Bond market to attract inflows

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PETALING JAYA: The Malaysian bond market is set to continue its resiliency in 2026, with foreign investors flocking into ringgit bonds, especially long-tenured government bonds.

Experts attributed this positive momentum to favourable domestic and external conditions despite heightened geopolitical risks.

Foreign inflows into the ringgit-bond market surged to RM25.6bil in 2025 versus RM4.8bil in 2024, the largest since 2021, with the strongest inflows occurring in early of the second quarter of financial year 2025 (2Q25), when global markets began to price in aggressive US Federal Reserve (Fed) easing.

MARC Ratings Bhd chief economist Ray Choy

MARC Ratings Bhd chief economist Ray Choy told StarBiz he expects foreign participation in the Malaysian bond market to remain resilient this year, supported by both favourable domestic and external conditions.

He said this resilience is likely to be anchored in Malaysian Government Securities (MGS) and Government Investment Issues (GII), rather than corporate bonds.

“Foreign investors have typically maintained modest exposure to corporate bonds, averaging around 2.1% of holdings between 2015 and 2025, while their participation in MGS and GII has been significantly higher, averaging 25.5%.

“Importantly, foreign holdings remain below the 2016 historical peak of 33.7%, suggesting that positioning is still underweight relative to past highs.

“This leaves room for further foreign participation in the local bond market,” Choy noted.

In terms of duration preference, he said foreign demand is expected to tilt toward the longer end of the MGS and GII curve, particularly the 10-year securities.

He said this preference is supported by a more favourable US Treasury (UST) and MGS spread, well-anchored inflation, a firmer ringgit profile, and Malaysia's credible fiscal consolidation trajectory over the medium-term, with the fiscal deficit projected to narrow from 3.8% of gross domestic product (GDP) in 2025 to 3.5% in 2026.

"Given the positive momentum and strength in Malaysia's GDP growth, we remain constructive on the ringgit and expect it to appreciate even further towards end-2026.

"Bank Negara Malaysia's decision to maintain the overnight policy rate (OPR) at 2.75% on Jan 22, supported by firm economic growth and moderate inflation expectations in 2026, will improve the MGS-UST yield differentials in favour of the ringgit.

"Since markets continue to price in at least two Fed rate cuts in 2026, while Malaysia's interest rate is expected to remain stable, foreign interest in ringgit assets will remain strong," Choy said.

The US Federal Open Market Committee, which sets the central bank's rate decisions, in its January 2026 meeting has kept the benchmark federal funds rate at 3.5% to 3.75% following three rate cuts in 2025.

He said, furthermore, expectations of fiscal consolidation reduce Malaysia's sovereign credit risk, while low inflation, forecast at 1.6% in 2026, below the pre-pandemic average of 1.8% (2015 to 2019), improves inflation-adjusted returns on MGS.

In addition, Choy said institutional reforms such as the proposed term limits for the prime minister announced in January, ongoing observance of the Public Finance and Fiscal Responsibility Act, the implementation of the Government Procurement Act in 2026, budgetary reform for the purpose of raising economic development in Sabah and Sarawak, alongside other initiatives are expected to strengthen governance and reinforce political stability.

He said these developments should further support investor confidence in the ringgit and Malaysian bond market.

RAM Rating Services Bhd senior economist and head of economic research Woon Khai Jhek

RAM Rating Services Bhd senior economist Woon Khai Jhek said he expects foreign investor demand for ringgit bonds to remain healthy in 2026, supported by global monetary easing prospects, Malaysia's resilient macroeconomic fundamentals, and a more encouraging fiscal trajectory.

The anticipated continuation of the US Fed's rate-cut cycle would support the narrowing of the UST-MGS yield differential, strengthening the relative appeal of Malaysian bonds.

He said this trend was already evident in 4Q25, when investors were pricing in incoming US Fed rate cuts.

Woon said the average 10-year MGS-UST yield differential narrowed to 59.1 basis points (bps) in 4Q25, from 84.7 bps in 3Q25.

