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U.S. GOVERNMENT SHUTDOWN INTENSIFIES RISKS TO THE U.S. ECONOMY AND FED POLICY OUTLOOK

U.S. Economy Faces Headwinds Amid Government Shutdown. The ongoing U.S. government shutdown after Congress failed to approve new spending before the fiscal year started on October 1 has exerting significant pressure on the U.S. economy. This is the first government shutdown since the 2018-2019 closure, which lasted a record 35 days due to a dispute over funding for a border wall requested by Trump. The disagreement revolves around Democrats' efforts to extend expiring healthcare subsidies and reverse Medicaid cuts enacted earlier this year. Although Republicans hold the majority in both Congress and the White House, they still need Democratic votes in the Senate to clear procedural obstacles, making healthcare funding the main sticking point in the ongoing standoff. Due to the shutdown, it will delay the publication of important U.S. economic data, including the September jobs report that should be released last Friday and the CPI data due on October 15, which both reports are produced by the Bureau of Labour Statistics (BLS). The absence of this important information poses challenges for the Federal Reserve (The Fed) as it prepares for its Federal Open Market Committee (FOMC) meeting on October 29-30, potentially making the policy outlook more uncertain. With the unavailability of latest data on the nonfarm payrolls amid the shutdown, the ADP National Employment Report has gained significance. U.S. private sector jobs declined by 32k, falling short of the anticipated 50k increase in September. Meanwhile, August's number was revised downward to a loss of 3k. This report has become a key provisional indicator of the labor market's current state. This disappointing job data alongside weak consumer confidence, which fell to its lowest level in five months to 94.5 in September signal a slowing U.S. economy. Furthermore, the shutdown could also weigh on the U.S.'s economic growth through lost government spending, furloughed workers cutting back on personal spending, and delays in business permits and financing. The Fed is widely expected to cut the federal funds rate (FFR) by 25bps at this month's FOMC meeting, with a 94.6% probability. Additionally, markets are pricing in another 25bps cut in December, with an 83.0% likelihood, according to the CME FedWatch tool. Simultaneously, the bond market saw increased demand for U.S. Treasuries as investors sought safer investment amid growing economic uncertainty.

President Trump announced to impose tariffs on imported wood product. Last week, Trump announced that there will be a 10% tariff on imported timber and lumber, and 25% duties on kitchen cabinets, bathroom vanities, and upholstered furniture. The proclamation stated that the tariff rates would take effect on October 14, with duties set to rise on January 1 to 30% for upholstered wooden products and 50% for kitchen cabinets and vanities imported from countries that have reached an agreement with the U.S. President Trump acknowledges that excessive dependence on foreign timber, lumber and related products could jeopardize the U.S. defence capabilities, construction sector and overall economic strength. Wood products are vital inputs across various industries, underpinning national defence, critical infrastructure, economic stability, and industrial resilience throughout the country. Since 2016, the U.S. has consistently imported more lumber than it exports, even though it has the practical capacity to supply 95% of the country's softwood lumber demand for 2024. This move adds additional tariffs on Canada as the largest supplier of softwood lumber to the U.S., where Canadian producers are already subject to roughly 35% in combined U.S. anti-dumping and countervailing duties stemming from a longstanding dispute over timber harvested on public lands. The announcement by Trump led to immediate concerns among investors about rising input costs for retailers and manufacturers, as well as potential trade conflicts.

