Malaysia 2027 Federal Budget Preview

Merdeka giveaways set election pace; revenue base stays narrow

OVERVIEW

- **Budget 2027** is the fifth MADANI Budget and the second year of 13MP, built around 10 focus areas (see Appendix 1). It aims mainly at the **cost of living,** easing financial pressure on households, especially the M40 group, amid global energy challenges. Its **growth priorities** are high-value investments in AI, semiconductors, and the digital economy. Long-term **fiscal consolidation** remains the core fiscal policy.
- **Plugging the leakages.** Notably, **there is no revenue-reform pillar this year**. The closest thing, Focus Area Five ("spending that delivers the best value for the people"), covers tax compliance, subsidy management, and spending efficiency. It plugs leakages in an existing base rather than widening it.
- **Read that alongside the Merdeka Eve giveaways, and the picture is clear: a pre-election budget**, possibly on a shorter runway than February 2028 implies. On 30 August, the PM pulled forward a Budget 2027-grade measure, the BUDI95/Budi Diesel quota restoration, by two months.
- **We project the 2026 deficit to edge up 3.8% of GDP (2025: 3.7%), with the BUDI95 restoration absorbed within that number. We expect it to narrow to 3.5% in 2027** on sustained GDP growth, and a manageable overall balance in line with consolidation efforts towards 13MP target of below 3.0% by 2030. That path is slower than a genuinely wider revenue base would allow. Our Brent assumption (USD80/bbl average for 2026, USD74/bbl for 2027) is under review and the revision will be higher (around USD90/bbl average for 2026, USD80/bbl for 2027); the figures in this note remain on the current path, and we will update the fiscal arithmetic once the new oil view is finalised.
- **Growth to stay resilient in 2027.** We expect MoF to take a slightly optimistic stance and set a 2027 GDP growth target of 4.5% to 5.5%. Our forecast is 5.0% (2026F: 5.3%), as some of 2026's temporary boost fades. Nevertheless, structural reforms of recent years should still support economic transformation, productivity and medium-term growth momentum.
- **SST stays.** The PM has ruled out a broad-based tax but is open to studying "acceptable GST features" within SST. We read that as reform of invoice mechanics and input-relief, not a GST comeback.
- **Contrarian flag:** don't mistake "GST features" for GST's return. Markets pricing a base-broadening story risk disappointment. What is actually on offer is MyInvois matching and rationalised exemptions, not a broad-based VAT.
- **Net expenditure projection to narrow to RM448.0b in 2027** (2026F: RM453.0b), on expectation of lower subsidy bill backed by the assumption that Brent crude normalising to around USD80/barrel. Spending discipline under Focus Area Five, not new taxes, is expected to do the consolidation work.
- **Federal government debt-to-GDP: Expected to ease to 62.2% in 2027** (2026F: 63.7%, 2025: 65.2%). Consequently, debt service costs should ease to 16.5% of revenue (2026F: 16.8%), still above the government's 15.0% threshold.
- **The bigger point:** a narrow revenue base keeps consolidation exposed to oil and commodity shocks. That is our read-through to the long end of the duration, and USDMYR. Durable currency support needs evidence of revenue diversification, not just a good growth quarter.

CONTEXT

- **Pre-Budget Statement 2027: ten focus areas, no dedicated revenue-reform pillar**
  - Budget 2027, to be tabled on 9 October 2026, is the fifth MADANI Budget and the second year of the 13th Malaysia Plan (13MP). It drops the three-pillar Ceiling/Floor/Reform structure. Budget 2026 was framed around "Raising the

Ceiling," "Raising the Floor," and "Driving Reform & Governance." The Pre-Budget Statement 2027 instead sets out ten more granular focus areas (Appendix 1).

- The main aim is to ease cost-of-living pressure on households, especially the M40 group, amid global energy challenges. Growth priorities are high-value investments in AI, semiconductors, and the digital economy, with long-term fiscal consolidation still the core fiscal policy. This is a shift in packaging as much as substance. Several 2026 reform threads (e-invoicing, MTRS, SST reviews) reappear but folded into Focus Area Five rather than given top billing.
- **Focus Area Five is the closest thing to a revenue chapter, and it isn't one**. Its language leans towards tax compliance, subsidy management, and spending efficiency: plugging leakages in an existing base rather than widening it. That is a very different agenda from Budget 2026's Medium-Term Revenue Strategy (MTRS) framing, which explicitly flagged base-broadening (Global Minimum Tax, regular SST reviews).
- **The PM's own words reinforce this**. Prime Minister Anwar Ibrahim has said Malaysia will retain SST as the national system and will not compromise on a tax that broadly affects the population, a direct reference to the political cost of the 2015 to 2018 GST experience. He has also said he is open to studying "acceptable GST features" within SST. We treat that as a mandate to fix SST's mechanics (cascading, input relief, invoice matching), not a coded signal of GST's return.