Additionally, he said this more attractive yield differential contributed to a notable foreign inflow of RM13.5bil in 4Q25, reversing the net outflow of RM9.3bil recorded in 3Q25.

Woon said: “While 2026 foreign inflows into the Malaysian bond market will hinge on the pace and consistency of global rate cuts, the backdrop remains broadly favourable.“

The Fed is widely expected to deliver around 50 bps of cumulative cuts, while Malaysia’s OPR is likely to remain unchanged at 2.75%, a combination that points toward continued support for ringgit-denominated debt.

“Although surpassing 2025’s exceptionally strong inflows would be challenging, the probability of sustained and healthy foreign demand remains high in 2026, especially if the Fed stays on a steady easing path.

“This is provided that no major geopolitical shocks derail investor sentiment this year.”
He said foreign buying is expected to stay concentrated in MGS and GII, which historically anchor foreign holdings. Notably, these instruments accounted for around 90% of the total RM25.6bil net foreign inflow in 2025.

Woon said there may also be a gradual return of interest in the government’s longer-dated bonds (MGS and GII) as uncertainties surrounding the future interest rate path continue to subside.

Better visibility around Malaysia’s fiscal consolidation path and improving macro fundamentals would further reinforce this outlook, he noted.

Meor Amri Meor Ayob, Chief Executive Officer, Bond Pricing Agency Malaysia (BPAM)

Bond Pricing Agency Malaysia (BPAM) chief executive officer Meor Amri Meor Ayob expects foreign demand to remain concentrated primarily in MGS, followed by GII, given their superior liquidity, benchmark status, and inclusion in global bond indices.

Echoing similar views, he anticipates foreign fund inflows into the ringgit bond market to continue in 2026.

He said this would be underpinned by a confluence of factors, including Malaysia's continued commitment to reforms, fiscal consolidation, a relatively stable political environment, and a steady growth trajectory underpinned by resilient domestic demand.

Meor Amri said Bank Negara Malaysia's policy stance would be central to anchoring yield expectations amid contained inflation and steady growth, while fiscal consolidation and disciplined issuance should help keep supply dynamics manageable.

However, he said the movement in the ringgit remains critical for foreign investors.

The ringgit to date has been Asia's best-performing currency, outperforming major currencies including the Japanese yen and Singapore dollar.

This indicates that investors see Malaysia as a potential and stable economic hub when other Asian countries are currently experiencing economic issues.

Malaysia's economy is projected to grow between 4% and 4.5% in 2026, down from 4% to 4.8% in 2025.

For 3Q25, growth, as measured by GDP, expanded by 5.2%, while the economy grew by an average of 4.7% in the first nine months of 2025.

Data from the Statistics Department showed advance real GDP rose 5.7% year-on-year (y-o-y) in 4Q25, up from 5.2% in the previous quarter, marking the fastest quarterly expansion since 4Q22.

Final 4Q25 and full-year GDP data are expected on Feb 13.

On another note, Meor Amri said despite a generally constructive outlook, several challenges could constrain foreign buying of Malaysian bonds in 2026.

"A resurgence of geopolitical tensions could trigger renewed risk aversion and prompt capital outflows from emerging markets, including Malaysia."

In addition, higher than expected global inflation may delay interest rate cuts, thereby reducing the relative attractiveness of ringgit-denominated bonds," he said.

Woon said the downside risks remain for the bond market this year.

One of the key risks includes a slower than expected Fed easing.

"If US rate cut expectations are delayed or reversed, UST yields could rise again and widen the UST-MGS yield spread, reducing the relative appeal of MGS and dampening foreign inflows.

"Besides that, any re-escalation in geopolitical tensions or shifts in US trade or tariff policies could reintroduce risk-off behaviour, similar to episodes witnessed in 2025."
Additionally, weak global trade and slowing external demand may weaken sentiment toward emerging market assets generally," he noted.