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GLOBAL FIXED INCOME FACES HEADWINDS, MALAYSIA'S GROWTH OUTLOOK CUSHIONS MARKET VOLATILITY

Investors on Edge as Fed Independence Threatened by Criminal Investigation into Chair Powell.
In an unprecedented escalation of tensions, Federal Reserve (Fed) Chair Jerome Powell disclosed that the Department of Justice (DoJ) has opened a criminal investigation into his Senate testimony concerning the renovation of the Fed's headquarters, an action he characterised as political intimidation. Powell suggested the probe is linked to President Trump's persistent pressure on the Fed to cut interest rates, warning that such actions pose a direct threat to central bank independence and the ability to conduct monetary policy free from partisan influence. Although Trump denied prior knowledge of the investigation, he continued to publicly criticise Powell's leadership. Former Fed Chair Janet Yellen weighed in, describing the probe as a "chilling" attempt to force Powell from office. While the controversy ostensibly centres on the cost overruns associated with modernising the Fed's historic building, it more broadly highlights the growing risk of politicising the U.S. financial system, raising "banana republic" concerns just months before Powell is due to step down in May.

Japanese Bond Auction Under Pressure. Investors are bracing for auction of 20-year Japanese government bonds on January 20, viewed as a critical litmus test for the market following a sharp sell-off that pushed yields to multi-decade highs. Market anxiety has been fuelled by Prime Minister Sanae Takaichi's call for a February 8 election and her promise of food tax relief, a move echoed by the opposition that analysts fear signals a shift toward fiscally expansionary policies and a worsening national deficit. With the 20-year yield having already hit its highest level since 1999 at 3.265%, the auction results will determine if these record returns are attractive enough to offset growing concerns over government stability and the Bank of Japan's upcoming policy path.

Constructive Outlook for 2026 as Malaysia Outperforms 2025 Growth Targets.
Malaysia's economy closed 2025 on a strong footing, with fourth-quarter growth exceeding expectations and lifting full-year expansion above official targets. Advance estimates from the Department of Statistics Malaysia (DOSM) show that GDP grew by 5.7% year-on-year in 4Q2025, surpassing the 5.4% median forecast and bringing full-year growth to 4.9%, above the government's 4.0%–4.8% target range. This resilience was underpinned by robust performances in the manufacturing and services sectors, as well as a decade-low unemployment rate of 2.9% in November 2025, which helped buffer the economy against the impact of newly imposed U.S. trade tariffs. Looking ahead to 2026, private consumption is expected to remain the main growth driver, supported by the Visit Malaysia Year 2026 initiative, although official projections point to a moderation in growth to 4.0%–4.5% amid persistent global headwinds. Notwithstanding late-year export contractions to the U.S., Malaysia's outperformance mirrors broader regional resilience seen in economies such as Singapore and Vietnam, reinforcing a stable domestic growth trajectory that remains attractive to both investors and policymakers.

Upcoming Events: Key Economic Data Release

Tuesday	Malaysia CPI (Dec), PBoC Central Bank Decision
Wednesday	U.K. CPI (Dec)
Thursday	BNM MPC meeting, U.S. GDP (3Q2025)
Friday	Singapore CPI (Dec), BOJ meeting

Weekly Changes, basis points (bps)

UST	Yields (%) 2-Jan-26	Yields (%) 9-Jan-26	Change (bps)	Yields (%) 16-Jan-26	Change (bps)
3-Y UST	3.55	3.59	4	3.67	8
5-Y UST	3.74	3.75	1	3.82	7
7-Y UST	3.95	3.95	0	4.02	7
10-Y UST	4.19	4.18	-1	4.24	6
MGS	**Yields (%) 2-Jan-26**	**Yields (%) 9-Jan-26**	**Change (bps)**	**Yields (%) 16-Jan-26**	**Change (bps)**
3-Y MGS	3.00	3.00	0	3.01	1
5-Y MGS	3.25	3.25	0	3.28	3
7-Y MGS	3.37	3.40	3	3.45	5
10-Y MGS	3.50	3.52	2	3.54	2
GII	**Yields (%) 2-Jan-26**	**Yields (%) 9-Jan-26**	**Change (bps)**	**Yields (%) 16-Jan-26**	**Change (bps)**
3-Y GII	3.09	3.09	0	3.11	1
5-Y GII	3.25	3.26	1	3.28	2
7-Y GII	3.34	3.34	0	3.36	1
10-Y GII	3.52	3.52	0	3.54	2