The Political Economy of Budget 2027: A pre-election budget on a compressed timeline

- GE16 isn't due until February 2028, but we wouldn't bet on the government waiting that long. Anwar's term runs to December 2027, and the election must be called by February 2028 at the latest. Speculation has swirled all year. The PM floated an early poll back in May amid coalition strain with Barisan Nasional over the Johor state election. Pakatan Harapan's loss of Negeri Sembilan to a BN-PN pact pushed expectations back out. The latest reporting points to 2Q27 as the working assumption. Even that as the working assumption inside the coalition. Even on that "later" reading, Budget 2027 is the last budget the government tables before the vote, which raises the stakes on every measure inside it.
- **The clearest evidence is the Merdeka Eve address itself.** On 30 August, the PM announced six cost-of-living and business-relief measures taking effect 1 September. He admitted outright that the BUDI95 and Budi Diesel quota restoration was originally meant for Budget 2027, then moved it forward and called it "temporary relief." That is about as direct a signal as a sell-side desk ever gets. Budget-grade measures handed out before Budget Day, exactly what you would expect if the political calendar is shorter than the official deadline. The fiscal cost is trivial, which is precisely what makes it a signal rather than a spending decision. A government willing to break its own Budget sequencing for a measure this cheap is optimising for the calendar, not the ledger.

Table 1: Merdeka Eve 2026 measures, effective 1 September

Measure	Detail
BUDI95 / Budi Diesel	RON95 quota restored 200L to 300L; diesel quota raised 300L to 400L; more than 16m users benefit
AI for Rakyat programme	Three months of free AI subscription services to 100,000 Malaysians aged between 18 and 30
School maintenance	2027 allocation raised 50%, from RM1.0b to RM1.5b
Microfinancing	Facility expanded by RM1.0b, taking 2026 total from RM5.0b to RM6.0b
Healthcare digitalisation	RM1.0b allocation; 150 government hospitals as early recipients for digital access / EMR rollout
Geran Sejahtera MADANI	New RM200m fund for hawkers, small traders, night-market traders and home-based businesses

Source: PMX National Day 2026 Address, Bernama, The Star, Kenanga Research. The PM also flagged further announcements at the Malaysia Day (16 September) event in Sarawak and at the Budget 2027 tabling itself, framing this explicitly as instalment one of a sequence, not a one-off.

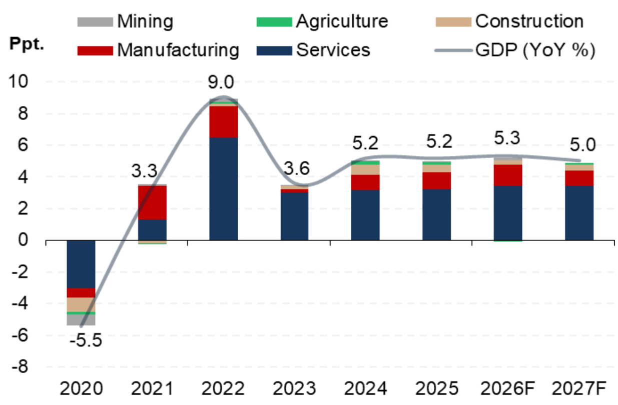
- Why this matters for our Budget 2027 numbers. Every one of these measures lands on the "goodies" side of the ledger: Cost-of-living transfers (Focus Area Two), SME support (Focus Area Eight), education and healthcare (Focus Area Four). We have already built these into the Expenditure section. None of it touches Focus Area Five's compliance-and-efficiency agenda. **A government pulling spending forward before an election is, almost by definition, not about to widen its tax base.** If anything, that strengthens our "plugging the leakages" thesis. The compliance-led, base-preserving revenue agenda we describe elsewhere is likely the full extent of reform on offer, because the political calendar rules out anything bolder.

- **Sabah & Sarawak tell the same story under** a different label. Seat redelineation after March 2026 is expected to add parliamentary seats in East Malaysia, and softer Malay-vote support in the Peninsula only raises the coalition's stake there. Focus Area One's infrastructure push in both states, and the PM's choice to make his next announcements from Sarawak on Malaysia Day, look as much like seat maths as regional development policy. Watch the actual East Malaysia development-spending numbers land in Budget 2027.
- Stated plainly: our 3.5% 2027F deficit call assumes a fairly normal consolidation path, and it is the number most exposed here. Start with what the September measures do not do. Average BUDI95 usage runs at roughly 100 litres a month and fewer than 1.0% of users consistently exceed 200 litres, so the cap never bound for most claimants. We estimate the incremental cost at RM0.5b to RM1.0b over September to December, or some 2 to 5 basis points of GDP. On their own, the measures are immaterial to the 2027 arithmetic. The risk lies in what follows. If the election comes earlier than the 2Q27 base case, or the government keeps rolling out BUDI95-style reversals and SARA top-ups outside the normal Budget cycle, we expect 2027 deficit closer to 3.6%-3.7%. That 10 to 20 basis point gap comes from successive rounds through 2027, not from anything announced so far. Keep this separate from the oil-price risk under Fiscal Deficit Outlook: one is a commodity shock, the other a political choice. Both push the deficit the same way.
- **Where we part ways with what the market may be pricing**: if MGS and MYR positioning assumes a standard, steadily consolidating Budget 2027 with the election safely parked in early 2028, we think that's too complacent, both on how soon the vote could come and on how the government is already behaving because of it. The Merdeka Eve package is the tell. Whatever date the election lands on, the government is already acting like it's closer than the deadline implies

