Malaysia Monitor

OCBC Bank

Moving On?

# Malaysia keeps deficit target unchanged

Jan 28, 2016

- **PM Najib Razak asked Malaysians to "move on" this week after he was cleared of corruption allegation, calling it an "unnecessary distraction". As oil price slump renewed fiscal concerns recently, investors have essentially been told to move on too with today's revision.**
- **The key feature of today's revision is that there has been no revision at all – with regard to the budget deficit target of 3.1% of GDP. The government is banking on the hope that a 3.4% reduction in expenditure will be enough to counter a 33% drop in oil price.**
- **The revision has an eye on downside risks to growth too, as its GDP forecast has been narrowed to 4.0-4.5%, from 4.0-5.0% previously. Employees' pension contribution rate is cut by 3% in a bid to boost consumer spending by MYR8bn, for instance.**

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### Changing Tide

As we pointed out in our Jan 8th report, "*Déjà vu*", it is quickly turning into a routine that, this time of the year, oil price would have moved sharply from the original assumption for Malaysia's annual budget that a revision has to be adopted.

Just today, PM Najib Razak announced that the government has rejigged its 2016 budget. Early in his speech today, he unleashed his inner bard by quoting a Malay saying that goes "*Sekali air bah, sekali pantai berubah*". It roughly means whenever the tide changes, the coastline will shift too.

In this case, the main factor which has changed since he first tabled the budget in October last year is none other than oil price. The USD48/barrel price assumption – which did not look out of place just a few months ago, to be fair - has drifted further and further away from the shore of reality lately. In its place, the government is now assuming a more grounded range of $30-35 now. By its calculations, the roughly 33% drop in oil price assumption would shave off MYR7-9bn from the government coffers. Indeed, it continues a trend in recent years whereby the portion of total revenue coming from oil-related sources has dropped continuously. For one, oil money would contribute just 9.4% of total revenue this year, compared to around 20-30% of the two years prior.

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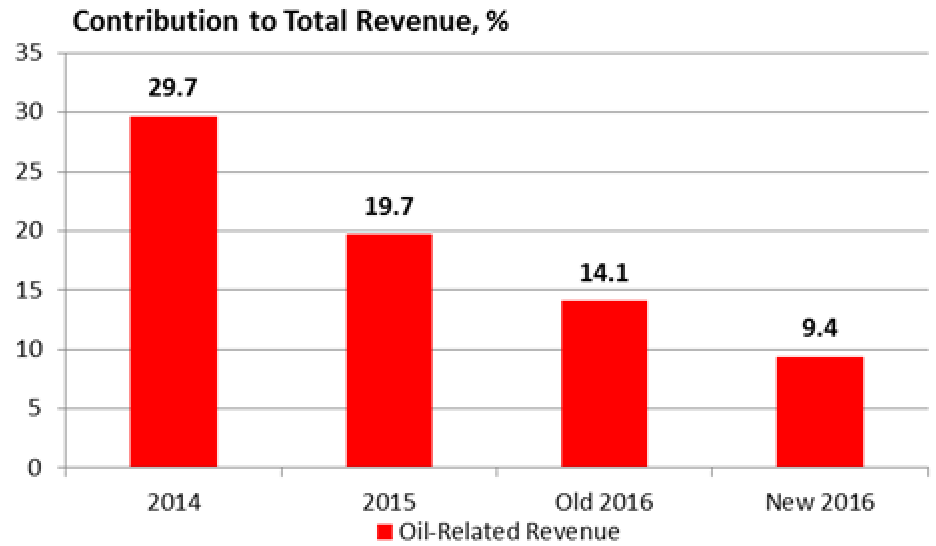
### No Pay Cut

Now, the expected drop in revenue has to be balanced by a broadly corresponding decrease in expenditure, if the government is to keep the original budget deficit target of 3.1% of GDP – which it has indeed proclaimed it will do.

