Mizuho Flash: Malaysia

Economics & Strategy | Asia ex-Japan

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Malaysia 2027 Budget: Consolidation on Paper, Risks Beneath

In a nutshell:

- Malaysia's fiscal deficit is projected to narrow from 3.6% of GDP in 2026 to 3.3% in 2027. **After accounting for revenue measures announced at Budget 2027, we estimate a more modest improvement to around 3.5%.**
- **Revenue growth in 2027 (3.9% YoY) remains driven by tax collections**, supplemented by higher Petronas dividends (18.5% YoY increase). Tax relief measures in Budget 2027 tempered the extent of revenue growth, while **progress in broadening the revenue base remains limited.**
- **Expenditure growth in 2027 remains contained at 3.8% YoY, but rising debt-servicing costs and sizeable subsidies constrain fiscal flexibility.** Development expenditure is projected to decline to 3.5% of in 2027, although it remains above the 3% minimum threshold under the Fiscal Responsibility Act.
- 2026 Revised Estimates project a **slight deterioration in the fiscal deficit to 3.6% of GDP**, from the original target of 3.5%. **Operating expenditure is expected to outpace the increase in revenue,** driven by higher subsidy spending, while stronger nominal GDP growth helped cushion the deterioration in the fiscal balance.
- Worryingly, their oil and gas comparative advantage **appear to be providing a thinner fiscal offset as higher subsidy costs increasingly erode gains from higher oil prices.** In 2026, higher petroleum income tax collections and Petronas dividends together offset less than half of the increase in the fuel subsidy bill.
- **Even as we expect a 3.5% fiscal deficit after budget measures with conservative 2027 growth estimates aiding revenue upside, risks around the fiscal consolidation path have increased** due to greater exposure to oil prices and the possibility of additional election-related support measures.
- Nonetheless, resilient growth, scope for revenue outperformance and expenditure assumptions that already account for elevated subsidy costs should provide some cushion.
- For markets, **Budget 2027 is neutral to mildly constructive for the MYR,** although higher fiscal risks may temper tailwinds. A modest decline in the debt-to-GDP ratio and manageable net borrowing should **contain MGS supply pressures, leaving MGS yields primarily driven by USTs, although marginal potential of a calibrated BNM rate hike in Q1 2027 may place modest upward pressure on front-end yields.**

- Malaysia's Budget 2027 projects a modest narrowing of the fiscal deficit from 3.6% of GDP in 2026 to 3.3% in 2027.
- Measures to address cost-of-living pressures featured prominently. These include i) enhanced STR and SARA cash assistance, ii) higher personal income tax relief, iii) income tax rate reductions for middle-income households and a higher rate for top earners, iv) an increase in minimum wage to RM2,000, and a v) RM160m co-funded initiative with Grab to improve the earnings and welfare of private-hire drivers

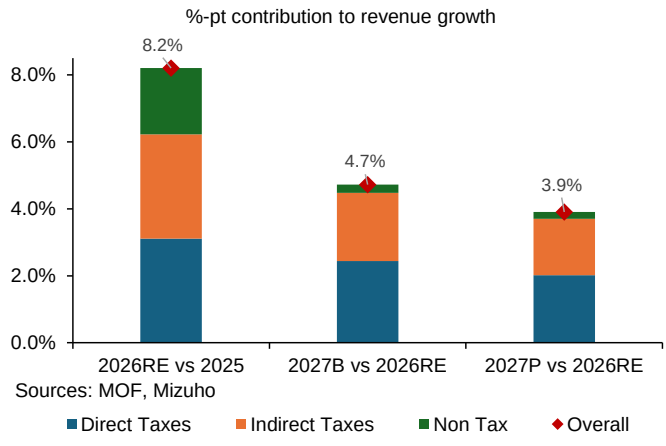
	2025	2026 Budget	2026 Revised Estimates		2027 Budget		2027 after budget measures	
	RM m	*RM m*	*RM m*	*% change*	*RM m*	*% change*	*RM m*	*% change*
Revenue	336,069	343,124	363,640	6.0%	380,817	4.7%	377,845	3.9%
Operating Expenditure	330,776	338,202	363,055	7.3%	376,840	3.8%	376,840	3.8%
Development Expenditure	80,582	79,500	79,100	-0.5%	81,500	3.0%	81,500	3.0%
Overall Balance	**(75,289)**	**(74,578)**	**(78,515)**		**(77,523)**		**(80,495)**	
% GDP	**-3.7%**	**-3.5%**	**-3.6%**		**-3.3%**		**-3.5%**	

