

Malaysia

10 October 2025

Budget 2026: Staying the course on policy priorities

- The government stayed the course on its policy priorities in Budget 2026. It remained committed to fiscal consolidation aiming to narrow the fiscal deficit to 3.5% of GDP from 3.8% of GDP in 2025, in line with our expectations.
- It also remained committed to building economic resilience focusing on infrastructure spending, supporting SMEs, moving up the value-chain while mitigating pressures from elevated costs of living.
- Budget 2026 provides Bank Negara Malaysia (BNM) with room to keep its policy rate unchanged on 6 November. We still see room for a 25bp cut from BNM in 1H26.

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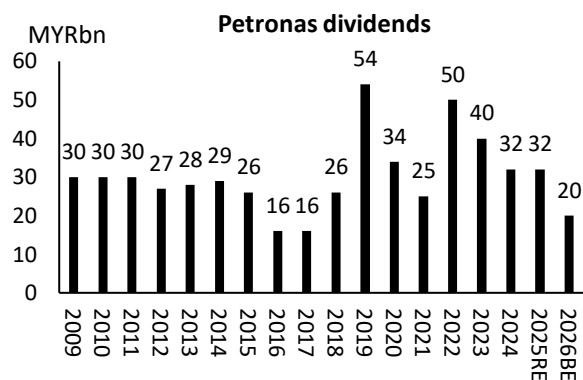
The priorities of the government were clearly laid out in Budget 2026 including fiscal consolidation and building economic resilience against rising external headwinds while mitigating cost of living pressures.

Doubling down on fiscal consolidation

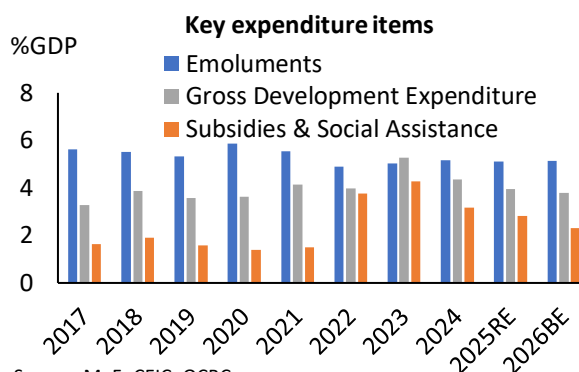
The government announced a narrower fiscal deficit target of 3.5% of GDP in 2026 from 3.8% of GDP in 2025, in line with our expectations. The revenue assumptions were more conservative than our own estimates, with tax revenue collections slated to grow at 6.7% YoY, modestly better than nominal GDP growth estimates.

The continued growth in tax revenues reflects a combination of past reforms bearing fruit, such as broadening of the sales and services tax, wider adoption of e-invoicing and administrative improvements, but also a set of newly introduced revenue measures. The government will introduce a carbon tax for select sectors steel, iron and energy in 2026 and will also raise the excise duty on alcoholic products by 10% and cigarettes by 2sen per stick and by MYR40 per kg for cigars, cheroots and cigarillos.

Non-tax revenues are expected to remain subdued in 2026, consistent with the government's objective to move away from more volatile revenue sources. Petronas dividends will drop to MYR20bn in 2026 from MYR32bn in 2025 while the lower assumption on global oil prices at USD60-65/barrel in 2026 from USD70/barrel in 2025 implies reduced commodities associated revenue collections.



Source: Petronas; Annual Economic Reports; OCBC



Source: MoF; CEIC; OCBC.

On the expenditure front, the government remains prudent with its allocations. The budget for subsidies and social assistance is expected to drop further by 14.1% YoY in 2026 after falling 15.3% in 2025 reflecting the authorities ongoing subsidy rationalisation efforts for diesel, water, eggs and RON95. These will continue to generate savings in 2026, but it is unclear of any of these schemes including Budi95 will be tweaked to generate additional savings. The Economic Report noted that “the Ministry of Domestic Trade and Cost of Living is developing the nationwide Cooking Oil Price Stabilisation Scheme System to curb leakages of subsidised packet cooking oil and ensure it reaches the targeted group.” This could further aid targeted subsidy efforts.

Spending on emoluments, pensions and gratuities is budgeted to increase further in 2026 on the back of the second phase of the SSPA implementation, which includes a 7% basic salary increase for civil servants in Grade 15 and below, and provide for a growing number of retirees. With the number of pensioners rising, the Economic Report noted that “the Government is finalising the implementation of a defined-contribution scheme to replace the defined-benefits pension scheme for public servants.”

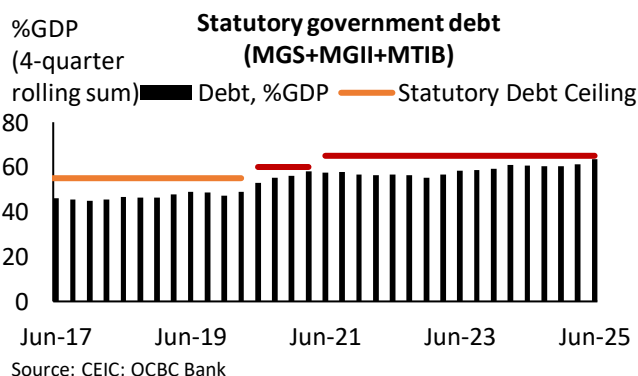
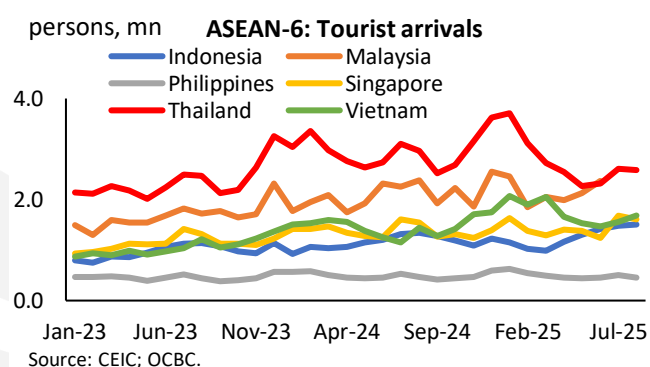
Budget 2026 focuses on building economic resilience

The development expenditure budget was largely stable at MYR81bn, in line with our expectations. The allocation of expenditures by function points to a focus on transportation infrastructure development, flood mitigation projects, healthcare, education and strategic industrial development projects.