ECONOMIC OUTLOOK

- **The Federal Government is expected to target GDP growth of 4.5%-5.5% in 2027, broadly in line with our forecast of 5.0% (KIBB 2026F: 5.3%)**
  - **Growth is expected to remain resilient in 2027**, though slightly slower than in 2026. Support comes from sustained domestic demand, structural reforms under the MADANI Economic Framework and the rollout of 13th Malaysia Plan (13MP) projects. External risks, including trade tensions and potentially slower global growth, remain the key downside, although Malaysia's diversified economic base offers some buffer.
  - **On the demand side**, **private consumption should remain the key growth driver**, backed by a stable labour market, steady income growth and targeted cash assistance. Subsidy rationalisation is expected to continue, but its impact on household spending should stay manageable given targeted implementation and offsetting support. Investment is the other pillar, driven by strong inflows into strategic sectors namely electrical and electronics (E&E), data centres, renewable energy, and advanced manufacturing. These should expand productive capacity, create jobs, and lift Malaysia's medium-term growth potential. Despite the general election timeline and geopolitical risks, we expect public spending to stay supported in 2027, albeit narrowing slightly, with operating expenditure (OE) falling and development expenditure (DE) rising slightly on faster project delivery. Net exports should moderate sharply as external trade normalises from an exceptionally strong 2026.
  - **On the supply side, services will remain the main growth engine**. Tourism should get a lift from the 34th Southeast Asian (SEA) Games across Kuala Lumpur, Sarawak, Penang, and Johor, alongside continued expansion in wholesale and retail trade, transportation, financial services, and the digital economy. Manufacturing is expected to keep growing, albeit more slowly, supported by new capacity, global technology and semiconductor demand, AI-related investment, and E&E exports, despite lingering global trade policy uncertainty over. Construction should stay robust, as implementation of major 13MP infrastructure projects gather pace. Agriculture is expected to benefit from food security and productivity measures. Mining could post modest growth as energy markets normalise after 2026's volatility, although commodity prices remain a key risk.

Graph 1: Growth Outlook by Sector (KIBB forecast)



Source: Department of Statistics, Macrobond, Kenanga Research

FISCAL DEFICIT OUTLOOK

- **Fiscal consolidation to continue, but at measured pace**
  - The 13MP targets a fiscal deficit below 3.0% of GDP by 2030, leaving four years to get there. We expect consolidation to remain gradual as policymakers balance fiscal discipline against the need to sustain growth, support household incomes, and fund strategic development.
  - **We forecast the fiscal deficit to narrow modestly to 3.5% of GDP in 2027** (KIBB 2026: 3.8%) as our base case. Revenue itself falls on a lower Brent assumption, so the improvement in the ratio comes from nominal GDP growth rather than from stronger collection. With the general election expected in 2Q27 on our base case, Budget 2027 is also likely to focus more on targeted assistance, household welfare, and development programmes that support domestic activity and ease cost-of-living pressure.
  - **Operating expenditure should edge lower on a smaller fuel subsidy bill**, though civil service pay, pensions, healthcare and social assistance keep it elevated in absolute terms. **Development expenditure is likely to remain supportive as the government speeds up key 13MP projects**, particularly in transport infrastructure, industrial development, digitalisation, and energy transition.
  - **On the revenue side, we do not expect major new taxes**. Instead, revenue collections should benefit from the expanded SST framework, wider e-invoicing adoption, implementation of the Global Minimum Tax (GMT), and ongoing tax administration reforms. Petroleum-related revenue should still provide a buffer, supported by the PETRONAS dividend, but the overall petroleum contribution falls alongside Brent and remains the most oil-sensitive line in the revenue base.
  - **Overall, Budget 2027 should balance fiscal consolidation against growth support.** We expect the fiscal position to improve slightly, as the government prioritise domestic demand, household support and development spending over aggressive deficit reduction.

Table 2: Federal Government Fiscal Balance Sheet Trend and Forecast

		COVID-19 Crisis						MoF	KIBB	
RM billion	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026F**	**2026F**	**2027F**
Revenue	**264.4**	**225.1**	**233.8**	**294.4**	**315.0**	**324.6**	**336.1**	**343.1**	**370.0**	**365.0**
Gross Expenditure	**317.5**	**314.0**	**333.5**	**395.2**	**407.4**	**405.5**	**412.7**	**419.2**	**453.5**	**449.0**
Net Expenditure	**315.9**	**274.7**	**294.8**	**362.9**	**406.4**	**403.8**	**411.4**	**417.7**	**453.0**	**448.0**
Operating Expenditure	263.3	224.6	231.5	292.7	311.3	321.5	330.8	338.2	369.5	364.0
Gross Development Expenditure	54.2	51.4	64.3	71.6	96.1	84.0	81.9	81.0	84.0	85.0
Less Loan Recoveries	1.6	1.3	1.0	1.4	1.0	1.7	1.3	1.5	0.5	1.0
COVID-19 Fund		38.0	37.7	31.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	**-51.5**	**-49.6**	**-61.0**	**-68.5**	**-91.4**	**-79.2**	**-75.3**	**-74.6**	**-83.0**	**-83.0**
% of GDP	-3.4	-3.5	-3.9	-3.8	-5.0	-4.1	-3.7	-3.5	-3.8	-3.5
Federal Government Debt (% of GDP)	52.4	62.1	63.3	60.2	64.3	64.6	65.2	N/A	63.7	62.2
Real GDP Growth (%)	**4.4**	**-5.5**	**3.3**	**8.9**	**3.6**	**5.2**	**5.2**	**4.0-4.5**	**5.3**	**5.0**
Average Brent Price (USD/barrel)	64.2	43.4	71.0	99.2	82.2	79.7	68.2	60.0-65.0	80.0	74.0

