Dr. Mohd Afzanizam Abdul Rashid | Chief Economist | 03-2088 8075 | afzanizam@bankislam.com.my
Shafiz Jamaluddin | Economic Analyst| 03-2088 8399 | shafiz@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst| 03-2782 1417 | norjannah@bankislam.com.my

Budget 2020 preview: Government to play more active role

Overview

The national budget for the 2020 will be tabled on 11 October 2019. The theme for the upcoming budget will be "Shared prosperity: Sustainable and inclusive growth towards high income economy". This budget will be the last budget under the 11th Malaysia Plan (11MP) which spanned from 2016 to 2020. In so far, the economic growth achieved has been in line with the Mid Term Review of 11MP target of 4.5% - 5.5% (original target 5.0% - 6.0%) whereby the average GDP growth between 2016 and 1H2019 stood at 4.9%. In the face of the global calamity brought by the trade tension - primarily between the US and China – as well as the uncertain fate of the UK Brexit, the implication of China slowdown and volatility in the crude oil prices, the global economy is likely to endure a challenging prospect next year. Already, major organization such as the International Monetary Fund (IMF), World Bank and Organization for Economic Co-operation and Development (OECD) have reduced their global growth projection for 2019 and 2020 (see Table 1).

At the same time, reducing the income disparity between the rich and the poor, urban and rural area as well as worker income are also the key agenda under the banner of shared prosperity. This was clearly spelled out in the Shared Prosperity Vision 2030 (SPV 2030) which was launched on 5 October 2019. This would mean capacity building via education, infrastructure spending and nurturing the culture of entrepreneurship are some of the key elements in the government aspiration to transform the economy into a developed nation by 2030. On that score, the Government of Malaysia (GOM) is projected to prescribe an expansionary budget in order to spearhead the domestic economic activities. Already, the monetary authority i.e. the Bank Negara Malaysia (BNM) has played their part by cutting down the Overnight Policy Rate (OPR) from 3.25% to 3.00% in May this year.

Table 1: Global growth forecast

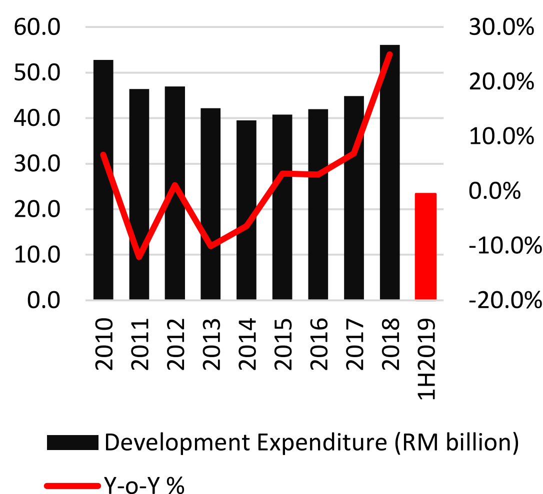
Institution	Revised Forecast		Previous Forecast	
	2019F	2020F	2019F	2020F
Organisation for Economic Co-operation and Development (OECD)	2.9%	3.0%	3.2%	3.4%
International Monetary Fund (IMF)	3.2%	3.5%	3.3%	3.6%
World Bank	2.6%	2.7%	2.9%	2.8%

