

Malaysia Budget 2027 Preview: Supporting Households, Sustaining Growth, and Preserving Fiscal Discipline

Executive Summary

- Budget 2027 will be the second budget under the 13th Malaysia Plan (13MP) and is expected to balance three competing objectives: supporting household purchasing power, sustaining the investment cycle and maintaining fiscal consolidation. The Pre-Budget Statement points to continued emphasis on raising economic capacity, improving living standards and strengthening governance, with productivity, digitalization, AI, energy security, food security and infrastructure among the key priorities.
- We expect Budget 2027 to remain moderately supportive of domestic demand, but not a broad-based fiscal stimulus. The Government has limited room to significantly increase spending given the medium-term objective of reducing the fiscal deficit towards 3.0% of GDP. At the same time, elevated living costs and the need to sustain household consumption are likely to result in further targeted assistance, particularly through Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA), selected tax reliefs and targeted subsidies.
- Our base case is for the fiscal deficit to narrow to around 3.4% of GDP in 2027, from an estimated 3.5% in 2026. This would represent continued, albeit gradual, fiscal consolidation.
- The composition of spending will matter more than the headline size of the budget. We expect development expenditure to increase moderately, with greater emphasis on infrastructure, water, transport, digital connectivity, energy transition, healthcare, and regional development. At the same time, the Government is likely to continue subsidy rationalization and expenditure efficiency measures to create fiscal space for more productive spending.
- On revenue, we do not expect Budget 2027 to introduce a major new broad-based tax. Instead, the emphasis is likely to remain on better tax compliance, e-invoicing, SST administration, the Global Minimum Tax and potentially carbon pricing, together with higher petroleum-related receipts.
- Overall, we view Budget 2027 as a "targeted support within fiscal limits" budget: protecting household purchasing power in the near term while attempting to shift government spending towards productivity-enhancing investment and longer-term economic resilience.

Summary of 2027 Budget Expectation

- We expect Budget 2027 to be moderately supportive but fiscally disciplined. The policy balance is likely to be:

Chart 1: 2027 Budget Expectation

Area	2027 Budget Expectation/View
GDP Growth	4.6%
Fiscal Deficit	~3.4% of GDP
Federal Revenue	~RM370bn
Total Expenditure	~RM440-RM445bn
Development Expenditure	~RM85bn
Gross Bond Issuance	RM175-RM180bn
Household Support	Higher, but targeted
Subsidies	Further rationalization, with targeted protection
Tax Policy	Compliance/reform rather than major new taxes
Infrastructure	Higher focus on execution and productivity
Growth Strategy	AI, semiconductors. Digital, energy transition and regional development

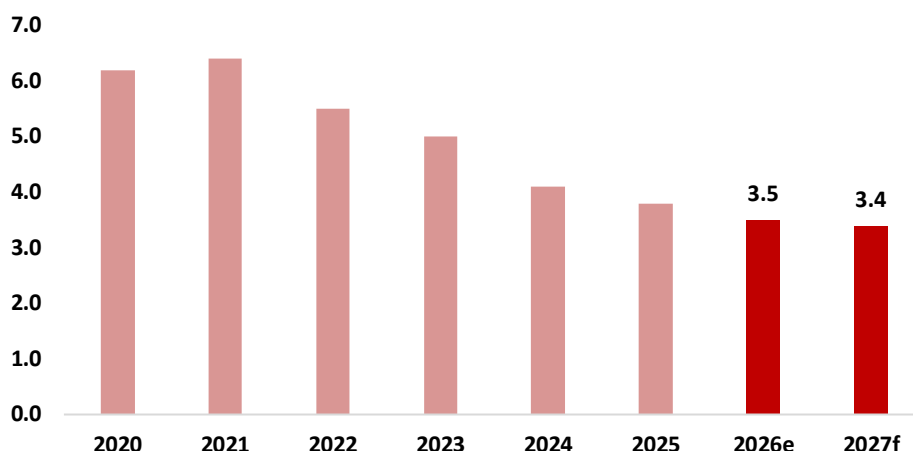
Sources: Bank Islam

BUDGET 2027 PREVIEW

Fiscal consolidation remains the anchor

- We expect the Government to maintain its medium-term fiscal consolidation path, with the deficit narrowing to approximately 3.4% of GDP in 2027.
- This should be achieved less through aggressive spending cuts and more through a combination of:
 - stronger tax collection and compliance
 - continued subsidy rationalisation
 - higher petroleum-related revenue
 - expenditure prioritisation
 - stronger development spending relative to less productive operating expenditure
- Our central estimate is for federal revenue of around RM370bn, with total expenditure at approximately RM440-445bn.
- The important point is that a larger nominal budget does not necessarily imply a significantly more expansionary fiscal stance. Higher expenditure will partly reflect higher operating costs, social protection and ongoing project commitments, while revenue growth and subsidy savings should help contain the deficit.
- In short, fiscal consolidation will continue, but the pace is likely to be gradual. The Government is unlikely to sacrifice household support or development expenditure simply to achieve a faster deficit reduction.