Sources: Malaysia MOF, Mizuho

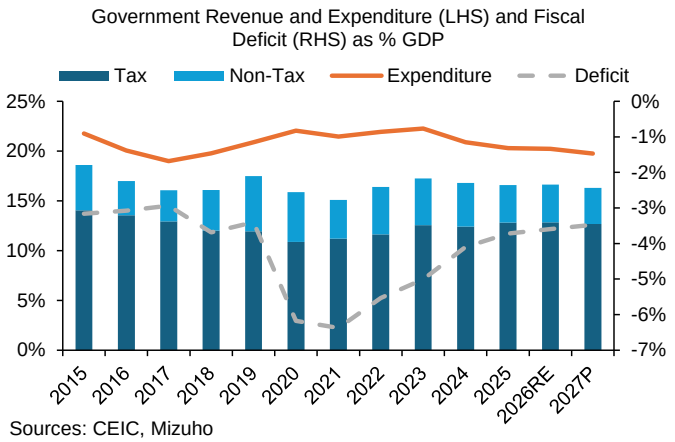
Fiscal Balance: Modest Narrowing, Helped by GDP Growth

- The government projects the fiscal deficit to narrow to 3.3% of GDP in 2027, from 3.6% in the 2026 revised estimate. **After accounting for revenue foregone from the tax relief measures announced in the budget, we estimate the deficit at around 3.5% of GDP which still represents an improvement from 2026.**
- This reflects the government's effort to strike a balance between providing cost-of-living support ahead of the next general election and maintaining progress towards fiscal consolidation.
- Although revenue growth is expected to outpace expenditure growth, the fiscal deficit continues to widen in nominal terms given the larger expenditure base. The improvement in the deficit-to-GDP ratio is driven largely by nominal GDP growth outpacing the increase in the absolute deficit.
- The Budget projects real GDP growth of 4.2%-5.2% in 2027, with a point estimate of 4.6%, following an updated 4.8%-5.3% in 2026. **With GDP growth already registering 5.5% YoY over Q1-Q3 2026, the forecast appears slightly conservative given the substantial carry-over effect.**
- While the outlook remains dependent on external demand and private investment, stronger-than-expected growth could potentially boost revenue collections and support faster fiscal consolidation.

