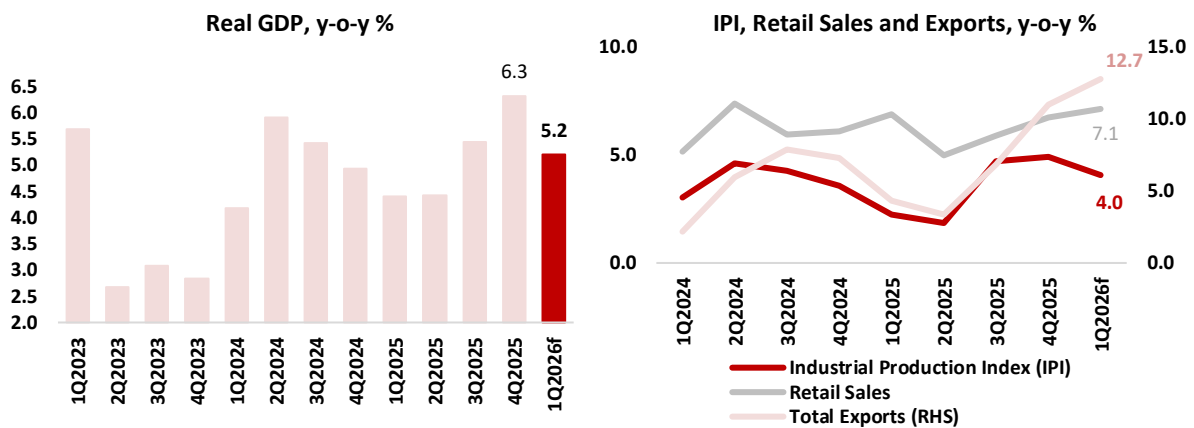


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1Q26 GDP PREVIEW: GROWTH EXPECTED SLIGHTLY BELOW ADVANCE ESTIMATE



Sources: Department of Statistics Malaysia (DOSM), Bank Islam

- Malaysia's 1Q26 GDP growth is expected to come in lower than the advance estimate.** The economy is projected to expand by 5.2% y-o-y in 1Q26, slightly below the Department of Statistics Malaysia (DOSM) earlier estimate of 5.3%, and easing from stronger 6.3% growth recorded in the previous quarter. The moderation largely reflects a more challenging external environment, particularly rising uncertainty linked to the ongoing U.S.-Iran conflict, which has contributed to volatility in global energy markets. The Industrial Production Index (IPI) moderated in 1Q26, expanding by 4.0% compared with 4.9% in 4Q25. The softer performance was primarily due to a 2.8% contraction in mining output, alongside a slight deceleration in manufacturing growth to 5.7% (4Q25: 6.0%). Nonetheless, domestic demand continued to serve as the main driver of growth. This was underpinned by resilient household spending, supported by a stable labour market, with the unemployment rate holding at 2.9%, as well as sustained wage growth. Additionally, festive season spending and targeted policy measures such as STR and SARA, further bolstered household disposable income. Reflecting these supportive conditions, retail sales, a key indicator of private consumption, remained strong, rising by 7.1% in 1Q26, up from 6.7% in the previous quarter.
- Export-led momentum drives industrial and manufacturing expansion in 1Q26.** In contrast, export performance strengthened markedly in 1Q26, with growth accelerating to 12.7% from 11.0% in the preceding quarter, driven largely by robust demand from the U.S. and China. Exports to the U.S. recorded a sharp increase, more than doubling to 30.3% from 14.4%, while shipments to China rebounded strongly, expanding by 11.8% following a more modest growth of 4.0% in 4Q25. However, exports to the European Union lost some momentum, easing to 17.6% in 1Q26 from 23.9% previously. By sector, manufacturing exports remained the key driver, expanding by 14.7% (4Q25: 12.4%), while agriculture exports dropped by 8.6% (4Q25: 1.9%). Meanwhile, manufacturing conditions strengthened, returning to expansionary territory as the Purchasing Managers' Index (PMI) rose to 50.1 points in 1Q26 from 49.9 points in 4Q25. The positive

momentum extended into the second quarter, with the PMI rising further to 51.6 points in April 2026, remaining solidly above the 50-point threshold that indicates expansion.

