

19 August 2026

The Other Energy Shock

Malaysia's fiscal case for diversification

OVERVIEW

- **Malaysia is net short oil on the fiscal account.** MoF estimates that each USD1.0/barrel (bbl) move raises federal petroleum revenue by RM300.0m a year, excluding PETRONAS dividends. We estimate the subsidy cost beta at about RM1.05b a year. The revenue offset therefore covers under a third of the increase. **We put the net fiscal exposure at roughly RM750.0m a year for each USD1.0/bbl, or about RM7.5b for a USD10.0/bbl move.**
- **The fiscal exposure has a relatively low strike.** Our analysis puts the **RON95 subsidy strike at around USD44.0/bbl Brent and the diesel strike at around USD48.0/bbl** following the RM2.10 BUDI Diesel price, both on a futures basis. Neither strike is close to our USD80.0/bbl average house-view for 2026, so the exposure persists even without another major oil shock.
- **Targeting has already reduced that exposure.** BUDI95 is delivering estimated annual savings of RM2.5b to RM4.0b, and BUDI Diesel a further RM2.0b from July, taking combined targeting savings to RM4.5b to RM6.0b annually. The Ministry of Finance (MoF) has consistently framed the savings as fiscal space for education, healthcare and public transport infrastructure.
- **The scale of the exposure makes the reform consequential.** MoF put combined RON95 and diesel subsidies at around RM3.5b per month at Brent near USD90.0/bbl, split RM2.0b RON95 and RM1.5b diesel. **MoF expects petroleum product subsidies of almost RM40.0b in 2026; we estimate RM38.0b to RM43.0b.** That single year approaches TENAGA's entire three-year RP4 capex allowance of RM42.8b.
- **Rebalancing Malaysia's energy exposure is the durable fix.** The options differ sharply in capital intensity, balance sheet location, import content and time to first contribution. We assess them on these dimensions rather than by technology.
- **Fixed income: Fuel subsidies are increasingly a direct input into fiscal supply.** A sustained rise in the unsubsidised pump price would widen the deficit before any policy response, making the monthly subsidy trajectory an early indicator of MGS supply pressure. This cuts both ways: administered pump prices also suppress headline inflation, which anchors the front end. We retain our 10Y MGS forecast at 3.60%.
- **FX: The longer-term ringgit benefit comes from a stronger external balance and rising economic complexity** as energy investment deepens domestic capacity. However, the buildout initially increases imports of capital goods, creating a near-term drag on the trade balance. We retain our USDMYR forecasts at 3.95 for end-2026.

CONTEXT

- **The recent oil shock has exposed a less visible vulnerability in Malaysia's energy balance.** Malaysia remains a net energy exporter, but its fiscal position is exposed to refined product prices through subsidy, while its trade position is short crude and long LNG exposure. The West Asia crisis reinforces the case for reducing the economy's exposure to subsidised fossil fuel consumption while preserving fiscal capacity for the energy infrastructure that rising electricity demand requires.

FROM COMMODITY SHOCK TO BALANCE SHEET TRANSITION

- **The transmission from oil prices to the Malaysian economy has changed at the margin.** The familiar pattern was straightforward. Higher oil prices lifted export revenue and PETRONAS receipts and supported the external position. That benefit still exists.