Sources: Federal Reserve Board, BNM, Bank Islam

Commentaries

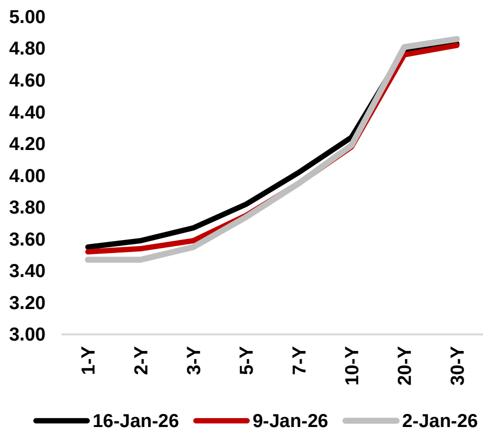
UST Yields

The U.S. Treasury (UST) yields edged higher in the range of 6bps to 8bps w-o-w for the week ending January 16 (Jan 9: -1bp to +4bps). Short-term yields edged higher following the release of U.S. labor market data that, while softer than expected, still pointed to underlying resilience. Job growth in December fell short of projections, weighed down by contractions in construction, retail, and manufacturing. Nevertheless, the unemployment rate declined to 4.4%, suggesting the labor market remains broadly stable rather than entering a sharp decline. Nonfarm payrolls increased by just 50K in December, below the 60K consensus forecast, following a downward revision to November's reading from 64K to 56K, reinforcing signs of a gradual cooling in employment momentum.

Thus, the latest jobs data prompted markets to scale back expectations for aggressive Fed rate cuts. While core consumer price index (CPI) offered some relief, a firm producer price index (PPI) and steady retail sales suggested persistent economic momentum and "sticky" inflation. Further upward pressure on yields stemmed from geopolitical tensions between the U.S. and Iran, alongside concerns regarding Fed independence following DoJ subpoenas.

Short-term outlook: UST yields are poised to drift higher as investors parse upcoming economic data and policy signals. The Core Personal Consumption Expenditures (PCE) reading will be the primary catalyst for inflation expectations, while ongoing geopolitical friction and a delayed Supreme Court ruling on global tariffs introduce further upside risk.

UST Yield Curves, %



Sources: Federal Reserve Board, Bank Islam

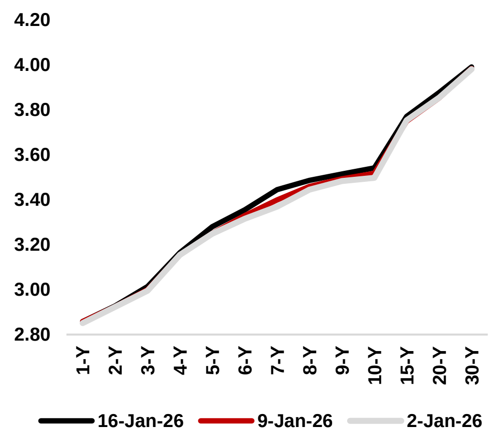
MGS/GII Yields

Yields on both Malaysian Government Securities (MGS) and Government Investment Issues (GII) increased marginally on a w-o-w basis by between 1bp and 5bps for the week ending January 16 (Jan 9: 0bp to +3bps). Local yields came under pressure following a tepid 15-year new issue of MGS, where a low bid-to-cover (BTC) ratio of 1.9x signalled cooling appetite for longer-dated tenors.

Domestically, while the outlook for 2026 remains broadly constructive, near-term sentiment has softened following a deceleration in November's IPI growth to 4.3% y-o-y, from 6.0% in the previous month, signalling a loss of momentum across key industrial segments. Nevertheless, the strong advance GDP estimate of 5.7% growth in 4Q2025 has helped anchor confidence in Malaysia's underlying economic trajectory. Globally, risk sentiment deteriorated after President Trump announced a 25.0% tariff on countries trading with Iran. This development, alongside rising JGB yields and persistent concerns over Federal Reserve independence, sustained upward pressure on global bond yields and reinforced a more cautious market tone.

