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Budget 2017:
Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Well-being of the Rakyat

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In a nutshell

- As expected, Budget 2017, which was tabled in Parliament this past Friday, 21 October 2016, focuses mainly on measures to address challenges arising from a weaker global and domestic economy, shrinking government revenue and rising cost of living. In Budget 2017, the government aims to sustain its fiscal position through prudent spending practices, maintaining decent economic growth as well as providing assistance to the *rakyat*, especially those in the bottom 40% income (B40) group. Measures to raise home ownership in the low- and medium-income groups were also a prominent feature of the Budget. With macroeconomic headwinds emanating from the slowdown in major economies as well as anxiety arising from the expected interest rate hike in the United States (US), Budget 2017 prioritises the need to support domestic demand through measures to boost private investments and consumer spending.
- In Budget 2017, the government proposed a total allocation of RM260.8 billion (excluding RM2.0 billion for contingencies), which is roughly 3.4% higher than the amount allocated in the revised estimate for 2016. Of the total allocation in Budget 2017, operating expenditures (OPEX) account for roughly RM214.8 billion while RM46.0 billion is slated for gross development expenditures. Total revenue is anticipated to grow by 3.4%, a rebound from an estimated 3.0% drop in 2016 (2015: -0.7%). As a result, the government foresees budget deficits to continue trending downward to 3.0% of gross domestic product (GDP) in 2017 from an estimated 3.1% of GDP (RM38.7 billion) in 2016.
- On this, MARC is of the view that the government revenue projection looks quite realistic. On the whole, however, achieving the deficit target of 3% of GDP in 2017 appears to be challenging especially at a time when nominal growth remains below trend. We think that the Ministry of Finance's (MoF) projection of a nominal growth of 7.4% is slightly on the high side, especially when real growth remains within the range of 4%-5%. Notably, the increasing gap between nominal and real growth suggests that inflation is projected to be rising at a faster pace, something which we think will not likely to happen in the near term due to a slower pace of demand in 2017. On the expenditure side, the government will continue to keep the Budget lean through prudent spending and deferment of certain non-critical projects. While this could be the means to further consolidate the government fiscal position, we feel that such approaches could weigh on headline GDP growth in 2017, especially when lacklustre global demand is exerting downward pressure on Malaysia's external trade performance. As such, we pencil in a GDP growth target below trend at 4% for 2017 (MoF: 4%-5%, central tendency of 4.6%).
- On the issue of fiscal deficits, we are encouraged by the effort to further enhance the efficiency in tax collection through the establishment of the Collection Intelligence Arrangement (CIA). At the same time, however, fiscal consolidation requires a long-term effort by the government to not only work on creating efficiencies in generating revenue but also to effectively contain unnecessary leakages. We are encouraged by the fact that the operating balance in the federal government balance sheet (revenue less operating expenditure) is anticipated to rebound in 2H2016 and continue to be positive in 2017 after being in deficit in 1H2016.
- On the sovereign rating, MARC continues to view that a slight deterioration in the government's balance sheet, if it happens, will not create an overly negative perception among credit rating agencies (CRA) and investors in general. In fact, during an economic down cycle, a short-term deviation from the government budgetary target will not be seen by CRAs as a derailment from its overall long-term fiscal consolidation path. It is not just the amount of deficit that matters: the source, nature and reasons of deficits will all be taken into consideration when sovereign risk is assessed. As such, we are of the view that a slower pace of fiscal consolidation is acceptable temporarily, provided that government spending is focused on areas which will boost growth considerably.
- Measures to mitigate the rising cost of living for the B40 group are commendable as this income group is the most affected. In this regard, we think that measures such as a higher amount of 1Malaysia People's Aid (BR1M) and direct and indirect assistance for civil servants through greater access to various types of loans and special payments can help prevent further deterioration in private consumption growth going forward. However, while we view positively the rebound in consumer spending in 2Q2016, we do not foresee a sharp acceleration in its growth in the near term. We anticipate consumers to remain cautious in their discretionary spending due to the rising cost of living following a weaker labour market, stubbornly high average home prices and possibly other subsidy rationalisation efforts as the government continues to minimise its OPEX. Notably, there are fewer measures for the middle 40% income (M40) group when compared with the previous

Budgets, and the new tax relief of RM2,500 for the purchase of books, computers, sports equipment and so on is actually lower than the combined amount given for each separate category in the previous years.

- With regard to the BR1M programme, we acknowledge its positive impact on the lowest-income group. Recent research findings suggest that income transfers such as BR1M have, to some extent, raised household income for this group in the past few years. Our only concerns on this are: (1) the long-term impact of cash transfers on work incentives could be negative as it can potentially create a culture of government dependency; (2) they can easily be misused as they are unconditional; and (3) it could be a permanent feature in future government OPEX that could weigh on the government balance sheet. We are still of the view that transfers are the optimum choice so long they are subject to certain conditions such as ensuring children attend school and so on.
- On housing, we feel positive about the government's proposal to provide further measures to increase home ownership in the low- and medium-income groups. We continue to feel that although these particular groups should receive special attention, credit availability should only be provided to those who will not find difficulty in servicing their debt, otherwise the *rakyat* will be burdened with unnecessary financial obligations. As such, MARC feels the continuing effort to provide homes priced below RM300,000 is commendable. However, it will be important for the agencies involved to enhance its communication with various stakeholders and the public, especially in updating the status of completion of these projects as they had been proposed in almost every Budget in the past few years. According to news flow, the 1Malaysia People's Housing Programme (PR1MA) scheme, which completed and delivered about 900 units at end of 2015, feels that a more realistic target for the corporation is to complete 210,000 units by 2018 and not 500,000 as is commonly believed.
- On the capital market, the measures proposed in Budget 2017 mirror the key strategies of the Capital Market Masterplan 2 (CMP2) of promoting capital formation and strengthening the capital market's information infrastructure. These measures include: (1) an allocation of RM522 million to the Malaysian Investment Development Authority (MIDA) for certain industries, namely chemicals, electrical and electronics, and research and development (R&D) activities; and (2) a special fund allocation of up to RM3 billion to fund managers licensed under the Securities Commission (SC) to invest in companies with the potential to become public-listed small and mid-cap companies. We view these measures positively as they will help address investment bottlenecks and encourage the rate of capital formation which will ultimately contribute to the expansion in equity market capitalisation.
- As for the proposed introduction of the Small and Mid-Cap PLC Research Scheme to conduct research on 300 companies, it is yet to be known whether this scheme will be implemented as an extension of the CMDF-Bursa Research Scheme (CBRS) announced in June 2005, which also focuses on listed companies that receive little or no research coverage. The Small and Mid-Cap PLC Research Scheme will, similar to the CBRS, facilitate the development and usage of equities research in the domestic capital market. We are also encouraged by the proposed establishment of a Capital Market Research Institute which will be established with an initial funding of RM75 million, as this will address information asymmetry and improve the access of listed small and mid-cap companies to funding.
- Based on the overall measures proposed in Budget 2017, we think that its implication for the future monetary policy direction is rather neutral. We are of the view that although the current economic backdrop calls for a more accommodative stance from Bank Negara Malaysia (BNM), we do not anticipate a major diversion from the present level. We acknowledge the downside bias of economic growth in the next one year. However, with banks already watching their balance sheets very closely to avoid further deterioration, lending will not likely pick up even if interest rates are lowered further. We sense that from the central bank's point of view, the failure to reignite growth through looser monetary policies as seen in many countries justifies its reluctance to reduce the policy rate in the medium term unless growth deteriorates substantially.
- Overall, MARC thinks that Budget 2017 broadly meets the challenges of addressing long-term structural issues such as budget deficits while attempting to fulfill the aspirations of the *rakyat*. Reducing economic imbalances while ensuring the *rakyat* is sufficiently protected from the impact of domestic and global economic weakness is a difficult balancing act which will continue to pose challenges to the government in 2017 and in the future.

