Malaysia Outlook

OCBC Bank

100 days later, what should we expect after this?

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Highlights

- **Manifesto promises may probably require a longer time period to be delivered**
- **Debt can risk weighing down on the government's fiscal situation**
- **Economic sentiment appears to be strong following the elections**
- **Growth will be slower for this year as the country goes through a transition phase**

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After 100 days, Prime Minister Mahathir Mohamad has claimed the government has achieved 21 out of 60 of its manifesto promises. In its own manifesto, Pakatan Harapan committed to deliver 10 promises in its first 100 days of which seven promises have actually been delivered or are on-going. However, it may be more crucial to understand what the first 100 days highlights directionally. Therefore, in this note, we will be looking at the situation of the first 100 days and the outlook going forward.

How has the government delivered on the manifesto?

Within the 100 days itself, at least seven of the ten promises which is to have either been delivered or are on-going. As for the others, three look to have been postponed and appear to be unlikely to be implemented soon given financial constraints. The five ongoing promises can be said to be ongoing with four of these likely to be implemented soon as they don't put as much of a financial constraint on the government. The only ongoing promise that may still see some delayed implementation is to "stabilise the price of petrol and introduce targeted petrol subsidies" given the financial commitment required.

However, other key promises in the manifesto to also watch closely include to "make the governance of our GLCs world class at par with international standards" which involves increasing Bumiputera equity holding through management buy-outs ,"spur investment and simplify business processes and trade" that involves improving the country's education system and raising productivity and "introduce a tax system that is people-friendly and entrepreneur-friendly" that will look into reviewing the tax system to particularly reduce the burden on small businesses. The government has been non-committal at this point on the timeline for the delivery of these promises.

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Table 1: Status of Pakatan Harapan's 100 days promises

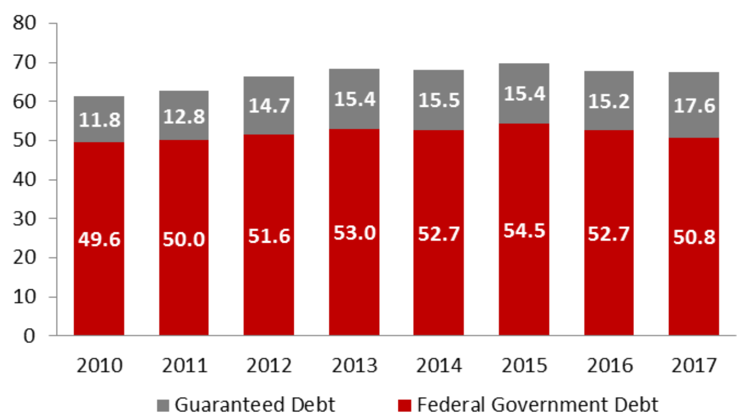
Promise	Status
Abolish the GST and take steps to reduce the cost of living.	Fulfilled
Initiate a comprehensive review of all megaprojects that have been awarded to foreign countries.	Fulfilled
Stabilise the price of petrol and introduce targeted petrol subsidies.	Ongoing
Set up royal commissions of inquiry on 1MDB, FELDA, MARA and Tabung Haji and to reform the governance of these bodies.	Ongoing
Set up a special cabinet committee to properly enforce the Malaysia Agreement 1963.	Ongoing
Equalize the minimum wage nationally and start the process to increase the minimum wage.	Ongoing
Introduce EPF contribution of housewives.	Ongoing
Abolish unnecessary debts that have been imposed on FELDA settlers.	Postponed
Postpone the repayment of PTPTN to all graduates whose salaries are below RM4,000 per month and abolish the blacklisting policy.	Postponed
Introduce Skim Peduli Sihat with RM500 worth of funding for the B40 group for basic treatments in registered private clinics.	Postponed

What fiscal situation does the government face?

From the very beginning, the new government highlighted the fiscal situation that it inherited, particularly pointing out the debt situation. Whilst, the Federal Government debt may only stand at 50.8% of GDP as of 2017, the guaranteed debt itself was at 17.6% of GDP. Even as Federal Government debt has been on the decline, the guaranteed debt itself has been climbing (see chart 1). Combined, the total debt stands at 68.4% of GDP. At this point, it is still not fully clear what constitutes the guaranteed debt. However, it is more crucial to understand the rest of the fiscal situation given that the debt can risk weighing down on the overall government position.

