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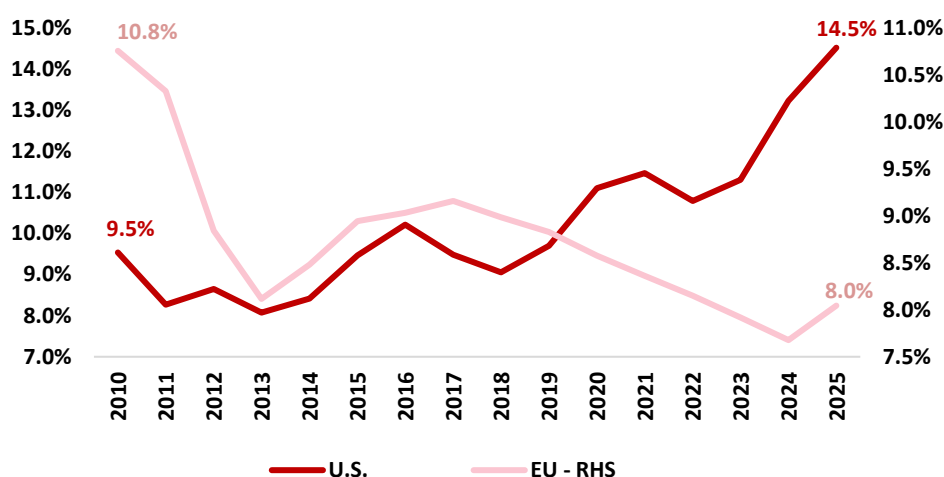
## THE POTENTIAL IMPLICATIONS OF THE U.S.-EU GEOPOLITICAL TENSION ON MALAYSIA ECONOMY

- Recent geopolitical tensions between the United States and the European Union, triggered by Washington's confrontational stance over Greenland, have underscored the growing risk of political disputes spilling over into trade and financial markets. What initially appeared as rhetorical posturing quickly escalated into a credible threat of economic retaliation, highlighting how geopolitical leverage is increasingly being exercised through trade policy. While Malaysia is not directly implicated in the dispute, the episode is relevant for open, trade-dependent economies, as it reinforces the vulnerability of global supply chains and investor sentiment to abrupt policy shifts among major advanced economies.
- The tensions intensified when U.S. President Donald Trump threatened to impose tariffs of up to 10% from February 1, potentially rising to 25% by June, on selected European countries, including Denmark, Germany, France, the Netherlands, the United Kingdom, and Nordic economies, unless Denmark agreed to what he described as the "complete and total purchase of Greenland" by the United States. The explicit linkage of territorial negotiations to punitive trade measures marked a sharp escalation, transforming the issue from diplomatic rhetoric into a direct economic confrontation. Had these measures been implemented, they would likely have disrupted transatlantic trade flows, altered global supply chains, and weighed on risk appetite, with indirect spillovers to emerging markets such as Malaysia through trade, investment, and financial market channels.
- Nevertheless, the immediate escalation risk eased following President Trump's subsequent remarks at the World Economic Forum in Davos. After discussions with NATO leadership, he announced a preliminary framework for cooperation over Greenland and the broader Arctic region, prompting a reversal of the tariff threat. According to Trump, the proposed arrangement would involve shared access to mineral resources and collaboration on missile defense initiatives, including the so-called Golden Dome project. Crucially, he confirmed that the punitive tariffs scheduled for February 1 would no longer be imposed. Although details remained sparse and the agreement was described only as a "concept of a deal," the announcement was sufficient to defuse near-term market concerns, with European responses measured but cautiously constructive.
- Financial markets reacted swiftly to the perceived de-escalation. Risk-on sentiment returned as investors unwound defensive positions built up amid fears of a transatlantic trade conflict, reflecting relief that the most immediate geopolitical shock had been contained. However, the episode has left a lingering imprint. Beyond the short-term market rebound, the abrupt swing from coercive tariff threats to diplomatic backtracking has reinforced concerns over policy

unpredictability under the current U.S. administration. In Europe, the Greenland dispute is widely seen as having strained confidence in the reliability of the transatlantic partnership, prompting EU leaders to reassess their strategic and economic exposure to U.S. policy risk. This residual distrust continues to surface in global markets and raises the risk that future disputes, whether geopolitical or economic, could escalate more quickly, with broader implications for global trade dynamics and emerging economies, including Malaysia.

