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SECTION 1

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Overview

The global economic landscape is anticipated to be characterised by moderating GDP growth, with developed markets facing a more pronounced slowdown than their developing counterparts. Lingered geopolitical tensions, trade frictions predominantly concerning US tariffs and persistent inflation will continue to influence the economic narrative. As the global economy prepares for a period of ongoing uncertainties, the appropriate fiscal strategy will require a delicate balancing act in prioritising targeted support, strengthening long-term resilience and rebuilding fiscal buffers. In this complex environment, fiscal policy must evolve beyond broad-based stimulus and embrace a more strategic approach. After years of significant fiscal expansion to combat the scarring economic impact of the pandemic, the primary focus for most nations will be to rein in deficits and rebuild fiscal space, which will be crucial to prepare the nation in facing future shocks and ensure long-term debt sustainability.

From the domestic perspective, Malaysia is on the path to reposition the country to be among the leading Asia economy, as aspired under the Ekonomi MADANI framework. The Government recognises the need to address long-term challenges, including income inequality, regional development imbalances and vulnerabilities arising from climate change. Furthermore, structural fiscal issues arising from a narrow revenue base and relatively high subsidy burden, coupled

with significant fiscal stimulus rolled out during the crisis, have led to the elevated debt level post-pandemic. In this regard, the recently tabled Thirteenth Malaysian Plan, 2026 – 2030 (Thirteenth Plan) outlined a strategic roadmap and reform agenda to address these challenges and spearhead the nation's development path in the next five years, emphasising structural shifts in domestic policy and initiatives that boost potential growth. Moreover, the Government will pursue strategic investments in areas that enhance long-term resilience, particularly in diversifying trade, strengthening public health and education as well as narrowing regional development divide.

Malaysia is undergoing a gradual fiscal consolidation plan, with clear and credible reform measures, guided by the Public Finance and Fiscal Responsibility Act 2023 [Act 850]. Revenue enhancement measures were mobilised and intensified beginning 2024, which are implemented in a phased manner. Expenditure is reprioritised towards high-impact programmes and projects, while blanket subsidies disbursement has transitioned towards a more targeted and means-tested assistance. A well-designed social safety protection system is essential to safeguard the needs of the vulnerable groups from economic shocks and to ensure inclusive growth. Meanwhile, to address the long-term fiscal liabilities, reforms are in progress to minimise the risk exposure, among others, the restructuring of the pension scheme from a defined benefit to a defined contribution scheme.

Fiscal Reforms and Economic Resilience – A Delicate Balancing Act

Amid potentially moderate external demand, as the first budget under the Thirteenth Plan, the Budget 2026 will focus on strengthening domestic economic drivers and promoting private investment. The Budget balances the imperative of fiscal consolidation in reducing deficits and debt with the need to stimulate growth, enhance social safety net and invest in transformative sectors. Through a prudent yet expansionary fiscal stance, complemented by targeted measures and strategic investments, the Budget positions Malaysia to further enhance its resilience and inclusive growth.

Fiscal incentives were also mobilised to attract private investment, both domestic and foreign, supported by efforts to reduce red tapes and improve the ease of doing business. Public-private partnerships and co-investment platforms will be leveraged to deepen domestic investment and human capital development as well as catalyse green and digital transitions, mainly through various initiatives via government-linked entities. In addition, the Public-Private Partnership Master Plan 2030 (PIKAS 2030) promotes user-pay models to mobilise private capital into infrastructure development, focusing on catalytic projects that deliver broad economic spillovers.

The conduct of fiscal policy will be within the public finance legal framework, anchored by Act 850 as well as other respective legislations. The recently passed Government Procurement Bill 2025 enhances governance and transparency which underpins efficient public spending. In addition, debt sustainability analysis is regularly conducted within the medium-term fiscal framework to assess the ability of the Government to serve the debt obligation in the future. Moreover, the monitoring of financial guarantees, which is capped at 25% of GDP under Act 850, will be continuously and stringently assessed,

ensuring manageable fiscal risks exposure. Acknowledging the Government's sound macroeconomic and fiscal management, major international credit rating agencies have reaffirmed the nation's sovereign ratings and outlook. In this regard, by strengthening the fiscal position, Malaysia will be able to withstand external shocks, while ensuring adequate financial resources to pursue medium- and long-term development agenda.

Fiscal Position in 2025

Against a backdrop of external uncertainty in the first half of 2025, growth remained resilient and continued to be driven by strong domestic demand, healthy labour market conditions and robust activity in the services and manufacturing sectors. As tabled during the Budget 2025, the Government targeted a lower fiscal deficit of 3.8% of GDP, down from 4.1% in 2024.