Chart 2: Fiscal Deficit, %



Sources: MOF, Bank Islam

Household support remains a key Budget 2027 feature

- Cost-of-living pressures are likely to remain politically and economically important despite relatively moderate headline inflation.
- We expect further targeted rather than universal assistance, particularly through:
 - higher STR/SARA allocations
 - targeted fuel and electricity subsidies
 - selected personal income tax relief
 - healthcare and childcare-related relief
 - support for vulnerable households
 - housing and first-home incentives
 - potentially additional support for middle-income households
- The emphasis on the M40 segment is particularly notable. The Government has also already brought forward several measures, including the restoration of BUDI95 and Budi Diesel quotas, higher school maintenance allocations, additional microfinancing and healthcare digitalisation. This reduces the need for Budget 2027 to introduce another large, broad-based consumption stimulus.
- Therefore, the policy mix should increasingly shift from blanket subsidies towards targeted income support, allowing the Government to protect vulnerable households without significantly reversing fiscal consolidation.

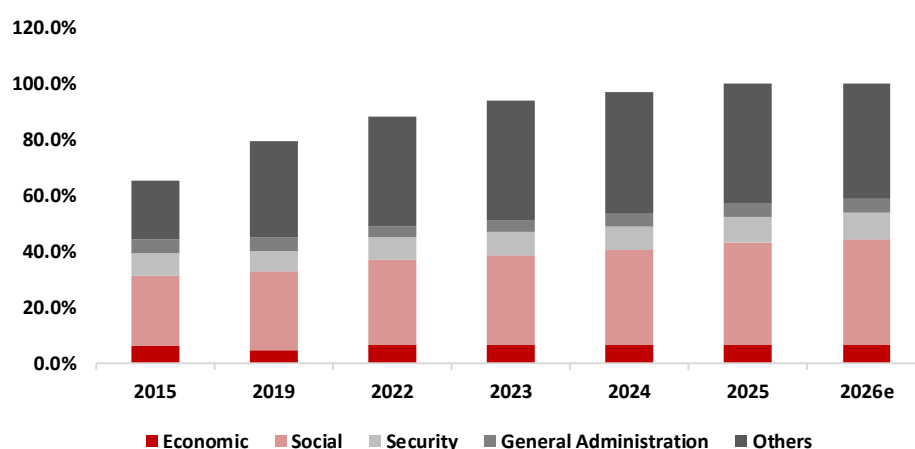
Operating Expenditure: Ongoing reform towards more targeted assistance

- On the expenditure side, **operating expenditure (OE) is expected to remain the dominant component of federal spending**, accounting for around 80% of total expenditure. Key spending items will continue to include emoluments, debt service charges, subsidies and social assistance,

as well as pension and retirement-related payments. The large share of these relatively fixed commitments limits fiscal flexibility and reduces the scope for substantial increases in growth-enhancing expenditure. Nevertheless, the government's ongoing fiscal reform agenda is likely to reinforce the shift from broad-based subsidies towards more targeted assistance mechanisms. Programmes such as STR and SARA are expected to remain important tools for protecting vulnerable households while improving the efficiency of public spending.

- However, fiscal risks remain tilted to the downside. Elevated global energy prices associated with geopolitical tensions in the Middle East have significantly increased subsidy costs, with the potential fuel subsidy burden estimated to approach RM40 billion in 2026. While higher oil prices may provide some offset through stronger petroleum-related revenue, the increase in subsidy expenditure could slow the government's fiscal consolidation efforts. This emphasizes the challenges of subsidy reform, as external energy shocks can quickly reopen fiscal pressures even after targeted subsidy mechanisms have been introduced. Against this backdrop, Budget 2027 will need to strike a careful balance between preserving affordability for households and businesses, maintaining fiscal sustainability, and strengthening incentives for more efficient energy consumption

