Economic Research

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Pre-Budget 2020:
Sharing the Prosperity of the Nation

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In a nutshell

- One of the primary focus of Budget 2020 will be to sustain the strength of domestic demand amid weakening prospects of the global economy. This is to avert a possible sharp deceleration in GDP growth. Both fiscal and monetary policy arsenals will likely be utilised for this purpose. Having said this, we do not expect the monetary policy to become too accommodative as it was during the Global Financial Crisis (GFC) due to possible ‘side effects’ as seen in the previous downcycle (i.e. rising asset prices and household indebtedness). Hence, fiscal policy measures will likely take the centre stage
- For the export sector, focus will likely be on key industries with high export growth potential such as aerospace, machinery & equipment (M&E) as well as electrical and electronics (E&E). There could also be more efforts to increase Malaysia’s trade volume with ASEAN and other Asian economies. Domestically, sectors with extensive linkages such as construction and tourism will likely see a boost in allocations. There will likely be continuous efforts to support the development of both the medical and retirement tourism sub-sectors, for which Malaysia is ranked among the best in the world.
- Measures to support consumer spending, which contributed more than 90% of headline GDP growth in 1H2019, will likely be introduced. In addition, resuming important infrastructure projects will be another economic agenda as they generate a high multiplier effect on the economy. Their forward and backward linkages with other sectors are key to their effective contribution to the economy despite forming a relatively small share of the economic pie.
- We do not foresee the government to be too stringent in setting the budget deficit target for 2020. Increasing the development expenditures that are required to bolster economic activities and cushioning the impact of the global slowdown on the domestic economy will be prioritised over achieving an unrealistic budgetary target in the short term. This is especially true when government revenue will likely be affected by softer global crude oil prices. We foresee the government budget deficit ratio to decline to 3.2% of GDP in 2020.
- MARC expects more budgetary initiatives aimed at easing the cost of doing business in Malaysia. As for SMEs, we foresee continuous efforts to create a more conducive ecosystem for them that includes appropriate policy-making, logistics support and export programmes. We anticipate more measures to be introduced to address unique problems faced by micro-enterprises which include access to financing, human resource availability as well as business operations. In addition, there will likely be more initiatives on Industry 4.0 and steps to overcome Malaysia’s premature deindustrialisation in Budget 2020.
- To ease the burden of the *rakyat*, the government could introduce measures to tackle high food prices given that one-third of total household expenditure among vulnerable and low-income households is on food purchases. Issues related to insufficient food production, monopolistic practices, manipulations by middle men and excessive profiteering activities could be addressed in Budget 2020.
- To strengthen the labour market, we expect more initiatives to assist graduates to secure jobs through job-matching platforms (i.e. MyJobs) and efforts to raise the quality of Technical and Vocational Education and Training (TVET). Given the potential contribution of female workers to the economy, we expect more measures to be proposed to enhance female labour force participation. MARC also believes that the education sector will continue to be given top priority in Budget 2020 given that only 29% of the labour force have tertiary-level education.

The Focus of Budget 2020

Cushioning the impact of external shocks on the economy

Part of the measures in Budget 2020 – to support the economy through measures that will reinvigorate external and domestic sectors

- Against a backdrop of deteriorating global economic prospects, part of the measures in Budget 2020 would be to sustain the strength of domestic demand. This is to avert a sharp deceleration in GDP growth. Both fiscal and monetary policy arsenals will likely be utilised for this purpose. However, as we do not expect the monetary policy to become too accommodative as it was during the GFC due to possible side effects as seen in the previous downcycle (i.e. rising asset prices and household indebtedness), fiscal policy measures will likely take the centre stage.

Externally…

Measures to boost the external sector

- There will likely be extra efforts to increase exports in view of the declining global trade momentum. This could include a bigger role for the Export Promotion Programmes Coordination Committee which is now tasked to review and approve all export promotion programme proposals from ministries and agencies. Its role as a market intelligence centre could also be enhanced. Such efforts will improve coordination and foster greater synergies among government agencies and ministries.
- Focus will also likely be directed towards key industries with high export growth potential such as aerospace, M&E as well as E&E. For instance, measures to streamline coordination between relevant government agencies and National Aerospace Industry Coordinating Office could be enhanced. This is crucial considering that exports of aircraft parts and components have grown at an astounding pace of 31% p.a. on a compound average growth rate (CAGR) basis between 2014 and 2018.
- There could also be more focus on increasing Malaysian trade volume with ASEAN and other Asian economies. This includes efforts to increase the penetration of halal exports into countries such as Indonesia, which has a large Muslim population. Measures to strengthen exports to Malaysia's single-largest market, China, could also be intensified to take advantage of the country's huge domestic economy.