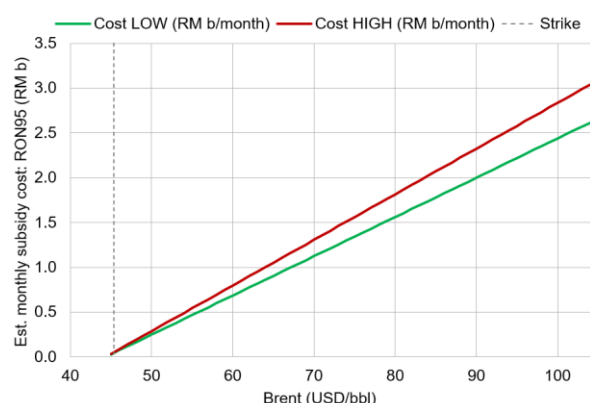
19 August 2026

- **What is new is the offsetting fiscal leg.** Higher oil raises the unsubsidised pump price while the subsidised price stays fixed. The fiscal transfer therefore widens automatically. MoF puts the fuel subsidy bill at RM0.8b a month in January and February, RM5.0b in March and April, and RM4.0b in May and June as prices moderated. For a steady state, MoF estimates about RM3.5b a month at Brent near USD90.0/bbl. Applying our estimated pass-through to the first-half outturn implies a 2026 total of roughly RM38.0b to RM43.0b (lower bound: USD80.0/bbl; upper bound: USD90.0/bbl).
- **Diesel drove the March and April spike, not petrol.** Unsubsidised diesel averaged RM5.80/litre in April against RON95 at RM4.01, a subsidy gap of RM3.65 versus RM2.02. A RON95-only view therefore understates the total exposure precisely when prices spike.
- **A second energy shock runs in the opposite direction.** AI workloads are driving data centre load, which is lifting peak electricity demand and requiring network and generation investment. That investment is recorded as productive capital formation and earns a regulated return.
- **This note treats the two as one balance-sheet question.** One converts a price Malaysia does not set into a recurring fiscal transfer. The other converts demand growth into an asset. Targeting fuel subsidies while expanding energy infrastructure shifts the composition of energy-related spending from consumption towards productive capital formation. The investment is undertaken through TNB rather than directly by the government, and with GLICs collectively holding more than 60.0% of TNB, the resulting earnings accrue substantially to government-linked investors.

THE SUBSIDY IS AN OIL PRICE EXPOSURE AND TARGETING IS SHRINKING IT

- **The subsidy structure behaves like an option.** The government sells fuel at a fixed price and buys it at a floating market price. It absorbs the difference. The fiscal payout is zero below the administered price and rises broadly linearly above it, scaled by subsidised volume. Volume is therefore the policy lever. Development spending, by contrast, is discretionary and allocation based. The quota fell from 300 to 200 litres a month on 1 April 2026, and we expect it to stay at 200 litres.
- **We put the subsidy strike at around USD44.0/bbl.** We regress weekly unsubsidised RON95 prices on the prior week's average Brent price over the BUDI95 float period from October 2025 to August 2026. This gives an estimated pass-through of RM0.034/litre for each USD1.0/bbl move in Brent. The fitted relationship puts the unsubsidised RON95 price at the RM1.99 subsidised price when Brent is near USD44.0/bbl. At that level the modelled RON95 fiscal exposure falls to zero. The strike is a gross measure. It does not net off any second-round revenue from the activity that lower pump prices support, which would raise the true break-even somewhat, though fuel subsidy multipliers are typically low and the adjustment would not change the conclusion.
- **Diesel carries the steeper exposure.** The same method applied to diesel gives a pass-through of RM0.059/litre per USD1.0/bbl, 1.7 times the RON95 coefficient, and a strike near USD48.0/bbl against the RM2.10 BUDI Diesel price. Diesel therefore reprices faster than petrol for any given move in Brent.
- **BUDI Diesel reduces leakage but reintroduces price exposure.** MoF identified diesel consumption rising from about 624.0m litres a month to almost 1.2b litres. Sabah and Sarawak alone use close to 2.0b litres a year against an estimated requirement of 1.0b. From 1 July, 700.0k private diesel vehicle owners receive subsidised diesel at RM2.10 through MyKad verification. This replaces a fixed RM400 monthly cash transfer. Removing leakage is positive. However, a fixed cash transfer carries no oil price exposure, while a per-litre subsidy does. The reform trades a leakage problem for a volatility one.

Graph 1: RON95 subsidy pass-through



Source: Bloomberg, Kenanga Research

Note: The band spans the MoF-calibrated volume and the stated 13.4b-over-nine-months volume.

19 August 2026

- **The exposure therefore persists across our forecast range.** Our house view of Brent averaging USD80.0/bbl in 2026 leaves Brent USD36.0 above the estimated strike. At USD80.0/bbl the model implies a subsidy gap of about RM1.22/litre and a RON95 cost of about RM1.8b a month. At Brent near USD90.0/bbl it implies about RM2.3b, modestly above MoF's RM2.0b, because it applies the full gap to every subsidised litre. We therefore treat our estimate as an upper bound.
- **Targeting has produced measurable and structural savings.** More than 14.2m of 16.7m eligible Malaysians have used BUDI95, covering over 13.4b litres of RON95 from October 2025 to June 2026. Average consumption is near 100 litres a month, and fewer than 1.0% of users consistently exceed 200 litres. Estimated annual savings of RM2.5b to RM4.0b are modest against the gross outlay. They are nonetheless permanent savings from removing non-citizen and commercial leakage, not savings driven by the oil price. The OECD recommends a gradual phase-out over the medium term, and the World Bank suggests a modest price adjustment.
- **We prefer further targeting to an immediate increase in the administered price.** MoF stated on 15 July that it will not reduce existing subsidies, consistent with our expectation of an expansionary Budget 2027. We therefore expect the current administered price and eligibility framework to remain in place until the election. Post-election, we see scope for further subsidy rationalisation, including a gradual increase in the administered price to strengthen the fiscal position.

