Executive Summary

- Growth outlook: The Malaysian economy remains resilient despite a challenging external environment marked by rising trade protectionism and geopolitical tensions. Led by robust domestic demand and strong electronics exports, growth is expected to stay firm, moderating in 2026 before stabilizing near its potential in 2027. Risks to this outlook are tilted to the downside, reflecting external uncertainties such as heightened geopolitical conflict, renewed trade tensions, and a cooling of the artificial intelligence boom.

- Strengths and weaknesses: Malaysia's resilience is a testament to its sound macroeconomic policies, underpinned by robust inflows of foreign direct investment, contained inflation, and stable financial conditions. However, structural issues persist, including wage stagnation, limited innovation, skill and talent gaps, a narrow revenue base, elevated public and household debt, and institutional challenges.

- Investment upcycle: Malaysia is undergoing an investment upcycle that presents a timely and pivotal opportunity to accelerate structural upgrading and lift growth potential. To catalyze durable transformation, policy priorities should focus on preserving macroeconomic and financial resilience, deepening domestic capabilities, and strategic positioning amid geoeconomic fracturing.

- Monetary policy: The monetary policy stance should remain supportive to sustain domestic credit and growth. At the same time, Bank Negara Malaysia (BNM) needs to continue to carefully monitor inflationary pressures and financial stability risks.

- Foreign exchange (FX) and financial sector policy: BNM is encouraged to strengthen foreign reserves buffers and maintain ample system liquidity to bolster resilience against potential credit and FX market shocks. Periodic assessment of macroprudential safeguards is essential to preserve financial stability, while continued development of the digital finance ecosystem can support more efficient and inclusive financial intermediation.

- Fiscal policy: The government should continue to pursue fiscal consolidation to reduce public debt and build durable fiscal space. This includes revisiting the RON95 fuel subsidy design to free up more resources for productivity-enhancing development spending and targeted social assistance, while broadening the tax base and eventually reintroducing goods and services tax (GST). Improving tax administration and compliance, alongside advancing governance reforms, will further enhance fiscal efficiency and public sector accountability.

- Structural policy: Malaysia should navigate strategic competition between the United States and China by pursuing pragmatic economic diplomacy and diversifying markets and technology sources to bolster resilience to external shocks. Deeper integration with ASEAN+3 economies can anchor Malaysia more firmly in regional value chains. The semiconductor and rare earth sectors can provide strategic leverage and facilitate integration into emerging industries. Capitalizing on the current investment upcycle to upgrade industrial capabilities, human capital, and productivity can help place Malaysia on a sustainable path toward high-income status.