Budget 2017: Key priorities

Budget 2017's main focus, while maintaining inclusive growth and sustainability, is the well-being of all *rakyat* and not just a particular group. Measures aimed at stimulating economic activity include efforts geared towards nurturing human capital and improving public services delivery. The *rakyat* should benefit from *rakyat*-centric budget initiatives that are expected to also further strengthen Malaysia's economic fundamentals and competitiveness.

- ### First priority: Putting the *rakyat* first

Budget 2017 uses a two-pronged approach to improve living standards by introducing a variety of measures to increase household incomes and reduce living costs. From a revenue perspective, the Budget will focus on improving people's disposable income. In 2017, BR1M will be increased for all recipients. For example, households earning between RM3,000 and RM4,000 will receive BR1M assistance amounting to RM900, compared to RM800 currently, while those earning less than RM3,000 per month will receive RM1,200.

To reduce living costs, the government will allocate subsidy allocations of nearly RM10 billion. This allocation comprises fuel subsidies (including cooking gas), toll charges and public transport.

The demand from first home buyers for affordable housing remains overwhelming. To enhance affordability, vacant government land will be provided to government-linked companies (GLC) and PR1MA for the construction of more than 30,000 houses with the selling price ranging between RM150,000 and RM300,000.

- ### Second priority: Accelerating economic growth

Against a backdrop of moderate global growth, measures will be taken to strengthen the country's economic fundamentals. For example, the government will review the corridor development plan. It will provide an allocation of RM2.1 billion for infrastructure and socioeconomic development in the five economic corridors, namely Iskandar Malaysia, Northern Corridor Economic Region (NCER), East Coast Economic Region (ECER), Sabah Development Corridor (SDC) and Sarawak Corridor of Renewable Energy (SCORE).

The government will also introduce measures to boost the capital markets and help exporters export to non-traditional markets. It will provide RM130 million through the National Export Promotion Fund for export promotion programmes that will benefit local small and medium enterprises (SME).

On the supply side, the Budget will focus on areas with high multiplier effects such as tourism. For this, the government will allocate RM400 million to, among others, clean air and ecotourism initiatives. The Budget will also extend the Pioneer Status and Investment Tax Allowance for new four- and five-star hotels to 31 December 2018.

- ### Third priority: Strengthening human capital

The government will allocate funds to the education sector to equip students with the knowledge and skills necessary for them to excel. In this regard, Budget 2017 will focus on strengthening the teaching profession and school performance, improving access to education and transforming Technical and Vocational Education and Training (TVET) to meet industry demand.

The government will enhance TVET education capacity with an allocation of RM4.6 billion to TVET institutions to produce a local workforce that meets the requirements of industries. In addition, RM270 million will be allocated to upgrade educational equipment in TVET institutions, and another RM360 million to the Skills Development Fund Corporation. Meanwhile, a sum of RM50 million will be allocated to extend the 1Malaysia Training Scheme (SL1M) programme by GLCs to benefit 20,000 graduates in 2017 compared with 15,000 graduates in 2016. The allocation is aimed at improving graduate employability.

- ### Fourth priority: Strengthening inclusive development

The government will continue to emphasise inclusive development so that all sections of society can enjoy the fruits of economic development. Budget 2017 will, for example, allocate funds to expand rural electrification and water supply. To address water supply issues, for example, the government will establish a Water Supply

Fund with an allocation of RM500 million. It will also allocate grants totaling RM156 million and loans amounting to RM509 million to improve water supply capacity.

There will be a RM300 million allocation under the 1Malaysia Maintenance Fund (TP1M) to repair facilities at flats and 113 People's Housing Programme (PPR) in urban and suburban areas. To create safer residential areas and surroundings, the government will allocate a sum of RM60 million to enhance the effectiveness of crime prevention programmes in cities.

- **Fifth priority: Strengthening public service delivery**

Budget 2017 is anchored on five principles and philosophies of the government. This includes a diligent government with efficient and structured implementation plans, which according to the Prime Minister, the government has and will continue to deliver.

The government remains committed to becoming more efficient and facilitative in both business and public-related services. For example, to enhance efficiency in tax collection and compliance that will help boost long-term fiscal sustainability, the government will establish, among others, the CIA under the MoF. The CIA initiative involves the sharing of data between the Inland Revenue Board (IRB), Royal Malaysian Customs Department and Companies Commission of Malaysia (SSM).

