Malaysia

OCBC Bank

Pre-Budget Outlook 2018

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Highlights

- Malaysia's 2018 budget: "Shaping the Future" is slated to be announced on 26th October 2017, ahead of its general election which is to be held before 24th August 2018.
- Our estimate suggests Malaysia is on track in achieving its target of -3.0% budget balance as % of GDP in 2017. The narrowing budget deficit is seen on the back of higher revenue, led by GST receipts (+14.4% yoy) as well as higher export duties (+29.1% yoy). The higher revenue thus, is able to cushion the relatively higher expenditure (operating: +2.7%, development: +7.9%).
- Into 2018, we expect the budget to address the rising cost of living through various targeted incentives for middle-low income groups through its BR1M programme. Other social policies could also revolve around the budget theme, which will likely concentrate on education & training, improving healthcare standards and affordable housing. The emphasis on economic development that uses technology, such as robotics and cloud computing, may be expected as well. To finance the higher expenditure, we foresee the government to see higher GST collection (up to MYR47.6bn from 2017 estimate of MYR47.1bn). Elsewhere, higher corporate and income tax revenue may also be expected in line with a relatively benign economic environment into 2018.
- All-in-all, we expect Malaysia to project a budget deficit of 2.9% of GDP in 2018, from an estimated of 3.0% in 2017.

Shaping the future

The Budget 2018 cannot be more aptly themed "Shaping the future", ahead of the many uncertainties and potentially disruptive technologies Malaysia may see into the many years to come. With the Transformasi Nasional 2050 plan (a 30-year initiative plan in the period 2020 – 2050) first announced by Prime Minister Najib Razak in the Budget 2017, we can expect more details to be released in terms of shaping Malaysia's SMEs and the digital economy. Moreover, similar to the previous budgets, we also expect the upcoming budget to promote the well-being of the Rakyat as well as supporting businesses, and eventually ensuring the economy expands at a healthy space, coupled with a more prudent fiscal deficit.

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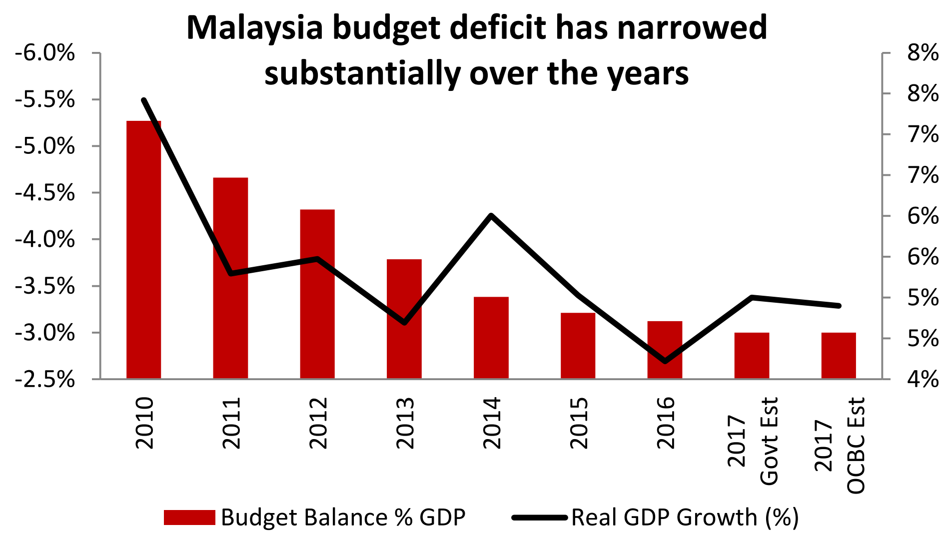
Chiefly, we expect the government to revisit its 2017 growth estimate of 4 -5% in the upcoming budget. Malaysia's economic growth has been relatively rosier versus 2016, underpinned by a robust uptick in trade activities and higher oil prices. Note that Bank Negara Malaysia (BNM) had highlighted that the strengthening global growth and pick up in trade is still being observed, and Malaysia's future growth prospects "will be sustained by the more positive global growth outlook and stronger spillovers from the external sector to the domestic economy". Moreover, foreign direct investments rose to MYR17bn in 1Q17 and MYR8.2bn in 2Q17 mainly seen in manufacturing, mining and services industries.