Upcoming Events: Key Economic Data Release

Monday	Thailand CPI (September)
Tuesday	US Trade Balance (delay), Philippines CPI (September)
Wednesday	BOT meeting, RBNZ meeting
Thursday	BSP meeting
Friday	Malaysia Retail IPI, Manufacturing Sales, Labour Market, Retail Sales (August)

Weekly Changes, basis points (bps)

UST	Yields (%) 19-Sep-25	Yields (%) 26-Sep-25	Change (bps)	Yields (%) 3-Oct-25	Change (bps)
3-Y UST	3.56	3.66	10	3.59	-7
5-Y UST	3.68	3.76	8	3.72	-4
7-Y UST	3.88	3.96	8	3.90	-6
10-Y UST	4.14	4.20	6	4.13	-7
MGS	**Yields (%) 19-Sep-25**	**Yields (%) 26-Sep-25**	**Change (bps)**	**Yields (%) 3-Oct-25**	**Change (bps)**
3-Y MGS	3.04	3.11	7	3.09	-2
5-Y MGS	3.12	3.21	10	3.21	0
7-Y MGS	3.32	3.41	9	3.40	-1
10-Y MGS	3.40	3.46	5	3.44	-1
GII	**Yields (%) 19-Sep-25**	**Yields (%) 26-Sep-25**	**Change (bps)**	**Yields (%) 3-Oct-25**	**Change (bps)**
3-Y GII	3.06	3.15	9	3.13	-3
5-Y GII	3.15	3.23	9	3.23	-1
7-Y GII	3.27	3.37	10	3.34	-2
10-Y GII	3.42	3.50	8	3.48	-2

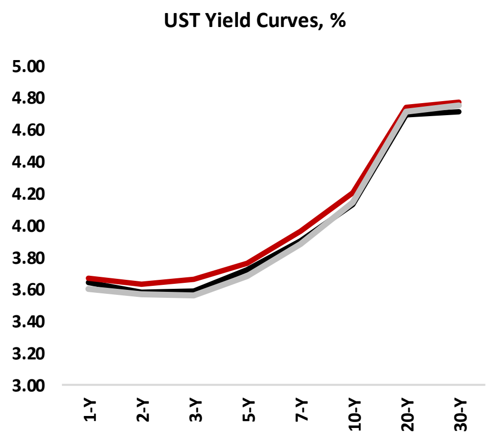
Sources: Federal Reserve Board, BNM, Bank Islam

Commentaries

UST Yields

The U.S. Treasury (UST) yields fell in the range of 4bps to 7bps w-o-w for the week ending October 3 (Sep 26: +6ps to +10bps). The decline was weighed by the unresolved dispute between Democrats and Republicans that led to the government shutdown, which also delayed the release of important job market data, key statistics typically used by the Fed to guide its monetary policy trajectory.

The weaker-than-expected ADP employment report and a drop in consumer confidence in September further suggest a weakening U.S. economy, prompting investors to seek safer assets. U.S. private sector payrolls declines by 32k, missing the expected increase of 50k, while August's figure was revised down to a loss of 3k. With the government shutdown suspending key data releases, including non-farm payrolls, the ADP report has become a crucial temporary indicator of labor market conditions. Amid uncertainty over the government shutdown, coupled with weak employment data, the market is widely pricing in another round of rate cut at this month's FOMC meeting.

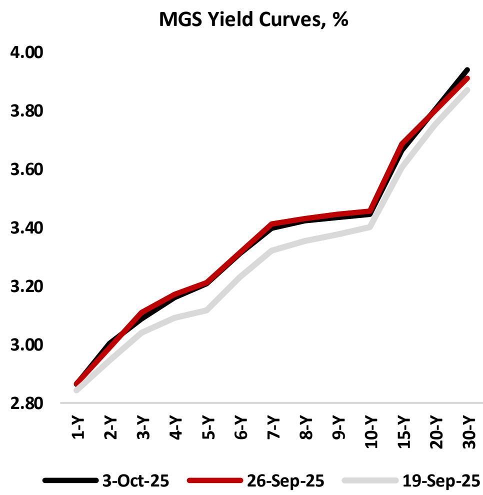


Sources: Federal Reserve Board, Bank Islam

Short-term outlook: U.S. Treasuries retreated as investors took profits amid a renewed appetite for risk, even as the federal government shutdown continued. If the shutdown drags on, trading activity is likely to remain subdued, which could push yields higher and trigger a bullish steepening of the yield curve, a pattern consistent with previous shutdown episodes. The release of several key economic indicators, including the trade deficit, weekly jobless claims, and wholesale inventories, is expected to be delayed. Nonetheless, markets will still hear from Treasury Secretary Scott Bessent and several senior Fed officials, while the upcoming FOMC meeting minutes, set to be released as scheduled, may offer fresh insights into the Fed's policy outlook.