Total revenue is estimated at RM334.1 billion, an increase by 2.9% compared to RM324.6 billion registered in 2024. Tax revenue performance is expected to be strengthened through the revision of the sales tax and service tax (SST) and the phased implementation of the e-Invoice system. In addition, non-tax revenue is expected to remain stable, underpinned by receipts from investment income. Meanwhile, petroleum-related revenue is expected to record RM56.6 billion or about 17% of total revenue, due to the lower-than-expected commodity prices.

In line with a more disciplined fiscal stance, total expenditure has been recalibrated to RM412.1 billion, representing a slight increase of 1.6% compared to 2024. Operating expenditure (OE) is expected to increase moderately by 3.3% to RM332.1 billion, attributed to the continued expenditure optimisation measures which include reprioritisation of programmes and review of blanket subsidies. Savings from the

implementation of fuel subsidy retargeting are rechannelled mainly through cash assistance for Budi MADANI and Sumbangan Tunai Rahmah (STR) as well as improving health, education and basic infrastructure. In advancing the subsidy retargeting agenda, the BUDI MADANI RON95 (BUDI95) programme was introduced with a monthly limit of 300 litres for every citizen with valid driving licence at a subsidised price of RM1.99 per litre. Meanwhile, in conjunction with the 68th National Day and Malaysia Day celebration, RM2 billion was allocated for a one-off RM100 Sumbangan Asas Rahmah (SARA) assistance. Development expenditure (DE) is projected at RM80 billion and remains above the annual 3% of GDP fiscal objective set under Act 850, signalling continued emphasis on public investments.

These additional revenue enhancement and expenditure efficiency measures reaffirm the Government's commitment in achieving the fiscal deficit target of 3.8% of GDP. Meanwhile, primary balance, after excluding debt service charges, is anticipated to register a lower deficit of 1.1% of GDP. With the deficit target on course, the Government's gross borrowing requirements are anticipated to ease, thus supporting a more sustainable debt trajectory in the medium term.

Outlook for 2026

Malaysia's economic outlook remains resilient, sustained by robust domestic demand as the key driver of growth. Fiscal policy will remain supportive of growth while balancing the consolidation of public finances. Total revenue for 2026 is estimated at RM343.1 billion, driven by improvement in both direct and indirect tax collection. The full-year implementation of expanded sales tax and higher service tax, aided by the ongoing digitalisation initiatives within the relevant tax collection agencies will ensure more sustainable revenue streams. In particular, the e-Invoice system which was carried out in phases beginning 2024, will be mandatory for businesses with an annual revenue between RM1 million and RM5 million in 2026, contributing towards greater tax compliance and administration. Meanwhile, non-tax revenue is projected to decline to RM72.7 billion, primarily due to anticipation of lower investment income.

On the expenditure front, the Government will continue to improve efficiency in public spending through reprioritisation and targeted distribution of fiscal resources. Total expenditure is budgeted at RM419.2 billion

TABLE 1.1. *Federal Government Financial Position, 2024 – 2026*

	RM MILLION			CHANGE (%)			SHARE OF GDP (%)		
	2024	2025 ²	2026 ³	2024	2025 ²	2026 ³	2024	2025 ²	2026 ³
Revenue	324,618	334,115	343,124	3.1	2.9	2.7	16.8	16.6	16.1
Operating expenditure	321,509	332,150	338,202	3.3	3.3	1.8	16.6	16.5	15.9
Current balance	3,109	1,965	4,922				0.2	0.1	0.2
Gross development expenditure	84,012	80,000	81,000	-12.6	-4.8	1.3	4.2	4.0	3.8
Less: Loan recovery	1,737	1,321	1,500	72.5	-23.9	13.6	0.1	0.1	0.1
Net development expenditure	82,275	78,679	79,500	-13.5	-4.4	1.0	4.3	3.9	3.7
Overall balance	-79,166	-76,714	-74,578				-4.1	-3.8	-3.5
Primary balance¹	-28,685	-22,414	-16,278				-1.5	-1.1	-0.8

¹ Excluding debt service charges

² Revised estimates

³ Budget estimate, excluding Budget 2026 measures

Source: Ministry of Finance, Malaysia

or 19.7% of GDP. The OE is projected to rise moderately to RM338.2 billion or 15.9% of GDP owing to lower subsidy allocation despite increase in other OE components. Meanwhile, DE allocation is increased to RM81 billion or 3.8% of GDP, in funding new programmes and projects under the Thirteenth Plan. In addition, the co-investment of resources through government-linked entities and projects under the PIKAS 2030 will complement the nation building agenda. Expenditure policy will continue to focus on retargeting blanket subsidies to ensure assistance reaches the intended beneficiaries. The operationalisation of the Government Procurement Act 2025 will enhance spending efficiency and reduce leakages. These measures will allow more fiscal resources to be redeployed towards improved social assistance programmes and development projects that generate long-term economic and social returns.