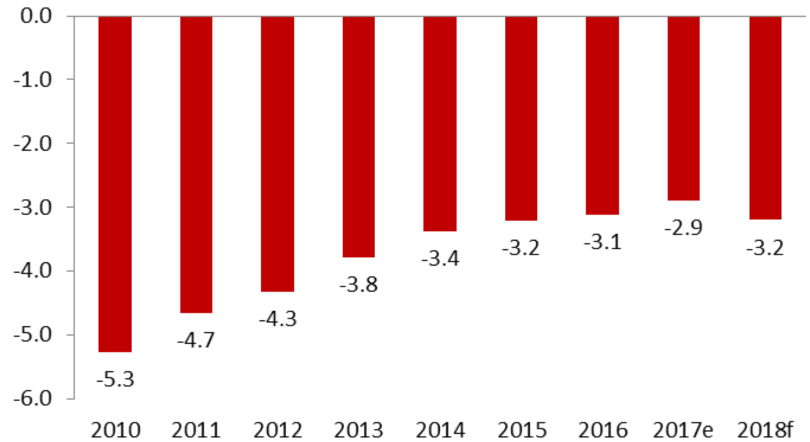
The fiscal deficit overall has been on the decline over the last few years (see chart 2) although we expect it to increase to 3.2% of GDP for 2018 given the budget changes made by the government and taking into account a revision to the growth forecast.

Chart 1: Federal Government and guaranteed debt, % of GDP



Source: Ministry of Finance Malaysia, CEIC and OCBC

Chart 2: Fiscal Deficit, % of GDP

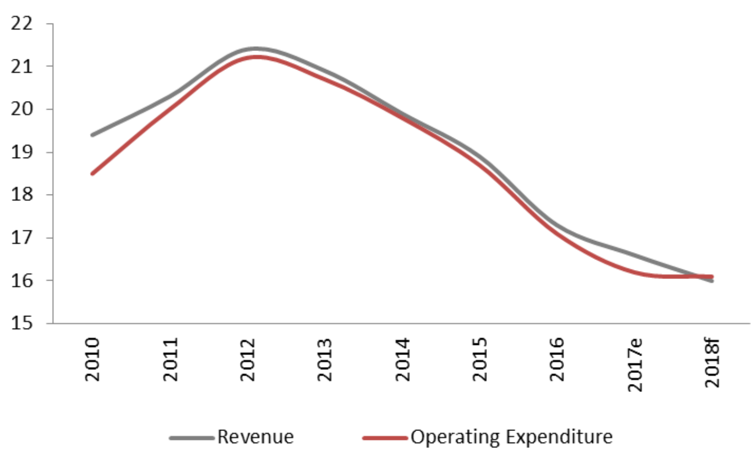


Source: Ministry of Finance Malaysia, CEIC and OCBC
Note: 2017 calculation based on MoF economic report 2018 and actual GDP growth

The government revenue as a percentage of GDP has been declining and we forecast it to further decline to 16.0% in 2018 (see chart 3). For 2018, the government increasingly finds itself more dependent on direct tax (see chart 4) and particularly on companies and petroleum income tax that is expected to constitute 67% of direct tax collection for 2018. Individual income tax only constituted about 24% of the direct tax and as a percentage of GDP, stood at 2.2%. The indirect tax as a percentage of total revenue is expected to decrease to 20% for 2018 given the government's decision to abolish GST. However, do note that Finance Minister Lim Guan Eng has recently said that "federal government revenue that was reported by the previous government is not accurate and larger than what it actually was".