Source: Ministry of Finance, Kenanga's Forecast

Note: Brent assumption under review; revision to follow, higher

REVENUE – Monetising Recent Reforms Rather Than Introducing New Taxes

- **Revenue to decline in 2027 on a lower Brent assumption, with compliance gains cushioning the fall rather than offsetting it**
  - We expect federal government revenue to decline in 2027 on expectation of lower Brent price, though still supported by the full-year impact of tax and administrative reforms introduced from the past two years. Importantly, we do not expect the government to introduce major new taxes in Budget 2027, given global economic uncertainty and a likely more growth-supportive stance before the next general election.

– Instead, the government is likely to maximise collections from existing measures, particularly the expanded SST, e-Invoicing and GMT, alongside better tax administration and enforcement. These should gradually lift effective collections without politically difficult broad-based tax increases. They should cushion the decline in collections, but broader revenue diversification remains a medium-term agenda.

- **Harvesting gains from existing revenue measures**

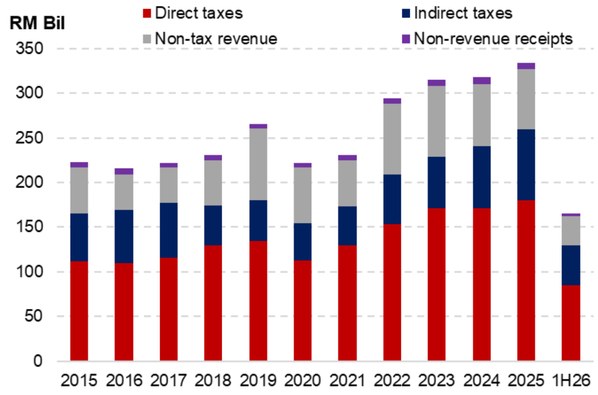
– **Expanded SST framework:** After SST coverage widened in 2025 and 2026, Budget 2027 is likely to focus on compliance, enforcement and collection efficiency rather than another major expansion. The broader framework should keep supporting indirect tax revenue, in line with the government's stance against reintroducing GST.

– **e-Invoicing:** Budget 2027 should therefore focus on closing coverage gaps and building audit capability, not on booking the revenue. Greater transaction visibility should reduce leakages over time and improved tax revenue collection, but we treat e-invoicing as a 2028 and beyond revenue story, not a 2027 one.

– **Global Minimum Tax (GMT):** Budget 2027 is likely to give an early read on GMT implementation. Collections should rise gradually as the framework matures, while keeping Malaysia aligned with international tax standards.

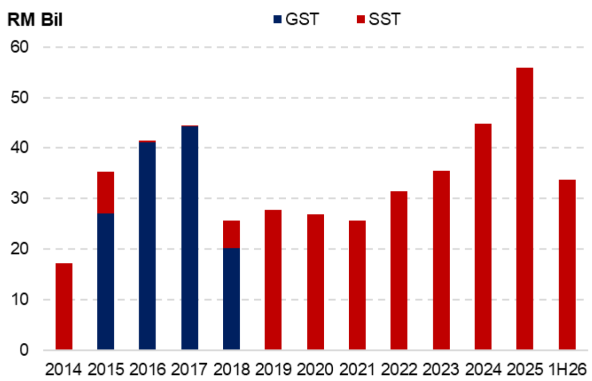
– **Subsidy rationalisation:** Although primarily an expenditure reform, better targeting of fuel and utility subsidies should improve the overall fiscal balance by cutting leakages and freeing fiscal resources for higher-priority spending.

Graph 2: Government Revenue Trend



Source: BNM, Department of Statistics, Kenanga Research

Graph 3: SST vs GST Collections



Source: BNM, Department of Statistics, Kenanga Research

- **Revenue diversification remains a work in progress**

– Despite progress on tax administration and compliance, Malaysia's revenue base remains relatively narrow. Policy points towards better compliance within existing tax bases, not major reforms such as reintroducing GST or significantly raising income tax rates.

– Carbon pricing or environmental taxes are likely to develop gradually alongside Malaysia’s broader low-carbon transition framework. We do not expect them to become a significant Federal Government revenue source in 2027.

- **Non-tax revenue remains exposed to petroleum-related Income**

– Petroleum-related revenue, including Petronas dividends, petroleum income tax (PITA), royalties and export duties, remains sensitive to global oil prices. Higher energy prices could create additional fiscal space, but relying on commodity receipts leaves revenue exposed to price swings. This reinforces the need to grow non-oil revenue through the MTRS, e-invoicing, SST optimisation and stronger tax administration.