Overall, the fiscal deficit is projected to narrow to 3.5% of GDP in 2026, in line with the medium-term trajectory, guided by fiscal objectives governed under Act 850. This gradual consolidation path demonstrates the Government's steadfastness in balancing support for growth and maintaining fiscal discipline. Meanwhile, the primary deficit is expected to decline to 0.8% of GDP, reflecting the ongoing fiscal consolidation commitment.

Medium-Term Fiscal Framework (MTFF) 2026 – 2028

The three-year rolling Medium-Term Fiscal Framework (MTFF) is anchored by the fiscal sustainability targets set under Act 850 and is in line with the Ekonomi MADANI framework. The 2026 – 2028 MTFF will support the implementation of the Thirteenth Plan, while maintaining the fiscal consolidation trajectory. The guiding assumptions of the MTFF include an average real GDP growth of 4.9%, with crude oil prices projected to average at USD70 per barrel and crude oil production between 450,000 and 500,000 barrels per day.

Total revenue is projected at RM1,072.2 billion or 15.7% of GDP for the period 2026 – 2028, contributed by non-petroleum revenue of RM943.1 billion or 13.8% of GDP, which accounts for 88% of the total revenue. This is expected to be supported by improved SST collection, digital-driven compliance as well as Global Minimum Tax (GMT). Petroleum-related revenue is estimated to moderate to RM129.1 billion or 1.9% of GDP, in line with revenue diversification efforts. The indicative ceiling for OE is estimated at RM1,045.9 billion or 15.4% of GDP, while DE is projected at RM247 billion or 3.6% of GDP. The average fiscal deficit is expected at 3.2% of GDP over the medium term, reaffirming the fiscal trajectory towards achieving the deficit target of 3% in 2028.

TABLE 1.2. *Medium-Term Fiscal Framework (MTFF), 2026 – 2028*

	RM BILLION	SHARE OF GDP %
Revenue	1,072.2	15.7
Non-petroleum	943.1	13.8
Petroleum-related	129.1	1.9
Operating expenditure	1,045.9	15.4
Current balance	26.3	0.4
Gross development expenditure	247.0	3.6
Less: Loan recovery	3.9	0.1
Net development expenditure	243.1	3.6
Overall balance	-216.8	-3.2
Primary balance	-31.7	-0.5
Underlying assumptions:		
Average real GDP growth (%)	4.9	
Average nominal GDP growth (%)	6.3	
Average crude oil price (USD per barrel)	70	
Crude oil production (barrels per day)	450,000 - 500,000	

Note: MTFF estimates, excluding Budget 2026 measures
Source: Ministry of Finance, Malaysia

Conclusion

Malaysia's fiscal stance remains anchored on economic resilience and fiscal sustainability, while ensuring the well-being of the rakyat. The consolidation path is being pursued gradually and in line with mandates under Act 850. Ongoing reforms in revenue administration, expenditure management and subsidy retargeting reflect a disciplined

yet adaptive approach to development needs. Looking ahead, the Government will continue to align fiscal strategies with medium-term development priorities under the Thirteenth Plan, while maintaining flexibility to respond to evolving challenges. This balanced stance reinforces confidence that Malaysia is well positioned to achieve its fiscal targets and lays the foundation for long-term economic stability and inclusive growth.

