Economic Research, Strategic Management

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Budget 2019 preview – making sure the house in order

Overview

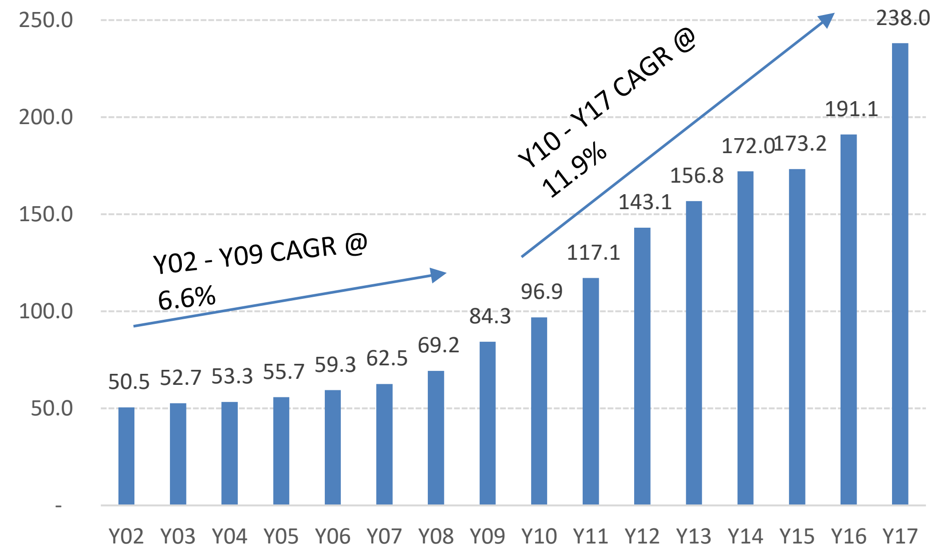
Malaysia's Budget 2019 is set to be tabled on 2 November will give a clearer picture for the general public and the investors on Malaysia's economic direction. Bracing for a "difficult budget" as mentioned by the Finance Minister, the government is now striving to ensure the house is in order. Such remarks came following the revelation of RM1 trillion public debts or approximately 80.3% of total GDP in 2017. Based on the Mid-Term Review of 11th Malaysian Plan (MTR11MP), fiscal deficit is targeted to reach 3% of GDP by 2020. As such, the government is not totally on austerity drive. At the same time, the government is not about giving up its fiscal consolidation mantra.

Thus far, a 10% pay-cut for all ministers and high-ranking officials has been implemented to reduce the operating expenditure**.** Furthermore, the implementation of zero-based budgeting to all its ministries and departments will reduce unnecessary spending and leakages. The **"**Rakyat-Centric" expenditure such as the Bantuan Sara Hidup (BSH) will most probably be pared down in the coming years as the government will look for ways that only deserving households will continue to receive such financial assistance. This is especially true when the optic for poverty definition will be multi-dimensional. This will include years of schooling, access to healthcare facility, conditions of living quarters and household incomes among others. That way, any assistance to the lower income group will be more targeted.

Meanwhile, government has reduced the cost of few mega projects such as Light Rail Transit 3 (LRT3) by 47.5% from RM31.65 billion to RM16.63 billion and MRT Line 2 (MRT2) above ground works by 23.0% from RM22.6 billion to RM17.4 billion. On top of that, the government has also been reviewing projects that involves government guarantees and public-private partnership schemes (PPP). This is to ensure that the government guaranteed (GG) liabilities will not post serious threat to its creditworthiness especially when debts guaranteed by the government has been growing at Compounded Annual Growth Rate (CAGR) of 11.9% between 2010 and 2017. This is by far lower compared to CAGR of 6.6% recorded between 2002 and 2009. Allowing GG to grow indefinitely would strain the government's cash flow at some point especially when some of it would be crystalised, leading to actual obligation on the part of the government to honour the debt repayments.

Therefore, the government has limited space to prescribe additional spending. Already, Moody's Investors sovereign analyst has indicated that the recent adjustment to the fiscal deficits in 2020 is deemed to be credit negative. As such, raising new taxes and keeping a lid on expenditure will shape the fiscal policy in the immediate terms.

