AmBank Group

AmBank Economics

#WhatWeThink

Next MPC to influence bond spreads

6 July 2026

Summary

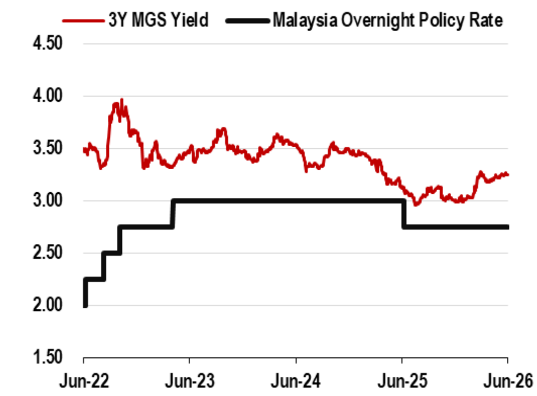
We are awaiting the next MPC meeting set for 9 July 2026. If BNM continues to signal a neutral stance, we foresee a modest steepening of the curve in the medium-term horizon, due mainly to our forecast of a larger drop in shorter tenor yields than in longer tenors. Our forecast for the 3Y MGS is 3.15% by end-3Q2026, 3.15% by 4Q2026, and a slight decline to 3.10% in 1H2027. Our forecast for the 10Y MGS is 3.64% by end-3Q2026, 3.66% by 4Q2026, and towards 3.64% in 1H2027. That should bring the 10Y/3Y spread from 36 bps at end-2Q2026 to widen to around 50 bps by the end of the year and towards 55 bps by end-1H2027.

Expecting a steeper curve by end-2026; the front end should receive support if BNM continues a neutral tone

Overall, our outlook for the MGS market remains constructive. Our outlook considers recent conditions in global markets, the impact of the war in West Asia, fallout from recent crude supply disruptions, the latest global inflation data showing elevated levels relative to pre-war conditions, and the remarks from global central banks, which are more hawkish bias. In addition, we consider domestic Malaysian macroeconomic and market conditions, and especially the last BNM MPC statement, which we view as neutral. As a recap, due to the war, MGS yields shot up in 1H2026, with the 10Y MGS closing 1H2026 at 3.60%, up 10 bps YTD, and the 3Y MGS at 3.25% up 25 bps YTD.

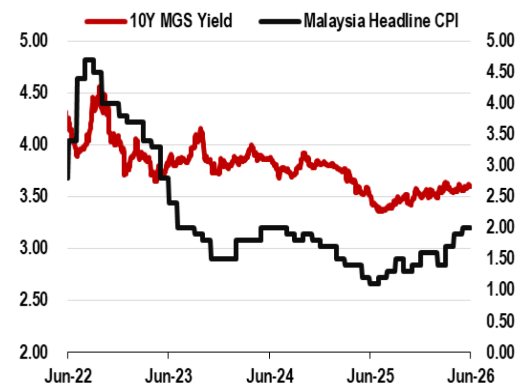
Yields elevated in view of Fed hike potential. Although there has been some decoupling of MGS correlation from UST (correlation of 0.24), interest rate differentials still affect MGS returns relative to UST. The 10Y UST spread above the 10Y MGS has risen to about 85 bps, brought on by the larger jump in UST yields versus MGS since March 2026. The spread was about 50 bps back in February. In March, 2Y and 10Y UST yields were up 42 bps and 38 bps to close at 3.79% and 4.32%. The MGS was tracking the rise in UST yields, though MGS yields were up a smaller 15-25 bps m/m. A risk to our view is that the Fed may turn dovish, such as in reaction to signs of slowdown in the US labour market. While Fed Chair Warsh has emphasised that price stability takes precedence over maximum employment, market participants appear unconvinced that this will translate into an aggressive tightening cycle. Despite inflation remaining at multi-year highs, investors may view inflation risks as eventually receding over time and the Fed's focus gradually shifting towards supporting the US labour market. As such, we expect downward pressure on UST yields, with MGS yields likely to follow.

Exhibit 1: 3Y MGS vs. OPR (%)



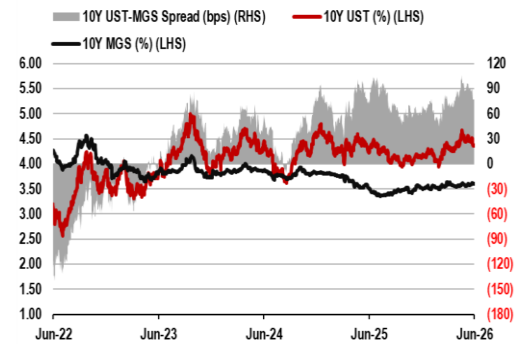
Sources: AmBank Economics, Bloomberg

Exhibit 2: 10Y MGS vs. Malaysia CPI (%)



Sources: AmBank Economics, Bloomberg

Exhibit 3: UST vs. MGS spread



Source: AmBank Economics, Bloomberg

We foresee a still-controlled inflation outlook for Malaysia in 2026, even as global geopolitical risks and elevated oil prices remain in the background. Our MGS yield projections assume a 2.0% full-year 2026 CPI and a 2.4% CPI for 2027.

BNM outlook. No rate action expectations guide trading at a time when the front of the curve may offer an opportunity. The next MPC meeting is on 9 July. We expect no rate hikes nor cuts from BNM for 2026. The 3Y MGS at around 3.20-3.30% (50-60 bps over the OPR) is steep against the OPR. In a neutral interest rate environment, the 3Y MGS/OPR spread is normally around 25 bps. Hence, if BNM's narrative remains neutral in the next 1-2 MPC statements, we foresee short-tenor MGS receiving support.

