

SECTION 1

Fiscal Policy Overview

111 OVERVIEW

111 FROM CONSOLIDATION TO RESILIENCE – BUILDING FISCAL SPACE FOR FUTURE PRIORITIES

113 FISCAL POSITION IN 2026

114 OUTLOOK FOR 2027

116 MEDIUM-TERM FISCAL FRAMEWORK 2027 – 2029

116 CONCLUSION

SECTION 1

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Overview

The global economic landscape remains vulnerable due to heightened uncertainty arising from prolonged geopolitical tensions, resulting in supply chain disruptions and volatile commodity prices, leading to higher production costs and inflationary pressures. Furthermore, escalating climate-related risks continue to intensify pressures on food security and livelihoods, reinforcing the need for greater resilience and policy preparedness. Against this backdrop, global policymakers have emphasised the importance of preserving macroeconomic stability and rebuilding fiscal space, while continuing to advance structural reforms and enhance institutional capacity to navigate an evolving global environment.¹

Leveraging on strong economic fundamentals as well as progress achieved through continuous structural reforms in recent years, Malaysia entered 2026 from a position of strength, with the economy performing better than expected in 2025. However, the prolonged West Asia conflict tested this resilience, prompting the Government to intensify its coordinated response through the National Economic Action Council (NEAC). The rollout of targeted measures to safeguard energy security, ensure the well-being of the rakyat and support businesses, particularly vulnerable industries and MSMEs, have enabled the economy to better withstand the effects of the global conflict. As a result, Malaysia maintained its growth momentum in the first half of 2026, underpinned by resilient domestic and external demand as well as sustained investment activity.

The Government remains steadfast in reinforcing fiscal resilience through various policy reforms, thereby ensuring the capacity to respond to emerging pressures. This allows Malaysia to continue supporting productive investment and strengthening its economic potential, while safeguarding the well-being of the rakyat, in line with the Ekonomi MADANI framework. The reform initiatives have resulted in consistent fiscal consolidation, with deficit being recorded lower than the budget targets for the past two consecutive years, underscoring prudent macro-fiscal management. Building on this progress, the Government remains committed to advancing fiscal consolidation, in line with the objectives outlined under the Public Finance and Fiscal Responsibility Act 2023 [Act 850].

From Consolidation to Resilience – Building Fiscal Space for Future Priorities

The progress made in strengthening public finances has provided greater fiscal space for the Government to mobilise resources effectively in response to external shocks. The implementation of revenue reforms has generated additional tax receipts, while broadening and diversifying the revenue base. Concurrently, expenditure reprioritisation, particularly the comprehensive targeted subsidies, has contained fuel subsidy costs, creating greater capacity to continue providing targeted social assistance. This approach ensures immediate policy responses reinforce, rather than compromise the medium-term fiscal resilience.

¹ Views expressed by global policymakers and senior economic officials as reflected in the IMF World Economic Outlook Update, July 2026 and the World Bank Global Economic Prospects, June 2026.

Efforts to improve revenue collection have advanced in tandem with the progressive implementation of various revenue reforms. The New Incentive Framework (NIF) has been implemented in phases across sectors effective March 2026. The framework aims to improve the current outcome-based approach to investment incentives, with clearer eligibility criteria and greater emphasis on high-impact investments, strengthening domestic linkages and technology transfer. Meanwhile, the ongoing implementation of e-Invoice has strengthened tax compliance and enhanced the Government's ability to identify under-reporting and leakages. The full-year effect of the expanded Sales Tax and Service Tax (SST) is also expected to enhance revenue collection in 2026.

On the expenditure side, stronger programme monitoring and project appraisal will encourage greater prudent spending while ensuring resources are directed towards higher impact priorities. Meanwhile, the use of technology in subsidy management through BUDI MADANI initiatives has provided greater capacity to detect misuse, wastage and leakages, while facilitating a more targeted and efficient mechanism. Pursuant to the enactment of the Government Procurement Act 2026 [Act 882], the Government will strengthen the procurement process through the core principles of transparency, fair competitiveness, integrity, accountability and value for money. Furthermore, these reforms will be complemented by greater adoption of digitalisation and artificial intelligence to enhance public sector capacity, improve service delivery and ensure that fiscal resources generate tangible benefits for the rakyat.

The strengthening of fiscal resilience is also supported by institutional reforms to enhance savings and create greater fiscal space over the medium term. The tabling of the National Trust Fund (KWAN) Bill 2026 in July, the first comprehensive review since its establishment in 1988, represents an

important step towards improving the framework for intergenerational savings, with clearer rules governing contributions, withdrawals, investments and oversight. This enhanced framework will provide a more disciplined mechanism for preserving a portion of the nation's wealth from non-renewable resources, while reinforcing governance and accountability.