Chart 3: Operating Expenditure by Sector, % of Operating Expenditure



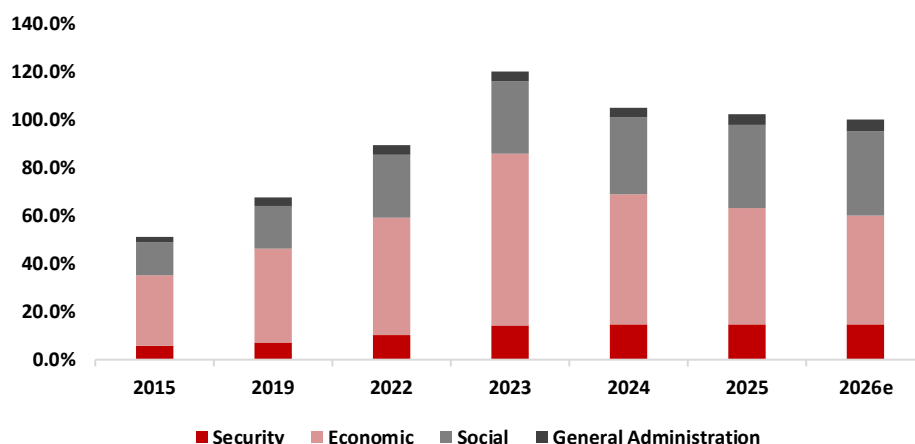
Sources: MOF, Bank Islam

Development spending: from spending more to spending better

- We expect **development expenditure (DE)** to rise to around **RM85bn**, or potentially somewhat higher depending on the final project pipeline. DE is expected to remain a key policy lever under Budget 2027, supporting the implementation of the 13MP and the government's broader economic transformation agenda.
- The focus should be on projects with measurable economic spillovers rather than simply increasing the number of projects.
- Likely priorities include:
 - **Infrastructure**
 - transport and rail connectivity

- water infrastructure
 - flood mitigation
 - roads and bridges
 - Sabah and Sarawak infrastructure
 - JS-SEZ-related infrastructure
 - **Digital and technology**
 - AI and digitalisation
 - data-centre infrastructure
 - cloud computing
 - semiconductor ecosystems
 - advanced manufacturing
 - **Energy transition**
 - renewable energy
 - climate resilience
 - grid upgrades
 - battery storage
 - electricity infrastructure
 - EV ecosystem
 - **Human capital**
 - TVET
 - healthcare
 - education
 - digital and AI skills
- In particular, investment in the energy sector is expected to gain further momentum amid heightened concerns over energy security following recent global energy market disruptions. The government's commitment under the National Energy Transition Roadmap (NETR) is likely to accelerate, with greater emphasis on expanding renewable energy capacity, battery energy storage systems, grid modernisation and cross-border electricity connectivity through the ASEAN Power Grid initiative.
- At the same time, higher coal and natural gas prices have highlighted the vulnerability of electricity generation to external energy shocks, reinforcing the need to diversify Malaysia's energy mix. As such, additional allocations may be directed towards renewable energy projects, energy-efficiency initiatives, smart-grid development and upgrades to transmission infrastructure. Investments in water infrastructure, flood mitigation, and climate adaptation measures are also expected to remain important as the government seeks to strengthen long-term economic resilience and sustainability.
- The effectiveness of Budget 2027, in our opinion, should ultimately be judged by execution and productivity gains, not the size of the allocation. Faster procurement and project implementation would generate a stronger economic multiplier than simply announcing additional allocations, reflecting the government's objective of balancing near-term support measures with long-term structural reforms and sustainable growth.

Chart 4: Development Expenditure by Sector, % of Development Expenditure



Sources: MOF, Bank Islam

Revenue: Consolidation Without a Major New Tax

- In 2026, government revenue is anticipated to outperform initial projections, partially supported by the impact of ongoing tax reforms and stronger oil-related receipts amid elevated global energy prices. Malaysia's fiscal position remains highly sensitive to fluctuations in the global oil market given the existing fuel subsidy framework. Following the escalation of U.S.-Iran tensions earlier this year, oil prices have largely trended higher, creating a significant upside risk to subsidy expenditure. The sustainability of the fiscal deficit target becomes increasingly dependent on how the ballooning expenditure could be mitigated by revenue growth.
- The conundrum yields a relatively simple answer. **Higher oil prices are expected to provide a boost to petroleum-related revenue**, partially cushioning the impact of a larger subsidy bill. Under the Budget 2026 assumption of Brent crude averaging between USD60-65/bbl, petroleum income tax (PITA) and petroleum royalty are projected at RM15.7 billion and RM5.1 billion, respectively. Assuming that these petroleum-related revenue rises proportionally to crude prices, a higher Brent assumption of USD95/bbl could lift PITA collections by RM7-9 billion while petroleum royalty could rise higher by RM2-3 billion. This implies potential additional oil-related receipts of RM9-12 billion, while possible upside from Petronas dividends would further improve total revenue.
- **Government revenue is expected to moderate in 2027** as global oil prices normalise while expectations for new tax measures remain limited. Despite recent efforts to diversify its revenue profile, Malaysia maintains a relatively notable reliance on petroleum-related income, leaving revenue vulnerable to a moderation in global crude prices. Additionally, the government is unlikely to introduce new taxes, preferring a more growth-supportive stance to stimulate domestic demand amid persistent global uncertainties. As such, Malaysia's tax base is expected to remain relatively narrow, limiting the scope for significant revenue expansion through new taxation measures.
- Nevertheless, the full-year implementation of **earlier tax reforms is expected to continue to**

