Malaysia Outlook

OCBC Bank

Preliminary views on budget 2019

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Treasury Research
Tel: 6530-8384

Alan Lau
Tel: 6530-5949
AlanLau@ocbc.com

Highlights

- **Fiscal deficit to be at 3.7% of GDP in 2018, 3.4% of GDP in 2019, 3.0% of GDP in 2020, 2.8% of GDP in 2021 and to be at 2.0% of GDP in the medium term.**
- **Overall expenditure is expected to increase from 20.2% of GDP in 2018 to 20.6% of GDP in 2019.**
- **Revenue is expected to increase from 16.5% of GDP in 2018 to 17.1% of GDP in 2019.**

This year's budget was themed as "a resurgent Malaysia, a dynamic economy, a prosperous society" with three focus areas 1) to implement institutional reforms, 2) to ensure the socio-economic well-being of Malaysians and 3) to foster an entrepreneurial economy. The focus areas clearly show an attempt by the government to strike a balance among reducing the burden of the people, inducing growth and setting the budget on the right trajectory.

The government sees that the fiscal deficit will be at 3.7% of GDP in 2018, 3.4% of GDP in 2019, 3.0% of GDP in 2020 and 2.8% of GDP in 2021 whilst in the medium term, it will be at around 2.0% of GDP. This is a rather rapid decline but the government claims that the elevated level in 2018 is due to the need to pay back 1MDB debt at RM1bn, the reclassification of RM3.7bn of off balance sheet liabilities back into the budget and the need to pay back GST refunds amounting to RM3.9bn.

Expenses

On the cost side, overall expenditure is expected to increase from 20.2% of GDP in 2018 to 20.6% of GDP in 2019. Operating expenditure is expected to increase from 16.4% of GDP in 2018 to 17.0% of GDP in 2019 whilst net development expenditure is expected to reduce from 3.8% of GDP in 2018 to 3.6% of GDP in 2019.

Among the measures the government has unveiled to reduce cost includes the following:

- **Implement zero-based budgeting:** This is a system that will require planning expenses for an item from zero instead of based on allocation on the item from the previous year.
- **Table a fiscal responsibility act:** The government did mention that this will only be tabled in 2021 and the exact details regarding it are still not clear.
- **Table a government procurement act:** This will apparently be tabled in 2019 to better ensure greater open competition and transparency in the procurement process via undertaking open tenders. It will also look to enforcing punitive measures on acts of abuse of power, bribery or negligence.

- **Transition to accrual based accounting from cash-based accounting:** In the government's view, this would help ensure more accurate disclosure of debts and liabilities. Accrual based accounting though will only be implemented from 2021 onwards.

It should be noted that implementing these measures successfully to prevent leakages will take time as it may require designing the system itself, training staff and enforcing the new rules.

Interestingly, the government is expecting emoluments and retirement charges as a share of operating expenditure to fall between 2017 – 2019. They see it making up 45.9% of operating expenditure in 2017 before falling to 45.4% in 2018 and 41.8% in 2019. This comes despite Lim Guan Eng's previous commitment that they would not be actively rationalizing the civil service.

The government will be allocating RM37bn to pay back the tax refunds in 2019. This comprises of RM19bn for GST and RM18bn for other taxes. This would exceed actually the amount the government claimed is owed in refunds of RM35.4bn and it also hints that they are expecting to pay it off in a year only. This is also possibly the main contributor to the increase in operating expenditure between 2018 and 2019.

Meanwhile, some interesting expenses that the government will be incurring include:

- **Providing a cost of living aid to the B40 group:** This has been reduced from BR1M. Households with incomes less than RM2,000 will receive RM1,000, those with income between RM2,001 to RM3,000 received RM750 whilst those RM3,001 to RM4,000 will receive RM500. However, that said, some households may receive more as each child below 18 years old in each household will receive RM120 limited to a maximum of 4 children (the quota does not include disabled children). 4.1 million households are estimated to benefit with a government allocation of RM5bn for this program.
- **Targeted fuel subsidies:** The government will provide a subsidy of 30 cents per liter to a limit of 100 liters for cars with engines of 1,500cc and 40 liters for motorcycles with engines of 125cc. This will only apply to RON95 petrol. The government has allocated RM2bn for this but it doesn't appear that it will be implemented immediately.

These expenses didn't come as much of a surprise although we believe it may take a while to implement the targeted fuel subsidy scheme. Realistically, we believe it may come in late 2019. The decrease in the cost of living aid was expected as Mahathir had already mentioned of a gradual phase out before although also as mentioned, some households may benefit more as the government intends to make it more targeted.

Revenue

On the revenue side, revenue is expected to increase from 16.5% of GDP in 2018 to 17.1% of GDP in 2019.

