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Budget 2019…it make sense!

Clarity in policy direction

In all honesty, most economists were anxious about what could come out from the budget announcement. The RM1 trillion debt and budget of sacrifice narratives are all seems to suggest that raising taxes and cutting down on expenses would be the immediate remedy to government finances. Additionally, the expected repayment of tax refund would definitely add salt to the wound as the amount is likely to be more than RM30 billion. To make things worse, Moody's has been pessimistic ever since the government announced the revised fiscal deficits target in 2020 (from 0.6% to 3.0% of GDP).

On the contrary, there is more clarity now. The government is not about to abandon ship as the low income group will continue to receive direct assistance albeit more targeted. The government raises the development spending trajectory to more than RM50 billion as opposed to RM44 billion average between 2010 and 2017. This would mean better prospect for construction sector. Additionally, the setting up of the Airport Real Estate Investment Trust (REIT) should also help government to reduce its development expenditure on airports especially when air travelling is likely to accelerate. Boeing recently projected that Asia Pacific would need 240,000 pilots, 242,000 technicians and 317,000 cabin crew as demand for air traveling is expected pick up its speed between 2018 and 2037. Therefore, REITs could be the smart way to raise fund and finance the expansion or upgrade of the existing airports. More importantly is the contribution from Petronas whereby it will contribute a total of RM54 billion in dividend next year of which RM30 billion will be in the form of special dividend. Consequently, total government debt is anticipated to be reduced to 73.5% of GDP in 2019 from 80.3% at the end of 2017.

So, in a nut shell, it make sense to us.

Government Finance

The total revenue is expected to grow by 10.7% to RM261.81 billion in 2019 mainly contributed by the introduction of new taxes i.e. Digital Tax, Soda Tax and Gambling Tax. Meanwhile, the government is expected to receive one-off special dividend of RM 30 billion from Petronas that will be used to repay the GST (RM19 billion) and income tax refund (RM18 billion) that could help the government to improve the well-being of the "rakyat". In addition, Malaysia's government will introduce the Fiscal Responsibility Act on 2021 to ensure that the government spending is limited while strengthening responsibility and purposeful spending of the budget resources.

Total spending allocation for Operating Expenditure (OE) and Development Expenditure (DE) for Budget 2019 is set at RM313.89 billion (2018: RM289.78 billion). Of this amount, the allocation for OE stands at RM259.85 billion increased by 10.4% from 2018. Meanwhile, the remaining revenue would be for DE which is allocated for RM54.04 billion, lower by 0.5% from 2018. Against such backdrop, the new government is expected to incur fiscal deficits of RM52.08 billion or 3.4% of GDP in 2019 (2018E: RM53.33 billion or 3.7% of GDP). In 2018, the government Debt-to-GDP ratio is estimated at 50.7% while the domestic debt stands at 49.2% of GDP.

After what has been said and done, the new government continue to focus on societal needs and “rakyat” centric measures. The aim is none other than to reduce the income gap especially for the Bottom 40% (B40) group. In this regards, a total of RM5 billion has been allocated for Bantuan Sara Hidup (BSH) that will benefit 4.1 million recipients. In addition, the fuel subsidy would be more targeted and the mechanism will be announced in the 2Q2019. The new fuel subsidy will benefit 4 million car owners and 2.6 million motorcycle owners with total allocation of RM2 billion in 2019.

As such, by improving the socio-economic and well-being of the citizen, the growth strategy will be more inclusive. Inadvertently, this will be the main key performance indicator whether the government led by Pakatan Harapan (PH) could deliver their promises and live up to expectation.

Table 1: Federal Government Finances

RM million	2017	2018E	2019F
Revenue	220,406	236,460	261,814
%chg	3.8	7.3	10.7
Operating expenditure	217,695	235,450	259,850
%chg	3.6	8.2	10.4
Current balance	2,711	1,010	1,964
Development expenditure(net)	43,032	54,337	54,044
%chg	5.9	26.3	-0.5
Overall Balance	-40,321	-53,327	-52,080
% of GDP	-3.0	-3.7	-3.4
Domestic Borrowings(net)	40,750	51,973	-
Offshore Borrowings(net)	-342	-293	-
Change in assets	-87	-353	-