- Investment momentum is expected to moderate amid persistent geopolitical headwinds.** In 4Q25, gross fixed capital formation (GFCF) expanded by 9.3% y-o-y (3Q25: 7.4%), supported by broad-based acceleration in both private investment (4Q25: 9.2% vs. 3Q25: 7.4%) and public investment (4Q25: 9.5% vs. 3Q25: 7.4%). This performance reflects Malaysia's favourable development environment, underpinned by a clear policy direction and the continued rollout of key national strategic initiatives. However, the outlook is likely to soften amid heightened geopolitical uncertainties, particularly following the escalation of U.S.-Iran tensions, which could weigh on investor confidence and lead to more cautious capital deployment. Geopolitical-related cost shocks are also expected to further dampen investment appetite. The closure of the Strait of Hormuz has disrupted global supply chains and triggered shipping delays, resulting in a sharp increase in freight costs and, consequently, higher input prices for key building materials. According to the Malaysian Construction Industry Development Board (CIDB), prices across seven key building materials have risen significantly, averaging an increase of approximately 12.6%. Given the fuel-intensive nature of construction activities, elevated global energy prices are likely to transmit directly into higher input costs, particularly through diesel consumption, machinery operations, and logistics. In addition, shipping delays and rising cost pressures are expected to extend construction timelines, indirectly increasing overhead expenses through higher labour and utility costs. As a result, rising input cost inflation may slow the pace of project execution and potentially delay the rollout of projects currently in the pipeline.
- Nevertheless, strategic capital flows into key sectors are expected to cushion the downside.** Public capital expenditure will remain focused on strengthening Malaysia's structural base and developing its renewable energy (RE) landscape, in line with sustainability commitments. Progress on major connectivity projects, including the Penang Light Rail Transit (LRT), Pan Borneo Highway, and the Johor Bahru–Singapore Rapid Transit System (RTS), will continue to anchor public investment. Meanwhile, data centres will take center stage in attracting robust private investment. Amid the global digitalisation wave and rising Artificial Intelligence (AI) adoption, Malaysia's strengthening technology ecosystem and comparative advantages positions it favourably to draw significant capital inflows, particularly across data centre developments. Evidently, while the value of construction work done moderated (1Q26: 8.5% vs. 4Q25: 10.3%), specialised trade activities recorded another quarter of significant growth (1Q26: 24.6% vs. 4Q25: 21.1%), suggesting that data center and technology-related construction remains robust.
- Malaysia's growth forecast for 2026 maintained at 4.7%, risks tilted to downside.** Although most key economic indicators registered robust growth in 1Q26, momentum began to ease toward the latter part of the quarter, suggesting that rising global uncertainty and moderating external demand are increasingly weighing on Malaysia's growth trajectory. Export performance, in particular, showed signs of softening, moderating from double-digit growth in the first two months of the quarter to 8.3% in March. The deceleration was broad-based across sectors, with manufacturing growth easing to 9.6% (Feb: 12.7%), agriculture remaining in contraction albeit improving to -7.8% (Feb: -15.8%), and mining declining slightly by 0.4% (Feb: +12.2%). This reflects weakening demand from key trading partners amid a more uncertain global environment. Similarly, the IPI moderated, holding at 3.1% for the last two months of the quarter after a strong expansion of 5.9% in January, reinforcing signs of a gradual loss in momentum. Meanwhile, the robust retail sales performance in 1Q26 was largely supported by seasonal festive spending, including Chinese New Year in February and Hari Raya Aidilfitri in March. With the absence of such seasonal factors

and additional policy support, retail sales growth may moderate in the coming months. Moreover, emerging inflationary pressures particularly from higher oil prices, which have already translated into increased fuel costs, could further erode household purchasing power and dampen consumption momentum. Looking ahead, Malaysia's growth outlook for the remaining quarters of 2026 is expected to remain positive but increasingly challenging, as escalating geopolitical tensions, particularly between the U.S. and Iran, continue to cast a shadow over the external environment. A prolonged conflict could push global energy prices higher, intensify inflationary pressures, and weaken global trade sentiment, thereby posing downside risks to the domestic economy. In addition, the likelihood of slower demand from major trading partners amid heightened global uncertainty may further weigh on export performance. Bank Negara Malaysia has highlighted that supply disruptions and rising fuel prices stemming from prolonged Middle East tensions could adversely affect global growth and inflation dynamics. We maintain our full-year 2026 growth forecast at 4.7%, in line with the International Monetary Fund's (IMF) latest projection, while acknowledging the increasing downside risks to the outlook.

- **Banks may face rising risks amid slower growth expectations and inflation pressures.** Moderating GDP growth and weaker export performance could increase repayment risks among businesses, particularly SMEs in manufacturing, agriculture, and trade-related sectors, thereby elevating the likelihood of higher non-performing loans (NPLs). Export-oriented industries such as electronics, palm oil, and manufacturing may also experience margin compression as growth moderates from double-digit to single-digit levels, potentially weighing on asset quality. Concurrently, prolonged conflict-driven oil price shocks could feed into domestic inflation, eroding household purchasing power and dampening demand for financing products. This may, in turn, increase vulnerabilities within retail loan portfolios, as rising living costs strain debt servicing capacity.

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