Fiscal consolidation will continue to be pursued while ensuring the Government's ability to invest in key economic sectors and expand future productive capacity. Public investment will remain geared towards projects that strengthen connectivity as well as enhance productivity and long-term economic competitiveness. In this respect, public-private partnerships (PPPs) and user-pay model enable the Government to leverage alternative financing arrangements, while optimising public resources. Likewise, the Government-Linked Enterprises Activation and Reform Programme (GEAR-uP) is mobilising domestic institutional capital into strategic sectors, with RM20.3 billion in domestic direct investment deployed in 2025 towards semiconductors, digital and logistics infrastructure, energy, healthcare and food security sectors.

Together with continued adherence to Act 850, the overall reforms will strengthen the Government's capacity to manage public finances and fiscal risks, maintain debt sustainability as well as preserve policy space for future priority needs. Prudent debt and financing management will continue to support orderly borrowing and maintain access to financing at competitive costs. The successful issuance of USD1.5 billion Global Sukuk in July 2026, which was 4.7 times oversubscribed and achieved Malaysia's tightest-ever spreads, demonstrates the Government's ability to access international markets at favourable financing costs, underscoring investor confidence in the fiscal and economic reform agenda.

The progress of Malaysia's fiscal and structural reforms has continued to receive recognition at the global level. Sovereign ratings have remained stable, with Moody's Investors Service and S&P Global Ratings reaffirming Malaysia's A3 and A- ratings, respectively, with stable outlooks, reflecting the country's resilient economic fundamentals, continued progress in fiscal consolidation and the strength of its policy and institutional frameworks. Malaysia's competitiveness has also improved markedly, with the nation advancing to 15th position in the 2026 IMD World Competitiveness Ranking, representing an overall gain of 19 places over the period.

Fiscal Position in 2026

The 2026 Budget was tabled based on projected GDP growth of 4% to 4.5% and a crude oil price assumption of USD60 to USD65 per barrel, with fiscal deficit targeted at 3.5% of GDP. These estimates factored in the expected full-year impact of subsidy rationalisation and revenue-enhancement measures. However, the escalation of the West Asia conflict and prolonged supply disruptions have placed significant pressure on global trade and the economy, thereby impacting the cost of living and fiscal resources.

The Government swiftly mobilised a coordinated whole-of-government response to safeguard the supply of energy and essential goods, contain cost pressures and strengthen economic resilience. Key measures included continued targeted fuel subsidies and temporary adjustments to fuel quotas and controls to manage demand as well as curb leakages. In addition, over RM15 billion in financing support was made available to MSMEs in 2026, including RM5 billion through Syarikat Jaminan Pembiayaan Perniagaan Berhad (SJPP); RM5 billion of SME Stabilisation Relief Facility under Bank Negara Malaysia (BNM); and microfinancing facilities of more than RM5 billion channelled

through various agencies and development financial institutions. Additional measures were also introduced to manage public sector operations, including flexible work-from-home arrangements, the scaling down of official ceremonies, functions and conferences as well as restrictions on non-essential overseas travel and training.

These efforts were complemented by expenditure reprioritisation to contain the fiscal impact of the higher global crude oil price, which resulted in the increase of fuel subsidies to RM40 billion. In response, the BUDI95 monthly quota was temporarily reduced to 200 litres per month in April 2026, while BUDI Diesel was standardised nationwide. Nevertheless, rakyat-centric measures, particularly Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA) were maintained to mitigate the cost-of-living pressures. In addition, electricity bill assistance was expanded, with the exemption threshold raised to 800 kWh per month until end-2026, providing additional relief to households amid higher energy costs. Following the stabilisation of the domestic energy supplies, the monthly quota for BUDI95 was restored to 300 litres, effective 1 September 2026.

The Government also implemented measures to realign spending commitments, including tighter controls on supplies and services, as well as rationalising grants and transfers to statutory bodies and agencies with sufficient revenue-generating capacity and reserves. Taken together, the various expenditure optimisation and reprioritisation measures resulted in an estimated savings of RM5 billion. Consequently, operating expenditure (OE) is projected to increase by 7.3% to RM363.1 billion in 2026 compared to initial budget estimate. Meanwhile, development expenditure (DE) is expected to be maintained at RM81 billion, with allocations prioritised towards rakyat-centric projects with a high-multiplier impact and faster delivery timeline.

