Targeted Spending

Malaysia's budget places emphasis on goodies

Oct 21, 2016

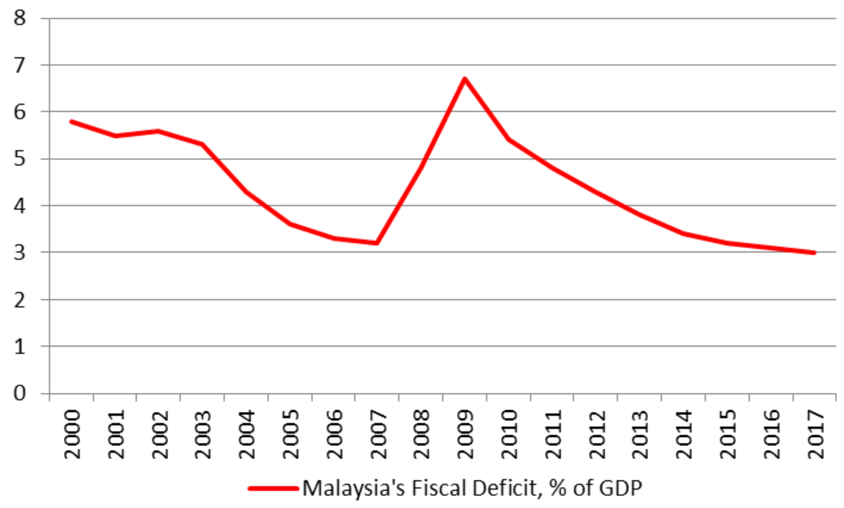
- **Malaysia's government announced its 2017 budget today, with PM Najib literally waxing poetic on the multitude of goodies for various segments of the population, from civil servants to rubber-tappers.**
- **His expenditure plan looks like it is maximizing whatever space made available by helpfully steadier oil price, and fruits from his previous moves to rationalize subsidies and implement GST.**
- **All these while also paying attention to at least the motion of fiscal consolidation, with a slight shrinkage of fiscal deficit to 3% of GDP being achievable if 2017 growth does prove to be as smooth-sailing as projected.**

Money for this, money for that

PM Najib of Malaysia – who is also the country's Finance Minister – spoke for a good 150 minutes in the parliament today, detailing his plan for the 2017 budget. His speech was a hotchpotch of items that managed to touch on everything from food recommendations for your next trip to Ipoh or Shah Alam, to quotes from India's Mahatma Gandhi to Indonesia's HAMKA.

For what matters most to the market, though, let's start from the overall numbers.

First, market would zoom in the projections for budget deficit in 2017. At 3.0% of GDP, it can – technically – still count as another year of fiscal consolidation, given that this year's fiscal deficit is projected to clock 3.1% of GDP. In and of itself, that should be enough to pre-empt the rating agencies from having to go through the motion of looking closely at any potential changes to their sovereign ratings for Malaysia.



Source: Bloomberg, OCBC.

Treasury Advisory

Corporate FX & Structured Products

Tel: 6349-1888 / 1881

Fixed Income & Structured Products

Tel: 6349-1810

Interest Rate Derivatives

Tel: 6349-1899

Investments & Structured Products

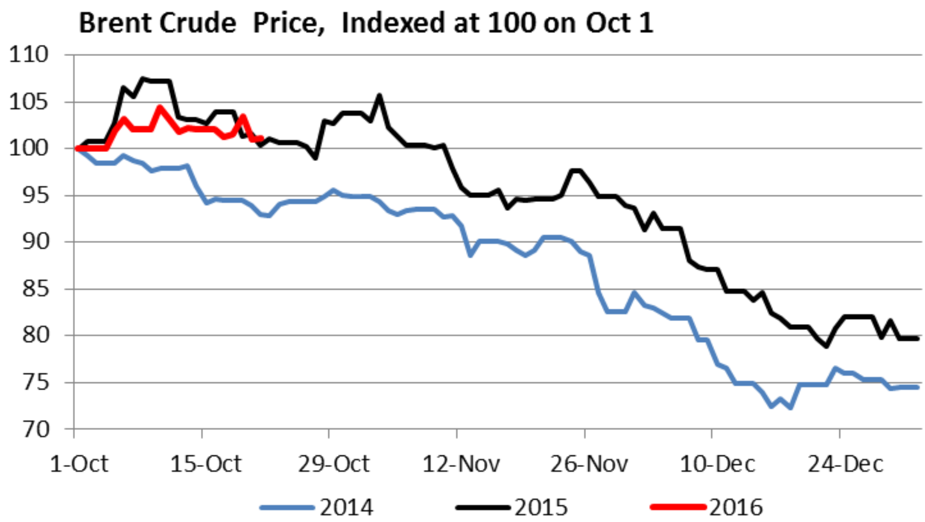
Tel: 6349-1886

Wellian Wiranto
Economist
Treasury Research & Strategy,
Global Treasury,
OCBC Bank

+65 6530-5949
wellianwiranto@ocbc.com

On the revenue side, the government's total income is expected to increase by a relatively modest 3% to MYR219.7bn in 2017. Continuing the trend established over the previous years, the contribution coming from oil and gas sector is expected to decline further to just 13.8% of total revenue in 2017, from 14.6% anticipated in 2016. This marks a significant downtrend from as much as 41.3% in 2009.