Revenue: Limited Progress in Broadening Revenue Base



Sources: MOF, Mizuho

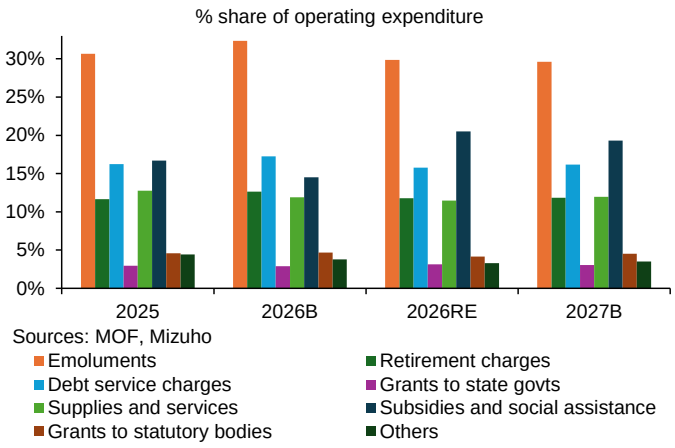


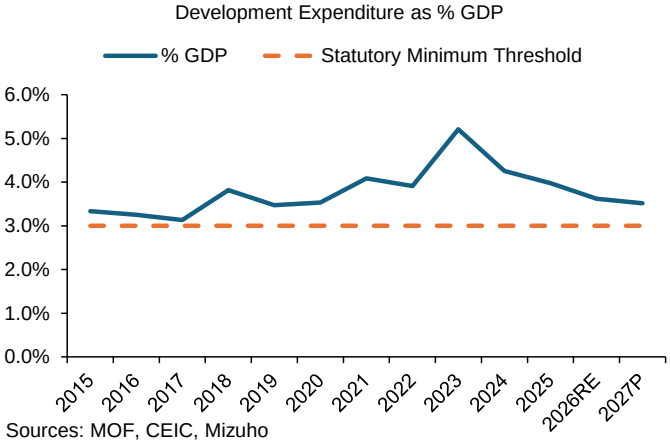
Sources: CEIC, Mizuho

*2027P refers to 2027 post-budget measures

- Federal revenue growth is expected to slow to 4.7% YoY to RM380.8b in 2027. After **adjusting for revenue foregone from budget measures of RM$3b, revenue growth moderates to ~3.9% YoY** at RM377.8b.
- **Tax revenue remains the primary driver, contributing 3.7%-pt to overall revenue growth.** Direct taxes contribute 1.7%-pt, supported by the phased implementation of e-invoicing, continued wage growth and low unemployment rate. Indirect taxes contribute a further 2%-pt, driven by stronger projected SST collections.
- Even so, tax revenue as a share of GDP is projected to edge down to 12.7% from 12.8% in 2026. This is unsurprising given the announced tax relief measures and the absence of any significant new revenue-raising initiatives. Reflects the tax relief measures announced in this year's budget outweighs the 1%-pt increase in tax rate for high income earners and operational efficiency in tax collections.
- **Non-tax revenue is expected to contribute a modest 0.2%-pt to overall revenue growth**. Higher Petronas dividends are expected to provide support, rising to RM32bn from RM27b in 2026 (from 1.2% GDP to 1.4% GDP).
- That said, revenue could modestly exceed budget projections, as underlying revenue growth (4.7% before Budget measures) appears conservative relative to the nominal GDP growth forecast of 5.8%-6.8% in 2027.