Source: Economic Outlook 2019

Table 2: Federal Government Debt

RM Mllion	2017	% GDP	2018	% GDP
Federal Government Debt	**686,837**	**50.7**	**725,241**	**50.7**
Domestic Debt	**665,572**	**49.1**	**704,101**	**49.2**
Treasury bills	4,500	0.3	7,500	0.5
Malaysian Government Investm	268,000	19.8	291,500	20.4
Malaysian Government Securitie	364,672	26.9	376,701	26.3
Government Housing Sukuk	28,400	2.1	28,400	2.0
Offshore borrowings	**21,265**	**1.6**	**21,140**	**1.5**
Market loans	15,580	1.2	15,527	1.1
Project loans	5,685	0.4	5,613	0.4

Source: Economic Outlook 2019

Table 3: Federal Government Operating Expenditure

	RM million			Chabngr(%)			Share(%)		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Emoluments	77,036	81,327	82,045	5.4	5.6	0.9	35.4	34.5	31.6
Retirement charges	22,800	25,760	26,557	8.4	13.0	3.1	10.5	10.9	10.2
Debt service charges	27,863	30,882	33,000	5.2	10.8	6.9	12.8	13.1	12.7
Grants & transfers to state govt.	7,109	8,023	7,571	2.4	12.9	-5.6	3.3	3.4	2.9
Supplies & services	34,738	36,501	29,068	15.5	5.1	-20.4	16.0	15.5	11.2
Subsidies & social assistance	22,354	28,128	22,269	-9.5	25.8	-20.8	10.3	11.9	8.6
Asset acquisition	516	576	673	-23.7	11.6	16.8	0.2	0.2	0.3
Refunds & write-offs	973	888	921	21.7	-8.7	3.7	0.4	0.4	0.4
Grants to statutory bodies	14,044	13,873	12,968	-5.2	-1.2	-6.5	6.5	5.9	5.0
Others	10,262	9,492	44,778	-11.3	-7.5	371.8	4.6	4.2	17.1
Total	217,695	235,450	259,850	3.6	8.2	10.4	100.0	100.0	100.0
Share of GDP (%)	**16.1**	**16.4**	**17.0**						

Source: Economic Outlook 2019

Table 4: Federal Government Development Expenditure by Sector

	RM million			Change(%)			Share(%)		
	2017	2018	2019F	2017	2018	2019F	2017	2018	2019F
Economic	**24,186**	**33,025**	**29,235**	**-3.7**	**36.5**	**-11.5**	**53.9**	**60.2**	**53.4**
Transport	10,429	15,501	13,388	33.2	48.6	-13.6	23.2	28.2	24.5
Trade and industry	3,800	6,686	5,721	-21.5	75.9	-14.4	8.5	12.2	10.5
Energy and public utilities	2,475	3,379	4,589	-15.4	36.5	35.8	5.5	6.2	8.4
Agriculture and rural developme	2,219	2,191	2,278	-23.5	-1.2	3.9	4.9	4.0	4.2
Environment	2,061	1,725	2,134	-12.2	-16.3	23.7	4.6	3.1	3.9
Social	**12,425**	**14,507**	**15,183**	**19.1**	**16.8**	**4.7**	**27.7**	**26.4**	**27.8**
Education & training	6,306	7,307	8,287	69.2	15.9	13.4	14.0	13.3	15.2
Housing	785	1,144	1,652	-64.9	45.8	44.4	1.7	2.1	3.0
Health	1,470	1,897	2,257	-1.7	29.1	19.0	3.3	3.5	4.1
Security	**5,334**	**5,338**	**7,082**	**10.4**	**0.1**	**32.7**	**11.9**	**9.7**	**12.9**
General administration	**2,939**	**2,030**	**3,200**	**81.4**	**-30.0**	**57.6**	**6.5**	**3.7**	**5.9**
Total	**44,884**	**54,900**	**54,700**	**6.9**	**22.3**	**-0.4**	**100.0**	**100.0**	**100.0**
Share of GDP (%)	**3.3**	**3.8**	**3.6**						

Source: Economic Outlook 2019

Macroeconomic targets

The Gross Domestic Product (GDP) is set to expand by 4.9% in 2019 from the estimated growth of 4.8% in 2018 (Bank Islam 2018 & 2019 forecast: 4.8% & 4.5%). Growth in 2019 will be mostly underpinned by the private sector expenditures whereby private consumption and private investment are both expected to record 6.8% (2018: 7.2%) and 5.0% (2018: 4.5%) growth respectively. This is in line with stable employment outlook next year while higher minimum wage that will be implemented in January 2019 is expected to help improve household income growth. On the other hand, external demand is anticipated to decline further with real exports projected to grow by 1.6% in 2019 from an estimated growth of 2.0% this year. Meanwhile, real imports would rise 1.8% in 2019 from an estimated growth of 1.4% in 2018.