That is definitely a good thing, given that there has been a rather uncanny tendency for oil price to decline in the months after budget announcements in the previous years. For instance, right when PM Najib announced his 2015 budget in October 2014, oil price saw more than 20% decline by the end of the year. That was a pattern followed a year after, and necessitating a deja-vu revisions to the budget soon after.



Source: Bloomberg, OCBC.

While it might well be that oil price should at least be stable, if not potentially heading up depending on OPEC, the fact that the government's revenue stream is less and less dependent on oil and gas contribution can only be a good thing in this context.

If hydrocarbon contributions are not to be counted upon to fund the government's expenditure program, then what is? The Prime Minister was fairly quick to point out the key role played by GST, an unpopular measure that he launched. He spoke about how, year-to-date, the program has contributed as much as MYR30bn to national coffers. The figure is expected to tick up to MYR40bn next year, which would thus comprise over 18% of total revenue. Even as he lauded the success of the GST program, he was also keen to shoot down talks about any increase of the consumption tax from the current 6%, calling them "just hearsays and untrue."

The crucial role played by GST becomes especially important when we consider that the income tax base for Malaysia remains relatively narrow. Out of the country's total workforce of 14.6mn, there are only 2.1mn income taxpayers, for instance, at less than 15%. Indeed, it is interesting to note that the PM announced today the setting up of an agency with a curious acronym of CIA, standing for Collection Intelligence Arrangement, that will be especially tasked to "enhance efficiency in tax collection and compliance."

Enough about revenues though, since the focus of the budget speech is pretty much skewed towards allocation of government money. Here, the focus of recent years in emphasizing on taking care of the poor, making sure the civil servants are happy, and the development of rural areas and important states of Sabah and Sarawak can still be seen.

For one, the BR1M scheme sees further emphasis, with a total allocation of MYR6.8bn. Indeed, the PM spoke longingly of how a gentleman who has received assistance via the scheme came up to him and held his hand tightly in appreciation. He might look forward to more of such moments, as the new budget allocates 12.5-20% increases in hand-outs.

Meanwhile, civil servants can look forward to expanded childcare leave, monetary help for loans to purchase smartphones, motorcycles and housing alike. For good measure, he also throws in a “special assistance” worth MYR500 to all current civil servants and half that sum to retired ones in early January next year. Without this news, the PM seemed to joke, the 1.6mn-strong civil service community “will have sleepless nights.”

Elsewhere, in making sure that the people in rural areas and eastern states do not feel left out, the PM also mentioned goodies including water treatment facilities, details about how many street lamps will be installed, as well increases in monetary help for village heads, fishermen and paddy farmers. Rubber plantation smallholders are not missed out too, with a new Rainy Season Assistance scheme to help them weather through low season.

Outside of these groups, for urban dwellers who were hoping for any sort of tax cut, they would have to wait. To be sure, there are some stuff to be excited about such as how broadband service providers will “provide double the speed at half the price” and tax relief will be extended to such items as smartphone purchase and gym membership fees.

For SMEs, some goodies in the form of tax rate discounts should be helpful, although the magnitude might not move the needle much. The discounts come in a graduated manner depending on how much more chargeable incomes a particular SME declares in years of assessment of 2017 and 2018, compared to this year. For those with increase in taxable income between 5-10%, for instance, the tax rate reduction is at 1 percentage point. Those with higher growth in taxable income enjoy higher tax rate reductions. The PM illustrates how a firm that boosts its income from MYR10mn to MYR12mn next year for instance can look forward to a saving of MYR80,000 for instance.

Adjustment for tax rates for SMEs

Increase in chargeable income, vs. 2016	Reduction in income tax rate
5%-10%	1 percentage point
10%-15%	2 percentage points
15%-20%	3 percentage points
>20%	4 percentage points

Source: Malaysia Treasury.

Overall, it is unlikely to be seen as a budget that breaks through into new grounds, given that the major reforms such as GST and subsidy rationalization have been pursued. It is more likely to be regarded as a continuation of previous years’ moves in fiscal consolidation given oil price constraints, even as the key segments of the population would notice receiving that much more attention.

On that note, although the PM had dismissed talks of this being an Election Budget, the emphasis of the expenditure allocations, together with how he ended his speech today drumming up the idea of how there will be an “ultimate victory in the 14th General Election to the Barisan Nasional” should not be missed by investors.

Co.Reg.no.:193200032W