Expenditure: Stable But Constrained

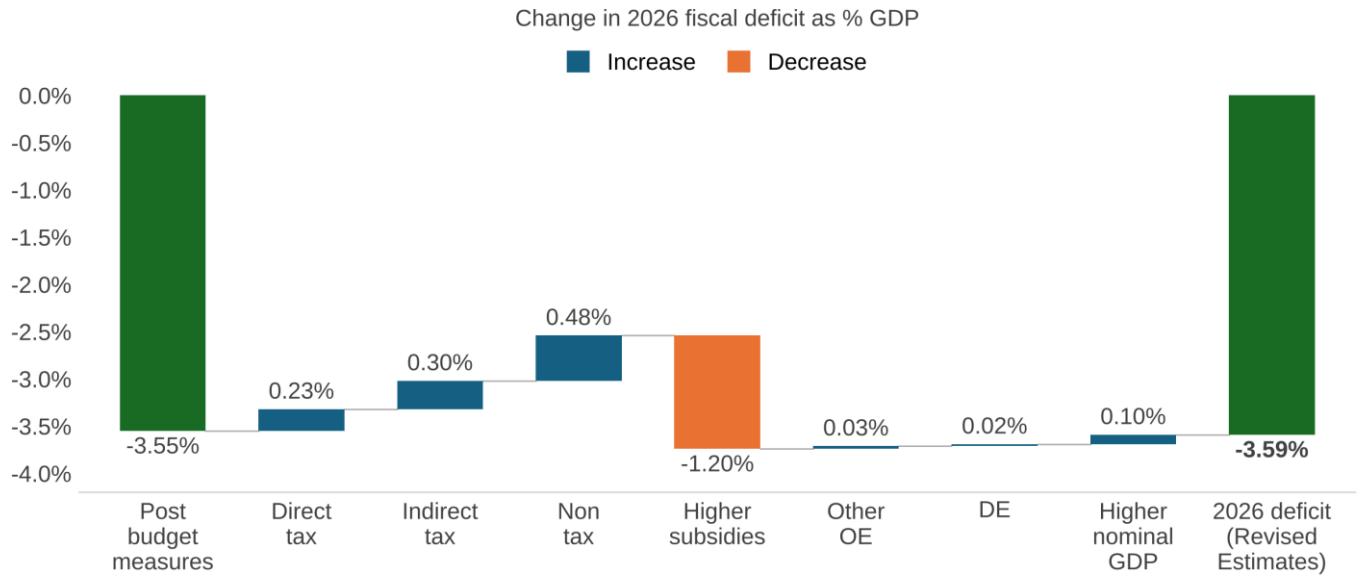




- Operating expenditure is projected to increase by 3.8% in 2027 to RM$376.8b in 2027, representing 19.8% of GDP.
- Debt servicing costs are the largest contributor, accounting for 1.0%-pt of expenditure growth, followed by Emoluments and Supplies and Services at 0.9%-pt each.
- Debt servicing costs are expected to rise 6.5% to RM61.0b, **accounting for 16% of federal revenue** that is above MOF's preferred benchmark of 15%. While the debt servicing burden remains relatively manageable and broadly stable at 2.6% of GDP, debt servicing costs has also been taking up a larger share of operating expenditure, **from 14.9% in 2023 to 16.2% in 2027,** gradually reducing fiscal flexibility.
- Additional expenditure pressures stem from higher emoluments and operating spending related to the extension of Visit Malaysia into 2027, preparations for the SEA Games, and the approaching general election.
- Notably, subsidies and social assistance spending is expected to ease modestly to RM72.7bn in 2027 from RM74.5bn in 2026 due to better subsidy management. Nevertheless, allocations remain sizeable, reflecting a cautious assumption of elevated subsidy requirements amid uncertainty surrounding energy prices and geopolitical developments.

- **Overall, expenditure is likely to come in broadly in line with budget.** Emoluments, which account for the largest share of expenditure is expected to remain stable, while the Brent crude assumption of US$85/bbl underpinning the subsidy and social assistance budget appears reasonable. Additionally, any expenditure savings from lower subsidy outlays, should oil prices undershoot assumptions, may be offset by additional cost-of-living support measures as the next general election approaches.
- Turning to development expenditure, **allocations remain sizeable but continue to moderate relative to the economy**. While development spending is budgeted to rise to RM81.5bn in 2027 (3.0% YoY), it is projected to decline to 3.5% of GDP, from 3.6% in the 2026 Revised Estimate and 4.0% in 2025. Although this remains above the 3% minimum threshold under the Public Finance and Fiscal Responsibility Act and supports the government's fiscal consolidation efforts, it could reduce the government's direct contribution to medium-term growth and productivity-enhancing investments.
- The economic sector remains the largest recipient, accounting for 45% of total development expenditure, led by transport infrastructure projects such as the Penang Mutiara Line and Pan Borneo Highway Sabah, which are expected to improve connectivity and support economic activity. The social sector follows with a 34% allocation, focused on enhancing education quality and learning infrastructure through the upgrading of existing facilities and classroom.

2026 Revised Estimates: Higher Subsidies Offset Revenue Gains



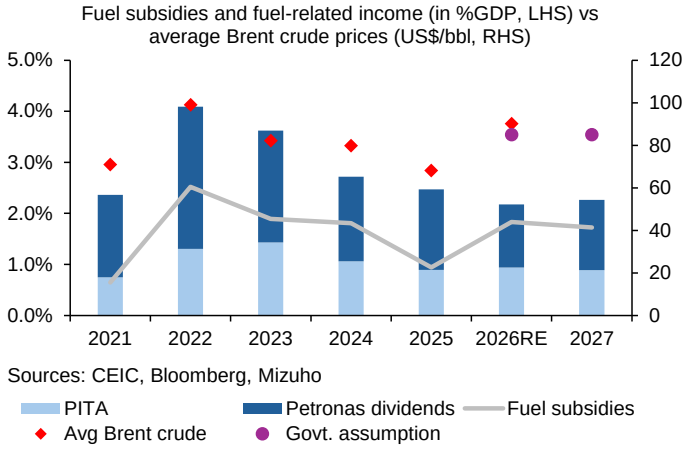
Sources: MOF, Mizuho

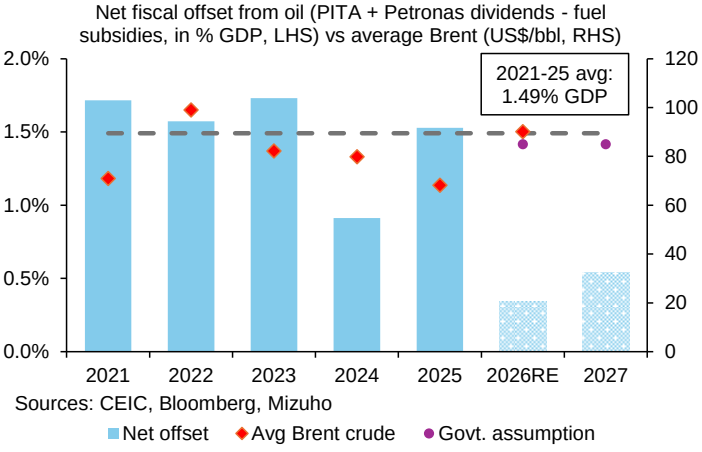
- **The revised 2026 fiscal deficit is projected at 3.6% of GDP, slightly wider than the original 3.5% target, as higher expenditure more than offset stronger revenue collections.**
- Federal revenue is expected to grow 6.0% relative to the original budget, supported primarily by elevated oil prices. Tax revenue growth was mainly driven by higher SST collections on the back of resilient domestic consumption and higher petroleum income tax collections, while non-tax revenue benefited from a larger-than-budgeted Petronas dividend of RM27b, up from the original RM20b assumption.
- Meanwhile, operating expenditure increased by 7.3% relative to the original budget, pushing total expenditure to 20.2% of GDP from 19.6%. This was **driven almost entirely by higher spending on subsidy and social assistance, which**

is expected to grow 51.8% compared to originally budgeted, driven by higher elevated oil prices.

