Malaysia budget 2027: Giving back with discipline, anchoring markets

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Key Points

- **Giving back without giving up fiscal consolidation**. Budget 2027 lowers the fiscal deficit to 3.3% of GDP from an estimated 3.6% in 2026, despite continued support to cushion households from elevated energy prices. Stronger revenues and earlier fiscal reforms are creating room for tax relief and SME support without derailing fiscal repair. The primary deficit also narrows to 0.7% of GDP from 1.0%.

- **Fiscal repair increasingly matters for debt dynamics, not just the deficit target**. Federal debt stood at 63.1% of GDP at end-June 2026 and is overwhelmingly ringgit-denominated. The effective cost of government debt remains around 4%, but debt servicing already absorbs around 16% of central government revenue. Slower debt accumulation is therefore important to protect future fiscal space for productive spending.

- **We see the rise in Malaysian yields as primarily externally driven**. Malaysia retains a benign domestic backdrop of contained inflation, fiscal consolidation and deep local demand for government bonds. In our view, this creates opportunities to receive MYR rates when the domestic curve is dragged higher by the US rates sell-off, particularly where market pricing embeds more tightening or term premium than Malaysia's domestic fundamentals justify.

- **Budget 2027 raises the floor while continuing to raise the ceiling**. Tax cuts, reliefs and transfers cushion disposable incomes, while higher development spending, grid investment, technology incentives, GEAR-uP investment and support for advanced manufacturing seek to turn Malaysia's investment boom into higher productivity and real wages.

- **Market view: constructive MGS and MYR, selective equities**. We favour receiving MYR rates on externally driven sell offs and remain constructive on MYR over the medium term. Equity benefits could be concentrated in infrastructure, utilities, technology, financial services, tourism, and domestic consumption rather than being uniform across the market.

PAST REFORMS ARE PAYING OFF

Budget 2027 reinforces a point we made in our pre-Budget report: the oil shock has slowed Malaysia's fiscal consolidation, but it has not reversed it.

The government estimates the fiscal deficit at 3.6% of GDP in 2026, modestly above the original 3.5% target, largely after higher global energy prices pushed up fuel subsidy requirements. This is understandable. The original budget was based on substantially lower oil-price assumptions, while the escalation of the Middle East conflict subsequently forced the government to absorb more of the energy shock and protect household purchasing power. Fuel subsidies would be larger than originally budgeted and operating expenditure was therefore consequently higher.

The more important signal for investors is what happens next.

The government is targeting a further narrowing in the budget deficit to 3.3% of GDP in 2027, while the primary deficit to improve to 0.7% from 1.0%. Fiscal revenue is projected to rise 4.7% to RM380.8bn in 2027, while operating expenditure grows by a slower 3.8%. Development expenditure, importantly, is raised to RM83bn from RM81bn.

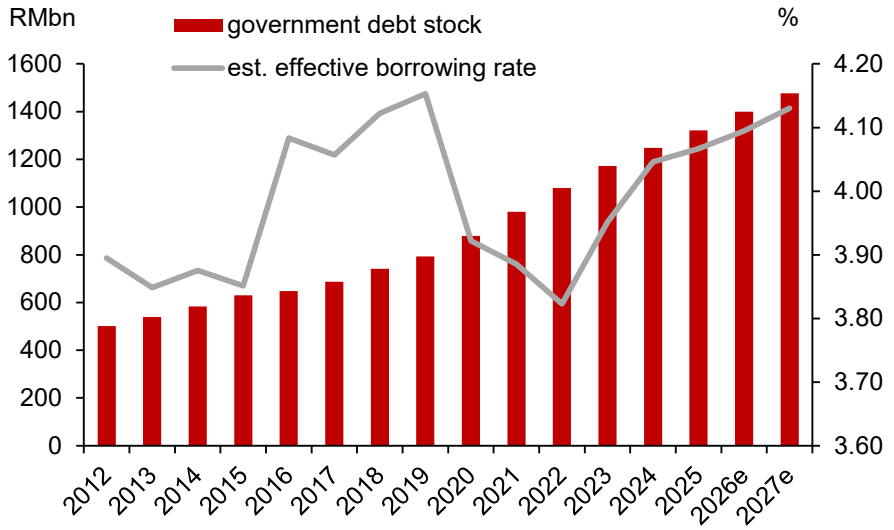
This is giving back with discipline. Past revenue and subsidy reforms have created some fiscal space for the government to respond to an unpredictable external shock without abandoning the medium-term consolidation path towards a fiscal deficit of 3% of GDP.

That matters for markets.

FISCAL CONSOLIDATION INCREASINGLY MATTERS FOR DEBT DYNAMICS

The government's borrowing costs remain manageable, but the growing debt stock is becoming a more important constraint on fiscal space.

