Better than Nothing

Malaysia's Budget Outlook

- **It's that time of the year again. Malaysia is slated to table its Budget 2020 tomorrow. It will aim to support growth in this uncertain climate, but fiscal largesse is unlikely and a consolidative posture remains crucial.**
- **We see 2020 deficit at 3.2% of GDP, halfway between 3.4% expected this year and the 3.0% that was originally coveted. Since GST re-introduction seems to be shelved, an oil price slump is the biggest fiscal risk, yet again.**
- **Monetary support will have to chime in as well to complement the fiscal one, even if both face their respective constraints. With growth momentum slowing down from here, any help is better than none.**

Give me a three, but not yet

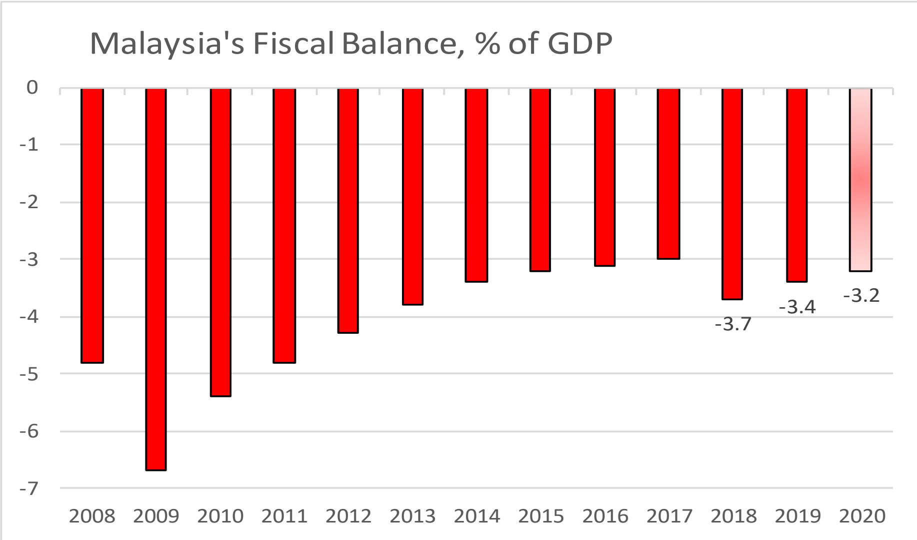
A year can be a very long time. When Finance Minister Lim Guan Eng delivered his maiden budget speech on 2 November last year, even as he accounted for past fiscal burdens by tabling a gaping deficit of 3.4% for 2019, he tried to limit the hit by saying that the deficit will be trimmed to 3.0% in 2020 and 2.8% in 2021.

Even back then, however, the world seemed like – comparatively speaking – a better place. While the US-China trade war was already turning hot with the first salvos of tariffs fired by both sides, there was still a lingering hope that it would not turn into a prolonged conflict. To be sure, concerns about global growth were already bubbling up, with the IMF, for instance, still projecting a respectable 3.7% growth for 2019 at that time.

Fast forward to today, however, it looks set to slash the already-downgraded 3.2% projection for 2019 growth it made in July even further next week. And, the trade war? We are in Day 461 and counting, staring at headlines to see if the spiral of events can end on a happy note.

Against the challenging global backdrop, slashing the fiscal deficit all the way to 3.0% of GDP in 2020 from the expected 3.4% this year might be deemed too dicey. The cyclical need to help cushion the economy from the global blows will feel increasingly more dominant, even as there is a structural need to put Malaysia's long-term fiscal situation on a more even keel due to the country's high debt level of 51.2% of GDP as of end-2018.

Balancing between the two constraints, we reckon that the upcoming Budget will adopt a middle-of-the-road approach and strive for a 3.2% deficit, which will add some fiscal juice to the economy while keeping the debt build-up concerns in check and the ratings agencies acquiescent. The 3.0% target will remain as a posture of fiscal consolidation but may be pushed back to 2021.



Source: OCBC and Bloomberg

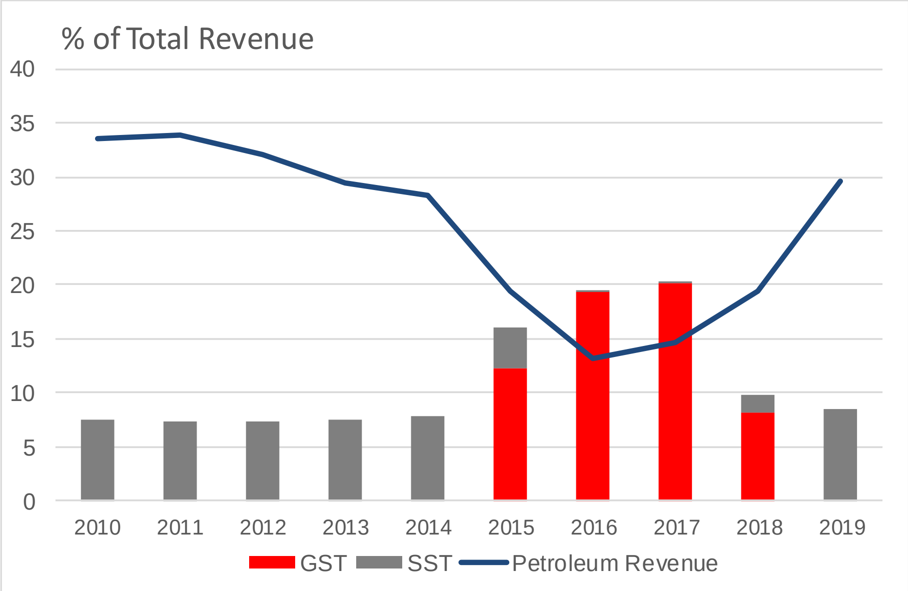
Debt Breakdown	in MYR bn			% of GDP		
	End 2017	Mid 2018	End 2018	End 2017	Mid 2018	End 2018
Federal Government Debt	686.8	725.2	741	50.7	50.7	51.2
Committed government guarantees	102.1	117.5	132.7	7.5	8.2	9.2
1MDB net debt	38.3	38.3	32.2	2.8	2.7	2.2
Other liabilities (PPP, PFI, PBLT)	260.1	184.9	184.9	19.2	12.9	12.8
Total	**1087.3**	**1065.9**	**1090.8**	**80.2**	**74.5**	**75.4**