Chart 1: Government guaranteed debt (RM billion)



Sources: BNM & CEIC

Table 1: Government guaranteed liabilities (RM billion)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Perbadanan Tabung Pendidikan Tinggi Nasional (PTPTN)	11.00	14.00	17.00	20.35	24.20	29.20	33.20	35.20	40.35
Federal Land Development Authority (FELDA)	-	1.50	2.55	3.42	3.82	5.72	5.15	4.57	4.15
Perbadanan Kemajuan Negeri Pahang	-	-	-	-	0.20	0.20	0.20	0.20	0.20
Lembaga Pembiayaan Perumahan Sektor Awam (LPPSA)	-	-	-	-	-	-	-	-	4.00
Total Statutory Bodies (A)	**11.00**	**15.50**	**19.55**	**23.77**	**28.22**	**35.12**	**38.55**	**39.97**	**48.70**
Companies									
1Malaysia Development Bhd (1MDB)	-	-	-	-	5.00	5.00	5.00	5.00	5.00
TRX City Sdn Bhd (formerly 1MDB Real Estate Sdn Bhd)	-	-	-	-	0.80	0.80	0.80	0.80	0.70
Asset Global Network Sdn Bhd	-	-	-	-	1.01	0.96	0.86	0.76	0.66
Bank Pembangunan Malaysia Berhad	9.42	8.07	11.94	12.76	12.32	10.99	13.71	7.20	6.52
Small and Medium Entreprise Bank (SME Bank)	0.41	0.27	1.03	0.99	1.41	1.36	2.34	2.32	2.31
Danainfra Nasional Berhad	-	-	-	-	2.40	6.50	14.10	20.70	29.70
Govco Holdings Berhad	-	-	-	-	3.00	3.00	3.00	3.00	4.60
Jambatan Kedua Sdn Bhd	-	0.72	1.49	2.88	3.79	4.72	5.16	5.55	7.40
Johor Corp	-	-	-	-	3.00	3.00	3.00	3.00	3.00
Khazanah Nasional Berhad	10.35	10.50	13.20	13.20	17.70	18.70	20.00	20.00	18.00
KL International Airport Bhd	8.42	7.79	7.22	6.68	5.99	5.33	4.72	2.52	0.29
Malaysia Debt Ventures Sdn Bhd	-	0.50	-	-	1.00	1.00	1.00	1.10	1.20
Malaysian Industrial Development Finance (MIDF)	0.19	0.15	0.13	0.10	0.06	0.03	0.02	0.01	0.01
Pelabuhan Tanjung Pelepas Sdn Bhd	-	0.72	1.28	1.64	1.56	1.87	2.10	2.01	1.93
Penerbangan Malaysia Berhad (PMB)	8.57	7.69	7.02	7.07	6.55	5.83	3.97	4.99	0.66
Pengurusan Air SPV Bhd (PAAB)	-	-	-	-	9.50	9.85	10.45	12.21	12.71
Projek Lebuhraya Usahasama Bhd (PLUS)	-	-	-	-	11.00	11.00	11.00	11.00	11.00
Prasarana Malaysia Bhd	7.10	9.10	9.10	8.91	9.91	11.91	13.91	17.56	18.70
Sabah Electricity Sdn Bhd (SESB)	0.04	0.04	0.03	0.03	0.02	0.02	0.01	0.01	0.08
Sarawak Hidro Sdn Bhd (SHSB)	4.00	4.00	-	-	5.35	6.35	6.35	5.64	1.00
Senai Airport Terminal Services Sdn Bhd	-	-	-	-	0.33	0.33	0.33	0.33	0.33
SRC International Sdn Bhd	-	-	-	2.00	4.00	4.00	4.00	4.00	4.00
Tenaga Nasional Bhd	4.41	4.40	4.36	4.43	3.66	2.63	2.33	2.33	2.87
Turus Pesawat Sdn Bhd	-	-	-	-	3.40	5.31	5.31	5.31	5.31
Sentuhan Budiman	-	-	-	-	-	-	-	0.40	0.65
Sarawak Capital Resources Ltd	1.46	1.21	0.81	0.58	0.31	0.10	-	-	-
Silterra Malaysia Sdn Bhd	-	-	-	-	1.80	1.80	-	-	-
Bank Pertanian Malaysia	0.11	0.08	0.06	0.05	0.02	-	-	-	-
Valuecap Sdn Bhd	-	5.00	5.00	5.00	-	-	-	-	-
Aircraft Business Malaysia Sdn Bhd	0.95	0.77	0.54	-	-	-	-	-	-
Total Companies (B)	**55.42**	**61.00**	**63.20**	**66.33**	**114.89**	**122.38**	**133.47**	**137.8**	**138.535**
Total(A + B)	**66.42**	**76.50**	**82.75**	**90.10**	**143.11**	**157.50**	**172.02**	**177.73**	**187.24**