CHART 1: RISING DEBT STOCK, RATHER THAN BORROWING COSTS, IS A BIGGER CONSTRAINT



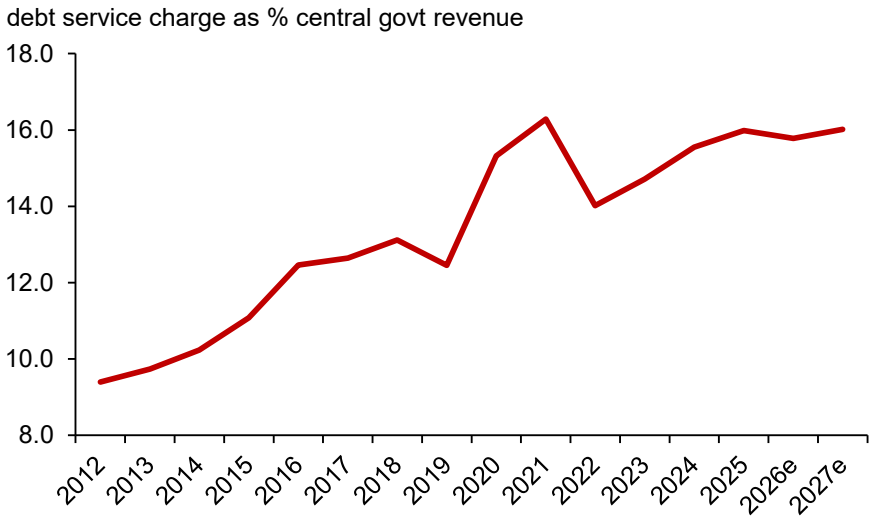
Source: CEIC, MUFG GMR est

Federal government debt stood at RM1.379trn, or 63.1% of GDP, as of end-June 2026. Malaysia's debt structure nevertheless remains relatively favourable, dominated by domestic debt with modest offshore borrowings. This limits FX

balance-sheet risks. There is also little evidence of an underlying funding problem. Residents hold 78.5% of outstanding federal debt, while non-residents account for 21.5%.

However, fiscal space is partly constrained by debt servicing charges. Debt-service charges rose to RM53.7bn in 2025, are estimated at RM57.3bn in 2026 and are budgeted at around RM61bn in 2027. Debt servicing absorbed 16% of government revenue in 2025 and 15.8% in 2026.

CHART 2: DEBT SERVICE ABSORBS A GROWING SHARE OF GOVERNMENT REVENUE



Source: CEIC, MUFG GMR

This is why fiscal consolidation matters even when Malaysia faces no obvious sovereign funding stress.

The aim is likely to ensure that government debt grows more slowly than the economy, reducing the debt burden over time and preventing debt servicing from crowding out more productive spending.

A lower deficit in 2027 should reduce new financing requirements and slow debt accumulation. This should gradually create greater room for infrastructure, education, healthcare and targeted household support.

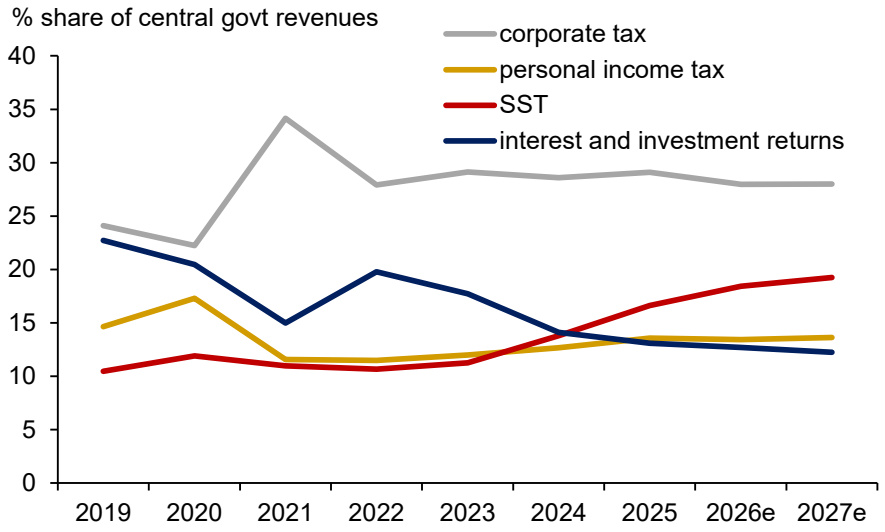
BETTER REVENUE QUALITY STRENGTHENS THE FISCAL ANCHOR

Revenue reform provides the other important buffer.

Federal revenue is projected to increase to RM380.8bn in 2027 from a revised RM363.6bn in 2026. More importantly, the composition of government revenues continues to improve.

