What Awaits Them

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Malaysia's new cabinet faces a big pile of economic issues

- It's about time. After weeks of political drama, Malaysia is having some semblance of normalcy back, with the announcement of a new cabinet. In a serious bid to win market confidence, banking sector heavyweight Zafrul Aziz has been appointed as the Finance Minister – a rare technocrat at the helm.
- The in-trays of these new ministers are going to be very full. As if being hit by the impact from virus and politics is not enough, the precipitous decline in oil price just gave the Malaysian economy another hard slap in the face.
- At a time when fiscal stimulus is sorely needed, the little space to do so has now been robbed by the slump in oil revenue. The onus is thus for BNM to ease more forcefully, even if market sentiment needs to be stable enough.

"Et tu, Brute?" (Even you, Brutus?)

- Julius Caesar, by William Shakespeare -

As Shakespeare has it, Julius Caesar is said to have uttered these last words as on the steps of the Roman Senate, as he recognized his long-time friend, Brutus, among the assassins out to end his life.

At the risk of over-dramatizing the situation, it might have felt like that for the Malaysian economy these days at the prospect of a deep fiscal wound from the sudden slump in oil price, at a time when it has already been at the receiving end of impact from Covid-19 and the political squabble.

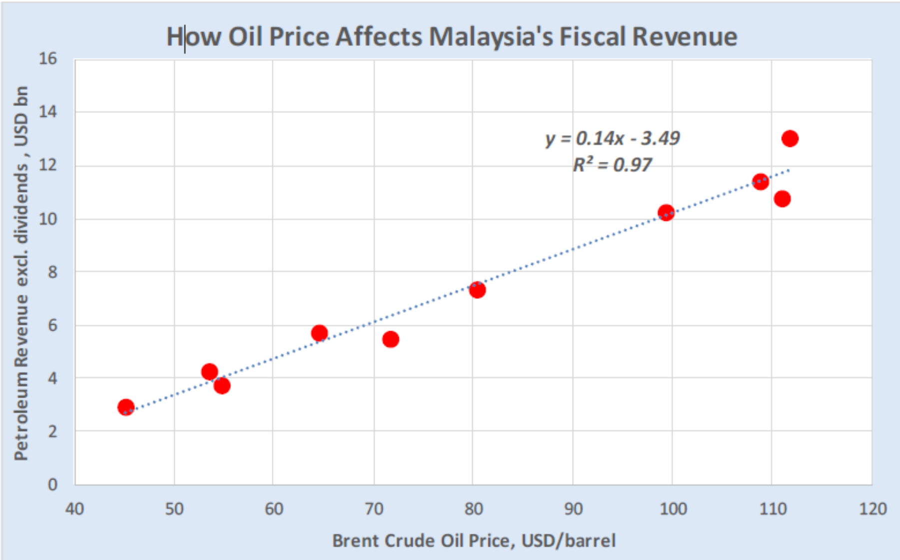
While successive Malaysian governments have been attempting to reduce the dependence of the government revenue on oil and gas receipts, the fact of the matter is that – in the absence of concrete revenue stream such as GST – it had been an uphill struggle.

It was all well and good when oil price was steady and better still when it was climbing, but a lot less so when it is plunging. When it comes to the relationship between Malaysia's fiscal stability and oil price, the 'friendship' can be as time-tested as the one between Caesar and Brutus.

The 2020 budget that was announced by the previous Pakatan Harapan government, for example, assumed a MYR50.5bn revenue from oil and gas, which made up a hefty 20.7% of the total revenue.

