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Nor Lyana Zainal Abidin
Economist
nlyanaz@bankislam.com.my

MARKETS CAUGHT BETWEEN TRADE SHIFTS, GEOPOLITICAL TENSIONS AND RATE CUT BETS

U.S.-China Trade Talks Conclude, Tariff Threats Loom, and Inflation Data Boosts Rate Cut Hopes. Financial markets received a boost after two days of U.S.-China trade talks in London concluded with a framework agreement, signaling a potential thaw in tensions between the two economic giants. This agreement focuses on putting the Geneva consensus into action and building on promises made during a recent presidential phone call. Despite this progress, President Donald Trump is expected to send formal letters within the next one to two weeks to key trading partners. These letters will outline unilateral tariff measures, designed to pressure countries into new trade agreements. However, there is a potential silver lining: Treasury Secretary, Scott Bessent indicated that the administration might extend the current 90-day pause on reciprocal tariffs for nations that show "good faith" in trade negotiations. Meanwhile, bond yields faced downward pressure as the May Consumer Price Index (CPI) report showed all key inflation measures coming in below expectations. The U.S. annual inflation rate in May 2025 edged up to 2.4%, marking its first increase in four months. This is a slight rise from April's 2.3%, which was the lowest rate since 2021. Nevertheless, the May figure still came in below the anticipated 2.5%. This data has strengthened market predictions that the Federal Reserve (Fed) could cut interest rates as early as September, with growing expectations for a second cut by December.

Escalating Middle East Tensions and Global Risk-Off Sentiment. Global markets are on edge due to soaring tensions between Israel and Iran, which are dampening investor confidence. Markets pulled back after Iran retaliated against Israeli strikes on its nuclear and missile sites, sparking fears of a broader conflict and pushing investors toward safe-haven assets. This "risk-off" sentiment intensified following Israel's preemptive strike on Tehran's nuclear program, a move that significantly escalated the regional conflict. Israeli leaders have vowed to continue operations until the threat is completely neutralized, further contributing to the market's cautious tone. Middle East geopolitical tensions are expected to stay in the spotlight after Israel's strike on Iran's nuclear facilities, raising concerns about a wider regional conflict. With the likelihood of further Israeli strikes, Iran's drone attack is unlikely to be its final response. Tehran must now weigh the need to reassert its deterrence capabilities, especially given its weakened proxy network, against the significant risk of provoking a broader war and direct U.S. involvement. While Iran's past actions suggest a potential de-escalation to preserve regime stability, the situation remains highly volatile.

Upcoming Events: Key Economic Data Release

Monday	China IPI & Unemployment Rate (May), Indonesia Trade Balance (May)
Tuesday	U.S. Retail Sales (May), Bank of Japan (BoJ) Meeting
Wednesday	Bank of Indonesia (BI) meeting, U.K. CPI (May)
Thursday	FOMC and Bank of England meetings
Friday	Malaysia External Trade (May)

Weekly Changes, basis points (bps)

UST	Yields (%) 30-May-25	Yields (%) 6-Jun-25	Change (bps)	Yields (%) 13-Jun-25	Change (bps)
3-Y UST	3.87	4.02	15	3.90	-12
5-Y UST	3.96	4.13	17	4.02	-11
7-Y UST	4.18	4.31	13	4.20	-11
10-Y UST	4.41	4.51	10	4.41	-10
MGS	**Yields (%) 30-May-25**	**Yields (%) 6-Jun-25**	**Change (bps)**	**Yields (%) 13-Jun-25**	**Change (bps)**
3-Y MGS	3.15	3.15	0	3.17	1
5-Y MGS	3.19	3.20	1	3.25	4
7-Y MGS	3.39	3.40	1	3.46	6
10-Y MGS	3.53	3.53	0	3.55	2
GII	**Yields (%) 30-May-25**	**Yields (%) 6-Jun-25**	**Change (bps)**	**Yields (%) 13-Jun-25**	**Change (bps)**
3-Y GII	3.17	3.16	-1	3.18	1
5-Y GII	3.29	3.29	0	3.32	3
7-Y GII	3.40	3.41	0	3.42	1
10-Y GII	3.53	3.53	-1	3.55	3

