Economics & Strategy

DBS Flash

Malaysia Budget 2020: Walking the tight rope

Economics/growth/fiscal/Malaysia

Group Research

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- *Budget 2020 was announced last week, with key focus on boosting economic growth and fostering inclusivity*
- *The budget remains expansionary, with the fiscal deficit expected to register 3.2% in 2020, from 3.4% in 2019*
- *However, the budget may not be enough to help the economy achieve the target growth of 4.8% in 2020. Further monetary easing may be required*
- *There is also marginal upside risk to the fiscal target amid potentially weaker than expected growth*
- ***Implication for our forecast** – full year GDP growth for 2020 is projected to register 4.6%, which is below the official target of 4.8%*
- ***Implications for investors** – monetary easing is on the cards to provide more support for the economy*

Budget 2020

Finance Minister Lim Guan Eng tabled Budget 2020 last week. This is the second federal budget by the Pakatan Harapan (PH) government, and it carries the theme "Driving growth and equitable outcomes towards shared prosperity". Besides being the final budget under the Malaysia 11th Plan, this budget also provides a clearer vision of the longer-term economic strategies of the current PH government.

In addition, the government also unveiled the Shared Prosperity Vision 2030 Plan prior to the budget announcement. The plan aims to raise the living standards of all Malaysians over the next ten years. There are three objectives to be fulfilled under the Shared Prosperity Vision agenda, 1) to address income and wealth inequality, 2) to create a more progressive and more participatory higher value economy and 3) to establish Malaysia as one of the leading economic pillars in Asia. As such, Budget 2020 is essentially the first instalment to achieving these long-term goals.

Some of the key thrusts include efforts to boost economic growth amid external headwinds, promote digitalization of the economy, invest in human capital and foster inclusive growth. Policymakers reckon that Malaysia's electronics cluster would benefit from the trade diversion effects resulting from the ongoing trade war. As such, tax incentives have been introduced to bolster growth in this cluster. In addition, a pipeline of infrastructure projects was announced in a bid to boost domestic growth.

These include the Klang Logistics Corridor, the Kota Perdana Special Border Economic Zone, as well as several other infrastructure projects across various parts of the country. Notably, the National Fiberisation & Connectivity Plan (NFCP) was also announced to create the necessary infrastructure to provide comprehensive coverage of high speed and quality digital connectivity nationwide over the next 5 years. The NFCP will adopt a public private partnership approach involving a total investment of MYR 21.6bn. Moreover, a whole slew of grants, cash handouts and tax incentives were also introduced to encourage growth in the digital industry and E-commerce, adoption of digital technology amongst SMEs and usage of digital transactions by consumers.

Measures were also put in place to encourage entrepreneurship, support start-ups and R&D activities. Specific industries such as the tourism industry (Visit Malaysia 2020 Plan), Islamic finance and green energy sectors have also received some fiscal boost from the authority. Efforts to foster inclusive growth include the significant amount of funding to the agriculture sector, and more importantly, improving the welfare of the Felda communities (MYR 810mn), and raising the income of workers employed in this sector (MYR 4.9bn).

To support workers, the government launched the Malaysia@Work initiative. Besides some support for on-job-training, this initiative is broadly a wage subsidization scheme for Malaysian workers, and to encourage employers to reduce their reliance on low cost foreign workers. For example, the sub-scheme Locals@Work involved cash incentives for both Malaysian employees and employers if the latter decide to replace foreign workers with locals. Though this will likely raise local employment, the potential drag on the fiscal balance, as well as whether such a scheme will lead to higher productivity for the overall economy are concerns to be reckoned with.

There is no significant tax changes in this budget except for the proposal for a new band for taxable income in excess of MYR 2mn to be introduced, and taxed at 30%. This is higher than the current 28% for top income earners. The move will affect approximately 2,000 top income earners in the country although the boost to tax revenue could be marginal given the small tax base for such an initiative.

A smaller budget

While the government has managed to achieve its fiscal target of -3.4% for the current financial year, Budget 2020 is a smaller budget compared to the previous one (Table 1). The government budgeted MYR 297bn in spending for 2020, 6% lower than the MYR 316bn earmarked for this year. In addition, revenue is also expected to drop to MYR 244.5bn in 2020, down 7.1% from MYR 263.3bn in 2019 due to the absence of Petronas dividends. This entails a slightly wider budget deficit of 3.2% of nominal GDP in 2020, from the original target of 3.0%.

Despite the wider deficit, we doubt the budget would be able to deliver the required impetus for the economy. Part of the reason for the higher than originally budgeted deficit is due to the "lost" GST revenue. The government abolished the highly unpopular GST in June last year and re-introduced the Sales and Services Tax (SST). That tax policy change has resulted in a net shortfall of about MYR 22bn (approx. 10% of revenue). Beyond the lost tax earnings, the government has also paid out about MYR

17.1bn of GST and income tax refund as of Apr19.

Perhaps what is encouraging is that developmental expenditure has risen by about 4.6% while some belt tightening is expected to reduce the operating expenditure (opex) by 8.1% to MYR 241bn. Yet, while the increase in developmental budget along with the associated multiplier effects could deliver some fiscal impulse, this could be partially offset in the near-term by opex reductions. As a result, net fiscal impact on economic growth could fall marginally short of expectation. As such, there may be a need for a slightly more accommodative monetary policy to render support for the economy beyond the announced fiscal budget. We expected another 25bps cut by Bank Negara by mid-2020.

Marginal upside risk on fiscal deficit

Indeed, the government's goal to pursue fiscal consolidation (2% deficit in the medium term) and reduce overhanging debt amid the current global economic climate is a challenging task. Slowdown in China and the ongoing trade disputes between the US and China, resulting in disruptions to the global supply chain, will continue to weigh on the growth prospects for the economy. Considering the impetus from both monetary and fiscal policies, we expect full year GDP growth in 2020 to improve just marginally to 4.6%, from a projected 4.5% this year. This is lower than the official target of 4.8% announced in this budget. Moreover, there are significant upside risks on expenditure given many of the broad-based subsidy schemes, but little optimism on the revenue front due to potentially slower than expected growth. By this account, there could be marginal upside risk to the projected fiscal deficit.

Table 1: Federal Government Financial Position, 2018-2020

	MYR million			% YoY change			% Share of GDP		
	2018	2019	2020	2018	2019	2020	2018	2019	2020
	Actual	Revised	Estimate	Actual	Revised	Estimate	Actual	Revised	Estimate
Revenue	232,882	263,300	244,530	5.7	13.1	-7.1	16.1	17.4	15.2
Operating expenditure	230,960	262,260	241,020	6.1	13.6	-8.1	16.0	17.3	14.9
Current balance	**1,922**	**1,040**	**3,510**				**0.1**	**0.1**	**0.3**
Gross development expenditure	56,095	53,700	56,000	25.0	-4.3	4.3	3.9	3.5	3.5
less: Loan recovery	788	900	766	-57.5	14.2	-14.9	0.1	0.0	0.0
Net development expenditure	55,307	52,800	55,234	28.5	-4.5	4.6	3.8	3.5	3.5
Overall balance	**-53,385**	**-51,760**	**-51,724**				**-3.7**	**-3.4**	**-3.2**
Primary balance	**-22,838**	**-18,760**	**-16,779**				**-1.6**	**-1.2**	**-1.0**

Source: Ministry of Finance, Malaysia

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).