provide structural support for government revenue. Measures such as the Sales and Service Tax (SST) framework revision, higher duties on selected imports and improved tax administration are expected to strengthen revenue collection, with signs of these reforms already materializing. Notably, the SST to GDP ratio had increased to 2.8% in 2025 from 1.7% in 2022, while its share to total revenue surged to 16.6% (2022: 10.7%). Additionally, indirect adjustments, particularly the civil servant salary hike, could support revenue through higher income tax collection. Taken together, stronger enforcement and continued implementation efforts are expected to enhance collection efficiency, supporting the view that Budget 2027 will likely focus on optimizing collection from these existing revenue streams.

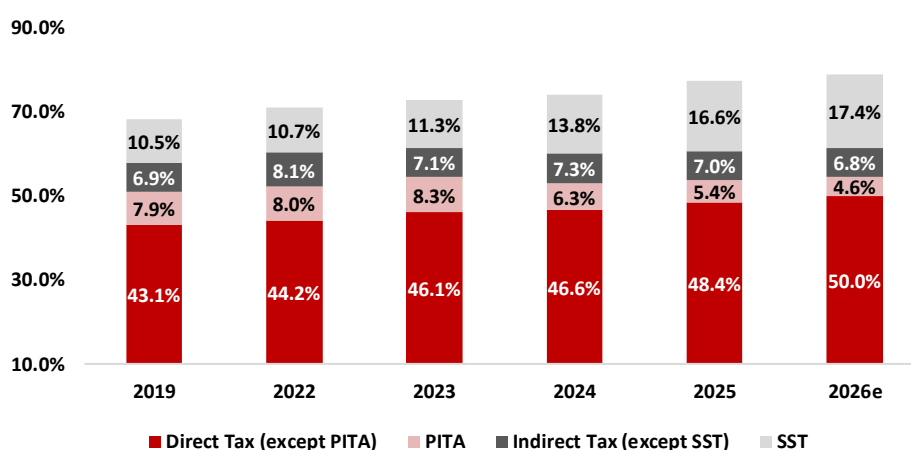
Chart 5: Key Revenue Streams

Reform measures	Optimisation of Revenue
Expansion of the Service Tax Framework	Between 2024-2025, the Service Tax rate was raised to 8% from 6%, with targeted exemptions in place, while the scope was broadened to cover six additional commercial service categories. As a result, the contribution of service tax to total revenue has risen to 9.0% in 2025 (2022: 5.1%).
Sales Tax Revision	The Sales Tax framework was revised in July 2025, with rates for selected discretionary goods raised between 5% to 10%. The measure had visibly translated into stronger collections, with sales tax accounting for 7.6% of total revenue in 2025 (2022: 5.5%), with the ratio expected to improve further amid the full-year implementation of the revised framework.
e-Invoicing	The implementation of e-Invoicing is expected to strengthen tax administration and improve compliance by enhancing transaction visibility and reducing leakages, which would help establish a more transparent tax system.
Service Scheme and Pay Adjustment (SSPA)	Phase 2 of the civil servant salary adjustment was implemented in January 2026, resulting in meaningfully higher wages for a significant share of Malaysia's labour force. The fiscal impact of this is expected to materialize through stronger income tax collection, while also strengthening broader consumption-related revenue streams over a longer period.
Minimum Wage Level Increase	The minimum wage was previously raised to RM1,700, reinforcing broader efforts to improve household income levels. Although the direct contribution to income tax revenue will be limited, the measure is likely to have cascading effects by raising the minimum wage floor, resulting in higher base pay across industries.
Import and Excise Duties	Several reforms have been introduced, including higher excise duties for selected imports and the expiry of import duty exemptions for imported Electric Vehicles (EVs), which are expected to provide additional support to government revenue. While individual contributions may be modest, the cumulative impact of these measures should help strengthen non-oil revenue receipts.

Source: Bank Islam

- In short, we do not expect Budget 2027 to be a major tax-raising budget. Instead, revenue enhancement should come primarily from:
 - better tax compliance and enforcement
 - wider adoption of e-Invoicing
 - continued SST collection
 - Global Minimum Tax receipts
 - improved tax administration
 - potential carbon pricing
 - petroleum-related revenue
- We therefore expect **tax reform to be evolutionary rather than disruptive**. Any refinement to SST should focus on reducing cascading effects, improving input relief and strengthening administration rather than introducing a new broad-based consumption tax.