Source: IMF, World Bank & OECD

Targeted fiscal deficits could be at 3.3% of GDP in 2020

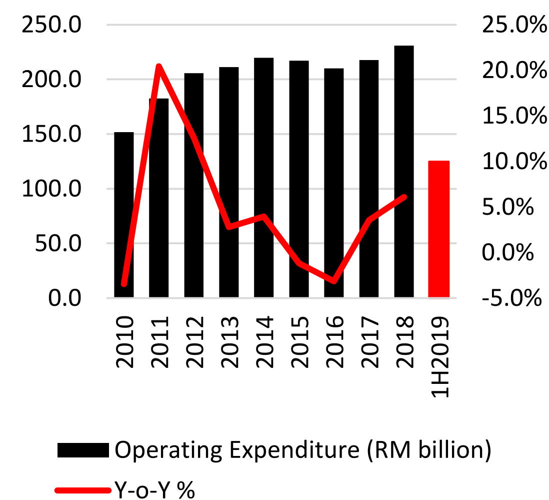
We anticipate fiscal deficits would be widened from an estimated RM51.8 billion or 3.4% of GDP in 2019 to RM52.6 billion **or 3.3% of GDP in 2020**. This was premised on slower growth in revenue and operating expenditure (OE) of 3.3% (2019E: 8.0%) and 2.2% (2019E: 8.1%) to RM260.0 billion and RM255.0 billion respectively in 2020. Apart from that, the development expenditure (DE) is expected to go higher by 7.0% (2019E: -2.7%) to RM58.4 billion next year. Against such backdrop, the official government debt would rise to 53.7.0% of GDP in 2020 from an estimated 51.9% in 2019. This is still lower than the self-imposed limit of 55.0% of GDP, suggesting that the government will continue to remain prudent in their financial management. In actual fact, the computation for the debt limit only covers the outstanding debt in Malaysian Government Securities (MGS), Malaysian Government Investment Issues (MGII) and Malaysian Islamic Treasury Bills (MITB) as stipulated in Loan (Local) Act 1959 [Act 637] and Government Funding Act 1983 [Act 275]. At the current juncture, the government debt ratio that takes into account the three debt instruments stood at only 48.0% as of June 2019. For next year, such ratio would be at around 50.3%. As such, the fiscal policy space does exist from the debt limit point of view.

Chart 1: Federal Government Development Expenditure (RM billion)



Source: CEIC, BNM Quarterly Bulletin

Chart 2: Federal Government Operating Expenditure (RM billion)



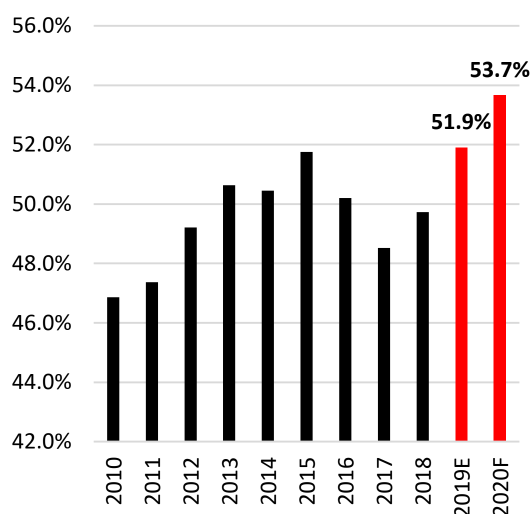
Source: CEIC, BNM Quarterly Bulletin

Table 2: Federal government budgetary position

RM billion	2015	2016	2017	2018	2019F	2020F
Revenue	219.1	212.4	220.4	232.9	251.6	260.0
%chg	-0.7%	-3.0%	3.8%	5.7%	8.0%	3.3%
Operating expenditure	217.0	210.2	217.7	231.0	249.6	255.0
%chg	-1.2%	-3.1%	3.6%	6.1%	8.1%	2.2%
Operating balance	**2.1**	**2.2**	**2.7**	**1.9**	**2.0**	**5.0**
%chg	101.8%	7.5%	20.6%	-29.1%	4.1%	150.0%
Gross development expenditure	40.8	42.0	44.9	56.1	54.6	58.4
%chg	3.2%	3.0%	6.9%	25.0%	-2.7%	7.0%
Less: Loan recovery	1.5	1.3	1.9	0.8	0.8	0.8
Net development expenditure	**39.3**	**40.6**	**43.0**	**55.3**	**53.8**	**57.6**
%chg	2.2%	3.5%	5.9%	28.5%	-2.7%	7.1%
Overall balance	**(37.2)**	**(38.4)**	**(40.3)**	**(53.4)**	**(51.8)**	**(52.6)**
Overall balance % of GDP	**-3.2%**	**-3.1%**	**-2.9%**	**-3.7%**	**-3.4%**	**-3.3%**

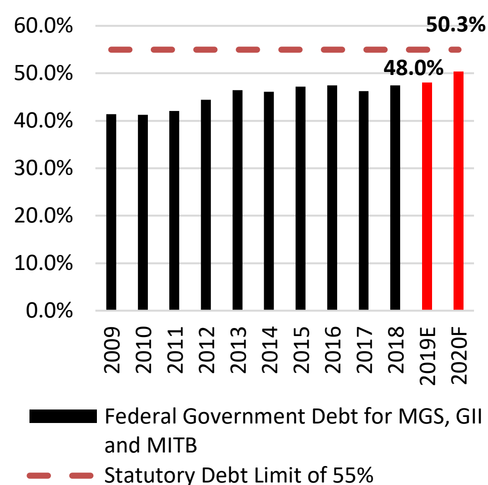
Source: CEIC, Bank Islam

Chart 3: Federal government debt (% of GDP)



Source: CEIC, Bank Islam

Chart 4: Federal government debt (MGS, GII & MITB) as % of GDP



Source: CEIC, Bank Islam

Why we think the deficits would go to 3.3%?