Source: The Edge Malaysia, 8 January 2018

Widening fiscal deficits expected

The fiscal deficits are expected to widened from 3.3% of GDP in 2018 (2017: -3.0%) to -3.7% in 2019. This is on account of slower revenue growth which is in tandem with moderation in the real GDP growth. In this report, we will also share our real GDP growth forecast for 2019. We are projecting GDP to grow from a revised 4.8% in 2018 (Previously: 5.1%) to 4.5% due to weak external demand as reflected in the contraction of net exports of 8.3% next year. Additionally, the one-off tax refunds (Outstanding GST Tax Refunds: RM19.4 billion, Income Tax and Real Property Gain Tax: RM14.6 billion) could also put a strain on government's operating expenditure in 2019.

Table 2: Federal government budgetary position

RM Mllion	2015	2016	2017	2018F	2019F
Revenue	219,089	212,421	220,406	227,459	232,008
%chg	-0.7%	-3.0%	3.8%	3.2%	2.0%
Operating expenditure	216,998	210,173	217,695	231,845	245,756
%chg	-1.2%	-3.1%	3.6%	6.5%	6.0%
Current balance	2,091	2,248	2,711	-4,386	-13,748
Gross development expenditure	40,768	41,995	44,884	44,435	44,435
%chg	3.2%	3.0%	6.9%	-1.0%	0.0%
Less: Loan recoveries	1,483	1,347	1,852	1,000	500
Net development expenditure	39,285	40,648	43,032	43,435	43,935
%chg	2.2%	3.5%	5.9%	0.9%	1.2%
Overall balance	-37,194	-38,400	-40,321	-47,821	-57,683
Overall balance % of GDP	-3.2%	-3.1%	-3.0%	-3.3%	-3.7%

Sources: MOF, CEIC & Bank Islam

Table 3: GDP growth projection

Growth	2015	2016	2017	2018F	2019F
GDP	5.0%	4.2%	5.9%	4.8%	4.5%
Domestic Demand	5.1%	4.3%	6.5%	4.9%	5.5%
Consumption	5.7%	4.9%	6.7%	6.0%	6.1%
-Public	4.4%	0.9%	5.4%	3.6%	3.3%
-Private	6.0%	6.0%	7.0%	6.6%	6.7%
Investment	3.6%	2.7%	6.2%	2.2%	3.9%
-Public	-1.1%	-0.5%	0.1%	-4.0%	5.0%
-Private	6.3%	4.3%	9.3%	5.0%	3.5%
Exports	0.3%	1.1%	9.6%	4.5%	3.5%
Imports	0.8%	1.1%	11.0%	5.4%	4.8%

