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

WEAK U.S. LABOUR DATA, GLOBAL TURBULENCE PUSH FED TOWARDS RATE CUTS

Weak Job Data Seals the Case for Fed Rate Cut. A recent report from the Bureau of Labor Statistics indicates a significant weakening of the U.S. labor market. For the first time since April 2021, the number of job openings has fallen below the number of unemployed workers. This downturn, described as a "turning point" by economists, is evident in the July Job Openings and Labor Turnover Survey (JOLTS) data. The report showed that job openings dropped to 7.18 million, falling short of the 7.37 million expected by analysts. This stagnation suggests that the labor market is not just cooling but has become "stale," with stagnant hiring, low turnover, and a continued reliance on a few key industries like healthcare and hospitality to drive what little growth there is. The weakness became even more apparent in August. The unemployment rate rose to 4.3%, the highest since late 2021, while nonfarm payrolls expanded by just 22K, well short of the 75K forecast. Gains in healthcare and social assistance were outweighed by job losses in the federal government, manufacturing, wholesale trade, and mining. The disappointing print triggered a flight to safe havens, driving demand for U.S. Treasuries and gold, and heightened market volatility. For the Federal Reserve (Fed), the data solidifies the case for policy easing. Markets now price in an 88.2% probability of a 25bps cut at this month’s meeting, with expectations of as many as three cuts this year holding a 68% likelihood, according to the CME FedWatch tool. The U.S. job market has slowed down this year due to two main factors: the delayed impact of the Fed's eleven interest rate hikes in 2022 and 2023, and the economic uncertainty created by President Donald Trump's policies, particularly his trade wars, which have made businesses hesitant to hire.

Japan’s Political Shift and Market Volatility. Japanese Prime Minister Shigeru Ishiba has announced his resignation, bowing to mounting pressure after the ruling Liberal Democratic Party (LDP) suffered heavy electoral losses, forfeiting its majority in both houses of parliament. His departure, less than a year into office, brings an abrupt end to a turbulent tenure marked by political instability and uncertainty over Japan’s fiscal direction. Ishiba said it was the “appropriate time” to step down, noting that he had concluded key trade negotiations with the U.S. that lowered tariffs on Japanese goods. The resignation has set off a high-stakes leadership contest within the LDP, with several heavyweight contenders emerging. Sanae Takaichi, a conservative stalwart, is campaigning on higher government spending and has openly criticized the Bank of Japan’s recent rate hikes. Shinjiro Koizumi, the popular agriculture minister and son of former Prime Minister Junichiro Koizumi, is positioning himself as a reformist alternative. Other names in the running include Chief Cabinet Secretary Yoshimasa Hayashi and former Foreign Minister Toshimitsu Motegi. Markets reacted swiftly to the political shake-up. The yen weakened against the dollar while long-term Japanese government bond yields climbed, reflecting investor unease that a new leader may adopt a more aggressive expansionary fiscal stance. The outcome of the leadership race will be critical in shaping Japan’s economic trajectory at a time when the nation is grappling with sticky inflation and rising living costs, key factors behind the public's dissatisfaction with Ishiba's government. While the next LDP leader is widely expected to become prime minister, the party's loss of its parliamentary majority leaves a slim possibility that the opposition could exert influence over the eventual outcome.

Upcoming Events: Key Economic Data Release

Monday	China Trade Figures (Aug)
Tuesday	Mexico Inflation Rate (Aug)
Wednesday	Malaysia Labour Market (July), China CPI, PPI (Aug)
Thursday	Malaysia IPI (July) U.S. CPI (Aug), ECB meeting
Friday	Malaysia Retail Sales (July)

Weekly Changes, basis points (bps)

UST	Yields (%) 22-Aug-25	Yields (%) 29-Aug-25	Change (bps)	Yields (%) 5-Sep-25	Change (bps)
3-Y UST	3.64	3.58	-6	3.48	-10
5-Y UST	3.76	3.68	-8	3.59	-9
7-Y UST	3.98	3.92	-6	3.80	-12
10-Y UST	4.26	4.23	-3	4.10	-13
MGS	**Yields (%) 22-Aug-25**	**Yields (%) 29-Aug-25**	**Change (bps)**	**Yields (%) 4-Sep-25**	**Change (bps)**
3-Y MGS	2.99	2.99	-1	3.03	4
5-Y MGS	3.09	3.08	0	3.11	3
7-Y MGS	3.27	3.29	2	3.32	3
10-Y MGS	3.39	3.39	0	3.41	2
GII	**Yields (%) 22-Aug-25**	**Yields (%) 29-Aug-25**	**Change (bps)**	**Yields (%) 4-Sep-25**	**Change (bps)**
3-Y GII	3.02	3.03	0	3.06	3
5-Y GII	3.13	3.13	0	3.14	2
7-Y GII	3.25	3.25	0	3.28	3
10-Y GII	3.41	3.42	1	3.43	1