TABLE 1.1. *Federal Government Financial Position, 2025 – 2027*

	RM MILLION			CHANGE (%)			SHARE OF GDP (%)		
	2025	2026 ²	2027 ³	2025	2026 ²	2027 ³	2025	2026 ²	2027 ³
Revenue	336,069	363,640	380,817	3.5	8.2	4.7	16.6	16.6	16.4
Operating expenditure	330,776	363,055	376,840	2.9	9.8	3.8	16.3	16.6	16.2
Current balance	5,293	585	3,977				0.3	0.0	0.2
Gross development expenditure	81,921	81,000	83,000	-2.5	-1.1	2.5	4.0	3.7	3.6
Less: Loan recovery	1,339	1,900	1,500	-22.9	41.9	-21.1			
Net development expenditure	80,582	79,100	81,500	-2.1	-1.8	3.0	4.0	3.6	3.5
Overall balance	-75,289	-78,515	-77,523				-3.7	-3.6	-3.3
Primary balance¹	-21,578	-21,215	-16,510				-1.1	-1.0	-0.7

¹ Excluding debt service charges² Revised estimates³ Budget estimate, excluding Budget 2027 measures

Source: Ministry of Finance, Malaysia

The increase in expenditure is anticipated to be partially offset by better revenue performance, attributed to revenue reforms implemented in previous years. The full-year impact of the expansion in the SST scope, together with the phased implementation of e-Invoice, is expected to yield higher receipts through a broader tax base and improved compliance. In addition, proceeds from PETRONAS dividend are expected to be revised upwards from RM20 billion to RM27 billion, in tandem with higher average global crude oil prices. These have provided an important fiscal buffer to accommodate the additional expenditure pressures, with Federal Government revenue estimated to increase by 6% to RM363.6 billion in 2026, compared to the initial estimate.

Taking into account the fiscal implications arising from external shocks and the measures undertaken to cushion the impact, the Federal Government's fiscal deficit for 2026 is revised to 3.6% of GDP, compared with the original target of 3.5%. This modest revision reflects the Government's calibrated response in navigating external headwinds, while stronger

revenue performance and expenditure reprioritisation have helped contain the impact on the overall fiscal position. Notwithstanding the challenging global fiscal environment, the Government remains committed to maintaining fiscal discipline and ensuring the medium-term consolidation path is on track. Borrowing requirements will continue to be managed prudently in line with financing needs, supporting fiscal resilience and preserving policy space over the medium term.

Outlook for 2027

Malaysia's economy is expected to maintain a favourable growth trajectory in 2027, anchored by robust domestic demand, continued investment activity and strengthening momentum across key sectors, particularly those linked to technology. Concurrently, reforms undertaken in recent years will continue to provide the impetus to pursue further consolidation, resulting in greater capacity to sustain support for economic activity and safeguard the well-being of the

rakyat. Amid a challenging global environment and elevated crude oil prices, the fiscal stance will remain supportive of growth, while maintaining the Government's commitment to fiscal consolidation.

The Federal Government revenue is estimated to grow by 4.7% to RM380.8 billion, with both direct tax and indirect tax collections expected to benefit from sustained economic activity and stronger compliance. Revenue collection will continue to be supported by the progressive implementation of e-Invoice, which has encouraged taxpayer registration while strengthening tax compliance and enforcement. This will be complemented by the transition towards the Stamp Duty Self-Assessment System beginning 1 January 2027. Meanwhile, petroleum-related revenue, including dividends will continue to remain sizeable amid elevated global crude oil prices. The focus will therefore remain on maximising the effectiveness of existing revenue measures and fine-tuning the implementation, thereby providing a more predictable taxation ecosystem, promoting a conducive business environment and enhancing the nation's competitiveness.

On the expenditure side, fiscal resources will continue to be allocated prudently and prioritised towards programmes with high economic and social returns. OE is budgeted at RM376.8 billion in 2027, an increase of 3.8% from the revised 2026 estimate, with spending focused on essential public services as well as targeted support for the rakyat, including social assistance and subsidies. Meanwhile, allocation for DE is higher at RM83 billion, with resources directed towards programmes and projects under the Thirteenth Malaysia Plan, 2026 – 2030 (Thirteenth Plan), particularly in infrastructure, human capital development and climate-resilient projects with high-multiplier impact. The implementation of Act 882 will further strengthen transparency,

open competition and value for money in government procurement, supporting more efficient use of public resources.

In line with the medium-term consolidation under Act 850, the fiscal deficit is projected to narrow further to 3.3% of GDP in 2027. The pace and quality of consolidation will remain calibrated to prevailing economic conditions, with fiscal adjustment anchored by sustainable revenue improvements and expenditure efficiency. Consequently, borrowing requirements will be contained, thereby supporting a more sustainable financing profile, reinforcing the medium-term debt trajectory. Greater private sector participation through PPP and co-investment arrangements will complement public financing for infrastructure and facilitate investment in areas with strong economic spillovers and long-term growth potential. GEAR-uP initiatives will continue to complement broader efforts to mobilise investment towards strategic sectors in line with national development priorities.