WHY LNG, NOT OIL, MAKES MALAYSIA'S ENERGY BALANCE POSITIVE

- **Malaysia is a net oil importer; LNG is what makes the headline positive.** In 2025, Malaysia ran a RM30.4b deficit in crude and condensate and only a RM3.2b surplus in refined products, resulting in a combined petroleum deficit of RM27.2b. The overall oil and gas surplus of RM18.2b exists because of a RM45.4b LNG surplus.
- **The distinction matters for the fiscal account.** The fuel subsidy is linked to refined product prices, while LNG receipts accrue to a different fiscal line and arrive with a lag. Higher oil prices therefore protect the budget far less than the overall energy export position implies.
- **PETRONAS provides an important offset, but not on a one-for-one basis with the subsidy bill.** MoF estimated that every USD1.0/bbl increase in Brent generates RM300.0m in additional revenue, excluding dividends, covering under a third of the corresponding subsidy increase in our estimates. Dividends provide an additional buffer, but sit on a different fiscal line and arrive with a lag. We project petroleum income tax and PETRONAS dividends at RM35.0b-40.0b in 2026, well above the initial Budget 2026 projection. While this broadly matches the subsidy bill in level terms, the two do not move together. Heavy dividend extraction could also constrain PETRONAS' capital reinvestment, creating longer-term fiscal and energy security risks.

Table 1: RON95 subsidy sensitivity to pump prices

Unsubsidised RON95 (RM/litre)	Subsidy gap (RM/litre)	Indicative monthly RON95 cost (RM b)
April (average): 4.01	2.02	3.03
Peak: 4.27	2.28	3.42
Week of 13-19 Aug 26: 3.62	1.63	2.45
Worst case assumption: 5.00	3.01	4.52

Source: Kenanga Research

Note: Our calculation, RON95 only, at an assumed ~1.5b litres per month, based on 13.4b litres over nine months. Not an MoF outlay figure.

Table 2: Malaysia's headline energy surplus is driven by LNG

2025	Exports (RM b)	Imports (RM b)	Net (RM b)
Crude and condensate	23.75	54.11	-30.36
Refined products	95.10	91.95	+3.15
Petroleum	118.85	146.06	-27.21
LNG	51.63	6.27	+45.36
Petroleum + LNG	170.48	152.33	+18.15

Source: DOSM, Kenanga Research

19 August 2026

THE DEMAND SHOCK THAT BUILDS ASSETS

- **The chain from AI to the national balance sheet is short and observable.** Data centre load is rising quickly. TENAGA's 1QFY26 briefing reported operational data centre load at 1.05 GW, up 117.0% year on year. A PETRA written parliamentary reply dated 24 June 2026 corroborated this, putting actual data centre consumption at 1,102 MW. PETRA forecasts data centre-driven peak demand at 12.9 GW by 2030 and 20.9 GW by 2040.
- **The investment response is already committed and regulated.** RP4 covers January 2025 to December 2027 with allowed capex of RM42.82b, comprising RM26.55b base and RM16.27b contingent, against RM20.6b under RP3. The regulated pre-tax rate of return is 7.3%. The Energy Commission set the operative base tariff at 45.40 sen/kWh from 1 July 2025, against the 45.62 sen originally approved and 39.95 sen under RP3.
- **The same structure appears in electricity, at smaller scale.** Under incentive-based regulation the base tariff is fixed for the regulatory period while generation fuel costs float. The imbalance cost pass-through (ICPT) recovers the difference from consumers, but the government has absorbed part of it. This exposure is roughly an order of magnitude smaller than the fuel subsidy. The mechanism is identical, and it shrinks with the same driver: less imported coal and gas in the generation mix.
- **Capital formation is the appropriate macro anchor.** National accounts record investment when it is incurred. Productivity gains, if they materialise, will take years and are difficult to attribute. The investment is therefore macro-positive in its own right, without requiring an assumption about future total factor productivity.
- **Realised load remains small relative to the projected buildout.** The PETRA reply put the approved pipeline at 2,050 MW, versus 1,102 MW operational, implying utilisation of 53.7%. Operational demand is therefore less than one-tenth of PETRA's 2030 forecast of 12.9 GW. The gap between approved and operational capacity is the more useful number to track.

CONSUMPTION AND CAPITAL: THE SAME FISCAL CAPACITY, DIFFERENT USE

- **The link is fiscal flexibility rather than direct substitution.** Data centres do not consume RON95, and growing electricity demand does not mechanically shrink the fuel subsidy. High subsidy costs instead reduce the fiscal flexibility available for infrastructure investment. Fuel subsidies give immediate household relief but recur with every oil-price shock. Energy infrastructure needs upfront capital but adds to the productive capital stock. The government retains other levers, including borrowing, revenue measures and expenditure reallocation, so the constraint is on policy choice.
- **The direct channel exists, but it is slow.** Electrifying transport is the only mechanism that directly reduces exposure to petrol subsidies. EV registrations reached 26,192 units in 1H26, up 106.0%, or about 6.8% of total industry volume. They remain a low single-digit share of the vehicle fleet. We therefore expect meaningful fiscal relief from this channel only in the 2030s.
- **The near-term gain is fiscal, not environmental.** The generation mix remains about 45.0% coal and 32.0% gas. Shifting transport demand onto the existing grid improves the fiscal and external position by reducing petrol consumption. It does not by itself reduce carbon emissions. The composition of the electricity mix is therefore an important part of the diversification question.