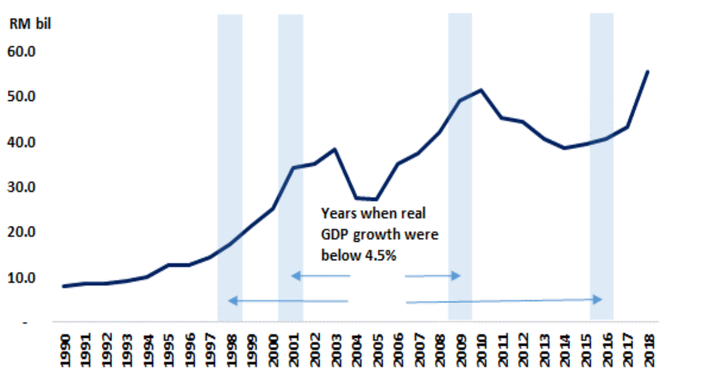
Domestically…

Some of the measures that could help the domestic economy

- Measures to support consumer spending, which contributed more than 90% of headline GDP growth in 1H2019, will likely be introduced. This could come in the form of (i) a reduction in EPF employee contributions as previously carried out during a mild economic downturn in 2016; and (ii) a larger amount of Bantuan Sara Hidup to help vulnerable and low-income households to cope with the present challenging economic environment.
- Development expenditures will likely be increased from 2019's level of an estimated RM54 billion (3.5% of GDP) to reinvigorate economic activities. This is in view of its declining share to GDP to circa 3.4% in 2015-2018 from 4.6% between 2010-2014 and 5.5% between 2005-2009. We think that the declining share of development expenditures to GDP was partly due to the increase in OPEX over the years (5.4% p.a. on a CAGR basis from 2010 to 2018). Historically, only about 80% to 90% of the yearly DE allocation was utilised. Net DE in 1H2019 stood around 43% of Budget's 2019 allocation.
- Resuming important infrastructure projects will be another economic agenda as they generate a high multiplier effect on the economy. Their forward and backward linkages with other sectors are key to their effective contribution to the economy despite forming a relatively small share of the economic pie. Hence, despite earlier announcements to shelve some infrastructure projects, the government has resumed a few viable projects after conducting appropriate cost rationalisation exercises (i.e. ECRL, KVLRT3, KVMRT2).

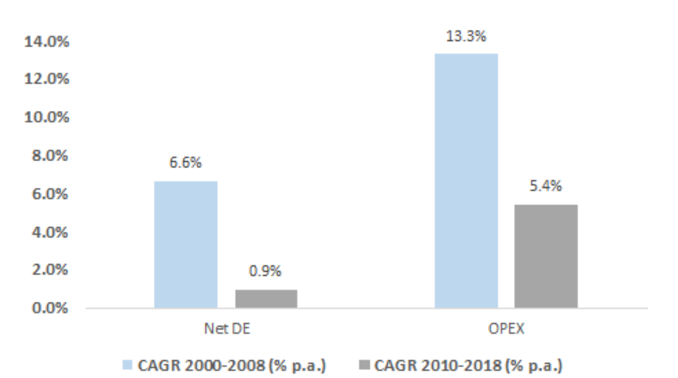
- Industries with extensive domestic linkages such as tourism will likely see a boost in allocations. This will augur well with Malaysia's efforts to promote Visit Malaysia Year 2020. Allocations could be channelled to develop new tourism products, increase the availability of skilled personnel in the tourism sector as well as to expand and upgrade tourism infrastructures to prepare for the influx of tourists. There will likely be continuous efforts to support the development of both the medical and retirement tourism sub-sectors, for which Malaysia is ranked among the best in the world. Malaysia attracted about 13.4 million foreign tourists in 1H2019, up 4.9% from the corresponding period in 1H2018. The rise contributed to a 6.8% increase in tourism revenue to RM41.7 billion.

Chart 1: Net DE as % GDP



Sources: CEIC, MoF, MARC Economic Research

Chart 2: Growth in OPEX and DE post AFC and GFC (CAGR%)



Sources: CEIC, MARC Economic Research

Striking a delicate balance between fiscal consolidation and growth

No rigid target for budget deficit but consolidation efforts will continue

Against a backdrop of deteriorating global economic prospects, we do not foresee the government to be too stringent in setting the budget deficit target for 2020. Raising necessary development expenditures that are required to defend economic growth will be prioritised over achieving an unrealistic budgetary target in the short term. This is especially true when government revenue will likely be affected by softer global crude oil prices (YTD Brent: USD65 per barrel versus 2018: USD71 per barrel).