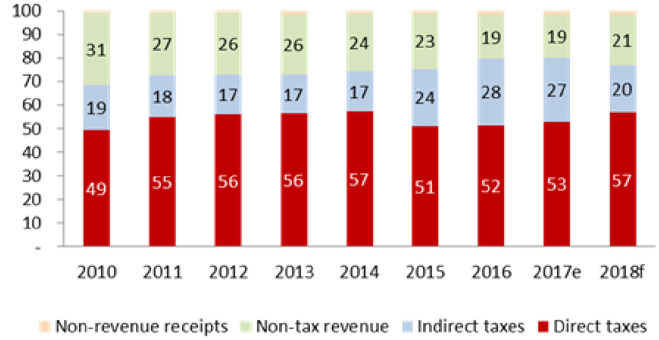
On the flipside, operating expenditure (OE) as a percentage of GDP (see chart 3) has been on the decline although salaries and pensions are expected to make up 44% of OE in 2018. Finance Minister Lim Guan Eng himself has said that there are 1.6 million civil servants and that there won't be a downsizing. Based on 2017 population figures, this would mean that there is 1 civil servant to 20 people.

Chart 3: Government revenue and operating expenditure, % of GDP



Source: Ministry of Finance Malaysia, CEIC and OCBC
Note: 2017 calculation based on MoF economic report 2018 and actual GDP growth

Chart 4: Composition of government revenue, %

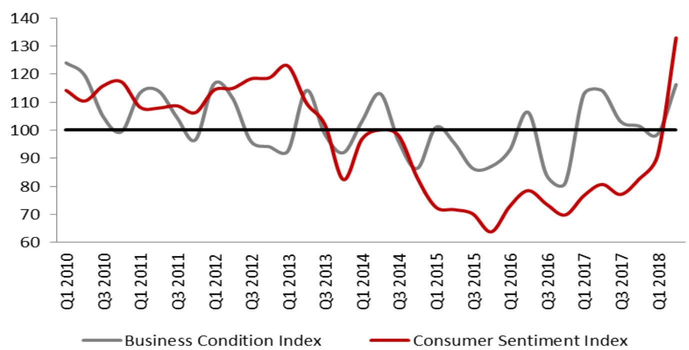


Source: Ministry of Finance Malaysia, CEIC and OCBC
Note: 2017 calculation based on MoF economic report 2018 and actual GDP growth

How is economic sentiment?

Economic sentiment appears to have taken an upturn following the election regardless of the policy uncertainty. After having been below the optimistic level of 100 for a few years, the Malaysian Institute of Economic Research (MIER) consumer index has finally turned optimistic crossing the 100 level in 2Q 2018 (see chart 5). There could be multiple reasons behind this including the abolishment of GST or the optimism related to change occurring. The MIER business conditions index has also crossed the 100 level (also see chart 4) to hit 116% despite the uncertainty related to the status of government linked companies (GLCs), major key government projects or reforms to any new laws. Private investment growth for 2Q 2018 also recovered to 6.1% yoy (1Q 2018: 0.5% yoy) which was driven particularly by capital spending in the manufacturing and services sector. Businesses possibly may be more focus on other positive points such as institutional reforms.

Chart 5: MIER consumer sentiment and business conditions index



Source: MIER, CEIC and OCBC

On the currency side, the MYR is weaker than before the election and year to date, USD – MYR has risen by 1.24% as of 21st August 2018. However, compared to other peer Asian currencies, the value of the USD – MYR has actually fared much better compared to the USD – IDR (7.46%), USD – PHP (6.96%) and USD – SGD (2.22%) as of 21st August 2018. Therefore, it can't be said that the change of government had significantly impacted the MYR but rather external factors such as stronger US data, Fed interest rate normalization and trade tensions could be bigger influences. The FBM KLCI is also recovering closer to its pre-election day value of 8th May 2018 (see chart 6). Prior to elections, we had mentioned that the elections do not historically represent a structural break in the stock market trends. It appears that an overnight change of government cannot immediately undo the economic system.