Table 3: Oil & Gas Related Revenue Trend and Forecast

RM billion	2017	2018	2019	2020	2021	2022	2023	2024	2025	MOF 2026F
Tax Revenue	**177.7**	**174.1**	**180.6**	**154.4**	**173.7**	**208.8**	**229.2**	**240.2**	**259.8**	**270.4**
Direct Tax	**116.0**	**130.0**	**134.7**	**112.5**	**130.1**	**153.5**	**171.3**	**171.7**	**180.6**	**187.4**
Petroleum Income Tax (PITA)	11.8	16.8	20.8	12.8	11.6	23.4	26.1	20.5	16.9	15.7
Indirect Tax	**61.6**	**44.0**	**45.8**	**41.9**	**43.6**	**55.3**	**57.8**	**68.5**	**79.3**	**83.0**
Export duties (Petroleum)	0.9	1.5	1.5	0.8	0.6	1.2	2.0	2.1	1.9	1.9
Non Tax Revenue	**39.5**	**51.1**	**79.8**	**62.0**	**51.1**	**79.6**	**79.0**	**70.1**	**66.9**	**72.7**
Investment Income										
Petronas Dividend	*16.0*	*26.0*	*54.0*	*34.0*	*25.0*	*50.0*	*40.0*	*32.0*	*32.0*	*20.0*
Petroleum Royalties	*3.7*	*4.0*	*5.6*	*8.4*	*3.7*	*6.0*	*6.8*	*6.7*	*5.5*	*5.1*
Non Revenue Receipt	**3.2**	**7.7**	**4.0**	**8.6**	**8.9**	**6.0**	**6.7**	**14.3**	**9.3**	**n/a**
Total Revenue	**220.4**	**232.9**	**264.4**	**225.1**	**233.8**	**294.4**	**315.0**	**324.6**	**336.1**	**343.1**
Total O&G tax revenue (RMb)	12.7	18.3	22.3	13.6	12.2	24.6	28.1	22.6	18.8	17.6
Total O&G revenue (RMb)	**32.4**	**48.3**	**81.9**	**56.0**	**40.9**	**80.6**	**74.9**	**61.3**	**56.3**	**42.7**
Growth %	12.7	49.2	69.4	-31.6	-27.0	97.0	-7.0	-18.2	-8.2	-24.2
O&G share (Kenanga)	**14.7%**	**20.8%**	**31.0%**	**24.9%**	**17.5%**	**27.4%**	**23.8%**	**18.9%**	**16.8%**	**12.4%**
Other O&G Revenue	**16.4**	**22.3**	**27.9**	**22.0**	**15.9**	**30.6**	**34.9**	**29.3**	**24.3**	**22.7**
Average Brent Crude per barrel	**54.8**	**71.6**	**64.2**	**43.4**	**71.0**	**99.2**	**82.2**	**79.7**	**68.2**	**60-65**
% change	21.4	30.8	-10.3	-32.4	63.6	39.7	-17.1	-3.0	-14.4	

Source: Ministry of Finance, Kenanga's Forecast

EXPENDITURE – Growth-Supportive Spending to Drive 13MP Priorities

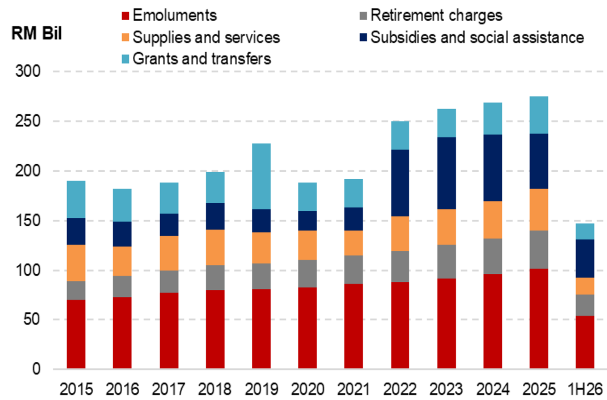
- Federal government expenditure is expected to stay elevated in 2027 as the government balances fiscal consolidation against supporting growth, easing cost-of-living pressures, improving public services and accelerating 13MP implementation.

- **Operating Expenditure (OE): Cost-of-living support and human capital remain priorities**

  - OE is expected to narrow slightly in 2027 on a lower fuel subsidy bill, but stay supported by higher emoluments, pensions, healthcare, education, and targeted assistance. The focus should remain on improving household welfare and strengthening economic resilience amid persistent external uncertainties.

  - Combined *Sumbangan Tunai Rahmah* (STR) and *Sumbangan Asas Rahmah* (SARA) allocations reached RM15.0b in 2026, the highest on record. We expect a further increase 2027 as the government steps up targeted assistance while continuing subsidy rationalisation. The composition shift matters: OE still falls overall because the fuel subsidy bill drops faster than cash transfers rise.

Graph 5: Federal Government Operating Expenditure



Source: BNM, Department of Statistics, Kenanga Research

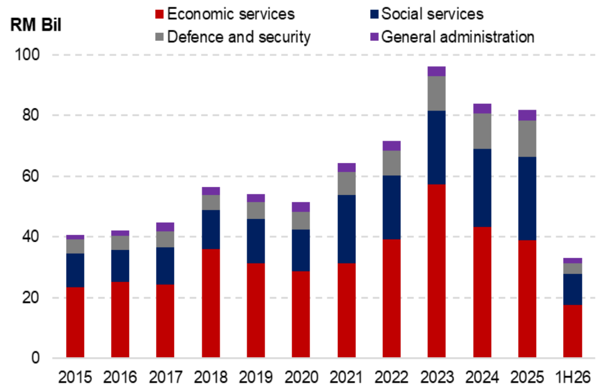
  - In line with the Pre-Budget 2027 focus on raising incomes and living standards, allocations for the Progressive Wage Policy (PWP), Technical and Vocational Education and Training (TVET), workforce reskilling and digital talent development should rise. These support productivity, wage growth, and efforts to ease skill shortages in high-growth sectors.