Our take on different issues in Budget 2017

- **On allocations and budgetary positions**

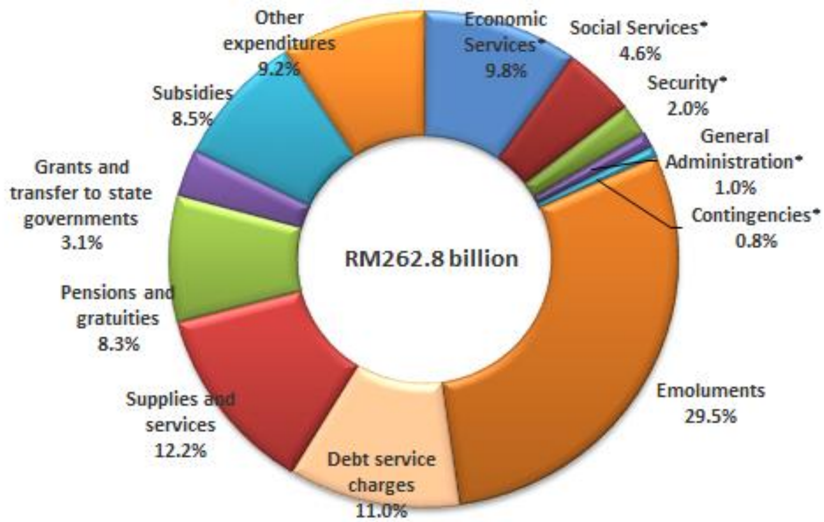
In Budget 2017, the government proposed a total allocation of RM260.8 billion, which is roughly 3.4% higher than the amount allocated in the revised estimate for 2016. Of the total allocation in Budget 2017, OPEX accounts for roughly RM214.8 billion while RM46.0 billion is slated for gross development expenditures. Total revenue is anticipated to grow by 3.4%, a rebound from an estimated 3.0% drop in 2016 (2015: -0.7%). As a result, the government foresees budget deficits to continue trending downward to 3.0% of GDP in 2017 from an estimated 3.1% of GDP (RM38.7 billion) in 2016.

On this, MARC is of the view that the government revenue target looks quite realistic. On the whole, however, achieving the deficit target of 3% of GDP in 2017 appears to be challenging especially at a time when nominal growth remains below trend. We think that the MoF's projection of a nominal growth of 7.4% is slightly on the high side, especially when real growth remains within the range of 4%-5%. Notably, the increasing gap between nominal and real growth suggests that inflation is projected to be rising at a faster pace, something which we think will not likely to happen in the near term due to a slower pace of demand in 2017. Based on our calculation, the MoF implicitly implies that the GDP deflator will be circa 2.6% in 2017 (2016 estimate: +2.2%, 2015: -0.4%). On the expenditure side, the government will continue to keep the Budget lean through prudent spending and deferment of certain non-critical projects. While this could be the means to further consolidate the government fiscal position, we feel that such approaches could weigh on headline GDP growth in 2017, especially when lacklustre global demand is exerting downward pressure on Malaysia's external trade performance. In other words, if the revenue drops more than forecast, there is a likelihood that expenditures will be slashed more than planned in 2017 in order to keep the level of deficit intact.

On the issue of fiscal deficits, we are encouraged by the effort to further enhance the efficiency in tax collection through the establishment of the CIA. At the same time, however, fiscal consolidation requires a long-term effort to not only work on creating efficiencies in generating revenue but also to effectively contain unnecessary leakages. We are encouraged by the fact that the operating balance in the federal government balance sheet (revenue less operating expenditure) is anticipated to rebound in 2H2016 and continue to be positive in 2017 after being in deficit in 1H2016. The last time the operating balance was in deficit was in 1987 after the commodities crisis in the mid-1980s.

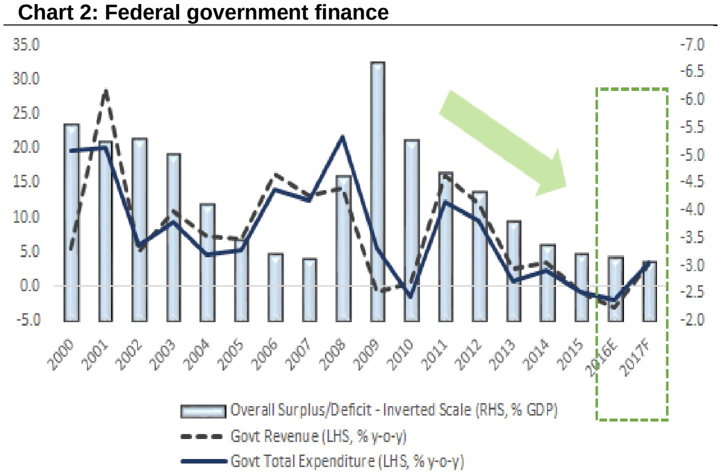
On the sovereign rating, MARC continues to view that a slight deterioration in the government's balance sheet, if it happens, will not create an overly negative perception among CRA and investors in general. In fact, during an economic down cycle, a short-term deviation from the government budgetary target will not be seen by CRAs as a derailment from its overall long-term fiscal consolidation path. It is not just the amount of deficit that matters: the source, nature and reasons of deficits will all be taken into consideration when sovereign risk is assessed. In addition, other macro parameters are used to assess the risk of a country. These include economic strength, external risks, stability of the banking system and so on. As such, we are of the view that a slower pace of fiscal consolidation is acceptable temporarily, provided that government spending is focused on areas which will boost growth considerably.

Chart 1: Budget 2017 – Spending allocation



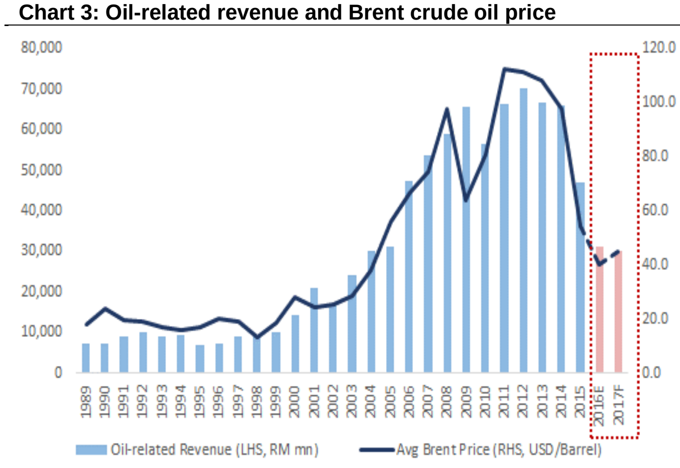
Source: MoF Economic Report 2016/2017
*Note: * = development expenditure*
*Items without * = operating expenditure*

Chart 2: Federal government finance



Source: CEIC, MARC Economic Research

Chart 3: Oil-related revenue and Brent crude oil price



Source: CEIC, MARC Economic Research

- ## On growth assessment

MARC's growth forecast is at the bottom range of MoF's projection (MoF: 4%-5%, central tendency of 4.6%). Our real growth target of 4.0% is premised on subdued global trade performance on the back of slower economic growth in China, Japan and Europe despite some improvement in the US. Growth in global trade volume has remained subdued, averaging 1% in the four-quarter period ending June 2016. It contracted in 1Q2016, its first since 2009 during the Global Financial Crisis (GFC). Value-wise, however, it fell at a more moderate pace, averaging 6.2% in 1H2016, compared with a -13.1% average in 2015. Mirroring global trade performance, Malaysia's exports in USD terms contracted at a slower pace of -4.1% in the two months through August, compared with a 9.4% average contraction in 1H2016.