Chart 6: Revenue by Component, % of Total Revenue



Sources: MOF, Bank Islam

Subsidies: the key fiscal swing factor

- Subsidy expenditure will remain one of the most important variables determining the final fiscal outcome.
- The Government has already demonstrated its willingness to move towards targeted subsidies, but the Middle East conflict and higher oil prices have complicated the adjustment. We also noted that fuel subsidy savings achieved through rationalisation have been partly absorbed by higher global energy prices.
- Our base case assumes that fuel prices and subsidy requirements moderate from the elevated levels seen in 2026. This should allow some fiscal savings to be redirected towards:
 - STR/SARA
 - infrastructure
 - healthcare and education
 - productivity-enhancing investment

- However, oil prices remain the principal upside risk to the fiscal deficit. A sustained rise in Brent would simultaneously increase subsidy requirements, while potentially weakening the current account and inflation outlook.

Borrowing and the bond market

- We expect gross government bond issuance to remain substantial but slightly lower than 2026, mainly because scheduled maturities are lower.
- This should provide some technical support to the MGS market, although the relief will be partly offset by:
 - elevated global bond yields
 - higher US Treasury yields
 - persistent government borrowing requirements
 - inflation and oil-price risks
 - uncertainty over the global monetary policy cycle
- We viewed that Budget 2027 should be broadly neutral to mildly supportive of the MGS market from a supply perspective, but the global duration environment will remain the more important driver of yields.

Key Budget 2027 Focus Areas

- The **energy** issue could consequently become one of the defining themes of Budget 2027. The current oil shock reinforces the importance of reducing Malaysia's vulnerability to externally driven energy price volatility. In the short term, targeted fuel and electricity assistance can help cushion households and businesses from excessive cost increases. However, longer-term resilience requires greater investment in renewable energy, grid capacity, energy storage and energy efficiency. The Government's Pre-Budget Statement has already identified clean-energy transition and energy resilience as key priorities, alongside food security, climate adaptation and disaster preparedness (refer to Chart 7 for other focus areas announced during 2027 Pre-Budget Statement). The current geopolitical environment strengthens the economic rationale for these measures. Energy transition is not only a climate objective but also an important form of macroeconomic risk management.
- **Food security** is closely linked to this energy challenge. Malaysia's reliance on imported food and agricultural inputs exposes domestic prices to international commodity prices, exchange-rate movements, freight costs and geopolitical disruptions. Higher energy prices can increase the cost of fertilizer, animal feed, transportation and agricultural production, while adverse weather can further constrain domestic supply. Budget 2027 therefore provides an opportunity to strengthen agricultural productivity rather than relying predominantly on price interventions. Investment in irrigation, agricultural technology, storage, cold-chain infrastructure and supply-chain efficiency could reduce structural vulnerabilities while improving farmers' productivity and incomes. The Government has already identified agri-food productivity and agricultural technology as areas of focus, reflecting the increasing importance of food security within the broader resilience agenda.

- **Water security** should similarly receive greater attention as Malaysia moves towards more resource-intensive industries. Rapid industrialisation, urbanisation and the expansion of data centres will increase demand for reliable electricity and water infrastructure. This creates a potentially important constraint on Malaysia's ability to attract investment if infrastructure capacity does not keep pace with demand. Water investment should therefore be viewed not merely as basic infrastructure expenditure but as an enabler of industrial growth. At the same time, climate change is increasing the economic costs associated with floods, droughts and extreme weather. Investment in flood mitigation, water infrastructure and climate adaptation may require substantial upfront expenditure, but underinvestment could ultimately generate larger fiscal costs through infrastructure damage, disaster relief, business disruption and agricultural losses. The Government's stated intention to accelerate flood mitigation, disaster preparedness and climate adaptation is therefore economically relevant beyond environmental considerations.

Chart 7: Budget 2027 Pre-Budget Statement: 10 Focus Areas at a Glance

No.	Focus Area	Key Priorities
1	Social Justice and Development for All	Reduce regional development gaps; strengthen Sabah, Sarawak, rural areas; empower MSMEs, cooperatives, youth, women and vulnerable groups; improve housing affordability, public transport and urban livability.
2	Protecting the People Against Cost-of-Living Pressures	Improve subsidy targeting and social assistance; strengthen STR, SARA and BUDI MADANI; stabilise prices of essential goods
3	Strengthening Social Protection for Affected Families	Expand EPF and SOCSO coverage; protect gig and informal workers; prepare for ageing society; develop care economy and long-term care services.
4	Empowering Education, Healthcare and Essential Services	Strengthen education reforms, STEM, AI and TVET; improve healthcare accessibility and affordability; enhance public infrastructure and digital connectivity.
5	Spending That Delivers the Best Value for the People	Improve spending efficiency; strengthen subsidy management; prioritize high-impact projects; enhance outcome-based budgeting and monitoring.
6	Governance and the Best Delivery of Public Services	Strengthening fiscal management, procurement and anti-corruption reforms; accelerate digital government services; improve public-sector performance
7	Prioritizing Workers' Welfare and Decent Wages	Promote productivity-driven wage growth; expand TVET, apprenticeships and reskilling; encourage women's labour participation; reduce dependence on low-skilled foreign labour.
8	Competitive Home-Grown Entrepreneurs and "Made by Malaysia"	Support start-ups and SMEs through financing, technology, certification and market access; promote local innovation and commercialisation of R&D.

