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Budget 2020

Driving Growth and Equitable Outcomes Towards Shared Prosperity

(Summary)

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In a nutshell

- Budget 2020 focuses mainly on efforts to strengthen the foundation of the Malaysian economy in the long term. It emphasises, among others, the need for continuing institutional reforms, enhancement of governance and restoration of public finance health. It also focuses on the need to improve the quality of life of Malaysians. A total of RM297 billion is allocated for Budget 2020 (Budget 2019: RM316 billion). Of the total amount being proposed, the allocation for operating expenditure (OPEX) is RM241 billion, 8.1% lower than the estimated spending in 2019. As expected, the allocation for gross development expenditure (DE) is higher, at RM56 billion (2019's estimated spending: RM53.7 billion).
- Amid the growing uncertainty over the prospects of the global economy, the government is projecting an overall real gross domestic product (GDP) growth of 4.8%, lower than Malaysia's growth trend of 5.2% in the past five years. Key support comes from the consumer side, with a hefty 83% growth contribution coming from private consumption. MARC concurs with the continuing upbeat prospects of private consumption despite projecting a lower real GDP expansion of 4.3% for 2020.
- The proposed increase in DE has been widely anticipated. The RM2.3 billion increase in DE is meant to reinvigorate economic activities and support growth through high-impact projects that include the Pan-Borneo Highway, MRT2 and electrified Klang Valley Double Track (KVDT). A respectable headline GDP growth will likely lead to a decent amount of non-oil revenue growth, a major source of federal government receipts. This should help relieve some of the fiscal pressure. Overall, we feel positive about the higher DE proposed in Budget 2020 as there is a need to support growth without compromising on the government's fiscal consolidation efforts. In addition, a fiscal injection is needed at a time when monetary policy arsenals, if not properly utilised, could worsen macroeconomic imbalances such as high household indebtedness.
- The expected budget deficit of 3.2% of GDP in 2020 anticipated by the government is slightly higher than its initial target of 3.0% of GDP. It is nevertheless lower than the estimated deficit of 3.4% of GDP in 2019. We do not think such a level would raise concerns among international credit rating agencies at this juncture. Overall, we are of the view that Malaysia's sovereign rating will hinge on the medium- and long-term prospects of generating sustainable revenue sources that would offset the decline in oil-related receipts in times of low crude oil prices. Future measures, other than steps to widen the scope of the Sales and Services Tax (SST) as well as a continuing effort to rationalise OPEX, will likely strengthen the case to keep Malaysia in the single-A rating band in the international sovereign rating universe. Having said this, a sharp deceleration in real GDP growth or continuing prospects of having narrow-based revenue sources could add pressure to Malaysia's sovereign rating at times when the global economic backdrop continues to deteriorate.
- Re-energising investment growth is among the top priority of Budget 2020. This is in view of the weaker expansion in private investments that averaged circa 5.9% per annum in the past three years (2010–2014: 13.6% per annum). Important measures that are proposed in Budget 2020 include: (i) an incentive package worth RM1 billion per annum for five years to attract targeted Fortune 500 companies and global unicorns in the high technology, manufacturing, creative and new economic sectors; and (ii) a RM1 billion annual investment incentive for a period of five years for Malaysian businesses that have the ability to grow and export their products and services globally. What we think is encouraging is the RM10 million allocation for the Ministry of International Trade and Industry (MITI) to increase their monitoring of approved investments, which have increased in recent times, and ensure their realisation.
- The government's efforts to embark on a new growth frontier through promotion of high value-added investments is also evidenced by measures to accelerate the adoption of digitalisation in the economy. The proposed measures include: (i) an allocation to expedite digital infrastructure establishment in public buildings; (ii) a matching grant fund to encourage more pioneer digital projects that benefit fibre optic infrastructure and 5G; and (iii) a grant to increase the digitalisation of operations for Small and Medium Enterprises (SME). Overall, we are encouraged by these measures and hope that the scope of the

recently proposed digital tax will not be extended to include local service providers in the near term as this could discourage the pace of digitalisation of the economy.

- The proposed measures to further strengthen the SME sector have been widely expected. This is in view of the sector's hefty contribution of roughly 40% of GDP. Measures to assist SMEs include, among others, an extra RM50 million allocation for My Co-Investment Fund (MyCIF) to help finance the underserved SMEs and a RM300 million fund by SME Bank. The latter allocation is aimed at supporting Bumiputera SMEs with potential to become regional champions. We continue to believe that efforts to create a conducive ecosystem for SMEs should be reviewed periodically in order to ensure its realisation.

- A significant push for greater women participation in the economy should be applauded as their contribution could increase overall economic potential. We believe that the proposed measures such as the extension to the year 2023 of income tax exemption for women returning to work, a guaranteed facility for women entrepreneurs by Syarikat Jaminan Pembiayaan Perniagaan (SJPP) and a RM200 million fund from SME Bank for women entrepreneurs will strengthen women's role and help improve Malaysia's long-term economic growth trajectory.

- In line with its theme of sharing economic prosperity, Budget 2020 also emphasises a push for the greater well-being of the *rakyat*. Notable are the proposed measures to lower the financial burden of the *rakyat* through aids and subsidies. These include welfare aid such as Bantuan Sara Hidup (BSH), a targeted fuel subsidy scheme, assistance for eligible rubber smallholders under RISDA and Lembaga Industri Getah Sabah, and socio-economic assistance to senior citizens. Other measures that could help provide support to consumer spending in the near term are special payment for civil servants and government retirees, special allowance for firefighters and discounts on toll charges for all PLUS highways.

- As for the financial market, the government's decision to resume measures introduced back in its previous budget is positive. They include the extension of double tax incentives on issuance costs of sukuk under the principle of Wakalah to another five years, ending in 2025, as well as the extension of the tax deduction on issuance costs of Sustainable and Responsible Investment (SRI) sukuk to 2023. To further promote Islamic fund and SRI fund management activity, the government has also extended the exemption for fund management companies managing Shariah compliant funds and SRI funds to 2023.

- In line with Malaysia's ambition to remain as the Global Islamic Finance Hub, the measures announced are set to encourage corporates to further tap into the sukuk market. In the first nine months of 2019, gross issuance of corporate sukuk in Malaysia had surged to RM70.6 billion, representing 67.0% of total gross issuance of corporate bonds. Gross issuance of sukuk in Malaysia in 2019 on a year-to-date basis has surpassed the amount recorded in the same period last year. As such, we believe that sukuk issuance in 2020 will continue to be robust as issuers are expected to leverage on the incentives combined with the lower yield environment.

- Furthermore, the government has announced that it has approved the proposal to acquire four Klang Valley highways – Shah Alam Expressway, Damansara-Puchong Expressway, Sprint Expressway, and SMART Tunnel. The acquisition will be financed through government-guaranteed borrowings. We expect the financing would be done through the issuance of sukuk by one of the quasi-government entities. This will further create a healthy pipeline of sukuk in 2020.

- Overall, MARC opines that Budget 2020 broadly meets the competing needs of laying a strong long-term economic foundation, providing the necessary counter-cyclical fiscal measures while keeping fiscal consolidation efforts on track. It also attempts to address the well-being of the *rakyat* and support the aspirations of the people. This is a delicate balancing act which, despite some areas of concern, the government has managed to achieve.

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