Apart from the need to spur the economic activities, we believe a slightly higher in the deficits ratio does not really affect the market sentiments negatively. The 5-year Credit Default Swap (CDS) spread currently stood 53 basis points. This is significantly lower compared to 491 basis points recorded during the US Sub Prime Crisis in 2008. What it means is that fixed income investors have placed lower probability of default for government of Malaysia. To some degree, it also indicates the level of confidence as the major Credit Rating Agencies (CRAs) have reaffirmed their rating on Malaysian sovereign debt at A3/A-. In that sense, its “OK” to spend a little bit more since the prevailing rating is expected to remain stable, at least in the next 12 months.

Chart 5: 5-year Credit Default Swap (CDS) spread for Government of Malaysia (GOM) in basis points

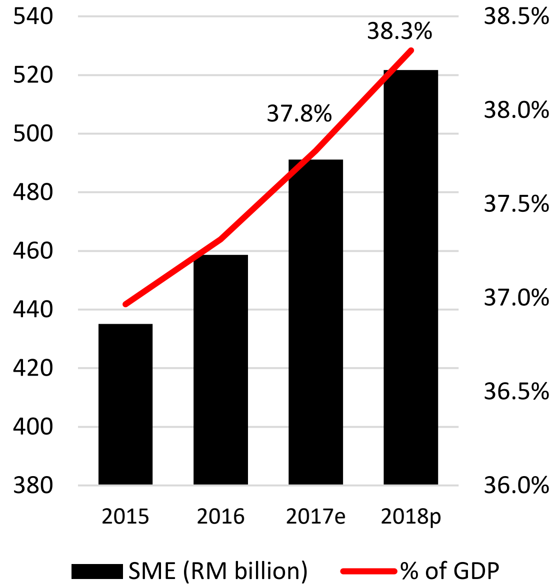
Source: Bloomberg

Our wish List:

1) Small Medium Enterprises (SMEs)

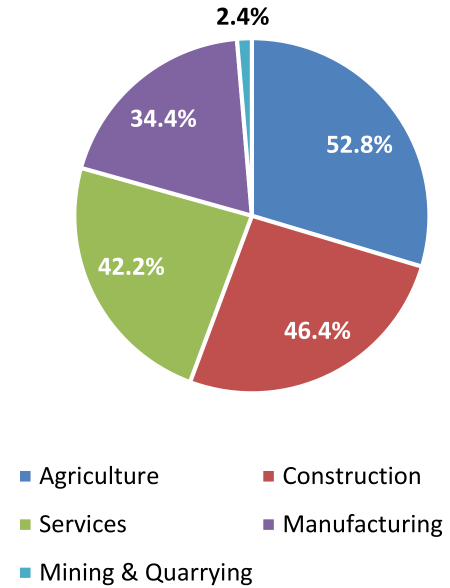
The Small and Medium Enterprises (SMEs) contribution to the Gross Domestic Product (GDP) has increased from 37.8% in 2017 to 38.3% in 2018. According to Department of Statistics Malaysia (DOSM), the size of SME's GDP stood at RM 521.7 billion (2017: 491.2 billion), growing at a rate of 6.2% in 2018 (2017: 7.1%). Such growth rate was higher compared to the national GDP of 4.7% during 2018. That is by a factor of 1.3 times. Therefore, it is imperative to ensure that the SMEs will continue to have access to finance. At the same time, Malaysian financial institutions have embarked a strategic move towards SME despite the higher credit risk premium. Against such backdrop, we are hopeful that the government would allow higher allocation to the Syarikat Jaminan Pembiayaan Perniagaan (SJPP) in order to facilitate the financial intermediation process in the SME sector.

