine output, they contribute little to total market value, whereas high-value magnet elements such as neodymium, praseodymium and dysprosium represent close to ninety per cent of total Rare Earth Oxide (REO) market value. These dynamics intensify competition for upstream resources, raise input costs and compress planning horizons for firms operating with thin margins. For Malaysian manufacturers, the transmission channels extend beyond material prices towards longer lead times, higher working-capital requirements and reduced flexibility to adjust sourcing strategies within tightening regulatory constraints.

FIGURE 39

GLOBAL PRODUCTION OF REO, 2024



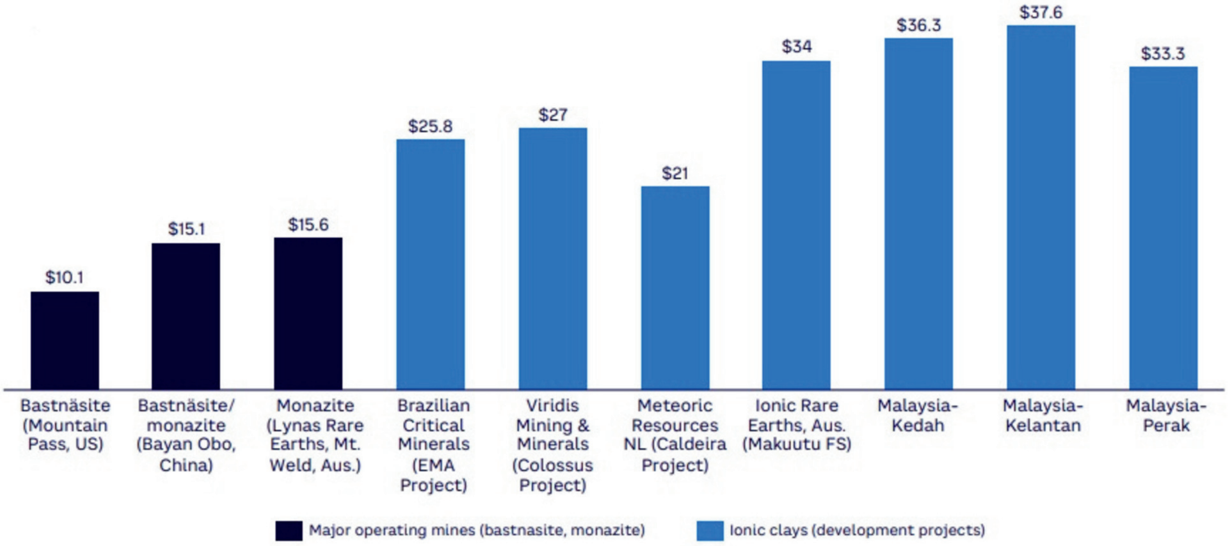
note: Modeled calculations of the market value and volumes have been made on the basis of total mined REO production in terms of REO contained in the mined concentrates. However, it is worthwhile to note that concentrate-to-mixed REO recoveries stay in the range of 90+% depending on technology used, element-specific recoveries, and feed origin (from traditionally mined and refined bastnaesite, monazite, or xenotime concentrates to pregnant IAC solutions). Cerium (Ce) and lanthanum (La) are foundational to high-volume chemical markets. Cerium serves as a workhorse in glass-polishing powders and three-way autoexhaust catalysts. Lanthanum is dominant in fluid-cracking catalysts for petroleum refining and in mischmetal alloys, used in NiMH (nickel-metal-hydride) batteries. Neodymium (Nd) and praseodymium (Pr), often with dysprosium (Dy) and terbium (Tb) to enhance high-temperature stability, are the driving force behind NdFeB (neodymium-ironboron) permanent magnets. These magnets are at the heart of EV motors, wind turbine generators, robotics, and a myriad of consumer electronics.
source: Arthur D. Little

Malaysia's policy and industrial response must align resource governance with ambitions for higher-value manufacturing and digital infrastructure expansion. The National Energy Transition Roadmap provides a foundation for strengthening grid resilience, expanding renewable capacity and gradually electrifying industrial processes. However, without targeted mineral supply diversification and environmental-risk management, rapid growth in data centres and semiconductor fabrication may outpace water-resource planning, refining capacity and climate-resilience investment. Malaysia holds promising ionic clay deposits enriched in high-value heavy REEs, with basket values estimated at thirty-three to thirty-seven dollars per kilogram. Capturing this advantage requires governance frameworks to accelerate responsible extraction, develop refining partnerships and ensure traceability to meet sustainability expectations in global value chains.

