

## Malaysia

### Kuala Lumpur: Boots on the ground

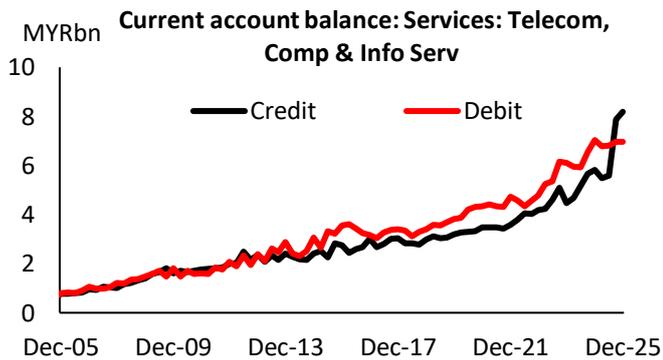
- We were in Kuala Lumpur intermittently over the past few weeks meeting policymakers and various economic and political observers.
- The economy is entering this latest bout of global volatility from a position of strength. We expect the 2026 GDP growth forecast range to be announced by officials to be 4.5-5.5%; our forecast remains 4.4%.
- Rising global oil prices presents a risk to inflation and the fiscal balance but also logistic costs. The authorities will remain nimble in their approach to dealing with external volatilities.
- There is some fiscal room to manoeuvre with the government maintaining RON95 subsidies under the Budi95 mechanism. Bank Negara Malaysia (BNM) will likely remain on hold in the near-term but also through 2026.
- The situation remains fluid and will continue to regularly assess the risks to our baseline forecast.

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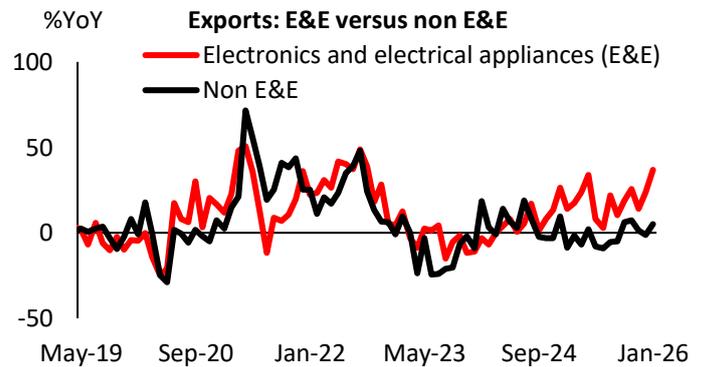
We were in Kuala Lumpur intermittently over the past few weeks meeting policymakers across Bank Negara Malaysia, Ministry of Finance, Malaysia Investment Development Authority and various economic and political observers. The bottom line is that the economy is handling external volatilities from a position of strength. Policymakers are closely monitoring global developments and have room to manoeuvre on fiscal and monetary policies.

### E&E exports to remain resilient

The present position of economic strength comes from better than expected 2H25 GDP growth. The real question is whether this growth can sustain in 2026. The authorities noted a durable demand for production and exports from the electronics and electrical products (E&E) sector. Specifically, the nature of data centre development has moved beyond a property play into services. There has been a mushrooming of local players – this is an encouraging sign that the local ecosystem is becoming more integrated into the data centre play. Information, Communication and Technology (ICT) services exports is one of the new avenues of growth and current account balance support.



Source: CEIC; OCBC Group Research.



Source: CEIC; OCBC Group Research.

Semiconductor sector growth is deemed sustainable underscored by a resilient order book for semiconductors. The development of semiconductors for the automotive sector was seen as a new avenue of growth. The divergence between E&E (the bulk of which is semiconductor exports to the US), and non-E&E exports has become more apparent. For the latter, growth started to slow sharply in 2H25 and will likely remain soft into 2026.

### Focused on small scale high multiplier projects and greater integration of local industries

The pipeline for large scale public infrastructure projects has largely been completed, with the next set of mega projects likely to show meaningful GDP contributions only in a few years. Public infrastructure will now be supported by small scale high multiplier projects including the water treatment in Machang (Kelantan), building of various hospitals, housing projects and flood mitigation projects.