9	Growth Through Investment and High-Value Jobs	Attract high-quality investments; strengthen local supply chains; focus on semiconductors, AI, digital services, energy transition and aerospace; improve investment implementation.
10	Building Energy, Food, Climate and Cyber Security	Accelerate renewable energy transition; strengthen food security; improve climate resilience, flood mitigation and disaster preparedness; enhance cybersecurity and critical infrastructure protection.

Sources: MOF, Bank Islam

Chart 8: Key Policy Signals

Theme	Likely Budget 2027 Direction
Cost of Living	Further enhancement of STR, SARA and targeted subsidies
Energy	Additional support for renewable energy, battery storage, grid upgrades and Energy Efficiency and Conservation Act (EECA) implementation
AI & Digital Economy	Greater incentives for AI adoption, talent development and digitalisation
Investment	Outcome-based incentives tied to jobs, local sourcing and technology transfer
MSMEs	Expanded financing guarantees and digitalisation support
Labour Market	More TVET, reskilling and progressive wage-related initiatives
Housing	Measures to improve affordability, especially for first-time buyers and renters
Healthcare	Public-private collaboration to contain healthcare inflation and improve access
Fiscal Policy	Continued fiscal consolidation while maintaining targeted support programmes
Data Centres	Stronger energy and water efficiency requirements tied to incentives

Sources: MOF, Bank Islam

Economic Review

- **Malaysia enters Budget 2027 with resilient economic momentum**, as GDP growth accelerated to 6.0% y-o-y in 2Q26 from 5.4% in 1Q26. Despite the strong performance, growing economic divide and uneven economic recovery is more visible. The 1H2026 witnessed a marked improvement in external demand amid the recovery in the global technology cycle and continued investment activity, particularly in artificial intelligence (AI)-related investments and data centre expansion. This was reflected in net exports of goods and services, which surged by 168.5% y-o-y growth in 2Q26, supported by robust demand for semiconductors during the period.
- In the first eight months of 2026, **exports of electrical and electronic (E&E) products expanded by 46.7% y-o-y**, significantly higher than the 16.5% growth recorded in the corresponding period last year. The strong demand for E&E products was reflected in the manufacturing sector, which accelerated to 7.3% y-o-y in 2Q26 from 5.9% in the preceding quarter. The electronic components and boards segments alone contributed approximately 3.9 percentage points (ppts) to overall manufacturing growth in 2Q26 and accounted for more than 25.0% of manufacturing GDP.

Chart 9: Malaysia's Economic Performance

Economy	2Q25	3Q25	4Q25	1Q26	2Q26
GDP (by expenditure)	4.6	5.3	6.2	5.4	6.0
Final Consumption Expenditure	5.5	5.4	5.8	4.6	5.2
Private Consumption	5.1	5.8	5.6	4.7	4.8
Public Consumption	5.7	5.8	6.6	4.1	7.6
Gross Fixed Capital Formation (GFCF)	12.0	7.4	9.3	7.3	4.6
Private Investment	11.7	7.4	9.2	7.8	4.3
Public Investment	13.5	7.5	9.5	5.3	6.3
Net Exports of Good and Services	-58.3	32.2	-32.9	13.5	168.5
Exports	4.5	4.6	6.3	5.2	17.0
Imports	7.9	3.0	9.0	4.6	13.9
GDP (by economic activity)	4.6	5.3	6.2	5.4	6.0
Agriculture	2.5	0.2	5.7	2.6	-3.7
Mining & Quarrying	-5.2	9.4	1.4	-2.1	9.2
Manufacturing	3.7	4.1	6.0	5.9	7.3
Construction	12.1	11.7	10.9	7.7	6.5
Services	5.1	5.3	6.2	5.6	5.9

Sources: Ministry of Finance (MOF), Department of Statistics Malaysia (DOSM), Bank Islam