## Trade Relationship between Malaysia and the U.S. and EU

Chart 1: Changes in Exports Share between the U.S. and EU (%), 2010-2025



Sources: DOSM, Bank Islam

- By composition, the U.S. and the EU together remain critical export destinations for Malaysia, collectively accounting for close to 23.0% of total exports in 2025, equivalent to RM362.2 billion. This underscores Malaysia's deep integration with advanced economies and its exposure to shifts in transatlantic trade dynamics. However, the relative importance of these two markets has evolved over time. The EU's share of Malaysia's exports has gradually declined to 8.0% in 2025 from 10.8% in 2010, reflecting slower growth in European demand and, potentially, structural changes in supply chains. In contrast, the U.S. has emerged as an increasingly significant destination, with its share rising to 14.5% from 9.5% over the same period, signalling stronger and more sustained demand from the U.S. economy, particularly for manufactured and technology-related goods.
- A closer examination of Malaysia's export composition to the EU, measured in both value (in RM billion) and their percentage share of total exports, as detailed in the accompanying table covering January to November 2025, highlights the sectoral channels through which external shocks could be transmitted. Machinery and transport equipment dominate Malaysia's exports to the EU, accounting for more than half of total shipments by value. This concentration reflects Malaysia's established strengths in manufacturing, electronics, and industrial supply chains, as well as the EU's reliance on Malaysia for high-value, technology-intensive intermediate and final

goods. The prominence of these sectors also implies that any renewed trade frictions, policy uncertainty, or demand weakness in Europe, arising from geopolitical tensions with the U.S., could have disproportionate spillover effects on Malaysia's manufacturing output, export earnings, and upstream industrial activity.

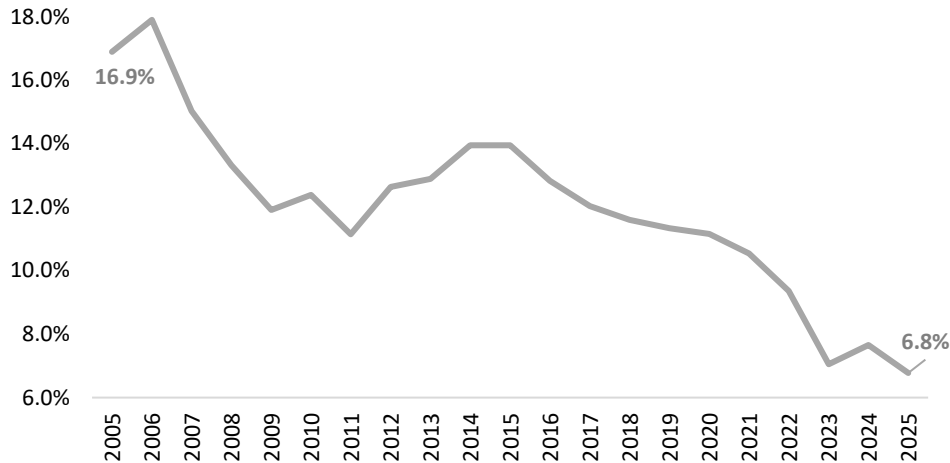
**Table 1: Malaysia's Key Exports to EU (January – November 2025)**

Product	RM'billion	% Share
Machinery & Transport Equipment	63.9	54.8%
Misc. Manufactured Articles	19.1	16.3%
Chemicals	12.8	11.0%
Animal, Vegetable Oils & Fats	8.5	7.3%
Manufactured Goods	7.7	6.6%
Food & Live Animals	1.7	1.4%
Crude Materials Inedible	1.5	1.3%
Mineral Fuels	1.3	1.2%
Beverages & Tobacco	0.1	0.1%
Others	0.2	0.1%
<b>Total</b>	<b>116.7</b>	<b>100%</b>