Sources: Federal Reserve Board, BNM, Bank Islam

Commentaries

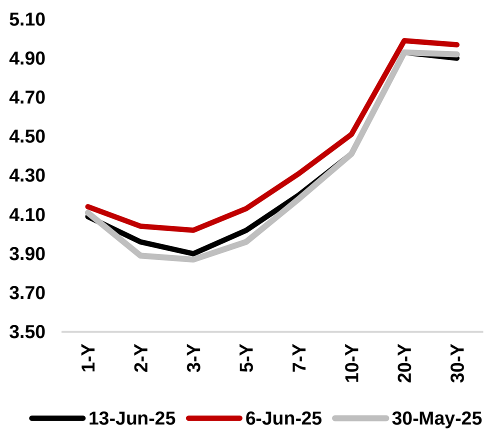
UST Yields

The U.S. Treasury (UST) yields declined in the range of 10bps to 12bps w-o-w for the week ending June 13 (June 6: +10bps to +17bps). Investors sought the security of safe-haven assets amidst a sharp escalation in Middle East tensions. This was triggered by Israel's preemptive strike on Iran's nuclear facilities, with Jerusalem vowing sustained operations until the threat is eliminated; a move U.S. officials clarified had no American involvement. The incident rattled global markets, intensifying an existing demand for Treasuries.

Earlier in the week, yields were already declining due to growing uncertainty over U.S. trade policy, fueled by President Trump's threats of unilateral tariffs for new agreements. In addition, U.S. annual inflation in May rose to 2.4% from April's 2.3%, marking the first increase in four months but falling short of the 2.5% forecast. Core inflation held steady at 2.8%, defying expectations of a rise to 2.9% and remaining at 2021 lows. Meanwhile, producer prices (PPI) aligned with forecasts, increasing 2.6% after a revised 2.5% rise in April. The softer-than-expected consumer and producer inflation data bolstered expectations for further Fed rate cuts this year.

Short-term outlook: Given Israel's recent strike on Iran's nuclear facilities, Middle East geopolitical tensions are anticipated to remain a key focus, fueling concerns about a broader regional conflict and rising demand for safe-haven assets, pushing yields lower. The existing market uncertainties, already fueled by tariff policies and US fiscal concerns, are now further compounded by the escalating situation in Iran.

UST Yield Curves, %



Sources: Federal Reserve Board, Bank Islam

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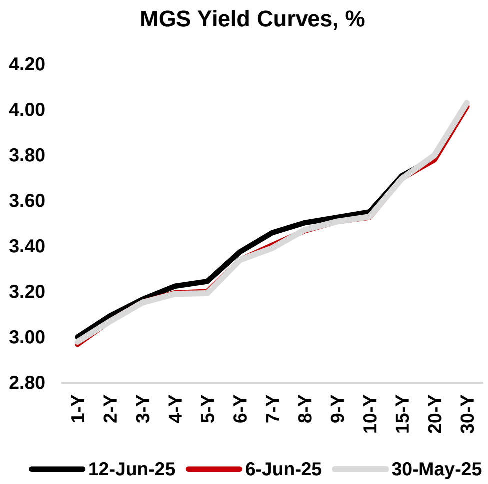
MGS/GII Yields

Yields on both Malaysian Government Securities (MGS) and Government Investment Issues (GII) ended slightly higher on a w-o-w basis, rising between 1bp and 6bps for the week ending June 13 (June 6: -1bp to 1bp). Bond yields saw a slight increase after the World Bank lowered Malaysia's 2025 growth forecast to 3.9%, down 0.6 percentage points from the January 2025 projection and its global growth projection to 2.3%, the slowest since 2008. As a small and open economy, Malaysia is especially vulnerable to renewed trade tensions, rising trade costs, and slower growth in key global economies where the recent manufacturing Purchasing Managers' Indexes (PMI) and goods trade indicators, show a general easing of manufacturing activity. Malaysia's manufacturing sector experienced a slight uplift in May, with the Manufacturing PMI rising to 48.8 from 48.6 in April. This indicates a continued, but slower, contraction in operating conditions along with business conditions which remained subdued. Manufacturers reduced production levels in response to weaker new orders, suggesting ongoing challenges in demand. Nevertheless, Malaysia's unemployment rate hit a 10-year low of 3.0% in April (Mar: 3.1%) which helped to limit the uptrend in yields. This positive trend reflects Malaysia’s strong economic performance, leading to consistent growth in the labor market, with more people employed and higher participation rates, all contributing to the continued decline in unemployment.