China's economy, although it has stabilised somewhat, will remain under pressure from high corporate debt that will continue to cause volatility in global financial markets. The good news, however, is the recent inclusion of the renminbi in the International Monetary Fund's (IMF) Special Drawing Right (SDR) which implies a greater likelihood of a more stable renminbi policy in the medium term.

On the domestic side, the rebound in consumer spending in 2Q2016 spells good news, although we do not foresee a sharp acceleration in its growth going forward. We anticipate consumers to remain cautious in their discretionary spending due to the rising cost of living following a weaker labour market, stubbornly high average home prices and possibly other subsidy rationalisation efforts as the government continues to minimise its OPEX.

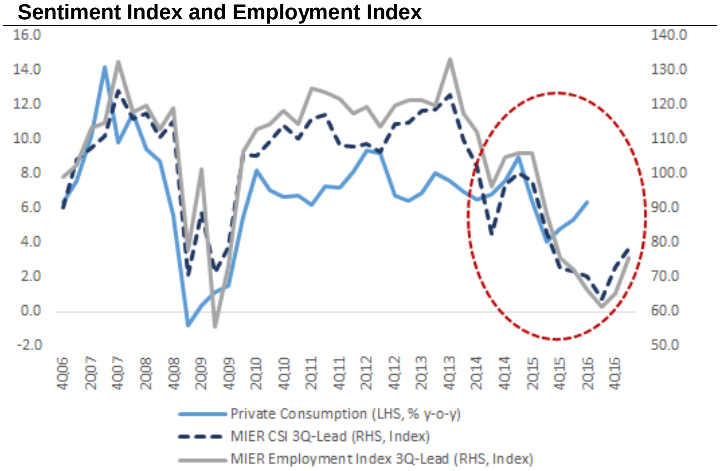
Another crucial factor is the inflation rate, which although remaining tepid so far this year, has risen to the highest level since 2008 when the transport index is excluded from the headline CPI. This suggests that low consumer prices have been mostly attributed to low pump prices. Excluding pump prices, consumer prices are actually higher than they may seem. Given that pump prices may start to recover following the positive sentiment in the oil market as a result of OPEC's efforts to curb production, consumers may continue to tighten their belts in 2017. Notwithstanding this, we do not expect a sharp reversal from the current growth trend. We anticipate consumer spending growth to be in the range of 4.7%.

Table 1: GDP growth on the demand side

Growth (%y-o-y)	2012	2013	2014	2015	1H2016	MARC		MoF	
						2016E	2017F	2016E	2017F
GDP	5.5	4.7	6.0	5.0	4.1	4.1	4.0	4.0 - 4.5	4.0 - 5.0
Domestic Demand	10.7	7.3	5.9	5.1	5.0	4.8	4.4	4.7	4.9
Private Consumption	8.3	7.2	7.0	6.0	5.8	5.3	4.7	6.1	6.3
Public Consumption	5.4	5.8	4.3	4.4	5.2	4.4	3.9	0.2	0.4
Private Investment	21.4	12.8	11.1	6.4	3.9	5.5	5.6	5.3	5.8
Public Investment	15.9	1.8	-4.7	-1.0	1.5	1.1	0.9	1.7	1.1
Real Exports	-1.7	0.3	5.0	0.6	0.2	0.5	2.0	0.7	2.5
Real Imports	2.9	1.7	4.0	1.2	1.6	1.3	2.4	1.4	2.6

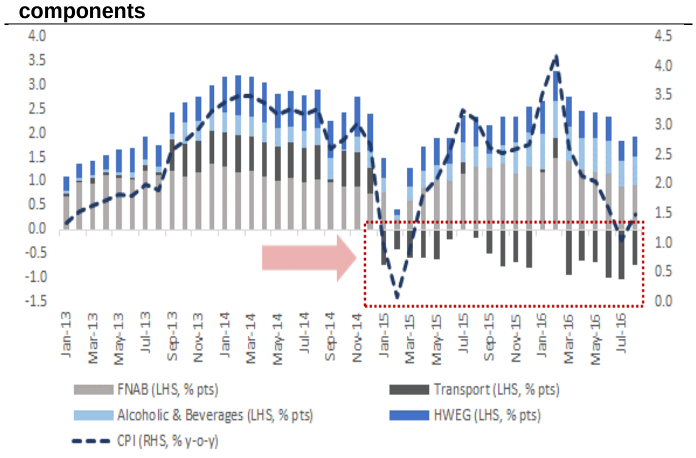
Source: CEIC, MoF, MARC Economic Research

Chart 4: Private consumption growth versus MIER's Consumer Sentiment Index and Employment Index



Source: CEIC, MARC Economic Research

Chart 5: CPI growth and contribution to growth by major components



Source: CEIC, MARC Economic Research

Note: FNAB = Food and non-alcoholic beverages
HWEG = Housing, water, electricity, gas and other fuels

On providing reliefs to cope with rising cost of living

There are numerous measures proposed in Budget 2017 to help the lowest-income group to cope with the rising cost of living. Overall, we feel that these measures are commendable as this income group is the most affected. We think that measures such as a higher amount of BR1M and direct and indirect assistance for civil servants through greater access to various types of loans and special payments can help prevent further deterioration in private consumption growth going forward. However, while we view positively the rebound in consumer spending in 2Q2016, we do not foresee a sharp acceleration in its growth in the near term.

Notably, there are fewer measures for the M40 group when compared with the previous Budgets, and the new tax relief of RM2,500 for the purchase of books, computers, sports equipment and so on is actually lower than the combined amount given for each separate category in the previous years. In addition, slower credit expansion by financial institutions as evidenced by increasingly weaker loan growth (August 2016: 4.2%) will have knock-on effects on consumers in the near term.