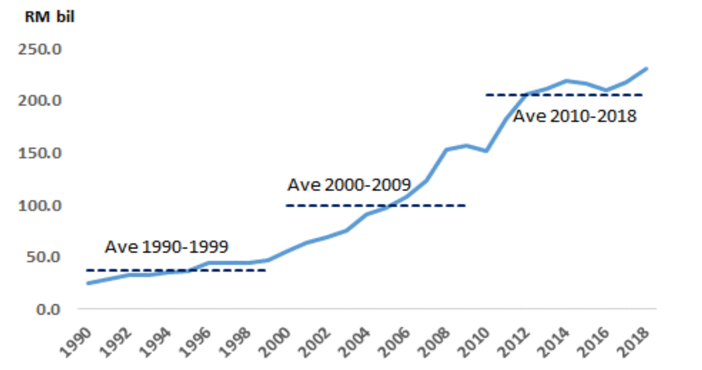
Continuous efforts to rationalise OPEX

Overall, we foresee continuous efforts by the government to rationalise OPEX. In 1H2019, OPEX rose by roughly 6% and accounted for 48% of the whole year's budget of RM259.9 billion. In this regard, there will be concerted efforts to reach out to targeted groups more efficiently through a more comprehensive database. Allocations will continue to be on a needs basis rather than across the board. Similarly, reducing financial leakages will be carried out through greater transparency of procurement processes.

No new major taxes to be imposed at a time when economic growth is below trend

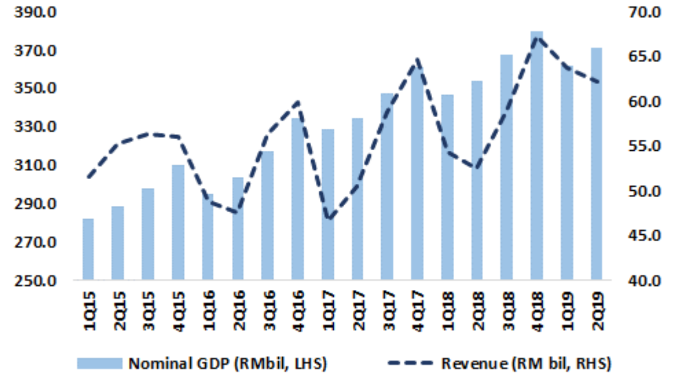
As we do not anticipate new major taxes to be imposed at a time when economic growth is below trend, the main way to increase revenue will be through greater efficiency in the collection of taxes. Some positive results have been seen i.e. direct tax collection grew by 12% in 2018 despite a moderation in economic growth from 5.9% to 4.7%. Going forward, with the impending implementation of the digital tax in 2020, the government could diversify its revenue base in the future. In addition, oil-related revenue will remain decent in 2020 based on the average medium-term oil price projections of between $53-$67 per barrel. We foresee the government budget deficit ratio to decline to 3.2% of GDP in 2020 from 3.4% of GDP in 2019.

Chart 3: OPEX and 10-yr averages 1990-2018 (RM bil)



Sources: CEIC, MARC Economic Research

Chart 4: Government revenue and nominal GDP growth



Sources: CEIC, MoF, MARC Economic Research

Enhancing the management of government debt liability

DE will likely continue to increase to buffer the economy against weaker global growth

- Increasing government development expenditures required to buffer the economy in times of heightening global uncertainties could mean the pace of federal government debt reduction could be slightly slower than initially anticipated. That said, the pace of debt accumulation will probably slow down and fiscal consolidation efforts will continue. Between 2010 and 2017, government debt rose by an average 7.8% p.a. on a CAGR basis, topping nominal GDP growth of 6.5% p.a.