  - The government recently announced an allocation covering 100,000 Malaysian youths under the *AI Untuk Rakyat* programme to strengthen digital skills and provide practical exposure to artificial intelligence (AI). We view the scale as insufficient for the broader workforce transformation required. Budget 2027 should widen access through subsidised AI tools and structured training, delivered both in person and online.

- **Development Expenditure (DE): Accelerating strategic investments under 13MP**

  – **DE should rise in 2027 and remain a key policy lever for Malaysia's economic transformation.** Allocations would likely track the ten priorities from the Pre-Budget 2027 consultation: raising incomes, managing cost-of-living pressure, improving healthcare and education, expanding affordable housing, strengthening connectivity, accelerating digitalisation, enhancing food security, promoting sustainable development, and strengthening governance.

Graph 6: Federal Government Development Expenditure



Source: BNM, Department of Statistics, Kenanga Research

  - **Infrastructure and Connectivity:** Infrastructure development is expected to remain a major beneficiary given its economic multiplier and its role in drawing private investment. Consistent with 13MP priorities, the focus should stay on timely project execution, better regional connectivity and fewer logistic bottlenecks. We also see scope for new or revived major infrastructure projects. DE should support continued rollout of the Penang LRT Mutiara Line, MRT 3, and complementary infrastructure around the RTS Link and ECRL. Other likely priorities include flood mitigation, water infrastructure, airport upgrades, port capacity expansion and logistics connectivity improvements to support trade and investment.

  - **Investment Promotion and Industrial Development:** In line with the 13MP and New Industrial Master Plan 2030 (NIMP 2030), DE should focus on strengthening Malaysia's industrial ecosystem and attracting higher-value investments. The Johor-Singapore Special Economic Zone (JS-SEZ) should remain a major priority, combining Johor's cost advantages with Singapore's role as a global financial and business centre. Budget 2027 could fund enabling infrastructure, transport and logistics links, utilities, talent development, customs facilitation and industrial park upgrades. Beyond the JS-SEZ, we expect continued development of strategic industrial clusters and economic corridors, and better links between industrial areas, ports and major transport infrastructure. Potential beneficiaries include the Kerian Integrated Green Industrial Park (KIGIP), Lumut Maritime Industrial City (LuMIC), Perlis Inland Port, existing ports nationwide and industrial developments along the ECRL corridor. We also expect further support for the National Semiconductor Strategy (NSS), advanced manufacturing, and the wider E&E ecosystem, as well as emerging industries such as AI, data centres, electric vehicles (EVs), battery technologies, aerospace and green manufacturing.

  - **Digital Economy and Artificial Intelligence:** Digitalisation is expected to take the spotlight in Budget 2027 as Malaysia builds on strong investments in data centres, cloud computing and AI. Policy support is likely to target digital infrastructure, technology adoption, workforce capabilities, and the investment ecosystem. Potential measures include grants and incentives to speed up AI adoption among SMEs, more digitalisation funding, wider broadband and 5G infrastructure, and stronger cybersecurity capabilities. Further allocations may go to AI talent development and digital skills that would help lower adoption barriers, raise productivity and support Malaysia's competitiveness in technology-intensive industries.

  - **Energy Transition and Sustainability:** Energy transition should remain a core development priority under the National Energy Transition Roadmap (NETR), as Malaysia works toward net-zero greenhouse gas emissions by 2050 while maintaining energy security. Potential allocations include grid modernisation, transmission upgrades, large-scale solar, battery energy storage systems, EV charging infrastructure and carbon capture, as well as utilisation and storage (CCUS) initiatives. We also expect further support for energy-efficiency initiatives, green financing and renewable energy integration, which would help crowd in private investment. However, policy execution must tackle the regulatory and implementation bottlenecks that have slowed project delivery.

  - **Food Security and Agricultural Modernisation:** Food security should also remain a policy priority amid climate risks and volatile global food supply chains. DE should focus on raising agricultural productivity and building resilience across the domestic food ecosystem. Potential initiatives include irrigation and drainage upgrades, as well as smart farming, AI and IoT applications, mechanisation, precision agriculture and agrofood supply-chain improvements. The government may also step up efforts to modernise padi cultivation, strengthen livestock production and upgrade cold-chain logistics, including refrigerated storage facilities, distribution centres and transport networks. This would raise self-sufficiency, cut post-harvest losses, stabilise food supply and support agricultural exports.

- **Healthcare, Education and Housing:** Human capital should keep receiving significant allocations in Budget 2027, reflecting the government's commitment to improving living standards and long-term productivity. In healthcare, spending is likely to prioritise new and upgrade hospitals, digital healthcare, telemedicine services and better rural healthcare access. In education, spending should prioritise upgrading of ageing schools, infrastructure, Technical and Vocational Education and Training (TVET) capacity and strengthening science, technology, engineering, and mathematics (STEM), semiconductor, AI and digital skills programmes. Closer alignment between education and industry needs would help ease skills shortages in high-growth sectors. Affordable housing should also remain a major priority. The 13MP targets 1.0m affordable homes between 2026 and 2030. Programmes such as Residensi MADANI, Rumah Bakat MADANI, Perumahan Penjawat Awam (PPAM), Perumahan Rakyat 1Malaysia (PR1MA) and Program Perumahan Rakyat (PPR) should continue to drive delivery, alongside support financing and enabling infrastructure to speed up supply and improve access to homeownership.