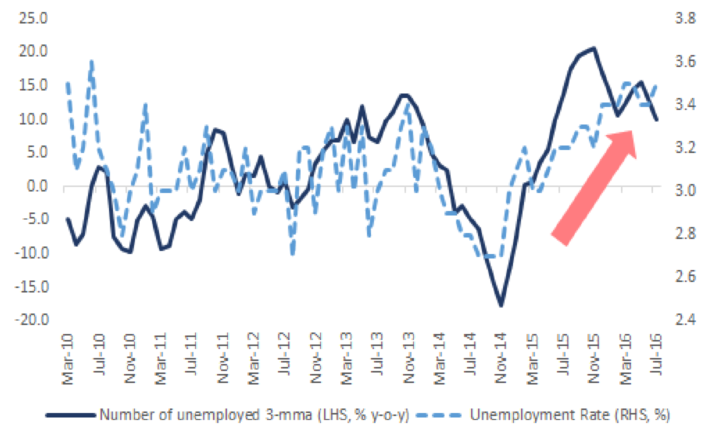
Labour market conditions have taken a new turn as the downturn in oil and gas sector reverberates across the financial sector. While the unemployment rate remains decent at 3.4% in the first seven months of the year, the number of people unemployed has been rising at a double-digit pace during the same period at an average of 12.1%, higher than the 11.7% rise in 2015. Moreover, job replacements are expected to become a major hurdle going forward as the number of job vacancies available in the market shrank to an average of 43,500 per month from an average of 128,800 per month in the six years through to 2015.

With regard to the BR1M programme, we acknowledge its positive impact on the lowest-income group. Recent research findings suggest that income transfers such as BR1M have, to some extent, raised household income for this group in the past few years. Accordingly, median household income has risen by 12.4% per annum on a compound annual growth rate (CAGR) between 2012 and 2014 despite tepid wage growth of 1.7% during the same period. Such assistance is a boon to lower-income households and has proven to be invaluable in rebalancing income and wealth inequality in Malaysia.

Notwithstanding this positive attribute, our concerns on this income transfer are: (1) the long-term impact of cash transfers on work incentives could be negative as it can potentially create a culture of government dependency; (2) they can easily be misused as they are unconditional; and (3) it could be a permanent feature in future government OPEX that could weigh on the government balance sheet. We are still of the view that transfers are the optimum choice so long they are subject to certain conditions such as ensuring children attend school and so on. In addition, strengthening its implementation to avoid its misuse is critical and should be carefully planned in order to realise the maximum benefit.

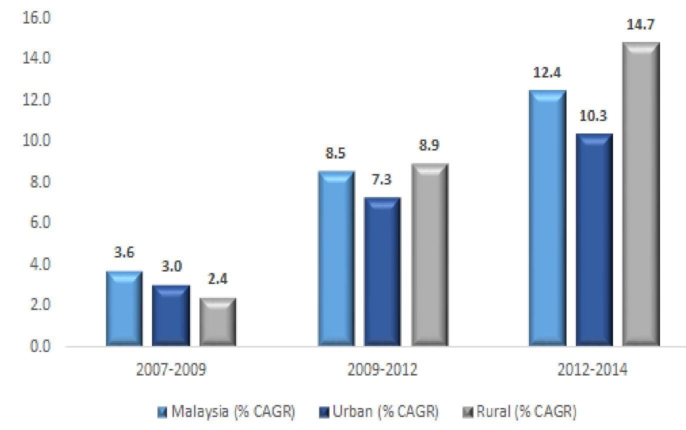
On housing, we feel positive about the government's proposal to provide further measures to increase home ownership in the low- and medium-income groups. We continue to feel that although these particular groups should receive special attention, credit availability should only be provided to those who will not find difficulty in servicing their debt, otherwise the *rakyat* will be burdened with unnecessary financial obligations. As such, MARC feels the continuing effort to provide homes priced below RM300,000 is commendable. However, it will be important for the agencies involved to enhance its communication with various stakeholders and the public, especially in updating the status of completion of these projects as they had been proposed in almost every Budget in the past few years. According to news flow, the PR1MA scheme, which completed and delivered about 900 units at end of 2015, feels that a more realistic target for the corporation is to complete 210,000 units by 2018 and not 500,000 as is commonly believed.

Chart 6: Growth in number of unemployed and unemployment rate



Source: CEIC, MARC Economic Research

Chart 7: Median household income growth by strata



Source: CEIC, DOS, MARC Economic Research

- ## On capital market measures

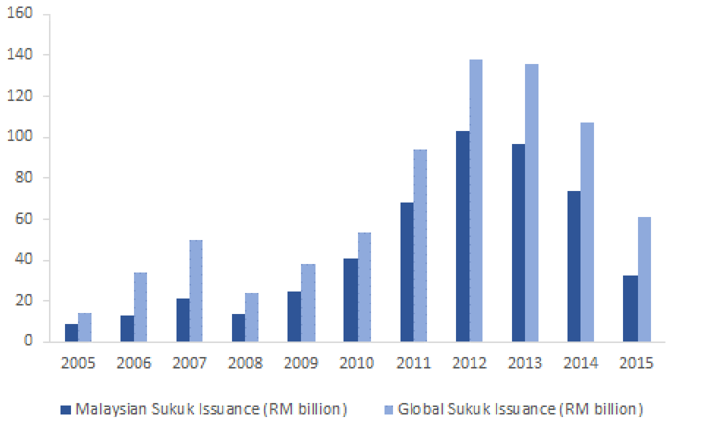
We note that the proposed capital market measures in Budget 2017 mirror the CMP2's key strategies of promoting capital formation and strengthening the capital market's information infrastructure. These measures include: (1) an allocation of RM522 million to MIDA for the certain industries, namely R&D activities and; (2) a special fund allocation of up to RM3 billion to fund managers licensed under the SC to invest in companies with the potential to become public-listed small and mid-cap companies. We are encouraged by these measures as they would help to address investment bottlenecks and encourage the rate of capital formation which will ultimately contribute to the expansion in equity market capitalisation. However, we would also like to see a similar fund to encourage investments in lower-rated bonds.

As for the proposed introduction of the Small and Mid-Cap PLC Research Scheme to conduct research on 300 companies, it is yet to be known whether this scheme will be implemented as an extension of the CBRS announced in June 2005, which also focuses on listed companies that receive little or no research coverage. The Small and Mid-Cap PLC Research Scheme will, similar to the CBRS, facilitate the development and usage of capital market research. Small and mid-cap companies stand to benefit from the scheme by the increased visibility and improved access to funding. We also view positively the government's initiatives to improve the efficiency of capital markets through its proposal to establish the Capital Market Research Institute. An initial funding of RM75.0 million will be provided through the Capital Market Development Fund, a trust fund set up in 2002 to support the development of Malaysia's capital market.

The government also revealed that the incentive for Private Retirement Scheme (PRS) contributors will be increased from the current RM500 to RM1,000 for contributors with a minimum accumulated investment of RM1,000 over a period of two years. We are generally encouraged by this continuing effort to encourage youths to make long-term investments as it would help deepen the capital market and develop the private pensions industry.

