Malaysia Policy Response to Tariff Risk

Targeted policy levers to navigate external turbulence

OVERVIEW

- The **special Dewan Rakyat sitting on 5 May** highlights the government's proactive approach to addressing the potential economic risks from Trump's tariffs and policy uncertainty, while aiming to safeguard Malaysia's trade, economic competitiveness and investor confidence.
- The **government has outlined a coordinated response** focused on export market diversification, targeted support for affected industries, and measures to bolster domestic demand while maintaining fiscal discipline.
- Several countries have announced **fiscal strategies** aimed at mitigating the effects of Trump's tariffs, prioritising long-term economic resilience. These efforts focus on industrial revitalization, innovation-driven investment, and targeted stimulus to sustain growth momentum amid heightened global trade uncertainty.
- **Global central banks are expected to maintain a cautious yet supportive monetary policy** in response to the economic challenges posed by Trump's tariffs. The policy will focus on preserving financial stability, with some central banks already easing rates, while others signal readiness to act if conditions worsen.
- The ringgit remains volatile but has strengthened due to USD weakness. Malaysia's macro stability and BNM's steady hand continue to attract bond inflows, though equity liquidity remains weak. **BNM is expected to keep rates unchanged, favouring targeted tools while preserving flexibility** amid tariff risks and global uncertainty.

CONTEXT

- The special Dewan Rakyat sitting on 5 May, initiated by Prime Minister Datuk Seri Anwar Ibrahim, signals the government's openness to discuss the impact of US tariff actions and their implications for Malaysia's trade and growth outlook. The Prime Minister addressed Malaysia's position, assuring the public and investors that the country remains resilient despite external uncertainties.
- The government has outlined immediate and medium-term policy responses, including structural reforms, regional coordination within ASEAN, and the ongoing bilateral negotiations with the US. Although most measures have been previously announced, new measures have been introduced aim to address the current situation. These include targeted measures for exporters through government guarantees and soft loans, promoting new export markets via additional grants, and boosting the domestic economy through accelerated construction projects.
- Overall, **we view this effort as timely and balanced, as the government strikes a diplomatic approach, provides targeted support for affected exporters, and continues its structural reforms agenda to reinforce economic resilience.** Though considered vulnerable given its export dependency, we believe Malaysia's economic outlook remains resilient despite external headwinds, largely due to potential benefits from trade and investment diversion as the US and China decouple.
- While the Prime Minister said Malaysia may not achieve the official 2025 GDP growth forecast of 4.5% - 5.5%, the government through MoF and BNM, is assessing the impact of the tariffs and will revise the outlook once clarity emerges from US tariff policies and negotiations. Right now, we maintain our 2025 GDP forecast at 4.8% (2024: 5.1%) as we expect the domestic-oriented sector to support growth going forward.
- On a separate note, Investment, Trade and Industry Minister Tengku Datuk Seri Zafrul Abdul Aziz stated that the US has made four demands to Malaysia in this tariff negotiations. This includes non-tariff barriers, trade deficit, safeguarding US technology and investing in American industries. The negotiation with the US will start today, 6 May. Additionally, Tengku Zafrul made a remark that trade growth may not be sustained in the coming months as exporters brace for the potential impact of new tariffs. Nevertheless, we still maintained our gross export forecast of 5.0% in 2025 (2024: 5.7%), a slight moderation from last year. However, if global trade tensions escalate, we may have to revise the current trajectory.

GLOBAL POLICY RESPONSES

- Several governments globally have rolled out substantial **fiscal measures** to cushion the blow from Trump's tariff regime while reinforcing long-term economic competitiveness. The full extent of the tariff impact remains uncertain, but countries like China, and South Korea have committed billions in stimulus, industrial support, and innovation funding. These responses reflect a broader shift toward proactive economic management amid rising global trade tensions.