Chart 6: FBM KLCI

Source: Bloomberg and OCBC

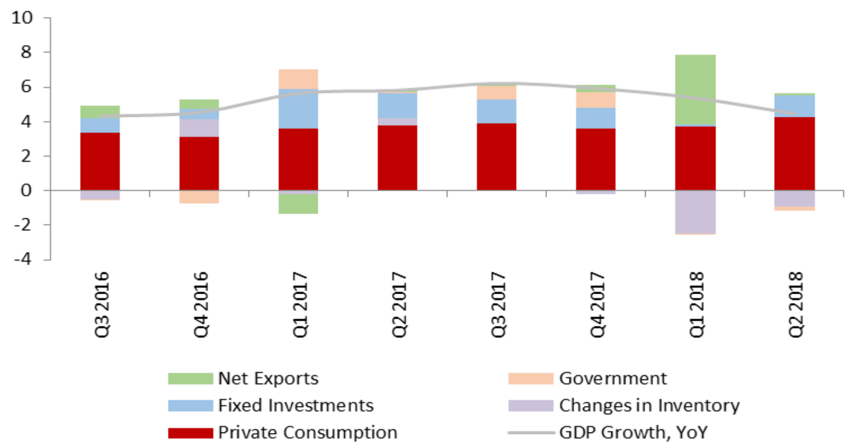
Going forward, we do expect that positive domestic economic sentiment would probably continue for a while as the new government focuses on institutional reforms. However, the MYR would probably continue to remain pressured due to external factors. We also do note that foreign equities flow year to date remains negative at US$2.2bn as of 21st August 2018 although it has been quite choppy recently. However, foreign ownership of Malaysian Government Securities appears to have bottomed out in July.

What is behind the sluggish 2Q 2018 growth? And what is the outlook?

Interestingly, it is difficult to attribute the growth slowdown in 2Q 2018 at 4.5% yoy (1Q 2018: 5.4% yoy) to the election uncertainty. As already mention, private investment growth actually recovered. Private consumption as expected strengthened to 8.0% yoy (1Q 2018: 6.9% yoy) possibly due to the tax holiday and increased government handouts during the election period. Rather the growth slowed down can be attributable to some unexpected shocks, namely supply issues related to the palm oil and LNG sector. For the LNG sector, according to The Edge, technical issues affected the Bintulu liquefied natural gas export plant back in early June. As for palm oil, production has been weak although it should improve going into the next quarter. Government expenditure also rose by 3.3% yoy due to increased spending on supplies and services whilst public investment contracted by 9.8% yoy. This was typical of an election period. Overall, the key caveat to draw from these growth figures is that at this point, there doesn't seem to be any immediate signs just yet of pessimism towards the transition happening this year.

For the entire 2018, we are now looking to revise down our forecast of 5.3% yoy as we do see it as difficult for the economy to play a catch up game in 2H 2018. Government expenditure will probably slow as fiscal consolidation takes place. Consumption will be strong in the 3Q 2018 as consumers frontload expenditure for the remaining period of the tax holiday but it should subsequently slow. Investment could potentially be strong as businesses remain optimistic of Malaysia's longer term potential. Any policy uncertainty may mainly only affect businesses tied to the major projects that are under review or have been reviewed. Trade may still remain slow though. However, any slowdown effect resulting from the trade war may possibly come later. We do see 2Q 2018 as the slowest quarter though and that growth would be more accelerated albeit still moderate in 2H 2018.

Chart 7: Contributors to GDP Growth, %



Source: Department of Statistics Malaysia, CEIC and OCBC

How about relations between Malaysia and China?

Prime Minister Mahathir Mohamad has reiterated, "This government is a new government and it will be business-friendly. It will not be corrupt." In his recent trip to China, Mahathir himself has said, "We're not against any Chinese companies but against Malaysians who borrow huge sums of money to carry out unnecessary projects." He also invited Chinese companies to invest in Malaysia, adding that Malaysia wanted to learn from Chinese manufacturers.

How about the 2019 budget and the 11th Malaysia Plan?

These would be the two major policy events to look out for going forward. The Malaysian budget would be release on the 2nd November 2018. The mid-term review of the 11th Malaysia Plan meanwhile would be tabled in either October or November 2018. The key items to look out for in the budget are the expenses related to fuel subsidies, government contribution to pension of housewives and the government support for the raising of the minimum wage. We would be releasing another note on the various scenarios and potential outcomes of the 2019 budget. As for the 11th Malaysia Plan, it would be key to look out for the direction the government will set with regards to the role of GLCs.

Conclusion

Going forward, signs at the moment are pointing more towards stronger domestic economic sentiment even though policy uncertainty may still persist. The government will push ahead with its fiscal consolidation exercise. Manifesto promises would likely be implemented over a longer time period. Growth will also be slower this year amid the continued restructuring of the economy.

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