On that front, PM Najib said in his speech that a series of "prudent measures" will be adopted to save the government as much as MYR9bn in spending this year. Not many details were given, however, on what exactly these measures are and what areas will be cut, except to point out what these would not involve. For one, he was keen to emphasize that he will not be shaving off civil service pay and the total number of people employed in its swollen ranks. Indeed, he went on to note that the no-cut policy includes "those appointed on contract basis." For good measure, he added that the pay increment for civil servants will continue to be implemented, "as promised in the 2016 Budget."




*Source: CEIC, OCBC.*

Hence, it does look like the bulk of expenditure cuts would come from at least some of the infrastructure projects. Given that he pointed out that the government will be "prioritising projects and programmes with high impact centred on the philosophy of the people economy", it probably means that most of the projects focused on the politically important rural areas and Eastern Malaysia states will be the sacred cows.

**New Money?**

Apart from the purported measures to decrease expenditure, the government is also looking at other alternative ways to raise money to counter the oil revenue shortfall. Again, here, the PM was keen to emphasize what the government will not do to achieve that aim. It will not be revising the 6% GST rate, for example, as some might have feared.

He did spend some time talking about improving tax collections, including a redoubling of compliance and audit efforts on tax evaders. There will also be a relaxation of penalty for those owing back taxes to encourage them to come clean. Meanwhile, the government is also going to tighten measures to reduce leakages of sin tax revenue at duty-free islands that have supposedly resulted in a loss of MYR1bn.

Meanwhile, for those who are keen to visit famous tourist spots across Malaysia, you might want to consider doing so before March 1st, before throngs of Chinese tourists come onshore once the visa requirement for them to enter the country becomes effective. Although the government did not offer specific figures on this, it does appear that it is going all out to woo more visitors from China to further capture tourism-related revenues.

**Impact on Growth and OPR**

The government has also effectively revised down its growth forecast today. Previously, it was expecting growth of 4.0-5.0% this year. Now it is looking at the lower half of that range, at 4.0-4.5% of GDP growth. Given that there will be some fiscal consolidation and effects from slower oil and gas related investment, that should not come as a surprise. Indeed, with that in mind, we are revising our growth forecast to 4.4%. Our previous 4.7% growth forecast was slavishly based on an oil price forecast of USD50/barrel by year end – a prospect which the Malaysian government deems to be dim enough for it to revise the budget today.

To provide some cushion against such slowdown, the government has also announced a 3% cut in employees' contribution to the EPF pension scheme from Mar 2016 – Dec 2017, while keeping the contribution by employers unchanged. This is slated to help increase private consumption by MYR8bn per year. A special tax relief of MYR2000 will also be given to those earning less than MYR8000 per month last year. Meanwhile, new schemes such as MyBeras program (to provide rice to poor households) and MyFarm (to sell provisions at discounts) will be rolled out too to drum home the sense that the government will have the poor in mind every time it tables the budgets.

All in all, if one objective of today's budget revision is indeed to get investors to move away from concerns about how oil price slump would threaten Malaysia's fiscal sustainability, it has probably achieved at least some qualified success. The MYR9bn cutback in expenditure is not a large one, accounting for no more than 3.4% reduction from the MYR262bn expenditure that was originally planned.

Investors would of course be more assured that the government can indeed reduce its spending by this amount – and hence keep to the 3.1% budget deficit target – if the PM provided more specific details today. As mentioned, given that he does not intend to cut down on civil service pay, which takes up around one-third of the current portion of expenditure, the government will likely cut back on areas such as supplies and services procurement, as well as postponing some development projects to make up the numbers.

Meanwhile, the downward revision in growth by the government is likely to be echoed by the central bank soon. As we highlighted in our Jan 21st report, "*Soft Touch*", there have already been a less sanguine growth outlook by BNM. Correspondingly, that would add to talks about potential rate cut.

Again, however, we must add that we do not think a cut is likely to happen in the near term, with Governor Zeti – who pointed out again today that monetary policy remains accommodative – at the helm until April. We do think, however, that there is a possibility for further SRR cut. After all, even after the 50bps cut last week, the 3.5% level remains relatively high compared to the 1% that SRR was at from 2009 until early 2011.