– **Overall, Budget 2027 should keep expenditure policy growth-supportive while preserving gradual fiscal consolidation.** Spending is likely to focus on household welfare, human capital and faster 13MP implementation. DE should increasingly target areas with stronger productivity and private investment multipliers, particularly the JS-SEZ, connectivity, digitalisation and AI, energy transition, food security, healthcare, education, and affordable housing.

DEBT MANAGEMENT & FISCAL SUSTAINABILITY

- **Federal Government debt to rise in ringgit terms but fall as a share of GDP in 2027**

– **Malaysia's debt position remains broadly manageable despite ongoing deficit financing and refinancing needs.** On the statutory measure (MGS, MGII and MITB), debt stood at an estimated RM1.37t as at August 2026 against a ceiling of RM1.43t, equivalent to 65.0% of GDP, leaving headroom of about RM61.6b. Treasury Bills and offshore borrowings also remain comfortably within their respective limits (Table 4). On the broader Federal Government measure, which adds Treasury Bills and offshore borrowings to statutory debt, debt is projected to ease to RM1.40t or 63.7% of GDP in 2026 (2025: 65.2%) and to 62.2% of GDP in 2027. In ringgit terms, Federal Government debt still rises to RM1.49t in 2027, because the overall balance holds near RM83.0b in both years. The ratio improves on nominal GDP growth, not on a smaller borrowing requirement, and the increase stays contained relative to the size of the economy

Table 4: Federal Government Debt Headroom (RM b)

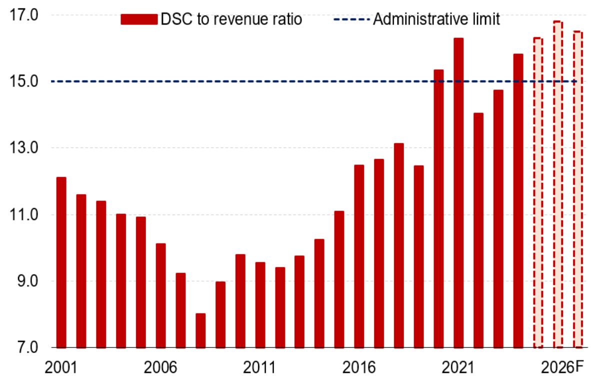
		latest	limit	balance
Offshore borrowing	**2Q26**	**16.7**	**35.0**	**18.3**
Malaysian Treasury Bills (MTB)	**Aug-26**	**7.0**	**10.0**	**3.0**
Statutory (MGS, MGII, MITB)	**Aug-26**	**1,370.2**	**1,431.8**	**61.6**
Statutory (% of GDP)	**Aug-26**	**62.2%**	**65.0%**	**2.8%**
Total:		**1,393.9**	**1,476.8**	**82.9**

Source: BNM, Kenanga Research

– Gross issuance is forecast to rise to RM192.0b in 2026 (2025: RM168.5b), driven mainly by heavy refinancing needs and a slightly wider fiscal deficit of 3.8% of GDP. Issuance growth is therefore largely rollover-driven rather than a sign of substantial new borrowing. Gross issuance should then moderate to RM184.8b in 2027 as maturities fall to RM101.8b (2026 estimate maturities: RM109.0b) and the fiscal deficit narrows to a projected 3.5% of GDP. Overall, debt sustainability rests on ongoing fiscal reforms, efficient revenue mobilisation, prudent spending and a credible medium-term fiscal consolidation path. Refinancing risks should stay manageable given deep domestic liquidity, sustained investor demand and continued policy discipline.

- **Debt service charges to decrease at a modest pace**
  - Debt service charges are expected to ease modestly, with the debt service charge (DSC)-to-revenue ratio projected to fall to 16.5% in 2027 from 16.8% in 2026, as gross issuance falls to RM184.8b and the deficit ratio narrows to 3.5% of GDP. While the ratio remains above the Government's self-imposed 15.0% threshold, the gradual moderation reflects ongoing consolidation and prudent spending management. Further cuts in financing costs depend on a stronger sovereign credit profile, built on sustained fiscal discipline, credible policy delivery, sound governance, and macroeconomic stability.
  - Malaysia's sovereign ratings of A3/Stable (Moody's), A-/Stable (S&P), and BBB+/Stable (Fitch) are expected to remain unchanged in the near term, supported by resilient economic fundamentals, strong institutions, fiscal consolidation and favourable funding conditions. Growth prospects remain supported by manufacturing, infrastructure investment, technology exports, digitalisation and data centre expansion, while recurring current account surpluses and a diversified export base bolster external resilience. We see an upgrade as unlikely before 2029. It would require sustained fiscal consolidation, a declining debt burden, continued growth resilience and consistent policy execution. Rating upside ultimately depends on policy continuity after the next election and a durable improvement in Malaysia's medium-term fiscal position.