Source: OCBC, ISEAS, Ministry of Finance

More GST no more?

In terms of risks to the fiscal stance going forward, the relative lack of revenue diversification would remain a key concern for investors. In particular, the effective abolition of Goods and Services Tax ("GST") when the current ruling coalition took over in May 2018 continues to leave a revenue gap that is yet to be filled with the Sales and Services Tax ("SST"). While the GST comprises 20% of total revenue in 2017, the successor tax regime is expected to contribute less than 9% to the total pot.

While there has been a build-up of chatters about a re-introduction of GST recently, PM Mahathir has put paid to it early this week, saying that he saw no need to do so, arguing that the government should focus on improving the SST system instead.

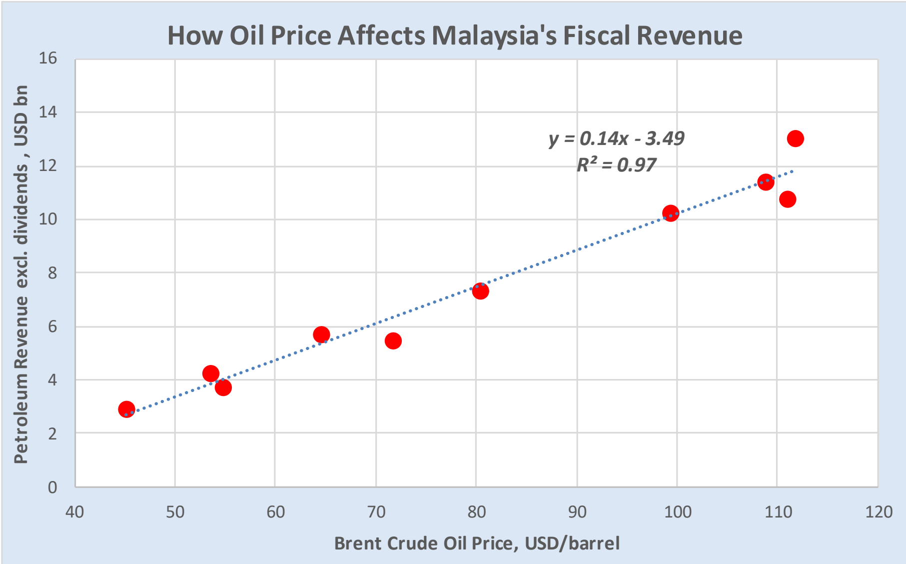


Oil to the rescue?
With the chances of a GST comeback diminishing, petroleum revenues will have to pick up the slack. Indeed, they have done that significantly in the 2019 budget. Including the MYR30bn special dividend from Petronas, petroleum revenues command around 30% of total revenue – a level of relative contribution that has not been seen since 2013. Even without that supposedly one-off contribution, the regular Petronas dividend, together with income tax and royalty proceeds from the petroleum industry still command 19.6% of the total revenue expected this year and is likely to continue contributing the lion's share in 2020.

Given that oil price has slumped of late to pre-Saudi drone attack level, naturally, investors will be wondering just how much of an impact crude prices have on Malaysia's fiscal footing.

Going by our calculations, the answer is: Quite a lot. For every dollar move in Brent prices per barrel, petroleum revenue coming from the more elastic petroleum royalty and income tax (i.e. excluding dividends) would change by USD140mn, or around MYR590mn in the current exchange rate.

That is to say, if the upcoming Budget carries over the relatively lofty $72/barrel from the existing one – and Brent ends up averaging $58 in 2020 where it trades now – there will be a potential revenue gap of over MYR8.2bn. That is equivalent to 0.5% of 2020 GDP and may prompt a fiscal readjustment if it comes to pass. Perhaps it is some comfort then that our house view is for oil price to recover some grounds to average $63 in 2020.



Source: OCBC, Bloomberg.

BNM's solidarity cut

While we expect a relatively supportive fiscal stance as mentioned, we do not think it will be enough to stop BNM from offering its help to the economy, as well. In fact, we see the room for the central bank to stand together with the government in preparing for a slowing growth momentum. Indeed, we hold the view that BNM will trim the OPR to 2.75% when it meets on November 5th.

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Emmanuel Ng
Senior FX Strategist
NgCYEmmanuel@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Howie Lee
Thailand, Korea & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu
Hong Kong & Macau
Dicksnyu@ocbcwh.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com

Co.Reg.no.:193200032W