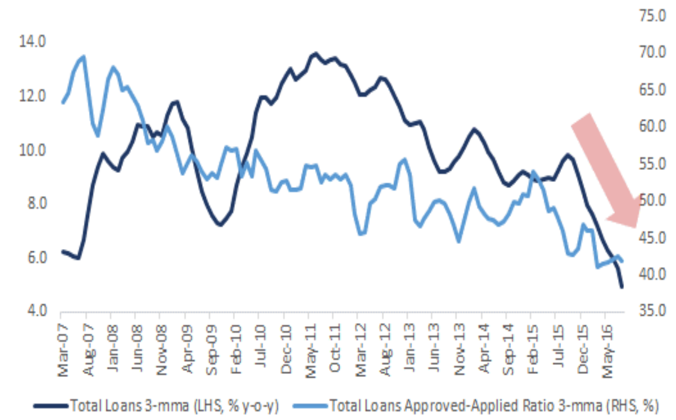
The government's decision to extend the period of income tax exemption to entities carrying out Islamic banking and Takaful business via the International Currency Business Unit (ICBU) in foreign currencies as well as stamp duty exemptions on instruments of such activities to the year of 2020 would ensure Malaysia remains at the forefront of the global Islamic finance sector. MARC believes that the continuation of such measures would also help strengthen Malaysia's position in the international sukuk arena which in the past few years had moderated since 2010. Notably, Malaysia's market share of global sukuk outstanding fell to 51% year-to-date (up to September 2016), from 54% at end-2015. As such, the proposed measure would, to some extent, help Malaysia sustain its position as the world's top sukuk market by encouraging local corporations to issue foreign currency-denominated sukuk to gain appeal among foreign investors.

Chart 8: Global and Malaysian annual sukuk issuances, 2005 - 2015



Source: Zawya, International Islamic Financial Market (IIFM), MARC Fixed Income Research

Chart 9: Loan growth and approval-applied ratio on a 3-month moving average



Source: Source: CEIC, MARC Economic Research

▪ Monetary stance – no major diversion

Although the current economic backdrop calls for a more accommodative stance from BNM, we do not anticipate a major diversion from the present level. We acknowledge the downside bias of economic growth in the next one year as the confluence of external and internal forces weakens consumption and investment activities. Loan growth has also slipped below 6% since June 2016 and the approval-to-application ratio declined to a record low of 38.5% in March 2016 before recovering slightly to 42.4% in August 2016.

Since Malaysia is grappling with challenges arising from its lingering budget deficit, its limited fiscal space seems to suggest that monetary policy is an alternative avenue to support its headline growth in the near term. However, with banks already watching their balance sheets very closely to avoid further deterioration, lending will not likely pick up even if interest rates are lowered further. We sense that from the central bank's point of view, the failure to reignite growth through looser monetary policies as seen in many countries justifies its reluctance to reduce the policy rate in the medium term unless growth deteriorates substantially.

As such, going forward in 2017, barring unforeseen circumstances, we foresee the OPR will be maintained almost at the current level, if not unchanged at all. We only foresee a 25 bps cut at the most if economic conditions worsen.

Budget 2017 Measures

RURAL TRANSFORMATION

- RM100 million proposed to install 97,000 street lights and 3,000 LED lights in 7,500 villages nationwide.
- RM1.2 billion to build and upgrade 616 km of village roads and bridges.
- RM4.6 billion to maintain the state road under the Malaysian Road Records Information System (MARRIS).
- RM350 million to build and refurbish 17,000 units of destitute and dilapidated houses and Orang Asli settlements.
- RM732 million proposed to provide clean water supply to 5,200 houses and upgrade FELDA water supply.
- RM665 million allocated to address water supply issues via States Water Supply Plan.
- RM460 million to provide electricity supply to 10,000 houses in rural areas.
- RM300 million proposed to maintain and repair facilities at flats and PPR through 1Malaysia Maintenance Fund.
- RM800 million allocated to implement People-Friendly Projects, which include upgrading and building *surau*, small bridges, drainages, community halls, markets and kiosks.
- RM495 million proposed to continue 69 Flood Mitigation Plans.
- RM222 million allocated to implement treated water supply projects at 42 Orang Asli villagers, entrepreneurship and economic development programmes, village resettlement, among others, at Sungai Ruil, Cameron Highlands.
- A sum of RM50 million proposed for land mapping in Sabah and Sarawak through Native Customary Rights project.
- A sum of RM140 million allocated under the National Blue Ocean Strategy (NBOS) to, among other things, build additional four Urban Transformation Centres (UTC) and three Rural Transformation Centres (RTC), establish a Job Centre in every UTC for job matching, as well as increase the number of buses for the Mobile Community Transformation Centre to four.

ECONOMIC DEVELOPMENT AND INVESTMENT

- RM2.1 billion allocated for infrastructure and socioeconomic development of five economic corridors, namely Iskandar Malaysia, NCER, ECER, SDC and SCORE.
- To invigorate digital economy, a sum of RM162 million allocated to implement digital programmes such as e-commerce ecosystem and Digital Maker Movement.
- New location categories as Malaysia Digital Hub will be introduced to spread the benefits of the MSC Bill of Guarantees, including tax incentives as well as the introduction of Digital Free Zones.

INFRASTRUCTURE AND PUBLIC TRANSPORT

- RM55 billion allocated to implement the new East Coast Rail Line (600 km) project connecting Klang Valley to the East Coast.
- RM100 million to restore the East Coast railway line along Gua Musang – Tumpat.
- RM1.1 billion proposed to purchase 19 sets of trains to increase the frequency of ETS services.
- The implementation of the Pan Borneo Highway in Sabah and Sarawak will be accelerated.
- RM1 billion allocated to widen the coverage and enhance the quality of broadband up to 20Mbps throughout the nation.
- Ethernet broadband speed in public universities will be increased to a maximum of 100Gbps.
- More competitive prices for broadband with a higher speed will be offered effective January 2017.
- RM60 million proposed to provide grant of RM5,000 to purchase new vehicles and offer individual taxi permits, benefitting 12,000 taxi drivers.
- RM60 million to introduce SOCSO scheme for individual taxi drivers earning less than RM3,000 per month.