Source: Bloomberg, CEIC, OCBC Bank

Centering on social policies

Given that it is a pre-election budget, we expect many "goodies" to be handed out. The budget will likely center on how the government could provide more assistance to both the middle-low income segments as well as SMEs. With social policies likely to center on the rising cost of living, we expect the budget to focus on targeted incentives for households (especially in the middle-low income groups or B60%), as well as lending support to civil servants. Statistically, the government has already distributed MYR5.9bn and MYR6.8bn in 2016 and 2017, respectively, through its 1Malaysia People's Aid (BR1M) programme, which we think will recur once again into 2018 (potentially having an allocation above MYR7.5bn).

Moreover, more social "goodies" may also be seen in the three key areas: (1) education and training, (2) affordable homes and (3) upgrading of healthcare services. These could include higher expenditure on healthcare and education subsidies into the next year, similar to what was seen in the previous election budget 2014. Moreover, a higher sum may be allocated for the Permata programme (early child education system for the intellectually disabled) as well as increasing the number of scholarships under the MyBrain15 programme to provide support for professional education in the nation. Affordable homes schemes can also be expected, in view of rising property prices and first-time home owners' struggle to obtain loans. The aid could come in the form of reduced GST payment on housing materials, while other targeted exemptions on stamp duty and the provision of special end-financing scheme could aid home-buyers. Lastly, healthcare subsidies may also be extended in order to defray the rising medical costs, as well as providing a sizable allocation to improve healthcare quality.

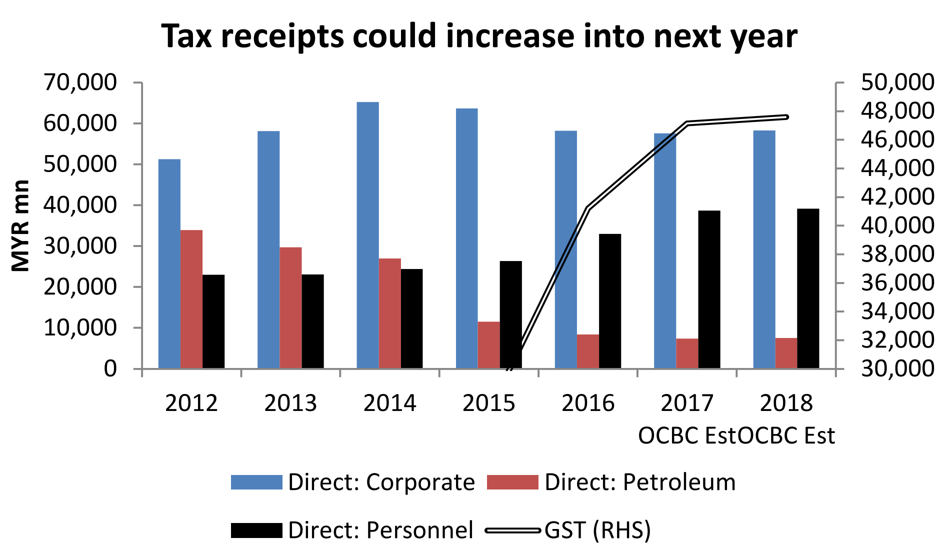
Shaping the business for the future

While Malaysians see higher standard of living (as well as costlier living), labour productivity has also been one of the key challenges its domestic economy faces. In the coming year, we believe that Budget 2018 will place a lot more emphasis on economic development that uses technology, in part to promote the digital economy, and at the same time provide the needed environment for improved labour productivity. These could include tax inventives for industries that pioneer in emerging technologies such as automation, robotic development, Fintech, and cloud services, as well as potentially giving extended incentives for SMEs to stimulate growth. A rather more ambitious (but plausible) move may also take form in encouraging SMEs start-ups in these targeted industries to direct the growth of its digital economy.

Lastly, the government will also likely signal its commitment to spend on major infrastructure projects to spur economic growth. These projects include the East Coast Rail Link, the Gemas-Johor Baru double-tracking project, the Malaysia Vision Valley and the Pan-Borneo Highway. The move to promote infrastructure spending into 2018 will definitely have a positive impact on the construction sector, and in turn provide the needed support for the overall economy. Importantly, infrastructure spending in Malaysia is expected to be among the fastest in the world, estimated to average 15.5% in nominal terms out to 2021, according to Timetric's Infrastructure Intelligence Center. Note Malaysia's construction industry grew rapidly at 7.4% (MYR166.4bn) in 2016, where infrastructure plans accounted 34% of total construction output.

Where is the money coming from?

Given the rosier economic environment into 2018 as well as higher oil prices, we opine that the bulk of the higher expenditure may be cushioned by higher individual and corporate tax revenues, as well as a bigger intake in GST revenue. Moreover, higher oil prices into the next year would also provide more petroleum tax intake as well. Essentially, our estimates suggest that corporate, petroleum and personnel tax reciepts could rise by between 1 – 2% in the next year, while GST intake could rise by 1.0% to MYR47.6bn, up from our 2016 estimate of MYR47.1bn.