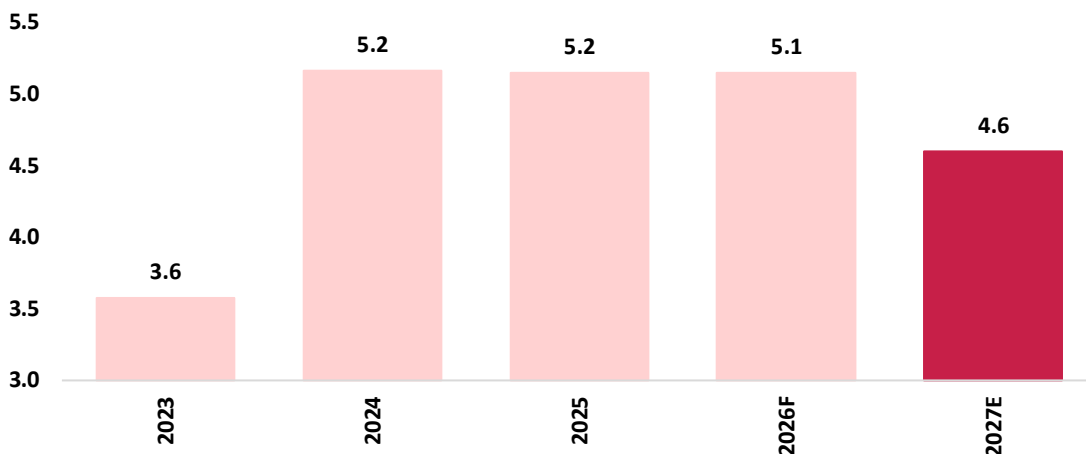
- Nevertheless, **private consumption growth moderated to below 5.0% for two consecutive quarters** after the exceptionally strong pace seen in late 2025. This reflects the fading impact of earlier policy support and front-loaded spending, alongside persistent cost-of-living pressures. Although retail sales remain resilient, growth has eased for two consecutive months, registering 6.4% y-o-y in July 2026. Higher global energy prices, driven partly by escalating geopolitical tensions in the Middle East, have indirectly weighed on household purchasing power through the pass-through of costs to consumer prices, while heightened uncertainty surrounding the conflict may have also encouraged consumers to adopt a more cautious approach to spending.
- Despite the strong growth in the first half of the year, we expect some moderation moving into 2H26. The external environment could become the key downside risk if geopolitical tensions persist, energy prices remain elevated and global trade conditions deteriorate. On the positive note, growth will continue to be supported by resilient demand for E&E products amid the ongoing semiconductor upcycle and supply-chain diversification trends. In addition, demand for machinery and equipment is expected to strengthen further, underpinned by continued investments in automation and digital infrastructure. **Overall, we project Malaysia's GDP to expand by 5.1% y-o-y in 2026.**

Economic Outlook

- The stronger-than-expected performance in 2026 provides the Government with some comfort as it continues fiscal consolidation, but the **outlook for 2027 will be shaped by a more uncertain external environment**. In particular, the ongoing tensions between the U.S. and Iran, which have increasingly broadened across the region, could heighten volatility in global commodity markets, especially energy prices.

- Recent geopolitical developments in the Middle East have intensified concerns over potential disruptions to global energy supply, pushing Brent crude oil prices above USD100/ barrel. **Should tensions persist and extend into 2027, the risk of sustained elevated energy prices could pose renewed challenges to inflation, household purchasing power and business operating costs.**
- Rising global energy prices create a policy dilemma, as higher oil prices may support petroleum-related revenue while simultaneously increasing fuel subsidy requirements, transportation costs and inflationary pressures. These represent key downside risks to the 2027 outlook, particularly if prolonged disruptions in the Strait of Hormuz and Bab Al-Mandeb affect global trade routes and energy flows.
- Heightened uncertainty and supply disruptions could also encourage resource-rich countries to prioritise domestic consumption through export restrictions,** further weighing on global trade and amplifying inflationary pressures, alongside expectations of lower agricultural output due to El Niño-related weather disruptions.