Table 1: Fiscal policy adopted in selected countries

Countries	Fiscal Response	Details
Thailand	Economic Stimulus Package	- Aims to inject THB500.0b (~USD15.0b) to boost economy. - Focus on domestic consumption, investment, and soft loans.
China	Special Treasury Bonds Issuance	- CNY1.3t (~USD180.3b) in ultra-long bonds for national strategies and consumption upgrades. - CNY500.0b (~USD69.3b) to recapitalize state-owned banks. - Issued bonds with tenures ranging from 5 to 30 years with low coupon rates.
South Korea	Industrial Support & Innovation Investment	- USD17.5b policy financing for companies hit by tariffs/export crises. - USD7.0b in new semiconductor subsidies (total now USD23.0b). - USD2.1b in low-interest loans for chipmakers. - USD9.7b supplementary budget.
Canada	Tariff Remission & Loan Facility	- Performance-based tariff remission for automakers maintaining Canadian production. - 6-month tariff relief for US goods used in manufacturing, healthcare, etc. - Launch of Large Enterprise Tariff Loan Facility (LETL) for liquidity support.

Source: Newsflow, Kenanga Research

- Meanwhile, global central banks are increasingly adopting supportive **monetary policies** in response to economic headwinds from Trump's tariffs. While the full ramifications are still unfolding, central banks such as Bank of Thailand, Bank of Korea, and European Central Bank (ECB), have eased monetary conditions through interest rate reductions or by signalling a more accommodative stance. These developments point to a broader trend of policy recalibration aimed at safeguarding growth and ensuring financial system stability amid intensifying global trade disruptions. Even in countries where policy rates remain unchanged, such as China, central banks remain vigilant and prepared to adjust as needed.

Table 2: Monetary policy adopted in selected central banks

Central Bank	Monetary Response	Details
Bank of Thailand	(Repo Rate: 1.75%)	Reduced its benchmark interest rate for the second straight meeting in April to provide additional support to the country's sluggish economic performance.
People's Bank of China	(Loan Prime Rate: 3.10%)	Opted to keep its policy rate unchanged, but bolster liquidity and financial stability, via the issuance of ultra-long special treasury bonds. Policymakers continue to exercise caution.
Bank of Korea	(Base rate: 2.75%)	Maintain its policy rate but highlight a notable increase in downside risks to growth. The central bank signal a continued bias toward monetary easing.
European Central Bank	(Key Deposit Facility Rate: 2.25%)	Lowered its key policy rate for the third time in April, in a move aimed at stimulating economic activity across the euro area. This latest rate cut also serves as a pre-emptive measure.
Bank of Canada	(Overnight rate: 2.75%)	Opted to keep its policy rate unchanged in April, after a cut in March, as it monitors the evolving landscape of US trade policy and its implications for the domestic economy. Despite a 0.2% contraction in GDP recorded in February, the central bank is taking a wait-and-see approach.

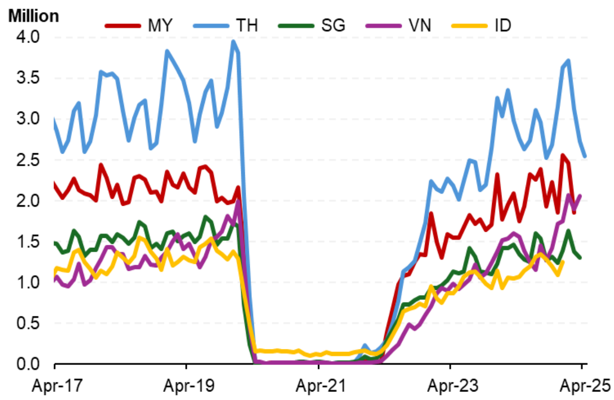
Source: Newsflow, Kenanga Research

MALAYSIA POLICY RESPONSE

- The government has unveiled a policy response aimed at buffering near-term downside risks while supporting medium-term economic resilience. Although the impact of Trump's tariff on the economy remains uncertain, we expect Malaysia to benefit from trade and investment diversion as the US and China decouple, while acknowledging that downside risks persist. Malaysia may face weaker external demand in the 2H25, particularly from the US if the reciprocal tariff or higher tariff is set to be implemented after the 90-day pause.