Source: CEIC, OCBC Bank

All-in-all, we pencil Malaysia's budget deficit decline slightly to 2.9% of GDP, from 3.0% in 2017. Higher tax receipts from both income and GST components, as well as a potentially stronger growth, will definitely aid Malaysia in narrowing its budget deficit further into 2018. At this juncture, we keep our 2018 growth and inflation estimate at 4.9% (with upside risk) and 2.9%, respectively.

Appendix

	2015	2016	1H17	8M17	2017 Govt Est	2017 OCBC Est	2018 OCBC Est
Budget Balance	**-37,193.8**	**-38,400.0**	**-33,972.9**	**-30,185.9**	**-40,374.0**	**-40,107.3**	**-37,295.1**
Budget Balance % GDP	**-3.2%**	**-3.1%**	**-5.2%**	**-4.6%**	**-3.0%**	**-3.0%**	**-2.9%**
Central Govt Revenue	**219,088.8**	**212,421.1**	**97,075.7**	**138,136.7**	**219,726.0**	**219,882.8**	**221,715.2**
Total Expenditure	**256,282.6**	**250,821.1**	**131,048.6**	**168,322.6**	**260,100.0**	**259,990.2**	**259,010.3**
Operating Expenditure	216,997.5	210,172.7	111,094.0	141,846.5	214,800.0	215,785.1	214,318.3
Development Expenditure	39,285.1	40,648.5	19,954.6	26,476.1	45,300.0	44,205.1	44,692.0
Development Expenditure Gross	40,767.7	41,995.0	20,219.5	26,962.3	-	45,300.0	46,000.0
Less: Loan Recoveries	1,482.6	1,346.6	264.9	486.2	-	1,094.9	1,308.0
Total Revenue	**219,088.8**	**212,421.1**	**97,075.7**	**138,136.7**	**219,726.0**	**219,882.8**	**221,715.2**
Tax	165,440.7	169,343.3	77,162.8	107,727.5	180,580.0	177,999.8	183,771.1
1. Direct	111,770.3	109,607.7	49,080.7	71,186.1	120,739.0	113,354.5	120,296.7
2. Indirect	53,670.3	59,735.6	28,082.1	36,541.4	59,841.0	64,506.0	63,474.3
Non Tax and Receipts	53,648.1	43,077.8	19,912.9	30,409.2	39,146.0	41,883.1	35,917.8
1. Non Tax	51,466.8	40,006.2	18,162.1	28,218.6	-	39,174.7	33,472.6
2. Non Revenue Receipts	2,181.4	3,071.6	1,750.8	2,190.6	-	2,708.4	2,445.1

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Operating Expenditure	**216,997.2**	**210,172.7**	**111,094.0**	**141,846.5**	**214,800.0**	**215,785.1**	**214,318.3**
Emoluments	70,050.7	73,108.4	38,690.7	48,200.9	-	72,694.6	71,951.2
Other Expenditure	1,108.3	913.4	662.4	849.0	-	936.5	986.1
Pension and Gratuities	18,872.4	21,029.0	11,572.0	14,092.9	-	20,775.9	20,225.7
Debt Service Charges (DS)	24,282.3	26,479.4	13,460.5	16,730.8	-	25,879.0	25,546.9
Supplies and Services	36,372.8	30,070.5	15,591.6	20,379.2	-	34,404.1	33,615.8
Subsidies	27,269.0	24,563.9	13,342.3	18,471.6	-	26,421.1	26,084.7
Asset Acquisition	1,722.7	675.7	71.0	315.4	-	1,190.7	1,196.4
Grants & Transfers	37,319.0	33,332.4	17,703.6	22,806.6	-	33,483.3	34,711.6
Development Expenditure Gross	**40,767.7**	**41,995.0**	**20,219.5**	**26,962.3**	**45,300.0**	**45,300.0**	**46,000.0**
General Admin	1,567.1	1,621.2	1,425.7	1,673.9	-	2,412.8	1,867.0
Defence and Security	4,753.9	4,832.5	2,024.6	2,708.2	-	5,669.0	5,085.1
Economic and Social	34,446.7	35,541.4	16,769.1	22,580.1	-	37,218.2	35,735.4
Economic Services (ES)	23,286.2	25,112.6	11,766.8	15,666.9	-	25,343.0	24,580.6
Social Services (SS)	11,160.5	10,428.8	5,002.4	6,913.2	-	11,875.3	11,154.9

Source: CEIC, OCBC Bank
Black: Empirical data
Blue: OCBC Estimates