EDUCATION

- RM140 million proposed to continue the Additional Food Assistance and Per Capita Grant to children in TABIKA and TASKA.
- RM60 million to improve daily nutritional food packages which include 250ml of milk, raisins and eggs.
- RM132 million allocated to improve access to preschool education in government schools for free.
- RM570 million proposed to reconstruct 120 destitute schools using Industrial Building System (IBS) and upgrade 1,800 science laboratories.
- RM478 million allocated to complete construction of 227 schools.
- RM90 million to strengthen English language proficiency programmes.
- RM340 million will be used to provide tablets to 430,000 teachers to lessen their workload.
- RM350 million allocated for Schooling Assistance Programme of RM100 each to students from families earning less than RM3,000.
- RM1.1 billion proposed to provide Hostel Meal Assistance Programme.
- RM300 million to continue 1Malaysia Supplementary Food Programme for primary school students.
- RM1.1 billion allocated to provide Additional Assistance for Payment of School Fees, Textbook Assistance and Per capita Grant Assistance.
- RM107 million propose to provide Special Needs Student Allowance of RM150 monthly to 67,000 students and replace buses or coasters for 21 special education schools.
- RM600 million allocated for maintenance of National Schools, National-type Chinese Schools, National-type Tamil Schools, Religious Schools, Full-residential schools, Government-aided religious schools, registered *Sekolah Pondok* and Maktab Rendah Sains Mara (MRSM).
- A sum of RM7.4 billion allocated for 20 public universities.
- RM300 million proposed to replace book vouchers with student debit cards worth RM250.
- A sum of RM4.3 billion allocated to continue providing scholarships through various channels.
- Additional discounts will be given to encourage repayments of PTPTN loans effective 22 October 2016 to December 2017.

HUMAN CAPITAL

- RM400 million proposed to transform nine unused Teachers' Training Institute (IPG) campuses into Polytechnics and Vocational Colleges, including one for TVET trainers.
- RM270 million allocated to upgrade teaching equipment in TVET institutions.
- RM360 million for Skill Development Corporation.
- Double tax deduction for Structured Internship Programme will be extended until year of assessment 2019 for students pursuing degree, diploma as well as Level 3 and above, under TVET programmes.
- RM50 million allocated to extend the SL1M programme by GLCs to 20,000 graduates in 2017 compared with 15,000 graduates in 2016.

COST OF LIVING

- RM6.8 billion allocated for an increase in BR1M payments, ranging from RM50 to RM200 as well as the continuation of the Bereavement Scheme for all BR1M recipients.
- RM1.3 billion allocated to paddy farmers to subsidise paddy price, seeds and fertilisers.
- RM250 million will be provided to registered rubber smallholders under Rubber Production Incentive.
- RM260 million allocated for Rainy Season Assistance to 440,000 rubber smallholders.
- The monthly allowance of RM200 to RM300 will be continued for 57,000 fishermen with a cost of RM250 million.
- RM1.6 billion for cooking gas subsidy.
- RM124 million was slated for electricity subsidy.

B40 GROUP

- RM45 million allocated to expand the MySuria programme, under which more than 1,600 housing units will be installed with solar panels and receive RM250 per month.
- RM30 million proposed to expand Mobileprenuer Programme by GIATMARA, targeting 3,000 participants using motorcycles.
- RM100 million allocated to implement Agropreneur programme involved in the production of high-value agricultural products.
- RM100 million proposed to revitalize eUsahawan and eRezeki programmes, comprising 300,000 participants.
- Encourage BR1M recipients to generate additional income by become ride-sharing drivers. For those who do not own vehicles, downpayment can be paid using BR1M with rebates up to RM4,000 for the purchase of Proton Iriz.

TAXES

- Lifestyle tax reliefs will be introduced effective year assessment of 2017 with relief up to RM2,500 per year for the purchase of reading materials, computers, sports equipment, printed newspapers, smartphones and tablets, internet subscriptions and gymnasium membership fees.
- Special tax relief up to RM1,000 effective year assessment of 2017 for working women for the purchase of breastfeeding equipment which is claimable every two years.
- Tax exemption up to RM1,000 will be given to parents who enroll their children aged six years and below into registered nurseries and pre-schools, from the year of assessment 2017.
- Stamp duty rate on instruments of transfer of real estate worth more than RM1 million will be increased to 3% from 4% effective 1 January 2018.
- Corporate tax reduction of between 1 and 4 percentage points for companies with significant increase in taxable income for year of assessment 2017 and 2018.
- Tax rate for SMEs with taxable income up to first RM500,000 will be reduced to 18% from 19%.
- Double taxation promotion on operating expenditure borne by anchor companies for the Vendor Development programme will be extended until 31 December 2020.

CIVIL SERVANTS AND PENSIONS

- The fully paid Study Leave with scholarship will be extended to the Support Group, which is currently limited to Management and Professional Groups.
- Quarantine Leave up to five days will be given without record to public servants whose children are ill and required to be quarantined.
- Computer Loan facility will be extended to include the purchase of smartphones, which can be utilised by public servants once every three years with a maximum loan of RM5,000.
- The limit of motorcycle loan facility will be increased up to RM10,000.
- 30,000 units of 1Malaysia Civil Servants Housing (PPA1M) will be completed, with selling price between RM90,000 and RM300,000.
- The contract of service and contract for service officers will be extended for at least one year.
- Grade 56 will be introduced for medical and dental specialists to address the issues of specialist doctors leaving the public service and delays in promotion.
- 2,600 medical doctors, dentists and pharmacists will be appointed on contract latest by December 2016.
- Special assistance of RM500 to all public servants and RM250 to government retirees which will be paid in early January 2017.

SECURITY

- RM55 million proposed for Special Insurgency Incentive Payment to veteran Malaysian Armed Forces.
- RM1.8 billion allocated for maintenance of main defense assets such as aircraft, patrol vessels, communication equipment, buildings and weaponry.
- A sum of RM1.3 billion is allocated to increase communication devices, rations and purchase of uniforms.
- A sum of RM323 million proposed for personnel deployment at the eastern border of Sabah to enhance effectiveness of ESSZONE operations.
- RM114 million allocated to upgrade interior roads in Sarawak under the Jiwa Murni Programme by ATM.
- RM15 million for expanding the Armed Forces School Ferry services involving 15,000 children of ATM.
- RM8.7 billion allocated for Royal Malaysian Policy to, among other things, build 12 district police headquarters, Commando 69 training centres and purchase vehicles.
- RM60 million proposed for urban crime prevention programme.
- RM80 million to provide uniforms for 200,000 RELA personnel.
- RM40 million allocated to reintroduce grant to registered Residence Associations, of which up to RM10,000 will be provided for the purchase of security control equipment, cleaning and maintenance of neighbourhood.