Budget 2027 will further advance the reform and development agenda, while maintaining an orderly fiscal consolidation path. Nevertheless, the outlook remains subject to both upside and downside risks. On the upside, stronger domestic demand, sustained investment activity and faster implementation of structural reforms is expected to support stronger growth and revenue performance. On the downside, however, heightened geopolitical tensions, prolonged trade policy uncertainties, together with volatility in commodity and financial markets, could weigh on growth, increase fiscal pressures and affect household purchasing power. Therefore, the Government remains vigilant and agile in responding to evolving conditions, with fiscal policy calibrated to preserve macroeconomic stability, safeguard the welfare of the rakyat, strengthen fiscal resilience and ensure policy space over the medium term.

Medium-Term Fiscal Framework 2027 – 2029

The Medium-Term Fiscal Framework (MTFF) for 2027 – 2029 sets the basis for allocating public resources, while maintaining prudent expenditure and strengthening the Government's capacity to manage emerging fiscal risks. In line with the fiscal objectives under Act 850, the MTFF charts a gradual and orderly consolidation path, with the projections based on average real GDP growth of 5%, crude oil prices averaging at USD78 per barrel and crude oil production of about 500,000 barrels per day. For the period of 2027 – 2029, total Federal Government revenue is projected at RM1,164.4 billion or 15.7% of GDP, with non-petroleum revenue remaining the main source of revenue.