- Notably, the fiscal deficit would have widened to around 3.7% of GDP under the previous GDP assumptions. Stronger-than-expected nominal GDP growth reduced the deficit ratio by around 0.1%-pt, limiting the deterioration to 3.6%.

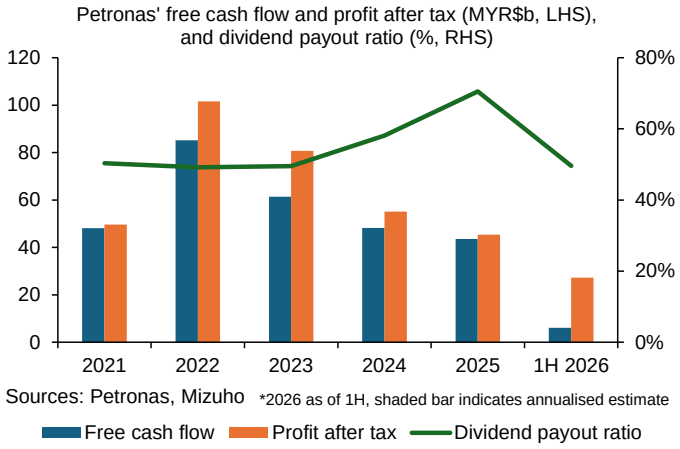
Oil: Smaller Net Fiscal Gain

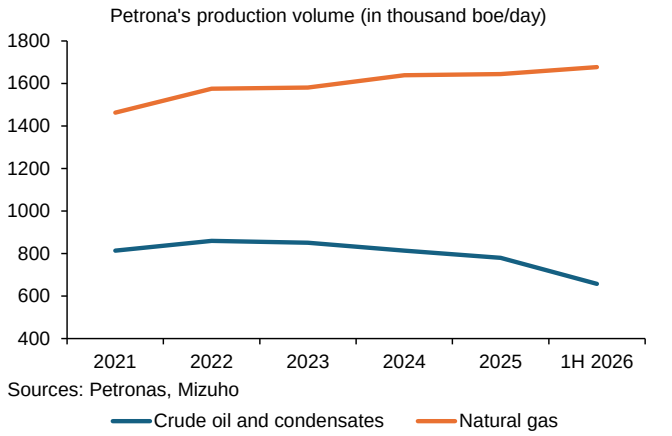




*Fuel subsidy costs reflect these policy changes: i) targeted diesel subsidies (June 2024), ii) targeted RON95 subsidies under BUDI95 (September 2025) and iii) reintroduction of nationwide diesel subsidies (July 2026).

- Elevated oil prices continue to have mixed fiscal implications for Malaysia, boosting revenues through higher petroleum income tax collections and Petronas dividends while also increasing fuel subsidy costs.
- Recent policy measures, including higher subsidised fuel quotas and the reintroduction of diesel subsidies in Peninsular Malaysia, have **increased the government's net fiscal exposure to oil prices**, weakening some of the gains achieved through earlier subsidy reform efforts.
- **While Malaysia remains a net beneficiary of higher oil prices, the fiscal support provided by fuel-related income has gradually diminished relative to the size of the economy**. That said this is in part due to efforts to diversify the economy away from commodity-related enterprises.
- Additionally, **Malaysia's fixed-price fuel subsidy structure means that the fiscal gains from higher oil prices are increasingly offset by higher subsidy costs.** In 2026, the fuel subsidy bill rose by around RM25bn, while higher petroleum income tax collections (+RM4.8bn) and Petronas dividends (+RM7.0bn) together offset less than half of the increase.
- There is scope for Petronas dividends to exceed current assumptions in 2027, given stronger annualised earnings in 2026 and the potential for a higher payout ratio. That said, weaker free cash flow due to elevated capex requirements may constrain the extent of any dividend increase.