Table 5: GDP by expenditure

Growth	2015	2016	2017	2018E	2019F
GDP	5.1%	4.2%	5.9%	4.8%	4.9%
Domestic Demand	5.1%	4.3%	6.5%	5.0%	4.8%
Consumption	5.7%	4.9%	6.7%	6.0%	5.9%
-Public	4.5%	0.9%	5.4%	1.0%	1.8%
-Private	6.0%	6.0%	7.0%	7.2%	6.8%
Investment	3.6%	2.7%	6.2%	2.6%	1.9%
-Public	-1.1%	-0.5%	0.1%	-1.5%	-5.4%
-Private	6.3%	4.3%	9.3%	4.5%	5.0%
Change in Stocks	-86.4%	-137.9%	148.6%	-472.9%	-115.2%
Exports	0.3%	1.3%	9.4%	2.0%	1.6%
Imports	0.8%	1.3%	10.9%	1.4%	1.8%
Net Export	-3.7%	1.7%	-1.9%	7.7%	0.7%

Source: Economic Outlook 2019

On the supply side, GDP growth will be spearheaded by services and manufacturing sector amidst turnaround in output growth in agriculture and mining industries. The services sector which accounted for 55% of GDP is expected to grow by 6.3% in 2018 and 5.9% in 2019 due to expansion across all subsectors. The wholesale and retail trade subsector is expected to remain strong driven by high consumption activities due to steady income stream and stable labour market condition. The upward revision of minimum wage rate to RM1,100 would certainly help to sustain household spending going forward.

Table 6: GDP by industries

	Share (%)	Change (%)		
	2018	2017	2018E	2019F
Services	55.3	6.2	6.3	5.9
Manufacturing	23.0	6.0	4.9	4.7
Mining	8.0	1.0	-0.6	0.7
Agriculture	7.8	7.2	-0.2	3.1
Constrution	4.5	6.7	4.5	4.7
GDP	**100.0**	**5.9**	**4.8**	**4.9**

Source: Economic Outlook 2019

Table 7: Services subsector estimates and forecasts

Subsector	Change (%) 2018E	2019F
Wholesale and retail trade	7.0	6.3
Finance and insurance	5.5	5.3
Information and communication	8.1	8.0
Real estate and business service	7.3	6.6
Transport and storage	5.8	5.5

Source: Economic Outlook 2019

Manufacturing sector is estimated to expand at 4.7% in 2019 from 4.9% in 2018 mainly supported by export-oriented industries. Electrical & Electronics (E&E) will be the key catalyst for growth, driven by increasing usage of wearable gadgets and smart home applications as well as the government is embracing Industrial Revolution (IR) 4.0.

Table 8: Manufacturing Production Index, January- August (2015=100)

	Share (%)		Change (%)		Share (%)	
	2017	2018	2017	2018	2017	2018
Export-oriented industries						
Petroleum, chemical, rubber and plastic products	106.9	111.4	3.7	4.1	29.6	29.4
Electrical and electronics products	113.0	119.6	8.1	5.8	27.7	27.9
Wood products, furniture, paper products and printir	109.2	114.1	6.4	4.4	6.7	6.7
Textiles, wearing apparel, leather products and foot	112.2	117.5	7.7	4.8	2.0	2.0
Domestic-oriented industries						
Non-metallic mineral products, basic metal and fabr	108.4	114.1	5.0	5.0	13.3	13.3
Food, beverages and tabacco	109.4	113.9	11.5	11.5	12.6	12.5
Transport equipment and other manufactures	103.2	108.9	6.0	6.0	8.1	8.2
Manufacturing production Index	**109.0**	**114.3**	**6.5**	**6.5**	**100.0**	**100.0**