Moreover, there is a push to raise domestic investments along with foreign investments. There are adequate sources of funding and good opportunities for investment consistent with the national masterplans and policies (National Industrial Master Plan 2030, National Semiconductor Strategy etc, Gear-Up program). Investment approvals will likely be softer in

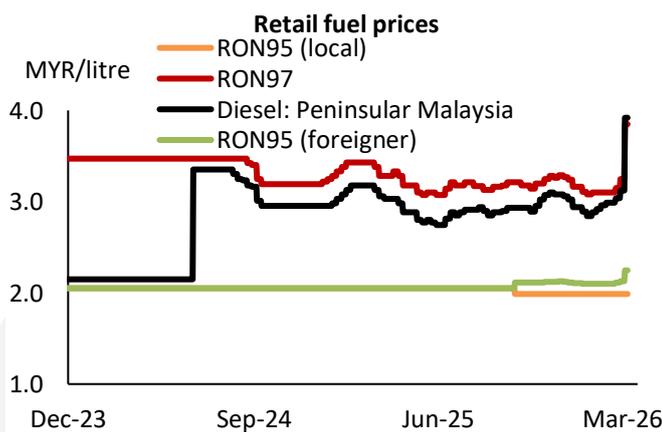
2026 compared to 2025 as the authorities are focussed on the quality of investments not the quantity. There is a greater emphasis on more localisation of industries into the foreign supply chain and strengthening the domestic investor base. Regional cluster development is being encouraged particularly for the Northern and Central regions to create a deeper and more complementary supply chain.

### Household spending resilience – a focus on the rakyat

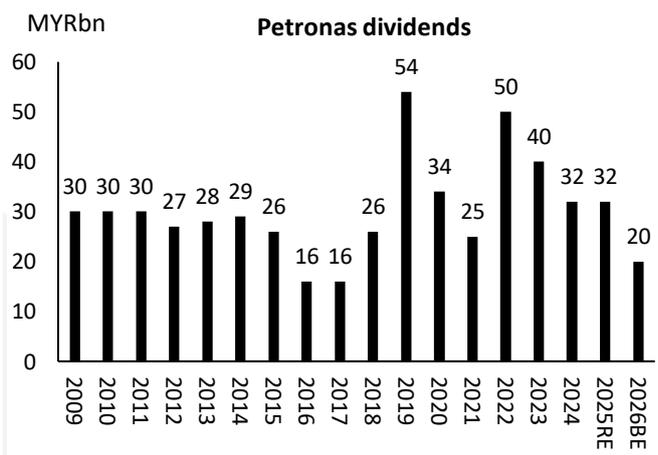
Meanwhile, private consumption spending is expected to remain resilient, growing 5% on an annual basis below the pre-pandemic average of 7% but strong nonetheless supported by government policies and continued wage growth. The authorities are interesting in gauging the extent of the impact of one-off measures in 2025 such as Sumbangan Asas Rahmah (SARA) handouts, minimum wage increases, civil servant salaries in boosting household consumption. The authorities noted that MYR15bn as the budgeted figure for SARA and Sumbangan Tunai Rahmah (STR) assistance, allocated from the savings in retargeting fuel subsidies.

### Near-term changes to fuel subsidies unlikely

Fiscal policy reforms over the past few years are bearing fruit, affording the government the policy room to adopt a wait-and-see approach in terms of the tensions in the Middle East. The PM noted, however, the allocation can be MYR2bn per month to maintain RON95 prices at MYR1.99/litre<sup>1</sup> through the Budi95 initiative, leading to expenditures of MYR24bn (1.1% of GDP). This is similar to our estimates of the RON95 subsidy bill if global oil prices average USD100/barrel for 2026. If oil prices hover around the year-to-date average of USD72.7/barrel, we estimate the subsidy bill to be ~MYR12.5bn (0.6% of GDP).



Source: CEIC; OCBC Group Research.



Source: Petronas; Annual Economic Reports; OCBC Group Research.

The authorities noted that 95% of those who can avail the Budi95 do not use more than 100 litres per month. This suggests limited reason to change volume allocations going forward. In fact, the mechanism to track individual consumption of fuel allows the authorities to also identify consumption anomalies.

<sup>1</sup> PM: Govt allocates RM2 bil in subsidies per month to maintain RON95 price at RM1.99 per litre, The Edge Malaysia, 15 March 2026.

More fundamentally, the authorities estimate that a USD1/barrel increase in global oil prices leads to MYR300mn in additional revenues, excluding Petronas dividends, but also costs MYR400-500mn in subsidies. This leaves for a fiscal gap of MYR150mn for every USD1/barrel increase in global oil prices. This net negative impact on the fiscal balance does not include potentially higher transfers from Petronas. The dividends from Petronas are budgeted to narrow to MYR20bn from MYR32bn in 2025.

Tax revisions can usually be done in June, September and November allowing for a slightly lower runway to determine whether adjustments are necessary. Importantly, the authorities noted that it is too early to tell whether Petronas will benefit or not from higher oil and gas prices considering the pipeline of committed capital expenditures, higher logistics and shipping costs as well as the ongoing dispute with Sarawak<sup>2</sup>.