- For 2027, the Budget assumes Brent crude at US$85/bbl, with fuel subsidies of RM40bn and a net fiscal offset of around RM12.5bn (0.54% of GDP), well below the 2021-25 average. Based on our estimates, every US$10/bbl increase in Brent would raise the net fiscal cost by around RM6bn (0.26% of GDP), highlighting the government's increased exposure to higher oil prices amid a thinner fiscal buffer.

	2026RE vs Budget	**Per USD$1 increase in Brent (RM$b)**
Brent crude assumption	+US$22.5/bbl (from US$60-65/bbl to US$85/bbl)	
Increase in fuel subsidy budget	+RM$25b	~1.1
Increase in oil-related revenues	+RM$11.8b	~0.5
Net cost	~RM$13b	~0.6

Sources: MOF, Mizuho

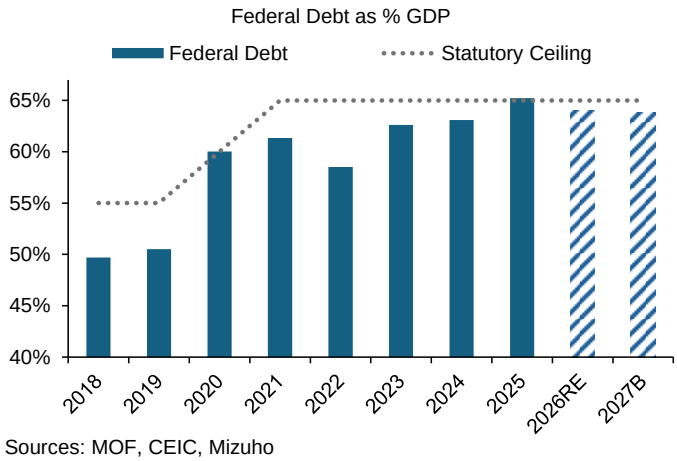
Risks: Consolidation Remains on Track amid Rising Vulnerabilities

- Overall, **we expect the fiscal deficit target of 3.5% deficit (post 2027 budget measures) to remain achievable, although risks around the consolidation path have increased.**
- The budget's greater exposure to oil price movements, a thinner net fiscal offset from higher oil prices, and the potential for additional election-related support measures in 2027 could weigh on fiscal consolidation efforts.
- Nevertheless, resilient economic growth, potential revenue outperformance, and conservative expenditure assumptions that already factor in elevated subsidy costs should provide some cushion against these risks.

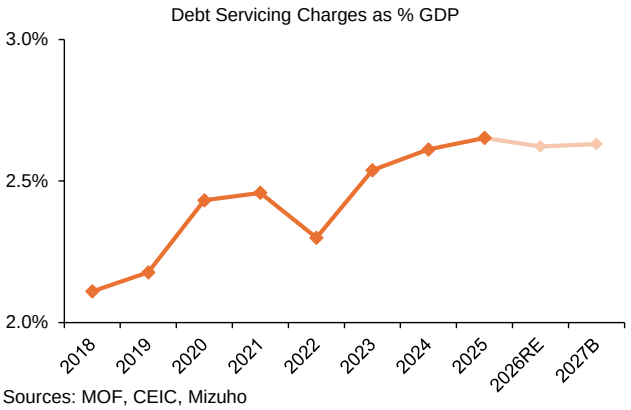
MYR and MGS: Mild MYR Tailwinds, Contained MGS Supply

- We expect Budget 2027 to be neutral to mildly constructive for the MYR, as modest progress on fiscal consolidation complements resilient growth and contained inflation, reinforcing Malaysia's macroeconomic fundamentals.

- **Federal government debt is projected to edge lower to 63.8% of GDP in 2027 from 64.0% in 2026**, as debt growth is projected to lag nominal GDP growth.
- With a marginal 2.5% growth of the deficit to RM80bn in 2027, **debt supply will remain broadly contained and limit upward pressure on MGS yields.**
- As such, we **expect MGS performance to remain primarily driven by external rates, particularly USTs.** While BNM is likely to keep the OPR at 2.75% through end-2026, we see marginal potential for a **calibrated 25bp hike in Q1 2027 to lean against inflation risks that remain tilted to the upside,** particularly from El-Nino related supply disruptions and stronger AI-driven demand. This could **exert modest upward pressure on front-end MGS yields,** resulting in a slight bear flattening of the curve.



Sources: MOF, CEIC, Mizuho



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