Source: Economic Outlook 2019

The agriculture sector growth is expected to rebound to 3.1% in 2019 after contracting 0.2% in 2018. The reversal in trend will likely due to expansion in oil palm and rubber production with both are expected to record 4.1% (2018: -0.1%) and 5.0% (2018: -18.0%) growth. The government projected CPO prices to be at RM2,400 per MT in 2019 from RM2,300 per MT in 2018 although this is somewhat optimistic view considering Soybean oil continue to remain low in the foreseeable future. Nonetheless, government remain supportive to the sector in view of the RM30 million allocation to help the smallholders to obtain the Malaysian Sustainable Palm Oil (MSPO) certification.

Table 9: Value Added in Agriculture Sector, 2017-2019 (At constant 2010 prices)

	Share (%)	Change (%)		
	2018	2017	2018E	2019F
Oil Palm	46.7	16.0	-0.1	4.1
Rubber	6.0	9.3	-18.0	5.0
Livestock	12.2	5.3	6.7	4.6
Other Agriculture	19.5	2.1	4.6	4.0
Fishing	10.4	-2.1	-0.6	0.1
Forestry and logging	5.2	-15.7	-7.8	-8.9
Agriculture	**100.0**	**7.2**	**-0.2**	**3.1**

Source: Economic Outlook 2019

Other macroeconomic indicators such as the current account balance (CAB) is predicted to maintain a surplus balance of between 2.0% and 3.0% of GNI in 2019 (2018E: at around 2.5% to 3.0%). Inflation rate is projected to increase between 2.5% to 3.5% in 2019 from 1.5% to 2.5% due to the low base factor this year. Meanwhile, the unemployment rate is envisaged to remain steady at 3.3% in 2018 and 2019 due to persistent in job creation. Based on the forecasted data, we can infer that Malaysia's economic growth would revolves around its potential growth level of 4.8%. This would mean imbalances in resource allocation is not too severe.

Measures that we like:

1.0 Small Medium Enterprises (SMEs)

SMEs role in economic development and social uplifting in Malaysia is paramount. The measures include:

- RM4.5 billion SME Loan Fund with 60% guarantee from Skim Jaminan Pembiayaan Perniagaan (SJPP)
- Corporate income tax rate reduced from 18% to 17% for taxable income up to RM500,000 and SMEs with RM2.5 million paid up capital
- RM100 million allocation to upgrade the capability of SMEs in halal industry
- EXIM Bank RM2 billion financing to encourage SMEs exports
- RM1 billion SME Syariah compliant financing scheme. Government will provide a subsidy of 2% profit rate.

2.0 Infrastructure projects

The following are the some of the infrastructure projects that has been announced in Budget 2019:

- RM2.46 billion allocation to upgrade and restore railway tracks
- RM926 million allocation to build and upgrade bridges
- RM694 million to supply electricity in rural areas
- RM738 million to supply water in rural areas
- DE for Sabah and Sarawak stands at RM5.0 billion (2018: RM4.1 billion) and RM4.3 billion (2018: RM4.3 billion).

- Pan Borneo Highway (Sabah & Sarawak) will continue subject to cost rationalisation
- Public Private Partnership (PPP) projects include RM5.2 billion to build schools, army camps, police and fire stations.
- Airport REITs will reduce the burden of the government to fund the projects while maintaining MAHB as an asset light operator not bogged down by heavy capital investments and debts. Good for future projects for new and expansion of existing airports.

3.0 Housing

- RM1.5 billion for Program Perumahan Rakyat, Perumahan Penjawat Awam Malaysia, PR1MA and Syarikat Perumahan Nasional Bhd
- RM1 billion BNM fund to help those who earned monthly income of RM2,300 to purchase affordable house with prices up to RM150,000
- For those who earned RM5,000 a month, the Government will allocate RM25 million to Cagamas Berhad to provide mortgage guarantees to enable borrowers to obtain higher financing from financial institutions, inclusive of down payment support
- Exemption of stamp duty for a period of two years until 2020 for first-time house buyers for house prices up to RM500,000.
- Waive all stamp duty charges for 6 months commencing 1 January 2019 to address property overhang.
- Real Estate Housing Developers Association (REHDA) indicated that that there will be a 10% reduction in the price of houses following the SST exemption on construction and building material.
- **‘**Property Crowdfunding’ platforms which will serve as an alternative source of financing for first time home buyers. It will be under supervision of Securities Commission (SC).