The government though has announced a number of changes to the tax system as follows. The key measures are as follows:

- **Tax on service imports:** Finance Minister Lim Guan Eng has said this will start from 1st January 2019 and it has been implemented to ensure that local service providers in the fields of architecture, graphic design, IT and engineering face fairer competition.
- **Online service tax:** Lim Guan Eng has said this will only take effect on 1st January 2019 for online services imported by Malaysian businesses. For online services imported by consumers, the foreign Service providers are required to register with customs by 1st January 2020.
- **Launching a special voluntary disclosure program for unreported tax:** This program will run from the 3rd November 2018 until 31st March 2019 with the penalty being 10% of the tax to be owed. However, for those who declare after that period, the penalty will be 15% of the tax owed if they disclose between 1st April 2019 – 30 June 2019. Any disclosure after the 30th June 2019 could result in a penalty between 80% to 300% of the tax owed depending on the law.
- **Review existing incentives and taxes under the various legislation to reduce leakages:** The government said it will look to impose restrictions on business losses, remaining capital allowances and unutilized residual allowances carried forward for up to 7 years of assessment.
- **Review the 130 fiscal schemes to support investments that are administered by 32 approving authorities:** This has long been talked about and the progress in this will be closely watched.
- **Strengthening the enforcement on illegal smuggling of tobacco:** Lim Guan Eng said that this will only be done after the SST system has been fully effectively implemented. He said the government can raise RM1bn from this.
- **Imposing a travel levy for those travelling overseas:** This will be at RM20 for travel within ASEAN and RM40 for travel to other countries.
- **Raising real property gains tax:** The change would see an increase from 5% to 10% for foreigners or nonresidents and an increase from 0% to 5% for citizens and residents (although exemptions apply to those in this group who purchase low cost housing, affordable housing, etc).
- **Raising stamp duty:** This was increased from 3% to 4% with the government claiming that is can raise RM1bn.
- **Abolish tax exemptions for the wholesale money market funds:** This would apparently take effect from 1st January 2019.
- **Changes to the gaming taxes as follows:**
  - Casino licenses raised from RM120m to RM150m
  - Casino duty raised to 35% of gross income
  - License for dealer machines to be raised from RM10,000 to RM50,000
  - Duty on collection from gaming machines to be raised from 20% to 30%.

Some of these measures look like they can take time to implement and therefore, it shouldn't be immediately expected to just come rolling out in 2019. As expected, a limited form of digital tax looks like it would only be introduced in 2019.

Other new revenue raising measures they have talked about include:

- **Private public partnerships model on land transactions to be done via open tender:** According to the government, this had previously been done via direct negotiations resulting in land being undervalued whilst project costs are too high. They claim they can achieve extra revenue of RM800m in this area.
- **Selling off land:** The government has stated that it would be undertaking this in a scheduled and gradual manner. No further details were revealed on this.

Again, these measure may take time to implement especially if the government wishes to maximize revenue raised from them.

Petronas is also expected to provide a dividend contribution of RM54bn for 2019 of which RM30bn would be a special dividend payment. This is not exactly unrealistic given the company's cash reserves and that ICE Brent prices may be above US$70 per barrel next year.

In an attempt to manage the debt levels, some of the key measures the government has announced include:

- **Selling off non-strategic assets:** The government has said that they would pay down the debt using the proceeds from the sales although it is not clear what would be sold or how the process to sell them would be done.
- **Launching an Airport Real Estate Investment Trust (REIT):** The government has claimed that they can generate RM4bn from selling 30% of the equity in the REIT. The REIT itself will pay out from the airport user fee itself. The REIT however will only be launched after the user fees and the asset base has been finalized. The government has noted that the airport REIT will provide more funds to improve and develop airports and therefore reduce the government's debt burden.
- **Setting up a debt management office:** This office will have oversight over debt issuance by the Federal Government, statutory bodies and special purpose vehicles. The office overall aims to streamline government funding.
- **Take all necessary actions to recover 1MDB funds:** The government has said it is using fraud as a reason not to pay back the balance of US$4.32bn to IPIC or Aabar under the consent award, and recover the US$1.46bn already paid. The government also said it is working hand-in-hand with other foreign authorities to recover other 1MDB assets.
- **Publish total debt and liabilities of the government publicly:** The government therefore now claims that total debt and liabilities is 80.3% of GDP in 2017 and expect to reduce it to 74.6% of GDP in 2018 before hitting 73.5% in 2019.

Overall, fiscal slippage was expected in the short term given that the government's situation was weighed down by the tax refund. Also, as mentioned, many of the measures need time to implement so therefore, in the longer term, the situation should improve if they are implemented successfully. Despite running a deficit, many of the factors driving it cannot necessarily be said to be simulative to the economy. The GST refunds after all go to firms rather than consumers. Going forward, the government has a big task at hand but they do appear determined to implement many of these measures.

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