- During the special parliamentary session, the government highlighted its cautious, data-dependent approach, monitoring key macro indicators such as manufacturing orders, exports, retail sales, employee retrenchment, and loan growth to strategise policy response. This approach ensures a structured, timely, and targeted response for affected groups. Additionally, it outlined specific measures for exporters. This includes:
  - **Export-Oriented Measures:** Assisting businesses impacted by the tariffs, especially small and medium enterprises (SMEs). This includes RM1.0b in government guarantees to help SMEs access bank financing, RM500.0m in soft loans via development financial institutions (DFI) and continued targeted aid for directly impacted exporters.
  - **Promoting Regional Cooperation and New Markets:** Emphasis on diversifying exports to new markets like Europe, the Middle East, Central Asia and South America, while strengthening ASEAN trade via ASEAN Power Grid and cross-border trade activities. An additional budget worth RM50.0m has been allocated to MATRADE. Previously the government has allocated RM40.0m under the Market Development Grant (MDG) to help exporters expand to new markets.
- **In our view, these efforts are crucial to cushioning trade disruptions while positioning Malaysian firms for growth in non-traditional markets.** Leveraging existing partnerships with ATIGA, DEFA, RCEP and CPTPP, as well as strengthening ties with BRICS, sh ould help Malaysia.
- Besides measures focusing on exporters, the government is also accelerating **infrastructure projects**, including flood mitigation, the repair of dilapidated schools, and the construction of clinics, with expedited approval processes and implementation, particularly for small contractors in the G1-G4 categories.
- However, we believe there is **room for additional measures** to support the economy and achieve the current growth target. These measures include:
  - **Stimulating Domestic Demand:** To support private spending, which we expect to remain the anchor of growth for this year, government may increase the cash assistance or e-wallet transfers for targeted groups, with conditions to encourage spending in sectors like food, retail, and tourism. Sector-specific incentives, such as tourism vouchers or domestic travel subsidies via e-wallets, could boost the services sector and digital economy.
  - **Boosting Services Exports:** There is potential for the government to intensify efforts in promoting services exports like tourism, education, and healthcare, in line with Visit Malaysia 2026 and taking opportunity from the potential diversion of large tourists and students from China. Expanding visa facilitation, particularly for countries like China and India, will also support the tourism sector going forward. Additionally, targeted tourism campaigns and activities as well as strengthening regional education partnerships will help tap into demand from neighbouring economies.
  - **Redirecting Export Surplus to Domestic Use:** In our view, some selected export-oriented goods can be redirected to local consumption if the price is more attractive and competitive than the imports while receiving fiscal support or incentives from the government via subsidies or grants. This includes electronics and processed food products which can be partially redirected to the domestic market. While the domestic market may not fully absorb the exports, it could provide some relief to exporters.
- Overall, we see room for the government to pursue a calibrated stimulus strategy, balancing short-term mitigation with longer-term reforms, particularly in boosting self-reliance and domestic economic linkages, making Malaysia more resilient to future external risks.

Graph 1: Tourist Arrivals in selected ASEAN countries



Source: Macrobond, Kenanga Research

Table 3: Policy recommendations by category or product

Category	Examples	Policy options
Electrical & Electronic Products (E&E)	Solar panel, TVs, air conditioners, consumer electronics and electrical appliances	Consumer rebates or subsidy, appliance incentives targeting energy efficiency, and renewable energy promotion.
Palm Oil & Palm-Based Products	Cooking oil, processed food, biodiesel	Expand and accelerate biodiesel mandates, promote local use.
Furniture & Wood-Based Products	Home furniture, office furniture, kitchen fittings	Tax relief, public sector procurement.
Automotive Parts & Components	Tyres, batteries, wiring harnesses	Support OEMs, expand and enhance aftermarket ecosystem with new investment.
Processed Food & Beverages	Biscuits, dairy, bottled drinks	Retail campaigns, GLC, and school procurement.
Building Materials	Cement, steel, glass, tiles	Accelerate and launch small and medium infrastructure projects, local sourcing mandates.