4.0 Education

- RM2.9 billion for food, text books and cash assistance for students from low income family
- RM652 million for school upgrade
- Donations to school and IPTA for the purpose of upgrading infrastructure will be tax exempted starting 1 January 2019
- RM100 million to reconstruct dilapidated schools
- RM206 million allocation for development and training programs at Polytechnics and Community Colleges
- Scholarships to all Malaysians amounting to RM3.8 billion

5.0 Palm oil & rubber

- Government will implement the Biodiesel B10 program (comprising a mix of 10% palm oil) for the transportation sector and B7 for the industrial sector in 2019.
- the Government will allocate RM30 million to assist smallholders to obtain the Malaysian Sustainable Palm Oil (MSPO) certification.

Our view

The government is treading on a fine line. Malaysia's GDP in 2019 is expected to be more or less around its potential growth of 4.8%, suggesting that decision on resource allocation is extremely critical as the external sector is not going to be very conducive. This is especially true when the trade friction between the US and China is expected to slash Malaysia's exports and GDP by 0.08 percentages points and 0.02 percentages points over the period of 2018 – 2020 based on the Minister of Finance (MOF) internal estimation. However, if the trade war continue to escalate and drags down global output by 0.4 percentage points by 2020, the Malaysian economy could be reduced by 0.7 percentage points. In that sense, if the 2019 baseline forecast is 4.9%, GDP growth could be reduced up to 4.2% should global output down by 0.4 percentage points following the increase in trade war intensity.

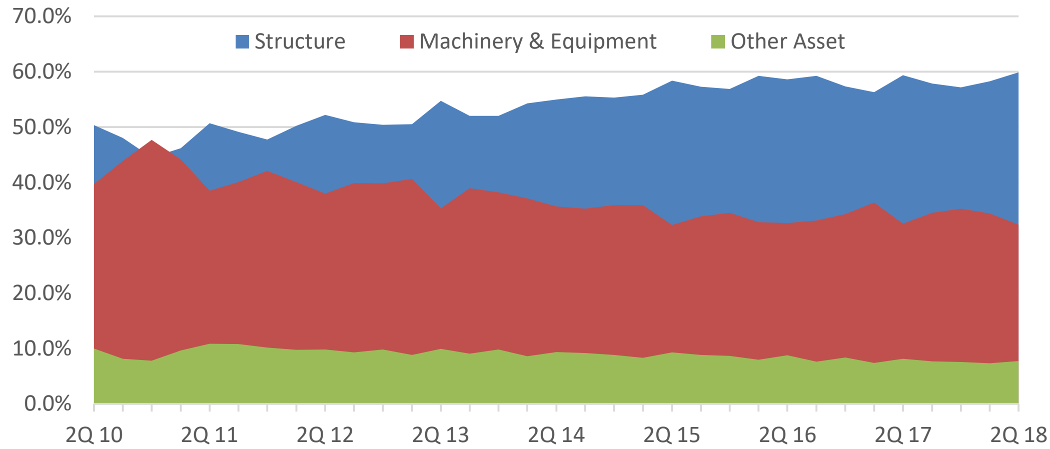
Therefore, domestic demand will likely do most of the heavy-lifting next year. Moreover, the Credit Rating Agencies (CRAs) is expected to scrutinize them like a fiscal hawk, limiting the space for populist measures and room to make policy mistake. On the flip side, government policies are geared towards capacity building especially the private sector. In particular, the fourth industrial revolution (4IR) has become the common narrative and closely embedded in achieving sustainable and more inclusive growth. This was reflected in the private investment which is anticipated to record 5% growth in 2019 from an estimated 4.5% expansion this year. This was premised on further spending by the private firms on Internet of Things (IoT), software, advanced electronics, smart machinery, automation and robotics, automated guided vehicle, aerospace and medical devices.