Short-term Outlook: With inflation and trade data forthcoming, and BNM widely expected to maintain the OPR at 2.75% at the January Monetary Policy Committee (MPC) meeting, the near-term backdrop for bond yields and foreign inflows remains favorable. Nevertheless, market participants should remain alert to global uncertainties, particularly geopolitical risks, which could weigh on risk appetite and pose intermittent challenges to the prevailing stability.

MGS Yield Curves, %



Sources: BNM, Bank Islam

Foreign Flows into Local Bonds Market.

The local bond market net foreign inflows slowed to RM3.0 billion in December from the net inflows of RM6.1 billion in November, marking the third consecutive months of foreign fund inflows into the bond market. The accumulated total foreign holdings of Malaysia debt securities increased further to RM300.8 billion in December 2025 (Nov: RM297.8 billion), the highest since May 2025.

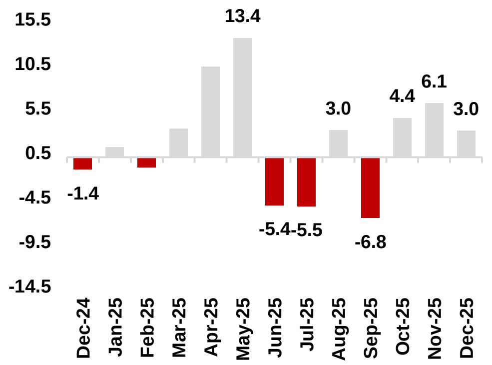
GII was the main driver with the net foreign inflows of RM2.4 billion in December (Nov: -RM1.1 billion). In addition, corporate bonds also saw net inflows of RM0.9 billion (Nov: +RM2.1 billion). Meanwhile, other segments in the local bond market recorded net foreign outflows. MGS recorded net outflows of RM0.2 billion (Nov: +RM5.0 billion). Additionally, Malaysia Islamic Treasury Bills (MITB) and Malaysia Treasury Bills (MTB) were also in the negative territory with net foreign outflows of RM90 million (Nov: +RM26 million) and RM84 million (Nov: -RM59 million).

Total foreign holdings' share to total outstanding in GII jumped to 8.4% in December (Nov: 8.0%). Corporate bonds and MITB also surged to 2.3% (Nov: 2.2%) and 13.2% (Nov: 12.5%) of total outstanding in December. Of note, the percentage of foreign holdings to total outstanding in local govvies bonds also surged to 21.5% in December (Nov: 21.4%). Meanwhile, MGS dipped marginally to 33.7% in December (Nov: 33.9%) and MTB declined to 12.0% in December (Nov: 13.9%).

Total cumulative foreign holdings in the local bond market closed at RM25.6 billion in 2025 and significantly higher relative to the cumulative net foreign inflows of RM4.8 billion in 2024.

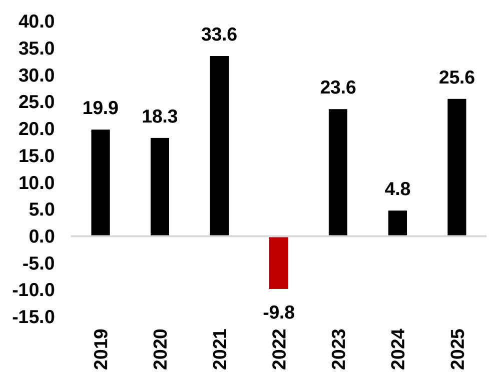
Short-term outlook: While global fixed-income markets continue to face headwinds from heightened geopolitical tensions and lingering concerns over Federal Reserve independence, Malaysian government bonds appear well positioned to remain resilient and continue attracting steady inflows. This strength is underpinned by solid macroeconomic fundamentals, highlighted by the robust 5.7% advance GDP growth in 4Q2025 and a stable sovereign rating outlook that supports investor confidence. Moreover, Bank Negara Malaysia's commitment to maintaining a steady OPR at 2.75%, alongside ongoing structural reforms and disciplined fiscal management, has further strengthened policy credibility. Collectively, these domestic anchors should enable the Malaysian bond market to better decouple from global volatility, reinforcing its appeal as a destination for capital seeking both stability and sustainable growth.

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