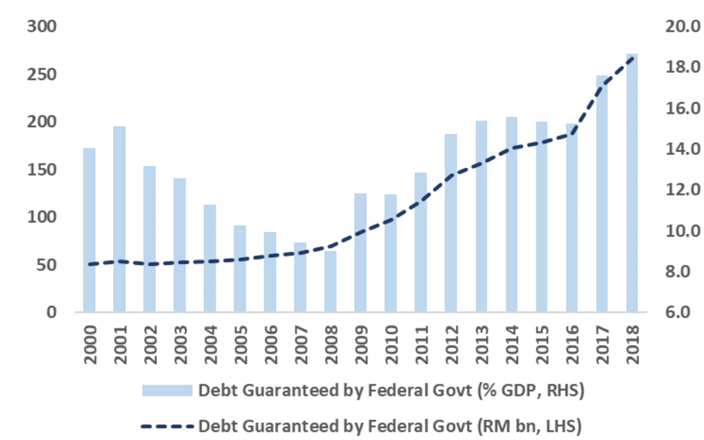
A limit on the amount of debt guaranteed by the government will be a positive step

- Recent rhetoric by the government to limit the amount of debt guaranteed by the federal government is a positive step, given that such debt has grown by roughly 13.5% p.a. post GFC (2010-2018), outpacing the 7.8% p.a. growth of direct debt. We foresee the government will provide clarity on the debt limit for government-guaranteed debt in Budget 2020. The introduction of such a cap will enhance the government's credibility in managing its overall liability and improve its perception among international credit rating agencies (CRAs).

Future debt payment affordability will likely improve

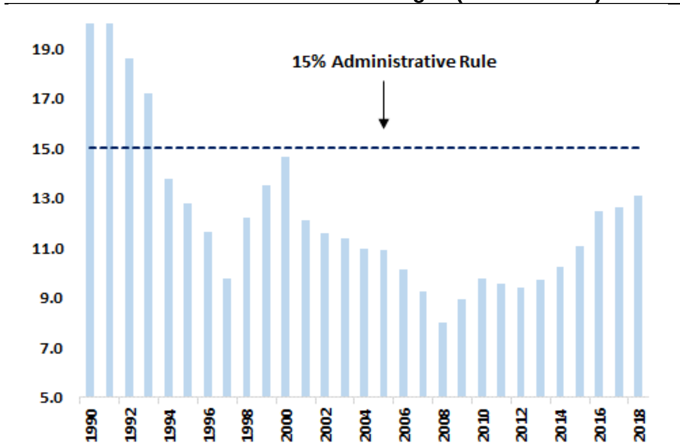
- We also anticipate future debt payment affordability to improve through cheaper sources of debt (i.e. Samurai bonds). Based on the news flow, the government is now considering to issue another round of Samurai bonds which carry low interest rates. In March, Malaysia had issued JPY200 billion worth of Samurai bonds at a cost of 0.63%. With lower debt service charges, Malaysia will likely be able to cap its government debt-service ratio (DSR) below 15%.

Chart 5: Debt guaranteed by Fed government



Sources: CEIC, MARC Economic Research

Chart 6: Government debt service charges (% of revenue)



Sources: CEIC, MARC Economic Research

Assisting businesses and further strengthening the role of SMEs

Focus will be on lowering cost of doing business

- MARC expects more budgetary initiatives aimed at easing the cost of doing business in Malaysia. This is because while Malaysia's position is at a commendable number 15 out of 190 economies in the World Bank Doing Business Report 2019, it is ranked at number 122 in terms of starting a business. It is important to note that entrepreneurial activity is a pillar of economic performance, a key competitiveness factor.

More conducive ecosystem for SMEs to enhance their potential

- For SMEs, MARC foresees continuous efforts to create a more conducive ecosystem that includes appropriate policy-making, logistics support, and export programmes. This is due to the fact that SMEs contribute as much as 37% of GDP and make up more than 98% of business establishments in Malaysia. SMEs are typically more dependent on their business ecosystem compared to large companies, hence, more needs to be done to enhance their competitiveness other than just assisting them in getting access to financing.

More measures to address problems of micro enterprises

- Realising the importance of SMEs in ensuring a more balanced economic growth and shared prosperity of the nation, we believe that additional measures will be introduced to address the unique problems faced by micro-enterprises. Comprising about three-quarters of SME establishments, micro-enterprises face a different set of challenges including access to financing, human resource availability as well as business operations. Unlike larger establishments, their concerns are more of cash flow management and day-to-day business survival. Hence, they require a whole different ecosystem.