Source: Kenanga Research

FISCAL SPACE AND DEBT HEADROOM

- **Current debt levels may allow minimal fiscal manoeuvring**
  - As of April 2025, Malaysia's fiscal position remained manageable, with a debt headroom of approximately RM83.9b. The statutory debt comprising Malaysian Government Securities (MGS), Government Investment Issues (GII), and Malaysian Islamic Treasury Bills (MITB), amounts to RM1,256.9b (~61.4% of GDP), leaving a buffer of ~3.6% of GDP or RM72.9b before reaching the 65.0% statutory debt ceiling.
  - In the first three months of 2025, the government collected RM72.1b in revenue, while expenditure reached RM94.0b, resulting in a deficit of RM21.9b, down 16.9% from the same period last year, reflecting government effort towards fiscal consolidation. The government projects a fiscal deficit of 3.8% of GDP or RM80.0b in 2025, leaving an additional RM58.1b fiscal deficit for the rest of the year. With a debt headroom of RM83.9b, the government has about RM25.8b fiscal buffer for new stimulus before hitting the debt limit. Nevertheless, this is still subject to economic performance.
  - While the government continues to demonstrate a proactive stance in addressing fiscal deficits, evolving global economic conditions amid rising external risks and potential delays in fiscal reforms may challenge the long-term commitment to fiscal discipline.

Table 4: Federal Government Debt Headroom for 2025

			RM bil	
		latest	limit	balance
Offshore borrowing	4Q24	28.0	35.0	7.0
Malaysian Treasury Bills (MTB)	Apr-25	6.0	10.0	4.0
Statutory (MGS, MGII, MITB)	Apr-25	1,256.9	1,329.8	72.9
Statutory (% of GDP)	Apr-25	~61.4%	65.0%	~3.6%
Total:		**1,290.9**	**~1,374.8**	**~83.9**

Source: BNM, Macrobond, Kenanga Research

- The SST expansion delay signals fiscal caution amid global uncertainty, but attention now shifts to the planned RON95 subsidy reform
  - Originally slated for implementation on May 1, 2025, the expansion of the Sales and Service Tax (SST) has been postponed. While this delay will naturally defer revenue collection and may complicate near-term fiscal projections, it likely reflects prudence due to heightened geopolitical tensions and persistent global trade uncertainty.
  - The bigger question is whether this postponement signals a broader shift, specifically regarding the RON95 subsidy reform scheduled for 2H25. Unlike the SST, which affects the broader population, subsidy reforms target the top 15.0% of income earners. Petrol subsidies, long plagued by leakages and inefficiencies, are economically unjustifiable. While the fiscal savings may be minimal, the current low Brent crude prices present a strategic window of opportunity for reform.

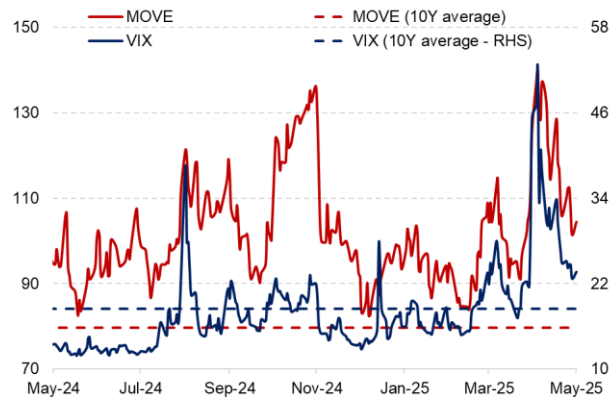
– Introducing subsidy rationalisation during a period of global trade flux could be framed as sound fiscal housekeeping, one that allows for expenditure reprioritisation and supports a healthier fiscal deficit trajectory. A credible commitment to reform, even amid external headwinds, would reinforce sovereign credibility and help anchor medium-term inflation expectations. Delaying this could undermine fiscal credibility and send the wrong signal.

CAPITAL MARKET DYNAMICS

- While Malaysia remains relatively insulated from the direct spillovers of US policy shifts, the repercussions are nonetheless being felt through the capital markets. From heightened exchange rate swings to diverging investor flows and cautious central bank manoeuvres, the ripple effects are clear.

  – **Currency Volatility:** The ringgit, though recently firmer, has fluctuated between 4.30 to 4.50 against the USD in the last few months, reflecting underlying volatility. Of note, **the ringgit's 21-day annualised rolling volatility has hovered between 6.2% and 9.3% in recent weeks, above its 10-year average of 5.1%**. This stems less from domestic fragilities and more from US policy uncertainty. Despite encouraging signals from trade dialogues and potential tailwinds from American deregulation and prospective tax reliefs, investor sentiment remains cautious. Persistent tariff rhetoric continues to cloud the outlook for emerging markets, making the ringgit vulnerable to mood swings driven by shifts in global risk appetite. That said, the ringgit has benefitted from bouts of positive volatility, strengthening as the USD faltered amid tariff-related uncertainty. While we still maintain our end-2025 forecast at 4.45/USD, **we now see growing potential for the ringgit to close the year stronger, possibly closer to 4.20/USD**, should downside pressure on the USD persist. With volatility still dominant and trade negotiations in flux, we refrain from making hasty revision, but the bias clearly favours further ringgit strength.