Petroleum-related revenues declined from 28% of total revenues in 2022 to 17.5% in 2025 and an estimated 15.1% in 2026. Meanwhile, SST has become an increasingly important revenue pillar following the broadening of its scope, while e-Invoicing has increased visibility over transactions and strengthened compliance. For 2027, corporate income tax is projected to increase 4.8% to RM106.6bn, personal income tax by 6.2% to RM51.8bn and SST by 9.5% to RM73.3bn.

CHART 3: SST BECOMES AN INCREASINGLY IMPORTANT REVENUE PILLAR



Source: CEIC, MOF, MUFG GMR

The next phase of fiscal reform therefore looks increasingly about collection efficiency rather than higher taxation. Better compliance allows the government to raise effective revenues without repeatedly increasing headline tax rates.

RAISING THE FLOOR: PROTECTING HOUSEHOLD PURCHASING POWER

Budget 2027 uses some of that fiscal space to give back to the rakyat. Personal tax relief is increased to RM12,000 from RM9,000, selected resident middle-income personal tax rates are lowered by 1ppt to 18% for chargeable income from RM70,001 to RM100,000 and to 24% for income from RM100,001 to RM150,000. The government estimates that these changes will raise additional disposable income by RM1,600 for each taxpayer, while STR and SARA allocations would rise to RM16bn from RM15bn. The minimum wage will also rise from RM1,700 to RM2,000 from June 2027, with MSMEs with sales less than RM50 million exempted. Together with continued fuel subsidies, housing support and broader social assistance, these measures help cushion household disposable incomes against the energy shock.

The larger macroeconomic benefit may instead come through keeping inflation contained, thereby protecting household purchasing power.

By absorbing part of the energy shock fiscally, the government limits the immediate pass-through from oil prices into transportation, food and services. This helps explain why Malaysia's inflation backdrop remains considerably more benign than the external energy shock might otherwise suggest. The trade-off is that the burden moves from household balance sheets onto the government's balance sheet.

SUPPORTING SMES THROUGH HIGHER COSTS AND STRUCTURAL CHANGE

MSMEs are among the direct beneficiaries of the Budget. The income-tax rate is reduced to 14% on the first RM150,000 of chargeable income and 16% on the next RM450,000. The tax saving is capped at around RM6,000 annually. These measures serve two purposes. In the near term, they help firms to partly absorb energy, financing and labour costs. Over the medium term, they can encourage capital

investment and greater technology adoption among smaller companies.

RAISING THE CEILING: FROM INVESTMENT BOOM TO PRODUCTIVITY UPCYCLE

The more interesting part of Budget 2027 is what happens beyond the oil shock. Malaysia has already succeeded in attracting substantial investment. The challenge is to turn higher capital formation into sustained productivity growth and eventually higher real wages.

Several Budget measures point in this direction.

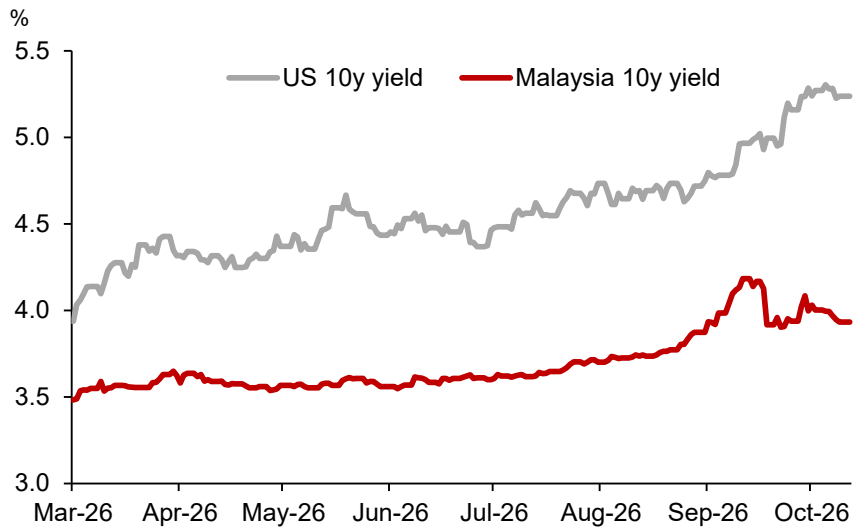
GLICs will mobilise RM25bn of domestic investment through GEAR-uP into strategic sectors including electrical and electronics, advanced manufacturing, and digital technology. Notably, Penang is designated as the technology finance centre.

At the same time, the government's emphasis on infrastructure addresses an increasingly important constraint created by Malaysia's own investment success. Data centres, AI and advanced manufacturing require enormous amounts of reliable electricity, connectivity and supporting infrastructure. TNB's RM15bn grid investment is therefore an increasingly essential component of Malaysia's industrial competitiveness. Development expenditure rises to RM83bn in 2027, with the economic sector retaining the largest allocation at 45.4%, alongside notable spending on social infrastructure and human capital.