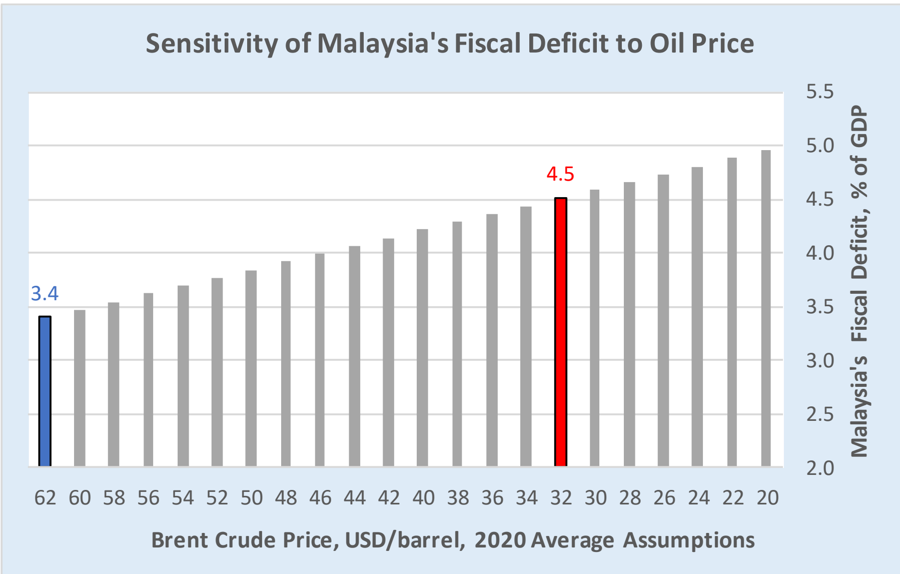
While the $62 per barrel average oil price assumption back at the time of Budget 2020 tabling in October 2019 was realistic, it is decidedly a lot less so now, with Brent threatening to break below $30 at one point after Saudi's shocking move to increase production for market share over the weekend.

Going by our calculations, for every dollar move in Brent prices per barrel, petroleum revenue from the more elastic petroleum royalty and income tax (that is, excluding dividends) would change by USD140mn, or around MYR590mn by the current exchange rate.



Source: OCBC, Bloomberg, CEIC.

Hence, in a dire scenario where oil price stays this low throughout the year, pulling the 2020 average down to $32 per barrel – a full $30 lower than the budget assumption – it would translate to a $4.2bn drop in oil revenue. At the current USDMYR level of 4.2, this would mark a MYR17.6bn loss (~1.1% of GDP). Hence, if we assume the unlikely event that no change is done to the expenditure to compensate for the drop in revenue, deficit level would pick up from 3.4% to as much as 4.5% of GDP.



Source: OCBC, CEIC, Bloomberg.

How to prevent the deficit from ballooning to such a level will be the key task for the finance ministry under its new boss, Tengku Zafrul Aziz. A career banker who rose through the ranks to become the CEO of CIMB, a major Malaysian bank, he had previously cut his teeth in the investment banking arms of Credit Agricole and Maybank. For what it is worth, he was also a judge on *The Firm*, a reality television show featuring contestants trying to be the next corporate high-flyer a la Donald Trump's *The Apprentice* but minus the catchphrase.

Given Tengku Zafrul's deep banking expertise, and the fact he is not deemed to be a political appointee, it appears that PM Muhyiddin Yassin understands the importance of presenting a market-friendly face for the crucial portfolio. Still, the honeymoon period for the new Finance Ministry is likely to be a short one, if there is any at all.

Apart from having to work out a more sustainable revenue source than the fickle petroleum – with GST being too hot a political potato to touch anytime soon – he would have his hands full in terms of finding ways to stimulate the economy.

On an immediate basis, his priority will likely be to implement the MYR20bn stimulus package that interim PM Mahathir Mohammad announced on February 28th. As we mentioned before, while the measures are helpful, much more would be needed in the face of ever-building sense of crisis.

Even compared to the time when the measures were announced, the impact of Covid-19 on the Malaysian economy would have increased significantly, given the unfortunate pick-up in cases globally that is going to weigh on global demand even more. The latest turn of events would thus result in lower exports, on top of the damage to domestic consumption and tourism sectors that came from the earlier wave of outbreak.

Although there would continue to be hope for further fiscal relief, the reality is that high fiscal deficit remains a bugbear for investors and would be even more so given the oil price slump. At most, the fiscal deficit can be pushed to 3.6-3.8% of GDP, depending on the severity of global situation, before the ratings agencies balk.

Hence, we continue to see monetary policy bearing the brunt of the policy response. As detailed in our March 3rd report, there remains a dovish tilt to BNM's statement, and we see the case for another rate cut to bring OPR to 2.25% in the next meeting on May 5th.

A lot, however, would hinge on whether the global market sentiment, especially on the currency front, is stable enough in the next two months. Given how choppy market has been even in the last week or two, this is going to be a long interim period where anything feels possible.

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