The authorities were clear that there will be no cutbacks to development spending for the moment and that it remains a priority under the Fiscal Responsibility Act (FRA) to keep development spending at 3% of GDP. Any reintroduction of the Goods and Services Tax (GST) is not under discussion, with the authorities relying on the already announced measures such as e-invoicing, sales and services tax scope expansion bearing fruit.

### Watching inflation

Ahead of heightened tensions in the Middle East, authorities were relatively sanguine about inflation. In fact, inflation as a topic of conversation came up at the very end of our exchange with officials. But the tensions in the Middle East and effective blockage of the Straits of Hormuz have shifted the matter of inflation back to the forefront.

Inflationary pressures did pick up during the previous energy price shock in 2022, albeit to a significantly lower degree compared to regional peers and the pickup implied by global oil prices. There are, however, two crucial differences since 2022 on account of much needed subsidy rationalisation. Fuel subsidies are no longer blanket subsidies as in 2022. The rationalisation from 22 September 2025 under Budi95 has exposed the headline CPI to some additional fluctuations. Second, electricity tariff rationalisation from July 2025 allows for an automatic fuel adjustment (AFA) mechanism of 10% from the current allowed generation tariff of 45.40sen/kWh.

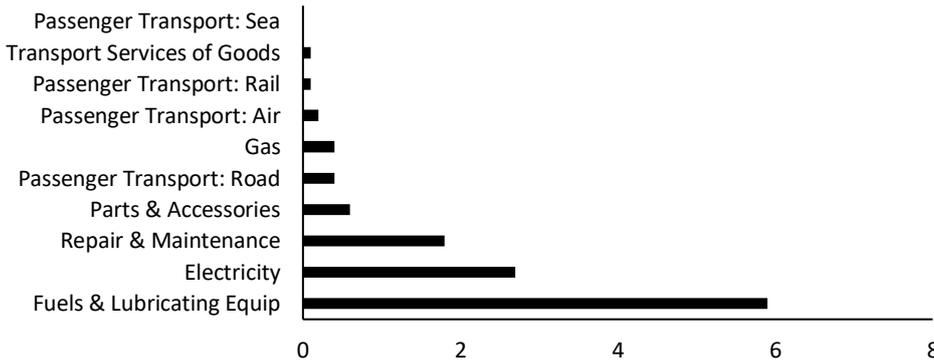
These changes were delivered well enough to keep headline CPI contained at an average 1.4% YoY in 2025 versus 1.8% in 2024. For 2026, our baseline forecast is 1.5% but the risks to this have risen since this assumes relatively flat oil prices compared to 2025.

The extent of the upside risk, however, depends on the period and persistence of elevated global oil prices. We estimate about 12.2% of Malaysia's CPI basket through direct and indirect mechanisms is exposed to higher oil and gas prices. Should global oil prices remain elevated and average USD84/barrel in 2026, headline CPI would average 2.7% YoY versus our baseline of 1.5%. This assumes that subsidies cushion approximately half the impact compared to a direct pass-through onto retail fuel prices. Indeed, the authorities recently

<sup>2</sup> Petronas gets leave to challenge Sarawak's O&G ordinances, Free Malaysia Today, 16 March 2026.

noted that about 85% of Malaysian households will remain unaffected by electricity cost increases despite tensions in the Middle East<sup>3</sup>.

**Malaysia CPI weights**



Source: CEIC; OCBC Group Research.

### Policy stance to remain nimble

The authorities were clear that their stance will remain nimble in handling of external risks. The authorities have some fiscal room to manoeuvre while keeping RON95 subsidies under the Budi95 mechanism in place. While monetary policy will remain flexible. The authorities were comfortable with MYR moves provided market functioning remained orderly and there was sufficient liquidity.

It was clear, in our interactions with the authorities, that the 25bp rate cut by BNM in July 2025 was to hedge against downside risks to growth and not the baseline. These downside risks have not abated and in fact remain heightened in the face of energy price increases. Despite being a net energy exporter, we see the balance of risks for growth skewed to the downside especially if the situation in the Middle East persists (see *Impact of rising global oil prices*, 9 March 2026).

We expect BNM to remain on hold through 2026; we will continue to monitor the risks to this call. We see little incentive for BNM to reverse the accommodation put in place since July 2025 at this juncture. BNM has in the past looked through supply side shocks but the second-round effects and the impact on inflation expectations will be watched closely.

BNM will likely release its 2026 Annual Report on 31 March. We expect the GDP growth range for the year will be 4.5-5.5%, similar to the originally announced range in 2025. Our GDP growth forecast at 4.4% is relatively consistent.

<sup>3</sup> Energy Minister: 85% Malaysians Safe From Electricity Cost Hikes Amid Middle East Tensions, SAYS, 17 March 2026.

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