TABLE 1.2. *Medium-Term Fiscal Framework (MTFF), 2027 – 2029*

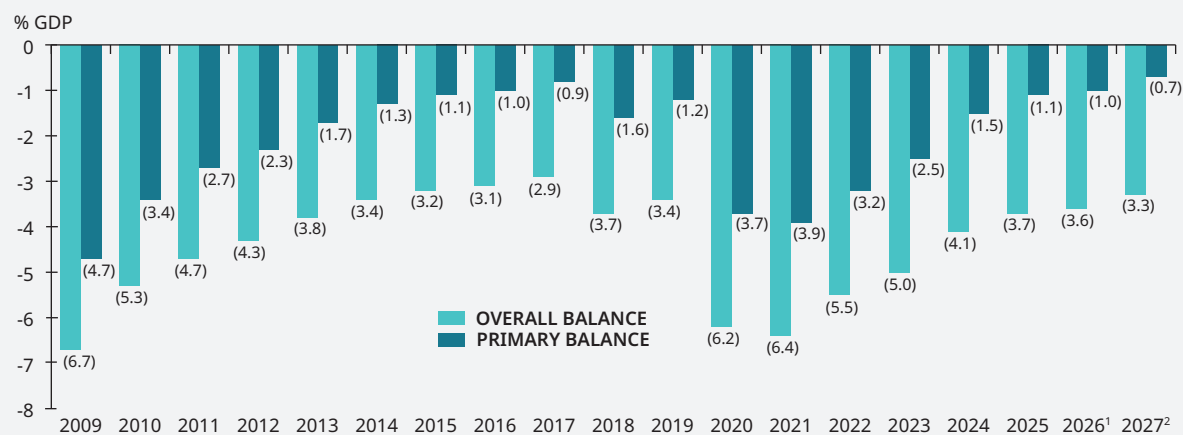
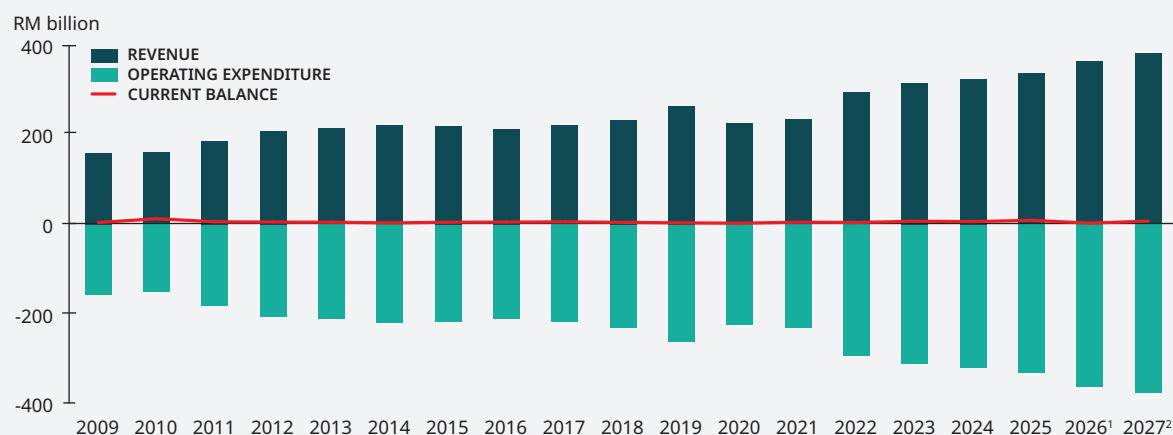
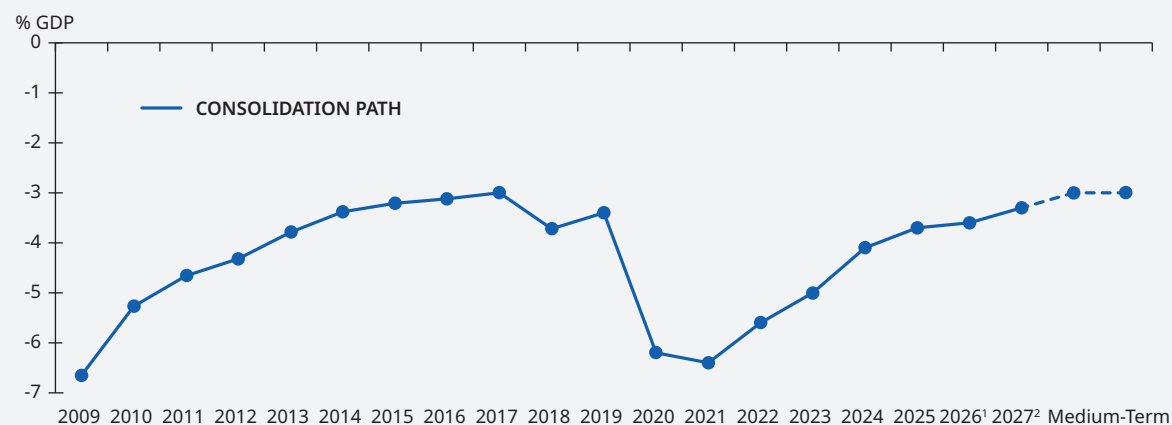
	RM BILLION	SHARE OF GDP %
Revenue	1,164.4	15.7
Non-petroleum	997.9	13.4
Petroleum-related	166.5	2.3
Operating expenditure	1,148.3	15.5
Current balance	16.1	0.2
Gross development expenditure	253.0	3.4
Less: Loan recovery	4.5	0.1
Net development expenditure	248.5	3.3
Overall balance	-232.4	-3.1
Primary balance	-39.2	-0.5
Underlying assumptions:		
Average real GDP growth (%)	5.0	
Average nominal GDP growth (%)	6.5	
Average crude oil price (USD per barrel)	78	
Crude oil production (barrels per day)	~500,000	

Note: MTFF estimates, excluding Budget 2027 measures
Source: Ministry of Finance, Malaysia

Total OE is projected at RM1,148.3 billion or 15.5% of GDP, while DE is expected to record RM253 billion or 3.4% of GDP, reflecting continued investment in strategic priorities under the Thirteenth Plan. Overall, the annual fiscal deficit during the period is projected to decrease, in line with the medium-term consolidation target of 3% of GDP. This projection is based on the assumption of continued revenue mobilisation, expenditure optimisation and stronger value for money in public spending. Greater private sector participation through appropriate financing and co-investment arrangements will complement public spending and support national development.

Conclusion

The successful implementation of fiscal reforms, particularly measures to enhance revenue collection and improve the targeting of subsidies, amid global economic headwinds, underscores the Government's resolve to strengthen public finances. These measures have yielded tangible outcomes, primarily by generating an adequate fiscal buffer to cushion external shocks. The fiscal space secured through these reforms has provided the Government with greater capacity to continue providing targeted social assistance. Notably, proactive efforts to curb the growth of the Federal Government debt will ensure future generations inherit stronger economic foundations without being burdened by excessive debt. Furthermore, the proposed legislation on government-owned entities will strengthen governance and oversight of these entities, supporting efforts to contain fiscal risks associated with operations and financial commitments. Moving forward, the policy stance will strategically channel public resources toward productive investments in elevating the nation's long-term economic potential, while remaining highly responsive to the immediate needs of the rakyat.

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 MTF Overall Balance¹ Revised estimate² Budget estimate, excluding Budget 2027 measures³ Forecast

Source: Ministry of Finance, Malaysia