Graph 7: DSC to revenue ratio trend since 2000



Source: BNM, Kenanga Research

Closing the Gap: The Tax Gap, Leakages, the Fiscal Trajectory

- **The tax gap is real, and its size is currently unknowable, which is itself the first problem to fix**. Malaysia does not publish a tax expenditure statement, so the true cost of reliefs, exemptions and zero-rating is not systematically measured. Nor is the stock of assessed-but-uncollected tax arrears transparently reported. Both gaps sit squarely within Focus Area Five's remit. They are also the two lowest-political-cost revenue levers available to policymakers, because neither requires a new tax or a new taxpayer.
- **Read the PM's SST/GST framing as a conversation about mechanics, not the base**. Retaining SST while studying "acceptable GST features" points toward invoice-level matching (MyInvois), less cascading through better input relief, and rationalised exemption scope. That is the plumbing of a broader-based system without adopting its base or repeating the political economy of 2015 to 2018.
- **E-invoicing's delayed completion is the clearest evidence the plumbing is not finished.** Budget 2026 treated full e-invoicing rollout as a near-term revenue driver. In practice, coverage has been pushed back rather than completed. Any credible "closing the gap" narrative has to account for this slippage rather than assume the infrastructure is already in place.
- **Why this matters beyond a five-year plan:** the 13MP's sub-3.0%-by-2030 deficit target is a destination, not a mechanism. Without structural revenue widening, even the compliance-led, base-preserving kind, each year's consolidation path remains hostage to the same two swing factors: Oil & gas-linked non-tax income, and whatever growth surprise (positive or negative) shows up in the denominator. The 2026 arithmetic worked out because growth surprised to the upside and BUDI95 usage stayed contained. That is a favourable roll of the dice, not a structural fix. A third swing factor now sits alongside those two: an election that may land well before the 2028 deadline, making any near-term move toward genuine base-broadening even less likely than usual (see "The Political Economy of Budget 2027" above).

Policy Priorities Outlook & House View Linkage

- **Where we diverge from what market pricing may imply**: if MYR strength or long-end MGS demand rests on an assumption that Malaysia is on a credible path to GST-style revenue diversification, we think that reads more into the PM's comments than is there. Our base case is a narrower, compliance-and-mechanics agenda under Focus Area Five. Useful, but incremental, and no substitute for base-broadening. We see currency or duration positioning built on an imminent GST narrative as running ahead of the policy signal. Concretely, we maintain our end-2026 USD/MYR forecast at 3.95, while revising our end-2026 10Y MGS yield forecast upward to 3.88% from 3.63% previously. We would fade ringgit or long-end rallies that price a GST-style revenue story into Budget 2027.

- **What would change our view:** Three verifiable signals: e-invoicing coverage gaps closing, a published tax expenditure statement, or arrears-collection data showing real progress. Each would be a genuine, verifiable signal of structural reform, as distinct from the noise of favourable growth surprises or one-off subsidy arithmetic. Until then, we treat the improving headline deficit ratio as good news that is more cyclical than structural, and anchor our USDMYR and long-end MGS views to oil prices and revenue diversification, not to the growth-driven ratio improvement alone.
- **Election timing is the second reason for caution on duration and MYR positioning into year-end.** Watch how Budget 2027 reads when tabled. More cost of living transfers (Focus Area Two, Three and Seven), another subsidy-quota reversal and limited follow-through on Focus Area Five's compliance agenda would point in favour of an earlier GE16. That would be a headwind for the "credible consolidation" narrative that would otherwise support MGS and the ringgit. We would treat a Budget 2027 that leans further into cost-of-living relief than our base case assumes as confirmation of the earlier-election scenario, not a one-off political concession.
- **On horizon, to be clear**. This is a tactical caution into the October tabling, not a change to our constructive MYR call. We keep USDMYR at 3.90 for end-2027 on Fed cutting from 2Q27 and a resilient external balance, and treat election-driven fiscal slippage as a headwind to the path rather than to the destination.

APPENDIX

Focus Area	Key Policy Direction	Potential Flagship Proposal
1. Social justice and development for all	Reduce regional disparities and promote inclusive development	Sabah & Sarawak infrastructure development; affordable housing expansion
2. Protecting the people against cost-of-living pressures	Strengthen targeted assistance and preserve purchasing power	STR & SARA enhancement; expanded BUDI MADANI; potential tax break for M40 group
3. Strengthening social protection for affected families	Improve retirement security and support vulnerable groups	Gig workers EPF matching scheme; caregiver support programme including new facilities
4. Empowering education, healthcare and essential services	Improve human capital and access to quality public services	AI & STEM education/course; public healthcare capacity upgrade
5. Spending that delivers the best value for the people	Enhance spending efficiency and fiscal sustainability	Outcome-based budgeting framework; propose quarterly spending review
6. Governance and the best delivery of public services	Improve transparency, accountability and public service delivery	GovTech 2.0 and one-stop digital government platform
7. Prioritising workers' welfare and decent wages	Raise productivity and support sustainable wage growth	National productivity & wage accelerator fund; 5-10 years minimum wage increase program; wage subsidy program expansion
8. Competitive home-grown entrepreneurs and "Made by Malaysia"	Build local champions and support innovation	Growth fund; research commercialisation fund; enhancement of GEAR-UP program
9. Growth through investment and high-value jobs	Attract quality investment and create high-skilled jobs	Strategic industries investment package (AI, semiconductors, aerospace, green technology)
10. Building energy, food, climate and cyber security	Strengthen national resilience against future shocks	Energy security & renewable energy fund; National food security programme

Source: Pre-Budget Statement 2027, Kenanga Research

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