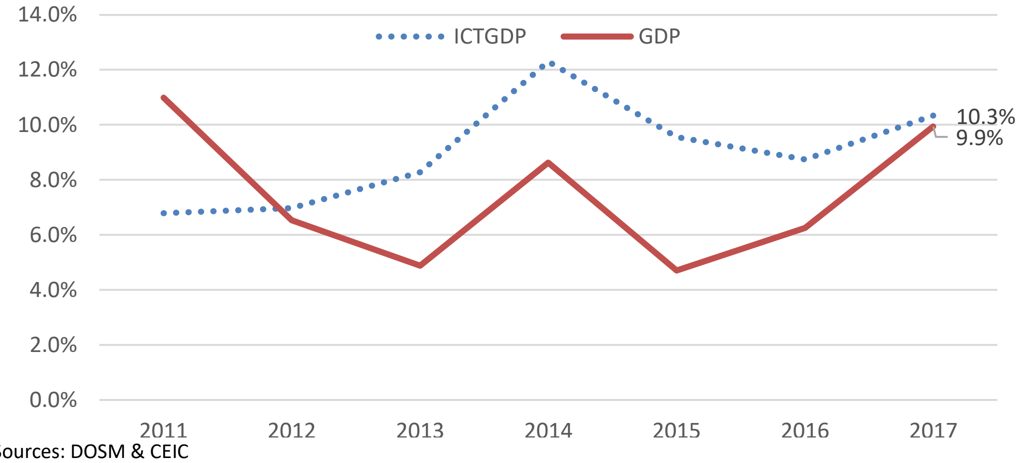
Source: Bank Islam

Budget 2019 Expectations

1) Digital tax

This appears to be the low-hanging fruits as the Information, Communication and Technology (ICT) industries have been growing at a rapid pace. In 2017, the GDP for ICT industries and gross value added for e-commerce of non ICT grew by 10.3% versus nominal GDP growth of 9.9%. Additionally, the contribution of total output in the sector to GDP increased from 16.5% in 2010 to 18.3% in 2017 which in absolute amount stands at RM247 billion. As such, there is urgencies to level the playing field between international and local players whereby the former has been enjoying a good business as a result of the proliferation of smart devices among Malaysians.

Chart 2: ICTGDP growth vs. nominal GDP growth



Sources: DOSM & CEIC

Table 4: GDP of ICT (ICTGDP) and gross value added for e-commerce of non ICT

RM Million		Gross value added	
Years	ICTGDP	e-commerice of non ICT	Total
2010	105,745	29,576	135,321
2011	108,103	36,407	144,510
2012	113,799	40,787	154,586
2013	122,734	44,641	167,375
2014	137,252	50,723	187,975
2015	151,861	54,077	205,938
2016	164,359	59,578	223,936
2017	178,217	68,858	247,075

Source: Department of Statistics Malaysia (DOSM)

Table 5: GDP of ICT (ICTGDP) and gross value added for e-commerce of non ICT

% of GDP		Gross value added	
Years	ICTGDP	e-commerice of non ICT	Total
2010	12.9%	3.6%	16.5%
2011	11.9%	4.0%	15.9%
2012	11.7%	4.2%	15.9%
2013	12.0%	4.4%	16.4%
2014	12.4%	4.6%	17.0%
2015	13.1%	4.7%	17.8%
2016	13.4%	4.8%	18.2%
2017	13.2%	5.1%	18.3%

Source: Department of Statistics Malaysia (DOSM)