Source: CEIC, Bank Islam

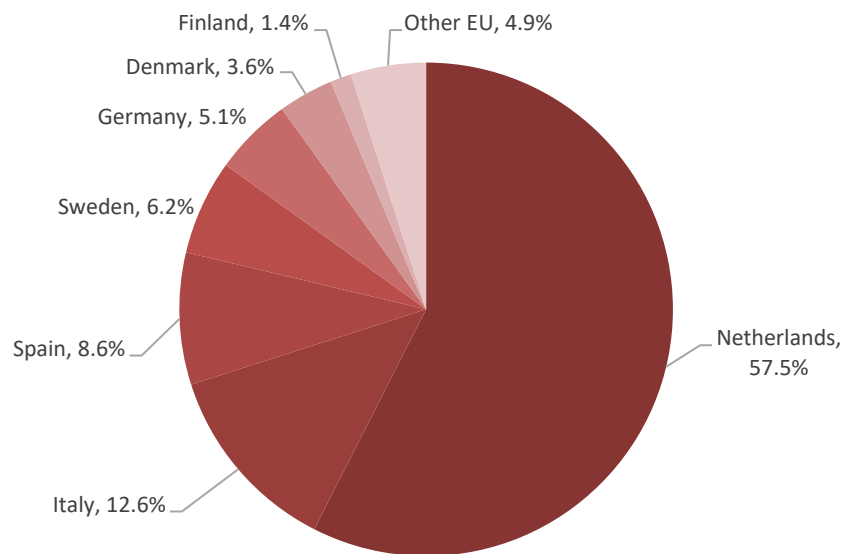
- In contrast to manufactured exports, Malaysia's exposure to the EU through palm oil trade is relatively limited. The EU accounted for less than 7.0% of Malaysia's total palm oil exports by volume in 2025 (January–November), a sharp decline from 16.9% two decades ago. More specifically, the collective share of the EU countries potentially affected by U.S. tariff threats—namely Denmark, Sweden, France, Germany, the Netherlands and Finland—accounted for only 4.8% of Malaysia's total palm oil exports in 2025, underscoring their relatively modest importance to the industry. Within the EU, the Netherlands remains the dominant destination, absorbing 57.5% of Malaysia's palm oil exports to the bloc, reflecting its role as a major trading and re-export hub. This is followed by Italy (12.6%) and Spain (8.6%).

**Chart 2: Share of EU in Malaysia's Total Palm Oil Exports, %**



Sources: DOSM, Bank Islam

**Chart 3: Malaysia's palm oil exports to EU: Netherlands as top destination, 2025**

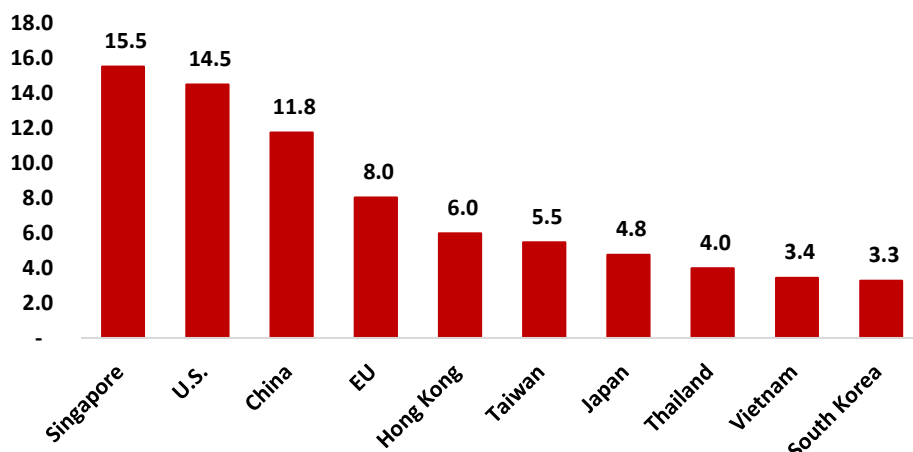


Sources: Malaysian Palm Oil Board, CEIC, Bank Islam

- Malaysia's external trade profile is underpinned by a high degree of diversification across multiple major markets beyond the U.S. and the EU, including ASEAN economies, China, Hong Kong, Taiwan, Japan and South Korea. In 2025, Malaysia's top ten export destinations collectively accounted for around 77% of total exports, demonstrating broad-based trade engagement. This diversified structure provides an important buffer against bilateral shocks and reduces Malaysia's vulnerability to disruptions originating from any single trade corridor. Consequently, even in a scenario where geopolitical tensions between the U.S. and the EU intensify, despite the two markets together accounting for 22.5% of Malaysia's total exports in 2025, the majority of Malaysia's export flows remain anchored in other regions. This dispersion of trade exposure enhances Malaysia's resilience and its ability to withstand disruptions between any two major economies, allowing exporters to partially offset weakness in one

market with demand from others.