Overall, the outlook is more tilted towards the positive than the negative. The front of the curve is elevated; hence, a more neutral BNM going forward should support shorter tenor bonds. Meanwhile, longer bonds are likely to see less support amid cautious over the long-term fiscal trajectory and an upward inflation path.

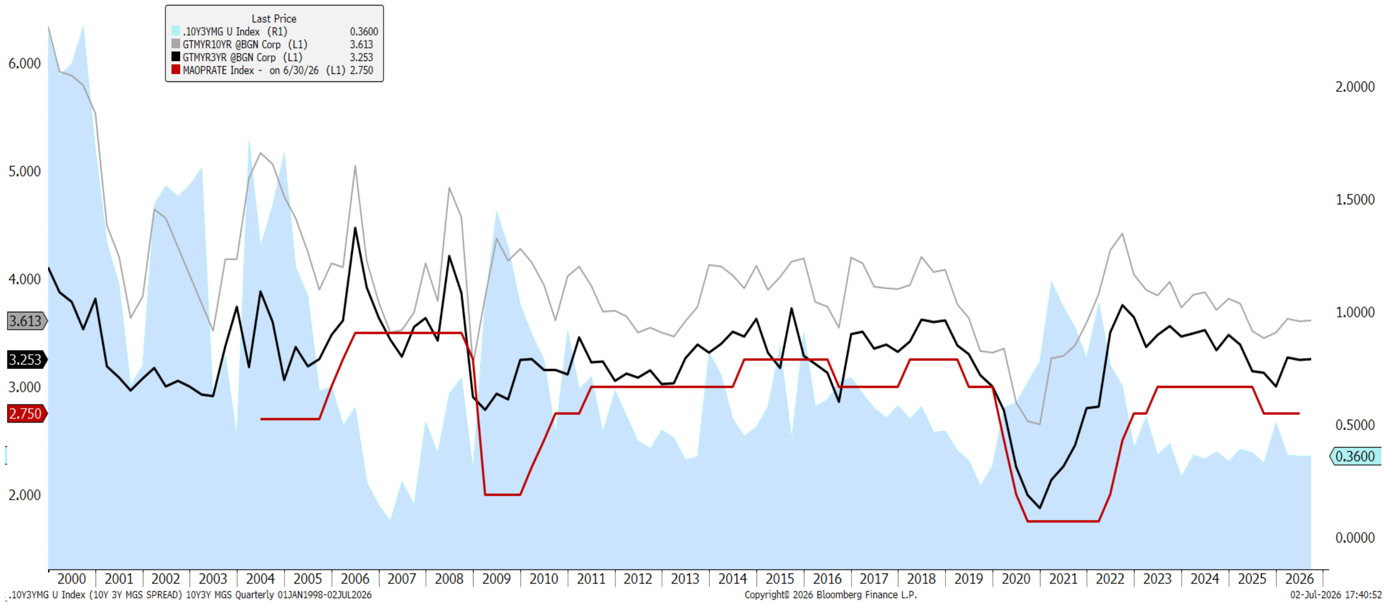
- **Steeper curve**. We foresee a modest steepening of the curve in the medium-term horizon, due mainly to a larger drop in shorter tenor yields than longer tenors. Our forecast for the 3Y MGS is 3.15% by the end of 3Q2026, 3.15% by 4Q2026, and declines slightly to 3.10% in 1H2027. Our forecast for the 10Y MGS is 3.64% by the end of 3Q2026, 3.66% by 4Q2026, and towards 3.64% in 1H2027. That should bring the 10Y/3Y MGS spread from 36 bps at the end of 2Q2026 to around 50 bps by the end of the year and towards 55 bps by the end of 1H2027. A steepening of the curve due to a larger yield decline in short-dated bonds than on longer bonds occurred more recently in 2019, 2022 and 2025. 2019-2020 saw cuts in the OPR, but this time, without hints of a cut, the market will merely reverse its previous pricing of elevated global interest rate risks.
- **Watch the gap**. A rally in UST should narrow the UST-MGS spread, thus allowing for a relative rise in MGS attractiveness going forward. Even though this works better to push demand on the shorter end than on the longer end of the MGS curve, players ought not to abandon duration as maturities up to the 10Y MGS may still attract demand on the cross-border basis. For 15Y and longer, a rally in USTs signals lower inflation risks, coinciding with more positive news on the geopolitical front, which is likely to weigh on MGS inflationary risks. Depending on central bank policy going forward and potential for short-term rates rising, overall valuations may not be cheap, but factors are working positively for MGS, such as backdrop of positive Malaysia macro (where growth and inflation boost policy outlook, both monetary and fiscal), local liquidity and onshore investors support, trading valuations and spread on duration basis, and spread against the UST.

Exhibit 4: AmBank Economics' latest MGS and UST yield forecast (%)

	2Q2026 (A)	3Q2026 (F)	4Q2026 (F)
3Y MGS	3.25	3.15	3.15
10Y MGS	3.61	3.64	3.66
10Y/3Y MGS (bps)	36	49	51
10Y UST	4.47	4.33	4.28

Note: (A) Actual, (F) Forecast
Sources: Bloomberg, AmBank Economics

Exhibit 5: 3Y and 10Y MGS spread vs. OPR (%)



Sources: Bloomberg

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