Realigning the existing private investment is also the main focal point. This especially true when the prevailing gross fixed capital formation (GFCF) is skewed towards investment in Structure, accounting for 59.9% of total GFCF in the 2Q2018 (see Chart 1). On the contrary, investment in Machinery & Equipment constituted only 32.4% during the same period and has been dwindling since data inception in 2010. In this regards, measures towards higher adoption rate of Information, Communication and Technology (ICT) among businesses especially the SMEs should translate into better productivity and efficiency gains. Thus far, the ICT usage has always been limited to sending or receiving email (70.6%), internet banking (41.3%), getting information about goods and services (38.9%) and posting information or instant messaging (36.6%) (see Chart 2).

Having said that, we believe the measures announced are very clear. The government is cognizant on the lost from GST revenue of RM21 billion. This has been mitigated by the tax reforms which saw some of the taxes have been raised such as the sin tax, Real Property Gain Tax (RPGT) for disposal of properties after fifth year, soda tax and many more. More importantly is the contribution from Petronas whereby it will contribute a total of RM54 billion in dividend next year of which RM30 billion will be in the form of special dividend.

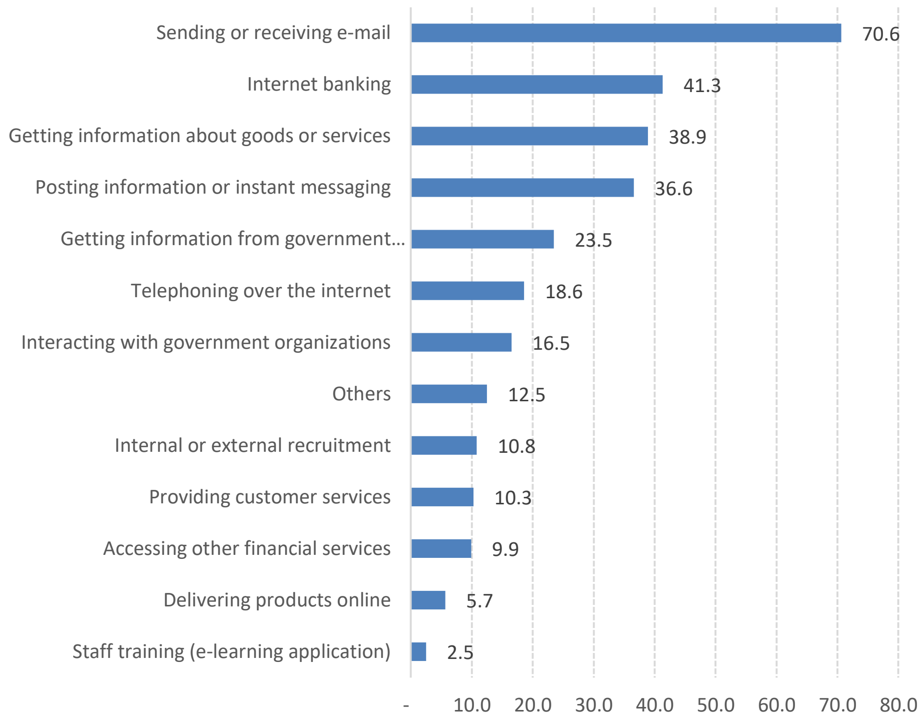
As such, we believe the Credit Rating Agencies (CRAs) would not budge its outlook and ratings. This premised compensatory measures which is quite credible. Thus, it should provide stability to ringgit, capital flows and financial markets subject external event such as US mid-term election and G20 meeting this November where Donald Trump and China's President Xi Jinping is supposed to meet during the summit.

Chart 1: Composition of gross fixed capital formation (GFCF) % of total



Source: CEIC

Chart : ICT application among businesses (%) in 2017



Source: Department of Statistics Malaysia (DOSM)

While the government is mindful of its finances, they remain committed to support critical sector such as Oil & Gas, Construction (Infrastructure), Telecommunication and Power. The projects include:

- RAPID Pengerang
- Floating LNG 2,
- Pengerang Cogeneration Plant
- Diesel EURO-5
- Integrated Bokor & Betty
- North Malay Basin Full Field Development
- Pan Borneo Highway
- MRT SSP Line
- Electrified Double Track Gemas-Johor Bahru
- Langkawi submarine power cable
- High Speed Broadband Phase 2
- Sub-Urban Broadband
- Jimah coal-fired power plant
- Pasir Gudang combined-cycle gas turbine (CCGT) power plants