Short-term Outlook: MGS/GII yields are expected to trade within a narrow range leading up to the upcoming Fed policy meeting. While no rate change is anticipated, market participants will be scrutinizing the Fed's commentary for future policy signals. Escalating U.S.-China trade disputes or a resurgence of Israel-Iran tensions are among key developments to watch for.



Sources: BNM, Bank Islam

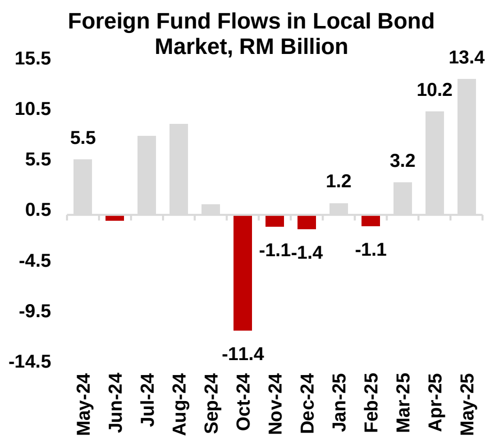
Foreign Flows into Local Bonds Market.

Net foreign inflows into the local bond market soared to RM13.4 billion in May (Apr: +RM10.2 billion) as tariff jitters and uncertainties drove foreign investors to reallocate their portfolio into domestic bond market. Consequently, the accumulated total foreign holdings of Malaysia debt securities surged to RM302.1 billion in May (Apr: RM288.7 billion).

Foreign investors showed net buying interest in most of the domestic bond segments. MGS and GII logged net inflows of RM12.5 billion (Apr: +RM9.1 billion) and RM1.8 billion (Apr: +RM0.6 billion) in May, respectively. Additionally, Malaysia Islamic Treasury Bills (MITB) and corporate bonds also logged net foreign inflows of RM3.5 million (Apr: +RM0.5 billion) and RM550 million (Apr: +RM2.4 million) in May. In contrast, Malaysia Treasury Bills (MTB) remained in the negative territory with net outflows of RM1.5 billion (Apr: -RM30.0 million). Total foreign holdings’ share to total outstanding in MGS edged higher to 36.3% in May (Apr: 34.6%). Other segments of the local government bond market also climbed with the share of foreign holdings of GII and MITB ticked upwards to 9.3% (Apr: 9.1%) and 9.2% (Mar: 9.1%). In contrast, the percentage of foreign holdings to total outstanding in MTB down to 21.2% in May (Apr: 42.2%). Overall, the foreign holdings’ share of total outstanding edged higher to 14.2% in May (Apr: 13.7%).

Total cumulative foreign holdings in the local bond market grew to RM26.9 billion for the first five months of 2025 and significantly higher relative to the cumulative net foreign inflows of RM1.5 billion from January to May 2024.

Short-term outlook: Foreign inflows into the local bond market is expected to continue amid Malaysia’s robust macroeconomic environment and the latest announcement on Sales and Services Tax (SST) implementation effective July 1, to lend a hand on fiscal strength which will give a slight boost to Malaysia’s sovereign credit rating profile.



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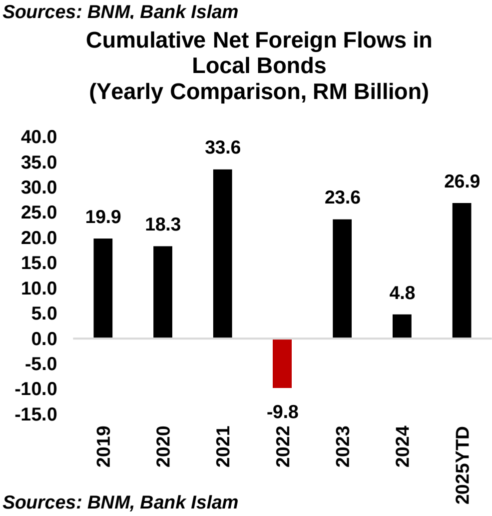

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