FIGURE 1.1. Federal Government Overall and Primary Balance

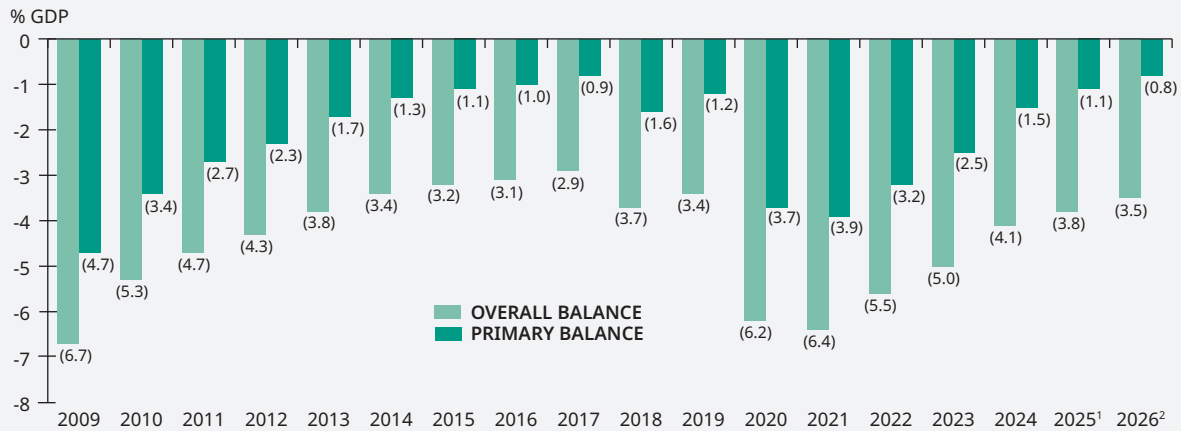


FIGURE 1.2. Federal Government Revenue, Operating Expenditure and Current Balance

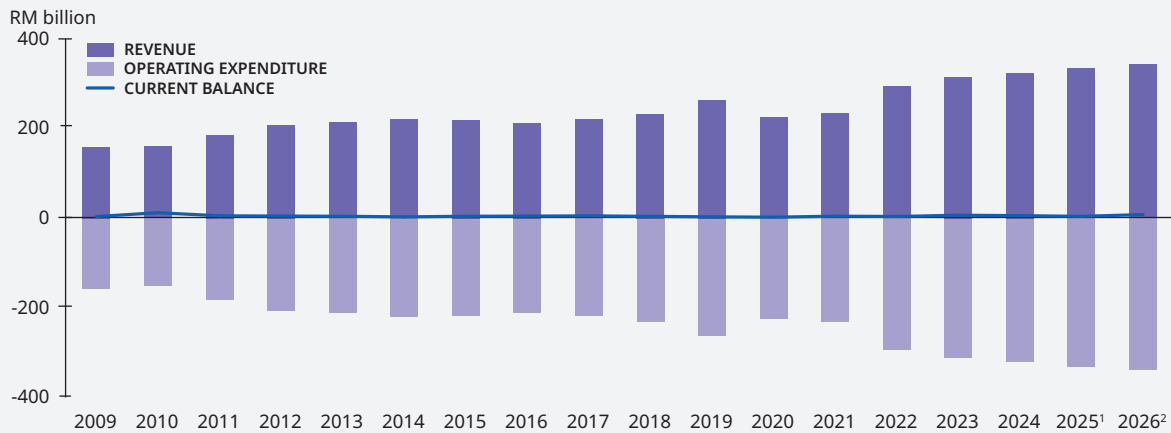
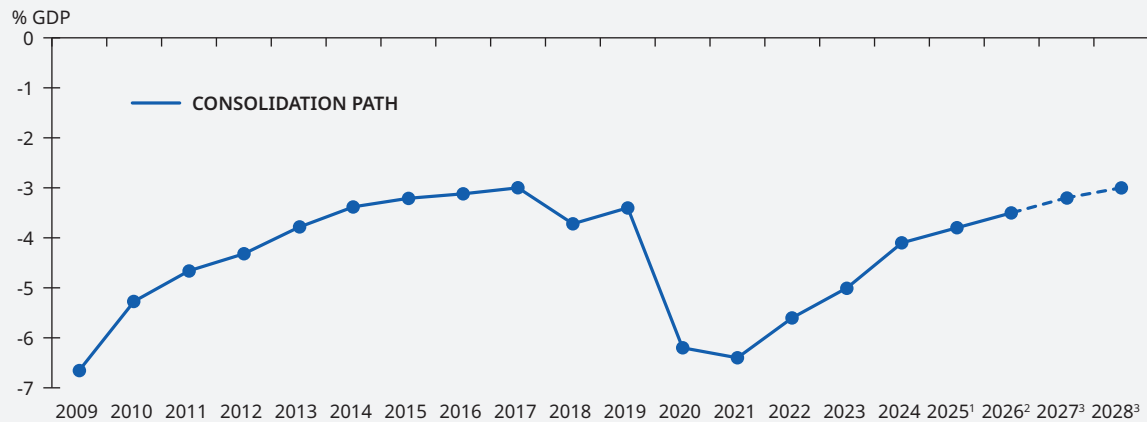


FIGURE 1.3. Federal Government MTFF Overall Balance



¹ Revised estimate

² Budget estimate, excluding Budget 2026 measures

³ Forecast

Source: Ministry of Finance, Malaysia