Chart 6: SME % of GDP



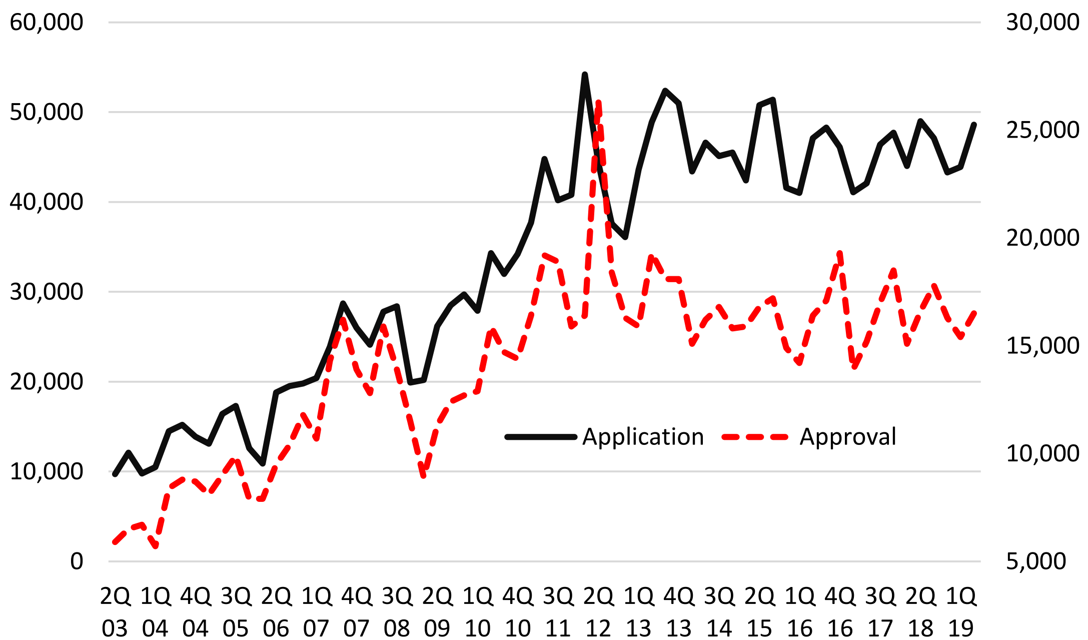
Source: DOSM

Chart 7: Contribution of SMEs



Source: DOSM

Chart 8: SMEs Loan Application and Approval (RM million)

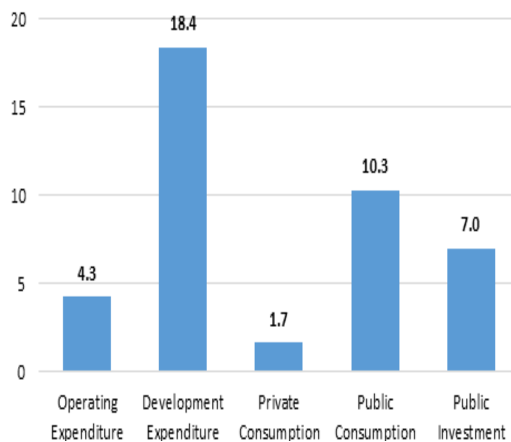


Source: CEIC

2) Construction sector - Higher Development Expenditure (DE)

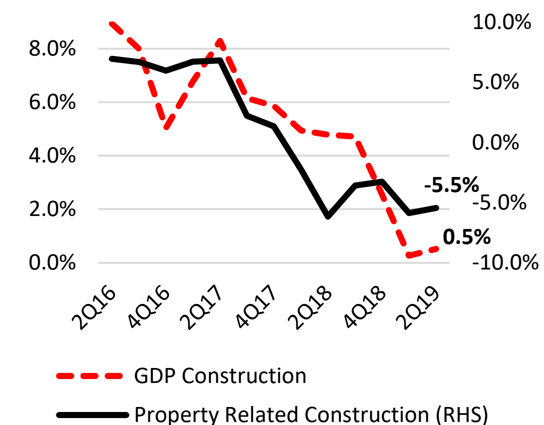
We expect the government to pump prime the economy via infrastructure projects. As such, the government will incur higher DE to re-energise the construction sector in 2020 which has been plagued by the higher unsold units in the residential properties. The Johor Baru-Singapore Rapid Transit System Link (RTS) project that could possibly be revived next year will help to improve further our construction sector in 2020. We foresee the government DE is expected to increase next year by 7.1% y-o-y to RM57.6 billion in 2010 from RM53.8 billion in 2019. In the first half of 2019, construction sector grew at a modest rate of 0.4% (1H2018: 4.7% vs. 2018: 4.3%). Indeed, the economy is in dire need of a stimulus. Our estimates showed that the marginal effect of DE is the highest among the GDP component (see Chart 9). As such, it makes sense to pump prime the economy at a time when sentiment in the private sectors have been very weak.