THE DIVERSIFICATION OPTIONS, RANKED BY BALANCE SHEET IMPACT

- **The technology debate is well covered.** The fiscal profile is less so. Our energy, market strategy and sustainability research teams have assessed these options based on generation economics and equity exposure. The macro question is different: who ultimately bears the cost, how much of it lands on the public balance sheet, how much of the build is imported, and when it starts contributing.
- **Three observations stand out.** First, the speed ranking has changed: efficiency contributes immediately, solar within 12 to 24 months, and gas now runs three to five years on turbine lead times. Second, the options differ most in where the risk sits. Hydro and nuclear place more of the investment on the public balance sheet, while grid capex falls on ratepayers through the regulated tariff. Third, efficiency and demand-side measures are the only options that are cheap, fast and domestic, yet remain the least discussed. Efficient room air conditioners alone could save about 17 TWh a year by 2040, or roughly 10.0% of total electricity use.
- **One structural constraint cuts across all options.** Integration capacity, rather than generation capacity, is the binding limit. Industry discussion points to a technical ceiling of around 6,000 MW of solar capacity before additional

19 August 2026

mitigation is required, with storage ratios rising sharply beyond it. Any diversification path therefore runs through the grid first, making RP4 an enabling condition rather than simply another investment option.

- **The broader policy implication extends beyond energy.** Malaysia's advantage increasingly lies in converting domestic resources and infrastructure into recurring value-added activity rather than relying primarily on resource extraction. The energy transition is therefore part of a wider shift towards productive capital formation and higher-value industrial capacity.

Table 3: Energy diversification differs sharply in fiscal risk

Option	Capital intensity	Balance sheet location	Import content in build	Time to contribute	Fiscal risk
Gas expansion	Moderate	Mostly private	High for turbines	3 to 5 years	Low-medium
Utility solar	Moderate	Private, tariff-linked	High for modules	12 to 24 months	Low
Solar + storage	High	Private, requires offtake	Very high	Short, once financed	Medium
Grid/transmission	High	Regulated, ratepayer-recovered	High for equipment	Continuous	Low
Hydro/Borneo	Very high	State/public	Moderate	Long	Medium-high
Interconnection	Very high	Multi-sovereign	High	2030s	Medium-high
Nuclear/SMR	Very high	Sovereign commitment	Very high	Decade+	Very high
Efficiency/demand-side	Low	Distributed private	Low	Immediate	Very low

Source: Kenanga Research

Note: Qualitative assessment. Ratings are ours and are intended to frame the fiscal trade-off, not to rank technologies on generation cost. Gas carries residual fiscal risk through the ICPT mechanism rather than through capex. Efficiency measures operate under the EECA 2024, which applies to Peninsular Malaysia and Labuan only.

CAPITAL MARKET IMPLICATIONS

- **Fixed income: The subsidy line is the largest single expenditure item linked to a price Malaysia does not set, which makes it a direct input into the government's issuance needs.** We estimate a net fiscal sensitivity of roughly RM750.0m a year for each USD1.0/bbl, or about 0.34pp of GDP for a USD10.0/bbl move on our in-house 2026F nominal GDP of RM2.2t. We forecast the 2026 deficit at 3.8% of GDP, partly on BUDI Madani commitments. A move of that size is therefore enough to determine whether the consolidation path holds. This cuts both ways. Administered pump prices also suppress headline inflation, which supports our expectation of a steady OPR and anchors the front end. The subsidy therefore pressures the long end through issuance while easing the front end through inflation, leaving a steepening bias rather than a level shift. We hold 10Y MGS near 3.60% and read the monthly subsidy path as a leading indicator of supply pressure. Budget 2027, due in October, is the next resolution point.
- **FX: The structural ringgit case rests on the external balance and rising economic complexity.** The energy buildout supports both over a multi-year horizon. This channel is slower and more durable than the oil price channel it partly replaces. The near-term complication runs the other way: capex of this scale front-loads imports of capital goods, which is a headwind to the trade balance before it becomes a tailwind. We keep USDMYR at 3.95 for end-2026 and 3.90 for end-2027.
- **Equities: Our Market Strategy team covers the beneficiary mapping across utilities, grid and transmission contractors, electrical equipment and the data centre ecosystem, and we defer to their coverage.** Our contribution is the macro precondition: the capex cycle underpinning these opportunities is more secure when the fiscal position is not absorbing an open-ended oil-price shock.

19 August 2026

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