Chart 10: Real GDP, y-o-y %

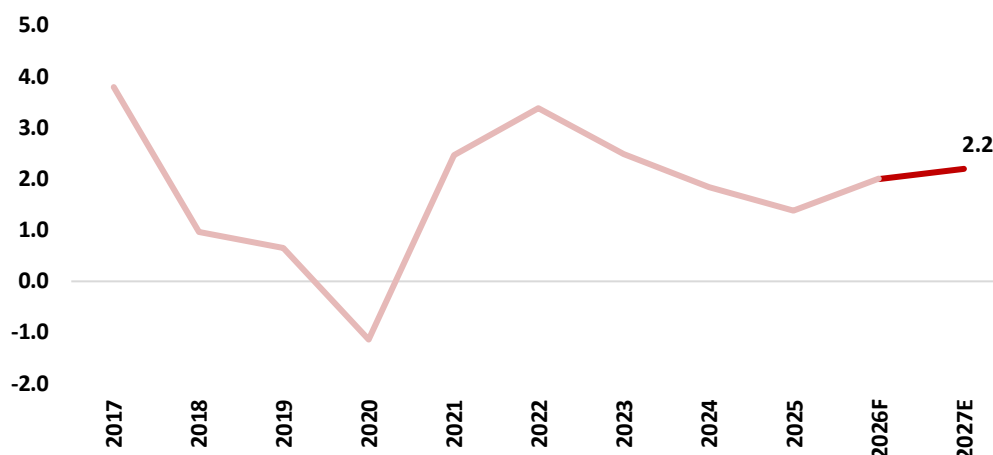


Sources: MOF, DOSM, Bank Islam

- Economic growth is projected to moderate to 4.6% in 2027,** reflecting a normalisation following the strong expansion registered in 2026 as favorable base effects dissipate and external demand becomes less supportive. While household spending is expected to remain resilient, underpinned by healthy labour market conditions, wage growth and continued government support through targeted assistance programmes such as STR and SARA, as well as fuel subsidies, households are likely to remain constrained by elevated living costs. Nonetheless, further tax relief measures for the M40 income group are anticipated to partially offset these pressures and lend support to private consumption.
- By sector,** the **services** sector is expected to remain the primary driver of growth, supported by the extension of Visit Malaysia Year until end-2027. Meanwhile, **manufacturing** activity is likely to expand at a slower pace as the exceptionally strong E&E demand seen in 2026 normalises. **Construction** activity is believed to remain supported by ongoing data centre developments and continued investments in renewable energy infrastructure, affordable housing and other strategic projects under the NETR and New Industrial Master Plan (NIMP). The **mining** sector,

however, is expected to moderate following its earlier rebound, as production facilities resume normal operations and output growth normalises. The **agriculture** sector is expected to remain weak in 2027, reflecting lower agricultural production due to El Niño-related weather conditions and reduced fertiliser application amid higher input costs stemming from elevated global energy prices linked to the U.S.-Iran conflict.

Chart 11: Headline Inflation, y-o-y %



Sources: MOF, DOSM, Bank Islam

- In 2027, headline inflation is projected to increase by 2.2% y-o-y**, up from an estimated 2.0% in 2026. While overall inflation remains relatively contained, rising by 1.9% y-o-y in August 2026 and averaging 1.8% during the first eight months of the year, food inflation has begun to show signs of gradual acceleration. In particular, inflation for food at home rose by 1.4% y-o-y, marking its highest increase since October 2023 (+2.1%). Selected food categories, particularly meat and vegetables, have recorded faster price increases in recent months, suggesting a lagged pass-through from higher energy costs following the escalation of the U.S.-Iran conflict beginning in March 2026. Looking ahead, food prices are expected to continue trending upward in 2027, compounded by lower agricultural production arising from El Niño-related weather conditions, which could constrain food supply and place additional pressure on prices. Meanwhile, transport inflation is expected to remain relatively subdued and partially offset food-related price pressures, provided the government maintains fuel subsidies next year.
- The labour market is expected to remain resilient in 2027**, with full employment conditions broadly maintained, while the unemployment rate is projected to stand at 3.1%. Job creation is likely to remain concentrated in the services sector, especially tourism-related activities. Nevertheless, persistent cost-of-living pressures may encourage greater prudence in household spending, potentially moderating labour demand in retail-related segments. At the same time, higher energy costs could increase business operating expenses, leading firms to exercise greater caution in their hiring decisions.

- Overall, **we expect Malaysia's economy to remain resilient in 2027, with GDP growth around 4.6%**, supported by:
 - continued investment in semiconductors and data centres
 - resilient domestic consumption
 - infrastructure investment
 - services-sector recovery
 - tourism
 - digitalisation and AI-related investment
- The 13MP targets annual GDP growth of 4.5%-5.5% between 2026 and 2030, alongside stronger productivity growth and higher median wages.
- The key issue is therefore not whether Budget 2027 can generate another short-term consumption boost, but whether it can raise Malaysia's productive capacity.
- This means greater emphasis should be placed on productivity, technology transfer, domestic value-added, skilled employment and local supply chains. This is particularly important given Malaysia's growing exposure to data centres, semiconductors and the global technology investment cycle.

Bottom line

- Budget 2027 should not be viewed as a return to broad fiscal expansion. Instead, it is likely to represent a recalibration of fiscal policy, providing targeted relief to households while reallocating fiscal resources towards infrastructure, investment and productivity.
- The biggest test will be whether the Government can raise the quality of spending while maintaining fiscal consolidation. A deficit of around 3.4% of GDP would keep Malaysia broadly on its medium-term consolidation path, but the durability of that trajectory will depend increasingly on revenue diversification and disciplined subsidy management, rather than relying on stronger GDP growth or petroleum receipts.
- For financial markets, the combination of a contained deficit and slightly lower bond issuance should be broadly supportive of MGS, although global bond yields remain the dominant risk. For the domestic economy, the larger impact should come from the composition of development spending and targeted household support, rather than the headline budget size.