More Industry 4.0 initiatives to further strengthen competitiveness

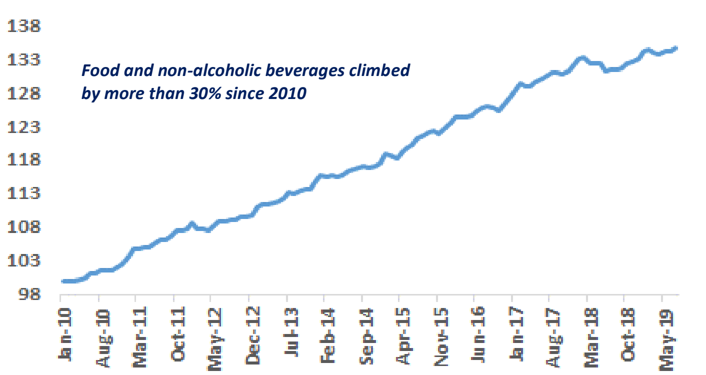
- There will likely be more initiatives on Industry 4.0 and steps to overcome Malaysia's premature deindustrialisation in Budget 2020. While the transition process has slowed, it is nevertheless a wake-up call to strengthen the manufacturing sector. MARC expects the initiatives to also include programmes aimed at increasing collaborations between public and private sectors and increasing the pace of technological adoption.

Sharing the economic prosperity and reducing the burden of the *rakyat*

Steps to ensure that high food prices are addressed

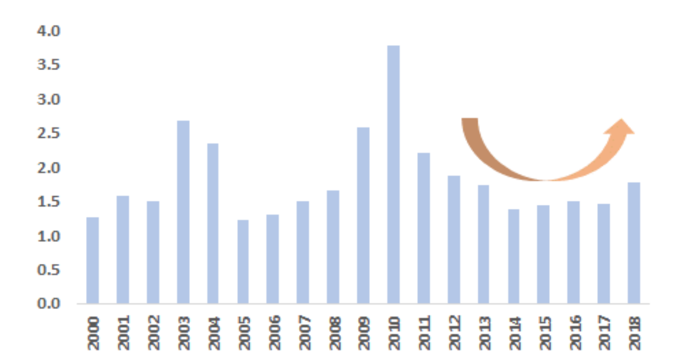
- Measures to tackle high food prices to lessen the burden on the *rakyat* could also be proposed, given that about one-third of total household expenditure among vulnerable and low-income households is on food purchases. Issues related to insufficient food production, monopolistic practices, manipulations by middle men and excessive profiteering activities are often cited as the major causes of rising food prices in Malaysia. Addressing such concerns are the government's top priority.

Chart 7: Food and non-alcoholic index – rebased



Sources: CEIC, BNM MARC Economic Research

Chart 8: DE on healthcare (RM bn)



Sources: CEIC, MoF, MARC Economic Research

To address the rising cost of living, the newly proposed Cost of Living Index could be used as a benchmark

- In tackling the rising cost of living, the government could provide measures to encourage businesses to use the recently proposed Cost of Living Index as a benchmark for wage increments. Studies on the cost of living such as *Belanjawanku* could be expanded to include other states in Malaysia to assist the *rakyat* to make appropriate decisions relating to their spending habits. Currently, *Belanjawanku* provides the minimum measurement of monthly expenses for households in the Klang Valley to live a comfortable life.

Measures to enhance employability

- To strengthen the labour market, public initiatives that can assist the *rakyat* to secure jobs through job-matching platforms (i.e. MyJobs) and efforts to raise the quality of TVET could be enhanced to boost the employability of graduates. Given the potential contribution of female workers to the economy, we expect more measures to be proposed to enhance their participation. Currently, Malaysia's labour force participation for female stood circa 56%, significantly lower than that of male of around 80%.

Allocations for healthcare could be increased for low-income group

- We believe the allocations for healthcare will continue to grow in line with the government's intention to expand the safety net for the *rakyat*, particularly for the low-income group. Over the last five years, spending on healthcare averaged at RM1.5 billion p.a., accounting for 3.4% of development expenditure. Other initiatives such as price controls on medicines could be imposed at the manufacturing stage as well as at the retail level.

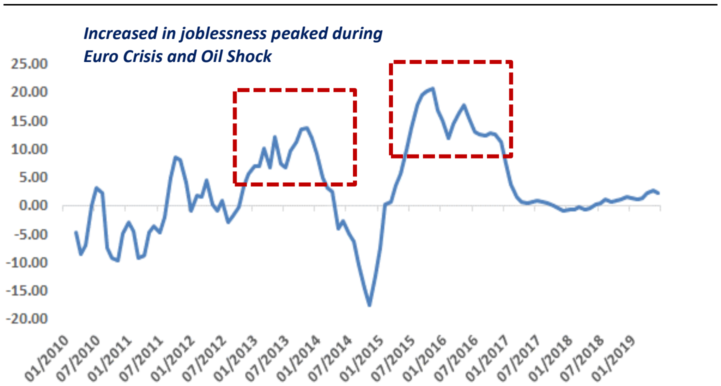
Education will continue to be given top priority

- MARC believes that the education sector will continue to be given top priority in the Budget. Statistics show that only about 29% of the labour force have tertiary-level education, suggesting that about two-thirds of the labour force are low- to mid-skilled. Furthermore, the employment rate (1H2019: 2.0%; 1H2018: 2.4%) has decreased while growth in the number of unemployed rose in the first half of the year (1H2019: 1.8%; 1H2018: -0.1%).