Chart 9: Marginal Effect of GDP Growth (%)



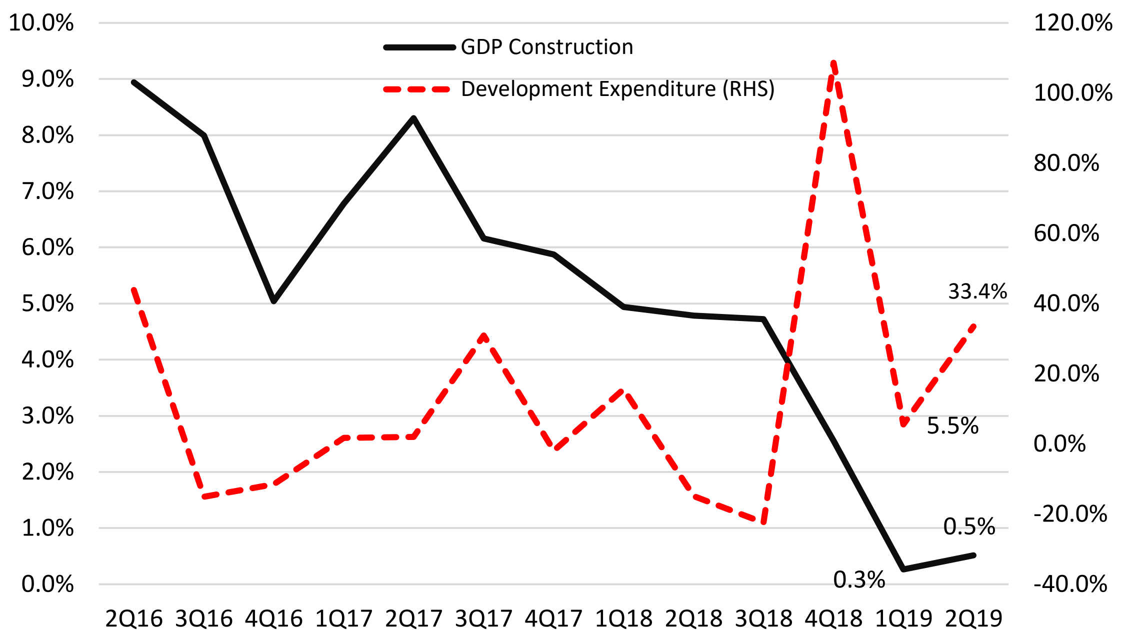
Source: Bank Islam

Chart 10: GDP Construction vs. Property Related Construction, y-o-y%



Source: CEIC

Chart 11: GDP Construction vs. Development Expenditure, y-o-y%

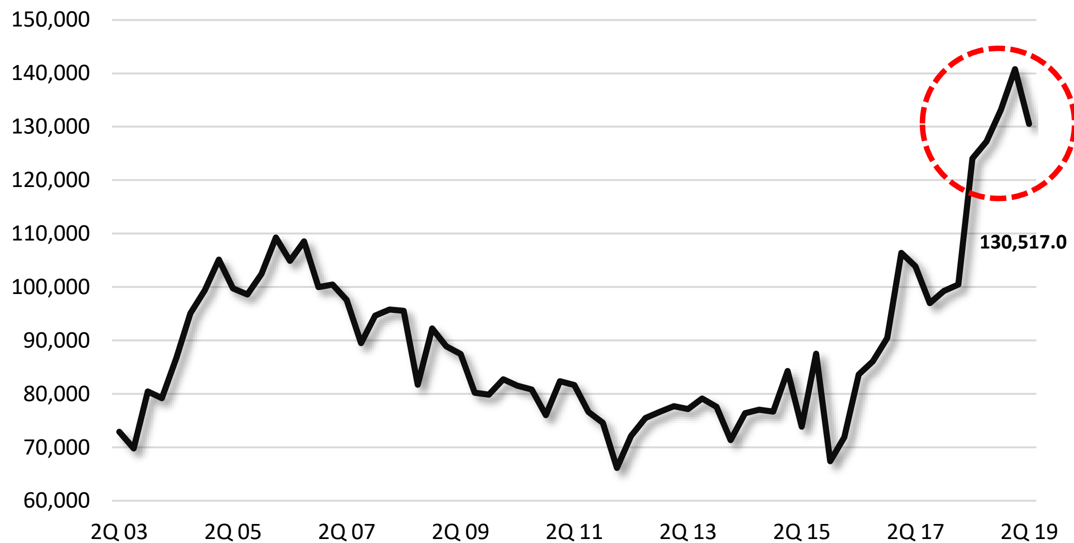


Source: CEIC

3) Extension of Home Ownership Campaign (HOC)