**Chart 4: Exports Share by Top 10 Export Destination, %**



Sources: DOSM, Bank Islam

## ***Positive Implications and Opportunities***

- While heightened U.S.–EU trade tensions carry obvious risks, they may also present tangible opportunities for Malaysia. Any escalation could trigger trade diversion, as importers facing tariffs or regulatory barriers in their traditional sourcing markets seek alternative suppliers. Malaysia is well-positioned to benefit from such shifts, owing to its strategic location within ASEAN, well-developed infrastructure, and participation in major regional trade frameworks, including the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). These factors enhance Malaysia's attractiveness as a reliable and efficient alternative supply hub.
- The potential reorientation of trade flows could also encourage foreign direct investment (FDI) and reinforce Malaysia's role in global supply chains, particularly in high-value, technology-intensive sectors. Firms exposed to potential U.S.–EU trade frictions may consider relocating or diversifying production to mitigate tariff risks, creating opportunities for Malaysia to capture investment in semiconductors, electronics, advanced manufacturing, and related industries. The country's competitive strengths, including a skilled workforce, political stability, established industrial parks, and supportive regulatory frameworks, further bolster its appeal as a destination for technology-driven FDI.
- Additionally, Malaysia's neutral geopolitical stance and balanced engagement with both the U.S. and EU enable it to navigate tensions strategically, avoiding entanglement in bilateral disputes. This positioning could allow Malaysia to capitalise on the reconfiguration of trade routes and production networks, strengthening its integration into regional and global value chains while enhancing its long-term economic resilience.

## ***Downside Risks and Challenges***

- Despite the potential opportunities arising from shifts in global trade patterns, Malaysia remains exposed to several downside risks stemming from heightened U.S.–EU trade tensions. A primary channel of vulnerability is the potential disruption to global demand and supply chains. Slower economic growth or trade restrictions in the U.S. and EU could weaken external demand for Malaysian exports, particularly in manufacturing and technology-intensive sectors, thereby affecting domestic industrial output, export earnings, and employment in the short term. Given the significant role of these advanced economies in global trade, even indirect spillovers could have material effects on Malaysia's economic momentum.
- Financial market volatility represents another important risk. Heightened geopolitical uncertainty can trigger swings in global equity and bond markets, tighten cross-border capital flows, and raise Malaysia's cost of financing. These developments may be exacerbated by risk-off sentiment, prompting investors to reduce exposure to emerging markets. In addition, trade disruptions could translate into cost-push pressures, particularly if supply of imported intermediate goods is delayed or constrained, leading to higher input costs for domestic producers. Such pressures could weigh on corporate margins, consumer prices, and ultimately inflation dynamics, adding complexity to domestic monetary and fiscal management.

## ***Summary of Potential Macroeconomic Impacts on Malaysia from an Escalation in U.S.-EU Escalation Geopolitical Tensions***

**Table 2: Macroeconomic Impact from the U.S.-EU Geopolitical Risk**

Indicator	Detail
GDP Growth	Remain resilient supported by strong domestic demand, government fiscal measures, alongside the “Visit Malaysia Year 2026” initiative, diversify exports, which any impact is indirect and mild, mainly via global sentiment.
Trade	Limited disruption to export volumes; selective gains from trade diversion in medium to long term
Inflation	Mild cost pressures from import prices but inflation remains manageable
Employment	Labor market remains stable with low unemployment rate, and job creation continues with a strong boost from tourism related sector
Financial conditions	Temporary market volatility, financing conditions remain broadly supportive

## Overall Impact

Low and manageable macroeconomic impact

Source: Bank Islam

## Conclusion

- At present, the U.S.–EU tensions over Greenland are unlikely to have a direct material impact on Malaysia, as the dispute remains primarily confined to transatlantic political and strategic considerations. Any effects on Malaysia would most likely be indirect, transmitted through global risk sentiment, heightened market volatility, or broader shifts in financial conditions.
- Malaysia's resilient domestic demand, diversified trade portfolio, neutral geopolitical stance, and strategic integration into regional value chains provide important buffers against potential spillovers. While the current situation does not pose immediate systemic risks, both government and the private sector should continue to monitor developments closely, particularly for any signs of escalation that could result in tariffs, sanctions, or disruptions to global supply chains. In such scenarios, Malaysia could experience softer external demand, inflationary pressures, and heightened capital flow volatility.
- Overall, the evolving U.S.–EU tensions underscore a dual narrative of risks and opportunities for Malaysia. In the short term, the country is exposed to indirect trade and financial channel effects, while in the medium term, it may benefit from trade diversion and investment relocation as global supply chains adjust. Malaysia's diversified trade structure, stable domestic conditions, and balanced geopolitical positioning are key factors supporting its capacity to navigate these developments, reinforcing the importance of proactive monitoring and engagement in global trade and investment networks.