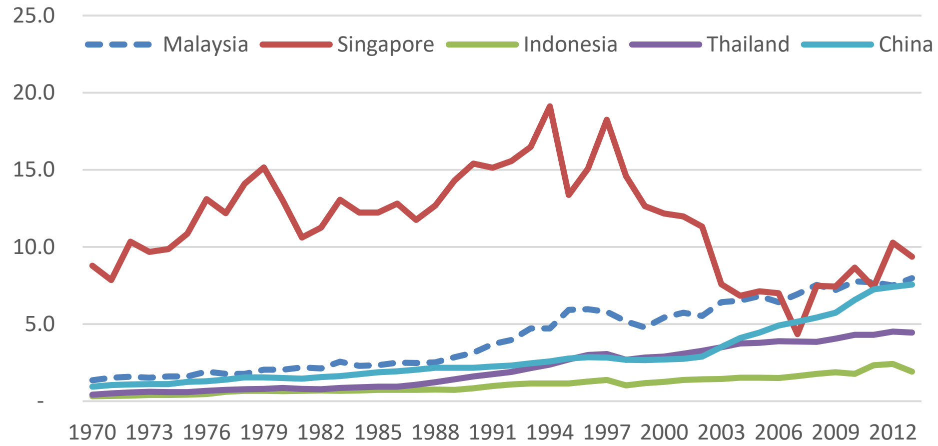
2) Sugar/Soda tax

The government may also considering to impose tax on sugar or soda consumption to encourage and promote healthy lifestyle among Malaysians. This is an initiative by the government to cut sugar content in carbonated drinks products due to the high prevalence of diabetes and obesity problem among the citizens. According to National Diabetes Institute (NADI), Malaysia has the highest rate of diabetes in Asia and one of the highest in the world. There are 2.5 million adults with diabetes in Malaysia

3) Logging and Carbon tax

The government should introduce these taxes to promote environmental sustainability and protect the green scenery. Extensive and unrestrained logging activities have led to environmental disasters, such as floods and landslides. Indirectly, it will destroy infrastructure and cause the government to spend more money to repair the damage. As such, the government needs to take action on this matter so that the activities can be controlled accordingly. Meanwhile, carbon tax should be introduced to ensure the industrial sector players to reduce the amount of greenhouse gases released by employing environmental-friendly technologies in their production.

Chart 3: CO2 emission (metric ton per capita)



Source: World Bank

In a nutshell…

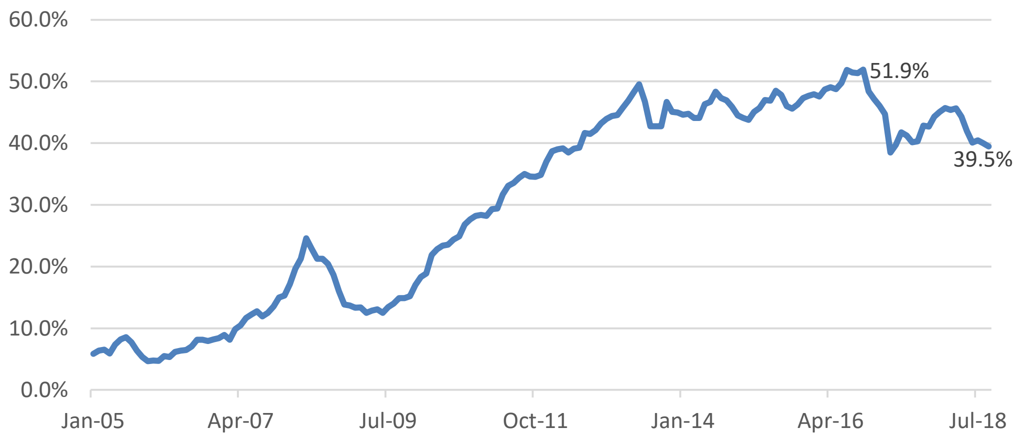
Higher indebtedness would mean the government would need to contain their expenditure in order to consolidate its fiscal position. Meanwhile, introducing a new taxes would be an ideal solution but it is an uphill task as the economy is expected to grow below the trend level (4.8%) in 2019. The recent reaction from the credit rating agencies are not forthcoming and the 5-year Credit Default Swap (CDS) spread has widened to 111 basis points from 93 basis points at the end of September. Perhaps, credit markets have become somewhat jittery on government budgetary position.

Chart 4: Malaysia's 5-year Credit Default Swap (CDS) spread

Source: Bloomberg

Despite that, foreign investors have been actively offloading their holdings in the Malaysian Government Securities (MGS) to 39.5% as of September. The highest level was reached at 51.9% in July 2016. It seems the sell-down in MGS has been quite overdone. Assuming there is no deterioration in Malaysian government credit, we believe USDMYR will continue to linger around its support and resistance level of RM4.1516 and RM4.2438. Our base case for 2019 is that the BNM might want to maintain the Overnight Policy Rate (OPR) at 3.25%. This should, to some extent, help to support ringgit in the immediate terms.

Chart 5: Foreign ownership in Malaysian Government Securities (MGS) % of outstanding



Source: CEIC