Sources: Federal Reserve Board, BNM, Bank Islam

Commentaries

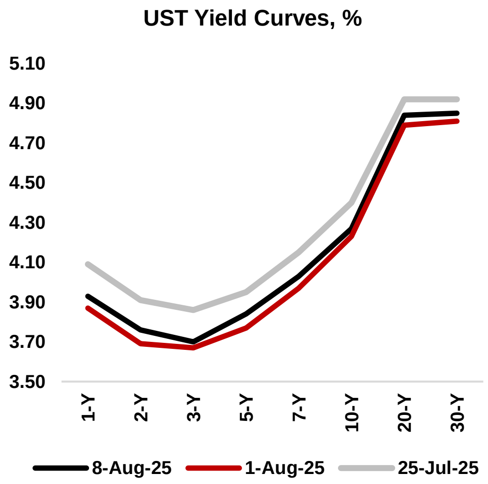
UST Yields

The U.S. Treasury (UST) yields dropped in the range of 9bps to 13bps w-o-w for the week ending September 5 (Aug 29: -3bps to -8bps). The yield on the 10-year US Treasury note dropped significantly to a five-month low of 4.10% on Friday. This sharp decline was triggered by new data showing a significant weakening in the U.S. labor market, which led investors to seek safer assets and anticipate a more dovish stance from the Fed.

U.S. nonfarm payrolls increased by only 22K in August, far below the expected 75K. This report confirms a continued slowdown in job growth since May, with the unemployment rate rising to its highest level since 2021. This has solidified market expectations that the Fe will resume its rate-cutting cycle with a 25bps reduction this month. Rate traders are now betting on a total of three rate cuts by the end of the year.

However, yields on 30-year bonds did not fall as much and are still higher for the year. This suggests that investors remain concerned about inflation due to ongoing tariffs and government spending. These lingering inflation concerns could limit the Fed's ability to cut rates further down the line.

Short-term outlook: This week's market direction hinges on a few key factors. First, the U.S. Producer Price Index (PPI) and Consumer Price Index (CPI) inflation data could be major swing factors, with any upside surprises likely limiting market gains. The ISM services data is also crucial, as it will provide a clearer picture of broader economic momentum. Beyond the data, concerns around the Fed's independence continue to add uncertainty to the future rate path. Finally, the upcoming BRICS summit may influence global trade dynamics and overall market sentiment.



Sources: Federal Reserve Board, Bank Islam

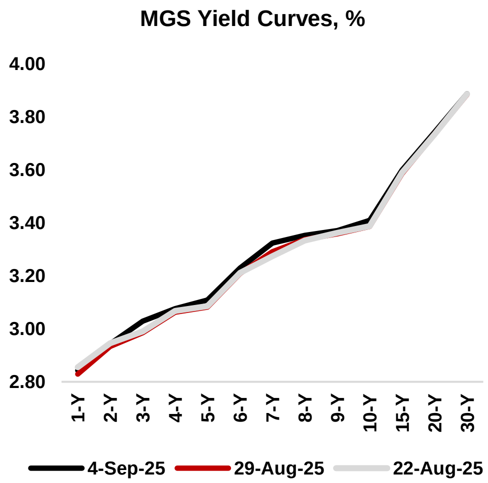
MGS/GII Yields

Yields on both Malaysian Government Securities (MGS) and Government Investment Issues (GII) closed slightly higher on a w-o-w basis by between 1bp and 4bps for the week ending September 4 (Aug 29: -1bps to +2bp). Bond yields rose slightly this week, driven by the concerns over trade tensions following President Donald Trump's comments on tariffs. However, the increase was limited by strong domestic economic data.

Malaysia's manufacturing sector showed signs of stabilization in August as the S&P Global Manufacturing Purchasing Managers' Index (PMI) increased to 49.9. This slight rise from July's 49.7 reading is the highest since June 2024, suggesting the sector is on a path to recovery. The government's new financial assistance program, Sumbangan Asas Rahmah (SARA), which was officially roll-out on August 31, also provided support, boosting consumer spending into the economy with more than 4.8 million people have used their RM100 cash aid to buy essentials nationwide.

In September, Bank Negara Malaysia (BNM) kept the Overnight Policy Rate (OPR) unchanged at 2.75% but struck a more upbeat tone than in July. The central bank expressed greater confidence in both global and domestic growth prospects, underpinned by resilient household spending and easing external risks. Notably, the Monetary Policy Committee (MPC) restored its forward guidance, which was omitted in the July statement, emphasizing that "at the current OPR level, the monetary policy stance is appropriate and supportive of the economy amid price stability." We expect the Overnight Policy Rate (OPR) to stay at 2.75% for the rest of 2025, assuming GDP growth remains within the government's target of 4.0%–4.8% and inflation is kept under control.