MALAYSIA RATES: THE GLOBAL SELL-OFF CREATES OPPORTUNITIES

Malaysia has participated in the global bond sell-off, but the adjustment has been considerably less pronounced than in the US. Based on our market data, the 10-year US Treasury yield has risen by around 107bp year-to-date, compared with roughly 44bp for Malaysia's 10-year MGS. This relative resilience is consistent with Malaysia's more supportive domestic backdrop.

CHART 4: MALAYSIA YIELDS PROVE RELATIVELY RESILIENT TO RISING US YIELDS



Source: Bloomberg, MUFG GMR

Malaysia's fundamentals do not point to the same degree of upward pressure on rates. Inflation remains contained and domestic inflation expectations are relatively

well anchored, while fiscal consolidation continues. Deficit financing should moderate in 2027, effective financing costs remain manageable, and the country continues to benefit from a strong domestic investor base. Importantly, BNM does not need to mechanically follow changes in US policy rates, providing some insulation from the global rates cycle.

Recent sovereign issuance also points to healthy funding conditions. Malaysia's July 2026 global sukuk was 4.7 times oversubscribed and achieved the country's tightest-ever spread, suggesting that investor demand remains robust and that sovereign funding conditions show little sign of material fiscal stress. Meanwhile, the sell-off had already pushed the 10-year MGS yield closer to estimated fair value, with foreign investors demonstrating a willingness to re-engage as valuations became more attractive.

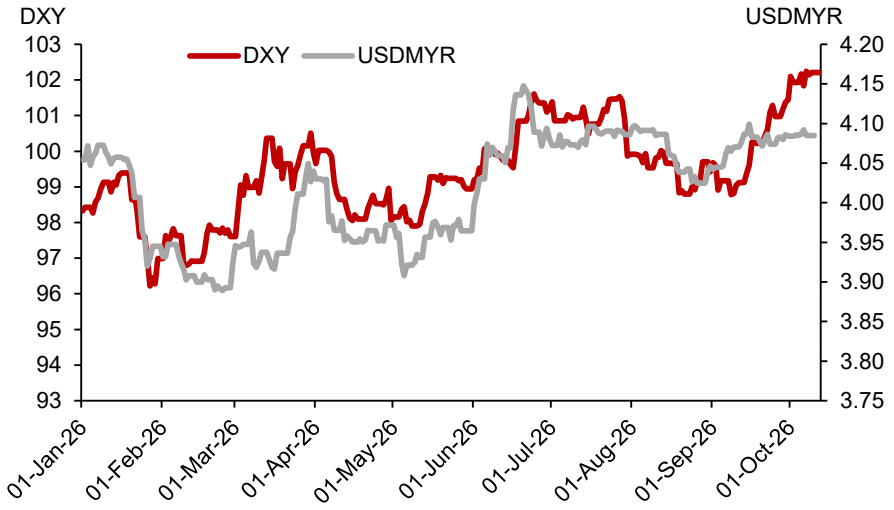
Against this backdrop, we favour receiving MYR rates when the domestic curve is dragged materially higher by a US Treasury-led sell-off without a corresponding deterioration in Malaysia's inflation or fiscal outlook.

MYR: FISCAL CREDIBILITY STRENGTHENS THE MEDIUM-TERM CASE

Budget 2027 is also incrementally supportive of the MYR, although the impact is likely to work through fundamentals rather than provide an immediate appreciation catalyst. The transmission operates through several channels. Continued fiscal consolidation should reinforce policy credibility and help contain Malaysia's sovereign risk premium, while attractive MGS yields could encourage foreign investors to re-engage with the domestic bond market. At the same time, infrastructure spending and support for strategic sectors should continue to attract FDI, supporting investment, productivity and ultimately Malaysia's potential growth. Together with contained inflation, these factors provide a relatively stable macro backdrop for the currency.

Importantly, however, the Budget by itself is unlikely to trigger a sustained move lower in USD/MYR. Near-term MYR performance will remain heavily influenced by external factors, particularly US Treasury yields, the broader direction of the US dollar, oil prices and global risk sentiment. The significance of a credible Budget is therefore less about generating immediate MYR strength and more about strengthening the currency's underlying resilience and its capacity to outperform once the external environment turns more supportive. The distinction between external volatility and domestic deterioration is key. A rise in USD/MYR driven by a global rates or dollar shock does not necessarily invalidate the constructive medium-term MYR story. Instead, where fiscal credibility, inflation stability and Malaysia's investment outlook remain intact, externally driven MYR weakness may represent an opportunity to add exposure rather than a reason to turn structurally bearish.

CHART 5: RINGGIT HOLDING FIRM DESPITE STRONGER DOLLAR



Source: Bloomberg, MUFG GMR

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