MGS/GII Yields

Yields on both Malaysian Government Securities (MGS) and Government Investment Issues (GII) edged lower on a w-o-w basis by between 1bp and 3bps for the week ending October 4 (Sep 26: +5 bps to +10 bps). The decline came amid renewed global risk aversion following President Trump's announcement of tariffs on timber, lumber, and related imports, which reignited trade uncertainty. Coupled with the escalating Israel-Palestine conflict, these developments spurred a flight to safety, driving investors toward Malaysian bonds. Consequently, demand for MGS and GII strengthened, pushing yields lower as investors sought refuge from rising geopolitical and trade-related risks.



In September, Malaysia's manufacturing PMI edged down slightly to 49.8 from 49.9 in August. Despite this marginal decline, new orders rose for the second consecutive month, supported by modest sales growth. Additionally, businesses experienced relief as input cost inflation eased to its lowest level in five months, thanks to reduced pressure on raw material prices.

Domestically, the rollout of the Budi Madani RON95 (BUDI95) initiative at the end of September aims to ease the cost of living burden by lowering transportation expenses and boosting household purchasing power. Together with the Sumbangan Asas Rahmah (SARA) program, this measure is expected to support retail spending and stimulate broader economic activity through stronger consumer demand across multiple sectors.

Short-term Outlook: Local government bonds are expected to trade on a constructive tone this week, with yields likely to edge higher amid positive momentum ahead of the Budget 2026 announcement on Friday. Market activity is expected to remain subdued until then, as investors await key domestic data releases, including August industrial production, labour market, and retail sales, which will help gauge underlying economic conditions. The upcoming budget is anticipated to prioritise growth-supportive measures such as higher infrastructure spending, incentives for green technology adoption, and targeted assistance for small and medium-sized enterprises (SMEs). At the same time, the government's continued emphasis on fiscal consolidation through prudent expenditure management and enhanced revenue measures is expected to reinforce investor confidence in Malaysia's long-term economic and fiscal outlook.

Auction Results (September 2025)

Of note, a total of RM19.5 billion was raised through four public offerings: a RM5.0 billion 3-Y Reopening of MGS, a RM3.0 billion 30-Y Reopening of GII, RM3.5 billion 15-Y Reopening of MGS and a RM5.0 billion 3-Y Reopening of GII. Investors showed robust demand on 3-Y Reopening of GII, with bid-to-cover (BTC) ratios at 2.9x. Meanwhile, the other three offerings were below 2.0x.

As of September 30, 2025, total gross issuances of MGS and GII amounted to RM139.0 billion (MGS: RM66.0 billion, GII: RM73.0 billion).

Issues	Amount (RM mil)	Amount Applied (RM mil)	BTC (x)	Private Placements (RM mil)
3-yr Reopening of MGS 04/28 3.519%	5,000	9,640	1.9	-
30-yr Reopening of MGII 03/54 4.280%	3,000	5,785	1.9	2,000
15-yr Reopening of MGS 04/39 4.054%	3,500	5,320	1.5	1,000
3-yr Reopening of MGII 07/28 3.599%	5,000	14,380	2.9	-

Sources: BNM, Bank Islam

Upcoming auction (October 2025)

In October, the MGS/GII auction calendar showed a total of three issuances are scheduled, of which two will be via MGS and one through GII with one private placement.

Issues	Month	Private Placements
30-yr Reopening of MGS 07/55	October	Yes
20-yr Reopening of MGS 05/44 4.180%	October	No
5-yr Reopening of MGII 08/30	October	No

Sources: BNM, Bank Islam