Transport
Road construction projects from Kalabakan to Simanggaris, connecting Malaysia and Indonesia borders
Development of the Air Traffic Control Centre in Kota Kinabalu, Sabah
Construction of two interchanges on the Lebuhraya Utara Selatan in Nilai, Negeri Sembilan and Kerian, Perak
Environment subsector
Flood mitigation projects in Kubang Pasu, Kedah; Kuala Nerus, Terengganu; Segamat, Johor and Serenban, Negeri Sembilan
New drainage system in Kota Bharu, Kelantan
River Conservation Project in KL, Johor, and Kelantan
Source: Ministry of Finance; OCBC.

Budget 2026 also emphasised the other priorities of the government, which will help bolster medium-term growth prospects. For example, small and medium enterprises looking to expand into new markets will be supported. The Syarikat Jaminan Pembiayaan Perniagaan (SJPP) will guarantee up to 70% of financing for export-oriented mid-sized companies, including those expanding into new markets with a total guarantee of MYR5bn. Malaysia External Trade Development Corporation will also receive MYR60mn to help SMEs export local products to current and new trading partners. The government also provide support to SMEs with SJPP guaranteeing over MYR100bn in business loans.

There was also a focus on promoting local tourism by providing MYR1000 tax relief on individual income tax for entrance fees to local tourism centres. The government is also allocating MYR700mn for the tourism in conjunction with Visit Malaysia 2026. PM Anwar noted that the government wants to attract 47mn tourists and generate MYR329bn in 2026. Tourist arrivals reached 12.9mn in 1H26, outpacing most regional peers except for Thailand.



The government was also keen on supporting regional growth in Johor, Sabah and Sarawak. The government is also supporting development in the northern border such as Delapan in Bukit Kayu Hitam Special Border Economic Zone. Enhancing support for higher value-added activities along the supply chain in sectors such as electronics along with digitalisation were also strong themes of Budget 2026. The government noted that Khazanah Nasional and KWAP will be investing MYR550bn in the semiconductor ecosystem to increase collaboration between domestic and multinational companies under the National Semiconductor Strategy.

Cost of living concerns are also addressed

Simultaneously, near-term priorities to mitigate cost of living pressures for households were also clear. The social assistance via the Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA) was also expanded. STR phase 4, of MYR2bn, will be distributed starting 18 October (earlier than expected) while a 50% toll discount will be provided coinciding with Diwali celebrations. For 2024, the total STR and SARA programs amounted to MYR13bn while the phase 1-3 of the STR amounted to MYR6bn. Under SARA, all Malaysian will receive a one-off MYR100 payment in mid-February in conjunction with Ramadhan and Chinese New Year.

MYRbn	2024	2025	2026	
	Actual	Revised Budget	Budget Estimate	%YoY
Central Govt Revenue	324.6	334.1	343.1	2.7
Tax Revenues	240.2	253.4	270.4	6.7
Direct Taxes	171.7	177.1	187.4	5.8
Indirect Tax	68.5	76.3	83.0	8.8
Non-Tax Revenues	84.4	80.7	72.7	-9.9
Central Govt Expenditures	403.8	412.1	419.2	1.7
Central Govt Current Expenditure	321.5	332.1	338.2	1.8
Emoluments	95.9	103.5	109.4	5.6
Pension and Gratuities	35.9	40.1	42.8	6.8
Debt Service Charges (DS)	50.5	54.3	58.3	7.4
Supplies and Services	37.7	42.5	40.3	-5.2
Subsidies & Social Assistance	67.4	57.1	49.0	-14.1
Asset Acquisition	1.2	1.2	1.0	-15.2
Net Development Expenditure	82.3	78.7	79.5	1.0
Gross Development Expenditure	84.0	80.0	81.0	1.3
Loan Recoveries	1.7	1.3	1.5	13.6
Fiscal balance	-79.2	-76.7	-74.6	
% GDP	-4.1	-3.8	-3.5	
Source: Ministry of Finance; OCBC.				

Stable deficit and debt dynamics

The commitment to fiscal consolidation, focus on revenue generation, reduced dependence on petroleum revenues as well as continued expenditure rationalisation bodes well for medium-term debt reduction prospects. The

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government noted that the federal government debt stood at 64.7% of GDP, with the statutory debt to GDP below that at 63.5% of GDP. We expect the government will keep debt levels below this statutory level into 2026.

Monetary policy to remain in wait-and-see mode

In terms of monetary policy implications, continued fiscal consolidation, a focus on the reform agenda suggests that monetary policy will remain in wait-and-see mode in the near-term. We expect BNM to remain on hold at its 6 November meeting.

We see the door open for another 25bps rate cut from BNM likely in 1H26. The risk to our call stems from GDP growth remaining more resilient than is pencilled into our baseline for the remainder of this year and 2026. This would likely allow BNM to keep monetary policy settings unchanged rather than ease further.

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