FIGURE 40

ECONOMIC VALUE DRIVERS IN THE RARE EARTH SUPPLY CHAIN (BASKET COMPOSITION)

OVERALL BASKET VALUE FOR DIFFERENT TYPES OF ORE, GIVEN STATED CHEMICAL COMPOSITION, MAY 2025 (USD/KG)



source: Arthur D. Little

A coherent strategy for AI-enabled industrial upgrading must therefore integrate technology access, energy and water resilience, and critical mineral security rather than treat them as separate policy domains. Malaysia cannot rely solely on tariff arbitrage or incremental process improvements. It must position itself as a credible participant in diversified REE supply chains, strengthen domestic capability in processing and recycling, and anchor long-term energy planning to high-load digital infrastructure demand. Failure to close these strategic gaps could constrain technology absorption and weaken long-term competitiveness. Conversely, coordinated policy execution, corporate investment discipline and cross-border industrial cooperation offer a pathway to convert the challenges of resource scarcity into durable competitive advantage in the emerging AI economy.

Conclusion: Macro Signals and Strategic Priorities for 2026

Malaysia enters 2026 with stronger macro foundations and clearer policy direction than at any point since the pandemic. Domestic demand remains synchronised, supported by stable wage gains, higher labour-force participation and expanding investment in digital infrastructure and advanced manufacturing. A firmer Ringgit, predictable monetary stance and gradual fiscal consolidation reinforce macro stability and help compress risk premia. Externally, Malaysia benefits from stabilising regional demand, deepening intra-Asian value chains and wider tariff certainty through reciprocal trade frameworks. The central strategic challenge in 2026 will be converting cyclical resilience into durable gains in productivity, competitiveness and risk absorption.

Macro Signals to Monitor

Key indicators point toward a shift from short-term volatility to structural execution pressures. Unit labour cost acceleration relative to productivity requires close monitoring as wage floors rise and labour markets tighten. Escalating tariff realignment and stricter documentation regimes will reshape cost structures and working-capital cycles across globally exposed value chains. Currency stability and narrowing interest differentials could support renewed portfolio reallocation toward Malaysian sovereign assets, while tighter supply-chain security frameworks heighten demand for traceability, certification and compliance capabilities. These signals underscore a more policy-dependent and institutional transmission–driven environment.

Strategic Priorities for Firms

Resilience for Malaysian firms, particularly MSMEs, will increasingly depend on capability strength rather than demand conditions. Strengthening compliance documentation, embedding digital traceability, enhancing workforce productivity and building working-capital buffers are now critical as tariff and regulatory pressures intensify. Cost governance should evolve beyond wage considerations toward total-compensation alignment, operational redesign and selective automation. Firms that invest early in compliance readiness, capability upgrading and export diversification will be well positioned to leverage Malaysia's expanding trade corridors and stabilising macro backdrop.

Strategic Priorities for Investors

For investors, the synchronisation of domestic engines, improving sovereign credit trajectory and predictable monetary stance support a constructive medium-term allocation view. Currency stability and gradually easing rate differentials favour selective duration in local fixed income, while strengthening foreign participation signals renewed confidence in Malaysia's sovereign curve. Equity allocations should prioritise sectors benefiting from structural catalysts: digital infrastructure, semiconductor-linked supply chains, tourism services and productivity-enhancing technologies. Performance dispersion is expected to widen as labour and compliance costs rise, reinforcing the need for rigorous bottom-up screening, focus on balance-sheet resilience and a geoeconomic lens in portfolio construction.

Policy Anchors to Reinforce Confidence

Policy continuity remains essential to secure macro-financial stability and translate aggregate resilience into firm-level competitiveness. A transparent subsidy rationalisation path, credible fiscal signals and a stable monetary stance will anchor inflation expectations and reduce funding uncertainty. Expanding capability-building programmes, strengthening trade-agreement utilisation pathways and improving institutional coordination across labour, trade and fiscal agencies can accelerate the diffusion of benefits to MSMEs and narrow productivity gaps. These anchors ensure macro stabilisation transmits more effectively into investment decisions, export readiness and enterprise resilience.

Malaysia's opportunity in 2026 lies not only in sustaining growth but in institutionalising competitiveness. Converting stabilisation into productivity, diversifying exposure before pressures materialise and preparing operational systems for a more fragmented global economy will be decisive in shaping long-term outcomes. With strategic alignment among policymakers, firms and investors, Malaysia is positioned to consolidate its standing as one of Asia's most stable and adaptive mid-sized economies.

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