The total of unsold residential properties has declined by 7.3% quarter-on-quarter (q-o-q) from 140.8k units in 1Q2019 to 130.5k units in 2Q2019. This suggests an improvement in residential property market in Malaysia after the number of unsold units have trended up sharply since 2017. Following this, we opine that the number of overhang units would decline albeit gradually for the next few quarters as the House Ownership Campaign (HOC) initiated by the government has received favourable response from the market. It was designed to encourage home ownership among Malaysians especially for the first-time home buyer. To some degree, it could also serve as a means to reduce the number of unsold properties. Thus far, the six months campaign starting January this year has been extended till the end of this year after achieving a good take-up rate. Perhaps, it makes sense for the HOC to be extended in 2020.

Chart 12: Total unsold units for residential properties



Source: NAPIC, CEIC

4) Tourism sector

In view of Visit Malaysia 2020 (VM2020), the government is expected allocate more funds to the tourism sector. According to Tourism Malaysia, the tourist's arrival is expected to grow to 28.1 million in 2019 and 30.0 million in 2020. In Budget 2019, the government has agreed to return 50% of tourism tax proceeds to the states to support their tourism activities. Of the RM67.7 million distributed to state governments, Sabah had received the highest allocation of RM12.7 million as of March this year[1] . For the upcoming budget, we foresee there would be more spending to develop the rural areas in order to promote rural tourism. Apart from that, the extension of the matching grant program under Galakan Melancong Malaysia 2019 (GAMELAN 2019) to 2020 could also be considered. The move is to spearhead promotional and marketing activities that could help to reduce the business cost among the local tourism operators[2].

[1] https://www.theedgemarkets.com/article/govt-proposes-additional-budget-2020-visit-malaysia-year-campaign

[2] https://www.matta.org.my/press-release/34499-matta-hopes-budget-2020-will-provide-tax-incentives-on-upgrading-of-tourism-vehicles

5) Energy sector

The Cabinet has approved a 10-year master plan to reform the domestic power industry, in which the government will now stop approving new independent power production projects that come with power purchase agreements (PPA). Under the Malaysia Electricity Supply Industry 2.0 (MESI 2.0), the main feature of the master plan is to introduce liberalisation across the industry from fuel sources, generation to transmission and distribution and retail in Peninsula Malaysia. It will also encourage and facilitate the supply of green energy in the country. The Energy, Technology, Science, Climate Change and Environment Minister, Yang Berhormat (YB) Yeo Bee Yin revealed that the key reform initiatives are:

1. Allow generators to source own fuel to optimise cost.
2. Move from PPA regime to capacity and energy market.
3. Establish third party access framework and network charges for grid to allow third party using the infrastructures.
4. Facilitate green energy producers and consumers.

According to YB Yeo, an investment of RM33.0 billion is required to meet the target of 20.0% Renewable Energy (RE) generation which will be contributed by government, private-public partnership as well as private financing[3]. On that note, the government would likely allocate funds for various initiatives, programs and policies to achieve the target.

Produced and issued by BANK ISLAM MALAYSIA BERHAD (Bank Islam) for private circulation only or for distribution under circumstances permitted by applicable laws. All information, opinions and estimates contained herein have been compiled or arrived at based on sources and assumptions believed to be reliable and in good faith at the time of issue of this document. This document is for information purposes only and has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. No representation or warranty, expressed or implied is made as to its adequacy, accuracy, completeness or correctness. All opinions and the content of this document are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Bank Islam as a result of using different assumptions and criteria. No part of this document may be used, reproduced, distributed or published in any form or for any purpose without Bank Islam's prior written permission

[3] https://malaysia.news.yahoo.com/yeo-malaysia-aiming-20pc-renewable-051425098.html