The rakyat's social welfare will be addressed by measures to improve home affordability

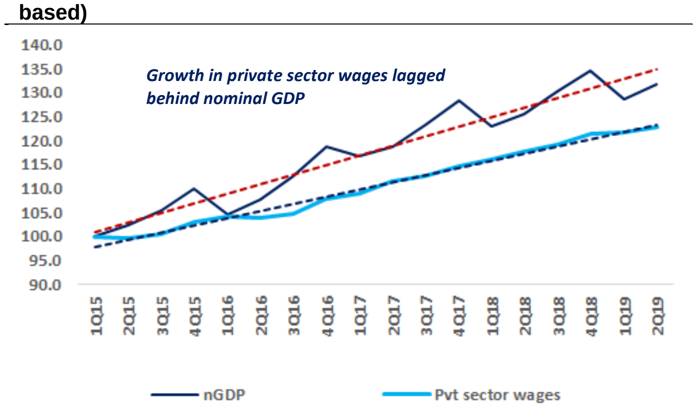
- There will likely be more efforts to assist low-income families to finance their first homes, similar to BNM's RM1 billion Affordable Housing Fund introduced in November 2018. In MARC's view, however, additional credit facilities should only serve as a temporary solution to a structural problem as the main impediments to owning a home are high property prices and low wage growth. Growth in private sector wages eased to 4.2% in 2Q2019, the slowest since end-2016 while average home prices in Malaysia remain elevated at above RM400,000.

Chart 9: Year-on-year change in number of unemployed (%)



Sources: CEIC, MARC Economic Research

Chart 10: Nominal GDP and private sector wages (index re-based)



Sources: World Bank, MARC Economic Research

Wrapping it up

Growth will continue to be below trend; consumers will provide an important support

- As the threat of a global economic slowdown continues to heighten in the near term, we expect the Malaysian economy to grow below trend at 4.3% in 2020 (2019 forecast: 4.6%). Private consumption will, once again, be the saviour of the economy, although its contribution to growth will likely moderate to circa 85% of headline growth (1H2019:93.1%). We anticipate private consumption growth to soften slightly to 6.5% in 2020 after a strong performance in 2019.

Mild inflationary environment in 2020

- Inflation will remain relatively benign at 1.5%-2.0%, albeit slightly higher than in 2019 due to the low base and slower growth in domestic demand. Weaker global crude oil prices will also contribute to the below trend inflation rate in 2020. We foresee a mild downward bias in the Overnight Policy Rate (OPR) due to a benign inflationary environment and slower growth in economic activity. We anticipate a 25-point reduction in the OPR from the current level to 2.75% between now and 1H2020.

Deficit ratio remains commendable; CA ratio to remain positive

- Budget deficit ratio to GDP will likely slip to 3.2%, lower than 2019's projected ratio of 3.4%. This is, however, slightly higher than the government's initial target of 3.0% of GDP. Lower revenue from declining crude oil prices and weaker growth in tax collection amid a softer economic expansion are the primary reasons behind this. The current account of the balance of payments will likely moderate to 1.5%-2% of GDP in 2020 amid declining export momentum.

Table 1: Real GDP growth forecasts (demand-side)

Growth (% y-o-y)	2014	2015	2016	2017	2018	2019F	2020F
GDP	6.0	5.1	4.2	5.9	4.7	4.6	4.3
Domestic Demand	6.0	5.1	4.3	6.5	5.6	4.3	4.4
Private Consumption	7.0	6.0	6.0	7.0	8.1	7.2	6.5
Public Consumption	4.4	4.5	0.9	5.4	3.3	3.5	3.8
Private Investment	11.1	6.3	4.3	9.3	4.5	1.8	2.5
Public Investment	-4.7	-1.1	-0.5	0.1	-5.2	-10.2	-7.4
Real Exports	5.0	0.3	1.3	9.4	1.5	-0.4	0.1
Real Imports	4.0	0.8	1.3	10.9	0.1	-2.1	-0.2

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