Short-term Outlook: 10-Y MGS yield is expected to hover near 3.40% ahead of next week's key domestic releases, including the Industrial Production Index (IPI), labor market, and retail sales data. On the global front, attention remains on the BRICS summit and remarks from President Donald Trump regarding tariffs. Meanwhile, softer U.S. labor market data has reinforced expectations for a 25bps rate cut in the upcoming FOMC meeting on September 17.



Sources: BNM, Bank Islam

Foreign Flows into Local Bonds Market.

The local bond market attracted net foreign inflows of RM3.0 billion in August (Jul: -RM5.5 billion), signaling renewed investor appetite despite lingering U.S. tariff uncertainties. Supportive domestic fundamentals helped sustain demand, even as global sentiment remained cautious. As a result, total foreign holdings of Malaysian debt securities edged higher to RM294.2 billion in August (Jul: RM291.1 billion).

In August, foreign demand returned to government securities, with MGS and GII registering net inflows of RM2.8 billion (Jul: -RM5.2 billion) and RM0.5 billion (Jul: -RM28 million), respectively. By contrast, Malaysia Islamic Treasury Bills (MITB) remained in negative territory, posting net outflows of RM0.2 billion (Jul: -RM0.3 billion). Corporate bonds also slipped into the red, recording net foreign outflows of RM0.2 billion after a modest RM41 million inflow in July.

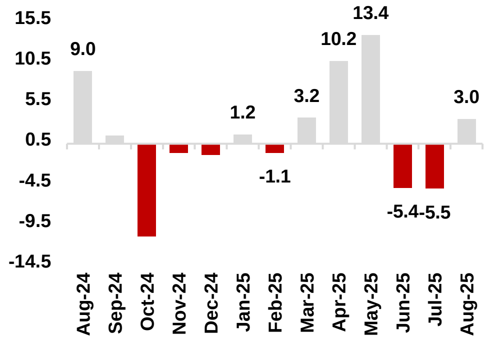
The share of foreign holdings in MGS was unchanged at 34.6% of total outstanding, while corporate bonds also held steady at 2.0%. GII slipped marginally to 8.6% (Jul: 8.7%), whereas MITB climbed to 8.7% (Jul: 6.7%). Overall, foreign participation in local government bonds remained at 22.1%. Despite recording net foreign inflows during the month, the aggregate foreign holdings share of total outstanding edged slightly lower to 13.5% in August (Jul: 13.6%).

Total cumulative foreign holdings in the local bond market closed at RM19.0 billion as of August 2025 and significantly higher relative to the cumulative net foreign inflows of RM17.7 billion from January to August 2024.

In 2Q2025, pension funds retained its spot as the largest holders of local government bonds, accounting for 30.1% of the total outstanding, closely followed by the banking institutions with a share of 29.9% of total outstanding. Other domestic institutional investors, including Development Financial Institutions, BNM, and insurance companies, also played a significant role in driving demand in the local government bond market.

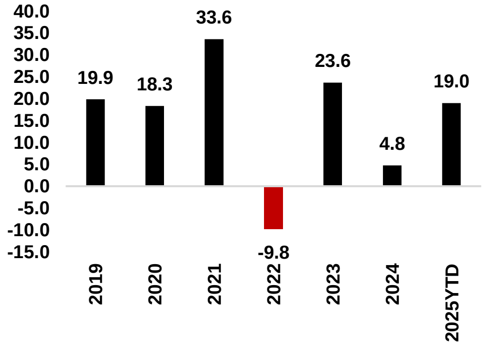
Short-term outlook: Malaysia's resilient domestic fundamentals and stable economic outlook continue to underpin the appeal of its bond market as a destination for foreign capital. Ongoing global uncertainties, especially around U.S. trade policies has driven a "flight to safety." Malaysia's stable economy and political environment make its government bonds a preferred safe-haven asset, which has been a significant driver of foreign interest. A key factor influencing foreign flows is the narrowing interest rate differential between Malaysia and the U.S. The Fed is widely expected to continue its rate-cutting cycle in late 2025, with a 25bps cut anticipated in September. In contrast, Bank Negara Malaysia (BNM) is expected to maintain the OPR at 2.75% for the remainder of the year. This policy divergence enhances the relative attractiveness of Malaysian bonds, as their yields become increasingly competitive against USTs.

Foreign Fund Flows in Local Bond Market, RM Billion



Sources: BNM, Bank Islam

Cumulative Net Foreign Flows in Local Bonds (Yearly Comparison, RM Billion)



Sources: BNM, Bank Islam