PROPERTY AND HOUSING

- RM200 million allocated to build 5,000 units of MyBeautiful New Home under NBOS for B40 households at a price of between RM40,000 to RM50,000 per unit, of which RM20,000 will be financed by the government while the remaining will be paid by owners on installment plans.
- RM710 million proposed to build 9,850 new units and complete 11,250 PPR houses
- 30,000 units of new houses will be built on government vacant land at strategic locations by GLCs and PR1MA with a selling price ranging between RM150,000 and RM300,000.
- 10,000 houses will be built in urban areas for rental to eligible youths with permanent jobs at below market rates.
- RM200 million will be provided to SPNB to build 5,000 units of People's Friendly Home (RMR), of which up to RM20,000 per unit will be subsidies by the government.
- 30,000 units of Perumahan Penjawat Awam 1Malaysia will be completed at a selling price of between RM90,000 and RM300,000, which is 20% below market price.
- A new special "step-up" end-financing scheme for the PR1MA programme will be implemented effective 1 January 2017 in collaboration with the BNM, EPF, as well as four local banks, to provide easier financing to buyers with total loan up to 90% to 100% with loan rejection rate to be reduced drastically.
- Stamp duty exemption to be increased to 100% from 50% on instruments of transfer and loan agreement for first home ownership between the period 1 January 2017 and 31 December 2018 with home values up to RM300,000.
- A sum of RM500 million allocated for Second-Generation House infrastructure development to FELDA (RM200 million), FELCRA (RM100 million) and RISDA (RM100 million).

YOUTH AND SPORTS

- RM450 million allocated to host the 29^{th} SEA Games and the 9^{th} Para ASEAN Games in 2017.
- RM50 million for the construction of Football Academy Phase II in Gambang, Pahang.
- RM122 million will be used to build and upgrade Youth and Sports Complex, 1Malaysia Futsal Complex and Community Sports Complex.
- RM70 million proposed for Elite Sports Podium Development Programme.
- RM54 million allocated to continue Sportsmen Development Programmes, which includes Athlete Preparation Programme and Paralympic Athlete Preparation Programme.

AGRICULTURE

- RM1.3 billion allocated to increase food production, which includes the development of agricultural infrastructure, as well as continuing high impact programmes such as paddy estates, aquaculture integrated zone and cage fish farms.
- RM140 million proposed for Distribution of Necessary Goods Programme, opening of additional four MyFarmOutlets and upgrading 150 Agrobazaar Rakyat 1Malaysia premise.
- Encourage the development of dairy industry as well as madu kelulut and coconut, reducing dependence on imported animal feed through the development of corn plantation as a pilot project in Terengganu and Kedah.
- A sum of RM286 million will be provided to increase exports of palm oil, rubber, cocoa and pepper.
- RM50 million allocated to conduct scientific research to enhance the quality of palm oil products.
- RM30 million worth of grant will be provided through Malaysian Palm Oil Board (MPOB) for replanting of palm oil by smallholders.

HEALTH

- New hospitals and clinics will be built and upgraded in Perlis, Kuching, Mukah, Jempol, Muar and Johor Bahru.
- RM536 million will be used to upgrade hospital facilities, including the provision of cardiology treatment equipment and the purchase of 100 ambulances.
- RM4.5 billion allocated for the operations of 340 1Malaysia Clinics, 11 1Malaysia Mobile Clinics, 959 health clinics and more than 1,800 existing rural clinics.
- RM4.0 billion for the supply of drugs, consumables, vaccines and reagents.
- A sum of RM20 million proposed in the form of soft loans for a cooperation between the government and the private sector or NGOs to operate non-profit charitable hospitals based on government hospital rates.
- RM70 million allocated for medical assistance to 10,000 underprivileged patients.
- A total of RM40 million will be used for a one-off grant worth RM200,000 for the purchase of equipment in new haemodialysis centres.
- RM80 million proposed to expand National Community Health Empowerment Programme and will implement initiatives to prevent and control contagious diseases such as dengue and Zika.

SOCIAL SAFETY NET

- Poor families will receive General Assistance up to RM300 per month, and Children Assistance up to RM450 per month.
- RM424 million allocated to provide senior citizens socioeconomic assistance of RM300 per month.
- RM535 million proposed to provide assistance to the persons with disabilities (PWD), including employee allowance, disabled children training allowance and assistance for PWDs who are unable to work.
- Registered PWDs will be entitled for GST relief for the purchase of aid equipment without going through Private Charitable Entities, and the list of eligible equipment will be expanded.

TOURISM

- A sum of RM400 million allocated to intensify promotion and improve tourism facilities, which include among other things, Visit ASEAN@50 Year Campaign, and hosting the 2017 SEA and Para ASEAN Games.
- The duration to submit applications for Pioneer Status promotion and Investment Tax Allowance for new 4 and 5 star hotels will be extended to 31 December 2018.
- Tax deduction will be increased to RM700,000 from RM500,000 to encourage sponsorships by the private sector in art and cultural performances and shows, as well as local and foreign heritage.

- EVisa facilities will be extended to countries in the Balkans and South Asia regions in a bid to achieve 32 million of tourist arrivals next year.

SMALL AND MEDIUM ENTERPRISES (SMEs)

- Year 2017 will be declared as the Startup and SME Promotion Year.
- RM75 million will be provided to implement programmes under SME Master Plan.
- All schemes under Syarikat Jaminan Pembiayaan Perniagaan (SJPP) with a guarantee up to RM15 billion will be extended until 2025.
- RM100 million allocated for a period of five years to provide 2% rebate on interest charge to SME borrowers under SJPP scheme to boost export-oriented SMEs, but limited to a total accumulated funding of RM1 billion.
- RM200 million will be used from the Working Capital Guarantee Scheme (WCGS) Fund to invigorate startups.
- A new pass category will be introduced, namely Foreign Knowledge Tech Entrepreneurs to encourage investment in high technology startups.
- RM80 million will be used to invigorate creative industries and film production.
- RM50 million allocated for Indian community for business financing programmes through TEKUN.
- RM100 million proposed to enhance the viability of bumiputera entrepreneurs and to expand their business capacity through SME Bank.

CAPITAL AND FINANCIAL MARKETS

- Small and Mid-Cap PLC Research Scheme to be introduced to conduct research on 300 companies.
- RM3 billion of special funds will be allocated by government-linked investment companies to fund managers licensed under the Securities Commission to invest in potential small and mid-cap companies.
- RM75 million fund will be allocated via Capital Market Development Fund to establish Capital Market Research Institute.
- The period of income tax exemption will be extended to the year of assessment 2020 to entities carrying out Islamic banking and Takaful business through the International Currency Business Unit (ICBU) in foreign currencies as well as stamp duty exemption on instruments of such activities.
- RM165 million will be provided for a one-off increase in PRS incentive to RM1,000 from RM500 for PRS contributors with a minimum accumulated investment of RM1,000 during a period of two years.

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