Graph 2: Volatility Indices (MOVE and VIX)

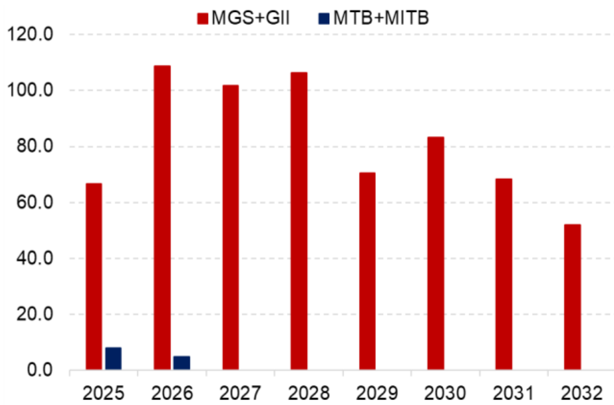


Source: Macrobond, Kenanga Research

  – **Capital Flows:** Despite the ringgit's fluctuations, Malaysia has quietly **benefited from capital rotation out of the US**. While it lacks the safe-haven status of Japan or the institutional depth of the euro area, Malaysia's appeal lies in its **relative macroeconomic stability, credible sovereign rating, steady monetary policy stance, and relative political stability**. These attributes have underpinned continued inflows into Malaysian government bonds, where yields remain attractive against a backdrop of subdued inflation and stable fiscal metrics.

  – **Bond Market and Issuance:** These favourable flows have translated into tangible support for Malaysia's bond market. Investor sentiment has markedly improved in recent weeks, bolstered by renewed optimism around US–China trade talks and signs of US economic slowdown. This has spurred a rally in MGS, supported by the country's resilient trade performance and deepening economic partnerships. While global bond markets may face occasional repricing, Malaysia's solid credit profile — and prospects for an upgrade between 2026 and 2027 — should continue to anchor confidence. In line with lower borrowing needs, gross issuance has been revised down to RM161.5b, with net issuance now forecast at RM78.0b. The narrowing fiscal deficit, projected at 3.9% of GDP, and reduced MGS/GII maturities have helped temper issuance expectations. That said, **we**

Graph 3: Malaysia Government's Bond Maturity Wall



Source: Bloomberg, Kenanga Research

may revisit our issuance forecast should the government announce additional stimulus to counter the economic headwinds arising from US tariff actions.

– **Liquidity Management:** While bond markets have remained a bright spot, equities have fared less well. Tepid corporate earnings, coupled with external uncertainties, have led to persistent foreign selling, sapping liquidity from Bursa Malaysia. Government-linked investment companies have attempted to stem the tide, but their interventions have only partially offset the sustained outflows. **At one point, expectations grew that Bank Negara Malaysia (BNM) might cut the Statutory Reserve Requirement (SRR)** to inject liquidity should trade tensions worsen or capital flight accelerate. **That risk, however, appears to have diminished in recent weeks**. Foreign investors have resumed modest net purchases, reversing a 26-week exodus, buoyed by signs of resilience in the domestic economy and optimism that Malaysia may weather the tariff storm better than most.

– **BNM's Monetary Policy Outlook:** If there is any potential adjustment to the SRR, it should be seen strictly as a liquidity management tool, not a signal of broader monetary easing. For now, BNM is likely to keep the Overnight Policy Rate on hold. Inflation remains benign, growth steady, and financial conditions manageable. However, if global trade tensions intensify and domestic growth slips below 3.5% in 2H25, the case for a rate cut could gain traction. Market consensus currently pegs GDP growth at around 4.0–5.0% for the year, giving the central bank sufficient leeway to maintain a wait-and-see approach. In the interim, **BNM is expected to prioritise targeted support instruments and preserve monetary flexibility, keeping its policy powder dry**.

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